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2026 Global Strategy Outlook
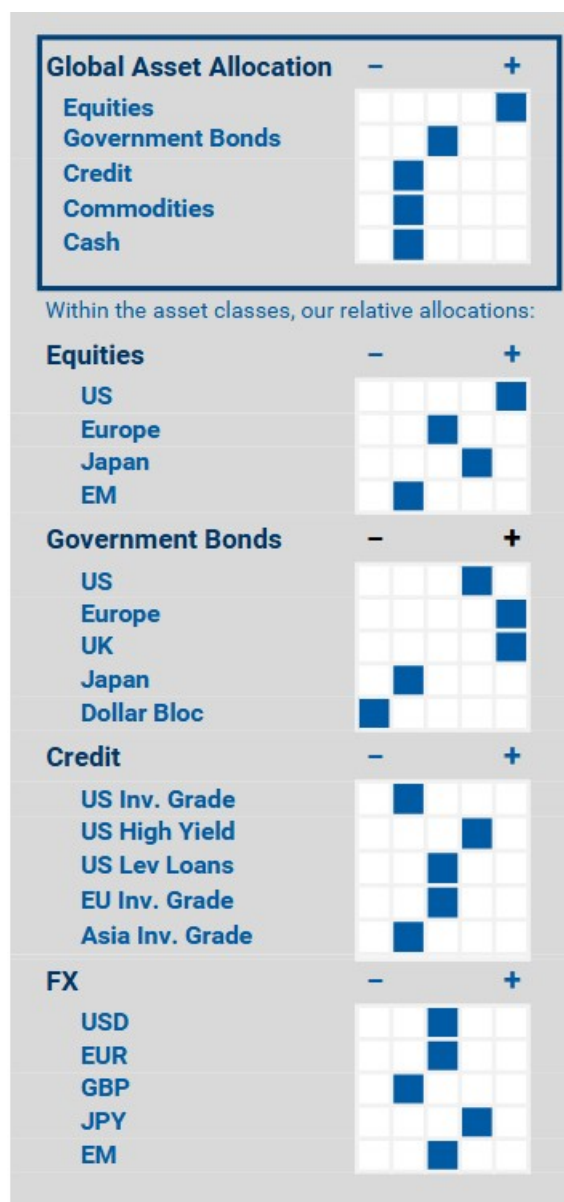
The Year of Risk Reboot

Risk assets are primed for a strong 2026, powered by micro fundamentals, accelerating AI capex, and a favorable policy backdrop. Global market outcomes will be shaped by US-led shocks, positive and negative. We recommend equities over credit and government bonds, with a preference for US assets.

Global Asset Allocation

	−				+
Equities					■
Government Bonds				■	
Credit		■			
Commodities		■			
Cash		■			

Within the asset classes, our relative allocations:

Equities

	−				+
US					■
Europe			■		
Japan				■	
EM		■			

Government Bonds

	−				+
US				■	
Europe					■
UK					■
Japan			■		
Dollar Bloc	■				

Credit

	−				+
US Inv. Grade		■			
US High Yield				■	
US Lev Loans			■		
EU Inv. Grade			■		
Asia Inv. Grade		■			

FX

	−				+
USD			■		
EUR			■		
GBP		■			
JPY				■	
EM			■		

Global equities – US ahead of the pack: US equities should outperform rest-of-world (RoW) stocks in 2026. The combination of positive operating leverage, supportive and pro-cyclical policy, and the potential for AI-driven efficiency gains drives our higher-than-consensus EPS assumption for the next two years. We also favor Japan equities, where the positive narrative resembles the US' story. We don't see similar tailwinds for Europe and EM equities, with the exception of Brazil and India.

G10 rates – overweight duration in 1H26: Yields stay range-bound in 2026, but it's a tale of two halves: a front-loaded rally as the Fed delivers 50bp of cuts in 1H, driving 10-year USTs to 3.75% by mid-year, before drifting up to 4.05% by 4Q. The 2s10s curve bull steepens to 145bp – the steepest level since 2021. In Europe, the ECB trims to 1.50% and holds, with Bunds ending 2026 near 2.45%. Gilts finish around 3.90% as the BoE heads toward 2.75%. Japan's curve steepens into 1Q but flattens by year-end as fiscal fears ease.

G10 FX – a choppy year ahead: The DXY is set to dip to 94 in 1H26 before rebounding to 99 by year-end. Risk currencies like AUD and SEK lead early gains on strong sentiment and local tailwinds, while falling US rates and fading risk premium push USD/JPY to a low of 140. European FX lose steam as ECB and BoE rate cuts diverge from a firmer US stance.

EM fixed income – good times roll into 2026: EM posts attractive returns across hard and local currency through 1H26, before 2H consolidation. Top-down conditions stay supportive with bottom-up fundamentals generally improving. BBs are the favored bucket in credit, with CEEMEA and LatAm to outperform Asia in local markets.

Corporate credit – animal spirits: 2026 sees more capex and M&A alongside easing fiscal, monetary, and regulatory policy. Carry dominates credit total returns as we expect some mild spread widening broadly, but there will be increasing variation in excess returns across ratings and regions. HY > IG in the US and Europe. Like 5-10-year in US/EU for good roll-down. Financials > cyclicals across regions. CDX and iTraxx exposure over cash.

Securitized products – regulatory relief arrives, finally: Deregulation in the US and EU bring back investors to support securitized products amid a positive backdrop tempered by snug valuations and heavy supply in competing asset classes. We recommend adding risk in shorter securitized credit, moving down in credit risk to conduit BBB-, and overweighting agency MBS versus IG credit. Affordability improves on the margin, but US home prices and housing activity stay range-bound.

Commodities – metals over energy: A soft supply/demand balance keeps Brent anchored around US$60/bbl. In metals, gold is our top pick, supported by macro factors and strong physical demand, which both look set to continue. We prefer copper and aluminum within industrial metals, with both facing significant supply challenges. In agriculture, we have a more constructive view toward soy prices.

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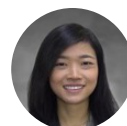
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Cross-Asset Strategy: The Year of Risk Reboot

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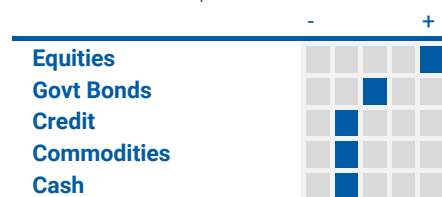+1 212 761-0826
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Exhibit 2:   Our top-down allocation

	-				+
Equities					■
Govt Bonds			■		
Credit		■			
Commodities		■			
Cash		■			

Source: Morgan Stanley Research

Key investment ideas

- **2026 is poised to be a strong year for risk assets:** A shifting focus from macro to micro along with the tailwinds of AI-related capex and a supportive policy mix make us constructive on risk assets.

- **It's all about US:** The US remains the most likely economy to drive material upside to global growth. Conversely, if there were to be a material slowdown, it probably has to come from a miscalculation about US growth. Thus, US-led shocks, positive and negative, should drive global market outcomes.

- **Financing of AI takes center stage:** Credit markets of all genres — unsecured, secured, securitized, structured — in both public and private credit markets will have an increasing role to play in enabling AI-related financing, which in turn leads to differentiated performance within credit

- **OW equities, turn EW high-quality fixed income:** Prefer US over RoW. Within spread products, HY and agency mortgages over IG.

2026 should be a strong year for risk assets, as support from an unusually pro-cyclical policy mix frees up markets to shift focus from the global macro concerns which have dominated this year to micro, asset-specific narratives — particularly those relating to AI-related investments. Such a constructive environment calls for a risk-on tilt: we recommend equities over credit and government bonds, with a strong preference for US assets.

Policy triumvirate triumphs

This has been a highly odd policy cycle: The triumvirate of fiscal policy, monetary policy, and deregulation all working together in a pro-cyclical way seldom happens at a time when the economy is *not* in or coming out of a recession (Exhibit 3). Across 2026-27, our US public policy strategists and economists are expecting the One Big Beautiful Bill Act (OBBBA) to reduce corporate tax bills by US$129 billion, even as any growth drag remains back-loaded. We see the administration prioritizing deregulation, and the Fed cutting by another 50bp into a stabilizing macro environment in 1H26, easing financial conditions. Although tariff risks and trade tensions persist, the most severe tariff levels

feared after Liberation Day have not materialized, and the pass-through to growth and inflation so far has been milder than expected. US equities stand to benefit most from this set-up.

Similar dynamics are unfolding globally. The ECB should ease rates as Germany ramps up fiscal spending, while the EU advances its Savings and Investments Union to spur retail demand for European assets. In China, we expect the PBOC to cut rates alongside a widening fiscal deficit and stronger policy support for AI and tech localization. While the circumstances and effectiveness of fiscal policy, monetary policy, and deregulation aligning across regions differ, **the key for risk assets is that this unusual global policy mix should turbo-charge riskier market segments in 2026, shifting focus away from the macro-driven cross-asset correlations that dominated in 2025.**

Exhibit 3: Over the last 50 years, the only other period when the Fed was easing and US government debt/GDP was rising when there's not been a recession was in the late 1980s

S&P 500 T12M Price Change
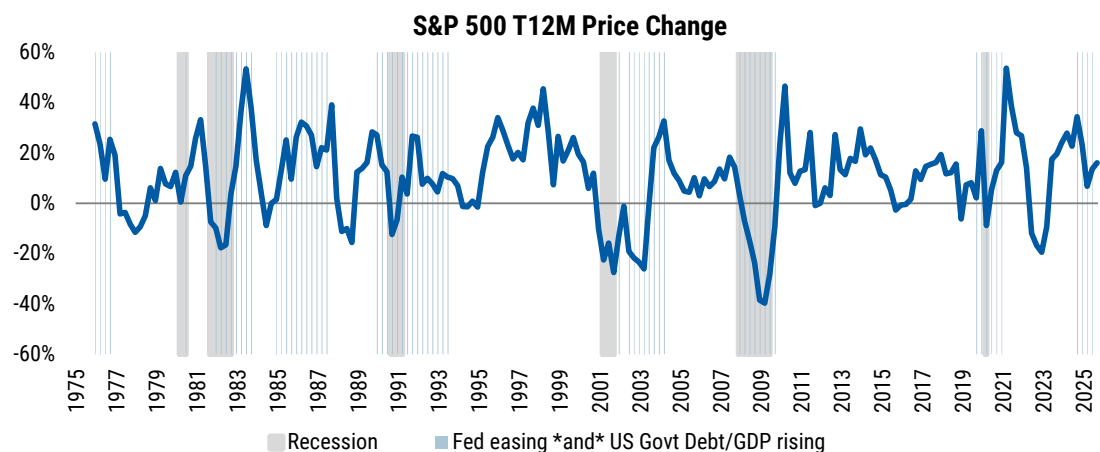
Source: Bloomberg, Haver Analytics, Morgan Stanley Research
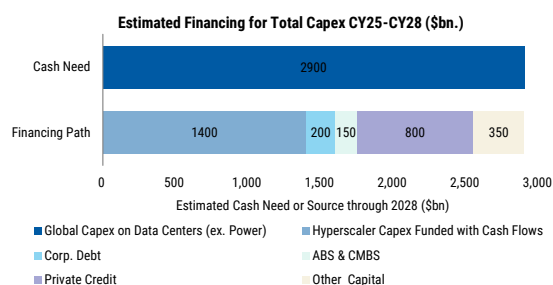
Market focus shifts from macro to micro

The supportive backdrop from pro-cyclical policies means that markets can move from the global macro concerns of 2025 to micro, asset class-specific stories that will drive performance over the next 12 months: Unlike this past year where trade tensions and policy uncertainty were *the* forces driving everything, markets should move to their own rhythm in the next year. For stocks, the core story – in the US especially – is earnings growth picking up, leadership broadening out, and cyclicals outperforming. For government bonds, it's the push and pull of weaker growth and inflation fears that keep yields range-bound. In credit markets, the focus moves toward the surge in AI capex-related issuance and a revival of M&A-related corporate activity, both of which should lead IG spreads wider, while HY stays more insulated. This pattern of micro stories dominating is likely to be true for markets outside the US too – for example, funding trajectories matter to idiosyncratic EM HY names. Macro concerns still matter, of course, but 'micro' will become a larger driver of asset returns in this cyclical recovery, in our view.

Much of AI and data center-related capex is still ahead

One of the major 'micro' stories is AI, both in terms of efficiency gains and how the large amount of hyperscaler capex spend can impact stocks and credit markets differently: Our view is that AI-related capex is *secular* and insulated from the ups and downs of the business cycle. It should continue to play a big role in setting up the basis for future productivity gains, although the full productivity boost should come with a lag. More importantly, much of the capex is still really ahead. For example, of the nearly US$3 trillion of data center-related capex we expect, the deployed capex amounts to under 20%. We expect the spend to pick up over the next few years. While about half of this spend will come from the operating cash flows of the hyperscalers, it still leaves a financing gap of US$1.5 trillion which needs to be sourced through various credit channels.

However, what matters *now* is how credit of all genres – unsecured, secured, securitized, structured – in both public and private credit markets will have an increasing role to play in enabling AI-related financing, which in turn leads to differentiated performance within credit: Our global corporate credit team projects substantial net issuance of investment grade corporate bonds in the US and Europe for 2026, largely from AI hyperscalers, while securitized credit markets could see significant data center ABS supply. Although demand for high-quality spread products should remain strong – particularly from US life insurers – we expect spreads of investment grade bonds and data center ABS to widen to absorb the additional supply.

Exhibit 4: Our estimated breakdown of data center financing needs (ex power)

Estimated Financing for Total Capex CY25-CY28 ($bn.)

Cash Need	2900
Financing Path	1400 · 200 · 150 · 800 · 350

Estimated Cash Need or Source through 2028 ($bn)

- Global Capex on Data Centers (ex. Power)
- Corp. Debt
- Private Credit
- Hyperscaler Capex Funded with Cash Flows
- ABS & CMBS
- Other Capital

Source: Morgan Stanley Research estimates

Exhibit 5: Even if we assume flows to fixed income to stay as strong as this year, they still pale in comparison to expected issuance in 2026

US Investment Grade

	$bn.
Net Issuance (2026e)	~1000
2025 YTD Net Flows	~500
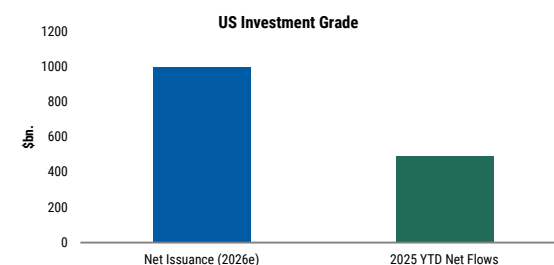
Source: Refinitiv, Haver Analytics, Federal Reserve, ICI, Morgan Stanley Research estimates; Note: Net flows include US ETF net share issuance, US mutual fund net new cash flow, pension fund flows for corporate and global bonds, international US corporate bond flows, and life insurance flows into corporate and global bonds. Year-to-date data as of September 2025 for ETF and mutual funds, and as of June 2025 for pension funds, insurance, and international flows. Credit flows across fund universes may not be mutually exclusive.

Our three high-conviction 'micro' calls for 2026:

US equities lead the pack

US equities should outperform rest-of-world (RoW) stocks in 2026: As we argued earlier, the policy triumvirate of fiscal policy, monetary policy, and deregulation should work in full force in 2026, and it's rare for this to be the case outside of recessionary periods. The benefits of these pro-cyclical policies will be the strongest for US companies, in our view, boosting growth. This, along with positive operating leverage and AI-driven efficiency gains, drives our higher-than-consensus EPS assumptions for the next two years.

There *will* be some bumps along the way, but we believe that the bull market is intact and that S&P 500 returns can beat other regions over the next 12 months.

We just don't see the same tailwinds for European and EM equities to what's driving our bullish view on US stocks. The European stocks outlook is still tied somewhat to global macro, both in terms of tepid forecasts for euro area growth next year on lingering tariff uncertainty, but also in terms of *structural* challenges, with the region losing ground in manufacturing as competition with China heats up. Similarly for EM, the broad outlook is driven in part by the macro story of China's slow reflation progress. **There are 'micro' narratives we like, though, including Indian and Brazilian stocks.** The former should see companies benefiting from strong domestic credit growth and GST cuts, while the latter can potentially see next year's presidential elections impact the market trajectory.

The narrative for Japanese equities resembles the US' positive 'micro' story more than Europe or EM's. ROE improvements boosted by fiscal and regulatory reforms under the Takaichi administration and domestic flows into equities should also support the market.

Exhibit 6:   Multiples across major equity markets are trading at extremes

Source: LSEG, Morgan Stanley Research

We note that our strong preference for US equities over Japan, then Europe followed by EM, is not a valuation-based call: Equity multiples across all the major markets are at or beyond the 80th percentile. Cyclically adjusted P/E (CAPE) for the S&P 500, currently at 38x, is close to the last peak in 2022; since 1921, the only instance when valuations were richer was during the dotcom bubble. We remain constructive on US equities *despite* these levels. It's worth remembering that elevated multiples aren't necessarily a headwind to forward returns, at least in the short term. History also suggests that rich valuations can persist when accompanied by strong macro drivers – the triumvirate of easy fiscal, monetary, and regulatory policy, along with AI tailwinds, should keep multiples supported for now.

Yield curve steepening continues

We see material UST curve bull steepening, much of which will materialize in the first half: The steepening should be driven by the front end as markets continue to underprice future Fed easing and growth slowdown tail risks, with the long end remaining mostly range-bound through 2026. We forecast UST 2-year yields to end 2026 at 2.60%, about 100bp lower from where we are now, and UST 10-year at 4.05%, 'only' 10bp from current levels, meaning the US 2s10s curve will bull steepen to 145bp. That's the steepest it's been

since 2021, but back then the move was driven by the *back end* moving higher on post-pandemic inflation concerns. The last time we saw bull steepening was in 2007-10 when front-end yields dropped on recession fears and eventually systemic risks from the global financial crisis.

Yield curves in the euro area and the UK are also expected to steepen, although to a much smaller degree than in the US. Japan is the exception — the curve steepens into 1Q26 as short-to-medium-term rate expectations are repriced lower, but then reverses course by year-end when long-end term premium gets priced out as fiscal concerns ease.

Exhibit 7: We're expecting the UST front end to decline considerably over 2026...

UST 2Y Yield (%)
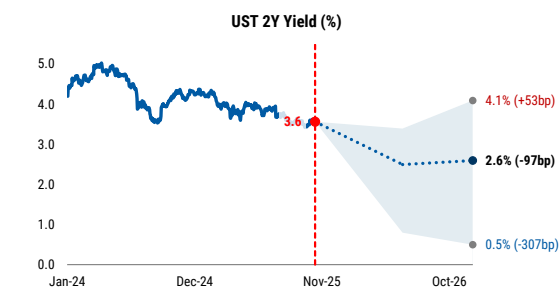
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 8: ...while the range-bound 10-year point means that the US 2s10s yield curve steepens to levels last seen in 2021

UST 2s10s Yield Curve (bp)
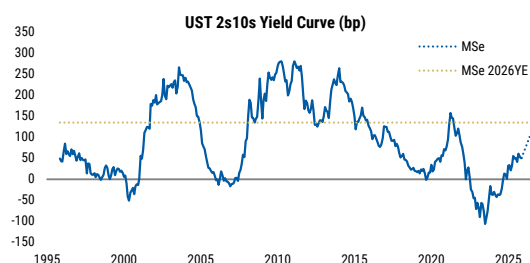
Source: Bloomberg, Morgan Stanley Research forecasts

Credit relative value opportunities abound

We expect significant shifts in relative value across the credit spectrum and see a ripe opportunity set of rotation in 2026: As noted earlier, credit markets at large have to contend with a substantial spike in issuance related to data center financing. Our corporate and securitized credit strategists expect that the data center financing-related issuance in 2026 will be predominantly in the IG space. While we continue to expect that credit fundamentals, both in corporate and securitized credit, will hold up, given the magnitude of issuance to come, spreads in IG as well as data center ABS will likely widen. Segments of the spread product markets that are relatively insulated from a spike in AI-related issuance (US HY, agency MBS, non-agency CMBS, and RMBS) are likely to outperform. From a relative value perspective, the prospect of the return of domestic bank demand for agency MBS after the Basel III rules are finalized means we favor agency MBS and senior tranches of securitized credit versus US IG corporate credit — supply technicals should weigh on IG spreads while demand technicals from the return of bank demand support agency MBS and securitized products. Greater animal spirits in the US compared to more tempered corporate activity in Europe means that European credit should outperform US credit over the next 12 months. And for EM credit, we forecast HY beating IG, both in excess and total return terms, as IG spreads struggle to rally with US IG spreads trending wider, while HY still has room to price out idiosyncratic risk premia. **Carry should still dominate credit total returns as we expect some mild spread widening broadly, but there will be increasing variation in excess returns across ratings and regions.**

Exhibit 9: Risk/reward across credit markets favors securitized products

Expected Excess Return/Risk
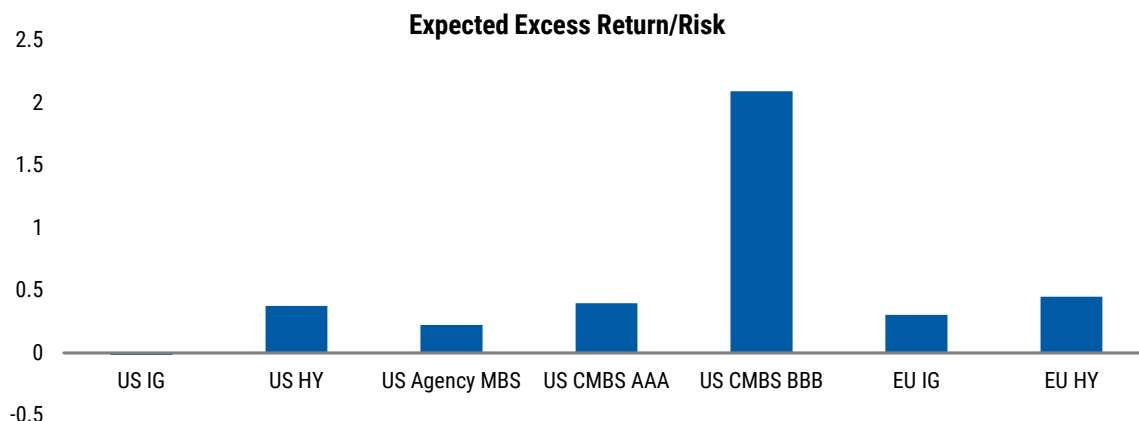
Source: Bloomberg, Morgan Stanley Research forecasts; Note: We show forecast excess returns versus government bonds, using Morgan Stanley 4Q26 forecasts. We use 10-year realized volatility as a proxy for risk.

A note on the dollar

For those keeping track, many of these **key investment themes and market views for 2026 we have laid out center on the US,** not unlike how they have been throughout this year. Also little changed is **our general preference for US assets over RoW** – with a few minor exceptions.

Exhibit 10: We are now expecting a tale of two halves for USD, with the dollar weakening in 1H26 and then rallying to end the year unchanged from where we are now

DXY Index
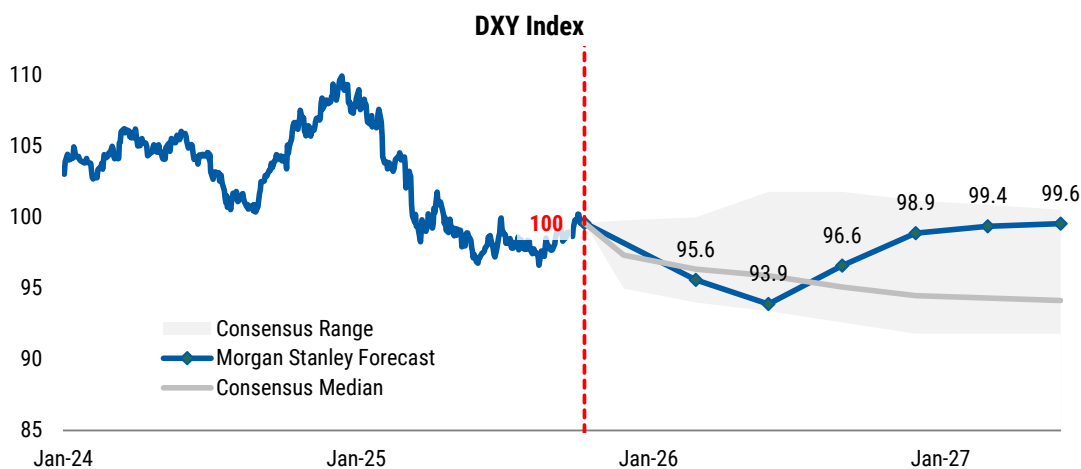
Source: Bloomberg, Morgan Stanley Research forecasts

What has changed the most on this front is that our FX strategists have turned less bearish on USD: While we still see USD weakness through 1H26, we now forecast DXY to end the year roughly unchanged. Notably, we are now *above consensus* on USD strength by the end of 2026. This reflects our view that there's scope for risk premium to rise early next year amid concerns about US labor market softness and uncertainty around whether the Fed's reaction function could change, before negative premium is priced out in 2H as clarity improves. What this means is that, **over a 12-month horizon, we are no longer recommending that investors should buy USD assets on an FX-hedged basis.** The dollar

won't be a big driver of outperformance for international investors holding USD assets, but it also won't be a large drag on returns, in our view.

Global economics outlook – at the crossroads

The US remains the most likely economy to drive material upside to global growth: Conversely, if there were to be a material slowdown, it probably has to come from a miscalculation about US growth. Consequently, our global scenarios are driven by US-led shocks. In their base case, our economists forecast the **US economy to expand by 1.8%Y as strong consumer and business spending** – especially in AI – help to offset labor market and trade headwinds. The euro area and China are also projected to see moderate growth, though China's nominal gains will be dampened by deflation. Inflation in major developed economies should move closer to central bank targets, and **monetary policy is expected to ease or remain neutral.**

Three alternative US-driven scenarios could shift this outlook: **demand-driven upside** with robust spending and rising inflation, **productivity-driven upside** fueled by rapid AI adoption and disinflation, and a **mild recession** triggered by tariffs, immigration constraints, and restrictive monetary policy, each with distinct implications for growth, inflation, and central bank actions.

For now, the Fed's conundrum is whether to take its signal from the slowing labor market or solid spending. Our baseline forecasts take elements from both, with the **Fed cutting to neutral on rising unemployment, but the economy recovering smartly in the second half.** Our two upside scenarios contrast stronger demand and productivity. Both have faster growth than the baseline, but in the first, the Fed shifts from policy easing to eventual rate hikes as jobs catch up to aggregate demand and inflation never abates. In the second, productivity drives disinflation, so the Fed can eventually cut despite the solid growth. In contrast, the downside scenario reflects the possibility that lags from past monetary policy depress growth further, tariffs have a larger drag on output, and immigration stunts growth more than we have modeled. However, even in this scenario, we think that a recession would be mild, to the extent that the Fed would not need to cut to zero.

Exhibit 11: Morgan Stanley growth, inflation, and policy forecasts

Region	Real GDP (%)		Core Inf. (%Y)		Policy Rate (%, EOP)	
	2026	2027	2026	2027	2026	2027
Global	3.2	3.2	2.1	2.2		
US	1.8	2.0	2.6	2.3	3.125	3.125
Eurozone	1.1	1.3	1.9	1.9	1.50	1.50
Japan	1.0	1.2	1.9	2.3	0.75	1.25
UK	1.2	1.8	2.1	2.3	2.75	3.00
China	5.0	4.5	0.6	1.1	1.30	1.30
India	6.4	6.4	3.8	4.0	5.25	5.75

Source: Morgan Stanley Research forecasts; Note: Global aggregates are GDP-weighted averages, using PPP weights. GDP and CPI figures represent 4Q/4Q estimates. Japan's core CPI is excluding energy and fresh food, and ex VAT and free child education impact. Policy rate indicated for Japan is the BoJ's uncollateralized overnight call rate upper limit; ECB deposit facility rate for the eurozone; 7-day reverse repo rate for China. Turkey, Egypt, and Argentina are excluded when calculating global aggregates. Saudi Arabia is excluded for core CPI aggregates.

What are the risks to our call?

AI investment cycle ending abruptly

Debate over AI-related capex centers on whether a sharp pullback in investment in the next 12 months could trigger cascading effects. A slowdown would likely pressure US equities, given hyperscalers' index weight — but could benefit IG credit by reducing issuance, the main driver of wider spreads in our forecasts. However, if the capex cycle's end raises concerns about off-balance sheet financing and ABS, fears of systematic risk could weigh on both credit and equities.

Animal spirits run *too* hot

Underlying our equities over credit over rates allocation is a return of animal spirits. But it's not the kind of irrational exuberance that marks the end of cycles, given the *rational* belief that the 'policy triumvirate' can stay supportive of risk. If sentiment overheats, our allocation tilts toward cyclicals and beta would be wrong. Historically, late-cycle expansions see IG outperform HY and equities, with bonds eventually leading returns.

Stronger growth emanating from outside of US

Our strategy base case assumes that the US will remain the primary driver of global markets in 2026, with all macro scenarios focused on US supply and demand shocks. However, stronger-than-expected growth from China could lift global growth, making our EM equity allocation appear conservative and pushing EM fixed income to outperform even our constructive outlook. At the same time, global reflation could prompt central banks to halt easing — or even start *hiking* — creating a large headwind for fixed income.

The Fed changing its reaction function

An alternative macro scenario involves the Fed becoming more inflation-tolerant with changes in FOMC composition. While we have conviction that this could mean risk premiums gets quickly priced back into the dollar, for other markets it's more uncertain. The UST curve would steepen as the front end rallies, but risk asset performance would hinge on whether it's bull or twist steepening. If duration underperforms amid rising term premiums and inflation expectations, IG could lag HY. Equities might benefit from stimulative Fed cuts but face valuation challenges if back-end rates rise and discount rates surge.

US public policy outlook — six FAQs for 2026

Michael Zezas, Ariana Salvatore

1) US policy choices in many ways drove outcomes for economies and markets in 2025. Should we expect more of the same in 2026? Probably not. Of the four key policy variables critical in 2025 —tariffs, immigration, fiscal policy, and deregulation — we think that most are now well-understood or have limited potential ahead. Tariffs remain relevant, but we think that most trade policy uncertainty is behind us. Policy risk persists in 2026, but is likely less influential than the corporate choices being made to manage these policy decisions.

2) How disruptive might tariffs be next year? We think that trade policy uncertainty is largely post-peak but risks remain skewed toward directionally higher tariffs. Our rationale:

1. Rolling deadlines on bilateral negotiations (China, Mexico);
2. The administration's stated intent to impose further Section 232 tariffs (semiconductors, pharmaceuticals);
3. Execution risk in bilateral trade 'deals' that lack congressional enforcement.

We also see two catalysts prolonging uncertainty: 1) The upcoming USMCA review (mid-2026), which will be critical for reshoring and the North American auto supply chain; and 2) An impending SCOTUS decision on IEEPA tariffs, which could trigger new Section 232/301 investigations even if current tariffs are overturned.

3) Should we expect more fiscal stimulus next year? No, but keep an eye out for executive actions. We see limited scope for further stimulus before 2027 following the passage of the One Big Beautiful Bill Act (absent a reactive fiscal policy in the event of a recession, a low-probability outcome according to our economists) given procedural constraints and a lack of broader party consensus on the issue. Executive actions (e.g., tariff rebate checks) would likely require congressional approval. Post-midterms, proactive fiscal policy largely depends on unified government; divided control typically results in gridlock.

4) Will the filibuster go away? Probably not, but its removal would ease a path toward fiscal expansion regardless of which party is in power. While we currently don't see sufficient Republican consensus for a second fiscal package, the elimination of the filibuster would reduce procedural hurdles if that consensus builds or crisis conditions arise, necessitating a response from Congress.

5) Are the midterms a catalyst for market outcomes? We wouldn't count on it. The major 2025 policy changes occurred via executive authority, which we expect is likely to continue, particularly if Democrats gain control of at least one chamber of Congress. Outperformance by Democrats could produce signaling legislation (e.g., resolutions of disapproval, efforts to reassign tariff authority to Congress), though a presidential veto remains probable.

6) What else is on the agenda? We expect continued deregulation, notably in energy and financial sectors. This dovetails with the administration's push toward alleviating the AI power bottleneck, vis-à-vis both executive action (easing permitting processes, leveraging the DPA) and taking more direct stakes in certain critical sectors. These initiatives align with the bipartisan policy trajectory on US-China competition. We provide takeaways from our recent AI and national security discussions in Washington.

Cross-asset allocation recommendation

Exhibit 12: Our asset allocation recommendation

Asset	Allocation	OW/UW	vs Bnch	vs Last
EQUITIES		+5%		+5%
US		+5%		+1%
Europe		+0%		+0%
Japan		+4%		+4%
EM		-4%		+0%
CORE FIXED INC.		+0%		-7%
Govt Bonds		+2%		-1%
USTs		+2%		-1%
EGBs		+0%		+0%
Agency MBS		+3%		+1%
IG Corporate		-5%		-7%
US IG Corp		-4%		-7%
EUR IG Corp		-1%		+0%
OTHER FIXED INC.		+2%		+5%
US HY Corp		+3%		+5%
EM $ Sov		+0%		+0%
EM Local		-2%		+0%
US Lev Loans		-1%		+0%
CLO AAA		+2%		+0%
COMMODITIES		-4%		-1%
Brent		-2%		+0%
Gold		-1%		-1%
Copper		-1%		+0%
CASH		-3%		-2%

Source: Morgan Stanley Research; Note: Overweights and underweights are versus our cross-asset benchmark; see Morgan Stanley Cross-Asset Benchmark for the full breakdown.

We recommend an OW in stocks, EW in core fixed income, EW in other fixed income, UW in commodities, and UW in cash.

OW equities (+5% versus benchmark): We add to our US OW on pro-cyclical policy aiding the rolling earnings recovery. We turn OW on Japanese stocks on reflation and ROE gains driving above-consensus EPS growth. We stay EW on Europe as lingering uncertainty leaves EPS muted, with upside reliant on multiple expansion. EM remains UW; while regions like India and Brazil look attractive, we are below-consensus on EPS and slow China reflation is a risk.

EW core fixed income (+0% versus benchmark): We pare back US Treasuries, but duration remains compelling over the next six months, so we avoid an UW. We upgrade agency MBS to OW from EW as regulatory and rate stability boost demand. This is funded by moving US IG to UW from OW; AI-related issuance and more aggressive corporate activity widen IG spreads, causing underperformance.

EW other fixed income (+2% versus benchmark): We go OW HY from EW, as better earnings growth and lower supply relative to IG mean reasonable excess returns. We continue to like CLO AAA – the tranche screens cheap within the cap structure, and demand from banks and insurers should keep the asset class well-supported.

UW commodities (-4% versus benchmark): Our commodities strategists remain bearish on Brent. While the team is constructive on gold and sees some upside from here, return adjusted for vol is not particularly attractive.

Exhibit 13: Discretionary allocation expected risk/reward

Metric	MS Cross-Asset Ptf	MS XA Benchmark	USD 60/40 Ptf
RISK REWARD			
Expected Return	10.4%	9.0%	11.7%
Vol	9.0%	8.7%	10.1%
Rtn/Vol	1.16	1.04	1.16
HISTORICAL RISK REWARD			
Historical Return	8.3%	7.7%	7.3%
Historical Vol	9.0%	8.7%	10.1%
Historical Rtn/Vol	0.93	0.89	0.73
RISK PROFILE			
Downside Dev*	1.8%	1.9%	1.9%
VaR*	-4.8%	-4.1%	-4.3%
cVaR*	-6.1%	-6.5%	-6.1%
Note:			
Based on trailing 10Y monthly returns.			

Source: Morgan Stanley Research forecasts; Note: Expected returns show FX-hedged returns.

Exhibit 14: Discretionary allocation betas

Metric	MS Cross-Asset Ptf	MS XA Benchmark	USD 60/40 Ptf
vs EQUITIES			
MSCI ACWI (H)	0.73	0.75	0.72
S&P 500	0.64	0.66	0.65
vs FIXED INCOME			
Global AGG (H)	1.24	1.42	1.45
US AGG	0.93	1.10	1.11
UST	0.45	0.60	0.66
vs COMMODITIES			
WTI	0.09	0.09	0.07
Gold	0.09	0.17	0.13
Copper	0.20	0.24	0.20
vs FX			
DXY	-0.62	-0.82	-0.70
EUR	0.46	0.62	0.50

Source: Morgan Stanley Research forecasts

Exhibit 15:

How do assets stack up combining a top-down cycle-adjusted fair value view and bottom-up strategists' next 12M forecasts?

Asset	(A) Top-Down Expected Returns			(B) Bottom-Up	(C) Framework Forecast	(D) Framework R/R	MS Cross-Asset			
	LTCMA	Cycle Drag/ Boost	Cycle-Adj. Rtn	MSe	Rtn Less Cash	Rtn/Vol	Alloc	OW/UW	vs Bench.	vs Last
EQUITIES								+5%	5	
US Eqty	7.3%	-7.2%	0.1%	15.1%	3.8%	0.2	35%	+5%		+1%
European Eqty	7.4%	-7.9%	-0.5%	7.5%	1.6%	0.1	10%	+0%		+0%
Japan Eqty	7.3%	-3.9%	3.3%	10.6%	5.3%	0.4	9%	+4%		+4%
EM Eqty	3.5%	2.6%	6.1%	2.1%	0.3%	0.0	6%	-4%		+0%
CORE FIXED INC.								+0%	0	-7%
GOVT BONDS							18%	+2%		-1%
USTs	4.5%	1.6%	6.1%	6.8%	2.6%	0.5	12%	+2%		-1%
EGBs	3.6%	-3.2%	0.3%	4.8%	0.6%	0.1	6%	+0%		+0%
SECURITIZED							8%	+3%		+1%
Agency MBS	4.7%	1.0%	5.6%	7.2%	2.6%	0.5	8%	+3%		+1%
IG CORPORATE							2%	-5%		-7%
US IG Corp	4.8%	-0.7%	4.1%	6.7%	1.6%	0.2	1%	-4%		-7%
EUR IG Corp	3.0%	-2.1%	0.8%	4.8%	0.9%	0.2	1%	-1%		+0%
OTHER FIXED INC.								+2%	2	
US HY Corp	4.2%	-6.1%	-1.9%	7.7%	-0.9%	-0.1	5%	+3%		+5%
EM $ Sov	4.6%	-2.8%	1.7%	9.9%	2.0%	0.2	2%	+0%		+0%
EM Local	~	~	~	6.2%	2.4%	0.6	2%	-2%		+0%
US Lev Loans	~	~	~	6.6%	2.8%	0.5	0%	-1%		+0%
CLO AAA	~	~	~	5.6%	1.8%	0.9	3%	+2%		+0%
COMMODITIES								-4%	-4	-1%
Brent	~	~	~	-3.7%	-7.5%	-0.2	0%	-2%		+0%
Gold	~	~	~	3.2%	-0.6%	0.0	0%	-1%		-1%
Copper	~	~	~	-2.4%	-6.2%	-0.3	0%	-1%		+0%
CASH								-3%	-3	-2%
Cash	~	~	~	3.8%	0.0%		0%	-3%		-2%

Source: Morgan Stanley Research; Note: 'vs Last' is versus last published November 2, 2025. For (C) we are using average of (A) and (B) less cash.

Exhibit 16: Morgan Stanley 2026 bull/base/bear forecasts

	As of Nov 12, 2025	Q4 2026 Forecast			Q4 2026 Return Forecast			Volatility	Base Case Return/Risk
		Bear	Base	Bull	Bear	Base	Bull		
Equities					**Total Returns**				
S&P 500	6,851	5,600	7,800	9,000	-17.1%	15.0%	32.5%	18%	0.81
MSCI Europe	2,343	1,920	2,430	2,700	-15.1%	6.7%	18.2%	15%	0.44
Topix	3,359	2,440	3,600	4,250	-25.2%	9.3%	28.7%	19%	0.49
MSCI EM	1,408	960	1,400	1,800	-29.5%	1.7%	30.1%	16%	0.11
FX					**Total Returns**				
JPY*	155	163	147	125	-8.6%	2.2%	20.8%	9%	0.24
EUR	1.16	1.05	1.16	1.36	-11.1%	-1.6%	15.6%	7%	-0.22
GBP	1.31	1.21	1.29	1.45	-7.8%	-1.7%	10.4%	9%	-0.18
AUD	0.65	0.61	0.67	0.75	-6.7%	2.5%	14.7%	10%	0.24
INR*	88.6	92.0	88.4	86.0	-1.2%	2.4%	5.0%	5%	0.51
ZAR*	17.1	18.7	17.8	16.4	-5.8%	-1.2%	7.0%	16%	-0.08
BRL*	5.29	6.20	5.20	4.75	-6.3%	10.1%	19.8%	16%	0.65
MXN*	18.3	21.0	18.2	17.5	-8.9%	4.8%	8.5%	13%	0.38
Rates (% percent)					**Total Returns**				
UST 10yr	4.07	5.15	4.05	2.65	-3.3%	5.3%	16.9%	7%	0.79
DBR 10yr	2.64	2.90	2.45	2.05	1.1%	5.0%	8.5%	6%	0.88
UKT 10yr	4.40	4.65	3.90	3.25	3.3%	9.1%	14.4%	7%	1.38
JGB 10yr	1.68	2.30	1.65	1.05	-2.9%	2.7%	8.2%	2%	1.08
Credit (bps)					**Excess Returns**				
US IG	82	140	95	70	-3.2%	-0.1%	1.6%	3%	-0.03
US HY	283	450	300	250	-2.9%	1.8%	3.5%	6%	0.30
EUR IG	81	150	90	60	-2.3%	0.4%	1.8%	2%	0.23
EUR HY	274	450	280	225	-4.1%	1.7%	3.5%	5%	0.36
EM $ Sov	268	400	260	225	-6.2%	3.0%	5.3%	7%	0.42
Sec. Products (bps)					**Excess Returns**				
US Agency MBS	28	50	25	15	-1.0%	0.5%	1.1%	2%	0.25
US CMBS AAA	74	110	75	60	-2.8%	0.6%	2.1%	2%	0.40
US CMBS BBB-	500	750	475	390	-19.8%	7.5%	15.9%	4%	2.10
Commodities					**Total Returns**				
Brent	63	50	60	120	-19.7%	-3.7%	92.7%	39%	-0.10
Copper	10,930	8,700	10,600	12,700	-19.9%	-2.4%	17.0%	21%	-0.11
Gold	4,137	3,825	4,500	5,400	-12.6%	2.8%	23.4%	15%	0.19

Source: Bloomberg, MSCI, Morgan Stanley Research forecasts; Note: Returns are total returns, except for credit, where we forecast excess returns versus government bonds. Commodity returns are calculated relative to futures to account for carry. Volatility is 10y realized vol. All currency returns are shown as XXXUSD return. *Currency forecasts shown for USDXXX.

What's changed

Exhibit 17: What's changed in our forecasts – economics

What's Changed - Economics

	Old Forecasts		New Forecasts		Δ from Last F'cast	
Real GDP (%)	2025e	2026e	2025e	2026e	2025e	2026e
Global	2.5	2.8	3.0	3.2	0.5	0.4
G10	0.9	1.0	1.2	1.5	0.3	0.5
US	1.0	1.0	1.6	1.8	0.6	0.8
Euro Area	0.8	1.0	1.1	1.1	0.3	0.1
Japan	0.3	0.6	0.0	1.0	-0.3	0.4
UK	0.7	1.7	1.0	1.2	0.3	-0.5
EM	3.8	4.2	4.3	4.5	0.5	0.3
China	4.0	4.2	4.6	5.0	0.6	0.8
India	5.9	6.4	6.3	6.4	0.4	0.0
CPI (%Y)						
Global*	2.1	2.0	1.8	2.0	-0.3	0.0
G10	2.4	2.1	2.6	2.2	0.2	0.1
US	3.0	2.5	2.9	2.6	-0.1	0.1
Euro Area	1.8	1.8	2.0	1.7	0.2	-0.1
Japan	1.7	1.7	2.6	1.6	0.9	-0.1
UK	2.6	1.8	3.4	1.9	0.8	0.1
EM*	1.9	1.9	1.3	1.9	-0.6	0.0
China	0.3	0.5	0.2	0.3	-0.1	-0.2
India	3.6	3.6	1.1	4.1	-2.5	0.5

Source: Morgan Stanley Research forecasts; Note: 'Old forecasts' refers to forecasts published on May 20, 2025. Real GDP and headline CPI are shown as %4Q/4Q. Global and regional aggregates are GDP-weighted averages, using PPP weights. Japan headline inflation includes VAT and free education impact. Turkey, Egypt, and Argentina are excluded when calculating global aggregates.

Exhibit 18: What's changed in our forecasts – assets

Base Case Forecasts	Old Forecasts	New Forecasts	Δ from Last F'cast
	Q2 2026	Q4 2026	
Equities			
S&P 500	6,500	7,800	20%
MSCI Europe	2,250	2,430	8%
Topix	2,900	3,600	24%
MSCI EM	1,200	1,400	17%
FX			
USD/JPY	130	147	13%
EUR/USD	1.25	1.16	-7%
GBP/USD	1.45	1.29	-11%
Rates (% percent)			**(bp Δ)**
UST 10yr	3.45	4.05	60
DBR 10yr	2.35	2.45	10
UKT 10yr	4.10	3.90	-20
JGB 10yr	0.90	1.65	75
Credit (bps)			**(bp Δ)**
US IG	90	95	5
US HY	335	300	-35
EUR IG	110	90	-20
EUR HY	335	280	-55
EM Sovs	361	260	-101
Securitized Credit (bps)			**(bp Δ)**
US Agency MBS	35	25	-10

Source: Morgan Stanley Research forecasts; Note: 'Old forecasts' refers to forecasts published on May 20, 2025.

Key Calls by Asset Class

US
Japan
Europe
EM

Equities – US leads the pack: US equities should outperform in 2026, supported by earnings strength and policy tailwinds. Japan benefits from reflation and improving ROE, while Europe faces headwinds from China competition. EM remains least favored on full valuations and fading FX support. **In the US, we prefer cyclicals over defensives and forecast the S&P 500 at 7,800 by end-2026.**

UK
Euro area
US
Japan
Dollar Bloc

Government bonds – overweight duration in 1H26: Treasuries, Bunds, and gilts rally into mid-2026 on policy easing; term premium rebuilds in the back half. JGBs richen into 1Q26, then cheapen as BoJ hikes are priced. Curves steepen in the US, Europe, and dollar bloc, and bear flatten in Japan. **We see UST 10Y at 4.05%, DBR 10Y at 2.45%, JGB 10Y at 1.65%, and US 2s10s at 145bp by end-2026.**

JPY
EM
EUR
USD
GBP

FX – DXY's year of two halves: USD weakens into 2Q26 on US-RoW rate convergence and buoyant risk appetite, then rebounds as long-end US yields rise and risk premium recedes. AUD and SEK outperform, EUR rallies with US front-end rates then fades as US growth outstrips Europe. USD/JPY troughs at 140 before rebounding in 2H. **We see EUR/USD at 1.16 and USD/JPY at 147 in 4Q26.**

EM Credit
EM Local Rates
EM FX

EM fixed income – credit and local rates > FX, HY > IG: Yields should head down in 1H26, driven by USTs and rate cuts. In EM FI markets, we see LatAm and CEEMEA outperforming with Asia lagging. We like CLP, KRW, and MYR while TRY could offer attractive carry. We see value in Brazil, Mexico, Thailand, and China rates. **In credit, we see index spreads reaching 260bp by end-2026.**

US High Yield
EU Inv. Grade
US Lev Loans
Asia Inv. Grade
US Inv. Grade

Corporate credit – more animal spirits: Going into 2026, we see more capex and M&A, alongside a triple easing in fiscal, monetary, and regulatory policy. Given better covenants, earnings growth, and relative supply, **we like HY > IG in the US and Europe. We continue to prefer financials > cyclicals across regions.**

US ABS
European ABS
US Resi Credit
US Non-Agency CMBS
US Agency MBS
Global CLOs
US Agency CMBS

Securitized products – bullish on beta: Deregulation and freed-up capital at banks should be supportive for most securitized products next year. **We like moving down in credit risk to conduit BBB-, and prefer agency MBS to IG credit.**

Gold
Copper
Brent

Commodities – metals over energy: Gold is our top pick given continued support from macro factors and strong physical demand, and copper prices should rise on supply challenges. **We see gold at US$4,500/oz and copper at US$10,600/ton, while Brent oil should remain anchored around US$60/bbl due to a soft supply-demand balance.**

Our Global View in Charts

Exhibit 19: Earnings revisions breadth in the US is rebounding once again

S&P 500 Earnings Revisions Breadth

May 2024

April 2025
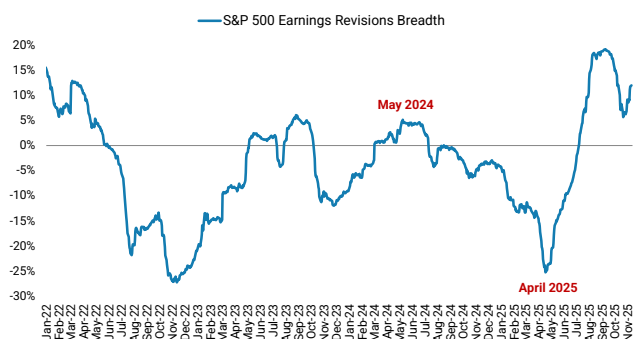
Source: FactSet, Morgan Stanley Research

Exhibit 21: We stand 5% above consensus on TOPIX EPS and forecast a 16% rebound in 2026

Bull Dec-27: 250
Base Dec-27: 240
Bear Dec-27: 200
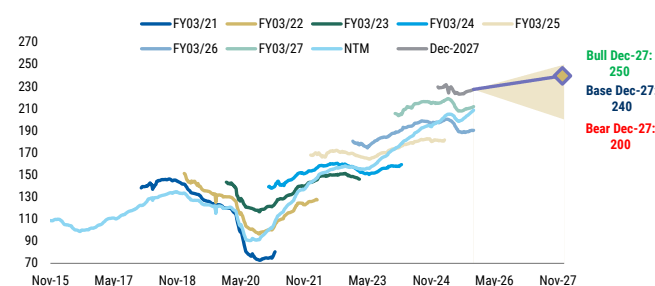
Source: Bloomberg, FactSet, QUICK Workstation, INDB, Morgan Stanley Research; Note: Data as of November 9, 2025.

Exhibit 23: Issuance, net of redemptions and central bank purchases
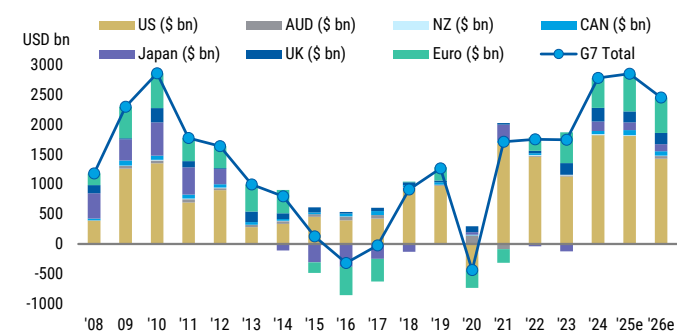
Source: National central banks, national treasuries, Morgan Stanley Research estimates

Exhibit 20: FX is a major determinant of European relative earnings revision trends versus the US

MSCI Europe vs US: FY2 Earnings Revision Breadth & EUR/USD cycles
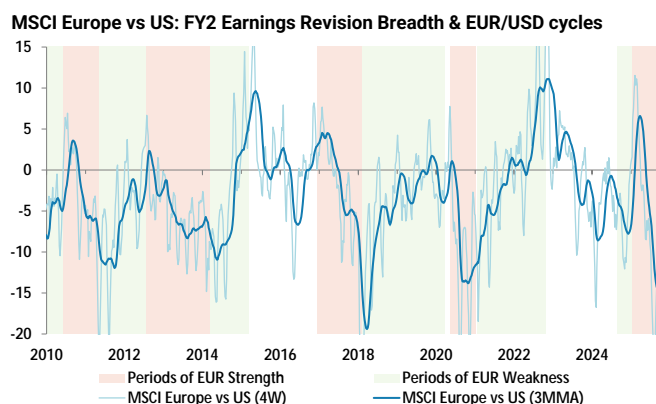
Source: IBES, LSEG Data & Analytics, Morgan Stanley Research

Exhibit 22: Within MSCI EM, semiconductors and equipment both currently have exceptional profitability and valuation premia
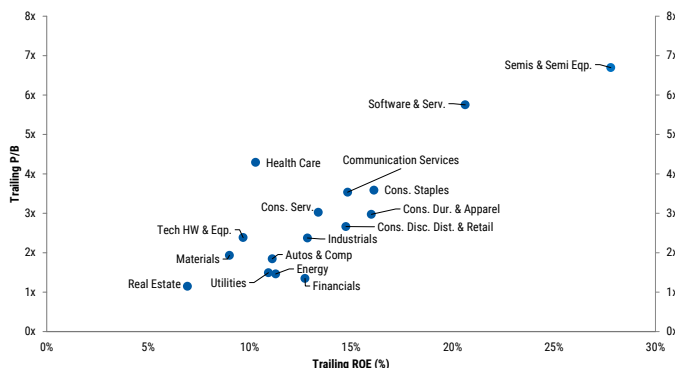
Source: FactSet, Morgan Stanley Research; Note: Data as of November 12, 2025.

Exhibit 24: Morgan Stanley's forecast of USD-negative risk premium over 2026

Expected USD-Negative Risk Premium in the DXY (% vs Predicted Value)

DXY Bull Case 3.8%
1.9%
-2.9%
DXY Bear Case
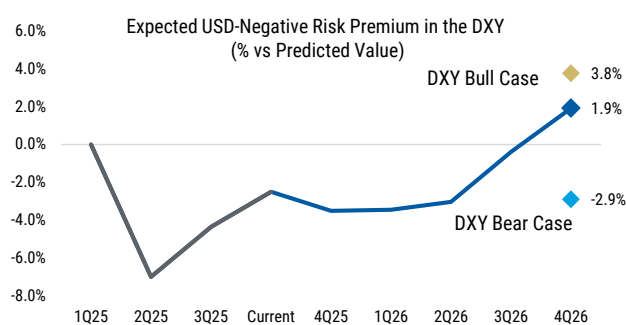
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 25: Global EM quarterly forecast returns

Legend:
- Sov Credit (TR)
- Sov Credit (Excess Return)
- Local Bonds (TR - $)
- Local Bonds (duration + carry)
- FX Spot
- FX TR

Source: Morgan Stanley Research forecasts

Exhibit 26: Comparing 2026 with 2005 and 1997/98 (US market data)

	Capex YoY	Capex Ex-Energy YoY	M&A YoY	M&A (% of GDP)	US 10yr (YE)	Core PCE (YE)	US U-3 Unemply.
1997	7%	5%	40%	24%	5.7	1.9	4.9
1998	9%	10%	38%	32%	4.6	1.5	4.5
2005	14%	9%	31%	29%	4.1	2.3	5.1
Avg. ('97-98, '05)	11%	8%	35%	29%	4.6	2.0	4.9
2026e	**9%**	**10%**	**20%**	**21%**	**4.1**	**2.6**	**4.6**
Diff	-1%	2%	-15%	-7%	-0.6	0.6	-0.3

Source: Dealogic, Bloomberg, Morgan Stanley Research estimates; Note: Capex is for the Russell 3000, M&A is global announced M&A. For 2026, we use Morgan Stanley estimates for announced M&A and technology capex.

Exhibit 27: Tighter lending standards lead to better performance as non-QM credit scores increase
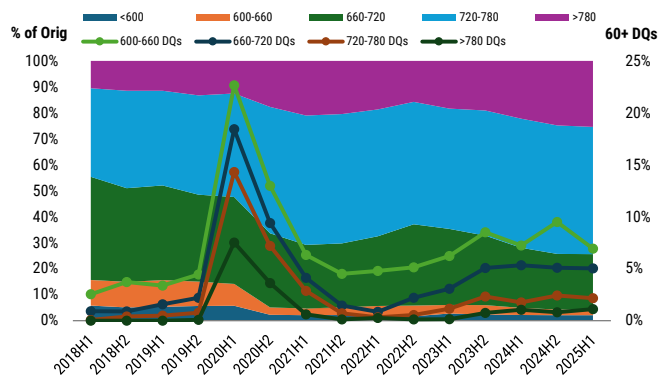
Legend:
- <600
- 600-660
- 660-720
- 720-780
- >780
- 600-660 DQs
- 660-720 DQs
- 720-780 DQs
- >780 DQs

Source: Loan Performance, Morgan Stanley Research; Note: Area chart refers to FICO distribution for each semi-vintage of originations on the left axis. Line charts show 60+ delinquencies for the relevant FICO bucket on the right axis.

Exhibit 28: Munis gross supply to reach a new record

Muni Gross Supply (in Bn $)

Source: Bloomberg, Morgan Stanley Research

Exhibit 29: Oil inventories have increased rapidly from both OPEC and non-OPEC supply

Observable crude oil and oil products inventories
On land, at sea and in-transit (mln bbl)
— 2021 — 2022 — 2023 — 2024 — 2025
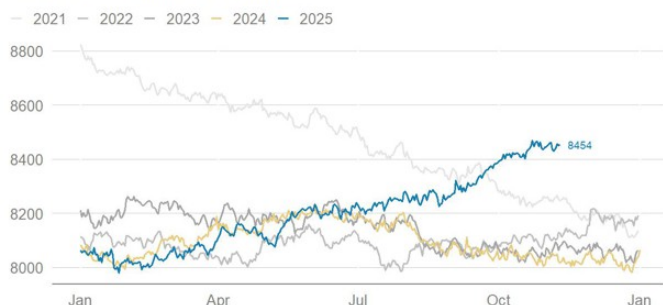
Note: Inventories include SPR
Source: IEA, EIA/DOE, PJK, IE, Genscape, PAJ, Platts, Vortexa, Morgan Stanley Research

Source: IEA, EIA/DOE, PJK, IE, Genscape, PAJ, Platts, Vortexa, Morgan Stanley Research; Note: Inventories include SPR.

Exhibit 30: ETF inflows have been a big support for gold this year

Gold and ETF Gold Holdings
— Gold, $/oz — ETF Holdings (mln oz, RH Axis)

Source: Bloomberg, Morgan Stanley Research

Global Equities: Earnings and Policy Tailwinds Support US Outperformance

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Exhibit 31: Equities top-down preferences

Equities	-				+
US					■
Europe			■		
Japan				■	
EM		■			

Source: Morgan Stanley Research

Exhibit 32: Equity index targets

4Q26 Target	Base	Next 3-6M Tilt
S&P 500	7,800	Constructive
MSCI Europe	2,430	Constructive
TOPIX	3,600	Constructive
MSCI EM	1,400	Neutral

Source: Morgan Stanley Research forecasts

Key investment ideas

- **US:** We raise our 12-month S&P 500 price target to 7,800 (22x forward EPS of US$356). This expectation incorporates higher-than-consensus EPS throughout our forecast horizon. We expect a broadening in leadership both in terms of price performance and earnings contribution.

- **Europe:** Benefits from US-led broadening with EPS growth picking up versus prior years but still well below consensus (MSe +3.6% in 2026 versus consensus at 12.7%). Europe's wide discount leaves room for further re-rating to 16x on rising investor hopes for a more meaningful EPS recovery in outer years.

- **Japan:** Reflation and ROE journey continues under new PM leadership. Our revised USD/JPY forecast profile is also likely to support moderately above-consensus earnings growth. Our TOPIX target rises to 3,600 (+7%)

- **EM:** With full valuations and reduced EM FX tailwinds, we see flat returns to our 1,400 target. We prefer India, Brazil, and UAE into 2026 and sector-wise like financials, consumer discretionary/e-commerce, and industrials. China reflation is only likely from 2027 onwards.

On the global stage, we continue to prefer US equities: Earnings strength is the main driver of our preference for owning **US** equities on a relative basis. We forecast a 14% 2025-27 EPS CAGR for the S&P 500, outpacing the TOPIX at 12%, MSCI EM at 11%, and MSCI Europe at 5%. Positive operating leverage, the re-emergence of pricing power, easy comparisons for the average stock, AI-driven efficiency gains, and growth-positive tax and regulatory policies support our constructive view on US earnings and cash flow growth throughout our forecast horizon. Our out-of-consensus view that the US equity market is entering an early-cycle environment suggests that small-cap stocks and economically sensitive pockets of the market should see outsized earnings growth relative to large-cap stocks. We also see an attractive return profile in **Japan** over the next 12 months (7% upside) driven by Takaichi administration beneficiaries in defense, infrastructure, and IP as well as ongoing reflation and reform. In **Europe,** we see a continued catch-up trade to the US but see lagging and below-consensus earnings growth. Finally, in **EM,** we prefer financials, industrials, and select e-commerce/internet names, with a market preference for India, Brazil, and UAE.

Exhibit 33: S&P 500 EPS growth revisions have reaccelerated post 'Liberation Day'

Next 12M EPS Growth Revisions
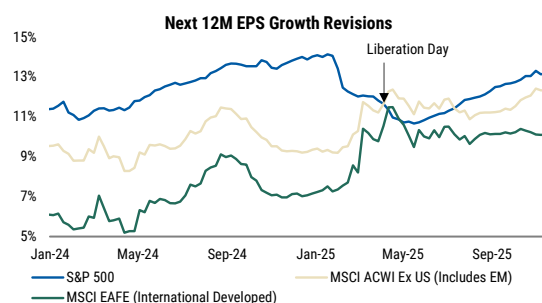
Source: FactSet, Morgan Stanley Research; Note: Based on bottom-up consensus revisions.

Exhibit 34: US relative performance versus international equities remains in a long-term uptrend

S&P 500 Vs. MSCI ACWI Ex US Relative Performance
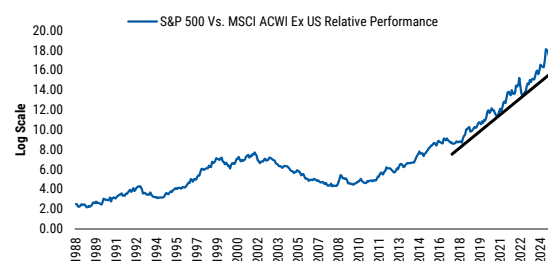
Source: FactSet, Morgan Stanley Research

Exhibit 35: US shows relative strength from an ROE...

ROE
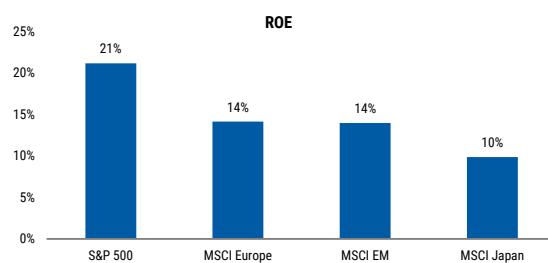
Source: FactSet, Morgan Stanley Research

Exhibit 36: ...and profit margin standpoint

Net Margin
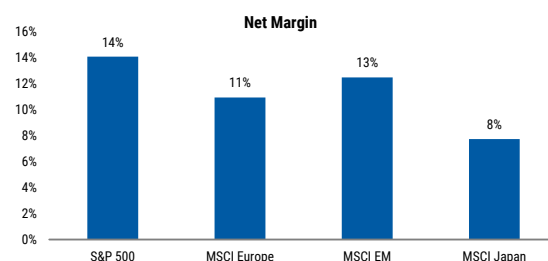
Source: FactSet, Morgan Stanley Research

Tying in valuation: While the US trades at a valuation premium versus international equities, we think that this is justified by attractive structural tailwinds and relative earnings strength. Furthermore, this valuation gap is not as wide as it was a year ago. Specifically, the S&P 500's relative forward P/E ratio versus MSCI All Country World Ex US has compressed by nearly 10% since late last year (Exhibit 37), coming closer to the historical median of this gauge. At the S&P 500 level, we expect the market multiple to decline modestly relative to current levels, but stay elevated versus history at 22x. Our analysis shows that it's quite uncommon to see significant valuation compression in periods of above-median earnings growth (~7-8%) and accommodative monetary policy (Exhibit 38). We see ~1 turn of multiple compression in both Japan (from 16x to 15x) and EM (from 13.9x to 13x). Meanwhile, we see multiple expansion in Europe (from 15.2x to 16.0x) as the US broadening trend and adoption ROI phase fuel investor expectations of a more meaningful outer-year recovery in European earnings.

Exhibit 37: S&P 500 versus MSCI ACWI ex US relative valuation has consolidated over the past year
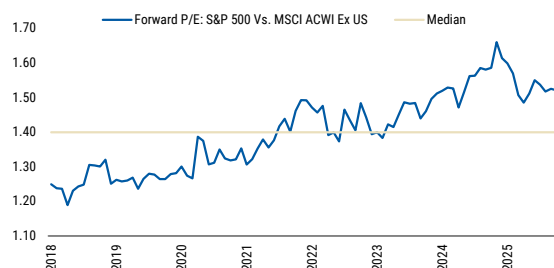
Source: FactSet, Morgan Stanley Research.

Exhibit 38: It's rare to see multiple compression in the US when EPS growth is above the long-term median and the Fed is accommodative

S&P 500 Fwd. P/E 12M Rate of Chg. in > Median EPS Growth + Accommodative* Fed Policy Environments	
Avg.	8.1%
Median	5.6%
Positive Hit Rate	91%
Max	22.6%
Min	-4.4%

Source: FactSet, Bloomberg, Morgan Stanley Research; Note: Excludes recessions and the one month before recessions. *12M rate of change in fed funds rate is negative.

Key themes to focus on in global equities: We see momentum building around **AI adoption,** alongside significant ROI and efficiency gain opportunities for corporates. The share of companies citing quantifiable benefits from AI adoption related to cost and revenue has been increasing steadily based on our systematic analysis of 7,400 earnings transcripts. Our research department's extensive work around AI mapping identifies stock-picking opportunities among this adopter cohort. We've also seen **M&A** return, with 3Q25 announced volumes up 43%Y and large strategic transactions leading the way. We expect a further broadening out in activity, with sponsors next. Our proprietary analysis and quant models offer stock ideas on this front. Finally, we expect demand for compute and subsequently power to continue to intensify amid the AI capex cycle, supporting investment ideas tied to the **powering GenAI** theme. Innovative 'time to power' solutions, including natural gas turbines, Bloom Energy fuel cells, nuclear, and crypto to data center conversions, continue to look attractive as the race to acquire power intensifies.

Exhibit 39: Global equity index forecast summary

Index	Current Price	Dec 2026 Base Case Index Target (% Upside)	Prior Target Jun-2026 (% Upside)	MS Top-Down EPS YoY %			Consensus EPS Forecast YoY %			MS Base Case N12M P/E Dec 2026	Current Consensus N12M P/E	10 Year Avg. Consensus N12M P/E
				2025	2026	2027	2025	2026	2027			
S&P 500	6,851	7,800 *14%*	6,500 *-5%*	272 *12%*	317 *17%*	356 *12%*	270 *11%*	307 *13%*	349 *14%*	22.0	22.8	18.6
MSCI Europe	2,343	2,430 *4%*	2,250 *-4%*	137 *-2%*	142 *4%*	152 *7%*	138 *-1%*	156 *13%*	174 *12%*	16.0	15.2	14.3
TOPIX	3,359	3,600 *7%*	2,900 *-14%*	190 *4%*	220 *16%*	240 *9%*	191 *4%*	211 *11%*	233 *10%*	15.0	16.0	14.0
MSCI EM	1,408	1,400 *-1%*	1,200 *-15%*	87 *10%*	98 *13%*	108 *10%*	88 *11%*	103 *17%*	116 *13%*	13.0	13.9	12.3

Source: FactSet, Morgan Stanley Research forecasts

Exhibit 40: Base/bull/bear case outlook for global equity indices

Index	Current Price	New Target Price - Dec 2026 (% from current levels)			Old Target Price - Jun 2026 (% from current levels)		
		Bull	Base	Bear	Bull	Base	Bear
S&P 500	6,851	9,000 *31%*	**7,800** *14%*	5,600 *-18%*	7,200 *5%*	6,500 *-5%*	4,900 *-28%*
MSCI Europe	2,343	2,700 *15%*	**2,430** *4%*	1,920 *-18%*	2,620 *12%*	2,250 *-4%*	1,610 *-31%*
TOPIX	3,359	4,250 *27%*	**3,600** *7%*	2,440 *-27%*	3,250 *-3%*	2,900 *-14%*	2,100 *-37%*
MSCI EM	1,408	1,800 *28%*	**1,400** *-1%*	960 *-32%*	1,360 *-3%*	1,200 *-15%*	870 *-38%*

Source: FactSet, Morgan Stanley Research forecasts

Sector and style recommendations: In the US, we maintain our overweight stance on financials and industrials, upgrade consumer discretionary goods from underweight to overweight, and upgrade health care (our preferred quality growth exposure) from equal-weight to overweight. Consistent with our call for a rolling recovery amid an early-cycle backdrop, we upgrade small caps to overweight relative to large caps and broadly prefer early-cycle winners. In Europe, among major sectors, we stay overweight banks, diversified financials, and defense, which top our refreshed sector model, and upgrade utilities to overweight as the powering AI theme broadens to Europe. We also remain overweight European software but acknowledge a difficult-to-shake AI disruption debate despite resilient fundamentals. In Japan, we prefer construction & materials, machinery, electrical appliances & precision instruments, IT services, and banks, while recommending an underweight stance in the low-beta food, pharma, and transport/logistics sectors. In EM, we expect further outperformance for financials and see industrials benefiting from multipolar world trends — both value exposures, which we barbell with select AI-driven communication services and discretionary names.

Exhibit 41: Equity sector and style preferences

Sector & Style Preferences	S&P 500	MSCI Europe	TOPIX	MSCI APxJ/EM
Sector Preferences	**OW:** Financials, Industrials, Consumer Discretionary Goods, Healthcare	**OW:** Banks, Defense, Div. Financials, Utilities, Software	**OW:** Construction & Materials, Machinery, Electrical/Precision Equip, IT Services, Banks	**OW:** Financials, Communication Services, Consumer Discretionary, Industrials
	UW: Consumer Staples, Real Estate	**UW:** Chemicals, Luxury, Autos, Transportation, Disc. Retail	**UW:** Foods, Pharma, Transportation & Logistics	**UW:** Energy, Materials
Style Preferences	**1)** Cyclicals over Defensives	**1)** Top vs. Bottom Combined Stock Screens: Factors, Cycle & Thematics	**1)** Large Cap, Liquid, High-Vol Stocks	**1)** Alpha via Focus Lists (APxJ, GEM, Thematic, Country)
	2) Small Caps over Large Caps	**2)** Powering AI Beneficiaries	**2)** Takaichi Admin. Policy Beneficiaries (Defense, Infra, Energy Security, IP)	**2)** Sentiment (Asia-ex-China); Value+Momentum (China)
	3) AI Adopters with Pricing Power	**3)** AI Adopters with Pricing Power	**3)** Corporate Reform Beneficiaries	**4)** China's AI Path & Emerging Frontiers Sub-Themes
	4) Strong Earnings Revisions	**4)** Analyst Top Picks		**4)** Corporate Reform Beneficiaries

Source: Morgan Stanley Research

US: The rolling recovery leads to a broadening

Our out-of-consensus US equity outlook a year ago was for a tougher first half of 2025 and a better second half. This stance was driven by our view that policy sequencing from the new Trump administration would be growth-negative to start (i.e., 'the kitchen sink'), before becoming growth-positive around mid-year. Policy developments in 2025 generally followed this cadence, though they came to fruition in a faster and more dramatic manner than we had expected.

In this sense, the capitulation around Liberation Day marked the end of a three-year rolling recession and the start of a rolling recovery. In other words, this event represented the trough rate of change in many key metrics we track following the 2022-25 rolling recession during which small-cap earnings declined by 20%, every S&P 500 sector experienced negative earnings growth (at different times), and key economic gauges remained in contraction territory including the ISM Manufacturing PMI and the Conference Board Leading Economic Indicator.

Entering 2026, we believe that the rolling recovery has begun, and that we're in the midst of a new bull market and earnings cycle, especially for many of the lagging areas of the index. We think that most of the elements of a classic early-cycle environment are with us today — compressed cost structures that set the stage for positive operating leverage, a

historic rebound in earnings revisions breadth, and pent-up demand across wide swaths of the market/economy that were mired in the preceding rolling recession. Early supporting evidence of an earnings recovery can be found in 3Q results – a 2.2% S&P 500 revenue beat rate (2x average) and 8% EPS growth for the median stock in the Russell 3000 (the strongest growth in four years). It's worth noting that our post-Covid framework assumes that we have entered a new inflationary regime, and this likely means hotter but shorter cycles.

The missing ingredient for the typical broadening in stock performance that happens early in a new business cycle is more significant rate cuts than the market expects. While there's uncertainty around this dynamic in the short term, over the next 6-12 months we think that moderate weakness in lagging labor data and the administration's desire to 'run it hot' will lead to an accommodative monetary policy backdrop involving both rates and the balance sheet. This, in addition to the stronger earnings backdrop that we expect for the average/median stock, is supportive of a broadening in leadership in 2026 – an out-of-consensus view based on our conversations with investors.

The bottom line is we raise our 12-month S&P 500 price target to 7,800 (22x forward EPS of US$356). This expectation incorporates higher-than-consensus EPS throughout our forecast horizon. We see 2025 EPS of US$272 (12% growth), 2026 EPS of US$317 (17% growth), and 2027 EPS of US$356 (12% growth). Key drivers of our bullish earnings/cash flow view include a return of positive operating leverage, greater pricing power, AI-driven efficiency gains, accommodative tax and regulatory policies that facilitate a public to private growth transition, and contained interest rates throughout the curve. We expect valuation to compress modestly versus current levels, but stay elevated relative to history at 22x. Our work shows that it's rare to see meaningful multiple compression in periods of above-median EPS growth (~7-8%) and accommodative monetary policy. In line with our call for a broadening in leadership amid a healthy EPS environment, we see small caps outperforming large caps and cyclicals outperforming defensives. We reiterate our overweight stances in financials and industrials and upgrade consumer discretionary goods to overweight from underweight. Health care remains our preferred exposure to quality growth, and we upgrade the sector to overweight as well.

Exhibit 42: Earnings revisions breadth is rebounding once again
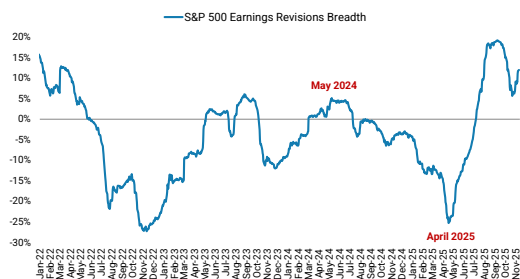
Source: FactSet, Morgan Stanley Research

Exhibit 43: An average of our leading earnings models points to mid/high-teens EPS growth over the next 12 months
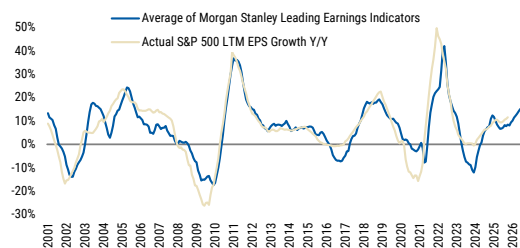
Source: FactSet, Bloomberg, Morgan Stanley Research forecasts

Europe: Playing catch-up

Moderate upside: We have 4% upside to our new end-2026 MSCI Europe LC target, 8% when considering dividends and buybacks. This upside is driven by a further expansion in Europe's multiple while 2026 earnings growth once again disappoints an over-extended consensus, in our view. Europe continues to follow the path of our 'lingering uncertainty' cycle playbook in which anticipation of a future v-shaped recovery is reflected in multiples pushing well above historical averages — as long as the US recovery is expanding. In reality, however, while there are idiosyncratic pockets of European earnings growth, the single-greatest constraint to broad-based growth remains expanding China competition in global manufacturing coupled with Europe's largely old economy exposure. On the domestic front, we see subdued infrastructure spend execution in Germany, continued political overhang in France, and slow progress on the Savings and Investment Union agenda.

Buoyed by the US: With about a quarter of European equities' revenues exposed to the US, it is difficult to expect the region to be down alongside our US team's mid-teens equities upside. The S&P has been up by mid-teens or higher in 15 of the last 35 years — in 14 of those 15 years, European equities were also up. On a regression analysis, 14% upside in the S&P has historically equated to c.4% upside to European equities, coincidentally aligning with our MSCI Europe target upside. Thus, as noted, we expect European equities to benefit from the halo effect of a 2026 broadening in the US late-cycle environment, even if this is more through multiple expansion than earnings growth and despite persistent fiscal risks at home and still-elevated policy risks abroad (see our analysis on Section 899).

Structural challenges: Structurally, we see continued challenges across the European landscape: 1) Consensus earnings growth expectations for 2026 are far too high, in our view, at 12.7% versus our revised estimate at +3.6% (previous: +2.4%). 2) The single-greatest growth challenge for European equities according to our analysis is competition with China in manufacturing at home and abroad coupled with Europe's old economy-heavy exposure. We estimate that c.60% of Europe's earnings downgrades in recent years have been driven by highly China-exposed sectors. Next year is not set up well in this regard, with consensus for many of these sectors embedding a dramatic v-shaped growth recovery following years of earnings declines. 3) On the domestic front, we turned cautious on the German infrastructure spend thematic in August and retain the view that execution is likely to disappoint investors. Our recent analysis shows that around two-thirds of planned German infrastructure fund spend over 2025-26 is likely to be allocated to other — in some cases pre-existing — budget items. Items such as commuting tax rebates and VAT cuts on restaurants are unlikely to be helpful to earnings growth, whereas direct infrastructure spend would boost corporate margins and productivity. Defense (overweight) is a different story and we expect a pick-up in momentum over 1H, but the sector makes up just 2% of the European index. Meanwhile, the French political backdrop should remain volatile on the challenging path to reduce France's fiscal deficit amid a divided government and into March municipal elections.

Europe's strength is idiosyncratic: Despite our structural caution relative to the US and China, we believe that European equities offer plenty of idiosyncratic opportunities under the surface of the index. Europe's stock-level dispersion continues to break above historical and seasonal averages and we expect dispersion to keep rising structurally as is

typical in a late-cycle environment. On the basis of our refreshed data-driven sector model, we especially like European banks, tobacco, defense, diversified financials, food retail (new overweight), utilities (new overweight), and software. Conversely, we would avoid European pulp & paper, chemicals, luxury, autos, transport, and discretionary retail (new underweight).

The bull case – AI adoption: It is no secret that Europe lags the US in terms of the magnitude of its enabler and 'core to thesis' AI exposure. However, as the narrative begins to shift from enabler growth to adopter ROI, we remind that our analysis indicates that European AI adopters with neutral-to-high pricing power are showing earnings outperformance relative to MSCI Europe, their respective sectors, and, from an ROE perspective, even US-equivalent adopters. Adoption ROI is critical to the outlook for Europe considering adopter or adopter/enabler exposure (up to the significant level) sits at more than two-thirds of the MSCI Europe index weight. And considering the starting point of European returns, demographic challenges, and productivity, the adoption ROI phase of the AI cycle could be Europe's moment, contrary to popular belief. **We incorporate initial AI adoption ROI in our new base case forecasts** on the basis of the analysis above.

Exhibit 44: Europe is hovering near the top of its long-term downtrend LFL valuation discount range versus the US

MSCI Europe vs US: Premium/Discount on NTM P/E (Daily)
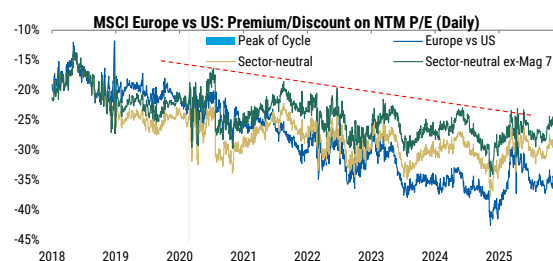
Source: LSEG Data & Analytics, MSCI, Morgan Stanley Research

Exhibit 45: A breakout is unlikely, in our view, considering the relatively weaker growth backdrop and far too high a bar for 2026 consensus (MSe: +3.6%)

MSCI Europe: EPS Growth (%YoY, LC)
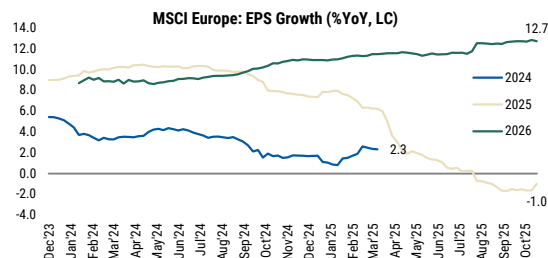
Source: IBES, MSCI, Morgan Stanley Research forecasts

Asia/EM: A robust approach for an uncertain world – prefer Japan to EM

For 2026 our outlook is cautiously optimistic and we have raised our base case targets, albeit while emphasizing a wide bear-to-bull spread. This reflects six dimensions of global macro risk and opportunity which should continue to drive performance: 1) US growth; 2) The US dollar; 3) China reflation; 4) US rates; 5) Multipolar world dynamics; and 6) AI capex and semis demand. There will continue to be twists and turns and interplay in each. Understanding what is in the price for divergent scenarios in each dimension is more important for investors than overly anchoring on specific baseline forecasts. This was the key feature for portfolio survival in 2025 just as in 2020, the closest parallel to this year in terms of exceptional market, sector, and stock performance trajectory. We don't expect this sector/thematic-relative volatility to die down in 2026. We advise investors to focus on dynamic stock selection in the form of our five core focus lists for global emerging markets, Asia Pacific ex Japan, China, Japan, and Asia thematics.

In the base case we think that Japan (FX unhedged) should outperform EM somewhat: Our TOPIX target is 3,600 (+7%), derived from 15x forward P/E and ¥240 EPS for 2027.

This is around 3pp above consensus for Japan EPS, with reflation and ROE improvement ongoing and likely boosted by fiscal and regulatory reforms under the Takaichi administration. Revisions breadth is firmer than EM in aggregate and the market has strength in depth in both domestic and export earnings stocks – the latter likely supported by less JPY strength than in our prior forecast. Structural domestic flows to equities in the form of buybacks and NISA 2.0 inflows, as well as another revision of the Corporate Governance Code, are also attractive features.

Exhibit 46: Our Asia/EM major 15 market allocation

Market	MSCI FF MC Weight	MS Weight	Current Active Allocation (bps)	Prior Active Allocation (bps)
Japan	28.0%	28.8%	75	50
China	18.4%	18.4%	0	0
Taiwan	12.5%	11.8%	-75	-100
India	9.6%	10.4%	75	100
Australia	8.1%	8.1%	0	0
Korea	7.9%	7.9%	0	0
Brazil	2.8%	3.3%	50	50
Saudi Arabia	1.9%	0.7%	-125	-125
Hong Kong	2.7%	2.7%	0	0
Singapore	2.2%	2.7%	50	75
South Africa	2.2%	2.2%	0	0
Mexico	1.2%	1.2%	0	0
Indonesia	0.7%	0.0%	-75	-75
Malaysia	0.7%	0.7%	0	0
UAE	0.9%	1.1%	25	25

Source: FactSet, Morgan Stanley Research; Note: Data as of November 12, 2025.

After a strong year in 2025, we expect that EM begins to lose relative performance momentum in 2026 and instead focus on stock selection: Our team's expected US dollar stabilization limits further easing of financial conditions. Our EM target is 1,400 (-1%), derived from 13.0x forward P/E and US$108 of 2027 EPS. Our earnings forecast is around 6pp below consensus (which compares with a 10-year average EM slippage of 24pp equivalent estimates at this point). We remain modestly overweight India, Singapore, and Brazil, versus underweight Indonesia, Saudi Arabia, and Taiwan. We hold an equal-weight stance on China, expecting deflation risk to be persistent in 2026 before gradual reflation becomes more evident until 2027, although valuations may be sustained not far below current levels given our base case of less multipolar world risk in 2026. For India, in contrast, our economics team is anticipating a cyclical recovery in 2026 with strong credit growth re-acceleration after interest rate and GST cuts. For Brazil, next year's presidential elections are likely to have a major impact on the market trajectory but we continue to like the combination of high ROE and low valuations.

On the sector side we continue with a core overweight in financials, consumer discretionary/e-commerce, communication services, and industrials/defense versus underweight energy and materials: We are equal-weight IT and telecoms, again with an emphasis on stock picking. In March 2025 we added back exposure to semis/IT on AI capex acceleration but are selective in our approach, cognizant of valuations (now 7x P/B), which require the sector's current exceptional ROE and EPS growth premium to the market to be sustained through 2027 and beyond. This should flow through to index performance for Taiwan and Korea in particular, given the high weight of this sector in their indices.

Exhibit 47: Valuation versus profitability of MSCI EM GICS sectors and select industry groups – semiconductors and equipment have both exceptional profitability and exceptional valuation premia currently
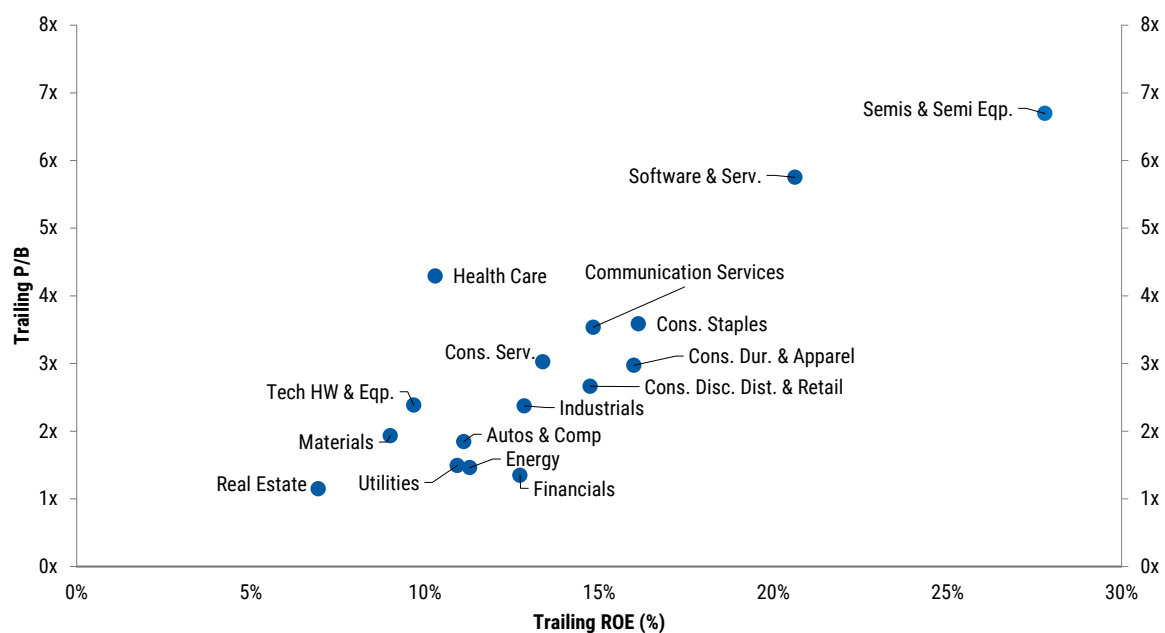
Source: FactSet, Morgan Stanley Research; Note: Data as of November 12, 2025.

The economy and the equity market…only distant cousins

Rajeev Sibal, Andrew Pauker

Strong equity market performance and earnings revisions, particularly in the US, have raised the question as to why nominal GDP data are not reflecting the same resilience of these indicators. However, even casual reflection reveals that although the intuitive correlation between nominal GDP and revenues can be found, there is often wide divergence. That fact should not surprise because nominal GDP measures **final** output while equity revenues derive from **all steps in the value chain.** This fact means that the prices many firms received are not included in GDP deflators, CPI, or PCE inflation.

The correlation between nominal GDP and earnings is even weaker. Again, given the many drivers for profits, there should be scant surprise. Lean cost structures, a weaker dollar, and benefits from the OBBBA all drive earnings/cash flow but are not captured in GDP measures. Similarly, the big increase in capex spending on AI had a more muted effect on GDP, because much of the components were imported, and imports offset investment in the GDP calculation.

A deviation between nominal GDP and revenues has started and could increase. Immediately prior to Covid, the relationship was weak, but since then the two have tracked, reflecting mostly the path of inflation in recent years. For example, in 2024 average nominal GDP growth was 5.4%Y relative to top-line growth of 5.3%Y, and in 2025 we expect nominal GDP growth to be 4.6%Y relative to top-line growth of 5.2%Y. However, in 2026, we think that the spread between nominal GDP growth and revenue growth could widen as corporates push prices higher and the dollar benefits revenues from overseas (particularly in 1H). The early signs of the deviation are apparent in 3Q reporting as the revenue beat rate for the S&P 500 is running at twice the long-term average.

Exhibit 48: The deviations between nominal GDP and revenues can be wide and persistent. The median stock is seeing its best earnings growth in four years
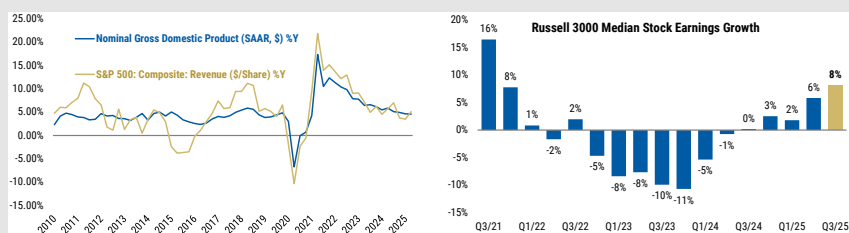
Source: BEA, Haver Analytics, Compustat, Morgan Stanley Research

For earnings, the disconnect between nominal GDP growth and profits is greater; profits reflect operating performance from input to output, while nominal GDP is just about final output. These differences can be amplified by the phase of the economic cycle. For example, the equity strategy view for margin expansion is driven by lean cost structures and operating leverage fueled by AI efficiency gains. And as important as the fundamentals are, the equity market is forward looking, so the market itself can disconnect even more from the economy at any point in time.

G10 Rates: The Double-Breaking Putt

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Exhibit 49: G10 rates top-down preferences

Government Bonds	−			+
US				■
Euro area				■
UK				■
Japan		■		
Dollar Bloc	■			
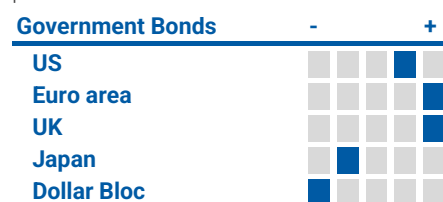
Source: Morgan Stanley Research

Exhibit 50: Bond yield targets

4Q26 Target	Base	Next 3-6M Tilt
10-year		
US	4.05	Lower
Germany	2.45	Lower
Japan	1.65	Lower
UK	3.90	Lower
2-year		
US	2.60	Lower
Germany	1.60	Lower
Japan	1.15	Lower
UK	3.05	Lower
2s10s (bp)		
US	145	Steeper
Germany	85	Steeper
Japan	50	Flatter
UK	85	Steeper

Source: Morgan Stanley Research forecasts

Key investment ideas

- **We suggest an overweight duration stance toward most government bonds** over the first six months of 2026.
- **In the US,** we expect a front loaded rally as the Fed delivers a further 50bp of cuts, with 10 year Treasuries near 3.75% by mid year before drifting to about 4.05% by 4Q26.
- **In Europe,** the ECB trims policy to 1.50% by mid year and holds; 10 year Bunds finish 2026 around 2.45%, while gilts end at 3.90% as the BoE moves toward 2.75%.
- **In Japan,** the BoJ holds at 0.75% and the curve flattens, with the 10 year JGB close to 1.65% by year end.
- **In the dollar bloc,** Canada eases toward 2.00% by 4Q26 with 10 year Canadian government bonds near 3.35%; New Zealand trades nearer neutral with 10 year NZGBs around 4.30%; Australia is more patient, with the RBA steady near 3.25% and ACGB 10 year yields around 4.40%.

In 2026, we expect global fixed income markets to pivot from monetary easing to policy normalization as central banks move toward equilibrium. In the US, we expect the Fed to settle near neutral, with rates just above 3% and inflation converging toward 2.5%Y.

Growth slows but avoids recession, allowing the Fed to pause after ending balance sheet runoff. The yield curve steepens modestly as front-end yields fall with policy stabilization and long-end rates rebuild term premium, signaling a shift from disinflation to a more balanced late-cycle environment.

Europe lags this transition. Softer growth, undershooting inflation, and a limited fiscal impulse push the ECB toward further easing, keeping policy mildly accommodative even as pension fund duration cuts steepen the curve.

The UK follows a middle path: inflation returns to target, growth stays subdued, and the BoE cuts toward neutral, anchoring gilt yields below forwards. Across the region, policy normalization coexists with fiscal restraint and fading term premium compression, leaving

rates markets caught between easing impulses and re-steepening pressures.

In Japan and the broader dollar bloc, policy cycles diverge. The BoJ pauses as inflation momentum fades, while Canada, Australia, and New Zealand follow the US steepening trend, shaped by their own fiscal and growth dynamics.

The global bond story in 2026 is one of transition, from synchronized tightening to differentiated normalization, where relative value and term premium rebuilding drive performance as central banks shift from fighting inflation to managing equilibrium.

In the US, the Fed completes its handoff from easing the stance of monetary policy to achieving a neutral stance. We set our baseline path for Treasury yields to the probability-weighted US economic and monetary policy outlook from our economists. The probability-weighted baseline path sees the policy rate at 3.125% in 1Q26 and 2.875% for 2Q26 to 4Q26, as growth cools toward potential and core PCE approaches 2.6%Y by year-end.

We see the 10-year Treasury yield reaching 3.75% in the first half of the year before rebounding to just above 4.00% at year-end. We forecast it at 3.80% in 1Q26, 3.75% in 2Q26, then 3.95% in 3Q26 and 4.05% in 4Q26. The 2-year Treasury yield follows the policy path and outperforms on the curve, while the 30-year is broadly stable in 1H at 4.45% before rising to 4.75% by year-end. The curve steepens on the front-end impulse, then edges wider as the long end rebuilds risk premium.

Macro conditions are a glide path, not a cliff. We expect sequential activity to firm into 2H after a soft start, leaving 4Q/4Q real GDP in the mid-1s and unemployment in the mid-4s. Disinflation continues but is not linear, which keeps the Fed comfortable holding near neutral while signaling opportunistic disinflation. QT remains on autopilot; guidance becomes more two-sided into year-end.

The Fed's balance sheet normalization process will conclude on December 1. With the conclusion of the portfolio reduction phase, the SOMA portfolio now enters the portfolio maintenance phase where the Fed will continue to let MBS run off the balance sheet, reinvesting the proceeds into bills in the secondary market. This reinvestment strategy will help to move the weighted average maturity of the Fed's holdings to Treasuries closer to that of the outstanding universe of Treasuries. As it relates to issuance, investors have finally come to understand that the issuance strategy from the Treasury seeks to keep coupon sizes steady for the foreseeable future, which we think lasts until February 2027.

Regarding breakeven inflation rates, we expect 5-year and 10-year breakevens to tighten from here to 2.15% and 2.20%, respectively, by mid-2026, as inflation risks cool and we move past the anticipated tariff-based inflationary bump. We see 10-year real yields falling to 1.55% by mid-2026 as investors grow concerned about the economy's growth outlook, and ending 2026 at 1.75% as the data begin to improve. As economic growth starts to recover, we see 5-year and 10-year breakevens moving to around 2.25% and 2.30%, respectively, by the end of 2026.

In the bond bull case tied to a mild US recession, the Fed cuts more aggressively to about 1.125% by 3Q26 and holds; the 2-year collapses toward 0.55% and the 10-year troughs between 2.40% and 2.55% in mid-2026 before retracing modestly to about 2.65% by 4Q26. In the bond bear case tied to an aggregate demand shock, the Fed pauses then lifts to about 4.125% by 4Q26; the 2-year rises to roughly 4.10% and the 10-year reaches around 5.15% by year-end.

Implementation emphasizes duration and curve. Into mid-year, we are biased to play for long duration and 2s10s steepeners that monetize front-end compression. As policy settles at neutral and the long end rebuilds term premium, we would rotate toward 10s30s flatteners and trades that lean into Treasuries richening versus swaps. We would size positions to the probability-weighted baseline with convexity reserved for the recession tail and carry-efficient curve protection for the demand-shock tail.

In the euro area, we see pressure for the ECB to ease further, an out-of-consensus view. The ECB takes the depo rate to 1.50% in 1H26, and keeps official rates at a mildly accommodative level throughout the forecasting horizon. For a comparison, consensus and forwards are pricing around half a 25bp cut.

On the activity side, we remain concerned about the lagged impact of tariff tensions but, more importantly, we expect the German government to fall significantly short of its fiscal easing targets, providing less support than assumed by others to the economy.

On the inflation side, in 2025 we have seen ECB forecasts being revised down sequentially, and further downgrades might be the catalyst for a resumption of the easing cycle. In our view, wage growth is already below levels consistent with price stability.

The miss is not going to be large, however, warranting only risk-management cuts and with a continuation of QT, a far cry from the previous decade of negative yields and large QE balances.

At the long end of the curve, we see conflicting forces, with the reduction of duration by Dutch pension funds being the most important factor prompting a further increase in term premium, with the bulk of extra steepening in the forwards.

Other important factors worth monitoring are the extent of front-running of the Dutch pension fund flows, the amount of DV01 that the German DMO will bring to the market and in general long-end supply from euro area DMOs and, on the demand side, European banks' demand after a torrid 1H25, and support from foreign investors given their renewed interest in the middle of the year.

In our baseline scenario, 2-year and 10-year German yields drop to as low as 1.50% and 2.30%, respectively, before rebounding slightly in the reminder of the forecasting period (end-2026: 1.60% and 2.45%, end-2027: 1.80% and 2.65%), due to some pressure from US interest rates.

Duration longs and curve steepeners should be profitable. Risks around this view are balanced.

Our bull case for the euro bond market is predicated on alternative outcomes that include a significant slowdown in the US: with more aggressive Fed and ECB easing (a terminal rate of 1% for the latter) we see 2-year and 10-year German yields at 1.10% and 2.05%, respectively, by the end of 2026, and even more curve steepening overall.

A bear scenario for duration would be justified by stronger activity data in the US, with global spillovers, or a worse-than-expected supply/demand imbalance domestically. Even in such a scenario we have the ECB squarely on hold until at least 2027. 2-year and 10-year German yields close 2026 at 2.25% and 2.90%, respectively, close to the forwards.

After another year of EGB spread compression, we broadly project sideways spread moves in 2026, with the low deficit countries outperforming the high deficit ones. The global risk environment remains supportive for carry trades in the baseline scenario but we expect less support for the periphery from asset managers as positions are already long, and there is some crowding out from global credit issuance. Also, 2027 elections in some countries might temper appetite for fiscal consolidation. However, even range-trading can be attractive in a low-vol environment.

The bear case for intra-EMU spreads is predicated on a global risk-off environment. We see spreads wider than the forwards. On the other hand, better-than-expected growth might lead to even further compression in spreads, but the room is limited given the starting point.

In the UK, in our baseline scenario, we expect inflation to move close to the 2%Y target, while growth remains below potential in 2026. This backdrop should support further policy easing by the BoE, with Bank Rate projected to reach 2.75% by end-2026, a level consistent with neutral rate estimates but below current market pricing.

Accordingly, we see scope for the curve to bull steepen before the market fully discounts the end of the easing cycle and reintroduces some term premium in short-dated rates. We expect 10-year gilt yields to end 2026 and 2027 at 3.90% and 4.15%, respectively, both below current market-implied forwards.

In the near term, fiscal policy takes center stage and adds uncertainty to our projections, as the government is set to deliver the Budget on November 26. In our base case, we expect fiscal policy to be broadly deflationary, with the government pursuing a degree of fiscal consolidation. That said, the latest newsflow raises risks to this view and increases the likelihood of a negative reaction in the gilt market, in our view.

Meanwhile, investor focus is likely to remain on supply/demand dynamics, particularly at the long end of the curve. We expect both gross and net gilt supply to have peaked in the current fiscal year, with the outlook improving even as issuance remains elevated by historical standards. Consequently, we expect gilts to outperform swaps marginally.

Long-end supply should stay muted, helping the long end of the curve after a difficult 2025. In 2026, we project bull steepening across the curve as the BoE delivers a deeper easing cycle than currently priced. However, as the easing cycle nears completion, we anticipate a bull flattening in the 10s30s segment, with subdued supply supporting long-end valuations.

That said, much of this expected downward shift in supply appears well discounted by the market, leaving some risk that issuance proves higher than expected or that global steepening pressures re-emerge. Conversely, short- and medium-dated issuance are likely to remain elevated by historical standards, though attractive gilt valuations should sustain demand for this part of the curve on relative value grounds.

In Japan, our economists expect the BoJ to deliver another 25bp hike in December 2025, but they do not anticipate additional hikes in 2026, as CPI excluding fresh food is projected to slow below 2%Y with food inflation stabilizing. They expect the BoJ to resume tightening in 2027, with two further 25bp hikes — to 1.25% — in January and July, supported by sustainable wage growth and a recovery in private consumption.

We expect short-to-medium-term rate expectations to be repriced lower and the JGB curve to rally — led by the belly — into 1Q26, as our US economists see rising downside risks for the US economy with tariff effects gradually passing through to consumers. That said, as the US economy recovers into 4Q26, we expect the market to gradually price in two rate hikes over the year, pushing JGB yields higher, led by the front end.

Meanwhile, we see long-end JGBs underperforming into early 2026 as a broad duration rally amid a US economic slowdown should reduce pension fund rebalancing from equities into bonds. However, as the US economy recovers into 4Q26 and fiscal concerns under a new administration ease, we expect some retracement of the long-end term premium.

Overall, we look for a bull steepening into 1Q26 — a combination of lower short-to-medium-term rate expectations and a higher long-end term premium — followed by a partial reversal of that move by end-2026. We expect the 10-year JGB yield to reach 1.65% in 4Q26 on a compound yield basis, below implied forwards. Yields beyond 10 years are likely to remain elevated throughout the forecast horizon. We expect the 30-year JGB yield to reach 3.25% by 4Q26 on a compound yield basis, almost in line with implied forwards.

In the dollar bloc, we see curves drifting steeper as central banks assess the effects of the easing they have delivered over the past year and as the Fed cuts and Treasury curve steepens notably. The Canadian curve begins flattening first as the Bank of Canada assesses that further cuts from its current level are not necessary; Australia and New Zealand flattening begin later as the RBA and (likely) the RBNZ both conclude that further easing is warranted. A continued expansionary fiscal stance in Australia keeps term premiums wider than in Canada and New Zealand, where we expect net issuance to decline through 2027.

In Australia, the curve bull steepens modestly through 2026 as the labor market loosens gradually and wage growth decelerates further. A resulting downshift in the RBA's inflation outlook allows front-end yields to drift lower relative to the long end as cuts later in the year are increasingly priced. Robust housing sector activity, an upward inflection in business capital expenditure, and continued government spending sustain a healthy term premium in the ACGB curve.

We see little reduction in the Australian deficit through 2026; elevated net issuance keeps 2s10s above 80bp through 2027. 2-year Australian yields end 2026 at 3.50% then rise to 3.80% by end-2027 as markets price an increasing possibility that the Australian economy will be 'off to the races' and RBA tightening comes into focus on the horizon.

In New Zealand, the curve bull steepens as the RBNZ likely shows a surprising decisiveness to ease the New Zealand economy back to sustained growth into 2026. As New Zealand growth recovers in mid-2026 and the RBNZ starts to signal in late 2026 that the next move may be a hike, we see the curve bear flattening through end-2027.

An expected deceleration in spending and issuance (the Treasury forecasts a return to an operating surplus) despite an election late in 2026 likely puts downward pressure on term premiums in 2027. 2s10s compresses further through 2027 as markets price a relatively swift RBNZ policy response to an improving growth outlook. We see 2s10s falling below the equivalent Treasury spread by mid-2027.

In Canada, we expect front-end yields to decline less than US equivalents through mid-2026. Our economists forecast that the Bank of Canada has completed its cutting cycle; we see limited scope for markets to anticipate further cuts despite substantial further easing from the Federal Reserve.

The curve drifts marginally flatter as the Canadian economy recovers through late 2026 and a shift in policy stance higher toward the middle of the Bank of Canada's estimated neutral range comes into view. Canadian term premiums do not compress as swiftly as in other dollar bloc curves as markets start to see effects from productivity-enhancing reforms passed in mid-2025.

Exhibit 51: Gross issuance
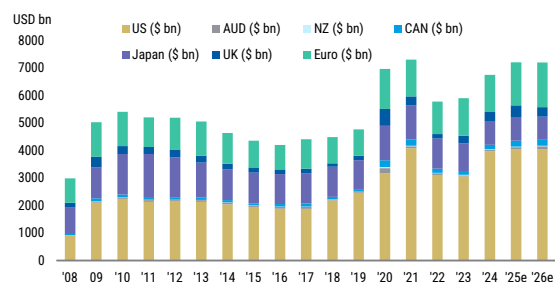
Source: National central banks, national treasuries, Morgan Stanley Research estimates

Exhibit 52: Issuance, net of redemptions
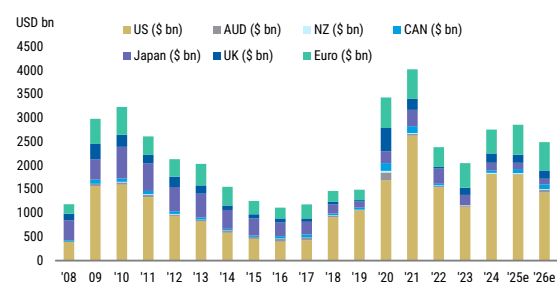
Source: National central banks, national treasuries, Morgan Stanley Research estimates

Exhibit 53: Central bank impact on supply
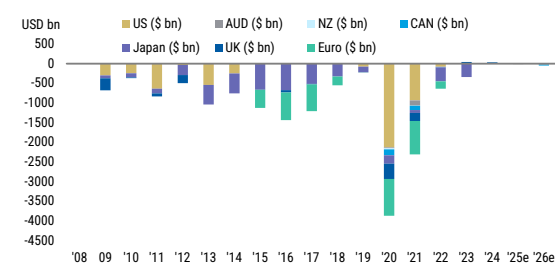
Source: National central banks, national treasuries, Morgan Stanley Research estimates

Exhibit 54: Issuance, net of redemptions and central bank purchases
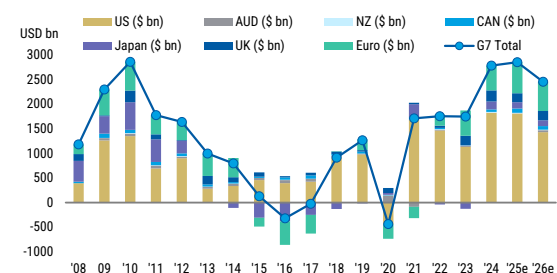
Source: National central banks, national treasuries, Morgan Stanley Research estimates

FX: Some Things Change, Some Things Stay the Same

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Exhibit 55: FX top-down preferences

FX	-	+
USD		
EUR		
GBP		
JPY		
EM		

Source: Morgan Stanley Research

Exhibit 56: FX targets

4Q26 Target	Base	Next 3-6M Tilt
EUR/USD	1.16	Constructive
USD/JPY	147	Constructive
GBP/USD	1.29	Constructive
AUD/USD	0.67	Constructive
USD/CNY	7.05	Neutral
USD/INR	88.40	Constructive
USD/BRL	5.20	Constructive
USD/MXN	18.15	Constructive
USD/ZAR	17.80	Neutral

Source: Morgan Stanley Research forecasts

Key investment ideas

- We expect a choppy year for the DXY, initially continuing its downtrend to 94 in the USD bear regime before a 2H26 rebound in the carry regime back to 99.

- Risk currencies like AUD and SEK lead outperformance thanks to buoyant risk appetite and positive local stories, while falling US rates and reduced risk premium see USD/JPY bottoming at 140.

- European FX lose steam as the ECB and BoE cut rates into accommodative territory, contrasting increasingly with their transatlantic peers.

- We expect EM to trade well through 2026, as top-down conditions and bottom-up fundamentals are supportive. CEEMEA and LatAm outperform AXJ.

2026 should be a tricky year for FX: In some cases we expect big changes in trend. In other cases we expect key themes to continue for longer. But ultimately we think that nimble investors watching for key signals can navigate these waters effectively.

On one hand, we expect some things to change, with 2026 bringing many pivots and key breaks in trend.

USD weakness should continue in the coming months, but then we expect USD to bottom and rebound around 2Q26, ending the USD bear market, and ending the year close to current levels and continuing to rise into 2027. European currencies, which led the G10 gains in 2025, should shift increasingly to laggard status, while the Antipodeans shift to the front of the pack.

Leadership within currency blocs should also shift. AUD's outperformance of NZD sees AUD/NZD breaking to a near 15-year high, before NZD jumps ahead, ultimately emerging as 2026's top spot performer. Among funding currencies, CHF appears more attractive than JPY in 1H26, but JPY emerges as the funder of choice later in the year.

On the other hand, we expect some key themes to stay the same: We think that risk currencies will continue to trade on the front foot all throughout 2026, aided by a buoyant US equity market and declining global interest rates. Oil-sensitive currencies like CAD and NOK, despite being risk sensitive, continue to face relative drags versus their

peers (SEK, AUD, and NZD) thanks to another consistent theme – the failure of oil prices to rise. And, with low realized volatility implied in the forecast profile, we think that carry will remain an important factor driving total returns through the year.

Exhibit 57: Morgan Stanley's forecast of USD-negative risk premium over 2026

Expected USD-Negative Risk Premium in the DXY
(% vs Predicted Value)

DXY Bull Case 3.8%
1.9%
DXY Bear Case -2.9%
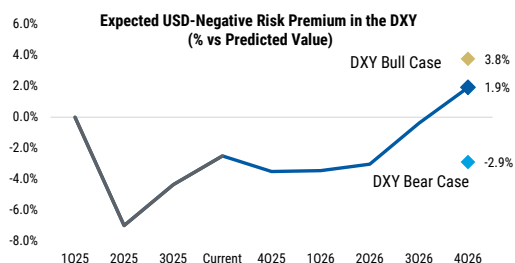
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 58: Morgan Stanley's total return forecast for G10 FX in 2026

CCY/USD Total Return Forecast
(4Q26 Forecast Relative to Spot)

MS Expects Positive Total Returns by end-2026

Carry
Spot
Total return
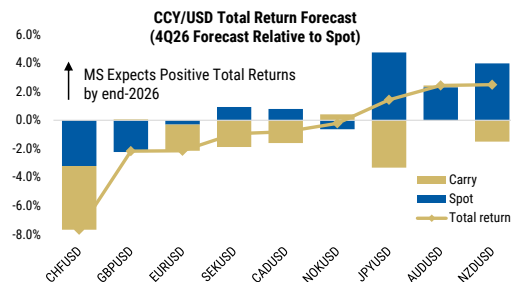
Source: Bloomberg, Morgan Stanley Research forecasts

A key factor explaining the pivots and consistencies relates to what we think will be the market regimes for 2026. **Initially, we think that the USD bear regime will continue,** which sees real rates falling, widening breakevens, broad-based USD weakness, and buoyant risk appetite. Much of 2025 was explained by the USD bear regime, and the continued decline in US rates, due to the Fed continuing to cut, keeps us in this regime.

But as 2026 evolves and long-end US rates begin rebounding, we think that the carry regime is more likely: Unlike the USD bear regime, which sees falling real rates and widening breakevens both putting downward pressure on USD, the carry regime sees more mixed forces as higher real rates counterbalance the USD negativity from wider breakevens.

The result is that some things change, some things stay the same. The regime shift from USD bear to carry means that USD turns around, and funding currencies, particularly JPY, find themselves losing their luster meaningfully. But risk currencies remain at the forefront, thanks to their greater correlation to consistently widening breakevens.

The decline and rebound reflect both the shift in rate differentials relative to market expectations but also the shift in risk premium: USD-negative risk premium has played a key role in explaining USD's poor showing in 2025. Initially we see scope for some additional risk premium in USD to rise again, aided by near-term worries about the US labor market, a refocus on the composition of the FOMC, and continued Fed cuts reducing FX-hedging costs. But we don't expect a return to the magnitudes of risk premium seen in 2Q25, and on net we see a reversal in risk premium closer to 0% by end-2026.

Exhibit 59: Morgan Stanley's forecast spot returns for G10 FX over 1H26 and the full year

CCY/USD Spot Return (1H26 and FY2026)
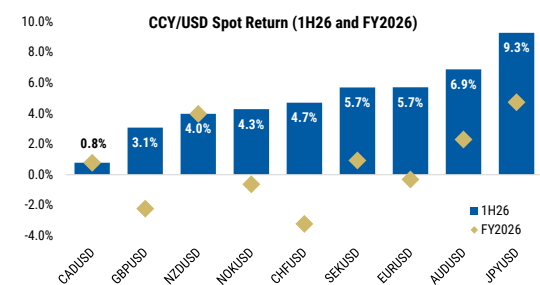
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 60: Morgan Stanley's G10 FX forecasts relative to Bloomberg median consensus

CCY/USD Forecasted Spot Returns vs Market Consensus (1H26 and FY2026)
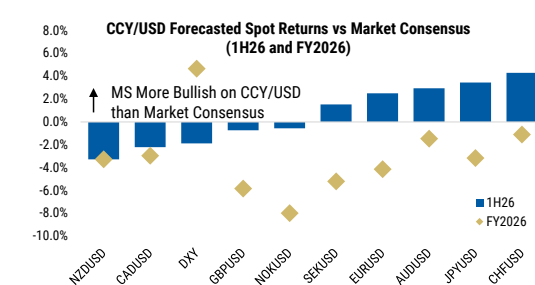
Source: Bloomberg, Morgan Stanley Research forecasts

It's important to emphasize that we continue to think that USD-negative risk premium will prove an amplifying move to USD moves based on rate differentials: Compression in US-RoW rate differentials reduces FX-hedging costs, which raises the incentive to do so, which adds USD selling beyond the decline in USD's fair value. Higher US rates versus the RoW has the opposite effect. For this reason, we think that investors should remain prepared for convex moves in USD, which is particularly evident in our bull and bear cases, where the move in US-RoW rate differentials is more pronounced.

The **DXY's** year of two halves see it initially falling to 94 by 2Q26, 2% below consensus and the lowest level seen since 2021. But the rebound in 2H26 sees it returning to roughly near current levels. This places our end-2026 forecast about 5% above consensus estimates, and we estimate that there is further room to run into 2027 as well. Timing the pivot into the carry regime may prove the critical determinant of investors' FX returns next year.

EUR/USD continues its uptrend thanks in large part due to USD weakness, rising to 1.23 by spring next year before turning lower to 1.16 by year-end. The rebound in US growth and the end of the cutting cycle increasingly contrast with the ECB which, forced to cut into accommodative territory, confirms investors' perception of Europe's relatively weaker return profile. Falling local rates amid growth weakness likely sees EUR's popularity as a funding currency rise.

USD/JPY should roughly follow the contours of the US bond market, falling to 140 in short order thanks both to the increase in USD-negative risk premium but also our colleagues' expectation for front-end rates to fall meaningfully in the coming months. While USD/JPY then rebounds to end the year at 147, JPY lags risk-sensitive peers even more, which keeps cross-JPY trades attractive, particularly on a total return basis.

GBP pivots from leader to laggard as rate cuts from the BoE shift us more firmly into the left-hand side of the 'sterling scowl'. High carry/vol is a key source of GBP strength, but with disinflation and labor market weakness both increasingly taking hold, the BoE cutting rates to and eventually below neutral sees GBP's carry advantage eroded meaningfully. **GBP/USD** initially gains a bit to 1.36 as the weaker USD outweighs the local story, but the currency can't defy gravity forever, falling to 1.29 by end-2026. GBP's total returns are the lowest in the G10 after CHF in 2026.

EUR/CHF finds itself caught between the competing forces of EUR-CHF rate compression to the downside and its low yield supporting its usage as a funding currency to the upside.

We forecast the pair in a tight range between 0.93-0.95. USD/CHF falls alongside the weaker USD in 1H26, though the total return is eroded by negative carry and the fall is more modest than USD/JPY's, suggesting CHF as the relatively more attractive funder.

We expect a marginally downward-sloping profile for both **EUR/SEK** and **EUR/NOK,** though NOK should underperform its Nordic peer thanks to sclerosis in oil prices and Norges Bank-Riksbank rate compression.

2026 is the key year for the Antipodeans **AUD/USD and NZD/USD** thanks to both the USD bear and carry regimes and positive local stories. AUD initially outperforms NZD thanks to strong domestic growth and an RBA firmly on hold, bolstering AUD/NZD's carry/vol profile and keeping the pair on its breakout to the upside to 1.21. But by 2H26 AUD/NZD pivots to a downtrend as the New Zealand government's fiscal expansion in an election year and a recovery in growth allow markets to price in hikes from the RBNZ back to neutral.

CAD follows a similar profile, lagging on crosses initially and underperforming all G10 currencies save for USD, but USD/CAD holds steady alongside the higher USD as Canadian growth recovers and BoC tightening comes into view later into 2026.

For **EM** currencies, our forecasts suggest continued gains for most markets through to the middle of 2026, and with the inclusion of carry total returns generally hold up through to end-2026 even as the DXY turns higher again.

Top down, we think that the asset class will be supported by a number of factors. First, global growth should maintain a solid pace through the year at around 3.0-3.2%Y, while equity markets should generally move higher. Second, while investors have increased their exposure to EM this year, local currency government bonds are still an under-owned asset class from a global perspective, given the modest inflows seen on a multi-year basis.

Finally, valuations remain attractive on a risk-adjusted basis as real yields at the index level are high relative to DM, while risk premia for fiscal risks is no longer a phenomenon reserved for EM.

There are, as always, substantial regional and inter-country differences. **AXJ** is split between the relatively higher-yielding markets of INR and IDR, and then the low-yielding CNY, KRW, TWD, THB, and MYR. The latter group are more likely to outperform given export exposure and valuations, while IDR lags on policy uncertainty and limited bond inflows.

In **CEEMEA,** we see TRY, HUF, and EGP outperforming through to the middle of the year while ZAR likely lags. In **LatAm,** elections will drive much of the investor debate with CLP likely to outperform and COP lagging. BRL and MXN come in the middle of the EM pack through to the middle of the year.

Global EM Fixed Income: The Good Times Roll into 2026

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Exhibit 61: EM fixed income top-down preferences

EM Fixed Income	-				+
EM FX			■		
EM Local Rates				■	
EM Credit			■		
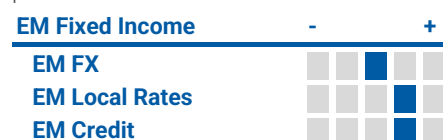
Source: Morgan Stanley Research

Exhibit 62: EM fixed income targets

4Q26 Target	Base	Next 3-6M Tilt
EM $ Sov Credit	260	Constructive
EM Local	6.2%	Constructive

Source: Morgan Stanley Research forecasts

Key investment ideas

- EM posts attractive returns which are worth staying long for across hard and local currency through 1H26, before 2H consolidation.
- Top-down conditions stay supportive with bottom-up fundamentals generally improving.
- Valuations are more challenging, with tight credit spreads and advanced easing cycles in local markets.
- BBs are the favored bucket in credit, with CEEMEA and LatAm to outperform Asia in local markets.

The double-digit total returns for **local currency government bonds** we expected for 2025 were easily achieved, thanks to strong contributions from both FX and duration gains. Experienced investors in EM local currency debt will know that it is rare to see two consecutive years of such robust returns, and so we moderate our expectations for the full year in 2026.

Yet, we see the good times for EM local currency debt persisting through to the middle of the year and project 8% total returns by 2Q26. Spot FX gains of ~2% combine with another 40bp decline in index yields as a weaker USD, lower UST yields, and a continued easing cycle from EM central banks all contribute to continued strong returns.

On USD, we see DXY falling to ~94 by mid-2026, which is naturally supportive of the asset class. This is driven by lower front-end UST yields as the US economy slows in the next two quarters and the Fed delivers another 75bp in rate cuts by April 2026.

However, there is considerable investor debate about that pathway, as many are more optimistic about the path for the US economy and the stock market and expect a more hawkish Fed than we are anticipating. While that outcome may result in less DXY weakness than our baseline, it would suggest a continued robust outlook for risk appetite provided the Fed is able to deliver at least one cut.

Thus, appetite for higher-carry currencies in EM should remain robust, even in this risk scenario of DXY not falling as we expect. It may mean that investors should consider a more diverse range of funding currencies, but the asset class should still deliver positive returns.

EM FX would come under more pressure in a scenario whereby the Fed needs to restart the hiking cycle, with higher yields and USD undermining the asset class.

On rates, our UST forecasts speak for themselves, with 5-year UST yields expected to drop to 3% by mid-2026. This would naturally support lower yields globally including in EM. Lower yields for the asset class are further supported by the following factors:

- Our economics team is expecting to see more rate cuts from EM central banks than are currently priced in. On an index-weighted basis the market is expecting ~50bp of cuts by mid-2026 versus our expectation for ~75bp. Morgan Stanley's dovish position versus the market only grows in 2H. Stronger EM currencies would help with this process and naturally support inflows and a lower yield curve.
- Morgan Stanley is generally more dovish on CPI than the consensus too, with the main exceptions being several LatAm economies and Turkey. But in CEE and much of Asia, we are on the dovish side of the inflation debate.
- Relative valuations have arguably improved, with EM 10-year real yield differentials versus the US widening around 35-40bp since the beginning of the year, and the same at the 2-year point widening closer to 70bp. We expect nominal yield differentials at the index level to widen modestly as USTs outperform through to the middle of 2026, before compressing in the back half of the year.

Exhibit 63: Global EM quarterly forecast returns
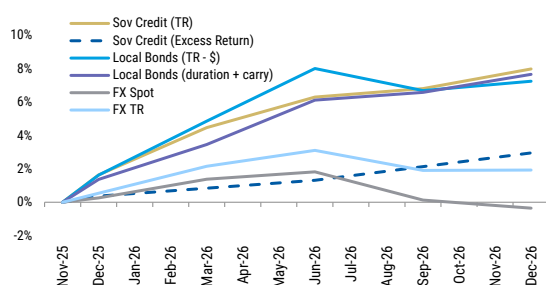
Source: Morgan Stanley Research forecasts

Exhibit 64: EM sovereign credit forecasts (bp)
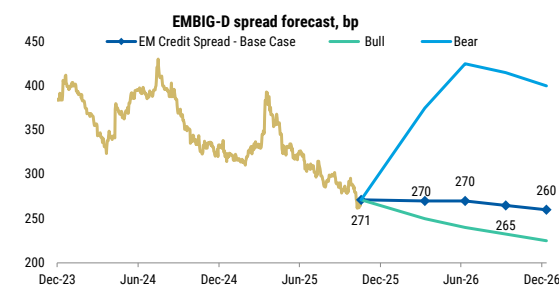
Source: Bloomberg, Haver Analytics, Morgan Stanley Research forecasts

Sovereign credit

Multiple factors still favor EM USD bonds: Most importantly, we see the Fed skewed toward easing further – 75bp in our central scenario – and we forecast lower UST yields. We also anticipate broader risk trading well in 2026, including US equities significantly higher (with the S&P 500 ending 2026 at 7,800), US credit spreads remaining tight (US IG ending 2026 at 95bp, HY at 300bp), and USD weakening. EM credit fundamentals are heading in the right direction. EM growth picks up further – both outright and versus US/ DM – helped in part by multiple reform stories that are emerging, and external liquidity risks are reducing. As a result, we expect aggregate EM sovereign ratings to keep improving, having troughed in 2022. Fiscal imbalances remain a clear vulnerability and should drive country differentiation, but are also slowly heading in the right direction. Finally, technicals are also supportive of EM. Market access has broadened out and demand is high, helped by flows and EM allocations that have room to pick up more.

Yet demanding valuations mean returns are now closer to the carry: EM yields peaked in October 2022 and have since fallen materially, leading to three years where total returns have annualized around 10%. From here, total returns run into increasing valuation

constraints, both from the US rates, US credit, and EM credit angles. As a result, we now think that the key driver of returns will be carry, with a smaller contribution from lower US rates (10-year UST yields end 2026 at 4.05%). We forecast EM sovereign credit spreads roughly flat at 260bp, maintaining the tight spreads versus history. EM HY outperforms EM IG, both in excess and total return terms. IG spreads struggle to rally due to upward supply-related pressure from US IG spreads, while HY still has room to price out idiosyncratic risk premia across multiple sovereigns.

The bull case would see an extended period of easy financial conditions, helped by the Fed cutting and global trade picking up. Demand for fixed income remains strong, pulling IG spreads tighter, and broad market access and dollar weakness pull HY spreads tighter. The index ends 2026 at 225bp. The bear case either comes from our economists' US upside scenario related to an aggregate demand shock that eventually makes the Fed hike. US exceptionalism and a Fed that hikes nearly always bode badly for EM credit, especially if this also comes with more trade uncertainty. Alternatively, it would be a global downturn, hence more severe than our economists' mild US recession scenario, where despite Fed cuts global credit spreads widen materially, especially HY. Across these two scenarios we would see spreads end 2026 at 425bp, yet only in the first would EM lag US credit materially.

Prefer BBs with a sprinkle of B/CCCs: Despite tight spreads, country return dispersion is in line with the historical averages, making country selection key. Outside of valuations which determine the risk/reward, the key bottom-up drivers we focus on are reform potential, fiscal trajectories, and funding availability. Overall, we find the BB bucket most attractive, including South Africa. In the single B and below-rated bucket, differentiation will likely be higher in 2026 yet in general we think that LatAm outperforms CEEMEA, including Argentina and Ecuador, where we move to like stances. Value is harder to come by in IG, but Mexico is a credit we like.

Local markets

In **Asia,** FX should be supported in 1H26 by the weaker DXY and a recovery in non-tech exports before giving back the gains in 2H26 as a rebound in USD and US yields weigh on the region given its low carry. With improving investor sentiment on China, we see the trade-weighted RMB returning to a modest appreciation path. KRW, MYR, and SGD should outperform in 1H26 given a higher share of non-tech exports to GDP and larger US asset holdings, benefiting from a potential increase in USD risk premium. INR should benefit from a better domestic growth and equity inflows outlook, high carry, and cheap valuations. PHP and IDR may lag with less benefits from the non-tech exports recovery and domestic policy uncertainty. In rates, opportunities to pay Asia rates should increase through 2026 as AXJ central banks conclude their easing cycles by 1H26. Malaysia and Korea rates may be relative underperformers as the local monetary easing cycles have likely concluded and both economies should benefit from the export recovery, though WGBI inclusion in April 2026 could help KTBs temporarily. India yields should also rise as the domestic growth recovery and pick-up in inflation allow markets to price in RBI rate hikes. Thailand and China rates could outperform relatively, with soft growth and inflation keeping prospects of rate hikes more distant.

In **LatAm,** some incremental DXY underperformance should support further gains in local currencies, though local elections and the renegotiation of the USMCA deal are likely to ultimately become more relevant drivers of price action. CLP should be the regional outperformer under an administration likely to implement an investment-friendly agenda. MXN and BRL should also outperform into end-2026, assuming some form of Mexico-US trade agreement in 2026 (including a bilateral one), and an election outcome in Brazil consistent with some mild fiscal consolidation. COP should underperform relative to peers and to USD as we expect fiscal deterioration to persist even in a scenario that does not involve policy continuity. As the alpha in regional receivers has eroded significantly, our rates bias is shifting into more cautious territory, particularly in the swaps space. In our view, with the exception of Brazil, front-end LatAm receivers no longer offer idiosyncratic value given the very mature stage of their respective easing cycles (in Chile and Mexico), and meaningful risks for a resumption of hikes (in Colombia). This implies that US rates remain the most important driver of regional rates. We expect rates in Mexico (bonds) and Brazil to outperform, in contrast to rates in Chile and Colombia.

In **CEEMEA,** regional economies face similar headwinds as the rest of the world, with sticky services inflation complicating the policy outlook for central banks. However, strong FX performance has helped to ease inflationary pressures across the region. In markets where monetary policy flexibility appears limited in the short term – such as Hungary and the Czech Republic – we expect FX to remain resilient as investors continue to capitalize on attractive carry opportunities. In Hungary, upcoming elections are likely to introduce FX volatility in 1Q26, though elevated interest rates should cushion the impact. In the Czech Republic, we expect pro-cyclical fiscal policy combined with the CNB's decision to hold rates to push EUR/CZK lower through 2026. Turkey and Egypt remain investor favorites in FX, supported by high real rates and relatively low sensitivity to external shocks, and should continue to offer positive returns to investors in 2026. Meanwhile, South African bonds continue to outperform on improving fiscal dynamics and we think that they could perform well in a weaker USD environment, and favorable terms of trade should keep the rand broadly anchored. That said, we expect ZAR to track USD moves closely – appreciating in the near term on the back of a precious metals rally but likely weakening in 2026 as political uncertainty ahead of local elections adds risk premium.

Exhibit 65: Our base case is for lower local government bond yields in EM by mid-2026
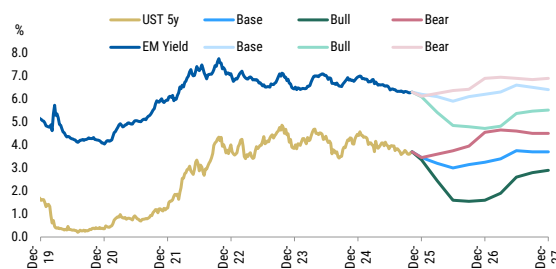
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 66: EM FX total return forecast
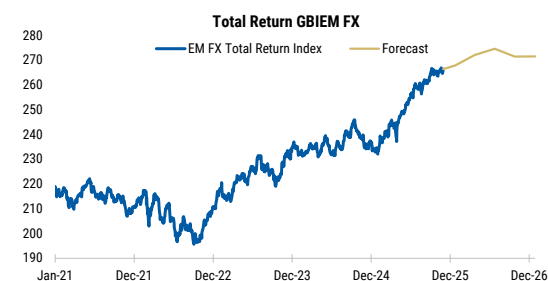
Source: Bloomberg, Morgan Stanley Research forecasts

Global Credit: Smells Like Animal Spirit

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Exhibit 67: Credit top-down preferences

Credit	−				+
US Inv. Grade		■			
US High Yield				■	
US Lev Loans			■		
EU Inv. Grade			■		
Asia Inv. Grade		■			
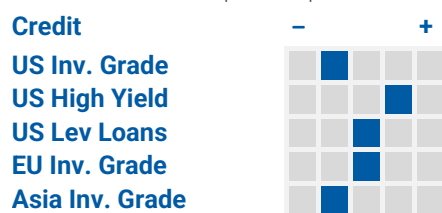
Source: Morgan Stanley Research

Exhibit 68: Credit spread targets

4Q26 Target (bp)	Base	Next 3-6M Tilt
US Investment Grade	95	Cautious
US High Yield	300	Constructive
US Lev Loans	425	Neutral
EUR IG	90	Neutral
EUR HY	280	Constructive
Asia IG	80	Cautious

Source: Morgan Stanley Research forecasts

Key investment ideas

- **More animal spirits:** 2026 sees more capex and M&A alongside easing fiscal, monetary, and regulatory policy. 2005 and 1997-98 are the template.

- **HY > IG:** Better covenants, earnings growth, and relative supply mean HY > IG in the US and Europe.

- **Key trades/themes:** Wider IG spreads but reasonable HY excess returns. Like 5-10-year in US/EU for good roll-down. Financials > cyclicals across regions. CDX and iTraxx exposure over cash, and monetizing implied volatility for income.

In a year dominated by headlines, it can be easy to miss larger shifts below the surface. 2025 will rightfully be remembered as a year that was about 'trade', with one's success largely dependent on navigating the chaotic days into and out of 'Liberation Day'. But it was also about something else. **The cycle of corporate aggression has started to turn.**

It's been a long time coming. Since Covid, government deficits ballooned, rates whipsawed, and equity markets soared. But companies were staid. Across the US, Europe, and Asia, IG and HY leverage moved sideways. Net issuance was modest. 2023-24 saw the *lowest* levels of corporate M&A in 30+ years.

This is now changing as secular forces converge. **Technology capex is booming** and increasingly funded through the debt markets. There is **tolerance for easier financial conditions,** as the Fed lowers rates (despite above-target inflation), deficits rise (despite high levels of debt), and regulatory policy eases (despite strong markets). **M&A has returned,** making up for unusually low recent activity and powered by those easy financial conditions. It smells a lot like animal spirit.

More animal spirits: Think 2005 or 1997/98 (not 2007 or 2000)

We believe that the playbook is 2005 or 1997/98 (corporate aggression increasing without the cycle ending). Both periods saw **rising issuance, rising M&A, and wider spreads** even as equity markets rose. Beyond this, there are notable similarities and differences.

- **1997/98** – more similar to the current scale of tech spending and our bullish 2026 S&P 500 forecast. More different in that it saw a ~200bp decline in 10-year yields, narrow federal deficits, and lower inflation.
- **2005** – more similar as a story of a weaker low-end consumer but strong structural forces (then: China, now: AI spending), along with above-target inflation and range-bound yields. More different in US central bank policy, as the Fed hiked throughout 2005.

Exhibit 69: Comparing 2026 with 2005 and 1997/98 (US market data)

	Capex YoY	Capex Ex-Energy YoY	M&A YoY	M&A (% of GDP)	US 10yr (YE)	Core PCE (YE)	US U-3 Unemply.
1997	7%	5%	40%	24%	5.7	1.9	4.9
1998	9%	10%	38%	32%	4.6	1.5	4.5
2005	14%	9%	31%	29%	4.1	2.3	5.1
Avg. ('97-98, '05)	11%	8%	35%	29%	4.6	2.0	4.9
2026e	9%	10%	20%	21%	4.1	2.6	4.6
Diff	-1%	2%	-15%	-7%	-0.6	0.6	-0.3

Source: Dealogic, Bloomberg, Morgan Stanley Research estimates; Note: Capex is for the Russell 3000, M&A is global announced M&A. For 2026, we use Morgan Stanley estimates for announced M&A and technology capex.

These periods offered distinct challenges. In both, credit underperformed an equity/ government barbell as corporate management started to take more risk. Idiosyncratic issues in single names and sectors rose, a reason why we have resumed screening for LBO candidates.

But 2005 and 1997/98 were also too early to 'hang it up'; index-level shorts were often frustrating. The overall market cycle still had room to run.

Clash of the titans: Higher supply versus still-strong demand

Supply will be central to how this breaks. This is a strong *regional* theme, and a key differentiator for our views across US, European, and Asia credit.

We forecast net supply to rise the most in US IG (+60%Y). The shift in the US is predominantly a technology story, as credit helps to fill a ~US$1.5 trillion financing gap for AI spending that we see through 2028.

Exhibit 70: Key 2026 forecasts: Spreads, returns, default rates, and issuance

Market	Spread to Govt. Current	Spread to Govt. 26YE Est.	2026e Return Excess	2026e Return Total	Default Rate 2025	Default Rate 2026	2026e Issue. (bn) Gross	2026e Issue. (bn) Net	2026e Issue. (YoY) Gross	2026e Issue. (YoY) Net
US IG	82	95	0.1%	4.7%	n.m.	n.m.	2,250	1,000	+25%	+60%
US HY	283	300	2.0%	8.5%	3.7%	3.0%	410	n.m.	+22%	n.m.
US Lev. Loan	396	425	2.1%	6.1%	4.3%	4.0%	490	n.m.	+2%	n.m.
EUR IG	82	90	0.5%	4.3%	n.m.	n.m.	790	260	+16%	+28%
EUR HY	276	280	1.7%	5.0%	3.6%	3.0%	120	32	+10%	+11%
Asia IG	62	80	-0.3%	6.7%	n.m.	n.m.	323	40	+27%	n.m.

Source: Dealogic, Bloomberg, PitchBook | LCD, Moody's, Bond Radar, Morgan Stanley Research forecasts; Note: We base Asia IG issuance on APAC credit issuance.

This is a *technical* problem rather than a *credit* problem, as these issuers generally have strong balance sheets and significant debt capacity. But tech issuers have also shown themselves to be less price-sensitive given the strategic importance of these projects – a dynamic that can still reprice the broader market. Large issuers who are less sensitive to price is a *new* dynamic credit markets haven't contended with for a long time.

The story differs in other areas and regions: With the US at the leading edge of these 'animal spirits', we see M&A and tech capex driving the most upside in US IG supply. Europe and Asia should lag in aggression. US HY supply from rising LBO/M&A activity should be partly balanced by strategic acquisitions removing paper from the market. This is one reason why EUR IG and US/EU HY all outperform US IG excess returns on our forecasts.

Of course, supply is only half of the equation. All-in yields for credit remain elevated, and it is these yields (rather than tight spreads) which are driving strong demand. Our base case is that **both supply and demand are healthy in 2026,** with a more negative skew in US IG and a more neutral skew elsewhere.

Our bear case would be a larger drop in yields driving even more supply. The bull case may be regulatory, with favorable changes toward banks and insurance driving more appetite.

Investing with the animals

At a *macro* level, 2026 doesn't look *that* much different from what we expected in 2024 or 2025. For the year ahead, Morgan Stanley sees global growth holding up, inflation coming down, and central banks easing policy (modestly) further. It is the *micro* which is shifting more, in our view, and greater 'animal spirits' should give the credit market a different feel.

Higher supply, lower front-end yields, and more aggression should push US IG spreads wider even as growth holds up and equities rise. Europe should outperform, especially in 1H, on less aggression, less supply, and relatively better regional growth trends early in 2026. Stable GDP, rate cuts, broadening EPS growth, and relatively less net supply help HY to outperform IG in both the US and Europe.

Similar to 2025 (or 2005), single-name and sector dispersion should remain a key theme. With steep credit curves and steepening yield curves, carry and roll could be a surprisingly large driver of total and excess returns.

Exhibit 71: European credit spreads can stay anchored even as animal spirits accelerate
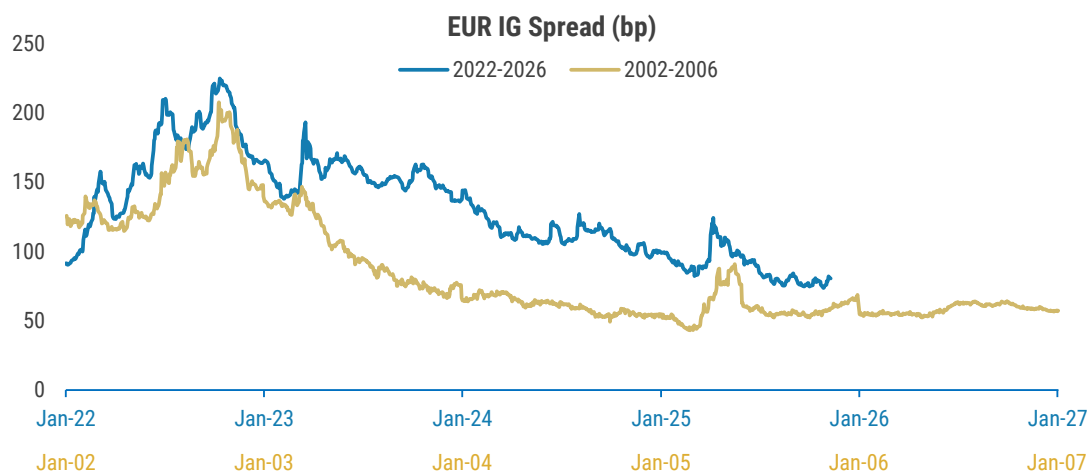
Source: ICE BofA, Bloomberg Morgan Stanley Research; Note: Spreads adjusted for current index ratings and duration weights.

Core recommendations

Our core global credit strategy themes for 2026 are as follows:

- **Regions – Europe > US:** The US sees the highest level of 'animal spirits', the largest increase in supply, the widest range of macro outcomes, and the largest decline in yields on our forecasts. All work against the credit story. Europe benefits from a narrower band of macro outcomes.
- **Sectors:** We continue to prefer financials over cyclicals across regions. We like US utilities and banks, EU insurers, banks, and health care, and prefer Asia banks senior over APAC non-fin IG**.** We dislike US consumer finance and tech, and await a better entry point for European IG chemicals.
- **Curves:** In the US, we are cautious on long-end valuations as supply increases, and think that the belly is a good place to hide out in. EU long-end total returns benefit from a decline in yields, but rising reverse yankee supply poses a headwind – we prefer 5-10-year.
- **Credit derivatives:** We like CDX exposure over cash, prefer selling OTM volatility to being outright long, and compression via the CDX indices and tranches.
- **HY > IG/loans:** In Asia, we prefer APAC HY over APAC IG. The recent decompression in EU HY presents a good entry point to re-engage, while subordinated bonds continue to benefit from yield buyers.
- **Complexity > cyclicality:** We like EU CLO BBs (~525-550bp) over leveraged loans (~400bp), and AUD corp bonds unhedged in Asia.
- **Equity > credit:** In theory, greater animal spirits and M&A should create an environment more friendly to equity than credit.
- **Relative value themes:** Within APAC credit, we prefer APAC single A over APAC BBB. In Europe, we see value in select AT1s offering a yield pick-up over the bank's stock.

The bull and bear case

One version of the bull case is that growth holds up but the 'animals' don't arrive. M&A disappoints. Tech companies moderate their spending, or fund more via cashflow and private markets. A second version: demand surprises to the upside, either because yields stay higher than we expect, or regulatory shifts drive more demand than we expect (especially via the CLO market).

The most significant risk for global credit remains recession, which would argue for wider spreads on economic grounds *and* weaker demand as yields fall. It would mean our spread forecasts are too optimistic and our call for HY over IG is wrong. A milder bear case is that aggression and supply are stronger than we think, creating conditions closer to 2H98-2H99. Then, US IG averaged ~111bp, +30bp from current levels, despite strong growth equity performance.

Global Securitized Products: Beta to the Future

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Exhibit 72: Securitized credit top-down preferences

Securitized	-				+
US Agency MBS				■	
US Agency CMBS			■		
US Non-Agency CMBS				■	
US Resi Credit				■	
Global CLOs			■		
European ABS				■	
US ABS				■	
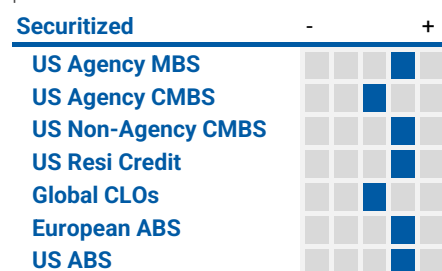
Source: Morgan Stanley Research

Key investment ideas

- Deregulation in the US and EU bring back investors to support securitized products amid a positive backdrop tempered by snug valuations and heavy supply in other asset classes (IG credit).

- Investors should consider adding risk in non-QM and other shorter securitized credit profiles, moving down the capital structure to conduit BBB- and CLO BBs, and overweighting agency MBS versus IG credit.

- Affordability improves on the margin, but home prices and housing activity stay range-bound as supply increases alongside any demand.

The macro backdrop for 2026 looks broadly supportive for securitized products, making us constructive on adding risk in securitized credit: Recession chances have fallen to ~15%, unemployment remains benign, and growth continues at a healthy pace. Our economists expect the Fed to move toward a more accommodative stance, easing financial conditions and sustaining liquidity. Our rate strategists forecast the 10-year Treasury ending 2026 near 4%, a level that should anchor demand from duration-sensitive investors. Lower front-end rates should bolster corporate performance, with loan default rates projected to decline by 50bp. Housing affordability stays challenged: mortgage rates near 5.75% cap home sales and keep price growth muted at +2%.

Supply technicals and valuations introduce a layer of complexity. Capital expenditures tied to AI infrastructure should drive a surge in issuance, with our corporate strategists projecting a 25% increase in IG supply and nearly 20% growth in HY. While the direct impact falls on digital infrastructure ABS and CMBS, secondary effects from wider IG spreads could ripple across securitized products. **This raises a critical question: how resilient will spreads be amid valuation pressure? Our view: securitized credit should hold up reasonably well while agency MBS outperforms corporate credit.**

Demand dynamics provide a counterbalance. Regulatory clarity and rate stability should underpin flows from banks and insurance companies: We anticipate a reproposal of Basel III Endgame in early 2026, likely requiring only modest capital increases and reducing uncertainty for banks. Potential reductions in risk weights for loans and securities could amplify appetite for higher-quality tranches and conventional mortgages. In Europe, Solvency II proposals should translate into more securitized

demand from insurance companies, alongside what we hope will be a market-friendly finalization of ongoing securitization regulatory reforms in the second half of the year.

Underwriting discipline remains a bright spot. Tighter lending standards in non-qualified mortgages and subprime auto loans have had an impact on delinquencies, while liquidation rates in commercial real estate are trending down. Lower front-end rates should support corporate fundamentals, reinforcing credit quality across sectors. Conduit BBB- is our favorite down-the-capital structure expression of these themes.

Housing and GSE reform to remain in focus: While affordability constraints persist, government initiatives — such as zoning reforms, new products, and homeowner tax credits — may gain traction. Any decline in mortgage rates will likely spur increased listing volumes alongside incremental demand, keeping home price growth muted. **Structural challenges remain, but a more stable rate environment could drive upside in housing activity, though we think that this is more likely a 2027 story. 2026 likely sees some form of resolution for GSE reform,** and our base case is an announcement that results in the GSEs still having some form of government backstop with a minimal impact on spreads.

Exhibit 73: 24-month spread ranges across securitized products
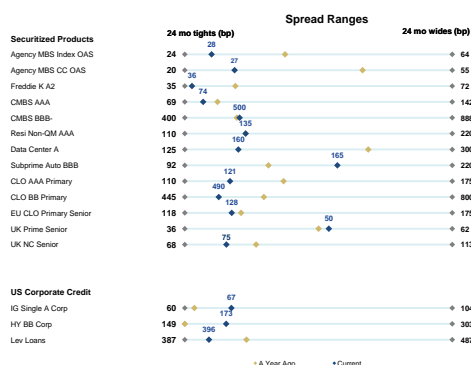
Source: Bloomberg, Yield Book, TRACE, Morgan Stanley Research; Note: Data as of November 12, 2025.

Exhibit 74: Morgan Stanley 4Q26 spread and excess return forecasts across securitized products

Product	Current	Spreads Bull	Base	Bear	Excess Returns Bull	Base	Bear
YoY HPA Forecast					5.0%	2.0%	-2.0%
Agency MBS Index OAS	28	15	25	50	1.1%	0.5%	-1.0%
Non-QM AAA	135	100	130	200	2.1%	1.5%	0.1%
Non-QM BBB	205	160	200	350	3.0%	2.2%	-0.9%
Prime Auto AAA	40	15	25	55	0.9%	0.6%	-0.2%
Subprime Auto AAA	60	30	50	100	1.3%	1.0%	0.3%
Subprime Auto BBB	165	100	125	225	3.4%	2.4%	-1.3%
Fiber A	150	130	150	180	2.5%	1.5%	0.0%
Data Center A	160	130	175	200	3.1%	0.9%	-0.4%
CMBS AAA Secondary	74	60	75	110	2.1%	0.6%	-2.8%
CMBS BBB- Secondary	500	390	475	750	17.0%	7.5%	-11.0%
Agency CMBS KA2	36	20	35	60	1.9%	0.5%	-1.9%
US CLO AAA Primary	121	110	125	170	1.7%	1.1%	-0.8%
US CLO BB Primary	490	440	530	750	7.9%	2.5%	-10.7%
UK Prime Senior	50	40	50	65	0.8%	0.5%	0.1%
UK NC Senior	75	60	70	90	1.3%	0.9%	0.2%
EU CLO Primary Senior	128	115	120	150	2.0%	1.7%	0.1%

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Data as of November 12, 2025.

The story for agency MBS next year is about a shift in demand as the marginal buyers of MBS become those who don't buy corporate credit and those who hedge with swaps not Treasuries. We look toward banks, REITs, and GSE retained portfolios, all of whom are somewhat insulated from the concerns around heavy AI-related supply to the IG credit market, and find more value in MBS given negative swap spreads. Mortgages should end up tightening modestly versus Treasuries but more clearly outperform either swap hedges or IG credit, and **we recommend a basis overweight versus swaps and an asset allocation of long MBS versus IG credit.**

We expect net issuance to remain modest, while assets that banks, REITs, and GSEs buy should outperform; we focus our overweight toward production and slight-discount MBS that offer more carry versus lower funding costs, while discount mortgages lag due to challenging valuations versus new IG deals coming to the market. We expect speeds to remain a concern, keeping premium mortgages under pressure, but demand for assets that are easy to hedge continues, providing support to belly coupons, specified pools, floaters, and agency CMBS.

Agency CMBS follows single-family MBS performance by outperforming IG credit and swaps more than Treasuries: Agency CMBS benefits from deregulation freeing up capital and a

bid for duration that holds into a rally, but the spread curve steepens to help to fund longer IG supply. The peak of multifamily completions is behind us, but elevated levels, a mild pick-up in maturing loan balance, and acquisition growth in a stable rate environment increase our gross issuance forecast to US$170 billion for next year.

If you're looking for better returns, **we forecast more opportunity from both a total and excess return perspective across most tranches of securitized credit:** Our rates forecast of 2-year notes rallying over 100bp versus the forwards benefits shorter tranches of securitized credit. Importantly, while our credit analysts are forecasting IG spreads to widen 10-15bp, that's based on supply-driven concerns, not a material pick-up in default expectations. The return of the bank bid and lower stress tests mean that bank portfolios and dealers can play a larger role in intermediating risk for securitized credit as well. Not to mention that stubbornly high rates in the belly of the curve should keep the yield-based buyer engaged in 2026. **While dispersion should remain a key theme, we find pockets of value across securitized credit products in both the US and Europe.**

Exhibit 75: Tighter lending standards leading to better performance: Non-QM credit scores increasing, bringing down 60+ DQs
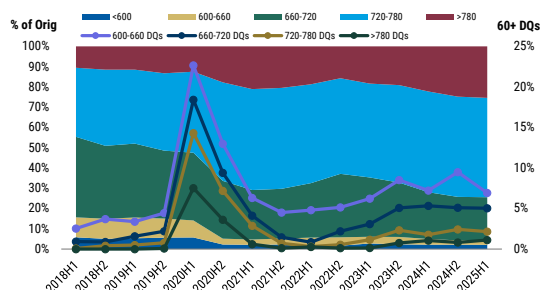
Source: Loan Performance, Morgan Stanley Research; Note: Area chart refers to FICO distribution for each semi-vintage of originations on the left axis. Line charts show 60+ delinquencies for the relevant FICO bucket on the right axis.

Exhibit 76: Securitized markets outstanding with 2026 gross and net issuance forecasts
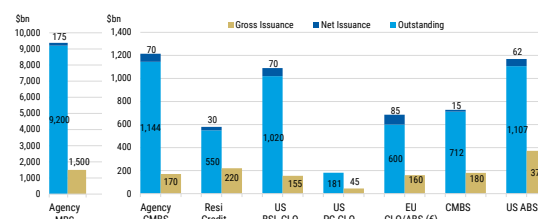
Source: Morgan Stanley Research forecasts

In non-agency RMBS, resilient home prices provide insulation against losses while tightening lending standards should keep distress contained. Slightly lower mortgage rates should keep prepay speeds in focus, and contribute to a preference for discounted paper. This should also portend increased origination volumes, but we think that a rejuvenated bank bid for jumbo whole loans and a resilient insurance bid for non-QM loans should keep securitization rates at the lower end of recent history and prevent the supply technical from turning too negative. When we combine this backdrop with a compressed capital structure and **valuations that we see as cheap to IG corporates, we think that non-QM AAAs offer one of the more compelling return profiles for the rating in securitized credit.**

Lower front-end rates should temper retail flows into the floating-rate **US CLO market,** but the aforementioned demand from both US banks and insurance companies should provide more-than-adequate support. We expect supply to remain robust as the arb improves amid widening loan spreads. A continued slowdown in amortization and liquidation rates means that net issuance doesn't provide as supportive a technical backdrop, but **the fundamental story is positive in aggregate** as our corporate credit strategists forecast loan defaults to come down 50bp while interest coverage improves and CCC buckets have been healing. **Dispersion remains a key theme and idiosyncratic risks should stay in focus.** While that dispersion will result in upside for certain CLO equity profiles, on the whole we prefer the

rated debt tranches, **with the AAA, AA, and BB tranches screening as the cheapest parts of the capital structure.**

Slightly lower and more stable 5-year and 10-year Treasury rates bode well for CRE valuations and set the stage for **a positive year for CMBS.** Elevated 2026 maturities, particularly SASB deals approaching final maturity, should help to drive increased issuance, which should again be focused in SASB and 5-year conduits. Fundamentals tend to lag in CRE, and while delinquencies might move higher, we expect the pace of growth to slow in 2026 while the liquidation rate has already come down across all non-office property types. The conduit capital structure is relatively steeper than most other securitized products. **Combining valuations with the supportive macro backdrop leaves CMBS as the product where we see the most value going down capital structures. We particularly see value in BBB- here.**

In the ABS market, we think that consumer credit performance is poised to improve: A macro backdrop of lower front-end rates, a limited increase in unemployment, and a higher-than-average tax refund season should support performance. In addition, tighter lending standards are decreasing delinquencies and should keep both gross and net consumer ABS issuance from increasing too much next year. While recent events highlight the importance of diligence in underwriting the underwriting standards, **we think that spread widening in subprime auto presents an opportunity in both the AAA and BBB part of the capital structure.** Meanwhile, **commercial ABS – and digital infrastructure in particular – bears the brunt of the supply technical in focus across fixed income markets.** While we continue to believe that digital infrastructure ABS offers attractive carry in a profile that is less levered to the broader economic narrative in 2026, and that fundamentals will be supportive as demand to occupy data centers in 2026 should outstrip supply of data centers, **we expect issuance volumes to force spreads wider in data center ABS. We think that fiber single As offer more attractive excess returns in the year ahead.**

For **European ABS and CLOs,** 2026 is likely to be about subdued growth but sequential improvement after 1Q. This supports fundamentals, despite strains remaining the case at the edges (for both consumers and levered corporates), alongside an additional positive from the aforementioned improving regulatory landscape. From a valuations standpoint, credit curves are rather flat across products, leading us to favor senior tranches generally. **In CLOs, AAA remains the cheapest relative to history and offers a pick-up over IG credit.** Nonetheless, the BB CLO tranche still offers a pick-up over HY corporate credit and what we think is an attractive risk/return profile compared to leveraged loans. EU CLO equity has cheapened up a lot in secondary after the recent weakness and, while the downside from these levels is more balanced, we think that being selective is important. Elsewhere, **we continue to like AU RMBS** although the pick-up over UK/EU is less compelling now. **CMBS looks incrementally more interesting now with a better backdrop in place, and we recommend seniors and AAs there.**

Where could we be wrong?

We're basing our outlook on low chances of recession, strong underwriting, and deregulation bringing banks to the market while IG credit widens modestly on AI-related supply. Bull cases revolve around higher capital relief than expected and our IG credit tightening lifting all risk assets. On the negative side, worsening fundamentals/increased recession chances are the biggest concern, but we also have to be careful about tail risks

around GSE reform, IG widening toward our bear case on heavier supply, and the consumer being less healthy than we expect. Housing risks are skewed more to the upside on activity and prices if demand responds more to lower rates than we expect and/or if government programs to spur demand materialize more forcefully than we anticipate. The downside involves more motivated supply coming online despite the locked-in nature of the homeowner.

Munis: Record Supply, Resilient Demand

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Exhibit 77: Base case targets

4Q26 Targets	Base	Next 3-6M Tilt
10Y AAA Ratio	70%	Neutral
30Y AAA Ratio	90%	Neutral
Credit Spread	35	Constructive
Total Returns	5.0%	Constructive
Excess Returns	0.5%	Neutral

Source: MMD, Morgan Stanley Research forecasts

Key investment ideas

- **Returns:** 5% total, 0.5% excess.
- **Ratios:** 70% 10Y, 90% 30Y base case.
- **Supply:** We expect another record year: US$600-625 billion.
- **Demand:** We think SMA flows (US$90 billion) exceed mutual fund (US$15 billion) and ETF flows (US$55 billion).
- **Credit:** Tax revenues should rise about 6%. Though credit quality remains good, we think upgrades slow and downgrades pick up. We favor IG over HY.

2026 begins with fewer concerns than last year. Unlike last year, tax reform is not on the table — removing an existential risk from the muni outlook.

Instead, the muni story is simpler: supply looks set to reach a record in 2025, and we think it reaches a new record in 2026. In some ways, our market is playing catch-up: municipal issuers held back on capex for years, and finally have the confidence to spend.

Public pension funding — another perennial worry for issuers and investors — may reach one of its highest levels ever. It's another reason to expect muni capex to increase.

We think that this creates a very interesting market for investors, though perhaps a less favorable one for traders. High supply may tame the spread compression that you'd ordinarily get in an inflow cycle. It also complicates trader positioning — we believe that secondary lots will struggle to hold investors' attention as new issue headlines dominate.

Though the curve should steepen, long rates may stay relatively range-bound. This should keep investors preferring SMAs and ETFs to mutual funds.

The outlook for the taxable muni market is less favorable than for tax-exempts. We think that taxable muni spreads may widen in sympathy with the IG corporate market.

The ratings cycle and credit cycle aren't always the same. Muni credit quality should remain strong in 2026, with tax collections rising for another year. But ratings agencies are likely to catch up with the last remaining 'wait-and-see' stories from the post-Covid period. This should result in fewer upgrades and more downgrades. We prefer IG over HY. In the HY and non-rated market, we think that distress/default rates will remain elevated.

Commodities: Metals Over Energy

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Exhibit 78: Commodities price targets

4Q26 Target	Base	Next 3-6M Tilt
Brent	60	Cautious
Copper	10,600	Neutral
Gold	4,500	Constructive
Soybean	12	Constructive
Corn	5	Neutral
Sugar	18	Cautious

Source: Morgan Stanley Research forecasts

Key investment ideas

- In energy, we expect a soft supply/demand balance to keep Brent anchored around US$60/bbl before a return to equilibrium by 2H27 provides some upside again.

- In metals, gold is our top pick, supported by macro factors and strong physical demand, which both look set to continue. We prefer copper and aluminum within industrial metals, with both facing significant supply challenges.

- In agriculture, we have a more constructive view toward soy prices. We forecast soybean at US$11.7/bu and corn at US$4.7/bu on a 12-18-month view, above current futures. We prefer soy over corn on skew given higher sensitivity to Brazil and a faster-tightening soy balance.

Energy

Crude oil: Heading for the most-anticipated surplus

Global oil inventories have built during the course of 2025, causing a steady weakening in oil prices. However, a few factors have still provided support: first, locations matter – not all inventories are equally important, and so far inventory has built mostly away from the key pricing centers. Second, the diesel market is tight, and crude can only weaken so much as long as a key product like diesel remains well-bid. Finally, sanctions have caused refiners in key countries to shy away from Russian oil, shifting demand to Brent- and Dubai-linked grades instead.

That said, the underlying balance in the market remains weak, and our modeling suggests that this will get worse in the coming quarters before it gets better. This is driven by several factors:

- **Demand has entered its seasonally weak part of the year:** Underlying oil demand remains broadly robust albeit slightly below trend. For 2025, we model close to 0.9 mb/d of demand growth, which is below the long-term historical trend rate of 1.2 mb/d. Still, it is an upwards revision from the 0.75 mb/d we forecast in April, However, seasonality is currently not favorable, as 4Q demand is typically below

3Q, and 1Q demand is typically below 4Q.

- **Non-OPEC supply continues to grow:** 2025 has seen a large cluster of new fields starting up in non-OPEC countries such as Brazil, Guyana, Argentina, Canada, Norway, Angola, etc. Most of these start-ups have already taken place, and these fields are now ramping up, but part of this cluster still lies ahead. Altogether, this drives non-OPEC supply growth of ~1.2 mb/d in 2025. This slows down significantly from early 2026 onward, but nevertheless non-OPEC supply ends 2025 at a (very) high level.
- **OPEC supply has grown too:** Since March, OPEC has unwound production cuts of ~2.6 mb/d. Actual production growth has been far smaller at ~0.85 mb/d, but this is still a meaningful amount of new supply. By now, we estimate that OPEC spare capacity is already getting diminished, but still OPEC production enters 2026 also at an elevated level.

Putting these estimates together points toward a surplus of ~2 mb/d across 2026, which temporarily reaches ~3 mb/d in 1H26. To store such quantities of oil, the forward curve will need to be in a sufficient contango to make storage economics attractive. This surplus is not open-ended, so the back end of the forward curve will likely remain anchored in the US$65-70/bbl range. However, we expect that this still requires the front-month price to fall to US$60/bbl to create this contango. We suspect that Brent will trade around this level next year, before starting to recover from mid-2027 onwards.

Exhibit 79: Both OPEC and non-OPEC supply have grown strongly in 2025
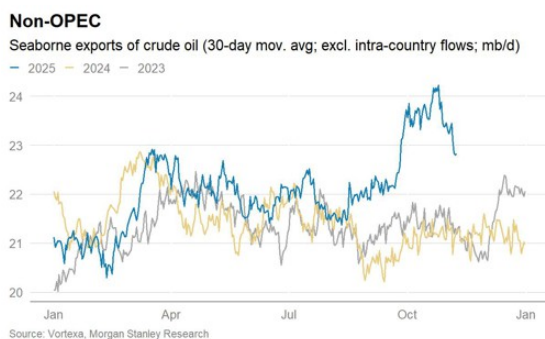
Source: Vortexa, Morgan Stanley Research

Exhibit 80: As a result, oil inventories have been increasing at a rapid rate
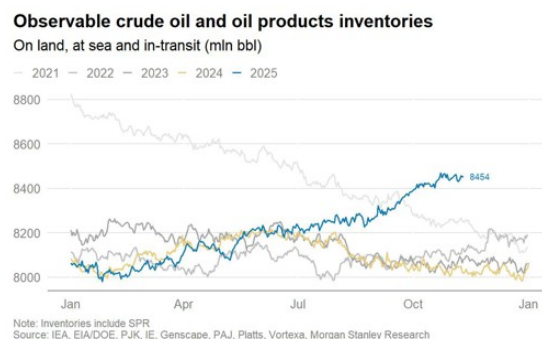
Source: IEA, EIA/DOE, PJK, IE, Genscape, PAJ, Platts, Vortexa, Morgan Stanley Research; Note: Inventories include SPR.

Metals

Amy Gower

Macro tailwinds, production struggles

We see numerous top-down tailwinds for the metals complex that make it hard to be too bearish across any of our coverage. In particular, more rate cuts ahead, a Fed that appears more tolerant of inflation, and generally low inventories drive our upward-skewed price outlook. China's base metals demand indicators (ex property) have surprised positively, supported by exports (of steel, EVs, solar panels, and appliances) and consumption measures. On top, with visible inventories low across many metals, there is less room to absorb unexpected disruptions.

Precious metals: Gold is our top pick

We maintain a positive outlook for gold into 2026, with strong physical demand and macro factors both providing support. The biggest shift in gold demand this year has been from ETFs, which have nearly fully reversed four years of net selling, adding the most gold since 2020. We expect this to continue into 2026 as interest rates fall, while central banks are still adding gold to their reserves, albeit at a slower pace, and jewelry demand is showing some stabilization. Demand for real assets as a hedge against upside inflation surprises and ongoing economic uncertainty provide additional support, with many investors rethinking what the right level of gold exposure is. The recent pullback offers buying opportunities, in our view, with a forecast of US$4500/oz by mid-2026. Downside risks include further price volatility, which may drive more selling in favor of other asset classes, or any moves from central banks to reduce their gold reserves. We also see modest further upside for silver, with prices likely to stay supported near record levels as the market stays in a deficit. Demand growth from the solar sector is likely to slow but it will be difficult for supply to respond given that silver is mainly produced as a by-product.

Base metals: Production challenges drive upside risks

We prefer copper and aluminum within the base metals complex, with both facing supply challenges: Copper mines around the world are being impacted by seismic issues, mud slides, rock falls, lower grades, and other challenges, meaning that the 2025 disruption allowance of 5% has already been hit. This has pushed 2025 into a small deficit which should widen further to around 600 kt in 2026. Aluminum is also seeing supply constrained, with China hitting its capacity cap while smelters elsewhere are competing with AI companies for power, meaning that restarts of idled capacity are less likely despite 'spot' smelter margins looking positive. According to the US Aluminum Association, smelters ideally need power contracts at around US$40/MWh, versus US$100+/MWh agreements that have been agreed by some tech companies.

US tariff expectations also support copper 'demand': We estimate that the US has imported an additional ~600kt of copper in 2025, driven first by expectations of 50% import tariffs which supported front-loading, and more recently by a 5% premium for the COMEX benchmark over LME driven by investor flows and expectations for a 15% import tariff from 2027. Unless the US does not unequivocally rule out copper import tariffs, this incentive to send metal to the US is likely to remain, keeping ex US markets tight and supporting LME prices. With this metal staying in the US, it almost behaves like a strategic reserve or a source of demand for copper, likely supporting prices next year.

However, high prices also bring demand destruction risks: As copper prices have risen toward US$11,000/t, the China Yangshan copper premium has been falling (this is usually a good indicator of physical demand), indicating some price sensitivity, while some of China's base metals end-use indicators like grid spend, solar panel output, EV output, and appliances output have also been moderating. We continue to monitor these indicators to determine the sustainability of current prices.

Exhibit 81: ETF inflows have been a big support for gold this year

Gold and ETF Gold Holdings
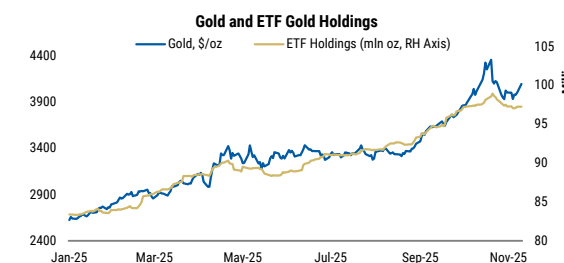
Source: Bloomberg, Morgan Stanley Research

Exhibit 82: The China Yangshan premium has been falling as the copper price has been rising, indicating some price sensitivity

Copper and the Yangshan Premium ($/t)

Source: Bloomberg, Morgan Stanley Research

Agriculture

Julia Rizzo, Julia Habermann

2026 grain outlook: We expect tighter credit conditions, rising interest rates, and reduced availability of subsidized loans – combined with elevated input costs relative to commodity prices – to slow Brazil's acreage expansion and keep global soybean output below consensus. Additionally, the onset of a La Niña year introduces heightened dry-weather risk for South American crops, historically exerting downward pressure on grain yields. **These dynamics point to tighter global supply balances, which should provide a supportive backdrop for higher soybean and corn prices ahead.**

Exhibit 83: Soy prices relative to input costs are at historical low levels, indicating lower profitability for farmers in this new crop
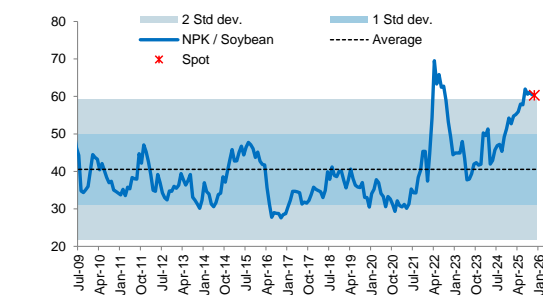
Source: NOAA, Morgan Stanley Research

Exhibit 84: The onset of a La Niña year introduces heightened dry-weather risk for South American crops, historically exerting downward pressure on grain yields
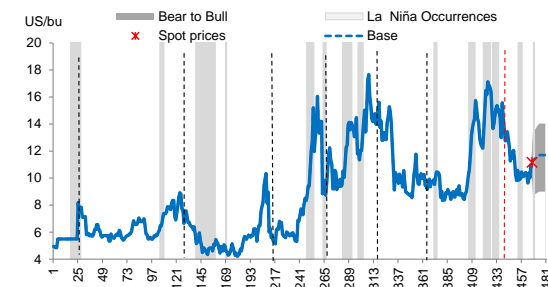
Source: LSEG, Datastream, Morgan Stanley Research forecasts

Brazil's cost-price squeeze and tighter credit should limit acreage growth and raise downside risk to 2025/26 output. The 2024/25 South America bumper crop left the market well supplied and prices depressed, but funding stress may impair Brazil's ability to expand its production output.

Exhibit 85: Funding is tighter: Agriculture credit growth is decelerating with delinquency at historical records in Brazil
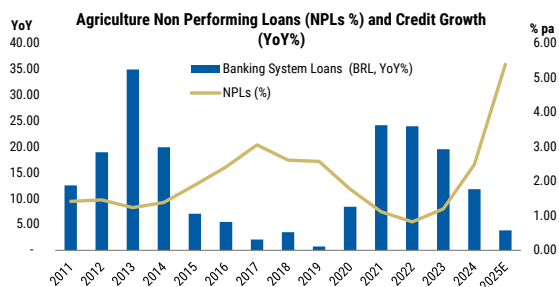
Source: FactSet, IBGE, Banco Central do Brasil, Morgan Stanley Research forecasts

Exhibit 86: Lower credit availability to agriculture is historically associated with lower area expansion in Brazil
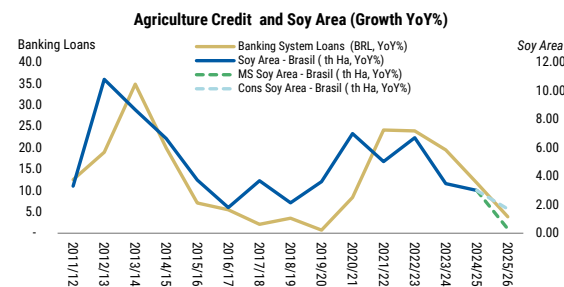
Source: FactSet, Banco Central do Brasil, Morgan Stanley Research forecasts

Global soybean balances should tighten from a comfortable 2024/25 base: Our below-consensus Brazil outlook should be partially offset by good US yields, yet it should be enough to flip the 2025/26 crop toward a deficit, with production around 415 Mt versus demand near 424 Mt. We estimate stocks-to-use at 27%, slightly above the 15-year average of 26%.

In corn, we expect global output to rise to 1,274 Mt on strong US and Argentina crops, but solid demand near 1,282 Mt (+2.7%Y) should keep the deficit in place. We estimate stocks-to-use of around ~18.6%, down from ~21% in 2024/25 and below long-run norms near the mid-20s. Brazil matters less for corn than soy, as price direction hinges on US yields and carryout.

Exhibit 87: We forecast lower production from Brazil, reducing global soy STU ratios to below historical averages to support higher prices ahead
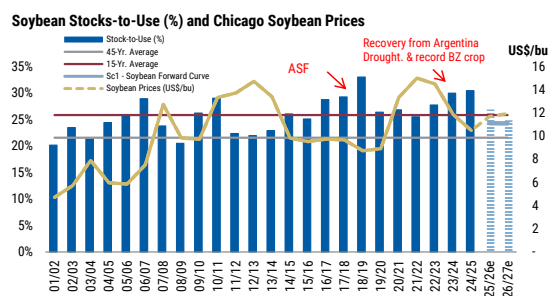
Source: FactSet, USDA, Morgan Stanley Research forecasts

Exhibit 88: Global corn inventory levels fall: STU ratio at 19% versus the historical average of 27%
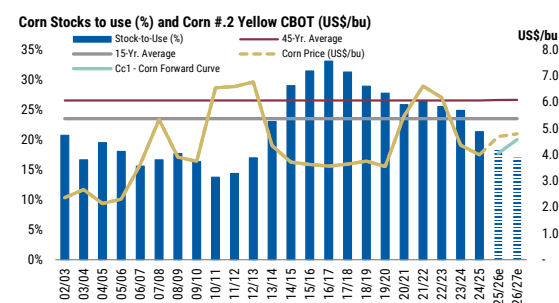
Source: FactSet, USDA, Morgan Stanley Research forecasts

Prices reflect these shifts in supply and demand: With spot near cost floors (soy below many US breakevens) and inventories set to decline, forward curves should keep steepening as markets should pay a premium to secure future supply. We forecast soybean at US$11.7/bu and corn at US$4.7/bu on a 12-18-month view, above current futures. We prefer soy over corn on skew given higher sensitivity to Brazil and a faster-tightening soy balance, while corn's path remains most sensitive to realized US yields and final carryout.

Global Quant: Leaning into the Turn

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Key investment ideas

- We expect a positive outlook for major systematic investment strategies. Our Visionary Quality strategy is set to benefit from the AI boom.

- Moving to regional equity factors, in the **US,** we suggest capturing profitable growth and earnings momentum in a steady expansion. In **Europe,** we focus on earnings resilience and cash generation as US strength underpins sentiment. In **Japan,** we suggest a dual approach integrating macroeconomic and micro-level insights. In **APxJ/EM,** we recommend Value + Sentiment in China and Sentiment in Asia ex China.

Our 2026 quant outlook is largely shaped by Morgan Stanley's economic and strategy forecasts. We highlight our views on the underlying equity market dynamics, expressed via factors, and emphasize several quantitative investment strategies (QIS) across asset classes that can help investors to navigate markets.

Quantitative investment strategies – broadly positive with a pro-cyclical focus

QIS Research uses a combined top-down and bottom-up approach to evaluate the performance outlook of systematic investment strategies. Based on this framework, we find generally a positive outlook for major systematic investment strategies (Exhibit 89). The most negative outlook is found for Commodity Cross Market Carry and Momentum strategies. On the other hand, Commodities Curve Carry has a rather positive outlook in terms of return generation. We also find a generally positive return for Volatility Carry strategies. Equity Quality, Low Risk, and Momentum investing are also expected to do well.

If we overlay this framework with additional indicators and market expectations, we find that Volatility Carry strategies are generally expected to perform in line with historical returns. Performance indicators for Volatility Carry – such as implied versus realized volatility, volatility term structure slope, implied correlations, and implied volatility levels – are all close to historical medians. If we evaluate this outlook versus the backdrop of

generally friendly economic and market expectations from our economists and strategists, this points toward an attractive opportunity set in Volatility Carry. While no Volatility Carry market stands out particularly in its attractiveness, we favor Volatility Carry in Brent and VIX due to their strong return dynamics.

Equity strategies appear generally favorable in light of particularly large idiosyncratic equity market volatility and realized return dispersion. Our Visionary Quality strategy is set to benefit in addition from the AI theme, which we expect to continue to drive markets, while also keeping a balanced defensive profile.

Exhibit 89: Expected returns of key systematic strategies versus t-scores
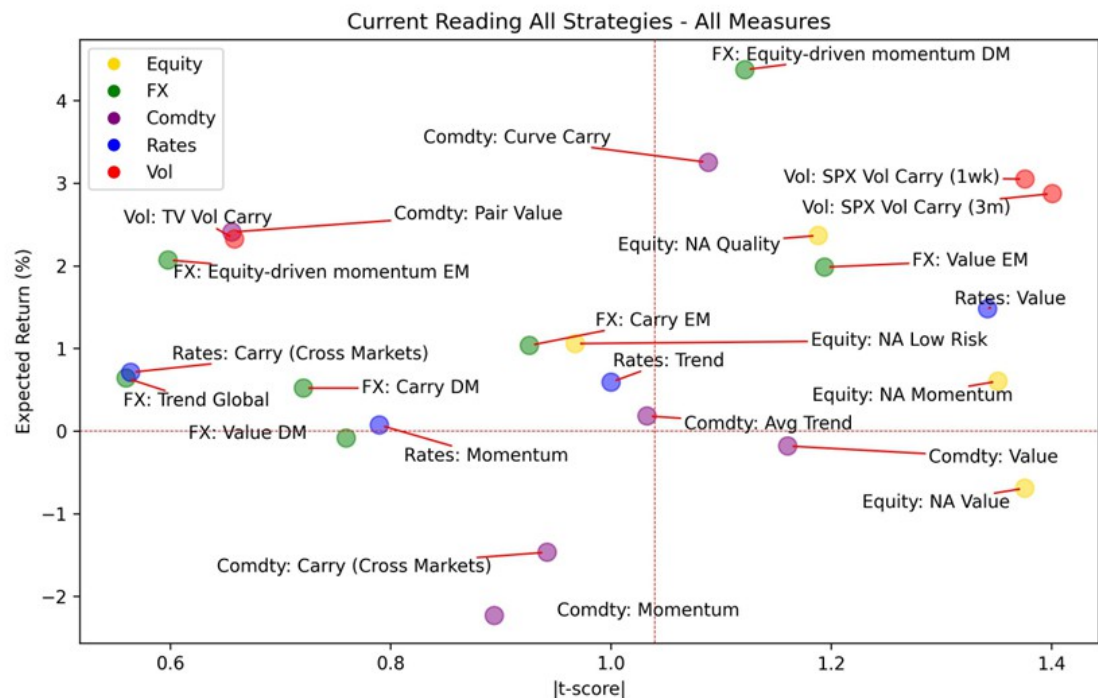
Source: Morgan Stanley Research

Finally, we think that 2026 may see a better year for trend following than recent years. Equity market trends are expected to continue in the US. Short-term rates trend following is also set to benefit from generally lower rates trends. Our enhanced trend-following strategy (see Understanding CTA Positioning and Forecasting CTA Flows, August 8, 2025) is well placed to benefit from these developments.

Exhibit 90: Backtest performance of our recommended US factors in various scenarios of CLI – Earnings Up-Down Revisions deliver consistent strength, while Internal Growth and PEG excel in baseline/upside regimes
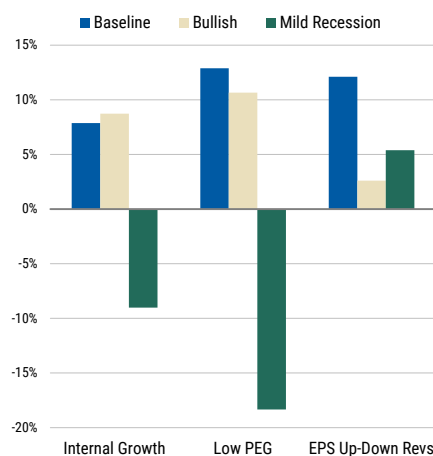
Source: FactSet, OECD, Morgan Stanley Research; Note: Data sample from January 1990 to October 2025. We backtest factor performance across three regimes – baseline expansion, bullish expansion, and mild recession – classified using the OECD CLI level and its monthly spread. Mild recession periods occur when the CLI is slightly below 100 with a negative spread, baseline expansion when it is close to 100 with a positive spread, and bullish expansion when it is well above 100 with a positive spread.

Exhibit 91: Backtest performance of our recommended Europe factors in various scenarios of CLI – all factors deliver consistent strength across scenarios
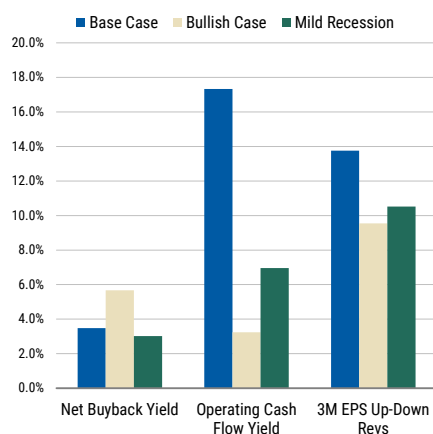
Source: FactSet, OECD, Morgan Stanley Research; Note: Data sample from January 1990 to October 2025. We backtest factor performance across three regimes – baseline expansion, bullish expansion, and mild recession – classified using the OECD CLI level and its monthly spread. Mild recession periods occur when the CLI is slightly below 100 with a negative spread, baseline expansion when it is close to 100 with a positive spread, and bullish expansion when it is well above 100 with a positive spread.

US quant factors – capturing profitable growth and earnings momentum in a steady expansion

Our economists expect the US economy to sustain moderate growth through 2026 as the effects of tariffs and immigration limits linger but are increasingly offset by rising productivity and steady domestic demand. Inflation should gradually decelerate after firming early in the year, bringing core readings closer to target by 2027. The Fed is expected to ease marginally through 2026 before holding rates steady near 3.125%, maintaining policy at a neutral setting. Our strategists view this as a continuation of the rolling recovery, with earnings growth driven by margin expansion and operating leverage, and leadership widening beyond technology into cyclicals.

Against this backdrop, we favor the Growth style with an emphasis on quality and attractive valuation. 'Quality growth' is well represented by the **Internal Growth** factor – defined as retention × ROE – which identifies companies with the capacity to fund expansion from retained earnings, thereby combining profitability, reinvestment, and quality. The factor currently offers a balanced mix of cyclical participation and quality bias, and is exposed to the AI-driven productivity theme, aligning with our economists' expectation of efficiency gains through 2026-27. Growth at attractive valuation is captured via the **Low PEG** factor, which blends valuation discipline with sustainable growth exposure. We also maintain focus on **Up vs. Down EPS Revisions,** reflecting our conviction that equity performance will continue to be distinguished by earnings upgrades and downgrades. Exhibit 90 shows the backtested performance of these three factors under our economists' growth forecast scenarios, using the OECD Composite Leading Indicator (CLI) framework.

Europe quant factors – focusing on earnings resilience and cash generation as US strength underpins sentiment

Our economists expect the euro area to experience a period of weak sequential growth through early 2026, as trade tensions and softer real wages weigh on exports and consumption. Fiscal expansion – driven by Germany's investment program and higher defense spending – should support activity gradually, with growth expected to strengthen into 2027 as investment rebounds and export headwinds fade. Inflation is likely to fall below target in 2026 before stabilizing near 2%Y the following year, prompting further ECB easing to around 1.50% by mid-year before policy turns neutral.
Our strategists note that Europe continues to trade largely on global market sentiment rather than domestic fundamentals. The region lacks clear internal drivers, and competition from China remains a structural challenge for Europe's industrial base. US market strength, AI-related capex, and cross-border M&A activity provide the key external supports. Against this backdrop, we maintain a focus on **Up vs. Down EPS Revisions (3ma),** as stock performance remains reliant on upcoming earnings delivery. We also continue to emphasize **Operating Cash Flow Yield** and **Net Buyback Yield,** which highlight firms with solid internal funding, disciplined capital allocation, and consistent shareholder returns. Together, these factors offer resilience against an uneven backdrop while positioning portfolios to benefit as optimism from global and AI-linked themes extends to European equities, as shown in the factor backtest under our economists' growth forecast scenarios based on the OECD Composite Leading Indicator (CLI) framework in Exhibit 91.
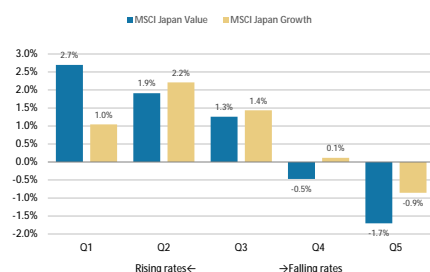
Japan quant factors – a dual approach integrating macroeconomic and micro-level insights

Our equity strategists expect Japanese equities to continue rising in 2026, forecasting the TOPIX to reach 3,600 by year-end. Meanwhile, our macro strategists anticipate that long-term interest rates will dip slightly early in the year but resume their upward trajectory thereafter.

Rising interest rates – partly driven by fiscal expansion from the new administration – and ongoing corporate reforms are supportive for the Value style in Japan. Moreover, our analysis indicates that the importance of Japanese interest rates has increased in recent years, particularly relative to the US. Within the Value factor family, we recommend **Forward P/E,** as earnings-based valuation should attract attention amid solid corporate performance and a rising equity market. Our second recommendation, **Low PEG,** blends Value and Growth, providing an effective hedge during periods when growth stocks – such as AI and semiconductor-related names – rally, as seen in the latter half of this year.

The third recommendation, **EPS revisions,** is a factor that has proven effective over the medium-to-long term. As corporate earnings continue to expand steadily, we expect stock selection based on earnings performance to remain a key driver.

APxJ/EM quant factors – Value + Sentiment in China, Sentiment in Asia ex China
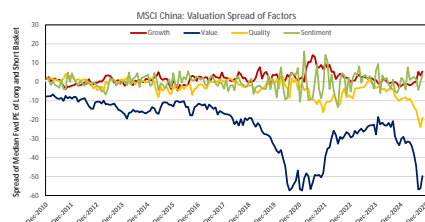
We suggest maintaining distinct strategies for China and Asia ex China – a framework that has helped to hedge factor rotations in China while capturing alpha in the rest of the region.

For China, we recommend pairing Value with Sentiment into 2026, following a strong year for Growth. Our economists expect a challenging macro backdrop and a gradual reflation path, with the GDP deflator likely to turn marginally positive only in 2027. This environment is structurally supportive of Value, which has historically outperformed in deflationary settings. Valuation spreads – the gap between the cheapest and most expensive stocks – are near historical extremes, similar to end-2020 levels, underscoring how stretched the upper tail remains. Seasonality should also provide a tailwind, as renewed risk appetite typically favors cyclical exposure early in the year. We recommend pairing this with Sentiment, as a robust strategy that can help to mitigate factor volatility.

In Asia ex China, we recommend a long position in Sentiment, alongside a balanced Value/Growth bias for Asia ex China stocks. Valuation spreads for expensive versus low-valuation equities remains stretched on a long-run basis, although less than for China. Corporate governance and market reforms should provide an additional tailwind for the factor. However, our colleagues expect a steepening path for the curve across various scenarios, which historically has proven better for growth exposure (and small caps) and hence our preference is for Sentiment (Earnings Revisions, Sales Revisions, Price Momentum, and Short-term Reversal), which has had the best long-run efficacy in the region.

The performance data provided is a hypothetical illustration of mathematical principles; it does not predict or project the performance of an investment or investment strategy. Past performance is no guarantee of future results.

Exhibit 92: Average monthly return of MSCI Japan Value and Growth under rise/fall in JGB 10Y yield environments

Source: FactSet, Morgan Stanley Research

Exhibit 93: China: Factor valuation spread looking particularly stretched for Value

Source: FactSet, Morgan Stanley Research

Exhibit 94: Rank of post-2001 factor returns based on information ratio during bear-steepening/bull-steepening regimes
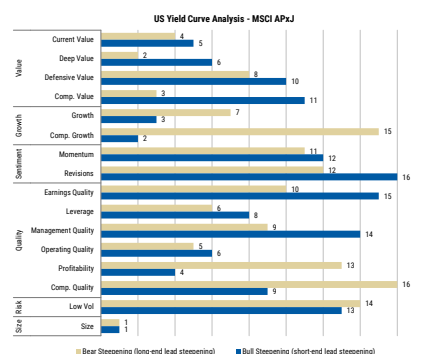
Source: Bloomberg, FactSet, Morgan Stanley Research

What We Debated

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As always, the year ahead outlook involved spirited debates among Morgan Stanley global economics and strategy teams. Here are some key issues we debated:

It's all about US? Resilient consumption, boosted by healthy consumer balance sheets and rising wealth, and strong business spending, especially AI-driven capex, have contributed to the resilience in US growth. Indeed, these two factors were why we never called for a recession earlier this year when markets pulled back on trade policy fears. We debated the prospects for the strength of the US economy to continue to drive global growth and concluded that over the forecast horizon the US remains the most likely economy to drive material upside to global growth. Conversely, if there were to be a material slowdown, it probably has to come from a miscalculation about US growth. Consequently, our global scenarios are driven by US-led shocks.

Policy easing amid resilient growth? Our economists' central case calls for two 25bp policy rate cuts by the Fed in 2026 (following a 25bp cut in December 2025) despite sequential growth improvements. Thanks to the federal government shutdown, we are operating in a data fog and, given the weakness in the labor market before data releases stopped, our economists argued the case for more policy easing ahead, albeit less than what was previously penciled in.

What's next for the global capex cycle? Some of the key debates centered on whether capex will be entirely AI-driven, how timing and sequencing are reflected in macro scenarios, and regional differences. We expect AI-related capex to boost US growth the most, with China's hyperscaler investments also a factor, but only contributing modestly. We debated if the current AI/data center-related capex cycle is a bubble. We concluded that it is not given that the demand for computational power vastly exceeds its supply and the demand/supply imbalance is unlikely to change for a few years. Unlike cyclical non-AI capex projected for 2026-27, we concluded that AI spending is *structural* and that we don't expect any sharp drop-off in AI-related capex — even in a US recession scenario.

Is credit cracking? In the past few months, a few well-telegraphed bankruptcies have sparked the debate on whether they are canaries in the coal mine and whether default rates will spike from here. We maintain the view that these are idiosyncratic and not signs of systemic cracks in the credit markets, both corporate and consumer. While we don't expect defaults to spike, we don't expect a meaningful decline either and instead expect defaults to remain relatively sticky around current levels. That said, we do expect US investment grade credit spreads to widen, mainly because of the expected supply to fund AI and data center-related capex. Having to absorb a meaningful spike in supply would push spreads wider rather than increase expected credit losses.

A choppy year ahead for FX: On one hand, we expect some things to change, with 2026 bringing many pivots and key breaks in trend. USD weakness should continue in the coming months, but then we expect USD to bottom and rebound around 2Q26, ending the USD bear market, and ending the year close to current levels and continuing to rise into 2027. On the other hand, we expect some key themes to stay the same. We think that risk currencies will continue to trade on the front foot all throughout 2026, aided by a buoyant US equity market and declining global interest rates. Oil-sensitive currencies like CAD and NOK, despite being risk-sensitive, continue to face relative drags versus their peers (SEK, AUD, and NZD) thanks to another consistent theme – the failure of oil prices to rise. And, with low realized volatility implied in the forecast profile, we think that carry will remain an important factor driving total returns through the year.

How Do Our Forecasts Compare?

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Where are we versus consensus?

While 'consensus' is a slippery term, we think that it's still informative to benchmark where we are versus the wisdom – or not – of our peers. The exhibits below show our forecasts for 4Q26 versus Bloomberg consensus.

Exhibit 95: How do our FX and commodities targets compare to consensus?

FX	Spot	MS Target	MSe	Cons.
USD/JPY*	155	147	5%	8%
EUR/USD	1.16	1.16	0%	4%
GBP/USD	1.31	1.29	-2%	5%
AUD/USD	0.65	0.67	2%	4%
USD/BRL*	5.29	5.20	2%	-7%
USD/MXN*	18.3	18.2	1%	-4%
USD/INR*	88.6	88.4	0%	1%
USD/ZAR*	17.1	17.8	-4%	0%

COMMODITIES				
Brent	63	60	-4%	-1%
Copper	10,806	10,600	-2%	-2%
Gold	4,123	4,500	9%	-2%

Source: Bloomberg, Morgan Stanley forecasts; Note: The box indicates Morgan Stanley target price and the diamond indicates consensus. The grey bars indicate the high-low range for consensus price targets. For FX with *, price changes are flipped.

Exhibit 96: How do our rates yield targets compare to consensus?

RATES (%)	Spot	MS Target	MSe	Cons.
UST 2yr	3.6	2.60	-99	-26
DBR 2yr	2.03	1.60	-43	16
UKT 2yr	3.76	3.05	-71	-20
JGB 2yr	0.93	1.15	22	25
UST 10yr	4.12	4.05	-7	-5
DBR 10yr	2.69	2.45	-24	28
UKT 10yr	4.44	3.90	-54	-17
JGB 10yr	1.69	1.65	-4	16
UST 2yr	3.59	2.60	-99	-26
UST 5yr	3.71	3.25	-46	-7
UST 10yr	4.12	4.05	-7	-5
UST 30yr	4.71	4.75	4	-10

Source: Bloomberg, Morgan Stanley forecasts; Note: The box indicates Morgan Stanley target price and the diamond indicates consensus. The grey bars indicate the high-low range for consensus price targets. For FX with *, price changes are flipped.

Where we are **more bullish than consensus:**

- **USD:** Our FX strategists now expect JPY, EUR, and AUD to strengthen less against USD than the consensus, and we are above consensus on the DXY by the end of 2026. This is a huge shift from our extreme bearish position on the dollar through most of this year.
- **US, Germany, UK, and Japan government bonds:** Our below-consensus targets for rates are driven largely by our economists' calls for cuts in 2026 for the Fed, the BoE, and the ECB; in particular, for the UK and euro area, we are expecting policy rates to move some way below market pricing. For Japan, we expect the BoJ to remain on hold in 2026.
- **Gold:** Gold has rallied strongly this year but remains our top pick, with strong physical demand and macro factors both providing support. Demand for real assets as a hedge against upside inflation surprises and ongoing economic uncertainty provide additional support.

Where we are **more bearish than consensus:**

- **GBP:** Our economist expects the BoE to cut rates to 2.75% by end-2026 given signs of disinflation and labor market weakness, which drives our GBP target materially weaker. Since high carry/vol is a key source of GBP strength, the BoE

cutting rates to and eventually below neutral sees GBP's carry advantage eroded meaningfully, shifting us more firmly into the left-hand side of the 'sterling scowl'.
- **Brent:** Steady weakening of oil prices driven by seasonally weak demand, continued growth of non-OPEC supply, and OPEC production entering 2026 at an elevated level despite space capacity getting diminished.

Where are our expected returns versus history?

We compare the expected performance of asset classes to returns they've achieved over the last 20 years in the exhibits below. For example, asset A and asset B both have expected annual return of +10%. But historically asset A only sees +5% every year on average, while asset B sees +10%. Asset A's forecast would screen as more notable.

Exhibit 97: Equities, credit, and commodities forecasts compared to past moves in the last 20 years

EQUITIES	Spot	MS Target	Exp Perf	%-tile over last 54%	Hist. Perf. Last 189.83 Low	Med	High	MS TARGET vs HISTORY Lower spot	Higher spot
S&P 500	6845	7800	14%	54%	-19%	13%	33%		
MSCI Europe	2325	2400	3%	39%	-21%	7%	26%		
TOPIX	3359	3600	7%	53%	-27%	5%	44%		
MSCI EM	1403	1400	0%	40%	-28%	6%	49%		

CREDIT (bp)	Spot	MS Target	Exp Perf	%-tile over last 20Y	Hist. Perf. Last 20Y Low	Med	High	MS TARGET vs HISTORY Lower spot	Higher spot
Agency MBS	27	25	-2	58%	56	3	-61		
US IG Credit	81	95	14	35%	152	-4	-102		
EUR IG Credit	82	90	8	40%	141	-2	-123		
EM Sovs	267	260	-7	50%	190	-7	-179		
US HY Credit	284	300	16	43%	438	-18	-343		

Commodities	Spot	MS Target	Exp Perf	%-tile over last	Hist. Perf. Last 152 Low	Med	High	MS TARGET vs HISTORY Lower spot	Higher spot
Brent	63	60	-4%	40%	-49%	2%	76%		
Copper	10806	10600	-2%	46%	-28%	2%	88%		
Gold	4123	4500	9%	48%	-15%	10%	45%		

Source: Bloomberg, Morgan Stanley forecasts; For FX with *, price changes are flipped. Grey cells show distribution of price/yield/spread changes; red dot represents MSe.

Exhibit 98: FX and rates forecasts compared to past moves in the last 20 years

FX	Spot	MS Target	Exp Perf	%-tile over last -	Hist. Perf. Last 20Y Low	Med	High	MS TARGET vs HISTORY Lower spot	Higher spot
USD/JPY*	155	147	5%	73%	-22%	1%	14%		
EUR/USD	1.16	1.16	0%	51%	-15%	0%	14%		
GBP/USD	1.32	1.29	-2%	41%	-18%	-1%	11%		
AUD/USD	0.65	0.67	3%	66%	-18%	-1%	19%		
USD/BRL*	5.30	5.20	2%	60%	-39%	3%	19%		
USD/MXN*	18.3	18.2	1%	61%	-25%	2%	12%		
USD/INR*	88.7	88.4	0%	74%	-18%	3%	9%		
USD/ZAR*	17.0	17.8	-4%	59%	-30%	7%	16%		

RATES (%)	Spot	MS Target	Exp Perf (bp)	%-tile over last 20Y	Hist. Perf. Last 20Y Low	Med	High	MS TARGET vs HISTORY Lower spot	Higher spot
UST 2yr	3.59	2.60	-99	81%	234	4	-210		
DBR 2yr	2.03	1.60	-43	78%	201	-8	-176		
UKT 2yr	3.76	3.05	-71	85%	240	-9	-214		
JGB 2yr	0.93	1.15	22	15%	54	0	-29		
UST 5yr	3.71	3.25	-46	68%	173	0	-156		
DBR 5yr	2.29	1.95	-34	65%	160	-10	-148		
UKT 5yr	3.90	3.30	-60	77%	220	-20	-152		
JGB 5yr	1.24	1.25	1	48%	56	0	-38		
UST 10yr	4.12	4.05	-7	50%	137	-6	-146		
DBR 10yr	2.69	2.45	-24	62%	132	-6	-118		
UKT 10yr	4.44	3.90	-54	78%	208	-12	-130		
JGB 10yr	1.69	1.65	-4	51%	60	-3	-39		
UST 30yr	4.71	4.75	4	49%	120	2	-134		
DBR 30yr	3.28	3.10	-18	59%	125	-5	-121		
UKT 30yr	5.23	4.70	-53	83%	190	-2	-107		
JGB 30yr	3.18	3.25	7	40%	78	-6	-57		

Source: Bloomberg, Morgan Stanley forecasts; For FX with *, price changes are flipped. Grey cells show distribution of price/yield/spread changes; red dot represents MSe.

Where we are expecting **much stronger performance compared to history:**

- **Front-end yields:** On top of being below consensus on our targets for front-end rates, the declines we're expecting to see are also bigger than 'normal'. This reflects our strong view that US front-end yields are underpricing the risk of more Fed cuts and a growth slowdown.
- **UKT:** Subdued supply and policy easing create a favorable backdrop for UKT yields to fall by a greater magnitude than what's typical.

Where we are expecting **much weaker performance compared to history:**

- **JGB 2Y:** Our economists expect the BoJ to deliver another 25bp hike in December 2025, no additional hikes in 2026, and resume tightening in 2027. We'd note that it would have been surprising if our forecast move in JGB yields looked relatively *in the range* of the last 20 years' history. After all, we are moving away from ZIRP with the BoJ resuming hiking in 2027.

Expected Returns and Risk/Reward

Exhibit 99: Morgan Stanley forecasts

	As of Nov 12, 2025	Q4 2026 Forecast			Q4 2026 Return Forecast			Volatility	Base Case Return/Risk
		Bear	Base	Bull	Bear	Base	Bull		
Equities						Total Returns			
S&P 500	6,851	5,600	7,800	9,000	-17.1%	15.0%	32.5%	18%	0.81
MSCI Europe	2,343	1,920	2,430	2,700	-15.1%	6.7%	18.2%	15%	0.44
Topix	3,359	2,440	3,600	4,250	-25.2%	9.3%	28.7%	19%	0.49
MSCI EM	1,408	960	1,400	1,800	-29.5%	1.7%	30.1%	16%	0.11
FX						Total Returns			
JPY*	155	163	147	125	-8.6%	2.2%	20.8%	9%	0.24
EUR	1.16	1.05	1.16	1.36	-11.1%	-1.6%	15.6%	7%	-0.22
GBP	1.31	1.21	1.29	1.45	-7.8%	-1.7%	10.4%	9%	-0.18
AUD	0.65	0.61	0.67	0.75	-6.7%	2.5%	14.7%	10%	0.24
INR*	88.6	92.0	88.4	86.0	-1.2%	2.4%	5.0%	5%	0.51
ZAR*	17.1	18.7	17.8	16.4	-5.8%	-1.2%	7.0%	16%	-0.08
BRL*	5.29	6.20	5.20	4.75	-6.3%	10.1%	19.8%	16%	0.65
MXN*	18.3	21.0	18.2	17.5	-8.9%	4.8%	8.5%	13%	0.38
Rates (% percent)						Total Returns			
UST 10yr	4.07	5.15	4.05	2.65	-3.3%	5.3%	16.9%	7%	0.79
DBR 10yr	2.64	2.90	2.45	2.05	1.1%	5.0%	8.5%	6%	0.88
UKT 10yr	4.40	4.65	3.90	3.25	3.3%	9.1%	14.4%	7%	1.38
JGB 10yr	1.68	2.30	1.65	1.05	-2.9%	2.7%	8.2%	2%	1.08
Credit (bps)						Excess Returns			
US IG	82	140	95	70	-3.2%	-0.1%	1.6%	3%	-0.03
US HY	283	450	300	250	-2.9%	1.8%	3.5%	6%	0.30
EUR IG	81	150	90	60	-2.3%	0.4%	1.8%	2%	0.23
EUR HY	274	450	280	225	-4.1%	1.7%	3.5%	5%	0.36
EM $ Sov	268	400	260	225	-6.2%	3.0%	5.3%	7%	0.42
Sec. Products (bps)						Excess Returns			
US Agency MBS	28	50	25	15	-1.0%	0.5%	1.1%	2%	0.25
US CMBS AAA	74	110	75	60	-2.8%	0.6%	2.1%	2%	0.40
US CMBS BBB-	500	750	475	390	-19.8%	7.5%	15.9%	4%	2.10
Commodities						Total Returns			
Brent	63	50	60	120	-19.7%	-3.7%	92.7%	39%	-0.10
Copper	10,930	8,700	10,600	12,700	-19.9%	-2.4%	17.0%	21%	-0.11
Gold	4,137	3,825	4,500	5,400	-12.6%	2.8%	23.4%	15%	0.19

Source: Bloomberg, MSCI, Morgan Stanley Research forecasts; Note: Returns are total returns, except for credit, where we forecast excess returns versus government bonds. Commodity returns are calculated relative to futures to account for carry. Volatility is 10y realized vol. All currency returns are shown as XXXUSD return. *Currency forecasts shown for USDXXX.

Exhibit 100: Global asset classes – expected 4Q26 return vs. risk
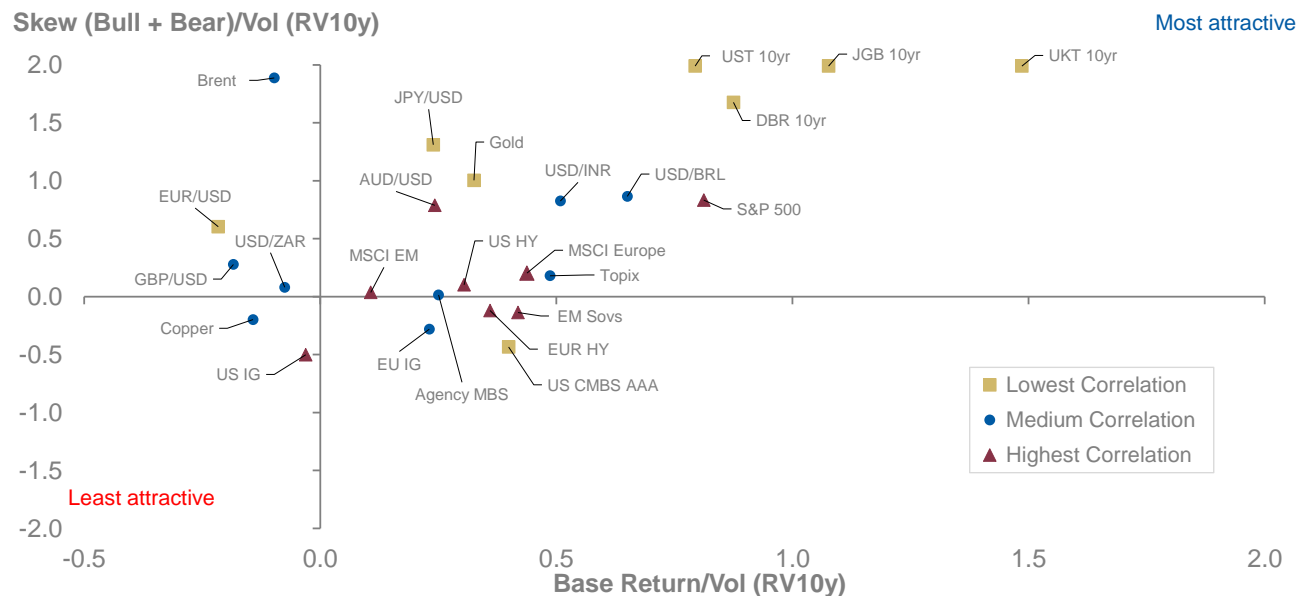
Source: Bloomberg, Market1, MSCI, Morgan Stanley Research forecasts; Note: 'Expected returns' based on Morgan Stanley strategy 4Q26 forecasts. Correlation is 10y relative to global equities (MSCI ACWI). Returns are total returns, except for credit, where we forecast excess returns versus government bonds. Commodity returns are calculated relative to futures to account for carry. All currency returns are shown as XXXUSD return. Volatility is 10y realised vol.

Major Markets Risk/Reward Charts

Global Equities

Exhibit 101: S&P 500 bull/base/bear forecasts
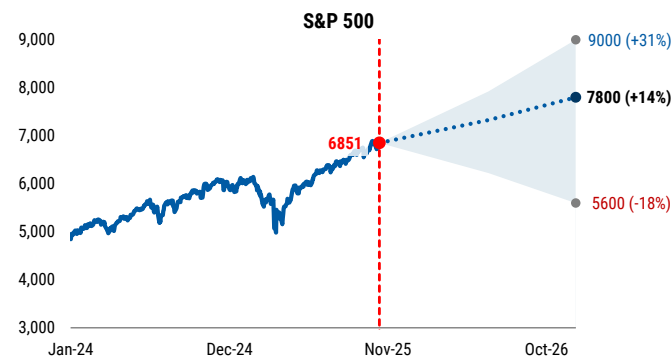
S&P 500

- 9000 (+31%)
- 7800 (+14%)
- 6851
- 5600 (-18%)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 102: MSCI Europe bull/base/bear forecasts
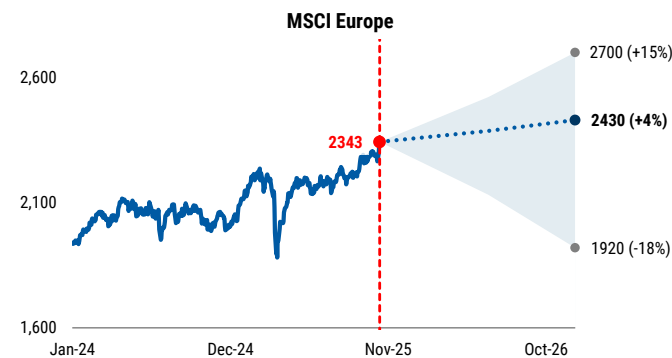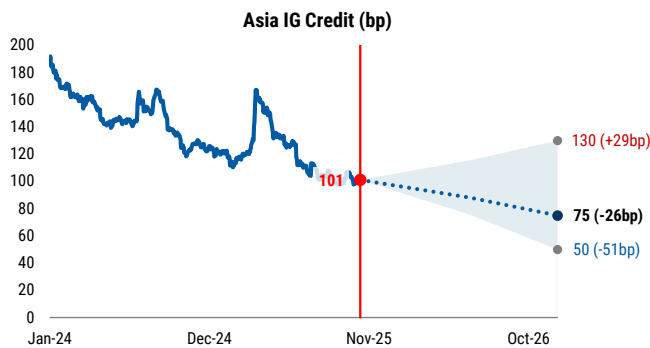
MSCI Europe

- 2700 (+15%)
- 2430 (+4%)
- 2343
- 1920 (-18%)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 103: TOPIX bull/base/bear forecasts
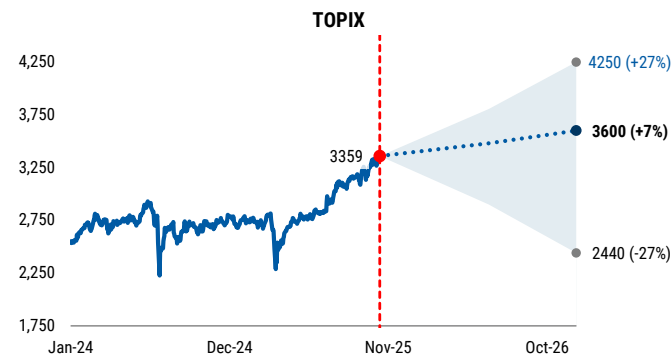
TOPIX

- 4250 (+27%)
- 3600 (+7%)
- 3359
- 2440 (-27%)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 104: MSCI EM bull/base/bear forecasts
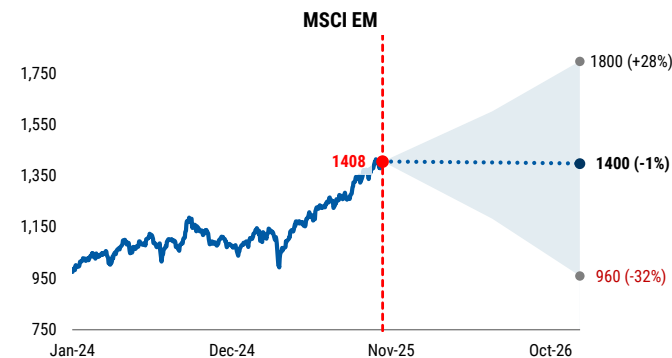
MSCI EM

- 1800 (+28%)
- 1400 (-1%)
- 1408
- 960 (-32%)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

G4 Rates - 2Y

Exhibit 105: UST 2Y bull/base/bear forecasts
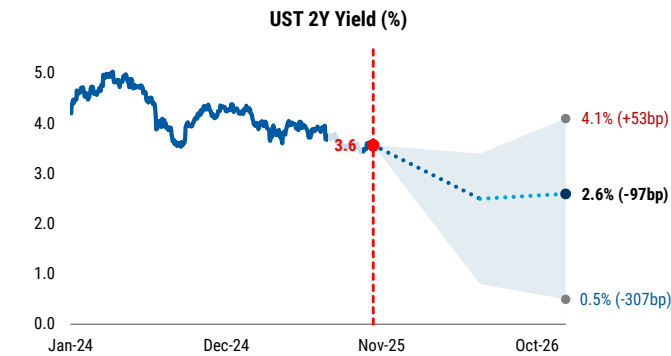
Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

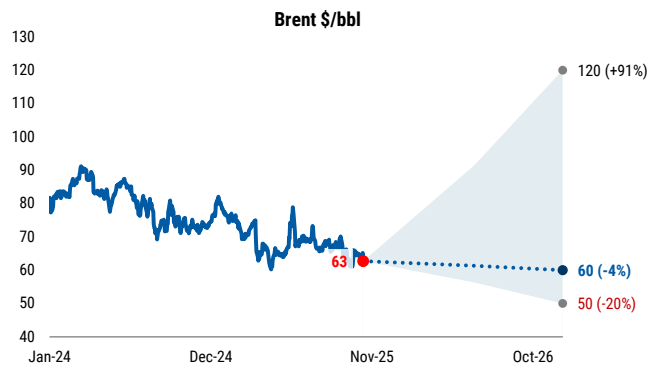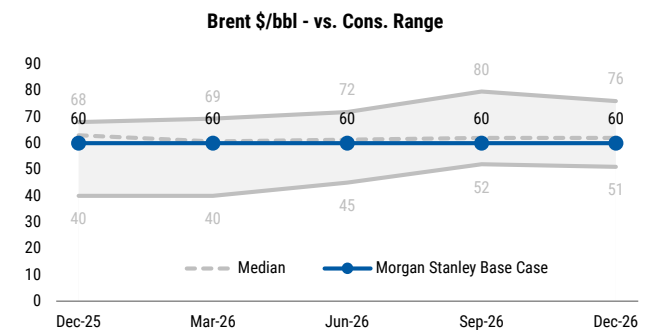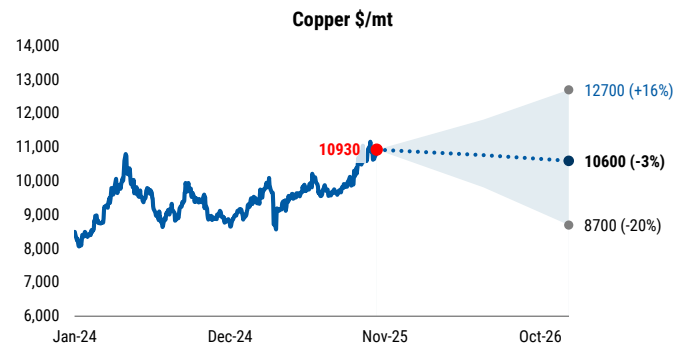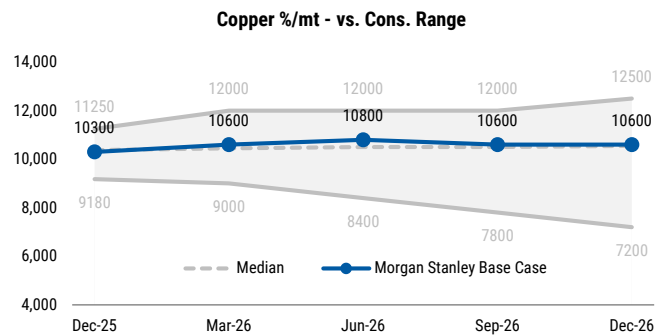**Exhibit 106:** UST 2Y - MSe vs consensus
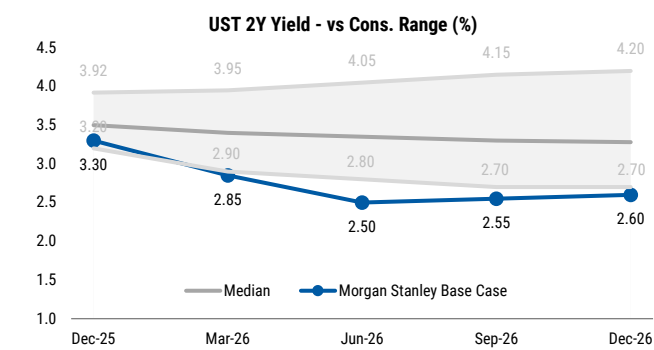
Source: Bloomberg, Morgan Stanley Research forecasts

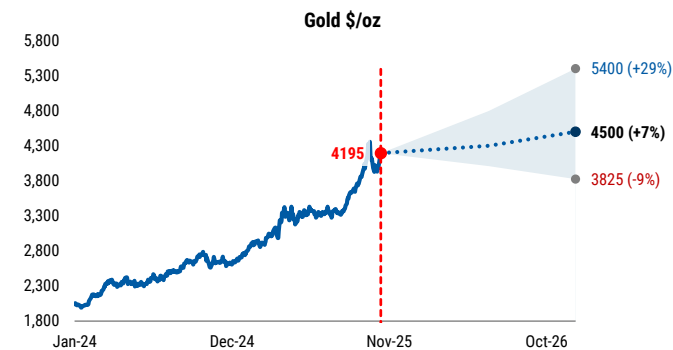**Exhibit 107:** DBR 2Y bull/base/bear forecasts
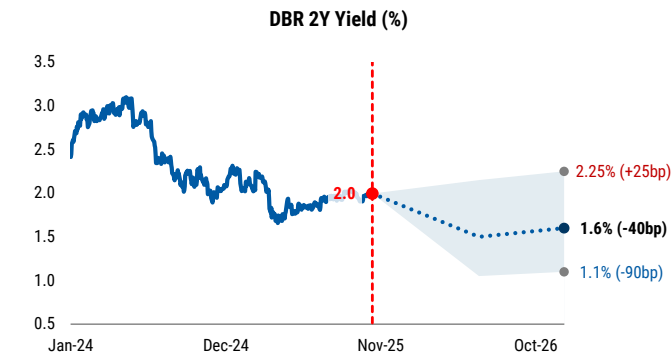
Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

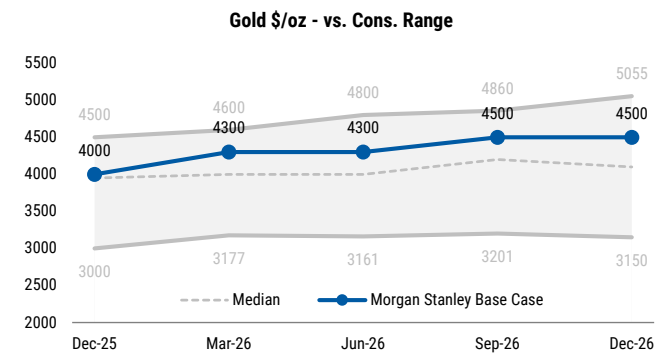**Exhibit 108:** DBR 2Y - MSe vs consensus
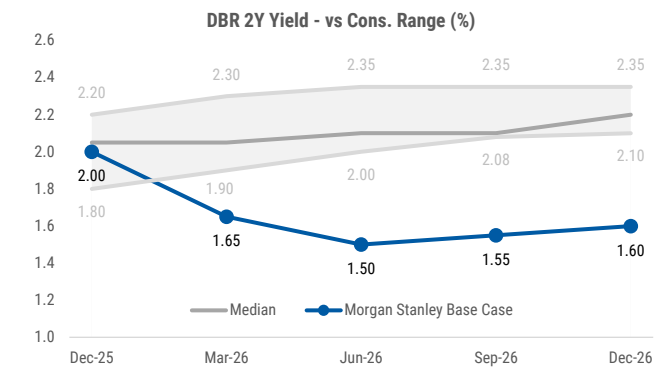
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 109: JGB 2Y bull/base/bear forecasts
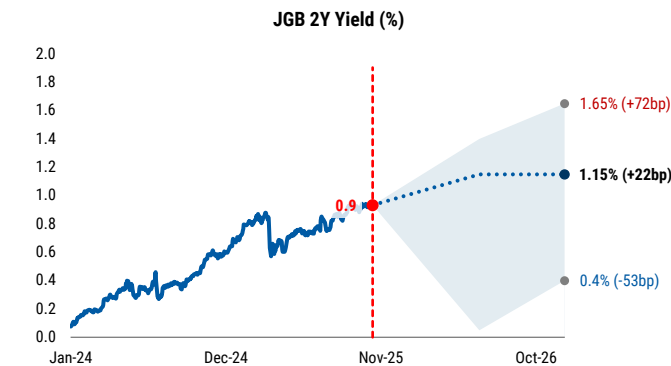
Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 110: JGB 2Y - MSe vs consensus
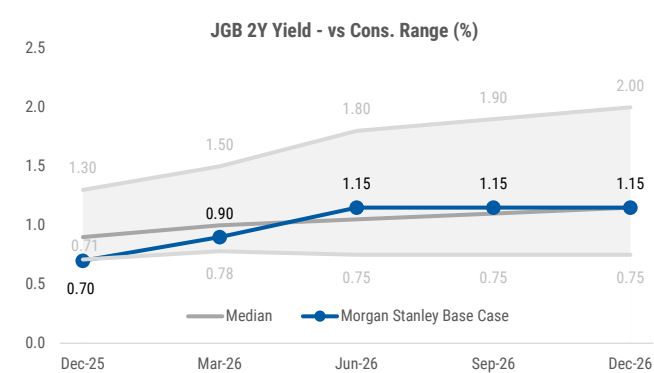
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 111: UKT 2Y bull/base/bear forecasts
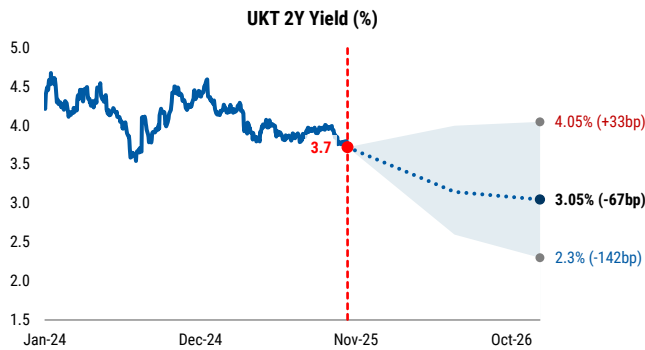
UKT 2Y Yield (%)

4.05% (+33bp)
3.05% (-67bp)
2.3% (-142bp)

3.7

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 112: UKT 2Y - MSe vs consensus

UKT 2Y - vs Cons. Range (%)

3.90 3.80 3.80 3.80 3.80
3.70 3.60 3.40 3.40 3.25
3.70 3.50 3.15 3.05 3.05

Median — Morgan Stanley Base Case
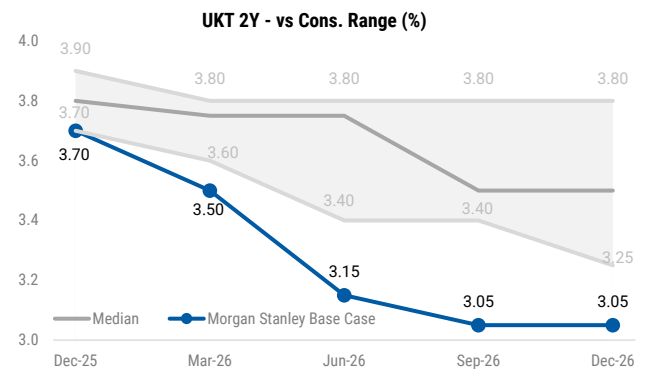
Source: Bloomberg, Morgan Stanley Research forecasts

G4 Rates - 10Y

Exhibit 113: UST 10Y bull/base/bear forecasts
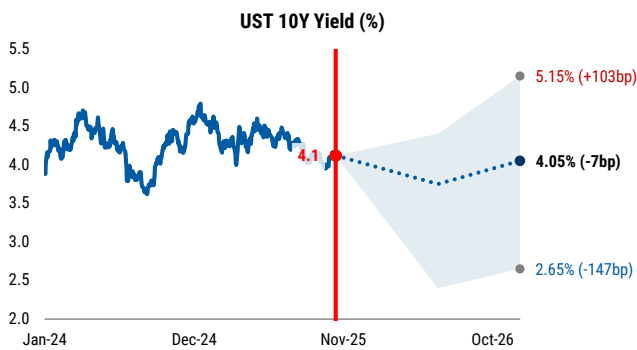
UST 10Y Yield (%)

5.15% (+103bp)
4.05% (-7bp)
2.65% (-147bp)

4.1

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 114: UST 10Y - MSe vs consensus

UST 10Y Yield - vs Cons. Range (%)

4.60 4.65 4.75 4.80 4.75
3.80 3.60 3.40 3.30 3.15
4.00 3.80 3.75 3.95 4.05

Median — Morgan Stanley Base Case
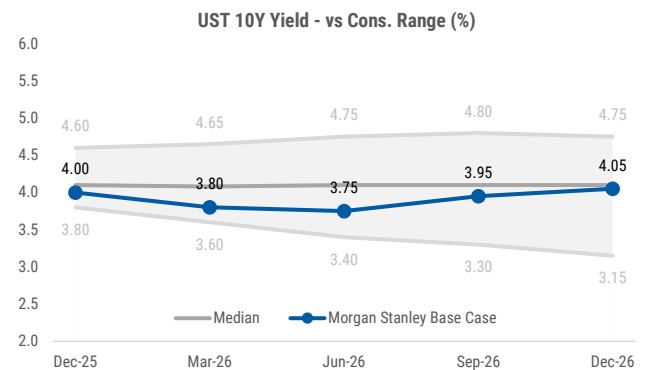
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 115: DBR 10Y bull/base/bear forecasts
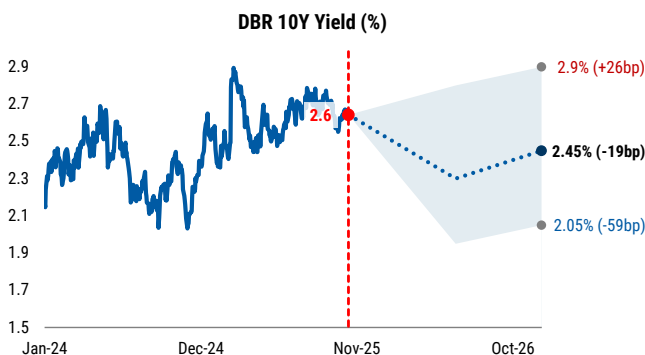
DBR 10Y Yield (%)

2.9% (+26bp)
2.45% (-19bp)
2.05% (-59bp)

2.6

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 116: DBR 10Y - MSe vs consensus

DBR 10Y Yield - vs Cons. Range (%)

3.00 3.15 3.30 3.30 3.25
2.50 2.60 2.70 2.70 2.70
2.65 2.40 2.30 2.35 2.45

Median — Morgan Stanley Base Case
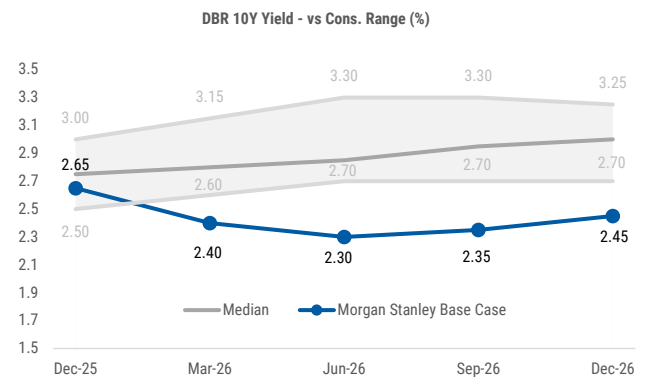
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 117: JGB 10Y bull/base/bear forecasts
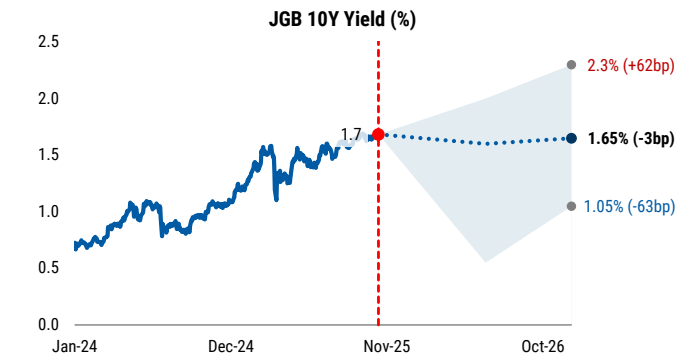
JGB 10Y Yield (%)

- 2.3% (+62bp)
- 1.65% (-3bp)
- 1.05% (-63bp)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 118: JGB 10Y - MSe vs consensus

JGB 10Y Yield - vs Cons. Range (%)

Median —— Morgan Stanley Base Case
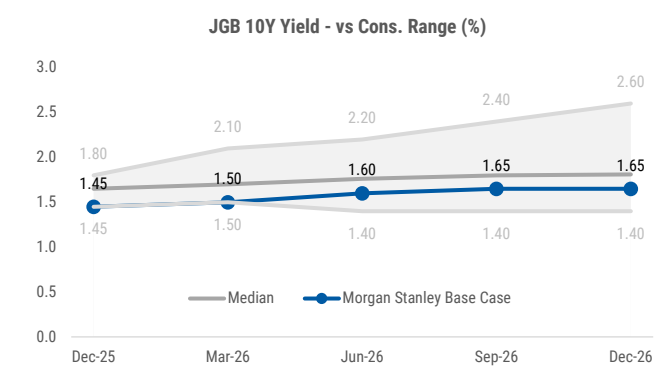
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 119: UKT 10Y bull/base/bear forecasts
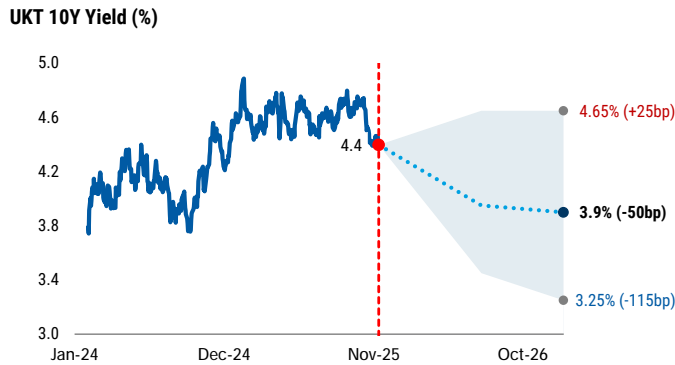
UKT 10Y Yield (%)

- 4.65% (+25bp)
- 3.9% (-50bp)
- 3.25% (-115bp)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 120: UKT 10Y - MSe vs consensus

UKT 10Y Yield - vs Cons. Range (%)

Median —— Morgan Stanley Base Case
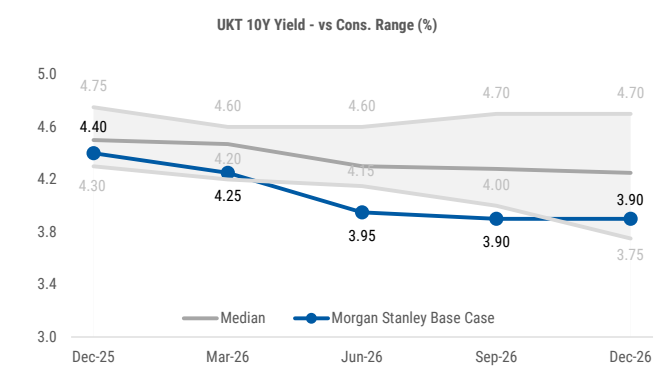
Source: Bloomberg, Morgan Stanley Research forecasts

FX

Exhibit 121: DXY index bull/base/bear forecasts

DXY Index

99 ... 98.90

Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 122: DXY index - MSe vs consensus

DXY - vs Cons. Range

Median —— Morgan Stanley Base Case
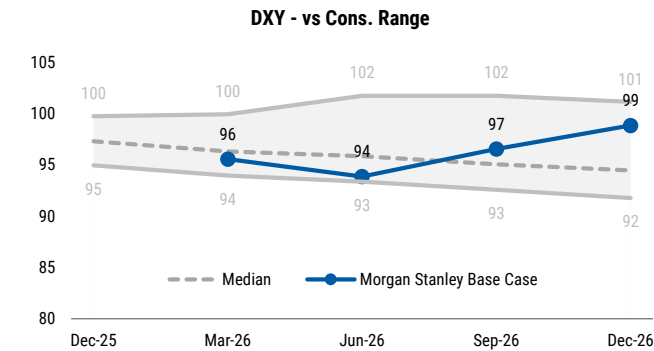
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 123: EUR/USD bull/base/bear forecasts
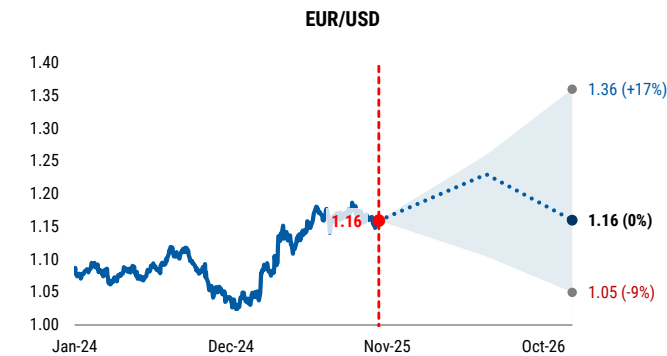
EUR/USD

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 124: EUR/USD- MSe vs consensus

EUR/USD - vs Cons. Range
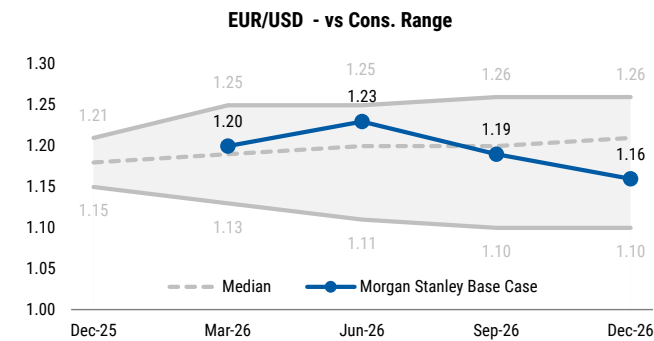
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 125: USD/JPY bull/base/bear forecasts
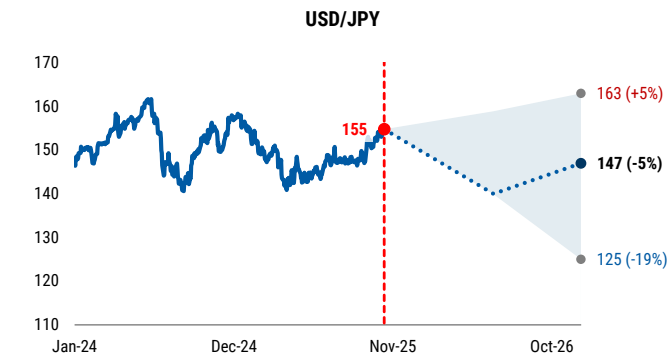
USD/JPY

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 126: USD/JPY - MSe vs consensus

USD/JPY - vs. Cons. Range
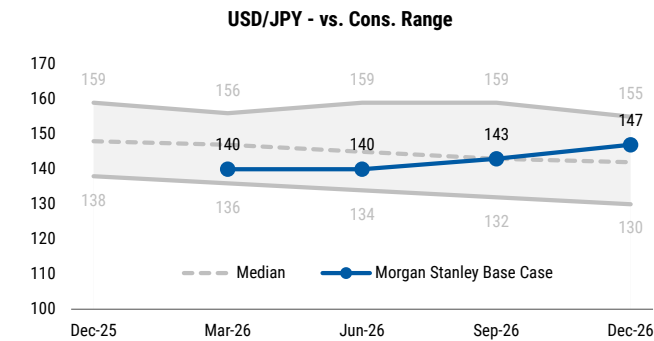
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 127: GBP/USD bull/base/bear forecasts
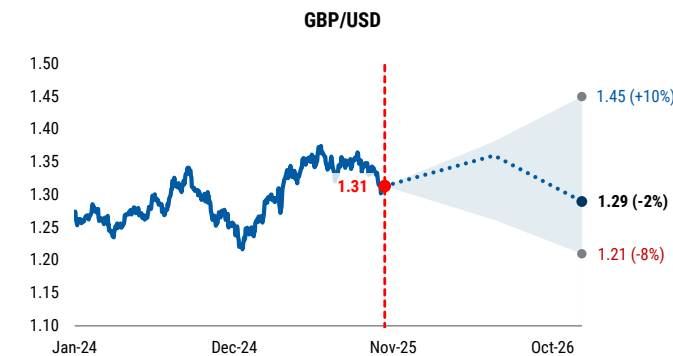
GBP/USD

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 128: GBP/USD - MSe vs consensus

GBP/USD - vs Cons. Range
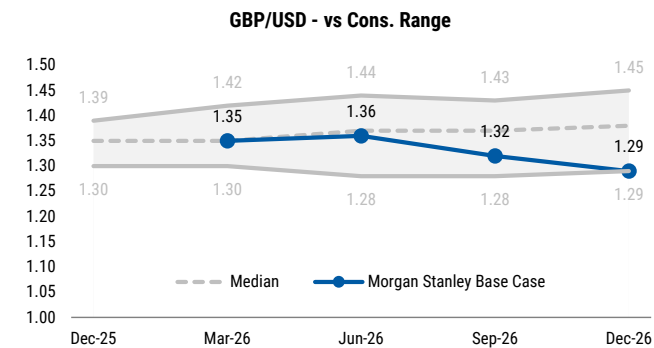
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 129: AUD/USD bull/base/bear forecasts
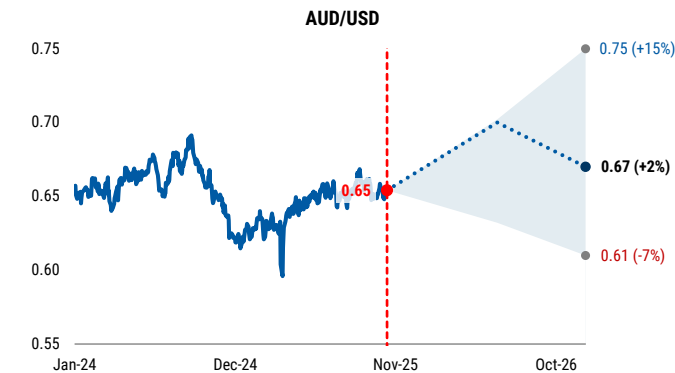
AUD/USD

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 130: AUS/USD - MSe vs consensus

AUD/USD - vs Cons. Range
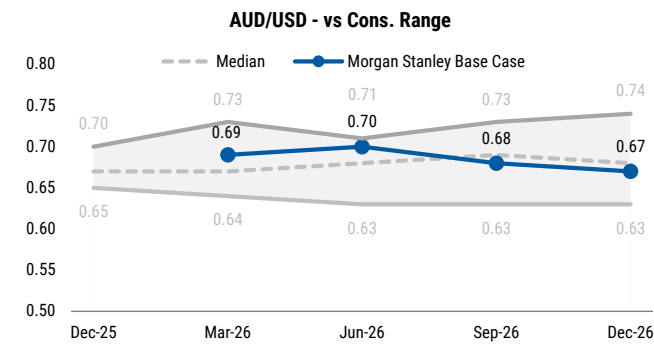
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 131: USD/INR bull/base/bear forecasts
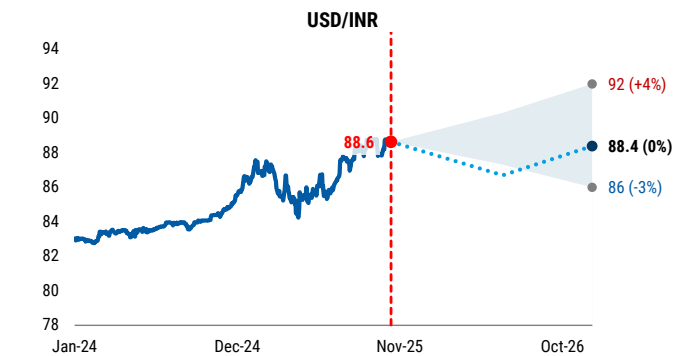
USD/INR

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 132: USD/INR - MSe vs consensus

USD/INR - vs. Cons. Range
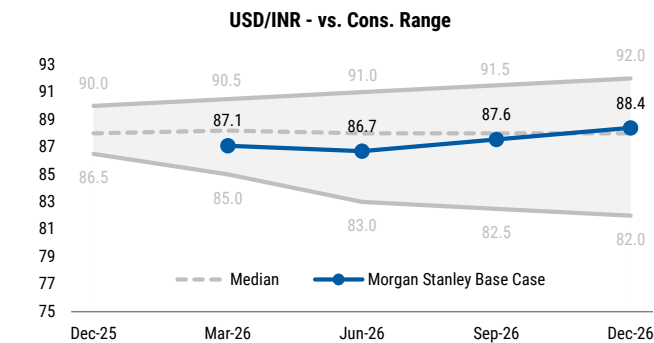
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 133: USD/BRL bull/base/bear forecasts
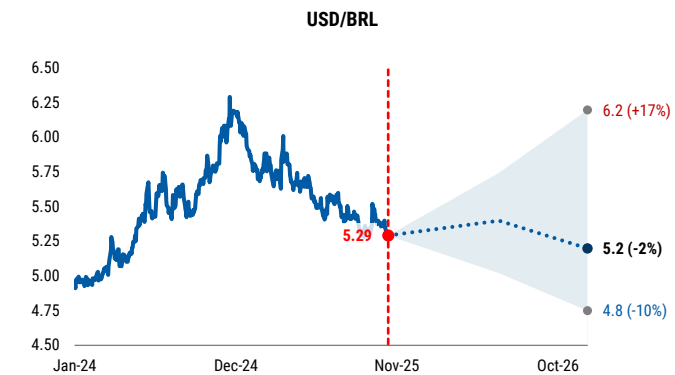
USD/BRL

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 134: USD/BRL - MSe vs consensus

USD/BRL - vs. Cons. Range
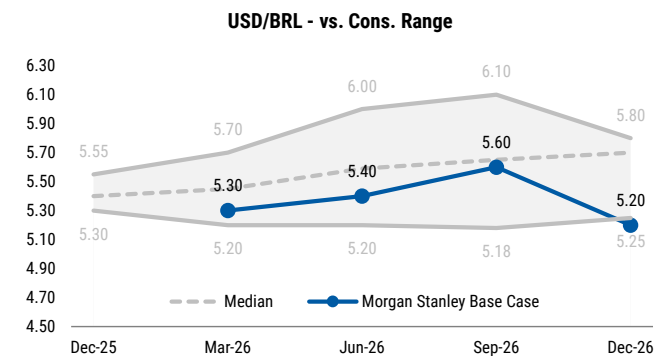
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 135: USD/MXN bull/base/bear forecasts
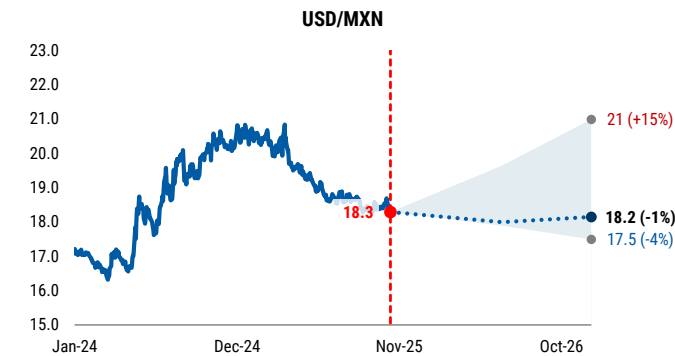
Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 136: USD/MXN - MSe vs consensus
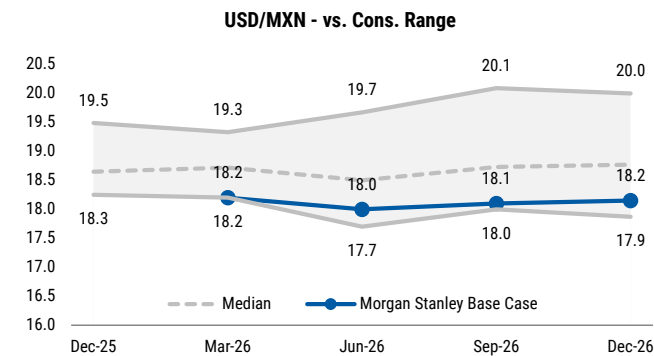
Source: Bloomberg, Morgan Stanley Research forecasts

Exhibit 137: USD/ZAR bull/base/bear forecasts
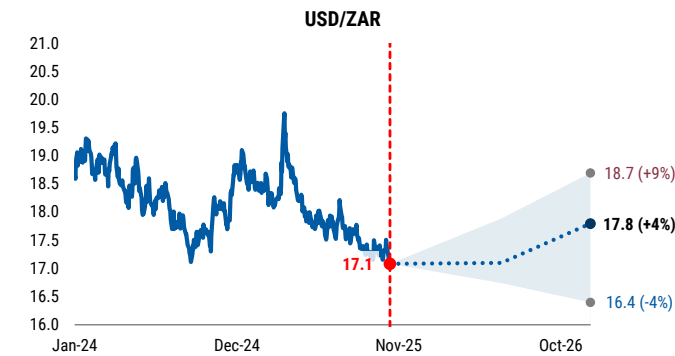
Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 138: USD/ZAR - MSe vs consensus
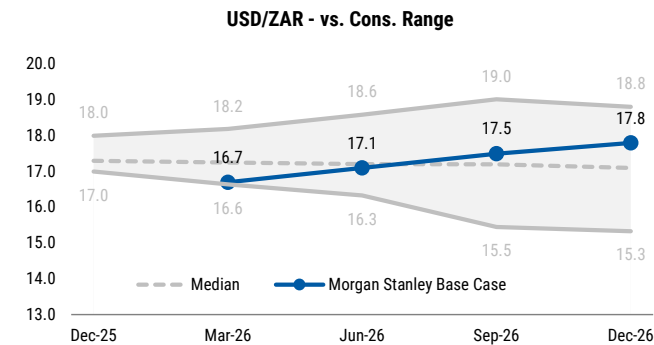
Source: Bloomberg, Morgan Stanley Research forecasts

Corporate Credit

Exhibit 139: US IG corporates bull/base/bear forecasts

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 140: US HY corporates bull/base/bear forecasts
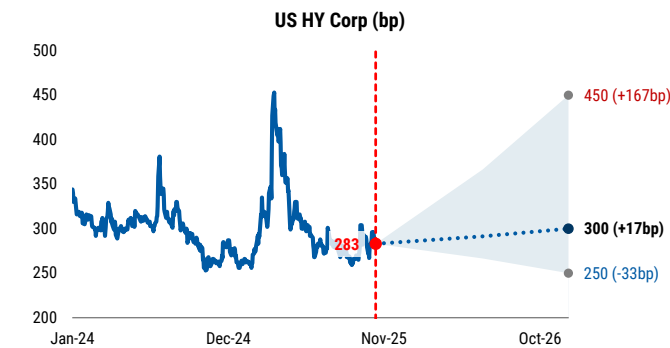
Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 141: EUR IG corporates bull/base/bear forecasts
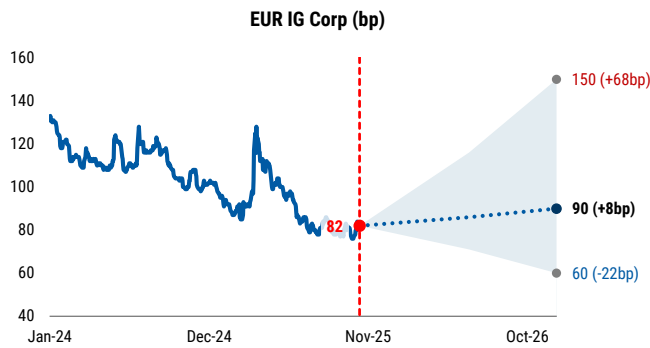
EUR IG Corp (bp)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 142: EUR HY corporates bull/base/bear forecasts
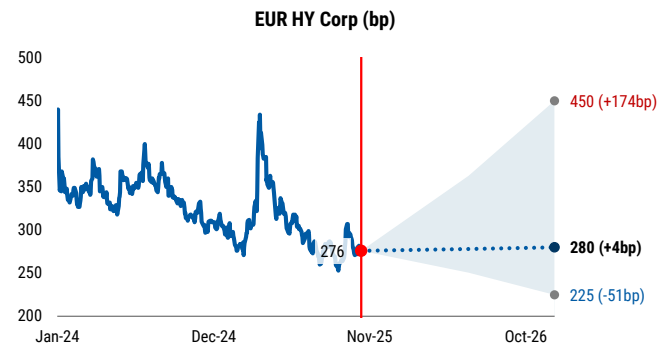
EUR HY Corp (bp)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 143: Asia IG credit bull/base/bear forecasts

Asia IG Credit (bp)

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Commodities

Exhibit 144: Brent bull/base/bear forecasts

Brent $/bbl

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 145: Brent - MSe vs consensus

Brent $/bbl - vs. Cons. Range

Source: Bloomberg, Morgan Stanley Research forecast

Exhibit 146: Copper bull/base/bear forecasts

Copper $/mt

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 147: Copper - MSe vs consensus

Copper %/mt - vs. Cons. Range

Source: Bloomberg, Morgan Stanley Research forecast

Exhibit 148: Gold bull/base/bear forecasts

Gold $/oz

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Range shows our bull/base/bear case targets.

Exhibit 149: Gold - MSe vs consensus

Gold $/oz - vs. Cons. Range

Source: Bloomberg, Morgan Stanley Research forecast

Morgan Stanley Key Economic Forecasts

Exhibit 150: Morgan Stanley economic forecasts

	2025				2026				2027				2025E	2026E	2027E
Real GDP (%Y)	1Q	2Q	3Q	4QE	1QE	2QE	3QE	4QE	1QE	2QE	3QE	4QE			
Global	**3.6**	**3.6**	**3.3**	**3.0**	**3.2**	**3.0**	**3.0**	**3.2**	**3.3**	**3.3**	**3.3**	**3.2**	**3.4**	**3.1**	**3.3**
G10	**1.8**	**1.8**	**1.6**	**1.2**	**1.4**	**1.2**	**1.1**	**1.5**	**1.6**	**1.6**	**1.6**	**1.7**	**1.6**	**1.3**	**1.6**
US	2.0	2.1	2.2	1.6	2.1	1.6	1.2	1.8	1.9	2.0	2.0	2.0	2.0	1.7	2.0
Euro Area	1.6	1.5	1.3	1.1	0.8	1.0	1.0	1.1	1.2	1.2	1.2	1.3	1.4	1.0	1.2
Japan	1.7	1.7	0.5	0.0	0.4	0.0	1.0	1.0	1.0	1.1	1.2	1.2	1.0	0.6	1.1
UK	1.8	1.4	1.3	1.0	0.7	0.7	0.9	1.2	1.4	1.6	1.7	1.8	1.4	0.9	1.6
EM	**4.9**	**4.9**	**4.6**	**4.3**	**4.5**	**4.4**	**4.4**	**4.5**	**4.5**	**4.4**	**4.4**	**4.4**	**4.7**	**4.5**	**4.4**
China	5.4	5.2	4.8	4.6	4.8	4.7	4.8	5.0	4.8	4.7	4.6	4.5	5.0	4.8	4.6
India	7.4	7.8	7.1	6.3	6.3	6.5	6.4	6.4	6.6	6.5	6.6	6.4	7.1	6.4	6.5
Brazil	2.9	2.2	1.9	2.2	2.2	2.1	1.7	1.9	1.7	1.4	1.9	2.4	2.3	2.0	1.8
Mexico	0.9	0.0	-0.2	1.1	1.0	1.1	1.5	2.0	2.4	2.3	2.2	2.0	0.5	1.4	2.3
Consumer price inflation (%Y)															
Global	**2.1**	**1.9**	**1.8**	**1.8**	**2.0**	**2.1**	**2.0**	**2.0**	**2.0**	**2.1**	**2.2**	**2.2**	**2.0**	**2.0**	**2.1**
G10	**2.6**	**2.4**	**2.7**	**2.6**	**2.2**	**2.4**	**2.3**	**2.2**	**2.1**	**2.1**	**2.1**	**2.2**	**2.6**	**2.3**	**2.1**
US	2.7	2.5	2.9	2.9	2.8	3.1	2.8	2.6	2.5	2.4	2.4	2.5	2.8	2.8	2.4
Euro Area	2.3	2.0	2.1	2.0	1.5	1.8	1.7	1.7	1.7	1.8	1.7	1.7	2.1	1.7	1.7
Japan*	3.8	3.4	2.9	2.6	1.7	1.8	1.9	1.6	1.8	2.0	2.0	2.1	3.2	1.7	2.0
UK	2.8	3.5	3.8	3.4	2.7	2.2	2.0	1.9	2.0	2.1	2.2	2.1	3.4	2.2	2.1
EM	**1.7**	**1.5**	**1.2**	**1.3**	**1.8**	**1.8**	**1.8**	**1.9**	**1.9**	**2.0**	**2.2**	**2.2**	**1.5**	**1.8**	**2.1**
China	-0.1	0.0	-0.2	0.2	0.3	0.2	0.2	0.3	0.5	0.7	0.7	0.8	0.0	0.2	0.7
India	3.7	2.7	1.7	1.1	3.5	4.4	4.0	4.1	3.6	3.8	4.4	4.5	2.3	4.0	4.0
Brazil	5.0	5.4	5.2	4.5	4.2	3.7	3.8	4.2	4.1	4.0	3.8	3.7	5.0	4.0	3.9
Mexico	3.7	4.2	3.6	3.6	3.8	3.6	3.8	4.1	4.4	3.7	3.6	3.6	3.8	3.9	3.9
Monetary policy rate (% p.a.)															
US	4.375	4.375	4.125	3.625	3.375	3.125	3.125	3.125	3.125	3.125	3.125	3.125	3.625	3.125	3.125
Euro Area^^	2.50	2.00	2.00	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50	2.00	1.50	1.50
Japan*	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	0.75	0.75	1.25
UK	4.50	4.25	4.00	3.75	3.25	2.75	2.75	2.75	2.75	2.75	2.75	3.00	3.75	2.75	3.00
China**	1.50	1.40	1.40	1.40	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.40	1.30	1.30
India	6.25	5.50	5.50	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.50	5.75	5.25	5.25	5.75
Brazil	14.25	15.00	15.00	15.00	14.50	13.50	12.50	11.50	11.00	10.50	10.00	10.00	15.00	11.50	10.00
Mexico	9.00	8.00	7.50	7.00	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	7.00	6.50	6.50

Source: IMF, Haver Analytics, Morgan Stanley Research forecasts; Note: Global and regional aggregates are GDP-weighted averages, using PPP weights. CPI figures represent period averages. *Japan headline inflation includes VAT and free education impact. Japan's core CPI is excluding energy and fresh food, and ex VAT and Free child education impact. Policy rate indicated is the BoJ's Uncollateralized Overnight Call Rate Upper Limit. ^^ECB Deposit Facility rate; **7-day reverse repo rate. Turkey, Egypt and Argentina are excluded when calculating Global, EM, CEEMEA and LatAm aggregates. Saudi Arabia is excluded for Core CPI aggregates.

Morgan Stanley Global Currency Forecasts

Exhibit 151: Morgan Stanley FX forecasts

	2026				2027			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
EUR/USD	1.20	1.23	1.19	1.16	1.15	1.15	1.14	1.14
USD/JPY	140	140	143	147	145	142	140	138
GBP/USD	1.35	1.36	1.32	1.29	1.28	1.28	1.27	1.26
USD/CHF	0.78	0.76	0.79	0.82	0.83	0.83	0.84	0.84
USD/SEK	9.08	8.86	9.16	9.31	9.33	9.34	9.36	9.37
USD/NOK	9.83	9.59	9.92	10.09	9.97	9.86	9.74	9.63
USD/CAD	1.40	1.39	1.38	1.39	1.38	1.38	1.37	1.36
AUD/USD	0.69	0.70	0.68	0.67	0.67	0.68	0.68	0.68
NZD/USD	0.57	0.59	0.59	0.59	0.61	0.62	0.64	0.66
EUR/JPY	168	172	170	171	167	164	160	157
EUR/GBP	0.89	0.90	0.90	0.90	0.90	0.90	0.90	0.90
EUR/CHF	0.93	0.93	0.94	0.95	0.95	0.95	0.96	0.96
EUR/SEK	10.90	10.90	10.90	10.80	10.76	10.72	10.69	10.65
EUR/NOK	11.80	11.80	11.80	11.70	11.46	11.23	10.99	10.76
USD/CNY	7.05	7.00	7.03	7.05	7.03	7.00	6.98	6.95
USD/HKD	7.79	7.78	7.80	7.80	7.82	7.81	7.81	7.80
USD/IDR	16450	16350	16520	16690	16450	16216	15986	15759
USD/INR	87.1	86.7	87.6	88.4	87.1	85.9	84.8	83.8
USD/KRW	1430	1410	1430	1450	1416	1382	1348	1315
USD/MYR	4.09	4.06	4.11	4.15	4.14	4.13	4.11	4.09
USD/PHP	58.2	57.8	58.4	58.9	58.2	57.4	56.7	56.0
USD/SGD	1.28	1.27	1.29	1.30	1.30	1.30	1.30	1.30
USD/TWD	30.5	30.3	30.6	31.0	30.7	30.5	30.2	29.9
USD/THB	31.8	31.5	32.0	32.4	32.3	32.2	32.1	32.1
USD/BRL	5.30	5.40	5.60	5.20	5.24	5.26	5.28	5.29
USD/MXN	18.20	18.00	18.10	18.15	18.49	18.83	19.17	19.50
USD/ARS	1387	1429	1501	1562	1552	1543	1535	1528
USD/CLP	900	890	885	880	873	866	859	852
USD/COP	3900	4000	4100	4050	3968	3886	3804	3722
USD/ZAR	16.70	17.10	17.50	17.80	17.68	17.55	17.42	17.29
USD/TRY	45.50	47.75	50.00	52.00	53.61	54.43	54.84	55.05
USD/EGP	48.00	48.50	49.00	49.50	50.00	51.00	51.50	52.00
EUR/PLN	4.24	4.25	4.27	4.30	4.30	4.30	4.31	4.31
EUR/CZK	24.2	24.0	24.1	24.2	25.1	26.0	26.9	27.8
EUR/HUF	387	380	385	390	394	397	401	405
DXY Index	96	94	97	99	99	100	100	100
Fed's Broad USD	118	117	119	120	120	120	120	120

Source: Morgan Stanley Research forecasts

Morgan Stanley Government Bond Yield/Spread Forecasts

Exhibit 152: Morgan Stanley government bond yield/spread forecasts – base cases

	2-Year		5-Year		10-Year		30-Year	
	2Q26	4Q26	2Q26	4Q26	2Q26	4Q26	2Q26	4Q26
US	2.50	2.60	3.00	3.25	3.75	4.05	4.45	4.75
Germany	1.50	1.60	1.80	1.95	2.30	2.45	2.95	3.10
Japan	1.15	1.15	1.25	1.25	1.60	1.65	3.30	3.25
UK	3.15	3.05	3.35	3.30	3.95	3.90	4.75	4.70
Australia	3.40	3.50	3.70	3.75	4.30	4.40	5.00	5.15
New Zealand	2.45	2.75	3.15	3.40	4.15	4.30	5.10	5.25
Canada	2.45	2.70	2.75	2.95	3.25	3.35	3.55	3.70
Austria*	15	15	20	20	30	30	50	50
Netherlands*	5	5	10	10	10	10	10	10
France*	30	30	40	40	70	75	100	105
Belgium*	20	20	30	30	55	55	95	95
Ireland*	10	10	15	15	25	25	40	40
Spain*	15	15	25	25	45	45	75	75
Italy*	30	30	45	45	70	70	110	110
Portugal*	0	0	10	10	35	35	70	70

Source: Morgan Stanley Research forecasts; Note: *Yield spread to Bunds in bp.

Exhibit 153: Morgan Stanley government bond yield/spread forecasts – bull, bear, base cases

2Y	Bull		Base		Bear	
	2Q26	4Q26	2Q26	4Q26	2Q26	4Q26
US	0.80	0.50	2.50	2.60	3.40	4.10
Germany	1.05	1.10	1.50	1.60	2.15	2.25
Japan	0.05	0.40	1.15	1.15	1.40	1.65
UK	2.60	2.30	3.15	3.05	4.00	4.05
Australia	1.70	2.00	3.40	3.50	4.45	4.35
New Zealand	0.75	1.45	2.45	2.75	3.35	3.25
Canada	0.75	1.25	2.45	2.70	3.25	3.15
Austria*	30	30	15	15	15	15
Netherlands*	10	15	5	5	5	5
France*	45	50	30	30	30	25
Belgium*	35	35	20	20	20	15
Ireland*	20	20	10	10	10	10
Spain*	30	35	15	15	15	15
Italy*	50	60	30	30	30	25
Portugal*	0	0	0	0	0	0

Source: Morgan Stanley Research forecasts; Note: *Yield spread to Bunds in bp.

Exhibit 154: Morgan Stanley government bond yield/spread forecasts – bull, bear, base cases

5Y	Bull		Base		Bear	
	2Q26	4Q26	2Q26	4Q26	2Q26	4Q26
US	1.60	1.60	3.00	3.25	3.75	4.55
Germany	1.45	1.50	1.80	1.95	2.40	2.50
Japan	0.20	0.55	1.25	1.25	1.60	1.90
UK	2.80	2.55	3.35	3.30	4.05	4.05
Australia	2.00	2.20	3.70	3.75	4.60	4.60
New Zealand	1.45	1.85	3.15	3.40	4.05	3.95
Canada	1.05	1.55	2.75	2.95	3.55	3.45
Austria*	35	40	20	20	20	20
Netherlands*	10	15	10	10	10	10
France*	65	70	40	40	40	35
Belgium*	50	55	30	30	30	25
Ireland*	25	25	15	15	15	10
Spain*	40	45	25	25	20	20
Italy*	70	80	45	45	40	35
Portugal*	15	20	10	10	10	10

Source: Morgan Stanley Research forecasts; Note: *Yield spread to Bunds in bp.

Exhibit 155: Morgan Stanley government bond yield/spread forecasts – bull, bear, base cases

10Y	Bull		Base		Bear	
	2Q26	4Q26	2Q26	4Q26	2Q26	4Q26
US	2.40	2.65	3.75	4.05	4.40	5.15
Germany	1.95	2.05	2.30	2.45	2.80	2.90
Japan	0.55	1.05	1.60	1.65	2.00	2.30
UK	3.45	3.25	3.95	3.90	4.65	4.65
Australia	2.60	2.80	4.30	4.40	5.15	5.15
New Zealand	2.45	2.75	4.15	4.30	4.90	4.80
Canada	1.55	1.95	3.25	3.35	3.95	3.85
Austria*	50	55	30	30	25	25
Netherlands*	15	20	10	10	10	10
France*	115	130	70	75	70	60
Belgium*	90	100	55	55	50	45
Ireland*	40	45	25	25	25	20
Spain*	75	85	45	45	40	35
Italy*	115	130	70	70	65	55
Portugal*	60	70	35	35	30	30

Source: Morgan Stanley Research forecasts; Note: *Yield spread to Bunds in bp.

Exhibit 156: Morgan Stanley government bond yield/spread forecasts – bull, bear, base cases

30Y	Bull		Base		Bear	
	2Q26	4Q26	2Q26	4Q26	2Q26	4Q26
US	3.20	3.50	4.45	4.75	5.00	5.70
Germany	2.70	2.80	2.95	3.10	3.35	3.45
Japan	2.05	2.60	3.30	3.25	3.45	3.85
UK	4.30	4.10	4.75	4.70	5.40	5.35
Australia	3.30	3.70	5.00	5.15	5.80	5.70
New Zealand	3.40	3.60	5.10	5.25	5.80	5.70
Canada	1.85	2.15	3.55	3.70	4.40	4.30
Austria*	80	90	50	50	40	40
Netherlands*	15	20	10	10	10	10
France*	165	185	100	105	100	85
Belgium*	155	175	95	95	85	80
Ireland*	60	70	40	40	40	30
Spain*	125	145	75	75	65	60
Italy*	180	205	110	110	105	85
Portugal*	120	140	70	70	60	60

Source: Morgan Stanley Research forecasts; Note: *Yield spread to Bunds in bp.

Morgan Stanley Cross-Asset Benchmark

Exhibit 157: Morgan Stanley cross-asset benchmark components and weights

Asset	Wght	Hedged Returns				Unhedged Returns			
		T1W	T1M	T3M	T12M	T1W	T1M	T3M	T12M
BENCHMARK	~	0.5%	1.5%	4.5%	13.9%	1.5%	2.6%	5.2%	21.4%
EQUITIES									
US Equities	30.0%	0.3%	1.5%	4.5%	14.7%	0.3%	1.5%	4.5%	14.7%
European Equities	10.0%	2.2%	3.2%	6.1%	20.5%	3.2%	3.4%	5.3%	30.1%
Japan Equities	5.0%	2.1%	8.5%	13.7%	32.4%	1.3%	6.9%	8.2%	29.9%
EM Equities	10.0%	1.1%	5.4%	12.3%	32.0%	1.2%	5.4%	11.3%	33.6%
CORE FIXED INCOME									
USTs	10.0%	0.2%	-0.0%	2.1%	6.2%	0.2%	-0.0%	2.1%	6.2%
EGBs	6.0%	0.0%	0.1%	1.3%	3.5%	0.9%	0.3%	0.6%	11.7%
Agency MBS	5.0%	0.2%	0.2%	3.1%	7.9%	0.2%	0.2%	3.1%	7.9%
US IG	5.0%	0.2%	-0.3%	2.2%	7.1%	0.2%	-0.3%	2.2%	7.1%
EUR IG	2.0%	-0.1%	0.1%	1.2%	5.6%	0.7%	0.3%	0.4%	13.9%
OTHER FIXED INCOME									
US HY	2.0%	0.3%	0.6%	1.8%	7.6%	0.3%	0.6%	1.8%	7.6%
EM $ Sov	2.0%	0.3%	1.9%	4.1%	12.7%	0.3%	1.9%	4.1%	12.7%
EM Local	4.0%	0.0%	-0.0%	0.9%	6.5%	0.5%	0.9%	1.4%	13.3%
US Lev Loans	1.0%	0.1%	0.7%	0.7%	3.7%	0.1%	0.7%	0.7%	3.7%
CLO AAA	1.0%	0.0%	0.1%	0.2%	0.8%	0.0%	0.1%	0.2%	0.8%
COMMODITIES									
Brent	2.0%	-0.7%	1.7%	-3.1%	-0.8%	-0.7%	1.7%	-3.1%	-0.8%
Gold	1.0%	5.2%	1.1%	25.2%	61.2%	5.2%	1.1%	25.2%	61.2%
Copper	1.0%	2.8%	1.9%	13.4%	22.9%	2.8%	1.9%	13.4%	22.9%
CASH									
CASH	3.0%	0.1%	0.3%	1.0%	4.4%	0.1%	0.3%	1.0%	4.4%

Source: Bloomberg, Morgan Stanley Research

Valuation Methodology and Risks

Exhibit 158: EM valuation methodology and risks

Trade	Date	Entry Level	Target	Stop	Rationale	Risks
Like Argentina Hard Currency Bonds	16-Nov-25	NA	NA	NA	Argentina's bull case is currently playing out, where strong governability comes together with US support to open up the path towards market access, including potential buybacks. Valuations wise there is also still further upside versus other large African single B issuers.	A wider-than-anticipated current account deficit in addition to lack of demand of local currency due to perceived FX overvaluation.
Like Ecuador Hard Currency Bonds	16-Nov-25	NA	NA	NA	Ecuador remains an improving credit story that now also sees reforms as possible due to the stronger governability of the president. A significant current account surplus also provides a supportive FX flows backdrop. Valuation wise there is also still further upside versus other large African single B issuers.	Fall in oil price that impacts fiscals negatively.
Like South Africa Hard Currency Bonds	12-Aug-25	NA	NA	NA	SOAF spreads have underperformed peers recently. Combined with waning fiscal risks, we now see risk/reward as positive.	A resurgence of risks related to the Government of National Unity.
Like Mexico Hard Currency Bonds	25-Apr-25	NA	NA	NA	Mexico has underperformed recently and now trades cheap versus peers. Fiscals worsened significantly in 2024 but show signs of improvement in 2025.	US recession that would have negative spillover to Mexico.

Source: Morgan Stanley Research

Exhibit 159: Credit valuation methodology and risks

Idea	Rationale	Risk
Europe > US	The US sees the highest level of 'animal spirits', the largest increase in supply, the widest range of macro outcomes, and the largest decline in yields on our forecasts. All work against the credit story. Europe benefits from a narrower band of macro outcomes.	A sharper European macro slowdown/ECB cutting cycle could weigh on yield buyer demand, causing the region to underperform.
Overweight banks, utilities, health care, underweight consumer finance, tech, chemicals	We like utilities and banks in the US, insurers, banks and health care in Europe, and Asia senior banks. We dislike US consumer finance and tech, and await a better entry point for European IG chemicals.	Stronger global growth could reverse defensive positioning and benefit cyclicals over financials.
Prefer the belly of the curve across US and EU	In the US, we are cautious on long-end valuations as supply increases, and think that the belly is a good place to hide out in. EU long-end total returns benefit from a decline in yields, but rising reverse yankee supply poses a headwind – we prefer 5-10-year.	A sharp tightening in spreads could drive better excess returns further out the curve.
CDX IG (53bp) > US IG cash (82bp)	Worsening supply-demand technicals should weigh on the basis, causing CDS to outperform.	Supply underwhelms versus our expectations.
HY > IG/loans	We expect IG to underperform HY amid resilient growth and accelerating IG supply. In Asia, we prefer APAC HY over APAC IG.	A material deterioration in liquidity conditions could weigh on risk sentiment, lift default expectations and drive a bigger decompression of HY.
EU CLO BBs (~525-550bp) > EU lev loans (~400bp)	Dispersion in leveraged loans has increased, while new issue loan spreads have been well anchored. Given the recent decompression in CLO mezz, we see better risk/reward compared to outright owning loans.	A material acceleration of CLO issuance could cause mezz to underperform, while simultaneously supporting loan demand, causing the latter to outperform.
Long AUD corp bonds unhedged in Asia	We are bullish on AUD and we expect it to appreciate by approximately 7% against USD by end of 1H26. In addition, AUD LC corp bonds offer slightly higher carry than Asia IG.	Weaker global growth drives commodity prices lower, which in turn cause AUD to weaken. If Australia growth weakens, RBA policy risk could be skew toward additional cuts, putting pressure on AUD to weaken.
APAC single A over APAC BBB	Given our expectation that APAC IG spreads will widen from current levels, we anticipate that most of the widening will come from BBB rated credits, as they are trading significantly tighter relative to single A credits.	APAC credit net supply remains negative, which helps to reduce the pressure for APAC IG spreads to widen. APAC single A credit net supply significantly outweighs APAC BBB credit net supply.
Like AT1s with yields > dividend yield	We see value in select AT1s offering a yield pick-up over the respective bank's stock. While our equity research teams remain constructive on the equity story, we think AT1s would also be supported, particularly higher carry instruments.	A material risk-off move could erase the carry in AT1s.

Source: Morgan Stanley Research

Exhibit 160: Securitized credit valuation methodology and risks

Trade	Entry Date	Rationale	Risks
Own 30yr (conv and Ginnie) 4.0 and 4.5s on basis	26/08/2025	Dovish Fed reduces uncertainty/vol improving technical picture, MBS cheap to alternatives, expectation is grind tighter	Risk assets widen, bank demand delayed, prepay risk

Source: Morgan Stanley Research

Exhibit 161: History of recommendations for stances

Like Ecuador Hard Currency Bonds		
Trade	Entry Date	Exit Date
Like Ecuador Hard Currency Bonds	06-Jan-2025	04-Apr-2025

Like Argentina Hard Currency Bonds		
Trade	Entry Date	Exit Date
Like Argentina Hard Currency Bonds	07-Oct-2024	04-Apr-2025
Like Argentina Hard Currency Bonds	02-Sep-2025	08-Sep-2025

Like South Africa Hard Currency Bonds		
Trade	Entry Date	Exit Date
Dislike South Africa Hard Currency Bonds	10-Feb-2025	22-Apr-2025
Like South Africa Hard Currency Bonds	12-Aug-2025	

Like Mexico Hard Currency Bonds		
Trade	Entry Date	Exit Date
Dislike Mexico Hard Currency Bonds	22-Nov-2024	10-Feb-2025
Like Mexico Hard Currency Bonds	25-Apr-2025	

Source: Morgan Stanley Research

Definition of terms

Buy/Long: The analyst expects the total or excess return (depending on the nature of the recommendation) of the instrument or issuer that is the subject of the investment recommendation to be positive over the relevant time period.

Sell/Short: The analyst expects the total or excess return (depending on the nature of the recommendation) of the instrument or issuer that is the subject of the investment recommendation to be negative over the relevant time period.

Selling protection or Buying Risk: The analyst expects that the price of protection against the event occurring will decrease over the relevant time period.

Buying protection or Selling Risk: The analyst expects the price of protection against the event occurring will increase over the relevant time period.

Pay: The analyst expects that over the specified time period the variable rate underlying the swap agreement that is the subject of the investment recommendation will increase.

Receive: The analyst expects that over the specified time period the variable rate underlying the swap agreement that is the subject of the investment recommendation will decrease.

Like: Based on current market conditions as of the date of this report the analyst expects that the relevant securities of the issuer that is subject of the recommendation will perform favorably over the relevant time period as compared to the overall market of comparable securities by other issuers. This is not intended to be, nor should it be interpreted as a formal fundamental rating of the issuer or its creditworthiness.

Dislike: Based on current market conditions as of the date of this report the analyst expects that the relevant securities of the issuer that is subject of the recommendation will perform unfavorably over the relevant time period as compared to the overall market of comparable securities by other issuers. This is not intended to be, nor should it be interpreted as a formal fundamental rating of the issuer or its creditworthiness.

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Principal is returned on a monthly basis over the life of the security. Principal prepayment can significantly affect the monthly income stream and the maturity of any type of MBS, including standard MBS, CMOs and Lottery Bonds. Yields and average lives are estimated based on prepayment assumptions and are subject to change based on actual prepayment of the mortgages in the underlying pools. The level of predictability of an MBS/CMO's average life, and its market price, depends on the type of MBS/CMO class purchased and interest rate movements. In general, as interest rates fall, prepayment speeds are likely to increase, thus shortening the MBS/CMO's average life and likely causing its market price to rise. Conversely, as interest rates rise, prepayment speeds are likely to decrease, thus lengthening average life and likely causing the MBS/CMO's market price to fall. Some MBS/CMOs may have "original issue discount" (OID). OID occurs if the MBS/CMO's original issue price is below its stated redemption price at maturity, and results in "imputed interest" that must be reported annually for tax purposes, resulting in a tax liability even though interest was not received. Investors are urged to consult their tax advisors for more information. Government agency backing applies only to the face value of the CMO and not to any premium paid.

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(as of October 31, 2025)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1501	41%	384	46%	26%	703	41%
Equal-weight/Hold	1609	44%	370	44%	23%	788	46%
Not-Rated/Hold	4	0%	1	0%	25%	1	0%
Underweight/Sell	568	15%	80	10%	14%	223	13%
Total	3,682		835			1715	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index or the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis over the next 12-18 months.

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Not-Rated (NR) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index or the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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