KANOS
CAPITAL MANAGEMENT, LLC

Kanos Capital Management

Quarterly Investor Letter

Third Quarter 2026

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Third Quarter Market Review

AI, War, and Bonds. These seemed to drive markets almost exclusively during the third quarter. The Artificial Intelligence (AI) development and buildout ecosystem, particularly the mega-cap companies, held up the US stock market. Despite a mid-quarter correction and deteriorating public opinion surrounding AI (datacenter NIMBY opposition, 'AI will kill us all' dustups), large-cap tech stocks led markets higher for the quarter. War dampened prospects, as the Iran War reflared, driving crude and energy product prices higher once more, pushing energy costs higher for countries, businesses, and consumers alike, while stoking inflation and influencing central bank interest rate hikes across the world. These rate hikes, driven by stubbornly high inflation, contributed to further bond selloffs, especially in US Treasuries. Late summer, especially August and September, has historically been a volatile, poor-performance time in markets, so the quarter's volatility is not entirely unexpected. And despite higher interest rates, large placements of AI-related and other corporate debt, especially investment grade, were sold successfully throughout the quarter. Should either the Iran War or the Russia-Ukraine War see at least partial resolution, markets could resume to their advances of the past couple of years.

Major US stock markets showed small gains for the third quarter, although the indices generally showed better performance than many individual stocks, highlighting the dispersion of results and the ability of mega-cap stocks to pull the indices higher, despite many constituents declining during the time period. The S&P 500 gained +2.3% to 7,651.54, while the Dow Jones Industrial Average lost -2.3% to 50,906.05 [all index/sector performance numbers reflect total returns]. Among sectors, winners were led by Energy (+16.3%), Healthcare (+6.5%), Communications (+3.8%) and Tech (+2.8%). Losing sectors included Utilities (-12.4%) [data center angst and rising interest rates], Industrials (-9.7%), Consumer Discretionary (-7.0%) and Real Estate (-6.3%). As mentioned above, bond prices fell hard during the quarter, led downward by Treasuries (-2.5%), with the Bloomberg Aggregate Bond index registering a -3.1% total return, reflecting inflation concerns, an oversupply of bond issuance, and, to a lesser extent, the unwinding of bond carry trades. The US 10-year Treasury closed the quarter at 5.28%, its highest yield since 2007. International stock markets were mostly lower, led by South Korea's KOSPI (-19.3%), France's CAC (-5.2%), India's Sensex (-5.2%) and Japan's Nikkei (-4.7%). Energy was the big winner in commodity markets, led by Brent crude oil up +42.0%. The lack of worldwide surplus refinery capacity drove products prices even higher, with diesel (+15.2%), jet fuel (+4.9%), and gasoline (+3.3%) leading the way. Precious metals were slightly higher, despite a stronger dollar and higher interest rates (higher rates are thought to incentivize investors more than non-yielding metals); gold gained +3.4% and silver rose +1.9%.

Looking Forward

Introduction

The US economy and financial markets are being affected by different forces, many directly opposed to each other, leading to volatility, confusion and an unusually wide range of opinions about the future. Seasonality only adds to this: the late August – mid-October period often produces increased volatility as the financial industry returns from summer vacations and wrestles with outlooks for the rest of the current year and the next, along with big trends (in this case AI, rising interest rates, rising debt levels and high valuations (compared to historical levels).

The approaching midterm elections have added to the urgency of asset allocations, as have the rapid large increases in interest rates, which traditionally have caused reallocation of stock and bond balances around the end of quarters. However, in this case, high interest rates are a worldwide phenomenon, adding reallocations among countries to the mix, creating even more crosscurrents.

The ongoing wars in the Middle East and Eastern Europe continue to add geopolitical angst to their upset of energy and commodity products, further upsetting cost structures around the world, and it is hard to see straightforward alleys toward cessation of hostilities in either case, although glimmers of hope continue to come out of the Iran War, however fleeting they end up being.

Despite such a conflagration of uncertainties, the US economy continues to hum along, demonstrated not only by the "AI ecosystem," which is humming in software development, facilities construction, infrastructure enhancement and energy expansions, but also reshoring of key industries (defense, pharmaceuticals, critical minerals production, processing and refining, etc.), advancing medicine and even consumer spending, at least in the aggregate.

Financial markets have been through an uncertain summer, with chip companies reporting huge earnings growth and other tech companies booming, too; however, many other sectors have seen slow growth and had their share prices suffer. Early summer euphoria turned to angst turned to some selling. But resilient demand, continued growth in AI / cloud / automation in tech, as well as in many other industries, has underpinned earnings growth in many sectors, leading to renewed optimism in prospects for US stocks. International stocks also have benefitted from better from growing earnings and attractive valuations, as well as more business-friendly developments in geopolitics (most of Latin America) and expanded business prospects (many countries in Asia). The "flies in the financial market ointment" are 1) stubbornly high energy costs (especially diesel fuel prices) caused by ongoing wars, and 2) rising interest rates around the world, due to higher growth prospects and higher expected inflation, which could put a damper on equity markets if higher yields start to present better risk/return opportunities for investors.

Economy

The US economy has continued to hum along in the AI / technology / industrial sectors as AI development of software, physical infrastructure, integration into corporate infrastructure and procedures combine with the buildout of data centers, infrastructure, and reshored industries to propel

growth throughout the country. In addition, increased utilization of energy infrastructure, increased utilization and refurbishment of utility assets and continued buildout of industrial / warehouse infrastructure nationwide has led to growth in those industries, providing efficiency and synergy with existing and developing tech infrastructure.

Meanwhile, the K-shaped economy we have talked about in past letters persists: the tech/industrial economy continues to boom while financial asset owners and property holders benefit from rising stock prices, rising income generation and higher asset valuations. In the recent past, this activity has led to inflation and cost of living increases that have been harder to absorb by the part of the country that has wage-oriented careers that rent their housing and have food and fuel constitute a higher percentage of their disposable income. These people are in the lower part of the "K" who find continued inflation and higher fuel prices impinging on their lifestyle, causing them to run higher credit balances and save less (or even raid their savings). They have never been able to adjust after the twin blows of higher prices produced by the post-Covid liquidity bubble and the Fed's 2022 raising of interest rates 5% in the quickest rate hike cycle in history.

The Bureau of Economic Analysis announced second quarter US real GDP rose at a 3.4% annual rate, accelerating from an upwardly revised 2.2% rate in the second quarter. Analyst estimates say the economy on average is growing around a 2.5% real rate, and it is estimated 1-1.5% of that rate is from the AI ecosystem, meaning the rest of the economy is growing only at around a 1.0% annualized rate. This non-AI ecosystem growth probably comes from infrastructure and reshoring construction plus defense modernization/expansion and energy development offset by a contracting consumer economy.

Higher interest rates (discussed below in the Bonds section at length) have yet to make a visible dent in this economy, and while most would argue that it will hurt consumers in the lower end of the economy most, we would argue that they've been paying much higher interest rates for some time, and that higher rates are mostly impacting the financial corporate world (remember, average credit card rates have been 22+% for years now). Thus, the industrial economy is probably at risk to slow down if higher rates are here to stay, but the amount of economic growth currently in process and future projects already financed and in motion should propel the economy for at least a couple more quarters.

The global wars do not seem to have affected the US economy significantly except for higher fuel costs, which are a slow burn for businesses who try to either absorb the higher costs or pass on some of them to customers. Once they no longer can do so, we may see an economic effect from fuel costs, but right now, there seems to be little effect, especially when looking at airline passenger miles, which continue to grow despite higher prices caused mostly by higher fuel costs.

Other economies around the world are affected in different ways. European economies, which have suffered over the past couple of years after the fuel shock of the Russia-Ukraine War, seem to have steadied to the point that the European Central Bank (ECB) raised rates in September (to 2.5% as opposed to the US Fed's 4.0% rate) to fight inflation without overly worrying about slowing the economy.

China's economy continues to be the one that is a concern. It's inability to restart economic growth post the deflating of its real estate bubble, coupled with its politically controlled economy and governmental allocation of capital, means the Chinese economy continues to be around stall speed, with very little real growth occurring (despite governmental reports that put growth at 4-5% annualized). One illustration of this is the October report of a 28% drop in domestic car purchases for August, showing Chinese consumers' reticence or inability to spend money on large purchases. The lack of any material

consumer consumption growth in China is an ongoing problem the government has yet to find a solution for.

The moribund Chinese economy has repercussions on economies worldwide though. China has ramped up exports of all kinds, producing goods in their factories to keep workers employed and selling (or dumping at below market prices) goods throughout Asia and Europe. It has gotten so bad that the European Union just imposed a 350,000 car/year cap on Chinese electrical vehicle imports to protect their industries. This behavior is happening all over the world, with a more limited effect in the US due to our relatively higher tariffs on Chinese imports as well as the repeal of the <$800 exception on goods. Worldwide exporting has led to China having a record trade surplus, crowding out competitors in countries around the world. They have used this cash flow to fund their high profile, national prioritized projects, including artificial intelligence, defense, automation and robotics. We think China will continue to have economic problems since they don't let their consumers determine demand for goods and services through a market mechanism, leading to poor economic resource allocation that may cost them in the future (think the USSR), but that is far in the future.

Japan's economic growth is also subpar at around 1.0% in 2025 while 2026 and 2027 are expected to slow slightly to 0.7% despite higher inflation than Japan has seen in decades. This growth is a combination of tech innovation but very slow consumer spending growth, similar to the US but slower. We are still bullish on the Japanese economy and stocks as we see them continuing to lead in automation and robotics, finding ways to cut costs in their economy and keep companies profitable while keeping inflation in check.

The other notable Asian economy showing strong growth is Korea, whose technology industry, anchored by semiconductor/memory makers Samsung and SK Hynix, is propelling growth around 3.0%. We see continued growth of AI around the world keeping demand high for memory and other Korean exports, although the extreme profits of the memory companies will almost certainly moderate in the near future.

Latin America is benefitting from more countries voting in business-friendly right-leaning governments, which are reforming and streamlining laws for business to prosper and expand. The exception to these is Brazil, which just saw a surprise win by the left-leaning incumbent Lula, leading to a crash in Brazilian markets since it will not be voting in a more economically friendly administration. We are bullish on Latin America (ex-Brazil, since we don't trust the Lula government) as the world has underinvested in commodities for many years, and LatAm will be a source of plentiful and abundant resources to be produced for domestic usage and export for decades to come.

Middle Eastern economies have suffered from ongoing hostilities and unrepaired damage from shifting combat zones. We see these countries as having to devote much of their economies to rebuilding over the next couple of years (at least, which depends on the shooting wars ending relatively soon). This probably removes these countries as economic leaders and sources of financing they have been in the recent past.

Bottom line: Economic growth continues to occur despite the two large war zones in the world. Much of the growth is driven by investment in AI and other technologies, helping to sustain economies with struggling consumer sectors.

We expect this economic growth to continue despite higher interest rates as productivity and national goals / defense are behind the scenes advocates of continued development of technology, defense and national security-driven buildout of strategic industries for the West, China and others.

While uncertainties around the wars continue to introduce volatility into continued economic growth, we believe the importance of continued investment and the distance of combat away from the developed world means the wars will only have indirect effects on world economic growth.

Equities

The whole financial world (at least) is holding its collective breath over the enormous amounts of money being spent on the AI ecosystem and wondering where it comes from and whether it is being invested productively. The AI universe includes hyperscaler companies, AI development companies, semiconductor companies (especially memory makers), electrical component/infrastructure companies, and data center developers. These companies are involved in an intense competition for contracts, compute and capability, trying to get data centers running AI and AI agents for as many paying customers as soon as possible.

These AI companies have been leading the markets higher, despite a late third quarter correction in most non-AI US stocks. For reference, 50% of the S&P 500 were down at least -10%, 40% were down at least -20%, and as many as 25% of S&P stocks were down -30% from their highs. Meanwhile, many US large-cap indices have hit new all-time highs in the last couple of weeks.

Going forward, we believe the equity markets will muddle along through this turmoil. The need for further AI development and its adoption across the economy and government should drive continued investment and economic growth, although progress will come in fits and starts, with even more volatility along the way.

The markets all hinge on seeing this technology revolution through to its conclusion, and we see industry, government and financial markets continuing to work together to get the facilities built and the systems installed to continue innovation and productivity throughout all sectors. <u>However, we also see this continued progress taking its toll on financial markets through shrinking of valuation multiples as growth occurs more slowly than originally forecast and high interest rates make equity issuance a big part of funding going forward, hurting forward equity returns.</u>

Meanwhile, getting data centers built is becoming more difficult. Permitting issues, NIMBY ("not in my backyard") protests, access to energy/electricity to power the facilities, and the challenges of raising enough money (generally starting in the tens of billions of dollars) mean AI growth may slow much more than developers, stockholders and debtholders had hoped. Recent announcements by data center developers Oracle, CoreWeave, Firmus and many others have indicated issues with getting data centers commissioned, announcing delays that could last months or even years past the planned in-service dates.

And just as SpaceX's historic June IPO sucked most of the capital out of the markets for at least a couple of weeks, Anthropic is projecting its own historic IPO to happen just before Thanksgiving. It is also expected to sap equity markets of tech-oriented liquidity, even though it made a mid-June announcement to its current (private) shareholders that due to slower than expected adoption, it was expecting to go public at a $1.5 trillion valuation, down 25% from its $2 trillion valuation estimate this

summer. OpenAI, the parent company of ChatGPT and other AI products, is raising money in this same environment at a lower valuation than earlier this year, acknowledging growth but at a slower pace.

The Gartner Group, a computing industry consulting firm, released a study in mid-October that helped quantify the issues with returns on the AI buildout. According to Gartner, AI data center owners would need to generate a cumulative $8.5 trillion to cover the costs of buildout, financing and a 12% return on AI datacenters. However, their estimates all the revenues to be collected adds up to only $3.6 trillion, leaving a roughly $5 trillion deficit. Their analysis suggests $3-5 trillion of data center costs might need to be written off in the 2030s as unrecoverable. This is the kind of math that keeps us from major investments in the sector.

However, we think that the AI race is like the Cold War arms race – It is a competition US industry and the US government will continue all out to win, marshalling private, governmental and industry financing and development resources to power through to more general adoption and usage across the economy, government and private sector, meaning the AI ecosystem will use expanded corporate and public resources to continue the buildout. Thus, we see the hyperscalers and large tech companies issuing a lot of more stock as well as debt as they go all out to be one of the winners. This will lead to lots of dilution and lower profitability going forward, hurting equity valuations and slowing down equity returns for quarters or years. But this "profits recession" is the needed fuel for the ultimate completion of an across-the-board adoption of AI in all aspects of the economy.

And increasingly, AI is putting the hugely profitable businesses of the mega-cap tech companies into decline, increasing their need to grow their AI/cloud businesses. Alphabet (Google), in its just released quarterly earnings, announced a miss on both revenues and earnings, with investors and analysts most concerned about much slower growth in its cash cow Search business, which the company also forecast to slow further in the future. We think investor Alexander Stahel in a 10/29/26 X.com post expresses the fortunes of the computer mega companies well:

> "The amazing thing about Google getting hammered today [after announcing quarterly results on 10/28/26] is not that its core Search business is under stress. It's how long it took investors to figure that out.
>
> "AI is changing the regime under which the hyperscalers became some of the highest-return-on-capital businesses in human history. Google & Meta, and to a lesser extent Amazon, are at the centre of this disruption.
>
> "They became the modern-day landlords of the digital economy. Google auctioned search intent. Meta auctioned attention. Amazon auctioned product discovery. They controlled access to consumers and charged advertisers increasingly expensive rents for the privilege. Beautiful low capital intensive businesses. Until the rules change.
>
> "AI is doing precisely that, faster than the internet revolution that created these empires. I barely use a web browser for search anymore. It has degenerated into a window for opening websites. Why scroll through sponsored links & SEO garbage for dog food when an AI assistant can find what I need? I doubt I am alone.
>
> Their response? Join the party and build staggering amounts of compute. Google alone is heading towards US$200bn of capex in 2026, while its Search growth is already slowing."

Thus, we see tech stocks as less attractive investments going forward, since these big companies should grow profits more slowly and consume much more capital than in the past. While the continued "passive bid" of retirement and index-related contributions will continue to underpin investment into the US stock market, company share buybacks, another big buyer of stocks in aggregate over the past few years, will no longer be there – Meta, Alphabet and Amazon are now free cash flow negative (due to their large AI investing), leaving no funds for their formerly large buybacks.

We have positions in a few companies that we think will continue to be attractive: Microsoft, Taiwan Semiconductor and ASM International. Microsoft is the backbone of business and personal productivity software, in addition to being integral in providing web, hosting, cloud and other essential computing services, and we see it maintaining attractive profit margins in some of its business segments. It just announced quarterly earnings, and its Azure cloud business accelerated to an annualized 49% growth rate. Taiwan Semi and ASML are integral to sophisticated chip manufacturing, which will need to occur going forward regardless of how fast or slow the AI buildout proceeds. They are at lower valuations than many of the high fliers and have large moats to their businesses, making us feel more comfortable holding these positions.

We feel strongly that our commodity investments will continue to well into the future. As we relate in the Energy section below, we think energy companies continue to be undervalued because investors are just now waking up to the inevitability of energy market upsets lasting for months and years, regardless of how quickly (or not) the two ongoing wars are settled. Underinvestment in many other commodities means attractive supply/demand balances continue to exist, especially in metals. Central banks' lip service in fighting inflation while keeping interest rates as low as they dare means inflation will continue at or above the Fed's stated 2% inflation rate, favoring investment in real assets like commodities. In addition, continued huge borrowing by world governments, now in competition with historically high corporate borrowing and AI-related borrowing introduces more and more brittleness in world financial systems, pointing more risk-averse investors toward investments like precious metals and non-governmental, non-tech related investments.

We still think our Essentials theme, investing in companies that produce products that will be needed in the future regardless of investment valuations, like pharmaceuticals, staples, defense, tobacco/food, etc. is an important component to customer portfolios. We see improving technology and research budgets moving human healthcare (both preventive and sustaining as well as medical) to grow in leaps and bounds in the future. We see pharma and biotech companies as the best way to capture some of this value. Staples, while needed and essential to all, are relatively expensive as their earnings growth has been constrained by higher input and employee costs, as well as customer pressure to moderate price increases. We see these as a sector that will see better valuations in the future, at which time we will be more interested in increasing our portfolio weights.

Defense is interesting not only because spending is increasing worldwide but also because recent wars have demonstrated the success of smaller, cheaper and more autonomous weapons systems. We see more opportunities to find interesting tech-oriented defense companies in the future, and we think the AI buildout will be integral to a new defense industry in which smaller, more nimble companies continue to grow in the mix of defense procurement by the US and other Western governments.

Internationally, there are some interesting stock markets as well. Latin American countries continue to look attractive, and we are looking for more interesting opportunities in a number of stock markets in the region. However, Brazil just surprisingly voted to re-elect its leftist President Lula, causing financial

markets to crash. We have been skeptical of Brazil because of Lula's past governance and the poor performance of many Brazilian companies under his administration. We will continue to avoid Brazil since we think the country has turned even more authoritarian as Lula and his administration was threatened by the potential political transition and the resultant loss of influence if he were to have lost.

Some Asian stock markets have also seen considerable selling, most notably in South Korea. Their Kopsi index, the runaway leader in performance the first half of the year, has given back a lot of gains, down 30+% from its mid-June highs. The index is dominated by two large semiconductor stocks, Samsung and SK Hynix, which powered the index higher by 116% in the first half. However, the end of a buyback by both companies, along with a rerating of multiples by AI investors, have led to a large giveback, which may or may not be done. The bubble properties of the move give us pause, so we are not looking at adding exposure there.

Chinese stocks also have seen some selling lately, and we are not interested in investments there. But other Asian stock markets continue to offer opportunities: Japan, in which we own some stocks and where we will also start looking for attractive situations as the stock market there has seen a correction in the past few weeks.

In Europe, France's CAC index has performed poorly lately, along with France's bonds, as fiscal problems have led to political uncertainty and civil unrest, culminating by anti-government protests nationwide by disaffected citizens and immigrants alike. The country's fiscal choices and permissive political environment have come back to bite the ruling party headed by President Macron, who is facing an election in the next few months; they have proposed a number of half-hearted "solutions" to some of the spending issues, none of which was well received, leading to the stock and bond markets rebelling and seeing large amounts of selling. We are not involved nor do we think that there are many attractive opportunities emerging there anytime soon.

Other European markets have outperformed France, but most have seen corrections during the last few weeks as higher energy costs and higher interest rates take their toll on relatively weak European economies. We continue to poke around for European opportunities, but we are hard pressed to have conviction with such poor political and business environments extant. Poland has been run much more conservatively than most other European countries, and so we are watching their stock market to see if there is an attractive entrance point, although it's so close to Ukraine that the spread of the war is a non-zero probability, somewhat cooling our enthusiasm currently. If any resolution of the war happens, we think Poland would be an excellent source of aid and rebuilding for the Ukrainian economy, so that keeps us interested.

Bottom line: We think the US stock market will continue to be volatile as investors see winners and losers emerging in the AI ecosystem and buildout. Tech profits will slow as the buildout requires more debt and equity issuance to fund more and more spending, but the integration of AI into industry, government and the private sector will demonstrate AI's ability to help economic growth and productivity, with passive money and governmental support underpinning the continued need for large amounts of capital.

Meanwhile, the rest of the US economy seems to be experiencing slow growth, with concern around consumer-facing businesses and whether they can generate enough growth to justify their still-high valuations compared to history.

Thus, we are most comfortable with our portfolios overweight in commodities, especially metals and energy, along with our Essentials holdings of pharma, defense, some tech, utilities and other infrastructure, as well as niches like tobacco/nicotine producers. We see our portfolios as benefitting from growth in the US while remaining well-positioned to withstand geopolitical, economic and market volatility we've been experiencing lately and expect to persist.

Bonds

Bonds had another tough quarter as interest rates rose around the world, pushing down bond prices. Pressure on bonds is primarily caused by growth and continuing inflation concerns, underpinned by ongoing wars in Ukraine and the Persian Gulf, and increasing supply of bonds being offered, not only by countries funding budget deficits but also by infrastructure developers and other AI companies.

US Treasury bonds have suffered in recent months from a hawkish Fed, surplus supply, lower international demand and inflation fears. In fact, the US 10-year Treasury hit a 24-year low in mid-October, pushing yields up near 5.5%. The Fed's September rate hike, the effect of which is now tempered due to recent, less hawkish employment statistics, still looms large over the bond market, as fewer than usual buyers mean more difficult Treasury auctions and higher yields. In part, this rise in yields represents a normalization of interest rates to more historical levels, caused by increased economic growth in the US and persistent inflation. This AI capex cycle, on top of reshoring and defense upgrading/restocking cycles, have pushed economic growth and its concomitant need for capital financing higher than in recent years, putting pressure on rates as multiple types of issuers compete for capital, with the vast majority being in world fixed income markets, highlighted by the huge US market.

Although core inflation has fallen in recent months, potential bond buyers still see overall inflation as a threat and demand some inflation premium before purchasing. We are in the camp that thinks overall inflation will continue to be a problem due to accumulated energy inflation effects throughout the supply chain. Core inflation, while having dropped this year, is expected to rise in the future by some analysts, most notably Doubleline Capital's Jeffrey Gundlach, who CNBC dubs the "current Bond King." He sees inflation rising due to "base effects," (old comparison numbers replaced by more recent numbers), which will probably bleed into the core inflation numbers, especially as we see little chance of permanent solutions to the two wars currently raging.

Another issue facing US bonds is the large amount of AI developer and hyperscaler bond issues that have recently hit the market, as well as the ones still slated to come to market later in 2026 and in 2027. Investment grade issuers are competing with US Treasury issuance, putting pressure on yields since most hyperscalers are mostly indifferent to interest costs since most have large cash flows to cover these costs. However, less than investment grade issuances have seen interest rates rise as more issuances compete for capital, while also competing against other large issuances, like Japan's Softbank's recent record issuance of junk bonds secured by its large investment in OpenAI. Recent earnings calls have announced during their forecasts that hyperscalers and other large tech firms continue to see large amounts of capital expenditures in the next few quarters, and many industry watchers expect part of that capex to be funded by new debt issuance, even as potential bond buyers continue to demand more premium due to higher risks and increasing skepticism on timing of returns.

In addition to higher-than-normal supply, fewer traditional buyers of US debt (especially US Treasuries) are in the market these days. Traditional Asian buyers, led by Japan and China, who have traditionally

recycled trade surpluses with the US into US Treasuries, have seen their holdings of Treasuries cut, but for different reasons: China for geopolitics and Japan for internal politics.

China has been diversifying their Treasury holdings for years as they vie in a "cold trade war" with the US, with the US throwing tariffs on Chinese goods after accusing China of "dumping" underpriced goods on US markets to gain market share.

Japan, whose bond markets have paid uncompetitive interest rates for decades as Japan slowly dug their way out of a disinflationary depression, has seen its domestic bond buyers refocus on its own (large) bond market as rates have climbed to competitive levels, steering capital away from foreign, and especially US, bond markets. This is because Japanese bonds finally offer competitive yields without foreign currency risk and because Tokyo needs to sell large amounts of bonds and the large Japanese retirement pools are seen as perfectly positioned to finally buy Japanese instead of foreign bonds for their fixed income needs.

Japan has also had one more reason to sell Treasuries: as the Japanese yen has continued to drop in value versus other currencies as Japanese interest rates rose more slowly than other countries' interest rates, Japan's Ministry of Finance (MOF) has had to sell reserves and buy yen to arrest the yen's drops (big currency drops undermine confidence in a country's investment prospects and can lead to increased inflation too). This selling of reserves is so large that it has involved selling US Treasuries to produce dollars to buy yen in support; but this selling has pushed more supply into US bond markets right when supply was already a problem, and without the Japanese, reliable buyers of Treasuries for many decades, there to be a buyer.

Thus, the absence of Chinese and Japanese buyers, exacerbated by Japan's MOF selling, has helped depress US bonds, helping push up interest rates.

Additionally, another cohort of traditional Treasury buyers, Middle East oil producers, have also been lesser buyers than in the past. Since the spring, their revenues have had to be partially refocused on defense and war expenditures in addition to sums needed to repair/replace energy, industrial and military infrastructure damaged or destroyed during the current Middle East wars, including hostilities with Iran and the Yemeni Houthis. The draw on capital for their economies and industries is another blow to the Treasury market – with the abovementioned Asian buyers, they have been bedrock buyers for Treasuries for decades and are now less, with the proposed building of pipelines to avoid the Strait of Hormuz pointing toward a multi-year need for internal capital, depriving the Treasury market for longer than originally expected.

Finally, another bedrock buyer of US fixed income – funds investing US passive retirement investment dollars – is set up to buy anything but Treasuries currently. Let us explain: over the past fifteen years, the popularity of passive equity investing, using indices as a destination for regularly allocated contributions to retirement accounts, has led large investment companies hosting these equity investments to extend the same approach to fixed income investment for retirees, trying to capture more of the traditional 60/40 equity/debt retirement investing universe.

For simplicity's sake, the financial sponsors used the equity model, in which indices are capitalization-weighted. This leads to more investment dollars going to issues increasing in price, while those underperforming assets receive less as capitalization drops due to lower prices. US Treasuries have performed least well in the fixed income universe in the past few years, meaning Treasuries continue to receive smaller and smaller allocations of fixed income dollars, especially as AI and other very large,

very popular issues attract large amounts of fixed income issuance and after-market buying. Thus, Treasuries have recently received a smaller share of fixed income dollars due to better performance of investment grade corporate debt, and as more issues have recently come to market and risen in the aftermarket, Treasuries' share of the fixed income passive retirement pools has continued to shrink.

Thus, while higher interest rates should make bonds more attractive (as rates go up, prices go down), the combination of increased supply, greater competition for capital, the absence of or reduced buying by traditional foreign buyers, and a shrinking share of passive retirement funds should continue to pressure bond prices.

These factors have recently combined to drive prices down so far as to push them into "oversold" territory, where a bounce has occurred during October. A number of savvy investors have started to nibble on bonds at these levels, saying that the reward of currently high interest rates makes the risk of further price drops and the eroding of value through inflation balanced. In addition, many of these investors also argue that if and when the AI buildout ever "hiccups," stock prices will suffer, and investors will run for bonds for stability and income, driving up prices. We continually look at economic, geopolitical, political and supply/demand factors to continue to judge whether to devote more capital to fixed income and in longer duration than the money-market fund / short duration investments we currently have as our yield investments. We currently don't think the rewards outweigh the risks at this point, especially because of international factors, which we discuss below.

We regularly check international rates as reference points in our research to understand how they shape investment conditions worldwide. However, recently, international bond markets have become more front-page financial news, forcing us to take more notice. From the issues we have noted in Japan and the UK in past letters, where fiscal concerns have driven up UK interest rates and inflation and economic growth have driven Japanese rates higher, now Europe, and especially France, have come into the headlines.

French interest rates have recently made headlines as they not only headed skyward but also rose much faster than their traditional close trading partner, Germany. German and French rates have generally moved in lockstep over the years as the two countries were the leaders of the European Union and the integration of Europe and European economies.

However, in October, French rates have blown out the French/German ratio to almost 180 basis points as French fiscal and political problems have led to unrest, fiery protests and flagging confidence in the French government and especially French finances. This is significant because with the weakening in German finances and competitiveness in recent years, France was considered the stronger economy, the bedrock of Europe. Its rates had been lower than US rates despite ongoing fiscal worries building over the years. Thus, French bonds ("OATs") have been used by European (and worldwide) hedge funds for the carry trade, where the funds bought OATs with lots of borrowed money, collected the difference in short rates used in financing and the OAT yields, with little concern about OATs' potential volatility and downside.

Well – that carry trade has blown up, leading to big losses and closing out of positions, contributing to the selling. In addition, OATs have been considered such good quality that they have been used in repo trades around Europe (and the world), where funds have pledged their OAT holdings as collateral for borrowing. Now, the OATs have lost a lot of value, creating a need for more collateral and pointing toward whether they should be accepted as collateral at all, again contributing to more selling.

Rates recently hit levels not seen since 2002, up around 170 basis points to 5.1% on the 10-year OAT, now roughly at par with the 10-year US Treasury, which traded at a discount to OATs for many years. Although French bonds have bounced in the past few days as a long-predicted credit downgrade on France was shelved for the time being, recent market action shows why we are leery of foreign bond investing, and we hope it won't be a precursor to what might happen in the US if our deficits and debt grow more quickly and start making people in finance around the world more concerned about holding Treasuries than they already are.

Japan's rates also have climbed during 2026, but since much of Japanese debt is held by Japanese institutions, or the Bank of Japan (BOJ), they don't make as large headlines as flareups in other parts of the world, like France. However, rising Japanese interest rates could start to affect the worldwide carry trade if rates rise either too quickly or too much (or both), as hundreds of billions of dollars are potentially still borrowing in Japan to buy what were formerly high-yielding assets in other parts of the world. We continue to keep an eye on Japanese rates and the reaction to them to see if their rise will start to make big waves, as rising French rates have done.

UK interest rates have been out of the news but their fiscal situation continues to generate headlines, meaning there continues to be pressure on UK Gilts. 30-year Gilts in early October reached over 6.0% for the first time since 1998, although yields have backed off since then, recently around 5.7%. The 10-year Gilt yield is up about 90 basis points on the year, showing its weakness but not as bad as France. We will monitor UK rates for their possible effects on other financial markets, but we have no interest in Gilts as they are buffeted by higher inflation, UK budget deficits, uncertain politics and an immigrant problem.

These are the main bond markets that we are following, largely because their moves affect stock and funding markets that could impact our portfolios' investments. We have no current interest in these bonds as they have ongoing fiscal, inflation and political worries that are not worth the meager rewards currently being offered.

Bottom line: Bonds have continued their sell-offs worldwide into the fourth quarter, although turbulence in other markets has led to some safe-haven buying in Treasuries during October. We are concerned not only with the fiscal, inflation and geopolitical concerns in the US and abroad, we are also leery of the supply coming to markets to fund government deficits, the AI buildout and new fiscal needs, like the buildup in defense spending, adding to the burgeoning deficits already extant in the US, Europe and Japan.

We expect bonds to be more volatile than in the past, as bond investors become more risk-averse due to large deficits and the threat of new large AI supply this year and in 2027.

Energy

Has the world become inured to the constant headlines fighting in the Middle East and Russian-Ukraine and the damage to energy infrastructure it's causing, especially to refineries and shipping? Even prices, which were wildly volatile starting in the spring and then throughout most of the summer, have settled down (although slowly risen to the year's highs) as headlines all start to look alike and "real" difference-making news is rarer to occur. With this calming down of the diversity of action, it makes it slightly

easier to sit back and assess the damage and what may lie ahead for energy and energy-oriented investments.

First and foremost, Iran, or more properly, the IRGC, will not go quietly into the night. Therefore, transiting the Strait of Hormuz (SOH) looks likely to remain treacherous for the foreseeable future, although plenty of ships are taking their chances (and making it out). The situation could change post-election, when President Trump has hinted that the US may restart attacks aimed at pushing Iran toward a lasting ceasefire. Meanwhile, although crude oil looks like it is being produced and transiting the SOH at a rate of over ten million barrels per day (and maybe closer to 15 million on some days), the products produced behind the SOH, most importantly the LNG from Qatar, aluminum from Kuwait, sulfuric acid from many Persian Gulf plants, and of course, petroleum products like diesel fuel, gasoline and jet fuel formerly produced at Persian Gulf refineries, are currently running at only a fraction of their capacities (or not at all, in some cases) due to lack of (safe) transportation for these products.

A recent analysis of the Middle East energy situation titled The Breaking Point offers one view of how energy dynamics may evolve while the Iran war drags on. Author Karl W. Miller opines that the upsets will last much longer than most in the energy markets originally thought, for a number of reasons. First, crude oil, feedstock for refineries, has generally been bought by refineries worldwide specifically for the refinery setup, with some running heavy crudes, others light crudes, some to deal with specific impurities. However, the war has upset the availability and trade routes for crude, forcing refiners to source alternate supplies from less optimal sources, leading to less efficient refinery runs and subpar product yields as a result.

In addition, Saudi Arabia, the producer that has been able to shift Gulf supplies to the Red Sea via its East-West pipeline, is encountering more attacks on the pipeline by the Houthis to the south, causing damage/delays to transshipment as well as attacks on tankers from the Saudis' Red Sea ports, cutting down on the overall ability to export. Thus, the amount of crude coming out of the region is seeing its alternative routes being attacked as well, cutting down on crude availability and dependability.

Finally, prolonged hostilities and the spread of attacks on energy and economic sites throughout the Persian Gulf and broader Middle East means that rebuilding will take much more time and money than originally thought. Miller estimates a base case of $1.2 trillion needed for rebuilding (possibly rising over $2 trillion if the war lasts much longer and destroys more facilities), that will then take until 2035-36 to complete, nearly ten years from now, due to the custom size and configuration of many of the facilities in the Middle East. From what we can find, this is a much larger and longer time frame to "return to normal" than has been espoused by analysts quoted in the press.

So what? This analysis illustrates the magnitude of the energy problem and the amount of capital needed to merely replace the current damage. To us, it also highlights the rising value of unattacked energy infrastructure and how underappreciated current non-Middle East facilities are.

US refiners, running at the highest utilization rates in history, are currently priced at less than ten times current and forward earnings, showing investors' optimism that the war will end soon and the worldwide energy systems will return to more normal operations relatively quickly. Investors and the public have grown used to refineries operating efficiently and taking a relatively small slice of the cost of fuel as profit.

Meanwhile, many governments worldwide have waged a decades-long war against refineries, trying to get them to close under heavy influence from the green/climate cabal, cutting down on the supply side. California is the poster child for this behavior, passing laws that make refining unprofitable and forcing refinery closures, but driving up the costs (and thus the prices to the consumers) in the process, and then howling about "price gouging" afterwards. Gasoline, diesel and jet fuel supplies are now more limited by area, leading to higher price differentials and more difficult logistics. "Replacement" refining capacity in the Middle East cannot get through the SOH, and Russian refineries have been damaged severely by continued Ukrainian attacks, meaning these sources are of no help to alleviate shortages and price shocks.

We think these worldwide actions push current US and European, and to a lesser extent Asian, energy infrastructure up in value, which will be more obvious in coming months when winter energy needs show up in shortages and higher prices. We think our holdings of oil majors, as well as our refinery and energy infrastructure companies, will continue to appreciate in value, and we will look at any corrections as a time to add to portfolios that have lesser allocations to energy companies currently.

Interestingly, despite the continued absence of Qatari LNG worldwide, natural gas prices in the US continue in the doldrums. Why? Almost certainly because so much natural gas is produced as a byproduct of crude oil production. With crude prices at multi-year highs, US (and worldwide) producers are producing flat-out, generating more associated natural gas than existing pipelines can transport. Producers then bid against each other to try to move their gas (and keep crude production flowing), pushing prices down. The lack of resolution of Middle East hostilities points toward this phenomenon continuing, so we will continue to be circumspect about natural gas production-oriented investments.

LNG is at a premium, however, due to the lack of supplies from Qatar, the world's largest producer. Europe, which depends on gas to anchor its heating systems, has benefitted in recent years from plenty of LNG supplies from the US and Middle East to replace the supplies the Europeans used to buy from the Russians but has been outlawed recently due to continued Russian aggression in Ukraine. Now, with Qatari supplies absent from world markets, European gas prices have risen significantly in recent weeks as Europeans get nervous about the coming winter. Dutch TTF prices, the benchmark for energy prices to supply Europe with gas for heating and electricity generation, have recently risen to the highest prices since the Russian invasion of Ukraine. We are interested in finding attractive ways to invest in LNG, especially the longer Qatar is absent from the market.

The competition from domestic natural gas has kept US thermal coal prices subdued in spite of a ramping up of coal stocks worldwide in front of the winter. However, coal continues to be the cheapest, most flexible fuel for heating worldwide, and we expect coal prices to rise over time as more consumers find lower prices and easy availability an alternative to more eco-friendly fuels.

Bottom line: We continue to think our investments in oil majors as well as energy production and infrastructure will continue to produce attractive returns going forward, especially with still-low valuations on many of the equities worldwide. Neither war seems easy to resolve, and even when a resolution is reached, both areas will take years to return to normal operations. We will maintain our energy investments, looking to upgrade them to even better energy opportunities on any price weakness. LNG is mostly a "big company" game, so we have exposure through our investments in the majors, and we are still looking for other attractive ways to invest going forward.

Currencies

The US dollar is still the North Star around which currency markets revolve. The dollar has been stronger in the past weeks as investors worldwide see rising US interest rates and a relatively hawkish Fed keeping rates high enough to attract capital to dollar-denominated assets, especially stocks in light of the poor performance of US bonds this year (thus far).

However, we think these may the best of times for the dollar. Any hiccups in the stock market, and the near-certain continued supply of bonds by the US government and capital-hungry AI developers will put pressure on the dollar in our eyes. In addition, any progress toward peace in the Middle East (and probably Ukraine as well) will lower the "flight to safety" bid in the dollar, which is a big factor in its recent strength. We think the risks are high the dollar has seen its highs, and that international investors will be allocating more capital into attractive investments in their home countries and regions, pulling capital currently allocated to dollar-denominated assets.

The euro has been relatively weak recently too, helping push the dollar higher by default. The fiscal issues in France, which are also occurring in Spain, Italy, Germany and other EU countries, have caused investors to allocate away from Europe during much of 2026. While we don't see Europe's economic problems getting better very rapidly, we see valuations dropping to more attractive levels than many highly-valued assets in the US and Asian countries. On balance, we see the euro finding support at these lower levels against the dollar as governments are forced to implement some austerity and market/regulatory reforms to stay anywhere close to competitive with the rest of the world. European economies will depend on it to stay "in the game." Any progress should help the euro.

The British pound faces similar challenges. The UK economy has serious challenges as runaway spending is taking its toll on the economy and UK politicians. The lower range of the pound in 2026 mirrors these problems. Like Europe, we think the UK has a lot of things to improve to get its economy going again, but we also see the pound as finding its footing at these lower levels.

The yen has essentially stabilized around the 157-159 yen/dollar range, after rising from 160 to 152 during late summer, and then settling down in the current range. We think the yen will strengthen but will take its time doing so, which we don't think merits any investment consideration at this time.

Bottom line: Currencies still don't hold much attractiveness as investments at the current time. We will be watching the yen to see if it affects world financing markets in its future movements, but the yen's recent rangebound trading indicates to us little chance of any exciting moves in the near future. We are unsure about the euro or pound due to the need for lower currency prices to stimulate exports which could help economies – could either the ECB or the BOE lower rates to help? We will be avoiding these until things become clearer in their economic futures.

Commodities

In some cases, commodities have become a subsidiary trade to AI, especially when additional demand is being attributed to the AI boom. Copper is an obvious example, but all industrial metals, including

silver, have lately been reacting to the ebbs and flows of investor sentiment around the extent of the AI buildout, leading to extra volatility in commodities.

Industrial metals have been volatile all year, and many have shown weakness in the last few weeks after seeing price gains earlier in the year. Copper is the most notable industrial metal, since it is used in so many industrial and residential infrastructure and products. It has also been the strongest, hitting an all-time high in late September. The trade continues to vacillate between concern over seeing supply deficits and mining problems in Latin America while then worrying about the effects of high prices on demand, especially if some AI investments will take longer to be permitted, funded or leased, pushing out demand to later months or even years, clouding demand forecasts.

We still think copper has a supply problem, namely older mines with declining output, coupled with a very slow pipeline of new mines coming onstream over the next few years. We continue to be bullish, owning copper miners despite volatility, since we see the supply/demand issues taking a longer time to improve than the market expects.

Other industrial metals, like aluminum and nickel, are much weaker, since they are not as integral to the AI trade. Also, these metals are more ubiquitous and sensitive to economic conditions, so rising interest rates and slower growth ex-AI worldwide combine to make them less attractive to investors.

Silver has come under more pressure lately as traders have started to doubt that silver's usage in AI infrastructure and data centers will build more than expected earlier this year, when silver spike higher on supply deficits. The lack of constant supportive buyers like central banks in gold have also affected silver, which has historically been one of the most volatile commodity markets anyway, due to its small size and historically concentrated buyers, who have pushed around the markets at times. We expect silver to gain back value over time, although we're leery of the volatility. Thus, we tend to own silver miners, which are also volatile but tend to dampen the volatility somewhat over time. The fundamentals continue to be good – the supply deficit has continued in 2026, although sources vary about 2027: some still see deficits while others question demand at these higher prices, although most "cheap silver" that would come out of households has already been recycled. Our take is that the deficit narrows but still survives in 2027, helping the case for our silver investments.

Gold has fallen out of the headlines lately as the two wars push up oil prices, and thus, inflation and bond yields. Higher yields push up the dollar, which theoretically then puts pressure on gold, which lately has been treated as the "anti-dollar."

However, gold continues to have a built-in demand base due to central bank reserve purchasing. The latest estimates by Goldman Sachs, using statistics gathered in August, show continued strong central bank buying, with August purchases increasing to an aggregate 79 metric tons, up from 44 metric tons in July. China leads the purchasers with 25 metric tons bought in August, down slightly from July's 35 metric tons of Chinese purchases, which was one of the largest months of purchases ever by China. Goldman's estimates of cumulative purchases put world central bank buying back to a rate which would see 1,000 metric tons bought during 2026, a reacceleration from 2025's aggregate central bank purchases of 863 metric tons, the estimated amount from the World Gold Council.

Buoyed by central bank buying, gold has been able to hold a range around $4,000/oz while fighting the headwinds of a stronger dollar and higher interest rates. We think the dollar headwind will fade in the near future as short-term interest rates start to react to slowing US economic growth ex-AI. We also believe the Fed will end up not raising rates as much as the forward curve assumes, which is currently 3-

5 additional 0.25% rate hikes before the end of 2027. We continue to believe gold represents a unique way to protect portfolios against loss of dollar purchasing power.

In addition, our investments in precious metals miners provide a source of earnings growth rivaling most other sectors in the stock market, thanks to extremely high and seemingly durable profit margins. These companies have expanded operations in a measured and shareholder-friendly manner born of extreme capital discipline imposed on mining companies during the bear market of 2012-2016 (that continues to this day, in many cases).

Agricultural and soft commodities had seen late summer price gains as traders anticipated possible supply disruptions from the rising attacks on grain shipments out of the Black Sea by both Russia and Ukraine as well as nervousness about forecasts for a strong El Nino weather pattern this fall. Those fears apparently have failed to materialize as prices have fallen back in many cases toward the price ranges seen earlier this year. We continue to monitor Ag prices but don't have strong feelings about the ability for agricultural companies to benefit unless prices start to climb steadily once more.

Bottom line: Commodities, especially metals, have seen their strong gains from earlier in the year mostly given back as mining companies have gotten caught in the volatility of AI supply/demand debates while the rest of the world economies see slow growth, cutting down on the demand for additional supplies.

Higher yields in fixed income and geopolitical upset have contributed to more headwinds for commodities lately, which we think affects both demand and supply over time – right now, demand worries have held sway for a few weeks.

Good fundamentals and favorable supply/demand balances should reassert their effects on price in the future, and we believe valuations, fundamentals and eventual weakening of the dollar will reignite interest in metals and other commodities in the near future, especially if AI angst turns into better visibility for the pace of growth in the future.

We think inflation is here to stay, regardless of how quickly either war gets resolved, because of the damage and lead time for rebuilding energy and commodity production infrastructure which will limit supplies for years to come.

In lieu of a Kanos Commentary this quarter, we thought the following two thought pieces would suffice in giving some interesting thoughts on possible future elements affecting

Interesting Article

We periodically come across articles that offer thoughtful perspectives on today's important issues.

We thought the following October 11, 2026 article from Andy Kessler, a longtime tech investor and writer from the Wall Street Journal editorial section was thought-provoking.

How the AI Boom Ends

Demand isn't about to let up, but prices will start plunging by factors of 10.



By Andy Kessler
Oct. 11, 2026 2:59 pm ET

I can tell you how the artificial-intelligence data-center boom will probably end, but I can't tell you when. Implementing large language models has been a brute-force approach: Big, fast and expensive GPUs from Nvidia crunch a trillion parameters using massive amounts of memory housed in liquid-cooled, gigawatt-gobbling data centers, all with brute-force pricing. It sure smells like IBM mainframes of old.

Be careful about extrapolating anything from today's pricing. With AI, like all new technologies, the refinement stage is kicking in—just as mainframes gave way to cheaper minicomputers, microprocessors, web servers and now AI architectures. AI token prices have been dropping but are set to plunge faster than most anticipate. Tech growth is never a straight line.

Silicon Valley's mantra for decades has been smaller, cheaper, faster, better. I asked venture capitalist Steve Jurvetson to translate that into numbers. "We often see a technology shift when the new approach is 10 times better. It can be 10 times more performant or 10 times cheaper, sometimes both." He calls it the "factor of 10."

And it's happening. Last week, according to OpenRouter, OpenAI and Anthropic were charging a premium for some of their models—$1 to $2 per million input tokens. Comparable Chinese open-weight models like Z.ai's GLM and Alibaba's Qwen charged 6 to 12 cents, around 90% less—that factor of 10 inflection point. American AI labs have gone from 70% market share last year to 30% today. All are still growing. But prices matter.

AI architecture is evolving. Instead of a trillion parameters, efficient small language models might use 70 billion and run on an Apple Mac. These local models have no token costs beyond the cost of hardware and electricity.

But they must be less capable than the large language models, right? Not really. Stanford researchers show that a locally run small language model "can successfully answer 88.7% of single-turn chat and reasoning queries." No question we'll always have high-end models running in data centers. IBM still sells mainframes. But growth will happen elsewhere.

Where? Another Silicon Valley saying I've lived by: Intelligence moves out to the edge of the network. The real breakthrough will happen when robust AI models run on smartphones. It's already starting. In September, California-based PrismML released a compressed version of the popular open-source Qwen3.8 27B AI model. The company got it down to under 6 gigabytes. That means it fits not only on PCs but also on high-end smartphones. The memory size is reduced by roughly 9 to 10 times. There's that factor of 10.

Technology doesn't stand still. Qualcomm recently announced a new Snapdragon neural processing unit, or NPU, for smartphones. Using what the company calls a "mixture-of-experts" model, it could run a 30 billion parameter AI model in 3 gigabytes of memory. According to the Deep View, the largest AI model on a phone has been four billion parameters on an Apple A20 Pro chip. Qualcomm provides a 7.5 times boost.

NPUs, like Qualcomm's new Snapdragon and Google's Tensor chips in its Pixel phones, are multiplying. Same for the latest Apple M- and A-series chips, engines that can run AI models locally on iPhones—maybe why Apple hasn't joined the AI data-center spending delirium.

A Nvidia-backed startup, Reflection AI, claims it matches leading Chinese open-weight AI models with "3-4x less inference compute." That's it? Only 3 or 4 times? Wake me up when it's 10 times. At the pace AI is moving, that could be year-end.

Agents are all the rage, from Meta's Muse to xAI's Grokbot. They run on virtual machines in data centers but raise all sorts of privacy concerns. Startup Perplexity recently teamed up with Nvidia to run agents on PCs. Zero token costs. And you own your data.

I often hear, that if tokens get cheaper, demand will go up. That's Jevons Paradox. Sure, elasticity works. But if prices drop 90%, demand must increase 900% just to stay flat. Remember when internet demand grew while debt-laden Global Crossing spectacularly failed because prices dropped too fast? Historically, semiconductors got 30% cheaper every year. When prices dropped by more than 50%, disaster struck with fabrication plant closings and company failures.

Will 2027 see peak data center? Again, timing is dicey. Current demand is gangbusters, but spending is a game of chicken until multiple factor-of-10

improvements kick in and prices collapse. This could set off a cascade of data-center halts and debt defaults, even as token demand increases.

Yes, model training, drug discovery and winning prizes like the recently solved Navier-Stokes equations require hot chips in data centers. But chatbots and agents and other tasks may increasingly be handled on PCs and phones and smart glasses and whatever new gizmos Silicon Valley invents over the next decade. I've heard this called the "Great Migration." Mr. Jurvetson's factor of 10 is visible now, as it often is, but ignored. Change doesn't happen overnight. It happens gradually, then suddenly.

Interesting Article 2

We also found this piece on the potential for rising interest rates around the world to be a compelling thought piece based on recent investment research. The following is an October 1, 2026 article from ZeroHedge.com. All emphasis in the article is by the author.

"Here We Go Again": Fed's "Original Sin" Means 10Y Yields Are Going To 8%, TS Lombard Warns

By Tyler Durden
Thursday, Oct 01, 2026

With the 10Y yield hitting 5.30% on Wednesday, the highest since 2002, much of Wall Street is asking whether 6% is next (for the record, some already think so, and we flagged the case back in August in "A 6% Yield On The 10-Year Treasury Is Coming"). For TS Lombard's chief US economist Steven Blitz, that's thinking far too small.

In a note titled **"Original Sin Redux"** published this morning, Blitz argues that the current rise in yields "is not done at 6%": **5.75% is the next plateau for the 10-year, and 8% is the long-run target**, reached over "a few years" and with "plenty of zigs and zags along the way."

His reasoning starts with theology, or at least the central-bank version of it:

*"The original sin of monetary policy is easing before a downturn fully starves inflation, and **here we go again – taking a bite out of the same apple."***

The sinner, in Blitz's telling, is Jerome Powell. Late last year, facing a downturn in hiring but an upturn in profits, "**Powell blinked and eased**" (not to mention also easing 2 months ahead of the

2024 presidential election in a gift to the then-Biden admin). To be fair (and Blitz is), he was being "big-time pressured" by the Administration and by "everyone running for Powell's job (including some FOMC members)", all of whom were upset Powell didn't "shut his eyes and ease more." Today, per Blitz, Trump, Bessent, Hassett et al. want Kevin Warsh to operate with "eyes wide shut" as a new upcycle takes hold.

Warsh, for his part, "resisted, sort of" with the September hike, which took the funds rate up 25bps to 3.75%-4.00% in a unanimous vote that the market had all but dictated. Blitz's parenthetical reaction: "**why not 50?"** His broader point is that the funds rate "means less than it did," and that real discipline will eventually come from the long end reaching yields that "quash equity performance." We aren't there yet. **But, Blitz warns, "the quash will come."**

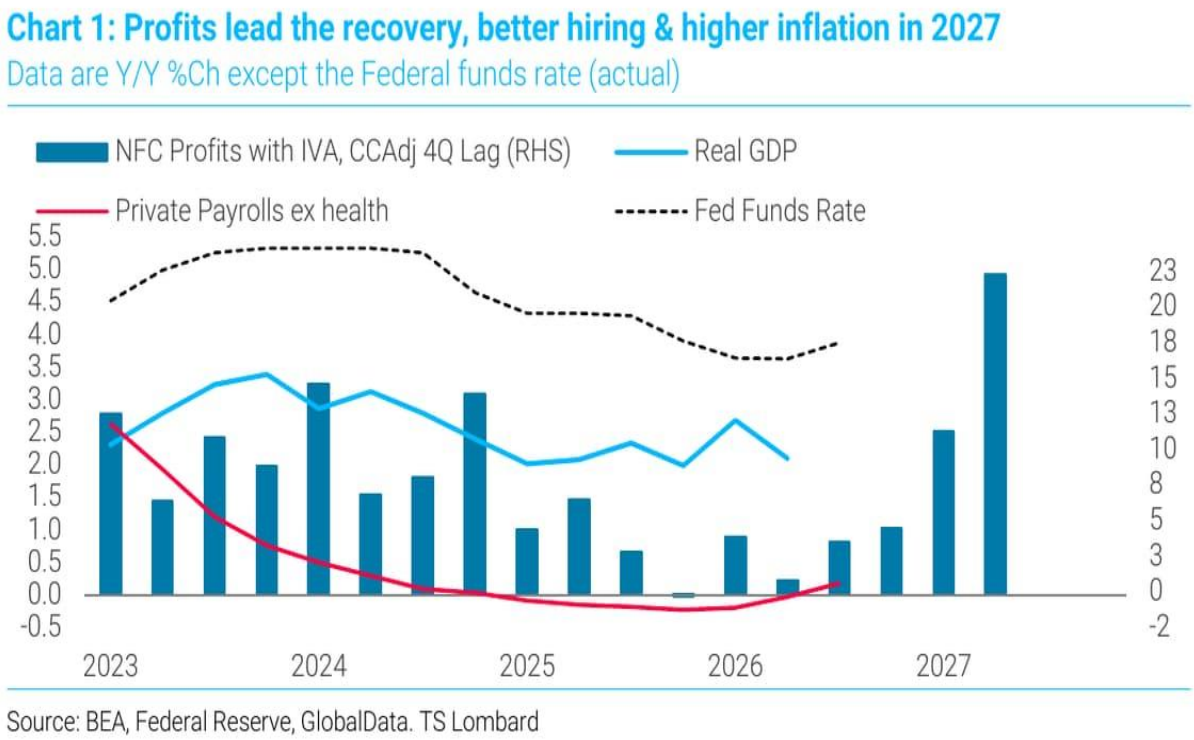
The recession that wasn't

Blitz's description of 2025 is "the recession that wasn't." After some 22 months of an inverted curve, private payrolls ex-hospitals were declining ("it was never about deportations"), and a contraction in real growth should have followed. It never came, because fiscal expansion was too big and because the Fed, under pressure from the Administration and several FOMC members (Bowman, Miran, Waller), cut just as profits were turning. Tariffs helped too.

Which brings us to two old Wall Street adages Blitz dusts off:

- **Adage #1:** profits lead employment, employment leads inflation.
- **Adage #2:** the best year of inflation is the first year of recovery.

That means 2026 was the good year. Underneath the tariffs and the oil spike, base inflation was actually lower. From here, "assuming the equity market cooperates," high profits imply faster hiring and, with that, **higher base inflation in 2027**. Chart 1 shows the lagged corporate profits (bars) flashing just that:

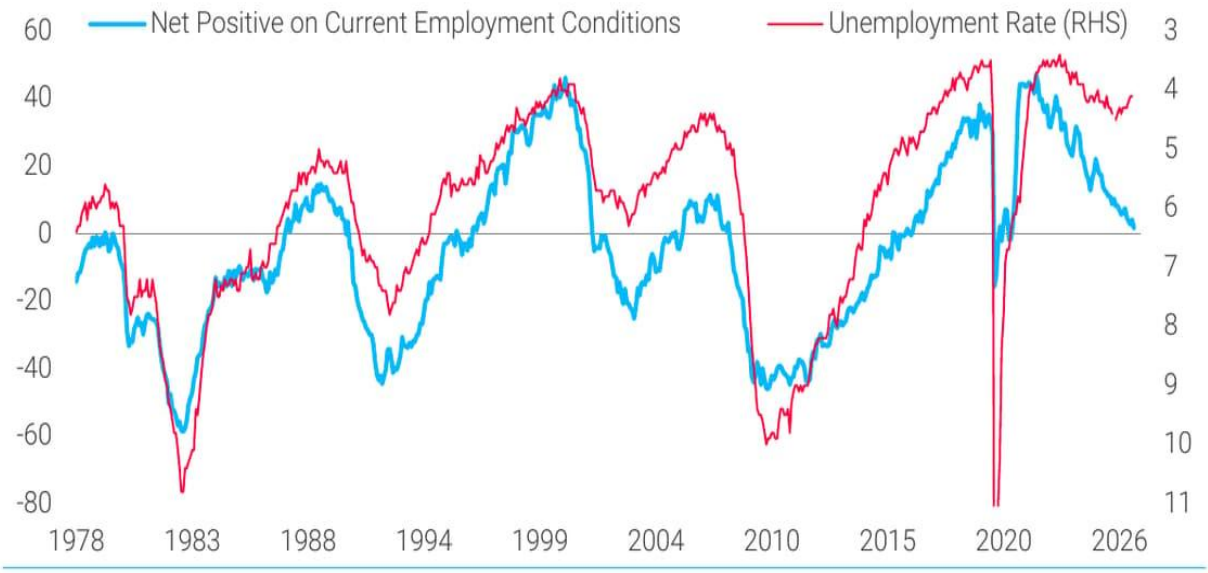


The timing is awkward: this morning's August core PCE "missed" at 0.2% only because the actual 0.247% print rounded down, while very convenient benchmarking revisions dragged the entire series lower. Supercore meanwhile rose 0.4%, helped by the biggest-ever jump in "other services" and a record increase in education costs. The 10Y quickly retraced its entire post-PCE rally, and as UBS put it in a mid-day note, markets have "*refocus[ed] on the strength of US growth*."

Sentiment lags, and the White House should be worried

But if the economy is truly recovering, **why does everyone still feel so bad?** Blitz's answer is that sentiment lags, which is also why, per his Adage #3, "presidents prefer recessions in the first year of their first term." Net-positive views on current jobs usually track the unemployment rate but stay negative well after joblessness starts falling. This cycle is odder still: job sentiment has collapsed far more than the rise in unemployment would explain. Blitz has his theories ("call me, happy to discuss") but expects sentiment to flip next year if hiring picks up as profits suggest.

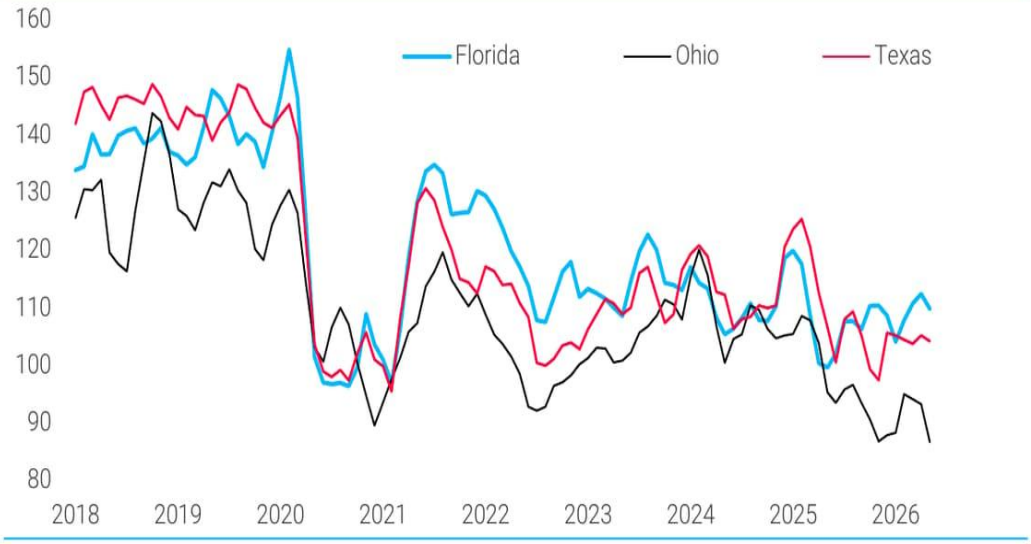
Chart 2: Consumer sentiment on jobs stays negative long after unemployment begins to fall



Source: BLS, Conference Board, GlobalData. TS Lombard

The political problem is that Trump has failed to reverse the post-Covid break in sentiment. Worse for Republicans heading into the midterms, sentiment in Ohio and Texas is lower than when Trump was re-elected, Florida is no better, and Ohio "has been steadily dropping since Trump's inauguration."

Chart 3: Weaker sentiment in Texas and Ohio should trouble Republicans

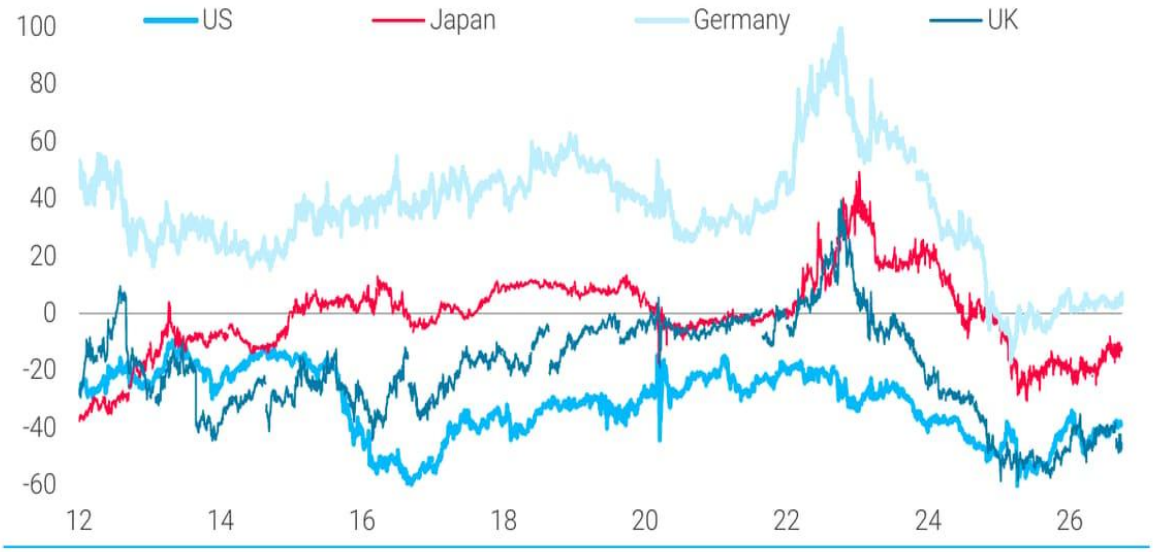


Source: Conference Board, GlobalData. TS Lombard

The swap spread tell

This is where Blitz's note stands out from the growing crowd of 6% calls. Behind the rise in yields, he argues, is "too much supply of sovereign DM debt that needs to be rolled against a backdrop of fiscal deficits rising faster than nominal GDP, and no central banks to take up the excess" (not to mention half a trillion in hyperscaler Investment Grade debt this year, which is roughly **half the total Treasury supply in DV01 terms).** The clearest sign is swap spreads. Investors keep choosing to receive floating overnight secured rates for 10 years rather than own fixed-coupon sovereigns. That has been the trend in the US since 2012, but since Covid it has gone global: UK (and French) swap spreads have collapsed, and even in Germany the choice is now roughly even.

Chart 4: 10Y Swap spreads sharply shift to favour O/N secured rates over government fixed-coupon debt. This is a risk preference, not a curve issue

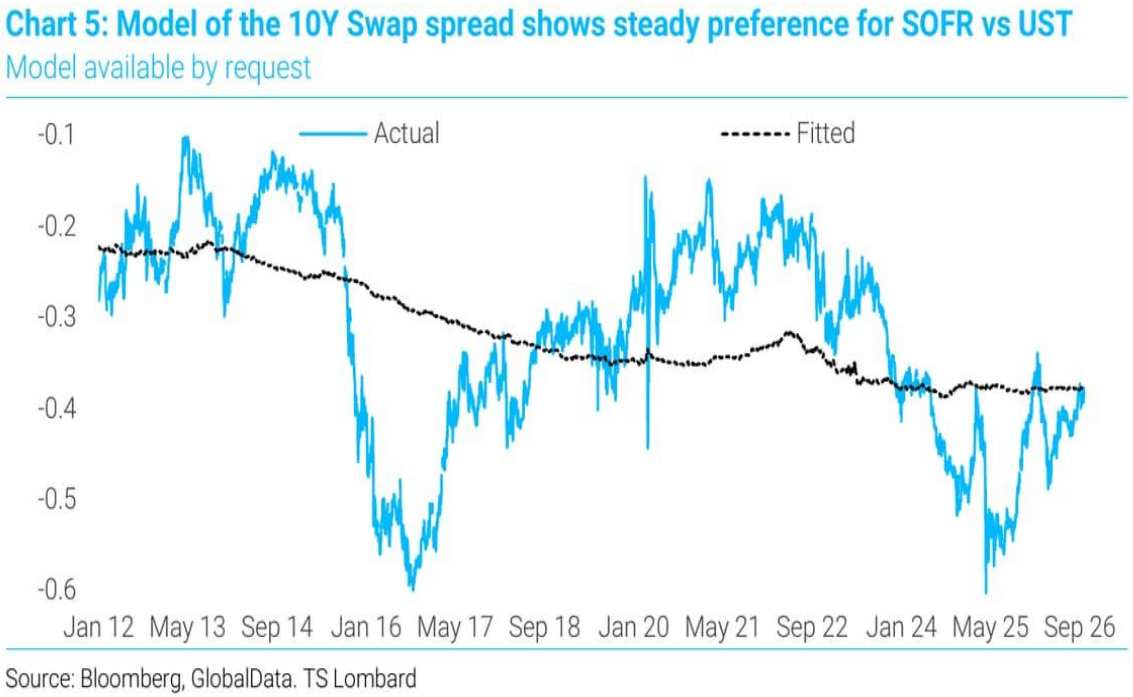


Source: Bloomberg, GlobalData. TS Lombard

Blitz stresses that this is **"a risk preference, not a curve issue."** France and Germany share a central bank, and the BOE generally follows the ECB, yet their swap spreads have diverged. *As* we noted previously*, **what the market is pricing is fiscal risk rather than the path of policy rates or inflation.***

For the US, Blitz built a model of the 10Y swap spread using the curve (1M10Y) and a couple of proxies for regulatory constraints on bank UST holdings. Periods of extreme Fed expectations explain the large deviations. The more important feature is the fitted line itself, which keeps sloping down, pointing to a "steadily increased preference" for receiving SOFR over holding

USTs. In other words, **even after adjusting for the curve and bank balance sheet rules, the market likes Treasuries a little less every year.**



Hamilton vs Jackson, and why 8%

Blitz's conclusion is that the policy mix of easy money and bigger deficits will deliver "***higher inflation and higher yields with each cycle***," and it won't end until there is the political will to cut inflation whatever the short-term hit to growth. For the US, 2029 is the earliest that could happen, "but I would not count on it." *Getting there would mean running the economy through the central bank (Hamilton) rather than government policy (Jackson),* and "the populism that will elect the next president favours Jackson." In a line that could summarize the last decade of US politics: "People are, in fact, socially conservative and fiscally liberal."

The key variable is the equity market, and specifically whether higher yields come from real rates or from inflation breakevens:

- **So far it has been real rates.** That has prevented a dollar buyers' strike and shaken stocks without doing real damage, while putting "a more realistic price of capital" into the market ("Warsh applauds").
- **If the move shifts to inflation premiums,** "stocks do okay and the dollar bears will have their day." That is when "the great dollar bear market everyone expects gets underway in earnest," possibly triggered by "eyes wide shut" policy under pressure from the White House.

The difference this cycle is that heavy government borrowing has **pushed the US net saving rate to zero, with "no sign of abating**." Hence Blitz's call: "**Eventually, we see an 8% 10Y**."

What breaks?

Blitz isn't predicting a crash in some specific asset. What he expects to break is a mindset, namely the *"market's determined confidence"* that inflation returns to 2% and that "you are always rewarded trading stocks and bonds from the long side." For a generation of investors trained by 40 years of falling rates and a BTFD reflex, that would be a big adjustment.

Two caveats. First, Blitz isn't alone in worrying about stocks: Goldman's one-delta desk head Rich Privorostsky said on Tuesday that the rates move is "getting too punitive to ignore", even as "equities have done an impressive job remaining resilient" (see also our Sep 24 post "Bonds Are About To Crash The Stock Market"). Second, the US Treasury gets a say in how high yields go. When Treasury expanded its buyback program in August, Rabobank called the result "***YCC-light,***" warning that "*higher yields worsen the fiscal outlook, which warrants a larger term premium, which raises yields further*" and that the intervention "*interrupted that loop; it likely did not break it."*

An 8% 10Y would require Bessent to lose that fight repeatedly, but Blitz's point is that a government which refuses to accept a recession doesn't get to choose.

It seems the apple still tastes good enough to keep eating.

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