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2026 Outlook: Perspective on Markets and the Economy

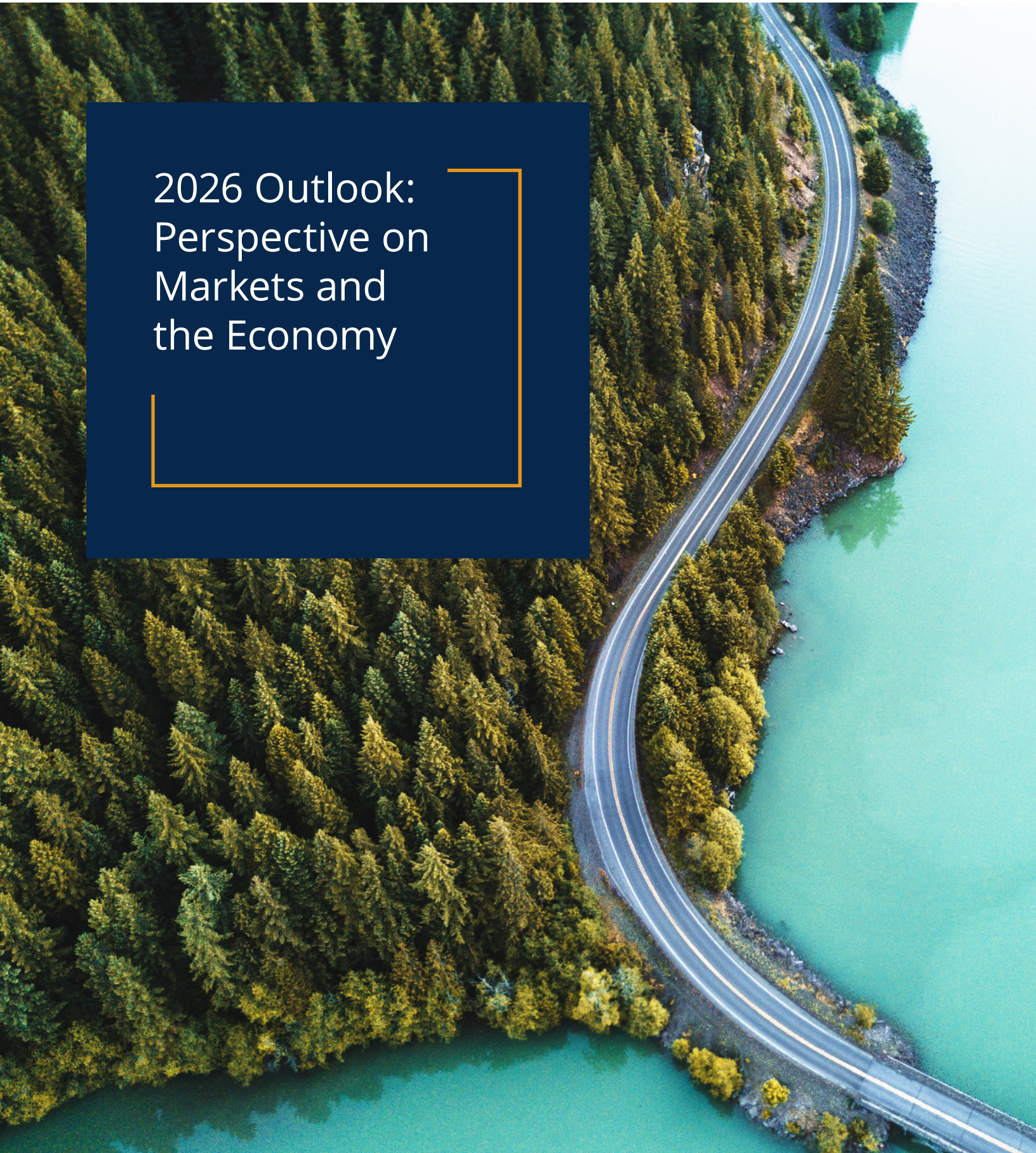

Table of Contents

Page

Global Macro

Elections, Earnings, and Global Stimulus Driving Returns 1

Prepare for Inflationary Growth 7

Take an Active Approach to Valuation Risk and Seek Opportunities to Diversify 12

Equities

Broadening Underway? 6 Equity Ideas for 2026 14

Earnings and Innovation: A Tailwind for Global Equities? 21

Fixed Income

Finding Durable Value amid Shifting Currents 27

Global Bond Market Conditions May Demand an Active Management Approach 31

Elections, Earnings, and Global Stimulus Driving Returns

Supportive policies, earnings growth, and shifting global dynamics set the stage for both opportunity and volatility across markets in the year ahead.

Key Points

The setup for 2026 is positive, including monetary and fiscal policy, and we continue to favor global equities over bonds. Despite pricey valuations, earnings have delivered, especially in the US, and we expect more of the same.

Among equity markets, we favor Japan, followed by the US. Within the US, we expect to finally see broadening from the technology sector to the rest of the market in 2026. Europe and emerging markets (EM) are less attractive in our view, due to slow progress on structural reform and lower earnings growth in Europe and a lack of profitability in China.

We favor government bonds over credit given tight spreads,[1] steeper government yield curves,[2] and the potential for increased credit supply coming from the technology sector. Our government-bond view might also help cushion volatility in the event of an equity sell-off. We think the large term premium[3] on UK bonds is particularly attractive.

Our only active weight in commodities is an underweight view on oil, where we expect supply to outstrip demand. We're biased toward adding gold in a sell-off given the multiple roles it can play as a hedge against geopolitical risk, stagflation,[4] and US-dollar concerns.

Downside risks include a rise in global interest rates spurred by inflation concerns that would feed into tighter monetary-policy expectations and likely damage risk appetites. Cracks in AI expectations and fiscal concerns could also upset equities. **Upside risks** include a jump in US productivity that increases growth potential without higher inflation, and meaningful structural reform in Europe and China.

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

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Managing Director and Multi-Asset Strategist – EMEA

In a feat not seen since 2019, global equities, bonds, and commodities all delivered positive returns in 2025,[5] thanks to waning tariff concerns, central-bank easing, AI-driven growth, and the many splendors of gold. So, can the good times keep rolling in 2026, amid questions about valuations, an AI bubble, US-China relations, and other risks? We think four factors could drive positive results on balance but may cause choppiness along the way:

1. **Earnings growth** – The AI picture is complicated by increased competition and blowout spending. But we expect earnings strength to broaden beyond mega-cap tech and show up across regions, sectors, and market caps. Despite tariffs, companies have maintained and even expanded margins, giving us confidence that earnings improvements will translate to positive equity returns.

2. **Global fiscal stimulus** – Even if government debt is becoming a longer-term threat, every developed-market (DM) region has planned fiscal stimulus that should support nominal growth, consumer sentiment, and business investment (**FIGURE 1**).

3. **Global interest rates** – A cooling US labor market is driving Federal Reserve (Fed) easing expectations and supports our long duration[6] stance. However, percolating inflation in the US and elsewhere could shift the landscape dramatically. Japan's tighter monetary policy could be the first shoe to drop.

4. **Political winds** – Voters and markets could register their dissatisfaction with inflation and policy. Populist shifts in elections in the US, Europe, or Latin America could create volatility.

FIGURE 1
Global Fiscal Stimulus Is Coming
Fiscal Stimulus vs. Global Unemployment Rate

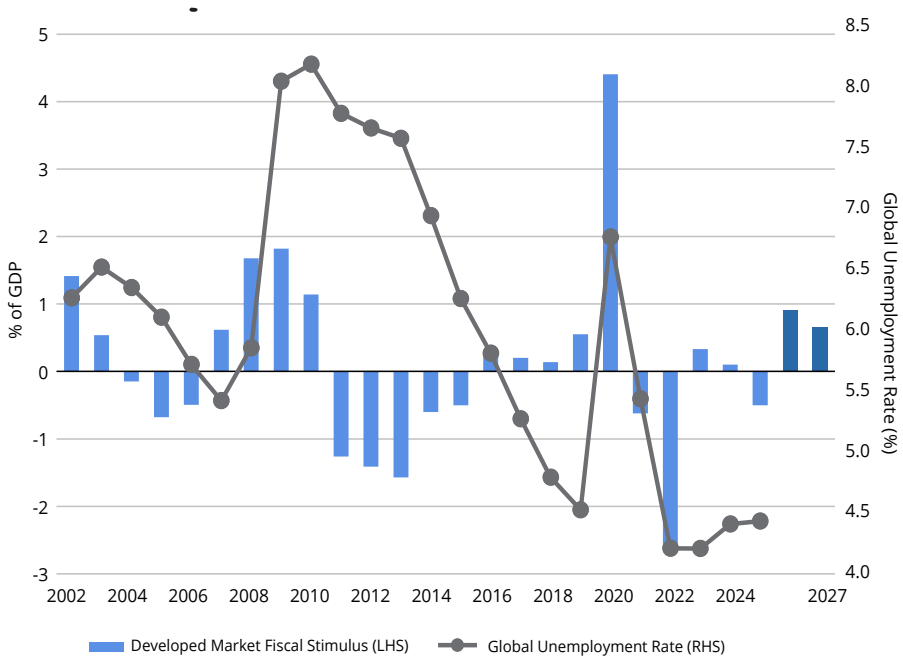

Chart Data: 2002-2027. DM fiscal stimulus calculated as the GDP-weighted change in cyclically adjusted balances across the US, European Union, UK, New Zealand, Canada, and Australia. Forward estimates (darker-blue bars) based on published fiscal plans from these same countries for the coming years. Data Sources: Wellington Management and National Finance Ministries.

These themes lead us to a constructive view on equities, though only slightly overweight relative to other asset classes. Within equities, we like Japan the most, given strong nominal GDP growth and positive earnings. We also like US equities and expect earnings breadth to improve thanks to fiscal stimulus and some cyclical acceleration in traditional industries. We're less optimistic on the eurozone, the UK, and EMs, all of which enjoyed multiples expansion[7] in 2025 but lackluster earnings growth.

In fixed income, steeper government yield curves, tight credit spreads, and concerns about AI-related debt supply leave us favoring government bonds over credit. A mismatch between bond prices, fundamentals, and policy underpins our preference for the UK over the eurozone and Japan.

Our Multi-Asset Views

Asset Class	View	Change
Global Equities	Moderately OW	—
DM Government Bonds	Moderately OW	—
Credit Spreads	Neutral	↓
Commodities	Moderately UW	—
Cash	Underweight	↑
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	Neutral	↑
Eurozone Government	Moderately UW	—
UK Government	Moderately OW	—
Japan Government	Moderately UW	—
Credit Spreads		
Global Investment-Grade credit	Neutral	—
Global High Yield	Neutral	—
EM Debt	Neutral	↓

OW = overweight, UW = underweight

Views have a 6- to 12-month horizon and are those of the authors and Wellington's Investment Strategy Team. Views are as of December 2025, 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.

Within commodities, we remain underweight oil, with supply expected to exceed demand, and hold a neutral view on gold as we wait for opportunities to add exposure at more favorable price levels.

Equities: Staying Constructive but with a Note of Caution

We maintain our moderately overweight view on global equities, given the positive monetary and fiscal policy backdrop and well-supported runway for earnings growth (**FIGURE 2**). After a year in which most markets (other than the US) generated more return through valuation expansion than earnings growth, we expect all major regions to post earnings growth of 6%–11% over the next 12 months. One of the biggest and most surprising factors driving earnings growth is margin strength. Despite uncertainties such as tariffs, large-cap companies have been able to expand margins—a testament to both their agility and to efficiency gains from innovation, including AI.

> “Margin strength is one of the biggest surprises driving earnings.

FIGURE 2
Positive Earnings Revisions in Most Regions

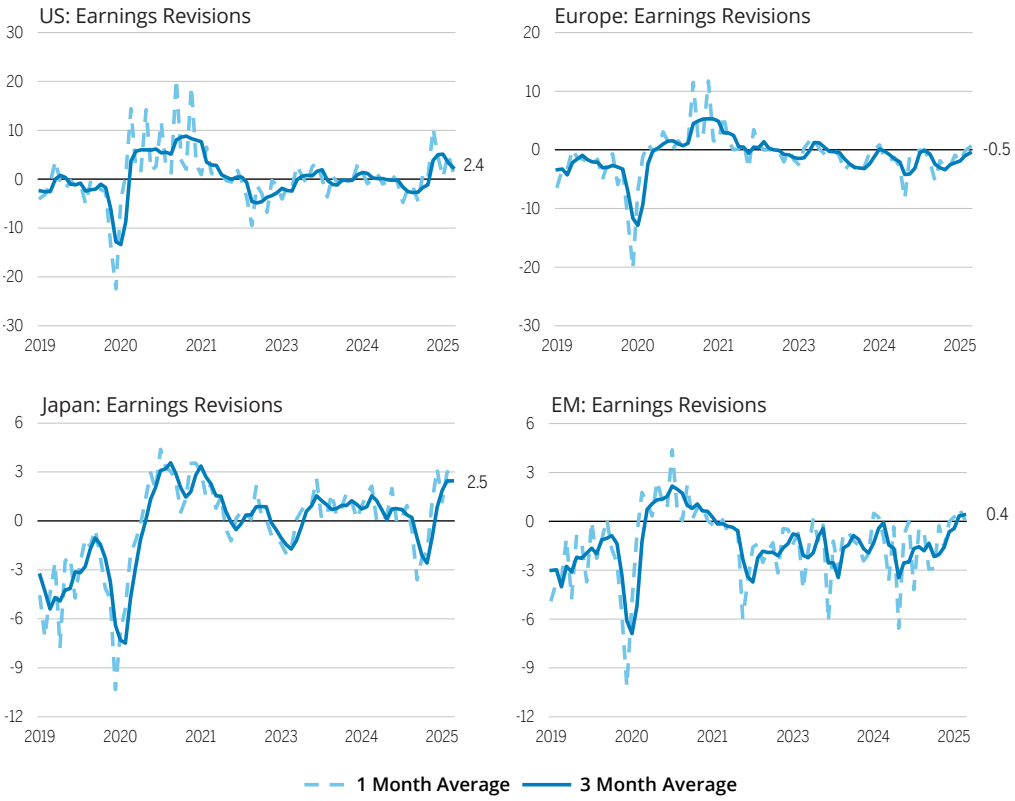

Chart Data: 1/19-11/25. Earnings revisions breadth measures the difference between upward earnings estimate revisions and downward earnings estimate revisions, divided by the total number of earnings estimates. Indices used: MSCI USA Index, MSCI Europe Index, MSCI Japan Index, and MSCI Emerging Markets Index. Please see page 6 for index definitions. Data Sources: Wellington Management, Refinitiv, and IBES.

The modest level of our overweight view on equities stems partly from caution related to tight equity-risk premiums,[8] which reflect a skew toward optimistic economic scenarios. Given risks around AI, momentum-driven rallies, and valuations, we expect occasional bouts of volatility.

We think Japanese equities could outperform other regions over the next 12 months. Strong nominal growth is a tailwind and, notwithstanding potential Bank of Japan rate hikes, monetary conditions remain loose with deeply negative real yields. Fiscal stimulus is about to turn even more positive, helping domestic sectors.

We also expect US equities to outperform, based not just on mega-caps and AI, but also a broadening earnings-per-share[9] recovery. Even small caps are experiencing positive earnings revisions, ending a multiyear downgrade cycle. We're watching for signs that AI growth is relying on too much leverage, but fundamentals are still strong for spending, including AI demand/supply, and we think high free-cash-flow margins represent a good buffer.

Turning to the largest index weights in EM, we're constructive on Korea and Taiwan but think India and China are more challenged. The global backdrop (lower US rates, a weaker US dollar) is supportive, but our lack of conviction on China and India makes it hard to be more constructive on the asset class overall. The anti-involution campaign[10] seeks to rebalance toward efficiency, and ultimately profitability, rather than production growth. This, however, will likely take time. In the meantime, the market has seen a sentiment- and liquidity-driven surge, with little support from earnings or a broader macro recovery.

We have a moderately underweight view on Europe ex-UK and the UK. The eurozone macro outlook is improving, but is being held back by the lack of clear progress on structural reform and by direct competition from China on key profit pools in industries such as autos and clean technology. Fiscal uncertainty in France and other countries as well as the potential for new elections further cloud the outlook. We expect high single-digit earnings growth here, though the region has consistently disappointed vs. consensus estimates. The UK is still the market with our lowest earnings expectations. It suffers from a lack of tech sector exposure and from policy uncertainty, which is impacting investment and spending.

> “We expect US equities to outperform, based not just on mega-caps and AI, but also a broadening earnings-per-share recovery.

Fixed Income: Favoring Government Bonds Over Credit

Comparing credit to government bonds, we prefer the carry[11] in higher-quality government bonds: Term premia are attractive and steeper yield curves are providing return from “rolling down the curve.”

Divergence is the story in government-bond markets, where cycles are less linked to the US. In fact, US 10-year rates rallied around 40 basis points (bps)[12] year-to-date in 2025, while other DM regions' yields sold off 5 to 90 bps, a highly unusual break in direction and magnitude from the past 10 years.[13] Another sign of the divergence is in central-bank policy expectations, with the market pricing in rate cuts by the Fed in 2026 and rate hikes by other DM central banks. These conditions are ripe for relative value opportunities, reflected in our overweight view on UK rates and underweight view on eurozone and Japanese rates.

Having been overweight credit in various sectors during 2025, we think the overall market's return profile is more balanced now, and have moved to a neutral stance. The backdrop remains positive for risk assets, but spreads are extremely tight, leaving little upside potential beyond carry. While we think the tech sector as a whole has room for leverage, as noted in the equities section, we're keeping a close eye on growing AI capital expenditures (capex)[14] funding in the credit markets, with the risk that some tech companies will allow their balance sheets to deteriorate.

Commodities: What's Ahead for Oil and Gold?

We have an underweight view on oil. While we think demand will be well supported, including by sustained stockpiling by China, we expect supply to exceed demand beginning in the first quarter and continuing throughout 2026 as OPEC+ pares back its supply cuts. Risks to our views include military action in Venezuela (short-term downside risk to supply) and a ceasefire in Ukraine resulting in sanctions being lifted on Russia (upside risk to supply).

We continue to hold a neutral view on gold. Financial demand drivers remain solid, including central-bank buying and digital-asset (stablecoin) demand. Speculative positioning (futures) is back to high levels while exchange-traded product flows have been supportive. Structural tailwinds remain as well, including fiscal deterioration and concerns about central-bank independence. However, valuations are extreme—they're at their highest level since 1980 relative to financial wealth.

Investment Implications

- **Equity outlook looks favorable** – The earnings and policy setup for equities is positive. At lofty valuations, however, markets will face questions about AI, fiscal stimulus, and great power competition. We think volatility could create opportunities to add risk. We also think better earnings breadth will make a case for diversifying across regions, sectors, and market caps.
- **Consider global government bonds as a play on attractive carry and regional divergence** – The combination of tight credit spreads and attractive yields in some parts of the government-bond market tilts us toward holding a slightly long-duration view while focusing on the attractive term premium in the UK.
- **Consider taking profits in credit** – We think historically tight spreads, concerns about balance-sheet erosion, and AI capex-induced supply warrant reducing exposure to a neutral weight. Since most total return during 2025 was captured after spreads widened, waiting for more attractive levels to add exposure may be prudent.

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

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

[2] The yield 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.

[3] 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.

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

[5] As of 11/30/25. Equities are represented by the MSCI ACWI Total Return Index, which is a free float-adjusted market capitalization index that measures equity market performance across global developed and emerging markets (net of dividend withholding tax), returned 21.07%. Bonds are represented by the Bloomberg Global Aggregate Total Return Index, which provides a broad-based measure of global investment-grade fixed-rate debt markets, returned 16.15%. Commodities are represented by the Bloomberg Total Return Commodity Index, which measures the performance of a broad group of commodity futures such as energy, metals, and agriculture, returned 7.89%. Data Source: Refinitiv.

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

[7] Multiples expansion occurs when equity valuations rise because investors assign higher price-to-earnings or similar valuation ratios to companies, rather than due to underlying earnings growth.

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

[9] Earnings per share measures how much profit a company makes per share of common stock.

[10] China's anti-involution campaign seeks to reduce wasteful, zero-sum competition among companies by discouraging excessive price cutting and overexpansion, and instead promoting efficiency, innovation, and sustainable growth.

[11] Carry is the return an investor earns from holding an asset, typically from interest or yield, after accounting for financing or holding costs.

[12] 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.

[13] Data Source: Yield changes are Bloomberg as of 12/17/25. Measurement reflects the change in 10-year government bond yields for the US, Germany, France, Italy, Japan, the UK, and Australia since 12/31/24.

[14] Capital expenditures are the money a company spends to buy or upgrade long-term assets such as buildings or equipment.

MSCI Emerging Markets Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance in the global emerging markets. MSCI index performance is shown net of dividend withholding tax.

MSCI Europe Index is a free-float adjusted market-capitalization-weighted index designed to measure the equity market performance of the developed markets in Europe.

MSCI Japan Index is a free-float adjusted market-capitalization index designed to measure large- and mid-cap Japanese equity market performance.

MSCI USA Index is a free float-adjusted market capitalization index that is designed to measure the performance of the large and mid cap segments of the US market.

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Prepare for Inflationary Growth

Positioning for growth as global markets adapt to fiscal tailwinds, innovation, and easing uncertainty.

A Return to More Frequent and Volatile Cycles

From a macro perspective, what matters for asset prices is, first, the interaction between activity and inflation, and second, the associated policy response. That sounds simple in theory and was for a long time in practice because globalization fostered a low-inflation, low-rate environment with extended growth cycles. However, in today's new economic regime, this interaction has become more complex because of:

- **Sticky inflation**, which in many countries remains well above central-bank targets.
- **Conflicting economic shocks** that are jolting the global economy, whether it's loose monetary and fiscal policy vs. tariffs, or the supply boost from AI vs. the drag from protectionism and demographics.
- **Increasingly politicized policy responses.** Against a backdrop of rising wealth inequality and populism, central banks and governments are slower to tighten policy and quicker to stimulate.

We've now returned to traditional cycles in which growth drives future inflation, and the economy can move rapidly across the four quadrants outlined in **FIGURE 1**. This ongoing shift to a more cyclical world has major implications for investors, as different assets and investment strategies will perform differently at each stage of the cycle. Moreover, markets can rapidly and frequently revise the probabilities they assign to different outcomes as we've already seen throughout 2025.

Given this backdrop, we believe the outlook for 2026 will revolve around four scenarios:

1. **Goldilocks:** In the near term, markets are likely to remain priced for noninflationary growth.
2. **Inflationary growth:** Investors may be underestimating the likelihood of an inflationary boom; we think this could be the most probable outcome for 2026.
3. **Recession:** While we view recession as less likely, it can't be entirely ruled out, with AI disappointment and higher private-sector savings in response to ongoing uncertainty being the key potential triggers.
4. **Stagflation:** There's a tail risk that signs of stagflation (i.e., slow growth, inflation, and a weak labor market) could emerge in 2026, potentially exacerbated by inappropriate policy responses.

Below, we explore each scenario and outline the characteristics that can help investors determine which quadrant we are in, and which market reaction to expect.

Insight from sub-adviser Wellington Management

John Butler
Head of Emerging-Market Equities

Eoin O'Callaghan
European Macro Strategist

Key Points

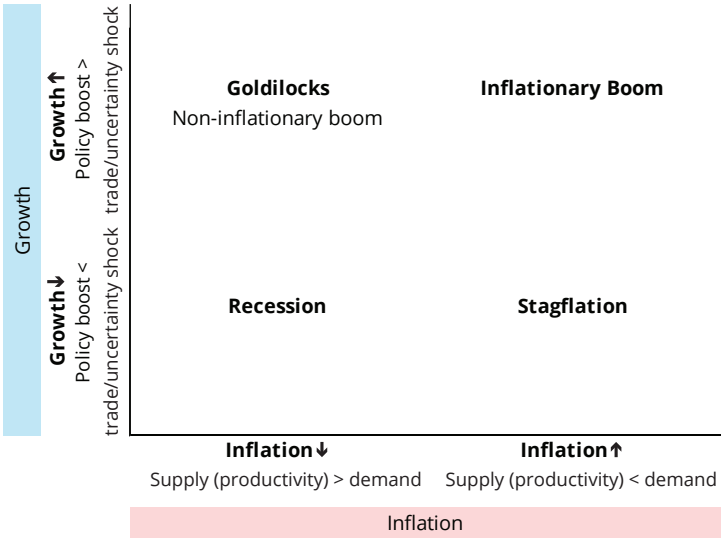
While markets are currently priced for a Goldilocks scenario in 2026, we think this is the least likely outcome.

Markets may remain anchored to this benign narrative until we see clear signs of stabilization in labor data.

Ultimately, the combination of negative global real rates, easing lending standards, and policy loosening at a time of already sticky inflation suggests that inflationary growth may be the most probable outcome.

Investors may have significant opportunities, provided they're prepared to adapt to very different scenarios, including the limited risk of recession and even stagflation.

FIGURE 1
The Four Quadrants of the Econmomic Cycle



For illustrative purposes only. Source: Wellington.

Four Potential Scenarios for 2026

1. Continued Goldilocks Market Narrative (For a While)

Looking across different asset classes, global markets still appear priced for a continuation of the noninflationary growth scenario that characterized the global economy prior to 2018. That's how you reconcile:

- Elevated equity valuations and strong earnings-per-share (EPS)[1] growth expectations, particularly in AI-related areas;
- Tight credit spreads;[2]
- Long-term bond prices reflecting low inflation expectations (breakeven rates) despite pricing in further central-bank rate cuts to neutral or slightly below neutral.

This scenario largely depends on the success of AI. If productivity gains from AI outweigh the negative impact of tariffs and rising protectionism, demand in the economy could remain strong without fueling inflation.

What Would This Mean for Asset Prices?
In this environment, we think equities would continue to rally, credit spreads would remain tight, and government bond yields would rise modestly to reflect better trend growth. Yes, unemployment rates may temporarily rise due to AI-driven displacement, but policymakers could respond with looser policy as productivity keeps inflation subdued.

We think this market theme is likely to persist in the near term, given our expectations for a weaker labor market and lower (but still elevated) inflation. However, our analysis suggests this is unlikely to be the dominant outcome for 2026.

2. Higher Growth With Inflation—the Most Likely Outcome, in Our View

Nominal global growth remains strong, but inflation continues to exceed the 2% target in most developed economies. Despite this, policymakers remain firmly accommodative as evidenced by:

- Global liquidity near all-time highs, which, if deployed, could further support nominal growth.

“If AI producitivity gains outweigh the negative impact of tariffs and protectionism, demand in the economy could remain strong without fueling inflation.

- Government initiatives to stimulate lending, including banking deregulation, even as private-sector credit conditions are already easing across many countries.
- Real global interest rates[3] at zero and could turn negative again.
- Forthcoming fiscal expansion, with developed-market economies set to embark on the sharpest fiscal easing since 2010 (excluding the COVID-19 years).

This policy stimulus is occurring at a time when the world economy is being hit by several inflationary supply shocks:

- The imposition of US tariffs and the growing protectionist response from the rest of the world represent a significant negative global supply shock. Just as globalization reduced inflation in global goods by allowing capital to flow to the lowest-cost producers, protectionism and a rising focus on security of supply is likely to raise it.
- China's increasing attempts to remove capacity in many sectors rather than continuing to add to it also has the potential to be a material source of sticky inflation.

If AI-driven productivity growth fails to materialize, conditions could be ripe for an inflationary boom in 2026, with policy stoking stronger demand amid weaker supply. While this theme may not yet dominate, signs of labor market stabilization could prompt a market shift if it becomes clear there won't be enough slack in the economy to bring down inflation.

> If AI-driven productivity fails to materialize, conditions could be ripe for an inflationary boom.

What Would This Mean for Asset Prices?

The policy response is key. An inflationary boom can still benefit risk assets:[4] Strong nominal growth[5] could lift equities and contain credit spreads. It also increases the likelihood of structurally higher yields in developed markets. The rally in risk assets may persist until policymakers stop prioritizing growth and start trying to rein in inflation through tighter policy, or if the bond market penalizes the "inappropriate" policy response and forces a tightening via higher term premiums.[6] Bond investors will, at a minimum, need to see data that exposes the inappropriateness of loose policy at this stage of the economic cycle, such as clear signs of labor-market recovery, and that may still take some time.

In our view, the near-term risks to the labor market globally are skewed to the downside, particularly in the US. But the longer it takes for signs of stabilization to materialize, the more policymakers risk generating the conditions for a boom and subsequent bust.

3. A Lower-Probability Risk of Recession

We can't completely discount the risk of a recession in 2026. The trigger could take many forms, but some would be more disruptive for risk assets than others. For example, tariffs and inflation already moving through the economy might have a harsher impact than current models predict. However, this scenario aligns more with a temporary slowdown, given loosening policy and low private-sector leverage.

For us, the bigger recession risks stem from:

1. **The market downgrading its views on AI**, from either a timing or future earnings perspective, which could trigger a sharp equity correction, hitting households' wealth perceptions.
2. **Today's rolling uncertainty and lack of fiscal discipline** prompting an increase in private-sector savings, as already seen in large parts of Europe. If sustained, such a response would be highly deflationary, reminiscent of Japan in the 1990s.

What Would This Mean for Asset Prices?
We view the risk of a noninflationary recession in 2026 as still relatively low, albeit rising. If realized, equities may likely sell off while bonds (at least initially) may rally, and credit spreads may widen sharply. If the recession is triggered by an AI-driven correction, it could also mean a substantially weaker dollar.

4. Stagflation: Also a Tail Risk to Monitor

Though currently a tail risk, some economies, most notably the UK, have exhibited signs of stagflation, which could be aggravated by escalating protectionism. The telltale sign would be inflation rising despite weakening employment. This risk matters because:

1. It would be very negative for risk markets.
2. Policymakers may repeat past mistakes, accommodating rather than countering inflation, similar to what occurred in the early 1970s.

What Would This Mean for Asset Prices?
Stagflation, especially if prolonged, would be most damaging for equities and credit spreads, but would also imply higher bond yields driven by breakevens and term premia.

> If a recession is triggered by an AI-driven correction, it would likely mean a substantially weaker dollar.

As summarized in **FIGURE 2**, we believe an inflationary upturn is the most likely scenario for 2026. For now, markets may cling to the Goldilocks scenario, before adjusting to the new reality of high nominal growth. While much less likely, we can't rule out the risk of a recession and even stagflation.

FIGURE 2
Where We're Heading in the Cycle, What To Look for, and the Market Implications

		Signs For Each Cycle				How Markets Could Trade		
	Probability	Productivity	Unempl. Leads	Inflation Leads	Inflation Expectations	Equities	Credit Spreads	Yield Curves
Goldilocks - Noninflationary upturn	20%	↗	↘	→/↘	Anchored at 2%	↑	↓	Not clear cut
Inflationary Upturn	50%	→/↘	↘	↗	↗	↑ initially	↓ initially	Steeper initially
Recession	15%	→/↗	↗	↘	↘/Anchored at 2%	↓	↑	Steeper
Stagflation	15%	→/↘	↗	↗	↗	↓↓	↑↑	Steeper

Note: Arrows indicate both direction (unchanged, down, upwards or combination thereof) and level of intensity (from single to double arrows). The yield 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. For illustrative purposes only. Source: Wellington.

Each scenario comes with very different implications for asset prices and portfolios. The most likely scenario—inflationary growth—generally supports risk assets, though policymakers may eventually tighten policy or, if they don't, markets could demand higher risk premiums.[7]

In this fast-changing environment, we think investors need to be vigilant: look for tell-tale signs of shifts in the cycle and consider actively adjust asset allocations to make the most of the significant opportunities that 2026 is likely to offer while mitigating the increased downside risks.

Talk to your financial professional about how to position your portfolio for a changing global landscape.

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

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

[3] Real interest rates represent the true cost of borrowing or the real return on savings after adjusting for inflation.

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

[5] Nominal growth refers to economic growth measured in current prices, without adjusting for inflation.

[6] Term premium is the compensation that investors require for bearing the risk of longer maturities, which are more sensitive to changes in interest rates.

[7] Risk premium is the investment return an asset is expected to yield in excess of the risk-free rate of return.

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.• 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. • There are risks of focusing investments in securities of companies in the utilities and industrials sectors which may cause performance to be sensitive to developments in those sectors. • The value of the underlying real estate of real estate related securities may go down due to various factors, including but not limited to, strength of the economy, amount of new construction, laws and regulations, costs of real estate, availability of mortgages and changes in interest rates.

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Take an Active Approach to Valuation Risk and Diversification

The economic backdrop is still conducive to returns, but diversification will be essential for building resilient portfolios.

As we head into 2026, there's a lot of concern about equity-market valuations. Comparisons are being drawn with the dot-com bubble of 1999-2000 due to significant investments being made by the hyperscalers into data centers and cloud infrastructure. At the same time, many AI start-ups are losing money, with their valuations being boosted by vendor financing. Against this backdrop, we've heard talk about canaries in coal mines, cockroaches (i.e., where one emerges there are usually many), and staying at the party for one last dance.

But let's leave analogies to one side and focus on our options.

The Risks of Too Much Risk Reduction

First, equity valuations are expensive. While they've not at extremes yet and have been more expensive in the past, you could argue for taking some risk off the table. For example, if you run a mature defined-benefit pension plan, you might be able to accept a lower rate of return at this point and bank some profit.

Most investors aren't in this camp, however. There are costs to sitting on your hands: Inflation needs to be outrun to preserve the value of savings and, with limits on how much can be saved, money has to be worked hard to deliver the funds required for retirement and other goals. You need a plan for the possibility that you could be waiting a long time for a correction and the golden buying opportunity.

The passive option is to stay invested in an equity index. Over the long term (20 years), history shows that equities deliver a decent return[1], particularly if fees are kept as low as possible to aid the compounding of those returns. The challenge with this approach is that, due to the concentration of equity indices in a small group of technology companies, you're particularly exposed to the equity valuations that everyone is so worried about. There's also significant idiosyncratic stock risk, if anything should go wrong with one of these large holdings.

I worry that not all investors realize how concentrated their exposure is. It's not always clear, in the case of passive investment, who oversees that risk for them.

Active Investing and Calculated Risks

Alternatively, you can try to risk-manage the situation. As active investors, we take calculated risks based on a broad range of factors, knowing that over time our clients need a return. Looking at market valuations, we think that equity markets are still supported by the fact that bond yields are well-behaved, inflation is quiescent for now, and central banks are likely to ease a bit more.

Over the medium term, I'm concerned about mounting government debt levels and the potential for inflation to accelerate, leading to higher discount rates, but over the next six months this risk is low. We also see low risk of a US recession; although the labor market is softening, unemployment is still low and private-sector balance sheets are in good shape. So, at a market level, we still see positive returns from equities.

Insight from sub-adviser Schroders Investment Management

Johanna Kyrklund
Group Chief Investment Officer

Key Points

Equity valuations are high, so consider trimming risk—but staying on the sidelines too long could mean missing out on long-term growth.

Active, stock-specific investing may remain essential; we see opportunities, especially as mega-cap techs evolve and market risks stay relatively contained.

Diversification may matter more than ever. Think beyond AI and the US, with value and emerging-market debt offering fresh potential.

[1] For the past 20 years (through 12/9/25), the average annualized return on global equities, as measured by the MSCI ACWI Index, was +8.17%. MSCI ACWI is a free float-adjusted market capitalization index that measures equity market performance in the global developed and emerging markets, consisting of developed and emerging market country indices. MSCI index performance is shown net of dividend withholding tax. Sources: Schroders, Bloomberg, 12/25.

There's the question of stock-specific risk, which I raised above, but we still see the potential for the hyperscalers to deliver revenues. We're monitoring the return on investment of these mega-cap companies as they have evolved from free-cash-flow monsters to big spenders, and we're also watching the performance of large-language-model and cloud-computing companies as a reflection of the adoption of the new technologies.

The bottom line is that we still see opportunity at the individual-stock level. Critically, we take this risk deliberately, backed by detailed fundamental analysis, rather than reliance on the weight of a stock in the index.

Diversification? Yes, Please!

Finally, we're finding opportunities for diversification. It hasn't been all about AI. 2025 has shown the benefit of geographical diversification, and the value style has performed outside the US. Emerging-market debt also my offer better dynamics and higher real yields than developed-market debt.

As active investors, we don't have the luxury of talking in vague terms about risks on the horizon. We have to take a view. For 2026, we see a low risk of recession, contained bond yields, and momentum in company earnings—which leads us to stay positive. Our processes allow us to quickly recognize if our views change or if we get it wrong, so that we can adapt and adjust our strategy.

The waters are getting choppier, but we still see ways of navigating them to get to our destination. It's too soon to seek shelter.

> "As active investors, we don't have the luxury of talking in vague terms about risks on the horizon. We have to take a view.

Talk to your financial professional about incorporating active and diversified approaches into your investment plan.

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Broadening Underway? 6 Equity Ideas For 2026

As global markets adapt to shifting leadership, AI-driven innovation, and new economic regimes, investors face a wider array of opportunities and risks.

The global economy and markets navigated a challenging backdrop in 2025, marked by rising trade tensions and tariffs, ongoing conflicts in Europe and the Middle East, and persistent weakness in China. Yet, despite these headwinds, global growth proved resilient, and inflation remained relatively contained. Corporate earnings surpassed expectations—most notably in the US—with strength also broadening to Japan and select emerging markets (EM).

It would be an oversimplification to frame 2025 as a year when "the rich got richer." While mega-cap tech leaders continued to dominate, many overlooked segments of the economy showed signs of stabilization—getting "less bad" rather than worse. The narrative of narrow market leadership holds true within the US, but beyond its borders, leadership has already begun to broaden.

Equity markets enter 2026 with resilience, even amid heightened geopolitical uncertainty. Supported by fiscal and monetary accommodation, ongoing deregulation, and the AI-driven capital expenditure[1] (capex) cycle, we anticipate a further broadening of economic growth in the year ahead. Here are six themes we're watching closely in 2026:

1. No AI Bubble … At Least Not Yet

We see compelling reasons to remain optimistic about AI in 2026. Continued technological advancements may not only accelerate capital investment but also begin translating into meaningful gains in productivity and economic growth.

That said, alongside this constructive outlook, we're mindful of several flashing yellow lights, including rising debt-financed capex, increased interrelated-party transactions and financings, and more speculative activity in high-beta[2] areas of the equity market (**FIGURE 1**). These will be critical trends to monitor throughout the year.

So far, most AI-driven equity market moves have been underpinned by strong fundamentals. Unlike the debt-fueled telecom buildout of the late 1990s, most AI-related capex has been funded through free cash flow[3]—though we're starting to see a shift at the margins.

From a valuation standpoint, big tech valuations remain well below the extremes of the late '90s. Importantly, rising rates helped burst the last bubble; this time, the Federal Reserve is easing, not tightening.

Finally, the internet boom of the 1990s was built on a "build it and they will come" mindset. In contrast, AI is already delivering tangible consumer and enterprise use cases. Enterprise demand for primary enablers (such as power, labor, and natural resources), as well as critical infrastructure (such as data centers, compute, and GPUs), is already outpacing current AI capacity supply.

Insight from sub-adviser Wellington Management

Andrew Heiskell
Equity Strategist

Nicolas Wylenzek
Macro Strategist

Key Points

Global equity markets are showing signs of broader growth, driven by resilient earnings, AI-fueled investment, and shifting leadership beyond mega-cap tech.

Changing correlations and new economic regimes in regions such as Europe, Japan, and emerging markets are creating fresh opportunities and risks for diversification.

Investors must adapt their strategies for 2026 by balancing AI enthusiasm with discipline, diversifying across regions and styles, and expanding risk-mitigation tools as traditional hedges lose effectiveness.

FIGURE 1
What Should Investors Look Out For?
An AI Bubble Checklist

Valuations	Traditional valuations stretched (price/earnings, price/book)[4]	**Moderate**	Valuations are high, but not extreme relative to market or growth prospects
	Alternate valuations stretched (market cap/GDP, Tobin's Q)[5]	**High**	Both measures at/near peak
Fundamentals	Over-investment in the "new thing"	**Moderate-High**	Risk of data-center overcapacity, but demand picture unclear
	GDP-level impact	**Moderate**	Impact of AI capex approaching 1% of GDP
	Market anomalies/dislocations	**Moderate**	US share of world market cap; IT share of S&P 500 Index[6]
	Unusual mergers & acquisitions or financing	**Moderate-High**	Circular financing; "off balance sheet" data center deals
Psychology	Cavalier attitude to risk ("can't lose")	**Moderate**	Market seems pretty engaged with AI risk
	"This time is different" mindset	**Moderate**	Lack of mean reversion[7] across multiple markets
	Conversation meter and FOMO	**Low-Moderate**	Uber Driver Index[8] feels low (Bitcoin > AI)
	Corporate rebranding	**Low**	No widespread dot-com era name changes
	Frauds and scams	**Low**	Recent examples were not linked to technology
Liquidity	Ample liquidity for the "new thing"	**Moderate**	Initial public offering market warming after a cold start; robust demand for private credit
	Easy conditions/low interest rates	**Low**	Catalyst in 2000 and 2008

Source: Wellington Management.

Investment Implications
While we don't see an imminent bubble, investors should remain vigilant for signs that one may be forming. Key questions to monitor include whether companies deploying AI-related capex are generating meaningful returns, whether today's favorable supply-demand dynamics persist, and whether monetary policy and financial conditions remain accommodative, thereby continuing to support investment and lending.

2. Will the Broadening Keep Broadening?

For much of the past three years, earnings growth has been concentrated among mega-cap companies. In 2025, US large caps continued to lead, but recent months have shown encouraging signs of broadening, both by market capitalization and region (**FIGURE 2**). Positive earnings-per-share (EPS)[9] revisions across large-, mid-, and small-cap stocks in the US, as well as in Japan and select EMs (particularly Taiwan and South Korea) suggest a wider set of potential beneficiaries. A more supportive macroeconomic backdrop could further reinforce this trend.

> Recent months have shown encouraging signs of a broadening equity rally, both by market cap and region.

FIGURE 2
The US Earnings Outlook Continues to Broaden Across Market Caps
12-Month Forward Earnings Trends

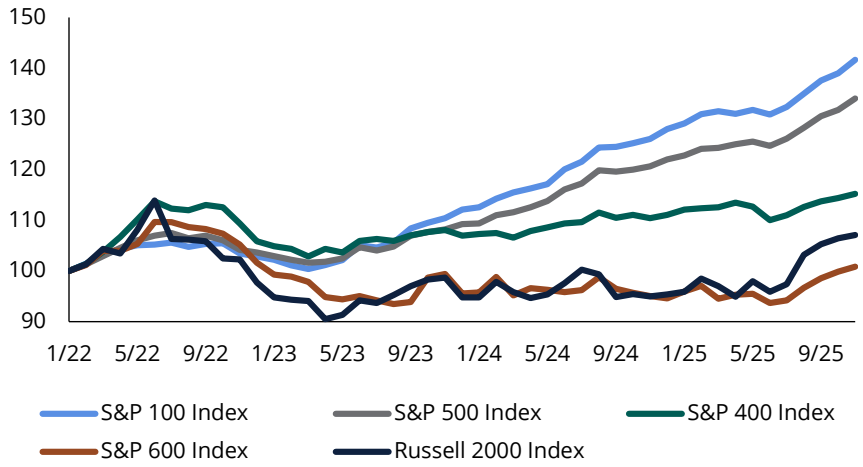

Chart Data: 10/30/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Data shows 12-month forward EPS indexed to 100 as of 1/22, for the S&P 100 Index, S&P 400 Index, S&P 500 Index, S&P 600 Index, and the Russell 2000 Index. Please see page 7 for index definitions. For illustrative purposes only. Select data provided and copyrighted by Refinitiv. Data Sources: Wellington Management, using data from Bloomberg Index Services Limited, S&P, and Refinitiv DataStream.

Investment Implications
Earnings growth is no longer confined to mega-caps. Positive revisions across regions and market caps point to a broader opportunity set. We see potential for a revival of earnings growth in Europe and across EMs, suggesting investors may want to position for more diversified sources of growth.

3. Changing Correlations Are Driving Increased Value in International Diversification

Historically, globalization fostered a highly correlated and synchronized global economy, leaving little room for divergent cycles. In an interconnected world, markets moved in unison, and volatility, inflation, and interest rates remained low. That paradigm is changing as the global order deglobalizes—or at least reorganizes. We're seeing greater cyclical divergence between countries, requiring different central-bank responses. The result: lower correlations,[10] less synchronization, and structurally higher volatility, inflation, and interest rates.

Investment Implications
The growing desynchronization of equity market moves—evident in 2025 and likely to persist into 2026—underscores the importance of diversification across geographies, industries, styles, and factors. Within styles, the sharp underperformance of quality in 2025 vs. strength in beta and momentum may present an attractive entry point. Quality may offer both offensive and defensive characteristics in a more volatile, less synchronized global environment.

4. Europe And Japan Continue to Transition to the New Regime

While the US market remains powered by the AI boom, Europe and Japan are charting their own distinct paths—idiosyncratic drivers that are strong enough to keep global markets and economies desynchronized (**FIGURE 3**).

> Earnings growth is no longer confined to mega-caps, and we see potential for a revival of earnings growth in Europe and across EMs.

The landscape in Europe is shifting. Slowing globalization and structurally higher inflation point to interest rates that could remain elevated over the long term. At the same time, the region is becoming more domestically focused and interventionist, with national security, economic resilience, and competitiveness now central to policy priorities. We think the potential winners in this new regime could be European value stocks rather than international growth names—a leadership shift supported by a recovery in European domestic demand.

An equally significant transformation is underway in Japan. After decades of deflation and sluggish growth, nominal growth is finally accelerating. Inflation has broadened, wages are rising, and both companies and households are shedding their deflationary mindset. Fiscal stimulus, accommodative monetary policy, and demographic shifts are reinforcing these trends.

This shift has two key implications. First, nominal growth drives equity returns by improving corporate earnings and margins, making equities more attractive than cash for households. Valuation outlooks are also improving as earnings become more predictable. Second, ongoing corporate governance reforms are enhancing shareholder value, further strengthening the case for Japanese equities.

> “Potential winners in this new regime could be European value stocks rather than international growth names.

FIGURE 3

In Europe and Japan, Value Outperforms Growth, Unlike in the US

Relative Performance of Value vs. Growth Equities

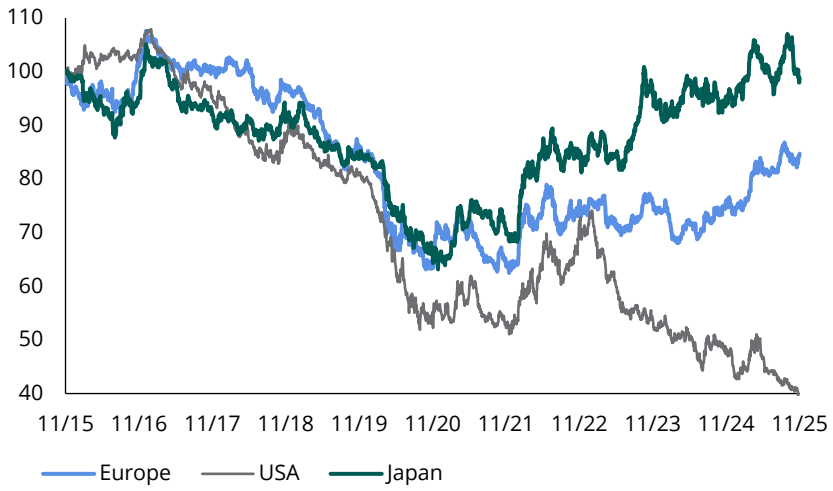

Chart Data as of 11/4/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Indices used: MSCI Europe Value Index, MSCI Europe Growth Index, MSCI USA Value Index, MSCI USA Growth Index, MSCI Japan Value Index, and MSCI Japan Growth Index. Please see page 7 for index definitions. For illustrative purposes only. Data Sources: Wellington Management, using data from MSCI and Bloomberg Index Services Limited.

Investment Implications

In Europe, investors may want to rotate away from former winners and focus on domestically oriented companies with strong margins (i.e., those aligned with regime-change beneficiaries). Sectors tied to domestic demand, such as telecoms, banks, and construction, look well positioned. Additionally, select defense stocks and utilities with high barriers to entry could emerge as winners in Europe’s transformation.

In Japan, the combination of fiscal support and accommodative monetary policy should continue to favor domestic cyclicals. Two sectors that stand out are banks and services.

5. Is The Time Finally Right for EMs?

Until 2025, EM equities lagged developed markets for nearly 15 years, weighed down by weaker EPS growth.[11] That narrative is changing. EM equities delivered their strongest year-to-date performance in seven years, signaling a potential turning point.

Like the US, 2025 returns were concentrated in tech and AI-related mega caps. While EM equity valuations remain lower than those in the US, they are no longer deeply discounted relative to history. Looking ahead to 2026, we expect EPS growth to broaden across EMs, supported by several factors:

- **Global Growth Tailwinds:** A more synchronized global recovery should benefit EM economies.
- **Currency Dynamics:** The US dollar's reserve currency dominance faces pressure from fiscal deficits, growth and inflation headwinds, and capital flows to other regions. A weaker dollar—potentially favorable for US policymakers—could boost EM returns and ease debt burdens tied to dollar-denominated liabilities (**FIGURE 4**).
- **Corporate Governance Reforms:** A growing focus on shareholder value is driving capital discipline and prioritizing returns. South Korea's Corporate Value-Up Program is making meaningful progress toward changing corporate behavior and increasing shareholder value. China's anti-involution campaign[12] reflects a similar push for reform, but both are supportive of long-term performance.
- **Policy and Financial Conditions:** The impact of tariffs on EM growth has been milder than expected, with policy responses emphasizing domestic resilience. Meanwhile, lower central-bank policy rates have provided a significant tailwind, with more global rate cuts in 2025 than in any year over the past two decades.

FIGURE 4

Is a Weaker Dollar a Catalyst for Asia and EM Outperformance?

EM Equity Performance Relative to US Dollar Strength

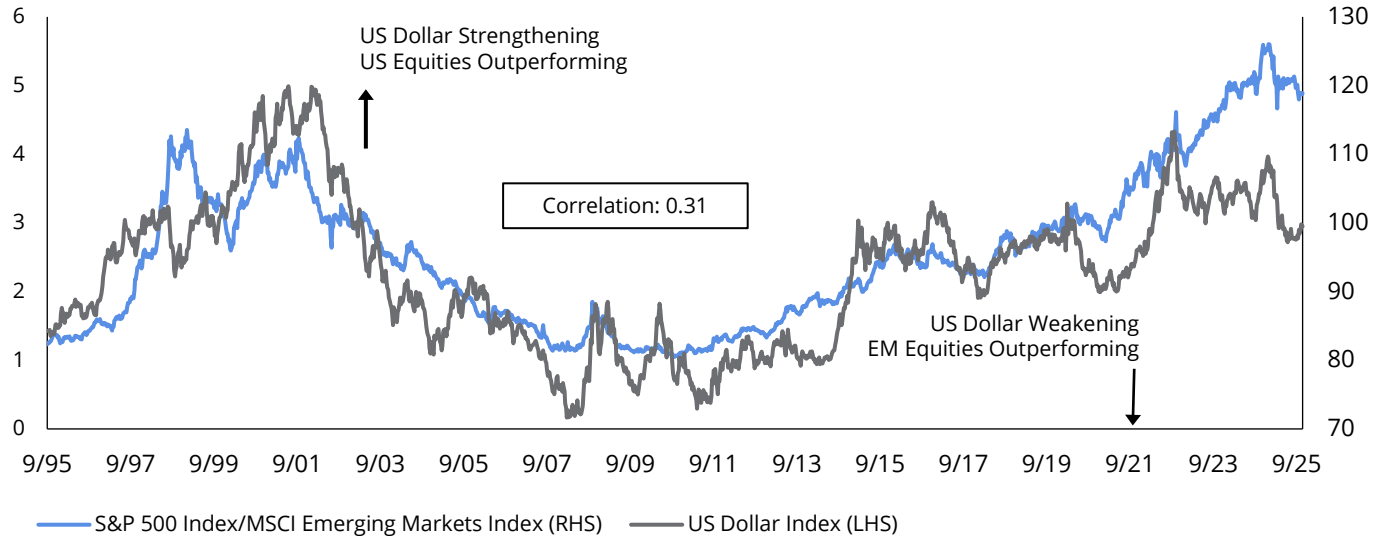

Chart data as of 11/10/25. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. Correlation is a statistical measure of how two investments move in relation to each other. Please see page 7 for index definitions. For illustrative purposes only. Data Sources: Wellington Management, using data from MSCI, S&P, and Bloomberg Index Services Limited.

Investment Implications

After years of neglect, investors may want to consider revisiting their allocation to EMs within a global portfolio. However, variation across countries remains high due to political, social, and industrial differences, meaning some markets will fare better than others. While EMs may offer a rich opportunity set, selectivity will be critical.

6. Equity Investors May Want to Look Beyond Bonds to Hedge Market Risks

The final theme we're watching is what could go wrong. Equity investors face a growing challenge in hedging downside risks as traditional correlations shift. Stocks and bonds have become more correlated in recent years (**FIGURE 5**), reducing bonds' effectiveness as an "all-weather" diversifier for equity exposure. Similarly, if US equities and the US dollar remain positively correlated, the dollar could lose its historic safe-haven status and instead becomes a risk multiplier. For non-USD investors, this dynamic heightens downside risk, making currency hedging or alternative protection strategies increasingly important.

The most difficult scenario would be a reflationary environment—one that pushes interest rates higher while driving stock and bond prices lower in tandem, as we saw in 2022.

FIGURE 5
How Might We Hedge Downside Risk?
Correlation between the S&P 500 Index and 10-Year Treasury Yields

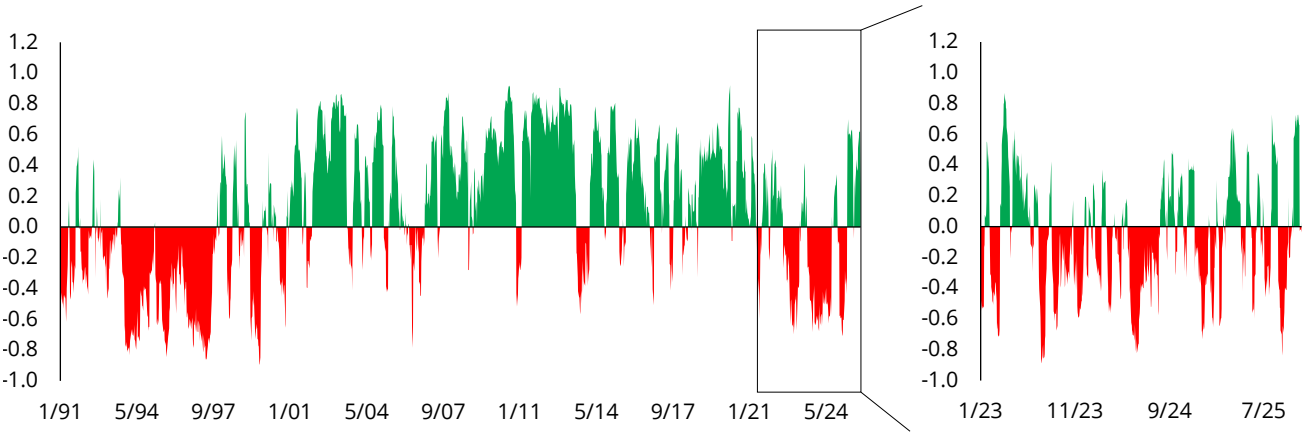

Chart data as of 11/5/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Please see page 7 for index definitions. For illustrative purposes only. Data Sources: Wellington Management, using data from S&P, and Bloomberg Index Services Limited.

Investment Implications

To help protect against downside risks, equity investors may want to consider:

- Portable alpha[13] strategies
- Stocks or strategies positioned to outperform in a higher-rate environment
- Alternative asset classes or commodities that tend to benefit from rising rates

A Broader Opportunity Set in 2026

Accommodative monetary and fiscal policy and accelerating AI-driven capital investment buoyed global growth in 2025. Looking ahead, growth may remain robust, but the investment landscape will be shaped by wider earnings variation, shifting correlations, and regime transitions in Europe, Japan, and select EMs. Against this backdrop, we believe equity investors will need to balance AI enthusiasm with discipline, diversify exposures across regions and styles, and expand their risk-mitigation toolkit to navigate a more volatile, less synchronized world.

To learn more about equity opportunities, please talk to your financial professional.

MSCI Emerging Markets Index captures large- and mid-cap equity performance across 24 emerging market countries.

MSCI Europe Growth Index represents European companies with higher growth characteristics such as earnings and revenue growth.

MSCI Europe Value Index tracks European companies exhibiting value traits like low price-to-book and price-to-earnings ratios.

MSCI Japan Growth Index measures Japanese stocks with strong growth fundamentals, including higher forecasted earnings growth.

MSCI Japan Value Index focuses on Japanese companies with value characteristics, such as lower valuations relative to fundamentals.

MSCI USA Growth Index represents US companies with above-average growth prospects in earnings and revenue.

MSCI USA Value Index tracks US companies with value attributes, including lower valuations and higher dividend yields.

Russell 2000 Index is a benchmark for US small-cap stocks, covering the smallest 2,000 companies in the Russell 3000 Index.

S&P 100 Index is comprised of 100 major US companies with large market capitalization and high liquidity.

S&P 400 Index represents US mid-cap stocks, typically companies ranked between large and small caps.

S&P 500 Index tracks 500 leading US companies across all major industries, widely used as a proxy for the US equity market.

S&P 600 Index measures US small-cap stocks, focusing on companies with smaller market capitalization and liquidity.

US Dollar Index gauges the value of the US dollar against a basket of major foreign currencies, including the euro, yen, and pound.

[1] Capital expenditures are the money a company spends to buy or upgrade long-term assets such as buildings or equipment.

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

[3] Free cash flow represents the cash a company can generate after accounting for capital expenditures needed to maintain or maximize its asset base.

[4] The price-to-earnings ratio measures a company's share price relative to its earnings-per-share and helps assess the relative value of a company's stock. Price/Book is the ratio of a stock's price to its book value per share.

[5] Tobin's Q measures how much the market values a company compared to what it would cost to replace its assets. A higher number means the market sees more value than the cost to rebuild.

[6] S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

[7] Mean reversion, or reversion to the mean, is a theory used in finance that suggests that asset price volatility and historical returns eventually will revert to the long-run mean or average level of the entire dataset.

[8] The Uber Driver Index is an informal, sentiment-based gauge rather than an official financial metric. It reflects how frequently popular investment themes (such as Bitcoin or AI) surface in everyday conversations, including among rideshare drivers. Analysts use it as a proxy for retail investor enthusiasm and market "buzz," recognizing that heightened chatter often coincides with periods of speculative fervor.

[9] Earnings per share measures how much profit a company makes per share of common stock.

[10] A correlation of 1.0 indicates the investments have historically moved in the same direction; a correlation of -1.0 means the investments have historically moved in opposite directions; and a correlation of 0 indicates no historical relationship in the movement of the investments.

[11] EPS growth is the projected growth rate in EPS for the next five years.

[12] China's anti-involution campaign seeks to reduce wasteful, zero-sum competition among companies by discouraging excessive price cutting and overexpansion, and instead promoting efficiency, innovation, and sustainable growth.

[13] Alpha measures how much an investment outperforms or underperforms its benchmark after adjusting for risk. In short, it shows whether a manager or strategy added value beyond what the market delivered.

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Earnings and Innovation: A Tailwind for Global Equities?

Alex Tedder examines reasons for optimism, even amid elevated valuations, while Tom Wilson explores the factors that could sustain emerging-market equity performance in 2026.

Investors in developed markets still face high valuations, policy uncertainty, and concentrated sector leadership, but we think supportive elements such as resilient earnings and advancements in AI could offer meaningful upside. Meanwhile, in emerging markets (EM), valuations remain reasonable, we expect earnings momentum to persist, and a resumption of US dollar (USD) depreciation could be a tailwind. As always, understanding the unique drivers and risks present in specific markets and sectors and with individual companies remains essential for navigating the global-equities landscape.

Global Equities: The Case for Cautious Optimism

By Alex Tedder, Portfolio Manager & CIO (Equities)

Notwithstanding market concentration, relatively high valuations, and rising fears about a potential AI bubble, the outlook for global equities isn't necessarily negative. Positive economic momentum, robust earnings support, and structural investment in new technologies may continue to underpin global markets for the foreseeable future.

Another Surprisingly Strong Year

In 2024, against a backdrop of macroeconomic and geopolitical uncertainty, global equities, as measured by the MSCI ACWI Index, delivered 18%.[1] Despite ongoing political volatility, global equity markets have again performed extraordinarily well, producing a return of 21.5% in dollars (as of November 30).[1]

A few factors are at work. The US economy remains robust, supported by massive fiscal stimulus (e.g., the One Big Beautiful Bill Act); high levels of capital expenditure (capex),[2] particularly by big tech companies; solid wage growth; and low energy prices. President Donald Trump's tariff policies have accelerated domestic investment in the US and, so far at least, not led to higher inflation. The overall result has been strong earnings growth: Earnings for the S&P 500 Index are on pace to rise 13% year-over-year in 2025.[3] It's not surprising, therefore, that investors have simply looked through the geopolitical noise and focused on the fundamentals.

In the rest of the world, optimism has also prevailed, with both European and Asian markets notching some of their best returns in many years. The drivers of return have so far been slightly different, however, as economic momentum and earnings growth have been much more muted in both regions. Re-valuation has been the primary factor. Investors are anticipating economic recovery in 2026 and concensus estimates are strong.

Insight from sub-adviser Schroders Investment Management

Alex Tedder
CIO Equities

Tom Wilson
Head of Emerging Market Equities

Key Points

We expect robust earnings and investment in new technologies, especially AI, to support global equities in 2026.

Elevated valuations may persist due to anticipated rate cuts and structural shifts, but risks of a correction remain.

Emerging markets present selective opportunities, with attractive valuations and a potential tailwind from US dollar depreciation.

Valuations Are High but Could Stay That Way (For Now)

A valid concern is that markets are already more than discounting a growth scenario. Almost all markets around the world look expensive relative to recent history, trading at multiples well above their 15-year medians.[3] Long-term fundamental measures such as the cyclically adjusted price-to-earnings ratio (CAPE)[4] or the market-cap-to-GDP measure (favored by Warren Buffett) are flashing red.[3] The doubters can certainly point to the fact that, historically, markets have always reverted to the mean,[5] and this suggests significant downside from current levels.

While this risk rightly looms large in our daily debate, all the market dynamics we've noted here lead us to believe those elevated valuations may be sustainable for now. We think short-term interest rates in many countries could fall, providing support to market multiples, specifically in the US. As confidence levels in economies such as China, India, or Brazil begin to improve, there could be strong demand for assets in these markets, particularly given diversified risk exposure.

Structural factors, such as China's transition to becoming a technology giant (already evident in the electric vehicle, renewable energy, and robotics sectors), are also probably being underestimated by the market. Similarly, in Europe, structural drivers such as technology infrastructure and energy transition remain fundamentally underestimated, in our view. All these factors suggest that relatively high valuations can be sustained and could go higher still.

> “Market dynamics lead us to believe that elevated valuations may be sustainable for now.

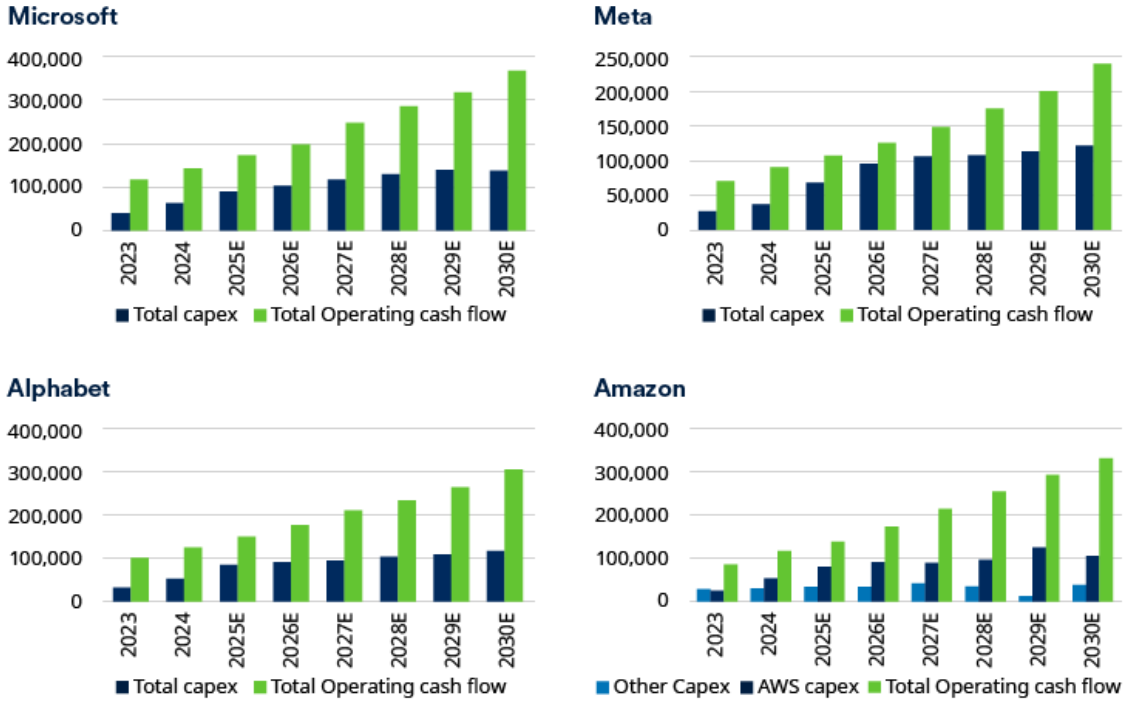
Concentration Isn't Inherently Bad

There's understandably a lot of focus on the degree of concentration in equity markets, particularly in the US. The 10 largest names in the S&P 500 Index now account for around 40% of the Index's market capitalization—a record high.[6]

Looking back in time, it's clear that every major phase of innovation has been characterized by prolonged periods of concentration. Unlike previous phases, the current technology-driven innovation wave is comprised of multiple innovation cycles, of which the most recent (and most rapid) is evident in the field of large language models, otherwise known as generative AI.

The share price performance of the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) has been driven by gigantic investment in AI infrastructure. Their rising capex in recent years represent a relatively small proportion of their operating cashflows (**FIGURE 1**). The biggest spenders have scope to increase spending quite a bit further if they deem it appropriate.

FIGURE 1
The Hyperscalers' Capex May Still Have Room to Grow
($ in Billions)



As of 7/31/25. Current economic and market trends are not a guide to future results and may not continue.
Figures are annualized; forward estimates are based on consensus estimates. Data Sources: Schroders and Bloomberg.

As the numbers have grown, so, too, have doubts about the likely return on investment and the circularity inherent in the current AI supply chain. With the largest firms accounting for more than 70% of the S&P 500 Index's total capex this year, it's no exaggeration to say that the fate of the US stock market, as a whole, depends on continued confidence in the future of AI.[7]

That confidence remains intact for now. There are some signs of irrational exuberance, as reflected in the outsized performance of AI-related companies with no earnings or even no revenues. However, the total market capitalization of those companies is small. The much more important question at this point is whether AI models can monetize at a rate that justifies their huge expenditures. There have been some encouraging signs in this regard, with Google parent Alphabet reporting a material contribution to revenue growth in cloud, search, and even YouTube from AI-related deployment.

Interestingly, ChatGPT itself is already generating revenue: About $20 billion in 2025. Based on our analysis, ChatGPT models could generate revenues of $200 billion by 2030.[8] That puts the current $500-billion market valuation of parent OpenAI into sharp context.[9] If the company were listed, a not-unrealistic valuation would be 10 times forward sales, implying a $2-trillion market capitalization. Given that AI-chipmaker Nvidia currently commands a $5-trillion valuation, the enthusiasm for AI investment suddenly becomes quite rational.[10]

Proceed With Confidence, Invest with Caution

Our optimism about the outlook for 2026 doesn't diminish our awareness of the risks. If markets continue to rise as we expect, the risk of a major correction becomes more acute. That's particularly true with valuations already at stretched levels.

The old adage that bull markets don't die of old age is probably as valid today as it's ever been. It implies that there must be a catalyst for a substantial correction to take

"If markets continue to rise as we expect, the risk of a major correction becomes more acute.

place. We don't currently see a clear catalyst for a correction. Sooner or later, however, a catalyst will come along, in our opinion, and we think it's most likely to come from the bond market. Trump's policies, while proving effective in the short term, are potentially storing up trouble in the form of higher inflation and rampant federal debt. Similarly, the UK economy, already struggling to find avenues for growth, may be overwhelmed by the weight of tax-funded government spending, eventually requiring a bailout.

There are several other potential catalysts, any of which could precipitate a reset in market valuations to more normal levels. In such circumstances, we think most assets will do quite poorly. Within equities, there's nevertheless a cohort of unloved, cash-generative, and well-funded companies that could do relatively well. Increased exposure to selective healthcare, consumer, and utilities stocks could offer useful diversification if a correction comes.

> We think the most likely catalyst for a market correction will come from the bond market.

EM Equities: Can a Bull Case Still Be Made for 2026?

Tom Wilson, Head of EM Equities

EM equities have performed strongly in 2025, outperforming global equities (as measured by the MSCI EM Index and MSCI World Index, respectively).[11] After more than a decade of underperformance, are we at an inflection point? And to what extent can EM equities continue to deliver attractive USD returns in 2026?

EM aren't homogenous, so it helps to look at their constituent parts. Four countries make up more than 75% of the MSCI EM Index benchmark: China, India, Taiwan, and South Korea.[12]

China faces ongoing structural and cyclical economic headwinds: Investment remains too high a share of GDP, debt levels are elevated, and the economy suffers excess capacity, persistent deflation, and appears to be in a liquidity trap. A real-estate bust has materially damaged local government finances and continues to suppress household confidence. However, China's strong innovation and competitiveness, along with better product quality, is driving import substitution and boosting its share of global exports.

China's equity market is very broad, and we can find multiple idiosyncratic stock opportunities. Furthermore, in the near term, abundant liquidity is proving a stronger driver of share prices than nominal growth. Geopolitical tension will continue, but China's dominance in rare-earth processing and magnets has proven a key point of leverage that defends China against excessive US tariff and nontariff action. Valuations have lifted after being cheap 12 months ago, but are reasonable, and we remain constructive on China.

India has delivered soft USD returns in 2025 and has materially underperformed after a long period of outperformance. Equity valuations have improved, but while the valuations for financials are attractive, nonfinancials valuations remain expensive. Equity supply has been a significant offset to domestic fund flows in 2024 and 2025, and other parts of EM have offered better valuations and similar or better earnings growth. However, relative performance could eventually change direction.

The narrative of structural growth is well recognized. On a shorter horizon, low inflation and a soft dollar have facilitated monetary easing, and we've also seen some modest fiscal easing. We think this could support a recovery in nominal growth from relatively low levels. A further catalyst may come in the form of tariff relief as the US tariff premium on India's import of Russian crude may at some point be removed, even if there's ongoing risk around India's service exports to the US. Finally, if the AI theme rolls over, we think India could benefit from redirected investment flows.

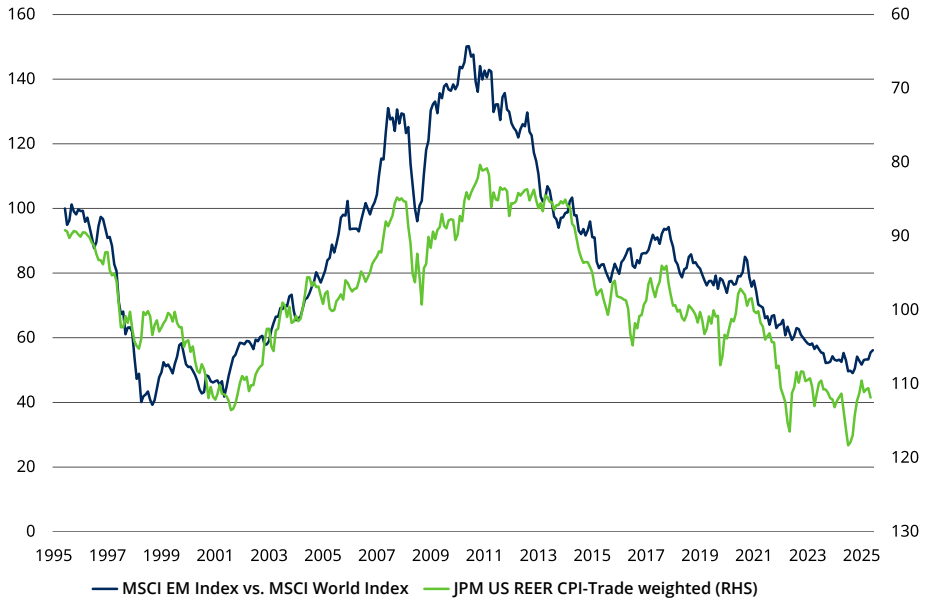
This brings us to Taiwan and Korea. Taiwan and Korea's benchmarks are currently 85% and 50% in technology, respectively.[13] AI hardware spending has been a powerful performance driver in 2025. Commentary from corporate-management teams, positive earnings dynamics, and a further material increase in capex guidance have strengthened our conviction that AI-related tech demand will remain robust into 2026, but there's uncertainty on capex in 2027. There are outstanding questions on the timing of AI monetization, the dilution of hyperscaler returns, and potential power constraints. We currently think information technology warrants an overweight, given its strong earnings momentum, but valuations have risen, and we think investors should be disciplined in trimming tech companies that run ahead of fundamentals.

Finding Opportunities Beyond the Big Four

Given their scale, the four markets discussed above dominate EM beta.[14] However, for active investors, we believe there are still plenty of alpha[15] opportunities in the universe. We think favorable conditions warrant an overweight allocation to Brazil. Equity valuations are attractive, the real effective exchange rate is cheap, and real interest rates are very high.

Elections in Brazil in October 2026 may see President Luiz Inácio Lula da Silva lose to a center-right candidate. A more fiscally responsible center-right government would calm fears about fiscal sustainability and could drive a material compression in real rates. We believe this would reduce the cost of capital, drive a marked rerating, support the currency, and drive an uplift in domestic-equity allocations from low levels. While this is partly anticipated by markets, we believe the risk/reward lies in favor of investors. Meanwhile, low inflation could permit a degree of monetary easing in 2026, and we think Federal Reserve easing and a soft dollar could provide additional support.

FIGURE 2
USD Real Effective Exchange Rate and EM Equites Relative Performance



As of 10/25. **Past performance does not guarantee future results.** Please see last page for index definitions. Data Sources: Bloomberg, Schroders, Macrobond, and BEA.

This leads us to the USD and longer-term trends. We're inclined to anticipate USD depreciation on a structural basis, given its rich valuation, a diminished appetite for foreign funding of US deficits, and longer-term potential for fiscal monetization. USD depreciation could provide a tailwind to EM relative equity performance as it eases financial conditions and has a positive translation effect, benefiting dollar-nominal growth and earnings.

FIGURE 2 shows the historic inverse correlation between the USD and EM equity relative returns. This factor, combined with attractive relative valuations, could lead to a potential stabilization or improvement in relative return on equity.[16] This is the bull case for EM but, as always, the outlook is uncertain. Meanwhile, key risks include a rollover of the AI theme, geopolitical tension, and policy volatility. Whatever the challenges, we believe EM equities continue to offer value and that investors could benefit from the diversification benefits and active investment opportunities that this market provides.

To learn more about the opportunity in equities, please talk to your financial professional.

J.P. Morgan's Real Effective Exchange Rate (REER) measures the value of a country's currency against a basket of other major currencies, adjusted for inflation.

MSCI ACWI Index is a free float-adjusted market capitalization index that measures equity market performance across both developed and emerging markets. MSCI index performance is shown net of dividend withholding tax.

MSCI EM Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance in the global emerging markets. MSCI index performance is shown net of dividend withholding tax.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

[1] Returns cited based on the gross total returns of the MSCI ACWI Index. Data Sources: MSCI, FactSet, and Schroders.

[2] Capital expenditures are the money a company spends to buy or upgrade long-term assets such as buildings or equipment.

[3] Projections are based on consensus estimates, as of 10/31/25. Data Sources: LSEG DataStream and Schroders. Forecasts are not guaranteed and should not be relied upon.

[4] CAPE is an acronym for cyclically adjusted price-earnings ratio, a valuation measure that uses real earnings per share over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.

[5] Mean reversion, or reversion to the mean, is a theory used in finance that suggests that asset price volatility and historical returns eventually will revert to the long-term mean or average level of the entire dataset.

[6] As of 9/30/25. The 10 largest companies in the S&P 500 Index represent 39.21% of the Index's total market capitalization. Data Source: FactSet.

[7] Data Source: Empirical Research Partners Analysis, 2018 through Q4 2024 estimated.

[8] CNBC, "Sam Altman Says OpenAI Will Top $20 Billion in Annualized Revenue This Year, Hundreds of Billions by 2030," 11/6/25.

[9] Reuters, OpenAI Hits $500 Billion Valuation After Share Sale to Softbank, Others, Source Says," 10/2/25.

[10] CNBC, "Nvidia Becomes First Company to Reach $5 Trillion Valuation, Fueled by AI Boom," 10/29/25.

[11] As of 10/25. Data Sources: Bloomberg, Schroders, Macrobond, and BEA.

[12] Country weights for the four largest constituents: China (28.81%), Taiwan (20.04%), India (15.78%), and South Korea (12.16%), totaling 76.79%. Data Source: MSCI Emerging Markets Index (USD) factsheet, as of 11/28/25.

[13] Information Technology weights: Taiwan (83.5%) and Korea (49.16%). Sources: MSCI Taiwan Index (USD) factsheet and MSCI Korea Index (USD) factsheet, both as of 11/28/25.

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

[15] Alpha measures how much an investment outperforms or underperforms its benchmark after adjusting for risk. In short, it shows whether a manager or strategy added value beyond what the market delivered.

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

Important Risks: Investing involves risk, including the possible loss of principal. • Foreign investments may be more volatile and less liquid than US 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. • Fixed income security risks include credit, liquidity, call, duration, event and interest-rate risk. As interest rates rise, bond prices generally fall. • Diversification does not ensure a profit or protect against a loss in declining market.

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Bonds: Finding Durable Value Amid Shifting Currents

We expect global yields to edge higher in 2026 as nimble investors weigh opportunities and risks.

Our expectation going into 2025 was that bond yields would stay higher for longer, central banks would look to cut policy rates, and governments would pursue increasingly activist fiscal policies. While these themes played out, we've also witnessed remarkable stability in bond markets. Except for the short-lived period of acute market stress following President Donald Trump's "Liberation Day" tariff announcement, bond investors have, to date, been relatively sanguine. Measures of bond volatility have edged lower and reached levels not seen since just before the inflation shock roiled markets in 2022. Credit spreads[1] have compressed to 15-year tights and global government bond yields have remained remarkably rangebound, despite increasing divergence across countries. Where do we go from here, and what are the key developments to watch as we move into 2026?

Central-Bank Independence Questioned

Over the last few years, it's become clear to investors that central banks are much more sensitive to protecting against potential economic shocks than to targeting inflation in the long or even short term. This focus on avoiding economic pain becomes especially relevant in a context in which fiscal policy continues to be expansionary and inflation remains well above central-bank targets in most developed economies—a scenario that puts monetary and fiscal policy at odds with each other. This policy disconnect is likely to be exacerbated by governments preferring, or potentially even pressuring, central banks to deliver decisions that support their expansionary budget deficits.

No central bank is more likely to see its independence implicitly or explicitly challenged than the US Federal Reserve (Fed). With Fed Chair Jerome Powell's term ending in May 2026, the combination of a new incoming Fed chair and a potentially altered composition of the rate-setting Federal Open Market Committee will provide markets with a clearer understanding of the extent to which monetary policy may further enable fiscal policy decisions. Eventually, this potential reduction in independence risks entrenching inflation and eroding cooperation across policymakers globally.

Risks to the Upside, but Yields Remain Attractive

Our base case is for global yields to edge higher throughout 2026, as expansionary fiscal policies and resilient economies could result in higher risk premia[2] across bond markets (despite some weakening in labor markets). Productivity gains could offset some of this upward pressure. But there is, of course, substantial timing uncertainty, particularly in relation to AI's ability to neutralize the negative impact of growing trade restrictions and deteriorating demographics. If business and consumer balance sheets remain resilient, we see little chance of a broad-based recession—barring a major exogenous shock. On the contrary, the economic cycle may be supported by significant capex[3] and fiscal stimulus. As the world adjusts to less-efficient supply chains and persistent trade-policy uncertainty, governments are signaling they'll continue to protect consumers from external shocks, implying further record bond issuance.

Insight from sub-adviser, Wellington Management

Amar Reganti
Managing Director at Wellington Management LLP and Fixed-Income Strategist for Hartford Funds

Marco Giordano
Investment Director

Key Points

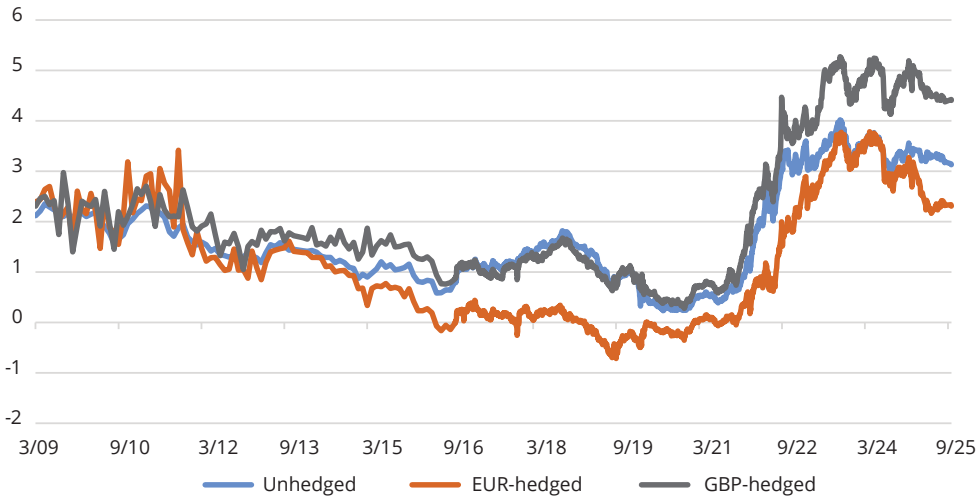
We believe global government bond yields continue to be attractive. But risks remain, underscoring the need for nimble positioning.

Debt sustainability concerns are translating into heightened volatility and growing divergence between countries, as well as upward pressure on longer-term yields that active investors can exploit.

Eroding central-bank independence is an area that warrants close monitoring.

Despite risks to the upside for yields as investors start to react to persistently higher debt—particularly at the longer end of the yield curve[4]—we think the total-return potential for rates remains very attractive. As **FIGURE 1** illustrates, yields on government bonds remain significantly above the levels seen between the Global Financial Crisis and 2022.

FIGURE 1
Global Government Bond Yields Remain Attractive
10-year Global Government Bond Yields (9/30/08–10/22/25)



As of 10/22/25. Data Sources: Bloomberg, Wellington Management, 12/25.

When Does Debt Become Unsustainable?

The game is up (or certainly becomes more difficult) for countries that lose the confidence of the market. Policymakers across major economies have increasingly turned to fiscal stimulus, delivering the most significant fiscal easing since 2010, if we exclude the extraordinary measures surrounding the COVID-19 pandemic. The key takeaway is that less economic integration and more activist fiscal policy may not only put structural upward pressure on long-term bond yields but may also lead to more compressed and more volatile cycles. We expect the theme of divergence across countries and regions to become even more pronounced heading into 2026.

US

The Trump administration's trade-policy agenda will likely remain a considerable source of uncertainty for global investors, especially as we approach the mid-term elections later in the year. The front end of the US curve will probably reflect an ongoing dovish policy tilt as the Fed will be under renewed pressure to continue its rate-cutting cycle, despite further fiscal expansion through the One Big Beautiful Bill Act. While labor demand has clearly softened, the administration's immigration policy has reduced supply, leading us to think that the labor market is weaker but will likely hold up in 2026. We note warning signs in some pockets of the credit markets but, absent a major exogenous shock, we don't anticipate a recession, meaning inflation pressures may remain elevated, especially if productivity gains don't materialize. In this scenario, yields could trend higher, particularly at the back end of the yield curve.

Europe

We expect continued differentiation across countries. Persistent political turbulence in France has not only cost the country its AA rating but also made it vulnerable

“Absent a major exogenous shock, we don't anticipate a recession, meaning inflation pressures may remain elevated, especially if productivity gains don't materialize.

to global investors' concerns over fiscal sustainability and political fragmentation. Without credible fiscal consolidation or a surge in productivity growth, countries that combine high debt levels, large deficits, and elevated interest costs relative to trend growth with heavy reliance on foreign financing are increasingly susceptible to a sudden loss of market confidence. This is likely to drive elevated term premia[5] and nominal yields. It also translates into curve steepening and widening spreads relative to countries deemed fiscally responsible. Among the key beneficiaries of the increased emphasis on fiscal rectitude is the Netherlands, which is emerging as a new risk-free benchmark for the euro area as Germany shifts toward more expansionary fiscal policy. Formerly crisis-stricken Greece, Spain, and Portugal are also enjoying increased investor confidence in their fiscal trajectories.

UK

The UK has long been identified as a bellwether for global investors' tolerance of countries with high debt levels and an unclear path toward debt consolidation. It also faces a particular challenge from persistent inflation, with a wide distribution of possible outcomes, including renewed economic growth on the one hand and the tail risk of stagflation on the other. Unless inflation is brought down by tighter demand- or supply-side policies, we expect UK rates to remain persistently higher than those of its European counterparts.

Japan

While the domestic inflation dynamics and strong nominal growth should imply the Bank of Japan has the go-ahead to keep hiking policy rates, it will likely remain on hold until it has more visibility on fiscal policy. Our structural view is for higher front-end yields and a stronger yen, but this theme will only play out if uncertainty clears.

The Shifting Shapes of Yield Curves

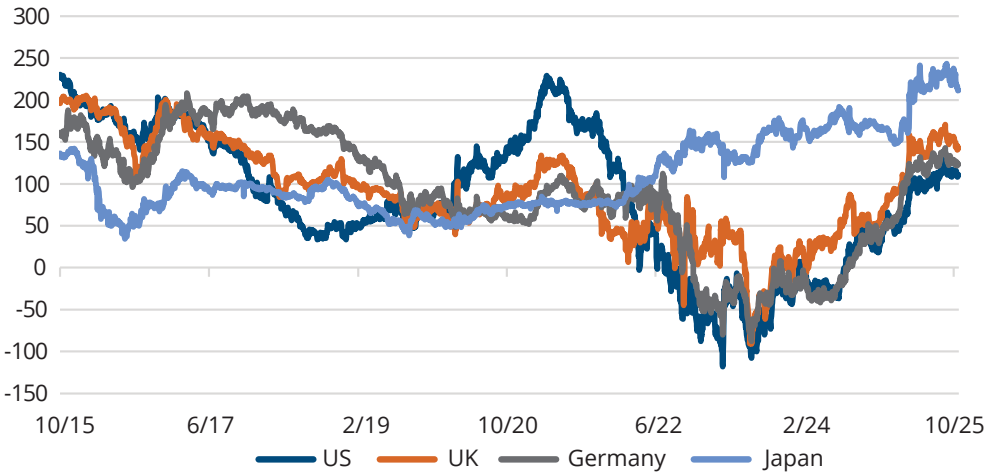
Since the lows of 2023, term premia have increased across multiple markets as yield curves normalize and investors demand more compensation for holding longer-dated bonds, as illustrated in **FIGURE 2**.

> “Unless inflation is brought down by tighter demand- or supply-side policies, we expect UK rates to remain persistently higher than those of its European counterparts.

FIGURE 2

Investors Demand More Compensation for Holding Long-Term Debt

Evolution of Spreads Between 2-year and 30-year Government Bonds (basis points)



As of 10/27/25. Spreads shown are Bloomberg-calculated spreads that replicate selling current 2-year US Treasuries, gilts, Bunds, and Japanese government bonds, and buying respective 30-year government bonds.
Data Sources: Bloomberg, Wellington Management, 12/25.

Periods of heightened volatility, while challenging, tend also to offer compelling opportunities for active investors—and this time is no different. As markets increasingly price in local growth/inflation dynamics, we see significant potential for alpha[6] generation through:

- Tactically adjusting portfolio duration[7] and yield-curve positioning
- Leveraging mispricing across regions and maturities
- Aligning exposures with differentiated macroeconomic views and policy-rate expectations, as markets increasingly price in local growth/inflation dynamics.

Conclusion

While we don't expect smooth sailing in the year ahead, we remain confident that bonds can play their role in generating income, providing diversification, and dampening volatility within a broader portfolio. Persistently high global yields should help government bonds to deliver positive total returns. However, we think careful country selection and curve positioning will make the difference, with investors needing to adjust their asset allocation to increasingly local growth/inflation dynamics and inevitable bouts of volatility.

Talk to your financial professional to learn more about fixed-income opportunities.

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

[2] A risk premium compensates investors for the higher risk of investments, providing returns above the risk-free rate. Investors typically receive higher premiums for riskier investments, as they accept a greater chance of potential loss.

[3] Capex refers to capital expenditures.

[4] The yield 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.

[5] The term premium is the extra yield investors demand for holding long-term bonds compared to rolling over a series of short-term bonds. This compensation is for the increased risks of tying up money for a longer period, such as the risk of changing interest rates

[6] Alpha is an investing term that measures an investment strategy's ability to outperform the market, often called its "edge." It represents the excess or abnormal return of an investment compared to a benchmark index, adjusted for risk. A positive alpha indicates the investment beat the benchmark, while a negative alpha means it underperformed.

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

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Global Bond Market Conditions May Demand an Active Management Approach

Experts from Schroders examine central-bank policy divergence, inflation risks, valuation dynamics, and emerging opportunities across global fixed-income markets.

As global fixed-income investors look toward 2026, the landscape is shaped by cycles that are increasingly out-of-sync across major economies, with the trajectories for inflation, monetary policy, and economic growth diverging across regions. The leaders of our fixed-income teams share their views on how these markets can be navigated in the new year.

Global Bonds: Desynchronized Cycles and Attractive Opportunities

Julien Houdain, PhD, Head of Global Unconstrained Fixed Income

2025 has been a year of differentiation in bond markets, with very large divergences in yield moves, both between geographies and at different maturities of the curve. We expect this to continue as we head into 2026.

Why? Simply because growth, labor market, and inflation outlooks are desynchronized by country, and major central banks are at different stages of their policy cycle. The US Federal Reserve (Fed) and Bank of England remain in the easing phase, the European Central Bank looks to be happily on hold, and the Bank of Japan is not yet done hiking rates.

This provides huge opportunity—but only to those who are active in their bond allocation and capable of taking advantage of fast-changing and disparate economic conditions globally. Passive management in this environment could leave portfolios overallocated to the relative "losers" as yield moves diverge, and that could lead to underwhelming returns and greater risks.

Insight from sub-adviser Schroders Investment Management

Julien Houdain
Head of Global Unconstrained Fixed Income

Lisa Hornby
Head of US Fixed Income

Abdallah Guezour
Head of Emerging-Market Debt and Commodities

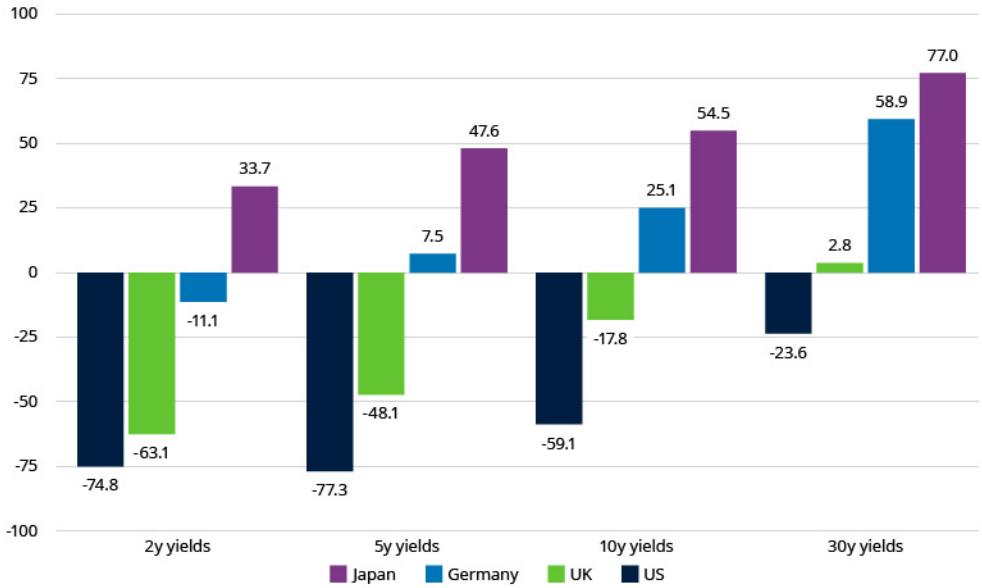
Key Points

Because central banks are at different stages of their policy cycles, there are significant opportunities for active managers who can adapt to fast-changing conditions.

The US bond market has benefited from moderating inflation, fiscal stability, and resilient consumer demand. In 2026, we expect US fixed income to remain attractive, but selectivity matters.

We expect emerging-market debt to continue to be supported by strong macroeconomic adjustments and favorable inflation trends. Improving liquidity and policy flexibility in key emerging markets may present attractive opportunities.

FIGURE 1
2025 Has Seen Desynchronized Yield Moves by Country and Maturity, and We Expect That to Continue in 2026
Year-To-Date Yield Moves Across Country and Curve (in Basis Points)



As of 10/28/2025. Current economic and market trends are not a guide to future results and may not continue. 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. Data Sources: Macrobond, Bloomberg, and Schroders, 12/25.

> We're optimistic about the outlook for the US economy in 2026 because of fiscal and monetary easing.

Too Much of a Good Thing?

We're optimistic about the outlook for the US economy in 2026 with both fiscal (as the full impact of the One Big Beautiful Bill Act hits) and monetary easing (spurred by a softening labor market in mid-2025) working their way into the economy.

While we welcome the government and central-bank support to reduce the rising hard-landing risks we saw in the summer of 2025, we worry about policymakers overcooking it on stimulus. Too much of a good thing is a real possibility, in our view. We're watchful for signs that policy has become too stimulative, such as a re-tightening of the labor market or rising core inflation and wages.

After a period of outperformance for US bonds, we're seeing better opportunities emerge for global portfolios. We also believe having inexpensive inflation protection is prudent given a strong growth outlook, dovish policymaking, and the ongoing threat of weakened credibility of the Fed with the end of Jerome Powell's term in May 2026 and the appointment of a new chairperson.

Europe's economy has been slowly improving throughout 2025. We see this continuing into next year and expect German fiscal stimulus to be additive, but not a game changer to overall eurozone growth, in our view.

In the UK, however, a loosening labor market, combined with a budget that will tighten fiscal policy, will likely keep UK growth below trend early in the year. We think this could continue to create opportunities in gilts, the government bonds issued by the UK.

The Only Certainty Is Uncertainty

Whether it's concerns over concentrated AI-driven growth, inflated equity prices, volatile US policy, or other risks, the diversification benefits of fixed income as an asset class are increasing as global inflation pressures remain benign.

For investors still heavily invested in cash, the safety net is not as strong as it once was. With cash rates falling and unable to keep pace with inflation, bonds remain an attractive income opportunity.

Patience Is a Virtue

Corporate bonds have enjoyed another year of positive performance, but we see the valuation starting point as the key driver of forward-looking returns. The spread[1] earned for taking additional credit risk over government bonds is now at historically low levels. With these very tight spread levels, significant exposure here seems unwise.

Opportunities to add risk in credit will present themselves in 2026, as they generally do, though we never know in advance what's going to be the catalyst for change. Given our optimistic growth outlook, we believe the ability to deploy capital when these better opportunities arise is the most sensible approach. In the meantime, it's important to use rigorous fundamental research, look where other investors aren't, and continue to innovate to generate alpha[2] within corporate bonds.

This flexible approach to asset allocation also means taking advantage of better opportunities when they arise. We think agency mortgage-backed securities could be supported by attractive valuations and declining rate volatility. In Europe, we're also finding good opportunities in quasi-sovereign and covered bond issuers.

2026 will inevitably bring both risks and opportunities. As such, we think an agile and active approach to bond investing will be even more important for delivering investment performance.

US Bonds: A Strong Year—and Supportive Conditions Could Extend Into 2026

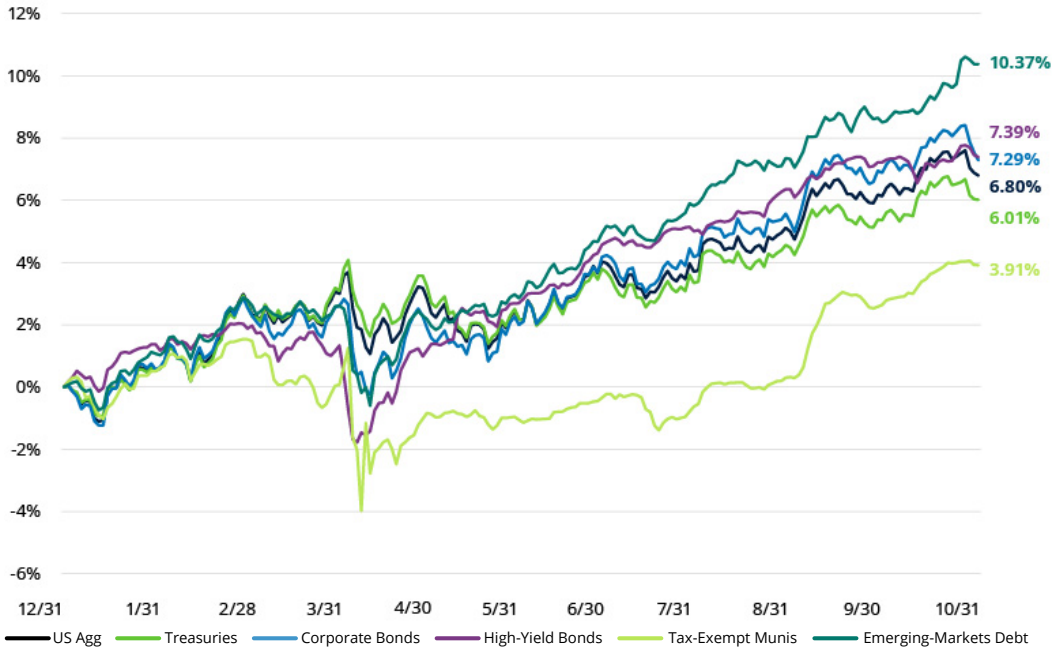
Lisa Hornby, CFA, Head of US Fixed Income

Despite early year pessimism, US fixed income posted solid performance across nearly all sectors. The strong and steady returns were driven by income earned from high coupons and further supported by price gains from lower Treasury rates and tighter spreads in the credit and mortgage-backed securities (MBS) sectors.

> 2026 will inevitably bring both risks and opportunities. As such, we think an agile and active approach to bond investing will be even more important.

FIGURE 2

Strong 2025 YTD Returns Across Most Sectors of the US Bond Market



As of 10/31/25. **Past performance does not guarantee future results.** US Agg represented by the Bloomberg US Aggregate Bond Index. Treasuries represented by the Bloomberg US Treasury Index. Corporate Bonds represented by the Bloomberg US Corporate Investment Grade Index. High-Yield Bonds represented by the Bloomberg US Corporate High Yield Index. Tax-Exempt Munis represented by the Bloomberg Municipal Bond Index. Emerging-Markets Debt represented by the Bloomberg EM USD Aggregate Index. Data Source: Bloomberg.

We believe today's benign economic conditions could persist and support US fixed-income performance in 2026. The US economy continues to absorb shocks effectively. The economy has settled into a mild mid-cycle environment, with growth moderating from last year's elevated pace but remaining positive, inflation trending toward a range in the Fed's comfort zone, and the labor market adjusting in a measured way. For fixed-income investors, this combination—slower growth without sharp contraction and contained inflation—has historically provided fertile ground for strong total returns.

Several factors could continue to support US bond markets in 2026. Notably, the inflation pass-through from tariffs remains limited, with companies absorbing more cost pressures through productivity gains and lower profit margins, thereby reducing the risk of an inflation spike. Provided this dynamic holds, there's room for interest rates to remain anchored or gradually decline further, and that could support further price appreciation for bonds.

Fiscal tailwinds from the One Big Beautiful Bill Act (OBBBA) are expected to persist into 2026, thereby potentially cushioning the economy from the effects of softer private sector demand for labor. Companies' immediate expensing of capital expenditures and increased federal investment commitments could continue to help steady nominal GDP growth, further boding well for credit quality.

The US consumer remains broadly healthy, supported by robust household balance sheets, although spending is increasingly concentrated among the top 10% of earners. This lends some fragility to growth, yet we think aggregate consumption is likely to remain resilient. This would provide a supportive backdrop for credit and structured products well into next year.

Such conditions—moderating inflation, fiscal stability, and a healthy consumer—would bode well for US fixed-income returns in 2026, from both attractive income and potential capital appreciation as yields adjust to an ongoing moderate central-bank policy and a backdrop of economic growth.

> “Moderating inflation, fiscal stability, and a healthy consumer would bode well for US fixed-income returns in 2026.

Risks to the Outlook Remain

Recent failures in less-regulated debt markets highlight the importance of transparency and liquidity—characteristics that will likely sustain interest in publicly regulated debt markets if volatility rises in 2026. Meanwhile, the rapid flow of capital into artificial intelligence (AI) ecosystems has increased interconnectedness in the technology sector. A valuation correction in one node of the AI supply chain could potentially trigger cascading effects across the entire ecosystem because of tightly woven financial relationships.

Positioning for Quality in a Higher-Yield World

We think the broader US fixed-income market continues to offer an attractive prospective return profile, especially as we look toward 2026. In our opinion, the current environment calls for greater selectivity across sectors. We see value in increasing exposures to high-quality duration[3] assets such as tax-exempt municipals and securitized instruments, while avoiding generic credit beta[4] that no longer offers sufficient spread premium. With yields already attractive, investors do not need to stretch for incremental income. We believe the focus should remain on securities and sectors where income is sustainable, and downside risks are limited.

Despite ongoing uncertainty, the core message remains: US fixed-income markets continue to benefit from moderating inflation, more stable fiscal dynamics, and a resilient—if slower—economy. In this environment, high-quality sectors such as agency MBS and long-dated tax-exempt municipals could remain well positioned in 2026. The strong performance in 2025 reinforces the thesis that starting yields matter, and investors who focus on quality and value could, in our view, be rewarded as supportive conditions carry into next year.

Emerging-Market Debt: The Stage Is Set for a New Reallocation Cycle

Abdallah Guezour, Head of Emerging Market Debt and Commodities

Emerging-market (EM) debt is on track to deliver a third consecutive year of strong returns, as markets continue to reward the macroeconomic adjustments experienced by key EM countries in the post-pandemic period. These adjustments—which broadly preserved fiscal and balance of payments sustainability and enhanced external buffers—explain the recent growth resilience of emerging markets in the face of the global trade and geopolitical dislocations. As global investors are now starting to recognize these achievements, a recovery in portfolio flows to EM fixed-income markets is underway. This capital reallocation cycle is still in its early stages and has further to go. Global asset allocators are still severely underinvested in the asset class despite its strong outperformance in recent years.

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More Room for Monetary Easing

In our view, this recovery in capital flows will be supported by emerging markets’ economic growth, which is expected to strengthen in 2026, thanks to improving domestic liquidity conditions as EM central banks regain room to ease monetary policy. This upturn in monetary and credit cycles is unfolding against the backdrop of already robust private-sector balance sheets, which could enhance the transmission of policy stimulus into real economic activity. Encouragingly, EM exports have also remained resilient despite the headwinds from recent US trade tariffs.

We expect these dynamics to keep the average EM growth premium over the US sufficient to warrant the recent renewed investors’ appetite for EM assets. However, China’s growth trajectory may remain subdued, as it could be constrained by persistent weakness in the property sector and the lingering risk of renewed trade or geopolitical tensions with the US. That said, continued calibrated policy support in China and a still-solid external position—including a healthy trade surplus and ample foreign-exchange reserves—could continue to provide a meaningful buffer against downside risks.

The global disinflation trend of the past two years remains intact, although the US may soon be an exception as tariff effects could start to feed through, thereby maintaining price pressures and potentially undermining the credibility of the Fed’s current easing cycle. While this represents a risk for EM assets, we take comfort from the fact that EM inflation remains more benign, supported by subdued food and energy prices and China’s ongoing export of deflation.

A Favorable Inflation Outlook

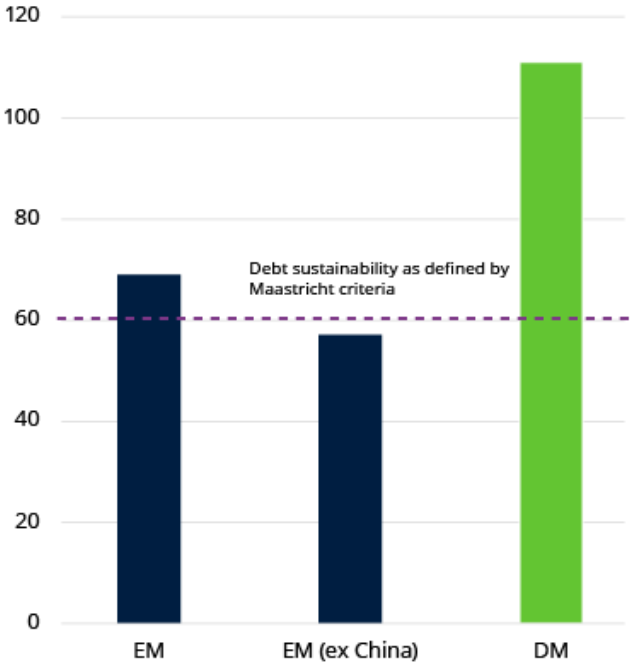
This disinflation emanating from China is particularly beneficial to EM economies with lower trade barriers and minimal export overlap with China, most notably the commodity-exporting nations in Latin America and Eastern Europe, the Middle East, and Africa. With this favorable inflation outlook, real rates across EM remain unnecessarily too high, in our view, and 10-year local government bond yields still offer appealing value. This appeal is reinforced by more favorable public-sector debt dynamics in EM, especially when compared with their developed-markets counterparts (**FIGURE 3**).

FIGURE 3

Debt Dynamics and Real Yields: EM and DM

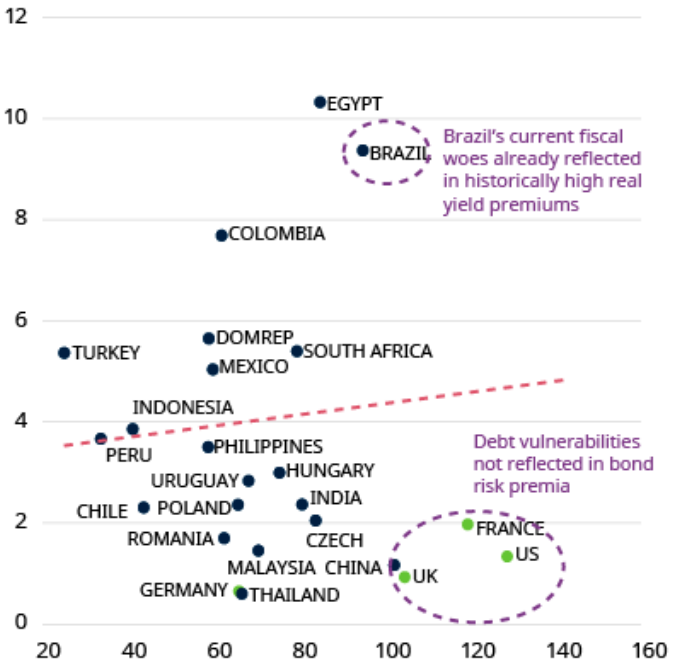
Average Government Debt/GDP %

DM Ratios Underestimate Real Level of Debt as They Exclude Unfunded Liabilities



Expected Inflation-Adjusted Yields vs. Gross Debt as a % of GDP

Real Yield (10y-12 Month Forward CPI) vs. Gross Debt



As of September 2025. Risk premia is the investment return an asset is expected to yield in excess of the risk-free rate of return. Maastricht criteria are a set of economic rules that European Union (EU) countries must meet to adopt the euro as their currency. Data Sources: IMF, Macrobond, and Schroders, 12/25.

A Currency Cycle That May Favor Non-US Assets

This favorable outlook could also be boosted further if the US dollar continues the cyclical downturn that began in 2025. While intermittent rebounds of the dollar may be expected and will require active currency risk hedging, various factors are likely to continue to put pressures on the greenback. Indeed, the dollar remains expensive on a real effective exchange-rate[5] basis. It's also losing interest-rate support and is increasingly affected by the unsustainable accumulation of twin deficits—fiscal and current account. With the dollar having broken its 15-year uptrend this year, the currency cycle appears to be turning in favor of non-US asset outperformance. This environment, combined with abundant global financial liquidity, reinforces the relative attractiveness of EM debt, particularly in local currency segments. We continue to favor markets such as Brazil, Mexico, South Africa, India, and parts of Central Europe, in which valuations remain compelling and policy flexibility is high. While EM dollar-denominated debt spreads have already tightened substantially, this sector still offers attractive high-income opportunities, especially among selective high-yield sovereign and corporate issuers.

To learn more about the opportunity in fixed income, please talk to your financial professional.

Bloomberg Emerging Markets Debt Index, an unmanaged index that tracks total returns for external-currency-denominated debt instruments of the emerging markets

Bloomberg Municipal Bond Index is designed to cover the USD-denominated long-term tax-exempt bond market.

Bloomberg US Aggregate Bond Index is composed of securities that cover the US investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

Bloomberg U.S. Corporate High-Yield Bond Index is an unmanaged broad-based market-value-weighted index that tracks the total return performance of non-investment grade, fixed-rate, publicly placed, dollar denominated and nonconvertible debt registered with the Securities and Exchange Commission.

Bloomberg US Corporate Investment Grade Bond Index covers all publicly issued, fixed rate, nonconvertible, investment grade debt.

Bloomberg Barclays US Treasury Index is an unmanaged index of prices of US Treasury bonds with maturities of one to 30 years.

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

[2] Alpha is the measure of the performance of a portfolio after adjusting for risk. Alpha is the excess return of a portfolio over its benchmark.

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

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

[5] Real effective exchange rate measures the value of a country's currency compared to a basket of other major currencies, adjusted for inflation.

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