**RAHEEL SIDDIQUI**
Senior Research Analyst, Global Equity Research

NEUBERGER BERMAN

# Equity Market Outlook 3Q 2025

**We maintain our belief that economic growth is likely to slow, but that a severe U.S. downturn appears unlikely. Against this backdrop, we remain constructive on global equity markets heading into the second half of 2025 and highlight potentially more attractive opportunities.**

- In contrast to prior economic downshifts, overall corporate financial health still appears strong: Profit margins and cash flows remain solid, and leverage remains low.
- While slowing U.S. economic growth would likely trigger volatility and modest market corrections in 2H 2025, we believe such episodes may allow long-term investors to add equity exposure at potentially attractive valuations.
- **Portfolio considerations (regions and styles):** We are upgrading Japan to overweight as our concerns about a stronger yen abate. We maintain our recommended overweight exposures to Europe and China, while underweighting India due to faltering economic growth and tighter financial conditions. On the style front, we reaffirm our preference for value over growth, and small caps over large caps in the U.S.

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# Investment Themes and Views[1]

We have retooled the methodology behind our equity recommendations to provide more actionable guidance for active asset allocators and portfolio managers. Our methodology is designed to assess developing risk and opportunity cycles at the index and sub-component levels (countries, sectors, regions and styles) and be more responsive to changes in market sentiment. The targeted investment horizon for these recommendations is approximately 12 months, but we expect more frequent adjustments at the sub-index level.

| USA | 2Q'25 | Δ[1] |
|---|---|---|
| Communication Services | Overweight | |
| Consumer Discretionary | Underweight | |
| Consumer Staples | Overweight | |
| Energy | Overweight | |
| Financials | Underweight | |
| Health Care | Market Weight | |
| Industrials | Overweight | |
| Information Technology | Underweight | |
| Materials | Overweight | |
| Utilities | Underweight | ⇓ |

| EQUITY STYLES | 2Q'25 | Δ[1] |
|---|---|---|
| Russell 1000 Growth vs. Value | Underweight | |
| Russell 2000 vs Russell 1000 | Overweight | |

| REGIONS | 2Q'25 | |
|---|---|---|
| EAFE | Overweight | |
| EM | Market Weight | |
| Europe | Overweight | |
| US | Market Weight | |
| Japan | Overweight | ⇑ |
| China | Overweight | |
| India | Underweight | |

[1] Changes Relative to Previous Quarter.

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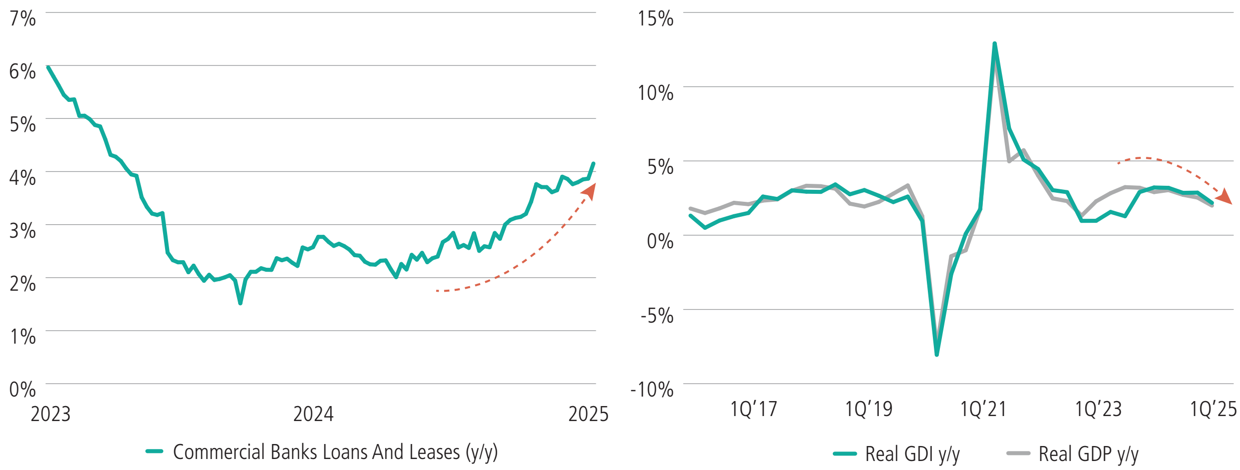
# Staying Constructive Amid Potential Headwinds

Much ink has been spilt over the looming fallout from tougher U.S. tariffs, whether and when the Federal Reserve will ease, the relative impact of rising bond yields versus potential AI-driven productivity improvements, and a host of other headline-grabbing issues. Widening the macro lens a bit, the underlying resilience of the U.S. economy keeps us constructive on the U.S. equity market, as evidenced by corporate earnings touching all-time highs,[1] improving growth in commercial lending (as shown on the left side of figure 1), and robust growth in nationwide tax collections in the second quarter.[2] Consequently, it is not surprising to us that the S&P 500 Index has maintained its strength—yet we believe there are reasons for caution ahead.[3]

**FIGURE 1: RISING COMMERCIAL BANK LENDING HAS SUPPORTED U.S. ECONOMIC GROWTH, YET SEVERAL INDICATORS SUGGEST POTENTIALLY DECELERATING MOMENTUM IN THE SECOND HALF OF 2025**




For illustrative purposes only. Source: Neuberger Berman and FactSet, data as of July 4, 2025.

## Growth Is Slowing, But a Recession Remains Unlikely

We believe several key indicators suggest decelerating U.S. economic momentum in the second half of 2025 (see the right side of figure 1). First, the labor market has recently exhibited signs of cooling as weekly jobless claims have risen from last year's lows[4] and both employment and personal income growth have begun to decelerate.[5] Second, recent tariff announcements have pulled demand forward, potentially dampening growth in coming quarters.

While we continue to anticipate a rebound in global manufacturing, growth in the U.S. service sector is slowing[6] and the outlook for both residential and commercial construction continues to raise concerns. We believe these trends suggest emerging economic softness, potentially curbing equity market performance. At the same time, we do not observe the typical investment, financing or spending imbalances that usually precede an economic contraction, and therefore do not expect the economy to slide into recession.

## Corporate Fundamentals Remain Robust

In contrast to prior pre-recession periods, overall corporate financial health appears strong in our view: Profit margins are strong and balance sheets remain solid. Corporate earnings indicators are holding firm, too: National Income and Product Accounts data show that profits rose 9% year-over-year at the end of Q1 2025, mirroring the strength observed within the S&P 500 Index.[7]

Since 1965, U.S. recessions tend to be preceded by periods of heightened investment, when economy-wide corporate cash-flow needs far exceed endogenous cash flow generation, leading to rapidly escalating debt levels—yet that's not what we're seeing now.[8] U.S. non-financial corporations are generating sufficient cash to meet their needs, and the overall net debt-to-GDP ratio is near a low not seen since the mid-1980s.[9]

We believe this disciplined financial management and abundant liquidity could help firms navigate a potential slowdown without resorting to drastic reductions in hiring and spending, decreasing the likelihood of a severe downturn.

## Macroeconomic Policy Supports a Soft-Landing Scenario

As inflationary pressures continue to soften, we believe the Federal Reserve has more flexibility to ease policy. Meanwhile, global central banks have also been in easing mode: Out of 60 institutions that we monitor, only 10 have tightened policy rates in the past six months; 30 have reduced policy rates; and another 20 have been on hold.[10] We believe this broad monetary easing, combined with the Fed's capacity for additional rate cuts, strengthens the case for a mild rather than severe economic downturn.

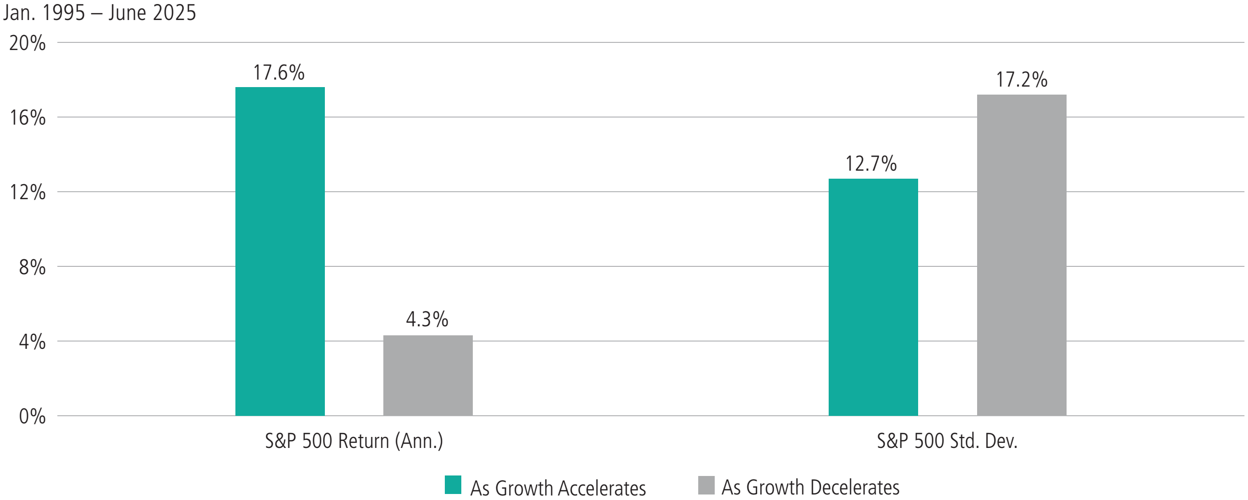
## Gird for Greater Volatility in the Second Half of 2025

For now, U.S. equity markets appear broadly sanguine, and for good reason: Steady dividend growth and record share buybacks, estimated to exceed $1 trillion in 2025, have combined to produce a total shareholder yield of 3%[11] as institutional equity allocations (though off their April lows) remain below the 15-year median, leaving potential for further upside.[12]

What might happen if growth moderates in the second half of the year, as we expect? As shown in figure 2, we find that periods of economic slowdown tend to persist for 15 to 20 months and are often characterized by mid-single-digit annualized equity returns and heightened market volatility. Yet given the encouraging underlying conditions discussed above, we expect that concerns over slowing growth would result in more frequent but relatively modest market corrections, allowing long-term investors to add equity exposure at potentially attractive valuations.

**FIGURE 2: AS ECONOMIC GROWTH MODERATES, INVESTORS SHOULD EXPECT LOWER EQUITY MARKET RETURNS AND HIGHER VOLATILITY**

Jan. 1995 – June 2025




**Past performance is not indicative of future results.** Source: Neuberger Berman Research and FactSet. Data as of June 30, 2025. Note: Periods of growth acceleration are defined as improving 12-month OECD LEI growth; periods of growth deceleration are defined as declining 12-month OECD LEI growth. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. For illustrative purposes only.

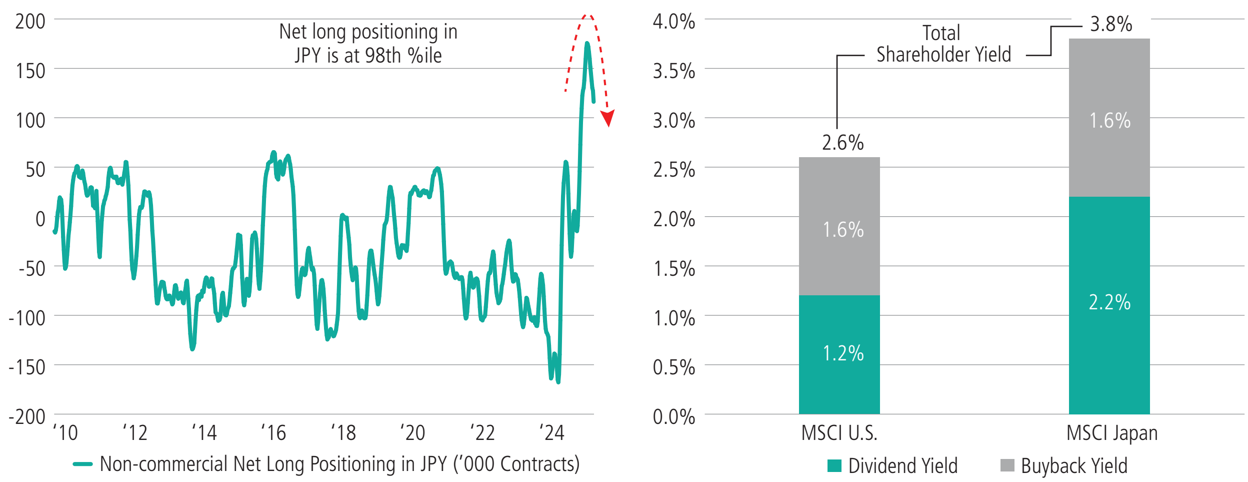
# Portfolio Considerations: Regions, Styles and Sectors

## Japan: Upgrading to Overweight

*Proliferating green shoots.* Japan's economy continues to gain momentum. Core inflation at 3.3%[13] is high enough in our view to invigorate revenue and profit growth, while low unemployment and recent wage increases have boosted spending, which has strengthened for three consecutive quarters.[14] Persistently negative real interest rates, amid elevated inflation and gradual rate hikes, are incentivizing corporate borrowing for investment and share buybacks, pushing Japan's buyback yield to 1.6%, well above that of the U.S. and Europe.[15] Japanese banks, too, are benefiting as higher long-term yields have increased their desire and ability to lend. These converging factors suggest a robust recovery in domestic earnings, in our view.

*Foreign demand and currency tailwinds.* Japanese manufacturers may stand to benefit as Chinese economic growth improves and currency dynamics turn more favorable. After a rally earlier this year, the yen has stabilized and now appears set to weaken as historically extreme bullish bets begin to unwind (left side of figure 3), potentially enhancing the competitiveness and profit margins of Japanese exporters. We believe these currency trends could further improve the earnings prospects of globally exposed Japanese firms and support stronger equity performance over the next 12 – 18 months..

**FIGURE 3: POTENTIAL UNWINDING OF BULLISH BETS ON THE YEN, ALONG WITH ATTRACTIVE TOTAL SHAREHOLDER YIELDS, COULD BE TAILWINDS FOR JAPANESE EQUITIES**

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*Attractive valuations and earnings outlook.* Despite potentially stronger growth, record corporate buybacks and ongoing shareholder friendly corporate reforms, Japanese equities remain under-owned[16] and relatively cheap compared to global peers. For example, as shown on the right side of figure 3, the 3.8% combined dividend-and-buyback yield of the MSCI Japan Index far outpaces the 2.6% total shareholder yield of the MSCI U.S. Index.[17] Consensus earnings expectations are also low: Analysts estimate that, over the next 12 months, earnings per share for the MSCI Japan Index will grow at 6% versus 12% for the MSCI ACWI.[18] Given how highly geared Japanese earnings are to steadily rising global trade volume, we think earnings growth could surprise to the upside.

## Europe: Maintaining Overweight

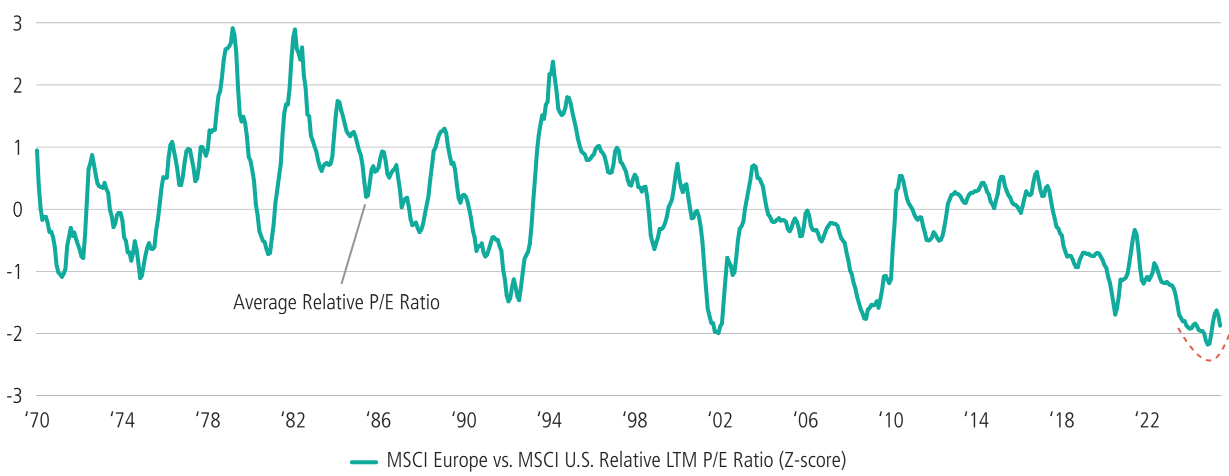
*Gathering tailwinds.* Successive economic shocks have been rapidly unwinding. First, energy costs have fallen from crisis peaks in 2022, boosting household purchasing power.[19] Second, the European Central Bank (ECB), after hiking rates 450 basis points in 14 months, recently delivered its eighth rate cut in the past year; borrowing costs responded, with the eurozone 2-year swap rate falling to 2% from 3.2% a year ago.[20] Third, China's balance-sheet recession has given way to stimulus, fortifying order books at Europe's industrial firms.

*Strengthening corporate earnings*. Improvements abroad are translating into stronger profits at home. As China recovers from its slump, European exports of capital goods, luxury products and automobiles are on the rise.[21] Fiscal policy also appears supportive of growth, including the European Union's new Green Deal Industrial Plan and Germany's €500 billion Climate Transformation Fund; furthermore, the European Commission expects €800 billion in defense investment across member states between 2025 and 2027.[22] We believe these various outlays will fortify earnings among Europe's strongest sectors, such as industrial machinery, construction, green tech and defense manufacturing.

*Strong domestic fundamentals.* After deleveraging through the 2010s and accumulating excess savings during the pandemic, European consumers look ready to borrow and spend again. In the ECB's April survey, senior loan officers reported easing credit standards for the first time since 2022,[23] along with rebounding demand for mortgage loans. As inflation has cooled and interest rates have declined, consumers are regaining confidence, and forward-looking gauges—such as Germany's Ifo Business Climate Index and the eurozone's Sentix Economic Index index—have turned positive for the first time in two years.[24]

*Attractive valuations.* From January through mid-July, the MSCI Europe Index advanced 25%, marking its best start since 1998 and outpacing the MSCI ACWI global benchmark by roughly 14 percentage points.[25] Yet, despite this outperformance, we believe valuations remain remarkably cheap: Europe offers an average dividend yield near 3%, approximately double the S&P 500's yield, which we believe could provide a potential income buffer should market volatility pick up again.[26] Furthermore, European equities continue to trade about two standard deviations below U.S. markets, nearly the largest relative discount in five decades (as shown in figure 4).

**FIGURE 4: DESPITE STRONG YEAR-TO-DATE RETURNS, EUROPEAN EQUITIES ARE STILL HISTORICALLY CHEAP RELATIVE TO U.S. MARKETS**

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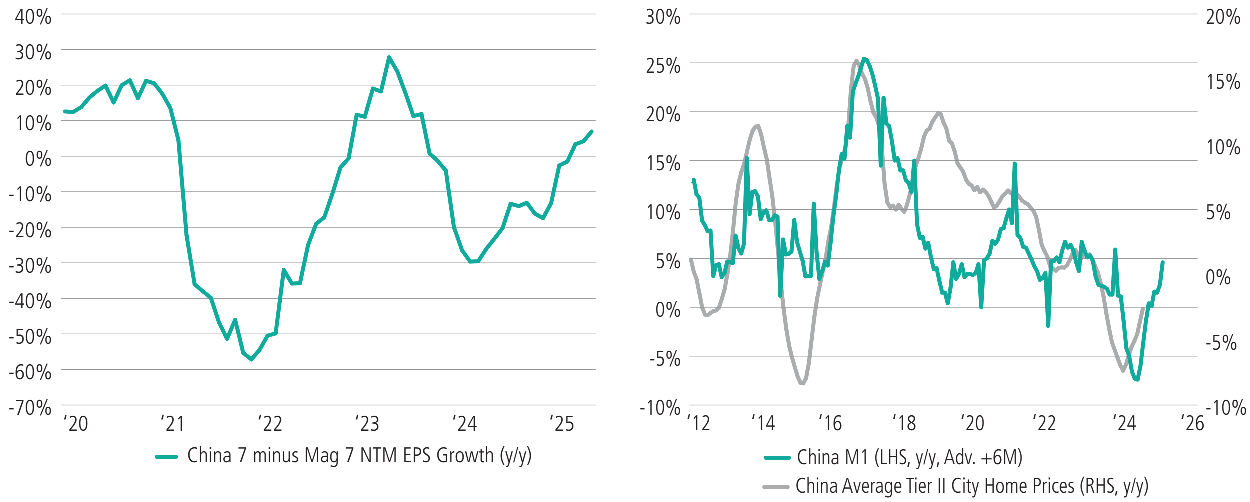
## China: Maintaining Overweight

*Technology leadership.* We believe China's top technology companies are emerging as global contenders to the U.S. Magnificent 7, reflecting President Xi's push for innovation in artificial intelligence and robotics.[27] Since March 2024, the combined market capitalization of the "China 7" (Alibaba, BYD, Meituan, Netease, PDD, Tencent and Xiaomi) has soared 54%. While these companies now make up 43% of the MSCI China Index, their market cap measures just one-ninth of the Mag 7's.[28] As shown on the left side of figure 5, next-12-month earnings for the China 7 are expected to grow faster than the earnings of the Mag 7, yet are collectively priced at only 11 times forward earnings vs. 28 times for the Mag 7.[29] We believe this yawning gap suggests considerable room for further upside.

**FIGURE 5: EARNINGS FOR THE "CHINA 7" ARE EXPECTED TO GROW FASTER THAN THOSE FOR THE MAG 7, AND CHINA'S BELEAGUERED HOUSING SECTOR IS BEGINNING TO STABILIZE**

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*Cyclical acceleration.* Tech isn't the whole story in China. Broadening drivers of economic growth have begun to widen equity market breadth, and leading names have recently included financial and consumer stocks. Additionally, the Chinese housing sector has begun to stabilize: In recent months, properties in Tier 1 and Tier 2 cities have cleared title faster; transaction volumes have ticked up; and the recent decline in home prices has slowed (as shown on the right side of figure 5), which we find to be consistent with recent re-accelerating growth in the money supply.[30] We believe these trends point to an early-stage housing rebound that, in turn, may encourage higher spending, boost retail activity and continue to extend Chinese stock market leadership beyond the tech sector.

*Supportive policy.* China is in both fiscal and monetary loosening mode.[31] Its central bank has cut lending rates and reserve requirements, while regulators have sought to bolster the banking system, including a RMB 500 billion recapitalization for state-owned commercial banks.[32] These moves, aided by recent weakness in the U.S. dollar, have helped Chinese policymakers ease more aggressively while supporting their currency. Early evidence suggests to us that the stimulus is taking hold as key liquidity indicators have turned upward: Growth in both the money supply and bank credit have risen—green shoots, perhaps, of a new credit cycle—and shares of Chinese banks have recently climbed to multi-year highs.[33] On the fiscal side, infrastructure spending and special bond issuance have also ramped up, and officials appear resolved to unleash even more stimulus to meet their 5% GDP growth target.[34] We believe these policy tailwinds reinforce the case for China's cyclical renewal over the next six to 18 months.

## India: Maintaining Underweight

*Faltering economic growth.* Recent income-tax relief for the middle class has failed to boost consumption—only a small fraction of households actually pay income tax—and many lower-income families have been cutting back on essentials amid higher food prices.[35] Analysts now expect India's real GDP growth to moderate to the mid-6% range in 2025, down from about 9% last year.[36]

*Tight financial conditions.* Policy rates remain elevated, and with inflation falling faster than the central bank has eased, real borrowing costs have spiked to roughly 15-year highs.[37] Liquidity is also constrained as the central bank has sold foreign currency reserves to defend the rupee, reducing its availability.[38] As a result, bank credit growth and money supply are nearly flat in real terms—a negative credit impulse that, we believe, signals a waning appetite for capex investment and slowing business activity.[39]

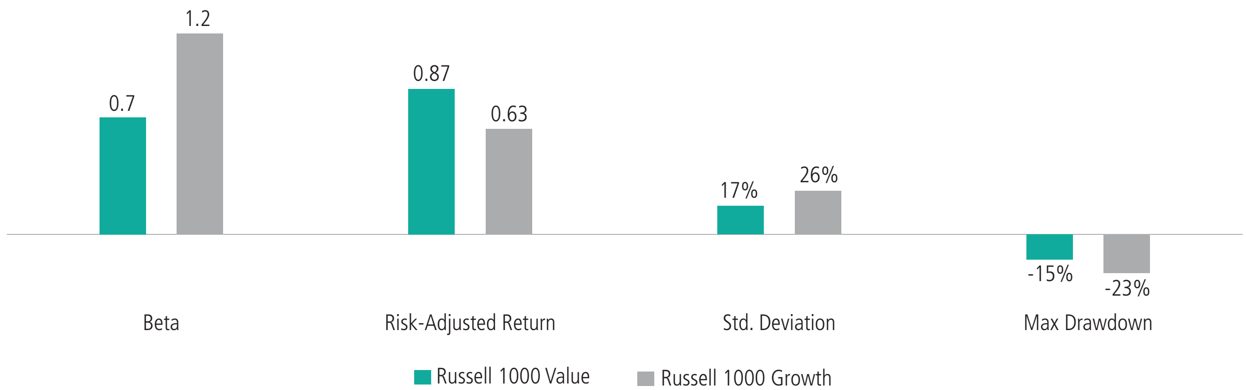
*Stretched valuations.* Despite the challenges listed above, Indian equities continue to trade at rich valuations, both in absolute terms and relative to peers. The MSCI India Index now trades at nearly 23 times forward 12-month earnings—about two standard deviations higher than the historical mean[40]—placing India among the most expensive markets in the world. And even after a recent market pullback, we believe current valuations still leave little room for error, and that any earnings disappointments could trigger further declines.

## Overweighting Value Versus Growth

While mega-cap growth stocks continue to steal headlines, value investors have enjoyed 35% – 50% better risk-adjusted returns than growth investors in the past 12 months, and especially in 2025. As shown in figure 6, the Russell 1000 Value Index, which has a beta of 0.7, has suffered far smaller drawdowns than the Russell 1000 Growth Index, which has a beta of 1.2 and 50% higher volatility.

**FIGURE 6: VALUE STOCKS HAVE OFFERED SUPERIOR RISK-ADJUSTED RETURNS COMPARED TO GROWTH STOCKS OVER THE LAST 12 MONTHS**

July 2024 to June 2025

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We expect more frequent bouts of volatility as the economy slows, further supporting our lower-beta value thesis. Unlike in many previous cycles, we think the current slowdown will be led by the services sector rather than by the industrially oriented goods sector, which we expect to continue to rebound. Given that value tends to be more geared toward industrial output than growth, we expect value to outperform growth as global industrial production continues to gain momentum after a slump that lasted well over two years.

## Overweighting Small Caps Versus Large Caps

Over a year ago, we made the case for a long-awaited revival in small caps, based on a projected pick-up in global industrial production and capital expenditures. (For more details, see our 2Q 2024 Equity Market Outlook.) While admittedly early, we see signs that a change in leadership may finally be gaining momentum.

Since early April, the smallest 1000 stocks within Russell 2000 Index have roundly outperformed all nine categories across the investment style box.[41] While by no means do we recommend chasing microcap performance, their remarkable 36% returns since April 8, versus 25% for the S&P 500 Index, suggest to us that investors' overall appetite for risk may be increasing.[42]

Furthermore, we believe that small-cap earnings, which tend to be strongly geared to global industrial output, should benefit as industrial momentum continues to strengthen. And while small cap returns tend to fluctuate more than large cap returns during market corrections, favorable policy measures and lower interest rates could mitigate those impacts, in our view.

## Utilities: Downgrading to Underweight from Overweight

Utility stocks have outperformed in 2025 and over the last 12 months, a strong run driven by the sector's defensive appeal and exposure to the AI theme. As concerns about tariff impacts, higher inflation and slowing economic growth took hold, utilities' stable cash flows and dividends attracted investors rotating out of riskier assets.

Meanwhile, utility companies have been investing heavily in grid upgrades and renewable infrastructure—the sector's largest capital expenditure cycle in decades—which we expect will likely put pressure on free cash flows. And while utility stocks have benefited from the narrative that power-hungry data centers (the backbones of the AI boom) will significantly boost energy demand, many analysts now believe the market has priced in those projections. With the sector trading at 18 times forward earnings, we tend to agree.[43]

Should industrial momentum continue to pick up as we expect, we believe investors will likely turn their attention away from defensive sectors potentially constrained by macro and regulatory forces. In this context, we believe continuing to overweight utilities risks locking in subpar returns while missing broader opportunities across other sectors and styles.

# Risks to Our Recommendations

In light of the strong rebound in recent months, we caution that the equity markets may exhibit greater sensitivity to negative exogenous shocks, and therefore advise that investors keep the following risks to our various recommendations in mind.

## Policy Uncertainty and Macro Volatility

A variety of unforeseen catalysts—including a simmering trade war, shifting Federal Reserve guidance and ongoing geopolitical conflicts—could disproportionately impact small caps and value stocks, in our view. We believe these segments are more leveraged to broader economic growth and tend to underperform in risk-off environments. Moreover, policy uncertainty could weigh on ex-U.S. allocations, particularly in Europe and China, where investor confidence remains fragile.

## A Cooling Labor Market

While healthy U.S. employment has supported consumption and earnings, we believe a faster-than-expected slowdown in hiring would imperil a soft landing. If job losses translate into weaker loan growth or capital spending, we believe that traditional value sectors, such as financials and industrials, could suffer.

## Inflation Reacceleration

We believe higher inflation could delay the anticipated easing cycle or even cause the Fed to hike, potentially tightening financial conditions and dampening earnings expectations, disproportionately hurting value stocks and small caps.

## A U.S. Dollar Rally

The first half of the year saw a weaker U.S. dollar, which benefited non-U.S. markets and U.S. exporters. If the dollar stages a strong counter-trend rally in the second half, it could pose a headwind to our non-U.S. exposures. This risk could materialize if, for instance, U.S. growth surprises to the upside relative to Europe or Asia, or if there is a flight-to-quality into dollar assets. We believe a stronger dollar would diminish overseas earnings for U.S. multinationals or indicate capital outflows from non-U.S. markets. Furthermore, we find that a firming USD tends to pressure small-cap valuations relative to large caps.[44]

## Interest Rate Shock and Debt Sustainability

Perhaps the most underappreciated risk to our recommendations is a potential spike in interest rates driven not by inflation, but by concerns around government debt sustainability. In the U.S., rising deficits and Treasury issuance could test investor appetite, and we believe a disorderly bump in yields could compress equity multiples and trigger a broader risk-off trade.

[1] Source: Neuberger Berman and FactSet. Data as of July 4, 2025.
[2] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[3] Source: Neuberger Berman and FactSet. Data as of July 14, 2025.
[4] Source: Neuberger Berman and FactSet. Data as of July 4, 2025.
[5] Source: Neuberger Berman and FactSet. Data as of May 30, 2025.
[6] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[7] Source: Neuberger Berman and FactSet. Data as of March 31, 2025.
[8] Ibid.
[9] Ibid.
[10] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[11] Source: Absolute Strategy Research. Data as of June 18, 2025.
[12] Source: Deutsche Bank. Data as of July 11, 2025.
[13] Source: Neuberger Berman and FactSet. Data as of May 30, 2025.
[14] Ibid.
[15] Source: Absolute Strategy Research. Data as of June 18, 2025.
[16] Source: BofA. Data as of June 26, 2025.
[17] Source: Absolute Strategy Research. Data as of June 18, 2025.
[18] Source: Neuberger Berman and FactSet. Data as of July 11, 2025.
[19] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[20] Ibid.
[21] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[22] "Can European Stocks Keep Beating U.S. Markets in 2025?", Morningstar, May 27, 2025.
[23] Source: Neuberger Berman and FactSet. Data as of March 31, 2025.
[24] Source: Neuberger Berman and FactSet. Data as of May 30, 2025.
[25] Source: Neuberger Berman and FactSet. Data as of July 11, 2025.
[26] Source: Absolute Strategy Research. Data as of June 18, 2025.
[27] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[28] Ibid.
[29] Ibid.
[30] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[31] Source: LongView Economics. Data as of June 12, 2025.
[32] Ibid.
[33] Source: Neuberger Berman and FactSet. Data as of July 11, 2025.
[34] Source: LongView Economics. Data as of June 12, 2025.
[35] Source: BCA Research. Data as of June 5, 2025.
[36] Source: Neuberger Berman and FactSet. Data as of July 11, 2025.
[37] Source: BCA Research. Data as of June 5, 2025.
[38] Ibid.
[39] Ibid.
[40] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.
[41] Ibid.
[42] Ibid.
[43] Ibid.
[44] Source: Neuberger Berman and FactSet. Data as of June 30, 2025.

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**Index Definitions**

The **S&P 500 Index** consists of 500 U.S. stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

The **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term (2-year) growth and higher sales per share historical growth (5 years).

The **Russell 1000® Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2-year) growth and lower sales per share historical growth (5 years).

The **MSCI ACWI Index** captures large and mid-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. DM countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the U.K. and the U.S. EM countries include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. With 2,837 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The **MSCI China Index** captures large and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs). With 655 constituents, the index covers about 85% of this China equity universe.

The **MSCI Japan Index** is designed to measure the performance of the large and mid-cap segments of the Japanese market. With 203 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

The **MSCI Europe Index** captures large and mid-cap representation across Developed Markets (DM) countries in Europe. The index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

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### FIRM HEADQUARTERS

New York
+1 800 223 6448

### REGIONAL HEADQUARTERS

Hong Kong
+852 3664 8800

London
+44 20 3214 9000

Shanghai
+86 21 5203 7700

Tokyo
+81 3 5218 1930

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**Neuberger Berman**
1290 Avenue of the Americas
New York, NY 10104-0001

**www.nb.com**