

Market Returns

(Returns in £)	1 month	3 months	6 months	1 year
UK Equities	-2.0%	1.7%	5.5%	13.2%
Global Equities	1.0%	1.3%	16.6%	19.1%
UK Gilts	-1.2%	-2.6%	-2.8%	-3.8%
UK Property	0.1%	0.8%	2.1%	4.3%
Gold	-4.2%	3.1%	-10.6%	10.1%
Commodities	2.3%	17.0%	11.4%	43.6%
Sterling	-1.3%	-0.2%	0.9%	0.1%

Returns to 30th September 2026. Source: Refinitiv

Market Overview

Whilst stock markets have plodded ahead in a reasonably calm fashion, it has been anything but for bond markets. Already under pressure for much of the year, bonds sold off heavily in September. Much of this emanated from the US, pushing up yields on bonds by half a percent. That may not sound like much, but in the world of bonds, it is dramatic. The sheer scale of the US debt market means it has a gravitational pull on global debt markets, with yields rising sharply elsewhere.

Inflation has become problematic again, with a jump in fuel and natural gas costs turning up the heat on expectations. Although the Bank of England chose to keep interest rates on hold in September, many other central banks raised rates in response to the inflationary threats. A lack of discipline over budget deficits, along with surging debt funded AI investments, has pushed up yields on longer dated bonds. This is important, as the cost of government debt is the reference price for other financial assets, as well as the cost of making new investments.

In contrast to these looming clouds, company profits are seeing some exceptional growth, much faster than was anticipated at the start of the year. This has been helped by global economic growth proving much more resilient to disruption in supplies passing through the Strait of Hormuz, but principally to the staggering sums being spent on AI development. Despite some existential fears and episodes of AI agents behaving in a rouge fashion, there is no sign of slowdown in spending and development, with the upcoming earnings report season likely to be just as hot as last quarter.

We remain fully invested, premised on a supportive outlook for company profits. However, we are watchful of two factors. The sell-off in bonds has stretched the elastic of valuations relative to stocks, and economic growth and company profits are looking increasingly reliant on AI investment and subsequent returns; they need to remain positive.

The Mexican standoff between Iran and the US, as well as tit-for-tat air strikes, has left the oil price elevated over the summer. It is impossible to know how, or when, resolution will be reached, but markets still have faith that necessity will encourage some agreement. In the meantime, the critical supply squeeze is in refining capacity keeping fuel prices high. Grain prices have also risen sharply, due to low harvest yields in drought conditions, which have also impacted river and canal shipments. Metal prices continue to be firm, as demand from infrastructure build out keeps markets tight.

Asia, followed by Europe has proven to be most exposed to the supply disruption, with some Asian countries having to ration fuel. China with substantial strategic reserves and its rapid transition to renewables looks well-placed to keep competitive advantage in a range of manufacturing areas. With ideological conflict and resource nationalism replacing globalisation, free flowing supply is being replaced by contested and constrained supply.

Bond yields are clearly signalling concern. With no sign of government fiscal discipline, heavy debt issuance, and inflation tilting back up, the willingness of buyers is being tested. The expectation of a global cycle of interest rate cuts at the start of the year has been put into reverse. Only peaceful agreement on the Strait of Hormuz, with a rapid return of shipments, is likely to give immediate relief to bond markets.

Politicians need to tread a careful line on fiscal policy, as they test the patience of bond markets; witness France! Despite the stimulus of AI investment, growth (particularly across Europe) is not sufficient to eat into government deficits. The quality of private credit lending is also being watched closely. Although nominally outside the banking system, it is often highly geared and has increasingly been invested in by pension funds and insurance companies.

The attractions of property and listed infrastructure have been reflected in a spate of takeovers, and challenges to Trusts, to realise

underlying asset values. Many trusts still trade on a discount to asset values and remain attractive, particularly for 'long-life' assets.

In the UK and Europe economic activity and confidence remain fragile, but data has yet to report any significant downturn from the Middle East situation. Meanwhile the tricky issue of how to fund greater levels of defence spending only adds to the deficit problem. Although there is some softness beginning to emerge in the employment market, with particular concern about the availability of entry-level jobs, saving levels are high. In aggregate, both household and business balance sheets are generally quite healthy. A return of confidence if inflation and interest rates ease, could see discretionary spending increase.

The red-hot investment binge in AI shows no sign of slowing, pulling adjacent spend up with it. Third quarter company results are expected to reflect this, continuing to drive exceptional reported profits growth. Any hint that this might be easing could unsettle valuations. Meanwhile some consumers have been showing greater price sensitivity, in what has been called a 'K' shaped economy, where those without investment savings, continue to struggle.

Obviously, AI and the conflict with Iran dominates everything and it is perhaps sobering to reflect that the conflict between Russia and Ukraine is well into its fifth year, with little sign of resolution. Wars are easier to start than finish. This has led to a substantial policy shift in Europe, with recognition that 'national security' needs a significant increase in defence spending. Some companies will be obvious beneficiaries of this, but this will need to be paid for, either with spending cuts elsewhere, tax increases or even more debt issuance.

Clearly peaceful settlement with Iran would be in everyone's interest, but that still feels a way off. Financial markets are likely to be volatile as they scrabble around for certainty. Staying calm, but vigilant, in this atmosphere is a challenge but is likely to provide a better outcome than rash decisions on emotional judgement.

Market Outlook

Equities	Stock markets generally continued to hold up through September. Exceptionally strong growth in company earnings is the main underpinning, offsetting supply disruption, inflation concerns and weak bond markets. Investment in AI is the dominant agent of economic growth and results show this continues unabated, despite worries that a bubble is forming. Should any cracks show in either the pace of investment or assumed rates of return on the investment, stock markets, particularly the US and some Asian markets, would be vulnerable to a correction.
Fixed Interest	Bond markets in general have been in a funk for much of the year, but September brought a heightened sense of anxiety and a further heavy sell-off, globally. With inflation creeping up again, most central banks have increased interest rates, whilst bond yields have not taken well to growing issuance of debt by governments and AI companies. With little immediate sign of inflation or debt issues easing, the yield curve is likely to remain elevated.
Commercial Property	The rise in the cost of debt has checked the gentle recovery that has been taking place in property. Discounts on listed property, however, are still significant, and with higher build costs and higher energy standards required, it is still cheaper to buy, than to build new. This is reflected in the recent acceptance of an American offer for one of the largest UK property companies, Segro, and purchase of Metrocentre by Land Securities.
Alternative Assets	Despite the uncertainty created by volatility in the cost of debt, often used to fund investments, and changing legislation around allowable rates of return and pricing controls, UK Infrastructure investment funds and private equity funds have attracted interest and corporate activity due to significant discounts to asset value. This is likely to continue, with the appeal of longer duration assets, and commodities benefitting from infrastructure investment demand.
Cash	The investment return on cash and cash like instruments is 'safe' and provides ballast to portfolios in current markets.

Drumnor Investments

2nd October 2026

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