Iso-mts Q3 2026 Letter:

Markets rarely stand still - they move from one obsession to the next. Before AI, the obsession was crypto. When we were preparing to launch ~4 years ago, many calls ended with something like this: "Thanks for the update, but what are you doing with crypto…"

In late 2021, Iso was preparing to launch, and we were lucky enough to meet several potential day-1 investors. Most hadn't thought about investing in long-short bank credit, and they often would try to weave in a discussion about crypto – they viewed banks as exposed to the imminent threat of de-dollarization and disintermediation. There was talk of Bitcoin ETFs, Elon Musk was accepting Bitcoin as payment for his cars, and premier sports athletes wanted to be paid in crypto. At the height of crypto mania, some proponents argued that crypto would eventually challenge (or even replace) the US dollar and banks would become dramatically less important. Fast forward to today, banks are thriving and Iso doesn't get any questions about crypto. The crypto chase has been replaced by AI and AI-related assets. And this chase is much more dangerous. Banks live at the center of it, but investors don't seem to be concerned. I am concerned.

How did we get here? Unfortunately it has been a sequence of mistakes. In our opinion, this is largely due to a "recency bias" created by 15 years of near zero rates and nearly zero inflation which ended with a rate hiking cycle in 2022. Everyone then spent time mistakenly worrying that high policy rates would lead to a recession. While there may have been some reasonable rationale to cut rates as part of policy risk management, we did not see it or believe it (and we wrote about that - which you can find on our website). Unfortunately for all of us, this exacerbated the impact of the following sequence of events:
(1) the arrival of AI – necessary for the chase – you've got to have a revolutionary economic event for a potential bubble this size, and AI gave it to us, (2) the confusion about where the neutral rate was in 2023-2025 led to what we believe were policy mistakes by the Fed, (3) multiple supply shocks from the Iran war, trade war, and AI infrastructure rush, moving the neutral rate up as the Fed was cutting, (4) tax cuts from OBBB, and finally (5) a generational ramp up in global defense spending.

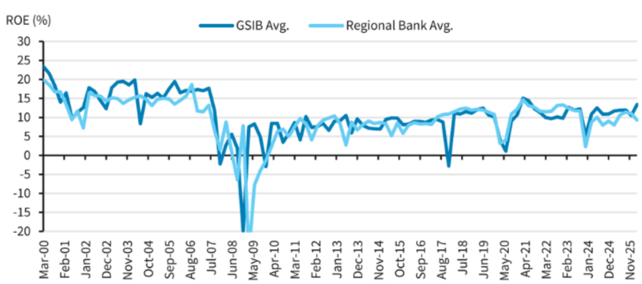
So what now? We believe we are left with two likely scenarios A) the Fed doesn't hike, inflation expectations soar and our government debt becomes unsustainable due to interest expense, or B) the Fed raises rates and pricks the bubble and we get a massive de-rating in asset prices. In a way, it's been finally made easy…we believe there is only one outcome you need to position for - lower prices, wider spreads, and potentially lots of damage done.

We focus on banks – they live at the center of all of this…they lend to AI builders, finance market speculation, etc, etc…in effect ballooning their balance sheets at a time of enormous market/economic excess. If their credit risk were priced appropriately, we would have more winners and losers to pick from (securities more than banks) – but almost nothing is priced appropriately.

Our views for Q3 –

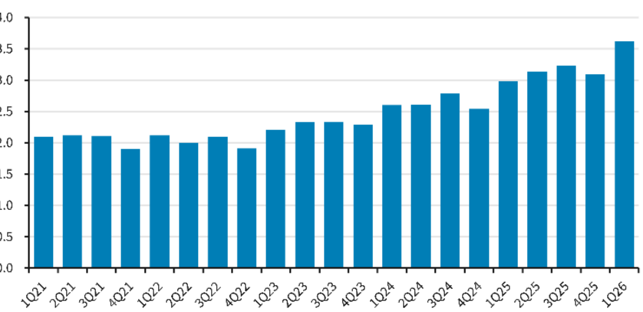
Bank fundamentals – leverage on bank balance sheets is increasing significantly. Return on Equity is growing quickly and reaching the highest levels since 2007. Bank loan growth is accelerating at the fastest pace in years and banks are running large securities portfolios following easing regulatory rules. Basel III endgame has been watered down and global regulators are all looking for ways to allow banks to help fund politicians' deficit spending. This has led to easing of balance sheet leverage restrictions. At the beginning of this year, the amount of capital banks were required to hold against their assets was reduced by ~25% (eSLR) or approximately $200bn in aggregate. Yes – that is what's going on. **The Fed, ECB, BoE and BOJ are all trying to feed the same monster.** They would like to move the securities they accumulated over 15 years off their balance sheet and onto the banks' balance sheets and are willing to adjust regulation to accommodate this. However, when banks reduce capital and ramp balance sheet exposure, at the all-time most expensive price of credit, it probably precedes pain. So far during this earnings period every large cap bank we cover has beaten expectations on EPS and revenues by roughly 15%, and pre-provisions net revenue due to fees and NII. The fees reflect the capital markets bubble and net interest income reflects the explosion in loan growth and securities purchases. Here are some charts to illustrate what we are looking at…

Average ROE for US GSIBs and large US reg banks



Barclays research, July 2026

Large Cap Banks – Trading Assets ($tr)



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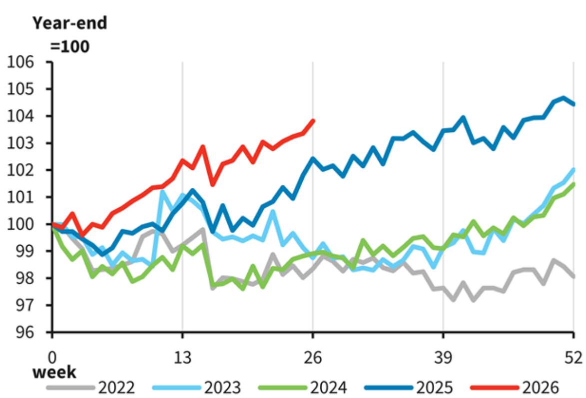
Large Banks – Asset and Deposit Growth, Indexed



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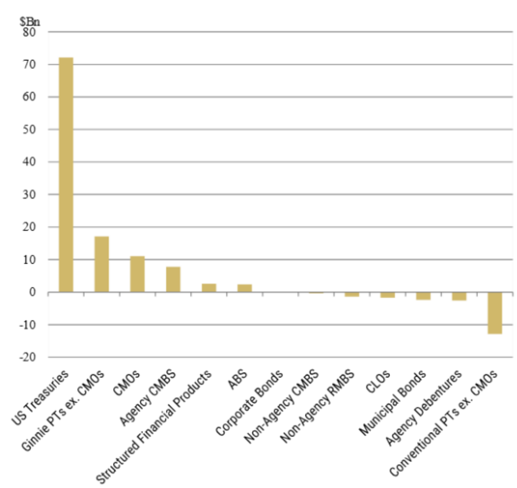
US Bank Q/Q change in Securities Holdings



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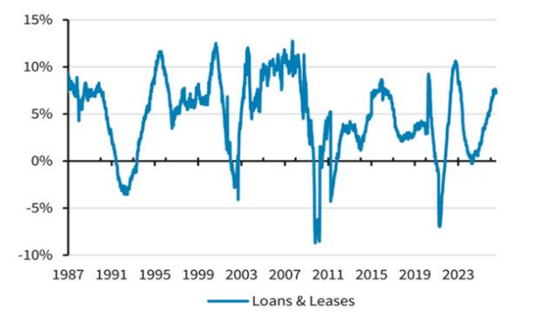
US Bank Loan Growth rolling Y/Y



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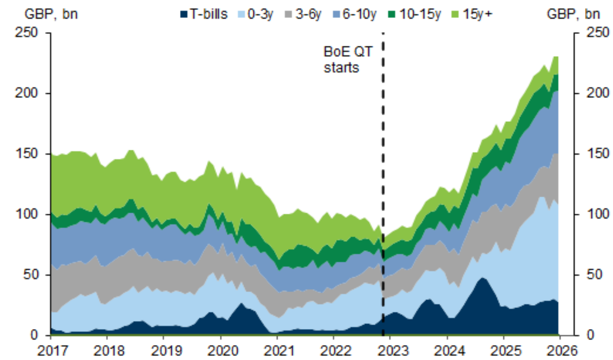
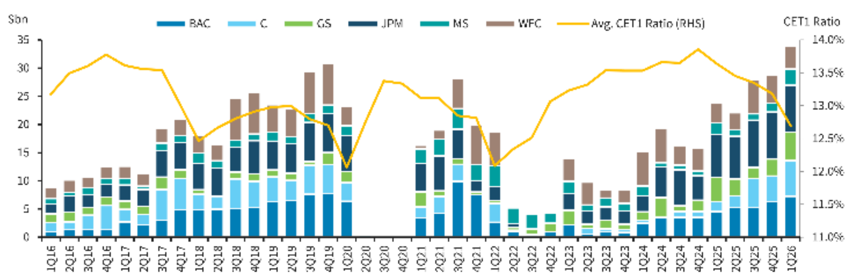
UK bank Gilt holdings increasing



Barclays research, June 2026

Big 6 US Banks Share Buybacks and Common Equity Tier 1



Barclays research, July 2026

Where does this leave us today….?

The explosive growth in bank balance sheets driven by deregulation is feeding a massive funding wave from the banks. Gross investment grade bank USD debt issuance reached a record in H1, up 15% to $178bn.[(1)] This is driven by the adjustment to the supplementary leverage ratio mentioned earlier. **Banks are issuing debt, and then buying bonds and lending, at historically tight spreads.** Perhaps more notably, net IG bank supply has also reached a record of $80bn in H1, up 100% from the $40bn issued in H1 2025.[(1)] **In summary, banks are now using their ability to fund at or near the all-time tightest levels to add significantly to their debt load, supporting a ramp up in lending, trading assets, share-buybacks and reduced capital ratios.**

This supply creates abundant opportunities for long-short positioning in the future, but currently both outright and relative value remain very poor as dispersion across credit quality and capital structure is historically low. Nonetheless recent supply-driven widening in certain credits and parts of the curve have provided an opportunity to monetize some shorts. **We believe core shorts should continue to be focused on securities with strong liquidity but poor valuation, or securities benefiting from significant negative convexity,**

(1) Source: Issuance data from Barclays research, July 2026.

especially in AT1. We have highlighted in recent letters and commentary how compressed AT1 subordination spreads have become and that extension risk is disregarded. We like using current prices to highlight the convexity relative value currently available in perpetual Tier 1. For most of these callable securities, spread to call and spread to worst are currently the same data point. For many securities issued prior to the past couple of years that is ok, because the underlying reset structure offers enough value to perpetuity that it reduces extension risk and limits downside price risk. But, for more recently issued securities, underlying reset spreads do not offer enough protection - any move wider in spreads is not protected by the reset spread. In simpler terms, we estimate that if generic Yankee bank issued AT1 securities widen to a +325bp spread to worst (roughly 50bp higher than the average new issue spread this year) the dollar price on securities issued since 2024 would move ~7pts lower, while securities issued prior to that time would only move 3.25pts lower. Similarly, for US Bank issued AT1 securities, if spreads were to move wider to a generic spread of +287.5 (roughly 50bp higher than the average new issue spread this year) the $price of securities issued since 2024 would drop roughly 7.2pts, whereas older vintage securities would only drop 1.9pts.

Why we prefer longs to be older vintage and shorts to be more recently issued…

Poor convexity and poor relative value in recent AT1 issues relative to older vintages		
	Seasoned Issuance **Issued prior to 2024**	**Recently Issued** **Issued 2024-on**
Generic Yankee Bank AT1 +50bp widening	- 3.25 pts	- 6.9pts
Generic US-based Bank AT1 +50bp widening	- 1.9 pts	- 7.2 pts

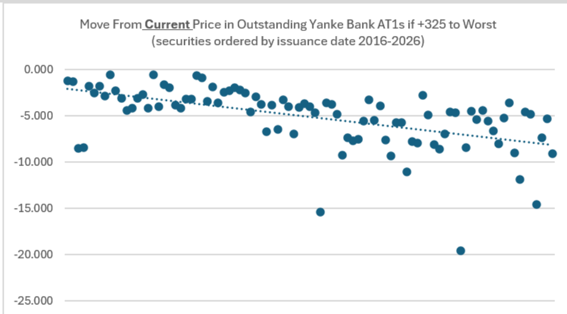
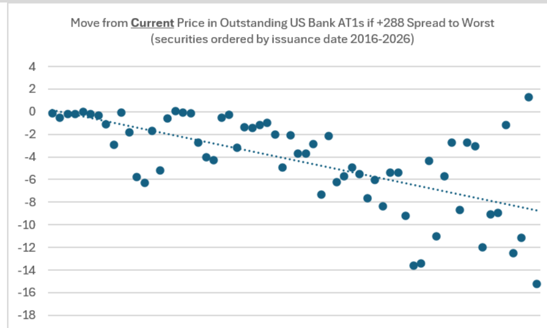
Source: Bloomberg, ISO-mts, July 2026.

Here is how horrible the convexity truly is - if AT1 spreads for Yankee Banks and US Banks tighten 100 bps on a spread-to-worst basis (to roughly +175bp spread for Yankee Banks and +137.5bp for US Banks), we calculate just 1.7pts of price appreciation for the Yankee banks, and 0.9pts for the US Banks respectively. These, of course, are just generic data points, and security selection remains crucial, but it is a good reflection of where we think opportunities exist within the current environment and how we are positioned in this part of the capital structure.

100bp of tightening barely moves prices irrespective of issuance vintage	
Generic Yankee Bank AT1 -100bp tightening	+1.7 pts
Generic US-based Bank AT1 -100bp tightening	+0.9 pts

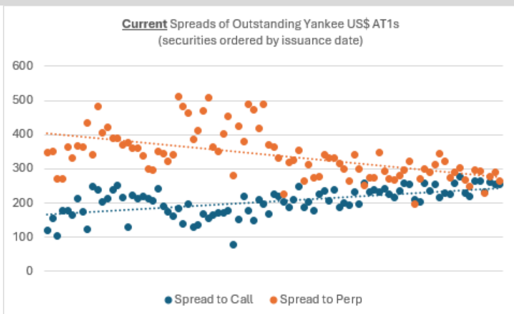
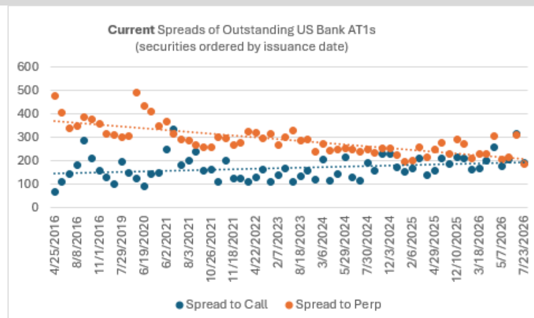
Source: Bloomberg, ISO-mts, July 2026.

More recently issued securities are at risk of a significantly greater price decline if spreads widen

Yankee Banks	US Banks
	

Source: Bloomberg, ISO-mts, July 2026. *Source: Bloomberg, ISO-mts, July 2026.*

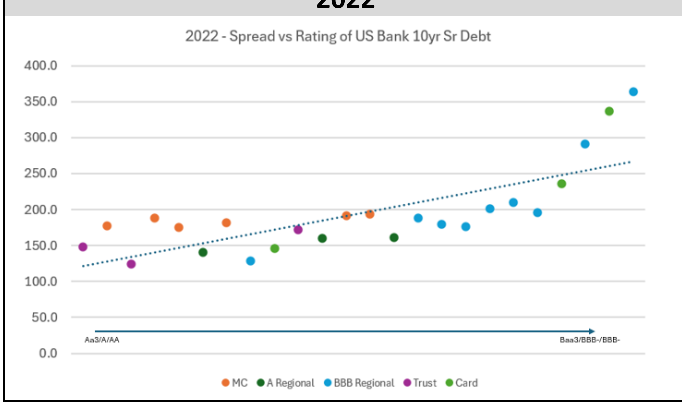
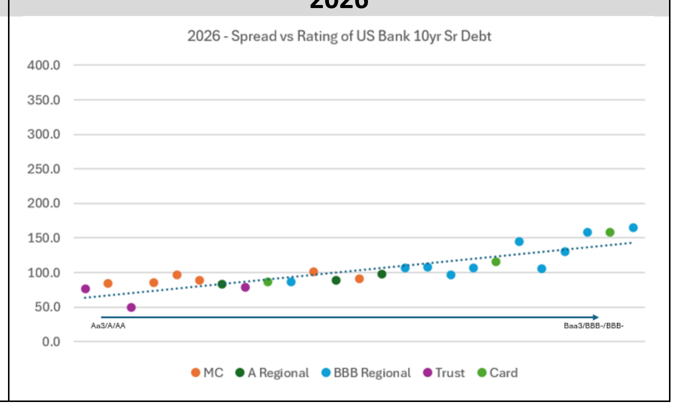
Older vintage securities with higher reset spreads offer better downside protection

Yankee Banks	US Banks
	

Source: Bloomberg, ISO-mts, July 2026. *Source: Bloomberg, ISO-mts, July 2026.*

We respect the fact that extreme market pricing has sustained itself for a long time and could continue. There is a select group of credits and securities that we believe offer moderately attractive long opportunities, while also maintaining strong liquidity. As a result, it is possible to maintain a short cs01 position with roughly flat carry. Opportunities for relative value do still exist, and while they are currently few and far between given the compression across credits and capital structure, it is key to remain laser focused on monitoring and reassessing these opportunities. We believe that net short positioning continues to be the best opportunity overall.

Compression across credit – Spread vs. Rating of 10yr Senior Debt for US banks

2022	2026
	

Source: Bloomberg, ISO-mts, July 2026. *Source: Bloomberg, ISO-mts, July 2026.*

Banks are one of the many IG sub-sectors at the tights since 2010

- Only 6 of the 55 IG sectors/sub-sectors below are not at the tights

Sector	Metrics							Spread change				Total return			
	Index weight	Mkt val ($bn)	OAS	Percentile rank (2010-today)	YTW	Dur	Rating	1-week	MTD	QTD	YTD	1-week	MTD	QTD	YTD
Basic Industry	2%	179.6	78		5.4	7.3	BAA1/BAA2	0	-2	-2	-12	0.0	-0.5	-0.5	0.9
Chemicals	1%	80.8	83		5.4	7.6	BAA1/BAA2	-1	-3	-3	-15	0.1	-0.5	-0.5	1.3
Metals & Mining	1%	72.7	70		5.3	7.6	A3/BAA1	1	-1	-1	-7	0.0	-0.6	-0.6	0.5
Paper	0%	26.1	86		5.3	6.0	BAA2/BAA3	0	-2	-2	-10	0.1	-0.3	-0.3	0.6
Capital Goods	5%	412.1	58		5.1	6.7	A3/BAA1	1	3	3	-8	-0.1	-0.6	-0.6	0.4
Aerospace & Defense	2%	151.1	65		5.3	8.1	BAA1/BAA2	2	2	2	-9	-0.2	-0.9	-0.9	0.3
Building Materials	1%	40.2	74		5.2	6.6	BAA1/BAA2	0	2	2	-2	0.0	-0.6	-0.6	0.3
Diversified Manufacturing	2%	117.5	58		5.1	6.4	A3/BAA1	1	3	3	-6	0.0	-0.6	-0.6	0.4
Construction Machinery	1%	57.7	36		4.7	4.6	A1/A2	1	7	7	-11	0.0	-0.3	-0.3	0.5
Packaging	0%	14.3	67		5.0	4.4	BAA2/BAA3	0	0	0	-14	0.1	-0.1	-0.1	0.9
Environmental	0%	31.3	45		4.9	5.9	A3/A3	2	4	4	-9	0.0	-0.4	-0.4	0.2
Communications	8%	579.0	107		5.7	8.4	A3/BAA1	1	7	7	13	-0.3	-1.5	-1.5	-1.4
Cable & Satellite	2%	126.4	160		6.3	8.9	BAA1/BAA2	2	9	9	22	-0.6	-2.0	-2.0	-2.0
Media & Entertainment	2%	134.0	91		5.6	8.4	A1/A2	-1	8	8	8	-0.2	-1.5	-1.5	-2.7
Wireless	2%	131.1	84		5.4	7.1	BAA1/BAA2	2	6	6	4	-0.1	-0.9	-0.9	-0.1
Wirelines	2%	187.4	98		5.7	9.0	BAA1/BAA2	1	6	6	10	-0.3	-1.5	-1.5	-1.0
Consumer Cyclical	7%	560.9	70		5.2	6.3	A2/A3	1	5	5	-2	0.0	-0.6	-0.6	0.1
Automotive	2%	169.1	82		5.2	4.3	A3/BAA1	1	3	3	-8	0.1	-0.2	-0.2	1.0
Leisure	0%	4.7	98		5.4	6.3	BAA2/BAA2	2	8	8	-4	-0.2	-0.8	-0.8	0.0
Gaming	0%	22.7	107		5.4	4.7	BAA2/BAA3	2	3	3	-4	0.0	-0.3	-0.3	0.8
Home Construction	0%	9.7	79		5.2	5.0	BAA1/BAA2	1	1	1	-5	0.0	-0.3	-0.3	0.6
Lodging	0%	19.6	67		5.0	4.8	BAA2/BAA3	1	3	3	-9	0.0	-0.2	-0.2	0.6
Retailers	4%	274.3	59		5.2	7.7	A1/A2	0	11	11	12	-0.1	-1.1	-1.1	-0.6
Restaurants	0%	32.2	58		5.2	7.6	BAA1/BAA2	1	3	3	-8	-0.1	-0.7	-0.7	0.4
Consumer Cyc Services	0%	28.6	74		5.2	6.1	A3/BAA1	2	2	2	4	-0.1	-0.5	-0.5	0.0
Consumer Non-Cyclical	15%	1118.3	64		5.2	7.7	A2/A3	2	2	2	-5	-0.2	-0.8	-0.8	0.1
Consumer Products	1%	59.5	45		4.9	5.8	A2/A3	1	2	2	-10	0.0	-0.4	-0.4	0.4
Food & Beverage	3%	230.7	68		5.3	7.6	A3/BAA1	1	1	1	-2	-0.1	-0.7	-0.7	0.0
Healthcare	4%	326.3	71		5.3	7.7	A3/BAA1	2	2	2	-7	-0.2	-0.8	-0.8	0.2
Pharmaceuticals	5%	403.0	56		5.2	8.3	A1/A2	2	4	4	-4	-0.2	-1.0	-1.0	-0.1
Supermarkets	0%	13.3	84		5.6	9.5	BAA1/BAA2	1	0	0	-2	-0.2	-1.0	-1.0	-0.2
Tobacco	1%	85.5	69		5.2	6.4	A3/BAA1	1	1	1	-10	-0.1	-0.5	-0.5	0.5
Energy	7%	525.5	79		5.4	7.6	A3/BAA1	0	1	1	-12	0.0	-0.7	-0.7	1.0
Independent Energy	1%	91.5	82		5.4	7.4	BAA1/BAA2	1	1	1	-14	0.0	-0.7	-0.7	1.6
Integrated Energy	1%	102.3	55		5.2	8.1	AA3/A1	0	0	0	-7	-0.1	-0.8	-0.8	0.2
Oil Field Services	0%	24.3	81		5.4	7.6	A3/BAA1	0	0	0	-16	0.0	-0.7	-0.7	0.9
Refining	0%	30.1	84		5.4	7.0	BAA1/BAA2	0	-2	-2	-21	0.1	-0.5	-0.5	1.6
Midstream	4%	277.1	86		5.5	7.5	BAA1/BAA2	0	1	1	-11	0.0	-0.6	-0.6	1.0
Technology	10%	781.6	84		5.4	7.1	A2/A3	2	7	7	11	-0.3	-1.1	-1.1	-0.6
Transportation	2%	140.5	65		5.4	9.1	A3/BAA1	1	1	1	-9	-0.2	-1.0	-1.0	0.3
Airlines	0%	16.3	76		5.1	3.7	A2/A3	2	1	1	-16	0.1	0.0	0.0	1.3
Railroads	1%	88.2	63		5.5	10.8	A3/BAA1	1	0	0	-6	-0.2	-1.3	-1.3	-0.1
Transportation Services	0%	36.0	66		5.2	7.3	A3/BAA1	2	4	4	-11	-0.1	-0.9	-0.9	1.0
Other Industrial	1%	38.3	58		5.3	10.3	AA3/A1	0	-2	-2	-8	-0.1	-1.0	-1.0	0.3
Utility	10%	765.6	79		5.4	8.1	A3/BAA1	1	1	1	-7	-0.1	-0.8	-0.8	0.4
Electric	9%	690.4	79		5.4	8.1	A3/BAA1	1	1	1	-6	-0.1	-0.8	-0.8	0.4
Natural Gas	1%	58.4	86		5.5	7.8	A3/BAA1	1	0	0	-10	0.0	-0.7	-0.7	0.6
Other Utility	0%	16.8	67		5.3	7.9	BAA1/BAA2	0	1	1	-4	-0.1	-0.8	-0.8	-0.1
Financial Institutions	32%	2406.4	79		5.2	5.4	A2/A3	3	6	6	2	-0.1	-0.5	-0.5	0.3
Banking	22%	1642.4	75		5.1	4.9	A2/A3	4	8	8	5	-0.1	-0.4	-0.4	0.2
Brokerage Asset Managers Exchanges	2%	120.6	79		5.2	6.1	A3/BAA1	1	1	1	7	0.0	-0.4	-0.4	0.1
Finance Companies	1%	110.1	145		5.7	3.6	BAA2/BAA3	0	0	0	2	0.1	0.1	0.1	1.0
Insurance	4%	330.5	84		5.5	8.2	A3/BAA1	1	1	1	-6	-0.2	-0.9	-0.9	0.2
REITS	3%	194.8	69		5.1	5.3	A3/BAA1	2	2	2	-9	0.0	-0.3	-0.3	0.7
Other Financial	0%	7.9	102		5.4	5.0	A3/BAA1	1	3	3	1	0.1	-0.2	-0.2	1.3
US Corporate IG		7507.6	77	0 50 100	5.3	6.9	A3/BAA1	2	4	4	0	-0.1	-0.7	-0.7	0.1

Goldman Sachs Research, July 2026

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