

Monthly Market Commentary

Global equity markets delivered mixed returns in the third quarter of 2026. A renewed rise in oil prices pushed inflation expectations and bond yields higher prompting the first Federal Reserve rate rise in three years. Strong earnings allowed large cap stocks to absorb the resulting pressure on valuations, while smaller companies and several major markets outside the US declined.

Index-level strength masked an early change in leadership. The momentum and high beta rally that had peaked in late June unwound through July. Even so, the S&P 500 reached a record high in early August, supported by earnings that again exceeded expectations and by hopes of an agreement over the Strait of Hormuz. Those hopes faded as hostilities intensified, lifting oil prices and pushing bond yields sharply higher. Equities became unusually sensitive to rates, with the positive correlation between US stocks and the US 10-year bond reaching its strongest level on records dating back to the 1960s. AI-related stocks also came under pressure due to higher rates and concerns over technology spending.

By region, the US posted modest headline gains, with the S&P 500 up 2.0% and the NASDAQ up 2.5%, but returns were concentrated in the largest companies. The mega-cap heavy S&P 100 rose 4.2%, while the S&P 600 small cap index fell 8.3% as valuation contraction outweighed earnings growth among smaller companies. Europe's STOXX 600 fell 1.1%. The UK and Germany were marginally positive, with the FTSE 100 up 1.0% and the DAX up 0.8%. France's CAC 40 fell 5.2%, weighed down by luxury stocks and by rising political uncertainty ahead of next year's presidential election. In Asia, the Nikkei 225 fell 4.7% as the yen strengthened following the first joint US and Japanese currency intervention in 15 years while the Shanghai Composite declined 6.2%.

Within sectors, leadership was shaped by oil and interest rates. Globally, Energy was the clear standout, rising 14.5%. Information Technology rose 6.1% with strength in US software more than offsetting weakness in semiconductors. Utilities were the weakest sector, down 10.1% due to higher bond yields. Industrials fell 5.9%, while Consumer Discretionary declined 4.4% as higher fuel prices and mortgage rates squeezed household budgets. Beneath these moves, the market rotated towards value and quality, with free cash flow yield the strongest performing factor.

WTI crude rose 30.1% to above \$90 a barrel, and the Bloomberg Commodity basket gained 15.1%. The Federal Reserve raised rates by 25 bps in September, and yields rose across the curve, with the US 10-year closing the quarter at 5.28%, up more than 80 bps and at its highest level since 2007. Credit spreads narrowed modestly and the VIX ended the quarter little changed. The US dollar index was broadly flat, while the yen rose more than 3% against the US dollar.

Looking at the portfolio, the biggest contributors to performance were HP, Pfizer and Newmont. HP reported strong quarterly revenue and raised its full-year earnings and free cash flow guidance. We sold the equity as the shares reached our assessment of fair value but still maintain some exposure via puts at a lower strike. Pfizer raised its full-year revenue outlook supporting a re-rate of the shares. Newmont's earnings rose, as it captured a higher gold price compared to a year ago, while operating costs rose only modestly. We continue to hold both positions.

The main detractors from portfolio performance were Essity and A.O. Smith (AOS). Essity's second quarter results showed lower margins as sales prices fell. Management also warned of a heavier cost burden in the third quarter from pulp, energy and oil-based raw materials. AOS narrowed its full-year guidance on soft North American residential water heater demand, higher steel costs and continued weakness in China, indicating the third quarter would likely be its weakest of the year. We continue to hold both on attractive valuations.

During the quarter, the Fund initiated new positions in Buzzi as well as CoreBridge, an insurer, and McDonalds, a quick-service restaurant franchise operator.

The Fund fully exited Chubb, Secom, TotalEnergies, Adobe, and Robert Half on valuation grounds following strong prior performance for all five.