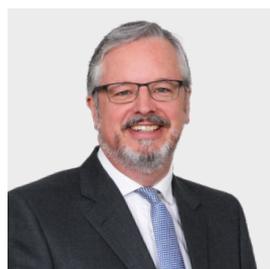




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Investing for a
world of change



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Defence remains key

What have been the most important developments in 2025, and how do they set the stage for 2026?

The year started with policy shocks, notably President Trump's 'Liberation Day' tariffs. Markets sold off on fears of slower growth and higher inflation, but the impact proved temporary as tariff terms shifted and markets gradually reassessed their significance.

Another major theme was AI driving equity markets and supporting a resilient US economy. However, that strength has been increasingly concentrated in a handful of mega-cap technology names, adding to market fragility. Inflation remains slightly above target but is easing, prompting the Federal Reserve (Fed) and other central banks to initiate a broad, albeit uneven, rate-cutting cycle.

At the same time, fiscal fears have resurfaced. France's instability has hindered deficit control, Japan's new government looks inclined towards looser policy, the UK remains wary post-Truss and the US continues to borrow heavily under the 'Big, Beautiful Bill', despite rising tariff revenues. That has raised questions about fiscal sustainability across major economies.

Talk of de-dollarisation has also grown, raising questions about whether the US is the safest store of capital and supporting demand for gold.

This year, much depends on how these forces resolve: can AI deliver on its promise, or will stretched valuations give way? Will the expected wave of capital expenditure materialise, and how will it be financed? Inflation is easing, but not yet anchored, and the US economy remains uneven – buoyant for the wealthy and AI-linked sectors, but stagnant for much of the rest.

Together these point to an unstable macro backdrop – one of lingering inflation risk, shifting policy and crowded markets. After a decade of repeated equity and bond drawdowns, that pattern could easily persist.

Central banks have shifted towards easing, yet longer-dated bonds have not offered their usual protection. What is behind this, and how should investors think about the role of duration today?

Central banks may be easing, but long-dated bonds remain weighed down by one dominant force: fiscal deterioration. Governments extended massive pandemic support well beyond the recovery. Corporates and households emerged in good shape, but public debt ballooned. With modest growth and still-high rates, that debt looks increasingly unsustainable.

This has left long-dated bonds vulnerable, while short- and medium-term maturities are better anchored by central-bank policy. So, duration is now a tactical call, not a structural one.

Selectivity matters: our focus is on markets with credible fiscal and monetary frameworks. We remain cautious on the long end until governments show credible deficit-reduction plans, favouring areas driven more by monetary than fiscal forces.

With government bonds offering less diversification, what still works as portfolio defence?

Defence comes from flexibility rather than fixed allocations, adapting exposure as conditions evolve. We avoid concentration in large developed markets such as the US, France, Japan and the UK, where fiscal pressures are greatest. Smaller economies like New Zealand, with better fiscal discipline and steeper yield curves, are better placed.

Emerging markets have also become more resilient than often assumed, with many now running more disciplined monetary and fiscal policies than their developed peers. Inflation is now better controlled, supporting bond markets, and most of the remaining risk lies in currency, which can be hedged.

Reliable income remains central – it is the most visible part of total return, providing it is backed by dependable cashflows. Finding it at a reasonable price provides a strong defensive anchor.

Finally, protection remains cheap: we use options across equities, bonds and currencies to manage downside while preserving upside, enhancing portfolio resilience.

In an environment of uneven growth and non-synchronised policy cycles, where are you finding the most resilient income opportunities?

There are still opportunities in developed and emerging government bond markets. In the developed world, we prefer short- to medium-dated sovereigns in New Zealand, Australia and Canada, where policy credibility is high and yields are attractive. In Australia, state issuers such as New South Wales offer a premium over Commonwealth bonds with little extra risk.

In emerging markets, countries like Mexico offer strong carry, solid fiscal discipline and well-anchored inflation.

We are more cautious on corporate credit: valuations are tight and investors are not being paid for risk. Quasi-sovereigns and government-linked entities look more appealing.

Equity income is harder to find, but not impossible. Outside the US, quality, cash-generative companies in sectors such as healthcare and consumer staples trade at reasonable valuations and can compound dividends steadily, offering reliable income in a more uncertain environment.

Markets have stayed remarkably calm despite policy uncertainty, high debt and stretched valuations. What could unsettle that calm and how is the portfolio positioned for such risks?

Markets are often calm until they are not – they climb the escalator on the way up and take the lift down. Valuations in some areas look stretched and rely on everything going right.

In addition, potential triggers are easy to envisage: lofty AI expectations may prove hard to monetise; spending on data centres remains heavy; China is flirting with deflation; and US payrolls are softening and could turn recessionary if unemployment rises meaningfully. Geopolitical developments are another potential source of concern.

Credit risks are also increasing. We are seeing an increase in credit events, and while a few have been fraud-related, the frequency is rising. When there is one cockroach, there are usually more. That could prompt a reassessment of credit risk, particularly as demand for borrowing to fund AI infrastructure grows.

Fiscal risk is another pressure point. We have already seen how quickly markets punish missteps, as with the UK's 'mini budget' in September 2022. In the US, some tariff revenues may be ruled illegal and need to be refunded, even as new spending plans emerge, testing the market's patience.

The portfolio remains defensively positioned, with limited credit and physical equity exposure, and uses options and dynamic hedging to manage volatility while preserving upside.

How are you positioned to maintain a defensive return?

Our focus remains on resilient, visible income at reasonable prices. The portfolio's yield is competitive against cash, government bonds and credit, but positioning remains deliberately defensive. Duration exposure is selective, and we are cautious on growth assets like equities and corporate bonds.

Options provide insurance, protecting against adverse outcomes while allowing participation if markets rally or yields fall. The underlying holdings are naturally defensive, giving balance across different environments.

The goal is steady income and capital preservation, seeking to perform well across different market conditions and limit drawdowns when sentiment turns. In what is likely to be a challenging year, that combination of resilience and flexibility feels like the right place to be.

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