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Editorial

One question that I am repeatedly hearing from investors is this: in an expensive market, where can I find opportunities? My answer has surprised them: look at quality stocks. Here's why.

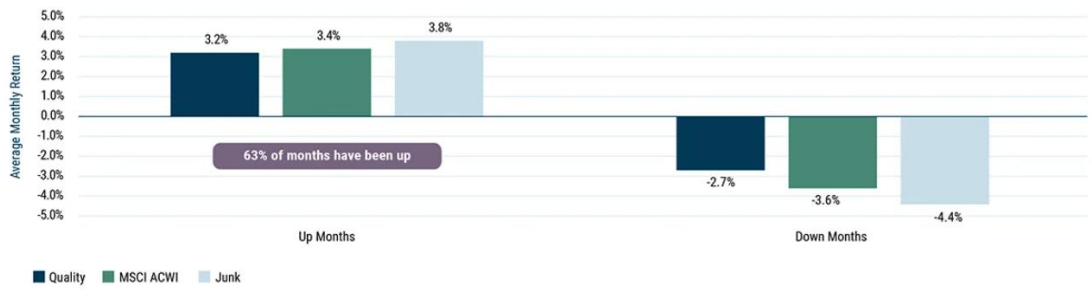
Let's first define what quality stocks are. MSCI indices say they're shares with attributes such as high returns on equity, predictable earnings growth and low debt levels.

The attributes make sense. A high return on equity suggests a company has a competitive edge that allows them to earn significant profits on the shareholder money invested in the business. Predictable earnings also denote an edge that is sustainable and repeatable. Finally, low debt levels imply a company that can grow without taking on too much leverage – and lower leverage makes earnings less volatile and reduces overall business risk.

Global quality has lagged

Globally, only one in five companies qualify as quality stocks. Over the past four decades, these stocks have handily beaten global indices and other types of investing such as value and growth. And they've done it with less volatility.

Quality companies slightly trail in up markets, but more than make up for it amid market declines



Data from 1-31/88 to 9/30/25 | Source: MSCI, GMO. GMO defines quality companies as those with high profitability, low profit volatility, and minimal use of leverage. Junk companies are the inverse.

For this reason, quality stocks have historically been highly priced, at a premium to the market.

That's less so today as quality stocks have trailed the market over the past year. In 2025, quality trailed global stocks by around 6%, and in developed markets, it was closer to 15%. These stocks were left behind as investors bid up more speculative stocks.

Australian quality stocks have trailed too

Defining quality stocks in Australia is a little fuzzier. There are three indices that track quality shares here – the Solactive Australia Quality Select Index, the S&P/ASX Quality Index, and the MSCI Australia IMI Quality Index.

In 2025, total returns from these indices differed markedly: Solactive's rose 12%, S&P's 5% and MSCI's 3% (this was price only as they don't give total returns).

Why the big gaps in performance? Well, each of them filters different characteristics for quality stocks, and I'm not sure any of them get it close to right.

For instance, Solactive's Australian Quality Select Index has the following stocks in the top 10 (top, right).

Perseus Mining shouldn't be in a quality index, in my view. It's a capital intensive gold miner that has a mixed track record through mining cycles.

Also, the inclusion of banks like ANZ, NAB and Westpac are questionable too. They sell commodity products and have low returns on equity (ROEs). For instance, ANZ's ROE was just 8% in its most recent 12 month results, which is below its cost of capital and lags the ASX 200's ROE of close to 10%.

So, Solstice's quality index defines quality very differently to what I would.

The returns from quality stocks in Australia over the past 12 months are more likely nearer those of the S&P and MSCI indices. This makes sense because the ASX 200's total returns were 10% in 2025, with resources up 36%, financials higher by 12%, while industrials increased by just 4%. Most of what I would deem as quality stocks fall into that industrials category.

For example, if I screen for ASX 200 stocks with ROEs above 18% in 2025, it comes up with the following list, excluding mining-related companies (bottom, right).

Just about all these stocks would fit my definition of quality, barring Qantas (capital intensive), Orora (no competitive edge?), and perhaps James Hardie (management is doing its best to destroy a fine business).

Name	Weight (%)
BHP	6.7
WESFARMERS	6.1
TELSTRA	5.7
ANZ	5.6
NATIONAL AUSTRALIA BANK	5.2
WESTPAC	4.4
COMMONWEALTH BANK	4.3
PERSEUS MINING	3.3
MONADELPHOUS GROUP	3.3
MACQUARIE	3.3

Source: Solactive

Investment Name	ROE %
ALS	20
Aristocrat Leisure	25
Brambles	27
Cochlear Limited	20
Coles Group	28
Computershare	28
Data3	57
Fisher & Paykel Healthcare	20
GQG Partners Inc.	93
James Hardie	20
JB Hi-Fi	29
Light & Wonder Inc.	128
Lovisa Holdings	110
Netwealth Group	59
Nick Scali	23
Orora Limited	34
Pro Medicus	45
Qantas Airways	205
REA Group Ltd	39
ResMed	23
Technology One	31
The Lottery Corporation	114
Ventia Services	43
Wesfarmers	32
Woolworths Group	19

Source: Morningstar

Many of these stocks significantly underperformed the ASX 200 index in 2025:

- REA -21%
- GQG -16%
- Aristocrat -15%
- Pro Medicus -12%
- Technology One -11%
- Woolworths -4%
- JB Hi Fi +4%
- The Lottery Corporation +4%
- Resmed +5%

**Price terms only*

Among these stocks, and other quality ones, may lie some great, even generational opportunities for investors. From the list, REA, Resmed, Aristocrat, Woolworths, and The Lottery Corporation look most interesting.

The best ways to invest in quality stocks

What are the ways to get access to quality stocks? Of course, you can buy the shares directly.

Many prefer to own ETFs nowadays. VanEck's MSCI International Quality ETF (ASX: QUAL) invests in quality shares outside Australia. Betashares Global Quality Leaders ETF (ASX: QLTY) invests worldwide in quality. Meanwhile, VanEck's Morningstar Wide Moat ETF (ASX: MOAT) owns quality stocks in the US.

For Australia, the options are more limited. Betashares has the Australian Quality ETF (ASX: QUAL) but it's based on the aforementioned Solactive Australia Quality Select Index, which I view as having serious limitations.

I think fund managers who invest in quality stocks, and have consequently underperformed of late, may be worth considering too. Aoris Investment is an Australian-based global fund managers with a great long term track record of investing in quality stocks. Airlie Funds Management focuses on Australian stocks and has smart minds running it. There's also AFIC, a listed investment company that had a terrible year yet owns a portfolio full of quality stocks, many of them mentioned above.

Disclosure: *VanEck is a Firstlinks sponsor, as is Airlie via Magellan Investment Partners.*

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Rob Almeida of **MFS** grabs onto a similar theme as my editorial above, suggesting that while cyclical stocks are hogging the headlines, 'compounders' may be on sale, and their resilience should shine through in the long term.

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In my article this week, I look at Ray Dalio's unique take on 2025 - dominated by a collapse in the value of money and a move away from US assets - and what he thinks it means for markets this year and beyond.

James Gruber

Also in this week's edition...

Some industry experts suggest Division 296 may double-tax franking credits but **Tony Dillon** says that's not the case, and explains why.

Auscap's Tim Carleton says Macquarie is becoming a significant competitor to the Big 4 banks in home loans and that brings earnings risk to the majors that isn't currently priced into the market - a stark warning for anyone who owns any of the Big 4, which includes just about every Australian.

There's been a lot written about AI but less about what the economic consequences could be from a boom, bust, or something in between. **Schroders' David Rees** breaks down the diffferent scenarios for the US and global economies.

When investing in A-REITs, many people think they're owning passive rental vehicles. But **Quay Global Investors** says that's mistaken, as development and funds management companies increasingly dominate the index, resulting in greater cylicality and volatility.

We care a lot about the price of milk at the supermarket, yet think little about the industry behind the products on the shelves. **Harrison Stewart** says dairy farming deserves greater attention as an alternative asset class.

Lastly, in this week's whitepaper, **Neuberger Berman** identifies five themes that will drive markets in 2026.

Curated by James Gruber and Leisa Bell

Ray Dalio on 2025's real story, Trump, and what's next

James Gruber

Investment legend Ray Dalio has a historian's eye and quantitative bent that gives him a unique perspective on markets. A recent post of his reflecting on 2025 and looking at what's ahead is a case in point.

Photo by Kimberly White/Getty Images for TechCrunch, CC BY 2.0, via Wikimedia Commons.

Tanking currencies

While everyone's fixated on US stocks and AI, Dalio suggests that they're missing the bigger picture. That's because last year's largest gains went to those betting on a collapse in the value of money and a shift away from US assets into international ones.

On the value of money, he says the US dollar fell 0.3% against the Japanese yen, 4% against the Chinese renminbi, 12% against the euro, 13% against the Swiss franc, and 39% against gold (he considers gold a currency and the second largest reserve currency behind the USD). Against gold, all the major currencies fell, but the weakest ones fell most while the strongest held up better, Dalio says. Reading between the

lines, it means he considers the US and Japan among the weaker currencies and the Swiss among the stronger ones.

Due to the fall in the value of money, the best major investment of 2025 was gold, returning 65% in US dollar terms, and outperforming the S&P 500 index by 47% (the index returned 18%).

Because of America's weaker currency, it made the S&P's returns look better than they were, Dalio believes. The S&P returned 18% for a dollar-based investor, 17% for a yen-based investor, 13% for a renminbi-based investor, but only 4% for a euro-based investor, 3% for a Swiss franc-based investor, and for a gold-based investor, it returned -28%.

The picture for US bonds wasn't much better. That's because *"when the value of money goes down, their real worth is lowered even as their nominal prices rise."* In 2025, 10-year US Treasury bonds returned 9% (roughly half from yield and half from price) in dollar terms, 9% in yen terms, 5% In renminbi terms, -4% in euro terms, -4% in Swiss franc terms, and -34% in gold terms. Cash in US dollars did even worse.

US dollar performance in 2025

Against:	
Japanese Yen	-0.3%
Chinese renminbi	-4%
Euro	-12%
Swiss Franc	-13%
Gold	-39%

Source: Ray Dalio, Firstlinks

S&P 500 performance in 2025

In:	
US dollars	18%
Japanese Yen	17%
Chinese renminbi	13%
Euro	4%
Swiss Franc	3%
Gold	-28%

Source: Ray Dalio, Firstlinks

10-year US government bond performance in 2025

In:	
US dollars	9%
Japanese Yen	9%
Chinese renminbi	5%
Euro	-4%
Swiss Franc	-4%
Gold	-34%

Source: Ray Dalio, Firstlinks

Moves away from US assets

Dalio says the other big theme from last year was investors' moving their money out of US stocks into other markets. More specifically, in US dollar terms, European stocks outperformed American stocks by 23%, Chinese stocks outperformed by 21%, Japanese stocks outperformed by 10%, and emerging market stocks outperformed by a whopping 34%.

Meanwhile, emerging market dollar debt returned 14% and emerging market local currency debt in dollar terms returned 18%.

"Clearly, investors would have much rather been in non-US stocks than in US stocks, just as they would have preferred to be in non-US bonds than in US bonds and US cash," Dalio says.

Drilling down on US stocks

Dalio says the strong returns from US shares, at least in US dollar terms, came from both earnings growth and an expansion in valuations on those earnings (price to earnings expansion). Breaking down the 18% total returns, earnings growth was up 12%, the P/E rose 5%, while the dividend yield contributed about 1%.

The Magnificent Seven stocks had earnings growth of 22% in 2025. Contrary to many media reports, profits from the remaining 493 companies in the S&P 500 were also healthy, up 9% year-on-year.

Revenue growth of 7% contributed the majority of the 12% in earnings growth. The rest came from a jump in profit margins.

Dalio says that means companies captured most of the earnings improvement at the expense of workers – and that's something to keep an eye on.

What's next for markets?

Dalio sums up 2025 as a year where just about everything went up in US dollar terms thanks largely to American policies to boost its economy, including higher government spending and lower interest rates.

He sees much of the same in 2026 though returns may be harder to come by as many assets are expensive now.

Dalio doesn't like the prospects for US stocks or bonds. He says valuations for shares are stretched, with high P/E multiples and low credit spreads (the difference in yields on riskier bonds versus risk-free bonds). If these spreads start to rise, it would be negative for shares. So would any rise in interest rates.

Dalio's long-term expected return for the S&P 500 is 4.7% per annum, which is low compared to the expected return from long-term government bonds of close to 5%.

But Dalio isn't a fan of US bonds either:

"Thus far, the bond supply/demand imbalance has not been a serious problem, but a large amount of debt (nearly $10tn) will need to be rolled going forward. At the same time, it appears likely the Fed will be inclined to ease to push real interest rates down. For these reasons, debt assets look unappealing, especially at the long end of the curve, and a further steepening of the yield curve seems probable, though it seems questionable to me that the Fed's easing will be as much as is discounted in the current pricing."

Without saying so explicitly, Dalio strongly hints that he prefers international assets outside of the US, including equities, bonds and currencies. In his view, these assets offer a hedge against a continuing decline in the US dollar.

He also continues to like gold as a diversifier in portfolios even though he acknowledges that it may be fully priced. He's previously said that gold doesn't carry someone else's liability, which makes it a strong store of value.

He's also previously highlighted inflation-protected bonds as useful for investors seeking protection against inflation and real loss of purchasing power.

Lastly, Dalio isn't a big fan of private assets. He says it's notable that stimulatory moves from the US Government and central bank didn't help venture capital and private equity in 2025:

"If one believes the stated valuations in VC and PE (which most people don't), liquidity premiums are now very low; I think it's obvious that they are likely to rise a lot as the debt these entities took on has to be financed at higher interest rates and the pressures to raise liquidity build, which would make illiquid investments fall relative to liquid ones."

The US mid-term election risk

Last year, Trump had control of both the House of Representatives and Senate and that meant he could do what he liked. And what he did was fashion a government-directed style of capitalism that stimulated the economy and was market-friendly.

Dalio predicts that Trump will lose control of the House of Representatives at the mid-term elections in November this year. If right, that would make Trump a lame duck President and give him limited power to enact further market-friendly policies.

This is a risk that markets aren't pricing in now but may start too as we move closer to the elections.

The long-term picture

Those familiar with Dalio will know that he views current events in the context of long-term historical cycles. He's mapped out the last 500 years of history and quantified key factors in long-term debt cycles and, more broadly, the rise and fall of major powers.

He believes long-term debt cycles last 50-100 years, and are characterized by:

- Short-term debt cycles of 5-10 years driven by credit expansion and contraction.
- Over decades, each short-term cycle adds more debt.
- Interest rates gradually fall toward zero.
- Eventually, rates can't be lowered further ? debt saturation.
- Central banks turn to money printing (QE).
- This often leads to:
  - Currency debasement
  - Asset inflation
  - Rising inequality
- The cycle ends with a major reset (restructuring, inflation, or default).

Dalio thinks the last major debt reset happened in the 1930s and that period has echoes to what is happening today.

It all sounds gloomy, though Dalio would call himself a realist. If he's correct, we're heading down a treacherous path that will bring both opportunities (think real assets) and rising risks (think the US dollar and bonds).

James Gruber is editor of Firstlinks.

No, Division 296 does not tax franking credits twice

Tony Dillon

There has been a lot written about franking credits over the years, and none more so than on Firstlinks. So please bear with me, as I sort through a perceived franking credits issue that has surfaced since the updated proposal for Division 296 tax legislation was announced by Treasurer, Jim Chalmers in October last year (also known as Better Targeted Superannuation Concessions).

Specifically, a number of industry experts, including auditors, accountants, and the SMSF Association, are concerned that a flaw exists in how franking credits are treated under Div 296, and they use the term "taxing a tax refund" or "tax on tax".

Their concern is that assessable income for Div 296 tax purposes includes franking credits attached to dividend income. Their argument is that the franking credit reflects company tax paid and therefore shouldn't be taxed again under Div 296. Hence the "tax on tax" term.

Note that assessable income for the standard super tax calculation (the earnings relating to the portion of super below the $3 million) includes franking credits, which are then deducted from the tax calculation in arriving at the assessed tax liability. It can result in a tax refund to the SMSF.

The concerns are borne out of a failure to separate company tax paid on profits, and the SMSF's tax obligation on dividend income. In effect, a franking credit serves a dual function. In the eyes of a company, it represents corporate tax paid, while from the recipient of the dividend's perspective, it is assessable income and a tax offset used to finalise the fund's tax liability. And what brings those who claim Div 296 is a "tax on tax" unstuck, is the thinking that the franking credit is tax already paid, rather than SMSF income.

This is better understood with some numbers.

Imagine an SMSF with a Total Superannuation Balance (TSB) of $5 million in accumulation phase. It will be subject to Div 296 tax at a rate of 15% x ($5m - $3m) / $5m = 6% on earned income. The fund's effective tax rate on earnings is therefore 15% + 6% = 21%.

Assume the fund's only income is a fully franked $70 dividend (see footnote for an unfranked dividend example). The economic outcomes are:

Company

- Earns pre-tax profit: $100
- Pays company tax to ATO: $30
- Pays dividend to SMSF: $70, ($30 franking credit attached)
- Net cashflow: $0

SMSF

- Receives dividend: $70 (assessable income is $70 dividend + $30 franking credit = $100)
- Ordinary fund tax: 15% x $100 = $15
- Less franking credit: $15 refund
- Div 296 tax: 6% x $100 = $6 (note, applies to franked dividend *plus* franking credit)
- Consolidated tax position: $6 - $15 = refund of $9
- Net cash received: $70 + $9 = $79

ATO

- Receives company tax: $30
- Pays refund to SMSF: $9
- Net tax received: $21

Economically:

- Total tax paid on $100 company profit = $21.
- Tax paid matches SMSF effective tax rate.
- Company is cashflow neutral.

In fact, it wouldn't matter what the effective SMSF tax rate was, the company would remain cashflow neutral, and the total tax paid would match the SMSF tax rate. It's as if therefore, the tax transaction has occurred between the SMSF and the ATO, with the company acting as an intermediary.

That is, under imputation, company tax on distributed profits functions as a prepayment of shareholder's tax, not as a final tax borne by the company. The company's role is mechanical, with final tax incidence lying between the shareholder (in this case an SMSF) and the ATO. The company does not bear the tax economically, the shareholder does. Acknowledging this makes it clear that ordinary fund taxation (the less than $3 million portion), and Div 296, apply to SMSF income, not to company tax. And it is why the "tax on tax" argument fails.

When company profits are distributed as dividends, the grossed-up amount including franking credits, becomes assessable income in the hands of the recipient. In essence, the company is effectively a conduit between the SMSF and the ATO, rather than a taxpayer itself in an economic sense.

To further illustrate, consider how the taxation of a non-dividend income source compares, and why the imputation system exists.

Consider again the SMSF with a TSB of $5 million. As before, the effective tax rate on earnings is 21%. This time assume the SMSF's only income is $100 bank interest. The following unfolds:

<u>Bank</u>

- Earns pre-tax profit: $100
- Pays interest to SMSF pre-tax: $100
- Pays 30% tax on profit less expenses: $0
  (interest paid is a deductible expense, net tax paid = $0)

<u>SMSF</u>

- Receives interest: $100
- Ordinary fund tax: 15% x $100 = $15
- Div 296 tax: 6% x $100 = $6
- Consolidated tax position: $6 + $15 = $21 payable
- Net cash received: $100 - $21 = $79

Whether receiving bank interest or fully franked dividends, the SMSF's net cash outcome is identical after tax. This demonstrates tax neutrality, where different income sources arrive at the same tax outcome. Excluding franking credits from income for Div 296 purposes would break that neutrality and favour dividend income over earnings from other sources.

In both cases, the SMSF's outcome is determined entirely by gross income and the SMSF tax rate. The company tax rate is irrelevant to the SMSF. This example also shows that Div 296 simply raises the effective tax rate on SMSF earnings, and it does not tax company tax, no matter the source of income.

The fact that Div 296, with the franked dividend included in earnings equalises outcomes across different income types, demonstrates that the "tax on tax" claim does not hold for dividend income.

And why the imputation system? Because dividends are fundamentally different to interest. Dividends are paid out of after-tax profit, and imputation ensures they are not taxed again in the hands of the

recipient. Interest, however, is tax deductible to the bank so no company tax is paid on that slice of profits. The interest can only ever be taxed once (in the SMSF), so no imputation is required.

And finally, even though the Div 296 is an overlay on the 15% tax on earnings relating to the portion of super below the $3 million, an 'all in' rate without added Div 296 would yield the same tax outcome.

To illustrate, in the above example with a TSB of $5 million, the overlay tax was 40% x 15% = 6%. So that the effective tax rate with Div 296 uplift is 15% + 6% = 21%.

If the tax rate on earnings was 21% instead of 15%, with no overlay Div 296 tax, then the tax on the $70 fully franked dividend would be 21% x the grossed-up dividend, being 21% x ($70 + $30) = $21. Less the $30 franking credit yields a $9 refund, exactly as above.

So under an overlay system such as Div 296, franking credits should remain in the earnings calculation, just as they are under a system with a single tax rate. The tax base does not change simply because Div 296 increases the effective tax rate on earnings. Franking credits form part of gross assessable income, are taxed only once, and then applied as a tax offset against the resulting tax liability just once.

In summary, franking credits are assessable to the recipient, including for Div 296 purposes. From the SMSF's perspective, they are not tax paid by another entity, but gross income against which tax offsets are applied. This is why the "tax on tax" argument breaks down. There is no flaw. Rather it is the imputation system operating exactly as intended, ensuring that all income is taxed only once, at the relevant tax rate.

Footnote

*As per the $5 million TSB example above, except the $70 dividend paid is **unfranked**. The fund's effective tax rate remains 15% + 6% = 21%. The economic outcomes:*

Company

- *Earns pre-tax profit: $100*
- *Pays company tax to ATO: $30*
- *Pays dividend to SMSF: $70, ($0 franking credit)*
- *Net cashflow: $0*

SMSF

- *Receives dividend: $70 (assessable income is $70)*
- *Ordinary fund tax: 15% x $70 = $10.50*
- *Div 296 tax: 6% x $70 = $4.20*
- *Consolidated tax position: $14.70 payable*
- *Net cash received: $55.30*

ATO

- *Receives company tax: $30*
- *Receives SMSF tax: $14.70*
- *Net tax received: $44.70*

Economically:

- *Company remains cashflow neutral.*
- *Total tax paid on $100 company profit = $44.70.*
- *Tax paid matches SMSF effective tax rate on after-tax company profits plus company tax rate = 21% x (1 – 30%) + 30% = 44.7%*

Rearranging, the additional tax relative to the fully-franked case, 30% x (1 – 21%) = 23.7%, reflects stranded company tax net of the tax that would otherwise have been paid on the unfranked $30, now not counted as earnings, as appropriate.

This outcome is entirely consistent with the imputation system. With full franking, company tax is credited to the recipient (the SMSF) and effectively unwound. With no franking, company tax is not credited and therefore remains part of the total tax burden. Div 296 continues to apply only to the SMSF's earnings, not to company tax paid. And it does not change the tax base, it only increases the SMSF's effective tax rate.

Therefore, the unfranked dividend is taxed more heavily not because of Div 296 or any "tax on tax", but because company tax is no longer credited to the SMSF under the imputation system.

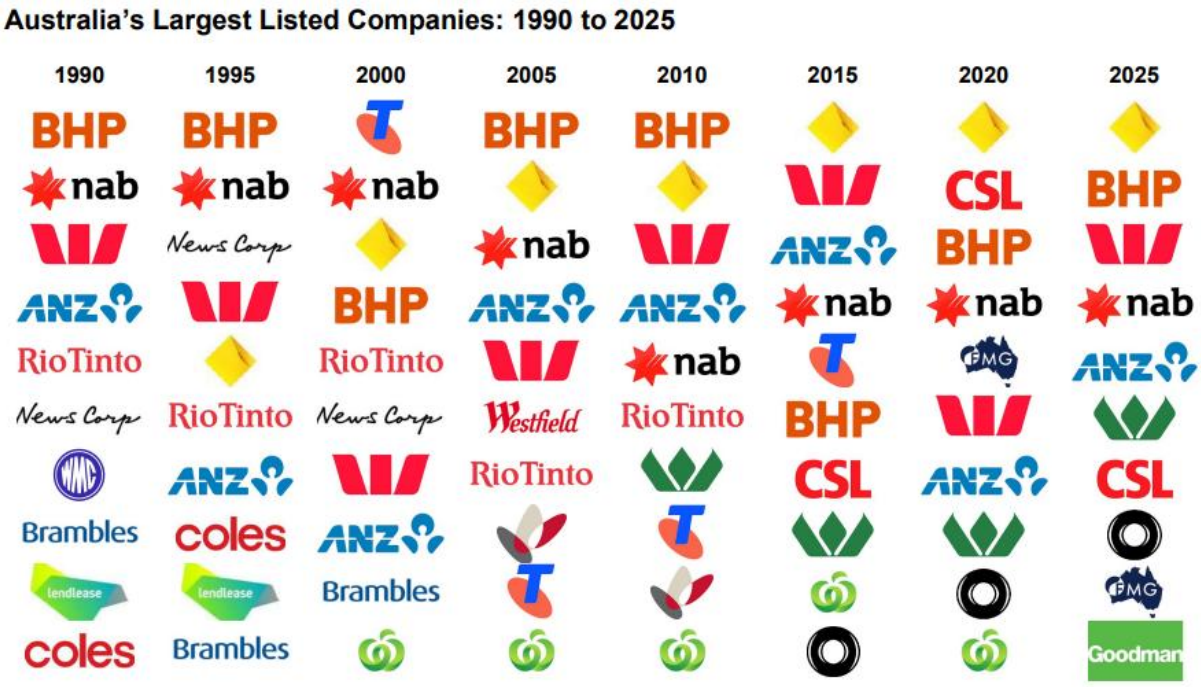
Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.

Who will get left holding the banks?

Tim Carleton

The major banks have been the mainstay of the domestic investment landscape in Australia for over 100 years. While credit cycles have come and gone, as the country has prospered and the population has grown, the banks have been a major beneficiary. Currently Australia's top five companies by market capitalisation are the four major retail banks and BHP. The prominence of the banks is a phenomenon that has long been the case. In fact, looking at the largest 10 companies by market capitalisation every five years since 1990 demonstrates the longevity of this dominance. As a result, the banks make up a very large proportion of the exposure most Australians have to domestic equities. ANZ, Commonwealth Bank, National Australia Bank and Westpac constitute 22.6% of the ASX200.

The question is, should investors be this invested in the sector? Or, for the first time in a very long time, is there a competitive threat for the banks' profits and business model emerging that the market might be underestimating?



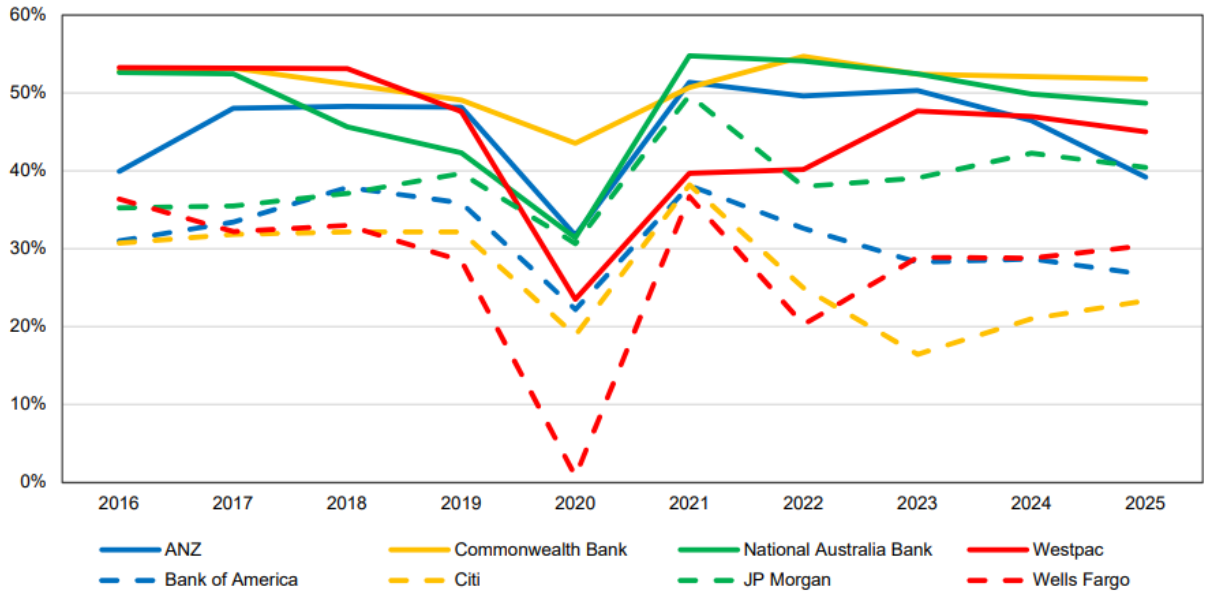
For most of the last 50 years the fundamentals of banking have not changed a great deal. A bank is a relatively simple proposition. You need funding, which is typically in the form of a combination of bank capital, wholesale funding and deposits from clients with savings. The funding mix is influenced by regulatory capital requirements and the cost of the relative sources of funding. And then you lend this capital to borrowers. You charge borrowers more than you pay those providing the funding, with the bank earning the spread between these two rates, which is called the net interest margin. You then have expenses, such as employee, property, technology, marketing, commission, utilities and regulatory costs. There are also expected credit losses and realised losses on loans that have gone into default and

are unable to be repaid in full. Deducting these expenses from the net interest margin earned and any revenue earned from trading and fees charged to clients gives you profit before tax.

The largest four domestic banks have a combined market share of over 70% of gross assets held by financial institutions in the domestic market. As a result, these banks have had significant scale advantages that increase profitability. Profit before tax (PBT) margins is one way of assessing relative profitability of different banking markets. It represents profit before tax as a percentage of revenue. For the major Australian banks PBT margins have averaged 47.5% over the last decade.

This is high by international standards. In the United States, the largest four banks, JP Morgan, Bank of America, Citibank and Wells Fargo, represent less than 40% of the total domestic assets held by financial institutions. These four institutions have averaged PBT margins of 31.2% over the same time frame. This is despite JP Morgan's elevated margins compared to peers, a function of its asset management and investment banking activities making it less comparable to traditional banks. There are over 4,000 banks in the US compared to less than 100 in Australia. In the United Kingdom, Lloyds enjoys market leadership with 20% of the domestic market, in the same way that Commonwealth Bank of Australia enjoys its market leading position domestically. Yet again, its PBT margins have averaged 38.8% over the last 10 years. There are between 300 and 400 banks in the UK. The more competitive markets in the US and UK have witnessed lower PBT margins.

Bank Profit Before Tax Margins (2016-2025)

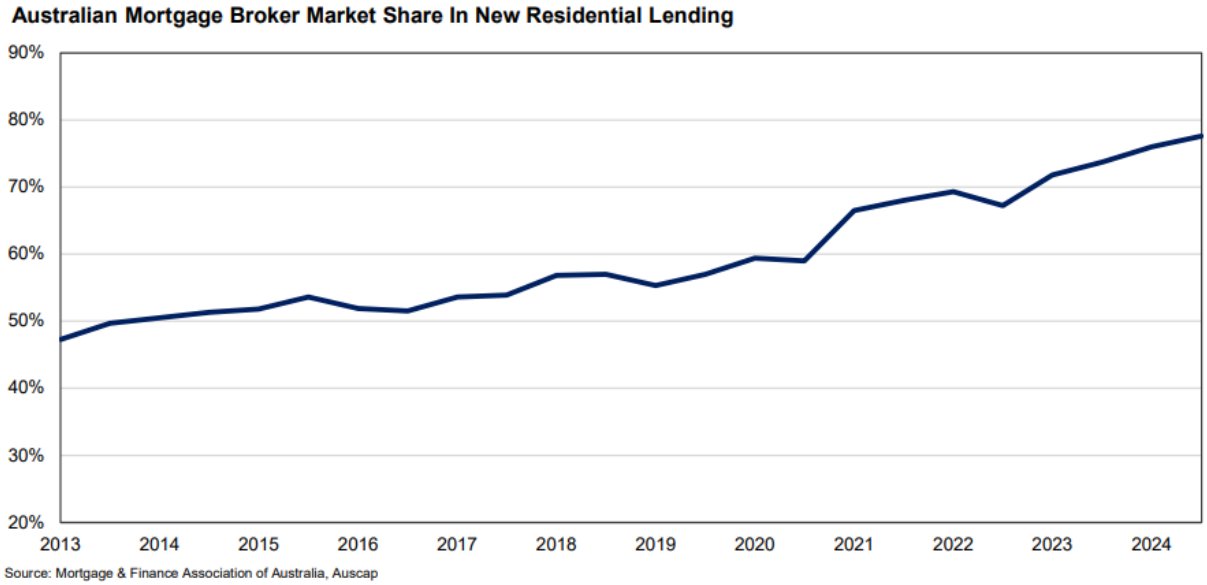


Source: FactSet, Bloomberg, Auscap

Historically, to borrow money in Australia, whether you were a family trying to buy a home or investment property, or a business trying to fund growth, you required direct contact with the bank which would assess your application. This led to a banking relationship that was sticky and advantageous for both the bank and the customer. For the bank, the familiarity with the client reduced the risk of default. For the customer, the bank's familiarity with them improved their chances of securing a loan and on potentially more favourable terms than offered elsewhere. Banking was therefore a relationship business.

This traditional model started to change in the mid-1990s following financial deregulation. Mortgage brokers started to appear on the scene with the emergence of Aussie Home Loans and this accelerated

with the emergence of other aggregators such as Wizard Home Loans in the early 2000s. Mortgage brokers rapidly became a very significant source of loan origination. By 2014, mortgage brokers were responsible for writing over 50% of residential mortgages. This percentage has since continued to climb. According to the Mortgage and Finance Association of Australia, in the September 2025 quarter, 77.3% of all new residential lending was facilitated by mortgage and finance brokers. This is 2.7% higher than a year earlier and 5.8% higher than in the September 2023 quarter.



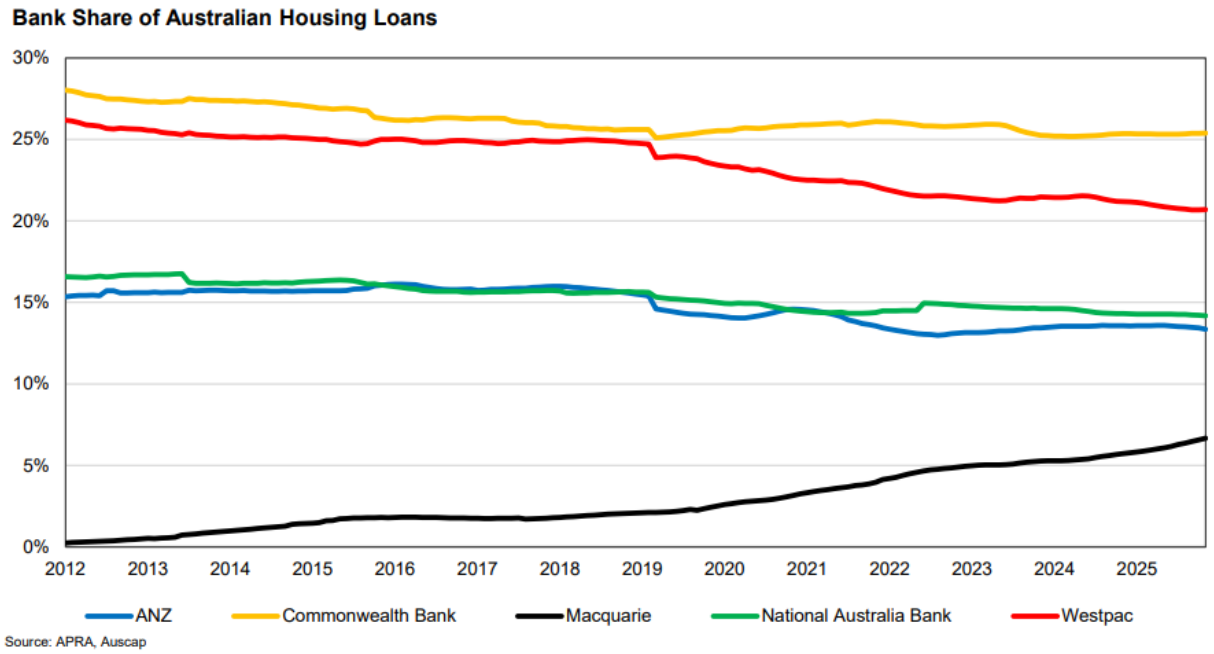
We see this change as extremely significant. For many residential property borrowers seeking to take out a new loan, extend an existing loan or refinance, they now contact their mortgage broker, not the bank. The banks, by allowing mortgage brokers to gain such a dominant position, have forfeited their role as relationship manager with the client. This is an egg that is very difficult to unscramble. As a major bank, if you choose not to play in the mortgage broker space, you risk serious market share losses given they control more than three quarters of the market. But the problem is, if a competitor comes along with a lower rate and better terms for the mortgage broker who is writing the business, then it is fairly straightforward for that competitor to win share. Moving from one bank to another is relatively simple. The 'economic moat' around the end customer has been diluted significantly and, in many cases, it simply does not exist. For years this has not been a problem, because there has not been a serious competitor seeking to scale and compete with the big four banks. The cosy oligopoly resulted in mortgage pricing that allowed the banks to maintain their market share and handsome profits. The question is whether this is now changing with Macquarie competing aggressively for share.

On the other side of the ledger, banks have been charging customers very significant implied fees on at call deposits for many years. When they offer low interest rates or even no interest on at call balances, and the Reserve Bank of Australia (RBA) cash rate is presently 3.6%, they are effectively charging customers that differential in fees to hold their money. Almost all of this is margin given the low costs associated with maintaining these accounts for the banks. Most of the “savings accounts” with the major four banks have considerable terms and conditions attached to them that result in clients failing to meet the requirements to receive the savings rate offered. Even most of the term deposit rates available at the time of writing were below the RBA cash rate, despite such accounts locking up your money for a period of time. Offering such low rates on cash balances has certainly resulted in higher net interest margins than would otherwise be the case. But it has left the major banks vulnerable to a more

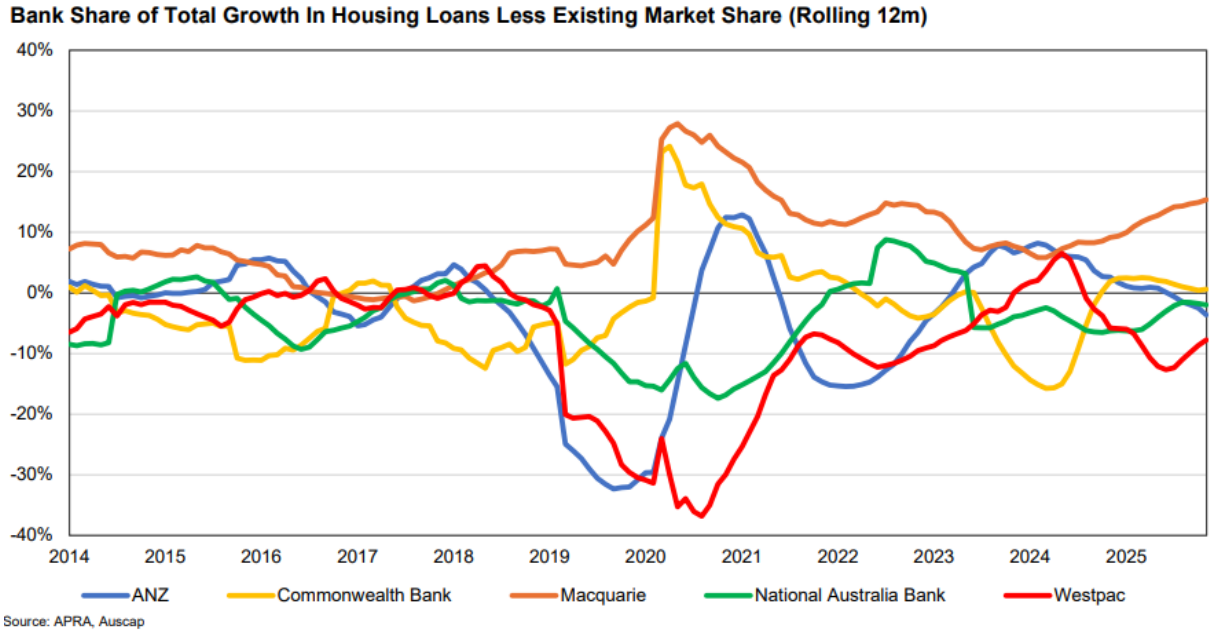
nimble player with a lower cost structure offering savers a better rate. This is particularly the case in an electronic world, where accounts can be established easily online, with no requirement for an in-person interaction.

A Macquarie savings account can be established online in a matter of minutes. This has no doubt fuelled the acceleration in the flow of deposits towards Macquarie in recent periods. Most customers no longer use the branch network for any part of their banking business. Few have relationships with individual bankers. Most of those who borrow get advice from a mortgage broker, someone who is at arm's length from any specific financial institution. Consumers are also more financially aware, with comparison sites highlighting superior offers on both the lending and deposit side.

As can be seen in the mortgage share chart below, Macquarie has become a formidable competitor in recent years, a trend we expect will continue. Today the combined market share of the four large retail banks sits at 73.6% of the domestic mortgage market, but this is down 10% in the last decade. Macquarie is quickly becoming a relevant player.



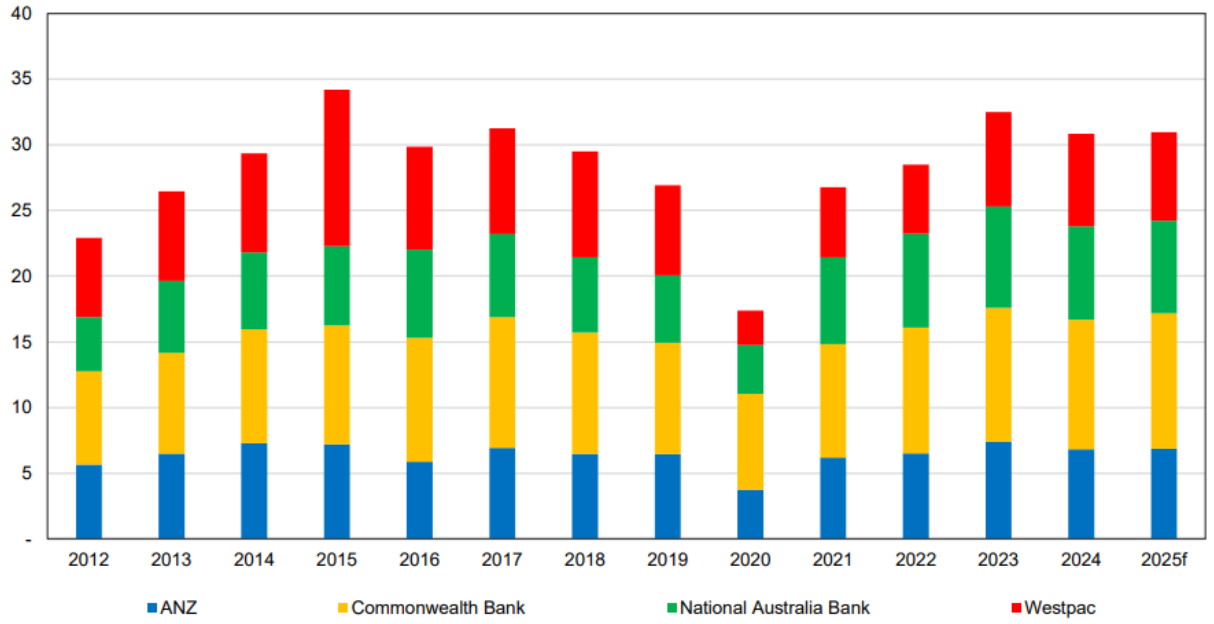
Macquarie is almost exclusively focused on the retail broker channel for its mortgage lending. More than 95% of the home loans Macquarie wrote in the last half year were originated via the broker channel. Macquarie is winning in this channel by offering the two things the mortgage broker cares most about, a competitive interest rate and market leading turnaround times. On the funding side, Macquarie is attracting deposits at a rapid rate by having a "no hoops, no catches" savings account offering for at-call deposits. At the time of writing Macquarie was offering a 4.25% rate on up to AUD$2 million. This is higher than nearly every publicly viewable term deposit rate offered by the major banks, let alone their at call accounts. It takes very little time to set up an account with multi-factor authentication for most customers. In the last year this resulted in an increase in deposits of nearly $40 billion, taking Macquarie's total deposit book to $192.5 billion.



On a rolling 12 month basis, the chart above shows the difference between each bank's share of the growth of the total Australian housing loan market and their existing market share. Macquarie has been the only bank to have consistently increased its market share since 2018, with a noticeable acceleration in the last year or so. Macquarie is benefitting from a modern technology stack that is more efficient than peers, a deliberate focus on simpler clients targeting lower loan-to-value ratio and owner-occupier lending tiers, and the absence of the costs associated with having a legacy branch network. These advantages resulted in PBT margins for Macquarie's Banking and Financial Services division of 45.1% in the 6 months to September 2025, up from 41% on the same period the prior year and approaching the average of its much larger peers. The operating leverage from this point should continue to be substantial. In the 12 months to 30 November 2025, Macquarie was responsible for 21.6% of the growth in the Australian mortgage market, taking its share of the aggregate mortgage market from 5.7% to 6.7%.

Macquarie is quickly gaining ground on ANZ and National Australia Bank's market share. Assuming the market share of new loans for the 12 months ending 30 November 2025, Macquarie's mortgage book would go past ANZ and National Australia Bank in market share within a decade. Of course a lot can happen in that time period, but the question is how the major banks will respond. It is difficult to see them taking a meaningful hit to profitability by changing their approach to at-call deposits, yet by capturing a greater share of deposits Macquarie is facilitating its growth in housing lending. Similarly, it would appear difficult for the major banks to immediately respond to Macquarie's focus on improving turnaround times for mortgage brokers. It most likely requires meaningful investment in systems and technology. Given the earnings leverage Macquarie is gaining from increasing the size of its mortgage book, it seems likely that it will continue to compete aggressively in this space. Banking and Financial Services made up 20.9% of Macquarie's net profit at the most recent result, having grown 22% on the same half a year earlier. No doubt Macquarie is eyeing the circa $30 billion in net profit after tax the big four banks make per annum.

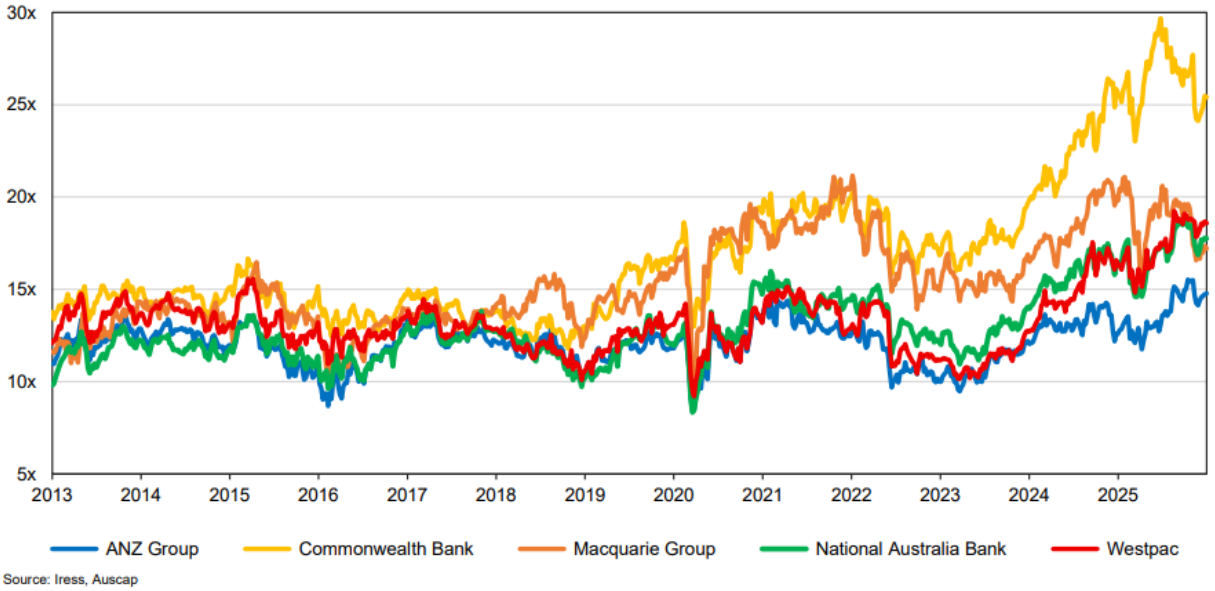
Combined Big Four Bank Net Profit After Tax ($bn)



Source: FactSet, Auscap

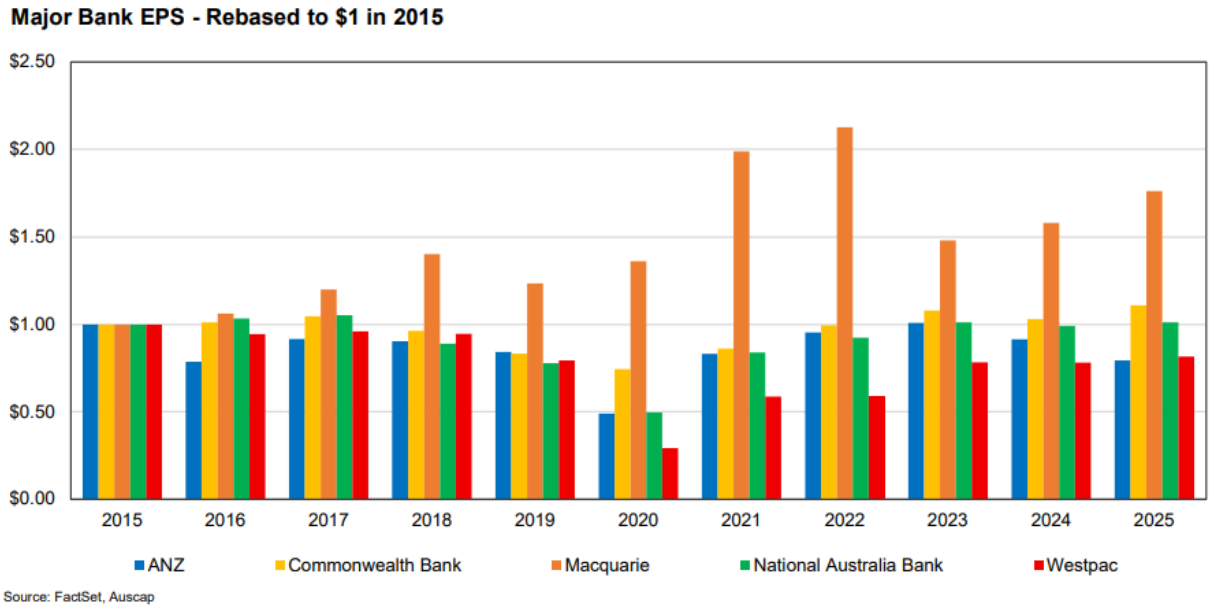
We acknowledge that Macquarie's business mix is very different to the major banks and some of its divisions have been facing headwinds recently. That said, it is interesting to note that, at a time when Macquarie is actively competing head-to-head with the major retail banks and presently winning considerable market share, Macquarie is trading on a lower one year forward price to earnings ratio than three of the four retail banks, which has not historically been the case.

Bank 12M Forecast Price to Earnings Ratios



Source: Iress, Auscap

Over time Macquarie has demonstrated superior earnings growth, as the chart below highlights, and has had a higher average historic return on equity, averaging 13.8% over the last decade compared to 13.1% for Commonwealth Bank, 9.5% for ANZ, 10.7% for National Australia Bank and 9.8% for Westpac.



Auscap continues to hold Macquarie Group, which has been a long-term investment, in our high conviction strategy. We are cognisant of the widespread exposure that Australian retail investors and superannuation funds have to the major retail banks. We suspect this period of renewed investment and direct competition carries earnings risk. This is occurring at a time when bank valuations are extremely elevated. We continue to focus on investments in high quality businesses priced attractively that are likely to deliver an attractive return driven by dividends and earnings growth.

Tim Carleton is the Chief Investment Officer and founder of Auscap Asset Management. This article is an extract from Auscap's January 2026 letter to investors. You can see a full version of the letter here. This article contains information that is general in nature. It does not take into account the objectives, financial situation or needs of any particular person.

AI economic scenarios: revolutionary growth, or recessionary bubble?

David Rees

Economists are not best placed to decide if we are in a stock market bubble. But as we look to the future of artificial intelligence's (AI) impact on global economies, we see two potential scenarios: an 'AI Boom', where AI is the real deal and is rapidly adopted; and an 'AI Bust', where a stock market bubble bursts. *Read on for a summary of our research, or download the full paper above or via this link.*

Two scenarios, one beginning

Both scenarios are based on our key assumptions that the solid macroeconomic backdrop, coupled with the sizeable investment plans of the hyperscalers – the big cloud computing companies – will see continued capital expenditure (capex) and a rising equity market performance for much of 2026.

We then assume a key moment late in the year when markets begin to question the ability of tech companies to deliver on the hype. Will the technology be monetised sufficiently to deliver a return on investment? At this fork in the road, our scenarios diverge.

In the 'AI Bust' scenario the stock market bubble bursts and tech companies pull back from rapid investment, which has a negative impact on the broader economy.

By contrast, in the 'AI Boom', clear evidence emerges from the market wobble that AI technologies – not only large language models (LLMs), but also autonomous robotics, vehicles and more – are shown to be transformative and profitable.

This is then assumed to spur rapid adoption of the technology that could see new market leaders emerge.

AI Bust

The many past instances of the bursting of historic market bubbles mean we can be more confident about the macroeconomic implications of this scenario.

We assume the market collapse would have an immediate, negative effect on private sector activity. As it becomes clear that tech companies will not be able to monetise AI investment, spending is shelved. We then assume a two-year investment recession like that seen in the aftermath of the dot.com bubble in the early 2000s.

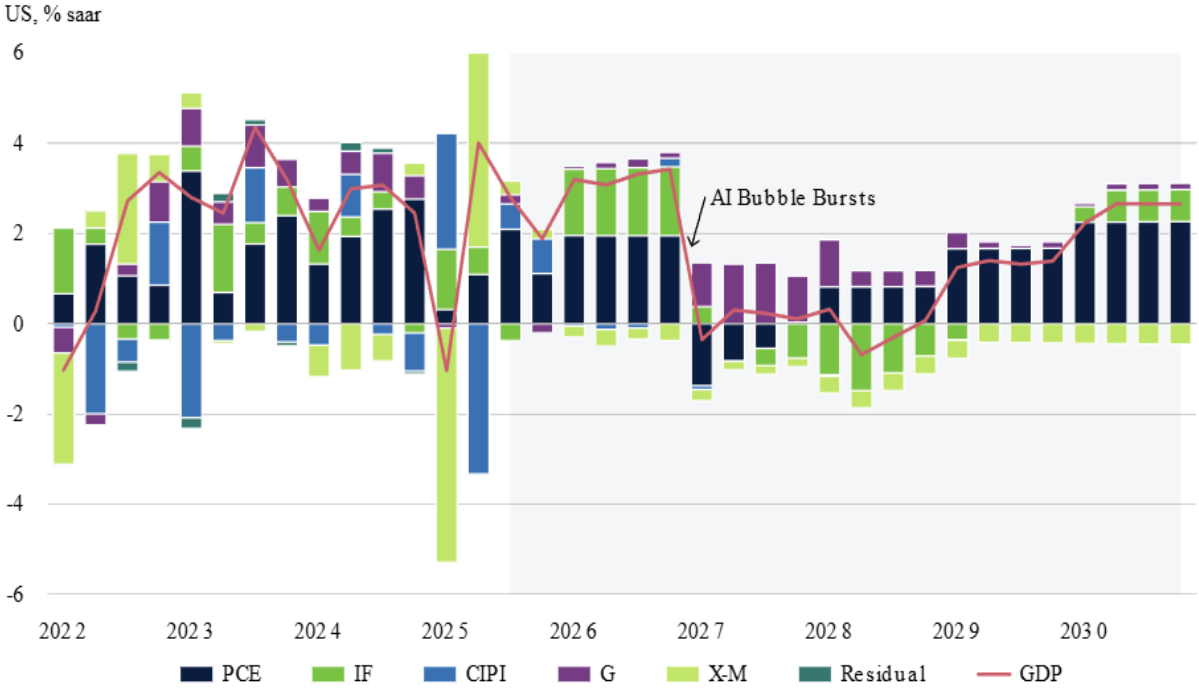
Falling stock prices and rising unemployment would have a negative impact on sentiment and spending. This would be enough to tip the US into a mild recession.

Rising unemployment and softer demand would relieve capacity constraints in the US economy and allow the Fed to cut interest rates to below neutral.

This, coupled with some fiscal stimulus, would set the scene for a cyclical, consumer-led recovery through late-2028 onwards.

In this environment, equities would begin to perform well again, but with more breadth and different market leaders.

AI Bust - Capex drops, with negative impacts on sentiment and spending



Source: Schroders Economics Group. 616661

Note: PCE = Personal Consumption Expenditures, IF = business investment, CIPI = change in private inventories, G = government spending, X-M = net exports

AI Boom

The AI Boom scenario is deliberately assumed to be extreme in order to tease out the long-term implications of a rapid, 'third industrial revolution' which unfolds over a matter of months rather than years or decades.

We have assumed that after a market wobble in late-2026, there is some pause in tech capex as the winners and losers of the AI arms race are thrashed out. After that, our key assumption is of an exponential ramp-up of capex as firms rush to roll out AI infrastructure and services as it becomes clear that AI is deeply transformative.

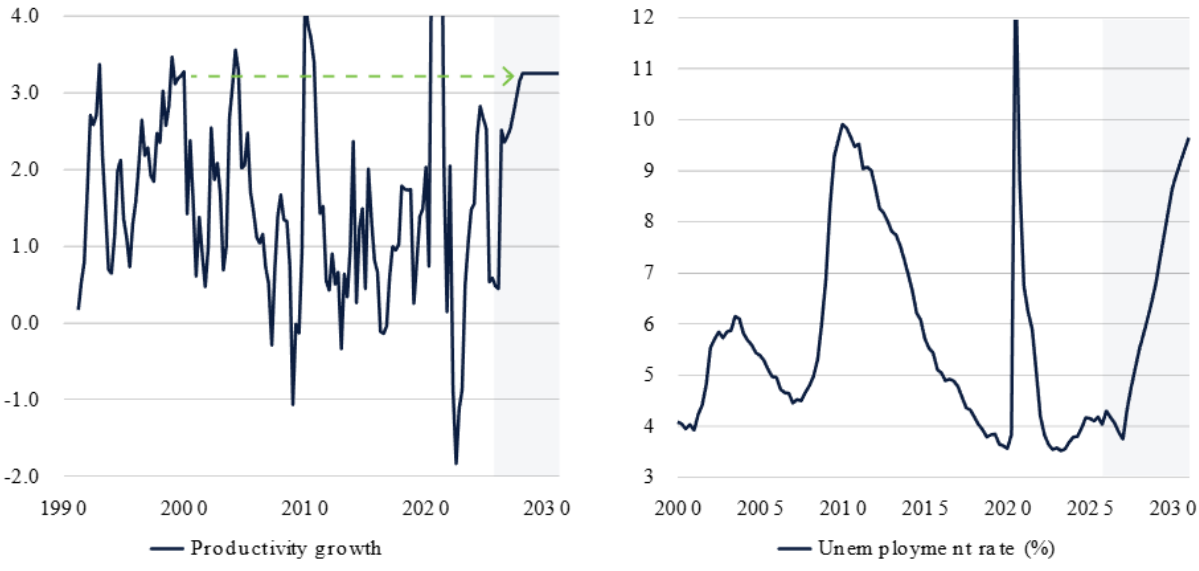
This is assumed to support robust US GDP growth.

However, in such a scenario where robotics and autonomous vehicles, amongst other technologies, begin to displace workers, the outlook for consumption is less clear cut.

We have assumed the AI Boom sees US productivity growth climb to the rates seen prior to the dot.com bubble and stay there – around 3.5% per year.

By assuming that both population growth and participation rates remain the same, such strong productivity would imply an increase in unemployment.

US productivity boom results in rising unemployment



Source: Schroders Economics Group. 6 November 2025. 616661

Twin-speed growth and inflation

It is also easy to construct a twin-speed story for US inflation in such a scenario.

Rising unemployment and pressure on incomes and consumer spending all sound deflationary – certainly for areas such as housing and core services. At the same time, the displacement of workers could bring down the cost of other service sectors.

However, the scramble to rapidly adopt transformative AI would likely cause strains on various areas of the economy. If tech firms struggled to keep up with strong demand, it is fair to assume there would be an inflationary impact in the goods sector.

There is also a lot of focus on the energy demands AI is likely to trigger through power-hungry data centres. Around half of US electricity is generated using natural gas, and rising demand could see prices rise.

Given the importance of natural gas to fertiliser production, it is feasible this could also begin to put upward pressure on food prices.

Tricky environment for policymakers

Ultimately, rising lay-offs and falling inflation would pave the way for much lower interest rates.

The prospect of jobless growth could also have profound implications for the US public finances.

Around three-quarters of federal revenues come from the taxation of labour whereas only about one-quarter comes from corporations. On the other side of the ledger, a large portion of federal spending is on welfare.

The implication is that the US – and other governments around the world – would need to raise more tax from corporations and perhaps totally overhaul tax and spending frameworks.

But finally, to take a step back, the most obvious question to come out of this scenario is whether governments would ever allow such unfettered adoption of AI.

From an investor's point of view, monitoring these developments is critical.

Where potential AI scenarios are as divergent as igniting a boom or triggering a bust, complacency must be among the bigger risks.

David Rees is Head of Global Economics at Schroders, a sponsor of Firstlinks. This article does not contain and should not be taken as containing any financial product advice or financial product recommendations. It does not take into consideration your personal objectives, financial situation or needs.

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The long-term case for compounders

Robert M. Almeida

In brief

- Market booms often lure investors into cyclical businesses, but history shows these cycles can be short-lived and expose investors to severe drawdowns and difficult recovery math.
- Compounders tend to deliver steadier, more durable profit growth across full cycles, making them better suited for long-term investors.

- Selectivity is especially important given the unique, negative economies of scale of some AI businesses.

In the heat of a market boom, the siren song of cyclical businesses can be almost impossible for investors to ignore. Whether it was the credit-fueled surge of the mid-2000s, the post-lockdown commodity spike, or the current frenzy surrounding hardware-heavy technology cycles, the narrative is always the same: *this time, the scale is different.*

History is filled with 'must-own' stories that were cycles in disguise. In the 1720s, it was the South Sea Company, where investors rushed to own a global trade monopoly, only to see their capital evaporate when profits failed to meet expectations. A century later, railways were going to change the world — and they did. However, excess competition and overcapacity wiped out the investors who funded them.

The lesson history teaches us is that cycle booms are finite. While the 'up cycle' provides the dopamine hit of outperformance, it's the full cycle that determines total return on capital.

This informs why we at MFS structurally lean away from 'cyclicals' and towards 'compounders'. To put this into greater context as we head into 2026 and navigate the heat of a technology "up cycle," we offer a hypothetical look at the hard math of losses during a full cycle.

A tale of two P&Ls

Consider a hypothetical 10-year window involving two businesses: Compounder Industries and Cyclicals Incorporated.

As shown in Exhibit 1, both start at the same place: $100 million in revenue and a healthy 30% profit margin. For the first few years, Compounder Industries raises revenue and costs at a steady 10% clip, maintaining its margin. It follows the mantra of "build it once, sell it a bunch," utilizing high operating leverage and differentiated products to generate consistent profits.

Then comes the 'boom'. A new technology or economic shift emerges, directly benefiting Cyclicals Inc. Revenues explode by 40%. Investors, captivated by the sudden margin expansion to 45%, rotate out of shares of Compounder Industries and into Cyclicals Inc. For the next three years, Cyclicals Inc.'s margins and profits materially outpace the market.

Exhibit 1: Math can work against cyclicals once the boom ends

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	
		Steady State	Steady State	Boom Start	Boom Peak	Late Cycle	Bust	Bust	Recovery	Recovery	
Compounder Industries											
Revenue	$100	$110	$121	$133	$146	$161	$177	$195	$214	$236	
Growth rate		10%	10%	10%	10%	10%	10%	10%	10%	10%	
Costs	$70	$77	$85	$93	$102	$113	$124	$136	$150	$165	
Cost inflation rate		10%	10%	10%	10%	10%	10%	10%	10%	10%	
Compounder Industries	$30	$33	$36	$40	$44	$48	$53	$58	$64	$71	$478
Profit Margin	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	
			Steady State	Steady State	Boom Start	Boom Peak	Late Cycle	Bust	Bust	Recovery	Recovery	
Cyclicals Inc.												
	Revenue	$100	$105	$110	$154	$201	$221	$132	$109	$114	$120	
	Growth rate		5%	5%	40%	30%	10%	-40%	-18%	5%	5%	
	Costs	$70	$74	$77	$93	$110	$126	$106	$87	$86	$84	
	Cost inflation rate		5%	5%	20%	19%	14%	-16%	-18%	-2%	-2%	
	Cyclicals Inc.	$30	$32	$33	$62	$90	$95	$26	$22	$28	$36	$454
	Profit Margin	30%	30%	30%	40%	45%	43%	20%	20%	25%	30%	

Source: This example is hypothetical and does not represent any actual data. This is for informational purposes only.

The asymmetry of the bust

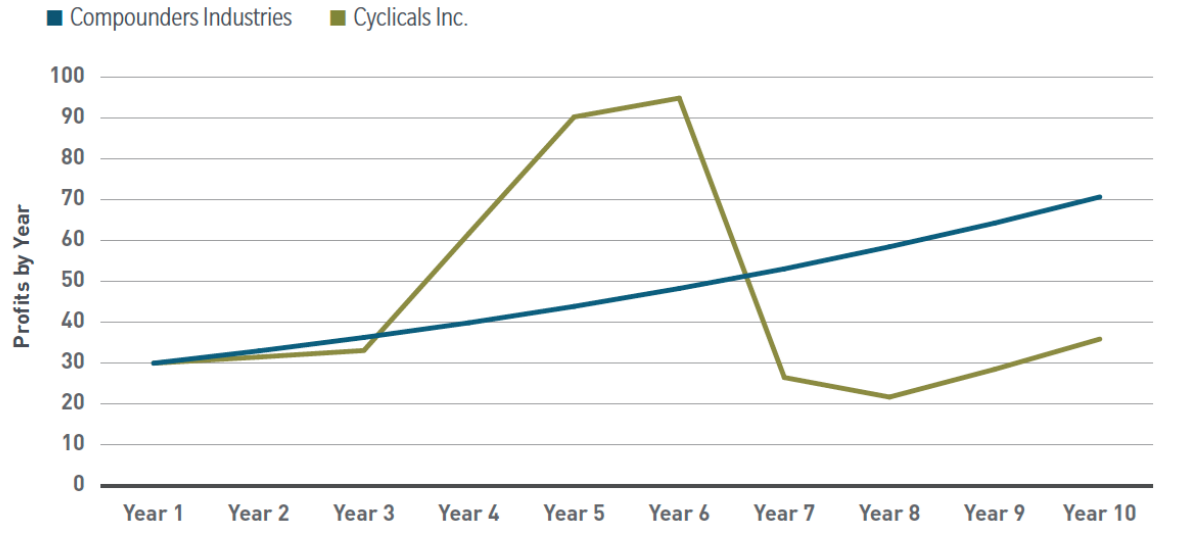
By Year 7, the cycle peaks as new competition saturates the market with supply. Cyclical Inc.'s sales fall by 40%. Despite aggressive cost-cutting and layoffs, profit margins are halved.

Though this scenario is hypothetical, the assumptions are rooted in history and designed to expose the mathematical trap that investors often overlook: to recover from a 40% drop in revenue and return to its Year-6 peak, Cyclicals Inc. doesn't just need a 'good' year — it needs to grow by 67% in a single year just to get back to even. That is an enormous hurdle that Compounder Industries never has to face.

The full-cycle experience

So, while both companies reach approximately the same total profits of just over $450 billion, their pathways are different. Compounder Industries' annual returns were almost double and with less volatility, as illustrated below.

Exhibit 2: Compounders tend to offer a smoother ride



Source: This example is hypothetical and does not represent any actual data. This is for informational purposes only.

Conclusion

In recent years, we've seen a massive rotation into companies tethered to product cycles — specifically technology hardware driven by AI. Some of today's AI models operate with negative economies of scale: every query triggers expensive compute costs that exceed revenue. This is the antithesis of the Internet 2.0 era, in which network effects created monopolies with historic profit growth. We believe these changed fundamentals warrant selective, rather than broad-based, exposure to today's technology businesses.

'Quality' is a term used so often in this industry that it has lost its teeth. At its core, quality isn't about a label; it's about the ability to avoid the 'math of the bust'.

We favor companies that we think can compound earnings through differentiated products and scalable structures. While the compounder might be a laggard during a boom, like today, they are often the ones delivering better financial outcomes for the patient, long-term investor who possesses a deep, fundamental framework.

Robert M. Almeida is a Global Investment Strategist and Portfolio Manager at MFS Investment Management. This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy. It has been prepared without taking into account any personal objectives, financial situation or needs of any specific person. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Firstlinks.

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AREITs are not as passive as you may think

Quay Global Investors

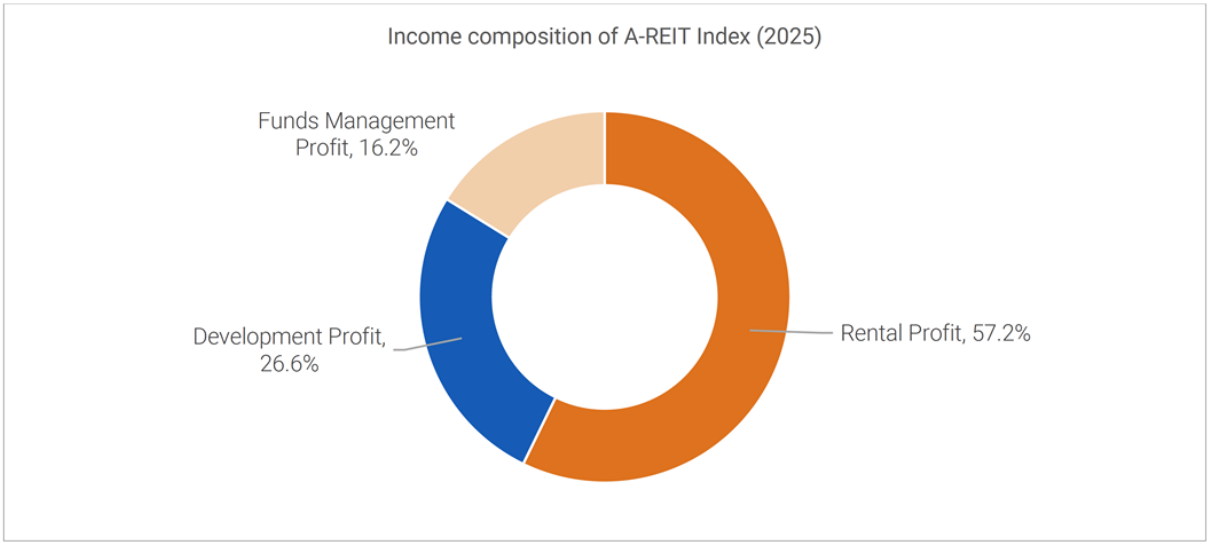
For non-specialists, one could be forgiven for believing the Australian real estate investment trust (A-REIT) sector is an efficient way to gain exposure to passive-style rental-based real estate returns. And in the past, this assumption would be true.

However today, the structure of the sector is such that a large proportion of the index generates income from highly active business which bears little resemblance to rental income flows.

Today, many REITs earn their income from one of three broad sources:

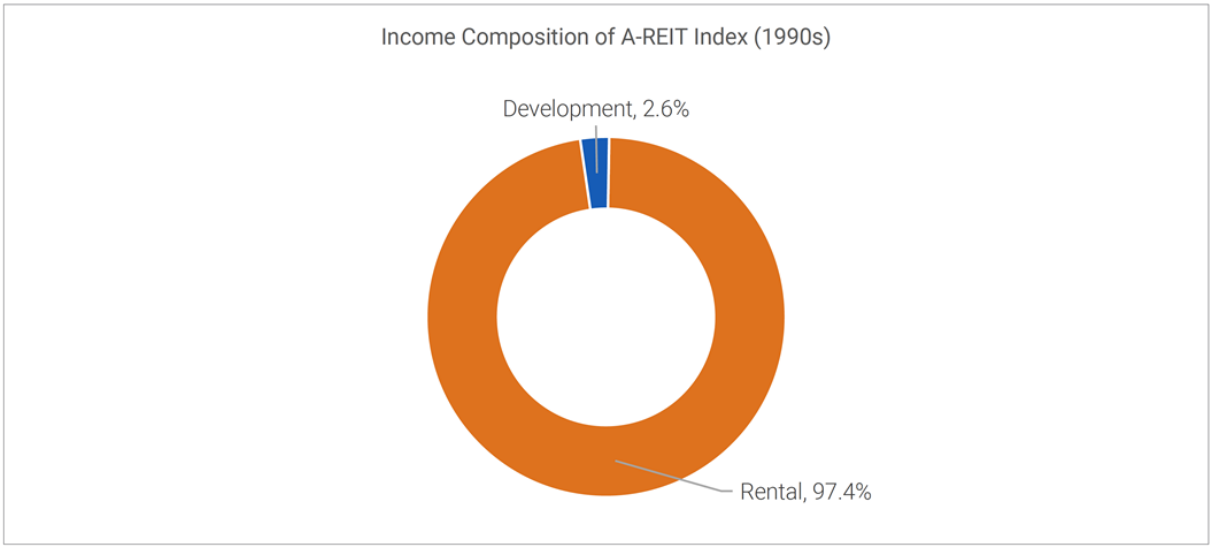
- Rental income (passive)
- Development income (fees and profits)
- Funds management / transaction income.

When weighted by index representation[1], an investor's underlying exposure to the index looks like this.



Source: Company reports, Quay Global Investors.

By comparison, in the 1990s when AREITS first rose to prominence as a source of low-risk rental-based income, the index looked like this.



Source: ANZ McCaughan (Australian Property Trust Review), Quay Global Investors.

In the 1990s, there were well over 20 listed REITs, with all but one earning passive rental income. The one exception was Stockland Trust Group where residential land subdivision accounted for ~20% of net income. Stockland was widely considered to be the 'risky one'[2].

The sector evolved into the early 2000s where companies like Multiplex and Mirvac added to the industry's 'active nature' to underlying profits. By 2008 however, it was the excessive debt that decimated the industry as a global credit crunch forced highly dilutive equity issues or even bankruptcies on a number of local REITs.

While the sector learned its leverage lesson from the GFC, from our perspective, many companies simply swapped financial leverage (debt) with operating leverage (uncertain revenues and margins) all in the pursuit of higher returns.

Why this matters

There is nothing wrong with the management of property development model per se. Without developers there would be no real estate. In the same vein, the real estate fund management business model can make sense. But at times we think investors who try to compare A-REITs to global REITS are underestimating the risks of these alternate exposures.

The developers

The developer model is pretty simple: Buy or gain access to a site, build a structure and sell it for more than the cost. The difference is profit. A very reasonable business. What comes across to us as unreasonable is assigning a traditional rental or equity multiple on this type of profit.

This is significantly different to passive rental income. For a developer, revenues can literally disappear overnight as would-be buyers pull out of the market for various reasons (GFC was a perfect example).

The earnings volatility here can be extreme. A development division profit could turn negative in the blink of an eye. And as we learned during significant risk off periods, banks and financiers will be loath to extend credit to non-income producing development sites.

Compare this to a passive rental REIT. If the environment turns unfriendly, near-term profits are somewhat protected by lease duration. And without the need for immediate capital for development, it can be relatively insulated from credit events so long as leverage ratios are reasonable. And while some occupancy loss may result in some income erosion, this type of asset class does not go from profit to loss in a matter of weeks due to an external shock.

The fund managers

The real estate fund management model is equally simple: Collect fees (management, transactional, performance) by amassing assets on behalf of investors.

Again, this too can be more volatile than passive income, as both the AMP and Lend Lease have discovered recently with the loss of (or winding down of) funds due to client and risk appetite changes. And while owners of passive real estate can lose a tenant, short term income loss can be replaced as the building structure is still owned by the investor. So, the income loss is temporary.

At first there is no risk, then it comes all at once

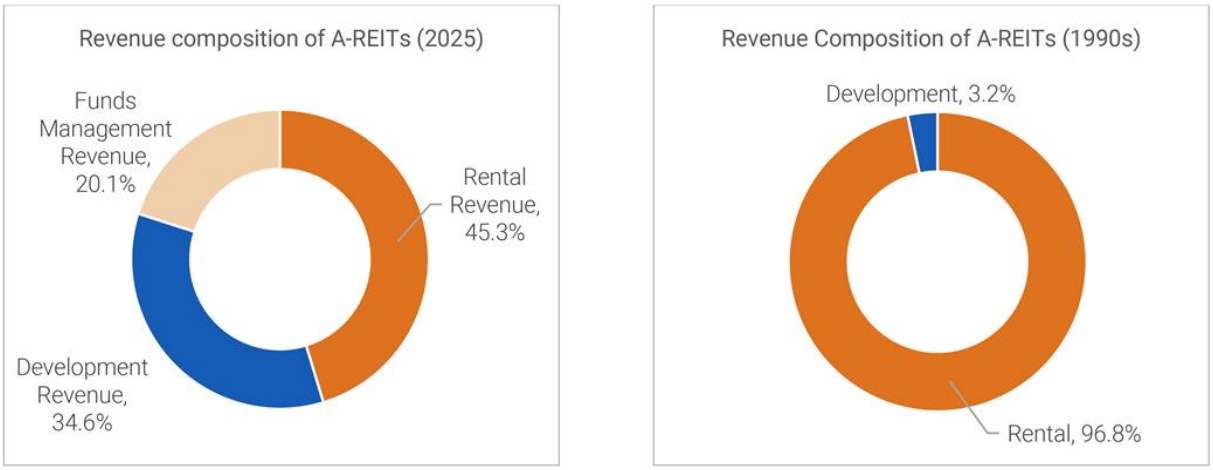
In a rising market, or within a sector with demand tailwinds, developers and fund managers can meaningfully outperform the passive rental REITs. After all, operating leverage works in both directions.

Understanding the underlying nature of these businesses, and hence the underlying risk of the A-REIT index is important. Because during an up-cycle there does not feel like there is any additional risk. Stocks within the sector move around in a similar fashion based on earnings guidance, and macro forces. Traditional risk measures such as betas, tracking errors, and standard deviations all look normal. And in good economic times development profits grow and fund management and performance fees swell.

It is only when there is a meaningful shift in the economy or sector do the risks come – and they can come all at once as development profits dry up, or performance based / transaction fees disappear.

Which brings us back to our original charts.

When thinking about the development and fund management exposure, the risk is not on the income. The risk relates to the revenue. Re-casting the sector on this basis (and comparing it to the 1990s) highlights just how much the sector has evolved from its history of being a passive rental income exposure to a much higher risk asset class.



Source: Company reports, Quay Global Investors.

Concluding thoughts

We explicitly exclude developers and fund managers from our investment universe. We do this because:

- owning a developer runs contrary to our philosophy of seeking assets priced below replacement cost (where developers operate in the exact opposite environment); and
- we fundamentally believe owning assets with low-income risk backed by stabilised assets translates into low investment risk.

This is not to say the A-REIT sector can't continue to perform in the near term, but for those that invest in the passive index, or in index aware strategies, be aware of your underlying exposure and just how much that exposure has changed over the years.

[1] S&P/ASX 200 REIT Index.
[2] As a side note, in the 1990s Stockland expensed all costs associated with the land bank through the profit and loss statement. The land was held truly "at historic cost". This compares to the modern practice of holding land at cost plus capitalised holding costs and capitalised interest. Stockland's margins were therefore wider and profits less risky.

Australia's quiet dairy boom — and the investment opportunity

Harrison Stewart

Almost every fridge in Australia contains some form of dairy product, and dairy is one of Australia's top agricultural industries. Yet few investors have direct exposure to dairy farms, even while dairy farms offer a 'real asset' alternative with low correlation to other investments.

Dairy was worth $6.2 billion in 2024, according to the ABS, placing it as Australia's third largest agricultural commodity behind only beef and wheat.

Sure, investors can get some exposure to dairy by investing in listed product manufacturers. But dairy farms provide an opportunity to invest right at the source, via an unlisted, less volatile alternative for investors, which includes potential for capital appreciation of the underlying farmland.

Dairy also brings greater consistency of income. Many agricultural businesses farming grain, horticulture or livestock often only have one crop/offspring/produce for sale yearly, which can be impacted by weather events such as hail, floods or commodity price movements. In contrast, dairy cows are milked every day, with a committed minimum annual milk price that provides more control over performance, and lower impact from isolated weather events.

While milk sales are hugely important, dairy farms behave similarly to other traditional commercial property investments, such as retail or industrial property, as an investment. Except rather than derive cashflow from rents, owned and operated dairy farms receive cashflow from dairy production, with potential for unrealised capital growth from the farmland itself.

Historically, capital growth for dairy farmland has proven significant.

For example, Tasmanian dairy farmland, some of the best available (and most expensive) in the country, has grown by an average annual rate of 10.3% over the last 20 years, according to the Bendigo Bank Farmland Values Report for 2025.

Median price $/ha					
	2024	YoY%	5yr CAGR	10yr CAGR	20yr CAGR
North West	$27,019	-5.9%	14.4%	8.6%	8.6%
Northern	$19,647	7.5%	13.2%	11.2%	9.7%
South	$8,260	-53.4%	9.5%	7.8%	8.1%
TASMANIA	**$23,202**	**14.2%**	**16.2%**	**11.6%**	**10.3%**

Source: Bendigo Bank Farmland Values Report 2025

The report shows another great dairy region, Southwest Victoria, has seen farmland appreciate by an average annual rate of 9.6% over the last 20 years, making farmland in these areas one of the top performing asset classes over the last 20 years.

It's worth noting reported farmland values can fluctuate year-to-year, as average prices are often influenced by relatively few sales. A long-term view provides a clearer picture, and with an appropriate gearing level these returns can be amplified.

As with other commercial property, there is a high barrier to entry, and compiling your own portfolio of dairy farms is a stretch for all but the wealthiest investors. The starting cost for buying a farm directly would be $5 million or above, plus costs for livestock and equipment. Hence diversification into dairy or agriculture is out of reach for most investors.

Investors can access dairy assets via Dairy Trusts, similar to how investors access industrial or retail properties which would otherwise be out of reach.

Dairy consumption shows resilience to cost-of-living pressures

A lift in domestic dairy consumption combined with a decline in dairy production is creating favourable fundamentals supporting Australian dairy.

The bad old days of the supermarket milk price wars are behind us, and it's hard to see another price war starting up since the landmark Dairy Code of Conduct was introduced on 1 January 2020.

The Code is a significant policy which governs how processors deal with farmers and is enforced by the ACCC. All dairy trade must now comply with the Code.

It has brought greater clarity including a minimum milk price, which is determined each year in June. Importantly, there is no maximum milk price for the year. Once the floor price is set, the dairy price can move higher: processors increased the farmgate milk price during the 2024-25 and 2025-26 seasons, following positive industry momentum.

Recent trends show consumer resilience has defied cost-of-living pressures. Dairy Australia's *Situation and Outlook* report for Year-end 2025 showed strong growth in sales value across all four dairy products (milk, cheese, yoghurt, and butter) over the last year.

Seeing an uptick in dairy consumption, at a time when many households have been cash-strapped, shows underlying resilience in the dairy market.

Meanwhile, Rabobank's *Global Dairy Quarterly*, released September 2025, said a marginal fall in Australian milk production has influenced higher farmgate milk prices, with prices already around 10% higher than last year's closing dairy price.

If we consider the big picture, there has been a long-term fall in the local dairy supply: over a 20-year period, Australia's national milk production fell from approximately 11 billion litres to 8 billion litres. Australia now needs approximately 70% of its national milk production to satisfy domestic consumption.

Australian market

Figure A3 Australian retail sales

	Take home volume	YoY growth	Take home value $m	YoY growth
Milk *As of 05/10/25*	1,430m. L ↑	1.1%	3,053 ↑	2.9%
Cheese *As of 13/07/25*	176kt ↑	3.8%	3,066 ↑	1.9%
Dairy spreads *As of 05/10/25*	61kt ↓	-0.9%	857 ↑	3.1%
Yoghurts *As of 13/07/25*	213kt ↑	8.4%	1,666 ↑	10.5%

Source: Dairy Australia calculation based in part on data reported by NielsenIQ through its Homescan Service for the fresh and long life milk categories, and dairy spreads to 5 October 2025, and yoghurt and cheese to 13 July 2025, for the Total Australia market, according to the NielsenIQ standard hierarchy. Copyright © 2025, Nielsen Consumer LLC. product

Source: Dairy Australia Situation and Outlook Report Year-end 2025

Global demand and tariffs

Demand for dairy products continues to grow globally. The International Dairy Federation projects a potential shortfall in global dairy production of 30 million tonnes by 2030 based on current consumption trends.

Rabobank has also confirmed a 12% uplift in the value of Australian dairy exports in the last 12-months.

President Trump's trade tariffs are not expected to have a material impact on Australian dairy, and its possible retaliatory tariffs on US dairy from Australia's key export partners (e.g. China) would be positive for local producers.

The US announced a 10% tariff on Australian Dairy commencing April 2025, but this should have little material impact given the US market accounts for just 0.6% of Australia's total dairy exports, and it ranks as our 20th largest export destination.

China is a more significant market for Australian dairy producers: Australia exported 185,466 tonnes of dairy products to Greater China in 2024 and there are currently no tariffs from China on Australian dairy.

Location, optimisation key for mitigating risks

Any agricultural product may experience seasonal fluctuations due to weather conditions, and dairy is not immune. Location is hugely important, and Australia's most valuable and productive dairy land is in high rainfall areas.

But sometimes even these areas experience unusual weather conditions, and two of Australia's most dependable, high-rainfall dairy areas in southwest Victoria and northwest Tasmania experienced record dry conditions during 2024 and early 2025.

While we can't control the weather, dairy farmers have some control over how they manage their resources. Farms with the ability to irrigate can mitigate the worst effects of dry periods. But good management and decision making to drive performance is most important.

An 'own and operate' structure, whereby one entity owns and manages the dairy farms, creates various efficiencies. It is more appealing as an investment by combining returns from both operational performance and the underlying capital growth of the farmland, something not achieved through investing in listed downstream dairy processors.

Dairy farms which control these common risks are set up to produce competitive returns over the longer term, adding something different to investor portfolios.

While dairy may face short-term challenges from time-to-time, over the longer term several fundamentals suggest this is an alternative investment to watch.

Harrison Stewart is a Senior Investment Analyst, Alternative Investments at Prime Value Asset Management, which offers a Dairy Trust fund.