

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.

For the Progressive Growth Fund specifically this means that defined returns in general are an attractive equity replacement strategy currently and employing an overlay of protection makes more sense than ever.

Income

The Fund is fully collateralised by high-grade sovereign debt. As such, its liquidity profile extends to the liquidity profile of the Income portfolio. A key pricing input for the Beta portfolio is rates; when rates are high, the level of return available from the Beta portfolio for a given level of risk is similarly higher than when they are low all else being equal. The current rates environment is continuing to allow the Fund to incept positions with defined returns above the Fund's return target, without taking on more risk than is and has always been stipulated at outset. This has also translated to a period of embedded returns significantly above the Fund's target return. As such, if we were to see a prolonged period of investment not calling, the levels locked in are far in excess of what is needed to return the Fund to its target.

Beta

The Beta Portfolio is the key driver of risk and return within the strategy. This portfolio has a number of investments linked to major developed equity market indices. The investments have strict rules around minimum protection levels such that they contractually earn defined positive returns even in significant drawdowns for the equities to which they are linked.

Within the Beta portfolio currently there are 59 investments with an average coupon of 8.9%.

It is worth repeating what we said last quarter in order to tie it into current market valuations and prognosis:

The portfolio is different in one sense and similar in another to how it entered the 2022 market turbulence:

In 2021, when rates and volatility were both floored by the extraordinary policy intervention that had been enacted post-Covid, the returns on offer for the protection barriers the strategy is able to employ were below the target return of the Fund. This meant that the Fund for a period endured lower returns than target. However, crucially, it did not change its risk profile based on prevailing market conditions, this is style drift.

Once after two or three years those positions had rolled off, they were able to be restruck at much higher levels of return, crucially, without changing the conservative setting of barriers that is and always has been the Fund's mantra. That means that in the event of a repeat event, and the current investments taking more than a year to call, the Fund has embedded within it levels of return to return it to above its overall target since launch.

This is how the strategy was designed at outset, the barriers dictate the short-term return, not the other way around and over time so long as our assumptions about the long-term averages of pricing inputs hold, the Fund will achieve its target.

With markets once more testing their highs, it is a significant point of note that if equities were set for a similarly tough period, this particular Fund is in a vastly different position to that which it entered the last protracted drawdown; a period in which investments within the portfolio did not call would allow the portfolio to embed returns well above target for longer. In other words, versus 2022 when anaemic returns were effectively locked-in for longer than one might have liked, the opposite is now true.

The recovery in markets also means that the Fund has significant levels of protection embedded with both protection of capital and return ~ 38%.

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Risk Overlay – Diversifier + Protection

In spite of the construct of the beta portfolio being carefully considered and designed to make money in all but the bleakest, and to date unprecedented, equity market scenarios, investors in these strategies will be aware that mark-to-market can be volatile, particularly during scenarios during which sizable equity falls are accompanied by spikes in implied volatility. It is for this reason that a risk overlay is employed that should not have a bearing on the final destination of the portfolio but should help on the journey of travel during the most volatile periods as it has already shown itself to do multiple times.

The current make up of the protection portfolio consists of S&P put options as well as Credit Default Swaps.

Outlook

The Fund behaved exactly as expected over the quarter and has now achieved its target return over 1, 3 & 5 years.

With regards to outlook, defined return funds allow for a slightly more prescriptive approach to be taken by investors as at any point one is able to ask of a fund of this ilk:

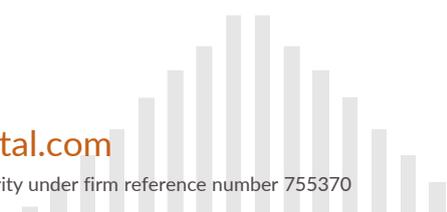
1. What is the risk
2. What is one currently being paid to take that risk

With regards to the risk at any point in time. Within the Progressive Growth Fund, one takes credit risk to high grade sovereigns given it is fully backed by sovereign debt. That currently extends to the governments of the US & UK. With regards to the beta portfolio one is exposed to deep OTM puts on major developed indices, so the key is where the portfolio currently sits with regards to the strikes of those puts. Currently there is plenty of protection as was alluded to in the beta section. So then what is one currently being paid to take on that risk? A significant amount:

Gross redemption yield of Beta portfolio:

Immediate spot moves	-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%
Return (%)	34.5%	26.0%	18.0%	11.5%	6.8%	5.8%	5.6%	5.6%	5.6%
Time to Maturity (Av. yrs)	4.0	3.0	2.1	1.3	0.7	0.6	0.6	0.6	0.6
GRY to Maturity (Av. %)	7.6%	7.9%	8.3%	8.7%	9.2%	9.3%	9.3%	9.3%	9.3%

*Scenarios are net of fees. Assumes no reinvestment of maturing investments.



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