

Please see below for a summary of our latest views:

Since the Second World War, every major inflationary episode has been caused either by war or by an energy price shock. Often – as today – the two combine.

Energy price shocks are bad for equities. Their input costs go up and their revenues go down. Consumer spending shifts to (literally) keeping the lights on. The real return on invested capital also falls, as does real free cashflow ¹.

Energy shocks are also bad for bonds. Bond yields rise to compensate investors for higher inflation. Higher discount rates may feedback into yet lower prices for equities.

This is bad for asset allocators: in inflationary times, the negative stock/bond correlation collapses. For a detailed review of these correlations, we strongly recommend reading 'A Changing Stock-Bond Correlation' (2023) by AQR Capital Management ².

What should investors do to try to insulate portfolios? The best protection comes, not surprisingly, from owning shares in energy producers. Second best is owning short duration inflation linked bonds where rising nominal yields are offset by a concomitant rise in breakevens. Third best, surprisingly, is cash (ideally denominated the currency of a net energy producer). In the 1970s – that disastrous decade for investors – cash generated a positive real return.

So much for theory. What about practice? Since the start of hostilities on 28 February 2026 the returns for some major asset classes (all in US dollars) are as follows:

- MSCI World: -2.9%
- US 10 Year Note: -2.3%
- European Energy Producer ETF: +3.1%
- US 2Y TIPS: -0.1%

We explicitly design our portfolios to withstand the kind of economic shocks we are witnessing. More than 40% of the portfolios are in inflation linked bonds of short-medium maturities. Around 30% is in short duration government bonds and credit. Our multi-asset funds are down about 1% since the start of the war and up over 2% year to date.

We hope for a swift resolution to the war and an end to hostilities, but our portfolios are prepared for something worse.

¹ Put another way, replacements costs rise relative to accounting depreciation.

² <https://www.aqr.com/Insights/Research/Journal-Article/A-Changing-Stock-Bond-Correlation>