# Fortem Capital Commodity Absolute Return

## Quarterly Commentary – 30th September 2025

UK & EU – For professional and institutional investors only
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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.

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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. 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 seeks to monetise a consistent and underappreciated source of return in commodity markets: the shape of the futures curve.

Most commodity investors don't actually take delivery of barrels of oil or tonnes of sugar. Instead, they gain exposure via futures contracts, which are typically priced higher the further out you go, a market structure known as contango. This shape reflects real-world frictions such as storage costs and producer hedging, and tends to be not just upward-sloping, but also concave; front of the curve is steeper than the back.

Because of this curve shape, some futures contracts lose value faster as they near expiry than others. The Fund exploits this by going short the more expensive front-end contracts (which suffer from steep roll decay) and long the more stable contracts further out. This approach is designed to capture structural inefficiencies and importantly is largely insulated from broader market direction or parallel shifts in commodity prices.

This strategy earns a return that many passive commodity funds actually give away. For example, traditional commodity trackers must keep rolling their contracts forward to maintain exposure, often locking in a loss as they "roll up" the curve. Over time, this erodes returns. Oil is a good example of illustrating where the difference between spot prices and tracker fund returns illustrates this "roll cost" effect.

During July and August, Natural Gas dominated performance with weakening spreads as spot prices sold off on milder weather and strong injections allowing for storage builds. September was more mixed as losses at the start of the month were reversed as it has been an unusually quiet period for hurricanes for the time of year and weather forecasts remained mild.

There were also gains from precious metals over the quarter. Much has been made of gold's huge rally, but the term structure is also heavily contangoed meaning it is a happy hunting ground for commodity curve carry currently.

Ags and livestock were also positive contributors during the quarter as much of the commodity complex is harvesting a reasonable premia.

The exception remains the energy complex outside of NG, where we still are in an environment of extreme backwardation where the premium is negative on short timespreads. Oil markets continue to face headwinds, with regards to this L/S implementation, from low inventory, EU sanctions on Russian oil and production declines.

**Outlook**

After a difficult start to the year the strategy has recovered well and much of the commodity complex has assisted in that. The Fund is now annualising at close to 10%, having returned 7.0% to September end. The premia itself is proven over multiple cycles but given the risks present in markets currently, having a diversifier in the portfolio for which the risk drivers in the main are genuinely different and unrelated to those driving the equity of a multi-asset portfolio makes a lot of sense. The fact that typically the short timespreads in energy and industrial metals can give a counter-cyclical tilt is a bonus at this stage of the cycle.

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