

Quarterly Commentary – 30th September 2025

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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.

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%

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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 short-dated, high-grade debt. As such, its liquidity profile extends to the liquidity profile of the Income portfolio.

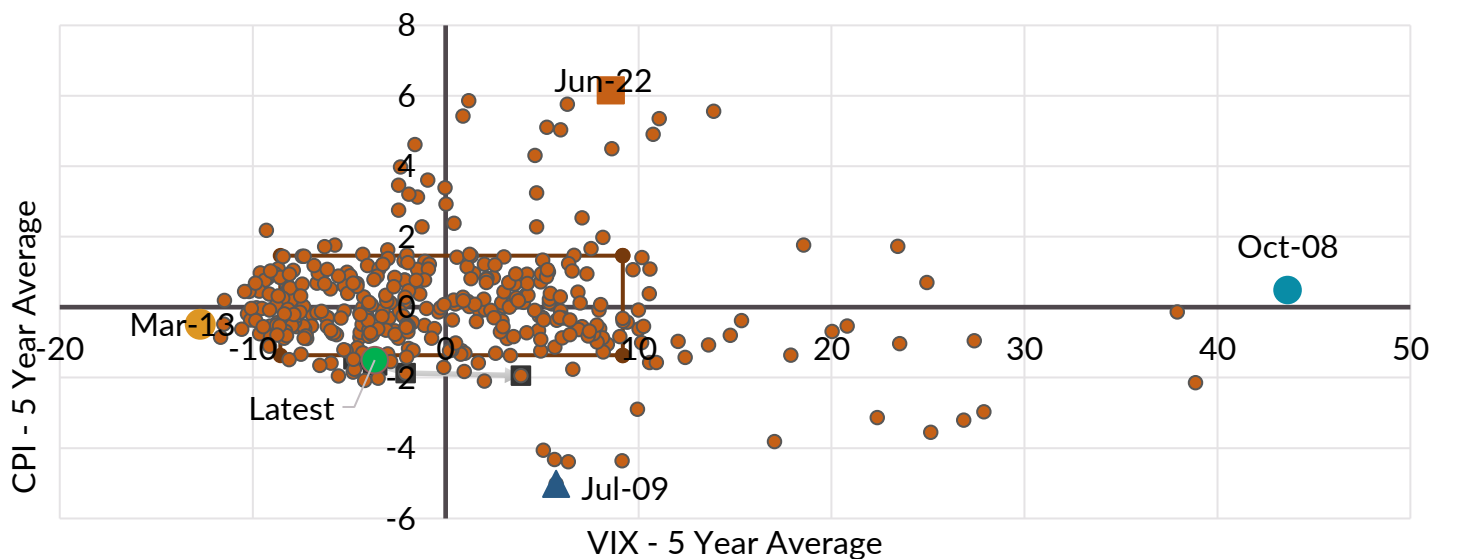
Aligned with the house view, the income portfolios are heavily skewed towards short-dated, high-grade sovereign debt currently. The guidelines within which the collateral of the Funds operate are both strict and conservative, and currently positioning is towards the conservative end of what are already conservative limits. However, given that inflation remains stubbornly above central bank targets, there is considerable yield to be harvested towards the front of the highest-grade yield curves.

Diversifier

The Diversifier Portfolio has its main exposure to core, structural alternative risk premia strategies, proven through various cycles over decades.

At Fortem we split regimes into four 'quadrants', which is not particularly novel. However, the axes upon which those quadrants are based are more aligned to the space in which we operate, while being highly relevant to multi-asset portfolios all the way down to single strategies and positions within those strategies themselves:

Fortem Regime Quadrant (Since 1995)



● Historical ■ Jun-22 ● Oct-08 ▲ Jul-09 ● Mar-13 ● Latest ➡ Last 6 Months — 90 Percentile

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The two axes upon which the quadrants sit are:

Economic price uncertainty (real economy)

Asset price uncertainty (financial markets)

The quadrants can be seen as something akin to an investment clock. During periods of market stress, particularly those in more recent times, policymakers, in their efforts to suppress asset price uncertainty, behave as if time itself can be reversed. This illusion of stability has had profound effects on the relationship between real economies and financial markets, where dislocations and distortions are now commonplace to the extent they are largely ignored. However, the distortions created by extraordinary policy measures do in fact matter and manifest themselves in economic price uncertainty where inflationary pressures build in response.

While policymakers may be able to pause time, and invariably when this occurs is when the 'this time it is different' arguments arise that economic time has been suspended indefinitely, the forces of economic and as a result financial entropy do eventually reassert themselves, returning uncertainty to the same asset prices that the policy was implemented to suppress; 'the great thing about time is that it goes on.'

As an investor one therefore cannot construct portfolios in a complete economic vacuum, if that were possible then in theory one could construct a portfolio and never touch it again. Instead, one must have respect for cyclicalities, recognising that time cannot be stopped, only managed. Diversification across betas and including those uncorrelated to the drivers of traditional asset price volatility is essential to this management. The investment clock is impartial, and ignoring the natural direction of time ensures portfolios are perpetually caught off guard when policymakers' interventions run out of time as they invariably do.

The Diversifier portfolio positioning is tilted to the bottom right quadrant, where in particular equity quality, FX value and commodity curve should thrive. We also retain our exposure to long rates volatility strategies in both Europe and the US.

One can see from the regime chart snail trail that, having dipped into the bottom right quadrant, we have very firmly moved back to the bottom left; goldilocks. The bottom left quadrant is one which should see risk assets of all kinds perform strongly, exactly as we have this year, and for the multi-asset investor who is likely to have the majority of their risk and return dictated by equity, this will be that happiest place for a portfolio to live. The Diversifier portfolio is not positioned for here and had a difficult quarter as a result, with falls coming from equity quality and rates volatility in particular.

The wider market continues to price a continuation of bottom left quadrant conditions, the Diversifier portfolio is positioned for an end to that goldilocks environment – which is likely what investors currently require from a diversifier.

Beta

The Fund's Beta portfolio remains both at the bottom of its range in terms of delta. There remains much scope to add beta to the Fund as and when the cycle bottoms, but at the time of writing the view is that this is not now.

Protection

The Fund's Protection Portfolio is made up of put options linked to the US 500 index as well as CDS on benchmark US and European credit indices. During the Q1 turbulence, the protection portfolio began to kick in in earnest before some profit was taken with volatility at its highs. The put positions were rolled once more during the quarter.

Outlook

Dynamic Growth is an absolute return Fund which has the widest remit in terms of its ability to take on little or much beta. It has been positioned at the very bottom of its ranges more or less since we took over the running of the Fund at the end of 2022. In that time it has produced reasonable absolute returns with a zero beta to global equities. Admittedly, we have been early in our view to keep beta at the bottom of ranges, whether we are wrong altogether is yet to be determined, but in the meantime the portfolio is positioned to weather any storm that may lie ahead and be repositioned accordingly as and when that comes and passes.

Fortem Capital Dynamic Growth Fund



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