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Next 12-Months Outlook: Our High-Conviction Calls

Deciphering Economic Momentum: Energy disruptions are starting to impact global economies - we model the impact to the supply side of the economy to a one quarter shock. There is a difference between a physical oil disruption and a price shock - a key difference, particularly in Asia and Europe where exposure varies dramatically between volume risks and price risks because in Asia, price risk is often alleviated by fiscal support to smooth price volatility. Duration is key; if oil prices remain above $100, we would expect central banks, already emphasizing data dependence and flexibility, to raise concerns around inflation risks, reinforcing their reluctance to commit to a clear policy path. At the same time, the downside risks to growth become more material if elevated prices persist or rise toward demand destruction levels above $125, further complicating the trade-off policymakers face between inflation and growth.

Staying Close to Home: Lingering uncertainty around oil supply disruption means outcomes for risk assets are less balanced - either we return to pre-March backdrop if tanker flows resume quickly, or markets sell off in earnest as recession probability rises on Brent spiking. We are **EW global equities, UW fixed income, OW cash**, with the biggest **UW in corporate credit** on binary spread outcomes. We continue to like US in stocks and government bonds given the region's better fundamentals, more defensive nature versus other regions.

Equities: US Leads the Pack

Geopolitical events historically have not led to sustained volatility for US equities. Absent a sharp and persistent rise in oil prices (i.e., Brent>$100/bbl), we remain constructive on US markets due to the combination of positive operating leverage, supportive and pro-cyclical policy, and the potential for AI-driven efficiency gains. While the value characteristics of Japanese equities may help support performance, we expect broader derisking given that Japan is a major energy importer. Beneficiaries of the Takaichi administration's reforms are likely to be more resilient. In EM, we find that low-volatility and high-dividend-yield stocks outperformed in prior geopolitical shocks while growth underperformed. As long as the Strait of Hormuz remains largely closed, we anticipate European equities to broadly trade choppy and sideways and lag the US. Earnings risk is to the upside but this is largely on the back of the Energy sector (>90% of recent upgrades on a weighted basis). Ex Energy earnings are for the most part resilient for now. If/when the strait reopens on a sustainable basis, we would expect broadening flows into European equities to resume and prefer Banks as a recovery play, given a historical tendency to outperform and see earnings upgrades coming out of energy disruptions.

Index (Local Ccy)	5/8/2026	MS Dec 2026 Price Target	Current P/E	MS Dec 2026 P/E Target	MS Top Down EPS YoY% 2026e	MS Top Down EPS YoY% 2027e
S&P 500	7,399	7,800	21.0x	22.0x	317	356
					+15%	+12%
MSCI Europe	2,426	2,600	14.7x	17.0x	143	153
					+3.8%	+7.4%
Topix	3,829	4,250	16.4x	17.0x	222	250
					+12%	+13%
MSCI EM	1,711	1,700	12.4x	13.0x	118	131
					+33%	+11%

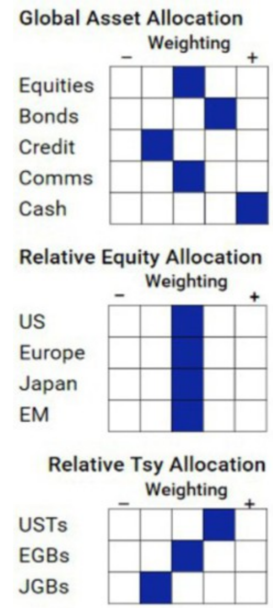
S&P source report; MSCI Europe source report; Topix source report; MSCI EM source report.

Next 12-Months Snapshot: Data Dependency

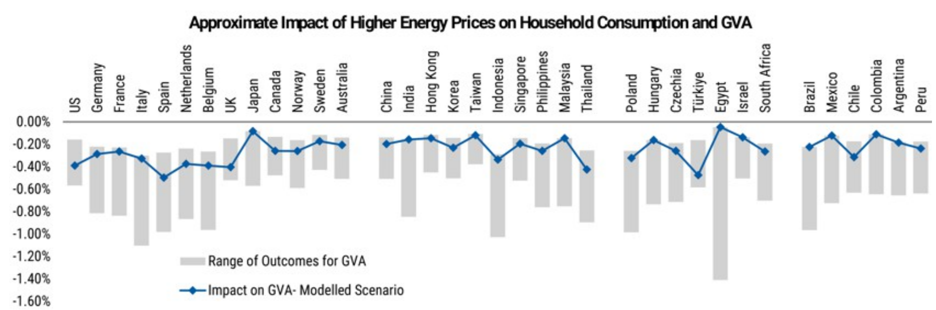
US 1Q26 GDP came in at 2.0%, driven by firm private domestic demand and robust equipment investment, reinforcing our view that real growth remains steady and consumption dynamics are closely tied to inflation, with fading price headwinds supporting our expectation that core inflation will soften by mid-year. At a global level, we have written about the risks to growth and second order effects may transmit across PMIs. Euro area PMIs started to show downside as services PMIs missed materially recently (while manufacturing PMIs were stronger than expected). Similarly, our Asia team has recently downgraded their growth outlook. If/when tensions ease, we see a quick resurgence in Asia's industrial cycle upswing, supported by a sustained rise in capex as the ongoing tensions catalyze medium-term energy and defense spending.

	GDP 4Q/4Q			Inflation 4Q/4Q		
	2025e	2026e	2027e	2025e	2026e	2027e
Global	3.4	3.1	3.3	1.9	2.9	1.8
US	2.0	2.2	2.1	2.7	3.1	2.2
Euro Area	1.2	0.5	1.2	2.1	3.8	1.4
Japan	0.4	0.5	1.0	2.7	3.6	-0.3
EM	4.9	4.4	4.5	1.5	2.6	1.9

Source: Global Economic Briefing: Key Forecast Profile (17 Apr 2026). Note: Forecasts as of 17 April, 2026



One Chart You Can't Miss: Energy Price Disruption - Estimated Risk to 1Q Gross Value Added for Key Economies



Upcoming Economic Indicators

Date	Economy	Event	MS Forecast	Consensus
12-May	BR	Brazil IPCA (Apr)	0.74% m-o-m	0.67% m-o-m
12-May	US	US CPI/ Core CPI (Apr)	3.8%Y/ 2.7%Y	3.7%Y/ 2.7%Y
13-May	EMU	Euro Area GDP (second estimate for 1Q26)	0.1%Q	0.1%Q
14-May	PE	Peru BCRP Monetary Policy Meeting	4.25% (No Change)	4.25% (No Change)
14-May	UK	UK Monthly GDP (Mar)	0.0%M	-0.1%M
14-May	US	US Retail Sales Advance/ Ex auto/ Control Group (Apr)	0.4%M/ 0.4%M/ 0.1%M	0.5%M/ 0.7%M/ 0.4%M

For details on upcoming economic indicators: US Europe Asia-Pacific LatAm CEEMEA

The Double-Breaking Putt; Regime Change Ahead

In the US, the Fed completes its handoff from easing the stance of monetary policy to achieving a neutral stance, but the downside risks to growth make long rate positions attractive. In the euro area, we expect the ECB to hike by 50bp in 2026, but unwind those hikes in 2027 and see 10-year Bunds ending '26 at 2.8%. We forecast 10-year gilts to end 2026 at 3.90% and JGBs to finish at 2.40%; the DXY should fall about 5% to 94 by mid-2026, only to reverse course and end 2026 close to where it started. We think FX is shifting from a Carry Regime—where inflation and higher real rates supported the USD—toward a Defense Regime as growth concerns take hold. While near-term USD strength may persist on geopolitical risk, we view this as a potential "bull trap", with DXY likely to stall and weaken as rate differentials compress and USD-negative risk premium rebuilds.

FX	5/8/2026	4Q26 Forecast
EUR / USD	1.18	1.16
USD / JPY	157	151
GBP/ USD	1.36	1.29

Rates (%)	5/8/2026	4Q26 Forecast
US 10yr	4.35	4.05
German 10yr	3.01	2.80
UK 10yr	4.91	3.90
Japan 10yr	2.48	2.40

Commodities

Oil: Why is the Price of Oil Not Higher? The oil market has lost nearly 1 bn barrels of supply by now, and given the time it takes to restart supply chains, this likely increases substantially further. Oil prices have risen, but still failed to reach the levels of 2022 - a much smaller disruption. Two trends have emerged that help explain this: 1) seaborne oil exports from the US have surged 3.8 mb/d YoY and 2) China has been willing to let its seaborne imports drop 5.5 mb/d YoY, seemingly preferring to use inventories instead. This has shielded the rest of the world but neither seem sustainable long run, posing the question what will happen first? SoH reopening? Or reversal in flows? Our base case is the former, and underpins our forecasts for Brent of $110/b for 2Q, $100/b for 3Q and $90/b for 4Q.

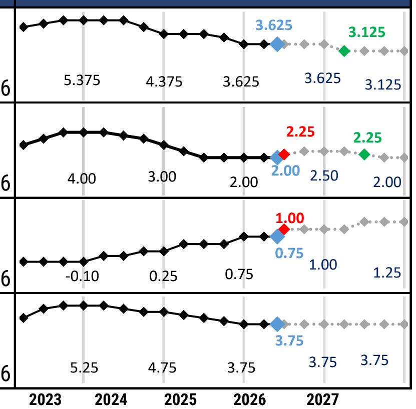
Gas: A Multi-Year Tightening: Missile strikes have damaged 2 of the 14 trains at the Ras Laffan LNG complex, tightening the market not just for '26, but likely next several years. This significantly reduces 2027-28 oversupply risk and extends the duration of strong prices. We raise our bal-26 JKM forecast to the upper end of our prior $25-30 range, followed by $15 in '27, and $12.50 in '28. European gas prices have remained more muted, as supply risk here is more medium-term than short-term, with soft demand and large import curtailments in Asia helping keep spot market looser than expected. However, low inventory levels and rising competition for LNG over summer maintains 3Q 26 upside risk for TTF, see: Calm on the Surface.

Metals: Two-Way Risks: The ongoing conflict in the Middle East continues to cloud the near-term outlook for metals. Macro implications of the conflict are weighing on the backdrop for copper although recent mine disruptions and growing risks to SxEw production may limit any price pullback. However, we think Chinese buying likely softens if prices rise too high. Nickel shows rising upside risk as sulphur shortages and the revised nickel ore benchmark add cost pressures in Indonesia. Lithium remains supported by strong ESS demand and supply disruptions, though prices may ease into 2027/28 as supply recovers. In Aluminium, tightness is showing up more in timespreads and regional premiums than in the headline LME price, as steep backwardation encourages end user to destock while existing investor positioning limits further gains. See: Moving Parts in Metals Markets & Why is Aluminium not Higher?

G4 Central Bank Monitor

Last month's run of central bank meetings reinforced our view that an uncertain macro backdrop is constraining policymakers' ability to offer clear forward guidance. For the **Fed**, April's FOMC marked a notable shift away from an easing bias toward more balanced risks, with dissents and Chair Powell's messaging raising the bar for cuts and emphasizing optionality. Resilient growth, persistent inflation and the oil shock argue for a delay in easing into 1Q27, with cuts potentially disappearing altogether if inflation proves stickier. The **ECB** held rates as expected but pushed back on earlier market pricing of aggressive tightening. We expect a June hike if energy prices remain elevated, while policymakers acknowledge more two-sided risks, with growth concerns emerging in services and gas restocking a key near-term risk. The **BoJ** also paused in April but maintained a tightening bias, with dissenting votes underscoring proximity to a hike and forecasts pointing to more durable inflation. However, policymakers are more explicitly weighing downside growth risks from higher energy prices, suggesting a greater willingness to pause even as normalization remains on track.

Economy	Current Policy Rate (Last Change)	Next Meeting Date	End of Quarter Policy Rate Forecast (23Q1 to 27Q4)
US	3.625% (No Change)	17-Jun-2026	
Euro Area	2.00% (No Change)	11-Jun-2026	
Japan	0.75% (No Change)	16-Jun-2026	
UK	3.75% (No Change)	18-Jun-2026	



Blue marker indicates current rate. Green and Red markers indicate quarters with next projected cut and hike respectively.

Credit: Poor Convexity

Given geopolitical risks, we think risk premium in US credit markets is not sufficient at these levels, and having a defensive posture/hedges make strategic sense. Importantly, credit has multiple headwinds beyond geopolitical concerns, namely significant issuance, and AI-related disruption concerns.

		4Q26		
	Current	Bull	Base	Bear
US Investment Grade	77	70	95	140
US High Yield	266	250	300	450
US Leveraged Loans	425	390	425	550
EUR IG	81	60	90	150
EUR HY	273	225	280	450
Asia IG	57	55	80	130

Important note regarding economic sanctions. This report references jurisdictions which may be the subject of economic sanctions. Readers are solely responsible for ensuring that their investment activities are carried out in compliance with applicable laws.