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MARKET OUTLOOK 2026

INTO A NEW WORLD

What an exciting year it has been! As a rule, investors don't like too much excitement, valuing predictability above all else. With the disruptor-in-chief sitting in the White House we had none of that. And still asset markets performed beyond most forecasters' expectations as economies and businesses displayed remarkable resilience. The coming year will stress test this tolerance and many of the assumptions underlying it. At this stage, we remain constructive and highlight the following key points:

- US recession risks remain low, and growth should accelerate after a soft patch as the AI story broadens out
- Global growth will hold up, with important contributions from Europe and, especially, emerging markets
- Inflation will remain an issue but not enough to seriously impact monetary policy and markets
- Low or even negative real interest rates will favor real assets, with equities first among them
- Nominal assets, i.e., bonds, could struggle, as US policy makers will tolerate moderately higher inflation
- The USD is the weak link in US economic policy, but the downside will be less pronounced than in 2025

2025 in review: performance of major asset classes

Assets and Markets			Year-to-date
Equities World		USD	21.8%
	S&P 500	USD	17.5%
	EuroStoxx 50	EUR	19.7%
	FTSE 100	GBP	22.2%
	Swiss Market Index	CHF	14.6%
	Nikkei 225	JPY	29.3%
Equities Emerging Markets		USD	29.7%
	China - CSI 300	USD	23.3%
	India - SENSEX	INR	10.4%
	Pakistan - KSE-100	PKR	47.7%
USD Investment Grade		USD	6.8%
	US Treasury	USD	5.8%
	US Investment Grade	USD	7.2%
	US High Yield	USD	7.9%
Emerging Market Sov USD		USD	12.8%
Gold		USD	65.3%
Oil (Brent)		USD	-14.4%
USD (trade weighted)		USD	-9.4%
	EUR	1.174	13.3%
	GBP	1.338	6.7%
	CHF	0.796	14.0%

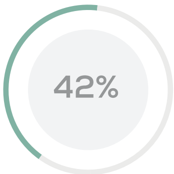
Source: Bloomberg as of 15 Dec 2025

Recommended portfolio allocation for 2026

(indicative positioning of USD global balanced mandate)

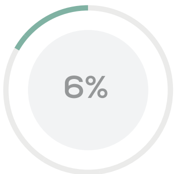
EQUITY (GROSS)

Region/Sector	Allocation
US	31%
Europe	8%
Japan	2%
EM	7%
RoW	2%



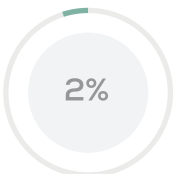
FIXED INCOME

Region/Sector	Allocation
Treasury/ABS	17%
Investment Grade	12%
Subordinated Bonds	4%
High Yield	5%
Emerging Markets	5%



ALTERNATIVES

Region/Sector	Allocation
Gold	6%



LIQUIDITY

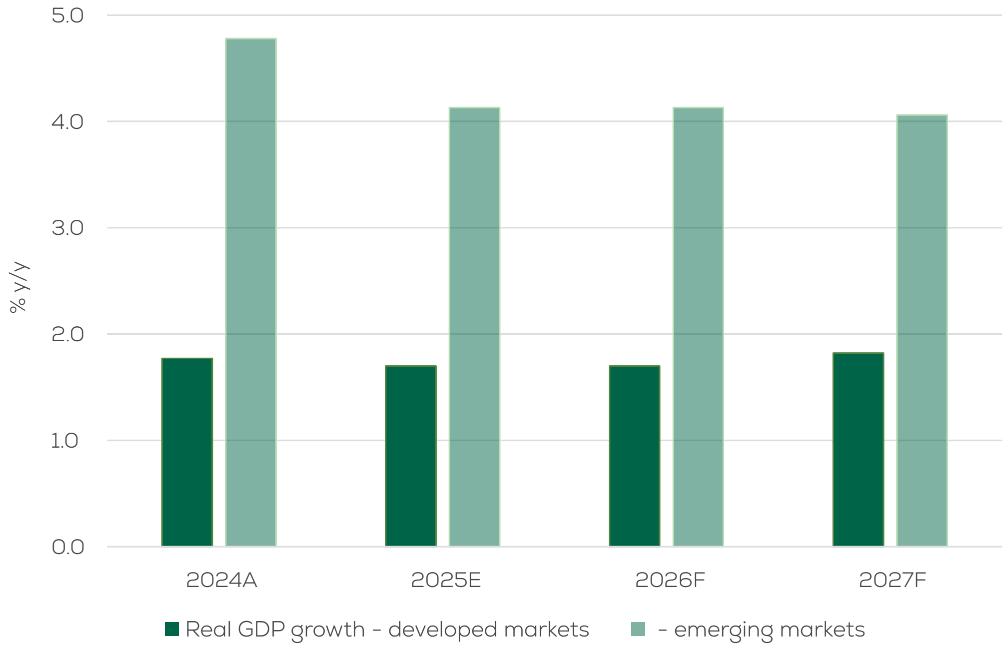
Region/Sector	Allocation
Cash	2%

OUR BASE-CASE SCENARIO

Driver	Comment	Trend	Risk implications		
			on	neutral	off
Global GDP growth	Global growth to hold up - no recession in the US	→		•	
Global inflation	Tariff impact on US inflation limited	↗↘		•	
Global policy rates	Fed & BoE to ease further, EB on hold for now	↘	•		
Global liquidity	Central banks to maintian high levels of liquidity	↘		•	
USD trade-weighted	US policy a challenge for USD	↘			•

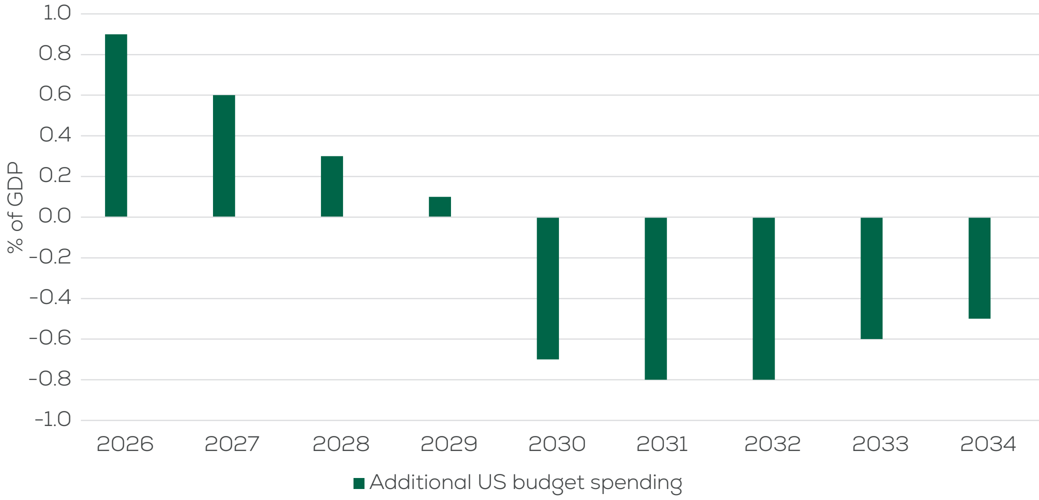
The global economy should do just fine in 2026. **Technological innovation and inward-focused US policy have started to reshape the post-World War II world order,** but these forces are not pulling in completely opposite directions. The combined vectors will continue to push the world economy forward and up, not in straight line and with some bumps, but up all the same. **While AI and technology in general will remain a major force of change** and disruption, three factors will underpin growth: **accommodative monetary policy, positive fiscal impulses, and greatly reduced headwinds from erratic US trade policy.**

Global: expansion continues



Source: Bloomberg, HBZ

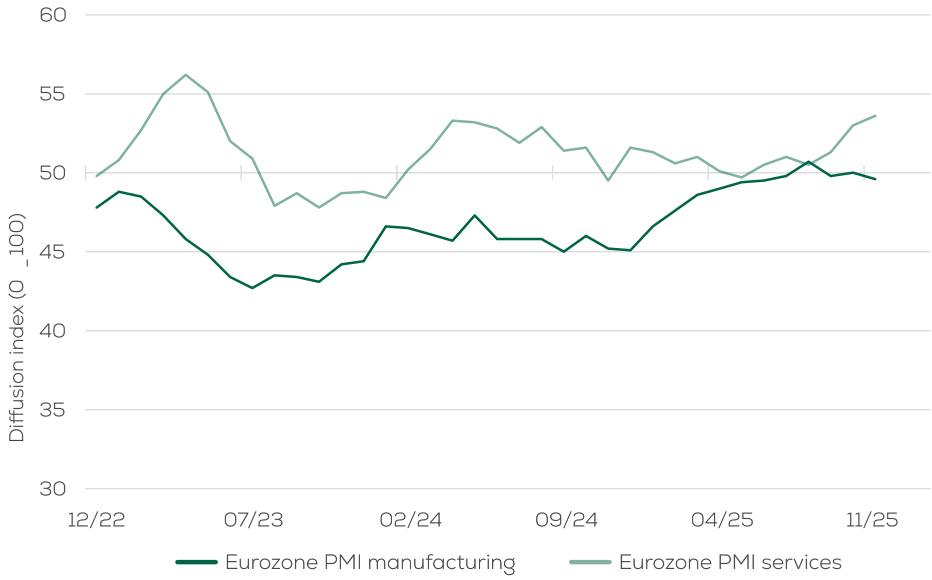
US: positive fiscal impulse



Source: Bloomberg, HBZ

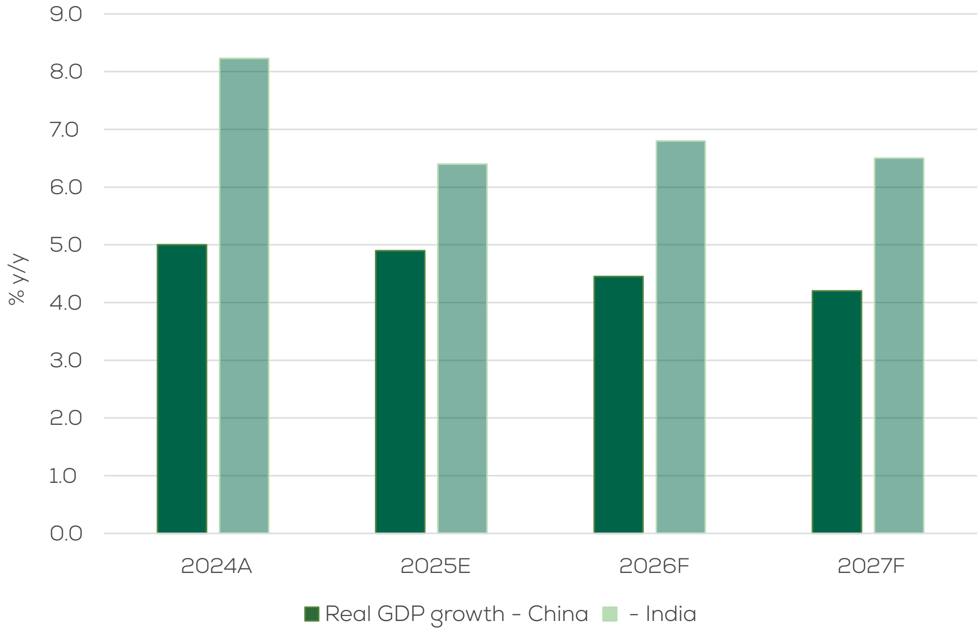
Behind the madness of some of Trump's policies there is some method, and 2026 will show whether his arguably unconventional approach will deliver. Early in the year, President Trump will announce a new Fed chair to take over from Jay Powell in May. The president would like to see rates substantially lower, but even a loyalist will unlikely sway the entire FOMC to put price stability at risk. Nevertheless, **the Fed will ease further,** but, importantly, will return as a buyer to the Treasury market, thereby stabilizing the very core of the global financial system. **Fiscal policy will turn stimulative again** – through both lower taxes and higher spending – just in time for the mid-term elections, when much will be at stake for the Republicans. The **AI-driven investment boom will continue.** AI is a truly transformative technology and the US cannot afford to fall behind China. Much of the investment is still funded by the extraordinary cash flows generated by the industry's dominant players. While there is always a risk of disappointment and misallocation with new technologies, we are not there yet. Moreover, **technological innovations tend to be disinflationary and productivity-enhancing.** Short term, this can lead to displacements in the labor force, which will dampen price pressures. The flip-side is a further accentuation of the so-called K-economy. The purchasing power of the lower income quartiles has stagnated owing to tariff-induced inflation and fewer employment opportunities, while the upper income groups benefit disproportionally, not least thanks to their exposure to the stock market.

Eurozone: improving growth prospects



Source: Bloomberg, HBZ

EM: India and China leading growth



Source: Bloomberg, HBZ

Two factors suggest that **moderate European growth will continue.** For one, **inflation has fallen back close to target,** which has already permitted the ECB and other European central banks to cut policy rates substantially. In addition, the large-scale **German fiscal stimulus measures** adopted earlier this year to address the country's creaking infrastructure and rebuild the long-neglected military will start to have an effect in Germany and beyond. Against these positive elements stand the well-known fiscal issues, which have paralyzed French politics and loom large over the eurozone, low productivity growth, as well as excessive regulation, also affecting the UK. In the end, **cyclical forces should prevail, while the structural problems will create drag** but not stop the expansion.

The so-called rest of the world is becoming an ever more important part of the picture. In 2026, **emerging-market (EM) growth will contribute the lion's share to global growth.** Despite its many problems, **China will continue to outgrow the US** and challenge the US's technological leadership as it did in January 2025 with the release of the Deep Seek chatbot. However, China's growth model, as outlined in the new draft five-year plan, will still be manufacturing and investment heavy, unnecessarily curtailing the potential of the country's domestic consumer pool. **India will again win the title of the fastest-growing major economy** thanks to its vast consumer-driven market. Many EM economies will enjoy lower local funding costs, as their central banks have room for additional monetary easing. The impact of the new US trade regime, disruptive as it was this year, will fade, as companies have quickly adapted to the new realities. As global supply chains continue to be redirected away from China, many EM countries will benefit thanks to their geographical proximity to their final markets, and attractive cost structure, not to mention the critical material ingredients. Further **tailwinds for the EM complex are lower US rates, the weaker US dollar** and, except for producer countries, **low oil prices.** More limited crude revenues will not, however, derail the strong momentum in the Middle East, but they will strengthen efforts to diversify away from the hydrocarbon sector.

OUR RISK SCENARIOS

AI as a true tail risk

Theme/topic	Comment	Risk implications		
		on	neutral	off
Growth/inflation	Stronger US, global growth with infation in check	•		
Growth/earnings	US recession as AI disappoints			•
Financial stabillity	US fiscal deficit, Fed independence; eurozone stability (France)			•
Political risk	US-China rivalry, Ukraine conflic, US trade policy (tariffs peaked)			•

Our main risk scenarios, both on the upside and downside, revolve mainly around the evolving AI theme. As already mentioned, we consider AI to be a truly transformative development which will fundamentally alter the way we work and live. However, there are multiple paths to an AI-led global economy. The best case would be a well-planned and executed investment program providing the infrastructure backbone to allow rapid AI adoption. Given the scale of the task, 2026 will be just a stage in this process, albeit an important one. **If the expected productivity enhancements start to materialize without undue disruption to established industries, the US could be on its way to higher trend growth.** Higher growth will not only deliver higher returns but also higher tax revenue, to the point where concerns about fiscal sustainability will move to the background. In such a context, the economy and markets could even absorb the resulting higher interest rates with only limited effects.

Events could, however, also take a more disruptive turn. AI would still prevail in some form, but with **greater misallocation of resources and a much-reduced impact on overall growth.** Moreover, disruptors are not immune to being disrupted themselves. With the ever-accelerating pace of technological innovation, today's leaders could end up in an evolutionary dead-end, overtaken by new entrants and having wasted billions in the process. The consequences would be felt beyond AI; it could trigger a far-reaching retrenchment in credit markets as investors scale back and write down investments in this space.

Beyond AI, **another risk is a global interest rate shock** triggered by two separate events or a combination thereof. One source of such a shock would be a **sudden return of inflation,** caused by higher pass-through of US tariffs to final customers. In such a scenario, the Fed would have to stop easing or might even have to lift rates once more. Japan represents another potential risk factor. With new commitments to fiscal stimulus, **upside pressures on Japanese yields could translate into higher global yields.** In the worst case, higher global bond yields could trigger widespread deleveraging, pressure on credits, and stress on sovereigns amid concerns about longer-term debt sustainability.

INVESTMENT IMPLICATIONS

Stay risk-on

Driver	Comment	Trend	Risk implications		
			on	neutral	off
Equity valuations	High US valuations leave no room for P/E expansion	↘			•
Equity earnings	US earnings growth to remain solid on lower taxes, rates	→	•		
Credit spreads	IG spreads with upside but total yields attractive	→		•	

For the third year running, **risk-taking was rewarded in 2025** with high, even double-digit returns in many asset classes. While equity investors again did particularly well, the choice of currency was of utmost importance. USD investors who did not go beyond the US dollar left a lot on the table, while US-centric investors with a different base currency will feel disappointed. Liberation Day injected a great deal of drama in April but, with hindsight, turned out to have been a great buying opportunity. The so-called TACO (Trump Always Chickens Out) trade perfectly summarizes the way **financial markets climbed every wall of worry facing them over the course of the year.** President Trump proved to be every bit as transactional as feared but also extremely sensitive to the market response to his actions. He therefore backed off in April and later in the year when China threatened further escalation in the traffic conflict.

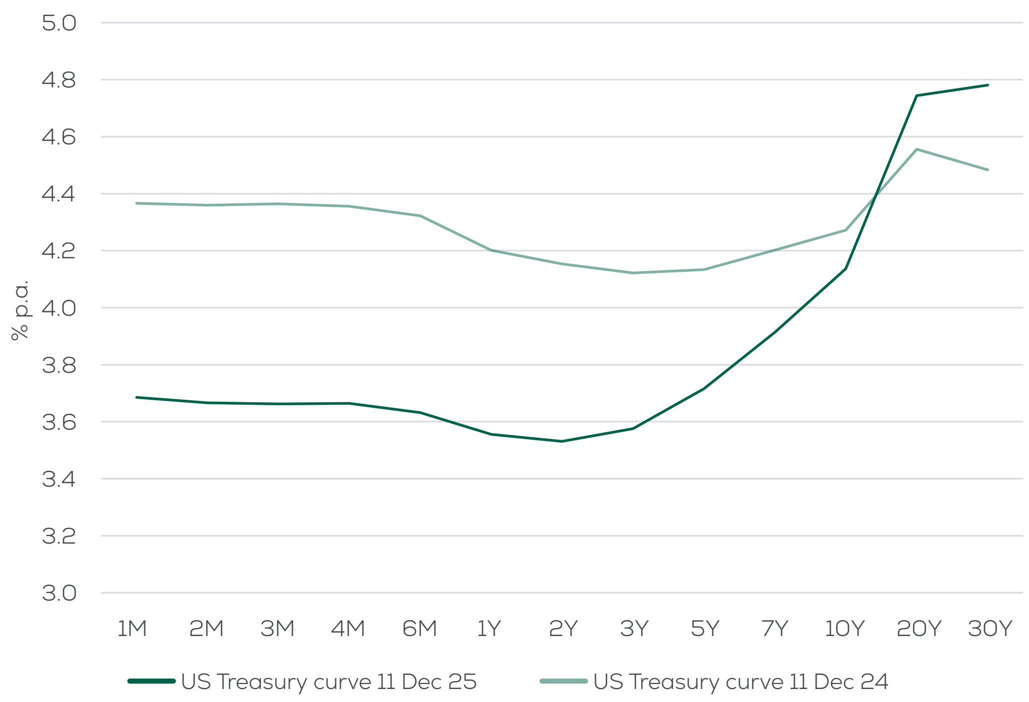
Equity returns were not as lopsided as last year, with emerging markets taking the crown for the best performer. Also noteworthy is the fact that the strong gains of the **S&P 500 were largely driven by earnings growth.** With US market valuations approaching excessive levels, there was no room left for multiple expansion. Fixed-income investors also enjoyed a good year. **Monetary easing,** and in particular the much more **limited impact of the US tariffs on inflation,** sustained a **broad-based bond market rally.** Emerging markets outshone the rest as the search for yield and exposure to non-USD assets drove down credit spreads. **Gold finally topped last year's already stellar returns** as its allure as a diversifier and risk hedge extended further. In many ways, gold proved to be what cryptocurrencies aren't: a store of value in an uncertain world.

In sum, **2025 was another good investment year for most risk profiles. Investors were largely unfazed by the political noise and focused on fundamentals.** And these prevailed: decent growth and strong corporate results. As we enter the new year, the main source of concern – actually the same as twelve months ago – remains: **high valuations make financial markets vulnerable to more sustained shocks.** With most developed market sovereigns highly indebted, governments could struggle to contain the fallout.

FIXED INCOME
Lengthen duration to lock in yields

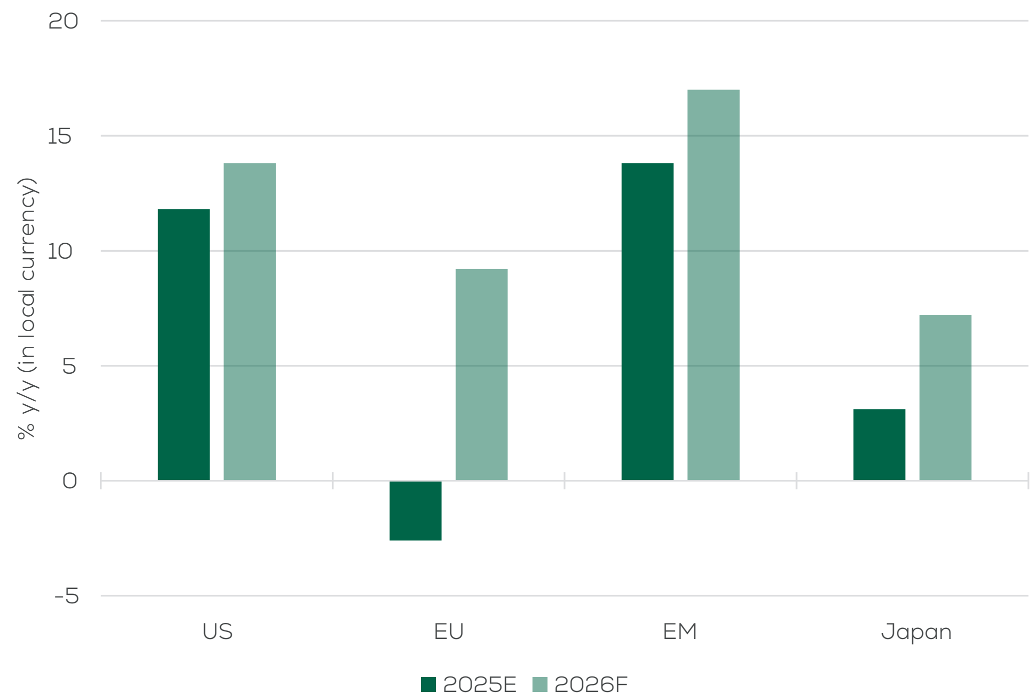
The normalization of the yield curve progressed over the course of 2025 as central banks – in the case of the US Fed after a prolonged pause – continued to lower their policy rates and, to a lesser extent, the middle of the curve followed. The US 10-year yield, meanwhile, declined much less, and yields on longer maturities actually increased. These movements will shape investors' preferred positioning in fixed income. **Money market investors will have to take on some duration risk** as roll-over yields in USD will fall further unless the Fed springs a massive surprise. At the same time, concerns about excessive US and other developed-market sovereign debt may keep long-end yields under pressure. Intermediate duration is therefore appropriate to balance risks. Given that credit spreads are close to 20-year lows, a focus on quality names is essential. Bonds have a binary outcome at maturity, and the lower the quality, the higher the risk of default. We remain convinced that **investment-grade corporate bonds** offer the best risk/return **to lock in attractive yields for longer.** Corporate high-yield in the developed world is simply too expensive, and for reasons listed earlier we prefer to seek additional yield in **emerging-market sovereign bonds.** We also maintain our long-standing recommendation for **European subordinated bonds** issued by tier-one financial companies. They offer an attractive combination of higher yield, moderate duration, and low default probability. Most portfolios will also benefit from exposure to **insurance-linked bonds,** whose returns have a low correlation to overall markets.

From money-market to bond investments



Source: Bloomberg, HBZ

Equities: earnings to drive returns



Source: Bloomberg, HBZ

EQUITIES
Thinking beyond the US

The AI theme remained the key return driver for the US equity market in 2025, to the point where many warned of an investment bubble. **We are not in the bubble camp.** Fundamentals are robust and key metrics such as the share of investment going into this space are still well below those recorded during the dotcom bubble or in the run-up to the subprime crisis. And while the so-called Magnificent 7 continued to outperform the broad market, the margin of outperformance was significantly lower than in the previous year. This suggests that i**nvestors have become more discerning** and are more cautious about what many consider a crowded and expensive trade. We expect this trend to continue in 2026 as AI-related investments broaden out. AI is not just chips and data centers, but also encompasses critical enablers such as utilities and, increasingly, users in just about every sector. Ever since the release of Deep Seek, if not before, the **AI story has become a global one.** It's time to look outside the US.

The **divergence in performance in currency terms** is another reason to think beyond the US, even though some structural features will continue to favor the US market. More diversified regional exposure will provide investors with access to **other unfolding themes** such as the rebuilding of Europe's infrastructure and military, and the sustained higher growth rates in emerging markets with their expanding middle classes and pent-up investment needs.

In concrete terms, we recommend constructing well-diversified equity portfolios around a US core – US equities continue to represent some 63% of the global market capitalization – with **material exposure to Europe and emerging markets.** Beyond the benefits of risk diversification, equities outside the US offer **significant valuation discounts,** not entirely justified by the historically higher operational efficiency and return on equity observed in the US. Within Europe, the eurozone offers a chance to leverage the German drive to revamp its infrastructure and stop de-industrialization, Switzerland provides a defensive market with a set of high-quality names, while the UK is the ultimate value play in terms of both valuations and sector composition. Moreover, given the US's hostile attitude towards the rest of the world, investors may increasingly direct flows to their local markets. In the case of China, there is also a policy imperative to provide locals with an alternative asset to stressed real estate. We have become **more circumspect about Japan** at this juncture. Its central bank is poised to raise interest rates against the global trend, but the currency may still depreciate further owing to higher inflation and increasing unsustainable government debt dynamics.

Our sector strategy maintains a **neutral allocation to technology and communications,** the key sectors of the AI theme, with a clear tilt toward quality to avoid untested and over-expensive stocks. Within the growth style, we **favor health care,** which has staged a timid recovery after years of underperformance. We're encouraged by both the sector's less demanding valuations and the secular rise in demand for health care products and services. Within value, we like **financials,** which tend to benefit from lower rates and offer attractive cash flows, and **utilities,** which are a central component of the emerging AI economy.

CURRENCIES & COMMODITIES

Downside risks for the USD remain

We have to confess that we did not expect the US dollar to weaken as abruptly as it did this year. Interestingly, though, most of the drop in the currency materialized ahead of and immediately after Liberation Day. Since then, the USD has broadly stabilized. **For 2026, we see further USD downside,** largely because the currency represents the weak link in the set of economic policies pursued by the Trump administration. Lower interest rates will undermine the USD yield advantage, while the tariff regime will curtail the foreign USD surpluses available for recycling back into USD-denominated assets. Moreover, the growth differential may no longer favor the US to the same extent as in the past few years. At the same time, foreign investors, both private and public, will seek to shield themselves from unfriendly US policies, shunning direct exposure to US assets, or at least hedging the resulting USD risks.

The diversification away from the USD will once again favor gold. It may be hard to see much upside after the metal's stunning rally of over 60% this year alone. However, EM central banks in particular still have a fairly low allocation to gold and will want to increase its share in their reserves. There are simply very few other assets that could take its place. Within the broad commodity complex, we see **downside risks for crude oil prices.** Supply growth has outpaced demand, and unless OPEC+ reverses course, prices will go lower. Demand and supply will also determine outcomes for industrial metals. The higher demand for metals related to AI, defense, and electrification will support prices, including the price of copper, which recently reached a new all-time high.

PRIVATE MARKETS

The risk of dilution

In times such as now of generally high asset prices, people are on the constant lookout for potential bubbles, AI and crypto the most prominent among them. Occasionally, private-market investments also make this list. Indeed, the aggressive marketing of private-market solutions raises legitimate questions about such investments. **Private equity, the original private market asset, has withstood the test of time as an efficient and value-generating investment** for institutional investors, family offices, and ultra-high-net-worth individuals. These three categories of investors share in common a well-understood risk appetite and loss-absorption capacity, a long investment horizon, and plannable liquidity requirements. Long lock-up times and limited or even no liquidity during the investment period make no difference to them. Today's solutions, in an attempt to access the broader wealth-management market, dilute these features. The result will almost invariably be lower returns, which in itself is not a major concern if at least part of the risk premium associated with private assets can be earned. This becomes more problematic when an increasing number of providers enter what remains a fairly small market. In private equity, this can lead to excessive valuations as more managers seek access to start-ups or M&A targets, or to lower quality and higher default risks when more private credit funds need to originate more loans to deploy their capital. Our view remains unchanged: If the risks and limitations are well understood, an allocation to this asset class makes sense in large portfolios with a long investment horizon and limited liquidity requirements.

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