IFM Investors

Economic Update
Q4 2025

The end of a turbulent year, but not the turbulence


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Global markets ended 2025 on firmer footing than expected in what was a turbulent year. Tariff shocks faded, but trade tensions and policy uncertainty loom for 2026. Advanced economies face modest growth, loose fiscal stances, and idiosyncratic monetary easing. Equity market gains need to broaden out to be sustained, while fixed income offers limited upside; real assets remain a defensive play.

GLOBAL: Easy does it into 2026

As 2025 draws to a close it appears that the global economy, and advanced economies in particular, have entered a period of relative stability - a somewhat surprising one given the tumultuous year it has been. The shock to confidence, economies and markets from tariff announcements has largely passed. Even though trade tensions have not, with further volatility in this space is likely to be a theme of 2026. Indeed, the relatively benign economic forecasts for advanced economies for 2026 (see Graph 02) risk being a placeholder for more volatility to come. And this comes as a risk to equity markets in particular, that have swung from being as much as 15% lower, (taking the US as an example), in the wake of 'Liberation Day' to as much as close to 18% higher. The sell-off in recent weeks has also been brief, even though the drivers behind it - Fed uncertainty, compounded by US government shutdown, concerns over AI-hype and a pull-back in broader sentiment – were valid, particularly as we approach an uncertain 2026. European markets (notably smaller ones) and selected emerging markets (as we noted last quarter) are also returning very well. Australian equity market gains being relatively modest by comparison. Fixed income also had a turning point mid-year underpinned by a choppy rally of US long duration government bonds, moving up the credit curve gained investors some return pick up as spreads remained tight despite economic risks.

GRAPH 01 US EQUITIES AND LONG DURATION TREASURIES

Source: IFM Investors, Bloomberg, Macrobond

Despite global policy rates falling through the year global long duration (over ten years) bonds underperformed the rally across the rest of the curve. The 10s30s yield curve across G7 countries steepened driven by an increase in 30-year bond yields and, at the time of writing was at 4.2% - a rate not seen since 2011. This comes as scepticism around fiscal discipline remains a thematic and investors seek a greater term premium to fund government largesse. Fiscal accommodation and large deficits seem likely to persist through 2026. Discontent with many advanced economy governments and the rumbles populism make it a difficult path to tighten fiscal policy; the UK may be a notable test case through the year. Pressures also stem from the need to increase defence spending across many jurisdictions. The cessation of the Russia-Ukraine conflict is a key geopolitical risk; however, such an outcome would not remove this need.

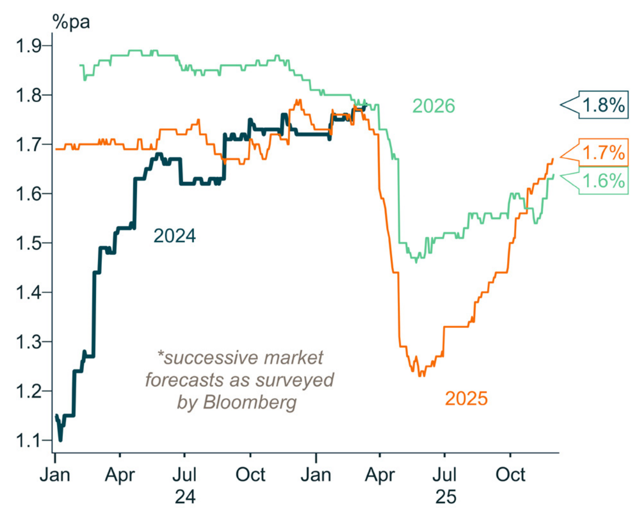
In a world where fiscal policy remains relatively loose then the room or need for further monetary easing remains modest. The Fed may find itself easing more than most of its peer central banks even though the outlook for US inflation remains on the high side. And central banks like that in Europe may ease more modestly even though its inflation rate allows it to go further. Central bank responses across advanced economies will be far more idiosyncratic in 2026. Outside of Japan, where modest hikes are expected, the trend will be to ease and hold. This is as policymakers feel for r*, hoping for stabilised labour markets and grappling with a weaker disinflationary pulse and accommodative fiscal stances.

Recession risks across advanced economies are not high going into 2026 given the absence of any specific disruptive shock on the horizon, even though we'd assess geopolitical uncertainty remains high. Indeed, economic growth for 2026 is expected to be much as it was in 2025, at trend, at best. Eurozone growth is expected to slow from 2025's pace, despite a pickup in the larger economies, notably Germany. There's little improvement expected in the UK or Japan. While no material improvement is expected in growth in the US its rate of growth is likely to be well above most advanced economy peers. Fiscal and financial condition tailwinds, the AI-investment super-cycle and what has been solid productivity growth should all underpin this differentiation. The consumer recovery will be supported by these themes, though many note the risk of a K-shaped growth dynamic across income quintiles.

Despite this expectation on the economy there are risks in both directions. We are but a year into the new Administration's term, mid-terms are on the horizon (a low Presidential approval ratings suggest a fiscal incentive could be announced), US-China trade tensions are unresolved nor are legal challenges to the broader tariff complex. And a watchful eye will be kept on the Fed as Chair Powell comes to the end of his term and on other potential changes that could occur. This is with a view to not only the potential for easier monetary policy but also the erosion of trust in a key institution.

A key thematic for economies and equity markets is AI. The investment in the real assets and its adoption to broaden-out productivity dividends. We will likely need to see the latter to give confidence to the former, that is a clearer path to how AI investment is monetised. This is important for the US equity market as, at the time of writing, the 12.3% price return year to date can be decomposed into 6.9ppts from AI companies and 5.4ppts from the rest of the index. For equity market returns in the US to again be solid in 2026 we'd expect economic performance will need to underpin earnings in non-AI sectors, especially if AI-hype takes a breather. We are not convinced that the thematic emerging market bid has materially further to run but potential policy volatility out of the US may again underpin the 'anywhere-but-the-US' trade that has supported other developed economy bourses through 2025. On fixed income, given the outlook, yields are again only expected to grind lower and in the context of a benign economic outlook the recent widening of credit spreads may narrow slightly but material outperformance of core fixed income seems unlikely. Real assets, in particular unlisted infrastructure, look attractive as a hedge against uncertainty that we think is likely to come in some form over the course of next year.

GRAPH 02 **DEVELOPED MARKET REAL GDP FORECASTS**



Source: IFM Investors, Bloomberg, Macrobond

Key takeaways

Equity markets
Non-AI sectors will need to lift to support US markets and US policy volatility underpins the other DM bid.

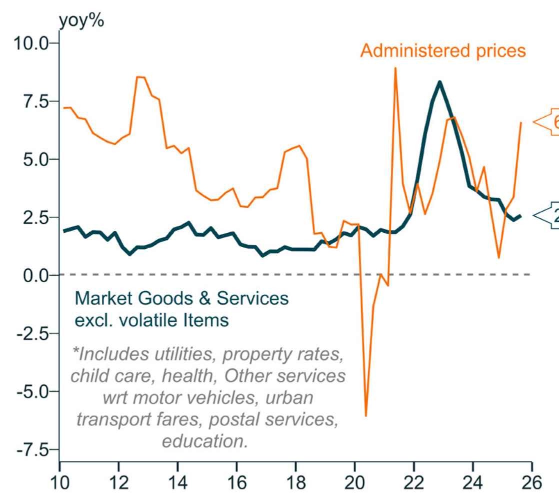
Fixed income
Bond yields drifting given the economic, fiscal and monetary outlook, resistance to move materially lower.

Geopolitics
Unlisted infrastructure attractive as a hedge against uncertainty.

AUSTRALIA: RBA forced to change tack

In Australia, the Reserve Bank of Australia (RBA) has had to pause its easing of policy indefinitely due to an unwelcome acceleration of inflation. The monthly indicators had provided some cause for concern in the lead up to September quarter's inflation which then confirmed what was feared. The inaugural monthly CPI release added further evidence still. Trimmed mean inflation, which had been forecast by the RBA, to remain comfortably near the mid-point of the target band accelerated to the top, hitting 3.0%yoy. On a 6-month annualized basis market service inflation hit 3.9%, ex-food & energy was 3.7% and non-tradable goods 4.4%. Also, an interesting dynamic is that 'administered prices' have accelerated markedly while market prices more modestly, this suggests there may be little for the RBA to do but wait and to us this rules out the prospect of near-term rate cuts – but does not make the case for the next move in rates to be higher.

GRAPH 03 ADMINISTERED INFLATION*



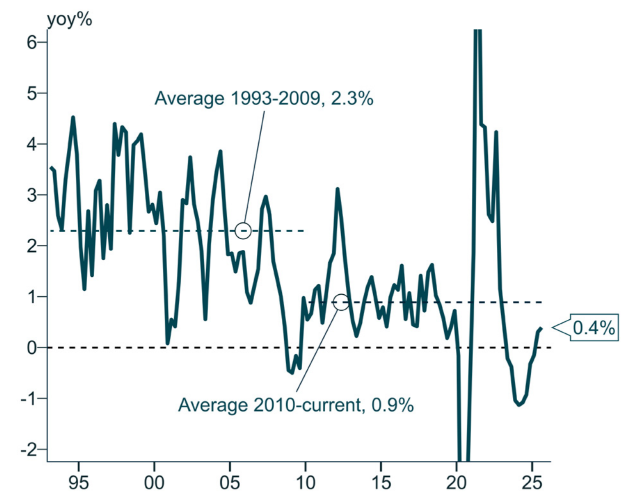
Source: IFM Investors, ABS, RBA via Macrobond

Recent labor market data was also shaping views on the RBA's policy stance with some weakness in employment seeing the unemployment rate rise to 4.5%. However, this retraced to 4.3% in October's release, reducing the risk unemployment will spike higher and put the RBA in an even more difficult position. For now, we'd expected the unemployment rate to grind higher, and the Bank will need to tolerate this as it stares down inflation. We wouldn't expect that the RBA will be able to support the labour market with further easing until late 2026 at best.

Real GDP growth expanded 0.4%qoq and 2.1%yoy in the September quarter, this represents a modest acceleration of growth. This outcome disappointed the RBA's implied expectation from its November Statement on Monetary Policy but upward revisions have meant its forecast to Q4 of 2.0%yoy will need only a 0.5%qoq outturn.

The positive from these national accounts was the broadening out of private sector demand, led by households and business investment in the quarter. However, despite solid private demand the rotation away from the public sector has not occurred and we risk having an economy that is pushing up against its potential rates of growth – an uncomfortable development given it comes at a time when inflation has accelerated. Improvements in productivity growth remain modest and a re-acceleration of population growth still suggests that our economy gets bigger more quickly than it gets better.

GRAPH 04 PER CAPITA REAL GDP GROWTH



Source: IFM Investors, ABS, via Macrobond

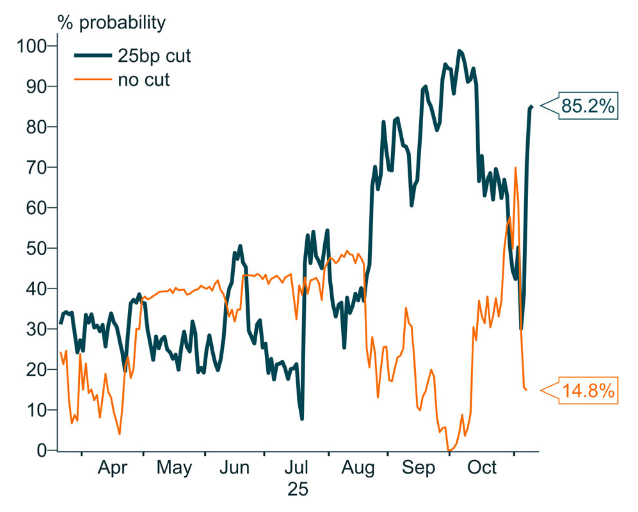
The outlook for Australia is for growth to be approaching potential at 2% in 2026. On the face of it this seems respectable in the global context, but it is an economy that is beset by imbalances. The first is population growth, we are coming off peaks in growth and as we do so we need productivity to pick up to underpin growth. We've become an economy too content to be bigger without really striving to get better. The second is closely related to the first and that is the rise and rise of government spending. Governments, both Federal and State, are far more focused on redistribution rather than reform, this has resulted in the public sector being too prominent in economic growth, and employment, at the expense of the private sector. It is difficult to see this being wound back but it should slow, or we risk even wider fiscal deficits. And lastly property, we have too much borrowing and household debt already without another upswing in the credit cycle – the latter might be modestly growth positive near term and a risk to growth in the medium term. What we need more of is housing supply, to curb both price and rental growth but material upside in that space seems limited into 2026. Similarly, business investment, outside the AI/data center thematic, is also likely to play a limited role in better economic growth in the coming year. A lot will depend on the consumer and here the K-shaped dynamic may be at play in the Australian context, those that might do well are higher income/lower debt cohorts and those that do less well are those on lower incomes, with higher debt and still facing cost of living pressures and potential job insecurity. Because of these factors, we expect the economy to drift through 2026.

US: Driving through fog

The quarter opened under a cloud of uncertainty – a consequence of the longest government shutdown in history. What began as a routine budget negotiation spiralled into a 43-day standoff which saw a freezing of federal operations injecting uncertainty into the outlook and downside risks to growth late in the year. At the heart of the impasse lay deep partisan rifts over healthcare funding and social safety nets. The shutdown also compromised the flow of critical economic data including employment reports, inflation reports and consumer spending metrics.

Labour market indicators that remained available throughout the shutdown provided the Federal Open Market Committee (FOMC) with sufficient confidence that downside risks to employment had 'risen in recent months' justifying a 25bp reduction in the funds rate to 3.75% in October. Despite the move lower, the minutes released in November struck a more hawkish tone with FOMC participants holding 'strongly differing views' about the prospect of a follow up cut in December, an outcome that 'almost all' participants had deemed appropriate just a month prior. Indeed, the minutes highlighted that 'many participants' perceived cuts as appropriate 'over time' rather than in the immediate future. The FOMC noted that the data vacuum contributed to a divergence in opinion over forward guidance with Chair Powell suggesting that it is prudent to proverbially slowdown when 'driving through fog'.

GRAPH 05 **FOMC DECEMBER MEETING MARKET IMPLIED PROBABILITIES**



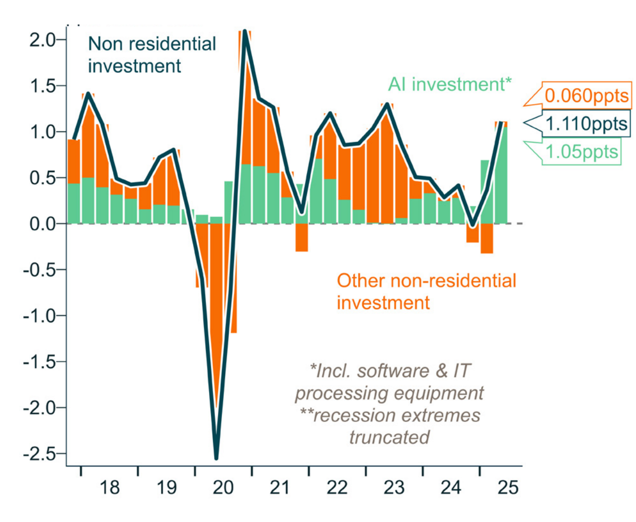
Source: IFM Investors, CME Group via Macrobond

The fog isn't showing any signs of clearing with the Bureau of Economic Analysis (BEA) having since delayed Q3 GDP and inflation reads and the Bureau of Labor Statistics (BLS) cancelling October's nonfarm payrolls data release outright. As the Government reopened, delayed September employment data came through offering the Fed an incomplete and dated look the labour market. The data beat expectations as non-farm payrolls added 119k, yet July and August figures were revised lower and the unemployment rate edged up a tenth to 4.4% as the labour force grew more than employment. These signals, in combination with hawkish Fed messaging saw a material repricing in market expectations for a December rate cut, falling from 85% mid-October to a low of around 40%. Diminished rate cut expectations and elevated tech valuations led to the worst weekly performance in the S&P500 since April's 'Liberation Day' selloff. Heavy losses were partially pared back after New York Fed President Williams signalled that he viewed tariff related price pressures as temporary and would back a quarter point cut in December. The market implied probability whipsawed back above 85% taking signal that on balance the FOMC sees risks tilted to a softening labour. Indeed, core-PCE has remained broadly stable over 2025 with Fed estimates of 2.8%yoy in September and participants flagging that the read would be close to 2% stripping out tariff pressures.

While growth has been resilient over 2025, composition matters. Final real GDP growth data for Q2 came in at 3.8%saar with household consumption, the typical bellwether of US growth, edging up a meagre 2.5%saar a marked slow-down from the previous quarter's strength. The headline was flattered by a post-war record 4.8 ppt boost from net exports, driven by the unwinding of tariff front-loading, alongside a 7.3% surge in business investment concentrated in equipment and IP amid the ongoing AI-driven capex cycle. By contrast other non-residential investment is barely contributing to real growth (GRAPH 06) consistent with a deterioration in capex intention indicators.

Meanwhile, US banks report household spending has become increasingly 'K-shaped,' with affluent households—buoyed by a record surge in financial wealth—accounting for the bulk of consumption. A sharp equity market correction or outright bear market would therefore reverberate through the real economy. We see this as a plausible risk to growth next year. That said, there are reasons for cautious optimism including: more expansionary fiscal policy (that may buoy weak consumer sentiment and be added to in the lead up to the mid-term elections), R&D incentives, accelerating AI adoption lifting productivity, and the prospect of a more dovish Fed. Indeed, positive and negative forces may largely net out and 2026 bring growth of just under 2%, much the same as 2025.

GRAPH 06 **AI & OTHER NON-RESIDENTIAL INVESTMENT REAL GDP CONTRIBUTIONS**

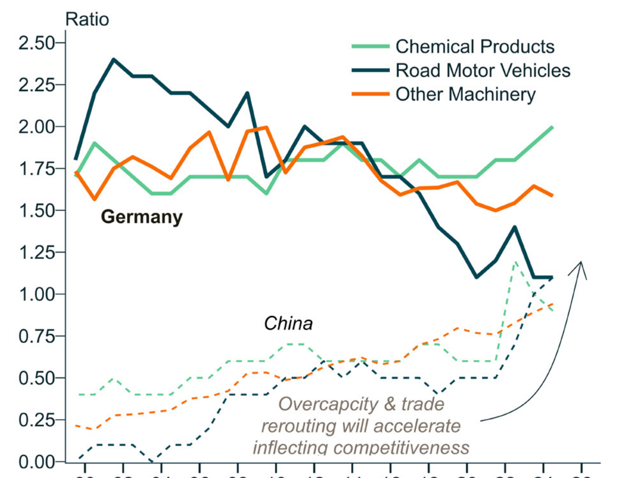


Source: IFM Investors, Bureau of Economic Analysis (BEA) via Macrobond

UK & EUROPE: Seismic shifts

Preliminary Euro Area Q3 activity data surprised to the upside as real growth edged up 0.2%qoq – a tenth ahead of expectations. The outturn points to meagre gains in private consumption, stronger investment and a smaller drag from net trade. Across the majors France (0.5%qoq) surprised to the upside amid strength in final domestic demand reflecting strength across household and public consumption and an expansion in private investment. Net trade contributed 0.9ppts to real growth supported by the aerospace sector despite a drag from inventories. German growth was flat with strength in investment unable to offset a contraction in exports while the Q2 print was revised a tenth higher to -0.2%qoq. The opposite was true of Italy where weakness in domestic demand was offset by positive contributions from net trade resulting in flat growth. Meanwhile, Spain continues to outperform, expanding 0.6%qoq – in line with expectations – supported by strength across household and government consumption and an acceleration in real gross capital formation.

GRAPH 07 **RELATIVE COMPARATIVE ADVANTAGE INDEX***



*Ratio country product exports to total country exports: global average

Source: IFM Investors, United Nations Trade & Development via Macrobond

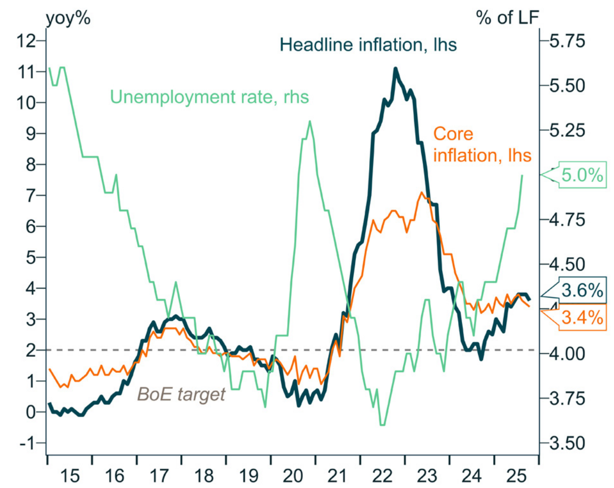
The European Central Bank (ECB) convened in late October, leaving the policy rate unchanged at 2.0% reaffirming that policy remains in a 'good place'. The Council has become seemingly more upbeat about the outlook welcoming the upside surprise to Q3 real growth and suggesting that downside risks had somewhat abated. While growth is still below trend, this view was corroborated by a firm October PMI outturn, now sitting at a 14-month high. Further, the labour market has proven resilient with the jobless rate holding near a record low of 6.3%. With a more positive growth outlook and target-consistent inflation, we see the ECB on hold for the foreseeable future with ample room to address a deterioration in activity or a pronounced inflation undershoot. Indeed, October headline inflation edged down to 2.10%yoy (prior: 2.24%) while core inflation was steady at 2.40%yoy – broadly in line with ECB projections for 2% and 2.2% respectively.

Looking ahead, the bloc is expected to grow 1.4% through 2025 before moderating at 1.1% over 2026. On a positive note, a resilient labour market and subdued inflation provide a supportive backdrop for real income growth and the consumer recovery while German fiscal stimulus will help counterbalance consolidation measures of other members. That said, China's 'Going Global' directive, excess capacity issues and trade rerouting have accelerated the penetration of cheaper Chinese products into global markets. This exacerbates a structural shift that we see as particularly problematic for Germany, Europe's largest and most trade-reliant economy, as it continues to haemorrhage competitiveness in key sectors (Graph 08). Moreover, the fragile US–EU trade truce leaves the bloc exposed to renewed tensions, as does NATO member under-delivery on defence spending commitments amid fiscal constraints.

In the UK, Bank of England (BoE) officials voted 5-4 to keep the bank rate stable at 4% in November. The coalition of hawkish voters argued that persistent inflation necessitated a more prolonged period of monetary restriction. Governor Bailey hinted that awaiting further data on inflation and assessing the economic impact of the Autumn Budget would be prudent ahead of the December meeting. Language on forward guidance signalled the bank rate would continue on a 'gradual downward path' whereas a 'gradual and careful' approach to the withdrawal of monetary policy restriction was previously called for.

Post-meeting dataflow was mixed. Real growth over Q3 rose 0.1%qoq a tenth below BoE projections. The result was underpinned by positive contributions from household and government consumption and an acceleration in investment – largely offset by a wider trade deficit. Labour market indicators have since disappointed as the jobless rate climbed to 4.97%. Inflation eased in October, with headline and services inflation, 3.56%yoy and 4.49%yoy respectively – but remains uncomfortably high. We see the combination of weaker activity and labour market reads and a positive inflation outturn tipping the balance in favour of a December cut. But these conflicting signals on inflation and unemployment will mean further easing in 2026 will be measured.

GRAPH 08 **UK UNEMPLOYMENT & INFLATION**



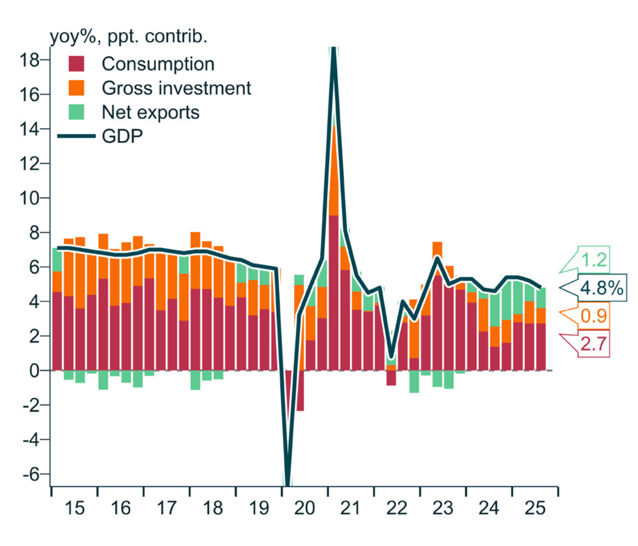
Source: IFM Investors, ONS via Macrobond

NORTH ASIA: China surprises, Japan slips, Korea lifts

China's Q3 GDP print exceeded expectations as real growth expanded 4.8%yoy. Yet, the result was mixed as industrial production surprised to the upside edging up 6.5%yoy courtesy of an acceleration in autos, computer and chemical output growth amid firm export growth. By contrast retail sales growth decelerated to 3.0%yoy on fading consumer trade-in impacts. Further, fixed investment contracted 6.7%yoy weighed on by the property downturn and 'anti-involution' policies aimed at curbing aggressive price cutting while manufacturing investment remained firm due to weather and government spending. Despite solid growth, deflationary pressures persist, although October CPI turned positive, edging up 0.2%yoy on 'Golden Week' demand and sales events, while PPI accelerated to 2.1%yoy.

At the 4th Plenum, policymakers set the tone for the 15th Five-Year Plan, prioritizing technology, security, and living standards while underscoring the need to 'activate incentives from business entities'. The agenda signals renewed effort to strengthen the private economy through deregulation. Meanwhile, the People's Bank of China (PBoC) maintained an easing bias in its Q3 policy report but adopted a more hawkish tone. References to 'strengthening' countercyclical adjustments were replaced with calls for "effective implementation" and officials emphasised importance of macroprudential management – positioning stability as a priority over growth.

GRAPH 09 CHINESE REAL GDP GROWTH



Source: IFM Investors, China National Bureau of Statistics (NBS) via Macrobond

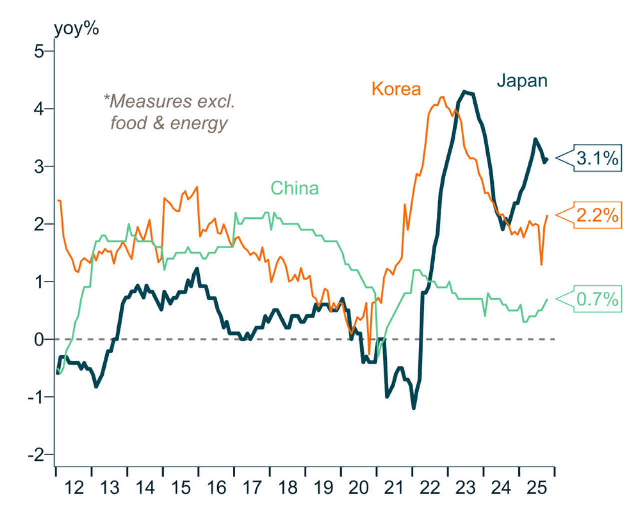
Activity data into the quarter softened, coinciding with a fresh tranche of US tariffs in response to Chinese rare earth export controls. While a de-escalation of tensions following the Trump-Xi meeting is positive, we see the US-EU and US-ASEAN demand substitution thematic continuing in 2026 – especially amid the ongoing structural shift in Chinese competitiveness, notably in autos, that may ultimately result in protectionist measures from EU policymakers over the medium term. Domestically, structural demand-supply imbalances will persist and a hawkish PBoC or insufficient fiscal stimulus are downside risks. We see risks as evenly balanced and look for growth of 4.9% in 2026.

After a solid June quarter Japan's economy had a marked setback in Q3 contracting 1.8%saar. Household spending growth was flat as cost-of-living pressures persist, notably durable goods spend contracted in the quarter. Domestically, it was the residential construction sector that was the most material drag. A confluence of tighter building regulations and energy efficiency standards increased costs, while tighter financial conditions and consumer caution prompted the decline. Business investment was relatively solid but a drawdown in inventories and subtraction from net exports also held growth back. We'd expect a pick-up in growth in Q4, but the slightly above potential growth rate expected for 2025 is likely to slip to around 0.7% in 2026. Expansionary fiscal policy is one upside risk to growth next year, yet bond markets are watchful of Japan's fiscal position the 30-year yield more than doubling over 2025 to 3.3%.

Inflation is still uncomfortably high in Japan with the core-core measure ticking upwards to 3.1%yoy in October. So, despite a relatively dovish Prime Minister the Bank of Japan (BoJ) will continue its gradual tightening of monetary policy and tapering of its quantitative easing program. A rate rise is possible later in December or the BoJ may opt to wait for insight into wage negotiations before moving in January. A follow up cut will likely occur in H1, an expected marked deceleration of inflation over 2026 will likely mean further increases are unlikely thereafter.

Across the strait, Korea's economy posted solid growth in Q3 expanding 1.2%qoq – a meaningful upside surprise. The result was driven by the largest quarterly contribution from consumption since 2022 reflecting policy support for EV and healthcare spending. Government consumption was also strong while net exports narrowed. Inflation firmed in October with headline inflation edging up 30bps on to 2.4% - the highest level since July 2022. With these signals on hand the Bank of Korea kept the policy rate at 2.5% with upward revisions to growth forecasts and fewer Committee members open to cuts over the next 3-months. We look for growth of 1.9%yoy in 2026 as fiscal policy and wealth effects support consumption and a US-Korea trade deal helps external demand. Property market instability and resurgent trade tensions remain downside risks.

GRAPH 10 ASIA CORE INFLATION



Source: IFM Investors, KoSIS, NBS, JSB via Macrobond

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IFM-04Dec2025-5034239