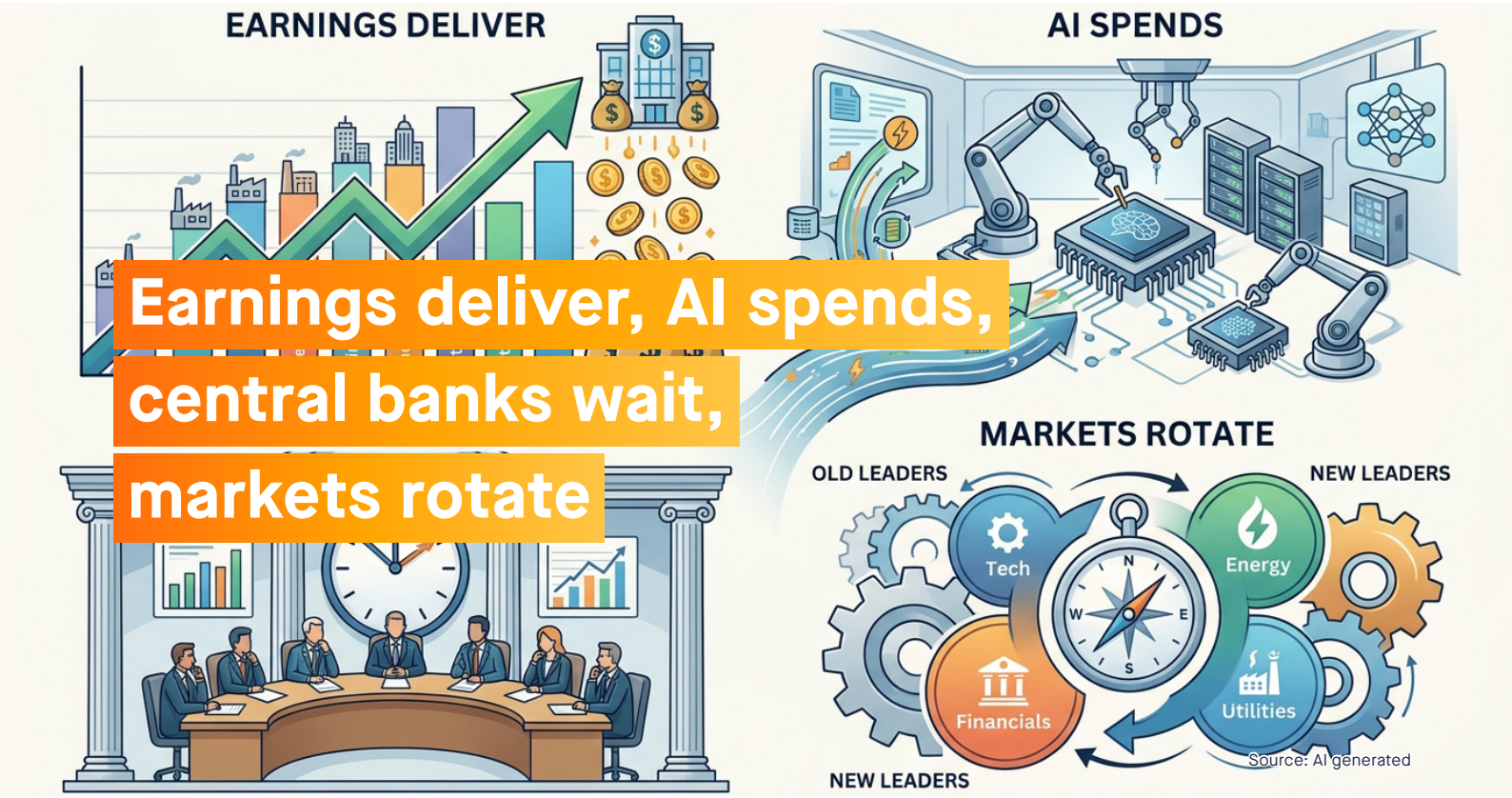


Earnings deliver, AI spends, central banks wait, markets rotate

Key takeaways

- October was the month central banks paused. The Fed (28 October), the ECB (29 October) and the Bank of Japan (30 October) all left rates unchanged after their September hikes, but none of them closed the door completely. At the Fed meeting, Governor Cook and Cleveland Fed President Hammack dissented in favour of an immediate hike, and Chair Warsh made clear that inflation remains the Committee's main concern.
- Markets swung between two forces. The US 10-year yield touched a 24-year high of around 5.3% in early October before easing back to about 5%, as investors sought safety in Treasuries during a sell-off in AI-related stocks, triggered by Big Tech results that showed capital spending outrunning cash flow. Brent crude climbed back to its highest close since April, of around USD 117 on 23 October, as attacks on Saudi energy infrastructure and disruption in the Strait of Hormuz intensified. The S&P 500 set new records early in the month, while gold held close to USD 4,000.
- Looking ahead, we expect the Fed to hike in December and only once more in 2027, while markets price one and a half rate hikes next year. Q3 earnings were very strong, but early signs that energy prices are biting into consumption lead us to lower our Macro pillar to neutral and to raise the probability of our "growth freeze" scenario.
- We make no changes to our asset allocation preferences grid this month. Within the five pillars, we lower Macro Cycle from moderately positive to neutral and raise Market Factors from moderately positive to positive. We stay neutral equities, overweight cash, underweight fixed income, with a moderate underweight in 1–10 year government bonds, underweight all major currencies against the US dollar, overweight gold and commodities and neutral hedge funds.

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THE BIG PICTURE

Rates: postponed, not abandoned

After three hikes in eight days in September, October brought three pauses in three days. None of them reads as the end of the tightening cycle.

The Fed held its policy rate at 3.75%–4.00% on 28 October as expected, but the decision was not unanimous: Governor Lisa Cook and Cleveland Fed President Beth Hammack voted for an immediate hike. Cook's dissent was the more striking, since she had been regarded as one of the Committee's doves and had never dissented before. The statement upgraded its description of economic activity to expanding "at a strong pace", and Chair Warsh also noted that first-half GDP growth had been revised up from 1.8% to 2.4%, with Q3 stronger still. The advance estimate, published the following day, put Q3 growth at 3.4% annualised.

Warsh also said the September hike is starting to restrain activity, with credit conditions tightening for some businesses and households, and that he does not see the AI sector as immune to interest rates. He again rejected forward guidance and announced that, from 2027, some FOMC meetings will be devoted to strategy rather than rate decisions. The message was balanced but hawkish enough to keep the December hike priced in.

The ECB kept its deposit rate at 2.50% on 29 October, noting that financing conditions have tightened and that energy prices pose upside risks to inflation and downside risks to growth, with Eurozone inflation at 3.8% in September. Christine Lagarde announced she will step down on 7 February 2027, ahead of the end of her term. A day later, the Bank of Japan held its policy rate at 1.25% in an 8–1 vote, with one member calling for a hike to 1.5%. It also raised its inflation forecast and signalled further tightening ahead.

Bonds: from 24-year high to safe haven

The US 10-year yield extended its September rise into early October, reaching around 5.3%, its highest level since 2002. A stronger-than-expected services price reading, Fed minutes suggesting another rate hike remained on the table, and heavy Treasury and corporate bond issuance added to pressure on longer-dated yields. September CPI, published on 14 October, offered little relief: headline inflation rose to 3.7% year on year and core inflation to 2.6%, while diesel and other motor fuel prices were up more than 60% from a year earlier.

The second half of the month told a different story. As AI-related stocks sold off, investors moved into Treasuries and the 10-year fell back to around 5.0% by 29 October. Real yields eased too, with the 10-year TIPS yield down to about 2.6% from almost 3.0%. Bonds once again provided a hedge as risk assets corrected, a welcome development after a difficult year.

In Europe, market concern shifted to France. The French 10-year yield rose above 5% for the first time since 2002, while its spread over German Bunds widened to around 155 basis points, with political uncertainty mounting ahead of the April 2027 presidential election. This reinforces our decision to avoid French government debt and favour sovereign issuers with sound public finances.

Equities: an earnings-driven market, with a rotation underneath

The S&P 500 posted its first close above 7,800 in early October and set fresh records before pulling back to around 7,720 by 29 October. The drivers are fundamental: with most of the index reported, Q3 S&P 500 earnings are up about 29.5% year on year, 83% of companies have beaten estimates and ten of eleven sectors are growing. Forward EPS stands at a record of around USD 411 and forward operating margins are at all-time highs in every region.

The pullback has been a rotation rather than a retreat. Investors are now questioning the cost of the AI build-out rather than its demand (see below), and on 29 October, as Alphabet fell more than 12%, the Russell 2000 rose to a three-week high, and eight of eleven S&P 500 sectors closed higher. Our market factor indicators have improved accordingly (see below).

Big Tech: the capex bill comes due

The Q3 reporting season of the four largest hyperscalers confirmed both sides of the AI story. Demand is accelerating: Microsoft's Azure grew 48%, Google Cloud more than doubled to USD 30.7bn with a backlog of about USD 561bn, AWS grew 39% and Meta's advertising revenue rose 26%. But the bill is rising faster. Combined quarterly capex for Amazon, Alphabet, Microsoft and Meta reached around USD 202bn in Q3, up from about USD 165bn in Q2 and roughly double the level of a year ago (see chart).

The market drew a sharp line between those who can fund the build-out from operating cash flow and those who cannot. Microsoft, whose capex of about USD 45bn came in below guidance, rose after its results. Meta fell 7% on 22 October after capex of USD 34.9bn exceeded its operating cash flow, free cash flow turned negative, the floor of its 2026 capex guidance was raised to USD 135bn, and it launched around USD 37.5bn of common and convertible preferred stock issuance; its five-year CDS touched a record. Alphabet fell more than 12% on 29 October as search growth slowed to 12%, capex reached USD 51.4bn and free cash flow was negative for a second quarter, with management signalling a significant increase in 2027 spending. Amazon dropped about 7% after hours the same day: Q3 capex of USD 77.3bn was well above expectations and Andy Jassy said 2027 spending would be meaningfully higher than the roughly USD 220bn planned for 2026.

For us, the message is not that the AI cycle is breaking, but that it is entering a more capital-intensive and more selective phase. Revenue growth and backlogs support the investment case, while the shift from self-funded to externally funded capex makes credit markets, rather than

earnings alone, the arbiter of how far and how fast the build-out can go. This is why AI capex funding is one of the four signals that would change our equity stance (see below).



Quarterly capital expenditure of Amazon, Alphabet, Microsoft and Meta, USD billions. Source: Fiscal.ai, company reports.

Oil: the Gulf moves from Hormuz to Saudi Arabia

Brent swung between about USD 100 (7 October) and USD 117 (23 October), its highest close since April. A G7 agreement to release up to 100 million barrels of crude and diesel initially eased prices, but Houthi attacks on Saudi energy infrastructure and airports, unconfirmed reports of mines in the Strait of Hormuz and a sharp drop in tanker flows pushed it back up. Meetings in Tehran on 26 October between Iran's president and Saudi, Pakistani and Turkish officials opened a new diplomatic channel, but no agreement is yet in sight.

Gold, meanwhile, held up well. It briefly dipped below USD 4,000 on 23 October before recovering to around USD 4,030, supported by the fall in Treasury yields during the tech sell-off. Higher real yields remain a short-term headwind, but central bank demand and gold's role as an inflation and geopolitical hedge are intact.

What sits ahead

Three points of framing for the coming weeks.

- **The US midterms and the Middle East are intertwined**. The midterm elections on 3 November coincide with an OPEC+ meeting on 1 November and press reports that Washington has asked Gulf states to prepare for a possible short campaign against Iran after the vote. Our base case still assumes a new agreement towards 2027, but the near-term path for oil is highly uncertain.
- **December is live for the Fed**. Markets price a hike in December, and we agree. October payrolls and October CPI will confirm or challenge that view; with Chair Warsh rejecting forward guidance, data surprises are likely to move rates more than Fed news.
- **AI capex funding is the new test**. The four largest hyperscalers spent around USD 500bn on capex in the first nine months of 2026, and all of them signal more for 2027. Investors are rewarding demand but scrutinising the bill: the ability to fund this from operating cash flow rather than debt and equity issuance is the variable we watch most closely, with Nvidia's results in November the next checkpoint.

The hinge: does the pullback stay a rotation?

Our view is that earnings, not multiples, are carrying this market, and that credit rather than rates has become the binding constraint. Four signals would turn us more defensive: financial conditions starting to bite, earnings revisions turning negative, technical foundations weakening, and AI capex funding breaking down. Today, three of them are green: forward EPS is at a record, market breadth remains constructive without the large negative divergences that typically precede major tops, and hyperscalers' funding remains sound overall. That last signal deserves closer attention after the Q3 reports: Meta and Alphabet posted negative free cash flow for the quarter, Meta turned to the equity market and its credit default swaps touched a record, and some smaller AI infrastructure providers have seen their credit spreads widen.

One signal is amber. CCC spreads have widened to around 11.3% and high-yield CDS have stayed above their rising 200-day averages for a third week. So far there is no spillover into investment grade or BBB credit. As long as that holds, we see the correction as rotational and would buy weakness once high-yield spreads turn; if stress spreads up the quality ladder, we will reconsider our neutral equity stance.

OUR TOP-DOWN CORE SCENARIO

Global growth and inflation perspectives

We expect the economy to stay on a solid growth trend, even if elevated energy prices and central bank hikes slow it down. The latest escalation in the Middle East has pushed energy prices higher again, which will dampen global growth in Q4, while the rate hikes of major central banks, including the Fed, will slow it in H1 2027.

It remains unclear whether tensions in the Middle East will ease or intensify, but high energy prices should dampen rather than derail global growth at this point. We expect a moderation of demand to ease inflation pressures and keep second-round effects in check.

Fiscal support is set to fade in the US in 2027, but additional spending in several countries to cushion the impact of higher energy prices, together with still strong capex, should help to partially offset the drag from high energy prices and higher rates.

Central banks outlook

The latest geopolitical developments, in combination with a strong and resistant demand in certain sectors have interrupted the trend of easing price pressures. Underlying price indicators outside energy showed the first signs of reversing their previous downward trend over the summer.

Together with concerns about stronger second-round effects, as refined petroleum products such as diesel rose much more sharply than crude oil, reaching levels above previous peaks, this led the Fed, the ECB and the BoJ to raise their key rates in September. Early signs of slowing consumption, however, allowed all three central banks to pause in October.

Even assuming a moderation of energy prices towards 2027, we expect the Fed, the ECB, the BoJ and the BoE to hike twice until next summer, and the SNB to deliver one hike. For the Fed, we expect the next hike in December and one more in the first half of 2027, while markets price one and a half hikes next year. We do not expect an aggressive hiking cycle at this stage.

Politics

The re-escalation of the Middle East crisis has raised geopolitical uncertainty, but we still believe the parties are incentivised to find a new agreement towards 2027, helping moderate energy prices.

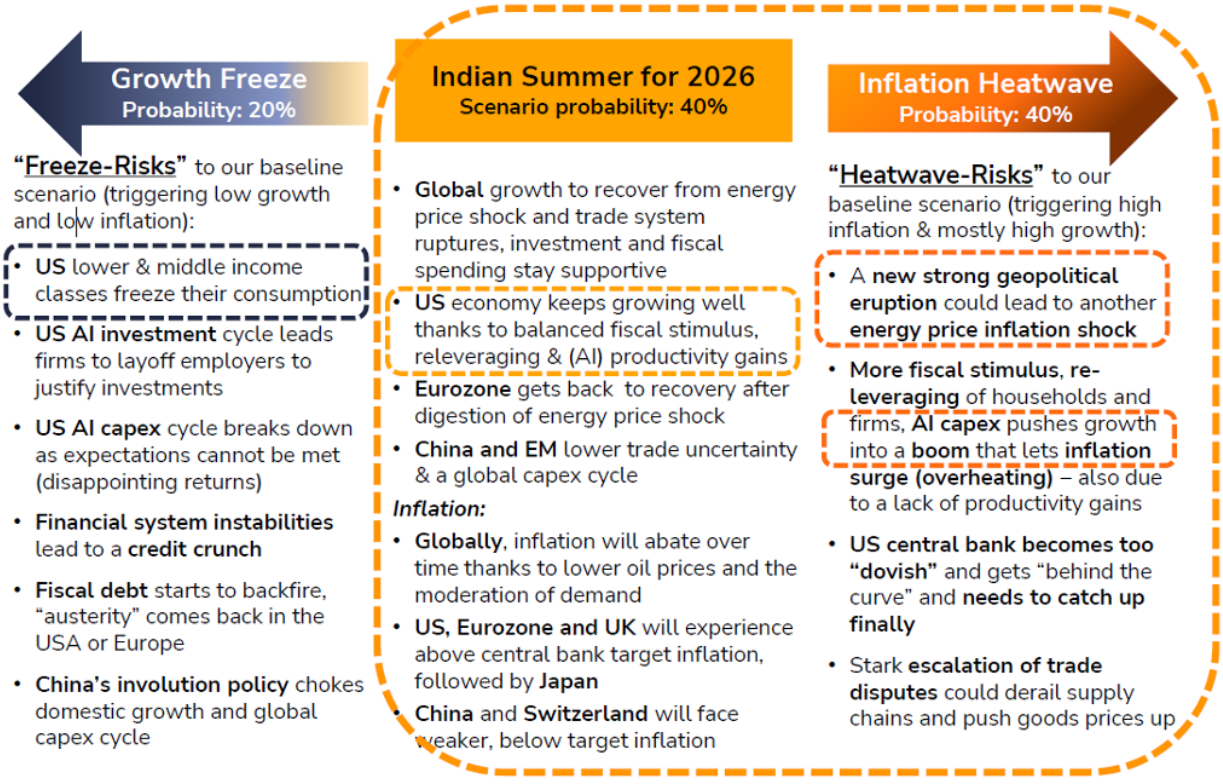
Apart from the energy shock, the boost to growth from expansionary US fiscal policy is expected to moderate in 2027 compared with 2026, although Congress could still alter this outlook. We continue to expect positive fiscal impulses in China and Europe, where several governments have also introduced additional measures to cushion the economic impact of higher energy prices.

The Middle East crisis, US tariffs and retaliatory measures continue to weigh on global trade momentum, though the negative impact remains below the peaks of H1 2026.

Our core and alternative top-down scenarios

The starting point for positioning remains our three-scenario framework. Early signs that energy prices are biting into consumption, including in the US, and that higher yields are slowing parts of the economy lead us to lower the probability of our "Indian summer" baseline from 45% to 40% and to raise the probability of a "growth freeze" from 15% to 20%. The probability of an "inflation heatwave" stays at 40%.

- **Indian summer for 2026 (baseline, probability 40%):** global growth recovers from the energy price shock, with investment and fiscal spending supportive. The US keeps growing on fiscal stimulus, releveraging and AI productivity gains, the Eurozone recovers, and China and emerging markets ride a global capex cycle. Inflation abates over time, though the US, Eurozone and UK run above target, and central banks tighten gradually.
- **Inflation heatwave (probability 40%):** a further geopolitical escalation delivers another energy shock, or stimulus, releveraging and AI capex push growth into an overheating boom; the energy shock broadens into core inflation, and central banks are forced into a more aggressive hiking cycle.
- **Growth freeze (probability 20%):** US consumption freezes, the AI capex cycle breaks down on disappointing returns or drives layoffs, higher rates trigger financial instability and a credit crunch, austerity returns, or China chokes the global capex cycle.



Macro scenarios. Source: Bank Syz.

THE WEIGHT OF THE EVIDENCE

Our preferences rest on five indicators, four macro and fundamental and one of market dynamics. This month we lower the Macro Cycle pillar by one notch and raise the Market Factors pillar by one notch; the other three are unchanged.

Syz Bank's five asset allocation pillars

Negative (-)	Neutral (=)	Positive (+)
	Macro Cycle	
	Liquidity	
		Earnings growth
	Valuations	
		Market Factors

Source: Syz Research

- **Macro cycle (lowered from MODERATELY POSITIVE to NEUTRAL):** the business cycle remains intact, but macro data cooled somewhat, mostly outside the US. Early signs have emerged that surging energy prices are starting to bite into consumption, also in the US, and that higher yields and key rates will slow parts of the economy.
- **Liquidity (NEUTRAL, unchanged):** further central bank hikes are priced in, and financial conditions have tightened moderately, but we see this because of a stronger outlook for nominal GDP growth rather than an external liquidity shock.
- **Earnings growth (POSITIVE, unchanged):** 2026 earnings growth expectations continue to rise to 34.4% in the US, 22.8% in Europe and 25.5% in Japan. Upgrades extend into 2027 across most regions, with growth forecast at 15.8%, 8.7% and 14.6% respectively.
- **Valuations (NEUTRAL, unchanged):** earnings have outpaced prices. The S&P 500 forward P/E has compressed to 18.5x from 23x a year ago (18.1x on 2027 estimates). Europe (14.7x), Japan (16.4x) and emerging markets (10.4x) trade near or below their historical averages, but the US earnings-yield cushion over bonds remains thin.
- **Market factors (raised from MODERATELY POSITIVE to POSITIVE):** the US raw score rebounded to 82%, with nine of eleven indicators in positive territory (only rate of change and the put/call ratio remain negative). The European raw score held at 60% after a volatile month, with six of ten indicators in positive territory, while four (rate of change, MACD, put/call ratio and volume) remained negative.

TACTICAL ASSET ALLOCATION (TAA) DECISIONS

The weight of the evidence leads us to stay NEUTRAL on equities: a weaker macro signal is offset by stronger market factors, while earnings remain the main support. We make no changes to the grid. In the model portfolios (reference: balanced USD):

- **Equities remain NEUTRAL**, balancing strong earnings and record forward margins against elevated real yields and widening stress in lower-quality credit. Q3 US earnings growth is running at 29.5%, although surprises are smaller and guidance increasingly drives stocks. 2026 consensus EPS growth stands at 34.4% in the US, 22.8% in Europe and 25.5% in Japan.
- **Fixed income remains UNDERWEIGHT, with 1–10-year government bonds at a MODERATE UNDERWEIGHT.** Higher yields now offer some value, and government bonds rallied when risk assets corrected, a reassuring sign of their safe-haven role. Long-dated government bonds (10 years and above) stay underweight. Corporate IG, high yield and EM debt remain neutral, with short maturities preferred, especially in high yield.
- **All currencies stay UNDERWEIGHT versus the USD** (EUR, CHF, GBP, JPY and EM), as higher Fed rate hike expectations, positive US interest rate differentials and flight-to-safety flows linked to the Middle East conflict support the dollar. Over the longer term we still see structural USD depreciation.
- **Commodities and gold stay OVERWEIGHT.** Commodities remain a hedge against renewed geopolitical escalation and energy price spikes. Gold remains a preferred long-term exposure as an inflation hedge supported by rising demand, even though higher Treasury yields have raised the short-term opportunity cost of holding it. Hedge funds stay neutral and cash stays overweight.

ASSET ALLOCATION GRID - TACTICAL ASSET ALLOCATION (TAA) – OCTOBER 2026

	Underweight -	Neutral =	Overweight +
			Cash
Asset Classes	Fixed Income	Equities	
		Alternatives	
Fixed Income	Govies 10+	Govies 1-10	
		Corporate IG (local)	
		High Yield (local / global hdg)	
		EM Debt	
Equity		United States	
		Eurozone	
		UK	
		Switzerland	
		Japan	
		Emerging Markets	
		China	
Alternatives		Hedge Funds	
Commodities			Gold
			Commodities
Forex (vs. USD)	EUR		
	CHF		
	GBP		
	JPY		
	EM Currencies		

Arrows show our latest TAA moves.

Source: Syz Research. No changes to the grid this month.

Asset classes views

Equities

We maintain a neutral equity exposure, balancing strong earnings and record forward margins against elevated real yields and widening credit stress.

Fundamentals remain constructive: Q3 US earnings growth is running at 29.5%, although surprises are smaller and guidance increasingly drives stocks. Consensus 2026 EPS growth stands at 34.4% in the US, 22.8% in Europe and 25.5% in Japan.

Valuations have improved: the S&P 500 forward P/E has compressed to 18.5x from 23x a year ago, while Europe, Japan and emerging markets trade near or below historical averages. Upside remains primarily earnings dependent.

Credit and funding conditions are the main risks. Corporate balance sheets remain resilient, with stress concentrated in lower-quality issuers. We monitor credit spreads and hyperscalers' ability to fund rising AI capex from operating cash flow.

Fixed Income

We maintain an overall underweight stance on fixed income, with a moderate underweight in 1–10-year government bonds and an underweight in longer maturities.

Government bonds: higher yields now offer some value, and bond markets rallied when risk assets corrected, reassuring investors about their safe-haven properties. We keep avoiding French government debt and remain cautious on countries with unfavourable public debt dynamics or where the central bank's commitment to containing inflation is in doubt. Bonds of sovereign issuers with solid public finances bring diversification to multi-asset portfolios.

Corporates: yields are attractive and our economic scenario remains constructive. However, tight spreads leave little margin of safety. We stay neutral on corporates, with a clear preference for shorter maturities, especially in high yield.

Emerging markets: EM fundamentals are generally robust. with spreads tight, we remain selective, favouring short- and medium-term maturities.

Forex & Commodities

Higher rate hike expectations for the Fed, positive US interest rate differentials and flight-to-safety flows linked to the Middle East conflict continue to support a positive view on the US dollar.

We therefore keep all currencies (EUR, CHF, GBP, JPY and EM) in an underweight position against the US dollar.

Over the longer term, we continue to expect the USD to depreciate, driven by structural factors.

Although we see a weaker longer-term outlook for the energy complex, we prefer to maintain an overweight exposure as a hedge against renewed geopolitical escalation and energy price surges.

Over the longer term, gold remains one of our preferred exposures, as an inflation hedge and due to rising demand. In the shorter term, higher US Treasury yields have increased the opportunity cost of holding gold.

INVESTMENT CONCLUSIONS

October showed that this is an earnings-driven bull market, not a multiple-driven one. Earnings have outpaced prices for a year, valuations are more reasonable than they were, and the latest pullback looks like a rotation within equities rather than a broad retreat from risk.

Central banks have paused, not pivoted. The Fed, the ECB and the BoJ all kept the door open to further hikes, and Chair Warsh left no doubt that inflation remains the Fed's priority. We expect a December hike and one more in 2027, a measured adjustment rather than an aggressive cycle.

At this stage, we keep our preference for equities (neutral) against fixed income (underweight), and we make no changes to our allocation grid.

The reasons to stay invested are strong: record forward earnings, positive revisions into 2027 and improving market internals. The reasons not to add are just as clear: weaker macro data, energy prices back above USD 110, a binary political calendar around the US midterms and the first signs of stress in lower-quality credit.

Within equities, investors are no longer rewarding AI spending unconditionally. They are asking how it will be funded and when it will pay off. We favour companies that finance their investment from operating cash flow and see the broadening of earnings growth beyond mega-cap technology as healthy for the market.

In fixed income, October was a reminder of why we hold government bonds: when equities corrected, Treasuries rallied. We keep our moderate underweight in 1–10-year government bonds, with a preference for shorter maturities, and stay underweight the long end, where supply, deficits and an uncertain inflation path continue to weigh.

The dollar remains supported by Fed hike expectations, positive rate differentials and safe-haven demand linked to the Middle East. We keep all major currencies underweight against it, while recognising that this is a tactical call against a structural backdrop of USD depreciation.

Cash remains overweight to provide liquidity and flexibility, and gold and commodities stay overweight as hedges against the energy and inflation risks that dominate the outlook.

Three developments would change our current positioning: credit stress spreading from CCC issuers into investment grade, a broad turn in earnings revisions, or a breakdown in the funding of the AI capex cycle. Conversely, a lasting agreement in the Middle East that brings oil prices down would strengthen the case for adding risk. Until then, we stay invested at benchmark weight and would use market weakness as an opportunity to add exposure once high-yield spreads begin to turn.

Welcome to Syzerland®

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