CITY OF LONDON
Investment Management Company Limited

Cross-Asset Quarterly Outlook

December 2025*

Overview

Beyond the Noise

- *Markets have been 'choppy', but AI-related growth and a dovish Fed stance should support risk assets going into 2026.*
- *We see further upside for global equities over fixed income, particularly in non-US markets as USD weakness re-emerges.*
- *We maintain an equity overweight, stay constructive on duration, and hold an underweight in high-yield credit. We remain overweight commodities while reallocating part of our precious metals position into industrial metals.*

The past few months could best be described as a period of 'choppy', range-bound trading. Chart 1 shows that most asset classes moved higher over the period; however, some areas of the market experienced elevated volatility - notably AI-related stocks and credit, cryptocurrencies, and Japanese government bonds. Over the same period, the VIX index spiked above 25 twice, in October and November.

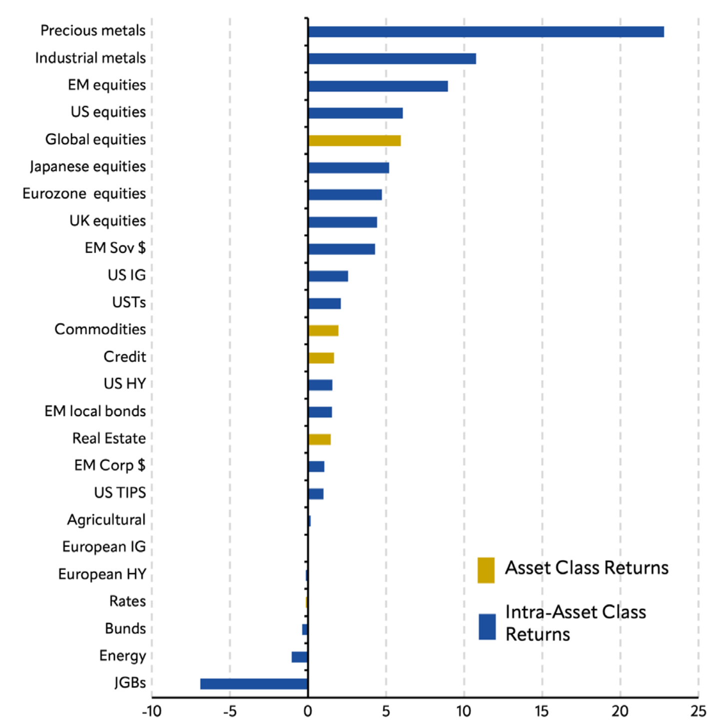
Some degree of market anxiety is understandable, at least in the short term. Rich valuations in technology stocks have fuelled concerns of an "AI bubble." Meanwhile, a court ruling on IEEPA tariffs remains pending, and key economic data releases were delayed by the US government shutdown in October and November. A data-dependent Fed has added to uncertainty, yo-yoing its guidance between pausing and cutting with a significant number of dissents.

Taking a step back from the recent noise, our views are largely unchanged from three months ago. Our base case remains that the Fed will maintain a dovish bias heading into 2026 - an environment that has historically favoured risk assets, provided a recession is avoided. The current K-shaped economic backdrop has created a quasi-Goldilocks scenario: pockets of economic weakness (particularly the labour market) have pushed the Fed toward a more dovish stance this year, while AI-related sectors continue to expand at a robust pace (chart 2).

Overall, we believe the AI theme remains durable, and investors should maintain exposure. A wall of worry may persist as hyperscaler capex spending continues to rise (chart 3). However, free cash flows (FCFs) remain elevated and stable (chart 4), suggesting bubble concerns may be premature - at least until debt becomes the primary funding source for AI investment. As with previous technology cycles, there will be winners and losers over time, and bottom-up investors should remain vigilant regarding froth in individual names. From a macro perspective, however, identifying and timing bubbles is notoriously difficult. One must assess when the aggregate market value of AI-linked firms exceeds realistic future cash flows and identify potential catalysts once the conditions of a bubble are met (for example, Fed hikes or an earnings recession). Our base case is the AI economy and future expectations can continue to grow for some time. Major banks and consulting firms will likely continue publishing widely divergent forecasts for the "AI economy" - often with trillion-dollar differences in size estimates. We therefore favour maintaining exposure to strategic AI themes, while ensuring adequate diversification.

Unlike AI-linked equities, the US dollar trading has been less eventful in recent months, with its prior downtrend stalling. Should US rates continue to decline into 2026, the dollar could reach new cyclical lows (chart 5). Additional Fed cuts would likely reinvigorate USD bears, supporting non-US indices relative to the US and bolstering both precious and industrial metals.

Chart 1: Sep-Nov Performance (%)



Source: Bloomberg

**The publication reflects asset performance up to November 28, 2025, and macro events and data releases up to December 4, 2025, unless indicated otherwise.*

Our view on duration remains balanced but with a positive bias. Long-term fiscal risks persist, yet we expect the new Fed Chair to adopt a dovish tilt and remain sensitive to anchoring long-end yields for financial-stability reasons. In addition, with the November 2026 midterms approaching, the Trump administration has strong incentives to maintain calm in rates, given their close link to equity and housing markets. The administration will likely appoint a dovish Fed Chair, while balancing bond investors' interests and potential pushback from Republican Senators committed to Fed independence. Finally, while inflation remains above target, underlying measures continue trending lower (chart 6). This disinflationary trend may eventually bring some hawkish FOMC members closer to the new Chair's stance.

Market Strategy:

Our positioning continues to reflect a barbell approach. Our existing overweight in equities and metals is likely to benefit from ongoing AI growth and easier Fed policy, while our underweight in credit provides protection should the K-shaped economy evolve into a broader recession (not our base case in 2026). This quarter, we make the following adjustments:

- Maintain an **equity** *overweight.* AI remains supportive for companies with direct or indirect exposure. A renewed dollar downtrend should support non-US equities, particularly in Japan and emerging markets (EM).
- Remain *overweight* in **rates,** with a preference for US TIPS and German Bunds, and an underweight in Japanese government bonds (JGBs). EM local debt is a potential upgrade candidate should USD weakness persist into 2026.
- Stay *underweight* in **credit,** particularly global high yield (HY). We see limited value in HY spreads, and an underweight offers an attractive diversifier in downside scenarios.
- Keep a *neutral* allocation in **real estate.** The asset class offers long-term value potential if rates fall and growth accelerates.
- Maintain an *overweight* in **commodities** through exposure to precious and industrial metals. Following the strong run in gold, we took partial profits and reallocated proceeds into industrial metals (chart 7).

*Justin Kariya***

December 4, 2025

***This document includes contributions from Tom Traill and Yasemin Engin.*

Asset Allocation

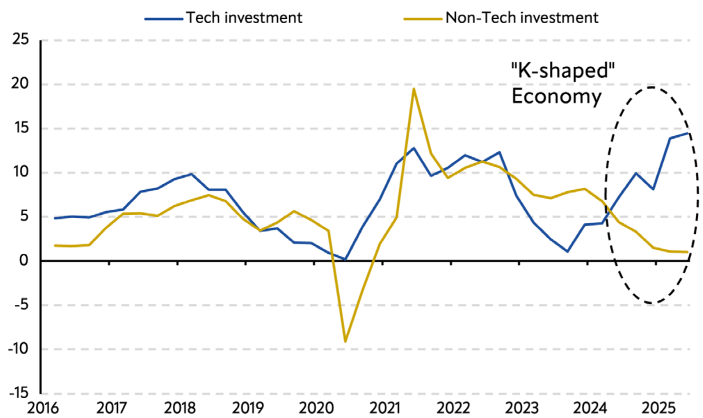
	Chg	-3	-2	-1	0	+1	+2	+3
Equities	-					■		
Rates	-					■		
Credit	-		■					
Real Estate	-				■			
Commodities	-					■		

	Chg	-3	-2	-1	0	+1	+2	+3
US equities	-			■				
Eurozone equities	-				■			
UK equities	-			■				
Japan equities	-					■		
EM equities	-						■	
USTs	-				■			
TIPS	-					■		
Bunds	-					■		
JGBs	-			■				
EM local bonds	-				■			
US IG credit	-				■			
US HY credit	-	■						
European IG credit	-				■			
European HY credit	-			■				
EM Sov $ credit	-				■			
EM Corp $ credit	-				■			
Energy	-				■			
Industrial metals	-					■		
Precious metals	↓					■		
Agricultural	-				■			

Note: Up/down arrows indicate a positive or negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

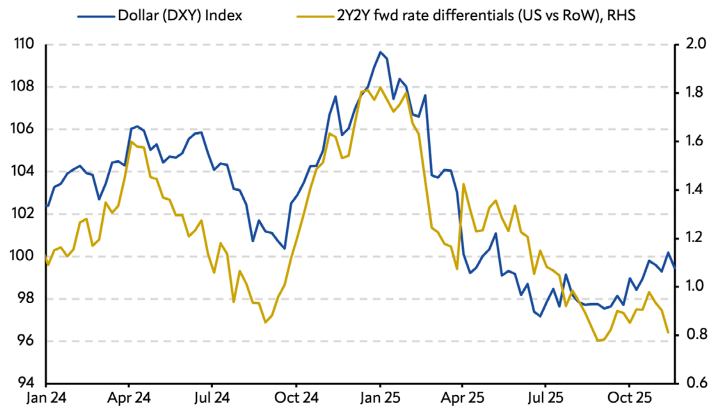
Source: CLIM

Chart 2: Tech and Non-Tech Investment (% yoy)



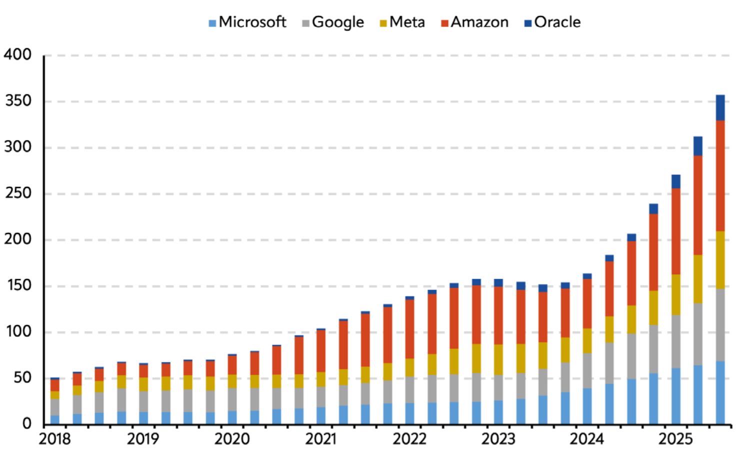
Source: BEA

Chart 5: US Dollar and Rate Differentials



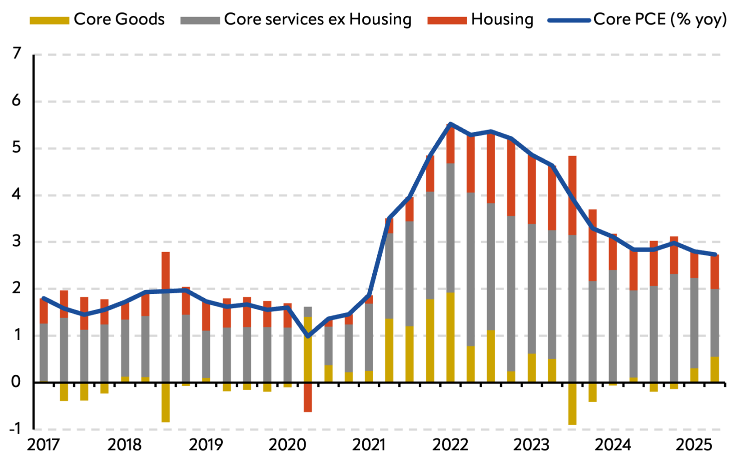
Source: Bloomberg

Chart 3: Hyperscaler Capex Spending ($bn, 12m trailing)



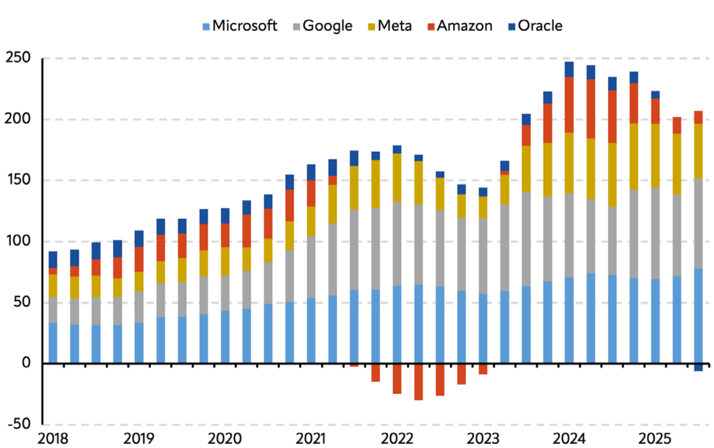
Source: Bloomberg

Chart 6: US Core PCE Price Index (% point contribution)



Source: BEA, CLIM

Chart 4: Hyperscaler Free Cash Flow ($bn, 12m trailing)



Source: Bloomberg

Chart 7: Precious Metals versus Industrial Metals (Index)

Source: Bloomberg

Equities

Overweight

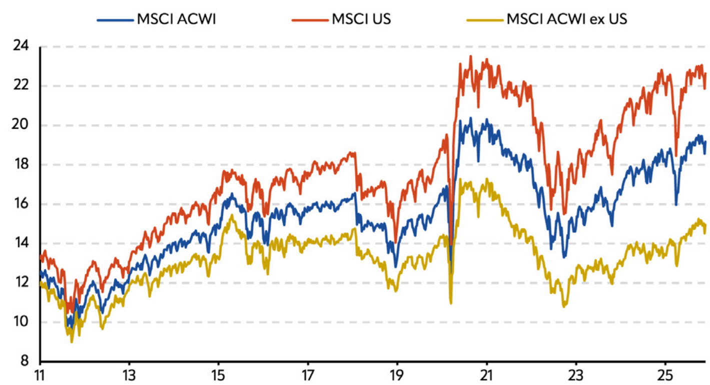
USD weakness and more attractive valuations favour non-US markets.

Global Equity Indicators

	3Y history	Latest	
Global P/E		22.6	Nov
DM P/E		23.6	Nov
US P/E		27.7	Nov
Europe P/E		16.6	Nov
Japan P/E		18.1	Nov
EM P/E		16.5	Nov

Source: Bloomberg, MSCI

Chart 8: 12m Forward PE Ratios



Source: Bloomberg

Asset	View	Chg	Commentary
Global equities	+1	-	We expect global central bank easing and looser financial conditions to support global equities. USD weakness should encourage a rotation toward non-US stocks. In addition, further AI spending should support the broader supply-chain and key companies within that ecosystem.
US equities	-1	-	US profit expectations remain strong. By most measures US equities are richly priced. Cyclical and structural forces should continue to weigh on the dollar, a trend that tends to favour non-US stocks. We maintain a small *underweight*.
Eurozone equities	0	-	The European economy is gradually improving; the Eurozone Composite PMI is low but above 50 and trending higher. Inflation has stabilised near target, and the ECB rate cuts should support the markets with a lag. While a weaker dollar typically benefits international stocks, a stronger euro may create headwinds for European exporters. We remain *neutral*.
UK equities	-1	-	While UK equities may see positive absolute returns, it lacks a clear catalyst for outperformance, and we expect it to underperform other DMs. Earnings expectations are low for 2025 and unremarkable for 2026. We therefore stay *underweight*.
Japan equities	+1	-	Japan's equity market offers undemanding valuations, while corporate governance measures continue to progress. Japan also includes some key firms in the AI ecosystem. Rising rates will continue to support the financial sector. We remain *overweight*.
EM equities	+2	-	AI and the associated hardware remain in a structural growth phase. EM leads in many of these technologies and are often comparatively cheaply valued. Easing US monetary policy has helped weaken the dollar, creating conditions that typically favour EM. We therefore continue to hold an *overweight* position.

Note: Up/down arrows indicate a positive or negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Rates

Overweight

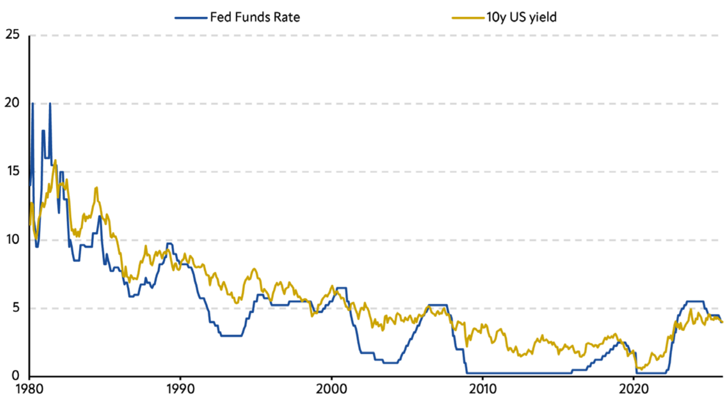
A global easing cycle and comparatively attractive yields support duration.

Global Rates Indicators

	3Y history	Latest	
Global Govt Yield		3.1	Nov
UST 10Y Yield		4.0	Nov
TIPS 10Y Real		1.8	Nov
Bund 10Y Yield		2.7	Nov
Italy 10Y Yield		3.4	Nov
JGB 10Y Yield		1.8	Nov
EM Local Yield		3.8	Nov

Source: Bloomberg Barclays Indices, US Federal Reserve. Yield in %

Chart 9: US 10y Yield and Fed Funds Rate



Source: Bloomberg

Asset	View	Chg	Commentary
USTs	0	-	The traditional safe-haven appeal of US Treasuries has been diminished by the ongoing US deficits. The potential for further dollar weakness also reduces their appeal. Further rate cuts from the FOMC should provide support, as might the early appointment of a dovish replacement for Chairman Powell. We remain *neutral*.
US TIPS	+1	-	Inflation remains elevated, suggesting a slight upside bias. However, breakeven inflation rate expectations have been subdued as future rates are strongly influenced by energy prices, which have been weighed down by excess supply. We maintain our *overweight* position.
Bunds	+1	-	A weakening dollar increases the appeal of euro-denominated assets. German fiscal loosening could become headwind for Bunds, but ECB policy and stable inflation are likely to keep yields contained. We keep our *overweight* position.
JGBs	-1	-	Unlike other developed market central banks, the BOJ is expected to raise rates. Inflation remains around 3%, so a gradual tightening is possible. The currency is cheap but has continued to weaken year-to-date. We remain *underweight*.
EM local bonds	0	-	Further dollar weakness should benefit EM local bonds, but the yield is already comparatively low relative to history, therefore we stay *neutral*. Should the dollar downtrend resume in 2026, EM local bonds are a potential upgrade candidate.

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Credit

Underweight

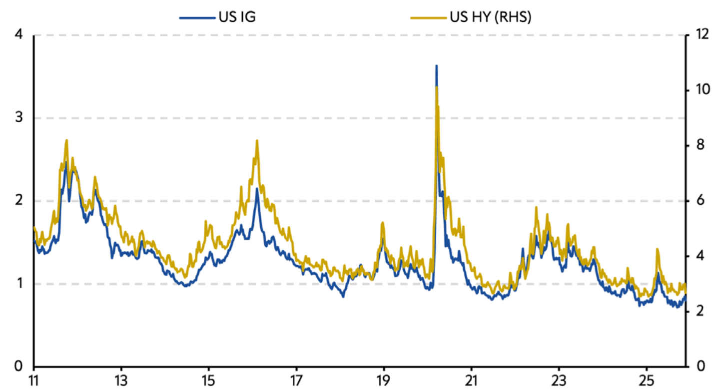
Spreads are priced for a low default regime.

Global Credit Indicators

	3Y history	Latest	
Global IG OAS		0.8	Nov
US IG OAS		0.8	Nov
US HY OAS		2.7	Nov
Euro IG OAS		0.8	Nov
Euro HY OAS		2.7	Nov
EM Sov $ OAS		2.0	Nov
EM Corp $ OAS		2.3	Nov

Source: Bloomberg Barclays Indices. Option-adjusted spreads in %

Chart 10: US Corporate Spreads (% points)



Source: Bloomberg

Asset	View	Chg	Commentary
US IG	0	-	Tech companies are increasingly turning to the credit markets to help fund their capex. This extra issuance has the potential to push up yields, but spreads remain tight with little apparent room for them to narrow further. Fed cuts should help support investment grade credit. We stay *neutral.*
US HY	-3	-	High-yield spreads remain narrow, thereby offering little protection against the risk of rising defaults – mean reversion to the historical average default regime would harm returns. Some companies are vulnerable to the need to refinance at higher rates and there has been some evidence that corporate profit margins are absorbing US tariffs. We continue to be *underweight.*
European IG	0	-	European investment grade spreads remain low, thereby offering little potential upside relative to Bunds. The ECB is expected to maintain loose financial conditions, which ought to help duration assets. We remain *neutral.*
European HY	-1	-	Spreads remain tight and do not provide adequate compensation for the risk of rising defaults. Refinancing at higher rates remains a risk. We maintain our *underweight* position.
EM Sov $ credit	0	-	Further weakness in the dollar – which may be aided by further Fed cuts – would traditionally support dollar-denominated debt. However, spreads remain unattractive, and therefore we stay *neutral.*
EM Corp $ credit	0	-	Spreads remain tight with little room for further compression, and do not offer an appealing entry point. Another move down in the dollar, and a lower Fed funds rate should help the asset class. We keep our *neutral* position.

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Real Estate

Neutral

An improvement in investor sentiment is positive; however, subdued rental growth projections keep us neutral.

Asset	View	Chg	Commentary
Global Real Estate	0	-	Fading uncertainty around tariffs has supported sentiment, with indicators such as JLL's Global Bid Intensity Index rising and direct real estate transactions growing in annual terms in Q3. Nevertheless, sentiment outside the US remains weak, as reflected in the RICS Global Commercial Property Sentiment Index remaining in negative territory in Q3. On valuations, falling US Treasury yields have provided some relief, yet valuations still look stretched. A continuation in the Fed's easing cycle is positive. Meanwhile, a stable economic backdrop implies only modest rental growth. As such, we stay *neutral*.

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Commodities

Overweight

While we expect structural drivers to continue supporting gold prices, we are trimming our allocation this quarter and adding to our industrial metals overweight given tight copper supply.

Asset	View	Chg	Commentary
Energy	0	-	Strong oil output from non-OPEC+ producers points to a global oil market awash with supply, even when accounting for robust demand and tighter sanctions on Russian oil. The EIA projects a global oil surplus through 2026, which will likely keep downward pressure on prices. A Russia-Ukraine ceasefire would pose a bearish risk to prices by reducing the geopolitical premium. In natural gas, despite projections for a "warmer" winter, cyclical demand should support prices. We stay *neutral*.
Industrial Metals	+1	-	Improving global economic conditions, combined with structural demand from the energy transition and AI-related data centres, amid a tight supply backdrop, is likely to support copper prices. Inventory build-up in the US in anticipation of US tariffs has left inventories outside the US limited, while mine supply growth is weak. The aluminium market is not as tight but appears balanced and should benefit from higher copper prices. Therefore, we increase our *overweight* allocation.
Precious Metals	+1	↓	Gold prices breached $4,000/oz in Q4 on the back of strong ETF flows and central bank demand. Structural factors such as concerns around the US's fiscal health, Fed independence and safe-haven demand should put a floor under prices. However, the rally and valuations appear stretched, as evidenced by the sharp pullback in prices in October. As such, we trim our *overweight* allocation.
Agriculture	0	-	The US-China trade deal is a positive for US soybeans, but high inventories could limit price gains. Comfortable supply balances in other agricultural commodities suggest limited upside for prices. We maintain our *neutral* allocation.

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KEY ASSET ALLOCATION INDICATORS (All data shown are as at end-Nov 2025 unless otherwise stated)

	ASSET ALLOCATION							PERFORMANCE						BENCHMARK INDEX & WEIGHTS	
	-3	-2	-1	0	+1	+2	+3	5Y	3Y	1Y	2024	Ytd	end Aug-end Nov		
EQUITIES					■			**76.0**	**67.0**	**18.2**	**17.5**	**21.1**	**5.9**	**MSCI ACWI**	**50%**
US			■					95.1	74.0	14.3	24.6	17.3	6.1	MSCI USA	25%
Eurozone				■				66.2	70.8	34.6	2.6	35.4	4.7	MSCI EMU	7%
UK			■					89.9	59.1	26.6	7.5	30.2	4.4	MSCI UK	3%
Japan					■			42.6	61.9	23.5	8.3	23.9	5.2	MSCI Japan	5%
EM						■		28.0	51.0	29.5	7.5	29.7	9.0	MSCI EM	10%
RATES					■			**-16.2**	**7.9**	**4.0**	**-3.6**	**6.7**	**-0.1**	**Bloomberg Barclays Global Treasury Total Return Index Value Unhedged**	**27%**
USTs				■				-4.8	11.1	5.0	0.6	6.7	2.1	Bloomberg Barclays US Treasury Total Return Unhedged USD	10%
US TIPS					■			7.4	12.5	5.7	1.8	7.4	1.0	Bloomberg Barclays US Treasury Inflation-Linked Bond Index	3%
Bunds					■			-18.3	13.6	7.4	-5.7	11.2	-0.4	Bloomberg Barclays Euro Aggregate Treasury Germany TR Index Unhedged USD	3%
JGBs			■					-41.7	-18.5	-8.7	-13.1	-4.4	-6.9	Bloomberg Barclays Asian-Pacific Japan Treasury TR Index Unhedged USD	5%
EM Local				■				6.9	28.1	12.8	-2.2	15.0	1.5	Bloomberg Barclays EM Local Currency Liquid Govt TR Index Unhedged USD	6%
CREDIT		■						**-0.2**	**22.2**	**7.8**	**1.1**	**10.0**	**1.7**	**Bloomberg Barclays Global Aggregate Credit Total Return Index Value Unhedged USD**	**13%**
US IG				■				0.2	19.2	5.9	2.1	8.0	2.6	Bloomberg Barclays US Corporate Statistics Index	4%
US HY	■							26.3	31.7	7.5	8.2	8.0	1.6	Bloomberg Barclays US Corporate High Yield Statistics Index	3%
European IG				■				-2.8	29.5	13.0	-1.8	15.7	0.0	Bloomberg Barclays EuroAgg Corporate Statistics Index USD	2%
European HY			■					15.0	42.4	16.0	1.4	17.5	-0.1	Bloomberg Barclays Pan-European High Yield (Euro) Index Statistics USD	1%
EM Sov $				■				9.6	33.8	10.8	7.0	12.5	4.3	Bloomberg Barclays Emerging Markets Sovereign TR Index Value Unhedged USD	2%
EM Corp $				■				2.9	25.2	6.7	7.0	7.6	1.0	Bloomberg Barclays Emerging Markets Corporates TR Index Value Unhedged USD	1%
REAL ESTATE				■				**15.9**	**18.4**	**3.8**	**0.6**	**11.3**	**1.4**	**FTSE EPRA/NAREIT Global Index Net TRI USD**	**5%**
COMMODITIES					■			**110.6**	**10.8**	**11.0**	**9.2**	**7.4**	**1.9**	**S&P GSCI Total Return Index**	**5%**
Energy				■				151.0	-0.3	4.9	9.9	-1.0	-1.1	S&P GSCI Energy Total Return Index	2%
Industrial metals					■			40.7	18.7	16.4	2.8	19.9	10.8	S&P GSCI Industrial Metals Total Return Index	1%
Precious metals					■			130.5	137.9	59.0	26.1	61.5	22.8	S&P GSCI Precious Metals Index Total Return Index	1%
Agricultural				■				35.3	-11.0	-1.9	0.4	-4.8	0.2	S&P GSCI Agriculture Index Total Return Index	1%

Source: Bloomberg, CLIM

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Disclosures