



Quarterly Insight 2Q26

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Contents

3	The Age of Strategic Competition
5	Global Macro Outlook
	Macro Outlook - United States
	Macro Outlook – Euro Area
	Macro Outlook – Other advanced economies
	Macro Outlook – Asia
	Macro Outlook – Brazil
	Macro Outlook – Commodities
19	Asset Class Views
21	Asset Allocation
23	Equities
27	Fixed Income
29	Forex

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The Age of Strategic Competition

Key Takeaways

- The global economy is entering an age of strategic competition where energy, technology and geopolitics are increasingly intertwined.
- The recent escalation in the Middle East reminds investors that energy remains a central driver of economic stability and inflation dynamics.
- Bond market volatility remains the key stress indicator for global financial markets.
- The meeting between Donald Trump and Xi Jinping at the end of March, if not postponed, may prove pivotal in shaping the trajectory of US-China relations.
- Artificial intelligence continues to transform the global economy, but its deployment depends on physical infrastructure, energy availability and geopolitical stability.

For much of the past three decades, investors operated in a world largely shaped by globalization, efficiency, and relatively stable geopolitical relationships. Capital flowed freely, supply chains expanded across continents, and technological innovation unfolded within a broadly cooperative international framework.

That world is gradually fading, and we are moving into what could best be described as **the age of strategic competition**.

In such an environment, economic dynamics cannot be analysed in isolation from geopolitics. The control of critical resources, the security of supply chains, and technological leadership are becoming central elements of national power. Energy, semiconductors, artificial intelligence and strategic minerals are no longer simply sectors of economic activity; they are increasingly instruments of geopolitical influence.

The recent escalation in the Middle East provides a powerful reminder of this transformation. For years, the shale revolution and the energy transition created the perception that oil was gradually losing its central importance to the global economy. Yet the disruption of maritime flows through the Strait of Hormuz — through which nearly one fifth of global oil shipments transit — demonstrates how rapidly energy can reassert itself as a decisive macroeconomic variable. For the moment, the global economy appears capable of absorbing the shock. However, this

resilience masks meaningful regional divergences in energy exposure.

While the United States is relatively insulated—having become a net exporter of energy and benefiting from a structurally lower oil intensity—Europe and Asia remain significantly more exposed to disruptions in Middle Eastern energy flows. Asia, and China in particular, relies heavily on seaborne crude imports from the region, making it especially sensitive to both price increases and potential supply disruptions. Europe, although more diversified than in the past, remains vulnerable through global pricing channels and its continued dependence on imported energy.

In this context, the level and duration of oil prices are critical. Oil stabilizing around \$100 per barrel for a limited period may remain manageable for the global economy. However, a sustained move above this level—either in price or in duration—would become materially more painful, particularly for net energy-importing economies. Higher energy costs would act as a drag on growth, weighing on consumption and corporate margins, while also complicating the inflation outlook.

The key variable, therefore, is not only how high oil prices rise, but how long they remain elevated. A temporary shock can be absorbed. A sustained period of higher prices would represent a more challenging macro regime—particularly for Europe and Asia—reintroducing stagflationary risks and

increasing pressure on both policymakers and financial markets.

At the same time, another structural force continues to reshape the global investment landscape: the extraordinary rise of artificial intelligence.

Over the past two years, AI has evolved from a promising technological theme into one of the most powerful investment cycles in decades. Capital expenditure on data centres, computing infrastructure and semiconductor capacity is accelerating at a pace rarely seen in modern economic history.

Yet the AI revolution also illustrates a central paradox of the current era. While artificial intelligence is often perceived as a purely digital innovation, its expansion depends heavily on very physical constraints: electricity generation, semiconductor manufacturing, critical minerals and stable global supply chains.

In other words, the digital economy increasingly rests upon a set of infrastructures that are themselves deeply embedded in geopolitics.

This reality explains why technological competition between the United States and China has become such a defining feature of the current global order. The relationship between the two powers now extends far beyond trade balances or tariff disputes. It encompasses access to advanced semiconductors, control over rare earth processing, leadership in artificial intelligence and influence over the architecture of global supply chains.

Against this backdrop, the meeting between Donald Trump and Xi Jinping at the end of March, if not postponed, takes on particular significance. It represents not merely a diplomatic encounter, but a potential inflection point in how the world's two largest economies manage their strategic rivalry. Whether the outcome leads to temporary stabilisation or renewed escalation will have important implications for global trade, investment flows and market sentiment.

Financial markets have so far absorbed these developments with remarkable resilience. Equity indices remain within relatively stable trading ranges, reflecting continued confidence in corporate earnings and the structural growth potential associated with artificial intelligence. However, recent market

dynamics suggest that investors are increasingly focused on a different variable: the bond market.

The experience of last year's "Liberation Day" sell-off offers an instructive precedent. At the time, the true point of stress for global markets did not emerge first in equities, but in the sharp rise in long-term yields and the accompanying surge in interest rate volatility. When the US 10-year Treasury yield approached 4.60%, financial conditions tightened rapidly, forcing policymakers and investors alike to reassess the sustainability of the prevailing market regime.

Today, the US 10-year yield has once again begun to move higher, recently approaching the 4.25% level. While still below the peak reached during the stress episode of May 2025, the trajectory of yields will be closely watched. In an environment characterised by elevated fiscal deficits, rising capital expenditure and geopolitical uncertainty, bond market volatility may once again become the primary transmission channel through which geopolitical shocks influence financial markets.

The lesson for investors is therefore not one of pessimism, but of adaptation. The age of strategic competition does not necessarily imply weaker economic growth or permanently fragile markets. On the contrary, the forces currently reshaping the global economy — artificial intelligence, electrification, industrial investment and supply chain reconfiguration — may support a powerful new cycle of innovation and productivity.

But navigating this environment requires a broader analytical framework than in the past. Economic indicators must increasingly be interpreted alongside geopolitical developments, technological rivalries and resource constraints. In such a world, diversification across regions, asset classes and strategies remains the most reliable way to manage uncertainty.

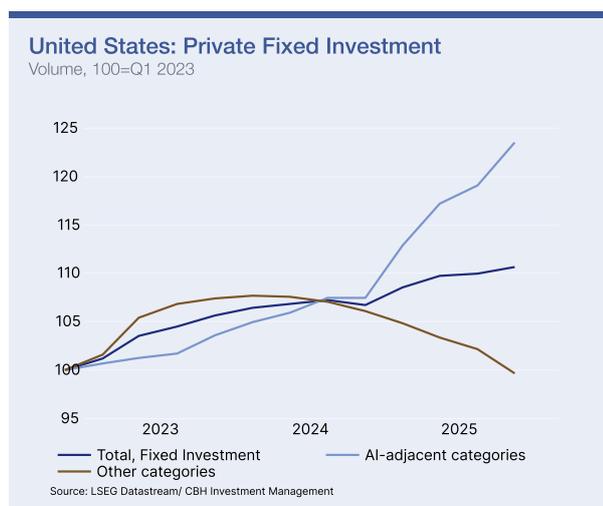
As Sun Tzu observed more than two millennia ago, "in the midst of chaos, there is also opportunity." The challenge for investors in 2026 is not to eliminate uncertainty — an impossible task — but to understand the forces that shape it. In the age of strategic competition, those forces lie at the intersection of energy, technology and geopolitics.

Macro Outlook – United States

Key Takeaways

- AI investment will remain a key driver of US growth in 2026.
- AI productivity gains will take time to materialise.
- The Fed faces a delicate balance between cooling growth and persistent inflation.
- Fiscal support and wealth effects will keep household demand resilient.
- Consumption divergence across income groups will continue to widen.

Artificial intelligence is at the centre of the US growth narrative for 2026. The gap between AI-related investment and other components of capital spending continues to widen. This raises two key questions: will AI adoption lead to meaningful labour displacement, and will the resulting productivity gains be sufficient to offset inflationary pressures?



Fears of rapid, large-scale AI-driven labour displacement appear overstated. Concerns about the return on the current surge in AI capital expenditure are more justified. The pace of AI adoption will likely prove slower than suggested by optimistic scenarios such as the so-called Citrini scenario, which assumes a rapid and broad-based diffusion of AI across firms and sectors. In practice, the binding constraint for any general-purpose technology—however transformative—is the speed at which work processes across the economy can be reorganised.

AI deployment is also more capital- and energy-

intensive than the internet era, requiring sustained expansion of data-centre and energy infrastructure. In our view, the AI capex cycle will still dominate in 2026, supporting aggregate demand and potentially adding to inflationary pressures, while productivity gains are likely to emerge first at the sectoral level and diffuse only gradually across the broader economy.

The macroeconomic impact of AI will therefore hinge largely on sequencing. If demand strengthens before supply expands, inflationary pressures could re-emerge. As with previous technological revolutions, the transition is likely to involve significant creative destruction and periods of friction along the way.

Fiscal policy is also set to be a meaningful driver of US growth in 2026, supporting both corporate investment and household demand. At the same time, its effects are likely to reinforce an increasingly pronounced divergence across income groups.

Higher-income households, supported by wealth effects from buoyant financial and real estate markets—alongside tax refunds—should continue to sustain strong consumption, particularly in services. Lower-income households, by contrast, are becoming more exposed, as some social transfers are scaled back and wage growth gradually moderates.

While the labour market remains resilient, it is no longer as tight as in recent years. Nevertheless, at the macro level, fiscal support combined with the spending power of wealthier households should keep overall household demand relatively firm.

The economic environment nevertheless remains uncertain. The Supreme Court’s decision to overturn some tariffs has opened a new phase of uncertainty regarding future trade measures. While the Trump administration remains focused on implementing protectionist policies, the form and scale of these measures have once again become unclear.

At the same time, the recent US–Israel strikes on Iran mark an escalation of geopolitical risk in the Middle East. **As with any geopolitical shock, the economic impact will largely depend on its effect on the US dollar and on energy prices**, as well as on the duration of the conflict. A temporary spike in energy prices would likely have only limited economic consequences, whereas more persistent disruptions to energy supply could have more significant effects, particularly on inflation .

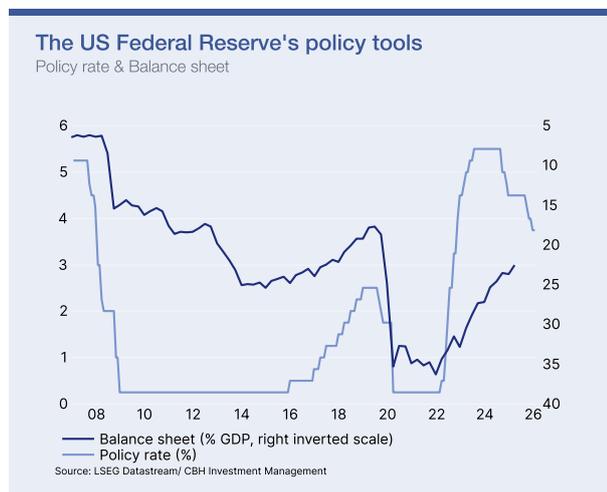
That said, the United States is less vulnerable than Europe or Asia to energy shocks, given its relative energy independence in both oil and natural gas.

Against this backdrop, monetary policy faces a delicate balancing act. The Federal Reserve must respond to a gradually easing labour market while inflation remains above target. Tighter immigration policies are adding complexity to this trade-off, simultaneously constraining labour supply and weighing on labour demand.

Inflationary pressures have not fully receded, and trade tariffs as well as geopolitical shocks could generate renewed price pressures. In this environment, the Fed is likely to remain focused on keeping inflation expectations firmly anchored. Fed Chair Jerome Powell, whose term runs through May 2026, has repeatedly emphasised that monetary

policy will remain data-dependent.

At the same time, recent challenges to the Fed’s independence and growing divisions within the committee have added uncertainty and contributed to greater volatility in market expectations. **The Federal Reserve is therefore navigating a difficult trade-off between supporting full employment and preserving price stability.**



Macro Outlook – Euro area

Key Takeaways

- Europe is vulnerable to energy shocks, which could further weaken competitiveness and the euro.
- Structural weaknesses, fragmentation, low productivity and weaker innovation, continue to weigh on growth.
- Domestic demand offers some support, with strong labour markets and rising real incomes.
- Governments are stepping up spending (infrastructure, defence), but fiscal and structural challenges remain.
- Inflation is close to target, but the ECB is likely to remain cautious given energy and wage risks.

Early 2026 is a fresh reminder of Europe's structural vulnerability to energy supply shocks.

Renewed tensions in the Middle East are likely to be felt most acutely in Europe and Asia. Europe — and Germany in particular — is still grappling with the lasting competitiveness shock caused by the surge in energy prices following the war in Ukraine.

A renewed increase in energy prices would therefore hit an already fragile landscape. Europe's structurally negative energy balance could widen further if oil and gas prices remain elevated for a prolonged period. This would put additional downward pressure on the euro and further erode the competitiveness of European companies.

These challenges come on top of persistently weak productivity growth and the protectionist measures introduced by the Trump administration, which

continue to create uncertainty for global trade. Altogether, Europe remains particularly exposed to external shocks at a time when its domestic growth drivers are already under strain.

Even though structural and fiscal measures are being rolled out across Europe — with governments stepping up efforts to strengthen infrastructure, restore competitiveness and increase defence spending — the region still faces deep structural challenges.

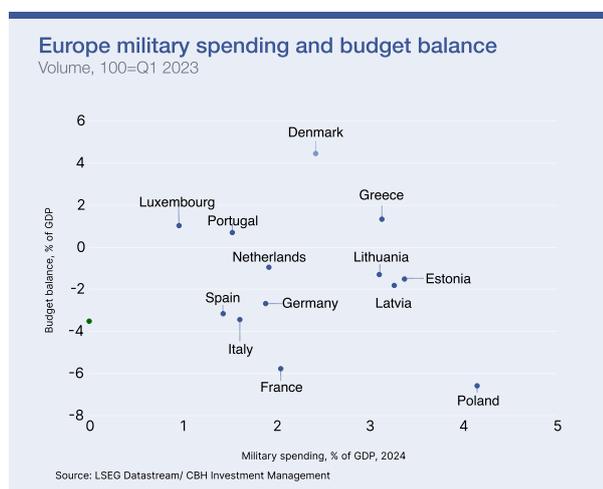
Europe remains a fragmented economic area.

Divides persist across regulatory frameworks, capital markets and the effective integration of the single market, while Europe's geopolitical positioning further complicates coordination. This fragmentation constrains the region's ability to respond swiftly and collectively to external shocks and continues to limit its economic potential.

Europe continues to lag its main trading partners in innovation investment, particularly relative to the United States and parts of Asia, weighing on its potential growth.

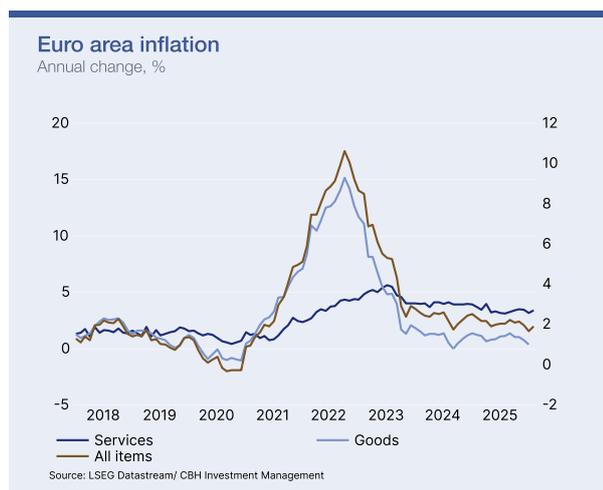
At the same time, several countries in the region must balance fiscal consolidation efforts with the need to invest in major structural transitions — notably demographic change, the energy transition and the push for greater strategic autonomy.

Nevertheless, provided tensions in the Middle East



do not escalate into a full-fledged energy shock, Europe's cyclical momentum remains reasonably supportive.

Solid labour markets and rising real incomes should support household consumption. Employment conditions remain tight, with persistent labour shortages in several sectors and unemployment rates near historical lows. A gradual decline in the savings rate could further boost spending. However, despite some recent improvement, consumer confidence remains fragile and is still well below pre-pandemic levels. Private investment, particularly in Germany, is expected to gain support from higher infrastructure and defence spending, alongside gradually improving financing conditions. However, heightened trade uncertainty, Europe's ongoing loss of competitiveness, and weak demand from China and the United States will continue to act as headwinds for the region.



Inflation in the euro area is now close to the ECB's target. Goods inflation has fallen markedly and is well below 2%, while services inflation remains more persistent, reflecting still-elevated wage growth and tight labour market conditions. Although wage dynamics are expected to gradually moderate, structural factors — including demographic pressures and labour shortages in several sectors — continue to support underlying inflation. Overall, the inflation backdrop has improved significantly but still warrants close monitoring, particularly given potential upside risks from energy prices or wage dynamics. In this context, the ECB is likely to maintain a cautious, data-dependent stance and keep its policy settings broadly unchanged in the near term.

Macro Outlook – Other advanced economies

Key Takeaways

- UK growth is expected to remain weak, constrained by fiscal consolidation, cautious household spending and limited external demand.
- Fiscal discipline remains a priority in the UK, supporting market credibility but offering little near-term boost to economic activity.
- Switzerland should see moderate growth, with resilient domestic demand offsetting weak exports and competitiveness pressures from the strong Swiss franc.

UK growth is likely to remain subdued in 2026.

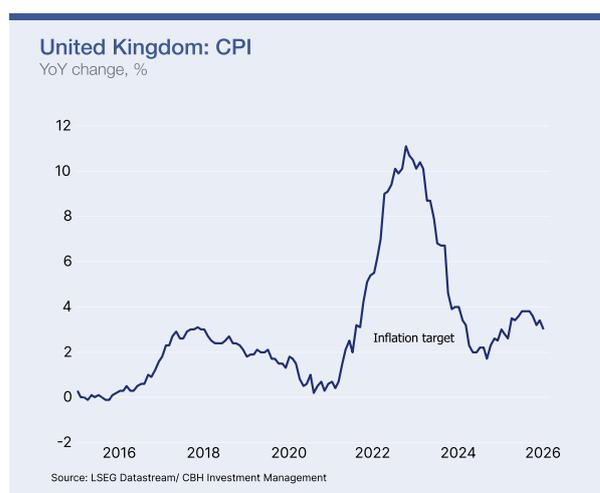
Economic momentum is soft, reflecting the ongoing drag from fiscal consolidation, cautious household spending, and a still-restrictive policy environment. While real incomes are gradually stabilizing as inflation moderates, domestic demand remains constrained and external demand provides limited support given weak growth in the Eurozone.

The fiscal stance remains a central feature of the macro-outlook. The government continues to prioritize fiscal discipline in order to stabilize public debt and maintain market credibility. However, this approach provides limited near-term support for growth, highlighting the structural tension between preserving fiscal credibility and supporting economic activity. Given the UK's reliance on external financing and the sensitivity of gilt markets to fiscal policy signals, maintaining credible fiscal anchors remains essential.

Investment dynamics remain weak. Elevated financing costs, subdued productivity growth and persistent global uncertainty continue to weigh on corporate capital spending. As a result, the investment cycle is unlikely to provide a strong impulse to growth in the near term.

Inflation risks also remain asymmetric. While headline inflation is expected to move closer to target over time, underlying pressures, particularly in services and wages, remain relatively persistent. In addition, renewed energy price volatility linked to geopolitical

tensions in the Middle East represents an upside risk to inflation. The UK economy remains relatively sensitive to energy shocks, which could slow the pace of disinflation.



Against this backdrop, the Bank of England is likely to proceed cautiously with policy easing. Persistent inflation risks and energy-related uncertainty suggest that the normalization process will be gradual. Overall, the UK macro environment remains characterized by modest growth, constrained policy space and elevated sensitivity to external shocks.

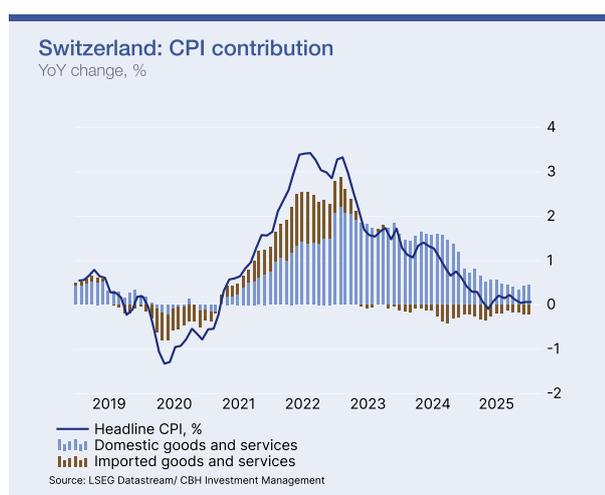
The Swiss economy is entering 2026 with subdued momentum following a volatile year marked by trade tensions and significant currency appreciation. Activity was initially supported by strong exports early in 2025 as companies accelerated shipments ahead of tariff increases. However, this temporary boost

faded quickly, leading to weaker export volumes and softer industrial activity later in the year.

While trade conditions have stabilised somewhat, the external environment remains challenging for Switzerland's highly open economy. Export-oriented sectors continue to face subdued foreign demand and persistent pressure from the strong Swiss franc, which is weighing on competitiveness and corporate margins. As a result, manufacturing activity and investment intentions remain cautious. Domestic demand, by contrast, continues to provide an important buffer. Private consumption remains relatively resilient and the services sector is expanding steadily, supported by stable household incomes and very low inflation.

Inflation remains comfortably within the Swiss National Bank's price stability range, reflecting the strength of the franc and contained domestic price dynamics. Against this backdrop, the SNB is expected to keep policy rates unchanged in the near term. Geopolitical tensions in the Middle East nevertheless represent a potential upside risk to inflation through higher global oil prices. However, the strength of the Swiss franc should help limit the pass-through of imported energy costs to domestic prices.

Overall, Switzerland is likely to see moderate but positive growth, supported by domestic demand while external headwinds continue to weigh on export-oriented sectors.



Macro Outlook – Asia

Key Takeaways

- Policy divergence is widening: China leans harder into stimulus and tech self-reliance, Japan's normalization is delayed by political transition, and India/ASEAN juggle growth resilience against imported inflation.
- Geopolitical shocks from the US–Iran war and a sustained oil spike are driving defensive rotation, pressuring net energy importers while selectively supporting producers.

Asia Pacific enters 2Q26 facing an acute external shock as the US–Iran conflict disrupts flows through the Strait of Hormuz, pushing Brent to as high as USD 118 per barrel and forcing central banks to reassess their inflation and growth paths. At the same time, renewed fears around broader Trump era tariffs on Asian exports are reviving concerns over margin compression and an accelerated restructuring of global supply chains. Private credit stress and spillovers from select European names have added to risk aversion toward financials, even as domestic policy responses increasingly differentiate country trajectories. Against this backdrop, structural themes such as China's domestic chip and AI substitution, Japan's governance driven capital efficiency, and ASEAN's role in "friend shoring" continue to offer selective opportunities rather than broad beta exposure.

China: Stimulus and Tech Self Reliance vs External Shocks

Chinese authorities have accelerated easing since the 15th Five Year Plan rollout, with early Q2 moves including a potential modest policy rate cut and RRR reduction to cushion the softening in consumer spending and ongoing property headwinds. The "Eastern Data, Western Computing" program is gaining urgency as Washington's tighter AI chip export controls push domestic GPU and accelerator development, reinforcing the state backed build out of AI data centers and cloud capacity. While higher energy costs and tariff noise weigh on export margins, resilient intra Asia trade and stepped up social spending help keep growth near the mid 4% handle, with equity markets likely to reward credible progress on AI infrastructure, cloud, and defensive

consumption, while property related assets stay highly policy dependent.

Japan: Normalization Delay and Energy Vulnerability

The Bank of Japan (BoJ)'s path toward policy normalization is complicated by leadership uncertainty and by Japan's heavy dependence on Middle East crude (around 95% of oil imports, with roughly 70% transiting Hormuz), which amplifies the pass through from higher Brent into CPI and corporate input costs. Governance driven reforms under the "Value Up" agenda and robust share buyback activity remain key supports for equity valuations, but the combination of yen weakness, higher energy import bills, and global risk off has driven outsized drawdowns in Japanese benchmarks during recent oil spikes. Markets will look to the new leadership's stance on BoJ tightening and fiscal support to gauge how sustainable the prior rally in cyclicals and exporters remains.

India: Growth Buffers vs Imported Inflation

India, one of Asia's largest oil importers and heavily exposed to Middle East supply, faces renewed macro pressure as elevated crude prices threaten to widen the current account deficit, lift inflation, and weigh on the rupee (INR). Equity markets have already shown the typical inverse relationship between crude and the Nifty, with energy intensive sectors (transport, cement, power) under pressure even as domestic demand and policy driven stories in infrastructure and digitalization offer partial offsets. The RBI's bias to keep rates on hold while monitoring second round inflation effects, and the progress on digital economy and manufacturing initiatives, will be central for

sustaining India's premium growth narrative in 2Q26.

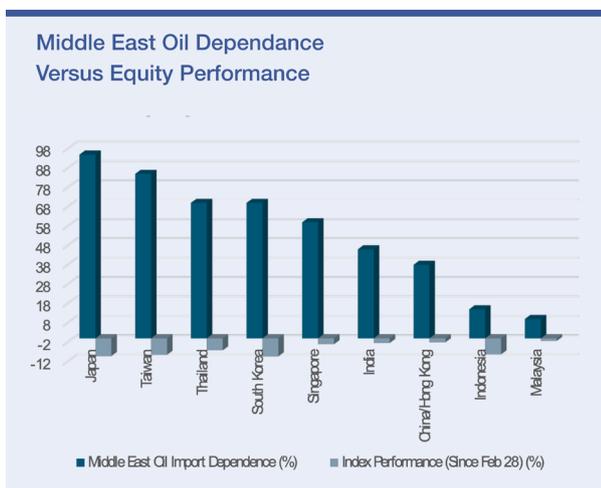
energy and utility names in Malaysia/Indonesia and across Asia's energy transition value chain.

High Oil Prices: Asia's Relative Winners and Losers

The Iran war has highlighted how Asia is structurally the most exposed region to Middle East energy: about 84% of oil and 83% of LNG shipped through Hormuz goes to Asian buyers, with China, India, Japan, and South Korea accounting for three quarters of crude flows. Within that group, Japan and South Korea are the most vulnerable, sourcing roughly 87% and 81% of their energy from imported fossil fuels, and relying heavily on oil and gas that pass through the Strait, leaving their currencies and equity markets particularly sensitive to extended disruptions.

Recent price action already reflects this shock: as Brent stay elevated, equity indices across North Asia and ASEAN sold off sharply, with Japan's and Korea's markets leading declines, while India, Singapore, Thailand, and Indonesia also saw broad based weakness amid fears of stagflation and weaker external balances. Thailand and the Philippines are expected to be among the most at risk in Southeast Asia given sizable energy deficits, whereas Malaysia (and to a lesser extent Indonesia) are relatively cushioned as net energy exporters, with higher oil and gas prices partly offsetting risk off flows into their broader equity markets.

For investors, this argues for a barbell, selective stance: underweight the most energy vulnerable importers where pass through to inflation and FX is largest (Thailand, Philippines, parts of India), while using corrections to add to structural winners in China's domestic AI/semiconductor ecosystem, Japanese governance beneficiaries, and select



Macro Outlook – Brazil

Key Takeaways

- International investors have sharply increased allocations to Brazil in early 2026, driven by diversification needs and attractive real-rate carry.
- Rising oil prices introduce inflation risks but are partially offset by Brazil's status as a net oil exporter and policy buffers.
- The upcoming 2026 presidential election is likely to heighten market volatility amid a highly polarized political environment.
- Brazil's economy is slowing but remains resilient, supported by strong employment, income growth, and moderating inflation dynamics.
- Investment positioning favors Brazilian inflation-linked bonds and uncorrelated alternative assets over equities, reflecting limited upside and a focus on carry and diversification.

A renewed international appetite for Brazil

The opening months of 2026 marked a meaningful inflection in international investor sentiment toward Brazil. In January alone, net foreign inflows into the Ibovespa reached BRL 25 billion, a figure that exceeded the entirety of flows recorded throughout 2025. Year-to-date, cumulative inflows now stand at BRL 43 billion, with the EWZ serving as the primary vehicle for this allocation. The movement is not isolated; it reflects a broader reconfiguration of global portfolios, as investors seek geographic diversification at a moment when risk has become increasingly concentrated in the United States. Anchored by a commodity-driven trade balance, Brazil offers a natural exposure to real assets that acts as ballast during periods of heightened uncertainty. Combined with the elevated carry embedded in domestic interest rates, this has positioned the country as one of the most compelling destinations within the emerging-market universe, resulting in a meaningful appreciation of the Brazilian real against the U.S. dollar and a strong run in Brazilian equities.

Economic activity and monetary policy: deceleration with resilience

On the domestic front, the Brazilian economy entered 2026 at a delicate juncture in the cycle. Activity showed clear signs of moderation, particularly in sectors more sensitive to the cost of capital, while services remained buoyant, supported by a labor

market operating near full employment (with the unemployment rate at 5.4%) and by double-digit nominal household income growth. Although this dynamic remains an underlying inflationary force, it has been offset by easing food prices, more contained commodity dynamics, and exchange-rate appreciation. Headline inflation is now running within the upper bound of the Central Bank's target band, which lends support to an initial easing cycle, with the policy rate currently at 15.0%. At its most recent meeting, the Central Bank signaled a possible start to rate cuts, following a straightforward logic: adjusting nominal rates to restore the real policy rate to an appropriate level without tightening beyond what the converging inflation path warrants.

The external shock: the war in Iran and a new risk variable

The recent rise in Brent crude, by feeding into inflation expectations, has weighed on the anticipated magnitude and duration of the easing cycle. The direct impact on Brazil, however, is partially cushioned by two mechanisms. The first is Petrobras' pricing policy, which follows a gradualist model designed to avoid the immediate pass-through of external volatility to domestic refinery prices. The federal government reinforced this buffer by temporarily zeroing out certain fuel taxes, limiting short-term damage to consumers. The second stabilizer lies in Brazil's trade balance. As one of the world's major oil producers and exporters, Brazil tends to benefit

during periods of elevated crude prices through stronger export revenues, a wider trade surplus, and improved current account dynamics, turning what is a terms-of-trade shock for most economies into a relative tailwind.

Politics and the 2026 election cycle

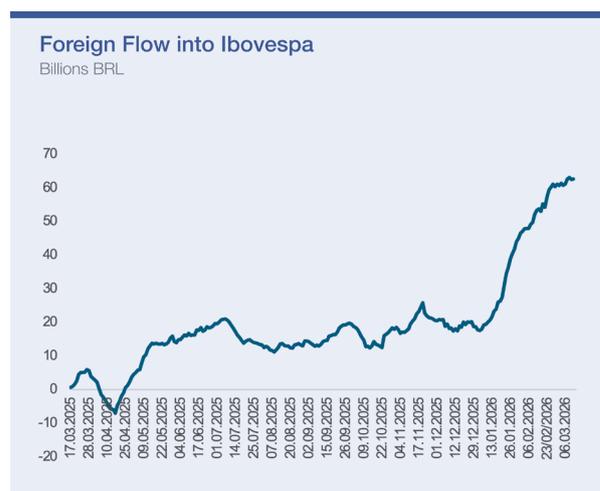
On the political front, Senator Flávio Bolsonaro, son of former President Jair Bolsonaro, has consolidated his position as the leading opposition figure for the 2026 presidential election, already polling in a statistical tie with incumbent President Lula. The outlook points to yet another highly polarized contest, marked by deep mutual rejection between the two main political camps and growing public discontent with the government on issues such as corruption, the tax burden, and public security. For markets, polarized elections in Brazil have historically been synonymous with elevated volatility, wider risk premia, and uncertainty over the continuity of the fiscal framework, a binary scenario in which markets are likely to penalize a left-wing victory.

How we are positioned

Our allocation reflects two distinct strategic pillars. In our view, Brazil has not undergone any structural transformation; rather, it has been the beneficiary of a broader wave of foreign inflows into emerging markets as an asset class. Despite the gains already registered in equities, we do not see a compelling entry point at current levels. Our Brazilian exposure is therefore concentrated in NTN-Bs, inflation-linked sovereign bonds that allow us to monetize the elevated carry embedded in real rates. We currently see a meaningful asymmetry in the real yield market: the scope for further rate compression is relatively constrained given the volume of public debt outstanding at real rates, while a normalization scenario could still bring real yields back toward historical levels some 200 basis points lower.

Our second strategic pillar is structural diversification through uncorrelated alternative assets, with a priority on structured credit backed by hard collateral and project finance transactions. The rationale is complementary to that of sovereign fixed income: these instruments are insulated from the day-to-day volatility of capital markets, their returns are anchored in real cash flows and contracts supported by tangible guarantees, and they consistently offer

an illiquidity premium relative to traditional private credit.



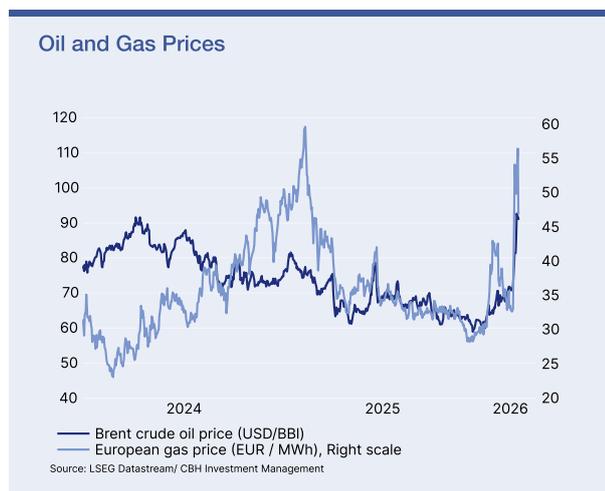
Macro Outlook – Commodities

Key Takeaways

- The Middle East escalation is primarily an energy shock, with oil and gas markets at the centre of global transmission.
- Disruptions in the Strait of Hormuz threaten a vital artery for global energy trade, keeping oil and LNG markets highly sensitive to geopolitical signals.
- Shipping markets are tightening as risks rise across Hormuz and Bab el-Mandeb, pushing up freight rates, bunker costs and war-risk insurance premiums.
- Aluminium appears particularly exposed among industrial metals, given its reliance on energy and alumina supply chains linked to the Gulf.
- Tin remains structurally volatile, with extremely low exchange inventories amplifying the impact of even modest supply disruptions.
- Gold continues to benefit from its multi-year rally, although recent dollar strength and higher US yields have tempered the immediate safe-haven response.

Oil, gas and the transmission of geopolitical shocks

Commodity markets are often the first channel through which geopolitical and military shocks reach the global economy. The latest escalation in the Middle East is no exception.



Energy markets reacted sharply following Israeli and US strikes on Iranian targets and Tehran's retaliation against US military facilities and energy infrastructure across the Gulf. Shipping through the Strait of Hormuz, one of the world's most critical energy chokepoints, has been severely disrupted. Roughly 20mn barrels per day (around one-fifth of global consumption) normally transits through the

strait, alongside large volumes of liquefied natural gas, most of it destined for Asian markets.

The Gulf is not only central to crude exports. It is also a major hub for refining and petrochemical production, meaning that disruptions can quickly ripple across downstream energy products and industrial supply chains.

Some producers have partial alternatives. Saudi Arabia, for instance, can reroute part of its exports through the East-West pipeline to Red Sea ports. Yet these routes can only absorb a limited share of Gulf production, leaving global energy flows significantly constrained.

For now, markets remain highly volatile, reacting to a steady stream of political announcements and counter-announcements from Washington and Tehran. Policymakers are also weighing a coordinated release of strategic petroleum reserves among G7 countries to cushion the shock.

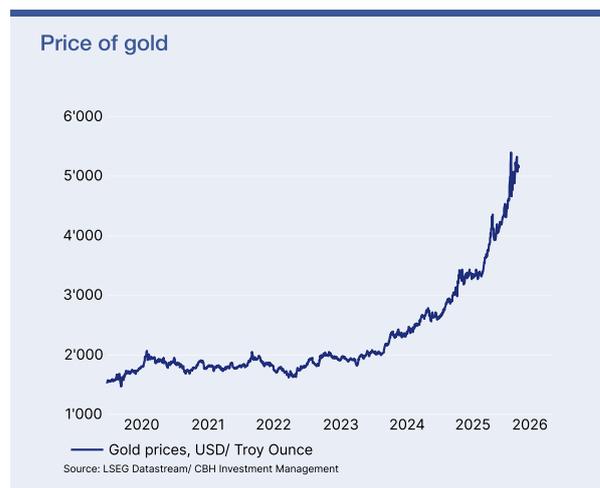
If disruptions prove short-lived, the global economy should absorb the shock through inventories, spare capacity and rerouted flows. But a prolonged impairment of Hormuz would constitute a major supply shock — with clear implications for inflation, trade costs and global growth.

Industrial metals markets have so far reacted more cautiously than energy, but the conflict still introduces several potential transmission channels. The Middle East is not a major producer of most base metals, yet it plays an important role in energy supply and downstream processing, both of which underpin global metal markets.

Aluminium could prove particularly exposed to the current tensions. Aluminium smelting is highly energy-intensive, making the metal especially sensitive to fluctuations in gas and electricity prices. The Gulf region has become a major aluminium hub, with large smelters in the United Arab Emirates, Bahrain and Saudi Arabia relying largely on natural gas. Damage to regional energy infrastructure could therefore tighten global supply. In addition, Gulf smelters may face difficulties securing alumina, a key input that largely transits through the Strait of Hormuz. Any sustained disruption there could constrain feedstock supplies and amplify price pressures in an already tight market.

Tin markets, meanwhile, remain structurally prone to sharp price swings. Prices briefly exceeded \$57,000 per tonne on the LME in February, reflecting a market characterised by fragile supply and extremely low inventories. Production is concentrated in a few countries, notably Indonesia and Myanmar, while demand remains strong from electronics and semiconductor-related sectors. With LME stocks covering only a few days of global consumption, even modest supply disruptions or speculative flows can trigger outsized price movements.

Shipping markets are also coming under increasing strain. The disruption of traffic in the Strait of Hormuz is beginning to affect maritime logistics across the Gulf. Several ports in the region are major bunkering hubs, supplying marine fuel to vessels operating between Asia, Europe and Africa. Tighter oil flows and disruptions to refining and storage infrastructure are therefore raising concerns about marine fuel availability, pushing up bunkering prices and operating costs for shipping companies. At the same time, the Bab el-Mandeb strait remains exposed to potential attacks, threatening another key corridor linking the Red Sea to the Indian Ocean. As risks increase across both chokepoints, freight rates and maritime insurance premiums are already moving higher, adding further pressure to global trade costs and supply chains.



Gold has extended the powerful rally of recent years, reaching fresh record highs since the start of 2026 amid persistent geopolitical uncertainty and robust central bank demand. Yet the escalation with Iran has not triggered the typical safe-haven surge. Instead, prices have edged lower in recent days, as US dollar strength and higher Treasury yields have weighed on demand. In the short term, currency and rate dynamics appear to be outweighing geopolitical risk in driving gold prices.

Key Macro Data & Forecasts

	Annual			
	2023	2024	2025e	2026e
United States				
Real GDP	2.9	2.8	2.1	2.4
Private consumption	2.6	2.9	2.6	2.4
Investment	3.4	3.0	2.7	2.5
Domestic demand (contribution, %pt)	3.0	3.2	2.5	2.2
Inventories (contribution, %pt)	-0.5	0.1	-0.1	-0.3
Net exports (contribution, %pt)	0.4	-0.5	-0.2	0.4
Inflation (CPI, %yoy)	4.1	3.0	2.7	2.4
Unemployment rate (%)	3.6	4.0	4.2	4.1
Euro area				
Real GDP	0.5	0.9	1.5	1.1
Private consumption	0.6	1.3	1.5	1.9
Investment	2.7	-2.6	3.1	2.4
Domestic demand (contribution, %pt)	1.2	0.6	1.8	2.1
Inventories (contribution, %pt)	-1.0	-0.1	0.3	-0.4
Net exports (contribution, %pt)	0.3	0.3	-0.6	-0.6
Inflation (HICP, %yoy)	5.5	2.4	2.1	1.9
Unemployment rate (%)	6.6	6.4	6.4	6.3
China				
Real GDP	5.4	5.0	5.0	4.5
Unemployment rate (%)	5.1	5.1	5.1	5.1
Inflation (CPI, %yoy)	0.2	0.2	0.0	0.7
Trade	1.0	3.6	4.1	2.6

Forecasts – Rates

Policy rate	Actual	Target		Last 5 years	
	12/25	3M	12M	High	Low
Fed funds (upper)	3.75	3.75	3.50	5.50	0.25
ECB deposit rate	2.00	2.00	2.00	4.00	-0.50
10-year rate					
Us Treasury	4.23	4.30	4.50	4.71	1.26
German Bund	2.95	2.60	2.50	2.95	-0.47
FX					
EUR/USD	1.15	1.15	1.22	1.21	0.98
EUR/CHF	0.91	0.91	0.93	1.10	0.91
USD/JPY	159.07	158	150	159.07	108.79
GBP/USD	1.32	1.32	1.27	1.41	1.13

Asset Class Views

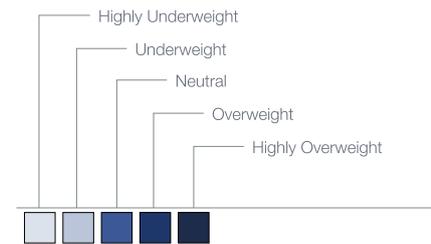
These asset class views have a 3 to 12 month horizon.

Where there has been a change since the last Quarterly Insight, the dot (•) indicates the previous view. These views should not be regarded as portfolio recommendations. This summary of our individual asset class views indicates the strength of conviction and relative preferences across a broad range of assets, but is independent of portfolio construction considerations.

Cash			■		
Fixed Income			■		
Government Bonds			■		
Corporate Investment Grade			■		
Corporate High Yield					■
Emerging Market Debt Local Currency			■		
Emerging Market Debt Hard Currency			■		
Duration			■		
Equities		■			
United States		■			
Europe			■		
UK			■		
Switzerland			■		
Japan			■		
Emerging Markets ex-China			■		
China			■		
Alternatives			■		
Hedge Funds			■		
Gold				■	•
Commodities		■			
Currencies (against USD)					
EUR				■	
CHF			•	■	
GBP		■			
JPY			■	•	

• – previous positioning

How to read the table?



This content provides a snapshot of the current market environment and is not intended to predict or guarantee future results. It should not be regarded as investment research or advice on specific funds, strategies or securities. Past performance is not a guide to future results. Any forecasts, projections or targets mentioned are for illustrative purposes only and are not guaranteed to be accurate or achieved.

Asset Allocation

Navigating Structural Trends and Geopolitical Risks

Key Takeaways

- Geopolitically induced volatility has become a persistent feature of markets in a more fragmented world.
- Structural trends in AI, electrification, and critical minerals provide durable growth foundations.
- Exposure to persistent structural themes enhances portfolio resilience amid uncertainty.
- Broad AI adoption and ongoing infrastructure investment underpin long-term sector growth.

The global investment landscape today is shaped by two broad forces: transformative structural trends—namely, the AI infrastructure buildout and the electrification and grid supercycle—and heightened geopolitical fragmentation, with sporadic, weaponized conflicts across key regions. The challenge for investors is clear: how to construct portfolios that are resilient in the face of these intertwined secular and geopolitical risks.

Capturing Structural Growth in Uncertain Times

At the forefront of market concerns is the ongoing conflict between Iran and the U.S., alongside its regional allies. While military outcomes are inherently unpredictable, our base case is that escalation will remain contained, with any spike in oil prices likely to moderate as supply adjusts. In this scenario, the episode would constitute a temporary, risk-off shock to markets. History, however, cautions against underestimating protracted conflicts: past U.S. interventions show that while initial military phases can be executed rapidly, wars with political objectives—such as regime change or strategic deterrence—rarely conclude quickly. In Iran's case, the conflict has already expanded across multiple countries and involves a combination of military and economic actions, making a short, easily resolved outcome less likely.

The renewed focus on the Middle East has brought oil markets back into the spotlight, with crude prices at risk of remaining above USD 100/bbl in the alternative scenario of a protracted conflict. In that environment

of elevated energy costs, slower global growth, rising inflation expectations, and less accommodative monetary policy, equity portfolios should emphasize structural growth drivers rather than broad macro beta to enhance resilience. We identify three interrelated thematic offerings offering durable exposure across sectors and geographies. First, the AI ecosystem, where opportunities are most compelling among providers of infrastructure and hardware rather than end-user applications at this stage. Second, the electrification and grid supercycle is being driven by the expansion of data centers and accelerating adoption of electric vehicles—trends that are increasingly energy-intensive and closely tied to the growth of AI infrastructure—while the modernization of energy networks reflects decades of underinvestment and aging infrastructure. Third, the critical minerals supercycle, underpinning both the energy transition and digital infrastructure by supporting supply chains for semiconductors, batteries, defense, and renewable energy technologies. In our view, Exposure to these three thematic offerings enables investors to capture secular growth while mitigating cyclical macro and geopolitical shocks.

The Structural Growth Case for the AI buildout

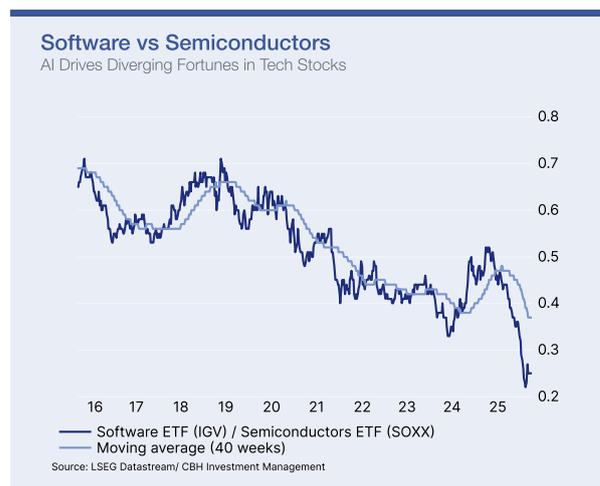
Among these thematic offerings, the AI ecosystem is particularly compelling given its broad enterprise adoption and ongoing infrastructure investment, making it the natural starting point for a closer examination. A central question in our 2026 Outlook was whether the strong rally in U.S. AI-related equities reflects durable fundamentals or a speculative bubble. Our assessment

remains that the technology sector's performance is largely supported by earnings fundamentals. Recent Q4 2025 earnings reports reinforce this view, highlighting several key catalysts that strengthen the structural growth case for AI.

Capital expenditure is a primary driver, with investment in AI infrastructure and platforms expected to grow 45% year-on-year in 2026 and at a 26% CAGR from 2025 to 2030 (Standard Chartered), reflecting ongoing buildouts and sustained adoption across industries. AI adoption rates in the U.S. have accelerated sharply, rising to 15–20% from just 3.8% in late 2023 (U.S. Census Bureau), underscoring the rapid diffusion of AI technologies into business processes and operations. These dynamics, combined with substantial capex plans announced by major technology companies during the Q4 2025 earnings season, reinforce our constructive view on the sector, particularly in semiconductors, which continue to benefit directly from the growth of the AI ecosystem.

While these fundamentals support long-term growth, near-term operational and valuation pressures are emerging. Hyperscalers are engaged in a capital expenditure “arms race,” investing aggressively in data centers, specialized chips, and cloud platforms. Capital spending has risen to 20% of revenue from a historical average of 8% (J.P. Morgan), reflecting a shift from asset-light to asset-heavy models. As highlighted in our 2026 Global Outlook, this dynamic resembles a “prisoner’s dilemma”: individually, companies might prefer to limit spending to preserve margins, but strategically they must go all-in to avoid losing ground in the AI ecosystem. Importantly, the recent derating in valuations already compensates for these margin pressures, leaving firms well-positioned to capture long-term growth from AI adoption.

Beyond infrastructure investment, market concerns have focused on the potential for AI to disrupt traditional software business models. Companies offering standardized or easily replicated software are more exposed to margin pressure, while providers deeply embedded in critical client workflows with proprietary data and AI integration are better positioned. By embedding AI into their offerings, these firms enhance product value, reinforce client reliance, and strengthen their competitive moat, supporting sustainable long-term growth. These dynamics are reflected in performance: U.S. technology equities



have lagged the broader market year-to-date due to softness in software and services, partially offset by gains in semiconductors and technology hardware. Globally, technology stocks are experiencing one of the weakest starts to a year relative to world ex-tech equities in the last 50 years, according to Goldman Sachs.

Another medium-term risk to the AI theme is a potential deceleration in AI-related investment. While we acknowledge this risk over the medium to long term, current evidence suggests a broad slowdown is unlikely to materialize imminently. Capital expenditure remains elevated across the AI ecosystem, extending beyond the largest hyperscalers to a growing cohort of software, semiconductor, and infrastructure providers. This diversification implies that any moderation by some firms is likely to be offset by continued investment from others, sustaining the sector's overall growth trajectory. AI's structural drivers—enterprise adoption, infrastructure buildout, and integration into critical workflows—remain robust, underpinning sustained medium- to long-term capital investment and earnings growth.

Building Resilient Portfolios

While geopolitically induced volatility has risen since 2022, structurally driven growth themes continue to provide a durable foundation for long-term investing. In an environment of episodic shocks, resilience comes from identifying sectors and companies where innovation, capital investment, and adoption trends are driving lasting change. These areas of persistent structural growth provide a framework for navigating uncertainty, enabling portfolios to capture long-term returns even amid volatile conditions.

Equities

Seeking Resilience in a Shifting Global Landscape

Key Takeaways

- The macro and earnings backdrop remains supportive for now despite the geopolitical shock.
- Regional sensitivity to oil prices warrants caution in Europe, Japan, and Emerging Markets, while the U.S. market remains resilient.
- Structural earnings growth is driven by sectors benefiting from long-term tailwinds.
- Strong expected EPS growth underpins U.S. valuations, with forward P/E levels not limiting further gains.

As we highlighted in our 2026 outlook, our base case was that a benign macroeconomic environment and solid earnings delivery would support a constructive year for risk assets, absent a major geopolitical shock. The first quarter has nonetheless delivered such an event, with the escalation into a full-scale conflict involving the United States and its Middle Eastern allies against Iran. Our baseline scenario remains that this episode will prove to be a temporary risk-off shock for markets. While military conflicts are inherently unpredictable, we expect escalation to remain limited, with any oil price spikes likely to ease over time as supply adjusts. Importantly, the underlying macro and corporate backdrop remains supportive: economic activity continues to show resilience, household balance sheets still benefit from positive wealth effects, and corporate earnings momentum remains robust. Against this backdrop, we believe periods of market weakness over the coming three to six months could provide attractive entry points for equity investors.

Structural Drivers Underpinning Earnings Growth

Looking beyond episodic shocks, long-term equity performance continues to be supported by structural earnings drivers. For 2026, the Information Technology sector is expected to deliver the strongest earnings growth across the S&P 500 (FactSet), with EPS projected to rise 33.5% and revenue by 21.5%, well above the index averages of 15.3% and 8%. Materials, Utilities, and Industrials are the next strongest contributors, with expected EPS growth

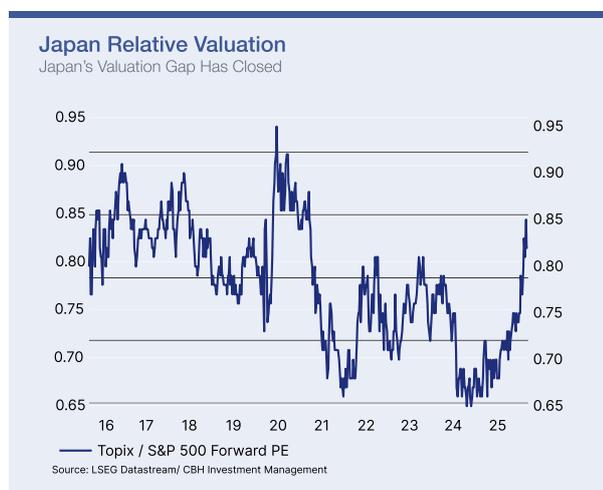
of 28%, 12.2%, and 11.3%, respectively. These four sectors—Technology, Industrials, Materials, and Utilities—have all seen consistent upward EPS revisions since the start of the year and together account for roughly 45% of the S&P 500, anchoring the market's overall earnings growth outlook. A common driver across these sectors is their exposure to the electrification supercycle, which continues to support earnings momentum.

Near-term 1Q26 expectations underscore Technology's leadership, with projected year-over-year EPS growth of 41.7%, up from 34.3% at the start of the year. Growth is broad-based across all six industries, led by Semiconductors & Semiconductor Equipment (+86%), Electronic Equipment, Instruments & Components (+28%), Technology Hardware, Storage & Peripherals (+26%), Software (+18%), Communication Services (+11%), and IT Services (+4%). Despite negative headlines on 4Q25 earnings, Software is still expected to post resilient growth. As the largest sector in the index, Technology remains the primary driver of quarterly, full-year, and 2027 projections, with EPS expected to grow 23.4% next year—the strongest among all sectors.

U.S. Valuations Are No Barrier to Further Gains

Strong earnings growth in the U.S. is providing the foundation for current valuations. While the U.S. market is often viewed as expensive relative to other regions, a closer look at relative forward P/E versus 10-year averages suggests these concerns

are less compelling today. Since the trough in relative valuations in 4Q24, Europe’s discount has largely normalized, Japan’s valuation gap has closed, and only Emerging Markets remain relatively inexpensive. On an absolute basis, the S&P 500 forward P/E has decompressed from 23x in 4Q25 to 20x, below one standard deviation above the 10-year average. Adjusting for the concentration of the “Magnificent 7” via the S&P Equal Weight index, valuations sit at 16.5x forward earnings—near the 10-year average. Importantly, U.S. equities have advanced primarily on the back of strong EPS growth rather than multiple expansion, suggesting that as long as earnings momentum continues, valuations are unlikely to constrain further gains.



Regional Sensitivity to Oil Prices

We entered the year with neutral allocations to Europe, Japan, and Emerging Markets. The recent energy shock—while temporary in our baseline scenario—has nonetheless highlighted the sensitivity of several regions to oil price dynamics. Japan remains structurally exposed to energy price shocks. The country imports virtually all of its crude oil, with more than 90% sourced from the Middle East, making it particularly sensitive to disruptions in the region. A sustained increase in oil prices would therefore translate rapidly into higher imported inflation, potentially complicating the Bank of Japan’s policy normalization path. A renewed surge in imported energy costs could create an unfavourable mix of higher inflation and weaker real income growth, increasing uncertainty around both monetary policy and the government’s policy response. Against this backdrop, we believe maintaining a neutral stance on Japanese equities remains warranted for the time being.

Emerging Markets also remain structurally exposed to higher energy prices. More than 75% of the MSCI Emerging Markets Index is composed of China, Hong Kong, Taiwan, South Korea, and India — all net oil-importing economies — making the benchmark particularly sensitive to spikes in crude prices. While we continue to see value in EM from both cyclical and valuation perspectives, the region’s sensitivity to energy costs warrants caution for now. As for Europe, in 2025, petroleum products and natural gas together accounted for nearly 60% of the EU’s gross available energy, making fossil fuels the dominant component of the energy mix. While Europe is less directly exposed to Middle Eastern supply disruptions—with crude largely sourced from the U.S., Norway, and Kazakhstan, and natural gas from Norway, the U.S., and Algeria—it remains fully exposed to elevated global crude and TTF gas prices. Higher energy costs are likely to squeeze corporate margins and household consumption, transmitting inflationary pressures through the economy as Europe faces energy headwinds mainly via global price transmission rather than direct supply risks. Although the Eurozone economy showed tentative signs of improvement early in the year, we would prefer greater stability in energy markets before considering an overweight position.

U.S. Market Resilient but Concentration Warrants Caution

In contrast, the U.S. remains the most attractive equity market in the current environment, largely irrespective of the oil price scenario. Technology, the largest sector in the S&P 500, continues to benefit from strong earnings growth expectations and the structural support provided by the ongoing AI infrastructure buildout. Alongside the broader electrification and energy transition theme, this buildout is extending into Utilities, Industrials, and other segments, creating structural tailwinds across multiple sectors. The macro backdrop remains supportive as well with consumer spending expected to remain resilient in 2026, mostly driven by middle- and upper-income households, who account for the bulk of U.S. consumption and benefit from wealth effects linked to equities and housing. Real disposable income remains positive, rising roughly 1% year-on-year in late 2025, supporting demand for discretionary goods and services. Continued momentum in the services sector, reflected in ISM

Services readings, underscores the resilience of broad economic activity and underpins corporate earnings growth.

However, amid ongoing debate over the sustainability of the AI-driven rally, elevated valuations in growth segments, and persistent concentration risk within the Magnificent 7, we maintained a modest underweight to U.S. equities during 1Q26. We are monitoring for an opportunity to move back to neutral and, ultimately, to an overweight should valuations or market conditions become more supportive. At the same time, we see merit in diversifying U.S. equity exposure beyond broad market beta. To this end, we initiated a targeted allocation to the U.S. quality factor, focusing on companies with resilient cash generation and strong balance sheets. We also introduced exposure to the electrification and power grid supercycle, which we view as a structural theme likely to support earnings growth across multiple sectors.

Equity Sectors

Communication Services	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Consumer Discretionary	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Consumer Staples	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Financials	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Healthcare	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Industrials	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Information Technology	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Materials	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Real Estate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Utilities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>

Fixed Income

Favoring Credit Opportunities Over Duration Amid Elevated Geopolitical Risk

Key Takeaways

- In our base case, credit markets remain resilient, with spreads underpinned by solid fundamentals and a benign macro environment.
- Emerging market debt shows diverging dynamics, with hard currency markets holding up and local currency bonds more sensitive to USD strength and energy-driven volatility.
- Markets have repriced interest rate expectations sharply, reflecting elevated inflation risk and faster-than-expected tightening.
- The Middle East conflict has reignited inflation pressures, driving short-term yields and spreads higher.

Oil Shock Sparks Inflation Concerns and Bond Volatility

The near closure of the Strait of Hormuz has introduced a significant disruption to energy markets, threatening to destabilize what had previously been a relatively benign macro environment. Recent developments have revived dynamics last seen in 2022: energy prices moving sharply higher, bond yields rising rapidly, and the stock-bond correlation at risk of turning positive as inflation concerns re-emerge. Equity markets have so far taken these developments relatively calmly, suggesting investors still view the broader macro implications as manageable. Fixed income markets, however—particularly in Europe—have reacted more forcefully, highlighting the region’s structural vulnerability to energy shocks given its reliance on imported energy. **Central Banks on Watch as Rate Repricing Accelerates**

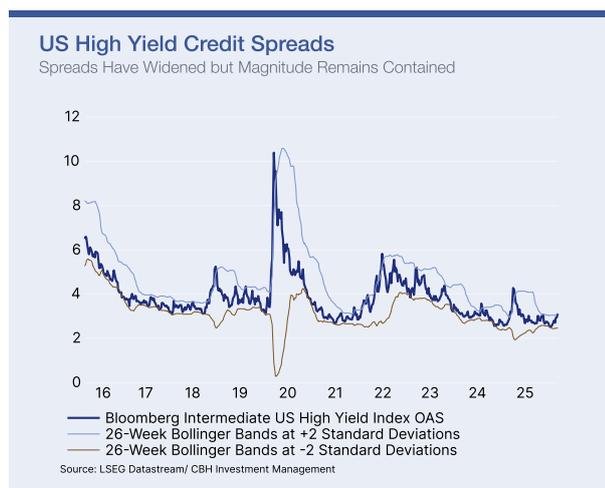
Some rate markets have rapidly repriced the outlook. In the euro zone, hawkish ECB comments have lifted pricing to around 40bps of hikes by year-end, compared with expectations of a potential additional cut before the shock. A similar adjustment has occurred in the UK, where markets moved from pricing two cuts before the war to roughly three-quarters of a rate hike currently. This repricing reflects the risk that central banks may delay easing.

Even if policymakers ultimately view the oil-driven inflation shock as temporary, their rhetoric is likely to turn less dovish, as many are keen to avoid repeating the 2022 policy mistake of starting tightening too late. At the same time, central banks face a difficult trade-off. Persistently elevated oil prices could create a stagflationary impulse, particularly in Europe due to its reliance on energy imports. Unlike the BoE and Fed, the ECB’s policy rate is already within its estimated neutral range of 1.75%–2.25%, leaving it more exposed to act if upside inflation pressures continue to build.

Credit Markets Remain Resilient but Increasingly Sensitive

Credit markets have so far remained relatively resilient with cash bond spreads remaining broadly in line with levels seen last quarter in main indices. High yield markets have experienced some widening, with spreads in both the U.S. and Europe rising by roughly 60 basis points from the January lows—more than two standard deviations above the six-month average. However, in the context of recent volatility episodes, this adjustment remains moderate, particularly compared with last year’s tariff-related shock, when spreads widened by more than 170 basis points across both regions. By contrast, more liquid instruments such as CDS indices have widened more noticeably, suggesting that investors

have increased hedging activity rather than materially reducing risk exposure.



Given our baseline scenario that the oil shock proves temporary and does not derail the otherwise benign global macro backdrop, we remain constructive on credit markets. While valuations are relatively tight, they are broadly supported by solid fundamentals at the index level and a still resilient macroeconomic environment. Any further repricing could therefore create more attractive entry points, reinforcing our positive medium-term view on the asset class. The primary risk lies in private credit and leveraged loan markets. Both have expanded rapidly in recent years and, taken together, are now roughly the same size as the U.S. high yield market. A disorderly adjustment in these segments could spill over into public credit and the wider risk complex, creating a broader shock.

Emerging Debt Faces Diverging Pressures

Emerging market hard currency debt started the year strongly before giving back part of those gains following the escalation of tensions with Iran. However, the recent pullback has been driven mainly by the rise in U.S. Treasury yields rather than a deterioration in credit fundamentals, with spreads across several markets remaining stable or even tightening. Although spreads are relatively tight by historical standards, this largely reflects the meaningful improvement in fundamentals in recent years. Reserve buffers have strengthened, current account deficits have narrowed compared with the past decade, and near-term refinancing risks remain contained following the post-Covid restructuring cycle. Market access had also been gradually improving prior to the recent geopolitical shock, with inflows beginning to return after a prolonged period

of outflows. Despite compressed spreads, all-in yields remain attractive relative to developed market credit, and we continue to maintain exposure to the asset class.

Local currency debt markets have been more sensitive to the recent geopolitical shock. Higher oil prices have strengthened the U.S. dollar, putting pressure on currencies in energy-importing economies and weighing on returns. Despite this near-term headwind, the medium-term outlook remains constructive in our view. Emerging market balance sheets have strengthened significantly in recent years, supported by improved external positions, higher reserve coverage, and stronger policy credibility across many economies. Real yields also remain elevated relative to both historical levels and developed markets, providing a meaningful carry cushion during periods of volatility. In addition, foreign participation in local bond markets remains well below past levels, leaving scope for renewed inflows once global uncertainty subsides. We maintain our medium-term conviction in this asset class.

Forex

Greenback Gains Amid Geopolitical Tensions and Oil Shock

Key Takeaways

- The U.S. dollar benefits from safe-haven demand and energy-exporter resilience, reviving the narrative of American exceptionalism.
- Sterling is constrained by energy shocks, higher gilt yields, and political uncertainty, limiting near-term upside despite improved fiscal credibility.
- The euro faces pressure from higher energy costs, a potential growth downgrade, and widening policy divergence with the U.S.
- The yen remains under stress as the BoJ's cautious stance and Japan's energy dependence keep USD/JPY exposed, with intervention risk above 160.

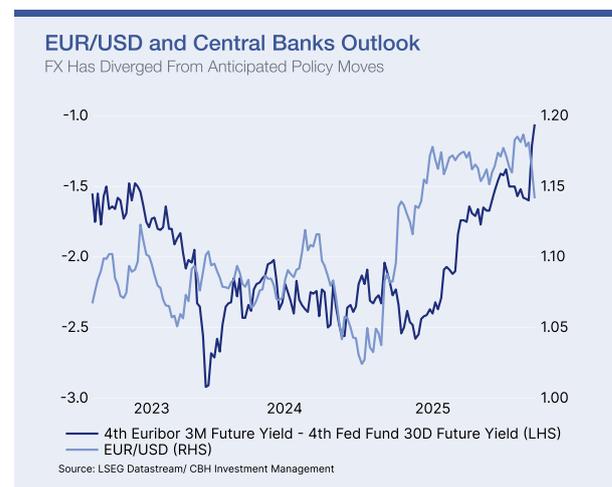
Greenback Reversal of Fortune Amid Middle East War

Geopolitics and policy responses are once again taking precedence over macro data, with the ongoing Middle East conflict emerging as the key driver of FX markets. Time is now the enemy for the macro outlook: the longer energy prices remain elevated, the greater the pressure on growth and inflation, and the more persistent the repricing of financial markets. Against this backdrop, the U.S. dollar has emerged as a clear beneficiary. Its traditional safe-haven appeal has reasserted itself amid heightened geopolitical risk, when both equities and bonds face vulnerability. Rising oil prices could weigh on global growth, particularly in energy-importing regions facing worsening external imbalances. However, the U.S., as a net energy exporter, remains more resilient than Asia or Europe, reinforcing perceptions of American economic exceptionalism. At the same time, elevated energy costs and stagflationary pressures are prompting a partial unwinding of positions in markets previously overweight Europe and emerging markets, further boosting dollar demand.

By contrast, the euro faces significant headwinds. Europe's growth narrative—previously supported by fiscal policy and historically lower energy costs—has been disrupted by surging energy prices. Softer equity markets, deteriorating real yield differentials, and the region's heavy reliance on imported energy (around 70% of needs) combine to pressure the currency.

This dynamic, together with the broader unwinding of positions in Europe and emerging markets, reinforces dollar strength.

While relative monetary policy has been the key driver of EUR/USD in recent years, we are now seeing a sharp decoupling in the current geopolitical-driven environment. Since the start of the war, rate markets have repriced both the Fed and the ECB outlooks, but the adjustment has been far more pronounced for the ECB. Nonetheless, the euro is unlikely to be supported by the more hawkish repricing of ECB policy, as European economies face a larger negative terms-of-trade impact from higher energy costs. The resulting inflationary and growth pressures are expected to weigh more heavily on Europe than the U.S., widening the policy divergence and reinforcing dollar strength.



Nevertheless, under our base scenario of a swift normalization of oil markets, we maintain our medium-term view that EUR/USD could re-extend beyond 1.20 later in the year. In the near term, however, the tactical recovery of the U.S. dollar is likely to persist, with EUR/USD already approaching 1.14. The key trigger for reversing recent dollar strength would be credible news of a reopening of the Strait of Hormuz and a resumption of energy flows. Until then, the greenback is poised to retain its recent gains.

Yen Under Pressure as BoJ Outlook Remains Uncertain

As the Middle East conflict pushes energy prices higher, the yen is under significant pressure while the U.S. dollar remains broadly supported. Japan's energy dependence amplifies the negative terms-of-trade shock, widening the import bill and reinforcing the structural link between a larger trade deficit and yen weakness, underpinning further USD/JPY gains. Higher energy costs also elevate inflation expectations, yet the BoJ is expected to remain cautious on preemptive rate hikes, keeping real policy rates low—potentially influenced by the Takaichi administration. Fiscal measures aimed at offsetting energy costs could also reignite concerns over Japan's fiscal position, which had eased following the LDP's lower house victory. Meanwhile, the yen's traditional safe-haven appeal remains muted, as limited JPY short-covering and broad USD strength constrain any defensive support.

In recent years, the JPY's near-term direction has been largely driven by the relative paths of U.S. and Japanese monetary policy. If recession risks push the Fed toward rate cuts while the BoJ continues its expected hikes, the U.S.–Japan yield differential would narrow, supporting the yen and potentially limiting USD/JPY gains. Conversely, if the BoJ pauses tightening while the Fed eases only modestly, the differential could widen, putting upward pressure on USD/JPY. In practice, this relationship is currently less predictable than in prior periods as market expectations for both central banks are adjusting rapidly, making USD/JPY sensitive to even small changes in forward rate pricing.

Since the onset of the conflict, market expectations for BoJ rate hikes have remained largely unchanged. For the April policy meeting, the market is pricing roughly 0.6 of a hike, reflecting anticipation that the BoJ will proceed cautiously while gauging the impact of higher energy prices on Japan's economy. Attention

will now turn to whether the energy shock prompts the Bank to signal a path toward additional tightening or encourages a more cautious approach that could delay further hikes. Meanwhile, if USD/JPY continues to climb despite BoJ rate checks or verbal interventions from the Ministry of Finance, focus could shift to outright FX intervention. While levels in the 160s were previously seen as a likely trigger, the current rally is driven more by broad USD strength than by yen-specific weakness, making intervention harder to justify and suggesting that the threshold for action may be higher than in past episodes.

Consequently, we raise our year-end USD/JPY forecast to 150, reflecting a base-case scenario of near-term de-escalation. In the event the conflict endures, USD/JPY could move above 160, with intervention risk likely to be priced in by the market ahead of any official action.

Sterling Vulnerable to Renewed Energy Shock and Political Risk

In our year-end outlook, we noted that the Autumn Budget would provide structural support for sterling through improved fiscal credibility, but tighter fiscal policy was expected to weigh on growth and reinforce expectations of Bank of England rate cuts, limiting near-term GBP upside. We are now turning more bearish GBP as a renewed energy shock adds to these pressures. Against this backdrop, the BoE is likely to keep policy on hold while assessing the inflation impact of higher energy prices. Although markets have scaled back expectations for rate cuts, any further hawkish shift driven by stagflationary pressures is unlikely to meaningfully support sterling. Higher gilt yields stemming from a supply-side energy shock—rather than stronger growth—would weigh on economic activity, potentially trigger tighter fiscal policy, and reinforce a familiar stagflationary dynamic, particularly given the UK's elevated vulnerability to energy costs relative to other G10 economies.

Adding to these macro headwinds, sterling has faced mounting political uncertainty over the past three months. Intensifying scrutiny of Keir Starmer's leadership amid internal party tensions and debates over fiscal rules—including the possibility of a leadership change toward Angela Rayner—has heightened market concerns about policy instability, further weighing on GBP.

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