Slowing global inflation should persist, but alternative scenarios must also be considered

October 2024

Inflation has moderated close to central bank targets as the great disinflation narrative has continued. For instance, the 3 month annualised rate of core US inflation now sits at 2%, which is the US Federal Reserve's (the Fed) target. Consequently, the market expects the Fed's recent 50 basis point cut to policy rates to be followed by cuts of another 200 basis points.

While we expect the lower global inflation trend to continue for a while, there is also a possibility of the inflationary pulse picking up through 2025 as the demand cycle re-accelerates. Australian inflation remains stickier, but on a similar trajectory to that of the US. We are likely to see a similar disinflation story play out locally over the next six months, with the main point of difference being sticky food price inflation in Australia.

The above stated central case represents the most obvious near-term future, however the inherent complexity of markets makes it difficult to predict a path with any consistency. Because the potential for deviations from the most likely path will always exist, investment consequences of less-obvious futures must also be considered and understood.

For instance, **growth may disappoint**. The US election outcome has the potential to significantly impact global trade should campaign proposed tariffs be implemented in any form. Additional US imposed tariffs on Chinese and European products would likely meet a retaliatory response, resulting in reduced trade and slower growth. The deglobalisation and rise of onshoring since COVID, brought about by the desire for greater security and reliability in supply chains would be exacerbated as more goods are produced domestically, albeit at greater cost than elsewhere.

An **upside growth surprise** should also be contemplated. The onset of the global easing cycle has the potential to lure both households and corporates into a releveraging cycle, creating a debt driven growth scenario. US household balance sheets remain robust due to predominately fixed rate mortgages and higher house prices leading to positive wealth effect dynamics. Excess consumer savings for the US consumer accumulated during COVID are mostly depleted, requiring higher wages or greater credit take up to fuel a growth surprise. US corporates also retain the ability to seize upon lower interest rates and increase debt however most remain disciplined in their balance sheet management and will need clear signs of stabilisation in the economy before increasing borrowings.

Portfolio positioning

Key portfolio positions at the end of the September 2024 quarter for our range of multi-manager, multi-asset funds are:

MLC MultiActive

- **Underweight position to unlisted property**. Whilst unlisted property provides a relatively stable income, some inflation protection and the potential for capital growth, the shorter-term return outlook for some sectors is below long-term averages.
- **Overweight position to fixed income**. Bonds currently provide a relatively attractive yield while offering diversified portfolios protection via duration. Large inflationary risks have also subsided globally, reducing the risk to bond prices.
- The overweight to fixed income includes an overweight to credit via short maturities, private debt and high yield bonds and loans. Credit offers an attractive return profile under a global economic normalisation scenario and strong corporate balance sheets, historically high coverage ratios, and falling corporate defaults are currently supporting this position.

MLC MultiSeries

- **Overweight position to fixed income.** Bonds currently provide a relatively attractive yield while offering diversified portfolios protection via duration. Large inflationary risks have also subsided globally, reducing the risk to bond prices.
- The overweight to fixed income includes an overweight to credit via short maturities, private debt and high yield bonds and loans. Credit offers an attractive return profile under a global economic normalisation scenario and strong corporate balance sheets, historically high coverage ratios, and falling corporate defaults are currently supporting this position.

MLC Horizon 2-5

- **Overweight position to alternatives.** The real return strategy and derivatives provide the portfolios with more liquid sources of real asset-like exposures to offset the underweight to property.
- **Overweight to fixed income**, which includes an overweight to credit via short maturities, private debt and high yield bonds and loans. Credit offers an attractive return profile under a global economic normalisation scenario and strong corporate balance sheets, historically high coverage ratios, and falling corporate defaults are currently supporting this position.

MLC Real Return

- A relatively **high level of diversified market exposure** spread across traditional shares and fixed income assets. These exposures are supplemented by alternative sources of return such as private equity, MLC opportunistic capital solutions and insurance-related investments.
- We have a **defensive orientation to both the Australian and global share exposures**. The Australian shares strategy is invested in what we believe are higher quality companies protected by sensible hedging strategies for risk control. Participation in rising markets is reduced in favour of a lower risk of negative returns in falling markets. The global shares strategy doesn't employ the same hedging strategy, but exposures are split across managers with a defensive growth and quality focus.
- Within our **derivatives and currency strategies**, we hold an exposure to Australian government bonds. With yields elevated compared to the recent past, bonds once again provide diversification against growth risk. This exposure provides income and is a reliable source of diversification against our exposure to growth assets.

MLC Index Plus

- **Overweight position to fixed income.** Bonds currently provide a relatively attractive yield while offering diversified portfolios protection via duration. Large inflationary risks have also subsided globally, reducing the risk to bond prices.

Portfolio activity

Changes to asset allocation and fund manager selection were made during the September 2024 quarter for some of our multi-manager, multi-asset funds. These were:

MLC MultiSeries

- **Changes were made to the strategic (benchmark) asset allocations** for these funds effective 30 September 2024. This included reducing benchmark allocations to alternatives and increasing allocations to fixed income.

MLC Horizon 2-5

- Changes **were made to the global listed property investment strategy** during the quarter. We believe these changes will provide a better balance of investment style and risk-adjusted return outcomes.

MLC Index Plus

- **Changes were made to the strategic (benchmark) asset allocations** for these funds effective 30 September 2024. This included reducing benchmark allocations to alternatives and increasing allocations to fixed income.

For more information on each portfolio's positioning, please speak with your financial adviser or access our quarterly updates published for each of our diversified funds at mlcam.com.au**.**
