

Quarterly Commentary – 31st December 2025

UK & EU – For professional and institutional investors only

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Markets navigated an unstable backdrop incredibly well during 2025.

Trade tensions escalated materially in the first half as US tariff rates rose to levels not seen since the 1930s, triggering a sharp but ultimately short-lived risk-off episode in April. At the same time, geopolitical stress intensified, and long-dated yields remained stubbornly high, reducing the transmission mechanism of looser monetary policy. These headwinds weighed heavily on sentiment early in the year but proved insufficient to derail broader risk appetite.

By mid-year, markets had pivoted decisively toward policy support and broad optimism. Fiscal expansion and the prospect of easier monetary conditions, combined with renewed enthusiasm around artificial intelligence, drove a synchronized re-rating across equities, credit and commodities. Emerging markets led equity performance, while developed markets recovered from early losses to post strong full-year gains.

The strongest signal of investor behaviour came through real assets. Precious metals significantly outperformed, and commodity returns remained positive despite falling energy prices. Fixed income also generated positive returns as inflation fears moderated and currency effects supported non-US investors, making 2025 the first year since the pandemic in which all major asset classes posted gains; an ‘everything rally’.

By year-end, investor positioning appeared increasingly predicated on the assumption that fiscal impulse will deliver the growth outcomes now embedded in market prices. Large deficits, sustained public investment and continued AI-related capex are widely treated as sufficient offsets to possible tighter financial conditions, and this optimism is reflected in elevated valuations and compressed risk premia across asset classes; positioning is highly stretched – over 2/3 of the individual country equity indices comprising the global benchmark are at record highs. What is less clearly priced is the cost of delivering that growth: higher funding costs, constrained monetary support, and the risk that investment proves lower-return or slower-to-realise than expected. As a result, markets enter the next phase with expectations anchored to an undying fiscal impulse. The narrative restates what is already priced, and ignores any risks which are inconvenient to it.

The Fund returned -1.4% over the quarter and -1.1% over the course of 2025.

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.

The income portfolio returned 0.8% over the final quarter of 2025, and the current yield of the book is 4.3%.

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:

Total Return	2025	Q4
UK 100	25.8%	6.9%
US 500	17.4%	2.6%
Europe 50	21.2%	5.1%
Japan 225	28.2%	12.2%
Hong Kong 50	33.5%	-3.3%
US 2000	12.8%	2.2%
Swiss 30	18.0%	9.6%
Global Equity	21.1%	3.1%
Global Bond	7.3%	1.1%
Commodities	11.1%	4.8%
PGF	8.9%	1.9%
AGF	0.4%	-1.5%
DGF	-0.7%	-1.3%
USI	16.7%	2.4%
ARF	9.2%	1.8%
CARF	8.8%	1.7%
LAF	8.4%*	4.4%

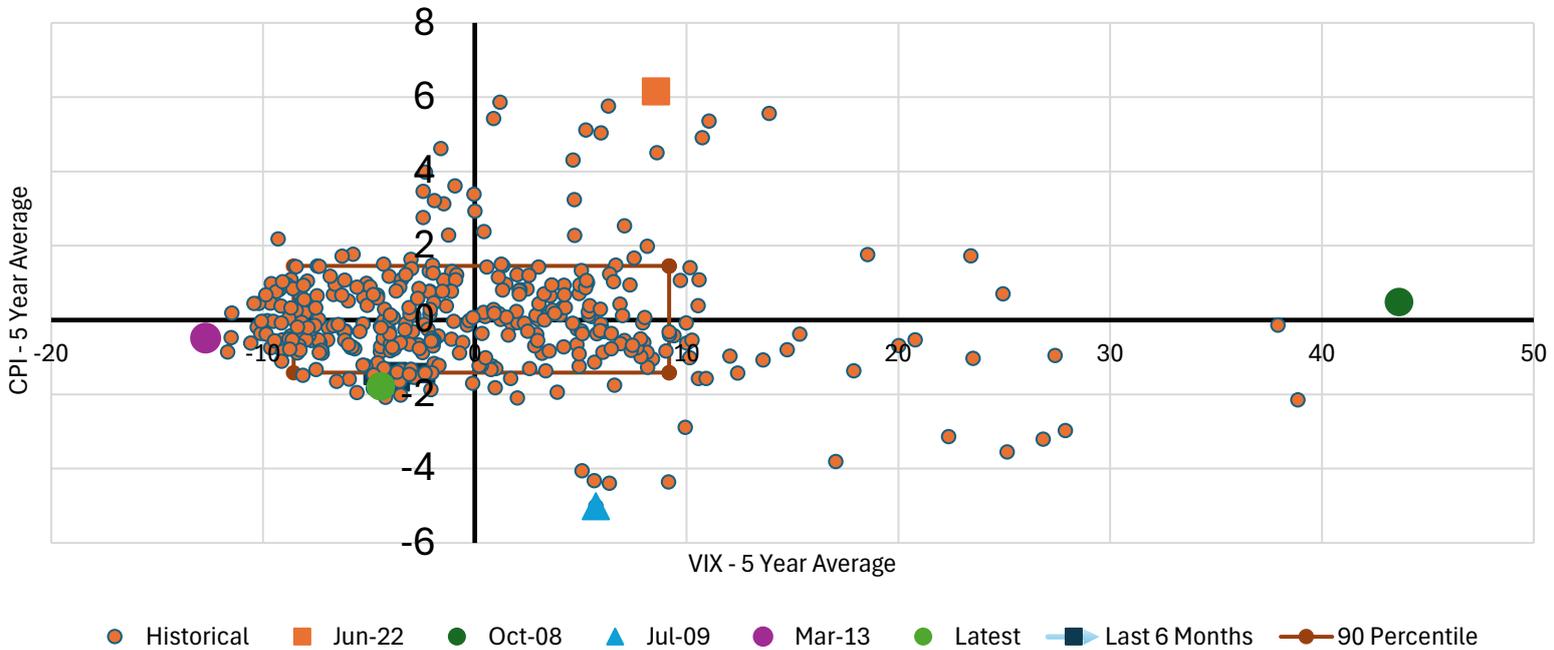
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Fortem Regime Quadrant (Since 1995)



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 that 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 cyclicity, 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 for the past 6 months, we have been firmly in the bottom left ‘goldilocks’ quadrant. In this environment, one should expect risk assets to perform well, as they have. For investors, it is whether they are comfortable with their entire portfolio, including the supposedly diversifying portion, positioning for a continuation of the goldilocks environment, versus anything not currently priced in causing a shift right along the volatility axis.

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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.

Over the quarter, the Diversifier portfolio returned -2.1%.

Unsurprisingly, given the ‘everything rally’, those losses were driven in the main by the two most defensive diversifier positions; equity quality and FX value.

Equity quality isolates the premia that financially strong companies tend to outperform over the longer term. Fortem’s implementation of this uses the Merton Distance to Default Model on the US 2000 index. The index is a sensible universe on which to apply the premia, given that over half of the companies that comprise it are loss-making. 2025 was a well-publicised ‘annus horribilis’ for the equity quality factor. However, there is something of a refinancing cliff approaching, and if yields remain elevated, those companies which have enjoyed debt that was restruck almost for free in the aftermath of Covid might come under far greater balance sheet scrutiny.

FX value positions were adversely affected by the weakening of JPY & CHF. These two currencies are particular safe havens so again there would be significant recovery expected if the ‘everything rally’ were to fade.

The outlook for the portfolio in its current guise is one that is highly constructive for an environment in which risk assets begin to underperform. Positioning certainly worked at the start of last year before the kerosene poured on the market by policymakers caused short-term underperformance.

Beta

The Fund’s Beta portfolio remains 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. Implementation is also via call options currently, thereby limiting max loss. These are the European and US benchmark indices.

Protection

The Fund began allocating to the protection bucket last year. The Fund’s Protection Portfolio is made up of put options linked to the US 500 index. 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 during the quarter.

Outlook

Markets increasingly appear to have shifted from an “everything rally” to something closer to an “everything bubble.” Asset prices across equities, credit and duration-sensitive assets are now heavily predicated on the delivery of a powerful and synchronised set of promises: a sustained surge in AI-related capex translating into durable productivity gains, a material and effective fiscal impulse, and further monetary easing that meaningfully loosens financial conditions. The difficulty is not that these outcomes are impossible, but that they are already well embedded in prices. As a result, there is very limited tolerance for disappointment on any front, whether in the scale, timing or efficacy of investment spend, the political feasibility of fiscal expansion, or the real-economy transmission of rate cuts. In this context, diversification must be treated with particular discipline. Assets held to diversify or protect risk-heavy portfolios cannot themselves rely on the realisation of these same optimistic assumptions for their return profile. True diversification requires exposures whose outlook is not contingent on AI monetisation, fiscal follow-through, or policymakers once again validating elevated valuations. Where diversification depends on the same promises that underpin risk assets, it is diversification in name only.

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 range more or less since we took over the running of the Fund at the end of 2022. Until recently, the Fund produced material absolute returns in spite of its defensive positioning. As the Diversifier book has faced structural headwinds, the past 6m has seen some of that performance given back. However, the portfolio is designed in the current climate to be resilient to turbulence and to take advantage of this by ramping up its beta at the appropriate moment.

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