

Investment Views October 2026

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Equities:

Another Eventful Quarter in the Tech Sector

Earnings Shield Equities From Higher Interest Rates

- Equities benefit from strong earnings
- Oil shock returns and drags yields higher
- AI recovers from summer wobble

The third quarter was a positive one for global equity markets. The MSCI World returned 1.9% in US dollar terms and a very similar 1.8% in sterling terms. This is close to the long-run average return for stocks over a 3-month period, but market volatility means that returns often vary widely around the average.

While equities looked relatively calm on the surface, there was a lot of dispersion below the headline indices. An investor looking at individual stocks would have seen a very eventful quarter. As many stocks moved around in different directions, however, this volatility largely cancelled out at the aggregate level.

In contrast, it was a challenging time for fixed income markets. Expectations for future interest rates increased during the quarter, which put upward pressure on bond yields. This meant that bond prices fell. Bonds generally pay interest (coupons), but these only



partially offset the falling prices. We generally invest in relatively short dated bonds, and these held up better than longer dated bonds. To put this into context, an index of 1-5 year US government and corporate bonds returned -0.9%, whereas the equivalent 5-10 year index returned -3.9%.

Geopolitical risk was again a feature in the third quarter. After a large rise in the oil price in March as Middle East hostilities escalated, oil prices fell materially over the summer. Oil peaked at \$118 per barrel but fell as low as \$72 in late June. Hopes of a ceasefire then faded and oil climbed back to \$109 in September. Central banks in the US and UK have tried to look through higher oil prices, but the longer the shock lasts the harder that becomes. Higher energy prices were a key driver of higher bond yields over the quarter, as the market priced in higher expectations for interest rates.

An energy price shock and sharply higher bond yields would ordinarily be a headwind for the equity market. However, equities have remained remarkably resilient, largely due to the strength of corporate earnings (profits). The rapid adoption of artificial intelligence and the associated buildout of data centres have provided a significant boost to corporate profits. While earnings have been strong, the multiple that investors are prepared to pay for them has fallen. The most commonly cited measure is the price earnings ratio, which for the S&P 500 has fallen from 22.5x to 19.0x. It has not been the case that equities have “ignored” the headwind of higher interest rates, but that the rise in earnings has been a more important factor. One can think of this as profits shielding equity markets from higher oil prices and bond yields.

The AI theme has attracted a lot of interest among investors over recent years, and this saw a lot of money flowing towards a relatively narrow range of stocks. Coming into July, this sentiment and positioning towards stocks deemed beneficiaries of AI was quite skewed. This was a factor in a period of volatility for AI-related

\$72

The lowest cost per barrel that oil reached in June.



stocks in July. The Philadelphia Semiconductor Index fell almost 30% peak to trough over the summer, and stocks linked to data centre construction also fell.

One can think of this like a boat, when too many people are on one side of the boat, a wave from the wrong angle may have more of an impact than if the people are well balanced. What was interesting about the summer sell-off in stocks linked to AI, was that it was not clear that there actually was a wave. News flow around AI has come thick and fast over recent years and may have been a catalyst for the summer sell off. A few high-profile companies noted that their AI spending was too high, with Uber reportedly burning through their entire 2026 annual AI coding budget in just four months due to heavy internal adoption and usage incentives. However, consumption of AI computing power has remained strong overall.

Overall, it was a quarter where equities outperformed bonds. This is generally associated with a growing economy. The global economy has indeed been more resilient than many expected when the energy price shock escalated in March. Alternative investments had an eventful period over the three months to the end of September. After a strong run in recent years, gold suffered in the second quarter falling 14.1%, before stabilising in July and recovering 9.7% in August. Gold finished the quarter with a very respectable 3.7% return, while commodities also performed well, helped by the rise in oil prices. Hedge funds struggled in July during the AI sell-off, but that followed a good first six months of the year. Alternatives remain a key part of many portfolios to help balance risk and support returns.



Bond Markets Under Pressure

- Inflation risks returned as energy prices surged
- Central banks shifted back toward tighter policy
- Real yields rose to increasingly attractive levels

The third quarter was the point at which the benign disinflation (falling inflation) story became much harder to sustain. Economic growth across the major developed economies remained firmer than expected, while the prolonged conflict in the Middle East pushed oil and refined-product prices sharply higher. Brent crude rose around 40% during the quarter, reviving concerns that the energy shock could spread into broader prices. Central banks were therefore no longer dealing with economies simply slowing towards target inflation; they were confronting renewed supply-side pressure at a time when demand has proved surprisingly resilient.

The United States remained at the centre of that adjustment. Consumer spending and investment held up surprisingly well through the summer, while inflation stopped making comfortable progress. By August, headline inflation remained firmly above 3%, with underlying measures also remaining elevated. These figures were less important individually than what they signalled collectively: inflation remained too high just as energy prices are threatening another impulse. Although, towards quarter-end, softer consumer confidence and signs of cooling labour demand



offered the first indications that higher borrowing costs might finally be beginning to restrain activity.

Central banks responded, with the Federal Reserve raising rates by 25 basis points in September, reversing the direction of policy that markets had expected earlier in the year. The ECB also tightened, as euro-area inflation moved higher, while the Bank of England held rates unchanged despite several policymakers voting for an increase. Japan moved further away from the ultra-low-rate era, while Australia and Norway also tightened during September. The message was unusually consistent: renewed inflation pressure could no longer simply be looked through.

Government bond markets absorbed that message quickly. The US 10-year Treasury yield rose sharply during the quarter to around 5.3%. Most of this move was driven by higher real yields, with the market pricing in a terminal base rate of 5%, while investors also demanded greater compensation for persistent fiscal deficits, heavy government issuance and the enormous capital requirements associated with AI infrastructure. Similar pressures pushed yields higher in Europe and Japan, while France came under additional pressure as concerns over its fiscal outlook widened its yield spread to Germany.

Credit markets were considerably calmer than government bonds. Investment grade spreads remained tight and corporate fundamentals broadly healthy, supported by still-buoyant nominal growth. There are signs of stress, however, as high-yield spreads moved wider, and investors became more selective towards highly leveraged borrowers. For now, strong nominal growth continues to support corporate balance sheets, but higher refinancing costs are likely to become increasingly important if economic momentum weakens.

China provided an important counterpoint to developments elsewhere. Industrial activity remained relatively resilient, but domestic demand continues to be weak. Retail spending remained subdued, investment continued to contract and the property sector

25bps

The amount the Federal Reserve raised rates in September.

remained a significant drag. Inflation is also considerably lower than in the major Western economies.

Currency markets increasingly reflected these differences in growth, monetary policy and energy exposure. The US dollar strengthened late in the quarter as real yields rose, and US activity has remained comparatively robust. The euro weakened as higher energy costs collided with fiscal concerns in France. The yen remained volatile despite tighter Japanese policy, while higher commodity prices and increasingly hawkish central banks provided a more supportive backdrop for commodity-linked currencies.

Valuations across fixed income have become increasingly attractive, although near-term momentum remains important. In the US, negative momentum has justified allowing duration exposure to drift lower, and we remain reluctant to fight that trend prematurely. Real yields, however, are now compelling, particularly as some early indicators suggest that growth momentum may be starting to slow. The balance between weak market momentum and increasingly attractive valuations is becoming more important.

We remain overweight inflation protection. Breakeven inflation rates have moved remarkably little, despite the rise in oil prices and renewed concerns over inflation. This leaves inflation-linked bonds attractively valued against the range of possible outcomes. Credit remains neutral. Investment-grade spreads offer little margin for disappointment and high-yield spreads have begun to widen, but nominal growth remains sufficiently buoyant to justify selective exposure to risk assets.

This quarter was difficult for bond markets, but it also restored something that had been largely absent for much of the post-financial-crisis period: genuinely attractive real yields. If tighter financial conditions now begin to slow growth while longer-term inflation expectations remain contained, the sell-off may ultimately create an increasingly attractive entry point for duration.

Another Eventful Quarter in the Tech Sector

- Software recovers while semiconductors struggle
- Utilities lag due to higher interest rates
- Volatility in South Korean technology

With oil prices again on the rise, it was no surprise that Energy was the best performing sector in the third quarter, retuning 15.2%. Technology was the second-best performing sector, retuning 6.2%, but there was a large gap between Technology stocks in the US, which returned 7.7% and global Technology stocks outside of the US, which fell 6.0%. Technology accounts for almost one third of major global equity indices, and it was a particularly eventful quarter for the sector.

Artificial Intelligence has been both a blessing and a curse for existing technology companies. Semiconductors have benefitted substantially from the AI buildout, both at the most advanced cutting-edge end of the spectrum and the more “everyday” semiconductors that you would find in a smart phone or personal computer. In contrast, software companies have been under threat from AI. The ability of AI to generate computer code lowers the cost of software development, and this could mean new competition for software incumbents. Software stocks were



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previously highly valued by the market due to their low marginal cost base, which means that they can sell another software license without incurring much additional cost. Furthermore, software spending typically tends to be contractual and is therefore considered recurring revenue.

Over the last year, Software stocks fell out of favour and their valuation multiples have been marked down. The P/E multiple of the MSCI World Software index fell from 34x last summer to 26x as at the end of September. However, over the summer, some of the concerns around Software stocks have lifted. The MSCI World Software & Services index fell a considerable 23.8% in the first quarter of the year, but recovered strongly in the third quarter, rebounding by 27.0%. Large software companies that are deeply embedded in large companies and operate as the system of record for the data are now seen as better placed to compete with new AI applications. Software also benefitted from the opposite dynamic to AI beneficiaries, i.e. sentiment and positioning was very light, so better news had a disproportionately positive impact on the stocks.

Another key area linked to the AI buildout that has been in focus is power. Data centres require a lot of reliable power, and this has meant a pickup in demand. This is being provided by a combination of the power infrastructure through the existing grid, and data centres building their own power generation infrastructure to sit alongside the site. While stocks linked to AI weakened in July after a very strong run, Industrial stocks linked to the data centre buildout also sold off. A pickup in demand for power is a positive for utility companies, but an added complication for them was the rise in bond yields over the summer. Utility companies tend to have a lot of debt and be valued based on a long stream of relatively stable earnings. Rising borrowing costs tend to be a headwind as future earning are discounted at a higher rate. We have held more exposure to Utilities than our benchmarks over the last couple of years, but in the third quarter we reduced this back to a benchmark weight. The

23.8%

The amount the MSCI World Software & Services index fell in Q1.

money was reinvested in Industrials, which we see as better placed to benefit from the pickup in power demand.

In terms of geographical equity performance, Japanese equities led the way, returning 6.0% in US dollar terms. Energy, Financials, and Communication Services helped drive performance, with banks benefitting from expectations of further rises in interest rates. South Korean equities were in the spotlight in the first half of the year, with technology companies there seeing very high returns from selling AI-related hardware. Some of these high-flying stocks suffered a sharp correction in July, with the MSCI South Korea Index falling almost 30% at one point in July, before recovering to finish the quarter down 6.7%. The index did return 102.4% in the first half of the year, so year-to-date returns remain strong. A fall in valuation multiples and strong corporate earnings are both supportive of the equity market, but higher oil prices, interest rates, and any disappointment with the AI rollout are risks to watch. We maintain equity exposure in line with respective benchmarks.



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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy



