StanfordBrown Private Wealth

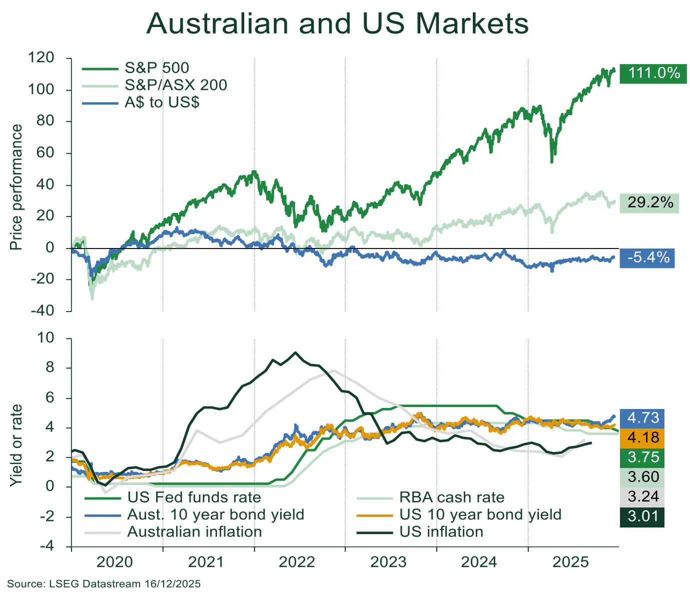
2026 Investment Outlook

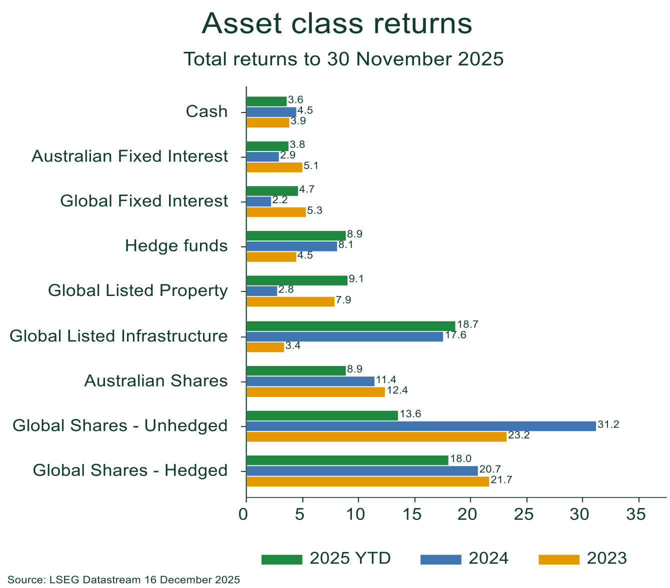
17th December 2025

01

Executive Summary

After April's equity market correction, following the ratcheting up of trade tensions, 2025 is shaping up to be another solid year for equities and multi-asset portfolios. Public equities have climbed the wall of worry from April's lows, as recession fears have receded, and higher US tariffs are yet to have a material impact on either consumer prices or corporate profits. Economies that were most exposed to the trade frictions have performed much better than feared and this, along with enthusiasm for artificial intelligence (AI), has helped support a recovery in investor sentiment and driven share prices higher. Low unemployment along with the ongoing recovery in consumer spending power as well as lower interest rates have also supported global growth in 2025.





When we compare how this year has unfolded relative to our expectations in last year's outlook, we were mostly correct with our predictions. As expected, the global economy has grown at around trend rates, driven by a better environment for consumers and stronger investment activity in areas such as data centres, artificial intelligence, defence, reshoring and energy transition. One area that we did get wrong was our view that inflation would continue to decline this year, whereas inflation has moved sideways or increased in many countries, including Australia.

On geopolitics, as we expected, the second Trump presidency brought a substantial increase in trade tensions, higher tariffs, broader policy uncertainty, mass deportations and some deregulation. Last year we also discussed the likelihood that Israel and the US may use bunker buster bombs to destroy Iran's nuclear facilities in 2025. Ongoing increases in defence spending, technological decoupling between the US and China in areas such as semiconductors, quantum computing and AI have also played out as we expected, with NATO's plans to lift defence spending to 5% of GDP over the next decade being the best example. In last year's outlook we also highlighted the possibility that China may impose export controls on critical minerals and that we could see escalation of the Ukraine conflict ahead of potential peace talks.

Although there are still a few weeks to go, it looks like we were once again too conservative in our expectations for equity returns this year. After 2023 and 2024 saw global equity returns above 20%, last year we wrote that more moderate high single to low doubt digit equity returns would be most likely, largely driven by underlying earnings growth. It looks like global equity returns could be close to or even above 20% in 2025 based on year-to-date returns. This has mostly been driven by stronger than expected global corporate earnings growth as well as a modest increase in valuation multiples. Within fixed income, as we expected, returns this year largely came from income rather than major moves in government bond yields and credit spreads.

In last year's outlook we expected the US economy to grow by around 2.7% this year compared with 2.8% in 2024, whereas US growth is now looking like it will come in at around 2.0%. This miss was largely due to incorrectly expecting that the incoming Trump administration would prioritise pro-growth initiatives such as deregulation and tax cuts in a similar playbook to 2017, before then turning its attention to trade policy. Like many others we underestimated the size and scope of Trump's tariffs and the resulting negative impact that they had on both business and consumer sentiment. We also underestimated the strength of the Eurozone's economy, which we forecast would grow only 0.8% this year, whereas the latest economist poll has average growth of

1.4% for 2025, partly helped by the loosening of Germany's debt brake and increased European defence spending. Our growth forecasts for China and Australia look like they will come close to the rates we expected in last year's outlook.

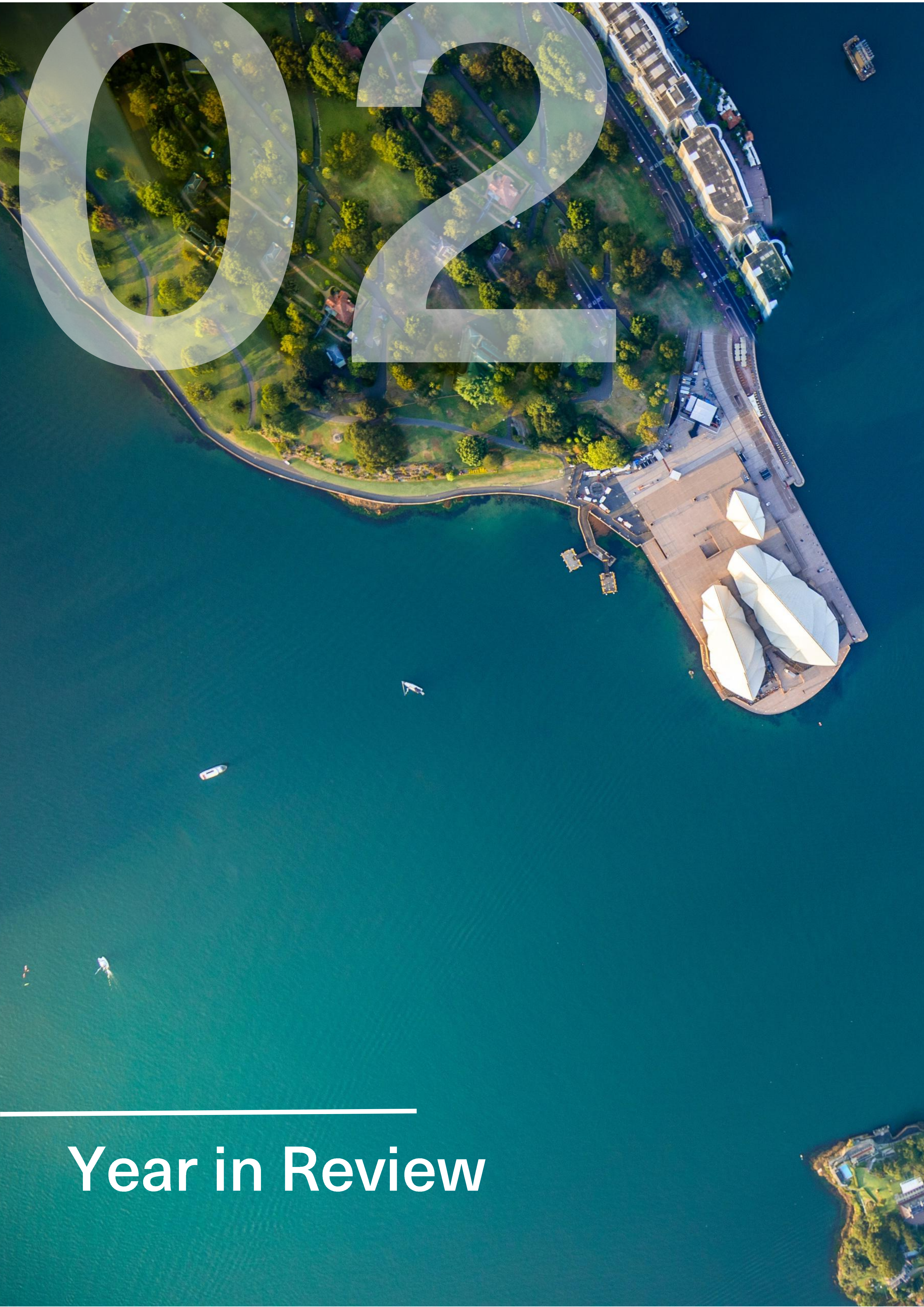
As we roll into a 2026, what will the next year bring for the major economies and key asset classes? Our views for the year ahead can best be summarised as cautiously optimistic. We expect macroeconomic trends we have observed this year to continue next year including low unemployment, further improvements in consumer spending power, stronger financial conditions (from lower interest rates, easier credit conditions and rising stock prices) and higher government spending in some countries due in part to increased defence and infrastructure spending. Business investment should also continue to grow driven by AI, data centre construction and the ongoing rollout of renewable energy projects. Although recessions are difficult to predict, given they are often caused by an unforeseen economic or financial shock, recession chances for the year ahead are low; economists are currently estimating chances of a US or Eurozone recession at around 20-22% in the next 12 months, down from 45% in April following the announcement of the Liberation Day tariffs.

Solid global growth is a positive tailwind for the business sector and corporate earnings should continue growing solidly which is a tailwind for asset prices including equities, corporate credit, property and infrastructure assets. After three straight years of very strong equity returns, we are overdue a correction or bear market, particularly given high starting valuations and much talk of an AI-driven equity bubble. While it is conceivable that 2026 will be the year that the AI bubble pops and creates a negative feedback loop that impacts economies through weaker discretionary spending and a pull back in business investment, as with the dot-com bubble in the early 2000s, this is not our base case. Global developed market equity earnings are expected to grow at around 14% annually over the next two years, based on current analyst forecasts and we expect total returns from global equities in the range of 10-15%, which factors in dividends and share buybacks as well as some valuation derating, typical analyst downgrades as the year progresses and weaker payback from big tech investment spending.

For defensive assets such as cash, government and corporate bonds, we again expect returns to be mostly driven by income. Given the growth environment we forecast in 2026, major movements in government bond yields and changes in credit spreads are not expected to be material drivers of fixed income returns over the year. We don't see major central bank rate cuts in 2026, given sticky inflation, with the possible exception that the US Federal Reserve determines to cut rates for political reasons when its new Chair commences in May. In Australia, the RBA looks unlikely to adjust interest rates in the first half of 2026 and there are emerging risks that the next move could be a rate hike, although much depends on whether some of the recent drivers of the local inflation increase prove temporary. We expect returns from cash, government and corporate bonds to be around 4.0-6.0% in 2026.

In terms of key upside and downside risks to our year-ahead views, these are the risks we are monitoring heading into 2026:

- AI bubble bursts resulting in a major correction of US tech stocks and global equity markets. As discussed above, this could also feed from the financial sector back into the real economy by slowing consumer spending and investment, as happened in the US after the dot-com bubble burst.
- US economy overheats helped by the One Big Beautiful Bill which provides tax refunds and corporate tax cuts in 2026, encouraging increased business investment and providing a growth boost to an economy which is already growing above trend. Fading trade uncertainty and the potential for the US Supreme Court to declare that tariffs under the International Emergency Economic Powers Act are illegal and order tariff refunds could also stimulate the US economy.
- Debt crisis from growing government deficits and rising debt issuance to fund data centres which could pressure bond yields and credit spreads. Also, emerging stress in private credit beyond the largely fraud-driven issues seen in 2025.
- The US Federal Reserve loses its independence and cuts interest rates for purely political reasons, and this destabilises US financial and currency markets, potentially leading to investors pricing in a second inflation wave and higher government bond yields which impacts the prices of other asset classes.
- Inflationary supply shock that could come from China cutting off or heavily restricting rare earth supplies or an oil shock.
- Geopolitics and grey zone warfare including China-Taiwan/Japan, Russia-Ukraine/US/NATO, European political fracturing and destabilisation due to the rise of more extreme politics and a US constitutional crisis.



02

Year in Review

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2025 in Review

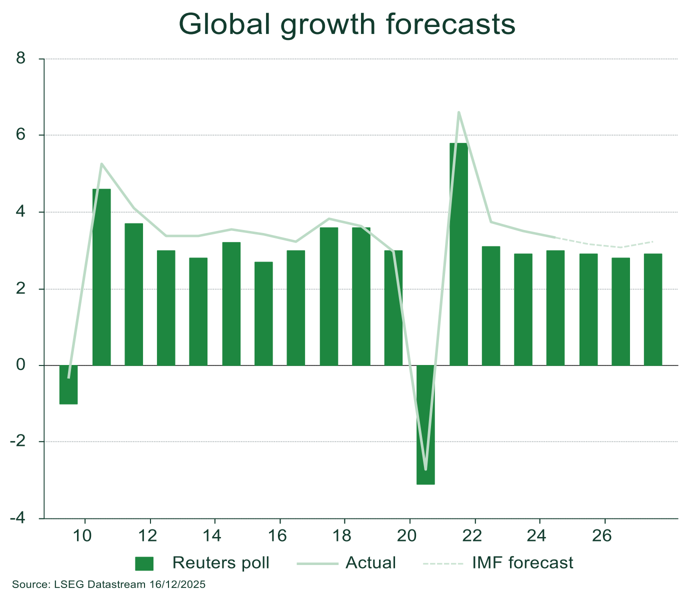
The financial and economic narrative of 2025 was defined by the resurgence of trade policy and economic uncertainty driven by Donald Trump's return to the US Presidency at the start of 2025. The year began with the gradual erosion of the optimistic "goldilocks" outlook that had prevailed in late 2024. In its place emerged a macroeconomic environment characterised by trade hostility and increasingly divergent central bank responses.

While the International Monetary Fund (IMF) projects global growth at a relatively resilient 3.2% for 2025, a small decline from 3.3% growth seen in 2024, the latest growth forecast for 2025 is materially better than the 2.8% that the IMF made in April following Trump's Liberation Day tariff announcement. The latest upgrade to growth forecasts can be attributed to front-loading of goods imports ahead of the tariffs, delays in US tariff implementation and also the slow pass through of tariffs to consumer prices as businesses waited to see where the tariffs were likely to land. Global growth has also been supported by fiscal expansion and rate cuts in many jurisdictions.

Despite the escalation in US protectionism and related policy uncertainty, which would otherwise dampen investment and consumption, the increasing investment in AI, data centres and defence infrastructure have been helping offset weakness in other sectors. In many countries, consumers have continued to enjoy higher real income growth helped by wage rises outpacing inflation combined with lower borrowing costs. Wealthier households have also benefited from rising asset prices - housing and equities - which has helped support discretionary spending, even though overall consumer sentiment remains weak in many regions as ongoing cost of living pressures remain.

Many commentators have described the resilience in overall economic activity as hiding a two-speed economy. The term 'K-shaped' is being used to indicate that consumers at the top end of the income and wealth spectrum are doing well and driving the strength in discretionary spending, while those at the lower end of the income spectrum are still feeling the cost-of-living squeeze, and are making fewer discretionary purchases or shifting into more value conscious products. The same could be said about the business sector where AI-related investment and infrastructure is accounting for much of the overall growth in investment activity, whereas many other sectors, particularly those exposed to manufacturing, trade and tariffs, continues to struggle.

Equity markets kicked off the year strongly until it became clear in mid-February, a few weeks into the second Trump presidency, that a trade war between the US and its major trading partners was brewing. After the S&P 500 retreated nearly 20% from its February highs, until Trump backed down in mid-April and delayed many of the Liberation Day tariffs, giving rise to the 'TACO' (Trump Always Chickens Out) acronym, equities rose in a near uninterrupted straight line until increase talk of AI bubbles saw markets soften briefly in November. The momentum-driven equity market rally was partly driven by the Magnificent Seven stocks but increasingly by lower quality, unprofitable technology and more speculative 'meme' stocks.



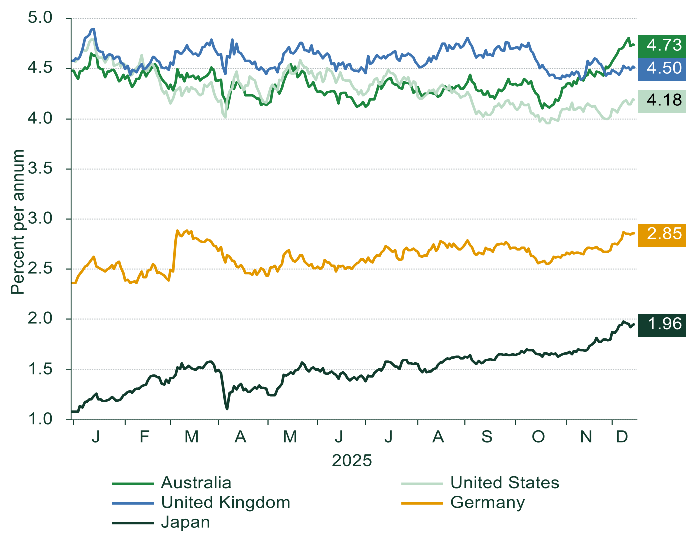
Regionally, emerging market equities performed strongly, helped by US Dollar weakness, a recovery in Chinese stocks and strength in Taiwanese and South Korean semiconductor and computer memory companies, which are benefiting from the AI investment boom. Japan's stock market has also performed strongly this year, as investors embrace the corporate governance reforms expected to result in stronger returns on equity and shareholder returns. Australian shares have lagged international equity markets hampered by modest total returns from the big banks, although the major miners have benefited from stronger than expected iron ore prices, as well as rising gold and industrial metals prices.

The relative narrowness of US and Australian equity market performance, with gains concentrated in overvalued or lower quality momentum stocks, made 2025 another challenging year for active fund managers, with many unable to outperform their benchmark indices, particularly if they applied traditional quality or valuation filters as part of their analysis. In Australia, APRA's Your Future Your Super test has had the effect of pushing large superannuation funds away from actively managed stock selection towards valuation insensitive index replication. This shift, along with more retail money moving into index-linked exchange traded funds, have reduced price discovery, and are partly to blame for some of the overvaluation in pockets of the Australian and other equity markets, as well as larger price moves when companies beat or miss earnings expectations.

In fixed income markets, government bonds have remained relatively range bound over the year with yields moving within a one percentage point range. Yields bounced around in April, after the Liberation Day tariffs increased risks of recession or a growth slowdown, and leveraged investors moved to unwind trades in longer dated US treasury bonds over worries about the end of US exceptionalism, the safe haven status of US treasury bonds and the US Dollar's reserve currency status. German and US longer dated bonds were also influenced by plans to increase government debt and deficits. Other bond markets, such as French government bonds, have also been impacted recently by political instability, and the rise of populist parties who favour lower taxes and higher government spending, with French bond yields now higher than Greek bond yields.

Concerns over the medium to longer-term trajectory and sustainability of government debt, has seen yield curves steepen in some countries over the past year. Longer-dated government bond yields are now pricing in marginally higher neutral interest rates and larger 'term premia' to compensate investors for the risks of lending to governments for longer periods. The steepening in the US yield curve was also due to lower short-term yields as concerns about softer conditions in the US labour market have led investors to price in further rate cuts from the US Federal Reserve over the next year. Australia's bond market has done a round trip in 2025, starting the year not pricing in any rate cuts and finishing the year in the same position. Credit spreads are also roughly where they started 2025, notwithstanding a sharp selloff in April as investors priced in a growth slowdown and higher default risk.

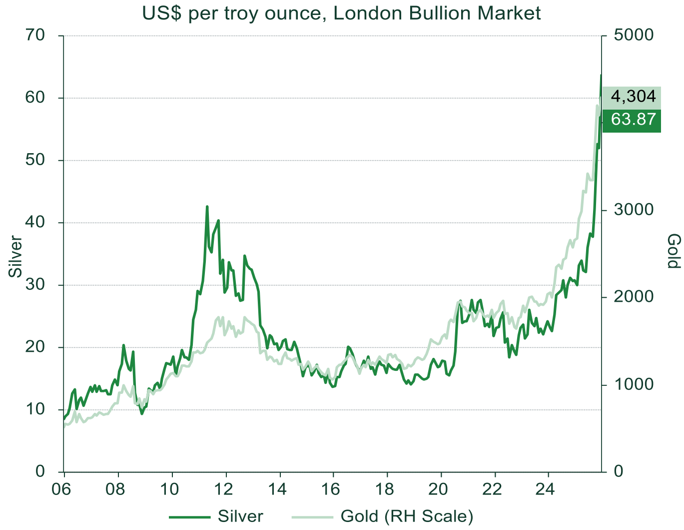
Ten-year government bond yields



Source: LSEG Datastream 16/12/2025

Silver and gold bullion prices

US$ per troy ounce, London Bullion Market



Source: LSEG Datastream 16/12/2025

In currency and commodity markets, oil prices spiked up to US$80 per barrel in June, due to the Israel/US attacks on Iran and fears that Iran may block the Straits of Hormuz, but prices subsequently retreated and are down around 15% year-to-date as slowing demand from China, due to increasing electric vehicle use, prospects of an end to the Ukraine-Russia conflict and rising OPEC+ oil production have supressed prices. Iron ore prices have been surprisingly resilient, remaining at around US$100 per tonne supported by expectations of Chinese stimulus and tight supply from Australia and Brazil. Precious metals, including gold and silver, as well as industrial metals such as aluminium, copper, nickel and zinc rose have posted strong returns this year – in part due to the AI investment boom and, in the case of gold, concerns around the US Dollar's reserve currency status as well as retail investor speculative buying.

The US Dollar, which was viewed as being overvalued, has lost 10% from its January peak, in part due to expectations of interest rate cuts in the US. The greenback was also weaker due to concerns earlier in the year about the end of US economic exceptionalism, increased policy uncertainty, prospects of a revenge tax on foreign investors and ongoing questions about debt sustainability and foreign demand for US Dollar assets as currency reserves. While there have been marginal shifts in foreign central bank reserves away from US Dollar assets, into gold and other currencies, there has been no evidence of large scale selling of US treasuries by foreign investors. The weaker US Dollar has pushed up the Australian Dollar from US$0.62 to around US$0.66 over the same period although the Australian Dollar has largely remained stuck in the same US$0.62 – US$0.68 range for most of the past three years, despite a brief dip below US$0.60 in April during the Liberation Day equity sell-off.

03

Key Themes for 2026

National security

The global order is undergoing a profound structural shift, moving away from the liberal, multilateral system that has been in place since the end of World War 2 and the rules-based system championed by the Washington Consensus of the 1980s/90s. Trade liberalisation and cost-driven globalisation is giving way to a more multipolar and transactional environment. This fragmentation, particularly evident with a renewed focus on national self-interest, necessitates a fundamental rethinking of how national security and economic security are intertwined. They are no longer separate policy domains but are being actively merged, with geopolitical strategy now dictating economic and industrial policy. These trends have gained more significant prominence following President Trump's return to the White House with his focus on America First and this theme is likely to continue to evolve in 2026.

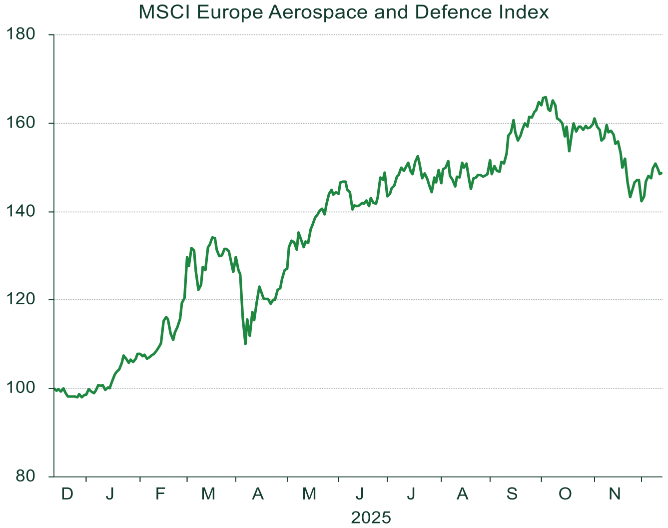
The new policy mandate across major economies is strategic autonomy which prioritises self-sufficiency in critical supplies, energy and defence over purely cost-driven global sourcing. The structural risks arising from geopolitical tensions, trade uncertainty, and weaponised interdependence (such as export controls on critical materials and semiconductors) have driven governments to implement large-scale industrial policy to safeguard strategic industries. The policy response to economic and national security is driving a global industrial renaissance, characterised by:

- Reshoring: Bringing manufacturing back home to domestic markets.
- Friendshoring/Nearshoring: Relocating supply chains to politically aligned nations or closer geographic hubs.
- Active State Intervention: Sustained investment and government support in foundational manufacturing, equipment, and critical technology.

This strategic imperative is fuelling industrial demand that is largely non-cyclical and therefore shielded from standard economic downturns given the support from government mandates. This policy-driven investment in defence and heavy industry is not confined to one nation; it is a global phenomenon leveraging state capital and mandates to restructure the industrial base. In the United States, major investments, notably the defence modernisation programs and significant government backing for foundational industries like semiconductors (such as support for Intel), are injecting vitality into once neglected industrial sectors. This spending focuses on integrating advanced technologies, including AI, robotics and specialised logistics as well as strengthening the metals and critical minerals industries.

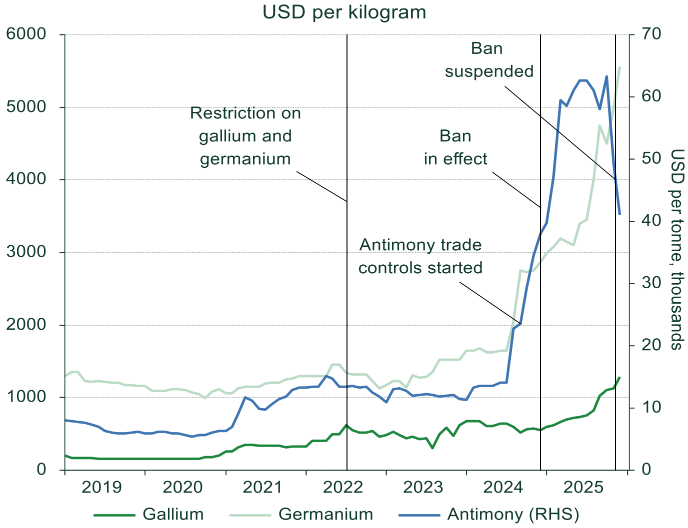
Similarly, Europe is actively pursuing its own strategic autonomy. Enhanced defence spending is creating significant demand for defence-grade materials and industrial capacity. Furthermore, substantial infrastructure spending and strategic reforms, under the banners of the EU Green Deal, ReArm Europe Plan and Critical Raw Materials Act, are anticipated to generate tangible investment opportunities which has already led to strong gains in European defence sector share prices. These policies collectively require a new class of specialised industrial and logistics assets to support reorganised, resilient supply networks.

European aerospace and defence shares



Source: LSEG Datastream 16/12/2025

China export restrictions



Source: LSEG Datastream 16/12/2025

Australia is also positioning itself as a secure, trusted supplier of essential materials for allied nations' industrial policies, directly linking its resource wealth to global economic and strategic resilience.

- **Critical Minerals Strategy**: Australia possesses some of the world's largest reserves of critical minerals (like lithium, rare earths and cobalt), which are vital for defence, advanced technologies and the global energy transition (batteries, renewable energy systems). The national strategy focuses heavily on downstream processing, not just extraction, to capture more value, strengthen sovereign capability and diversify global supply chains away from single-source dependencies, particularly given China currently dominates downstream rare earth processing capabilities.

- **Future Made in Australia Program**: This flagship industrial policy agenda aims to maximise the economic and industrial benefits of the move to net zero. It provides significant incentives for processing critical minerals and substantial financing to facilitate private sector investment. More recently the government has bailed out Glencore's copper smelter ($600m), Whyalla steelworks ($2.4b) and Nyrstar zinc smelter ($135m) to counter high energy costs, global competition (especially from China) and maintain critical processing capacity, with critics calling it "future bailed out in Australia" and raising concerns about ad-hoc support for powerful companies.

This merging of national security and economic policy supports sectors and assets that are strategically vital and supported by government policy. Investment opportunities are expanding into traditional capital-intensive sectors, steel manufacturers, diversified industrial firms and heavy equipment providers as they provide the fundamental infrastructure and materials for capacity upgrades. The combined force of national security spending and the industrial renaissance is cementing these strategic sectors as core, long-term growth engines for the foreseeable future, alongside technological themes like AI capital expenditure.

Artificial intelligence

The emergence of artificial intelligence (AI) continues to generate considerable excitement and investment, but the debate over whether AI is currently an investment bubble or if it truly represents a long-term structural productivity boost has reached new levels of intensity since we wrote about it last year. The sheer scale of capital expenditure and the increasing complexity of its financing now dominate the conversation with concerns about a financial bubble centred on the growing revenue gap, technical limitations and infrastructure strains. We set out some of the key ‘AI is a bubble’ arguments below:

- **High Spending with Exponentially Larger Revenue Requirements**: Companies are investing heavily in AI infrastructure, with McKinsey & Company estimating cumulative total spending of US$6.7 trillion on data centres up to the end of 2030. However, the economic hurdle required to justify this spending is dramatically increasing. According to Bain & Company, AI revenues would need to reach US$2 trillion annually by 2030 to generate an adequate return on all this AI investment. In other words, that would be about 100% of today’s global advertising revenues (US$1 trillion annually) plus total revenues from all annual consumer and business subscriptions and licences in media, software, cloud computing and related services (another US$1 trillion annually). Just one company, OpenAI, the provider of ChatGPT, and until recently a not-for-profit entity which is estimated to lose US$10 billion this year, has signed infrastructure deals totalling more than US$1.4 trillion. Whether there are sufficient use cases and paying customers to generate the revenues needed for an acceptable return on all this capital expenditure seems unlikely in our view.

- **Growing Financial Vulnerability and Circularity:** The AI boom has entered a new, riskier phase driven by debt, moving beyond the initial funding using internal cash flows. The big tech companies, referred to as hyperscalers, are moving from low debt, capital light businesses to higher debt, capital heavy business models and they recently raised a staggering US$184 billion in bonds over a seven-week period to fund the investment spree. This debt-fuelled expansion, combined with opaque and intricate circular financing deals (where companies like Nvidia invest in model makers like OpenAI, who then uses Microsoft AI infrastructure, which then leases AI compute from neocloud providers like CoreWeave, who in turn purchases Nvidia chips), strongly echoes the circular vendor financing problems of the late 1990s telecom and dot-com bubble.

- **Accelerated Obsolescence and Accounting Risks:** The chips at the heart of AI infrastructure have an estimated useful lifespan of only one to three years due to rapid technological advances and physical stress. However, major hyperscalers have moved to depreciate these assets over five to six years. This potentially represents a "US$4trn accounting puzzle" that creates an artificial earnings cushion which lowers reported annual depreciation costs for the hyperscalers and boosts reported profits. If these assets were depreciated over a more realistic lifespan (say three years), the potential overall hit to the combined pre-tax profit of the biggest AI firms could be measured in the trillions of dollars.

- **Adoption Slowdown and Capability Plateau:** While the initial surge in consumer usage was explosive (ChatGPT reaching 800 million weekly users), data suggests corporate adoption is plateauing or even slowing and a recent MIT study found that 95% of companies that piloted or rolled out AI programs were getting zero measurable financial return. The scepticism centres on the technology's continued struggle with reasoning, hallucinations and a lack of genuine world understanding, leading some experts to describe current generative AI as "autocomplete on steroids". This has created what is called "workslop," where low-effort AI-generated content, which superficially seems polished, shifts the burden of correction, review and interpretation to co-workers, resulting in lost productivity and weaker collaboration. In other research relating to AI use in software development, one 2025 study found that when experienced software developers used AI tools, tasks took 19% longer compared with if they had not used any AI tools.

- **Infrastructure Bottlenecks:** The physical demands of the AI build-out are imposing severe constraints. The expansion of data centres is heavily straining electricity grid infrastructure, leading to interconnection backlogs that can delay full operation for up to eight years in key regions. This power crunch is forcing hyperscalers to seek expensive alternative solutions, such as deploying onsite gas turbines or seeking to restart old US nuclear plants. This massive electricity demand is also projected to increase US residential power prices by 15% to 40% over the next five years. This is not just a US phenomenon, the same is happening in Europe and Australia. Many data centres are also placing significant demands for fresh water supplies, as water is often used as a cheaper method for cooling data centres, compared with air conditioning, which requires large amounts of electricity.

On the other hand, AI may not be an investment and financial bubble as it still possesses the key characteristics of a truly transformative technology that promises long-term structural benefits. Reasons why AI may not be in a bubble include:

- **Historical Precedent for Simultaneous Transformation and Mania:** History suggests that a phenomenon can be both a speculative bubble and a truly transformative technology simultaneously. The 19th century railroad mania, which triggered multiple financial panics and ruined many investors, ultimately yielded vast economic benefits for the general public through increased productivity by shrinking time and space through faster transport. Similarly, the economic value of generative AI could be huge with large increases in overall productivity and faster global economic growth, which could justify the projected cumulative AI capital expenditures, suggesting a compelling macroeconomic justification for the spend, even if the financial benefits do not necessarily flow through to the model providers and hyperscalers.

- **Financially Robust Incumbents**: Unlike previous technology bubbles, the AI revolution is being driven by the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) which are well-capitalised with strong balance sheets and massive free cash flow, enabling them to fund their capital expenditure without relying solely on risky debt financing (at least initially). This robust financial standing suggests that while a market correction is possible, if there is fallout it is less likely to cause a systemic economic collapse compared to previous debt-fuelled bubble bursts. Moreover, the share price appreciation of leading tech stocks has been largely driven by a long period of fundamental success and accelerating earnings growth, not just speculative valuation increases. Valuations for the Magnificent Seven, at around 30 times earnings, are around half those see for the market leaders during the late 1990s tech bubble.

- **Shifting Value to the Application Layer**: While the compute layer faces commoditisation (evidenced by falling rental rates for Nvidia chips, falling prices of AI model tokens and emergence of open-source Chinese competitors), this benefits AI application layer companies who are consumers of AI compute. Lower AI model costs and computational costs increase the gross margins and improve the unit economics for software companies and AI application providers. This trend is already visible in the rapid emergence of a "0 to 100 million club" - companies scaling revenue rapidly by building truly useful applications on top of AI models.

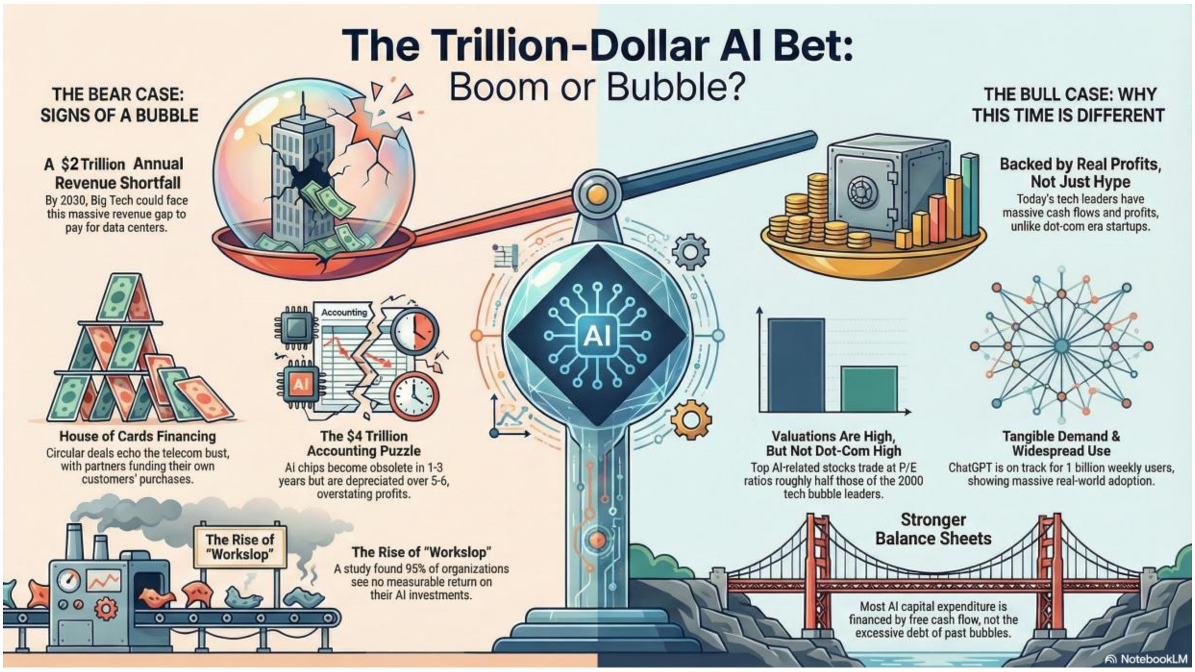
- **Enduring Transformative Potential**: Generative AI retains its potential to fundamentally change workflows, drive significant labour cost savings and boost productivity across diverse industries. While setbacks exist, companies continue to explore ways to get productivity gains following AI application deployment. For example, OpenAI is pivoting its research and development to solving and finding more economically useful applications for its AI beyond helping students with homework. The technology is not likely to "fizzle out" given the institutional investment, distribution networks and customer bases already committed by large, established companies.

The fundamental belief that AI will ultimately deliver significant, structural productivity gains remains sound, establishing AI as the most important technology of the next decade and beyond. However, the current investment environment requires a degree of caution. The rapid escalation of capital expenditure is creating a massive data centre/hardware investment bubble driven by overoptimism, vendor circular financing and aggressive accounting. This spending is occurring even as technical progress shows incremental improvements rather than breakthroughs and widespread enterprise adoption remains low.

We feel investors should maintain a highly selective approach, differentiating between reality of companies growing AI related earnings and the hype in companies with escalating losses and eyewatering valuations, which are mostly in the venture capital sector in our view. It is also critical to work out which companies are at risk from AI disrupting their business models, such as some Software-as-a-Service (SaaS) companies versus those that can do well from disruption.

While the hyperscalers and hardware providers are capturing massive value today, the long-term winners may be those companies with applications that leverage falling compute costs to generate measurable value for end-users and achieve scale and monetisation. The recent success of Google parent Alphabet with its latest Gemini models and vertically integrated business, where it also develops and deploys its own AI chips, shows that the competitive environment can shift quickly. Given the uncertainty in timing and the increasing financial and physical infrastructure strains, it remains critical to focus on companies with clear paths to monetisation and profitability, recognising that the long-term payoff will arrive more slowly and unevenly than the current investment boom suggests.

Our current view is that there is a bubble forming in parts of the AI value chain, but in our view this is most clear in unlisted AI model providers such as OpenAI, Anthropic and xAI and the next layer down in the value chain including neo-clouds such as CoreWeave that provide outsourced AI compute services and have limited competitive advantage over the longer term. Many venture capital backed AI startups will fail as around 60% of all venture capital investment is currently being allocated somewhat indiscriminately to AI start-ups despite AI making it cheaper and easier to launch (and disrupt) technology businesses. Some of these AI enabled businesses will, however, survive and benefit from a potential collapse in the cost of using AI models upon which their software sits. So, in conclusion there are part of the AI value chain that are overvalued bubbles and it pays to be cautious and diversified, however, we don't think that the entire AI industry and the Magnificent Seven are in overvaluation bubble...yet.



Gamification of investing

Last year we wrote about the ongoing theme of democratisation of alternative investments with retail investors being offered the opportunity to invest in less liquid investments such as private credit and private equity funds. We cautioned about a large influx of ‘hot’ money investors that could all head for the exit at the same time if there was a downturn or investor panic. This year we have another theme playing out in democratisation of financial markets that is specifically aimed at retail ‘hot’ money investors.

Modern financial markets are undergoing a fundamental structural transformation, characterised by the convergence of low-cost trading, sophisticated technology and behavioural lures designed to generate extreme turnover and higher volumes of transactions. This structural shift has fundamentally blurred the boundary between longer term investing and pure, high-stakes shorter term gambling across assets ranging from retail favourite ‘meme’ stocks, short-dated options, leveraged exchange traded funds, highly volatile cryptocurrencies to new prediction markets and event contracts, which payout based on outcomes of financial, political and sporting events.

Digital trading and brokerage platforms are incorporating design elements into their websites and phone applications borrowed from gaming and social media and these are central to this evolution, transforming investing into highly engaging trading activity. Features such as confetti animations, badges for achievements and leaderboards are deployed by trading platforms to lower psychological barriers to entry and encourage repeat activity. While these tools have been credited with democratising access to investing, especially for younger participants, they also actively encourage excessive trading and acute risk-taking.

Academic studies note that speculative behaviour is rooted in neurochemistry, as brain scans confirm that placing an in-game bet and executing a day trade on financial markets activate the same dopamine reward centres in the brain. The pursuit of high, potentially life-changing returns in speculative investments elicits a nearly identical neurochemical response as traditional gambling. Compulsive speculators and traders often justify their high-stakes investment activity as based on analysis, even as they display classic problem gambling markers such as chasing mounting losses.

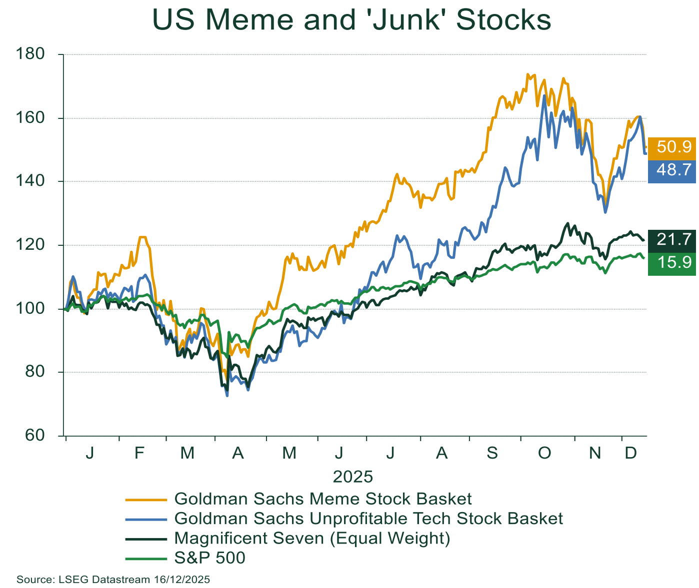
Financial markets have increasingly provided instruments perfectly suited for high-velocity, high-risk appetite investors especially since the COVID lockdowns which shifted sports betting to betting on financial markets. First there was the rise of "meme stock" trading and more recently leveraged exchange-traded funds, that can triple the pain or pleasure of a daily move in an underlying asset price, and Zero-Days-to-Expiry (0DTE) options. The "meme stock" phenomenon, involving highly volatile loss making publicly traded companies like GameStop, was enabled by zero-commission trading that reduced barriers for retail investors and amplified coordination through social media sites such as the aptly named ‘wallstreetbets’ forum on Reddit.

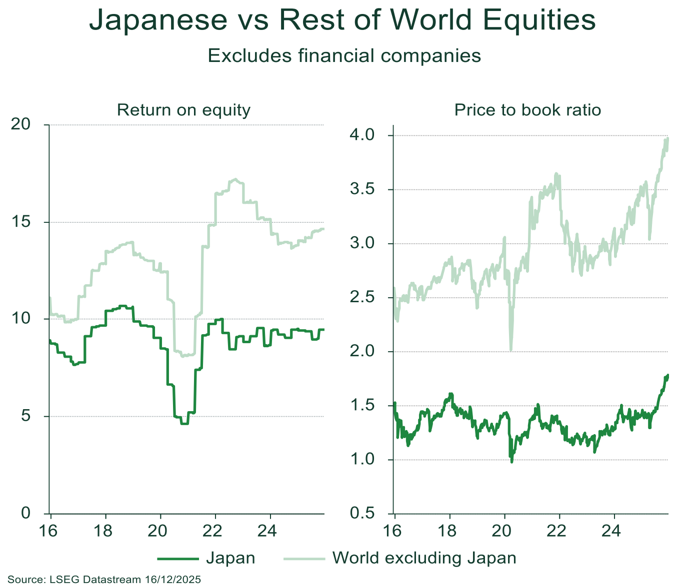
0DTE options—contracts that are launched, trade and expire within a single day - offer maximum leverage on intraday price movements in major indices and exchange traded funds, providing large potential rewards from rapid changes in the value of the options. 0DTE options now account for approximately 49% of S&P 500 option volume traded on Cboe, corresponding to an estimated daily notional dollar volume of about US$1 trillion.

Driving this speculative engine is the structural economics of the US retail stock brokerage model. The zero-commission trading environment is economically sustained by Payment for Order Flow (PFOF), where wholesale market makers compensate retail stockbrokers for routing retail client orders to them. This system creates an inherent conflict of interest because roughly two-thirds of all PFOF revenue is derived from options trading and means brokers earn substantially higher revenue when clients trade options compared to equities, thus structurally favouring the adoption of highly leveraged products that guarantee rapid turnover.

The blurring line between speculative investment and random games of chance is best epitomised in the emergence of prediction markets or event contracts. These platforms translate event forecasts into tradable futures or options contracts, allowing participants to bet on future outcomes ranging from central bank interest rate changes to sporting events. These event contracts have created a huge regulatory dilemma as the platforms have been largely successful in side-stepping sports betting and wagering laws in many jurisdictions, arguing that the contracts are cash-settled financial futures contracts or options even when they look like a simple bet on a football game. While investment relies on the expectation of generating future income or appreciation, gambling, by definition, always carries a negative expected return, namely the intrinsic "house edge" or hidden fees and transaction costs that are embedded into these financial contracts.

The integration of prediction markets data across mainstream media, coupled with the entry of major retail stockbrokerages like Robinhood into the space, underscores the increasing mainstream commercialisation of generalised gambling. New York Stock Exchange owner Intercontinental Exchange recently announced an investment of up to US$2 billion in the cryptocurrency--based betting platform Polymarket while derivatives exchange operator CME Group is partnering with an online gambling site, FanDuel, to offer event contracts tied to everything from sports to economic indicators and stock prices. NASDAQ, the New York Stock Exchange and Cboe all recently announced plans to move to nonstop round-the-clock trading in stocks and related options, potentially allowing trading for up to 24 hours a day, seven days a week. We expect this theme of the blurring of investment and gambling to continue and will be monitoring how it influences asset prices and whether it creates opportunities for longer term investors.





Japanese corporate reform

Japan is experiencing a major shift in its corporate landscape, driven by unprecedented regulatory pressure and a surge in shareholder activism that is forcing companies to optimise historically inefficient balance sheets and unlock significant trapped value. This systemic change has put Japanese equities back into the international investment spotlight, promising significant returns for those positioned to benefit from enhanced capital efficiency. Over the past one and two years the Japanese equity market has been one of the strongest performers globally.

The Tokyo Stock Exchange (TSE), together with the Ministry of Economy, Trade and Industry (METI) and the Financial Services Agency (FSA) have been driving corporate governance reforms among public companies. The primary driver was TSE's directive in 2023, which raised concerns that more than half of listed Japanese companies had share prices that were trading below book value and required all companies to enhance capital efficiency to address this situation. This has led many firms to sell cross-shareholdings, deploy idle cash and increase shareholder payouts through higher dividends and share buybacks. This is the start of the process of returning an estimated 15 years' worth of net income back to shareholders which has been retained on the balance sheets of Japanese companies.

Japanese companies famously maintain lazy balance sheets directly linked to decades of corporate risk aversion. The median firm held approximately 33% of its market capitalisation in cash and 16% in long-term investments (primarily cross-shareholdings). This accumulation of idle capital and inter-corporate equity stakes stemmed from a historical focus on long-term survival and, in the case of cross-shareholdings, a defence against foreign acquisitions.

The TSE is actively working to shift the management mindset from a traditional profit and loss-driven approach to one centred on balance sheet and cash flow efficiency. Companies continuously trading below one times share price to book value ratio (P/B) are now required to disclose robust action plans detailing specific goals and processes to raise their share price valuation. Listed companies that fail to improve their corporate value and meet rigorous standards risk being delisted or moved to a lower section of the stock exchange.

Today, there are about 1,000 public companies in Japan trading at less than one times book value (and about 200 trading below 0.5x P/B) which is down from around 1,800 when the initiative was launched in 2023. Partly this is due to the strong price appreciation of Japanese stocks over the past two years and partly due to managers undertaking measures to improve balance sheet efficiency, boost shareholder engagement and strengthen corporate governance. This means there is still a fertile hunting ground for value conscious activist investors, private equity firms and other active or passive funds that build value portfolios focussed on the cheapest Japanese companies such as those trading below book value.

This pursuit of overlooked value in Japan has attracted value investors like Warren Buffett, whose Berkshire Hathaway has strategically invested in Japan's major trading houses, recognising them as cash-generative, recession-resistant businesses trading at deep discounts. Private equity firms have also been active in taking listed companies private or working with larger Japanese companies to buy part or full ownership of neglected divisions to help crystallise value for shareholders in the listed parent company.

Corporate activist investing is the most in-vogue approach where a fund will take large stakes in a small number of targeted undervalued companies and the fund then pushes the company's managers and directors to make changes to governance, balance sheets and agitates for other proposals to unlock value. This can be done privately or publicly at shareholder meetings or through more aggressive proxy battles. This strategy has a mixed track record in Japan with a high failure rate for shareholder proposals at recent annual general meetings. Many companies are also being internally proactive ahead of receiving activist proposals given they are also being pressured by the TSE to unlock value themselves.

For value investors, the acceleration of corporate reform and the consequential unlocking of value - whether through streamlining complex corporate structures, unwinding cross shareholdings or returning excess cash to shareholders - presents a multi-year opportunity that signals a profound and lasting shift in Japanese capitalism. Investing in this theme is fundamentally a bet on the rerating of cheap Japanese stocks and the shift toward a more dynamic corporate environment in Japan.

Geopolitics

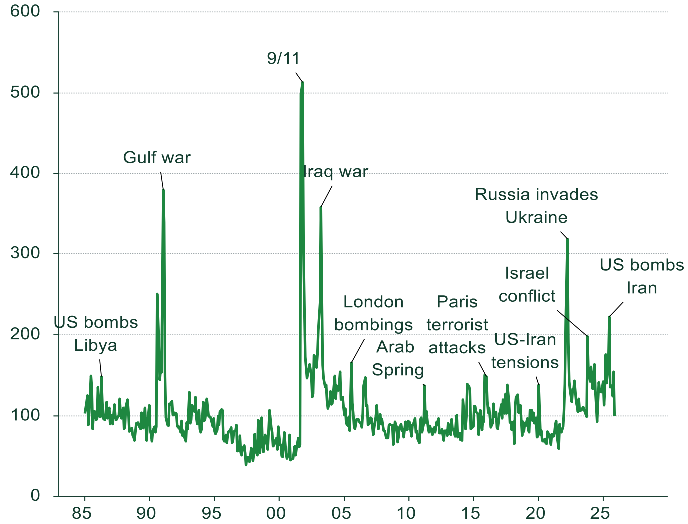
As we wrote last year, the global geopolitical order continues to transition into a fragmented multipolar world. This environment is characterised by the assertion of regional spheres of influence, transactional diplomacy, geopolitical competition, weaponisation of trade tools such as critical minerals and semiconductors and elevated risks of regional conflicts, particularly around Russia and China. Although this reordering has been a multi-year theme, the geopolitical landscape for 2026 is characterised by a delicate and tense calm amidst fundamental structural fragmentation and accelerating instability. This is largely being driven by US President Donald Trump's focus on restructuring the global economic and geopolitical order as part of the America First agenda that involves the US focussing greater attention on its own neighbourhood in the Western Hemisphere – 'Trump's Corollary to the Monroe Doctrine'.

The global system is witnessing transactional diplomacy that disrupts established alliances and multilateral institutions, forcing global business strategies to account for this volatility as a constant factor. Within this dynamic, we think that a rapid decline in US influence is exaggerated, even as China's economy and society are seen as more resilient than many previously thought. The central feature remains the long-term balancing act between the United States and China, although relations are expected to deteriorate, with little trust existing between the two sides even if they engage in trade and diplomatic agreements from time to time. Amidst the competition between major powers, non-aligned countries such as India and Saudi Arabia are strategically taking advantage of the perceived US vacuum to pursue independent agendas, while multilateralism endures as new alliances form rapidly outside the traditional US and Chinese spheres.

Regional instability remains a prominent concern, with geopolitical risks elevated, particularly around Russia and East Asia. Europe finds itself centrally focused on security, navigating potential ceasefire and any aftermath of the war in Ukraine, while the Middle East is transitioning to a post-Israel-Hamas war era with many questions unresolved regarding future stability and security. In 2026 there remains reasonable prospects for a ceasefire in Ukraine which could also reshape geopolitics if President Trump succeeds in pulling off a "Reverse Nixon" - driving a wedge through the Russia-China relationship by reintegrating Russia into the global economy.

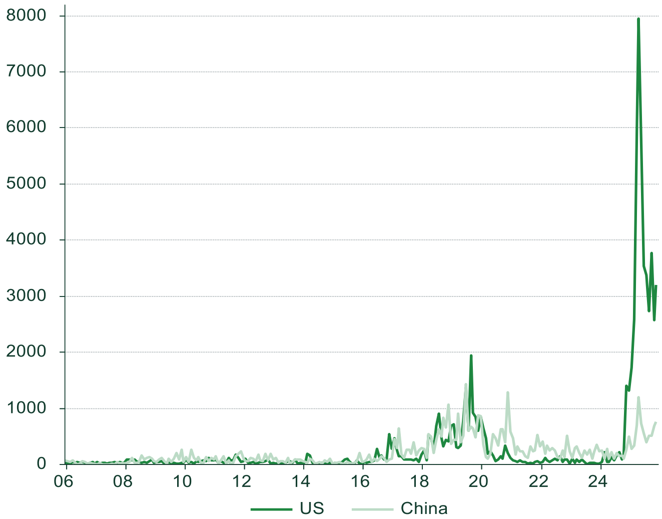
Chances of a Chinese invasion of Taiwan in 2026 remain low in our view although a mishap could still trigger conflict. We think that China needs more time to modernise its military forces to be capable of invading Taiwan and ensure its economy is more self-sufficient, including making high end computer chips, while the US also needs more time to build semiconductor manufacturing and rare earth processing capabilities. In our view this means neither side is likely to be prepared for a conflict over Taiwan over the next few years.

Geopolitical risk index



Source: LSEG Datastream 16/12/2025

Trade policy uncertainty index



Source: LSEG Datastream 16/12/2025

Assuming there are no snap elections, 2026 will be just the second time in the 21st century with no major G7 country elections scheduled, which is change on the last few years with new governments in the US, UK and Germany. However, a defining political event of the year will be the mid-term elections in the US in November, given the current environment is marked by significant risk stemming from attacks on democratic institutions and upcoming Supreme Court rulings that could impact investor confidence. Beyond the US, there are major elections in numerous countries including Israel, Brazil, Colombia, Hungary, Peru, and Sweden.

The outlook for 2026 highlights structural risks, notably the interplay between populist politics and the bond market's effective limits on government debt and deficits. Techno-nationalism continues to drive global fragmentation in the digital space, forcing countries to pursue digital and AI sovereignty through regulatory measures like export controls, copyright protection, localisation demands and, in Australia's case, bans on social media for teenagers. Furthermore, the nature of conflict is evolving, with hybrid warfare expected to increase and become more normalised. The rise of autonomous weapons, particularly drones, represents the future of warfare and expands the corporate threat landscape, shortening warning times for attacks on critical assets. Finally, the fragility of the deterrence equilibrium is a significant concern, driven by increasing military tensions, including the return of nuclear weapons developments as a focal point.

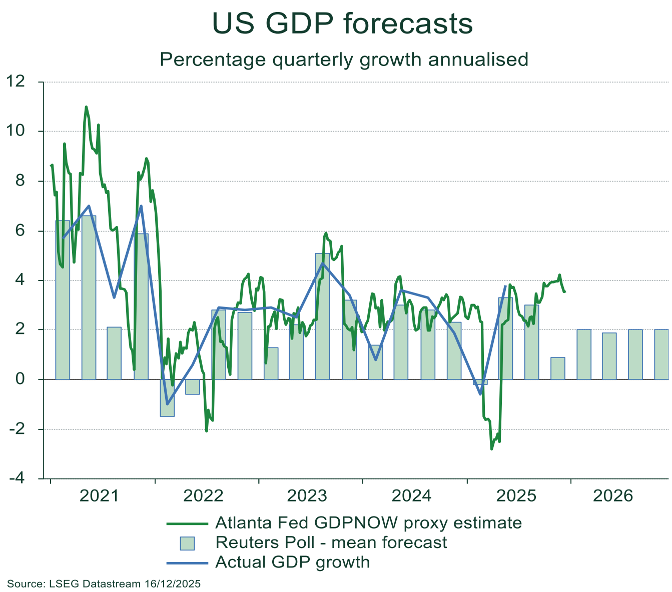
United States

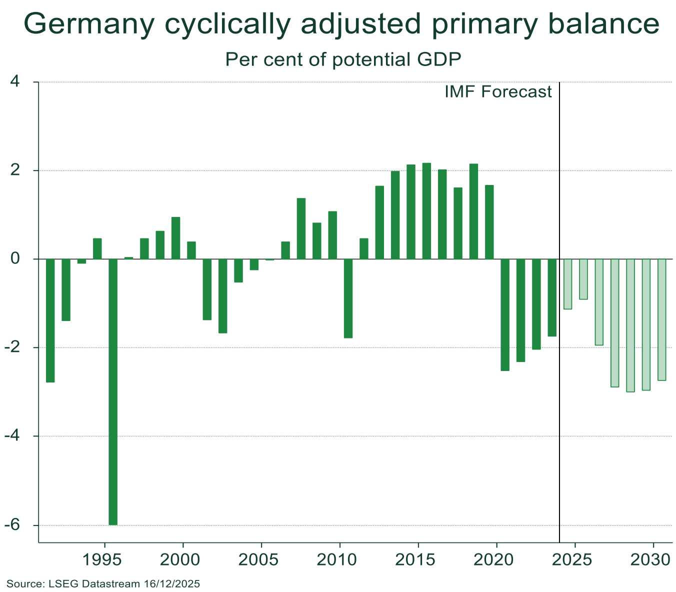
The US economy has been relatively resilient in 2025, growing at around 2%, helped by AI related investment activity which has been a major contributor to growth, helping offset some of the weakness created by a softer labour market, weaker immigration and tariff uncertainty. In the second half of the year, higher tariffs have begun to flow through and impact business profit margins and goods prices. This has impacted manufacturing activity, consumer sentiment and employment. The 43-day US government shutdown in October will dent fourth quarter activity and has made it more difficult to get an accurate gauge on how the US economy is travelling, given publication of key economic measures have been delayed or skipped.

The One Big Beautiful Bill, passed in July, will see tax cuts, corporate depreciation incentives and tax refunds begin to flow through in early 2026 and these measures are expected to boost growth by around 0.9% next year. There is also the prospect of additional US rate cuts in 2026. Members of the Fed's rate setting committee are divided, with broad acknowledgement that inflation remains too high, and the labour market has weakened, but they have differing views on whether more rate cuts are necessary. In 2026 we could see this internal division persist, depending on the makeup of the committee and the identity of the new Chair. Finally, there are chances that the Trump administration rolls back some tariffs (or the Supreme Court deems certain tariffs illegal) after cost-of-living concerns continue to impact consumer sentiment, and voter perceptions of the government's management of the US economy have weakened, ahead of the mid-term elections at the end of 2026.

Given the lack of recent official economic data on employment and inflation, it is challenging to get an accurate gauge on current economic momentum, but it is clear that employment has slowed dramatically this year. Some of this is due to weaker demand from businesses, due to high levels of uncertainty about the outlook. Some has been attributed to layoffs of federal government workers as well as AI impacting graduate and white-collar worker hiring. However, the slowdown has also been attributed to weak supply of new workers due to falling immigration and, in some cases, accelerated retirement of older workers, helped by rising share prices that boost retirement assets. There is no evidence of widespread layoffs, job vacancies are still high, and unemployment claims have stayed low, so it seems that softer demand and lower supply are offsetting each other which means the rate of unemployment is unlikely to have risen much.

US inflation has largely moved sideways in 2025, and is up marginally over the past six months, as tariffs have started to flow through into consumer prices. Inflation is expected to remain high in the first half of 2026 as companies slowly adjust prices to reflect higher import duties. On the other hand, housing inflation, which adjusts slowly, but accounts for around 40% of the core consumer price index weighting, has continued falling, helped by softer house prices, the strong supply of new apartments in recent years and slower wage growth. Although the tariff impact on inflation is regarded as being temporary, there are risks that growth-boosting fiscal and monetary policies could also add to inflation pressures next year.





The consensus view of economists is for growth to slow to around 2.0% next year, similar to 2025. We think the US economy can grow a little faster, around 2.2-2.4%, as policy uncertainty fades and data centre investment accelerates, AI boosts productivity and the Trump administration look for ways to improve the economic growth ahead of the mid-terms.

Eurozone

As Europe turns the page on a surprisingly resilient 2025, the continent faces a defining year in 2026 with a cyclical upswing driven by fiscal stimulus, against a backdrop of entrenched structural issues. While 2025 defied pessimistic forecasts, particularly regarding trade headwinds, the coming year promises an acceleration in growth, albeit one overshadowed by political fragmentation and the urgent need for strategic investment. Despite external challenges, the Eurozone economy proved robust in 2025, with growth estimates revised upward to 1.4%. Looking ahead, economists see annual average growth of 1.1% in 2026 with year-on-year growth accelerating from 1.0% in the current quarter to 1.5% in the final quarter of 2026.

The primary engine for this recovery is Germany. After years of stagnation, Europe's largest economy is expected to return to growth in 2026, fuelled largely by an expansionary fiscal policy. A significant infrastructure and defence spending plan is anticipated to deliver a Keynesian style growth burst over the next two years, leveraging slack in the economy before capacity constraints eventually bite.

While Germany hits the accelerator, the outlook elsewhere is mixed. Growth in the UK is expected to slow marginally from 1.4% this year to 1.2% in 2026. The UK labour market has stalled and rising political uncertainty is constraining investment. However, fiscal and monetary policy remain supportive of growth. The outlook in France is one of muddling through. While the French economy is expected to avoid a crisis, government finances remain an issue, creating divergence from Germany where the government has plenty of capacity to borrow and spend. Political fragmentation continues to complicate French structural reforms, and the labour market is expected to soften as labour productivity moves back to pre-pandemic levels creating more slack in the labour market while policy uncertainty and AI dampens demand for workers.

As Eurozone growth picks up, inflation is expected to temporarily undershoot the European Central Bank's (ECB) 2% target in early 2026, driven largely by energy base effects. Headline inflation is forecast to average 1.8% in 2026 down from 2.1% in 2025. Despite this dip, the ECB is expected to keep rates on hold at 2% throughout the year, with the first hike likely in mid-2027. This caution is due to medium-term upside risks to inflation, specifically from fiscal expansion and a tight labour market. The labour market remains a bright spot; the unemployment rate is projected to remain steady at around 6.3% next year, similar to 2025, before declining in 2027, driven by persistent labour demand and shrinking supply of workers.

A major theme for 2026 is the pivot toward European strategic autonomy. Europe is under pressure to ramp up investment in defence, technology, and AI to compete in a rapidly changing geopolitical landscape. While Germany is pressing ahead with defence and infrastructure spending, action across the broader continent remains slow, hamstrung by high public debt and complex dependencies on the US and China. In 2026, Europe's economic outlook depends on whether its cyclical resilience can outlast its structural rigidities. With fiscal stimulus providing a boost, the short-term outlook is positive, but the clock is ticking on the need for deeper reforms.

China

After successfully navigating a challenging 2025, China's real GDP growth is expected to come close to hitting the government's 5.0% growth target. In 2025 China showed that it could be successful in navigating US-China tensions and its economy displayed resilience, helped by fiscal stimulus which helped alleviate headwinds from softer domestic consumers and weaker export demand. There was some slowing in the latter half of the year due to new industrial policies aimed at cutting overcapacity and a deepening property sector downturn. For the coming year, the Chinese government's focus shifts to tackling entrenched deflationary pressures while maintaining an expansionary fiscal stance.

The government is widely expected to lower its official growth target for next year, with real GDP growth forecast to moderate to 4.5% in 2026. Crucially, the long-awaited rebound inflation is expected to materialise. CPI inflation is forecast to average 1.5% in 2026, a significant increase from 0.0% in 2025. This reflation is largely based on the normalisation of food prices, specifically a projected rebound in pork prices, which had dragged on overall CPI throughout 2025. On the industrial side, producer price inflation is also expected to turn positive by the second half of 2026 after several years of falling producer prices.

This anticipated improvement in consumer and industrial prices is crucial for the Chinese economy, given weakness in nominal GDP growth which is expected to rise to 5.3% in 2026 from just 4.0% in 2025. This acceleration in nominal economic growth is expected to provide a much-needed boost to corporate profitability and labour incomes which have been weak in recent years.

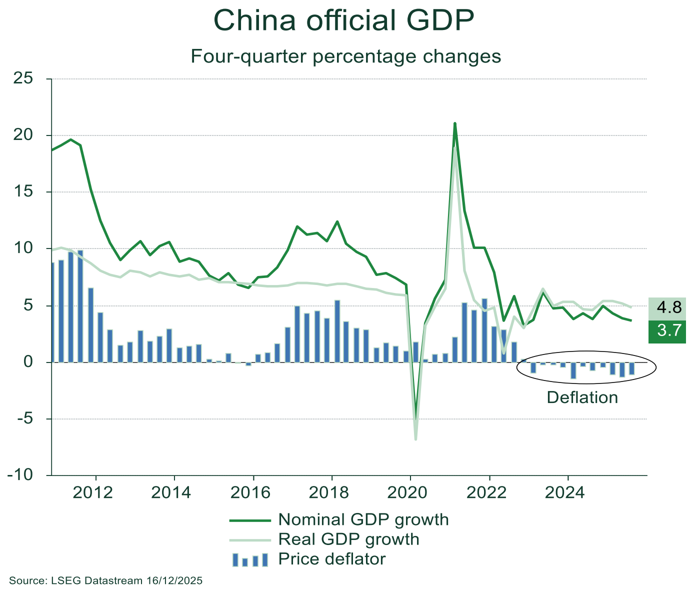
A key driver for this reflationary push is the government's "anti-involution" policy, a top priority for 2026. This is a new round of supply-side reform, targeting overcapacity and excessive competition, or 'involution', in key industries dominated by private companies. Unlike previous reforms, which focused on state-owned enterprises such as steel makers, the current strategy aims to increase market concentration by facilitating mergers and acquisitions among firms with excess capacity. Historically, such measures have rapidly increased producer prices, making successful implementation essential for restoring corporate profitability.

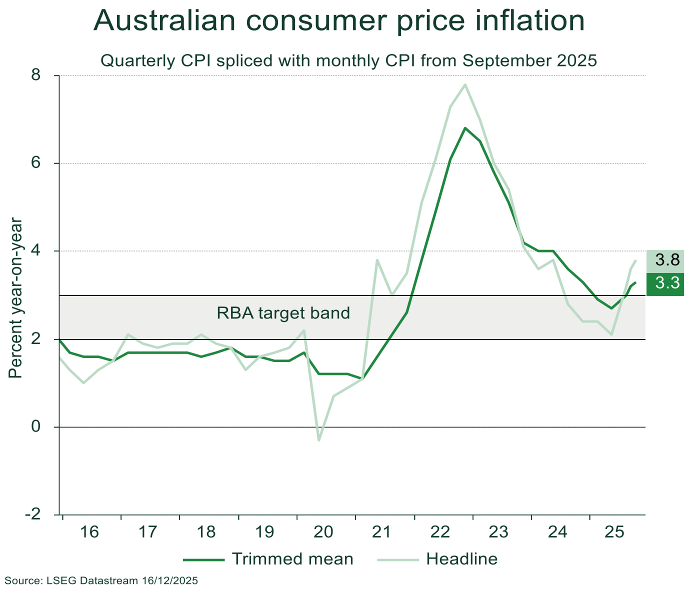
Fiscal policy is also expected to remain expansionary to underpin demand in the Chinese economy. The government's budget deficit is projected to remain elevated at 8.5% of GDP in 2026 and the government is expected to continue supporting infrastructure investment. Consumption is forecast to remain the largest contributor to GDP growth. The government's efforts to boost purchases of consumer goods through trade-in subsidies is facing diminishing returns after being introduced more than a year ago, while services consumption is likely to gradually improve due to government support.

Monetary policy is likely to remain steady next year. The People's Bank of China (PBOC) is expected to keep its key policy rate unchanged at 1.40% through 2026, aiming to preserve bank profit margins as inflation lifts. To support credit, the PBOC is expected to rely on injecting liquidity into the banking system and a further cut to bank reserve requirement ratios.

On the export side, trade remains robust despite US-China trade tensions. Export growth is forecast to remain strong next year, supported by Chinese exporters gaining market share in non-US and developing markets, coupled with stable US-China trade relations. This external strength is also expected to drive currency appreciation, with the CNY projected to strengthen to 6.7 per US Dollar by the end of 2026 from around 7.1 currently.

The main domestic headwind remains the property sector which has been weak for several years now. Contrary to our "muddle through" expectation last year, new home sales dropped again in 2025, and even secondary home sales showed signs of softening. Despite various easing measures, activity is expected to remain subdued in 2026, offering little support to overall growth or a stronger inflationary rebound. Furthermore, the rapid application of AI, a key focus for China especially after the boost to technological confidence following the 'DeepSeek Moment' earlier in the year, poses a potential downside risk to employment.





Australia

As 2025 closes, the Australian economy finds itself in an unexpected state of stronger than expected growth, coupled with persistent capacity constraints, having largely bypassed the hard landing that many predicted. The recent GDP report showed domestic demand, which strips out inventories and trade, rising by 1.2% over the third quarter, its strongest gain since 2012 outside COVID-era swings. The underlying pace of consumption growth remains solid, supported by an improvement in household real income growth, while business investment growth was also strong, helped by data centre investment. The key takeaway is that the Australian economy is growing back at trend rates driven by the recovery of the private sector over the past year.

The outlook for 2026 is defined by a tense standoff: resilient domestic demand continues to drive growth, but it is also creating surprisingly sticky inflation which has placed the Reserve Bank of Australia (RBA) in a difficult dilemma. Real GDP growth is forecast to accelerate modestly in 2026, rising from an annual average of 1.7% in 2025 to 2.2% in 2026. This recovery is primarily driven by further normalisation in household consumption as well as dwelling and business investment. Private consumption growth is likely to build on recent momentum supported by real disposable income gains from previous tax cuts and lower interest rates. However, these tailwinds could subside with increased possibility of rate rises next year, which would test the durability of the consumer recovery.

Inflation proved to be materially stronger in late 2025, surprising many, including the RBA, with trimmed-mean inflation re-accelerating to 3.3% by October. For 2026, underlying (trimmed-mean) inflation is forecast to end the year at 2.7%, but critically, it is expected to remain above the RBA's 2-3% target band until the third quarter of 2026 due to base effects. The labour market, while easing, is not loose enough to offset inflation concerns. Employment growth has slowed significantly from its 2024 peak, yet the unemployment rate is expected to stabilise at a historically low 4.3% to 4.5% in 2026. Encouragingly, private sector wage growth has been decelerating, which may suggest the labour market is not as tight as some official measures imply.

On the trade front, the resilient global market for Australian exports is expected to continue supporting the currency, with the Australian Dollar forecast to strengthen to 69 US cents by the end of 2026, according to the latest poll of currency projections. Fiscal policy is expected to contribute to activity, with forecasts assuming a modest pick-up in government spending next year. However, one key near-term risk to inflation is the expiration of government electricity price subsidies, which would create a large upward contribution to CPI inflation in early 2026.

Our base case is for the RBA to maintain the cash rate at 3.60% throughout 2026. However, the RBA views the economy as already operating near trend rates of growth with little spare capacity. Following the December RBA meeting, Governor Bullock acknowledged that the RBA Board is uncomfortable with where inflation is at present despite the RBA statement saying that some of the recent increase in underlying inflation was due to temporary factors. When asked about the balance of risks around rate hikes or cuts in 2026, Bullock was quick to dismiss rate cuts, but not nearly as willing to dismiss rate hikes. The bottom line is that if the inflation data released in January confirms that the recent increase in inflation was not due to temporary factors then a rate hike in February remains a strong possibility.

In summary, 2026 is set for near-trend growth, but its trajectory will be determined by whether the recent inflation spike is temporary, or if it forces the central bank to choose between a painful rate hike and accepting a longer period of inflation overshoot.

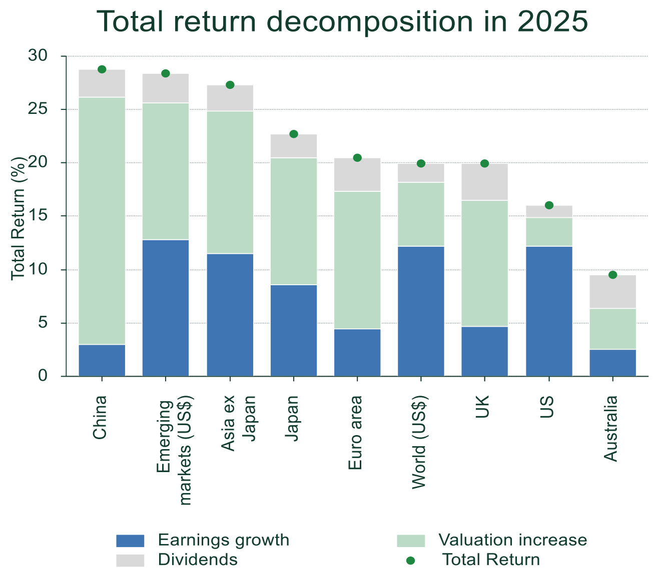
04

Asset Class Views

Equities

Based on our expectations for solid global growth in 2026, the outlook for corporate earnings remains constructive, supported by healthy nominal GDP growth and ongoing investment in AI, infrastructure and defence. We expect earnings to do most of the heavy lifting next year, driving a 10-15% total return including dividends from developed market equities in 2026. Recent equity gains have been driven more by earnings than by valuation expansion, and that dynamic is likely to persist given that forward price to earnings ratios remain elevated relative to history. Valuations across the US, Europe and Asia are fully pricing in the current growth environment, leaving little room for multiple expansion and reinforcing the need for selectivity and discipline rather than broad equity market exposure.

Market leadership continues to be concentrated in the largest US technology companies, but 2026 is shaping up as a year of greater dispersion. The Magnificent Seven remain dominant, yet investors are increasingly focused on monetisation, cash flow discipline and the durability of AI-related spending. We expect hyperscaler capital expenditure on AI infrastructure to remain strong, underpinning demand for semiconductors, compute power and data management, but there are risks around financing structures and depreciation assumptions. While the AI theme is far from exhausted, the investment narrative is evolving from pure infrastructure build-out to application-layer economics, where companies that can demonstrate clear paths to monetisation and profitability will command a premium. Beyond the mega-caps, opportunities are emerging among the “picks and shovels” of the AI boom—businesses enabling adoption through software, analytics, power and cooling solutions.



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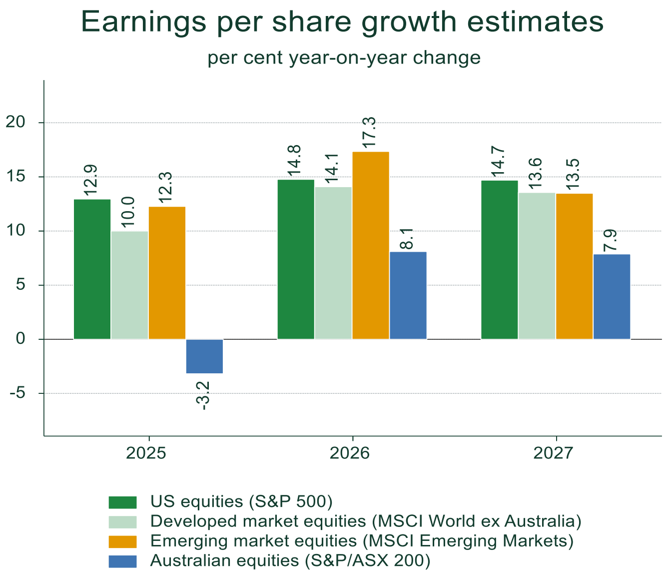


Source: LSEG Datastream 16/12/2025

If rate cuts proceed without a recession, history suggests small and mid-cap equities could outperform, and there is scope for smaller companies to benefit from lower US interest rates, revived dealmaking and improving earnings momentum. In Europe, valuations remain at a deep discount to US peers even after adjusting for sector mix and fiscal stimulus combined with increased defence and infrastructure spending could catalyse a value re-rating, particularly in industrials, financials and energy transition.

Emerging markets look attractive, trading at roughly a 40% discount to US equities, with strong earnings profiles and tailwinds from a softer US Dollar. China and India are key focal points, with themes around advanced manufacturing, clean energy and resilient consumption, although policy and tariff risks require careful navigation as well as high valuations in parts of these markets. Japan continues to benefit from corporate governance reforms, stable monetary policy and a supportive fiscal backdrop, with exporters aided by a weaker Yen and domestic companies buoyed by wage growth and rising shareholder returns.

The risks we are monitoring include tariff-related inflation pressures, fiscal sustainability concerns that could steepen yield curves and weigh on equity valuation multiples and potential cracks in credit markets as AI-related debt issuance rises. While recent credit events appear idiosyncratic and fraud related rather than systemic, they underscore the importance of balance sheet strength and active security selection. AI capex execution risk also needs to be watched, with infrastructure bottlenecks and monetisation timelines creating a wide range of potential outcomes.

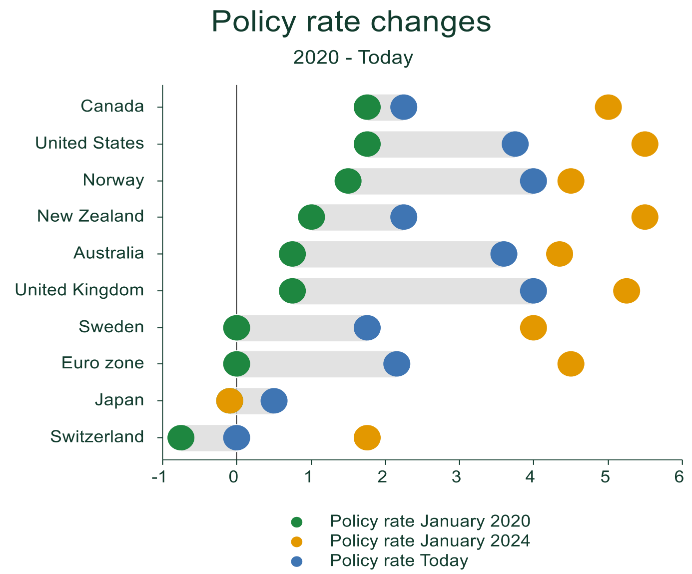
Against this backdrop, our overall stance remains neutral on equity allocations but with a clear preference for active risk-taking through quality-tilted stock selection and regional diversification. We continue to anchor equity portfolios in undervalued and high-quality growth companies with strong fundamentals, stable earnings and clear competitive advantages to navigate potential volatility, capitalise on market rotations and ensure that total exposure to high flying momentum stocks, particularly those attached to the broader AI rally, do not overly dominate performance of equity portfolios. We are avoiding low quality, loss making tech names and other speculative high momentum stocks

Cash and Fixed Income

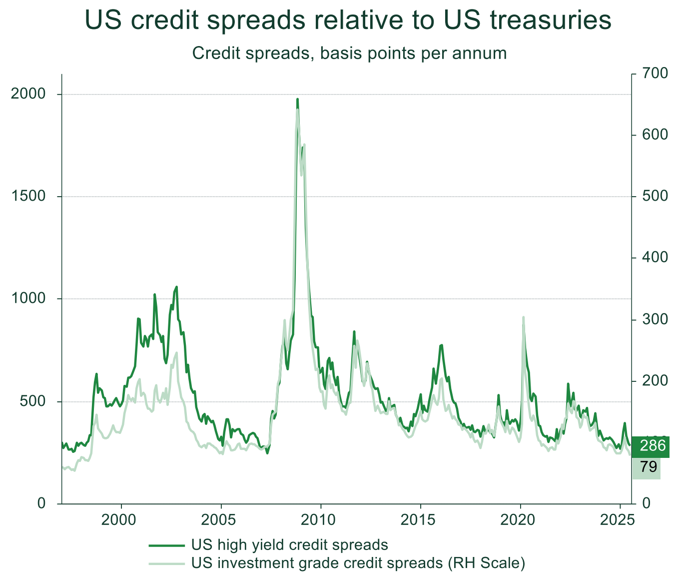
Steady or declining inflation and still-low unemployment should support a broadly stable monetary policy backdrop in 2026, but the pace and depth of rate adjustments will be far more measured than in prior easing cycles given the solid growth backdrop and sticky inflation. Overall, the global monetary policy stance has shifted from interest rates being restrictive towards more neutral levels with few countries needing aggressively accommodative policy.

We expect the US Federal Reserve to deliver only limited cuts, perhaps one or two additional cuts following a pause after the recent cut, reflecting sticky core inflation and political uncertainty around the Fed's leadership transition. There are risks that a less independent Fed could cut rates more aggressively in 2026, something President Trump has long advocated for. In Europe, the ECB is expected to remain on hold at 2% throughout 2026, with the first hike likely deferred to mid-2027, even as deficit spending and tight labour markets keep medium-term inflation risks alive. The Bank of England should complete its cutting cycle by mid-year, taking its Bank Rate to around 3.25% and the Bank of Japan should continue lifting its policy rate to 1.25% by early 2027. The RBA is likely to stay on hold at 3.60%, with a modest risk of a hike or two next year, if domestic inflation proves persistent. Following this year's RBA cash rate cuts, current cash returns net of inflation are relatively unattractive unless rates rise next year and/or inflation declines from the 3.80% rate seen in October.

For fixed income investors, this environment argues for tempered return expectations and a focus on income generation rather than capital gains. There are some prospects of steepening in major yield curves as equilibrium rates reset higher and term premia continue to rebuild, with 10-year US Treasury yields ending 2026 closer to 4.45% versus 4.15% today and German Bunds around 3.10% up from 2.85%. Structural drivers such as larger fiscal deficits, stubborn inflation, reduced global savings and ongoing supply-demand imbalances in government bond markets are the main drivers of the increase in longer dated bond yields.



Source: LSEG Datastream 16/12/2025



Source: LSEG Datastream 16/12/2025

While temporary disinflationary forces - such as softer energy prices - may slow the upward repricing in yields, the longer-term backdrop of fiscal expansion and strategic reindustrialisation points to higher neutral rates than the post-GFC era. Against this setting, real yields on longer-dated government bonds remain compelling, particularly in the US (once tariff induced inflation washes through) and the Eurozone where disinflation is more advanced than in Australia.

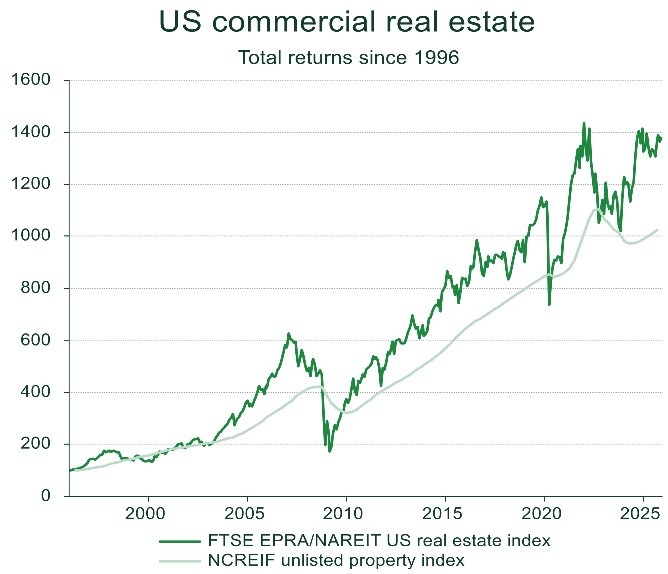
Emerging market (EM) sovereign bonds enter 2026 on a relatively strong footing, supported by moderating inflation, credible policy frameworks and improving external trade and debt balances. Local currency EM bonds should benefit from easing monetary conditions, while hard currency EM bonds are benefiting from a weaker US Dollar, lower US interest rates and prudent fiscal and monetary policy which have improved credit fundamentals, resulting in widespread sovereign rating upgrades. Dispersion in EM sovereign bond returns is likely to increase in 2026 as election cycles and fiscal dynamics create risks in different countries and high-yielders reliant on external funding may face pressure if global liquidity tightens. Overall, EM sovereign debt remains a source of high real yields and diversification but requires selective positioning and active risk management.

Credit markets should deliver positive returns, but spreads are likely to widen modestly from current tight levels as the business cycle ages and AI-related debt issuance accelerates. Speculative-grade credit default rates should remain contained - around 4.5% and 2.7% in US and European respectively - but idiosyncratic risks tied to leveraged loans and private credit warrant caution. Companies with balance sheet strength and refinancing flexibility are critical in this environment and we continue to prioritise credit quality, high levels of sector and/or geographic diversification avoiding overexposure to sectors reliant on aggressive capital expenditure or opaque financing structures.

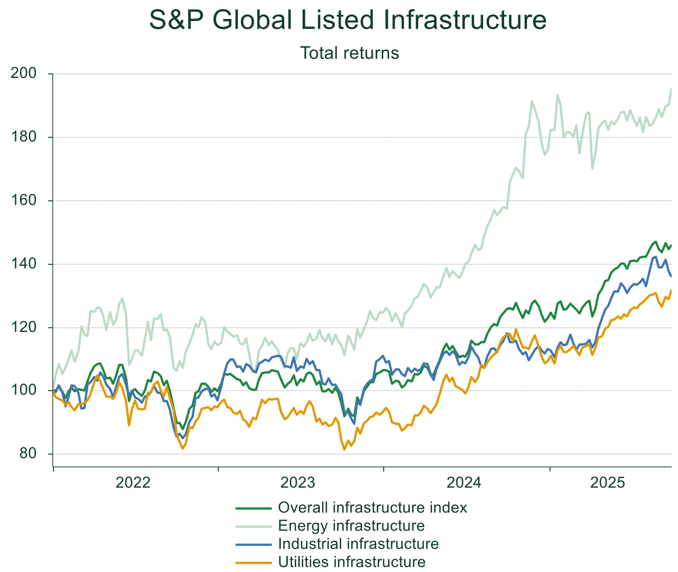
In summary, cash and fixed income allocations should continue to serve as stabilisers, but with returns driven primarily by income rather than gains from credit spread or duration moves. We maintain a preference for high-quality sovereign bonds in both developed and emerging markets as well as investment-grade credit, complemented by selective exposure to riskier high yield bonds and private credit that can provide higher levels of income. While the worst of the rate volatility appears behind us, structural forces - higher equilibrium rates, rising levels of government and corporate sector debt and evolving geopolitical dynamics - mean that fixed income will remain a source of both opportunity and risk in the year ahead.

Property and Real Assets

Listed property and infrastructure have both produced solid returns in 2025, helped by interest rate cuts, a resilient economic environment and rising equity markets. We expect the tailwinds that have helped drive strong listed property and infrastructure returns in 2025 to carry into 2026, albeit with more modest total return potential as higher neutral interest rates and slightly higher long term bond yields place limits on valuation expansion and lower capitalisation rates. The longer-term themes of fiscal expansion, defence spending, AI investment and strategic reindustrialisation are supportive for real-asset demand, but to the extent that they boost economic growth and inflation, they also temper valuation upside compared with the post-GFC era.



Source: LSEG Datastream 16/12/2025



Source: LSEG Datastream 16/12/2025

Unlisted core real estate valuations stabilised in 2025, confirming that the sharp headwinds from earlier interest rate increases and rising capitalisation rates are largely in the past. Pricing for commercial real estate is settling near the cycle bottom. Capitalisation rates for many sectors have stabilised around pre-pandemic levels, though capitalisation rates for office and retail properties still hover near multi-year highs. In Australia, yield compression is already beginning to materialise in the retail sector as consumer spending improves. For core infrastructure, discount rates underpinning valuations have remained broadly resilient.

In listed securities, Global REIT (GREIT) valuations saw improvement, with discounts to Net Asset Value (NAV) narrowing significantly back towards the long-term historical average discount of -7.8%. This narrowing suggests that the compelling valuation arbitrage previously seen in listed GREIT assets compared to private assets has reduced.

Future real estate returns are highly dependent on achieving durable income growth. Structural factors related to supply and demand are creating divergence across sectors:

- **Retail:** This sector is experiencing strong performance due to resilient consumer demand and critically constrained new supply. Institutional capital is actively targeting necessity-based retail, anticipating potential cap rate compression.
- **Residential & Healthcare:** These sectors benefit strongly from demographics and affordability constraints. Healthcare property, particularly US seniors housing, is expected to outperform, driven by the "silver tsunami" (aging population) and historically low construction pipelines. Residential rental markets remain robust due to the high cost of home ownership.
- **Office:** The office market remains fundamentally bifurcated. Demand is heavily concentrated on high-quality, premium assets, while older assets face obsolescence. In the US, older office blocks are being demolished or, where possible, converted to residential, which is reducing net supply. Leasing activity showed momentum in some core areas, but national vacancy remains elevated (around 15% in Australia). Lease incentives, while still high, are showing early signs of easing in core markets.
- **Industrial:** Near-term market challenges exist due to elevated speculative new supply, resulting in rising vacancy and incentives. However, the long-term outlook remains positive, especially from mid-2026 onward, when a forecast sharp drop in construction aligns with underlying demand growth.

The infrastructure sector is significantly influenced by powerful macro tailwinds shaping the global economy.

- **AI and Digital Infrastructure:** The explosion of demand for AI processing power and cloud computing is the key thematic driving activity in data centres and digital infrastructure like fibre networks and mobile phone towers. This demand is outstripping supply capacity, supporting greenfield development opportunities and resulting in elevated pricing.
- **Energy Infrastructure and Transition:** The immense electricity requirements of data centres necessitate substantial capacity buildout in power generation and transmission assets. The broader energy transition continues to offer opportunities in renewables and utility-scale batteries. However, policy volatility, particularly around regulatory incentives for emerging segments like green hydrogen, remains a key downside risk.
- **Geopolitics and Reshoring:** Geopolitical tensions are contributing to demand for infrastructure through efforts toward supply chain security, leading to reshoring and re-industrialisation. This supports investment in related manufacturing logistics and core infrastructure assets, including those linked to increased defence spending.

In essence, 2026 is poised to favour real assets characterised by durable cash flows and exposure to structural growth themes (AI, demographics and energy needs), while emphasising the need for active management in volatile, cyclical sectors like office and industrial property.

Alternative Investments

Alternative investments such as hedge funds have had a reasonable year both from an absolute return perspective but also on a risk-adjusted basis. So far in 2025, broad hedge fund indices are up over 8%, or around four percentage points above cash returns, which is broadly in line with our long-term targets. Non-hedge fund liquid alternative investments, such as insurance-linked securities, have also provided solid returns in 2025 with the Swiss Re Global Catastrophe Bond index up 11.6% year-to-date.

We expect that alternative investments will remain a critical source of both diversification and strong risk-adjusted returns in 2026. Hedge funds continue to demonstrate strong portfolio benefits, with multi-strategy and quantitative strategies delivering superior returns and resilience amid market volatility. Hedge fund allocators currently favour these strategies given the high barriers to entry - high technology and data costs that quantitative and multi-strategy firms have to incur – in order to generate sustainable returns above cash rates. Equity long/short managers are expected to benefit from persistent stock-level volatility and greater alpha opportunities. However, elevated crowding and concentration in high-beta positions, including some of the Magnificent Seven stocks, highlight the need for disciplined risk management.

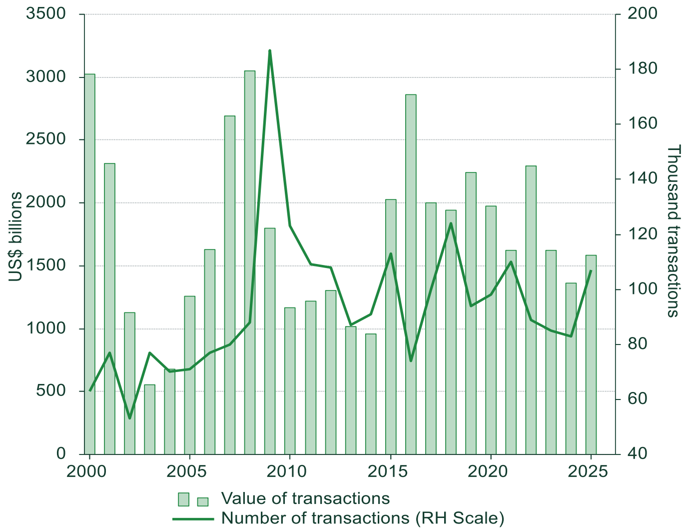
Insurance-linked securities (ILS) or catastrophe bonds also stand out as a compelling alternative investment option, offering uncorrelated returns and attractive gross yields of around 10%, before any insurance losses, supported by robust catastrophe bond pricing and structural demand from insurers seeking protection against climate and higher replacement cost-related risks. Despite modest softening in reinsurance pricing, conditions remain historically favourable, reinforcing ILS as a strategic diversifier alongside hedge funds in portfolios.

All the main hedge fund sub-strategies have produced strong year to date returns, with the exception of systematic trend-following funds. Trend followers or Commodity Trading Advisors (CTAs) had a difficult first half of the year due to whipsawing of financial, currency and commodity markets around April's Liberation Day tariff announcements but recovered most of these losses in the second half of 2025, helped by price momentum in equities, precious metals (including gold and silver) and other commodities. We continue to include these strategies in portfolios for diversification and portfolio insurance purposes as they can generate strong, non-linear returns in equity and/or bond bear markets, such as 2022, even though returns may be relatively subdued in other years.

Trend following and Commodity Trading Advisors

Source: LSEG Datastream 16/12/2025

Global mergers and acquisitions



Source: LSEG Datastream 16/12/2025

With equity valuations elevated, and low quality companies with weak earnings showing strong momentum driven returns, we are optimistic that 2026 could also provide a good environment for both fundamental and quantitative stock pickers where equity long/short and market neutral hedge funds shine as stock price moves become less about the macroeconomic, geopolitics and interest rates and more about the valuations and fundamentals of individual companies. Within the equity long/short and equity market neutral sectors, we favour funds managed by firms with a competitive edge such as proprietary technology and data, or specialist knowledge and research skills in a particular part of the market overlooked by other investors.

The lack of corporate deal activity over the past three years has meant that the environment for event-driven hedge funds that invest in companies engaged in a merger, takeover, capital raising or restructuring, has been more challenging. In 2026, we expect merger and acquisition and initial public offerings to continue to recover back to pre-pandemic levels, helped by US deregulation, lower interest rates, less policy uncertainty and increased CEO confidence. This should benefit event-driven hedge funds focused on mergers and takeovers and special situations funds such as those investing in catalyst driven credit opportunities that look for stressed and distressed corporate opportunities.

Other liquid alternative investment strategies such as fixed income relative value trading and convertible bond trading remain attractive given changes to supply and demand dynamics. Also of interest are niche trading strategies that are hard to access with large amounts of capital or where the returns are only attractive infrequently, which requires a more nimble and opportunistic approach, and this favours the use of multi-manager funds with the ability to quickly move in and out of these strategies as the opportunities present themselves.

05

Market and portfolio snapshot

Current Balanced portfolio positioning summary

Asset Class	Positioning	View
Cash	Neutral	Short term cash rates are likely to remain steady at around current levels. Real returns are relatively unattractive given inflation is currently running at 3.8%, however, there is a chance of one or more rate hikes in 2026.
Australian Debt	Neutral	Retain a neutral weighting with interest rate duration close to benchmark of around five years. Yields already reflect expectations of potential rate rises in 2026, however, if the recent lift in inflation proves temporary, and rate hikes aren't required, Australian bonds can perform strongly.
Global Debt	Neutral	Hold a neutral weighting with interest rate duration close to benchmark of around seven years. Higher US inflation from tariffs is likely to be temporary, and the softening of the labour market could lead to a few more US cuts this cycle. Credit is relatively expensive but can provide attractive income and total returns in a non-recessionary environment.
Alternative Defensive	Neutral	Alternative strategies should help to diversify portfolios. These strategies have traditionally held up relatively well when more traditional defensive strategies, tied to bond yields and the credit outlook, have suffered.
Alternative Growth	Neutral	Alternative growth strategies benefit from higher price volatility and dispersion with returns less correlated to broader risk sentiment. We expect 2026 will be a better year for active stock pickers deploying long/short or market neutral strategies. Merger activity should lift next year which will help event driven strategies.
Property & Real Assets	Neutral	Property and infrastructure should provide a more defensive exposure in a global downturn relative to equities. The demand and supply dynamics for property and infrastructure assets (particularly in energy and digital infrastructure) are improving helping lift income growth and valuations.
Australian Shares	Neutral	The earnings growth outlook is relatively muted while equity valuation multiples, particularly for the major banks, are still high relative to history and compared with international peers. Australian miners are benefiting from resilient iron ore prices as well as increases in prices for industrial and precious metals.
Global Shares	Neutral	Hold a neutral allocation, as although investor sentiment and valuations, particularly for US tech companies, are high, economic and corporate fundamentals, such as solid earnings growth, remain supportive. We are alert to risks of an AI asset bubble, which we do see in parts of the AI value chain. Accurately timing when bubbles form and when they burst remains a challenge and we don't believe major listed AI stocks are in a bubble yet.
Currency hedging	Fully unhedged	Although the US Dollar has lost some of its shine driven partly by lower interest rates and policy uncertainty, in a risk-off scenario, it is again likely to regain some of its safe-haven status as there are few alternatives. Prefer to remain currency unhedged in Global Shares as potential weakness in the Australian Dollar, which is sensitive to global risk appetite, can help offset losses during a sell-off in equities.

Strategic Asset Allocation (SAA) and Dynamic Asset Allocation (DAA) weights

Portfolio	Conservative		Moderate		Balanced		Growth		High Growth	
Asset Class	**SAA**	**DAA**	**SAA**	**DAA**	**SAA**	**DAA**	**SAA**	**DAA**	**SAA**	**DAA**
Defensive Assets	70.0	70.0	50.0	50.0	35.0	35.0	20.0	20.0	5.0	5.0
Cash	15.0	15.0	10.0	10.0	5.0	5.0	2.5	2.5	2.5	2.5
Australian Debt	20.0	20.0	10.0	10.0	5.0	5.0	0	0	0	0
Global Debt	30.0	30.0	25.0	25.0	20.0	20.0	15.0	15.0	0	0
Alternative Defensive	5.0	5.0	5.0	5.0	5.0	5.0	2.5	2.5	2.5	2.5
Growth Assets	30.0	30.0	50.0	50.0	65.0	65.0	80.0	80.0	95.0	95.0
Property & Real Assets	5.0	5.0	7.5	7.5	10.0	10.0	10.0	10.0	10.0	10.0
Alternative Growth	5.0	5.0	7.5	7.5	10.0	10.0	7.5	7.5	7.5	7.5
Australian Shares	5.0	5.0	15.0	15.0	20.0	20.0	25.0	25.0	25.0	25.0
Global Shares	15.0	15.0	20.0	20.0	25.0	25.0	37.5	37.5	52.5	52.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Major financial markets

To 30 November 2025	Latest	1 Month	3 Month	Year-to-date	1 Year	3 Year	5 Year
Equities		Local currency returns including dividends in percentage, not annualised					
Australia - S&P/ ASX 200	8614	-2.7	-3.1	8.9	5.5	32.1	60.1
Japan - Nikkei 225	50254	-4.1	18.5	28.3	34.1	90.5	109.4
US - S&P 500	6849	0.3	6.3	17.8	15.0	75.3	103.6
US - NASDAQ Composite	23366	-1.5	9.1	21.7	22.4	108.3	98.8
UK - FTSE 100	9721	0.4	6.4	23.0	21.5	43.5	86.5
Europe - STOXX 600	576	1.0	5.2	17.3	16.8	44.6	73.1
Developed Markets - MSCI World	3418	0.3	6.2	18.3	16.0	69.0	93.9
Emerging Markets - MSCI EM	85303	-1.6	10.2	28.7	30.2	58.2	45.4
Government bond yields			Change in annual yield in percentage points				
Australia - 2 year	3.82	0.25	0.48	-0.10	-0.16	0.70	3.72
Australia -10 year	4.54	0.22	0.24	0.06	0.17	0.99	3.63
US - 2 year	3.49	-0.11	-0.12	-0.75	-0.68	-0.88	3.34
US - 10 year	4.02	-0.08	-0.20	-0.55	-0.18	0.32	3.18
UK - 10 year	4.44	0.03	-0.28	-0.13	0.20	1.28	4.14
Germany -10 year	2.69	0.05	-0.03	0.33	0.60	0.75	3.26
Currencies and Commodities				Change in price			
Australian Dollar (US$)	0.6558	0.0012	0.001	0.037	0.004	-0.014	-0.081
US Dollar Index	99.44	-0.36	1.67	-9.04	-6.29	-6.51	7.57
Gold (US$/ounce)	4200.10	221.15	758.66	1574.75	1540.65	2448.16	2425.71
Iron Ore (US$/tonne)	106.09	-1.18	1.83	4.98	0.78	4.26	-23.22
Crude oil (WTI, US$/barrel)	58.58	-3.17	-5.78	-13.86	-9.68	-21.87	13.24

Nick Ryder

Chief Investment Officer

Nick Ryder is an investment professional with deep and broad experience built over 30+ years in the investment management and financial services industries. Before joining Stanford Brown, Nick was a senior investment strategist at Commonwealth Bank, JBWere and NAB providing investment strategies to wealthy individuals, families and not-for-profit-clients.

He is passionate about helping clients grow and preserve their wealth, ensuring they also have a strong understanding of how their money is being invested.

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