

Global Outlook

January 2026

The narrow path to the new normal

In many countries weak growth exposes structural challenges.

AI and the productivity promise.

NZ looks better in 2026, but the recovery remains hard work.

BEVAN GRAHAM

AI!

Implications For Investors

Equity diversification beyond the US may be further rewarded in 2026.

Corporate health still sound, but geopolitical environment is deteriorating.

Bond selectivity is crucial, with supply surging from governments and private issuers.

GREG FLEMING

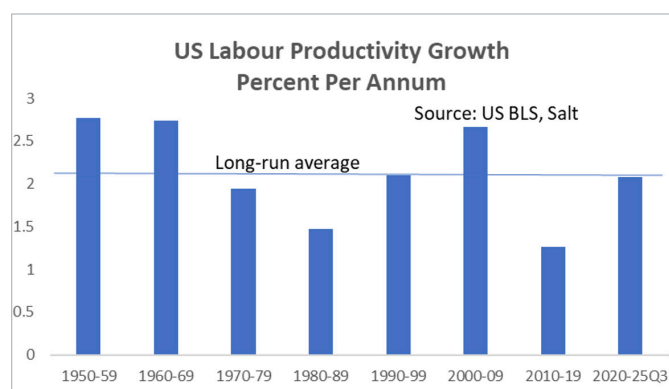
The Narrow Path to the New Normal

The global economy enters 2026 at a delicate stage. The extraordinary turbulence of the early decade including pandemic disruptions, energy shocks and policy volatility continue to fade into the background. Evolving in its place is a still fragile “new normal” encompassing a tougher global trading environment, lower trend growth, difficult fiscal challenges, inflation moving toward target but in many cases not quite there, and policymakers navigating a narrow path between restraint and support as they nudge their way towards neutral interest rate levels that are still yet to be determined.

Structural growth challenges exposed

As growth gravitates towards new normal trend levels, it will expose the underlying strengths and weaknesses of various economic models that have been masked for years. The era of easy disinflation, cheap capital, and frictionless globalisation allowed many economies to grow without confronting hard structural choices. That period is now over.

The United States enters 2026 as still the most dynamic developed world economy. Flexible labour markets, a strong culture of innovation, and a corporate sector that adapts quickly to technological change will see the US remain as a strong performer and contributor to global growth. But even the US is not immune to longer-term pressures — higher borrowing costs, a shrinking labour supply from slowing immigration, and a fiscal stance that cannot stay expansionary forever.

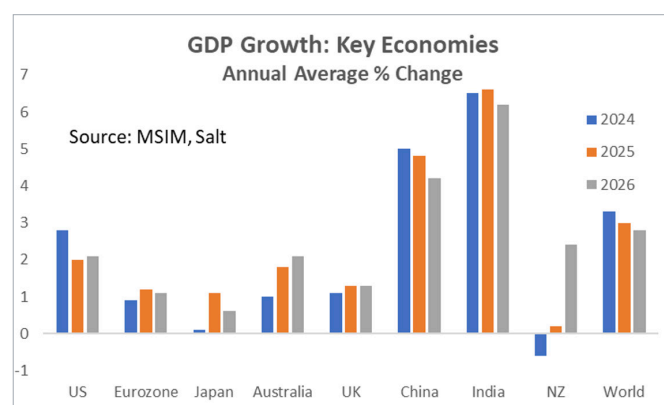


In Europe, the cracks are more visible. Weak productivity growth, rigid labour markets, and elevated energy costs continue to challenge competitiveness. For economies

that rely heavily on trade into a fragmenting global system, growth looks increasingly fragile. Improvements in economic prospects are increasingly reliant on necessary domestic reforms. Japan faces similar demographic constraints, where a shrinking workforce risks keeping domestic demand soft, with an offset provided by labour-saving investment.

China's structural challenges are the most pronounced. The transition from property-led expansion to a more balanced model is proving slow and uneven, weighing on confidence and leaving the economy vulnerable to deflationary forces and continued capital misallocation. Meanwhile, India and parts of Southeast Asia are emerging as new engines of global growth — but their rise also reflects a shift in the geographic distribution of opportunity, not just cyclical momentum.

On balance, global growth in 2026 should reach around 2.8%, slightly softer than the estimated 3.0% in 2025. More tellingly, this marks the second consecutive year that global growth will come in below the long-run average of closer to 3.5%, a level that now seems something of a stretch target.



Fragmenting globalisation

In the late 20th and early 21st centuries, increasing globalisation was a key driver of global growth and played a significant role in reducing inequality between countries. Markets used to view trade frictions as cyclical annoyances, or as episodic disruptions that would soon be resolved by economic pragmatism. But in 2026, geopolitical rivalry, national-security priorities and industrial policy have made trade fragmentation a structural, not a temporary, feature.

The shift can be seen in three clear trends. First, tariff and non-tariff barriers are expanding, with major economies turning to trade policy as an instrument of strategic competition. Second, supply chains are being redesigned for resilience rather than cost minimisation. Third, global economic alliances are shifting, becoming more fluid and more contested as countries balance economic needs with geopolitical alignment.

These forces increase the cost structure of the global economy and reduce the disinflationary tailwinds that markets once took for granted. They also introduce persistent policy unpredictability. Geopolitics now behaves like a permanent source of uncertainty and potential disruption, as we have already seen in 2026 with events in Venezuela.

Hopefully 2026 sees less tariff noise with several trade deals signed, and a less fractious US-China relationship. However, the broader economic consequences of a more fragmented trading environment are yet to fully emerge.

The AI wave and the productivity promise

Against this challenging backdrop, the most potentially transformative force is the ongoing AI-driven investment cycle. For the first time in years, the global economy is staring at a technology that could meaningfully lift productivity, something most advanced economies have struggled with for decades.

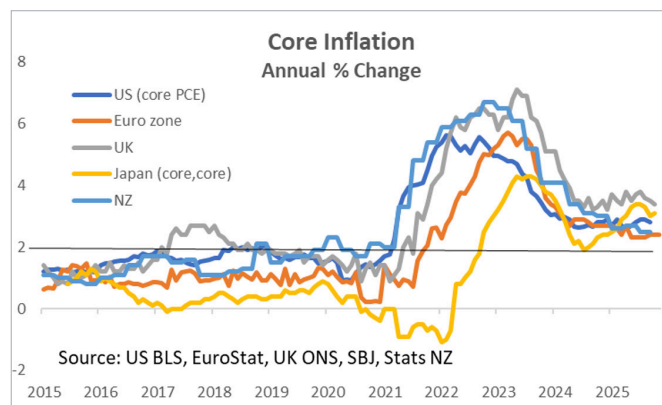
However, unlike previous digital innovations, the AI revolution is capital intensive. It demands vast investment in data centres, energy supply, cloud infrastructure, chips, specialised labour, and secure supply chains. The “capital-light” era is over.

In 2026, the world sits at the intersection of immense promise but uncertain pay-off. Corporate investment will continue the shift toward AI, perhaps even before the full productivity benefits materialise. This introduces asymmetry in the sense that the costs arrive early while the gains come later. This raises the challenge that expectations run ahead of uncertain realised economic benefits.

Still, if AI succeeds in raising productivity meaningfully, it could offset some of the structural drags from demographics, debt and weaker globalisation.

Inflation down, but far from out

Inflation has slowed sharply as the pandemic-related disruptions to supply chains were resolved and central banks, albeit belatedly, tightened monetary conditions aggressively. However, the final step to target inflation has proven either temporary or elusive for many central banks as service sector inflation in particular proved sticky.

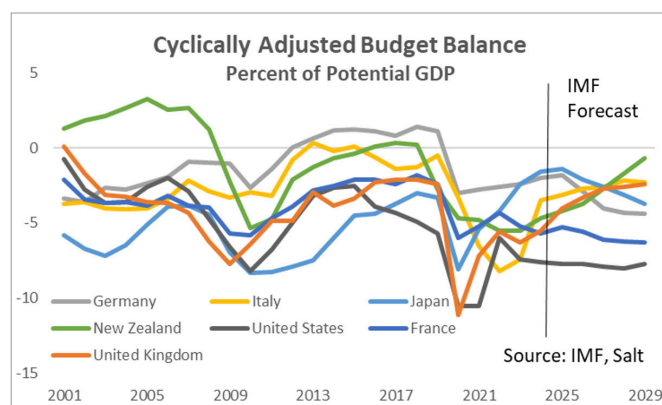


Structural inflation drivers have shifted. Labour markets still exhibit firm wage growth in many economies that are not offset by productivity gains. Supply chains are less efficient, and governments are using fiscal tools to pursue strategic aims, even as large structural deficits persist.

The result is a higher neutral interest rate than prevailed through most of the 2010s. As we enter 2026, central banks will therefore need to tread carefully. Cutting too slowly risks choking off economic momentum, while cutting too aggressively risks reigniting inflation pressures. Some countries will be able to lower interest rates a little further but cuts similar to those in 2025 are unlikely to be repeated.

Fiscal duress

If monetary policy is shifting gears, fiscal policy enters 2026 under growing strain. Governments worldwide carry debt loads far higher than before the pandemic, and many now face rising interest costs, aging populations and political constraints on consolidation.



For years, markets tolerated high debt on the assumption that low interest rates made it manageable. That assumption no longer holds. With real rates structurally higher, debt servicing consumes a growing share of national budgets. The resulting squeeze limits governments’ ability to invest in long-term priorities, from climate transition to healthcare to digital infrastructure.

At the same time, political incentives often lean toward

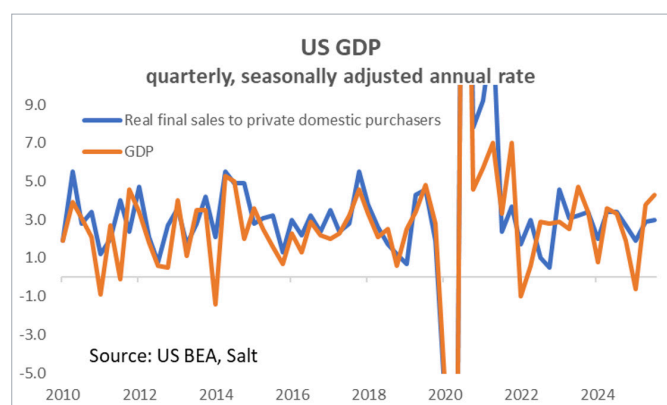
short-term relief rather than long-term discipline. This tension between political promises and fiscal arithmetic will become increasingly visible in 2026, especially in economies with weaker institutional anchors or less credible fiscal frameworks.

The Bottom-Line

The global economy continues to navigate a path to the new normal. The challenges are immense, but there are also significant opportunities. In 2026 we will move closer to discovering whether AI can deliver productivity rather than just promises, whether central banks can normalise without destabilising, and whether governments can reconcile political ambition with fiscal reality.

A quick trip around the world

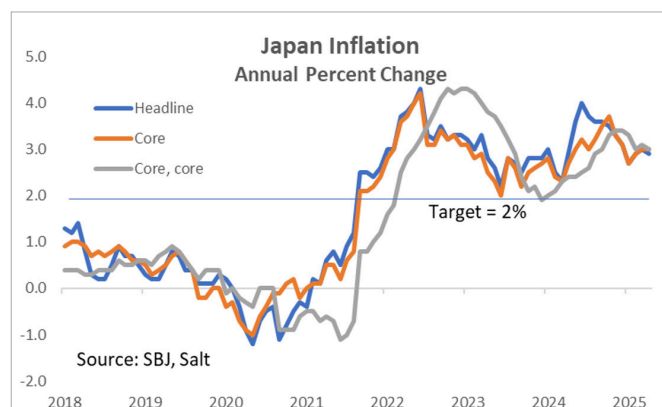
The United States ended 2025 with the disruption that came with the record longest US government shutdown of 43-days. Data releases resumed towards the end of the year as the shutdown concluded. However, the reports on CPI inflation and labour market raised more questions than they answered given the less than fulsome component data. It won't be until we see data from early 2026 that any clear insights can be gleaned. September quarter growth exceeded expectations with a seasonally adjusted increase of +4.3% boosted by strong net exports, as the pre-tariffs front-loading of imports continued to unwind, but also still-strong domestic demand. Heading into 2026 the boost from net exports appears unlikely to continue at this rate and consumer spending will face the challenge of softening consumer confidence. The US Federal Reserve cut interest rates for a third consecutive time in December, taking the Fed funds rate to 3.75%. The December decision came with dissents in both directions, highlighting the divergence in views amongst committee participants and the lack of clarity about the outlook. The critical question for the Fed in 2026 is the apparent disconnect between still strong growth in the economy and weak labour demand. Add in still sticky inflation and you've got a real conundrum. Fed policy making doesn't look like it's going to get any more straight-forward as 2026 progresses.



The Eurozone economy is expected to grow modestly in 2026, with real GDP expansion around 1.0% as activity remains constrained by weak external demand and ongoing geopolitical risks. Structural challenges such as fragmented investment and reliance on energy imports are likely to keep growth below historical averages, though fiscal support in some member states could provide pockets of resilience, though this comes with the caveat of bond market concerns about fiscal sustainability. The European Central Bank continued its "on hold" approach into the end of the year. In the Statement the ECB reiterated its data dependence and meeting-by-meeting approach. Both inflation and growth forecasts were tweaked higher, and President Lagarde said all options remain open in terms of the ECB's next move. We think the ECB is on hold for a considerable period.

The UK's economy is forecast to expand roughly 1.2% in 2026 with inflation moving closer to the Bank of England's target. However, weak domestic demand, elevated input costs, and labour market softness are likely to constrain momentum, resulting in a slower and uneven recovery. Indeed, softer inflation and a 5-year high in the unemployment rate was enough for a narrow decision by the Bank of England to cut interest rates in December. The vote was 5:4 in favour. Governor Bailey was cautious in his signalling of further rate cuts to come, saying there was "more, limited space" for further cuts.

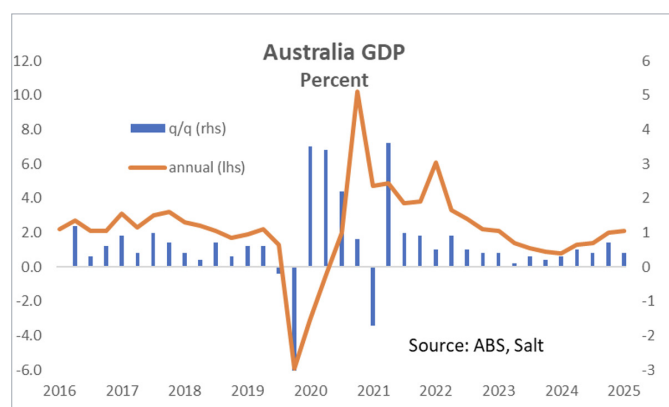
Japan's economy is anticipated to grow at a modest pace, around 0.6% in 2026, reflecting ongoing demographic headwinds, cautious consumer spending, and gradual monetary policy tightening by the Bank of Japan as it continues to normalise interest rates. Inflation is expected to ease somewhat after a long period well-above target. The Bank of Japan raised interest rates for a second time in 2025 in December, taking the policy rate to 0.75%. The first hike of the year was way back in January, and the policy rate is now at its highest level in 30-years. With above target inflation looking increasingly entrenched, further interest rate normalisation appears likely in 2026.



China's growth is projected to slow further in 2026, with

real GDP expanding at around 4.5% amid unwinding pandemic-era stimulus, structural shifts in the property sector, and external demand headwinds. As we have become well used to, slower population growth and global trade frictions will likely temper the pace of expansion relative to the past. The recent Politburo meeting has set strengthening domestic demand as its top priority for 2026, reiterating the commitment to proactive fiscal policy and moderately loose monetary policy.

Inflation data surprise to the upside in Australia in September and October, though the expected moderation in November was larger than expected. Still, core (trimmed mean) inflation remains well above target at 3.2% y/y. This saw the RBA leave interest rates unchanged at both the November and December meetings, with comments from Governor Bullock at the December meeting indicating a tightening bias. GDP growth is recovering though September growth surprised to the downside. However, inflation indicators within the data (unit labour costs) were stronger than anticipated. Markets are pricing the next RBA move to be a hike. We agree though think some expectations of a move as soon as the February meeting are too soon.

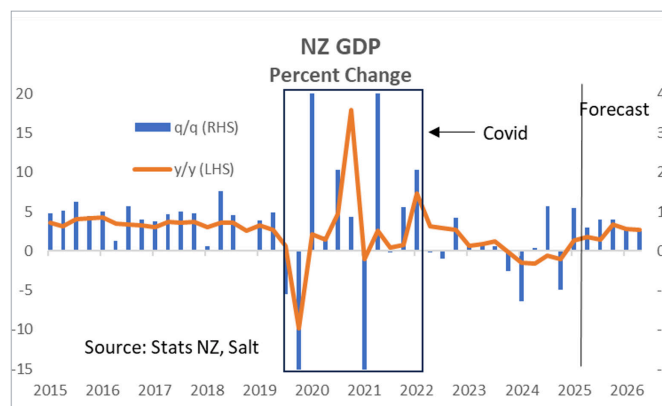


New Zealand: Starting to fire

It has taken a while, but the New Zealand economy is finally starting to fire. The recovery was delayed by the absence of two traditional tailwinds of New Zealand economic growth; population growth as net migration slowed and the wealth effect of rising house price as house price inflation remained subdued. That left the recovery reliant on recently higher commodity prices and the resulting rise in the terms of trade, and lower interest rates that were always going to take time to impact on household disposable given the high level of fixed rate mortgages.

2025 was volatile from a GDP growth perspective. Growth of +1.1% q/q in the first quarter of the year was followed by a disappointing contraction of -1.0% in the second quarter, only to be followed by a bounce back of

+1.1% in the third quarter. That volatility only serves to remind us that growth accounting can be a bit confusing sometimes and that some of the angst-ridden hand-wringing that followed the June quarter contraction was a bit over the top. Indeed, at the time of the release of that data there were already early signs of recovery emerging and there were a few idiosyncratic sectoral factors (manufacturing) in the result that would likely bounce back in the following quarter. It also makes things challenging for a data-dependent central bank.



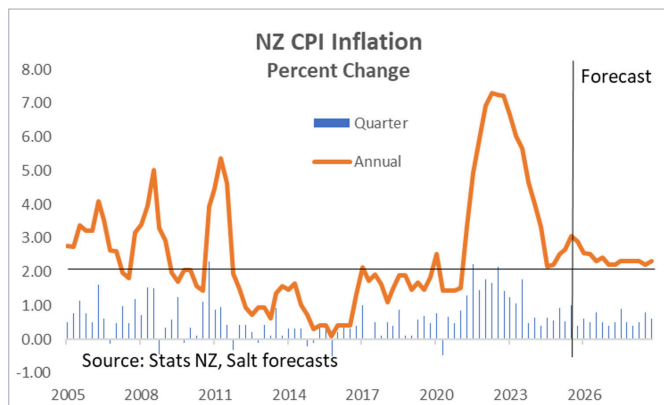
A growth bounce-back in the September quarter was to be expected as some of the sector specific weakness that came through in the June quarter (manufacturing for example) was only going to reverse. And even at the time of the June quarter release there were already signs of a recovery in activity starting to show through in some of the higher frequency data.

Looking through the quarter-to-quarter volatility, the better metric to look at right now is annual growth which shows the September quarter of 2025 was 1.3% higher than the same three-month period last year. That feels about right and is consistent with our view that this recovery was going to be a slow, hard grind.

We think the September quarter result will mark the start of a period of more consistently positive GDP results, but not at the magnitude we saw in that three-month period. The recovery is going to remain hard work with growth in 2026 doing well to reach 2.5%, still short of the level that once saw us awarded the moniker of a "rock star" economy.

Headline inflation to fall back towards 2%

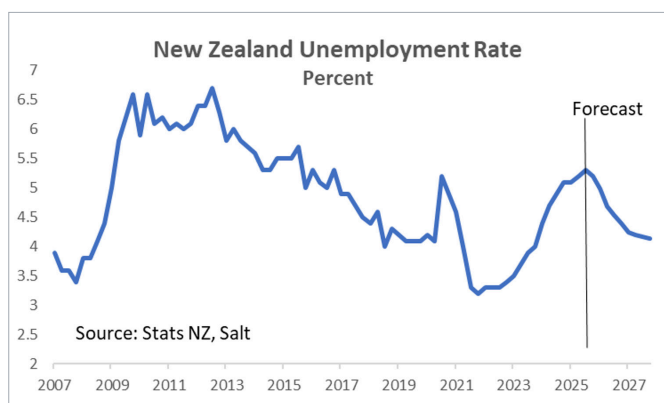
Headline inflation fell to 2.2% in the year to September 2024, but then headed up again as higher electricity, local authority rates and food prices fed through into the Consumer Price Index (CPI). The annual rate of CPI inflation reached 3.0% in the year to September 2025, the top of the Reserve Bank of New Zealand's 1-3% target band. We expect the annual rate of inflation to head lower into 2026 as the impact of those past increases fall out of the annual calculation.



There are risks to the expected lower inflation. Firstly, higher recorded inflation could feed through into higher household inflation expectations which would make getting actual inflation back to 2% more challenging. The second risk is that after two years of tough trading conditions, firms may look to increase prices to restore profit margins.

Employment will be slow to recover

However, with the unemployment rate at cyclical highs, wage pressure will remain subdued which will act to keep domestic inflation pressures in check. The unemployment rate increased to 5.3% in the September quarter, the highest level since the end of 2016. We expect this will be the peak in the cycle, but the recovery will be long and hard. Given our expectation of only modest growth in activity through 2026, the recovery in employment will also be modest. And with a likely recovery in net migration adding to the supply of labour as the year progresses, we anticipate the unemployment rate will have only nudged down to around 4.5% by the end of 2026.



It is mostly due to the recent increase in the unemployment rate and the increased spare capacity in the economy that has generated that has allowed the RBNZ to lower interest rates. At the peak in the interest rate cycle the Official Cash Rate (OCR) reached 5.5%, but interest rate cuts that began in August 2024 have seen the OCR reduced by a total 325 basis points to 2.25%. Unless the nascent signs of economic recovery begin to falter, this will mark the low for interest rates this cycle.

Stable interest rates in 2026

That means 2026 should be a year of relatively stable interest rates. However, as we get into the second half of the year, interest rate markets will be starting to anticipate the first increase of the next interest rate cycle. The issue for the RBNZ is that New Zealand has a relatively low potential growth rate. Potential growth is the rate of GDP growth an economy can sustain without generating above target inflation. The RBNZ will therefore need to start raising interest rates before growth becomes so strong it risks the upside of their inflation mandate. That first increase is likely to come around the start of 2027. If the upside inflation risks manifest themselves, it could well be earlier.

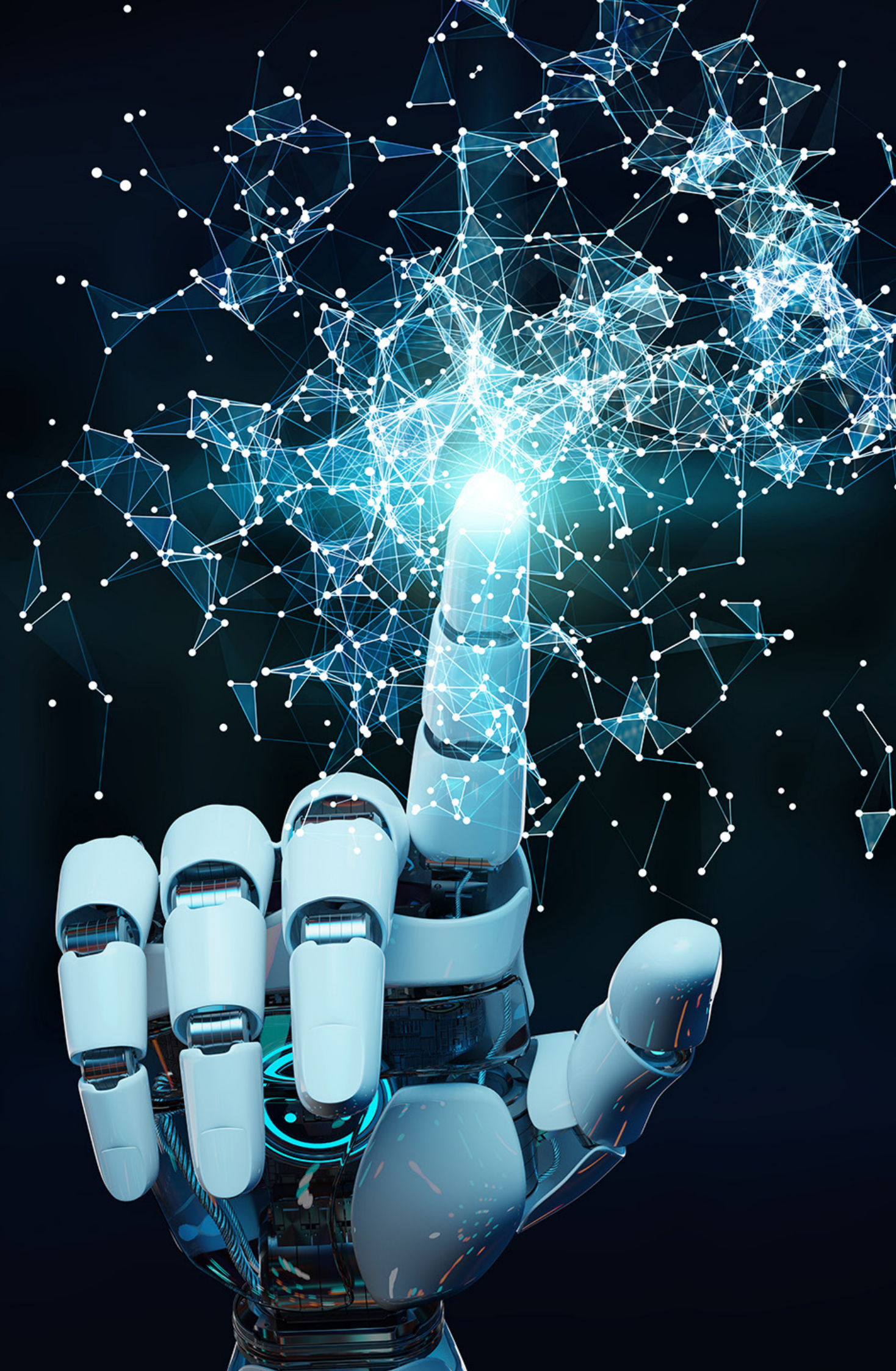
Election year

Finally, 2026 is election year in New Zealand. There will be the usual wide range of issues that voters will cast their vote on and that will determine the shape of the next Parliament. From a financial market perspective, the election is shaping up as a contest defined by growth, productivity, and fiscal credibility.

Fiscal choices will be front and centre. Room for large-scale stimulus is limited by rising debt and higher interest costs yet demand for improved public services and stronger climate and resilience investment remains intense. Retirement incomes policy will also be a focus with a few political parties already announcing positions on KiwiSaver.

From a broader macro-economic perspective, the higher cost of living, higher neutral interest rates, and a constrained growth environment adds urgency to the debate about supply-side reforms. The election will ultimately hinge on who can credibly articulate a path to stronger, more inclusive growth without compromising long-term fiscal sustainability.

Bevan Graham

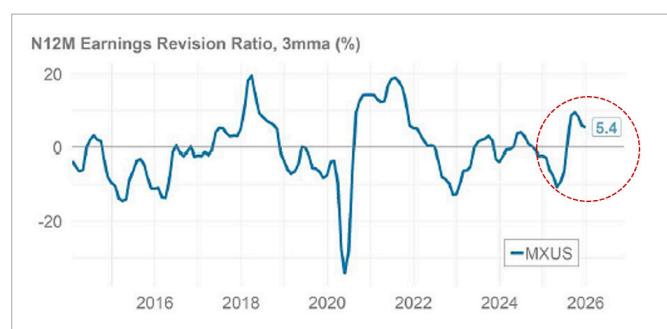


Implications for Investors

Despite widespread caution through the first half of 2025, last year proved to be the third year in succession to furnish annual international equities return approaching double the historical long-run average. Cautious investors, whose fundamentals-focussed market analysis led them to expect a clear re-pricing of equity risk, based on the economic disruptions (and at times, disarray) of the Trump Administration, have for now been disappointed. Momentum was the ruling tide in 2025.

A clear reversal in the expected tendency of US companies' earnings revisions set in quickly last year, after the modification of the so-called "Liberation Day" tariff announcements. Upward revisions to profit forecasts, as analysts diluted their previous trade war-based assumptions, carried market sentiment higher and the net balance of positive revisions only turned downwards again as 2025 ended. The relief in markets as companies adapted and profit hits proved "less bad" than anticipated, has arguably led to a positive overshooting and worrying US complacency.

US corporate earnings proving better than feared



Source: MSCI, IBES

Although many of US government's waves of erratic, arbitrary, and certainty-sapping policies and geopolitical actions continue to hit the headlines, so far, market participants appear to be willing to take America's new direction in their stride. The first part of January alone has seen additional piecemeal announcements from the Trump administration, proposing for instance massive defence spending increases (fiscally fraught,) intervention in the listed market for rental homes (populist and ineffective,) and proposals to carve up the natural resource assets of Venezuela amongst US companies according to the President's personal judgment of their deserts.

More seasoned observers are left wondering if all this high-handedness may signal dark times ahead for free markets and for rational investment price discovery. On the other hand, optimists on US assets tend to ignore the bizarre policy mix sampled above, and stress instead the snowballing scope for Artificial Intelligence, interest rate and tax cuts, and a newly-unleashed natural resource bonanza, now unconstrained due to the US' weakening of the global consensus on mitigating climate change. Thus, there is a market consensus on expecting another good year for equities in 2026. We are more cautious, and even wonder about the sustainability of 2025's rally. However, there are still reasonably-valued sectors and regions that active managers prefer.

Due to recent years' exceptional valuation performance of the Information Technology and associated US communications sectors, the American multinational MegaCaps are now dominant in terms of driving asset returns for typical global equity fund investors. For instance, there are now no non-US stocks within the top ten constituents of the MSCI World Index, and only one amongst the MSCI AC World Index (which includes Emerging Markets) – and that is Taiwan Semiconductor Manufacturing, which occupied 10th position as of 31 December.

These concentration issues are well-known, and have been canvassed throughout the last year. It really now remains only to note that a great deal now depends on an actualisation of projected profitability and productivity gains arising from the massive scaling-up of Artificial Intelligence and associated product distribution channels. The primary present risk to the golden outlook is geo-political: in a period of ever-darkening international relations, smooth sailing is a bold assumption given the complex global interdependencies of the microchip manufacturing industry. The secondary risk is, that profits from these unprecedentedly large investments prove slow to accrue. That could be because costs are higher than planned, or final demand is lacking.

Investing in an Era of US Interventionism

From the middle of last year, markets swung from showing disapproval for the radical and irrational parts of the Trump agenda, to beginning to appreciate that for the next three-four years, the US government is becoming a market-changing active player in key industries, which can be anticipated to advantage. However, that does

necessitate an investment philosophy dependent on contingencies – not one based on established metrics and processes. The US government has shown itself more than willing to take putatively “strategic” stakes in major companies, and having broken what was previously a Republican taboo, significantly more of the “Intel ilk” should probably be anticipated. There is now scope for ad hoc asset purchases using US Federal funds, which in the past has only happened in financial crisis periods, and is usually limited to bond markets (QE) rather than in the equity or property / infrastructure asset classes.

Agile market participants, aided by waves of politically and technologically-enthused retail believers, restored the bull market trend. In an economy and culture now very susceptible to what Robert Shiller named “Narrative Economics,” the bullish and brave celebrity CEOs came to the aid of the Administration’s credibility, via a series of Summit events where technology sector leaders stood side by side with Trump Cabinet appointees and began to re-arrange the story into more market-friendly terms. Broadly the same policy mix as had disturbed investors was re-cast in terms of the individual relationships between Corporates and Patrons in power.

Meanwhile, many analysts, having not discerned a marked improvement in either trade policy, consistency, or even in the realism of some new corporate opportunities, have remained skeptical of the sustainability of the equity gains since May. They point out that much is being taken on trust. Against this backdrop, valuations have again become extremely expensive.

This uneasy equilibrium, which has been characterised as a “tug-of-war” between almost irreconcilable market and worldviews, persists as the year ends, and will no doubt dominate much of 2026. It is partly a generational caution – market participants with memories of previous contractions and multi-year earnings recessions tend to be less blithe about the invincible A.I. / America Exceptionalism story.

Wall Street’s microprocessor-hungry miracle machines, versus a US Main Street mood mired in an affordability malaise. Which will prevail? We believe 2026-27 will see a climax of current contradictions and tensions, and that it will most likely involve higher volatility and uncertain overall market direction.

On the positive side of the ledger, stands the well-behaved nature of US wage growth, small upgrades to global growth forecasts and the possibility that Technology company earnings may prove less sensitive to the economic cycle due to transformational features. So far, earnings surprises have been predominantly positive, and much reliant on the technology and associated e-commerce industry set.

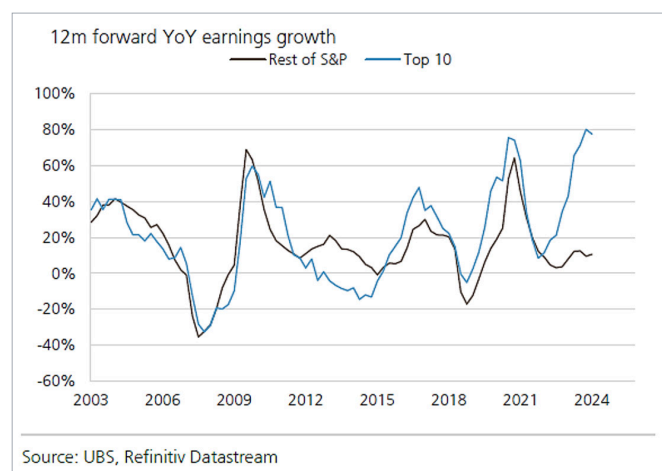
It is an understandable, if optimistic, expectation, that A.I. won’t prove vulnerable to cyclical demand forces.

The industry focus is squarely on building supply and assuming demand will follow. Presently, tech companies are in a very profitable phase, allowing them to underwrite the datacentre and advanced microchip requirements of the digital infrastructure frameworks needed to further develop A.I. and semi- autonomous product ranges such as humanoid robots or automated drones and cars.

The vital question is, will the array of revolutionary applications of Artificial Intelligence and Robotics be able to be straight-forwardly monetised into consumer products for the investors, and over which timeframe? A great deal of the equity market multiple expansion that has already occurred, and of the debt issuance that is now underway, relies on the answer being affirmative/

A pathway running out two years from now, leading to genuinely profitable A.I. in widespread use, would validate the heavy commitment of investment capital that has occurred in 2024-5. If the timeframe were to threaten to stretch out to five years, many investors would become nervous, and would likely rush to pre-emptively reduce their very high current exposures to such themes.

US corporate profit growth is ever-more Mega Cap. dependent



Data to 30 November 2025

Global regions improve, outside the Americas

Despite logging exceptional value gains in 2025, as shown in the table below, European, Emerging Market and East Asian equities remain more attractive in pure valuation terms than the US market – which as noted, dominates the capitalisation-weighted benchmarks. Of course, many of the strong 2025 performers had lagged the S&P 500 in prior years, but it is interesting that investor rotation outside the US equity market now seems to be progressing. That is probably a hedge against extreme policy uncertainty and valuation reversion, as profit growth forecasts still favour the US equity market over most others. This could well change in 2026, but needs a catalyst.

MSCI EU and MSCI EM led real returns in 2025

Ranking	2023	2024	2025
1	S&P 500 (22%)	S&P 500 (22%)	MSCI EU (33%)
2	MSCI JP (17%)	MSCI CN (16%)	MSCI EM (31%)
3	MSCI EU (17%)	US Small (8%)	MSCI CN (28%)
4	US Small (13%)	Global HY (6%)	MSCI JP (22%)
5	Global HY (10%)	MSCI JP (6%)	S&P 500 (15%)
6	US HY (10%)	US HY (5%)	Commod. (12%)
7	US REITS (8%)	MSCI EM (5%)	EM \$ Sov. (10%)
8	EM \$ Sov. (7%)	EM \$ Sov. (4%)	US Small (10%)
9	MSCI EM (7%)	Commod. (3%)	Global HY (9%)
10	US IG (5%)	USD Cash (2%)	EM Local (6%)
11	EM Local (3%)	US REITS (2%)	US HY (6%)
12	US Agg (2%)	US2Y (1%)	US10Y (6%)
13	USD Cash (2%)	MSCI EU (0%)	US IG (5%)
14	US2Y (1%)	US IG (-1%)	US Agg (4%)
15	TIPS (1%)	TIPS (-1%)	TIPS (4%)

Source: Morgan Stanley Research (returns are net of CPI inflation)

"No-one rings a bell at the top of the market"

Given the price momentum in all things microchip and A.I.-themed still underway despite hitting some air pockets recently, it would be imprudent to predict a specific negative turning point for ebullient sentiment on these increasingly dominant segments of the US and thereby, of Global equity markets. Typically, very-richly priced equity market sectors require a substantial and systemic shock to reverse direction, like the paradigm shift that GFC banking collapses worked for Financials stocks, to definitively melt the overarching narrative and restore a more fundamental-based pricing in the industry. It is impossible to predict such a shock with any precision, whether with regard to its type or its timing. It could emerge domestically, or globally.

In considerable and persistent uncertainty, prudence counsels continuing investing in high Quality, technology and software enterprises, but to locate the bulk of such investments adjacent to any single technology that is at the centre of the "revolutionary earnings growth" hypothesis. This approach is akin to investing in companies that supply Emerging Markets, rather than in Emerging Markets themselves, in that it allows participation in the growth potential of a frontier industry / economy, without incurring the worst hazards of over-concentration. It is notable that so far, the main beneficiaries of A.I. equity investment enthusiasm has been in the hardware aspects, and not much in the industries which stand to gain most from transformations. Opportunities lie there.

Similarly, the national equity markets where valuations are not "red hot" compared with their historical norms most likely have greater resilience over the medium-term. Another way of looking at the relative value argument is, that if A.I. technologies indeed prove as revolutionary to global enterprise as current valuations imply, the scope for positive marginal productivity impact is greater in

regions which are not yet significant adopters and where the use case of generative A.I. has the most scope to generate margin gains, e.g. benefitting health care, food retailing, hotels, conference companies, budget airlines and financials, amongst others. Potentially strong beneficiaries of A.I. adoption are companies that are labour-intensive (high employee numbers to sales or low Enterprise Value per employee,) and have pricing power. There are many such enterprises in Europe, Developing Markets, and even Australasia – the US is already very efficient.

Traditional valuation metrics imply widespread price risk

Region	Trailing PB	Trailing PE	Forward PE
MSCI ACWI	3.6	22.9	21.8
S&P 500	5.5	27.3	25.7
MSCI Europe	2.4	17.0	16.9
FTSE 100	2.3	15.0	14.7
Germany DAX	2.1	19.0	18.0
France CAC 40	2.1	17.8	17.7
Japan Topix	1.7	17.8	17.9
Korea KOSPI	1.3	18.2	14.5
Hang Seng	1.4	12.8	12.5
Brazil Bovespa	1.5	11.3	9.7
Mexico BMV	2.3	15.6	14.2
S. Africa Top40	2.3	16.7	15.2
MSCI China	1.7	14.9	13.7
MSCI India	3.8	26.0	25.8

Source: Morgan Stanley Research (redder shading shows more historically-extreme)

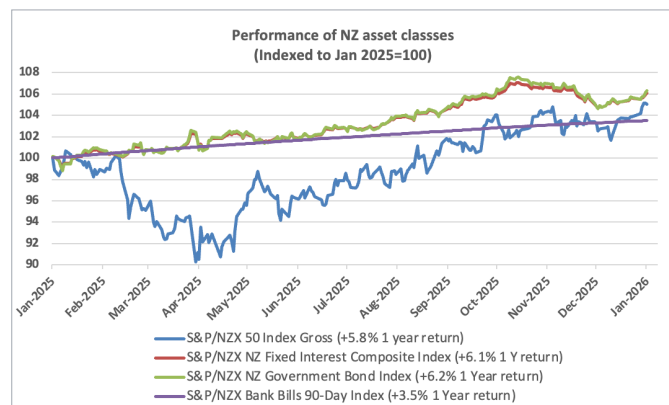
Taking a brighter view of NZ equities

Whilst the New Zealand economy is still in the throes of the very difficult domestic trading environment, we believe that the easing path now well-advanced by the Reserve Bank of New Zealand and the defensive nature of the industries that are heavily represented on the NZ exchange means that NZ equities should stay resilient. Int 2026 we anticipate incremental domestic demand improvement, alongside some probable election year pump-priming, allowing the local market to build upon its moderate recent gains.

However, as the influence of US markets never leaves New Zealand unaffected, equity exposures should be carefully managed. NZ equity valuation multiples are rather more palatable than either Australian or US shares' - especially if one looks at the NZ market on a median stock basis. Whilst not obviously cheap, the NZ market is therefore at acceptable valuation levels and has scope to rise further, assuming no major offshore negative turn in risk appetite. There is still a preponderance of pessimism implied in many domestic equity prices, and longer-term NZ investors or international acquirers (after

rigorous due diligence and comparative value analysis) will likely begin to accumulate stock in our home Equity market.

As shown below, the NZX 50 Gross return over the last year is still slightly below that of the return from domestic bonds, though it is ahead of the NZ cash return. That situation – while understandable when the economy was still in borderline recession with the RBNZ continuing easings and global bond yields moving lower – now seems to undervalue the NZ equity market’s near-term future returns potential as the economy incrementally improves this year.



Source: S&P Global Indices, Salt

The bond diversification argument remains complex

US and European fiscal adventurism and the accompanying debt-pricing dynamics are another problem zone for investors aiming at achieving a reasonable degree of understanding of their asset choices in turbulent times. While typically, a clearly-slowing global economy would argue strongly for raising Fixed Income securities weightings within multi-asset funds and portfolios, the present situation and outlook make us rather cautious.

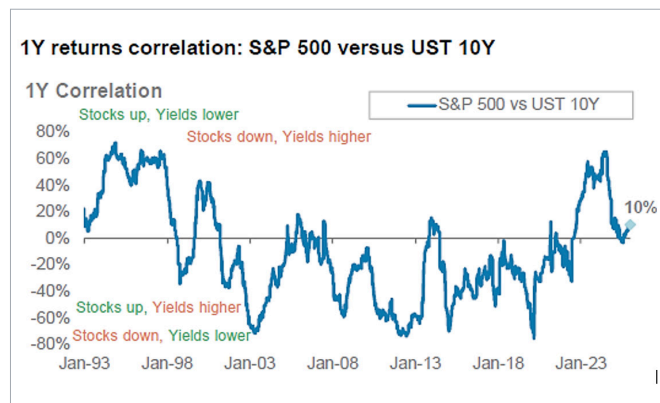
The enormity of the global demographic and economic challenges is reflected in the fiscal furores that have recently been topical in the US, the UK and France, and look ever-more intractable, given limited political willpower to adopt fiscal discipline. Other things being equal, that keeps Sovereign yields higher and thereby, elevates the yields on other securities that derive a spread over a putatively “risk-free” Sovereign interest rate of a comparable tenor.

Meanwhile, corporate debt quality, which has been high, is beginning to show indications that the credit cycle is unlikely to get any easier in 2026, and it may begin to fray for weaker issuers. So, bonds will likely again provide moderate returns next year, but there is a higher probability of marked differentiation in fixed income total returns, by specific credit type and

borrower domicile.

If nominal interest rates (such as the Fed Funds Rate or the NZ Official Cash Rate) are held somewhat higher than they have been over past cycles, due mainly to persistent inflation dangers, the argument for seeking a risk premium by placing funds in longer term debt securities “further out along the yield curve” and taking on duration and/or credit risk becomes more finely balanced. A return to term premia is healthy, but it can disrupt other markets short-term if reliance on easy, cheap credit has been too great.

Bonds are once again diversifying to a degree



Source: Morgan Stanley Research to 31 Dec, 2025

Finally, after two years in which there was little diversification benefit to be gained from Sovereign Fixed Interest, the directional correlation between bond and equity prices has returned to around zero. While a negative correlation is desirable for superior diversification, this has not been available since 2020 when the Covid-era interventions kicked off an extended period of positively-correlated returns. That was good for most diversified portfolios’ returns, but those returns were dependent on gains on both the equity and the fixed income legs of their holdings.

Were one of these elements’ returns to flag going forward, as we think is likely, it is preferable that the pricing of the other leg is now less prone to move in lock-step. Safer holdings are preferred, though it remains too early to lift Cash weightings in diversified funds, particularly as sovereign yield levels are suppressed across the board and barely compensate for the prevailing inflation rate in NZ, particularly when taxation is accounted for. Any wait for much lower yields may prove a long one, as investors are now acutely aware that buying sovereign debt implies underwriting uncertain government policies and priorities, for only a small compensation compared with cash.



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