PRINCIPIA

INVESTMENT CONSULTANTS

QUARTERLY MARKET REPORT

DECEMBER 31, 2025

The last quarter can be characterized as one of diverging fortunes. For most of the year Australian and US equities have been tracking closely – including the steep fall and quick recovery in markets in April as tariffs were announced and then paused. Similarly, 10 year bond yields in both Australia and the US have moved largely in tandem for the last 5 years. But November has seen a divergence

This divergence is linked to differing outlooks for inflation. Markets are now pricing in somewhere between unchanged rates and a potential hike in Australia in 2026, whereas in the US the market is pricing in one to two cuts.

Markets around the world experienced volatility in November, as sentiment in the US turned cautious. Equity valuations in general were seen as stretched, and in particular investors began to worry that perhaps the exuberance around AI was now making that sector frothy. Furthermore, the labour market was displaying weakness while inflation remained elevated.

In Australia, at the end of October the September quarter inflation print came in much higher than what the markets were expecting. The bond market immediately priced in expectations that interest rates would remain on hold for the greater part of 2026, with the potential that the next rate decision would be an increase.

The central banks followed the playbook the market was expecting. On December the 9th the RBA left the Australian overnight cash rate on hold at 3.6% and confirmed that they expected to stay at that level for some time. The following day the US Federal Reserve cut their Fed Funds rate by 25bps, bringing it into the range of 3.5% to 3.75%, and indicated that the majority view of the Governors of the Federal Reserve was that there would be further cuts in 2026 and 2027.

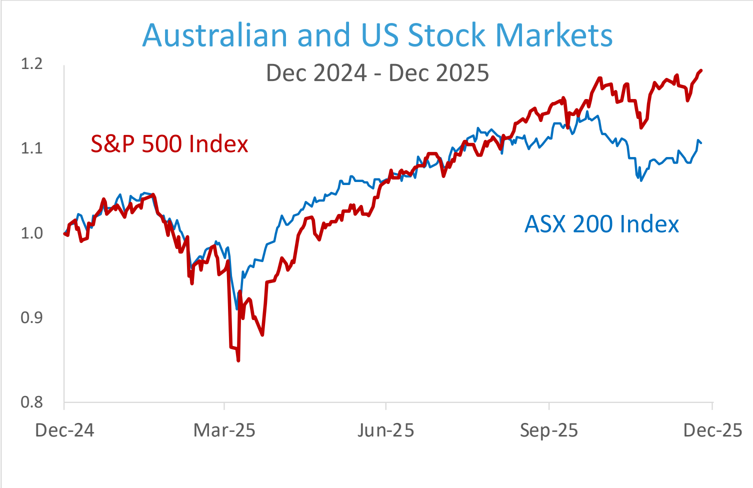
Despite the wobbles in November and the diverging fortunes between the Australian and US financial markets, it's been another excellent year for investors in a diversified portfolio. Overall the Australian market is up by over 10% - higher than the long term average return. International developed markets are up nearly 13%, while the emerging markets have recorded an annual return of 24% (in AUD).

As always, maintaining diversification and discipline remains the most effective way to achieve a rewarding investment experience.

Equity and Bond Market Overview

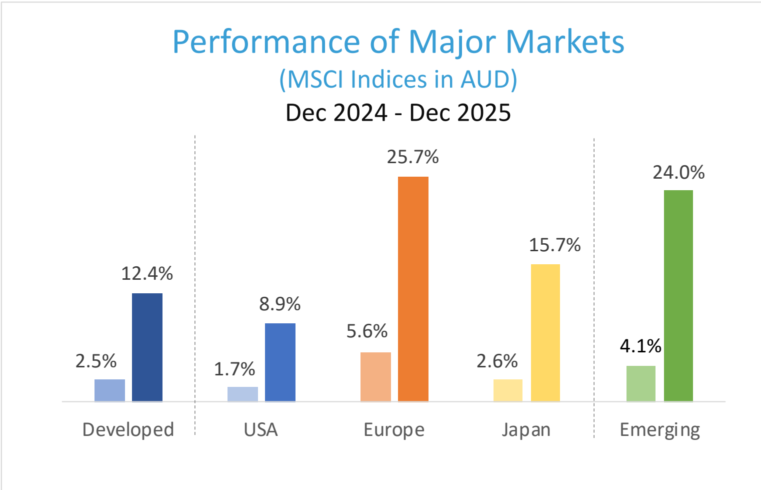
AUSTRALIA AND US MARKETS DIVERGE IN THE LAST QUARTER.

The local share market has had a flat quarter after stronger than expected inflation data led to a volatile November. The ASX 200 index is down -1% for the quarter but up over 10% for the year. The US market wobbled in November due to a range of economic factors, but the S&P 500 index is up 2.7% for the quarter and up around 18% for the year.



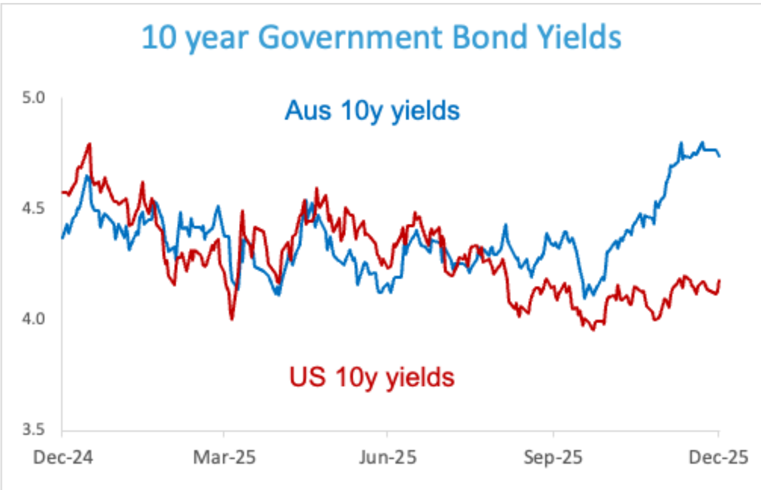
GLOBAL MARKETS DELIVER ANOTHER STRONG YEAR.

Markets around the world experienced volatility in November, as sentiment in the US turned cautious. However by December global markets returned to familiar territory by pushing higher with low volatility. Overall, it's been an excellent year for Australian investors in a diversified portfolio, with strong returns from global markets.



AUSTRALIAN AND US 10 YEAR YIELDS DIVERGE IN Q4.

After moving largely in tandem for the past five years, yields on 10-year US and Australian government bonds have now diverged. This shift is linked to diverging outlooks for inflation. Markets are now pricing in between flat rates and one hike in Australia in 2026, versus one to two cuts in the US. The delta between the two yields has not been at these levels since mid-2022.



Source: investing.com, FE Analytics

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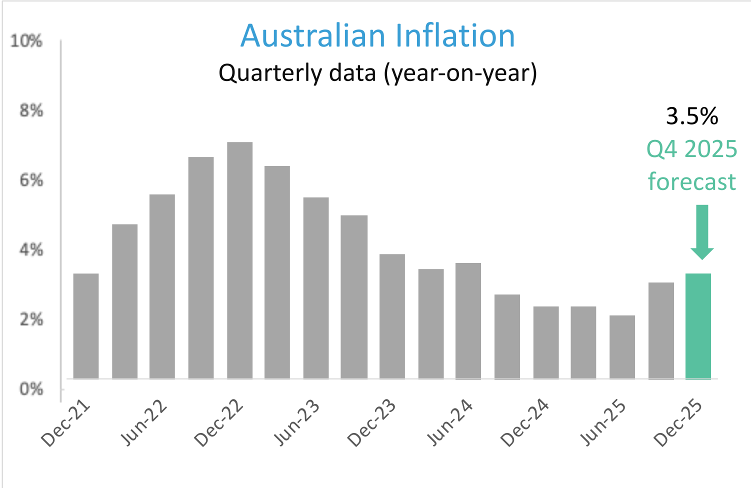
Economic Review and Forecasts

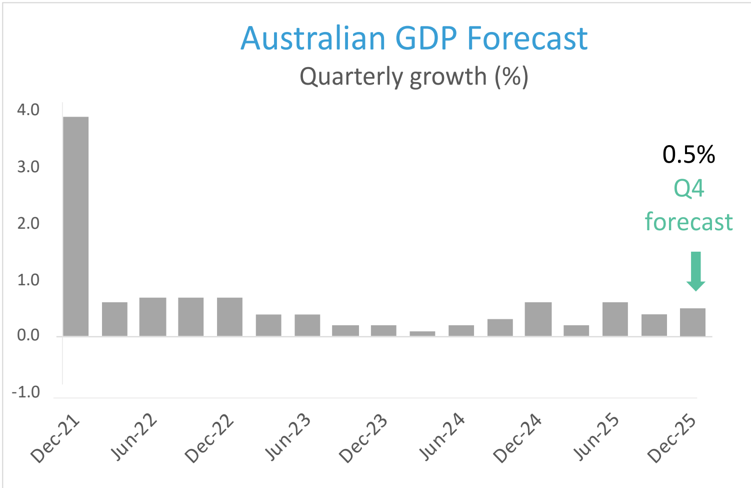
INFLATION REMAINS ABOVE THE RBA TARGET BAND.

September CPI data (published at the end of October) was higher than expected, forcing the RBA to continue to keep interest rates on hold at their December meeting. The inflation rate in Australia is expected to be 3.5% by the end of this quarter, outside the RBA's target band, according to analysts' expectations.



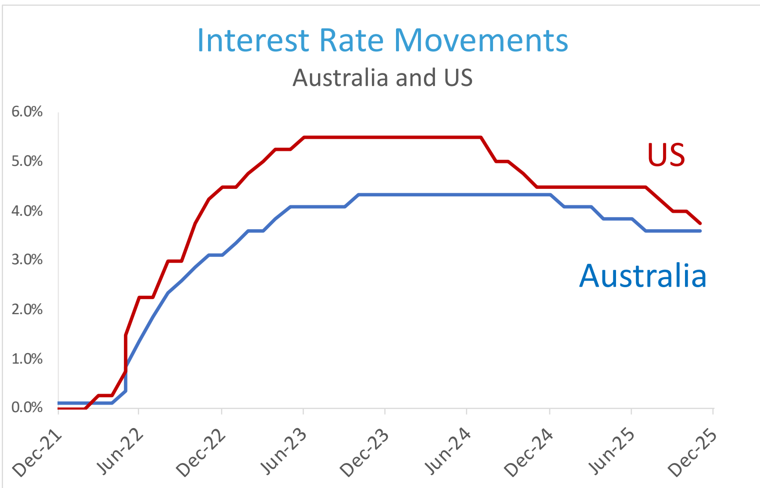
AUSTRALIAN GROWTH SLOW BUT STEADY.

The Australian economy expanded 0.4% quarter on quarter in Q3 2025. It was the 16th straight quarter of rise, driven by domestic demand, due to higher spending on discretionary and essential goods. Looking to Q4, the GDP Growth Rate in Australia is expected to be 0.5%, according to analysts' expectations.



AUSTRALIA AND US INTEREST RATES ON DIVERGENT PATHS.

In Australia, stronger than expected inflation data has meant the RBA has continued to leave rates at 3.6% for the fourth meeting in a row. Markets are now pricing in that next change will be upward sometime in 2026. Conversely in the US the Federal Reserve cut rates by 25bps at their December meeting and the consensus is for further cuts in 2026.



Source: tradingeconomics.com

Market Returns to 31 December 2025 (net returns, AUD)

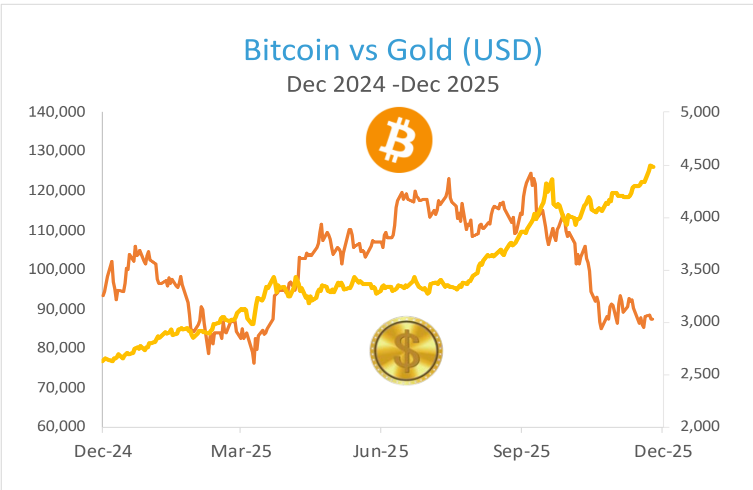
Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	0.9%	4.0%	4.1%	2.7%	2.1%
Australian Bonds	-1.2%	3.2%	3.7%	-0.4%	2.0%
Global Bonds	0.7%	4.5%	4.0%	-0.6%	2.0%
Australian Equity	-1.0%	10.3%	11.4%	9.9%	9.3%
Developed Markets	2.6%	12.5%	22.1%	15.6%	13.2%
Developed Markets (hedged)	4.1%	19.4%	20.6%	12.3%	11.9%
Emerging Markets	4.1%	24.0%	17.1%	7.3%	9.4%
Australian REITS	-1.4%	9.2%	15.0%	8.8%	7.9%
Global REITs	-3.0%	-1.2%	6.7%	5.9%	

Source: MSCI, Bloomberg, S&P Global

- Longer bond yields have fallen since the start of 2025, resulting in positive returns for bond indices. However recent inflation data has pushed up bond yields in Australia, resulting in a negative return for the AusBond Composite Bond Index in the 4th quarter.
- The Australian stock market had been rallying since early April up until the end of October but declined in November on local and global economic data. However, the Mining sector had a strong quarter on an improving outlook for the Chinese economy.
- Developed markets returned over 12% for the year in AUD, driven by the US market (which returned 17.9% in USD terms).
- The Emerging markets returned 24% over the last 12 months. The standout performer was Korea, which returned 26% for the quarter and 86% for the year.
- The Australian dollar relative to the USD has been appreciating over the quarter due to the narrowing in the interest rate differential and the weakness in the US dollar against other currencies. Consequently hedged international equities have outperformed unhedged stocks over the quarter and over the year.
- Global REITs continue to underperform global equities, while Australian REITs are performing in line with the broader Australian equity market.

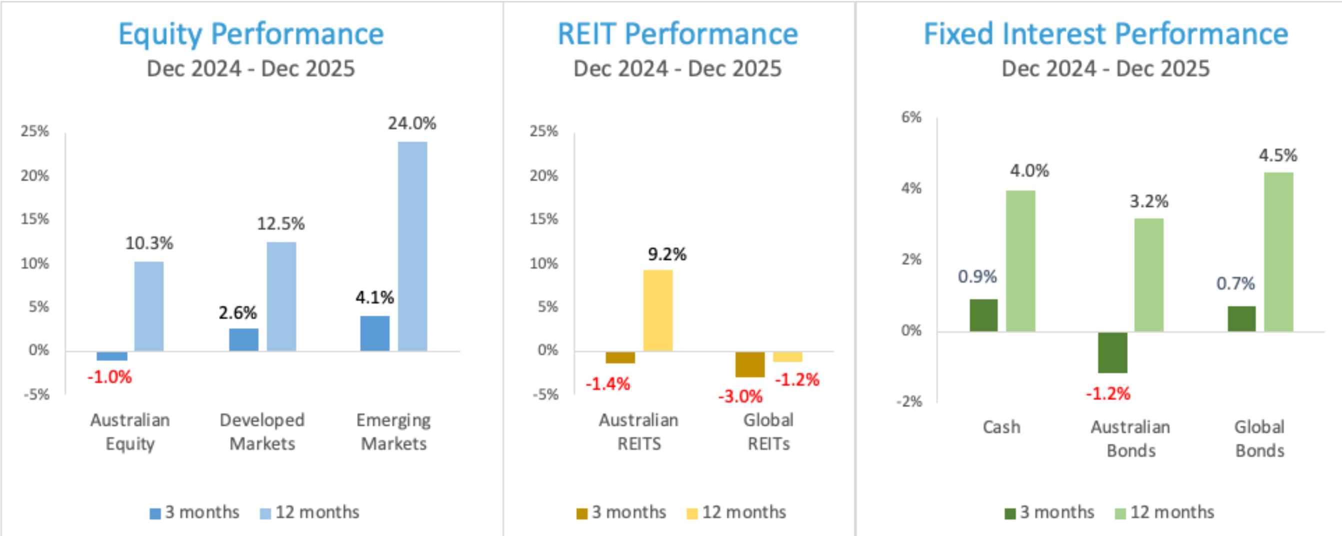
DIVERGENT FORTUNRS: BITCOIN VERSUS GOLD

An exodus of money from exchange-traded funds has accelerated a slump in bitcoin, with the world's most popular cryptocurrency erasing all its gains this year. Bitcoin is down -23% for the quarter and down – 6.4% for the year. Gold has continued to surge throughout 2025 and is up 12% for the quarter and 64% for the year.



Source: investing.com

Market Returns (Chart)

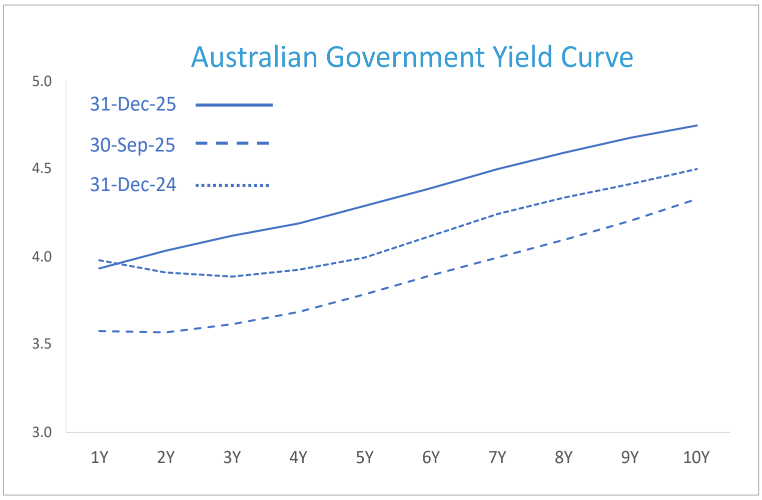


Source: investing.com, FE Analytics

Yield Curves

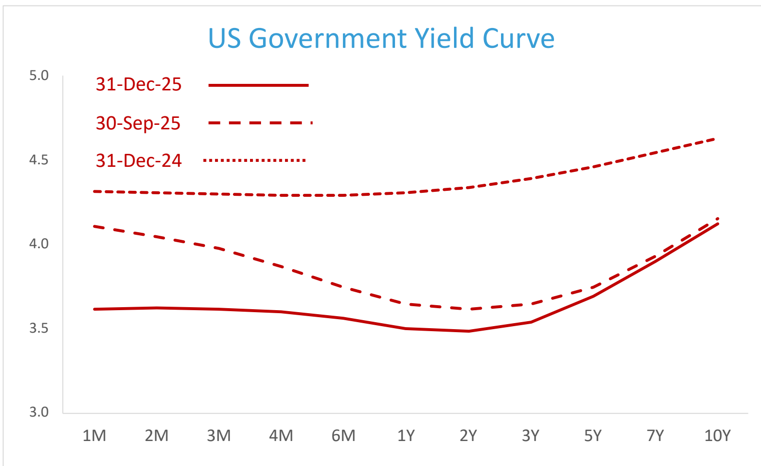
AUSTRALIA

Bond traders have slashed their expectations for further interest rate cuts in Australia after an unexpectedly strong inflation data signalled to some in the market that the central bank could be done with lowering borrowing costs this cycle. Bond yields jumped after the consumer price index ticked up to 3 per cent in November, and the yield curve has shifted upwards.



UNITED STATES

Reflecting the divergence between the Australian and US interest rates, the US yield curve is significantly lower than at the end of 2024, as the bond market is pricing in further cuts to the US interest rate in 2026 and 2027. This is also a reflection of lower inflation, higher unemployment, and a general slowing of the economy.



Source: investing.com

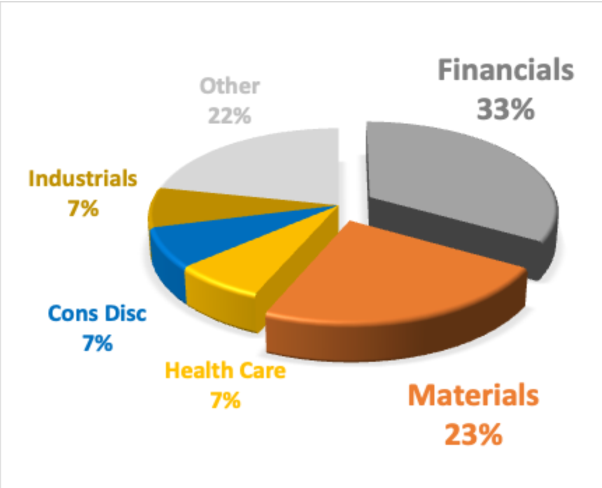
Sector Performance

AUSTRALIA

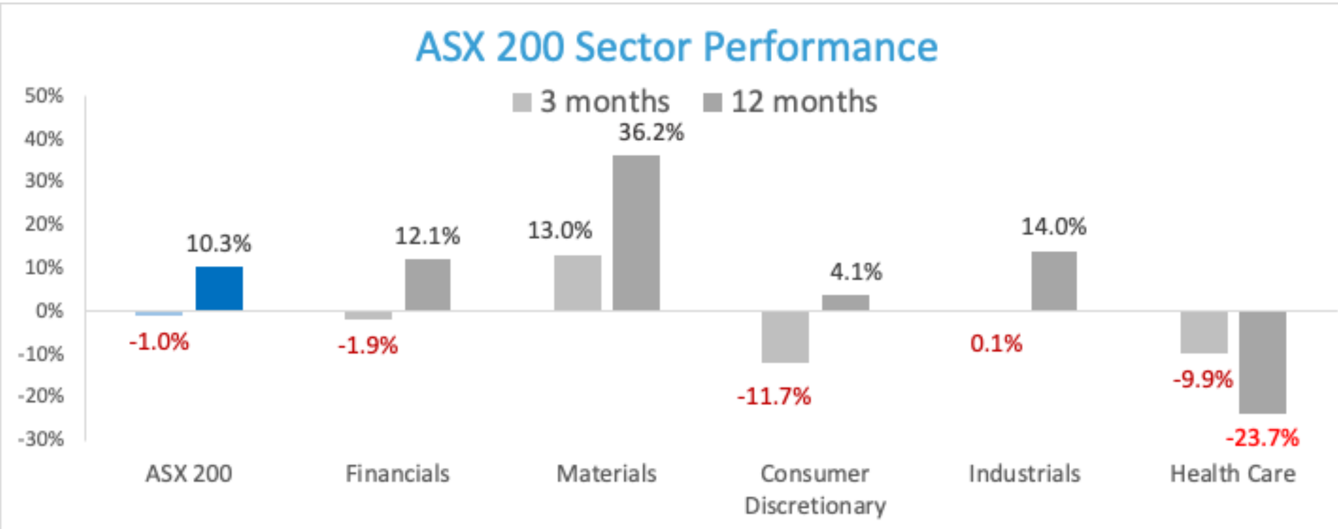
In Australia, the Materials sector outperformed (due to BHP, RIO and Fortescue) boosted by optimism around Chinese demand, while the interest rate-sensitive Financial sector lagged. Health Care was dragged down by CSL (down -13% for the quarter and -38% for the year), while the Consumer Discretionary sector was also negative for the quarter. The IT sector was down -26%, although this is only a small part of the ASX 200 index.

Sector	3 months	12 months
ASX 200	-1.0%	10.3%
Communication Services	-6.5%	10.6%
Consumer Discretionary	-11.7%	4.1%
Consumer Staple	-1.0%	2.0%
Energy	1.2%	3.2%
Financials	-1.9%	12.1%
Health Care	-9.9%	-23.7%
Industrials	0.1%	14.0%
Information Technology	-26.0%	-20.8%
Materials	13.0%	36.2%
Real Estate	-1.6%	8.4%
Utilities	-2.6%	13.2%

Five sectors make up approximately 78% of the market, with the two largest constituting more than 50%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Financials	33.4%	33.4%
Materials	23.2%	56.6%
Consumer Disc	7.4%	64.0%
Industrials	7.4%	71.4%
Health Care	7.1%	78.5%
Real Estate	6.7%	85.2%
Communiation Services	3.7%	88.9%
Energy	3.6%	92.5%
Consumer Staples	3.4%	95.9%
Information Technology	2.5%	98.4%
Utilities	1.4%	99.8%



Source: FE Analytics

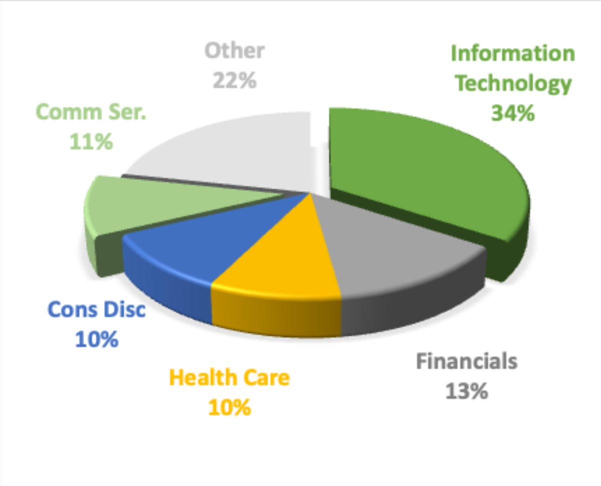
Sector Performance

UNITED STATES

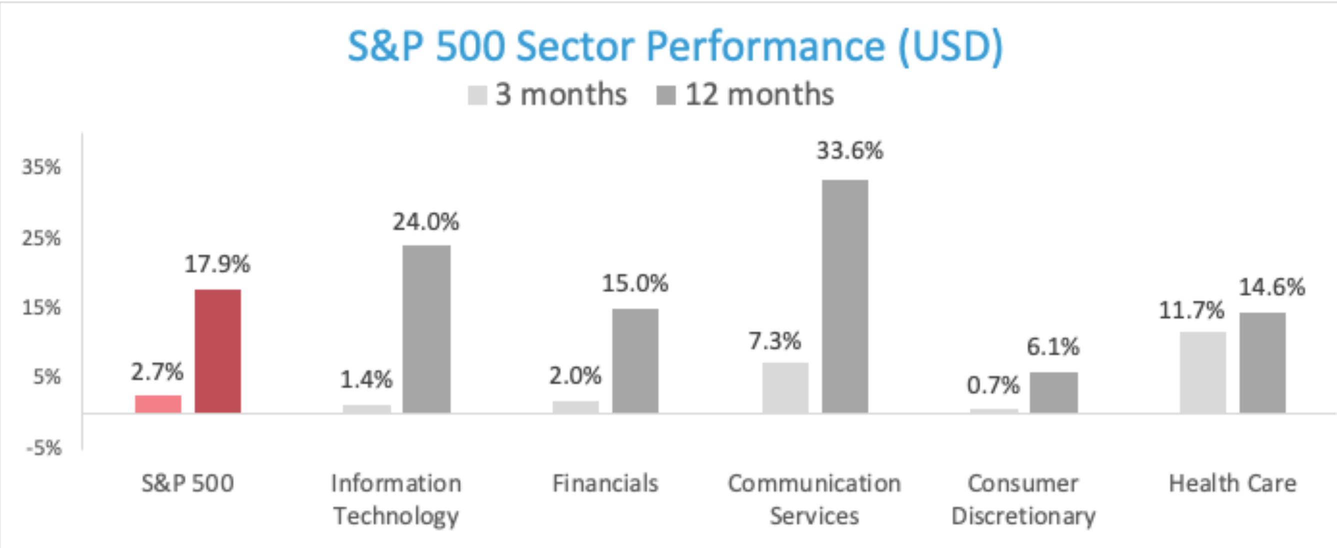
The US Tech sector (Communication and IT stocks) are once again the main drivers of the overall US market. The continuing rally in stocks with greater growth potential is a headwind for more defensive sectors like Financials, Health Care and Industrials, although those sectors were still material contributors to the overall S&P 500 index. The Communication Services sector saw major contributions from tech giants like Alphabet (Google), Meta and Netflix.

Sector	3 months	12 months
S&P 500	2.7%	17.9%
Communication Services	7.3%	33.6%
Consumer Discretionary	0.7%	6.1%
Consumer Staple	0.0%	3.9%
Energy	1.5%	8.7%
Financials	2.0%	15.0%
Health Care	11.7%	14.6%
Industrials	0.9%	19.4%
Information Technology	1.4%	24.0%
Materials	1.1%	10.5%
Real Estate	-2.9%	3.2%
Utilities	-1.4%	16.0%

Five sectors make up approximately 78% of the US market, with Tech companies constituting around 40%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Information Technology	34.4%	34.4%
Financials	13.4%	47.8%
Communication Services	10.6%	58.4%
Consumer Discretionary	10.4%	68.8%
Health Care	9.6%	78.4%
Industrials	8.2%	86.6%
Consumer Staples	4.7%	91.3%
Energy	2.8%	94.1%
Utilities	2.2%	96.3%
Materials	1.8%	98.1%
Real Estate	1.8%	99.9%

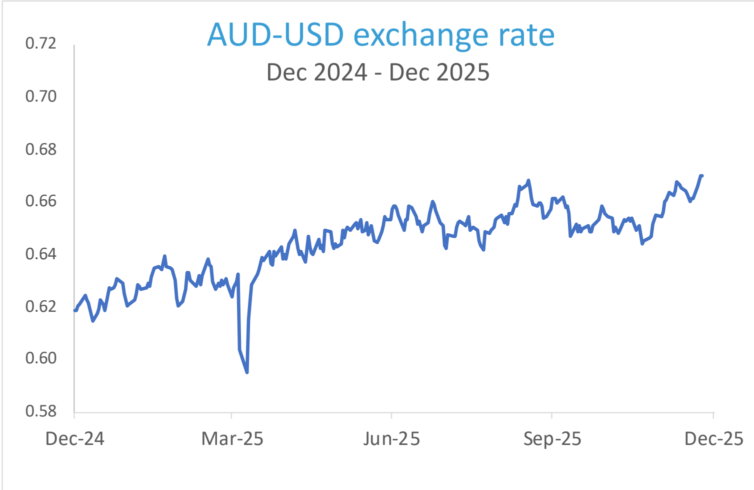


Source: FE Analytics

Currency and Commodities

EXCHANGE RATE

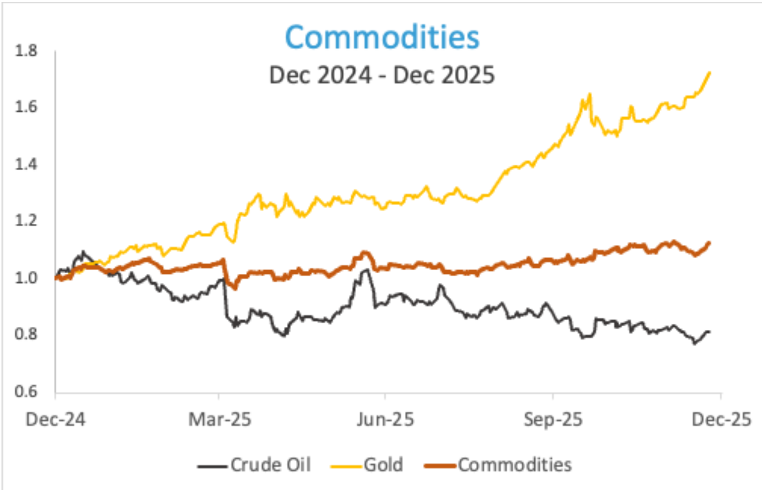
The Australian dollar climbed to around $0.670 by the end of the quarter, boosted by growing expectations of lower interest rates in the US while the RBA is expected to keep local rates on hold through 2026. The Aussie was further supported by surging demand for precious and industrial metals and is up close to 8% for the year.



Source: investing.com

COMMODITY INDEX BALANCED BY GOLD AND OIL DIVERGENCE.

Gold and oil (specifically crude oil, a key energy commodity) are both major components of broad commodity indices and are among the most actively traded commodities in the world. Oil is down nearly 20% for the year, while gold continues to surge and is up over 70% for the year. The broad commodity index is up 12% for the year.



Source: Dow Jones Commodity indices, investing.com. In USD

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