Quarterly Insight 4Q26

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The Price of the Prisoner's Dilemma

Key Takeaways

- The Prisoner's Dilemma has expanded from AI investment to geopolitics, defence, energy and industrial policy.
- Companies and governments are competing for capital as well as electricity, equipment and skilled labour.
- During the quarter, we increased our allocation to alternative Global Carry strategies, which seek to capture risk premia across asset classes. Their diversified sources of return are particularly valuable when geopolitical uncertainty and shifting interest-rate expectations can trigger abrupt moves in traditional equity and bond markets.
- AI is supporting growth, but productivity and investment returns must increasingly validate the scale of spending.
- Higher yields raise the return required from equities while making government bonds more attractive.
- We moved equities from Overweight to Neutral, returned US equities to Underweight and reduced our Underweight in government bonds. These are tactical adjustments within a constructive medium-term view.

At the beginning of the year, we described 2026 as *"The Year of the Prisoner's Dilemma."* Our focus was primarily technological. In the race for artificial intelligence, no major player could afford to stop investing while competitors continued to accelerate. Individually, the decision to keep spending was rational. Collectively, it raised the possibility of excess investment, stretched supply chains and increasingly demanding return expectations.

Nine months later, the dilemma has grown larger. **USD 7.6 trillion could be invested between 2026 and 2031** across computing capacity, data centres and power infrastructure.

The race is no longer confined to technology companies.

The same logic increasingly defines geopolitics. The United States and China compete for technological leadership while remaining deeply interconnected economically. Europe seeks greater strategic autonomy while still relying on the United States for security and maintaining significant economic ties with China. Russia's war in Ukraine continues to force Europe to rethink defence and energy security. In the Middle East, renewed confrontation with Iran has again shown how quickly geopolitical tensions can spill into energy markets and the global economy.

In each case, cooperation could theoretically produce better collective outcomes. Yet trust is scarce, and the perceived cost of being the only player to step back has become too high. As in the classic Prisoner's Dilemma, individually rational decisions can produce collectively expensive outcomes.

And this is where geopolitics meets economics.

Everyone needs capital

Artificial intelligence requires unprecedented investment in computing capacity, data centres, electricity generation and grids. Global hyperscaler capital expenditure is projected to exceed **USD 760 billion in 2026—more than USD 2 billion per day.** Hyperscalers alone could invest more than **USD 6 trillion in AI by 2030.**

Meanwhile, governments must modernise defence capabilities and critical infrastructure. Companies are redesigning supply chains and expanding production

capacity closer to home. Europe faces the additional task of turning its strategic ambitions into sustained investment.

All these ambitions compete for many of the same resources: energy, equipment, skilled labour—and capital.

This trend is leading to rates becoming even more firmly entrenched in a structurally higher "post-COVID" environment. For much of the past fifteen years, capital was abundant and extraordinarily cheap. Today, access to capital, and the price paid for it, are becoming more consequential.

The AI cycle illustrates this shift. Investment remains a major engine of US economic growth. Data centres, semiconductors, electrical infrastructure and computing equipment support industrial activity and corporate earnings. Yet each new stage of the buildout also requires physical capacity, specialised labour and, increasingly, external financing.

At the beginning of the year, we asked whether any major technology company could afford not to invest. Today, we must also ask whether all those investments will earn an adequate return on the capital deployed.

The technological revolution is real, and the potential addressable market is immense. Yet the sheer scale of investment, combined with uncertainty over which parts of the AI value chain will capture the value created, makes it far from clear whether returns will ultimately justify the capital committed.

Productivity will be the ultimate test: can AI generate sufficiently broad and durable gains to justify the scale of capital being committed?

Growth has a price

For now, the US economy remains resilient. Consumption has held up, the labour market continues to provide support and AI investment is delivering a powerful growth impulse. Rising equity markets have reinforced household wealth, creating a feedback loop between technology spending, corporate earnings, asset prices and consumption.

But this resilience brings its own complications.

Strong demand for investment coincides with geopolitical pressures, higher energy prices and inflation that remains above central bank targets. The forces supporting economic activity can therefore also keep financing costs elevated.

This is the paradox confronting investors: growth remains strong enough to support earnings, but also strong enough to make a return to cheap capital less likely.

The US 10-year Treasury yield's move towards 5% illustrates the change. At that level, future cash flows are discounted more heavily and ambitious investment programmes face closer scrutiny. That scrutiny is becoming visible in credit markets: investors have shown less appetite for debt linked to certain highly leveraged AI infrastructure projects, particularly where execution, power supply or counterparty risks are difficult to assess.

The question is no longer simply whether companies can grow. It is what investors should pay for that growth—and whether new investments can earn more than their rising cost of capital.

From conviction to selectivity

This changing balance of risks has led us to adjust our tactical positioning. We have moved our overall equity allocation from **Overweight to Neutral** and, within it, **US equities back to Underweight** following their rally over the past six months.

This is consistent with the selective stance we have maintained over recent quarters. On average, we have tactically underweighted US equities despite their concentration of the world's leading technology companies. That distinction has mattered: the US market has lagged several other major equity regions over both one- and two-year horizons.

Our medium-term view remains constructive. Corporate earnings are supportive, and AI, electrification and productivity remain powerful structural themes. But strong market performance, elevated valuations and long-term rates near 5% have made the near-term balance between potential gains and losses less attractive.

Other market signals reinforce our caution. Risk

appetite remains strong, credit spreads are exceptionally tight and some weaker segments of the credit market have begun to show strain. Together, these conditions leave equities more exposed to a change in sentiment or a further rise in yields.

At the same time, we are gradually **reducing our Underweight in government bonds.**

Our structural concerns remain: large fiscal deficits, rising public borrowing needs and competition for capital may continue to put upward pressure on long-term yields. Yet above 5%, US government bonds once again offer meaningful carry. In the five- to ten-year segment, their potential reward relative to downside risk has improved considerably.

The comparison with equities has also shifted. Measured as the S&P 500 earnings yield—using the average of trailing and expected earnings—less the US 10-year Treasury yield, the US equity risk premium is at its **lowest level in roughly twenty years.** Equities therefore offer unusually little earnings-yield compensation relative to government bonds. Meanwhile, bearish bond positioning and sentiment suggest that bonds have become less vulnerable to a positive surprise.

These allocation decisions reflect the same change in the price of capital. Higher yields raise the return required from equities while rebuilding the expected return available from government bonds.

The price of staying in the game

The strategic races defining this decade are unlikely to stop. Technology companies cannot easily withdraw from the AI race. Europe cannot ignore the need to strengthen its defence. Governments must secure energy supplies and critical infrastructure. And the United States and China are unlikely to abandon their competition for technological leadership.

For each participant, the perceived cost of stepping back remains high.

But every additional investment in technology, defence, energy security or industrial resilience must be financed. When everyone needs to invest at once, capital becomes more contested—and potentially more expensive.

That is the price of the Prisoner's Dilemma.

For investors, the challenge is increasingly to identify who can afford the price of staying in the game—and who can earn a return from doing so.

Macro Outlook – United States

Key Takeaways

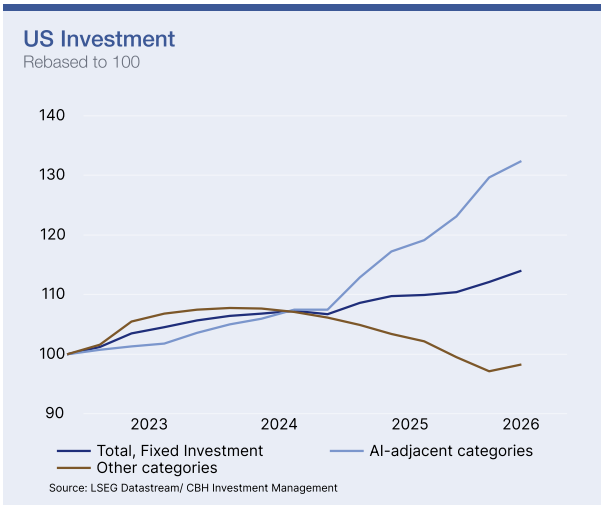
- US growth remains resilient, supported by consumption and AI investment.
- AI-driven wealth effects are reinforcing growth but increasing concentration risk.
- The labour market is cooling without materially weakening.
- Persistent inflation has pushed the Fed back into tightening mode.
- Higher rates and fading fiscal support should slow growth in 2027.

United States: Resilient Growth, Sticky Inflation

The US economy continues to demonstrate remarkable resilience despite tariffs, tighter immigration policies and the renewed energy shock. Growth remained above potential during the first half of 2026, supported by robust consumption, exceptionally strong AI-related investment and a sizeable fiscal impulse. The expansion should remain solid through year-end, although tighter monetary policy and fading fiscal support are likely to produce a more visible slowdown in 2027.

Although underlying domestic demand, consumption and private investment have remained strong, the main drivers of the economy's resilience are becoming increasingly concentrated.

AI investment has become a major engine of US growth. Spending on data centers, semiconductors, electricity infrastructure and computing equipment continues to support capital expenditure, industrial production and corporate earnings. Current investment plans suggest that this momentum should persist into 2027, although growth rates will inevitably moderate from exceptionally high levels.



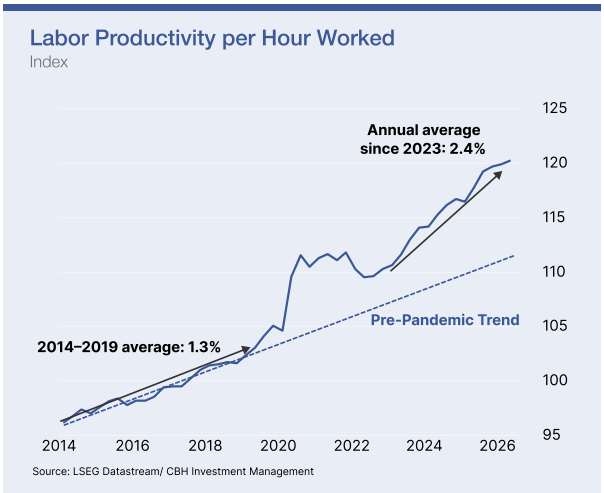
The scale of this investment also creates vulnerabilities. AI-related capital expenditure is increasingly financed through debt and rests on ambitious assumptions about future revenues and productivity gains. It is also intensifying demand for electricity, specialized equipment, skilled labor and long-term capital. AI is therefore supporting growth while simultaneously contributing to inflationary pressures and higher funding costs.

Private consumption has also remained resilient, underpinned by employment, income growth and strong household balance sheets. However, aggregate figures conceal increasingly divergent experiences across income groups. Higher-income households continue to benefit from rising equity and property values, while lower-income consumers remain more exposed to elevated food, energy and borrowing costs. These wealth effects are themselves increasingly linked to the AI cycle, as technology-related investment, earnings expectations and equity valuations reinforce one another. For now, this creates a virtuous circle in which AI investment supports asset prices, household wealth and consumption, which in turn sustain economic growth. However, it also increases concentration risk: any reassessment of AI revenues or valuations could simultaneously weaken investment and consumption. **Growth is therefore becoming more dependent on both a**

relatively narrow group of affluent households and the continued strength of the AI investment cycle.

The labor market continues to support this picture. Hiring has slowed from its post-pandemic pace, but unemployment remains low. Wage growth is moderating without collapsing, reducing the risk of an abrupt downturn in household spending. Nevertheless, slower recruitment and rising financial stress among vulnerable borrowers suggest that consumption should gradually lose momentum.

Productivity growth remains an important source of upside. Recent gains are running above the pace recorded during the decade before the pandemic, reflecting years of strong investment in digital technologies and intellectual property, as well as more flexible working practices. It is probably still too early to attribute the improvement primarily to generative AI, but wider adoption should gradually reinforce productivity growth. The key question is whether these gains will become sufficiently broad to justify the scale of current investment.



Inflation remains the principal macroeconomic challenge. Underlying PCE inflation has been stuck well above the Federal Reserve's 2% target, driven particularly by non-housing services and renewed goods-price pressures. Tariffs are likely to exert a more persistent influence than their initial impact suggests, as companies reorganize supply chains and pass higher costs through gradually. The energy shock adds a further layer of pressure. Historically, sustained increases in oil prices have affected core inflation with a lag, implying that the full impact may become more visible over the coming quarters. While the risk of a 2022-style wage-price spiral remains limited by a less overheated labor market, inflation is unlikely to return sustainably to target in the near term.

The Federal Reserve has now moved from patience to renewed tightening. On 16 September, the FOMC unanimously raised the federal funds target range by 25 basis points to 3.75-4%, its first increase since July 2023. Chair Kevin Warsh emphasized the persistence of inflation and left the door open to further action. Most policymakers expect at least one additional increase before year-end, confirming that the debate has shifted from whether the Fed should tighten to how far rates ultimately need to rise. Warsh's preference for less forward guidance is also likely to make policy expectations more sensitive to individual data releases. This may restore some flexibility to the Fed's reaction function, but it could also generate greater volatility at the front end of the yield curve. Jerome Powell's continued presence on the Board adds institutional continuity, although differences within the FOMC over the relative risks to inflation and employment are likely to become more visible.

Fiscal policy remains highly supportive in 2026, reflecting tax measures, defense spending and elevated transfers. However, much of this impulse should fade or reverse in 2027, just as higher interest rates begin to exert a stronger drag on activity. Persistent deficits and rising debt-servicing costs will also keep upward pressure on Treasury issuance and long-term yields.

The US economy therefore enters the final part of 2026 with strong momentum but a narrowing margin for error. AI investment, household wealth and fiscal support continue to sustain growth, while the labor market remains resilient. Yet inflation is proving sticky, monetary policy is tightening again and growth has become increasingly dependent on a small number of powerful but potentially fragile drivers. A soft landing remains achievable, but it now requires the Fed to contain inflation without destabilizing the investment cycle on which much of the economy's resilience increasingly depends.

Macro Outlook – Euro area

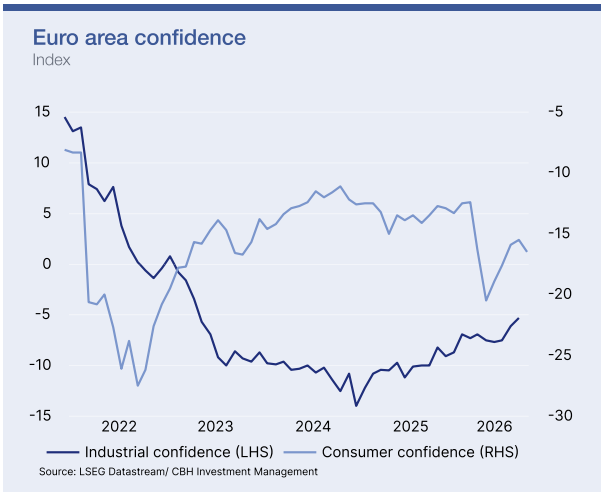
Key Takeaways

- Europe's recovery is broadening despite the energy shock.
- Consumption, exports and fiscal support are sustaining growth.
- Persistent inflation could require further ECB tightening.
- Germany is recovering, but structural challenges remain.
- Stronger investment and financial integration are essential for lasting growth.

Europe's economic outlook has improved despite the persistence of the energy shock. Activity proved more resilient than expected over the summer, supported by household consumption, a recovery in external trade and a gradually more expansionary fiscal stance. The euro area is no longer merely avoiding recession: underlying growth appears to be strengthening. Yet this resilience comes with a less favorable inflation outlook and an increasingly difficult policy trade-off.

Ireland's volatile national accounts continue to distort aggregate figures, but activity excluding Ireland has also accelerated and may now be running above its modest potential rate. Business surveys recovered over the summer, while labor-market conditions remained broadly stable. The improvement is also becoming more geographically balanced, with several peripheral economies performing well and Germany finally showing signs of recovery.

Household consumption has become a more reliable source of growth. Spending increased solidly in the second quarter, supported by employment, wage growth and the earlier recovery in real incomes. Renewed increases in energy and food prices will weigh on purchasing power, particularly among lower-income households, but relatively healthy household balance sheets should prevent a sharp retrenchment.



External demand is also becoming more supportive. After subtracting from growth for four consecutive quarters, net trade rebounded sharply in the second quarter. Part of this improvement reflected the normalization of Irish pharmaceutical exports, but exports also recovered outside Ireland, including in Germany. Stronger global demand for pharmaceuticals, advanced equipment and AI-related products should continue to support European manufacturing.

Investment remains the weaker part of the picture. Capital expenditure declined during the first half of the year, largely because higher borrowing costs interrupted the housing recovery. Equipment and intellectual-property investment also lost momentum. Europe is benefiting indirectly from the global AI cycle through demand for semiconductors, electrical equipment and infrastructure, but has yet to generate an investment boom comparable with the United States or technology-intensive Asian economies.

Germany epitomizes both Europe's improving cyclical prospects and its longer-term challenges. Following several years of stagnation, the economy should benefit from a substantial fiscal impulse, recovering exports and greater demand for defense,

energy and infrastructure equipment. This should generate positive spillovers across European supply chains.

Fiscal expansion will not, however, resolve Germany's structural weaknesses by itself. Its industrial model remains exposed to Chinese competition, high energy costs and the transformation of the automotive industry. Higher public spending must therefore be accompanied by faster planning procedures, greater digitalization and stronger investment in innovation if it is to produce sustained productivity gains.

More broadly, euro-area fiscal policy should remain moderately supportive. Higher defense expenditure, energy-security investment and the continued deployment of NextGenerationEU funds will sustain activity beyond 2026. However, fiscal space remains unevenly distributed and increasingly constrained by higher debt-servicing costs. Any additional support in response to energy prices should therefore remain targeted and temporary.

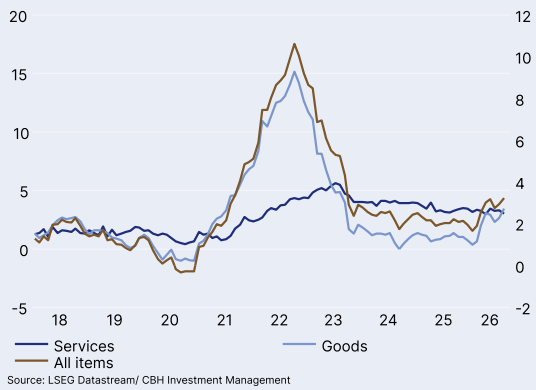
The main deterioration in the outlook concerns inflation. Headline inflation has risen above 3% as higher energy costs feed through to consumer prices. Food prices are also likely to accelerate, reflecting heatwaves and disruptions to global agricultural production. More importantly, inflationary pressures are broadening: goods inflation is rising again, supply-chain costs remain elevated and firms appear to have regained some pricing power.

The risk is no longer simply that energy temporarily raises headline inflation, but that higher costs spread into wages, margins and underlying prices. Persistent labor shortages and demographic pressures should keep wage growth relatively firm, leaving core inflation above the ECB's target for longer.

This combination of resilient growth and persistent inflation leaves the ECB with little room for complacency. September's rate increase to 2.5% confirmed a more hawkish reaction function. With activity holding up and inflation risks still tilted to the upside, the ECB is likely to tolerate some weakening in demand rather than risk a de-anchoring of inflation expectations. Further tightening cannot be excluded if second-round effects continue to build.

Europe therefore enters the final part of 2026 in a stronger cyclical position than appeared likely only a few months ago. But the margin for error is narrowing. The region must finance defense, energy security, digitalization and industrial transformation while facing higher energy and borrowing costs. Its central challenge remains unchanged: converting abundant savings and growing public commitments into productive investment. The recovery has gained momentum, but making it durable will require Europe to translate that investment into stronger productivity and competitiveness.

Euro area inflation
Annual change, %



Source: LSEG Datastream/ CBH Investment Management

Macro Outlook – Other advanced economies

Key Takeaways

- UK growth should slow as higher energy prices weaken real incomes.
- Fiscal constraints and weak productivity continue to weigh on the UK outlook.
- The Bank of England is likely to keep rates higher for longer
- Switzerland remains supported by resilient demand and low inflation.
- Carry-trade unwinding could trigger a sharp franc appreciation.

UK: Resilient Growth, but a Difficult Autumn Ahead

The UK economy has performed better than expected in 2026, but momentum is likely to weaken towards year-end. The UK was the fastest-growing G7 economy during the first half of the year, while GDP surprised positively again in July. However, this resilience partly reflects temporary factors, including inventory accumulation in response to supply-chain risks and a strong contribution from AI-related activities. These supports are unlikely to be repeated at the same pace.

Household consumption should lose momentum as higher energy prices erode real incomes. Nominal wage growth is moderating, consumer-facing services are already showing signs of weakness and uncertainty ahead of the Autumn Budget may encourage households to postpone discretionary spending. The labor market is also gradually loosening, limiting the prospect of a powerful rebound in domestic demand.

Investment presents a mixed picture. Higher financing costs, policy uncertainty and structurally weak productivity continue to weigh on traditional capital expenditure and construction. However, investment in AI-related equipment has strengthened. Computer programming and technology services contributed significantly to July's stronger-than-expected expansion, suggesting that the UK may benefit from the global AI investment cycle. The broader growth impact remains uncertain, however, as much of the required hardware is imported and the gains remain concentrated in a relatively narrow group of activities.

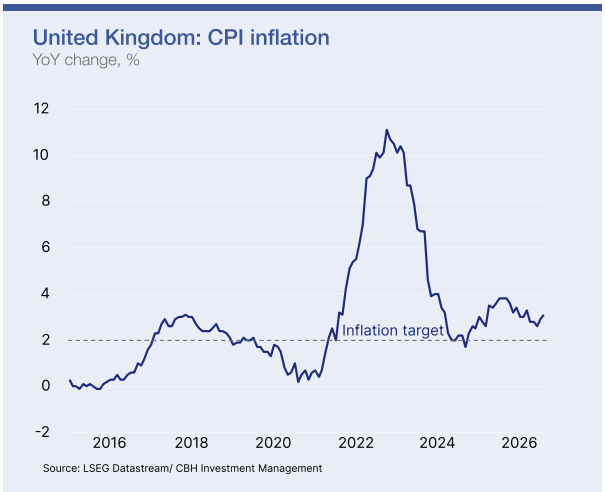
The fiscal outlook remains a major constraint. Rising gilt yields and a weak medium-term growth outlook have reduced the government's headroom ahead of a difficult Budget. The UK is expected to deliver one of the largest fiscal tightening among G7 economies over the coming years. This adjustment comes when the country also faces substantial infrastructure needs. The UK has consistently underinvested relative to its peers, but limited fiscal capacity means that closing the infrastructure gap will require greater private-sector participation, faster planning procedures and a more stable policy framework. Without such reforms, fiscal consolidation risks further weakening potential growth.

Inflation has become the most immediate policy challenge. Headline inflation rose to 3.1% in August, driven largely by transport, particularly motor fuels. It is likely to increase further as the cumulative impact of the Middle East conflict, supply disruptions and higher food prices reaches consumers. However, core and services inflation have so far remained better contained, while weaker demand and a softer labor market should limit the pass-through into wages.

The Bank of England therefore faces an uncomfortable but increasingly familiar trade-off. At its September meeting, the MPC voted by six to three to keep Bank Rate unchanged at 3.75%, with soft labour-market conditions and already restrictive financial conditions

arguing against an immediate increase. However, inflation risks remain tilted to the upside, and three members voted for a 25bp hike. The BoE also announced a gradual and predictable reduction of its bond holdings through 2034, helping to ease pressure on long-term yields. The policy rate is likely to remain unchanged in the near term. However, the policy bias has clearly shifted towards further tightening if inflationary pressures broaden.

Overall, the UK economy has proved more resilient than anticipated, but the foundations of that resilience remain narrow. AI-related investment is providing a welcome source of growth, but higher energy costs, restrictive monetary policy and fiscal tightening should weigh on activity. The central challenge is to prevent short-term fiscal discipline from further undermining the investment and productivity gains required to strengthen the medium-term outlook.



Switzerland: Stronger Activity, but External Risks Persist

The Swiss economy has continued to outperform expectations despite a challenging external environment. Growth strengthened markedly during the first half of 2026, supported by industrial production and exports. However, headline GDP remains heavily influenced by the volatile pharmaceutical sector and temporary trade effects. The underlying picture is therefore one of resilient but still moderate growth rather than a broad-based acceleration.

Domestic demand should remain an important stabilising force. Employment conditions remain favourable, household balance sheets are sound and low inflation continues to support real purchasing power. Monetary conditions are also accommodative, with the policy rate at 0%. Nevertheless, households remain relatively cautious and investment intentions outside a few high-value-added sectors are subdued.

The external environment remains Switzerland's main vulnerability. The trade agreement with the United States has reduced tariff uncertainty and restored a more level competitive position relative to European exporters. Nevertheless, Swiss manufacturers continue to face weak global demand, geopolitical disruption and persistent pressure from the strong franc. The impact is particularly visible among smaller industrial companies, which have less pricing power than the pharmaceutical, luxury and precision-engineering groups that dominate aggregate export data.

The recent strength of headline activity should therefore be interpreted cautiously. Some of the expansion reflects trade flows and pharmaceutical exports rather than a comparable improvement across the domestic economy. Although the gradual European recovery should provide support, higher global energy prices and weaker international demand are likely to restrain export growth over the coming quarters.

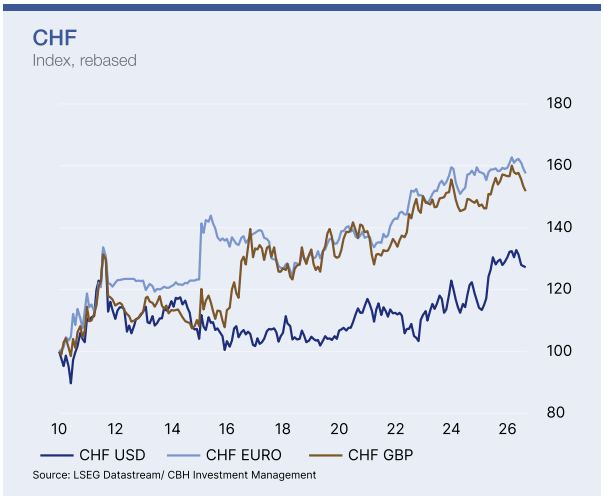
Investment is likely to remain uneven. Large internationally competitive companies should continue to invest in research, advanced manufacturing and digitalization. However, the combination of currency strength, tariff uncertainty and weaker external orders is encouraging greater caution among export-oriented SMEs. Switzerland's strong innovation ecosystem remains a structural advantage, but it cannot fully insulate the economy from a prolonged weakening in global trade.

Inflation has increased but remains exceptionally low by international standards. Higher oil prices have raised imported inflation, but the impact has been contained by the strong franc and Switzerland's relatively low energy intensity. Inflation expectations also remain consistent with price stability. This contrasts sharply with the euro area and the UK, where the same external shock has produced a much larger increase in headline inflation.

Against this backdrop, the SNB is likely to maintain its policy rate at 0%. Stronger activity and the modest increase in inflation reduce the case for a return to negative rates. At the same time, subdued underlying price pressures leave little justification for tightening.

The franc's recent modest depreciation also provides some relief. It may partly reflect its increasing use as a funding currency for carry trades, as yen volatility encourages investors to seek alternatives. However, an abrupt unwinding of these positions could trigger a rapid appreciation of the franc. Foreign-exchange intervention therefore remains the SNB's most likely first line of defence against excessive currency strength.

Switzerland therefore enters the final part of 2026 in a relatively favourable position. Growth has been stronger than expected, inflation remains contained and monetary conditions are supportive. However, the economy remains highly exposed to global trade, the European cycle and currency movements. The recent depreciation of the franc should not be viewed as a durable easing of exchange-rate pressures, given the risk of a sharp reversal if carry-trade positions are unwound. The central scenario remains one of continued but below-trend expansion, with domestic resilience offsetting only part of the pressure facing export-oriented industries.



Macro Outlook – Asia

Key Takeaways

- Rising US fiscal and term premia are becoming a headwind for Asian equities, funding costs and capital flows.
- The Iran war has made energy security Asia's key macro fault line, widening the gap between energy winners and import-dependent economies.
- A more hawkish global policy backdrop is turning higher-for-longer rates into an Asian funding-cost and currency challenge.
- AI rotation: AI capex remains massive, but bottlenecks are shifting from chips to power, cooling and memory—reshaping Asia's opportunity set.
- China's AI progress, Japan's corporate reforms and AI exposure, and Hong Kong's renewed financial-hub role remain key structural opportunities, with currencies and monetary policy the main risks.

The Price of US Debt becomes Asia's Problem

The US fiscal picture deteriorated markedly during 3Q26, led to a sharp rally in long end yields. US national debts crossed USD 40 trillion and is within sight of the USD 41.1 trillion statutory limit, further complicated the picture with another potential US government shutdown. The Treasury's latest move, expanded buyback operations, disappointed on its first outing and did little help to contain the yield rally.

For Asia, these matters through four channels. First, the discount rate: 5% risk-free yield compresses multiples everywhere, and impact on high valuation Asian growth equities. Second, the dollar: elevated real yields have kept the dollar firm, pressured Asian currencies and forced defensive rate hikes from Jakarta to Manila. Third, the reserve channel: Japan and China are the largest foreign holders of Treasuries, and every tick higher in yields raises the opportunity cost of holding US paper, a slow-burn repatriation risk for JGBs and CGBs alike. Fourth, the silver lining: higher yields are repricing financials and value stocks, and any credible US fiscal consolidation would be a powerful tailwind for Asian risk assets. Until then, we treat episodic bond-market stress as the key tail risk for 4Q26.

The Iran War Burns to Asia

The conflicts between US and Iran intensified again, prompted sharp surge in oil and lifted the European gas prices to their highest since 2023. If Hormuz traffic remains constrained throughout the year 2026, that will bring another wave of war-led inflation to the globe, especially the Asian countries that heavily rely on imported fuels. The winners and losers map is now well established: Japan, South Korea, India and the Philippines are the most exposed importers; Malaysia, as a net energy exporter, captures a revenue windfall as a net exporter, but its expanding fuel subsidy burden threatens to offset those gains. The second-round effects are the ones to watch in 4Q26, where fertilizer costs up 100–150% in the region imply food-price pass-through well into 2027. The energy-linked inflation may keep Asian central banks restrictive even as growth softens. This stagflationary combination not only places direct pressure on Asian economic growth, but also risks capping regional equity performance by diluting the broader 'AI premium'.

China: Tech-Led Exports Provide Resilience, but Consumption Remains the Missing Engine

China enters 4Q26 with a more balanced but still uneven growth mix. Export momentum has strengthened materially, led by high-technology goods, AI-related equipment, semiconductors and automobiles. For instance, August exports rose 25% year on year in USD terms, while high-tech exports rose 42.9% in value over the first eight months of the year. Semiconductor export values more than doubled, although this partly reflects the higher value content of shipments rather

than a proportionate surge in volumes.

Export strength provides a near-term cushion against persistent weakness in property, private confidence and household consumption. China's manufacturing base is benefiting from global demand for electronics, industrial upgrading, renewable-energy equipment and AI infrastructure. However, external demands cannot fully solve the structural weakness in domestic consumption. The continued property downturn has weakened household wealth effects and restrained consumer confidence. In addition, the shift toward high-value technology, EV and advanced-manufacturing exports may intensify trade friction, particularly where Chinese exports are perceived as displacing domestic production in developed markets or in regional manufacturing hubs. Hence, policy support is likely to remain accommodative, combining targeted credit support for strategic sectors with selective fiscal and consumption measures. The strategic focus on technology self-reliance should remain a central investment theme with key focus in AI models, data centers, semiconductors, automations and robotics.

For 4Q26, the main upside risk is that export strength, targeted fiscal support and improving capital-market sentiment begin to feed into broader private-sector confidence. The main downside risk is renewed escalation in trade restrictions or tighter technology controls, which could undermine exports and corporate investment before domestic demand has recovered sufficiently. We remain constructive on selected Chinese innovation and advanced-manufacturing exposure, but cautious on broad beta until consumption and property conditions show a clearer and more durable improvement.

Japan: The End of Free Money Brings New Opportunities and New Risks

Japan moves into 4Q26 facing a more consequential policy mix than earlier in the year. The Bank of Japan (BoJ) had raised its policy rate to 1.25% at its September meeting. The split decision and governor Ueda's insistence of data dependence prompted the market to expect another rate hike may only come in December 2026 or January 2027. However, the accelerating inflation pressures, firmer wage dynamics, and increased imported-price pressure from weaker yen, give no excuse for BoJ to stay behind the curve. Yet Japan's challenge extends beyond the policy rate. The 10-year Japanese government bond (JGB) yield has risen sharply, touching 3% for the first time since 1996, reflecting both expected BoJ tightening and concern over the interaction between expansionary fiscal policy, tax relief and government financing needs. Also, a risk of disorderly rise in JGB yields can potentially trigger broader global bond-market volatility, where higher JGB yields could encourage Japanese investors to retain more capital at home, reducing the long-standing incentive to allocate heavily to foreign bonds and other overseas assets. This raises the risk of Japanese capital repatriation, which could add to volatility in global sovereign bonds, credit markets and foreign exchange.

We expect the BoJ to normalise cautiously but with a clearer hawkish bias through 4Q26. The most likely outcome is not an aggressive tightening campaign, but a pattern of gradual hikes accompanied by careful communication aimed at preventing a further deterioration in yen expectations. The government may continue to use fiscal measures to cushion the cost-of-living burden, but the credibility of fiscal funding plans will matter increasingly to investors.

The landmark event in 3Q, without hesitation, surely the coordinated US/Japan FX intervention. The action sent a clear message that both authorities have a shared mandate to prevent disorderly yen depreciation and contain risks to wider financial stability. It also marked a significant shift in market signalling: Japan's intervention now carries explicit US backing, increasing the risk of further official action if USD/JPY weakness becomes excessive or one-sided. The yen is likely to remain volatile with the risks become more two-sided: renewed yen weakness may be capped by intervention risk, while rapid yen appreciation could be amplified by short-covering.

The execution of Japan's "Value Up" corporate-governance agenda and the global AI-infrastructure buildout remain the key structural narratives for Japanese equities. The global AI demand cycle should continue to support high-quality technology supply-chain companies. However, the risk of yen appreciation may drive a gradual rotation away from export-oriented names toward financials and selected domestically focused industrial companies.

South Korea: Clear AI beneficiary

South Korea is undoubtedly one of Asia's clearest beneficiaries of the global AI buildout, supported by leadership in advanced memory, HBM, semiconductor manufacturing and the broader electronics supply chain. The investment case is further reinforced by the government's proposed record KRW821 trillion 2027 budget, including KRW21.3 trillion for semiconductor, physical-AI and AI-data-centre megaprojects, alongside investment in power grids, logistics and R&D. However, this strength has already been reflected in market performance, with the KOSPI up more than 60% year to date. The Bank of Korea has also revised its 2026 GDP-growth forecast to 3.4%, explicitly citing the semiconductor and AI super-cycle as key drivers.

The key question for investors entering 4Q26 is whether the memory upcycle is evolving from a conventional cyclical recovery into a more structural period of supply constraint. The near-term fundamentals remain favourable: AI-server demand is lifting requirements for HBM, high-density server DRAM and enterprise storage simultaneously, while the transition to more advanced HBM products absorbs substantially more wafer capacity than conventional DRAM. With industry capacity heavily committed through 2026, supply is unlikely to respond quickly, creating scope for further memory-price increases and continued earnings upgrades for leading Korean suppliers. The tightness may also extend beyond HBM itself, as capacity is redirected from conventional memory toward higher-value AI products. On the flip side, the principal risk will be the slowdown of hyperscaler's capex and faster than expected in global yields.

Hong Kong: Financial-Market Revival in High-Rate, High-Restriction World

Hong Kong enters 4Q26 with a distinctly improved financial-market backdrop. The revival in capital-market activity, renewed wealth-management flows and stronger cross-border connectivity are helping the city regain traction as an international financial centre. Hong Kong regained a leading position in global IP fundraising last year with the momentum carried into 2026. According to Bloomberg, IPO proceeds are already 78% ahead of the same period in 2025 and are projected to exceed USD57 billion, which would mark the strongest year since the 2021 boom.

This recovery is important because it broadens the local growth story beyond consumption and property. Hong Kong is increasingly positioned to benefit from Chinese companies' overseas and offshore financing needs, the expansion of regional wealth management, greater interest in technology and AI-related listings, and the ongoing internationalisation of the renminbi. Authorities have expanded the RMB liquidity facility to RMB500 billion and extended available tenors, reinforcing Hong Kong's role as the main offshore RMB hub.

The city's macro-outlook remains closely linked to China, but the near-term drivers are more diversified than in prior cycles. Strong demand for AI-related products, cross-border financial activity and resilient consumption supported growth in the first half of 2026, while the local stock market and IPO pipeline have benefitted from renewed investor interest in Chinese technology and innovation sectors.

For 4Q26, Hong Kong's principal sensitivity remains US yields. The currency peg means local monetary conditions are heavily influenced by the Federal Reserve, and elevated US rates continue to weigh on property affordability, financing costs and rate-sensitive domestic sectors. A sustained rise in Treasury yields would therefore remain challenging for developers and highly leveraged corporates, even if the equity-market and wealth-management recovery continues.

While we are constructive on Hong Kong as a financial and capital-markets recovery story, particularly for exchanges, brokers, wealth managers, selected banks and companies connected to the IPO, cross-border-investment and offshore-RMB ecosystem, we remain cautious on property and highly leveraged domestic sectors. Elevated funding costs and the lagged effects of restrictive monetary conditions continue to weigh on affordability, refinancing capacity and asset valuations. Hong Kong should also benefit indirectly from the China technology and AI narrative, but the opportunity remains subject to significant geopolitical and regulatory risk. Continued US restrictions on China's access to advanced AI chips, semiconductor-manufacturing equipment, high-performance computing capacity and related technologies could constrain the development path, capital spending and valuation multiples.

Asean: The Energy shock and AI Separates Winners From Underperformers

Asean growths remain underpinned by domestic demands, China+1 supply-chain relocation and digital-infrastructure investment, but the growth path among regions is becoming far less homogeneous. High oil prices, a firm US dollar and constrained room for rate cuts are most challenging for fuel-importing economies with external-financing needs. Indonesia and the Philippines are particularly exposed through their oil-import bill, currency sensitivity and the risk that central banks must defend exchange rates even as domestic growth softens. Thailand remains the region's more difficult structural case where tourism and data-centre investment provide support, but low trend growth, weak household balance sheets and limited fiscal space constrain the upside.

Malaysia and Vietnam remain the more compelling structural stories, albeit for different reasons. Malaysia is emerging as ASEAN's clearest data-centre, power-infrastructure and semiconductor-services beneficiary, while its net energy-export position offers a partial buffer against the oil shock. Vietnam remains central to electronics assembly, supply-chain diversification and foreign-direct-investment inflows, but is more vulnerable than Malaysia to weaker global goods demand and trade-policy friction.

In conclusion, selective approach on geographical exposures remains the key call for 4Q26. AI remains a core investment theme but emphasis on infrastructure and scarcity value chain such as memory, power, grid equipment, data centres and semiconductor-enabling technologies. China remains investable through technology substitution, advanced manufacturing and domestic innovation, but not on the assumption that property and household consumption will recover quickly. Japan is a regime-change market, where corporate reform and rising nominal growth create opportunity but where yen volatility and higher JGB yields require extra caution. Hong Kong is best positioned as a financial-market, offshore-RMB and China-connectivity recovery rather than a blanket equity rerating, while Malaysia and Vietnam offer the clearest structural upside among ASEAN. Indonesia, the Philippines and Thailand warrant greater caution. Across the region, the principal macro risk is not necessarily a conventional recession, but a renewed US bond-market and fiscal shock transmitted through higher discount rates, a stronger dollar and tighter funding conditions.

Macro Outlook – Brazil

Key Takeaways

- Growth is losing momentum as household financial stress increasingly weighs on consumption.
- Inflation has eased, but temporary factors mask persistent underlying services pressure.
- The BCB is calibrating rates lower while maintaining a clearly restrictive policy stance.
- Expansionary fiscal policy continues to offset monetary restraint and worsen the debt outlook.
- A polarized election keeps uncertainty elevated, supporting a conservative and uncorrelated allocation.

Activity Appears to Be Losing Momentum

In the previous quarter, we highlighted how difficult it had been for activity to slow down. Since then, there are signs of a broader moderation. GDP grew 0.5% in 2Q, down from 1.1% in the previous quarter, with industry and services nearly flat and growth concentrated in agriculture and investment. The monthly GDP proxies, which are more recent, reinforce this reading: they declined in June and July, confirming the dynamics on the supply side. On the demand side, household consumption is starting to show signs of slowing, with its sharpest quarterly contraction since late 2024. Household balance sheets show mounting strain, with debt service and delinquency at record levels. The share of income committed to debt service reached 28.9%, and household delinquency rose to 5.8%, the highest levels in their respective historical series.

Current Inflation Has Slowed, but Part of the Relief Is Temporary

In the previous quarter, twelve-month inflation reached 4.72%, above the 4.5% ceiling of the target range, pushed by fuel and freight costs amid the oil shock. More recently, the picture has become calmer. Inflation surprised to the downside and fell to 4.22% over twelve months in August, back within the target range, with a monthly deflation of 0.32%, the sharpest in four years. The relief came mainly from administered electricity prices, a one-off effect expected to reverse. Food also helped, amid favorable agricultural supply and contained freight costs. Oil, in turn, did little damage this quarter: even at elevated levels amid the Middle East conflict, its pass-through to domestic prices was contained by Petrobras' pricing policy and by diesel tax relief and subsidies. Underlying services remain under pressure, weighing on expectations, in a tight labor market with unemployment at record lows.

The Central Bank Is Calibrating, Not Easing

The Central Bank's Monetary Policy Committee delivered its fifth consecutive 25 basis-point cut, taking the policy rate to 13.75%. The Committee described the decision as consistent with inflation converging to around the 3% target over the relevant horizon, currently the first quarter of 2028, for which it projects 3.2%. The logic is one of calibrating the real rate rather than easing. With inflation receding, holding the nominal rate unchanged would make policy excessively contractionary, and the adjustments aim to preserve an adequate degree of restriction, since the Central Bank still sees inflation pressured by demand. The minutes make clear why caution persists. Above all, de-anchored inflation expectations call for restrictive policy for longer. External uncertainty, mainly tied to the Middle East conflict and oil, also weighs, as does a fiscal policy that stimulates demand while monetary policy tries to contain it.

Fiscal Policy Keeps Working Against the Effects of Monetary Policy

The Central Bank itself notes that fiscal policy acts

in the short term mainly by stimulating aggregate demand, and that stimulus to consumption weakens the transmission of restrictive effects to activity. The government has relied on precisely this kind of instrument, combining measures that support disposable income with subsidized and earmarked credit. The election period has widened this room, with additional budget space amid the political contest. With spending growing at a fast pace, the Senate's Independent Fiscal Institution projects gross debt above 100% of GDP by 2032. Markets therefore appear to expect a more structural fiscal adjustment in 2027, the first year of the next term, to slow the growth of debt.

A Polarized Presidential Election Between Opposing Agendas

The presidential race has settled into a binary contest between President Lula, seeking a fourth term, and Senator Flávio Bolsonaro, the eldest son of former President Jair Bolsonaro. Markets tend to associate Lula's re-election with continuity of the current policy mix. An opposition victory, in turn, tends to be associated with a potential shift toward tighter fiscal management and structural reforms. Lula leads first-round voting intentions, but Flávio Bolsonaro has gained significant ground and is statistically tied in runoff simulations. His advance was driven by a deterioration in the government's approval and by institutional tensions involving the Supreme Federal Court. These episodes may have strengthened the opposition's anti-corruption message. As a result, an extremely volatile market environment is expected, along with a very tight outcome decided by a few percentage points.

We Remain Conservative and Uncorrelated While the Scenario Unfolds

Given an external backdrop still complicated by the Middle East conflict and a binary, polarized election between candidates with opposing views on economic policy, we have maintained a conservative and uncorrelated allocation. Our main liquid exposure to Brazil remains concentrated in inflation-linked government bonds, which combine high real carry, inflation protection and sovereign credit. Among the risks available, we prefer to carry the mark-to-market risk of these bonds, compensated by their carry. In parallel, we continue to build the uncorrelated pillar of the portfolio, with strategies whose returns depend less on the macro scenario and more on execution, such as structured credit backed by hard collateral, special situations, legal claims and a measured allocation to venture capital and private equity.

Macro Outlook – Oil Market

Key Takeaways

- The oil market initially absorbed the shock, but its buffers are diminishing.
- Prices have risen less than the scale of supply disruption would suggest.
- Recovering Chinese imports are adding to market tightness.
- Refined-product markets are tightening faster than crude markets.
- Further supply disruptions could trigger a sharp price increase.

Oil Market: Resilience Is Giving Way to Scarcity

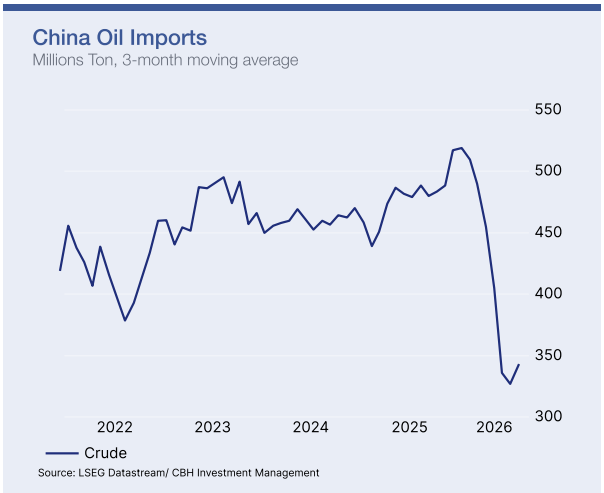
The global oil market has absorbed an extraordinary supply shock more effectively than historical comparisons initially suggested. Yet the adjustment is becoming increasingly painful. The prolonged disruption of the Strait of Hormuz, combined with attacks on Russian refining capacity and renewed threats to Saudi export infrastructure, has removed a substantial volume of crude oil and refined products from international markets. Brent has now risen close to $100 per barrel, while diesel prices and refining margins have reached much more extreme levels.

Several factors initially prevented a more dramatic price surge. The market entered the crisis with surplus supply, elevated commercial inventories and significant strategic reserves. Producers outside the Gulf increased exports, while governments coordinated emergency stock releases. At the same time, exceptionally high prices, physical shortages and weaker economic activity produced a much larger demand response than initially anticipated.

Demand destruction has become the market's principal balancing mechanism. The IEA now expects global oil consumption to fall by 2.5 million barrels per day in 2026, a significant downward revision from its previous forecast. The contraction was particularly pronounced during the second quarter and is expected to moderate towards year-end, but not disappear. High fuel prices, constrained petrochemical feedstock availability and shortages of refined products are weighing on transportation, industrial activity and household consumption.

Emerging economies have accounted for a significant part of the adjustment. Because they now represent a much larger share of global oil consumption than during previous energy crises, their greater price sensitivity has accelerated the demand response. This helps explain why the initial disruption did not produce a price increase comparable with the oil shocks of the 1970s.

China initially acted as the market's main balancing force, sharply reducing crude imports and refinery activity following the disruption of Gulf supplies. However, this adjustment has recently started to reverse. Crude imports increased by around 6% month on month in August, while refinery throughput rose for a second consecutive month, supported by the easing of fuel-export restrictions and strong international refining margins. Seaborne arrivals are also expected to remain relatively firm in the near term as state-owned refiners rebuild supplies and increase product exports. Nevertheless, imports remain well below their pre-conflict levels, domestic fuel demand is subdued and part of the increase in refinery activity has been sustained by significant inventory drawdowns. China is therefore providing less demand relief to the global market than earlier in the crisis, without yet signalling a broad recovery in domestic consumption. The recent recovery in Chinese purchases removes one of the buffers that initially helped the market absorb the supply shock.



The nature of the pressure has also shifted from crude oil towards refined products. Global refinery throughput is expected to fall by around 2.6 mb/d in 2026 and remains more than 4 mb/d below last year's level. Disruptions to Gulf exports, attacks on Russian refineries and constrained capacity elsewhere have created acute shortages of diesel, jet fuel and petrochemical feedstocks. Refining margins reached record levels in August, led by diesel.

This distinction is economically important. Crude oil can be rerouted, stored or blended relatively easily, but refining capacity cannot be replaced quickly. Diesel is also essential for freight, agriculture, construction and industry, where short-term demand is relatively inelastic. Product shortages therefore transmit more directly into production costs and consumer inflation than movements in crude benchmarks alone would suggest.

The supply outlook has simultaneously deteriorated. More than 10 mb/d of Gulf production remained offline in August, while Saudi output fell sharply as restricted export capacity forced producers to reduce extraction. The IEA no longer expects the Strait of Hormuz to return to normal operations before the end of 2026, transforming what was initially treated as a temporary disruption into a more persistent constraint on global supply.

The shutdown of Saudi Arabia's East-West pipeline following drone attacks has further highlighted the vulnerability of alternative routes designed to bypass Hormuz. The pipeline, which can transport several million barrels per day to the Red Sea, may resume at least partial operations relatively quickly. However, uncertainty surrounding the extent of the damage remains high. More fundamentally, the episode demonstrates that the disruption is no longer confined to a single maritime chokepoint: the risk now extends across pipelines, export terminals and alternative shipping routes.

Inventories remain the critical buffer, but their effectiveness is diminishing. Strategic and commercial stocks absorbed a large share of the initial shortfall, preventing physical disruption from immediately translating into extreme prices. However, emergency releases have slowed substantially, while readily accessible commercial inventories have continued to decline. Headline inventory figures may also overstate the volume that can be mobilised without disrupting refinery operations and domestic distribution systems.

Inventories can smooth a temporary disruption; they cannot indefinitely replace a major share of Gulf exports. Moreover, strategic reserves will eventually need to be rebuilt, creating an additional source of demand even after supply conditions improve. The return of Chinese purchases will make that replenishment process more difficult if Gulf exports remain constrained.

The market therefore faces an uncomfortable adjustment. In the near term, elevated prices will continue to ration consumption and weaken global growth. Incremental production from the Americas can offset part of the Gulf shortfall, but the response is constrained by infrastructure, investment discipline and the time required to bring new supply online. Long-dated oil prices may also remain insufficient to generate the scale of investment required to sustain future non-OPEC production.

The oil market has not escaped the consequences of the Hormuz shock; it has redistributed them. Instead of an immediate and disorderly price surge, the adjustment has occurred through inventory depletion, lower refinery activity and an unprecedented contraction in demand. This has made the market appear more resilient than during previous crises, but it has not made it less vulnerable.

The central scenario is therefore one of persistently high and volatile prices rather than a continuous rise.

Weak demand should periodically cap crude prices, while declining inventories, recovering Chinese imports and severe product shortages will prevent a durable normalisation. Any further disruption to Gulf or Russian infrastructure could produce a non-linear price response. The market has managed the initial shock, but its remaining capacity to absorb another one is now considerably smaller.

Oil Price
Brent, USD/bbl

Source: LSEG Datastream/ CBH Investment Management

Key Macro Data & Forecasts

	Annual			
	2024	2025	2026e	2027e
United States				
Real GDP	**2.8**	**2.1**	**2.1**	**2.1**
Private consumption	2.9	2.6	2.2	1.6
Investment	3.0	2.7	3.9	2.2
Domestic demand (contribution, %pt)	3.2	2.5	2.3	1.8
Inventories (contribution, %pt)	0.1	-0.1	-0.3	0.0
Net exports (contribution, %pt)	-0.5	-0.2	0.1	0.0
Inflation (CPI, %yoy)	3.0	2.7	3.3	2.4
Unemployment rate (%)	4.0	4.3	4.1	4.1
Euro area				
Real GDP	**1.1**	**1.3**	**1.1**	**1.3**
Private consumption	1.5	1.5	1.1	1.5
Investment	-2.0	2.9	0.7	1.1
Domestic demand (contribution, %pt)	1.0	1.7	1.1	1.3
Inventories (contribution, %pt)	-0.2	0.2	-0.2	-0.1
Net exports (contribution, %pt)	0.3	-0.6	0.1	0.2
Inflation (HICP, %yoy)	2.4	2.1	2.9	2.3
Unemployment rate (%)	6.4	6.3	6.3	6.3
China				
Real GDP	**5.0**	**5.0**	**4.6**	**4.1**
Unemployment rate (%)	5.1	5.1	5.1	5.1
Inflation (CPI, %yoy)	0.2	0.1	1.2	1.2
Trade	3.7	5.0	3.5	4.3

Forecasts – Rates

	Actual	Target		Last 5 years	
Policy rate	09/26	3M	12M	High	Low
Fed funds (upper)	4.00	4.25	4.25	5.50	0.25
ECB deposite rate	2.50	2.75	2.75	4.00	-0.50
10-year rate					
Us Treasury	5.10	4.80	4.50	5.10	1.34
German Bund	3.55	3.00	3.00	3.55	-0.39
FX					
EUR/USD	1.14	1.15	1.19	1.20	0.96
EUR/CHF	0.94	0.92	0.94	1.08	0.90
USD/JPY	158.31	161.00	157.00	163.86	110.74
GBP/USD	1.33	1.36	1.34	1.38	1.07

Asset Class Views

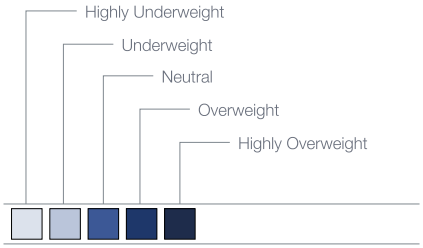
These asset class views have a 3 to 12 month horizon.

Where there has been a change since the last Quarterly Insight, the dot (•) indicates the previous view. These views should not be regarded as portfolio recommendations. This summary of our individual asset class views indicates the strength of conviction and relative preferences across a broad range of assets, but is independent of portfolio construction considerations.

	Highly Underweight	Underweight	Neutral	Overweight	Highly Overweight
Cash			•		
Fixed Income					
Government Bonds					
Inflation-Linked bonds					
Corporate Investment Grade					
Corporate High Yield					
Emerging Market Debt Local Currency					
Emerging Market Debt Hard Currency					
Duration					
Equities				•	
United States			•		
Europe					
UK					
Switzerland					
Japan				•	
Emerging Markets ex-China			•		
China					
Alternatives					
Hedge Funds					
Gold					
Commodities					
Currencies (against USD)					
EUR					
CHF					
GBP					
JPY					

• – previous positioning

How to read the table?



This content provides a snapshot of the current market environment and is not intended to predict or guarantee future results. It should not be regarded as investment research or advice on specific funds, strategies or securities. Past performance is not a guide to future results. Any forecasts, projections or targets mentioned are for illustrative purposes only and are not guaranteed to be accurate or achieved.

Asset Allocation

Further to Run, Eyes on the Horizon

Key Takeaways

- AI remains compelling, but monetisation and financing risks call for greater selectivity.
- Resilient growth, strong earnings and attractive yields keep us constructive, while elevated risks favour diversification.
- U.S. midterms may generate volatility, but fundamentals should ultimately prevail.
- Depleting oil inventories raise the risk of renewed energy pressures and stagflation.

Resilience Against the Odds

The global economy and corporate sector have proved more resilient than many expected in recent months, repeatedly absorbing geopolitical conflict, energy-price shocks and inflation concerns without materially derailing activity or earnings. This resilience leaves us constructive on the investment outlook, although several important questions remain for the months ahead. Three stand out: whether the AI investment cycle can deliver sufficient monetisation to sustain its extraordinary pace, how the war in the Middle East will affect the global economy, and whether the U.S. midterm elections generate more than temporary market noise.

Can AI Deliver?

The AI investment cycle continues to accelerate rather than fade, with hyperscalers repeatedly revising capital expenditure plans higher as demand for computing capacity expands. Capex is expected to approach USD 800 billion in 2026 and surpass USD 1 trillion in 2027, with cumulative investment in AI and data-centre infrastructure estimated at more than USD 5 trillion through 2030. Importantly, this spending does not appear to be creating significant idle capacity: cloud growth remains robust, capacity remains constrained across parts of the ecosystem and demand for AI infrastructure continues to expand.

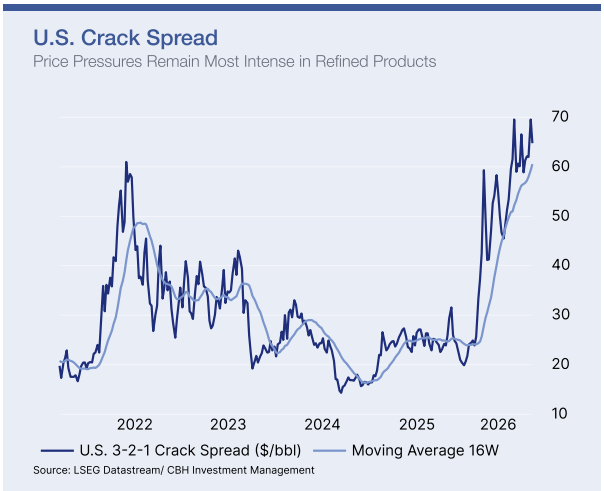
The key question is whether AI can be monetised rapidly enough to generate adequate returns on this unprecedented investment. Evidence from the recent earnings season is encouraging and increasingly broad-based. Microsoft 365 Copilot has surpassed 30 million paid seats, AI infrastructure demand helped Google Cloud grow 82%, while Google and Meta are already using AI to enhance their search and advertising businesses. Financing nevertheless represents a growing risk. While the first phase of the buildout was largely funded by hyperscalers' strong cash flows and balance sheets, its increasing scale is requiring greater use of corporate debt, private credit and structured financing, raising the vulnerability of the cycle should monetisation disappoint.

For investors, the AI investment cycle remains attractive, but greater selectivity is warranted. We favour companies positioned at critical bottlenecks in the AI buildout, where supply constraints support pricing power and demand visibility, alongside strong competitive positions, diversified end demand and limited reliance on external financing.

Running Down the Buffers

So far, the economic impact of the Middle East energy crisis has been surprisingly contained, helping to explain the relative complacency of financial markets. The initial supply shock was cushioned by lower Asian imports, alternative production and trade routes, substantial emergency stock releases and, increasingly, demand destruction. Stock drawdowns have played a particularly important role, with global inventories falling by more than 500 million barrels since February and IEA members releasing over

300 million barrels of emergency reserves. This adjustment has allowed an extraordinary physical disruption—with Gulf oil exports still almost 50% below pre-war levels and refined-product exports down around 60%—to be absorbed without an equivalent increase in crude prices or a more severe deterioration in global activity.



This resilience should not be mistaken for a return to normal. The buffers that have contained the shock are being progressively exhausted, with inventories still declining at around 3 mb/d despite significant demand destruction. Gulf supply remains heavily disrupted and renewed tensions around Hormuz and the Red Sea threaten key export routes. As inventories become increasingly constrained, the burden of balancing the market will shift back towards prices and demand, raising the risk of another leg higher in energy costs. The macroeconomic consequences would be increasingly stagflationary, creating a more challenging backdrop for both equities and bonds. For investors, this argues against treating the energy shock as a temporary geopolitical disturbance and points instead to continued upside risks for energy prices, alongside growing pressure on transportation, energy-intensive industries and consumer-sensitive sectors.

Looking Through the Midterms

The November US midterms elections will determine control of Congress for the final two years of President Trump's term, with potentially important consequences for the administration's ability to pursue its domestic agenda. The implications could be particularly significant for politically sensitive areas such as fiscal policy, healthcare, defence and trade. The vote also comes against a challenging backdrop for Republicans, with Trump's low approval ratings putting their narrow congressional majorities at risk. For investors, however, the political stakes should not be confused with the market stakes. History suggests that fundamentals ultimately outweigh electoral outcomes in driving asset prices, with political events typically generating only temporary volatility unless they meaningfully reshape the economic backdrop. The resilience of markets through recent policy uncertainty, trade tensions and geopolitical shocks is consistent with this pattern. Once the uncertainty surrounding the midterms clears, we expect investors to refocus on fundamentals.

Staying the Course

For now, the balance of risks remains favourable. AI continues to be the main engine of investment and earnings growth, with strong demand and early signs of monetisation sustaining the cycle over the coming months. By contrast, we expect the U.S. midterms to generate primarily short-term volatility rather than alter the fundamental market outlook. The more significant risk lies in energy: a sustained rise in energy prices could simultaneously weaken growth, revive inflation pressures and constrain the ability of central banks to ease policy. Against this backdrop, we remain broadly constructive and favour diversified exposure across asset classes, geographies and sectors. Strong earnings continue to underpin equities, while attractive yields provide compelling income opportunities in fixed income. Alternative investments provide an additional source of diversification in an environment where geopolitical, inflation and market risks remain elevated.

Fixed Income

Fixed Income at a Crossroads

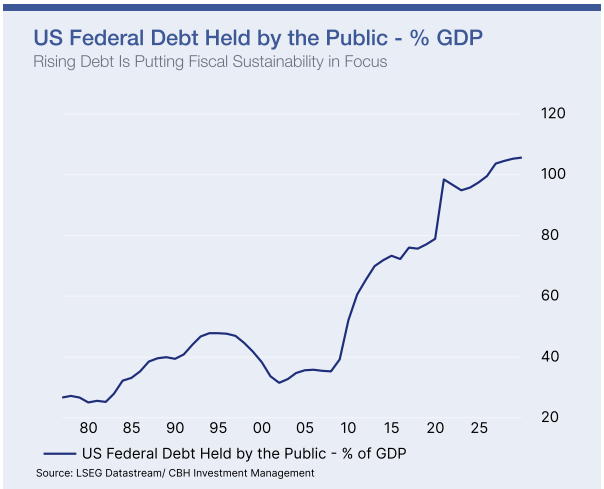
Key Takeaways

- Attractive carry keeps us tilted towards short-term credit over duration.
- Structural forces should keep upward pressure on the long end of curves.
- Higher yields are tactically improving the risk-reward of adding duration.
- Emerging-market debt remains supported by strong fundamentals and attractive real yields.

Rates: The Bond Vigilantes Are back

The outlook for U.S. rates has shifted following what we believe is a structural repricing of duration at the long end of the curve. With longer-term inflation expectations remaining broadly anchored, the rise in long-dated yields appears to reflect less a de-anchoring of inflation expectations than an increase in the term premium. We see two main forces behind this shift: a structural deterioration in U.S. fiscal dynamics and a change in the Fed's policy framework under Chair Warsh.

The first is the gradual deterioration in U.S. public finances. Federal debt held by the public has risen from around 75% of GDP a decade ago to roughly 105% today and is projected by the Congressional Budget Office (CBO) to reach around 120% by 2036 and 175% by 2056. The consequences are increasingly visible in the federal budget: in 2025, Social Security remained the largest individual outlay at USD 1,581 billion, or 23% of total spending, while net interest was already the fourth largest at USD 971 billion, or 14%. In ten years' time, rising debt-servicing costs are projected to make net interest the second-largest individual federal outlay, reaching USD 2,144 billion, or 22% of total spending, behind only Social Security. Persistently large financing needs imply greater Treasury supply, while the deteriorating debt trajectory increases uncertainty around the long-term fiscal and interest-rate outlook. Both factors increase the compensation investors demand for holding duration, putting upward pressure on the term premium.



The second is the shift in the Fed's policy framework under Chair Warsh. First, the balance-sheet backstop: large-scale Fed purchases provided a significant source of demand for long-duration Treasuries, reducing the amount of duration that private investors had to absorb. Reduced reliance on balance-sheet intervention therefore shifts more duration back to the private sector, increasing the compensation required to hold it. Second, the forward-guidance anchor: by signalling the likely future path of policy rates, the Fed reduced uncertainty around short-term rates over the life of a bond. Less forward guidance makes that path less predictable, increasing the risk of holding longer maturities. Third, the perceived "Fed put": investors had come to expect Fed intervention when severe market stress threatened financial conditions. A less predictable response to bond-market volatility leaves investors bearing more of that tail risk. Together, the removal of these anchors increases the risks borne

by long-term bondholders and puts further upward pressure on the term premium.

Importantly, this repricing could prove persistent. Unlike expectations for monetary policy, which can adjust quickly as economic conditions change, the term premium embedded in longer-dated yields is increasingly supported by structural fiscal pressures that are unlikely to reverse with the business cycle. Moreover, the new Fed policy framework is only beginning and is likely to remain in place for several years, leaving more duration and policy risk to be absorbed by private investors. We therefore expect long-term yields to remain elevated, with risks still skewed to the upside, even if the Fed eventually turns more accommodative.

Rates: The Case for Duration Builds

At the shorter end of the curve, the outlook remains more closely tied to the Fed and the evolution of inflation, employment and growth. Under Chair Warsh, policy remains clearly focused on containing inflation, while reduced reliance on forward guidance increases data dependency and the potential for rate volatility.

This sensitivity to economic conditions also creates a counterweight to rising short- and medium-term yields. As higher rates tighten financial conditions and begin to weigh on activity, they should eventually feed back into expectations for monetary policy. While duration remains tactically challenging, its risk-reward is therefore becoming increasingly attractive as yields rise: the further yields increase without a corresponding improvement in the medium-term growth outlook, the stronger the case for eventually extending duration.

Higher yields are also strengthening the strategic role of fixed income within multi-asset portfolios. Higher income provides a greater cushion against volatility and reduces reliance on capital gains to generate returns. Should growth weaken sufficiently to allow the Fed to ease policy, extending duration could provide greater potential for capital appreciation while strengthening the diversification benefits of government bonds in a risk-off environment.

Credit: Carry Does the Heavy Lifting

Credit markets have once again performed strongly this year, with sub-investment-grade credit outperforming higher-quality corporate and sovereign bonds on both sides of the Atlantic. Corporate credit remains supported by solid credit fundamentals, healthy profitability and a still-supportive economic backdrop. This resilience has been particularly notable given the recent surge in sovereign yields globally, with credit spreads remaining tight despite the sell-off.

Within credit, high yield remains particularly attractive as an income proposition. While spreads remain close to historical tights, current valuations are at least partly justified by the strength of underlying fundamentals, which should help contain broader spread widening in the absence of a significant economic or sector-specific shock. With limited scope for further spread compression, however, returns should increasingly be driven by carry rather than capital gains. All-in yields of around 7.5% remain attractive, while default expectations are broadly benign and high yield's shorter duration profile provides lower sensitivity to rate volatility in an environment of elevated term premia. Technicals also remain supportive, with U.S. issuance dominated by refinancing rather than new leverage, pushing much of the maturity wall into 2028–29 and reducing near-term refinancing pressure. Dispersion nevertheless remains elevated, with CCC-rated credits lagging the broader market as weaker issuers face greater refinancing challenges and more stretched capital structures.

Emerging Debt: Resilience Shines Through

Emerging market debt has remained remarkably resilient to the rise in global yields and renewed energy-price pressures. Hard-currency sovereign and corporate debt continues to benefit from resilient credit fundamentals, attractive carry and contained spreads, reflecting stronger external buffers and more credible macroeconomic frameworks than in previous cycles. These improved fundamentals should continue to provide support, although the regional impact of higher energy prices remains uneven. Latin America benefits from commodity exposure, while parts of Asia and CEEMEA are more vulnerable to higher energy import costs and the associated inflation pass-through.

Local-currency EMD has been the standout credit asset class this year, delivering strong returns despite persistent dollar strength. High real yields have provided attractive carry, while resilient domestic macroeconomic frameworks and a recovery in

several EM currencies have added further support. We remain structurally constructive on EM FX, where stronger external balances and improved policy credibility should provide a more resilient backdrop than in previous cycles. Regional differentiation nevertheless remains important, particularly as higher oil prices create divergent inflation and monetary-policy dynamics across emerging markets. Overall, attractive real yields, resilient fundamentals and the potential for further currency appreciation remain supportive of local-currency EMD.

Harvesting Carry, Waiting on Duration

Against this backdrop, we remain broadly neutral on duration, favouring the intermediate part of the curve, where yields offer attractive carry with less exposure to further term-premium repricing. We would look to extend duration more decisively as clearer catalysts emerge, notably a sustained weakening in the labour market, an easing of energy-driven inflation pressures or evidence that tighter financial conditions are translating into a meaningful slowdown in growth.

In credit, we maintain a neutral allocation across the main asset classes, including developed-market investment grade and high yield, as well as hard- and local-currency emerging market debt. We nevertheless see selective opportunities within credit, retaining an opportunistically constructive view on corporate hybrids and mezzanine CLOs, where attractive carry continues to offer favourable risk-adjusted return potential.

Equities

Earnings Still Doing the Heavy Lifting

Key Takeaways

- Earnings momentum remains exceptionally strong, with positive revisions extending into 2027 .
- Profit growth is broadening beyond mega-cap technology and across structurally supported industries.
- Strong earnings are allowing equities to absorb higher yields without multiple expansion.
- Neutral tactically amid near-term risks, while the fundamental outlook remains constructive.

The cyclical equity bull market that started in Q4 2022 remains fundamentally earnings-driven, with double-digit profit growth rather than multiple expansion continuing to power returns. Against a still-favourable macroeconomic backdrop, we expect strong earnings delivery, positive revisions and increasingly broad participation to sustain the bull market, while valuations should remain broadly stable.

Beyond the Magnificent Seven

The Q2 earnings season confirmed the exceptional strength of the U.S. corporate sector, with S&P 500 earnings rising 53% year-on-year—the strongest growth in five years. Importantly, the gains extended well beyond the Magnificent Seven, as earnings for the rest of the index grew 34%, while 87% of companies exceeded EPS expectations. This broadening reduces the market's dependence on a small number of mega-cap technology companies, providing a broader foundation for further equity gains. Q2 also saw strong EPS growth in industries benefiting from structural tailwinds, including Semiconductors at 143%, Oil & Gas at 164%, Metals & Mining at 53% and Construction & Engineering at 65%. Such strong earnings growth across structurally supported industries reinforces the case for thematic equity investing.

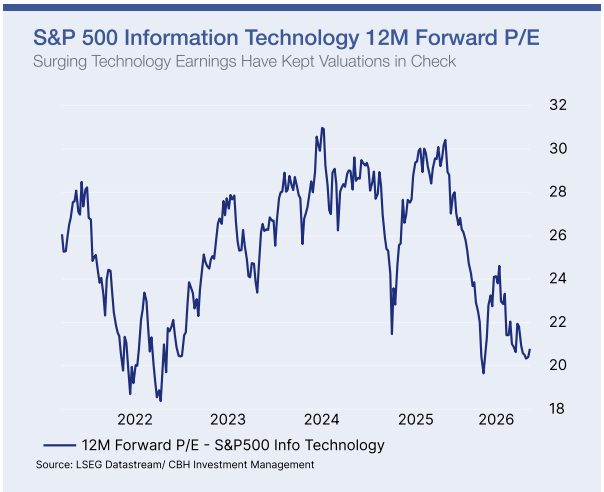
Importantly, this earnings momentum shows little sign of fading. S&P 500 earnings are expected to grow 28.9% year-on-year in Q3, which would mark a third consecutive quarter of growth above 25%, with all eleven sectors expected to contribute positively. More importantly, estimates continue to move higher: Q3 EPS forecasts have risen 1.6% since the end of June, an unusual development given that analysts typically revise estimates lower as the reporting period approaches. Energy has seen particularly strong revisions, with expected earnings growth rising from 79% to 110%, while Technology has been revised from 57% to 63%. The strength extends further out, with full-year 2026 S&P 500 earnings growth now expected at 32%, up sharply from 24% at the end of June. Growth should normalise in 2027 but remain healthy at 15%, with Technology still expected to deliver an exceptional 40%.

Defying Gravity

Strong earnings also explain why the sharp rise in bond yields has so far failed to derail the bull market. Higher yields would normally weigh on equity valuations through higher discount rates, but earnings growth has been strong enough to offset this pressure, allowing share prices to advance while valuation multiples remain broadly stable. As long as earnings continue to deliver, elevated yields should remain manageable for equities, while any meaningful decline would provide an additional tailwind.

The same dynamic makes elevated valuations less concerning than headline multiples might suggest as the bull market continues to be driven primarily by earnings growth rather than P/E expansion. The U.S.

technology sector now trades near its lowest earnings multiples since Q4 2022, despite substantial share-price gains, while the valuation premium of the U.S. market relative to Europe has narrowed to its lowest level since Q1 2023. The key question is therefore not whether valuations are high in absolute terms, but whether earnings can continue to justify them. So far, they have. Conversely, elevated multiples leave less room for earnings disappointment, making delivery increasingly important.



A Tactical Step Back

Despite this constructive fundamental backdrop, the balance of shorter-term risks led us to adopt a more neutral stance in September. We reduced our equity allocation from overweight to neutral as the combination of U.S. 10-year yields crossing 5%, shifting sentiment around the AI narrative and renewed pressure on energy prices created a toxic cocktail for risk assets. Regionally, we remain underweight the U.S.—by far the largest weight in the benchmark—funding overweight positions in Europe, Japan and Emerging Markets. At the industry level, we currently see the most attractive opportunities in semiconductors, metals & mining, oil & gas, capital goods and pharmaceuticals.

Looking beyond these near-term risks, the outlook for equities remains constructive. A benign macroeconomic backdrop and strong earnings growth, with the AI buildout remaining a key driver, continue to support the bull market. The main risks are a deterioration in earnings momentum and persistently elevated energy prices as the war increasingly appears likely to be prolonged.

Equity Sectors					
Communication Services	☐	☐	■	☐	☐
Consumer Discretionary	☐	▪	•	☐	☐
Consumer Staples	☐	▪	•	☐	☐
Energy	☐	☐	■	☐	☐
Financials	☐	☐	■	☐	☐
Healthcare	☐	☐	☐	■	☐
Industrials	☐	☐	•	■	☐
Information Technology	☐	☐	☐	■	☐
Materials	☐	☐	•	■	☐
Real Estate	☐	▪	☐	☐	☐
Utilities	☐	☐	■	☐	☐

Forex

Policy Expectations Remain King, but Keep Moving

Key Takeaways

- Stable policy differentials should keep EUR/USD broadly range-bound between 1.14 and 1.18.
- Dollar support persists, but crowded expectations leave room for a euro counter-rally.
- Wide yield differentials continue to support USD/JPY, limiting sustained yen appreciation.
- Intervention risk and potential domestic flows should increasingly constrain upside above 160.

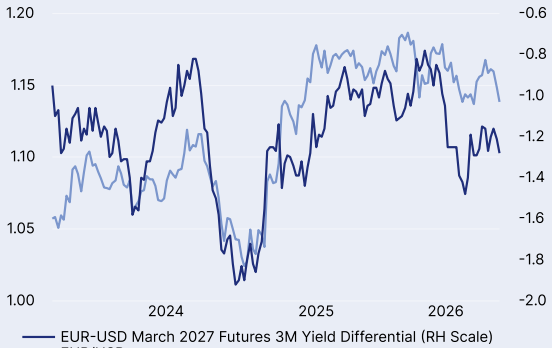
EUR/USD : Limited Upside, but Room for a Counter-Rally

We expect EUR/USD to remain broadly range-bound between 1.14 and 1.18 in Q4 2026, with risks tilted towards the lower end of the range. Relative monetary policy remains the key anchor for EUR/USD. Current market pricing implies around 70 bps of additional ECB tightening and 65 bps from the Federal Reserve through next March, leaving the expected policy-rate differential broadly unchanged. Policy expectations can adjust abruptly as the macroeconomic outlook evolves, but for now we see the balance of risks around the differential as broadly neutral.

Energy and relative growth should provide a more meaningful source of dollar support. With the conflict in the Middle East increasingly likely to persist, the risk of prolonged pressure on energy prices remains elevated, particularly across refined products. The U.S. economy should prove considerably more resilient than the Eurozone to such a shock, leaving European growth more exposed should elevated energy costs persist. That said, since July EUR/USD has decoupled from the expected growth differential, which has narrowed in favour of the euro. Eurozone growth expectations for 2026 have risen from a low of 0.54% to 0.9%, while U.S. expectations have remained broadly stable at around 2.1%.

EUR-USD March 2027 3M Yield Differential

EUR/USD Continues to Be Primarily Driven by Policy Expectations



Source: LSEG Datastream/ CBH Investment Management

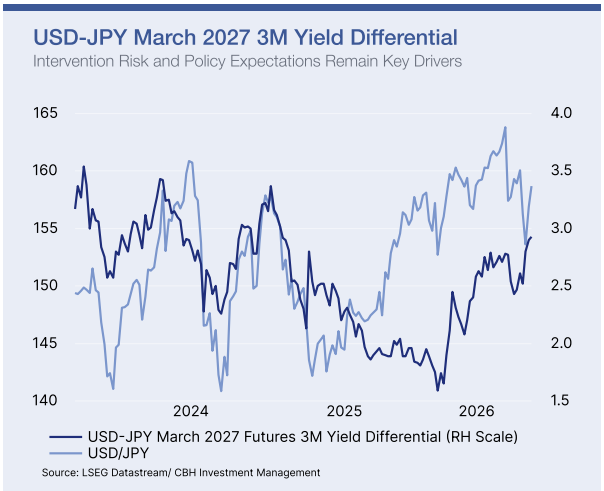
Risk sentiment should also continue to underpin dollar strength. Continued geopolitical uncertainty reinforces its safe-haven appeal, while concerns surrounding France's fiscal and debt trajectory represent an additional source of risk for the euro and could periodically weigh on sentiment towards European assets.

Taken together, we see limited scope for sustained euro appreciation into year-end. However, with considerable good news already priced into the dollar and significant pessimism embedded in the euro, the risk of a counter-rally remains material. Even moderately better news on the war, energy prices or European public finances could trigger a meaningful rebound in EUR/USD, although we would expect any such move to remain capped around 1.18.

USD/JPY : Yield Support Meets Intervention Risk

We expect USD/JPY to trade broadly between 155 and 163 into year-end, with interest-rate differentials remaining the main source of dollar support. The Fed's September rate increase and hawkish bias have pushed U.S. rate expectations higher, while the

Bank of Japan's latest 25 bp hike was accompanied by a more cautious message on the pace of further tightening. This should keep the expected U.S.-Japan yield differential wide and limit the scope for sustained yen appreciation.



Several forces should nevertheless prevent yen weakness from becoming one-sided. Recent intervention by Japanese authorities demonstrates their willingness to resist excessive depreciation, while further BOJ tightening remains possible. Intervention alone is unlikely to reverse the underlying trend while yield differentials continue to favour the dollar. It should, however, make investors increasingly reluctant to chase USD/JPY substantially above 160.

Another potential source of yen support is a change in the investment allocation of Japan's Government Pension Investment Fund (GPIF), one of the world's largest pension funds. A shift towards greater domestic exposure and reduced foreign allocations could generate sizeable repatriation flows and strengthen the yen. For now, however, discussion of such a shift has yet to translate into meaningful portfolio changes.

Taken together, the fundamental backdrop continues to favour the dollar, but the asymmetry changes as USD/JPY moves above 160. With intervention risk rising and potential domestic sources of yen support emerging, we see increasingly strong resistance towards the upper end of our 155–163 range.

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