2026 Year-Ahead Outlook

Macro, Equities, Retail, Funds, Agency RMBS, Non-Agency RMBS, CMBS, and CLO Insights

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LSEG DATA & ANALYTICS

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Executive Summary

1. Macro

Although there remain global risks, including geo-political, outright recession risks in the US and globally appear relatively low in 2026, and compelling evidence of bubbles in credit and equities is hard to find in conventional valuation measures. Global financial conditions have eased steadily since the tariff spike in April 2025, and central banks have signalled they do not wish to shrink balance sheets to pre-GFC levels, to reduce financial stability risks. Inflation is still above some central bank targets, but there is little evidence of a return to a high inflation regime. Thus, the US Fed has scope to ease policy further if required, should unemployment increase faster in 2026. In Europe, with ECB rates already at 2%, more active use of German fiscal policy is an important supplement to demand growth. Longer dated government bond yields near post-GFC highs, and above 5% in some maturities, also discount substantial debt/GDP ratios and funding burdens in the G7.

2. Equities

Equities endured one of the sharpest drawdowns since the Great Financial Crisis last year amid tariff uncertainty, only to rebound and deliver a third consecutive year of double-digit returns as trade tensions eased and optimism shifted towards Artificial Intelligence and resilient corporate earnings. If the S&P 500 delivers another year of double-digit returns in 2026, it would mark only the fourth time in the past 125 years that the index has achieved four consecutive years of double-digit gains – with previous occurrences in the 1940s, 1950s, and 1990s.

Looking ahead to 2026, fundamentals remain supportive, driven by a) resilient earnings which are expected to broaden outside of Magnificent-7, b) profit margins near all-time highs, c) potential operating leverage improvement as AI adoption drives productivity and cost efficiencies, and d) Fed Funds futures are pricing in two to three rate cuts this year.

A key risk outside of the macro risks highlighted above lies in investor patience with AI's return on investment and whether hyperscalers are over-investing for uncertain payoffs. With valuations near levels last seen during the internet bubble, volatility around earnings and AI enablers could dictate equity price trajectories in the near term.

3. Retail Consumer

The LSEG Retail/Restaurant Index projects moderate growth for 2025, following two years of double-digit gains. Earnings are expected to rise 5.9% and revenue 4.6% for the year, supported by resilient consumer demand. Q3 2025 delivered 8.2% earnings growth, while Q4 is forecasted to slow to 1.1%. Looking ahead, 2026 growth momentum is set to accelerate, with earnings projected to climb 10.9% and revenue 5.8%, signaling a positive trajectory for the sector.

4. Funds

Money Market USD funds dominated flows in 2025. Their appeal persisted despite reinverted yield curves late in 2024, driven by the Federal Reserve's high interest rates, which kept MMF yields above 4–5%, outperforming bank deposits. Non-US investors also favoured MMFs due to the US' higher rates, despite dollar weakness in early 2025.

ETFs dominated equity flows (+$502bn), overshadowing mutual funds. Equity US funds fell from second place in 2024 to eighth in 2025, with inflows about 20% of the previous year, along with a huge rotation from mutual funds into ETFs in this classification. US flows were volatile, swinging from heavy outflows in May to strong inflows in November. European enthusiasm faded after late-2024 spikes, with large redemptions over the summer, while Asian investors remained consistently positive.

Equity Global ranked second in Europe and Asia but stayed negative in the US, while Equity Europe rebounded in 2025 after prior sell-offs, while U.S. investors diversified into Europe and Canada. Equity US Small & Mid Cap, suffered the worst redemptions, hurt by concerns over tariffs, high rates, and weak growth.

5. Agency RMBS

The Agency RMBS market is expected to remain generally resilient in 2026, supported by steady issuance, tempered housing price growth, and potential declines in mortgage rates. Recent policy initiatives, such as agency MBS purchases, restrictions on institutional buyers, GSE reforms, VantageScore 4.0 adoption, and mortgage portability, could influence affordability and liquidity, but their effectiveness and timing remain uncertain. Prepayment activity is expected to stay muted for deeply out-of-the-money cohorts, while in-the-money and modestly OTM cohorts may see some pickup if mortgage rates decline further.

Overall, the combination of stable issuance, supportive policy measures, and incremental improvements in affordability points to a cautiously optimistic outlook for the Agency RMBS sector in 2026.

6. Non-Agency RMBS

2025 has been a very strong year for the Non-Agency public and private market with an increase in issuance by 42% compared to 2024 led by the uptake in the Non-QM sector. In a stable macroeconomic environment in 2026, further Non-Agency issuance growth may continue.

As the mortgage rates started to ease in the second half of 2025 we have seen increase in prepayments for the 2023 – 2025 origination vintages for Jumbo and Non-QM. This cohort has been originated in considerably higher rates and has greater incentives to refinance at the new interest rates. We expect increase in prepayments until mid 2026 especially for the Prime Jumbo mortgages.

Credit risk has been stable in 2025 and with stabilization of inflation and a strong job market the outlook for the credit risk on the Non-Agency mortgages is stable for 2026.

7. CMBS

7.1. Agency CMBS

Agency CMBS had a strong year in 2025, with issuance rising more than 34% YoY amid rate cuts and benign financing conditions. Spreads were largely stable for most products, except a short-lived widening in April tied to tariff distress. However, multifamily property fundamentals were softer in vacancy and rent. Meanwhile, credit performance was generally resilient, and prepayment speeds remained muted in general given limited refinance incentives.

The base case scenario assumes gradual rate normalization, stable capital market demand, and slow improvement in fundamentals as supply recedes—implying stable issuance, range-bound spreads, and steady credit and prepayment performance.

7.1 Non-Agency CMBS

The CMBS market achieved post-GFC record issuance in 2025 on improved liquidity and sentiment in CRE, despite mixed macroeconomic conditions. CRE fundamentals continued the recovery though the momentum has slowed down in rent and cashflow growth and the recovery remained highly uneven. Meanwhile, property valuations have finally stabilized after three-year slide even though some credit metrics continued to deteriorate.

To frame the outlook for 2026, we anchor major CMBS themes to the expected rate path and broader economic conditions, with two key scenarios on focus: 1. A baseline scenario where the Federal Reserve delivers 1-2 additional rate cuts for the year and inflation continues to ease gradually with the labor market softening but remaining resilient; 2. A stress scenario of stagflation where labor market deterioration accelerates and unemployment climbs above 5% while inflation remains sticky or even rekindles, putting Fed in a conundrum.

8. Collateralized Loan Obligations (CLO)

As we move into 2026, we see major headwinds including elevated inflation and input costs and a weakening labor market which may slow economic growth and pressure leveraged loan credit fundamental. While we expect continued rate cuts to support investor sentiment, lower policy rates may reduce demand for floating rate products. On the bright side, a resurgence in M&A and LBO activities will boost leveraged loan supply, supporting issuance and arbitrage. Additionally, deregulation in financial market may fuel bank demand.

Overall, we have a constructive outlook for the CLO market in 2026. Further Fed easing, sustained investor demand, and stabilizing credit fundamentals provide a solid foundation for continued market growth. Meanwhile, default and downgrade activities are expected to continue, albeit at a more moderate pace compared to recent years. Credit dispersion will remain a key theme with risks concentrated in selected industries facing tariff-related pressure or AI disruption, particularly among issuers with weaker balance sheets and elevated leverage. As such, asset analysis and manager selection remain critical for CLO investment with focus on tail risk mitigation.

Section 1 – Macro Outlook

Another year of living dangerously or are fears of a crash greatly exaggerated?

Section Summary

- Although there remain global risks, including geo-political, outright recession risks in the global economy appear relatively low, and compelling evidence of bubbles in credit and equities is hard to find in conventional valuation measures.
- Global financial conditions eased steadily since the tariff spike in April 2025, but they are not at extreme levels, and central banks have signalled they do not wish to shrink balance sheets to pre-GFC levels, to prevent financial stability risks.
- High quality policy regimes and favourable inflation performance are reflected in the strong performance of EM equities, and lower EM sovereign spreads.
- Some central banks have scope to ease policy further if required, should unemployment increase faster in 2026, notably the US Fed and Bank of England. In Europe, with ECB rates at 2%, more active use of German fiscal policy is an important supplement to demand growth.
- Inflation is still above some central bank targets, but there is little evidence of a de-stabilisation in inflation expectations and return to a high inflation regime.
- Successful re-wiring of supply chains since Covid is reflected in lower tradeable goods inflation, although tariff increases are causing a modest one-off increase in US inflation.
- Longer dated government bond yields near post-GFC highs, and above 5% in some maturities, also discount substantial debt/GDP ratios and funding burdens in the G7. These considerations suggest recession risks in the macro-economic and policy outlook for 2026 are not the central case.

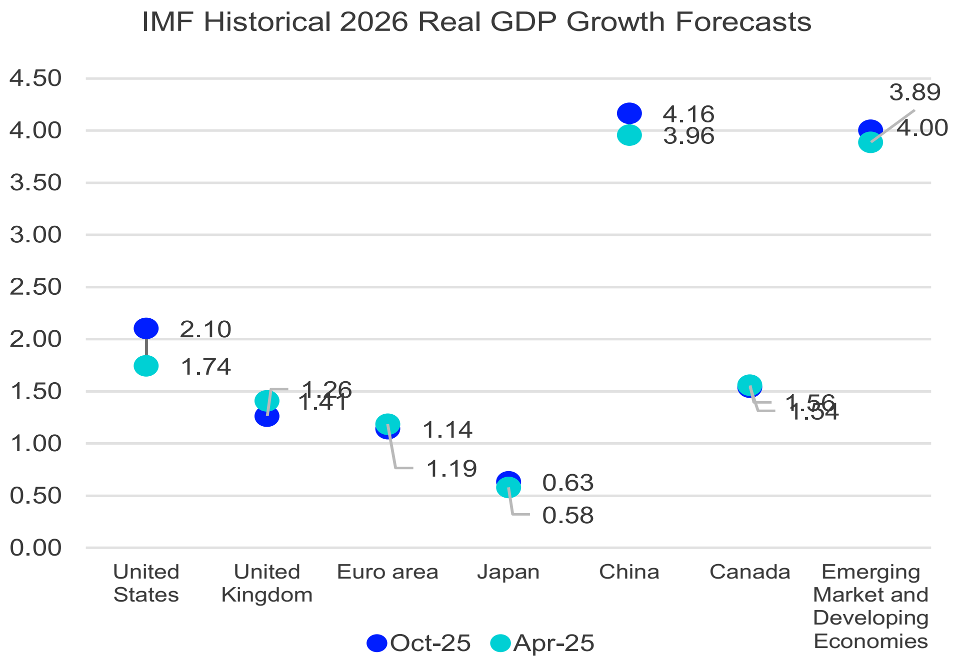
The global economy survived major US tariff-related turbulence in 2025, helped by central bank policy easing, and the boom in US AI, and significant fiscal stimulus in the G7. Risk assets showed further strong gains, despite weak real growth in parts of the Eurozone, and geo-political turbulence. Investors now need to assess macro-economic and financial risks for 2026, including whether global recession risks are higher? Does de-globalisation and the emergence of a multi-polar global economy since Covid increase or reduce recession risks? Are these risks greater because of an over-investment boom in AI, and "bubble" [1] in credit and other risk assets, and limited scope for further policy easing? In addition, are financial conditions constructive for markets and the global economy, implying broader recession risks are no more than tail risks?

IMF and private sector forecasts show low recession risks in 2026

Latest IMF forecasts show relatively low forecast recession risks in 2026, as Exhibit 1 - 1 shows, though we would note recessions are often not forecast, since they are either driven by shocks (GFC or Covid) or discontinuities and discrete changes in corporate or consumer behaviour. The other point to note here is that because expectations for tariff increases became so negative in early-2025, the outcome of a 17.5% trade-weighted increase in US tariffs was regarded favourably by markets. Although higher tariffs are already having some impact on US goods inflation, the overall pass-through to final consumer prices from tariff increases appears likely to be a more modest 50% of the increase, based on Fed corporate surveys, compared to nearly 100% after the 1st round of tariff increases in 2018.

[1] In financial commentary, bubbles are rarely defined but often cited based on pronounced over-valuation on a particular metric.

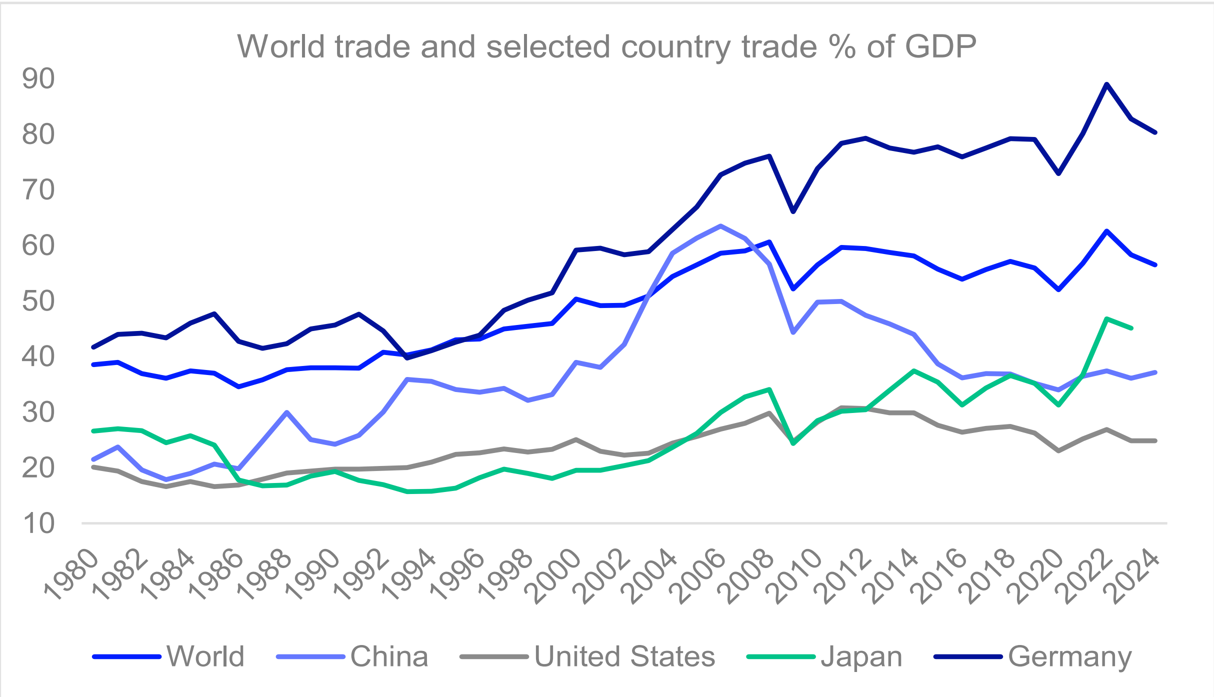
Exhibit 1 - 1: IMF Real GDP Forecasts



Source: IMF, October 2025.

Meanwhile, evidence of de-globalisation, or slow-balisation may be found in the stalling out of world trade shares as a share of GDP, shown in Exhibit 1 - 2. Note however that this is not a unique post-Covid or US tariff driven phenomenon, but has been developing since the GFC in 2008-09, which marked the end of the rapid growth era in world trade from the late-1980s onwards.

Exhibit 1 - 2: Trade as a Percentage of GDP



Source: World Bank, latest data to end-December 2024.

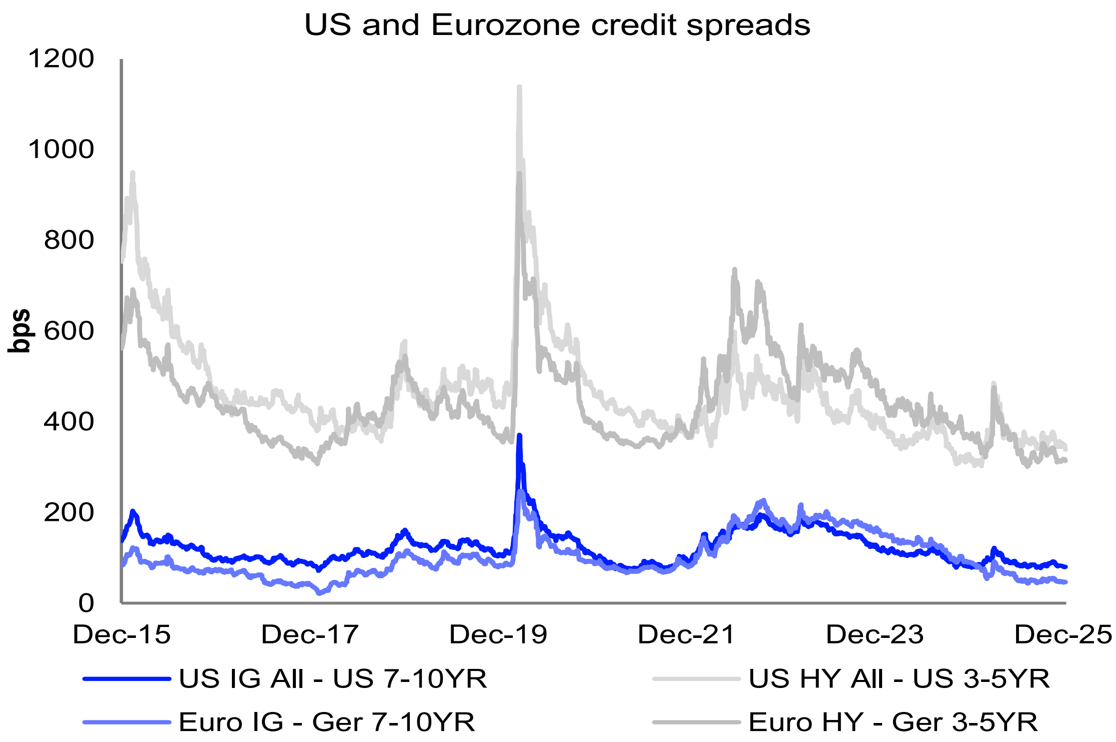
Nor is there evidence of global supply chain pressures becoming more acute, because of a slowdown in globalisation. Tradeable goods inflation has fallen sharply since the Covid spike, as global supply chain pressures have eased. More localised, and regionalised supply chains since Covid appear to have eased these pressures.

But is there a bubble building in credit and equity markets?

The case for a credit bubble is built on (a) credit spreads in public markets being at multi-year lows, and (b) concern about rapid growth in opaque, and unregulated private credit markets in recent years, i.e., from the BIS[2]. This growth in private credit has occurred mainly in economies with low interest rates and tougher bank regulations since the GFC, like the US, where credit has been dis-intermediated outside the banking system.

Exhibit 1 - 3 shows credit spreads versus govt. bonds are indeed near 10-year lows for both investment grade (IG) and high yield (HY) in the US and Eurozone, which prima facie suggests over-valuation, or some kind of bubble. However, low credit spreads partly reflect the back-up in government bond yields, and absolute yields on credit are still notably higher than during the pre-Covid era of very low interest rates, as Exhibit 1 - 3 also shows. So, although yields have fallen on both IG and HY credit, they are not at exceptionally low levels.

Exhibit 1 - 3: US and Eurozone Credit Spreads



Source: FTSE Russell, LSEG data to Dec 31, 2025.

But investor risks are also driven by the duration of the underlying asset, as investors found to their cost in 2022-23, when yields backed up sharply, and both govt bonds and credit valuations collapsed, led by those with longer duration. Since then, there has been a sharp decline in duration in credit markets, as shown in Exhibit 1 - 4.

This reflects lower grade HY issuers struggling to access long-term capital, and shorter dated issuance as a result, and also the impact of higher yields, and lower valuations in shortening market duration. Lower duration means investors are receiving higher yields per unit of duration risk than pre-Covid as Exhibit 1 - 4 also shows.

Other metrics also show improved credit quality, with the share of fallen angels near a 25-year low (credits which have fallen from IG to sub-IG or HY) and a decline in the share of BBB credits relative to single-A[3].

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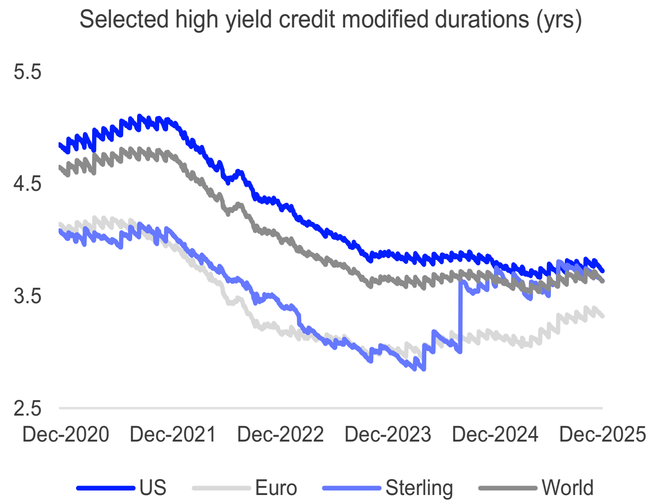
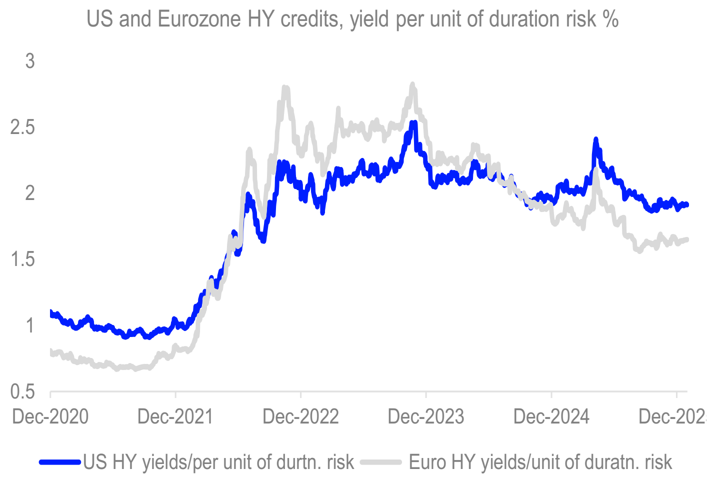
[2] The global drivers of private credit – F.Avalos, S.Doerr, G.Pinter, BIS Quarterly Review, March 2025.

[3] See www.lseg.com/en/ftse-russell/research/are-fallen-angels-still-angelic-performers October 2025.

Exhibit 1 - 4: High Yield Duration





Source: FTSE Russell/LSEG data to Dec 31, 2025.

Since private credit deals are not publicly traded, but customised deals between borrowers and lenders, there is restricted data available. However, BIS estimates suggest the market now exceeds $2.5 trillion, and is as large as the high yield market globally. Since private credit deals are generally structured for borrowers who do not have access to public credit markets, or the banking system, and may have negative EBITDA, deals tend to be covenant-heavy with a strong emphasis on protection against default risks, which both borrower and investor seek to avoid. They are generally floating rate loans of 6-8 yrs maturity, and not subject to maturity transformation like bank transactions. The deals mostly sit on the balance sheets of long-only investors, like pension funds, until maturity.

The fact the market withstood the Covid and interest rate shock in 2020-22 is encouraging evidence of its robustness, though there has been an increase in private investor involvement in recent years, increasing regulators' concerns. Valuing more recent deals based on financing AI data centres and future cash flows is also not straightforward, given rapid underlying structural changes, so there will be pockets of risk, like any financial system.

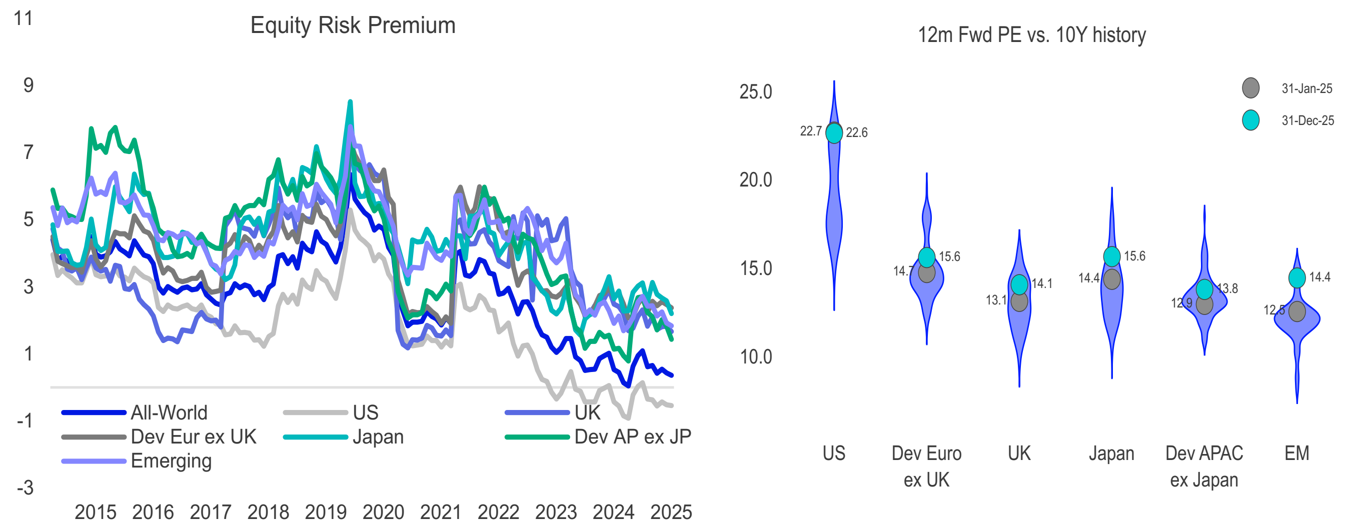
But the lack of maturity transformation, deal focus on default risks, and strong presence of long-only investors is more reassuring. There are parallels also with the early days of the high yield credit market, when there were doubts it would ever be able to function as a source of capital for lower grade borrowers. But as the market developed more infrastructure, with more data, bond indexes and credit rating methodologies, these fears eased.

But are equities in a bubble?

If credit is not in a bubble, are other risk assets, like equities? Equities enjoyed another strong year of performance in 2025, with gains of 20-25%, but note that leadership in the global rally rotated away from the US, as other markets played catch-up, and investors focussed on cheaper valuations outside the US, and the boost to returns in overseas markets from the weaker US dollar.

Equity market gains were driven both by earnings growth and an increase in p/e valuations in 2025, as Exhibit 1 - 5 shows. However, with the exception of the US, other markets stand on valuations which are not far above 10 yr means. Similarly, the combination of equity market gains and the increase in govt bond yields in 2024-25 has left equity risk premia at historically low levels, though this is more pronounced in the US than other major markets. So overall, these valuations do not suggest a major bubble in equity markets.

Exhibit 1 - 5: Equity Risk Premium and Forward P/E

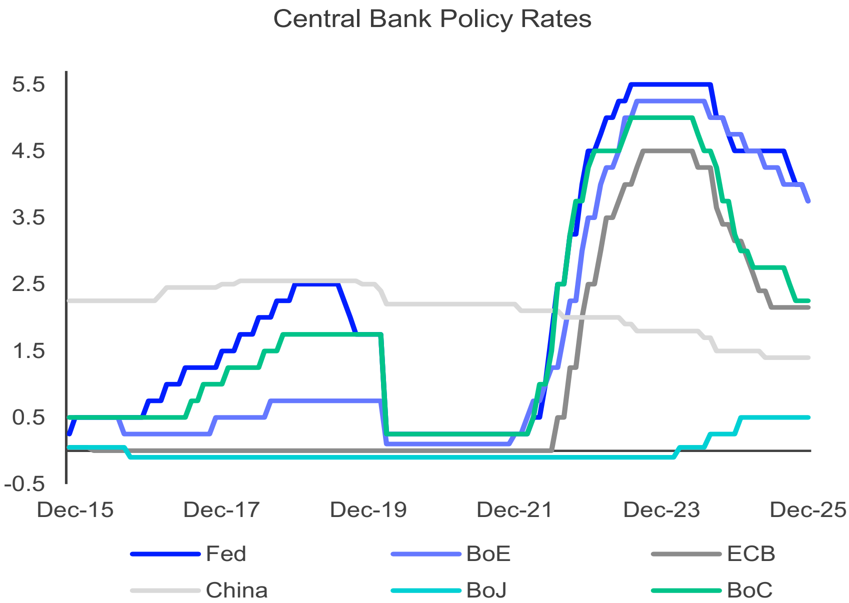


Source: FTSE Russell, LSEG. Data to Dec 31, 2025

Scope for further policy easing varies reflecting divergence and de-globalisation

Reflecting de-globalisation and divergence in growth and inflation, this has been a de-synchronised central bank easing cycle in the major economies (exc.Japan where policy tightening is underway) since easing began in June 2024. Exhibit 1 - 6 shows the US Fed and Bank of England notably lagging policy easing elsewhere, and the BoC and ECB leading the cycle. This is in sharp contrast to the GFC and Covid easing cycles, which were led by the US Fed, and showed a much faster pace of policy easing, and synchronised policy moves.[4] In this cycle, sticky services inflation in the US and UK particularly explain the " higher for longer " approach to policy easing, since inflation has been persistently above 2% yy targets in these economies. But there is little evidence either of de-stabilisation in inflation expectations, measured by breakevens, which have mean-reverted to 2% or below in 2025.

Exhibit 1 - 6: Monetary Policy Rates



Source: FTSE Russell, data to Dec 31, 2025.

[4] See www.lseg.com/en/insights/ftse-russell/timing-tempo-and-terminal-rates-lessons-from-previous-g7-easing-cycles, February 2024.

Although ECB easing is near completion, role of fiscal policy changes in Germany

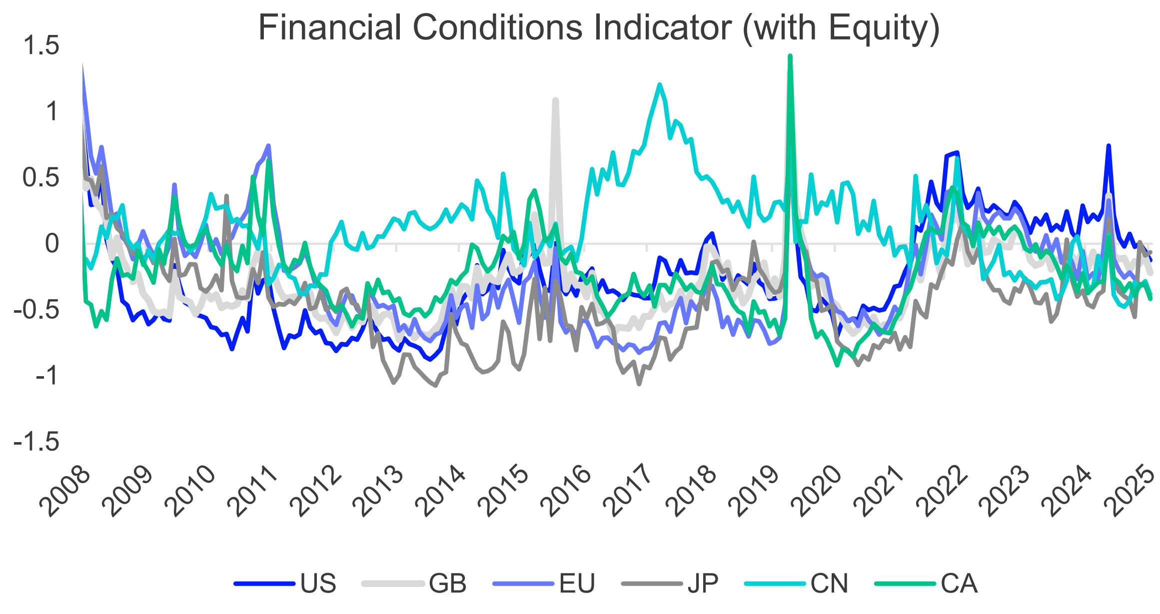
With policy rates now down to 2% in the Eurozone and Canada, scope for further policy easing is more restricted, barring a recession, or spike in unemployment. In fact, the ECB has held rates at 2% since June 2025, and with inflation at the target level of 2% y/y exactly, there is little reason for the ECB to adjust policy. In that regard, the decision in Germany to abandon the fiscal orthodoxy that has prevailed since the Eurozone began in January 1999 is significant. It can be argued that with German growth flat-lining since 2022, and much lower debt/GDP ratio than other G7 members, a Keynesian fiscal stimulus is more appropriate in Germany than elsewhere. But it is also evidence of a broader shift to more activist fiscal policy, despite the high level of government debt/GDP ratios, after the Covid and GFC recessions. Provided the German govt is able to ease fiscal policy and achieve the 3.5% budget deficits and increase in defence spending planned for 2025-29, this makes the German and Eurozone economy less dependent on further ECB rate cuts in 2026.

But the policy dynamics of the Fed may be the most difficult to predict, after the departure of Fed Chairman Jay Powell in May 2026. Q4 2025 policy decisions already showed a fracturing of the traditional policy consensus and split votes for easing further. With a dual mandate for full employment and 2% yy inflation, gauged by the PCE deflator, policy setting would be complex anyway with unemployment now trending higher to 4.4%, and inflation measures still close to 3% yy. But the Chairman's exit and a lack of Fed consensus on what constitutes a neutral policy setting for Fed funds, or the so-called r*, increases more uncertainty. Risks are still tilted towards further easing, from the current 3.5-5.25% range for Fed funds, given the slowdown in the labour market.

Fed and Bank of England have most scope to ease monetary policy further

Reflecting the slower pace of US monetary policy easing, US financial conditions have eased less in 2025, relative to other major economies, on the FTSE Russell financial conditions indicators[5], even though the US dollar weakened in 2025. But as Exhibit 1 - 7 shows, the key message on financial conditions across the major global economies is that although they have eased significantly since the 2022-23 policy tightening, they are not at the extremely loose levels seen during the era of zero rates and QE in 2020-21. Indeed, most central banks have only just concluded Quantitative Tightening programmes and have also signalled, given financial stability risks, that there is no intention to contract central bank balance sheets to the much smaller size that prevailed before Covid and the GFC. And with Fed funds still in a range of 3.5% - 3.75%, the Fed has scope to ease policy considerably further if required.

Exhibit 1 - 7: Financial Conditions Indicator

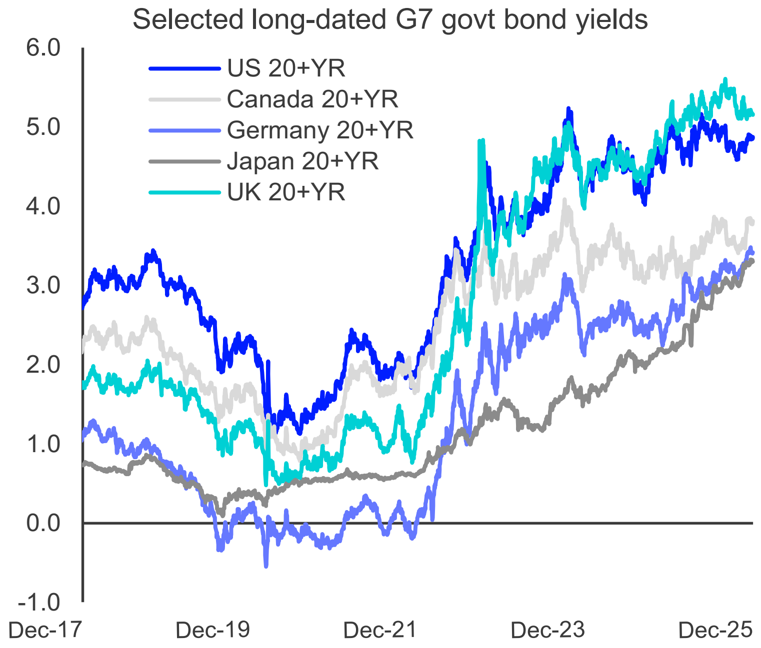


Source: FTSE Russell. Data to Dec 31, 2025

[5] See www.lseg.com/en/ftse-russell/research/building-the-ftse-russell-financial-conditions-indicator, September 2025.

Similar considerations apply to government bond yields, which have backed up to post GFC highs in some long maturities, on fears of higher fiscal deficits and debt sustainability concerns. This cheapening in government bonds, and increase in the term premium, shown in Exhibit 1 - 8, help explain both why equity risk premia and credit spreads, appear so low. But it should also be borne in mind that higher govt bond yields and discount rates sharply improve the net funding position of defined benefit (DB) pension schemes globally, by reducing the value of future liabilities for these schemes[6]. This has offered the opportunity for liability driven investors to de-risk by increasing weightings in longer dated govt bonds, so there are countervailing forces, such as LDI flows, which may serve to reduce long dated yields. There may be some evidence of this in the Q4 rally in long gilts and Treasuries.

Exhibit 1 - 8: Government Bond Yields, %



Source: FTSE Russell, LSEG, data to Dec 31, 2025.

[6] See " Pensioned off? A chance to fill G7 DB pension deficits and implications for the choice of discount curves | LSEG, August, 2025.

Section 2 – Equities Outlook

Strong Fundamentals, Signs of Rotation, and Hyperscaler AI in Focus

Section Summary

- S&P 500 earnings to grow 15.5%, marking three consecutive years of double-digit growth – a two-decade milestone.
- Greater contribution from S&P-493, with earnings growth of 13.2% – highest since 2021.
- Forward P/E near an all-time high and at a level not seen since the internet bubble of 2000.
- Hyperscaler capex to reach a record $485 billion in 2026; could exceed $515 billion according to SmartEstimate.
- Russell 2000 earnings are expected to grow 45.5%; earnings revision ratio turns positive after three years.

Equities endured one of the sharpest drawdowns since the Great Financial Crisis last year amid tariff uncertainty, only to rebound and deliver a third consecutive year of double-digit returns as trade tensions eased and optimism shifted towards Artificial Intelligence and resilient corporate earnings. If the S&P 500 delivers another year of double-digit returns in 2026, it would mark only the fourth time in the past 125 years that the index has achieved four consecutive years of double-digit gains – with previous occurrences in the 1940s, 1950s, and 1990s.

Looking ahead to 2026, fundamentals remain supportive, driven by a) resilient earnings which are expected to broaden outside of Magnificent-7, b) profit margins near all-time highs, c) potential operating leverage improvement as AI adoption drives productivity and cost efficiencies, and d) Fed Funds futures are pricing in two to three rate cuts this year.

A key risk outside of the macro risks highlighted in Section 1 lies in investor patience with AI's return on investment and whether hyperscalers are over-investing for uncertain payoffs. With valuations near levels last seen during the internet bubble, volatility around earnings and AI enablers could dictate equity price trajectories in the near term.

2025 Earnings Recap: Earnings Take Lead Amid Elevated Valuations

2025 was a strong year for S&P 500 earnings, rising at the fastest pace in seven years outside the pandemic rebound of 2020-2021. When decomposing index returns, earnings (including share buybacks) drove nearly three-fourths of total performance last year (Exhibit 2 - 1). This marks the highest share relative to other components in recent years, which is reassuring given current valuation multiples.

With the first three quarters in the book, the 2025 blended growth rate stands at 13.2%, combining reported results from Q1-Q3 with estimates for Q4, which will soon begin reporting. Throughout the year, we saw a consistent theme where companies surpassed analyst expectations and delivered upside surprises. To quantify this, a typical quarter saw its earnings growth rate improve by roughly 660 basis points, doubling the typical pace. This strength was driven by strong results from the Magnificent-7 (Mag-7), fueled by AI demand, and Financials, who broadly benefitted from a steeper yield curve and stronger capital markets activity.

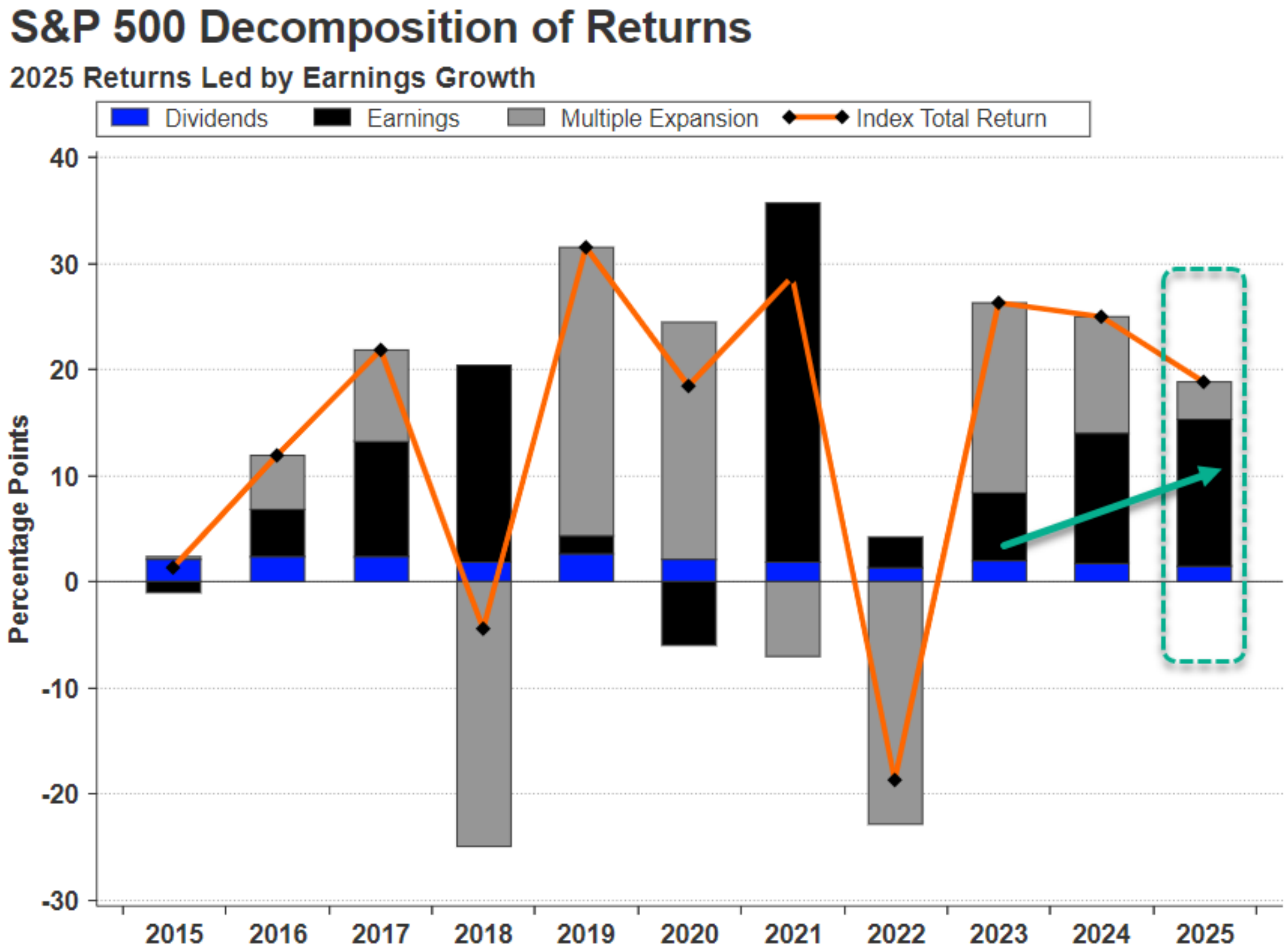
Focusing on the latest reported earnings season quarter (Q3), it was a blowout quarter on multiple fronts due to higher sales growth and margin expansion. Aggregate earnings surpassed $600 billion for the first time and have more than doubled in the last five years. A record 83% of companies beat expectations, with an earnings surprise magnitude of 9.5% – both the highest in four years and notable given estimates were raised heading into earnings season. Top-line revenue grew 8.3%, the strongest in three years, while revenue surprises averaged 2.2%, a full percentage point above the prior three-year average. Profit margins also hit an all-time high of 12.7%.

The goldilocks quarter lifted Q3 earnings by 14.9%, matching Q1 (+13.7%) and Q2 (+13.8%), a rare level of consistency that has so far reassured equity markets the economy remains on solid footing. Even after stripping out the potential distortion of a share-weighted methodology, the Q3 median earnings growth rate of 10.1% was the highest since 2022.

Looking ahead to the Q4 earnings season, which begins in January, it will serve as an important indicator for revisions to 2026 estimates. Q4 earnings are expected to grow 8.8%, in part due to more difficult year-over-year comparisons. Sector leadership looks strikingly narrow, as 10 of the 11 sectors are projected to post single-digit growth, with two in negative territory. Information Technology is the only sector to grow earnings by double digits, and when excluding this sector, Q4 earnings growth falls to 2.8%. Moreover, seven of the 11 sectors are forecast to see earnings grow more slowly than revenue, a sign of negative operating leverage. This is reflected in Q4's estimated net margin of 12.4%, down 300 basis points from the prior quarter.

Q4 estimates have modestly risen by 110 basis points heading into earnings season, an unusual trend given that analysts typically lower estimates by about 320 basis points heading into the quarter. Our research shows that when earnings estimates are revised upward before earnings season, the final growth rate at the end of the season has always exceeded the starting estimate, based on two decades of data. At the sector level, Technology is the only group to see a material upgrade in year-over-year earnings growth, revised up by 700 basis points to 26.5% heading into Q4. In contrast, Utilities, Materials, and Consumer Staples have experienced the largest downward revisions, ranging from 350 to 700 basis points.

Exhibit 2 - 1: Decomposition of S&P 500 Returns Over the Last Decade



Source: LSEG Datastream | Note: Index Return ≈ Dividend Yield + EPS Growth + Δ in P/E multiple

2026 Earnings Outlook – Early Signs of Rotation into S&P-493

S&P 500 earnings are projected to grow 15.5% in 2026 to $314 per share according to analyst estimates, marking a third consecutive year of double-digit growth, a feat not seen in two decades. Revenues are expected to rise 7.0%, reaching a multi-year high. Taken together, 2026 is expected to be one of the strongest years in the past decade (Exhibit 2 - 2).

Earnings breadth remains strong, with every sector expected to post positive earnings growth, a rarity seen only twice in the past 25 years. Momentum is also solid, as eight of the eleven sectors are projected to accelerate earnings growth versus last year, and nine are expected to deliver higher revenue growth.

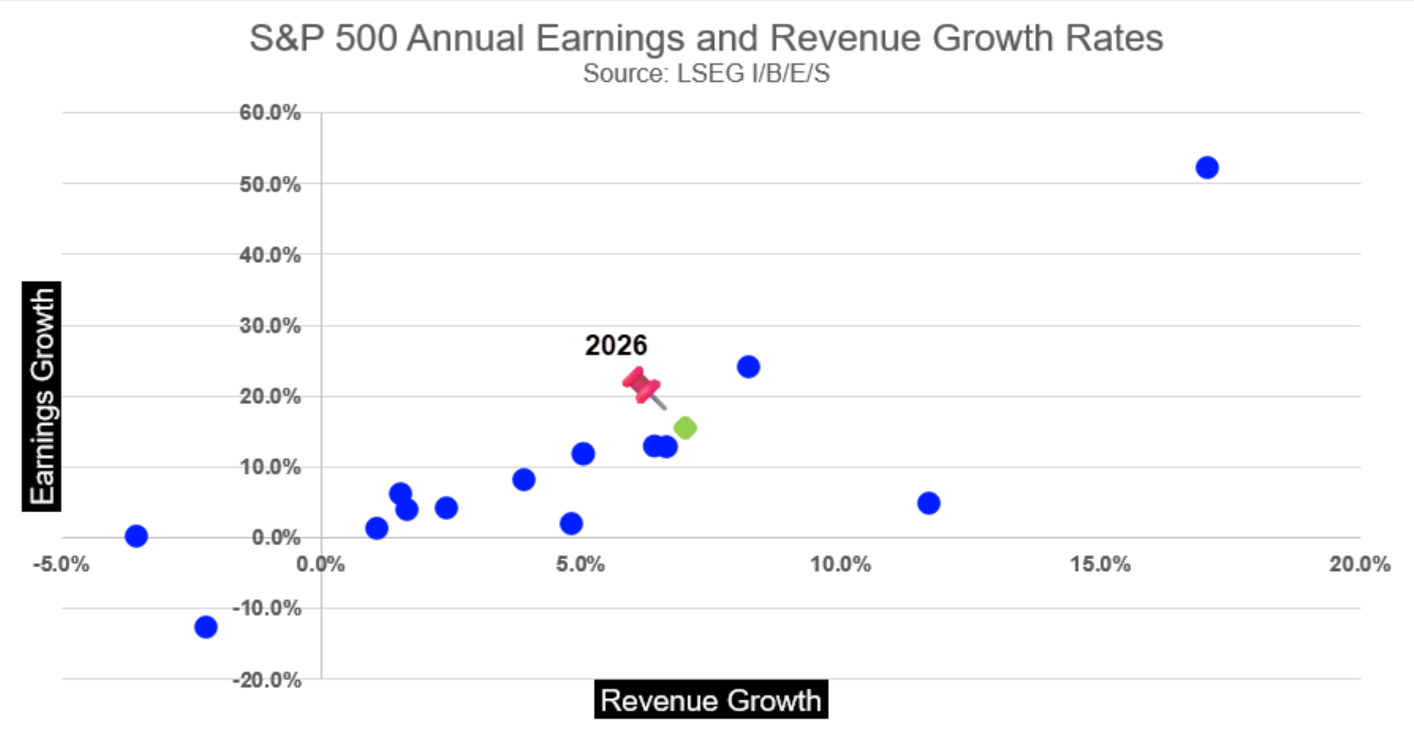
Perhaps most importantly, we're seeing early signs of earnings growth broadening beyond the Mag-7, which have dominated results in recent years. In 2025, the Mag-7 contributed 38% of net earnings growth, which is expected to decline to 35% this year. More notably, excluding Information Technology, seven sectors are each projected to contribute more to overall earnings growth than they did last year, signaling broader earnings participation from the S&P-493.

Specific examples include Energy, which is expected to exit its earnings recession and post growth for the first time in three years, led by the Oil & Gas Refining & Marketing sub-industry. Consumer Staples is another, expected to grow earnings by 7.4%, its fastest pace in five years. Consumer Discretionary, which typically posts stronger earnings growth than Staples due to Amazon's large weighting, is forecasted to grow 11.5% – roughly 400 basis points higher than Staples and, notably, marking the smallest gap between the two sectors since 2019. Industrials are set for a third straight year of earnings growth, up 15.5%, doubling last year's pace, driven by stronger capex and manufacturing tailwinds.

While rotation is evident in some sectors, two groups continue to dominate: Aerospace & Defense and Semiconductors. Aerospace & Defense is expected to grow earnings by 52.1% this year, following 62.2% last year, marking the strongest two-year combination of any industry. Semiconductors and Semiconductor Equipment rank next, with expected earnings to rise 61.1% this year, following

43.7% growth last year. Metals & Mining also join this high-growth cohort with earnings growth of 34.9% this year, following 29.5% last year as it benefits from stronger gold, copper, platinum and silver prices. Silver surged 146% in 2025 and the gold-to-silver ratio is now at a 13-year low. Turnaround stories include Automobiles, rebounding from a 23.4% decline last year to a rise of 21.8% this year, along with Independent Power and Renewable Electricity Producers, swinging from -12.0% last year to +35.2% this year.

Exhibit 2 - 2: S&P 500 Annual Earnings and Revenue Growth Rates (Each Dot Represents One Year)



We extend our earnings analysis to the Mag-7, given their concentration in the S&P 500 with a 36.0% market cap weight. The group is expected to grow earnings by 23.4%, 800 basis points higher than the overall index. When excluding Mag-7, the S&P-493 growth rate is 13.2%, the highest since 2021. Just as encouraging, S&P 493 revenue growth is projected at 5.7% this year, surpassing last year's 5.3%, 4.0% in 2024, and 1.5% in 2023, signaling a clear trend of broadening strength.

Within the Mag-7, Nvidia dominates the group and is placed in the coveted "50/50 Club". Nvidia is only one of three companies in the S&P 500 that are expected to grow both revenue and earnings by at least 50% in 2026. Nvidia will contribute 3.2 percentage points to the overall index's net earnings growth rate – more than the rest of the Mag-7 combined, which adds just 2.2 points. Put differently, when excluding Nvidia, the Mag-7's earnings growth contribution falls in half from 35% to 18%.

This concentration risk is reflected in valuations, where the Mag-7 continues to command a significant premium to the broader index. Justifiably, the group offers both higher earnings and revenue growth while generating double the margins of the index. The forward four quarter P/E for the group is 29.9x compared to 22.5x for the index. When excluding the Mag-7, the S&P-493 P/E is 20.0x. On a price to sales basis, the Mag-7 trades at 8.2x compared to 3.0x for the index, which falls to 2.1x when excluding the group.

Valuations at Tech-Bubble Highs – Déjà Vu or New Paradigm?

The S&P 500 forward P/E recently peaked at 23.2x, near an all-time high and a level not seen since the internet bubble of 2000 and fueling concerns of an 'AI bubble'. Notably, the index has hovered around this level for more than a year, which suggests that the market has been able to absorb this premium, in part due to the strong earnings outlook and optimism around Artificial Intelligence.

History shows that valuation matters most over the long-run, and today's forward P/E of 22.5x implies an increased probability of below-average returns over the next decade (Exhibit 2 - 3). As the chart illustrates, at this valuation level, subsequent 10-year annualized returns have historically ranged from -1.0 to 5.0%, well below the long-term average annualized return for U.S. stocks of 9.1% over the past 40 years. For context, since 1900, only three decades have delivered negative returns (1910s, 1930s, and 2000s), while six decades, including the current one, have posted gains exceeding 100% or more.

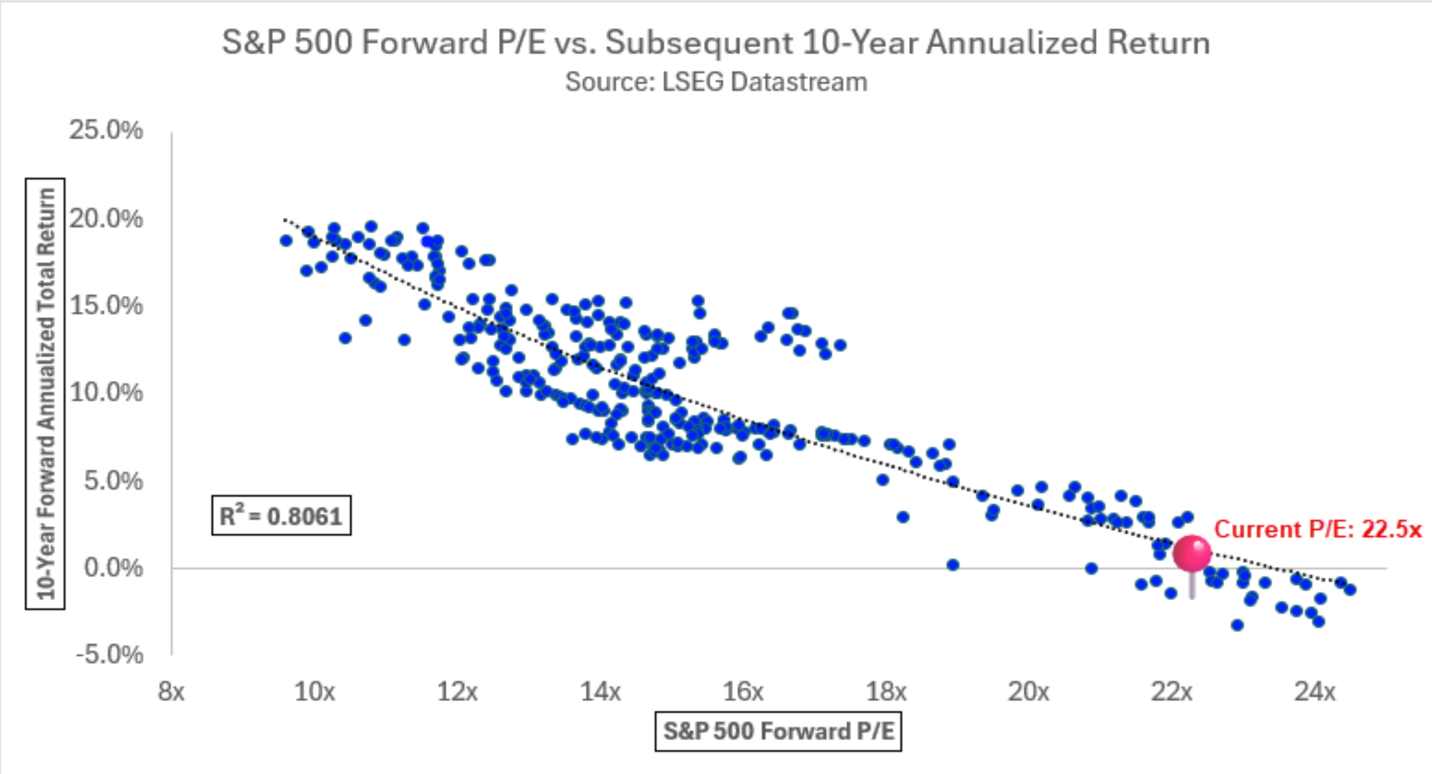
Looking back at the internet bubble of 2000 – the last comparable period to today's valuations – the S&P 500 forward P/E peaked at 24.4x in January 2000. In the years leading up to the bubble's burst in September 2000, quarterly earnings growth averaged 15.0% from 1992-2000, well above the long-term median of 9.4%. When the bubble popped, both earnings estimates and stock prices fell sharply, driving the forward P/E down from 23.0x to 15.4x peak-to-trough.

Drawing parallels to today, valuations are similarly elevated while we enter a period of above-average earnings growth – 14.6% on average from 2025 to 2027, eerily similar to the internet bubble era. Does that mean history will repeat itself?

It's hard to envision equities facing the same fate as in 2000 for several reasons. Most importantly, the rise of Artificial Intelligence promises transformative benefits for the broader economy over the coming decade, boosting efficiency and labor productivity and, in turn, supporting GDP growth. From an equity perspective, market composition today is fundamentally stronger than the speculative environment of 2000, as companies are delivering record revenue, profits, and cash flow while maintaining healthier balance sheets and lower leverage. In short, today's combination of above-average earnings growth and higher-quality fundamentals makes it reasonable for valuations to remain elevated, despite near-term concerns about an 'AI bubble'.

At the sector level, Energy, Materials, Health Care, and Financials all trade at a discount to the index. Energy is the only sector trading at a discount both to the overall index and to its own 10-year average – roughly 32% on each measure.

Exhibit 2 - 3: Forward P/E vs. Subsequent 10-Year Annualized Return



Hyperscaler Spending Surge – AI Ambitions vs. Financial Discipline?

While valuations will likely dictate long-term returns, what matters most for 2026 is investor patience on hyperscalers' 'AI return on investment' and its impact on profitability.

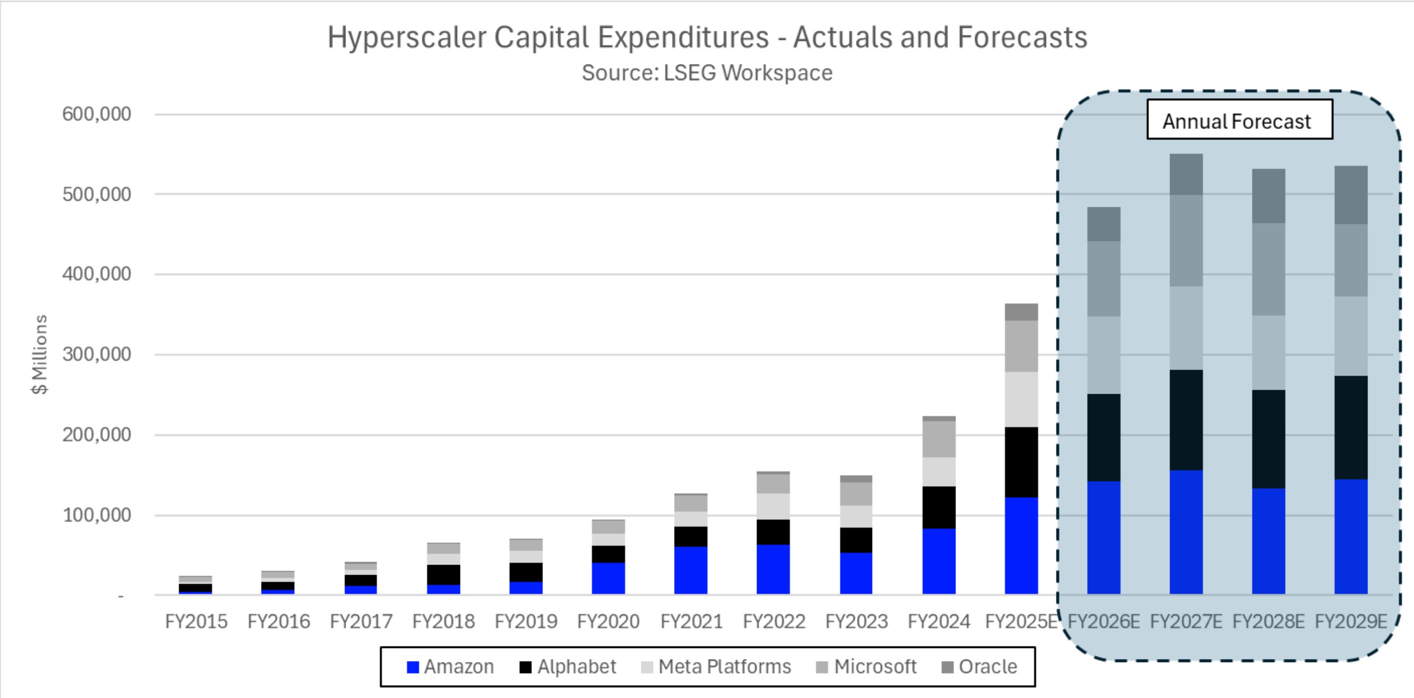
Amazon, Alphabet, Meta Platforms, Microsoft, and Oracle have made it clear on recent earnings calls that winning the race in AI is a strategic priority and they will continue investing heavily in AI infrastructure, including data centers, servers, GPUs, and networking and fiber equipment. Consensus estimates point to a record $484.5 billion in capex for this group in 2026, representing 34.6% of total S&P 500 spend. This translates into a year-over-year growth rate of 33.1%, compared to just 1.2% for the rest of the index.

This year's expenditure will also double what we saw just two years ago in 2024 (Exhibit 2 - 4), which highlights the velocity in spend being carried out by the group, led by Amazon ($141.6b), followed by Alphabet ($109.9b), Meta Platforms ($96.4b), Microsoft ($93.7b), and Oracle ($42.9b). Moreover, the StarMine SmartEstimate, which places greater weight on the most timely and accurate analysts, suggests capex could climb even higher to $518.2 billion this year, as Oracle and Meta Platforms are expected to materially outspend current consensus estimates.

The group is expected to surpass $500 billion in annual expenditure through 2029, reinforcing a structural shift that businesses once considered asset-light are becoming more capital-intensive. This transition could compress margins and profitability, erode free cash flow, and increase leverage.

To illustrate this shift, U.S. technology sector capex has grown at a compound annual growth rate (CAGR) of 24.9%, the fastest of any sector over the past five years and roughly double the overall index CAGR of 12.8% and the Energy sector's 11.1%. In terms of 'capex intensity', measured as capex relative to sales, technology now ranks second at 14.0% and surpasses Energy, a traditionally capital-intensive sector, for the first time in 2022.

Exhibit 2 - 4: Capital Expenditures for Major Hyperscalers

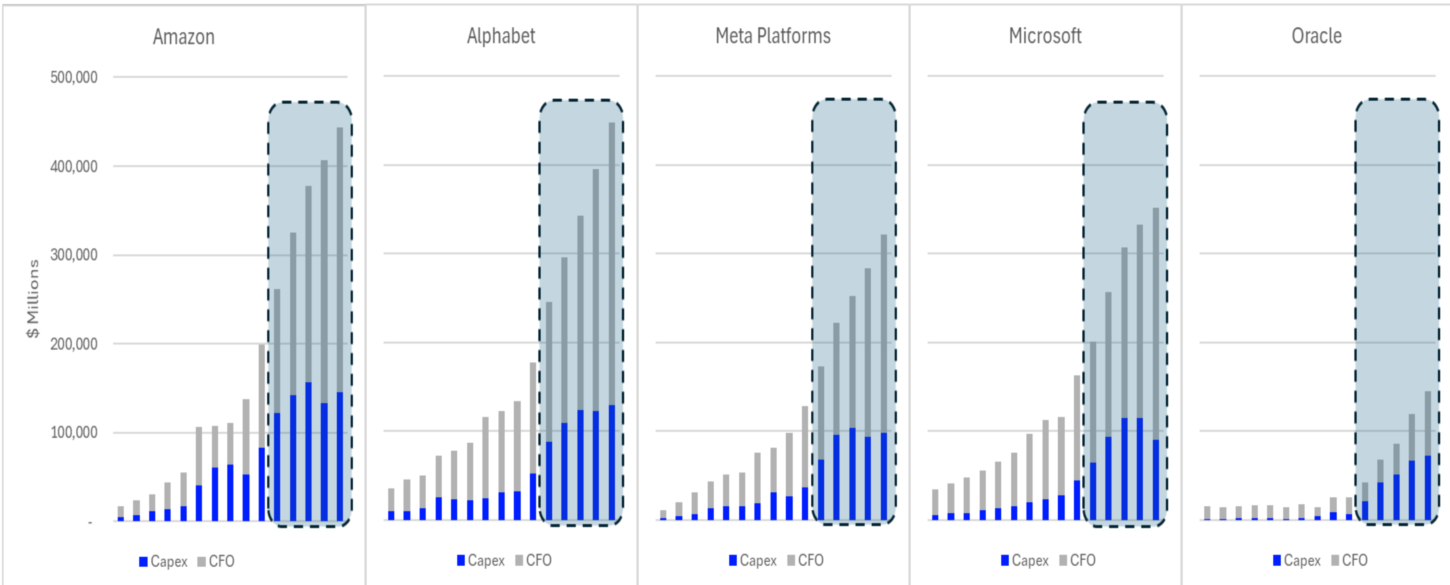


Looking at the capex impact on free cash flow, four of the five hyperscalers (excluding Amazon) are expected to see year-over-year capex growth outpace operating cash flow. As a result, Oracle and Meta Platforms are projected to see the largest year-over-year declines in free cash flow over the next twelve months, down 70.8% and 61.1%, respectively.

While capex is expected to pressure free cash flow, we also examine capex spending relative to cash flow from operations to gauge a company's ability to self-fund investments without compromising liquidity or increasing leverage. All five hyperscalers are expected to allocate a substantial share of operating cash flow toward capex, highlighting the scale of investment required to support AI and cloud infrastructure.

Building on that analysis, the key takeaway is that all major hyperscalers – excluding Oracle – are expected to fully fund capex from internally generated operating cash flow, which will provide some relief to investors that companies can manage near-term spend (Exhibit 2 - 5). Microsoft and Alphabet have the greatest buffer over the next twelve months, with the lowest capex-to-CFO ratio at 58.5% and 63.2%, respectively. In stark contrast, Oracle has a staggering ratio of 184.9%, by far the largest of the group, alongside a capex-to-revenue ratio of 72.1%, again the highest by a wide margin.

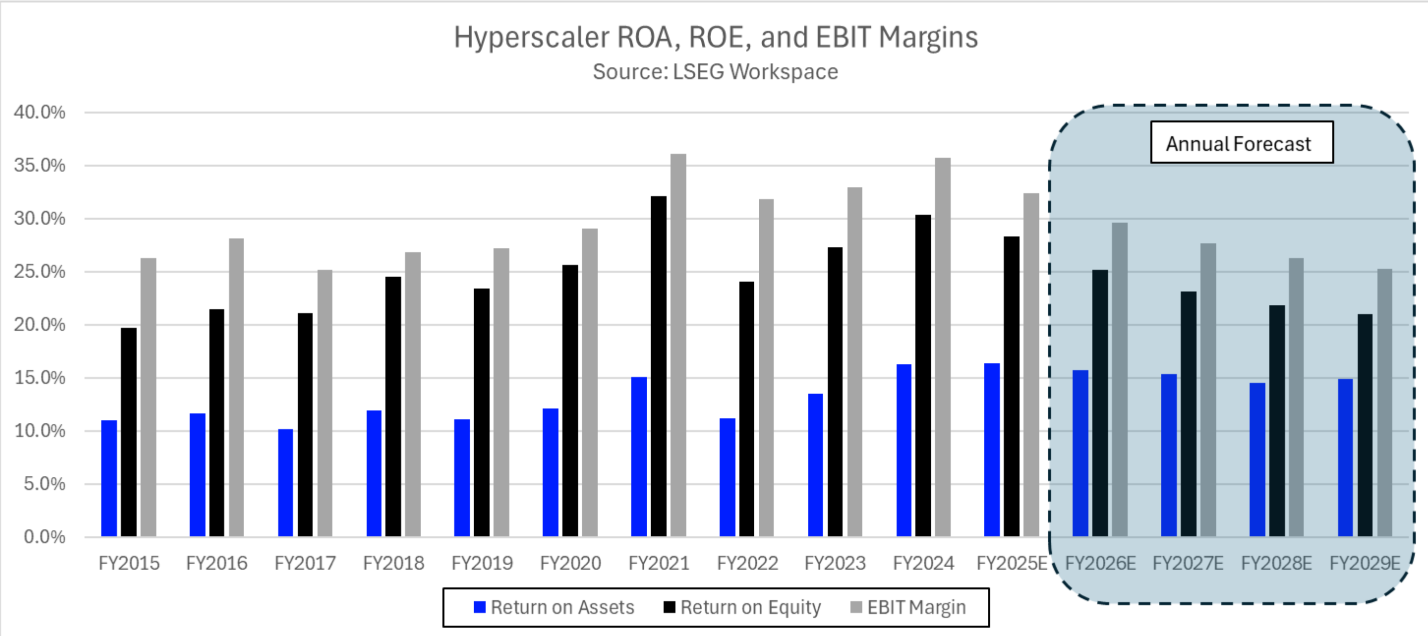
Exhibit 2 - 5: Hyperscalers Capex vs. CFO from 2015-2029 (Note: Shaded Bars are Annual Forecasts)



While most hyperscalers can fund capex from internal cash flow, it comes at a cost of lower returns and margin pressure. As a group, EBIT margins improved steadily from 2017 to 2021, rising from 25.2% to 36.1%. Since the launch of ChatGPT in 2022, margins fell to 31.8% and are expected to decline further to 29.6% in the year ahead, continuing down to 25.2% by 2029 (Exhibit 2 - 6).

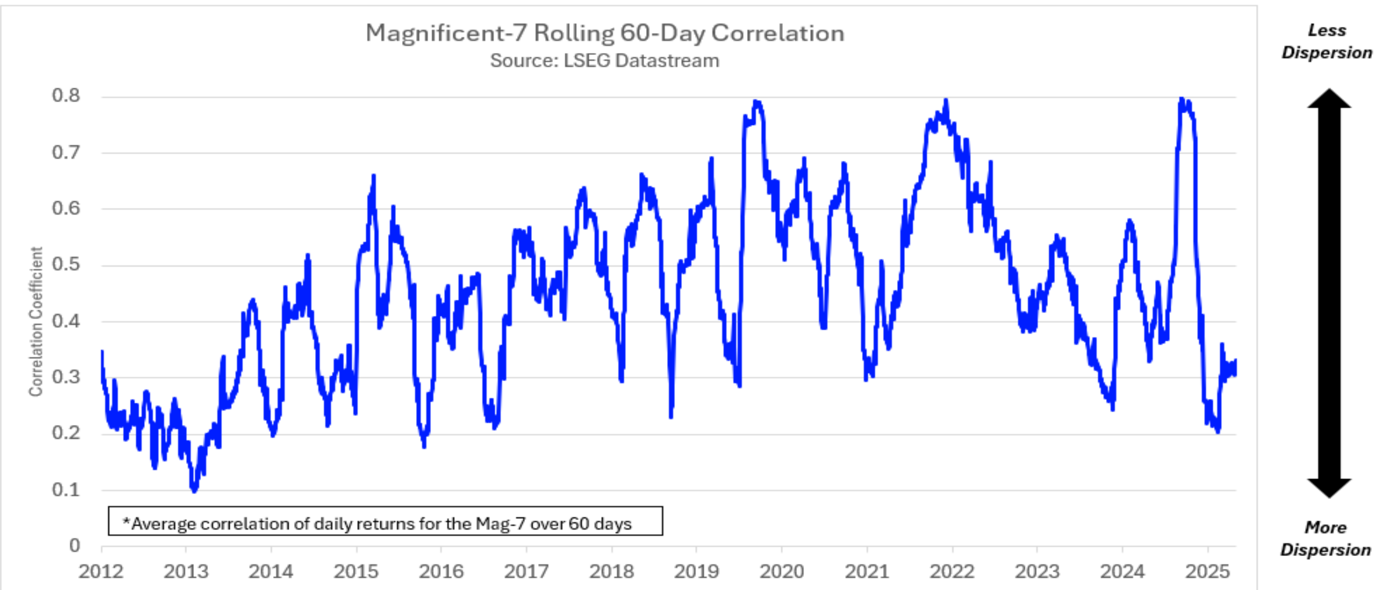
Beyond margins, the impact of higher capex will show up in profitability ratios such as Return on Assets (ROA) and Return on Equity (ROE), as net profits are pressured by rising depreciation and amortization expenses (or interest costs if debt-financed). Aggregate ROA likely peaked last year at 16.4% and is expected to slip to 15.7% this year, with further marginal declines ahead. ROE is projected to decline more sharply, falling from 30.4% in 2024 to 21.0% by 2029.

Exhibit 2 - 6: ROA, ROE, and EBIT Margins for Hyperscalers



Bringing this back to investor sentiment and the 'AI ROI' debate, the second half of 2025 saw a sharp rise in return dispersion among hyperscalers and the broader Mag-7. Exhibit 2 - 7 highlights the pairwise correlation of stock price returns among the Mag-7, which fell from a peak of 0.8 in May to 0.3 by year-end.

Exhibit 2 - 7: Correlation of Magnificent-7 Stocks



Small Caps – Earnings Momentum Meets Valuation Opportunity

The sharp drop in correlation suggests the market is no longer treating hyperscalers as a single AI trade but is differentiating based on execution. This marks a shift from the 'AI hype' phase to the 'AI builder' phase, where capital allocation discipline and cash flow durability will drive relative performance in the year ahead.

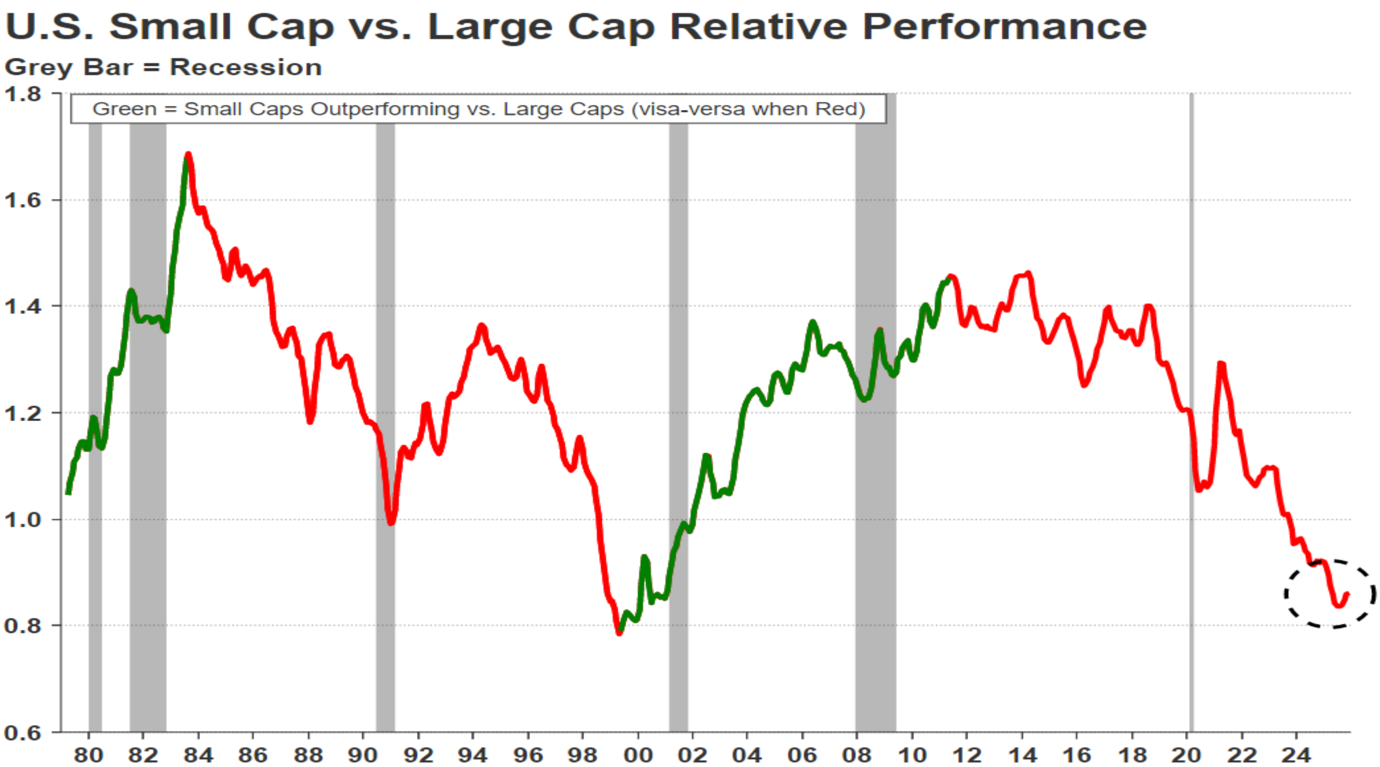
We pivot from U.S. large caps to small caps, where relative performance has historically followed long, cyclical patterns. Over the past 45 years, there have been three major cycles, each lasting more than a decade. From 1983 to 1999, Russell 2000 lagged Russell 1000, following a reversal between 1999 and 2011 when small caps outperformed. Since 2011, however, small caps have underperformed again.

These cycles can be partially explained by structural differences between the two groups, as small caps have lower operational flexibility, lack of scale, weaker pricing power, and higher sensitivity to interest rates and macroeconomic conditions, both of which have become more challenging since the pandemic.

Encouragingly, we see early signs of a reversal beginning in the second half of 2025 where Russell 2000 has outperformed (

Exhibit 2 - 8), supported by a strong earnings outlook and improving analyst sentiment.

Exhibit 2 - 8: Relative Performance of Small-Caps vs. Large-Caps



Source: LSEG Datastream

U.S. small caps, as defined by the Russell 2000, now account for only 4.4% of the Russell 3000's total market capitalization, down from roughly 8.2% two decades ago. Yet the group has delivered three consecutive years of double-digit price returns and stands to benefit from an accommodative interest rate environment.

Earnings growth for small caps is expected to significantly outpace large caps this year, while valuations remain meaningfully lower. Additional tailwinds include AI-driven productivity which would boost operating leverage and profit margins, in addition to improved access to cheaper capital if interest rates fall. Furthermore, Russell 2000's index composition has a larger tilt towards Financials, Health Care, and Industrials compared to Russell 1000, all which are expected to benefit from a rotation outside of large-cap tech.

The case for small caps strengthens when looking at the earnings outlook for the Russell 2000, which is forecasted to outpace large caps by a wide margin this year. Russell 2000 earnings are expected to grow 45.5% this year, following an impressive 41.3% increase last year, while revenues are expected to rise 6.1% in 2026. Both earnings and revenue growth represent the strongest annual gains since the pandemic (Exhibit 2 - 9).

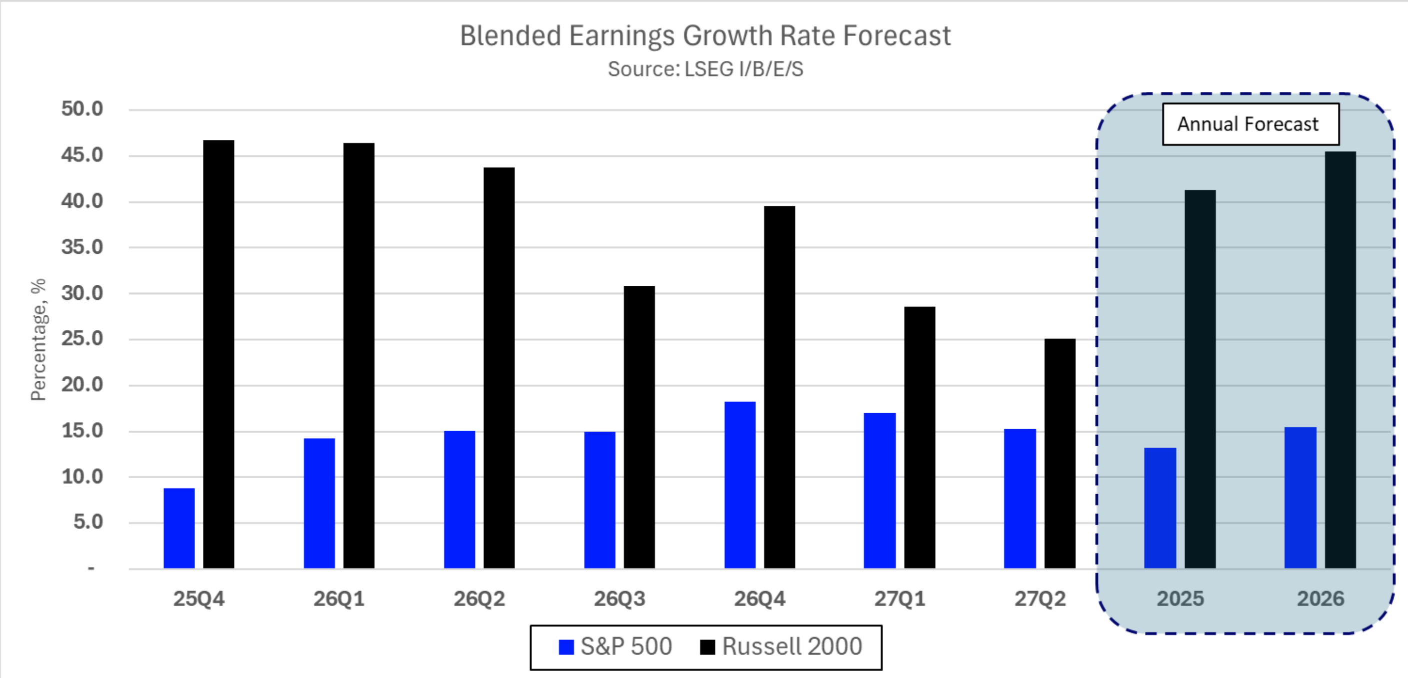
Drilling deeper into the Russell 2000 earnings outlook, Financials, Industrials, and Consumer Discretionary are expected to lead the pack, contributing 50.6% of the net earnings growth this year.

Banks are expected to benefit from a steeper yield curve if rate cuts materialize, boosting both net interest margin and net interest income. The Senior Loan Officer Opinion Survey (SLOOS) shows credit conditions have eased since Q3 2023, with medium and small banks more willing to lend, while demand for commercial and industrial loans have recovered from the trough in Q2 2023 – both pointing to a strong operating environment for smaller banks.

Lower interest rates would also benefit small businesses. The interest rate on short-term loans, at 7.9%, is nearly at a two-decade high according to the National Federation of Independent Business survey. Rates on small business loans exceed the federal funds rate as lenders price in additional risk premiums including credit, collateral and liquidity conditions. A more accommodative Federal Reserve would ease borrowing costs for smaller businesses, who often hold variable debt financing.

Uncertainty is near a record high according to the NFIB survey, which began in 1986. In the near-term, if small businesses can reduce the cost of capital while realizing efficiencies through AI as a starting point, this could boost operating leverage and profit margins, which are forecasted at 4.6% this year (5.8% when excluding Health Care), up from 3.6% in 2025.

Exhibit 2 - 9: Earnings Growth Rates, S&P 500 vs. Russell 2000

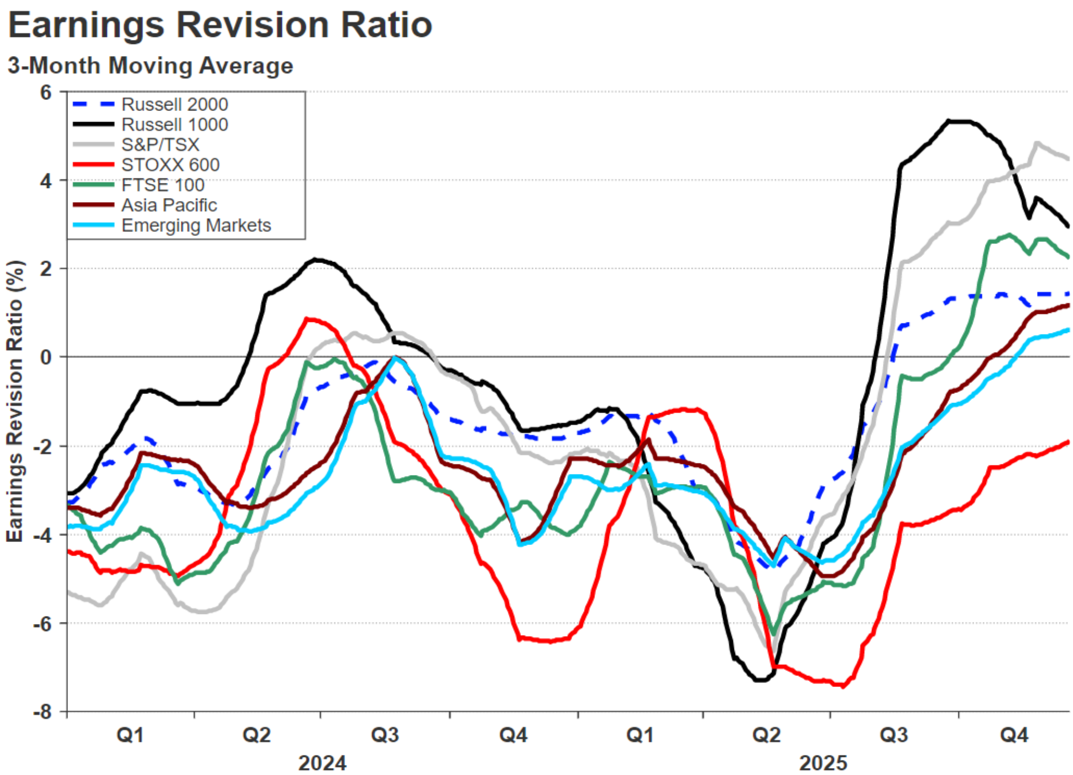


Supporting the earnings outlook is a clear rebound in analyst sentiment. The Earnings Revision Ratio tracks the balance of upward versus downward estimate changes and has moved into positive territory for the first time since 2022 (Exhibit 2 - 10). Materials, Consumer Discretionary, and Industrials, have seen the largest improvement in year-over-year earnings growth forecasts over the past year.

Valuations remain compelling for small caps, as the adjusted four-quarter P/E ratio for the Russell 2000 (excluding Health Care) is 17.7x – a 21% discount to the S&P 500. This gap partly reflects structural differences, as small caps typically operate with lower margins.

While Health Care does include many early-stage, unprofitable companies, this often leads to a conflated narrative that the entire index lacks profitability. In reality, only 26.0% of Russell 2000 companies were unprofitable in 2025, and this drops to 16.3% when excluding Health Care. The trend improves further in 2026, with the overall share falling to 22.3% and just 12.2% excluding Health Care – highlighting broadening earnings growth across the index.

Exhibit 2 - 10: Earnings Revision Rato, Selected Indices and Markets

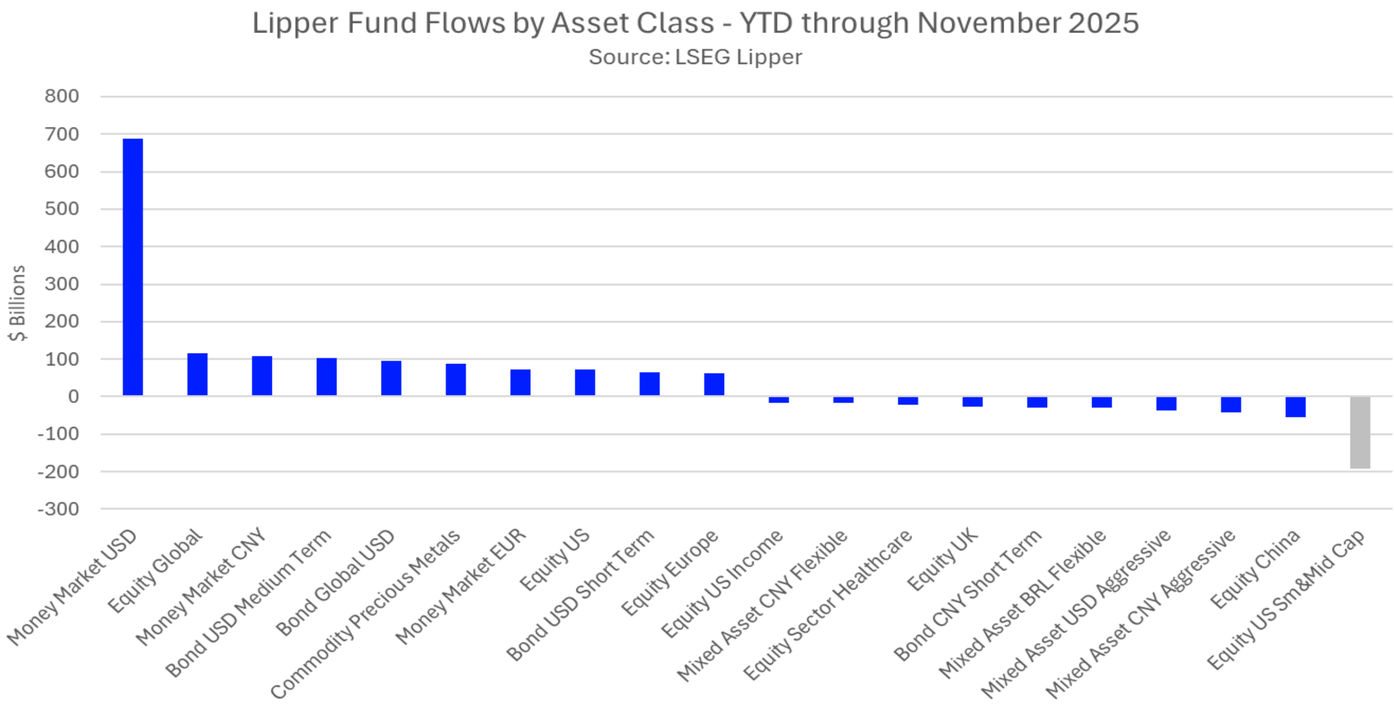


Source: LSEG Datastream

The improving outlook for small caps could prompt active managers to revisit a segment that has seen a secular decline in participation over the last decade. Lipper data shows that active participation – measured as the share of active small-cap AUM relative to total small-cap AUM (active + passive) for U.S. domiciled mutual funds has declined every year since 2016 by roughly two percentage points annually. Today, active AUM represents 44.1% of total small-cap assets, down from 61.1% a decade ago.

Near-term sentiment reflects a similar trend, as U.S. Small & Mid-Caps saw the largest redemption in 2025, with outflows of nearly $200 billion (Exhibit 2 - 11).

Exhibit 2 - 11: Lipper Fund Flows by Asset Class



Section 3 – Retail Consumer Outlook

From Promotions to Experiences: Key Drivers of 2026 Consumer Behavior

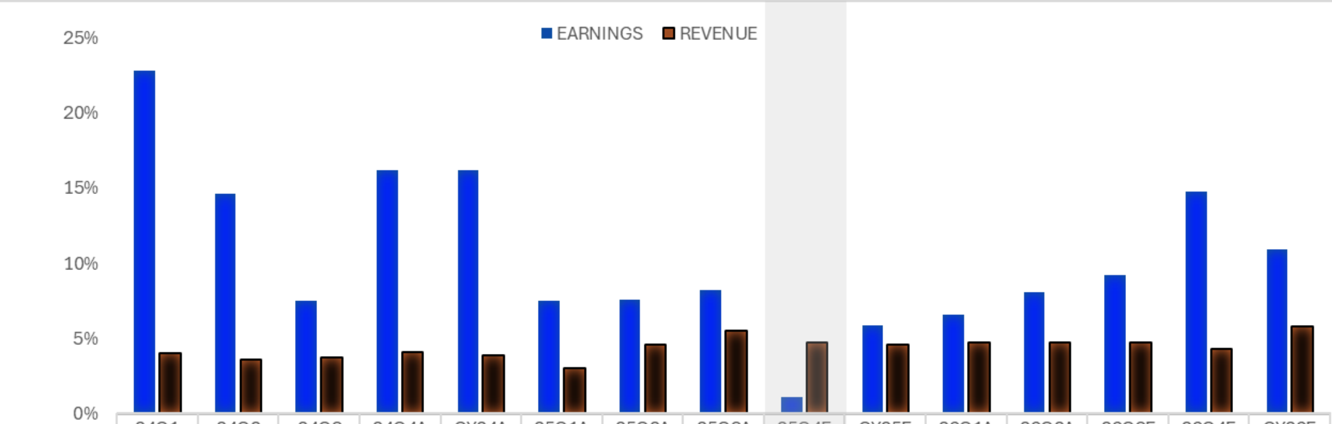
Section Summary

- Retail and restaurant earnings growth is moderating to 5.9% in 2025 after two years of double-digit gains, but momentum is expected to accelerate in 2026 with a projected 10.9% earnings increase. Despite inflationary pressures and shifting consumer behavior, strong performance is anticipated in experiential sectors, while select retailers show potential for earnings surprises.
- Retail and restaurant sectors remain resilient: After moderating to 5.9% earnings growth in 2025, the industry is poised for a strong rebound with 10.9% growth projected for 2026. Experiential categories lead the way as consumer demand evolves
- Retail Growth Slows in 2025, Surges Ahead in 2026: Earnings projected to jump from 5.9% to 10.9%, signaling strong momentum for experience-driven sectors.
- LSEG Retail/Restaurant Index forecasts 2025 earnings growth of 5.9% and revenue up 4.6%, with acceleration to 10.9% earnings growth in 2026. Hotels, restaurants, and leisure sectors are expected to outperform as consumers prioritize experiences.

After two years of double-digit growth, the LSEG Retail/Restaurant Index is on track to report a 5.9% earnings growth rate for calendar year 2025. Retailers just posted an 8.2% earnings growth rate for Q3 2025 and are on track to report a 1.1% gain for Q4 2025 (Exhibit 3 - 1).

The LSEG Retail/Restaurant Index anticipates steady growth in the sector, projecting earnings to increase by 5.9% and revenue by 4.6% for the calendar year 2025. This outlook reflects continued consumer demand resilience. Looking ahead to 2026, growth momentum is expected to accelerate, with earnings forecasted to rise by 10.9% and revenue by 5.8%. These projections underscore a positive trajectory for the sector as it adapts to evolving consumer behaviors and macroeconomic conditions.

Exhibit 3 - 1: The LSEG Retail/Restaurant Earnings Index: Q1 2024 Act – Q4 2026 Est.



	24Q1	24Q2	24Q3	24Q4A	CY24A	25Q1A	25Q2A	25Q3A	25Q4E	CY25E	26Q1A	26Q2A	26Q3E	26Q4E	CY26E
EARNINGS	22.8%	14.6%	7.5%	16.2%	16.2%	7.5%	7.6%	8.2%	1.1%	5.9%	6.6%	8.1%	9.2%	14.8%	10.9%
REVENUE	4.0%	3.6%	3.7%	4.1%	3.9%	3.0%	4.6%	5.5%	4.7%	4.6%	4.7%	4.7%	4.7%	4.3%	5.8%

Source: LSEG I/B/E/S

A closer look at the data reveals that the slowdown is concentrated around two main consumer sectors. The Household Durables sector is expected to post the weakest Q4 2025 performance, with profits projected to decline by 27.4% (Exhibit 3 - 2). The Textiles, Apparel & Luxury Goods sector follows, with a -16.4% Q4 2025 growth estimate that reflects underlying softness in earnings momentum. Additionally, the Household Durables sector is forecast to deliver the weakest earnings growth in the first half of 2026, further highlighting the pressure facing consumer discretionary categories. Conversely, the Hotels, Restaurants & Leisure sector is poised to lead growth in 2026, driven by consumers' continued preference for experiences over goods.

Exhibit 3 - 2: The LSEG Retail Index Sectors: Q3 2025 Act – Q4 2026 Est.

GICS Industry	Q3 2025	Q4 2025	Q1 2026	Q2 2026	Q3 2026	Q4 2026
Distributors	1.3%	-2.1%	6.7%	6.3%	4.5%	9.8%
Hotels, Restaurants & Leisure	3.7%	15.4%	11.2%	17.1%	22.1%	17.5%
Household Durables	-20.1%	-27.4%	-15.6%	-3.2%	4.9%	12.7%
Household Products	0.3%	1.0%	3.9%	2.2%	4.4%	5.6%
Consumer Staples Distribution & Retail	8.2%	8.7%	11.4%	11.8%	10.0%	10.4%
Leisure Products	-17.2%	25.6%	2.6%	5.8%	21.0%	32.9%
Broadline Retail	35.5%	4.4%	8.8%	9.0%	0.8%	19.4%
Personal Care Products	3.5%	-4.3%	5.3%	17.3%	11.5%	16.6%
Specialty Retail	5.9%	-2.1%	4.2%	3.8%	8.6%	11.8%
Textiles, Apparel & Luxury Goods	-17.2%	-16.4%	19.8%	3.1%	15.7%	20.0%
TOTAL	**8.2%**	**1.1%**	**6.6%**	**8.2%**	**9.1%**	**14.8%**

Source: LSEG I/B/E/S

This is in line with the LSEG/Ipsos Primary Consumer Sentiment Index, which finds that overall American consumer sentiment remains lower than last year. The softness is driven by a sharp decline in purchasing comfort and a continued deterioration in perceptions of the current job market. Previously, much of the unease shown by consumers was rooted in fears about the future of the economy. However, consumers are now more pessimistic about their current situation. American consumer confidence continues to demonstrate the broader economic uncertainty the public feels today.

StarMine Predicted Surprise

Despite broader sector challenges, there are pockets of optimism. Looking ahead to Q4 2025 earnings, analysts surveyed by LSEG are already bullish on Dillard's. The consensus estimate for Dillard's Q4 2025 EPS stands at $10.61. Notably, a highly rated five-star analyst with a very accurate rating has issued an estimate of $11.03, above the consensus. This divergence suggests a potential earnings beat and the possibility of a positive surprise when Dillard's reports.

The StarMine SmartEstimate is a weighted average of analyst estimates, with more weight given to more recent estimates and more accurate analysts. Our studies have shown that when the SmartEstimate differs from the consensus (I/B/E/S mean) by more than 2%, the company is likely to post subsequent earnings surprises directionally correct 70% of the time.

Exhibit 3 - 3: Dillard's StarMine Predicted Surprise %: Q4 2025 Est.

▼ EARNINGS PER SHARE - Consolidated USD Per Share	
Custom Calculated Mean	$ 10.61
SmartEstimate®	$ 11.20
Mean	$ 10.61
Predicted Surprise %	5.60%
Median	$ 11.03
Low: $ 9.14	High: $ 11.66

Source: LSEG Workspace

Similarly, the companies listed below have a Predicted Surprise exceeding 2.0% for Q4 2025, and Q1 2026 (Exhibit 3 - 4). This indicates a strong likelihood of outperforming earnings expectations and delivering positive surprises.

Exhibit 3 - 4: Strongest StarMine Predicted Surprise %: Q4 2025 and Q1 2026 Est.

		Earnings Per Share - Predicted Surprise PCT	
Identifier	**Company Name**	**Current Qtr (FQ1)**	**Next Qtr - (FQ2)**
DDS.N	Dillard's Inc	5.6%	1.2%
CHDN.OQ	Churchill Downs Inc	5.5%	10.5%
EXPE.OQ	Expedia Group Inc	3.7%	10.6%
AMZN.OQ	Amazon.com Inc	2.4%	2.4%

Source: LSEG Workspace

Conversely, the companies listed below have a negative Predicted Surprise of less than -2.0% for Q4 2025, and Q1 2026; indicating they are likely to miss earnings expectations and deliver negative surprises.

Exhibit 3 - 5: Weakest StarMine Predicted Surprise %: Q4 2025 and Q1 2026 Est.

		Earnings Per Share - Predicted Surprise PCT	
Identifier	**Company Name**	**Current Qtr (FQ1)**	**Next Qtr - (FQ2)**
JILL.N	JJill Inc	-78.6%	0.8%
HZO.N	MarineMax Inc	-26.6%	-37.6%
SNBR.OQ	Sleep Number Corp	-23.7%	-71.5%
CRMT.OQ	America's CAR-MART Inc	-12.8%	1.0%
PII.N	Polaris Inc	-11.0%	-10.3%

Source: LSEG Workspace

Pricing Pressures

According to the U.S. Bureau of Labor Statistics, the Consumer Price Index (CPI) increased 0.2% from September to November 2025 and rose at an annual rate of 2.7% as of November 2025. Retailers continue to face headwinds from subdued consumer sentiment and heightened price sensitivity as shoppers manage elevated living costs. CPI data underscores that consumers are paying more for essentials such as food, electricity, medical care, and transportation compared to a year ago.

In contrast, apparel prices have diverged from the broader inflation trend, reflecting widespread markdowns. This pattern aligns with LSEG data showing significant price reductions across apparel categories. In partnership with Centric Market Intelligence, we have tracked weekly average original prices in U.S. mall stores since December 2024 through January 2026. Among the monitored categories, Women's Apparel posted the steepest decline, while Men's Apparel recorded a modest 1.0% increase (Exhibit 3 - 6).

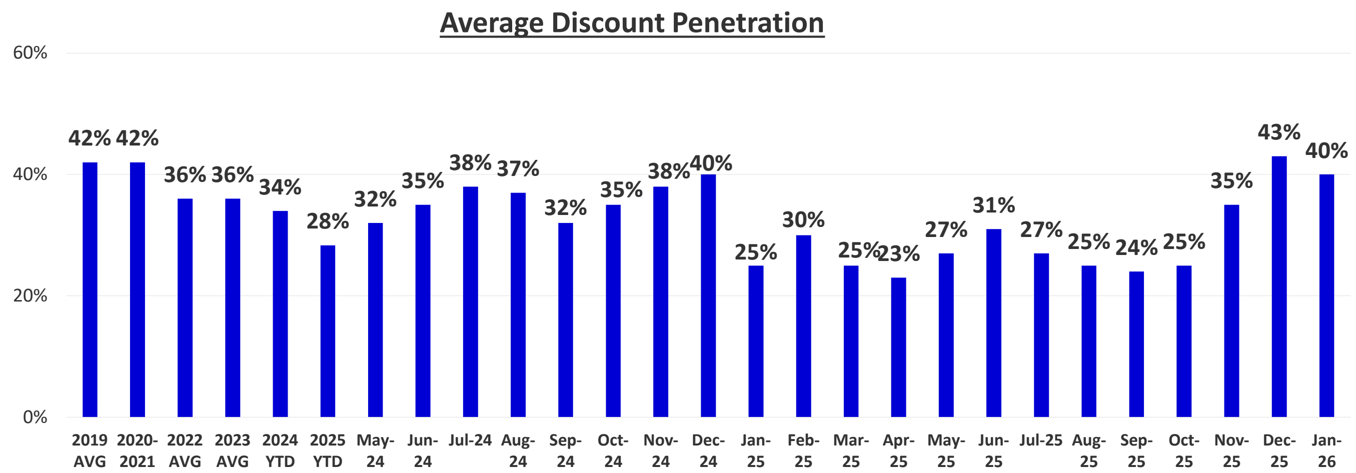
Exhibit 3 - 6: Average Price Changes: December 2024 – January 2026 Est.

	Women's Apparel	**Men's Apparel**	**Footwear**	**Accessories**	**Backpacks**
% Price Changes	-0.2%	1.0%	1.8%	4.0%	3.1%

*Accessories includes scarves, hats, gloves, keychains/bag charms, glasses, ties, wallets, belts
Source: Centric Market Intelligence.

Retailers entered the holiday season with an elevated level of promotional activity. The discount penetration, defined as the percentage of merchandise on sale, rose to 43% in December, slightly above the historical range of 34% to 42% observed over the past decade (Exhibit 3 - 7). For the full year 2025, average discount penetration settled at 28%, down from 34% in the prior year and below pre-pandemic norms. This decline reflects a strategic recalibration as retailers respond to increasingly value-conscious consumers and shifting demand dynamics. Notably, elevated discounting persisted into January 2026, with penetration at 40%, as retailers work to clear winter inventory ahead of introducing full-priced spring assortments.

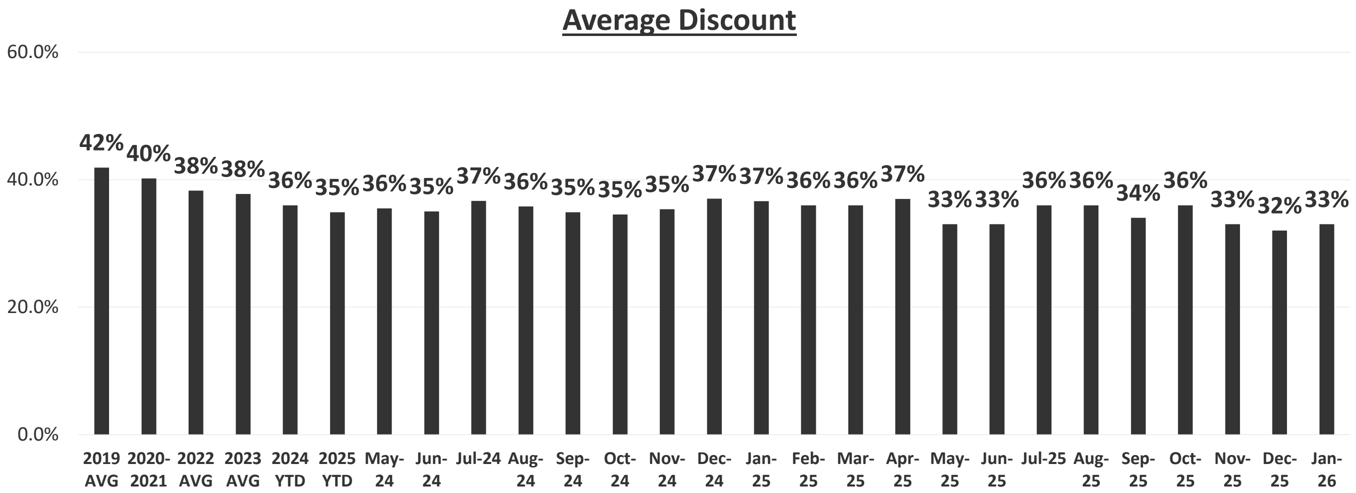
Exhibit 3 - 7: Average Discount Penetration: U.S. Online Retailers



Source: Centric Market Intelligence

The average discount rate moderated to 33%, below both the 2025 average of 35% and the prior year's 36%.

Exhibit 3 - 8: Average Discount: U.S. Online Retailers



Source: Centric Market Intelligence.

Retail Same Store Sales

In the retail sector, approximately 74% of the companies in our SSS index are on track to deliver positive same-store sales (SSS) results for 2026. Aritzia is leading the pack with the strongest SSS performance in Q4 2025 and is expected to maintain robust comps throughout this year. Similarly, Tapestry and Costco are also projected to post consistently healthy same-store sales in 2026.

Exhibit 3 - 9: Retail Strongest SSS estimates: Q4 2025 – Q4 2026

		Same Store Sales Estimates				
Retailer	**Ticker**	**Q4 2025**	**Q1 2026**	**Q2 2026**	**Q3 2026**	**Q4 2026**
Aritzia Inc	ATZ	15.0%	4.8%	6.3%	6.0%	8.0%
CVS Corp	CVS	12.1%	8.5%	8.5%	8.7%	8.6%
Tapestry Inc.	TPR	11.8%	8.0%	7.3%	12.0%	6.5%
American Eagle Outfitters	AEO	8.4%	4.2%	3.4%	2.4%	2.0%
Citi Trends Inc.	CTRN	7.9%	3.3%	3.4%	3.2%	3.8%
Costco Wholesale Corp	COST	6.2%	6.3%	6.0%	5.4%	5.0%

Source: LSEG I/B/E/S

Meanwhile, mall-based stores including J.Jill and Kirkland are on track to report the weakest comps in 2026. In fact, about 26% of the retailers in our SSS Index are on track to report consistently weak comps this year. Target is on track to report a -2.3% comp in Q4 2025. While the following quarters' estimates remain weak, the results reflect a sequential improvement in performance (Exhibit 3 - 10).

Exhibit 3 - 10: Retail Weakest SSS estimates: Q4 2025 – Q4 2026

		Same Store Sales Estimates				
Retailer	**Ticker**	**Q4 2025**	**Q1 2026**	**Q2 2026**	**Q3 2026**	**Q4 2026**
J.Jill Inc	JILL	-7.1%	0.4%	1.0%	1.3%	2.0%
Destination XL Group Inc.	DXLG	-5.1%	2.2%	3.0%	3.0%	3.1%
Michael Kors Holdings Ltd	CPRI	-2.8%	-2.6%	2.5%	3.3%	4.4%
Shoe Carnival Inc.	SCVL	-2.5%	-3.0%	-1.0%	1.0%	3.0%
Kirkland's Inc.	TBHC	-2.4%	-1.0%	-0.9%	-1.1%	-1.1%
Target Corporation (Consolidated)	TGT	-2.3%	0.9%	0.4%	1.1%	1.2%

Source: LSEG I/B/E/S

Restaurant Same Store Sales

In the restaurant sector, approximately 61% of the companies in our SSS index are on track to deliver positive same-store sales (SSS) results for 2026. The Quick Service sector is on track to outperform Casual Dining, with Papa John's and Domino's Pizza leading the pack with the strongest SSS performance in Q4, and is expected to maintain robust comps in 2026. The other restaurants will experience low single-digit positive comps.

Exhibit 3 - 11: Restaurant Strongest SSS estimates: Q1 2025 – Q4 2025

		Same Store Sales Estimates				
Restaurant	**Ticker**	**Q4 2025**	**Q1 2026**	**Q2 2026**	**Q3 2026**	**Q4 2026**
Papa Johns International Inc	PZZA	6.3%	4.5%	2.5%	2.0%	2.0%
Texas Roadhouse Inc (Company)	TXRH	5.6%	5.9%	5.1%	5.0%	5.0%
Brinker International (Consolidated)	EAT	4.1%	2.9%	3.2%	3.8%	4.6%
Dominos Pizza Inc (Total Domestic)	DPZ	3.8%	3.6%	3.0%	2.5%	2.7%
McDonald's Corp (Global)	MCD	3.4%	3.5%	2.7%	2.6%	2.7%

Source: LSEG I/B/E/S

Meanwhile, CBR Group is on track to report consistently negative comps into the first half of 2026. In fact, about 39% of the restaurants in our SSS Index are on track to report weak comps this year.

Exhibit 3 - 12: Restaurant Weakest SSS estimates: Q1 2025 – Q4 2025

		Same Store Sales Estimates				
Restaurant	**Ticker**	**Q4 2025**	**Q1 2026**	**Q2 2026**	**Q3 2026**	**Q4 2026**
CBRL Group Inc.	CBRL	-8.4%	-5.1%	-4.0%	5.0%	6.0%
Wendys International (Systemwide)	WEN	-5.7%	-0.5%	0.6%	1.7%	2.4%
Wingstop Inc	WING	-5.3%	-0.3%	1.9%	3.9%	4.5%
Jack In The Box (Company)	JACK	-4.2%	-0.5%	1.6%	2.0%	3.0%
Red Robin Gourmet Burgers	RRGB	-3.2%	-2.9%	2.5%	1.9%	2.9%

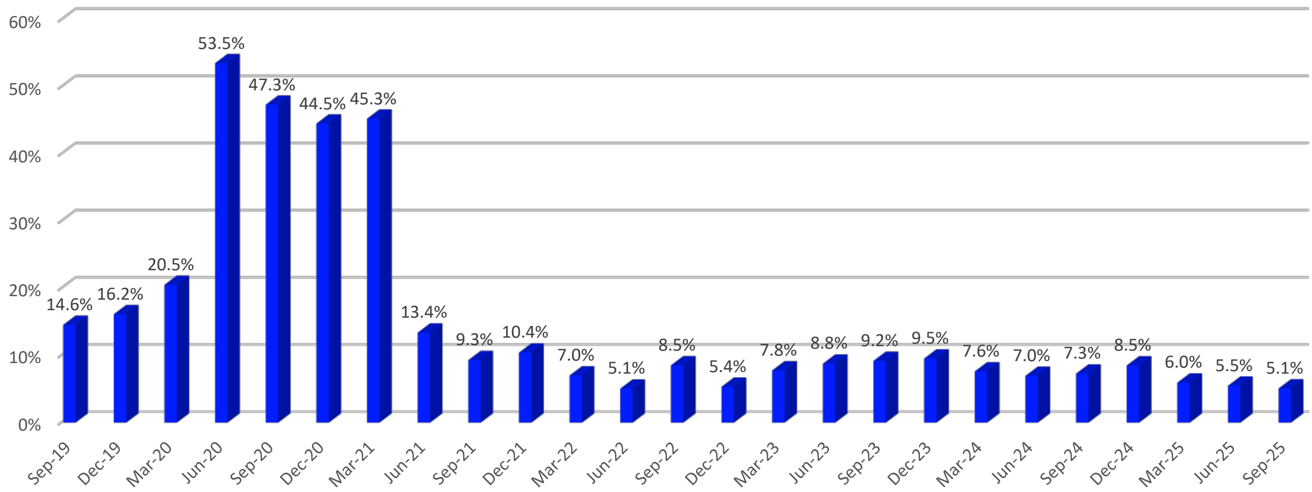
Source: LSEG I/B/E/S

E-COMMERCE SALES

According to the latest e-commerce report from the U.S. Census Bureau, online sales reached $310 billion in Q3 2025, representing a 5.1% year-over-year increase. However, this marks a slowdown from the 7.6% growth observed over the previous year (Exhibit 13). LSEG data suggests that total consumer spending online in 2026 is likely to remain below 2025 levels.

E-commerce currently accounts for just 16.4% of total U.S. retail sales, indicating that the majority of consumers still prefer shopping in brick-and-mortar stores. A significant portion of the retail market remains underpenetrated by major online players like Amazon.

Exhibit 3 - 13: E-commerce growth data



Source: LSEG Workspace

Shifting Consumer Behavior

With rising product and living costs, consumers have become increasingly discerning, delaying big-ticket purchases and capitalizing on promotions and discounts before opening their wallets. This behavior has driven a spike in discounting as retailers strategically lean on markdowns to attract traffic. The approach proved effective during the holiday season, with specialty retailers, the most promotional sector, also recording the highest sell-through rates.

At the same time, consumers continue to trade down to discounters and off-price retailers, while discretionary splurges are shifting toward travel and experiences rather than goods. Despite these trends, shoppers remain engaged largely because of stable employment, though job security remains the biggest risk to future spending.

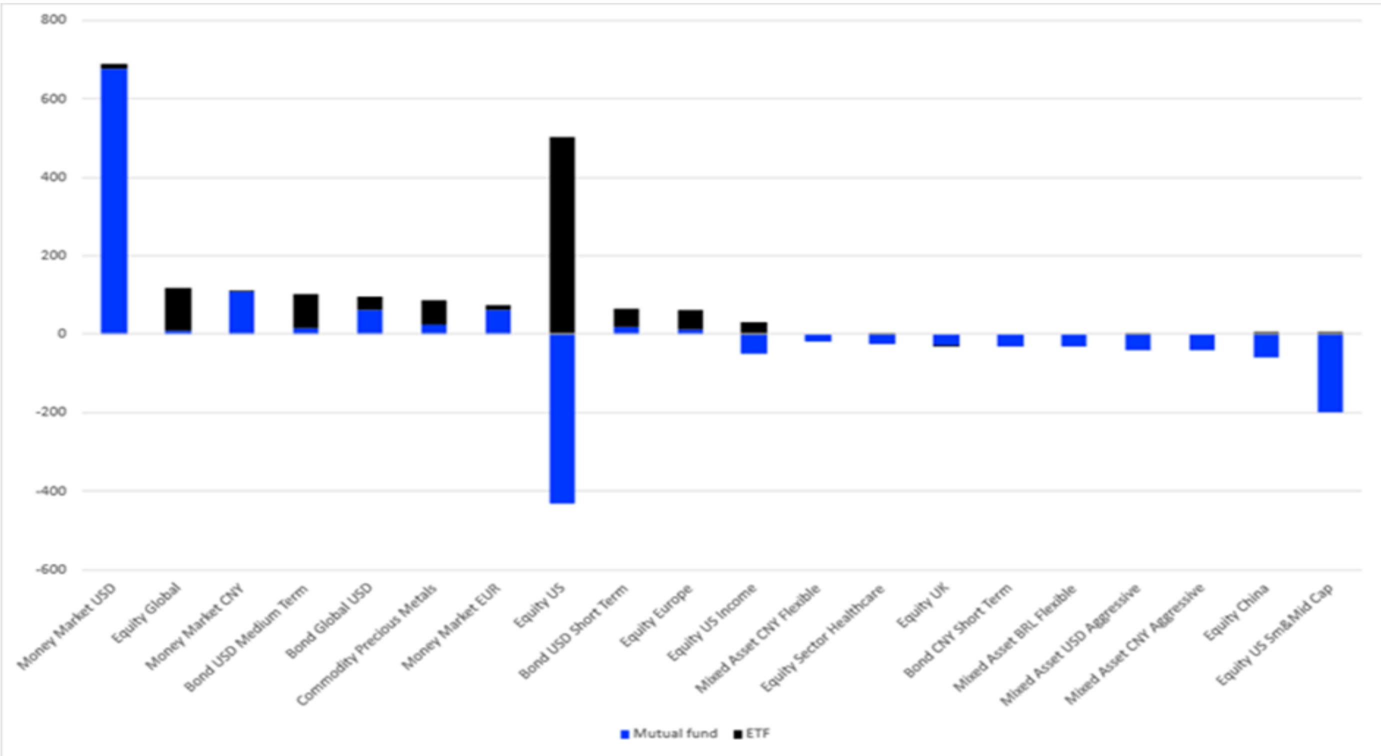
Section 4 – Funds Outlook

Loving the Greenback, but Skittish on US Equities

Section Summary

- Cash was king in 2025, at least in terms of dollar money market funds
- Uncertainty over US equities grew, as investors diversified into other geographies.

Exhibit 4 - 1: Global largest inflows and redemptions to mutual funds and ETFs globally, January to November 2025 (USD bn)



Source: LSEG Lipper

Money Market USD was by far the most popular fund classification over 2025, as was the case in 2024 (+$687.97bn versus +$845.35bn in 2024). This had been reinforced by inverse yield curves for some time, but these reinverted towards the fourth quarter of 2024, yet these funds still retained their attractiveness.

The Federal Reserve maintained high interest rates through 2024 into early 2025. This pushed USD money market fund (MMF) yields well above typical bank deposit rates—often more than 4–5%, giving them an attractive risk-return profile. MMFs can investment in short-duration assets such as commercial paper and repos, where yields lagged Fed cuts because of longer average maturities, making Money Market USD more attractive than simply holding cash on deposit.

The US' higher rate environment also made Money Market USD attractive to foreign investors, who have faced lower rates at home, although there was a trade-off between rates and a weakening dollar in the first half of 2025.

Equity US

In contrast, Equity US funds, while still in positive territory, have ceded their second place in 2024, slipping to eighth (+$71.41bn from January to November 2025, versus +$317.44bn in 2024). Nevertheless, they have remained the most popular ETF category (+$502bn), illustrating how ETF flows have come to dominate equity fund flows, often at the expense of their mutual fund equivalents.

Total monthly global flows to Equity US varied between about -$8bn and +$bn the first ten months of the year, with August to October's being about +$17bn, +$12bn and +$13bn respectively… then in November shot up to nearly +$65bn (December: +$60bn), with the incoming Trump administration promising an investor-friendly environment of tax cuts.

These trends, however, conceal some interesting distinctions at the regional level.

US flows to Equity US spiked from -$3.42bn in October 2024 to +$32.66bn in November and +$21.31bn. There was then something of a saw-tooth profile in flows between +$2.29bn and +$36.43bn (April 2025), until a rush for the exits occurred in May (-$28.07bn), with flows not turning positive until November.

But it wasn't just the home crowd initially breaking out the Bollinger: European fund buyers were also keen on the change in residency at the Oval Office. Monthly Equity US flows in the region had been between +$2.69bn and +$18.08bn over the first ten months of 2024, then spiked to +$25.02bn in October, and +$20.54bn in December.

This enthusiasm cooled quickly, with February 2025 seeing European fund buyers commit less than $1bn by April, and a significant sell-off (-$22.95bn) in July. As a result, total sales for the first 11 months of the year were +$7.35bn in Europe, well behind the +$118.85bn for FY 2024.

Asian investors, in contrast, have been more consistently supportive of Equity US funds, which is the most popular classification for the region in 2025 (+$46.03bn). Sales peaked to +$9.92bn in January 2005, from +$2.99bn the previous October. The nadir came in June 2025 (+$416m), from where it has crept up again. But, unlike the US or Europe, it has never gone negative.

Not the US

Equity Global sales have remained strong over 2025 in both Europe and Asia, being the second-most popular classification. This contrasts with the US, where the classification is in negative territory for both years. Given that the US is nearly two-thirds of the leading global equity indices, that is not too surprising—why double up? In 2024, Equity Global ex US was the eleventh most popular classification in the US, and the second most popular equity classification after Equity US, attracting $19.06bn. In 2025, it was still the second most popular equity classification, netting £13.62bn. Equity US was in negative territory over 2025, with Equity Sector Information Technology the most popular (+$24.39bn).

Equity Europe appeared on US fund-buyers' radars over 2025, going from nowhere in 2024 to net $11.96bn over the first eleven months of 2025, indicating that some US investors are looking to geographically diversify. Globally, Equity Europe ETFs attracted $51.14bn, the ninth most popular classification. Equity Canada also saw an uptick in US investor interest (+$8.2bn).

European investors have discovered the merits of the staycation, at least in equity terms. Over 2024, Equity Europe was their second-least favoured port of call, after the perma-gloom that is Equity UK, which suffers ongoing structural headwinds of pension funds' shift from bond to equity—ongoing, as they locked in attractive gilt yields as 2025 progressed—and investors' shift from UK to global benchmarks. Despite an attractive performance over the course of 2025 (the FTSE 100 was up 21.5% over 2025 in GBP terms), European investors broadly missed out on the UK.

The UK's woes kept Equity Europe off the bottom of the European table in 2024, but European fund investors still sold off more than $25.19bn over the year. However, the new year saw a rebound into positive territory, where it has stayed ever since, peaking at $8.18bn in March 2025.

This, then, doesn't look like a European reaction either the threat of tariffs, a weak dollar or Mag Seven valuations and AI concerns, though no doubt it's a reflection of all of these to varying degrees at varying times.

Not easy being small

The classification that has suffered the worst redemptions globally over 2025 is Equity US Small & Mid Cap, with redemptions of -$193.08bn between January and November—although it's noteworthy that ETF flows have gone the opposite direction, netting $6.63bn.

In aggregate, US investors have pulled $182.98bn from these funds. This isn't a new phenomenon: the classification also suffered the worst redemptions over 2024. This may be due to the unclear situation with the tariffs, as it is to be expected that small and mid caps get hit the hardest, since they do not have the pricing power and political influence to either pass increasing costs over to their customers or have the political muscle to negotiate tariff reductions. US' higher-for-longer rate environment has also hit smaller companies, which are more reliant on variable-rate debt than their large-cap peers; weaker earnings that their large-cap peers, with growth focused on Mag Seven over the period, and sluggish domestic growth, which smaller companies are more exposed to. While all of this contributes to the bear case for US small caps, it's still hard to see how it justifies such a feverish rush for the exits.

While US large cap has outperformed small and mid over the past couple of years (circa 48% for the Russell 1000 from the start of 2024 to mid-December 2025, compared to circa 34% for the Russell 2000 in USD terms), just how much this has been down to the very largest is evidenced by the equivalent return on the equal-weighted Russell 1000 (27%).

Section 5 – Agency RMBS

Prepayment Dynamics and Federal Policy Considerations

Section Summary

- The Agency RMBS market is expected to remain generally resilient in 2026.
- Market support comes from steady issuance, moderated housing price growth, and potential declines in mortgage rates.
- Recent policy initiatives, including agency MBS purchases and restrictions on institutional buyers, may influence housing affordability.
- GSE reforms, VantageScore 4.0 adoption, and mortgage portability could affect market liquidity, though the timing and impact remain uncertain.
- In-the-money and modestly OTM cohorts may see some pickup in prepayments if mortgage rates decline further.
- Interest rates, housing supply, and policy developments will continue to be key drivers of prepayment behavior and overall market performance.

Summary

The Agency RMBS market is expected to remain generally resilient in 2026, supported by steady issuance, tempered housing price growth, and potential declines in mortgage rates. Recent policy initiatives, such as agency MBS purchases, restrictions on institutional buyers, GSE reforms, VantageScore 4.0 adoption, and mortgage portability, could influence affordability and liquidity, but their effectiveness and timing remain uncertain. Prepayment activity is expected to stay muted for deeply out-of-the-money cohorts, while in-the-money and modestly OTM cohorts may see some pickup if mortgage rates decline further.

Overall, the combination of stable issuance, supportive policy measures, and incremental improvements in affordability points to a cautiously optimistic outlook for the Agency RMBS sector in 2026.

Federal Housing Market Policy Initiatives

- Restrictions on Institutional Investment in Single-Family Housing

On January 7, 2026, the administration outlined a proposal to restrict or ban large institutional investors from purchasing single-family homes is intended to reduce competition for owner-occupant buyers and improve access to homeownership, particularly for first-time buyers. While institutional investors account for a relatively small share of the national housing stock, their presence is more concentrated in certain local markets, where they may exert disproportionate influence on pricing and bidding dynamics. As a result, the policy could moderate investor-driven demand in select regions, potentially easing pressure on entry-level home prices. However, the overall impact on national housing affordability and supply is likely to be limited, as the measure does not directly increase housing construction and may face legal, definitional, and enforcement challenges that constrain its effectiveness.

- Mortgage-Backed Securities Purchases

Also in early January 2026, the administration announced a directive to purchase up to $200 billion in agency mortgage-backed securities through Fannie Mae and Freddie Mac, signaling a renewed policy focus on housing affordability. By increasing demand for agency MBS, the initiative aims to compress MBS spreads and place downward pressure on primary mortgage rates, potentially lowering monthly payments for homebuyers and supporting refinancing activity. While the program is modest in scale compared with prior Federal Reserve quantitative easing efforts, it could provide incremental support to mortgage market liquidity and rates in the near term. However, without a corresponding increase in housing supply, the resulting affordability gains are likely to be limited, with some of the benefit potentially translating into firmer home prices rather than materially higher transaction volumes.

Housing Finance Reform and Mortgage Market Policy

- Privatization of Fannie Mae and Freddie Mac

In 2025, efforts to transition Fannie Mae and Freddie Mac out of federal conservatorship and toward greater private ownership continued to evolve, shaping policy discussions and investor expectations in the Agency RMBS market. The Federal Housing Finance Agency (FHFA) and the U.S. Department of the Treasury unveiled a joint framework outlining a roadmap to guide an orderly exit, restoring Treasury authority over any release from conservatorship and calling for stakeholder input on a comprehensive exit strategy.

The administration has shown interest in advancing privatization, with FHFA Director William Pulte indicating that a public offering could be evaluated in the near term. Early discussions suggested a late-2025 IPO, but updated guidance now points to early 2026 as the earliest plausible window. While some investors remain optimistic about a 2026 privatization event, analysts caution that operational, regulatory, and capital framework challenges could delay the offering further. Surveys of mortgage-backed securities investors indicate that many expect privatization within the next several years, while a notable portion believe it could take longer or may never happen, reflecting significant uncertainty in both timing and execution.

Private proposals have emerged, including market-driven plans aimed at enhancing shareholder value while preserving mortgage affordability. Independent lenders and housing advocacy groups have emphasized that any exit from conservatorship should carefully consider impacts on mortgage accessibility, market stability, and smaller lenders' competitive positions. Key structural, legal, and regulatory questions remain unresolved, leaving the ultimate path and timing uncertain.

Overall, privatization of the GSEs remains a central but fluid policy focus. While a public offering could occur in early 2026, the timeline, scale, and impact on the housing finance market will depend on administrative decisions, regulatory approvals, and legislative engagement. The outcome of these deliberations will have significant implications for mortgage market dynamics, credit availability, and Agency RMBS performance in the coming years.

- Adoption of VantageScore 4.0 and Credit Reporting Transition

In July 2025, the FHFA officially approved VantageScore 4.0 for Fannie Mae and Freddie Mac mortgage underwriting, ending the GSEs' long-standing reliance on Classic FICO. Lenders may now qualify borrowers using either VantageScore or FICO, increasing competition in credit scoring and expanding access to consumers with thin or nontraditional credit histories. This change is expected to unlock up to $1 trillion in additional mortgage activity and bring millions of previously excluded borrowers into the conforming market.

The credit scoring transition occurs alongside the future adoption of FICO Score 10T. While FICO 10T has been validated for use by the GSEs, it has not yet been launched for widespread implementation. FICO and FHFA have agreed to release historical 10T loan-level data, a critical step that will allow lenders and modelers to validate the score's predictive performance and integrate it into risk and prepayment models. Despite this progress, there is no mandated implementation date for FICO 10T in GSE underwriting, and mandatory use remains to be determined.

The transition from tri-merge to bi-merge credit reporting has been discussed throughout 2025, with an expected implementation originally targeted for the fourth quarter of 2025. Under this proposal, lenders would pull credit reports from two rather than three major consumer reporting agencies, potentially reducing costs and supporting competition. However, FHFA and the GSEs later revised the implementation timeline, and several elements were shifted to "to-be-determined." Mandatory bi-merge reporting has now been postponed and lacks a set implementation date. Lenders currently continue to obtain tri-merge reports, which remain the standard for conforming loans.

A key uncertainty for investors is the absence of published Loan-Level Price Adjustment (LLPA) metrics for VantageScore 4.0 loans. Without LLPA guidance, lenders and prepayment modelers face challenges in loan pricing and prepayment forecasting, as historical models were largely calibrated to FICO-based risk profiles. The combination of new credit scoring models and limited performance data introduces potential variability in prepayment speeds and loan-level economics, requiring close monitoring as these loans enter Agency RMBS pools.

For investors and modelers, these developments reflect a broader modernization of GSE mortgage underwriting. While expanded credit access and more diverse borrower profiles are expected to support Agency RMBS volumes, the effects on prepayment behavior, risk-adjusted yields, and collateral performance remain uncertain. Market participants are updating systems, disclosures, and modeling frameworks to incorporate VantageScore 4.0, FICO 10T, and the shift from tri-merge to bi-merge credit reporting, while tracking early loan performance to recalibrate prepayment and credit risk assumptions heading into 2026 and beyond.

- Assumable and Portable Mortgages and Their Impact on Lock-In Effects

Assumable mortgages allow a qualified buyer to take over a seller's existing loan at its original interest rate and terms and are most commonly associated with FHA, VA, and USDA programs. Portable mortgages, which would allow borrowers to transfer an existing mortgage and rate to a new property, remain largely conceptual in the U.S. but have gained renewed attention in 2025 as policymakers and market participants explore tools to address affordability and homeowner mobility challenges in a high-rate environment.

Recent discussions have elevated the profile of both loan types. FHFA leadership has indicated that Fannie Mae and Freddie Mac are evaluating broader use of assumable and portable mortgage features, although no formal implementation timeline has been announced and policy development remains exploratory. At the same time, industry groups and real estate market participants have publicly advocated for expanding assumable mortgage options as a way to ease affordability pressures and encourage housing turnover. In parallel, several technology-enabled platforms have emerged to streamline the process of identifying and executing assumable mortgage transactions, reflecting growing borrower and investor interest despite operational complexity.

Despite increased attention, these products face meaningful structural and practical limitations. As highlighted by recent policy analysis, assumable mortgages are unlikely to materially stimulate housing market activity without substantial changes to underwriting, equity financing, and secondary-market frameworks. Equity gaps between home values and outstanding loan balances, appraisal constraints, and investor pricing considerations continue to limit broad adoption. Portable mortgages face even greater hurdles, as the U.S. mortgage system is built around property-based securitization rather than borrower-based loan portability, making widespread implementation operationally challenging.

From an Agency RMBS perspective, assumable and portable mortgages can weaken the lock-in effect by allowing borrowers to retain below-market financing when moving, thereby increasing housing turnover even when market rates are higher. However, given their niche usage and the absence of broad policy adoption, their overall impact on Agency RMBS issuance and prepayment behavior is expected to remain modest in the near term. Continued monitoring of policy signals, lender participation, and transaction volumes will be important in assessing their longer-term implications.

Issuance

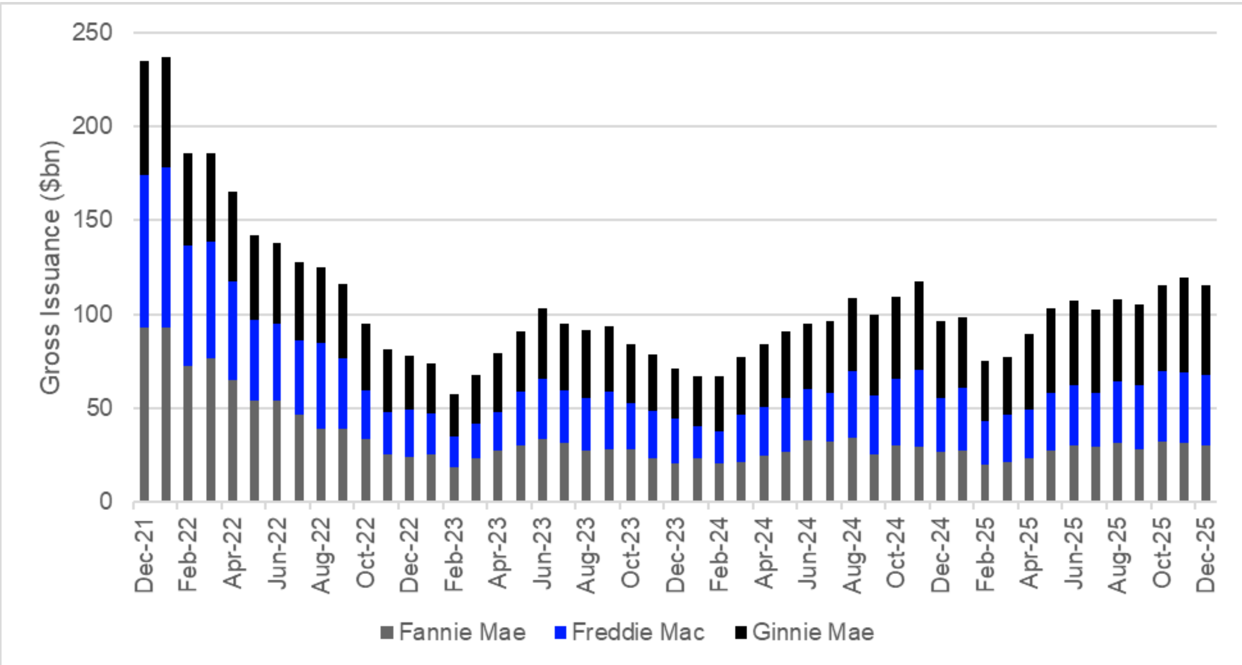
Agency RMBS issuance in 2025 shows a modest but more sustained improvement relative to 2024, marking a shift from last year's late-cycle recovery to a firmer and more consistent issuance profile.

In 2024, gross issuance remained historically low through the first half of the year, largely in line with 2023 levels, before improving modestly in the back half as mortgage rates stabilized and housing inventory increased gradually. By contrast, 2025 entered the year at higher baseline levels, with issuance consistently exceeding comparable months in early and mid-2024.

Throughout 2025, issuance across Fannie Mae, Freddie Mac, and Ginnie Mae has remained directionally stronger than 2024, indicating improving origination capacity and a broader-based recovery. Ginnie Mae continues to provide relative stability, while Fannie Mae and Freddie Mac show incremental gains as origination conditions improve.

Despite this improvement, 2025 issuance remains well below the historical highs of 2021, when refinancing-driven volumes dominated the market. In 2026, Our preliminary estimate places gross issuance at $1.7 trillion, subject to changes in rate dynamics and housing market conditions.

Exhibit 5 - 1: Agency RMBS Gross Issuance by Month



Source: eMBS

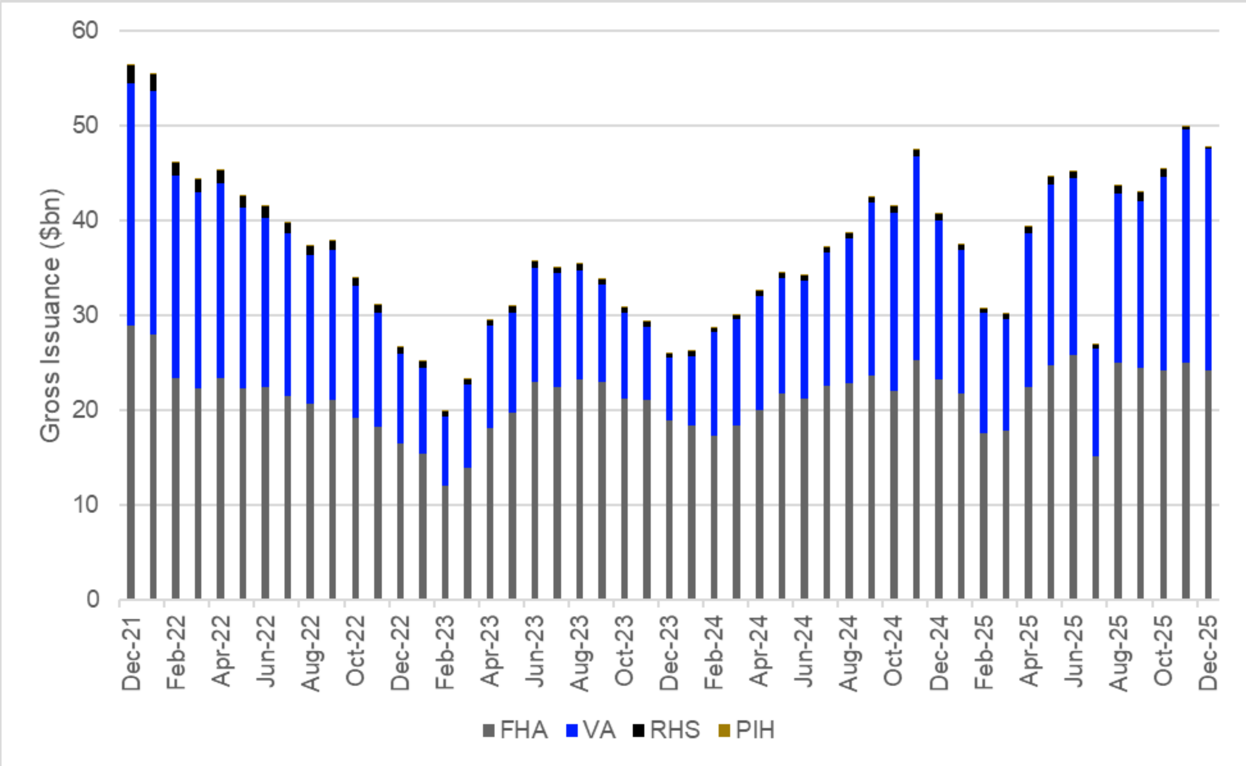
In 2025, GNMA issuance continues to be dominated by FHA and VA, which together account for the vast majority of total GNMA volume. Relative to 2024, both programs show higher and more sustained issuance levels, indicating improved origination flow rather than a temporary rebound.

FHA-backed issuance remains the largest contributor to GNMA production in 2025. Volumes are generally higher than comparable months in 2024, reinforcing FHA's central role in supporting first-time homebuyers and borrowers with tighter credit profiles. As affordability constraints persist, FHA's flexible underwriting standards continue to anchor GNMA issuance.

VA issuance shows a more pronounced improvement in 2025 compared to 2024, extending the recovery that began after the lows observed in 2023. VA volumes trend meaningfully higher across much of the year, reflecting both an expanding eligible veteran population and continued demand for VA loan features such as lower down payments and competitive pricing. This dynamic points to a gradually increasing VA share within total GNMA issuance.

In contrast, RHS and PIH remain a very small portion of total GNMA issuance, with volumes largely unchanged in relative terms compared to prior years. While issuance from these programs has edged modestly higher alongside overall GNMA activity, they continue to represent only a fractional share of total volume, consistent with their targeted policy mandates rather than broad market participation.

Exhibit 5 - 2: Ginnie Mae RMBS Gross Issuance by Guarantor



Source: eMBS

With 2025 agency RMBS issuance tracking within our projected range, we look to 2026 for a continued, measured improvement in issuance. Assuming moderate economic growth, a slight easing in mortgage rates, and the ongoing central role of the GSEs despite policy uncertainty, we expect issuance to trend higher. Our preliminary forecast anticipates $1.5 trillion to 1.7 trillion in total agency RMBS issuance in 2026, reflecting improved purchase activity, modest refinancing, and sustained demand for agency-backed securities.

Existing Home Sales and Inventory

According to the National Association of Realtors, November existing-home sales rose to a seasonally adjusted annual rate of 4.13 million, up 0.5% from October (4.11 million) but down 1.0% from November of last year (4.17 million). While sales have improved from the mid-2025 trough of 3.93 million in June, overall activity remains subdued and near multi-year lows, reflecting persistent affordability challenges.

In the current environment of high mortgage rates and elevated home prices, weak sales are not surprising. Affordability constraints remain severe, and high inflation has further reduced buyers' real disposable income. Although sales have stabilized in recent months, they remain well below pre-pandemic norms and consistent with a market operating at historically low turnover.

On the supply side, housing inventory declined to 1.43 million homes in November, down from 1.52 million in October and 1.55 million during the summer months, but up from 1.33 million a year ago. This level of inventory remains modest by historical standards. For comparison, housing inventory stood at 1.83 million in August 2019, and the long-term average inventory level prior to 2024 was approximately 2.25 million units dating back to 1982.

The persistently low inventory is partly driven by the mortgage rate lock-in effect, as homeowners with low fixed-rate mortgages are reluctant to sell. While inventory has increased modestly on a year-over-year basis, it remains insufficient to meaningfully ease supply constraints. As a result, limited supply continues to place upward pressure on home prices, reinforcing affordability challenges and further dampening sales volumes.

Exhibit 5 - 3: Existing Home Sales and Inventory by Month

	11/25	10/25	09/25	08/25	07/25	06/25	05/25	04/25	03/25	02/25	01/25	12/24	11/24
Existing Home Sales (M)	4.13	4.11	4.05	4.00	4.01	3.93	4.04	4.00	4.02	4.27	4.09	4.29	4.17
Inventory (of homes) (M)	1.43	1.52	1.53	1.53	1.55	1.54	1.54	1.45	1.33	1.23	1.18	1.14	1.33
Inventory (of months)	4.2	4.4	4.5	4.6	4.6	4.7	4.6	4.4	4.0	3.5	3.5	3.2	3.8
Median Sales Price ($K)	409.2	414.9	412.3	422.4	425.7	432.7	423.7	414.0	403.1	396.8	393.4	403.7	404.4

Source: National Association of Realtors

Overall, the housing market appears to be stabilizing at a low level of activity, characterized by constrained supply, soft demand, and minimal turnover.

The 2026 outlook for existing-home sales points to a gradual and uneven recovery, with activity likely to improve modestly as affordability constraints ease and macroeconomic conditions continue to stabilize.

Policy developments will remain a key driver of market dynamics. In particular, continued reforms of the GSEs could play an important role in expanding access to homeownership. The broader adoption of VantageScore 4.0 by housing finance agencies has the potential to expand homebuyer eligibility, especially among first-time buyers, younger households, and borrowers with thin or nontraditional credit histories.

However, a sustained and meaningful recovery in existing-home sales will still likely require either materially lower mortgage rates or a significant expansion in housing supply. Mortgage rates remain elevated relative to pre-pandemic levels, and housing inventory continues to be constrained by the mortgage rate lock-in effect. Without a notable loosening of financial conditions or a structural increase in supply, gains in sales activity are expected to remain modest rather than robust.

Overall, the 2026 housing market is likely to be characterized by slow normalization rather than a sharp rebound, with policy-driven improvements in credit access and affordability acting as important, but not sufficient, catalysts for a stronger recovery.

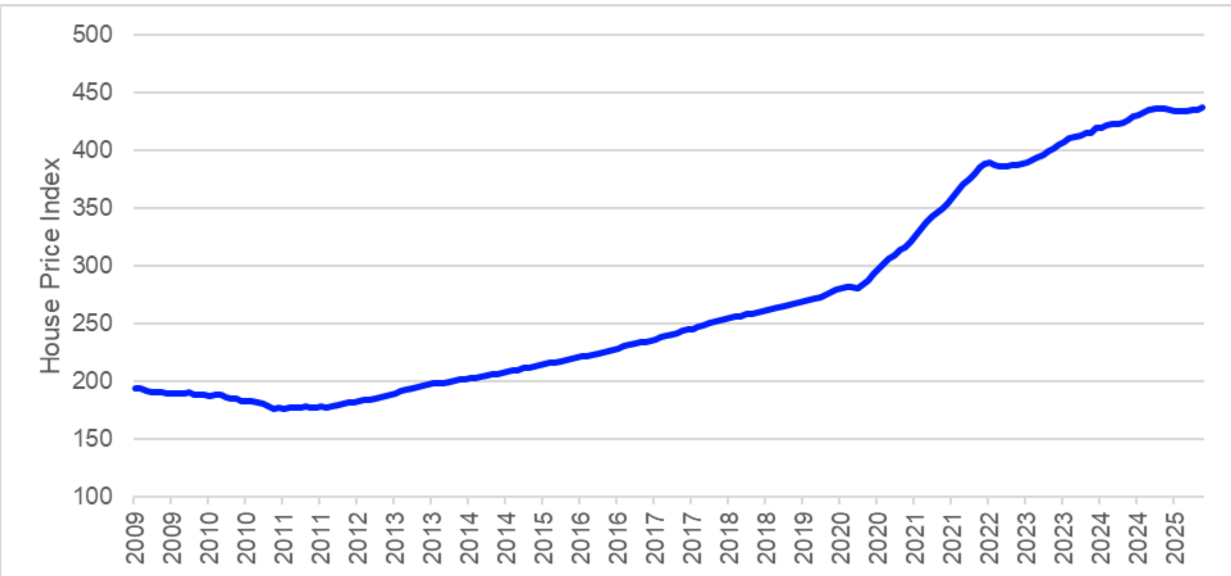
House Price Index

The FHFA reported in December that the purchase-only House Price Index rose 0.4% in October from the prior month and increased about 1.4% from a year earlier, reflecting continued but moderating price appreciation. The index reached a new all-time high of 436.8 in October, surpassing its previous peak early in 2025. Despite the recent slowdown in year-over-year growth, house prices remain elevated, with the index up roughly 55% from about 280 in January 2020.

Fannie Mae's HPI forecast points to a continued moderation in home price growth through 2026 and beyond. After a relatively strong 5.8% year-over-year increase in Q4 2024 and an annual gain of 3.6% in 2025 in last year's forecast, price appreciation is now expected to slow further, with home prices projected to rise 2.5% in 2025, 1.3% in 2026 on a Q4/Q4 basis, and around 1.2% in 2027. This progression highlights a clear deceleration from the elevated price growth seen in recent years, reflecting easing demand pressures and ongoing affordability constraints. In model v25.1, Yield Book assumes annualized HPA of 3% for Q2-Q4 2025, 1.5% for 2026, and 3% thereafter.

Overall, the combination of moderating prices, better credit access, and more inventory contributes to a cautiously optimistic outlook for the housing market in 2026. Buyers are expected to benefit from modestly improved inventory availability and mortgage rates that are lower than their recent peaks, easing affordability constraints at the margin. Housing price growth has also tempered, with forecasts showing slower appreciation compared to the rapid gains of prior years, which further supports affordability for prospective buyers. The labor market is likely to remain relatively resilient, though uncertainty around AI-driven automation, productivity shifts, and potential restructuring within government agencies could weigh on employment expectations and household confidence. These risks may temper buyer sentiment even as financing conditions improve. Overall, the combination of moderating prices, better credit access, and more inventory contributes to a cautiously optimistic outlook for the housing market in 2026.

Exhibit 5 - 4: US Monthly FHFA House Price Index (Purchase Only)



Source: Federal Housing Finance Agency

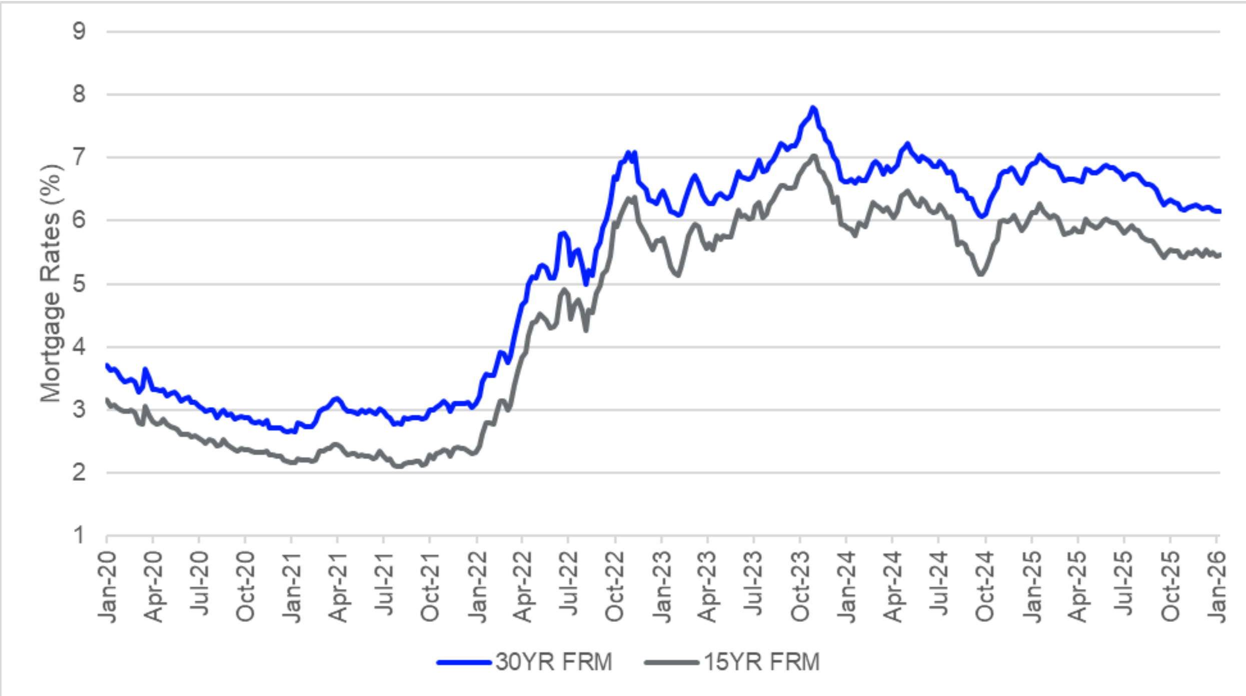
Mortgage Rates

In 2025, 30-year fixed mortgage rates trended downward steadily, reflecting gradual stabilization in the mortgage market. Rates started the year around 7.0% in January and declined consistently, finishing at approximately 6.15% in late December. The decline provided modest relief for homebuyers and supported some refinancing activity, though rates remain elevated relative to historical averages.

By comparison, 2023 mortgage rates were significantly higher, averaging 6.8% and peaking above 7.7% in October. In 2024, rates declined only modestly despite Federal Reserve rate cuts in the second half of the year, ending the year around 6.7% to 6.9%. In 2025, the Federal Reserve implemented three additional cuts to the benchmark rate, bringing the target range down to 3.5% to 3.75%. These policy actions helped drive the steady decline in mortgage rates throughout the year.

Overall, the 2025 trend reflects a continuation of the stabilization that began in 2024, with rates responding to Federal Reserve policy easing, moderating inflation, and market expectations. Looking ahead, mortgage rates in 2026 are expected to remain sensitive to economic growth, inflation, Fed policy, and broader macroeconomic conditions, with potential for further gradual declines of approximately 50 basis points.

Exhibit 5 - 5: US Weekly Primary Mortgage Market Survey



Source: Freddie Mac

Prepayment

Prepayment speeds for both conventional and GNMA securities increased in 2025 relative to December 2024, with particularly strong activity in the second half of the year. For example, FNMA 30-year speeds rose from 5.9 CPR in December 2024 to 8.8 CPR in December 2025, while GNMA II 30C increased from 8.7 to 13.2 CPR. This rise reflects a combination of factors, including gradually declining mortgage rates from around 6.9% in January to 6.15% by December and a slow but steady improvement in housing inventory. As refinancing conditions improved, more homeowners took the opportunity to refinance, driving a noticeable increase in prepayment activity across FNMA, FHLMC, and GNMA II 30- and 15-year products over the year.

Exhibit 5 - 6: Actual Prepayment Speed by Product

	RPB($B)	12/25	11/25	10/25	09/25	08/25	07/25	06/25	05/25	04/25	03/25	02/25	01/25	12/24
FNMA 30	2,908.0	8.8	8.4	10.5	7.9	7.2	7.4	7.1	7.4	7.4	6.6	5.0	5.1	5.9
FNMA 15	299.7	8.0	7.1	8.8	8.1	7.9	8.1	7.8	7.8	7.4	7.1	6.1	6.3	6.6
FHLMC 30	2,575.1	9.5	9.2	11.5	8.4	7.4	7.6	7.3	7.6	7.7	6.5	5.1	5.1	5.9
FHLMC 15	255.0	8.8	7.7	9.9	8.7	8.5	8.5	8.2	8.0	7.7	7.2	6.1	6.5	6.7
GNMAII 30M	1,905.0	12.1	12.1	14.7	10.9	9.4	8.9	8.7	10.3	11.1	9.4	7.0	7.5	8.2
GNMAII 30C	591.1	13.2	11.8	13.4	11.1	9.6	9.2	8.9	10.2	11.3	9.7	7.4	7.8	8.7
GNMAII 15M	13.5	11.7	10.2	13.0	11.2	11.7	11.3	11.4	11.2	11.1	11.1	9.3	9.7	9.5
GNMA 30	40.8	6.5	5.9	6.7	6.5	6.6	6.9	6.6	6.7	6.4	6.1	5.5	5.8	5.9

Source: eMBS

Exhibit 5 - 7 shows projected prepayment rates for Fannie Mae and Ginnie Mae II mortgage cohorts under a scenario where mortgage rates decline. The values are expressed as the percentage of mortgages paying off within one year, broken down into refinance driven prepayments and home sale driven prepayments. As rates decrease from the current level down to 2.5% lower, refinancing activity rises sharply for both FNMA and GNMA II, while prepayments due to home sales remain relatively stable. The table highlights the strong sensitivity of prepayment speeds to falling rates, particularly for ITM cohorts.

Exhibit 5 - 7: Projected Prepayment in Rate Rally Scenario (% of Mortgage Paying Off in 1 Year)

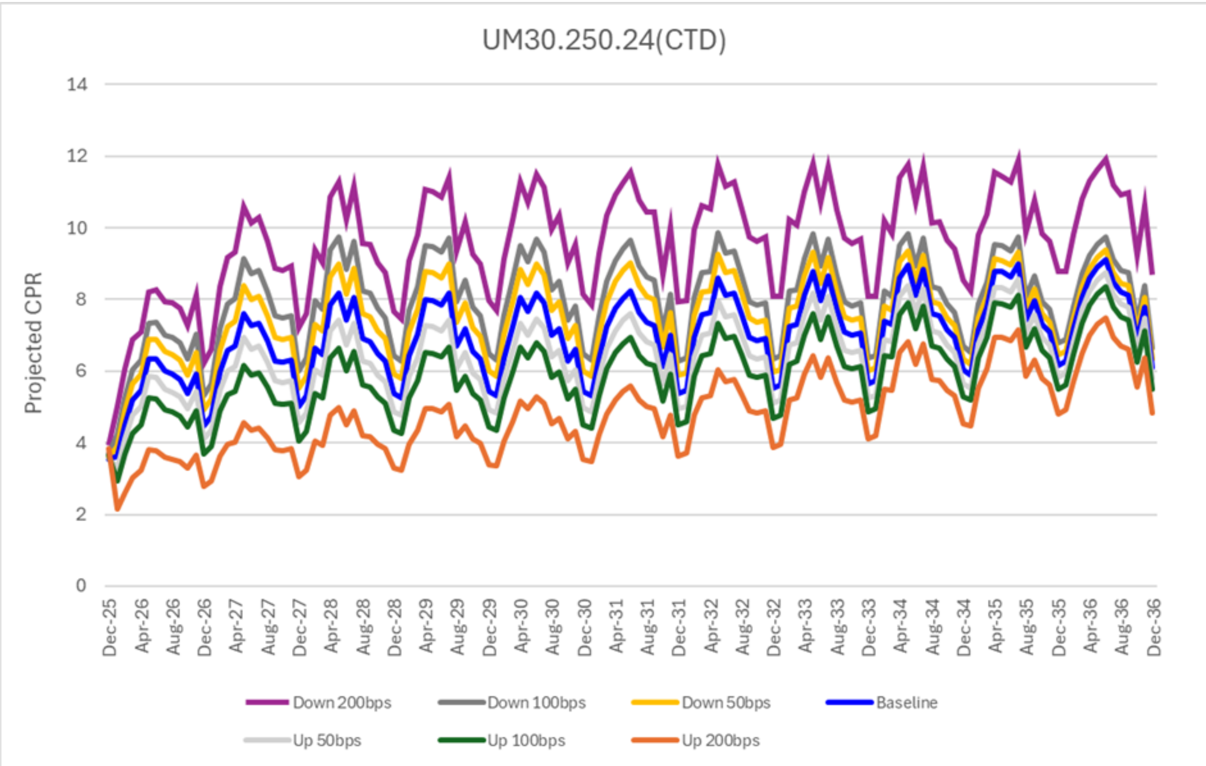
Rate Change	Fannie Mae (FNM) Refinance / Home Sale	Ginnie Mae II (G2) Refinance / Home Sale
Current	4.45% / 4.36%	8.22% / 4.66%
-0.50%	8.37% / 4.55%	16.59% / 4.82%
-1.00%	13.19% / 4.70%	24.14% / 4.94%
-1.50%	17.50% / 4.82%	32.41% / 5.06%
-2.00%	20.27% / 4.94%	38.65% / 5.18%
-2.50%	22.46% / 5.06%	41.81% / 5.30%

Source: eMBS

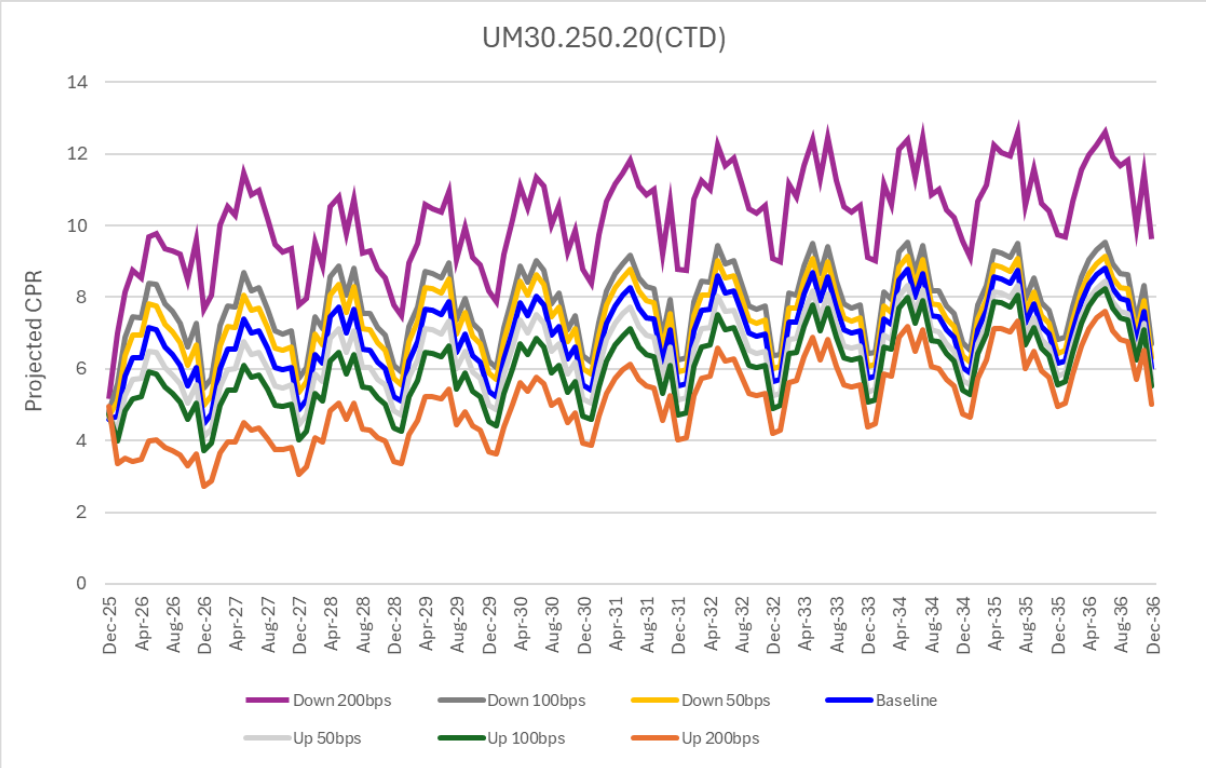
For out-of-the-money (OTM) agency RMBS, turnover-driven prepayment speeds are expected to remain largely muted in 2026, as the mortgage rate lock-in effect continues to discourage both home sales and refinancing. That said, modestly OTM cohorts could see some pickup in prepayment activity if mortgage rates decline further and reduce the spread relative to borrowers' existing loan rates. Any increase, however, is likely to be limited, as persistent housing inventory shortages and ongoing affordability constraints are expected to continue restraining overall transaction volumes.

Exhibit 5 - 8 presents projected prepayment speeds across various interest rate scenarios for the deeply OTM UMBS 30-year cheapest-to-deliver (CTD) cohort originated in 2024 and 2020 with a 2.5 coupon. In a scenario where the rate curve declines by 200 basis points, prepayments are projected to rise by roughly 3 CPR over the next 12 months, primarily driven by increased turnover, followed by modest gains in cashout and curtailment activity. Conversely, if rates rise by 200 basis points, turnover speeds approach the model's assumed floor, indicating limited downside in prepayment under higher-rate conditions.

Exhibit 5 - 8: Yield Book Prepayment Projections for Different Rate Scenarios (OTM Cohort) – UM30.250.24(CTD)



Source: Yield Book

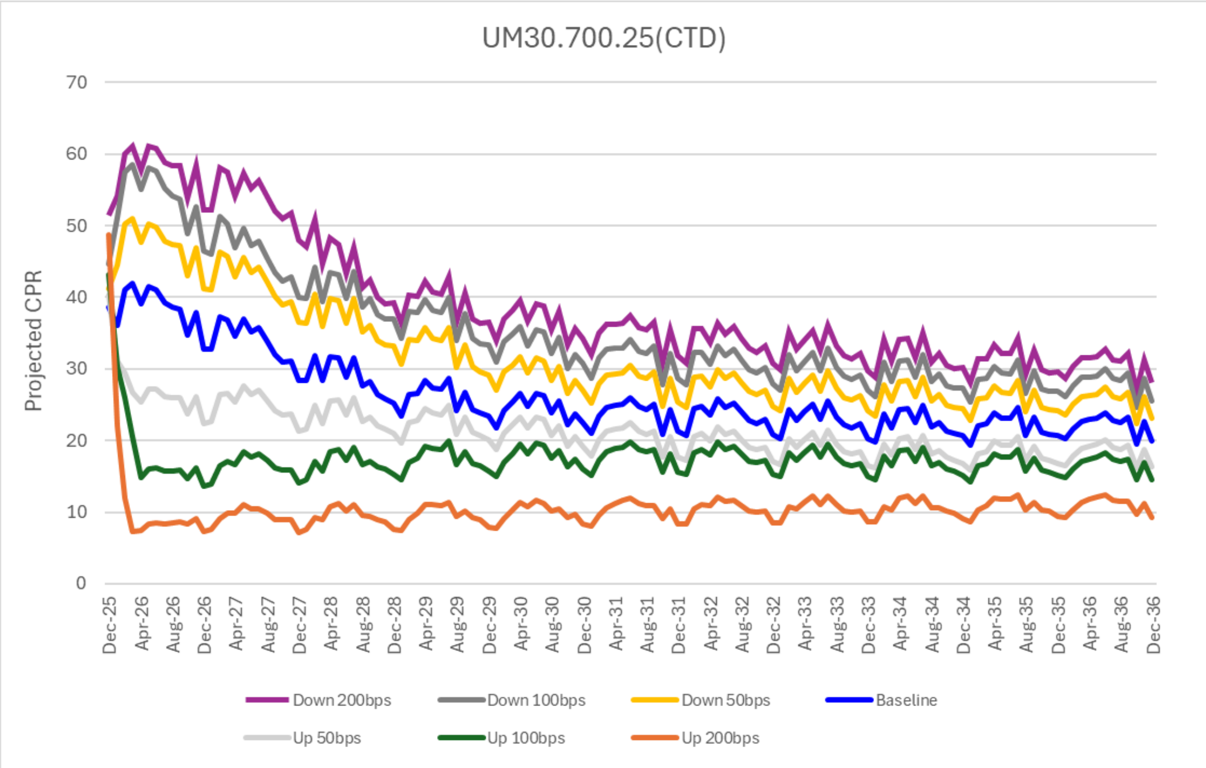


Source: Yield Book

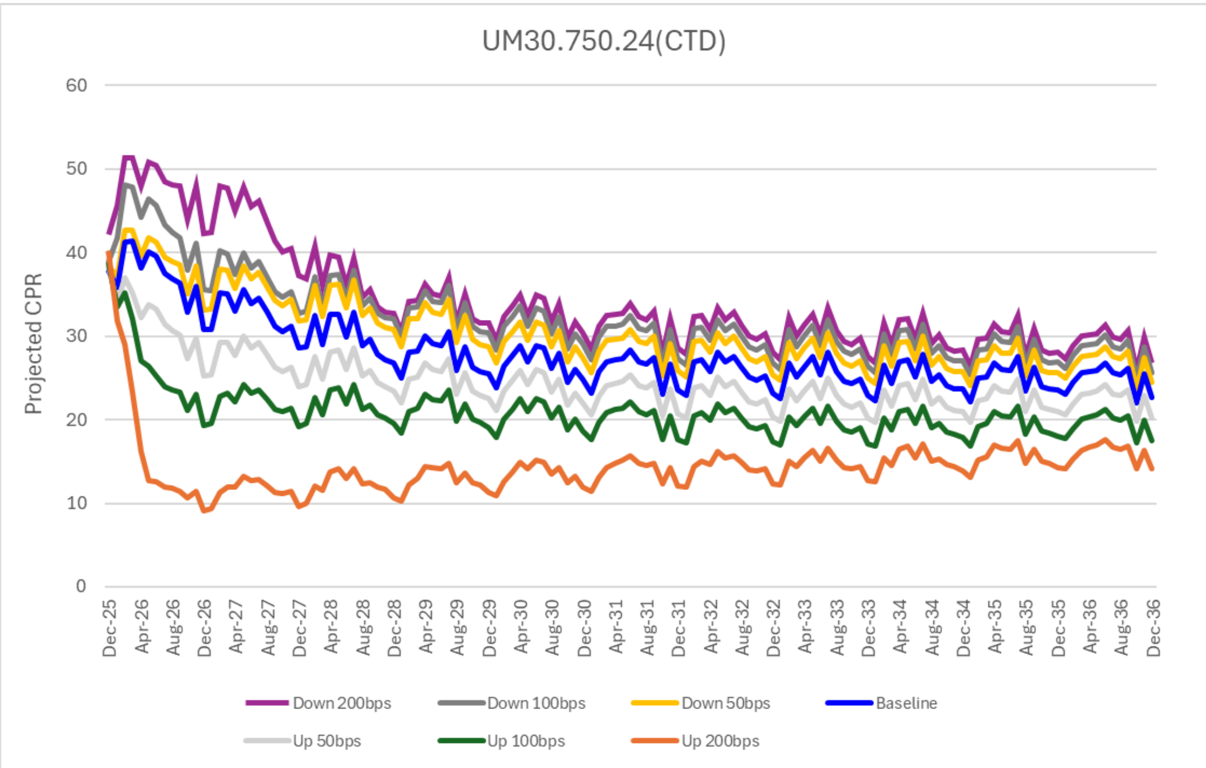
For in-the-money (ITM) cohorts, prepayment activity is expected to accelerate in 2026 if mortgage rates continue to decline, as borrowers become increasingly incentivized to refinance or move. The responsiveness is likely to be particularly pronounced in newer vintages, where lower prevailing rates relative to existing loan coupons create the strongest financial incentive. Media coverage and heightened borrower awareness of refinancing options may further amplify prepayment activity, potentially resulting in a surge in prepayment speeds compared with 2025 levels.

Exhibit 5 - 9 illustrates projected prepayment behavior for two deeply in-the-money (ITM) UMBS 30-year cheapest-to-deliver (CTD) cohorts with 7.0% coupons, originated in 2025 and 2024. For the 2025 cohort, prepayment speeds are highly sensitive to both upward and downward shifts in mortgage rates of 50 and 200 basis points, with refinancing activity driving most of the increase as borrowers respond to changing rates. The 2024 cohort exhibits a similar pattern, with prepayment speeds rising when rates decline, though the magnitude of the response is slightly smaller compared with the newer cohort.

Exhibit 5 - 9: Yield Book Prepayment Projections for Different Rate Scenarios (ITM Cohort)



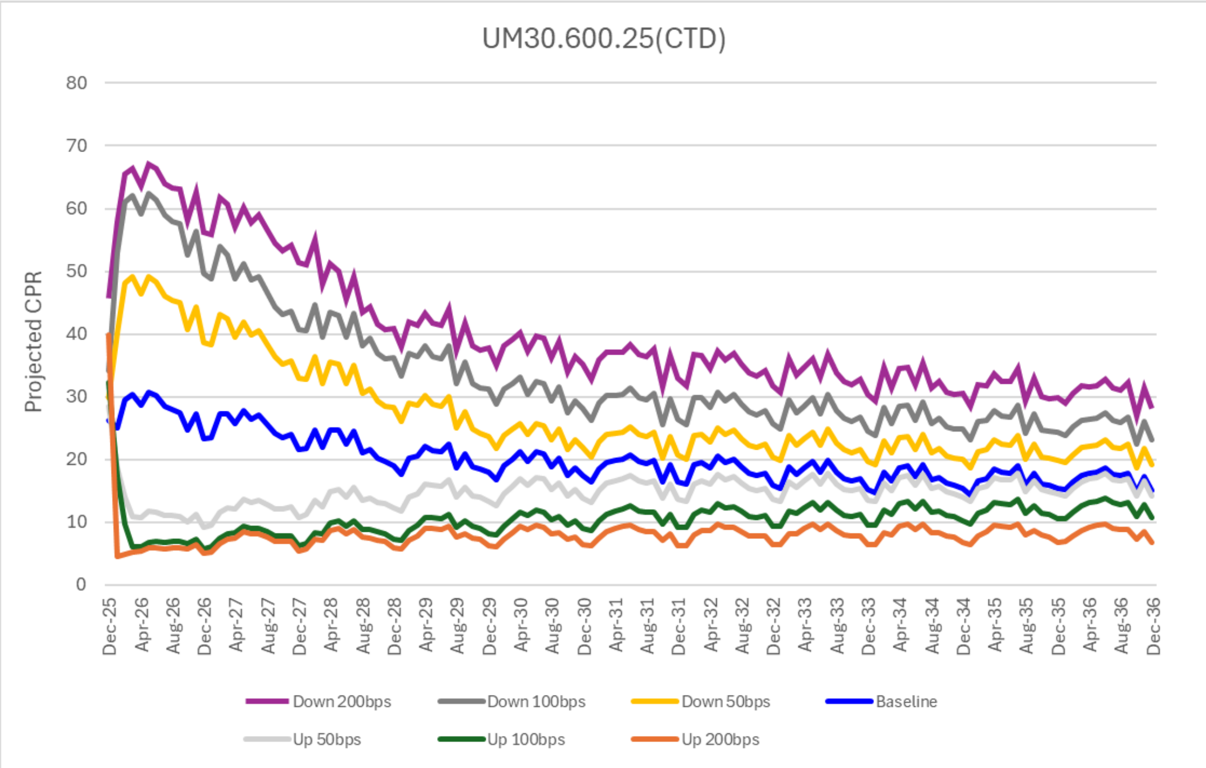
Source: Yield Book

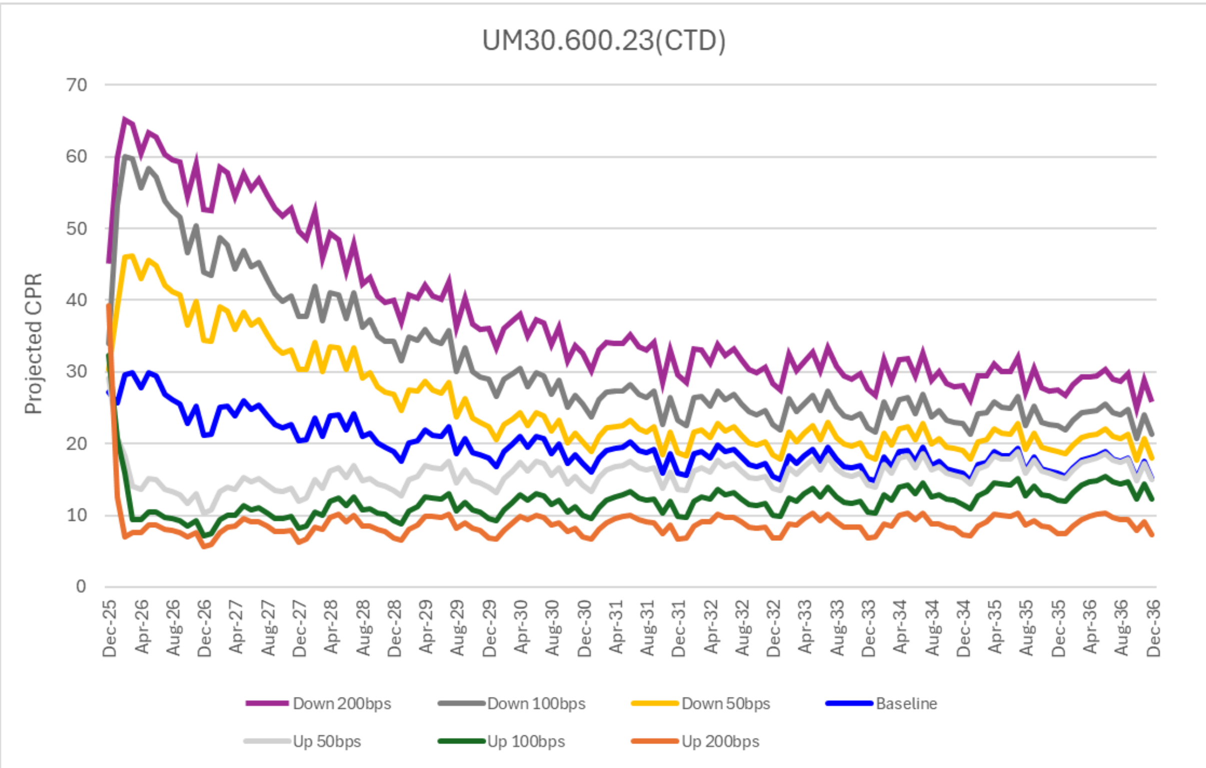


Source: Yield Book

Exhibit 5 - 10 presents projected prepayment speeds under various interest rate scenarios for the at-the-money (ATM) UMBS 30-year cheapest-to-deliver (CTD) cohorts with 6.0% coupons, originated in 2025 and 2023. In both newer and older vintages, prepayment rates are projected to increase sharply in response to declining interest rates.

Exhibit 5 - 10: Yield Book Prepayment Projections for Different Rate Scenarios (ATM Cohort)





Source: Yield Book

Conclusion

The Agency RMBS market is expected to remain resilient in 2026, supported by steady issuance, tempered housing price growth, and potential declines in mortgage rates. Recent policy initiatives such as MBS purchases, limits on institutional buyers, GSE reforms, VantageScore 4.0 adoption, and mortgage portability may improve affordability and liquidity. Market participants should continue to monitor interest rates, federal policies, and housing supply, which will remain key drivers of prepayment activity and overall market performance in 2026.

Section 6 – Non-Agency RMBS

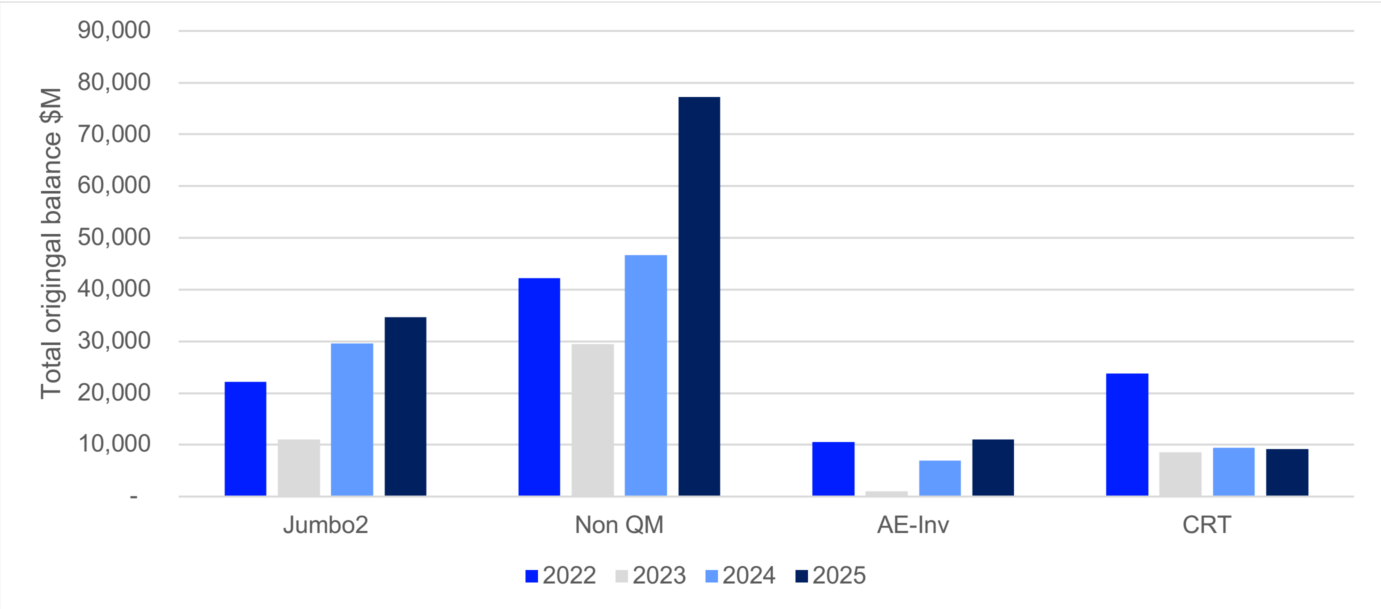
Issuance, Prepayments and Delinquencies

Section Summary

- 2025 has been a very strong year for the Non-Agency public and private market with an increase in issuance by 42% compared to 2024 led by the uptake in the Non-QM sector. In a stable macroeconomic environment in 2026, further Non-Agency issuance growth may continue.
- As the mortgage rates started to ease in the second half of 2025 we have seen increase in prepayments for the 2023 – 2025 origination vintages for Jumbo and Non-QM. This cohort has been originated in considerably higher rates and has greater incentives to refinance at the new interest rates. We expect increase in prepayments until mid 2026 especially for the Prime Jumbo morgages.
- Credit risk has been stable in 2025 and with stabilization of inflation and a strong job market the outlook for the credit risk on the Non-Agency mortgages is stable for 2026.

Issuance

Exhibit 6 - 1: Non-Agency Issuance



Source: LSEG Yield Book (December 2025)

Non-Agency issuances continue strong recovery from post-pandemic lows, with total bond issuance volume growing 42% YoY between 2024 and 2025. Non-QM continues to lead the recovery, growing 65% YoY. This follows a 60% Non-QM growth between 2023 and 2024. Non-QM deals now account for over 58% of Non-Agency issuances. Prime-Jumbo issuance had a steady recovery though volume is yet to re-trace pre-pandemic highs. Agency Eligible is recovering strongly, albeit from a lower base and CRTs settled into a steady cadence.

We anticipate Non-QM originations see continued growth as self-employed, Debt Service Coverage Ration backed loans and second lien mortgages become more commonplace. Helping to drive the demand are strong investor appetite as Non-QM have proven to have better than initially expected risk profile, with high bond coupon and behaviour similar to prime loans.

With strong HPI growth and elevated rates post-pandemic, we observe somewhat elevated Loan to Value and Debt to Income within the CRT, Jumbo2 and Agency Eligible deals. However, these indicators remained steady for Non-QM deals throughout.

In 2026 we anticipate muted HPI growth, slightly elevated unemployment rates and higher CPI/PCE. Despite the inflationary pressures, markets anticipate a Fed rate cut which would reduce 30-year mortgage rates. Under these conditions we should see growth in the Non-Agency originations in 2026.

Borrower & Collateral Profile

Borrower and collateral profiles remain clearly differentiated between Jumbo2 and Non-QM across vintages. The discussion below summarizes observed credit metrics and collateral composition using coverage table derived directly from the internal data.

Exhibit 6 - 2: Jumbo2/Non-QM Collateral Profile

Sector	Vintage	FICO	CLTV	DTI
JUMBO2	2019	761	71	35
	2020	770	70	32
	2021	776	68	32
	2022	767	73	35
	2023	765	75	37
	2024	771	73	36
	2025	776	73	37

Sector	Vintage	FICO	CLTV	DTI
Non-QM	2019	732	68	36
	2020	732	69	32
	2021	737	69	34
	2022	741	70	33
	2023	738	71	34
	2024	742	70	34
	2025	746	69	35

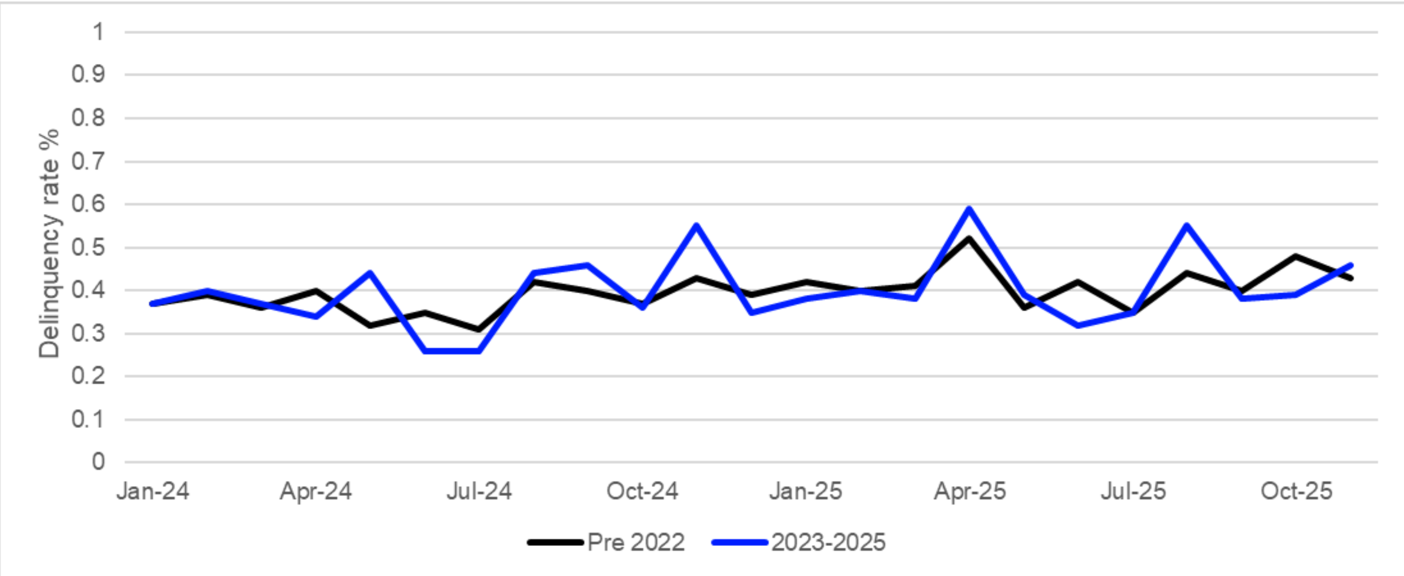
Source: LSEG Yield Book (December 2025)

Jumbo2 consistently exhibits higher FICO and a more conservative collateral profile, while Non-QM shows lower FICO and a slightly higher-risk borrower mix. Recent vintages show that Jumbo2 remains anchored in strong-credit borrowers, whereas Non-QM has leaned modestly toward improved borrower quality, consistent with a tighter origination environment and more selective loan delivery into securitization pools. Across both sectors, DTI appears broadly stable over time.

Credit Risk

Delinquency behavior between Prime Jumbo and Non-QM shows clear segmentation by vintage year and type. This section summarizes the delinquency behavior.

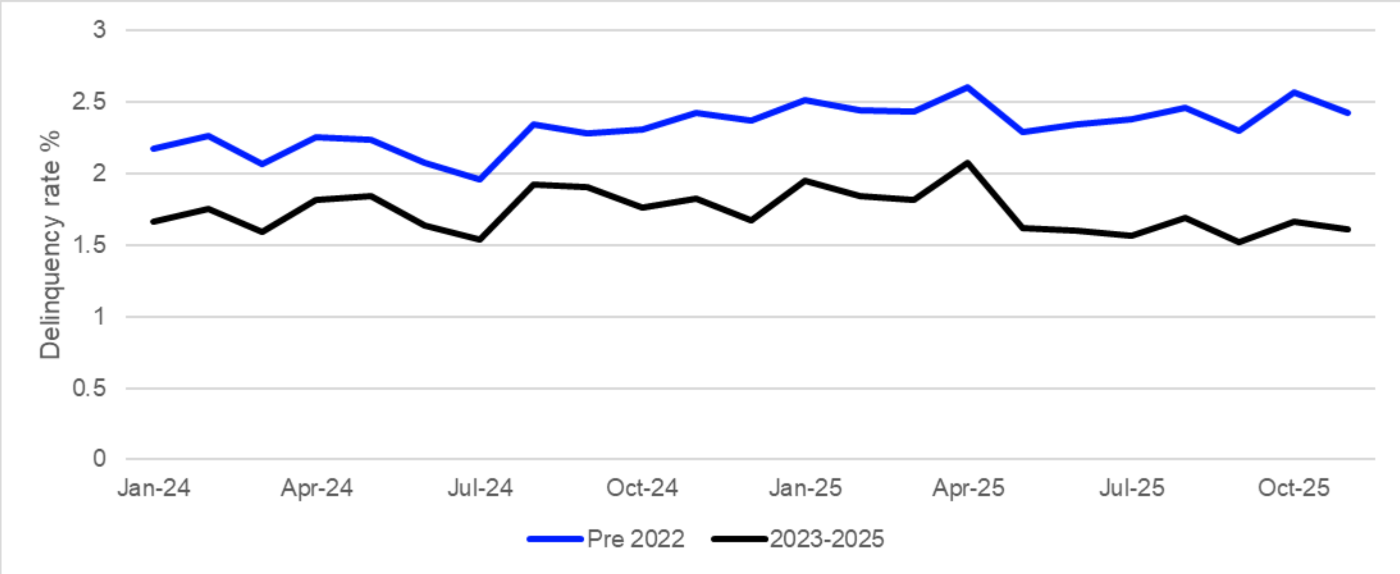
Exhibit 6 - 3: Prime Jumbo Early Delinquency Performance by Issuance Vintage



Source: LSEG Yield Book (December 2025)

For Prime Jumbo, delinquency stays low overall. Both cohorts have similar and stable delinquency rates. In 2026 if unemployment remains stable and interest rates continue to ease our base case expectation is of stable delinquency rates throughout 2026.

Exhibit 6 - 4: Non-QM Delinquency Performance by Issuance Vintage



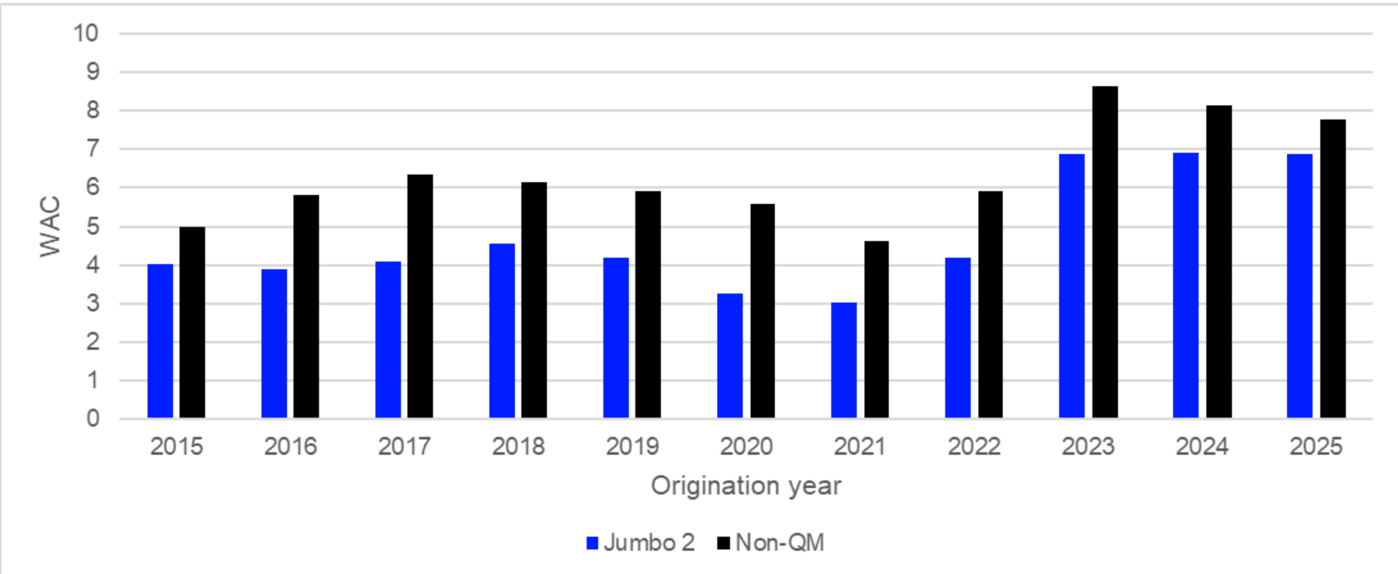
Source: LSEG Yield Book (December 2025)

For Non-QM, delinquency is higher than Prime Jumbo, which is expected given the borrower profile. The 2023-and-after cohort runs clearly below pre-2022 across 2024–2025. We believe that this is driven by the slightly better credit profile and improved underwriting standards. In a stable environment we don't expect any increase in delinquencies in 2026.

Prepayment Risk – Observed Performance

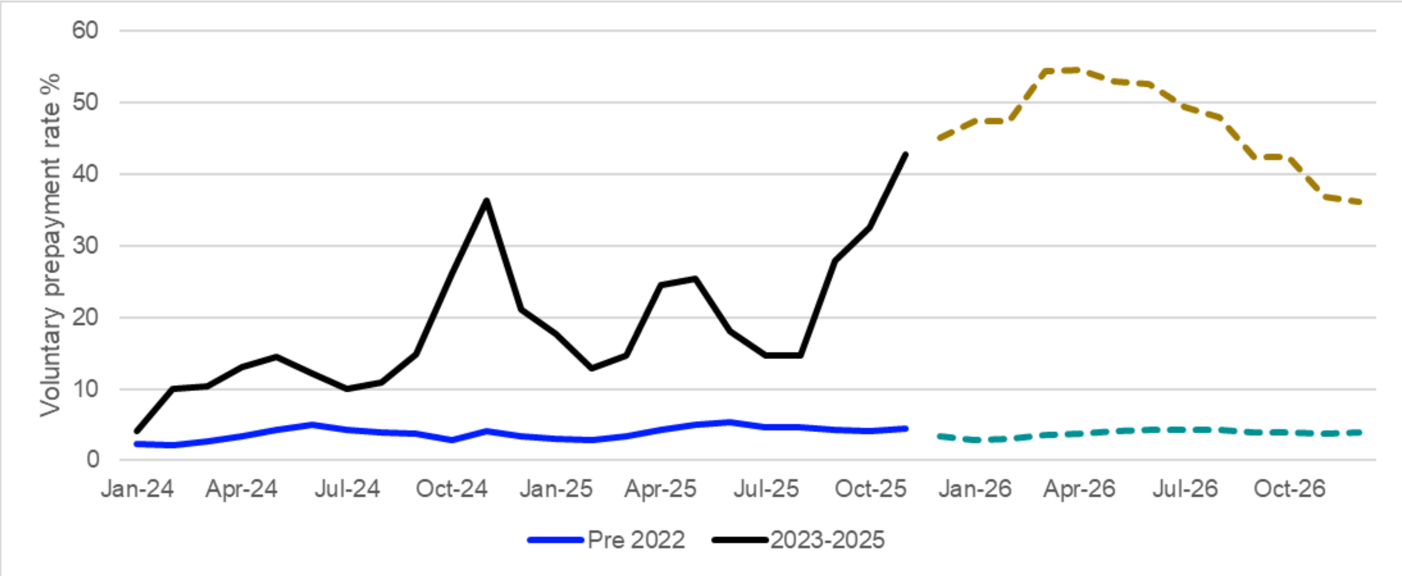
Prepayment risk between Prime Jumbo and Non-QM shows clear segmentation by vintage year and type, shaped the spread between origination and new mortgage rates. As Non-QM becomes more competitive and investors get at ease with the credit risk, the interest rates between the two sectors have tightened in 2025. This in turn would suggest that Non-QM prepayments may start behaving like Prime Jumbo in the upcoming years.

Exhibit 6 - 5: Non-Agency Mortgage Rates



Source: LSEG Yield Book and Optimal Blue via FRED (December 2025)

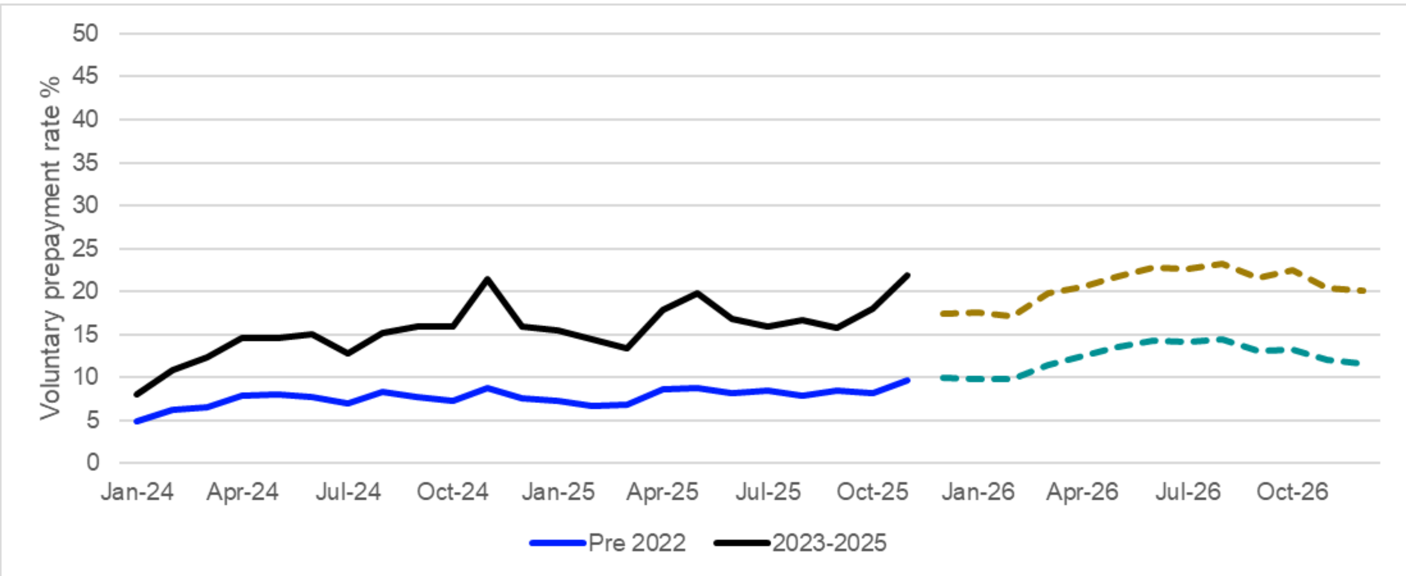
Exhibit 6 - 6: Prime Jumbo Voluntary Prepayments



Source: LSEG Yield Book (December 2025)

Jumbo2 prepayment speeds show a clear cohort split. The 2023-and-after cohort runs meaningfully faster than the pre-2022 cohort through 2024–2025, while the older cohort remains low and steady. This pattern is consistent with the interest rates backdrop: post-2023 originations generally have higher coupon rates, therefore rate relief creates more refinancing opportunities, whereas many pre-2022 loans are on low coupons with limited refinancing incentive, keeping VPR low. The prime Jumbo recent cohorts show increasing trend and we expect that they will continue to raise peaking mid-2026 and revert in Q3 of 2026.

Exhibit 6 - 7: Non-QM Voluntary Prepayments



Source: LSEG Yield Book (December 2025)

Non-QM prepayment speeds also show a clear cohort split. The 2023-and-after cohort remains consistently above the pre-2022 cohort across 2024–2025. Relative to Jumbo2, the gap is smaller. Recent Non-QM cohorts have been seeing similar trend of increased prepayments. Since we are still unsure if they will be as sensing to drop in rates as Prime Jumbo our forecast remains more conservative.

Section 7 – CMBS Outlook

Credit Transparency with Fundamentals Finally Bottoming Out?

Section Summary

- The CMBS market achieved post-GFC record issuance in 2025 on improved liquidity and sentiment in CRE. CRE fundamentals continued the recovery though the momentum has slowed down with office sector gaining confidence and multifamily struggling in rent and cashflow growth.
- We maintain a cautiously constructive outlook for CRE and CMBS markets in 2026 amid stable financing conditions. We foresee continued growth in issuance for both agency and non-agency CMBS with spreads tightening modestly on robust investor demand.
- Accelerated liquidation of troubled assets will help credit transparency as we finally pass the trough of the cycle.

Agency CMBS – 2025 Recap

Agency CMBS had a strong year in 2025, with issuance rising more than 34% YoY amid rate cuts and benign financing conditions. Spreads were largely stable for most products, with a short-lived widening in April tied to tariff distress before settling back into tight, range-bound levels for the remainder of the year. Despite the stable capital market backdrop, multifamily property fundamentals were softer: national vacancy climbed to 7.2%, exceeding its COVID peak, rent growth turned more negative over the year, and property valuation remained flat since its 3Q23 trough as the market worked through a historically large supply pipeline.

Credit performance was generally resilient despite the softening fundamentals. GNPL delinquencies improved through most of the year, driven by nursing-home recovery and operator consolidation; Fannie DUS delinquencies stayed exceptionally low; and Freddie Mac performance was stable overall with pocket stress concentrated in the Small Balance segment.

Prepayment activity stayed muted across fixed-rate products given limited refinance incentives, with isolated spikes in sectors like healthcare—linked to HUD 232 refinancing cycles—and floating-rate loans facing cap expirations or business-plan completions. Together, these dynamics defined a year where capital-market strength overshadowed fundamental softness, setting the stage for a more nuanced environment heading into 2026.

Key Drivers for 2026

The 2026 outlook is shaped first by the rate environment. As Fed easing continued in 2025, rate volatility fell and investor sentiment improved, creating a steady backdrop for agency lending and securitization. These conditions supported strong 2025 issuance and are expected to remain constructive into 2026.

Policy and liquidity support from the agencies further reinforce this backdrop: FHFA raised the 2026 multifamily caps to $88 billion per GSE—up 20.5%—while maintaining the 50% mission-driven requirement and workforce-housing exemptions, ensuring ample capacity to meet refinancing demand.

Supply dynamics also play a role: although 2025 marked peak deliveries from the 2021–23 construction wave, new starts have dropped sharply, and completions are expected to fall to roughly 430k–441k units in 2026, suggesting fundamentals may begin to stabilize despite notable regional variations. Investor demand remains a key technical and we expect that demand to carry into 2026, supporting spreads and continued issuance momentum.

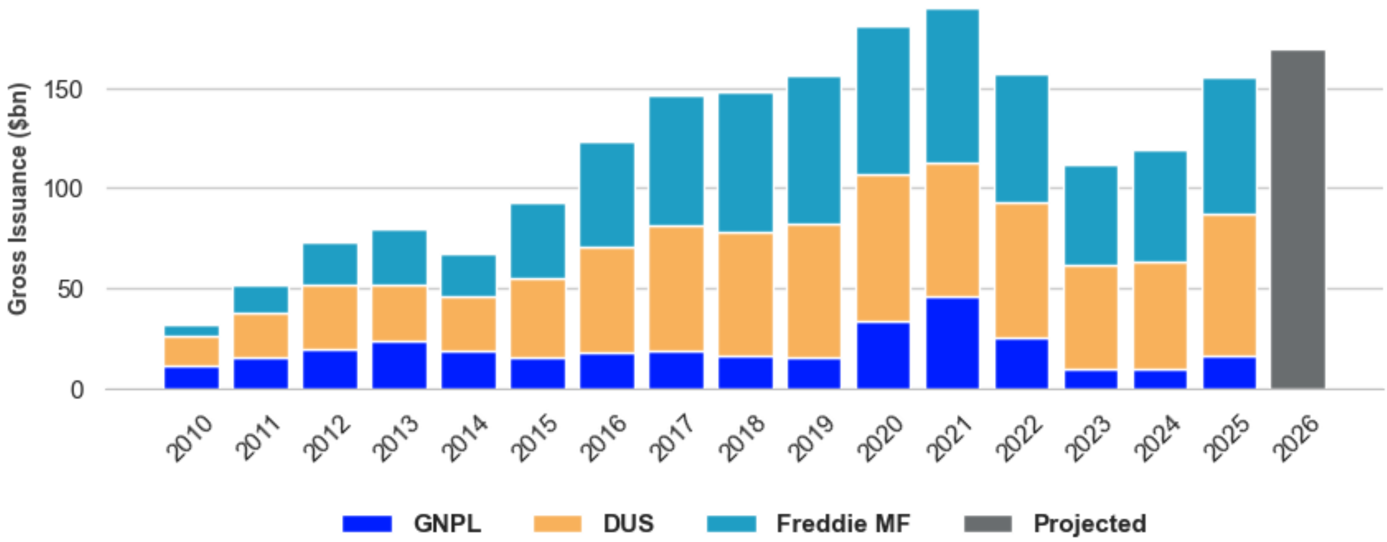
Another looming factor is GSE reform. While a full exit from conservatorship remains unlikely in 2026, incremental steps—such as capital-framework refinements or early groundwork for future recapitalization—may re-enter the policy conversation. Any such movement could introduce spread volatility as investors reassess long-run structures, but near-term lending capacity and agency CMBS issuance should remain largely unaffected under continued FHFA oversight.

These forces collectively define our 2026 scenarios. The base case scenario assumes gradual rate normalization, stable capital market demand, and slow improvement in fundamentals as supply recedes—implying stable issuance, range-bound spreads, and steady credit and prepayment performance. The optimistic case scenario envisions more and faster rate cuts as inflation trends down to 2% target, resulting in stronger investor appetite, tighter spreads, and higher issuance volumes. The stress case scenario reflects rekindled inflation and sharply weakening labor market, leading to wider spreads, softer issuance, and heightened pressure in multifamily fundamental.

Issuance

Agency CMBS posted a strong year in 2025, with combined issuance across the three agencies rising 34.4% YoY to $155.5 bn as of December. Growth was broad based: GNPL climbed 73.9% YoY to $16.1 bn, supported by a 73% surge in nursing home issuance; Fannie Mae DUS increased 32.1% to $71.3 bn; and Freddie Mac multifamily rose 22.4% to $68.1 bn, driven by a 17.8% increase in K Series issuance to $32.6 bn and a 30.2% jump in Multi PC issuance to $29.6 bn. This momentum was underpinned by a Fed easing cycle, strong demand for nursing home facilities, heightened competition between Fannie Mae and Freddie Mac amid the Trump administration's renewed push toward GSE privatization, and the FHFA's continued emphasis on affordable housing, all of which helped lift agency lending volumes throughout the year.

Exhibit 7 - 1: Agency CMBS Gross Loan Issuance by Year



Source: GNMA, FNMA, FLHMC, LSEG Yield Book (December 2025)

Entering 2026, we expect $170bn total issuance, modestly higher than 2025 under our base scenario with gradual policy easing and solid investor demand, $190bn issuance under our optimistic scenario with risk-on market sentiment and fully utilized agency caps, and $130bn in our stress scenario with renewed inflation concern and slowing economic growth.

Market Spreads

Agency CMBS spreads were mostly stable through 2025 despite a brief widening during peak tariff distress. AAA and mezzanine tranches tightened into February, widened modestly post Liberation Day, and then settled into narrow, steady ranges through November.

It's worth noting agency RMBS spreads followed a similar path to agency CMBS, with the current coupon ZV spreads retracing the spring widening and then compressing sharply into December. The steep year end contraction—driven by falling rates volatility and strong demand for duration—underscores that both sectors were responding to macro conditions rather than any shift in credit fundamentals.

Entering 2026, we expect the spreads to tighten by 2-3 bps under the baseline scenario, and tighten 5-10 bps under the optimistic scenario, but widen by 15-35 bps under the stress scenario.

Exhibit 7 - 2: Market Spreads for DUS, K, and FNMA RMBS CC Bonds

Agency	Bond	Nov 24	Dec 24	Jan 25	Feb 25	Mar 25	Apr 25	May 25	Jun 25	Jul 25	Aug 25	Sep 25	Oct 25	Nov 25	Dec 25
FHLMC	K - A1	49	51	48	43	49	50	49	48	48	48	44	45	46	46
FHLMC	K - A2	47	47	40	41	49	49	45	42	40	40	37	38	40	38
FHLMC	K - AM	52	52	44	45	54	55	49	46	44	45	41	42	44	44
FHLMC	K - AS	58	58	53	54	59	63	61	60	60	58	58	58	61	60
FHLMC	K - B	115	125	125	144	190	205	181	179	175	174	177	180	180	175
FHLMC	K - C	209	228	226	245	290	305	281	279	275	274	277	282	282	275
FNMA	DUS - 10/9.5	52	51	48	49	56	54	49	47	48	46	44	49	49	46
FNMA	DUS - SARM	60	60	58	60	60	65	64	62	58	57	58	58	61	61
FNMA	30Yr - CC	141	136	130	134	139	153	139	139	132	123	124	123	121	105

Source: CMA, LSEG Yield Book (December 2025)

Multifamily Fundamentals

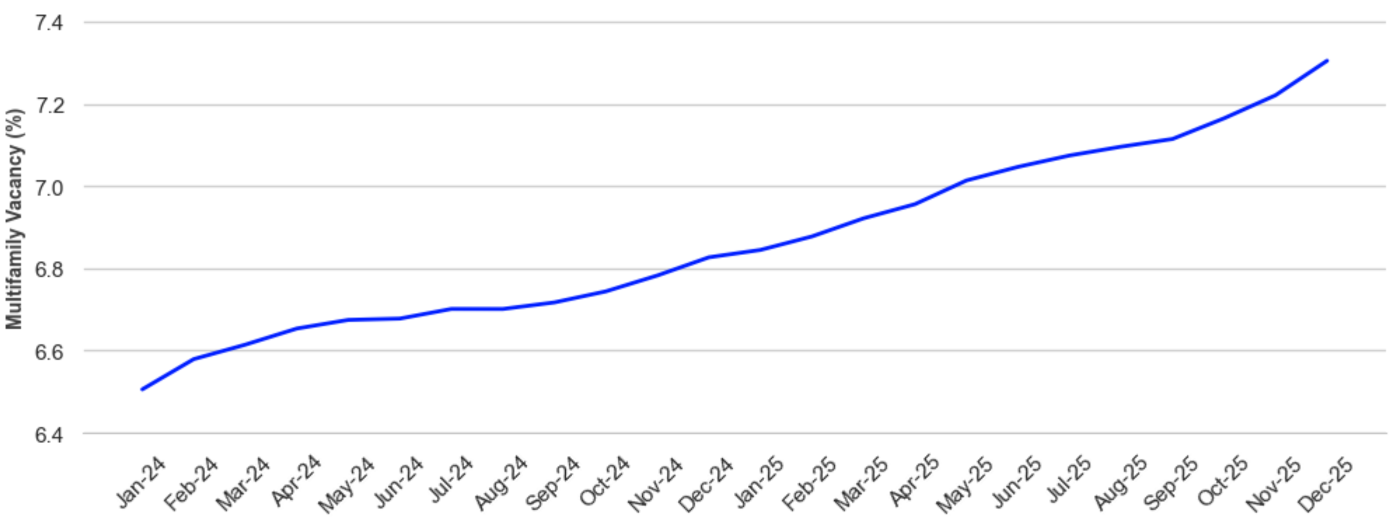
Despite the strength in agency CMBS issuance, multifamily fundamentals weakened in 2025. National vacancy has climbed steadily since 2021 and reached 7.3% in December, surpassing the COVID-era peak. Rent growth has been negative since early 2023 and deteriorated further to -1.3% YoY in December as new deliveries continued to outpace absorption. At the same time, the multifamily price index has been essentially flat since bottoming in 3Q23, reflecting sluggish transaction activity and limited price discovery in a market still digesting a historically large supply wave.

The disconnect between robust agency CMBS issuance and soft multifamily fundamentals reflects the fact that securitization volume is driven primarily by capital-market conditions and refinancing needs, rather than by real-time rent or vacancy trends. As long-term rates eased and market volatility moderated, securitization economics improved, keeping agency spreads stable and providing Fannie Mae, Freddie Mac, and GNMA with a supportive platform to originate and pool loans. At the same time, many multifamily owners facing maturities, floating-rate resets, or expiring bridge loans had few viable alternatives amid a weak sales market. Consequently, even properties with deteriorating fundamentals gravitated toward agency financing out of necessity.

Market-share dynamics magnified this effect. Banks remained cautious toward CRE, and insurance companies tightened underwriting, leaving the agencies as the most reliable source of liquidity. Because Fannie and Freddie securitize nearly all of their loan production, the shift in volume toward the agencies directly translated into higher CMBS issuance. GNPL issuance added another layer of support, as nursing-home performance strengthened and consolidation activity accelerated, driving a surge in HUD-backed refinancing even as multifamily operating metrics weakened.

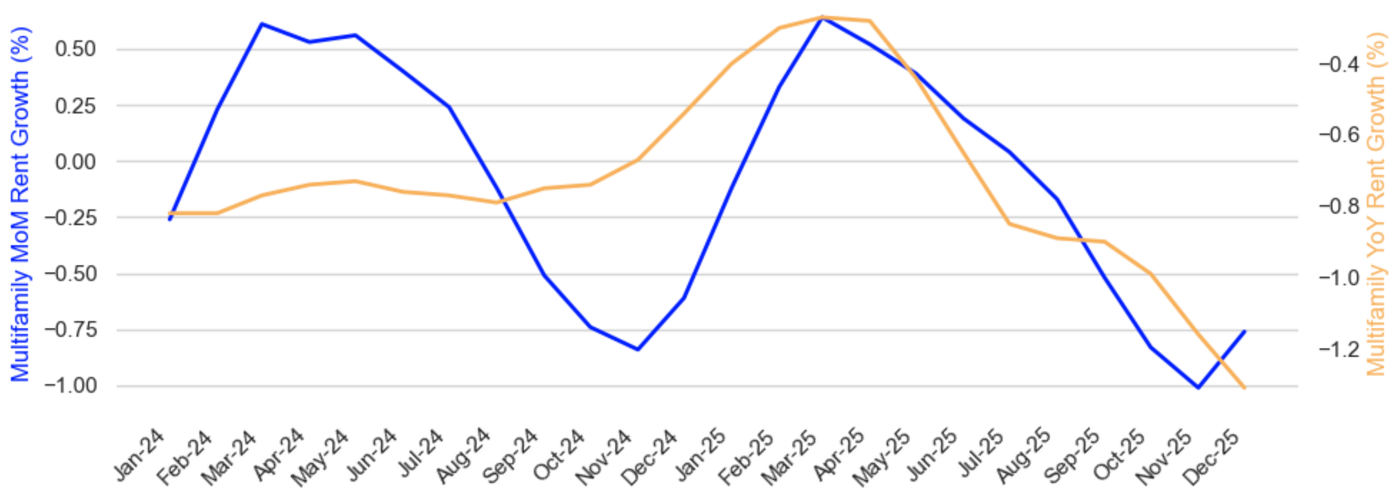
Looking ahead, under the base case scenario we expect vacancy to plateau and drop below 7%, rent growth to turn positive as completions retreat from 2025 peaks, and multifamily property valuation to improve gradually. In the optimistic scenario, we expect vacancy to edge down to 6.5% with YoY rent growth up to 2-3%, and property valuation up by 2-5%. In the stress scenario, we expect multifamily vacancy to climb further and rent growth falling deeper into negative territory, and multifamily valuation down by 5-10% with supply absorption slowing and Sunbelt/Mountain metros lagging further.

Exhibit 7 - 3: Multifamily Vacancy Rate



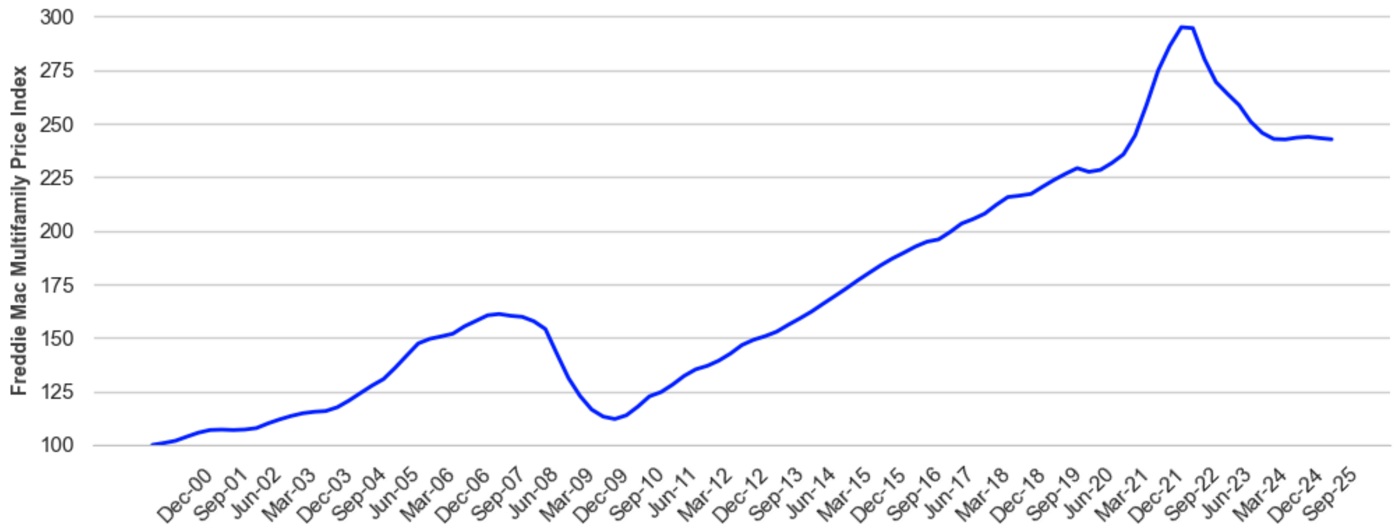
Source: Apartment List, LSEG Yield Book (December 2025)

Exhibit 7 - 4: Multifamily Rent Growth Rate



Source: Apartment List, LSEG Yield Book (December 2025)

Exhibit 7 - 5: Multifamily Property Price Index



Source: FHLMC, LSEG Yield Book (December 2025)

Credit Performance

Credit performance for agency CMBS was steady in 2025:

- GNPL 30d+ delinquency trended down for most of 2025 from 1.10% in January to a trough of 0.74% in September, before a modest tick-up to 0.79% in November[7], consistent with broad operational improvement and late-year idiosyncrasies. Nursing home delinquency rate improved materially from 3.38% (January) to a record low of 1.71% in October on consolidation and census recovery, with a small Nov rebound to 1.98% tied to operator transitions rather than broad deterioration.

- DUS delinquency rate remained low and stable overall, starting out at 0.20% in January and drifting to 0.32% in December, supported by conservative underwriting and sponsor quality. The largest segment is Multifamily (~$450 bn), which hovered in a

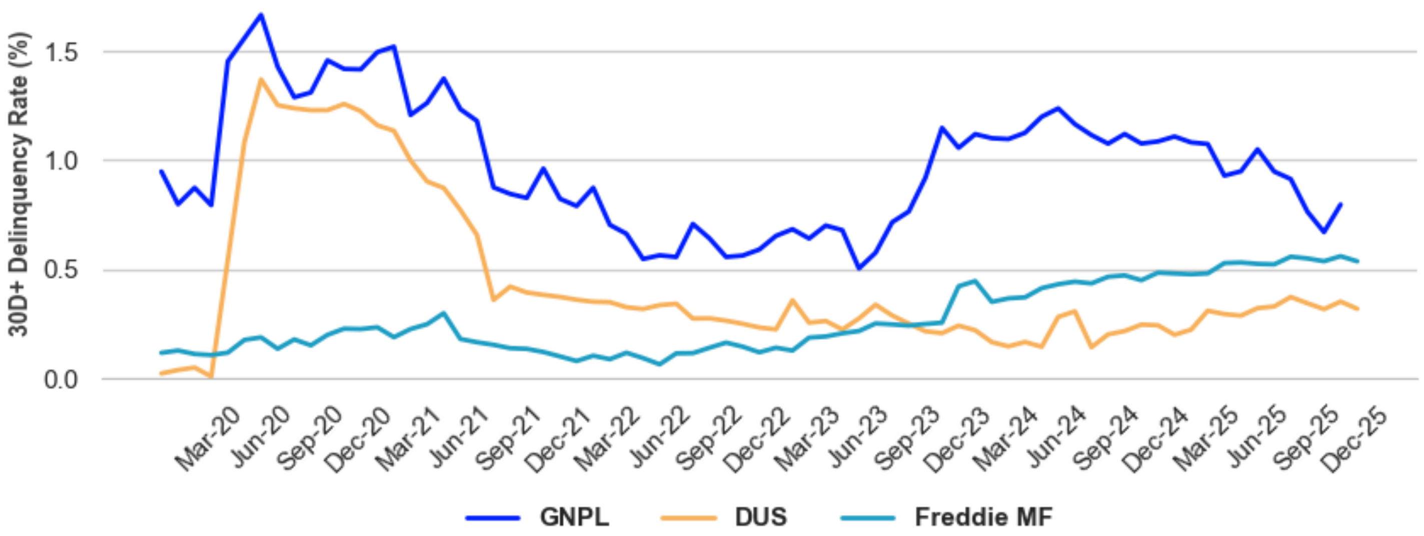
[7] December data is not available for GNPL as of time this article is published.

0.20–0.37% band despite weaker rent growth and higher vacancy—indicating resilience in stabilized assets. Among other sizeable books, Manufactured Housing (~$22 bn) stayed near zero (falling to 0.05% by Oct–Nov), reflecting sticky occupancy; Dedicated Student (~$11 bn) showed mid-year seasonality (rising to ~0.97% Jun–Jul before easing to ~0.36% Dec); and Seniors (~$12 bn) had a brief April spike (~0.66%) that declined to 0.0% by year-end as operator changes settled.

- Freddie's headline 30+ delinquency rose through 2025 from 0.12% (January) to 0.56% (November), driven largely by SB (~$25 bn), which climbed from ~3.42% Jan to ~3.91% Nov amid thinner reserves, tertiary-market exposure, and expense inflation. The largest product, K-Series (~$307 bn), stayed low and orderly (~0.33–0.41% across the year), consistent with institutional underwriting and diversified collateral. Multi-PC/MPC (~$93 bn) remained benign (~0.11–0.16%), while Q-Series (~$6 bn) printed higher but improving readings (~0.90–1.98% mid-year, easing to ~1.30% Nov). Freddie's watchlist corroborates forward pressure in select lending programs (notably Q-Series and Multi-PC fixed) where delinquencies are still contained—signaling deteriorating DSCRs due to negative rent growth and elevated operating costs.

Looking ahead to 2026, we expect credit performance across agency CMBS to remain stable. In our base case scenario, we expect GNPL delinquency to hold in the mid-0.70s to low-0.80s range, Fannie DUS delinquencies to remain contained near 0.25–0.35%, and Freddie MF delinquency to stay around 55 bps, reflecting modest NOI pressure but no systemic deterioration. Under the optimistic scenario, we expect easing inflation and firmer rent trends to pull GNPL toward the low-0.70s, DUS back to 0.20–0.25%, and Freddie MF delinquencies down into 50 bps as occupancy stabilizes, vs. 1%, 0.40–0.55% range, and 60bps respectively in the stress scenario where we expect renewed rate volatility and weaker multifamily cash flows.

Exhibit 7 - 6: **Agency CMBS 30D+ Delinquency Rates**



Source: GNMA, FNMA, FHLMC, LSEG Yield Book (December 2025)

Prepayments

Agency CMBS loan prepayments remained low in 2025, due to elevated interest rate, depressed property valuation, and strict call protection.

For GNPL, the prepayment speeds for Health care (nursing homes) were the most volatile, with CPR surging Feb–Apr (~5–6%) and again in Oct (~7%+), consistent with operator consolidation and ownership transitions, and HUD 232/Lean[8] refinancings in closing waves. GNPL residential stayed low but showed a mid-year pop (Jul ~3–4%) as some seasoned loans prepaid. As multifamily property valuation struggled to recover, the turnover activities for GNPL remained muted.

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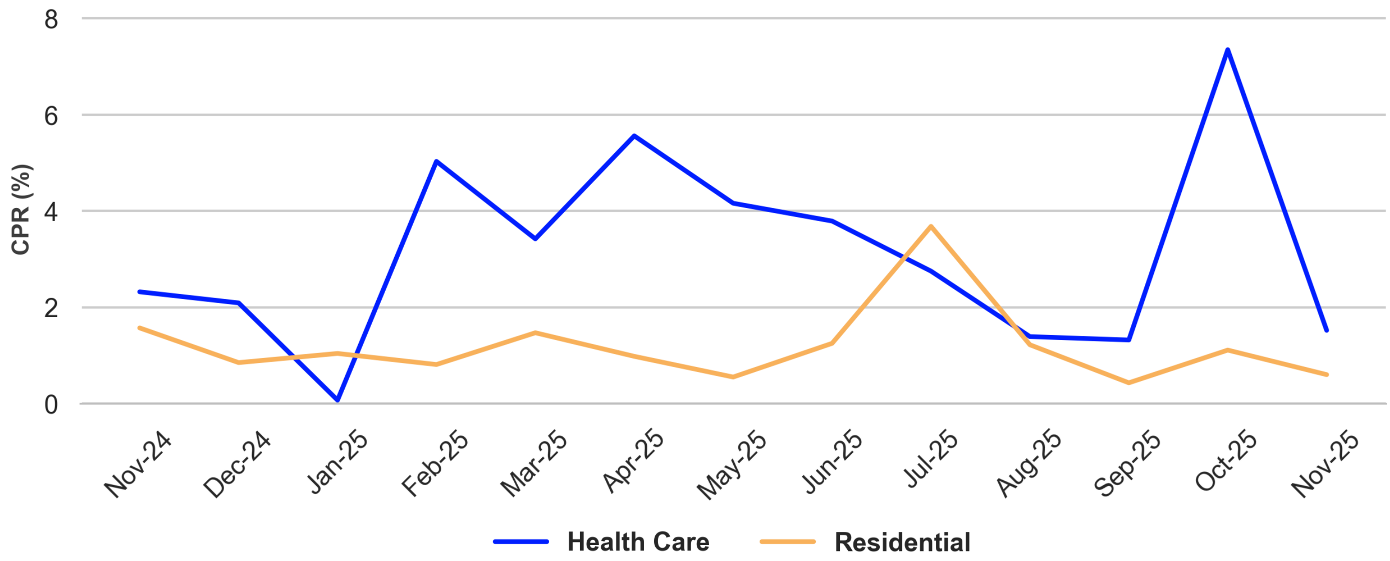
[8] HUD's LEAN Processing model was introduced in 2008 by the Office of Healthcare Programs (OHP) to modernize and streamline underwriting for Section 232 health-care facility loans (skilled nursing, assisted living, memory care)

Heading into 2026, we expect GNPL prepayments to remain low overall, with healthcare continuing to show periodic CPR spikes driven by 232/Lean refinance cycles and industry consolidation, while residential stay muted amid soft valuations. In the optimistic scenario, smoother operator transitions and firmer property values would modestly boost CPRs and reduce healthcare speed volatility; under the stress scenario, turnover falls further across sectors, with CPRs compressing as transactions and refinancings slow.

Exhibit 7 - 7: GNPL Actual Prepay Speeds By Property Type[9]



Source: GNMA, LSEG Yield Book (December 2025)

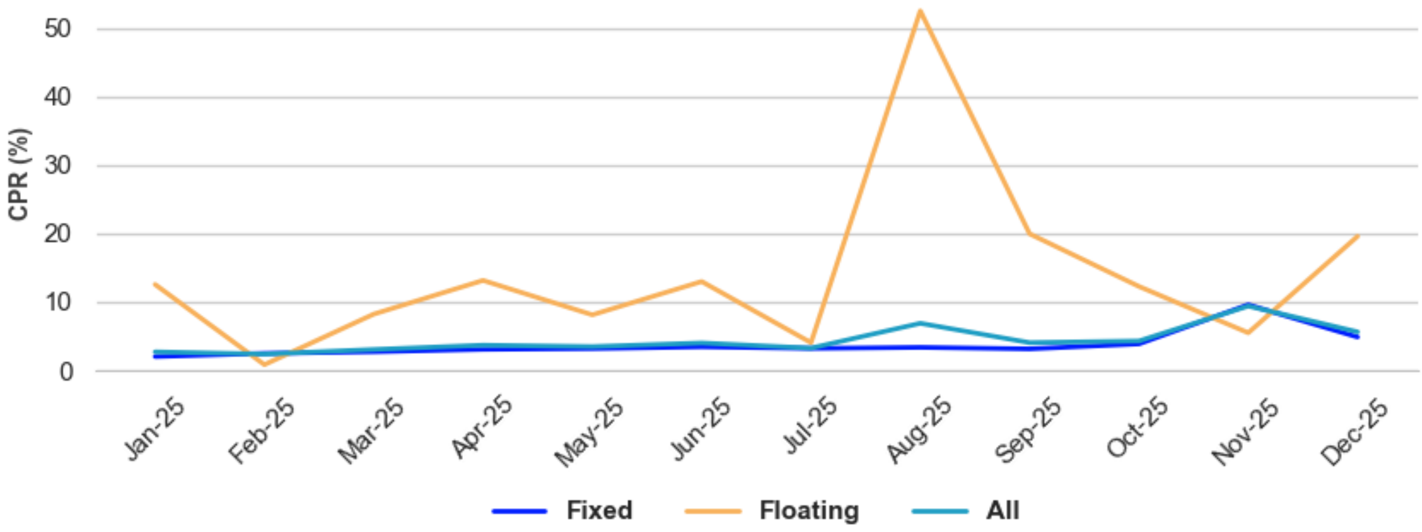
Prepayment speeds for fixed DUS loans (88% of total) remained subdued (3–6 CPR) with only a modest Aug bump, reflecting make-whole costs and limited rate incentive. Entering 2026, we expect fixed-rate DUS prepayments to remain firmly anchored in their recent 3–6 CPR range, thanks to the yield maintenance call protection.

The prepayment speeds for DUS floaters were extremely volatile, collapsing early-year and then spiking to 52 CPR in Aug, before easing into 20 CPR December, with the speed changes caused by cap expirations/resets, rising hedge costs, and lender-driven exits.

As we move into 2026, we expect DUS floater prepayments to stay volatile—averaging around 10 CPR—with intermittent spikes. The sharp churn observed in 2025 is likely to persist given ongoing business-plan completions and the sensitivity of floaters to financing-cost resets. Under more favorable rate conditions, CPR could firm up to the mid-teens, while in a stress environment, weaker DSCRs and higher hedge costs would push turnover toward the lower end of the range.

[9] GNPL prepayment speeds data is not available for December as of the time this report is published.

Exhibit 7 - 8: DUS Actual Prepay Speeds by Coupon Type

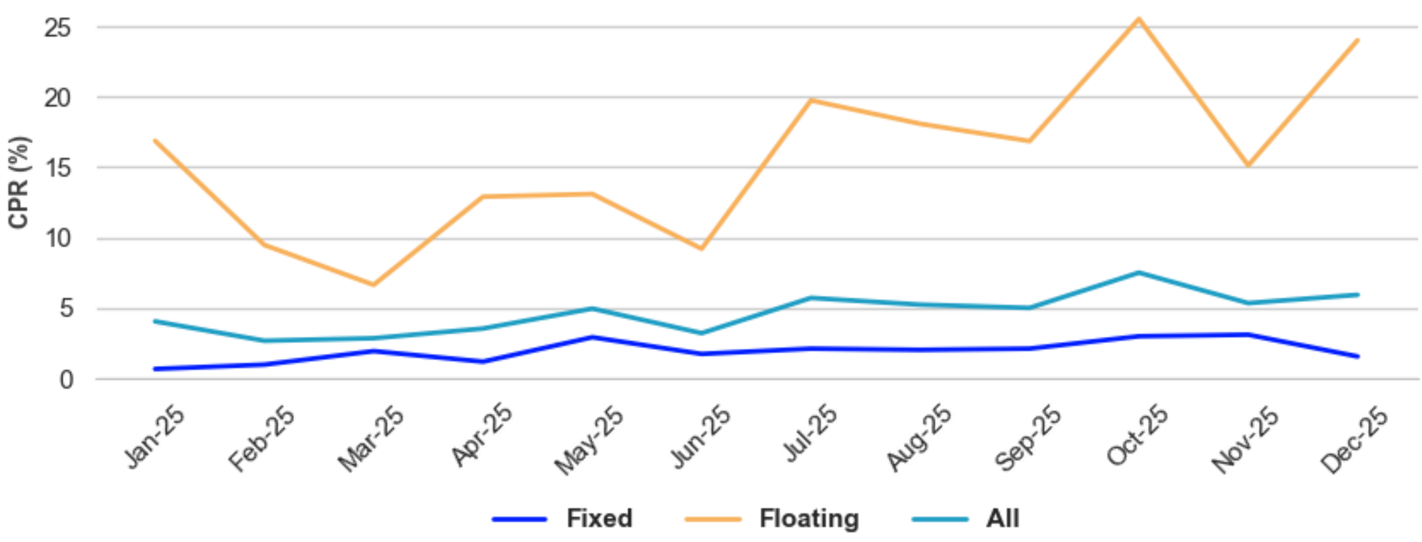


Source: FNMA, LSEG Yield Book (December 2025)

For Freddie K loans, 81% are paying a fixed rate with the rest paying a floating rate. The prepayment speeds for fixed rate K-loans stayed low (~2–4 CPR) due to strong call protection. On the other hand, the speeds for K floaters were elevated (roughly 15–20 CPR in Jun–Jul, ~25 CPR in Sep), thanks to the weaker call protection.

For 2026, we expect fixed-rate K-loan prepayments to stay very low (~2–4 CPR) given strong call protection, while floater speeds remain significantly higher due to weaker protections.

Exhibit 7 - 9: Freddie K Actual Prepay Speeds by Coupon Type



Source: FHLMC, LSEG Yield Book (December 2025)

Non-Agency CMBS - Overview and Macro Backdrops

The CMBS market achieved post-GFC record issuance in 2025 on improved liquidity and sentiment in CRE, despite mixed macroeconomic conditions. Inflation has cooled, but stayed well above the 2% target level. Tariff distress following Liberation Day largely faded throughout the remaining of the year, but the higher effective tariff rates are weighing on expenses. Financing costs remained elevated despite rate cuts. And softened labor market threatens to slow down economic growth and consumer spending. On the other hand, CRE fundamental has continued to recover, and the Fed easing cycle fueled market optimism and improved liquidity conditions across CRE and CMBS markets, resulting in higher transaction and lending activities.

While Fed delivered three rate cuts in 2025, it signaled only limited cuts ahead, leaving policy uncertainty going into 2026. Much of GDP growth this year was fueled by heavy AI infrastructure investment, but any significant slowdown in AI-related capital spending, or worse, an AI Capex bubble burst, could pose a major risk to growth in 2026. Consumer spending reflected a K-shaped pattern with lower-income consumers reeling from inflation. Overall, growth remains supported but vulnerable to labor market weakness and uneven consumer dynamics.

To frame the outlook for 2026, we anchor major CMBS themes to the expected rate path and broader economic conditions, with two key scenarios on focus: 1. A baseline scenario where the Federal Reserve delivers 1-2 additional rate cuts for the year and inflation continues to ease gradually with the labor market softening but remaining resilient; 2. A stress scenario of stagflation where labor market deterioration accelerates and unemployment climbs above 5% while inflation remains sticky or even rekindles, putting Fed in a conundrum.

Issuance

In review, 2025 non-Agency CMBS issuance continued the momentum of 2024 with total issuance volume (Conduit, SASB, CRE CLO combined) reaching $163.5 billion (42.6% higher than 2024's $114.5 billion), for a post-GFC record.

Rate cuts eased refinancing stress, particularly for floating-rate SASB loans, as rate cap costs dropped significantly from prior-year levels. Rate volatility also subsided compared to 2024, facilitating smoother loan closings and enhancing confidence among lenders and investors. Overall, the combination of disinflation, policy easing, and reduced volatility created a favorable environment for transaction activity and CMBS issuance throughout the year.

SASB securitization dominated the deal flows in 2025, with issuance climbing from 2024's $72.8 billion to $99.2 billion, driven by maturity refinancing volume and the financing flexibilities favored by institutional sponsors. CRE CLO issuance also surged, tripling year-over-year to $30.6 billion from $8.7 billion, on better collateral quality and capital market conditions. Meanwhile, conduit issuance only ticked up slightly from $32.9 billion to $33.7 billion, as conduit loan origination remained subdued and market participants increasingly preferred larger, more concentrated executions and floating-rate products over diversified fixed-rate conduit pools.

Other notable issuance themes include (1) shorter duration financing such as 5yr fixed-rate remained to be popular as borrowers seek flexibility amid uncertainty; (2) office lending saw rapid growth as the market became more comfortable with the sector fundamental, leading to significant higher exposure in CMBS deals (>20% vs. <10% in 2024).

Looking ahead to 2026, we expect continued Fed easing, albeit at a slower pace, and steady economic growth to provide a stable macro backdrop allowing continued expansion of CMBS market. We continue to see strong SASB lending momentum and a pickup in conduit and CRE CLO deal flow, with positive drivers including AI infrastructure and data center securitization.

We expect SASB deal flow to lead the volume again, supported by the same dynamics that drove issuance in 2025. Under our baseline scenario, SASB issuance is projected at approximately $110 billion, compared to $90 billion under the stress scenario.

Approximately $40 billion of conduit CMBS loans are scheduled to mature in 2026, and based on the realized refinancing success rate of about 70% for 2025 maturities, we estimate roughly $28 billion could be refinanced. Additionally, we anticipate a pickup of acquisition loans with up to $7 billion to be securitized through conduit CMBS, for a total of $35 billion in conduit CMBS issuance for 2026 (vs. $25 billion under the stress scenario).

CRE CLO issuance, which found a firm footing in 2025, is expected to carry the momentum into 2026 with strong support from CLO issuers. We forecast annual CRE CLO issuance to grow to $35 billion in the baseline case and to decline to $25 billion under the stress scenario.

Overall, we are forecasting $180 billion of total non-agency CMBS issuance for 2026 under the baseline scenario (10% higher YoY), vs. $136 billion total under the stress scenario (17% lower YoY). As we started to notice some early signs of easing of underwriting standards, collateral quality might slip with leverage ticking up in 2026 amid ample liquidity and rising competition in loan origination, which investors should watch out carefully.

Exhibit 7 - 10: Non-Agency CMBS Issuance Forecast

	2024 ($bn)	2025 ($bn)	2026 proj. ($bn) - baseline	2026 proj. ($bn) - stress
Conduit	32.9	33.7	35	26
SASB	72.8	99.2	110	85
CRE CLO	8.7	30.6	35	25
Total	114.6	163.5	180	136

Source: Trepp, LSEG Yield Book (December 2025)

CRE Fundamentals

In 2025, the CRE fundamentals continued the recovery post pandemic, though the recovery momentum has slowed down in rent and cashflow growth, with the top line hindered by supply pressure and bottom line eroded by rising expenses. Meanwhile, property valuations have finally stabilized after three-year slide since 3Q22 peak, signaling the worst is probably behind us, even though some credit metrics (such as delinquency and special servicing rates) still registered further deterioration YoY. It's worth noting that CRE fundamental recovery and credit performance remained highly uneven depending on the property type/class and geographic location, and this theme of differentiation may continue to unfold in 2026.

The U.S. office market in 2025 showed tentative signs of stabilization as vacancy rate started to decline recently. But it continued to face the structural challenges driven by remote work. While the sector overall might be bottoming out, it remained a bifurcated market with Class B and C properties struggling as tenants gravitated toward modern, amenity-rich Class A spaces. New office construction fell to its lowest level in over a decade, while conversions and demolitions surged, outpacing new completions and signaling a net reduction in office inventory. Adaptive reuse gained momentum as housing shortages fueled demand for office-to-residential conversions, though cost and complexity remain barriers.

Retail real estate once again demonstrated exceptional resilience amid a challenging macroeconomic environment. Supported by steady consumer spending and muted new supply, neighborhood and community shopping centers remained solid, while foot traffic at malls returned to—or exceeded—pre-pandemic levels. Investment activities were strong with retail transaction volume rising significantly as cap rates stabilized and even compressed on high-quality assets. That said, performance varied: necessity-based formats thrived, while lower-tier regional malls lagged and continued to grapple with underperforming occupancy and liquidity challenges. In addition, recovery momentum has slowed with rent growth normalizing, making the sector vulnerable to any weakness in consumer spending.

Multifamily faced mounting challenges in late 2025 as supply pressures weighed on fundamentals and a weakening labor market curbed tenant demand. Vacancy climbed to a record high and rent growth reversed course with effective rents dropping below prior-year levels amid increased competition among landlords offering concessions. That said, housing affordability remains a long-term tailwind for rentals, and investor sentiment remained resilient with confidence in the sector's relative stability compared to office and retail. However, elevated vacancy and pricing pressure suggest that fundamentals will remain under strain in 2026, particularly in oversupplied Sun Belt markets, while gateway cities with constrained development pipelines may stabilize sooner.

Hotel extended its post-pandemic recovery in 2025 with healthy RevPAR levels in general, but the K-shaped consumer sharply divided the market as upscale and luxury properties continued to outperform while low tier and economy hotels suffered falling occupancy from budget-wary travelers.

Industrial entered a normalization phase in 2025 with vacancy returning to historical norms as the surge of speculative development met cooling demand, driven by slower e-commerce growth and inventory rationalization. Rent growth decelerated with landlords offering concessions to maintain occupancy. Going forward, onshoring and surging data center demand may continue to drive the growth of the sector, though investors have been concerned about AI capex bubble and real estate residual value risks for data centers.

In 2025, the combined CMBS delinquency rate (conduit and SASB) rose to 6.61%, up from 5.87% at the end of 2024, driven primarily by a sharp increase in multifamily delinquencies, which climbed to 5.39% from 3.62%. The office sector showed signs of stabilization, with delinquency dropping by 25 bps. Lodging experienced a modest uptick, rising by 58 basis points, while retail posted a 37-bp decline.

We expect continued distress in the maturity pipeline next year to drive further, but limited, delinquency rate growth as rising resolution and issuance offset new delinquencies. Under our baseline scenario, we project CMBS delinquencies to reach approximately 7% overall (11% for office and 6% for multifamily), and under the stress scenario, about 9% overall (13% for office and 8% for multifamily).

CRE CLO delinquencies fell in 2025 to 4.69% from 6.12% year-end 2024 on the heels of deal calls and active management of issuers. As noted in the issuance section, CRE CLOs staged a strong rebound in 2025, supported by improved liquidity and market condition. We are forecasting 5% delinquency rate in baseline scenario as transitional multifamily fundamental stabilizes amid benign economic backdrop and 7% in stress scenario for CRE CLO in 2026.

Exhibit 7 - 11: Non-Agency CMBS 30 day+ Delinquency Rate Forecast

		Dec 2024	Dec 2025	2026 proj. - baseline	2026 proj. - stress
Conduit and SASB combined	Industrial	0.27%	0.72%	1%	2%
	Lodging	5.15%	5.73%	6%	8%
	Multifamily	3.62%	5.39%	6%	8%
	Office	10.61%	10.36%	11%	13%
	Retail	6.91%	6.54%	7%	9%
	Overall	5.87%	6.61%	7%	9%
CRE CLO		6.12%	4.69%	5%	7%

Source: Trepp, LSEG Yield Book (December 2025)

Maturity Performance and Loan Disposition

Despite a daunting maturity wall, CMBS loan maturity performance improved across sectors in 2025. Conduit CMBS loans maturing in 2025 achieved a 69.9% refinance success rate, up from 65.1% in 2024, while conduit office loans posted a 46.1% refinance rate versus 44.0% in 2024. SASB maturity performance also strengthened YoY, with a 12.0% refinance rate in 2025 compared to 7.9% in 2024 with SASB office loans at a 22.5% refinance rate (up from 15.0% in 2024). Meanwhile, CRE CLO maturity performance improved modestly, with a 28.2% refinance rate compared to 26.2% in 2024.

Looking ahead, we anticipate a more constructive refinancing environment under the baseline scenario, driven by lower interest rates and improving liquidity. Conduit loans should maintain steady performance, while SASB transactions are expected to benefit from lower rates and sponsors' continued engagement. CRE CLOs are likely to see further easing in maturity stress as sector optimism strengthens. Overall, maturity risk across CMBS should lessen as borrowers regain confidence and demonstrate greater willingness to inject capital when needed (i.e., cash-in refinance). Conversely, in a stress scenario marked by rate volatility or economic headwinds, financing conditions could tighten sharply, aggravating maturity default woes.

Exhibit 7 - 12: Non-Agency CMBS Maturity Performance

Deal Type/Year	2024			2025 YTD		
	paid off %	dlq %	extension %	paid off %	dlq %	extension %
Conduit	65.1%	22.4%	12.4%	69.9%	19.0%	11.1%
Conduit Office	44.0%	44.2%	11.8%	46.1%	37.6%	16.4%
SASB	7.9%	2.3%	89.7%	12.0%	3.5%	84.5%
SASB Office	15.0%	6.2%	78.8%	22.5%	5.7%	71.8%
CRE CLO	26.2%	7.5%	66.2%	28.2%	8.6%	63.2%

Source: Trepp, LSEG Yield Book (December 2025)

Liquidation activity accelerated in 2025, with average monthly disposition volume rising to $261 million from $216 million in 2024 and the average loss severity on CMBS loan dispositions declining slightly to 58% from 60% in 2024.

The disposition volume uptick reflected reality check that prompted many inevitable liquidations of fundamentally impaired assets, after years of "kick the can" sentiment in servicing. And we believe the trend is likely to pick up steam in 2026 with more transactions and distressed sales to happen as property valuation crystalizes and bid-ask spreads narrow. Special servicers are likely to become more discretionary in modifications and extensions as they scrutinize troubled loans.

We also expect loss severity to remain elevated as liquidation of the most troubled assets (especially some of office and retail properties which have seen property valuation plummeting 70-80% from underwriting) continues, which would serve to clarify bottom valuation levels and set the stage for a recovery in transaction activity and pricing. As the delinquency pipeline clears up, we expect loss severity to moderate gradually as we pass the trough of the cycle and property values start to rebound. However, we want to caution that the rebound magnitude might be fairly limited in 2026, on account of challenging NOI growth and elevated cap rates.

Exhibit 7 - 13: Non-Agency CMBS Loan Disposition

	2024	2025 YTD
Monthly Avg Disposition Volume ($mm)	216	261
Avg Loss Severity	60%	58%

Source: Trepp, LSEG Yield Book (December 2025)

Spreads and Investment Outlook

Conduit CMBS spreads ended 2025 with a mixed tone. While AAA super-senior spreads held near 80 bps—roughly unchanged from a year ago and near February tights—BBB- spreads widened materially to 452 bps from 400 bps at YE2024, signaling persistent tail risk concerns. The widening at the bottom of the stack suggests that while liquidity returned for senior bonds, risk appetite for subordinate tranches remained precarious.

Under the base scenario with Fed continuing easing cycle and rate volatility remaining subdued, we expect investor demand for CMBS securities to strengthen in spite of increased supply, as looser regulation fuels bank purchase. And we also expect to see credit curve flattering with lower part of the capital stack showing relative value. Conduit LCF AAA spreads should hold near current tights or compress slightly, reaching 80 bps for 5-year deals and 75 bps for 10-year deals. BBB- spreads could tighten from year-end 2025 levels to around 400 bps as investors start to discount the most draconian scenarios and become enticed by yield. On the other hand, if macro conditions deteriorate or rates back up unexpectedly, spreads could widen under stress scenario with AAA spreads moving out to 100 bps for 5-year deals and 90 bps for 10-year deals, and BBB- spreads blowing out to 600 bps.

Exhibit 7 - 14: Conduit CMBS New Issue Spreads Forecast

Year	LCF AAA spreads (bps)		BBB- spreads (bps)
	5-yr deals	10-yr deals	
2024 year-end	85	80	400
2025 year-end	83	79	452
2026 proj. (baseline)	80	75	400
2026 proj. (stress)	100	90	600

Source: Trepp, LSEG Yield Book (December 2025)

Looking ahead, our baseline assumption is that the macro outlook remains positive as the Fed continues its gradual easing cycle in 2026, supporting property market health and further spread compression at the top of the stack. However, we caution that any resurgence in inflation or severe labor market weakness could reignite volatility and widen spreads, particularly for subordinate bonds.

We believe 2026 is shaping up to be a year for credit transparency to emerge as the CRE fundamental finally bottoms out. We expect CMBS valuation to remain resilient and investment success in CMBS to hinge on asset selection and credit differentiation.

Conclusion

In a quick summary, we maintain a cautiously constructive outlook for CRE and CMBS markets in 2026 as inflation is expected to continue easing, and the Fed is likely to deliver measured additional rate cuts, supporting stable financing conditions. However, risks cannot be overlooked: a sharper labor market downturn, rate policy uncertainty amid sticky inflation, and potential cracks in AI-driven growth could derail the recovery and pressure CRE fundamentals. While the baseline scenario points to resilience, the stress scenario underscores the need for vigilance as macro volatility and tail risks could create turbulence for spreads and issuance.

Section 8 – CLO Outlook

Another Robust Year with Continued Credit Dispersion

Section Summary

- We have a constructive outlook for the CLO market in 2026. Further Fed easing, sustained investor demand, and stabilizing credit fundamentals provide a solid foundation for continued market growth.
- We forecast issuance to be down slightly from 2025's record levels but remain robust, spreads a touch wider, Caa% and default rate to trend down, and Junior OC and equity return to improve modestly.
- Credit dispersion will remain a key theme with risks concentrated in selected industries facing tariff-related pressure or AI disruption.

A Record Year in 2025

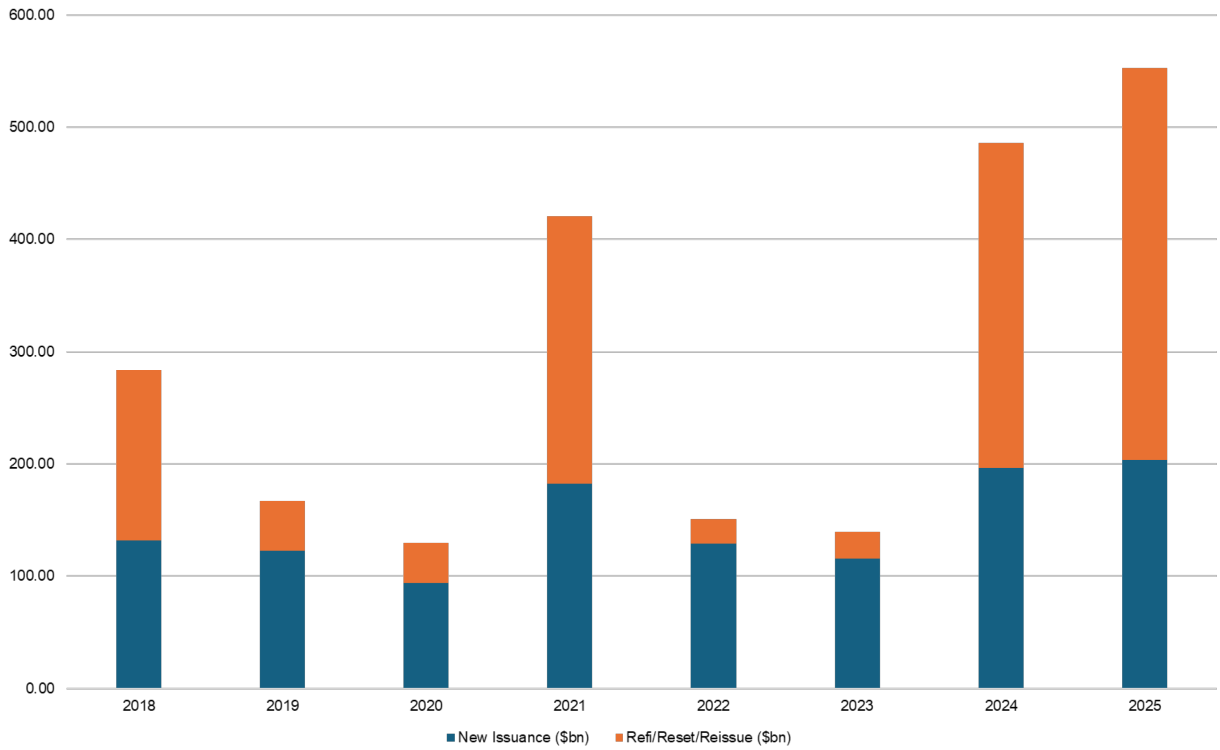
CLO market delivered another year of solid performance in 2025, marked by record new issuance and refinancing/reset volume despite tariff distress and a softening labor market. Spreads were near post-GFC tights amid strong investor sentiment driven by Fed rate cuts. Credit fundamentals were broadly stable with strong corporate earnings.

In our opinion, the CLO market in 2026 will be shaped by key macroeconomic themes, particularly around inflation, trajectory of policy rates, and employment conditions. We outline three scenarios for 2026: 1. Baseline scenario: Inflation remains steady or trends down and the Fed continues measured easing. 2. Optimistic scenario: Faster and more rate cuts with disflation accelerating and labor market staying resilient. 3. Stress scenario: Inflation rekindles and Fed pauses rate cuts or even starts to hike again.

Issuance to remain robust in 2026

CLO new issuance in 2025 was robust despite market volatility and challenging arbitrage. Following a strong start in first quarter, deal flows pulled back following Liberation Day tariff announcement in early April. Issuance decelerated in Q3 but managed to rebound in Q4 to finish a record year of $203.88bn, 4% higher than the 2024 level. The strong issuance was led by BSL CLOs (4.5% up YoY), while Private Credit (PC) CLO issuance (down 5.3% YoY) lagged amid investor caution around credit concerns. Meanwhile, total U.S. CLO refinance/reset posted a new record volume of $349.13bn in 2025, 21% higher than 2024 level, driven by the tight CLO liability spreads.

Exhibit 8 - 1: U.S. CLO Issuance



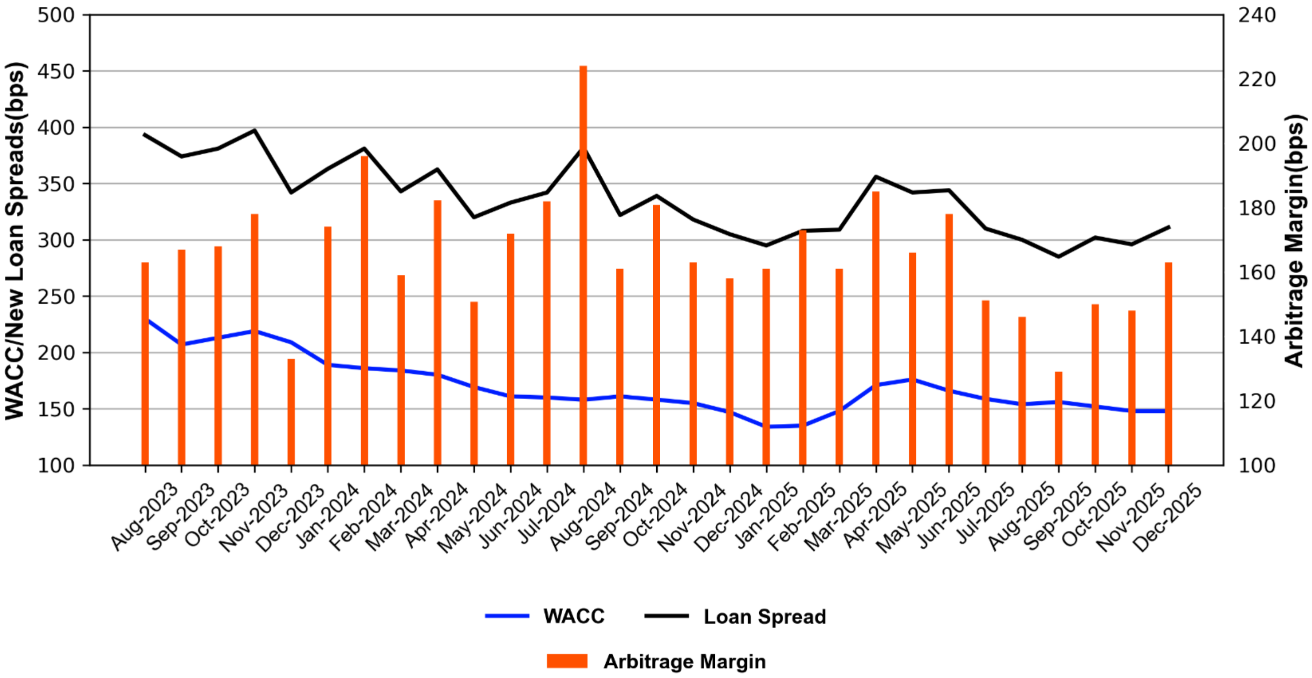
Source: Green Street, LSEG Yield Book (January 2026)

Supported by strong investor appetite and limited net supply, CLO liability spreads tightened meaningfully across much of 2025, with BSL AAA spreads ending the year around 124 bps and the WACC declining to around 150bps.

However, leveraged loan spreads tightened even more aggressively due to constrained new loan supply and high demand. This imbalance drove CLO arbitrage margins to multi-year lows in September, briefly threatening the economic viability of new issuance. The arbitrage margin rebounded later in the year but remained at low level.

The arbitrage margin averaged 159bps in 2025, 16bps lower than the 2024 average. With a pickup in M&A and LBO activities, we are seeing increased acquisitions and new loan supply, which might push loan spreads modestly wider. As CLO liability spreads hold in range bound, we would expect the arbitrage margin to improve.

Exhibit 8 - 2: CLO WACC, new loan spreads and CLO arbitrage margin (new issues)



Source: Green Street, LSEG Yield Book (January 2026)

As we move into 2026, we see major headwinds including elevated inflation and input costs and a weakening labor market which may slow economic growth and pressure leveraged loan credit fundamental. While we expect continued Fed easing, lower rates present a double-edged sword for floating-rate assets, likely reducing demand from investors for CLO assets (including CLO ETFs and insurance companies). On the bright side, a resurgence in M&A and LBO activities will boost leveraged loan supply, providing fresh collateral fuel for CLO issuance in 2026. Additionally, deregulation in financial market and the emerging clarity of the Basel Endgame rules may help free up capital reserves for large banks, amplifying demand for CLOs and supporting market spreads and issuance.

The PC CLO market navigated a few high-profile default events (such as First Brands) in 2025 with a modest decline in issuance YoY. But we remain positive on the sector's future due to resilient fundamentals and disciplined underwriting. Both borrower and investor demand are expected to grow in a benign credit backdrop, supporting healthy growth of PC CLO issuance.

Under our baseline scenario, we project a 4% decline in BSL issuance and an 8% pickup in PC issuance. For the BSL AAA spreads, we expect them to stay around 128bps over SOFR. The BB spreads will likely stay steady around 550bps, maintaining compelling relative value vs. other credit products. PC AAA spreads are expected to tick up to 149bps, with the basis vs. BSL AAAs to remain around 21bps.

In our optimistic scenario, we project a 10% increase in BSL issuance and 15% increase in PC CLO issuance in 2026. For new issue spreads, we would look for AAA spreads to tighten further from the current level to 118bps over SOFR, and BB spread to tighten to 500bps area. The PC AAA spreads may also tighten significantly to 136bps.

Conversely, in the stress scenario, we project a 20% drop in both BSL and PC issuance. We expect BSL AAA spreads to widen significantly to 145bps over SOFR, BB spreads to blow out to 650bps, and PC AAA spreads to widen to 175bps.

Exhibit 8 - 3: 2026 CLO Issuance Forecast

Year	BSL Issuance ($bn)	Private Credit Issuance ($bn)	Total ($bn)
Full Year 2023	86	26	112
Full Year 2024	154	37	191
Full Year 2025	161	35	196
Proj. 2026 (baseline)	154	38	192
Proj. 2026 (optimistic)	177	40	217
Proj. 2026 (stress)	129	28	157

Source: LSEG Yield Book, LSEG LPC (January 2026)

Exhibit 8 - 4: 2026 CLO New Issue Spreads Forecast

Year	BSL AAA spread (bps)	BSL BB spread (bps)	PC AAA spread (bps)
Year End 2025	124	535	145
Proj. 2026 (baseline)	128	550	149
Proj. 2026 (optimistic)	118	500	136
Proj. 2026 (stress)	145	650	180

Source: LSEG Yield Book, LSEG LPC (January 2026)

We see a growing wave of 2024 vintage deals exiting their non-call periods which will continue to drive refinancing and reset activity into 2026. The first half of the year is expected to remain particularly active, as many 1H24 transactions still carry relatively wide spreads, creating strong incentives for managers to refinance/reset. However, activity is likely to moderate in the second half of 2026 as the pool of high-cost candidate deals shrinks and refinancing/reset may become more opportunistic pending on market spreads movement.

Under our baseline scenario, we anticipate a modest decline in overall refinancing/reset volumes compared to the torrid pace seen in 2025, though activity level should remain healthy by historical standards. We see a total of $376bn of CLOs exiting reinvestment period by the end of 2026 with $285bn deal par in the money for refinance (with AAA spread greater than or equal to 133bps, 10bps higher than the current AAA spread level). Separately, there are $89bn of par amount with deal WACC greater than 157bps (10bps higher than the current WACC level and less than two years of reinvestment period left) prime for reset. In total, we see $338bn in par likely to get refinance/reset in 2026, a mere 3% drop from 2025's record level.

Exhibit 8 - 5: 2026 CLO Refinance/Reset Forecast

	Count	Par ($bn)	Par %
Outstanding US CLOs (YE 2025)	2259	911	100.0
Out of non-call by end of 2026	943	436	47.8
Refinance Candidate	622	285	31.3
Reset Candidate	196	89	9.8
Refinance/Reset Candidate	734	338	37.1

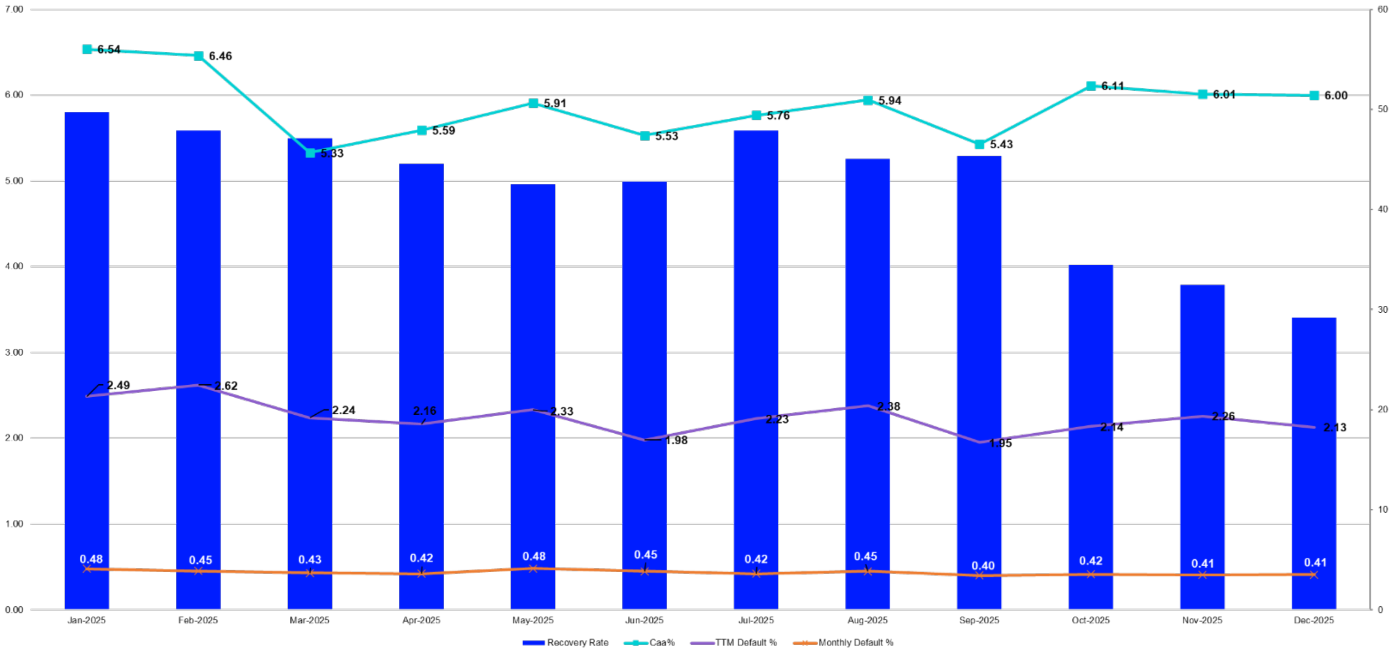
Source: Trepp, LSEG Yield Book (January 2026)

Stable credit fundamentals despite dispersion

CLO credit fundamentals were resilient in 2025 amid a benign economic backdrop and active manager trading. By year-end, key credit metrics including Caa/CCC exposure and default rates declined compared to beginning of the year, with credit weakness remaining isolated to some tariff-impacted sectors and idiosyncratic risks. On the other hand, recovery rates on defaulted loans (we use market prices for defaulted names as a proxy) declined sharply in the second half of 2025, driven primarily by increased liability management exercises (LMEs). We would note that manager tiering is in full display through LMEs as larger managers are often able to participate in debt restructuring and realize higher recovery, while smaller managers are left out.

For PC CLOs, despite several credit headlines raising concerns about direct-lending, investors generally view these developments as idiosyncratic events and remained confident on the quality of private credit loans.

Exhibit 8 - 6: Key credit metrics remained stable in the last 12 months



Source: Trepp, LSEG Yield Book (January 2026)

Recent collateral performance by industry shows Wholesale, Services, and Healthcare leading in Caa-rated exposure, while Chemicals, Wholesale, and General Manufacturing report the highest default rates. From a tail-risk perspective, Wholesale carries the largest concentration of assets priced below 80, followed by Chemicals and Business Services.

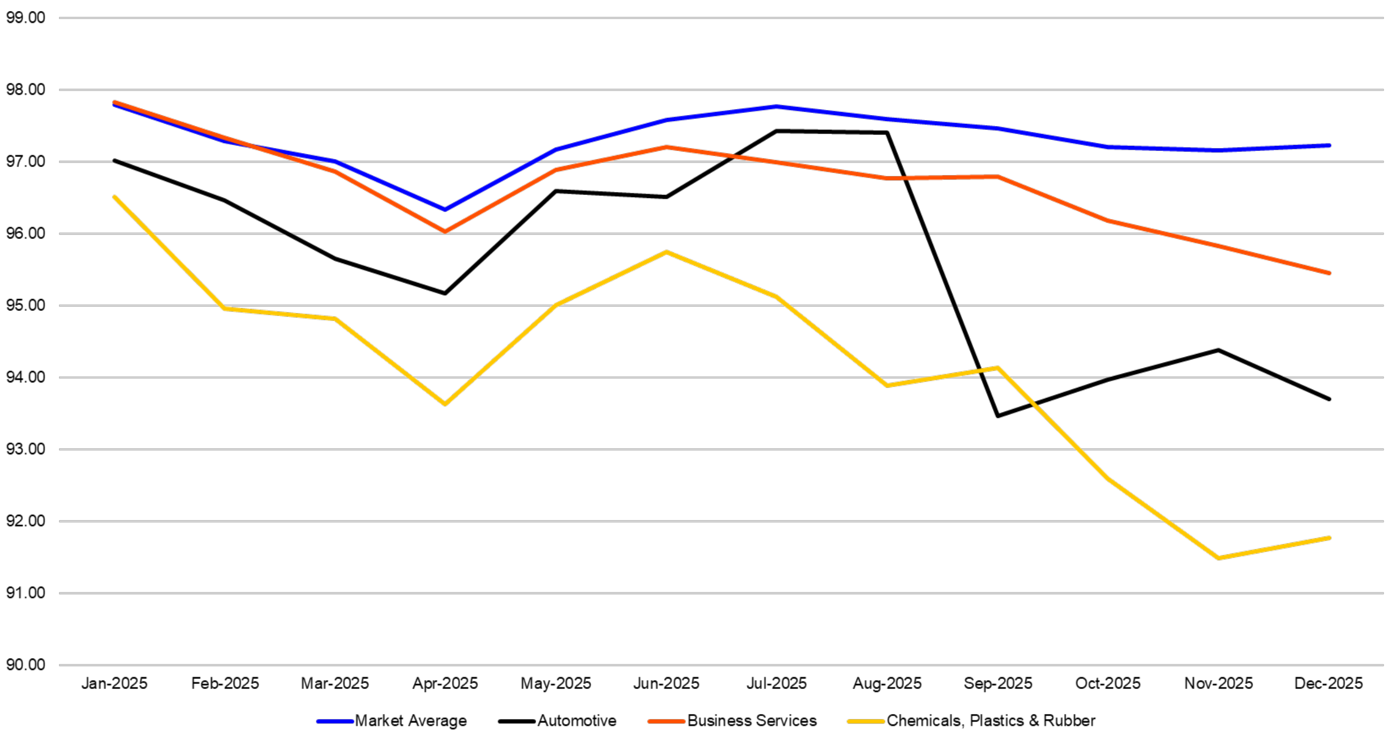
Exhibit 8 - 7: BSL CLO collateral performance of the top 10 industries by CLO exposure

Industry	CLO Exposure (%)	Caa or below (%)	Defaulted (%)	Price<80 (%)
Financial Services	14.13	1.56	0.01	3.17
Technology	13.94	4.87	0.28	2.81
Business Services	8.19	6.32	0.04	5.84
Healthcare	7.74	8.54	0.38	4.18
Services	6.03	13.25	0.13	5.73
General Manufacturing	6.01	4.71	0.51	3.77
Leisure and Entertainment	3.73	2.37	0.10	1.09
Chemicals, Plastics & Rubber	3.47	6.44	1.85	9.80
Wholesale	3.44	13.94	0.82	11.01
Utilities	3.37	3.19	0.09	4.17
Overall Market Average		6.01	0.41	4.30

Source: LSEG Yield Book, LSEG LPC (January 2026)

By examining the loan price movements in 2025, we found the Chemicals and Automotive sectors continued to face mounting pressure from tariffs and trade frictions, while Business Services also underperformed due to growing AI disruption (impacting education technology, call services, outsourcing, etc.), a theme which may continue to unfold in 2026.

Exhibit 8 - 8: Weighted average price for tariff/AI impacted sectors vs. overall market in 2025



Source: LSEG Yield Book, LSEG LPC (January 2026)

For 2026, we see Fed continues measured easing, which would ease debt service stress and improve coverage ratio for issuers, and we expect CLO loan default rate to trend lower with benign financing conditions. However, we are mindful of the risks of elevated inflation, weakening labor market, and AI CAPEX bubble bursting. Additionally, delayed tariff impacts could weigh heavily on Chemicals, Automotive, and Wholesale, increasing downgrade and default risk in those sectors. Another credit headwind is potential underwriting quality deterioration amid competition for new loan issuance which could drive less covenants, higher leverage, and growing prevalence of PIK, aggravating concern of transparency and structural risk in new origination loans.

Under our baseline scenario, CLO asset credit fundamentals are expected to remain steady in 2026 with the proportion of Caa or lower-rated assets to decline toward 5.50% (vs. 6.00% at YE2025) and the Trailing 12-month (TTM) default rates down to 2.00% (vs. 2.13% at YE2025).

Under the optimistic scenario, we see corporate fundamentals to strengthen on earnings growth with Caa share falling to 4.75% TTM defaults down to 1.75%, compared to 7.00% Caa and 3.00% TTM default rates under our stress scenario.

Exhibit 8 - 9: 2026 Forecast of Caa% and Default Rate

	Caa%	TTM Default %
YE 2024 level	6.23%	2.27%
YE 2025 level	6.00%	2.13%
Proj. 2026 (baseline)	5.50%	2.00%
Proj. 2026 (optimistic)	4.50%	1.75%
Proj. 2026 (stress)	7.00%	3.00%

Source: Trepp, LSEG Yield Book (January 2026)

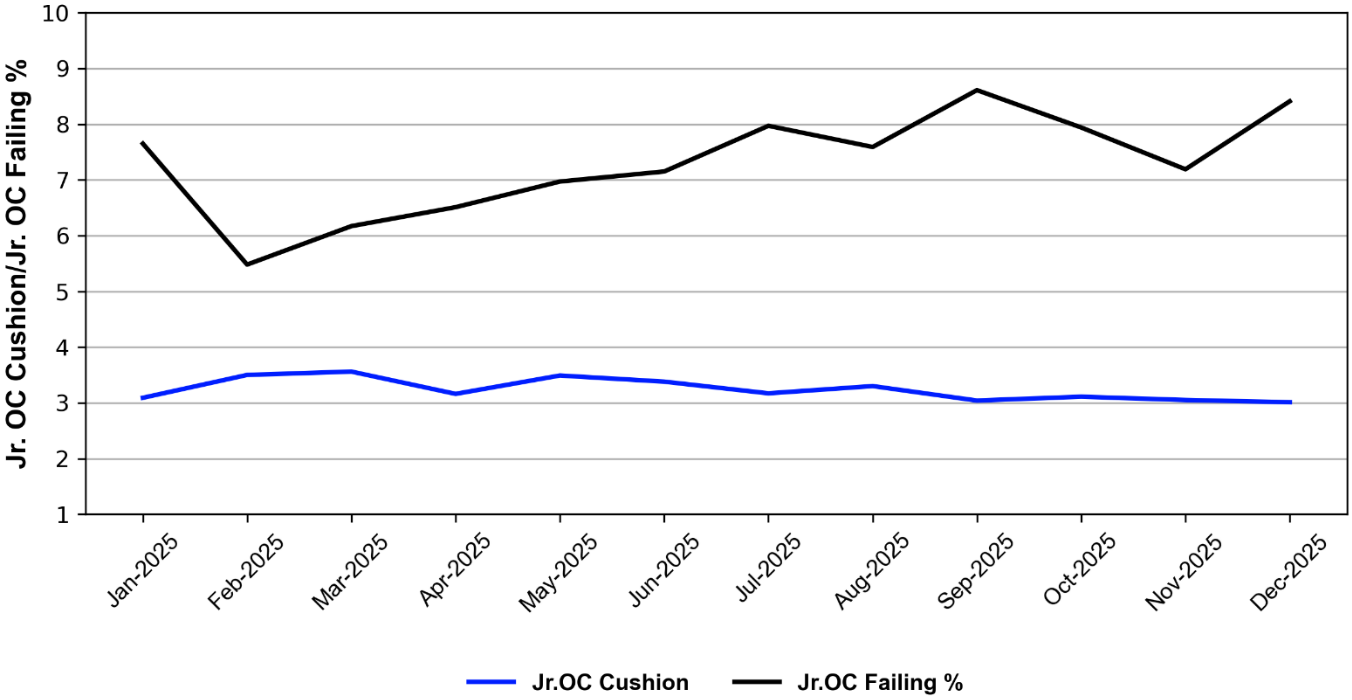
CLO Performance to remain resilient

In 2025, CLO managers remained active in portfolio management in face of elevated downgrade and default levels and limited trading opportunities, though their performance lagged in terms of par build and equity returns.

CLO structural protection remained solid with the Junior OC cushions holding in around 3%, while Junior OC test failing rates ticked up modestly to end the year at 8.41%.

Looking ahead, the combination of lower funding costs, steady credit fundamentals, and active portfolio management should create a more favorable backdrop for CLO structures in 2026. We expect the pace of asset downgrades to slow down, which would help stabilize OC metrics and reduce pressure on compliance tests. Under our baseline scenario, Junior OC cushions are projected to improve slightly from current levels to around 3.25%, supported by healthy collateral performance and lower tail-risk exposure. Under our optimistic scenario, upgrades and improved collateral performance may boost Junior OC cushions to 3.50%. Conversely under our stress scenario, Junior OC cushions could compress further to 2.75%, reflecting heightened collateral risk and rising downgrades.

Exhibit 8 - 10: Market average Junior OC cushion and Junior OC test failing rate



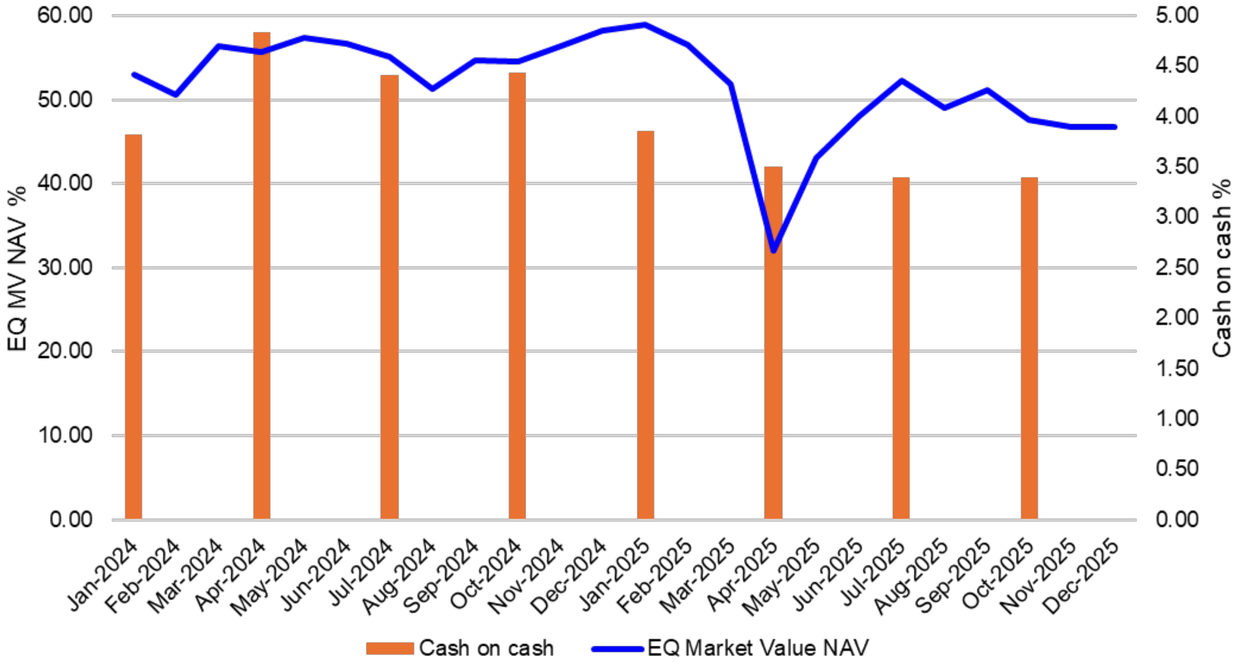
Source: Trepp, LSEG Yield Book (January 2026)

One of the biggest challenges managers faced in 2025 was building par, in face of limited loan supply, shrinking original issue discounts (OIDs), and sharp price selloff in distressed loans. As a result, cumulative par build averaged -0.4%, on par with 2024. With credit quality improving and OID recovering amid loan supply growth, par build is expected to rebound, restoring structural flexibility and supporting reinvestment opportunities as we move into 2026.

Equity performance also softened notably in 2025 as the wave of loan refinancing and repricing compressed spread margins beyond what tranche refinancings and resets could offset. For the BSL deals within RP, equity cash-on-cash returns totalled 14.16%, down notably from 17.50% in 2024. At the same time, equity NAV declined with falling loan prices, dropping to 47.74% in December, compared to 58.29% a year ago.

With excess spreads remaining compressed, cash-on-cash ratios are expected to stay under pressure around 14.5% in 2026, a touch above 2025 levels in our baseline scenario. In our optimistic scenario, falling default and downgrade rates could lift returns to around 15.5%. Under the stress scenario, economic weakness may widen loan spreads and boost excess interest, but higher downgrades and defaults would offset these gains, leaving cash-on-cash returns at roughly 14.5%, on par with the baseline scenario projection.

Exhibit 8 - 11: CLO Equity market value NAV and Cash-on-Cash Return



Source: Trepp, LSEG Yield Book (January 2026)

Exhibit 8 - 12: 2026 CLO Junior OC Cushion and Equity Cash-on-Cash Forecast

	Junior OC Cushion	Equity Cash on Cash
December 2024	3.18%	17.50%
December 2025	3.01%	14.16%
Proj. 2026 (baseline)	3.25%	14.50%
Proj. 2026 (optimistic)	3.50%	15.50%
Proj. 2026 (stress)	2.75%	14.50%

Source: Trepp, LSEG Yield Book (January 2026)

European CLO market to deliver another strong year

The European CLO market delivered a strong year in 2025 with robust issuance and investor demand. New issue volume totalled €62.21bn in 2025 (29% higher than 2024), with AAA spreads holding largely steady around 131 bps. Credit performance remained solid, with relatively low Caa/CCC exposure, minimal defaults, and stronger OC cushions compared to US peers, though liquidity and diversification risks remain more pronounced than those in the US market.

Looking ahead to 2026, issuance is expected to stay strong, driven by steady credit fundamental and rising investor demand. Competitive dynamics is likely to propel further issuance growth as new entrants (including seasoned U.S. managers) expand their footprint in the European market. On the other hand, disadvantages of European CLOs include slower economic growth (e.g., conservative AI-related investment) and limited easing prospect compared to the US.

In our baseline scenario, we anticipate an increase in new issuance to €70bn with AAA spread staying roughly unchanged at 130bps, vs. new issuance volume of €80bn with AAA spreads tightening to 125bps in our optimistic scenario, and €45 billion and 145bps respectively in our stress scenario.

Exhibit 8 - 13: 2026 European CLO Issuance Forecast

Year	New Issuance (€bn)	AAA spreads (bps)
2023	26	173
2024	48	127
2025	62	131
Proj. 2026 (baseline)	70	130
Proj. 2026 (optimistic)	80	125
Proj. 2026 (stress)	45	145

Source: LSEG Yield Book (January 2026)

Conclusion

Overall, we have a constructive outlook for the CLO market in 2026. Further Fed easing, sustained investor demand, and stabilizing credit fundamentals provide a solid foundation for continued market growth. Meanwhile, default and downgrade activities are expected to continue, albeit at a more moderate pace compared to recent years. Credit dispersion will remain a key theme with risks concentrated in selected industries facing tariff-related pressure or AI disruption, particularly among issuers with weaker balance sheets and elevated leverage. As such, asset analysis and manager selection remain critical for CLO investment with focus on tail risk mitigation.

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