Insight INVESTMENT

# GLOBAL MACRO RESEARCH
# ASSET ALLOCATION IN FOCUS

NOVEMBER 2025


BNY | INVESTMENTS

# EXECUTIVE SUMMARY

## REVISITING OUR ASSET-ALLOCATION FRAMEWORK

- Changes in monetary or financial conditions, and their lagged impact on the rate of growth, are the starting point for our thought process. It then follows that growth dynamics (either periods of excessively strong or unusually weak activity) may have implications for both inflation and/or real interest rates. These interactions are important in understanding economic cycles and these dynamics provide useful insights from an asset-allocation perspective.
- Our growth, inflation and real rate framework allows us to assess how asset-class behaviours differ in various states of the world going back over 50 years. The clarity and consistency of our findings suggest that our framework is robust and can provide a solid starting point for making asset-allocation decisions.
- The key drivers of asset-class performance appear stable through time. For equity markets, growth is a dominant force; for FX and bonds, real rates matter most. For commodities, inflation is key. The interaction of these forces is also important and can provide signals to the behaviour of a range of alternative investments as well as traditional asset classes.
- Combining growth, inflation and real rate regimes allows us to easily compare prevailing conditions with history and analyse how different asset classes performed over similar periods. Once the prevailing regime is established, our framework can provide important insights into how the regime is likely to evolve, using history as a guide, or whether the unique circumstances of the current environment suggest other periods of history may be more relevant when assessing likely investment performance.

## CONTENTS

# ASSET ALLOCATION IN FOCUS

We refresh our annual overview of the regime driven investment framework that underpins our investment process, now enhanced with two new case studiies that explore critical issues shaping today's market environment. In case study #1 we explore the interplay between business investment, corporate profits and growth, and how the boom in AI infrastructure spending is likely to underpin growth for years ahead, while in case study #2 we explore whether there has been a structural shift in the nature of market setbacks compared to the past.

## **Case study #1:** Business investment, profits and the growth cycle (and the role of AI capex in global growth)

Our analysis over many years has found that the growth cycle is a dominant influence on the behaviour of risk assets, and thus our assessment of global growth dynamics is the most important factor within our asset-allocation regime framework. In this case study, we examine the role of business investment – particularly the recent surge in AI-related capital expenditure – in shaping global growth.

We explore:

1. The historical link between investment, profitability, and growth cycles
2. US exceptionalism and its investment advantage
3. The AI capex boom and its implications for global growth
4. How we capture these dynamics in our regime framework

Figure 1: The investment, profit and growth cycle link[1]


### 1 THE HISTORICAL LINK BETWEEN INVESTMENT, PROFITABILITY, AND GROWTH CYCLE

The intrinsic relationship between economic growth, corporate profitability, and business investment is clear. Higher levels of investment are associated with higher rates of economic growth and profitability. That in turn leads to the opportunity for additional re-investment, which in turn can drive further gains in growth and profitability. Investment is also an important 'swing factor' where changes in investment tend to lead to changes in the growth cycle – specifically falls in investment consistent with downturns. The current surge in IT-related capex looks set to be the latest test to this thesis.

The clearest example of this feedback loop can be evidenced through the lens of US exceptionalism.

### US EXCEPTIONALISM – HIGHLIGHTING THE ROLE OF INVESTMENT

We discussed features that make the US economy unique in our note 'US exceptionalism at a crossroads'. From a big-picture perspective, the scale of the economy, its ample resources, affordable inputs, growth friendly government policy and regulation, dynamic capital markets and of course, the US dollar's 'exorbitant privilege' as the world's reserve currency, all play a part.

At a corporate level, a culture of innovation, a supportive ecosystem for startups and an attitude which encourages both the creation of new businesses and the closure of failing ones, thereby reallocating resources to more profitable enterprises, emphasise the efficient deployment of capital and the importance of return to shareholders. These forces combined have been a cornerstone of the US exceptionalism story.

[1] For illustrative purposes only.

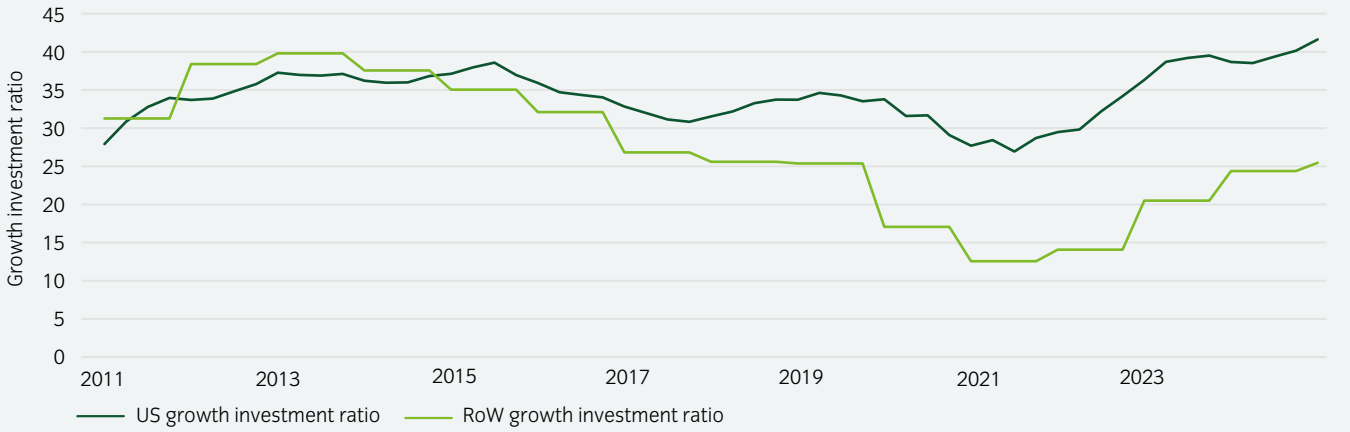
## BETTER GROWTH, INVESTMENT, AND RETURN ON INVESTMENT…

The result has been an economy that has outperformed most of its trading partners in recent decades. The US annualised growth rate in the past 20 years has averaged roughly 1.8% versus only 1% in the eurozone and UK and 0.3% in Japan.

What is interesting is the extent to which the expansion has been driven by capital expenditure – gross fixed capital formation (GFCF) – which grew at 2.4% versus 1.2% in the UK, 0.6% in the eurozone and -0.2% in Japan. Looking at investment from a bottom-up perspective we can also see that US companies tend to invest more than other countries.

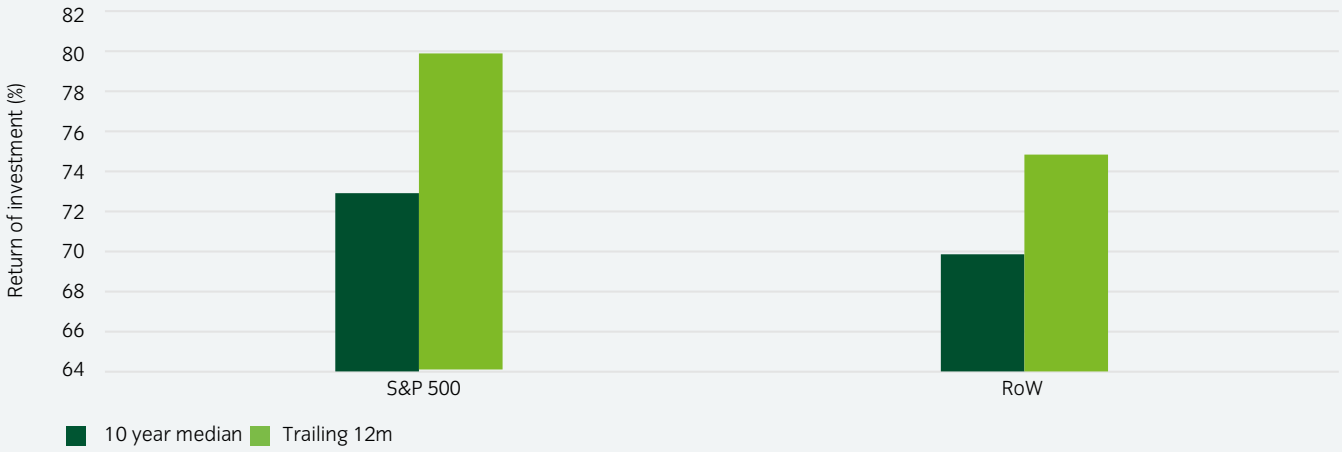
Figure 2 shows the 'growth investment ratio' calculated by Goldman Sachs. This shows capex (less depreciation) plus R&D as a percentage of cashflow from operations. The gap with the rest of the world has increased in recent years. The 'Magnificent Seven', the seven largest stocks by market capitalisation, are part of the story. They account for around 32% of the market capitalisation of the S&P 500 Index but Goldman Sachs estimates they account for 49% of overall growth investment spending by companies within the index[2].

Figure 2: US growth investment ratio is materially higher than the rest of the world[2]




US companies have invested more, then as Figure 3 shows, in aggregate, they have generated better returns on that investment. Once again, the US advantage has increased relative to its long-run (10-year) average over the last 12 months.

Figure 3: US return on investment is also much higher than the rest of the world[2]




[2] Source: Goldman Sachs data, published August 2025.

## ...WHICH DRIVES PROFITABILITY

The result of both higher investment and higher returns from those investments is higher profit generation. Translating this into stock-market performance, it is clear that the well-documented outperformance of the US stock market, relative to the rest of the world, has been a function of superior earnings growth. The same is true of the tech-heavy NASDAQ Index versus the broader US market.

It is worth highlighting just how elevated corporate profitability has been in the US in recent years. As Figure 4 illustrates, profit margins expanded rapidly throughout much of the 21st century, with only a brief dip during the global financial crisis. Signs of moderation began to emerge heading into 2020, but the post-COVID recovery saw margins surge once again driven by unprecedented policy support, pent-up demand and savings, and the accelerated adoption of technology and remote working.

Figure 4: US profit margins stand at 70-year highs[3]


The sustainability of relative US earnings' outperformance, and the valuation premium that implies, are a subject for another time. But viewed in the context of the US historical experience of higher levels of re-investment, the starting point of record-high profits suggests a robust investment environment. High and expanding profit margins provide a backdrop where corporates are able to plan investment decisions with a higher level of confidence. Conversely, periods of margin contraction make the economy more vulnerable to shocks. This is because low or falling margins force companies to be more cautious when making both hiring and investment decisions.

High levels of economic uncertainty are likely to make both business and households delay investment decisions; this remains a risk given the US administration's erratic policy decisions on trade and other matters closer to home. That said, the focus of current investment spending is non-cyclical in nature. A large beneficiary of this profit expansion has been the handful of technology firms known as the Magnificent Seven. Several of these firms (known as the hyperscalers) sit at the heart of what is increasingly becoming a material secular tailwind for global growth: the AI capex boom.

[3] Source: Insight and Bloomberg. Data as at 30 September 2025.

## 2 THE AI CAPEX BOOM AND ITS IMPLICATIONS FOR GLOBAL GROWTH

The largest hyperscalers (Amazon, Microsoft, Google, Meta and Oracle[4]) have started using the profits generated over the previous decade to ramp up capital expenditure to match the explosive growth in demand for AI and cloud computing. This acceleration in capex began in earnest 2023, but looks set to continue for the next five or more years.

### WHERE DOES AI SPENDING SHOW UP IN GDP?

AI-related spending is increasingly influencing GDP growth statistics across four key areas: investment in equipment (such as semiconductors and IT hardware), structures (including data centres and power infrastructure), intellectual property (notably R&D and software), and net trade in AI-related goods and services. The effects of this investment wave are already visible in the data. According to Pantheon Economics, AI-related capex contributed approximately 0.5 percentage points to real US GDP growth in the first half of 2025. Without this boost, annualised growth would have been just 0.6%, compared to the reported 1.1%.

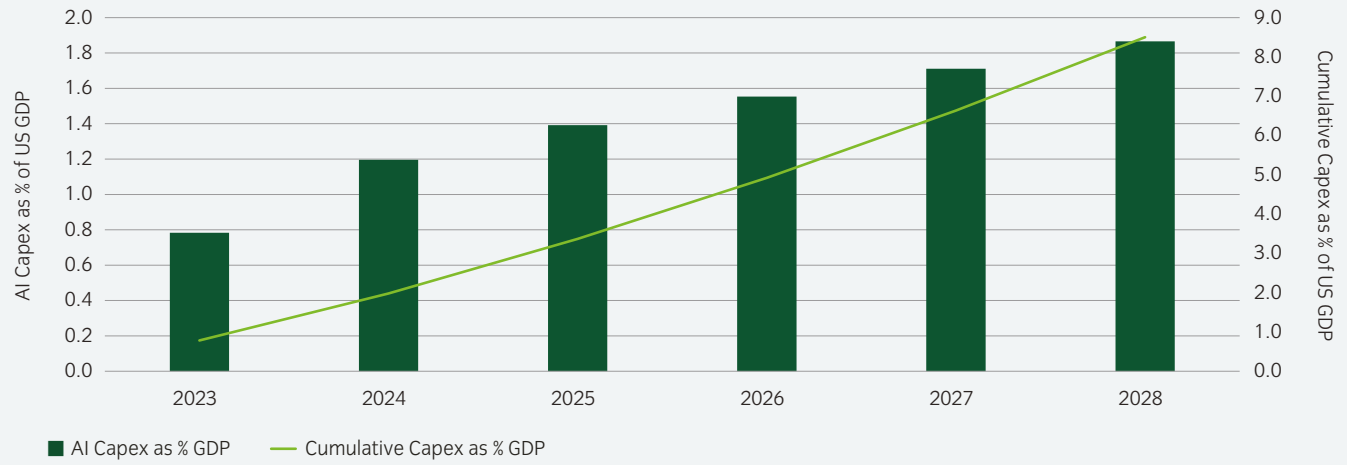
Additionally, there is likely a positive contribution from the wealth effect, as rising equity valuations – driven by AI-related optimism – have increased household exposure to the stock market. We explore this dynamic further in Section 3.

### THE OUTLOOK FOR CAPEX PRESENTS A MATERIAL TAILWIND FOR GROWTH

The nuances of GDP measurement aside, the projected numbers for global capex should provide a meaningful tailwind for global growth. Figure 5 presents Morgan Stanley's projections for capex growth among the largest hyperscalers, alongside the cumulative investment expressed as a percentage of US GDP.

Figure 5: Expected capex from hyperscalers[5]

| Year | Total capex (USD bn) | Year-on-year growth (%) | Cumulative capex (USD bn) | Cumulative capex as a percentage of GDP |
|---|---|---|---|---|
| 2023 | 228 | 59% | 228 | 0.8% |
| 2024 | 348 | 52% | 576 | 2.0% |
| 2025 | 405 | 16% | 981 | 3.4% |
| 2026 | 452 | 12% | 1,433 | 4.9% |
| 2027 | 498 | 10% | 1,931 | 6.7% |
| 2028 | 543 | 9% | 2,474 | 8.5% |




While these projections are dramatic, they should be viewed with a degree of scepticism. Insight's Credit Analysis Team notes that actual investment figures may be overstated due to duplicative project filings across multiple states. Even so, applying a conservative adjustment, such as a 50% reduction, still leaves us with capex estimates of sufficient scale to imply a meaningful impact on global growth.

To quantify the potential feedthrough to the global economy, we break down the projected capex into three primary categories: equipment, structures, and power. Barclays estimates that 50%-60% of spending will be directed towards semiconductors and networking

[4] The mention of a specific security is not a recommendation to buy or sell such security.
[5] Source: Morgan Stanley, September 2025.

hardware. The next largest allocation, 20%–30%, is expected to go into the construction of data-centre shells, encompassing land acquisition, build costs, and the 'grey space' infrastructure (which provides power, cooling, and structural support). The remaining 10%-20% is likely to be invested in power infrastructure, a segment we explore in more detail below.

Even after applying a substantial haircut to account for double counting, projected capex over the next three years still runs into the hundreds of billions of dollars across each category.

## LESS CLEAR BENEFITS FOR LABOUR, AND HUGE POWER REQUIREMENTS

One concern that remains front of mind for both market participants and policymakers is the softening of the labour market, particularly in the US. This raises an important question: how much of the current wave of AI-related investment will translate into net job creation?

It is reasonable to assume that the largest category of capex – semiconductors and hardware – will generate relatively few direct jobs.

The construction of data centres to house AI infrastructure is likely to have a more tangible impact on labour markets. A 2024 report commissioned by the State of Virginia[6] – widely regarded as the data centre capital of the world – found that a typical large facility (around 250,000 square feet) can employ up to 1,500 on-site workers during the construction phase, with many earning salaries in excess of $100,000 per year, excluding overtime. However, once operational, data centres are far less labour-intensive. Day-to-day operations typically require only around 50 employees, including facility managers, engineers, technicians, and maintenance staff.

Perhaps the most significant macroeconomic impact will stem from the surge in power demand driven by AI infrastructure. Insight's Credit Analysis Team estimates that data-centre electricity consumption will rise from 147 TWh in 2023 to approximately 606 TWh by 2030, equivalent to 12% of total US electricity demand. This will necessitate an 8% increase in installed capacity (from 1,345 GW today) and an 11% uplift in overall generation.

While US firms lie at the heart of this expansion, the growth impact should extend globally (see Figure 6).

Figure 6: Expected growth in data-centre capacity[7]

| Region | Data-centre capacity growth (expected compound annual growth rate, 2024-2030) | Estimated GDP impact |
|---|---|---|
| Global | 23% | High |
| US | 26% | Very high |
| China | 16% | High |
| Europe | 19% | Moderate |
| United Arab Emirates | 100% | High |
| Saudi Arabia | 117% | High |

## PRODUCTIVITY IMPACT REMANS THE TRILLION-DOLLAR QUESTION

A central question for the medium and long term is how productive the current AI investment boom will ultimately prove to be. The scale and speed of expected capital expenditure, coupled with intense market enthusiasm, naturally invite comparisons to previous episodes of exuberance – most notably the late-1990s tech boom. Measuring AI's impact on productivity in real time is inherently difficult; as with past general-purpose technologies, the full story will only become clear with hindsight.

For now, the evidence remains mixed. A 2024 OECD report[8] describes AI as a "new general-purpose technology" with the potential to significantly enhance both economic productivity and societal wellbeing. However, it notes that productivity gains are currently concentrated in large firms, with adoption uneven across sectors and regions. Similarly, a Brookings Institution study[9] highlights early improvements in areas such as customer support, software development, and scientific research – particularly among less-skilled workers – but also flags risks around job displacement and a widening productivity-pay gap.

AI may follow a similar trajectory to past general-purpose technologies like electricity and personal computing: slow to show up in the data, but ultimately transformative.

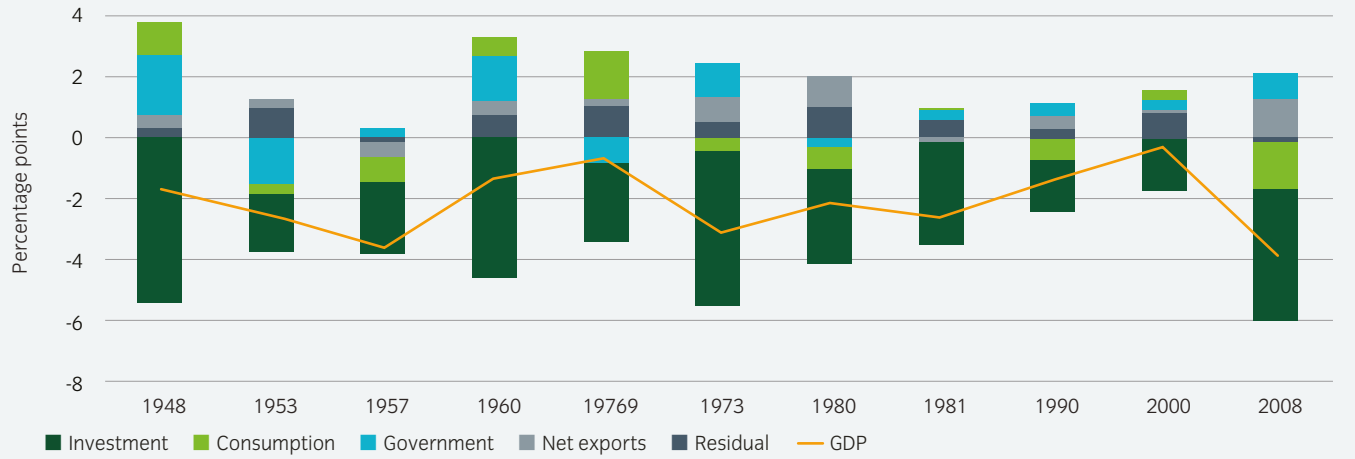
[6] Source: https://jlarc.virginia.gov/pdfs/reports/Rpt598-2.pdf
[7] Source: Morgan Stanley, September 2025.
[8] Source: https://www.oecd.org/content/dam/oecd/en/publications/reports/2024/04/the-impact-of-artificial-intelligence-on-productivity-distribution-and-growth_d54e2842/8d900037-en.pdf
[9] Source: https://www.brookings.edu/articles/mapping-the-ai-economy-which-regions-are-ready-for-the-next-technology-leap/

## 3 POTENTIAL RISKS FROM AN IMBALANCED ECONOMY

The recent softening in the US labour market presents the most immediate risk to the growth outlook, primarily because employment underpins consumption, which remains the largest component of GDP. If labour market conditions continue to deteriorate, it is unlikely that capital expenditure alone could offset a broader downturn. That said, investment has historically acted as a key swing factor in the growth cycle, and given the scale of capex outlined above, it should continue to provide some support.

Economic contractions have consistently been driven by sharp declines in investment. A breakdown of growth dynamics during recessionary periods (see Figure 7) highlights the pivotal role of business investment in driving downturns. In every post-war US recession, falling investment has been the largest negative contributor to GDP during contraction phases. As such, shifts in corporate investment intentions remain a critical indicator to monitor.

Figure 7: Falling investment has been the key driver in every post-war recession pre-COVID[10]




As highlighted earlier, the impact of AI-related capital expenditure on labour markets is far from straightforward. Despite their vast physical footprint and immense power consumption, data centres operated by firms like Google and Microsoft typically require only 50 to 200 core staff, a fraction of the workforce needed for traditional industrial facilities of comparable size. However, labour demand during the construction phase is significantly higher, and a more meaningful employment boost may come from the power infrastructure buildout, as discussed above.

Looking further ahead, the long-term implications of AI for labour demand remain highly uncertain. A September 2024 IMF report[11] found a modest net decline in employment in US regions with higher AI adoption compared to those with lower adoption. The negative effects were unevenly distributed, and concentrated in manufacturing and low-skill services, among middle-skill workers, non-STEM occupations, and individuals at both ends of the age spectrum. The report also noted that men were more adversely affected than women.

In the short term, the most visible economic boost from AI has come via positive wealth effects. Gains in US tech stocks – particularly the Magnificent Seven – have significantly supported consumption among wealthier households, who account for the bulk of US consumer spending. According to Oxford Economics[12], household expenditure increases by approximately $0.14 for every $1 of equity wealth gained, and this dynamic has contributed to roughly one-fifth of US consumption growth since late 2019. While this has underpinned consumer resilience in recent years, it also introduces a clear vulnerability: any material decline in tech stocks or broader equity markets could pose a significant drag on spending.

[10] Source: Insight and Bloomberg. Data as at 30 September 2025.
[11] Source: https://www.imf.org/en/Publications/WP/Issues/2024/09/13/The-Labor-Market-Impact-of-Artificial-Intelligence-Evidence-from-US-Regions-554845
[12] Source: https://www.oxfordeconomics.com/resource/us-wealth-effects-are-packing-a-larger-punch-than-ever/

## 4 POTENTIAL RISKS FROM AN IMBALANCED ECONOMY

As outlined in this paper, one of our preferred tools is the purchasing managers' index (PMI), which reflects the health of both manufacturing and service sectors. When we examine the longest available PMI time series – the US ISM Manufacturing PMI – we observe a clear lead-lag relationship with private business investment.

We have also found that looking at sector-level PMI data can provide additional insight into global growth dynamics. To do this we first split the data into those sectors which have the highest beta to the more forward-looking components of the PMI (future output, new orders and output) and those with the with the lowest beta. The high-beta sectors include technology equipment, industrials and machinery and equipment. The low-beta sectors include healthcare, food and insurance. We then take the difference between the two to produce an indicator that closely maps the global manufacturing PMI. While this does not offer a strong lead on the PMI, it currently suggests a smoother recovery path in growth is under way.

Figure 8: The Insight Sector PMI Indicator has historically been a good indicator of global manufacturing activity[13]


## CONCLUSION

AI-driven investment is powering US and global growth, contributing around 0.5pp to US GDP in H1 2025. Hyperscaler spending on semiconductors, data centres, and power systems is set to continue at scale, helping offset trade and labour headwinds.

While productivity gains may take time, near-term employment benefits are focused in infrastructure buildout. Rising equity market concentration poses risks to consumption via the wealth effect.

To track these dynamics, we've added a new PMI-based growth indicator blending cyclical and secular signals – early readings suggest a smoother global recovery than headline PMIs imply. As AI capex continues to accelerate, monitoring shifts in corporate investment intentions, profit margins, and PMI differentials will be critical to anticipating the next inflection point in the global growth cycle.

[13] Source: Insight and Bloomberg. WHERE MODEL OR SIMULATED RESULTS ARE PRESENTED, THEY HAVE MANY INHERENT LIMITATIONS.

# **Case study #2:** The rise of the mini-bear

Markets experienced several material pullbacks in recent years, including two of historic magnitude. Notably, the combined equity and bond bear market of 2022 stands out as one of the most severe cross-asset dislocations in recent memory. These episodes raise a critical question: do they signal a structural shift in the nature of market setbacks compared to the past?

Figure 9 illustrates the drawdowns of equity market returns, focusing on the S&P 500 Index, dating back to the Great Depression of the 1930s. Bear markets are categorised into three tiers: 'normal' (declines of 20% or more), 'big' (declines between 20% and 40%), and 'mega' (declines exceeding 50%). On this basis, the past 25 years have witnessed two 'normal' bear markets, two 'big' bears, and one 'mega' bear – the global financial crisis. Viewed through one lens, the bear markets of the 21st century align with long-established historical patterns, where deeper drawdowns tend to coincide with periods of economic and corporate earnings stress. Notably, two recent episodes – the COVID-19 sell-off and the tariff-induced correction in early 2025 – stand out for their brevity.

Figure 9: History of bear markets[14]

| | Bear market characteristics | | | Growth environment | | | Government bond performance |
|---|---|---|---|---|---|---|---|
| Dates | Drawdown | Length (months) | Realised volume (high 22d) | Earnings decline (normal) | GDP decline (peak to trough) | ISM manufacturuing falls (points) | |
| **Normal bear markets** | | | | | | | |
| Jun-46 to Apr-48 | -28% | 22 | 43 | -29% | -13.0% | | |
| Aug-56 to Oct-57 | -22% | 15 | 24 | -22% | -3.7% | | |
| Dec-61 to Jun-62 | -27% | 6 | 37 | -12% | -1.6% | -12.4 | |
| Feb-66 to Oct-66 | -22% | 9 | 20 | -5% | 0.0% | -12.0 | |
| Nov-80 to Aug-82 | -27% | 21 | 20 | -5% | -2.6% | -22.7 | 29.7% |
| Jul-90 to Oct-90 | -20% | 4 | 25 | -37% | 0.0% | -2.1 | 2.2% |
| Dec-21 to Oct-22 | -24% | 9 | 34 | -3% | 0.0% | -14.0 | -16.0% |
| Mar-25 to Apr-25 | -20% | 2 | 50 | | | | 2.7% |
| **Average** | -24% | 7 | 32 | -18% | -3.5% | -11.4 | |
| **Big bear markets** | | | | | | | |
| Jan-73 to Oct-74 | -48% | 22 | 35 | -15% | -3.2% | -25.9 | |
| Nov-68 to May-70 | -36% | 19 | 32 | -13% | -0.6% | -13.1 | |
| Aug-87 to Dec-87 | -34% | 5 | 92 | -13% | 0.0% | -1.9 | 2.3% |
| Mar-00 to Oct-02 | -49% | 31 | 46 | -54% | -0.4% | 14.1 | 37.5% |
| Feb-20 to Mar-20 | -32% | 1 | 86 | -33% | -19.2% | -9.6 | 6.9% |
| **Average** | | | | | | | |
| **Mega bear markets** | | | | | | | |
| Sep-29 to Jun-32 | -86% | 33 | 101 | -75% | -27.0% | | |
| Mar-37 to Apr-42 | -60% | 62 | 56 | -49% | -18.0% | | |
| Oct-07 to Mar-09 | -57% | 18 | 88 | -92% | -5.1% | -18.3% | 22.2% |
| **Average** | -68% | 38 | 82 | -72% | -16.7% | -18.3% | |

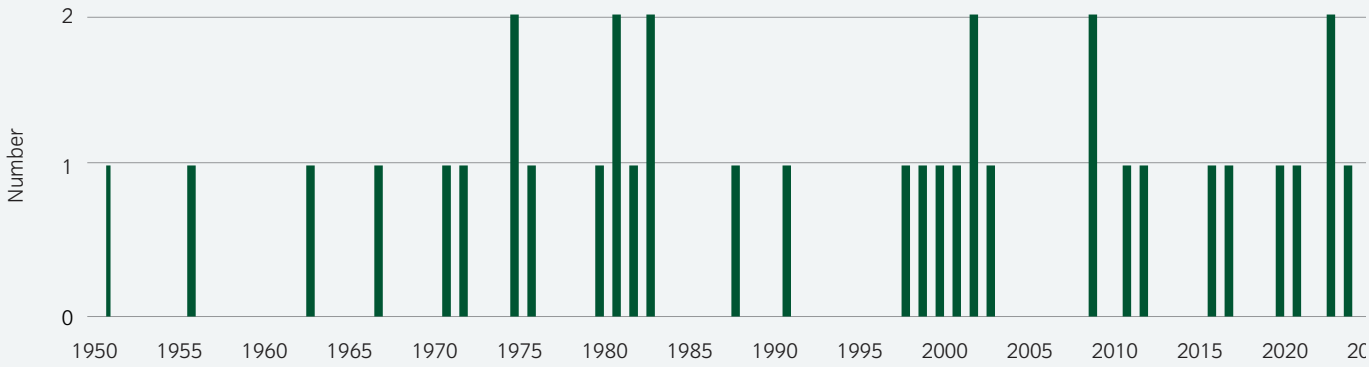
The strength of our regime-based macro framework as a guide for asset allocation lies in its ability to identify when bear markets are either rooted in, or severe enough to trigger, real economic consequences. These are the types of downturns our framework is designed to detect. But could the increasing frequency of short, sharp retrenchments followed by rapid recoveries introduce a new dynamic that challenges this model?

[14] Source: Insight and Bloomberg. Data as at 31 October 2025. Drawdowns show the peak to trough performance of the S&P 500 Index, government bond performance is of the ICE BoA 7-10 Year US Treasury Index.

## ARE 'MINI BEARS' BECOMING MORE FREQUENT?

While the two recent episodes mentioned above don't offer conclusive evidence for the emergence of a 'mini bear' market trend, a more granular analysis of sharp drawdowns and swift recoveries provides additional perspective. To explore this, we examined less extreme market signals – specifically, S&P 500 Index declines of 10% or more that were followed by rapid reversals, such as the correction observed in April 2025. In Figure 10, we track the frequency of these short-lived market corrections, or 'mini bear' markets, from 1950 onwards.

Figure 10: Number of short-lived swings of at least 10% in S&P 500 Index per annum[15]

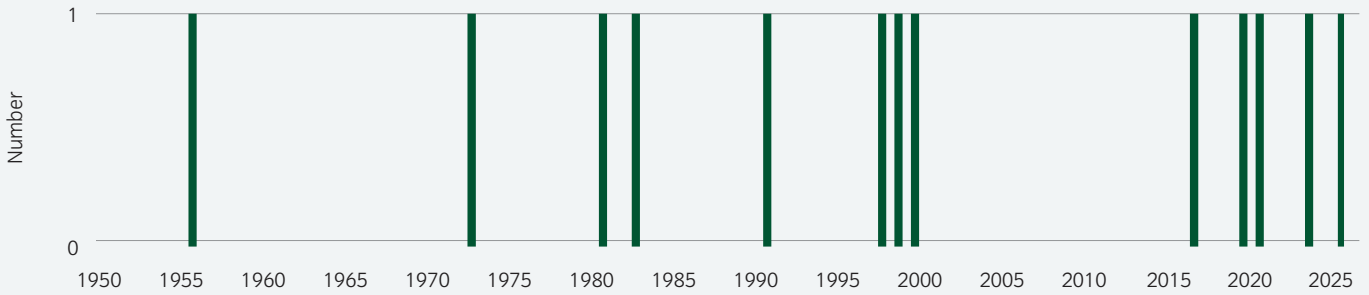



Market dynamics have clearly evolved over time, with short-lived corrections being relatively rare before the mid-1990s. Earlier setbacks, such as those in the early 1970s during the oil shocks and the recession of the early 1980s, were associated with substantial economic downturns. Since the mid-1990s, however, there appears to have been an uptick in short, sharp market shocks, though not an accelerating trend. Over the past five years (2021-2025), we've seen four such episodes – one more than in the preceding five-year period (2016-2020).

### Distinguishing the wood from the trees

Our pursuit of greater clarity continues. A key challenge is distinguishing between 'mini bear' markets and bigger bear phases. Big bear markets often involve pronounced moves in both directions, which can sometimes be captured by our mini-bear criteria. In short, we need to separate the signal from the noise. In Figure 11, we highlight instances of short-lived market corrections that were not part of broader bear market cycles. Viewed through this lens, the frequency of true mini-bear markets becomes more apparent.

Figure 11: Occurrence of mini bears, stripping out broader bear cycles[16]




Most of these mini bears appear to be sell-offs that did not reflect, or induce, a material economic downturn and where there was a clear and significant policy response that enabled market participants to look ahead through any near-term weakness.

[15, 16] Source: Insight and Bloomberg. Data as at 31 October 2025.

Figure 12: Greater detail on mini bears, stripping out broader bear cycles[17]

| | Dates | | | Length (months) | | | Returns (S&P 500) | | | Catalysts |
|---|---|---|---|---|---|---|---|---|---|---|
| Count | Peak | Trough | Recovery | Drawdown | Recovery | Round trip | Drawdown | Recovery | Round trip | Rebound |
| 1 | Sep-55 | Oct-55 | Nov-55 | 0.6 | 1.1 | 1.7 | -11% | 14% | 24% | |
| 2 | Sep-71 | Nov-71 | Feb-72 | 2.5 | 2.8 | 5.3 | -11% | 17% | 28% | |
| 3 | Feb-80 | Mar-80 | Jun-80 | 1.5 | 3.0 | 4.4 | -17% | 19% | 36% | |
| 4 | May-82 | Aug-82 | Nov-82 | 3.0 | 3.0 | 6.0 | -14% | 39% | 53% | |
| 5 | Jul-90 | Oct-90 | Dec-90 | 2.9 | 2.4 | 5.3 | -20% | 12% | 32% | |
| 6 | Oct-97 | Oct-97 | Dec-97 | 0.7 | 1.4 | 2.0 | -11% | 12% | 23% | |
| 7 | Jul-98 | Aug-98 | Nov-98 | 1.5 | 3.0 | 4.4 | -19% | 25% | 44% | |
| 8 | Jul-99 | Oct-99 | Dec-99 | 3.0 | 2.5 | 5.5 | -12% | 18% | 30% | |
| 9 | Dec-15 | Feb-16 | Apr-16 | 2.4 | 2.3 | 4.7 | -13% | 15% | 28% | Policy |
| 10 | Oct-18 | Dec-18 | Mar-19 | 2.7 | 2.9 | 5.6 | -20% | 21% | 41% | Policy |
| 11 | Feb-20 | Mar-20 | Jun-20 | 1.1 | 2.5 | 3.6 | -34% | 44% | 78% | Policy |
| 12 | Jul-23 | Oct-23 | Jan-24 | 3.0 | 3.0 | 5.9 | -10% | 19% | 29% | Economic data |
| 13 | Feb-25 | Apr-25 | Jul-25 | 1.6 | 2.9 | 4.5 | -19% | 26% | 45% | Policy |
| **Average** | | | | | | | | | | |
| All | | Every 5.4 years | | 2.0 | 2.5 | 4.5 | -16% | 22% | 38% | |
| Pre 2015 | | Every 7.5 years | | 2.1 | 2.4 | 4.5 | -15% | 19% | 34% | |
| Since 2015 | | Every 2 years | | 1.9 | 2.8 | 4.7 | -21% | 30% | 51% | |

## A breakdown of mini bears over the last 10 years

- **2015-2016:** A relatively mild mini-bear market. During this period, equity markets declined amid concerns over slowing global growth – particularly in China – and the prospect of tighter monetary policy. While Chinese economic growth was decelerating, the Federal Reserve raised interest rates for the first time since before the global financial crisis. The S&P 500 Index ultimately bottomed out with a 13% decline but quickly rebounded following supportive intervention from Chinese authorities and a more cautious tone from the Federal Open Market Committee regarding future rate hikes.
- **2018:** Amid an escalating trade war between the US and China, the Federal Reserve raised interest rates five times over the course of 12 months. This aggressive tightening contributed to a sharp 20% drawdown in the S&P 500 Index, culminating in the worst December performance since 1931. The severity of the sell-off prompted a notable shift in policy – the so-called 'Fed Pivot' – as the central bank softened its hawkish stance and paused further rate hikes.
- **2020:** The COVID-19 driven crash, classified as a 'big bear market' in our framework, stands out for its extraordinary speed of recovery. The pandemic's sudden onset and the unprecedented policy response – effectively a global shutdown of economic activity – initially triggered a sharp market sell-off due to fears that growth and corporate earnings would be materially impacted. However, the scale and speed of support were equally unparalleled. On the fiscal side, governments introduced direct household transfers, enhanced unemployment benefits, and broad-based business support. On the monetary side, central banks slashed interest rates where possible and launched aggressive quantitative easing programmes, purchasing government and corporate bonds to ensure liquidity and restore confidence. In hindsight, the sheer scale of stimulus – particularly on the monetary front – combined with widespread supply chain disruptions, created an environment of excess demand that ultimately fuelled a surge in inflation in the years that followed.
- **2022:** At first glance, the 2022 bear market resembled another mini-bear episode. Following a 13% decline in the S&P 500 Index, dip buyers and short covering drove a notable rebound, supported by a prevailing narrative that inflation was transitory and the economy resilient enough to absorb modest tightening. However, this optimism proved premature. Persistent inflation forced a reassessment, as a far more challenging mix of inflation and growth dynamics emerged. In retrospect, this episode stands out as one of the most severe cross-asset bear markets in modern history.

[17] Source: Insight and Bloomberg. Data as at 31 October 2025.

- **2023:** The 2023 correction was notable in that both the sell-off and subsequent rebound were driven more by macroeconomic data than by policy intervention. Much like the 2022 bear market, persistently high inflation prompted expectations of tighter monetary policy, with the Federal Reserve raising rates and bond yields surging to nearly 5% – a 17-year high. This triggered a broad-based equity market sell-off, but as inflation began to moderate and the labour market showed signs of softening, expectations of a Fed pivot gained traction, prompting a swift market rebound.
- **2025:** The tariff-induced mini-bear market of 2025 was the most recent and ranked as the third most intense, with a 45% roundtrip over just 4.5 months. The initial sell-off was triggered by an unexpectedly aggressive shift in US trade policy, with immediate tariff hikes reaching levels not seen in the post-war era. Markets reacted swiftly to both the speed and scale of the announcement, resulting in a 19% decline in the S&P 500 Index. However, a significant moderation in policy – where tariffs were reduced, delayed, or withdrawn – sparked a sharp rebound, driving equities up by 25% in just three months and returning markets to their previous highs.

### The rise of the retail investor and buying on the dip mentality

COVID marked a turning point in many aspects of life, including the behaviour of retail investors. While retail participation has long been a feature of the US equity market, its influence has grown significantly since the pandemic. A surge in new retail accounts, combined with a revolution in trading platforms offering commission-free access and easy entry into options markets, has empowered retail investors to exert greater influence – not just on individual stocks, but at times on broader market dynamics.

The widespread availability of low-cost call options has enabled retail investors to deploy leverage more easily, amplifying their impact. This has been most visible in the extreme price movements of so-called 'meme stocks'. Unlike institutional investors, retail participants are often driven by different motivations and sources of information. Studies suggest that many retail investors actively 'buy the dip' during market declines. When combined with increased options activity, this behaviour may help explain why some recent market setbacks have been followed by unusually swift and powerful rebounds.

## CONCLUSION

Our review of recent market episodes suggests several important themes:

- Policy intervention is increasingly front-loaded and aggressive. In four out of the last five quick reversals, a decisive policy response played a key role in stabilising markets. While such interventions are now expected early in a downturn, their effectiveness can be constrained – particularly when inflation limits the scope for monetary support.
- Dip-buying and short-covering remain influential. Although the success of dip-buying strategies varies, recent history suggests that when policy action is anticipated – or when economic data hints at a reprieve – these behaviours can trigger swift, albeit sometimes short-lived, market recoveries.

These observations reinforce the enduring relevance of our regime-based macro framework. The link between asset-class performance and core macroeconomic forces – growth, inflation, and interest rates – continues to hold over time, providing a reliable anchor for asset-allocation decisions. However, in a world characterised by more interventionist policy and a growing cohort of investors willing to 'catch falling knives', downside protection strategies must evolve. They need to account for the increasing likelihood of sharp, temporary rebounds that can complicate traditional risk-management approaches.

# 1 FINANCIAL CONDITIONS THE STARTING POINT FOR OUR ASSET-ALLOCATION FRAMEWORK

The performance of any asset class is driven by a complex set of forces. Some are driven by 'top-down' or macroeconomic influences, and others are shaped by 'bottom-up' or security-specific issues, which collectively drive a market in a specific direction. Other influences can be captured by looking through the lens of factors (sector, style, and many other risk premia). Of course, valuations play a part – especially the price investors (the market) are willing to pay, at any point in time, for the range of attributes that make up an underlying investment. Taken together, this can be a bewildering list of variables to track and analyse. From an asset-allocation standpoint, macroeconomic, or cyclical forces, appear to have a strong influence on returns, and this observation led us to build a simple transparent framework to help us understand how different macro regimes can influence the behaviour of individual asset classes.

## FINANCIAL CONDITIONS ARE KEY TO SETTING THE BROADER BACKDROP

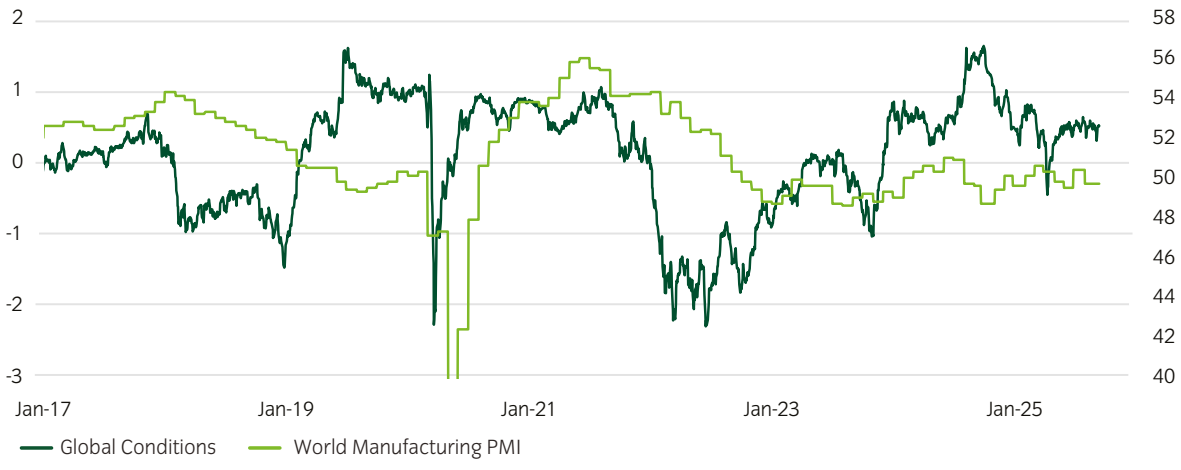
The starting point for our analysis stems from a simple economic transmission mechanism that we outline in Figure 13. The idea that monetary or financial conditions lead growth sits at the heart of central-bank policy decisions. Historically at least, periods of excessive growth brought with them inflationary pressures and, whilst such pressures have largely been absent in recent years, the post-pandemic inflationary pulse brought that relationship back into sharp focus.

Figure 13: The transmission mechanisms from macroeconomic forces into asset-class behaviours[18]


### Financial conditions are a way to incorporate a broader range of financial factors

There are many ways to monitor financial conditions in a broader sense. Some of these are 'real-time' indicators factoring a range of variables that are meant to influence the price of funding for the real economy. In our view, they are useful indicators as to whether the overall conditions within an economy are either conducive to, or a headwind for, growth. Our own financial conditions indices are calculated by using interest rates, corporate yields, exchange rates and equity markets across five regions (US, Europe, UK, Japan and Australia), weighted by GDP.

Figure 14: Insight global financial conditions – a good lead indicator of future growth[19]




[18] For illustrative purposes only.
[19] Source: Insight and Bloomberg. Data to 30 September 2025.

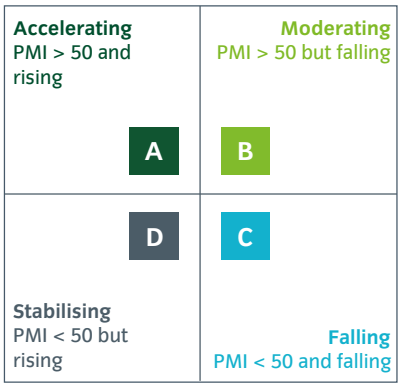
# 2 ASSET-ALLOCATION FRAMEWORK: GROWTH REGIMES

When assessing growth dynamics, we look at a wide range of indicators, some forward-looking, some co-incident. One of the best sets of timely indicators are the purchasing managers' indices (PMIs) which reflect the health of the manufacturing and service sectors, and we track 38 monthly country and regional releases.

Our historical analysis focuses heavily on manufacturing. Despite its smaller contribution to GDP (manufacturing accounts for only 10% of US GDP) we view it as the most useful from a market perspective. It gives a greater insight into global trade dynamics, is more cyclical and has historically had a closer link with swings in corporate profitability. According to the McKinsey Institute[20] US manufacturing drives 20% of capital investment, 35% of productivity growth, 60% of exports and 70% of business R&D expenditure. Interpreting PMIs is relatively simple, and any data point can be allocated to one of four regimes.

From a multi-asset perspective, we can use this framework to examine historical asset-price returns and other performance characteristics (for example volatility and drawdowns) across these different regimes since the 1970s. This analysis then serves as a guide to our asset-allocation decisions.

Figure 15: A stylised view of PMI growth regimes[21]




**A basic guide to purchasing managers' indices (PMIs)**

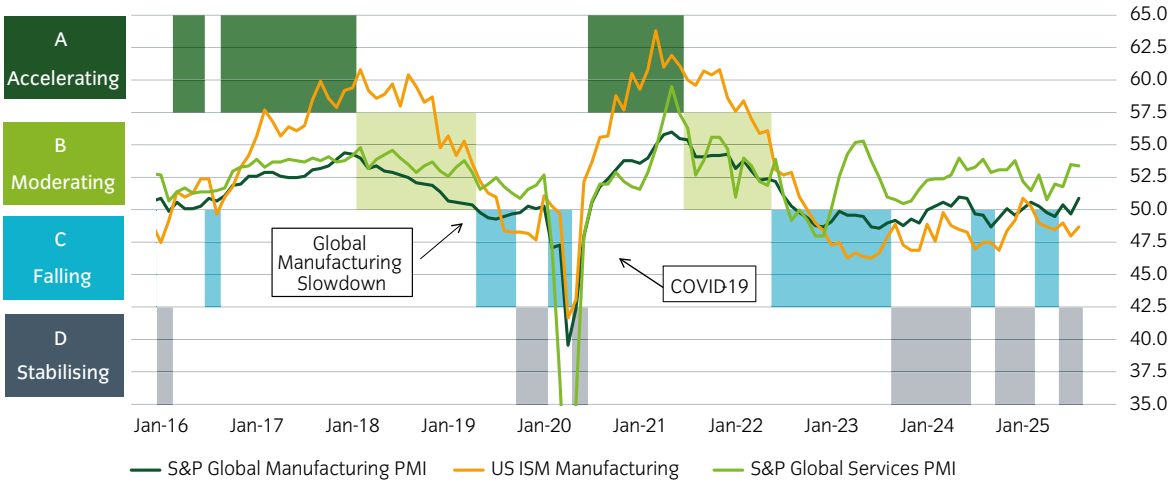
- Each month, a carefully selected group of private sector companies are surveyed on the state of conditions within their industry
- This provides a valuable insight into the underlying trends that companies are experiencing, from the level of new orders to the ease, or difficulty, of finding new employees
- The data is aggregated into an overall score, which can be used to judge the health of the broader economy and whether growth is accelerating or decelerating
- A score above 50 indicates that activity is improving, with a score below 50 indicating contraction

[20] Source: https://www.mckinsey.com/capabilities/operations/our-insights/delivering-the-us-manufacturing-renaissance
[21] For illustrative purposes only.

## THE ECONOMIC ENVIRONMENT HAS GENERALLY BEEN POSITIVE SINCE THE GLOBAL FINANCIAL CRISIS

Looking back since the global financial crisis, we have spent more times in 'good' economic environments and less in bad, i.e., we have spent the majority of time in either regime A or B (Accelerating and Moderating), with only short and shallow dips into the sub-50 PMI regimes (C and D) which were often insufficient to tip the US (or other economies) into recession.

Figure 16: Growth environments since the global financial crisis[22]




On a cross-country basis, few other countries have seen such an impressive cycle as the US. The US economy has spent significantly more time in regimes A and B, and far less time in regimes C and D relative to the other 38 countries we follow.

Over the very long term, the traditional triggers of recession – such as industrial downturns, oil shocks, or policy missteps like excessive interest rate hikes to curb inflation – have largely faded from prominence. Instead, recession risks in recent decades have emerged through financial transmission mechanisms. Examples include the inflated equity valuations of the late 1990s and the real-estate bubbles that culminated in the sub-prime mortgage crisis and the ensuing global financial crisis. In 2020, recession arrived via an exogenous shock: the pandemic.

However, the post-pandemic policy response has arguably reintroduced an economic cycle driven by policy decisions – something not seen for several decades. The aggressive deployment of both monetary and fiscal stimulus during lockdowns, when supply chains were constrained, unleashed a surge in demand that sparked an inflationary wave which still hasn't fully dissipated. This caused central banks to initiate the fastest interest-rate hiking cycle in a generation, aiming to rein in inflation that had been amplified by the very policies designed to cushion the pandemic's economic blow. As inflationary pressures started to recede, so the narrative shifted again, with major central banks cautiously easing rates.

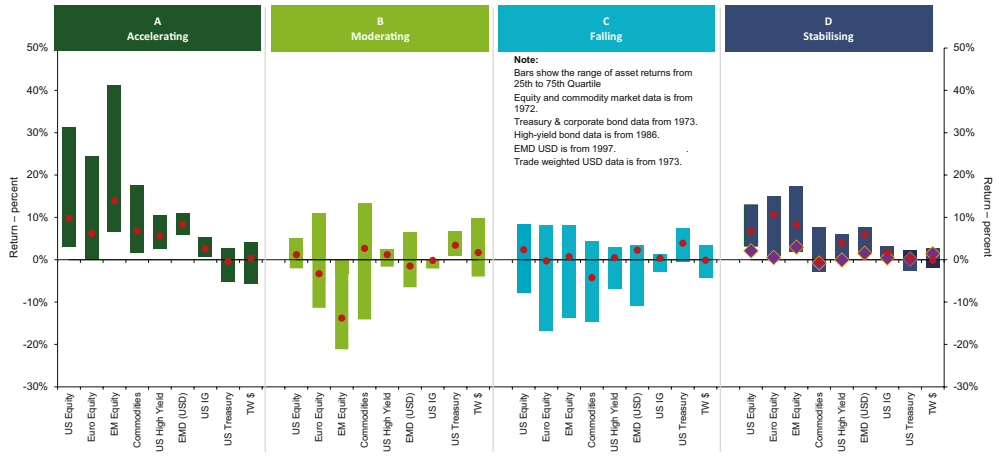
We believe that our growth framework is an effective indicator to assess a wide variety of shocks because, whatever their initial cause, they need to be big enough to have real economic consequences if they are to have significant medium-term asset-allocation implications.

## GROWTH IS KEY FOR ASSET PRICES, ESPECIALLY EQUITIES

When we analyse historical data, the sweet spot for risk assets tends to be an Accelerating growth regime (A), when growth is strong and getting stronger. During these times, the correct asset-allocation strategy has been to skew towards pro-cyclical exposures such as equities and away from government bonds which have historically been one of the worst-performing assets when activity is accelerating. As growth loses momentum and we enter a Moderating growth regime (B), it becomes a more challenging equity environment and the most cyclical assets such as emerging market equities tend to perform poorly. The Falling growth regime (C) is the only one in which average equity market returns have historically been negative but is one in which government bonds tend to perform well. This environment has also been especially poor for commodity prices.

[22] Source: Insight and Bloomberg as at 30 September 2025.

Figure 17: Risk assets have performed well when growth is strong and getting stronger[23]




In Moderating growth regimes (B) risk assets have generally experienced slightly higher volatility and a greater chance of meaningful drawdowns than in Accelerating growth regimes (A). However, volatility tends to be much higher when PMIs are sub-50 (regimes C and D).

Figure 18: Volatility increased notably when PMIs are sub-50 (regimes C and D)[24]


Historically, drawdown risks have been greatest in a Falling growth regime (C), an environment where the economy and likely earnings are contracting. For areas that are more leveraged into global growth such as emerging markets, they have also been notable in a Moderating growth regime (B).

Figure 19: The Falling growth regime (C) has by far the most extreme peak-to-trough drawdowns historically[25]

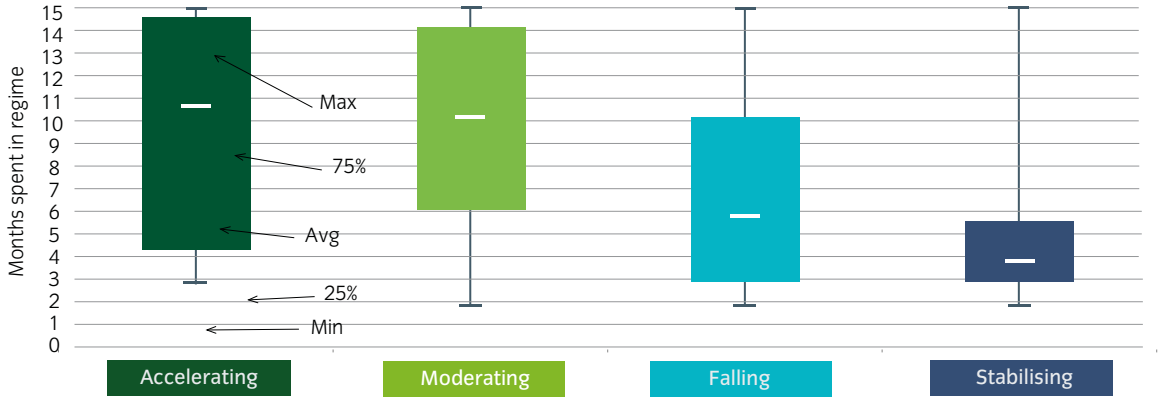

[23, 24, 25] Source: Insight and Bloomberg as at 30 September 2025. Note: Bars show the range of asset returns from 25th to 75th Quartile. Equity and commodity market data is from 1973. Treasury and corporate bond data from 1973. High-yield bond data is from 1986. EM USD and local debt data is from 1993. Trade weighted USD data is from 1973.

## ASSESSING CYCLE LONGEVITY

When we analyse the persistence of growth regimes over the longer term, some interesting observations can be made. The regime with the greatest average longevity is regime A, where PMIs are above 50 and growth is accelerating. Once growth starts to moderate, regime B, there is generally a prolonged period where PMIs remain above 50 and, as our analysis has shown, this is not an unattractive environment for some risk assets, although not as attractive as regime A.

By comparison, the length of time typically spent in the sub-50 PMI regimes (C and D) is relatively short. Regime C, where PMIs are below 50 but growth is still falling, is the only regime in which average equity market returns have historically been negative, and the historical range of drawdowns has been more extreme in regime C than in other regimes. This analysis can provide important context as we assess how regimes are evolving and how best to adapt our asset-allocation decisions in anticipation of a shift to a new regime.

Figure 20: The most persistent regimes are those where PMIs are above 50[26]




[26] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

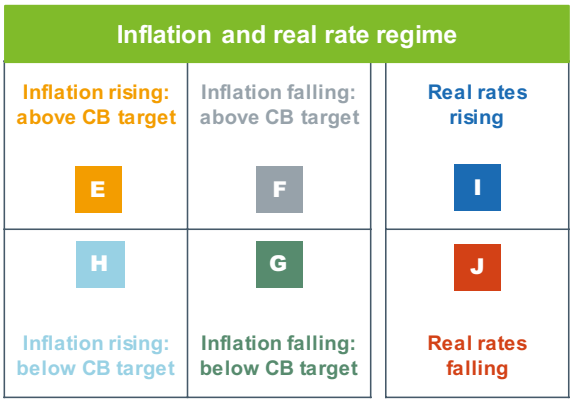
# 3 ASSET-ALLOCATION FRAMEWORK: INFLATION AND REAL RATES REGIMES

Once we have established the growth regime, the next step is to establish the inflation and real-rate regimes. The logic goes that growth dynamics (either periods of excessively strong or unusually weak activity) may have implications for both inflation and/or real interest rates. In turn, these dynamics provide useful insights from an asset-allocation perspective.

We consider both current and expected future inflation using consumer price indices and breakeven inflation rates. Our analysis on the relationship between inflation and asset-class price behaviour shows that, much like in our growth framework, both the level and rate of change matter. For example, an environment in which inflation is rising but below central-bank targets has historically been very good for equities. However, when inflation is rising, but above central-bank targets, this has historically been a bad environment for equities, given the implications for corrective monetary policy to cool inflation down.

For real interest rates, our analysis shows that what really matters is whether they are rising or falling. The level of real interest rates tends to trend over long periods of time and hence the absolute level is less important than the direction of travel. Real yields indicate how cheap or expensive it is for companies to borrow, invest and ultimately grow, and can also be a key indicator of margin pressure as real cost rises may be more difficult to pass onto customers.

Figure 21: A stylised view of inflation/real-rate regimes[27]




**A basic guide to inflation and real rates**

- For the current inflation rate we use a country's CPI index. This measures the rate of change in prices for a basket of goods and services that are typically purchased by households.
- For the expected future rate of inflation, we use a country's breakeven inflation rate. This is the rate of inflation at which a country's nominal government bonds would generate the same return as inflation-linked government bonds. This gives us the level of future inflation that markets are currently pricing in.
- Real interest rates are the nominal level of yields adjusted for expected inflation. For the US this is the yield derived from Treasury Inflation-Protected Securities (TIPS) bonds. This gives the real cost of financing for a borrower.

## REGIMES WHERE INFLATION IS SLOWING ARE GENERALLY GOOD FOR EQUITIES AND BONDS

When we analyse the historical data, one finding that seems relatively clear is that the best regimes for equities and government bonds are generally those where the pace of inflation is decelerating, regardless of whether inflation is above or below central-bank targets (regimes F and G). If real rates are falling as well, this has tended to be especially beneficial for US equity markets.

[27] For illustrative purposes only.

Broadly speaking, it is also clear that assets generally perform positively when inflation is below central-bank targets, regardless of whether inflation is rising or falling (regimes G and H). The exception to this is the US dollar, which performs poorly in those regimes, but here real rates are key, as the dollar has historically performed far better during environments where real rates are rising than falling.

For commodities, a reflationary regime is optimal, where inflation is rising but still below central bank targets (regime H). By far the worst regime for broad asset returns is E, where inflation is above target and rising, and this is an environment in which, perhaps unsurprisingly, most assets struggle, including commodities.

Figure 22: Returns across historical inflation regimes[28]

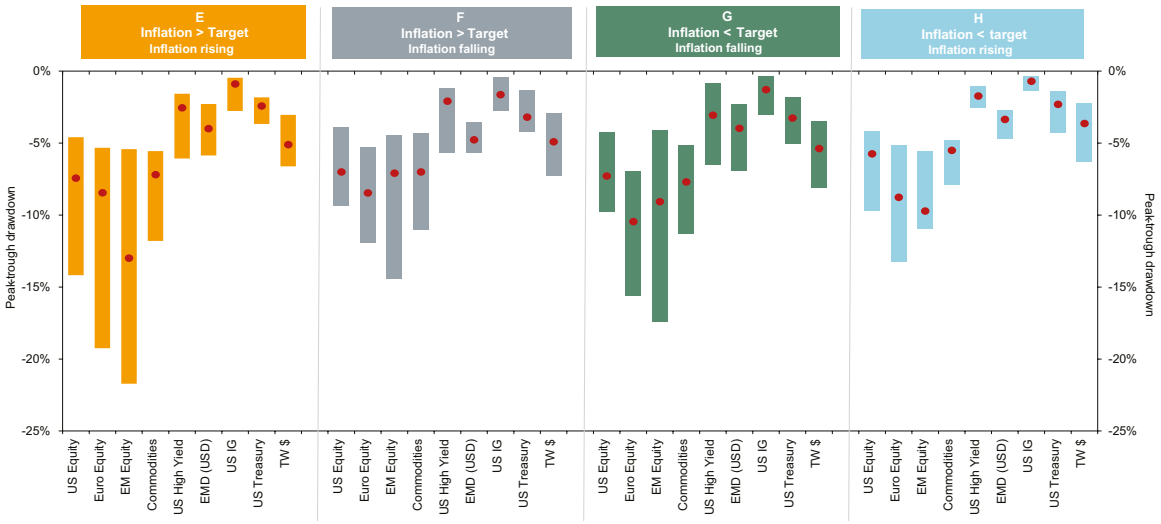

Surprisingly, divergences in volatility are more nuanced across inflation regimes, but volatility tends to be slightly lower during periods when inflation is converging with central bank targets in either direction (regimes F and H). In these periods, central banks will generally be returning to a more neutral policy position. For investment grade credit, reflationary environments (regime H) where inflation is below target but rising, have historically been periods where volatility is particularly subdued.

Figure 23: Volatility across historical inflation regimes[29]


Perhaps unsurprisingly, for more cyclical assets such as emerging markets, drawdowns have been significantly worse when inflation is above central-bank targets but still rising (regime E). This makes sense as it implies an environment where major central banks are likely to react most aggressively to bring inflation back under control, and investors are likely to be returning to core markets in that scenario.

[28, 29] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

Figure 24: Drawdowns across historical inflation regimes[30]

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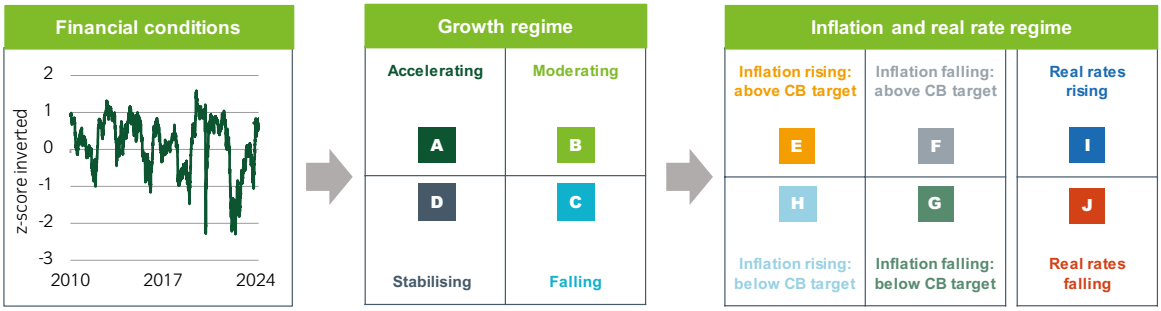
By far the worst regime for broad asset returns is E, where inflation is above target and rising, and this is an environment in which, perhaps unsurprisingly, most assets struggle, including commodities.

[30] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

# 4 ASSET-ALLOCATION FRAMEWORK: BRINGING EVERYTHING TOGETHER

Viewed within the context of broader financial conditions, the combined growth, inflation and real-rate regimes allow us to categorise the prevailing investment environment, and to view the outlook for asset-price performance within a historical context. Once the current environment is established, we are able to utilise both our macro-economic models, and our fundamental understanding of the particular forces at play at the time, to understand how a given environment is most likely to evolve going forward. We can then compare our most likely scenarios to the historical patterns, or regime sequences, that we have witnessed in the past. This allows us to use our rich data set to provide insights into how we believe different asset classes should be expected to perform, allowing us to adapt our asset-allocation to best take advantage of the prevailing and likely future environments.

Figure 25: A clear framework for our assessment of the macro environment[31]




## SINGLE ASSET-CLASS EXAMPLE OF A COMBINED REGIME FRAMEWORK

Let us illustrate how this framework looks when assessing the prospect for a single asset class – (US) equity.

To do this we can look at an environment similar to that seen in the summer of 2025.

- Stabilising growth (D)
- Inflation coming down – but remaining above central-bank targets (F)
- Real rates edging lower (J)

In Figure 26, we rank the performance of US equity in the various combinations of our three regimes. The first three columns show different combinations of growth, inflation and real interest rates. We then show the average excess return, Sharpe ratio, drawdown and 'hit rate' (percentage of time we recorded a positive return) for each. To the right, these regimes are ranked according to their combined behaviours. What this ranking shows clearly is the historical dominance of the growth factor for US equities. The best environments for equity performance have been when growth is stabilising or accelerating while the worst environments have been when growth is moderating or falling. Similar return profiles can be built for a broad range of asset classes. It is notable that DFJ is an environment that has historically been one in which equity markets have performed very well.

[31] For illustrative purposes only.

Figure 26: Equity market regime ranking[32]

| Growth Regime | Inflation Regime | Real Rate Regime | Combined Regime | Excess Return | Sharpe | Drawdown (3 quartile) | Hit Ratio | Return Ranking 40% | Sharpe Ranking 20% | Drawdown (3 quartile) Ranking 20% | Hit Ratio Ranking 20% | Weighted Ranking | Time Spent I Regime | Regime coun |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Stabilising | Inflation > Target & Falling | Real Rates Falling | DFJ | 6.3% | 2.6 | -5% | 86% | 2 | 2 | 3 | 3 | 2.40 | 2% | 7.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Falling | AFJ | 4.1% | 3.1 | -2% | 83% | 7 | 1 | 1 | 4 | 4.00 | 2% | 6.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Rising | AGI | 6.3% | 2.0 | -6% | 78% | 4 | 3 | 4 | 9 | 4.80 | 4% | 9.0 |
| Stabilising | Inflation < Target & Falling | Real Rates Falling | DGJ | 9.6% | 1.5 | -12% | 100% | 1 | 5 | 19 | 1 | 5.40 | 2% | 4.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Falling | AGJ | 5.8% | 1.0 | -8% | 100% | 5 | 10 | 15 | 1 | 7.20 | 4% | 6.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Rising | AHI | 4.0% | 1.6 | -4% | 69% | 9 | 4 | 2 | 12 | 7.20 | 5% | 13.0 |
| Stabilising | Inflation > Target & Falling | Real Rates Rising | DFI | 4.0% | 1.4 | -6% | 78% | 8 | 6 | 6 | 9 | 7.40 | 3% | 9.0 |
| Moderating | Inflation > Target & Falling | Real Rates Falling | BFJ | 3.8% | 1.3 | -6% | 80% | 10 | 7 | 8 | 7 | 8.40 | 4% | 10.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Falling | AHJ | 6.3% | 1.2 | -9% | 67% | 3 | 8 | 16 | 13 | 8.60 | 4% | 6.0 |
| Falling | Inflation < Target & Falling | Real Rates Falling | CGJ | 4.1% | 0.8 | -10% | 83% | 6 | 13 | 17 | 4 | 9.20 | 2% | 6.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Rising | AEI | 2.9% | 1.0 | -7% | 82% | 12 | 11 | 13 | 6 | 10.80 | 5% | 11.0 |
| Falling | Inflation > Target & Falling | Real Rates Falling | CFJ | 3.3% | 0.8 | -8% | 79% | 11 | 12 | 14 | 8 | 11.20 | 6% | 14.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Rising | AFI | 2.7% | 1.0 | -6% | 62% | 13 | 9 | 7 | 16 | 11.60 | 6% | 13.0 |
| Moderating | Inflation < Target & Falling | Real Rates Falling | BGJ | 2.2% | 0.7 | -6% | 56% | 14 | 14 | 5 | 18 | 13.00 | 4% | 9.0 |
| Moderating | Inflation < Target & Falling | Real Rates Rising | BGI | 1.1% | 0.4 | -7% | 67% | 15 | 15 | 10 | 13 | 13.60 | 2% | 6.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Falling | AEJ | 0.0% | 0.0 | -6% | 75% | 16 | 16 | 9 | 11 | 13.60 | 4% | 8.0 |
| Moderating | Inflation > Target & Falling | Real Rates Rising | BFI | -0.3% | -0.1 | -7% | 67% | 17 | 17 | 11 | 13 | 15.00 | 4% | 9.0 |
| Moderating | Inflation > Target & Rising | Real Rates Rising | BEI | -1.5% | -0.4 | -7% | 62% | 20 | 20 | 12 | 16 | 17.60 | 6% | 13.0 |
| Moderating | Inflation > Target & Rising | Real Rates Falling | BEJ | -0.9% | -0.1 | -11% | 53% | 19 | 18 | 18 | 19 | 18.60 | 11% | 15.0 |
| Falling | Inflation > Target & Rising | Real Rates Falling | CEJ | -0.8% | -0.2 | -14% | 53% | 18 | 19 | 21 | 19 | 19.00 | 6% | 15.0 |
| Falling | Inflation < Target & Rising | Real Rates Falling | CHJ | -4.3% | -0.9 | -18% | 33% | 21 | 21 | 23 | 21 | 21.40 | 3% | 6.0 |
| Falling | Inflation > Target & Rising | Real Rates Rising | CEI | -4.9% | -1.4 | -13% | 0% | 22 | 23 | 20 | 23 | 22.00 | 2% | 6.0 |
| Falling | Inflation > Target & Falling | Real Rates Rising | CFI | -6.1% | -1.3 | -14% | 11% | 23 | 22 | 22 | 22 | 22.40 | 4% | 9.0 |

Once we've established the current regime and the backdrop for asset returns in similar historical regimes we can then look at how the regime is most likely to evolve. This provides a potential insight into future asset returns.

## Our assessment of two potential regimes that could follow DFJ:

### 1. (CEJ) – Growth falling, inflation above target and rising, while real rates are falling

With the world facing significant headwinds from the new US tariff regime through the second half of 2025, a potential path for growth could be a shift to a 'Falling' growth regime into the end of the year. At the same time measures of core and sticky inflation appear to be showing signs of bottoming, with tariffs complicating the inflation outlook. This raises the risk that inflation shifts to a Rising regime, while still being above central bank targets. If markets consider inflation temporary, and focus on the deteriorating growth outlook, then real rates could decline. This has historically been a poor regime for risk assets.

### 2. (AFI) – Growth accelerating, inflation above target and rising, while real rates are rising

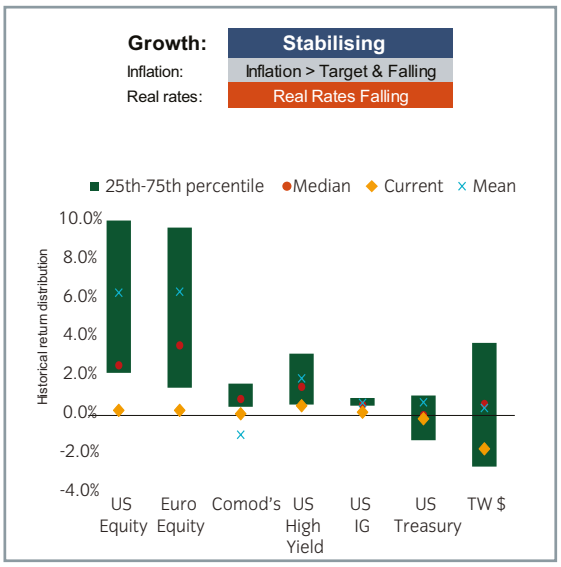
If tariffs prove to be less of a headwind than expected, then rate cuts could boost growth, shifting it from a Stabilising regime to an Accelerating regime. If inflation is also accelerating while remaining above central-bank targets, then markets are more likely to push real rates higher. This has historically been a moderately positive regime for risk assets.

[32] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

Figure 27: Regime pathway – two very different risk scenarios appear possible[33]

We have spent most of the recent year in a 'stabilising' growth regime with 'falling' inflation, historically a very positive backdrop for equity returns

But where we might get to is more nuanced….




**Growth:** Falling
Inflation: Inflation > Target & Falling
Real rates: Real Rates Falling

**Growth:** Accelerating
Inflation: Inflation > Target & Rising
Real rates: Real Rates Rising

Figure 28: A shift from DFJ could present a very different environment for equities[34]

| Growth Regime | Inflation Regime | Real Rate Regime | Combined Regime | Excess Return | Sharpe | Drawdown (3 quartile) | Hit Ratio | Return Ranking 40% | Sharpe Ranking 20% | Drawdown (3 quartile) Ranking 20% | Hit Ratio Ranking 20% | Weighted Ranking | Time Spent I Regime | Regime count |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Stabilising | Inflation > Target & Falling | Real Rates Falling | **DFJ** | 6.3% | 2.6 | -5% | 86% | 2 | 2 | 3 | 3 | 2.40 | 2% | 7.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Falling | AFJ | 4.1% | 3.1 | -2% | 83% | 7 | 1 | 1 | 4 | 4.00 | 2% | 6.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Rising | AGI | 6.3% | 2.0 | -6% | 78% | 4 | 3 | 4 | 9 | 4.80 | 4% | 9.0 |
| Stabilising | Inflation < Target & Falling | Real Rates Falling | DGJ | 9.6% | 1.5 | -12% | 100% | 1 | 5 | 19 | 1 | 5.40 | 2% | 4.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Falling | AGJ | 5.8% | 1.0 | -8% | 100% | 5 | 10 | 15 | 1 | 7.20 | 4% | 6.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Rising | AHI | 4.0% | 1.6 | -4% | 69% | 9 | 4 | 2 | 12 | 7.20 | 5% | 13.0 |
| Stabilising | Inflation > Target & Falling | Real Rates Rising | DFI | 4.0% | 1.4 | -6% | 78% | 8 | 6 | 6 | 9 | 7.40 | 3% | 9.0 |
| Moderating | Inflation > Target & Falling | Real Rates Falling | BFJ | 3.8% | 1.3 | -6% | 80% | 10 | 7 | 8 | 7 | 8.40 | 4% | 10.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Falling | AHJ | 6.3% | 1.2 | -9% | 67% | 3 | 8 | 16 | 13 | 8.60 | 4% | 6.0 |
| Falling | Inflation < Target & Falling | Real Rates Falling | CGJ | 4.1% | 0.8 | -10% | 83% | 6 | 13 | 17 | 4 | 9.20 | 2% | 6.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Rising | AEI | 2.9% | 1.0 | -7% | 82% | 12 | 11 | 13 | 6 | 10.80 | 5% | 11.0 |
| Falling | Inflation > Target & Falling | Real Rates Falling | **CFJ** | 3.3% | 0.8 | -8% | 79% | 11 | 12 | 14 | 8 | 11.20 | 6% | 14.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Rising | **AFI** | 2.7% | 1.0 | -6% | 62% | 13 | 9 | 7 | 16 | 11.60 | 6% | 13.0 |
| Moderating | Inflation < Target & Falling | Real Rates Falling | BGJ | 2.2% | 0.7 | -6% | 56% | 14 | 14 | 5 | 18 | 13.00 | 4% | 9.0 |
| Moderating | Inflation < Target & Falling | Real Rates Rising | BGI | 1.1% | 0.4 | -7% | 67% | 15 | 15 | 10 | 13 | 13.60 | 2% | 6.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Falling | AEJ | 0.0% | 0.0 | -6% | 75% | 16 | 16 | 9 | 11 | 13.60 | 4% | 8.0 |
| Moderating | Inflation > Target & Falling | Real Rates Rising | BFI | -0.3% | -0.1 | -7% | 67% | 17 | 17 | 11 | 13 | 15.00 | 4% | 9.0 |
| Moderating | Inflation > Target & Rising | Real Rates Rising | BEI | -1.5% | -0.4 | -7% | 62% | 20 | 20 | 12 | 16 | 17.60 | 6% | 13.0 |
| Moderating | Inflation > Target & Rising | Real Rates Falling | BEJ | -0.9% | -0.1 | -11% | 53% | 19 | 18 | 18 | 19 | 18.60 | 11% | 15.0 |
| Falling | Inflation > Target & Rising | Real Rates Falling | **CEJ** | -0.8% | -0.2 | -14% | 53% | 18 | 19 | 21 | 19 | 19.00 | 6% | 15.0 |
| Falling | Inflation < Target & Rising | Real Rates Falling | CHJ | -4.3% | -0.9 | -18% | 33% | 21 | 21 | 23 | 21 | 21.40 | 3% | 6.0 |
| Falling | Inflation > Target & Rising | Real Rates Rising | CEI | -4.9% | -1.4 | -13% | 0% | 22 | 23 | 20 | 23 | 22.00 | 2% | 6.0 |
| Falling | Inflation > Target & Falling | Real Rates Rising | CFI | -6.1% | -1.3 | -14% | 11% | 23 | 22 | 22 | 22 | 22.40 | 4% | 9.0 |

[33] For illustrative purposes only.
[34] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

In fixed income markets, a transition from DFJ to CEJ has historically marked a shift from a moderately supportive environment to a significantly more favourable one. CEJ is also a regime in which bond markets have historically outperformed equities. In contrast, a move from DFJ to AFI has typically signalled a much more challenging regime for bonds.

Figure 29: The next regime could suggest a better environment for fixed income[35]

| Growth Regime | Inflation Regime | Real Rate Regime | Combined Regime | Excess Return | Sharpe | Drawdown (3 quartile) | Hit Ratio | Return Ranking 40% | Sharpe Ranking 20% | Drawdown (3 quartile) Ranking 20% | Hit Ratio Ranking 20% | Weighted Ranking | Time Spent I Regime | Regime coun |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Accelerating | Inflation > Target & Falling | Real Rates Falling | AFJ | 3.1% | 2.5 | -1% | 100% | 2 | 1 | 1 | 1 | 1.40 | 2% | 6.0 |
| Falling | Inflation < Target & Rising | Real Rates Falling | CHJ | 3.1% | 2.4 | -2% | 83% | 1 | 2 | 4 | 3 | 2.20 | 3% | 6.0 |
| Moderating | Inflation > Target & Falling | Real Rates Falling | BFJ | 2.2% | 1.7 | -2% | 70% | 6 | 4 | 6 | 8 | 6.00 | 4% | 10.0 |
| Falling | Inflation < Target & Falling | Real Rates Falling | CGJ | 2.4% | 2.0 | -4% | 100% | 4 | 3 | 18 | 1 | 6.00 | 2% | 6.0 |
| Moderating | Inflation < Target & Falling | Real Rates Falling | BGJ | 1.5% | 1.3 | -2% | 78% | 10 | 5 | 2 | 5 | 6.40 | 4% | 9.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Falling | AGJ | 2.8% | 1.0 | -3% | 83% | 3 | 9 | 16 | 3 | 6.80 | 4% | 6.0 |
| Moderating | Inflation > Target & Rising | Real Rates Falling | BEJ | 2.3% | 1.1 | -2% | 60% | 5 | 7 | 8 | 13 | 7.60 | 11% | 15.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Falling | AHJ | 2.0% | 1.2 | -2% | 67% | 8 | 6 | 7 | 9 | 7.60 | 4% | 6.0 |
| Falling | Inflation > Target & Rising | Real Rates Falling | **CEJ** | 2.2% | 1.0 | -3% | 73% | 7 | 8 | 12 | 7 | 8.20 | 6% | 15.0 |
| Moderating | Inflation < Target & Falling | Real Rates Rising | BGI | 0.6% | 0.6 | -2% | 67% | 13 | 12 | 3 | 9 | 10.00 | 2% | 6.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Falling | AEJ | 1.2% | 0.7 | -3% | 75% | 11 | 11 | 11 | 6 | 10.00 | 4% | 8.0 |
| Falling | Inflation > Target & Falling | Real Rates Falling | CFJ | 1.7% | 0.8 | -3% | 64% | 9 | 10 | 14 | 12 | 10.80 | 6% | 14.0 |
| Stabilising | Inflation > Target & Falling | Real Rates Falling | **DFJ** | 0.7% | 0.5 | -2% | 57% | 12 | 13 | 5 | 14 | 11.20 | 2% | 7.0 |
| Stabilising | Inflation > Target & Falling | Real Rates Rising | DFI | 0.3% | 0.2 | -3% | 67% | 14 | 14 | 9 | 9 | 12.00 | 3% | 9.0 |
| Moderating | Inflation > Target & Rising | Real Rates Rising | BEI | -1.3% | -1.0 | -3% | 45% | 16 | 18 | 15 | 17 | 16.40 | 6% | 11.0 |
| Stabilising | Inflation < Target & Falling | Real Rates Falling | DGJ | -1.4% | -0.7 | -5% | 50% | 17 | 15 | 19 | 15 | 16.60 | 2% | 4.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Rising | AGI | -1.2% | -0.8 | -6% | 44% | 15 | 16 | 22 | 18 | 17.20 | 4% | 9.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Rising | **AFI** | -1.4% | -1.0 | -3% | 17% | 18 | 20 | 13 | 23 | 18.40 | 6% | 12.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Rising | AEI | -1.8% | -1.3 | -3% | 30% | 20 | 23 | 10 | 20 | 18.60 | 5% | 10.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Rising | AHI | -1.4% | -1.2 | -5% | 38% | 19 | 21 | 21 | 19 | 19.80 | 5% | 13.0 |
| Falling | Inflation > Target & Rising | Real Rates Rising | CEI | -2.2% | -0.9 | -7% | 50% | 23 | 17 | 23 | 15 | 20.20 | 2% | 6.0 |
| Falling | Inflation > Target & Falling | Real Rates Rising | CFI | -1.9% | -1.0 | -5% | 22% | 21 | 19 | 20 | 22 | 20.60 | 4% | 9.0 |
| Moderating | Inflation > Target & Falling | Real Rates Rising | BFI | -2.0% | -1.2 | -4% | 29% | 22 | 22 | 17 | 21 | 20.80 | 4% | 7.0 |

For those with greater flexibility, currency markets can also offer interesting opportunities. Regime AFI has historically been associated with some of the strongest periods for the trade-weighted US dollar (see Figure 30), while a CEJ has generally been associated with a weakening in the US dollar. This can provide additional ways to position to add alpha or seek diversification for those that have the flexibility to access currency-based strategies.

Figure 30: In currency markets, a regime shift could suggest a much stronger dollar environment ahead[36]

| Growth Regime | Inflation Regime | Real Rate Regime | Combined Regime | Excess Return | Sharpe | Drawdown (3 quartile) | Hit Ratio | Return Ranking 40% | Sharpe Ranking 20% | Drawdown (3 quartile) Ranking 20% | Hit Ratio Ranking 20% | Weighted Ranking | Time Spent I Regime | Regime coun |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Moderating | Inflation > Target & Falling | Real Rates Rising | BFI | 2.9% | 2.0 | -3% | 56% | 1 | 1 | 2 | 8 | 2.60 | 4% | 9.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Rising | **AFI** | 2.7% | 1.8 | -3% | 77% | 3 | 2 | 4 | 2 | 2.80 | 6% | 13.0 |
| Falling | Inflation > Target & Rising | Real Rates Rising | CEI | 2.7% | 1.5 | -5% | 67% | 2 | 3 | 8 | 3 | 3.60 | 2% | 6.0 |
| Moderating | Inflation < Target & Falling | Real Rates Rising | BGI | 1.2% | 0.8 | -3% | 67% | 5 | 5 | 1 | 3 | 3.80 | 2% | 6.0 |
| Stabilising | Inflation > Target & Falling | Real Rates Rising | DFI | 0.9% | 0.6 | -5% | 78% | 6 | 6 | 11 | 1 | 6.00 | 3% | 9.0 |
| Falling | Inflation > Target & Falling | Real Rates Rising | CFI | 2.4% | 1.0 | -7% | 67% | 4 | 4 | 18 | 3 | 6.60 | 4% | 9.0 |
| Moderating | Inflation > Target & Falling | Real Rates Falling | BFJ | 0.7% | 0.4 | -4% | 50% | 7 | 8 | 5 | 13 | 8.00 | 4% | 10.0 |
| Moderating | Inflation > Target & Rising | Real Rates Rising | BEI | 0.5% | 0.3 | -3% | 54% | 9 | 10 | 3 | 11 | 8.40 | 6% | 13.0 |
| Stabilising | Inflation > Target & Falling | Real Rates Falling | **DFJ** | 0.4% | 0.3 | -4% | 57% | 10 | 9 | 6 | 7 | 8.40 | 2% | 7.0 |
| Moderating | Inflation < Target & Falling | Real Rates Falling | BGJ | 0.6% | 0.4 | -5% | 56% | 8 | 7 | 12 | 8 | 8.60 | 4% | 9.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Rising | AHI | 0.3% | 0.2 | -5% | 54% | 11 | 11 | 13 | 11 | 11.40 | 5% | 13.0 |
| Falling | Inflation < Target & Falling | Real Rates Falling | CGJ | -0.5% | -0.4 | -7% | 67% | 13 | 13 | 17 | 3 | 11.80 | 2% | 6.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Rising | AEI | -0.7% | -0.4 | -5% | 55% | 14 | 15 | 7 | 10 | 12.00 | 5% | 11.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Falling | AEJ | -0.7% | -0.4 | -5% | 50% | 16 | 16 | 9 | 13 | 14.00 | 4% | 8.0 |
| Moderating | Inflation > Target & Rising | Real Rates Falling | BEJ | -0.4% | -0.1 | -9% | 47% | 12 | 12 | 21 | 16 | 14.60 | 11% | 15.0 |
| Falling | Inflation > Target & Rising | Real Rates Falling | **CEJ** | -0.7% | -0.4 | -5% | 33% | 15 | 14 | 15 | 17 | 15.20 | 6% | 15.0 |
| Accelerating | Inflation > Target & Falling | Real Rates Falling | AFJ | -0.8% | -0.7 | -5% | 50% | 17 | 18 | 14 | 13 | 15.80 | 2% | 6.0 |
| Falling | Inflation < Target & Rising | Real Rates Falling | CHJ | -1.3% | -0.9 | -5% | 17% | 18 | 19 | 10 | 21 | 17.20 | 3% | 6.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Falling | AGJ | -1.6% | -0.5 | -12% | 33% | 19 | 17 | 23 | 17 | 19.00 | 4% | 6.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Rising | AGI | -2.2% | -1.3 | -5% | 33% | 21 | 22 | 16 | 17 | 19.40 | 4% | 9.0 |
| Falling | Inflation > Target & Falling | Real Rates Falling | CFJ | -2.1% | -1.1 | -7% | 29% | 20 | 20 | 19 | 20 | 19.80 | 6% | 14.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Falling | AHJ | -3.8% | -1.7 | -8% | 17% | 23 | 23 | 20 | 21 | 22.00 | 4% | 6.0 |
| Stabilising | Inflation < Target & Falling | Real Rates Falling | DGJ | -2.6% | -1.2 | -9% | 0% | 22 | 21 | 22 | 23 | 22.00 | 2% | 4.0 |

[35, 36] Source: Insight, Bloomberg. Data between December 1976 and September 2025. US Treasury and trade-weighted US dollar.

# 5 LOOKING BEYOND TRADITIONAL ASSET CLASSES INCREASES THE POTENTIAL FOR DIVERSIFICATION AND RETURNS

To be able to position for all possible environments, we believe that a multi-asset strategy must take a flexible approach that gives access to both traditional assets and alternative assets. The ability to access such a broad opportunity set offers different ways to add diversification at a time when traditional sources of diversification may prove less reliable than in the past and our asset-allocation framework can be just as applicable to these alternative strategies.

To illustrate this, we can compare a range of alternative assets across two of the regimes in our growth framework (see Figure 31). These include alternative assets (convertible bonds, fallen angels and dividend futures), alternative alpha trades (commodity carry and quantitative currency returns, also known as QCR) as well as alternative hedges (equity dispersion and equity quality long/short). Although higher government bond yields have once again increased their attractiveness as a diversifying asset, alternative strategies such as relative value or defensive currency trades can offer ways to enhance diversification. In environments where both bond and equity markets may generate negative returns, we believe multi-asset strategies need all available tools to mitigate against downside risks.

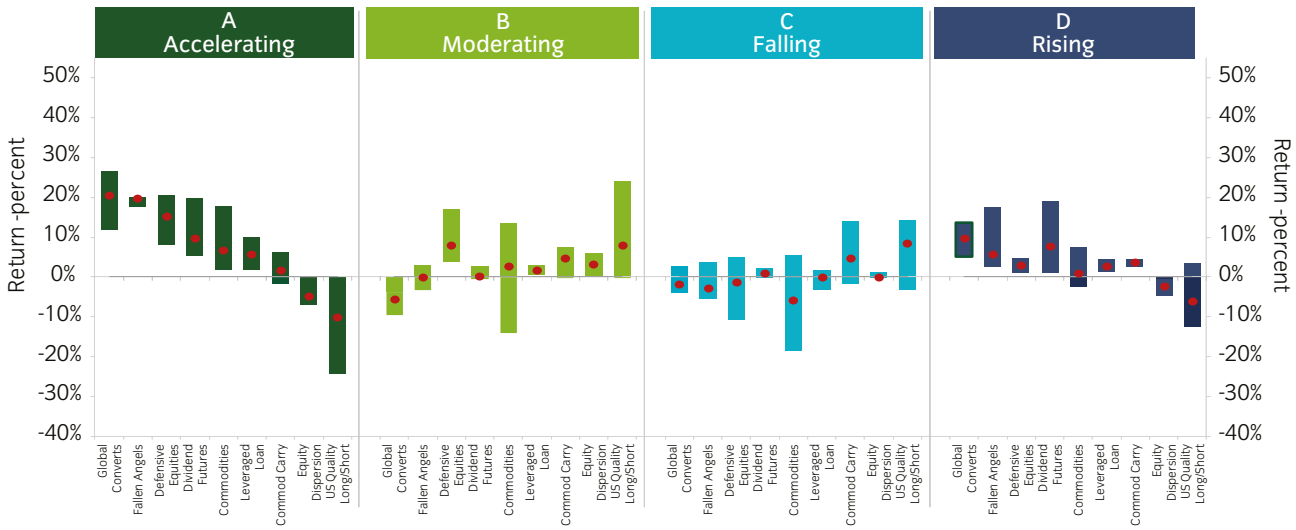
While the regime framework was primarily built as an asset-allocation tool for traditional assets, we have also found it a useful tool when allocating between alternative assets. For example, Figure 32 shows the performance characteristics of equity dispersion across all growth, inflation and real rate regimes. What is striking is how the economic environments which tend to be the worst for equities that we discussed earlier, are actually some of the best for equity dispersion, highlighting its appeal as a hedge. Figure 33 applies the same analysis to a commodity-carry strategy (explained below). What is notable here is that there is no clear pattern, either from a growth or inflation perspective for the environments this strategy has historically performed poorly or well. This highlights its attraction as a potentially more alpha-generative strategy, less dependent on broad market direction, where a risk-based framework for allocation would be more appropriate.

## COMMODITY CARRY STRATEGIES EXPLAINED

Commodities markets cover a large spectrum of raw materials (including energy, metals and agriculture) that investors can trade through futures contracts. Generally, the price at which futures contracts are traded will be higher (known as contango) or lower than prevailing spot prices (known as backwardation).

The shape of the futures is mainly dependent upon the fundamental supply and demand dynamics of the underlying markets, the levels of inventories and the costs of storage and delivery of the physical assets. Commodity-carry strategies are designed to harvest the yield available from the futures curve, without relying on the direction of movements in spot price.

Figure 31: Alternative strategies across growth regimes[37]




[37] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

## Figure 32: Equity dispersion characteristics across the combined regimes[38]

| Growth Regime | Inflation Regime | Real Rate Regime | Combined Regime | Excess Return | Sharpe | Drawdown (3rd quartile) | Hit Ratio | Return Ranking 40% | Sharpe Ranking 20% | Drawdown (3rd quartile) Ranking 20% | Hit Ratio Ranking 20% | Weighted Ranking | Time Spent In Regime | Regime count |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Falling | Inflation > Target & Falling | Real Rates Rising | CFI | 9.4% | 2.7 | -2% | 38% | 1 | 1 | 8 | 5 | 3.20 | 4% | 3.0 |
| Falling | Inflation > Target & Rising | Real Rates Rising | CEI | 3.4% | 2.2 | -1% | 17% | 2 | 2 | 6 | 10 | 4.40 | 2% | 2.0 |
| Moderating | Inflation > Target & Rising | Real Rates Rising | BEI | 2.4% | 1.3 | -2% | 15% | 4 | 4 | 7 | 12 | 6.20 | 6% | 3.0 |
| Moderating | Inflation < Target & Falling | Real Rates Rising | BGI | 2.2% | 1.4 | -4% | 50% | 6 | 3 | 16 | 1 | 6.40 | 2% | 3.0 |
| Falling | Inflation < Target & Rising | Real Rates Falling | CHJ | 1.3% | 0.6 | -3% | 50% | 7 | 7 | 13 | 1 | 7.00 | 3% | 4.0 |
| Moderating | Inflation < Target & Rising | Real Rates Rising | BHI | 2.3% | 0.7 | -5% | 50% | 5 | 6 | 19 | 1 | 7.20 | 1% | 2.0 |
| Falling | Inflation < Target & Rising | Real Rates Rising | CHI | 0.4% | 0.4 | -2% | 50% | 10 | 9 | 9 | 1 | 7.80 | 1% | 1.0 |
| Falling | Inflation > Target & Falling | Real Rates Falling | CFJ | 0.6% | 0.5 | 0% | 8% | 8 | 8 | 3 | 13 | 8.00 | 4% | 1.0 |
| Falling | Inflation < Target & Falling | Real Rates Falling | CGJ | 2.4% | 0.9 | -8% | 17% | 3 | 5 | 21 | 10 | 8.40 | 2% | 4.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Rising | AGI | 0.5% | 0.3 | -2% | 33% | 9 | 10 | 10 | 6 | 8.80 | 4% | 4.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Rising | AHI | 0.0% | 0.0 | -3% | 23% | 12 | 12 | 14 | 8 | 11.60 | 5% | 7.0 |
| Moderating | Inflation < Target & Falling | Real Rates Falling | BGJ | 0.2% | 0.2 | -4% | 22% | 11 | 11 | 18 | 9 | 12.00 | 4% | 3.0 |
| Moderating | Inflation > Target & Rising | Real Rates Falling | BEJ | -0.5% | -0.1 | -2% | 7% | 13 | 13 | 12 | 14 | 13.00 | 11% | 2.0 |
| Moderating | Inflation < Target & Rising | Real Rates Falling | BHJ | -0.6% | -0.8 | -1% | 0% | 14 | 19 | 4 | 15 | 13.20 | 1% | 1.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Falling | AEJ | -0.7% | -0.5 | -1% | 0% | 16 | 15 | 5 | 15 | 13.40 | 4% | 2.0 |
| Moderating | Inflation > Target & Falling | Real Rates Rising | BFI | -1.0% | -0.8 | 0% | 0% | 17 | 18 | 1 | 15 | 13.60 | 5% | 1.0 |
| Moderating | Inflation > Target & Falling | Real Rates Falling | BFJ | -1.2% | -0.7 | 0% | 0% | 19 | 16 | 1 | 15 | 14.00 | 5% | 1.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Falling | AGJ | -0.6% | -0.3 | -4% | 0% | 15 | 14 | 15 | 15 | 14.80 | 4% | 2.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Falling | AHJ | -2.0% | -1.0 | -5% | 33% | 20 | 21 | 20 | 6 | 17.40 | 4% | 5.0 |
| Stabilising | Inflation < Target & Rising | Real Rates Falling | DHJ | -1.0% | -0.9 | -4% | 0% | 18 | 20 | 17 | 15 | 17.60 | 1% | 2.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Rising | AEI | -3.6% | -2.3 | -2% | 0% | 22 | 22 | 11 | 15 | 18.40 | 6% | 2.0 |
| Stabilising | Inflation < Target & Falling | Real Rates Falling | DGJ | -2.2% | -0.8 | -9% | 0% | 21 | 17 | 22 | 15 | 19.20 | 2% | 3.0 |

## Figure 33: Commodity-carry return characteristics across the combined regimes[39]

| Growth Regime | Inflation Regime | Real Rate Regime | Combined Regime | Excess Return | Sharpe | Drawdown (3rd quartile) | Hit Ratio | Return Ranking 40% | Sharpe Ranking 20% | Drawdown (3rd quartile) Ranking 20% | Hit Ratio Ranking 20% | Weighted Ranking | Time Spent In Regime | Regime count |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Stabilising | Inflation < Target & Falling | Real Rates Rising | DGI | 4.6% | 2.7 | 0% | 100% | 5 | 5 | 1 | 1 | 3.40 | 0% | 1.0 |
| Moderating | Inflation > Target & Falling | Real Rates Falling | BFJ | 6.2% | 4.4 | 0% | 40% | 2 | 2 | 1 | 14 | 4.20 | 5% | 4.0 |
| Moderating | Inflation > Target & Falling | Real Rates Rising | BFI | 11.6% | 6.3 | 0% | 11% | 1 | 1 | 1 | 23 | 5.40 | 5% | 2.0 |
| Stabilising | Inflation < Target & Rising | Real Rates Falling | DHJ | 3.3% | 2.9 | -1% | 100% | 6 | 4 | 10 | 1 | 5.40 | 1% | 2.0 |
| Moderating | Inflation > Target & Rising | Real Rates Falling | BEJ | 4.7% | 1.8 | -1% | 47% | 4 | 8 | 8 | 13 | 7.40 | 11% | 7.0 |
| Falling | Inflation > Target & Falling | Real Rates Rising | CFI | 6.0% | 3.0 | -2% | 38% | 3 | 3 | 12 | 16 | 7.40 | 4% | 3.0 |
| Falling | Inflation < Target & Falling | Real Rates Falling | CGJ | 3.2% | 2.2 | -5% | 67% | 7 | 6 | 23 | 5 | 9.60 | 2% | 6.0 |
| Falling | Inflation < Target & Rising | Real Rates Rising | CHI | 2.4% | 2.0 | -2% | 50% | 9 | 7 | 15 | 9 | 9.80 | 1% | 2.0 |
| Falling | Inflation < Target & Rising | Real Rates Falling | CHJ | 1.6% | 1.0 | -2% | 67% | 12 | 10 | 13 | 5 | 10.40 | 3% | 6.0 |
| Falling | Inflation > Target & Rising | Real Rates Rising | CEI | 2.5% | 1.8 | -1% | 17% | 8 | 9 | 7 | 21 | 10.60 | 2% | 2.0 |
| Falling | Inflation > Target & Rising | Real Rates Falling | CEJ | 1.9% | 1.0 | 0% | 20% | 11 | 11 | 1 | 20 | 10.80 | 6% | 5.0 |
| Moderating | Inflation < Target & Rising | Real Rates Rising | BHI | 1.2% | 0.9 | -2% | 100% | 17 | 12 | 11 | 1 | 11.60 | 1% | 2.0 |
| Stabilising | Inflation < Target & Falling | Real Rates Falling | DGJ | 2.0% | 0.8 | -4% | 75% | 10 | 15 | 20 | 4 | 11.80 | 2% | 4.0 |
| Moderating | Inflation < Target & Falling | Real Rates Falling | BGJ | 1.5% | 0.9 | -4% | 56% | 13 | 13 | 19 | 7 | 13.00 | 4% | 8.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Rising | AEI | 1.2% | 0.7 | 0% | 36% | 15 | 16 | 4 | 17 | 13.40 | 6% | 4.0 |
| Accelerating | Inflation > Target & Rising | Real Rates Falling | AEJ | 1.2% | 0.8 | -1% | 13% | 16 | 14 | 6 | 22 | 14.80 | 4% | 2.0 |
| Accelerating | Inflation < Target & Rising | Real Rates Falling | AHJ | 1.3% | 0.6 | -5% | 50% | 14 | 17 | 21 | 9 | 15.00 | 4% | 6.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Rising | AGI | 0.7% | 0.5 | -2% | 56% | 19 | 18 | 14 | 7 | 15.40 | 4% | 6.0 |
| Accelerating | Inflation < Target & Falling | Real Rates Falling | AGJ | 0.8% | 0.3 | -3% | 50% | 18 | 19 | 16 | 9 | 16.00 | 4% | 4.0 |
| Moderating | Inflation > Target & Rising | Real Rates Rising | BEI | 0.1% | 0.0 | -1% | 38% | 21 | 21 | 9 | 15 | 17.40 | 6% | 8.0 |
| Falling | Inflation > Target & Falling | Real Rates Falling | CFJ | -0.7% | -0.3 | -1% | 25% | 22 | 22 | 5 | 19 | 18.00 | 4% | 5.0 |
| Moderating | Inflation < Target & Falling | Real Rates Rising | BGI | 0.4% | 0.2 | -5% | 50% | 20 | 20 | 22 | 9 | 18.20 | 2% | 5.0 |

[38, 39] Source: Insight, Bloomberg. Data between December 1976 and September 2025.

# CONCLUSION

Absent a crystal ball, we don't know exactly how the macroeconomic landscape will unfold in the years ahead. It seems fair to assume that inflation and interest rates will not return to pre-pandemic levels any time soon. That period was an abnormal one, and it followed the extended period of unconventional policy support in the wake of the global financial crisis. Trends in globalisation seem less disinflationary while geopolitical risks seem elevated on multiple fronts. Such forces may make it harder for policymakers to adjust monetary policy to fine-tune the global economy and this may translate into more fluctuations both in terms of growth and inflation which makes relying on a stable equity/bond correlation harder.

We believe there are several ways in which asset allocators will need to adapt to deal with this new investment landscape.

1. **Greater diversification.** This alone is unlikely to be enough to create good investment outcomes but having a range of building blocks at an investor's disposal could help when others are being challenged.
2. **A robust framework for asset allocation.** Investors will benefit from using a framework that helps them to understand the particular environments in which certain investments are likely to do well and poorly, and then using it with conviction to dynamically asset allocate in a manner consistent with that roadmap. The regime framework discussed in this note aims to be a cyclical framework to help guide asset-allocation decisions.
3. **Tools to build asymmetry into a portfolio's return profile.** Dynamic asset allocation, specifically actively moving to assets or investments that are likely to do well in the prevailing macro environment, and away from those where the current economic forces are a headwind, is a start. Adding a layer of asymmetry – essentially creating option-like pay-out profiles via more fluid risk or momentum-based indicators – can provide an extra element of systematic rigour to work alongside a fundamental regime-based approach.

# APPENDIX #1: COMMODITIES AS A DIVERSIFIER

Commodities are an asset class with unique characteristics which can make them an important building block in multi-asset portfolios. They have two specific attributes:

- Cyclicality: as the inputs to manufacturing, commodities have a natural link to the growth cycle. Energy, agriculture, and particularly industrial metals see increased demand as economies increase their output.
- Inflation protection: history shows that commodities can yield their best returns when inflation is high and rising. While this relationship isn't perfect, it is often when bonds and equities go down in unison and so they can act as a good inflation hedge.

## AN ASSET CLASS WITH UNIQUE ATTRIBUTES

Figure 1 illustrates this by showing the correlation of the broad commodity index with inflation and manufacturing activity. The chart also shows that they also exhibit low correlations to the other asset classes that form the building blocks of a multi-asset portfolio. Over the last 96 years the correlation between commodities and equity is only +0.2 while the correlation to government bonds is -0.2. Given this, commodities can be a useful diversifying building block in portfolios. At a static level, the addition of commodities to an equity/bond portfolio can improve real and excess returns, as well as overall risk-adjusted return and average drawdown potential.

Figure 1: Correlation of commodities to macroeconomic indices and asset returns, 1929 to 2024[1]

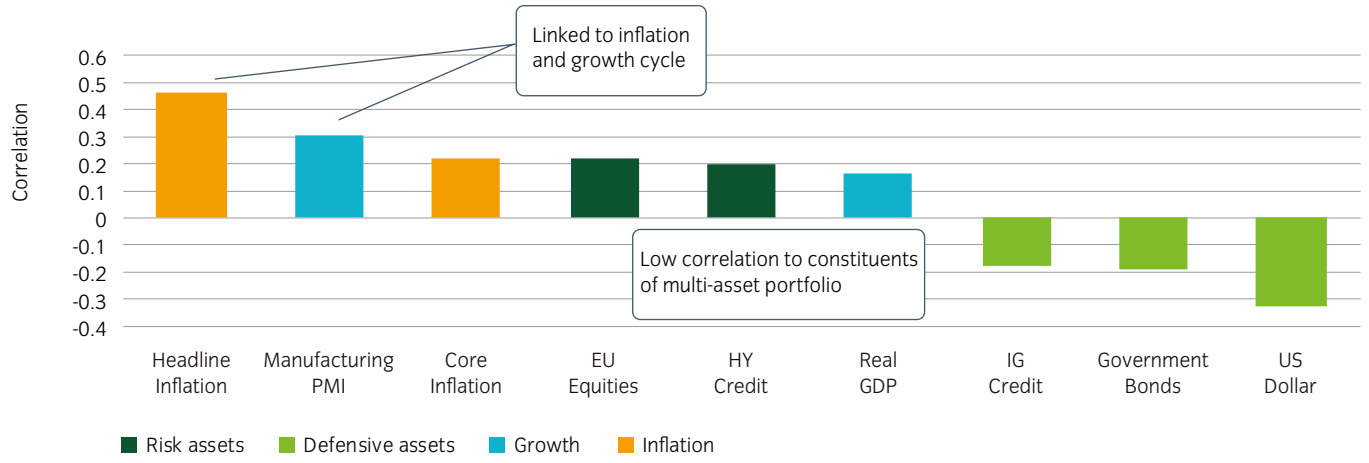



Figure 2 shows the historical risk and return characteristics of equities, bonds, and commodities against a static 60/40 portfolio and then a portfolio which includes commodities. As we can see, the addition of commodities to a 60/40 portfolio would have improved both the total and risk-adjusted return of a traditional 60/40 portfolio. However, Figure 2 also reminds us that commodities, like equity markets, can experience meaningful drawdowns. So, while static exposure to commodities could be additive to portfolios, potentially large drawdowns can wipe out years of positive gains. To us this argues that commodity exposure needs to be managed dynamically via strategies that aim to capture as much upside as possible while limiting downside in the event of a cycle downturn. The risk-adjusted return of such an approach could be significantly improved, in our view, mainly due to the halving in the average and maximum drawdown experience.

Figure 2: Return characteristics of static portfolios, 1929 to 2024[2]

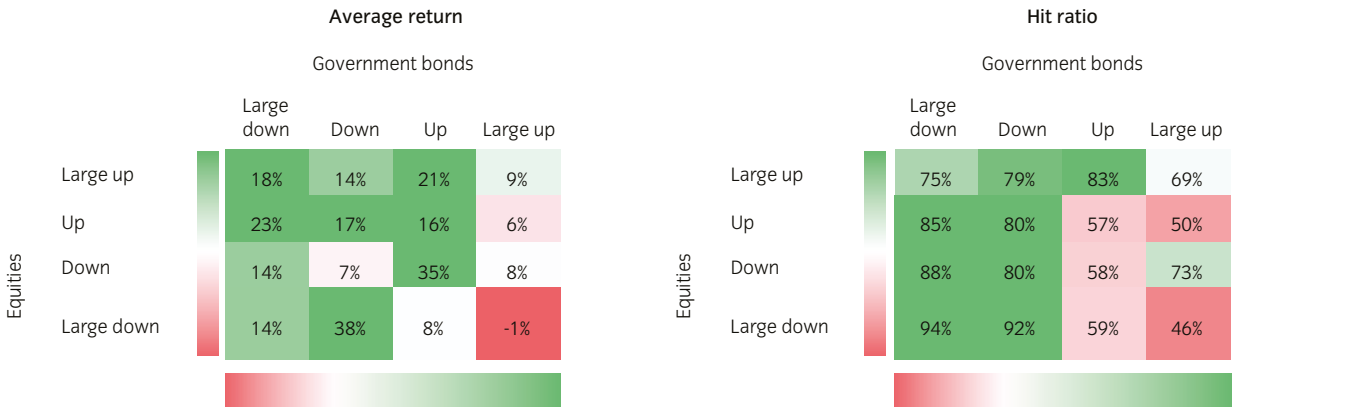
| | Equity | Bonds | Commodities | 60/40 | 80% 60/40 20% commodities |
|---|---|---|---|---|---|
| Total return | 9.4% | 4.9% | 8.7% | 8.1% | 8.5% |
| Real return | 6.0% | 1.7% | 5.3% | 4.7% | 5.1% |
| Excess ratio | 5.4% | 1.1% | 4.7% | 4.1% | 4.5% |
| **Sharpe ratio** | **0.29** | **0.18** | **0.28** | **0.35** | **0.42** |
| Avg drawdown | -15% | -2% | -17% | -6% | -6% |
| Max drawdown | -86% | -23% | -77% | -66% | -67% |
| % time spent >10% below high | 37% | 3% | 50% | 20% | 17% |

[1, 2] Source: Insight and Bloomberg as at 30 June 2024.

## A FRIEND WHEN YOU NEED ONE MOST

Importantly, commodities have historically provided a good source of positive returns when we need them most – which is when other mainstream assets (equities and bonds) are both selling off. We illustrate this in Figure 3 which shows annual US equity returns on the vertical axis compartmentalised into four sections (large up, up, down, large down) while the same is done for US Treasury returns on the horizonal axis. The corresponding commodities return is shown in the matrix. The cyclical nature of commodities can be seen in that they tend to perform well when equities are also doing well. However, in years where both equities and bonds are performing badly commodity returns really stand out. In simultaneous large down years, commodities have an average return of 14% with a positive hit rate (percentage of years where returns are positive) of 94%.

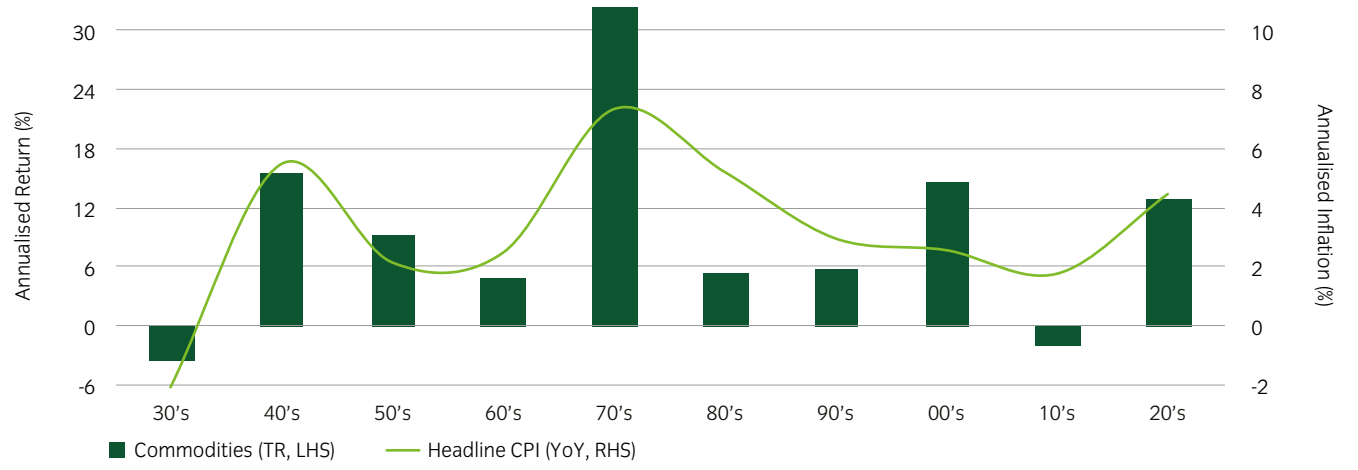
Figure 3: Commodity returns stratified by annual equity and bond returns, 1929 to 2024[3]




## A NATURAL INFLATION HEDGE

The 2020s have so far provided a stark reminder to investors of the significant impact inflation can have on economies, markets and the value of their portfolios. This decade has already seen an average annualised inflation rate of 5% in the US, versus 1.7% in the 2010s and 2.5% in the 2000s[4]. We know that high inflation is a challenge to both bond and equity markets, but high-inflation environments have historically been associated with positive commodity returns. Indeed, the largest returns from commodities coincide with periods of high inflation (see Figure 4). This is of course logical in that some of the underlying components such as energy and agriculture are direct inputs into goods and services costs and hence feed through into inflation.

Figure 4: Commodities versus inflation by decade[5]

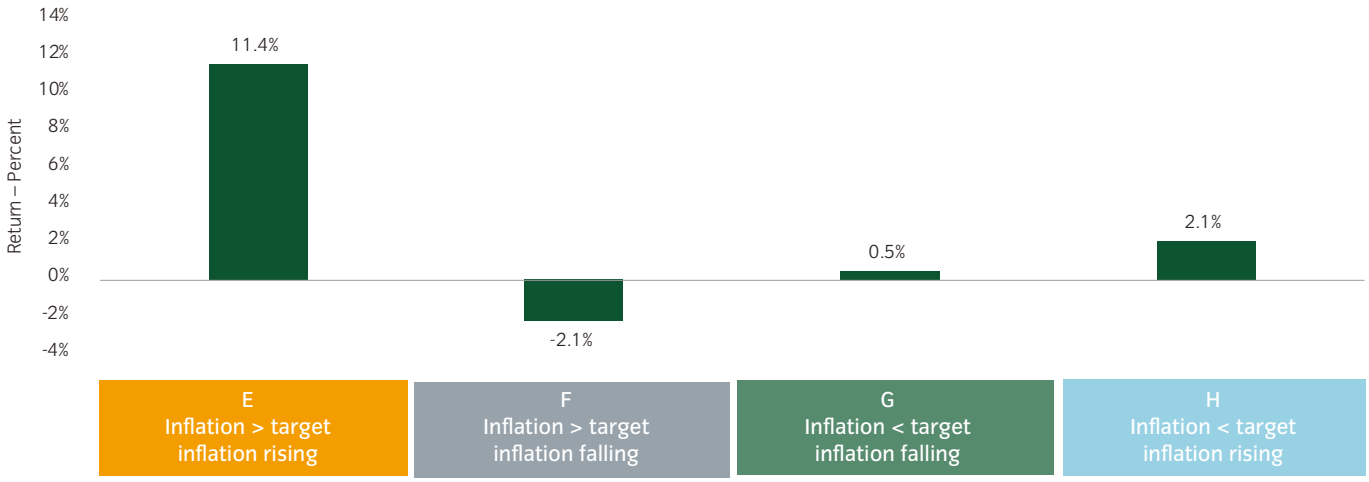



[3] Source: Insight and Bloomberg as at 30 June 2024.
[4] Source: Bloomberg - US CPI to end May 2024.
[5] Source: Insight and Bloomberg as at 30 June 2024.

## REGIMES IN FOCUS

This longer-term perspective is useful, but how do commodities fit into our regime framework? Both from a growth and inflation perspective commodities have behaved as you might expect. In Figure 5, we see positive returns when inflation has been rising (either below or above target) but the largest returns have come when inflation has been both above target and rising (such as in 2021-2022).

Figure 5: Mean commodity return by Insight inflation regime, 1972 to 2024[6]



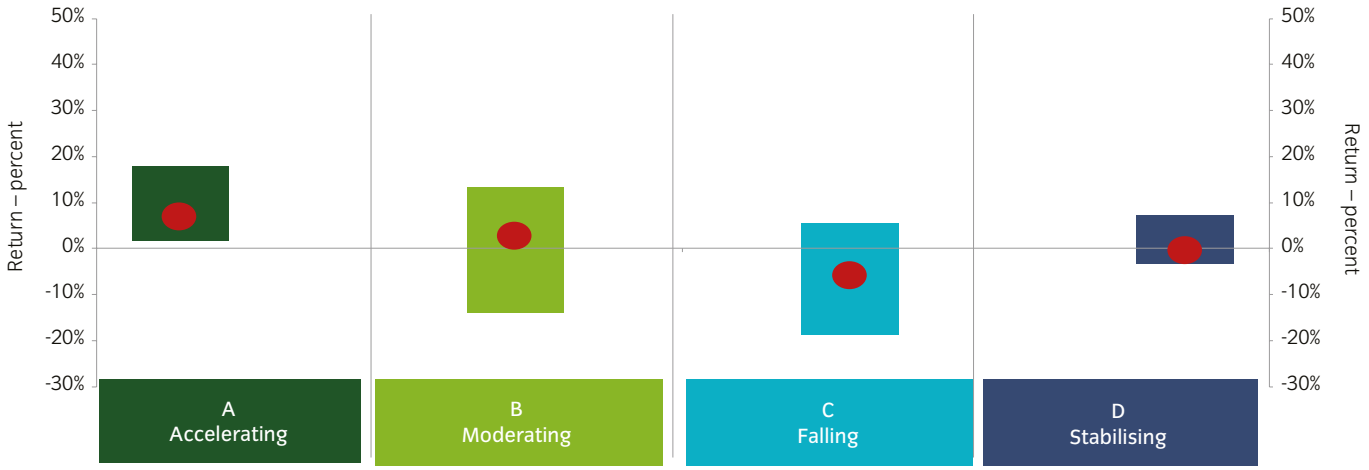

Similarly, commodities exhibit a strong relationship to the growth cycle. As growth increases, demand in the economy for energy, agriculture, and particularly industrial metals, increases. Conversely, commodity returns are particularly sensitive to recessions (see Figure 6), which typically occur as the cycle moves from moderating to falling.

Figure 6: Commodity return by recession, 1929 to 2024[7]

| | Non-recession | Recession |
|---|---|---|
| Average annualised return | 13% | -3% |

Indeed, what we find when we look through the lens of our regime framework (Figure 7) is that the most consistent returns occur in the Accelerating phase, while the outsized returns in the Moderating regimes have been usually associated with late-cycle high inflation.

Figure 7: Commodity return by Insight growth regime, 1972 to 2024[8]

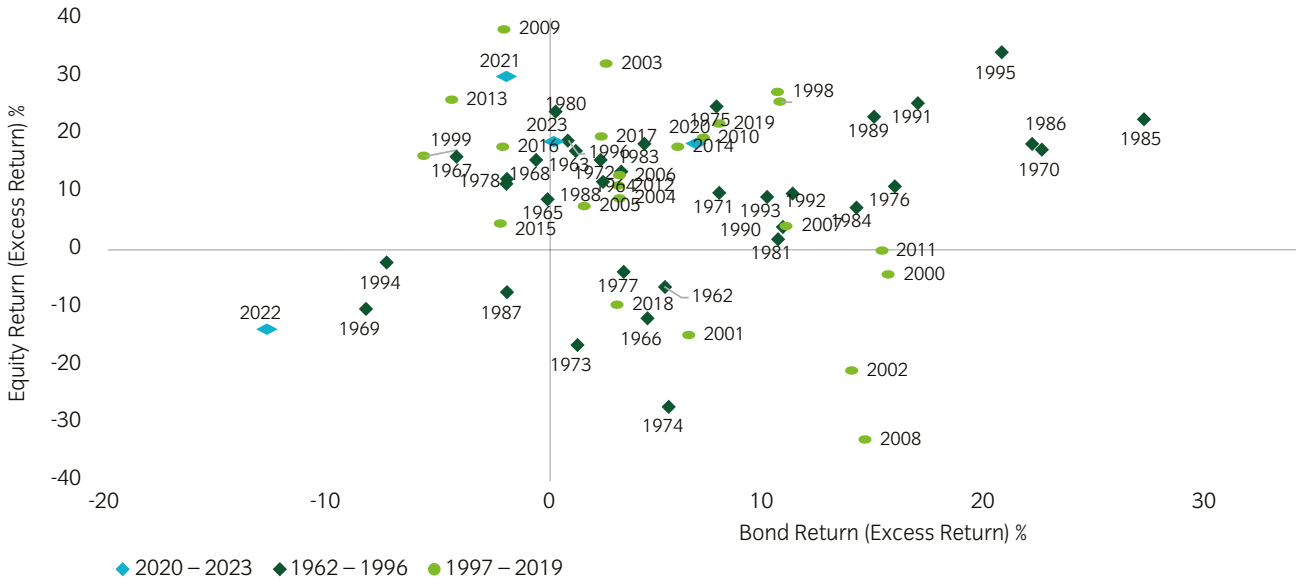



[6] Source: Insight, Bloomberg. Data between December 1976 and June 2024.
[7] Source: Insight, Bloomberg. Data between 1929 and June 2024.
[8] Source: Insight, Bloomberg. Data between December 1976 and June 2024.

# APPENDIX #2: EQUITY/BOND DIVERSIFICATION

Generally, having some mixture of equities and fixed income makes sense in a growth portfolio but the diversification benefits of doing so are not always as clear as generally assumed. 2022 brought this into sharp focus (as both asset classes performed particularly poorly at the same time), but as Figure 1 shows, equities and bond returns moving in the same direction happens more often than not. The chart shows calendar-year returns split into four quadrants, highlighting when both equity and bond returns have either positive or negative. Over the 62 years covered, equities and bonds posted returns in the opposite direction (equities up/bonds down or equities down/bonds up) only 35% of the time. Of course, holding any two assets, providing they don't have a correlation of one, is diversifying to a point but often there is an assumption that bonds will bail an investor out in periods where equities decline.

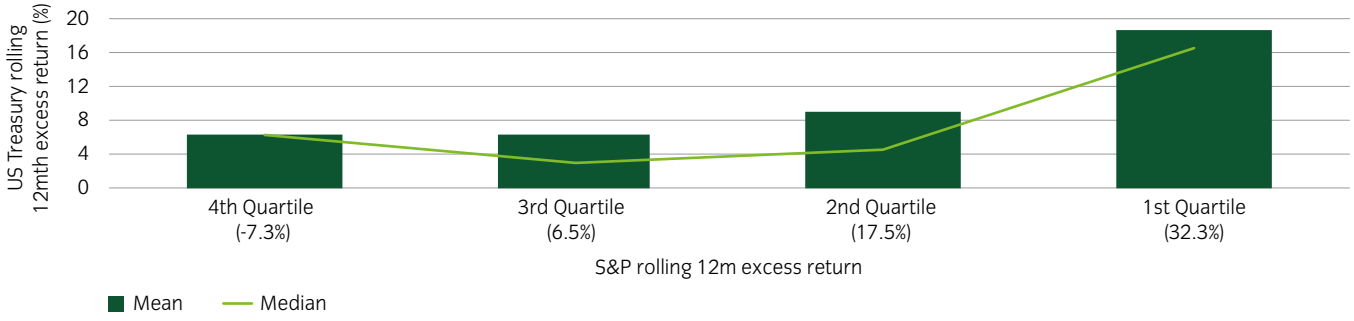
Figure 1: Equity and bond return matrix 1962 to 2023[1]




The best period for both equities and bonds came in the 1980s at the beginning of what has been termed the 'great moderation'. From this period – arguably up until the global financial crisis in 2007 – we saw reduced business-cycle volatility attributed in large part to the success of central banks in taming inflation. This gave policymakers the flexibility to respond to growth shocks with stimulative policy to micro-manage or extend the business cycle. Stocks benefited both from long periods of growth (earnings) and from a falling discount rate as interest rates declined, creating a boom period for equity and bond investors alike.

Figure 2 shows bond returns split by quartile and set against the corresponding quartile of equity market returns during the 1980s. Average annualised returns over the decade were in double digits for each asset class (17% for the S&P 500 Index and 12% for the Bloomberg US Treasury Index) but what the chart highlights is that the best bond returns were in the environments where equity returns were also delivering their best (first quartile) returns. These were good times to be investing.

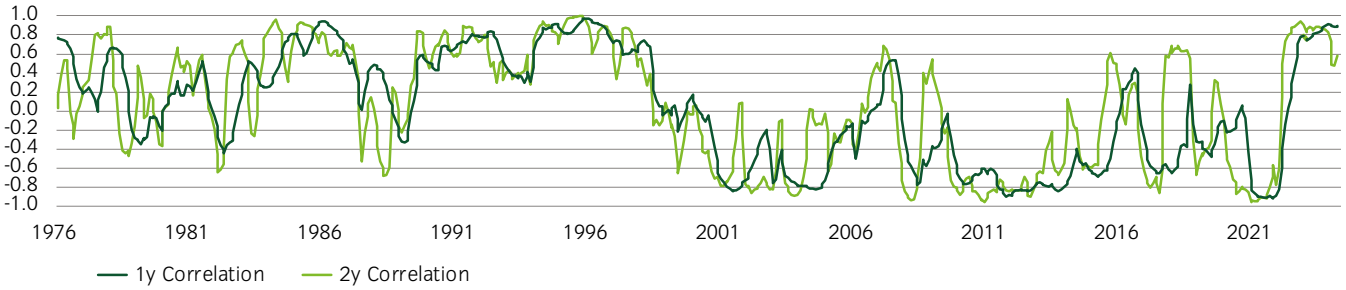
Figure 2: Equity and bond returns spilt by quartile – 1980s[2]




[1] Source: Insight and Bloomberg as at 30 June 2024. Equities: S&P 500 Index. Bonds: Bloomberg US Treasury Index. Calendar-year returns.
[2] Source: Insight and Bloomberg as at 30 June 2024. S&P 500 Index and Bloomberg US Treasury Index.

From a shorter-term perspective, the way in which equities and bonds interact is also critical from an asset-allocation perspective. The correlation between the two is key in assessing the diversification benefits bonds have when paired with risker, higher return, investments. Figure 3 illustrates how this correlation has changed since 1975.

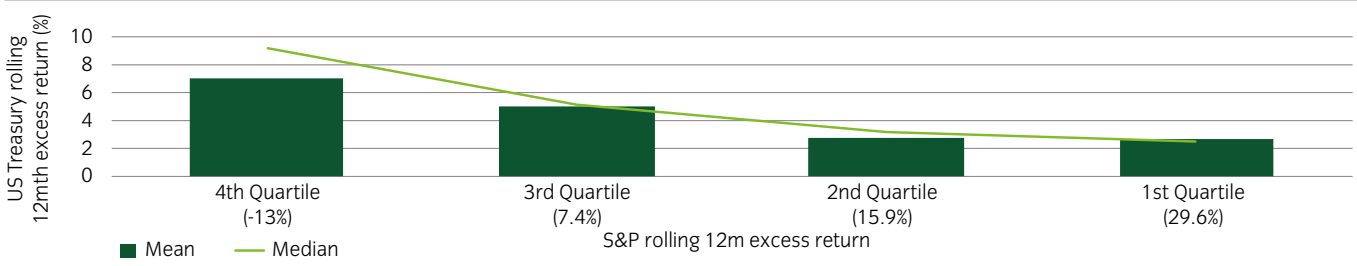
Figure 3: The equity/bond correlation flipped in 1996[3]




Since the late 1990s a negative correlation between equities and bonds has largely held following a period of positive correlation in the 1970s and 1980s (as mentioned earlier, both assets enjoyed positive returns in the 1980s). The reasons are well documented. In a low-inflation world, negative growth shocks put downward pressure on equities, due to lower earnings expectations. If these moves were sufficient in size, they would spur expectations of monetary easing to offset the impending hit to growth. This interaction meant that when equities went down bonds served the role of a hedge within a growth-orientated investment portfolio.

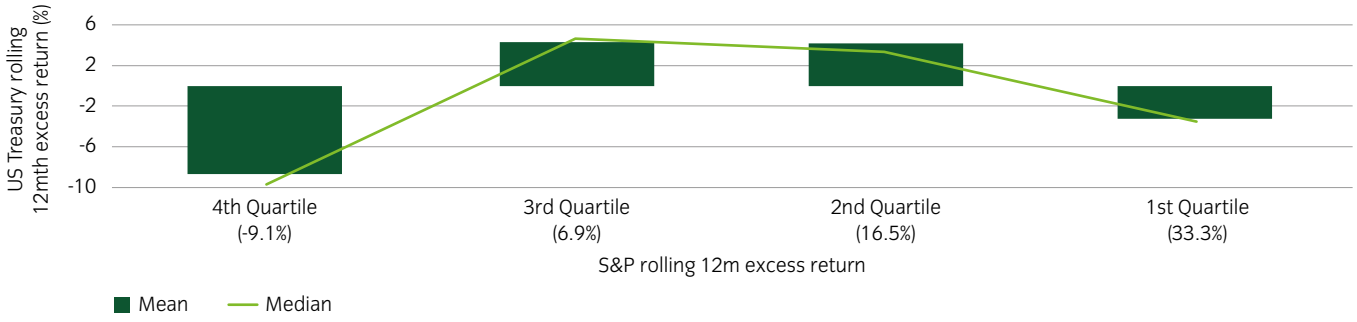
Figure 4 looks at the returns from government bonds broken down by the corresponding performance of the equity market in the periods when the equity/bond correlation was clearly negative (1997 to 2023); over the period, both assets did well (annualised returns of +10% and +2% excess for stocks and bonds respectively). But as the chart shows, by far the best returns for bonds were when they were needed most – when equities were performing worst.

Figure 4: Equity and bond return quartiles (1996 to 2023)[4]




More recently, since around the second half of 2021, this relationship has broken down. High and volatile inflation has dictated the path of monetary policy so, irrespective of the growth environment, bonds have struggled. This has been an environment where expectations for monetary tightening have trended upwards and where high inflation has depressed the value of outstanding debt in nominal terms. Of course, for equity markets, the rising cost of capital and impending impact on growth and earnings has been a negative for returns. Given this, Figure 5 is not a surprise; it shows the extent to which the worst bond and equity returns occurred at the same time. Indeed, these forces combined to make 2022 the worst on record for a balanced equity/bond portfolio. Whilst it was an extreme case, we have already illustrated that for many periods in decades before the late 1990s, the relationship between equities and bonds was also far less helpful from a diversification standpoint.

Figure 5: Equity and bond return quartiles (2020-2023)[5]




[3, 4, 5] Source: Insight and Bloomberg as at 30 June 2024. Equities: S&P 500 Index. Bonds: Bloomberg US Treasury Index.

# APPENDIX #3: THE IMPORTANCE OF RECESSIONS TO EQUITY BEAR MARKETS

Our analysis on the interaction of economic data with asset-class behaviour across history shows us that periods of strong or weak growth are significantly influential for equity markets. This is unsurprising; the intrinsic relationship between economic growth, corporate profitability and share prices is clear. However, it is worth noting just how pronounced these linkages are, particularly in more extreme periods of economic contraction where equity downside risks are dominant. To demonstrate this, we can analyse the various bear markets[1] that have occurred for the S&P 500 Index over the past 100 years. We have split these into three categories: normal bear markets (declines of -20% to -30%), large bear markets (declines of -30% to -50%) and mega bear markets (declines of more than -50%). Once defined, we can then look at the growth indicators across those periods (see Figure 1).

Figure 1: Historical US economic environment during S&P 500 Index bear markets[2]

| | Bear market characteristics | | | Growth environment | | |
|---|---|---|---|---|---|---|
| Dates | Drawdown | Length (months) | Realised vol. (high 22d) | Earnings decline (nominal) | Real GDP decline (peak to trough) | ISM manufacturing fall (points) |
| **Normal Bear Markets** | | | | | | |
| Jun 46 to Apr 48 | -28% | 22 | 43 | -29% | -13.0% | |
| Aug 56 to Oct 57 | -22% | 15 | 24 | -22% | -3.7% | -12.4 |
| Dec 61 to Jun 62 | -27% | 6 | 37 | -12% | -1.6% | -12.0 |
| Feb 66 to Oct 66 | -22% | 9 | 20 | -5% | 0% | -8.0 |
| Nov 80 to Aug 82 | -27% | 21 | 20 | -5% | -2.6% | -22.7 |
| Jul 90 to Oct 90 | -20% | 4 | 25 | -37% | 0% | -2.1 |
| **Average** | **-24%** | **13** | **28** | **-18%** | **-3.5%** | **-11.4** |
| **Big Bear Markets** | | | | | | |
| Jan 73 to Oct 74 | -48% | 22 | 35 | -15% | -3.2% | -25.9 |
| Nov 68 to May 70 | -36% | 19 | 32 | -13% | -0.6% | -13.1 |
| Aug 87 to Dec 87 | -34% | 5 | 92 | -13% | 0% | -1.9 |
| Mar 00 to Oct 02 | -49% | 31 | 46 | -54% | -0.4% | -14.1 |
| Feb 20 to Mar 20 | -32% | 1 | 86 | -33% | -19.2% | -9.6 |
| **Average** | **-40%** | **16** | **58** | **-26%** | **-4.7%** | **-12.9** |
| **Mega Bear Markets** | | | | | | |
| Sep 29 to Jun 32 | -86% | 33 | 101 | -75% | -27.0% | |
| Mar 37 to Apr 42 | -60% | 62 | 56 | -49% | -18.0% | |
| Oct 07 to Mar 09 | -57% | 18 | 88 | -92% | -5.1% | -18.3 |
| **Average** | **-68%** | **38** | **82** | **-72%** | **-16.7%** | **-18.3** |
| **2022 Bear Market** | **-25%** | **9** | **34** | **-2.5%** | **0%** | **-15.0** |

**Key observation:** A key observation is that each and every bear market has been historically associated with a growth decline, most notably in earnings and the ISM manufacturing, with the size of the bear market tending to reflect the severity of the growth decline.

**Implication:** As an asset allocator, a timely understanding of when the growth backdrop is deteriorating should always be a key component of an investment framework.

It is notable how unique the pandemic-driven bear market was in terms of the rapidity of the market drawdown and scale of recession. Each period in history has its own unique facets, but the link between big drawdowns in stock markets and growth holds, even if the causality can work both ways.

It is also interesting to note that the bear market seen in 2022 has not yet coincided with a material corporate earnings decline. This is in striking contrast to the 16 point fall in the ISM Manufacturing Index and a historic precedent. This highlights the unique nature of the post-pandemic growth environment. The strength of consumer balance sheets combined with a surge in re-opening demand, has allowed companies to raise prices without materially hurting volumes, helping maintain corporate profitability despite a huge tightening in financial conditions and sharp manufacturing decline.

[1] A bear market is defined as a peak-to-trough decline of more than 20%.
[2] Source: Insight, Bloomberg. Data between December 1976 and June 2024.

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