Welcome to the 2026 edition of Conversations. This year, we are shifting our focus toward "The Long View." Our CEO, Damien McIntyre, will be joined by investment managers and strategists from across GSFM's partner network to explore the long-term outlook for their respective specialties. While we will continue to monitor and address short-term market noise –recognising its power to shift long-term trajectories – our primary goal is to provide you with a clear, strategic perspective on the enduring trends shaping the future of investment.

Today Damien is in conversation with GSFM's investment strategist Stephen Miller. As a long-time bond man, Steve's a regular commentator on markets, economics and importantly, rates – that's why this podcast is being recorded shortly after February's RBA rate announcement.

Before I hand over, I need to read this important notice:

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Damo and Steve, over to you.

Damien McIntyre

Thank you very much, Tracey, and welcome, Steve.

Stephen Miller

Thank you, Damien.

Damien McIntyre

Now, we've got a live one today, Steve, as we speak the RBA about a half an hour ago, increased interest rates by a quarter of a percent. Why don't we start there, and I want to ask you a couple of questions along this line. Is it firstly, inflation has proven to be quite sticky or stubborn? Why do you think that's so?

Stephen Miller

I think there's a few reasons. One of them is that the economy has actually done better. What we're sort of seeing toward the back end of 2025 is that certainly consumer spending was a bit stronger than a number of people might have anticipated early in 2025. I think the other reason, I think this is important, is that monetary policy is not getting much help from other areas of policy. I mean, fiscal policy hasn't been profligately expansionary, but it certainly hasn't supported monetary policy. You know, it hasn't had an anti-inflationary tilt.

And I think the other thing, and this often goes unremarked, certainly not by me, but unremarked in general, there's been very little by way of structural reform or micro reform in Australia for a number of decades. That's either at the federal or state level and regardless of the political colour of the government of the day. And I think what that's

meant has been that Australia's productivity has suffered. And we've seen interventions in the labour market, which whilst well-intentioned, probably have the effect of creating headwinds to productivity growth. That keeps what's known as unit labour costs high, which is, as the name sounds, it's how much it costs to produce a unit of output. Unit labour costs have been growing at around 5% per annum for the last couple of years.

And sort of trying to reconcile that with the achievement of a RBA target of, or the midpoint of the target of 2.5% is difficult. So, there's a number of reasons. One is the economy's a bit stronger; that's the good news. The others are that other elements of policy, in particular fiscal policy and what we might call structural policy, haven't helped the RBA in achieving its target. And that all said, I think, fair to say that jumping inflation toward the end of 2025, not only surprised the Reserve Bank, but I think it sort of surprised a number of private sector economists as well.

Damien McIntyre

The shadow treasurer suggests strongly that inflation is high because the government spends too much for one of a better description. The treasurer denies this and suggests that the RBA has not brought high spending to his attention. Your thoughts? Are they spending too much or not?

Stephen Miller

If you're the treasurer and you need the RBA to bring high spending to your attention, you're not up to the job. I think I can say that. I think that's a convenient political device from the treasurer. But look, the reality is, as I said, fiscal policy probably is too expansionary, but to call it profligate is probably overegging the cake a bit.

Fiscal policy could do more. There's no doubt about that. I think the treasurer is guilty of a little bit of gauging and a bit of sophistry there. The shadow treasurer implies it's all about fiscal policy, but it's more than that. As I said earlier, the good news is, it is that the economy is stronger. It is true that fiscal policy, and I think more importantly structural policy, has not supported the RBA. That's the truth.

I mean, there's a political debate that goes on about where the blame resides. We understand that. We get that. We know what Jim Chalmers wants to emphasise, what he wants to emphasise. We know what Ted O'Brien wants to emphasise, what he wants to emphasise. But that's the political side of things. What I'm talking about is the economic side, and it's those three reasons. Stronger than anticipated consumer spending, not much support from fiscal policy, and very little support from structural policy.

Damien McIntyre

So, do you see the trajectory of inflation with this quarter point rise in rates? What do you think that does to the trajectory?

Stephen Miller

I think this may well prove to be a stitch in time. A number of market observers sort of think this might be one and done. I'm not quite so sure. I think we do need to see some support come in from those other arms of policy to be certain that we won't. This is not the start of a series of rate hikes. I don't think we can necessarily make that judgment now. It might do the job. I underline and put in italics that *might*. There is still some prospect that we might see another policy rate hike this year and particularly if we don't get that support from fiscal policy and structural policy. I might just make a point on fiscal policy too. It's not just the federal government. You know state governments have been just as guilty in let's say being injudicious with their finances.

Damien McIntyre

That's true. I mean, that's government spending across the board, isn't it? One thing that's been commented very, very recently is that perhaps there could be some relief to inflation and prices because of recent strengthening in the Australian dollar making imports cheaper. Again, red herring. Do you think it's a small contribution?

Stephen Miller

I think that's real. The big question is whether the disinflation impact of a rising currency outweighs the strong demand and limited supply, so excess demand that's sort of driving prices at the moment. I keep returning to the fact that if we can't get unit labour cost growth down, that is a labour cost or wages adjusted for productivity, it's just going to make our job harder regardless of what the currency does. So yeah, the currency will have some impact.

Sitting here at $0.70 versus the US dollar at the moment, I don't think we could be confident at this stage it's sufficiently strong to stall another increase. The other thing I will point out too, is that a large part of what we're

seeing in that bilateral strength versus the US dollar, it reflects a weak US dollar more so than a strong Aussie dollar. So Aussie dollar against Euro, for example, probably hasn't moved quite as much. It's moved a bit. The bigger influence is the weakness in the US dollar, even though the Aussie dollar is marginally stronger against third currencies.

Damien McIntyre

That's where I was going to lead. Sure, we've had rising commodity prices…

Stephen Miller

Look, I think the Aussie dollar's outperformed; but a large part of what we're seeing is a weak US dollar.

Damien McIntyre

And in addition to that, interest rate differentials with our rates being a wee bit higher than US rates. But no, it's not really the strong headwind behind the Aussie, is it? It's more about US dollar weakness than Aussie dollar strength.

Stephen Miller

There's a little bit of independent strength, but I think the bigger part of the story is US dollar weakness.

Damien McIntyre

Now, I know this is against the rules of the game. Our want is to think long-term and I'm going to ask you to park that for a moment and just focus on where to from here for bond markets first and equity markets later.

Stephen Miller

Bond markets have some challenges ahead of them. I mean, if biggest bond market in the world has some challenges ahead of it, all bond markets have some challenges ahead of it. And by the biggest bond market in the world, I'm talking about the US. And this is a sort of a longer-term view. But the US has a budget deficit of 6.5% of GDP, and it's not that far off full employment.

That's a big worry. Because what that means is you have to sell a lot of bonds to fund that deficit. And every now and then, the market will get indigestion, and that could send particularly longer-dated US bond yields higher. The other issue is that this has come at a time when there's question marks about the desirability of the US dollar as an official reserve asset.

So, what's in it for China to keep a large or the dominant portion of its official reserve assets in US dollars? And by extension, by Treasuries. What's in it for India? What's in it for the European community? What's in it, even dare I say, for Canada? Now, that's not to say these entities are going to sort of dump the US Treasury holdings, but it's going to make them think twice about the rate at which they're accumulating them. It's a reason why, if you like, US 10-year bond yields haven't done much in the last year. So again, that's another reason to think that US yields may stay higher.

The third one is we've just had Donald Trump nominate a new Fed chair. Now, this Fed chair does think that rates can be lower, and I think he argues credibly why that can be the case. It's a bit of the opposite to the circumstances in Australia. The US has had fantastic productivity growth, which means their unit labour costs are growing very moderately, which may well allow inflation to come down. That's not obvious yet. Inflation has been sticky in the US. But if that is the case, we might be able to see the prospect that rates can be taken lower in a credible fashion. And I emphasise in a credible fashion as the year progresses under the new Fed chairman. I don't think we're there yet.

Inflation is still sticky in the US. But were it to become the case that the sort of economy that Kevin Walsh, the new Fed chair nominee, thinks we're entering into, that is a high productivity US economy, low unit labour cost growth US economy, higher speed limit, as it were for the economy, before inflation starts to take off, that might sort of change the bond calculus a bit. That's contestable at the moment.

But the other two elements I mentioned, the fact that there's a big US budget deficit and inflation is currently sticky, I think will probably tend to put a floor under bond yields indefinitely. Longer term bond yields mainly. Not so much short-term bond yields, which are more subject to the vagaries of where the Fed might take the policy rate.

Damien McIntyre

You've described the president as mercurial several times in our conversations, and he is unpredictable and so on and so forth. But all that said, the deficits aside, the US economy looks a lot like ours. It's quite strong at the moment, for example.

Stephen Miller

I would say it looks in much better shape than ours. If you'd told me that back in the time of the liberation date announcements back in April, to say I would have been surprised at what we now know about US economic performance would be an understatement. I think it surprised a number of observers, the strength in the US economy, and I think what we might have been guilty of is probably overplaying the macro, overplaying the fact that bond yields may stay high because of deficits and inflation and less official buying from other central banks.

I think what we failed to see was the impact of some of the structural mega trends that are very, very big in the US. The most obvious of these is AI, but there are others too that have underpinned economic growth. Defense companies are obviously enjoying renewed interest, let's put it that way. So those sorts of things have probably driven growth, and I think those sort of macro structural trends, some of us were a little bit guilty of underplaying those and sort of overly focusing on the macro around the time of the liberation day announcements, not just the potential impacts of tariffs, which President Trump has sort of walked back some of the more dire threats.

Also what's offset some of those headwinds to growth, particularly those that have kept bond yields high, is this tremendous AI spend that has sort of created this productivity revolution in the US economy, which not only has lifted growth, but it might mean more sustainable long term growth, a higher speed limit for the economy over the longer term. So that's sort of something I think we've got to bear in mind.

Nick Griffin always reminds me that the macro economy is not the share market, and he's quite right in thinking that because whilst there are all those uncertainties about the macro economy in 2025, post liberation day, the share market did extremely well, reflecting, I think, those sort of structural mega trends that I was talking about.

Damien McIntyre

One thing I've always believed firmly is that capital will always chase a profit. We have moments of volatility sure. Eventually, the money goes where it's going to be treated well. Coming back to AI and productivity revolution, it's interesting to observe that the US labour market hasn't weakened significantly. It really has been quite resilient, hasn't it?

Stephen Miller

Yeah, given the pace of GDP growth, it probably hasn't kept pace with the rate of GDP growth. Given that rate of GDP growth we saw through 2025 and a sense of how it's continued into 2026, we might have expected a more robust labour market. But you're right in saying that whilst there's been some cooling, it certainly hasn't been alarming in any way. Yes, it has been resilient, the US labour market. And you know what? That's why the current Fed under Chairman Powell chose to leave rates unchanged last week. The economy was in good shape. The labour market's not too bad and inflation's a bit sticky and we've cut rates three times in 2025. So, let's just take a pause and see what it looks like.

Damien McIntyre

My point about the resilience of the labour market is that massive amounts of money have been invested in AI. When you listen to the comments of CEOs of the mega companies in the US, they all talk about cost efficiencies, et cetera, or greater efficiency, and that's code for labour force reduction to some extent. And we just haven't seen it in size yet. For all the dough they're spending, it's not reflected in higher unemployment numbers yet, which is horrible.

Stephen Miller

You and I know that the advance of technology throughout history is always heralded concerns about job losses. And what people don't take into account is that industry spring up that have never existed before that do need to employ people. You had the Luddites smashing the loon machines way back when. We used to fret about what would happen to all the bank tellers, but we've sort of managed to technologically advance without permanently disrupting the labour market.

Labour markets tend to come under more intense pressure during times of cyclical weakness or through big sort of global events like we had in the 70s when we saw the unemployment rate go to double digits. That wasn't technology, that was mismanagement coupled with a couple of oil crises. So, I think we always get fearful about the impact of technology on jobs, and we have done for centuries, but over time, new jobs, new industries, things that we haven't even contemplated spring up and start to employ people and if you're an optimist, that'll go on happening.

Now that's not to say there might not be some process of adjustment where there are some job losses and it is a bit difficult, but I think over time, these things tend to get implemented with less disruption to the overall labour market than we might assume. That's my view anyway.

Damien McIntyre

Look, I agree with you and you're right. In the interest of time, I want to ask, just if you can speculate on how do you think Powell and the new guy, how do you think that'll play out? Do you think he'll be respectful of Powell's role and not lean on him too much to drop rates?

Stephen Miller

Look, I think Powell will serve at his time as chair, whether he stays on as a member of the Federal Reserve after his term as chair expires, we don't know. Kevin Walsh is a professional central banker, and I think he's articulated what is an incredible view. He's got to be confirmed yet, and I think he'll let Powell finish out his term and will assume the role in May when he's scheduled to assume the role. I mean, it's not that far away now. And as I say, Walsh might have different views from Powell, but that doesn't mean they're less valid.

His view is very similar to the one that Greenspan used to propound in the 90s, whereby, as I said earlier, we're going through some form of productivity revolution enabled by technology, particularly AI, which means that the economy's speed limit in terms of GDP growth is higher means we can run the economy a little hotter without igniting inflation. And I think that's a credible view.

And so, we'll see what happens when he assumes office. And I don't think Powell last week ruled out another cut under his chairmanship, whether we get one or not is another question. So, despite noises from the sideline from the administration and from the president, Powell will see out his term. The new guy will take over. We might have a more aggressive approach to policy rate cuts after he takes over. The extent of it, I think, is the item about which we worry or should worry.

Damien McIntyre

The last question on this subject I want to ask you is, this is the year of the midterms. Do you see the President himself aggressively pump-priming the economy to create a rosier picture for potential Republican voters?

Stephen Miller

Well, he hasn't done much to close that budget deficit that I mentioned earlier. You're also seeing some creeping regulationist tendencies, which might have a short-term political palliative, but are maybe a longer term or a little bit dangerous. So, some of the things that I can think of are banning big institutions from the single-family home market, bill to rent, putting caps on credit card interest rates.

Now look, none of us like paying those 20% credit card interest rates, and we avoid it if we can. But the reality is, if you put caps on it, it becomes less profitable for the credit providers. Consumer credit will shrink, even if it sort of might sort of play well as a political device. But Donald Trump, like all politicians, he'll probably do things that will sort of help him as we approach the midterms.

The danger might be that those things that might help him politically might involve, in certain instances, some economic damage. And look, Donald Trump's not alone in doing that. All presidents have done that. We just have to wait and see what those measures look like and, you know, the sort of damage they might do to the economy.

Damien McIntyre

Look, my comments are without prejudice. I'm just trying to speculate on how he's driving the bus. He either wants a bigger majority in the house or at a minimum to hold what he's got now. I'm just wondering what do you reckon he's got up his sleeve and how that plays out for markets?

Stephen Miller

I mean, I'm not a political expert. I sort of wonder if the US economy doing quite well and the labour market okay, and inflation not rising, even if it's not falling as much as we'd like, I wonder if the economy is the thing he needs to focus on when he's crafting a political message. We're sort of seeing other issues, I think, perhaps have a bigger impact on the electorate than conventional macroeconomic sort of variables.

How the government approaches immigration, for example, and the measures it takes to discourage immigration and whether they might be perceived as over the top in certain instances might be playing bigger politically than the economy. Now, of course, I think President Trump's probably a better politician than I am, so he's in a better position to make judgments about what he needs to do to increase the attractiveness of Republican candidates, but I don't think the economy is the one and only issue on the political agenda at this point in time, if you know what I mean.

Damien McIntyre

Yeah. Well, thanks, Steve. Look, so to sum things up, the Australian economy, it's not growing as quickly as the United States economy, but it's doing okay. It's doing okay, which should be a reasonable setup for the equity market here, one would assume. And equally, the United States is going along quite nicely. It's not a massive clip. It's certainly expanding faster than we are.

Stephen Miller

I think it's all true, and when I say our economy is doing okay, it is just okay, inflation is sticky, interest rates may need to go up further, I think we're sort of all waiting, umming and aahing on that. That will be a headwind for the equity market here, and what we desperately need in Australia is support from other arms of policy, which is how we started this out.

But the US, it looks a little more rosy. I think the other thing though is I've never known uncertainties to be as elevated as they are now on a global scale. And whilst we've been surprised about the lack of visible impact of the President's sort of trade measures, I sort of don't rule out that those chickens can come home to roost at some stage.

So, what I would take out as an investing lesson out of all this is it just goes to re-emphasise the importance of diversification, and I've said this before, but diversification is more than a 60-40 equity bond portfolio. I don't know what the numbers are, but it could be 50-20-30, where 50 is equity, 20 bonds, and 30 is other. And what's the other? Well, it could be a combination of things. It could be long-short portfolios, macro hedge funds, corn hedge funds, gold, and other commodities and precious metals. Could be liquid alts. It could, although this is a bit more nuanced, encompass elements of private markets.

So, I think what we're sort of saying here is, well, things look okay as we stand here and now today, but given the levels of uncertainties, we might want to just make sure that our portfolio is diversified, and beyond the 60-40 portfolio, we want to add things that are potentially uncorrelated with both equity and bond beta, and that would be the biggest point I'd make about the investing landscape as we go into 2026.

Damien McIntyre

Well, thank you for your thoughts, Steve. Insightful as always and thank you to everyone for listening.