

Q2 2026

# House View

Seeing through the fog: shifting  
growth and inflation risks

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Past performance does not guarantee future results.





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

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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.

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.



# Executive summary

- The effective closure of the Strait of Hormuz has triggered a sharp oil and gas price shock, lifting uncertainty and skewing near-term macro risks.
- Higher energy prices reduce global growth and lift headline inflation, with monetary policy easing likely delayed or possibly abandoned.
- Prolonged closure risks materially higher inflation and weaker growth, while rapid normalisation should restore the pre-conflict growth recovery.
- This situation makes us more cautious on asset allocation, but we remain overweight equities, underweight credit, neutral duration and selective in FX.

## Iran conflict and Hormuz disruption raise inflation and growth risks

Robert McNamara, the United States Secretary of Defence under Presidents Kennedy and Johnson, famously said “...you must try to see through the fog of war”. As we look to Q2 and the remainder of 2026, the conflict that began in Iran at the start of March has resulted in a fog descending over the global economy. The surge in oil and gas prices followed the effective closure of the Strait of Hormuz, blocking the flow of around 20 per cent of the global oil and LNG market. Uncertainty over when the conflict might end, whether the region can sustain a lasting cessation in hostilities and the length of time it might take to re-open the Strait has created a material upside risk to inflation and associated downside risk to growth. It is possible that the fog clears rapidly and those risks quickly subside. The US has said it has made good progress in achieving its military goals and the Iranian regime has suffered a significant set-back and may be willing to negotiate in good faith. If this were to unfold, we would retain our relatively optimistic outlook for a revival in global growth, albeit with somewhat higher inflation than previously anticipated.





Higher energy prices trim 2026 global growth and lift headline inflation by around 1-1.25pp, with monetary policy easing likely delayed or possibly abandoned

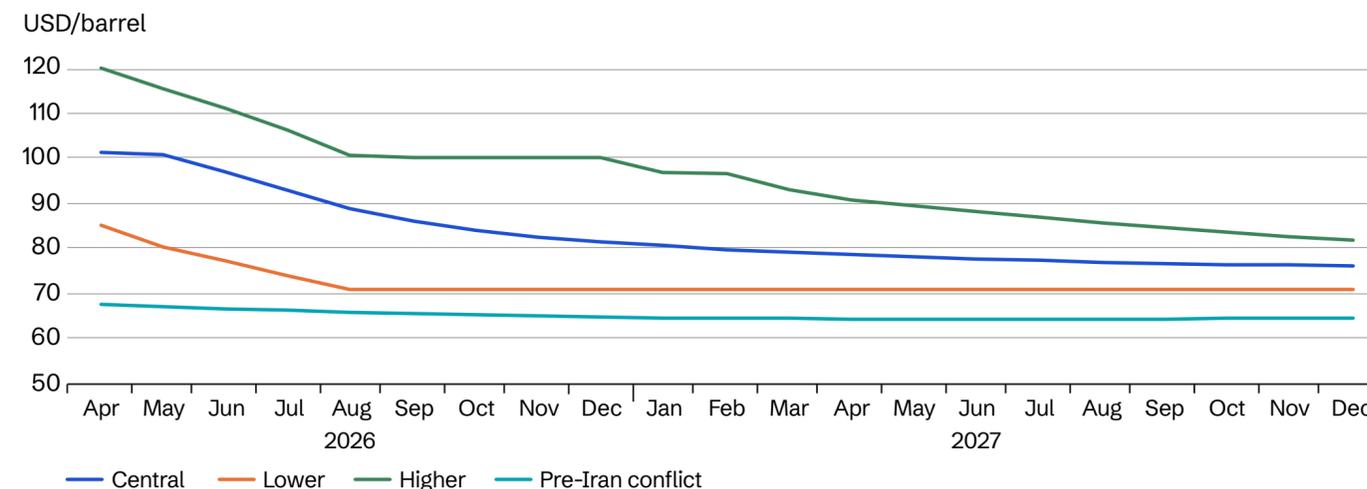


## Energy price shock trims 2026 growth and delays the rebound

But there are also a range of more severe outcomes for the global economy. The uncertainty could persist for many months, leaving visibility impaired and the global economy once again struggling to respond to a negative supply shock. In trying to see through the fog, we put less weight than usual on our central view and more on the range of scenarios on how the situation might evolve from here. In our central case, we make the simplifying assumption that global oil and natural gas prices evolve in line with the futures. That implies around a 30 per cent increase in oil prices and a near doubling in European natural gas prices over the year ahead when compared to our previous House View forecast (Figure 1). Combining this news in energy prices with other developments – many of which have been more constructive for growth – leads us to revise down our central case global growth forecast for 2026 by around 0.2pp to around 2.75 per cent. The downward revision mainly reflects weaker growth in energy importing economies, including the Eurozone, UK, Japan and China (Figure 2). Overall, it leaves our expectation of a global growth revival delayed until 2027.

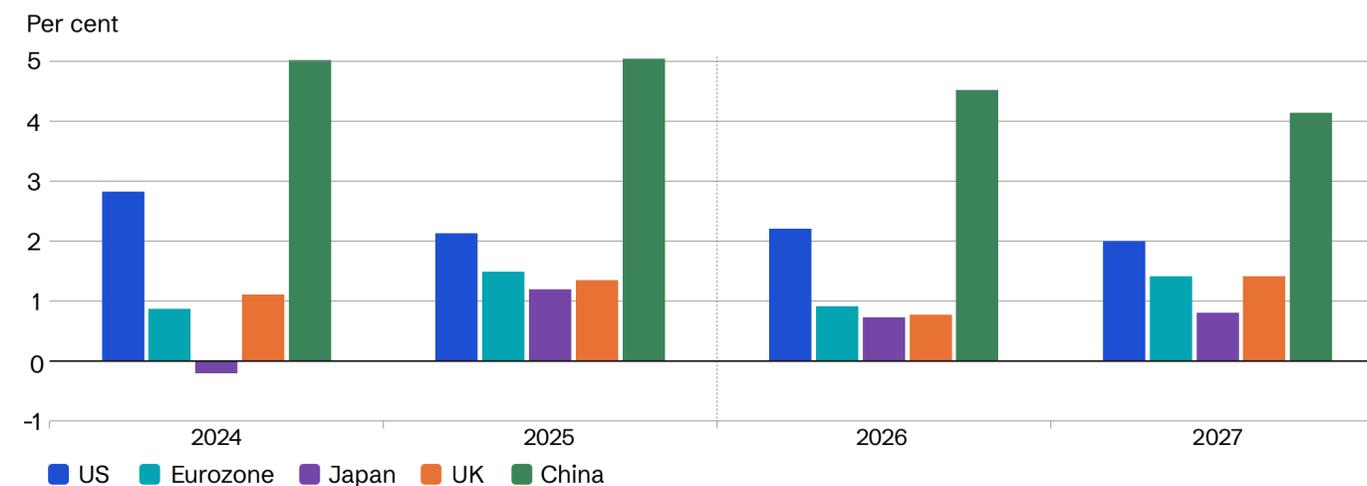
The uncertainty could persist for many months, leaving visibility impaired and the global economy once again struggling to respond to a negative supply shock

Figure 1. Scenarios for Brent crude oil prices (USD)



Source: Aviva Investors, Macrobond as at 20 March 2026.

Figure 2. Aviva Investors GDP growth projections



Source: Aviva Investors, Macrobond as at 20 March 2026.



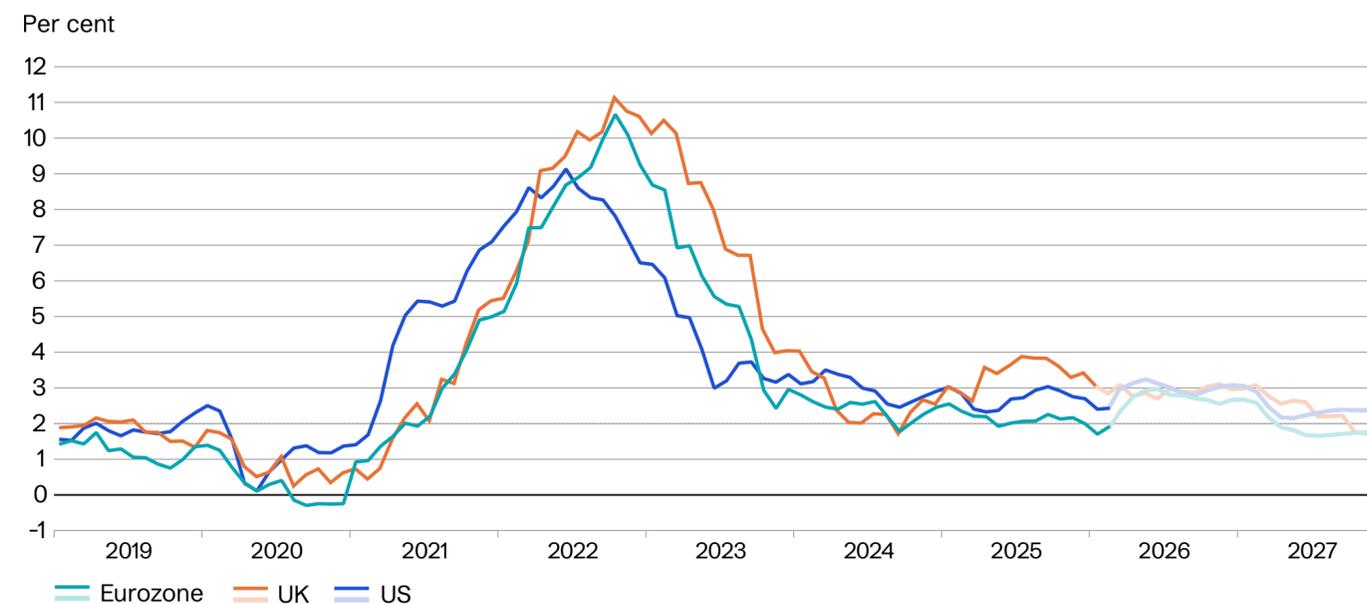
## Higher energy feeds through to headline inflation; central banks may look through it, but market is right to price in some premium

The drag on growth primarily reflects the inflationary impacts of higher energy prices. The pass-through into petrol prices and home heating and electricity are assumed to be complete and fairly rapid (in the UK the impact on home heating and electricity is delayed by the regulation of quarterly price changes). In our central scenario, headline rates of inflation in 2026 are around 1-1.25 percentage points higher than in our last forecast. For the US, EZ and UK, this means inflation is now expected to rise this year, rather than fall, peaking around 3 per cent and only moving meaningfully back towards target in 2027 (Figure 3). Typically, in response to an unexpected supply-side inflation shock central banks look through what is likely to be only a temporary deviation, accompanied by weaker demand. Given the lags in monetary policy, the central bank would be unable to prevent the direct effects of higher energy prices on inflation, while raising rates would only serve to weigh more heavily on activity and inflation up to a year after the event.

## Second-round effects could keep policy tighter than the central forecast

However, that assumes that there will be little in the way of second-round effects on underlying inflation stemming from an increase in inflation expectations. The recent experience of the inflationary period in 2022 and 2023 may make it more likely that households and businesses seek to respectively resist the decline in real wages and margins, creating further inflationary consequences. We think this is a relatively low probability, given the significant differences in demand and economic slack, but cannot rule out the possibility that central banks may want to pre-empt such an outcome. As such, we think it is reasonable for the increased probability of rate hikes to now feature in market pricing. In our central case we now expect that the ECB will raise rates this year, but that the Bank of England and Federal Reserve can be patient and still deliver some easing later in the year. But in considering the weighted probability that includes further upside risk to energy prices, we can also see the potential for the BoE and Fed to raise rates this year.

Figure 3. Aviva Investors CPI inflation projection



Source: Aviva Investors, Macrobond as at 20 March 2026.

In our central case we expect that the ECB will raise rates this year, but that the Bank of England and Federal Reserve can be patient and deliver additional easing later in the year



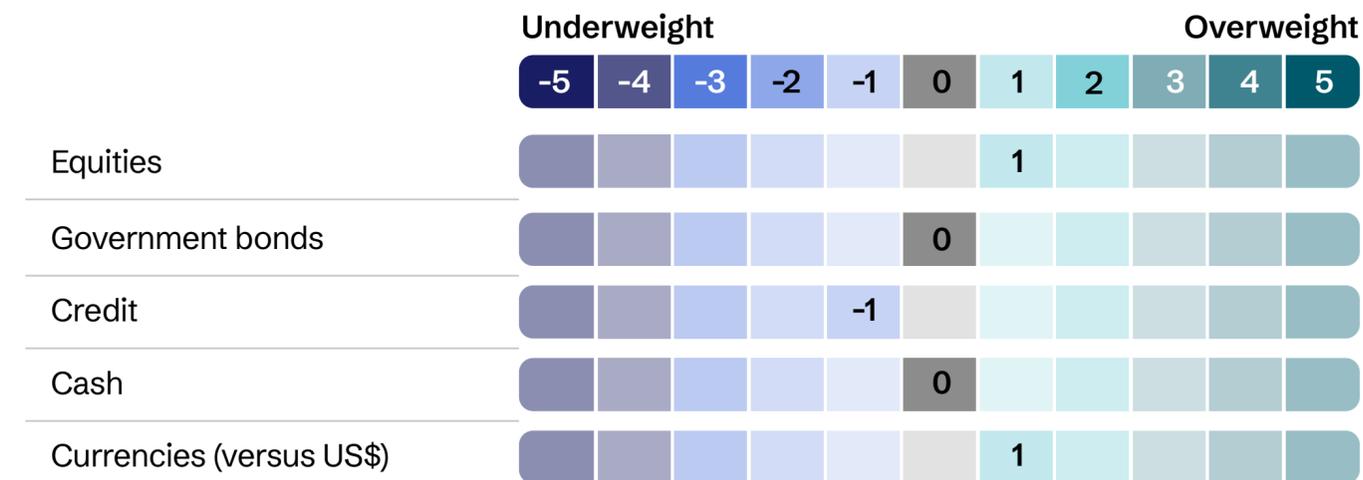
## Energy price paths depend on how long Hormuz stays closed

As highlighted above, it is important given the uncertainty and wide range of possibilities to place weight on the alternate scenarios for oil and gas prices. Critically, the period that the Strait of Hormuz remains closed will determine the severity of the energy price shock. In our higher price scenario, oil is assumed to average around 60 per cent higher than pre-conflict and natural gas around 135 per cent, reflecting a longer conflict and a more extended closure of the Strait of Hormuz. While in our lower price scenario we do not retrace all the way back to the pre-conflict levels due to residual risk premia. Rather oil and gas prices average around 15 per cent and 30 per cent higher than pre-conflict respectively. In the higher price scenario, headline inflation rates peak around 3.5-4 per cent in the major economies, while global growth this year is reduced to around 2.5 per cent, consistent with mild global recession. In the downside price scenario, the impact of the shock is sufficiently contained as to keep our pre-conflict view of improving growth intact, with only a temporary pickup in inflation. Given the situation as at the time of writing, we place more weight on the upside oil and gas price scenario than the downside price scenario.

## More cautious tactical asset allocation, but remain overweight equities (US, Japan and EM preferred)

The conflict in the Middle East and the uncertainty created has led us to take a more cautious approach to our tactical asset allocation views (Figure 4). Overall risk assets – equity indices, high yield corporate credit spreads and emerging markets – have so far only experienced a relatively modest sell-off. That modest reaction comes despite – or maybe because of – there being somewhat of a derailing of the equity rotation thematic we highlighted in the last House View. Industrial and materials sectors had performed strongly in recent months, while tech had lagged. That broadening in market performance was an important part of our thesis for being overweight equities. The market has once again narrowed following the conflict in the Middle East and regional equity performance has shifted back towards the US. Looking ahead, we think earnings fundamentals support Emerging Market and Japanese equities, alongside the US, with Europe becoming less attractive. Overall, we have moderated our equity view on the balance of risks but remain overweight.

Figure 4. Tactical asset allocation view



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. For illustrative purposes only. Source: Aviva Investors as at 20 March 2026.

## Underweight credit, neutral duration, and selective in FX

In terms of corporate credit, we continue to see the risk-reward as unfavourable given that spreads remain relatively tight and both duration and spread risks have risen. We therefore continue to prefer to be underweight. On government debt, we think that the energy shock has offsetting effects on longer-dated duration, given the higher inflation and lower growth trajectory. We therefore prefer to remain neutral but look for steeper bond curves on both long-term fiscal concerns and re-pricing of the front-end rates markets. On currencies, while we continue to see a compelling medium-term case for USD depreciation, the conflict in the Middle East has introduced a powerful counter-cycle that makes us more cautious and therefore looking for more idiosyncratic views, such as an overweight in the Australian dollar and selective EM currencies.



# Key investment themes and risks

**1****Resilient growth challenged****2****Inflation pressures re-emerging?****3****Fragmentation in financial markets and economies****4****Market rotation**

## 1. Resilient growth challenged

The global economy has endured many shocks in the past decade, but has not had a major downturn aside from the self-imposed Covid shutdown. As we headed into 2026, the economy looked set to accelerate further (albeit not into high gear), as lower interest rates translated into better housing activity and investment, capex into resources, energy and AI infrastructure gathered pace, and fiscal spending and tax cuts kicked in for many developed market economies. All these drivers seem to remain intact, along with a weaker dollar and spreading equity market recovery making life easier for Europe and Emerging Markets (see [Theme 4](#)).

This impressive economic hardiness is being tested once again, and as before firms, consumers, and governments will need to absorb some pain and clear some hurdles, from time to time. Tariffs and protectionism are here to stay, with resource nationalism and other elements of decoupling and fragmentation (see [Theme 3](#)) meaning efficient and optimal supply chains are secondary to control and de-risking. Immigration issues, populism, political risks, and labour market fragility are challenging in a few economies – the UK and US most notably.



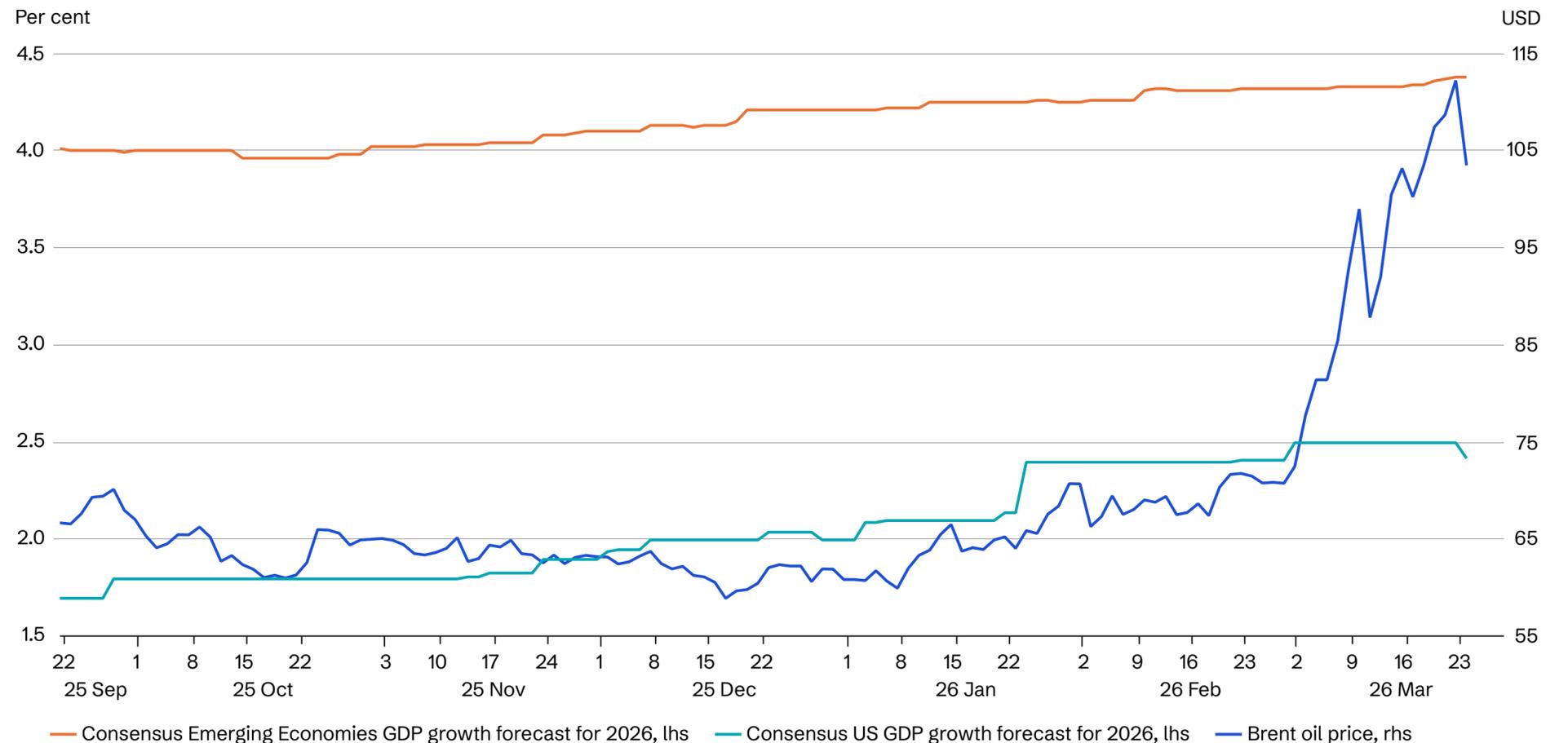
The main challenge for economies in the near term is a more pronounced and longer-term supply shock



Some market risks persist as well, although much higher interest rates, which often induce recessions, are very unlikely. A handful of rate cuts have been priced out of Fed and BoE expectations, in some cases even before the Middle East attacks, and there might need to be upward adjustments by other central banks, either to pre-empt or react to second-round effects – or in Emerging Markets, to contain currency weakness. With credit spreads tight, a spotlight on Private Credit exposures, and high optimism in many equity markets, a sharp re-pricing is a possibility (see [Risk #2](#)). While our Market Outlook sees fundamentals as supportive, markets can be fickle, and the sharp rebounds of past years might not recur, which could lead to some negative feedback loops.

The main challenge for economies is a more pronounced and longer-term supply shock ([Risk #1](#)). A disruption is already the reality, but no one knows exactly how the conflict in Iran and the Persian Gulf will play out ([Figure 5](#)), and what it means for shipping oil and other goods through the Strait of Hormuz. But the global economy has buffers and has weathered \$90-120 oil before; many countries use a mix of subsidies or price caps to blunt the impact on households and businesses, although this has fiscal impact. Even after a de-escalation a risk premium will remain, as strategic reserves are rebuilt, perhaps to higher levels or including refined products. In the worst case, if affected countries simply cannot export oil production of some 15 million barrels per day (around 75 per cent of their total production, and 15 per cent of global consumption), a much higher price will be needed to induce some extra production elsewhere, destroy demand, and hurt real incomes through higher inflation.

**Figure 5. Improved growth forecasts have not yet reflected an energy disruption**



Sources: Aviva Investors, Bloomberg, Macrobond as at 20 March 2026.

**In the worst case, a much higher oil price will be needed to induce additional production elsewhere and destroy demand**

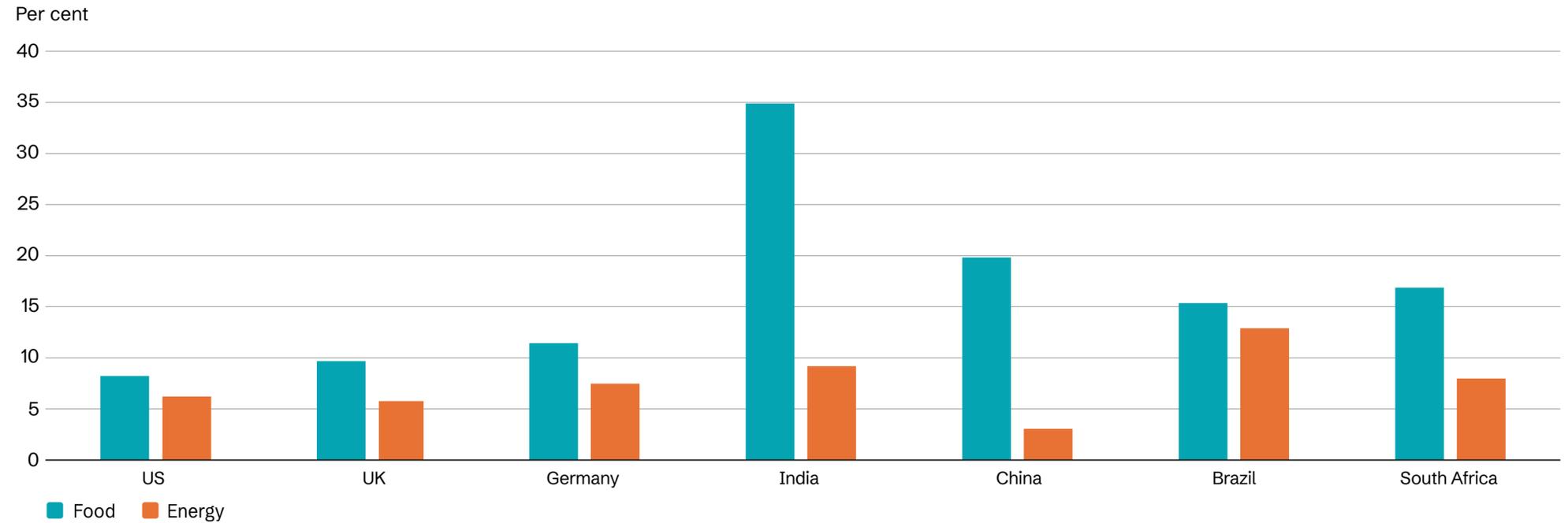
## 2. Inflation rising

Going into 2026, inflation was becoming less of an issue for economies, even as it remained salient for politicians and lower-income cohorts struggling with post-Covid cost-of-living increases. For central banks, ‘mission accomplished’ means prices go up moderately, not that wages keep up or prices go back down to previous levels. By late 2025, most economies were finally finding that sticky inflation was slowly but surely approaching their 2 per cent targets.

Yet, just as the inflation genie had been nearly rebottled, allowing most G10 central banks to reduce interest rates to around ‘neutral’, some of the risks we warned of in our last quarterly House View publication have started to emerge. On top of that, the Middle East conflict has led to a spike in energy prices, and concerns on supplies of certain chemicals and fertilisers. Near-term CPI readings will be higher than previously forecast, and the risk of a larger, longer, and more disruptive supply shock can lift overall inflation substantially. But it can also hurt demand, and prove temporary or even reverse, and central banks should only respond if there are second-round effects or expectations get de-anchored.

The AI boom has continued apace, with hyperscalers announcing around \$700 billion in spending for this year. This data centre and R&D increase will mean huge purchases and investment in ‘compute’ and ‘cloud’, i.e. semiconductors, as well as construction materials, power, and the entire infrastructure needed to support the running of a data centre: everything from transformers and generators, to fibre cabling, to cooling systems and so on.

**Figure 6. CPI inflation weights for food and energy**



Source: IEA, Macrobond, Aviva Investors as at 20 March 2026.

Bloomberg calculated that the recent 500 per cent rise in the price of DRAM chip prices will lift US CPI by 0.2 per cent, as producers of goods from phones to cars pass on those costs to consumers. Electricity prices (and noise pollution!) have risen in areas near data centres, from Ireland to Virginia, to the ire of locals and their representatives.

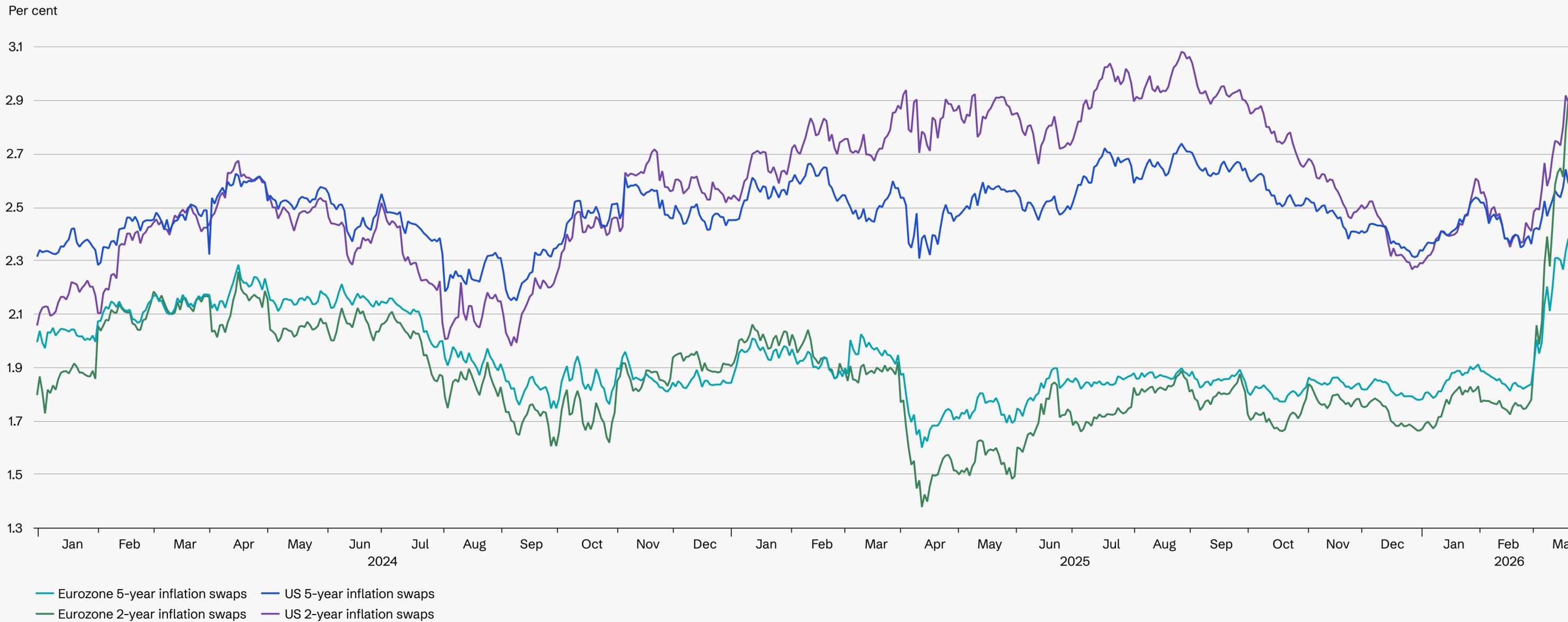
Europe responded to the Russian invasion of Ukraine by substituting cheap natural gas with more expensive LNG, but its dependency on energy has not changed much despite some conservation efforts. Most of Asia is better prepared, but still highly dependent on energy imports; emerging markets in general have higher weights in their CPI baskets for food and energy (Figure 6). While food prices are not solely determined by energy, they are impacted by transport, temperature control, and fertiliser costs, as the world saw in 2022.

The push to electrification is structural (and linked to the world’s Net Zero and decarbonisation efforts) and will raise costs of materials and metals. According to the UN, food prices rose over 50 per cent after Covid and Russia’s invasion of Ukraine but then fell back to about 20 per cent higher than pre-crisis levels. Lately they have been increasing at around 3-4 per cent annually.

For now, the better growth and slower disinflation have proven tolerable for monetary policy authorities, resulting in somewhat delayed rate cuts, or recalibration to a slightly higher ‘neutral rate’. The energy shock is being watched carefully, though: if it feeds into inflation expectations (Figure 7), raising food and non-energy products (via input costs and transport), as well as wage settlements, then central banks will have a harder time looking through the fog and concluding that a one-off shift can be contained by leaving rates unchanged.



Figure 7. Market-based inflation expectations have reacted to the energy disruptions



Sources: Aviva Investors, Bloomberg, Macrobond as at 20 March 2026.



### 3. Fragmentation in financial markets and economies

The ‘End of History’ after the Cold War proved all too short, yet globalisation and integration still seemed to be the main trend in the early 2000s. The warning signs were there: terrorism and wars, an occasional Russian invasion here or there, another failed state somewhere, a takeover by a populist leftist or right-wing autocrat – and hardly in the background, the rapid rise of China to an economic superpower.

Tensions between the US and its erstwhile allies on one side, and China and Russia on the other, are the unfortunate reality for 2026 and beyond. Selective decoupling of industries, particularly technology and natural resources, is to be expected, and competitive confrontation to be the best way to describe the increasing strain between unresolvable world views.

Beyond trade in goods and services and integration of supply chains, the so-called international rules-based order implied an alignment in beliefs about how the global economy should run and the guidelines that should govern it. This led to increased interdependency, increased institutional framework and stability.

The breakdown of this world order is not new and has been a theme in our House Views previously – particularly after the EU fragmented and Trump imposed tariffs on China in his first term. After Covid, the steady, gradual increases in global fragmentation decoupling and de-risking became starker, but apart from Russia’s isolation, there still has not been a full break from the old system. Yet multilateralism (e.g. WTO rules, or information-sharing amongst NATO allies, or commitments to the Paris

Agreements) is critically weakened and unstable, and that means investors can be caught off-guard if they rely on a global structure that no longer exists. What’s more, President Trump seems determined to turn up the heat in 2026. This is not the end of countries cooperating, of course, but unilateralism or plurilateralism, what the Financial Times terms “bespoke gatherings of like-minded countries focusing on particular issues”... is the way to go.

There is no going back to the post-1948 consensus. The future will be ever less predictable and stable, and will likely entail larger defence spending and arms races, resource nationalism,

restrictions or bifurcation in technologies such as AI, quantum computing, and semiconductors, and duplicative supply chains emphasising security over efficiency. This could induce more market volatility rather than less, if cross-border capital flows may become more regionalised as industrial policy shapes investment incentives. For now this hasn’t happened; if it does then currency and bond markets will continue to adjust, though given the hundreds of trillions of dollars of cross border portfolio and direct investment countries have, alongside tremendous fiscal and refinancing needs, we cannot take for granted that the shifts will be as orderly as they have been to date.

Selective decoupling of industries, particularly technology and national resources, is to be expected, and entails arms races, resource nationalism, and restrictions in technology



## 4. Market rotation

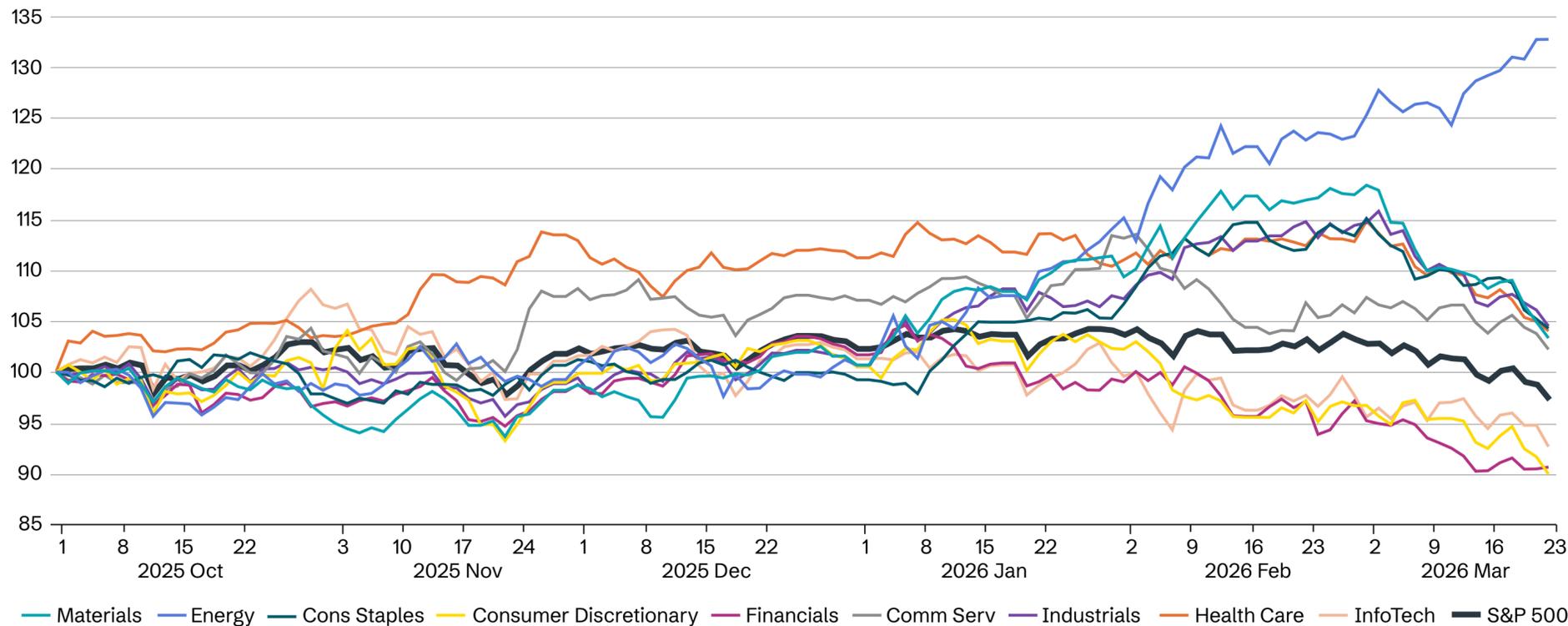
When an investor sells shares or bonds of one company, sector, or country and buys another, someone else is buying the former and selling the latter. The same number of stock or debentures are still in existence, being held by someone else. Thus, when we speak about ‘rotation’ and ‘flows’ we are really talking about sentiment shifts and expectations, which manifest themselves in prices and performance. In this sense, the central rotation theme is a convenient and colloquial way to express the change from a quite narrow, tech-led equity market toward a broader market leadership, particularly into manufacturing-exposed cyclicals (Industrials and Materials). Tech and cyclicals are complementary, with AI capex driving demand and contributing to the earnings recovery in traditional cyclical sectors. The energy transition/addition, defence expenditures, and a race for resources and supply chain security related to the fragmentation theme, are also gathering steam and helping other sectors that had underperformed before late 2025 (Figure 8).

Valuations matter too, and tech already reflects a lot of optimism. In contrast, after roughly two years in a quasi-earnings recession, sectors which are not tech beneficiaries look to have entered a new earnings cycle, reflected in strong earnings surprises, upgrades and outperformance – e.g. Industrials and Materials prior to Middle East tensions.

As with our growth theme, the main threat to a continued rotation is a prolonged energy shock, which could undermine manufacturing momentum via higher costs, damage consumers’ real incomes, and slow investment either via uncertainty or market turbulence – especially if bond issuance or the loan market is affected.

Figure 8. Equity Market performance has broadened out beyond tech stocks

Sector Sub-Index (30 Sept 2025 = 100)



Sources: Aviva Investors, Bloomberg, Macrobond as at 20 March 2026.

In terms of regional rotation, we continue to favour the US, but also see the better performance in Japan and Emerging Markets enduring. While some negative impact from a more adverse Middle East scenario is unavoidable, these should be better insulated than Europe and Pacific ex-Japan, which not only have not had as much fundamental growth

improvement, but are far more vulnerable to oil and LNG disruption (see Market Outlook for further discussion). EM currencies can still do well, but this will probably be more against DM more broadly, as the dollar’s weakness will be delayed thanks to its safe-haven status and terms-of-trade, but the euro, yen, and sterling will face some headwinds.

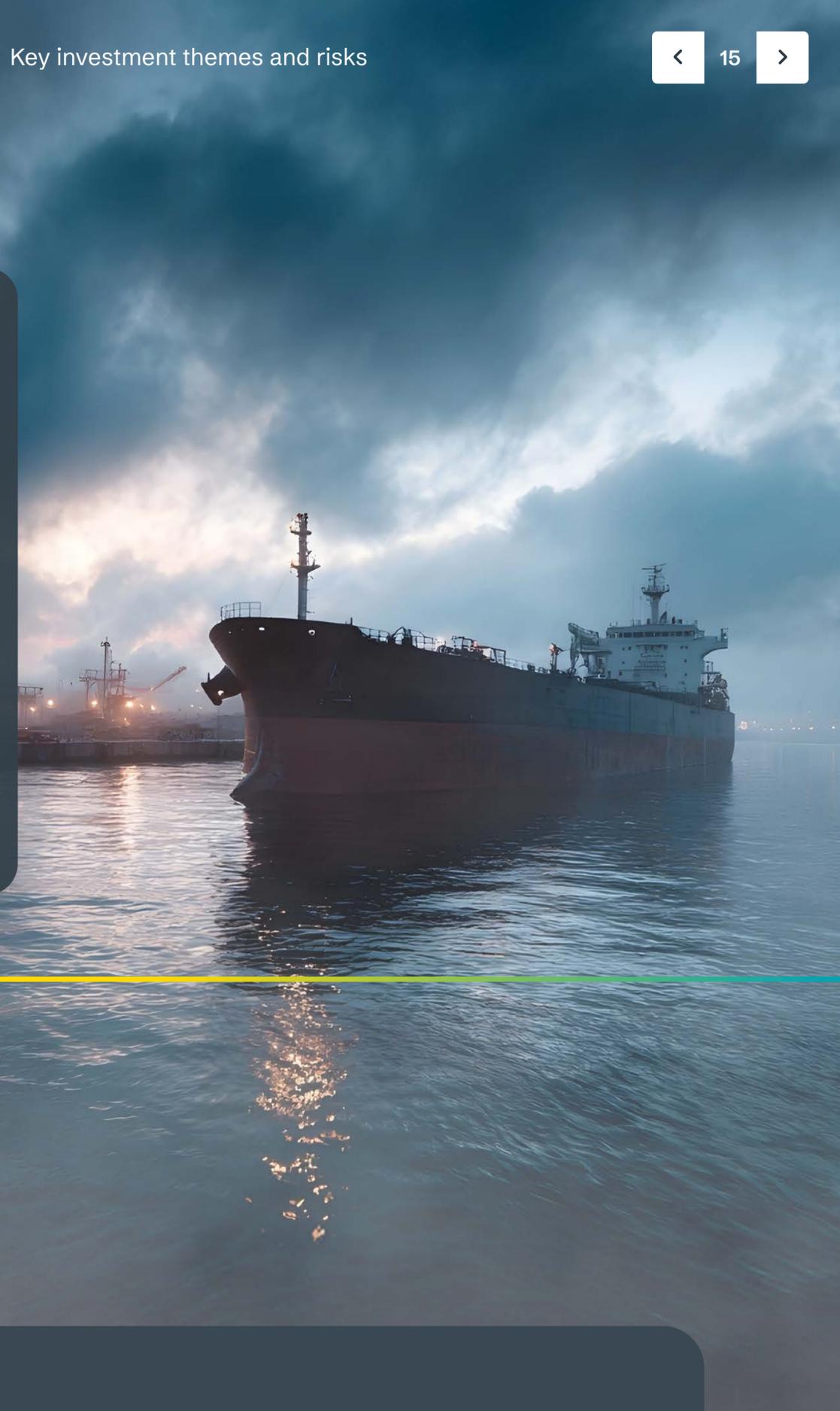
Tech and cyclicals are complementary, with AI capex driving demand and contributing to the earnings recovery in traditional cyclical sectors



“A prolonged closure of the Strait of Hormuz risks materially higher inflation and weaker growth”



**Michael Grady**  
Head of Investment Strategy  
and Chief Economist





# Risks

## Supply-side shock

When policymakers are faced with supply side shocks, distinction matters. Monetary policy can do very little to avert a permanent structural supply shock, given it has no influence over long run trends in the real economy; the task is simply to keep inflation anchored. On the other hand, temporary supply shocks may necessitate a monetary policy response, but it must be tempered – and it is challenging, in the middle of unfolding events, to know how ‘transitory’ episodes might be. In the case of a negative supply shock, a mix of weaker growth and higher inflation poses a difficult trade-off to an inflation-targeting central bank, as ensuring that inflation returns to a target consistent rate in the medium term is the priority, even if this requires further suppression of growth. Governments’ regulatory and spending policies can provide some counterbalance, though this can be dependent on market dynamics and pre-existing fiscal space.

The current shock emanating from the ongoing conflict in the Middle East, and its impact on energy prices and global supply chains, is symptomatic of such a negative supply shock. Given its global nature, relative exposures to the affected commodities could be key in driving differentiation in policy outcomes across geographies. For instance, net energy importers (e.g. Japan, Korea or Europe) will likely see a more severe impact than net energy exporters (e.g. Canada, Brazil or the US), who will experience a positive terms-of-trade boost and improved trade

balances, although these income and wealth gains will likely be concentrated in a few sectors. In the case of a severe and prolonged disruption to oil, LNG, and other goods from the Middle East, prices will rise dramatically until demand destruction and behavioural changes force lower demand and/or induce increased production or substitutes. This would be painful for the global economy: as a rough benchmark, the 2022 oil and gas supply shock was estimated by the IMF and others to have suppressed global growth by almost a full percentage point, or about \$1 trillion in lost output, in addition to causing severe hardship to the most vulnerable in societies. What should policymakers do?

The impact of an energy price shock on inflation occurs via “direct” and “indirect” channels. The initial, direct impact occurs via energy-related components within an economy’s inflation basket, e.g. petrol prices and utility bills, which will mechanically lift the headline inflation rate. Yet, assuming no further shocks,

this direct impact will naturally fade over time, even if prices stay high. Indeed, a key feature of this type of supply shock is that the first order impact on prices will not be visible in “core” inflation given these direct energy-related components do not feature in these measures. Thus, for a brief spike in energy prices, the impact upon headline inflation can be seen as temporary whilst “underlying” inflation is unaffected allowing a central bank to “look through” such a shock and feel less compelled to tighten its policy stance. However, both the duration and magnitude of the shock matter; a longer period of higher or rising prices increases the likelihood of spillover impacts across global supply chains, thus broadening the price impact beyond just energy products. Governments are usually slow to respond, but many will eventually provide subsidies to low-income cohorts, and experience reduced revenues. Thus, greater spending, more bond issuance, and steeper curves are likely if financial conditions do not tighten aggressively.

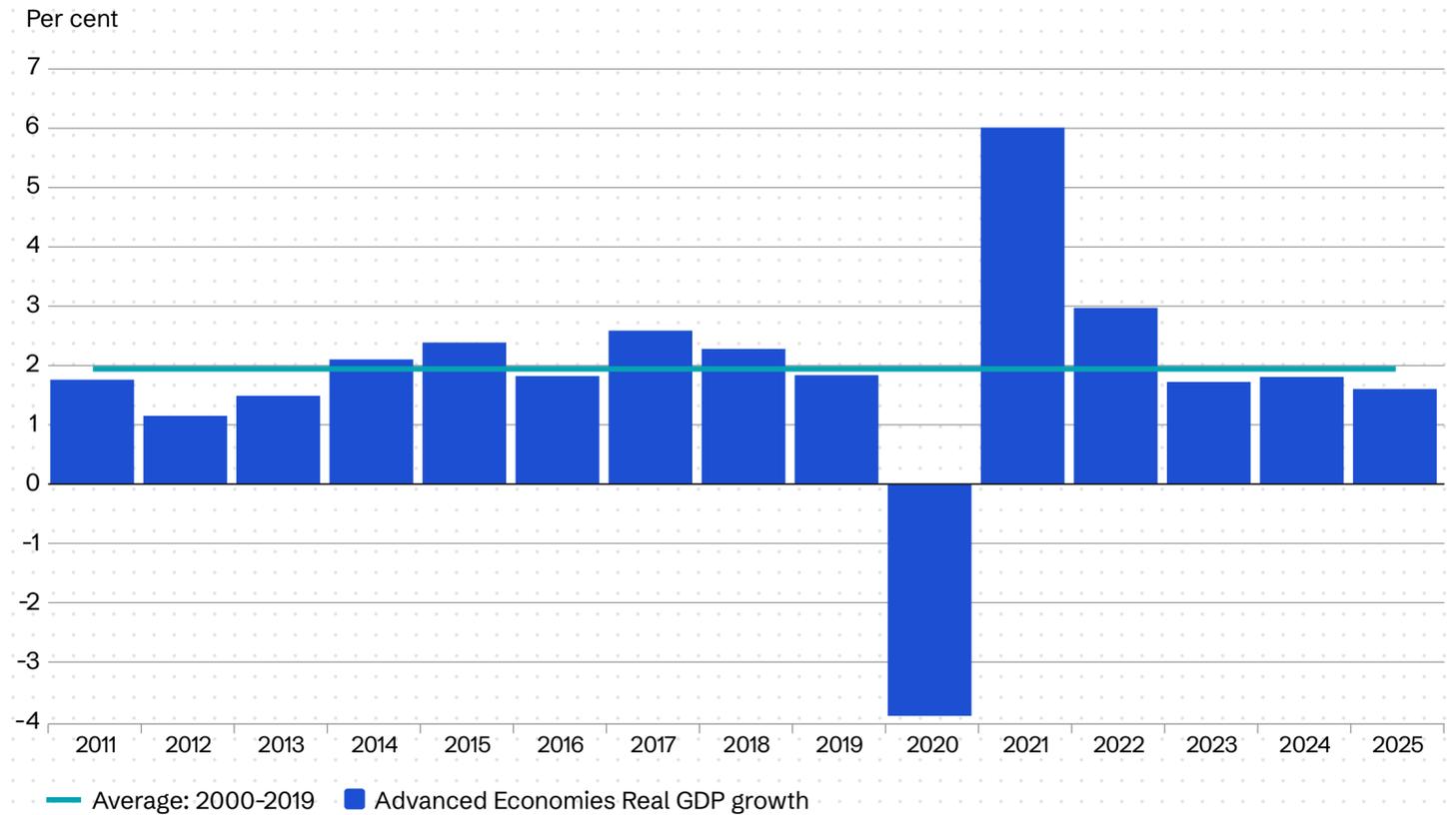
**The duration of the ongoing energy supply shock will be crucial to the ultimate impact upon inflation and central bank reaction functions**



The second, “indirect” channel occurs via future inflation expectations. Should the inflation expectations of consumers and firms start to rise then this may affect price setting and wage bargaining outcomes. Such developments pose a significant threat to a central bank’s mandate for stable inflation in the medium term, as it can spur self-fulfilling feed-back loops between wages and prices more broadly – higher wages will create demand for services and non-energy goods, too. An important caveat is that transmission via this indirect channel is conditional on the initial state of the economy; companies may lack the pricing power to expand margins and pass on costs, while workers may lack the bargaining power to attain higher wages, all of which dampens the ability for elevated inflation expectations to drive higher inflation outcomes. Indeed, there is a greater amount of spare capacity in the global economy today relative to the last significant global energy price shock in 2022, when post-Covid supply chain and labour market disruptions were still evident ([Figure 9](#)).

How a central bank responds to these shocks will ultimately depend on their confidence that the initial energy price shock will be contained to the initial first order impact outlined earlier, as well as their perception of spare capacity in the economy at the onset of the shock. We think that the perceived duration of said energy shock is key; the longer the shock persists, the greater the test to a central bank’s ability to treat such a shock as “transitory” as there is greater scope for stronger first order impacts which raise the likelihood of the impact broadening throughout the economy, and raise the likelihood of second-order effects.

**Figure 9. The global economy is much less capacity constrained than in 2022**



Source: IEA, Macrobond, Aviva Investors as at 20 March 2026.

There is a greater amount of spare capacity in the global economy today relative to the last significant global energy price shock in 2022



## Abrupt repricing of risk assets

Equity and bond markets are volatile, and asset values often reprice sharply lower. That’s not news, and usually such an occurrence reflects a risk materialising, rather than itself being the precipitating cause of a structural change in the economy or markets. For example, in 2018 the S&P500 lost 18 per cent after tariffs and rate hikes, in 2022 the index went down 25 per cent alongside a war, commodity shock, and rate hikes, and last year dropped 17 per cent due to tariffs; the only bigger loss was the 32 per cent fall in 2020 after the global pandemic. Except for 2022, these proved short-lived thanks to policy responses, and only Covid caused a very sharp and short, self-induced recession.

There are additional reasons to worry about asset markets now, with equities pricey on many measures and spreads close to record tight (particularly versus government bonds). In Private Credit, market attention on liquidity and credit quality epitomises that compression of risk premia, and investors have willingly accepted opaque structures intermediating financing to end-borrowers.

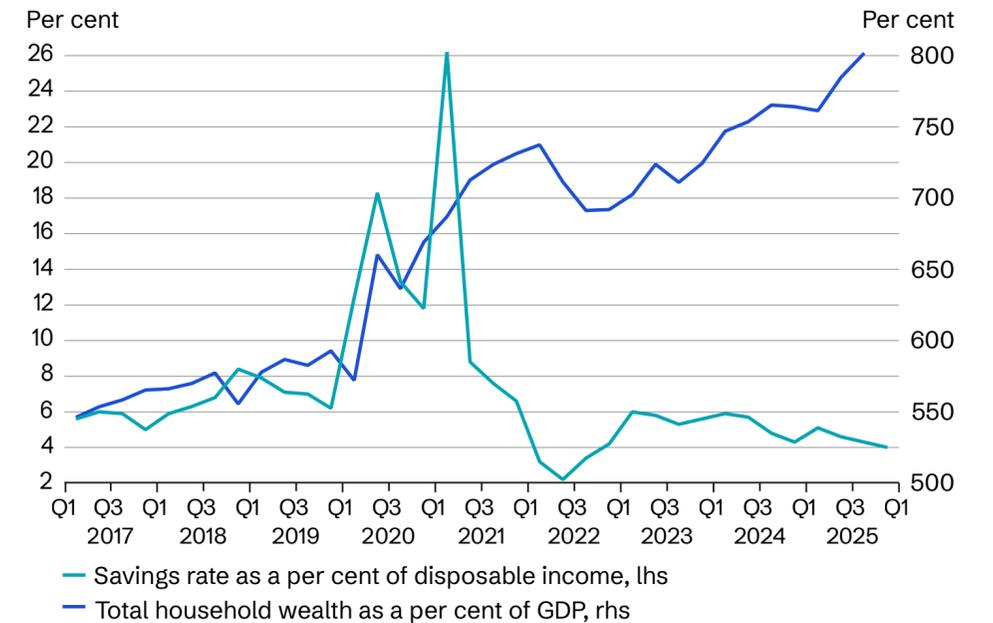
The AI boom appears central, as hyperscalers continue to seek alternative funding sources, both through corporate bond markets and structured finance. Anxiety surrounding the return on investment derived from extensive capital expenditure committed by large technology firms is unlikely to dissipate near term. After extended periods of compressed risk premia, spurred by AI-centred ambitions, markets could abruptly reprice based on timing and deliverance of those proposed returns – or simply see wider and wider spreads as big borrowers issue trillions of dollars’ worth of bonds.

Meanwhile, AI’s application to enterprise functions has called into question the profitability and business models of software companies, which have been large borrowers in recent years from Business Development Companies and Private Credit. However, market sensitivity and scrutiny appear plagued by a few individual fraudulent cases rather than widespread defaults or impairment, though NPLs seem to be rising. The truth is, we don’t know for this asset class: the inability to test assets’ values in the marketplace and to provide instant liquidity is a feature, not a bug! On an individual company basis, we have seen markets severely punish faltering cash flow visibility, with repricing occurring across other risk markets more broadly. But for most loans, until there is a cash flow problem or covenant violation, the price stays at par.

Technology cycles often see ebullience and ‘irrational exuberance’ turn to disappointment; Infotech remains an attractive sector but is undergoing some rotation, with investors trying to discern winners and losers – the rapid bifurcation of hardware and software being a case in point.

So far, none of the previous equity downturns or the recent repricing of risk assets has triggered any systemic problems or had a major economic impact. Going forward, greater focus should be placed on the potential for US consumers to react badly (though they will probably buy the dip first). Wealth creation and the household balance sheet have become increasingly intertwined with risk assets, and equity markets are playing a growing part – whilst savings rates continue to subside ([Figure 10](#)).

**Figure 10. US household savings rates have been low as wealth increased**



Source: Aviva Investors, Macrobond as at 20 March 2026.

## Technology cycles often see ebullience turn into disappointment

Hence, consumption may become more responsive to market volatility, particularly skewed towards the downside. With inflation well above target fiscal deficits ballooning as automatic stabilisers kick in, the Fed might not ride to the rescue, and long-end bond yields might stay elevated, preventing mortgage markets or investment from cushioning the downturn. For non-US markets, a US-led “event” might allow for outperformance, but would still be a headwind for growth and for total returns.



# Macro forecasts charts and commentary

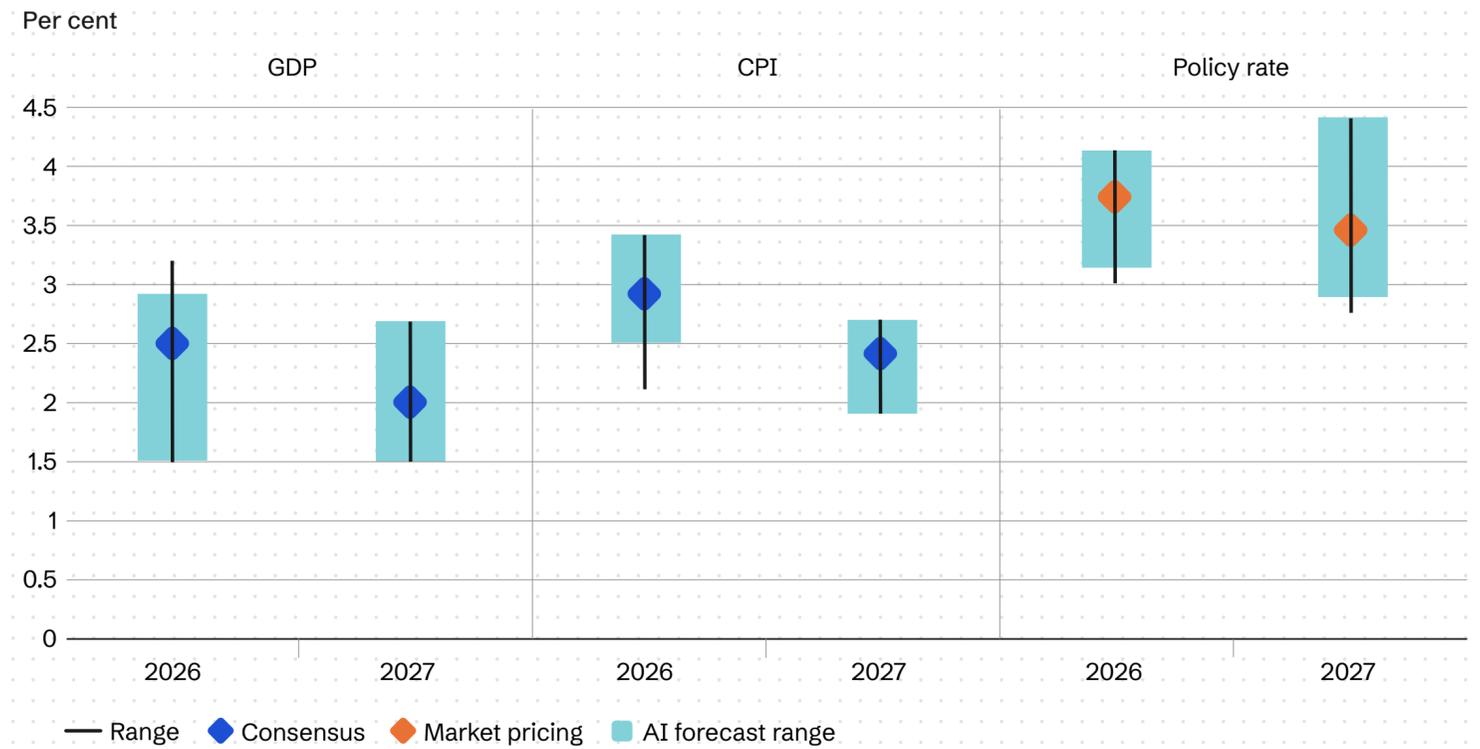
## US

### Resilient recovery?

The US economy entered 2026 on a firmer footing than expected, following a volatile 2025, distorted by the impact of both tariffs and the government shutdown. While growth slowed to 2.2 per cent in 2025 – the weakest non-recession outcome since 2018 – activity held up better than expected given the trade policy disruption. Household demand softened and government spending eased. While AI-related investment continued to surge, its net contribution to GDP growth was limited by high import intensity. Importantly, the drag from tariff uncertainty and direct tariff costs appears to have largely passed by the end of 2025. Looking ahead, recovery in real personal spending growth will depend on scale of the inflation shock and the impact on real disposable income. Tailwinds from tax refunds, lower personal income taxes and the cumulative impact of past Fed easing should provide support. We expect GDP growth to be around 2.2 per cent this year (Figure 11).

The conflict in the Middle East has seen oil prices rise sharply. The impact this will have on US activity is, like elsewhere, dependent on how high prices go and how long they remain elevated. The US is a net exporter across the wider energy complex, and as such, we think the negative growth impacts are likely only modestly negative. Looking further ahead, the growth impulse from AI should become more meaningful in 2026 as spending broadens beyond hyperscaler capex into wider business adoption, reducing import leakage and strengthening domestic demand. While a low household saving rate is a vulnerability, it only becomes a material concern if the energy price shock persists or another unexpected shock comes along.

Figure 11. US



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.  
Source: Aviva Investors as at 20 March 2026.



Labour market dynamics remain central to the outlook. Job creation in 2025 was the weakest for any non-recession year since the early 2000s, yet unemployment rose only modestly, reflecting ongoing constraints on labour supply as net migration slowed sharply. A range of labour market indicators suggest the soft patch in demand seen in the second half of last year has largely passed, with labour demand stabilising and beginning to improve. However, the weak labour market report for February, where employment fell and the unemployment rate rose, was a surprise and therefore warrants close attention over the coming months. We expect the labour market to recover through 2026, leaving the unemployment rate broadly stable or edging modestly lower. Wage growth has settled in the 3.5–4 per cent range, balancing a modest increase in slack against a tailwind from improving productivity.

Tariffs lifted core goods inflation in 2025, but pass-through now appears largely complete, with goods inflation expected to ease through 2026. Services inflation should remain broadly stable: shelter disinflation continues, partly offset by firmer core services ex-shelter as activity recovers and capacity tightens. Inflation expectations remain well anchored, but progress on disinflation has slowed. If the rise in oil prices persists, inflation could pick up more materially through the year. Based on oil futures at the time of publication, we expect CPI inflation to rise to around 3 per cent by April and remain around that level for the remainder of 2026. Against this backdrop, the Fed has shifted to a more patient stance after cutting rates by 75bp at the end of 2025. With labour market risks and inflation risks now more evenly balanced, policy remains modestly restrictive and there is no urgency to ease further. While one or two additional cuts in the second half of 2026 remain possible, the bar for further easing is rising. Indeed, a persistent rise in oil prices would make further rate cuts unlikely, with the possibility that rate hikes re-enter the discussion for early to mid 2027.

AI-related investment continued to surge, but its net contribution to US GDP growth was limited by high import intensity



## Eurozone

### Recovery consolidates but geopolitical risks emerge

Euro area growth proved resilient in 2025, with GDP expanding by 1.5 per cent – close to trend and above early year expectations – helped by a strong 1Q and steady domestic demand throughout the year. Real GDP has now broadly realigned with its 2010–19 trend, with household consumption and investment continuing to normalise. The labour market has loosened only marginally, unemployment remains near historic lows, and wage growth has slowed while exhibiting a volatile profile.

For 2026, we expect growth of around 0.9 per cent (Figure 12). The moderation reflects (1) importantly, the outsized contribution of 1Q25 in last year’s growth rate (which flatters the annual 2025 growth number), rather than a softening in fundamentals and (2) an impact to growth due to the conflict in the Middle East and the increase in energy prices. At the same time, consumption should remain supported by tight labour markets. Germany’s fiscal stimulus is a key change relative to recent years: with the deficit widening by about 1 per cent of GDP (due to increases in infrastructure and defence expenditure) and spending weighted towards high multiplier infrastructure investment, we estimate an impulse of around 0.8 percentage points to German growth and roughly 0.2 percentage points for the euro area (not considering spillovers), offset by net trade headwinds and geopolitical events in the Middle East. Execution risks are lower this year in Germany given the late rollout of 2025 measures, forthcoming state-level spending and expected improvements in permitting reforms.

Inflation returned to the ECB’s 2 per cent target in 2025 but its evolution over this year will depend on the magnitude and duration of the energy shock. Based on the current pricing of energy curves, our forecasts indicate that inflation will rise in 2026 and end the year at around 2.7 per cent Y/Y and then drop substantially in 2027 before returning to target in 2028. Aside from energy prices, the main uncertainty lies in services inflation, which – though easing – remains above 3 per cent across several measures. Wage normalisation is progressing but has been volatile as of late, while ongoing labour market tightness could slow the adjustment.

Figure 12. Eurozone



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.  
Source: Aviva Investors, Bloomberg as at 20 March 2026.



The conflict in the Middle East has triggered a largely pure supply-side shock to energy prices. This differs from 2022, when supply bottlenecks were significantly amplified by a strong demand impulse. In principle, central banks should react to supply shocks only if there is a material risk of inflation expectations becoming de-anchored. That said, the experience of 2022 is likely still fresh in policymakers' minds. And after successive inflationary shocks, inflation expectations may be more sensitive to higher inflation. Against this backdrop, we now expect the ECB to raise rates a couple of times this year, assuming energy prices broadly follow the path implied by current futures curves. Nonetheless, uncertainty remains elevated. There is a material probability that energy prices retreat, in which case ECB tightening may not be required.

Other risks to our outlook include: (1) Wage growth normalisation stalling, keeping services inflation elevated; (2) External demand softening more than we expect due to tariff uncertainty, increased Chinese competitive pressure or other geopolitical developments; and (3) Delays in Germany's fiscal execution reducing the expected growth boost.

Eurozone inflation returned to target in 2025 but its evolution will depend on the magnitude and duration of the energy shock



# UK

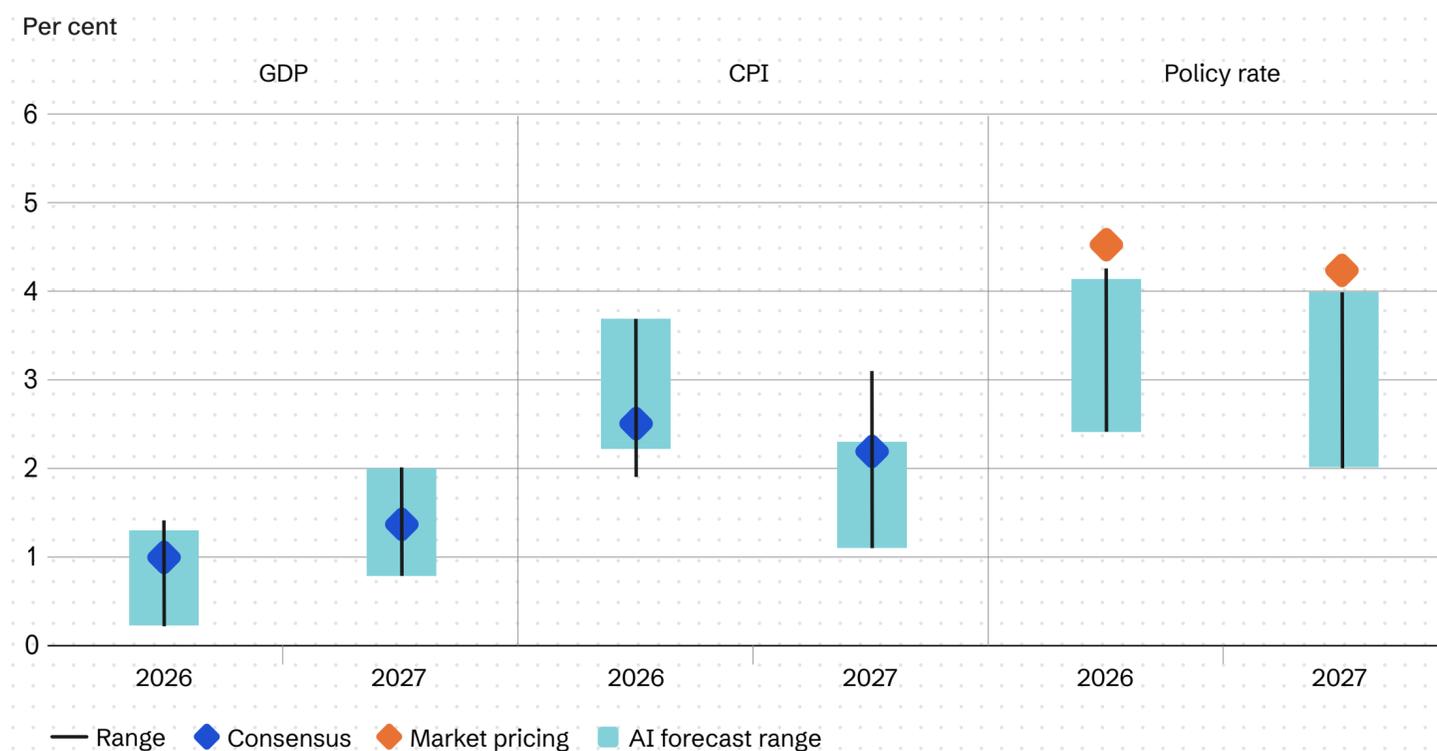
## Growth slows while new risks emerge to the disinflation process

UK GDP grew by 1.3 per cent in 2025, though momentum weakened sharply after a strong, export boosted first quarter. Inventories and government consumption were the main supports, while net trade dragged. Household spending improved but remained subdued relative to history, and the investment surge was confined to 1Q25. Excluding government spending, real GDP is just 1.8 per cent above pre-pandemic levels, with private sector activity essentially flat since mid 2025.

For 2026, we expect growth of 0.8 per cent, with risks skewed to the downside (Figure 13). The labour market continues to soften: unemployment has risen to 5.1 per cent, and while vacancies have stabilised, payroll data show notable private sector job losses. Private wage growth has slowed sharply to 3.3 per cent Y/Y, while public sector wage growth remains elevated. UK activity will be constrained by a loosening labour market, cautious households and a modestly contractionary fiscal stance – alongside dampened sentiment and increased uncertainty due to the Middle East conflict. Assuming the Bank Rate declines further (though uncertainty has sharply risen due to the inflationary impact of the energy price shock), consumption should begin to recover gradually toward 2027. Fiscal policy will continue modest tightening as the deficit shrinks by roughly 0.8 per cent of GDP in 2026, with further consolidation ahead. Political uncertainty has risen meaningfully – Labour’s deteriorating polling, the fallout from the Mandelson affair and the prospect of a leadership contest introduce notable fiscal policy risks. Reform UK currently leads national polls, while market risk premia do not yet fully reflect these dynamics.

Inflation, long above target, peaked at 3.8 per cent Y/Y in mid 2025 due to administered price changes and NIC adjustments. It has since fallen to 3 per cent and was set to decline rapidly as base effects unwind, but the rise in energy prices means increases later are inevitable; in our central scenario, we expect UK inflation to end 2026 around 2.9 per cent Y/Y.

Figure 13. UK



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.  
 Source: Aviva Investors, Bloomberg as at 20 March 2026.



With a loosening labour market and moderating wages, we then expect inflation to fall rapidly in 2027 before stabilising close to target in 2028. Services inflation remains high at 4.4 per cent but should ease as wage growth normalises further. The BoE has cut the Bank Rate to 3.75 per cent, with markets now expecting hikes this year due to the impact of higher oil prices. In our central scenario that utilises the current energy price curves, we still see the BoE lowering rates close to 3%, with cuts in 3Q26, 4Q26 and 1Q27. This is because we believe the economy is too weak to sustain current, let alone higher, interest rates. However, if energy prices move materially higher from current implied curves, cuts would likely be off the table this year. If, in addition, second round effects prove strong and persistent, the Bank could ultimately be forced to raise rates.

Aside from this, other risks to our outlook include: (1) Prolonged political instability/fiscal uncertainty that elevates risk premia materially and sustainably; (2) Labour market deterioration weighs more heavily on consumption and investment; and (3) Services inflation/wage growth prove stickier reducing the scope for BoE rate cuts.

For 2026, we expect UK growth of 0.9 per cent, with risks skewed to the downside



# China

## Slower and superficially stable

China’s lowering of its growth target to a range of 4.5-5.0 per cent in its “Two Sessions” is part of the initial Five-Year Plan implementation, but does not transform the struggling and wasteful economic model that is relying on infrastructure and industrial overproduction. This is supported by fiscal largesse – the augmented fiscal deficit should stay at around 14 per cent of GDP – leading to a growing debt overhang, as nominal growth is similar if not lower to the headline real target, due to persistent deflation. While the aim is to treat 5 as a goal, but 4.5 as a floor, we expect annual GDP growth to decelerate meaningfully this year to 4.6 per cent y/y as a weak consumer and external shocks (tariffs, geopolitics) subtract from the fiscal impulse. Core CPI and PPI remain negative y/y while headline CPI finally broke above zero on food prices, and should stay close to zero, though oil and commodities may impart some upward pressure. Deflation is set to keep bond yields low and maintain the ‘balance sheet recession’ dynamics ([Figure 14](#)).

From a macro perspective, there is little good news, though this is partly because the 2025 boost to fend off tariffs achieved 5% growth, with consumption boosted early on and exports strong. This will make 2026 have difficult ‘comps’, since we don’t see such stimulus repeating, with a focus on risk mitigation. Consumer sentiment is low, and trade-in subsidy schemes bring forward some sales, but are running into diminishing returns. The excess supply of goods has led to strong exports, but these could slow as protectionist barriers are going up; a \$1.1 trillion trade surplus is probably set to remain, but export volumes will slow, remaining at very elevated levels. A Trump-Xi meeting is set for Q2, and while a “deal” is only a temporary truce, it may improve the outlook and reduce a downside risk.

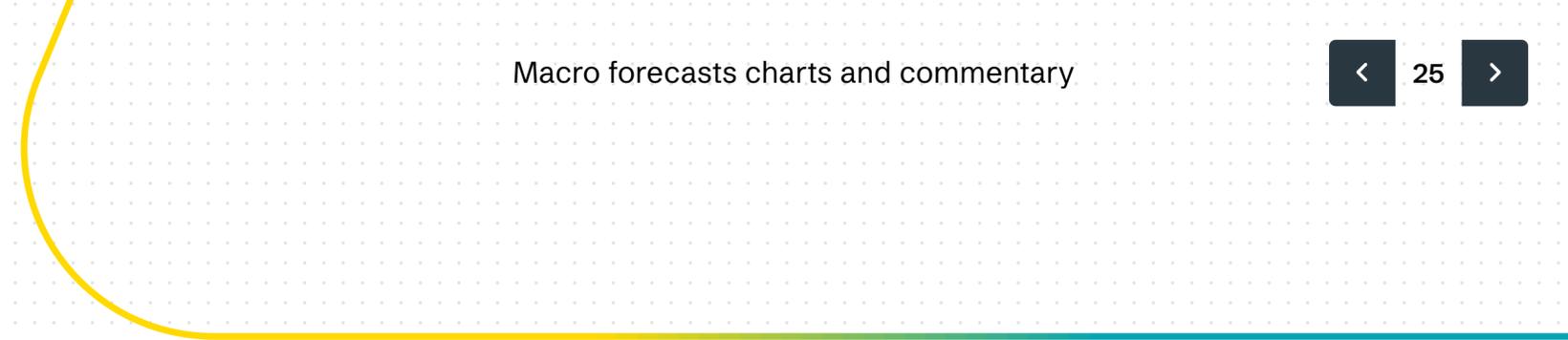
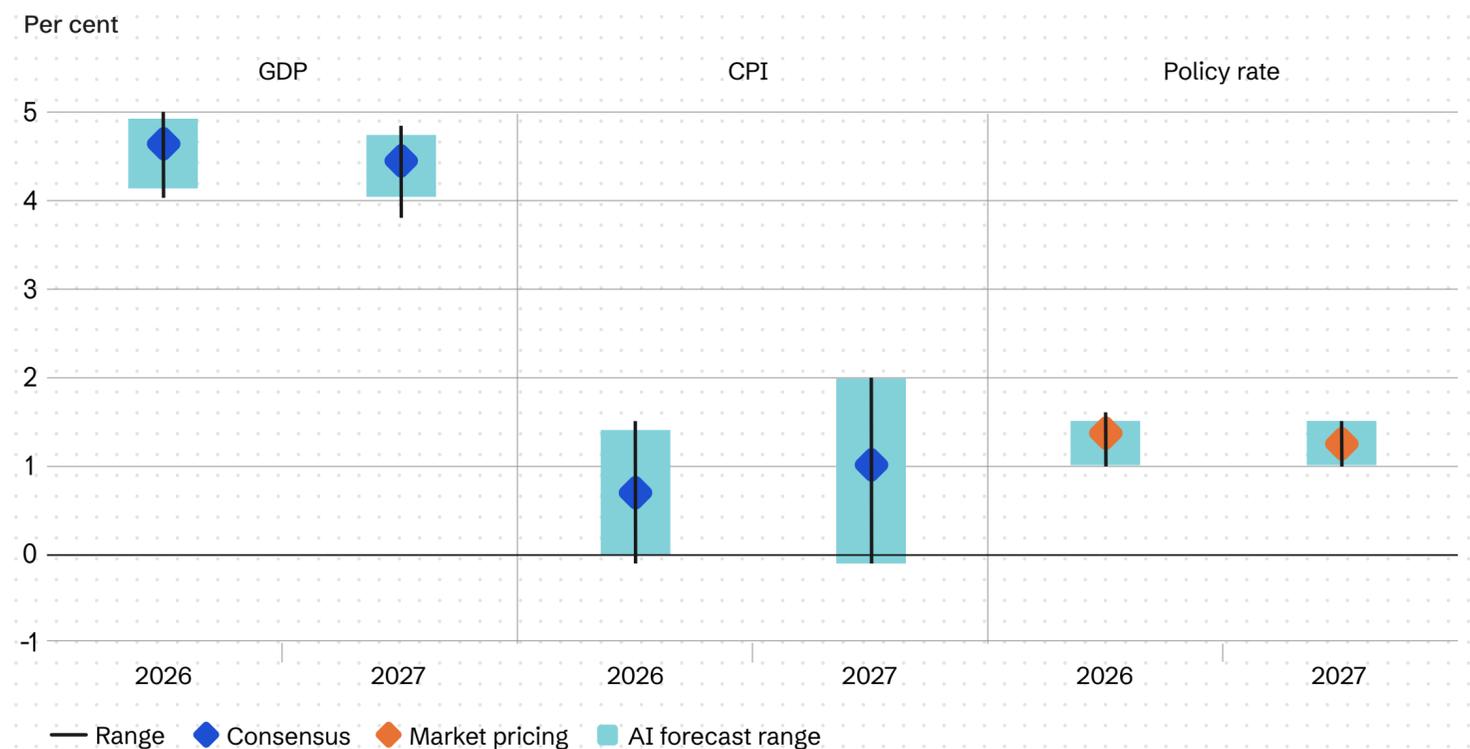


Figure 14. China



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.  
 Source: Aviva Investors, Bloomberg as at 20 March 2026.



Investment in the property sector, along with house prices and unsold inventory, is going from bad to worse, despite the depression being in its sixth year. The astounding wealth destruction is negative for sentiment, dampening hopes of a consumer recovery; retail sales, which got boosted in early 2025 to above 6 per cent growth, ended the year growing less than 1 per cent. Fixed capital investment overall is also being dragged down into contraction weak: land sales are constraining cash flow, and so local governments and their financing vehicles (LGFVs) are prioritising rolling over debt. Fiscal funds are also being directed towards social spending, rather than more infrastructure and redundant roads and railways and airports. For manufacturing, domestic competition, deflation and external uncertainty have been the key drivers. In short, the anti-involution message is being heard, but the results may have been similar without it.

The 15th Five Year Plan continues. The government's aim is to retain domination and/or achieve self-reliance in processed materials, power, technology and high-value-added manufacturing across a range of sectors, and expand into areas like 6G, quantum computing, and AI. Yet we expect no real change in the debt-fuelled investment-led growth model.

While at home political, business, and military changes have destabilised China in some ways, the effort to dominate sector after sector has built up resiliency. High-end tech is the Achilles Heel, but many firms have circumvented that, in some cases simply setting up shop elsewhere. Energy investment has boomed, thanks to domestic and foreign coal, partnership with Russia on oil and gas, and the surge in wind and solar power; hydropower is also being added to the mix with several colossal projects planned. Thus, while the Middle East conflict is tough for China as for any energy importer, estimated strategic petroleum reserves have tripled over the past decade, and thus coverage had actually doubled to some four months' worth of imports, even as demand to feed China's huge needs has increased to some 16 million barrels per day (two-thirds of which are imported), or about 15% of global production.

In sum, alongside the amazing productivity and technological achievements its companies have attained, China continues to struggle with debt, exacerbated by deflation, the uncertainty of deglobalisation or decoupling, and rigid but erratic dogma. Growth is above its sustainable level, but to slow down would entail deleveraging and defaults. All of these dangerous, dastardly Ds are intertwined with demographics. Recent statistics showed that 2025's birth rate dropped to a new low, declining by 1.5mm to below 8mm: a fertility rate of below 1.0! What was a mild drag pre-2020 is turning into a strong negative impulse for housing, consumption, and the labour force. As the post-Great-Leap-Forward baby boom of 1961-75 is front-loaded, with around 300 million people retiring over the next 12 years, the challenges to keep the economy stable will only intensify.

The excess supply of Chinese goods has led to strong exports, but these could slow as protectionist barriers are going up



# Japan

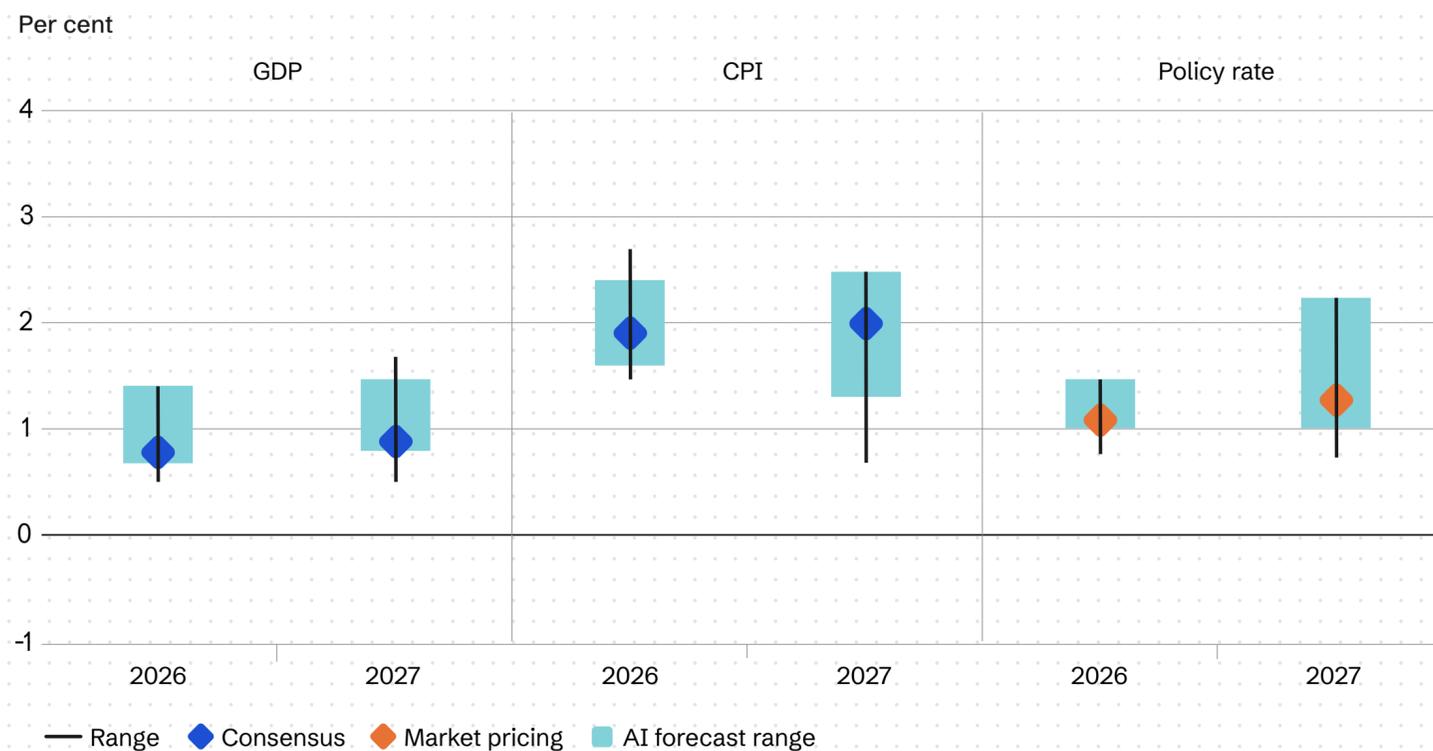
## Takaichi takeover

Following a remarkable election win by the LDP, Prime Minister Sanae Takaichi has almost unprecedented power over the world’s fifth largest economy and eleventh most populous country. While the Lower House in Japan’s Diet will remain in safe hands, dominated by the LDP’s 68% seat count, and the more divided Upper House limits constitutional changes (the next election there coming in mid-2028), Japan’s economy and politics will not remain a halcyon island in a turbulent world. The main policy trajectory is likely to stay similar to our previous House View: loose fiscal and monetary policy, intervention to suppress inflation and keep BoJ on a very gradual rate hike path, and bumpiness for the yen and JGB yield curve.

The upsized fiscal boost will support growth, which can stay around 1 per cent in 2026 and 2027 (Figure 15); Q4’s final figures showed real growth at 1.3% with nominal GDP at nearly 5.0%. For a country that has a shrinking population and workforce, this is a fairly impressive 1.5 per cent real GDP-per-capita growth. PM Takaichi’s election promise to eliminate VAT on food and beverages for two years might end up being permanent, and will boost consumption once it kicks in, probably in Q2. Private investment should be solid, with tech export demand as well as industrial production recovering from its 2024 slump, and business spending ending 2026 more strongly than expected.

While productivity growth is a driver of economic expansion, Japan’s output gap is estimated to have closed years ago, and that is manifested in inflationary pressures: underlying inflation is well above 2 per cent, but subsidies and the VAT reduction will kill three birds with one arrow: subdue popular dissatisfaction with the weak yen, help with the cost of living by lifting real wages, and give the BoJ a good excuse to remain in slow motion. That risks pressures on JPY or long-end JGBs re-emerging, which so far has been met with threats of FX intervention and promises to fund the large deficits with bills, but not longer-maturity issuance. Yet, thanks to the robust nominal GDP growth combined with low interest rates, Japan’s enormous debt “burden” is being inflated away rapidly, and a steep yield curve is appealing to local institutions that don’t, and will never, mark-to-market.

Figure 15. Japan



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4.  
 Source: Aviva Investors, Bloomberg as at 20 March 2026.



It is on tariffs, defence, and investment that the government can use its muscle most effectively, deploying its institutional power to fuse economic policy with national security. Trade policy remains pragmatic: avoiding broad tariff escalation, but using subsidies and cooperating with allies to reshape supply chains and secure critical minerals and components. Defence is the clearest inflection point, with spending likely to increase beyond the current goal of 2% of GDP and other members to support the domestic defence industry. Government investment is being channelled into semiconductors, energy, food security and defence R&D, designed to crowd in private capital and lift potential growth.

The Middle East conflict has so far had a much more muted impact on Japan's economy and financial markets in comparison with historical shocks (1970s oil embargos, or 2022 Russian invasion). While the terms-of-trade shock will be felt - how much depending on the length and size of oil or other disruptions - the yen is already weak, and the MoF has shown a desire to limit volatility. Among developed countries, Japan is the leading example of reacting to the 1970s OPEC crisis by undertaking a huge structural change, with industry and the power sector decoupling almost completely from oil, while transport efficiency, EVs and a very large strategic reserve will limit any damage, even if oil and LNG prices stay high and flows are somewhat disrupted.

Japan's loose fiscal and monetary policy may induce more bumpiness for JGBs and the yen



# Canada

## A narrow path to recovery

In Canada the path to cyclical recovery remains attainable, but narrow. We keep our call for an unchanged BoC policy rate for 2026 though we believe the downside risks to this call have increased.

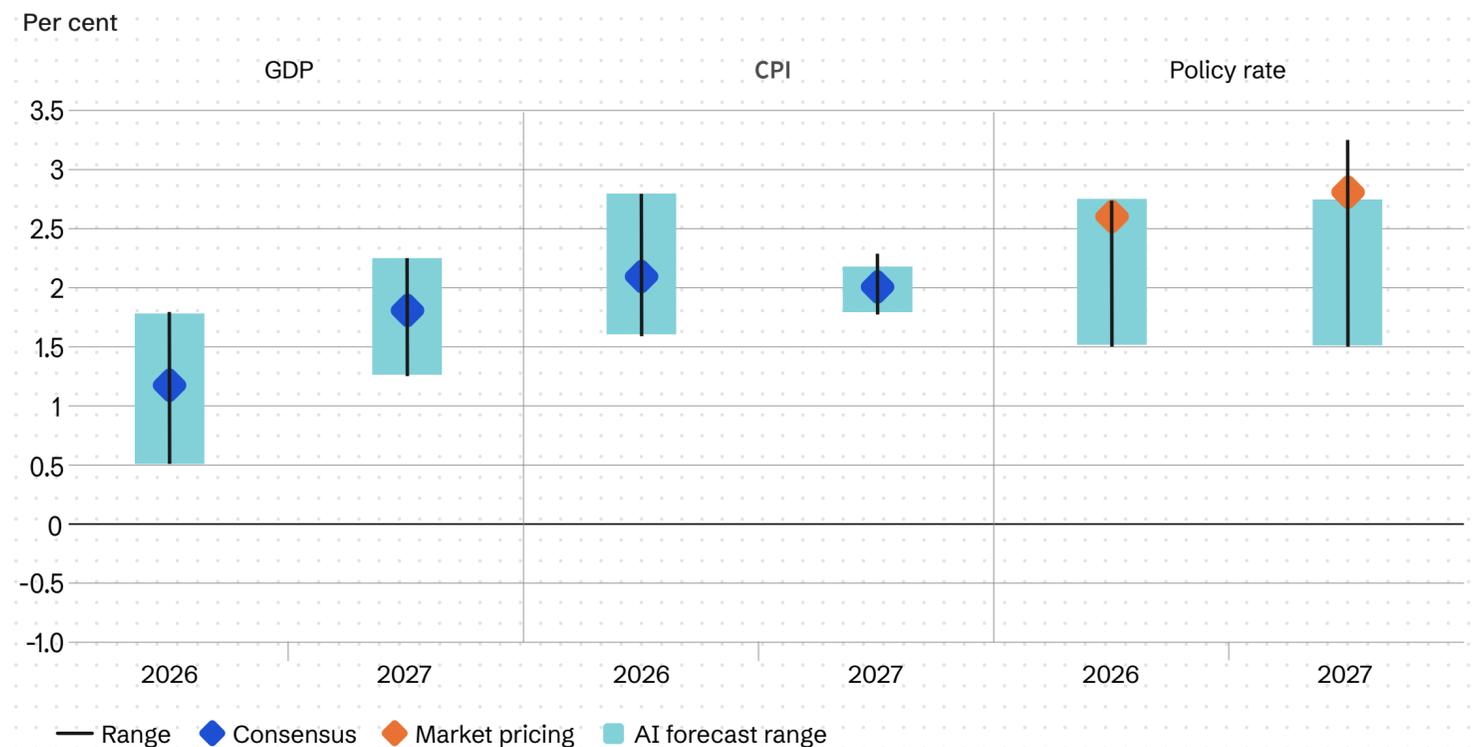
The weight of evidence from alternate indicators imply Canada’s labour market remains in a precarious position, with the spurt in job growth towards the end of last year seeming to be an anomaly rather than the emergence of a new trend. Q4’s GDP release showed that private domestic demand remains sluggish, largely owing to weak business investment volumes, which fell in 2025 YoY. We feel this is indicative of the BoC’s policy stance being less accommodative than others may appreciate as the pace of credit creation remains lacklustre.

Indeed, this sluggish trend has continued thus far in 2026. The momentum in realised job gains has faltered and at 6.5% the unemployment rate remains historically elevated whilst surveyed forward looking employment intentions remain uninspired.

Canada is facing acute structural issues – namely through the reduction in labour supply through migration inflows and a landmark shift in trading relations – which are becoming increasingly visible in the data. The trend in US bound exports slowed in 2025, in response to tariffs. Whilst Canadian population growth has fallen to all-time lows of c.0.2% year over year in Q4 2025, owing to reduced migration flows, which has seen labour force growth similarly plummet to historically low levels (Figure 16).

These headwinds bias estimates of potential growth lower and as a result could arguably raise the bar for the adverse growth outcomes needed to prompt policy intervention. Yet despite this, growth in 2025 looks to have been below the BoC’s reduced estimates of potential and, as per their own forecasts, they expect for this to remain the case in 2026.

Figure 16. Canada



Note: GDP calendar year growth; Consumer Price Index (CPI) Q4/Q4; Policy Rate Q4. Source: Aviva Investors, Bloomberg as at 20 March 2026.



The BoC has often commented on the impact that policy uncertainty can, and has been having, upon the real economy. We think this remains the greatest risk to Canada's expansion and will likely reach another peak in H1 2026 given the upcoming USMCA negotiations and the ongoing conflict in the Middle East.

Ultimately, benign trends in inflation, a looser labour market and slower wage growth should give the BoC more scope relative to other G10 central banks to look through any temporary supply driven commodity inflation shocks that may occur in the near term. Better US and global growth outcomes remain the main source of upside risks to our outlook for Canada, as does the fiscal support that is expected in the latter half of this year.

Below trend growth in 2026  
keeps Canada vulnerable  
to any external shocks that  
may materialise



# Global market outlook and asset allocation

**Equities:** Geopolitical shocks raise questions about how much equity markets could broaden out.

**Fixed income:** Fundamental steepening pressures remain our base case, though the Iran conflict has injected sharp front-end volatility.

**Credit:** Widening in spreads from historically tight starting levels should continue medium-term as issuance grows significantly and risks are underpriced.

**Currencies:** Structural USD-weakness drivers remain in place, but geopolitical shocks have infused a safe-haven bid.

**Private Markets:** We expect some rebalancing as private debt yields normalise and real asset equity (real estate and infrastructure) improve on adjusted pricing, resilient demand and constrained supply.





## Global market outlook

Global markets in 2026 have so far been defined by the conflict in the Middle East, which sparked sharp cross-asset volatility as an improving macro backdrop collided with a major geopolitical shock. Energy prices surged, with Brent jumping from around \$70 to above \$110/bbl amid an effective closure to the Strait of Hormuz, disrupting nearly 20 per cent of global oil flows and injecting a renewed inflation impulse into the outlook. Equities weakened broadly as risk appetite deteriorated, and volatility indices climbed. Front end rates reacted violently to the upside, pricing in hikes in places with heavy dependency on energy, such as Europe and the UK. Safe-haven demand drove the USD higher, reversing its prior losses for the year. Credit spreads have overall widened (particularly in European HY) but in general have behaved more orderly. With energy-driven inflation rising but global demand threatened by conflict-related uncertainty, markets increasingly priced a stagflationary mix.

Our central case now sees slower global growth this year, with escalating geopolitical tensions skewing the risks to the downside, while the energy-driven inflation shock alters the risk distribution across markets and pushes many investors towards US assets.

In equities, the conflict in the Middle East has affected Asian and European markets more significantly than the US market. While the S&P 500 index has moved circa 4.5 per cent lower since the beginning of the conflict, the European Stoxx 600 index is down circa 8.5 per cent, the MSCI Emerging Markets index is down circa 12 per cent and the Japanese Nikkei is down circa 11 per cent. This makes sense when viewed against the points we raised earlier in this report about the US being the region least impacted by energy shocks.

It is also noticeable how the conflict has served as a catalyst for the Technology sector to regain some lost ground after a period of underperformance since October 2025; the conflict and resulting energy price shock have raised questions for equity investors about the nascent recovery in manufacturing-exposed cyclical sectors such as Industrials and Materials and brought investors' focus back to the structural growth behind the Tech sector. Going forward we believe US equities and the Technology sector are likely to continue to show resilience amid the geopolitical conflict, as the structural growth in those stocks is likely to persist, save in the event of a deep global recession. We see the performance of European equities as most at risk. While in our base case we continue to have conviction in the broadening of equity markets across Industrials and Materials, the magnitude of that broadening needs to be adjusted lower as the energy shock is likely to weigh on margins and demand for traditional manufacturing cyclical sectors. Moreover, the bear case could stop that broadening process in its tracks. Finally, the Consumer sector recovery, which we already saw as more fragile prior to the conflict, is at risk even in our base case now given the impact of higher energy prices on disposable income and inflation.

In fixed income, markets entered 2026 still shaped by the structural steepening trend that began in 2024, driven by rising term premia, fiscal dominance and stretched sovereign balance sheets. While the steepening phase stalled in mid-2025 as early drivers faded, we continue to see room for long-end yields to rise across major economies, supported by higher issuance, debt-trajectory concerns and a productivity-investment cycle linked to AI. However, the energy shock has disrupted this backdrop, triggering a material front-end repricing in Europe and the UK despite being a classic supply-side shock that central banks typically "look through". The size and duration of the shock are

important alongside the second-round impacts on inflation expectations. Based on the current pricing of energy curves we think that once the conflict subsides, uncertainty will stabilise, allowing structural forces to reassert and yield curves to resume a moderate steepening bias. But clearly the distribution of risks has shifted and under our scenario for even higher energy prices, the moves in the front-end of curves would be more explicable.

In credit, the year started off well, with bumper issuance taking advantage of positive earnings, and a hiatus in worries about issuer-specific risks from tech and private credit. By the end of Q1 these resurfaced, with the software sector acting as a vector from AI's productivity gains, to a downside risk to companies' business models, to exposure of private credit firms and BDCs to the software sector. Hyperscalers appear undaunted, as they issue record-breaking amounts of bonds to fund their announced \$600-700bn spending spree this year (with more next year). Most of these are investment grade, but some HY pressures have caused spreads in US and Europe to widen over 50bps from recent lows, though both IG and HY spreads remain well below the post-"Liberation Day" April levels.

In FX the medium-term case for USD depreciation remains in place, anchored by persistent overvaluation, weakening institutional credibility, and the structural burden of large fiscal and external deficits. While the dollar had been trending lower through early 2026 - supported by softer US exceptionalism and stronger performance in higher-beta FX - the Iran conflict has reversed that pattern, injecting a safe-haven bid and tightening global financial conditions. This interruption does not alter the underlying forces pointing to gradual USD weakness, but the duration and severity of the geopolitical shock will determine whether recent dollar strength proves fleeting or evolves into a more persistent counter-cycle.



Our central case now sees slower global growth this year, while the energy-driven inflation shock alters the risk distribution and pushes investors towards US assets



## Equities

### A prolonged energy shock risks derailing the nascent recovery in manufacturing cyclicals

In our previous House View we discussed the idea that the environment in equity markets was akin to an early cycle for traditional cyclical sectors not exposed to Artificial Intelligence. The data since that last House View confirmed that idea, especially in sectors such as Industrials and Materials where the earnings season just passed saw the majority of stocks delivering robust growth and surprising significantly to the upside of consensus earnings forecasts.

Within the US, the broadening out of Tech and “Magnificent 7” stocks into traditional cyclical sectors has laid solid foundations over the last several months in our view. After most areas outside of Tech spent over two years in or close to an earnings recession; during the second half of 2025 those sectors emerged from that quasi-earnings recession into a new earnings cycle. Profits for non-tech stocks in the US over the past few months have grown at an “escape velocity” that is usually seen at the start of new earnings cycles (Figure 17). And this growth acceleration was being reflected on performance with the US Materials and Industrials sectors moving up circa 17 per cent and 14 per cent respectively from the start of the year until before the conflict in the Middle East started.

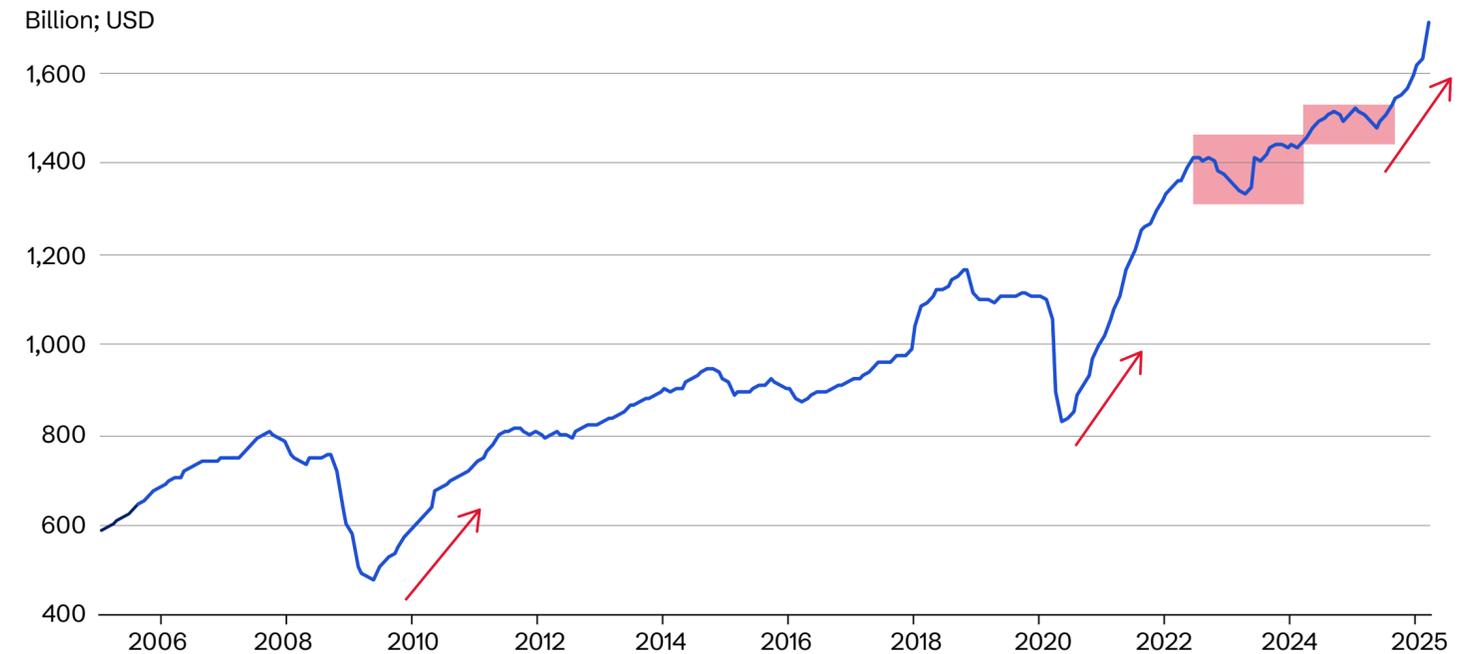
We believe that, as long as the energy shock is contained and economic growth remains robust, this broadening process from Technology into Industrials and Materials should continue. However, higher energy costs will be a headwind for margins in the manufacturing sector and hence the potential magnitude of that recovery in Industrials and Materials sectors reduces with each day that the conflict in the Middle East lasts.

We see even greater risks for a recovery across Consumer sectors. The data has been less compelling for those sectors, and the energy shock is likely to cause inflation perception to rise and real incomes to contract making a recovery that already seemed fragile less likely over the short term.

**We continue to see opportunities in the broadening out of equities into manufacturing-exposed cyclical sectors**

**Figure 17. Non-Tech S&P 500 companies have seen a significant acceleration in earnings growth**

Total Profits for Non-Tech S&P 500 Stocks\*



Source: Aviva Investors, Refinitiv Workspace as at 20 March 2026.

\*Aggregated Total 12M Forward Net Income for S&P 500 Stocks excluding the Information Technology (Level 1) sector and the Media & Entertainment (Level 2) sector.

As we highlighted before, the broadening process should not translate into a bearish view for the Technology/AI stocks. In fact, the continuation of the Tech cycle and the broadening out process are complementary as capex investments from Technology names benefit the manufacturing companies exposed and contribute to the recovery in those stocks.

In addition, the recent market moves suggest the conflict in the Middle East has brought investors’ attention back to the solid structural growth in the Technology sector and many Tech stocks have shown quasi-defensive characteristics in the recent volatility. If the conflict is resolved in a timely fashion and the impact of the energy shock is contained, we continue to see opportunities in the broadening out of equities into manufacturing-exposed cyclical sectors. And we believe that, more than ever, positioning in those sectors should be side-by-side with positions in the Technology sector where growth remains robust and is likely to be resilient to the geopolitical shock.



## Unique regional shifts – further complicated by geopolitics

We remain of the view that there is no strong “sell US” case. On the contrary, despite demanding valuations the case for the US equity market remains compelling: a strong Technology cycle which has significant further room to run: coupled with a broadening of equities and a recovery in Industrials and Materials sectors points to plenty of opportunities in US equities. The US market continues to deliver significant upwards revisions in earnings, higher margins and higher RoEs, justifying those demanding valuations. In addition, valuations have moved up significantly outside of the US, making the relative valuations less demanding for the US.

Despite that, the US equity market had been and remains an underperformer year to date, even after showing more resilience since the beginning of the conflict in the Middle East. However, we would caution against buying into a rotation out of the US. We do not believe the US need to underperform under the thesis we subscribe to: that of a broadening of equity markets. And the recent geopolitical conflict brings back to light the resilience of US growth.

In our view, for non-US equities to continue to outperform, they must deliver growth that is at least within reach of the US double-digit growth. Only if other regions outgrow the US or that growth differential to the US is small enough, then the lower valuations of other regions might be enough to continue to drive outperformance. This case is easier to make in EM and Japan than in Europe or Pacific ex-Japan.

EM and Japan are both seeing significant improvement in RoEs and profit margins, and in Japan earnings forecasts are being significantly upgraded. EM is also seeing earnings upgrades but in a highly concentrated fashion: the Tech sector is mainly responsible for the increase in the overall EM earnings expectations while most other sectors are seeing more downgrades than upgrades. This is also generating issues about concentration in EM equities, something we often discussed in relation to US equities.

The largest seven stocks in EM (five of those are Technology stocks: TSMC, Samsung, Tencent, SK Hynix and Alibaba) now account for circa 21 per cent of the market cap of the index. While this is still some way away from the circa 32 per cent of the S&P 500 that the Magnificent 7 account for, the rise in concentration has been fast since 2023.

In Europe, however, the fundamentals show little support for the outperformance. Earnings remain stuck in a downgrade cycle that started in August 2023 and while valuations have moved up sharply (PEs moved from ~13x at the end of 2024 to ~16x today and P/Book went from 1.8x to 2.3x) RoEs and margins have shown only very modest improvement. RoEs have remained stuck around 14 per cent since 2022 and margins only improved modestly from ~10.5 per cent to ~11 per cent. This means EM stocks now offer higher RoEs and similar margins to European stocks. So even if there is a quick resolution to the conflict in the Middle East, the fundamentals do not suggest Europe should resume its outperformance trend of earlier in the year. The case for Pacific ex-Japan is similar with fundamentals failing to justify the outperformance of late.

All in all, while the conflict in the Middle East has raised tail risks for equities, we maintain a positive view of equity markets, conditional on timely resolution to the conflict that limits the impact of the energy shock and avoids a recessionary scenario. Within equities we have a preference for US, Japan and EM over Europe and Pacific ex-Japan across regions.

**The US market continues to deliver significant upwards revisions in earnings, higher margins and higher RoEs, justifying its demanding valuations**



## Fixed income

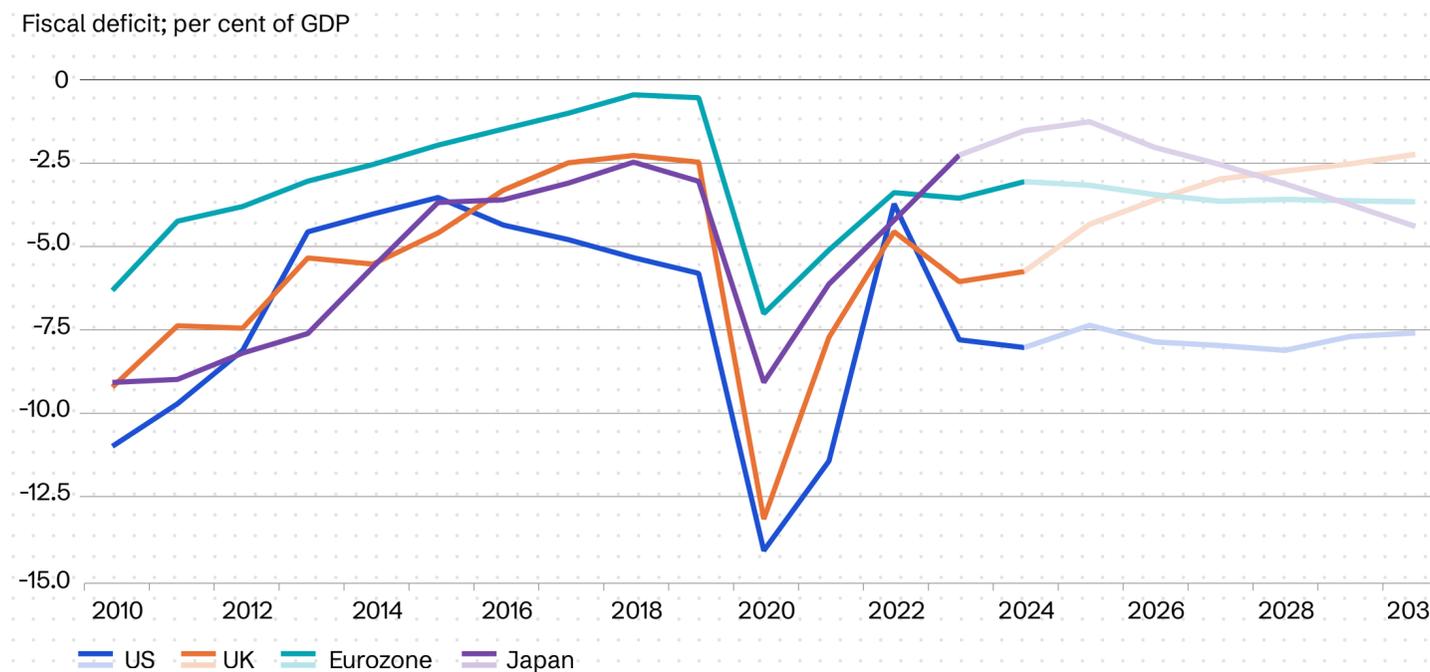
### Structural steepening interrupted by a geopolitical energy shock

Global fixed income markets entered 2026 still shaped by the structural transition that began in 2024 and carried through part of 2025. Yield curves across major developed markets steepened as term premia rose for most of the time, reflecting the end of the QE suppressed era of the 2010s and the re-emergence of fiscal dominance. By mid 2025, however, the global steepening phase stalled as the initial drivers – aggressive pricing of rate cuts and rapidly rising term premia – lost momentum. In the United States, term premia compressed before rising sharply between November and January 2026, only to give way again to a flattening pattern from February.

In our view however, there is still room for the steepening trade to run, predominantly via the long end due to the emergence of fiscal dominance, and the impact of a large productivity investment cycle associated with AI adoption. Together, these imply a structurally higher equilibrium for term premia. At the same time, sovereign balance sheets (Figure 18) – particularly in the US – are increasingly stretched, making long end yields more sensitive to debt trajectory concerns (Figure 19) and to the interaction between issuance and global savings. Although a potential second “China savings wave” is discussed frequently in markets, China’s retreat from US Treasuries over the past decade means any incremental excess savings are unlikely to replicate the downward pressure on yields observed in the early 2000s.

These structural forces frame our fundamental yield and yield curve views in major economies. In the US, we expect both a steeper curve and higher long term yields over our forecast horizon. With the 10-year yield around 4 per cent likely marking the lower bound of its trading range, we believe the market is underpricing the risks posed by fiscal dominance, increased Treasury supply, a less unified Federal Reserve, and resilient growth. In the Euro Area, heavy sovereign issuance, additional EU level borrowing and a modest cyclical improvement all point toward higher long yields and steeper curves as both real yields and inflation risk premia drift higher.

Figure 18. Deficits are expected to remain wide or widen further in most major economies



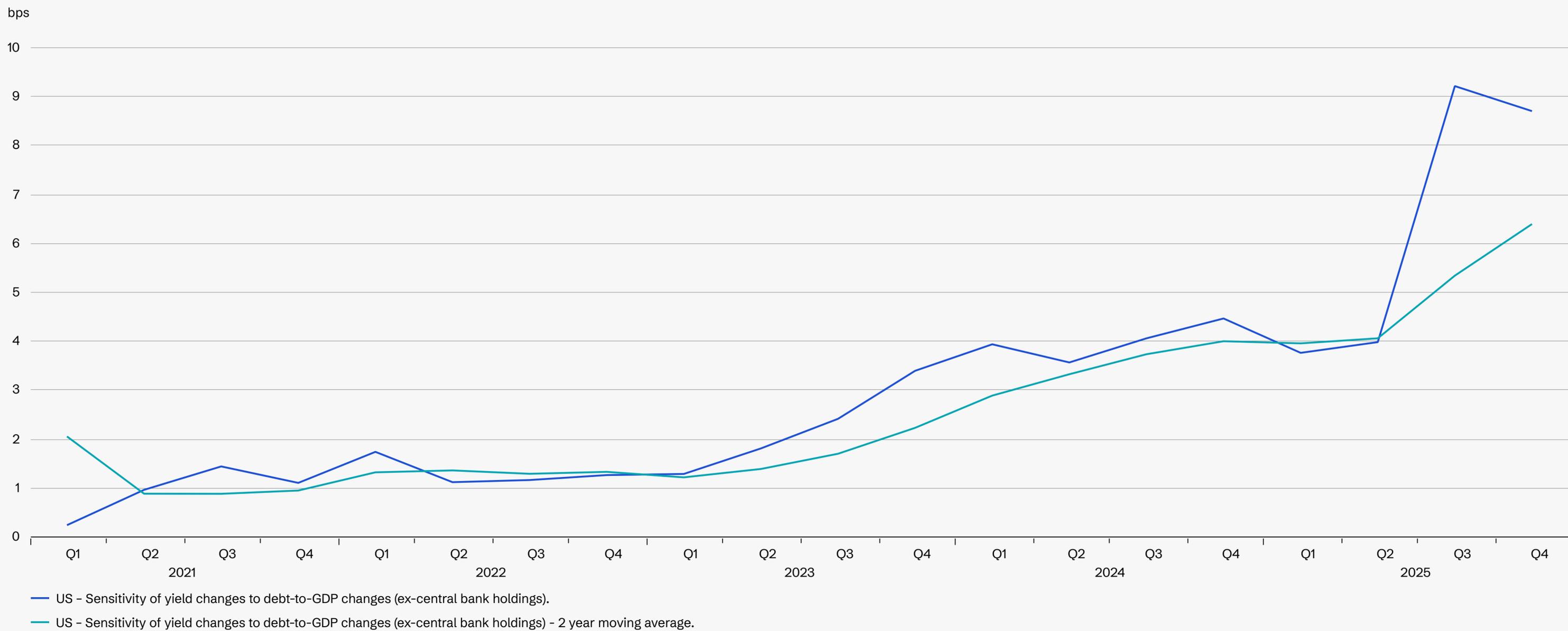
Source: Aviva Investors, Macrobond, IMF as at 20 March 2026.

Global fixed income markets entered 2026 still shaped by the structural transition that began in 2024 and carried through part of 2025



**Figure 19. The sensitivity of US 10Y yields to debt-to-GDP (after controlling for macro variables) has been increasing since COVID**

(We regress changes in US 10Y yields on changes in the US debt-to-GDP ratio and some other macro variables; the chart shows the evolution of the estimated coefficient of the debt variable)



Source: Aviva Investors, Macrobond as at 20 March 2026.



## The Iran conflict: a supply side shock, unlikely a new full-blown hiking cycle

It is against this fundamental backdrop that the sharp escalation in the Middle East conflict and the associated surge in energy prices must be understood. The abrupt rise in oil and gas prices produced a classic supply side cost push shock, significantly disrupting what had been a relatively orderly curve environment, for the most part. Markets responded with a forceful front end repricing in the Euro Area and the UK and a reversal of front end easing expectations in the United States. In principle, central banks should react to supply shocks only if there is a material risk of inflation expectations becoming de-anchored. That said, the experience of 2022 is likely still fresh in policymakers' minds. And after successive inflationary shocks, inflation expectations may be more sensitive to higher inflation.

As such, we think part of the aggressive repricing higher is justified. The UK is a notable exception in our view, as under our central scenario the economy already appears too weak to sustain current, let alone higher, interest rates. More broadly, taking into account both current front-end pricing and the significant curve flattening since early March, we see scope from here for some curve steepening and a gradual realignment with the medium-term fundamental driver of higher term premia.

That said, the distribution of risks has clearly shifted. The tails have become fatter, and the ultimate outcome will depend critically on the magnitude and duration of the shock.

Markets responded with a forceful front end repricing in the Euro Area and the UK and a partial reversal of front end easing expectations in the United States

In the UK, we continue to see a significant degree of economic slack, creating pressure for the Bank of England to ease monetary policy further. The gilt curve therefore retains a steepening bias, driven by both front end softness and structural upward pressure on long end premia, especially as UK specific political uncertainties pose intermittent risks of disorderly curve moves. Finally in Japan, yields are off their recent highs and yield curves have flattened following substantial steepening. The BoJ should continue to hike rates, but pace will depend on the political constraints. We also hold low conviction on the shape of the yield curve in Japan as it will end up being a battle between higher term premia (due to the sizeable fiscal stimulus) and the extent to which the BoJ manages to normalise policy.

Turning to credit, corporate bond issuance began the year at a torrid pace and was absorbed by seemingly insatiable demand and strong inflows into the asset class in Europe and the US, and in HY as well as IG. Going forward the disruption in energy markets caused by the Middle East conflict and greater uncertainty has had only a minor negative impact; should the situation worsen and become more 'stagflationary', we believe credit spreads will continue to widen (as in past war/energy events), and this will modestly tighten financial conditions, as discussed below. The private credit market risks we warned about are not systemic for the financial sector, as in 2008, but investors are right to demand greater compensation for opacity and illiquidity, and the software sector does face real threats; meanwhile the AI cap-ex related issuance will increase rapidly and appears price insensitive. The financial and tech sectors should underperform and drag the index's average OAS higher. We are not highly pessimistic, though, as more broadly, macro and corporate fundamental conditions are favourable, and recession risk remains low - there are lots of long-term buyers who are matching liabilities and don't ever plan on selling or marking-to-market. However, we are underweight the asset class because spreads remain at tight levels relative to history: the upside of spread tightening a few basis points is still outweighed by a negative skew towards wider spreads.



## Currencies

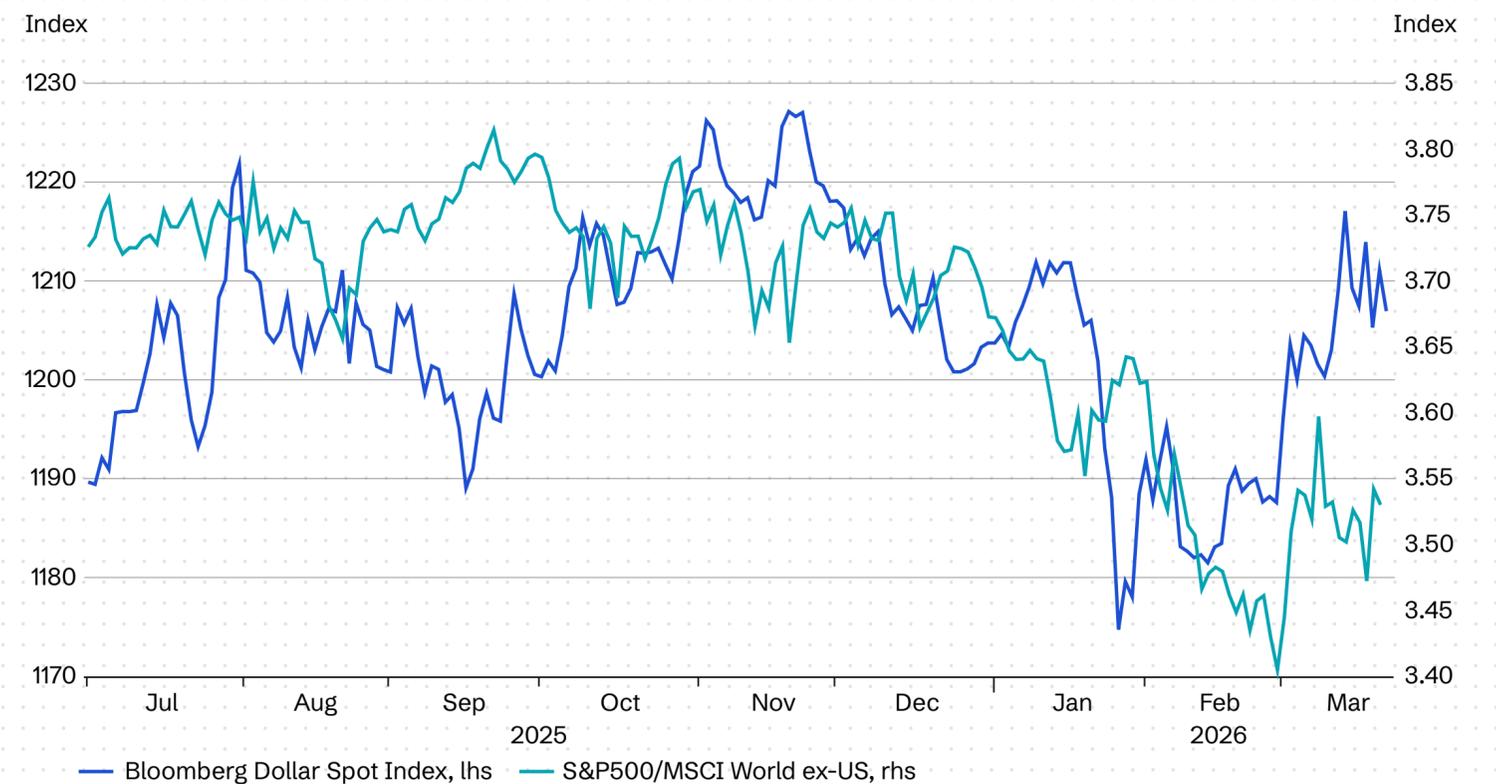
### USD structural and cyclical pressures remain, though geopolitical tensions inject support

In our 2026 House View we argued that the dollar would remain in a gradual multi-year depreciation phase as its valuation premium, institutional credibility, macro-financial exceptionalism and its entrenched twin-deficit position continued to erode. We also noted that this adjustment would not be linear: the broader downtrend would be intermittently interrupted by cyclical forces, including shifts in global risk appetite, relative growth momentum, and policy expectations. Until the recent geopolitical shock, this pattern largely held. Earlier this year, the dollar extended its decline by around 1 per cent following an 8 per cent fall in 2025 – even as US data firmed and growth expectations were revised higher – underscoring how structural valuation pressures and the burden of large fiscal and external deficits continued to anchor the currency lower.

These medium-term forces remain in place. The dollar is still materially overvalued in real-effective terms, and the sustainability of persistent fiscal deficits and a wide current-account shortfall remain uncertain. As a twin-deficit economy, the US depends on ongoing foreign capital inflows – something investors are increasingly questioning as relative US asset attractiveness evolves. Prior to the Iran conflict, global conditions still favoured higher-beta G10 FX (AUD, NZD), EM FX and carry strategies, supported by improving global data momentum and idiosyncratic domestic tailwinds. These dynamics were reinforced by fading US macro-financial exceptionalism even as US growth expectations improved: US equities underperformed (Figure 20), signalling a marginal reassessment of US relative-performance appeal.

Much of the dollar’s weakness through 2025 also reflected a rise in structural risk premia: growing concerns about the politicisation of institutions, policy volatility (from tariffs to regulatory unpredictability), and doubts around long-term fiscal sustainability. These forces have not disappeared. Accordingly, once episodic shocks subside, we continue to expect a gradual marginal shift away from US assets – not abrupt selling, but lower incremental allocations and increased FX hedging of US exposures – consistent with a medium-term trend of gradual USD depreciation.

Figure 20. Dollar impacted by relative equity performance in late 2025



Source: Aviva Investors, Bloomberg, Macrobond as at 20 March 2026.

US equities underperformed, signalling a marginal reassessment of US relative-performance appeal

## Geopolitical Risks

### Energy shock, safe-haven demand, and the case for USD strength in a prolonged conflict

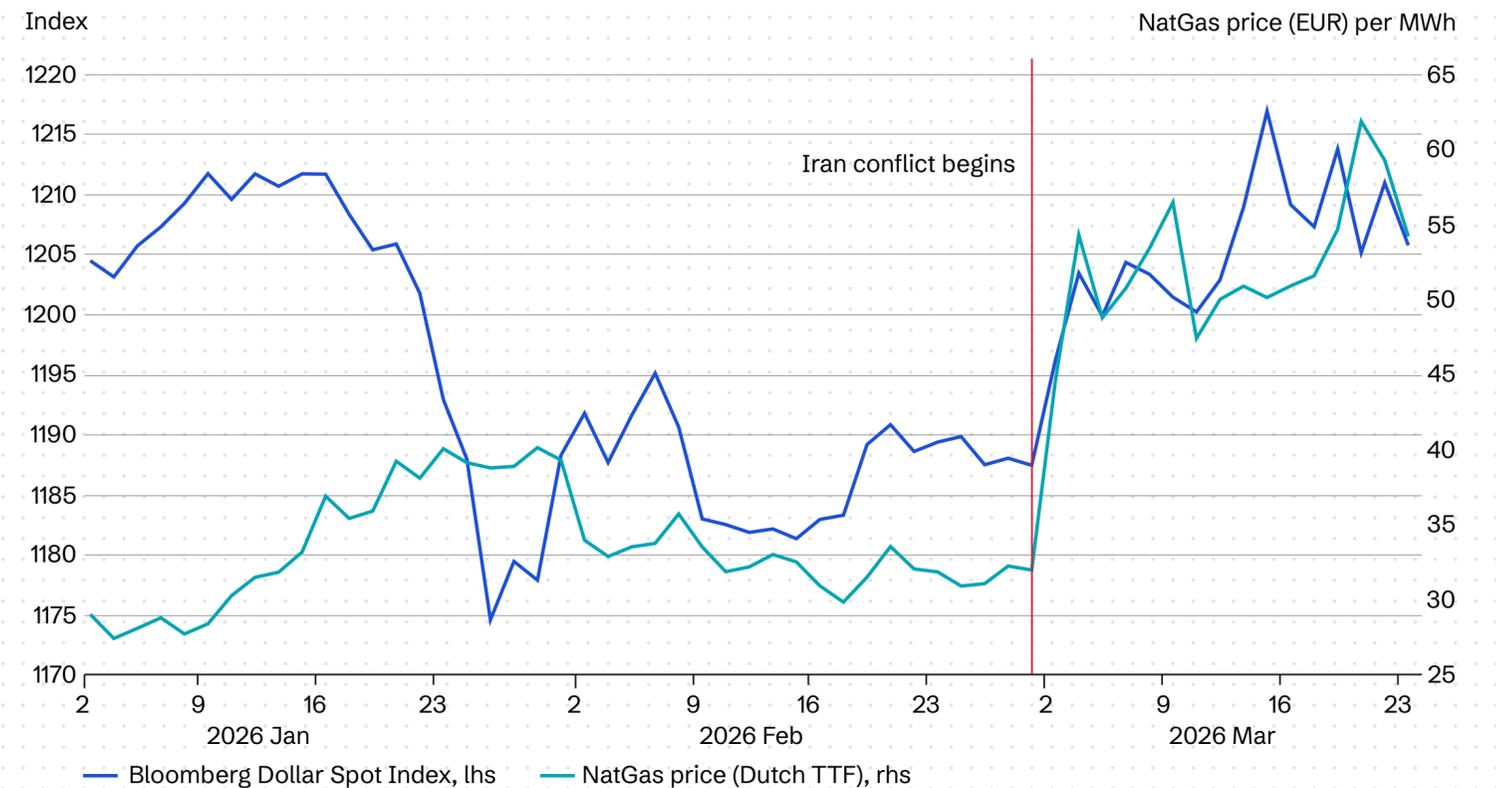
The outbreak of the conflict in the Middle East has disrupted this otherwise orderly narrative. The surge in oil and gas prices has materially altered near-term dynamics, sharply raised global uncertainty and driven a renewed safe-haven bid for the USD (Figure 21). Tighter global financial conditions, weaker risk appetite, and concerns about potential supply chain and energy-market disruption have led to tactical inflows into the dollar.

If the conflict proves relatively short-lived, the macro-impact should remain contained, allowing the dollar to resume its medium-term downward trend as volatility fades and structural forces reassert themselves. But a more prolonged conflict – particularly one that keeps parts of Gulf energy infrastructure offline – would have far more consequential global implications. A multi-month energy shock would weigh on global growth, tighten financial conditions, and sustain a more persistent bid for safe-haven assets, with the USD benefitting disproportionately. In this scenario, dollar strength would stem not from US outperformance, but from a broad deterioration in global activity, weaker EM sentiment, and reduced willingness to hold higher-beta currencies.

A sustained energy shock would also raise the risk of inflation expectations becoming less anchored outside the US. This could force some central banks into some tightening even as growth slows, amplifying recession risks abroad more than in the US and reinforcing asymmetric flows into the dollar. Conversely, if US equity outperformance were to re-accelerate, or if US fiscal consolidation surprised meaningfully, the case for structural USD weakness would face additional hurdles.

Overall, while we continue to see a compelling medium-term case for USD depreciation, geopolitical risks have introduced a powerful counter-cycle. The duration and scale of the Iran conflict will determine whether recent USD strength is a brief interruption – or the beginning of a more persistent period in which safe-haven demand overwhelms fundamental valuation pressures.

**Figure 21. Dollar has largely followed energy prices since Iranian conflict**



Source: Aviva Investors, Bloomberg, Macrobond as at 20 March 2026.

**A multi-month energy shock would weigh on global growth, tighten financial conditions and sustain a more persistent bid for safe-haven assets**



## Private Markets outlook

### Evolving risk adjusted return dynamics

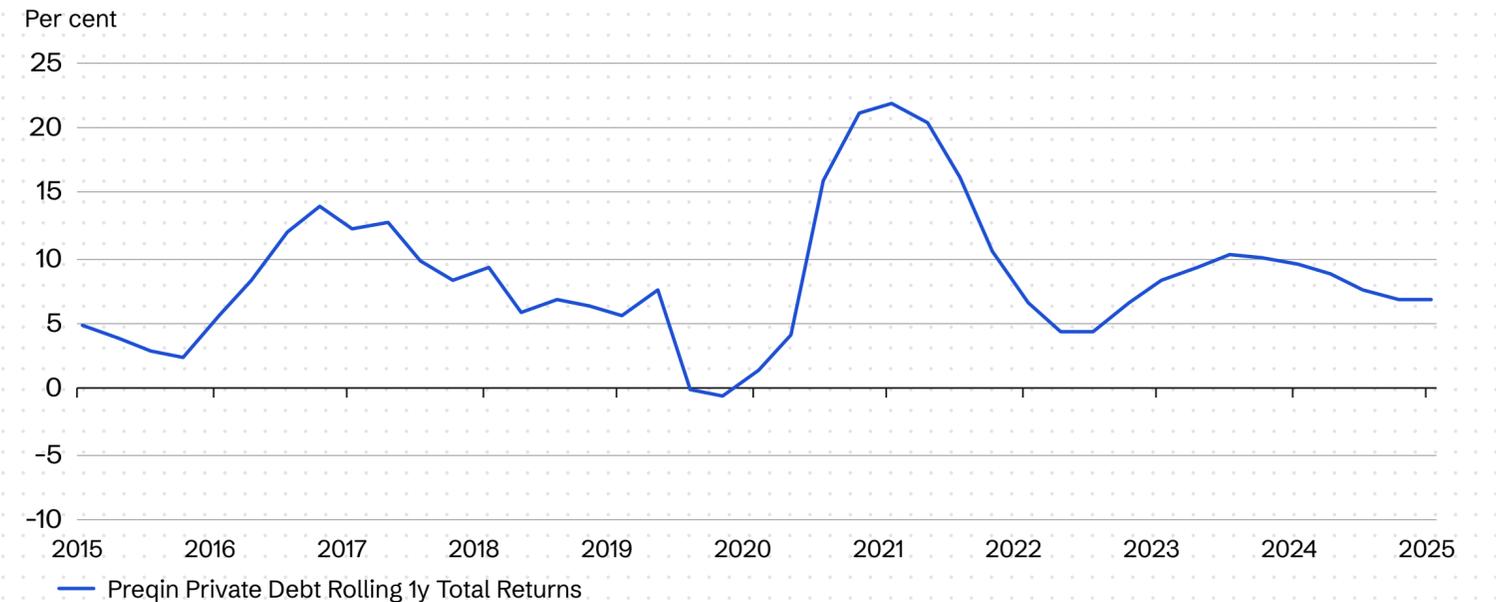
Private markets delivered broadly resilient performance through 2025, despite ongoing macro and geopolitical uncertainty.

In Real Estate Equity, the MSCI global asset level index posted a 6 per cent, unlevered return for the year, marking a return to its 15-year long run average. Income was the primary driver of returns, with dispersion across sectors, reflecting a K-shaped recovery. Higher yielding areas such as retail and selected growth-oriented segments (most notably industrial and prime office) outperformed, supported by robust occupier demand, limited new supply, and stabilising financing conditions.

In Infrastructure Equity, the MSCI global asset level index recorded a 10 per cent return in the 12 months to Q3 2025, with performance consistently stable across quarters, driven by strong performance in North America. Recent historical patterns reinforced the asset class’s defensive characteristics, with sectors that provide essential services or benefit from regulatory frameworks continuing to exhibit the most stable performance, underpinned by predictable cashflows and inflation-linked revenue.

Private debt is often treated as a monolith but it covers multiple sectors and a broad risk spectrum from lower risk IG private debt to higher risk Sub-IG (or unrated) private debt. Prequin’s global private debt fund index, which captures \$1.78 trillion across a number of strategies and risk profiles, but does have a floating rate and Sub-IG bias, shows an annual total return of 7 per cent to Q3 2025 as shown in [Figure 22](#).

**Figure 22. Prequin Private Debt Funds: 12m rolling returns**



Source: Prequin Private Debt Index Q3 2025 as at 2 March 2026.

Non-accrual measures in private debt remain low, albeit there were some high-profile defaults in the Sub-IG space. Underneath this however, there was and continues to be dispersion in performance across managers, reinforcing the importance of manager selection.

In 2026, assuming our central case materialises, we expect a broad rebalancing across private markets. The gap between risk adjusted returns in private debt versus real estate equity and infrastructure equity has narrowed meaningfully.



Private markets delivered broadly resilient performance through 2025, despite ongoing macro and geopolitical uncertainty



## Real Estate equity

The repricing phase that followed the sharp rise in policy rates in 2022 is now largely complete, and we view the adjustment as cyclical rather than structural. Supply and demand dynamics remain balanced across most sectors, with development pipelines constrained. Elevated construction costs, labour costs, and a more challenging financing environment prevented the typical late cycle surge in supply, leaving many markets with structurally thin pipelines.

The K-shaped recovery noted through 2025 is now less evident and increasingly confined to structurally challenged segments such as secondary offices, in particular non-prime regional stock, and portions of retail. Over the next couple of years income is expected to remain the primary driver of total returns. Improving occupational markets, constrained supply, and rental tension in selected sectors and markets reinforces an income-led environment.

Liquidity conditions continue to normalise with investment volumes in the UK now aligned with long-term averages, and Europe approaching similar levels. For global investors, Europe stands out, offering a combination of macro stability, strong sector fundamentals, and a diverse opportunity set.

As we move into a new real estate cycle, we expect confidence to rebuild gradually, with capital shifting away from purely defensive positioning towards selective re-risking. However, if macro uncertainties or geopolitical risks intensify, the adjustment phase could extend for longer, favouring defensive, income oriented assets.

## Infrastructure equity

The sharp repricing triggered by higher real yields appears to be behind us, with implied discount rates stabilising at levels above long-term averages. This stabilisation, combined with more predictable inflation trajectories, creates an attractive entry point for long-term investors.

Infrastructure's cash flow resilience remains a central part of the return profile reinforcing the asset class's defensive characteristics amidst shifting geopolitical dynamics. Within the European market, Renewable energy remained the largest recipient of capital in 2025, reflecting ongoing global mega trends centred on energy transition, and energy security. These themes are expected to remain dominant in 2026, alongside opportunities in digital infrastructure.

Importantly, government policy remains a strong tailwind. Contract for difference (CfD) style frameworks, fiscal incentives, and broader regulatory support continue to de-risk capital deployment, sustain investment pipelines, and improve visibility on forward returns.

The sharp repricing triggered by higher real yields appears to be behind us, with implied discount rates stabilising at levels above long-term averages



## Private debt

Private debt continues to offer attractive relative value, supported by a higher for longer rates environment and elevated illiquidity premia. Across investment grade assets, the illiquidity premia of around 100bps based on our proprietary data set shown in [Figure 23](#), remains above long-term averages, with spreads tightening less aggressively than in public credit. In Sub-IG grade assets, our proprietary dataset highlights the average illiquidity premia is closer to 300bps reflecting both elevated compensation for risk and structurally lower competition from banks and insurers.

Given a more uncertain macro backdrop, we remain selective in Sub-IG grade lending, favouring structures with robust downside protections, including strong covenant packages, seniority, and asset-backed security.

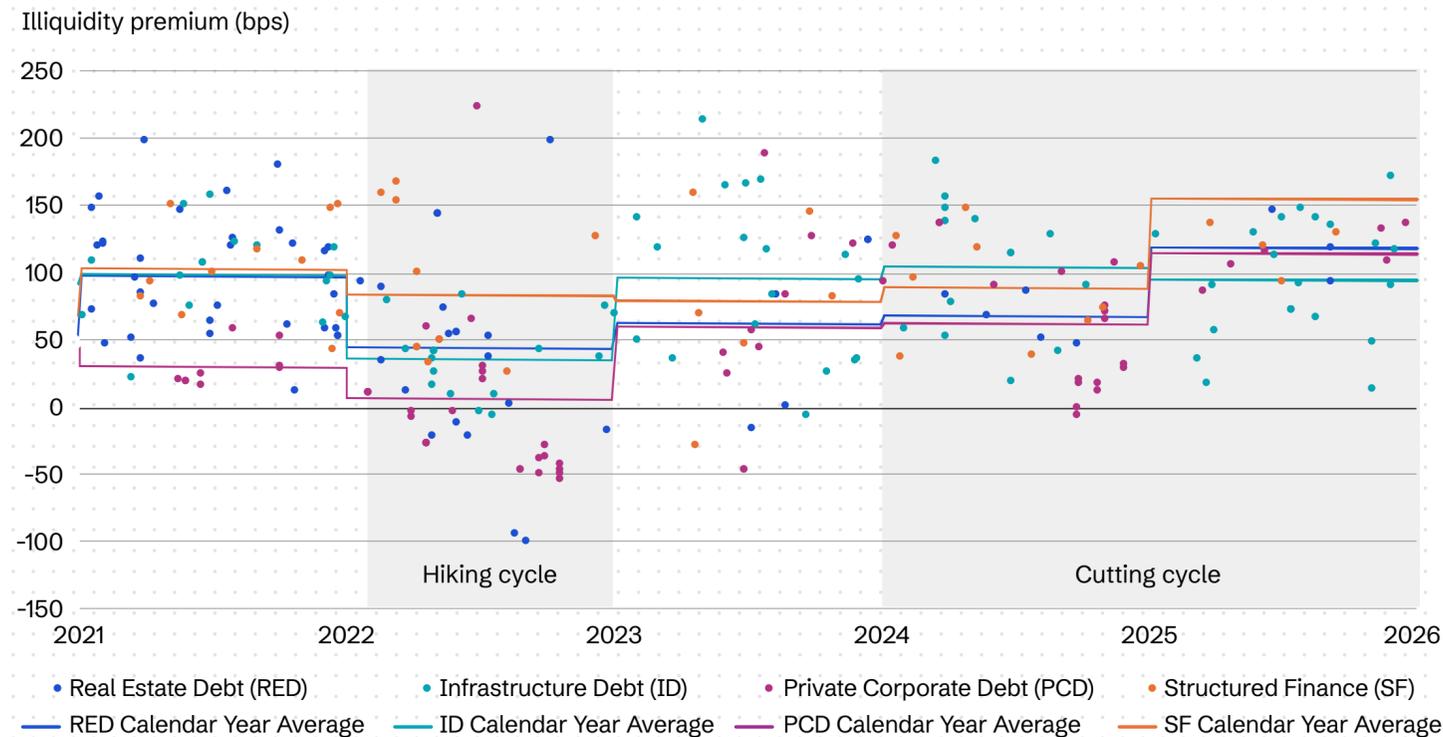
As we touched on last quarter, while private debt and its connection to the wider banking system does not appear to be large enough to be systemic, it could amplify stress during market dislocations rather than being the primary trigger.

### Evolving risk-adjusted return dynamics in private markets

Across private markets, we expect 2026 to mark a period of re-balancing between asset classes alongside renewed opportunities, should our central case materialise. Private debt yields are normalising from elevated levels, whereas real asset equity fundamentals, in both real estate and infrastructure, are improving as pricing has adjusted, demand remains resilient, and supply remains constrained. Long-term thematic trends, from the energy transition to demographic change, continue to shape opportunities for growth and reinforce the strategic importance of private market allocations.

Against this evolving backdrop, we expect to see increased investor interest in equity oriented private markets strategies in 2026, supported by improving fundamentals.

Figure 23. Illiquidity premia

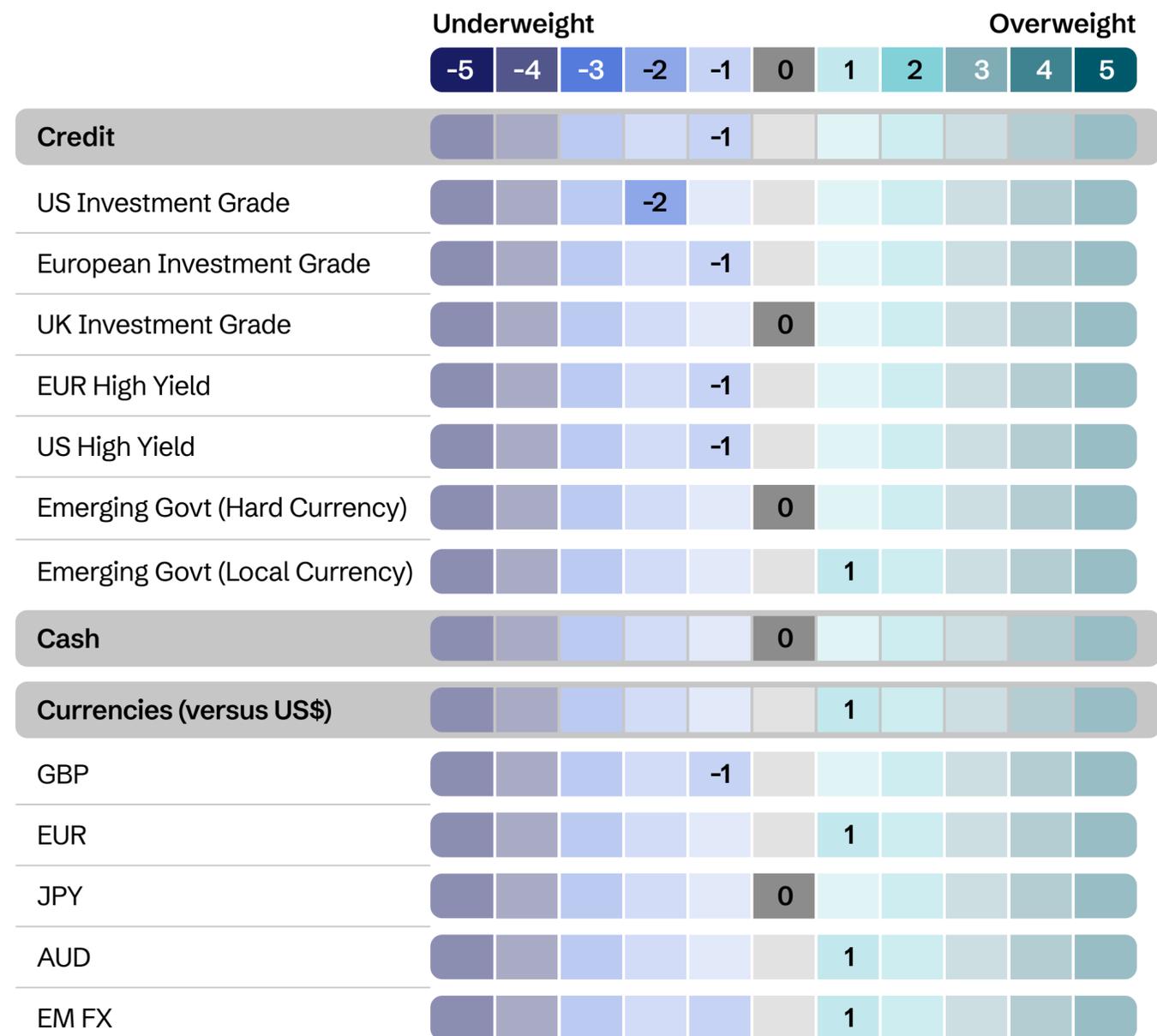
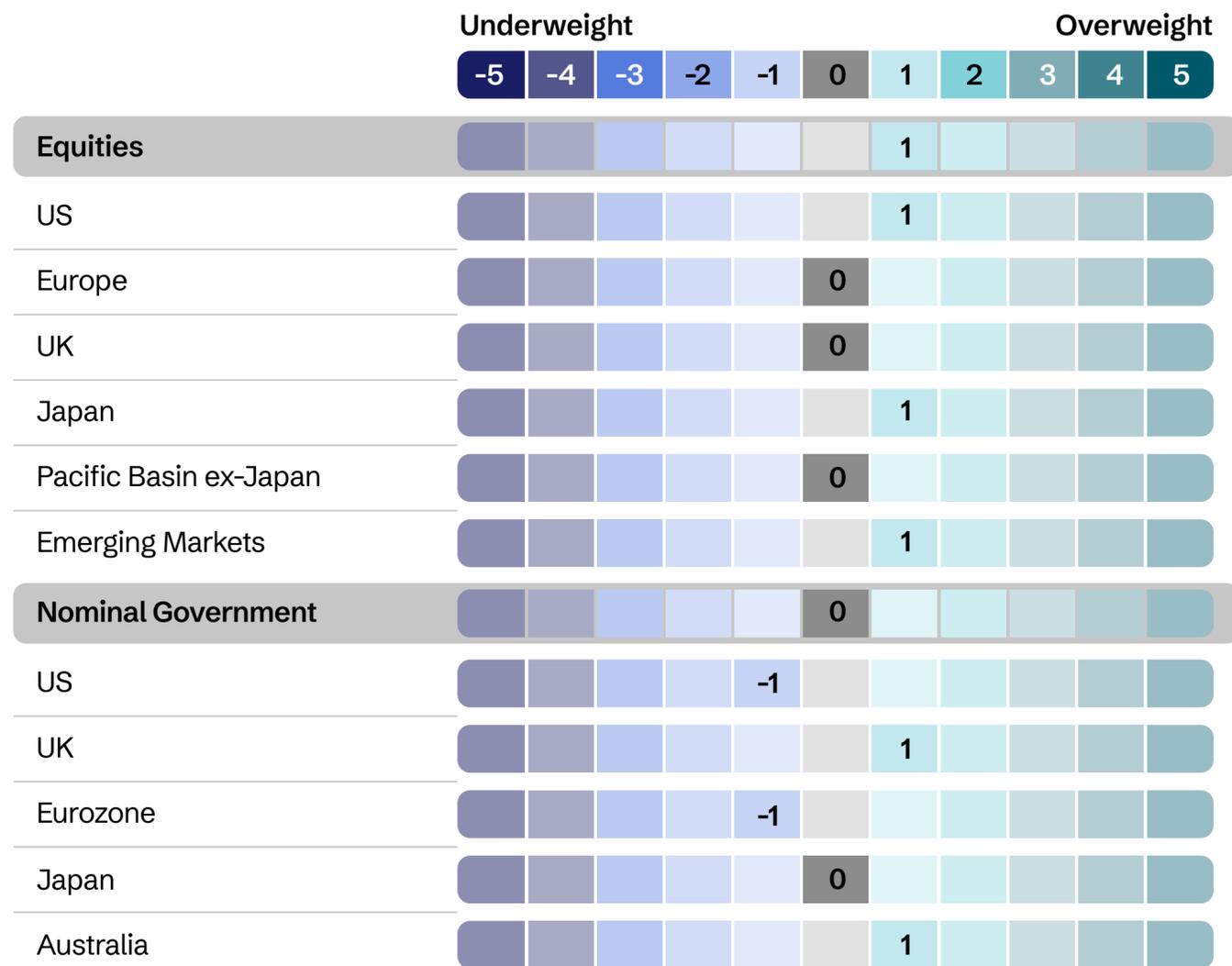


Source: Aviva Investors as at January 31, 2026.

Private debt continues to offer attractive relative value, supported by a higher for longer rates environment and elevated illiquidity premia



Figure 24. 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.

For illustrative purposes only.

Source: Aviva Investors as at 20 March 2026.



 **Webcast**

# House View Q2 2026

23 April 2026 | 15:00 BST | 45 MINS

Join our House View Q2 2026 webcast, hosted by Nicole Lowe (Investment Director), Vasileios Gkionakis (Senior Economist and Strategist), Harriet Ballard (Portfolio Manager) and David Hedalen (Head of Private Markets Research).

Together, they explore the key macro themes, opportunities and risks shaping markets, and the implications for asset allocation.



QUALIFIES FOR 45 MINUTES CPD



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