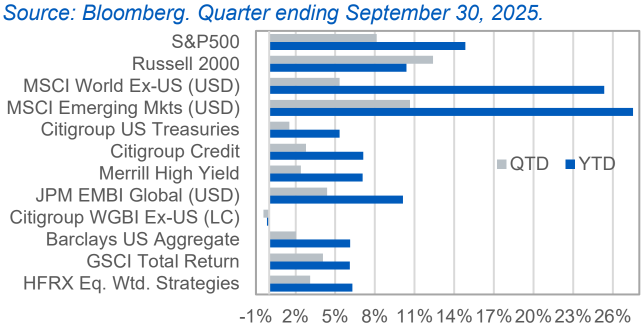
Global Market Review

Global equity markets posted solid returns in the third quarter, extending already sizeable gains. U.S. credit markets also rose, squeezing credit spreads to historically narrow levels. Although economic policy uncertainty remains high, risk premiums and expected market volatility remain low. AI enthusiasm is driving equity markets higher, while AI-related investments are also contributing importantly to economic growth. U.S. and Chinese equities have especially benefitted from the AI frenzy, but the tech sector has been a prominent driver of returns across many non-U.S. advanced and emerging equity markets. The U.S. equity market has also been emboldened by the prospect of further Fed rate cuts and continued fiscal stimulus, notwithstanding mounting government debt, continued high levels of policy uncertainty, and a government shutdown. These concerns have, however, weighed on the U.S. dollar, which has depreciated this year against most major currencies. Gold, in contrast, has soared.

Exhibit 1
Performance of Major Market Indices
Source: Bloomberg. Quarter ending September 30, 2025.

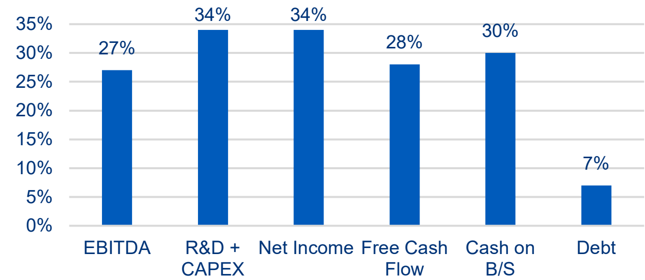


AI leads broad-based equity gains in Q3.

AI Ascendancy

AI ascendancy remains the dominant market narrative, a story that lionizes AI's potential to unleash a golden age for profits, productivity, and prosperity. It is also reflected more concretely in the share of the Mag 7 across select financial indicators. The Mag 7 accounts for roughly 30% of the broader market's capitalization, earnings, R&D and capital expenditure, free cash flow, and cash on the balance sheet, but only 7% of debt (Exhibit 2).

Exhibit 2
Mag 7 Dominates Key U.S. Equity Market Indicators
Source: BlackRock. Mag 7 as a share of the S&P 500 ex. financials.



Accounting for the bulk of output growth in the first half of the year, AI-related capital expenditure is having an outsized impact on GDP growth. AI is also indirectly supporting consumer expenditure, especially among the wealthy, via the strong appreciation across equities as well as other assets. The top fifth of the U.S. income distribution is driving total household consumption, while the spending of the bottom four fifths has barely kept pace with inflation. A highly concentrated market and an economy heavily dependent on AI as a driver of capital expenditure and, indirectly, household consumption are vulnerable to an unravelling of the AI narrative.

AI Accentuates Broad U.S. Equity Gains

The S&P 500 gained 8.1% in the third quarter. It is up nearly 15% so far this year. The strong performance of the third quarter was broad based but heavily influenced by AI's ascendancy. All sectors generated positive returns in the third quarter, but stocks in the communications and IT sectors handily outpaced the rest, as they have for much of the year. Moreover, tech-heavy growth stocks (+10.4%) led value

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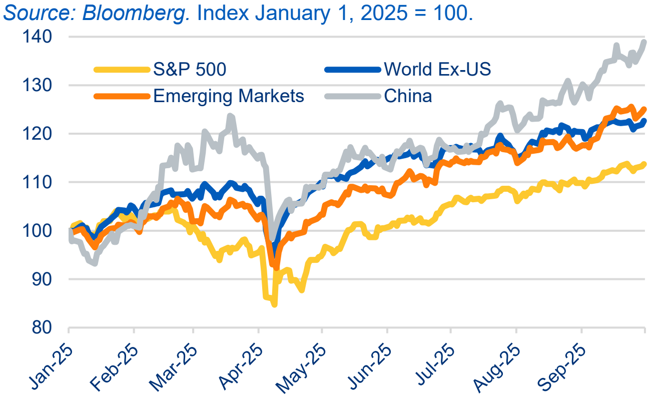
(+5.6%) by a wide margin in the third quarter. In the first nine months of the year growth was up 16.8% versus value's 11.5% return.

AI Propels Chinese Equity Market Higher

Strands of the same narrative fueling the strong rally in U.S. equities are also driving a surge in the Chinese equity market, which is leading all other major markets so far this year (Exhibit 3). The Hang Seng tech index of the 30 largest tech stocks listed on the Hong Kong exchange is up 48.4% so far this year. The rally is driven by DeepSeek's breakthrough in increasing AI efficiency as well as the adoption of policies by the Chinese government to promote domestic chip production and other aspects of AI development. Reforms to improve corporate governance as well as monetary and fiscal stimulus and government-supported share buy-back schemes also contributed to the Chinese market's 20.7% gain in the third quarter, bringing its gains so far this year to 41.6%.

Exhibit 3
Chinese Equities Outperform Other Markets
Source: Bloomberg. Index January 1, 2025 = 100.



Other non-U.S. equity markets have also generated strong returns so far this year, outpacing the U.S. market thanks in part to the appreciation of non-U.S. currencies against the U.S. dollar. The MSCI World ex-U.S. index of advanced economy stocks rose 5.3% in the third quarter. So far this year, it is up 25.3% in U.S. dollar terms, well above the index's local currency return of 15.3% thanks to the dollar's depreciation. Emerging equity markets rose 10.6% in the third quarter, reflecting strong gains across Asian and Latin American markets, and are up 27.5% so far this year.

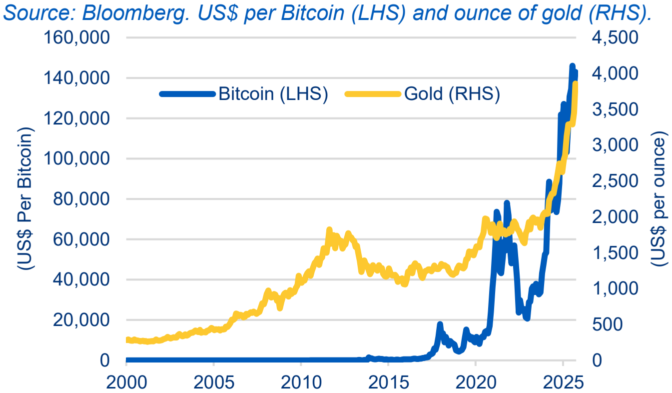
Fed Chooses Growth Over Price Stability

Faced in its September meeting with a choice between an economic downturn or rising inflation, the Fed, to no one's surprise, chose growth over price stability. Commenting on the dilemma facing the Fed, Chair Powell observed that "in the near term, risks to inflation are tilted to the upside and risk to employment to the downside, a challenging situation." Noting that the current pace of job growth was barely sufficient to keep the unemployment rate from increasing, Powell observed that the "marked slowing in both the supply of, and demand for, workers is unusual."

Despite persistent above-target inflation and surprising economic resilience, the Fed's dot plot of FOMC member projections of key economic indicators and interest rates suggests that there will be two further 25 basis point rate cuts this year. However, the range of opinions on the future path of the Fed funds rate is unusually wide. At one extreme, the most recently appointed FOMC member is projecting a Fed funds rate of 2.8% by year end, a decline of 125 basis points. At the other, one FOMC member envisages that rates will need to be raised by 25 basis points before the end of the year. The futures market, for its part, attaches a 99% probability to a 25-basis point cut in rates in October and a 98% chance that rates will be reduced by the same magnitude in December.

The prospect of lower interest rates coupled with soaring fiscal deficits and debt levels and declining confidence in the reliability of U.S. economic governance have contributed to a 10% depreciation of the U.S. dollar index this year. Gold and bitcoin prices, in contrast, have soared. Gold is up 47% so far this year, while Bitcoin has gained 22% (Exhibit 4).

Exhibit 4
Gold Glitters as the Dollar Loses its Luster
Source: Bloomberg. US$ per Bitcoin (LHS) and ounce of gold (RHS).



Hedge Funds Generate Steady Gains

The HFRX equal-weighted hedge fund index rose 3.1% in the third quarter. It is up 6.3% so far this year. High volatility and valuation dispersion in equity markets have put a premium on managers skilled in adding value through security selection.

Income Supports Real Estate Returns

Real estate, as measured by the NCREIF Open-End Diversified Core Equity Index (reported with a delay), rose 2.7% in the 12 months through June 2025, reflecting income growth that more than offset a decline in prices. The office sector remains the worst performer over the one-year period, while retail and apartments led other property types.

Buyout and Growth Outperform Venture

The Thomson Reuters/Cambridge Index (reported with a delay) was up 6.8% for the year ending March 2025. Growth equity (+8.9%) and buyout (+6.9%) strategies outperformed venture (+6.0%) over this one-year period, as they have for the 3-, 5-, and 10-year periods ending in March.

Outlook & Strategy

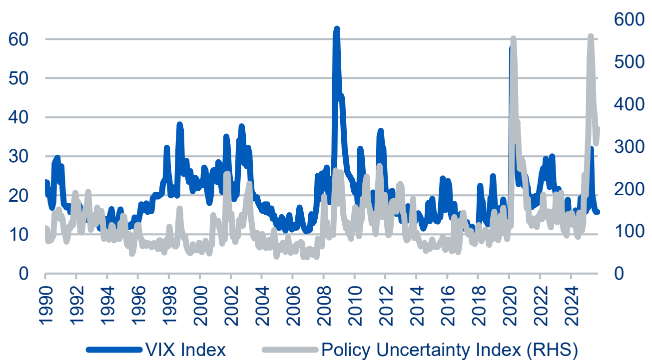
Complacent Markets

In April, markets faced extreme levels of policy uncertainty. Core policy tenets – free trade, Fed independence, the role of the U.S. dollar as the anchor of the global monetary system, and of U.S. Treasury securities as the ultimate safe haven – were all in flux. Policy uncertainty has since fallen but remains unusually high. Expected market volatility, in contrast, signals relative calm. At end-September, the VIX index (aka the fear gauge, a measure of the expected volatility of the S&P 500) was half a standard deviation below its long-term average (Exhibit 1).

Exhibit 1

U.S. Equity Market Shrugs Off Elevated Policy Uncertainty

Source: Fred. The VIX is an option-based measure of short-term volatility of the S&P500. Data as of September 30, 2025.

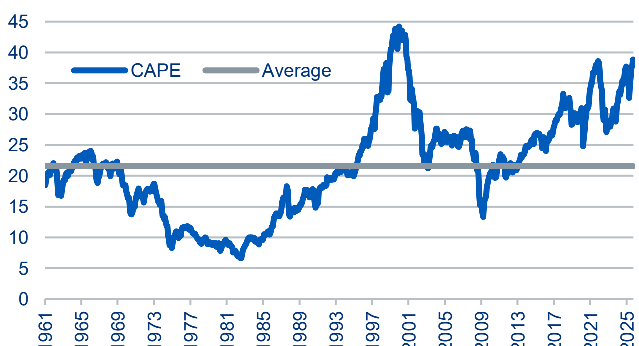


U.S. equity prices also suggest complacency. The S&P 500 closed near a record high in September. The cyclically adjusted price earnings (CAPE) ratio of the S&P 500 is two standard deviations above its long-term average. Valuations have only been higher once previously, just prior to the bursting of the 2000-01 tech bubble (Exhibit 2).

Exhibit 2

U.S. Equity Valuations Near Record Highs

Source: Robert Shiller. Data as of September 30, 2025.



A Fragile Resilience

One source of this complacency is the apparent resilience of the U.S. economy. This resilience reflects in part the front-loading of consumption and investment in anticipation of the impact of tariffs on prices. Economic resilience has also been supported by expansionary monetary and fiscal policies in major advanced economies. Rising stock prices, compressed credit spreads, and abundant liquidity in funding markets have further stimulated economic activity.

The apparent resilience of the economy rests on an unbalanced and potentially fragile foundation. The wealthiest 20% of U.S. households account for the bulk of consumption growth, while capital expenditure and overall GDP growth is heavily skewed to AI-related investments. Unemployment remains low but job growth has been anemic and the demand for labor has slowed sharply.

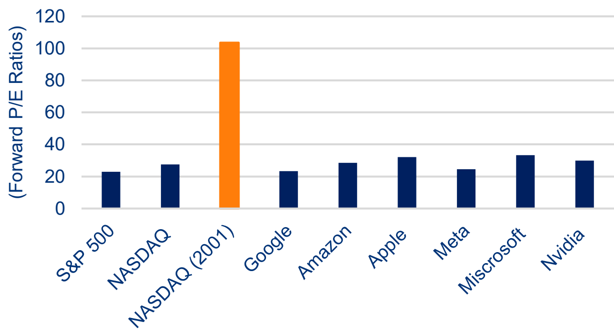
Other supports of economic resilience may be reaching their limits. With debt service payments rising to historic highs, U.S. government debt dynamics are on an unsustainable trajectory, calling into question the continued viability of fiscal expansion. Moreover, with inflation remaining stubbornly above target and unemployment at low levels, the case for further monetary easing may be difficult to make, especially if tariffs begin to have a more visible impact on prices. The ultimate wild card, however, is whether an AI bubble is forming.

Is AI a "Good" Bubble?

Jeff Bezos' remark that AI was a "good" bubble neatly encapsulates the spirit of the times. In this view, AI is not a financial bubble, but rather an "industrial bubble" that will usher in a golden age of technological progress whose benefits will justify any excesses of its birth. In our book, all bubbles are bad. This time will not be different. Past bubbles were not propagated by railroads, the internet, or houses, but by how those sectors were financed. All bubbles are financial, their destructive legacy runs deep, and the recovery period is invariably long.

But is the current AI frenzy already a bubble? We hope not yet, although there are worrisome signs. Most troubling is the all-consuming messianic fervor of the current AI narrative used to justify ever greater capital expenditure and higher equity valuations. Fortunately, the valuations of most publicly traded AI firms, while quite high, have not yet reached the wild excess of the 2001 tech bubble when the P/E ratio of the NASDAQ index breached 100 (Exhibit 3). In contrast to the dotcom era, today's publicly traded AI firms are large and profitable. But the massive investments needed to build AI infrastructure, estimated to be in the trillions of dollars, dwarf the investment boom of the tech bubble. While much of the funding for the investment in AI infrastructure has so far come from earnings, circular financing deals in which firms in effect fund their own demand while also propping up stock prices are emerging. How widespread such circular financing becomes could well determine whether the current AI frenzy builds to a bubble.

Exhibit 3
AI Valuations Are Not Near Tech Bubble Extremes
Source: Bloomberg. Forward P/E Ratios. Data as of September 30, 2025, unless otherwise noted.



Active Portfolio Positioning

We use active top-down positioning sparingly and remain focused instead on adding value through security selection. Bottom-up strategies remain in our view the most fruitful and persistent source of alpha. Valuation dispersion across securities in public and private markets remains wide, offering fertile ground for skilled active managers to add value through security selection.

Our limited top-down portfolio positioning has not changed from the second quarter. We are neutral to equities overall structured as an underweight to U.S. equities with overweight positions to more favorably valued non-U.S. advanced and emerging equity markets. We believe that the near record valuations and concentration of the U.S. equity market justify this continued underweight. We are gradually reducing our current underweight in real estate to a more neutral position, while limiting new commitments to the problematic office sector. In the case of fixed income, we retain a neutral allocation to duration and credit risk and are complementing our bond portfolio with opportunistic and direct lending investments.

Public Equity Portfolio Structure

We continue to structure the U.S. equity portfolio to include active managers using a combination of quantitative and fundamental techniques, risk-controlled extension and portable alpha strategies, and industry-focused specialty managers in the biotech sector. Our non-U.S. equity portfolio also includes managers using a combination of quantitative and fundamental techniques. The portfolio comprises global managers, managers specializing in developed, emerging, or frontier markets, as well as country-focused strategies.

This structure increases the scope for adding value through security selection, diversifying the sources of portfolio return, and enhancing the resilience of the portfolio. This resilience stems from the large number of independent sources of value added we aim to embed in our equity portfolios. Portfolio resilience is further enhanced by the low correlation of manager excess returns from stock selection with broader market movements.

Exploiting Value in Credit Markets

Although credit spreads are quite compressed across the investment grade and high yield segments of the bond market, we continue to see opportunities to add value through security selection in the credit markets. Our barbell approach to portfolio construction using U.S. Treasury securities to balance exposures to higher yielding credit products provides us flexibility to exploit anomalies in the pricing of credit securities and adapt bond portfolios to changing circumstances. The heterogeneous and segmented credit markets continue to offer attractive opportunities to specialist managers with the requisite experience to discriminate among issuers in niche segments of the market.

We complement the public fixed income portfolio with direct lending and opportunistic investments in less liquid credit strategies. These investments have higher expected returns than our public fixed income investments and provide a degree of diversification to the portfolio.

Diversified Alpha Through Hedge Funds

We continue to allocate the hedge fund portfolio across a wide range of strategies and to diversify sources of tracking error across managers. We remain focused on constructing low-beta hedge fund portfolios comprising highly diversified streams of potential alpha. Despite the favorable conditions for hedge fund strategies in the current environment, we continue to target a neutral allocation. This positioning aims to balance the benefits of hedge funds against the desirability of maintaining sufficient liquidity to rebalance client portfolios in case of asset market swings.

Gradually Increasing Real Estate Allocation

We are undertaking a phased increase in our real estate investments, targeting a return to a neutral weighting over the next 24 months. We plan to implement this move through initial investments in open-ended funds, followed by specialist closed-end fund investments. We are making new commitments to real estate managers focusing on favorably valued properties in the industrial sector, which is benefiting from accelerating e-commerce growth, and the housing sector, which is facing tight supply.

Private Equity Portfolio Structure

The AI frenzy is also apparent in the private markets with new venture capital fund raising and investments heavily oriented towards AI start-ups. Nevertheless, investments in private firms continue to offer attractive opportunities for strong returns and added value. We strive to exploit these opportunities by focusing on lower and middle market firms with solid earnings growth in the industrial, technology, and consumer sectors. Our portfolios include a combination of buyout and growth equity funds at their core combined with smaller positions in venture capital investments. We continue to make co-investments with select managers. We are also considering opportunities in the growing secondary market across private equity strategies.

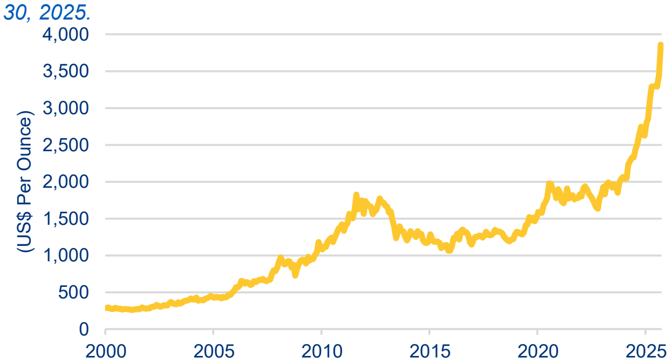
Special Topic

Gold's Time to Shine

It is perhaps natural that many should turn to gold as concerns mount over the U.S. dollar's continued role as the global monetary system's anchor. Gold, after all, has a long and storied history as money, an official reserve, and the anchor of the global monetary and trading system.

Gold is up 47% so far this year (Exhibit 1). The U.S. dollar, in contrast, has depreciated about 10% against a basket of major currencies. The gold rally so far this year is the largest since 1979, when the price of gold doubled in the wake of inflation fears triggered by the oil price shock. And adjusted for inflation, gold prices are well above their previous 1979 peak (Exhibit 2).

Exhibit 1
Gold Shines as U.S. Dollar Loses its Luster
Source: Bloomberg. US$ per ounce of gold. Data through September 30, 2025.



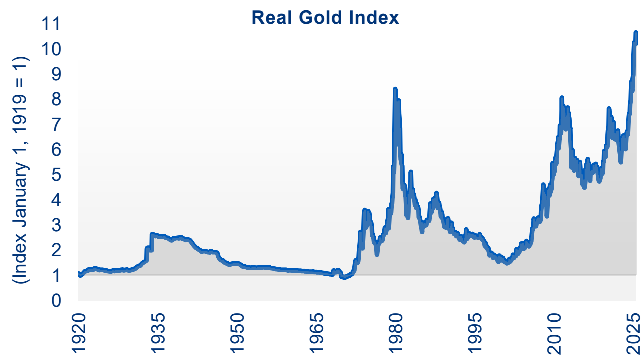
Central Bank and ETF Gold Flows

There have been two notable drivers of demand for gold over the past 18-24 months: central banks and ETFs. Gold purchases by central banks have increased sharply in recent years. Since 2022, annual acquisitions have exceeded 1,000 tons, about double the annual pace over the previous decade. By the end of 2024, gold, valued at market prices, was the world's second largest reserve asset, representing 20% of total central bank reserves compared with 46% for the U.S. dollar and 16% for the euro.

The surge in central bank purchases that began in 2022 coincided with Russia's invasion of Ukraine and, according to survey data, was motivated largely by geopolitical uncertainty, concerns about sanctions, and in "anticipation of changes in the international monetary system." Concerted gold purchases by Russia, which began as part of a de-dollarization campaign following its invasion of Crimea in 2014, represent about half of recent central bank purchases. While demand has been motivated by geopolitical factors, gold has traditionally been held by central banks as a long-term store of value, a hedge against economic risks and inflation, and a diversifier from the U.S. dollar and other reserve currencies.

Gold-backed ETFs have also been a key source of recent demand. Since their creation in 2003, these ETFs have grown considerably as a major holder of gold. By the end of the third quarter, global gold ETFs held 3,838 tons of gold ($472 billion), more than any central bank except the U.S, which held 8,133.5 tons. ETFs have increased their gold holdings at a near record pace so far this year, with net inflows through September totaling 619 tons ($64 billion). U.S. ETF flows dominated global flows, although European ETF demand has also been strong.

Exhibit 2
Gold's Volatile Real Value Now at All-Time Highs
Source: FRED and Strategic estimates. Data through September 30, 2025.



Drivers of Gold Demand

Because gold earns no income and holding gold entails storage costs, gold prices are typically modelled as inversely related to real interest rates. This inverse relationship held up well between 2008 and 2022, but has broken down since, giving credence to survey data that recent gold demand has been driven largely by geopolitical concerns.

In addition to the concerns related to Russia's invasion of Ukraine, erratic U.S. economic and trade policies have raised doubts over the economic governance of the keeper of the globe's monetary anchor. The prospect of easier monetary and fiscal policy during a period of full employment and above target inflation is raising fears of currency debasement.

As highlighted by the volatility of its real value (see in Exhibit 2), history suggests that gold has not been a consistently reliable inflation hedge. Nevertheless, it is still viewed as a hedge against adverse economic developments and is naturally in high demand when economic policy uncertainty and geopolitical tensions are high. Another dimension to the recent run in gold prices is momentum. As Oscar Wilde observed, "nothing succeeds like excess." Fear of missing out on a once in a lifetime rally is a prime driver of recent gold demand, especially by ETFs. It is a source of demand that can be just as easily reversed.