

Investment Outlook

Q4 2026



WILL HIGHER RATES DERAIL THE STOCK MARKET RALLY?

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Not yet—but the rally has become more fragile. Equity markets remained resilient overall in the third quarter, but performance was uneven. The S&P 500 gained around 2% in the third quarter, while the blended estimate for year-on-year earnings growth stood at 29.0% as of 16 October. Yet market breadth narrowed in September, small-cap stocks lagged the headline indices, and some market segments posted losses. The headline return therefore masks a narrower group of market leaders, leaving indices more vulnerable to disappointments in a handful of influential companies.

That sensitivity is increasing because inflation and interest rates have moved back into focus. Renewed conflict in the Middle East pushed energy prices higher and revived concerns that inflation could remain persistent. In September, the Federal Reserve and the European Central Bank raised rates; bond yields rose as well. Higher yields make bonds a more credible alternative to equities and increase the discount rate investors apply to future corporate earnings. Neither development automatically ends a stock-market advance, but both raise the hurdle: companies must deliver enough growth to justify today's prices. This is particularly relevant for highly valued US technology stocks, where expectations for continued expansion and AI-related profitability are already high.

The case for a continuing rally has not disappeared. The US economy remains robust, earnings have been strong, and investment in AI infrastructure continues at a high level. The question is not whether AI investment is taking place, but whether it will produce durable productivity gains and cash flows that support today's valuations. We will look for earnings growth to broaden



beyond a narrow set of companies and for actual results to validate these investments. If profits remain concentrated or fail to meet expectations, market leadership could be vulnerable even if overall economic growth holds up. Strong earnings provide support, but high valuations leave little margin for error.

Our answer, then, is conditional: higher rates have not derailed the rally so far, but they have made it more vulnerable to setbacks. We are not positioning for an immediate collapse in equities; we remain invested while retaining a slightly defensive stance. In US equities, particularly technology, we hold a moderate underweight, and we remain underweight in high-yield bonds. We continue to overweight government bonds, whose yields are attractive, and maintain a neutral allocation to commodities after our increase at the end of June. This positioning reflects the uneven balance of risks: earnings and the economy offer support, while inflation, higher yields, narrow market breadth and demanding valuations argue for discipline. The next test is whether broader earnings momentum can carry the rally through a more restrictive rate environment.



Financial markets

The ceasefire agreed between the US and Iran in April did not hold. In late summer, military hostilities in the Middle East flared up again, driving energy prices sharply higher – the price of oil (Brent) rose from around USD 70 per barrel at the start of July to over USD 100 per barrel by the end of the quarter.

Against this backdrop, inflation expectations once again came under greater pressure. Both the ECB and the US Federal Reserve responded with rate hikes in September. The yield on ten-year US Treasuries subsequently rose to around 5.3%, the highest level in 19 years.

Despite these headwinds, equity markets proved remarkably resilient: the S&P 500 gained around 2% in the third quarter, supported by expectations for strong earnings growth. Following the broad-based market recovery in the second quarter, market breadth narrowed noticeably again in September, with small-cap stocks underperforming the headline indices.

Gold initially rose to a multi-month high of over USD 4'600 per ounce in August, before falling back below USD 4'200 in September amid rising bond yields.

The US dollar benefited from higher US yields and the Fed's more restrictive stance. The euro, in turn, came under additional pressure from growing concerns about French public finances, which drove the risk premium on French government bonds to its highest level since the euro crisis.

Central Banks

During the third quarter, global monetary policymakers turned more hawkish, as the renewed escalation of the Middle East conflict drove energy prices higher and reignited inflation concerns across major economies. Central banks that had largely held steady over the summer shifted toward renewed vigilance.

The Fed left rates unchanged in July but raised its target range by 25 basis points to 3.75–4.00% in September — its first hike in three years — citing inflation that has remained above target for over five years, a resilient labour market, and the renewed energy shock from the Middle East conflict. Chair Kevin Warsh struck a hawkish tone, and markets now price in further tightening into 2027.

The ECB paused in July before resuming its tightening cycle on 10 September with a further 25-basis-point hike, lifting the deposit rate to 2.50% — its second increase this year — citing persistent Middle East-driven inflation pressures and raising its 2027-28 inflation forecasts.

The Bank of Japan raised its policy rate by 25 basis points to around 1.25% — its highest level in 31 years — as inflation moved closer to target amid continued wage-to-price pass-through.

By contrast, the Bank of England held its Bank Rate at 3.75% for a sixth consecutive meeting, with three members of its Monetary Policy Committee (MPC) again voting to hike to 4%, as UK inflation rose to 3.1% on higher fuel prices and is expected to climb further toward 4% by early 2027.

The SNB likewise left its rate unchanged at 0%, reiterating its willingness to intervene in FX markets, as Swiss inflation remains low by international standards.

Overall, the quarter reflected a broader shift in central bank sentiment, as policymakers grew increasingly wary of letting an energy-driven inflation shock become entrenched. This more vigilant posture suggests that interest rates are likely to stay higher for longer should price pressures persist.

Private Markets

According to Carlyle AlpInvest's latest Global Private Markets Quarterly, private markets remained broadly resilient in the second quarter despite elevated geopolitical volatility and a renewed energy price spike from the Middle East conflict.

Buyout activity continued to rotate from asset-light businesses toward tangible assets and infrastructure: utilities and energy accounted for roughly a quarter of global buyout volume in the first half (USD 63.4 billion), while machinery deals rose to 10% of activity, up from just 2% in 2025, driven by investment in power generation, grid upgrades and AI infrastructure.

AI continued to dominate venture capital, capturing 86% of global VC capital deployed in H1, with valuations surpassing 2021 highs across every funding series.

Global M&A activity reached USD 1.8 trillion in Q2 2026, up 66% year-on-year. Separately, SpaceX raised USD 86 billion in its June IPO at a USD 1.8 trillion valuation. In Q2, it also completed a USD 60 billion stock acquisition of Cursor.

US buyout activity pulled back sharply in Q2 (-45% quarter-on-quarter) as managers digested higher energy prices and faded Fed rate-cut hopes, while Europe picked up the slack, with volumes up 51% to exceed the US.

Carlyle reports more than USD 2.1 trillion in Q2 private-market exit value, with 80% attributed to the SpaceX IPO. By contrast, buyout exits fell by more than 20%. Secondary markets remain an important liquidity source, though secondary-market fundraising cooled sharply after a record 2025.

Private credit sent a mixed signal. US direct lending deal volumes fell sharply in Q2 (-56% quarter-on-quarter) as the US buyout slowdown reduced deal flow, while default rates continued to improve. The US leveraged-loan trailing twelve-month default rate, including distressed exchanges, fell to 2.8% in June from 4.5% a year earlier. Software-related credit concerns persisted, with secondary bids on software loans slipping to around 86 cents on the dollar. Despite this, broader credit markets stayed open and functioning well, with private debt fundraising rebounding to a record USD 101 billion in Q2, led by an all-time high USD 72 billion in direct lending commitments. Overall, private market fundamentals remain sound, even as activity grows increasingly concentrated in a smaller number of very large deals and sponsors.

Outlook

The US economy remains robust, supported by high levels of investment in the expansion of AI infrastructure as well as an expansionary fiscal policy. At the same time, the geopolitical situation in the Middle East remains tense, and a swift normalisation of energy prices currently appears unlikely. We interpret the Fed's rate hike in September as reinforcing the Fed's commitment to its 2% inflation target. We therefore expect a continued restrictive stance and the possibility of further rate hikes.

Against this backdrop, we maintain our slightly defensive portfolio positioning. We continue to view the high valuations in the US equity market, particularly in the technology sector, as well as the question of whether the extensive AI investments can be converted into sustainable corporate earnings going forward, with scepticism.

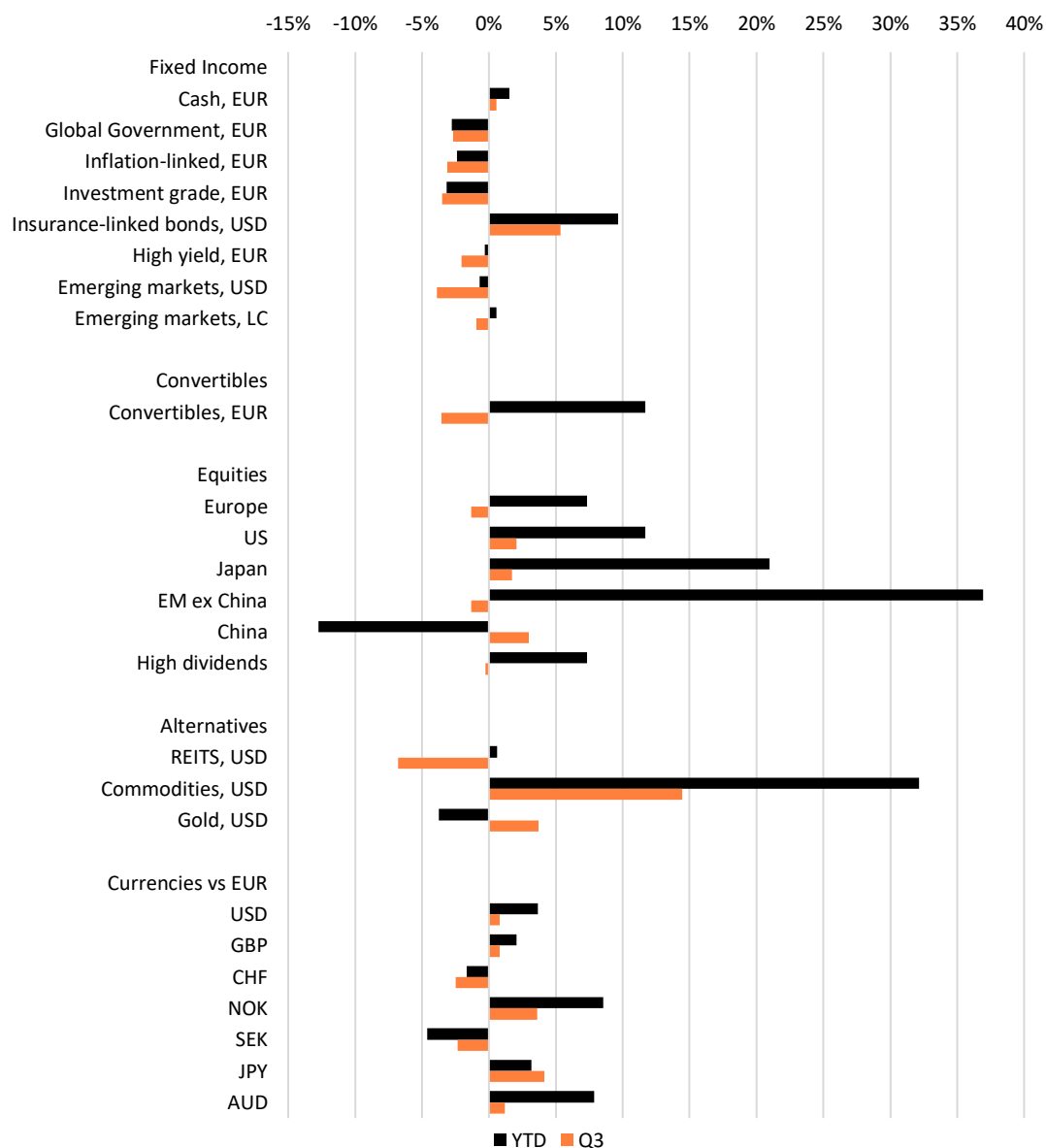
ASSET ALLOCATION

In the third quarter, bond yields rose due to strong nominal economic growth, persistent inflation, concerns about high debt levels — especially in France and the US — and central bank rate hikes. This also weighed on stock market performance, resulting in an uneven development across regions and sectors: all markets delivered noticeably weaker returns than in the previous quarter, with some — REITs, Europe, and Emerging Markets ex-China — even posting negative performances.

Convertible bonds corrected as a result as well.

Commodities remained strong performers, driven especially by higher energy and agricultural prices.

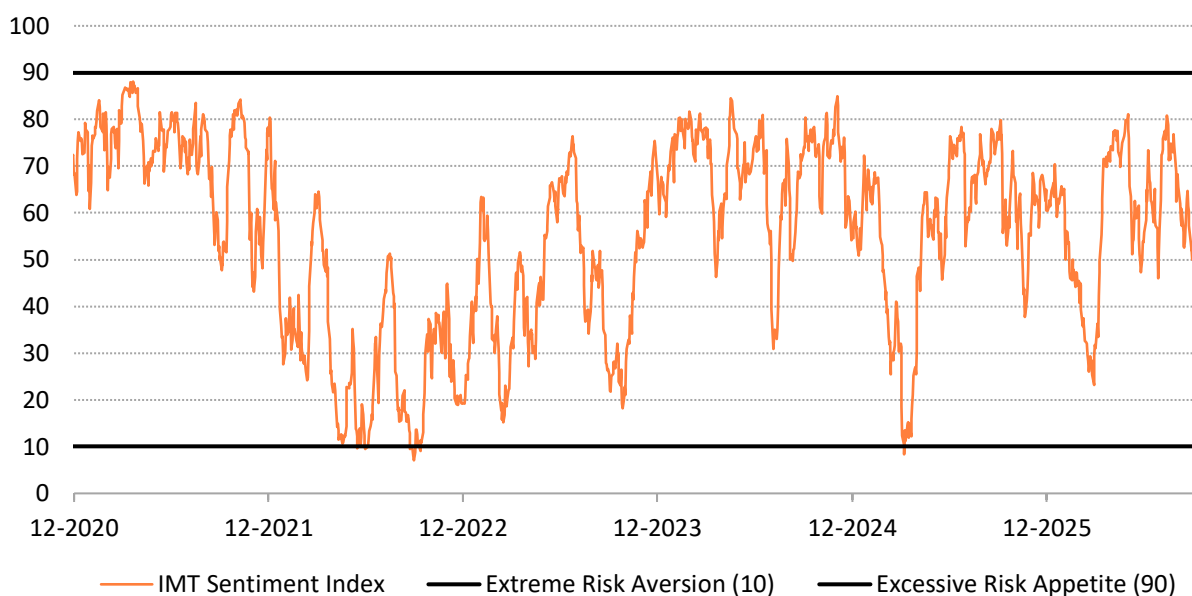
Gold, meanwhile, staged a modest recovery after the sell-off that began in late February. Despite the late-quarter pullback, gold rose 3.7% over the full third quarter.



IMT SENTIMENT INDEX

Having stood slightly above its long-term average last quarter, the IMT Sentiment Index fell sharply this quarter to around 40 — signalling a marked deterioration in risk appetite compared to the previous quarter, though it remains above the extreme-pessimism threshold of 10.

This decline was driven by broad-based weakness across sub-indices — several of which are inversely scaled, so that rising stress or hedging demand shows up as a falling sub-index value: credit stress rose sharply as high-yield spreads widened, the put-call ratio rose on higher hedging demand, equity market momentum weakened, and market breadth declined sharply.

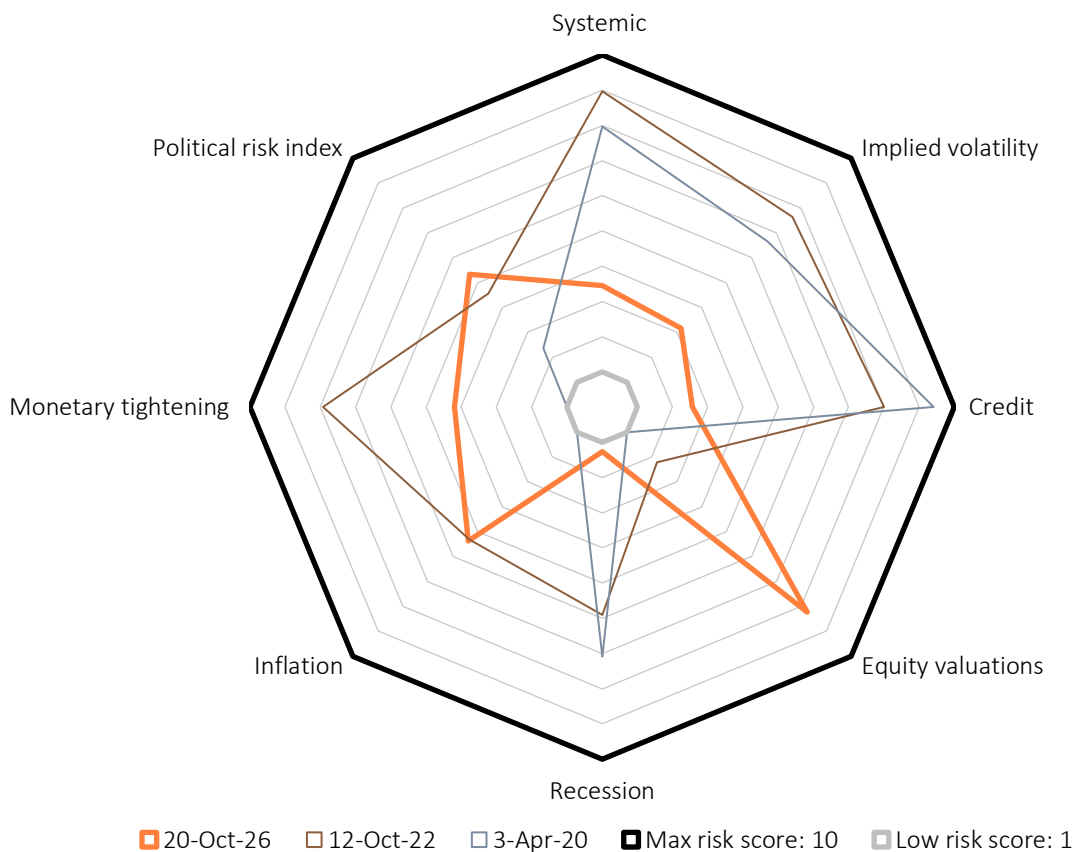


IMT RISK MONITOR

Having pointed to a largely benign backdrop last quarter, our risk monitor now signals a worsening risk landscape.

Political risk has risen, driven by the re-escalation of military conflict in the Middle East, which also raises the risk of renewed inflationary pressure. As a result, the likelihood of further central bank rate hikes has increased somewhat, pushing up monetary tightening risk. Systemic risk in the financial and banking sector has edged up as well, reflecting somewhat greater concerns

about stability within this sector. Credit spreads, which had remained near historically tight levels, have widened moderately, pointing to slightly rising investor concern about default risk. Equity valuations, meanwhile, remain elevated by historical standards, leaving markets somewhat vulnerable to further repricing should these risks persist.



3-Apr-2020: Global pandemic

12-Oct-2022: Inflation shock

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