OCTOBER 2026

MIRABAUD



MONTHLY NEWSLETTER
MIRABAUD WEALTH MANAGEMENT



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INTERNATIONAL

WINTER OF DISCONTENT

In the spring of 1978, Californian homeowners ran out of patience. Years of inflation had pushed up the assessed value of their houses, and their property taxes with it, until some retirees could no longer afford homes they had owned for decades.

On 6th June, almost two voters in three approved Proposition 13, which capped property taxes at 1% of assessed value and rolled assessments back to their 1976 levels. It was the start of a taxpayer revolt across the country.

Five months later, Americans voted in a midterm election with consumer prices rising by more than 8% a year and the Federal Reserve having raised its policy rate by two and a half percentage points since January.

On the surface, the result looked mild: Jimmy Carter's Democrats lost about fifteen House seats and three in the Senate and kept large majorities in both. But the wind was already turning: voters in about a dozen states, from Michigan to Texas, approved limits on taxes or public spending.

The discontent was not American alone. Across the major economies, a decade of inflation had been eroding wages and patience, and the oil shock of 1979 would make it worse.

In Britain, a government trying to hold pay rises to 5% with inflation near 10% faced a winter of strikes, with rubbish piled high in Leicester Square and gravediggers walking out in Liverpool. On the day of the general election in May 1979, a tabloid borrowed a line from Richard III to name the season that had just ended: the Winter of Discontent.

Margaret Thatcher won that election, and in November 1980 the same discontent cost the Democrats both the White House and the Senate. Widespread anger over the cost of living is among the oldest forces in democratic politics, and it tends to erupt at the ballot box.

Forty-eight years later, the backdrop looks familiar. An inflationary blizzard is again sweeping across the major economies: euro area prices are rising at their fastest pace in three years, and the European Central Bank and the Bank of Japan both raised rates in September.

The discontent had already reached the streets: in mid-October, hundreds of thousands protested over the cost of living in France, in some of the most violent demonstrations in years, and the unrest spread to the cities of northern Italy.

In the United States, the storm has now met the voters. On 3 November, Americans voted with inflation rising, the Federal Reserve raising rates, and only one voter in five approving of the President's handling of the cost of living. The ice cracked as the polls had suggested: the Democrats won control of both the House and the Senate.

Before the vote, the most common question was who would win. By the time of publication it has been answered, and the answer does not change the message of this letter. The more relevant questions remain: whether the result matters for markets, and what the season after the vote has in store.

The Prevailing Wind

The first part of the answer is that the outcome is rarely a surprise. Since the Civil War, the President's party has gained seats in the House at only four midterm elections: 1902, 1934, 1998 and 2002. The Italian economist Alberto Alesina, writing with Howard Rosenthal in 1989, explained why: this is not simply protest, but design. Americans elect a president from one of two polarised parties and then, halfway through his term, deliberately use Congress to pull his policies back towards the centre. The midterm is a counterweight built into the machine; discontent only decides how much pressure it applies.

If the check is built in, it should come as no surprise, and this year it did not. Before the vote, the President's approval rating had fallen to about a third in several polls, the lowest of his second term, and betting markets gave the Democrats about a 90% chance of winning the House and roughly two chances in three of taking the Senate. Voters did what Alesina described: they reined in a second-term president, taking both chambers from his party, as they did in 2006.

Once delivered, the check has rarely left investors out in the cold. Since 1950, the S&P 500 has gained about 16% on average in the year after a midterm, whichever way Congress went, with only small differences between outcomes: when the opposition held both chambers, as it now does, when Congress was split, and when the President's party kept control. Across only nineteen elections, differences this small mean little.

Gathering Clouds

If the result matters less than it seems, the calendar matters more. Midterm years have a bad reputation, and it is partly deserved. Returns have been weaker on average, but not reliably so. What is reliable is turbulence: at some point in a midterm year, the S&P 500 has fallen 16% from its peak on average, against 11% in other years.

«... THE WINTER OF THE VOTE HAS PASSED; HOW GLORIOUS THE SUMMER PROVES WILL DEPEND ON THE CLIMATE BENEATH IT.»

This year, the clouds were slow to gather. Even during the March oil shock, the S&P 500 never fell more than 10%. Then the wind rose. Technology shares ended October about 9% below their peak, hit at the end of the month by doubts about the payoff from AI spending. Even so, the S&P 500 finished the month of October up about 11% for the year. The usual pre-election clouds gathered, if late.

Clearing Skies

History suggested the tension would not outlast the vote by much: in eight of the last nine midterms, market volatility fell in the week after the vote. This time the storm abated on the first day, with the S&P 500 up 1.6% on 4 November.

Then the season turns. Since 1950, the S&P 500 has risen in the year after every midterm, nineteen times out of nineteen, gaining 16.5% on average: more than twice the 6.8% of other years over the same months. If most calendar patterns in finance fail scrutiny, this one endures. It has held whichever party won, and regardless of how far the market had fallen beforehand.

Why the rally happens is less certain than that it does. Alesina's theory explains why the result matters little: the check is expected. William Nordhaus offered a reason for the strength that follows: the year after a midterm is the run-up to the next presidential election, when incumbents have every incentive to keep the economy buoyant. The evidence is mixed, but one detail matters for 2026: when the President could not run again, the rally has been smaller on average.

A second detail concerns the vote itself. When the ruling party lost full control of Washington D.C., as it has this year, the rally started more slowly, but it had caught up within a year. When the winds of discontent have blown hardest at the ballot box, they have delayed the blossoming, although they have not cancelled the summer.

Nineteen out of nineteen is a pattern, not a law. It describes what has happened, not what must; clear skies after a storm are a habit of the season, not a promise of the forecast.

The Climate Beneath

While the weather of the vote clears, the climate beneath it persists. This year has been shaped by a long chain of events, from geopolitics to prices, from prices to rates and from rates to valuations, and none of these links has been unshackled by the ballot, even if oil prices fell sharply on the day after the vote.

Today's climate was set by the oil shock of the spring. Geopolitical tension has averaged its highest in four decades this year, and it has filtered into markets through energy. Inflation has climbed from below 3% in December to nearly 4%. Rising inflation has weighed on midterm years before, though rarely on the year after the vote. But the closest precedent is sobering. In 1978, with prices rising by more than 8%, the rally after the vote was among the weakest on record.

Rates have followed. The Federal Reserve resumed hiking in September, and bond markets have gone further. Yet inflation has risen faster than the Fed's rate, which in real terms is now barely above zero: the mark of a central bank behind the curve, as in 1974 and 2022, two of the weakest midterm years, although both were followed by a rally. Further out, inflation-adjusted bond yields reached their highest since 2008 in early October.

Equities have so far weathered the storm, because profits have done the work. Earnings are growing by about 30% a year, so shares look reasonably priced on the profits expected ahead, even if they are expensive on those already earned. But margins are near record levels, part of the growth comes from the very oil shock that feeds voters' discontent, and analysts expect it to slow sharply by mid-2027, as the first six months after the vote come to an end. With shares offering only a slim premium over inflation-protected government bonds, the ice is thin.

None of this has prevented a post-midterm rally before: in years of rising inflation, rich valuations or geopolitical tension, the year after the vote was still positive every time. When rates were rising sharply, however, the first six months delivered little more than half the usual gain.

The Long-Range Forecast

Our long-range forecast therefore comes in two parts. For the weather, the outlook is fair: the vote of 3 November produced exactly the counterweight Alesina described, and markets have rarely been hurt by it. For the climate, it is more mixed: the forces that will shape 2027 lie in inflation, rates and valuations rather than in the ballot box, and we would expect the first months after the vote to deliver less than their historical average.

We would not sell US equities because of the election, nor buy them because of the calendar. We remain constructive on US equities, but selective, with a preference for quality companies with visible earnings growth and exposure to structural investment trends. The election on its own does not justify a change in allocation. The climate, however, calls for some caution: higher energy prices and tighter financial conditions have made the risk-reward in high yield less attractive, so we have cut our high-yield exposure by half and moved the proceeds into sovereign bonds, which should offer better protection if growth cools or sentiment sours.

Richard III is usually quoted as if it announced a looming winter. In fact, it announces the end of one: "Now is the winter of our discontent / Made glorious summer by this sun of York." Nineteen times out of nineteen since 1950, the months after a midterm have been such a summer for equities. In 1978, when the discontent was about prices, the summer came but stayed pale, and this year's discontent is of the same kind, if not of the same degree. The winter of the vote has passed; how glorious the summer proves will depend on the climate beneath it.

PERFORMANCE OF THE MAIN FINANCIAL INDICES SINCE 2022:

	Oct.	Oct. $	2026	2026 $	2025	2025 $	2024	2024 $	2023	2023 $	2022	2022 $
S&P 500	-0.87		11.75		17.86		25.00		26.26		-18.13	
Stoxx 50	-2.06	-3.67	8.71	3.30	22.14	38.51	11.90	4.67	23.22	27.28	-8.55	-13.97
MSCI EM	-8.04		13.76		34.33		8.00		10.12		-19.87	
SMI	7.09	8.49	15.07	10.45	18.04	35.03	7.54	-0.29	7.06	17.61	-14.29	-14.99
Euro - USD	-1.50		-4.99		13.44		-6.21		3.12		-5.85	
US Dollar Index	0.42		3.62		-9.37		7.06		-2.11		8.21	
Gold Spot - USD	-6.80		-10.30		64.58		27.22		13.10		-0.28	
CHF - USD	1.30		-3.92		14.47		-7.27		9.87		-1.32	
Brent	13.63		93.33		-18.48		-3.12		-10.32		10.45	
Bitcoin	-7.41		-11.67		-6.47		120.46		157.01		-64.30	
Global Agg.	1.41		-1.30		8.17		-1.69		5.72		-16.25	
US Agg.	2.44		-0.54		7.30		1.25		5.53		-13.01	
US Treasury	2.36		-0.47		6.32		0.58		4.05		-12.46	
US T Bills	0.37		3.08		4.30		5.29		5.12		1.30	
Global HY	-0.21		-0.36		12.06		9.19		14.04		-12.71	
Euro Agg.	0.96	-0.56	-1.58		1.25		2.63	-2.71	7.19	10.99	-17.18	-22.02



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BRAZIL

"THE PROBLEM WITH SOCIALISM IS THAT YOU EVENTUALLY RUN OUT OF OTHER PEOPLE'S MONEY." (Margaret Thatcher)

In the December 2024 Mirabaud Monthly Newsletter, we used this same quote by Mrs. Thatcher as an epigraph to draw attention to the fact that expansionary fiscal policies sooner or later die of sheer exhaustion and leave no long-term legacy in the economy other than debt and inflation.

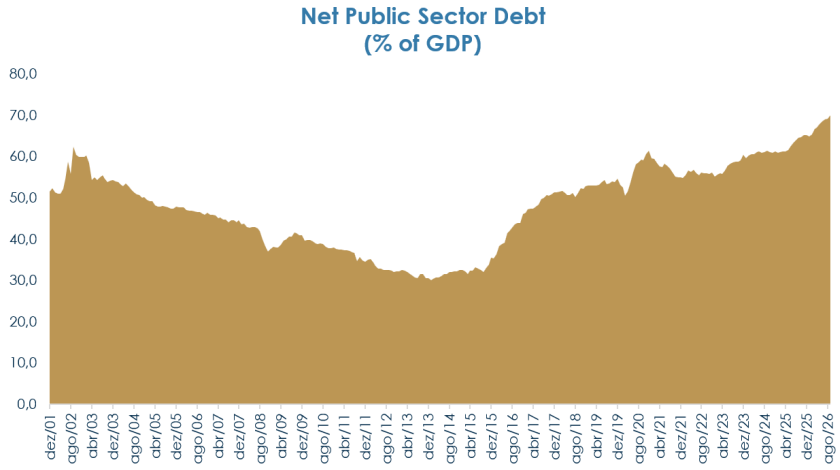
In the December 2024 Newsletter, we wrote:

"A common denominator underlies all these experiences of state-induced growth (including that of the United Kingdom): expansionary fiscal policies inevitably collapse once they encounter the financial limits to the growth of public debt, that is, when a country runs out of its own money and is forced to resort to other people's money (also known as the 'capital market'), whose availability, sooner or later, also runs out."

Those interested can find the Mirabaud Monthly Letters on the website www.mirabaud.com.br

But what does Mrs. Thatcher's quote, the Iron Lady, explain about Brazil today, on the eve of the start of the new (old) government?

As we warned in the April 2026 Monthly Newsletter, Brazil's public debt has been growing at an excessively rapid (and dangerous) pace since the beginning of President Lula's current term. As shown in the chart below, net debt-to-GDP recently reached an all-time high of 70% of GDP, an increase of more than 13 percentage points since the start of the administration, surpassing even the levels recorded during the Covid-19 pandemic.

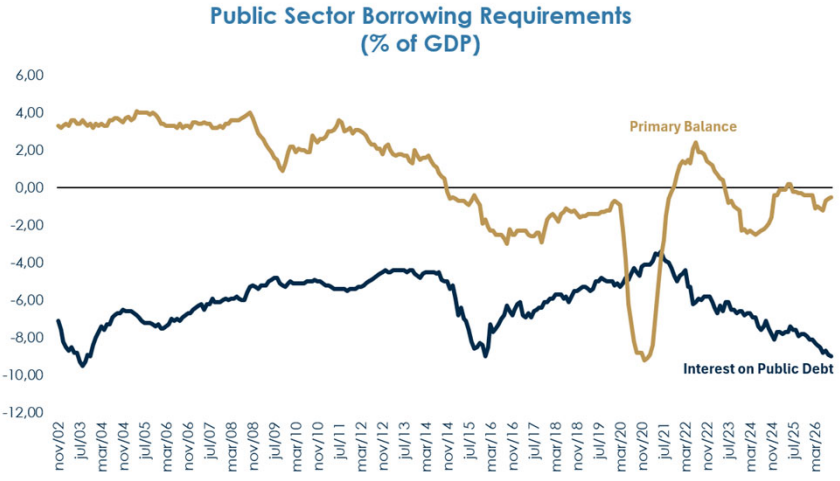


Source: Bloomberg

The risk of insolvency caused by the rapid increase in public indebtedness has not gone unnoticed by the market, which demanded a higher interest-rate premium from the government and led the National Treasury to cancel and reschedule several government bond auctions since June of this year in order to avoid debt rollover problems.

In other words, in the eyes of the market, which is no longer willing to imprudently finance this government's fiscal profligacy, other people's money has run out.

However, as shown below in the chart on Public Sector Financing Requirements, most of the spending that adds to public indebtedness is due to interest expenses on debt rollover, rather than primary expenditure, which remains under control under the burden of the tax increases imposed by this administration.



Source: Bloomberg

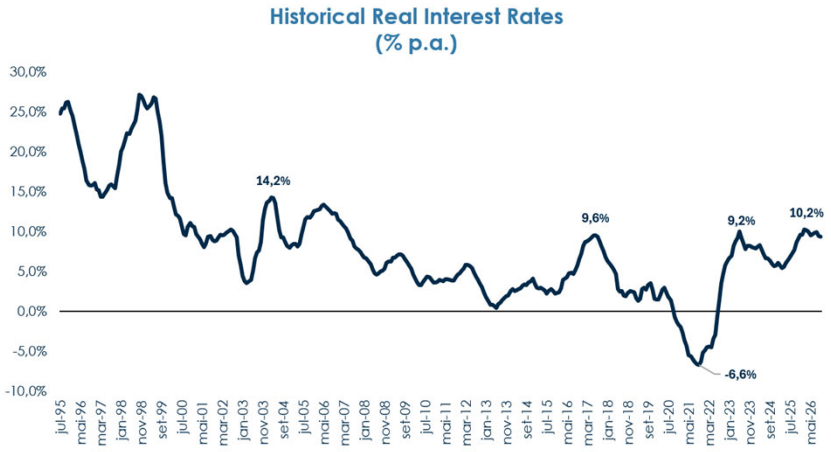
« IN SHORT, IN BRAZIL'S CURRENT BIZARRE MACROECONOMIC EQUILIBRIUM, THE GOVERNMENT IS THE ONE SPENDING TOO MUCH, BUT THE PRIVATE SECTOR IS THE ONE PAYING THE BILL, SUFFERING FROM THE HUGE REAL INTEREST RATES IMPOSED BY THE CENTRAL BANK TO KEEP INFLATION FROM EXCEEDING ITS TARGET.»

A quick glance at the chart might lead the unwary to conclude that all it takes is to cut interest rates for debt to stop growing, right? After all, there is always a simple — and wrong — solution to a complex problem.

The truth is that interest rates are extremely high precisely because of the inflationary impact of excessive government spending.

In its profligate and interventionist zeal, a government pursuing fiscal expansion tends to put pressure on aggregate demand, creating inflationary pressure which, in the absence of higher interest rates, tends to spread and contaminate the entire economy.

Under an inflation-targeting regime, such as Brazil's, the Central Bank is responsible for calibrating the economy's benchmark interest rate to prevent the second-round effects of fiscal excesses on prices from materializing. And that is what the BCB has done, bringing real interest rates (calculated in the chart as the Selic rate deflated by the IPCA over rolling 12-month periods) to around 10% per year, a level extremely harmful to economic activity.



Source: Bloomberg

In short, in Brazil's current bizarre macroeconomic equilibrium, the government is the one spending too much, but the private sector is the one paying the bill, suffering from the huge real interest rates imposed by the Central Bank to keep inflation from exceeding its target.

Consequences of simple — and wrong — solutions to complex problems

As we have seen so far, high interest rates have a very clear reason: excessive government spending which, even when financed by higher tax burdens, shifts the price equilibrium toward accelerating inflation.

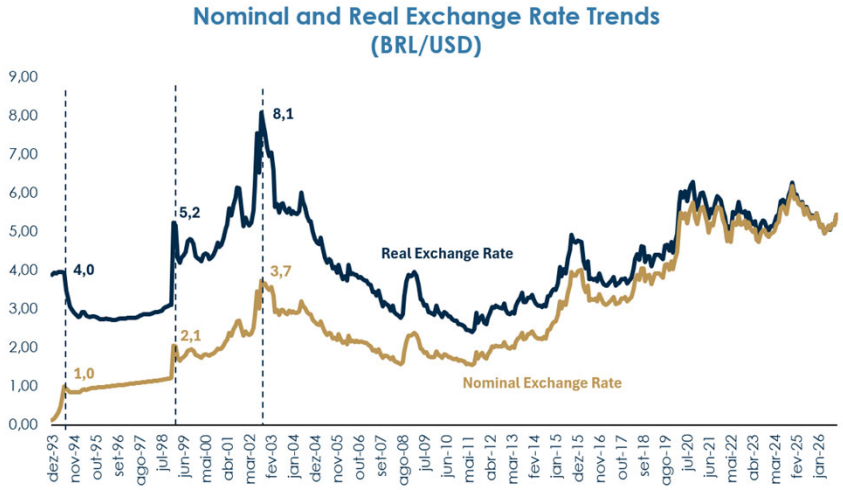
However, one of the most important side effects of high interest rates is currency appreciation, since high rates attract short-term capital seeking investment returns. When this capital enters the country, it drives down the dollar's exchange rate against the real.

In other words, we can say without any risk of being wrong that any measure resulting in lower domestic interest rates must necessarily lead directly to a less appreciated exchange rate.

But the question that really matters is: how much less appreciated?

To answer this question, let us turn to a chart we use fairly often. It shows the exchange rate in reais per US dollar, both in nominal terms (the value observed in day-to-day transactions) and in real terms (the nominal value adjusted over time for the inflation differential between Brazil and the United States).

Adjusting the nominal exchange rate by the cumulative inflation differential between Brazil and the United States allows us to make a fair comparison between two values observed at different points in time. Inflation is an insidious phenomenon that distorts the nominal prices of all goods and services over time, including, and especially, the exchange rate between two countries.



Source: Bloomberg

A quick first visual inspection of the chart already yields some interesting insights:

The value of 1 real per dollar at the beginning of the Real Plan, adjusted for inflation to today's prices, would be equivalent to 4 reais per dollar. This provides a more accurate measure of how overvalued the real was at an exchange rate of 5 reais per dollar, since that rate would imply only a 25% real depreciation from 1994 to today (for comparison, the equivalent nominal depreciation would be 400%, but inflation has eroded that difference).

Similarly, the rate of 2.1 reais per dollar at the time of the 1999 maxi-devaluation would correspond to 5.2 reais per dollar today, while the rate of 3.7 reais per dollar during the crisis surrounding Lula's first election in 2002 would correspond to 8.1 reais per dollar today.

In an optimistic scenario, if the government presents a credible fiscal consolidation program and reduction in public spending, we expect the exchange rate to depreciate to the range of 6.0–6.5 reais per dollar, as a result of the subsequent decline in interest rates. Even in this scenario, we believe 2027 GDP growth would be considerably lower than in recent years, falling below 0.5% in real terms.

Alternatively, if the government remains on its irresponsible path of maintaining current spending levels, we expect the exchange rate to depreciate to around 7.0 reais per dollar, with the risk of reaching as high as 8.0 reais per dollar if there is an arbitrary measure forcing the Selic rate down.

In this alternative scenario, GDP would not slow down and could post real growth above 1%, but the gains from the expansion in economic activity would quickly be wiped out by higher inflation, which could reach an IPCA rate of 6% or more if the Selic rate were forcibly reduced.

Economists, analysts, and market participants unanimously state that the government's room for populist policies has reached a dead end. We hope the new government has the good sense to see what is already so clear.

PERFORMANCE OF THE MAIN FINANCIAL INDICES:

Renda Fixa		30/10/26	MTD	3M	YTD
CDI	-	109,76	1,07%	3,28%	11,70%
IMA-B	-	11.919,93	(1,03%)	3,70%	8,98%
IMA-B 5	-	11.912,74	0,53%	3,86%	11,96%
IMA-B 5+	-	12.921,19	(1,98%)	3,62%	6,70%
IRF-M	-	23.254,78	(1,52%)	1,58%	7,63%
IMA-S	-	9.090,59	1,03%	3,24%	11,77%

Índices Globais	País	30/10/26	MTD	3M	YTD
Ibovespa	BRL	167.921,80	(9,88%)	(5,66%)	4,22%
Dow Jones	USD	51.770,31	1,70%	(1,36%)	7,71%
S&P 500	USD	7.580,07	(0,93%)	1,21%	10,73%
NASDAQ	USD	28.384,85	(6,65%)	0,39%	12,42%
Euro Stoxx 50	EUR	6.131,31	(2,20%)	(3,57%)	5,87%
FTSE 100	GBP	10.729,78	1,17%	(1,27%)	8,04%
MSCI Emerging	EM	61,04	(8,61%)	(4,76%)	12,15%
MSCI World	World	4.862,38	(0,82%)	0,30%	9,75%

Moedas	País	30/10/26	MTD	3M	YTD
Real/Dólar	USD	5,44	(5,08%)	(7,19%)	0,68%
Euro	EUR	1,12	(1,50%)	(3,18%)	(4,99%)
Franco Suíço	CHF	0,83	1,30%	(2,12%)	(3,92%)
Libra Esterlina	GBP	1,34	0,95%	(0,68%)	(0,62%)
Bitcoin	BTC	76.782,20	(8,18%)	22,07%	(12,40%)

Hedge Funds	País	30/10/26	MTD	3M	YTD
Ind. de Hedge Funds	BRL	6.447,61	(1,61%)	2,17%	5,31%

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