2025

4Q Outlook Asset Allocation

HARTFORDFUNDS

Our benchmark is the investor.®

Rational Exuberance: Will the Bulls Keep Running?

Why strong earnings, supportive policy, and a focus on quality may keep markets resilient through uncertainty.

Key Points

- **We're relatively optimistic on global equities and favor a modest increase in exposure.** Earnings are supporting higher valuations, especially in the US, while monetary and fiscal policy are stimulative and trade uncertainty has receded. We see little risk of recession and favor equities over bonds.
- **We favor the US and Japan over Europe in developed market (DM) equities**. AI euphoria in the US is unlikely to fade, given the mega-cap companies' strong Q2 results, advances in technology, and growth in capital expenditures.[1] In Japan, we see evidence of improved capital return to shareholders and positive earnings revisions. European companies face a challenging mix of slow economic growth and earnings prospects that lag other regions.
- **We have a slight overweight view on duration[2] and credit.** Within duration, we have a moderately overweight view on the UK and a moderately underweight view on the US, Japan, and the eurozone. Within credit, we've downgraded our view on high yield to neutral and raised our view on hard-currency emerging-market (EM) debt to moderately overweight, given slightly better valuations and a more defensive quality profile.
- **We maintain our underweight stance on oil given our view that the oil market is likely to be in surplus this year** as OPEC slows production cuts. We continue to lean positively toward gold as a potential hedge against stagflation[3] and given continued central-bank demand, but we currently see a case for taking profits and staying neutral while waiting for a better reentry point.
- A spike in inflation remains the main **downside risk** to markets, as it would undermine the current "Goldilocks" view of growth and inflation. In addition, a much softer US labor market could raise recession risks, and geopolitics remain a risk to watch. **Upside risks** include reasonable US trade deals with Europe, Japan, and China, as well as concrete signs that productivity is increasing as a result of AI.

Insight from sub-adviser Wellington Management

Nanette Abuhoff Jacobson
Managing Director and Multi-Asset Strategist at Wellington Management and Global Investment Strategist for Hartford Funds

Supriya Menon
Managing Director and Multi-Asset Strategist – EMEA

Global equities marched almost 7% higher in the third quarter, as more barriers to market optimism fell by the wayside. Despite open questions about US fiscal health (including a government shutdown as of this writing) and central-bank independence, the US dominated the global picture as softer labor-market data led the Federal Reserve (Fed) to pivot back to easing after a year's hiatus, and AI spurred eye-popping revenues and earnings. In addition, ample liquidity in the financial system continued to support animal spirits.

So, will this exuberance end in tears? Maybe, but we think the fundamentals can remain supportive for the next 12 months, and we maintain our overweight view on global equities relative to bonds. The key to our optimism is that we continue to see good earnings driving higher returns in the US, particularly among the mega-cap names. In addition, we see historical evidence that even after long pauses in central-bank interest-rate cuts, the market has responded well to the resumption of cuts. **FIGURE 1** shows that even in recessions, global equities and US investment-grade (IG) bonds delivered positive returns after cuts resumed.

FIGURE 1

Is the Fed Rate Cut Positive for Risk?

Equity Return: Fed Pause, Then Cut

Credit Return: Fed Pause, Then Cut

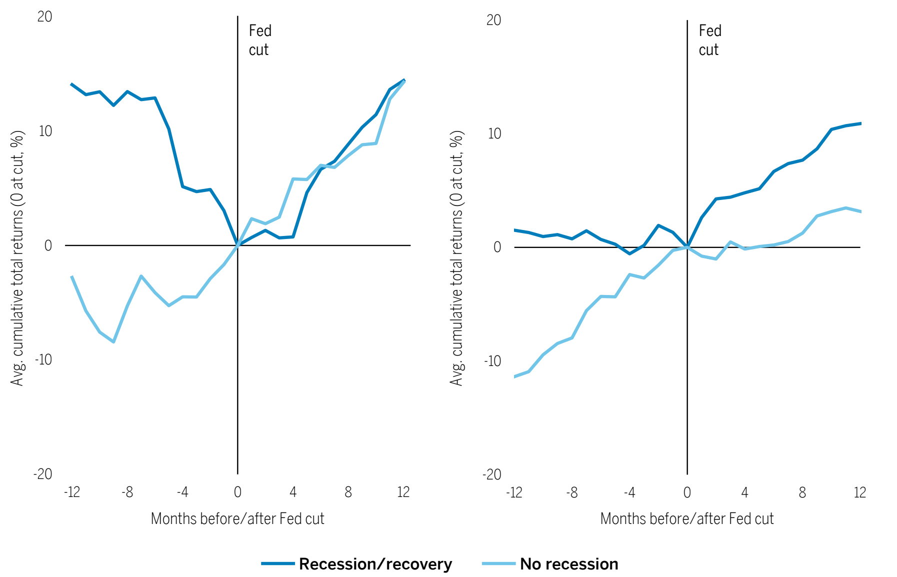

Chart Data: 1/31/70-9/30/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Charts shows average returns 12-months before and after the date of a Fed policy rate cut that follows another cut with a pause of at least four months. Data split between recessionary periods, defined as a recession within 12-months of the cut, and non-recessionary periods. Indices used: MSCI World Index and the Bloomberg US Corporate IG Bond Index. Please see page 7 for index definitions. For illustrative purposes only. Data Sources: Wellington Management and Refinitiv.

That said, we think allocators should consider diversifying exposure from growth-dominated US equities to more value-oriented non-US equities. We continue to favor Japan, with its improving earnings outlook and shareholder-friendly policies, while we have a moderately underweight view on Europe. Optimism about German fiscal support is understandable, but we're not seeing it come through in broad earnings revisions or market breadth, and France and the UK are facing budget tensions. Within EM, we see a stronger case for taking risk in debt than equities. EM equity outperformance vs. DMs has been driven by multiples, not earnings, and China, the largest index weight, has benefited from positive sentiment around AI and retail flows while the economic fundamentals have deteriorated.

In fixed income, we continue to see opportunities to take advantage of regional differences in monetary policy and market pricing. Our highest-conviction view is to be long UK rates. Term premia[4] are compensating for fiscal concerns in our view, and we expect a weaker economy to spur further rate cuts by the Bank of England. This contrasts with Europe and the US, where rate cuts may fall short

Our Multi-Asset Views

Asset Class	View	Change
Global Equities	Moderately OW	—
DM Government Bonds	Moderately OW	↑
Credit Spreads	Moderately OW	—
Commodities	Moderately UW	↓
Cash	Large UW	↓
Within Asset Classes		
Global Equities		
US	Moderately OW	↑
Europe ex-UK	Moderately UW	↓
UK	Moderately UW	↓
Asian DMs	Moderately OW	—
EMs	Neutral	—
DM Government Bonds		
US Government	Moderately UW	↓
Eurozone Government	Moderately UW	—
UK Government	Moderately OW	—
Japan Government	Moderately UW	—
Credit Spreads		
Global IG credit	Neutral	—
Global High Yield	Neutral	↓
EM Debt	Moderately OW	↑

OW = overweight, UW = underweight

Views have a 6–12-month horizon and are those of the authors and Wellington's Investment Strategy Team. Views are as of 9/30/25, are based on available information, and are subject to change without notice. Individual portfolio management teams may hold different views and may make different investment decisions for different clients. This is not to be construed as investment advice or a recommendation to buy or sell any specific security.

of market expectations. In credit, we lowered our view on high yield to neutral when spreads[5] approached their all-time tights, and we raised our view on EM debt to moderately overweight. Around half of EM debt is IG, and spreads aren't as compressed. We're monitoring credit closely after pockets of weakness surfaced in consumer finance in the US, particularly among lower-income cohorts, though these appear to be isolated cases rather than signs of broader economic or credit risk.

Equities: Still a Positive Vibe, Though Valuations Give Pause

We continue to hold a moderately overweight view on global equities. While the post-April rally has been strong and US equities are expensive, the global earnings picture is solid—though admittedly driven by US mega caps—and the policy backdrop is supportive, as central banks are easing globally, apart from Japan (**FIGURE 2**). While questions remain regarding US tariffs (e.g., a Supreme Court ruling on their legality), much of the uncertainty is behind us, and companies have mitigated some of the impact by passing on roughly half the cost to consumers or down the supply chain.

FIGURE 2

Earnings Being Revised Upward in The US and Japan

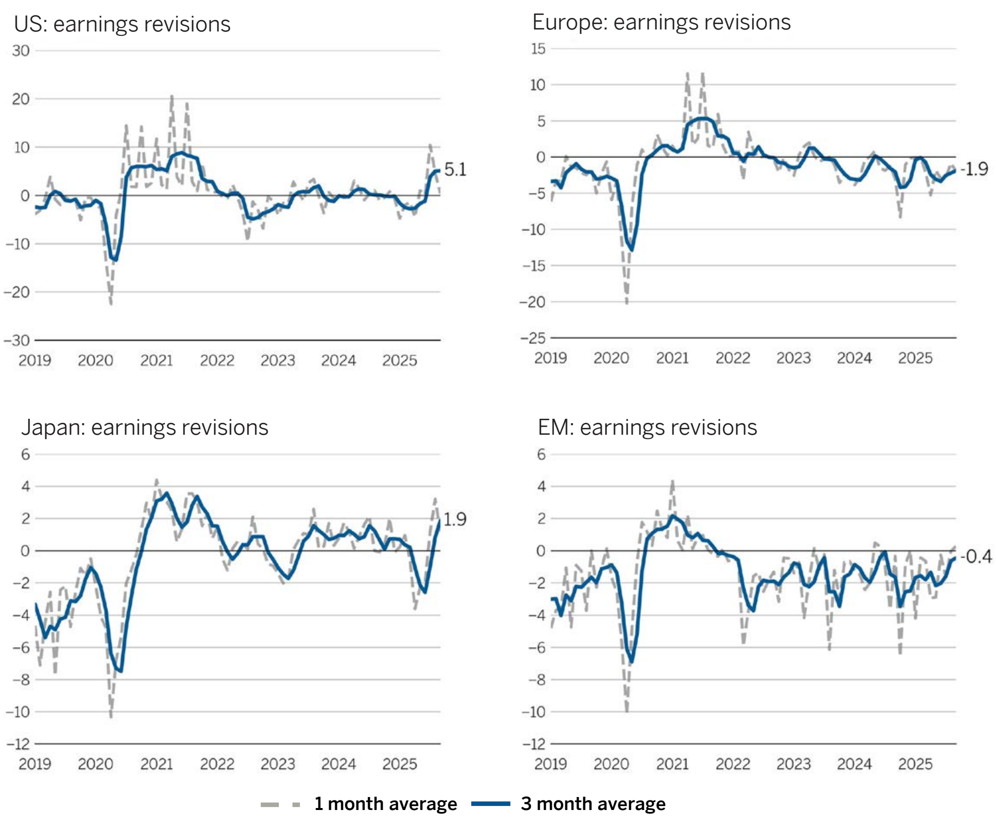

Chart Data: 1/19-9/25. Earnings revisions breadth measures the difference between upward earnings estimate revisions and downward earnings estimate revisions, divided by the total number of earnings estimates. Indices used: MSCI USA Index, MSCI Europe Index, MSCI Japan Index, and MSCI Emerging Markets Index. Institutional Brokers' Estimate System used for estimates. Please see page 7 for index definitions. For illustrative purposes only. Data Sources: Wellington Management, Refinitiv, and IBES.

We continue to view AI positively, with the massive investments being made providing a near-term boost to the economy and potentially driving even more meaningful long-term productivity gains. Despite the investments required, the largest tech companies have been able to generate strong cash flows and maintain high margins.

Why aren't we more positive given these drivers? Valuations have risen, particularly in non-US markets with weaker earnings growth, and uncertainty remains high on several policy fronts in the US and elsewhere, including around issues of fiscal sustainability, monetary policy independence, and regulatory and industrial policies.

We've moved our view on the US from moderately underweight to moderately overweight. While gains have been limited to a relatively narrow group of mega caps and large AI names, we see some signs of a broadening earnings-per-share (EPS)[6] recovery and expect Fed rate cuts to support small caps and value segments. In addition, lower corporate taxes, higher levels of investment, productivity gains, and deregulation seem likely to help some of the laggards. We would see any market broadening as a positive. While the market is richly valued, that's in line with a high return on equity,[7] and companies are still delivering strong earnings. On the earnings side, the US is clearly ahead of other regions, with a sharp recovery in both the number and breadth of revisions across companies.

> "In the US, we see some signs of a broadening earnings recovery and expect rate cuts to support small caps and value.

We maintain our moderately overweight view on Japanese equities. Corporate governance reforms and restructuring continue to provide a tailwind, and buybacks are at record highs (and still rising). That, combined with a relatively high dividend yield, translates to a high cash return to shareholders. This has pulled in foreign investors, who flipped from net sellers to net buyers in the middle of the second quarter. However, positioning still doesn't appear to be stretched. At the macro level, ongoing reflation is a positive for Japanese equities. Despite strong nominal GDP, monetary conditions remain loose even with a potential rate hike later this year. Valuations have become less supportive as the market has undergone a re-rating the past few months.

We've lowered our view on Europe ex-UK and the UK from neutral to moderately underweight, mainly because of weak earnings prospects. The lack of earnings growth indicates that recent gains in Europe ex-UK have been valuation-driven, which means the region is no longer cheap or unloved. EPS for 2025 and 2026 haven't recovered, and both Europe ex-UK and the UK are lagging on company revisions and breadth. Optimism around German fiscal support is justified, and we expect an impact in terms of stock-level winners and losers, particularly among German small/mid-caps, defense, and infrastructure, but we think the broad market impact is likely to be limited. We also see a growing divide between Europe's periphery, which shows stronger macro fundamentals, and the core, which suffers from challenges in key industries (such as autos) and the impact of a strong euro on exporting industries. For its part, the UK suffers from an absence of tech exposure and from its heavy reliance on its own economy and policies. While European earnings showed signs of a recovery over the last few months, they're now weakening again.

We maintain our neutral view on EM, particularly after a powerful rally driven by valuation expansion. Lower US rates, a weaker US dollar (USD), and stronger risk appetites all support EM. However, much of the move has been sentiment-driven, with earnings not improving. Even in China, neither macroeconomic nor earnings fundamentals are improving, although optimism on AI and tech innovation seems partly justified.

Sector-wise, a variety of factors, whether earnings-, technical-, or valuation-driven, are shaping our preferences, rather than any strong overarching theme. We have an overweight view on communications, staples, and utilities, and an underweight view on materials, healthcare, and industrials. We have a neutral view on technology and financials.

Government Bonds: Divergence and Opportunity

During the third quarter, fiscal concerns weighed on most DM government-bond markets, pushing up 10-year yields. The exception was the US, where labor-market weakness replaced inflation as the dominant theme, and the Fed pivoted toward rate cuts. We find overall duration a more attractive opportunity relative to cash for two reasons: 1) the combination of real yield and "roll down the curve"[8] return is providing the potential for positive excess returns across developed rates markets, and 2) we think yields are pricing in too much negativity on the fiscal side, especially in the UK.

As we noted last quarter, central banks are generally moving toward rate cuts, but the magnitude, timing, and market expectations vary substantially, and so we see opportunities to take advantage of these regional differences within our long-duration view. Our highest-conviction regional view is to be long duration in the UK, which has been the poster child for poor fiscal management since 2022, when former Prime Minister Liz Truss signed off on tax cuts combined with big borrowing, and markets revolted. Today, the term premium is higher than during the "Truss moment." With the UK facing a fiscal shortfall and new rules requiring a balanced budget by 2029–2030, all eyes will be on the budget announcement in late November. The consensus is that Chancellor Rachel Reeves will present a combination of tax hikes and spending cuts equivalent to £30 billion or 0.35% of GDP a year, but we think the fiscal hole will be substantially smaller and spread out over several years through 2028.

> Our highest-conviction regional view is to be long duration in the UK. By contrast, we're bearish on the US, Europe, and Japan.

In contrast to our bullish UK view, we're bearish on the US, Europe, and Japan. We think the market's gotten ahead of itself on Fed rate cuts in the US because inflation is still sticky and recession risks are low. There's not much more cutting for the European Central Bank to do, after already delivering 150 basis points[9] of rate cuts over the past year, and we see some upside growth potential from German fiscal expansion. We maintain our short-duration view on Japan, where monetary policy is accommodative, inflation risks are to the upside, and fiscal policy is likely to loosen following the election.

Credit: Time To Take Profits in High Yield?

Tight spreads keep getting tighter, so upside is limited. We're seeing isolated cases of credit stress in consumer finance emanating from weaker income cohorts such as subprime and 24–30-year-olds struggling with higher unemployment and the resumption of student-loan repayments. Still, we see no clear catalyst for broader spread widening, and the overall backdrop appears positive for risk assets,[10] with liability-driven allocators looking for attractive all-in yields in the 4%–6% range. Given rich valuations, however, we believe the time has come to move up in quality within credit, from high yield to EM sovereign debt.

The macro backdrop for EM is positive—Fed easing, a weaker USD, and loose financial conditions. EM debt's composition is about 50% IG and 50% high yield, a more defensive allocation relative to equities than high yield. In addition, US high-yield bonds are callable, giving this market a negatively convex profile[11] relative to the bullet structure[12] of EM debt and IG corporate bonds. Finally, EM debt offers a potential spread pickup relative to both global corporate IG bonds and high yield. In a more stressed US economic environment, EM debt spreads would also tend to benefit from their longer duration relative to other spread markets.

Commodities: Focusing on Oil and Gold Prices

We have a moderately underweight view on commodities driven by our view on oil, where we have a small underweight view given the rise in oil prices. With OPEC barrels returning, the demand/supply balance points to a potentially sizable oversupply. We think this makes for an attractive entry point for shorting crude, with the primary risk being the substantial negative carry[13] drag.

We've taken off our long-standing overweight view on gold. While the geopolitical environment and the investor/central bank urge to diversify remain favorable for gold, recent momentum has taken the gold price beyond our target, and the technical set-up looks somewhat fragile after the strong push higher.

Investment Implications

- **Consider maintaining a slight pro-risk stance** — While we may be past peak policy uncertainty, there are important questions to be answered in areas such as fiscal sustainability and central-bank independence. That said, we think the equity backdrop is supportive, including loose central-bank policy and strong earnings momentum. AI optimism isn't a theme we're ready to bet against.
- **Within equities, emphasize earnings growth over valuations** — Within global equities, we favor Japan and the US over the UK and Europe ex-UK. We see stronger macro conditions in the US and Japan and think superior earnings/margin prospects will support higher valuations in both markets.
- **Look for divergent policies to generate regional duration opportunities** — We have a small overweight view on duration, but our higher-conviction views are on regional duration opportunities. While fiscal dynamics are worsening in most DMs, yields in Europe, the US, and Japan price in less risk and smaller inflation premia than the UK. In our view, Fed rate-cut expectations have gone too far.
- **Consider moving up in quality in spreads** — We've lowered our view on global high yield to neutral, given very tight spreads. Instead, we see a case for a small credit overweight in hard-currency EM spreads, which have a lower beta[14] to equities than high yield and may offer some pickup in carry relative to both DM high-yield and IG bonds.

Talk to your financial professional about how to position your portfolio amid a changing economic landscape.

[1] Capital expenditures are funds used by a company to acquire, upgrade, and maintain physical assets such as property, plants, buildings, technology, or equipment. Capital expenditures are often used to undertake new projects or investments by a company.

[2] Duration is a measure of the sensitivity of an investment's price to nominal interest-rate movement.

[3] Stagflation is an economic cycle characterized by slow growth, inflation, and signs of labor market weakness.

[4] The term premium is the amount by which the yield on a long-term bond is greater than the yield on shorter-term bonds. This premium reflects the amount investors expect to be compensated for lending for longer periods.

[5] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

[6] Earnings-per-share growth is the projected growth rate in earnings per share for the next five years.

[7] Return on Equity is the average amount of net income returned as a percentage of shareholder's equity over the past five years.

[8] The yield curve (the curve) is a line that plots interest rates of bonds having equal credit quality but differing maturity dates; its slope is used to forecast the state of the economy and interest-rate changes.

[9] A basis point is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

[10] Risk assets refer to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate, and currencies.

[11] Convexity is a measure of the curvature, or the degree of the curve, in the relationship between bond prices and bond yields.

[12] Bullet structure refers to a bond design where the principal is repaid in full at maturity, rather than through periodic amortization.

[13] Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

[14] Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index.

Bloomberg US Corporate IG Bond Index measures the performance of U.S. dollar-denominated, investment-grade, fixed-rate corporate bonds issued by US and non-US companies across industrial, utility, and financial sectors.

MSCI Emerging Markets Index tracks large and mid-cap stocks across 25 emerging market countries, representing about 85% of the investable equity market in each.

MSCI Europe Index captures large and mid-cap equity performance across 15 developed European countries, covering roughly 85% of the region's market capitalization.

MSCI Japan Index represents large and mid-cap segments of Japan's equity market, covering approximately 85% of its free float-adjusted market capitalization.

MSCI USA Index measures the performance of large and mid-cap US stocks, accounting for about 85% of the US equity market's free float-adjusted capitalization.

MSCI World Index tracks large and mid-cap stocks across 23 developed countries, representing roughly 85% of the investable equity market in each.

Important Risks: Investing involves risk, including the possible loss of principal. • Foreign investments may be more volatile and less liquid than U.S. investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets or if focused in a particular geographic region or country. • Small- and mid-cap securities can have greater risks and volatility than large-cap securities. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Investments in the commodities market may increase liquidity risk, volatility and risk of loss if adverse developments occur. • Diversification does not ensure a profit or protect against a loss in a declining market.

Index Provider Notices may be found at hartfordfunds.com/index-notices.