

Geopolitics Coalesce at Market Speed

**“When we try to pick out anything by itself, we find it
hitched to everything else in the universe.”**

– John Muir, *My First Summer in the Sierra*

Introduction:

I am very privileged in my role to gain access to some of the world’s most experienced and interesting people. Over the past several weeks, I have had the honor of speaking with several geopolitical strategists, a former US Army general, two cabinet members of a prior presidential administration, investment managers, and several of my CIO peers during our annual two-day study group. Some conversations took place individually while I was working through the ideas that became our recent LNW piece, [“When Wars Start to Rhyme.”](#) Others happened when outside speakers joined the study group and had their views tested by a room full of investors. The range of opinions was wide, which made the discussions useful.

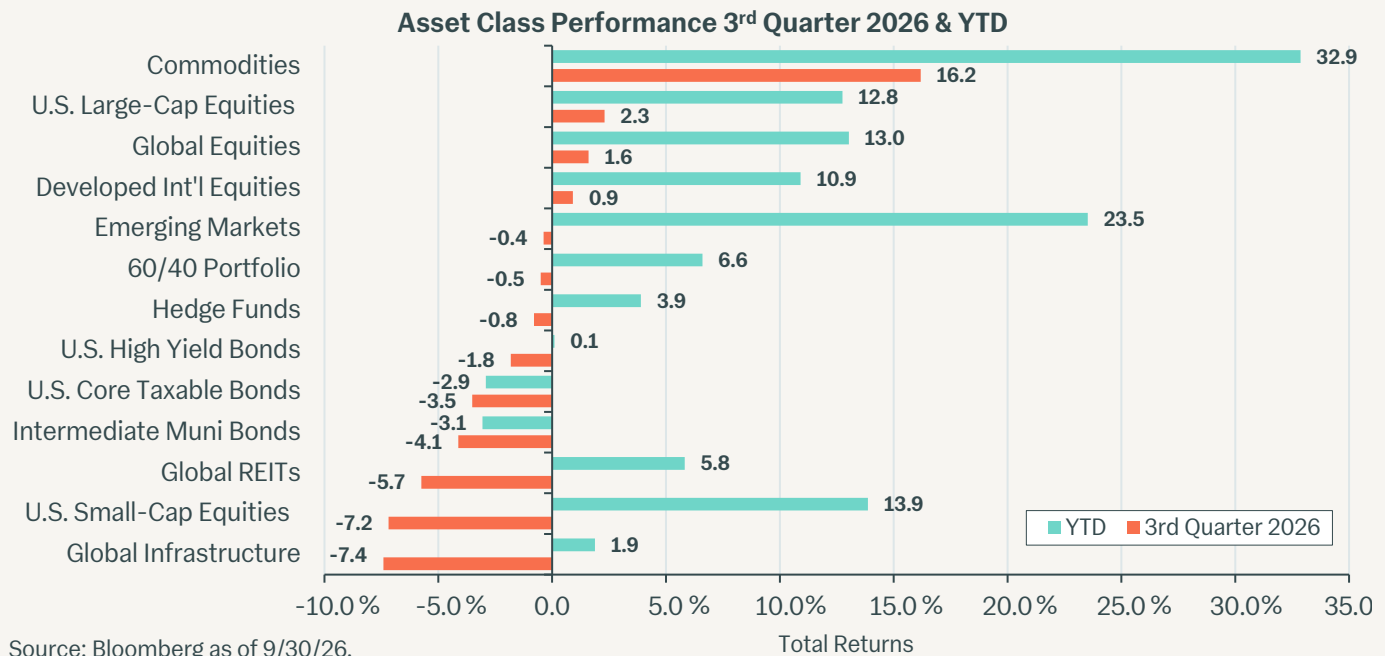
A few subjects kept reappearing in my notes: The upcoming midterm election was one, although the discussion stretched well past November. Iran and Ukraine came up as the situations seem to be moving in different yet related directions as we explored in “When Wars Start to Rhyme”. Inflation entered through energy and later through capital spending. Artificial intelligence was a recurring theme throughout, although much of the discussion centered on the massive amounts of capital being deployed toward the physical buildout.

What I find striking is that all of these geopolitical issues now overlap to magnify economic and market consequences. That is unusual when, for most of my career, geopolitics has sat in the background of investment decisions. Each has its own causes, to be sure, but they are increasingly tied together by how governments, markets and companies respond. And it is becoming clear governments and companies are incorporating in their responses many of the lessons that were learned about their individual weaknesses, both military and economic, uncovered during the pandemic. So, while many investors still devote considerable energy to figuring out when the world will return to conditions they remember - the good ol’ days when inflation and interest rates were low, geopolitics was a fleeting consideration, and D.C. wasn’t making headlines every day - I remain more convinced now that our thesis, now nearly five years old, of a generational regime change, continues to unfold.

In this quarterly commentary, I’ll provide insights into the deep and revealing conversations I’ve had in recent months, but first, we’ll take a look back at how markets unfolded in Q3.



Quarterly Asset Class Performance Summary



Investment portfolios generally retained substantial gains through September, with equities supported by earnings and AI investment, but Q3 made the cost of capital harder to ignore. Rising yields reduced bond returns and weighed on economically sensitive and capital-intensive businesses, widening the differences beneath headline market results.

U.S. Equities: U.S. stocks carried their strong spring recovery into Q3, although the pace slowed. The S&P 500 finished September up nearly 13% year to date and approximately 2% for the quarter. AI remained a major support for large-cap stocks, as investors continued to reward the businesses supplying computing capacity and the technology companies deploying it. Nevertheless, September exposed the market's dependence on a limited group of leaders: the S&P 500 slipped only about 0.5%, but 78% of its constituents declined. More capital-intensive small-cap stocks fell sharply in Q3 as financing costs spiked but have still outgained large caps year-to-date.

International Equities: Foreign equities also retained meaningful gains, with emerging markets ahead of developed international markets for the year. International developed stocks returned just under 1% for the quarter and about 13% year-to-date. Asian technology stocks remain central to the emerging-market story, although with significant volatility. Korea surged into the summer rising almost 85% through June, but has fallen 8% since then. Currency effects have also diverged: the dollar weakened against the yen during Q3, while rising Treasury yields helped it regain ground against the euro and other currencies. European stocks have alternately been helped and hurt by less tech sensitivity, but the region's net energy dependency has complicated the outlook for investors.

Fixed Income: Bonds experienced the clearest reversal of the year's earlier improvement. The Bloomberg U.S. Aggregate Bond Index fell 3.5% in Q3 for a total decline of 2.9% year-to-date. Meanwhile, core municipal bonds fell more than 4%, though shorter municipal maturities held up better than intermediate and longer issues. The most consequential Q3 figure was the 10-year U.S. Treasury yield, which rose almost 0.9% to 5.3% as investors priced in hawkish Fed policy after the Fed rate hike in September. The increase in income provided some offset, but it could not overcome the repricing of duration.



Real Assets: Real assets delivered sharply different outcomes as energy supply concerns and rising rates pulled returns in different directions. Brent crude rose roughly 40% in Q3 and approximately 70% year to date, putting the Middle East supply shock back at the center of the inflation debate. Listed infrastructure and real estate struggled to keep pace as higher financing costs and more competitive bond yields outweighed the longer-term appeal of investment in power, data centers and other physical capacity. Meanwhile, September's renewed dollar and yield pressure again weighed on gold.

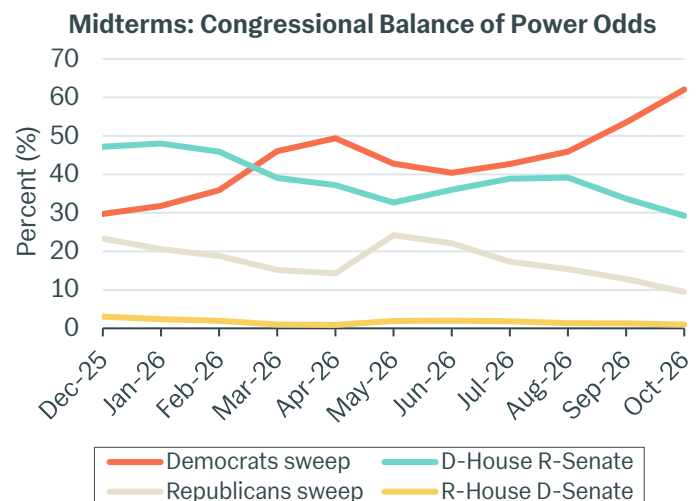
Diversifiers and Private Markets: Hedge fund indices were slightly negative for Q3 but have returned almost 4% year-to-date as macro hedge fund positioning has offered a potential counterweight to equity and bond volatility. Private equity continued to face a slow conversion of portfolio values into cash distributions, with financing costs and extended holding periods complicating exits. On a related basis, private credit's liquidity pressures have been uneven. Reuters reported Q3 repurchase requests of 10% to more than 16% at major non-traded funds, while simultaneously noting signs of easing pressure across the industry. Borrower quality and the terms governing investor access to capital remain central to interpreting reported income and returns.

Looking Past November

No surprise, given the time of year, our study group elected (pun intended) to invite a speaker who runs government affairs for one of the asset managers we invest with to explore the midterm elections. Polls and congressional control occupied part of the conversation, with most participants seeing Democrats taking over the House of Representatives and an outside, albeit growing, probability of taking over both chambers.

It is interesting to consider a specific electoral scenario unfolding in the midterms that could persist as a demographic shift in elections that follow. The populist base supporting Republicans has absorbed higher costs associated with tariffs and the effects of war on household budgets. While the policy agenda of that base is vastly different from that of the progressives, there is a Venn diagram where the overlap is the feeling of household needs not being met as they have had to battle through multiple supply shocks and, as a result, a higher cost of living, while corporations and the wealthy have benefited from rising asset prices. The upcoming midterm election will test the loyalty of that base to the less populist components of the Republican agenda versus looking for economic answers from any party that will promise solutions, even if it means looking far across the aisle to the liberal progressive wing.

Regardless of how it would come to be, a possible Democratic-controlled congressional agenda would likely include subjecting the AI industry to sustained oversight beginning in 2027, with multiple House and potentially Senate committees investigating issues ranging from electricity costs, antitrust, and copyright to AI safety and corporate disclosure. This scrutiny could have meaningful business and investment consequences, prompting AI firms to behave more defensively, slowing product launches and capacity expansion, increasing compliance and safety measures, and raising the likelihood of regulation. Additional revelations about AI safety or alignment could even generate bipartisan support for tougher rules, with spillover effects extending beyond



Source: Kalshi as of 10/13/26.



leading AI developers to the broader AI ecosystem. For investors, the risk is that heightened political and regulatory pressure modestly reduces expected growth at a time of elevated valuations, while congressional hearings could also build public support for legislation that shifts more of AI's infrastructure and electricity costs onto the industry itself.

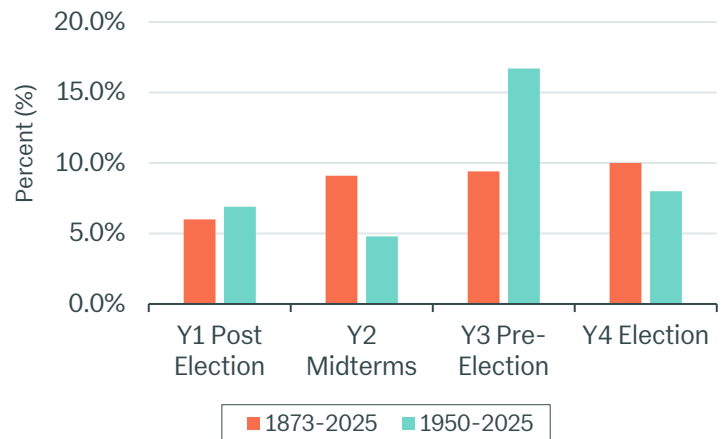
From a purely historical financial markets perspective, the third year has generally produced the strongest real equity returns, and performance has been particularly strong following midterms in which the president's party lost both the House and Senate. Gridlock can make sweeping policy changes more difficult, and markets have generally been comfortable with that outcome. The current economy also retains support from capital spending and corporate earnings (for now).

So, history, and much of the current economic data, offer a reasonable basis for optimism about 2027. With that said, I don't recommend naively relying on history for optimism and certainly not as a basis for managing client portfolios. As such, during the midterm election discussion, I challenged my colleagues on whether 2027 could defy the historical pattern. My thesis? Markets could spend part of 2027 anticipating the policy debate that follows in 2028, one that could involve a higher tax regime.

A strong Democratic showing in November could raise the odds of winning the presidency and both chambers of Congress in 2028, leading investors to begin discounting higher taxes before the election and well before legislation is drafted. The prospect of higher corporate taxes as well as taxes on the wealthy could impact expectations and, therefore, asset valuations. A historically favorable point in the presidential cycle could therefore carry more uncertainty than the historical averages suggest.

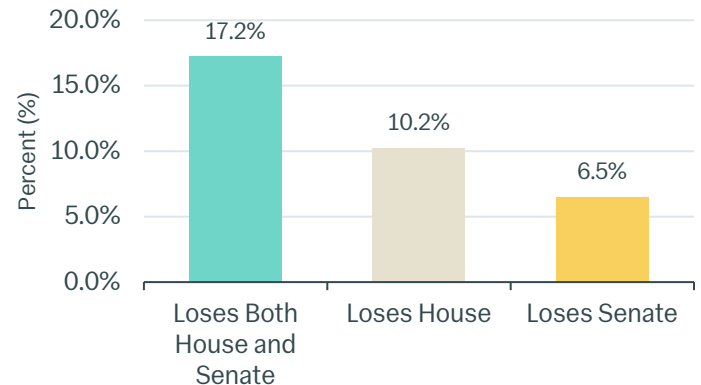
A surprising conclusion my colleagues and I came to, however, is that regardless of which party is in power in 2028, we may be facing higher taxes. It makes sense not only because the populists and progressives feel left behind but, also, because of the unsustainable level of our annual federal deficits and mountain of national debt. As you can see in the charts, the United States remains near the low end of the range in terms of taxes on goods and services. That leaves room for future policymakers to raise revenue if political support develops, although the eventual form and timing remain uncertain.

S&P 500 Real Total Return by Presidential-Cycle Full History vs Modern



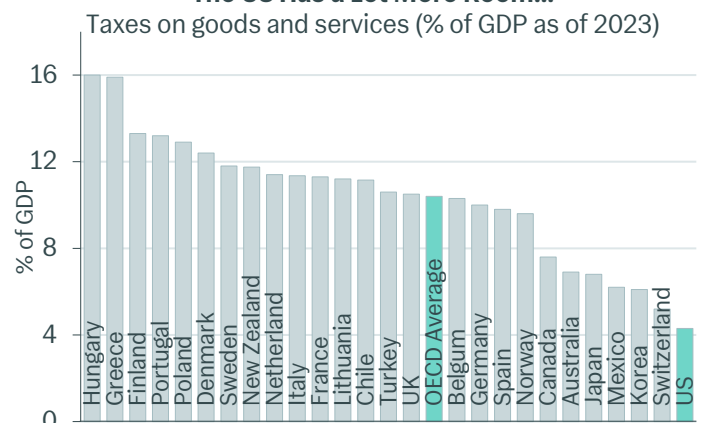
Source: BCA Research, September 2026.

S&P 500: 12M Total Return After Midterm Elections in Real Terms Since 1994 (Presidents Party)



Source: BCA Research, September 2026.

The US Has a Lot More Room...



Source: BCA Research, OECD Glbl Rev. Statistics, September 2026.



Elements of a higher tax environment are already visible. Tariffs raise the price of imported goods and function economically as a tax on consumption, even when the strategic purpose is to change trade behavior or encourage domestic production. The cost passes through some combination of lower margins and higher consumer prices. Future tax changes could arrive through more familiar channels as voters become less tolerant of large deficits and policymakers look for revenue.

With that said, nimble tax management of portfolios will only become more important in the years ahead. 2026 has presented a somewhat less common opportunity to harvest losses within fixed income. Doing so now may allow for more effective rebalancing of portfolios that may have accumulated more equity risk than their risk profile would suggest.

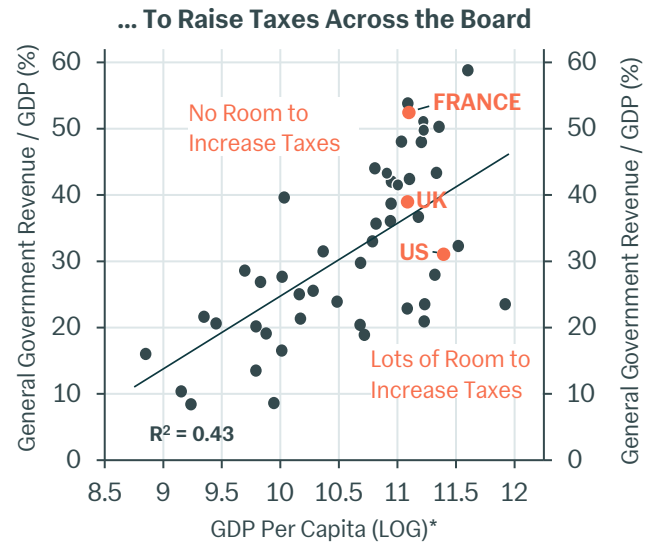
Wars at Different Temperatures

The conflict involving Iran has cooled from a raging boil to more of a mild boil (for now). Shipping activity through the Strait of Hormuz has improved somewhat, oil continues to move, and energy markets have adapted better than many expected. However, this seismic disruption within the global supply chain will have major impacts on the supply chain reengineering process we have talked about. Companies and governments have been examining vulnerabilities and developing redundancy and resiliency plans.

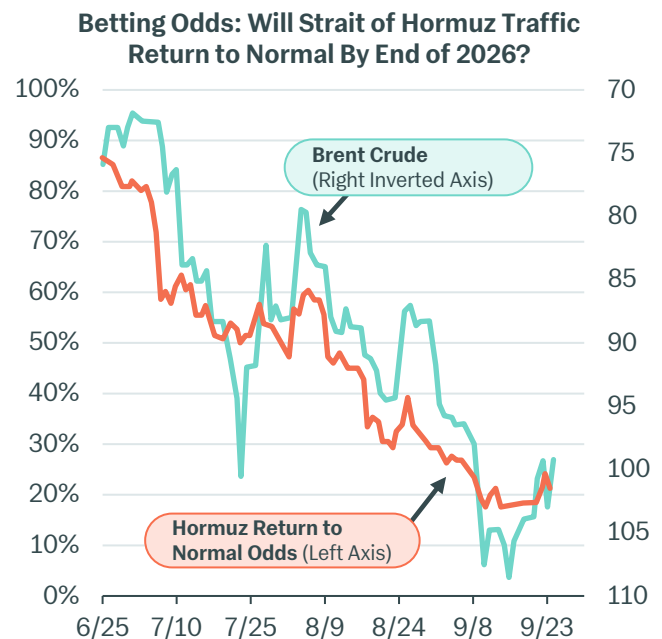
One beneficiary of the wake-up call caused by the closure of the Strait should be alternative forms of energy. I have occasionally joked that this administration may ultimately be remembered as the "greenest" administration in history. Not because of climate policy, but because the war may prove to be the final catalyst that accelerates investment in alternative energy and other efforts designed to reduce dependence on oil moving through vulnerable chokepoints.

Meanwhile, Russia and Ukraine appear to be moving toward a more dangerous phase. Ukraine's drone campaign has increased pressure on Russian energy infrastructure while Russia has become more willing to test Europe through sabotage, cyber activity, and other forms of deniable pressure. Several strategists expect Europe to experience more of this activity before any eventual ceasefire emerges. The concern is less about a direct confrontation with NATO and more about actions that occupy the gray area between peace and open conflict.

Neither conflict has an obvious off ramp today. Both carry the risk of escalation through miscalculation, particularly when military activity, energy security, and domestic politics become intertwined. At the same time, wars do eventually end, but investors do not have the luxury of waiting for that outcome. Governments and businesses are already making decisions based on the lessons they are learning today, and those decisions are likely to influence capital flows and investment priorities long before peace arrives.



Source: BCA Research, IMF WEO (April 2026), September 2026.



Source: Strategas Research Partners, Polymarket, September 24, 2026.



A Tug of War Around Inflation

In recent press interviews, I have made the argument that supply shocks tend to destroy demand and, as a result, the Fed should be more worried about slower growth or even recession in 2027-2028 than supply shock-driven inflation. An increase in energy prices reduces household purchasing power and raises operating costs. Consumers adjust their spending, while businesses may delay hiring or accept lower margins. The process can be painful and eventually takes pressure off prices as activity slows. That dynamic remains part of the current inflation picture despite the impact of the Iran conflict energy shock being less severe than feared.

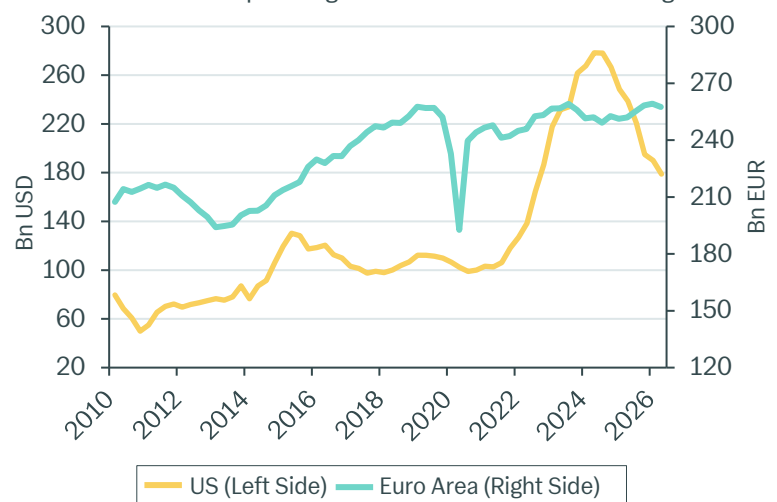
My discussions revealed another dynamic that I had considered but perhaps had not put the proper weight on. The path back to 2% inflation also runs into resistance due to the reengineering of the global supply chain emphasizing resilience and redundancy as well as the increased focus on defense by countries who used to depend on the U.S. as their protector. As we have discussed in prior commentaries, Europe is spending to reduce energy dependence and improve its defenses. Companies are adding capacity after discovering how easily supply chains can break. These projects extend over years and create demand for labor and materials well after the original shock.

This chart shows industrial spending becoming a shared priority across the Atlantic. Europe and the United States have both increased industrial capital expenditures as national security concerns changed the economics of domestic production.

While supply shocks still weaken demand as higher costs work through household and corporate budgets, countries and companies investing in resilience will likely continue long after the immediate supply pressures ease. Restrictions on immigration may also limit labor supply, providing support for wages. These forces help explain why the economy has remained resilient while inflation has taken longer to return to target.

This remains consistent with our view from early 2022 that inflation and interest rates were moving toward a higher steady state. The wars have added momentum to the investment cycle as countries reduce dependence on vulnerable energy routes and security relationships.

The US Is Not the Only Country That Can Surge Industrialization
Construction Spending in Real Terms: Manufacturing



Source: BCA Research, US Census Bureau, Eurostat, September 2026.

The investment implications reach beyond the United States. Years of U.S. outperformance have left many portfolios concentrated in U.S. assets and the AI theme. Going forward, countries' efforts to reinvest in their home countries could provide more support for earnings abroad, where valuations remain lower in many regions.

AI Debt Adds Pressure to Global Rate Rise

Higher interest rates matter because they raise the hurdle rate across the economy. Mortgage affordability deteriorates, corporate borrowing and refinancing become more expensive, and projects that looked attractive when capital was cheap become harder to justify. For financial markets, a higher risk-free rate also increases the discount rate applied to future cash flows, creating a particular challenge for richly valued or long-duration assets. This is relevant to the current enthusiasm around AI: massive capital expenditures can contribute meaningfully to growth



today, but higher financing costs and the eventual depreciation associated with that investment make the earnings hurdle more demanding tomorrow.

Much of the attention surrounding AI has focused on equities, but our CIO discussions spent considerable time on the bond market because the buildout is now large enough to affect the price of capital. Recent research estimates about \$320 billion of 2026 debt issuance from the major hyperscalers and Nvidia, which is equivalent to roughly 70% of net new long-maturity Treasury borrowing in 10-year equivalents. So far, the market has absorbed this supply well, often with substantial oversubscription, although issuers are paying more at the margin as they compete for investor capital. AI-related companies generally have strong balance sheets and credit spreads remain well behaved, but the sheer volume of their borrowing may keep the cost of capital above the levels investors became accustomed to during the 2010s. The AI issuance glut also arrives as cash-strapped governments across the developed world are issuing heavily to fund resilience, redundancy and defense.

Higher Treasury yields have drawn considerable hand-wringing, but they are hardly a uniquely U.S. phenomenon. Global government borrowers are drawing on the same pool of savings, which is one reason why yields have risen across much of the developed world. Japan is part of that story. After decades of shipping their savings abroad because of very low interest rates, more recent higher domestic yields give Japanese investors more reason to keep capital at home, leaving less of their savings available to finance other governments and AI related borrowers.

Meanwhile, France has emerged as one of the clearest examples of how fiscal concerns can migrate from the background to the foreground of financial markets. Years of persistent deficits have left public debt approaching 120% of GDP, while economic growth remains subdued and higher borrowing costs are steadily increasing the government's interest burden. The challenge is increasingly political as well as economic: a fragmented parliament, public resistance to spending restraint and an approaching 2027 presidential election make it difficult to implement the fiscal consolidation investors would like to see. Markets have begun demanding compensation for that uncertainty, pushing

French government bond yields to their highest levels in more than two decades and doubling the cost to insure against a government default in just a few weeks. Is France a canary in the coal mine for a European debt crisis? For now, this looks more like a repricing of French fiscal risk than a repeat of the 2009-2018 euro-area debt crisis as there has been limited evidence of broader contagion. However, it illustrates an increasingly important global theme: when debt levels are high and interest rates remain elevated, governments have less capacity to solve economic and social problems simply by spending more.

Global interest rates have become arguably the most important chokepoint for both the economy and financial markets. The 10-year Treasury yield has climbed roughly 120 basis points this year, reaching about 5.3% at end of September, as investors are absorbing a cocktail of inflation, higher energy prices, resilient economic growth and this increasingly heavy government borrowing. Are rates destined to rise further? The Fed's September decision to raise its policy range by 25 basis points to 3.75%-4.00% acknowledged that inflation remains too high despite continued economic resilience. Importantly, though, this does not necessarily signal the beginning of another 2022-style

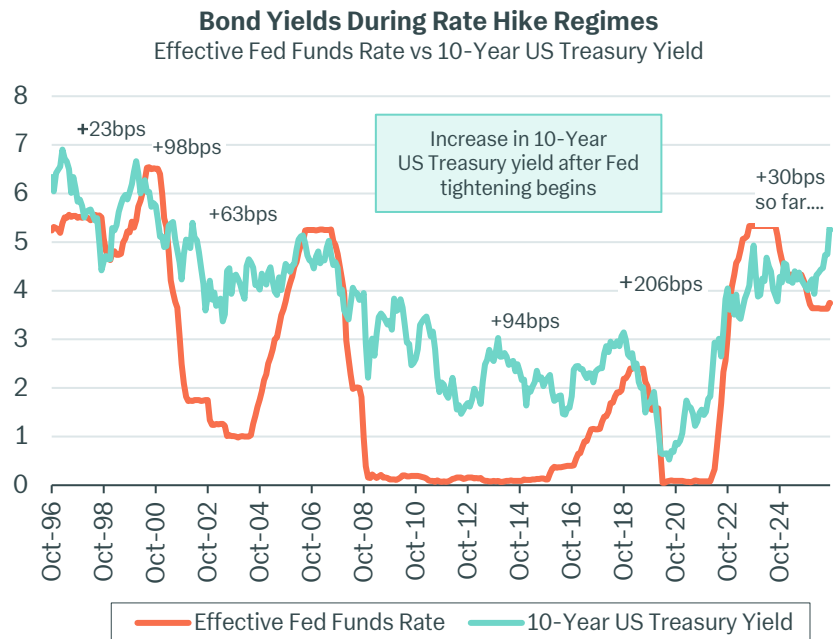


Source: Bloomberg as of 10/12/2026.



tightening campaign. The Fed's September projections suggest a year-end policy rate around 4.1%, and considerably less tightening than markets experienced several years ago, while the minutes revealed meaningful debate around the appropriate path from here.

Moreover, the rise in long-term yields itself is doing some of the Fed's work. A 5%+ 10-year Treasury tightens financial conditions through mortgages, credit markets and equity valuations without requiring an equivalent increase in the overnight policy rate. The further long-term yields rise, the more powerful that restraint becomes—and, eventually, the greater the likelihood that slower activity and weaker demand begin to put downward pressure on both inflation and rates. History also offers some perspective on how much further the long end must necessarily travel once the Fed begins tightening. In the five substantial hiking cycles since 1996, the 10-year Treasury's increase from the first Fed hike to its peak during the hiking period was approximately 97 basis as seen in the chart below.



As I suggested earlier, history is far from the end-all be-all of prognostication—persistent inflation, fiscal deterioration or another supply shock could certainly push yields higher—but it is a reminder that long-term rates tend to anticipate monetary tightening rather than simply follow the Fed higher. With yields already incorporating a substantial repricing of inflation, policy, and fiscal risk, can rates rise further? Of course. But after what we have seen already, a further dramatic and sustained increase in interest rates is going to require materially worse news on inflation than what we have today.

In terms of portfolio management, while elevated rates have caused somewhat painful adjustments to core bond market values, at the same time, yields that now exceed 5% in many cases create something that investors largely lacked during the post-2008 global financial crisis era: A meaningful prospective return from high-quality fixed income. So, while higher rates are a constraint on growth and valuation, they present an expanding source of portfolio opportunity as well.

Portfolio Implications

Arguably the most important observation from my discussions was how otherwise independent variables are seemingly more and more interrelated. Oil prices, interest rates, election odds and the prospects for tax policy changes now feed into one another. A disruption in the Middle East can reach household budgets, Fed policy, and voter sentiment within weeks. That speed is important. The conversations behind this commentary reinforced how quickly policy and geopolitics now reach markets. Energy affects inflation and rates, while financing the investment response can influence yields and valuations. Portfolio risks do not stay in separate buckets for long.

From an investment perspective, our approach is to first diversify across those connections. Infrastructure and real assets participate in the physical buildout, while international equities provide exposure to different investment and policy cycles. High-quality fixed income still provides income and liquidity, with modestly shorter duration to account



for heavier global issuance and the possibility that long-term yields could move higher. Short-term fixed income also offers us liquidity and gives us room to rebalance when markets react quickly.

But these connections also compel us to dig deeper for opportunities to enhance shock-absorbing elements in the portfolio to address a heightened level of volatility. Many diversifying strategies, such as hedge funds, can take advantage of the wider pricing gaps created by policy and geopolitical shocks.

We also continue to look for ways to pull the levers we have some control over- tax management; leaning into exposure to the global capex investment cycle; infusing inflation-mitigation ingredients and incorporating risk and return drivers that do not all depend on the same U.S. equity outcome.

Perhaps that outcome will take a long time to determine. The prior regime developed over decades, and the current system will also take time to evolve. Higher investment and a greater willingness to pay for resilience are already visible. Governments and companies are unlikely to forget the lessons simply because a ceasefire is reached or an election passes.

The years ahead will still contain periods of strong growth and falling inflation. The foundation underneath those outcomes is changing. In summary, portfolios need enough flexibility to participate in the buildout while remaining prepared for the volatility around it.



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DEFINITION OF INDEXES

Global REITs = FTSE EPRA NAREIT Global Index

A global equity benchmark designed to track the performance of publicly traded real estate companies and REITs worldwide. It includes property owners and operators that meet strict criteria for real estate activities, liquidity, and transparency.

Intermediate Muni Bonds = Bloomberg Municipal 1-10 Year Index

A bond index measuring the performance of U.S. investment-grade municipal bonds with maturities between 1 and 10 years. It includes tax-exempt bonds issued by state and local governments and their agencies, focusing on the short-to-intermediate segment of the muni market.

US Core Taxable Bonds = Bloomberg U.S. Aggregate Bond Index

A broad, market-capitalization-weighted benchmark for the U.S. investment-grade fixed income market. It includes U.S. Treasuries, government-related bonds, corporate bonds, mortgage-backed securities (MBS), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS).

Hedge Funds = HFRX Global Hedge Fund Index

An investable index designed to represent the global hedge fund industry using a rules-based selection of hedge funds. It covers multiple strategies (e.g., equity hedge, event-driven, macro, relative value) and emphasizes transparency, liquidity, and lower survivorship bias.

US High Yield Bonds = Bloomberg U.S. High Yield Bond Index

A benchmark tracking the performance of U.S. dollar-denominated, below-investment-grade corporate bonds publicly issued in the U.S. domestic market. It reflects the high-yield (or “junk”) segment of the corporate bond market.

US Large Cap Equities = S&P 500 Index

A widely followed equity index measuring the performance of approximately 500 large-capitalization U.S. companies. It is market-cap-weighted and designed to represent the core of the U.S. equity market across multiple sectors.

US Small-cap Equities = Russell 2000 Index

A U.S. equity index that measures the performance of approximately 2,000 small-cap companies drawn from the broader Russell 3000 Index. It represents the small-cap segment of the U.S. stock market and is widely used as a benchmark for U.S. small-cap equities, which typically exhibit higher growth potential and higher volatility than large-cap stocks.

Global Equities = MSCI ACWI (All Country World Index)

A global equity index capturing large- and mid-cap stocks across both developed and emerging markets. It represents the broadest commonly used benchmark for global equity performance, covering roughly 85% of global investable market capitalization.

Emerging Markets = MSCI Emerging Markets (MSCI EM)

An equity index representing large- and mid-cap companies across emerging market countries. It provides exposure to faster-growing economies with higher potential returns and higher volatility relative to developed markets.

Developed Int'l Equities = MSCI EAFE

An equity index covering large- and mid-cap stocks in developed markets outside the U.S. and Canada, specifically Europe, Australasia, and the Far East. It is a standard benchmark for international developed-market equities.

Commodities = Bloomberg Commodity Index

A broadly diversified benchmark tracking the performance of futures contracts on physical commodities. It provides exposure across major commodity sectors, including energy, metals, and agriculture, with weighting constraints to limit concentration in any single commodity or sector.

Global Infrastructure = S&P Global Infrastructure Index

A global equity index designed to measure the performance of publicly traded infrastructure companies around the world. It includes firms involved in infrastructure-related businesses such as transportation (airports, toll roads, railways), utilities (electricity, gas, water), and energy infrastructure (pipelines and storage). The index is structured to provide diversified exposure across regions and infrastructure subsectors and is commonly used as a benchmark for global listed infrastructure investments.