FOUNDED IN	EMPLOYEES	LOCATED IN	ASSETS DIRECTLY UNDER MANAGEMENT	ASSETS HELD BY INVESTEE & AFFILIATED COMPANIES
1988	80+	10+ COUNTRIES	USD 1.6 BILLION	USD 50.4 BILLION

ICM Monthly Outlook

OCTOBER 2026

Market Review

The global government bond market has been in the spotlight since our last letter. Since mid-September, the 2-year US Treasury yield has increased by c.55 basis points to 4.89%; the 10-year yield has risen by c.36 basis points, from 4.95% in late September to a peak of 5.31% on 5 October, before easing back to c.5% as of today; the 30-year yield has crossed 5.63%, an increase of 40 basis points, making both the 10- and 30-year yields the highest since 2002. The 30-year mortgage rate has climbed past 7.5%. Bond prices fall as yields rise.

Several converging factors pushed up yields and triggered a sell-off in bond prices.

On the one hand, rising bond yields can be seen as consistent with a booming economy. The rise in 10-year yields to 19-year highs reflects stronger-than-expected US manufacturing and services activity, supporting the view that the US economy remains robust and that the Fed has room - and reason - to keep rates elevated and remain on a hiking cycle.

On the other hand, some view rising yields as a distress signal. A weaker-than-expected US Treasury auction in late September contributed to the sell-off, suggesting that the US government must pay more to borrow. A hotter-than-expected inflation report on 14 October lent credence to a chorus of Fed officials suggesting that further rate hikes will be necessary to bring inflation back to the 2% target. Both Fed Governor Barr and St. Louis Fed President Musalem warned that inflation risks remain elevated. At the same time, New York Fed President Williams stressed that supply chain shocks with persistent price effects cannot be looked through.

We previously highlighted how constrained energy supply is fueling inflation fears and driving simultaneous selloffs in US Treasuries and European government bonds. We have also highlighted that US net interest costs continue to rise. In fiscal 2026, the US government's interest cost reached a record $1.05 trillion, up 8% year on year, raising concerns about the sustainability of US government borrowing.

Irrespective of your preferred narrative, downward pressure on bonds remains across the curve, with an eventful period ahead.

In September, equity markets performed better. The S&P 500 slipped only 0.35% and is still up c.12.7% year-to-date. The 0.35% decline is flattering. Bloomberg says the median S&P 500 stock fell 5.1%. Technology rose 4.5%, and the Philadelphia Semiconductor Index rose 9.6%; while nine of the eleven sectors fell. Essentially, a handful of AI mega-caps did the heavy lifting while the rest of the market quietly sagged under the weight of higher interest-rate expectations. An equal-weighted S&P 500 index fell 4.8%.

In our July letter, we highlighted the Russell 2000's best first half since 1991, as capital rotated away from the most AI-exposed names. In September, the Russell 2000 fell 5.3%, its worst month since March 2025. Higher interest rate

expectations reversed that rotation. Russell 2000 companies tend to be more rate sensitive because of higher leverage, so higher borrowing costs hit them faster.

During October, the AI trade has also wobbled. On 8 October, OpenAI announced annualised revenue of closer to USD 50 billion, below expectations of USD 68 billion. Nvidia, Oracle and CoreWeave all fell as a result. CoreWeave lost nearly 25% in a week, and the Nasdaq fell more than 2% on Friday 16 October.

Market Outlook

Investors face an unusually crowded calendar of political, economic, and geopolitical risks over the coming weeks and months, given the myriad major events on the horizon, namely: the US midterm election; Q3 earnings, with special emphasis on AI mega-caps; a burgeoning sovereign debt crisis in France; a widening war in the Middle East; an intensifying war between Russia and Ukraine; and the US Treasury's quarterly refunding statement on 4 November.

Who could blame investors for taking to the sidelines for a while amid so many challenges and an already strong year-to-date performance?

Our central case scenario is that equity markets trade sideways, rangebound, for the rest of the year, awaiting a clearer line of sight on several of the challenges listed above. We are back to our "tired bull" characterisation of markets for now. Lest we forget, US equities tend to perform well in the 12 months following midterm elections.

US Midterms
We believe financial markets already reflect the likely outcome of the midterm elections, though surprises are always possible. According to Polymarket, the Democrats have a 66% chance of taking the Senate and a 92% chance of taking the House of Representatives. If the Democrats take both the Senate and the House, President Trump will become a lame-duck President. In this scenario, we can expect myriad investigations, blocked nominations, and political noise around impeachment.

These must be worrying times for President Trump, who heads into these midterms with approval ratings consistently below 40%, reportedly the lowest in decades for any President. We do not envisage a significant downside from the midterms. We may see some volatility if there is a significant upset to the current forecasts. The biggest upset would be Republicans holding both houses, which would likely boost equity markets but isn't our central case. The sense of inevitability surrounding the election is why we believe inflation and interest rates could have a bigger impact on financial markets going forward.

Inflation
September's inflation report nailed on another interest rate hike by the US Federal Reserve Bank. Headline US CPI rose 0.6% month-on-month and 3.7% year-on-year, up from 3.4% in August and above the 3.6% consensus. Core CPI rose 0.3% month-on-month and 2.6% year-on-year, both above expectations.

US gasoline jumped 9.1% during the month, while a barrel of oil is near $115, up from $64.4 at this time in 2025. Energy is not solely to blame; price pressure is broad-based. Wages are rising c.3% while prices rise 3.7%; the US consumer is getting poorer in real terms. The market's odds of a December hike are 100%.[1]

The Federal Reserve Bank must be a bit worried, and it is not alone. Global central banks are back in a hiking cycle. In general, they have pivoted towards tighter policy in response to higher inflation. In September, the Fed, the ECB, and the Bank of Japan all hiked rates. Long-term yields have risen sharply almost everywhere. At the start of the year, we predicted AI-driven disinflation and softer job growth would push central banks to cut rates. The opposite happened, despite September's disappointing employment data. It didn't have to be this way.

AI update
Companies on the periphery of AI (neoclouds) are feeling the heat of higher interest rates, much to the US government's chagrin. The credit-financed periphery of the AI build-out was premised on falling interest rates. This premise changes as rates rise.

Neoclouds are high-yield companies renting their processing power (GPUs) to Hyperscalers (Microsoft, Alphabet, etc.). They have funded their expansion through expensive high-yield debt. CoreWeave is one such company.

They say data is the new oil, so let me draw an analogy to the oil market.

CoreWeave can be likened to a wildcat oil-and-gas exploration and development company hoping to get rich quick through debt-fueled expansion. Microsoft, Alphabet, etc., are like oil majors that can fund capex largely from free cash flow and investment-grade balance sheets. CoreWeave has become the poster child for this scenario, expanding aggressively to meet the insatiable demand that we have frequently mentioned. Now, with OpenAI missing revenue forecasts and triggering valuation concerns, CoreWeave's bonds trade at a significant discount to par, yielding 16%.

16% is an unsustainable cost of debt for anyone. Anyone can sustain a large amount of debt at low interest rates; no one can sustain a small amount of debt at high interest rates. CoreWeave has revenue of c.USD 13 billion against c.USD 37 billion in capex commitments in 2026, and credit default swaps (the cost of insuring that debt) have widened from c.370 basis points to c.1200 basis points over the past year.

Investors are sensibly asking whether neocloud providers that have borrowed tens of billions of dollars to build data centres will be able to repay or refinance their debt when the 10-year Treasury yield exceeds 5%. The trigger for the deterioration in the sentiment toward neoclouds was not weak AI demand. It was renewed scrutiny of expected revenue combined with more expensive debt. The pressure is coming from higher borrowing costs, outstripping revenue.

We are not invested in CoreWeave, so for us the question is whether CoreWeave could cause systemic problems. We strongly doubt it. CoreWeave's problem is rudimentary: too much debt relative to revenue, and some questions around collateral values. CoreWeave's debt is c.USD 50 billion, a mere drop in the ocean of the sector's value, if Anthropic's estimates are to be believed. Anthropic believes its total addressable market is USD 30 trillion, roughly the same size as the US economy for one year.

We believe that, if necessary (a big if), CoreWeave will be subsumed by its largest customers, cauterising this particular sore. Something like what happened to Silicon Valley Bank in March 2023, when regulators stepped in to prevent contagion. CoreWeave doesn't have a regulator, per se, but its biggest clients may act in a similar way to protect their investments and infrastructure. In the immediate aftermath, neocloud and hyperscaler valuations could be dented. Still, we should not lose sight of the fact that demand for compute continues to outpace supply, and AI remains one of the biggest arms races of all time.

Nor do we believe this signals a slowdown of the AI capex cycle; the hyperscalers have the balance sheets to keep building. Heavy hyperscaler issuance has been absorbed with ease. The demand for AI continues to grow.

War in the Middle East

Last month, my central case was a managed de-escalation before the midterms, with a deal spun as a victory for all sides. I was wrong. We said that if talks failed, that Brent price of USD 110 was realistic. Today, Brent is about USD 110. I wish I had been wrong, again. President Trump rejected Iran's seven-day proposal to reopen the Strait of Hormuz. Iran then roughly doubled its weekly pace of attacks on shipping, with nine attacks in the first week of October - roughly half the September total. The conflict has widened geographically rather than narrowing, with Houthi rebels attacking airports in Riyadh and Abha. We continue to believe the open/shut Strait of Hormuz will leave a persistently higher risk premium in oil prices, regardless of any deal.

Worryingly, US media reported that the White House asked the Pentagon to draw up strike options that could be executed before the midterms.

The desperate version is a pre-election strike on Iran. This would renew escalation of attacks on Gulf energy infrastructure, driving oil prices even higher, potentially to USD 120-plus, triggering another hot inflation report, and even more pressure on the Federal Reserve to hike rates further. While this is not our central case, it's not exactly an outlandish tail risk, either.

So far, investors and consumers have been resilient to the war in the Middle East, but patience will wear thin when increasingly short-term solutions run out. For example, the US Strategic Petroleum Reserve is at its lowest level in over forty years, at 283 million barrels versus the five-year average of 400 million, and less than at any time since September 1982. Despite President Trump's narrative that oil prices will fall after the midterm election, industry leaders believe otherwise. On 20 October, Ryanair's CEO warned that airfares in Europe would be 20% higher in 2027.

The global economy is built on cheap energy. The world cannot tolerate expensive energy, such as oil at $100 a barrel, for a long, drawn-out period.

Bending the debt curve
As mentioned in the market review section, the 10-year Treasury yield reached 5.31% on 5 October, its highest level since 2002. This prompted Treasury Secretary Bessent to jawbone the market. Secretary Bessent isn't worried. He has a plan. He reassured the market that GDP growth above 3% and spending restraint would start bending the debt-to-GDP curve downwards, possibly very quickly. It triggered the predictable quip, "Bend It Like Beckham Bessent." Let's consider the figures.

The Committee for a Responsible Federal Budget estimates it would take 4.5% real GDP growth (it was 2.2% annualised in Q2 2026[2]) to bring the deficit down to Bessent's 3% target. The Congressional Budget Office expects debt-to-GDP to exceed its 1946 record of 106% by 2030.[3] Federal debt held by the public is already about 100% of GDP, while gross federal debt is about 124%. Continued accumulation of publicly held debt will increase Treasury financing needs, potentially putting upward pressure on long-term yields if investor demand fails to keep pace with supply. The extent of that pressure will depend on economic growth, inflation expectations, Federal Reserve policy and the willingness of domestic and foreign investors to absorb additional issuance. US economists expect the US budget deficit to be roughly 6% of GDP this year, amid low unemployment, solid growth, and an expensive war.

Refinancing makes it worse. The average interest rate on marketable Treasuries was 3.48% at the end of August, while investors now demand more than 5% for maturities ranging from five to thirty years. Every maturing bond that is refinanced now comes at a higher rate. Bessent has yet to set out a fiscal program, and Congress, not the Treasury, controls the purse strings.

Funding statement
We've written before about the Treasury's growing toolkit of "liquidity support": buybacks, tweaks to bank capital and stablecoin demand. The next item on the agenda will be the quarterly funding statement on 4 November, the day after the midterms. We expect the US Treasury to lean less on long-dated bonds given their cost. Shortening the maturity of US debt lowers today's interest bill but increases tomorrow's refinancing risk. It is kicking the can down the road. In January's letter, we called US indebtedness the 500-pound gorilla in the corner. It is no longer in the corner.

Oh, Mon Dieu
France's ongoing saga of political and fiscal instability has dragged on way too long, manifesting in social unrest with very sad consequences. The French situation brings back memories of the European sovereign debt crisis of 2010–2012. We could write all day about why France is not working. But let's begin with the end in mind. We consider France too important to the European Union to fail. The ECB would not want the European Union to fragment and will eventually cut rates to support the French government's efforts to reduce its budget deficit while France introduces the necessary reforms. That's after the ECB has deployed the Transmission Protection Instrument to buy French government bonds and help manage the current disorder if it threatens the eurozone. We believe the current French crisis will eventually bring on a rally in European government bonds. I expect to write more about it in the coming months.

In summary
Recently, rising interest rates have tested the three stories that carried the market higher in 2026: the AI capex boom, the US fiscal position, and investors' patience with the various wars and their impact on energy prices. The cost of money is the dominant thread running through these challenges.

The market has been financed with cheap money for the past few years. A shift to more expensive money will be a hard pill to swallow, and not everyone can tolerate yields above 5% for a long period. Society would benefit from a return to lower interest rates to avoid a painful recalibration.

For some, it is a nervous time. Nerves lead to fear; fear leads to panic; panic leads to selling.

We are nowhere near there yet. We are just cautious for now.

We remain constructive on risk assets over the longer term, but we are more selective than at any point this year. In equities, we prefer companies that fund their growth from cash flow rather than from the bond market. In credit, we continue to favour quality and remain cautious about lower-rated issuers or anyone borrowing against fast-depreciating assets. Yields at levels last seen in 2002 offer an opportunity to lock in attractive income, and we continue to prefer European over US duration. We have long been proponents of buying the dip, and have recently picked up attractive risk-adjusted opportunities at yields not seen in years. We remain cautious on US equities, with valuations still within touching distance of their highs.

Here's hoping for a drama-free rest of the year.

Kind regards,

Conor Spencer

28 October 2026

Source Data: ICM, Bloomberg as of 30 September, 2026.

[1] Bloomberg WIRP
[2] https://www.bea.gov/news/2026/gdp-third-estimate-industries-corporate-profits-state-gdp-and-state-personal-income-2nd
[3] Bessent's Bend-the-Debt-Curve Hope Seen as More Market Jawboning – Bloomberg News, 6 October 2026

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