Navigating a Frustrating Environment

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I am approaching F27 with a dour outlook, though that's more about the economy – which is suffering from relentless self-harm – than the market (ASX 200) itself since its composition is more resilient. If the AI boom continues then I suspect Australia and the ASX 200 will continue to lag; if anything, Australia represents a low-beta yield generating hedge for a world where AI hasn't consumed all. I subscribe to the view that in any environment there are actionable ideas and ways to make money but you need to start with a clear-eyed perspective on the outlook.

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The Australian economy was functionally at stall speed in Q1 of 2026, with the consumer somewhere between fatigued and distressed (depending on economic circumstances). Three rate hikes (on enormous consumer debt levels), persistently high real inflation which is the lived experience (not what goes into a CPI basket) and an energy crisis had created recessionary style confidence levels. That already highly flammable environment was then overlaid with a confidence destroying budget which combined poor and terrible policy choices under the guise of 'fairness'. Red lines were crossed with respect to policy certainty and trust which further erodes confidence and increases risk.

In the short term, the most obvious impact is on the golden goose (which was maimed) of the Australia economy: residential property, where 65% of consumers' net assets reside. By effectively eliminating investors (40% of recent demand) a price and volume slump has been engineered, with the confidence and wealth effect likely to cause another leg down in consumer activity (half of GDP!) and the real economy.

The longer-term impact, however, could be far more profound with respect to CGT changes. They will lead to a massive redistribution of investment capital from higher risk/growth oriented/job creating areas into more mundane/income generating safe havens. Given the cards Australia has been dealt (pocket aces), I can't help but form the view we are playing the hand badly with excessive regulation, taxation, wasteful fiscal expenditure and a confused agenda which leaves Australia failing to deliver on its potential. Yet rather than measuring Australia vs. its potential, we are instead told to take comfort that it's not as bad as OECD peers. Is that the limit of ambition?

With that as a central view, I will attempt to summarise 10 actionable ideas for the year ahead:

1. Brace for a consumer recession

Thankfully only ~10% of the ASX 200 is consumer stocks (~70%% of which by market weight is discretionary) but with the macro backdrop continuing to remain hostile, **being underweight the sector is logical (e.g. Woolworths, Coles, Wesfarmers)**.

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2. Don't get too excited about rate cuts

Many commentators are now calling for cuts in 2027 (after the three recent hikes and possibly one more), but any bull thesis on rate cuts ignores why rates might actually be cut! It's usually the signpost for an economy that has faltered and is in distress. **Remaining underweight REITs (IR sensitive sector) is also a conviction call**.

3. Gravity might actually matter for banks in F27

With bank fundamentals having been stable for the last few years and strong supportive flows (superannuation, passive etc.), valuations have been at logic defying unprecedented levels. However, bank fundamentals are likely to take a leg down with credit growth halving (as property slumps), margin pressure intensifying (as per usual in a low growth environment), expenses remaining poorly contained (as per usual) and bad debts going from abnormally low levels to normal or above normal. As CSL has demonstrated, faltering fundamentals will eventually outweigh passive flows. With the banks at 20-times earnings and yields a mere 3-4%, a significant vulnerability exists. **Being underweight banks is a clear call**.

4. The oil crisis isn't over, investors can still profit from it

Oil demand is at peak levels and virtually inelastic, but with 15-20% of global production offline and inventories drawing down quickly it could well reach a pinch point. The implications for inflation are clear and ominous, but for Australian oil/gas producers it could well prove a golden era. Reliable non-middle eastern production is highly desirable and lucrative: **Woodside appears to be a stand-out, with Origin a close second**.

5. Be open minded, software could be a winner from AI

Claims it will be an existential loser are largely based on unfounded and speculative concerns. Software (and marketplace) stocks globally have de-rated dramatically with a view AI removes/weakens their moats. It's possible AI can strengthen software, enhance its value in use and possibly earn the right to do more/charge more. **The likes of Xero, Car Group and SEEK are offering standout long-term value**.

6. For resources, cost curves have moved structurally higher and changed the game

Lost in the bearish views on China and hysteria around critical minerals/AI-linked commodities is a recognition that mining has never been harder or more expensive. Red/green tape and construction costs have lifted the incentive price required for new mines and the cost curves have shifted up dramatically. Resources will remain cyclical, but the downside is better protected for existing miners, and long-term commodity forecasts often appear too low today. **Investors can capitalise by owning the likes of BHP, Alcoa, Iluka or Capstone**.

7. Recognise AI is the world's most crowded trade (possibly ever!)

There are genuine grounds for excitement, but trees don't grow to the sky and the slightest hint of a slow down or pause will be cruelly dealt with (recall Nvidia fell 17% on 28 Jan 2025, when DeepSeek caught global attention). The quality and durability of what you own will matter. **We are opting for the lower beta 'picks and shovels' stocks, with the likes of NextDC and BHP/Capstone Copper providing the right indirect exposure**. **I suspect the fast/easy money has already been made on the AI moonshots, if you are late you could be painfully wrong.**

8. In turbulent and higher risk environments, place a higher premium on great management teams

Great management teams (and boards) can best navigate turning points and difficult environments. **bull markets can be very forgiving, but bear markets/recessions are ruthless. Teams we rate highly include the likes of Tabcorp, ResMed and Orica**.

9. Those old (or well-read enough) to remember the early 1990s or GFC should have Private Credit shivers

There is absolutely nothing wrong with the concept, but the recent boom in commercial/residential construction lending is terrifying in light of the pending property slump. We are hearing about another default literally every day, and we expect the value of loans and the recovery process will be sorely tested in coming years. Despite what might be claimed, this is an illiquid asset class and 'hard assets' aren't capital protected assets. It's naïve to assume the issues are ring-fenced to private lenders only – there will be a blast radius if it goes off and is another reason we remain cautious on banks and property developers.

10. Australia's domestic energy & decarbonisation policy is a circus, invest elsewhere

With unrealistic goals, constant intervention and seismic policy shifts, projecting returns is guesswork. Large, capital intensive, long dated investments require certainty to attract capital and generate solid returns. It comes as no surprise there has been under-investment and that targets are at risk – how many people believe Australia will double its current level of renewable energy in three and a half years to hit 82% by 2030? We are actively avoiding those companies investing heavily in what is a moving feast.

With weaker growth, property market pressures and policy uncertainty all large drags on the domestic economy, we are reminded that periods of heightened uncertainty often create compelling opportunities and bear traps. We continue to look beyond consensus, remaining underweight those areas most exposed to slowing growth and, instead, favouring quality companies across energy, resources, and technology.

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Finding opportunities amid Australia's economic headwinds

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