

Q4 2025

House View

Global policy aftershocks:
challenges and opportunities

This document is for professional clients and institutional/qualified investors only.





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The House View document serves two main purposes. First, its preparation provides a comprehensive and forward-looking framework for discussion among the investment teams. Secondly, it allows us to share our thinking and explain the reasons for our economic views and investment decisions to those whom they affect. Not everyone will agree with all assumptions made and of the conclusions reached.

No one can predict the future perfectly. But the contents of this report represent the best collective judgement of Aviva Investors on the current and future investment environment.

Our House View document is a comprehensive compilation of views and analysis from major investment teams.

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Executive summary

Global policy aftershocks: challenges and opportunities

- Global policy shocks have eased, but their aftershocks – especially from US tariffs and fiscal shifts – will continue to shape growth, inflation and market dynamics into 2026.
- Artificial Intelligence investment is surging, with implications broadening across a range of sectors.
- Growth is resilient but uneven, with the US slowing, China stabilising and Europe and the UK showing modest recovery.
- Monetary policy is diverging, with the balance of risks shifting to more near-term cuts in the US, but fewer in other major economies.

Global policy disruption has been a central focus for financial markets throughout much of 2025. The second Trump Presidency brought with it a raft of policy changes that have upended decades of free trade, easy global movement of capital and people, and benign fiscal policy. The changes were so vast, the ultimate motivations so unclear and the implications so difficult to assess, that uncertainty soared and – for a period at least – financial markets swooned. However, by the late summer, the fear of descending into a global trade war subsided, with the Trump administration agreeing deals with major trading partners that raised US tariffs materially, but which brought with it a greater degree of certainty. At around the same time, the passage of the US budget delivered a set of tax and spend changes that were largely in line with expectations. Meanwhile, China pushed through further support for local industries, underpinning growth there, and in Europe, the German government delivered on a budget that agreed to a significant increase in spending to finance defence capabilities and infrastructure.



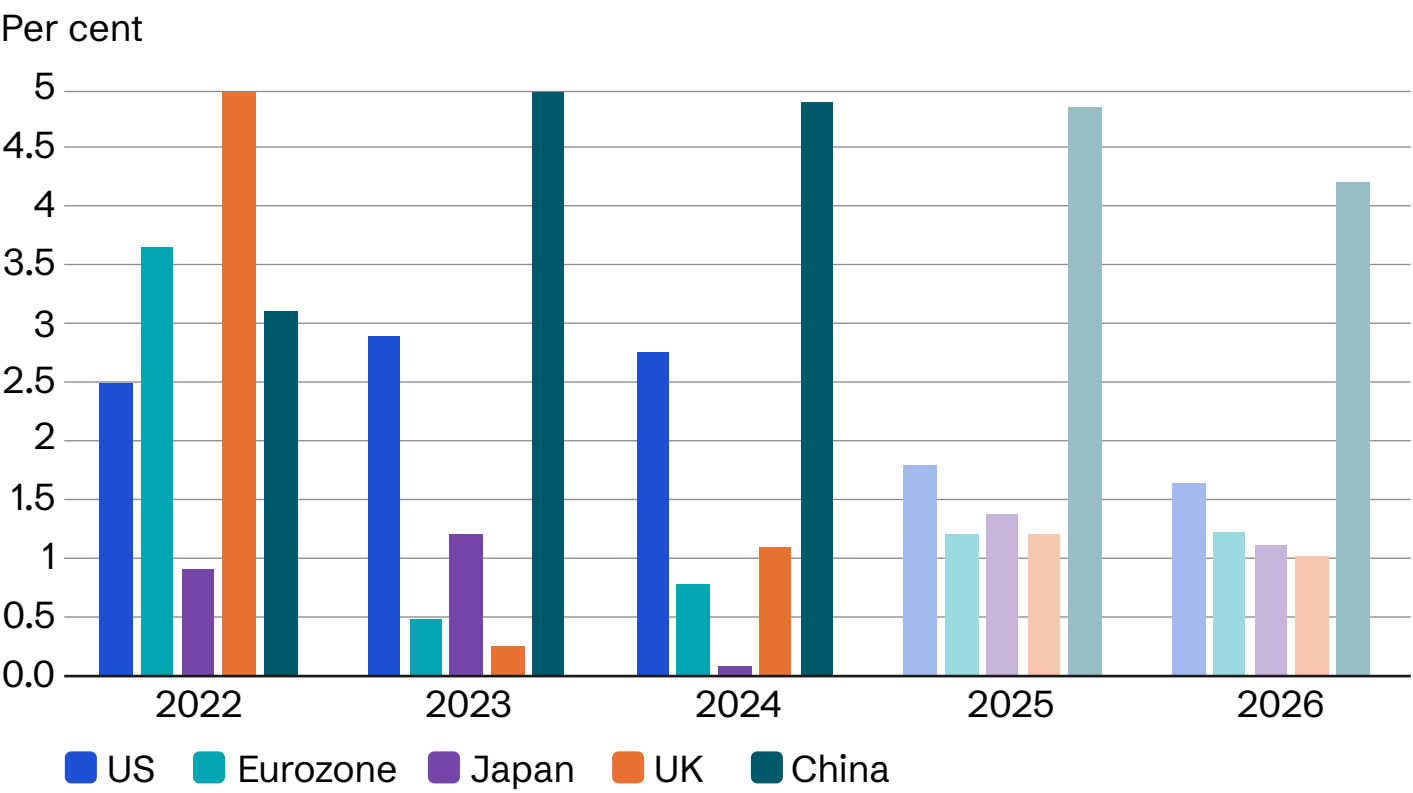
As we enter the final quarter of the year, the major policy shocks feel like they are likely behind us for now and the focus shifts to how the world reacts to the changes



As we enter the final quarter of the year, the major policy shocks feel like they are likely behind us for now and the focus shifts to how the world reacts to the changes. The aftershocks will continue to reverberate, creating challenges, but also opportunities. While the new tariff regime in the US has been largely accepted by the rest of the world, the magnitude of the change should not be downplayed. We expect an effective tariff rate of around 15 per cent in the US, a six-fold increase. We think that equates to a tax rise of around 1.5 per cent of GDP, which will have to be absorbed in combination between businesses in the form of lower profits and households in the form of higher prices and lower real spending. Much of this impact is still to come through – having been delayed by the boost in imports ahead of the tariffs and the temporarily lower tariff rates seen in the middle of the year. As such, we expect it will weigh on spending in the US through to the end of 2025 and into early 2026. Similarly, the negative impact on demand for imports will feed through to weaker export volumes with major trading partners – something that is already seen in the decline in Chinese exports to the US.

As the ongoing effects of these policies ripple out across the world, central banks will be attentive to both the downside risks associated with slow growth and weakening labour markets, alongside the uncomfortably persistent inflation seen in many economies. That trade-off is expected to be most stark in the US, where the Federal Reserve re-started the cutting cycle in September, following a pause of nine months, with another 100-150bps in cuts priced by financial markets over the next 12 months. But with inflation expected to rise and the labour market predicted to weaken, it will be the balance of those two forces that determines whether there will be fewer or more cuts than priced. We think the balance of risks are tilted more to the downside.

Figure 1. Aviva Investors growth projections for major economies



Source: Aviva Investors, Macrobond as at 30 September 2025.

One factor that is increasingly important in driving investment spending – especially in the US – and is expected to start impacting hiring decisions is the adoption of Artificial Intelligence (AI) tools, such as generative AI.

To date, the rapid build of Large Language Models (LLMs) and the associated computing power needed to train the model and use for inference has led to an estimated US \$400bn in investment in 2025, with the major tech companies announcing plans to increase investment to US \$500bn in 2026. The scale of this capex is macroeconomically meaningful and touches more than just the producers of chips, but also industrial or construction and materials companies which build the data centres, as well as the electrical equipment and energy required to run them. Surveys are now showing a rapid pick-up in adoption rates amongst businesses. However, there remains less clarity on the

Growth is resilient but uneven, with the US slowing, China stabilising and Europe and the UK showing modest recovery

potential productivity gains and related employment effects of AI technology. So far there is tentative evidence that hiring decisions are being impacted in those sectors with the highest adoption rates. We expect the AI thematic to become a significant macroeconomic driver in the years ahead, with the equity market implications broadening out from the chip makers and hyperscalers.

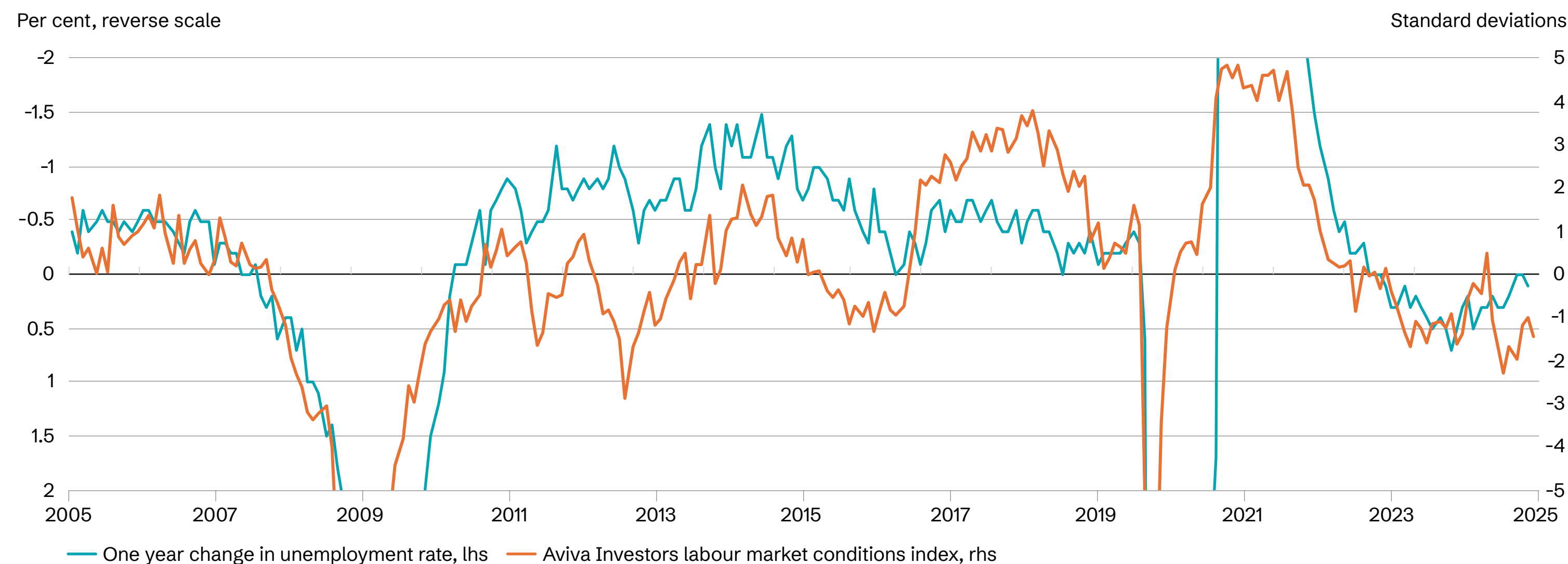
Turning to our economic outlook, we expect global growth of around 3 per cent in 2025 and 2026, a modest upgrade on our earlier projection, which mainly reflects a somewhat less negative impact from tariffs on growth in the US and elsewhere. That said, we expect growth in the US to be markedly weaker than in 2024, rising by 1.8 per cent for the calendar year (Figure 1) and only 1.5 per cent in Q4 compared to a year earlier. Growth is then expected to recover to around trend.

However, as we outline in the *Themes and Risks* section, a key downside risk to the US outlook is if the recent weakening in the US labour market worsens, and the decline becomes self-perpetuating. Using a statistical approach of combining the information from 13 different labour market surveys, the present situation looks somewhat worse than the increase we have seen so far in the unemployment rate (Figure 2). If the unemployment rate were to rise by 0.5-1pp, it would likely require deeper cuts by the Fed, which in that scenario would be perceived to have fallen behind the curve. That could weaken the dollar and put pressure on risk assets.

We expect growth in China to be close to the target of 5 per cent, but the mix remains problematic, with the state-supported manufacturing sector booming, while the real estate sector remains in long-term decline and consumers cautious. High saving rates and oversupply have driven consumer inflation down to zero, while producer prices are falling. In the Eurozone, we expect growth of 1.2 per cent this year, a little above consensus, with domestic demand reviving as consumer spending improves. The fiscal impulse should grow in 2026, supporting slightly better growth next year. While the UK saw growth surprise to the upside early this year, household demand remains anaemic and investment weak. We expect growth of 1.2 per cent this year, with next year remaining sluggish. The Budget in November is expected to deliver further tax increases, adding to the growth headwinds.

Inflation in the US has picked up in recent months, in part reflecting the start of tariff pass-through, though that impact remains relatively modest so far. We expect CPI inflation to continue rising in the coming months to around 3.5 per cent

Figure 2. US labour market conditions have weakened



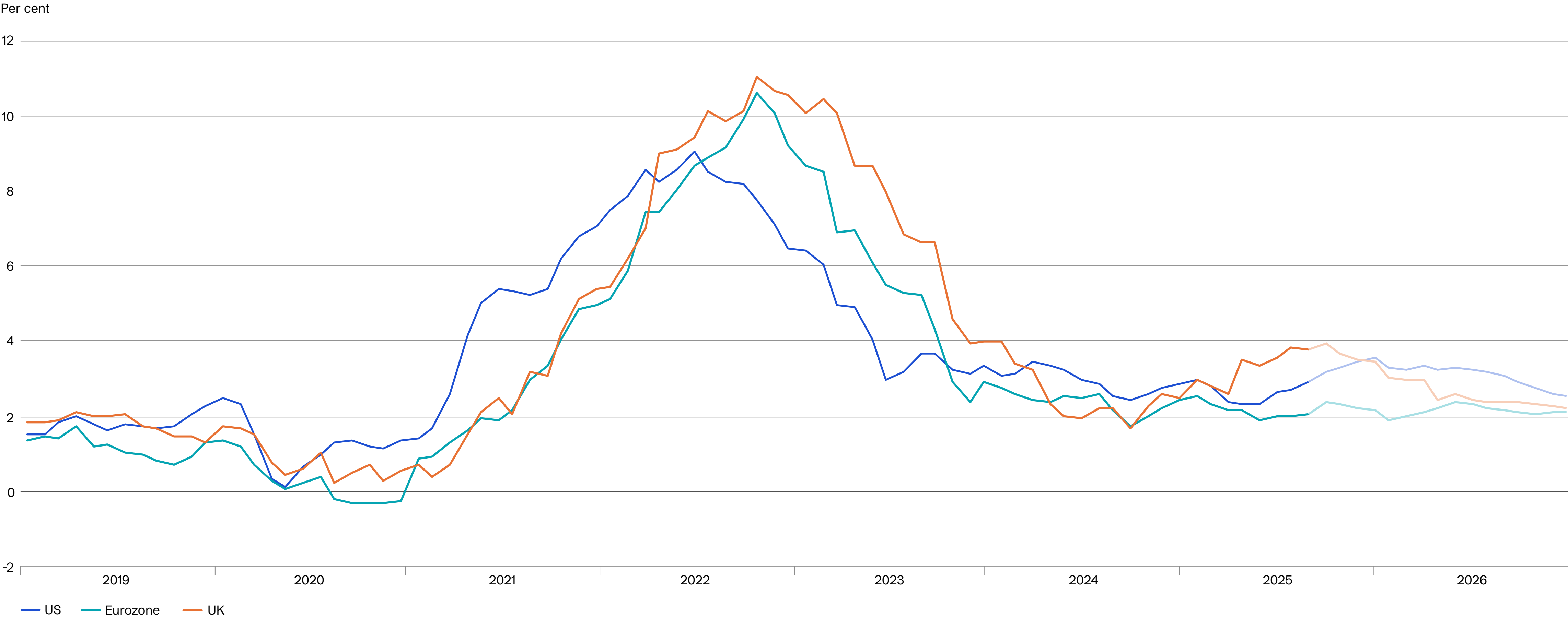
Source: Aviva Investors, Macrobond as at 30 September 2025.

(Figure 3), of which around 1 percentage point is expected to come from tariffs. We expect inflation will slowly head back towards 2 per cent in 2026 as underlying pressures ease and tariff effects drop out. In the Eurozone inflation is at target and expected to remain near 2 per cent through to the end of 2026, while in the UK energy, administered and indexed prices pushed inflation up to nearly 4 per cent. Those effects should drop out over the next six months, while core services inflation is expected to ease further as a softer labour market weighs further on wage growth.

Given the growth and inflation backdrop, as well as the balance of risks around those, we expect the Federal Reserve will reduce its policy rate to 3 per cent over the next six months, but with the risk tilted to them having to do more than that. We think that the European Central Bank (ECB) is done with rate cuts and expect the market to start thinking about the timing of the first rate hike towards the end of 2026. We expect the Bank of England (BoE) to reduce rates to 3.25 per cent by mid-2026, but with a risk of a slower speed initially, ultimately resulting in the need for somewhat deeper cuts. We expect the Bank of Japan to continue to be the outlier, with a rate rise in Q4 this year and one or two more next year.



Figure 3. Aviva Investors inflation projections for major economies



Source: Aviva Investors, Macrobond as at 30 September 2025.



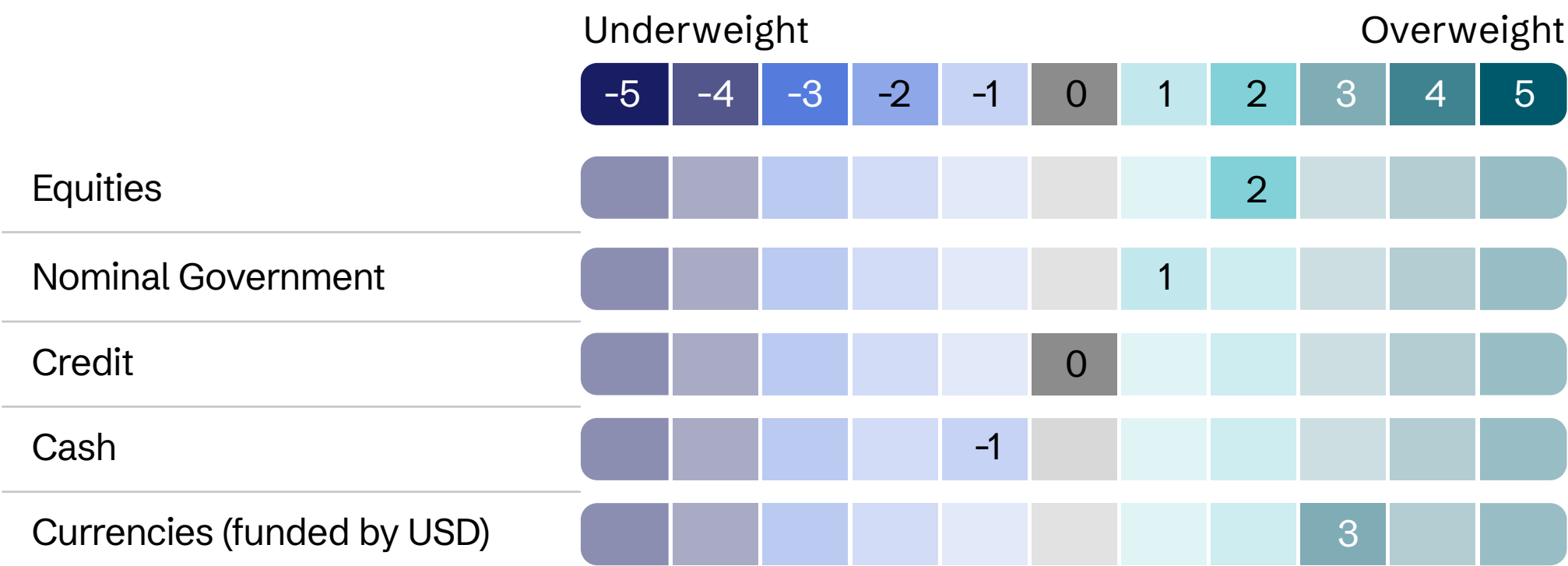
Turning to our asset allocation views, with the major policy events likely behind us, the market must now digest how the aftershocks play out. For global equity markets, we think the central scenario of slower growth, but not recession, alongside easier monetary policy and a number of thematic drivers should continue to support returns.

The AI thematic remains the dominant one and is a key driver for US equities in particular, but with the theme broadening, other sectors and geographies can start to benefit. We prefer to be overweight (Figure 4), with a relatively broad geographical allocation. That said, we are conscious of the growth and inflation risk cases, either of which would be challenging for equity returns were they large enough.

Within fixed income, we think that front-end pricing is roughly fair for the central scenario and that term premia could widen further on rising global issuance and perceptions of risk to Fed independence. That said, we think the downside growth risk is sufficient to have a small overweight in duration. In credit, the central scenario is again one in which already tight spreads will be unlikely to widen much even as ex-ante returns look increasingly meagre. But with limited upside we prefer to be neutral. Finally, in FX we continue to expect the dollar to weaken, with hedging flows a key factor, supported by narrowing rate differentials.

For global equity markets, we think the central scenario of slower growth, but not recession, alongside easier monetary policy and a number of thematic drivers should continue to support returns

Figure 4. Asset allocation summary table



Note: The weights in the Asset allocation table only apply to a model portfolio without mandate constraints. Our House View asset allocation provides a comprehensive and forward-looking framework for discussion among the investment teams.
Source: Aviva Investors as at 30 September 2025.



Key investment themes and risks

1

Adjustments after the
policy shocks

2

AI's impact broadens
across markets, sectors,
and economies

3

US upheaval widens

1. Adjustments after the policy shocks

On a global level, policymakers and businesses alike have had to process a number of major disturbances in early 2025. Economies and markets are digesting and adapting to these changes.

First and foremost was the extreme uncertainty of US tariff levels and who would be hurt by these import taxes (or helped by their protection), whether and when they would or would not be imposed, if there would be retaliation or not, and if some essential components such as rare earths and magnets would continue to be available to those that sourced them from China. After front-loading imports to build inventories and re-routing of certain supply chains, the tariffs on transhipped goods, combined with tariffs being imposed on China by Mexico, India, Brazil, and others are likely to weaken global demand for some goods alongside China's continued manufacturing supply surge.

Fiscal expansion in the US, Europe, and Japan has pushed up growth, inflation, and yields

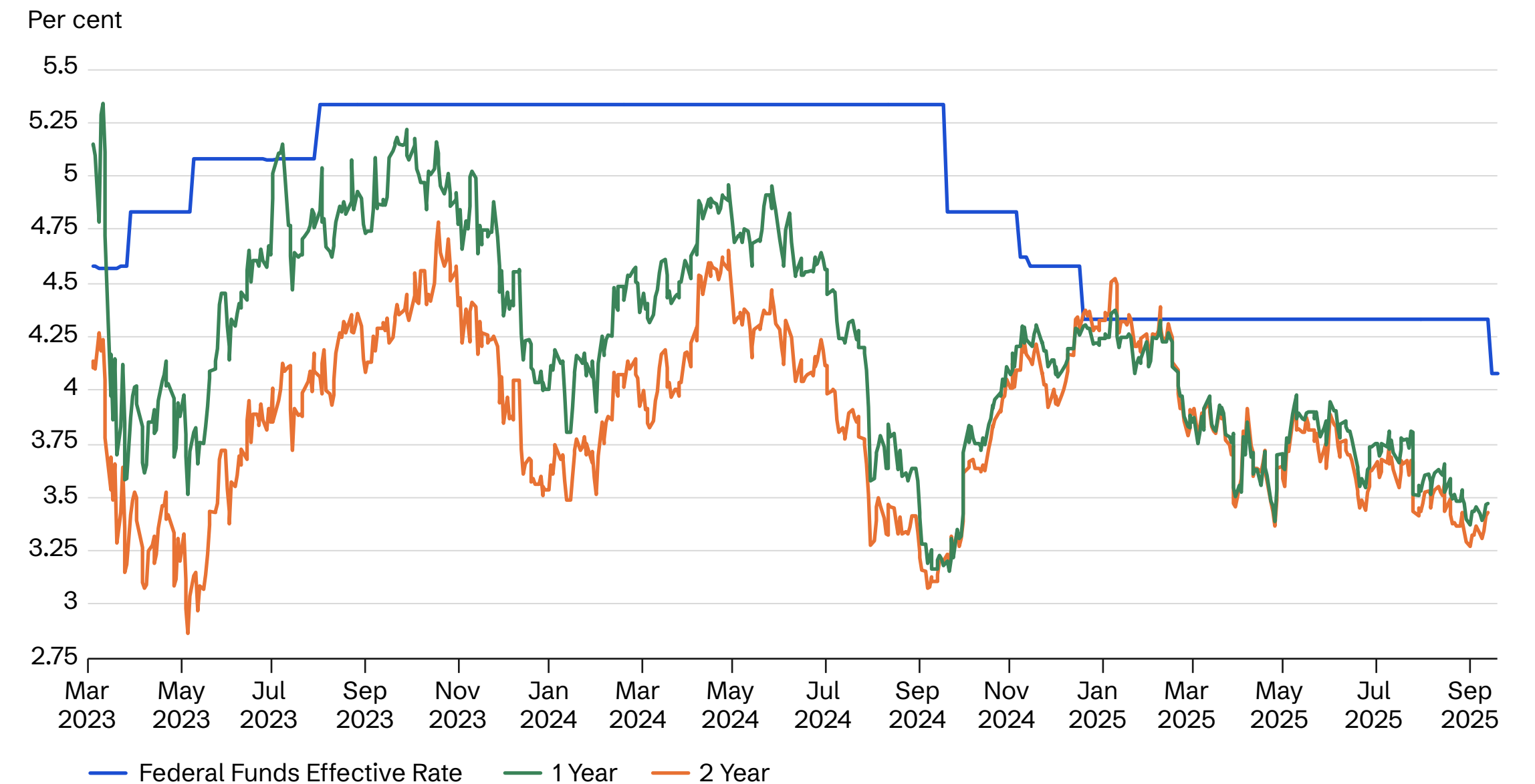
Outside of the US, Japan and France both have governments under stress after election losses, and will end the year under partly new, untested leadership. In Europe, the shake-up of German politics and the realisation that the US relationships with erstwhile allies is permanently altered has also led to some soul-searching. So far this has resulted in a forceful set of promises for action and money, for defence and infrastructure at a minimum – not just in Germany but on an EU-wide level. Raised government spending levels pushed up yields, and we expect these choices to lift structural growth and inflation and offset some of the tariff damage. More importantly, after two decades of damaging underinvestment that has weakened growth prospects (OECD, June 2025) there are real hopes that both public and private capital accumulation will enable lasting productivity gains.

Alongside the EU’s fiscal expansion, the US budget was passed earlier than expected, with front-loaded tax cuts partially funded by benefits slashed in later years. We expect to see the impact of hundreds of billions of dollars’ worth of tariffs combined with tax cuts wash through into inflation and growth in the coming quarters. This will likely raise US inflation, already around 3 per cent, complicating the Fed’s job to deliver on both parts of its dual mandate.

Aside from the impact of protectionism and isolationism, which were important parts of the US’s exceptionalism eroding discussed in the previous House View, net job creation has flatlined and revisions repainted the picture of a solid labour market. For the fourth time in 2 ½ years, markets expect a major Fed rate-cutting cycle to “neutral” (Figure 5), with other central banks also expected to keep easing policy (except for the SNB and ECB, which are probably done adjusting their policy rates).

Our expectations are that, thanks to fiscal policy loosening in nearly all Developed countries, the AI-driven bonanza for US technology firms and Asian tech exporters, and previous removal of most monetary restrictiveness, recessions will be avoided. But there are two-sided risks, both on the downside if growth slows, or to the upside if the soft patch proves ephemeral and investment booms and wealth effects reignite demand-side pressures.

Figure 5. Fourth time’s a charm? Markets are pricing in cuts again, having jumped the gun three times in three years.



Source: Aviva Investors, Macrobond as at 30 September 2025.

For the fourth time in 2 ½ years, markets expect a major Fed rate-cutting cycle



2. AI’s impact broadens across markets, sectors, and economies

The AI investment boom has surpassed expectations

High valuations and elevated concentration levels in equity markets have left many market participants sceptical on the Artificial Intelligence thematic. While we share some level of doubt about the more excessive estimates of the impact of AI, on the whole we believe the theme is an extremely powerful one and will be a positive tailwind for markets for years to come.

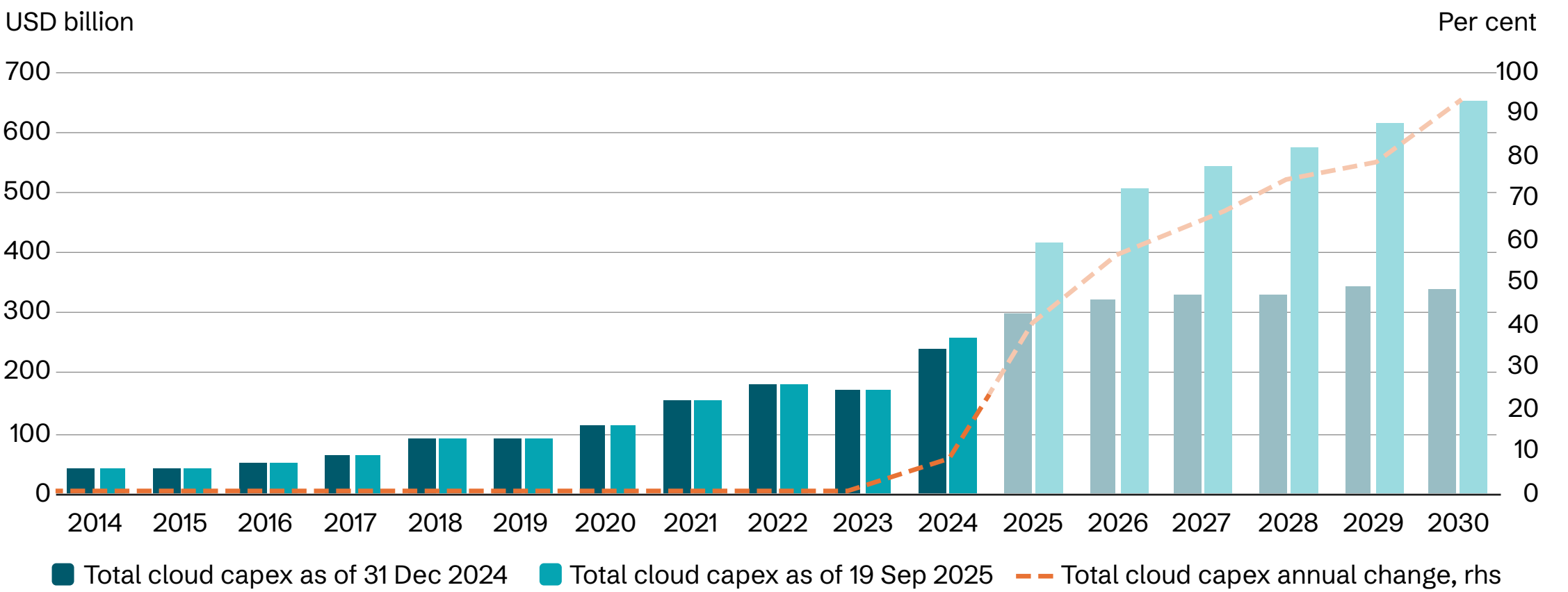
Business commentary and commitments, actual cash earnings, government initiatives, a strong capex cycle and positive impacts on productivity and margins all provide support to the AI theme. Moreover, while so far the returns may seem clustered around a small group of mostly US and mostly tech companies, both the investments of the “hyperscalers” and the productivity potential of the technology are already showing signs of benefiting a much wider group of firms.

Part of the scepticism comes from concerns about the sustainability of the investment cycle. But so far such concerns have been quashed (Figure 6). Hyperscalers have reaffirmed their commitment to spend very large sums on AI-related infrastructure. Total cloud investment capex in 2025 is circa USD 400 billion; this far exceeds the estimates made at the end of last year which pointed to circa USD 300 billion. Projections approach half a trillion dollars in 2026 and surpass that level from 2027.

Such immense investments – in excess of 1 per cent of US GDP – have broad ramifications for the economy and markets, as the capex spending becomes revenue for companies along the supply chain. This first-order effect is only related to the direct investments in technology infrastructure, before any considerations into productivity gains from the actual use of technology, which we discuss further below.

AI investments and productivity gains already show clear signs of benefiting a much wider group of companies than just the “hyperscalers”

Figure 6. Cloud capex continues to exceed expectations



Source: Aviva Investors, Bloomberg as at 30 September 2025.



The AI supply chain – one company’s capex is another company’s revenue

The investments in AI infrastructure are broad and expand far beyond buying chips from semiconductor companies. Construction and materials and many industrial conglomerates and machinery companies are also clearly paramount to the burgeoning build-out of data centres, and many more areas benefit too: electrical equipment companies provide transformers, cooling systems, routers, etc; tech hardware companies provide the IT components; utilities companies provide the energy to power it all. There are spill-overs to less-discussed areas such as real estate and insurance, too. All of those sectors (and others, this is not an exhaustive list) are gaining, and will continue to benefit, at least for the medium term, from the large magnitude of investments into the AI/cloud infrastructure ecosystem.

While one should be careful not to exaggerate those benefits, we should be equally careful not to neglect their growing impact. The utilities sector is a perfect example: on one hand we should not overstate the impact of data centres as they remain a small component of total global electricity demand. But it would be a mistake to dismiss or disregard it, as this contribution is increasing rapidly (12 per cent per year since 2017) and at the regional level, in areas such as Northern Virginia or Ireland, demand is already very significant. Overall, utilities companies are likely to experience a continuous tailwind via a progressive increase in energy demand over the coming years. Even as other consumers may face higher prices, this provides a pillar of support for the sector, all else equal.

AI “power users” – who may benefit first from the technology?

Beyond the conversational AI and image generation tools which are rapidly being adopted, use cases for productivity gains in goods and services are still mostly anecdotal. But we already clearly see a few ways in which companies that are “first in line” are applying and extracting benefits from AI. A major defining factor in our view is data; companies that deal with and have large pools of data are likely to see a clear AI investment case earlier on.

So far we have seen software companies at the forefront, using AI to produce code that was previously done by human programmers. This is proving an opportunity for certain companies while also becoming a disruptor to others within the sector, as well as a force that lowers barriers of entry and allows smaller companies to compete at a larger scale. Other areas where we can see most examples of tools being applied and generating returns so far also tend to focus on data intensive areas such as online retail, financials, pharma & biotechnology, etc.

Companies that deal with and have large pools of data are likely to see a clear AI investment case earlier on



Even before we consider the potential productivity gains from the use of AI tools, the powerful AI capex cycle already underway is having a strong positive impact on the economy and markets



Thoughts on macroeconomic measures of productivity

Broadly speaking, one can break down labour productivity into two forces: “capital deepening”: a measure of the quantity of inputs available to workers, and “total factor productivity”, or TFP: how efficient workers are with these inputs. The first is easier to measure directly and effectively represents the capex investments we discussed above.

The impact of AI upon the second driver, TFP, comes from three main channels: i) automation of tasks, ii) augmentation of worker abilities (i.e., analysing larger amounts of data, better and quicker decision making, etc), and iii) development of new professions/industries.

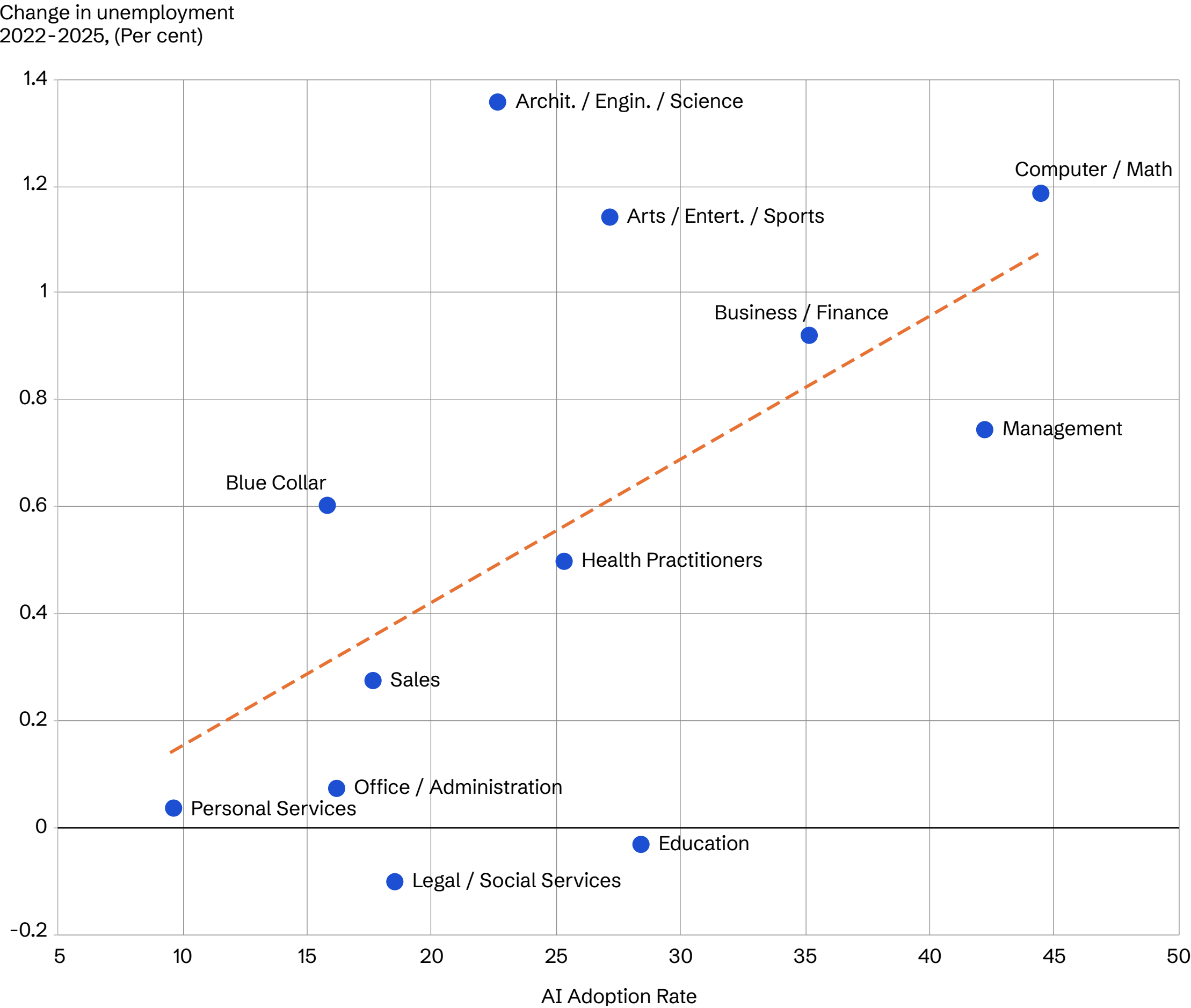
AI abilities are expanding at a rapid pace and so-called “hallucination” rates (when large language models “make up” an answer that is not based on facts) have continued to fall¹, though the error rate remains another cause of scepticism for some observers – humans, of course also make mistakes, both intentionally and unintentionally, so the bar for AI adoption perhaps should not be to completely eliminate hallucinations, but simply to make fewer errors than humans do. The extent of AI developments, and how it is perceived by society and regulators, is critical for adoption rates and hence in determining the impact on the economy.

Adoption rates also give us further confidence as the Real-Time Population Survey² suggests AI adoption is outpacing that of comparable periods of technological advancement. Additionally, a recent New York Fed study³ implies that c.40 per cent of US services firms are AI users thus far in 2025, as are c.25 per cent of manufacturing companies, implying both a fast pace of adoption and considerable amount of further room to run.

This same NY Fed survey implies that AI usage is impacting hiring decisions. Whilst hard to disentangle from ongoing cyclical gyrations, there is now evidence that AI usage may be impacting unemployment in sectors with greater adoption rates (Figure 7) as well as data to suggest youth employment is being negatively affected. Software/IT companies mentioned above stand as a prime example, for whom job postings have fallen well below their pre-Covid levels. This can be disruptive, but job losses from invention and progress have always gone hand in hand with improvements in productivity, and have also always been a perennial worry since the industrial age.

1. [AI Hallucination Report 2025: Which AI Hallucinates the Most?](#)
2. [Real-Time Population Survey](#)
3. [Are Businesses Scaling Back Hiring Due to AI? - Liberty Street Economics](#)

Figure 7. Some early signs that AI adoption is impacting employment



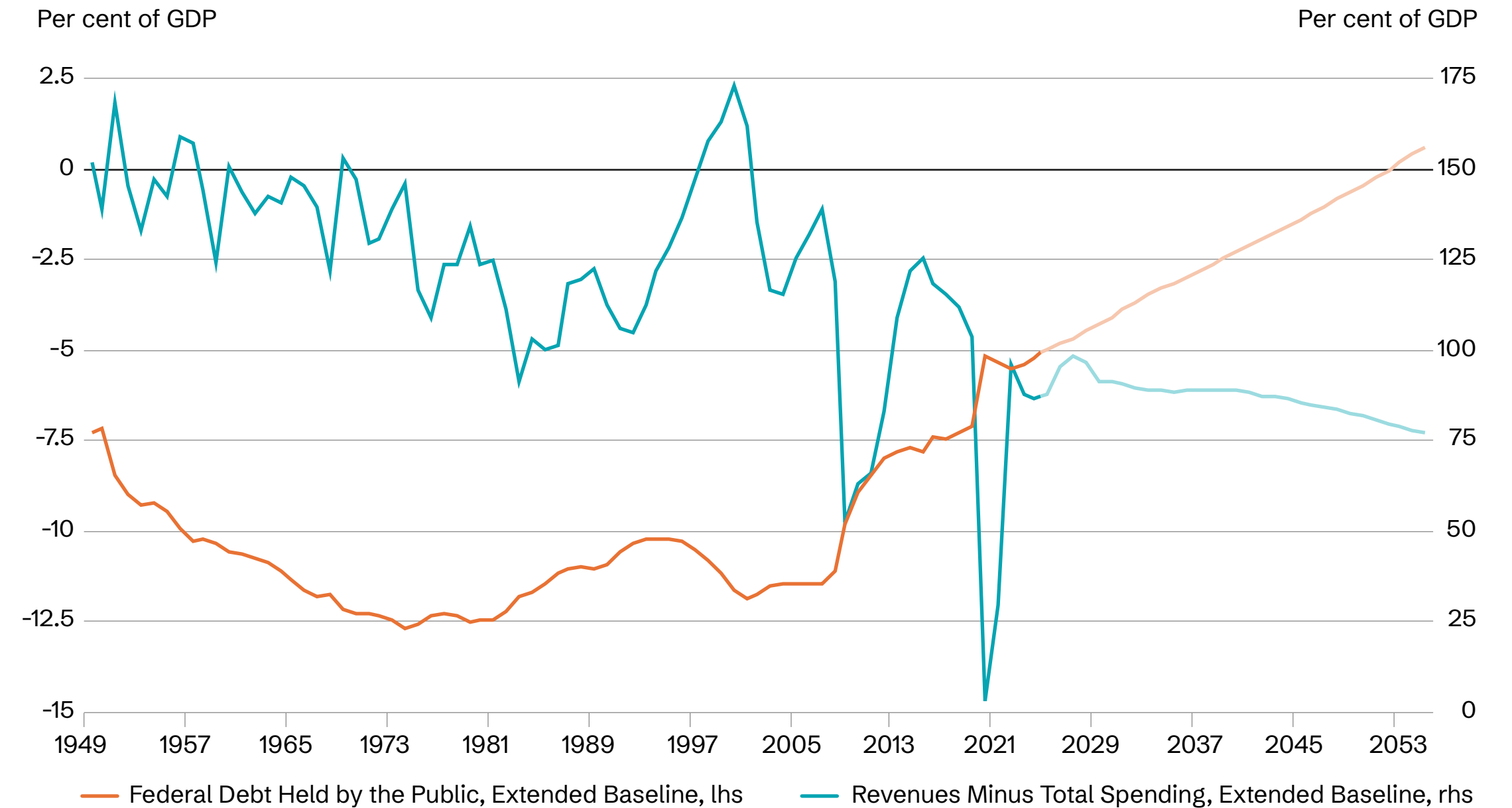
Source: Federal Reserve Bank of New York as at 30 September 2025.

3. US upheaval widens

The first eight months of “Trump 2.0” have been a non-stop flood-the-zone torrent of projects for 2025 and beyond. The One Big Beautiful Bill Act had front-loaded benefits for many households and investors, but also removed many federal workers and regulators and cancelled Biden-era contracts, grants, and subsidies. Student loans have been un-cancelled, immigration curtailed, and ICE raids have ramped up just as the labour market data have been revised down sharply and inflation pressure returned. Officials daring to bring differing views, or just reporting statistics, whether on science, job numbers, or foreign policy, have been forcibly removed. As usual, worries about the debt (either genuine or just posture) by officials before the election disappeared once in office: US federal debt is big (about 100 per cent of GDP) and getting bigger, while 6 per cent deficits will not be reined in significantly (Figure 8). General government deficits, including state and local, are now estimated by the OECD to be in the order of 7.5 to 8 per cent over the next few years, and will grow further afterwards. Even being agnostic about the necessity or advisability of the spending and tax levels, the borrowing will be huge, and the markets – yields, asset swaps, exchange rates, inflation – will have to accommodate the deluge.

In a broader context, the deconstruction of the regulatory state doesn’t just reduce bureaucracy and burdens of paperwork, but rolls back protection for consumers and the public, with complex consequences for profits (e.g. alternative energy projects) and competition. The Supreme Court’s ruling on how much independent action federal agencies can take when not explicitly spelled out by Congress seems to limit federal power, and many other court rulings have gone against the more aggressive actions of the executive. The constant attacks on the Federal Reserve are one of the most serious manifestations of the broader institutional erosion taking place; fair and balanced treatment for businesses, both foreign and domestic, is being questioned by many. We continue to expect an increased US risk premium to manifest itself in steeper yield curves (the level being more a function of the Fed and the business cycle) and the dollar weakening in order to clear the supply of US borrowing with the demand from foreign buyers and their desired hedge ratios; this is similar in some respects to past heterodox policies or politicisations in many Emerging Markets. As mentioned above, France, the UK, and Japan also are grappling with difficult political challenges, and negative repercussions in bonds and yield curves; see our Market Outlook section for a further discussion.

Figure 8. The US debt trajectory is up, up and away



Source: CBO; Aviva Investors, Macrobond as at 30 September 2025.

The first eight months of “Trump 2.0” have been a non-stop flood-the-zone strategy of projects for 2025 and beyond



“Upside inflation risks and downside labour market risks leave central banks with a difficult trade-off to manage.”



Michael Grady
Head of Investment Strategy
and Chief Economist



Risks

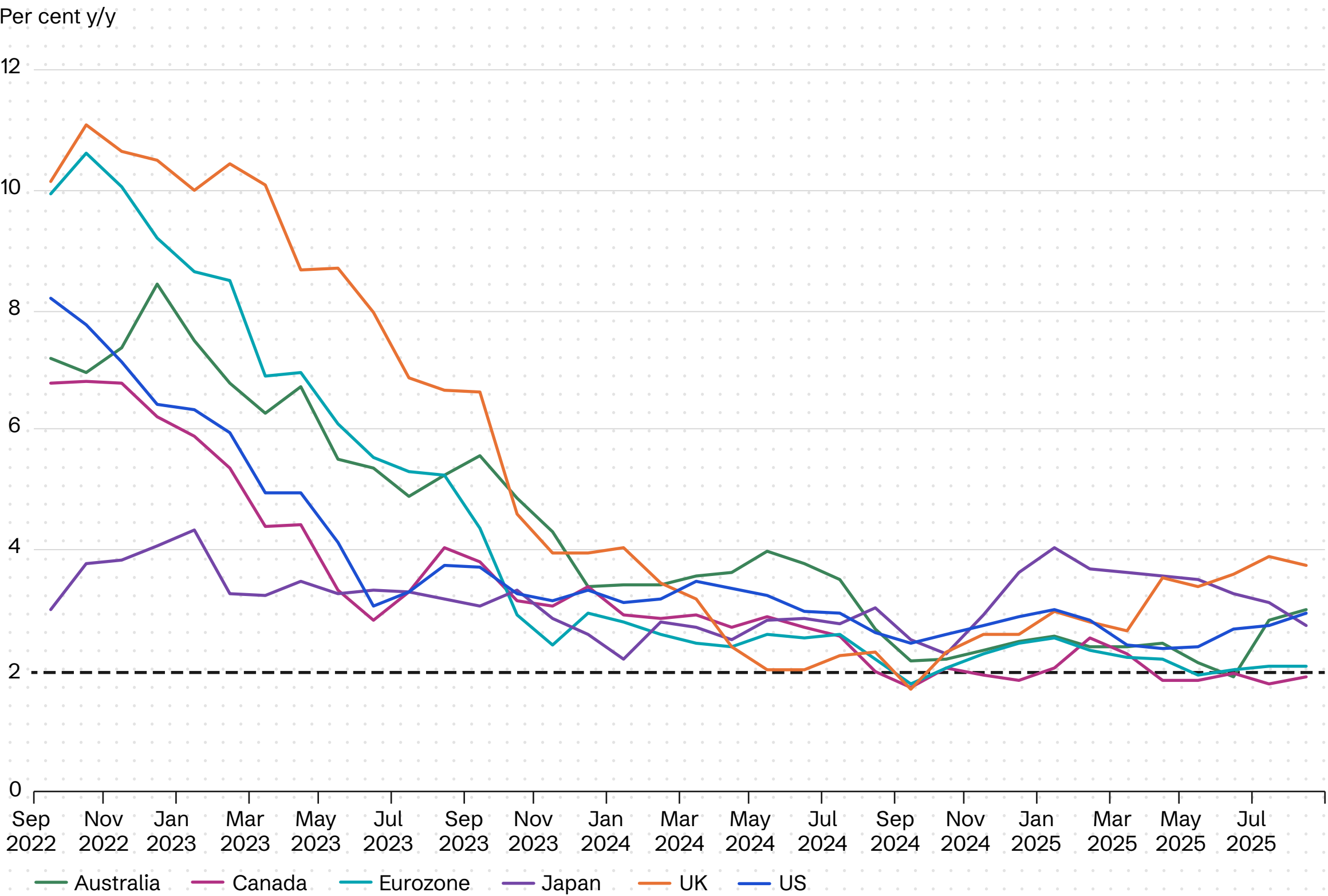
Inflation is non-transitory

In 2021-22, global inflation trends were vastly underestimated – including by us, though our House Views were consistent in projecting price rises above consensus and highlighted major risks. After Covid, inflation rose to 4-5 per cent, but instead of coming down towards 3 per cent, inflation rose further, and was only “transitory” after central banks collectively pulled the handbrake, slowing growth and rattling bond and equity markets.

The causes were well understood: fiscal and monetary easing on a massive scale, labour shortages as demand came back, and supply chain issues due to the travel and shipping disruptions. Then Russia’s invasion caused an energy shock on top of it all. Although less severe at present, inflation remains a problem, and in many countries the expected progress towards targets has failed to materialise. The “last mile” is proving most difficult, partly because central banks optimistically cut interest rates proactively, to decrease risks of slowing growth too much. Is the consensus complacent, expecting tariffs to be a transitory price adjustment? Fiscal policy is as loose as ever, and precious metals’ record prices may also signal a possible risk. Central banks insist on easing carefully, but as the charts below (Figure 9 and Figure 10) show, inflation keeps surprising, driven mainly by goods, despite some early evidence of labour slack.

If above-target inflation fails to be transitory, central banks ought to keep rates restrictive or hike rates; this is not priced in and would, like early 2025, be a shock to bond markets and likely have consequences for currencies and equities. Should this scenario be realised together with labour market deterioration, particularly in the US, where recent data has been shaky, the Fed or other monetary authorities will have a difficult if not impossible balance to strike.

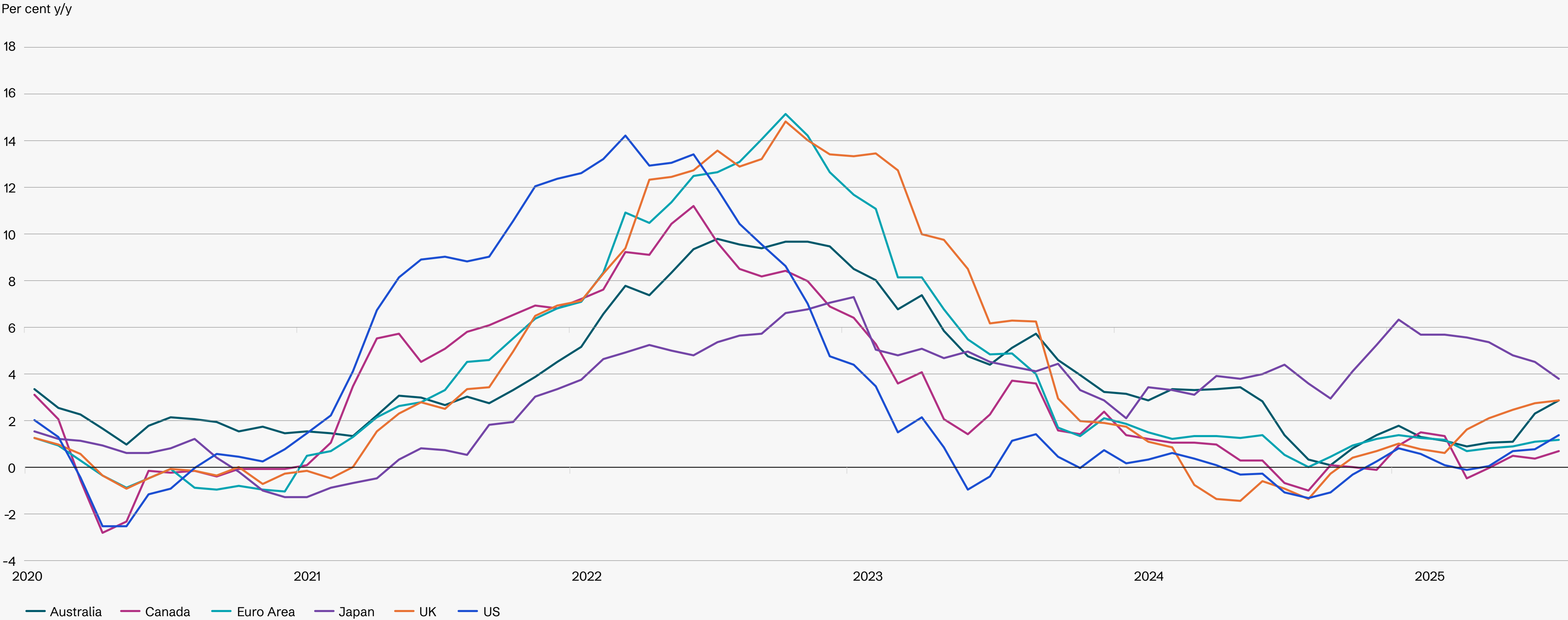
Figure 9. Inflation (Headline CPI) is close to target, but rising in some developed markets



Source: Aviva Investors, Macrobond as at 30 September 2025.



Figure 10. Goods inflation shows a more pronounced upward trend



Source: Aviva Investors, Macrobond as at 30 September 2025.



US labour market deteriorates

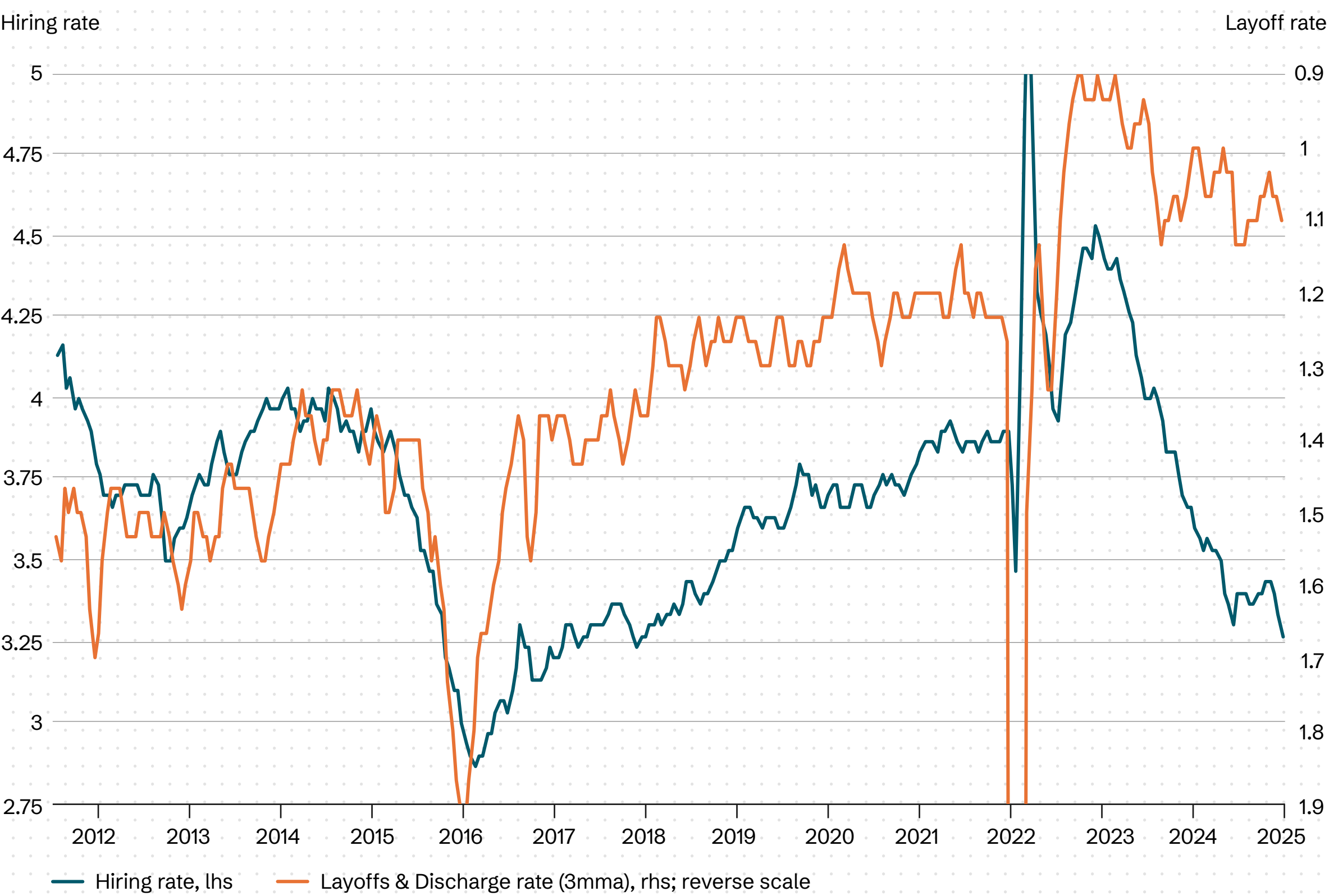
Both unemployment and layoffs remain historically low in the US, but hiring of new workers has also been subdued for several quarters, and threatens to shift lower still (Figure 11). When the economy was running at above-trend growth, such a balance did not seem much cause for concern, but now this environment has changed and so too have the risks for the Federal Reserve to achieve its employment mandate.

One aspect of the evolution in the balance of risks is depicted by economists in the Beveridge curve, which considers the relationship between vacancies and unemployment. This perspective supported the idea that the overheated labour market post-Covid could be cooled off without a large rise in unemployment. Now, after the period of extreme labour market tightness has passed, we are returning to a more “normal” relationship where unemployment becomes more sensitive to changes in vacancies. Underemployment (U6)⁴ has meaningfully risen to 8.1 per cent since its 2023 trough, with nearly half of the move coming in 2025, and hiring rates have plummeted to depths not normally seen outside of recessions. This suggests the US labour market is approaching the point where weakness in growth may cause layoffs to start to pick up, driving further unemployment at an increased pace.

Unemployment is still low yet the US labour market has transitioned into an increasingly fragile state

4. A broader measure relative to the standard U3 Unemployment measure, encompassing those “willing but unable to find work”

Figure 11. Whilst layoffs seem manageable at present, hiring has plummeted



Source: Aviva Investors, Macrobond as at 30 September 2025.



The pace of job gains has been, without question, diminishing. Since the end of 2025 Q1, the three-month average pace of non-farm payroll gains has fallen from over 100,000 to just under 30,000 jobs per month, with the first bout of negative job growth this cycle occurring in June 2025. Moreover, the dispersion of job gains has continued to narrow with gauges of employment breadth at levels consistent with past recessions. While concerning, this may be not be as dangerous as it first seems.

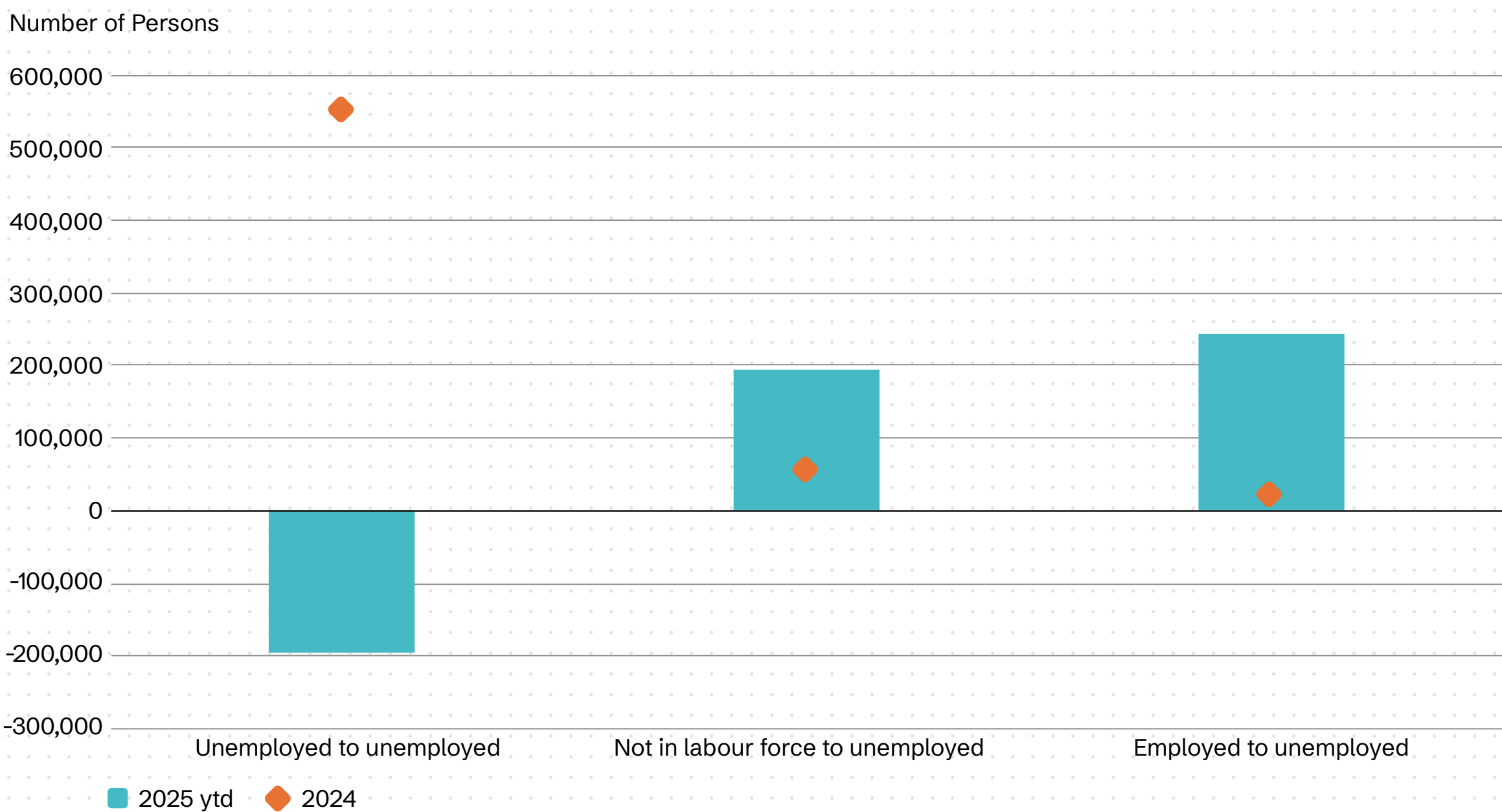
Indeed, the seismic change in migration flows arguably renders the non-farm payrolls measures inadequate, if not obsolete, as an indicator of labour market health. This is due to the uncertainty regarding estimates of the “breakeven” number of payrolls⁵, owing to a lack of completeness in the migration data.⁶ Many economists – and more importantly, the Federal Reserve decision makers – judge that the unemployment rate is a superior gauge of labour market slack.

Given the higher foreign participation rates, the surge in migration likely explains much of the rise in unemployment last year (and slightly paradoxically, some of the large NFP gains, too.) Foreign-born unemployment rates surged in 2024, consistent with the narrative of migrants flowing into the labour force but not being immediately hired. The abrupt cessation of net migration flows should bias the participation rate downwards, and means that lower hiring numbers won’t necessarily increase unemployment as they would when the total labour force is growing robustly.

There is some more cause for concern when we look at what has caused the unemployment rate rise recently: it appears that flows out of employment are the main driver of unemployment gains thus far this year, according to the BLS’s Central Population Survey (Figure 12). Although there may be nascent signs of a pickup in activity elsewhere in the economy, the current fragile state of the labour market and its non-linear nature likely skews risks to the downside. In our central scenario where the US economy continues to grow below trend throughout the rest of the year, these risks will likely only build.

5. The number of jobs in a particular month that an economy must add to keep the unemployment rate constant.
6. Using current estimates of Latino participation rates, cumulative Southwestern border control encounters since 2022 imply a cumulative c.5.5m inflow of foreign workers into the US labour force. This implies a 1m shortfall in potential workers due to the undocumented nature of the migration surge.

Figure 12. US labour market flows into unemployed



Source: Aviva Investors, Macrobond as at 30 September 2025.

Should the US economy continue to run below trend, risks of a more pronounced fallout in labour markets will build



Macro forecast charts and commentary

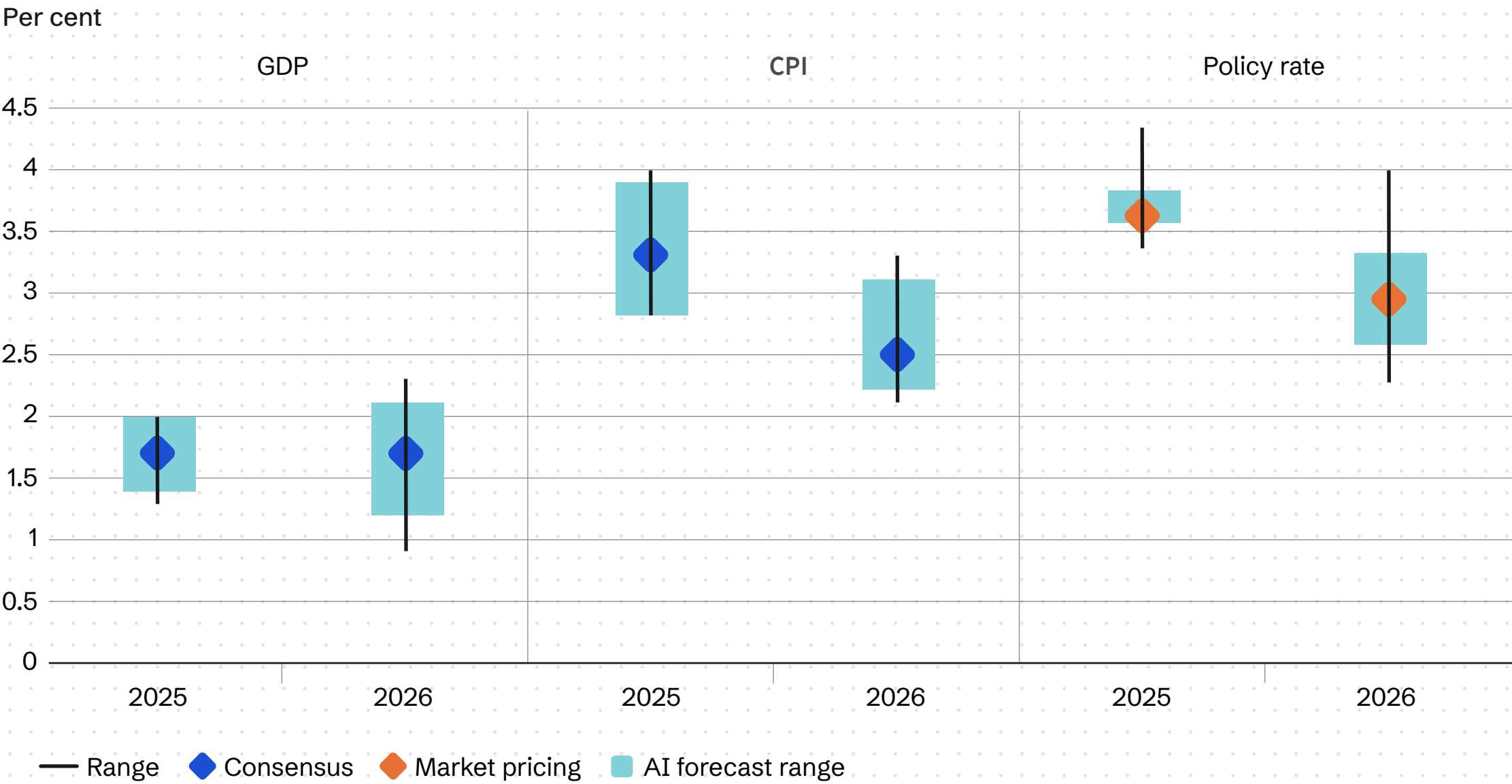
US

Late-cycle risks emerge as Fed rate cuts restart

In 2025 H1, growth in the US slowed to around 1.6 per cent annualised. Outside the COVID period, it was near the slowest pace of growth in a decade. That slowdown largely reflected a sharp retrenchment in the pace of consumer spending, as real disposable income growth remained moderate and personal saving rates increased. The uncertainty created by tariff policies weighed on sentiment and resulted in a more cautious consumer. That was despite very little of the inflationary impact of tariffs being passed through to consumer prices through to the end of June. Indeed, even through to August, the impact of higher tariffs – where the effective rate has settled close to our expectations of around 15 per cent – has likely only raised inflation by a few tenths of a per cent so far. The delay in pass-through likely reflects a combination of factors: the stockpiling of inventory in Q1 (imported ahead of the tariffs) still working its way through the supply chain; the uncertainty about the end-point for tariff rates and therefore company pricing decisions; and healthy corporate margins acting as a short-term shock absorber. We expect those factors to diminish in the coming months and ultimately expect inflation to be around 1pp higher due to tariffs. That will weigh on real disposable income and we expect will restrain consumer spending in H2.

The pressure on households is also expected to increase with a continuation of the recent weakening in the labour market. The unemployment and underemployment rates have both picked up in recent months, reflecting a marked slowdown in jobs growth and despite a softening in labour supply at the same time. Typically, employment growth follows activity closely and as such, the recent softness should not come as a surprise.

Figure 13. US



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.
Source: Aviva Investors, Bloomberg as at 30 September 2025.



However, it has been a key factor in bringing the Federal Reserve back to the table: the central bank restarted rate cuts in September, having been on hold for the past nine months. With the risks to growth tilted to the downside, there is a possibility that we see outright declines in employment and a more rapid rise in the unemployment rate. That risk has appropriately led to a shift in pricing for a faster pace of rate cuts over the coming months, reaching a modestly accommodative level. In our central scenario we expect the Fed to deliver on 125bps of cuts over the next six months, to a terminal rate of 3 per cent. However, the risks are tilted to more, rather than fewer.

One area of the economy that continues to power ahead is investment related to the Artificial Intelligence revolution and the rise of Generative AI. While this investment spending is down to just a handful of the tech “hyperscalers”, the size is macroeconomically meaningful, contributing several tenths of a per cent to GDP growth in recent quarters. Announced investment plans suggest that it will continue being a key contributor to economy-wide business investment growth.

Looking ahead to 2026, we expect that the household sector will have largely adjusted to the tariff-induced inflation increase, while starting to benefit from some of the additional tax cuts in the One Big Beautiful Bill Act. Moreover, rate cuts will support the recovery with growth expected to rise sequentially through 2026. That is somewhat masked, however, in calendar-year averages, which look similar in 2025 and 2026, around 1.6 per cent ([Figure 13](#)). Inflation is expected to head back down from mid-2026 towards 2.5 per cent as tariff effects are seen as temporary and underlying inflation pressures muted.

Outside the COVID period,
H1 2025 was near the
slowest pace of growth
in a decade for the
United States



Eurozone

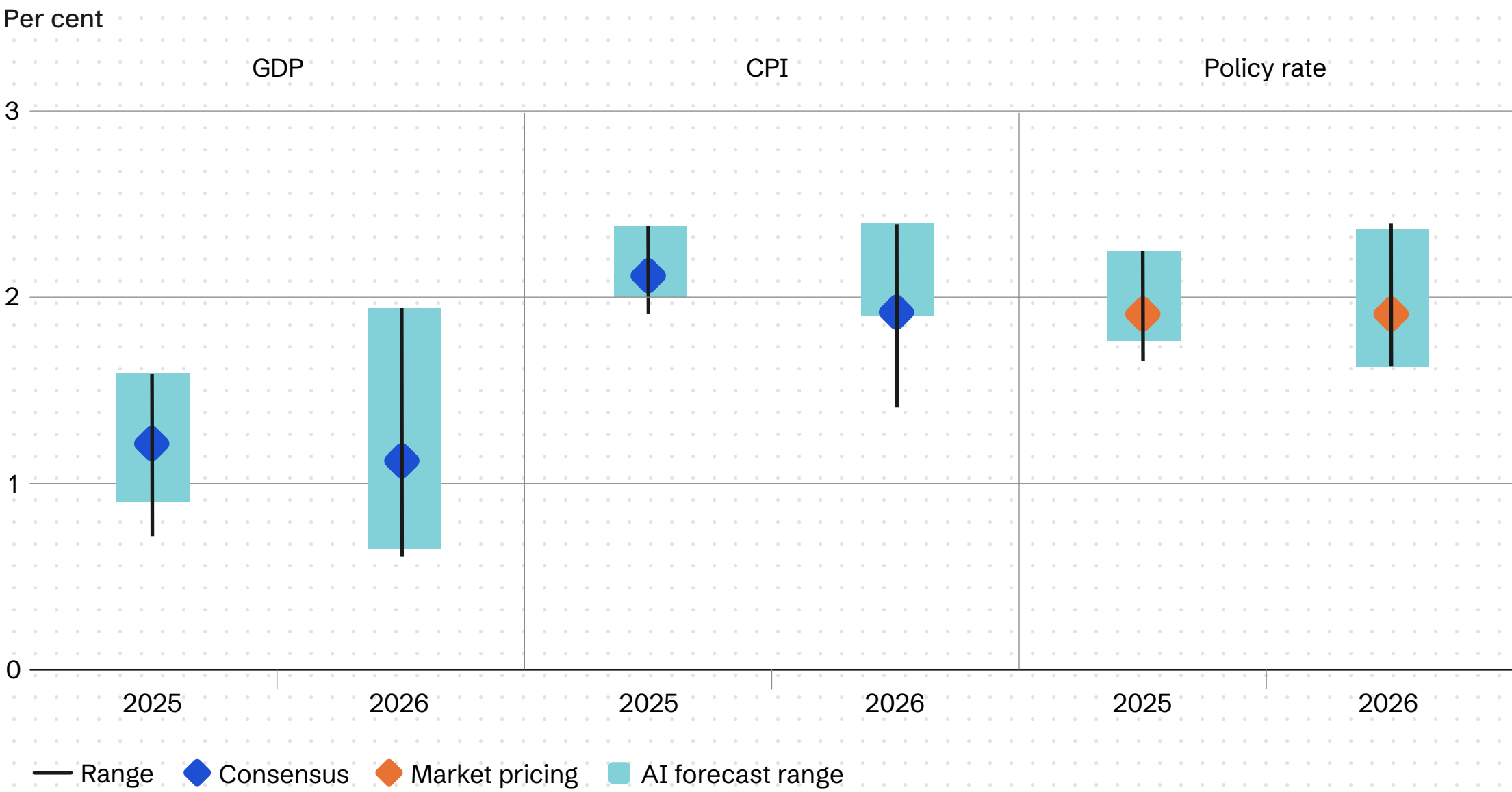
The ECB easing cycle is over

During 2025 H1, the euro area economy grew by 0.7 per cent, albeit with some volatility owing to the front loading of exports in the first quarter; inflation decelerated early in the year but in the last few months appears to have stabilised close to 2 per cent. We expect growth this year at 1.2 per cent (higher than consensus) and 1.3 per cent in 2026 (Figure 14); annual inflation to end 2025 at 2.2 per cent and 2.1 per cent in 2026. Finally, we think the ECB easing cycle is over and while we expect unchanged rates over the next year or so, we see the risks tilted in favour of a hike (at least over the next 18 months).

Hard data have been volatile but smoothing the underlying numbers shows that EZ GDP is growing at c.0.4 per cent QoQ – a tad higher than the 0.3 per cent average in 2010-19 – and importantly, domestic demand is reviving, with household final consumption rising on average 0.4 per cent per quarter, twice the average rate in 2010-19; easier financial conditions, the accumulation of excess savings and positive real wage growth are helping in this regard. We expect these factors to remain in place – at varying degrees – while the fiscal impulse should only add to activity tailwinds, directly, and indirectly via private investment and sentiment.

Although wage growth will decelerate and some residual tariff hit may be in the offing, there are still offsetting factors that suggest inflationary pressures have not disappeared from the pipeline. For starters, inflation is likely to pick up in the months ahead (before temporarily falling in 2026 Q1) on account of energy base effects, still material food inflation contribution and solid underlying/core readings. Second, and more importantly, the significant fiscal impulse will be inflationary; the size of the impact will depend on the extent that the economy hits capacity constraints.

Figure 14. Eurozone



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.
Source: Aviva Investors, Bloomberg as at 30 September 2025.



For these reasons, we expect the ECB to be on hold for the remainder of the year and think that the next move will be a hike. Absent an exogenous shock, the underlying domestic resilience coupled with the fiscal stimulus are suggestive of some inflationary pressures in 2026 & 2027. This does not necessarily point to a steep hiking cycle but given that rates are now roughly in neutral (maybe slightly accommodative) territory, the direction is more likely to be upwards. Timing is hard to predict so far out but overall, it seems that the market is complacent to have priced virtually nothing for the next 18 months or so.

Risks to our constructive euro area view include: (1) a bigger tariff hit that dents the (slow) growth momentum; (2) domestic demand fading due to a number of uncertainties that force households to increase savings; (3) exogenous shocks (e.g. a recession in the US or rest of the world slowing materially) that impact domestic activity, investment and consumption; and (4) geopolitical risks, e.g. relating to the ongoing crisis between Ukraine and Russia.



We think the ECB
easing cycle is over



UK

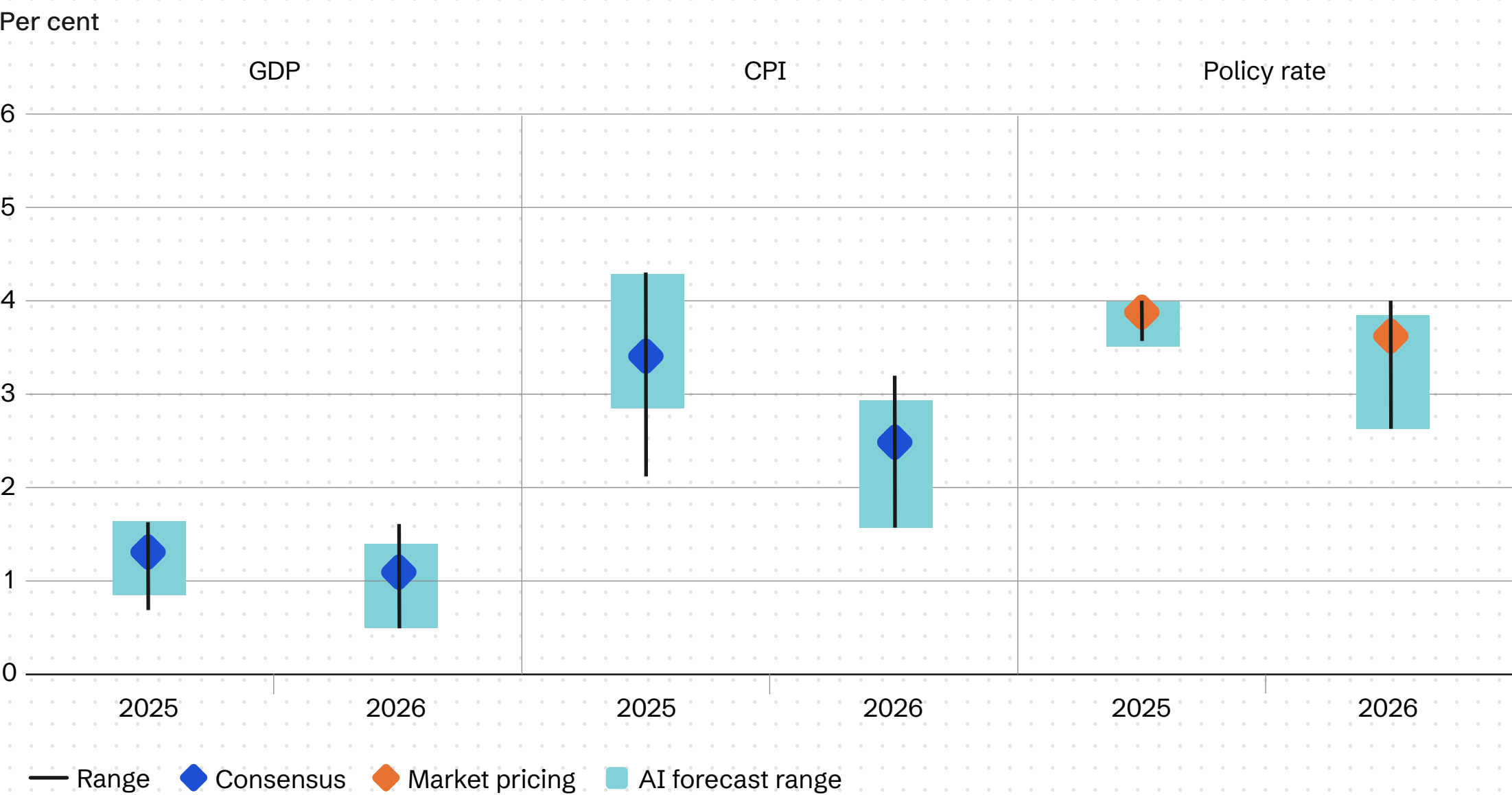
Growth to decelerate

The UK economy grew by 1 per cent in 2025 H1, thanks mostly to a strong first quarter; however, many of the 2025 Q1 drivers – like household consumption, business investment and net exports – reversed or faded in the second quarter. On balance, household demand remains anaemic and investment weak; we expect this to carry on in the second half of the year, when budget uncertainty will intensify and forecast total 2025 growth of 1.2 per cent. For 2026, we have pencilled in a moderation to 1 per cent mostly due to the risk of the BoE delivering a more delayed (though ultimately deeper) easing cycle. Inflation should end the year close to 3.5 per cent YoY but decline towards 2.0 per cent YoY at the end of 2026 (Figure 15).

On the activity front, GDP has been rising by an average of 0.3 per cent QoQ (on a 4Q MA basis) with both household consumption and business investment relatively weak and short of the average rates they achieved in the 2010-19 period. With monetary policy still in restrictive territory, material labour market softness, inflation (temporarily) high largely due to administered price increases and uncertainty over the outcome of the Autumn Budget, we anticipate that growth will decelerate in the remainder of the year and into 2026.

Wage growth is coming down but is still high relative to levels consistent with price stability. As the labour market softens further, we expect more deceleration in wage growth. This together with the fading out of the temporary factors that have taken inflation significantly above target, should allow eventually price growth to converge towards 2 per cent – we expect this to happen in mid-to-late 2026.

Figure 15. UK



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.
Source: Aviva Investors, Bloomberg as at 30 September 2025.



The mix of weak growth and high inflation complicates the BoE's job. In our base case, we still expect one more rate cut this year and the terminal rate to reach 3.25 per cent by mid-2026. However, there is clearly now a risk that the higher-than-expected inflation outturns (though driven by volatile components) could delay the timing of the next cut. We believe that the more the BoE delays further easing, the lower the terminal rate will end up being. Of course, this will also be a function of other factors that will impact the trajectory of the economy, like the Autumn Budget. In this regard, we expect that the Chancellor will deliver tax increases that do not largely violate manifesto promises and spending cuts that in their totality will manage to close the fiscal gap – one change we expect is for the Chancellor to announce only one set of OBR forecasts per year (as the IMF has suggested), from two currently, avoiding in the future the regular drama and speculation that surrounds these events. That said, any adjustment to the self-imposed fiscal rules could have unintended consequences for markets.

There are two main risks to our UK forecasts: (1) the economy could turn out to be stronger than expected and/or inflations to turn out stickier, meaning that the easing cycle will be less intense than we expect; and (2) the rise in UK risk premia could extend further forcing the Chancellor to impose tighter fiscal stance, weighing on domestic economic growth.

The mix of weak growth
and high inflation
complicates the BoE's job



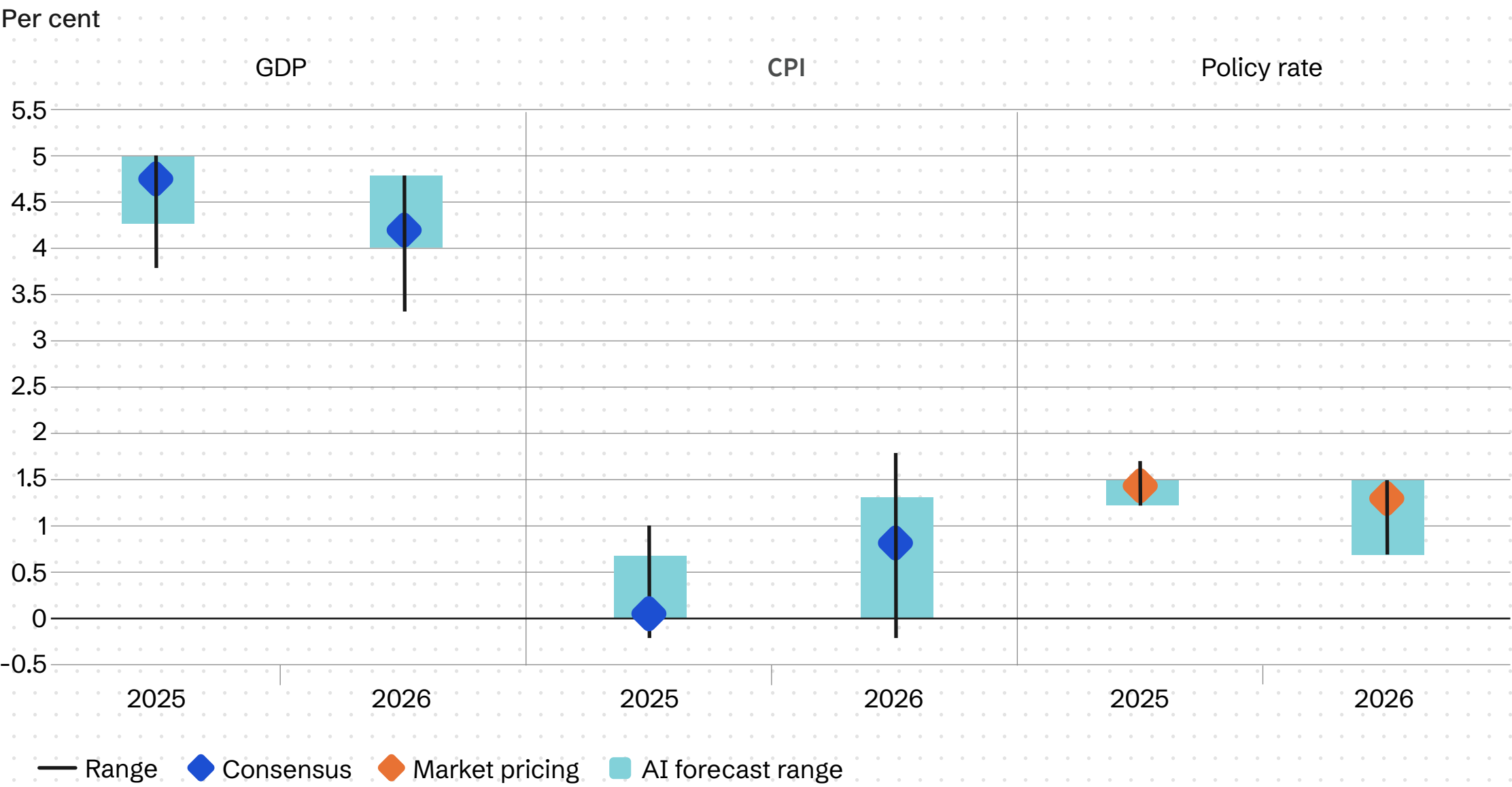
China

Fighting off threats, external and internal

Foreign trade is in focus this year in China for three main reasons. First, although the tariffs imposed by the US were not as severe as the two countries’ game of chicken ended with some de-escalation, 40-50 per cent levies on most goods still mean a decrease in demand will result, even as importers will for the most part simply force consumers to pay the extra taxes. Second, China’s manufacturing boom means that the lower exports to the United States are resulting in even more ‘oversupply’ for everyone else, and thus more disinflationary pressure. This should be cheered by consumers, but is more painful for both the Chinese manufacturers and their foreign competition, whose profits, if any, are squeezed. In more and more cases, despite intense diplomatic pressure, countries are fighting back against China’s subsidies, IP theft, and import restrictions with anti-dumping measures or additional tariffs, including US-sponsored transshipping duties. Finally, the weaker growth outlook (Figure 16) and continued malaise in real estate that is a chronic drag on consumer confidence has meant import growth has stalled out since the Covid rebound: China still buys \$2.5 trillion worth of foreign goods, but this is down 10 per cent from the peak, now over three years ago. Price declines in some commodities are part of this, but despite being a huge buyer in many markets, in growth terms China is now a negative impulse for the rest of the world. Another aspect is the intentional import-substitution efforts the Communist Party of China has made to insulate itself from dependency on potential adversaries, though China remains dependent on key commodities such as energy, metals, and advanced microchips.

The oversupply of many goods and high savings rates means there is no inflation pressure: CPI is stuck below zero and PPI, which is closely tied to corporate profits, is around -3 per cent y/y. This is not in spite of achieving close to 5 per cent growth, which we expect China to record for 2025, but because of it; there have been many temporarily effective consumer subsidies and stimulus efforts, but at the same time huge investment in many sectors that have overcapacity. Structurally, China’s growth will slow because of demographics, debt, deflation, a more fragmented global trade and world financial system.

Figure 16. China



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.
Source: Aviva Investors, Bloomberg as at 30 September 2025.



Monetary policy is loose in terms of liquidity, but restrictive when looked at through the lens of real rates. Yet the PBoC was unable or unwilling to risk cutting rates to zero or negative as the ECB or BoJ did; one reason was a fear of further exchange rate depreciation. Now that the dollar's strength has reversed, there is scope for continued loose liquidity, and controlled slow appreciation of the CNY vs USD which will, in trade-weighted terms, regain some of the lost competitiveness assuming other trade partners' currencies appreciate more quickly.

The so-called anti-involution push has become a renewed priority for the central government, but it is not new; such efforts have come and gone many times when certain sectors outgrew demand and led to inefficient capital allocation and losses. There will most likely be some improvement in pricing after a shakeout of some of the weaker firms, with a focus on steel (again), solar panels, batteries and EVs. Together with credit easing and pushing bad loans into the distant future through 'liability management swaps', hope for better profits and clear signals to support private enterprises in general (and equity markets in particular) has led to very favourable conditions in local shares. This may boost sentiment if it is not yet another bubble: the ability of firms to maintain discipline and prioritise profits is one key, and the capability of Chinese firms to catch up or take the lead in key technologies is another.

Risks to our forecasts include:

- A more damaging fallout from tariffs, not only from the U.S. but other countries concerned with Chinese competition or due to U.S. pressure
- Financial instability caused by overleveraged local governments, SOEs, or related vehicles
- On the positive side, aggressive – and effective – fiscal and monetary stimulus coupled with social and economic reforms and growing support from Russia, India, and others

Hope for better profits and clear signals to support private enterprises in general and equity markets in particular has led to very favourable conditions in local shares



Japan

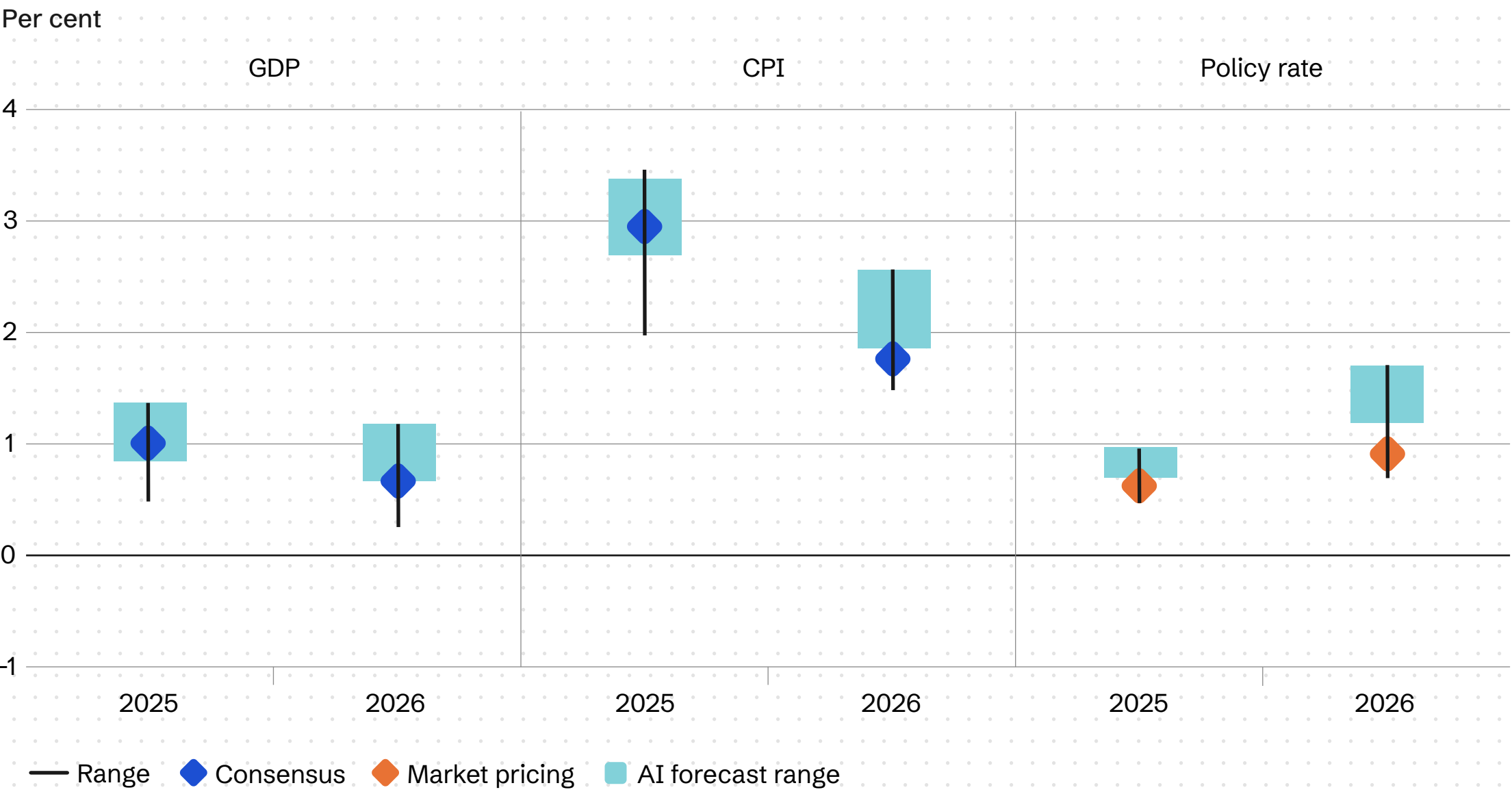
Inflation is high, broad, and sustained

Inflation has been maintained at around 3 per cent, with wage gains and other measures showing that price pressures should persist and broaden, though political uncertainty, external factors (tariffs and geopolitical uncertainty) and subsidies have given the BoJ leeway to bide its time with further hikes. However, statements accompanying recent decisions to leave rates unchanged have made it clear that further hikes are a question of when, not if. This should help to strengthen the yen, at the margin, but the exchange rate appreciation is being driven more by the broad dollar trend, terms-of-trade, and US rates, with domestic uncertainty and the bond market weakness probably playing a countervailing role, in the short term. The yen has been in the 140s most of the time since the large Fed hikes of 2022-23.

While the BoJ has kept the overnight rate at 0.5 per cent since its 25bp hike in January, the JGB yield curve has steepened dramatically: the 30-year yield marched steadily from 2.3 per cent to 3.2 per cent. Yet trying to find a good reason is elusive: bond yields rose almost everywhere, from Germany to the UK to Canada – and paradoxically, yields rose more where they were low and central banks were cutting rates! The answer is a complex mix of structural demand changes from pension funds, attractive money market rates, an investment boom, and on the supply side, large and unsustainable fiscal deficits – not just in Japan but also in most Developed Markets – and precious little willingness to rein them in.

Little has changed on the growth front, where GDP is expected to grow at around potential of 1-1.5 per cent (Figure 17), with some noise from tariffs and politics. Japan’s export sector should grow steadily, with tech providing upside risks. It is the coming change in government leadership, with some chance of snap elections, that may matter the most. Following Prime Minister Shigeru Ishiba’s intent to resign after just one year, the new leader of the LDP may set a new course on reforms or fiscal policy, as well as foreign policy and defence. As the world saw with “Abenomics”, as well as political upheavals in the UK and the US, new leaders can effect big changes in markets. Some of that uncertainty should be clearer in Q4.

Figure 17. Japan



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.
Source: Aviva Investors, Bloomberg as at 30 September 2025.

Statements accompanying decisions to leave rates unchanged have made it clear that further hikes are a question of when, not if



Canada

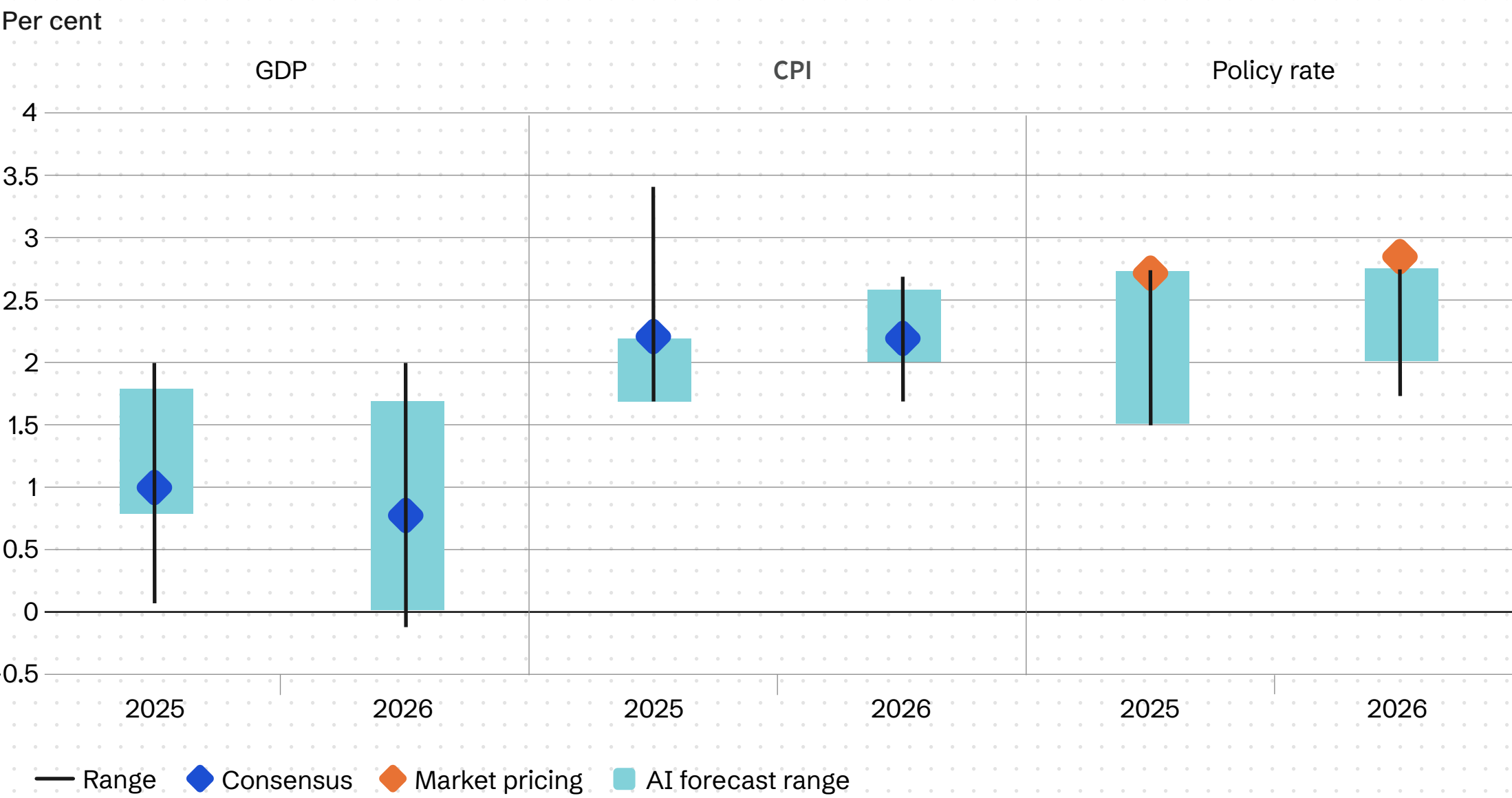
Prolonged stall speed increases downside risks

The Canadian economy barely grew in H1 2025, expanding at a c. 0.2 per cent annualised pace. Whilst headline inflation has remained below 2 per cent, Q2’s GDP figures, showing a 1.6 per cent contraction on the quarter, narrowly disappointed an already pessimistic Bank of Canada forecast, though much of this softening has been externally driven via net trade, with a more positive outturn for domestic demand. Yet, beyond the national accounts, after some initial improvement, the broader soft data showed some signs of weakness heading into the end of Q3.

Ultimately, whilst external forces are largely to blame, the economy continues to grow below trend, as it now has been for nearly three years, and this economic slack is visibly weighing broadly across labour markets. After a brief resurgence in June, the six-month moving average of payroll growth has declined from c.25,000 jobs to the losses of c.7,000. Whilst 2025 has now seen three months of outright job losses, two of which being in the recent months of July and August. Moreover, these job losses have permeated beyond the confines of trade related, manufacturing sectors, with the soft contour of services employment indicating that this labour market weakness has become broader based. Indeed, unemployment has now climbed to 7.1 per cent, akin to levels seen during the peak of the 2015/2016 recession.

This continued slackening in labour markets is clearly weakening worker bargaining power with nominal wage growth continuing to trend downwards. Real wage growth may remain somewhat solid, thanks to the soft contours of headline inflation, but at this current juncture, the labour market is not a source of inflationary upside risk to the BoC, more so the opposite.

Figure 18. Canada



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.
Source: Aviva Investors, Bloomberg as at 30 September 2025.



The confounder in this narrative of weak activity has been inflation with the BoC's core measures narrowly breaching the target range of 2-3 per cent YoY to the upside in April, and has remained at c.3 per cent since. However, although the YoY rate remains undesirable, sequential measures have shown notable improvement with the three-month annualised rate falling to 2.5 per cent as of August. Services inflation continues to slow, and core goods (to which the pickup in core inflation has been largely attributed) now seems to have peaked in June and is showing only mild signs of tariff effects.

We still see monetary policy as restrictive; private fixed investment remains subdued whilst longer tenor mortgage renewals at current market rates still represent a significant drag on household cash flows. Moreover, the labour market is seeing renewed rises in the unemployment rate, which is likely perilously close to levels which may provoke adverse, “non-linear” outcomes in which self-fulfilling layoff cycles may occur.

Given the above, we lower our prior terminal rate of 2.25 per cent to 2 per cent ([Figure 18](#)). What lies ahead for Canada remains further, lacklustre, below-trend growth coinciding with a labour market that seems to be sinking further into turmoil - after nearly six months on the sidelines: such an environment will see the BoC hard pressed not to deliver further cuts.

Risks to the upside rest on a larger than expected fiscal impulse at the upcoming budget announcement in the Fall. Whilst downside risks encompass a more severe slowdown in the housing market or the labour market weakness becoming self-propagating.

Continued slackening in labour markets is clearly weakening worker bargaining power with nominal wage growth continuing to trend downwards



Global market outlook and asset allocation

Equities: We remain positive and see potential for a broadening out of both equity markets and the impact of the AI thematic.

Fixed income: We continue to see higher risk premia and steeper curves; we are bearish Europe and Japan but bullish the UK, US and Australia.

Credit: As long as recession risk is considered low, spreads are unlikely to widen even as ex ante returns look increasingly meagre.

Currencies: We maintain the view of further dollar weakness, predicated on rising term premia, concerns over the Fed's independence, a slowing economy and Fed rate cuts.

Private Markets: We expect the relative value between private markets debt and equity assets to align more closely: we see pressure on private debt illiquidity premia and early signs of a resurgence in private market equity strategies.





Global market outlook

2025 Q3 was a positive quarter for risk assets, with Japan leading the gains in DM, followed by the US and the UK, while European equities underperformed, giving back all of the relative performance of 2025 H1 (and some). Small Caps outperformed Large Caps while the Growth factor continued to outperform the Value factor in the US and in EM. In Europe and Japan the Value factor still had the upper hand. EM equities had also a very strong showing (rising by more than 10 per cent QoQ), powered by China and Korea and technology exposure due to lower US yields and prior dollar weakness; EMEA equities underperformed notably. Fixed income was characterised by some divergence in yield directions across regions. In the US, following the sharp deterioration in domestic labour market conditions, yields ended lower for the quarter, whereas they rose materially in the Eurozone, the UK and Japan. On the whole, yield curves steepened, especially in the 5s30s space: in the US this was led by a repricing lower at the short end (Fed rate expectations), whereas in the other major economies the steepening was driven by the very long end, mostly due to the pricing in of higher risk premia, as the theme of “fiscal dominance” gained traction. In Credit tight spreads got even tighter, breaking through pre-GFC levels in IG versus Treasuries, while HY delivered solid absolute and relative returns in Europe and the US.

Going into the fourth quarter of the year, we envisage the following market themes:

In equities, while the risk of a short-term “bull market correction” is present given elevated valuations and the strong run of equity markets since the early April lows, we believe there is further upside. Our long-standing expectations of small outperformance of US over Europe this year appear to be playing out and we see this continuing over the short to medium term. We see the theme of AI (and technology more broadly) as central to the investment case for equities but highlight the key here is the broadening of the theme. So far benefits of the technology cycle have accrued mostly to AI enablers/hyperscalers, but those companies are now investing very large sums in AI capex and that capex means revenue for companies down the supply chain. This should mean benefits start to accrue more broadly. If we add to this environment the impact of the adoption of AI tools on productivity and margins, lower rates, tax and regulatory benefits from the US administration and the signs of an end to a period of weakness in manufacturing, it appears we have robust support for equities to continue to trend higher over the medium to long term.

Within fixed income, we think the theme of curve steepening continues, as risk premia ought to reflect more accurately the associated fiscal stance/risks. We have little conviction on the exact levels of US yields as we see many moving parts – including Fed independence concerns – playing out; we are bearish Europe and Japan and bullish on the UK front end and longer-dated maturities in the US and Australia.

In credit, as long as recession risk is viewed as low, and central banks are removing restrictiveness, spreads will be unlikely to widen even as ex ante returns look increasingly meagre. Supply is absorbed as fixed income’s real yields are decent in most countries and favour corporate debt relative to profligate governments’ issuance of bonds.

Finally, in currencies, we maintain the view of further dollar weakness, predicated on the erosion of US exceptionalism (hence, more FX hedging of US asset ownership), concerns over the Fed’s independence, risings US term premia, a slowing economy and Fed rate cuts.

Our long-standing expectations of small outperformance of US equities over Europe this year appear to be playing out and we see this continuing over the short to medium term



Equities

How would an AI-driven bullish case for equities play out?

The AI driven tech boom is an integral part of the case for equity markets, especially for US equities. Both bullish and bearish arguments usually have technology and AI at their core. Bullish arguments often highlight historically high profitability, margins, capex investments and returns of equity markets while bearish arguments typically focus on extended valuations and market concentration. All of the above is largely driven by AI and Tech.

That means any structural bull case for equities must start from the premise that the AI cycle is sustainable. If one believes AI will either disappoint or deliver, then one should likely hold the same belief about equity markets. Our view is positive on both AI and equities.

For that structural bullish case to play out we see four necessary conditions: 1) the persistence of the current AI capex cycle, as well as 2) the continuing returns of the AI enabler/hyperscaler stocks. Both of those conditions are highly visible already and provide support for the positive case. In our view these prerequisites are necessary but not sufficient, as the next stage is critical, requiring 3) an ever-growing set of companies incorporating AI-related technology tools to their operations and 4) those tools leading to higher returns and productivity.

Both the initial returns and the pricing impact are clearly visible in AI “enablers” – companies that are responsible for the development of the technology

Where are we in this AI-driven cycle?

Both the initial returns and the pricing impact are clearly visible in AI “enablers” – companies that are responsible for the development of the technology. But as these companies invest very large sums of money in the AI infrastructure needed for the technology to advance, the AI investment theme should gradually broaden to the “adopters” of the technology, as well as to the companies within the AI supply chain. That broadening process should provide ongoing support for equities.

However, this second stage is still in its infancy. What we observe today is the initial stage of the technology cycle, where AI enablers (hyperscalers) dominate.

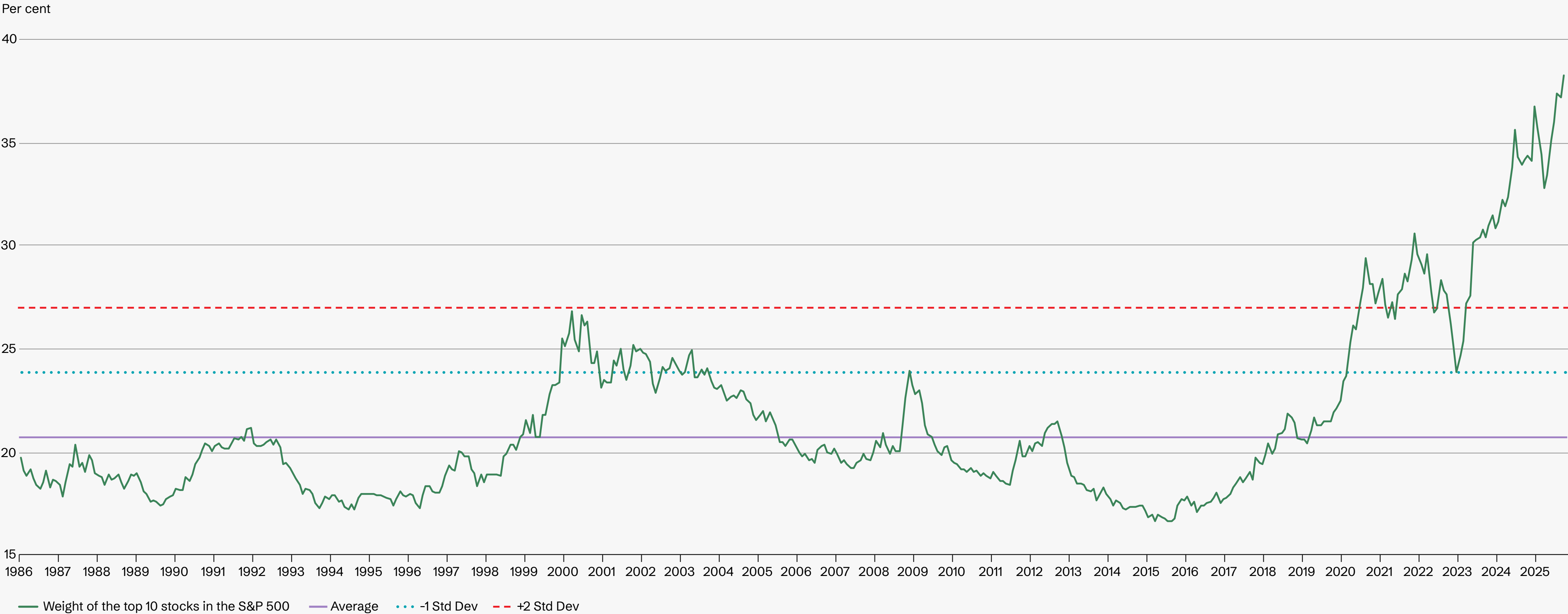
In this initial stage, concentration is a feature, not a bug:

The issue of market concentration ([Figure 19](#)) is often talked about as an anomaly and a cause for concern in equity markets.

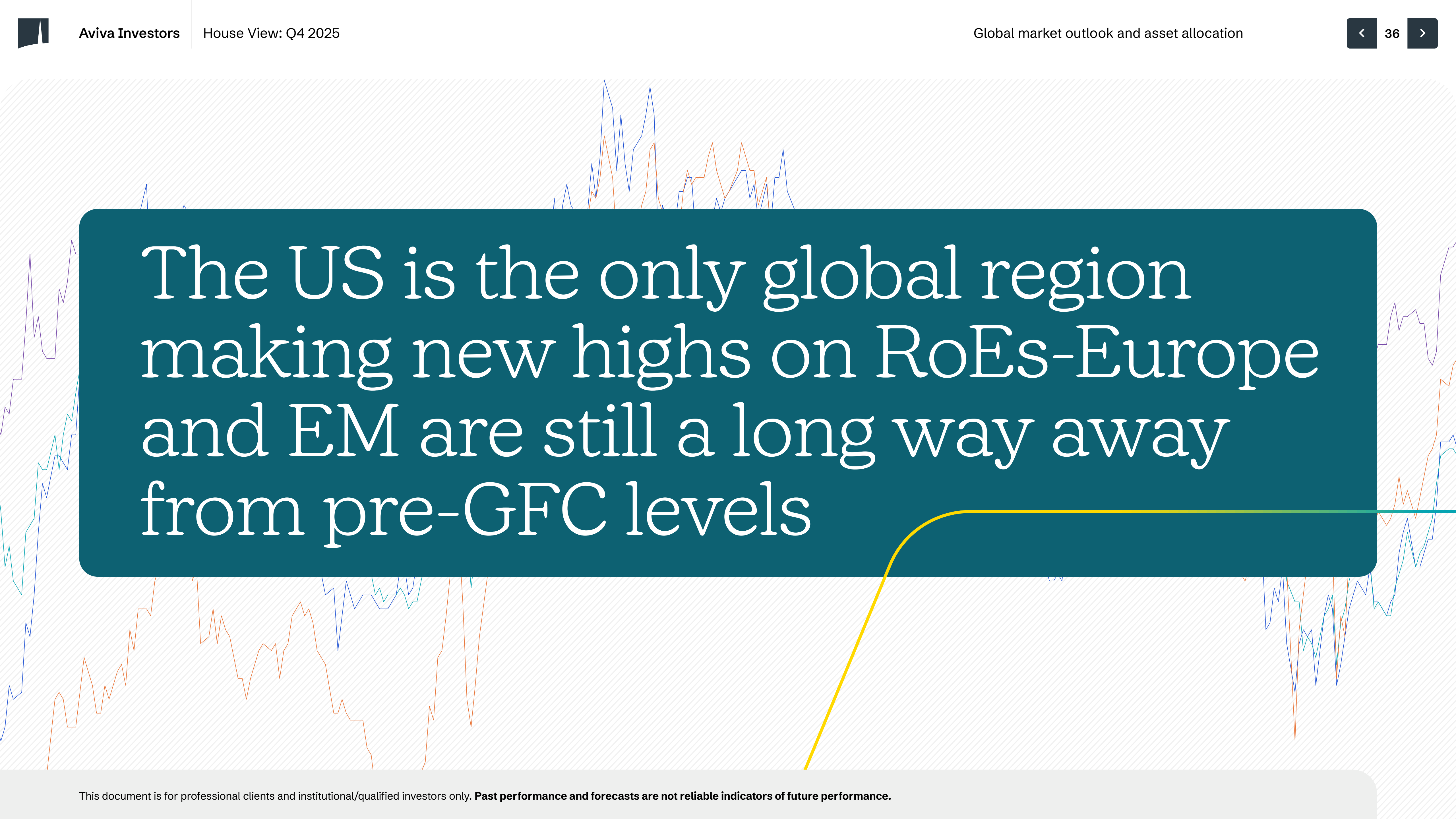
However, in addition to the fact we operate in a market dominated by global monopolies/oligopolies with divisions larger than entire countries’ equity markets (something we have discussed in the past), this concentration also fits with the current early stage of the cycle, where AI enablers extract most of the benefits of the technology, and before the broadening that allows adopters and suppliers to reap a larger share of the benefits. Hence, such concentration is not a result of “irrational exuberance”, but a rational response to both the businesses themselves and the still nascent stage of the technology’s development.



Figure 19. Equity market concentration



Source: Aviva Investors, Refinitiv Workspace as at 30 September 2025.



The US is the only global region making new highs on RoEs-Europe and EM are still a long way away from pre-GFC levels



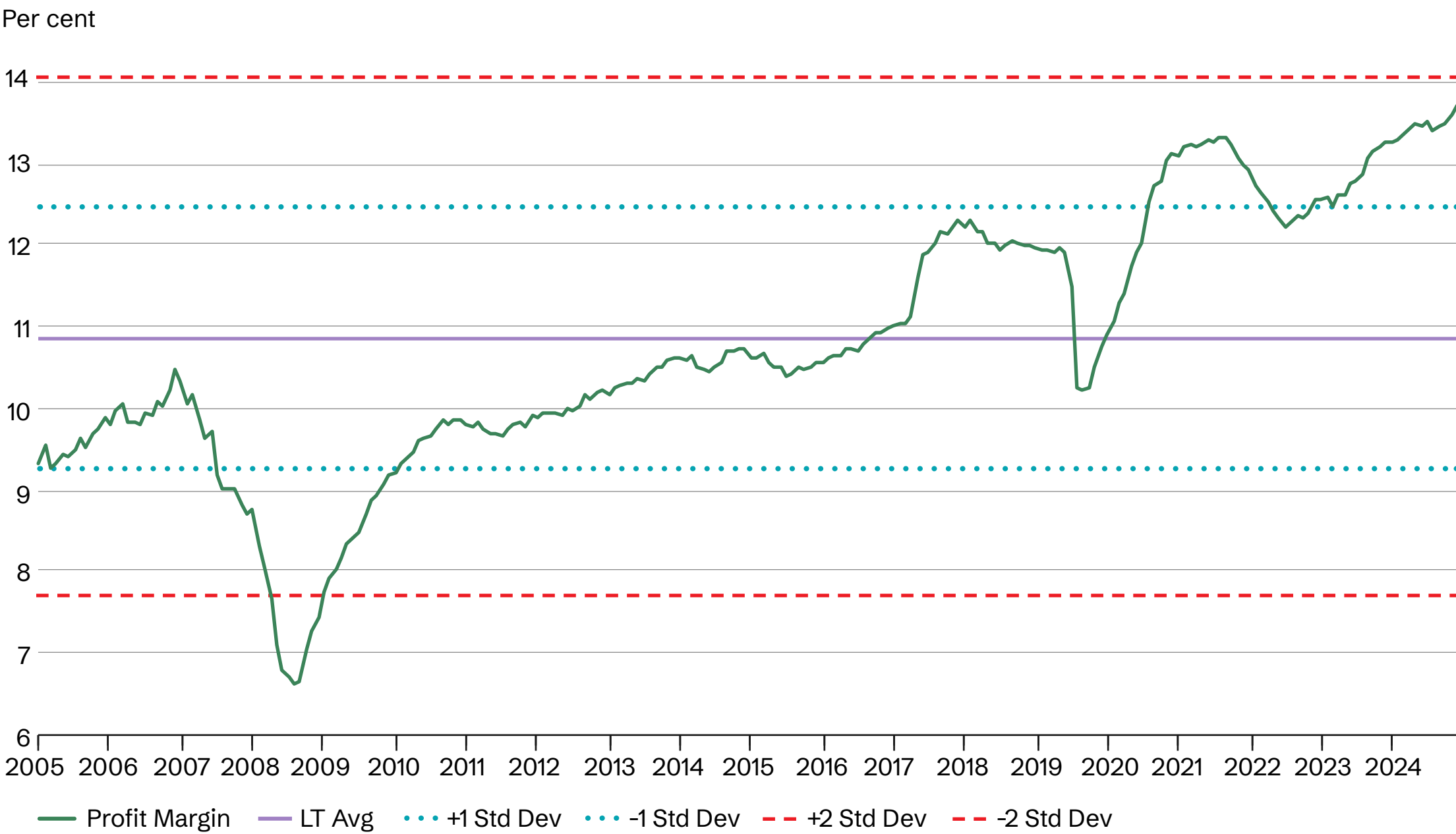
Can we see any benefits from all that investment yet?

In short, yes. S&P 500 margins have climbed to new all-time highs and profits have accelerated at a pace not seen in decades (Figure 20).

If we look at the Nasdaq, instead of the S&P, where the impact of AI/tech is more pronounced, we can see the margin run has been even more impressive, and after something of a plateau earlier this year, margins appear to be on the rise again.

Figure 20. US equity market margins

S&P 500 profit margins



Source: Aviva Investors, Refinitiv Workspace as at 30 September 2025.

If we look at the S&P 500 RoE, we can see more signs of the impact of AI/tech as the US market reaches a new all-time high Return on Equity (Figure 21).

Incidentally, the US is the only global region making new highs on RoEs – Europe and EM are still a long way away from pre-GFC levels, while Japan has only recovered roughly back to the same pre-GFC RoEs. This also suggests AI, and technology more broadly, are the main drivers.

Nasdaq profit margins

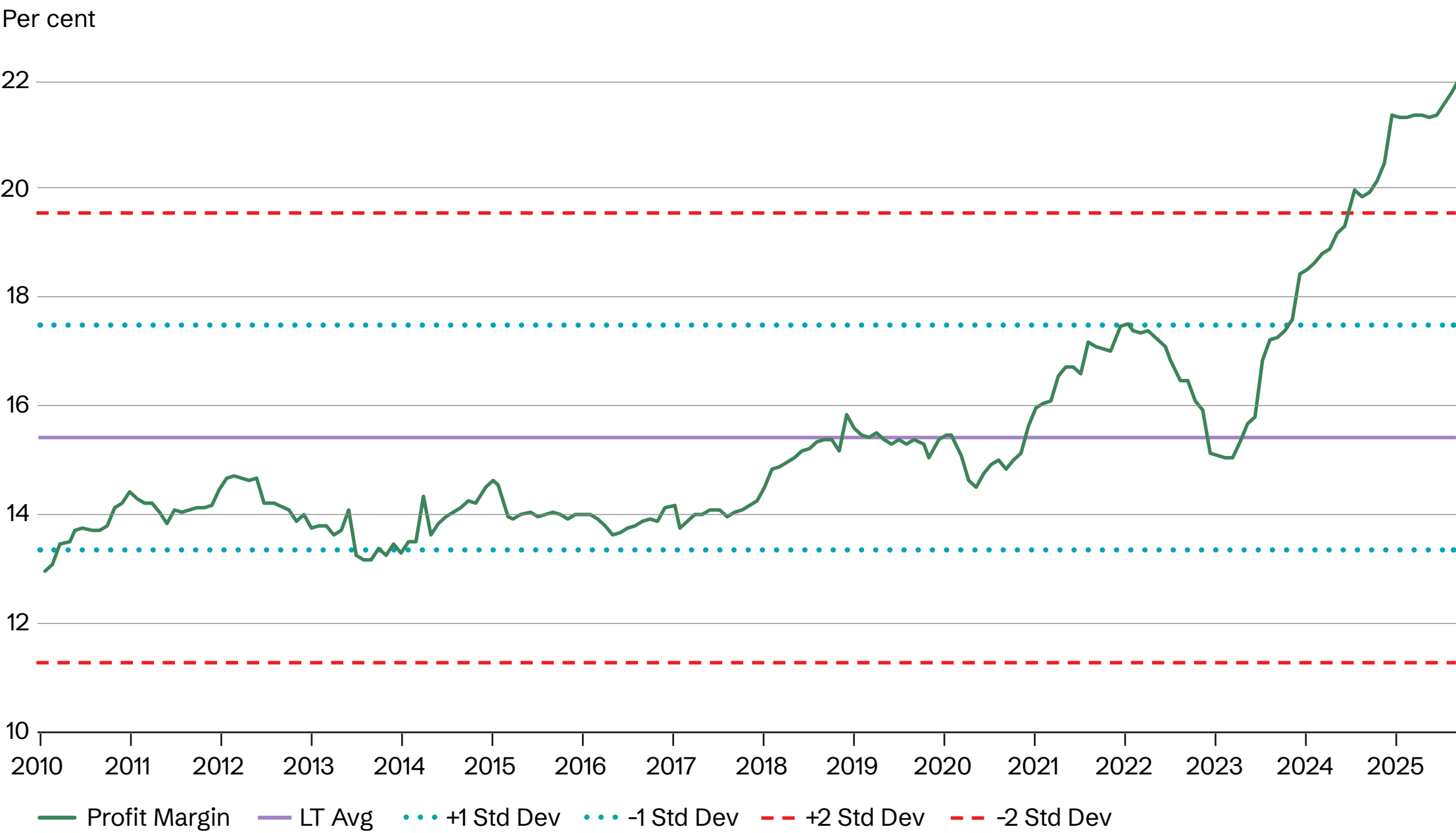
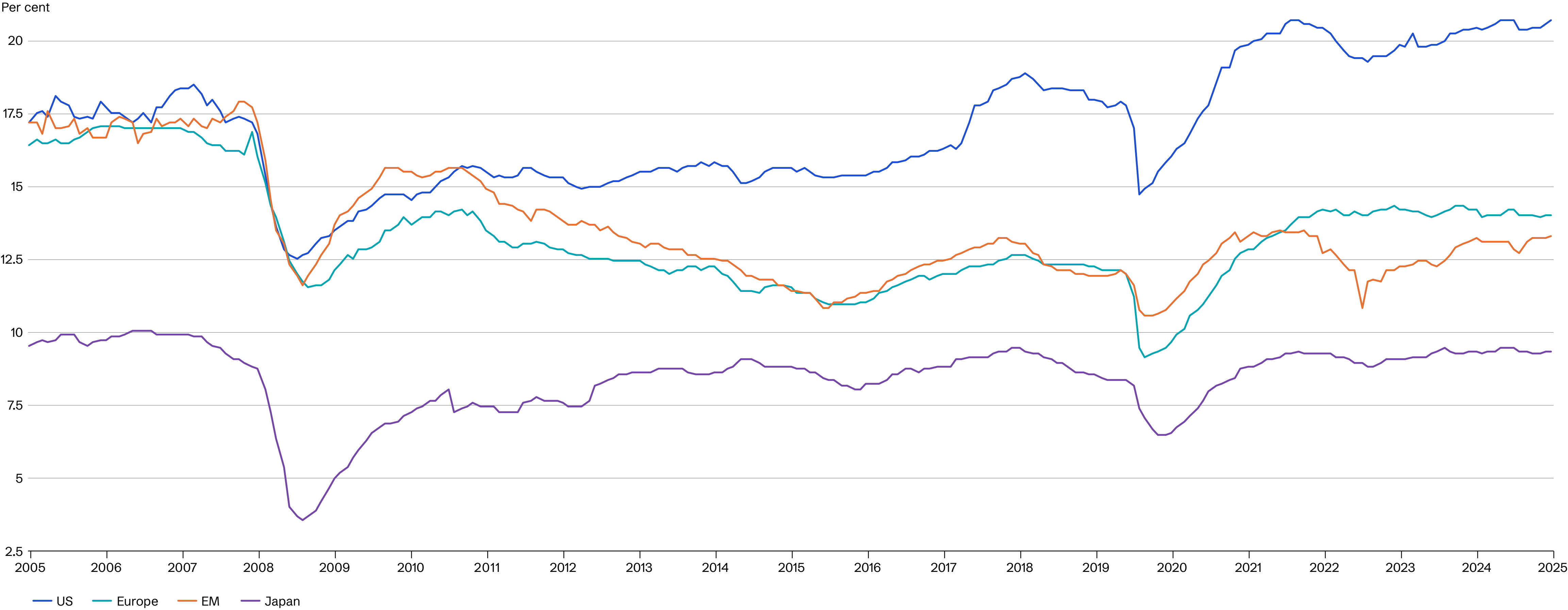




Figure 21. Return on equity (RoE) across major regions



Source: Aviva Investors, Refinitiv Workspace as at 30 September 2025.



The technology cycle and the business cycle

As we highlighted in the past, during much of the ongoing equity market run the earnings for the remainder of the market, outside of Big Tech, have been weak. Equity indices were effectively carried higher by a small group of large companies – most of them in the technology sector. Had it not been for the big tech cohort and the AI boom, we could well have had an earnings recession over the recent past.

Circa one year ago, much of the conversation centred around that and the potential for a “broadening out” of equity markets i.e. the question of whether the remainder of the market (exc. Big Tech) would return to earnings growth. This broadening out process, of which there were clear signs at the end of 2024, was effectively ground to a halt by the tariff shock.

Where does that leave us? “Liberation day” brought the market down nearly 20 per cent (a bear market in the space of a few weeks) as companies and investors scrambled to find out what to do in the face of unprecedented import tariffs. Now, circa six months later, that period in April looks more and more like a clearing event, which allowed the rest of the market to eventually return to growth. It may seem at first too “convenient” to think equity markets were saved from an earnings recession by the timing of a new and powerful technology cycle, and now both the broadening out of this tech cycle as well the broadening out of equity markets may take place in tandem. But being convenient (or inconvenient) does not make it any less likely, and there is plenty of evidence in equity markets to suggest this may indeed be the case.

“Liberation day” brought the market down nearly 20 per cent as companies scrambled to find out what to do in the face of unprecedented import tariffs. Nearly six months later, it looks more and more like a clearing event, which allowed the rest of the market to eventually return to growth



Fixed income

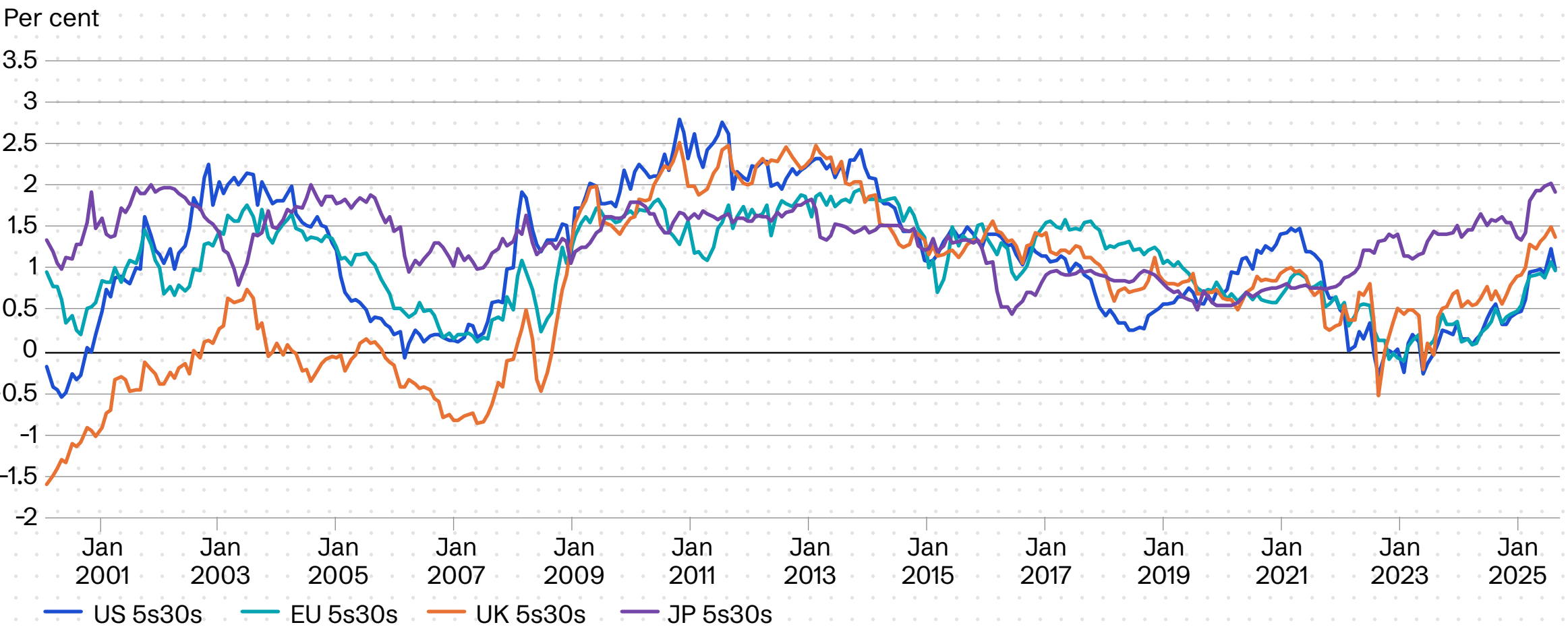
Risk premia at the forefront

Fiscal concerns and higher risk premia alongside Fed rate expectations dominated movements in the yields/rates space in 2025 Q3. The theme of fiscal dominance and flaring up of worries over the Fed’s independence sent long-dated yields higher across the major economies. However, following a sharp deceleration in the US labour market, a divergence emerged with US yields eventually lower for the quarter vs materially higher yields in the Eurozone, the UK and Japan.

Overall, yield curves steepened, especially in the 5s30s space (Figure 22): in the US this was led by a repricing lower at the short end, whereas in the other major economies the steepening was driven by the very long end, mostly due to the pricing in of higher risk premia (Figure 23).

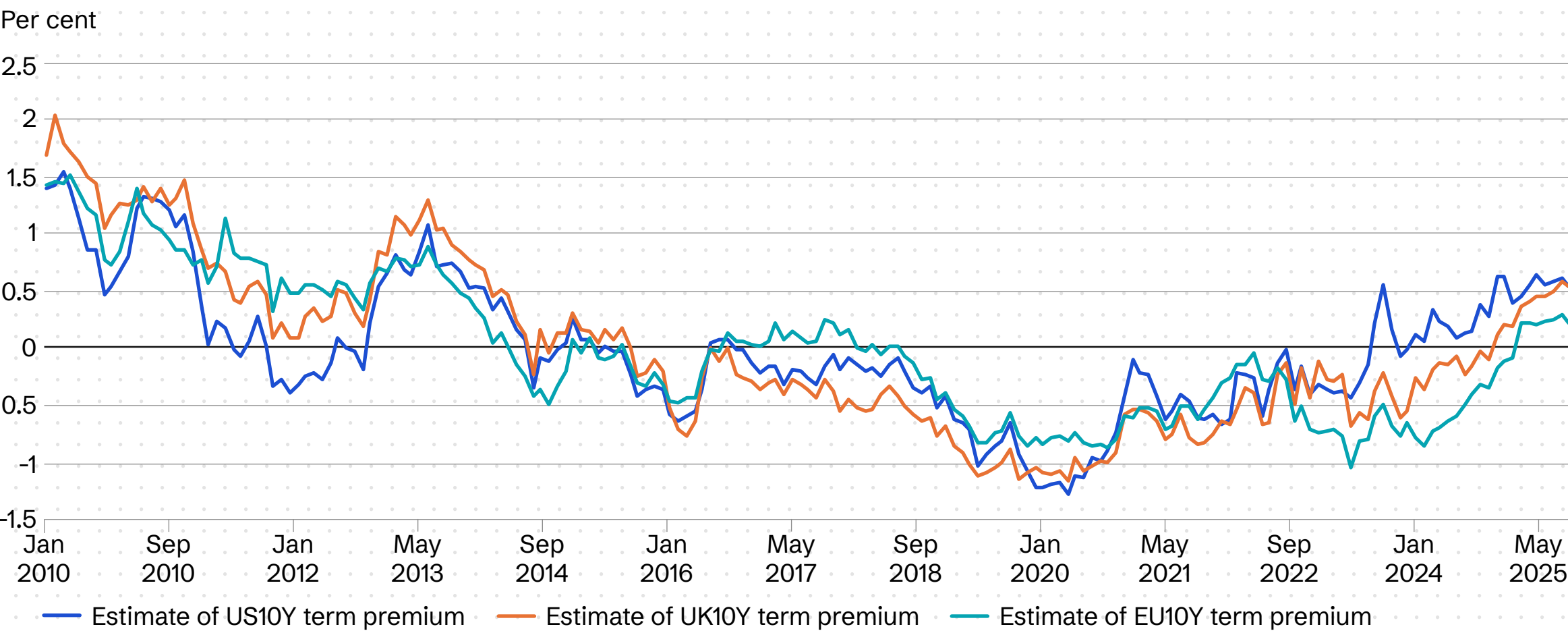
The theme of fiscal dominance and flaring up of worries over the Fed’s independence sent long-dated yields higher across the major economies

Figure 22. Yield curves have steepened materially



Source: Aviva Investors, Macrobond, Bloomberg as at 30 September 2025.

Figure 23. Term premia on the rise



Source: Aviva Investors, Macrobond, Bloomberg as at 30 September 2025.



We believe the theme of curve steepening has further to run, although we hold various degrees of conviction about the level of yields in different jurisdictions. Namely:

In the US, there are already 100-150bps of Fed easing priced and for that to extend further, recession risks would have to rise. This would require the deceleration in the jobs market rippling through to the rest of the economy, something which we have yet to see. Furthermore, tariff pass-through to inflation remains a material risk that could restrain the Fed and alter market pricing. Overall, we have little confidence on the direction of US yields but have higher conviction in further curve steepening on account of higher risk/inflation premia at the longer end, in part due to concerns about Fed's independence (and still sizeable levels of budget deficits). Main risks to our view include a reacceleration of the economy and/or higher-than-expected inflation that would push the short end of the curve higher; and the pricing out of risk premia at the long end if the market assesses the administration's policies to revert to a more mainstream pathway, potentially stepping away from attempts to influence Fed's decisions.

In the Eurozone, we are bearish on Bunds as we expect the start of the German fiscal stimulus will (1) rerate growth expectations higher and (2) increase further the associated risk premia. Here too, we expect further steepening, especially since both 2s10s and 5s30s are below historical averages. Main risks here include a hit to growth due to a bigger-than-expected impact from tariffs/global trade and bottlenecks in the implementation of the German fiscal stimulus.

We are bullish on the UK gilt market because we expect growth to slow and the BoE to deliver more easing than the market is pricing. We acknowledge that the Autumn budget poses upside risks to term premia but expect that the Chancellor will deliver enough to dispel most of the concerns. Curves have steepened meaningfully this year: we expect some further steepening to take place led by the short-end of the curve, but it seems to us that most of the gains here have already been realised. Our bullish view on UK rates would be challenged if inflation proves more persistent – beyond the impact of the recent one-offs and resets – that would restrain the BoE from easing policy as much as we expect.

We are bearish on Japan, expecting the short end of the curve to move higher as the BoJ engages in further policy tightening, although we acknowledge that political hurdles may make this a very “slow burn”, which we see as the main risk to our bearish view. We also expect some flattening to take place led by short rates.

In credit, as long as recession risk is considered low, and central banks continue to remove restrictiveness, spreads are unlikely to widen even as ex ante returns look increasingly meagre. Supply is absorbed as fixed income's real yields are moderately attractive in most countries and favour corporate debt relative to profligate governments' issuance of bonds.

The start of the year has seen unusual diverging performance in bond markets across the major economies



Foreign Exchange (FX)?

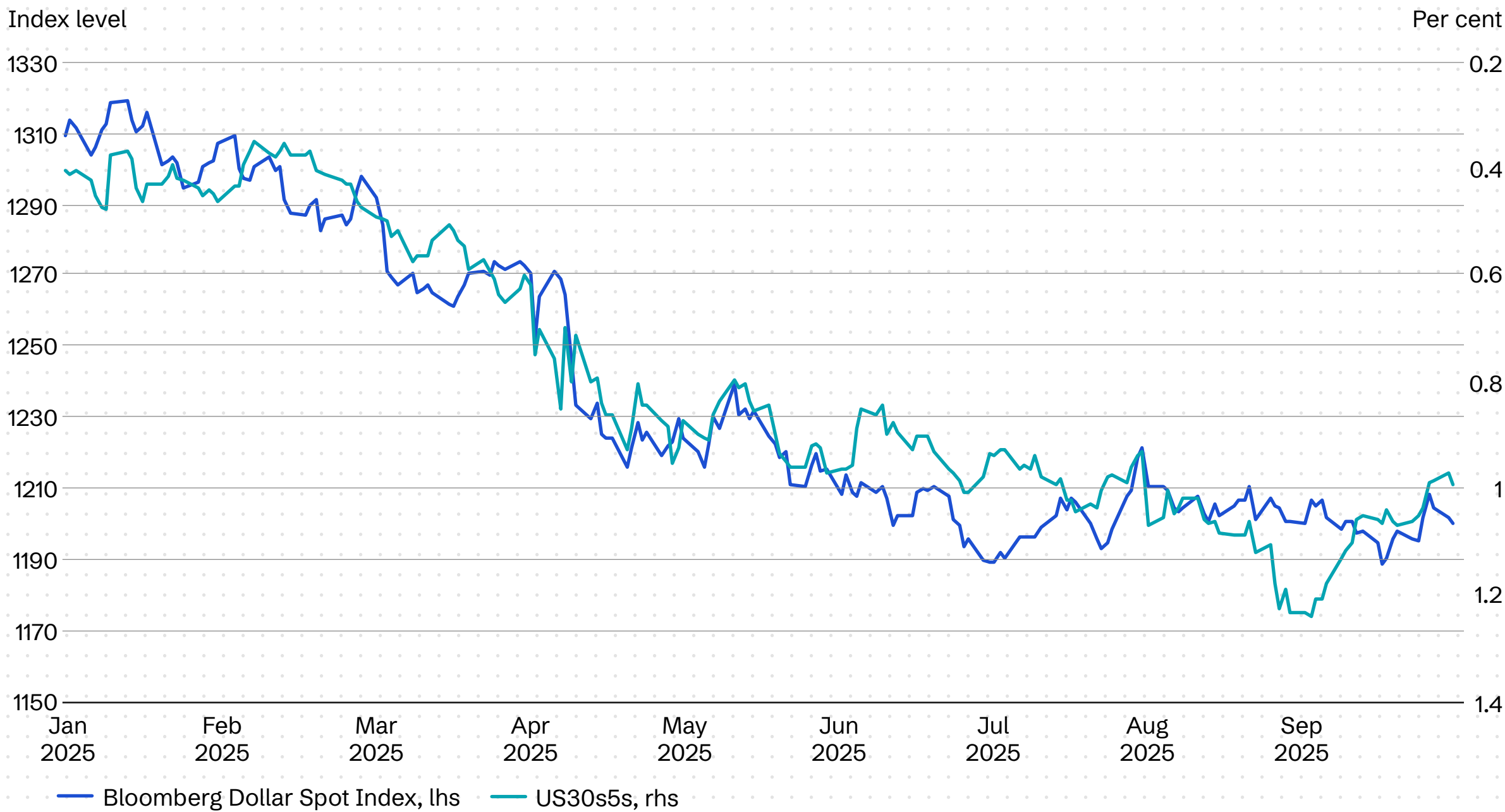
Remain dollar bearish

This year’s dollar downtrend came to a halt in 2025 Q3, despite falling US yields and wider RoW-US rate differentials. This was likely due to some paring back of extended short USD positioning rather than a change in the fundamental backdrop. As a result, EURUSD was broadly flat in the quarter, while GBPUSD weakened modestly due to the flaring up of concerns about the UK’s fiscal trajectory in anticipation of the UK Budget this autumn. EM FX was marginally weaker, although high carry currencies like the MXN and BRL managed to hold up.

We maintain the view of further dollar weakness, predicated on the erosion of US exceptionalism (hence, more FX hedging of US asset ownership), concerns over the Fed’s independence, risings US term premia, a slowing economy and Fed rate cuts; this is why we think that the recent tight correlation between the steepening of the yield curve and the dollar will remain in place for the foreseeable future (Figure 24).

We still expect EURUSD to rise beyond 1.20, especially since we think the ECB is done easing and the economy will benefit from domestic tailwinds on the back of the upcoming fiscal stimulus. GBPUSD should also benefit from dollar weakness, but we see headwinds in the form of a weaker-than-expected economy and more BoE rate cuts than the market is pricing; ultimately, we see EURGBP rising towards 0.90. We still see JPY strengthening on multi-quarter horizons on the basis of sizeable USDJPY overvaluation and the BoJ’s tightening but acknowledge that this is likely to be a “slow burn” with some volatility, especially due to the political hurdles that the central bank must navigate.

Figure 24. Dollar highly correlated with the 5s30s this year



Source: Aviva Investors, Macrobond, Bloomberg as at 30 September 2025.

We maintain the view of further dollar weakness, predicated on the erosion of US exceptionalism

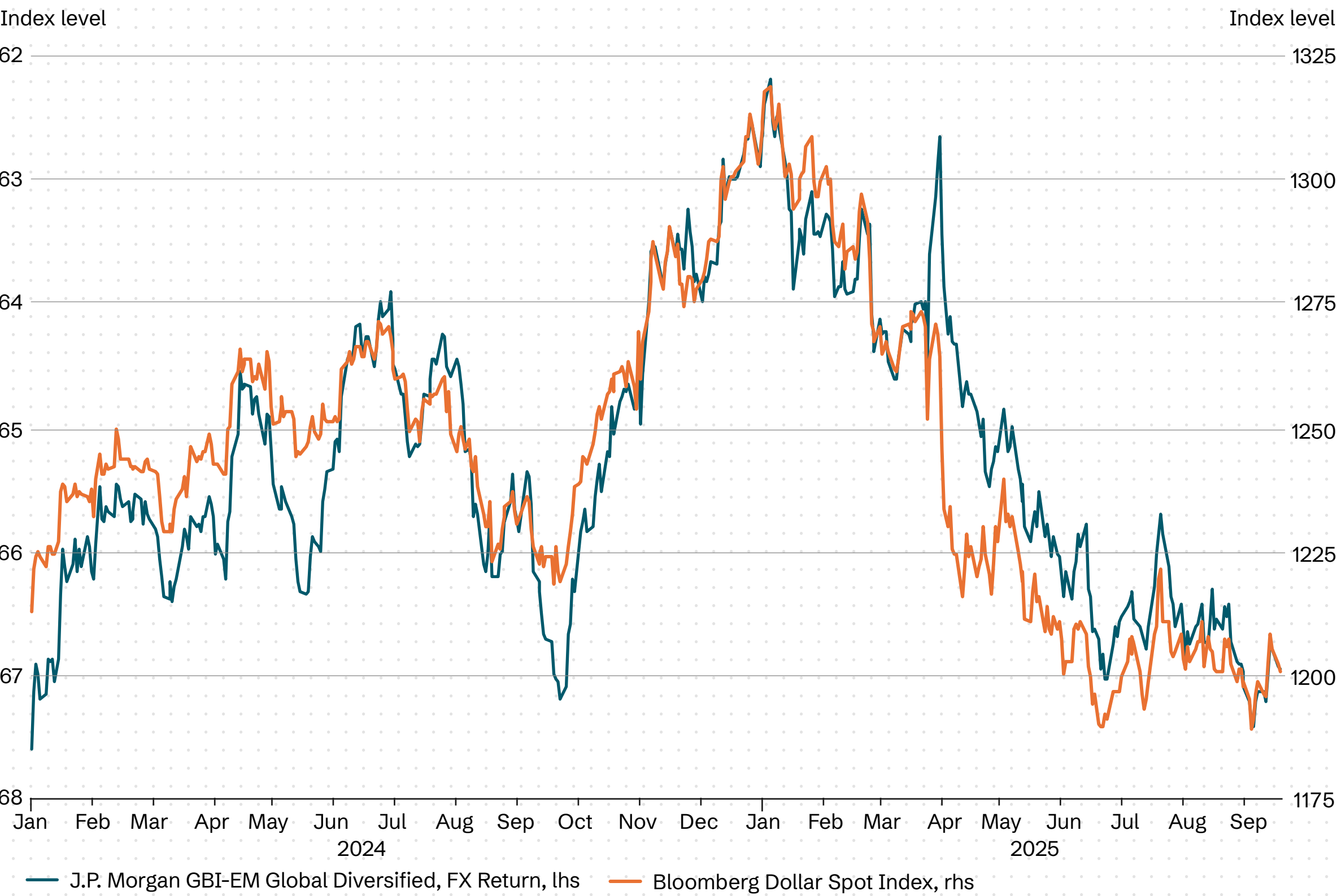


In EM FX, we still think high-carry currencies should perform and prefer BRL and MXN in Latin America; more idiosyncratically, TRY and EGP have delivered extremely high returns while managing their exchange rates to suppress volatility and inflation. In Asia, KRW and CNH are benefiting after past depreciation and thanks to tech prowess. But the EM currency story has so far not really played out in a meaningful way, trading mostly one-for-one with G10 FX against the dollar (Figure 25). Over time, higher real yields should provide some outperformance and diversification; tariff impacts and domestic political challenges are medium-term risks – both upside and downside.

Risks to our FX outlook include (a) a higher-than-expected acceleration in US inflation that should lead the Fed to ease policy by less than priced; (b) a re-acceleration in US growth; (c) tariffs impacting global trade more than we expect triggering RoW growth to slow; and (d) unforeseen geopolitical events that could generate demand for dollars.

Over time, higher real yields should provide some outperformance and diversification; tariff impacts and domestic political challenges are medium-term risks – both upside and downside

Figure 25. The EM FX Complex has been extraordinarily dollar-driven lately



Source: Aviva Investors, Bloomberg, Macrobond as at 30 September 2025.



Private markets outlook

Rebalancing the Private markets landscape

Private markets continue to evolve in response to macroeconomic shifts, policy evolution, and investor sentiment. As we enter the final quarter of 2025, we expect the relative value between private markets debt and equity assets to align more closely.

Over the past three years, private debt has benefited from a favourable rate environment, offering compelling all-in yields and healthy illiquidity premia. However, the landscape is evolving. Public credit spreads have compressed, with a wall of capital targeting a finite pool of opportunities likely to put pressure on private debt illiquidity premia.

Conversely, private markets equity strategies, in particular tangible asset backed investment in infrastructure and real estate, are showing early indicators of a resurgence. Tailwinds from thematic megatrends, fiscal stimulus and re-based asset pricing all strengthen the opportunity for growth, with investor appetite already building. Preqin data for the first half of 2025 shows fundraising volumes in real estate and infrastructure have already exceeded full year totals for 2024.

Over the past three years, private debt has benefited from a favourable rate environment, offering compelling all-in yields and healthy illiquidity premia

Real estate

Repricing complete, income in focus

The real estate cycle has entered a new phase. Across both the UK and continental Europe, repricing is largely complete, with assets having adjusted to higher interest rates. This sets the stage for income driven returns, particularly in sectors with strong tenant demand and constrained supply.

In Europe, we have a balanced view on the outlook for Real Estate. Macro stability supports sentiment, but geopolitical tensions (notably in Eastern Europe) and slower than expected capital deployment are tempering momentum.

In the UK, investor sentiment remains subdued. The focus has shifted from yield compression to income resilience, with capital gravitating towards assets offering stable cash flows and inflation linkage.

We continue to favour sectors aligned with long-term structural trends in particular the two sectors we discussed last quarter:

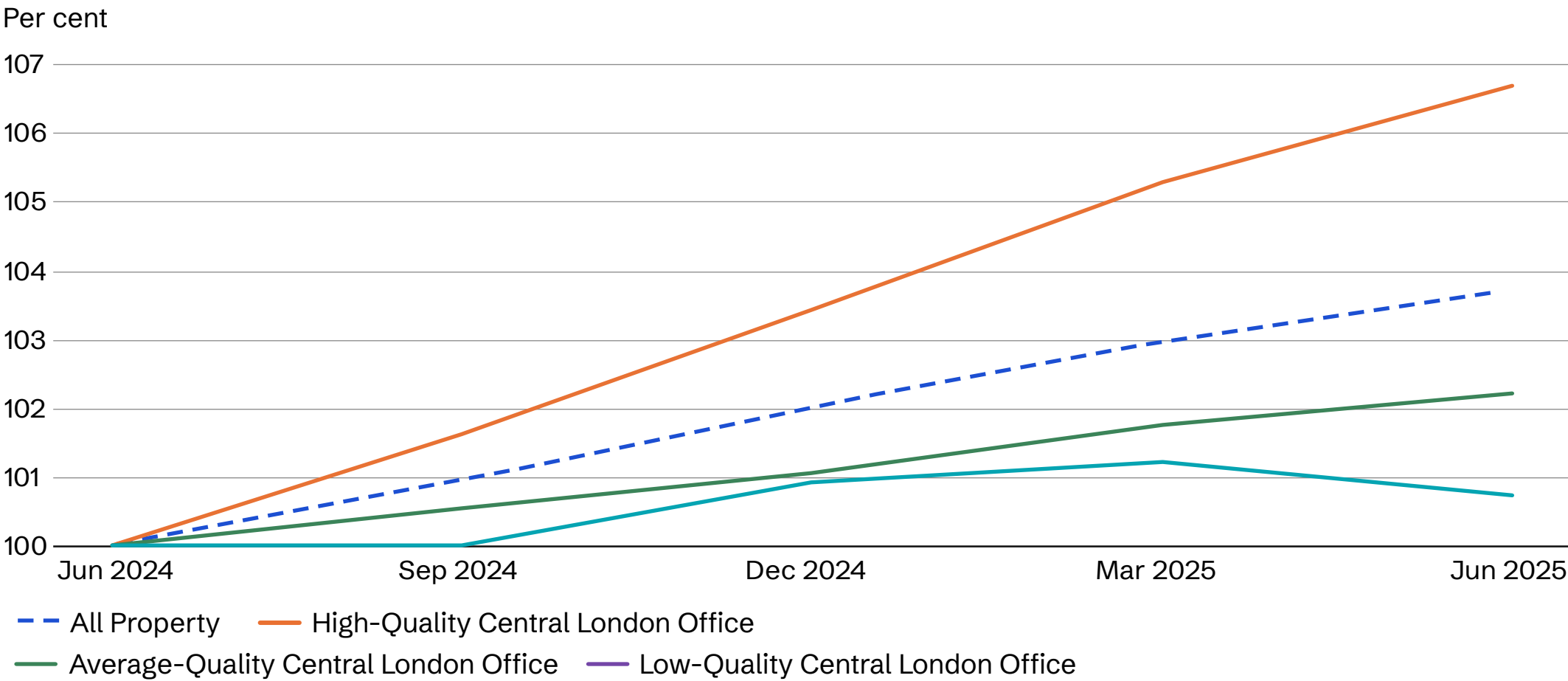
- **Urban logistics:** Benefiting from e-commerce growth, supply chain reconfiguration, and scarcity of infill sites, UK and European logistics assets are experiencing rental tension and moderate yield compression.
- **Living sectors:** Demographic shifts and housing undersupply underpin demand. UK Purpose Built Student Accommodation (PBSA) is buoyed by rising international student numbers and constrained supply. UK single-family housing (SFH) is supported by affordability pressures and evolving household dynamics. In Spain, Build to Rent (BTR) is gaining traction in Madrid and select regional cities, driven by low homeownership affordability and favourable policy tailwinds.



A third sector that continues to stand out as an appealing opportunity is central London office. The development pipeline remains muted, with new completions at multi-year lows, creating a supply pinch for Grade A space. This scarcity is exerting upward pressure on prime rents, particularly in well connected, amenity rich submarkets such as the West End and the City Core, illustrated in [Figure 26](#). Leasing activity has proven resilient, with take-up levels rebounding to match previous cycles, supported by robust demand from tech, legal, and financial occupiers.

Vacancy rates for prime assets remain below trend, reflecting a clear flight to quality. Occupiers are consolidating into high-specification, ESG compliant buildings, driving demand for newly built assets with strong transport credentials. This bifurcation between prime and secondary assets is widening, offering opportunities for strategic repositioning in the best locations. Encouragingly, capital markets are beginning to reawaken. Investment activity is picking up, pricing is stabilising, and bid-ask spreads are narrowing, all signs of renewed confidence in the London office market.

Figure 26. Bifurcation in London office rental growth



Source: MSCI UK Quarterly Property Index as at 30 September 2025.
Note: Central London Office quality based on estimated rental value per sqft. “High-Quality” is defined as the upper quartile, “Low-Quality” the lower quartile.

Infrastructure

Valuations stabilising, optionality emerging

Infrastructure continues to offer defensive characteristics and inflation protection, with valuations stabilising as real yields peak. While there were significant capital flows in 2024 and H1 2025, infrastructure asset valuations remain attractive, presenting an advantageous entry point for long-term investors. Moreover, the funding gap across Europe and the UK remains substantial, reinforcing the opportunity for strategic investment in defensive assets.

In the UK and Europe, renewables remain the dominant sector for capital deployment, supported by persistent energy security concerns, elevated power prices, net-zero commitments, and ongoing technological advancements. Within this, we see particular value in energy storage, a segment that is rapidly emerging as a cornerstone of the energy transition.

Battery storage plays a critical role in both stationary (Battery Energy Storage System) and mobile (EV) applications, enhancing renewable integration, balancing supply and demand, and supporting grid stability. The sector offers a compelling combination of revenue optionality, cost deflation, and policy support. As Europe advances towards full electrification, batteries will be essential to manage intermittency and provide grid services during periods of low solar or wind generation.

Compared to other infrastructure sectors, battery storage presents lower operational complexity and risk, while benefiting from regulatory tailwinds. While the maturity of energy storage markets varies across Europe, the trajectory is clear, batteries are becoming indispensable.

Infrastructure continues to offer defensive characteristics and inflation protection, with valuations stabilising as real yields peak



Private debt

Relative value persists, but selectivity is key

While the attractiveness of private markets equity asset classes is elevating, private debt remains attractive, particularly in the context of higher base rates and achievable illiquidity premia. However, with increased competition, selectivity is increasingly critical.

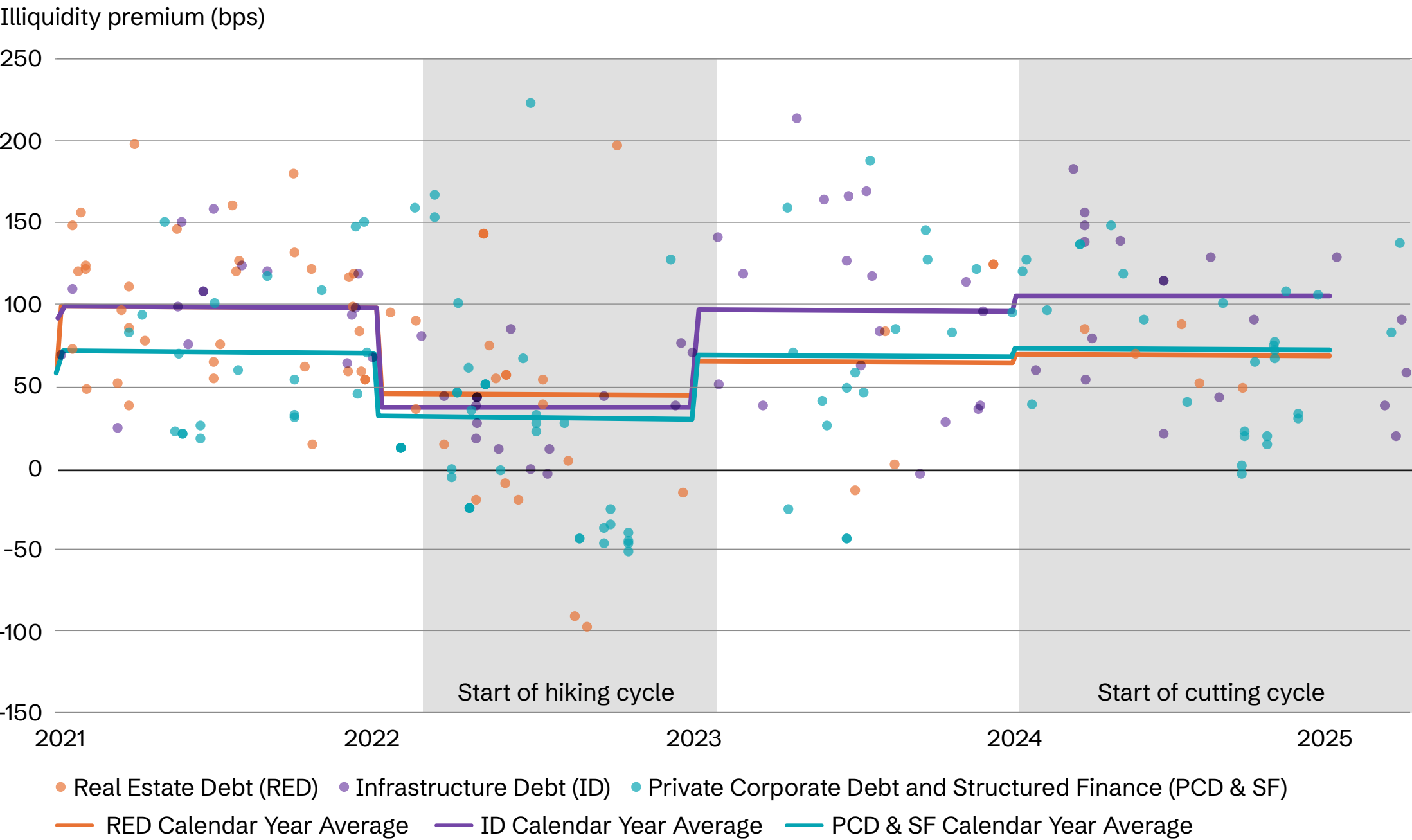
In Q2, illiquidity premia for Investment Grade (IG) private debt moved above long-term averages, following a period of market volatility, shown in [Figure 27](#). Competition for matching adjustment (MA) assets remains elevated, while non-MA eligible IG debt presents a compelling risk-adjusted return for liability aware investors seeking diversification and yield enhancement. These assets often trade at a premium due to their regulatory status, as well as offering robust credit fundamentals and stable cash flows.

Sub-Investment Grade (Sub-IG) strategies offer materially higher illiquidity premia and are gaining traction, particularly in geographies where traditional lenders remain constrained. Reduced competition from banks and insurers has created space for alternative lenders to step in, especially in crossover and sub-IG segments. These strategies are well positioned to deliver attractive risk-adjusted returns, supported by disciplined underwriting and deep market access.

We also favour high-quality securitisations and newer, more complex structures that can deliver a complexity premium. These formats reward deep underwriting and structuring expertise, and are well suited to investors with the capacity to navigate niche markets. Currency dynamics further enhance the opportunity set: GBP-denominated debt offers higher all-in yields, while EUR exposures provide stronger illiquidity premia, allowing investors to tailor portfolios to their specific objectives.

The interplay between private markets debt and equity strategies is shifting

Figure 27. Illiquidity premia in observed deals are at attractive levels



Note: The illiquidity premia are calculated based on Aviva Investors’ proprietary deal information. There are various methodologies that can be employed to calculate the illiquidity premium. Please note that the illiquidity premia shown are measured against broad relevant public debt reference data, are rating band (not notch) matched and are not duration/maturity matched.

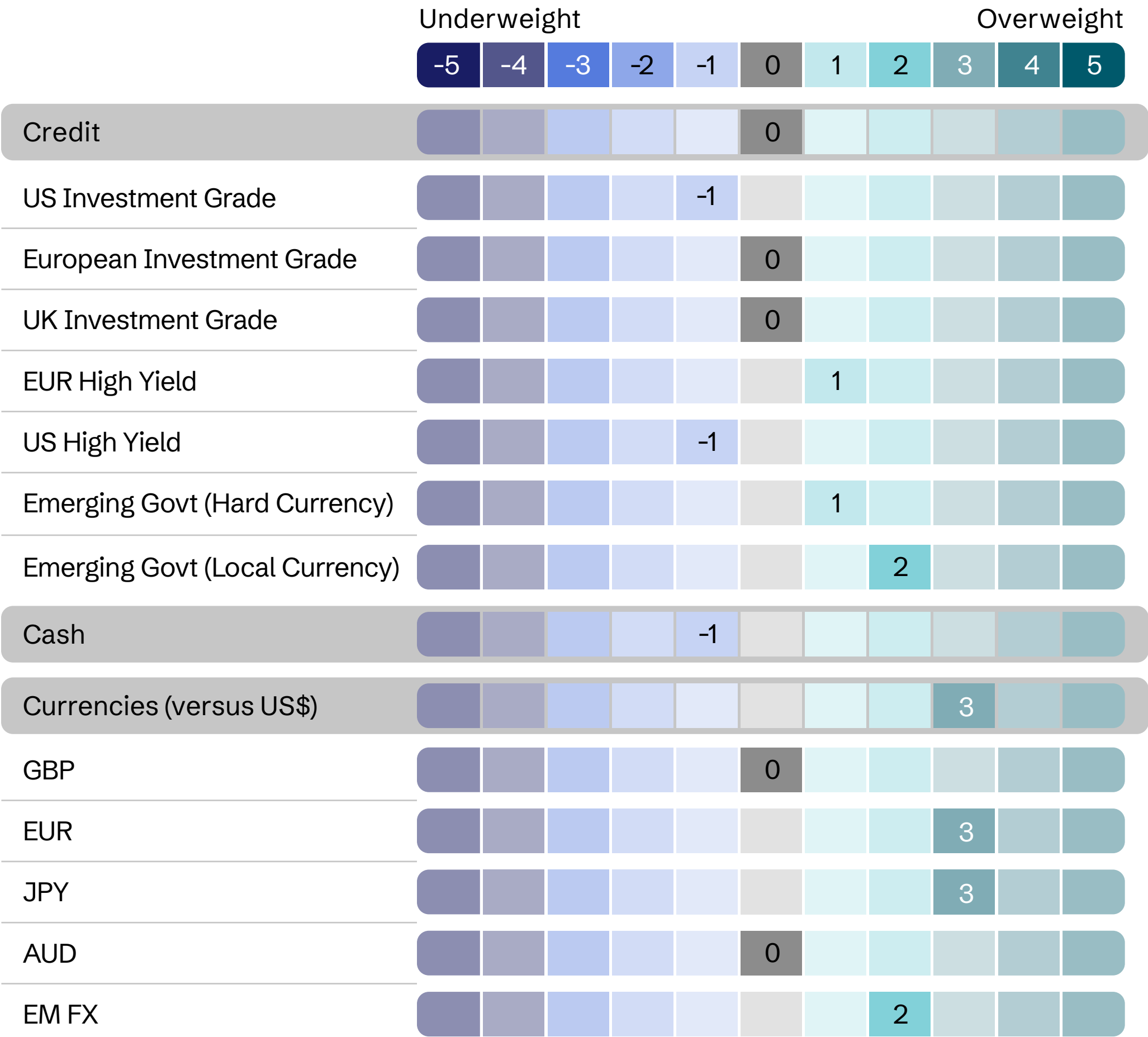
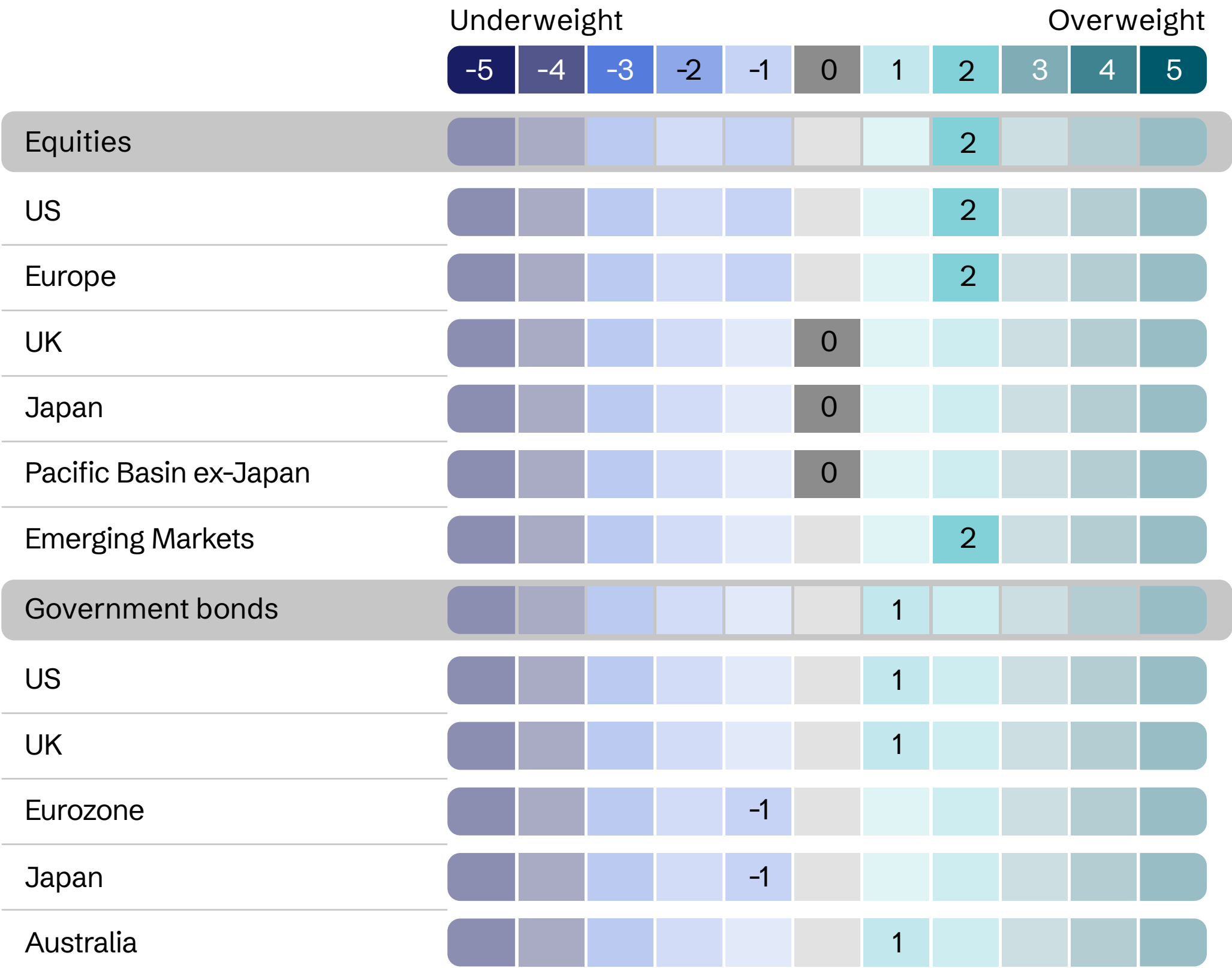
Source: Aviva Investors, ICE BofAML sterling and euro investment grade corporate indices as at 30 September 2025.

Looking ahead

Private markets are entering a phase of recalibration. The interplay between debt and equity strategies is shifting, driven by macro dynamics, capital flows, and investor priorities. While private debt continues to offer relative value, equity strategies are re-emerging as opportunities for growth.



Figure 28. Asset allocation



Note: The weights in the Asset allocation table only apply to a model portfolio without mandate constraints. Our House View asset allocation provides a comprehensive and forward-looking framework for discussion among the investment teams.
Source: Aviva Investors as at 30 September 2025.



Webcast

House View Q4 2025

23 October 2025 | 3.00pm BST | 45 MINS

Register now for our House View Q4 2025 webcast hosted by Peter Smith, Senior Investment Director, who will be joined by Vasileios Gkionakis, Senior Economist, David Hedalen, Head of Private Markets Research, and Sotirios Nakos, Multi-Asset Fund Manager as they discuss the latest economic changes impacting asset allocation.



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