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Global Outlook 2026

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December 2025

Overview

Shifting market leadership may define 2026. As lofty US valuations face increased scrutiny and the dollar weakens, non-US equities could build on their outperformance in 2025.

United States

Accelerating inflation and a weakening economy

- Tariffs could drive core inflation higher than expected, while immigration policy could shrink the labor force and slow GDP growth.
- AI drove two-thirds of first half 2025 GDP growth, a pace unlikely to continue in 2026.
- I expect the US labor market to weaken in 2026. The key question is to what degree.

China

Ongoing uncertainty with limited policy support

- Inflation is likely to remain undesirably low, and current GDP growth forecasts appear overly optimistic as the housing crisis continues to weigh on demand.
- The expansion of “new economy” sectors is set to continue, but export-driven growth could face protectionist headwinds.
- Meaningful fiscal stimulus is unlikely, as Beijing sees current growth levels as sufficient.

Eurozone

Lower rates and renewed growth potential

- Trade policy stabilization should support confidence, spending, and investment.
- Rate cuts are already benefiting companies and consumers—and more cuts are possible in 2026 as inflation is likely to dip below the European Central Bank’s (ECB) 2% target.
- Increased defense and infrastructure spending could boost growth, if commitments are fulfilled.

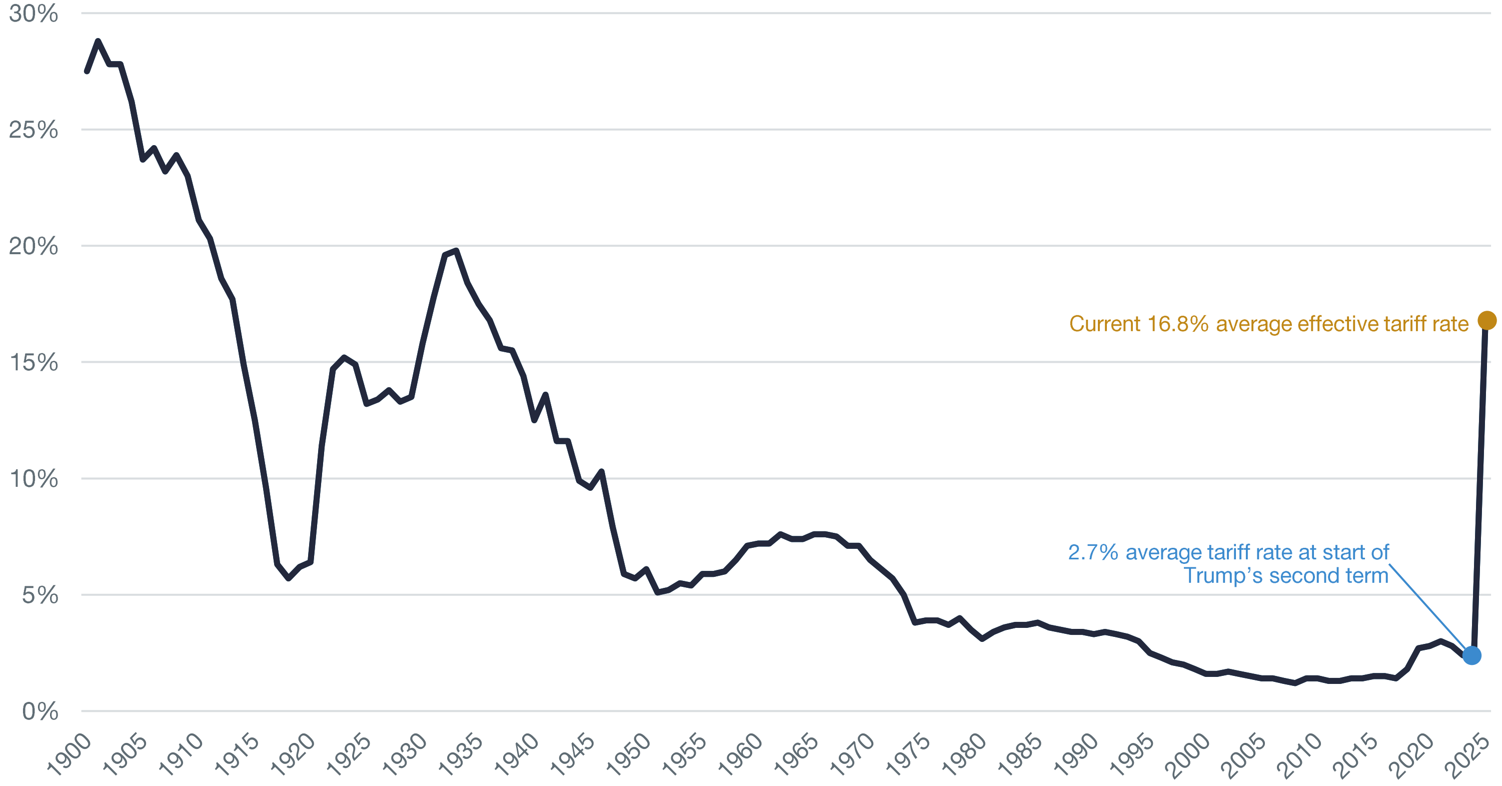
Japan

New phase of growth amid political change

- Economic normalization enters a new stage under Prime Minister Sanae Takaichi’s expansive fiscal and regulatory agenda.
- The Bank of Japan (BoJ) prioritizes tightening to control inflation.
- Rising China tensions and US trade challenges could hinder economic progress.

US Tariffs Are the Highest since 1935

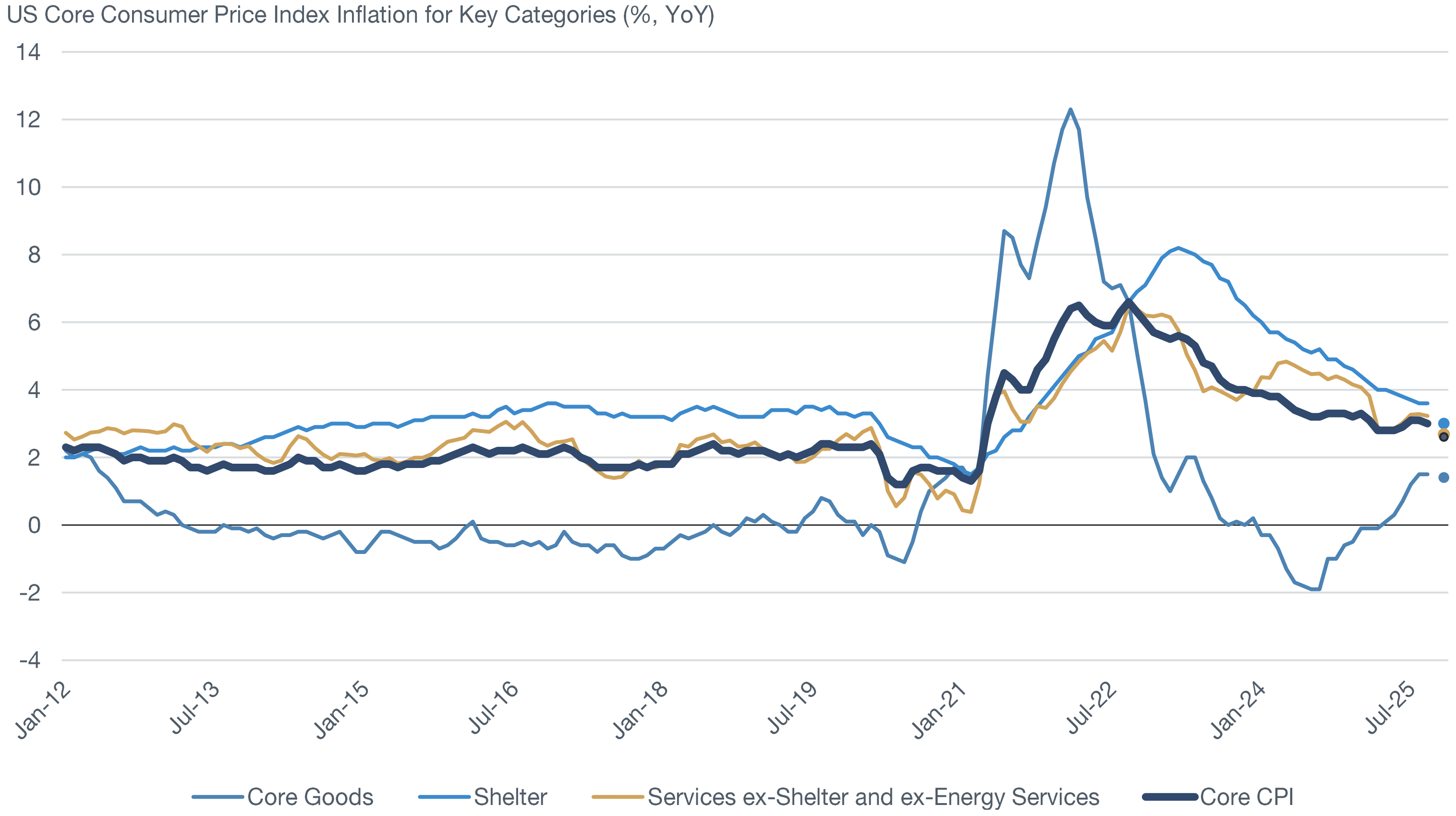
US Average Effective Tariff Rate on Goods Imports



- The US administration raised tariffs on goods imports to 16.8%, the highest level since 1935.
- A key question for 2026 is whether the Trump administration will be able to continue collecting tariffs imposed based on the International Emergency Economic Powers Act.
- Even if tariff revenue remains at current levels, the federal deficit is likely to remain on an unsustainable trajectory, exceeding 6% of GDP per annum for the foreseeable future.

As of 17 November 2025
This chart reflects the weighted average US tariff on goods. This rate estimate does not factor in substitution effects. Actual rates will depend on final policy implementation.
Source: Yale Budget Lab

US Inflation Is Likely to Peak in the First Half of 2026

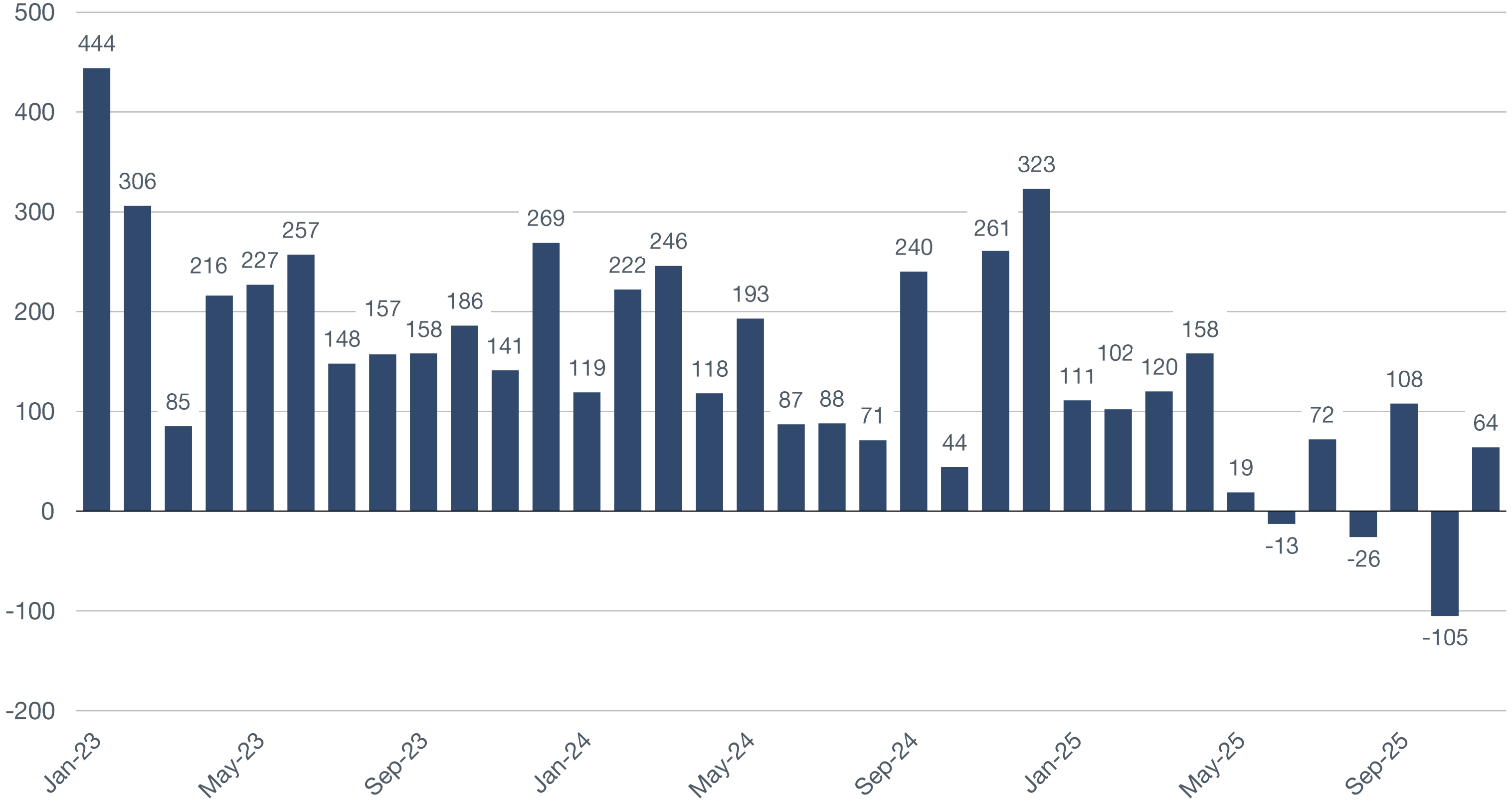


- Current tariff levels could push US inflation to a peak of over 3.5% in the first half of 2026, as pre-tariff inventories run out and higher import costs take effect.
- To protect margins, merchants will either have to raise prices or cut other costs to offset tariffs.
- One potential mitigating factor is decreased rent inflation, reflected in Zillow data. If the recent slowdown in rent inflation persists, lower shelter inflation could partially offset higher goods inflation driven by tariffs.

As of November 2025
Core goods represent ~24% of core CPI, shelter represents ~44%, and services ex-shelter and ex-energy services represent ~32%.
Source: Bureau of Labor Statistics, Haver Analytics

US Nonfarm Payroll Growth Has Slowed to 17,000 per Month

Average Monthly Change in Nonfarm Payrolls (Thousands, Seasonally Adjusted)

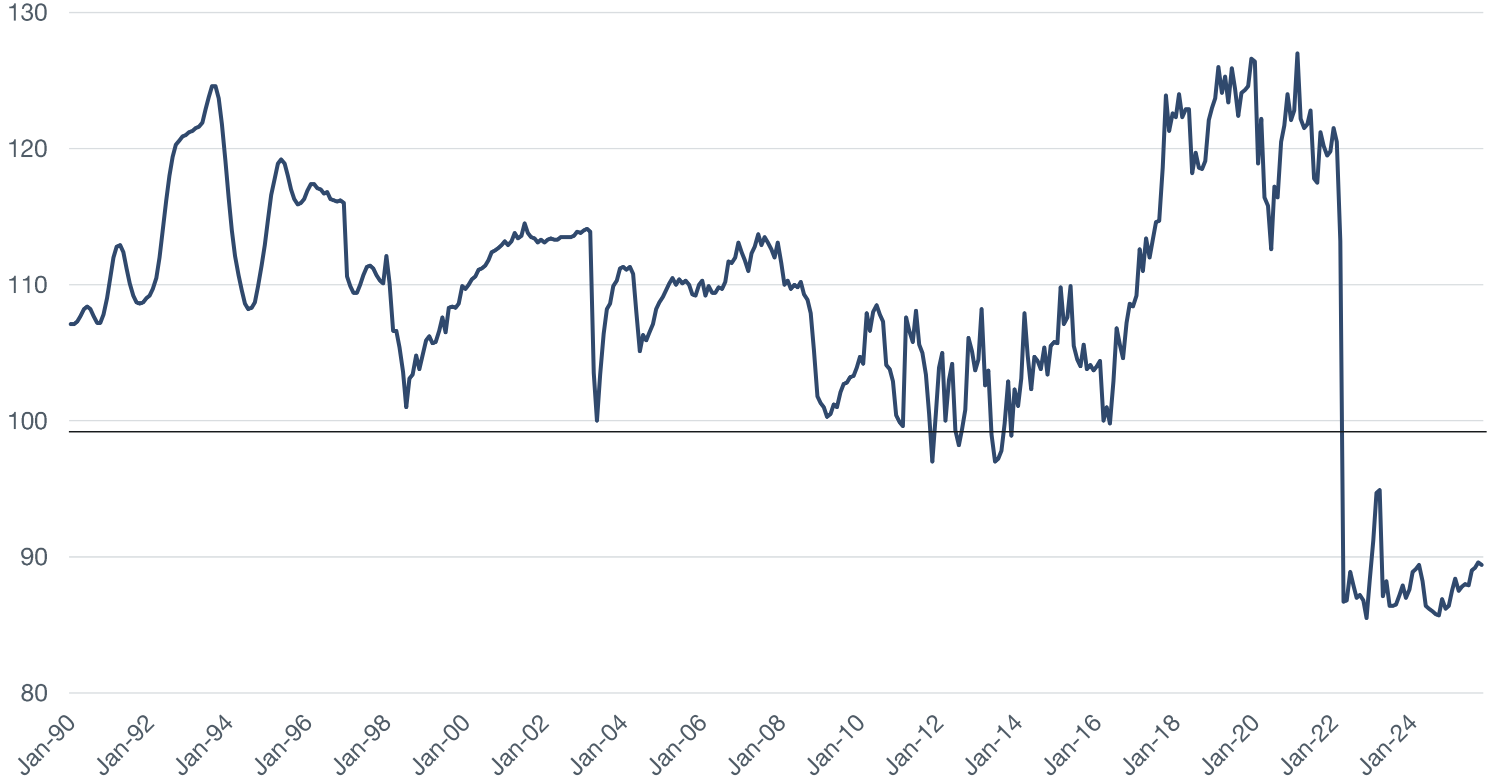


- I expect the US labor market to weaken in 2026. The key question is to what degree. Labor supply growth has been curtailed by immigration reforms, while at the same time demand for workers has weakened. Predicting the relative balance between these factors is difficult, but I expect unemployment to grind higher in 2026.
- Decision making at the Federal Reserve is likely to become more fraught in 2026 as policymakers face the tension of whether to tighten policy to reduce inflation, or ease policy to address a softening labor market.
- Ultimately, I believe the Fed will prioritize employment, operating under the assumption that tariff-induced price increases will be a one-off while threats to labor demand could be more persistent.

As of November 2025
Source: Bureau of Labor Statistics, Haver Analytics

Chinese Consumer Confidence Remains Near Record Lows

Survey of Chinese Consumer Confidence (Greater than 100 = Optimistic)

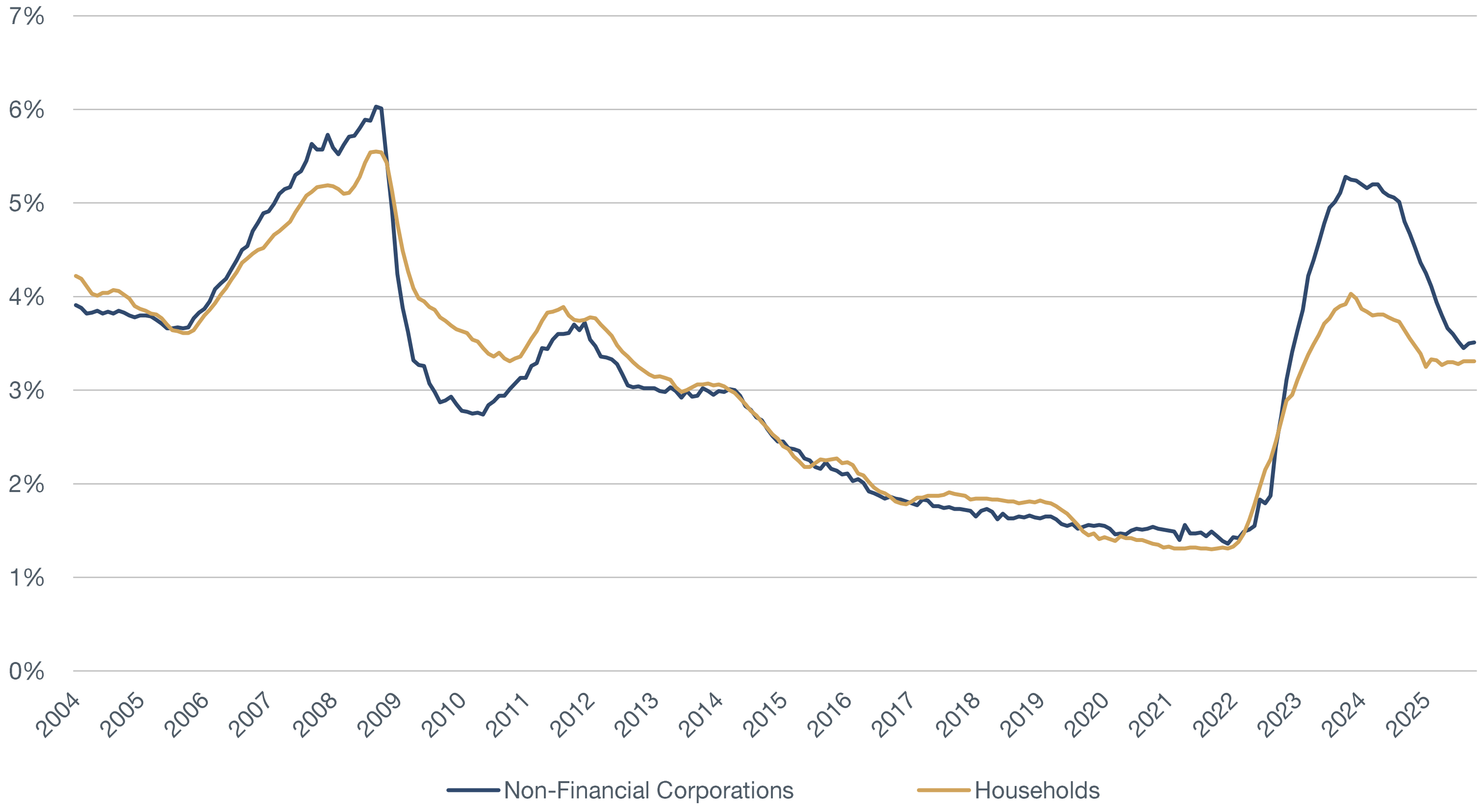


- Through 2025, China's consumer confidence figures have remained near record-low levels.
- While the collapse in confidence in early 2022 was driven by the government's mishandling of the zero-COVID lockdowns, the initial bounce when lockdowns ended was short-lived.
- I attribute the sustained negativity since COVID to a combination of falling house prices, weak economic growth, and a loss of confidence in the government.

As of October 2025
Source: Haver Analytics, National Bureau of Statistics of China

Borrowing Environment Bolstered by ECB Rate Cuts

Average Eurozone Cost of Borrowing for Households and Non-Financial Corporations (Interest Rate)

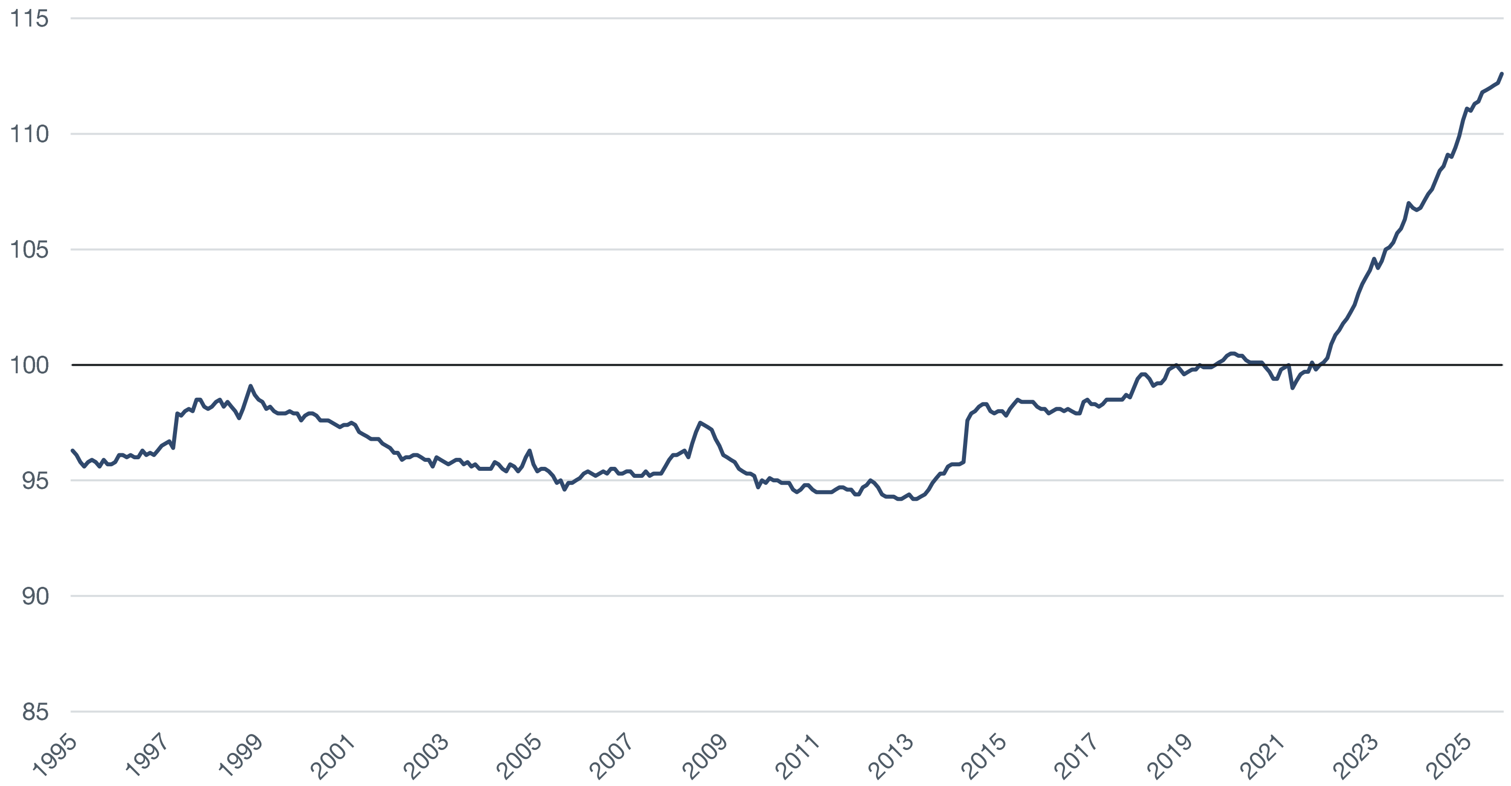


As of October 2025
Source: ECB, Haver Analytics

- Inflation is likely to fall below the ECB's 2% target, leaving room for one or two additional rate cuts despite market expectations of an end to easing.
- Monetary policy has a more magnified and immediate effect in Europe than in the United States. Because more debt in Europe is floating rate, we have already seen the benefits of rate cuts—including lower borrowing rates and accelerating loan growth—transmitted to consumers and companies.

After 24 Years of Almost No Inflation, Prices Have Increased >12%

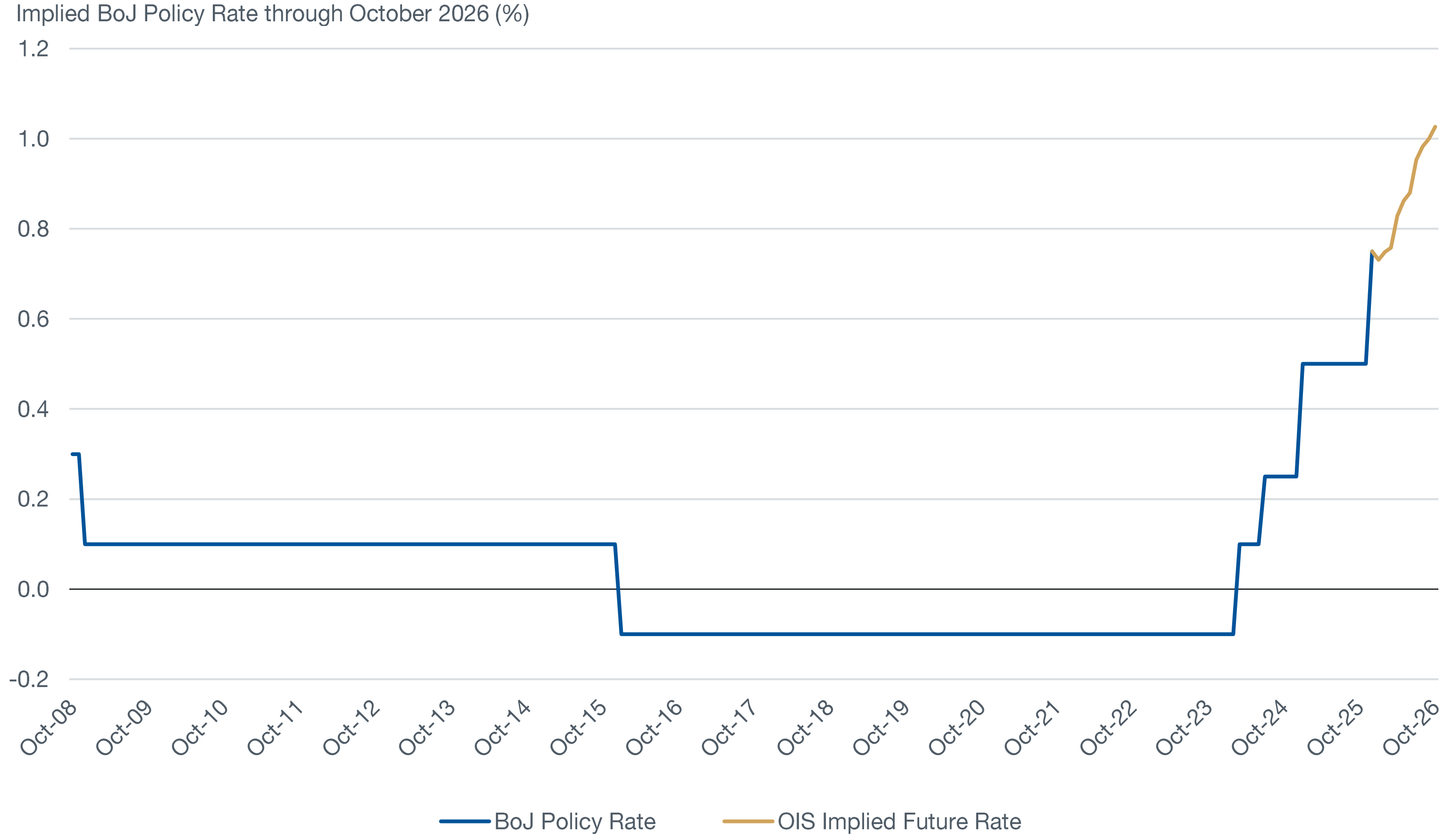
Japan General Consumer Price Index (SA, 2020 = 100)



- Consumer prices rose 12% over 2021–2025, ending a period of over 20 years with almost no inflation. This paradigm shift is forcing consumers and companies to think differently about spending and investment decisions.
- Japan's Diet has approved an ¥18.3 trillion supplemental budget, targeting inflation relief for households and investment in strategic sectors such as AI and shipbuilding.
- Stimulus representing over 2% of GDP in 2026 will be implemented without significant fiscal offsets, likely signaling a less conservative fiscal stance.

As of October 2025
To learn more about Japan's economic transformation, see Three Forces Driving Japan's Economic Renaissance.
Source: Haver Analytics, Japan Ministry of Internal Affairs and Communications

Markets Suggest ~55 bps of BoJ Rate Hikes through October 2026

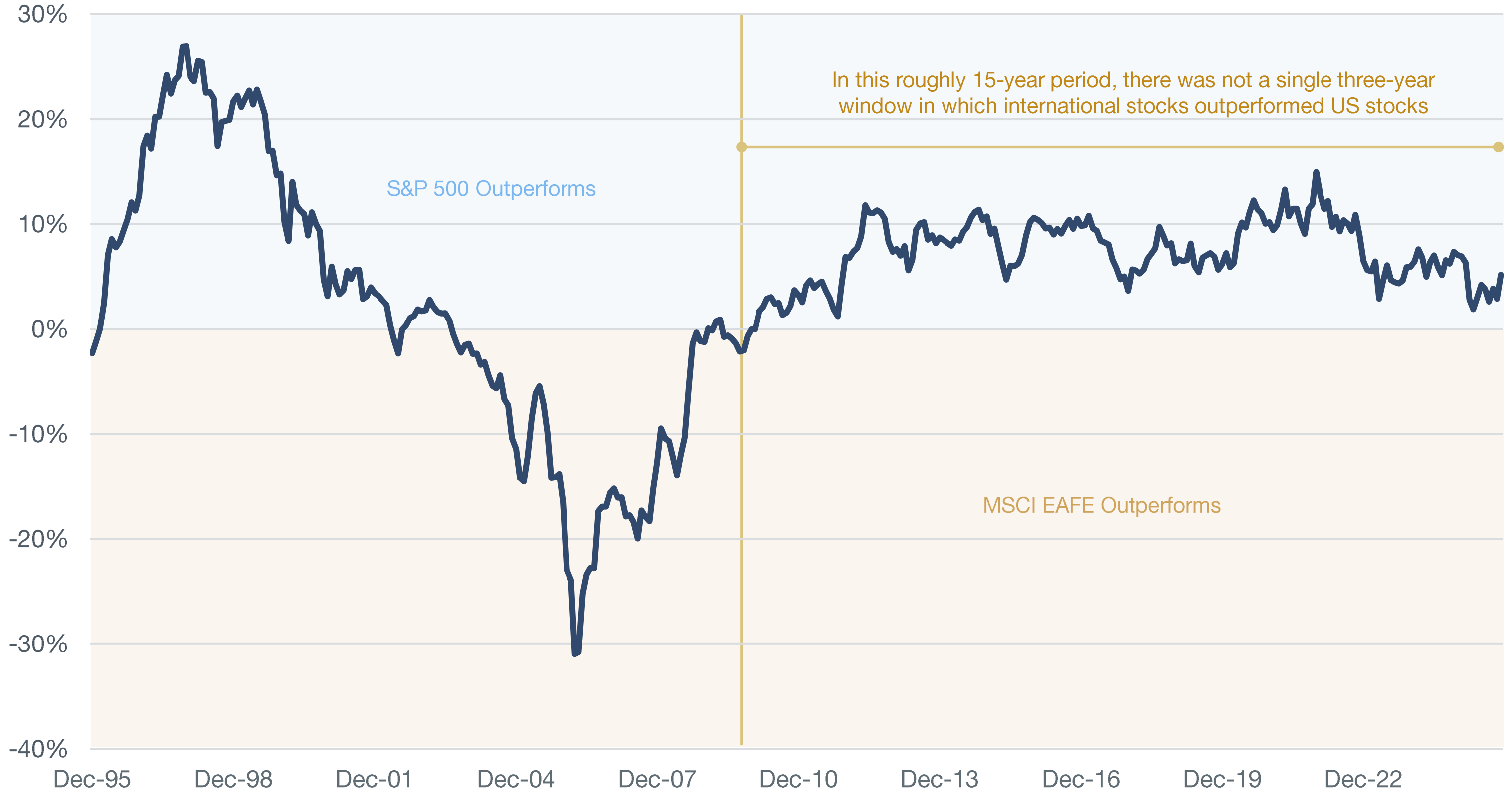


- Japan's multi-year economic normalization is likely to enter a new phase in 2026 under the leadership of Prime Minister Takaichi.
- Markets are pricing rate hikes to 1% by the end of 2026—but with inflation likely to decelerate, the pressure on the BoJ to "normalize" policy could fade.
- Wage growth is likely to stay strong, with unions seeking increases of at least 5%.

As of 22 December 2025
Source: Bloomberg

After ~15 Years of Steady Outperformance, US Dominance Is Waning

Three-Year Rolling Difference, S&P 500 vs. MSCI EAFE

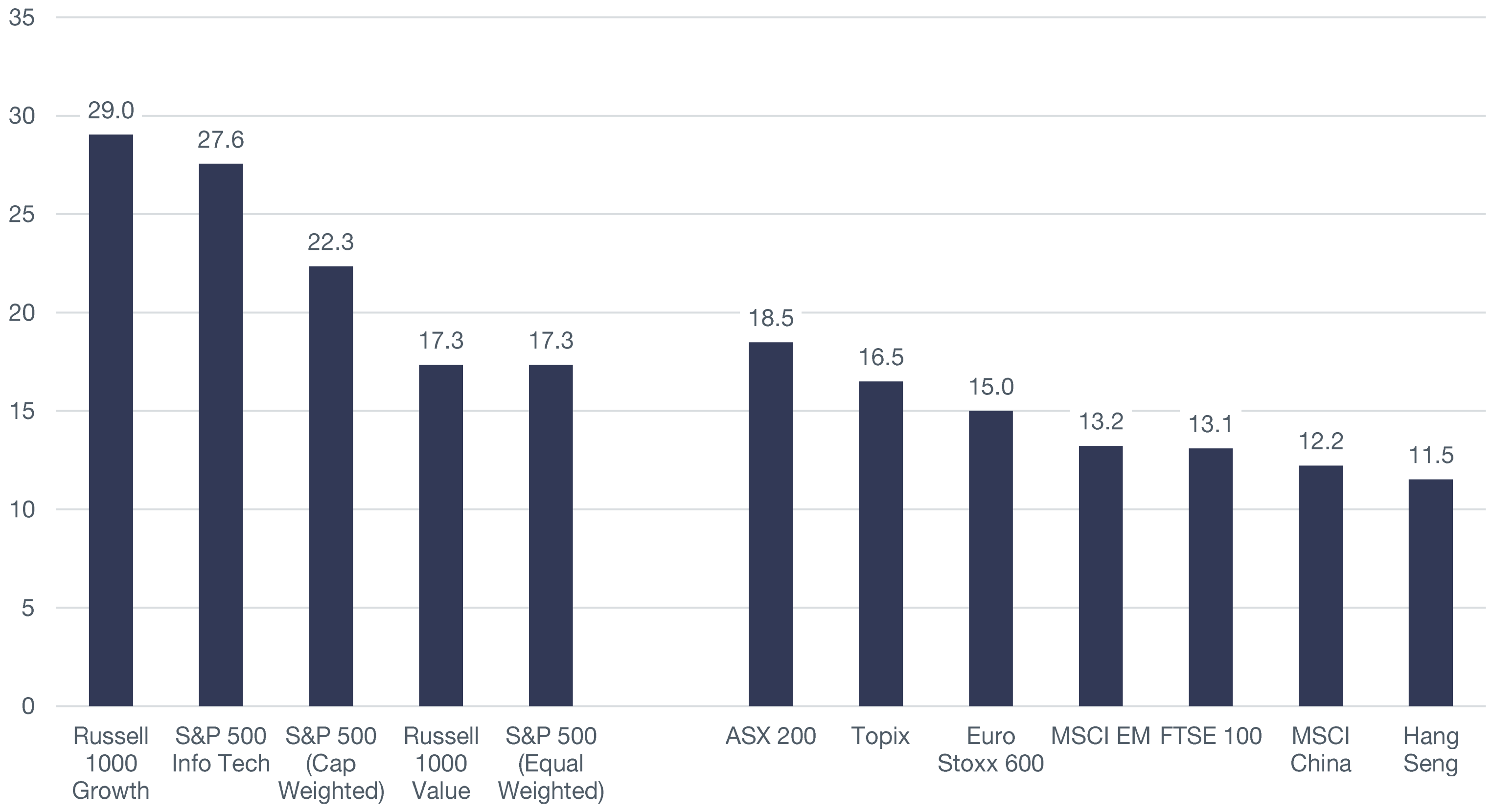


- For 15 years, US stocks outperformed international stocks on a rolling three-year basis—meaning a sustained overweighting of US stocks and underweighting of international stocks would have resulted in significant outperformance.
- But 2025 potentially marked a significant reversal, with the US equity market meaningfully underperforming most non-US markets in both developed and emerging economies.
- I believe a fading GDP growth advantage, a weakening US dollar, and stretched US valuations could lead to sustained outperformance by non-US equities in 2026.

As of 30 November 2025
From 2009 to 2024, there were only three years where US stocks underperformed international stocks (2015, 2017, 2022) and in each case, that underperformance was less than 3%. For more insight into this topic, read The Risk Exhaustion Regime Continues.
Source: MSCI, S&P 500

US Equities Trade at a Sustained Valuation Premium

Forward US and non-US P/E multiples, from highest to lowest



- Valuations for non-US equities are materially lower than for US equities, which means expectations for earnings growth are much less demanding.
- Investors may increasingly look to non-US opportunities to diversify the drivers of capital appreciation, reduce valuation risk, and mitigate US currency exposure.

As of 12 December 2025
Source: Bloomberg

Key Takeaways

Risks and opportunities to watch in 2026

Risks in the AI Trade

- I am skeptical that the AI equity trade will be sustained through 2026. Investors are increasingly questioning the funding sources for major capex announcements as vendor financing and debt offerings become increasingly prominent.
- There is no doubt that AI will be revolutionary, but concerns are growing over certain AI assets' longevity. If AI infrastructure ends up being overbuilt, and the cash flows are realized too late, the hardware itself might be obsolete before there is demand for it.

Global Opportunities

- Emerging markets are particularly appealing, offering AI exposure at far lower valuations alongside multiple uncorrelated growth drivers. Risks from geopolitical intervention remain—but similar risks are rising in the United States.
- Japanese equities benefit from ongoing pressure to improve corporate governance and balance sheet management that should raise returns on capital.

Fixed Income, Currency

- Elevated debt and deficits combined with diminished Fed independence are the biggest risks to US debt markets and the US dollar.
- Local currency EM debt could benefit from US rate cuts as well as currency gains from US dollar weakening.

Real Assets and Gold

- In a world of stretched valuations, uncertain growth, and modest bond yields, income-producing real assets—especially infrastructure—offer inflation protection and moderate appreciation with lower volatility.
- Gold, while lacking cash flow, could also continue to serve as tail risk insurance in an environment of reduced dollar exposure and rising central bank demand.

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Published on 29 December 2025.

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The MSCI USA Quality Index is designed to capture the performance of large and mid-cap US quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth, and low financial leverage.

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