

PORTFOLIO PERSPECTIVES

Practical applications for asset allocators // Q4 2025

Portfolio Perspectives

*Practical applications
for asset allocators*

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Source: ¹Bloomberg.GDP growth estimates based on Atlanta Fed GDPNow forecasts as of 30 September 2025. ²Bloomberg. Daily data from 31 December 2024 to 30 September 2025. US dollar represented by the DXY Index. ³SIMFA Research, as of 30 September 2025.

SUMMARY

In this quarter's edition of Portfolio Perspectives, we cover key topics facing asset allocators today:

- Lifting the Hood on US Equities
- Opportunity in European Equities
- The Appeal of Total Yield
- A Strategic Case for Diversified Fixed Income

So far this year, tariffs, the OBBBA, a Fed rate-cutting cycle and a US government shutdown have left many investors' heads spinning. But except for April's volatility spike, risk markets have taken all of it in stride, with global equities on track so far for their third year of **double-digit gains**, and credit spreads are bouncing around multi-decade **lows**. Despite concerns over the impact of tariffs on growth, the US economy surprisingly accelerated through the summer, with current growth estimates at more than 3%.¹ In addition to a walk back of initial tariff levels and delayed negotiations, companies have likely been able to absorb higher costs via **value chains** in response to the increased tariffs. While some industries, such as auto manufacturing and construction, have been harder hit by tariffs, others managed by sharing increased costs across exporters, importers, suppliers and retailers. So far, aggregate consumer prices and corporate **profit margins** have not been meaningfully impacted by the tariffs. While it is certainly possible that the weight of tariffs will be felt in future months as the impact of inventory front running and final trade deal negotiations play out, we are now six months past Liberation Day and the likelihood of any significant disruption fades as time ticks on.

The **US Federal Reserve** has been under constant pressure from the Trump administration from day one to lower the policy rate, even if it means changing the composition of FOMC members. Although the effort to oust Fed member Lisa Cook has been unsuccessful so far, the administration was able to appoint administration insider **Stephen Miran** to the Fed Board of Governors,

filling the chair vacated by Adriana Kugler earlier this year. The Fed is facing mixed signals, with inflation running hot at around 3% while the labor market is showing early signs of weakness. While the focus was on reducing inflation since 2021, it now appears to be shifting towards supporting the labor market from further deterioration.

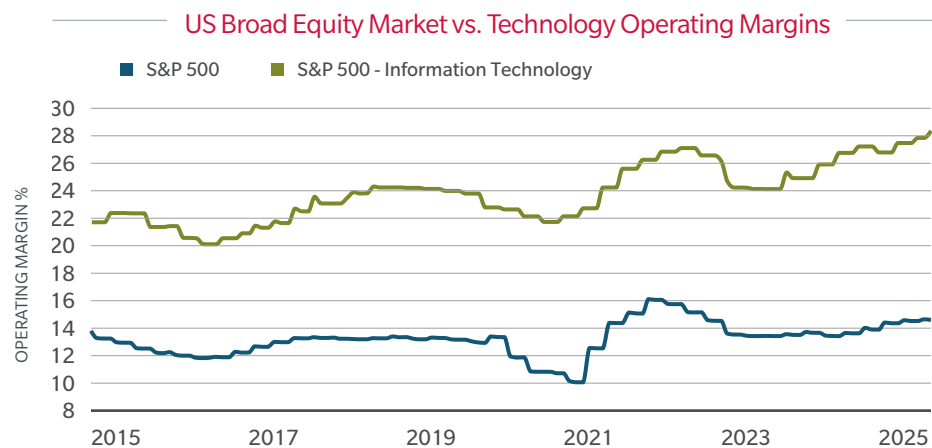
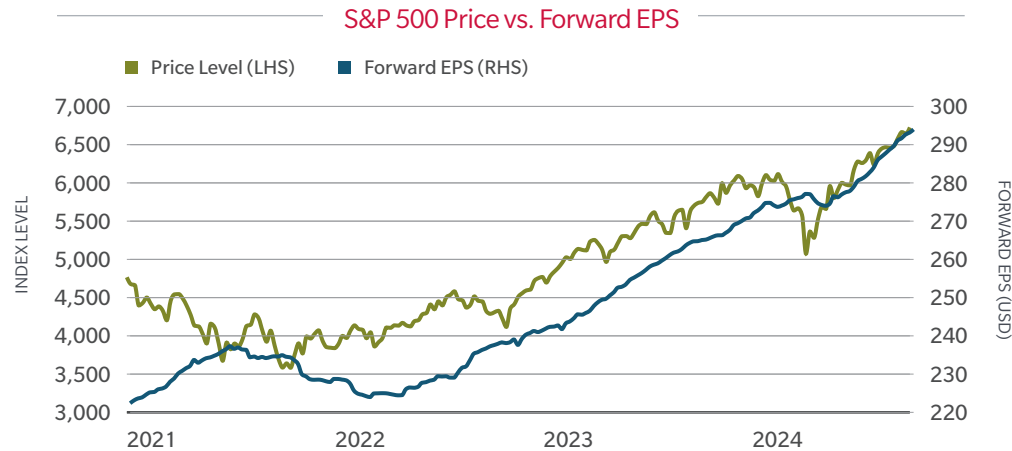
Turning to the markets, global ex US equities have led US equities to date with strong performance across **European** equities and a sharp rally in **Chinese** equities bolstering emerging markets. A weaker **US dollar**, around 10% lower than at the start of the year, has served as a tailwind for international equities for dollar-denominated investors.² Strong US large cap performance resumed after the April rout, with several Magnificent Seven names reaching new highs, although dispersion has widened as the year has progressed.

Credit markets have remained incredibly resilient, with over \$1.7 trillion of issuance through September, up 5.9% year over year.³ **Investment grade** bonds in particular have been in high demand. A few of the highest quality issuers have traded at negative spreads to Treasuries, suggesting, at least theoretically, that they are less likely to default than the US government. However, there have been two recent high profile bankruptcies that have captured headlines, but these appear to be more idiosyncratic rather than systemic issues.

While it's unclear if the current **"everything rally"** can continue, solid economic and corporate earnings growth along with global central banks largely in rate cutting mode signal the likelihood of a strong close to the year. However, geopolitical conflict, potential tariff-related cost passthroughs to businesses and consumers, and unforeseen credit deterioration remain key risks that should motivate investors to remain disciplined and diversified. ▲

Lifting the Hood on US Equities

High profits and margins accompany high valuations



While we would agree that traditional measures of valuation indicate that S&P 500 is expensive compared to long-term historical measures, just looking at aggregated valuations leaves out critical information as to what is going on under the hood. Understanding these nuances is critical when sizing US equity allocations in asset allocation portfolios.

Operating Margins And Technology

One of the key concerns for investors over the past several years has been the meteoric climb in US equity markets, which has been largely driven by a relatively narrow set of technology-oriented stocks. These large-cap companies, known as the Magnificent Seven (“Mag 7”), have benefitted from several secular technological trends, such as the rise of mobile devices, cloud migration, and the explosion of artificial intelligence, to name a few.

The scale of these businesses and their “winner takes all (or most)” dynamics, combined with the sheer acceleration of innovation within technology, has resulted in explosive growth in operating margins, allowing for more of each dollar of revenue to fall to the bottom line. Technology sector operating margins over the past decade have far outpaced those of the overall market, with margins nearing 30%, almost double the broader S&P 500 operating margin of 15%.¹ A decade ago, the operating margin for information technology was 21% compared to S&P 500’s 13% (Exhibit 2).

Interest Expense

Another key dynamic leading to the growth in corporate profits has been the decline in net interest expense, as companies refinanced when interest rates were at rock bottom.² From June 2020 through December 2021, US investment-grade bonds yielded less than 2.5%, giving companies 18 months to lock in lower interest rates on their debt in order to expand their businesses, issue dividends, or buy back stock. With yields around 4.8% today, companies would have to refinance or raise new debt at higher, although still historically reasonable, levels.³

Pricing Power

In the early 2020’s, several factors sparked the worst bout of inflation the US has experienced since the early 1980s. These included a combination of significant fiscal and monetary stimulus, shifts in buying habits across goods and services, and frozen supply chains. Companies have been able to push prices higher as consumers adjusted to the increases and higher prices became normalized in the consumer psyche. Inflation has remained above the Fed’s 2% target for over four years and, given the Fed’s increasing focus on employment, it does not appear to be heading down in any material fashion.

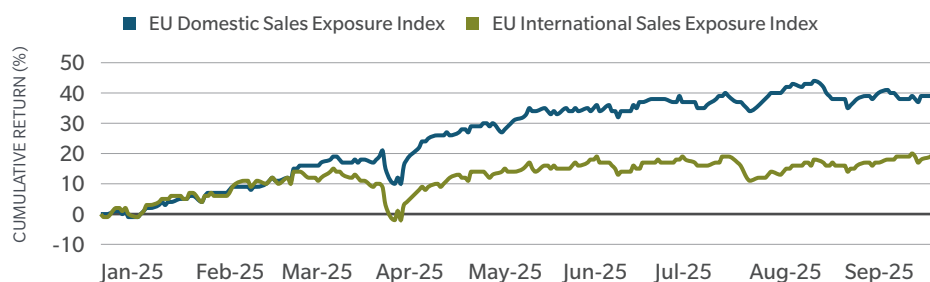
While the above might explain why investors are paying up for US equities, it does not address the sustainability of these factors. We believe that determining the ability to maintain strong growth, defend margins and maintain pricing power is best done at the company level as the operating environment changes, which it inevitably will. ▲

Source: Top LHS – Bloomberg. Weekly data from 31 December 2021 to 3 October 2025. Forward Earnings per Share (EPS) is next-twelve-months. Bottom LHS – Bloomberg. Monthly data from 30 January 2015 to 30 September 2025. Operating margins are last twelve months. ¹ Please note that several Mag 7 names have different sector classifications. ² Ricardo Marto, “[What’s Driving the Surge in U.S. Corporate Profits?](#)” St. Louis Fed On the Economy, April 21, 2025. ³ Bloomberg. US investment-grade bonds = Bloomberg US Aggregate Corporate Index. 4.8% yield is as of 30 September 2025.

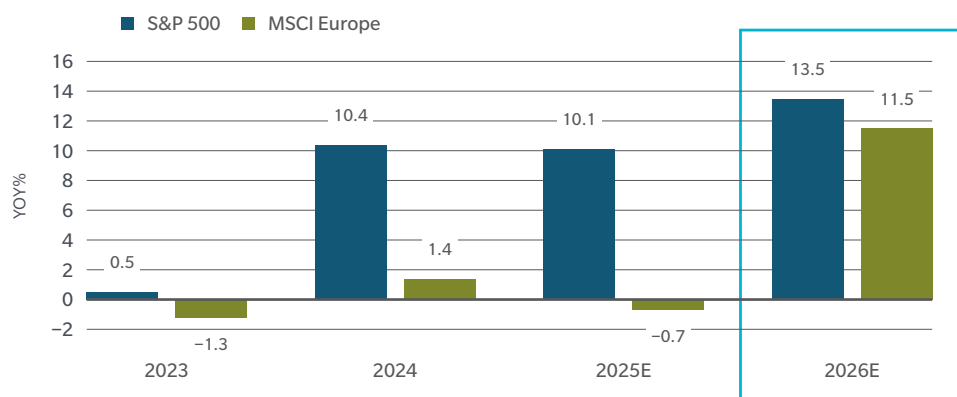
Opportunity in European Equities

Fiscal spending, attractive valuations and an improving earnings outlook

European Companies Performance Based on Sales Exposure



Earnings Growth



Source: Top LHS - Bloomberg. Daily data from 31 December 2024 to 30 September 2025. EU Domestic Sales Exposure Index = Goldman Sachs EU Domestic Sales Exposure Index. EU International Sales Exposure Index = Goldman Sachs EU International Sales Exposure Index. Returns are in USD. Bottom LHS - FactSet. Earnings estimates are as of 30 September 2025. Annual earnings data uses the year over year change in actual and estimated calendar year earnings results. Earnings are in USD for S&P 500 and EUR for MSCI Europe.

¹FactSet. Year-to-date returns calculated using daily data from 1 January 2025 to 30 September 2025. Returns are gross for S&P 500 (US equities) and net for MSCI Europe (European equities) and are in USD. ²European companies' revenue exposure to US sourced from FactSet as of 30 September 2025. European companies based on constituents in the MSCI Europe index. ³FactSet, as of 30 September 2025. Valuation discount = MSCI Europe (European stocks) Forward P/E divided by S&P 500 (US stocks) minus 1. Forward P/E is next-twelve-months. ⁴FactSet. Year-to-date returns for MSCI Europe - Banks (European banks) calculated using daily data from 1 January 2025 to 30 September 2025. Returns are net and in USD.

After a decade of lagging performance, European equities have surged in 2025, posting a more than 27% year-to-date return — well ahead of the near 15% gain in US equities.¹ This outperformance comes as global investors face concerns that US tariffs may hurt earnings, keep inflation high, and expand the budget deficit. In contrast, Europe's improving growth prospects, solid earnings potential, and relatively appealing valuations make it increasingly favorable relative to US equities.

Drivers Of Growth

Europe's promising growth potential is underpinned by several factors, which in turn are expected to boost corporate profits and business sentiment. Germany is leading the fiscal expansion, with a €500 billion fund for defense and infrastructure, while the EU aims to allocate over €800 billion to strengthen its defense readiness in the coming years. These fiscal initiatives stand to benefit European industrials, which make up the second largest sector in the MSCI Europe index. Additionally, the European Central Bank has cut rates by 200 basis points since June 2024 and paused further cuts as inflation has reached its 2% target. Lower rates are anticipated to support consumer spending and confidence, especially given Europe's sensitivity to floating interest rates and cheaper borrowing costs.

Revenue Exposure To Tariffs

A new US-Europe trade deal places a 15% tariff on most European exports, including autos. However, since only about a quarter of European companies' revenues come from the US, Europe appears to be somewhat insulated from higher tariff-related costs.² Notably, European stocks with primarily domestic revenues have led performance and are likely to continue to do so amid ongoing disruptions to trade flows.

Earnings And Valuations Outlook

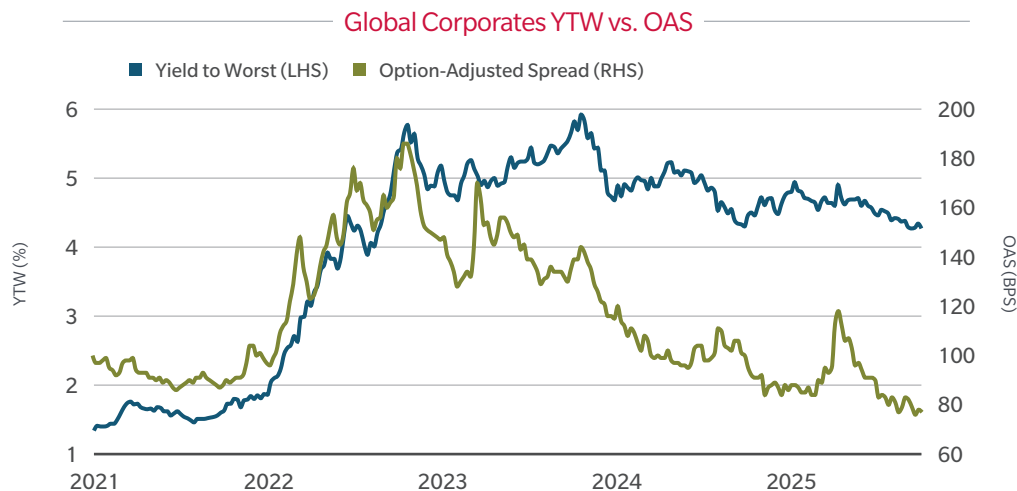
European equities are expected to significantly narrow the earnings growth gap with US equities by 2026, supported by lower interest rates and fiscal spending. Additionally, the EU aims to establish a savings and investment union to retain capital within Europe and has proposed tax incentives to encourage more ambitious investment strategies by European savers, which would further stimulate corporate profits. From a valuation standpoint, European stocks are trading at a steep discount of 35% relative to US stocks; as earnings converge, this valuation gap may narrow.³ As such, current valuations present a compelling entry point for investors.

Sector Spotlight

Financials, the largest sector in the MSCI Europe index, have been a standout for European equities. In particular, European banks have soared this year, achieving a more than 72% return year to date, thanks to stronger fee and trading income, as well as reduced costs.⁴ Despite rate cuts, bank profitability remains strong, with robust capital buffers supporting higher buybacks and dividends. Their domestic focus also makes them less vulnerable to tariffs, and with a stable economic outlook and improving loan growth, European banks are well positioned for continued upside and will likely be supportive of the broader market. ▲

The Appeal of Total Yield

Investment grade spreads are tight, but fundamentals and technicals remain strong



A hallmark of the current credit cycle has been the steady tightening of credit spreads, except for a few brief periods of widening. Pockets of the global credit markets are sporting spreads not seen in decades, with the Global Investment Grade index trading inside 80 basis points as of the end of September. Investors are rightfully asking: are markets underpricing credit risk? While we believe individual security selection in credit markets is a critical aspect to portfolio construction, at the asset class level there are several supporting arguments as to why global credit makes sense for many investor portfolios, despite very tight credit spreads.

Solid Fundamental And Technical Backdrop

Although there has been some modest softening of corporate fundamentals, corporate balance sheets are still in overall good shape, with deleveraging in Europe proving to be a positive dynamic for global credit. In the US, the passage of the OBBBA extends favorable treatment of corporate interest expenses and provides additional provisions for full expensing and bonus depreciation, both of which should be supportive of corporate health and could serve as tailwinds to further capital spending. From a technical standpoint, investor demand has been incredibly strong, far outstripping supply. An aging retail investor base, combined with derisking of corporate pension plans, has helped keep demand high.

High Total Yield

While credit spreads may be near multi-decade lows, total (all in) yield is not. While spreads are a useful metric for determining relative value and risk within credit markets, total yield is what pays out to investors and is therefore the most correlated to total return over longer time periods. For the 11 years following the global financial crisis, yields were significantly below current rates, with multiple periods when they were less than half current levels. While the sharp reset in yields in 2022 was painful for many fixed income investors, yields appear to have settled into a higher range for now, offering investors an attractive risk/return profile.

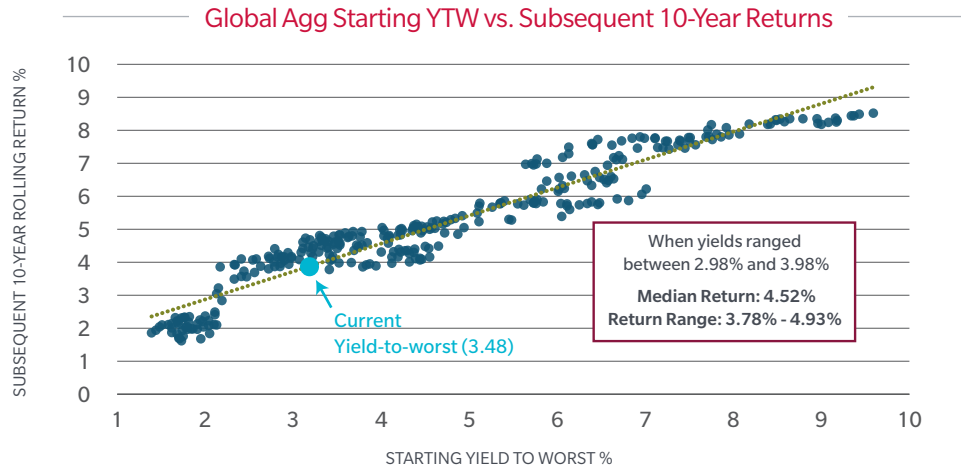
A Strategic Position Within Asset Allocations

There are multiple benefits to corporate credit as a core holding within an overall asset allocation and investors who are not currently exposed to the asset class should consider it, particularly as an effective way to derisk portfolios. Global investment grade offers duration, corporate credit exposure, and regional diversification across a wide opportunity set. ▲

Source: Top LHS – Bloomberg. Weekly data from 31 December 2010 to 3 October 2025. Bottom LHS – Bloomberg. Weekly data from 1 January 2021 to 3 October 2025. OAS = option-adjusted spreads.

A Strategic Case for Fixed Income Diversification

Current yields present an opportune time to diversify



In the years leading up to 2022, persistently low inflation and interest rates resulted in subdued yields across global fixed income markets. Historically, starting yields have shown a strong relationship with future returns, and periods of low initial yields have typically led to weaker 10-year global bond performance. Since late 2021, however, yields across fixed income sectors have nearly doubled, driven by surging inflation, aggressive central bank rate hikes, heightened budgets, and geopolitical risks. With global bonds currently yielding 3.5%, fixed income markets offer greater carry, suggesting the potential for solid bond returns over the next decade.

Central Bank Accommodation

Most global central banks have shifted toward more accommodative monetary policies. While some major banks like the ECB have paused rate cuts after achieving their inflation targets and seeing a more stable economic outlook, the Fed has resumed rate cuts in response to a cooling labor market, despite inflation remaining above its 2% target; further rate cuts are slated to continue through the end of 2025 and into 2026. While short term interest rates globally are expected to normalize, we do not anticipate a return to a near-zero-percent interest rate environment. In a higher-for-longer rate environment, global bonds are likely to remain a reliable source of income for investors as current yields continue to provide meaningful cushion.

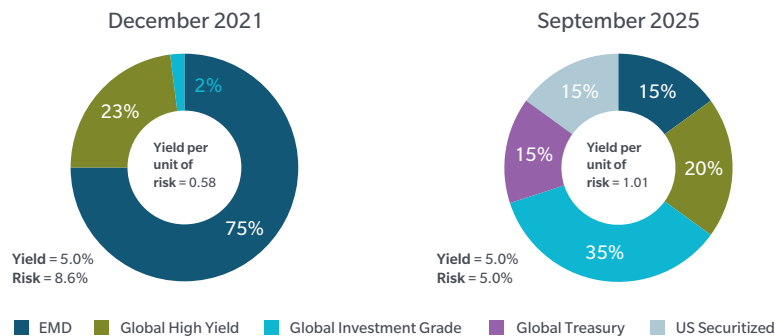
Yield And Diversification

Today, a diversified fixed income portfolio offers investors a 5% yield. Four years ago, yields were suppressed across most fixed income sectors and emerging market debt (EMD) was one of the few segments offering yields above 5%. Attaining a 5% yield at that time required allocating 75% of a portfolio to EMD, which would result in taking on higher volatility. Today, with robust yields available across the fixed income spectrum, investors can reach a 5% return with significantly lower risk by adopting a more diversified portfolio approach across multiple sources of credit and duration risk.

Go Global

Furthermore, we continue to see merit in adopting a global perspective for fixed income investing. Rising concerns over US deficits and debt sustainability have prompted investors to reassess long-term risks, while tariffs and shifting global trade flows have heightened US inflationary concerns. These dynamics may contribute to further weakening of the US dollar and ongoing volatility in US Treasuries, leading foreign investors to diversify into other international bonds, such as German bunds. Despite these shifts, US bond flows remain healthy overall thanks to attractive corporate credit fundamentals, while non-US bonds have also experienced robust inflows as investors seek to diversify. Overall, global bonds provide investors with broader diversification across countries, currencies, and asset classes while balancing domestic idiosyncratic risks. Allocating to global investment grade bonds provides exposure to high-quality securities, while a balanced allocation to global high yield and emerging market debt can enhance return potential. ▲

Hypothetical Fixed Income Portfolio to Generate a 5% Yield



Source: Top LHS – FactSet. Monthly data from 31 January 1990 to 30 September 2025. Global Agg = Bloomberg Global Aggregate. Returns are gross and hedged in USD. Yield range = +/- 0.5% deviation from current yield to worst (YTW). **Past performance is no guarantee for future results.** Bottom LHS – FactSet, Bloomberg, J.P. Morgan. Yields are yield-to-worst as of each date indicated. Indices used: Global Treasury = Bloomberg Global Aggregate Treasury Index, Global High Yield = Bloomberg Global High Yield Index, Global Investment Grade = Bloomberg Global Aggregate Corporate Index, Emerging Markets Debt = J.P. Morgan EMBI Global Index, US Securitized = Bloomberg US Aggregate Securitized Index. Returns used for volatility and correlation are gross and in USD. Volatility shown is annualized. **Hypothetical portfolios for illustrative purposes only.**

Index Returns – US Investor

As of September 30, 2025

BENCHMARK	10 YEARS	5 YEARS	3 YEARS	1 YEAR	YTD	3 MONTHS
EQUITY						
S&P 500	15.30%	16.47%	24.94%	17.60%	14.83%	8.12%
Russell 1000® Growth	18.83%	17.58%	31.61%	25.53%	17.24%	10.51%
Russell 1000® Value	10.72%	13.88%	16.96%	9.44%	11.65%	5.33%
Russell 2000®	9.77%	11.56%	15.21%	10.76%	10.39%	12.39%
MSCI EAFE	8.17%	11.15%	21.70%	14.99%	25.14%	4.77%
MSCI Emerging Markets	7.99%	7.02%	18.21%	17.32%	27.53%	10.64%
MSCI ACWI	11.91%	13.54%	23.12%	17.27%	18.44%	7.62%
FIXED INCOME						
Bloomberg US TIPS	3.01%	1.42%	4.88%	3.79%	6.87%	2.10%
Bloomberg US Aggregate	1.84%	-0.45%	4.93%	2.88%	6.13%	2.03%
Bloomberg Global Aggregate	2.32%	0.36%	5.20%	3.06%	4.05%	1.21%
CASH						
Cash	2.12%	3.10%	4.98%	4.61%	3.34%	1.11%

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Source: FactSet. Monthly data ending 30 September 2025. Returns are in USD. Equity returns are gross for S&P 500 and net for non-US indices. Fixed income returns are gross and hedged in USD. Cash = FTSE 3-month Treasury Bill Index. Past performance is no guarantee of future results. It is not possible to invest in an index.

Cash is based on returns for the FTSE 3-month Treasury Bill Index.

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Index Returns – Euro Investor

As of September 30, 2025

BENCHMARK	10 YEARS	5 YEARS	3 YEARS	1 YEAR	YTD	3 MONTHS
EQUITY						
S&P 500	14.11%	15.90%	17.07%	11.26%	0.90%	7.92%
MSCI Europe	8.24%	12.83%	16.42%	10.00%	13.00%	3.56%
MSCI EM	7.44%	6.97%	11.26%	11.44%	12.39%	10.53%
MSCI World ex USA	7.86%	11.55%	14.45%	10.21%	10.46%	5.23%
FIXED INCOME						
Bloomberg Global Germany (7-10Y)	-0.51%	-3.30%	1.18%	-1.38%	-0.21%	0.06%
Bloomberg US Aggregate (EUR Hedged)	-0.17%	-2.32%	2.65%	0.74%	4.45%	1.38%
Bloomberg Euro Aggregate	0.35%	-1.97%	3.16%	1.15%	1.01%	0.17%
Bloomberg Global Aggregate (EUR Hedged)	0.36%	-1.43%	3.02%	1.00%	2.42%	0.58%
CASH						
Euro Cash	0.63%	1.56%	3.03%	2.78%	1.86%	0.49%

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Source: FactSet. Monthly data ending 30 September 2025. Returns are in EUR. Equity returns are gross for MSCI Europe and net for non-Europe indices. Fixed income returns are gross and hedged in EUR. Euro Cash = ICE BofA Euro Currency Deposit Offered Rate Constant Maturity (3M). Past performance is no guarantee of future results. It is not possible to invest in an index.

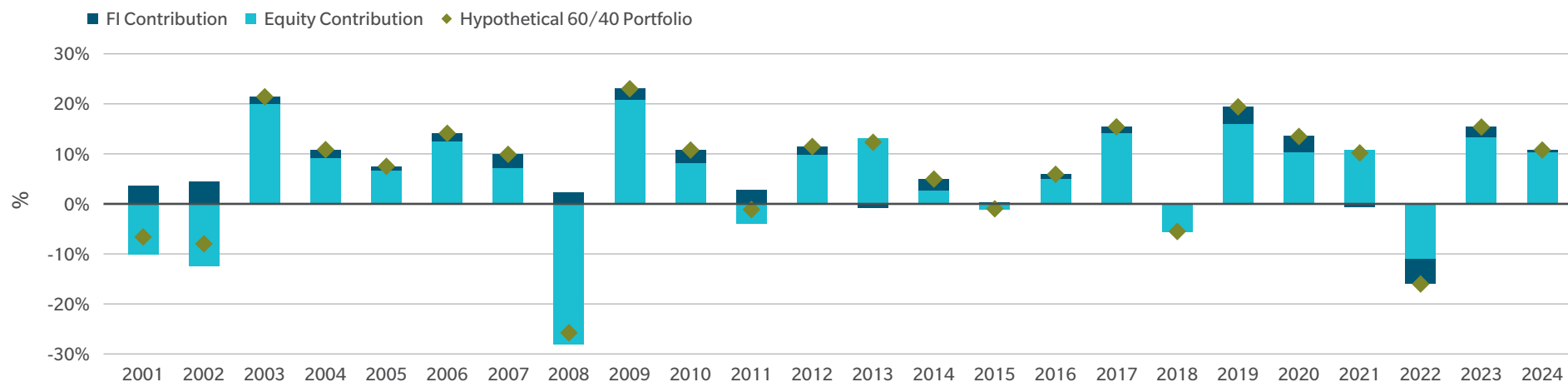
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Reference Portfolio's Statistics

Return, risk and contributions to return

60/40 Calendar-Year Returns



Hypothetical Portfolio Statistics for Various Asset Mixes

	GLOBAL EQUITY WEIGHT (%)	US AGG WEIGHT (%)	10-YEAR RETURN	EQUITY 10-YEAR CONTRIBUTION	FI 10-YEAR CONTRIBUTION	VOLATILITY	SHARPE RATIO
MORE FIXED INCOME ↑	0%	100%	1.84%	0.00%	1.84%	5.05%	-0.06
	20%	80%	3.93%	2.43%	1.50%	5.92%	0.31
	40%	60%	5.99%	4.86%	1.13%	7.67%	0.51
	60%	40%	8.01%	7.26%	0.75%	9.83%	0.60
	80%	20%	9.98%	9.61%	0.37%	12.20%	0.65
MORE EQUITY ↓	100%	0%	11.91%	11.91%	0.00%	14.66%	0.67

Source: FactSet. 60/40 portfolio is 60% MSCI AC World (Equity) and 40% Bloomberg US Aggregate (FI). Returns are net for MSCI ACWI and gross for Bloomberg US Aggregate, and in USD. Returns are rebalanced monthly. Top chart – Annual data from 31 December 2001 to 31 December 2024. Bottom chart – Monthly data ending 30 September 2025. **Past performance is no guarantee of future results.** It is not possible to invest in an index.

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