SKYBOUND CAPITAL

Q4 2025 & 2026 Outlook

ECONOMIC QUARTERLY REVIEW

Market & Macro Review for Q4 2025

Markets showed modest but respectable gains over the final quarter of 2025. The "periodic table of returns" below by Asset Class and Style Returns summarises this. These returns are even more surprising given the elevated volatility of Q4. What's really impressive are overall returns, shown in local FX, for the year as a whole. Once again, if you blinked, you missed out, massively!
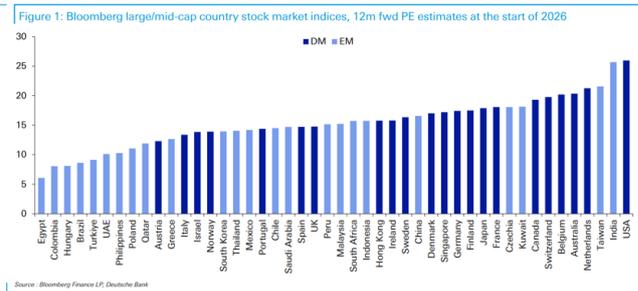
2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Q4 '25
Growth 3.5%	Small cap 13.3%	MSCI EM 37.8%	Global Agg -1.2%	Growth 34.1%	Growth 34.2%	Global REITs 32.6%	Cmdty 16.1%	Growth 37.3%	Growth 26.2%	MSCI EM 34.4%	Cmdty 5.9%
Global REITS 0.6%	Value 13.2%	Growth 28.5%	Global REITS -4.9%	DM Equities 28.4%	MSCI EM 18.7%	Cmdty 27.1%	Value -5.8%	DM Equities 24.4%	DM Equities 19.2%	Value 21.6%	MSCI EM 4.8%
Small cap 0.1%	Cmdty 11.8%	Small cap 23.2%	Growth -6.4%	Small cap 26.8%	DM Equities 16.5%	Value 22.8%	Global Agg -16.3%	Small cap 16.3%	Value 12.3%	DM Equities 21.6%	Value 3.5%
DM Equities -0.3%	MSCI EM 11.6%	DM Equities 23.1%	DM Equities -8.2%	Global REITs 24.4%	Small cap 16.5%	DM Equities 22.4%	DM Equities -17.7%	Value 12.4%	Small cap 8.6%	Growth 21.3%	DM Equities 3.2%
Global Agg -3.2%	DM Equities 8.2%	Value 18.0%	Value -10.1%	Value 22.7%	Global Agg 9.2%	Growth 21.4%	Small cap -18.4%	Global REITs 10.9%	MSCI EM 8.1%	Small cap 20.4%	Small cap 2.9%
Value -4.1%	Global REITS 6.5%	Global REITS 8.0%	Cmdty -11.3%	MSCI EM 18.9%	Value -0.4%	Small cap 16.2%	MSCI EM -19.7%	MSCI EM 10.3%	Cmdty 5.4%	Cmdty 15.8%	Growth 2.8%
MSCI EM -14.6%	Growth 3.2%	Global Agg 7.4%	Small cap -13.5%	Cmdty 7.7%	Cmdty -3.1%	MSCI EM -2.2%	Global REITs -23.7%	Global Agg 5.7%	Global REITs 2.8%	Global REITs 8.4%	Global Agg 0.2%
Cmdty -24.7%	Global Agg 2.1%	Cmdty 1.7%	MSCI EM -14.2%	Global Agg 6.8%	Global REITs -10.4%	Global Agg -4.7%	Growth -29.1%	Cmdty -7.9%	Global Agg -1.7%	Global Agg 8.2%	Global REITs -0.8%

Source: Bloomberg, FTSE, LSEG Datastream, MSCI, J.P. Morgan Asset Management. DM Equities: MSCI World; REITs: FTSE NAREIT Global Real Estate Investment Trusts; Cmdty: Bloomberg Commodity Index; Global Agg: Bloomberg Global Aggregate; Growth: MSCI World Growth; Value: MSCI World Value; Small cap: MSCI World Small Cap. All indices are total return in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 December 2025.

Here's a summary of key asset class performance and factors driving their returns:

1. **EQUITIES:** AI remained the dominant theme. This drove US returns which, in turn, drove global returns. Communication and IT delivered +33% and +23.6% respectively – and that's despite all the bearish talk about an impending dot-com bubble and the AI infrastructure spend about to implode on itself. The S&P 500 delivered an impressive near +18% for the year thereby maintaining its double-digit returning trajectory of yesteryears. To think it was outdone by EM (MSCI EM +34%) and Asia (MSCI Asia +33%). Even Japan's TOPIX returned a very healthy +25.5% while the UK's FTSE All Share delivered +24% with Europe ex-UK on +20%.

   EM performance was broad-based and is depicted below vs. DM. It also compares their valuations at the start of 2026:

Figure 1: Bloomberg large/mid-cap country stock market indices, 2025 total return in USD (%)

Figure 1: Bloomberg large/mid-cap country stock market indices, 12m fwd PE estimates at the start of 2026

Consumer-facing sectors struggled on the back of noise around jobs numbers and the decline in consumer confidence. The latter placed a natural lid on inflation – which has so far been tame. Within the Mag (Magnificent) 7, only two of its names outperformed the S&P 500!

2. **COMMODITIES:** Commodities saw oil come under even more pressure as a combination of strong supply and tepid demand continues to drive a surplus. This scenario is expected to dominate in 2026. Furthermore, the slow move towards some sort of resolution in Ukraine has meant a reduction in oil risk premium. Precious metals, on the other hand, have had a volatile but upward trend. US$ weakness has meant a steady increase in prices. This has affected base metals too (e.g. copper).

3. **FIXED INCOME:** The rally in risk assets also extended to the fixed income arena. Spreads (a measure of risk) narrowed further but better value was still to be had among US IG (Investment Grade) and HY (High Yield). There were some impressive returns delivered over 2025: EM Debt +13.5%, Global IG +10.3%, Global IL (Index-Linked) +9.1% and US HY +8.5%. In the world of Sovereign (Government) bonds, Global Gov. +7%, US Treasuries delivered +6.3% and UK +5%. Contrast these with Euro Governments +0.6% (France remains in gridlock and has proved itself to be unable to reach a compromise on a deficit reduction plan) and German Bunds -0.9% as the country decided to relax fiscal tightness and vastly increase spending). The worst performers were Japanese JGBs at -6.2% (due to a shift away from keeping rates down and letting them normalise).

4. **FX:** The US$ was down -9.4% on the year – improving over Q4. Overall, considering everything that went on (geopolitics, tariffs, etc.), that's an impressive performance. The GBP gained +7.5%, the Euro +12% and Yen -0.5%. The primary catalyst for these moves: the Fed's easing cycle – and the expectations that it will go even further.

Outlook for Q1 2026 & Beyond

So, where to from here? Here are some of the key factors likely to affect Q1 and the rest of the year:

1. **RATES, R* AND INFLATION EQUILIBRIUM:** When it comes to the economy, markets will be watching carefully to see if an equilibrium can be maintained between an economy operating at its full potential (generally deemed to be full employment) alongside stable inflation (i.e. what is deemed to be its target level). This is how R* is defined. This then determines bond yields (which are reached by markets). The latter will define debt-servicing costs! The table below summarises various, indicative levels for R* alongside yield curve calculations (based entirely on what we know to be the case today) and assesses how today's yield curve looks if we strip out cyclical noise?

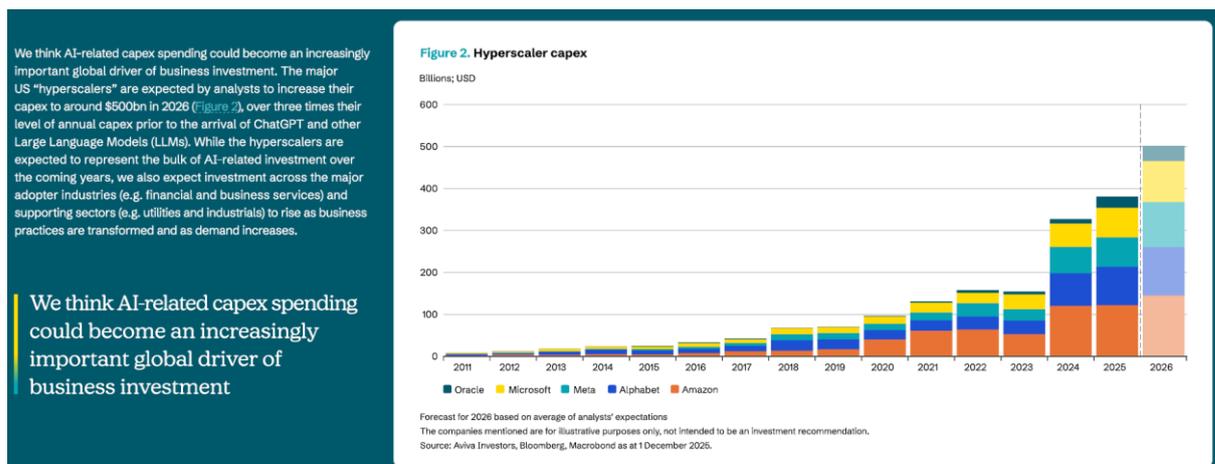| Region	Estimated R* (Real)	Implied Nominal Policy Rate (Long-Run)	Yield Curve (now) vs Fair Value	Commentary
United States	2.75%–3.25% (currently: 3.00%-3.50%)	4.75%–5.25%	**Front end:** below neutral but converging; **Belly of the curve:** modestly rich; **Long end:** materially rich	Markets price further easing and eventual policy restraint. Long-end yields still embed an assumption that fiscal dominance and inflation credibility risks remain contained — an assumption we view as fragile.
Eurozone (Core)	1.75%–2.25% (currently: 1.8%-2.0%)	3.75%–4.25%	**Front end:** rich; **Belly of the curve:** rich; **Long end:** materially rich	Curve pricing remains anchored to weak-growth narratives and underestimates QT, rising bund supply and fiscal expansion. The spread compression seen in the Peripherals hides core duration risk.
Japan	0.75%–1.25% (currently: 0.75%-1.25%)	1.5%–2.0%	**Front end:** near fair value; **Belly of the curve:** slightly rich; **Long end:** rich	A genuine regime shift is underway, but markets still assume an implicit ceiling on yields. Further repricing depends on wage persistence and BoJ tolerance for yen strength.

Footnotes / Methodology

1. **R* (real neutral rate)** The real interest rate consistent with output at potential and inflation at target, absent cyclical stimulus or restraint. Estimates derived from a synthesis of central-bank models (e.g. HLW),
2. market-implied real yields (e.g. TIPS), fiscal arithmetic and structural forces (demographics, capex, debt).
3. **Implied Nominal Policy Rate (Long-Run)** The nominal expression of R*, calculated as: *Implied nominal neutral ≈ R* + long-run inflation anchor*. Note: This is an equilibrium **anchor**, not a policy forecast.
4. **Fair Value Yields (FV)** Indicative equilibrium ranges assuming positive term premia in a post-QE world, rising sovereign supply, no financial repression and broadly intact inflation credibility.
5. **Current ranges shown** are market-implied ranges i.e. inferred from traded prices such as interest-rate derivatives (OIS), not the official government target (e.g. Fed 3.50%-3.75%).

The answer to this is split between the three segments of a yield curve i.e. its front end (typically up to 2 years), it's 'belly' (the middle part, typically over 2y up to 7y) and lastly (and very importantly), the long end (10y+). The upshot: the front end of the yield curve (YC) remains suppressed by expectations of near-term easing; the belly still has embedded in it an assumption that the low-rate regime eventually returns; however, here's the danger: the long-end remains anchored to the pre-Covid norms we experienced and this is increasingly inconsistent with higher debt, higher R* and less credible policy! While the above is not a call on timing, it is a structural observation i.e. the longer markets cling to outdated anchors (i.e. the post-GFC assumptions that neutral rates are structurally near zero, long end yields can be suppressed indefinitely and fiscal excesses will self-correct), the greater is the risk of adjustment and the stronger the force with which it will be delivered (whiplash).

2. **AI/CAPEX SPEND:** My last quarterly referenced sources (e.g. McKinsey) that looked at the success of GenAI pilots. It openly challenged the efficacy of many of them. The worldwide

adopted of GenAI (for 2025) is already in the order of 15% to 20%. Of course, this is by no means even; for example, top quartile sector adoption is running at 40% to 50% while among SME adoption is less than 10% globally. However, projected growth rates for 2026 to 2027 are almost double these rates! Furthermore, when one drills down to "chip category" (e.g. AI Accelerators GPU/ASIC, Data Centre CPUs, DRAM/HBM, etc.), the projected growth rates are "Strong to Very Strong". In this regard, the chart below (source: Aviva) shows what the projected Hyperscaler CAPEX levels are (Oracle, Microsoft, Meta, Alphabet and Amazon).

We think AI-related capex spending could become an increasingly important global driver of business investment. The major US "hyperscalers" are expected by analysts to increase their capex to around $500bn in 2026 (Figure 2), over three times their level of annual capex prior to the arrival of ChatGPT and other Large Language Models (LLMs). While the hyperscalers are expected to represent the bulk of AI-related investment over the coming years, we also expect investment across the major adopter industries (e.g. financial and business services) and supporting sectors (e.g. utilities and industrials) to rise as business practices are transformed and as demand increases.

We think AI-related capex spending could become an increasingly important global driver of business investment

Figure 2. Hyperscaler capex

Billions; USD

Forecast for 2026 based on average of analysts' expectations
The companies mentioned are for illustrative purposes only, not intended to be an investment recommendation.
Source: Aviva Investors, Bloomberg, Macrobond as at 1 December 2025.

These levels become even higher if one looks beyond the hyperscalers. It also highlights the risk – the sheer quantum involved is a material portion of their cash piles. We are not concerned by the odd $1bn here and $2bn there…however, these amounts matter. So, the growth rates referred to above need to demonstrate rising growth to support scale and therefore economic returns on CAPEX investment. This enormous demand for AI equipment results in an ever-growing demand for energy (next section).

3. **ENERGY:** To facilitate the growth in AI Infrastructure, the table below best sums up the sheer power load needed for the projected growth rates ahead. Right now, Global Data Centres use up 1.5% to 3% of all total global electricity usage. Of this, some 5% to 15% is consumed by AI workloads. Given the vast growth rates projected, how will energy production keep up? 80% of all energy production is hydrocarbon-generated. The growth rate in non-hydrocarbon is simply not fast enough…and even if we go all-out hydrocarbon, the refining rate can't keep up (not enough refineries, many are obsolete). There is the ever-present risk of geopolitical disruption – though this has alleviated considerably with developments over Russia-Ukraine and now with recent US events over Venezuela.

Topic	Summary	Supporting Comments from Reports
Current Global Data Centre Power Usage	415-460 TWh per year (this is 1.5% to 3% of global electricity); AI workloads consumes 5% to 15% of that consumption.	[Goldman Sachs (Dec 2025)]: The present grid is capable of powering current AI/Digital infrastructure because AI is a small slice of broader electricity use. This is rapidly changing!
Forecast AI-Driven Power Demand (by 2030)	Doubles to 945 TWh/year; in extreme growth case, could reach 2,000 TWh by 2035. AI-driven workloads may account for 35% to 50% of data centre use.	DB (Nov 2025) & GS (Dec 2025): Global electricity demand is currently growing at 3% to 4% pa. AI data centre power needs are increasing 2–3× faster than the current growth rate! Implies a 10% to 15% CAGR in power demand from AI alone.
Growth Required in Power Grid Capacity (2030 target)	+110% growth (compound) vs 2023 levels.	McKinsey & PGIM: Growth in demand far outpaces infrastructure expansion; grid needs to double output in 5–7 years to keep pace.
Actual Grid Expansion Rate (Current CAGR)	About 2.4% globally (4% in China, under 2% in US/EU); this could call for over $3tn spend by 2028 to support AI expansion.	PGIM (2025) & GS: Major lag in developed markets; permitting delays, NIMBY (Not-In-My-Back-Yard) constraints, lack of transmission investment cited.
Gap Between Required and Actual Grid Growth	Shortfall of about 7–10% CAGR	GS & PGIM: Grid investments globally are some $300bn/year vs the required $600bn/year; this is a serious mismatch and overlooks the time required to roll it out (2y to 5y+). Grid growth is steady and incremental; AI demand is lumpy, concentrated & accelerating. Some regions (e.g. EMEA) are already experiencing power constraints and are already trying to slow data centre buildout.
Estimated Infrastructure Cost to Close Gap (2024–2030)	$2.5–3.0 trillion globally!	DB & GS (2025): Includes renewables, HVDC lines, grid-scale batteries; assumes US and China drive bulk of CAPEX.
Timeline to Close Infrastructure Gap	7–10 years (realistically) [Compares current total electricity growth of 3%-4% vs the 8%-12% needed to meet AI growth alone]	DB: Even with accelerated approvals and funding, grid builds take time. High voltage lines often require 5–7 years from planning to operation.
Feasibility of Achieving Power Targets	Partially achievable but requires policy acceleration and private capital (more achievable in China vs elsewhere due to all sorts of regulatory, environmental and consumer challenges).	PGIM & BCG: Realistic only if (i) AI datacentre efficiency improves, (ii) power-hungry models shift to edge/low-power inferencing, (iii) governments streamline energy permitting.

4. **RISKS:** Most analysts would list a string of risks – and I am sure they could make a case for any one of them. The one that concerns me the most is inflation. What we have seen – and why it is different this time around – is the multivariate nature of it. Services inflation has become sticky. Within that, key items such as food are even stickier and running at alarmingly high levels. To cap it all, given the above analysis around energy, there is every argument that energy costs cannot sink that much lower from here. If this view materialises, then we can circle back to the very first point around R* and bond yields. We have seen what happens when yields start rising, and we already know what debt-servicing costs are being incurred by countries. The chart below is a good point to end on. It highlights the drag we have seen from energy inflation is over while services inflation remains sticky. Furthermore, if energy inflation picks up sufficiently, it feeds back into services!

"Energy" – simple average of YoY change in Energy/Energy related CPI (Japan, Norway, Sweden, Switzerland, Euro Area, UK & the US)
"Services" – simple average of YoY change in Services CPI (Japan, Norway, Sweden, Switzerland, Euro Area, UK & the US)
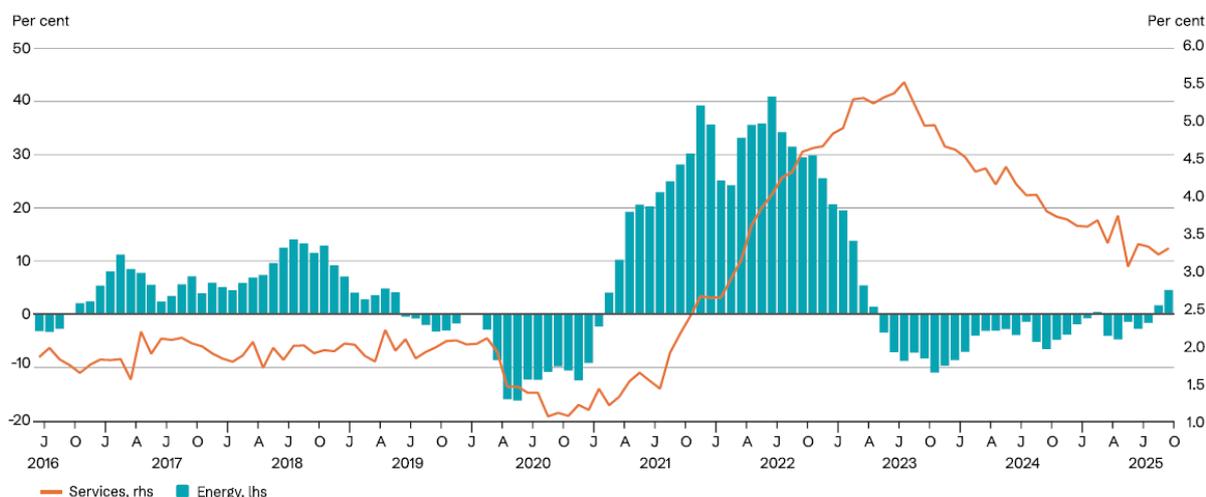
Source: Aviva Investors, Macrobond as at 1 December 2025.

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Jabir joined Skybound Capital in 2011 and serves as Group Chief Investment Strategist. He leads the firm's macroeconomic research. He sits on the Investment Committee, where he evaluates prospective lending opportunities, assesses credit quality and downside risk, and determines whether proposed transactions meet the firm's return and risk criteria. He plays a central role in shaping Skybound's credit framework and communicating market insights to institutional and professional clients.

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