SKYBOUND CAPITAL

Quarterly Report

Q3 2026 Review and Q4 2026 Outlook

Market & Macro Review for Q3 2026

Three-quarters of the way through the year and volatility simply hasn't let up. The same persistent themes dominate – the Gulf War and the ensuing energy crisis, sticky inflation and rising bond yields resulting in more expensive debt, higher debt-servicing costs and interest rates outperforming growth (r > g). See below a summary of the performance for Q3 and YTD 2026 by asset class and style as well as prior years:

2017	2018	2019	2020	2021	2022	2023	2024	2025	YTD	Q3 '26
MSCI EM 37.8%	Global Agg -1.2%	Growth 34.1%	Growth 34.2%	Global REITs 32.6%	Cmdty 16.1%	Growth 37.3%	Growth 26.2%	MSCI EM 34.4%	Cmdty 32.9%	Cmdty 16.2%
Growth 28.5%	Global REITS -4.9%	DM Equities 28.4%	MSCI EM 18.7%	Cmdty 27.1%	Value -5.8%	DM Equities 24.4%	DM Equities 19.2%	Value 21.6%	MSCI EM 23.7%	Value 4.0%
Small cap 23.2%	Growth -6.4%	Small cap 26.8%	DM Equities 16.5%	Value 22.8%	Global Agg -16.2%	Small cap 16.3%	Value 12.3%	DM Equities 21.6%	Value 15.3%	DM Equities 2.0%
DM Equities 23.1%	DM Equities -8.2%	Global REITs 24.4%	Small cap 16.5%	DM Equities 22.3%	DM Equities -17.7%	Value 12.4%	Small cap 8.6%	Growth 21.3%	Small cap 12.7%	Growth 0.0%
Value 18.0%	Value -10.1%	Value 22.7%	Global Agg 9.2%	Growth 21.4%	Small cap -18.4%	Global REITs 10.9%	MSCI EM 8.1%	Small cap 20.4%	DM Equities 12.1%	MSCI EM -0.2%
Global REITS 8.0%	Cmdty -11.2%	MSCI EM 18.9%	Value -0.4%	Small cap 16.2%	MSCI EM -19.7%	MSCI EM 10.3%	Cmdty 5.4%	Cmdty 15.8%	Growth 9.0%	Global Agg -2.5%
Global Agg 7.4%	Small cap -13.5%	Cmdty 7.7%	Cmdty -3.1%	MSCI EM -2.2%	Global REITs -23.7%	Global Agg 5.7%	Global REITs 2.8%	Global REITs 8.4%	Global REITs 5.8%	Small cap -3.6%
Cmdty 1.7%	MSCI EM -14.2%	Global Agg 6.8%	Global REITs -10.4%	Global Agg -4.7%	Growth -29.1%	Cmdty -7.9%	Global Agg -1.7%	Global Agg 8.2%	Global Agg -2.7%	Global REITs -5.7%

Source: Bloomberg, FTSE, LSEG Datastream, MSCI, J.P. Morgan Asset Management. DM Equities: MSCI World; REITs: FTSE NAREIT Global

Despite the headwinds of the above factors resulting in Brent crude moving back above $100 per barrel, European gas prices over €70 per megawatt-hour for most of September and over 80% of developed-market central banks (CBs) raising policy rates – as well as the US raising a new wave of trade tariffs, the global economy still displays some degree of resilience. The latter is evidenced by activity indicators, employment data, consumers holding up (by drawing on savings as incomes soften) and the massive splurge in AI investing. Summarising performance:

- The re-escalation in the Iran conflict and the breakdown in the MoU (Memorandum of Understanding) drove up oil prices. Brent crude rose +42% in Q3 while West Texus Intermediate (WTI)blom Crude oil rose +30%.
- Agricultural commodities also surged. The Bloomberg Agriculture Spot Subindex rose +13% in Q3, its biggest since 2022. Sugar (+23%), Corn (+21%) and Wheat (+16%) were the main highlights.
- The inflationary push had a huge impact on yields in September alone: US 10-year Treasury yield surged +53bps – their biggest jump in four years. The Eurozone (EZ) was

not spared either! Euro-area sovereign bonds fell -4.4% over Q3, their worst quarterly performance since 2022. French 10-year Bonds (OATs) soared over German Bunds.

- Earnings remain robust with Flash Purchasing Managers' Index (PMI) (activity) indicators showing an acceleration in growth. The S&P 500 gained +2.3% over Q3 while the Magnificent Seven gained +11.1%. Ironically, the growth strength itself contributed to the bond sell-off.
- The bond sell-off occurred across both long-dated and short-maturity bonds. The former highlights ever-rising risk premia while the latter reflects rising rates.

Outlook for Q4 2026

What happens when the genie **simply won't go back in its bottle?!** In my last quarterly report, I summarised the current state of play as follows:

Growth Engine	Current Status	Commentary
Consumer	Slowing	Higher oil squeezing disposable incomes
AI Capex	Strong	Still the world's most powerful growth engine
Government Spending	Accelerating	Defence, infrastructure and industrial policy **[Geopolitics → Government Spending → Growth]**
Housing	Improving	Gradual recovery as rates stabilise
Manufacturing	Mixed	AI strong, consumer goods weaker

The first three remain largely unchanged. Housing is starting to suffer as mortgage rates begin to bite for new mortgages. Manufacturing is seeing input prices rise and this is reflected in output prices at the factory gates. The recent lull in military action is almost entirely down to upcoming elections at the end of this month in Israel and the first week of November in the US (midterms).

At the end of September, key bond yields stood at:

Country	10-year yield (%)	30-year yield (%)	10-year move, rolling one-month period (bp)	30-year move, rolling one-month period (bp)
US	5.19%	5.47%	+53bp	+30bp
UK	5.38%	5.87%	+42bp	+16bp
Germany	3.60%	3.87%	+35bp	+13bp
Japan	3.09%	4.16%	+21bp	+10bp

Since then, they have shot up even more! The US 10y now stands at 5.24% while the 30y is at 5.60%. In the UK, they stand at 5.42% and 5.93% respectively. Germany and Japan's 10y have come down a touch.

What jumps out is the scale of the sovereign bond sell-off – not just US Treasuries either. Every major market has experienced a material increase in 10y yields over the past month while 30y yields have also risen across all four – just not to the same extent. In other words, there has been a 'flattening' taking place at the longer end of the yield curve. The significance of this is higher

interest-servicing costs on debt – not existing but new debt used to finance funding needs. It would be wrong to assume ALL debt suddenly moves higher.

This leads into the first of two major, looming issues: **The Global Maturity Wall.** By kicking the can down the road all these years, that same can has simply become bigger! The issue isn't just about the sheer size of debt outstanding – but HOW MUCH of that debt now needs to be refinanced at substantially higher rates given where yields and interest rates are moving. The OECD's Global Debt Report 2026 (published March 2026) addresses much of this issue:

Borrowing & Refinancing Requirements	Latest	Why it matters
Government + Corporate borrowing in 2026	**$29tn**	**+$4tn / +17% vs 2024; roughly double a decade ago**
OECD Sovereign borrowing in 2026	$18tn	Record borrowing requirement
Of which: refinancing existing Sovereign debt	78%	$14tn is refinancing rather than new borrowing
OECD fixed-rate Sovereign debt maturing 2026 to 2028	⅓ of outstanding	Huge volume of legacy debt rolling over
IG Corporate debt refinancing 2026 to 2028	24% of outstanding	**65% of maturities currently carry coupons ≤4% (a significant refinancing gap!)**
Non-IG Corporate refinancing 2026 to 2028	31% of outstanding	**67% currently carry coupons ≤6% (significant refinancing pressure building!)**
9 major AI companies: projected bond issuance 2026 to 2030	$1.2tn	New borrowing competing for the same capital

The issue is: **cheap legacy debt maturing → refinances at today's much higher yields → interest expense rises → earnings impact → more capital required → investors demand greater compensation.** To make things even more complicated, governments and corporates have responded to higher long-term borrowing costs **by shortening the maturity of new issuance.** The share of debt over 10y issuance has fallen to its lowest level since 2009 for sovereigns and the lowest on record for corporates.

This leads into the second of two looming issues: **Valuation – based on the Dividend Discount Model (DDM). At its simplest, the value of an equity is the present value of its future cash flows.** So, comparing – and contrasting – current (trailing) dividend yields off our major indices to their national sovereign 10y yield, we have the following (as of end-September):

Market	Current dividend yield	Current 10-year sovereign yield (%)	Yield gap (i.e. Equity dividend yield less 10-year Sovereign yield)
S&P 500	1.04%	~5.2%	~-4.2%
FTSE 100	3.08%	~5.4%	~-2.3%
Euro Stoxx 50	2.32%	~3.6%	~-1.3%
TOPIX	1.8%	~3.1%	~-1.2% to -1.4%

In other words, **the risk-free alternative is becoming increasingly competitive with equity income.** For instance, in the US, an investor can earn roughly 5% or more from a 10y Treasury versus, say, a 1% cash dividend from the S&P 500. That's NOT to say Treasuries are automatically

preferable! However, it does mean considerably MORE of the equity valuation must now be justified by future growth.

Index	Div. Yield	5-year Dividend Growth*	Terminal Growth*	+25bp	+50bp	+100bp
S&P 500	1.04%	11.0%	4.0%	**-14.5%**	**-25.4%**	**-40.5%**
FTSE 100	3.08%	5.0%	4.0%	**-7.0%**	**-13.0%**	**-23.0%**
Euro Stoxx 50	2.32%	7.0%	3.5%	**-7.3%**	**-13.7%**	**-24.1%**
TOPIX	1.8%	8.0%	2.5%	**-9.6%**	**-17.6%**	**-30.0%**

*The valuation changes are NOT market forecasts! These are based on a two-stage DDM. Only the sovereign/risk-free rate is being "shocked" in the above (i.e. +25bp, +50bp and +100bp). The rest (dividend growth, terminal growth and equity risk premium) are all held unchanged.

The message is stark: the lower the current dividend yield or the more distant the cash flows, the greater is the theoretical sensitivity to higher discount rates. That's why the potential impact is so large – particularly in the case of the S&P 500! What happens if the discount rate (sovereign) permanently rises say +50bp and absolutely nothing else changes? **Real markets do not behave like that because a +50bp hike may well coincide with a stronger nominal GDP à stronger revenues à stronger earnings à stronger dividends.**

If +50bp (+0.50%) theoretically knocks -25% off the S&P 500 DDM valuation, how much additional earnings/dividend growth is required to restore that 25% back i.e. can wegrow our way out of it?

This is where the distinction between corporates and sovereigns becomes key:

- **CORPORATES: the key question is what level of earnings offsets the refinancing pressure?** OECD identified 24% of global IG (investment grade) corporate debt and 31% of non-IG debt outstanding as of end-2025 that needs to be refinanced in 2026 to 2028. Of the debt coming due, 65% of IG carries a coupon of 4% or less and 67% of non-IG carrying a coupon of 6% or less! **The OECD expects much of this legacy debt to refinance at a higher cost.** The issue is whether earnings can rise quickly enough to absorb these costs **e.g. a company refinancing 25% of its debt from 4% to 5% increases the total interest bill by some +6% EBITDA (Earnings Before Interest, Tax, Depreciation & Amortisation) growth to preserve Interest Cover (IC). Refinancing the same portion at 6% raises that hurdle to around 13% of EBITDA growth.**

- **SOVEREIGNS: the key question here is how much growth offsets higher rates?** It's wrong to suggest GDP has to exceed the 10y Bond yield because governments refinance gradually, not the entire debt at the same time. The relevant rate is the effective interest rate across the ENTIRE debt stack – not today's marginal 10y yield. **The OECD's** research shows interest payments **amounting to some 3.3% of GDP in 2025. It projects this to add +2.5% to the OECD debt-to-GDP ratio while inflation reduces it by 2.4% in 2026.** In other words, the beneficial denominator effect from inflation is no longer keeping ahead of the interest bill.

CONCLUSION: Can we grow our way out of this?

Possibly – but the hurdle is rising!

- **For corporates, the issue is whether earnings can grow faster than the interest bill?** If 25% of debt currently costing some 4% refinances at 5%, the total interest bill rises by some 6%; refinance it at 6% and the increase becomes some 13%! It requires a roughly corresponding amount in growth to preserve existing interest cover.

- **For governments, the issue is nominal growth vs the effective interest rate on the entire debt stack – NOT today's 10y yield.** As more cheap legacy debt refinances at today's higher rates, that effective rate rises, and so doesthe growth hurdle.

And the great paradox? AI! AI is currently PART of the problem: Capex → Borrowing → Capital Demand → Yields rise. If, ultimately, it delivers the promised productivity gains, **AI could become part of the solution: Productivity rises → Earnings/GDP rise → Greater capacity to absorb those higher financing costs.** It all comes down to timing. A US/Iran settlement would certainly help put PART OF THE GENIE BACK INTO ITS BOTTLE. However, it doesn't change the Maturity Wall, government deficits or the extraordinary competition for capital!

The final answer may not even be substantially lower yields at all; it may be sufficiently stronger earnings, productivity and nominal GDP growth to LIVE WITH HIGHER YIELDS! The Genie may eventually go back in the bottle – but only partly. It's highly questionable whether it still fits!

AUTHOR

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Jabir joined Skybound Capital in 2011 and serves as Group Chief Investment Strategist. He leads the firm's macroeconomic research. He sits on the Investment Committee, where he evaluates prospective lending opportunities, assesses credit quality and downside risk, and determines whether proposed transactions meet the firm's return and risk criteria. He plays a central role in shaping Skybound's credit framework and communicating market insights to institutional and professional clients.

Previously, Jabir worked at Hasma Capital Advisors as Investment Director and at Punter Southall Financial Management as Chief Investment Officer. He is a Fellow of the Chartered Institute of Marketing, holds an MBA from Warwick Business School anda BA (Hons) inAccounting and Finance from North London University.

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