



# MARKET COMMENTARY

QUARTER 3, 2026

# GLOBAL MARKETS DENTED BY INFLATION RISK AND UNCERTAIN GEOPOLITICS

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INVEST

The past quarter will not only be remembered for high market volatility but also for global central banks deciding it is time to change direction. Central banks have become unusually hawkish with the repricing of the interest-rate outlook and have pivoted back toward raising interest rates. It remains a difficult environment for central banks, as inflationary pressures are largely coming from the supply side — central banks cannot reopen the Strait of Hormuz or increase refinery capacity.

As a result long-term government bond yields in developed economies climbed to levels not seen in decades. In the US, the 10-year Treasury yield surged to 5.29%, its highest level since 2004. Across the globe, the surge in US Treasury yields triggered a synchronised sell-off in international sovereign debt, pushing borrowing costs to multi-year and multi-decade highs.

Bond markets are sending yields to multi-decade highs



The sell-off in global bond markets reflected investor angst over **inflation** and **government debt** levels. Government deficits are out of control, inflation is stubborn and geopolitics, from trade wars to actual wars, threaten to make both worse. In addition, competition from corporate borrowers is acting as a headwind for longer-maturity government debt globally. As tech companies seek to expand their AI infrastructure, they are increasingly issuing bonds with long-dated maturities so they do not have to pay back investors for decades. This means governments are facing more competition from corporate debt issuers.

Yields were near zero in the aftermath of the global financial crisis when the outlook for economic growth was poor. The recent increase in yields could be viewed as a normalisation to pre-crisis levels. While it feels like an anomaly compared to the post-2008 zero-rate era, a 5% yield on US 10-year debt is historically closer to the long-term average seen over the past four decades.

Markets are moving into a higher-yield regime



People love to use the phrase ‘higher for longer,’ we would argue a far better characterisation is ‘normal for longer.’

- Tom Porcelli and Michael Pugliese (Wells Fargo economists)

Global equity markets have remained relatively robust despite the sharp drop in global bond markets. The MSCI AC World Index (\$) was up 1.6% in Q3, while the Bloomberg Global Aggregate Bond Index (\$) dropped 2.5%. The interesting feature over the quarter was the disconnect between equities and bonds. While a persistently higher risk-free rate increases the cost of refinancing for companies and weighs on growth, its impact on shares has been relatively limited. Much of the resilience in equity markets can be attributed to upbeat corporate earnings, strength in the global economy and continued hype around artificial intelligence (AI).

Shares remain resilient despite surge in borrowing costs





## US: GROWTH REMAINED RESILIENT, UNDERPINNED BY AI

The US economy reaccelerated in Q3, supported by resilient consumer spending and strong AI-related investment, although a cooling labour market and inflation still above the Fed's target of 2% remain key concerns. Headline CPI for August was 3.8% yly. A significant feature this year has been the continued investment boom associated with AI infrastructure, data centres, semiconductors and technology. This has helped support business investment and overall GDP growth. Deloitte's latest assessment also identifies the AI buildout as an important reason why the US economy has maintained relatively strong growth – GDP was up 2.2%, annualised in Q2.

### Fed increased rates

The Fed raised rates by 25bps to 3.75 - 4%, the first hike since 2023. Inflation remains too high and the Middle East conflict pushed oil and other energy prices higher. This has fed directly into consumer prices and created a risk that higher energy costs could become more persistent.



**"Inflation is too high and has been for too long."**  
- Kevin Warsh (Fed Chairman)

### Big tech pushed markets higher

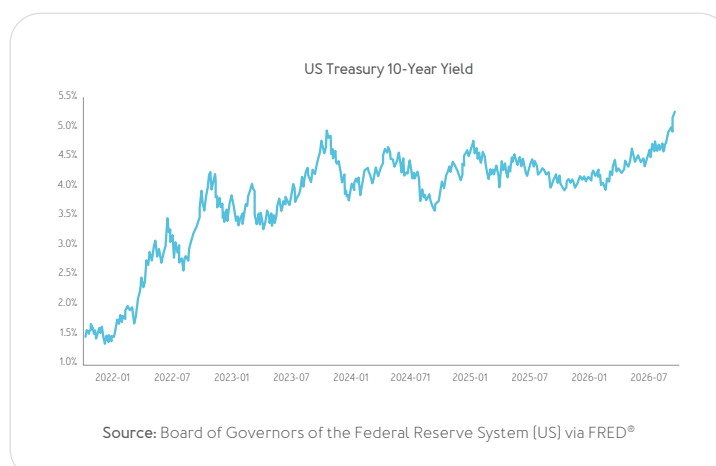
Investors might have been expected to run for the hills in the face of an extraordinary surge in US borrowing costs, wars, oil up 40% and warnings that AI might wipe out humanity. Yet, US markets continued to rally higher during a tumultuous third quarter. Momentum has been carried by strong corporate earnings and a surge in business spending on AI. The S&P 500 climbed 2.3% in Q3 (+12.7% YTD) and the Nasdaq Composite jumped 2.6% (+16% YTD).

Large-cap technology significantly outperformed the broader US market. *Microsoft*, *Meta*, *Nvidia* and *Apple* all gained more than 10% during the quarter. The difference between the S&P 500 (+2.3%) and the equal-weight S&P 500 (-1.9%) is particularly significant. It indicates that the headline index's positive return was driven disproportionately by its largest companies rather than broad-based gains across the market.

Late in the quarter semiconductor shares soared as early signs of success for *Meta Platforms Inc.*'s new AI agent sparked a wave of enthusiasm around demand for the chips needed to power such agents. *Meta's* Muse AI Agent reached the top slot among *Apple Inc.*'s App Store free applications following its launch. That stoked a renewed frenzy for shares of companies that produce the central-processing units (CPUs) necessary to power AI. *Meta* said it can help with various tasks including online shopping, buying movie tickets and scheduling appointments. But it is already facing scrutiny over privacy concerns and *Amazon* blocked *Meta's* AI agent from shopping on its site. *OpenAI* released its latest contender in the AI-assistant race with Dot, an always-on agent that works in the background to complete tasks on behalf of users.

### Fiscal worries pushed bond yields higher

The 10-year US Treasury yield, a yardstick for global borrowing costs and asset prices, rose to 5.3% on the back of sticky inflation and fiscal worries. Investors are now demanding greater compensation for holding long-term government debt amid high borrowing requirements. The US government is expected to borrow almost \$2 trillion from the bond market this year and will do so at higher yields than in recent years. Nearly one in five dollars of revenue goes to interest payments. Why? Because the US national debt has more than doubled over the past decade to reach a milestone \$40 trillion, buoyed by tax cuts as well as the fallout from the 2008 financial crisis, the COVID pandemic and recent energy and geopolitical shocks.



Over the past half-century, federal interest costs averaged 2.1% of GDP. That figure is expected to hit 3.3% this year on its way to 4.6% in 2036, according to the *Congressional Budget Office*. However, that is just the new borrowing – there are also around \$8 trillion of maturing bonds that must be rolled over. In other words, old bonds will be swapped for new ones, at higher yields. Strategists warn that the bond market sell-off is pressuring equities and credit, requiring asset repricing while governments remain reluctant to implement spending cuts.



## EUROZONE: PROVIDED ADDITIONAL DIVERSIFICATION

The Eurozone economy grew 1.0% y-o-y in Q2, accelerating from an upwardly revised 0.5% in the previous quarter. Strong AI-related investment, resilient government spending and one-off factors helped offset the impact of the conflict in Iran.

The STOXX 600 Index performed solidly YTD, up 7% despite a disappointing Q3 when it lost almost 2%. Due to a combination of rising bond yields and an ECB interest rate hike, inflation rose to 3.3% in August. Overall, strong corporate earnings and big thematic shifts such as spending on tech, power, defense, and infrastructure are buoying European shares. European equity infows are at their highest level since 2021. The equity market offers a distinct, cheaper valuation entry point relative to concentrated US mega-caps.



## CHINA: A LOPSIDED ECONOMY PUNISHED CONSUMER SHARES

The Chinese economy grew by 4.3% y-o-y in Q2, its slowest growth rate in more than three years.

China has been experiencing a two-speed economy. The country's technological expertise is growing, as evidenced by cutting-edge AI models that have rattled Silicon Valley. And exports are soaring, with vehicle sales being a good example. China's motor industry is on a tear overseas, storming markets from Europe to Southeast Asia and heaping pressure on long-established automakers like Toyota and Volkswagen. But it is a different story at home, where car sales have been in steady decline since late last year, as weak consumer demand and years of intense price competition have left the world's biggest auto market glutted with excess capacity. Meanwhile, the domestic economy continues to struggle with a yearlong property market downturn, muted household spending and a contraction in investment.

Chinese equities experienced a significant correction in Q3 as concerns over slowing domestic growth outweighed optimism around technology, AI and export growth. Under the shadow of Beijing's single-minded focus on AI, consumer shares are trapped in a lost decade. The MSCI China's consumer goods sub-indices plunged roughly 18% over the past six months to near 10-year lows, while the AI-heavy technology gauge surged to more than double its 2016 level. As a result, the MSCI China Index (\$) dropped 11.8% this year.



## JAPAN: THE ERA OF CHEAP DEBT IS OVER

Japan's economy remained in a moderate recovery during Q3, although momentum was uneven. The key theme was a gradual shift from a long period of very low inflation and interest rates toward an economy characterised by stronger wages, persistent inflation and tighter monetary policy.

In September the Bank of Japan (BoJ) hiked its policy rate to 1.25% to fight rising inflation and protect the economy from high import costs – a stubbornly weak yen increased the cost of imported raw materials and food. Markets appeared to be expecting the BoJ to raise interest rates with intervals of about six months, given underlying inflation had approached its 2% target. The central bank's monetary tightening cycle means the era of artificially cheap Japanese debt is over. The BoJ's aggressive pivot toward higher interest rates has triggered a dramatic sell-off in fixed income, sending Japanese Government Bond (JGB) yields surging to multi-decade highs. The 10-year government bond yield reached 3% for the first time in 31 years, which means Japan's interest bill will rise substantially. Japan has the highest public debt-to-GDP ratio in the developed world, exceeding 200% of its economy. This has been driven largely by decades of deflation, near-zero economic growth and massive social spending for a rapidly aging population.

### AI shares drag on equity performance

The Nikkei 225 Index recorded its first quarterly decline since early 2025. After a historic, record-breaking surge in Q2 that saw the index peak above 72 300 in June, the index pulled back during the third quarter, losing 3%. Despite a strong tech-driven rally on the final trading day of the quarter, the overall performance for Q3 was weighed down by the prolonged US-Iran conflict, surging bond yields and the July sell-off in AI-related stocks. Technology represents almost 57% of the Nikkei 225, with companies such as *Advantest* and *Tokyo Electron* having substantial index weights.



## SOUTH AFRICA: GROWTH TRIMMED BACK

Q3 was challenging for the local economy, with the combination of weaker growth, higher prices and renewed inflation pressure becoming more important. The economy contracted 0.2% in Q2, ending six consecutive quarters of growth. Mining, manufacturing and trade were particularly weak. The SARB consequently reduced its expected 2026 GDP growth to 1.2%. It still expects a recovery in the second half of the year but described the risks to growth as being skewed to the downside.

Inflation increased to 4.4% in August, compared with 4.3% in July, with fuel prices being the major concern. Higher international oil prices have resulted in renewed domestic fuel price pressure. The SARB expects inflation to move above 5% later this year and into early 2027, before eventually declining as the fuel shock – hopefully – fades.

### SARB adopts cautious approach

Deciding where to place the emphasis – on the downward pressure on economic activity or the upward pressure on inflation – is difficult and the SARB, as with most other central banks, has adopted a cautious approach since the war started. Supply disruptions can spill over into other areas, pushing up the prices of goods and services. It was against this backdrop that the Reserve Bank raised the repo rate by 25 basis points to 7.25% last month, as inflation remained well above the goal of 3%. Unfortunately, the combination of relatively high interest rates, weak economic growth and renewed fuel-price increases is likely to weigh on household finances and business margins.



**We cannot wait for second-round (inflation) effects to enter the room – that would be too late.**

- Lesetja Kganyago [SARB Governor]

On the positive side, the rand has been resilient, food inflation is exceptionally low and structural reforms could support medium-term growth. The SARB continues to see potential for growth around 2% over the medium term, provided global conditions stabilise and domestic reforms improve the business environment.

### Equity market struggled to maintain momentum

The JSE All Share Index has been a notable laggard. After delivering 42% in 2025, the local market has given some gains back this year – down 3.2% and flat in Q3 (-0.3%). Gold and platinum (PGM) shares have been up and down but industrial shares have been a notable drag on the local bourse, primarily driven by a deep structural contraction in local manufacturing, subdued domestic demand, global competition and business strategy. Below are household names that were sharply down year to date – more than 30%, which is huge.

- **Naspers [-36%] and Prosus [-35%]:** due to escalating AI costs and a bottom-line miss at *Tencent*, coupled with aggressive reinvestment spending in their own core e-commerce portfolios – reinvestment plans/spending in its Brazilian food delivery unit, *iFood*, and the ongoing sale of non-core portfolio assets like *Delivery Hero*. Because *Tencent* makes up the vast majority of their asset base (approximately 23%), any negative sentiment in Hong Kong directly hammers the two holding companies.
- **Clicks [-38%]:** following a disappointing set of interim results for the six months ended February 2026.
- **Foschini [-43%]:** investors continue to worry about weak earnings growth and shrinking profit margins.
- **Woolworths [-33%]:** driven by a sharp slowdown in sales momentum, margin pressure in non-food units and a negative index rebalancing fallout – dropped out of FTSE/JSE Top 40 Index.

### Bonds lagged

Bonds experienced a modest correction in Q3 after their exceptional Q2 rally, as renewed inflationary pressures and the SARB's September rate hike pushed yields higher. The JSE All Bond Index was down 0.7% but the market remained well ahead over the longer term. The 12-month return of the index was 13%, where investors were rewarded with solid real returns in excess of 8%.



Property shares struggled and gave back some of the strong returns achieved over the past 12 months.

Overall, it was not a great quarter for the main local asset classes. Only money market assets, with a return of 1.7%, produced a positive return for the quarter.

### In summary

Normally, rising bond yields would put greater pressure on equity valuations, but exceptionally strong earnings expectations, particularly around AI, helped offset that effect to date. The biggest change going into Q4 is therefore the level of global bond yields. With the benchmark US 10-year yield above 5%, higher oil prices and renewed inflation concerns, the market environment has become considerably more dependent on whether economic growth and corporate earnings can continue to justify elevated equity valuations. Can equities shrug all of that off again?

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