

Global Asset Allocation Viewpoints: Europe

The Fed lifts off as AI borrowing builds

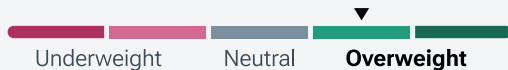
October 2026



How we're positioned

▼ = this month. ▽ = last month (not shown if positioning is unchanged).

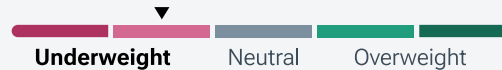
Equities



Earnings support a modest overweight

- Resilient economic growth and strong earnings, with expectations still high, support equities.
- Artificial intelligence (AI) investment is now benefiting companies well beyond US large-cap growth.
- Conflict-driven energy prices, inflation, and higher rates pose a bigger risk than any slowdown in AI demand.
- Elevated valuations argue for a measured approach.

Bonds



Short duration as long-term yields rise

- The underweight is concentrated in European government bonds and US high-quality bonds, as resilient growth, fiscal funding needs, and inflation risks keep upward pressure on long-term yields.
- We moved to neutral on global high yield, which offers healthy fundamentals and shorter duration but with tight spreads, and maintain the overweight on emerging market local currency bonds.

Cash



Staying flexible in volatile markets

- Cash yields remain reasonably attractive, but we moved to neutral on cash to fund an increased overweight to equities and reduction in the underweight to fixed income.

Key themes

Easing off the accelerator

The first rate hike from the Federal Reserve (Fed) is best seen as a partial reversal of last year's insurance cuts. Capital spending and demand remain firm, suggesting growth should remain resilient—levelling off rather than rolling over. Financial conditions remain accommodative, meaning businesses and households can still access capital. In other words, the Fed is easing off the accelerator, rather than slamming on the brakes. Inflation will decide how much further it needs to go, and policymakers appear to be placing more weight on how broad and persistent it is. If price pressures fail to cool while growth stays strong, further hikes become more likely, reinforcing the case for short duration.

A few hikes alongside resilient growth could be absorbed relatively well. A longer cycle driven by stubborn inflation would challenge both duration and risk assets.

Financing the build-out

The AI investment cycle is entering a more capital-intensive phase, and hyperscaler balance sheets are no longer the whole story. Corporate bonds, data centre financing, and chip-backed structures are forming a distinct AI credit ecosystem, with AI-related hyperscaler and infrastructure bonds rising from about 5.4% of the US investment grade corporate benchmark at the end of 2025 to now 8.3%.¹ Enterprise adoption is moving towards scaled production, even as regulation and safety draw more scrutiny. Continued investment and adoption support our overweight to US growth stocks. While the risk of higher yields remains the main driver of our underweight on US Aggregate bonds, heavy AI-related issuance adds a technical headwind for investment grade bonds.

The same AI cycle can support corporate earnings while requiring enough new capital to create a tougher technical backdrop for investment grade bonds.

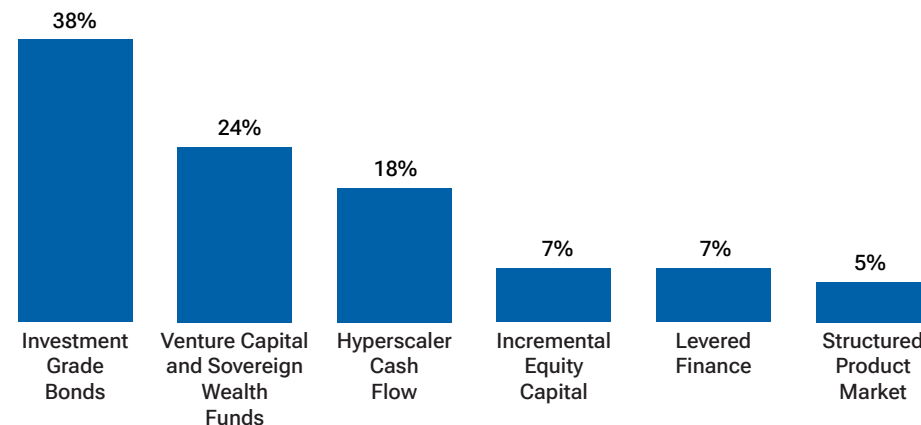
¹ Source: T. Rowe Price analysis, as of September 9, 2026.

(Fig. 1) Financial conditions are still accommodative



As of September 14, 2026.
Chicago Fed Adjusted National Financial Conditions Index, month-end readings of weekly data.
Source: Federal Reserve Bank of Chicago. See Additional Disclosures for more information.

(Fig. 2) Investment grade bonds are expected to fund the largest share



Shares of an estimated USD 5.5 trillion in cumulative funding needed for AI and data center investment by source, 2026 to 2030.

There is no guarantee that any forecast made will come to pass.

Source: J.P. Morgan Chase. See Additional Disclosures for more information.

Equities: Regions

▼ = this month. ▽ = last month (not shown if positioning is unchanged).

Region	Positioning	Rationale
US	 Underweight Neutral Overweight	Strong earnings and AI-related investment support US equities. Cheaper valuations and fiscal support abroad are offset by higher energy prices and tighter monetary policy outside the US.
Europe ex-UK	 Underweight Neutral Overweight	Fiscal expansion and improving manufacturing support the outlook, but modest growth, higher energy costs and tighter monetary policy continue to constrain the upside.
UK	 Underweight Neutral Overweight	Attractive valuations and healthy earnings remain supportive, while fiscal concerns, inflation, and policy uncertainty ahead of the forthcoming Budget continue to weigh on sentiment.
Japan	 Underweight Neutral Overweight	Fiscal stimulus, real wage growth, and improving corporate earnings have kept the economy resilient, but tighter monetary policy and rising government debt may present challenges.
Australia	 Underweight Neutral Overweight	Commodity exposure and a resilient banking sector offer some support, but weak relative earnings growth, rich valuations, and rate hikes into a softening housing market weigh on the broader market.
Emerging Markets (EM)	 Underweight Neutral Overweight	Attractive relative valuations and AI infrastructure beneficiaries support the outlook. Technology cyclicality and higher oil prices for energy-importing economies remain the key risks.
China	 Underweight Neutral Overweight	Policy support and anti-involution efforts may aid margins, but housing weakness and soft demand keep gains uneven.

Equities: Styles and Market Cap

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Style and Market Cap	Positioning	Rationale
Global Growth vs. Value	A horizontal bar divided into three sections: Underweight (red), Neutral (grey), and Overweight (green). The bar is currently positioned in the Overweight section. A dashed arrow points from the Neutral section to the Overweight section, with a ▽ symbol above it. A solid arrow points from the Overweight section to the right, with a ▼ symbol above it.	For growth, earnings growth is exceptional, supported by continued AI investment and adoption. Improved relative valuations are supportive, though elevated expectations and questions around the returns on AI capital expenditure remain risks. For value, broadening earnings and cyclical strength remain supportive, including some beneficiaries of AI investment. However, valuations have become less compelling.
Global Small-vs. Large-Cap	A horizontal bar divided into three sections: Underweight (red), Neutral (grey), and Overweight (green). The bar is currently positioned in the Overweight section. A solid arrow points from the Overweight section to the right, with a ▼ symbol above it.	For small-caps, broadening growth, fair valuations and capital-markets activity remain supportive. Higher rates remain the key risk for smaller, more leveraged companies. For large-caps, fundamentals remain very strong and are broadening outside mega-cap leaders, but elevated valuations and expectations leave less room for disappointment.

Bonds: Regions and Sectors

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Regions and Sectors	Positioning	Rationale
Euro Government Bonds	Underweight Neutral Overweight	France's fiscal strains mean the European Central Bank (ECB) can no longer raise rates freely while it shrinks its balance sheet without risking fragmentation. It will likely tighten by less than the 3.25% terminal rate the market prices, and with explicit caution. If French and Italian government bond spreads over German Bunds keep widening, it may stop shrinking its balance sheet and tilt reinvestments towards French and Italian debt, both of which point to a more dovish central bank. We have therefore reduced our underweight to European government bonds.
Euro Inflation Linked	Underweight Neutral Overweight	Inflation expectations as reflected in break-even rates remain anchored, while inflation pressures driven by elevated and volatile energy prices remain a risk.
Euro Investment-Grade (IG) Corporates	Underweight Neutral Overweight	Yields are attractive and credit fundamentals are supportive, but tight spreads and continued upward pressure on long-term rates warrant a cautious stance.
US IG Aggregate	Underweight Neutral Overweight	Attractive yields and supportive fundamentals are offset by tight spreads, a flat yield curve, and the risk of higher long-term rates. Heavy AI-related issuance adds a further technical headwind.
Global High Yield	Underweight Neutral Overweight	Healthy fundamentals, strong corporate profits, and a shorter duration profile support high yield. With spreads tight, income is likely to drive returns, while higher yields and expected new issuance may create opportunities.
EM Dollar Sovereigns	Underweight Neutral Overweight	Attractive yields and generally supportive fundamentals remain constructive, although higher US rates and geopolitical risks could contribute to volatility.
EM Local Currency Bonds	Underweight Neutral Overweight	Compelling yields remain supportive, while local currencies could benefit from an eventual softer US dollar; elevated global rates remain a near-term risk.
EM Corporates	Underweight Neutral Overweight	The sector offers a shorter duration than that of EM dollar sovereigns. Spreads are tight, but total yields remain attractive relative to some other fixed income sectors.

Currency

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Currency	Positioning	Rationale
EUR vs. USD	▼ UnderweightNeutralOverweight	Current valuation, German fiscal expansion and ECB hikes support the EUR. However, we remain neutral because of heightened political uncertainty in France, geopolitical uncertainty and the potential for a flight-to-quality to the USD during periods of stress.
EUR vs. JPY	▼ UnderweightNeutralOverweight	We remain neutral on the yen. Elevated energy costs could push up inflation in Japan, leading the Bank of Japan to adjust its monetary policy. As a safe-haven currency, the yen can find support during periods of heightened geopolitical uncertainty and currency intervention.

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Fig. 1: Higher readings indicate tighter financial conditions and lower readings easier conditions.

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