CIO Office

CIO Insights

Cusson Leung, Chief Investment Officer

Investment Outlook for 2026

L E A D

Liquidity Shift

Earnings Focused

Adding Credit

Diversified Asset

2 January 2026

Key Focus In 2026: The 3M Phenomenon

The 3M Phenomenon Continues to Unfold, Driving Market Changes in 2026

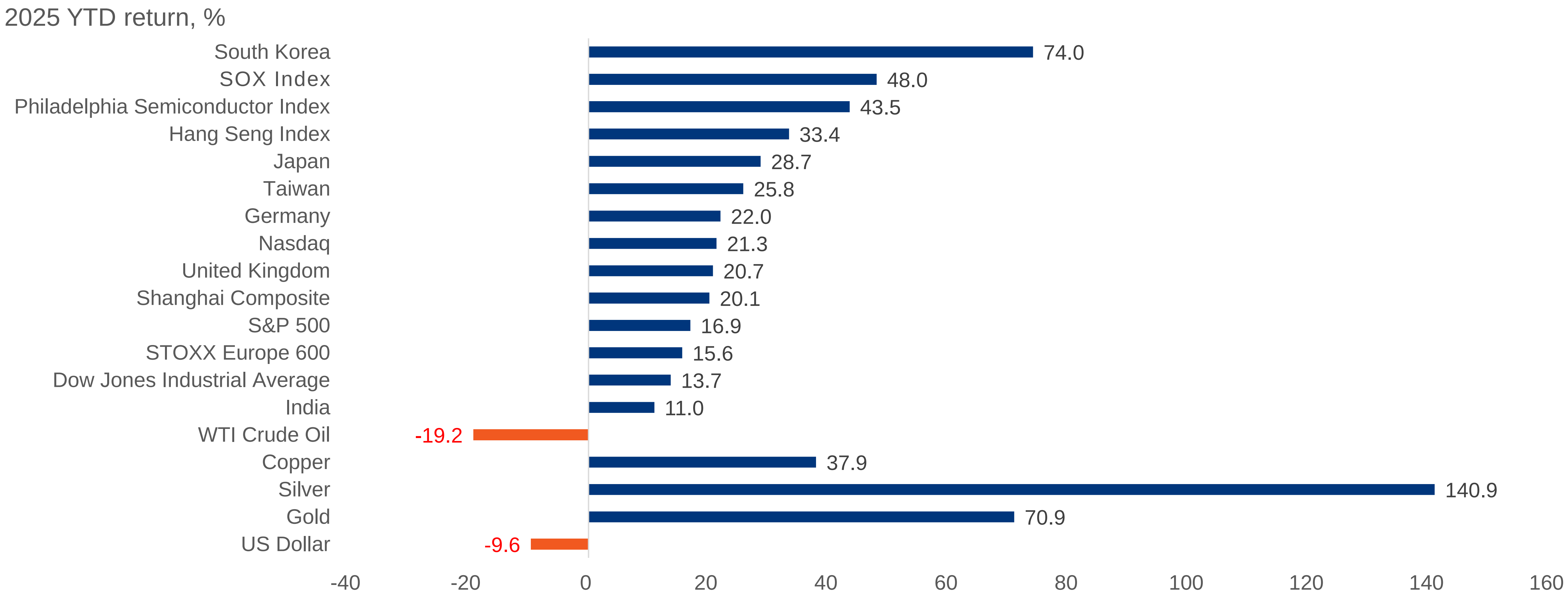
Focus 3M Phenomenon in 2026

Multipolarity Deepening	U.S. & China Resource Competition Intensifies, National Interests Prevail	**Currency And Asset Diversification Trend Takes Shape**
Midterms Impact	Policy Uncertainty Gradually Eases	**Equity Markets Expected to Trough Before Rising**
Meddling in the Fed	Trump Gains Greater Influence Over Federal Reserve Board	**Yield Curve Turns Steeper**

Source: KGI

2025 Major Equity Market Performance Review

Except for the SOX Index, U.S. Equities Underperformed Most Global Markets. Diversification Is the Key Investment Strategy for 2026

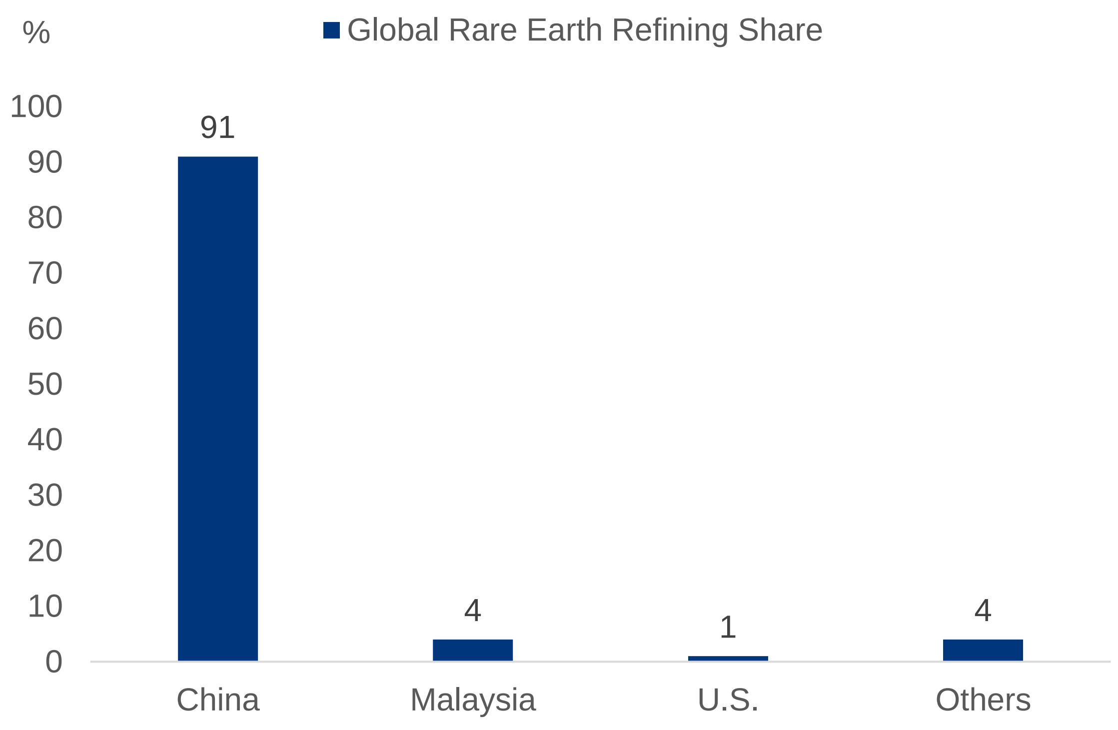


Source: Bloomberg

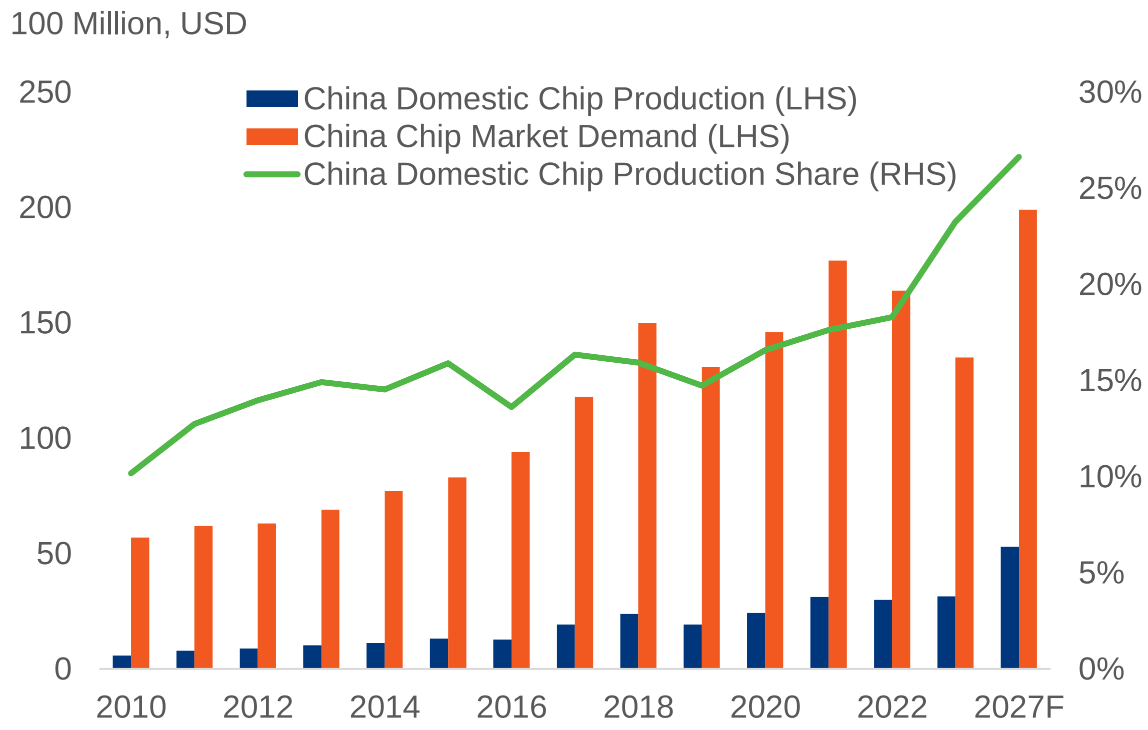
U.S. Holds Chips, China Controls Rare Earths, Strategic Competition to Persist

Despite the U.S.-China Truce Offering Short-Term Supply Chain Stability, Stalled Negotiations Could Trigger Recurrent Frictions and Conflicts

China Nearly Monopolizes Global Rare Earth Refining



China's Domestic Chip Production Falls Far Short Of Demand

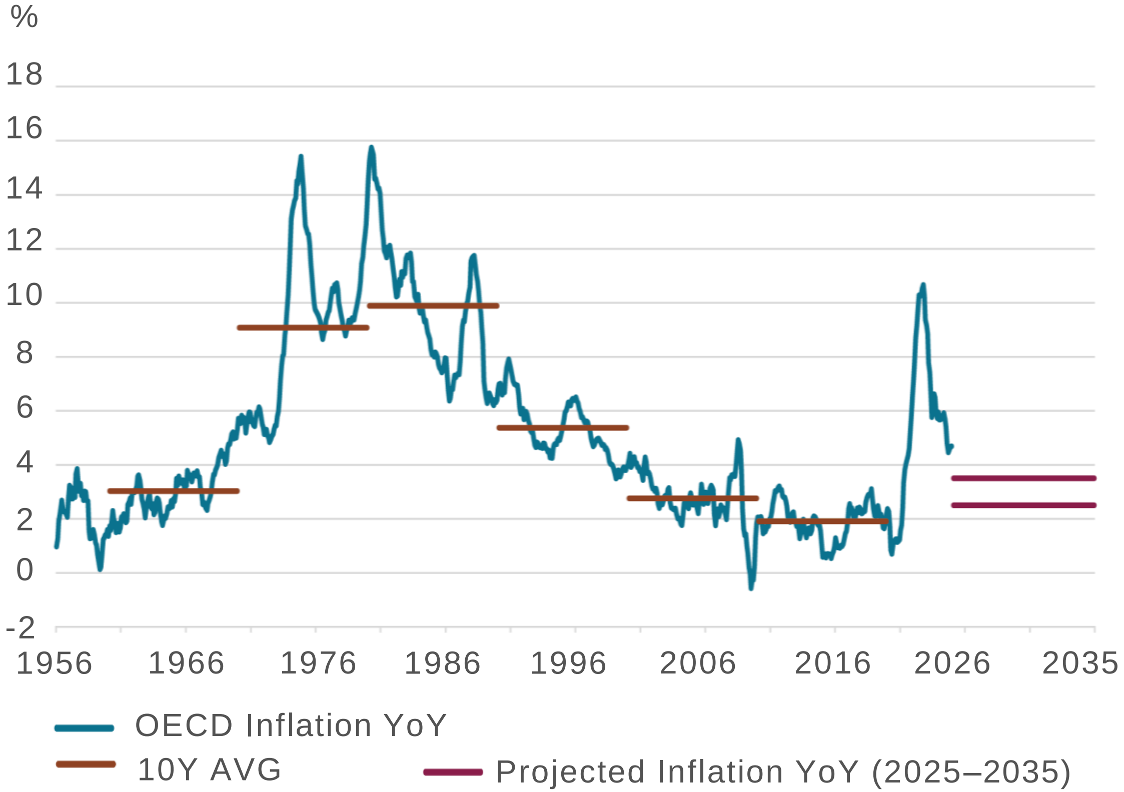


Source: Bloomberg, TechInsights, KGI

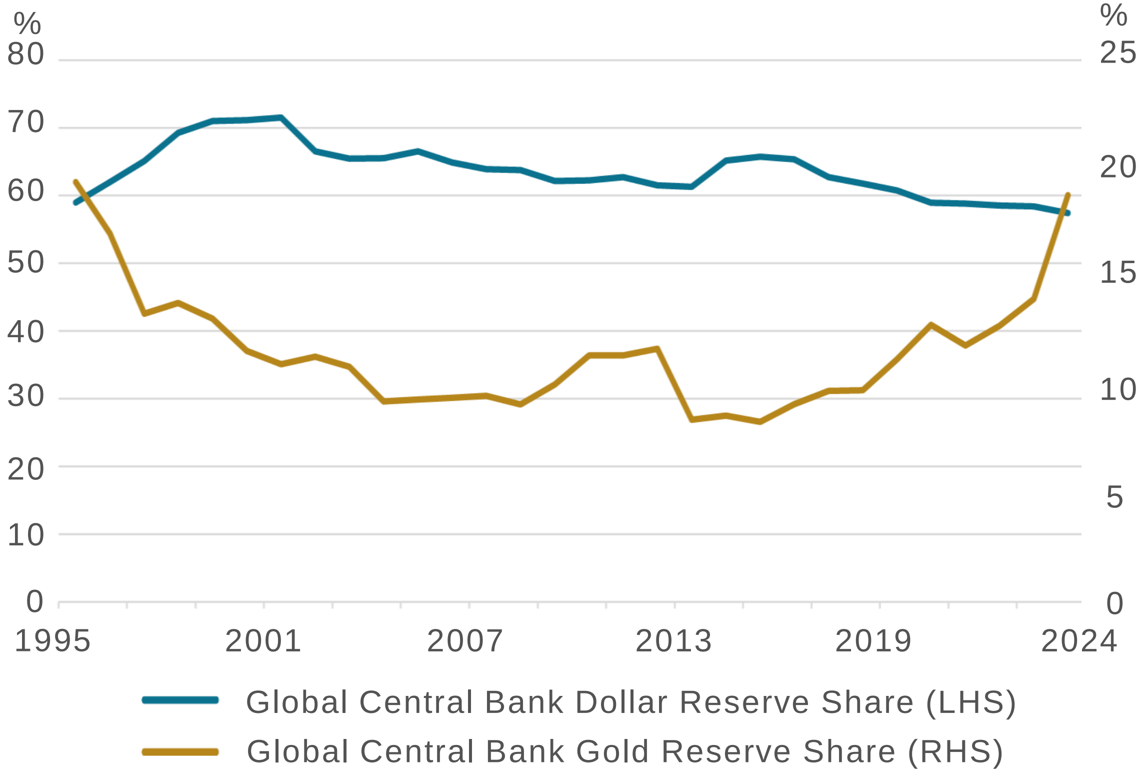
National Interests Prevail, Supply Chain Fragmentation and Resource Competition Likely to Become the Norm

Trump's Policies Drive Nations to Focus On Strategic Interests; Long-Term Inflation Supports Gold; Declining U.S. Credibility Weakens Dollar Status

Inflation Unlikely to Return to Pre-Pandemic Levels in the Long Term



Dollar's Share as Reserve Currency Declines, Central Banks Increase Gold Holdings

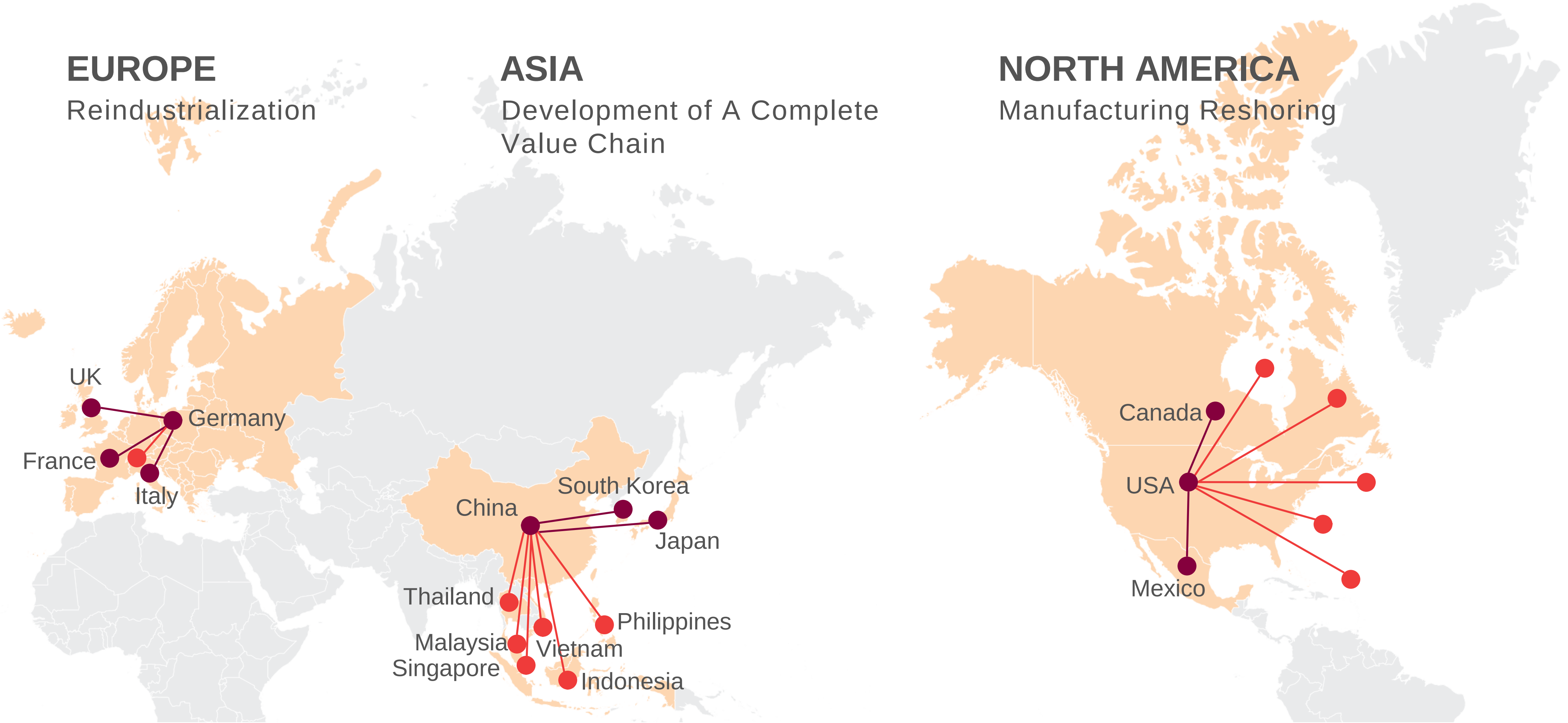


Source: Factset, Old Mutual Investment Group, KGI

KGI

No Economy Is an Island !

Multipolar Trend Shifts ‘Globalization’ Toward ‘Regionalization’, Yet Supply Chain Change Does Not Mean Full Economic Decoupling

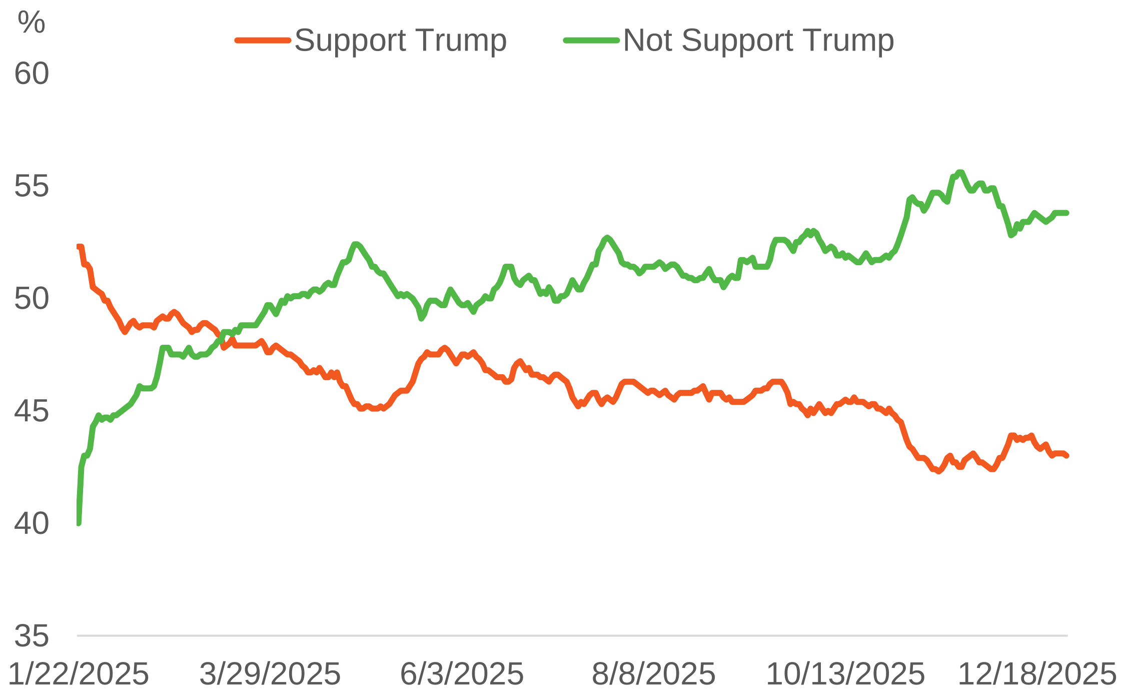


Source: WDI, Roland Berger, KGI

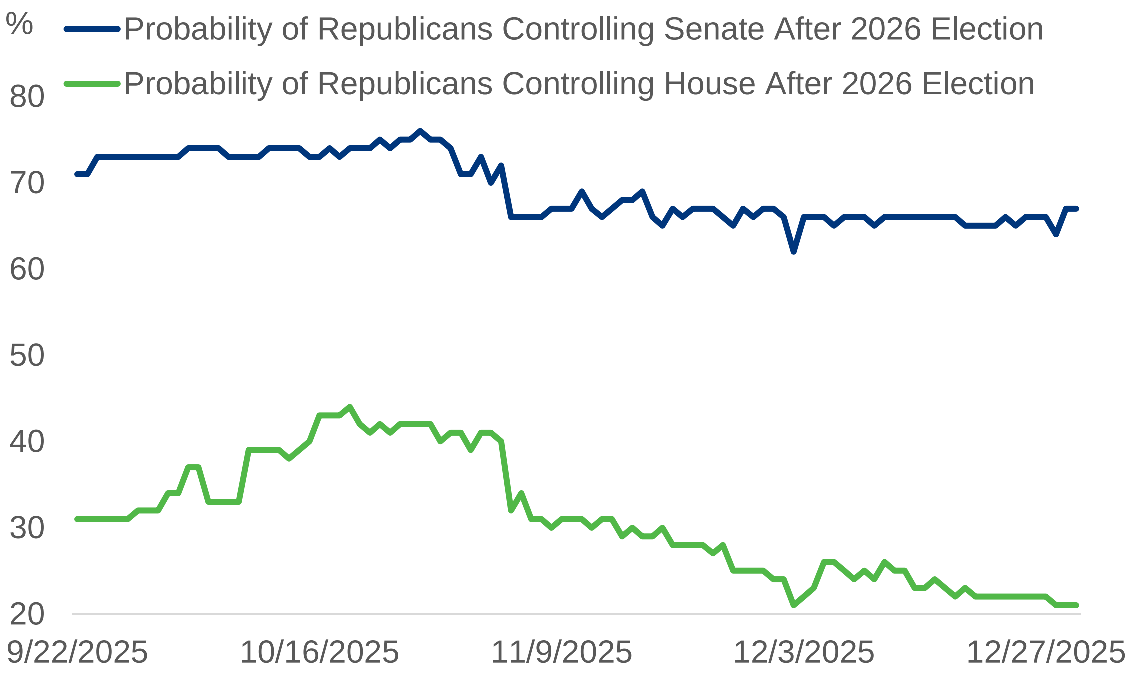
Trump's Polls Are Falling; Republicans May Keep the Senate but Lose the House

Immigration and Tariff Policies Likely Drag On Support, While Economic and Equity Growth Remain Key Tools to Lift Approval

Trump's Approval Continues to Decline



Betting Markets Estimate Republicans Probability of Retaining Congress

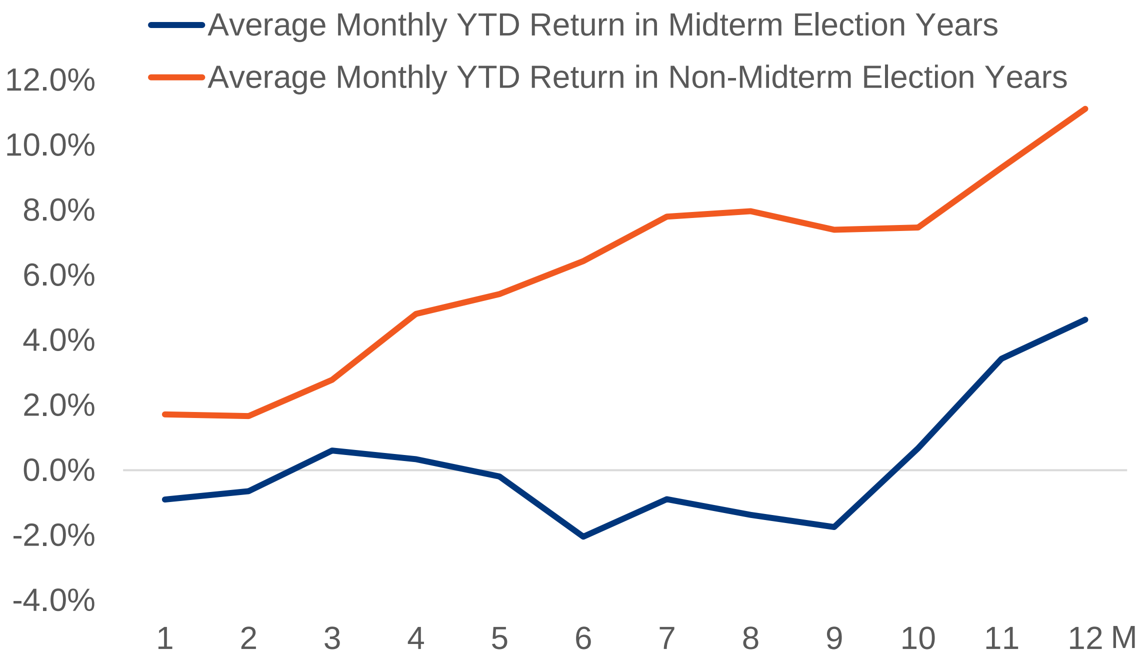


Source: Bloomberg, KGI

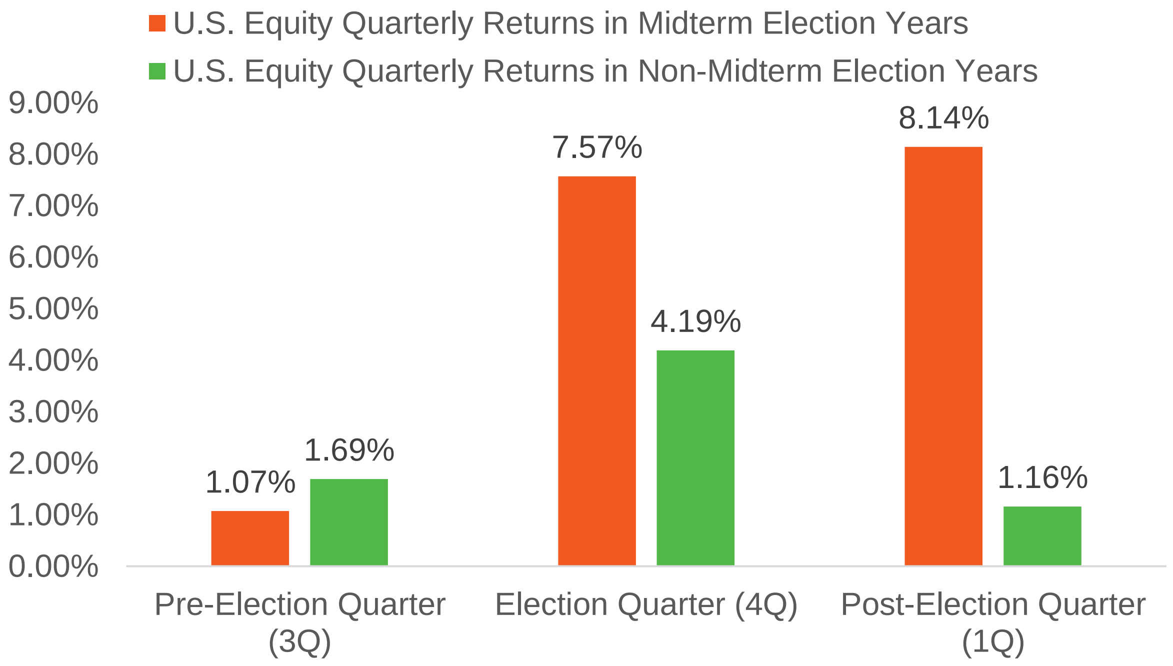
Midterm Years Bring Volatility, but U.S. Stocks Often Strengthen Around Elections

Election Uncertainty Drives Market Fluctuations During Midterm Years, Yet Clarity and Results Typically Lift Stocks

U.S. Equities Volatile in Midterm Election Years, but Rebound Near the Election



Post-Midterm Elections, U.S. Equities Extend Seasonal Strength

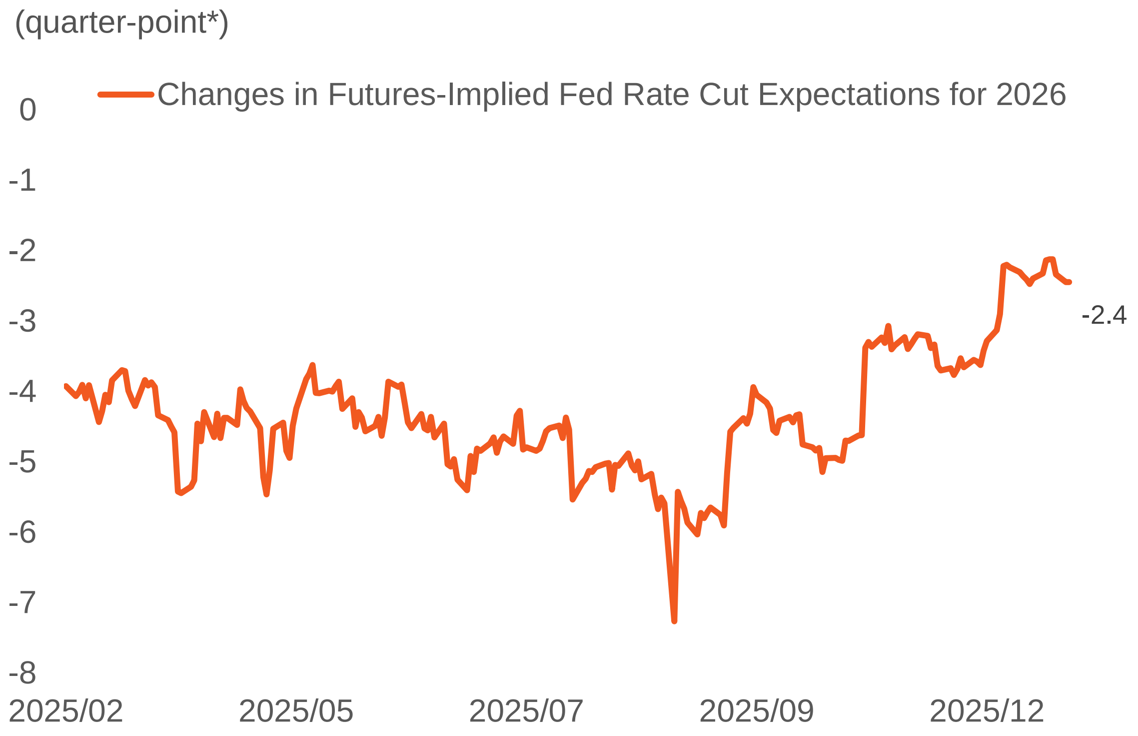


Source: Bloomberg, KGI , Note: Statistical period 1950–2023

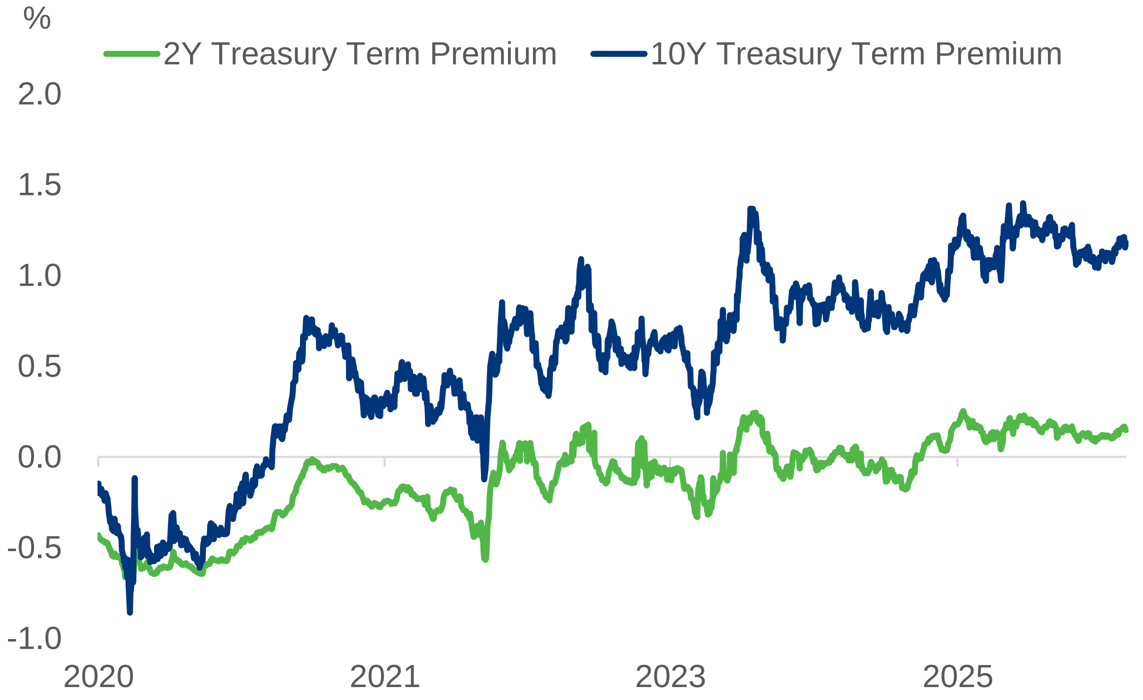
Powell Steps Down in 2026, Fed Likely Turns More Dovish, With Trump's Influence Increasing

Trump's Intervention in Monetary Policy Fuels Rate-Cut Expectations, Market Concerns Over Fed Independence Rise, Driving Higher Term Premiums

Futures-Implied Fed Rate Cuts



U.S. 10-Year Term Premium Remains Elevated



Source: Bloomberg, Fed, KGI, Note: One unit ("quarter-point") equals 25 bps

Unexpected Risks to Watch in 2026

Monitor Fed Rate Cuts Falling Short of Expectations or A Tech Bubble Burst, While Recession And Escalating U.S.-China Tensions Appear Relatively Lower Risks

Fed Rate Cuts Fall Short of Expectations

Fed Rate-Cut Pace

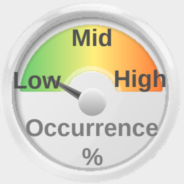
- Firms Passing Tariff Costs to Consumers, Inflation Turns More Persistent
- Unexpectedly Strong Labor Market Reduces Need for Rate Cuts
- Structural Factors Such as Supply Chain Fragmentation Increasingly Impact Inflation

Tech Bubble Burst

Valuation Expansion

- Energy Price Volatility Raises Operating Costs for Power-Intensive AI Firms
- Capital Expenditure Fails to Translate Into Revenue, Pressuring Cash Flow and Profitability
- Unexpected Liquidity Tightening, May Trigger Short-Term Outflows From High-Valuation Sectors

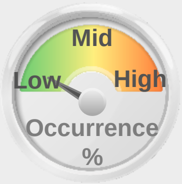
Economic Recession



Economic Momentum

- Employment Data Shows Sharper-Than-Expected Decline
- Negative Impact of Reciprocal Tariffs on Overall Demand Proves More Persistent Than Anticipated
- Stagflation Emerges, Driving Demand Contraction

Escalating U.S.-China Tensions



Great Power Competition

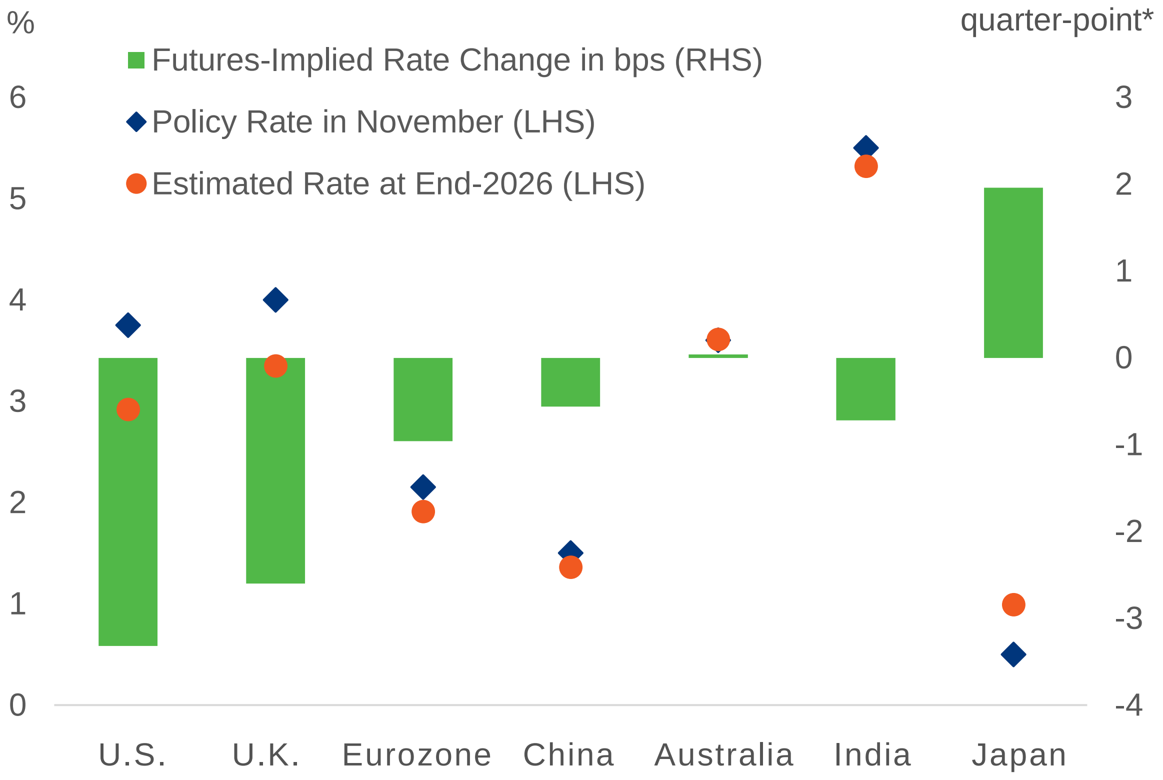
- Renewed U.S.-China Tariff Conflict Disrupts Trade Flows
- Non-Tariff Competition (Chips, Rare Earths) Sparks Operational Disruption Risks in Certain Industries
- Proxy Wars Among Major Powers Expand or Escalate Into Military Conflict

Source: KGI

Main Theme of Capital Flows in 2026: Currency Diversification Most Appropriate

U.S. and U.K. Hold Greater Rate-Cut Room; Dollar Weakens Slightly, Capital Outflows Likely Toward Asia and Europe

Futures-Implied Interest Rate Changes In Major Economies For 2026



Source: Bloomberg, KGI, Note: One unit (“quarter-point”) equals 25 bps

L Liquidity Shift | Main Strategies

U.S.: Larger Rate Cuts, Weaker Currency Adjustment

U.S. and U.K. policy rates remain among the highest in major economies. The dollar may rebound briefly on equity market pullbacks, but expectations of stronger political intervention in Federal Reserve appointments next year, coupled with rising investor concerns over Fed independence, point to deeper U.S. rate cuts relative to peers and a weaker currency adjustment.

Asia and Europe: Limited Rate Cuts, Capital Inflows Likely

Fiscal support in the Euro Area is set to gradually materialize, while inflation expectations ease. The European Central Bank is expected to deliver only limited rate cuts, leaving the euro slightly firmer. China’s pace of rate cuts is slowing, but accommodative financial conditions support the broader Asian economy. Benefiting from a low base effect, capital inflows into Asia and Europe are likely.

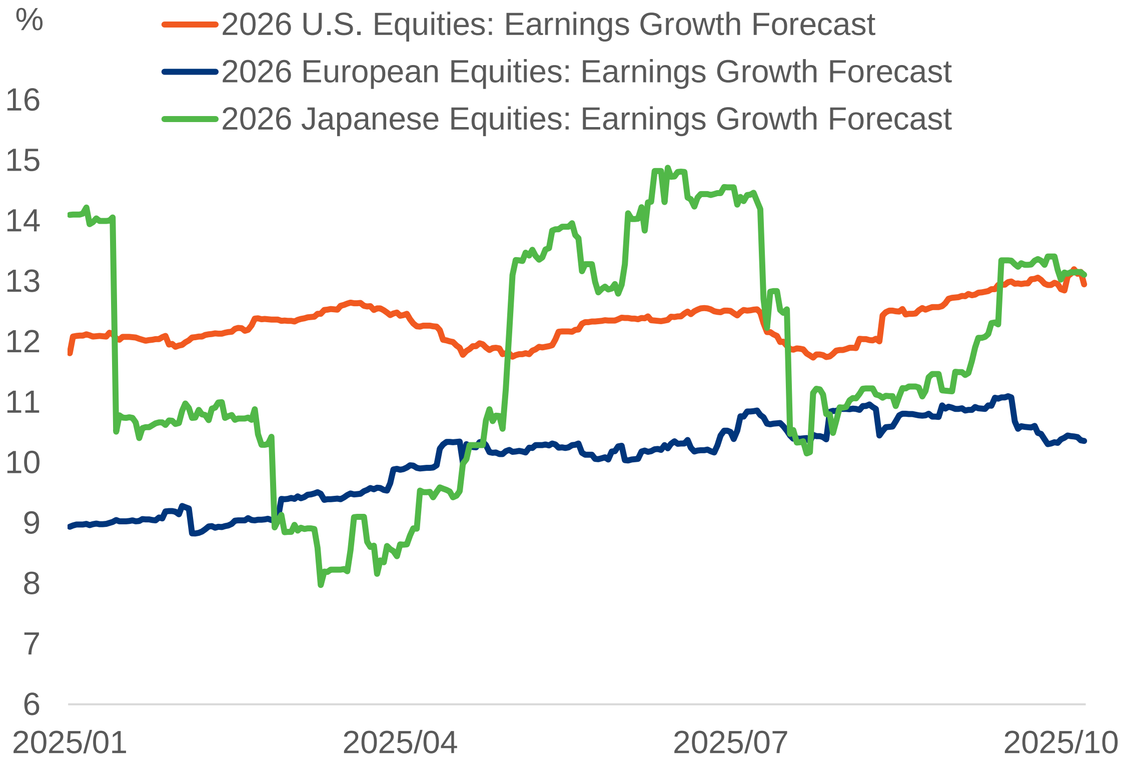
Japan: Rate Hike Expectations Persist, Yen Weak First Then Stronger

The government of Sanae Takaichi focuses on improving Japan’s economy while keeping inflation under control, aiming to avoid an overly dovish stance that could trigger a sharp depreciation of the yen, imported inflation, and a decline in cabinet support. The market expects the Bank of Japan to gradually raise interest rates next year, while the Federal Reserve will move toward easing. As the policy rate gap between the two countries narrows, the yen is projected to depreciate this year but gradually appreciate slightly next year.

Fundamental Momentum of Market in 2026 Is Expected to Drive the Index Higher

Strong Earnings Outlook Fuels U.S. Equity Opportunities; Europe and Japan Markets Trend Higher

2026 Earnings Forecast: Major Countries and Regions Set for Double-Digit Growth



Source: Bloomberg, KGI

E Earnings Focused | Main Strategies

U.S. Equities to Start Weak, End Strong, Positioning Opportunities Ahead

The U.S. economy is expected to improve quarter by quarter, with stronger corporate earnings easing valuation pressures. However, the 2026 midterm elections will inevitably bring market volatility. Historical data shows that while election years often see fluctuations, as the election date approaches, policy incentives are gradually introduced, helping the stock market recover, pay close attention to positioning opportunities.

Europe's Economic Recovery, Watch Sector Performance

The Eurozone retains fiscal expansion capacity, with domestic demand likely to drive sequential economic growth. In addition, earnings expectations for European equities are rebounding, supported by valuation advantages. At the country level, Germany merits attention, while sectors such as banking and defense/aerospace stand out as potential beneficiaries.

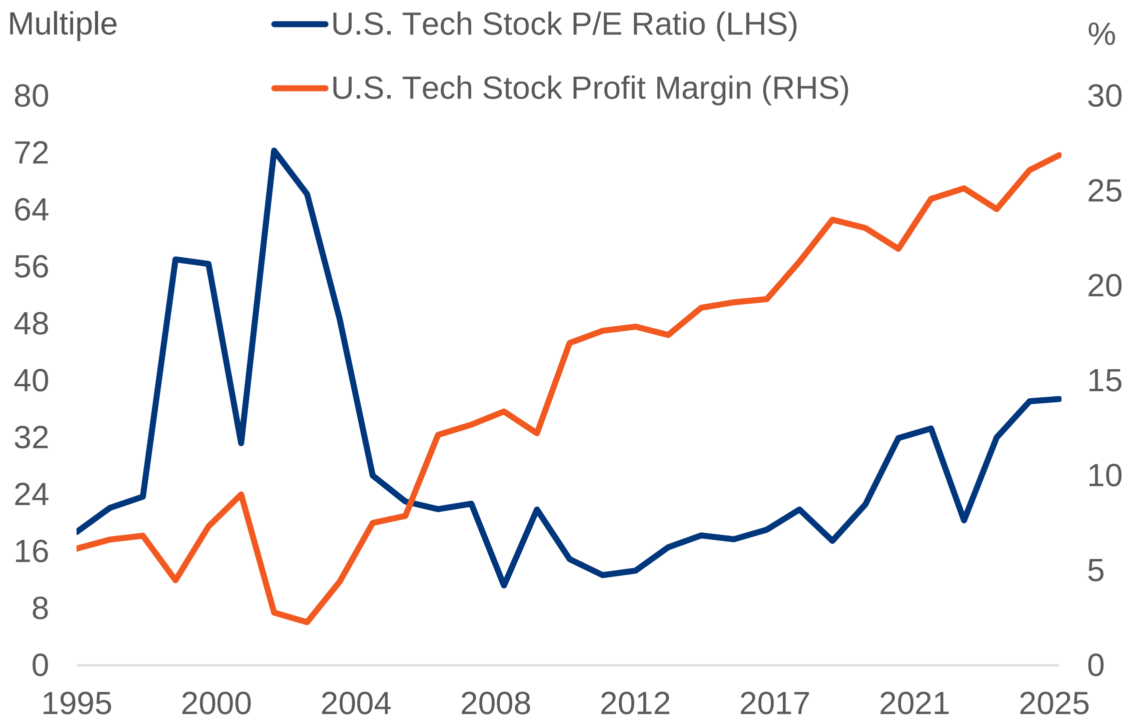
Corporate Reforms Bearing Fruit, Fiscal Stimulus Provide Extra Support

Japanese companies have advanced reforms and improved capital efficiency, leading to gradual enhancements in ROE and ROA. This has lifted previously depressed price-to-book ratios and continues to attract foreign investors. At the same time, the Takaichi administration is leaning toward fiscal stimulus to support the economy. Market optimism suggests that the pace of economic and earnings recovery will likely continue, underpinning sustained gains in Japanese equities.

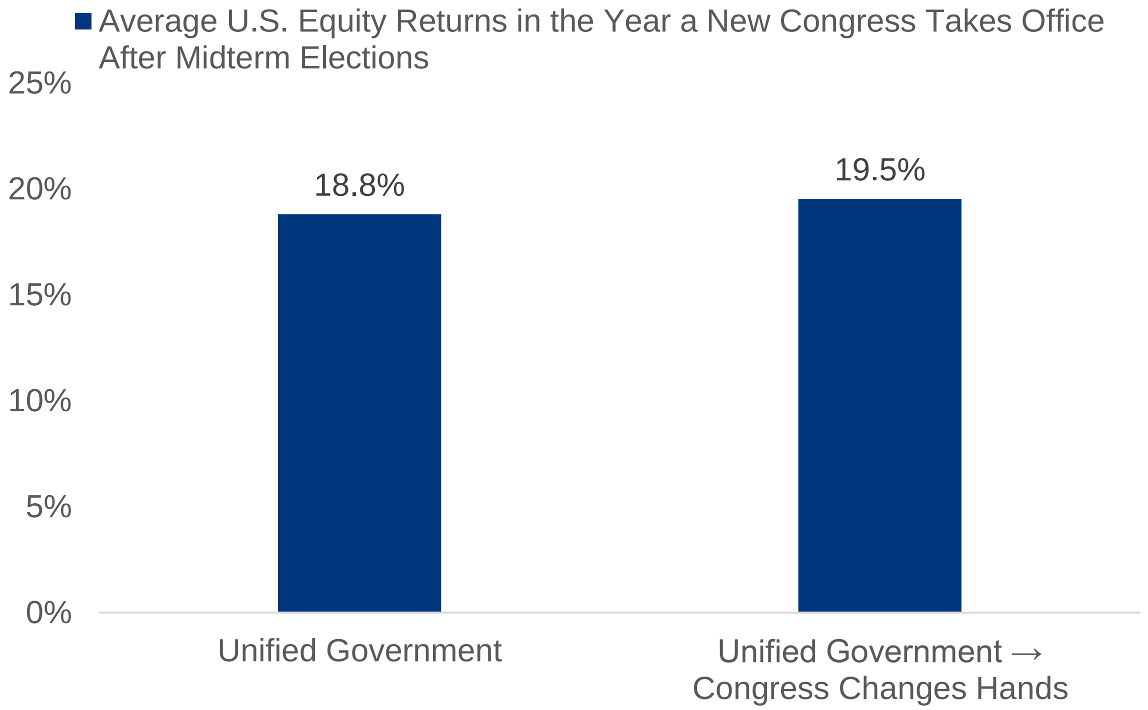
U.S. Equities: AI Themes Provide Earnings Support, Positioning Opportunities Ahead of Midterm Elections

Both Parties' Pre-Election Policies to Become Clearer in Late 2026, Added Incentives Expected to Support U.S. Equity Upside

U.S. Tech Stocks Show Stronger Earnings Support Compared with the 2000 Dot-Com Bubble



U.S. Equities Tend to Perform Strongly After Midterm Elections Regardless of Outcome

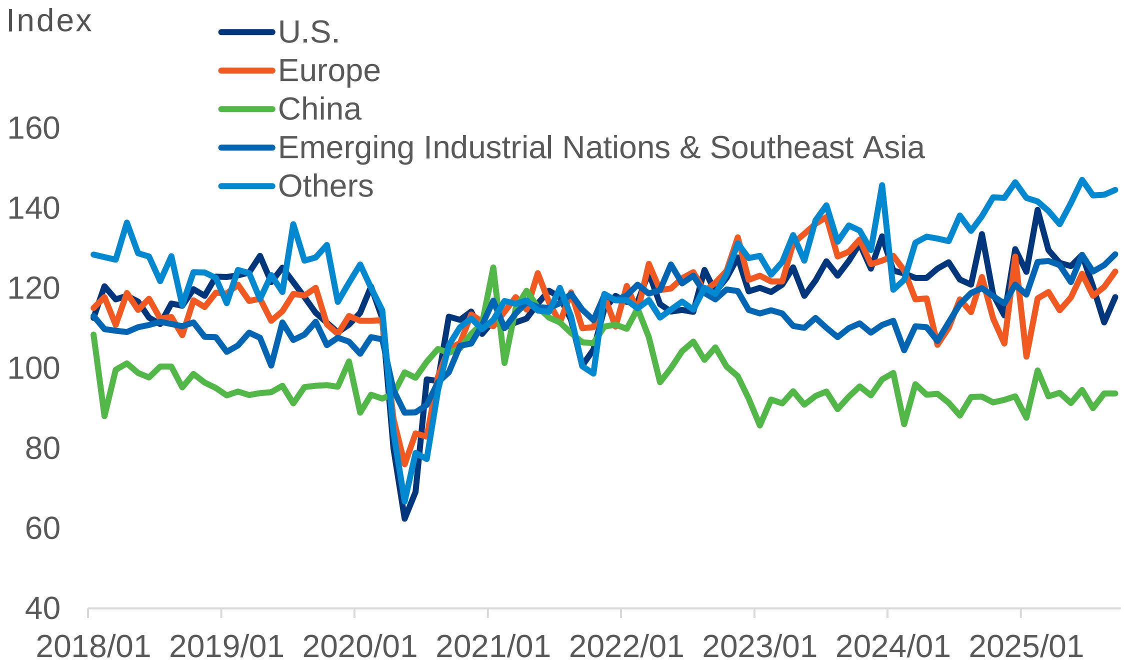


Source: Bloomberg, KGI

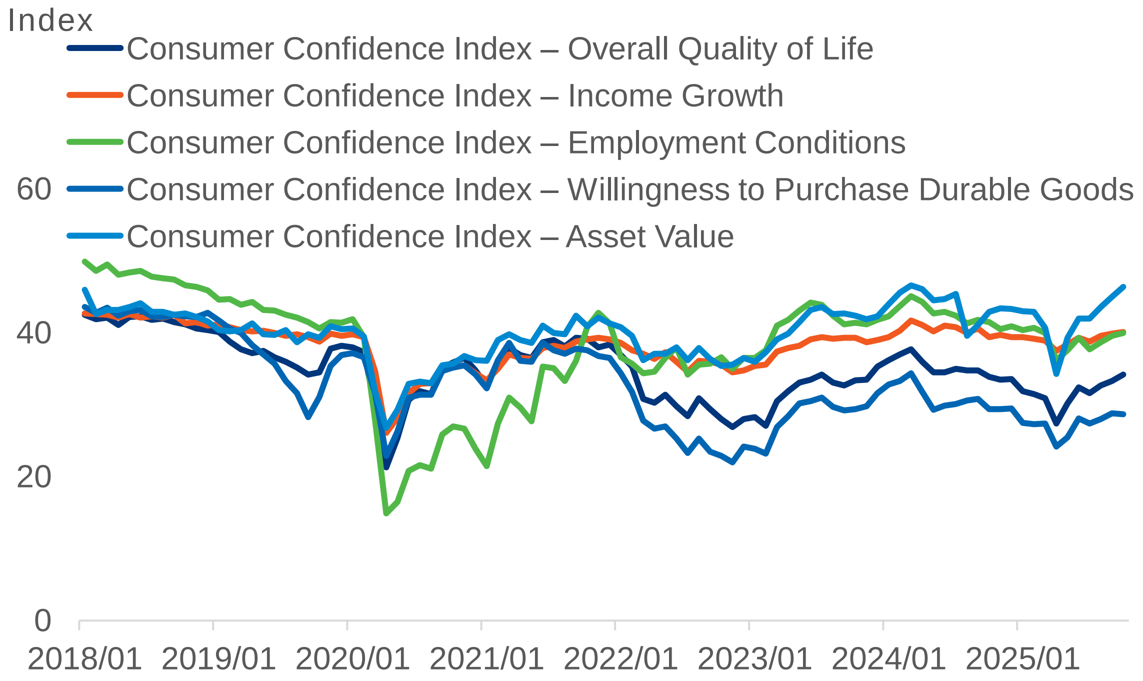
Japan Equities: Clear Policy Direction, Business and Consumer Confidence to Support Market Performance

Domestic Demand to Drive 2026 Growth, Corporate Governance Reforms Seen Sustaining Japan Equities

Supported by U.S. Tariffs, Real Exports in Asia and Other Regions Remain Robust



Positive Consumer Confidence Signals Stable Domestic Demand

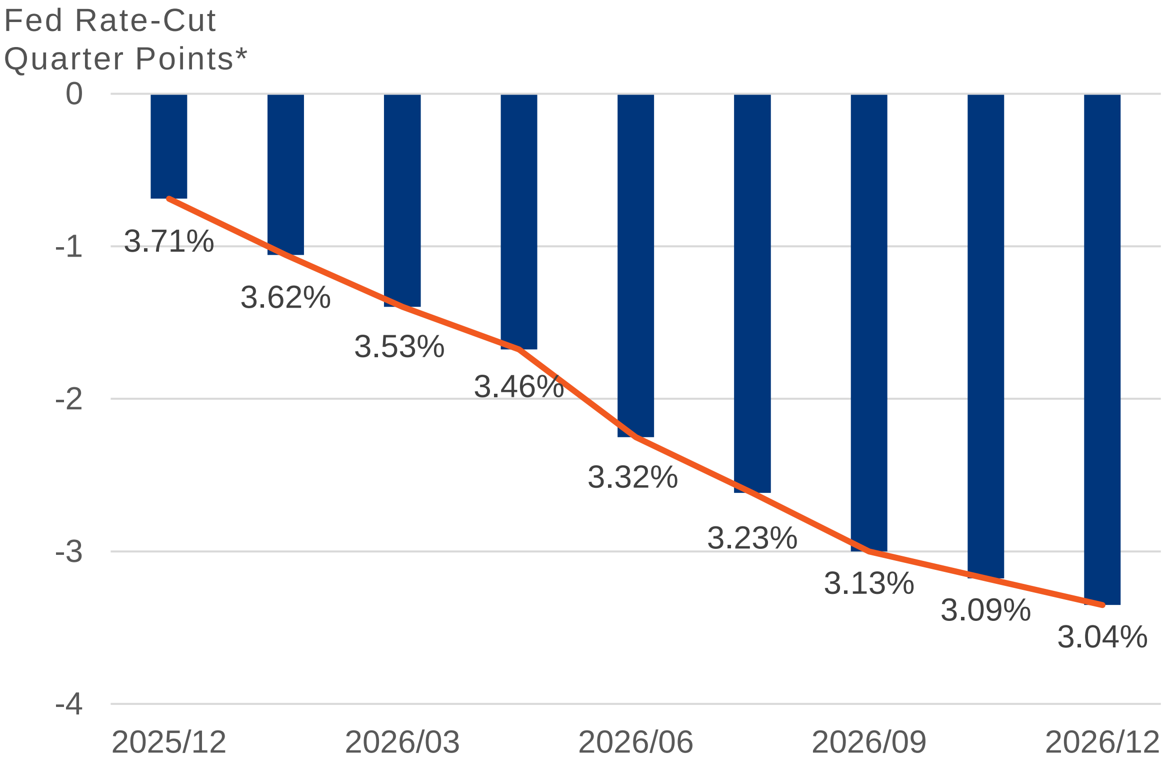


Source: Bank of Japan, KGI; (Note) Real exports are calculated by dividing nominal value by price index, seasonally adjusted and indexed to the 2020 annual average (100).

Economic Slowdown and Rate-Cut Expectations Urge Bond Yield Lock-In

Credit Concerns and Geopolitical Uncertainty; Diversified Quality Bond Allocation to Reduce Volatility

2026 Rate-Cut Cycle Continues, Supporting Market Liquidity Stability



Source: Bloomberg, KGI, Note: One unit (“quarter-point”) equals 25 bps

Adding Credit | Main Strategies

Fed Liquidity Support, U.S. Treasury Yields Face Downside Potential

Economic slowdown expected in H1 2026. The Fed halts balance-sheet reduction and reinvests MBS maturities into Treasuries, ensuring ample liquidity. With room for rate cuts, U.S. Treasury yields hold downside potential. On yield upticks, allocate to major sovereign bonds to lock in rates and reduce volatility.

Event Risks Persist, Capture Quality Bond Opportunities

The 2026 U.S. midterm elections may heighten political and economic uncertainty. Favor locking in yields on A-rated or higher corporate bonds, focusing on sectors with stronger risk-adjusted spreads such as financials, utilities, industrials, and communications. With economic recovery expected in H2 2026, wait for wider spreads before adding high-yield exposure.

Dollar Depreciation Risks Remain, Diversify into Non-U.S. Bonds

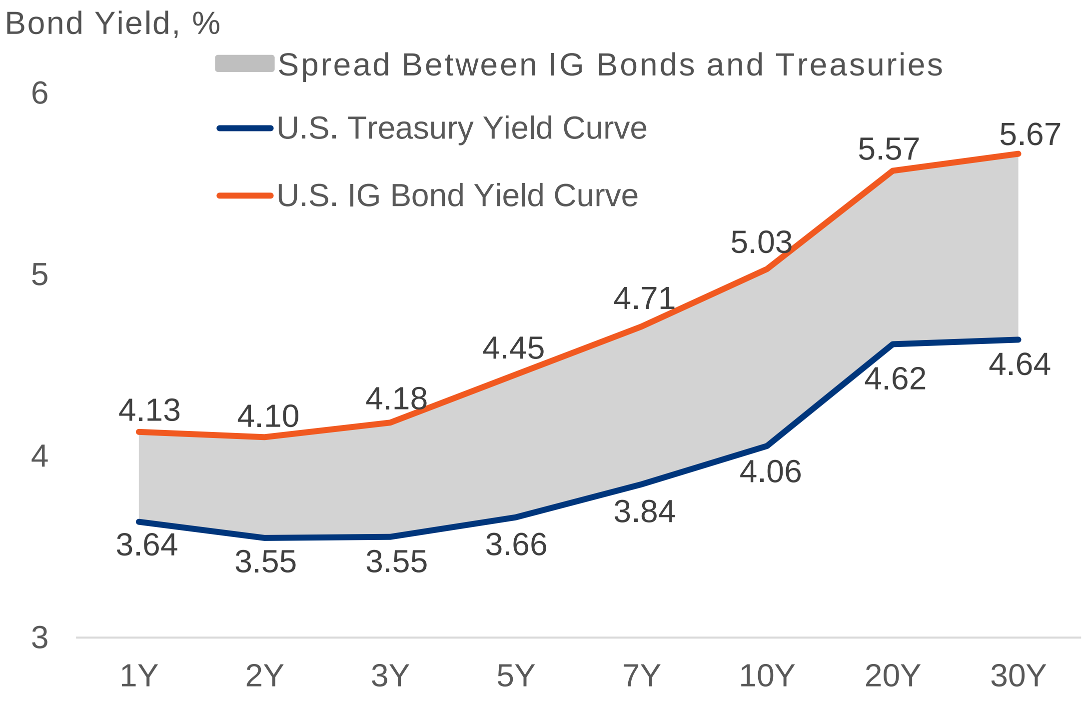
Policy divergence between the Fed and Europe/Japan narrows yield spreads between U.S. Treasuries and other developed sovereigns. Coupled with de-dollarization risks, diversify into euro-denominated and other major non-U.S. investment-grade bonds to mitigate FX volatility. Given persistent geopolitical risks, keep emerging-market debt as a satellite allocation.

IG Bonds: U.S. Corporate Spreads at Lows, Market Volatility Revives Opportunities

IG Bonds Remain the Top Choice for 2026. Narrowing Yield Spreads Between U.S. Treasuries and Major Non-U.S. Sovereigns Also Create Opportunities to Lock in Non-U.S. Quality Bonds.

IG Bonds Unaffected by Credit Deterioration, Moderate Supply Supports Spreads

U.S. Medium-Term IG Yields Offer Relative Attractiveness

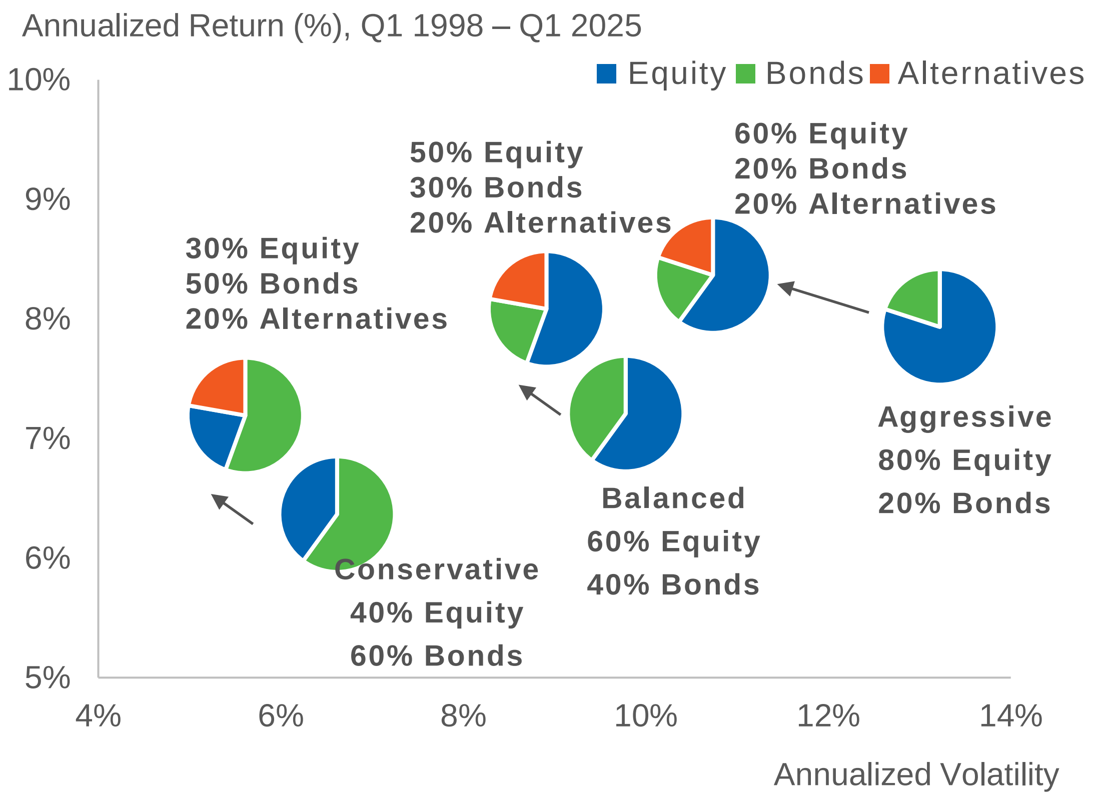


Source: Bloomberg, KGI

Beyond Traditional Equity-Bond Allocation, Alternatives Become New Portfolio Component

Rising Equity-Bond Correlation Reduces Diversification Effect; Investors Turn to Alternatives for Greater Resilience

Historical Back-Tests Show Adding Alternatives Enhances Risk-Return Profile



D Diversified Asset | Main Strategies

Alternative Investments Include commodities, virtual currencies, and private assets – non-traditional asset classes with performance drivers distinct from traditional markets. Moderate allocation helps diversify portfolio risk and enhance returns.

Gold

Gold prices recently corrected after gains. Looking ahead, a more dovish Fed stance, continued central bank purchases, and expanding government debt provide momentum for further upside.

Virtual Currencies

Despite short-term volatility, spot ETFs still hold nearly USD 150 billion. Market volatility has declined significantly compared with the past, and with rising investor acceptance and a more supportive regulatory environment, the long-term outlook remains positive.

Private Assets

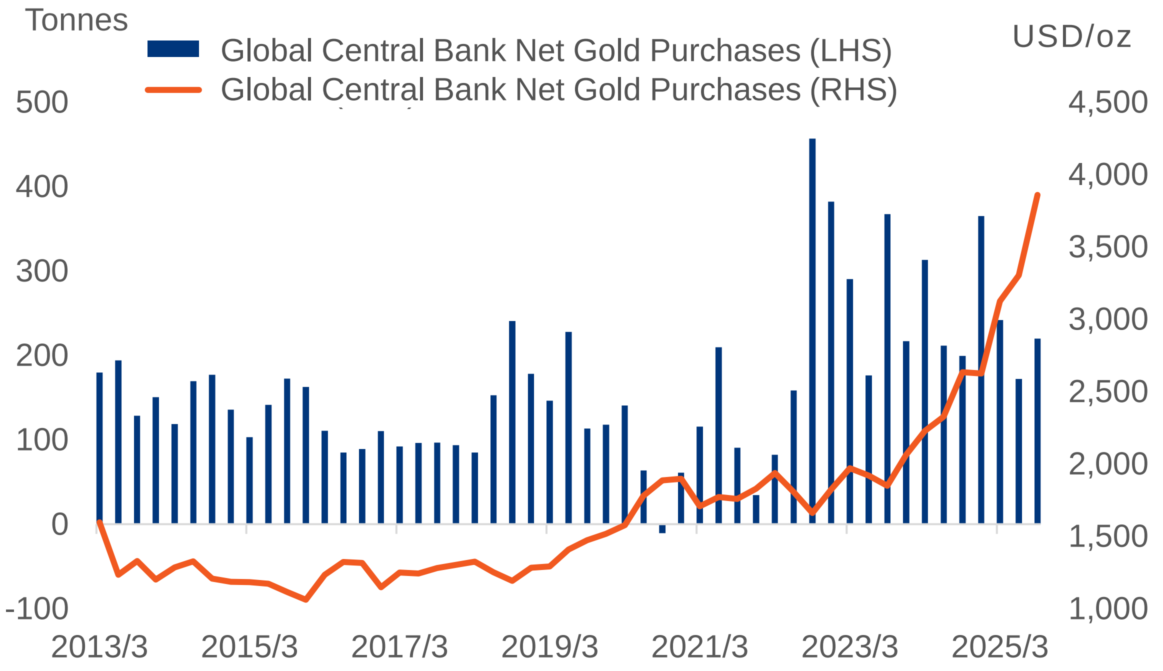
Including private equity, private debt, and real estate/infrastructure. Growth-oriented private equity represents the largest and fastest-expanding segment, favored by institutional and high-net-worth investors.

Source: J.P. Morgan Asset Management. Note: Left chart uses back-tested data. Equities represented by the S&P 500 Total Return Index; bonds by the Bloomberg U.S. Aggregate Bond Total Return Index; alternative assets include private equity, hedge funds, and real estate, calculated on an equal-weighted basis. Past performance is not indicative of future results.

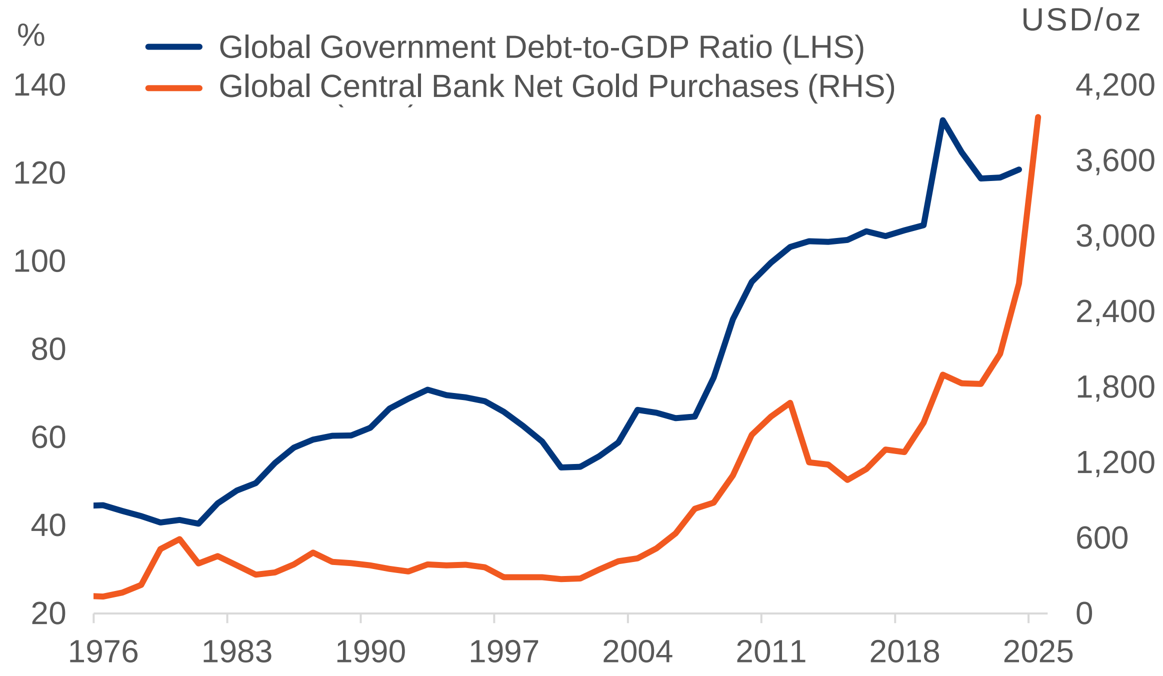
Gold: Central Bank Buying and Fiscal Expansion Support Positive Outlook

After Recent Pullback, Gold Remains Supported by Central Bank Purchases and Its Role as a Hedge and Currency Substitute

Global Central Banks Continue to Allocate Gold as Part of Reserves, Providing Price Support



Expanding Government Debt Adds Liquidity, Offering Further Upside Momentum for Gold



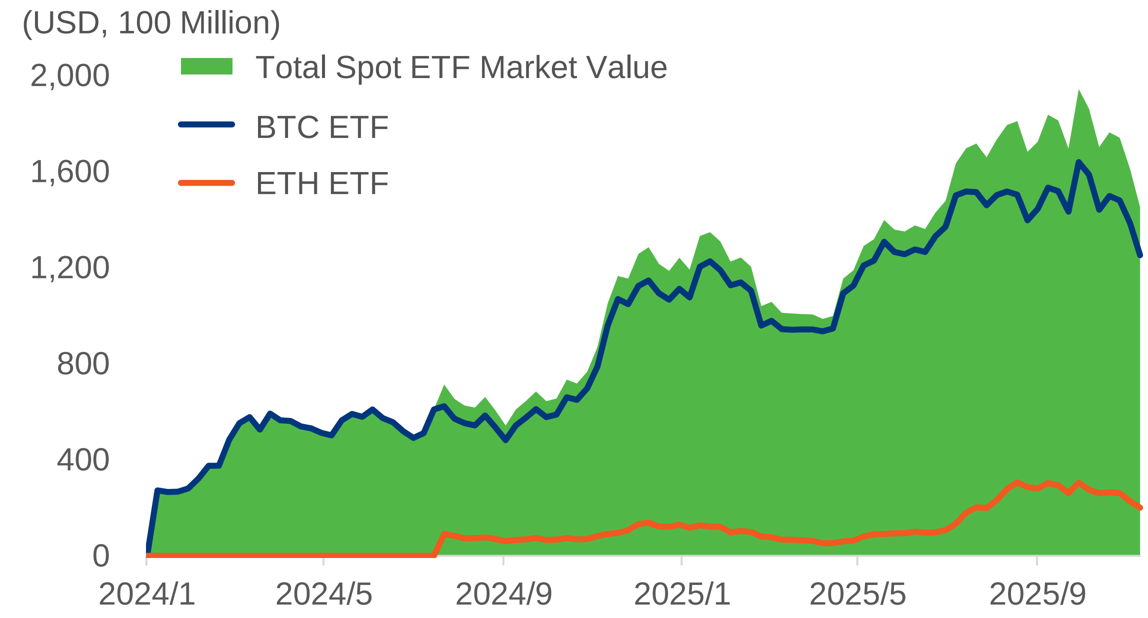
Source: Bloomberg, KGI

Virtual Currencies: Larger Bitcoin Market, Lower Volatility Supports Spot ETF Trading

Safer U.S. Regulatory Environment Keeps Long-Term Positive Outlook for Virtual Currencies Unchanged

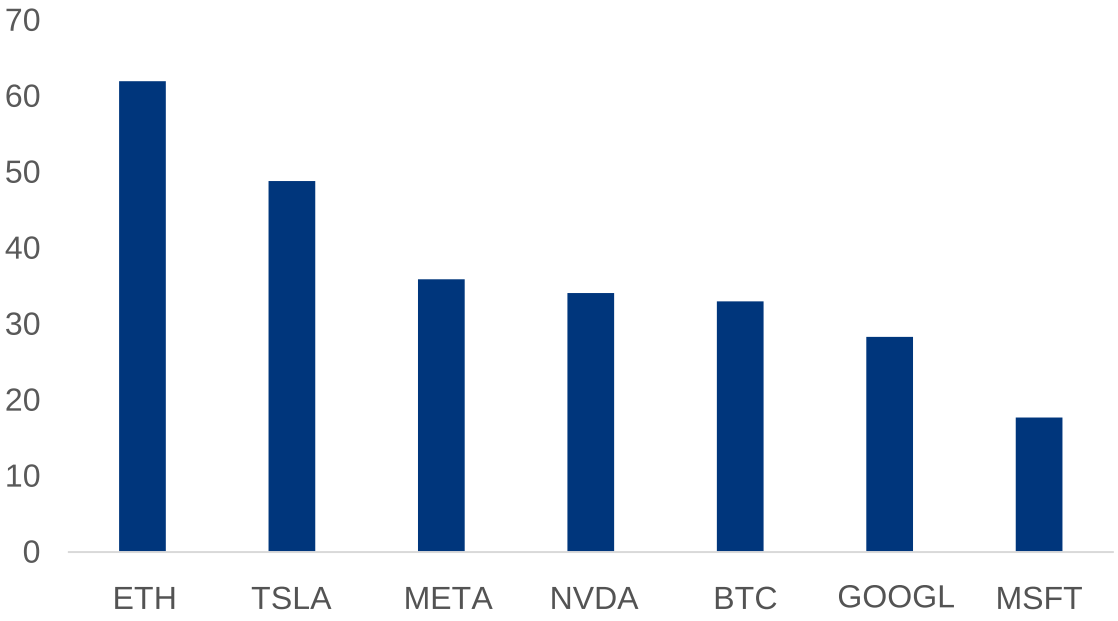
Spot ETF Market Size Peaked Near USD 200 Billion

Virtual Asset Spot ETF Market Size



Bitcoin Volatility Now Similar to Tech Stocks, Ethereum Still More Volatile

90-Day Asset Volatility (%)



Source: Bloomberg, KGI

Professional Investor Portfolio Allocation

Conservative Allocation

Equities	**25%**
U.S.	12.5%
Eurozone	5.0%
Japan	2.5%
Asia (ex-Japan)	5.0%
Bonds	**70%**
U.S. Treasuries	12.5%
U.S. IG Bonds	37.5%
U.S. HY Bonds	10.0%
Emerging Market USD Bonds	10.0%
Alternatives	**5%**
Virtual Currencies / Private Assets / Gold	

Balanced Allocation

Equities	**47.5%**
U.S.	27.5%
Eurozone	7.5%
Japan	5.0%
Asia (ex-Japan)	7.5%
Bonds	**47.5%**
U.S. Treasuries	7.5%
U.S. IG Bonds	25.0%
U.S. HY Bonds	7.5%
Emerging Market USD Bonds	7.5%
Alternatives	**5%**
Virtual Currencies / Private Assets / Gold	

Aggressive Allocation

Equities	**65%**
U.S.	37.5%
Eurozone	12.5%
Japan	5.0%
Asia (ex-Japan)	10.0%
Bonds	**25%**
U.S. Treasuries	5.0%
U.S. IG Bonds	12.5%
U.S. HY Bonds	5.0%
Emerging Market USD Bonds	2.5%
Alternatives	**10%**
Virtual Currencies / Private Assets / Gold	

Source: KGI

2026 Global Asset Allocation Outlook

Asset Class		Reduce — Increase	Outlook Commentary
Bonds (Slightly Bullish)	U.S. Gov Bonds	□□□■□	Position in Treasuries to Lock Yields; Reduce Long-Term Exposure Near Late-2026 or End of Fed Easing
	IG Bonds	□□□■□	IG Ratings Trend Stable; Allocate to Financials, Utilities, Industrials, and Energy With Risk-Adjusted Spreads.
	HY Bonds	□■□□□	Issuance Likely to Rise in 2026; Avoid CCC-Rated and Below. Re-Enter After Economic Bottoming or Spread Widening
	EM Bonds	□□□■□	Many EM Countries Face Rate-Cut Opportunities in 2026; Upgrades Expected to Outpace Downgrades. Credit Trends Stable; Outlook Raised to Neutral-to-Positive
Equities (Slightly Bullish)	U.S.	□□□■□	Early Volatility from Midterm Elections, but H2 Monetary Easing and Pre-Election Tailwinds Support Bullish View
	Eurozone	□□□■□	Fiscal Expansion and Earnings Recovery, Attractive Valuations Support Positive Outlook
	Japan	□□□■□	Corporate Reforms Deliver Results; Fiscal Stimulus and Domestic Demand Provide Additional Support
	Emerging Asia	□□■□□	AI Theme Drives Taiwan and Korea; India/ASEAN Lack AI Catalyst; China Fundamentals Weak—Mixed Performance, Neutral Outlook
Dollar (Bearlish)	Dollar	□■□□□	Fed's Hawkish Rate Cuts Delay Future Easing Expectations; Weak Labor Market and Cooling Inflation Increase Scope for U.S. Cuts, Dollar Still Seen Adjusting Weaker
	Yen	□□□■□	New Government Faces Dilemma: Stimulate with Low Rates vs. Avoid Imported Inflation; Yen Weak Short-Term, Modest Rebound Next Year as U.S.–China Rate Gap Narrows
Gold/ Alternatives (Bullish)	Gold	□□□■□	U.S. Fiscal, Fed Independence, and Market Uncertainty Persist; Lower Rates Keep Dollar Slightly Weak, Supporting Gold
	Alternatives	□□□■□	Equities, Bonds, and Digital Assets Correct After Gains; Rising Market Volatility Highlights Role of Alternatives for Diversification

Source: KGI

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