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Letter from the Manager – Lazard Australian Equity

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ASSET MANAGEMENT

Australian Equities at Mid Year: Momentum Reigns, Fundamentals Wait Their Turn

Australian equity markets remained volatile through the June quarter, with valuations and stock dispersion staying near historic extremes. Momentum, rather than fundamentals, was the dominant factor globally — the NASDAQ posted its strongest quarterly gain in 25 years, and the Philadelphia Semiconductor Index and the Korean semiconductor led market rose sharply, while fundamentally-driven strategies broadly lagged.

Within that backdrop, fundamental value continued to outperform fundamental growth, though both trailed momentum-driven flows.

Concerns around the domestic economy intensified over the quarter, centered on softening housing sentiment, elevated inflation rate, and lingering uncertainty tied to the Federal Budget. The $12 trillion housing market remains a key swing factor for confidence, and investors are reassessing growth assumptions for domestic consumer-facing businesses.

Australian banks also began trading more like cyclicals again, with several brokers modestly downgrading earnings on concerns over softer lending volumes and increased mortgage competition — even as banks themselves cut rates to defend market share. During the quarter, SME focused Judo bank reported a deterioration in its credit book, with a modest $20m increase in credit provisions triggering a 40% share price fall on the day, wiping out roughly $400m in market value. Is this the first crack in an otherwise unbeatable credit cycle? We remain materially underweight the sector, and continue to view current valuations, particularly CBA, as difficult to justify against history, global peers, and quality alternatives on the ASX.

Globally, the healthcare sector staged a sharp recovery after a period of heavy selling, with CSL rallying roughly 30% off its lows — broadly in line with a ~40% rebound in the broader US healthcare index following earlier concerns around US policy pressure on the sector.

Easing geopolitical risk also supported markets: fears over a Strait of Hormuz closure earlier in the year proved larger on paper than in practice, as the global energy system demonstrated more flexibility than anticipated — the US stepped up exports, and demand adjusted.

Reflecting these dynamics, the key aspects of sector positioning is as follows:

- **Energy**: We have substantially lowered our active weight in energy, having entered the year with a large overweight that we have progressively reduced following strong sector performance and the de-escalation of Middle East supply risk.
- **Resources/Commodities**: We have also reduced our active exposure to resources names. Base and precious metal miners had a strong run over the past year but pulled back meaningfully in the most recent month, and we are now back to an underweight position in miners. We continue to hold no exposure to gold stocks.
- **Healthcare**: We have added to healthcare, which now represents approximately 10% of the portfolio, anchored by CSL and Cochlear. Cochlear was added following an approximately 40% share price decline earlier in the year, consistent with a broader pattern of former market darlings being heavily de-rated on cyclical and sentiment-driven concerns.

- **Hard assets and Idiosyncratic**: We have increased exposure to company-specific opportunities including James Hardie and Reliance, both trading at attractive valuations near the low point of the US building cycle; as well as Aristocrat and Treasury Wine Estate, where we see internal catalysts to delivery a re-rating largely independent of the macro cycle.
- **Real Estate**: We have increased REIT exposure following sector underperformance, adding Stockland, a hard-asset holding trading at a discount to NTA, with defensive income characteristics.
- **Technology**: We continue to maintain no exposure to Information Technology, reflecting ongoing caution around AI-related disruption risk and valuations across domestic software names.
- **Banks**: We maintain limited exposure to Australian banks, where valuations remain elevated relative to historical averages despite modest earnings growth prospects

In our view, maintaining a disciplined focus on sustainable business models and valuation is key to identifying companies capable of delivering sustainable returns. We have three broad themes in our portfolios, which have remained unchanged from last quarter.

Consumer

Preferencing secure industry positions and solid balance sheets.

Delivering strong earnings growth and trading at attractive prices.

Hard Assets

Minimal to zero AI disruption risk.

High replacement costs and predictable cash flows.

Idiosyncratic

Stocks with value drivers that are not solely dependent on the economic cycle.

We include **Health Care** in this theme.

Outlook - Thinner Markets, Sharper Moves

We believe the market remains both expensive and distorted relative to long-term valuation norms. While the pull-back from the extremes of Q3 2025 has driven positive relative performance for our portfolios, markets appear to have only partially normalised, with valuation dispersion still elevated. We are also observing greater day-to-day and reporting-season volatility across stocks, which may reflect reduced market depth as passive ownership continues to grow. Against this backdrop, we remain focused on companies with resilient balance sheets, durable earnings and idiosyncratic growth drivers, while remaining selective around cyclically exposed names. If market valuation were to continue to normalize, we believe our value strategies are likely to outperform, reflecting those observed following prior peaks in valuation dispersion.

Important Information

As of 10 July 2026.

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