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Investment Management

Window on the World

OCTOBER 2026



Bond markets set the tone for capital markets in September, with central banks in developed markets confirming the likely start of a new interest-rate-hiking cycle.

The U.S. Federal Reserve raised interest rates for the first time since 2023, and both the European Central Bank and the Bank of Japan followed with hikes of their own. Here in the U.K., the Bank of England held steady, although three of the nine policymakers voted for a hike. As a result, long-dated Government borrowing costs saw one of their sharpest rises in recent years. In this month's publication, we assess the impact on global markets and financial conditions, building on last month's discussion.

Capital market review September 2026

	Total Return (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	-2.0	1.8	17.0	9.5
US Equities	-0.3	2.3	15.7	12.7
European Equities	-2.2	-0.6	16.7	11.0
Japanese Equities	-0.3	3.8	33.9	23.1
Emerging Market Equities	-0.7	-0.4	29.4	23.5
UK Gilts	-1.3	-2.8	0.3	-2.8
UK Corporate Bonds	-1.3	-2.1	1.4	-1.2
UK High Yield Bonds	-1.6	-2.1	2.3	1.1
US Corporate Bonds	-2.6	-3.7	-2.0	-2.8
US High Yield Bonds	-2.5	-1.8	1.4	0.0

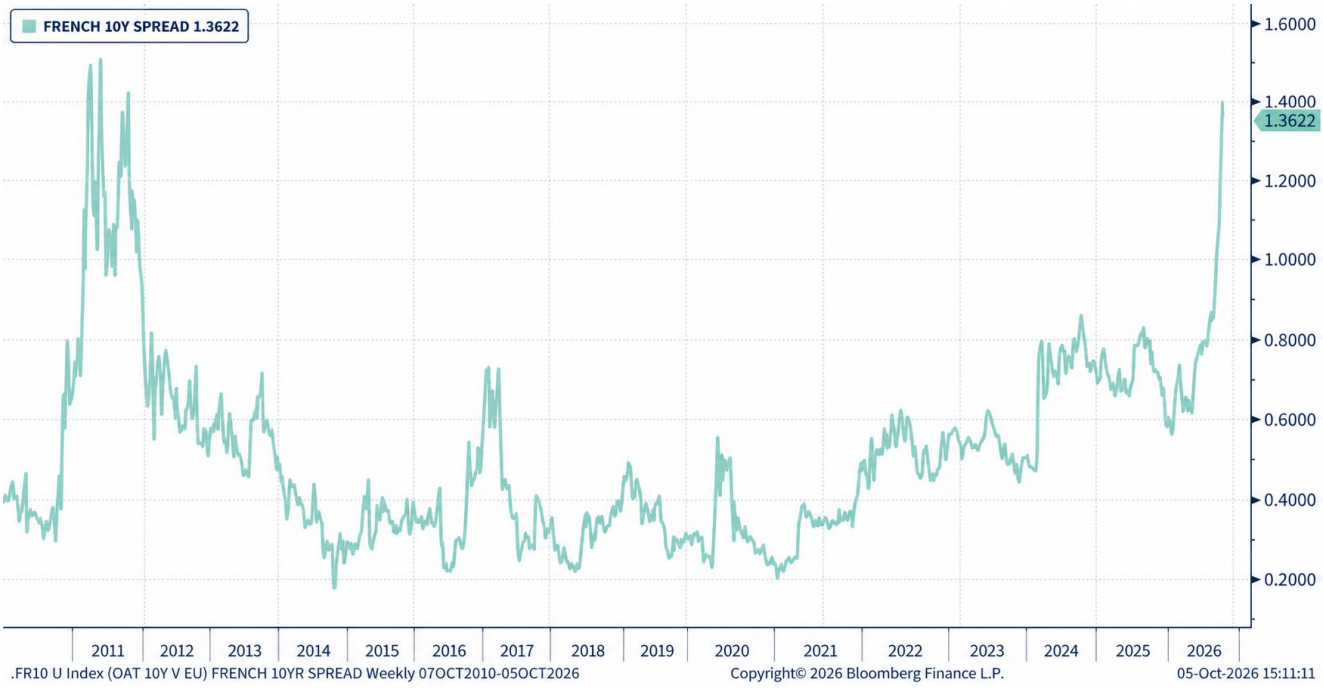
Source: Bloomberg, Verso Investment Management, as of end September. Returns in local currency
Past performance is not a reliable indicator of future results.

While some summer headlines focused on all-time highs in certain equity indices, investors have also had to contend with a relentless rise in long-dated bond yields. This is a global phenomenon across developed markets, with bond yields on longer-maturity Government securities reaching multi-decade highs. Here in the U.K., over the third quarter the yield on the 10-year U.K. Government bond rose from 4.75% to 5.42%. It therefore remained a challenging period for fixed-income investments, with gilts in aggregate delivering a negative return of 1.3% in September.

Several factors drove this move in yields during the month. One was rising oil prices, with the conflict between the U.S. and Iran unresolved and shipping through the Strait of Hormuz still disrupted. The price of a barrel of Brent Crude pushed through $100 during the month, peaking at $107 and returning to levels last seen in May. This has heightened concerns about sticky inflation, with bond investors responding by demanding a higher return to lend. This weighed not just on Government bonds but also on credit markets, which delivered negative returns for the month. U.S. high yield had a particularly poor month, suffering one of its heaviest setbacks since 2022.



THE PREMIUM (OR ADDITIONAL RETURN) YOU EARN ON A 10-YEAR FRENCH GOVERNMENT BOND VERSUS ITS GERMAN NEIGHBOUR IS 1.35%, A LEVEL LAST SEEN DURING THE EUROPEAN FINANCIAL CRISIS



Source: Bloomberg, as of 5 October 2026

The turbulence in fixed-income markets weighed on equity markets, which ended the month modestly lower. U.K. and European equity markets declined by 2%, with the greatest pressure felt in areas sensitive to higher interest rates, such as smaller companies, cyclicals, and real estate. Large-cap technology stocks were the standout performers, with the Nasdaq closing the month approximately 1.9% higher on a total-return basis.

Stepping back from the near term, equity market returns over 12 months have been strong across the board, while fixed-income investors have found the going more difficult.

Are tighter financial conditions driving a narrower market?

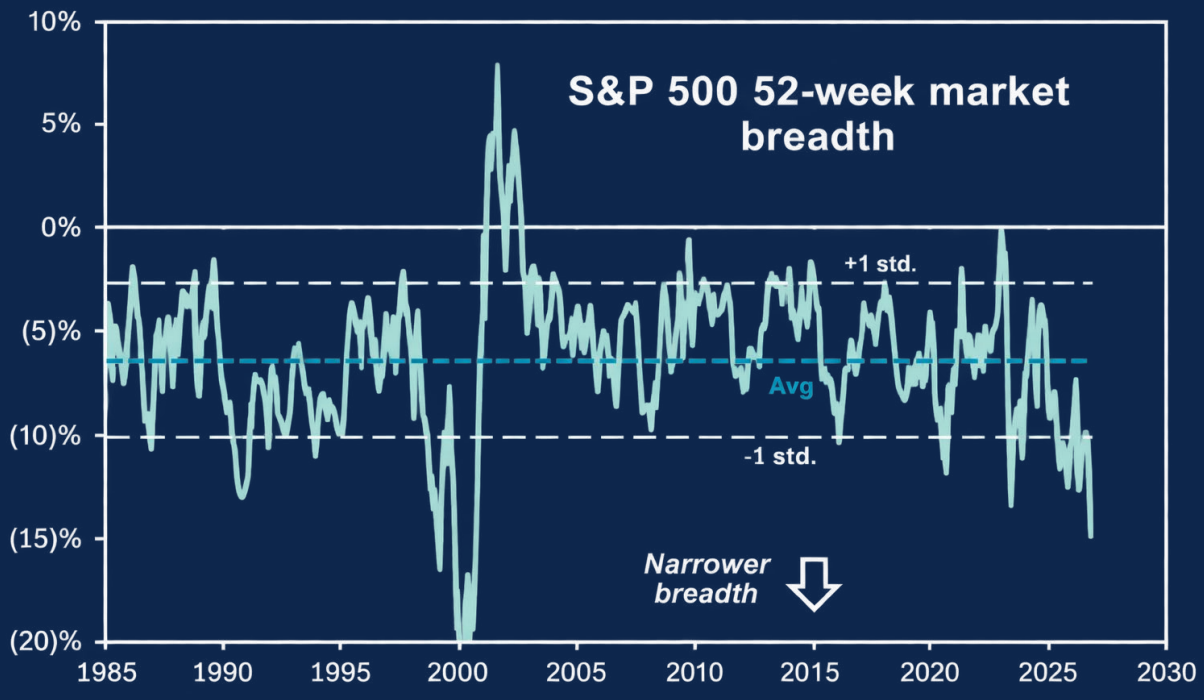
Time will tell if the recent move by central banks is the start of a series of rate hikes, or a case of “one and done”. The move in bond yields suggests the market has already made up its mind, particularly in the U.S., where the two-year Government bond yield, at a peak of 4.9%, was already a full percentage point above the base rate. In addition, futures markets were pointing to three more hikes from the Federal Reserve by mid-2027.

These moves in bond markets are already tightening financial conditions (how easy or expensive it is for households and businesses to borrow, spend, and invest). Borrowing costs for companies have risen, and mortgage costs for new homeowners have also risen dramatically in recent months. While these higher rates have yet to filter through to economic activity, there are signs that markets are beginning to price in their impact.



One way of assessing that is by looking at market breadth, or more specifically, which sectors or companies have been supporting markets at these levels. On some measures, market breadth has collapsed to levels last seen during the TMT bubble from 1999 to 2001. A closer look at the U.S. equity market, in particular, shows that the average stock is about 15 to 20% below its 12-month high, while U.S. technology stocks remain at all-time highs. As such, the broadening out of returns seen earlier in the year has unwound somewhat.

MARKET BREADTH WEAKENED OVER THE SUMMER AND IS AT MULTI-YEAR LOWS



Source: Goldman Sachs, as of 27 September 2026

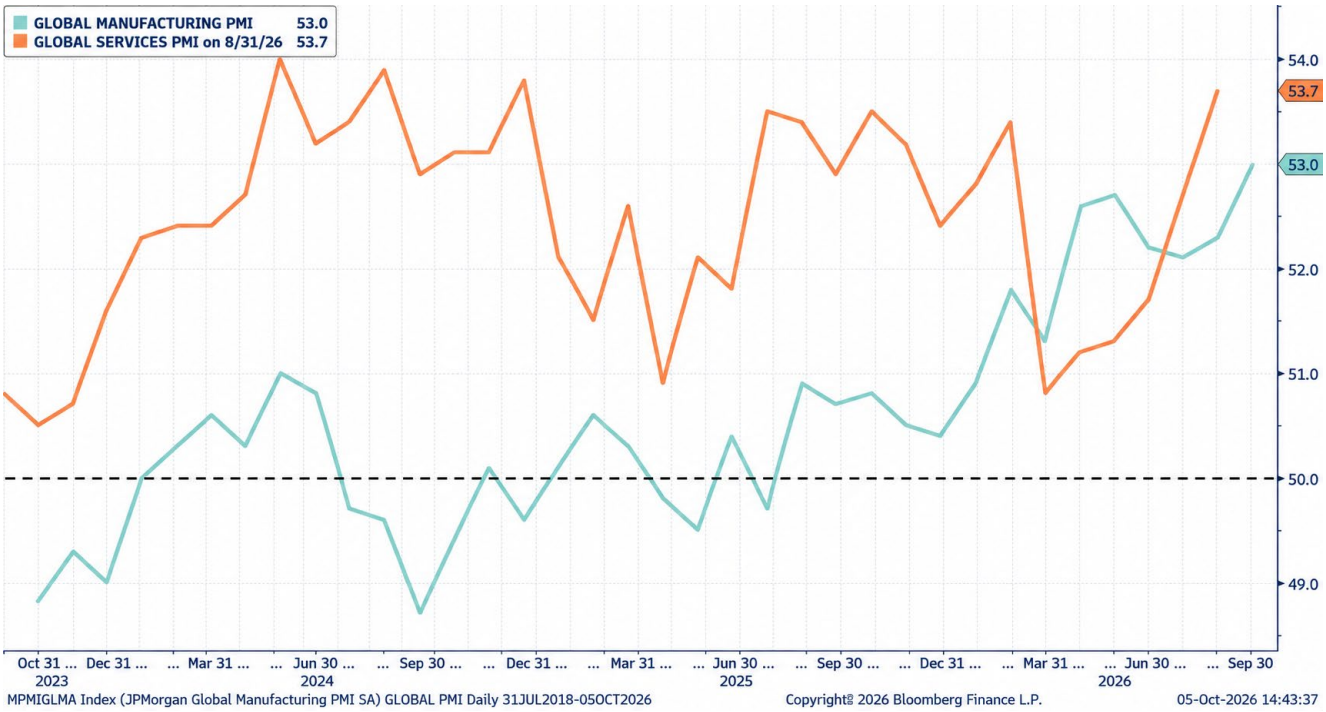
Higher rates can generate this dispersion in returns, and pockets of weakness in certain sectors, because tighter conditions do not hit every company equally. Many large-cap technology firms are cash-rich, with strong balance sheets and rapid profit growth, and can weather higher rates. The same is not true for smaller companies and other sectors, such as financials and property companies. Those areas most sensitive to higher interest costs and credit availability are suffering the most, and share prices have moved to reflect that higher risk.

Despite the rise in interest rates, global economic conditions have held up well. In the U.S., where nominal GDP growth has been very strong, growth was revised up to 2.2% in the second quarter of 2026, and labour market conditions remain broadly supportive. Globally, both manufacturing and service industry surveys have been trending higher, indicating that the outlook for economic activity also remains constructive. That should support corporate earnings, whose growth has exceeded expectations this year and has been a key underpinning of equities' strong performance over the past 12 months.

Nevertheless, higher interest rates typically affect economic activity with a lag, and pressure is likely to show up first in areas such as housing, hiring at small firms, and capital investment outside of technology and AI. Companies with high levels of debt that need refinancing at these higher levels may also feel the pinch. We will watch credit markets and the tightness of credit spreads, along with corporate earnings outside the technology space.



THE OUTLOOK FOR GLOBAL ACTIVITY REMAINS CONSTRUCTIVE, WITH MANUFACTURING AND SERVICES SURVEYS POINTING TOWARDS FURTHER EXPANSION.



Source: Bloomberg, as of 5 October 2026

Portfolio positioning

September reminded us that markets rarely move in straight lines. Tighter financial conditions, an unresolved conflict in the Middle East, and a U.K. budget on the horizon mean that higher volatility cannot be ruled out. That said, the underlying macro picture still looks bright, with economic activity resilient and robust, and the outlook for corporate earnings positive. Equity market valuations do not look overly stretched, and fixed-income investments are offering their best return profiles since the global financial crisis. Patience and diversification continue to underpin our approach to building resilient and robust portfolios.

Within equities, we maintain a preference for emerging market and European equities, funded by a reduced allocation to U.S. equities. In both regions, valuations and the outlook for corporate earnings remain attractive, while a reduced U.S. allocation recognises the high level of concentration in that market and keeps us positioned for a broadening out of equity returns. Within fixed income, we are predominantly invested in short-dated Government and investment-grade credit, avoiding the worst of the sell-off in longer-dated issues.



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Chief Investment Officer



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