Market Outlook

August 2026

Sun Life Asset Management

Low-Carbon Investment: Seeking Stability Amid Uncertainty

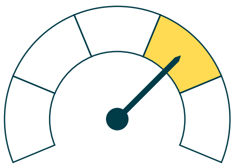
The Federal Reserve kept interest rates unchanged at its July meeting, reflecting a cautious balance between inflation that remains above target and signs of cooling in the labour market and broader economic momentum. We expect U.S. inflation to ease in the second half of the year, giving the Fed greater room to stay on hold. However, if oil prices rise further, another rate hike cannot be ruled out. With the interest rate outlook still uncertain, market volatility may persist.

In uncertain markets, investors may prefer to hold more cash to strengthen downside protection. However, cash is better suited for short-term liquidity management and may not serve well as the core of a long-term portfolio. As interest rates decline, cash returns may fall quickly. Holding too much cash for an extended period could also erode purchasing power through inflation and weaken the effect of compounding. Investors may therefore consider allocating part of their portfolios to lower-volatility, more defensive equity sectors, which can help manage overall portfolio volatility while maintaining exposure to market growth.

A global low-carbon strategy can play this role. By diversifying across developed markets and sectors, while focusing on companies with stronger sustainability profiles, the strategy can help reduce exposure to single-market or sector risks. For example, the FTSE Developed Low Carbon Index recorded volatility of 10.4% over the past year, around 20% lower than traditional global equity strategies. In July, global equity markets experienced notable volatility, with some Asian markets posting double-digit declines, while the global low-carbon strategy still delivered positive returns. Reducing losses during market drawdowns can help preserve capital and support better long-term compounding.

Source: Bloomberg

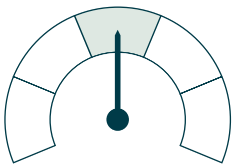
12-Month Outlook



Slightly Positive

US Equity

ESG (Low Carbon)



Neutral

European Equity

Asian Equity

China/HK Equity

Global Bond

Cash

Equities

US Equity

Slightly Positive

No Change

- The US labor market and economy remain resilient. Although the Federal Reserve has adopted a more hawkish stance, we expect it to keep policy rates unchanged for the rest of this year, subject to inflation developments
- Corporate earnings and capital expenditure—particularly in AI infrastructure—remain strong. The AI theme remains intact, but be cautious to higher bar on outlooks
- Geopolitical tensions in the Middle East have eased. However, unexpected flare-ups could still trigger short-term market volatility

European Equity

Neutral

No Change

- The European Central Bank raised interest rates by 25 basis points in June. As geopolitical tensions in the Middle East have eased, the outlook for the European economy has improved, supporting further monetary policy tightening by the central bank
- Corporate earnings in the region are improving, but mostly benefited from commodity names

Asian Equity

Neutral

No Change

- We view AI as a structural growth theme in Asia. South Korea and Taiwan, in particular, are capitalizing on robust hardware demand, which remains a primary catalyst for short-term earnings growth
- Certain non-fundamental risks (e.g. De-leveraging in Korean market, JPY carry trade unwind) remain, but less worrying in the short near term. Recent correction has made valuations attractive despite ongoing volatility
- The trajectory of the USD is expected to remain a key source of short-term volatility across the region

China/HK Equity

Neutral

No Change

- China set a GDP growth target of 4.5%-5% in 2026. While recent growth was buoyed by strong exports, domestic consumption remains lagging.
- Market dynamics show a rotation from high-growth technology sectors into undervalued, high-dividend stocks. A "barbell Strategy" can balance structural risks while delivering stable returns. On one side of the barbell, focus should remain on the "AI+" theme, which is poised to become a key engine driving "New Quality Productive Forces" and the commencement of the "15th Five-Year Plan"

Thematic Equities

ESG (Low Carbon)

Slightly Positive

No Change

- The US-Iran conflict has exposed the global dependence on fossil fuels, which accerlates the investment demand for low-carbon transition
- In an increasingly volatile market, low-carbon strategies are demonstrating superior resilience, offering stronger downside protection and more attractive risk-adjusted returns compared to traditional equity strategies

Fixed Income & Cash

Global Bond

Neutral

No Change

- US 10-year yield may stay range-bound, but with high uncertainty given the Iran conflict and the potential "regime changes" under Warsh's Fed
- Corporate credit valuations are rich, though fundamentals are expected to remain benign. We believe allocating to high-quality, investment-grade bonds will enhance portfolio risk management

Cash

Neutral

No Change

- With expectation of market jitters continuing in the near term, cash remains as a defensive asset

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