Fortem Capital Absolute Return Fund

Quarterly Commentary – 30th September 2025

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Total Return	2025	Q3
UK 100	17.7%	7.5%
US 500	14.5%	8.0%
Europe 50	15.4%	4.5%
Japan 225	14.3%	11.6%
Hong Kong 50	38.0%	12.4%
US 2000	10.4%	12.4%
Swiss 30	7.7%	1.7%
Global Equity	17.4%	7.3%
Global Bond	6.1%	2.0%
Commodities	9.4%	3.7%
PGF	**6.9%**	**2.0%**
AGF	**1.9%**	**-1.3%**
DGF	**0.6%**	**-2.0%**
USI	**14.0%**	**7.9%**
ARF	**7.3%**	**3.7%**
CARF	**7.0%**	**3.1%**

Our previous commentary talked of an extraordinary second quarter of the year in which we saw policy u-turns send markets to fresh highs and reignite a euphoric backdrop. The third quarter of 2025 similarly provided much joy for risk assets as we saw broad rallies across equities, commodities as well as bonds.

Markets first enjoyed the effects of trade tensions subsiding and the re-establishment of AI-mania before a Fed pivot finally appeared on the horizon in earnest.

This cocktail has created an extreme goldilocks environment in which the rate cuts priced in are only justified if accompanied by a material slowing in growth or worsening of employment conditions. Currently, the market is happy to out-dove the Fed without adjusting growth expectations or employment conditions lower.

June 2025:

What has also not changed is that economic data neither justifies markets re-testing their all-time highs nor does it yet look poor enough to justify monetary intervention through lower rates. However, as has become customary, the market is front-running the Fed aided by comments coming from the White House. There can be no mistaking that market participants now see the role of policymakers as including being supportive of asset prices irrespective of the financial stability mandate.

Wherever one cares to look asset prices look stretched; equities, commodities, credit and this is at a time when we are now beginning to see slowing show up in the data. There remains three possible outcomes:

Soft landing
Hard landing
Higher for longer

Since this was written we have seen the Fed begin to act, but this has only served to cause the market to act in a bigger way. We are now at a point where the market is pricing in hard landing cuts to justify soft landing prices. This is not an unusual phenomena and indeed is a reason why the biggest falls in stockmarkets tend to occur after the pivot, not before.
What remains priced at very low probability is a non-linear jump in unemployment that could put an end to the goldilocks environment. One of course cannot bet on that with any certainty, but employment looks fat-tailed here and it is worth noting that there are some cuts already priced that the Fed would simply catch up to if we were to see employment deteriorate significantly.

Whether that would manifest simply as another tantrum to add to the recent list or something more convex and material is again difficult to predict with any certainty. However, equity itself accounts for considerably more as a percentage of US household wealth now than even it did at the height of Dotcom. Given the make-up of these equity portfolios, they are all-in on the AI theme, something that should be occupying much attention currently.

The AI narrative has fuelled this last leg higher, yet signs are mounting that bear the hallmark of a classic bubble. We know that Moore's law does not hold for LLM information parsing ability per unit of power, in fact we are seeing diminishing returns here. Even if it did, the energy supply and infrastructure required to sustain the promised growth in compute simply does not exist. The return on investment has yet to justify the extraordinary capex, much of which is circulating between the same few dominant players, raising questions about the sustainability of these revenue loops. Moreover, the limitations of the technology remain clear; LLMs still struggle to perform basic reasoning with reliability or indeed replicate the same task consistently, something which has proved limiting to its ability to replace workers. The economic logic also is conflicted; the AI narrative and unemployment rate are unhappy bedfellows. For AI to prove truly seminal, it must lead to mass displacement of labour, we have not heard yet of any credible plan of how to deal with this. For now, AI remains an extraordinary narrative, but one whose fundamentals are nowhere near justifying its pricing.

It is also important to acknowledge when one has been wrong, and we have been wrong this year about the market's capacity to rebound and the apparent resilience of the US economy. However, beneath the surface, employment is beginning to crack, and it increasingly feels as though the AI narrative is the final pillar holding up the illusion of strength. That foundation is precarious. We may yet be early, or indeed we may be wrong, but the convexity in current pricing favours contrarian positioning, recognising that when narratives become this dominant, the payoff from being right on their eventual unwind can be disproportionately large.

Income

The Fund is fully collateralised by very short-dated, high-grade debt. As such, its liquidity profile extends to the liquidity profile of the Income Portfolio. The Fund has a 70% overhang of cash to deploy within the Income portfolio. Therefore, when the risk free rate is high so is the base level of return available to the strategy. It allows investors to somewhat 'have their cash cake and eat it' within an alternative allocation.

Beta

The Fund makes no allocation to the Beta Portfolio.

Diversifier

The Fund's Diversifier Portfolio consists of an US dollar equity long / short strategy with a low and stable beta of ~0.2 to global equities. That beta has been very stable through time and environments and is maintained through monthly rebalancing of the long and short legs back to target weights.

The long leg, which overweights the factors of quality, value, momentum and size (favouring smaller companies) whilst maintaining the same ex-ante volatility of the parent index, has outperformed the heavily large cap and growth biased parent index over the first three quarters of 2025 by 2.3%. This has allowed the beta overhang to perform well in absolute terms. However, the equity long short is global, and dollar exposed, thus the Fund will pick up some mark-to-market from dollar moves. This year the mark-to-market has not been in the Fund's favour as the dollar exposure has cost ~2.6% in sterling terms.

Within the factor exposures during the quarter, quality was the major detractor just as it has been within the wider Diversifier portfolios across the funds. Similarly, as the market continues to be driven higher by the AI narrative, unsurprisingly size (targeting small versus big) was a detractor also as the market retains its lack of breadth in a few extremely big companies.

Outlook

The Fund has performed well this year as a result of numerous of its attributes enjoying the environment.

The start of the year saw benefit from equity factors other than growth finally starting to perform, but there was a headwind from the dollar. However, as growth came roaring back, this coincided with a broader beta recovery as well as some recovery in the FX.

Even in the past quarter, during which we have seen a broad re-rating higher of risk assets, the long leg has outperformed the short, and the Fund sits on healthy returns for the year and stocks up well against its more expensive peer group of equity long / short strategies.

With regards to outlook, the systematic nature of the strategy means investors are afforded a reasonable amount of predictability as to how the Fund is likely to behave in different environments. The Fund will particularly like an environment in which beta provides positive returns, particularly if driven by non-growth factors. Its positive beta means that one might expect drawdowns in an environment in which beta struggles, but given the low and stable beta these drawdowns should be contained by construct alone. In addition, the factor and dollar exposures can provide some buffer here as they did in 2022 when the strategy was up in a year in which global equities fell 18% overall.

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