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# Portfolio Perspectives

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## Key Messages for Investors

- Stay invested but build in more resilience. The global backdrop has become more inflation-sensitive, but it is not yet a recession environment. Investors should avoid overreacting, while positioning portfolios for higher energy prices and tighter policy.
- Global growth is slowing, not collapsing. The world economy entered this shock from a stronger starting point than in many previous crises. Growth is likely to soften, but the base case is still below-trend expansion rather than global recession.
- Inflation is now the main market risk. Higher oil, gas and input costs are increasing the risk that inflation stays elevated for longer. That matters because it reduces the chance of near-term policy easing and raises the prospect of rates staying higher for longer.
- Central banks are unlikely to 'look through' this shock. After the inflation experience of recent years, policymakers appear more determined to prevent temporary price pressures from becoming entrenched. That means markets may need to contend with a more cautious central bank response.
- Australia looks more vulnerable than the US. The US economy remains relatively resilient, supported by structural growth drivers and a still-solid consumer. Australia, by contrast, faces a more difficult mix of slowing growth, stubborn inflation and household pressure.
- Be selective about where risk is taken. Areas most exposed to higher energy costs and higher interest rates (including emerging markets, global small caps and parts of Australia ex-resources) warrant caution. Better opportunities may lie in quality fixed income and selective high-quality growth.

## Staying invested in a more inflation-sensitive world

### **Energy shock, resilient growth, and a narrower margin for error**

The investment backdrop has become more complicated over the past month. The Iran conflict and the associated disruption to energy supply have introduced a new layer of uncertainty for markets, not simply because of geopolitics itself, but because of what it means for inflation, interest rates and growth. Oil, gas and related input costs matter well beyond the energy complex. They affect transport, manufacturing, agriculture, chemicals, consumer prices and business confidence. When those costs rise sharply, the consequences are rarely contained to one sector.

That is the key issue facing investors today. The global economy entered this period in reasonable shape. Growth had been improving, corporate earnings momentum was firm, and a number of structural tailwinds (including AI investment, defence spending, energy security and industrial reconfiguration) were still supporting demand. But the margin for error has narrowed. If disruption through the Strait of Hormuz persists for longer than expected, inflation pressures may prove more durable and central banks could be forced to keep policy tighter for longer, even as economic growth begins to slow.

Our current view is that investors should remain invested, but portfolio settings should be positioned to be more resilient to a world of higher energy prices and a less forgiving policy environment. This is not the same as moving wholesale to a defensive stance. In fact, we think the opportunity cost of

overreacting is still high. If the current supply shock eases in coming months, markets could recover quickly on the back of still-resilient earnings and decent underlying growth. However, this is also not a backdrop for complacency. The risks have become more balanced, and in some areas, more asymmetric.

### **The base case remains slower growth, not recession**

The first point worth emphasising is that we are not currently forecasting a global recession. That distinction matters. Markets often move as though every geopolitical shock must inevitably lead to a deep global downturn, but the evidence so far does not support that conclusion.

The global economy was not entering this shock from a position of weakness. Growth had been regaining momentum in recent quarters, with the US in particular still benefiting from strong structural investment drivers and a resilient consumer. Corporate earnings were also holding up better than many had expected, despite earlier concerns around tariffs, policy uncertainty and the broader growth outlook. This stronger starting point matters because it gives businesses and households more capacity to absorb a temporary hit.

It is also true that the world economy is less sensitive to oil shocks than it was in earlier decades. Advanced economies use less oil per unit of GDP than they once did, thanks to better energy efficiency, a greater services mix and a more diversified energy base. In the United States, for example, the shift from net importer toward a far more energy-secure position also changes how an oil spike flows through the economy. Oil still matters, but it is no longer as singularly destructive to growth as it was in the 1970s or even the early 2000s.

That said, “less sensitive” is not the same as “immune.” This is still a very large shock, and in some respects a more complex one than markets are used to dealing with. It is not just about crude oil. The disruption has implications for LNG, refined fuels, fertiliser, shipping routes and industrial inputs more broadly. The impact is therefore likely to be uneven across countries and sectors, with energy-dependent importers most exposed. If the shock proves short-lived, the global economy should be able to absorb it. If it becomes prolonged, the drag on growth will deepen meaningfully.

### **Inflation has moved back to centre stage**

If growth is the medium-term question, inflation is the immediate one.

Before the latest escalation, inflation risks were already not fully extinguished. In the US, tariffs, fiscal looseness and the potential for liquidity-supportive policy settings had all complicated the disinflation story. In Australia, inflation was already uncomfortably high and had left the Reserve Bank with limited room to prioritise growth. The new energy shock now adds to those pressures.

This is why the inflation story matters more than the growth story in the near term. Markets can tolerate a moderate slowdown if inflation continues to behave and central banks retain flexibility. What they struggle with is a stagflationary mix: softer growth, but sticky prices, forcing policymakers to stay cautious or even tighten further. That is the scenario investors need to keep in view.

The encouraging news is that medium- to long-term inflation expectations remain reasonably anchored. Market pricing still suggests investors see this as, at least for now, a supply shock rather than the beginning of an uncontrolled inflation regime. But shorter-term expectations have

moved higher, business surveys have deteriorated, and input cost pressures appear to be accelerating. That combination deserves attention.

Central banks are also reacting differently than they might have in the past. After the inflation experience of 2022 and 2023, policymakers appear much less willing to “look through” energy-led price pressures. They know they cannot lower oil prices directly, but they are focused on preventing another cycle in which temporary supply shocks become embedded in wages, corporate pricing behaviour and consumer expectations. In effect, they are trying to defend credibility early rather than rebuild it later.

For markets, that raises the prospect that interest rates remain restrictive for longer than investors would prefer, even if the ultimate growth outcome is only modestly weaker.

### **The United States remains the key anchor**

The resilience of the US economy remains central to the broader global outlook. It is still the main engine of global demand, and at this stage there is limited evidence of outright demand destruction in the hard data.

High-frequency measures of consumer activity have remained relatively firm. Travel, hospitality and broader discretionary activity have not yet shown the kind of collapse that would normally accompany an imminent recession call. The labour market also remains relatively solid, and corporate balance sheets are entering this period from a stronger footing than in many previous energy shocks.

This does not mean the US is without risk. Higher input costs will pressure margins. If

companies choose to absorb those costs, profitability falls. If they pass them on, inflation rises further. Either path becomes more challenging if the shock persists. Growth-sensitive sectors would also face greater pressure if long-end bond yields rise materially in response to persistent inflation concerns.

Still, for now, the US looks more like a moderating economy than a breaking one. That distinction is important. It supports the case for staying invested, while also arguing for selectivity and balance rather than concentration in the most rate-sensitive parts of the market.

### **Australia looks more vulnerable**

The domestic picture is less comfortable. Australia had been showing encouraging signs late last year and into early 2026, with growth improving and hopes building that the economy might navigate a relatively benign reacceleration. That optimism has faded.

The challenge in Australia is that the economy was already carrying more obvious fragilities before the latest external shock arrived. Inflation was still too high. Interest rates had already risen again. Household cashflow pressure remained intense. And the non-resources part of the economy was never especially robust. Higher energy costs now compound those existing stresses.

Survey data have weakened sharply, particularly in services, suggesting growth momentum has deteriorated materially. While hard data have not yet fully rolled over, the leading indicators imply that below-trend growth is increasingly likely in coming months. Importantly, Australia also remains highly exposed to transport and logistics-related energy costs, which means oil still

matters domestically even after the long-term decline in oil intensity.

This creates a difficult policy backdrop for the RBA. Growth is softening, but inflation remains uncomfortably high and could move higher still. The Bank is understandably reluctant to be caught out again by persistent inflation, which means policy is likely to remain cautious. Market pricing for multiple additional hikes may ultimately prove excessive if growth weakens sharply, but that does not remove the near-term challenge for households or domestic cyclical.

For portfolios, this reinforces our caution on Australian equities. Resource-linked exposures may still benefit from the commodity backdrop, but the broader domestic equity market looks less attractive where higher inflation, rate pressure and weak discretionary demand converge.

### **Portfolio resilience matters more than wholesale defence**

In periods like this, the instinct to reduce risk aggressively can be understandable. But we think a more measured approach is appropriate.

The case for remaining invested rests on three points. First, the global economy is slowing, not collapsing. Second, corporate earnings momentum outside the geopolitical shock remains reasonably solid. Third, if the supply disruption eases, markets could rebound quickly and sharply. Selling risk aggressively into uncertainty can be expensive if the fundamental backdrop proves more resilient than feared.

That said, the composition of risk matters more now. We think portfolios should be positioned for resilience rather than maximum cyclical. Areas most exposed to an extended conflict and a higher-for-longer

rate backdrop deserve caution. Emerging markets are vulnerable because higher energy and food prices tend to hit growth, inflation and external balances simultaneously. Global small caps also remain more exposed to tighter financial conditions and rising funding costs.

By contrast, parts of fixed income are becoming more interesting. Policy divergence across regions is creating better relative value, and higher yields mean investors are increasingly being paid to take measured duration or credit exposure.

We also think selective opportunities are emerging in quality growth. The recent derating across parts of the growth universe has been meaningful, particularly where AI disruption has unsettled sentiment around software and longer-duration business models. For high-quality businesses with durable earnings and strong balance sheets, that sell-off may be opening more attractive entry points. The main caveat is that growth assets remain sensitive to long bond yields, so this is an area where discipline and selectivity are critical.

### **Discipline remains the most important asset**

The current environment is not simple, but it is navigable. Geopolitics has raised the stakes, inflation risk has increased, and Australia in particular looks more exposed to the downside than it did a quarter ago. Even so, the broader picture is still one of slower growth rather than systemic breakdown.

That is why our central message remains one of balance. Investors do not need to abandon risk, but they do need to be more deliberate about how that risk is taken. The right response is to stay invested while leaning toward resilience: stronger balance sheets, more selective equity exposure, caution in

the most energy- and rate-sensitive segments, and a readiness to take advantage of opportunities as valuations improve.

The coming months will hinge heavily on duration. If the energy shock begins to fade, the global economy should be able to absorb the hit. If it drags on, inflation becomes the greater threat to both growth and markets. Either way, flexibility and discipline will matter more than bold macro calls.

In uncertain periods, portfolio construction does much of the heavy lifting. The goal is not to predict every turn in the geopolitical story. It is to build portfolios that can withstand a wider range of outcomes while remaining positioned for long-term returns. That, in our view, remains the right approach today.

## Portfolio Perspectives

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### Growth Assets Outlook

Asset Class	Outlook Negative ← → Positive				Comments
<b>Growth Assets</b>					Despite geopolitical risks, the broader macro backdrop remains supportive. Global growth is improving and earnings remain resilient. We recommend remaining invested in growth assets but adjusting portfolios for improved inflation resilience if the dispute drags on.
Australian Equities					Positive earnings momentum from February has been overshadowed by expectations of higher inflation and interest rates through 2026. Higher input costs, mortgage pressure.
Australian Small Caps					Unprofitable junior miners make up a large portion of the Small Caps sector vs Large Caps. There is also considerable froth in this portion of the market due to the strength in gold.
Global Equities					We remain neutral global equities with strong earnings momentum offset by rich valuations. Sector opportunities within are nuanced by the risk of inflation as conflict continues in the Middle East, and the question of AI disruption to business models over the medium to long term.
Global Small Caps					Small Caps represent attractive relative value, have historically delivered strong trend EPS growth, and the recent broadening of earnings growth are all supportive. A higher inflation and rates environment represents a risk, in an otherwise supportive setup for small caps.
Emerging Markets Equities					Earnings growth continues to accelerate across emerging markets. EM equities face a range of interconnected risks from an escalation of conflict in the Middle East, with impacts transmitted through energy markets, capital flows, tighter financial conditions, and currency volatility.
Property					Global Listed Property valuations are attractive in comparison to global equities. The challenges of growth and supply are fading. Remain mildly overweight, be conscious, however, of the combined real asset position.
Infrastructure					Structural tailwinds exist leading to an expansion in the asset base. Increased capex sets the sector up for a lower dividend yield but higher growth outlook. We maintain our overweight with the view the sector has further outperformance potential.
Alternatives - Growth					Signs of improvement in the exit environment for private equity may falter under a higher-for-longer scenario. Global multi-strategy hedge funds that are liquid and can respond to rapid changes in macro conditions and sentiment are well positioned.

## Defensive Assets Outlook

Asset Class	Outlook Negative ← → Positive		Comments
<b>Defensive Assets</b>			We are neutral on defensive assets.
Australian Bonds			Australian duration offers attractive value at near 5% YTM. A slowdown in Australian growth would likely see Australian Fixed Income outperform.
Global Bonds	→		Once AUD hedging is included, the all in yield on global fixed income has become attractive. While risks remain for global inflation volatility and lack of fiscal discipline a concern, a YTM of 5.5% for Global Aggregate as fair compensation for these risks. We move to neutral.
Diversified Income			Credit spreads remain tight despite minor loosening in March. Excess returns are at the lower end of historical ranges. We remain neutral in recognition of more modest forward looking return expectations.
Alternatives - Conservative			Gold acts as a risk-diversifier against a further deterioration in economic conditions or escalation in geopolitical tensions.
Cash and Enhanced Cash			Cash can serve as a useful short-term tactical defensive exposure while credit spreads are tight.

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