

Inflation, Private Credit, and Key U.S. Developments

On Melbourne Cup Day, while everyone else was busy placing bets, the market sat this one out, the result was already clear. Call it a win for the RBA, for the market, or maybe a draw where everyone got what they expected. Governor Bullock stepped up and delivered exactly what was priced in: no rate cut.

Last month's unemployment data briefly spooked the market, jumping from 4.2% to 4.5% as more people entered the labour force. That was enough for market punters to reverse their bets, suddenly pricing in a 70% chance of a cut. But the RBA was waiting for the quarterly inflation print to steer the horse, and inflation came in hotter than expected.

The CPI rose 1.3% in 3Q, stronger than both the forecast (0.8%) and consensus (1.1%). Core inflation also surprised, with the trimmed-mean CPI up 1.0% quarter on quarter, lifting the annual rate to 3.0% from 2.7%, an upside shock to the RBA's August projections. For September, the monthly CPI indicator rose 3.5% year on year (consensus: 3.1%), up 0.5% month on month.

The pickup in core inflation killed any chance of a November rate cut. What was a 70% probability heading into the month evaporated by Cup Day. The RBA's trimmed mean, its preferred gauge, climbed back to the top of the 2–3% target band, forcing a more hawkish tone. Most of the jump looks temporary, tied to the expiry of cost-of-living relief and a 9% quarterly surge in electricity prices, now up 23.6% year-on-year. Property rates (+6.3%) and the usual seasonal lift in travel and accommodation costs also added to the headline number.

Governor Bullock was blunt, inflation remains the priority, and rate cuts weren't even on the table. For now, neither the market nor the RBA is entertaining a cut. But with inflation still running ahead, this could be one race the central bank can't afford to lose.

A week before Cup Day, the Fed met with 25bps already priced in and delivered exactly that. The Federal Reserve remains focused on the labour market, with jobs and openings central to policy. Inflation is still a concern, but the Fed is taking a measured approach, keeping rates in a neutral range while monitoring household finances and consumer spending.

At the 29 October FOMC meeting, the Fed cut the federal funds rate by 0.25% to 3.75–4.0%. There were two dissenters: Stephen Miran for a 0.5% cut, and Kansas City's Jeffrey Schmid for no change. Chair Powell noted that opinions within the FOMC are increasingly split, and a December rate cut is "not a foregone conclusion". Recent cuts are seen as preventative against downside risks to employment, but future moves will remain data dependent. Overall, the Fed appears composed, balancing support for jobs with ongoing inflation pressures, and staying guided by broad economic indicators rather than reacting to short-term market signals.

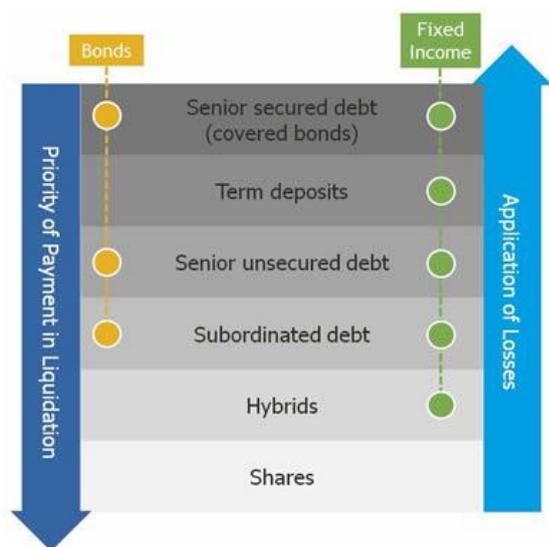
Taken together, the RBA and the Fed are navigating a delicate balancing act, but with very different priorities. In Australia, inflation dominates the agenda, leaving little room for rate cuts despite softening unemployment. In the US, the focus remains squarely on jobs, with the Fed taking a cautious, data-driven approach to sustain growth while keeping inflation in check. For markets, this means central banks are not signalling dramatic shifts anytime soon, policy will continue to be patient, measured, and closely tied to incoming economic data.

Private Credit; growing asset class with emerging risks

Attention has recently turned to other areas of potential market risk, namely private credit.

Private credit, simply put, is non-bank lending where institutional investors provide funds directly to companies. It's grown rapidly as banks retreat from traditional lending, giving investors a way to diversify risk and pursue higher returns. While the asset class isn't new, it has existed for decades as a diversifier, given it's less correlated to traditional asset classes. Its development accelerated after the Global Financial Crisis (GFC), when regulators tightened capital requirements. In Australia, prudential standards went further than most jurisdictions, with higher CET1 ratios that curtailed bank lending and opened the door for private credit to fill the gap.

Today, Australia's private credit market is estimated at around \$200 billion, small relative to the \$2.5 trillion global market, but expanding quickly. Growth has been supported by the Australian Prudential Regulation Authority's (APRA) late-2024 decision to wind down the \$43 billion hybrids market by banning new issues with call dates beyond 2032. APRA's move, aimed at shielding retail investors from unintended consequences, compels banks to replace that layer of capital with subordinated debt, tier 2 securities, or equity.



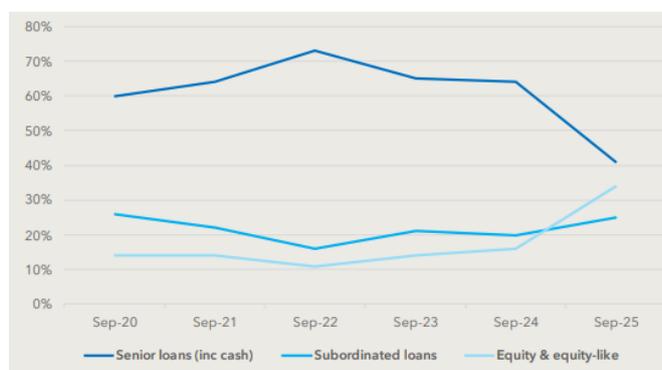
That decision followed the collapse of Credit Suisse in 2023, a stark reminder that “too big to fail” is not a guarantee. In a controversial move, Swiss regulators wiped out US\$17 billion of the bank’s additional tier 1 hybrid securities, leaving hybrid holders worse off than shareholders. These instruments were designed to absorb losses in times of stress, and regulators exercised that power fully.

The outcome has been clear: the demise of bank issued AT1 hybrids has breathed new life into private credit. As hybrids phase out, yield-seeking investors are increasingly turning to private credit and credit funds, reshaping Australia’s fixed income landscape.

Still, the rapid rise of private credit hasn’t come without cracks. Over the past year, Australians have lost more than \$1 billion in retirement savings following the collapse of several funds linked to superannuation platforms, including First Guardian, Shield Master Fund, and Australian Fiduciaries. While these weren’t private credit funds per se, they offered a useful lens into the

opacity of the broader private markets, often described as a “black box.”

Retail private credit funds in Australia have delivered returns between 4% and 10% yet charged fees ranging anywhere from 2.5% to as high as 44.51%. The composition of these funds has also shifted over time. What was once dominated by senior debt has, in recent years, tilted toward higher-risk loans or equity like investments with lower security.

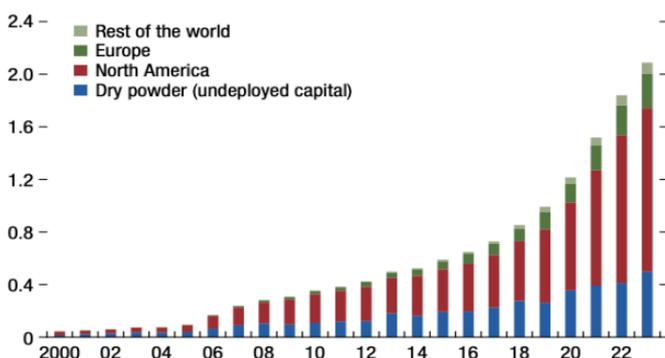


ASIC’s long-awaited report into the private credit market offered little comfort. The regulator found that disclosure practices were inconsistent, with some funds earning additional income from borrowers beyond standard interest charges and retaining all or part of those fees. It also identified weak governance, poorly managed conflicts of interest, and limited transparency, issues that will only grow in importance as the market expands.

For now, there’s no sign of systemic risk but it’s a risk quietly building beneath the surface. What stands out in Australia’s private credit market is its concentration: roughly 20–40% of lending is corporate or commercial, 10–30% is asset-backed or securitised, and 40–60% is tied to real estate. That last figure underscores a growing concentration risk.

This risk isn’t confined to Australia; as highlighted in the last [update](#) on the two U.S. companies, First Brands and Tricolor, whose recent bankruptcies exposed vulnerabilities in the private-credit market, the threat is clearly building on a global scale.

U.S. life insurers have become an increasingly significant force in private credit, with nearly one-third of the sector’s US\$5.6 trillion in assets now invested in private debt, up from 22% a decade ago, according to Credit Sights. The quality of these assets is under scrutiny, as ratings are often issued by smaller agencies, a trend the Bank for International Settlements has recently highlighted as a growing risk.



This has sparked a broader reassessment across the industry. The UK financial sector is preparing for new regulations on private credit, and the US\$1.7 trillion global market appears poised for significant change. While it hasn’t reached systemic risk yet, the increasing regulatory attention signals that it could.

The initial warnings came from ASIC, particularly concerning how private credit funds are rated and the transparency of those assessments. A global issue is clearly emerging, and while it’s reassuring that



regulators are alert, the flagged vulnerabilities mean investors should remain vigilant.

DAY 41: U.S. Government Shutdown Ends

We are now deep into the U.S. 3Q reporting season. Looking at the last 60 quarters of S&P 500 earnings, quarter-on-quarter results show consistent strength, reinforcing that fundamentals continue to underpin the market rally, a point we have highlighted for some time. Positive earnings surprises are particularly notable this quarter, with 89.1% of companies beating consensus estimates, the highest level in the past 60 quarters.

The market, however, has been relatively muted. Historically, strong earnings seasons coincide with solid market gains, but lingering skepticism about AI, including concerns of an AI bubble, combined with the longest U.S. government shutdown on record, weighed on sentiment. Extended shutdowns threatened to impact consumer spending and confidence, as benefit payments, federal paychecks, and key economic data releases were delayed. Certain sectors were hit harder than others: the aviation industry, for example, saw more than 7,200 flights delayed and 2,100 cancelled, largely due to a shortage of air traffic controllers under the Federal Aviation Administration (FAA).

By comparison, the previous record shutdown lasted 23 trading days in 2018–19, during which the market gained 8%. That comparison, however, is imperfect. Back then, the Fed was hiking rates and stocks were already falling, so the shutdown coincided with a rebound off late-December lows. Today, the Fed is cutting rates, and the S&P sits near record highs. Recent volatility likely reflects profit-taking and valuation concerns more than the shutdown itself.

As this is being written, the Senate has passed legislation to end the longest government shutdown in U.S. history. A critical splinter group of Democrats joined Republicans to approve a spending package, though it omitted the health insurance subsidies Democrats had long demanded. The 60-to-40 vote on Day 41 of the shutdown marks a break in gridlock that had shuttered the government, leaving hundreds of thousands of federal workers furloughed, millions at risk of losing food assistance, and widespread disruptions across air travel. In anticipation of the resolution, the market rallied sharply last night with the S&P 500 closed up 1.53%, the NASDAQ gained 2.26%, while Treasury yields advanced.

S&P 500 Returns During Government Shutdowns





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