

The hidden inflation assumption in retirement portfolios

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Most portfolios treat inflation as a background variable — something to be forecast, averaged, and assumed to be absorbed over time.

For investors in retirement, this assumption is far more consequential.

Unlike investors in accumulation, retirees are not able to defer consumption or rely on future earnings to recover lost purchasing power. Income is drawn in real time, and the impact of inflation is immediate. Even modest inflation, if sustained, can materially erode financial outcomes.

This creates a structural vulnerability that is often overlooked: inflation is not simply a macroeconomic outcome — it is a portfolio construction risk.

Inflation is priced, but not necessarily protected

At the time of writing, US Treasury Inflation-Protected Securities (TIPS) imply a five-year inflation expectation of approximately 2.57%. Inflation outcomes can differ across countries, and from what markets currently price. This is often interpreted as a benign signal — that inflation risk is contained, expected, and manageable.

However, this pricing reflects expectation, not protection.

A portfolio constructed on the assumption that inflation will behave within a narrow band may still be exposed to outcomes that differ from that expectation. More importantly, it may not be structured to absorb the impact should inflation persist, surprise, or interact with other risks.

The interaction with sequencing risk

Inflation does not operate in isolation.

For retirees, the interaction between inflation and sequencing risk is critical.

Where inflation coincides with periods of market weakness, the effect is compounded:

- withdrawals continue in nominal terms
- purchasing power declines
- capital losses reduce the base from which recovery can occur

Two portfolios with identical average returns may produce very different outcomes once inflation and return sequencing are considered together.

This is not a question of forecasts. It is a consequence of structure.

Inflation and the role of volatility

Inflation is not only an erosion of purchasing power. It is often associated with a change in market behaviour.

Periods of elevated or uncertain inflation have historically coincided with higher realised volatility, as markets adjust to shifting expectations around interest rates, growth, and policy.

For portfolios constructed on assumptions of stability, this introduces a second layer of risk:

- not only is purchasing power affected
- but the path of returns becomes less predictable

This is where structure becomes critical.

Volatility is typically treated as a risk to be minimised. However, it is also a source of opportunity for strategies designed to operate within it.

A portfolio that can respond to volatility, rather than simply absorb it, is better positioned to navigate periods where inflation and market uncertainty interact.

Over time, this has implications beyond short-term outcomes. For investors in retirement, the ability to generate returns across varying market conditions contributes directly to addressing longevity risk, where sustaining capital over extended periods becomes essential.

Volatility is not an exception to normal conditions — it is part of them.

The assumption embedded in traditional portfolios

Traditional asset allocation assumes that diversification across asset classes provides sufficient protection.

In practice, this relies on:

- stable correlations
- predictable inflation behaviour
- the ability of growth assets to outpace inflation over time

These assumptions can hold in benign environments. They become less reliable when conditions change.

Inflation, like market risk, is continuously repriced. It does not move in a linear or predictable way, and its impact is felt differently depending on when it occurs.

For investors drawing income, timing matters as much as magnitude.

Inflation within a broader risk framework

Inflation is one component of a broader set of structural risks faced by retirees.

Within the Gyrostat SMILE framework — Sequencing, Market, Inflation, Longevity and Emotion — inflation represents the gradual erosion of purchasing power that interacts with more visible risks.

It is often less volatile than market movements, but no less important.

A portfolio that manages market risk without considering inflation may still fail to deliver real outcomes.

From prediction to structure

The question is not whether inflation rises or falls, or whether current market expectations prove accurate.

The question is whether portfolios are structured to withstand a range of outcomes.

This requires a shift away from relying on forecasts and toward building portfolios that can operate across different environments — including periods of persistent inflation, volatility, and market stress.

Inflation is not just a cost of living issue. It is a structural consideration in how portfolios are constructed and how outcomes are delivered over time.

Conclusion

For investors in retirement, inflation is not a distant risk. It is experienced in real time, through income and purchasing power.

Treating it as a secondary variable may be convenient, but it embeds an assumption that may not hold.

The challenge is not to predict inflation with precision, but to ensure that portfolios are designed to remain resilient regardless of how it evolves.

It may result in outcomes that are inconsistent with the needs of the client, particularly where stability of capital and income are required.

Conclusion

The practical implication of this framework is reflected in how portfolios behave across different market conditions.

Recent performance snapshot

For the quarter ended 31 March 2026, Class A returned +3.66% and Class B returned +6.20%.

Gyrostat Risk Managed Equity Fund

Performance Report - Class A and Class B

Absolute Returns at 31 March 2026

Class	1yr	2yr p.a.	3yr p.a.	4yr p.a.	Max Qtr Loss (3Yr)	Beta
A	+8.92%	+9.28%	+7.72%	+10.41%	-0.52%	-0.08
B	+11.90%	+10.71%	+10.03%	+13.87%	-0.84%	-0.21

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