2026 Mid-Year Outlook

Staying invested, staying selective

June 2026

MACQUARIE

Mid-year reviews provide an opportunity to reflect on the path taken by markets after gazing into the crystal ball at the end of last year. In particular, we look at how factors we identified back then are evolving and what surprises have come along that reshape our outlook for the rest of the year. At the end of last year, we noted:

- Artificial Intelligence (AI) has given but it can also take away
- A more growth-friendly White House
- Inflation is a threat that still lingers
- US risk assets are priced for perfection.

The outlook for risk assets more broadly depends on the AI evolution. We were right in acknowledging that it would remain positive. But we probably underestimated how big it would become by mid-year. The US reporting season in February was exceptionally strong and the catalyst for another leg up in confidence in the AI outlook. This increase in confidence has manifested into the expectation that 2026 will see the largest initial public offerings (IPOs) in equity market history.

EM, Europe and Japan were our preferred equity markets over Australia and the US at the start of the year. EM has been the star, and has exceeded even our own bullish expectations, while the performance of Japan and Europe has reinforced our positive view on these markets. Australia has underperformed in line with our expectations and, if anything, the outlook has deteriorated further. On the other hand, lofty valuations haven't stopped the US juggernaut, with earnings expectations driving returns.

We expected the White House to be growth friendly leading into midterm elections, with last year's tax cuts providing a clear support for US consumers still struggling under cost-of-living pressures. But the conflict with Iran and the oil global price shock was an unexpected development. Recent events in Venezuela offered a reminder that geopolitical conflict and resource politics remain closely linked. The focus on reopening Venezuela's oil sector after Maduro's removal highlighted that countries with large hydrocarbon reserves have strong incentives to restore market access, particularly when sanctions, conflict or disrupted exports are weighing on revenues.

A memorandum of understanding between the US and Iran has improved the near-term risk backdrop, with details pointing to a reopening of the Strait of Hormuz and a staged easing of the US naval blockade.

We have held the view at the start of the war that the pain from higher oil prices should be relatively temporary for two key reasons: i) the war is voluntary, and ii) both sides need oil to be flowing through the Strait. As such, we haven't wavered from our positive view on risk assets, despite the volatility in both oil and equity markets.

The economic data is showing the stagflationary consequences of the sharp rise in oil prices, prompting the RBA, ECB and BoJ to raise rates. Meanwhile, governments around the world have bought their economies time during the conflict by releasing supply of oil reserves and realigning supply chains. But these measures are only temporary, and a tipping point is fast approaching where tight supply will cause prices to rise sharply once again. It is vital that the deal is signed off and oil flows freely once again.

We don't know under what conditions the Strait will reopen and how long it will take for production and delivery of oil to normalise. These unknowns mean the price of oil is likely to be volatile.

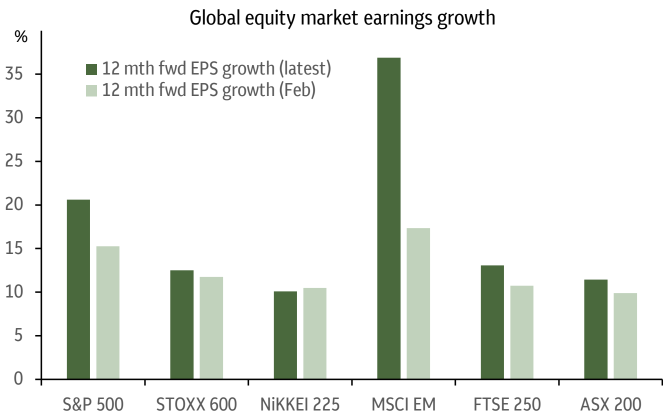
Equity market valuations, particularly in the US and Australia, remain stretched. This is an added layer of complexity for portfolio construction given overvalued markets generally perform the worst during selloffs.

The list of uncertainties investors must navigate for the remainder of the year is long. Volatility is likely to remain high, and investors should be prepared to pivot if the fundamentals change. It's important then that fundamentals have not deteriorated markedly over the past five months, despite the rise in the price of oil.

At end of last year, we thought central banks would continue to support growth after defeating the worst of the post-pandemic inflation shock. Inflation was set to ease slowly even though it was likely to linger above most central bank targets. This was derailed by the largest oil shock in history. Provided the deal is sealed and oil flows freely, most central banks still have policy settings that are broadly supportive of growth and there will be less pressure to tighten policy.

Still, even if a deal to end the war is elusive, if it takes longer than the market expects, or if it doesn't meet market expectations, we do not think this warrants a wholesale shift to a defensive portfolio stance. The best approach is to ensure portfolios are constructed to reflect an investor's risk tolerance and drift within portfolios is managed pragmatically. Portfolios should be diversified and big concentrated bets should be avoided.

Global equity market performance



Source: LSEG, MWM Research, June 2026

There are two key positive factors that mean a good portion of portfolios should be in risk assets. Firstly, the US consumer does not look to be buckling under the current level of the price of oil. Risk assets would be hurt if this were to occur. Secondly, the AI boom likely has further to go.

Overall, we are cautiously optimistic about the outlook for risk assets for the remainder of the year but acknowledge that volatility is likely to persist and a lot depends on the details in the agreement to end the US-Iran conflict. Interest rate support has slipped a little as inflation broadens, and growth is likely to slow a little near-term. But equities normally rally through slowdowns.

Macquarie Wealth Management Investment Strategy Team

Key insights

The AI juggernaut

February reporting season in the US added to the positive momentum of the AI trade. We warned in our outlook at the end of last year that we thought that the hype around AI was becoming mature and it would need to show it was transitioning into an engine of economic growth. There are signs this is occurring but following the reporting season it became clear that the boom has further to go. AI capex continues to snowball, and it will make 2026 the year of the largest IPOs in history.

Even with strong earnings and easily funded capex, the AI boom could still prove unsustainable. We see some of these characteristics, but we also don't see it coming to an end in the near-term. The boom would likely come to an end if the US consumer were to stop spending, but normally this would take tight financial conditions. Inflation has not met the Fed's 2% target for 5 years now and it's possible at some point the calculus changes and the Fed needs the economy to grow below trend.

It's also possible that the boom ends because its own lofty expectations are not met, but that would take a trigger or some event. For now, labour productivity is picking up. It may not be possible to attribute it directly to AI, but it's sufficient to recognise that this is what the data is showing. Rising productivity growth raises living standards, by helping lift corporate earnings and keeping a lid on inflation. For now, the near-term looks very positive.

The AI trade is broadening, but its foundation has been built by a relatively small number of US mega stocks that are driving the entire market. Broadening use of the technology creates competition amongst its suppliers and users and that can undermine earnings if companies do not adapt. We have always said there will be winners and losers out of the evolution, and the challenge for investors is to identify them early. Investors should ride the boom either directly or indirectly but have signposts that indicate when to use the offramp.

Growth looks positive beyond the oil speed bump

We expected economic growth to pick up a little in 2026 without much more support from interest rates. But this was scuttled by the Trump administration's conflict with Iran. The price of oil has moved up and down in parallel with the direction of noise coming out of the White House. The stagflationary consequences of the sharp rise in oil prices are embedded in the data, although the rise in inflation is larger in magnitude to the hit to growth.

Equities have mostly moved in the opposite direction to oil but have assumed that the fallout will be temporary. Importantly, AI earnings are not affected directly by movements in the oil price. In sectors such as transport, agriculture, construction and manufacturing the impact is significantly larger. But these sectors are not driving global equity markets.

Economies such as Australia, Europe and Japan will take a larger hit to growth because they have limited spare capacity and their central banks have been forced to raise rates in response to the inflation threat. For example, in Australia the RBA's three interest rate rises and change in tax policy are causing housing prices to fall in the Sydney and Melbourne housing markets.

In the economies where rates have risen, the economic impact is not only larger, but it will also have a longer duration. In contrast, in the US where rates have not risen, the oil shock has been absorbed much more easily. Provided the price of oil continues to retreat then the second half of the year could see growth pick up again, but this seems to be mostly priced by markets.

Time to dress up for midterms

The economic damage caused by last year's lift in tariffs and the sharp rise in the oil price appears to have been absorbed without too much collateral damage. But pain is still being felt. US tariffs are still at their highest level since the 1940s, despite decisions by several courts making them illegal. The price of gasoline is $US3.9/gallon after peaking at $US4.35/gallon in early May. But it is still 44% above the price just before the US-Iran conflict began ($US2.7/gallon).

More positively, tax cuts from the One Big Beautiful Bill Act are helping to ease pressure on household budgets. But the President can use Executive Orders to help household budgets such as changing tax rules, lowering tariffs and increasing energy production to lower costs. The US fiscal position doesn't have room to provide further support, and the legislative process takes time to navigate. Recent polling indicates Republicans will likely lose the House, with the Senate and State Governor races a coin toss. The approval rating for the President has fallen sharply since the beginning of the conflict with Iran. The incumbent party usually faces losses in midterm elections. On average since WWII, the president's party has lost 26 seats in the House, and 4 seats in the Senate. If this was repeated in November both chambers would become Democrat.

No clear path to lower inflation and rates

The global oil price shock has put central banks on edge, so a clean end to hostilities and the resumption of unobstructed free passage through the Strait of Hormuz is important. Global central banks remain on edge, with inflation above most of their targets and unlikely to ease significantly in the short-term.

Lower inflation and policy rates will take time and probably not emerge until the second half of 2027, at the earliest. Bond yields are therefore likely to remain relatively high, with structural support from global government spending, and investment in areas such as defence, clean energy increasingly absorbing global savings.

Even if productivity growth continues to increase in the US and assist in keeping a lid on inflation, we doubt it will ease upward pressure on bond yields. Historically, it tends to do the opposite because growth becomes more resilient to higher rates.

Risk assets are optimistic

US and Australian equity valuations are high, leaving them more exposed to bouts of volatility. Forward price-to-earnings (PE) ratios are well above average in both markets. But more concerning, PE ratios are high assuming very strong earnings growth over the next 12 months. If the AI capex fails to deliver a cash return, then the US market and global markets could see a sharp downturn. This doesn't look likely in the short-term, but it is a longer-term concern. Earnings in Australia are expected to rise solidly (9% over the next 12 months), but interest rate rises and property tax changes are both working to slow the domestic economy making 9% earnings growth potentially difficult to achieve.

Global economics: Higher oil prices bite

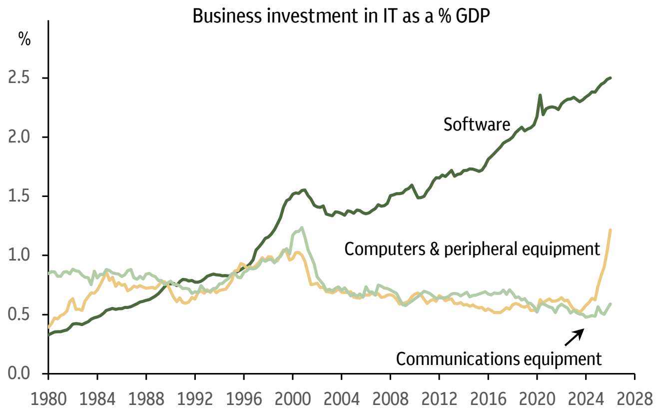
- Global economic growth is likely to slow on the back of the oil price shock, however growth is likely to pick up in 2027. Inflation is broadening and increasingly forcing more central banks to raise rates. Whether other central banks join the RBA, ECB and the BoJ will depend on the direction of the price of oil.
- The AI capex boom is gearing up and providing a timely offset to the loss of growth from the oil shock. It is unlikely to be derailed directly by even higher oil prices. But it probably wouldn't survive a major downturn in consumer spending. This could easily occur if the Strait of Hormuz is not fully opened soon.
- Australia's housing market is weakening, which gives the RBA a good reason to keep policy steady. However, inflation remains too high and policy needs to remain slightly restrictive for some time.

US

The US is at the pointy end of the AI boom, with investment in IT accounting for around 4% of GDP. The big, listed IT firms have indicated they will invest around $US580bn in 2026, and $US900bn in 2027 and 2028. Provided the US consumer can weather the oil price shock then the growth prospects for the economy remain solid.

Importantly for the Fed, the US labour market is balanced with the number of job openings broadly consistent with the number of job seekers and average weekly earnings around 3.6% However, inflation is still a threat. It has not reached the Fed's 2% target for 5 years and inflationary pressures are broadening due to the rise in the price of oil. Newly appointed Fed Chair Kevin Warsh takes over at a time when there is political pressure to lower rates, but also an inflation problem that may need to be addressed with interest rates potentially moving in the opposite direction at some point.

The AI capex boom looks set to continue

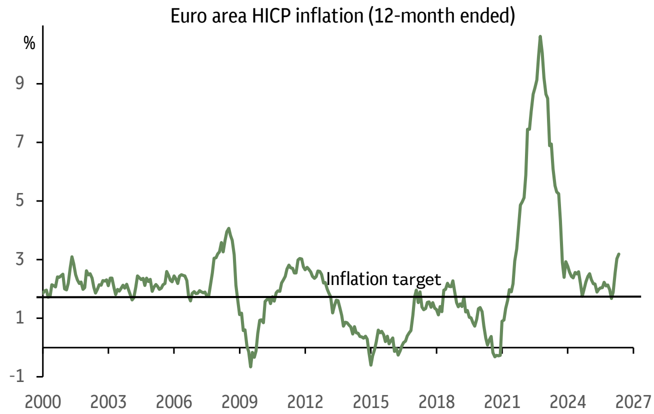


Source: LSEG, MWM Research, June 2026

Europe

The ECB was the second major central bank to raise rates behind the RBA in response to the oil price shock. The Governing Council also raised its near-term inflation forecasts and marginally lowered its GDP growth forecasts. GDP growth for the four quarters to Q4 2026 was revised down to 0.9% from 1%, while growth for the year to Q4 2027 was still expected to be 1.4%. The forecast for core inflation was revised up to 2.6% from 2.2% for the year to Q4 2026 and to 2.3% from 2.2% for the year ending Q4 2027. Core inflation was expected to remain a little above the 2% target in the year to Q4 2028 at 2.2%.

European inflation is increasing

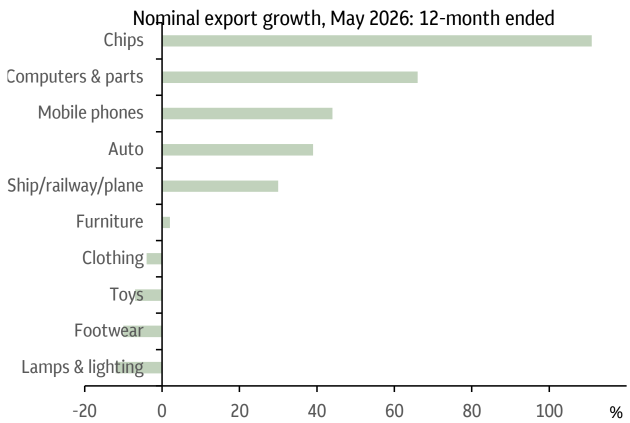


Source: LSEG, MWM Research, June 2026

China

China has successfully absorbed the increase in US tariffs by redirecting exports to other markets, particularly in ASEAN. Exports of computers and parts, phones and EVs have surged, while residential investment and consumer spending have remained weak. Macquarie's economics team think the authorities' GDP growth target of 4.5%- 5% is likely to be achieved this year. China has coped with the large fall in oil supply from the Middle East this year by importing it from other markets such as Russia, Brazil, and Indonesia. It also has drawn down its large strategic reserves.

China's exports are riding the AI boom



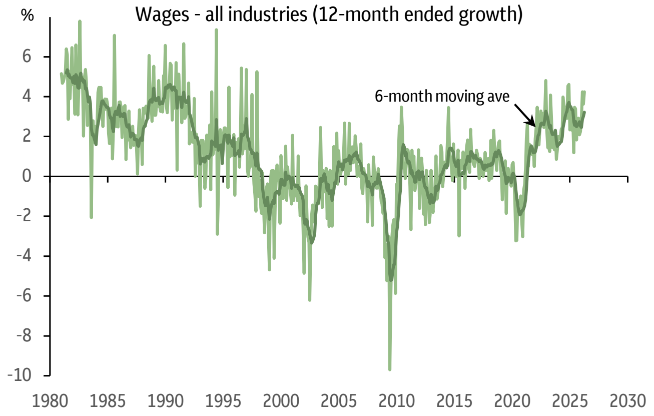
Source: LSEG, MWM Research, June 2026

Japan

The BoJ joined the RBA and the ECB as the only global central banks to raise interest rates during the oil price shock. The latest BoJ forecasts show GDP growth of 0.5% in FY26 (prior 1%) and 0.7% in FY27 (prior 0.8%). The bank expects core inflation to average 2.6% in FY26 (prior 2.2%) and 2.6% (prior 2.1%). These inflation forecasts are a significant uplift that keeps alive prospects of tightening in policy beyond the 25 bps increase in rates this month. Markets are currently pricing the BoJ to raise rates once again in January 2027.

The increase in inflation forecasts is not just due to the impact of higher oil prices. Broad measures of wages growth are the strongest in around 30 years as cost pressures from oil feed into goods and wage negotiations.

Wages growth is the strongest in 30 years



Source: LSEG, MWM Research, June 2026

Australia

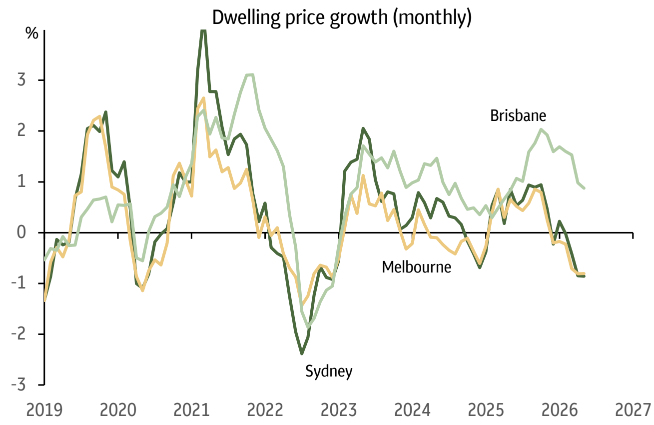
The RBA was the first major central bank to raise rates during the oil price shock after growth began picking up late last year and spilling over into higher inflation. After tightening policy three times this year, Macquarie's economics team thinks the RBA can afford to see how the housing market responds to both the interest rate rises and the changes in capital gains tax and negative gearing policy. Financial markets are not pricing in a further tightening over the next 12 months but the risk is that the next move is up and not down.

The tax changes have passed the lower house, but are yet to pass the Senate, with an inquiry underway. There is some chance that there may be small carve outs, given the government needs the support of the Greens in the Senate to see the legislation passed. The legislation creates a disincentive to invest in established property, which has been on average around 80% of new investor lending.

Investment in new or newly constructed property makes up the remaining 20% of investor lending and it will retain the benefit of negative gearing.

It's still too early to properly estimate the full impact of the tax changes given they have not yet become legislation. However, the uncertainty created by the announcement coupled with this year's three interest rate rises have contributed to moderate price falls in both the Sydney and Melbourne markets. Price growth has slowed in the smaller capital city markets of Brisbane, Adelaide and Perth.

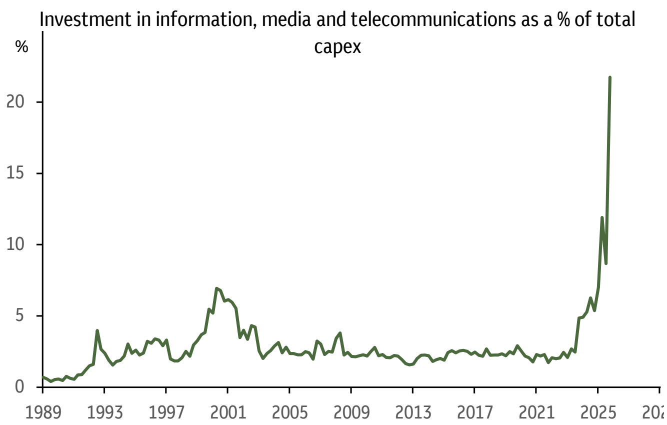
Housing is slowing quickly



Source: LSEG, MWM Research, June 2026

Housing and consumer spending may be under significant pressure, although there are other areas of growth. The big US tech firms dominate the capex spending in AI, but Australia has also been the recipient of some of this investment. Capex in IT has risen sharply over the past couple of years and is now around 20% of economy-side capex.

Australia has not missed the AI boom



Source: LSEG, MWM Research, June 2026.

The labour market is where the rubber hits the road for the RBA and recent developments are positive, given their intention of gradually bringing down inflation without sacrificing unnecessary job losses.

The unemployment rate has been between 4.2% and 4.5% since last July. The RBA expects it to be 4.3% by year-end before slowly drifting up to 4.6% by the end of next year. Wages growth is set to remain around 3.2% over the next 18 months. The employment: population ratio has declined a little over the past year, suggesting some spare capacity is slowly emerging, and the latest data shows trend employment growth is around 22k per month.

Macquarie macroeconomic forecasts

	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
GDP, QoQ									
US	0.1	0.4	0.6	0.7	0.7	0.7	0.7	0.6	0.6
China	1.2	1.3	0.7	1.3	1.3	1.2	1.0	1.0	1.1
Eurozone	0.2	(0.2)	0.2	0.2	0.3	0.4	0.4	0.4	0.4
Japan	0.2	0.5	0.2	0.0	0.2	0.2	0.3	0.1	0.2
UK	0.2	0.6	0.1	0.1	0.2	0.3	0.3	0.3	0.3
Canada	(0.2)	(0.0)	0.5	0.6	0.6	0.6	0.6	0.5	0.5
Australia	0.9	0.3	0.4	0.3	0.3	0.3	0.4	0.5	0.5
New Zealand	0.5	0.8	0.2	0.4	0.6	0.6	0.7	0.8	0.8
Global (MER)	0.6	0.6	0.5	0.7	0.8	0.8	0.7	0.7	0.7
Global (PPP)	0.8	0.8	0.6	0.8	0.9	0.9	0.8	0.8	0.9
GDP, YoY									
US	2.0	2.6	2.2	1.8	2.5	2.8	2.8	2.8	2.6
China	4.5	5.0	4.4	4.7	4.8	4.7	4.8	4.4	4.2
Eurozone	1.2	0.3	0.4	0.3	0.5	1.1	1.3	1.5	1.6
Japan	0.4	0.3	0.2	0.8	0.8	0.6	0.7	0.8	0.8
UK	1.0	1.1	1.1	1.1	1.1	0.8	0.9	1.1	1.2
Canada	0.7	(0.1)	0.7	0.8	1.7	2.4	2.5	2.4	2.3
Australia	2.5	2.5	2.0	2.0	1.3	1.4	1.3	1.5	1.7
New Zealand	1.5	1.5	2.3	1.9	2.2	1.8	2.3	2.7	2.9
Global (MER)	2.7	2.8	2.5	2.4	2.6	2.8	3.0	3.1	3.0
Global (PPP)	3.4	3.4	3.1	2.9	3.1	3.2	3.5	3.5	3.5
CPI, YoY									
US (PCE)	2.8	3.1	3.8	3.3	2.7	2.2	1.6	2.0	2.4
China	0.4	0.7	1.2	1.1	0.9	0.9	0.7	0.8	0.8
Eurozone	2.1	2.0	3.1	3.0	3.1	2.8	2.0	2.0	2.0
Japan	2.7	1.4	1.4	1.6	1.3	1.9	1.8	1.8	1.9
UK	3.4	3.1	3.1	3.5	3.7	3.3	2.8	2.1	1.9
Canada	2.2	2.1	2.8	2.3	1.7	1.6	1.4	1.8	2.3
Australia	3.7	4.0	4.6	4.1	4.1	3.3	2.8	2.6	2.7
New Zealand	3.1	3.1	4.1	3.8	3.6	3.3	2.2	2.3	2.4
Policy Rate									
US (Fed funds rate)	3.63	3.63	3.63	3.63	3.88	4.13	4.13	4.13	4.13
China (1-yr MLF rate)	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40
Eurozone (deposit rate)	2.00	2.00	2.25	2.50	2.50	2.50	2.50	2.25	2.00
Japan (policy rate)	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.50
UK (base rate)	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.50
Canada (overnight cash rate)	3.50	3.50	2.25	2.25	2.50	2.75	3.00	3.00	3.00
Australia (cash rate)	3.60	4.10	4.35	4.35	4.35	4.35	4.35	4.35	4.35
New Zealand (overnight cash rate)	2.25	2.25	2.25	2.50	2.75	2.75	3.00	3.00	3.00
10-year yield									
US	4.18	4.30	4.50	4.75	5.00	5.00	4.75	4.50	4.50
China	1.85	1.82	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Germany	2.85	3.01	2.90	3.00	3.15	3.15	3.00	2.85	2.85
Japan	2.06	2.36	2.60	2.70	2.85	2.90	2.85	2.75	2.75
UK	4.54	4.94	4.75	4.90	4.90	4.90	4.90	4.90	4.75
Canada	4.18	5.18	3.50	3.75	4.00	4.00	3.75	3.50	3.50
Australia	4.76	4.97	4.85	4.95	5.05	5.00	4.90	4.80	4.80
New Zealand	4.50	4.73	4.45	4.60	4.70	4.75	4.60	4.50	4.50

Source: Macquarie Macro Strategy, June 2026

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