

GRYPHON INVESTMENT ADVISORS BAHAMAS
CONFIDENTIAL*Thoughts for the Day*
Monthly Overview**A Month Like a Slow Squeeze**

Dear Fellow Investors,

September was the month the bond market stopped asking permission. For most of this year it has been possible to treat the war in the Gulf as an oil story and the Federal Reserve as a question of timing. By the final week of the month, neither view held. The US ten-year Treasury yield closed above 5.2%, a level not seen since 2007, and the world's major central banks spent the month tightening into an energy shock rather than looking through it.

The direction did not surprise me. The breadth did. The Federal Reserve, the European Central Bank, the Bank of Japan and the Reserve Bank of Australia all raised rates within three weeks of one another, and three of the nine members of the Bank of England's Monetary Policy Committee voted to join them. Yet the S&P 500 ended the month within a few points of where it began, and equity volatility sat close to its lows for the year. The index gave a calm reading. Beneath it, bonds, gold, the typical stock and the price of diesel all moved sharply, and that is where investors needed to be looking this month.

THE DOMINANT STORY**An Energy Shock Becomes an Inflation Regime**

The month began with the conflict with Iran, now more than six months old, flaring again after a month-long lull. The first week brought the heaviest fighting since July: renewed US strikes, Iranian retaliation across the Gulf states, attacks on tankers and a US naval escort programme running at its wartime peak. Brent moved from around \$90 into the mid-\$90s. Then the shock changed shape. It moved from the Strait of Hormuz to the routes built to bypass it. Brent settled at \$107.63 on 10 September, its highest close since May. The following day, drones launched from Iraq struck Saudi Arabia's East-West pipeline, the only meaningful route around the Strait. Within days Houthi forces had taken islands commanding the Bab el-Mandeb, and later in the month their missiles targeted Yanbu, the Red Sea port the pipeline feeds.

The month closed with some relief. Iran offered to reopen Hormuz within seven days in exchange for an end to the US blockade, which Washington rejected. Even so, the Saudi pipeline restarted and the United States offered the final 40 million barrels of its Strategic Petroleum Reserve. Brent settled at \$102.59 on 29 September. The damage, however, is now in the refined product market rather than crude. US retail diesel reached a record \$6.52 a gallon, distillate inventories are at their lowest in more than 40 years, and Ukraine's campaign against Russian refineries has pushed Russian refining output to its lowest level since 2002. Refiners have outperformed oil producers by close to 97 percentage points this year. Few statistics tell the story of this shock more clearly.

The transmission into inflation was visible throughout the month. US consumer prices rose 3.4% year on year in August, with core prices running ahead of expectations and energy supplying more than a third of the monthly gain. Producer prices rose 5.4%. Euro-area inflation was 3.3% in August, and Spain printed 5.0% for September. The market priced the first-round effects quickly. It moved the odds of a Fed hike from roughly 60% at the start of the month to about 90% by the eve of the meeting. What it is still working through is the second round: freight, fertiliser, food and wages. Those are the channels that turn a price spike into a persistent inflation problem.

My read is that the market is pricing the diplomacy rather than the logistics. The consensus assumes crude has already shed its war premium and that a settlement after the US midterm elections on 3 November will normalise flows. Spare capacity that sits behind a chokepoint is not spare capacity. The US reserve buffer is close to exhausted. Qatar's LNG force majeure now runs into December. Even a genuine settlement leaves a repair and restocking cycle measured in months. If I am right, the risk to portfolios is not a higher oil price as such. It is diesel and freight holding core inflation above target well into 2027, which keeps central banks tightening. That outcome punishes long-duration assets of every kind, and it rewards the owners of scarce physical capacity.

THE SECOND LAYER

The AI Build-Out Meets the Cost of Capital

Running quietly beneath the energy story was a change I regard as equally important over the long run. For the first time, the artificial intelligence capital cycle is being financed into a rising cost of capital. The scale is now macroeconomic. Goldman Sachs estimates capital spending by the major US cloud providers at about \$806 billion this year against roughly \$110 billion in China. Bond issuance by the largest technology companies and their financing vehicles is on course for a record of around \$320 billion, equivalent to some 70% of Treasury issuance, against 30% last year. This month Fed Chair Kevin Warsh, New York Fed President John Williams and ECB President Christine Lagarde each cited AI-related borrowing as a force pushing bond yields higher. Central bankers do not usually name a single industry in this way.

The two themes reinforce each other, and that is what concerns me. The energy shock is lifting the policy rate. AI borrowing is lifting the term premium. Together they raise the discount rate applied to the long-duration assets that the AI build-out is supposed to create. Sentiment is fragile too. In mid-month, Anthropic chief executive Dario Amodei published an essay calling for a slower pace of frontier development, OpenAI's Sam Altman ruled out a listing this year, and the Philadelphia Semiconductor Index fell 5.9% in a single session. A week later the Nasdaq Composite set its first record since June, with leadership rotating into memory and processors and AMD crossing \$1 trillion in market value. By the month's end, OpenAI's second pause in model training in three months had knocked chip stocks down again, with the Philadelphia index falling more than 3% on 28 September. The order books have not changed. Investor conviction, however, is now swinging on weekly headlines.

For the investment cycle, the implication is that returns are migrating towards whoever controls the bottleneck. Micron's leading-edge memory capacity is sold out through 2026, and its shares are up 279% this year. Transformers and substations are in short supply. Grid access and local planning approval, not silicon, now set the schedule. The risks are accumulating in the financing chain. The build-out is increasingly funded off balance sheet and at the riskier end of the capital structure: Meta's \$27 billion joint venture with Blue Owl for its Hyperion campus, Nvidia's vendor

financing of Nscale, CoreWeave's \$3.7 billion convertible, and SoftBank paying 8.75–9.875% on an \$11 billion high-yield raise to fund its OpenAI commitment. The balance sheets carrying it are losing headroom. Oracle has been cut to BBB-, one notch above high yield, on \$125 billion of debt, and S&P judges Amazon's headroom in some years to be very limited. The danger is not that AI fails to monetise. It is that monetisation arrives two or three years later than the debt was priced to expect.

RATES, CURRENCIES & MARKET DIRECTION

What the Markets Are Telling Us

THE RATE NARRATIVE

The Federal Reserve raised its target range by a quarter point to 3.75–4.00% on 16 September. The vote was unanimous, and it was the Fed's first increase since 2023. The median projection shows one further hike this year. Chair Warsh was unusually direct: inflation has been too high for too long, underlying growth is higher than assumed, and he would struggle to call current financial conditions restrictive. The ECB had already lifted its deposit rate to 2.50% on 10 September. The Bank of Japan followed with a move to 1.25% on 18 September, its highest policy rate in 31 years, and the Reserve Bank of Australia raised to 4.60% on 29 September. The Bank of England held at 3.75% on a 6–3 vote and paused its gilt sales, yet the market still ended the month pricing a November hike as highly likely.

The more important message came from the long end. The ten-year Treasury yield rose from around 4.78% at the start of the month to 5.25% on 29 September, and the 30-year reached 5.59%, its highest since 2002. The five-year auction cleared at the highest yield since 2006, and foreign participation at the 20-year sale fell to a record low. The two-year yield rose 72 basis points between Jackson Hole and 24 September, its largest 21-day rise since March 2023, just before Silicon Valley Bank failed. In the final week, yields kept rising even as oil eased and the Conference Board's consumer confidence index fell to 81.9, its lowest level since 2014. That is a repricing of term premium, not an inflation scare. By the month's end, the odds of another Fed move in October had fallen back to about even, and a December hike was almost fully priced.

“Equity investors are treating the energy shock as transitory and the rate response as symbolic; rates investors are not. One of those positions is wrong.”

From my daily note of 11 September

CURRENCIES

The dollar began the month failing to rally on a genuine supply shock, and that told us how far its haven status has eroded. It found its footing once the Fed moved. The dollar index rose to 101.40 by 29 September, its highest level since late July, and speculative dollar positioning rose at its fastest weekly pace in seven years. The euro slipped from about \$1.16 to \$1.14. Sterling was more instructive. It fell to test \$1.32, a two-month low, even as ten-year gilt yields rose to 5.40%. When yields rise on fiscal risk rather than growth, the currency weakens rather than strengthens, and that is the market's verdict ahead of the 28 October Budget. The yen strengthened to its best level of the year in early September before giving much of it back, despite the Bank of Japan's hike and a record ¥15.4 trillion spent by Japan's Ministry of Finance on intervention this year. The People's Bank of China, meanwhile, guided the yuan to its strongest level in more than three years around the Washington summit.

Gold deserves a word of its own. It ended the month near \$4,170, more than 25% below its January record, even as a war continued in the Gulf and the People's Bank of China extended its gold buying to a 22nd consecutive month. For now, gold is trading as a real-rate asset rather than a geopolitical hedge. With US real yields at an 18-year high, that is uncomfortable but rational. It does not change my view that official-sector demand sets a floor over time.

EQUITIES

The S&P 500 finished broadly unchanged, but the index hid a great deal. At the end of the month only about a quarter of its members were trading above their 50-day averages, and the median stock stood 16% below its 52-week high. Nvidia and Apple together now account for more than 15% of the index, a record for two stocks. Leadership swung between energy, memory, health care and defensive staples, while financials, utilities and real estate absorbed the rise in yields. EPFR data showed \$21.1 billion leaving US equity funds in the week to 23 September. The VIX spent much of the month around 14, while the MOVE index of bond-market volatility stood at 104. That gap is the clearest mispricing on the board. In my view the market is looking through the rates regime: with the equity risk premium compressed to pre-2008 levels, stocks are priced for long yields that stabilise, and September gave no evidence that they will.

GEOPOLITICS & THE INVESTMENT CYCLE

The World Beyond the Markets

Three developments mattered structurally. The first was President Xi Jinping's summit with President Trump in Washington, the first visit by a Chinese leader to American soil since 2015. It extended the trade truce to 10 January 2027 and produced matching tariff-reduction lists covering about \$30 billion of goods on each side. What it left out matters more: semiconductors and critical minerals were absent, and China made no new commitments on rare earths. Chinese magnet exports to the United States fell 21% in August. The second was the widening of the Gulf war from a single chokepoint to the whole regional bypass system. Abu Dhabi's launch of a \$300 billion "Zero Hormuz" fund, alongside diversion projects by ADNOC and DP World, to build infrastructure that avoids Hormuz tells us the Gulf states now treat the disruption as permanent. The third was the continued erosion of the transatlantic relationship: Chancellor Friedrich Merz's remark that US-European friendship is probably over, escalating US-Canada trade measures, and a Pentagon review led by Pete Hegseth of withdrawing up to a third of US forces from Europe.

Together, these developments are redirecting capital in a consistent direction: towards security of supply, even where it is uneconomic on a narrow cost basis. The US defence procurement ban on Chinese-origin magnets takes effect on 1 January 2027, underpinned by the Pentagon's \$110 per kilogram price floor for NdPr oxide and \$14.8 billion of letters of interest from the Export-Import Bank of the United States. Canada secured around C\$500 billion of investment commitments at its September summit, and Neo Performance Materials began commercial magnet production at Narva in Estonia, Europe's first large-scale plant. Copper made the point in price: it hit a record \$14,875 a tonne on 10 September and finished the month about 9% higher, with the London market in backwardation and mined supply on course for its first annual decline since 2017. Refining, gas infrastructure, nuclear and defence are being structurally reinforced. The low-cost, just-in-time supply chain is quietly being retired.

Three tail risks look underpriced to me. The first is the truce cliff on 10 January, with both chips and minerals still unresolved; the market treats the extension as permanent. The second is the window after the US midterms. President Trump has said he expects a deal with Iran after 3

November, which also means the political constraint on escalation lifts on that date. The third is the proposed US secondary sanctions on Iran's trading partners, which could extend to China and would collide directly with the summit's détente. Any one of these could force a repricing within the next three months.

THE INVESTMENT CYCLE

Where Capital Is Moving — and Why

CAPITAL SPENDING & THE AI BUILD-OUT

No major cloud provider has cut its capital spending guidance, and the physical footprint keeps growing. US data-centre capacity is forecast to rise from about 62 gigawatts to 152 gigawatts by 2030. Industry estimates put 30–50% of the large projects due this year at risk of delay because of power and equipment constraints, and Texas has halted new environmental permits for data centres. The build-out is now large enough to move the national accounts. It widened the US trade deficit through imports of capital goods, lifted Korea's chip exports by more than 250% year on year, and is feeding directly into power prices and copper demand. In Bank of America's September fund manager survey, a record 33% of respondents said companies are over-investing. My own view is that the cycle continues into 2027, because the commitments are contractual. The marginal dollar, however, is increasingly borrowed, and each rise in long yields raises the hurdle it has to clear.

CREDIT & PRIVATE MARKETS

Public credit has not yet confirmed the stress in rates. The US investment-grade spread stood at 79 basis points late in the month and widened only 5 basis points as bond volatility jumped. The pressure is showing at the edges. The lowest-rated high-yield bonds are showing the first signs of strain. EPFR recorded the largest high-yield fund outflow in six months, and European credit funds ended a 23-week run of inflows. The clearest signal came from Oracle. On 24 September it served a force majeure notice on Project Jupiter, the Stargate data-centre campus in Doña Ana County, New Mexico, preserving its right to suspend rent if the facility misses its 2028 start. The campus is being developed by STACK Infrastructure, with Blue Owl Capital holding roughly \$3 billion of equity, and is financed by about \$18 billion of construction loans from a syndicate of around 20 banks. Santander and Jefferies are among the syndicate lenders now reported to be holding more of the debt than planned, and parts of the loan are trading at 89–91 cents on the dollar. Blue Owl says the notice does not change the financial commitments. The market has concluded otherwise: the risk is moving from the tenant to the lenders and the equity. JPMorgan, meanwhile, curbed lending to the AI-focused investment fund Situational Awareness after losses on its AI exposure. That is the mechanism by which a sentiment shock becomes a funding shock, and private credit markets are where I expect it to surface next. With \$7.94 trillion sitting in money-market funds, investors are being paid to wait.

DEAL ACTIVITY & CAPITAL MARKETS

The capital markets are open for scale and closing for leverage. Anthropic is preparing a listing, expected after the midterms, at a valuation that could exceed \$2 trillion, while OpenAI is raising \$30 billion privately at \$1.4 trillion. September also brought large strategic transactions: Paramount's \$110 billion merger with Warner Bros. Discovery, backed by \$24 billion of Gulf sovereign capital; Kimberly-Clark's \$40 billion acquisition of Kenvue; and Skyworks' \$22 billion combination with Qorvo. Nvidia added \$150 billion to its buyback authorisation. At the margin, the picture is different. Oura postponed its \$2.2 billion IPO despite strong demand, Barry Diller's

People Inc. withdrew its \$18 billion take-private bid for MGM Resorts as rates rose, and the Advent–Stripe consortium walked away from PayPal. Buybacks executed by Bank of America's clients are running 34% below last year. Companies with cash are buying; those that need borrowed money are stepping back. That is the behaviour of management teams that believe we are late in the cycle, not early in a new one.

CLOSING THOUGHTS

Where We Stand

September confirmed what we suspected in the summer. The energy shock is inflationary, and central banks are no longer willing to look through it. It complicated the picture in one important way: the long end of the bond market is now moving on its own terms, driven by fiscal supply, AI borrowing and the loss of the Treasury market's safety premium, and no longer simply by the policy rate. We are better placed to make decisions than we were 30 days ago. The ambiguity has gone, and the price of money is telling us plainly that it will stay higher for longer than equity markets are prepared to accept.

What I am watching in October:

1. The September payrolls report on 2 October. Consensus sits at around 84,000 after August's 162,000 surprise. With the odds of an October Fed hike at roughly even, this single release will decide whether the Committee moves again this month or waits for December.
2. Four decisions in four days at the end of October. The Fed meets on 27–28 October, the UK Budget follows on the 28th, the ECB meets on the 29th and the Bank of Japan on the 30th. The Budget matters most to me: with ten-year gilts at 5.40%, it is the test of whether sterling assets are being priced for fiscal risk or for growth.
3. Whether the Gulf bypass routes stay open. Saudi Aramco has guided to full East-West pipeline operations by around the end of October, and bids for the final tranche of the US Strategic Petroleum Reserve close on 6 October. If the pipeline returns to full service, diesel should ease. If Yanbu is hit again, there is no buffer left.
4. Third-quarter results from Microsoft, Alphabet, Amazon and Meta in late October. Their capital spending guidance, and the credit market's reception of the debt that funds it, will show whether the AI cycle can absorb a 5% ten-year yield or whether the financing chain starts to slow the build-out.

I have spent 40 years watching markets, and the months I have learned to respect most are not the dramatic ones. They are the months like this one, when the headline numbers barely move and the ground shifts underneath. I would rather tell you plainly that the ground has moved than reassure you with a flat index. Thank you, as always, for your trust. I will write again in November.

Leonard Watson

Portfolio Manager

Gryphon Investment Advisors Bahamas (GIAB)

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