AGENDA ITEM 9

Border to Coast Pensions Partnership Limited

Joint Committee

Date of Meeting: 23 September 2026

Report Title: Q2 2026 Investment Markets Update

Report Sponsor: Joe McDonnell – CIO

1. Executive Summary

1.1. This report provides a brief overview of investment markets, responsible investment and stewardship activity over the quarter. We have also introduced a quarterly "thematic" section to the report, designed to provide deeper insight into an investment issue that is shaping markets, portfolios or long-term investment outcomes for Partner Funds. The intention is both to share evolving thinking on topics that may materially affect Partner Fund portfolios and to provide a framework for Partner Funds to input into our thematic views and research agenda.

1.2. In this instance, Border to Coast is not providing financial advice or making any personal recommendation regarding the suitability of making specific investments. The information supplied is intended to be factual and should not be interpreted as advice tailored to the circumstances of any Partner Fund or individual.

1.3. A separate item on the agenda provides detail on performance of Border to Coast propositions.

2. Recommendation

2.1. That the Committee notes the report.

3. What happened in markets over the quarter?

3.1. Equity returns were strong over the quarter with emerging markets outperforming developed markets, even allowing for the outsized negative return of the Chinese market. *(Appendix 1, Chart 1)*

3.2. Within the US total quarterly return of around 15%, performance was less concentrated in large-cap tech names that has been the case in recent quarters. Illustrating this, the all-market, S&P500 outperformed the so-called "Magnificent Seven" by 3.5% on the quarter.

3.3. While mega-cap stocks took a back seat in terms of performance, investor attention remained firmly focused on the AI theme, with semiconductor stocks delivering strong returns. This sector-driven dynamic was also reflected in pronounced regional dispersion. Chinese equities declined over the quarter, in stark contrast to the semiconductor-heavy Korean market, which generated a total return of more than 80% over the same period.

3.4. Within developed markets, the UK was a significant underperformer, a combination of the large energy weight of the FTSE100 and the decline in oil prices between March and June (with WTI crude around $100 per barrel at the start of quarter falling to $70 by the end).

3.5. Having been the first to begin cutting policy interest rates in 2024, the European Central Bank (ECB) was again ahead of the Federal Reserve and Bank of England and raised rates in June *(Appendix 1, Chart 2)*. ECB policymakers explained this as a response to near-dated inflation concerns that had been particularly elevated earlier in the quarter, prior to the previously mentioned oil price fall.

3.6. The decline in oil prices also meant that inflation expectations in the UK[1] fell over the quarter, although remained slightly elevated compared to 12-months earlier *(Appendix 1, Chart 3)*. In turn, this meant that Gilt yields were also able to retreat from their Q1 highs *(Appendix 1, Chart 3)*.

3.7. Sterling investment grade spreads (the additional yield from lending to a corporate, over a government) were mostly unchanged on the quarter, reflecting the broader stability in risk sentiment encouraged by the decline in energy costs. Relative to its own history, the sterling investment grade market appears fairly valued relative to Gilts *(Appendix 1, Chart 4)*.

4. Looking ahead

4.1. Although oil prices have not returned to their late-Q1 highs, the decline in energy costs that encouraged risk sentiment during the second quarter has not continued into Q3, so far. At the time of writing, WTI crude was increased from $70b to $88b, almost exactly halfway between its pre-Iran war level of $60b and April high of $112b.

4.2. Despite this, there remains little evidence that higher energy costs are feeding through to inflation. In most regions, headline CPI inflation has declined, and core CPI (prices excluding food and energy) has shown no signs of responding to elevated energy costs.

4.3. However, government bond yields that had declined during the second quarter have since increased to multi-decade peaks. At the time of writing, the 10-year benchmark gilt yield was 5.2%, the highest since August 2008 and significantly exceeding the 4.5% peak seen during the Liz Truss/Emergency Budget episode of early-Q4 2022.

4.4. Continuing the trend seen in H1, this increase in nominal yields has not been the result of increasing inflation expectations, but higher real yields as investors grapple with large government deficits in most developed economies at the same time as competition for debt-capital from high levels of bond issuance (largely to fund AI activity).

4.5. While the ongoing risks of energy price volatility and government deficits are being captured in government bond yields, equity markets are being supported by positive

[1] As measured by the UK breakeven inflation curve

earnings growth and forecasts. Crucially, including in the US and Asian tech sectors where high existing valuations require the justification of ongoing strong earnings growth.

4.6. We believe bond yields have now reached a point where further meaningful increases in yields could begin to undermine some of the more optimistic equity valuations in tech and related sectors. We would also be concerned if we were to begin to see evidence of large tech companies suffering margin compression because of over-capacity in the sector.

4.7. However, we believe bond yields, already at multi-decade highs in many developed economies, already adequately capture the deficit and broader funding risk pressures described above. Likewise, we see no sector-wide evidence of tech overcapacity.

5. Quarterly theme – the changing face of passive

5.1. The rationale for passive equity investing has long been straightforward: buy the market, accept average returns, avoid active manager fees and gain broad diversification. The challenge today is that passive investors are now exposed to a far less diversified basket of stocks than in previous decades. Instead, they are increasingly concentrated in a small number of large-cap technology companies, fundamentally altering the risk characteristics of passive investing.

5.2. For most of the post-war period, index investing provided meaningful diversification across industries, economic cycles and investment styles. Market leadership rotated between sectors and companies, allowing passive investors to own a broad cross-section of the real economy. Today, however, index performance is increasingly driven by a small group of companies linked to artificial intelligence, cloud computing, semiconductors and internet advertising. These themes are highly interconnected, creating significant concentration risk *(Appendix 2, Chart 1)*.

5.3. Research suggests that this concentration is not solely a consequence of changes in the real economy. Instead, growing passive fund inflows may themselves be reinforcing the dominance of the largest companies. When passive funds receive inflows, they allocate more capital to the largest index constituents, lowering their cost of capital and potentially strengthening their competitive position. This creates a feedback loop in which size attracts capital, which increases size further.

5.4. The scale of passive investing means this dynamic could now be a significant influence on market structure *(Appendix 2, Chart 2)*. If passive flows affect company growth and market leadership by cheapening the cost of capital to already large (and highly index weighted) companies, then passive investing is no longer simply reflecting the structure of economy; but possibly impacting its structure[2].

5.5. The implications extend beyond sectors into investment styles. Academic research has shown that long-run equity returns are influenced by factor exposures such as size, profitability and valuation. Historically, market-cap indices offered relatively balanced factor exposure. Today, passive investors have a significant tilt towards

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[2] Recent research by Hannah Unterberg argues that the shift from active to passive investing has created persistent demand effects that influence prices and help explain weaker active manager performance.

large-cap growth and momentum factors. What appears to be a neutral equity allocation is increasingly an active bet on the continued dominance and strong earnings growth of a small number of technology companies *(Appendix 2, Chart 3)*.

5.6. This does not mean these companies are unattractive investments. Many generate substantial earnings and may justify their valuations. The central issue is not whether individual mega-cap technology firms are good investments, but whether their dominance in portfolios is fully considered.

5.7. Concentration itself is not necessarily a problem. Equity market wealth creation has always been concentrated among a relatively small number of successful companies. However, investors should recognise that passive investing has evolved.

5.8. For long-term investors such as LGPS funds, index investing undoubtedly has a place within a comprehensive equity portfolio that is diversified across geographies, sectors and styles. Index strategies can also provide cost-effective, liquid and flexible market exposure, serving as useful tools for long, and short term, allocations. The key point is not that passive investing should be avoided, but that its increasing prominence has introduced new risks. As with any investment, understanding precisely what exposures are being purchased is essential.

6. Risks

6.1. Effectiveness of Oversight: There is a risk that the Joint Committee does not receive sufficient information, context and insight to effectively oversee Border to Coast's investment activities and understand the implications of market developments for Partner Fund outcomes. The existing oversight framework is currently being reviewed and developed through work being undertaken by the Joint Committee Oversight Working Group and the Officer Operations Group. This report forms part of the current framework and provides market context, emerging themes and forward-looking analysis to support informed discussion and challenge while the future approach to oversight is being developed.

6.2. Risk of Narrow Perspectives: There is a risk that investment oversight and strategic discussions become reliant on a limited range of viewpoints, resulting in insufficient challenge to prevailing assumptions and a reduced ability to identify emerging risks, opportunities or changes in market structure. This risk is mitigated through Border to Coast's engagement with a broad range of external stakeholders, including investment managers, advisers, research providers and market participants. The Pool also draws on a wide range of external research and market intelligence when developing its investment views and thematic analysis, helping to ensure that discussions are informed by diverse perspectives and evidence from across the investment industry.

6.3. Risk of Insufficient Market Context: There is a risk that proposition performance and investment outcomes are considered without sufficient understanding of the wider market environment in which they are delivered, potentially leading to incomplete conclusions regarding performance, risk and long-term outcomes.

7. Author

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4 September 2026

8. Supporting Documentation

Appendix 1: Key explanatory charts for Q2 2026

Appendix 2: Quarterly thematic charts

Appendix 3: Market performance Q2 2026

Important Information