

Courtville Partners – Investment Outlook, October 2026

Summary of the key points in this quarter's Investment Outlook

- The notably sharp spike in bond yields over the last quarter owes to a bucketful of different inflationary forces.
- The world's economy continues to experience an inflationary boom.
- No one can predict when the boom might turn to a bust – but we see warning signs, including historically low equity risk premia and narrowing value creation spreads for companies.
- We are far from bullish on bonds as an asset class, but are happy to bolster our equity hedges by adding modestly both to fixed income and to commodities.

From the private citizen's point of view, what is the purpose of portfolio investment? Why do we bother? There are many plausible answers to these questions, some of which involve the twin impulses of fear and greed. But it seems to us that in the modern era (since the First World War, say) the fundamental reason has lain in individuals' efforts to stop inflation eroding the value of their accumulated savings or wealth. Until the late 19th century such a claim would have seemed strange. Long-run economic history is made up mostly of extended periods of minimal – or even negative – price inflation. But we, our parents and our grandparents have all inhabited a world in which prices almost always go up – and the only uncertainty is the rate at which they will rise. If the cost of our continuing liabilities goes up, we naturally look for assets whose value will rise at least as fast. Every saver understands intuitively that inflation eats away at the purchasing power of their savings; and, fortunately for them, equities have generated decent inflation-adjusted returns over the long run.

Our econo-philosophical navel-gazing is prompted by the inflation landscape we see in front of us. In many ways it is not a pretty sight. The most prominent feature, as it were, is the mountain range represented by rising bond yields. Yields on US and UK government 10-year bonds have been rising at an unusually brisk clip. During 3Q26 alone they rose by 87bp and 73bp, respectively, to 5.33% and 5.49% and are now 116bp and 101bp higher than at the start of the year. Here's another telling yardstick: US 10-year TIPS (inflation-linked bonds) now offer real yields of 2.9%, up a cool 90bp year-to-date – and well above the breakeven rate of 2.4%. From this we infer, first, that Mr Market definitely thinks inflation is on the up and, second, that TIPS offer rather good value. To be fair, inflation data and expectations are not the only reasons for higher bond yields (as we will discuss later on), but they are the biggest single influence.

The absolute level of yields available on government bonds reminds us how far we have travelled since our first Investment Outlook exactly 10 years ago. Back then we observed with barely disguised horror that 10-year gilts were yielding less than 1% (and 10-year US treasuries just 1.6%). No surprise, then, that we kicked off our Model Portfolio with an aggressively underweight position in bonds; and not much has changed in the interim. We have been consistently – and for the most part correctly – hawkish on inflation over the decade; and this remains the case. Nevertheless, the current levels of yield on offer represent a challenge to our longstanding and relentless bearishness on bonds.

The sharp spike in bond yields has brought with it a deluge of commentary from every quarter. Indeed, the sheer quantity of column-inches on the subject may itself betray a gathering nervousness. The one question to which all investors would like the answer is: how much higher can bond yields go before relative valuation undermines equities? The basic measure of relative

bond/equity valuation, the equity risk premium, stands near the bottom of its long-term range, but cannot on its own predict when investors might migrate from equities to bonds.

Inflation can be stoked by many different factors. What has arguably made the current decade unusual by historical standards is, first, the sheer multiplicity of influences (wars, energy prices, labour markets, demographics, ultra-loose fiscal policy, etc.) and, second, the unhappy coincidence of *supply*-side disruption and *demand*-side cost-push. To put it another way, it's one thing for the Strait of Hormuz to be closed, but it's another for hyperscalers to splurge trillions of dollars on AI infrastructure, commandeering vast chunks of available capital in the process. In theory, most of the factors pushing prices higher could disappear tomorrow: Hormuz could re-open fully; the US government's crackdown on immigration could end; fiscal policy could become more restrictive; and central banks could rediscover their long-lost inflation-fighting credentials. But none of these reversals seems likely.

For the time being the global economy remains squarely in an inflationary boom. The evidence is everywhere. How about a whopping 20% year-on-year jump in US corporate profits in 2Q26 (versus a long-run average growth rate of 6% p.a.)? Or September global "flash" PMIs (purchasing manager indices) at near-record highs? Research firm Gavekal keeps tabs on the spread between US companies' real ROIC (returns on invested capital) and real WACC (weighted average cost of capital), i.e. an economy-level measure of value creation. When this spread has fallen below its 20-year median, it has usually signalled recession. For now, though, real ROICs are not only healthy, but at all-time highs; and the spread over real WACC remains above the 20-year line. In other words, there is no sign (yet) of the AI capital expenditure boom eroding returns on investment; nor has the cost of capital risen enough to kill off that boom.

But will this inflationary boom turn to inflationary bust? As the adage goes, economic expansions don't die of old age, they are murdered by increases in interest rates. Have we seen the worst (of rising yield) in bond markets – or is there worse to come? At the risk of over-simplification, an investor who believes that the Federal Reserve under new chairman Warsh will squeeze inflation back to the official target of 2% after 63 consecutive months above this level might be tempted by 10-year treasury yields above 5%. If *nominal* US GDP grows over the long run at about 4.5% p.a., then 10-year treasuries ought to yield roughly the same. But if the Fed allows inflation to run at, say, the average rate of the last seven years, then bond yields could easily hit 6%. The relationship between nominal GDP growth and nominal interest rates is crucial: once interest rates exceed growth, the government's budget deficit must expand rapidly (the so-called "debt trap"), at least until corrective fiscal action is taken.

Inflation or no, global equities continued along their upward path during 3Q26, rising a modest +3% in dollar terms after 2Q26's blow-out +13% rise. So far this year equities are up a handsome +14%, which comes on top of last year's +22% gain and 2024's +12%. Global equity returns have averaged +11% p.a. over the last five years and almost +20% p.a. over the last three, all of which is well above the long-run average of +8% p.a. The party is in full swing. As we've already noted, robust corporate profit growth – especially in the US – has helped propel stocks higher. Consensus earnings growth estimates for the S&P 500 have ballooned from +15% at the start of 2026 to +32% now, going against the usual pattern of early optimism fading as the year unfolds and compressing aggregate multiples into the bargain. Using consensus earnings forecasts, the S&P 500's forward P/E has fallen to 19x from 22x at the start of the year.

One caveat on earnings... The GAAP earnings of several hyperscalers (Amazon, Alphabet, Meta, Microsoft and Nvidia) were materially flattered in 2Q26 by an aggregate \$160bn of "other income", which turns out to be nothing more than non-cash revaluations of stakes in other AI-

linked companies. (In our experience, every stock market bubble features confusion between capital and income. It seldom ends well.) This number on its own boosted S&P 500 earnings growth from +29% to +48%, according to one estimate. We might usefully think of this “other income” line as the accounting expression of all those organograms showing how inter-linked the AI corporate world is. By definition, it is “income” that can go into reverse if the valuations of the underlying companies are ever marked down. Such a risk is far from negligible. The latest Chinese open-source models (e.g. DeepSeek’s V4-Pro) offer 95% of the performance of the US “frontier” products, but at just 5% of the price. No wonder the price of tokens has halved since June. (We ought to correct ourselves: not *all* prices go up.)

Talking of things that haven’t gone well, our early-2026 bet on Chinese equities is not looking too clever. After a dreadful 3Q26, the index is back to flat year-to-date. China’s economy enjoys myriad structural advantages, whether in cost of capital, cost of energy, cost of labour or capacity for innovation. For all China’s export success, however, there is no escaping the chronic weakness of domestic demand – or the government’s reluctance thus far to stimulate demand. The hugely undervalued renminbi is being allowed to appreciate at a slow, but regular, pace (about 0.5% a month). At some point it may appreciate enough to encourage the repatriation of the \$4-5trn bank deposits that Chinese companies have built up in Hong Kong in recent years. If this was to happen, it might do wonders for domestic Chinese asset prices.

While equities have continued to party, bonds have been having an abysmal time – OECD government bonds, that is. But this has been the pattern since the beginning of the decade. Among OECD government bonds, only those of Switzerland have produced a positive *nominal* return over the period; and none has beaten US inflation. German and Japanese bonds have performed particularly badly. Admittedly OECD bonds have had to contend with many adverse factors, including crazy starting valuations, reckless fiscal policy, several wars, energy disruptions, the AI capex boom – and so on. But whatever the reasons, most government bonds have failed utterly in their historic role of stores of value. The same has definitely not been true of bonds issued by many (so-called) Emerging Market countries – from China to Brazil to South Africa to Indonesia. (We have owned Chinese bonds in the Model Portfolio since April 2020.)

We have already suggested that the current inflationary boom could well continue for the time being. In past cycles, typical bubble-bursters have been bank failures, more aggressive monetary policy or a bond buyers’ strike; and there is no real trace of any of these for now. But investors are still left with the challenge of hedging their portfolios against the inflationary boom turning to inflationary bust somewhere up the road. To some extent we have already addressed this in the Model Portfolio by allocating 17% to a variety of commodities or commodity-linked assets. Oil in particular and energy in general still look to us like sensible ways to hedge the very real risk of another oil price spike. Market data, whether WTI NYMEX open interest or energy stocks’ tiny representation in the S&P 500 (less than 4% versus technology’s 38%), suggest that this is the opposite of a crowded trade.

The global economy is performing too strongly to turn us into bond bulls. That said, we think it is reasonable to trim the Model Portfolio’s aggressively underweight position. We have added 1% each to the existing gilts and Chinese bond ETFs and put 2% into a new position in five-year US TIPS. We have also added 1% to our oil ETF. These purchases are offset by selling 3% of the Emerging Markets ETF (in response to strong performance and concentration risk) and 2% of the FTSE 250 ETF (which always benefits less from currency weakness). Gold has gone nowhere this year, but remains a valuable counterweight to further US fiscal profligacy: the inverse correlation with the US twin deficits has been uncanny for several decades.

Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	7.0	10.4
International Equities	55.0	55.1
Fixed Income	14.0	22.2
Alternatives	18.0	8.1
Commercial Property	0.0	0.0
Cash	6.0	4.2
Total	100.0	100.0

Courtville Partners Model Portfolio	ETF	Oct Weight (%)	Changes this quarter	Weighted OMC (%)
UK Equities		7	-2	
UK	VUKE LN	7	0	0.09
UK	VMID LN	0	-2	0.10
International Equities		55	-3	
Global	IWQU LN	4	0	0.30
US	VUSA LN	7	0	0.07
	XDPG LN	9	0	0.09
	EWSP LN	9	0	0.20
	IUVD LN	3	0	0.20
Euro	VERX LN	5	0	0.12
Japan	VJPN LN	4	0	0.19
Asia ex-Japan	VAPX LN	5	0	0.22
Emerging Markets	VFEM LN	7	-3	0.25
China	CNUA LN	2	0	0.24
Fixed Income		14	4	
UK	IGLT LN	4	1	0.07
US	TIP5 LN	2	2	0.10
EM	SEML LN	4	0	0.50
China	CNYB NA	2	1	0.35
Japan	XJSE SW	2	0	0.15
Alternatives		18	1	
Gold	PHAU LN	4	0	0.39
Oil	WEL5 GY	4	1	0.18
Global Miners	GDIG LN	2	0	0.53
Infrastructure	INFR LN	2	0	0.65
Electricity Infrastructure	FGRD LN	2	0	0.35
Uranium	NUCG LN	2	0	0.55
Water	IH20 LN	2	0	0.65
Commercial Property		0	0	
Cash	XSTR LN	6	0	0.15
Total		100		0.22%

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2026 YTD	12.1%	9.2%	2.9%
Since inception(1/1/2015)	172.6%	143.3%	29.2%
CAGR	8.9%	7.9%	1.0%

The value of your investments can fall as well as rise. You may not get back all the money you invested.