

What risks are lurking behind the stock market hitting record highs?

Video highlights:

- Geopolitical risks have eased in the short term, and U.S. 1Q2026 corporate earnings were generally better than expected. Driven by this optimism, High Beta and growth stocks have performed exceptionally well, with AI-related sectors and Asian chip-exporting regions emerging as standout performers. The KOSPI has surged over 50% since bottoming out on March 31, with cumulative year-to-date gains exceeding 80% (as of May 11, 2026), outperforming most major global markets.
- However, the current market is so clouded by optimism that it seems to be overlooking several bearish factors—specifically inflation risk, which may be undervalued. The Strait of Hormuz remains a point of concern; history from 2022 shows that central bank and market expectations regarding "transitory" inflation can deviate significantly from reality.
- While many global markets are hitting record highs, market breadth is notably lacking, as the number of individual stocks hitting 52-week highs is failing to keep pace with the indices. This indicates the market is being driven by a small handful of heavyweights; if negative news hits and these leading sectors lose momentum, it could drag down the entire market.
- The S&P 500's peaks are primarily fueled by the technology and semiconductor sectors, creating extremely high market concentration. If these sectors face profit-taking or growth revisions, overall volatility will amplify—especially since 2026 is a U.S. midterm election year, which historically shows seasonal weakness in May and June.
- While AI and semiconductors hold long-term structural growth potential, massive capex marks as a "verification phase" in 2026, so portfolios should avoid over-concentration. Valuations of U.S. tech giants have recently fallen back to or below historical averages, and further market volatility could increase their long-term investment appeal.
- The energy sector may benefit from sustained high oil prices, while utilities are being driven by AI computing power and electrification needs. Additionally, raw materials (including metals and mining) face upward price pressure due to supply shortages and serve as an inflation hedge, though their high volatility requires careful position sizing. Infrastructure, specifically data centers and fiber optic networks, will continue to benefit from AI development. Overall, equity strategy should maintain tech as a core holding but diversify into value, defensive sectors, and non-U.S. markets to reduce volatility.
- Following the financial crisis, the Federal Reserve expanded its role beyond price stability and lender of last resort to become a dominant participant in financial markets. Its balance sheet currently stands at approximately \$6.7 trillion, with bank reserves still around \$3 trillion. Under the current US government administration, Fed Chair nominee Kevin Warsh strongly advocates for significant balance sheet reduction to return the Fed to traditional tools centered on interest rates and price stability. Similarly, Fed Governor Stephen Miran has proposed 15 reform measures to shrink the balance sheet by \$1.2–2.1 trillion under an

ample reserves framework, primarily through gradual runoff of maturing securities rather than active sales.

- Although current US President favors interest rate cuts, Warsh's push for balance sheet shrinkage can coexist with easing. Historical precedents in September 2024 and 2025 demonstrate the Fed successfully cutting rates while continuing QT. Rate cuts provide economic stimulus, while QT allows long-term yields to better reflect genuine supply and demand. Warsh and Miran's approach includes regulatory easing to reduce banks' dependence on reserves, thereby creating policy space for rate cuts even during balance sheet normalization.
- Implementation of aggressive QT under Warsh is likely to push long-term bond yields higher in the near term as the Fed steps back from the market. This normalization process may increase short-term volatility but should ultimately lead to more efficient market pricing over the longer horizon.
- Investors could consider maintaining portfolio duration in the 4–6 year range to lock in currently attractive yields while retaining flexibility to benefit from safe-haven demand if the economy slows. Diversification across global bond markets, particularly into Chinese bonds with their lower correlation to U.S. assets, can reduce overall volatility. The core portfolio should focus on high-rated government bond and investment-grade credit, with selective exposure to asset-backed securities (ABS) and mortgage-backed securities (MBS) backed by real assets. Although QT introduces temporary volatility, elevated yields today provide a solid buffer, positioning bond portfolios for both income and risk management in the evolving policy environment.

Full version is only available in Chinese language.

Important Note and Risk Disclosure Statement

This document is issued by China CITIC Bank International Limited (“the Bank”) and used for reference purpose only. The information or opinion herein is not to be construed as professional investment advice or any offer of, or invitation by or on behalf of the Bank to any person to purchase or sell or acquire or invest in any investment products. The information or opinion presented has been developed internally and/or taken from sources believed to be reliable, but the Bank makes no warranties or representation as to the accuracy, correctness, reliabilities or otherwise with respect to such information or opinion, and assume no responsibility for any omissions or errors in the content of this document. For information which is provided by the Information Provider and other companies such as fund houses, it is being re-transmitted by the Bank in the ordinary course of business to you for general information and reference purposes only. The Bank makes no warranties or representation as to the accuracy. This document is not intended to provide any investment advice. Investors should not make investment decisions solely based on the content of this document, nor should they consider any content in this document as guidance for determining whether individual markets are suitable for investment. Before making any investment decision, investors should carefully consider the risk factors relating to an investment product in light of their own financial circumstances, investment objectives and experiences and other personal circumstances, and should seek appropriate professional advice if necessary. The Bank accepts no liability for any direct, special, indirect, consequential, incidental damages or other loss or damages of any kind arising from any use of or reliance on the information or opinion herein.

Investment involves risks, investment value and return may go down as well as up. Past performance of each investment product is not indicative of its future performance. Losses may be incurred but may not necessarily result in profits as a result of buying and selling investment product. Investment in emerging markets involves above average investment risks, such as possible fluctuations in foreign exchange rates, political and economic uncertainties. The price of securities fluctuates, sometimes dramatically. The price of securities may move down or up and may become valueless. It is as likely that losses will be incurred rather than profits made as a result of buying or selling securities.

When investing in high-yield or unrated bonds or related products, investors face higher default risk, credit risk or liquidity risk, and are more susceptible to the impact of economic cycles. During economic downturns, their value typically declines more as (i) investors become more risk-averse and (ii) default risk increases. Foreign currency investments are subject to exchange rate risk which may result in gain or loss. The fluctuation in the exchange rate of foreign currency may result in losses in the event that customer converts the foreign currency into HKD or other foreign currencies. Renminbi is not freely convertible at present. The actual conversion arrangement will depend on the restrictions prevailing at the relevant time.

China CITIC Bank International Limited is an authorized institution under the Banking Ordinance and is regulated by the Hong Kong Monetary Authority

This document is issued by the China CITIC Bank International Limited and has not been reviewed by the Securities and Futures Commission (“SFC”) or any regulatory authority in Hong Kong.

No part of this document may be reproduced or transmitted in any form or by any means without the prior written permission of the Bank.