

---

## Market Review

February 2026 will go down in history as the month when artificial intelligence abruptly repriced the global software sector, exposing vulnerabilities in the rapidly expanding private credit market in the process. The S&P North American Expanded Technology Software Index, which includes behemoths the likes of Microsoft, Palantir, Oracle and Salesforce, had just endured a mid-teens drawdown in January, its second-worst month on record, as concerns about potential displacement had weighed on the group for several months. However, things were about to get worse. On February 3<sup>rd</sup>, roughly US\$285 billion in market capitalisation was wiped out from software, financial data and professional services stocks across three continents in a single trading session. The pressure intensified on the 5<sup>th</sup>, after Anthropic introduced Claude Opus 4.6, its new flagship large language model (LLM) capable of coordinating “agent teams”, that is, multiple specialised AI agents collaborating on complex projects. Over the subsequent days, the buzzword “vibecoding” began circulating across Wall Street. The term describes a development paradigm in which engineers, or even non-technical users, can describe a desired piece of software conversationally to an AI system and receive a functioning application as output. Rather than manually writing thousands of lines of code, developers can iteratively refine prompts until the AI produces the desired functionality.

If AI models can generate production-level applications with minimal manual intervention, the barriers to entry that historically protected SaaS companies may collapse rapidly. In such an environment, the economic logic underpinning subscription software, where businesses pay recurring fees for standardised tools, may weaken as companies increasingly generate customised software internally using AI systems. Within a week, losses had swelled to around US\$1 trillion, according to Bloomberg, as investors began questioning the long-term viability of the traditional “Software as a Service” (SaaS) model. At the same time, US\$17.7 billion of American technology loans slipped into troubled territory, pushing the sector’s total distressed debt to US\$46.9 billion, estimates from Bloomberg Intelligence show. The shock deepened less than two weeks later with the launch of Claude Sonnet 4.6, which incorporates a capability the company describes as “human-level computer use”. The model can interpret and operate graphical interfaces directly, enabling it to navigate dashboards, menus and enterprise tools much like a human employee. The release of Claude Code Security on the 20<sup>th</sup> hammered the Nasdaq CTA Cybersecurity Net TR Index and was followed four days later by the launch of Claude Cowork Enterprise, which enables so-called “Deep Connectors” to link with Google Drive, Gmail, Docusign and FactSet.

The contagion from the “SaaSocalypse”, as dubbed by Jefferies, spread to alternative asset managers, with the Red Rocks Global Listed Private Equity Index tumbling to its lowest level since Liberation Day amid risks related to credit exposure. Barclays estimates that Business Development Companies (“BDCs”) hold roughly 20% of their portfolios in SaaS companies. If AI were about to disrupt their business model, the loans underpinning those companies were suddenly at risk. UBS analysts warned that private-credit default rates could rise as high as 13% in an extreme-case scenario. Investment firms with significant exposure to technology lending found themselves under heightened scrutiny, with Blue Owl Capital seizing the spotlight. The company, one of the largest direct lenders globally with more than US\$300 billion in AUM, had built a substantial franchise providing credit to middle-market companies through both institutional and retail-focused funds. One of the latter, the Blue Owl Capital Corporation II (OBDC II), had received redemption requests from investors that exceeded its quarterly 5% liquidity limits. As a result, on February 19<sup>th</sup> Blue Owl permanently restricted withdrawals in accordance with the fund’s governing terms,

a mechanism commonly known as “gating”. While such provisions are standard in the industry, enforcing them during a turbulent period for the asset class made apparent the inherent mismatch in private credit funds, which promise periodic liquidity against a backdrop of illiquid underlying holdings.

Simultaneously, Blue Owl disclosed it had sold approximately US\$1.4 Billion of loans from three of its credit funds at close to par, including roughly US\$600 million from its gated BDC, equivalent to 30% of its portfolio. The company declared that it was accelerating rather than slowing the overall return of capital to investors, distributing “six times as much capital [...] to all shareholders over the next 45 days”. However, the optics of the sale stoked unease, particularly after it emerged that one of the institutional buyers involved in the transaction was an affiliated insurance vehicle. Moreover, analysts pointed to the shares of several publicly traded BDCs sinking below 80 cents on the dollar of reported assets. Compounding the situation, Saba Capital Management, led by activist investor Boaz Weinstein, and Cox Capital Partners announced tender offers for various Blue Owl BDC shares at a 20% to 35% discount to the most recent estimated net asset value and dividend reinvestment price. The proposal drew fresh attention to the assessments and transparency of private credit portfolios. Eventually, markets began to stabilise after Anthropic emphasized that its technology was intended to augment rather than replace existing enterprise software, helping to temper panic selling. Nonetheless, structural risks persist with defaults in US private credit climbing to 5.8% over the 12 months through January, according to Fitch Ratings.

### **International Equities**

US equities ended February mixed after experiencing choppy trading. The S&P 500 made little directional progress as declines were repeatedly absorbed while rallies struggled to gain traction, leaving the index down a modest -0.87% in USD terms for the month. The Nasdaq 100 (-2.32%) was dragged lower by the “Magnificent Seven”. Despite delivering blockbuster earnings results, the group recorded its third worst month ever in terms of relative performance vis-à-vis the rest of US large caps. The Dow Jones Industrial broke to new all-time highs at the beginning of February but failed to sustain its momentum. By month-end, the index had added +0.17%, marking its tenth consecutive monthly advance, a streak last achieved in early 2018. The Russell 2000 (+0.71%), the popular benchmark for smaller companies, exhibited continued strength, outperforming the Russell 1000.

OpenAI remained dominant in the headlines in February after it successfully completed a US\$110 billion funding round, one of the largest private capital raises on record, valuing the ChatGPT creator at roughly US\$840 billion post-money. Major investors included Amazon (US\$50 billion), Nvidia (US\$30 billion) and Softbank through its Vision Fund (US\$30 billion). Despite this vote of confidence in the sector, public markets continued to be roiled by the “Anything by AI” trade, as investors piled into the physical infrastructure of the economy, assets that cannot be easily replaced or downloaded (“atoms”), and fled from the “algorithms” (“electrons”) that run on them. Popularised by Ritholtz Wealth Management, the so-called “HALO” renaissance, short for “Heavy Assets, Low Obsolescence”, prioritises tangible sectors such as industrials, infrastructure and raw materials, things that “you can’t prompt your way out of”. As a result, a combination of cyclicals and defensives led gains, with breadth expanding as 67% of the S&P 500 outperformed the benchmark. Utilities topped the list, followed by energy, materials, consumer staples, industrials and real estate, each posting returns above +5%. However, given their light weight in the index, their

contribution only partially offset the drawdown in the heavy sectors, that is, technology and communication services.

US equities trailed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) by the widest margin since May 2009 in February. Sentiment was boosted by the Supreme Court's decision on February 20<sup>th</sup> to strike down the broad tariff regime introduced by Trump. The ruling invalidated the trade measures imposed since April 2025, citing the President's lack of authority under the IEEPA. However, policy uncertainty stayed elevated as the administration signalled its intention to pivot to alternative measures (Section 122) following the formal expiry of the original levies on the 24<sup>th</sup>, while downplaying the likelihood of refunds. Japan was the best performing region, buoyed by a landslide victory for the Liberal Democratic Party (LDP) in the House of Representatives which reinforced expectations for political stability and pro-growth policies. Emerging markets came second as semiconductor and memory-related stocks remained well bid in South Korea and Taiwan. China fell sharply despite MSCI Global Standard Indexes increasing the number of Chinese companies by 21 following a review, the largest such inclusion since May 2023. All in all, the MSCI AC World Daily TR Index was up +1.29% in USD terms but down -0.76% in AUD terms.

### **Australian Equities**

Australian equities rose in February, with the MSCI Australia Net TR Index beating the MSCI AC World Daily TR Index for the third month in a row and by the most since the Russian invasion of Ukraine. The half year 2026 reporting season concluded on a positive note, with the domestic benchmark posting an average EPS growth beat of +12%, as companies largely issued positive guidance for the full year 2026. However, it was accompanied by extreme dispersion, with over a third of index constituents moving more than  $\pm 10\%$  during the month. In the end, the S&P/ASX 300 jumped +3.89% on the back of the outsized gains posted by banks, materials, consumer staples and utilities. The "Big Four" accounted for an estimated half of the index's advance for the month, with CBA heading the pack. Within miners, diversified giants BHP and Rio Tinto continued to attract robust inflows. At the other end of the spectrum, healthcare suffered double-digit losses following CSL's disappointing results. Technology fell for the seventh consecutive month as Xero's AI strategy fell short of alleviating upheaval fears. Finally, the Top 20 trounced mid-caps and smaller companies as domestic and global growth concerns, amplified by geopolitical tensions, pushed the latter into negative territory.

### **International Fixed Income**

The three major global central banks that met during the month held interest rates steady. On February 5<sup>th</sup>, the Bank of England (BOE) maintained its official bank rate at 3.75%. The decision passed by a narrow 5-4 majority, with Governor Bailey casting, once again, the deciding vote. Despite the pause, the tone was distinctly dovish, with the statement noting that the "Bank Rate is likely to be reduced further". On the same day, the European Central Bank (ECB) delivered a unanimous decision that was neither dovish nor hawkish as it opted to keep its policy interest rate unchanged at 2%, a 3-year low. Policymakers did not appear in a rush to ease further, with the economy described as "resilient," unemployment "low" and balance sheets "solid" while inflation was characterised as being "in a good place." On February 18<sup>th</sup>, the Reserve Bank of New Zealand (RBNZ) held its Official Cash Rate (OCR) at 2.25%, in line with expectations, but provided a dovish surprise by indicating that its stance "is likely to remain accommodative for some time". Yields were generally lower across the world, particularly at the long end, as tensions related to Iran and widening credit

---

spreads fuelled demand for government bonds. All in all, the Bloomberg Barclays Global Aggregate Index hedged back to AUD rose +1.39% for the month.

### **Australian Fixed Income**

On February 3<sup>rd</sup>, the RBA raised the cash rate to 3.85%, its first hike since November 2023. The move stands out in a global context where most major central banks have paused (in Europe) or are leaning toward easing (in US and several emerging Asian economies). The accompanying statement was clearly hawkish, suggesting that the RBA may not yet finished with tightening. It highlighted that inflationary forces have picked up “materially” and, while some of these were described as temporary, policymakers acknowledged that private demand is growing faster than expected and labour market conditions remain tight. Consistent with this assessment, the central bank revised its inflation forecasts higher, reflecting more persistent price dynamics, and now expects inflation to remain above target for longer, even under assumptions of further policy tightening. Its decision to become the first monetary authority in the world to raise interest rates this year was vindicated on February 19<sup>th</sup>, as the domestic jobless rate held at 4.1%, below economists’ expectations of 4.2%, while employment increased by 17,800, driven entirely by full-time jobs. The Bloomberg AusBond Composite 0+ Yr Index rose +0.88% as the yield curve bull-flattened, with the 2-, 5- and 10- year yields falling 2, 11 and 16 basis points to 4.19%, 4.31% and 4.65% respectively. The Australian Dollar strengthened across the board, ending the month above 70 cents vis-à-vis the greenback for the first time since January 2023.

### **Real Assets**

Global property rallied +7.37% in USD terms and +5.20% in AUD terms for the month. Asia led the way, with Japanese REITs catching a bid on the back of potentially stimulative government policies, improving office sector fundamentals and a strong earnings season. Conversely, Australia lagged for the second consecutive month, ending February in negative territory. At the sector level, data centres delivered double-digit gains after heavyweight Equinix raised its 2026 outlook.

A defensive rotation into income-generating real assets boosted global infrastructure, with the group gaining +7.73% in USD terms and +5.55% in AUD terms in February. Energy infrastructure and utilities were notable performers, while transportation stocks delivered mixed results, with rail outperforming the general index and toll roads trailing.

### **Alternatives**

Alternatives (+2.34%) posted their best month since March 2022 and by the end of February were on track for their strongest start to a year since 2012. Trend following and discretionary macro mandates continued to shine, capitalising on the broad-based bull run in commodities.

---

## Market Outlook

When Trump unveiled his “reciprocal tariffs” last year on Liberation Day, markets tanked, as his actions were interpreted as a potential “regime change” in the geopolitical order that had underpinned global trade and capital flows for the past 50 years. During that period, the US consistently ran trade deficits, importing from the Rest of the World (RoW) more than it exported, while the RoW “recycled” its accumulated greenbacks into physical and financial American assets. The logic behind the selloff was that a sustained policy push to bring manufacturing back to the US shores would have caused, over time, a reversal of these flows and brought an end to the era of “American exceptionalism”. However, Trump promptly “TACOed”, triggering one of the most furious six-month rallies in the history of US equities, completely blindsiding investors who have reduced their exposure. In other words, those who believed in a break from the “status quo”, and took action to position their portfolios, accordingly, got badly burned. Fast forward to today, a war designed to produce a “regime change” in the balance of power of the Middle East is raging on. Whereas the motives of the various belligerents are disputed, it seems fair to state that the current conflict is aimed at systematically weakening Iran’s influence, degrading its ability to project power across the region, and, in turn, diminishing its longstanding role as a geopolitical “kingmaker” in the Gulf and the Levant. This time, though, markets have remained comparatively resilient, with volatility relatively contained. Investors appear to have been conditioned by the recent experience and internalised the “escalate to de-escalate” playbook adopted by Trump on multiple occasions. With the spectre of a “TACO” reversal looming large, market psychology seems more concerned with the risk of missing a relief rally than of being trapped in a prolonged downturn. As a result, rising geopolitical uncertainty has not triggered a more pronounced risk-off response. Admittedly, Trump appears to have been looking for an “off-ramp” recently, repeatedly characterising the conflict as “very complete, pretty much” and asserting that the US had effectively prevailed. However, as an astute commentator put it, “it takes two to TACO”, or perhaps even three. Market assumptions may rest on a fragile foundation, as they implicitly presume that the US retains control over the trajectory of the conflict and can engineer a timely resolution before any systemic damage occurs. However, the situation may be more complex, with key actors pursuing fundamentally different objectives.

The US is primarily focused on achieving strategic deterrence while minimising the economic fallout. Its objectives are macroeconomic as much as geopolitical, requiring a policy calibrated to ensure that global oil supply remains adequate, thereby preserving growth and avoiding a shock that could reignite inflation or trigger a recession. This is critical given the domestic political considerations and the sensitivity of both consumers and financial markets to energy costs. Iran, by contrast, operates under a different set of constraints. Its primary objective is regime survival, which it seeks to secure by increasing the economic and strategic cost of conflict for its adversaries. Lacking the capacity to prevail in a conventional military confrontation, the country’s approach is inherently asymmetric. It leverages its geographic and strategic position, most notably its influence over the Strait of Hormuz, to create “controlled” disruption in global energy markets, that is, sufficient to exert pressure, but not so severe as to undermine its own oil revenues or alienate key trading partners. Israel’s focus is to neutralise Iran as an existential threat. Unlike the US, it is less constrained by global macroeconomic considerations and more willing to tolerate escalation, and economic pain, if in doing so it advances its long-term security objectives. Against this backdrop, the price of oil remains the dominant variable. At current levels, that is, around US\$100 per barrel at the time of writing of this note (March 19<sup>th</sup>), prices are up roughly +40% since the first strike. While elevated, they remain manageable. They feed into inflation and act as a modest drag on growth, but they do not fundamentally alter the economic trajectory, at least not yet. Policymakers appear acutely aware of this risk and are taking steps to contain it. Two key developments have helped keep oil prices orderly since March 9<sup>th</sup>, the first day, in our view,

when markets began to liquidate more broadly, with investors shifting from "rotation" to outright "de-risking". First, the easing of sanctions on Russian oil has allowed additional supply to reach the market, arguably a temporary measure, but nonetheless one that has meaningfully increased available barrels despite the ongoing conflict in Ukraine. Second, Iranian oil and gas continues to flow to global buyers, including China and India. As a result, authorities appear to be tolerating a degree of enforcement leakage, effectively prioritising price stability over strict adherence to sanctions. These actions suggest a coordinated effort to prevent an uncontrolled and destabilising surge in oil prices.

Against this backdrop, we frame our outlook for 2026 in terms of three scenarios. The first, and still our (and the market's) base case, is one in which the conflict remains contained and short-lived, with oil prices stabilising at current levels or moderately higher. In this scenario, the global economy experiences a delayed but ultimately intact reacceleration. Growth may shift from the first quarter to the second quarter of 2026, but the underlying drivers remain in place. Early signs of improvement in Europe, particularly in Germany and France, support this view, suggesting that momentum was already building prior to the recent escalation. On this basis, our positioning has continued to favour a more cyclical tilt, with an emphasis on markets outside the US, including emerging markets, and an allocation to global small cap equities. These markets are more leveraged to a synchronized expansion and benefit from the weaker US Dollar that typically accompanies it. However, the situation becomes significantly more challenging if prices rise materially from here. A sustained move toward US\$150-200 per barrel or higher would result in an inflation shock, eroding real incomes, materially increasing the probability of a global recession and ultimately translating into lower asset prices. The distinction between regions or sectors would become less relevant as correlations rise and liquidity conditions tighten sharply. The third scenario is one of "divergence", in which the global economy avoids a recession but exhibits increasing regional differentiation. In this environment, higher energy prices weigh on growth globally, but the inflation response varies. Outside the US, where inflation pressures are currently more subdued, the impact of higher oil prices is primarily disinflationary in real terms, that is, it reduces purchasing power and slows growth. In contrast, the US may face a more complex dynamic. Stronger underlying demand, fiscal support and relative energy independence could allow growth to remain resilient, even as inflation begins to reaccelerate. This creates a more challenging environment for monetary policy. While central banks in other regions may be able to look through energy-driven inflation and prioritise growth, the FED may find its ability to ease policy constrained. Not surprisingly, expectations for rate cuts have already been scaled back, and additional policy easing may not be forthcoming. In any case, we do not foresee the repeat of 2022, when central banks rushed to hike rates to combat rapidly rising prices, crashing fixed income markets. Today's conditions are vastly different, with the clear and present danger centred on recession rather than inflation. As bond yields behave, the sharp earnings downgrades and multiple de-rating observed in equities should be avoided.

Shifting gears, the current environment presents a more challenging outlook for traditional "quality" investment styles. These strategies have historically favoured companies with high returns on equity, low capital intensity and stable earnings profiles, characteristics well suited to a low-growth, low-rate backdrop where capital efficiency and margin stability were highly valued. However, the rise of AI has introduced a structural tension. Companies built on asset-light models and minimal reinvestment may now face disruption risks that require increased investment to remain competitive. In other words, maintaining their market position may necessitate higher capex, increased spending on technology and lower returns on capital, effectively eroding the very characteristics that define them as "quality." This creates a conundrum for both companies and investors. Firms that fail to invest risk obsolescence, while those that do invest may see their financial profiles deteriorate in the near term. For portfolio managers, this raises questions about whether traditional quality screens remain appropriate

in a period of technological disruption. Recent underperformance among quality-focused strategies reflects both valuation compression and shifting market dynamics, suggesting a structural headwind. As a result, we are increasingly inclined to rebalance exposure away from pure quality strategies toward value-oriented approaches, particularly those with a global and emerging market bias. Value strategies, by construction, are more exposed to sectors that benefit from reflation, capital investment and tangible asset bases, all of which are consistent with our macro and market outlook. Emerging markets are particularly notable in this regard. They offer a differentiated form of exposure to AI, not through end-user applications, which dominate US markets, but through the underlying infrastructure. Economies such as South Korea and Taiwan play a central role in the global semiconductor supply chain, producing critical components such as memory and advanced chips. In this sense, emerging markets provide access to the “picks and shovels” of the AI ecosystem, often at more compelling valuations, while simultaneously offering broader exposure to traditional value sectors, including financials, materials and industrials. This combination of cyclical leverage, structural growth and relative valuation support underpins our constructive view on the asset class.

*AZ Sestante is a specialist investment consultant focused on designing and managing a range of multi-manager model portfolios via SMAs, MDAs, and fund of funds. Our parent company Azimut is Italy's largest independent asset manager listed on the Italian stock exchange.  
E: [invest@azsestante.com](mailto:invest@azsestante.com) | [www.azsestante.com](http://www.azsestante.com)*

**Important information**

*The Morningstar Historical Corporate Sustainability Score is a weighted average of the trailing 12 months of Morningstar Portfolio Corporate Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, more-recent portfolios are weighted more heavily than older portfolios. Combining the trailing 12 months of portfolio scores adds consistency while still reflecting portfolio managers' current decisions by weighting the most recent portfolio scores more heavily.*

*ESG pillar scores are displayed as a number between 0 and 100 with most scores range between 0 and 25. It is the asset-weighted average of the company environmental, social, governance risk scores for the covered corporate holdings in a portfolio. The scores measure the degree to which a company's economic value may be at risk driven by environmental, social, and governance factors. The risk represents the unmanaged risk exposure after taking into account a company's management of such risks.*

*This document has been prepared by AZ Sestante Limited, ABN 94 106 888 662, AFSL 284 442 (AZ Sestante). This document is not an offer of securities or financial products, nor is it financial product advice. As this document has been prepared without taking account of any investors' particular objectives, financial situation or needs, you should consider its appropriateness having regard to your objectives, financial situation and needs before taking any action. Past performance is not a reliable indicator of future results. Although specific information has been prepared from sources believed to be reliable, we offer no guarantees as to its accuracy or completeness. The information stated, opinions expressed, and estimates given constitute best judgement at the time of publication and are subject to change without notice. Consequently, although this document is provided in good faith, it is not intended to create any legal liability on the part of any other entity and does not vary the terms of a relevant disclosure statement. All dollars are Australian unless otherwise specified.*