Regions Asset Management

2026 Capital Market Expectations (CME's)

Geopolitical Risks And Midterm Election Year Doldrums Present Headwinds, But Pro-Growth Policies Should Win Out

Powered By Multi-Asset Solutions (MAS)

REGIONS

2026 Capital Market Expectations Summary

Stocks: Our return expectations for U.S. large cap stocks were unchanged year over year, but our return assumptions for U.S. SMid, international developed, and emerging market stocks moved lower, albeit by just 25-bps in each case. In the U.S., we expect expansionary fiscal policy, less restrictive monetary policy, and potential AI productivity gains to boost earnings growth and equity performance in the coming year(s), particularly for larger firms with scale. Abroad, fiscal spending should raise the floor for economic and earnings growth, but to what degree remains to be seen, and developed market central banks likely have little room to further ease policy to buoy growth. Emerging markets have near-term tailwinds, in our view, but after a 30%+ gain in 2025, we felt it prudent to modestly lower our return estimate for this cohort of stocks.

Bonds: Fixed income had a good year in '25, but with lower yields and credit spreads historically tight, our return expectation for the Bloomberg Aggregate fell by 50-basis points to 4.25%, just below the 4.32% yield-to-worst at year-end. After very strong returns in 2025, our return assumptions for both U.S. high yield and U.S. dollar denominated emerging market debt both fell, with the former falling 50-bps and the latter lower by 25-bps versus our assumptions last year. On high yield, at 6.25%, our return expectation is just below the index's yield-to-worst of 6.53% at year-end, so we are baking in a modest uptick in defaults and potentially some widening in credit spreads over the near-term. The same holds true for emerging market debt after the asset class annualized 8.9% over the prior three years, and some tempering of expectations is warranted there.

Alternatives: A broad basket of daily liquid hedge fund-like strategies is again projected to generate a 5.75% return, in-line with last year's assumption. Despite our constructive outlook on global infrastructure, we moved our return expectation lower by 50-bps, largely due to our belief that valuations are lofty as capital continues to chase returns stemming from areas tied to AI such as power generation, among others. Our return assumption for private debt moved lower by 50-bps, and this is an area where we are less constructive in the near-term as we expect recent defaults/bankruptcies to raise underwriting questions.

Cash & Equivalents: We moved our return expectation for cash lower by 25-bps this year as we expect the FOMC to continue easing monetary policy in the coming year. We currently expect inflation to run around 2.6% year over year in 2026, and with the FOMC likely to cut the funds rate further, investors should expect a lower real yield on cash in the quarters to come, increasing the appeal of longer-term bonds.

Asset Class	Asset Class Sub-Type	10-Year Expected Annualized	Year-Over-Year Change in Return	10-Year Expected Standard Deviation
Equity	Domestic Large Cap	6.50%	0.00%	17.00%
	Domestic SMID	7.00%	-0.25%	20.00%
	International Developed	6.75%	-0.25%	17.50%
	Emerging Markets	7.75%	-0.25%	20.50%
	Global Stocks	7.00%	0.00%	17.50%
	Commodity-Related Equities	5.75%	0.00%	23.00%
Fixed Income	Domestic Investment Grade	4.25%	-0.50%	5.00%
	Investment Grade Credit	5.00%	0.00%	6.00%
	Long Duration Credit	5.25%	0.00%	12.00%
	International Fixed Income	4.00%	-0.25%	5.00%
	TIPS	4.00%	0.00%	5.75%
	High Yield	6.25%	-0.50%	9.00%
	Bank Loans	5.50%	-0.50%	8.00%
	Intermediate Municipals	3.75%	0.00%	5.00%
	High Yield Municipals	5.25%	0.00%	8.75%
	Emerging Market Bonds	5.75%	-0.25%	9.50%
Alternatives	HFRX Global Hedge Index (Liquid Alts)	5.75%	0.00%	6.25%
	HFRI Global Hedge Index (L.P.)	6.50%	0.00%	5.50%
	Private Equity	9.50%	0.00%	23.50%
	Private Debt	7.25%	-0.50%	12.00%
	Private Real Estate - Core	7.00%	0.00%	14.00%
	Public Real Estate (REITs)	7.50%	0.00%	19.00%
	Global Infrastructure	7.00%	-0.50%	16.00%
	Commodities	4.50%	0.00%	17.25%
Cash & Equivalents	Cash and Equivalents	3.25%	-0.25%	0.75%
	Enhanced Cash	3.50%	-0.25%	1.00%

Revisiting, And Reaffirming 2025's Themes

1) **Exceptionalism Will Attract Capital Into U.S. Stocks, Generating Continued Strong Relative Performance.**

   Reaffirmed: Developed markets abroad performed well in the first half of 2025 as capital moved out of the U.S. due to concerns that tariffs would reduce global trade, contributing to weakness in the U.S. dollar and leading capital to be repatriated back into its country of origin. However, as uncertainty surrounding tariffs/trade eased, U.S. stocks played catch-up, and the U.S. dollar found its footing, a sign that investors remained willing to invest in U.S. dollar-denominated assets. Stepped up fiscal spending has been cited as a reason to allocate more capital into the Eurozone and Japan in '26, but if you're buying European or Japanese equities due to more expansionary fiscal policies/spending and the expected positive impact on economic growth you should look no further than U.S. stocks for the same reasons as tax refunds, favorable expensing of capex, and less restrictive monetary policy should buoy risk assets stateside.

2) **More Volatile Backdrop For Interest Rates/Treasury Yields A Byproduct Of Policy Uncertainty.**

   Reaffirmed: 2025 was a strong year for bonds, broadly speaking, as policy uncertainty forced Treasury yields lower, and a resilient U.S. economy contributed to historically tight credit spreads. However, lower starting yields and credit spreads near historically tight levels present investors with a more challenging environment. Policy uncertainty is unlikely to ease much, we expect inflation, as measured by personal consumption expenditure (PCE) to fall to around 2.5% in 2026, while economic growth is more likely to surprise to the upside than the downside, in our view. This backdrop should limit how much the FOMC can cut the funds rate and leads us to the view that rates in the belly of the yield curve will be volatile, with the Bloomberg Aggregate generating a coupon-minus return in '26.

3) **Liquidity Backdrop Still Supportive Of Selective Risk Taking, But Larger And More Frequent Equity Drawdowns Are Likely.**

   Reaffirmed: The S&P 500 experienced two bouts of significant volatility in 2025 - a peak-to-trough drawdown of over 20% from mid-February through early April, and a 5% pullback from the October high into mid-November - but the average VIX reading fell short of its historical average. The end of quantitative tightening (QT) and the prospect of shock and awe stimulus in the lead-up to November's midterm elections should leave enough liquidity to push stock prices higher, but elevated volatility/deeper drawdowns have been common in midterm years such as this.

New Themes To Monitor For 2026, And Potentially Beyond

Potentially A Strong Start For U.S. Stocks Followed By A More Defensive Posture Into Midterms

- U.S. stocks have potentially powerful tailwinds in the first half of the new year, but the back-half may be more challenging as midterm election years have presented hurdles time and time again.
- Corporate capex and tax refunds should buoy consumption and investment in the first half of the year. The end of quantitative tightening (QT), potential AI productivity gains, and the prospect of transformative M&A could also provide powerful tailwinds.
- Historically, in midterm election years more defensive areas have led in the lead-up to November, which could lead to a rotation out of both cyclical and secular growth areas in 3Q or thereabouts.

Themes Set To Drive U.S. Stocks

- Expansionary Fiscal And Monetary Policies In The U.S.
- Less Onerous Regulatory Backdrop Leads To M&A Surge
- Economic/Earnings Upside Possible As AI Drives Productivity

Investment Implication:

Neutral/Overweight U.S. Stocks

Emerging Over Developed Abroad: Emerging Markets With More Powerful Potential Tailwinds

- Developed market stocks abroad performed well in 2025, but the bulk of the gains for this cohort occurred in the first half of the year as the U.S. dollar weakened materially. We expect the U.S. dollar to find its footing in the coming year, shifting from a tailwind for foreign developed markets into a headwind.
- With inflationary pressures easing abroad, emerging market central banks have more room to ease monetary policy to spur growth, drive capital inflows. This should benefit EM stocks, bonds, and currencies, broadly speaking.

Themes Dictating International Market Performance

- Fiscal Hopes Meet Economic Reality In Europe
- A Bumpier Ride Ahead For Japan Due To Policy Crosscurrents
- EM Currency Strength Allows For Policy Easing

Investment Implication:

Overweight Emerging Markets Vs. Developed Markets Abroad

Growth, Inflation, Fiscal Spending Dynamics Could Make For Tougher Sledding Ahead For Bonds

- Bonds, broadly speaking, fared quite well in 2025 despite sticky inflation and resilient economic growth. However, this performance likely pulled forward gains and further upside from core investment-grade bonds is more limited as a result.
- Economic growth could surprise to the upside in the U.S., while sticky inflation in Japan and stepped-up fiscal spending in the Eurozone and Japan are reasons to believe sovereign yields will move higher in '26.
- Multiyear theme: credit spreads should normalize/move wider, presenting opportunities to strategically and tactically alter positioning. More liquid and transparent markets are more desirable after high-profile bankruptcies and defaults, which could limit how wide credit spreads can go in the coming year.

Themes Set To Impact Interest Rates

- Global Fiscal Impulse
- U.S. Economic Growth Accelerates, Will Inflation?
- China Aside, Emerging Market Central Banks Ease

Investment Implication:

Neutral Across Fixed Income Segments As We Wait For Dislocations To Materialize

U.S. Stocks: Potentially A Strong Start Followed By A More Defensive Posture Into Midterms

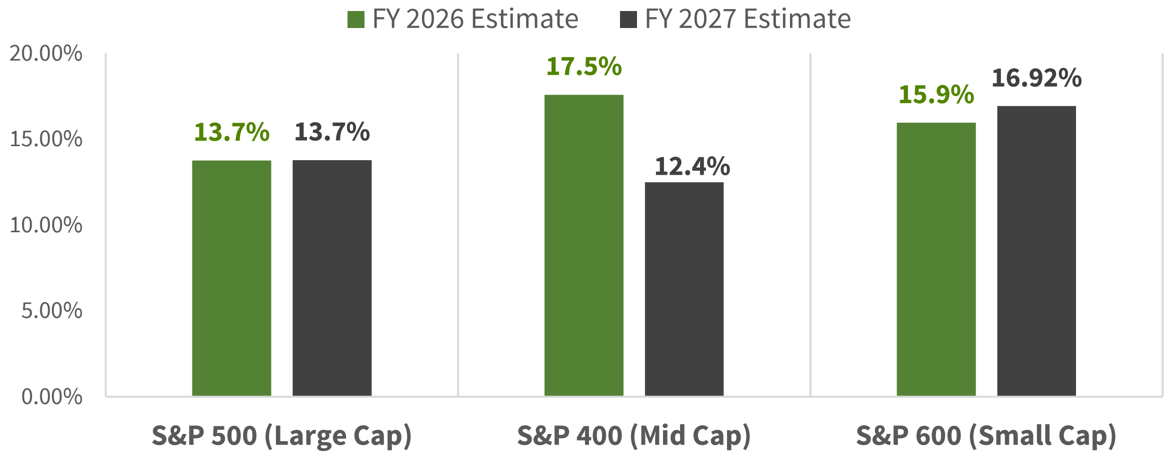
Tailwinds Early In ‘26, But The Back-Half Of The Year Could Prove More Challenging

U.S. stocks appear set for a strong start to the new year. After pulling back in late November, with many indices approaching oversold territory as risk appetite waned alongside hopes for a rate cut out of the FOMC in December, positioning and sentiment were reset. This reset and the sector rotation that accompanied it are healthy events and could help breathe new life into what was looking like a tired market. We expect tax refunds at both the consumer and corporate levels to spur consumption and investment early in 2026, boosting economically sensitive sectors, specifically. Spending on artificial intelligence infrastructure should remain robust in the coming year, but the prospect of unforeseen stimulus in the lead-up to midterm elections is a reason for optimism surrounding consumer-oriented sectors and economically sensitive areas as well. Improved breadth/participation could push the broader market higher into mid-year; however, in midterm election years, more defensive areas such as consumer staples and health care have fared best, and those sectors may catch safe-haven bids yet again.

From a fundamental perspective, earnings estimates for 2026 and 2027 continued to move higher throughout the 4th quarter of 2025, which sets a higher bar for expectations, but also provides reason for investors to maintain allocations to U.S. stocks. The S&P 500 is expected to earn $310 per share in 2026, which leaves the index trading at 22X projected 2026 earnings at year-end and implies 13.5% year over year earnings growth relative to 2025. We don’t expect valuation multiples to expand in the coming year as discount rates remain sticky and could be poised to rise alongside Treasury yields farther out on the curve, but a reasonable base-case for U.S. large-cap stocks in the coming year is a return in-line with earnings growth. It’s notable that the S&P 500’s total return of 17.8% in 2025 outpaced the index’s 10% growth in EPS, so we could see a reversal of sorts in ‘26 with the S&P 500’s total return falling shy of earnings growth.

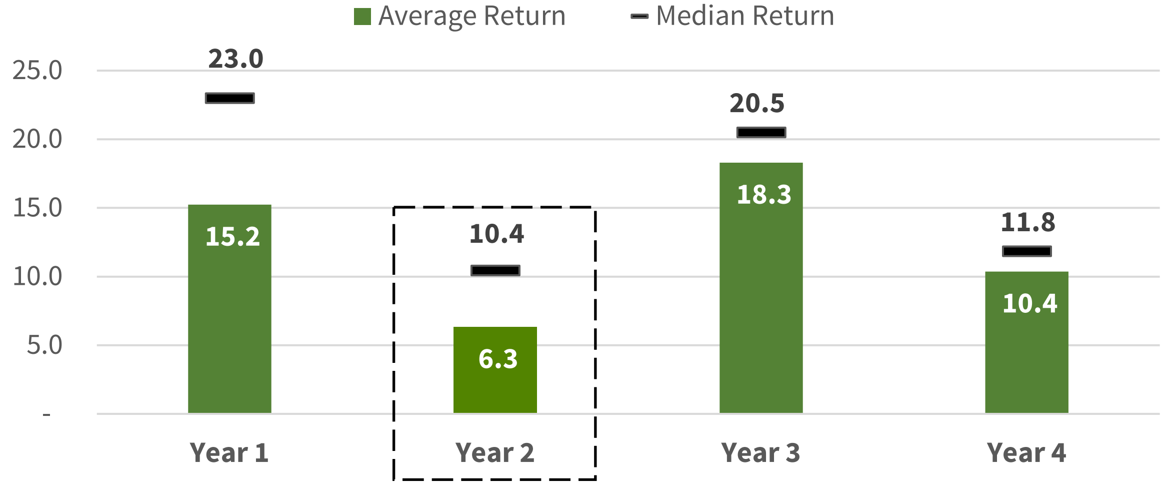
Mid-cap valuations remain attractive, and even after the S&P Midcap 400 index easily surpassed the consensus earnings per share estimate in the 3rd and 4th quarters, investors and analysts barely noticed with estimates for both ‘26 and ‘27 little changed. This provides investors with an attractive opportunity to allocate to a segment of stocks that are more economically sensitive and levered to an upside economic surprise in the U.S., while doing so in a higher quality cohort of stocks that could benefit from an uptick in M&A activity as well. Suffice it to say that there are a litany of ways for mid caps to potentially ‘win’ in 2026.

Earnings Growth To Drive Gains Across The Market Cap Spectrum



Source: Bloomberg

The S&P 500 Has Faced Tough Sledding In Midterm Election Years



Source: Bloomberg, S&P 500 Returns From 1976 Through 2022

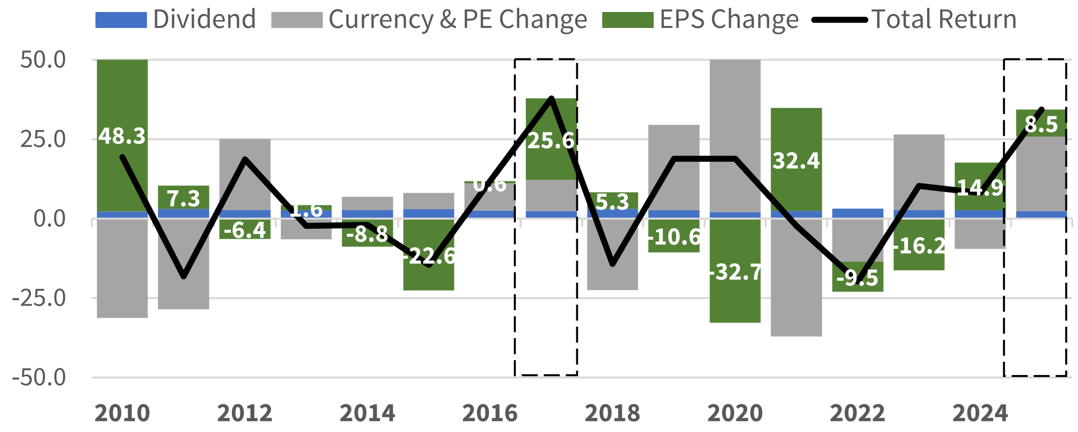
Favor Emerging Over Developed When Allocating Capital Abroad

Fiscal Spending, Valuations Supportive Of Developed, But Emerging Markets Have An Earnings Advantage

Radical, and largely unexpected shifts in fiscal policy in Europe and Japan positively altered the course for foreign markets in 2025, but fiscal tailwinds have now been accounted for in valuations and must bear fruit to justify a sustained move higher. Economic growth expectations have moved higher for developed markets abroad, but economic growth doesn't translate perfectly into earnings growth. In our view, with valuations abroad now more demanding, investors may want to see tangible benefits from fiscal spending relatively soon this year or this cohort of stocks risks turning into a value trap. An improved fiscal outlook is one part of the equation, but deregulation and innovation that come from strong capital markets are still needed to achieve secular growth, which leaves us skeptical that Eurozone and U.K. stocks, specifically, can continue to rally.

Relative to developed markets abroad, emerging market equities appear to have greater earnings potential and cheaper valuations. These economies also stand to benefit from U.S. easing and relatively tame inflation readings that should allow for flexibility around currency/monetary policy adjustments. Also, while developed market indices abroad tend to skew toward cyclicals/economically sensitive sectors, the MSCI EM has a nice blend of both cyclicals as well as secular growth-oriented areas such as information technology which is still poised to benefit from the buildout of artificial intelligence (AI) infrastructure.

Multiple Expansion & Earnings Growth Have Been Difficult To Sustain In Foreign Developed Stocks



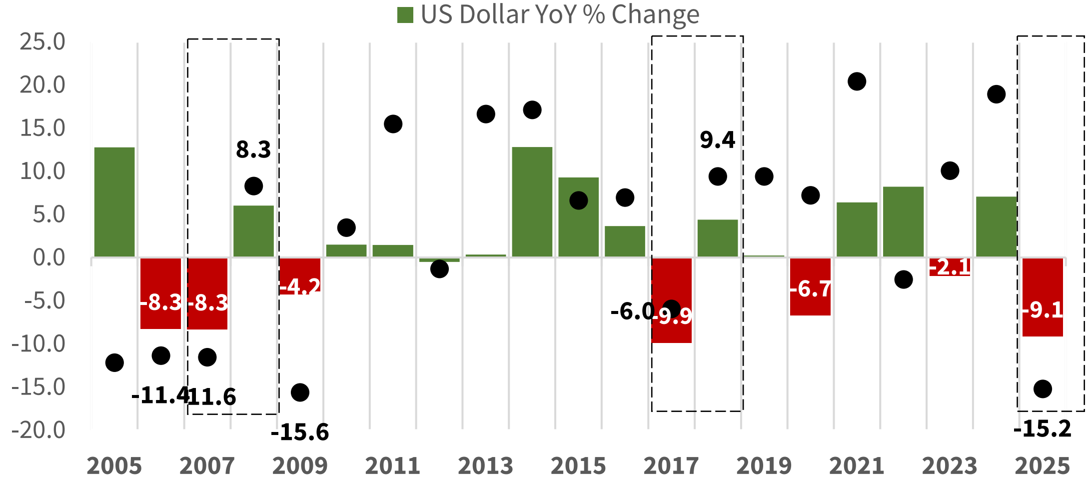
Source: Bloomberg

Room For Appreciation In Emerging Market Currencies, But Developed Strength Has Likely Run Its Course

After the U.S dollar index, or DXY, fell by 9.1% last year, many prognosticators are continuing to call for weakness to persist and lift international assets in the new year. However, over the last 20 years, we've only seen the U.S. dollar depreciate in consecutive years once., with that back-to-back decline occurring in the 2006-2007 timeframe in the lead up to the Global Financial Crisis (GFC). However, in our view, 2025's drop in the DXY looks more like what materialized in 2017, the last tariff induced downturn in the dollar. Revisiting that period, we saw the greenback bounce the following year as safe haven assets caught a bid, and the U.S. dollar was flat in 2019, with U.S. stocks outperforming foreign stocks by over 9% in both '18 and '19.

If U.S. growth reaccelerates, inflationary pressures gradually ease, and the labor market doesn't deteriorate further, the FOMC may struggle to lower the Fed funds rate early in the year, which would put a floor under the greenback. A backdrop such as this would suggest that the pendulum will swing back from the macro forces that put developed market equities on top in 2025, in favor of a more fundamental and valuation-driven approach that pushes capital back into emerging market stocks. Emerging market currencies, broadly speaking, appreciated versus the dollar in the back-half of '25, evidence of capital inflows into a broad swath of developing economies. This gives central banks the cover to ease policy to spur growth in the year to come.

Large Downdrafts In The US Dollar Rarely Repeat Year Over Year



Source: Bloomberg

Interest Rate Volatility, More Muted Returns Lie Ahead For Bonds

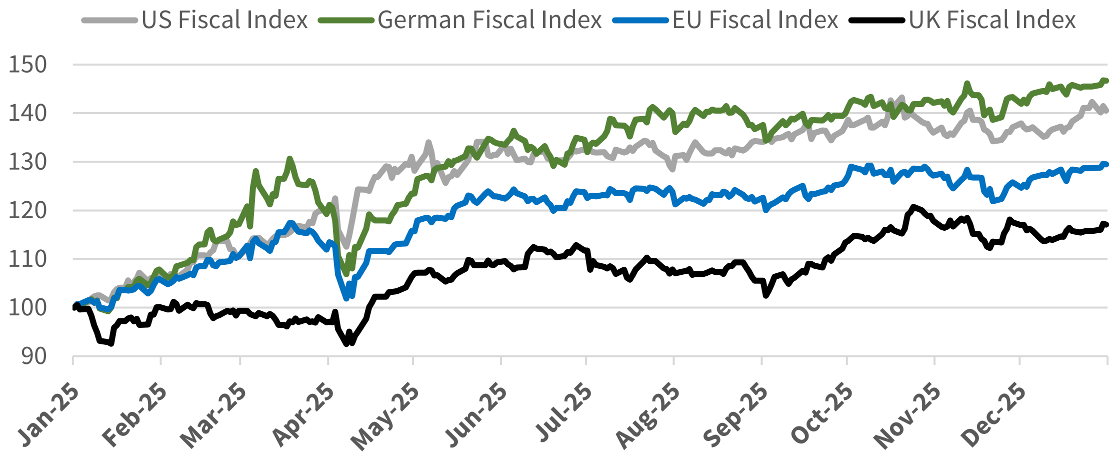
Fiscal Spending A Headwind For Sovereigns, Improved Growth Outlook An Offset

Expansionary fiscal policy will be a worldwide phenomenon in 2026 as many countries attempt to run their respective economy 'hot' This backdrop should keep persistent upward pressure on global sovereign bond yields as investors require higher yields to take down government bonds. However, increased deficit spending could be offset by an improved economic growth outlook, particularly in the U.S., limiting how high yields climb.

- Japan's debt-to-GDP is 230%, and with the yield on 2-year Japanese Government Bonds (JGBs) and 10-year JGBs approaching/surpassing 2006-2007 levels, its clear investors have started to push back on the country's deficit spending plans which need to bear fruit in the form of an improved growth outlook in the coming year(s).
- U.S. government debt-to-GDP is around 125%, and Eurozone debt-to-GDP is approaching 90%, percentages that appear reasonable when compared to Japan, but these are all-time high levels. While there's little margin for error in the U.S., there's even less so in the Eurozone as fiscal stimulus failing to boost economic growth could push rates/yields materially higher. This could be painful in the near-term, but present opportunity in the coming years for investors to pick-up sovereign paper at higher yields.

Increased Government Spending Will Keep Upward Pressure On Yields

(Indexed To 100 To Highlight Which Areas Were Most Aggressively Easing Fiscal Policy In '25)



Source: Bloomberg

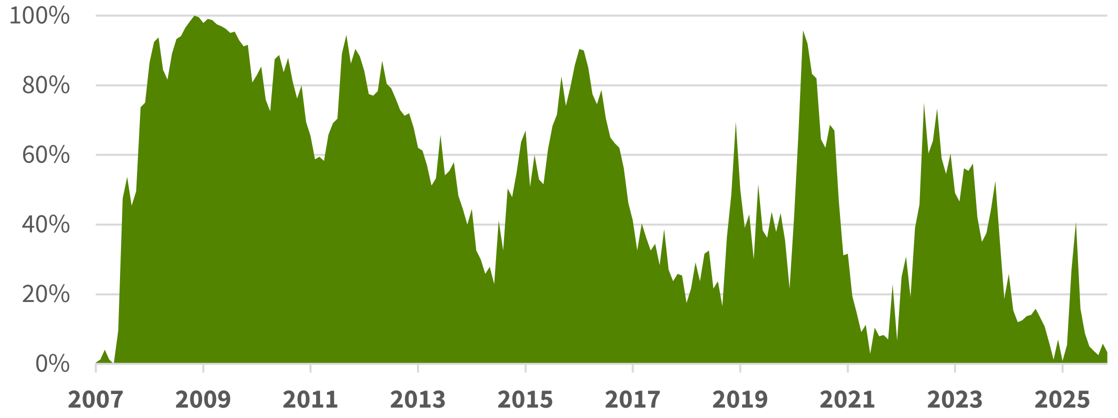
Low Yields And Historically Tight Credit Spreads Make For A Difficult Starting Point

Relative to their own history, investment-grade (IG) and high yield (HY) corporate bonds are trading at lofty valuations. With credit spreads just 77- and 265-basis points above similar duration Treasuries at year-end, investors shouldn't expect much upside to total return for taking credit risk early in the new year.

- A resilient and potentially strengthening U.S. economy should embolden investors to reach for yield in riskier segments of the fixed income marketplace, and with liquidity ample and potentially improving as the FOMC ends quantitative tightening (QT), we don't expect credit spreads to move materially wider in the coming year. However, total return potential out of high yield corporate bonds, specifically, is limited with credit spreads within a few basis points of the tightest level seen since before the global financial crisis.
- However, should Treasury yields move higher due to a combination of sticky inflation/improved economic growth, higher quality and longer duration investment grade corporate bonds could see yields move higher and produce a coupon-minus return year.

High Yield Index Valuations Trading Near The 'Richest' Level Seen In 20 Years

(The Closer The Green Bar Is To The Y-Axis, The Lower The Credit Spread/Yield Over Treasuries)



Source: Bloomberg

The Consensus View Entering 2026 Vs. Our Own

1) The Consensus View: Another positive year lies ahead for the S&P 500.

- **The Regions View:** This appears to be the most widely held consensus view coming from sell-side strategists. S&P 500 price targets range from 7,100 to 8,100 for year-end 2026, with most estimates clustered in the 7,400 to 7,700 range. We expect the S&P 500 to generate a positive return this year, but an 'average' year in which the S&P 500 generates a return of around 8% (the average annualized S&P 500 total return dating back to 1999) is quite rare, historically speaking. Instead, we could see a year in which the market makes fools of the greatest number of participants and the S&P 500 either generates a return far exceeding the consensus view, i.e. 20%-plus, or generates a loss, i.e. between 0% and -10%. Forced to choose, we would favor the former to the latter, but the herd is certainly positioned for this eventuality.

2) The Consensus View: Participation at the individual stock level will broaden out in 2026 with the consensus expecting the equally weighted S&P 500 to outperform the market cap weighted version of the index in the coming year.

- **The Regions View:** Should U.S. economic growth surprise to the upside due to fiscal spending and less restrictive monetary policy, economically sensitive sectors (consumer discretionary, energy, financials, industrials, materials) could fare better in the coming year. However, AI-related spending will remain a big part of the story in '26, with the information technology sector the most levered to this theme. In short, we do expect breadth to improve relative to 2025's narrow leadership profile, but as information technology goes, so still likely goes the broader market in the coming year.

3 The Consensus View: Developed markets abroad are set to outperform the U.S. again in '26, driven by cheaper valuations, fiscal spending benefits.

- **The Regions View:** Japan approved a $135B fiscal spending package in November, the Eurozone passed a package in early 2025 that earmarked €800B per year by 2030 to "Re-Arm the EU," and Germany unveiled a €500B infrastructure fund and uncapped defense spending. These moves should be growth-positive in the coming years, but the jury is out regarding whether this spending will translate into a material near-term upswing in consumption and investment to justify last year's strong returns out of these markets. Contrast this dynamic with what we expect in the U.S., which should have tailwinds from fiscal spending tied to the One Big Beautiful Bill (OBBB) and from less restrictive monetary policy which should boost growth in the coming year. Weakness in the U.S. dollar in the first half of '25 drove the bulk of the gains in international developed market stocks, but an improved economic growth outlook in the U.S, a measured and gradual move lower in short-term interest rates, and clarity on trade policy should attract investment capital stateside and allow the dollar to steady vs. the euro, pound, and yen. Absent substantial weakness in the U.S. dollar, U.S. indices should outperform or at least keep pace with international developed market stocks in '26.

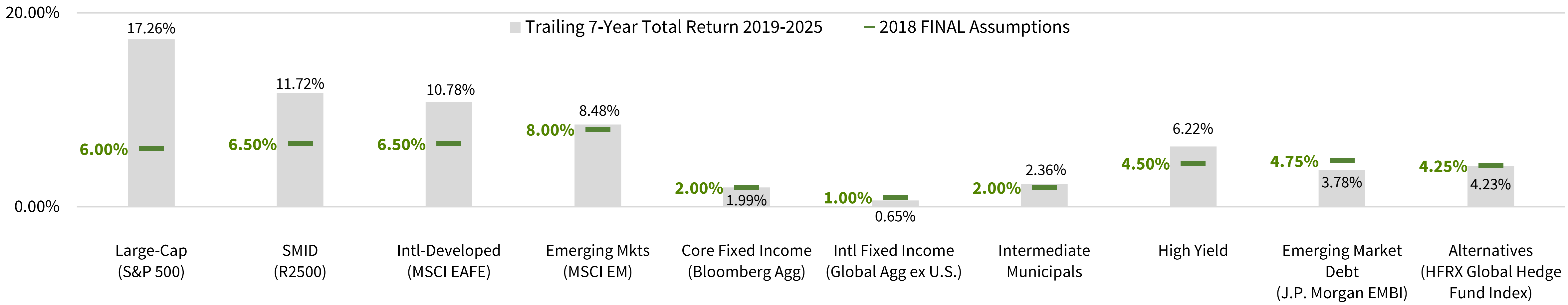
Revisiting Prior Assumptions: The 7-Year Lookback (2019-2025)

- **Domestic Stocks:** Both U.S. large cap and U.S. small and mid-cap (SMid) stocks have easily exceeded the return expectations we laid for seven years ago. The S&P 500 has bested our expectation by over 11% on an annualized basis as valuations/earnings multiples have expanded due to easier monetary policy/increased liquidity, specifically the FOMC substantially expanding its balance sheet amid the onset of the COVID pandemic, and more recently the mania surrounding artificial intelligence (AI) which has contributed to a run-up in information technology stocks. Of note, looking at the prior 20 years on a rolling quarterly return basis, the 17.2% annualized trailing 7-year return for the S&P 500 at year-end trails only the Mach 2009 through March 2016 return of 19.8%.

- **International/Emerging Market Stocks:** Developed markets abroad have received a bad rap over the past decade, likely due in part to the strong absolute returns posted by U.S. large cap stocks over that timeframe. However, the MSCI EAFE index has annualized a respectable 10.7% return during the prior seven years, outpacing our 6.5% return assumption. Of course, last year's 32% gain out of the EAFE helped pull that return figure higher, and fiscal spending in the Eurozone and Japan are reasons to believe the EAFE could post gains again in '26, albeit smaller in magnitude. Seven years in, we haven't been far off on our projection for returns out of the MSCI Emerging Markets index, but the index has done a bit better, due in large part to last year's 34% total return. Historically, gains and relative outperformance from emerging market stocks tend to cluster and come in waves, and we are optimistic that tailwinds in 2026 will allow EM equities to generate a positive return for the third consecutive year.

- **Bonds:** It has been tough sledding for fixed income investors over the past 7 years, with the Bloomberg Agg annualizing just shy of 2% over that time frame, in-line with our assumption. With core personal consumption expenditure (PCE), the FOMC's preferred inflation gauge, annualizing 3.1% from the start of 2019 through the 3rd quarter of 2025, real returns from core fixed income have fallen short and reduced purchasing power for investors heavily allocated to higher quality bonds over that time frame. Conversely, high yield bonds have performed better than we expected, returning 6.2% versus our 4.5% estimate, with the majority of this excess return driven by a consistent narrowing of credit spreads over the lookback window. Emerging market debt has performed well in recent years and has finally recovered after falling sharply in 2022 but has still fallen short relative to our expected return laid forth seven years ago.

- **Alternatives:** At the end of 2018, we projected a 7–10-year return of 4.25% for a broadly diversified portfolio of liquid alternative strategies, and seven years in we have been almost spot-on, with the HFRX Global Hedge Fund Index annualizing 4.23% over that time horizon. Our expected return for liquid alts moving forward is higher, due in large part to the starting point for Treasury yields which is far more appealing for strategies with higher betas to bonds than it was at the end of 2018.



Executive Summary

- U.S. large-cap stocks had another good year in 2025 with the S&P 500 higher by 17.3% on a total return basis, and we expect another year of gains ahead, driven in large part by earnings growth. The current consensus estimate calls for the S&P 500 to generate $310 per share in earnings this year, and $350 in 2027, figures that imply earnings growth of 13% in back-to-back years. However, with the index's 17.3% total return outpacing the 10% year over year earnings growth produced by the S&P 500 in 2025, last year's gains may have been 'borrowed' from this year, to some degree. As a result, we would not be at all surprised if S&P 500 earnings grow in excess of the annual return generated by the index this year.

- U.S. small and mid-cap (SMid) stocks lagged large and mega-cap names as well as foreign stocks last year as investors sought out exposure to artificial intelligence (AI) beneficiaries and other areas of secular growth, which led them directly to the communication services, information technology, and utilities sectors within the S&P 500. However, we expect cyclical, or economically sensitive sectors to perform better on a relative basis in the coming year as a global economic recovery or upswing takes root, leading investors to reposition portfolios and increase exposures to consumer discretionary, financials, industrials, and materials stocks, among others. Given the S&P Midcap 400 and Small Cap 600 indices carry substantially larger weights to these cyclical sectors and much less exposure to last year's winners in the communication services and information technology sectors, we look for U.S. SMid to play catch-up in the coming year as investors look to play catch-up in segments that have lagged.

- Developed markets abroad outperformed U.S. equities in '25, with much of that outperformance taking place in the first half of the year as the U.S. dollar weakened. Capital outflows stemming from tariff/trade uncertainty are in the rearview mirror and given our expectation that U.S. economic growth could surprise to the upside in the year to come due to a combination of corporate investment and consumer spending, capital inflows should prop up the U.S. dollar and in turn U.S. equities over the balance of 2026. The economies of both the Eurozone and Japan will receive a boost from government spending, but with the MSCI Europe and MSCI Japan rising 36.4% and 24.9%, respectively, on a total return basis last year, a lot of good news has been priced in, and if consumption/earnings growth fall short, investors may look at these markets as value traps.

- Emerging markets performed well in 2025, with the MSCI EM index closing out the year higher by 33.8% on a total return basis. Performance dispersion at the country level was as wide as we've seen it in some time, evidenced by India and South Korea, both of which are top-5 exposures within the MSCI EM index, with the former up just 4% on the year, while the latter jumped 100%. We remain constructive on emerging markets – both stocks and to a lessor degree bonds - in the year to come, driven by a cyclical upswing in the global economy and the prospect of central bank easing across a broad swath of developing economies. China, South Korea, and Taiwan account for over 60% of the index, and as those country's go so goes the broader index, but we do expect improved relative performance out of pockets of Latin America, and potentially even India in '26.

- Bonds, broadly speaking, had a tremendous 2025 as U.S. Treasury yields fell and credit spreads narrowed to near record levels, leading to sizable gains for investors in U.S. Treasuries, both investment-grade and high yield corporate bonds, as well as emerging market debt. Low yields and tight credit spreads make for a tougher starting point for investors allocating to fixed income, and as a result more muted returns likely lie ahead. However, with liquidity ample and investors forced to take risk to generate income, we don't expect credit spreads to widen materially this year.

- The HFRX Global Hedge Fund Index (HFRX), a broadly diversified portfolio of daily liquid hedge fund-like strategies, produced a return of 7.1% in '25, roughly in-line with the Bloomberg Aggregate Bond index. With bond yields low and credit spreads historically tight entering 2026, alternatives are a tool to lower overall portfolio volatility and limit drawdown should Treasury yields rise/bonds sell off. We expect a portfolio of less illiquid alternative strategies (HFRI) to produce a return 75-basis points above the HFRX on an annualized basis over the next decade as investors require an illiquidity premium to allocate to these managers. We lowered our expected return for Private Debt and Infrastructure relative to last year, but our outlook for both areas is little changed. We maintain a cautious view on Private Debt as concerns surrounding underwriting standards and exposure to non-bank lenders are likely to persist after recent high-profile bankruptcies/defaults. While we remain constructive on the outlook for Infrastructure as this area should continue to benefit from AI-related spending, we are concerned that managers are paying premium prices and making more aggressive assumptions in order to put capital to work, thus likely lowering returns on investment at some point in the coming years.

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Portfolio Strategist
Multi-Asset Solutions

CME Building Blocks

Equity

Equity Expected Return =	Earnings Growth Expectations +	Expected Dividend Yield +	Expectations for Valuation Expansion Or Contraction

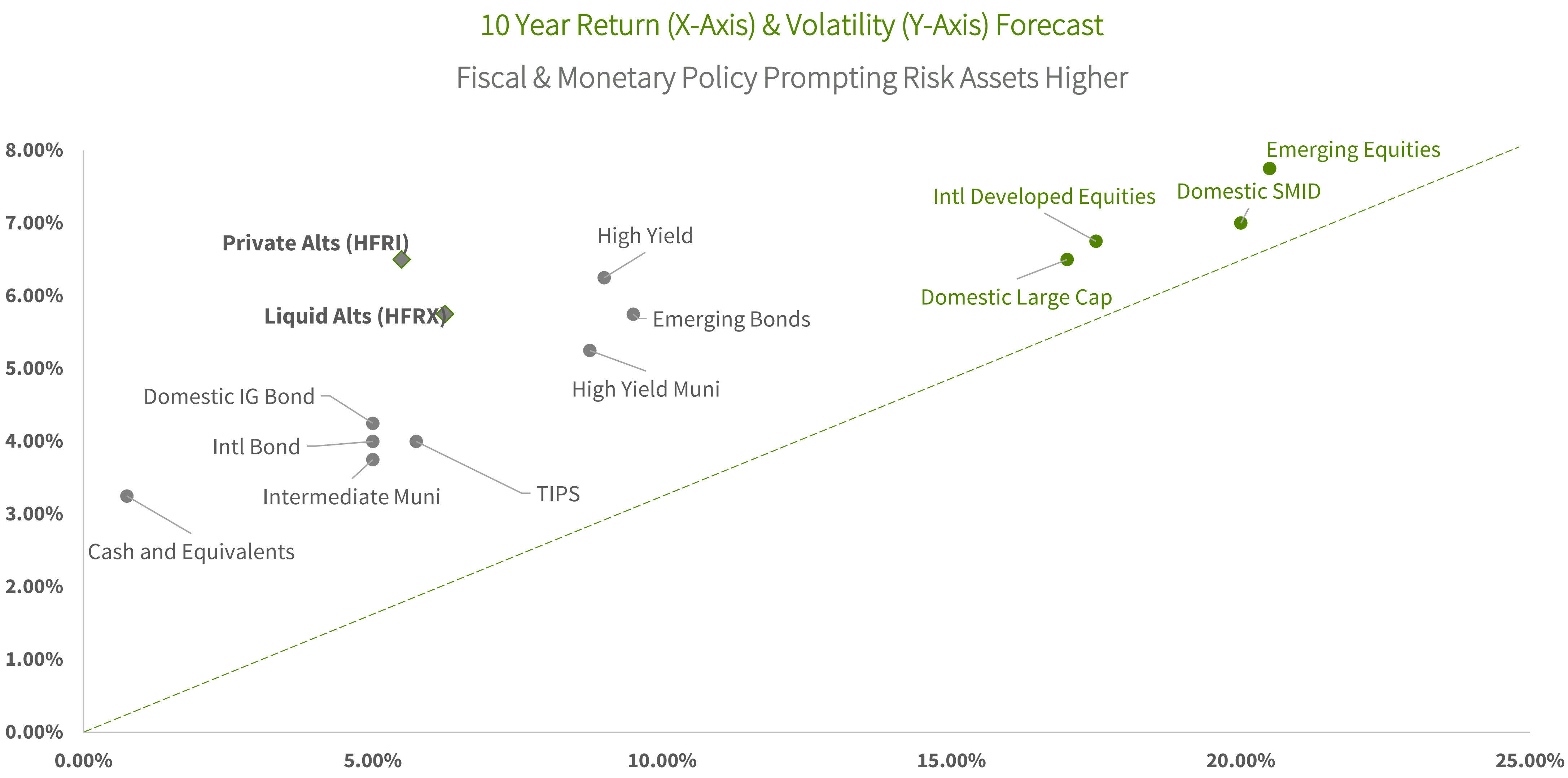
- Equity capital market expectations are derived from established fundamental drivers of return including income estimates and capital appreciation forecasts.
- Expected earnings growth is tied to economic growth, which is impacted by variables such as monetary policy, population growth, and productivity, all of which require other assumptions to be made, increasing the likelihood of deviation from actual experience across the forecasted time horizon.
- Expected dividend yield is a relatively straightforward input as we can use the trailing yield of an index and adjust for expected annual dividend growth, a figure unlikely to change much from one year to the next. This is the easiest component of expected return to forecast but is also the least variable from year to year and thus shouldn't cause the final return estimate to shift much.
- Expansion/contraction in valuations (earnings multiples) are tied to expectations surrounding economic growth, monetary policy (easy monetary policy leads to higher forward earnings multiples, i.e., expansion, while tighter policy leads to lower multiples, i.e., contraction), and investor sentiment (risk appetite), among other variables. Valuations are often intertwined with global central bank policy regimes as valuations expand as liquidity is injected and compress as liquidity is removed. We're entering a period in which liquidity is going to be injected into the global economy, which should be supportive of forward price-to-earnings (P/E) and other valuation metrics. Notably, after valuations may remain elevated relative to historical levels due to how much liquidity has been injected in recent years.

Fixed Income

Fixed Income Expected Return =	Current Yield-To-Worst +	Change in Default Expectations +	Expected Base Currency Gain/Loss (USD)

- Formulating capital market return expectations for fixed income is a simpler exercise with fewer variables relative to what is required for equities.
- Current yield for 'risk-free' bonds such as U.S. Treasuries, or yield-to-worst for corporate credit and other riskier types of debt, are observable and the primary contributor to expected forward returns for fixed income. A bond's yield or yield-to-worst should be an investor's expected return, assuming the issuer makes coupon payments on time and avoids default, which is why formulating an expected return for core, investment-grade fixed income is a more straightforward exercise with fewer assumptions required than it is for riskier bonds such as high yield corporates and emerging market debt.
- Default expectations must be a consideration for investment-grade and high yield corporate bonds, and it is our expectation that defaults for high yield issuers, will rise modestly over the coming year which should be supportive of a 'clip your coupon'-plus type environment.
- Appreciation or depreciation of the U.S. dollar versus foreign currencies is a variable to consider but given that the bulk of our exposure to foreign bonds is tied to U.S.-dollar denominated debt, this isn't an input that's going to cause large shifts in forward expectations. However, given our outlook which calls for the U.S. dollar to depreciate in '24, foreign issuers could find themselves in a far better position to repay existing U.S. dollar denominated debt and may find a more willing buyer base that allows them to float new debt to fund/finance future economic growth.

Capital Market Expectations: Long Term Return Outlook



Source: Prepared by Regions Asset Management. Data as of 12/31/24.

Appendix

Asset Class Statistics (Simulated)

Asset Classes	Arithmetic Mean	Geometric Mean	Standard Deviation	CVaR Cutoff 5.0%
DS	5.9	5.8	5.9	6.6
Equity	8.3	6.9	16.7	24.5
Taxable FI	4.6	4.5	4.4	4.8
Tax Exempt FI	4.0	3.9	4.3	5.1

Correlations

	DS	Equity	Taxable FI	Tax Exempt FI
DS	1	0.59	0.19	0.17
Equity	0.59	1	0.25	0.17
Taxable FI	0.19	0.25	1	0.77
Tax Exempt FI	0.17	0.17	0.77	1

Asset Mix Statistics (Simulated)

	Taxable		Tax Exempt	
Asset Mix	Geometric Mean	CVaR Cutoff 5.0%	Geometric Mean	CVaR Cutoff 5.0%
Aggressive Growth	6.8	22.3	6.8	22.4
Growth	6.6	18.3	6.6	18.4
Growth w Income	6.3	13.3	6.1	13.4
Balanced	6.0	9.9	5.8	10.0
Income w Growth	5.8	8.3	5.5	8.4
Current Income	5.4	5.9	5.0	6.0
Enhanced Income	4.7	4.0	4.1	4.3

Source: Regions Asset Management and Morningstar Direct

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