STENHAM
ASSET MANAGEMENT

Q3 2026 Investment Letter

Portfolio perspective, manager insight and outlook

12 November 2026

Markets in review

Global equities ended the third quarter modestly higher at 1.6%, with the S&P 500 +2.0% and Nasdaq Composite +2.5%, but the headline masks a turbulent quarter in which the AI trade swung sharply and gains narrowed to a small group of stocks. Asia was the most volatile region: the KOSPI fell 19.3% over the quarter, after losing 22% in July alone and then rebounding 17.9% in a single session on 31 July, while the Nikkei 225 fell 4.7%. The Morgan Stanley TMT momentum factor recorded its largest drawdown since inception, falling more than 50% from its late-June peak to mid-August. The July unwind of crowded AI positions, including the collapse of a leveraged AI-focused hedge fund, was a reminder of how quickly crowding can reverse.

Conflict in the Middle East and stubborn inflation drove the broader macro picture. Renewed attacks on shipping in the Strait of Hormuz and US strikes on Iran ended a fragile June agreement, and Brent crude rose 34.4% to $98 a barrel, with European natural gas up 66.3%. With US headline inflation at 3.4% (CPI), the Fed raised rates by 25bps on 16 September, its first hike in 3 years from 3.75 to 4.00% and signalled that further tightening may follow. The ECB and Bank of Japan also raised rates. Bonds suffered as a result: the US 10-year yield rose 82bps to 5.29%, its highest level in nearly 2 decades, and the Bloomberg Global Aggregate Bond fell 2.5%. Commodities were the strongest asset class (S&P GSCI +17.9%). The USD was broadly flat over the quarter (+0.3%), although it rose 2.0% in September.

For Stenham, three conclusions stand out.

1) As the July unwind demonstrated, concentration risk is building beneath market indices. AI-related issuance and positioning now span both equity and credit, so we are assessing this exposure across our managers in aggregate rather than by strategy label.
2) Higher rates combined with tight headline spreads are concentrating stress in the lowest-rated credit. It remains to be seen whether this spreads more widely across credit markets.
3) A more volatile and less directional market reinforces the case for portfolios that aim to have limited dependence on the direction of equity or bond markets.

Our central view

Headline indices are masking a high degree of underlying volatility. Quarterly index returns reveal little about the dispersion, crowding and financing stress beneath the surface. Our focus has therefore been on controlling common factor exposure across our managers and strategies.

Market environment: opportunity behind the headlines

AI sector dominates markets

The scale of the AI theme is hard to overstate. On current estimates, which have only moved higher, AI-related capital expenditure will reach 3.6% of US GDP, compared with 1.1% for the technology build-out of the early 2000s and 2.2% for the 19th-century railroads. Nor is the theme confined to a handful of listed technology companies. The infrastructure needed to train and run increasingly capable models is driving investment across semiconductors, memory, data centres, power generation, grids and the commodities that support them.

At the same time, equity market concentration is well documented: the Magnificent 7 now account for 36.1% of S&P 500 earnings and 40.6% of its market capitalisation.

Weight of the top 10 companies in the S&P 500[1]

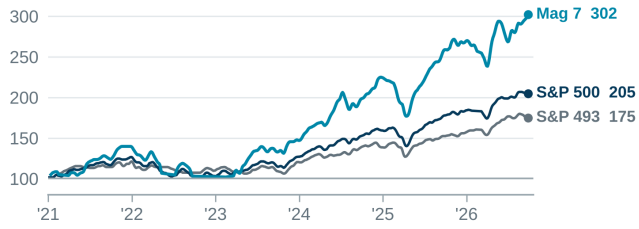
% of S&P 500 market capitalisation & % of last 12M earnings



Magnificent 7 performance in the S&P 500[1]

	'21	'22	'23	'24	'25	'26 YTD
S&P 500	27%	-19%	24%	23%	16%	12%
S&P 493	23%	-12%	11%	14%	13%	12%
Mag 7	40%	-40%	76%	48%	23%	12%
*Mag 7 share of S&P 500 return**	*33%*	*56%*	*63%*	*55%*	*46%*	*34%*

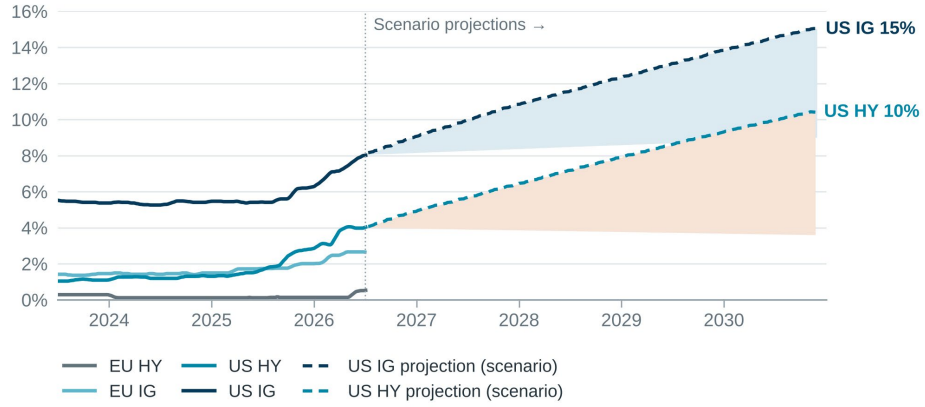
Price return, indexed to 100 on 1 Jan 2021



AI is now a credit story too. The hyperscalers are the largest investment grade issuers, and AI-related names make up around 25% of both IG and high yield issuance this year. With consensus capex now $8tn, double the start-of-year estimate, AI is on course to become the largest sector in credit, raising the risk of tighter correlation with equities. This is most pronounced at the long end, where hyperscalers represent 30% of long-duration corporate issuance.

Share of credit indices related to AI[2]

AI-related public debt as a share of IG & HY markets (%)



[1] *Source: JP Morgan Asset Management (Guide to the Markets). * Share of S&P 500 price return attributable to the Mag 7. 26F = forecast.*

[2] *Source: Sona Asset Management, Bloomberg as of 31 Aug 2026. Dashed lines and shaded bands show the projected scenario range.*

We continue to believe in AI's transformative potential. But a transformative technology does not guarantee good outcomes for everyone financing its build-out. The railway boom of the 1840s and the telecom fibre build-out of the late 1990s both reshaped the economy yet left over-leveraged participants unable to earn an adequate return on capital. Hundreds of billions of dollars may well be poorly invested this time too. The AI debate has moved from whether demand is real to whether the capital can be funded and earn a return. The bear maths is hard to dismiss; consensus has hyperscalers and frontier labs spending $5-7tn between 2025 and 2030. Spenders need to generate $2-3tn of incremental annual AI revenue, a considerable sum in the context of $6tn in global IT spend today. We therefore expect the gap between large, well-funded issuers and smaller companies that depend on continued access to financing to matter more and more.

Early signs of stress are already visible. Hyperscaler CDS spreads have widened, though this reflects supply technicals more than any deterioration in credit quality. The real strain is in more levered names such as CoreWeave, whose bonds traded in the 70s recently.

Stenham view

We monitor AI-related exposure across all our managers on a consolidated basis. While we believe the theme will create attractive opportunities, we are careful to keep aggregate risk at a manageable level and, importantly, to ensure the portfolio is not overly exposed should a stress scenario materialise.

Increase in interest rates

Q3 saw a dramatic move in long-end interest rates. The 10-year Treasury yield ended the quarter at 5.29%, its highest since 2007, and the 30-year at 5.62%, its highest since 2004. The Fed raised rates for the first time since 2023, and the market is pricing in a further hike at its December meeting.

There was no single cause. Heavy supply (to which AI-related issuance contributed), elevated commodity prices, hawkish Fed commentary and stronger growth all pushed yields higher, while both the term premium and inflation expectations rose. Concern over the fiscal direction of developed economies also came to the fore, particularly in the more exposed countries. France is the clearest example: high debt, a large deficit and a volatile political backdrop have pushed the spread for OATs over German bunds above 150bps.

Stenham view

Higher rates and heavy AI issuance are making credit both more expensive and harder to obtain, which, all else being equal, will weigh on weaker capital structures and on profitability. For governments, elevated debt means higher rates sharply increase servicing costs. Spending cuts have little political support, leaving higher taxes or more borrowing as the likely response.

Political division increases

Political division only seems to be deepening. Where voters face a choice between candidates or parties at opposite ends of the spectrum, even relatively small swings in the vote can produce stark differences in policy. Brazil's recent presidential election was a case in point, with a close and unpredictable contest between right and left. In France, frequent and at times violent protests have fuelled division ahead of next year's presidential election, where polling points to the possibility of a run-off between the far right and the far left.

In the US, the November mid-terms have just taken place and look set to reshape the balance of power in Congress. Whatever the final tally, the result points to a more confrontational political environment for the remainder of President Trump's term, with policymaking likely to become more difficult.

Division on this scale inhibits longer-term decision-making, and that has consequences for fiscal policy, regulation and, ultimately, markets.

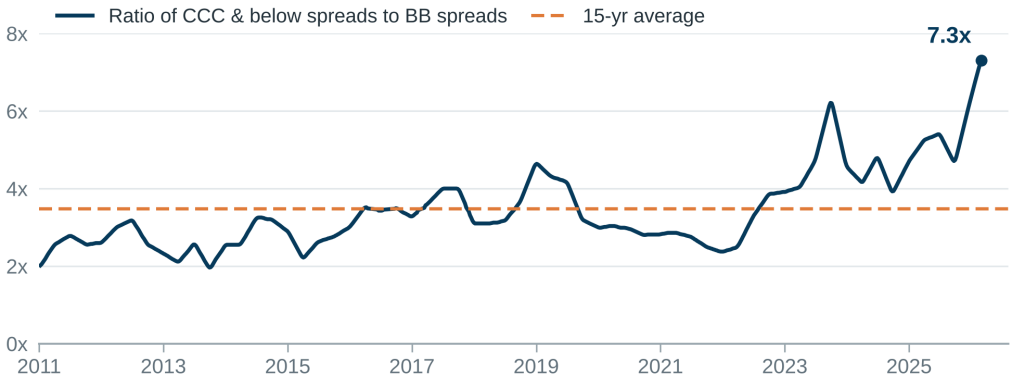
Stenham view

We do not position our portfolios around any single electoral outcome. Our emphasis is on managers driven by security selection and relative value, with macro and long-volatility exposure retained as a potential buffer should political shocks hit rates, currencies or credit spreads.

Credit dispersion and stress

Index-level credit spreads remain near historic tights, but this masks real stress in lower-rated names. At quarter-end, CCC high yield bond spreads were at the 78th percentile of their post-2002 range and CCC loans at the 96th, against the 11th percentile for the high yield index overall. Dispersion between the weakest credits and the rest of the market is near record levels.

Historical ratio of CCC & below spreads to BB spreads[1]



While CCC stress varies by issuer, higher rates are the common driver. Some cases involve liability management exercises (LMEs) or political factors, but most reflect debt issued in the near-zero rate environment of 2020–21 now needing to be refinanced at far higher rates. Many weaker capital structures cannot absorb that, and restructurings are likely to follow.

Stenham view

For now, credit remains a smaller allocation in our portfolios, with our largest exposure in uncorrelated strategies. We remain open-minded but would want stress to broaden across more names before the opportunity set becomes compelling. At that point, it could offer both distressed investments and the chance to provide out-of-court refinancings that avoid formal bankruptcy. Heavy AI-related supply, by crowding out capital for other borrowers and pushing spreads wider, may well accelerate that process.

Main perspective

This is a market that rewards selectivity. Strong index returns are not the same as low risk, and a market that keeps rewarding optimism grows more exposed to complacency. That is why we continue to favour managers whose returns aim to have limited dependence on the market's direction.

[1] *Source: Arini Capital Management, Bloomberg (Bloomberg CCC Index and Bloomberg BB) as of 31 Aug 2026.*

Strategy review

Our core multi-strategy portfolios saw no significant strategy shifts this quarter. Our focus remains on returns with low correlation to broader markets, hence higher allocations to global macro, market-neutral equity long/short, event arbitrage and market-neutral systematic strategies. We limit exposure to less liquid strategies and those that depend on leverage to generate returns.

Discretionary macro

Discretionary global macro managers had a subdued quarter, ending with small losses overall. July's drawdown was led by managers with exposure to the AI theme. August was positive, but managers struggled again in September as bonds sold off sharply and yield curves bear-flattened, with rates-focused managers the main detractors. Throughout a turbulent quarter, managers kept risk tightly controlled. There were also bright spots, including a commodity specialist and Asia-based macro managers, who sidestepped much of the volatility and generated uncorrelated returns from their home markets.

Stenham view

Despite a volatile quarter, our macro managers remain constructive on the opportunity set. Rising interest rates, unpredictable politics, growing doubts over the durability of the AI capex cycle and concerns about the health of credit markets are creating cross-currents that should continue to generate attractive trading opportunities.

Risk monitored

We are watching for crowding in rates and equities, wary of a repeat of March, when consensus trades were sharply unwound. Many younger portfolio managers have never traded a higher-rate environment, so we continue to upgrade the portfolio towards managers with that experience and a long record of disciplined risk management.

Systematic

In contrast, systematic strategies contributed strongly, with every manager in the allocation positive. Gains came across equities and futures, led by equity statistical arbitrage managers who capitalised on volatility, mean reversion and liquidity provision opportunities.

The strategy has held up well so far in what has been a challenging year marked by several distinct market regimes.

Stenham view

We continue to believe that an environment with multiple competing narratives, healthy volatility and good liquidity provides tailwinds for these strategies. Systematic managers are also at the forefront of using AI and new techniques to continuously enhance their processes.

Risk monitored

Continued strong performance tends to attract more capital, which can lead to crowding and raises the risk of a sharp de-grossing in the event of an unforeseen market shock. We favour managers who take less factor risk and operate with shorter holding periods.

Relative value

Relative value strategies were also modestly profitable. Unlike their directional counterparts in macro, relative value rates managers preserved capital and generated gains from the dislocations, while keeping overall directional exposure to fixed income very low throughout the quarter. Treasury management was a meaningful source of returns.

Stenham view

Relative value strategies, particularly in fixed income, have delivered more subdued returns over the past 12-18 months. We expect returns to improve as volatility in Treasury markets increases and yields remain at higher levels.

Risk monitored

Although leverage is running well below historical averages and managers are carrying hedges, a sudden shock in fixed income markets could still trigger a period of forced de-leveraging.

Long Volatility

Long volatility managers were positive, led by one manager's long exposure to rates volatility. With equity dispersion near record highs, correlation is cheap, and one manager is positioned long correlation, which would rise sharply in a crisis.

Stenham view

We continue to value this allocation as a potential source of portfolio protection, particularly as market pricing of volatility remained muted until recently, despite growing uncertainty.

Risk monitored

Because volatility tends to mean-revert, it is important for managers to monetise gains quickly when a crisis hits.

Equity long/short

Fundamental equity long/short managers detracted over the quarter, though they remain positive YTD. The HFRI Equity Hedge (Total) declined even as broad global equity indices posted gains. Resilient earnings and continued strength in AI capex kept the major indices near their highs, but headline performance masked extreme volatility underneath. This was most evident in July, when high-momentum AI and semiconductor stocks unwound violently. More broadly, rising oil prices, higher rates and widespread deleveraging created a hostile environment for momentum, small caps and crowded longs. We expect AI capex to remain strong, but the market is unlikely to keep rewarding the theme indiscriminately, and investors will need to be more discerning in their exposure.

Stenham view

Q3 was a difficult environment for fundamental long/short managers. With non-fundamental factors exerting an outsized influence on returns, the quarter tested risk management more than stock selection.

Risk monitored

In this environment, we are paying particularly close attention to leverage, crowding and how managers handle non-fundamental risks within their portfolios.

Event-driven

Event-driven results were mixed. One manager was positive, sticking to high-probability deals and avoiding complex or regulatory-heavy transactions. Another posted moderate losses from softer-catalyst names, partly offset late in the quarter by completion of the Paramount/Warner Bros merger. We remain cautiously optimistic: higher rates paused activity, but the mid-term results have increased the prospect of a Democratic administration in 2029, which may prompt companies to transact while the current antitrust regime is seen as more accommodating.

Stenham view

We value having a mix of styles within the allocation, and the contrast between the two managers illustrates the benefit of pairing high-completion specialists with managers able to underwrite more complex situations.

Risk monitored

We continue to monitor deal-completion risk and position concentration closely, particularly in softer-catalyst names, as shifting politics may add further uncertainty to deal outcomes.

Credit

Credit managers detracted over the quarter, although the allocation remains modestly positive for the year. Losses were concentrated in stressed positions in the communications and telecoms sector. While largely idiosyncratic, they also reflected the widening of lower-rated credit relative to higher-rated credit.

Convertible bonds cheapened relative to fair value, so positions fully hedged against equity risk lost value. Issuance remained very strong in Q3, bringing the YTD total to $230bn, compared with $173bn for the whole of 2025. Together with active capital markets, this should provide a strong opportunity set for convertible bond trading.

More broadly in credit, the dispersion between higher- and lower-quality borrowers, combined with upcoming refinancing needs, should generate opportunities, though we remain conscious of the illiquidity of the asset class.

Stenham view

Our managers have extensive experience across multiple credit cycles, and we believe they are well placed to navigate a more challenging environment.

Risk monitored

We are alert to the risk of contagion if other managers in this less liquid asset class face redemptions and are forced to sell. While we believe our managers are well positioned, we remain cautious and intend to keep dry powder available should dislocations emerge.

Outlook

Although returns were more modest this quarter, our outlook remains encouraging across most strategies.

AI-related investment, geopolitical uncertainty, persistent inflation and uneven financing conditions should continue to create dispersion across companies, countries and capital structures. These conditions are supportive for hedge fund managers, but they also heighten the importance of disciplined manager selection and portfolio construction.

Our objective is not to identify a single winning strategy but to combine differentiated managers so that the portfolio can participate in attractive opportunities while remaining balanced across equity, credit, macroeconomic and volatility risks. We remain diversified by strategy, and in an increasingly uncertain environment we are more cautious than ever about illiquidity and leverage.

Our priorities are unchanged: secure access to high-quality managers, maintain balance across distinct return drivers and manage the common risks that can build up beneath apparently diversified holdings.

Closing perspective

We believe the current environment favours experienced hedge fund managers with a strong history of risk management. Stenham's role is to identify differentiated investment talent, seek access to capacity-constrained opportunities and combine those managers into portfolios designed to be resilient.

Thank you for your continued confidence. Please get in touch if you would like to hear more about our strategies or funds. Further information is also available on our website.

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