Building portfolios with structural inflation: Why now?

August 2026

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Key takeaways

— Structural inflation may become a more persistent portfolio consideration, requiring investors to look beyond the post-1980 playbook of falling rates and reliable stock-bond diversification.

— Organizing portfolios around economic exposures such as growth, defense, and inflation sensitivity can help investors build resilience across a wider range of market regimes.

— A total portfolio approach can better integrate public and private markets by focusing on the risks and outcomes each exposure contributes to the overall portfolio.

For most of the last four decades, investors benefited from an investment environment that was remarkably supportive of traditional portfolio construction. Inflation trended lower, interest rates declined, and globalization expanded. Capital moved freely across borders, demographics were favorable, and central banks enjoyed considerable credibility. A simple combination of growth and defensive assets generated strong risk-adjusted returns across a wide range of market environments.

Today, however, many of the assumptions underpinning that framework are being tested. While the inflation shock of recent years may ultimately prove less severe than the experiences of the 1970s, the forces shaping the global economy suggest inflation may remain structurally higher, more volatile, and more consequential than investors became accustomed to during the previous generation. The question is not whether inflation will average a certain level (i.e. 2%, 3%, etc.), but whether inflation has become sufficiently important that investors must once again incorporate it directly into portfolio architecture.

This raises an important challenge: how can portfolios be constructed in a world where inflation is no longer an occasional disruption, but a permanent consideration?
This article is the first in a broader series exploring that question. In future pieces, I will examine the implications of inflation for portfolio construction and specific solutions to mitigate this structural risk. However, I begin by addressing a more foundational question: is the traditional asset class framework the most effective way to build portfolios in an era of structural inflation?

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The end of the post-1980 playbook

It is difficult to overstate how supportive the post-1980 environment was for investors. Inflation fell steadily from the highs experienced during the 1970s and early 1980s. For nearly four decades interest rates declined across developed markets, global supply chains improved efficiency and reduced costs, labor became increasingly integrated into a global marketplace, and technological innovation boosted productivity. It is also worth emphasizing that government debt levels remained manageable relative to today. The primary result of this confluence of factors was strong growth and stable inflation, creating an environment in which equities and bonds complemented one another and were negatively correlated.

Over time, investors became accustomed to viewing stock-bond diversification as a structural feature of markets rather than a characteristic of a specific economic regime. The events of 2022 provided an important reminder that the relationship is not guaranteed. Global inflation surged to its highest rates in decades driven by post-pandemic economic reopening, severe supply chain bottlenecks, and energy and food shocks from the war in Ukraine. When inflation rises unexpectedly, both stocks and bonds can struggle simultaneously, and diversification becomes more difficult. Assets that appeared distinct from one another suddenly reveal exposure to the same underlying macroeconomic risk. The key question since then has been whether 2022 was an isolated inflation shock or an early indication of a more persistent shift in the investment landscape.

Inflation is becoming structural

The term "structural inflation" is often misunderstood. It does not mean inflation will rise continuously. Nor does it imply a return to the double-digit inflation rates of the 1970s. Rather, structural inflation refers to a world in which inflation remains an important and recurring feature of the investment landscape rather than a largely dormant risk. Several long-term trends support this possibility.

Globalization is no longer accelerating at the pace experienced in previous decades. Supply chains are increasingly being optimized for resilience as well as efficiency and geopolitical competition is leading to duplication of production capacity in strategically important industries. Aging populations are reducing labor force growth in many developed economies, which is particularly pronounced in Asia. Fiscal policy has also become more active, due to resiliency concerns and populist tendencies from national leaders.

Even artificial intelligence, often cited as a potentially disinflationary force, may initially require massive investment in infrastructure, energy, semiconductors, and data centers before productivity benefits become fully realized. We've seen early evidence of this with high inflation in the cost of computing. However, none of these factors alone guarantee higher inflation. Collectively, however, they suggest inflation may become more variable, more political, and more influential than investors experienced from the mid-1980s through 2020. If inflation becomes a persistent portfolio consideration, then portfolios need to be designed accordingly.

The challenge with asset classes

Traditional strategic asset allocation begins with asset classes. Investors determine allocations to equities, fixed income, real estate, alternatives, and cash. Expected returns and risks are estimated, correlations are modeled, and portfolios are optimized. There is nothing inherently wrong with this approach and in fact, it remains a highly effective framework for many investors.

However, another useful way to think about portfolios is through the lens of fundamental economic exposures. For many years, institutional investors have described portfolio behavior through three broad drivers – growth, defense, and inflation.

The framework is elegant because it reflects the fundamental forces influencing portfolio outcomes rather than the implementation vehicles used to gain exposure to them. Growth assets benefit from expanding economic activity, defensive assets perform best during economic stress or slowing growth, and inflation-sensitive assets benefit from rising inflation or inflation surprises.

During the post-1980 era, investors often succeeded with only the first two pillars (growth and defensive). Inflation exposure frequently appeared unnecessary. That world may be changing. Inflation-sensitive exposures may once again deserve a strategic allocation rather than a tactical one. This does not mean investors can abandon equities or build portfolios around specific asset classes but rather inflation could become an explicit consideration within portfolio architecture. The objective is not to predict inflation – the objective is to ensure portfolios remain resilient across a wider range of inflation outcomes.

Integrating public and private markets

Perhaps the most important implication of this shift involves the relationship between public and private markets. Many investment organizations continue to manage public and private assets separately, with differences in team coverage, reporting, and governance. Yet from an economic perspective, the boundaries are often less meaningful than they appear. Public equities and private equity are both growth assets, listed infrastructure and private infrastructure frequently derive value from similar cash flow characteristics. A portfolio organized around economic exposures naturally encourages greater integration across public and private markets. Rather than asking whether an idea belongs within public or private investments, investors can ask which economic exposure it contributes to and whether the portfolio already possesses sufficient exposure to that risk. This perspective may become increasingly important as private markets continue to expand and occupy a larger share of institutional portfolios.

Figure 1 - From asset classes to return drivers: A common economic lens can connect public and private implementation

Return driver	Public market implementation	Private market implementation
Growth	Global equities	Private equity; Venture capital
Carry	High yield; Emerging-market debt	Private credit; Direct lending
Inflation	Commodities; Inflation-linked bonds	Infrastructure; Real estate
Illiquidity	Small caps; Special situations	Private markets
Diversification	Systematic and alternative strategies	Real assets

Key observation
Asset classes are implementation vehicles. Return drivers and risk premia are the underlying sources of return.
Discussion question
Should portfolio design begin with asset classes or underlying return drivers?

Source: Invesco, for illustrative purposes only.

A practical framework for structural inflation

If structural inflation remains a defining feature of the next decade, portfolio architecture may evolve toward a framework built around three core functions. We'll structure this series around the following outcomes: growth, resilience, and total portfolio integration.

The focus for ***growth*** is on long-term capital appreciation and includes exposures such as global equities, private equity, venture capital, growth-oriented credit, and other return-seeking assets.

For ***resilience (defensive and Inflation-linked)***, the objective is to address how to maintain purchasing power and improve robustness across a range of economic environments and provide adequate defense in more risk-sensitive environments. This may include exposures such as core bonds, diversifying alternative strategies, real estate, inflation-linked securities, commodities, and other inflation-sensitive exposures.

For the third outcome, ***total portfolio integration (implementation of Total Portfolio Approach or TPA)***, this topic will cover portfolio optimization, liquidity management, rebalancing and risk budgeting across the full portfolio. The objective is not merely to manage individual sleeves but to optimize the portfolio as a whole – this framework treats public and private markets as complementary implementation vehicles rather than separate worlds. More importantly, it recognizes inflation as a permanent portfolio consideration alongside growth and defense.

Figure 2 - A practical total portfolio architecture: Organize investments around outcomes with a central function optimizing the whole

Growth		Inflation and Resilience		Total Portfolio Implementation
Maximize capital appreciation		**Preserve purchasing power and increase portfolio resilience**		**Optimize and integrate total portfolio**
Global equities	>	Infrastructure and real estate	>	Capital allocation and risk budgeting
Private equity		Inflation-sensitive assets		Liquidity and scenario analysis
Venture capital		Commodities		Rebalancing and implementation
Growth-oriented credit		Defensive carry and diversifiers		Public/private integration

Key Shift

Traditional model: Asset classes compete for capital	>	**Asset class-based decision framework:** Return drivers compete for capital	|	**Central challenge:** Governance and decision rights, not simply portfolio labeling.

Source: Invesco, for illustrative purposes only.

Governance is becoming more important

The greatest challenge in implementing this framework may not be investment selection but in governance. Most investment organizations continue to structure decision-making around asset classes. They have heads of equities, fixed income, private markets, etc. However, few organizations have explicit ownership of growth risk and inflation risk. Even fewer possess a genuine total portfolio function capable of evaluating all investments within a common framework.

Yet as inflation becomes more important and portfolios become more complex, governance increasingly determines outcomes. We believe that the institutions most likely to succeed may not be those with the best forecasts but those with the clearest decision-making frameworks, the strongest organizational alignment, and the ability to view the portfolio holistically. In other words, governance itself may become a source of alpha.

Conclusion: The beginning of a broader discussion

The investment challenge of the coming decade is unlikely to resemble the one investors faced during the previous forty years. Inflation may not return to the extremes experienced during the 1970s. But neither does it appear stable enough to ignore. That distinction matters. Portfolio construction was greatly simplified by an era of declining interest rates, stable inflation, expanding globalization, and reliable stock-bond diversification. The next era may be characterized by more persistent inflation, changing correlations, geopolitical fragmentation, supply-side constraints, and greater dispersion across economic regimes.

In that environment, investors may need to reconsider how they think about portfolio construction. The traditional starting point has been asset classes, but the future starting point may increasingly be the underlying drivers of return and risk. Asset classes remain important, but increasingly as implementation vehicles rather than the primary organizing framework for portfolio construction. The question is no longer whether investors should think about inflation, but whether their portfolios have been designed for a world in which inflation matters again.

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