Australian Equities Midyear Outlook: Turning Market Overreaction into Opportunity

5 August 2026

Key Takeaways

- Historically wide valuation spreads provided a strong foundation for active returns during the past financial year. When the valuation gap between the team's portfolios and the broader market has previously exceeded 40%, it has been followed by significant alpha generation as mispricing normalised.
- Some of the year's most important opportunities were found among Australia's largest companies. Active positioning in stocks including BHP, Commonwealth Bank and Woolworths demonstrated that substantial mispricing—and meaningful alpha potential—can still emerge within the market's top 20.
- Passive flows and systematic strategies are allowing valuation dislocations to persist for longer, while also contributing to much sharper corrections around results and other major events. Price moves that once unfolded over several years can now occur within days, rewarding investors able to combine patience with active portfolio management.
- As momentum and passive trading increasingly influence conventional measures such as beta, the team's research has evolved beyond simplistic definitions of quality and risk. Greater emphasis is being placed on valuation, factor positioning, enduring competitive/economic moat type of analysis and fundamental red flags.
- Looking ahead, Australian Select Opportunities portfolios remain supported by solid earnings and attractive valuations, with most holdings trading below 15 times earnings. Australian Equity Income portfolios are also benefiting from stronger earnings growth, a franked yield of approximately 6% and an environment that may support further dividend growth.

Introduction

We sat down with ClearBridge Head of Australian Equities Reece Birtles as he reflects on the drivers of the team's strong returns for the Australian Select Opportunities and Equity Income strategies, and explains how passive flows, systematic trading and sharper price dislocations are creating opportunities for fundamental investors in the coming year.

Financial year 2026 was a tumultuous year for many fundamental active managers, but basking in the relative glory of a very strong year of returns, do you sort of sit back and wonder how on earth did we do that?

Reece Birtles: Well, of course you never expect to have as strong an alpha year as we did, especially with the Australian market only delivering a 6% return compared to world markets more in double digits. It wasn't seen as an easy year for Australian stocks. So, to deliver such a strong return across many of our portfolios, such as Australian Select Opportunities and Australian Equity Income, was not something we ever particularly forecast to do[1].

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[1] Source: ClearBridge, FactSet; as of 30 June 2026. Data shown for ClearBridge Australian Select Opportunities and Australian Equity Income representative accounts. In A$ gross of management fee. Index: S&P/ASX 200 Accumulation.

Past performance is not a guide to future returns.

However, in many ways, statistically we did expect exactly this. For some time, we have been making the forecast while past performance is not a guide to future returns, when the valuation spread between our proprietary valuations for holdings in our Australian Select Opportunities portfolio versus the broader Australian market goes over 40%, for each time period it has occurred in the past, we've delivered more than 10% alpha in the 12 to 18 months post that event. That's what has happened when spreads hit this level this time around too, so you can that in a way that we did forecast it, we just didn't know exactly when it was going to crystalise.

Looking at attribution, we can see some big names making a big contribution. And that sort of flies in the face of some of the perceived wisdom, that there's not a lot of alpha to be made amongst the top 20. Is that how you saw it?

Reece Birtles: Our positioning in BHP was a major contributor, Commonwealth Bank added to relative returns as a key underweight, and what we did in terms of buying into Woolworths at the right time made a big difference. For us, the results from all these positions were from following our disciplined investment process[2].

BHP was under a massive amount of pressure in 2024 and even into the first half of 2025. We went from a maximum underweight position to a maximum overweight position in BHP as we believed in our investment thesis, and then the stock's delivered 50% outperformance relative to Commonwealth Bank in that 12-month period. This was about understanding valuation, mid cycle earnings, how it would impact, and being quite active in terms of positioning the portfolio. Passive trade flows are really impacting stocks like Commonwealth Bank but also creating opportunities in names like BHP.

Regarding passive indexing and the weight of money behind systematic strategies leading to more fundamental price dislocation in the market, how have you been able to take advantage of that through the course of this year?

Reece Birtles: We think this really needs to be broken down into two things.

In one part you need to be quite patient and understand that passive flow is going to cause, for example, Commonwealth Bank's price relative to valuation to be dislocated for a long period of time. It's really only getting corrected around big news event dates like the budget or around earnings announcements where there's more trading activities. So, you need to be quite patient in terms of when that would pay off.

But, on the other hand, we're also seeing a lot more short-term opportunity. For the typical position that we take in a stock for our Select Opportunities portfolios, we seek to get a 20% excess return compared to the market over a one-to-three-year period. You're now seeing movements in stock prices on single days around events that are ±10%, so we're almost getting our full investment horizon in short periods. So, you need to be quite active around those names.

We think a lot of those names are really driven by the systematic investors who might be taking a view on, for example, global healthcare and ignoring the stock fundamentals that exist on Australian stocks. This is causing much bigger swings in loans than we've seen before.

Stepping back through the evolutions in the Australian market over the past decade or so, how has the team's research and development focus shifted or helped you in sustaining that premium over that period?

Reece Birtles: Our team have quite a strong quantitative skill set where we can analyse what we do as investors and our fundamental insights and how to improve our portfolio risk reward opportunities. We would say that early in the last decade it was very much a momentum-driven market and everything was about speed. Now it's very much about over-reaction. There are so many ways to execute quickly and there's so many systematic strategies. As active fundamental investors, our ability to bet against the crowd is important, and that is something that we've always done.

A recent research topic for us has been about better understanding factor positioning. Even if you like factors like quality or growth, you need to understand that they can get too expensive, or valuation can get too cheap.

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[2] The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the security transactions discussed here were, or will prove to be, profitable. References to particular industries, sectors or companies are for general information and are not necessarily indicative of a fund's holding at any one time.

Past performance is not a guide to future returns.

Another one is how beta has been polluted by momentum and passive trading, and that it is no longer a good measure of the quality of a company. The ‘SaaS-pocalypse’ has really highlighted that the definition of quality over the last 10 years, which was based on low capital intensity, large Total Addressable Market (TAM), and an ability to raise prices every year without anything new in the product, was not a good definition of quality. The market needs to go back to that traditional competitive or economic ‘moat’ type of analysis. Our work around that, and around red flags as genuine predictors of stock risk, has really added to our performance.

Looking in on the upcoming reporting season, which is kicking off now, what is the outlook for both our income portfolios and our total return-oriented portfolios? Do you see a little bit of trouble ahead?

Reece Birtles: Markets have been strong globally, but you can feel that there's concerning things going on in the world around AI and investment trends and everything else, and it feels quite disconnected with how well our Australian portfolios are doing.

We're focusing on companies that have good solid earnings, reasonable valuations. Most stocks in our Australian Select Opportunities portfolios are on less than on 15x P/E ratios[3]. Our Australian Equity Income portfolios have a 6% expected franked yield, and earnings growth is stronger now than it was 12 months ago[4]. In more of a nominal inflation environment, we're seeing more growth in dividends. So, our expected total returns are still in the double digits, which is like what we did last year, even if the market environment is not necessarily going to be that kind for the broader Australian index.

In both portfolios we like stocks we could call ‘HALO’ stocks - Heavy Assets, Low Obsolescence. For example, a stock like Ampol that involved in the fuel supply chain, inflation is good for this type of business, energy resilience is good, and AI cannot disrupt them. There's lots of those sorts of positions in our portfolios that are not particularly impacted by the weak productivity growth in Australia, nor related to the AI theme. The outlook on the individual stocks we build our portfolios from looks good.

Conclusion

While global markets have been strong, concerns around elevated valuations, artificial intelligence, investment trends and weak Australian productivity suggest the next 12 to 18 months may be more challenging for the broader market.

For the ClearBridge Australian Equities team, however, the outlook is determined less by the direction of the index than by the earnings, valuations and fundamental resilience of the individual companies held in its portfolios.

Passive and systematic investment flows are contributing to wider and more frequent departures between share prices and underlying value.

- For the **Australian Select Opportunities portfolios**, this is creating opportunities to invest against the crowd when quality companies become materially mispriced—and to actively manage positions when that value is realised more quickly than it has been historically.
- For the **Australian Equity Income portfolios**, solid earnings, attractive franked income and exposure to companies with heavy assets and low obsolescence provide a foundation for both income and capital growth. Many of these businesses may also benefit from nominal economic growth while remaining relatively insulated from technological disruption and weaker productivity trends.

[3] Source: ClearBridge, FactSet; as of 30 June 2026. Data shown for a ClearBridge Australian Select Opportunities representative account.

[4] Source: ClearBridge, FactSet; as of 31 July 2026. Data calculated for a ClearBridge Australian Equity Income representative account. Expected next 12 Months (NTM) yield is calculated using the weighted average of broker consensus forecasts of each portfolio holding – because of this, the returns quoted are estimated figures and are therefore not guaranteed and may differ materially from the figures mentioned. The figures may also be affected by inaccurate assumptions or by known or unknown risks and uncertainties. In respect of the broker consensus data the number of brokers included for each individual stock will vary depending on active coverage of that stock by a broker at any point in time. A median of brokers is typically utilised. All estimates avoid stale forecasts which are removed after a certain number of days. Assumes zero percent tax rate and full franking benefits realised in tax return.

Together, these conditions continue to provide a constructive backdrop for active Australian equity investing, with both the Australian Select Opportunities Strategy and Australian Equity Income Strategy offering differentiated ways to access the opportunities arising from market overreaction.

About the Author

Reece Birtles, CFA
Managing Director, Head of Australian Equities, ClearBridge Investments

- 33 years of investment industry experience
- Joined the firm in 1995
- Master of Finance from RMIT University
- Bachelor of Business in economics and finance from RMIT University
- Graduate of the Australian Institute of Company Directors

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