

De-Risking the Portfolio

Avoid the Irrationality

17 October 2025

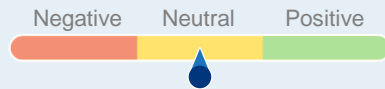
KGI View

Equity: Rate Cuts Are Not a Panacea for Stock Markets

Economic Outlook

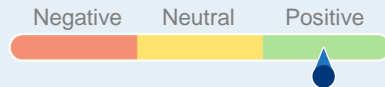
- US economic slowdown to continue in 4Q25F; market attention shifting to the impact of US-China tariffs war

US



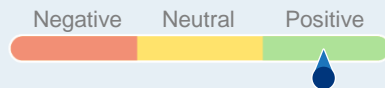
- Monetary policy may turn out to be less accommodative than expected in the face of potential rising China tariffs. After recent volatility, US equities now face correction risks in 4Q25.

Europe



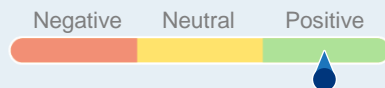
- Signs of improvement in structural factors have emerged, and index pullbacks are viewed as opportunities for positioning

Japan



- Monitor the outcome of the PM leadership; maintain a long-term core allocation in bank stocks and domestically driven sectors

Hong Kong/ China

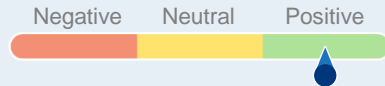


- The market entered a consolidation phase after a significant rally but the uptrend is expected to resume driven by the loose liquidity in China and a significant discount of valuation as compared to the US

KGI View

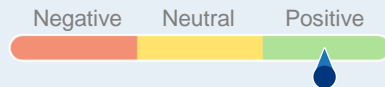
Fixed Income: Focus On Defensiveness

US Treasuries



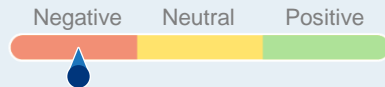
- Allocate to medium duration US Treasuries. US-China tariff war, if happens, may reignite inflationary expectation which would negatively impact the short and long end of the yield curve.

Investment-grade bonds



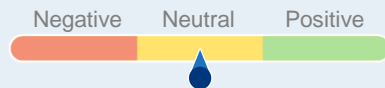
- We prefer IG in economic downturn – focus on utilities, banks, insurance and industrials

High yield bonds



- Maintain Underweight in non-IG bonds; avoid bonds rated CCC/Caa & below

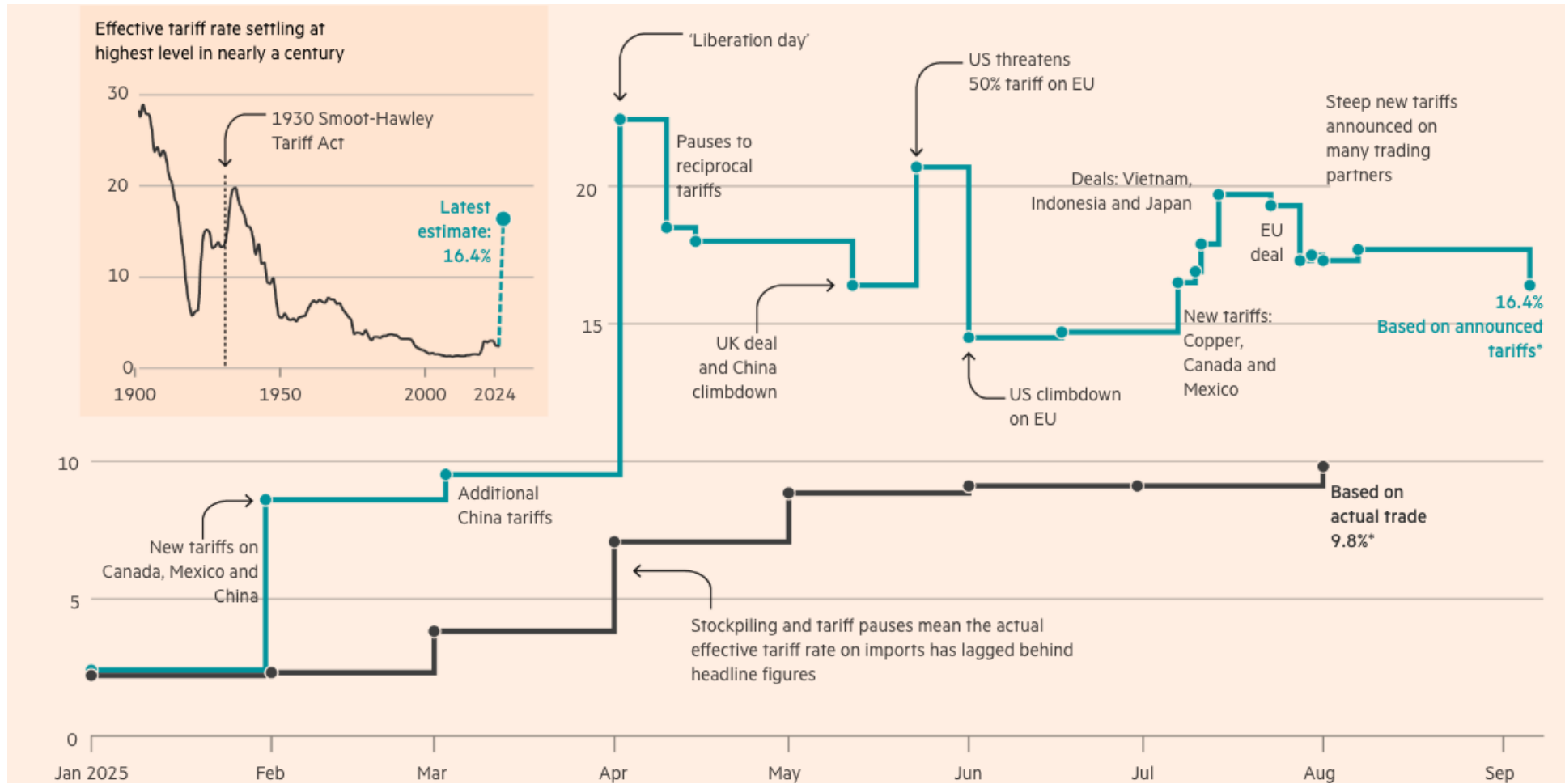
Emerging market bonds



- Weak US dollar supports EM bonds, favor sovereign debt in India, Indonesia and the Philippines.

If Tariff on China Imports Reach 130%, Average Tariff in the US >25%

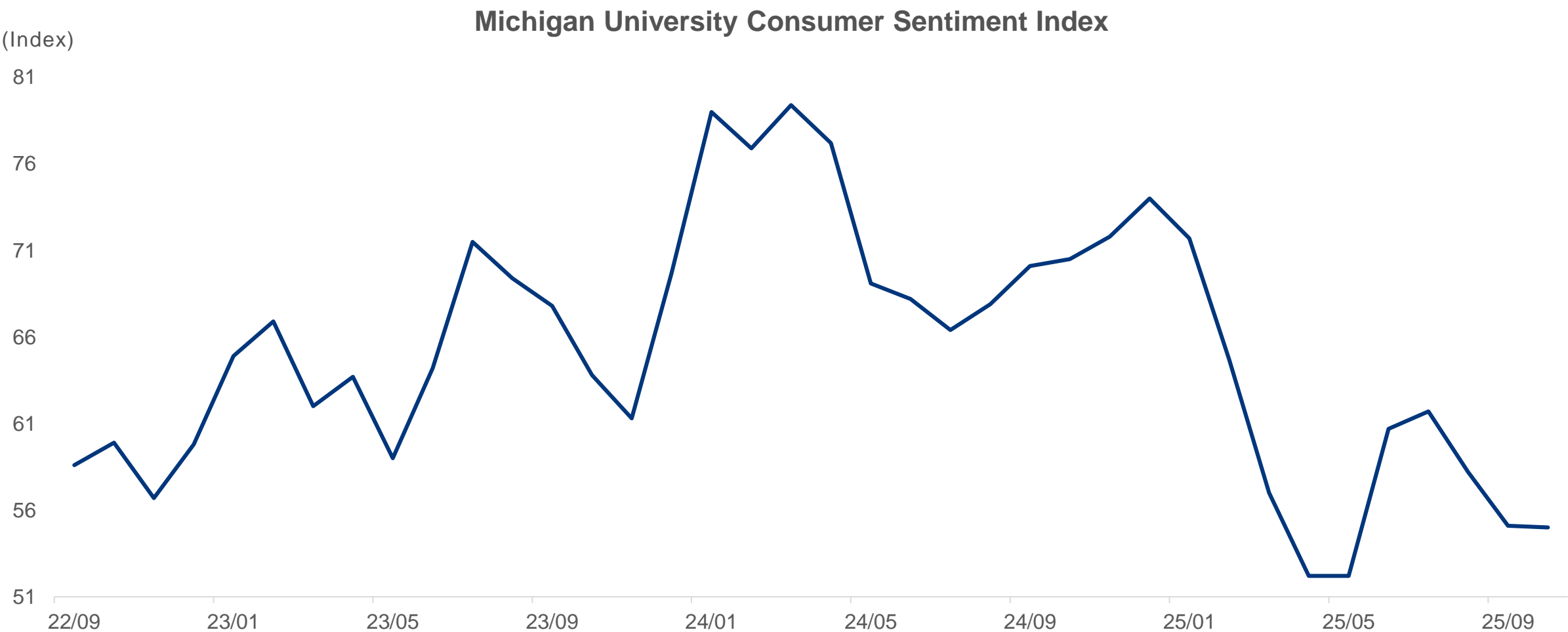
If No De-Escalation in One or Two Months, This Will Accelerate Inflation Expectation in the US



Sources: Yale Budget Lab; US Census Bureau.* 'Actual trade' rate is customs duty revenue as a % of value of goods imported.'Based on announced tariffs' is the estimate of the long-run effective tariff rate based on current announced policy, after accounting for consumption shifts.FT graphic: Alan Smith

Michigan University Consumer Sentiment Index

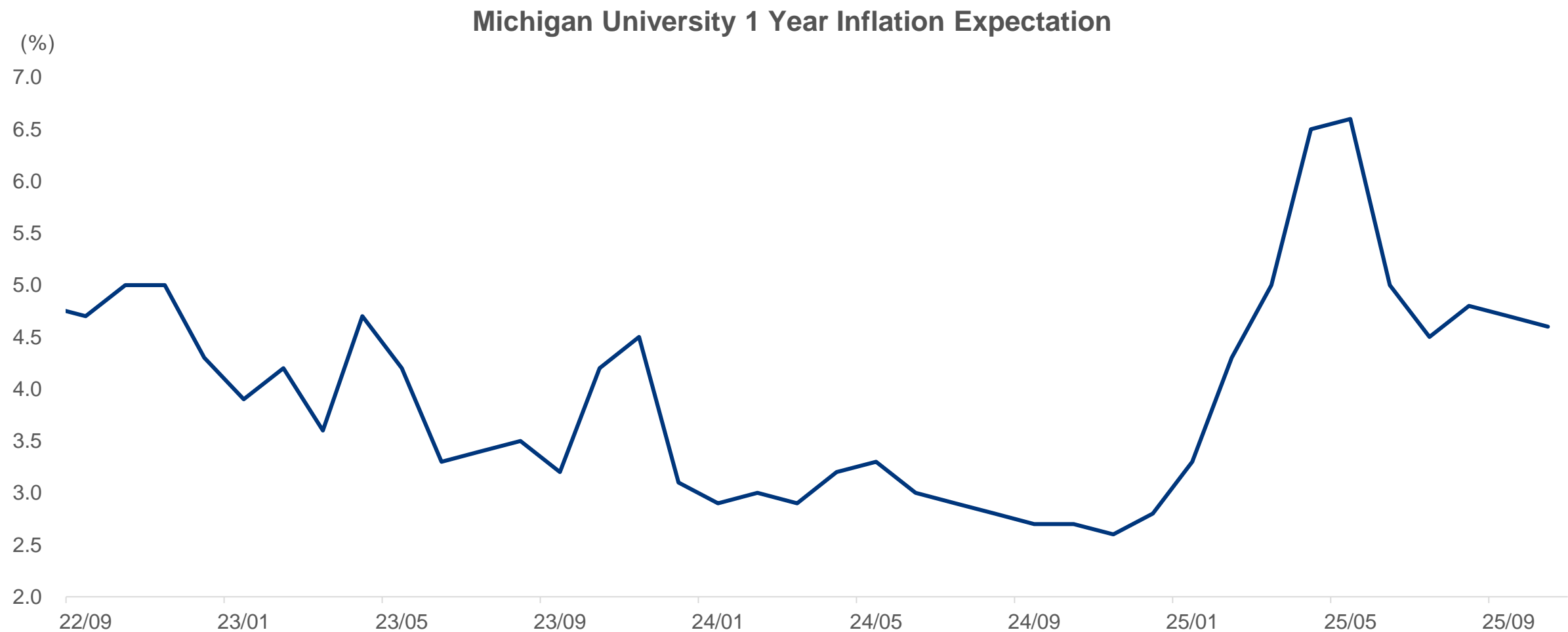
Worst-Case Scenario: When Tariff on China Was >100%, Consumer Sentiment Index Was at 52



Source: Bloomberg, KGI

Michigan University 1 Year Inflation Expectation

Worst-Case Scenario: When Tariff on China Was >100%, Inflation Expectation Was > 6%



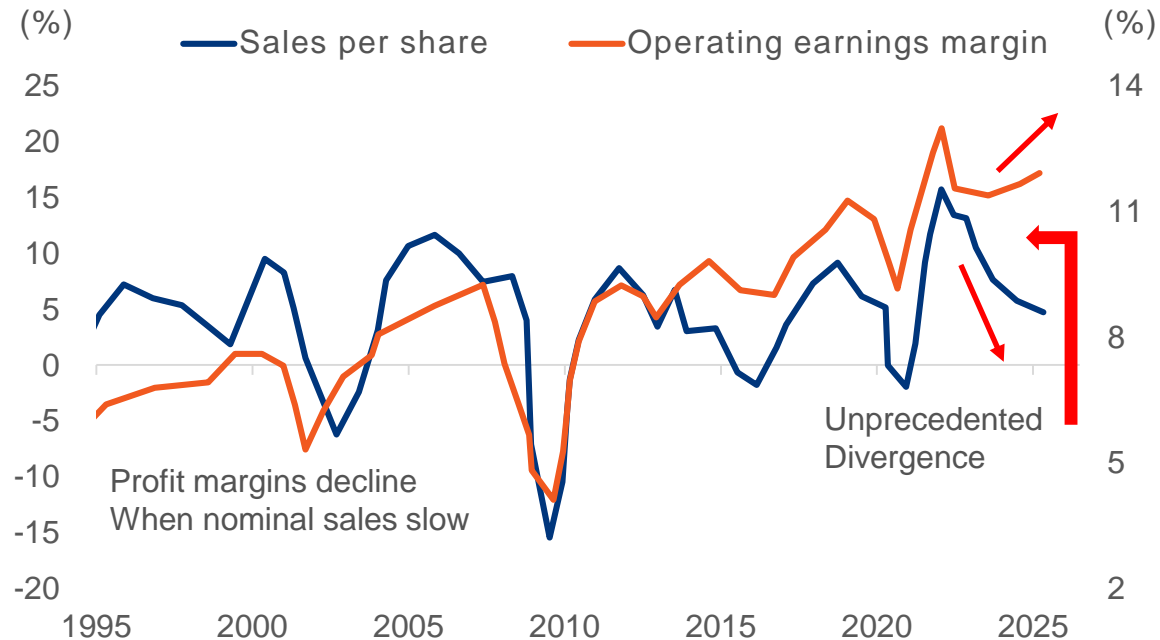
Source: Bloomberg, KGI

2Q25 Earnings Backed by Cost Reductions

US-China Trade War or Not, Corporate Sector Is Starting to Feel the Impact of Weaker Economy

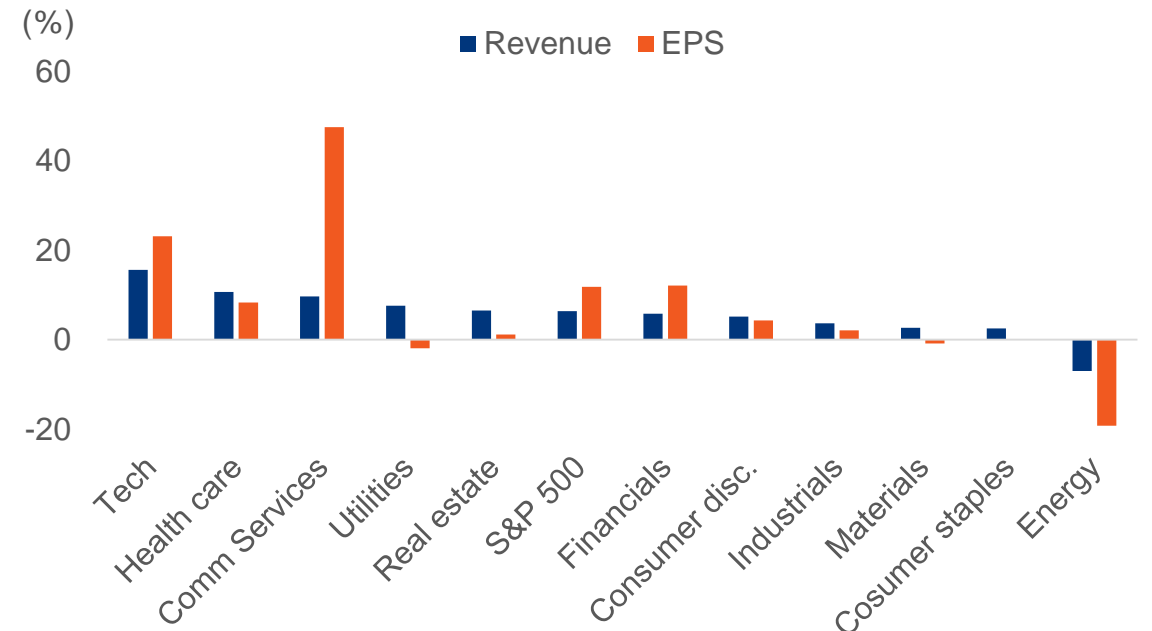
Operating margin growth had been driven by cost reductions, not sales growth

S&P 500 sales per share YoY, percent (LHS);
Operating earnings margin, percent (RHS)



The fact that most sectors saw earnings growth outpace sales growth in 2Q25 further validates this view

S&P 500 revenue & EPS growth by sector in 2Q25, percent

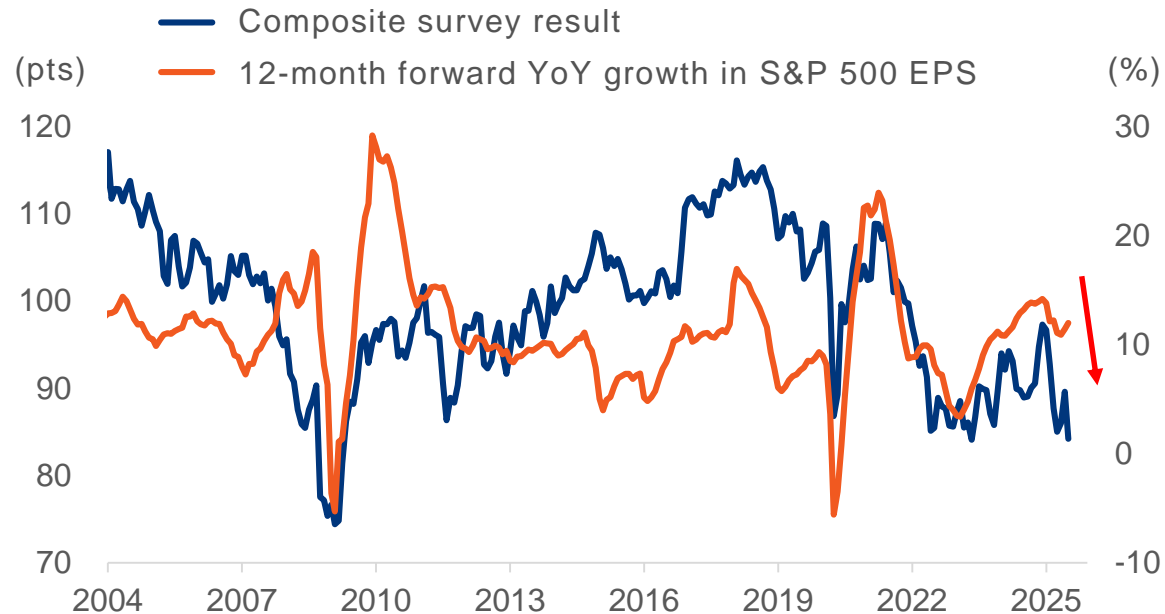


Expect Further Downward Revisions to Earnings Growth

Macro Uncertainties and High Ratio of Net Consensus Downgrades

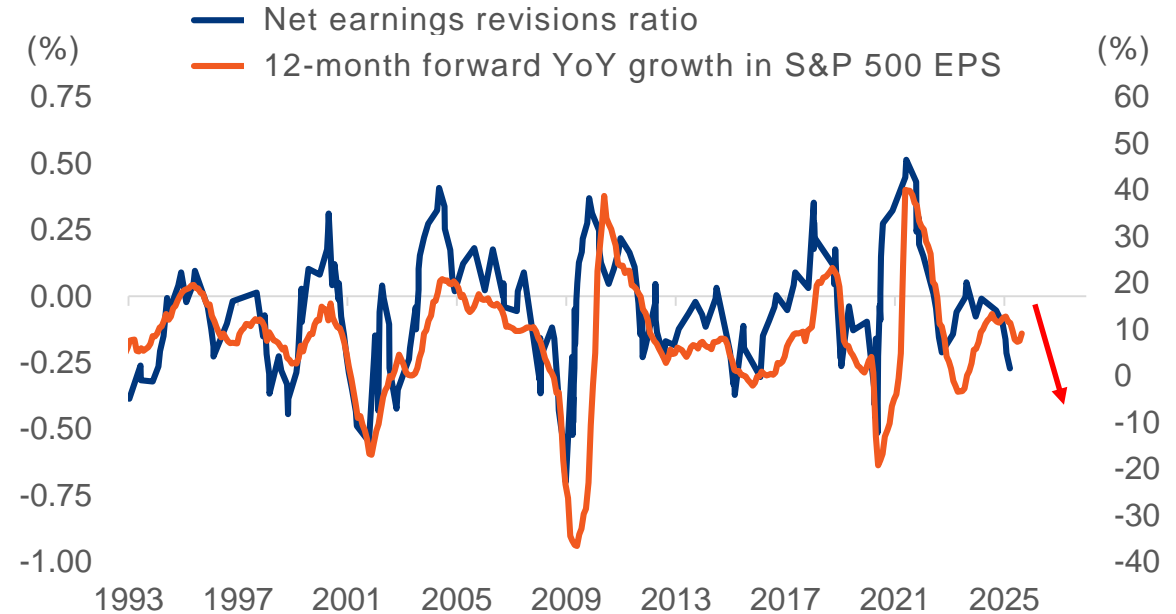
Survey data indicates clear downtrend, warranting further earnings downgrades for US stocks

Composite survey results (soft data), points (LHS); 12-month forward YoY growth in S&P 500 EPS, percent (RHS)



Overall EPS growth to edge down on sharper earnings downgrades

Net earnings revisions ratio, percent (LHS); 12-month forward EPS growth YoY, percent (RHS)



Too Much Hope on Rate Cuts

Rate Cuts Are Not a Panacea for Stock Markets; Background of Rate Cuts Matters

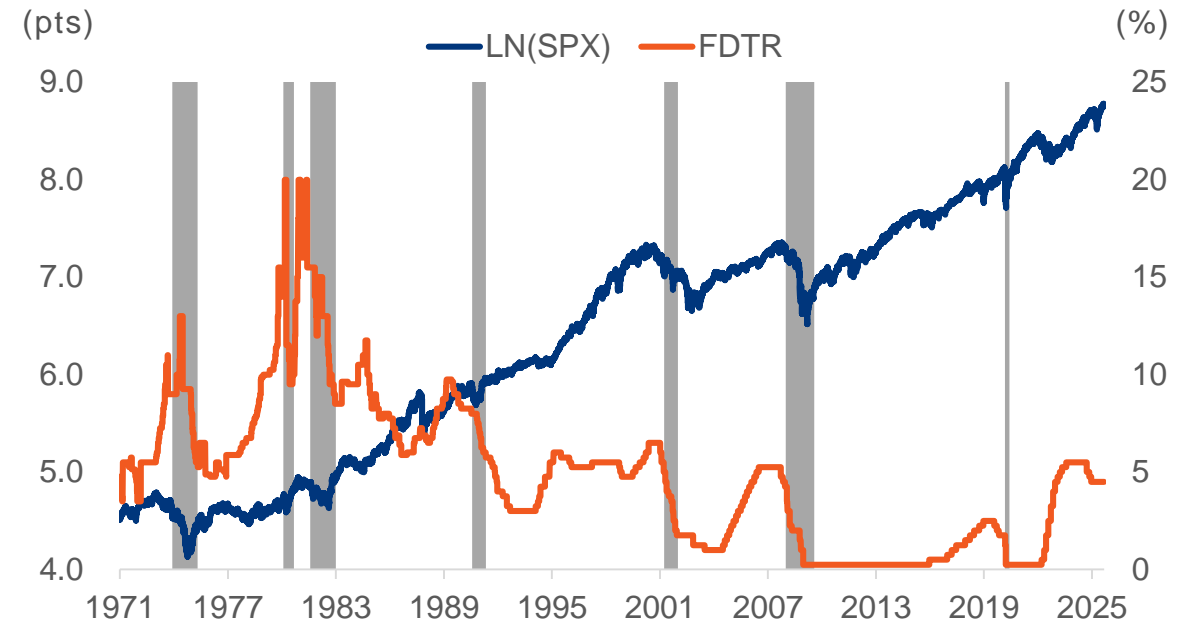
Risk premium of stock market tends to rise during a rate cut cycle

S&P 500 risk premium, point (LHS); Fed discount rate, percent (RHS)



Rate cuts in light of an economic downturn cannot shore up stock markets in most cases

S&P 500 index (in logarithm), point (LHS); Fed funds rate, percent (RHS)



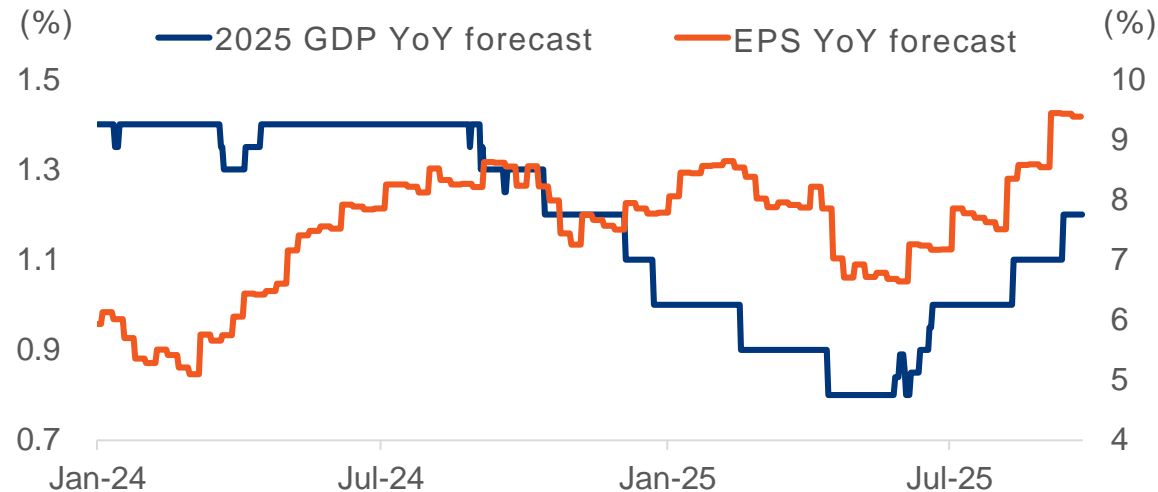
European Equity – Signs of Improvement in Structural Factors

We Maintain Outperform on European Equities, Mainly Due To:

1. Deeper eurozone integration, reflected in stronger identification with the euro and the EU, as well as greater financial market consolidation
2. Improved fiscal health among the peripheral economies—excluding France, most major European countries have healthier debt service ratio than the US, and Germany has shifted its fiscal stance from tightening to expansion
3. Significantly improved bank balance sheets, with capital adequacy ratios surpassing those of US banks and the gap widening further, non-performing loan ratios declining sharply, and bank ROEs now exceeding those in the US

Economic growth & earnings forecasts in the Eurozone have been revised up

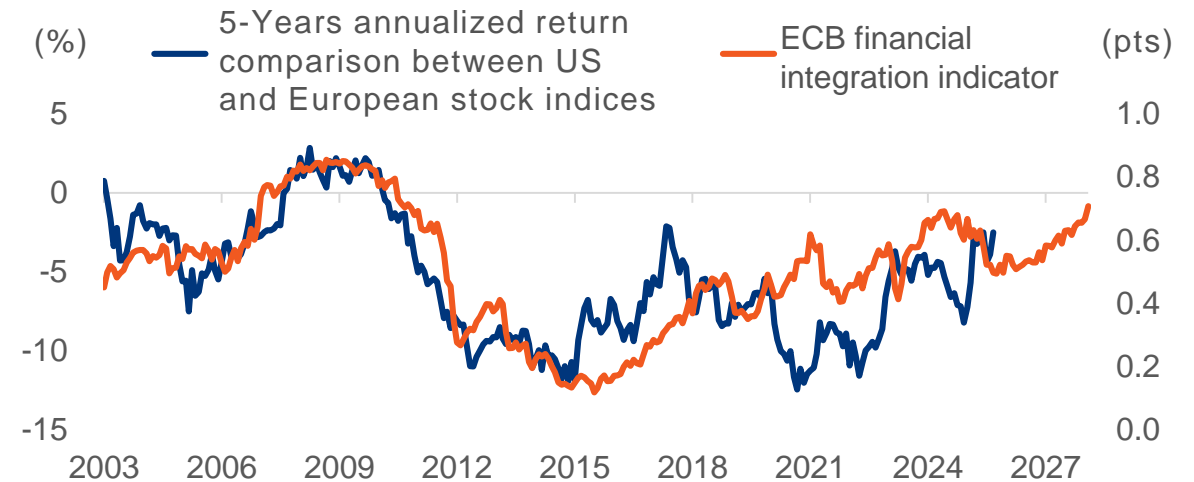
Eurozone 2025 GDP YoY growth forecast, percent (LHS); STOXX 600 12-month forward EPS growth forecast, percent (RHS)



Source: Bloomberg, LSEG, ECB, KGI

Greater financial market integration helps narrow return gap between European and US equity indices

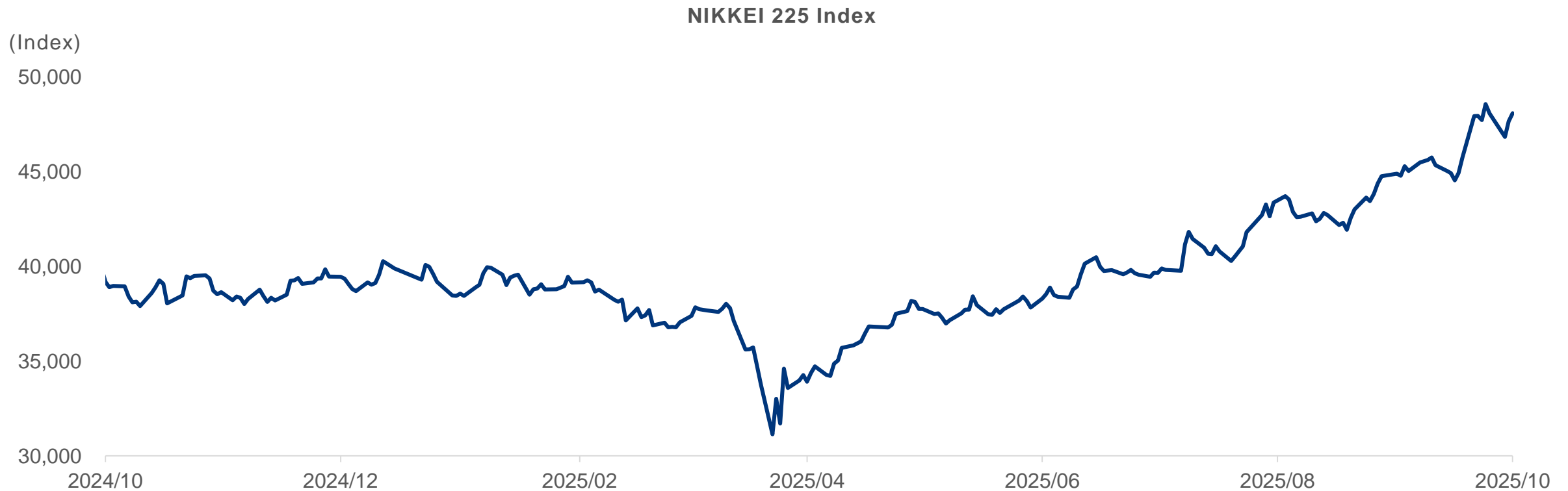
EURO STOXX 50 Index – S&P 500 Index 5-year annualized return spread, percent (LHS); ECB financial integration indicator (3-year lead), points (RHS)



Japan Equity

Maintain a Long-Term Core Allocation in Bank Stocks and Domestically Driven Sectors

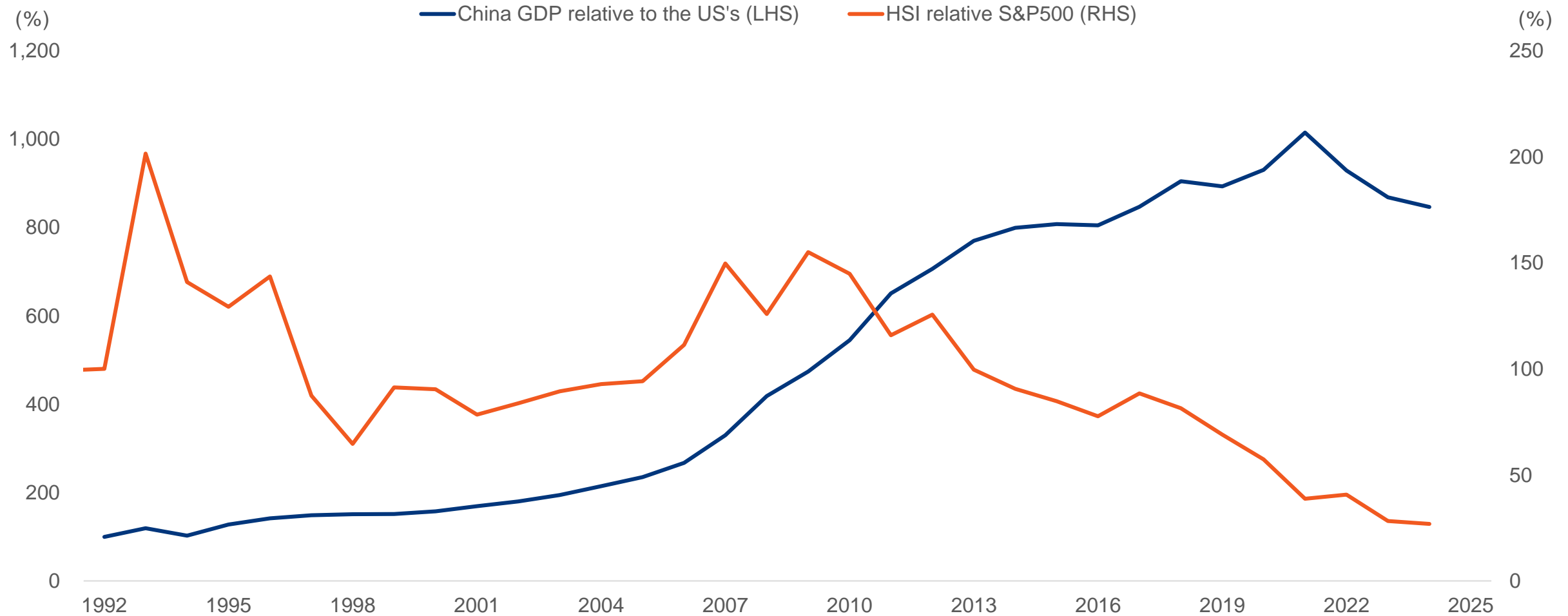
1. Despite the short-term leadership uncertainty, we continue to believe in the reflationary trade in Japan
2. Banks and domestic consumption should benefit from a continued reflationary environment



Source: Bloomberg, KGI

Hong Kong/China Equity

Despite the Economic Strength, HSI Has Underperformed by 60%



Source: Bloomberg, KGI

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