MARKET COMMENTARY

January 2026

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Global Outlook[1]

In December 2025, global equities, measured in local currency, continued to generate positive gains, led by South Korea (7.3%), Taiwan (4.8%), and Malaysia (4.7%), while Hong Kong SAR lagged. The global bond market, as represented by the Bloomberg Global Aggregate Index, gained 0.3%.

Asia Pacific ex-Japan equities are expected to do well in 2026, supported by easy monetary conditions, higher earnings growth (+16% in 2026 vs +10% in 2025), attractive valuations, further improvement in governance and shareholder returns, and healthier fiscal balance sheets.

With trade tensions abating, this helps China, Korea and Taiwan regain their footing in the global tech race. The emergence of globally competitive tech firms in AI, internet-platform tech, smart manufacturing, and robotics is key for the economy to grow and drive productivity improvements. Within Asia, we prefer equities to bonds on a 12-month view. Asia's EPS is seeing upward revisions and fund flows have been positive.

Global Outlook of the two capital markets: Fixed Income & Equities

Region: Developed economies

Fixed Income

- Our view: **Positive**.
- The Fed executed its third policy rate cut of 25 basis points (to 3.5%–3.75%) at its December meeting. Based on the minutes from that session, there is a division regarding the pace and timing of further cuts due to economic uncertainties.[2]
- The BoJ raised rates to a 30-year high of 0.75%, signalling further hikes and spiking bond yields. The ECB held rates steady as inflation neared its 2% target, while the BoE cut its rate by 25 bps to 3.75% due to easing inflation and economic strain.[2]

Equities

- Our view: **Positive.**
- In Dec 2025, composite PMI data showed that private sector activity in the US, Eurozone, and Japan remained expansionary (above 50.0), but momentum cooled across all three regions. The US hit an eight-month low of 52.7 amid slowing new orders and rising cost pressures. The Eurozone composite fell to a three-month low of 51.5, driven by slowing service growth and ongoing manufacturing contraction. Japan saw activity ease to a seven-month low of 51.1, though this was supported by stabilizing factory output and robust job creation.[2]

Region: Regional (Asia-Pacific ex-Japan)

Fixed Income

- Our view: **Positive.**
- Asian bonds performed positively overall, driven by declining U.S. Treasury yields and a softer U.S. dollar, which improved foreign investor sentiment. All Asian dollar bond markets saw gains for the month.[3]
- We expect investment-grade Asian bonds to provide a gross yield of 4.00% to 4.50% in 2026. This will likely allow Asian central banks more flexibility to ease monetary policies. [3]

Equities

- Our view: **Positive.**
- In Dec 2025, composite PMI data across key Asian economies indicated continued expansion, albeit with diverging trends. China showed a recovery as its official PMI rose to a six-month high of 50.7, driven by a rebound in manufacturing and domestic demand.
- Across the ASEAN region, business activity remained resilient, closing out the year with its strongest quarterly performance in four years despite slight year-end moderation.[1]

Region: China

Fixed Income

- Our view: **Neutral**.
- In Nov 2025, China's new yuan loans increased to CNY 390 bn, still below market expectations and indicating weak household credit demand, while Total Social Financing reached CNY 2.49 tn, exceeding forecasts due to government bond issuance.
- As of Sept 2025, the non-performing loan ratio for China's commercial banks remained stable at approximately 1.5%, though the balance of NPLs rose and risks from property and retail lending persist. [4]

Equities

- Our view: **Neutral**.
- China's December PMI beat expectations, finishing the year above 50. Despite tariffs, net exports remained strong, with the 11-month trade surplus exceeding US$1 trillion. However, domestic consumption stayed weak and deflationary pressures lingered. At year-end, the government announced consumer durable trade-in subsidies and relaxed property restrictions in Beijing, signaling continued targeted economic support.[4]

Region: Domestic (Malaysia)

Fixed Income

- Our view: **Positive**.
- Malaysian bonds saw renewed net foreign inflows in late 2025, reversing earlier outflows, supported by stable fundamentals and a firmer ringgit, which is increasingly viewed as a high-quality carry currency and, together with Malaysia’s strong credit profile, is likely to sustain foreign demand into 2026. [5]

Equities

- Our view: **Positive**.
- Malaysia's Dec 2025 manufacturing PMI held at 50.1, indicating expansion for a second month. The key highlight was a 7-year high in employment growth. This suggests strong 4Q25 GDP growth, following 3Q25's robust 5.2% expansion. The OPR is expected to remain unchanged after the July cut, as inflation ticked up slightly to 1.4% in Nov.[5]

Investment Implication:[6]

- While the recent geopolitical tensions between the U.S. and Venezuela have caused some concern, the financial market impact is expected to remain largely contained, as Venezuelan assets represent an insignificant weight in the emerging market equity and bond indices. We expect the focus of investors to remain on fundamentals.

- The market in 2026 is projected to continue its positive performance, driven by optimism in abundant liquidity, stable macroeconomics, and the ongoing growth in digital transformation. Investors are advised to adhere to long-term principles—using diversification and a phased-in strategy—to manage timing risk, reduce emotion, and benefit from market fluctuations. Our strategy focuses on quality growth companies with domestic earnings, supplemented by quality bonds for portfolio stability during uncertainty.

- **Global Equity:** We maintained a neutral allocation across regions, remained underweight cash, and held off-benchmark exposures, including Asia, Gold, and Copper ETFs. US equities will be supported by solid earnings growth and expectations of Fed rate cuts. That said, valuation is becoming stretched and will need to be supported by continued earnings growth in 2026. We have neutralized both US and European exposures, while remaining cautious on valuation risks, particularly among expensive US technology names. While we are constructive on Japan because of the positive economic impact from PM Takaichi's fiscal stimulus, Japan's positioning is neutral because we deployed into preferred off-benchmark opportunities (Asia, Gold and Copper ETFs).

- **Asia ex Japan Equity:** Asian equities should do well in 2026, supported by easy monetary conditions, earnings growth, and further improvement in governance and shareholder returns policies. The portfolio focuses on companies demonstrating market leadership, durable competitive advantages, strong free cash flow generation, and improving capital management. We remain constructive on financials, industrials, alongside technology leaders in internet platforms and semiconductors.

- **Malaysian Equity:** In this early part of the year, the focus is on portfolio clean-up, realizing losses, and rebalancing. The intention is to maintain a high asset allocation and portfolio beta with continued focus on quality domestic earnings exposure in sectors like Construction, Utilities, and Consumer—beneficiaries of cash handouts, Visit Malaysia Year 2026 (VMY26), and a strengthening Ringgit (MYR). The portfolio is also positioned in the Technology thematic and AI value chain. Key risks include unexpected downside to Malaysia's economic momentum, increased volatility from tariff uncertainty, and geopolitical events.

- **Malaysia Fixed Income:** We expect BNM to keep the OPR unchanged in the near term, supported by a stronger ringgit and contained inflationary pressures. While a rate cut is not our base case, we do not rule out a pre-emptive easing later in the year should growth momentum soften. Asset allocation continues to favor corporate bonds, where carry remains attractive relative to government securities. We maintain a preference for high-quality, domestically oriented credits, as these issues are better insulated from potential external risks, including evolving tariff dynamics and global trade uncertainty. Primary market opportunities remain a key focus, particularly where new issues offer incremental yield pick-up over the secondary market. In the government bond space, movements are expected to be largely driven by external factors, including US rate developments and global risk sentiment. With government bond spreads to OPR already nearing five-year lows, we see limited near-term downside and remain cautious amid the prospect of increased government bond supply. As such, we will take profit on government bond rallies, while selectively participating in government securities for trading opportunities, supported by improved sentiment from a firmer ringgit. Overall, we maintain a neutral to modestly overweight duration stance, balancing carry accumulation with active trading opportunities, while remaining disciplined amid valuation constraints and supply considerations.

Special Topic [6]

AI cycle vs Dotcom bubble

- The launch of ChatGPT in late 2022 ignited widespread excitement around AI and an arms race among the mega cap technology companies. Over the past 3 years, the Magnificent 7 (Mag 7) have seen their stock prices more than double collectively as of Dec 25, outperforming the broader Nasdaq by a wide margin.
- The Mag 7 now represent 32% of S&P500 as of end December. This dominance by a few stocks in the index was last seen during the dotcom era (1999-2000).
- Some observations of this AI cycle vs the dotcom era:
  - Market gains are far smaller than the dot-com bubble peak
  - Valuations are elevated, but not as high as during the dotcom
  - Fundamentals are stronger than in the dotcom era. AI leaders are generally profitable and FCF positive
  - There are however some signs of bubble forming

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Dot-com vs AI cycle

The AI market currently differs from the dot-com bubble in several important ways

How the AI cycle compares to the Dot-com bubble

Category	Dot-com (1995–2000)	AI Cycle (2022–present)
Technological maturity	Low	High
Core winners	Mostly undefined	Already concentrated (MSFT, NVDA, GOOG, AMZN)
Revenue reality	Weak	Strong at top of stack
Adoption	Slow internet rollout	Adoption rate is fast and broad
Bubble locus	Consumer startups	Infrastructure capex + some application hype
Long-term impact	Massive (but delayed)	Likely massive, but path depends on enterprise ROI

Source: Principal Asset Management, Dec 2025

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Investment Conclusions

- **AI represents a transformational tech with long-term economic impact**. However, the speed and scale of improvement means it is incredibly difficult to forecast demand for AI. Use cases today may not have anything to do with use cases tomorrow because AI may be able to do 100x what it does today. Hence it is not possible to conclude that markets are behaving irrationally.

- **Bubble risk is real**, but getting the timing right is harder than knowing a bubble will eventually form. Exiting too early can be as costly as staying too long.

- It remains unclear where sustainable AI profits ultimately accrue with the competitive hierarchy still evolving. This reinforces the need for selectivity, as **winners may rotate over time**. If a key player fails to monetize, it can trigger cascading stress along the entire AI infrastructure chain. The best approach is to be **appropriately diversified** and maintain **a moderate position** at this juncture. Chinese and US tech exposure are likely to move in different cycle.

- Beneficiaries include:
  - AI enablers : Platform/Hyperscalers, Model providers, Chipmakers, Infrastructure and Power
  - AI adopters : Platform/Hyperscalers**,** Non-tech (Financials, Healthcare, Defense, Mining, Retail)

- **Warning Signs to look out for :**
  - Deteriorating free cash flow at Hyperscalers or key AI players
  - Rising leverage and/or the emergence of circular financing
  - Higher Capex announcement is met with lower share price

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Sources:

1 Bloomberg, 31 December 2025
2 Federal Reserve Board, BOJ, European Central Bank, 31 December 2025
3 JP Morgan Research, Bloomberg, 31 December 2025
4 National Bureau of Statistics of China, 31 December 2025
5 BNM, Bloomberg, 31 December 2025
6 Principal, 31 December 2025

Glossary of Terms

UW: *Underweight*
OW: *Overweight*
MoM: *Month-over-Month*
YoY: *Year-over-Year*
FOMC: *Federal Open Market Committee*
ECB: *European Central Bank*
UST: *United States Treasury*
PMI: *Purchasing Managers Index*
SoE: State-Owned Enterprise
SEZ: Special Economic Zone
BNM: *Bank Negara Malaysia*
MPC: Monetary Policy Committee

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