Q4 2026

House Report

Private Clients

Call to arms

The world's factory is enlisting physical AI as its new workforce. Is the investment potential within reach?



A tale of two markets
Stocks and bonds are reading the economy differently, creating opportunities

A material difference
How we're broadening our commodities exposure in the age of global fragmentation

How we invest
A reaffirmation of our long-term investment philosophy and process

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Marketing communication

SARASIN & PARTNERS

From the editor



Stephen Rothwell
Editor

Welcome to the latest edition of the Sarasin House Report.

For a remarkably long time, the simple concept of the balanced portfolio held sway in investment management, providing a sensible starting point for most long-term investors. Negative correlation between bonds and equities was the cornerstone of this approach; when equities dropped, bonds would often cushion the blow.

However, following the post-Covid inflation shock in 2022, when equities and bonds fell at the same time, this approach has faced challenging market conditions. In this edition, Guy Monson's lead article examines how the relationship between asset classes might be changing again, pointing out that this year is on track to be the first since 2021 in which stock and bond prices have moved in opposite directions. For now, sticky inflation and pressure to raise interest rates have led to government bond prices falling across major economies. However, higher yields improve the income on offer, and at some point, bonds may once again support portfolio returns if equities wobble.

Alternatives form the third building block of many portfolios, and commodities have long provided valuable diversification from equities and bonds. In 'Commodities make a comeback', Robert Wilson and Colm Harney explain how we are expanding our exposure beyond gold to include broad commodities and industrial metals.

Turning to equities, Adam Hamilton and Imogen Millington give us an update on the fast-moving world of robotics and 'physical AI', fresh from a visit to China. Fiona O'Neill also focuses on equities, with a deep dive into Sarasin's thematic approach, discussing our investment process and the philosophy that underpins it.

Stewardship remains a core part of our philosophy and, as Tom Lindsay and Tom Vernon highlight in their article, this year has shown once more that climate change and biodiversity loss pose real threats to economic and financial security.

Finally, Raymond Lahaut writes about 'The double life of listed real estate', giving us an insight into real estate investment trusts, which combine the liquidity of equities with exposure to physical property.

Please get in touch at housereport@sarasin.co.uk.

“In his lead article, Guy Monson examines how the relationship between asset classes might be changing again, pointing out that this year is on pace to be the first since 2021 in which stock and bond prices have moved in opposite directions.”

Our thinking

Keep up to date via the Sarasin website, where we feature our latest articles, market commentary and videos. You can also read the House Report online and download PDFs of recent editions.

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A tale of two markets

Equities are celebrating strong growth and rising profits, while bond markets are sounding the alarm over inflation and government debt. What does this divergence mean for multi-asset investors?



Guy Monson
Chief Market Strategist
and Senior Partner

Key points

Strong nominal growth is supporting corporate earnings while keeping inflation and bond yields elevated.

Heavy government borrowing and rising private investment are intensifying competition for capital and putting pressure on bond markets.

Higher yields are improving prospective returns, while bonds are once again providing valuable diversification from equities.

In September, *The Economist* ran the headline: 'Soaring bond yields, gaping deficits and towering debts: what could go wrong?' Add rising interest rates around the world, and oil prices that have climbed 70% this year, and the backdrop for asset prices looks pretty grim. Or does it?

For bond investors, it has certainly been challenging. US 30-year Treasury yields climbed above 5.6% in late September, the highest since 2002, while UK 30-year gilts touched 6% on 1 October, a level not seen in almost three decades. In the short term, the surge in energy prices has revived inflation fears; over the longer term, concerns about government debt sustainability continue to push up the term premium – the additional return investors require to compensate for the risk that interest rates may change over the life of a bond.

By contrast, equity investors seem to inhabit a very different world. Stockmarket indices hit new records at the end of September, with the MSCI World delivering returns well into double digits in 2026. Geographically, the gains have broadened out compared to 2025, with US and European equities performing remarkably similarly, but they have continued to be predominantly technology-led.

More striking still, this broad-based equity rally has arrived with surprisingly little fuss. The VIX index, which measures volatility in the S&P 500, was trading at just 16 at the end of September, comfortably below its 20-year average of 19.4. This stands in sharp contrast to the MOVE index, its counterpart in the Treasury market, where volatility remains well above its long-term average as bond yields have climbed to new highs.

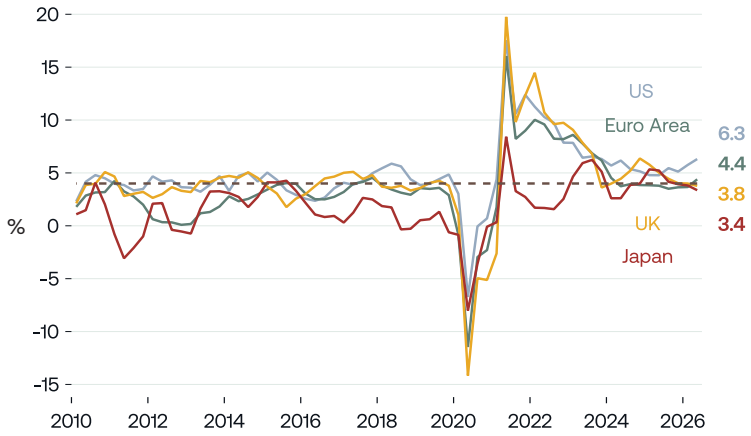


Figure 1: Nominal GDP growth (%)
4% nominal GDP growth now more of a floor than a ceiling

Source: Macrobond, 30.09.26

Why are equity investors cheering just as bond investors run for the door?

So why are equity investors confident enough to look through today's complex geopolitical and economic risks, while bond investors appear to be making a disorderly dash for the exit? The answer, in part, is that the same economic forces are sending very different signals to the two markets.

America is now enjoying something close to an inflationary boom, with nominal growth running at an extraordinary 6.3% annualised. Euro area nominal growth, at 4.4%, is robust too. Indeed, for much of the past 20 years nominal GDP growth of 4% seemed close to the ceiling for Western economies. Today, it looks more like a floor (figure 1).

> "What looks like an earnings boom through the equity lens can look rather more like an inflation problem through the bond lens."

This matters because equities and bonds respond very differently to strong nominal growth. For companies it means rising revenues and, where margins can be maintained, rising profits. For bondholders it brings the threat of persistent inflation, higher policy rates and ultimately higher yields. In other words, what looks like an earnings boom through the equity lens can look rather more like an inflation problem through the bond lens.

The drivers of global growth today are clear

The causes of this growth surge are not hard to find: strong business investment led by AI infrastructure, deficit-financed government spending and a resilient consumer – supported by positive wealth effects – have all contributed.

Business investment has been particularly strong, driven increasingly by the enormous capital requirements of AI. Data centres need not only semiconductors and servers, but also electricity generation, grids, cooling systems, construction and industrial equipment. The investment boom is therefore spreading well beyond the handful of technology companies that initially dominated the AI story.

Consumers, meanwhile, have been supported by strong household balance sheets and buoyant asset markets. Fidelity recently reported that the number of 401(k) accounts – US employer-sponsored personal pension accounts – it administers holding more than $1m surged 19% during the second quarter to a record 769,000. Rising equity prices continue to provide a powerful wealth effect for many households.

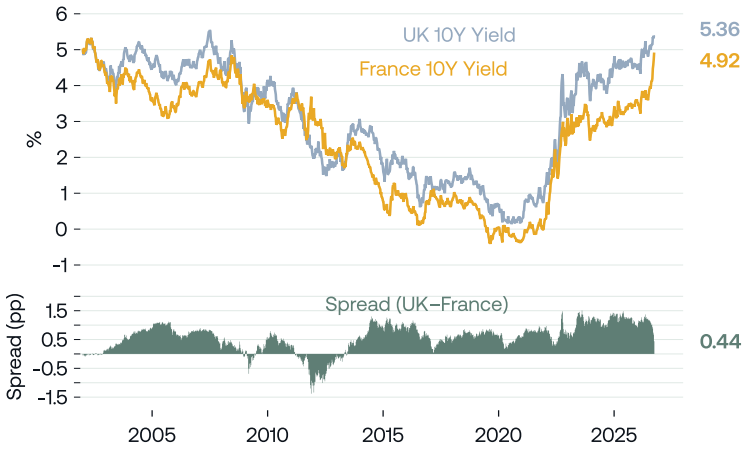


Figure 2: UK and French government bond yields (%)
Markets sceptical of French and British debt sustainability

Source: Macrobond, 30.09.26

For equity markets these are powerful supports for corporate revenues and earnings. For bond investors, however, strong private investment combined with large fiscal deficits can create competition for capital just as governments need to issue larger quantities of debt.

The US economy is running hot

The result is a US economy that looks to be running hot. Inflation, on the Federal Reserve's preferred gauge, the PCE price index, is 3.4%, well above its 2% target, which the central bank has now missed for five years in a row.

The latest acceleration in headline inflation has been driven in large part by sharply higher global energy costs. So far, however, there is little evidence that these are feeding decisively into longer-term inflation expectations, which remain broadly stable in both the US and Europe. That helps explain why equity markets have been relatively relaxed: investors are still treating much of the energy shock as a hit to the price level rather than the beginning of another inflationary spiral.

Bond investors have less room for complacency. Even if inflation expectations remain anchored, stronger nominal growth and higher current inflation make rapid interest-rate cuts increasingly unlikely. They also raise the risk that policy rates remain higher for longer.

The UK faces a similar problem. Headline inflation, at 3.1%, is being pushed higher principally by the global energy shock, but Britain's sticky services inflation means the underlying picture is less benign than the core rate of 2.6% suggests. The Bank of England therefore has little room simply to look through higher oil prices.

Why are bond and equity markets reading the data so differently?

Which brings us back to the puzzle. Why have equities barely blinked at these inflationary warning lights, while global bond markets have sold off so sharply? There are four further explanations.

First, fiscal sustainability. The increase in 10-year bond yields in 2026 has been particularly aggressive in France (+130bps), the US (+113bps) and the UK (+96bps), all of which face daunting long-term budgetary challenges. In France, two governments have already fallen while trying to pass a budget and markets are sceptical that Prime Minister Lecornu's 2027 budget, unveiled at the beginning of October, will survive parliament – French government bond yields are already at their highest since 2002.

Meanwhile, in the UK, Prime Minister Burnham is sticking to his predecessor's fiscal rules, but with the promise of tightening only towards the end of his term.

> "In France, two governments have already fallen trying to pass a budget and markets are sceptical that Prime Minister Lecornu's 2027 budget will survive parliament."

> “This year is on pace to be the first since 2021 in which stock and bond prices have moved in opposite directions… when equities stumble, bonds can provide ballast.”

For bondholders this matters today. Governments must refinance existing debt and fund new deficits in markets that are already being asked to finance an extraordinary private-sector investment boom. Investors therefore demand a higher yield to hold long-dated government debt. For an equity market much more focused on next quarter’s earnings, fiscal sustainability can still be treated as tomorrow’s problem.

Second, strong nominal growth also means strong profits. The extraordinary profit boom in the hyperscalers after the pandemic has migrated to semiconductors and memory on the back of AI demand. It is now broadening out to industrial equipment and metals.

Nor is it just AI spending. The Trump White House, for all its faults, is strongly pro-business. The One Big Beautiful Bill Act (OBBBA) of July 2025 has delivered a sizeable corporate tax windfall: the CBO puts the reduction in corporate tax receipts at almost $100bn this year. That is good for corporate earnings and cash flow, but a challenge for government finances – and Treasury bonds. Once again, the same policy can look positive to an equity investor and troubling to a bondholder.

Third, monetary policy has changed. There is a new Chair at the Federal Reserve, Kevin Warsh, who surprised markets with his hawkish tone at the September FOMC meeting. In raising rates by 25bps (0.25%) and strongly recommitting to the 2% inflation target, he made clear that the move was removing a “dose of accommodation”, implying that further rate rises may be in the offing. Market pricing now shows a high probability that US rates will be at least another 25bps higher by the December FOMC meeting.

There remains, however, a lingering sense that the White House would prefer lower rates. Its continuing pressure on the Federal Reserve, including its efforts to remove Governor Lisa Cook over mortgage-fraud allegations, which she denies, has not disappeared. Bond investors are therefore probably still demanding some additional risk premium for the governance risks surrounding the central bank.

Finally, technical factors may now be amplifying the sell-off. The five large hyperscalers (Alphabet, Amazon, Meta Platforms, Microsoft, and Oracle) alone have issued about $220bn of debt this year, according to LSEG data. While this is not in itself especially significant relative to the size of global capital markets, debt-funded investment in AI capacity and data centres is competing for capital at the same time as government issuance is rising.

There is also evidence, reported by the *Financial Times*, that hedge funds and other leveraged investors have been forced to sell long-duration bonds as losses mount or risk limits are breached. It is difficult to know how significant this is, but such selling can become self-reinforcing. Rising yields create losses, losses force investors to reduce risk, and that selling pushes yields higher still. What began as selling by the ‘bond vigilantes’ may now, at the margin, have become an issue of leverage.

For investors there is one other particularly encouraging development. This year is on pace to be the first since 2021 in which stock and bond prices have moved in opposite directions. That matters because negative correlation between the two asset classes is the cornerstone of the classic 60/40 portfolio: when equities stumble, bonds can provide ballast, and vice-versa.

> “The recent back-up in yields has increased real yields and investors can now earn a decent income from government bonds without reaching far out on the yield curve or taking excessive credit risk.”

That relationship broke down painfully during the inflation shock of 2022, when both asset classes fell together. Today we have other tools in our alternatives box, including commodities and other real assets, that can provide additional diversification. But a bond allocation that provides useful diversification is important for overall client outcomes.

So are bonds back?

The recent back-up in yields has increased real yields and investors can now earn a decent income from government bonds without reaching far out on the yield curve or taking excessive credit risk. At the time of writing UK investors can achieve yields in excess of 4.75% for a bond maturing in less than two years. In the US, an investor with a similar time horizon can achieve inflation-protected yields in excess of 2.5%. Higher yields have undoubtedly inflicted considerable pain on existing bondholders, but they also improve prospective returns for new investors. At some point, therefore, the bond sell-off begins to create its own opportunity.

These are early days. Bond yields are still rising, market sentiment remains fragile and the combination of inflation, heavy government issuance and leveraged positioning argues for some caution. We have been underweight bonds for some years but now have a neutral weighting in government issues.

So yes, bonds are back – but handle with care for a little while longer.

Robots, price wars and politics

Our trips to China reveal why smarter robot arms could outpace humanoids, why price wars are here to stay, and how politics now decides where Chinese technology can be sold.



Adam Hamilton
Economist



Imogen Millington
Global Equity Analyst

Key points

In robotics, AI that makes standard factory arms more flexible is a bigger opportunity than humanoids.

Chinese overcapacity is structural, pushing firms abroad and keeping global prices low.

Data security, more than tariffs, now decides where Chinese technology can be sold.

What happens in Chinese factories and boardrooms matters for global investors, even those not invested there directly. A global superpower, China accounts for around 20% of global GDP (in terms of purchasing power parity) and 27% of global manufacturing, while it is also automating fast, having installed 59% of the world's new industrial robots in 2025. Last year, it also ran a record trade surplus of $1.19trn, a sign of an economy that makes far more goods than it buys. China shapes the prices we pay, the supply chains firms rely on, and the speed at which new technology spreads.

To understand this dynamic better, we made two trips to China this year, meeting 30 companies in robotics, autos, batteries, semiconductors, and software in seven cities.

Three messages came through repeatedly. In factories, the bigger opportunity is AI that makes standard robots more flexible; humanoids suit the smaller share of work that involves moving around. Price competition at home is structural and is pushing firms abroad. And politics increasingly decides where Chinese technology can be sold.

Robots do not need to look like us

'Physical AI' has become one of the technology industry's favourite phrases since Nvidia's chief executive, Jensen Huang, began promoting it in 2024. Behind the buzzword is a simple idea. A physical AI system combines three things: sensors that read the world around it, such as cameras, lidar (laser scanning that maps surroundings in 3D) or touch sensors; an AI model that decides what to do; and a machine that carries out the action, whether a car, a robot arm or a humanoid.

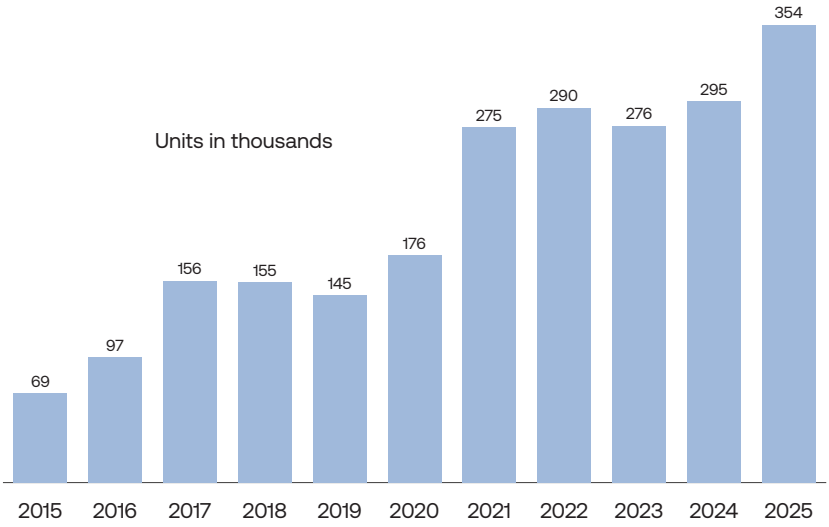


Figure 1: Rise of the machines
Annual installations of industrial robots in China (1,000 units). China has further strengthened its position as the world leader in robot adoption, according to the International Federation of Robotics. The country installed 354,000 industrial robots in 2025, up 20% year-on-year, and beat its previous record by almost 60,000 units. China now accounts for 59% of global deployments.

Source: IFR, World Robotics, 2026

Humanoids get most of the attention. They are easy to film and easy to relate to. But companies on both trips made the same point: a familiar shape is not the same as a useful one. Factories are highly structured places. They reward precision, accuracy, and low variability, qualities that, with apologies to our readers, are not traditionally associated with the human form. Humanoids are also far harder to build. A standard industrial robot arm has six motorised joints; a humanoid needs dozens, plus legs, balance and hands. Each adds cost and another thing to go wrong.

The bigger opportunity lies elsewhere. Much factory work is still done by hand even though it happens at a fixed station and is repetitive: machine operators, assemblers, parts handlers. Traditional automation struggled with these jobs. Robot arms lacked the dexterity to handle awkward or varied parts, and needed costly reprogramming whenever a task changed. Physical AI is tackling both problems. Cameras and AI models let an arm pick from a jumbled bin, adjust its grip and switch tasks without an engineer rewriting its code. Factories can upgrade the robots they already own and automate jobs that were previously out of reach, without paying for a human form they do not need.

Of roughly 500 million manufacturing workers worldwide, we estimate about a quarter do fixed, repetitive work that AI-enabled robot arms can take on now. A further third or so do skilled manual work at a fixed station, such as sewing, welding or woodworking, which better robotic hands could reach over time. Mobile robots, which include humanoids but also wheeled robots and four-legged inspection robots, are best suited to mobile work, such as moving parts around a plant or maintaining equipment, which we think accounts for just over a tenth of roles. Cost will decide how many of these jobs are automated, but on our numbers the balance favours fixed robots, which look suited to about five times as many roles as mobile robots.

As with any generalisation, there is nuance. Humanoids may prove their worth in less structured settings built around people, such as homes or care facilities, where no two tasks are alike. Some factory work may suit them too, such as fetching parts in older plants designed for human workers. But within factories, the larger slice of the pie looks like smarter robots at fixed stations.

“Of roughly 500 million manufacturing workers worldwide, we estimate about a quarter do fixed, repetitive work that AI-enabled robot arms can take on now.”

Built for scale rather than returns

Western firms are judged on returns. Chinese ones are often judged on other metrics. Many put market share, jobs and resilience ahead of profit, and expand up and down the supply chain to get them. National government policy and local government incentives encourage this. Local governments compete to attract new entrants and resist consolidation, because a closed factory costs local GDP and jobs. Capital is plentiful, too. High household savings, stuck in a low-return economy, keep flowing to new ventures and investment with low hurdle rates.

The result is that competition does not end when it should. In autos, purchase subsidies have gone and margins are shrinking, yet the market is still crowded, with many weak carmakers kept alive by local backing. New models appear every few days across the industry. Hardware is copied and cheapened quickly. Margin pressure here is a lasting structural feature.

Home demand offers little relief. Consumer spending is weak outside the big cities. Millennials, the generation that grew up with Western brands, have been hurt by the property slump and by tech layoffs that tend to hit workers in their mid-30s. Younger shoppers are doing better but prefer local brands. Meanwhile the old sources of growth – cars and consumer electronics – have matured, and growth has moved to energy storage and AI data centres.

So firms go abroad. Electric vehicle specialist BYD is the clearest case – it reportedly told analysts it made about RMB 20,000 (approx. £2,200) per car sold overseas in the first half of 2026, against analyst estimates of under RMB 3,000 (£330) at home.

Policy from Beijing is likely to manage overcapacity rather than resolve it. Any squeeze is more likely to come from smaller local government subsidies and changes to local government GDP growth key performance indicators than from orders to cut capacity. The rest of the world should expect a steady supply of cheap Chinese goods.

Politics determines business models

Politics now shapes how Chinese firms are built. Sunwoda, a battery maker, keeps its best technology at home and sends older versions abroad, in line with Beijing's own export controls. Alibaba deliberately avoids the American market. Hesai, a lidar maker, challenged its Pentagon blacklisting in court and won an appeal, though it remains on the list for now. Sharpa, a robotics firm started by Hesai's co-founders, is headquartered in Singapore, with research and manufacturing in Shanghai. It presents itself as a neutral partner, neither Chinese nor American.

Tariffs are only one of the barriers redrawing supply chains. Local-content rules, safety regulations, and licensing requirements all push production closer to the customer, and Chinese firms are responding by building abroad. BYD is putting a factory in Brazil. Sunwoda is building in Hungary, where licensing and certification alone took about two years. Trade is being rerouted rather than fully cut off.

Data security and national security concerns are harder to get around. The US has banned Chinese driving software from connected cars from the 2027 model year, and a bipartisan bill introduced in March 2026 would bar federal agencies from buying Chinese robots. Exporters whose growth depends on software, data and connected products face the highest barriers.

Politics also sets the pace at home. Beijing is slowing the rollout of driverless taxis to protect the jobs of drivers, many of them gig workers who lost better-paid work elsewhere. It is also subsidising human-made video against AI. In China, worries about jobs decide how fast technology spreads as much as engineering does.

> "As long-term investors, our job is to find companies within our thematic framework whose competitive advantages cannot be priced away."

What does this mean for investors?

In automation, the nearer-term opportunity lies in making existing robots smarter: the vision systems, sensors, software and precision components that let a standard arm take on more varied work. These businesses sell into a large installed base and do not need humanoids to succeed. Humanoid makers may yet find their market, but the timing and economics remain uncertain.

Five takeaways from our China trip

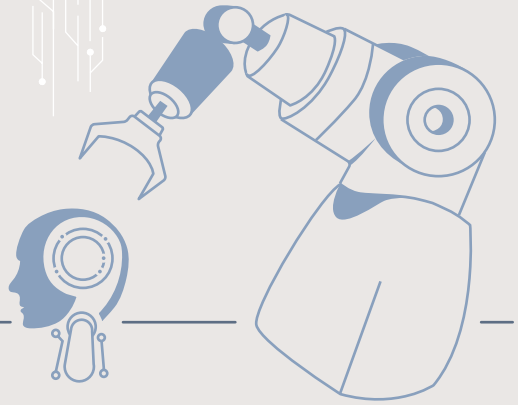
1. **AI could unlock opportunity in existing automation**
   Robot arms have traditionally been limited to repeating pre-programmed movements. AI is beginning to ease that constraint, potentially allowing standard arms to take on new tasks.

2. **Humanoids are better suited to operate around people**
   Humanoids have advantages in less structured settings built around people, such as homes or care facilities.

3. **Domestic price wars are encouraging Chinese companies to look overseas**
   Companies can often make bigger profits abroad, while consumer spending at home is weak outside the big cities.

4. **Policy is unlikely to resolve overcapacity quickly**
   Exports appear to be more important to growth than at any point in the past 25 years. Any squeeze on capacity seems more likely to come from reduced local government subsidies and stricter tax collection.

5. **Tariffs have yet to deter Chinese exporters**
   The companies we met are still growing and, in many cases, earning healthy margins in the US.



Source: Sarasin & Partners, 2026

Exporters that depend on connected products need more caution. Data security, even more so than tariffs, is the biggest barrier facing Chinese technology abroad. Firms whose growth relies on software and data in sensitive markets face real limits. Those selling plain hardware, or building close to their customers, should be better placed.

Price pressure looks set to persist. Beijing is likely to manage overcapacity in strategic sectors rather than remove it, so cheap Chinese goods will keep coming.

As long-term investors, our job is to find companies within our thematic framework whose competitive advantages cannot be priced away. Examples include brands strong enough to command a premium, products so embedded in a customer's operations that replacing them is costly and risky, and manufacturing know-how built up over decades that cannot simply be bought or copied.

Stewardship matters here too. China shows that how fast automation spreads is ultimately a social and political choice, not just an engineering one. Where governments are slow to set guardrails, we believe long-term owners have a role to play, pressing the companies building and deploying AI to put safety, transparency and human oversight at the core of the investment case.

Commodities make a comeback

Higher and more volatile inflation is changing the investment landscape. We explain why we're broadening our alternatives allocation beyond gold.



Robert Wilson
Analyst/Portfolio Manager – Alternatives



Colm Harney
Investment Strategist/ Portfolio Manager

Key points

Commodities offer diversification, particularly when unexpected inflation challenges traditional portfolios.

Global fragmentation provides a more supportive environment for commodities than the previous decade.

We are expanding beyond gold into broad commodities and industrial metals, where demand could outpace supply.

Commodities have long been an established and broad asset class within alternatives, providing potentially valuable diversification from equities and bonds. The nature of different commodities, and how we access them as investments in our portfolios, can vary across different market regimes and economic conditions. Here we describe the opportunities and explain the rationale behind our recent decision to expand our alternatives allocation beyond gold to include a broader basket of commodities and industrial metals in client portfolios.

Our starting point is the Bloomberg Commodity Index (BCOM), a widely used benchmark that splits the universe roughly into a third in energy (36.1%), a third in agriculture and livestock (34.9%), and a third between industrial metals (mainly copper, aluminium, zinc, and nickel, totalling 14%) and precious metals (mainly gold and silver, 15%). Unlike some other alternatives – such as absolute return funds – commodities are not generally suited to downside protection when markets are volatile, although gold does have qualities that make it different. Its historically low correlation to stocks and bonds means it is often preferred as a safe haven during times of geopolitical or economic uncertainty.

Broadly, commodities are not a low-returning asset class and, historically, looking at data back to 1960, they have delivered total returns in excess of cash, bonds, and the industry-standard 60/40 investment strategy (60% in equities, 40% in bonds). However, the flip side is higher volatility, and the long-term volatility-adjusted ratio (the return earned for each unit of risk taken) for commodities significantly lags both equities and bonds over most periods, while drawdowns for the asset class are extremely

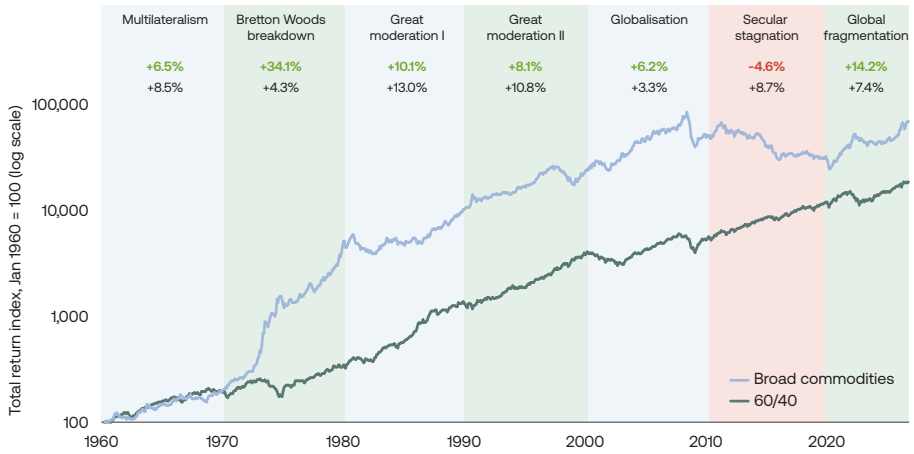


Figure 1: Commodities thrive in some regimes
Performance has varied significantly between market regimes, with particularly strong returns during periods of higher and more volatile inflation.

Source: Sarasin & Partners, Bloomberg. Monthly total returns in GBP, January 1960 to early July 2026, log scale. Annotations show annualised total returns per regime: broad commodities (upper figure) and GBP cash (lower figure).

high. Still, recognising the risk and return characteristics of the wider asset class gives us a good understanding of the role commodities can play in portfolios today.

Why commodities, and why now?

Commodities tend to perform well in exactly the conditions where traditional 60/40 portfolios struggle: periods of unexpected inflation. Returns have clearly varied hugely by economic era – very strong in the 1970s and since 2020, and notably weak during the low-inflation Secular stagnation regime of 2009–2020. That variability matters because it shapes how we think about the asset class today. Commodities are not consistently 'good' or 'bad' across the board – they are highly sensitive to the market regime.

With our post-war market regimes framework as the basis for our analysis, we can see (figure 1) that there have really only been two periods where performance was extreme in either direction: the Bretton Woods breakdown regime (1968–79), when commodities dramatically outperformed everything else, and the Secular stagnation period (2009–20), when they underperformed cash, bonds, and equities alike. In every other regime, performance has tended to sit close to a 60/40 portfolio – neither a standout nor a drag.

Since 2020, we have been in a regime of Global fragmentation characterised by higher and more volatile inflation, supply chains being restructured, strong government and corporate investment, and less spare capacity in the system to absorb shocks. We see this environment as more like the supportive regimes of the past than the weak one of the last decade – part of why we are broadening beyond gold to improve the overall risk and return profile of client portfolios.

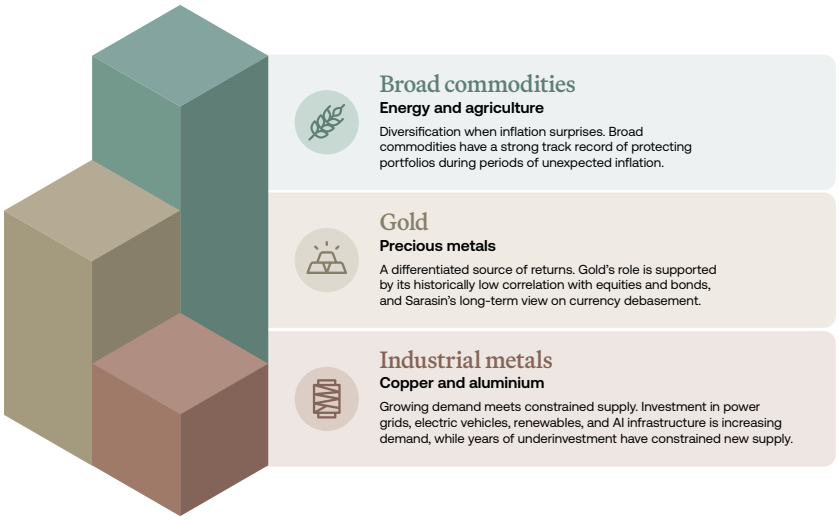
Another supporting factor behind adding commodities is their inherent historical diversification benefit. While we do need to take into account the aforementioned volatile nature of the asset class, backward-looking data (figure 3) suggests that commodities broadly protected portfolios in every inflation shock of the past 60 years, offering a hedge that traditional bonds and equities cannot.

This is no guarantee of future performance, and these inflation-surprise episodes are relatively rare – making up under a quarter of the period we studied – but commodities outperformed a 60/40 portfolio in every single one. That consistency is one of the strongest arguments for holding the asset class as insurance against a stagflationary scenario (high inflation, slow or stagnant economic growth, and elevated unemployment at the same time), even for clients who are not taking a strong directional view on prices.

> "Another supporting factor behind adding commodities is their inherent historical diversification benefit."

Figure 2: Three building blocks for a changing world
Higher and more volatile inflation has strengthened the case for commodities. Sarasin has broadened its allocation beyond gold, combining three sources of diversification and return.

Source: Sarasin & Partners, 2026



Building blocks

Let's look in more detail at the sectors that form our commodities allocation, each with a different driver of returns behind it.

The first part of the basket – the broad diversified mix of energy, agriculture, and metals – has perhaps the strongest historical case, as well as the most consistent diversification benefit, particularly during inflation surprises. These sectors have also proven less regime-dependent than commodities' reputation for volatility might suggest: outside the two extreme episodes we mentioned earlier (during the Bretton Woods breakdown and Secular stagnation regimes), returns have generally tracked broader markets reasonably closely.

Precious metals include silver, platinum, palladium, and a host of others, although the main component of this allocation is gold – which we have held in portfolios for some time now. Our conviction in gold remains, based in part on our long-standing view on currency debasement. Gold has delivered strong, differentiated returns historically, and the case for holding it does not depend on the same industrial supply-and-demand dynamics as other commodities.

Industrial metals (mainly copper and aluminium) are the new addition to the allocation. Unlike the broader basket of commodities and gold, the historical return case alone is not compelling – on the numbers, industrial metals have not historically protected a 60/40 portfolio as reliably as broad commodities have. So this recommendation relies more heavily on our specific forward-looking view: that demand will outpace supply over the next decade, tightening the physical market and supporting prices.

Copper supply is constrained by years of underinvestment in new mining projects, while demand from power grids, electric vehicles, renewables, and AI infrastructure is growing faster than demand from the rest of the market is shrinking. We expect demand to modestly outstrip supply over the next 10 years, supporting prices – although this is a moderate- rather than high-conviction view, given that a large share of demand still comes from slower-growing areas such as construction that could disappoint.

> "Our conviction in gold remains, based in part on our long-standing view on currency debasement."

What could go wrong?

No asset class comes without its risks, and commodities are no exception. The main risk we see that could derail the story is a potential return to Secular-stagnation-style conditions – low growth, weak inflation, and ample supply – which is the one environment where commodities have historically disappointed across the board. However, we see this as less likely than average right now, particularly given the structural forces pushing towards higher and more persistent inflation, but it remains the key risk we will be monitoring.

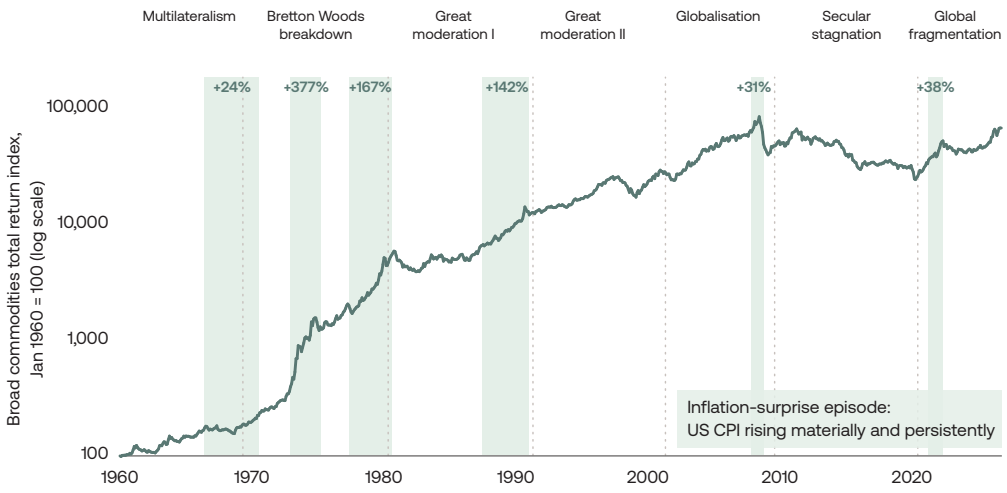


Figure 3: A hedge against inflation surprises
Broad commodities have broadly protected portfolios during every inflation-surprise episode identified over the past 60 years.

Source: Sarasin & Partners, Bloomberg. Broad commodities total return in GBP, January 1960 to early July 2026, log scale. Shaded bands are the six inflation-surprise episodes; labels show cumulative (not annualised) total return over each episode. Episodes cover 23% of all months since 1960. The broad series contains no energy before 1983 and no industrial metals before 1991, so early episodes reflect a narrower index.

Alongside this macro risk, we will also be watching the physical copper market directly to assess whether the market is behaving in the way our thesis expects, or whether additional supply and demand substitution are keeping the market better balanced than we anticipate.

What this means for portfolios

Sarasin clients will see that their portfolios now have a wider commodities allocation, moving from gold only to include broad commodities and industrial metals. In typical portfolios, the commodities allocation within alternatives has risen from 20% to 25%, funded from alternative equity, such as listed private equity and infrastructure investment companies. This is sized to reflect moderate – rather than high – conviction on the industrial metals component specifically, while our conviction in broad commodities and gold remains higher.

> “Sarasin clients will see that their portfolios now have a wider commodities allocation, moving from gold only to include broad commodities and industrial metals.”

In choosing the right vehicles for the portfolios, we began with a universe of over 350 broad-commodity funds and applied specific hard gates – including track record length, investment structure, and daily dealing – before narrowing further on quantitative measures including drawdown behaviour, consistency of returns, and scale. A small shortlist went through manager meetings and full due-diligence questionnaires, from which two funds emerged as our highest-conviction recommendations.

JSS Commodity – Transition Enhanced implements broad commodities exposure through a constant-mix, direction-agnostic strategy. In short, this means monthly rebalancing back to equal weights within each sector, which systematically sells recent outperformers and buys underperformers.

Secondly, as a complementary addition, we also selected Neuberger Berman Commodities. Its process is built on the idea that in commodities, unlike equities, sustained high volatility is usually a sign of acute physical supply stress rather than a risk investors should be paid to hold. The fund systematically reduces exposure to commodities showing that kind of stress-driven volatility, while allowing structural overweight positions in commodities with calmer, more persistent scarcity dynamics.

We have deliberately chosen two managers with genuinely different processes, rather than one. Beyond the diversification of investment approach this brings, using two funds also lets us build a meaningful commodities position without concentrating the allocation too heavily in a single vehicle.

Where will future earnings power accrue?

Our thematic equity approach seeks to understand how structural change is reshaping industries – and identify the companies positioned to capture the resulting growth and value creation.



Fiona O'Neill
Head of Investment, Global Equities

Key points

We identify where economics and earnings power will accrue as structural change reshapes industries.

We believe markets do not always fully capture the duration, profitability and value creation associated with structural change.

We seek to capture outperformance through disciplined fundamental investing, underpinned by active engagement and an ownership mindset.

I joined Sarasin at the beginning of 2026 with the view that the team's long-term global thematic approach aligned closely with my own investment philosophy. Here, I will introduce the personal principles that have brought me to this point, and reaffirm those shared beliefs underpinning our investment philosophy and process.

My 20 years of investing across global equities – as a stock analyst, portfolio manager, and leader of one of the world's largest fundamental research platforms – have convinced me that the best investment outcomes stem from combining intellectual curiosity, collaborative debate, and long-term thinking. With this in mind, four principles guide my working week.

First, live and breathe an investment thesis: every holding, regardless of size, should have a clear, enduring reason to own it. Second, keep it simple: if we cannot explain an investment clearly to clients, we probably do not understand it well enough ourselves. Third, control what we can control: process, preparation, research, and ultimately our decision-making. Finally, evolve with intent: keep what works, improve what does not, and never stand still.

That last point is crucial, as economies and industries are not static either – they are constantly being reshaped by structural change. Technology is an obvious example of this structural change, particularly given rapid developments in artificial intelligence (AI) today, which are having a profound impact on the fortunes of businesses that specialise in it, and indeed our daily lives. Other sources of structural change include demographics, resources, regulation, policy and geopolitics, which can all fundamentally alter the economics of an industry.

Figure 1: Growth engines
Long-term growth is driven by three engines of economic progress – people, resources and technology – with technology the most powerful driver of productivity and progress.



People

Demographics, migration and shifts in purchasing power shape labour supply and consumption, altering the distribution of economic activity across industries, regions and generations.



Resources

Energy, land, water and raw materials shape economic growth and industrial competitiveness. Scarcity, abundance and efficiency gains create significant shifts in industry economics.



Technology

The most powerful and scalable driver of productivity. From the steam engine to AI, innovation enables economies to create more value with fewer inputs – the primary source of structural opportunity.

Source: Sarasin & Partners, 2026

Markets are clearly forward-looking, but they are not always right. In particular, we think they can underestimate how long this structural change will last, how profitable it will be, and ultimately how much value it will create. That gap between what we think will happen and what the market is pricing is where we believe the investment opportunity comes from.

At the heart of Sarasin's investment philosophy, then, is one question: where is future earnings power going to accrue, and can we invest before the market has fully priced that in? Simply finding a great company exposed to a great theme is not enough. If everybody already knows it and the opportunity is fully priced in, it may not be a good investment. Ultimately, we are looking for a gap between our view of long-term value and the market's expectations today.

"Markets are clearly forward-looking, but they are not always right. In particular, we think they can underestimate how long this structural change will last, how profitable it will be, and ultimately how much value it will create."

Thematic thinking

Even before I joined the firm, I had always known of Sarasin as a pioneer in thematic investing. From working with the team over recent months, I have become clearer in the conviction that markets systematically underestimate the duration, profitability and value creation associated with the aforementioned structural change that ultimately informs our themes.



Figure 2: Insight into themes
Themes emerge from the convergence of growth drivers and regimes – they capture shifts that can create sustained value.

Source: Sarasin & Partners, 2026

So, what is behind our themes? Taking a step back, we start very broadly with the forces driving change – these being the long-term growth engines behind economic progress: people, resources, and technology. They help us understand what is changing, whether that is ageing populations, changing patterns of consumption, resource scarcity, electrification, AI or automation.

However, these forces do not operate in isolation. At the same time, we need to understand the market regime in which that change is taking place. You can see our seven post-war regimes in figure 1 on page 15. Each one is built around a set of conventions, behaviours, and institutional arrangements that characterise each period. It is clear that interest rates, fiscal policy, regulation and geopolitics can accelerate a structural change, slow it down, alter its economics or change who ultimately benefits from it.

It is important to note here that we do not think of those growth engines and regimes as two consecutive steps in our process. Rather, the engines help us understand the underlying direction of change. The regime helps us understand how that change is likely to play out economically. We need both to understand where value is likely to accrue.

It is through this combined lens that we identify six major thematic areas – Automation, Digitalisation, Evolving consumption, Ageing, Security, and Climate change. We see each as an investment conclusion about a durable change in the world that we believe is sufficiently powerful to reshape industry economics and create sustained opportunities for value creation.

AI, for example, is a powerful manifestation of our technology growth engine. Our thematic work asks what that technological shift changes economically – whether the falling cost of intelligence reshapes productivity, business models and competitive advantage.

Importantly, a theme tells us where to look for stocks to express it in our portfolios. It does not tell us what to buy. That is where the next part of the process comes in.

> “We must ensure a disciplined way of focusing our research effort on the areas where structural change is most likely to matter.”

Narrowing the universe

Our universe of global equities starts with the MSCI All Country World Index (ACWI), which covers approximately 85% of the global investable equity market. It includes more than 2,400 stocks across 23 developed and 24 emerging market countries.

We must ensure a disciplined way of focusing our research effort on the areas where structural change is most likely to matter. This is where we use quantitative evidence, alongside our thematic judgement, to identify the industries where we see attractive economics and credible structural tailwinds. That gives us our thematic universe: our hunting ground for fundamental research.

> “As active, long-term owners, we engage with the companies we hold. Our stewardship approach helps us to understand the risks they face and we are upfront in using our influence to encourage behaviours that support enduring value.”

Our first task is to narrow that wider universe to a thematic basket of around 1,000 companies for fundamental research, across numerous industries, from automobiles to financials, healthcare, utilities and many others. Our analysis spans evidence around factors such as historical growth, margins, returns and reinvestment.

This sits alongside our thematic work to identify the parts of the market where we think structural change is creating the most interesting opportunities. While part of this is quantitative, the aim is to use our systems to test, inform, and challenge our judgement, rather than replace it.

When it comes to selecting individual stocks for our funds and portfolios, judgement and fundamental investing really take over. The kinds of questions we ask when assessing stocks include: which companies are actually going to capture the value? What could their earnings power look like in five or 10 years? How durable is that opportunity? Can they reinvest and compound? What are the risks?

Critically, we ask: what is already in the share price? Our aim, in short, is to find where our view of long-term value differs from what the market expects today.

Our commitment to stewardship

Alongside Sarasin’s thematic approach to investing, I have also long been aware of its heritage as a steward of clients’ capital, something embedded in the investment approach. Indeed, stewardship runs through the whole of the investment process. Before we invest, it gives us additional insight into the environmental, social, governance and regulatory forces affecting industries and companies – it helps us to identify structural change and judge who it favours.

As active, long-term owners, we engage with the companies we hold. Our stewardship approach helps us to understand the risks they face and we are upfront in using our influence to encourage behaviours that support enduring value. We are committed to driving positive change on our clients’ behalf, and we see stewardship as a long-term responsibility to grow and protect their assets.

Clarity and discipline

Since joining Sarasin, I have focused on understanding what is distinctive about our investment approach, where it works well, and where greater clarity and discipline could make it stronger still, enabling long-term performance outcomes. Our distinct thematic heritage and deep fundamental research capability have truly impressed me, while the team and I are also seeing ways we can evolve our thematic thinking further in the months and years ahead. My objective has not been to reinvent our approach, but to make what is distinctive about it clearer for our clients. I hope this article has helped in that regard, and I will make sure I keep you up to date as we continue on this journey.

Nature's line of defence

Climate change and biodiversity loss are becoming threats to economic and financial security, making resilient natural systems increasingly important to protecting long-term capital.



Thomas Lindsey
Partner



Tom Vernon
Partner, Head of Private Clients

Key points

Climate change and biodiversity loss are increasingly threatening food security, economic resilience, and long-term capital.

Protecting portfolios means understanding how climate and nature risks can increasingly affect inflation, company cash flows, and financial stability.

Active stewardship can help identify emerging risks, strengthen portfolio resilience, and support the transition to a more secure future.

Climate change and biodiversity loss are no longer isolated issues. They increasingly threaten our food security, financial systems, national resilience, and therefore the long-term capital on which many investors depend. What does this mean for investors, and what should their investment partners be alert to as they seek to build resilience and protect long-term capital?

The photographs are dramatic: orange skies, exhausted firefighters and roads jammed with cars, as thousands of residents and holidaymakers escape lines of burning trees. By late July, more than 325,000 people had been forced to flee their homes in France and Spain as wildfires raged across Western Europe.

At their peak, the fires in the Gironde region had advanced to within nine miles of the Bordeaux metropolitan area, home to more than a million people. Such was the scale and intensity of the blaze that it generated a phenomenon seldom seen before in Europe: pyro cumulonimbus or 'fire thunderstorms', in which wildfires effectively generate their own weather systems, producing high winds and lightning strikes that spread the footprint of the fires further still.

In Spain, 265,457 hectares had burnt by 12 August 2026, which is more than half of the EU's total burnt area for the year according to the EU's Copernicus European Forest Fire Information System (EFFIS). That is still below the more than 382,000 hectares Spain had lost by the same point in 2025, the worst wildfire season in the EFFIS record (2006–present).

By late August, the element had changed, but the images were no less shocking. Along the Nepal–Tibet border, a glacial collapse so violent that its seismic signal was initially mistaken for a

magnitude 5.2 earthquake sent a wall of water, ice and rock down the Bhote Koshi and Trishuli river systems. The Trishuli rose by as much as nine metres in just half an hour. At the time of writing, more than 390 people had been reported dead and over 1,400 missing; at least 19 bridges had been destroyed and nearly 40km of road damaged. Scientists have not yet established how much climate change contributed to this particular collapse, but the wider trend is unambiguous: glaciers across the Hindu Kush Himalaya are now losing ice 65% faster than the rate recorded at the turn of the century.

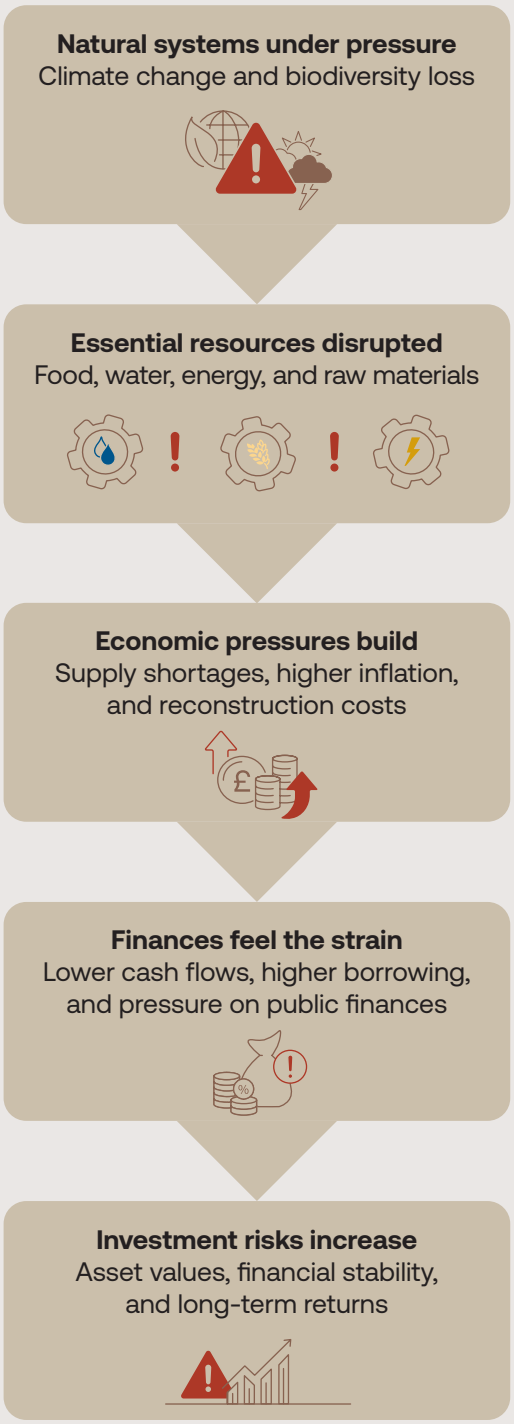
Fire and flood may appear to be opposite calamities. In practice, both are symptoms of the same fragility, and the feedback loop between climate change and biodiversity loss. Heat, drought and fire degrade forests and soils, while retreating glaciers expose darker underlying rock, soil or ocean water that absorbs more solar heat. Degraded ecosystems store less carbon, regulate less water and offer less protection against future shocks. What looks like an environmental problem can therefore quickly become agricultural, economic, political and, ultimately, an issue of national security.

Losses migrate through the economy in multiple and often self-reinforcing ways. Homes and crops must be replaced; transport, energy and water infrastructure repaired; insurers and banks absorb claims and credit losses; tourism and local commerce suffer; and governments fund emergency relief, reconstruction and, increasingly, insurance backstops. For investors, there is a double materiality: the social and/or environmental needs they exist to address may intensify just as the real value of the assets supporting their missions comes under pressure.

Security begins with nature

This is the central message of the Joint Intelligence Committee's assessment, Global biodiversity loss, ecosystem collapse and national security. Its institutional provenance matters. This is not a campaign paper produced by an environmental group, nor a prospectus from the defence industry. It was developed by analysts and experts across the security services and applies the methods, probability language and uncertainty framework used in intelligence assessments.

How nature risk becomes investment risk
Climate and biodiversity loss can travel through the economy in multiple ways, turning environmental disruption into financial risks that ultimately affect long-term capital.



Source: Sarasin & Partners, 2026

40%

of the food consumed in the UK is imported. Disruption to major food-producing regions could therefore have direct consequences for the country's food security and inflation



Source: Defra, UK Food Security Report 2024

The report's conclusions are stark. It judges with high confidence that ecosystem degradation and collapse threaten UK security and prosperity, and that every critical ecosystem it examined is on a pathway to collapse. It traces the consequences through food and water insecurity, inflation, migration, organised crime, conflict and interstate competition, and identifies the Amazon and Congo rainforests, boreal forests, the Himalayas, and South-East Asia's coral reefs and mangroves as especially critical. The precise timing is uncertain, as it should be in any honest forecast; nevertheless, the report sees a realistic possibility of some collapses occurring as soon as 2030.

The connection made to security is intuitive: damaged ecosystems mean weaker pollination, soil formation, water regulation, disease control, and carbon storage. The next links are crop failures, water scarcity, fisheries losses, extreme weather and disrupted supply chains. These, in turn, can lead to food inflation, increased poverty, migration, organised crime, political polarisation and competition between states for land, water and critical resources. Nature is not scenery surrounding the economy; it is the infrastructure beneath it.

The UK is particularly exposed to food insecurity. We import around 40% of our food and are also partly dependent on imported fertiliser. The assessment warns that the failure of two or more major food-producing regions would almost certainly drive global food prices sharply higher and could limit the UK's ability to import. In a fragmented world, increasingly scarce supply is unlikely to be allocated by a frictionless market: states will intervene, secure provisions and restrict exports.

What action can investors take?

As stewards of our clients' capital, our first responsibility is to recognise the regime in which we are operating. As physical climate losses become more frequent and economically material, not only will affected communities suffer, but governments will be under intense pressure to provide disaster relief, reconstruction, public insurance schemes and support for households and companies. That will intensify pressure on public resources and, as many climate shocks constrain supply, drive more volatile inflation. Central banks already recognise that acute physical events can push output and inflation in unhelpful directions at the same time.

Rebuilding may temporarily lift measured economic activity, but replacing a bridge, factory or home is not the same as creating new wealth. GDP growth can rise while the stock of physical, human and natural capital falls. Investors need to distinguish activity from prosperity, and growth in output from growth in wealth.

There is no credible way to put a precise figure on the consequences. The interactions between climate, ecosystems, technology, policy and geopolitics are too complex. But precision is not the same as preparedness. The task is first to face in the right direction: to stress-test assumptions, demand larger margins of safety where risks are under-priced, and look for companies and assets that strengthen resilience.

This thinking shapes the themes on which our equity stock selection process focuses. Sarasin introduced Security as its sixth investment theme in April 2025, alongside Ageing, Automation, Climate Change, Digitalisation, and Evolving Consumption. Energy security depends on grids, storage and diversified supply. Food security depends on healthy soils, water, seeds, fertiliser and agricultural productivity. Access to critical minerals depends on geology, processing capacity, trade routes and political relationships. Cybersecurity, defence and resilient infrastructure naturally sit within the same system.

At a more granular level, a company may benefit from expenditure on grid resilience while facing water stress in its factories. A miner may supply metals essential for electrification while imposing material costs on land and communities. An agricultural technology business may improve yields, but only if its products are affordable and protect the natural systems on which crops depend. Ultimately, our role, as allocators of capital, is to understand the practical consequences of these deeply interconnected themes and identify those that will be most material.

From analysis to stewardship

Climate and nature are embedded in our fundamental analysis. Our Sustainability Impact Matrix considers 15 environmental, social, and governance factors. Five are explicitly environmental: climate change, circular economy, land, water, and air. This gives us a consistent way to identify both financial materiality: how environmental shifts affect a company's operations, and impact materiality: how a company itself affects both people and planet. The two frequently converge through regulation, litigation, resource costs, customer demand, capital expenditure and the cost of capital.

This work is supplemented by Net Zero Alignment Assessments and Climate Value at Risk analysis of our most carbon-intensive holdings. We examine physical disruption as well as transition risks and opportunities. Where a business is poorly placed to adapt and long-term capital is at risk, that matters to valuation and investment selection; where it has the capacity to transform, active ownership can help accelerate progress.

Stewardship is therefore not an optional accompaniment to portfolio construction; it is an integral part of risk management. Our research into banks illustrates this point. Banks are exposed when severe weather damages borrowers and collateral, when transition changes undermine business models, and indirectly when climate shocks weaken economic growth. In a July 2026 *Financial Times* letter, Sarasin and the Local Authority Pension Fund Forum cited estimates that California's 2025 wildfires cost $95bn to $164bn; a state law granting mortgage forbearance to affected borrowers made the connection to bank lending explicit.

We believe that climate should be treated by financial institutions like other risks, such as cyber, global pandemics or geopolitical instability. Expected-credit-loss accounting is forward-looking to ensure that banks build resilience to future threats; climate risk should not receive a special exemption. That principle informs our engagement with company boards, auditors, regulators and accounting standard-setters. We press for material climate assumptions to be visible in accounts, capital allocation and lending decisions, and we escalate where dialogue fails. The purpose is not to produce tidier sustainability reports. It is to protect long-term capital by making sure risks enter the numbers on which decisions are based.

> "Stewardship is not an optional accompaniment to portfolio construction."

A practical choice

Climate is integral to how we think about economies, themes, securities and stewardship. For investors seeking a more explicit approach, Sarasin offers 'Responsible' global equity, bond and multi-asset funds which have suitability-related and ethical exclusions embedded as part of their investment processes. We can also offer investors access to segregated mandates, including equity-only or bespoke multi-asset portfolios, for those requiring a stronger climate tilt and/or tailored exclusions.

Investors do not need to predict the date of the next wildfire or ecosystem tipping point. They do need to ask whether their investment policy, appointed manager and reporting recognise that climate and nature loss can affect inflation, balance sheets, company cash flows and social stability all at once. National security begins with functioning natural ecosystems. Financial security does too.

The double life of listed real estate

Real estate investment trusts (REITs) combine the liquidity of equities with exposure to physical property. After a painful rate shock, improving fundamentals are strengthening the case for recovery.



Raymond Lahaut
Analyst / Portfolio Manager, Global Real Estate

Key points

Listed real estate offers investors liquid access to a global, diversified property market worth around $2.1trn.

REITs behave like equities in the short term, but track private property more closely over longer periods.

Refinancing pressures are easing, while stabilising asset values and attractive yields support the return outlook.

Commercial property, or real estate, is often favoured by investors looking to diversify portfolios away from traditional equity markets and bonds. For many, talk of the asset class conjures a single building: an office block, a shopping centre, a block of flats, bought directly and held for years. While holding bricks and mortar directly is one way of investing, listed real estate is something different, and in many ways more powerful.

A real estate investment trust (REIT) is a company that owns and operates income-producing property, structured so that investors can access those assets through the stock market rather than through direct ownership. This is typically via a tax-transparent structure that, in exchange for distributing the great majority of rental income to shareholders each year, avoids the layer of corporate tax that direct property funds cannot escape.

A global and sector-diverse asset class

The scale of this universe is easy to underestimate. Across the European Public Real Estate Association's FTSE EPRA Nareit Global Real Estate Index, the listed real estate opportunity set spans 503 stocks in 40 countries, with a combined market capitalisation of around $2.1trn – 81% of it structured as REITs, the rest as listed property companies. The Americas dominate at 61.2% of global value, with Asia Pacific the second-largest region at 26.7%, and EMEA smaller still at 12.1%.

Perhaps more striking than the geographic spread is the sector spread. Retail and offices – the sectors most people associate with real estate – together make up only around a quarter of the global listed universe by value. The rest is spread across residential, diversified portfolios, industrial and logistics, and a fast-growing "specialty" bucket that includes data centres, self-storage, student

housing, and healthcare real estate. Some of the perceived highest-quality assets in the world – flagship logistics parks, hyperscale data centres – are simply not for sale in the direct market; they can only be accessed by owning the listed company that holds them.

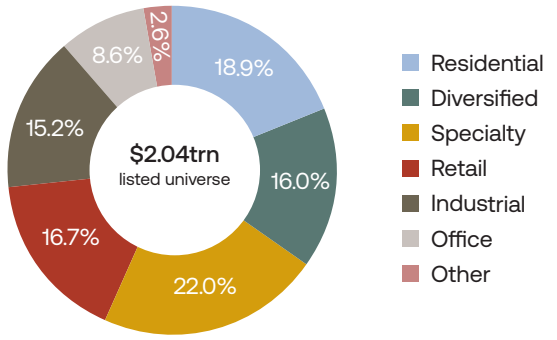
Are REITs equity, or are they real estate?

Ask a REIT analyst and an appraiser the same question – "is this a stock or a building?" – and both will answer confidently, but differently. Legally, a REIT is unambiguously an equity: priced every second the market is open, sitting inside benchmark equity indices, tradeable in seconds. None of that is true of a warehouse or a shopping centre. On that basis, sceptics have long argued that REITs belong in an equity allocation, not a real estate one.

Research from Green Street settles the question by horizon. R^2 is a measure of how closely an investment's performance moves in line with its benchmark, expressed as a percentage. Measured quarterly, REITs show a high R^2 against the S&P 500 (0.4) and almost none against private property values (0.0), as per the NFI Open-End Diversified Core Equity (ODCE) Index. However, stretch the horizon to three years and it flips: correlation with the S&P 500 falls to 0.2, while correlation with private property (once its lagging, appraisal-based pricing is corrected for) climbs to 0.8–0.9. Judged over the short run, a REIT looks like a stock; judged over the run that matters to most investors, it looks like a building.

> "REITs are structurally rate-sensitive through two separate channels, and both bit hard as long-term bond yields rose sharply between 2021 and 2023."

Figure 1: Property beyond offices and shops
The global listed real estate market spans residential, industrial, specialty, retail, office, and diversified property sectors.



Source: UBS, EPRA, Datastream, December 2025. Specialty includes data centres, self-storage, student housing, and healthcare real estate.

Why the last three years were so painful

That equity/property duality explains the sector's most difficult recent stretch. REITs are structurally rate-sensitive through two separate channels, and both bit hard as long-term bond yields rose sharply between 2021 and 2023 – driven not by central bank policy rates directly, but by a surge in inflation that pushed up the long end of the yield curve.

The first channel is leverage: as debt matures, it refinances at the prevailing rate, and a sharp rise in benchmark yields means each refinanced tranche lands at a materially higher coupon – a direct hit to interest expense before any rental growth reaches the bottom line.

The second channel is valuation: commercial property is priced, in essence, as a multiple of its rental income, and as government bond yields rise, property yields tend to follow, since real estate must keep offering a credible premium over the "risk-free" rate. A higher property yield applied to the same rental income produces a lower net asset value, regardless of how well the building is performing operationally.

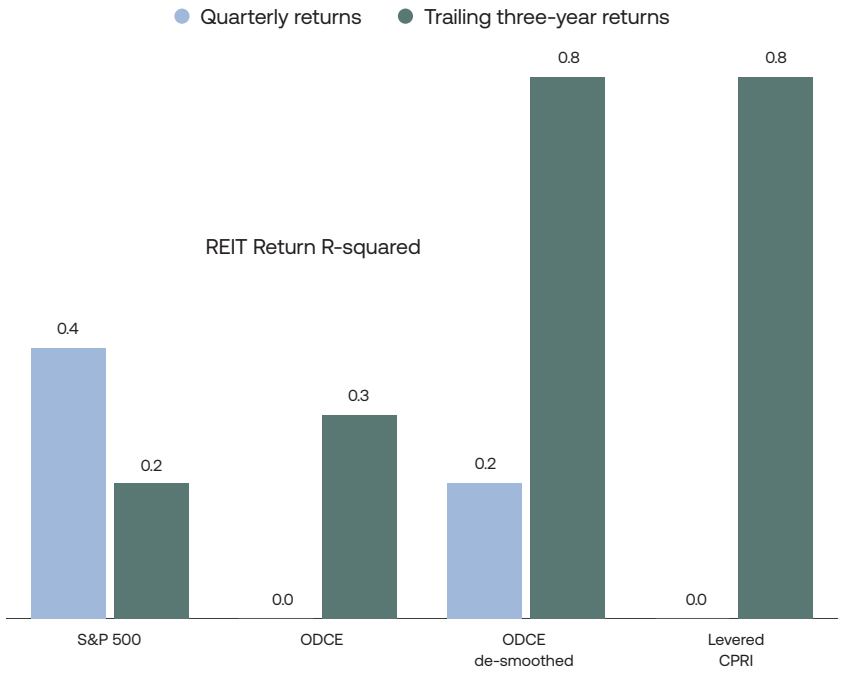


Figure 2: Short term, REITs behave like stocks; long term, like property
REIT returns track equities more closely in the short term, but increasingly reflect private property values over longer periods.

Source: Bloomberg, NCREIF, Green Street, October 2025. REIT return R-squared against S&P 500, ODCE, ODCE de-smoothed, and Levered CPRI, quarterly vs trailing three-year returns.

Both channels ran together through the sharpest years of that bond yield sell-off, from 2021 to 2023, and the resulting de-rating was severe. What makes that period unusual is that fundamentals mostly held up throughout it: occupancy stayed high across most major sectors, and rental growth – often explicitly inflation-linked – remained strong.

> "Even after two decent recovery years in 2024 and 2025, listed real estate share prices remain stuck close to where they stood at the depth of that shock in early 2023"

This was a cost-of-capital problem, not a demand problem. Yet even after two decent recovery years in 2024 and 2025, listed real estate share prices remain stuck close to where they stood at the depth of that shock in early 2023. This is with the sector still trading close to a 30% discount to net asset value, a historical extreme, and valuation multiples running roughly 18% below their 15-year average.

Since 2023, the picture has changed. Long-term bond yields have stayed high, with periodic bouts of volatility, but have not risen materially further, and 2024 and 2025 proved decent years for the sector as a result, with 2026 continuing that improvement. Companies across the sector have now refinanced a large share of the debt that matures through the cycle, meaning much of the pain of rolling onto higher rates has already been taken rather than still lying ahead.

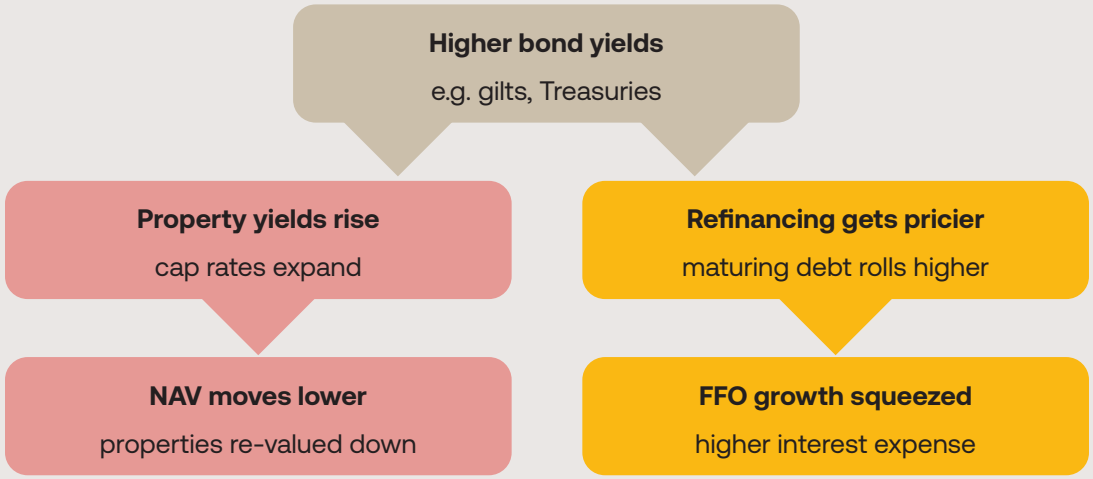
Our estimates suggest that sector-wide interest costs are still expected to climb further, from around 2.4% today towards roughly 3.4% by the end of the decade, as legacy low-rate debt continues to roll onto today's higher, but now broadly stable, rate level.

The sharp, front-loaded shock of 2021–23 is behind the sector. NAVs, after three consecutive years of decline through that shock, have stabilised since and, in a growing number of cases, begun to tick higher again.

The outlook is higher-for-longer

The question now is whether that improving picture finally closes the gap between fundamentals and share prices, or whether the gap simply persists. Our view is not that markets are due a sharp re-rating, but rather that the sector no longer needs one to deliver an attractive return.

Figure 3: How higher yields hit real estate
Rising bond yields can reduce property values while increasing refinancing costs and squeezing earnings growth. Considered as channels, one squeezes income, the other cuts asset values, and in 2022–23 both hit at once.



Source: Sarasin & Partners, 2026

The case rests on income and growth alone. Funds From Operations (FFO) is a key profitability metric used for REITs. Listed real estate today offers an implied FFO yield of a little over 7%, the highest level since 2013 – a reflection of how far valuations fell rather than any deterioration in income. On top of that sits growth: net recurring earnings are projected to grow at a modest 2.5% a year to 2028 (modest specifically because interest expense is still climbing, taking a bite out of roughly 5% gross rental growth), while NAVs are projected to compound at around 5% a year as property yields gradually ease back.

Put together, a starting yield of around 7%, FFO growth of around 2.5%, and NAV growth of around 5% builds to an implied total return in the region of 14–15% a year – constructed entirely from income and growth, before any credit is given for the sector's roughly 30% NAV discount narrowing at all. Should that discount close even partially as the market re-rates improving fundamentals, the return path improves further still.

The return case's resilience is the more important part of the story. The sector's equity-market beta hasn't disappeared – a renewed shock to bond yields, or a further escalation of the US–Iran conflict, could still see more leveraged names sell off in sympathy with broader risk sentiment. But with balance sheets repaired and the sharpest repricing already behind it, the sector is far better placed to absorb that kind of shock than it was three years ago. The outlook here is genuinely constructive: a gradual drift towards better fundamentals and a narrowing discount, doing the work quietly from here.

> "The outlook here is genuinely constructive: a gradual drift towards better fundamentals and a narrowing discount, doing the work quietly from here."



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