

Global Outlook

October 2026

THE PRICE OF RESILIENCE

The global economy is proving remarkably resilient

More inflation is being driven by geopolitics, energy, trade and supply constraints that central banks cannot directly control

The cost of capital is structurally higher than before the pandemic, raising the hurdle rate for investment

BEVAN GRAHAM

IMPLICATIONS FOR INVESTORS

Interest rate-sensitive assets had a tough Third Quarter as bond yields surged

Equities held on to modest gains, but the advance remains very narrow and many stocks missed out

NZ Dollar staged an abortive rally, but could not hold gains as US Dollar rebounded after Fed. tightening

GREG FLEMING

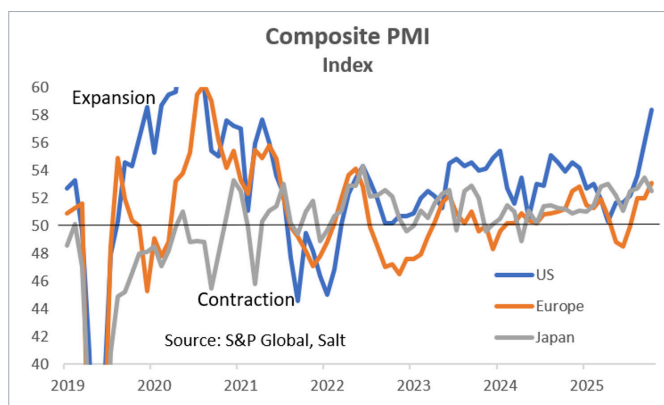
The Price of Resilience

Structural change meets economic resilience

In our July Global Outlook, we argued that many of the structural themes we had been highlighting for some time were moving centre stage. Geopolitical tensions, trade fragmentation, fiscal pressures, demographic change and technological disruption were no longer simply long-term considerations. Increasingly, they were influencing the economic cycle and financial markets in real time.

Three months later, that assessment still holds. If anything, those forces have become more overt. Energy markets remain volatile, geopolitical uncertainty is elevated, governments face increasingly difficult fiscal choices, while the investment demands associated with artificial intelligence, defence, energy security and supply-chain resilience continue to grow.

What has perhaps been more surprising is how well the global economy has absorbed these pressures. Global growth has remained comparatively resilient despite higher energy prices, tighter monetary policy and rising long-term bond yields. The US economy continues to expand at a solid pace, while activity elsewhere has generally held up better than might have been expected given the scale of the shock's economies have absorbed.



That resilience is encouraging. But it also raises an important question - if economies can withstand higher interest rates better than previously thought, have we underestimated where interest rates ultimately need to settle?

There is another complication. The nature of inflation itself is changing. Increasingly, the inflation shocks confronting policymakers are originating from areas over which central banks have little direct control: geopolitics, energy, tariffs, supply chains and structural capacity constraints. Monetary policy remains critical in preventing those shocks becoming embedded, but higher interest rates cannot themselves produce more energy, remove a trade barrier or expand an economy's productive capacity.

Many of the solutions therefore lie on the supply side. Greater energy security, more resilient supply chains, better infrastructure, technological innovation and stronger productivity all require investment. At the same time, governments are borrowing heavily to fund defence, ageing populations and existing fiscal commitments.

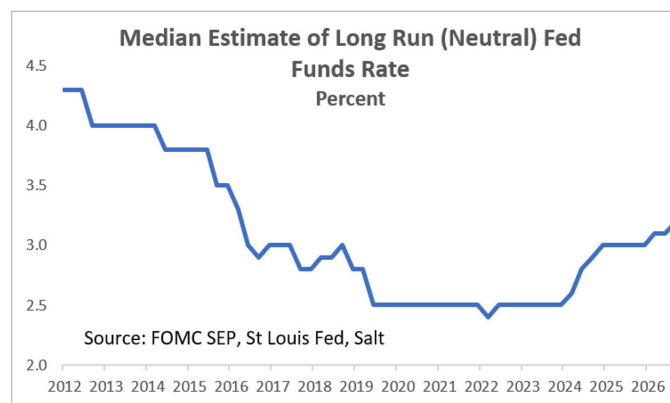
The result is increasing competition for capital. That interaction sits at the heart of this Global Outlook. The world needs substantial investment to become more resilient and expand productive capacity. But financing that investment at the same time as governments are borrowing heavily may itself keep interest rates and the cost of capital higher than investors became accustomed to during the decade before the pandemic. Resilience, in other words, comes at a price.

Maybe neutral really is higher

For much of the period following the Global Financial Crisis, the prevailing assumption was that neutral interest rates had moved permanently lower. Ageing populations, weak productivity growth, excess global savings and persistent disinflation were all cited as reasons why economies could sustain only very low real interest rates.

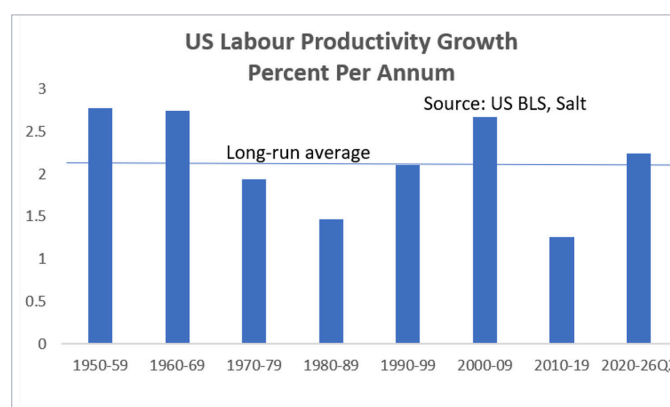
That assumption increasingly deserves to be challenged. The global economy has absorbed a significant tightening in monetary conditions without experiencing the downturn many expected. Labour markets have generally remained resilient, corporate investment has continued and activity has held up despite policy rates substantially above their pre-pandemic norms.

In the United States, the Federal Reserve continues to describe activity as expanding at a solid pace, with resilient domestic spending, strong productivity growth and robust capital investment.



There are good structural reasons why neutral rates may now be higher. Fiscal policy is generally more expansionary than during the 2010s. Governments need to finance defence, infrastructure and energy security while simultaneously meeting the costs associated with ageing populations. Businesses are investing heavily in artificial intelligence, automation, supply-chain resilience and energy infrastructure. These forces increase the demand for capital at precisely the time governments are also competing more aggressively for global savings.

Stronger productivity could ultimately offset some of those pressures. Indeed, recent US productivity performance is one reason the economy may have been able to sustain comparatively strong growth without generating even greater inflation pressure. But stronger productivity also increases potential returns on investment and can therefore support a higher equilibrium real interest rate.



There is an important counterargument. The resilience of growth does not, by itself, prove that neutral rates have moved higher. Monetary policy operates with long and variable lags, and many households and businesses locked in low borrowing costs before interest rates rose. The full impact of higher rates may therefore still be working through the economy.

That possibility should not be dismissed. But as time passes without a significant deterioration in activity, the case that economies can tolerate higher interest rates becomes increasingly difficult to ignore.

None of this means rates only move higher from here. Monetary policy will continue to fluctuate around neutral as economic conditions change. The more important point is that the centre of gravity may have shifted.

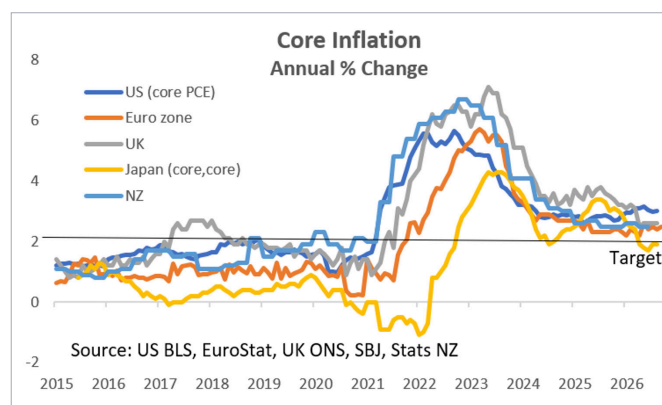
For New Zealand, that reinforces our view that neutral may ultimately sit closer to an OCR of around 3.5% than the significantly lower levels markets have periodically priced in. More broadly, the question is becoming less about when interest rates return to their old normal and more about whether that old normal still exists.

Central banks in a different inflation world

A potentially higher neutral rate is only one reason why the next phase of monetary policy may prove more difficult. The other is that inflation itself has become harder to interpret.

For much of the conventional monetary policy framework, inflation was viewed primarily through the lens of aggregate demand. When demand exceeded the economy's productive capacity, inflation rose and higher interest rates were required to restore balance.

That mechanism still matters. But an increasing share of the inflation shocks confronting central banks is originating elsewhere. Energy markets, geopolitical conflict, tariffs, trade restrictions and supply-chain disruption can all push prices higher without reflecting excessive domestic demand. Structural forces including ageing populations, infrastructure constraints and weaker globalisation can also limit economies' ability to expand supply.



Central banks can respond to inflation generated by these forces, but they cannot directly address its source. Raising interest rates will not increase global oil production, reopen a disrupted shipping route, remove a tariff or build additional electricity generation.

Instead, monetary policy works indirectly. Central

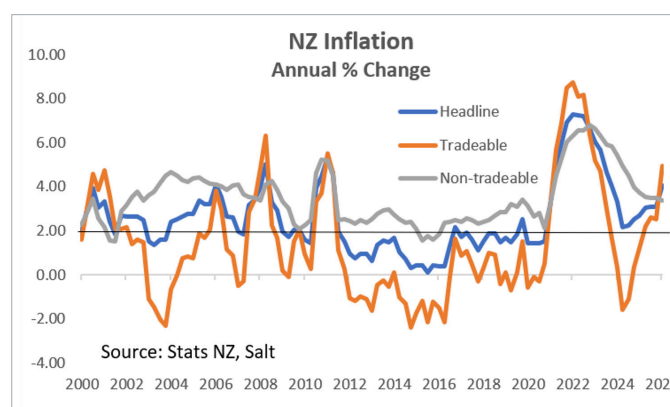
banks can weaken demand elsewhere in the economy sufficiently to offset inflation generated by the original supply shock.

That creates an uncomfortable trade-off. Respond too aggressively and policy-makers risk unnecessarily weakening growth and employment in response to an inflation problem monetary policy did not create. Look through supply shocks entirely and they risk allowing higher headline inflation to influence expectations, wages and broader price-setting behaviour.

The challenge is therefore increasingly one of diagnosis. Central banks must distinguish between inflation that reflects excessive domestic demand and relative-price shocks that should initially be looked through but closely monitored for second-round effects. That is easier said than done, particularly when several shocks arrive simultaneously or persist for longer than expected.

Recent energy-price volatility illustrates the problem. The lesson from the Iran conflict was not that oil prices would remain permanently high. Prices subsequently fell sharply before rising again. The more important lesson was how quickly geopolitical events can change the inflation-growth trade-off.

New Zealand provides a useful example. Headline inflation rose to 4.1% in the June quarter, largely reflecting higher fuel prices associated with the Middle East conflict. Yet inflation excluding vehicle fuels fell to 2.9%, most measures of core inflation remained within the target band, though in the top half, and longer-term inflation expectations remained around 2%. The RBNZ nevertheless raised the OCR in September, reflecting the need to guard against the risk that externally generated inflation eventually becomes embedded in domestic price and wage setting.



That helps explain why the next stage of monetary policy may look different from the last. We do not necessarily expect another large, synchronised global tightening cycle. Instead, central banks may make more frequent but smaller adjustments around neutral as they respond to changing domestic conditions and external shocks.

This does not make monetary policy less important. If anything, maintaining inflation credibility becomes more important when supply shocks are more frequent. But interest rates cannot carry the entire burden.

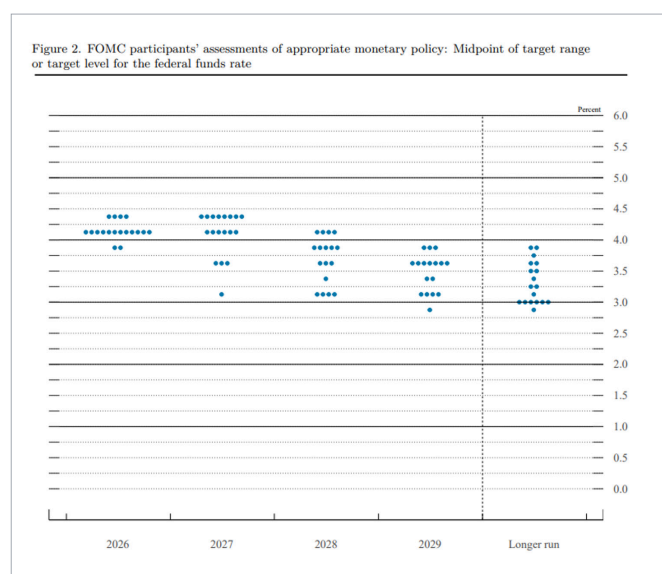
Governments also have a role through policies that improve productivity, competition, infrastructure, energy supply and the economy's ability to respond to shocks. Ultimately, many of today's inflation challenges require an expansion of supply rather than simply the suppression of demand.

Warsh's Fed: from theory to practice

When we wrote our July Global Outlook, Kevin Warsh's chairmanship of the Federal Reserve was sufficiently new that much of the discussion centred on what a Warsh-led Fed might eventually look like.

We now have considerably more evidence. One early lesson is that Warsh has not produced the dramatically easier monetary policy some initially expected. The Federal Reserve raised the funds rate by 25 basis points in September, taking the target range to 3.75–4.0%. The decision was unanimous, with the Committee pointing to solid economic activity, resilient domestic spending, strong productivity and robust capital investment while noting that inflation remained elevated.

The September projections are also instructive. They suggest policy rates will decline only gradually over time, while the longer-run estimate of the funds rate has continued to edge higher. That is hardly the profile of a central bank expecting a rapid return to the exceptionally low interest-rate environment of the previous decade.



Warsh's influence may ultimately be felt as much through the Fed's institutional framework as through the precise level of the funds rate. Communication has become more concise, forward guidance less prescriptive, and policymakers appear increasingly reluctant to validate

market expectations simply because those expectations have become embedded in asset prices.

That is healthy, but it comes with challenges. Markets will inevitably attempt to anticipate the Fed, while the Fed must avoid allowing those expectations to dictate policy simply through their impact on financial conditions; the “hall of mirrors” problem Warsh himself has highlighted.

There is also an interesting tension between Warsh’s optimism about productivity and the inflation environment confronting the Fed. Stronger productivity potentially allows the US economy to grow faster without generating inflation. Artificial intelligence may eventually play an important role in delivering that outcome.

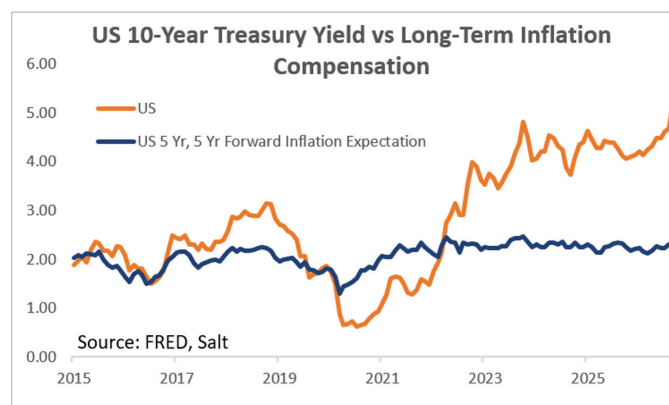
But central banks need to be wary of conducting monetary policy today on the basis of productivity gains that may arrive tomorrow. The investment required to deliver those gains may itself add to demand and inflation before productive capacity meaningfully expands.

For now, the Warsh Fed looks less revolutionary than some expected. But it may still represent an important shift in monetary policy philosophy: less forward guidance, greater acceptance of uncertainty and a stronger emphasis on maintaining optionality in an environment where inflation has become harder to diagnose.

The bond market becomes the macro story

The changing balance between savings and investment may also help explain one of the defining features of the current environment: the continued rise in long-term bond yields.

At first blush, it is tempting to interpret higher yields as another manifestation of the inflation problem. But that does not appear to be the main story. Longer-term inflation expectations have remained comparatively well anchored, while much of the increase in nominal bond yields has instead reflected higher real yields and a rising term premium.

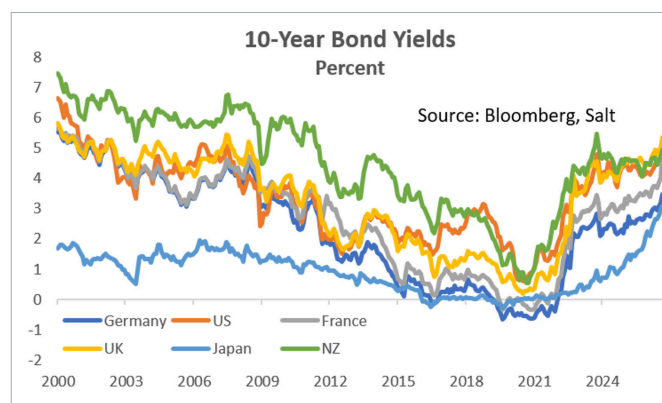


That distinction matters. Higher real yields suggest investors are reassessing the underlying strength of the

economy and the level of real interest rates it can sustain. That is consistent with the resilience we have observed in global growth and adds weight to the possibility that neutral interest rates are higher than they were before the pandemic.

At the same time, a higher term premium suggests investors are demanding greater compensation for committing capital over long periods. Fiscal concerns are clearly part of that story. Government deficits remain large, debt stocks are rising and investors are being asked to absorb substantial volumes of sovereign issuance at a time when central banks are no longer suppressing long-term yields through large-scale asset purchases.

Recent experience supports this interpretation. Longer-term government bond yields have risen across developed markets even as longer-term market-based inflation expectations have remained broadly stable. In other words, the bond market does not appear to be signalling that central banks have lost control of inflation. Instead, the repricing is occurring increasingly through real rates and the compensation investors require to hold long-duration assets.



But fiscal concerns may not be the whole story. There is another possibility - the world simply needs more capital. Governments are borrowing heavily to fund defence, infrastructure and social spending. At the same time, businesses are undertaking enormous investment programmes in artificial intelligence, data centres, electricity generation, transmission networks, automation and supply-chain resilience. The pool of global savings therefore faces increasingly intense competition.

In that sense, the rise in bond yields may be telling us something quite different from the inflation-driven sell-offs of recent years. Rather than signalling that investors have lost confidence in central banks’ ability to control inflation, it may increasingly reflect a repricing of the real cost of capital.

That is potentially a much more structural development. If higher yields were primarily the consequence of

elevated inflation expectations, we might reasonably expect them to decline significantly as inflation normalises. If instead they reflect stronger real growth, higher equilibrium interest rates and greater competition for capital, the adjustment may prove considerably more persistent.

This also connects directly to the supply-side challenges discussed earlier. Many of the investments required to make economies less vulnerable to future inflation shocks—energy infrastructure, diversified supply chains, automation and additional productive capacity—require significant upfront capital. They may ultimately expand supply and reduce inflation vulnerability, but financing their construction adds to today's demand for savings.

The bond market may therefore be telling us something more fundamental than where inflation or the next central bank move will be. It may be signalling that capital itself has become scarcer relative to the demands being placed upon it.

AI - from technology story to capital cycle

Artificial intelligence is perhaps the clearest example of this transition. AI remains one of the most important potential sources of stronger long-term productivity growth. If successfully deployed across the broader economy, it could allow output and real wages to grow faster, alleviate labour shortages and ultimately reduce inflation pressure.

Our caution has always been about the journey rather than the destination. In July, we argued that AI could initially prove inflationary rather than disinflationary. Building an AI-enabled economy requires enormous investment in semiconductors, data centres, electricity generation, transmission networks and digital infrastructure, alongside intense competition for skilled labour.

Demand therefore rises before the resulting productivity gains materially expand supply. That argument can now be taken a step further. AI is increasingly becoming not simply a technology or equity-market story, but a capital-cycle story.

The first phase of the AI boom was largely reflected in equity markets, particularly among semiconductor manufacturers and a relatively small number of large technology companies. The second phase is the enormous investment programme now underway. The third may be when AI becomes a genuinely macroeconomic phenomenon, influencing electricity markets, construction, credit creation, interest rates and ultimately economy-wide productivity.

That evolution is important because investment on this scale must eventually generate adequate returns.

The willingness of companies to commit significant capital demonstrates the scale of the opportunity they perceive. But it also raises the hurdle. As financing costs rise, increasingly ambitious investment programmes must deliver increasingly substantial productivity and earnings gains to justify the capital committed to them.

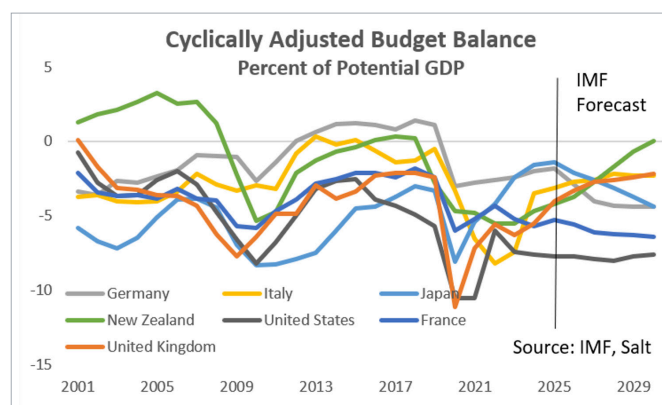
This is not an argument that AI is a bubble or that the productivity gains will fail to materialise. It is an argument that timing matters. In the near term, the AI build-out may add to demand for energy, labour and capital. Over the longer term, if the technology fulfils its promise, it should expand productive capacity and become increasingly disinflationary.

The macroeconomic question is how long the economy must finance the former before receiving the benefits of the latter.

Fiscal dominance: the constraint gets tighter

The same competition for capital brings us back to one of the structural themes we have emphasised for some time: fiscal sustainability.

Governments across the developed world face an uncomfortable combination of large existing debt stocks and growing future spending demands. Defence budgets are rising. Ageing populations are increasing pension and healthcare costs. Infrastructure needs remain substantial. Energy security and industrial policy require additional investment.



These pressures were easier to manage when governments could borrow at exceptionally low interest rates. They become significantly more difficult when sovereign yields are materially higher. This does not imply an imminent sovereign debt crisis. But it does mean fiscal choices are becoming more consequential.

Higher interest costs consume a greater share of government revenue, leaving less room for other priorities. Governments can respond through stronger growth, higher taxes, lower spending or additional borrowing. None is painless.

It also increases the risk of fiscal dominance, not

necessarily in the narrow sense of central banks directly financing government spending, but in the broader sense that fiscal pressures increasingly constrain the environment in which monetary policy operates.

This becomes particularly important in the different inflation world described earlier. Governments may understandably want central banks to reduce borrowing costs when fiscal positions become uncomfortable. But easier monetary policy cannot create the energy, infrastructure or productive capacity required to solve supply-side inflation problems. If anything, easing policy without addressing those constraints risks adding demand to an economy whose supply side is already struggling to respond.

Central banks cannot sustainably solve fiscal problems through monetary policy, just as monetary policy cannot solve many of the structural causes of inflation. That places greater responsibility on governments to make choices that improve the supply side of their economies while maintaining fiscal credibility.

For New Zealand, the starting position remains better than in many large, developed economies, but that should not be a source of complacency. Higher global bond yields feed into domestic financing costs, while weak productivity growth makes the long-term fiscal arithmetic harder. Fiscal credibility therefore becomes more valuable as the cost of capital rises.

Looking ahead: a higher hurdle rate

The global economy enters the final months of 2026 in better shape than might reasonably have been expected given the shocks it has absorbed. Growth remains comparatively resilient, labour markets have generally held up and investment remains strong.

That provides a solid starting point for the period ahead. The challenge is that the environment in which that growth is being generated has become more demanding. Interest rates are higher, long-term bond yields have risen and competition for capital is intensifying. Governments, businesses and households are therefore confronting financing costs that look increasingly likely to remain above the exceptionally low levels that characterised much of the previous decade.

At the same time, many of the problems economies need to solve require substantial investment. Greater energy security, more resilient supply chains, better infrastructure and stronger productivity cannot be delivered by central banks. They require capital, innovation and difficult choices about how resources are allocated. That makes the next stage particularly interesting.

So far, resilience has largely been demonstrated by the

economy's ability to absorb higher interest rates and repeated shocks. The test from here is whether that resilience can be sustained as higher borrowing costs work more fully through corporate investment decisions, household balance sheets and government finances.

There are good reasons for optimism. Stronger productivity growth, particularly if the promise of artificial intelligence begins to translate into measurable gains across the broader economy, could allow economies to sustain stronger growth without generating additional inflation. Continued business investment could expand productive capacity and help alleviate some of the supply-side constraints that have characterised the post-pandemic period.

But the hurdle rate has risen. Capital is no longer virtually free, and that should ultimately impose greater discipline on how it is allocated. Governments will need to make harder fiscal choices, businesses will face greater pressure to demonstrate adequate returns on investment, and central banks will have less latitude to respond to every period of weaker growth with substantially easier monetary policy.

That does not make the outlook inherently negative. A world of higher investment, stronger productivity and more disciplined capital allocation could ultimately prove a healthy one. But it is likely to be a more demanding environment, with greater differentiation between countries, companies and investment opportunities.

As we look towards 2027, the key question is therefore shifting. It is no longer simply whether the global economy can withstand higher interest rates. It has already demonstrated a considerable capacity to do so. The more important question is whether stronger productivity and economic growth can ultimately justify the higher price of capital required to sustain that resilience.

Bevan Graham

Implications for Investors

A new environment for equities

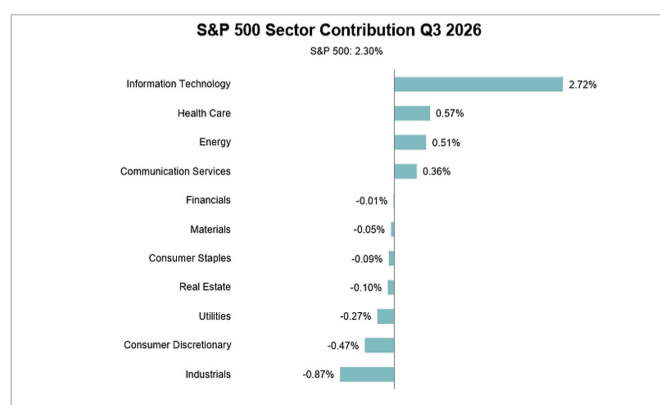
The sharp rises in global sovereign bond yields seen in the Third Quarter, as capital found a range of new and compelling alternatives to out-of-favour Treasury bills, weighed on international share markets. The interest-rate sensitive sectors within equity markets were particularly weak.

A bifurcation of the market along earnings lines has rewarded the listed industries that are generating extraordinary profits presently (Energy and Information Technology) and has broadly relegated the companies exposed most to consumer activity (Financials and Discretionary.) This effect is unusual to the extent that it reflects a lop-sided economy in which two sectors are driving much investment activity, while consumption is showing signs of flagging as cost-of-living and finance costs mount.

In the US, for the Third Quarter, the traditional industrial stocks represented by the Dow Jones Industrials Index (DJIA) were hit, logging a -2.7% quarterly decline, and US sectors such as real estate, utilities and consumer discretionary stocks all weakened by 5% or more over the Quarter. On the other hand, the strength in US equities again narrowed. Given the geopolitical turbulence prevailing, it is no surprise that Energy was by far the strongest US performer for the three-month period(+17.2%) and for the Year-to-Date (+40.3%).

Beyond the oil- and gas industries which have received such a boost from the various confrontational or self-sufficiency driven policies of the Trump Administration, Information Technology also experienced a strong Quarter's performance, gaining 7.2% (+23.4% YTD.) In part that reflected a substantial rebound in the Software industry, which rallied +27% for the Quarter, but which remains just 5% higher for the first nine months of 2026, due to the prior severe sell-down triggered by initial AI-mania. The sentiment swings within IT are evidence of a febrile market.

Quarterly US Equity composition of +2.3% Index return



Source: S&P Dow Jones Indices

Is Health Care a bell-weather of rotation?

Interestingly, the sector in third ranking for the US market over the last three months (and second-strongest contributor in the chart above,) as well as in 2026-to-date, was Health Care (+6.5%, QoQ and +10.2% YTD.) Following several years of trailing the broader market, the Health Care sector's recent strength is being driven by a combination of attractive initial valuations, macro-driven market rotation, and powerful structural tailwinds, such as ageing populations and regulatory clarifications on the funding of a range of therapies and facilities. The market rotation aspect is significant – reflecting the view that additional gains in the most highly-valued and crowded parts of the US market could be challenged, after a period of almost bullet-proof resilience in the last eighteen months. An electoral shift in the US could also catalyse further gains in the sector, which has been battered last year by Republican-led spending cuts.

Thus, the performance of Health Care - historically a markedly defensive sector - is this year driven by a set of special factors, rather than reflecting as yet any strong investor flight into reliable and revenue-stable securities like the listed Health sector. That defensive driver is more likely to emerge in 2027. For now, what matters is that of the US\$10 trillion spent annually on Health Care globally

each year, more than half (\$5.3 trillion) is spent in the US, and a large fraction of that is spent in private or listed corporate entities, whether in pharmaceutical, biotech, surgery, insurance or hospital operation applications. Health Care is also expected to be a prime beneficiary of AI.

Finally, Health Care is considered a less interest-rate sensitive equity sector, when compared with growth or cyclical industries. This makes it an excellent diversifier when risks are rising that an upward shift in the cost of credit will progressively undermine risk appetite.

If investors consider, as we do, that certain parts of the US political economy have been distorted by rampant Trumpism since the start of 2024, with mid-term elections in November, the opportunity arises to move some exposure out of the more contested or controversial parts of the US share market and toward the laggards, which often boast quality features such as cashflow surety, lower revenue volatility, defensible product “moats” and loyal customer bases.

As an aside, although the drivers of profitability and the main customer bases of US and New Zealand Health Care enterprises are wildly different, a period of better international sentiment towards the sector could potentially bode well for the NZ equity market into 2027. With the largest sectoral weighting in the NZX-50 Index due to the scale of Fisher & Paykel Healthcare (as a listed exporter) and of EBOS (as a listed importer and distributor) the sector is well-positioned and can attract investor attention as process and productivity enhancements are accruing rapidly in many aspects of medical industry.

Considerable churn beneath a placid surface

The overall positive momentum in International Equities in 2026-to-date continues to mask intensified swings in market sentiment. The enthusiasms and periods of re-assessment are alternating, and leading to substantial volatility within individual markets. The current focus of this scrutiny remains the semiconductor industry. Markets will need to assess whether pressure on hyperscaler shares, which marked the Second Quarter and only partially lifted in the Third, changes the perceived path for AI capital expenditure.

Indications that spending plans remain intact would help reassure investors that demand for AI infrastructure remains durable, but further evidence of caution could keep attention focused on very high valuations, massive financing needs, and extensive concentration risk.

The Trump Administration has most recently indicated that there will be no near-term Regulatory risk, at least not on the US side, to crimp the activities of the key Artificial Intelligence developers. However, since

mid-2025, the promise of AI has at times been perceived as a major threat – not only to future human flourishing, but specifically, to the global Software industry. What is now emerging is a more considered view: that software and AI are closely interwoven technologies, and that adept companies of either denomination should be able to generate superior returns on their considerable investments. Others will be found to have over-invested, given their ability to grow customers and traffic, and their securities are likely to be treated with little market mercy.

US equity valuation became less stretched in Q3 2026

A positive reversal in the expected tendency of US companies’ earnings revisions set in late last year, after the dilution of the so-called “Liberation Day” tariffs. Upward revisions to profit forecasts, as analysts diluted their prior trade war-based assumptions, carried market sentiment higher and the net balance of positive revisions has only turned downwards very recently. It is very early to call a significant slide in profit forecasts, although it must be said that the outsized earnings revisions (which skew the average upwards) have come from AI-related enterprises. Profits, as well as operating margins, are around historical highs, and create a high bar in terms of what it now takes for a company to beat investor expectations.

Corporate earnings outlook rebound topping?



Source: MSCI, IBES as at 30 September 2026

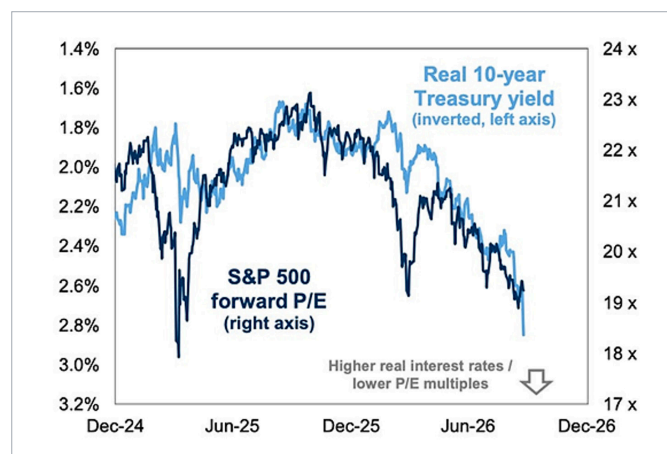
The relief in markets as companies adapted and profit hits proved “less bad” than anticipated in 2025 arguably led to a positive overshooting and worrying US complacency. As the third quarter concluded, the balance of corporate earnings revisions, though still strongly positive has paused, and that can presage an adjustment in overall equity market bullish sentiment. The market adjusted moderately downward in the Second Quarter and awaited a positive catalyst – which arrived, in the form of bullish outlook statements from an array of microchip sector multinationals, in US Europe, and Asia. What the next bullish catalyst may be is harder

to identify, given the elevated political risk to a wide range of current US policies and international positions were control of Congress to shift after the November mid-term elections.

Potentially, any credible wind-down to Gulf hostilities and more international co-operations generally could give the global equity outlook a fresh lease of life. However, that scenario is not looking strong, as at the time of writing.

Exceptional US corporate profit projections have in the course of 2026 had the mathematical benefit of lowering the Forward Price/ Earnings-based valuation level for the S&P 500, the key US equity index. That said, the most recent run-up in real Treasury yields, and the flattening in the yield curve, appears to imply that additional valuation de-rating may be pending. That is especially true if yields prove “sticky” at current levels, and / or if guidance for the upcoming earning seasons proves meaningfully less reassuring.

US S&P 500 Price / Earnings ratio has trended down in 2026



Source: FactSet, Goldman Sachs Global Investment Research at 30 September 2026

Persistently-soft NZD has boosted Global Shares' returns...

The unhedged returns from global equities to NZ investors again benefited during the quarter, as NZD slipped -4.8% against the US dollar in September month and over the three-month period. This reflects a stronger US dollar which has unfolded this year, as markets priced in expectations of a moderate Federal Reserve monetary tightening path, regardless of the President's wishes. The NZD's sogginess also reflects potential for a more incremental interest rate policy normalisation in New Zealand, to a lower terminal rate for the cycle. given the still-uninspiring mood in the domestic economy. This is most notable in the North Island major cities.

The slide in the NZ dollar against the US currency in September month insulated unhedged NZ investors, and

produced a +3.5% monthly return from World Equities in NZD terms. For the Quarter as a whole, the NZD ended the period close to where it began it, at 0.565 USD, having almost touched 0.6 USD in late August before succumbing to a broad advance in the Greenback. With three months of 2026 still to run, overall, the softness in the NZ dollar has boosted returns from US equities, by around 3% as of 30 September.

That Foreign Exchange effect continues to argue for retaining a decent portfolio allocation to unhedged international equity markets. At some point, the NZD will prove itself able to retain and build upon valuation gains against key global currencies, and a degree of hedging should be considered at that point. At present, however, any prediction of a Bear Market for the US currency is unwise, given the interest rate picture and the tendency of the US dollar to strengthen in times of turbulence.

All the same, the New Zealand domestic equity market is an outlier in the global developed markets universe, as its fundamentals are now indicating meaningful relative cheapness, and we continue to believe that NZ could be a more compelling destination for defensively-inclined investor capital as asset allocators prepare for a different set of performance drivers into 2027. Particularly when compared with the Resources- and Financials companies dominating the Australian equity market, NZ domestic stocks continue to appeal as they are concentrated outside the main cyclical sectors.

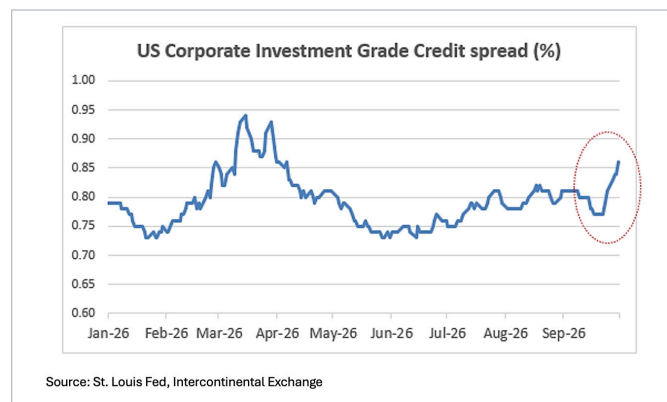
...while Global Bond returns have been a drag for most portfolios

Because it is very unusual for New Zealand investors to take unhedged foreign exchange risk in their international fixed income holdings, the softness in the NZD was not an offset for what was one of the weakest Quarters for global bonds since the very poor returns experienced in 2022, during the post-Covid inflation shock. The widely-followed Bloomberg Global Aggregate Index (which includes Sovereign, Corporate and Agency bonds) declined -2.9% in the September Quarter, in NZD-hedged terms. However, that headline drop in bond index valuation masks a wide range of outcomes, depending on the issuer, the bond's duration, and the prior level of running yield before market rates surged.

For example, the global “benchmark” United States 10-Year Treasury Note has risen by 1.0% in the last 9 months; from 4.2% at the beginning of January, to 5.3% on the final day of September. That translates into a -5.3% Year-to-Date return, after the -3.7% September month return, on the US 10-Year note. Considering this security is often considered the “world's most important single interest rate,” its sell-off reveals the degree of uncertainty now present in the global fiscal issuance and

bond demand landscape, for the reasons covered in our Economics section earlier.

The longer-duration government bonds have fared worse in the Third Quarter, with the US long end valuations declining by between 6% and 9%. In the Corporate Bond domain, credit spreads - which can at times be a leading indicator of equity market peaks - have shown signs of widening, albeit from the exceptionally narrow levels which persisted through mid-year. However, there is little indication in the current pricing of credit that market participants see substantial trouble ahead for the US corporate sector.



It bears observing that the earnings momentum track for Japan, and Europe have over the same period begun to pick up again, after a short-lived deterioration in mid-2026. That dip for major non-US markets' projections partially reflected the impact of rising imported fossil fuel energy costs in those regions, which is not broadly the case as a major constraint on the Tech. sector in the US.

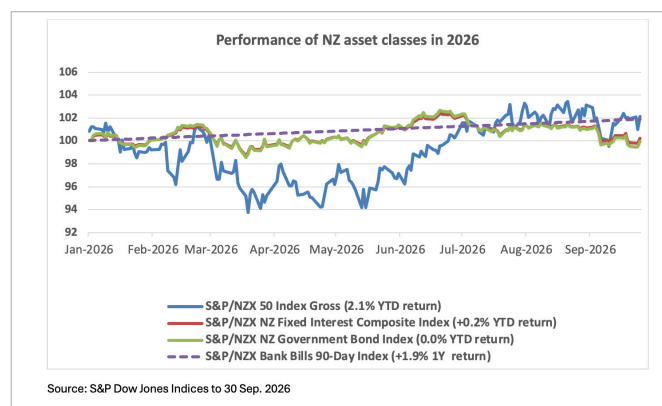
Additionally, major US enterprises active in the AI-semiconductor capacity surge have both spent existing free cash-flow and been willing to issue debt securities to cover immediate, gargantuan investment costs. To a degree, the immediate profit impacts of steady or sustained inflation in energy prices is masked. The impact is likely to be clarified only towards 2026-year end or early next year, as the reporting season coming up will still not fully capture all the pass-throughs and pricing adjustments along very extended value chains.

NZ equities held on to modest Third Quarter gain

New Zealand equities managed a 1.5% quarterly recovery and ended September modestly improved (+2.1%) on a YTD basis. An incipient recovery from late 2025 into the first quarter of this year was effectively erased immediately after the oil price shock and its impact on global equity markets from February onward. However, by July, as news-flows clarified, a base had formed for domestic markets, and the NZ share market matched the slightly negative local currency return from

the MSCI World equity index in September, with a dip of -0.6%.

On our internal valuation metrics, NZ equities were priced on around a 6% discount to Australian equities, based on the bottom-up Discounted Cash-flow valuation methodology. All the same, investors in domestic shares need to be aware that fuel costs jumping and erratic consumer sentiment mean downward pressure on the earnings of some cyclical stocks, albeit mainly in the short-term.



Retaining a patient positive view of NZ equities

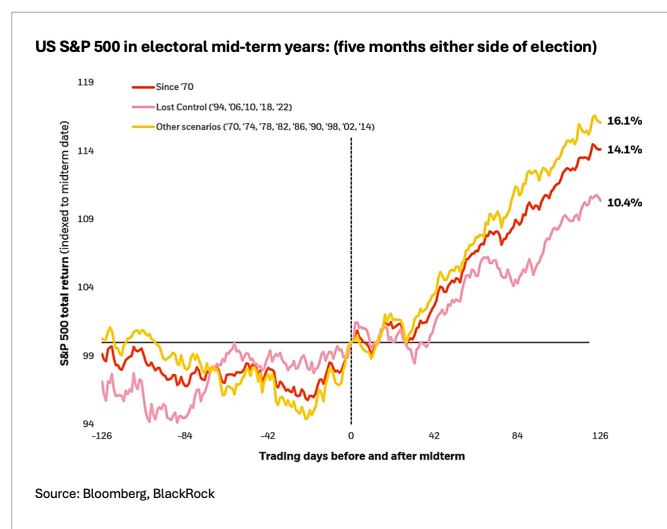
We retain a modest overweighting in NZ equities within our multi-sector diversified funds, and do not anticipate diluting that position in the remainder of this year. Whilst the New Zealand economy is still in the throes of the difficult domestic trading environment, we believe that the stimulatory period now completed by the Reserve Bank of New Zealand and the defensive nature of the industries that are heavily represented on the NZ exchange means that NZ equities should prove comparatively resilient. Into late-2026, we anticipate incremental domestic demand improvements, alongside some election year clarity, potentially allowing the local market to build upon its moderate one-year gains of 7% gross. At the time of writing, the NZX 50 Index reached an all-time high on a points basis, though there is definitely no euphoria present in the NZ market.

However, as the influence of US markets never leaves New Zealand unaffected, equity exposures should be carefully managed. NZ equity valuation multiples are rather more palatable than either Australian or US shares' - especially if one looks at the NZ market on a median stock basis. The NZ market is therefore at acceptable valuation levels and has scope to retain recent selective strength, assuming the negative global turn in risk appetite does not deepen into stagflation. There is still a preponderance of pessimism implied in many domestic equity prices, and longer-term NZ investors or international acquirers (after rigorous due diligence and comparative value analysis) will continue accumulating NZ equities in the remainder of this year and into 2027.

The NZX 50 Gross return over the last year is once again ahead of that of the returns from domestic bonds, and well ahead of the NZ cash return. That present situation – while understandable when the economy was still in borderline recession territory – now seems to undervalue the NZ equity market 's future returns potential. We would look to add exposure on geo-political weakness, but very selectively, given vulnerability of some domestic companies to any additional travel disruptions, fuel cost jumps, or export capacity challenges.

Refresher: US Equity impact of mid-Term elections

Historically, mid-term election years in the United States, where scope exists for a change in Congressional leadership, have been associated with more subdued market returns. But as the election nears, history has shown a tendency to rally. Since 1990, the average S&P 500 return in non mid-term years was 12% vs. only 3% in mid-term years. But that masks large dispersions at the sector level: Healthcare and Energy have historically held up better, whilst Industrials and Financials have tended to drag the market down in the full course of mid-term years (there have been 14 such instances, between 1970-2022.) However, since 1970, there have been only six comparable set-ups as the one that US voters face in 2026: where a single party controls the Presidency and both houses of Congress. The historical average returns pattern is shown below.



It the dominant party (i.e. the Republicans, in 2026) lose control on one or of both houses of Congress, the historical data indicates that average 6-month forward return after elections when the incumbent party loses control is materially lower (10%) than in other scenarios (16%).

Every year is unique, with its distinct fears and focus points. 2026 has arguably an even more intense array of critical issues facing the electoral and investing communities. The indifferent performance of US equities

in the first quarter was more typical of the characteristic pattern shown in the chart, where this year's roughly -5% market decline fitted the pattern. However, the second quarter resurgence in US stocks goes dramatically against the typical mid-term trend.

That suggests either the AI-semiconductor narrative is so powerful that it has overwhelmed the typical policy-driven criteria for setting share market sentiment, or, that investors have jumped ahead and already priced in a positive resolution to pre-election uncertainty. These are likely elements of both explanations currently in play. The second possibility – investors getting ahead of expected good news – is an indication of another aspect of elevated current disappointment risks.

Greg Fleming

Conclusion: Our Investment and Asset Class outlook

- We still favour specific Equities over Bonds, and moved global fixed income funds to a shorter duration profile at 4.6 years. Within Equities, we favour stable cash-flow compounders and within Bonds, prefer markets with good carry and scope to outperform in stickier inflation and cooling growth into 2027.
- Yields (both nominal and real) are now much more tempting, and we lifted our Income Fund's allocation to global bonds to reflect that improved scope for carry income into 2027.
- Listed real assets of infrastructure and real estate weakened in response to higher interest rates, but we retain confidence in these segments, as they are still not expensively valued and have functioned well as diversifiers during equity turbulence.
- NZ's economy has been weak and patchy, but 2026 saw an improvement. However, investors are looking forward across the sentiment trough to a recovery that is finally getting underway. Rate stability, strong terms of trade and greater corporate efficiency after a testing period should assist an incremental valuation improvement for NZ equities.
- Within the NZ market, large cap stocks screen as fairly- valued after de-rating but the median stock is slightly cheap. This is a similar theme to globally – mega caps are much more expensive than the median stock or equally-weighted index.
- Trump risks remain significant. Deregulation is the key potential positive but may become much harder after November's mid-terms. Non-tariff barriers, immigration crackdown, war and energy brinkmanship are major supply-side shocks. The US fiscal deficit and Fed independence remain key risks, even with Warsh in the Chair and a rate increase already in the bag. Trump may press harder for no rate increases in 2027, especially if Congressional support for his policies is weakened by Democratic gains.
- US Administration is clumsy managing all these risks. Consumer Confidence is close to post-Covid lows, despite positive wealth effects and the news of the US-Iran ceasefire.
- A great deal of investor enthusiasm is linked to the AI- Data centre – Space frontier story, and risks disappointment. Presently, prices for key US chipmakers, AI developers and satellite communications / data firms are very high, but in the decade ahead, profitability will require steadfast political support. Any change in US Government composition or spending priorities could easily upset the prevailing narrative and trigger sharp re-pricing.



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