

Monthly Interest Rates Chartbook

January 2026

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Economic Summary

US Forecasts

We expect near-term growth softening with a rebound in H2 26.

(%)	2025		2026			
	Q3 Act	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP QoQar	4.3	1.2	2.4	1.5	2.5	2.4
Real GDP YoY	2.3	2.2	3.0	2.4	1.9	2.2
Core PCE YoY	2.9	2.5	2.3	2.1	2.0	2.1
Unemployment	4.3	4.7	5.1	4.8	4.5	4.5
Fed Funds Rate Upper Bound	4.25	3.75	3.25	3.25	3.25	3.25
2 Year	3.61	3.47	3.25	3.25	3.25	3.25
10 Year	4.15	4.17	4.00	4.25	4.25	4.25

Source: BEA, BLS, Federal Reserve and SMBC Nikko

Summary of views

- Growth:
 - We expect growth to cool into Q2 26 and then quickly recover this summer
 - Led by continued rapid investment in AI equipment
 - And effects from last year's tax cuts and changes to capital expensing
 - AI-fueled productivity may begin boosting output in 2027 although as we discuss below there are measurement and behavioral effects that could influence the outlook
- Inflation:
 - We look for inflation to decelerate as rent costs follow home prices lower.
 - Tariff effects on goods prices appear to have peaked
 - Our sense is the IEEPA tariffs will be reversed. Replacement tariffs may have smaller effects on goods prices
- Fed:
 - We tentatively look for two rate cuts this year in April and June
 - It is possible that growth has picked up enough by summer for the Fed to deliver just one rate cut

Anemic Hiring

ADP and nonfarm payrolls (chng, 000)



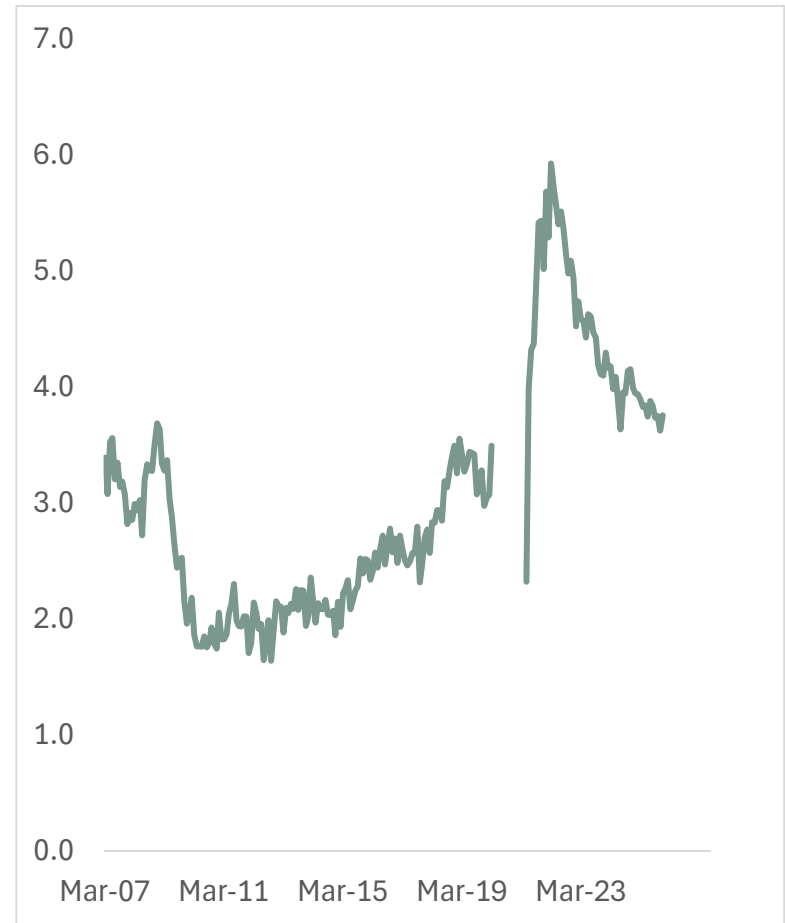
- Private sector measures indicate that hiring has slowed

Note: 3m moving average change. Sources: ADP, BLS, SMBC Nikko

...along with wages

- Labor market tightness pushed average hourly earnings growth above 5% in 2023
- But although wage pressures have ebbed since then, they remain higher than after the slow period following the financial crisis^{1/}

Average hourly earnings (%y/y)



^{1/} This is also the case for the ECI, a broader measure of labor costs that includes benefits and accounts for the changing composition of jobs over time.

Note: We remove the COVID period for clarity. Sources: BLS, SMBC Nikko

Inflation remains sticky

- Inflation has fallen but the deceleration has flattened in recent months
 - We look for cooling shelter costs to pull core inflation lower

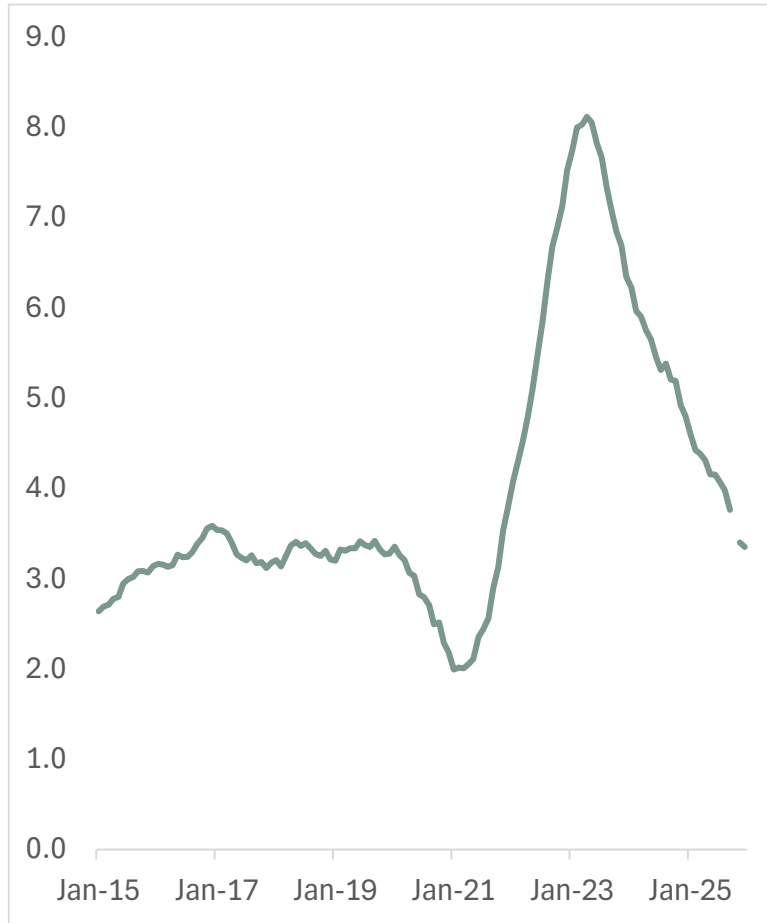
Inflation (%y/y)



Sources: BLS, SMBC Nikko

Cooling shelter costs...

Owners equivalent rent (%y/y)



National home prices (%y/y)



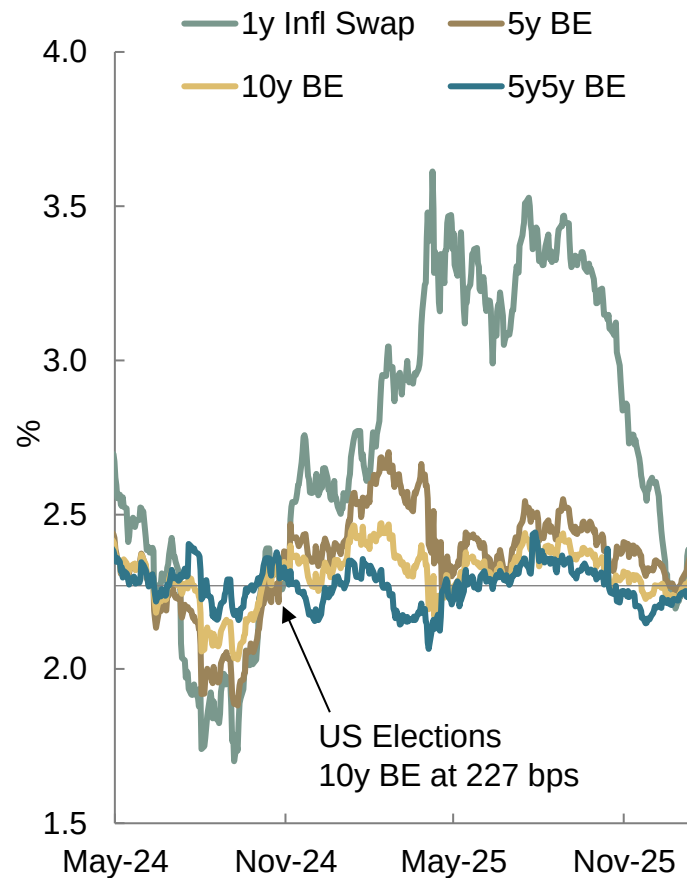
Sources: BLS, SMBC Nikko

Sources: Case-Shiller, SMBC Nikko

Muted term inflation expectations

- 1y inflation swaps have fallen from their April high of 3.5% to 2.38% with the legal challenge to tariffs and lower oil prices
- 10y TIPS breakevens are a few bps higher than their election day levels

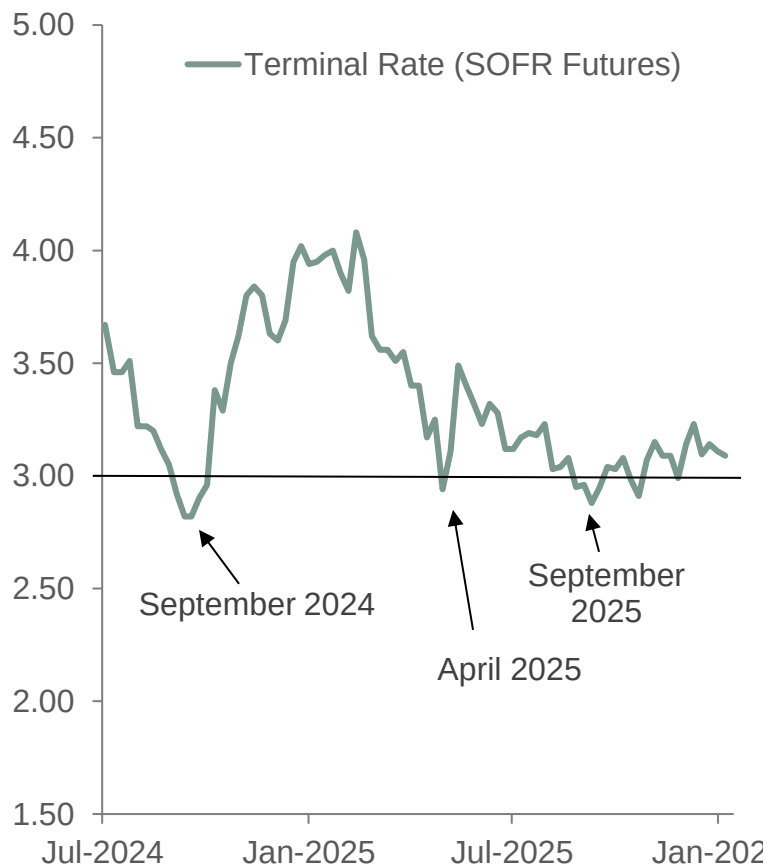
Inflation breakevens (%)



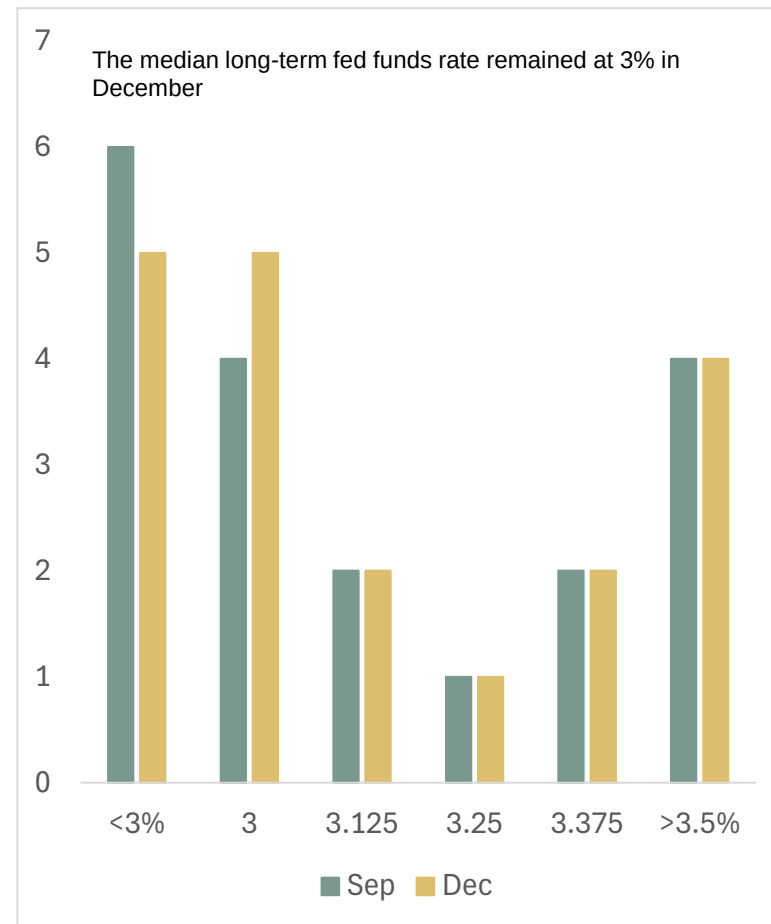
Sources: US Treasury, Bloomberg, SMBC

Fed policy expectations

Terminal rate pricing (%)



Longer run fed funds rate distribution



Note: Using SOFR futures. Sources: Bloomberg, SMBC Nikko

Sources: Federal Reserve, September and December 2025 FOMC Surveys of Economic Projections, SMBC Nikko

IEEPA reversal and yields

- Expectations were high that the Supreme Court would rule on the IEEPA tariffs in mid-January
 - But as of publication no decision has been made
- While our sense is that these tariffs will be reversed, we are unclear about the timing
- Assuming the IEEPA tariffs are reversed what effect might that have on Treasury yields?

IEEPA revenues

- Although the US Customs Bureau collected \$215bn in tariffs in FY 2025, not all these revenues came from IEEPA
 - Annualizing the Customs Bureau statistics and assuming full year implementation at current rates, we estimate the IEEPA tariffs are raising about \$170bn/year
 - Of this amount \$110bn is tied directly to the reciprocal tariffs
- As a result, assuming no change in consumer behavior, the reversal of the IEEPA tariffs might reduce Treasury revenue by between \$1.1 and 1.7trn over the next decade^{1/}
 - But what portion of these revenues might be replaced with other tariffs?

1/ There is a broader question – are these tariffs meant to raise revenue or change behavior?

Replacement tariffs

- The Administration has other channels for imposing tariffs that are less likely to be legally challenged. The two most significant are Sections 232 and 301 but neither raises significant sums.
- **Section 232:** Allows the President to impose tariffs if foreign trade practices are found to be a threat to national security. This is determined by the Commerce Department. Section 232 tariffs on steel, aluminum, and autos have been in place since 2018. The Commerce Department is currently reviewing 12 other products for these national security-based tariffs.
 - While there is no limit on the rate Section 232 tariffs raised just \$35bn in FY 2025
- **Section 301:** Allows the US Trade Representative to impose tariffs or trade restrictions against countries deemed to be discriminating against US businesses. There is no limit on the rate but these tariffs have a 4y limit after which they must be renewed. Currently, Section 301 applies only to Chinese goods.
- **Section 122:** Allows the President to impose temporary tariffs and import restrictions without an investigation of trade practices. Tariffs are limited to 15% and can only be set for a maximum of 150d. While it can be extended, the extension requires Congressional approval.
- **Section 338:** Allows the President to declare that a foreign country imposes “unreasonable charges...regulations or restrictions” on US trade. The President can impose unilateral tariffs of 100% or even import bans. Dates from 1930.

Rate effect

- *Assuming the IEEPA tariffs are reversed and the Treasury can replace between 25-50% of the revenue through other trade measures we estimate 10y yields could rise by 30bp*
- Some of this has already been priced into yields since the Supreme Court heard oral arguments
 - And some doubts were raised about their sustainability

Tariff refunds?

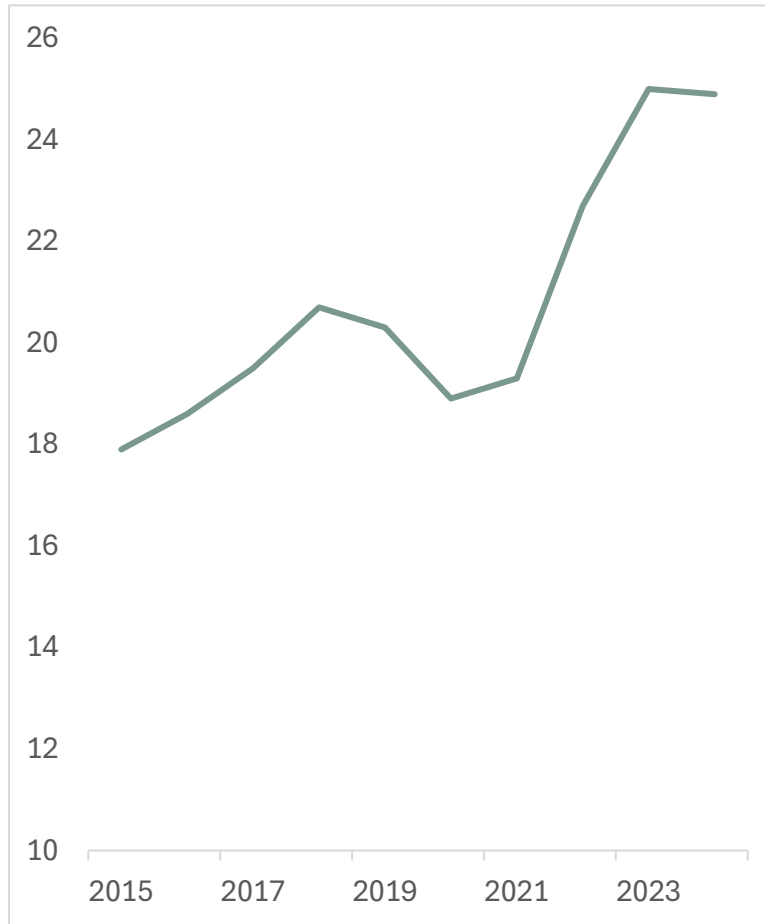
- Will the Treasury need return its IEEPA revenues if the duties are overruled?
 - We do not know – this is likely to be decided in court with importers suing to recover IEEPA tariffs
 - Our sense is that this could take some time
 - And as a result, we do not expect an immediate reduction in the Treasury's cash balance
 - Or a surge in bill issuance to finance refunds

Capping credit rates

- The President has proposed implementing a 10% cap on credit card interest rates
 - The cap would be temporary – lasting only a year
- Although no details are available yet, the idea is similar to legislation pending in Congress (S.381/HR 1944)
 - The legislation was proposed in February 2025 and has Democratic and Republican sponsors
 - Although it has not moved forward
 - The legislation does not include a temporary cap
 - And includes credit card fees within the 10% cap
 - Violations would be subject to Section 130a of the Truth in Lending Act which could subject the issuers to statutory damages and class action status
- Banks are opposed to the cap
 - The cap would reduce their lending – particularly to subprime borrowers
 - And could force borrowers toward less regulated lender alternatives

Average credit card APR

Average credit card APR (%)

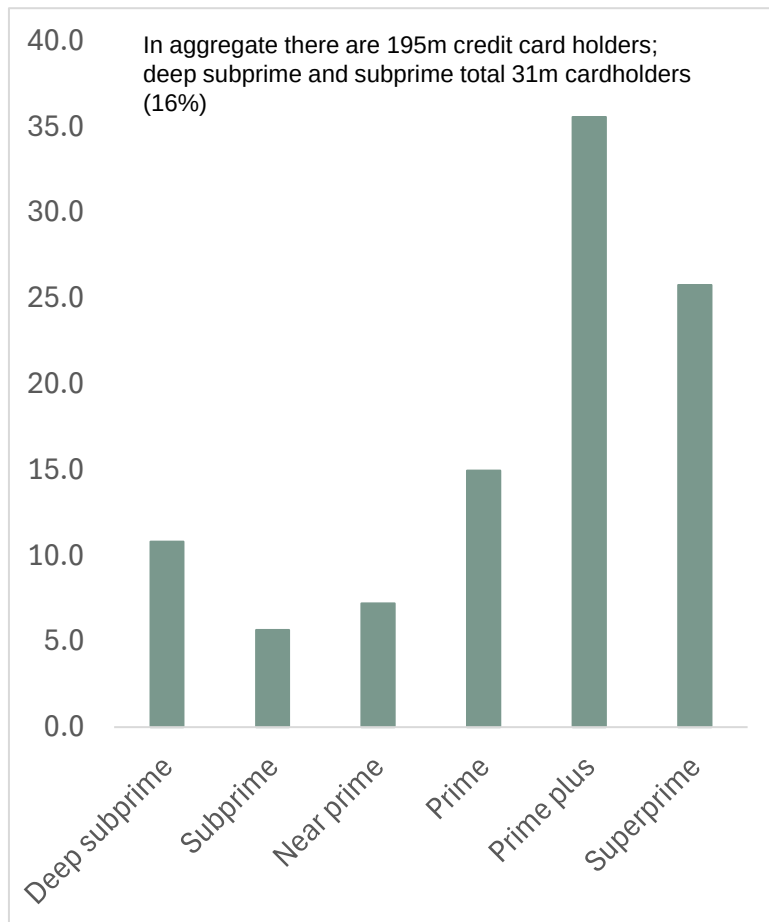


- The 10% cap would apply to the APR
- APRs are typically tied to the prime rate
 - And as the Fed has tightened, rates on credit cards have risen
- But the APR may not reflect the borrower's actual interest expense
 - Which can be affected by (temporary) promotional rates
- And the average APR varies by borrower type

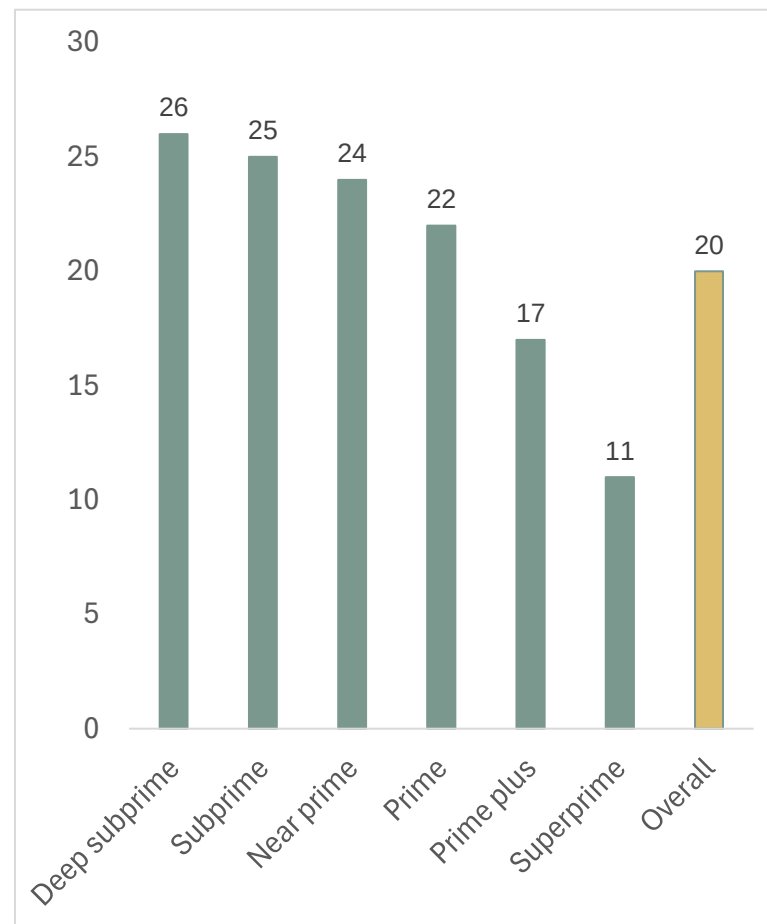
Sources: CPFB, SMBC Nikko

Borrowers and annual interest costs

Borrower distribution (% total)



Effective interest rate (%)



Sources: CPFEB, SMBC Nikko

Sources: CPFEB, SMBC Nikko

Credit card promotions

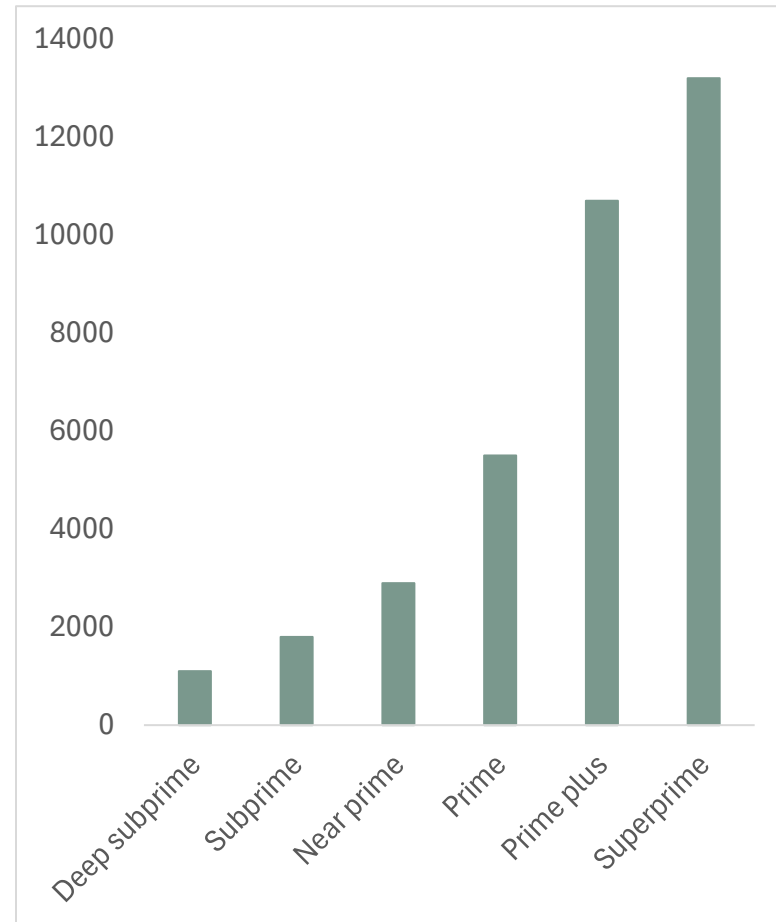
- Temporary promotional rates on credit cards are common
 - 52.8% of the balances on credit cards were in some introductory period with a lower rate as of December 2024^{1/}
 - About 1/3 of yearly purchases in 2024 (~\$900bn) were made on cards with promotional interest rates
 - Nearly all the promotions offered in 2023-24 had 0% introductory APRs with periods ranging from 6 to 21m
- More than 80% of cardholders do not cancel their cards after the promotional period ends
 - And more than half (52%) add to their balances after the promotion ends

^{1/} See, "The Consumer Credit Card Market: Report to Congress", Consumer Financial Protection Bureau, December 2025

Annual purchases are topcoded

- Prime and above borrowers spend more annually on their cards than lower tier borrowers

Annual purchases (\$)



Note: Purchases by account. Sources: CPFB, SMBC Nikko

Macroeconomic considerations

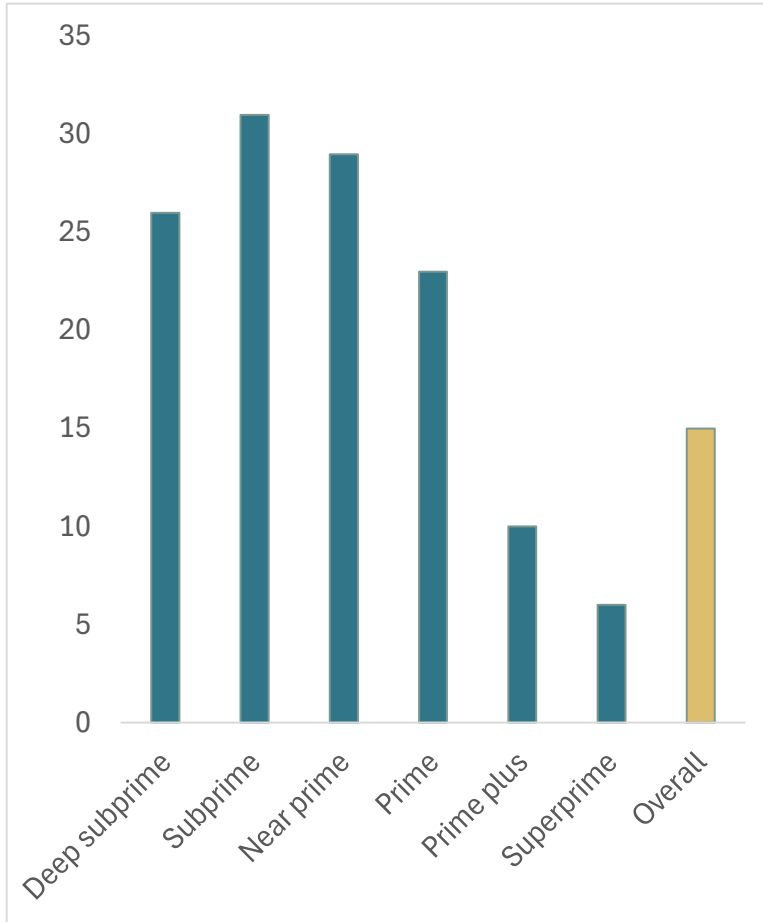
- Capping APRs on credit cards could push banks to reduce the extension of credit particularly to lower tier borrowers
 - Higher minimum required payments^{1/}
 - Lower credit limits
 - Fewer promotional rates and program rewards
- *But, it is not clear how these effects might feed into consumer spending*
 - Lower tier borrowers spending on credit cards is lower
- And the cap is temporary
 - Do banks and households adjust their behavior because of a temporary change?
 - Households may use the savings to paydown debt rather than accumulate higher balances^{2/}
 - The credit card industry is highly competitive – do banks risk losing market share for a temporary change in APRs?

1/ See next slide

2/ As they did during COVID

Minimum payments

Minimum payment (% tot by borrower)

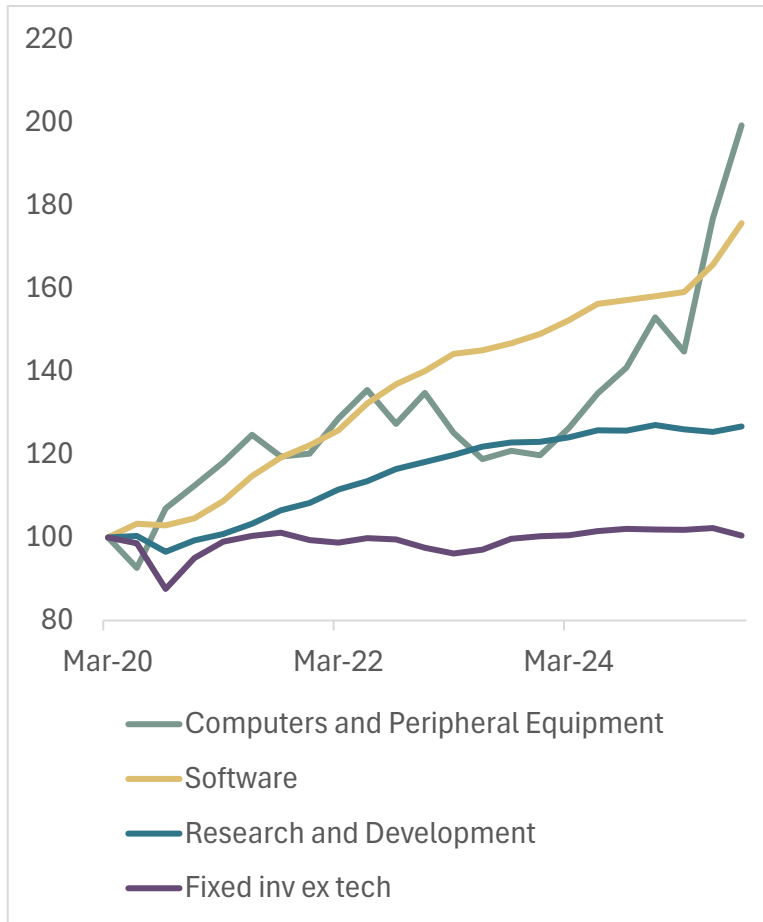


- 15% of credit card holders on average made only their minimum monthly payment in 2024
 - But this share is sharply higher for borrowers below prime

Sources: CPFEB, SMBC Nikko

AI capital deepening

Real fixed investment (Q4 19=100)

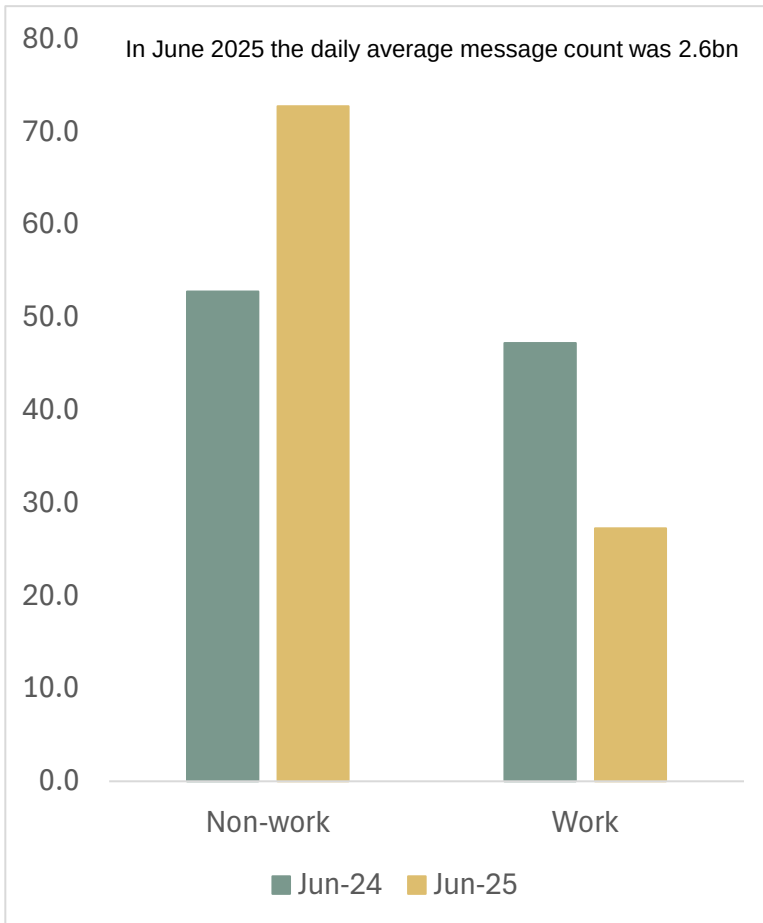


- Since 2020, there has been rapid growth in investment in computers and software
 - As AI-driven demand for computing power has surged
- Outside of the sector, real fixed investment has been sluggish

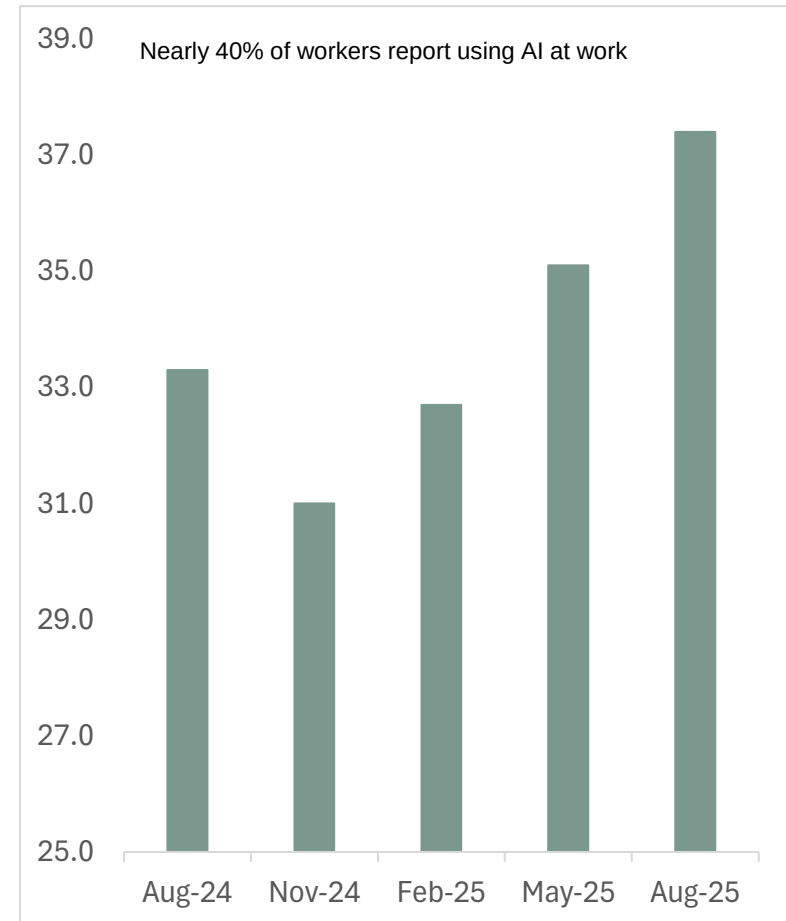
Sources: BEA, SMBC Nikko

AI use

ChatGPT messages (% total)



AI use at work (% employees)

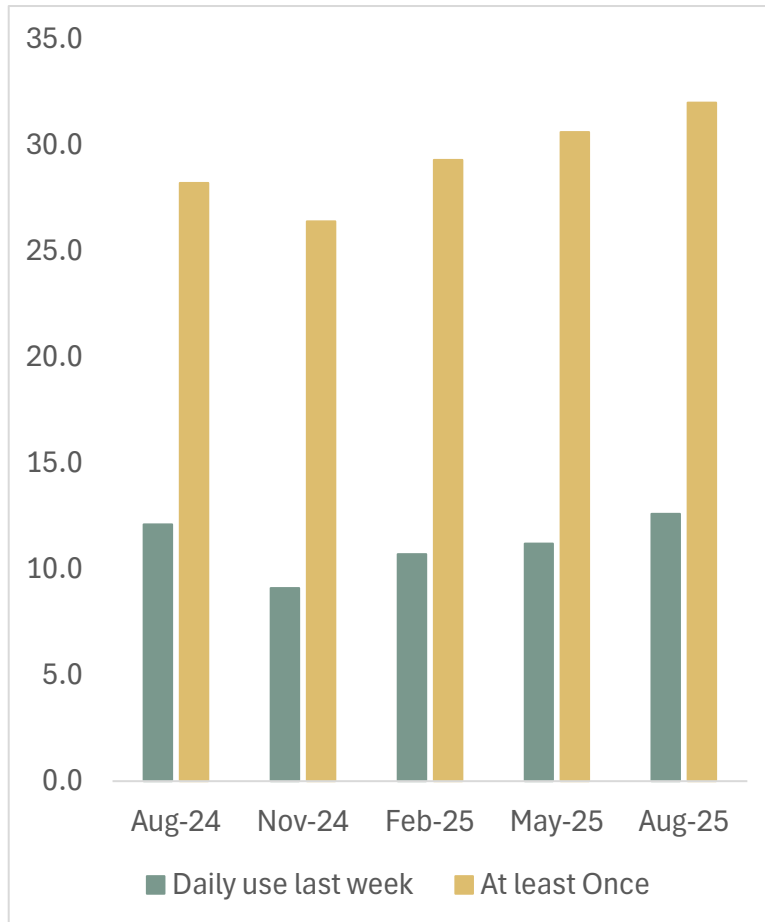


Sources: Chatterji et al., SMBC Nikko

Sources: Bick et al., SMBC Nikko

Frequency of work use

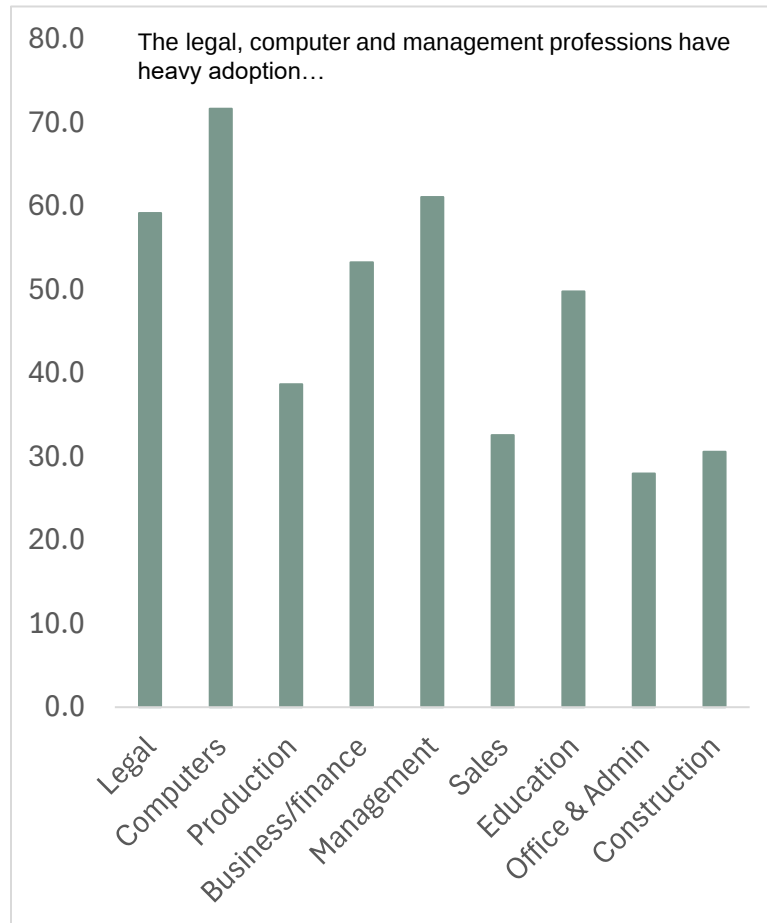
Frequency of use (% workers)



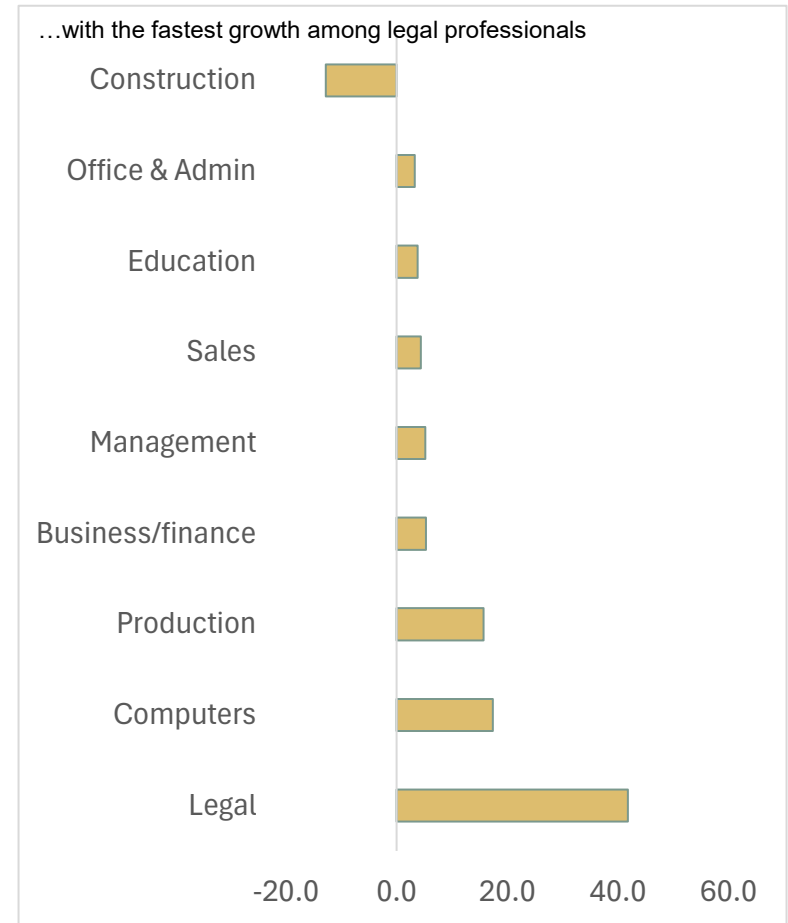
- Alongside the increase in adoption, workers are using the technology more frequently
 - The average worker reports using AI for about 2h/week^{1/}
 - Up 40m from a year-earlier

AI use by occupation

AI use by occupation (% workers)



Growth by occupation (% change)

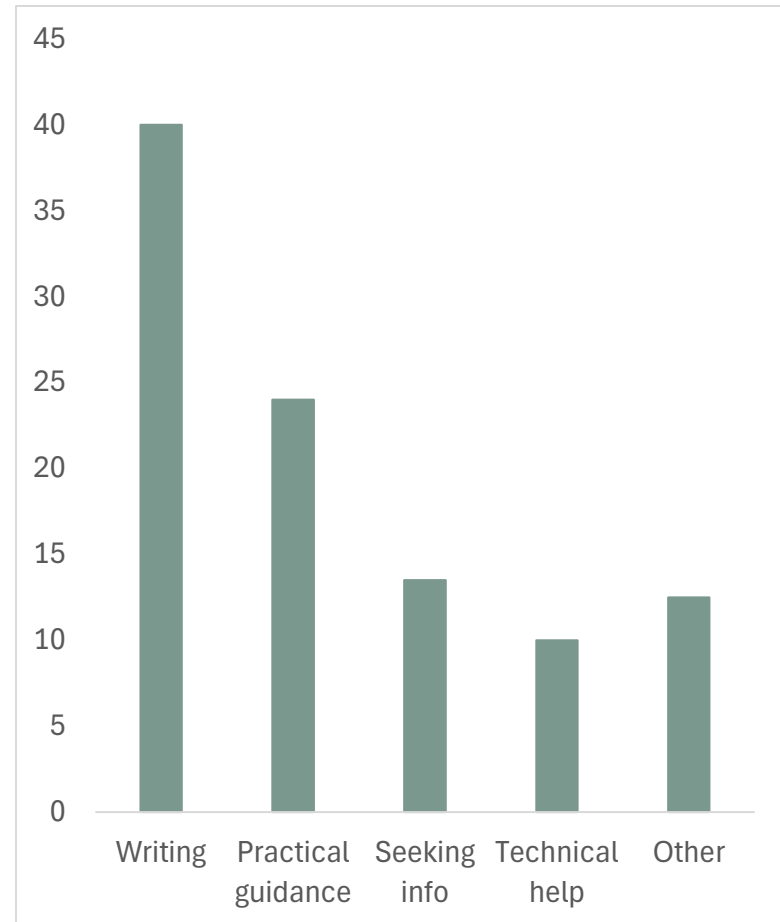


Sources: Bick et al, SMBC Nikko

Note: Change since August 2024. Sources: Bick et al, SMBC Nikko

AI tasks

AI tasks (%)



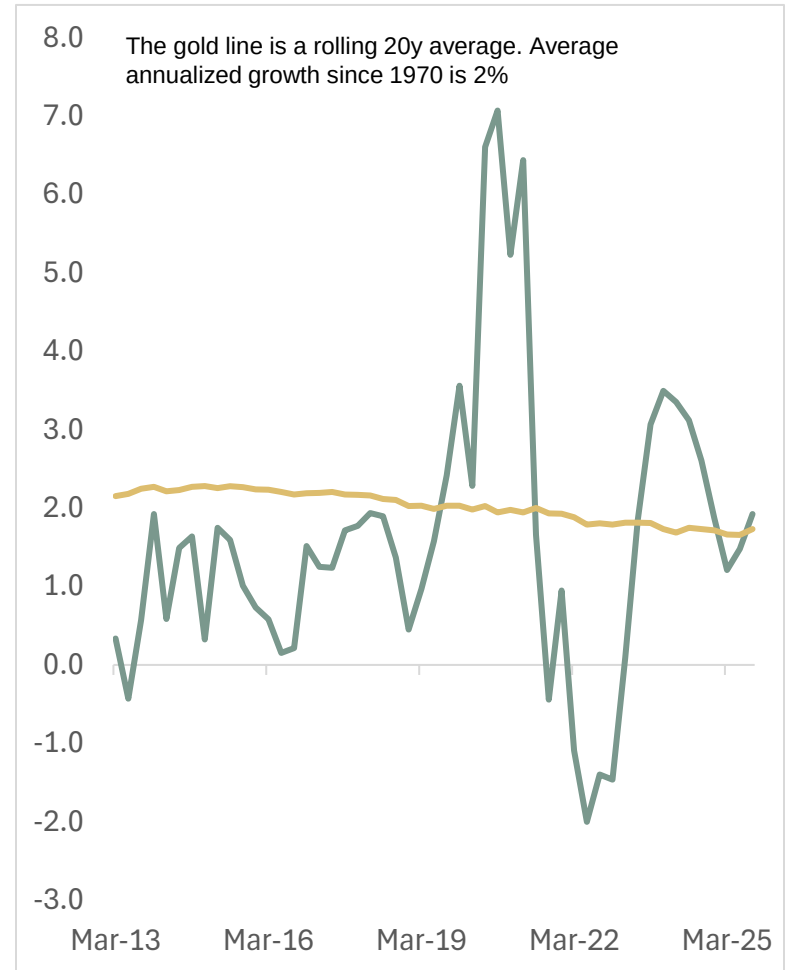
- Writing is the most common AI task
 - But most of this involves using existing text
 - Editing, translating or summarizing

Sources: Chatterji et al. SMBC Nikko

Where is AI productivity?

- To paraphrase Robert Solow, it seems that AI “is everywhere but the productivity statistics”

Non-farm productivity (%/y)



Sources: Federal Reserve Bank of New York, SMBC Nikko

Task studies

- Task studies involving AI use at work point to significant time savings. Yet measured non-farm productivity is growing close to its long-term average and only modestly faster than its pre-COVID pace
- AI significantly shortens the time needed to complete many work tasks.
 - Hartley et al report average time savings of 71% across 34 common work jobs^{1/}
 - This matches time savings estimated from Claude conversations^{2/}
 - And Peng notes programmer using AI for coding were 56% faster than non-users^{3/}

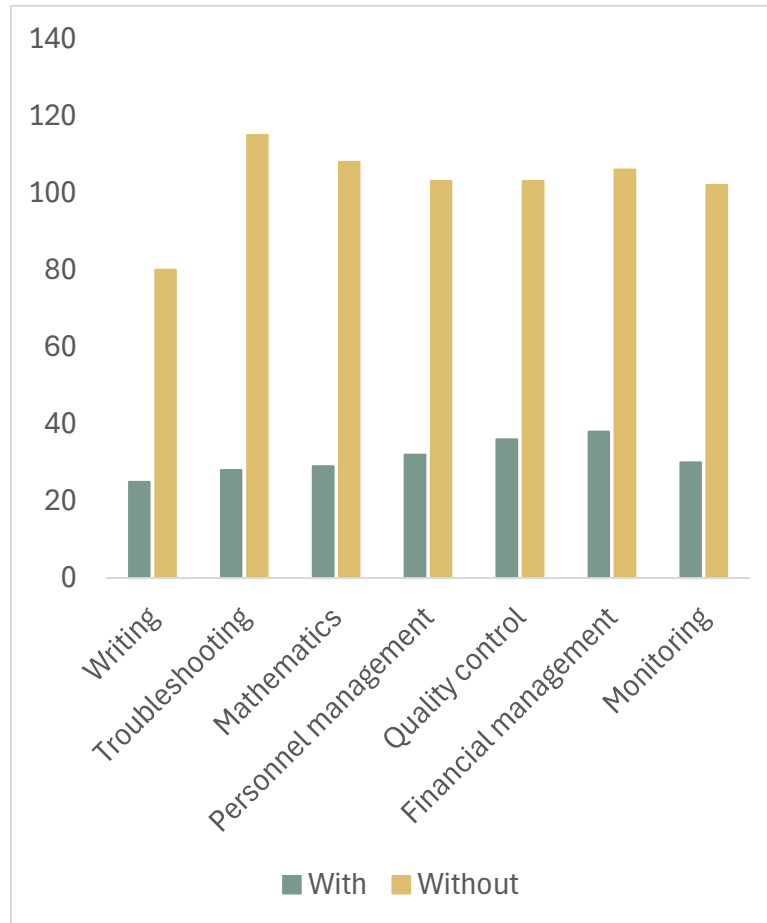
1/ See, "The Labor Market Effects of Generative Artificial Intelligence", J. Hartley, F. Jolevski, V. Melo, and B. Moore, Stanford University, World Bank, Clemson, and Stanford, October 2025

2/ See, "Estimating AI productivity Gains from Claude Conversations", A. Tamkin, and P. McCrory, Claude.ai, November 5, 2025

3/ See, "The Impact of AI on Developer Productivity: Evidence from GitHub Copilot", S. Peng, E. Kalliamvakou, P. Cihon, and M. Demirer, Microsoft Research, GitHub, and MIT, arXiv:2302.06590v1, February 13, 2023

AI time savings by task

Minutes saved with AI (min)



- Workers estimate that without AI their regular work task would take significantly longer
 - By an average of 81m across the tasks examined in Hartley et al^{1/}

Note: As of August 2025. Source: Hartely et al., SMBC Nikko

1/ We plot 7 of the 34 identified. See “The Labor Market Effects of Generative Artificial Intelligence”, J. Hartley, F. Jolevski, V. Melo, and B. Moore, Stanford University, WorldBank, Clemson University, and Stanford, respectively, October 2025

Estimating productivity gains

- *Task study results when extrapolated economywide suggest productivity gains on the order of 1 to 1.8% over 10y*
 - The higher estimates would imply a doubling of the current pace of productivity
- But there are measurement and behavioral issues that suggest the gains could be smaller:
 - AI use is only in the experimental or pilot stage at most employers
 - AI is likely to replace low value and easy-to-automate tasks first where the productivity gains are highest^{1/}
 - Productivity gains may be harder to achieve for more complex tasks – especially, those for which there are no clearly defined outcome or for which there is no database of results
 - Reported AI use at work may be affected by social desirability bias^{2/}
 - Workers may report using AI and sharp gains in productivity because their management values the efficiency gains
 - Separately, while the task studies suggest significant time savings, it is not clear what workers do with the time released

1/ See, “The Simple Macroeconomics of AI”, D. Acemoglu, MIT, April 5, 2024.

2/ Social desirability works in the opposite direction for college students. See, “Underreporting of AI Use: The Role of Social Desirability Bias”, A. Imas and Y. Ling, University of Chicago, May 2025.

Interest Rates Strategy

Interest rates summary

- Fed officials appear content to hold off on additional rate cuts until the economic data provides more sense of the direction of the economy
 - We are tentatively looking for two rate cuts this year – Q2
 - As the labor market slackens and the unemployment rate peaks near 5%
- Reserve management purchases (RMPs) have begun and short-term interest rates have normalized
 - We expect these purchases will remain directed to bills this year
- GSE mortgage purchases may be financed through discount note issuance
 - We think this extra supply would easily be absorbed by money market funds
 - With little pressure on bill and repo rates
- We look for the Treasury to keep coupon auction sizes steady this year.
 - In turn, it will need to ramp up bill issuance by \$600bn
- We think the 10y term premium is consolidating after rising 100 bps since September 2024 and is likely to resume its climb higher in 2026 once the worries about the labor market subside.

Reserve management purchases (RMPs)

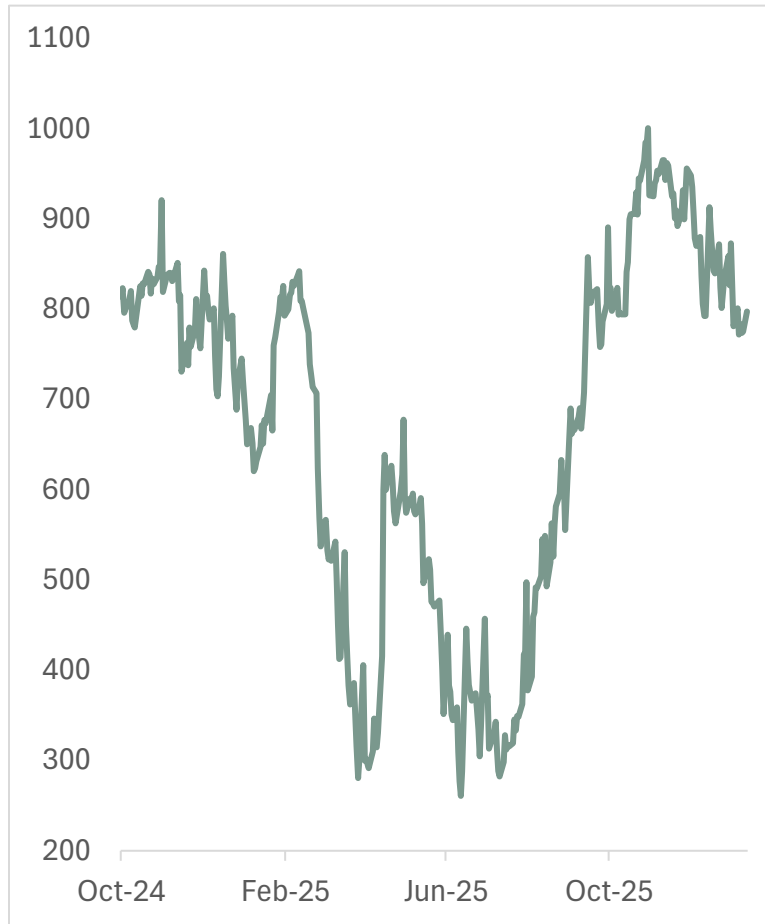
- Reserve management purchases began in December
 - These (bill) purchases are meant to offset the growth in the Fed's non-reserve liabilities such as currency and the Treasury account
 - All purchases will be in the secondary market
 - The Fed set the initial monthly purchases at \$40bn/m^{1/}
 - But these could be increased depending on market conditions and the Fed's expectations about the Treasury's April tax collections
 - In 2024, the Treasury's cash balance increased \$160bn in April^{2/}
 - We think this might be a rough estimate of the pre-tax season RMPs
 - After April, RMPs might slow to around \$5bn/m to match the growth in currency
 - The Fed indicated that it could buy <3y paper if market conditions make it difficult to buy the full amount of bills
 - Our sense, however, is that there is enough supply for the Fed to purchase only bills
 - 75% of these purchases will be in maturities from 1-4m; the balance will be out to 12m

1/ The Fed will buy an additional \$15bn/mo or so in bills to offset the ongoing run-off of its MBS portfolio.

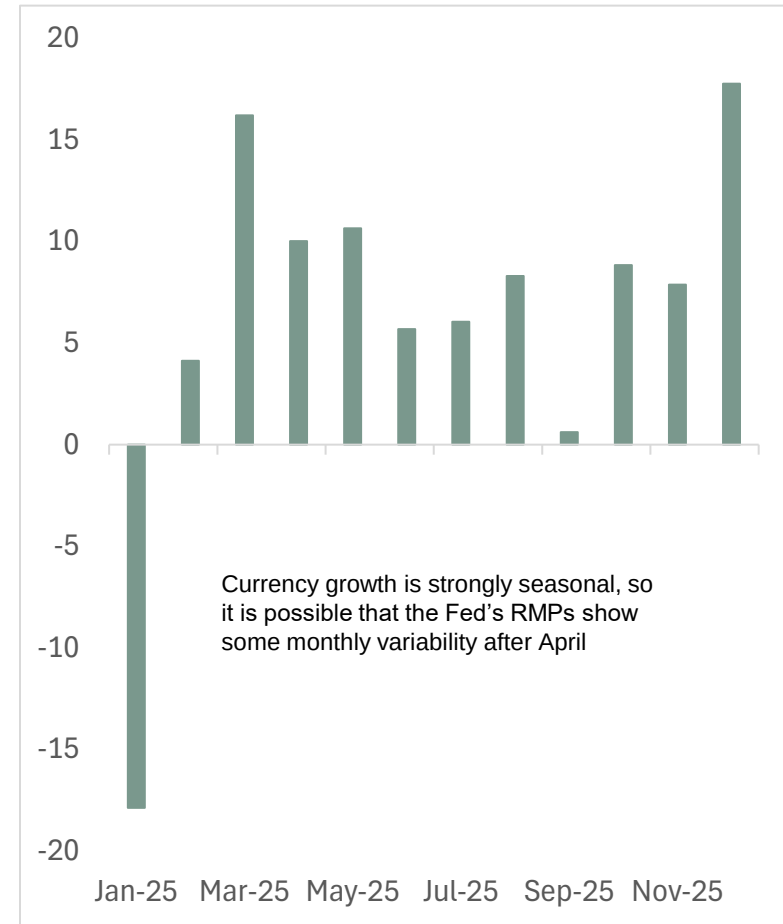
2/ We use 2024 for comparison because last year's cash balance was influenced by the debt ceiling.

Non-reserve liabilities

Treasury balance (\$bn)



Change in currency (m/m, \$bn)



Sources: US Treasury, SMBC Nikko

Sources: Federal Reserve, SMBC Nikko

Bank reserves will move higher with RMPs in Q1...

Bank reserves (% bank assets)

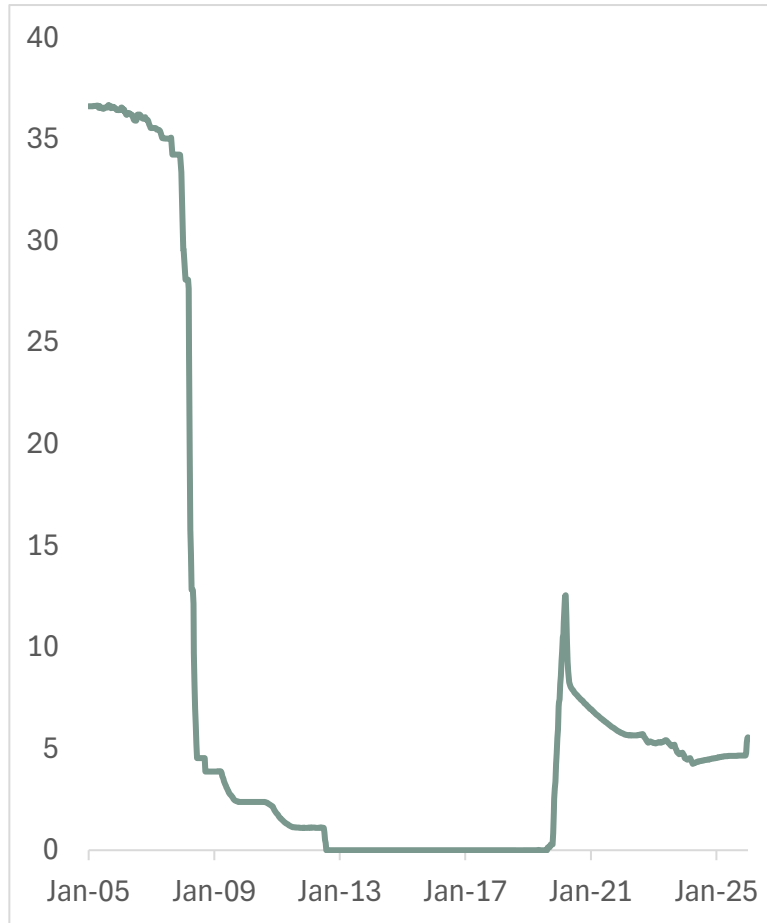


- The Fed's RMPs have pushed reserve balances back above \$3trn and 12% of bank assets

Sources: Federal Reserve, SMBC Nikko

...as the Fed's bill holdings increase

Bill holdings (% Treasury holdings)



- Although the Fed's bill holdings are increasing, they remain below the market level (22%)
 - We think the Fed's bill holdings may exceed 13% at year-end
- At the December FOMC meeting the Fed had not reached a decision about what maturities to buy for its long-term reserve management

Sources: Federal Reserve, SMBC Nikko

Higher reserve demand

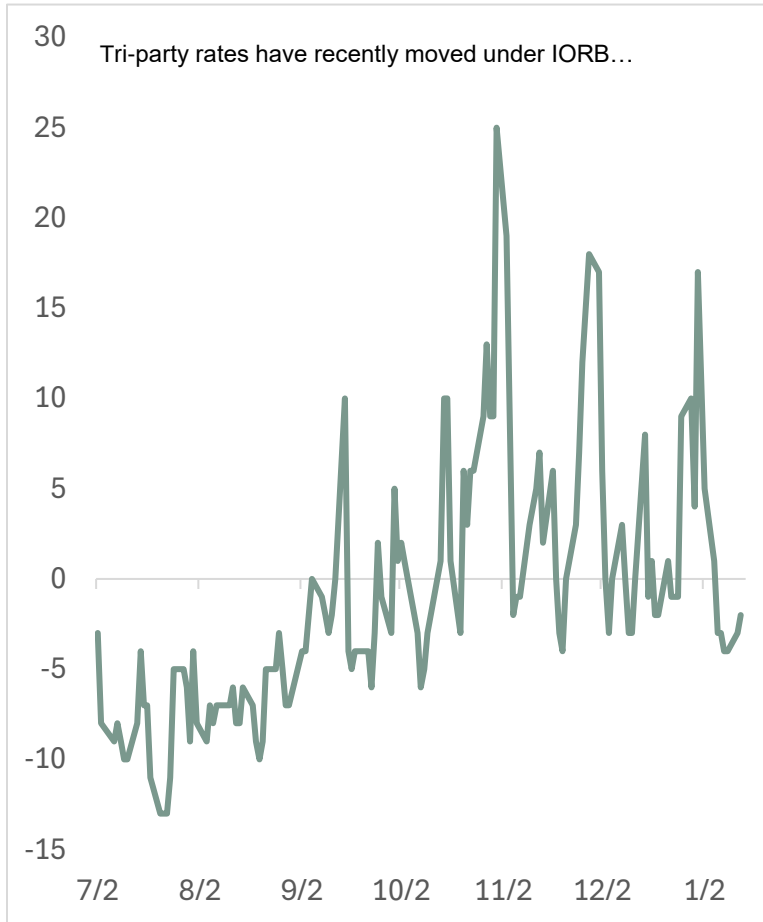
- We suspect that banks' demand for reserves has increased
 - Some of the increased demand reflects the fact that in an abundant reserve regime, banks do not have to work as hard to find alternatives to meet their liquidity requirements
 - In addition, banks may prefer to hold reserves over Treasuries as these are immediately available
 - Where Treasuries need to be monetized – in the market or through one of the Fed's liquidity programs (the Discount Window and the SRP)
- *The Fed could reduce the demand for bank reserves if banks felt more comfortable using these programs as part of their daily, business as usual, liquidity management*

Gradations of ampleness?

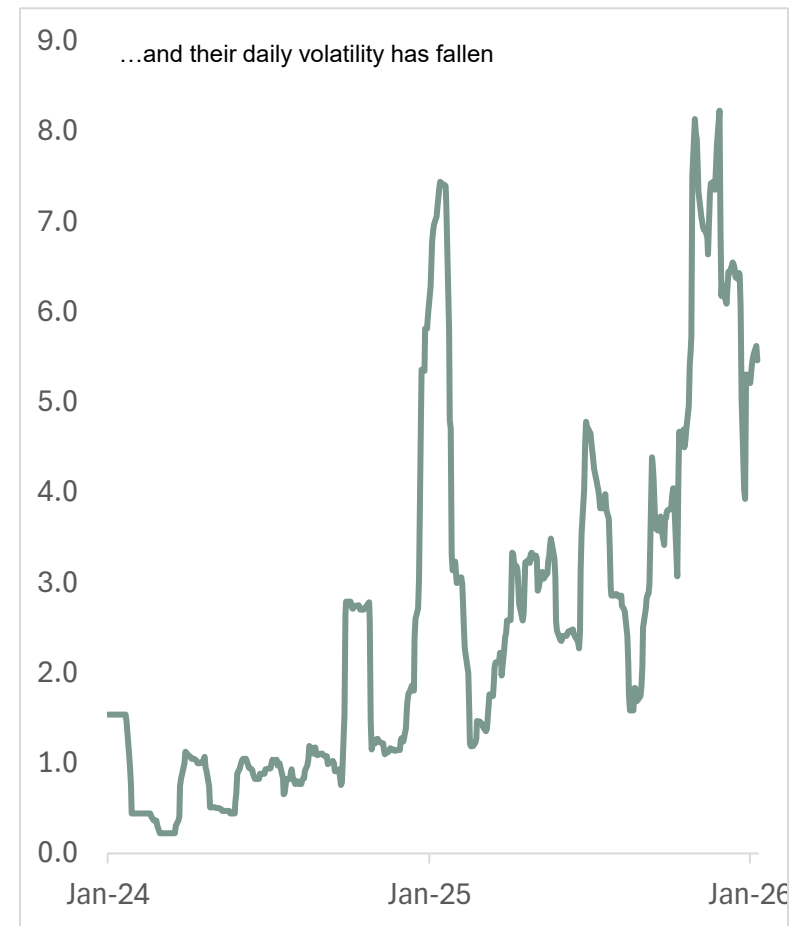
- Even though tri-party repo traded 5bp above IORB between mid-October and the December FOMC meeting, FOMC participants still felt that reserves were in an “ample range”
- We thought that there was a sharper threshold between ample and scarce
 - And that in equilibrium, ample reserves meant that the cost of liquidity (overnight market rates) would equal its return (IORB)
- Instead, it appears that there are gradations of ampleness
 - And the Fed’s objective is to keep the supply of reserves in a roughly defined range so that they are sufficient to meet bank demand on most days
 - With banks using the SRP to temporarily “top up” their desired cushions on other days
 - And SRP borrowing is meant to temporarily push balances from less to more ample
- The decision to begin RMPs may have reflected the FOMC concerns about the volatility in repo rates and their increased sensitivity to coupon settlements

Tri-party rates are trading closer to IORB...

Tri-party less IORB (bp)



Trailing standard deviation (bp)



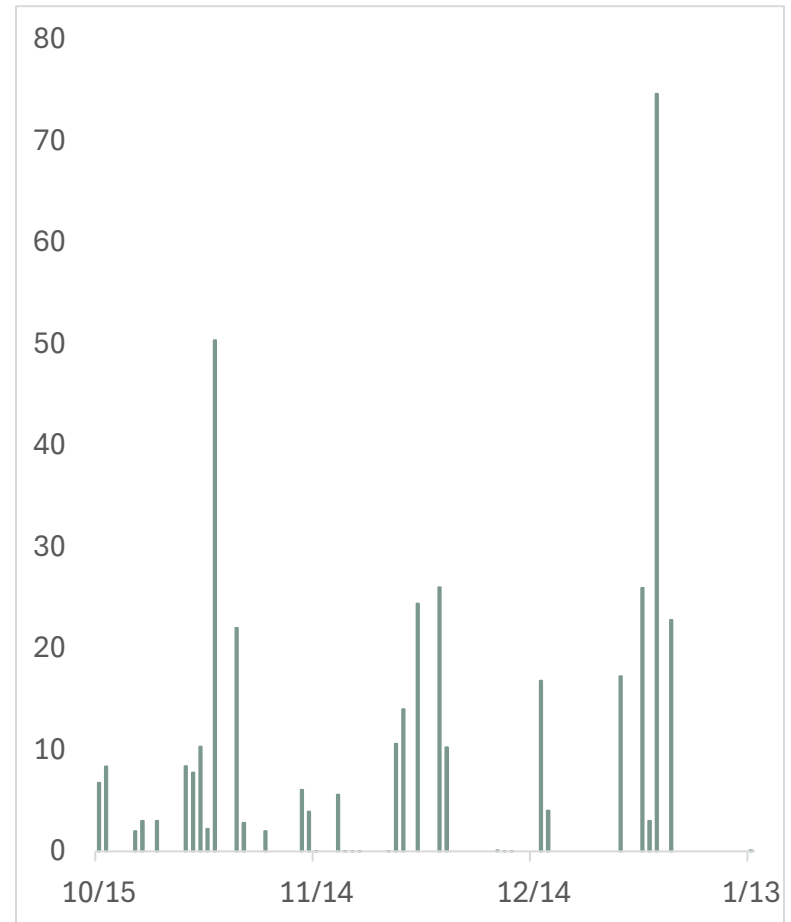
Sources: Federal Reserve, SMBC Nikko

Note: Trailing 20d standard deviation. Sources: Federal Reserve, SMBC Nikko

...and SRP use has declined

- As repo pressure subsided, the frequency and size of SRP borrowing has declined
- At the December FOMC, the Board attributed the lack of SRP use to:
 - Misperceptions about its function
 - Operational issues
- It clarified that the program is meant to be part of banks' "business as usual" liquidity management
 - And replaced "facility" with "program" in the name
- It also removed the \$500bn cap on the program
 - And noted that this continues to study centrally clearing the program

SRP usage (\$bn)

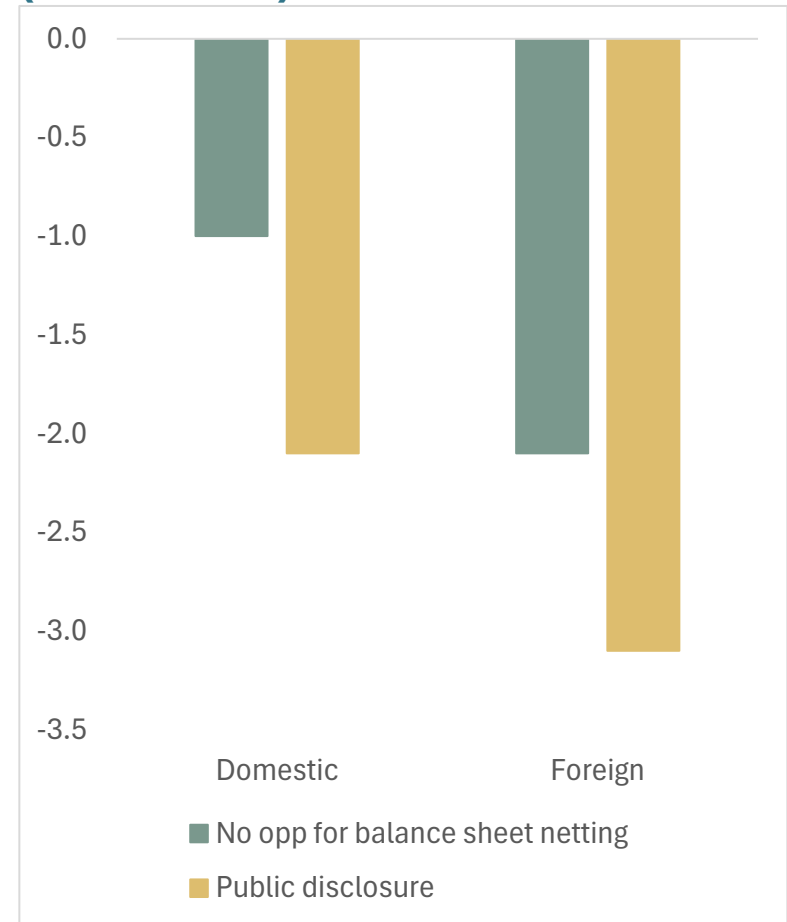


Note: Daily level, against all collateral. Sources: Federal Reserve, SMBC Nikko

Is there SRP stigma?

- Like the Fed's other liquidity programs, usage of the SRF is publicly disclosed
 - Operation amounts are reported immediately after the operation
 - But participants' names are reported with a two-year lag
- In the March 2025 Senior Financial Officer survey, banks were asked about their attitudes toward the SRF^{1/}
 - Public disclosure was a key concern
 - For both domestic and foreign banks
- *Reputational concerns reflect management psychology, fears of bank regulator scrutiny as well as worries about attracting market attention*

SRF features: Attractive or not? (scale -4 to 4)

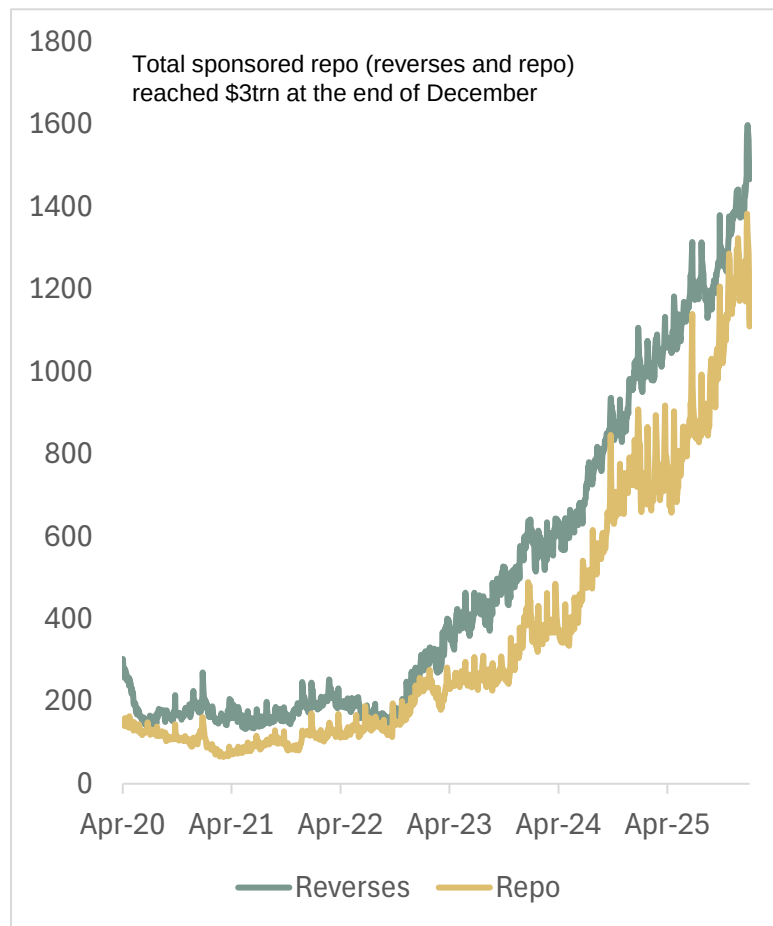


1/ See "Senior Financial Officer Survey", Federal Reserve Board, March 2025.

Note: -4 "strongly discourages" use while 4 "strongly encourages use."
Sources: Federal Reserve, SMBC Nikko

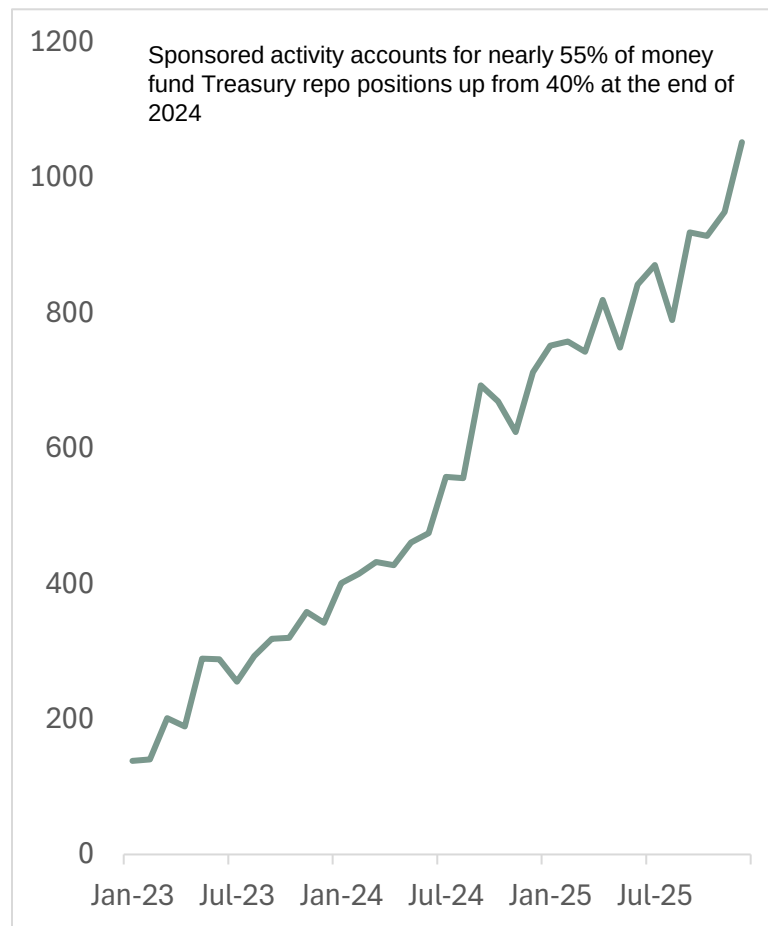
Sponsored activity is rising as the clearing deadline approaches

Sponsored repo volumes (\$bn)



Sources: DTCC, SMBC Nikko

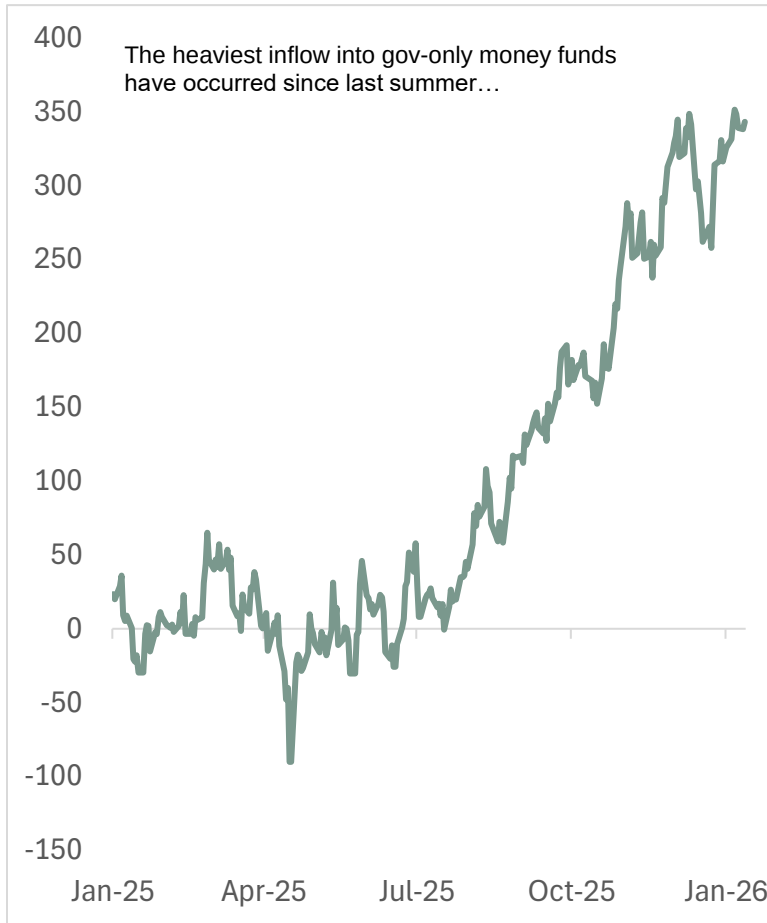
Money fund sponsored repo (\$bn)



Sources: Crane's Data, SMBC Nikko

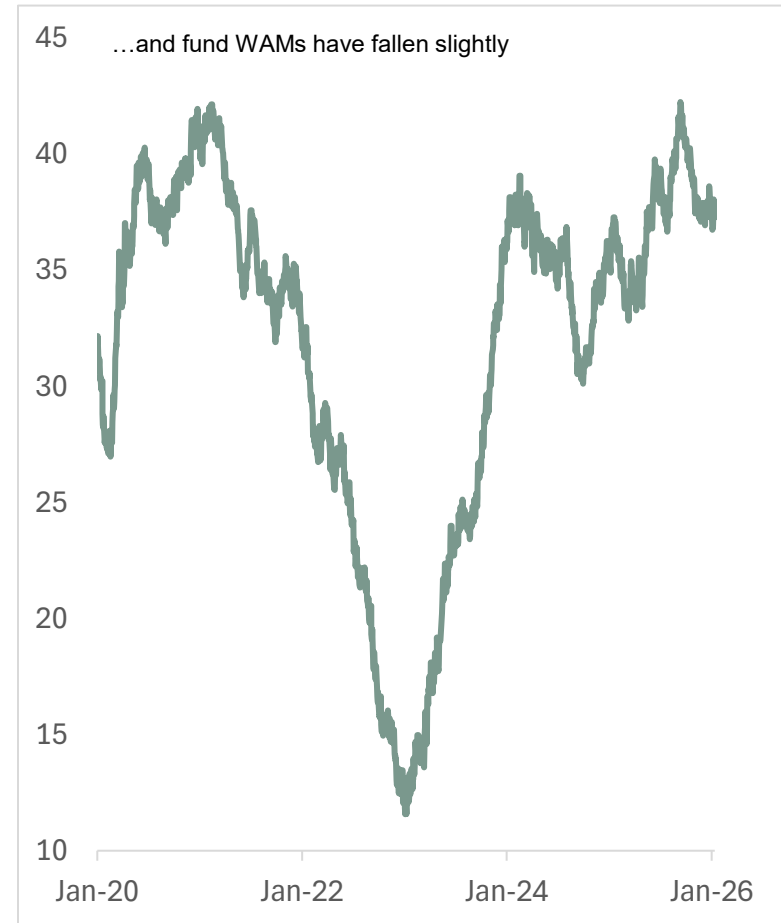
Money fund balances continue to grow

Gov-only inflows (\$bn)



Note: Cumulative inflows since December 31, 2024. Sources: Crane's Data, SMBC Nikko

Institutional gov-only WAMs (d)



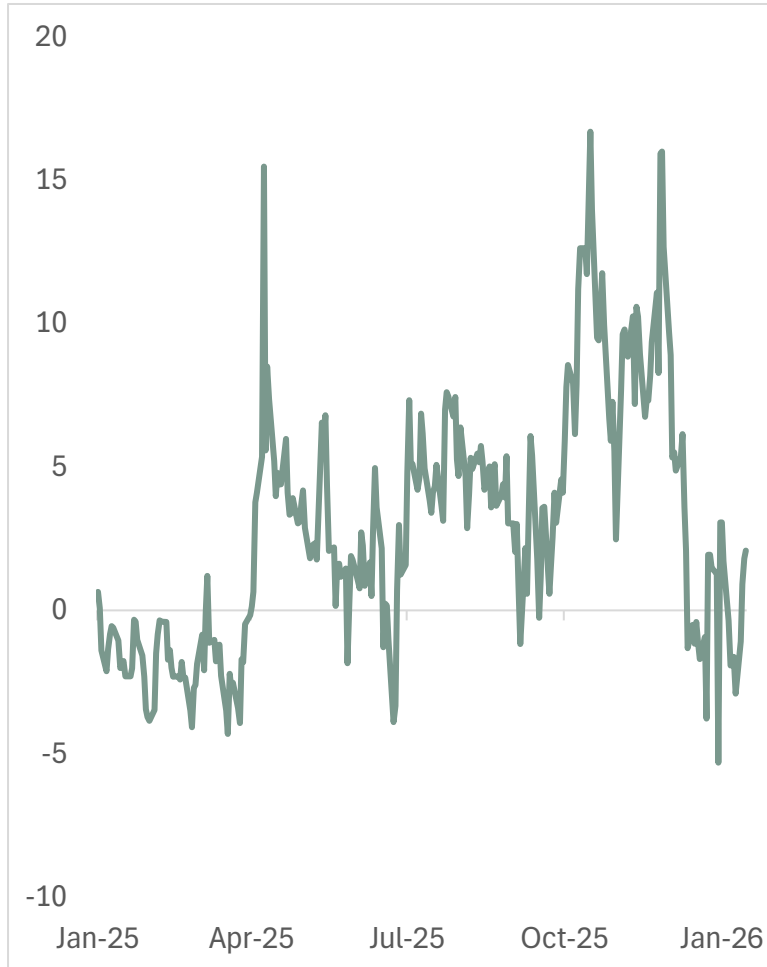
Sources: Crane's Data, SMBC Nikko

Bill supply outlook

- We look for a FY 26 deficit of \$2trn – somewhat wider than FY 25
 - With a year-end cash target of \$900bn
- The November refunding suggests the Treasury can keep coupon auction sizes unchanged for “several quarters” – through at least September 2026
 - But we think it might be able to keep auction sizes unchanged through December 2026
 - This would require increasing bill supply by \$600bn
 - This would push the bill/debt share closer to 23%

Reduced bill issuance pulled rates lower

3m bill less OIS (bp)

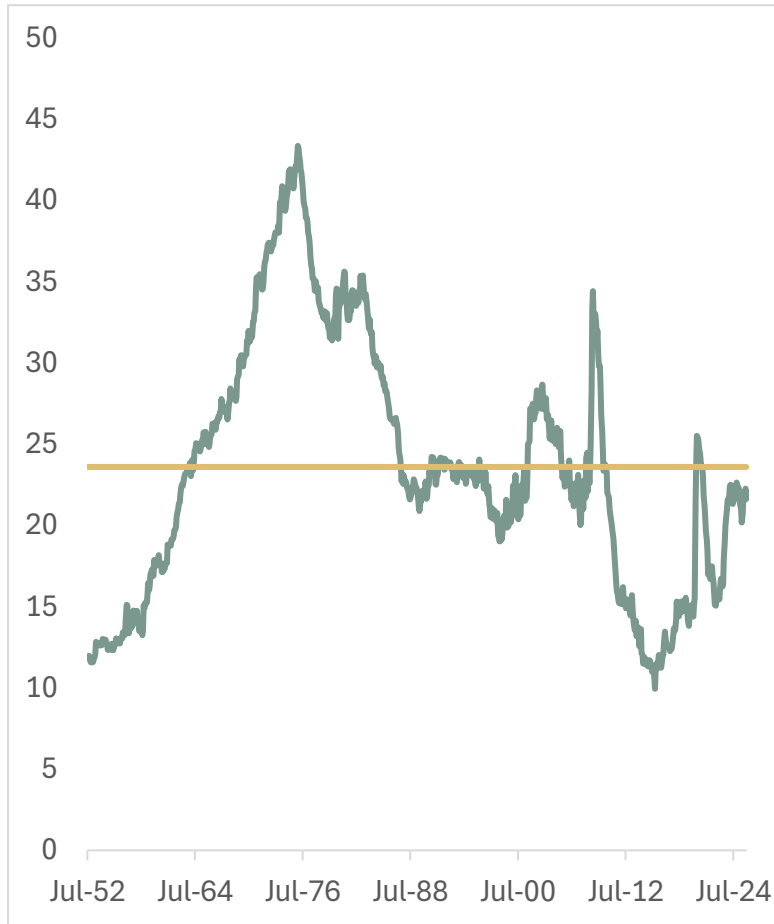


- Reduced bill issuance at the end of last helped bring bill yields
- We expect bill supply to pick up ahead of the peak in tax refund issuance in February and March
 - Quarterly bill issuance is expected to total \$200bn or so
- We do not expect this will cheapen bill yields by more than a couple of basis points
 - Or crowd out repo rates

Sources: Bloomberg, SMBC Nikko

Bills outstanding

Bills (% outstanding debt)

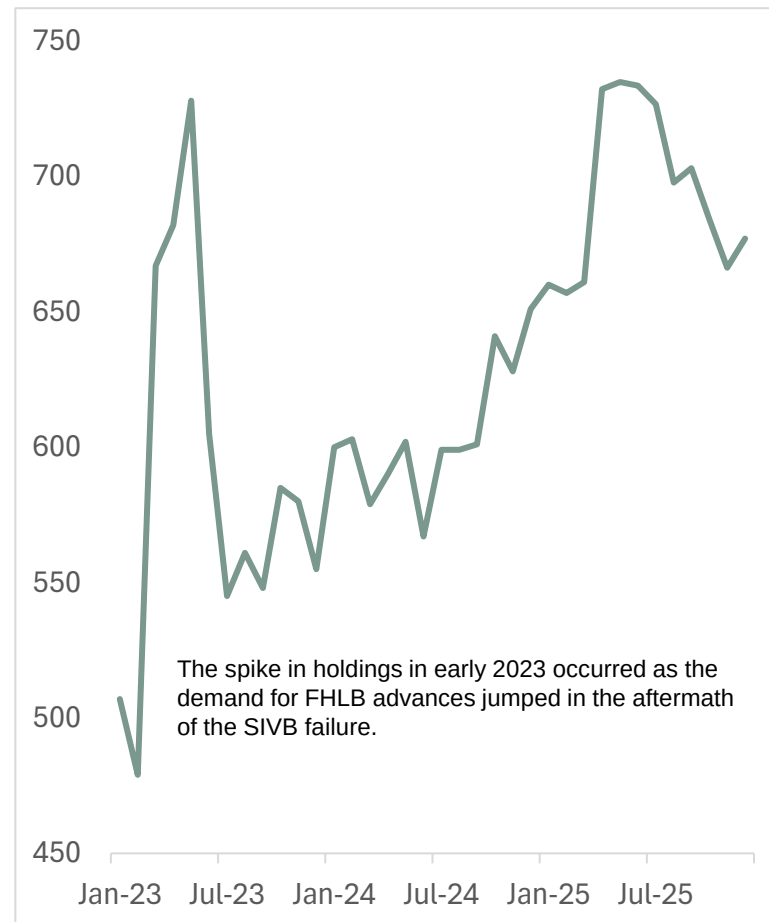


- Total bills outstanding are close to their long-run historical average^{1/}

MBS purchases?

- The Administration is considering instructing FNMA and FHLMC to purchase \$200bn of mortgages
- We think this might lower mortgage rates by 25bp or so
- Unlike QE, however, these purchases must be financed
 - Our sense is that the GSEs could issue discount notes to fund the purchase
 - As money funds have plenty of appetite for short-maturity GSE debt^{1/}

Money fund FHLB holdings



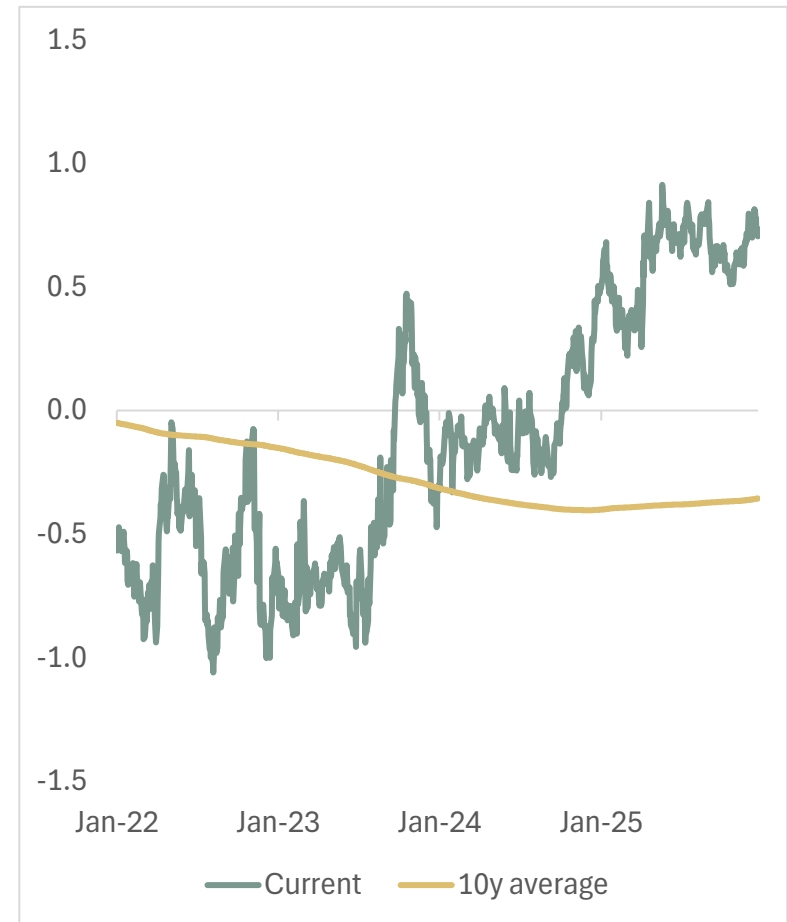
1/ Most of the money funds' GSE holdings are FHLB discount notes.

Sources: Crane's Data, SMBC Nikko

Higher term premia

- Treasury 10y term premia have risen 125bp since January 2022
 - So, issuing more debt at shorter maturities might be cheaper

10y term premia (bp)

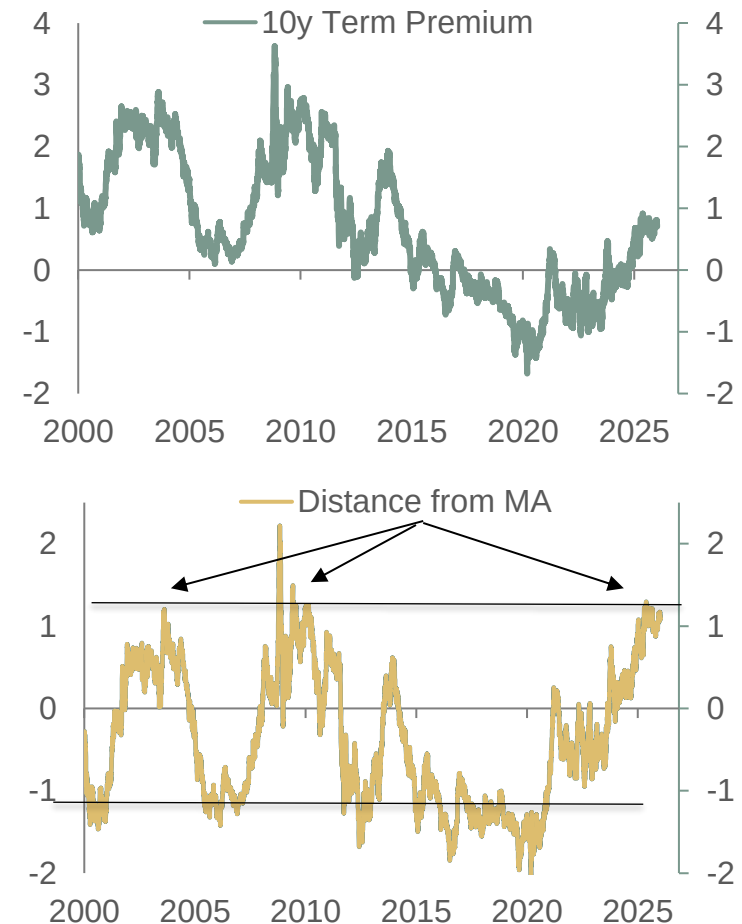


Sources: Adrian, Crump, and Moench, Federal Reserve Bank of New York, SMBC Nikko

Term premium in consolidation phase ?

- History shows that term premium meets resistance after a rise of 115-140 bps from the 10y moving average.
 - Currently term premium at 70 bps vs. 10y average at -36 bps.
- Unless the fiscal situation improves, term premium may resume rising

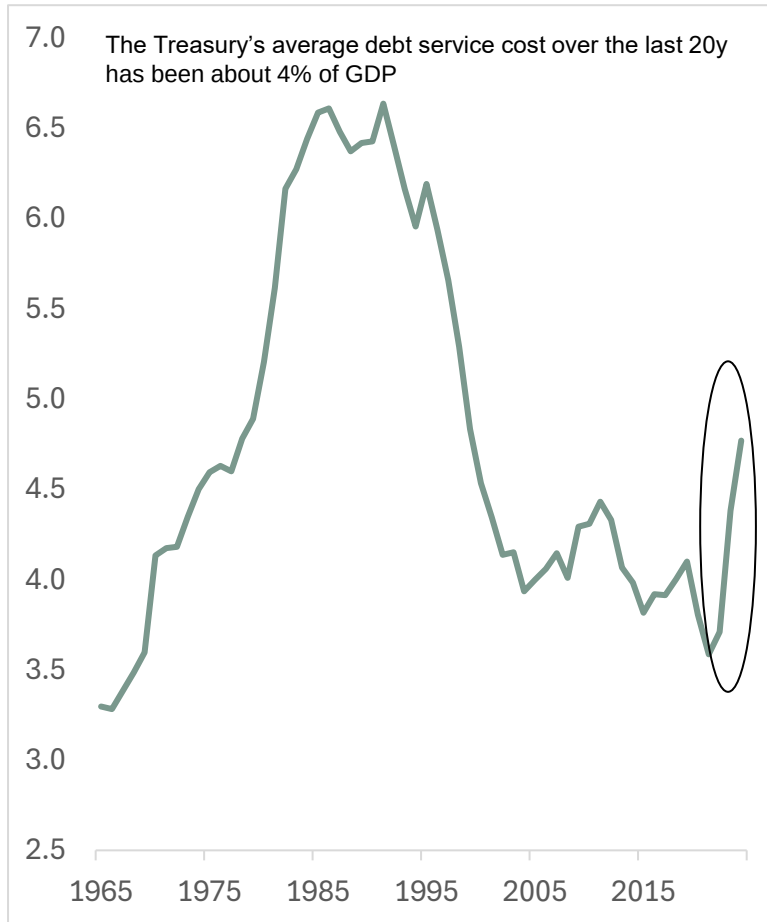
Estimated term-premium and its distance from the 10y Moving Average (%)



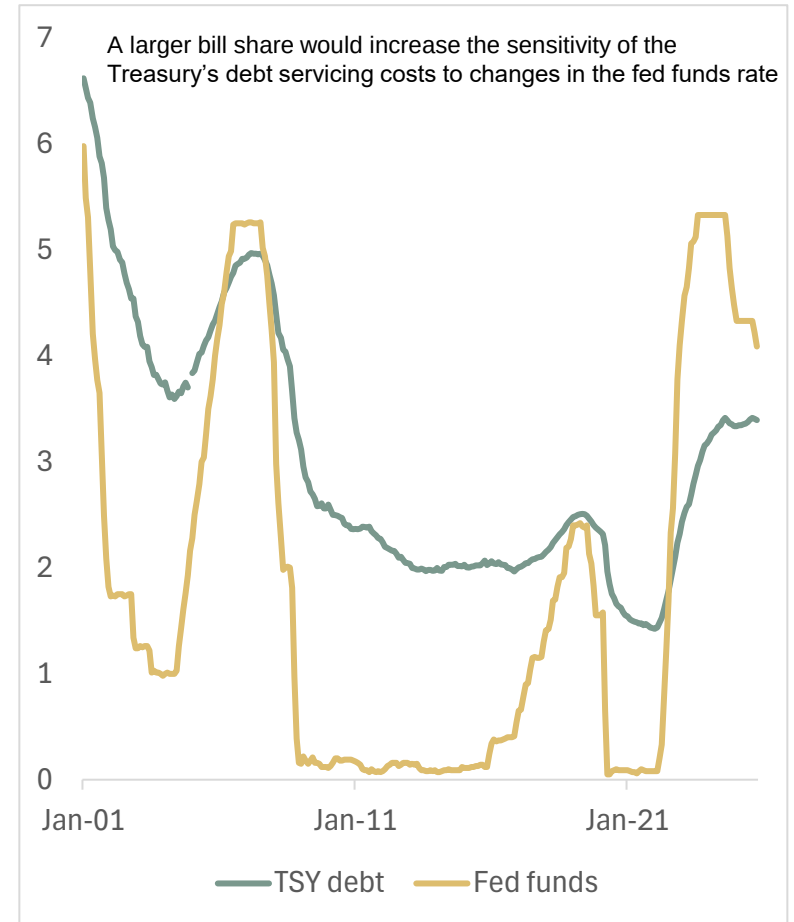
Sources: Federal Reserve, Bloomberg, SMBC

Debt servicing costs are rising

Interest (% GDP)



Marketable debt rate and fed funds (%)



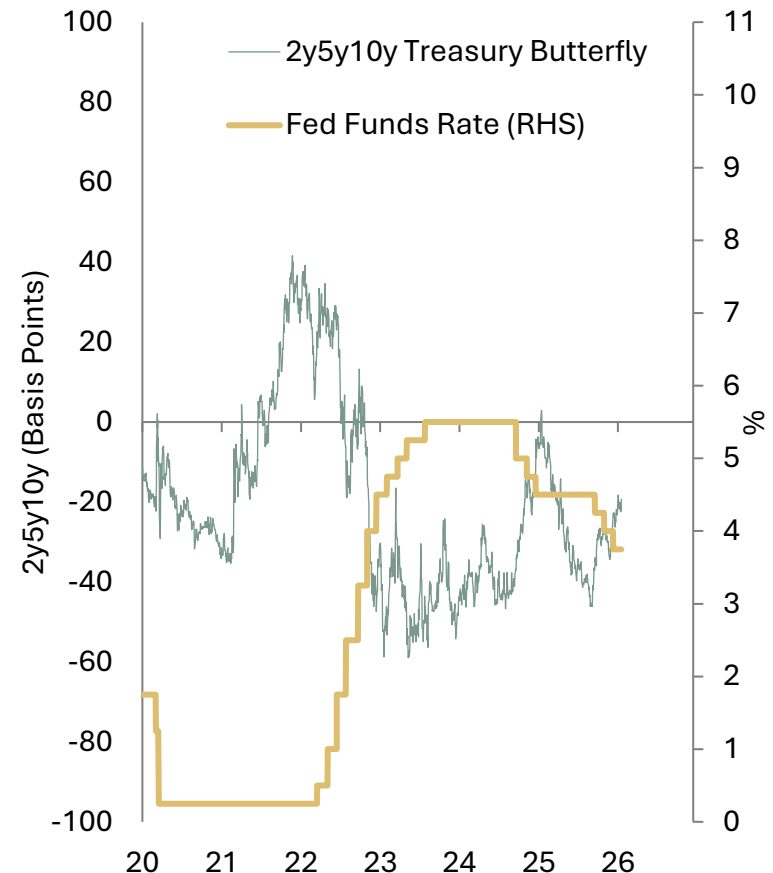
Sources: BEA, SMBC Nikko

Sources: US Treasury, SMBC Nikko

5y has cheapened against 2y and 10y but more room to go

2y5y10y UST Fly (bps) vs. Fed Funds (%)

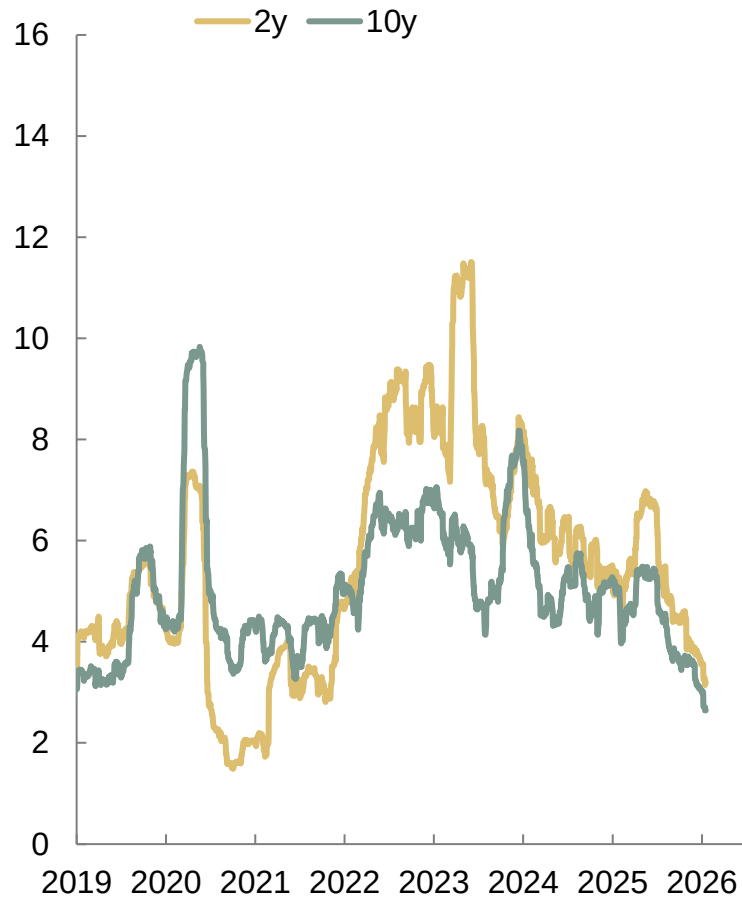
- 5y has richened from January to September 2025 as the 2s5s flattened (cuts being pushed out) and the 5s10s curve steepened (term premium being injected in the long end)
- 5s has richened as investors that were hiding in the 5y-7y part of the curve (going underweight) into September 2025 are extending to 10y-30y part of the curve, as they turn neutral.
- The cheapening in the 5y has been fast and some consolidation is welcome but there is more room for cheapening of the 5y.



Sources: US Treasury, Bloomberg, SMBC

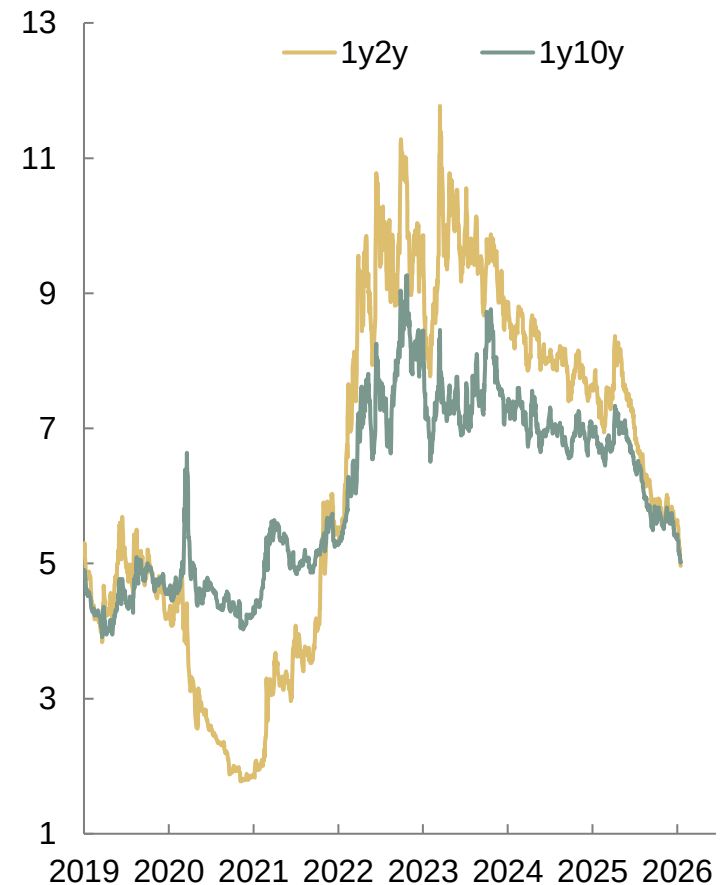
Buy Gamma on Dips

Realized vol (daily bp)



Sources: Bloomberg, SMBC Nikko

Implied vol (daily bp vol)



Sources: Bloomberg, SMBC Nikko

History Shows that Range can Break in the Next 3-4 Months

- 10y yields trade in a range in the weeks/months after the first Fed cut but the range tends to break in six months.
- A breakout one way or other should support vol

10y Yields Around First Fed Cut



Sources: Bloomberg, SMBC Nikko

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