



THALASSA CAPITAL

Quarterly Investment Letter

Q3 2026

Written on October 1st, 2026

Another eventful three months have passed which have confirmed a more hawkish Federal Reserve Chairman than originally expected, and which have seen bond yields reaching highs not experienced in a couple of decades.

WHAT HAPPENED AND WHY IT MATTERS

The real story of the last few weeks focuses on the rapid rise in yields for US Treasuries and especially for the benchmark 10-year Treasury bond. As of this writing, the yield on the 10-year US Treasury is 5.29% and on the 30-year bond is 5.64. The last time yields on the 30-year bond were at 5.6% it was September 29th, 2002.

KEY DATA POINT

Using the U.S. Treasury's daily par-yield data, comparing **August 28 to September 29, 2026:**

Treasury	Aug. 28	Sep. 29*	Change
2-year	4.34%	~4.81%	+47 bp
5-year	4.48%	~4.98%	+50 bp
10-year	4.73%	~5.25%	+52 bp
30-year	5.22%	~5.60%	+38 bp

There are several explanations on why this acceleration of yields occurred. Of course, inflation expectations continue to defy the Fed's target of 2%, and the credibility of the new Chairman required strong language and hiking action. The unresolved war in Iran and the related closure of the Strait of Hormuz continue to put pressure on energy prices which quickly feed into those untamed inflation expectations. However, on this topic, it is important to note how, given the negative backdrop of two wars (Iran and Ukraine), the energy shock remains somewhat contained. JP Morgan indicates how oil still flows thanks to human ingenuity and greed; boats willing to take the risk to cross the Strait can be rewarded at the tune of \$1.2 million a day...boating anyone? Where stress really shows up in energy is in the crack spread or the difference between the cost of the refined product (like gasoline) and the basic material (like crude).

Another and probably more intractable reason for bond weakness is the ballooning US deficit and the complete lack of interest by either party to tackle the issue. Other analysts point to a "normalization" of rates after the aberration of the last two decades. There is certainly truth to this

notion as yield are high relative to the post 2008 averages but not particularly high relative to longer historical experience. For instance, the average 10-year yield in the 2000s was 4.5% and in the 1990s a striking 7%.

Whether bonds are a bargain or a value trap at this juncture depends on how inflation behaves in the next few months and how fiscal policy will look like after the Midterm elections. Certainly, bonds' attractiveness is increasing by the day and while the turning point may require patience, these yields are providing a good buffer in nominal and real terms. What one should also consider is the asymmetric aspect of the bond trade: a 1% increase in rates on the 10-year Treasury will cause a 1.6% loss on the principal but a 1% decrease in rates will produce a 12.7% upside move in the principal.

EARNINGS SURPRISES OR BUBBLES?

Equities ultimately performed much better than expected year to date and defied all kind of uncertainties and negative factors that tried to derail their ascent. The interesting element is that while some pockets of good old fashion irrational exuberance did arise, stocks were generally a reflection of recurrent earnings surprises. To put things in perspective, the year over year earnings growth in the SP500 in Q3 2025 was 13.5%, in Q4 2025 it dipped to 10.9% and then in Q1 and Q2 2026 it accelerated to respectively 29% and an astonishing 50%!

This growth has been the engine of the recent equity run which makes some valuation metrics look even tame. Of course, the risk is in future expectations and whether investors may be too optimistic in how quickly and how significantly such growth will eventually decelerate.

Earnings momentum is also very much concentrated around the AI story, whose development is more and more difficult to chart having to deal with questions spanning from increasing leverage to doubts about near term profitability, from energy issues to public's pushback... and of course that little thing about AI possibly eliminating the whole of humanity within the next ten years.

The historical cyclicity of earnings and its concentration into the AI sector, call for a diversification of equity exposure and pure hedges against tech exposure. One should note that the top 10 stocks in the SP500 are responsible for 33% of trailing index earnings and represent almost 40% of the index market cap.

EARNING YIELDS VS. BOND YIELDS

Regarding portfolio allocation, one way to look at relative value between bonds and equities is to compare bond yields to earning yields. The classic comparison uses the Bloomberg AGG yield and the one-year forward earnings for the SP500 over its price.

For a long time, bond yields were dramatically below earnings yields indicating poor attractiveness of bonds relative to equities. However, since 2023 the two metrics have been essentially equal.

Furthermore, while earning yield are messy predictors of future equity performance, bond yields are strong indicators of future returns. In other words, high-quality starting yields of over 5% should resolve into similar annualized returns in the medium term (sources: PIMCO and JP Morgan).

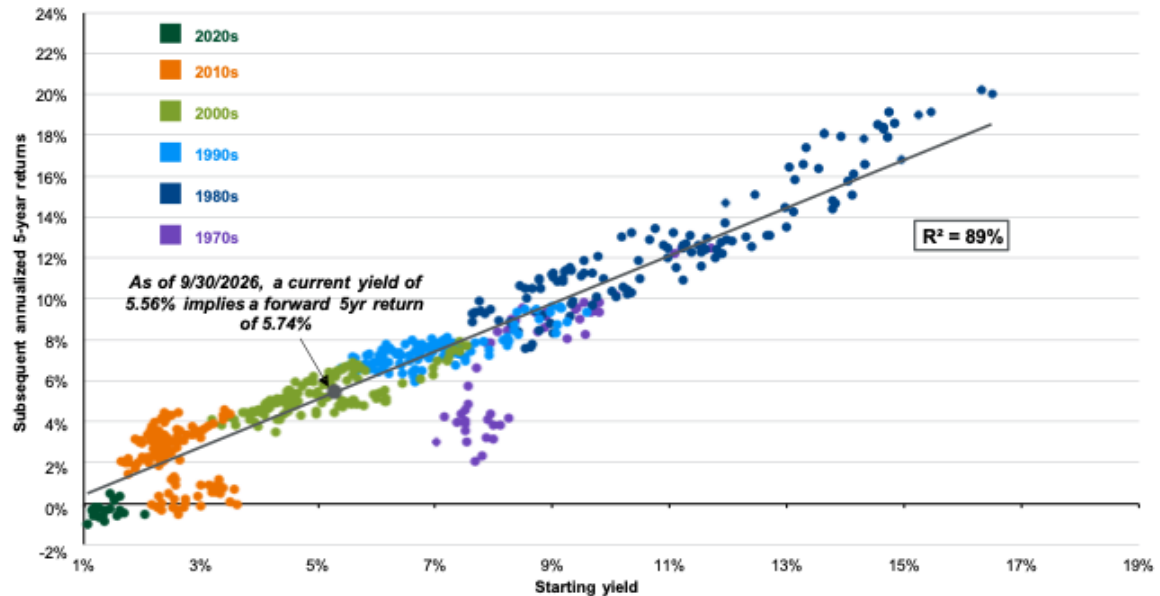


Fixed income yields and forward returns

GTM U.S. 41

Yield to worst and subsequent 5-year annualized returns

Bloomberg U.S. Aggregate Total Return Index



Source: Bloomberg, FactSet, J.P. Morgan Asset Management.
Returns are 60-month annualized total returns, measured monthly, beginning 1/31/1976. R^2 represents the percent of total variation in total returns that can be explained by yields at the start of each period. Past performance is no guarantee of future results.
Guide to the Markets – U.S. Data are as of September 30, 2026.

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ASSET MANAGEMENT

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OUR POSITIONING AND STRATEGY

Our positioning is not significantly changing since our last quarterly letter. We advise retaining a balanced allocation and consider trimming or hedging any tech/AI concentration. Diversification remains the name of the game and while so far fixed income has somewhat disappointed, we increasingly see value in the space. From a decorrelation aspect, we also want to share this chart, courtesy of JP Morgan, showing the returns of the Bloomberg AGG index during years when equities were negative. Over the last century, 21 years out of 25 that equities produced negative returns, bonds were actually positive.



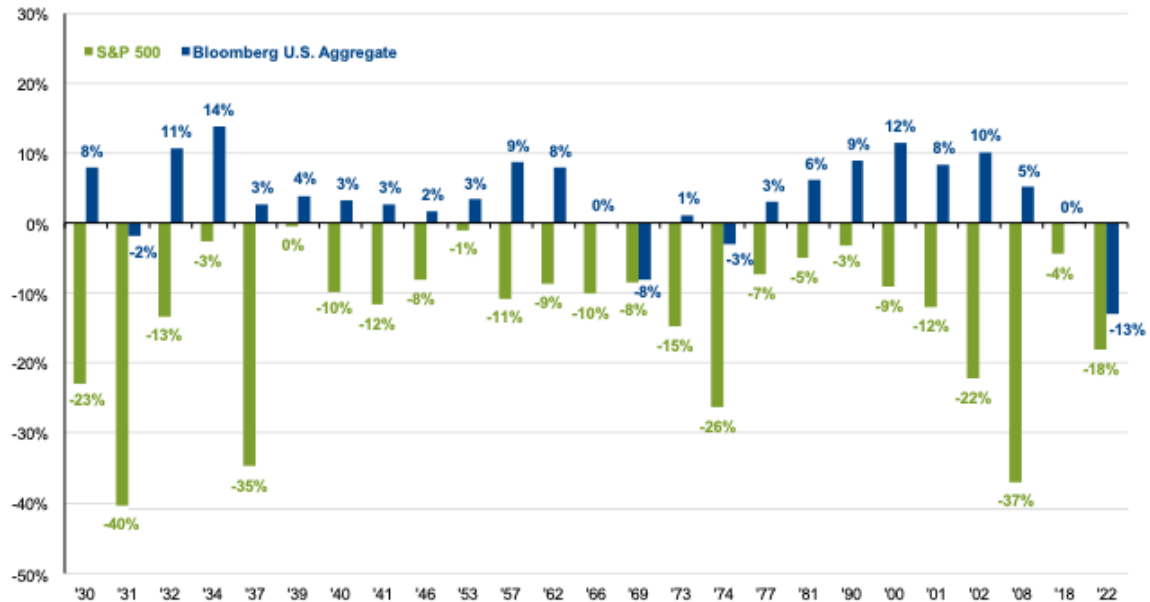
Bond performance in equity down years

GTM U.S. 40

Bond performance when stock returns were negative

Over the last century, bond returns were positive in 21 of the 25 years that stock returns were negative

Fixed Income



Source: FactSet, Strategas, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of September 30, 2026.

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CLOSING THOUGHTS

In conclusion, we remain committed to the investment philosophy that has guided our work from the beginning: patient, disciplined, research-driven capital allocation with an unwavering focus on risk-adjusted returns. We are grateful for your continued trust and partnership.

Respectfully yours,

Davide Accomazzo
Chief Investment Officer

Youri Bujko
Chief Executive Officer

IMPORTANT DISCLOSURES

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