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Finding Investment Opportunities Across Shifting Global Macro Climates

MACRO OUTLOOK | BROAD MARKETS FIXED INCOME | 2025

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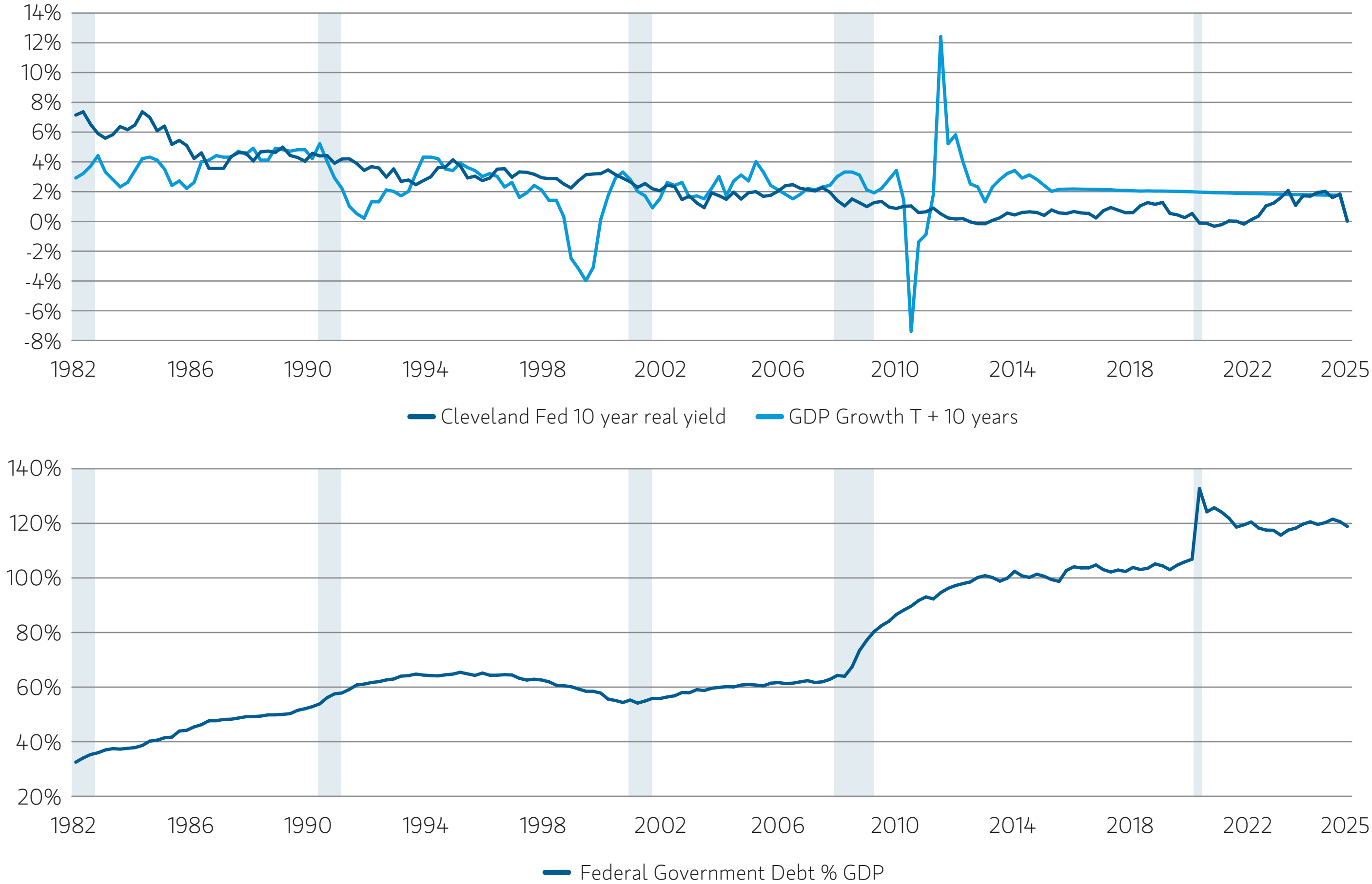
The global macro environment entering 2026 reflects a world adjusting to structurally higher real yields, reduced fiscal flexibility and diverging monetary-policy paths—the U.S. easing, Japan tightening and others likely on hold. Real rates globally have reset after the end of almost a decade and a half of post-Global Financial Crisis (GFC) monetary policy repression and now reflect the impact of persistent fiscal expansion funded less by central banks and more by private sector investors.

Investment opportunities in 2026 emerge from these asymmetries: curve steepening in the U.S., UK, and Australia; long-end real-yield value in Europe and Australia; selective sovereign-spread opportunities across the Eurozone; and inflation-linked strategies where global inflation remains sticky around 2.5%–3.0%. Geopolitical risk and trade policy pressures could influence macro outcomes more directly than in past cycles. China continues to expand its manufacturing and export footprint, even as domestic demand remains weak, policymakers avoid aggressive easing and U.S. trade policy becomes more restrictive.

Across economies, the central question shifts from “who cuts fastest?” to “who can sustainably operate within the constraints of higher real rates, fiscal limits imposed by growing government indebtedness and geopolitical uncertainty?” This environment rewards selective duration, real-yield exposure, inflation hedges and sovereign differentiation.

DISPLAY 1

10-Year Real Yield vs 10-Year Moving Average GDP Growth in Subsequent Decade



Source: Federal Reserve Bank of Cleveland, Congressional Budget Office (CBO). **Past performance is no guarantee of future results.**

United States

Coming in Hot — Strong Nominal Growth, Fiscal Expansion, Monetary Easing and a Steepening Curve

The U.S. enters 2026 with exceptionally strong macro momentum. High-frequency indicators such as GDPNow[1] and CPI Nowcasting[2] suggest nominal gross domestic product (GDP) growth between 6% and 7%, supported by resilient consumption, healthy real income growth, and some of the most expansionary fiscal conditions in the Group of Seven (G7).[3] Federal deficits are projected to remain near 6% of GDP for the next decade, sustaining a structurally high level of Treasury issuance.

The Federal Reserve (the Fed) has delivered 75 basis points (bps) of easing in 2025, with markets pricing a possibility of up to three more cuts in 2026. This likely overestimates the degree of easing we expect, as core inflation remains close to 3%, far above the 2% target. Bringing policy rate to ~3% would barely be restrictive with nominal GDP at 7%. The Fed's decision to end quantitative tightening (QT) removes another constraint on liquidity, and leadership changes expected in May could tilt policy more dovishly.

The Treasury market faces a potent combination of strong growth, sustained issuance and a relatively cautious Fed, making 2026 a compelling environment for bear-steepening. Ten-year yields continue to struggle to remain below

[1] GDPNow is a nowcasting model for measuring gross domestic product from the Atlanta Fed that produces a running estimate of U.S. real GDP growth for the quarter right after the most recent one with an official government estimate, updating whenever new economic data is released.

[2] CPI nowcasting is the process of generating real-time, daily estimates of the Consumer Price Index (CPI) before the official data is published by the Bureau of Labor Statistics (BLS).

[3] The G7 is an informal forum of seven major advanced economies—U.S., UK, Canada, France, Germany, Italy, and Japan—that meet to discuss global economic, political and security issues.

4% given supply dynamics and the Fed's reinvestment preference for bills rather than coupons.

Treasury inflation-protected securities (TIPS) remain one of the best-positioned asset classes:

- The TIPS curve is steep relative to nominals.
- 10-year breakevens near 2.3% understate inflation risk.
- Real yields at 1.8%–2.0% align with long-term U.S. real growth forecasts, echoing the pre-GFC regime.

The U.S. dollar (USD) outlook is tactically bearish. Earlier Fed easing narrows rate differentials, and tariff-driven inflation impulses erode USD support. The composition of foreign financing — shifting from fixed-income to equity inflows — also weakens traditional USD support channels.

Overall, the U.S. macro environment is defined by strength, not fragility. Opportunities lie in curve steepeners, long-duration TIPS and tactical USD strategies.

Eurozone

Steady Ground — Stability Without Dynamism

The Eurozone enters 2026 with a stable but subdued macro profile. Growth expectations center around 1.1%, inflation remains somewhat sticky and the European Central Bank (ECB) is broadly expected to remain on hold throughout 2026 unless data materially weaken. The front end of the curve is therefore anchored.

Inflation dynamics show moderate progress but persistent stickiness. Core Consumer Price Index (CPI) at 2.4% year-over-year (YoY) is expected to fall to target by early 2026. However, history suggests Eurozone disinflation tends to proceed slower than forecasts imply. Wages remain firm and services inflation elevated, reducing pressure on the ECB to cut.

Fiscal policy is highly differentiated:

- Germany provides a stimulus pushing roughly 1.2 percentage point (pp) of GDP, but the composition skews toward low-multiplier spending.
- France faces widening deficits (4.5%–5.0% range) and continued heavy Obligations Assimilables du Trésor (OAT)[4] issuance, making OAT-Bund spreads structurally wide.
- Spain exhibits strong momentum, modest consolidation and will receive ~1% of GDP in European Union (EU) funds.
- Italy maintains a primary surplus but carries significant legacy debt burdens.

The business cycle is mixed. Services remain resilient, supported by real income gains and strong household balance sheets. Manufacturing remains soft but shows signs of stabilization, particularly if global trade tensions remain muted.

Structural risks include:

- Reliance on export-driven manufacturing, especially Germany's exposure to global capital-goods cycles.
- Fiscal rules limiting governments' ability to deploy countercyclical stimulus.
- Increased vulnerability to U.S.-China trade dynamics.

Investment implications for 2026:

- Long-end Bunds offer compelling real-yield value.
- Curve steepening risks are elevated due to Dutch pension-reform changes.
- Spain and Greece offer improving sovereign-spread opportunities.
- France remains an outlier with widening risk.
- 2–5 year Eurozone breakevens remain attractively priced for above-market inflation risk.

United Kingdom

Cool Change — Attractive Gilt Valuations Amid a Weakening Economy

The UK enters 2026 with weakening macro momentum. Growth surprised to the upside in late 2025, but the fading of prior fiscal support and softening domestic demand point to a slower trajectory. Consensus forecasts: 1.4% GDP in 2025 and 1.1% in 2026.

The labor market is clearly loosening:

- Unemployment at 5%, expected to rise gradually.
- Wage growth decelerating for the first time in years.
- Participation remains structurally weak.

These trends provide the Bank of England (BoE) — an institution with a well-established dovish bias — with room to ease once services inflation moderates. Markets price roughly -60 bps of cuts by November 2026, though a move to 2.75% is plausible if disinflation gains momentum.

Fiscal policy is caught between competing pressures:

- The Labour government faces demands for expanded public investment.

[4] Obligations Assimilables du Trésor are French government bonds for medium to long-term borrowing, offering fixed interest and acting as key sovereign debt.

- Markets and rating agencies demand fiscal discipline.
- Political pressure from Reform UK complicates long-term commitments.

The UK's longstanding structural weaknesses persist: low productivity, chronic current-account deficits, and reliance on foreign capital. The shift of UK defined benefit (DB) pension schemes into surplus eliminates a traditional anchor of long-duration gilt demand, forcing markets to rely more heavily on foreign buyers — a key driver of the structurally wide term premium.

Gilt valuations appear compelling across multiple metrics:

- Elevated real yields.
- Attractive cross-market spreads vs USTs and Bunds.
- Strong carry and rolldown in the 10-year and 20-year sectors.

Risks include sticky inflation, political noise and increasingly crowded long-gilt positioning. Still, gilts rank among the most attractive developed-market duration opportunities for 2026.

Japan

Slow Burn — Gradual Normalization With Wage and Tariff Uncertainty

Japan remains the only major developed economy actively tightening policy as the Bank of Japan (BoJ) continues a slow, deliberate exit from ultra-easy settings. Rate hikes are expected every 6–9 months, barring major surprises.

The central determinant of the BoJ's trajectory is wage growth. While headline Shunto[5] negotiations appear encouraging, official wage data remain uneven due to measurement issues and sectoral dispersion. The BoJ views 3% wage growth as consistent with maintaining 2% inflation sustainably, making the 2026 Shunto round a decisive moment.

The BoJ's QT path is pre-set: monthly Japanese Government Bond (JGB) purchases taper gradually each quarter, with no expected adjustments before the June 2026 review unless markets show dysfunction. Governance changes — including the departure of Asahi Noguchi (a key BoJ board member known for advocating easing/caution on hikes) and Junko Nakagawa (a BoJ member considered neutral/dovish) — may incrementally reduce dovish influence, though near-term effects appear limited.

Fiscal policy is more accommodative under the Takaichi Cabinet (formed in October 2025 when Sanae Takaichi was appointed Prime Minister), delaying consolidation and shifting issuance toward the front end and belly of the curve. Reduced structural demand for super-long bonds pressures the long end and raises questions about long-term sustainability given Japan's exceptionally high debt load.

Key vulnerabilities:

- Tariff risk is Japan's largest macro unknown. Even after the U.S.–Japan agreement, political volatility could reignite trade tensions.
- Weak consumption, especially after price increases in staples such as rice, continues to suppress domestic demand.
- Possible inflation declines in 2026 due to base effects may complicate market communication if the BoJ continues hiking.

Japan's strengths include improving wage- and price-setting norms, resilient corporate investment and progress toward escaping its deflationary past. Nevertheless, 2026 is characterized by gradual normalization, fragile domestic demand and two-sided risks.

China

Crosswinds — Policy Caution, Domestic Fragility and Export-Led Strength

China enters 2026 under a deliberately cautious policy stance. Despite cyclical softness, policymakers avoid aggressive easing given concerns about capital outflows, currency volatility and financial stability risks. Authorities emphasize Renminbi (RMB) stability, especially as global rate differentials compress.

Domestic demand remains constrained by weak consumer confidence, soft labor markets and ongoing property-sector adjustment. Although Beijing has announced initiatives to boost household wealth and consumption, the measures lack the scale and clarity required to meaningfully shift behavior. The property sector remains a structural drag: home prices continue to decline, developers face funding stress and local governments suffer from reduced land-sale revenues.

The manufacturing sector remains the core of China's economic strategy. The 4th Plenum reaffirmed that advanced manufacturing — electric vehicles, solar, automation and industrial machinery — sits at the center of China's long-term growth model. This capacity buildup supports exports but

[5] Shunto (Spring Wage Offensive) refers to Japan's annual, coordinated spring negotiations where major labor unions bargain with large corporations for wage hikes and better conditions.

intensifies global competitive pressures, especially across Europe and emerging markets (EM) Asia.

China's exports have shown remarkable resilience, even through political disruptions such as Liberation Day. Supply-chain adaptability and persistent global demand for competitively priced Chinese goods help explain the performance.

Risks remain two-sided:

- Upside: A more forceful, coordinated policy response could catalyze a sharper domestic rebound.
- Downside: Renewed U.S. tariff escalation or synchronized global slowdown would severely pressure China's manufacturing-heavy growth model.

Overall, China's 2026 outlook balances policy caution, domestic fragility and structural external competitiveness.

Canada

Northbound or Nowhere?

Canada faces a challenging macro landscape shaped by slowing growth, trade uncertainty, and sovereign bond valuations that remain rich. Canadian 10-year Government of Canada bonds (GoCs) trade 65-95 bps through U.S. Treasuries (USTs), a level difficult to justify given relative fundamentals and inflation dynamics.

The Bank of Canada (BoC) has cut rates to 2.25%, the bottom of its estimated neutral range, and now signals a conditional hold as core inflation remains near 2.5%. While the BoC could consider nudging rates higher late in 2026 if U.S. tensions ease, policy space remains limited.

The Carney government's C$280 billion fiscal program aims to revive productivity and enhance competitiveness. While structurally positive, execution risk is high and timelines long. Canada's strengths include exceptionally low net debt (~13% of GDP) and a robust domestic pension-investment base, providing stable demand for sovereign issuance.

The July 2026 United States-Mexico-Canada Agreement (USMCA) review is the key macro risk. Potential outcomes range from minor revisions to severe tariff escalation or even lapse scenarios, with profound consequences for Canadian growth.

Australia

The Lucky Yield Curve

Australia remains an attractive developed-market duration opportunity for 2026, but faces near term challenges. Australian Commonwealth Government Bonds (ACGBs) benefit from:

- A steep curve,
- Elevated real yields,
- Strong fiscal positioning and
- A deep, stable domestic pension investor base.

After two years of fiscal surpluses, Australia now runs modest deficits (1%–1.5% of GDP), keeping net debt near 30% of GDP, among the lowest in the developed world.

With that said, the Reserve Bank of Australia (RBA) has been required to hold policy steady as sticky trimmed-mean inflation (3.0% in Q3 2025) complicates the disinflation narrative. To ensure that inflation will return to target, it's likely that the RBA will be on hold for a while, and potentially hike rates.

Australia's vulnerabilities — notably weak productivity growth and exposure to geopolitical tensions between its two largest trading partners — remain, but do not overshadow the relative value in the back end of the sovereign curve with the 5-Year Forward Inflation Expectation Rate (5y5y)[6] rate now above 5%.

[6] The 5y5y rate is a key financial metric showing the market's average guess for inflation over a five-year period, starting five years from now, derived from TIPS and nominal Treasury yields.

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