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Growth Meets Gravity

Earnings are still delivering. Rates, inflation and expectations are pulling the other way.

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Q2 was a shock that tempted us to de-risk. Q3 was a rally that tempted us to re-concentrate. Q4 brings something less dramatic and harder to manage: gravity.

Earnings remain strong and the AI investment cycle has not slowed. But the Fed has hiked, inflation has proved stickier than we expected, and the conflict involving Iran is lasting longer than markets hoped. Meanwhile the bar for good news has risen so high that even record results no longer move share prices.

This quarter we make a modest reallocation within Growth and High Growth only. It is not a retreat from equities. It is about the quality of what we own when money is no longer cheap and expectations are no longer low.

Our objective is not to outperform every quarter. It is to compound wealth through disciplined diversification, while avoiding decisions driven by short-term market sentiment.

What changed

One reallocation, in Growth and High Growth, effective from the publication of this note. Defensive and Balanced are unchanged.

HOLDING	GROWTH	HIGH GROWTH
V9N (AI infrastructure)	2% → 0%	3% → 0%
WHEA (global health care, new)	0% → 2%	0% → 2%
IWQU (Quality factor)	3% → 4%	4% → 6%
GRID (grid infrastructure)	3% → 2%	4% → 3%

We have exited V9N, the more direct AI component of our thematic sleeve. GRID stays, trimmed by one point to fund the health care position, and remains our only infrastructure thematic. Electricity networks need substantial investment whichever AI companies ultimately succeed. Unlike direct AI infrastructure, grid investment also draws on broader electrification demand and runs on longer investment cycles. That does not remove valuation or interest-rate risk, but we believe the structural opportunity remains attractive.

We have opened a small position in global health care. Health care brings earnings drivers that differ from the rest of the portfolio: ageing populations, largely non-discretionary demand and a steady pipeline of innovation. AI adds to that innovation, in drug discovery and diagnostics, but it does not define the investment case. At 2% it is large enough to matter but still a modest sector diversification position, not a hedge, and it will not materially change how the portfolios behave in a drawdown. We see it as an initial allocation that we may increase if valuations or the macro backdrop strengthen the case.

We have increased Quality. In High Growth, Quality is now our largest factor tilt, ahead of Value.

We have kept Small Cap Value at 3%. Higher financing costs are a real headwind for smaller companies. But the long-term valuation and diversification case remains intact, and the modest weight keeps refinancing risk from dominating portfolio outcomes.

We have not exited AI. Our core global equity funds still hold the leaders, though below their global market weight given our US underweight, and that exposure is unchanged.

Why

We were wrong on the Fed

In July our base case was that the Fed would hold. It raised rates by a quarter point in September, to 3.75% to 4.00%, and we now expect one more hike before year-end. We were right on the Bank of England, which held at 3.75% in September, although three of its nine members voted to hike. But the US call matters more, and we want to own it plainly.

We underestimated two things. Inflation has proved stickier than the softening labour market suggested. And the conflict involving Iran has lasted longer than expected, keeping oil in an elevated "new normal" rather than fading as we assumed. Long-dated yields have followed, with the US 10-year now above 5%.

Our bond positioning limited the damage. We hold no long-duration bets, and our ultrashort holdings reset quickly to higher policy rates. The larger lesson is for equities: when money stays expensive for longer, balance sheets and pricing power matter more. That is what Quality buys, and why we are adding to it.

AI is not over, but our exposure was too concentrated

The AI investment cycle is intact, and we are not calling a peak. Our concern is concentration. Our core equity funds already hold the AI leaders, though below their global market weight given our US underweight, and those leaders now dominate the index. V9N added a second, narrower layer of the same exposure, in a part of the market that is capital-intensive and vulnerable to overcapacity if demand disappoints.

High expectations make that concentration more expensive to hold. BlackRock notes that analysts expect S&P 500 earnings to grow 18% a year over the next five years, the highest such estimate in 40 years and well above the 12% average. Samsung illustrated the point this week. It guided to record third-quarter operating profit of about 107 trillion won (roughly $80 billion), slightly ahead of consensus, and the shares did not rally. One stock's reaction proves little on its own, but it shows how high the bar now is.

We are not abandoning AI. We are reducing our concentrated exposure while retaining meaningful participation through our diversified core equity holdings.

One caveat on Quality: the Quality factor holds many highly profitable large-cap technology companies. The rotation reduces our direct AI infrastructure exposure, but it does not remove all exposure to US technology valuations. We accept that trade-off for Quality's stronger balance sheets and steadier earnings.

This is a refinement, not a trigger

In July we listed three conditions that would make us reassess the portfolios. None has been fully met, and the architecture is unchanged. The equity, bond and gold mix of every portfolio stays where it was. What we have changed is the composition of the equity sleeves, in response to a shift in risk and reward we can name and measure. That is different from reacting to the mood of the market.

What the major houses are saying

The large houses are constructive on risk, and on most of the big questions they agree with our architecture. Where they part from us is on how much US equity to own.

HOUSE	HEADLINE VIEW	MOST RELEVANT TO US
J.P. Morgan Asset Management	Pro-risk; overweight US and Japan; three Fed hikes in total	Stocks and bonds can fall together when inflation runs above 3%; infrastructure and commodities diversify
BlackRock	Risk-on but risk-aware; leadership broadening beyond AI	Top 10 stocks now 37% of the S&P 500, nearly double 2010; financials, industrials and materials underappreciated
HSBC Private Bank	Broad multi-asset; overweight IT plus financials, industrials and commodities	Electricity infrastructure and security as priorities; bullish on gold

Where we agree. All three describe the broadening we have positioned for since the start of the year. BlackRock sees a cyclical upswing outside AI in financials, industrials and materials. HSBC pairs its technology overweight with financials, energy and materials for diversification. That is the case for our Value tilt, made independently. All three also put power and grid investment at the centre of the next leg of the cycle, which is the case for GRID.

Where we differ. J.P. Morgan and HSBC are both overweight US equity. We remain below market weight. Their case rests on earnings, and the earnings are real. Ours rests on concentration and expectations: when ten companies make up 37% of the index and expectations sit at 40-year highs, the cost of being wrong is concentrated too. We would rather own the broadening than the crowd.

What we considered

Adding global miners. BlackRock makes a strong case: copper and grid metals are the physical layer of the AI and electrification buildout, supply is constrained, and miners now pay out more than they did in the last cycle. We passed for now. Commodities have already had a strong run, and mining is cyclical and high-beta. Adding it would cut against a quarter in which we are building resilience. It stays on the list.

Extending duration. With the US 10-year above 5%, higher yields are starting to look attractive, and J.P. Morgan argues that gilts offer better value than Treasuries. We are not extending yet. This is not about waiting for the last Fed hike, since bond markets price policy in advance. It is that inflation remains sticky, and the term premium (the extra yield investors demand to lend long) could rise further as governments and AI companies borrow heavily. For now, the reward for extending does not yet compensate for that risk. Longer duration is firmly on our radar for the coming quarters.

Following the houses into US equity. Discussed above. We passed.

Defence and security. The houses increasingly treat it as part of a broader "economic security" theme spanning energy, grid and critical materials. Our grid sleeve captures the electricity part of that buildout, but it does not replicate defence exposure. Adding defence would mean a second thematic, and we hold one by design. It stays on the list.

What we're watching

How AI is being paid for. In July we flagged how much of their operating cash flow the hyperscalers are now spending on capex. The next stage is debt: HSBC notes that AI-related corporate bond funding has doubled in a year. Debt-funded capex is not a problem while returns arrive on time. It becomes one if they slip, because the strain then spreads to credit markets and to the rates everyone else pays.

Credit. The private-credit stress we flagged in April remains contained. HSBC places it chiefly in 2021-vintage software and smaller-company loans, and notes that redemptions are easing. High-yield spreads remain tight. Credit exposure is unchanged, and we keep watching it more closely than its calm suggests.

Gold. The houses are split. HSBC thinks gold has bottomed. J.P. Morgan sees higher real yields as a short-term headwind. We hold gold for the moments when stocks and bonds fall together, a risk J.P. Morgan itself highlights this quarter. It stays at 5% in Balanced, Growth and High Growth, and 10% in Defensive.

The US midterms on 3 November. Elections can bring short-term volatility. We do not position for them.

What would change our positioning

We are disciplined, not stubborn. Here is where the three conditions we set in July stand, plus one we add this quarter, with the evidence that would make us act.

CONDITION	EVIDENCE WE WATCH	STATUS	COMMENT
Inflation broadens beyond energy into wages and core services	Core services inflation and wage growth reaccelerating over several readings	Closest to being met	Inflation is stickier than we expected, but still driven mainly by energy and supply rather than wages. This is why we added Quality.
Earnings revisions turn negative	Forward earnings revisions persistently negative over three months	Not met	Revisions remain strongly positive across regions.
Valuation dispersion between the leaders and the rest widens materially	Forward P/E premium of the largest US companies over the rest of the market	Not met	Concentration is higher, but the leaders' gains have come from earnings: US tech trades at lower multiples than a year ago.
AI capex strains credit markets (new)	Hyperscaler credit spreads widening materially against broad investment-grade credit	Not met	Investment-grade spreads remain tight despite heavy AI-related issuance.

We assess these indicators together rather than rely on any single numerical threshold. If inflation broadens into wages, or if AI financing starts to crack, we would revisit the overall balance between equities, bonds and gold, not just the composition of individual sleeves.

Portfolio implications

Full sleeve weights and ETF detail are on the portfolios page. The strategic architecture is unchanged. This quarter's tactical adjustments are the V9N exit, the health care position, a smaller GRID weight and the higher Quality weight. The conditions for further change are set out above.

- **US equity below market-cap weight in every portfolio.** Balanced holds just under half of its equity in the US on a look-through basis, against roughly 62% in a cap-weighted global benchmark.
- **Value and Quality as structural tilts from Balanced upward.** 4% Value and 3% Quality in Balanced. Growth now holds 4% Value, 4% Quality and 3% Small Cap Value. High Growth holds 5% Value, 6% Quality and 3% Small Cap Value.
- **Fixed income at moderate duration.** Core global bonds paired with sterling ultrashort, for income and ballast, with no long-duration bets. Extension is on our radar.
- **Defensive without factor tilts.** 30% core equity, 60% bonds, 10% gold: the lowest-risk portfolio is the simplest.
- **Grid infrastructure as the only infrastructure thematic.** GRID at 2% in Growth and 3% in High Growth.
- **A small sector diversification position in global health care.** WHEA at 2% in Growth and High Growth, as an initial allocation.
- **Gold at 5%, and 10% in Defensive.**

Q2 tested whether we would sell into a shock. Q3 tested whether we would chase a rally. Q4 tests whether we can adjust to gravity without abandoning the architecture.

Stay invested. Stay diversified. Stay disciplined.

See you next quarter, unless something important changes.

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House views referenced: J.P. Morgan Asset Management, Global Asset Allocation Views 4Q 2026 (1 October 2026); BlackRock, Equity Market Outlook Q4 2026; HSBC Private Bank, Investment Outlook Q4 2026 (3 September 2026).

Vestaris quarterly notes are published at the beginning of each quarter. Monthly all-clears confirm subscriber portfolio status between scheduled notes. Bulletins are published only when a market event reaches a threshold we believe warrants direct communication.