RATHBONES
ASSET MANAGEMENT

Rathbone SICAV Multi-Asset Portfolios

Rathbone SICAV Strategic Growth Portfolio

Quarterly investment update July to end September 2026

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Hot topics

Markets hot topics (Macroeconomic)

This information reflects our general views and should not be taken as a recommendation or advice as to how a specific market is likely to perform.

The Budget: new Chancellor, same tightrope

Years of simmering fiscal malaise has boiled down the most important day of the year for UK governments to one summarising measure: the 'fiscal headroom'. That's the government's expected surplus after day-to-day spending by 2029/30. One of the government's fiscal rules is that this must be in surplus by then. The other is that public debt as a share of GDP must be falling by that point as well, but it's the day-to-day spending that seems to get most of the attention from pundits and economists.

This reduction to a single number is disappointing, but also illuminating about the central problem of the UK: a lack of imagination and courage to make bold reforms. Most of the problems are well known by anyone: a tax regime that looks like an Escher print, a nightmare scape of ups and downs that delivers wildly different outcomes based on form or family situation, rather than substance or effort. A welfare and social care system that manages to be both extortionately expensive and ineffective. A lack of homes and infrastructure, and an almost complete inability to build what's required at a reasonable cost. The list goes on. The fiscal rules are essentially a straitjacket that – depending on how you lean politically – either gives the government an excuse to stagger on with the status quo or prevents them from doing something truly effective.

We have a new Chancellor following John Healey's appointment by new Prime Minister Andy Burnham. Yet we (sadly) expect little else to change. In March, the Office for Budget Responsibility reckoned the Government had £23.6 billion of fiscal headroom. Since that forecast, Israel and the US attacked Iran, sparking a tit-for-tat conflict that has severely curtailed the flow of oil, gas and fertiliser through the Strait of Hormuz. This lingering conflict has helped change the likely path of interest rates from downward to upward. UK 10-year government bond yields have risen a full percentage point since then, to 5.5%. This means the government must pay that much more to roll over maturing debt and to borrow more. In early October, accounting firm EY estimated that the headroom has shrunk to about £11.3bn, or roughly 1% of all tax receipts, so razor-thin. But that's predicated on the Strait of Hormuz reopening essentially immediately. If it stays shut into next year, EY thinks the cushion could swing to a deficit of around £7bn.

The Bank of England has stepped in, or at least eased off. It announced a multi-year plan to run down the remaining £488bn of gilts it bought under quantitative easing. It had been selling billions of pounds of bonds to market buyers each fortnight, pushing prices lower and yields higher. The BoE is now cutting these sales by about 40%, and it has stopped selling 30-year gilts entirely. Long-dated gilts rallied hard on the news, but have

since given up the gains. The move helps, but doesn't solve the problem. It lowers one source of supply in a market that still has to absorb heavy new government borrowing. Yet another huge cost for the government remains: when the BoE bought up all those bonds during QE, it created money to do so. That cash – 'reserves', effectively commercial bank deposits held at the BoE – still exists, and will continue to do so until the gilts are sold or mature and the BoE can destroy it. Until then, like all deposits, these reserves attract interest (at the BoE's Bank Rate). At the current 3.75%, the cost of £488bn of reserves is about £18bn a year. That's much lower than a couple of years ago when reserves were much larger and the interest rate was above 5%, but it's still a big drain on the public purse.

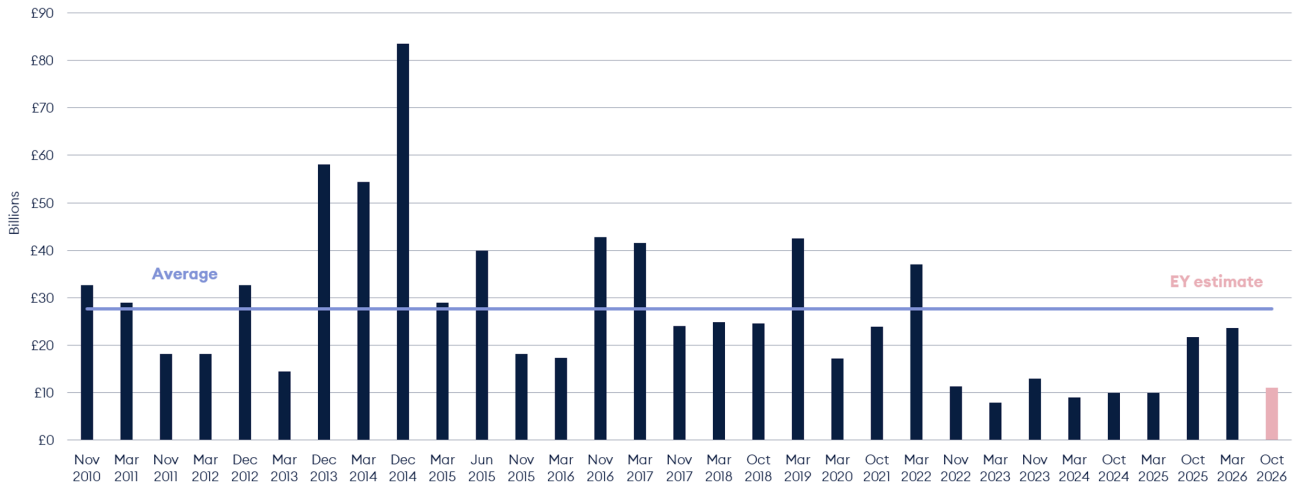
So what's on the menu at the Bistrot Déjà Vu? EY estimates that manifesto pledges ring-fence about 70% of tax revenue. That leaves wealth taxes, capital gains tax and levies on particular sectors among the realistic options. Expect plenty of fiddling at the margins and a lot of talk about 'growth', which, to be fair, is the only lasting way out of this. Yet, as we've said, this won't happen unless serious reforms are made to incentivise people to strive and companies to invest.

1998

the last time 30-year UK government bond yields were above 6%, which was hit in early October.

For our portfolios, we don't expect the Budget to change the big picture. We aren't trying to guess tax policy. What matters to us is how gilt investors take the Budget. A credible plan for the medium term should help long gilt yields settle further. A plan that relies on optimistic forecasts would be punished. We are cautious on long-dated gilts and prefer generally shorter maturities, where yields are attractive and there's less risk of big price swings if sentiment turns.

UK's fiscal headroom expected to slump after rise in yields, squeezing the Chancellor's options at the Budget



Source: OBR; headroom is the government's expected surplus after day-to-day spending by 2029/30; past headrooms standardised against forecast GDP at the time and then calculated as if the economy was the size expected at the end of 2029-30; latest forecast unofficial estimate by accounting firm EY

Bonds are pricing problems that may not last

The UK isn't the only country whose bonds have been hit hard. Government bond markets haven't had a quarter like this for a long time. Government borrowing costs blew out in most countries, most significantly in the US, UK and France. Long-term 30-year bonds were the worst hit (see chart).

The trigger was renewed fighting in the Persian Gulf. Brent crude hovered near $109 a barrel in mid-September, and US diesel hit a record $6.31 a gallon. In September the US Federal Reserve (Fed) raised rates for the first time since July 2023, to 3.75-4.00%, and its officials pencilled in one more hike this year. The ECB has hiked too. The Bank of England has held so far, but its rate-setters are openly talking about hiking if inflation keeps building. A year ago everyone was asking how fast rates would fall. Now they're asking how far they'll rise.

We think markets have got ahead of themselves for three reasons.

First, politics. The US administration has every reason to bring this conflict to an end and get oil back to a sensible price. Petrol prices weigh on voters in the run-up to an election, and most US voters blame the war for higher fuel costs. When the White House has that much riding on cheaper oil, betting on permanently high oil prices looks like a poor wager. The upcoming mid-term elections could catalyse a change in the President's strategy, especially if the Republicans do very poorly indeed. In fact, it already has. In early October the President made a deal to buy Russian diesel. Considering that undermines years of bipartisan foreign policy aimed at punishing the country for its war in Ukraine, it shows the lengths Trump is willing to go to ameliorate the effects of higher energy costs.

$6.31 per gallon

the record average price for US diesel at the pump (that's $1.67/litre – we know, what are they complaining about!)

Second, higher prices attract more production. Countries that can get oil to market are racing to make as much money as possible while the profits are good. Those whose usual trade routes are gummed up by the conflict are finding different ways to move their produce, often through new oil pipelines.

30-year bonds caught the worst of a bad quarter for government debt

Source: FactSet; 1 January 2006 to 1 October 2026

Third, the squeeze does the job by itself. Expensive energy and higher borrowing costs act like a tax on households. Each extra dollar spent on fuel or mortgage payments is a dollar not spent elsewhere. US inflation is already running ahead of wage growth, and the Fed's hike has pushed up credit card rates. In a sense, an oil shock does part of the job for the central bank, even as it prepares to raise rates to tamp down any consequent inflation. Raise rates aggressively on top of that and you risk tightening twice.

We expect fewer hikes than markets currently price. If we're right, today's yields are a chance to lock in income, rather than a warning to stay away. We've been gradually adding duration, focusing on US Treasuries and short-to-medium-dated gilts, where we think investors are being paid well to take the risk. We're more wary of France, where the problem is as much political as inflationary. A ceasefire won't fix that.

We could be wrong, of course. A long closure of Hormuz would push inflation higher and keep it there (economic activity is effectively energy converted). That's why we hold assets that do well in that scenario, including oil majors and inflation-linked bonds as insurance.

Americans hate AI, but do they love the economy it's driving?

On 3 November, Americans vote on all 435 seats in the House of Representatives and 35 of the 100 Senate seats. Democrats are favourites to win the House, while control of the Senate is close to a coin toss. CBS polling suggests the Democrats' edge comes from unhappiness with prices and from Republican voters who are less likely to turn out (again, because of unhappiness with the path of prices). Ask an American how the economy's doing and, these days, they'll tell you what groceries cost.

The likeliest result is divided government. That will mean plenty of colourful headlines. For investors, it usually means gridlock, and markets have tended to cope well with gridlock. Much of the administration's agenda already runs through executive action, and a Democratic House can make life awkward without reversing it. We don't expect the election to change the US economic or political direction much.

Company and economic fundamentals matter more, and they look good. In the second quarter, 78% of S&P 500 companies beat their earnings forecasts, and profits rose 53% from a year earlier. Some of that came from one-off investment gains at the big tech firms, but the underlying results were still strong. Revenue growth sped up to almost 13%. Consumers grumble, but they're still spending. Core US retail sales rose 1.2% in August and 5.6% from a year earlier, and employers added about 162,000 jobs. People don't spend like that if a recession is in the offing.

What's driving this is one of the oddities of our time: the US economy is leaning heavily on a technology most Americans don't much like. ING estimates AI-related investment accounts for about a third of US growth this year. Yet 39% of Americans tell Gallup pollsters that AI does more harm than good, and only 9% say the opposite. More now think AI will slow economic growth than speed it up. Most think it's moving too fast and want safety and independent oversight put ahead of speed. Americans are using AI more than ever while trusting it no more than before.

The US economy is a great paradox at the moment. Americans usually feel happy and optimistic when GDP is doing well: "It's the economy, stupid," remember? Yet, with growth holding up well and unemployment low, they are miserable and restive. Prices are the problem, according to US punters: 'inflation' has been far and away the nation's top problem highlighted by voters for four

years in a row (see chart). And this at a time when inflation – while noticeably higher than target – hasn't been terribly high. In fact, complaints about inflation got worse even as inflation improved.

The question becomes: how much of this angst over inflation is down to vibes? And how much is a legitimate grievance, as experienced by Americans, yet unrecorded by stats agencies that still rely on armies of shelf checkers and telephone surveys? As AI-fuelled algorithms personalise everything from Instagram feeds to the music we hear and the news we see, are they also personalising the prices people pay?

Consumer watchdogs in the US report growing use of 'surveillance pricing' since 2021 (helped by the rapid progress of AI models) – both online and in stores, that pushes up the actual prices Americans are paying in the real world. Some companies are using personal data and shopping histories to sell the same products to different people at different prices – even at the same stores on the same day. It only takes someone noticing this once before they see the potential for it everywhere and become suspicious that they are always being ripped off, even if they aren't.

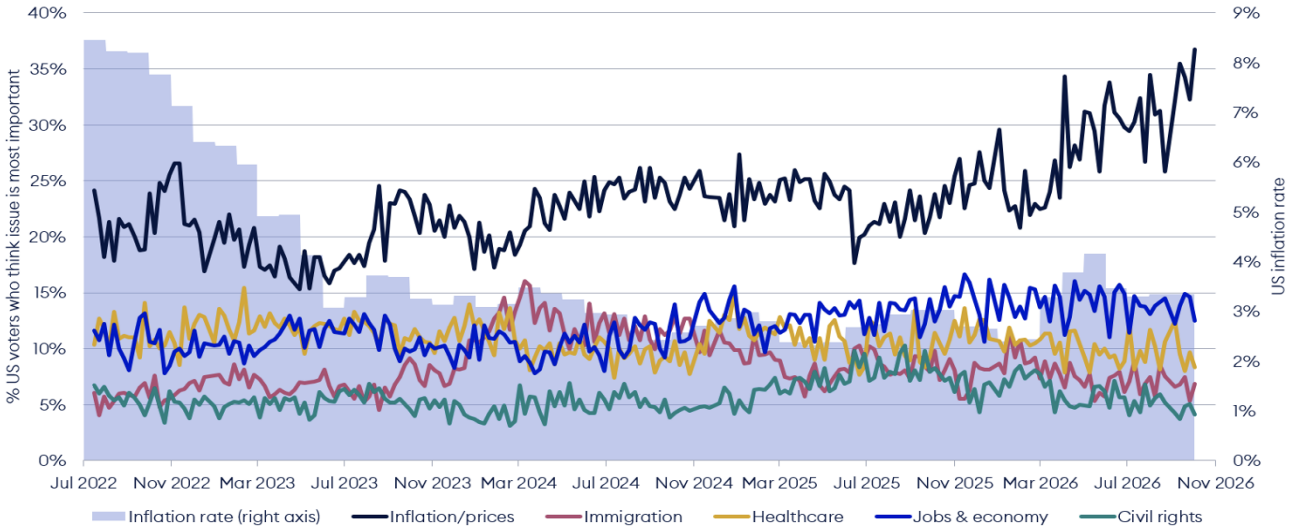
53%

US Q2 earnings soared on the same quarter a year earlier

Putting that together, it starts to make sense why Americans might say that they think inflation is actually much higher than the CPI stats say. And why they distrust the data showing the economy doing well: they may feel like it's extraction from their pocket, rather than genuinely positive.

All of this also reinforces the public feeling that AI is very powerful, but not really being used in their interest. Of course, it's impossible to know where the truth lies. But this gap between the public sentiment and the economic data (growth, profitability and inflation) is worth watching. Public unease can turn into regulation, and the midterms could amplify it. For now though, household spending continues, and our AI exposure sits mainly with the 'picks and shovels' suppliers: chips, networking and power infrastructure. We think they're paid for building the infrastructure, whatever voters end up thinking of it.

Rising prices is consistently the most important issue for US voters — even as inflation has fallen from its peak to relatively benign levels



Source: FactSet, Economist/YouGov Poll of registered US voters asking 'Which of these is the most important to you?'; latest poll consisted 1,381 respondents between 2 and 5 October 2026; inflation is CPI annual change; data 1 July 2022 to 30 September 2026

Portfolio activity

Key purchases/additions	Key sales/trims
US Treasury Inflation-Linked 0.125% 07/15/2031 (purchase)	UK Gilt 0.375% 10/22/2030 (sale)
Intel (purchase)	Legal & General (sale)
Applied Materials (purchase)	Aptiv (sale)
ING Groep (purchase)	Sony (sale)
ARM Holdings (addition)	Novonesis (sale)

Source: Rathbones

As bond yields rose we saw more value further in bonds that mature further into the future. We slightly extended our 'duration' (the sensitivity of a bond's value to changes in interest rates) by selling the UK Government 0.375% 2030 and replacing it with the 1% 2032. The new bond has a slightly higher yield and noticeably higher sensitivity to changes in interest rates.

US government inflation-linked bonds became very good value as well. With inflation expectations and yields jumping higher, we managed to buy US Treasury Inflation-Protected Securities (TIPS) 0.125% 2031 at attractive real yields (after adjusting for inflation). If inflation goes significantly higher – say if they are driven by continuing unrest in the Middle East – these bonds should help protect us.

There's incredible demand for chip makers in general, where bottlenecks are significant and very difficult to fix in the short term. With limited capacity coming on line, these shortages are likely to last until the end of the decade, helping to turbocharge earnings for the sector. We bought American CPU manufacturer Intel and chip-making equipment manufacturer Applied Materials as their prices fell back. We also added to chip factory TSMC, data centre connection specialist Arista Networks, and ARM Holdings, whose technology is critical for most mobile and power-efficient chips. Semiconductor manufacturing is an infamously cyclical industry. In the past, it tended to go through bouts of constrained capacity followed by overeager expansion. This remains a risk; however, we think today's market dynamics create strong tailwinds that should continue for some time yet.

We sold UK life insurer L&G in early August after its valuation rose markedly. We like the business, but we felt its value had risen too high for the risks that it carries. The business is making money from higher bond yields because it can expect higher returns for the premiums that it can invest. And there are plenty of opportunities for it to grow by picking up pension transfers from companies looking to offload them. However, there's plenty of competition for this business, and it seems to be growing fast. We felt it was best to sell and reinvest in other areas.

Another sale was Aptiv, which supplies electric cars with the software programs, hardware and sensors needed for their digital safety systems, and electrified tools. While the auto sector has been challenged for many years, Aptiv has been able to grow regardless because it sells tools that increase safety and electrical content within cars – a growth area. However, now even this part of the market is facing increasing competition from Chinese rivals. We question whether its revenue can sustainably outgrow vehicle production, so sold the stock.

We also sold Japanese electronics and media company Sony. Rising prices for memory and other computer components, pushed higher by the insatiable AI build-out, mean its physical products will be going up in price. This is a tough position. Either Sony will have to eat some of the price increases itself to stay competitive, decreasing its profitability, or it will pass on very chunky price hikes that will almost certainly weigh on sales. Added to this, Sony has some unexpected concentration risk in its business customer base that could intensify the harm from any drop in end demand for gadgets: it supplies camera sensors for all iPhones. Losing that business would make a dent in its overall earnings. And iPhone prices have already been hiked dramatically. We thought, given the clouds gathering over consumer hardware, it was best to sell and move on.

We used this cash to buy Dutch lender ING Groep, which is performing well. It's one of the cheaper globally operating banks, yet we think that unfairly represents the quality of its business. As a bank, it's generally pretty closely tied to underlying economic growth and interest rate dynamics. While it has a presence all around the world, about 85% of its business is based in Europe. The Continent isn't renowned for being an economic powerhouse, but its GDP expansion has been generally ok overall, and some individual nations are growing very well indeed. And with rates higher than they've been in years, we think ING should be able to keep earning a decent spread between what it pays to finance itself and how much it lends to customers. It also offers us diversification from the overwhelming American and AI theme that is currently driving all before.

Spotlight

In this quarter, the spotlight is on our ASML and Ecolab holdings.

ASML

- The blue-chip player globally in the manufacturing of the equipment required to make chips found in a wide range of products including computers, smartphones and medical equipment
- ASML possess significant technological expertise and the deep pockets required to drive innovation to enable microchips to be smaller, cheaper, and more powerful and energy-efficient – this expertise and financial strength drives out competitors
- The design of their products extracts the maximum value from the materials they use, increasingly important in today's supply-constrained environment
- Structural shifts to artificial intelligence and generally more technology-enabled products should lead to a significant expansion of opportunities for ASML through chip-hungry areas such as industrials, and data centres

Ecolab

- Ecolab's strategy is focused across the four areas of water, food, health and climate all of which are supported by long term macroeconomic and consumer trends
- Ecolab's products reduce labour costs and increase overall productivity for customers which brings customer stickiness
- By providing a high-quality service, scientific expertise and data-driven insights they have created a huge competitive advantage leading to strong pricing power and recurring revenues from loyal customers
- A conservative balance sheet has enabled it to acquire businesses in high growth areas such as data centres

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.
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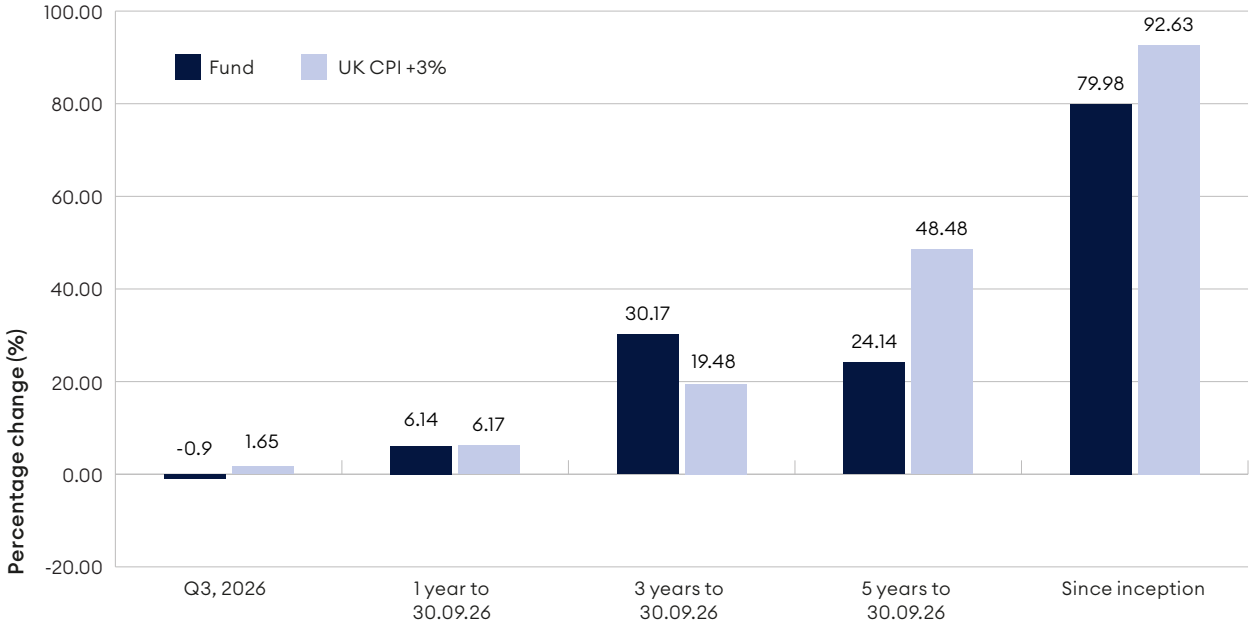
Fund performance

Rathbone SICAV Strategic Growth Portfolio – Quarter 3 2026



Performance (based on 'S-class' shares). Net of expenses and tax. Net reinvested. Data source: FE fundinfo.
*At 14 December 2021, the benchmark measure changed to solely UK CPI +3%.

12-month rolling performance					
Year to:	**End Sep 2026**	**End Sep 2025**	**End Sep 2024**	**End Sep 2023**	**End Sep 2022**
Strategic Growth	+6.14%	+8.33%	+13.21%	+6.35%	-10.33%
UK CPI +3%*	+6.17%	+6.89%	+5.28%	+9.84%	+13.14%
Annual calendar performance					
Calendar year	**2025**	**2024**	**2023**	**2022**	**2021**
Strategic Growth	+11.15%	+6.21%	+8.92%	-9.81%	+12.25%
UK CPI +3%	+6.34%	+5.69%	+7.05%	+13.96%	+8.27%

Price performance based upon bid to bid prior to 21 January 2019 and single price (mid) thereafter.
Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment.
Our benchmarks are calculated on the rate of change of the CPI index, over different time periods (e.g. if we were calculating year to date figures in January 2021, we would look at the percentage change from December 2020 to the end of January 2021). So we take CPI to the current value, and add on 3%, prorated over a year (roughly 0.25% per month). If the CPI Index benchmark were to fall, more than the amount pro-rata, the benchmark year-to-date will be negative, even though inflation as reported by the media (calculated specifically as a 12M rate of change), remains positive.

Fund performance

Top performers		
Holding	**Performance**	**Contribution**
Microsoft	+37.63%	+0.48%
SAP	+37.53%	+0.18%
Thermo Fisher Scientific	+34.62%	+0.26%
Shopify	+29.77%	+0.13%
Chevron	+24.15%	+0.18%

Bottom performers		
Holding	**Performance**	**Contribution**
Rentokil	-29.68%	-0.22%
Aptiv	-25.65%	-0.16%
Caterpillar	-23.79%	-0.19%
CRH PLC	-22.38%	-0.21%
Home Depot	-18.82%	-0.16%

Note: Top and bottom performers are taken from the list of all holdings of 0.25% and above of the portfolio. Performance and contribution data shown above is based on unhedged GBP capital returns.
Source: Rathbones

It was an up-and-down quarter, as a short-lived de-escalation in the Persian Gulf gave way to more tit-for-tat strikes and another spike in the oil price. Higher energy costs put more pressure on households and businesses, even as central banks are squeezing them with higher interest rates to prevent runaway inflation. Meanwhile, the risks and opportunities of extraordinarily large AI investments ('capex') by the hyperscalers and their suppliers keep investors both greedy and fearful in equal measure.

Bond values fell as the US Federal Reserve was forced to raise interest rates in September – its first increase in three years – as the oil shock fed through into inflation expectations, and the US 10-year government bond yield climbed to its highest level since 2007. The UK 10-year government bond yield pushed above 5.4%, even as the Bank of England kept rates on hold. Because bond prices fall as yields rise, our government bonds lost money. The consolation is that the yields on offer from here are higher still: our sterling investment-grade broadly held its value, with high-yield corporate bonds eking out a positive return in the face of higher yields, and our cash added a little as well.

Higher oil prices and the growing acceptance that the US Federal Reserve would increase its benchmark overnight interest rate by a quarter-percentage-point to the 3.75-4.00% band led to a shift in markets. Energy stocks and large-cap software did the heavy lifting, while the companies supplying the physical infrastructure behind artificial intelligence – our standout winners in the second quarter – went into reverse, along with the wider industrial complex.

Energy was a strong contributor as continued disruption in the Middle East pushed Brent crude back above $100 a barrel, peaking above $130 in September, as most of the Gulf production remained shut in and traffic through the Strait of Hormuz ran at a fraction of its normal rate. Our oil majors – Shell, TotalEnergies and Chevron – all rose strongly. Energy had been the biggest drag on our returns in the second quarter, showing how capricious markets are at the moment.

Our technology stocks split neatly into two camps. Software and platform businesses delivered excellent returns. German enterprise software group SAP, office tools developer Microsoft, iPhone maker Apple, Canadian e-commerce platform Shopify, and chip designer Nvidia were among our largest individual contributors. The chip equipment makers were a different story. Investor scepticism about the level of AI capex and just how profitable it will turn out to be drove a partial reversal of Q2's extraordinary strength. This was reinforced by fears about the level of debt building up in the AI ecosystem, and pushback on data centres in the run-up to the US mid-terms. And then some AI leaders publicly called for a slowdown in the development of frontier AI models after a raft of security breaches. The companies that sell the tools to build chips bore the brunt: chip design software provider Cadence Design Systems, and chip-making equipment makers ASML and ASM International fell, as did the iShares MSCI Global Semiconductors ETF we bought earlier in the year. On balance, technology still delivered solid performance.

Our financials delivered for us as well. Derivatives and options marketplace CME Group rebounded strongly, recovering much of the ground it lost last quarter to competition from events-betting platforms. Hong Kong-listed insurer AIA Group, lenders HSBC and ING Groep, and payments networks Visa and Mastercard made gains. US banks fared less well, with investment banks Morgan Stanley and Goldman Sachs, and US regional lender US Bancorp, all down. Healthcare offered a mixed picture. Life sciences names were strong, with lab equipment and systems supplier Thermo Fisher Scientific a standout, and pharmaceuticals business Roche and medical devices designer Abbott Labs also performing well. Joint replacement and robotic surgery specialist Stryker and drug business AstraZeneca were weak. The former suffered from a cyber-attack, while the latter reported disappointing drug trials.

Industrials were a material detractor. Digger maker Caterpillar handed back a meaningful slice of an exceptional run, as investors questioned both its valuation and how long data centre-driven demand for its power equipment will last. Pest control business Rentokil Initial, building materials business CRH and industrial gases business Linde all fell. Consumer-facing holdings were weak too: car parts maker Aptiv, luxury goods house Hermès, home improvement retailer Home Depot and catering services provider Compass Group all detracted, only partly offset by Chinese e-commerce group Alibaba, US beauty retailer Ulta Beauty and Coca Cola. Utilities also sagged – as expected as rapidly rising yields hurt the value of their steady, bond-like cashflows. US energy provider WEC Energy Group, National Grid and German utility E.ON were all affected.

Diversifying assets were mixed. Our systematic strategies tracking US and European interest rate volatility were among the best performers as bond markets repriced sharply. Against this, a structured product tied to US bond rates fell and our equity index put protection (which partially protects our stocks if they fall below a certain level) detracted. The put was a drag because equity markets didn't fall far enough for it to pay out (the best result, really). Our systematic strategies also lost a little.

Asset allocation changes

Asset allocation split	30.06.26	30.09.26		% Change		12 month change
Liquid assets (10%-50%)	19.8%	21.3%	^	1.6%	^	3.1%
Equity-type risk (20%-60%)	69.8%	67.7%	v	-2.1%	v	-4.5%
Diversifiers (0%-50%)	10.4%	10.9%	^	0.5%	^	1.4%

For more information on our liquidity, equity-type risk and diversifiers (LED) risk framework, please consult our investor brochure.

Asset class split	30.06.26	30.09.26		% Change		12 month change
Equities	69.0%	67.3%	v	-1.7%	v	-0.9%
UK	6.6%	6.3%		-0.3%		-1.9%
US	37.4%	39.8%		2.4%		0.5%
Europe	12.4%	12.0%		-0.4%		1.3%
Japan	2.6%	2.3%		-0.2%		-0.2%
Asia ex-Japan	4.6%	5.4%		0.8%		2.3%
Emerging Markets	0.0%	0.0%		0.0%		0.0%
Global	5.3%	1.4%		-3.9%		-3.0%
Index-linked bonds	1.5%	2.2%	^	0.7%	^	2.2%
Conventional government bonds	13.3%	14.2%	^	1.0%	v	-0.9%
Corporate bonds	0.4%	0.4%	<>	0.0%	v	-0.2%
Emerging market debt	0.3%	0.0%	v	-0.3%	v	-1.0%
Private equity	0.1%	0.0%	v	-0.1%	v	-0.2%
Alternative investment strategies	8.3%	8.4%	^	0.1%	^	0.4%
Property	0.0%	0.0%	<>	0.0%	<>	0.0%
Infrastructure	0.0%	0.0%	<>	0.0%	<>	0.0%
Commodities	2.2%	2.6%	^	0.4%	^	1.0%
Cash	5.0%	4.9%	<>	0.0%	v	-0.2%

Investment outlook

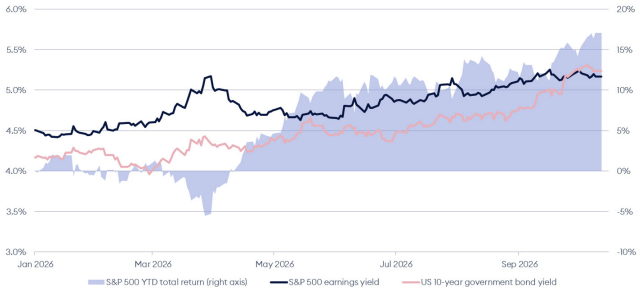
A disconnect has developed between an equity market that keeps straining to go higher, and a bond market that is faltering.

Bondholders are focused on the soaring cost of energy that's sending inflation higher, and recalculating the path of interest rates for the coming years. If rates and inflation are higher than expected over the life of a bond, then they are going to lose money. Because of this, bond prices dropped markedly this quarter, which sends their yields higher in response. Yet stocks continue to grind higher, despite all these risks.

Yet are these two markets really in opposition to each other? Maybe not. The AI buildout is all-consuming for attention, money and economic growth. It's driving prices higher in many areas of computer hardware and construction. It's also delivering phenomenal growth in company sales and profits that have scarcely been seen in the past. All of this has pushed stock markets higher, particularly at the top of the US market, in AI-boosted industries, and in emerging markets where most of the chips are made.

While the S&P 500 index has risen inexorably this year, its valuation – the amount people are willing to pay for every dollar of profit (the PE) – has fallen back markedly. That is effectively the equity equivalent of a rising yield (see the chart) below. The only difference is that there is no ceiling on what stocks can make, unlike bonds, whose returns are fixed (thus the name 'fixed income'). This means that stocks can become less valuable (their PE can fall), even as their prices go higher (because they are making so much more profits). Bonds don't have that luxury.

Per dollar of profit, the value of US stocks has dropped along with bonds, but they are making so much profit that the index is racing higher anyway



Source: FactSet, Rathbones; S&P 500 earnings yield is inverse of price/earnings for 1 year ahead, so rising yield means lower PE; S&P 500 total return in GBP; data 1 January 2026 to 12 October 2026

The US Federal Reserve (Fed) – and other central banks – are in a bit of a bind. They are faced with a resurgence in inflation from an energy shock that they can't control. Raising interest rates won't result in more energy either, so raising rates won't even help the problem. Yet not acting could leave people and businesses starting to assume that inflation will be much higher, starting a price-wage spiral that could get out of hand and damage the credibility of the bank and the dollar itself.

So the Fed decided in September to hike its benchmark rate by a quarter point to 3.75-4.00%. The US economy is still resilient, helped by enormous spending on data centres and by the tax breaks in the One Big Beautiful Bill, so it should be able to stomach a hike that is more signal than palliative.

For us, the main driver of all this turmoil is the price of oil. While the conflict with Iran keeps supply through the Strait of Hormuz tight, higher energy costs risk spreading into wider inflation. That would make central banks keep raising rates and put more strain on stretched government finances. A calmer Gulf and cheaper oil would change the picture quickly. The pressure isn't only on the US: in Europe, rising debt and borrowing costs are making investors ask how long some governments can keep kicking the can down the road.

Because of this, we're foraging carefully in government bond markets. They once again offer real yields (returns greater than inflation), and they should act as a safe haven if growth stumbles. But we've favoured shorter-dated bonds to reduce our exposure to fears about government spending. Alongside them we hold diversifiers, including structured products linked to rate volatility and put options on equities. We're also sticking to our fundamentals instead of chasing an overexcited tech market. That means owning the companies quietly enabling the AI build-out, rather than going all-in on the ones getting the most attention.

If there are any of the commentaries you require further clarification on, then please contact your advisers or via the Rathbones Asset Management website.

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