

The Way We See It

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Rising Bond Yields, Elevated Oil Prices and Surging AI Investment: Which Force Will Prevail by Year-End?

Three powerful forces are shaping markets as investors navigate the final quarter of the year.

Review of Developments

- Global Economies

Region	Q3 2026 GDP Growth	H2 2026 GDP Growth	2027 GDP Growth Forecast	2027 Core Inflation	Budget Deficit (% GDP)	Policy / Cash Rate (End-2027)
United States	1.80%	1.70%	1.60%	2.70%	-7.00%	4.75%
Eurozone	0.80%	0.90%	1.00%	2.10%	-3.50%	2.25%
Japan	0.70%	0.80%	0.90%	1.80%	-4.50%	1.00%
China	4.20%	4.30%	4.00%	1.50%	-8.0%*	2.00%
EM (ex-China)	3.70%	3.80%	3.90%	3.80%	-4.00%	5.00%

* Including central and local government support programmes.

Source: IMF, Bloomberg Consensus, OECD, national statistical agencies and GOJI.
Forecasts and estimates as at 30 September 2026.

Global economic activity remains subdued, with only a limited number of sectors continuing to demonstrate meaningful growth. Most notably, investment linked to AI infrastructure, semiconductor production and government expenditure has remained robust. Beyond these areas, economic momentum across most major economies has been restrained, reflecting cautious consumer demand, tighter financial conditions and persistently elevated headline and core inflation.

A significant portion of inflation's persistence stems from policy uncertainty and ongoing geopolitical developments. Changes in US tariff policy have complicated supply chain planning and increased input cost volatility for manufacturers worldwide. At the same time, tensions involving Iran have contributed to higher energy and petrochemical prices, with knock-on effects across transportation, fertiliser production and broader industrial activity. Meanwhile, tighter US immigration policies have contributed to labour shortages in selected lower-skilled sectors, placing modest upward pressure on wages and constraining service-sector capacity.

These inflationary forces, coupled with widening US fiscal deficits and substantial capital requirements associated with the rapid expansion of AI infrastructure, have placed upward pressure on long-dated US Treasury yields and other developed-market sovereign bond yields. Rising term premia have tightened financial conditions globally, weighing on business investment and consumer spending while complicating efforts to bring inflation back towards central bank targets.

Although energy price volatility continues to influence headline inflation, there are tentative signs of moderation in underlying price pressures. US Core PCE inflation has eased from approximately 3.3% to 3.0%, and Federal Reserve policymakers have continued to emphasise their commitment to returning inflation sustainably to the 2% target. Financial markets generally interpret this stance as reinforcing the possibility that monetary policy may need to remain restrictive for longer than previously anticipated.

Geopolitical risks also remain elevated. Ongoing conflicts in the Middle East, continued tensions surrounding Ukraine and East Asia, and broader regional instability all have the potential to disrupt supply chains, commodity markets and trade flows. Against this backdrop, investors should continue to prioritise resilience, diversification and disciplined risk management when constructing and reviewing strategic asset allocations.

Persistently high inflation, rising bond yields and elevated geopolitical risk continue to weigh on a broadly subdued global economy.

- Global Markets Review of September 2026

Global equity markets consolidated and, in some cases, retreated modestly during September following the strong rally recorded in July and August. Investor sentiment weakened amid renewed tensions in the Gulf region, which led to higher oil prices and a sharp rise in long-dated government bond yields.

US equities declined marginally, falling 0.4% over the month, as rising Treasury yields and a more hawkish tone from the Federal Reserve weighed on valuations. Global equities fell by 1.2%, with non-US markets underperforming, declining 3.2%. Emerging markets proved comparatively resilient, easing by just 0.5%. In Asia, ex-Japan equities slipped 0.3%, while Chinese equities experienced a more pronounced correction, declining 4.6%.

Near-term performance of various asset classes

Asset Class Index	US Equities MSCI USA	Global Equities MSCI World	Global ex US Equities MSCI World ex USD
1 month	-0.36%	-1.15%	-3.22%
3 months	2.32%	1.96%	0.97%
YTD	12.63%	12.09%	10.64%
FY 2025	17.75%	21.60%	32.55%

Asset Class Index	US Corporate Bloomberg US Corporate	US Treasury Bloomberg US Treasury	US Aggregate Bloomberg US Agg
1 month	-2.72%	-2.24%	-2.61%
3 months	-3.94%	-3.04%	-3.51%
YTD	-3.11%	-2.77%	-2.91%
FY 2025	7.77%	6.32%	7.30%

Asset Class Index	Global Govt Bonds Bloomberg Global TSY	Global Aggregate Bloomberg Global Agg	GEM Equities MSCI EM
1 month	-2.07%	-2.38%	-0.50%
3 months	-2.00%	-2.46%	-0.24%
YTD	-2.91%	-2.67%	23.73%
FY 2025	6.82%	8.17%	34.36%

Asset Class Index	Asia ex Japan Equities MSCI AC Axi	China A MSCI China A Onshore	China Offshore MSCI China
1 month	-0.25%	-6.09%	-4.55%
3 months	-0.23%	-13.27%	3.72%
YTD	26.05%	0.35%	-11.75%
FY 2025	33.02%	30.26%	31.42%

Asset Class Index	Global Commodities CBR	Gold Spot Price	USD Norm. Broad USD Index
1 month	-0.08%	-6.56%	2.03%
3 months	16.02%	3.66%	0.04%
YTD	37.75%	-3.77%	0.71%
FY 2025	0.37%	65.51%	-7.24%

Source: GOJI, MSCI, Bloomberg; data as of 30/9/2026

September delivered negative returns across most asset classes, while energy outperformed.

Fixed income markets delivered notably weak returns as bond yields continued to move higher. The US Treasury Index generated a total return of -2.2%, while the Bloomberg US Aggregate Bond Index fell 2.6%. Global government bond and aggregate bond indices also declined by 2.1% and 2.4%, respectively. These moves reflected the combined impact of elevated energy prices, persistent core inflation and concerns over substantial government financing requirements. At the same time, intense capital demand associated with the global build-out of AI infrastructure has continued to absorb liquidity, contributing to upward pressure on long-term yields.

Commodity markets were broadly flat in aggregate, although performance diverged significantly across sectors. Energy was the standout performer, with Brent crude oil rising 9.4% during the month, supported by geopolitical tensions and supply concerns. In contrast, gold declined 6.6%, giving back some of its recent gains as higher real yields and a stronger US dollar reduced its relative appeal.

The US dollar strengthened modestly against most major currencies, supported by the Federal Reserve's continued hawkish stance and the rise in US bond yields.

Market Outlook

Remainer of 2026, and beyond

Global equity markets have delivered solid gains year-to-date through September, led primarily by the continued strength of semiconductor and AI-related companies. While the sector experienced a sharp correction in July, as crowded positions in semiconductor and AI infrastructure stocks were unwound, technology remains the principal driver of market performance in 2026. Market participants, particularly traders and systematic strategies, generally remain constructive on risk assets, although longer-term fundamental investors continue to maintain a modest underweight position.

Investor surveys indicate that many fundamental investors remain positioned neutrally or slightly underweight equities. Their caution reflects several

Systematic strategies remain constructive on risk assets; longer-term fundamental investors stay modestly underweight.

enduring concerns. US core inflation remains above target, long-dated bond yields continue to trend higher, and geopolitical tensions in the Gulf present ongoing risks to energy markets and global supply chains. In addition, investors are increasingly scrutinising the long-term returns that hyperscale technology companies may ultimately generate from their substantial AI-related capital expenditure programmes. Equity valuations also remain demanding when assessed against the backdrop of historically elevated nominal and real bond yields.

Discretionary vs Systematic Equity Positioning



Source: Deutsche Bank Asset Allocation

Retail investor participation has likewise remained relatively restrained. Investor confidence has yet to fully recover following the volatility experienced in July, when the rapid unwinding of heavily owned semiconductor positions triggered a sharp pullback across technology-related sectors.

In contrast, the decline in market volatility since the summer correction has encouraged systematic and quantitative investment strategies to increase risk exposure. Many trend-following and volatility-targeting funds have rebuilt overweight equity positions, with some now carrying substantial market exposure.

Market sentiment softened during September, with the Fear & Greed Index spending much of the month in fear territory. Nevertheless, from a technical

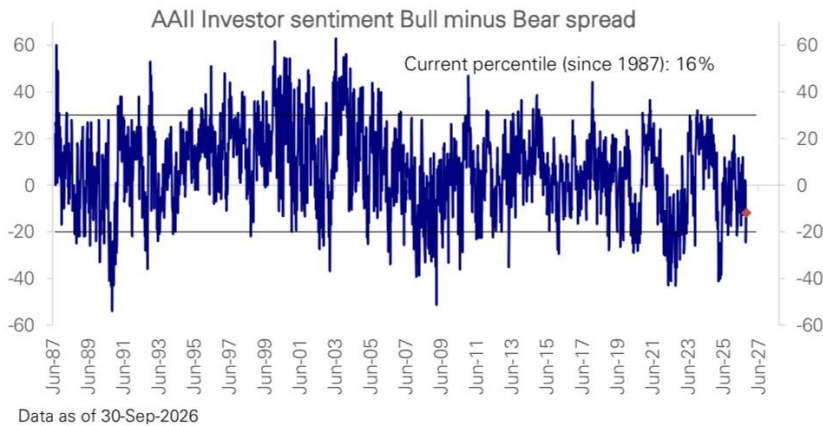
Feed & Greed Index



Source: CNN Business
Last update September 30 at 8:00:00 PM ET

perspective, the underlying trend remains constructive. Major US equity indices continue to trade above both their 50-day and 200-day moving averages, suggesting that the longer-term upward trend remains intact despite recent consolidation.

Investor Sentiment



Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

S&P 500 Stock Price Index



Looking ahead, markets are likely to be driven by three key forces: AI-related investment, the path of inflation and interest rates, and geopolitical developments affecting energy markets. While higher bond yields and stretched valuations may continue to generate volatility, the long-term growth potential of digital infrastructure and artificial intelligence remains supportive of corporate earnings. In this environment, investors should remain diversified, maintain discipline, and focus selectively on opportunities where valuations remain attractive and risks appropriately rewarded.

Three key forces are shaping markets as investors navigate the final quarter of the year.

The Way We See It

- Global Markets and Investment Thematics

At GOJI, our investment framework combines short-term tactical agility with long-term strategic discipline. We distinguish between tactical positioning, typically spanning three to six months, and strategic asset allocation, which is guided by a one to two-year investment horizon. This dual approach enables us to respond dynamically to changing market conditions while remaining anchored to long-term investment objectives.

Long-Term Strategic View: Neutral Risk Stance

Since March, GOJI has maintained a neutral long-term risk stance. Whilst supportive factors such as AI-related investment, innovation-led productivity gains and selective pro-growth policy initiatives remain in place, we believe the investment backdrop continues to be characterised by elevated valuations, modest economic growth and heightened geopolitical uncertainty.

In our view, current market pricing does not fully reflect the range of potential risks facing investors. As a result, a prudent approach remains appropriate.

We continue to hold a modest underweight allocation to higher-beta growth assets. At the same time, maintaining meaningful exposure to cash and high-quality fixed income enhances portfolio resilience, preserves capital and provides the flexibility to capitalise on opportunities that may arise from periods of market dislocation. We believe this balanced positioning offers an attractive risk-reward profile in the current environment.

Short-Term Tactical Positioning

We expect market volatility to remain elevated over the coming months, with major equity indices likely to finish the year within approximately $\pm 5\%$ to 10% of current levels. In the near term, we maintain a neutral stance on equities while remaining prepared to add duration through long-dated government bonds as yields become more attractive.

GOJI: we maintain a neutral long-term risk stance.

GOJI: we maintain a neutral short-term stance on equities and prepare to add duration through long-dated govies.

Within equities, semiconductor, AI and US mega-cap technology stocks continue to dominate market leadership. While we acknowledge their strong structural growth drivers, we caution against chasing current valuations. Rising financing costs are likely to place increasing pressure on AI infrastructure investments, while questions remain over the long-term sustainability of returns across the broader AI ecosystem. In addition, growing competition from open-source AI models may challenge the future monetisation potential of leading proprietary platforms.

Meanwhile, government bonds are becoming increasingly attractive. With US 10-year Treasury yields approaching 5.3% and 30-year yields nearing 6.0%, investors are once again being offered compelling long-term income opportunities. Should 10-year Treasury yields move towards 6%, we would consider reducing equities to an underweight position while increasing allocations to high-quality fixed income.

We remain cautious on lower-quality corporate credit and illiquid private credit, where risk-adjusted returns appear less attractive in a higher-rate environment.

US – Treasury Yield Spread



Source: MacroMicro

Yield spread between UST 30Y vs 10Y is reducing notably.

Preferred Positioning

Equities

- Value over Growth.
- Asia and emerging markets over Europe.
- Focus on quality businesses with resilient earnings and strong balance sheets.

Fixed Income

- Prefer high-quality government bonds and investment-grade credit.
- Increase duration selectively as yields rise.

Foreign Exchange

- Maintain a broadly neutral currency stance.

Concluding View

As we enter the final quarter of 2026, we believe investors should remain disciplined and well diversified. Whilst AI-driven innovation continues to provide powerful long-term growth opportunities, elevated bond yields, persistent inflationary pressures and geopolitical uncertainty are likely to create intermittent volatility across asset classes. In such an environment, preserving flexibility, focusing on quality and maintaining a balanced approach to risk remain the most effective tools for navigating an increasingly complex investment landscape.

GOJI: investors should remain disciplined & well diversified.

Special Section: Has Rising Bond Yields Created a New Defensive Asset Class?

When Traditional Defensives Fail, Where Do Investors Hide?

1. Bond Vigilantes and the Rise in Global Interest Rates

Over recent months, global bond markets have witnessed a renewed resurgence of so-called "bond vigilantes", with investors demanding higher risk premia to hold government debt. The consequence has been a broad-based rise in bond yields across developed markets.

Both short- and long-term interest rates have moved materially higher. Contributing factors include tariff-related inflationary pressures, elevated energy prices, increasing government borrowing requirements, and substantial capital demands associated with the global AI infrastructure build-out. Combined, these forces have intensified competition for capital between public and private borrowers.

As a result, central banks across the developed world have been forced to maintain a restrictive policy stance. Throughout September, the Federal Reserve, European Central Bank, Bank of Japan, Bank of England and Reserve Bank of Australia all tightened monetary policy, with markets continuing to price in the possibility of additional rate increases.

The impact has been significant. Fixed income markets have generated poor returns as bond prices declined, while higher discount rates have weighed on a large portion of equity markets. However, not all sectors have been affected equally. This has contributed to an increasingly pronounced divergence in equity market performance and may, at least temporarily, have led to the emergence of a new form of defensive asset.

2. Market Bifurcation and the Emergence of a New Defensive Asset

The rise in global bond yields has created a sharp distinction between market winners and losers.

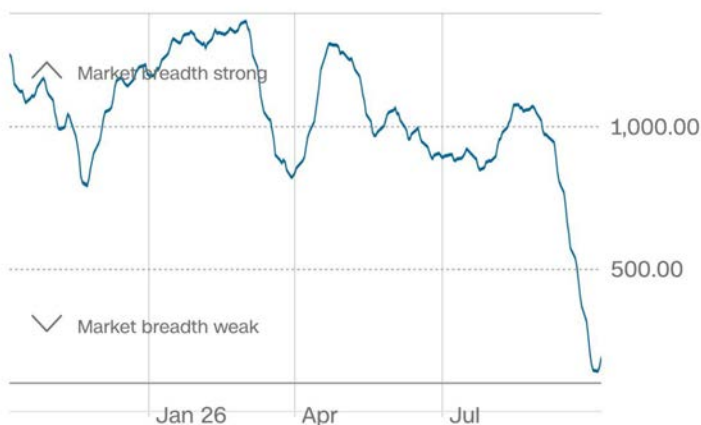
Traditionally defensive sectors such as Utilities and Consumer Staples have struggled, while many cyclical and value-oriented sectors, including Industrials, Consumer Discretionary and Financials, have also underperformed. This trend is particularly evident when comparing the performance of value-oriented markets such as Hong Kong and China with the technology sectors of the United States, Taiwan, South Korea and Japan.

In the United States, market breadth has remained unusually narrow. A relatively small number of mega-cap technology companies have driven the majority of gains in both the Nasdaq and S&P 500, while a considerable proportion of listed companies have delivered weak or negative returns.

STOCK PRICE BREADTH

EXTREME FEAR

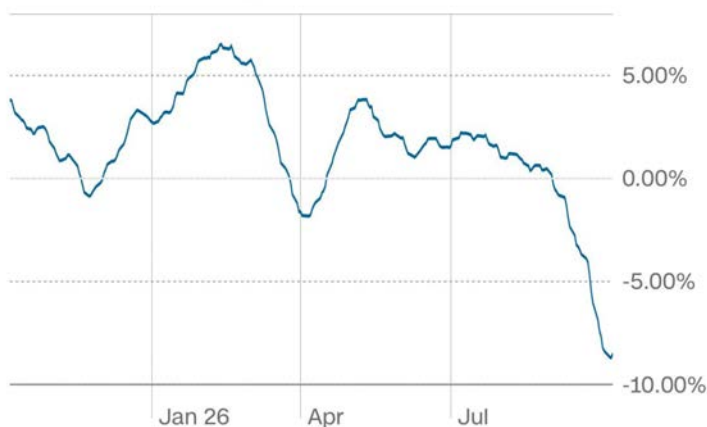
McClellan Volume Summation Index



STOCK PRICE STRENGTH

EXTREME FEAR

Net new 52-week highs and lows on the NYSE



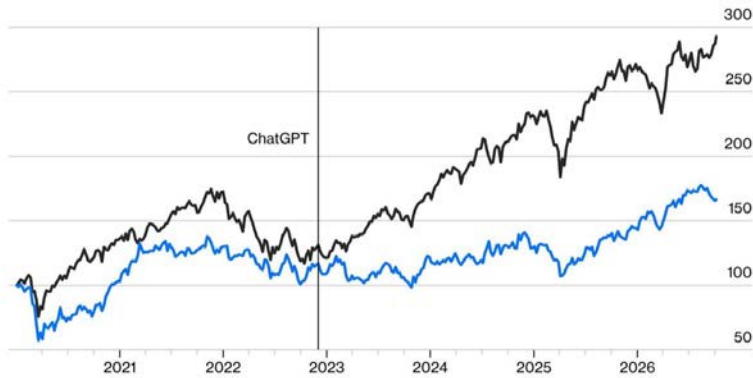
Source: CNN. Last updated Oct 6 at 8:59:58 PM EDT

Similarly, global growth stocks have continued to outperform value stocks by a wide margin.

A Decade of Big Growth

Small and value stocks have lagged during the AI boom

■ Russell 2000 Value ■ Russell 1000 Growth



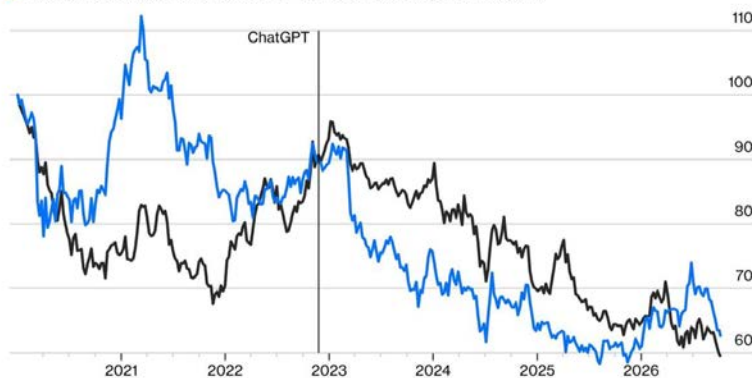
Note: Data is indexed to 100 on Jan. 3, 2020
Source: Bloomberg

Bloomberg Opinion

Small Isn't So Beautiful

The trend against small and value stocks is remorseless

■ Russell 2000 Relative to Top 50 ■ S&P 500 Value Relative to Growth



Note: Data is indexed to 100 on Jan. 3, 2020
Source: Bloomberg

Bloomberg Opinion

Against this backdrop, one could argue that AI-related and mega-cap technology stocks have temporarily assumed the characteristics traditionally associated with defensive assets. Whilst not defensive in the conventional sense, investors have increasingly viewed them as relative safe havens within the equity market because of their superior earnings growth, dominant market positions and strong balance sheets.

Supporters of this view argue that demand for AI infrastructure remains exceptionally robust. Capital expenditure across hyperscale data centres, AI platforms and supporting infrastructure is expected to exceed US\$1 trillion this year and may rise further

New Defensive Asset Class, as New Safe Haven for liquidity.

towards US\$1.3 trillion in 2027. The largest beneficiaries continue to be semiconductor manufacturers, hardware suppliers and the major technology platforms driving AI adoption.

As capital increasingly flows towards these sectors, traditional equity sectors and portions of the bond market may find themselves competing for a shrinking pool of investment capital. This dynamic has contributed to the persistence of elevated interest rates and the continued leadership of AI-related equities.

How long this environment endures remains uncertain. However, as long as energy prices remain elevated, geopolitical tensions persist and AI-driven capital expenditure continues at its current pace, technology and growth-oriented equities may continue to outperform on a relative basis.

3. Investment Implications for the Next 6-12 Months

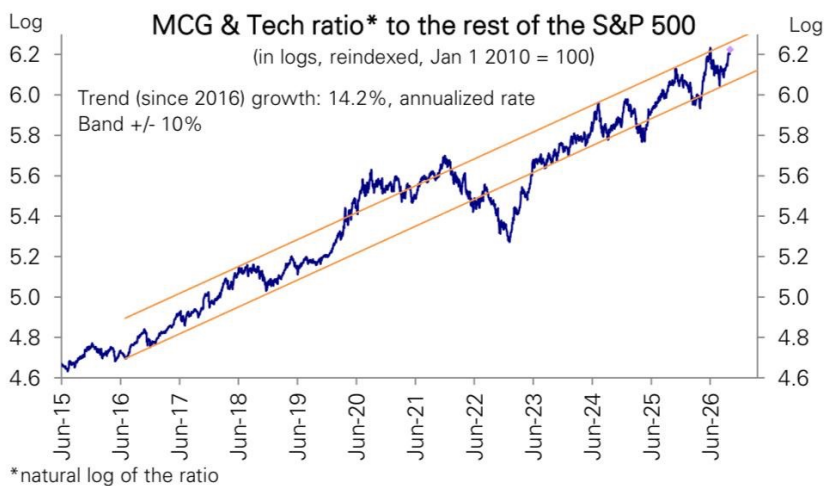
Despite the strong performance of AI-related equities, GOJI remains cautious regarding parts of the sector.

We remain unconvinced that frontier AI model developers can consistently earn returns on invested capital exceeding their cost of capital given the scale of current and planned investment programmes. Questions also remain regarding whether sufficient data-centre capacity, power generation and supporting infrastructure can be developed quickly enough to accommodate projected demand.

In addition, a growing number of data-centre operators have accumulated substantial debt burdens. Should borrowing costs remain elevated, access to additional financing may become increasingly challenging.

Valuations also warrant caution. Excluding NVIDIA, leading mega-cap technology, AI and semiconductor companies currently trade at approximately 30 times forward earnings on average, implying continued strong earnings growth is already reflected in market expectations.

Consequently, we believe there is a meaningful probability that mega-cap technology stocks could experience a period of correction or consolidation over the coming months. Relative performance indicators suggest that the exceptional outperformance of growth over value may be approaching cyclical extremes.



Source: Bloomberg Finance LP, Deutsche Bank Asset Allocation

Should this occur, value-oriented regions, sectors and companies with attractive valuations may finally have an opportunity to narrow the performance gap and potentially outperform on a relative basis.

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