

WHEN INFLATION BITES

GLOBAL REAL RETURN IN FOCUS: INVESTING THROUGH PERSISTENT INFLATION

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Inflation is no longer behaving like a temporary shock. As policy choices, geopolitical tensions, demographic shifts, and deglobalization reshape the investment backdrop, the assumptions that supported the last decade of portfolio construction may no longer be enough.

If inflation remains structurally higher, investors may need to reassess return expectations, prepare for greater dispersion across markets, and place more emphasis on actively managing inflation risk. In this context, we consider how BNY's Global Real Return strategy may be relevant for investors seeking a more flexible approach to navigating persistent inflation and its wider market effects.

How does inflation affect your investment universe?

The inflationary backdrop changes the rules that many portfolios were built around. For much of the last three decades, the 60/40 equity-bond portfolio worked well. Equities drove growth; bonds cushioned returns, typically rallying when equities fell, to provide genuine diversification. The negative correlation between the two asset classes was not a fundamental principle; rather, it reflected the characteristics of a disinflationary, falling interest-rate environment. As inflation has proven stickier than expected, remaining at 3% to 4% in many developed markets rather than near 2%, that relationship has broken down.

We believe we are now in an environment of fiscal dominance, where government spending and borrowing shape financial assets more than monetary policy does. With deficits running at levels that can put government bond markets under pressure, duration can sometimes become a risk rather than a source of protection.

The structural conditions that made broad market exposure effective appear to have shifted in a fundamental way. The opportunity set is changing, and we think that makes active, selective positioning increasingly important, directing capital toward assets more likely to prove resilient in an environment of persistent inflation and fiscal pressure.



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Given the current inflationary backdrop, how can absolute-return strategies help?

We believe absolute-return-seeking portfolios like BNY's Global Real Return strategy may be a relevant option for some investors seeking flexibility in this environment. A portfolio with an absolute-return objective is constructed differently from one designed to track or beat a benchmark over short periods. That perspective matters because it centers the process on client-relevant outcomes, not relative returns that may owe more to benchmark exposure than genuine differentiation. The strategy has a dynamic approach to asset allocation that provides the flexibility to adjust positioning both strategically and tactically to reflect changing economic circumstances.

Given the inflationary backdrop, we have favored shorter-duration positioning, where carry can be generated without taking on significant duration risk. We also have significant exposure to real assets and selective equities with pricing power, alongside mitigation measures against the downside risks that portfolios with index-based exposure may leave unhedged.

The strategy's approach to diversification is designed to reduce exposure to concentration risk in major global equity indices, where nine stocks represent almost 25% of index exposure.¹

The challenge is not simply choosing the right assets but constructing a portfolio that can participate in the upside while withstanding sharp drawdowns. These could include a recession scare, a policy error, or a geopolitical shock that turns out to be deflationary rather than inflationary.

The strategy manages risk without relying on a negative correlation between bonds and equities. Instead, it takes a broader, more diversified approach, using derivatives, safe-haven currencies, precious metals, and tail-risk hedges. In some market conditions, explicit tail-risk management, deploying options and convex hedges, can be more efficient than buying index puts.

In a more demanding environment for portfolio construction, we believe that active management becomes more valuable.

Where are you finding the most compelling opportunities right now, and what risks are you watching most closely?

We see the most compelling opportunities in real assets and selective, well-positioned equities. The case for commodities is structural, not tactical: demand is supported by supply-chain rebuilding, industrial capacity expansion, artificial intelligence energy needs, infrastructure spending, and the energy transition. Meanwhile, years of underinvestment have left supply constrained. We see potential signs of a more supportive backdrop for commodities, with gold and silver, energy equities, and metals such as uranium offering exposure.

Within equities, stock selection matters more in an inflationary environment. Companies with pricing power, international revenues, and real-asset exposure are likely to be better placed than asset-light, high-multiple growth stocks. We see banks, health care, and European defense as favorably positioned.

In fixed income, a short-duration approach leaves room for selective local-currency debt in resource-producing economies with strong external balances, such as Australia, New Zealand, Poland, Sweden, and the Czech Republic.

One risk we are watching is the prospect of stagflation, or persistent inflation with slowing growth. Should this take hold, markets may prove to be too heavily positioned in assets vulnerable to that backdrop, notably growth equities and some areas of the bond market. Investors already ahead of that shift could be well placed to benefit.

1. Source: MSCI, July 31, 2026.

Important information

All investments involve risk including loss of principal. Certain investments involve greater or unique risks that should be considered along with the objectives, fees, and expenses before investing. Past performance is not necessarily indicative of future results.

Asset allocation and diversification cannot ensure a profit or protect against a loss.

Risks

Equities are subject to market, market sector, market liquidity, issuer, and investment style risks to varying degrees. **Bonds** are subject to interest-rate, credit, liquidity, call and market risks, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. The use of derivatives involves risks different from, or possibly greater than, the risks associated with investing directly in the underlying assets. **Derivatives** can be highly volatile, illiquid, and difficult to value and there is the risk that changes in the value of a derivative held by the portfolio will not correlate with the underlying instruments or the portfolio's other investments. Investing in **foreign- denominated and/or domiciled securities** involves special risks, including changes in currency exchange rates, political, economic, and social instability, limited company information, differing auditing and legal standards, and less market liquidity. **Currencies** are subject to the risk that those currencies will decline in value relative to a local currency, or, in the case of hedged positions, that the local currency will decline relative to the currency being hedged.

Definitions

Sticky inflation is a condition in which the rate of inflation remains higher than expected and declines only slowly over time, even after the factors that initially drove prices higher have eased. Sticky inflation may reflect persistent wage growth, sustained demand, or expectations among businesses and consumers that prices will continue to rise, and it can complicate efforts by central banks to bring inflation back toward target levels. **Safe-haven currencies** are currencies that investors historically have tended to favor during periods of market stress, geopolitical uncertainty, or economic instability, and that may retain or increase in value when riskier assets decline. The U.S. dollar, Swiss franc, and Japanese yen are commonly cited examples of safe-haven currencies. **Tail-risk hedges** are investments or strategies designed to help protect a portfolio against tail events, which are extreme, low-probability outcomes that fall in the "tails" of a return distribution and may result in losses well beyond those associated with typical market downturns. **Explicit tail-risk management** is a deliberate, rules-based approach to identifying, measuring, and hedging tail risks through a dedicated allocation, predefined triggers, and a documented plan for establishing, maintaining, and unwinding hedges. **Convex hedges** are hedges whose potential payoff increases at an accelerating, non-linear rate as the magnitude of an adverse market move grows, such that the further the market moves against the portfolio, the greater the value the hedge may gain relative to the loss being offset. **Index puts** are put options written on a broad market index, such as the S&P 500, that give the holder the right to sell the index at a predetermined strike price on or before a specified expiration date, and that generally increase in value when the index declines below the strike price.

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