Investing for a
world of change

Goldilocks prevails: investing in 2026

2026 Investment Views: Global Outlook

January 2026

Contents

fast

After a disorienting 12 months, investors need to recalibrate their perceptions of risk – a Goldilocks macro environment is likely to prevail in 2026. But while conditions appear 'just right', thoughtful positioning is required within each asset class.

The fast view

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- **Macro:** Investors should position for a goldilocks macro backdrop, with above-trend growth (despite higher-than-target inflation rates), mild disinflation and risks to the upside. It adds up to a relatively benign outlook for cross-asset returns.
- **AI:** The risks of an AI crash or super-bubble appear to be waning. More likely is a necessary but modest correction that reprices risk and resets the economics of providing AI services.
- **Geopolitics:** The risks between the major powers likely peaked in 2025, with the US and China entering a new era of détente. But relations between China and the EU could come under further strain.
- **Currencies:** The structural forces underpinning US dollar strength are turning – this is a year to sell dollar rallies, not chase them. Narrowing rate differentials and reduced geopolitical risk offer potential in select ex-US currencies, notably in emerging markets.

The content of this communication is intended for readers with existing knowledge of financial markets.
The views expressed are as at the date of publication and may no longer be current.
Opinions based on current market conditions; subject to change without notice and without any obligation to update.

— **Developed markets equities:** Global earnings remain solid, but valuations and concentration risk argue for rebalancing. Equity market performance should broaden to include more cyclical, value and rate-sensitive equities. We expect international markets to outperform US markets.

— **Emerging markets equities:** The global backdrop is supportive for EM equities, especially if we see a material US-dollar downtrend, while net-issuance headwinds have faded. To mitigate a key risk, we favour balancing exposure between AI and non-AI segments.

— **Developed markets bonds:** Developed bond markets currently offer reasonable value, and at these valuations are likely to play diversifying roles in portfolios once more. With central banks maintaining a pro-recovery stance, we expect modest steepening: yield declines for shorter-dated bonds but a 'sticky' long end of the curve.

— **Emerging markets bonds:** Disinflation, high real policy rates and still-light foreign positioning create a constructive backdrop for local bonds. Hard-currency debt continues to offer competitive carry.

— **Credit:** Public credit should stay resilient amid firmer growth, but more mainstream private credit markets will continue to be strained by leverage. A focus on quality issuance and specialist areas such as structured credit is appropriate. In private markets, less crowded markets such as EM, offer a favourable risk profile.

— **Commodities:** Gold's structural bull market persists. Copper should benefit from tight supply and robust demand, while mining and energy equities offer attractive valuations and diversification potential.

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Macro:
growth will dominate

Investors should position for a goldilocks macro backdrop, with above-trend growth (despite higher-than-target inflation rates), mild disinflation and risks to the upside. It adds up to a relatively benign outlook for cross-asset returns.

Are markets early, mid or late cycle? It is surprisingly difficult to answer. Labour markets appear soft and credit spreads are tight, a classic late-cycle dynamic of high expectations and weakening data. On the other hand, accelerating capital expenditure on equipment and intellectual property, along with falling inventory-to-sales ratios, imply early-cycle dynamics of economic stabilisation and renewed growth. It is possible to say markets are undergoing a series of rolling recessions, or the opposite: markets are undergoing a series of rolling recoveries.

How did we end up in this disaggregated, idiosyncratic cycle? For a series of interlocking reasons, 2022 did not trigger the typical reset expected from sharp, sustained interest-rate hikes in response to an inflation shock:

- Fiscal policy remained loose in many economies, strengthening already healthy private-sector balance sheets with long debt lock-ins. This underpinned an income-driven, as opposed to credit-driven, spending dynamic.
- Buoyant asset prices and highly unequal ‘K-shaped’ asset holdings (wealthier households holding the majority of assets have benefitted most from rising markets) have kept consumption elevated.
- The labour market responded to interest-rate hikes in unusual ways, adjusting from 2022-2024 through fewer vacancies rather than big layoffs, as employers hoarded workers after their experiences with pandemic staff shortages.
- Following the rate hikes, from H2 2023 onward advanced economies have undergone a second wave of tightening via term-premia increases in long rates. This extra-volatile tightening pathway does not map neatly onto textbook rate-hiking phases.
- The unpredictable nature of the US-China decoupling, including recent tariffs – in the context of an historic Chinese property tightening cycle – has increasingly rendered the notion of a single global cycle misleading.
- Rolling energy shocks have disrupted various supply chains, not least after the Russian invasion of Ukraine in 2022.
- The gargantuan ramp-up of AI spending has occurred despite global central banks holding monetary policy at restrictive levels.

For investors, establishing a realistic macro picture requires reorientation to a new environment. It also means temporarily moving away from the idea of a cycle altogether. A cycle implies recurrence, regularity and repetition. What we are going through is more idiosyncratic and chaotic.

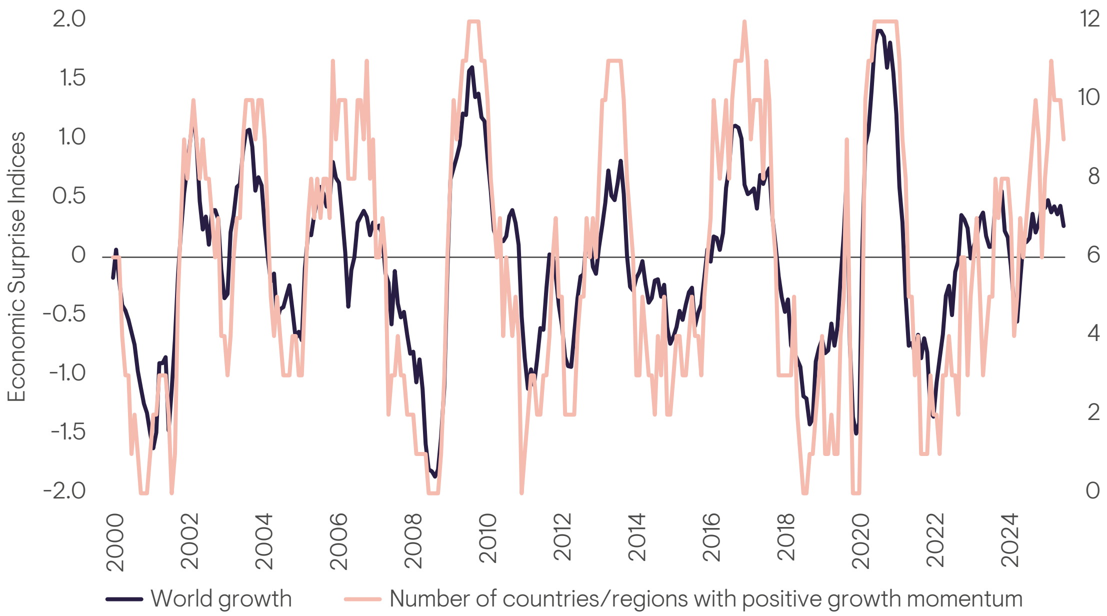
To an extent, of course, every cycle is idiosyncratic. The word 'cycle' is really just a shorthand for describing broad phases – expansions, peaks, contractions and troughs – as a complex system reconfigures via a series of shocks. But the past year has been more disorienting than usual for those looking for overarching patterns. So rather than thinking in cyclical phases, we think the key is to disaggregate the macro building blocks and realign them into a narrative that makes sense for the circumstances we find ourselves in.

The key call for 2026

The main call investors have to make for 2026 – the cornerstone building block – is whether growth or inflation will be the dominant market driver over the next 12-18 months. When growth dominates, equities correlate negatively with bonds. When inflation dominates, equities and bonds are often positively correlated.

In our view, growth will be more important than inflation in 2026, underpinning a relatively benign environment for cross-asset returns. For the past six months, global policy easing has been feeding through into monetary and credit data, supporting a recovery. At first, the improvement was more visible ex-US; more recently US data has also picked up, with growth momentum improving across the board. Meanwhile, inflation has been relatively well-behaved, helping sustain the easing backdrop.

Figure 1: Improving growth momentum



Source: Bloomberg, Citigroup, November 2025.

Inflation more likely to undershoot

For most of this year, inflation is more likely to surprise on the downside than the upside. Even if it remains above target in advanced economies, and will almost certainly rise somewhat in H1 on base effects, stimulative policy and continued tariff pass-through, we expect it to end the year somewhere around 2% in the US and eurozone.

In the US, the Personal Consumption Expenditures (PCE) price index has a reasonable shot at meeting consensus and reaching 2.5% year-on-year by Q4 2026. If the big, slow-moving component of shelter (a 15-18% weight in the PCE and 33-36% in the Consumer Price Index (CPI)) continues to disinflate and new leases to rise at only about 2%, shelter's contribution to CPI and PCE will mechanically fall further in 2026. While the US fiscal stance is set to ease sharply early in 2026, in part through one-off fiscal refunds early this year, it will be in tightening mode for the rest of the year. Meanwhile, the inflation impact of tariffs on prices is likely to materially fade by the end of the year as households absorb costs, and importers shift sourcing to blunt tariff impacts (e.g., China's share of US goods imports is already falling, and is now under 10%). There is potential upside risk were the administration to pursue a further fiscal boost via stimulus cheques.

In Europe, a larger fiscal impulse led by Germany is expected to build in 2026/2027, which risks slowing or stalling disinflation in the context of sticky inflation. Nevertheless, CPI is likely to end the year at or around 2%. China is an outlier in the sense that its GDP deflator has been negative for 10 straight quarters, underpinning a disinflationary global impulse. While Chinese real growth is holding up and 2026 forecasts are set to be revised upwards, PPI is still likely to be in deflation by year-end and CPI comfortably below 1%. Emerging markets inflation, particularly in Asia, is muted and likely to remain so in 2026.

Growth will run above trend

Growth is the next macro building block investors have to make a call on. In our view, global growth will run above trend in 2026, at >3% in real terms. Currently, economies are still benefitting from policy easing in 2025. The rough rule of thumb is that monetary policy leads growth and inflation by 12-24 months, with easing impacting growth sooner than inflation. The lags can be longer or shorter, depending on the economic cycle and region. For instance, the transmission mechanism has historically been shorter in the EU and the UK, primarily due to the structure of mortgage markets.

Fiscal support in the US will see the GDP impact of the One Big Beautiful Bill (OBBB) peaking in Q3 2026, just before the midterm elections. The relatively blunt IMF US fiscal impulse metric (a measure of the impact of discretionary changes in fiscal policy) for 2026 indicates a contraction of 0.3 percentage points due to tariffs. In contrast, a more granular fiscal impulse metric from Brookings shows that US fiscal policy is likely to be stimulative in 2026, especially in H1, as a result of the OBBB. There is even upside fiscal risk as a response to the affordability crisis – and the partly consequent poor performance of the Republicans in gubernatorial and state votes in November 2025 – for instance via the US$2,000 tariff-dividend cheques the Trump administration has discussed. To the extent that the Supreme Court reassess the legal basis of President Trump's tariffs (specifically, his use of the International Emergency Economic Powers Act), things could get messy, especially with the refund process. However, we believe the US administration would ultimately be able to recreate most of the tariff policies under different legal bases. While average tariff rates may move down a few percentage points, the big picture is that they will still be multiples of what they were at end-2024.

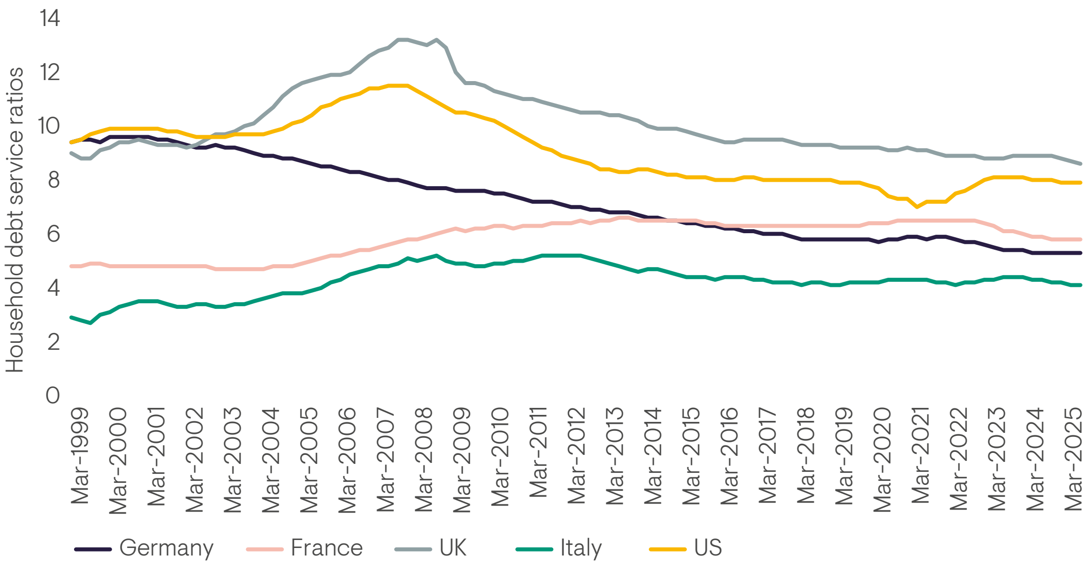
In the eurozone, fiscal policy will add 0.2 percentage points to GDP for 2026 and another 0.2 percentage points for 2027. Germany is the epicentre of the fiscal shift, with the amendment to the famous debt-break (Schuldenbremse) propelling defence and infrastructure spending to add 1 percentage point to GDP for 2026 and also for 2027. Japan's fiscal impulse will be 0.5 percentage points in 2026, on account of the planned stimulus to jumpstart the economy from new Prime Minister Sanae Takaichi's government. China's fiscal impulse is likely to be flat.

The global credit impulse has turned modestly positive, a classic lead indicator for firmer nominal growth activity. This is particularly true for the US, where credit growth is now accelerating. As rate cuts continue to exert an easing effect on the economy, the rate-sensitive (and currently weak) segments should begin to improve, while the strong segments may cool but seem unlikely to fall off a cliff, yielding a broader, more robust recovery.

Risks to the growth outlook

There are obviously risks to our growth outlook. While our base case is that labour markets remain tight while loosening at the margin, there is the possibility of a more disorderly outcome. We are in a low-hire/low-fire economy, and the US unemployment rate is rising (the eurozone unemployment rate continues to fall). Consumption over the last few years has been supported by tight labour markets, with strong balance sheets in the US and high savings in Europe. Indeed, continued household deleveraging has pushed household debt-service payments as a share of disposable income to the lowest level since the late 1990s in the US and elsewhere. All that is at risk if labour markets start to weaken.

Figure 2: Households are deleveraging



Source: Bloomberg, June 2025.

AI poses two-way risks

There is also a small but growing possibility of a negative growth impulse from a reassessment of AI investment. Unlike in the late 2000s when widespread leverage helped cause a debt-fuelled bubble in subprime housing, today's AI spending has been mostly equity-financed. In that sense, the AI boom is closer to 1999 than 2009. Nevertheless, the longer the boom goes on, the more it is likely to involve debt and opacity. Meanwhile, US consumers are more financialised than they were in the late 1990s, with more of them in the market and increasingly spending gains from asset-price appreciation. While US private balance sheets are healthy, the share of US household assets in equities is now 21%, vs. the 17% peak in 2000. Also, foreign investors are more invested in US stocks, where gains have been highly concentrated in the AI theme. IMF chief economist Gita Gopinath's back-of-an-envelope estimates suggest that a crash of the same magnitude as dotcom could wipe out US$35 trillion of global financial wealth. The longer the boom goes on, the lower the bar is for a bigger correction.

Of course, AI also poses upside risks to growth. The technology is being adopted rapidly and could substantially accelerate innovation and automation across sectors, as well as boosting labour productivity. While economists are sceptical that AI is having much impact on labour markets, businesses are telling a different story. AI labour productivity estimates for the next decade range from 0.2 – 1.3 percentage points annually, depending on the country. However, AI's impact on markets depends on whether it contributes to higher revenues or merely lower costs. If the latter, it would keep the economy weaker than expected; if the former, it could contribute to the goldilocks outcome of boosting growth and keeping inflation low as early as this year. Both scenarios would be visible in profit margins.

Policy evolution

The next building block: how is central-bank policy likely to evolve in 2026? At the most basic level, central banks have to judge whether they are more concerned about unemployment or inflation. For 2026, we think the US Federal Reserve (Fed) is still in a world where it is more concerned about disorderly labour markets than accelerating price rises.

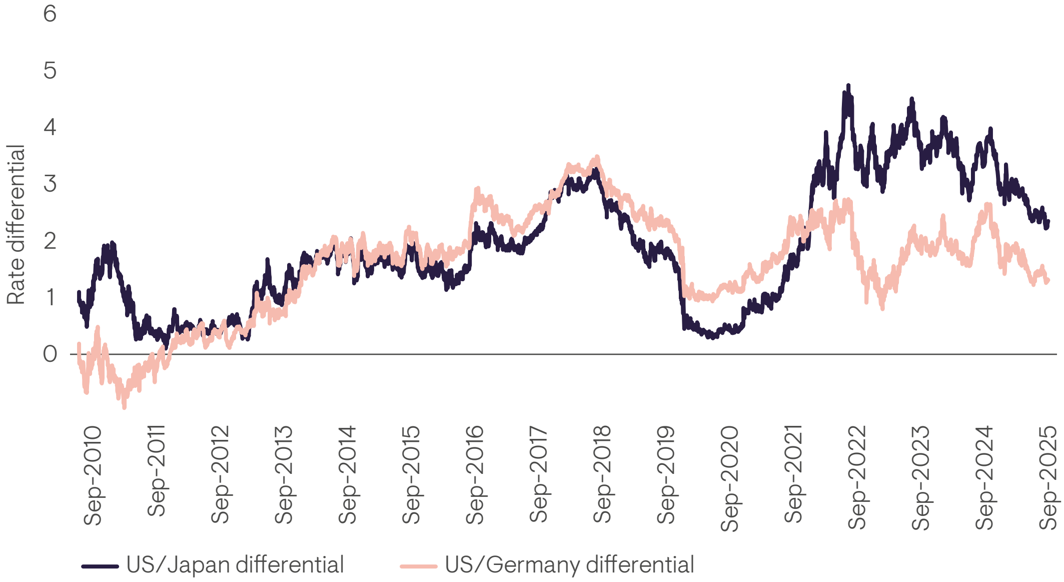
One reason for this is that central banks are now increasingly mindful of growing political risk, as seen in the politicisation of Fed appointments recently. Independent central banks know they have one job, which is to keep inflation under control, and will therefore use their powers to push back on political interference. Nevertheless, they are fully aware of the stakes for their institutions, and on balance that is likely to raise the bar for adopting a tightening/hawkish stance. We do not think the choice will come to a head in 2026 because inflation is likely to stay muted.

Currency currents

As is so often the case in macro analysis, the expression of the environment is most easily seen in the performance of foreign exchange, another key macro building block. We think the US dollar passed a significant inflection point in early 2025, entering a multi-year downcycle for reasons we have set out elsewhere. This year, we see an environment for selling US dollar rallies, rather than chasing them. It is true that, while inflation remains above target, the room for Fed easing is capped and any further bouts of US exceptionalism would keep the US dollar firmer. On the other hand, a stumble in the AI trade in the context of large fiscal and external deficits would send the dollar sharply lower. In any scenario, foreign portfolios are likely to hedge more of their US equity exposure after their experience in April 2025, when President Trump's new tariff policies rocked markets.

Figure 3: Rate differentials have narrowed

Difference in 2-year yields

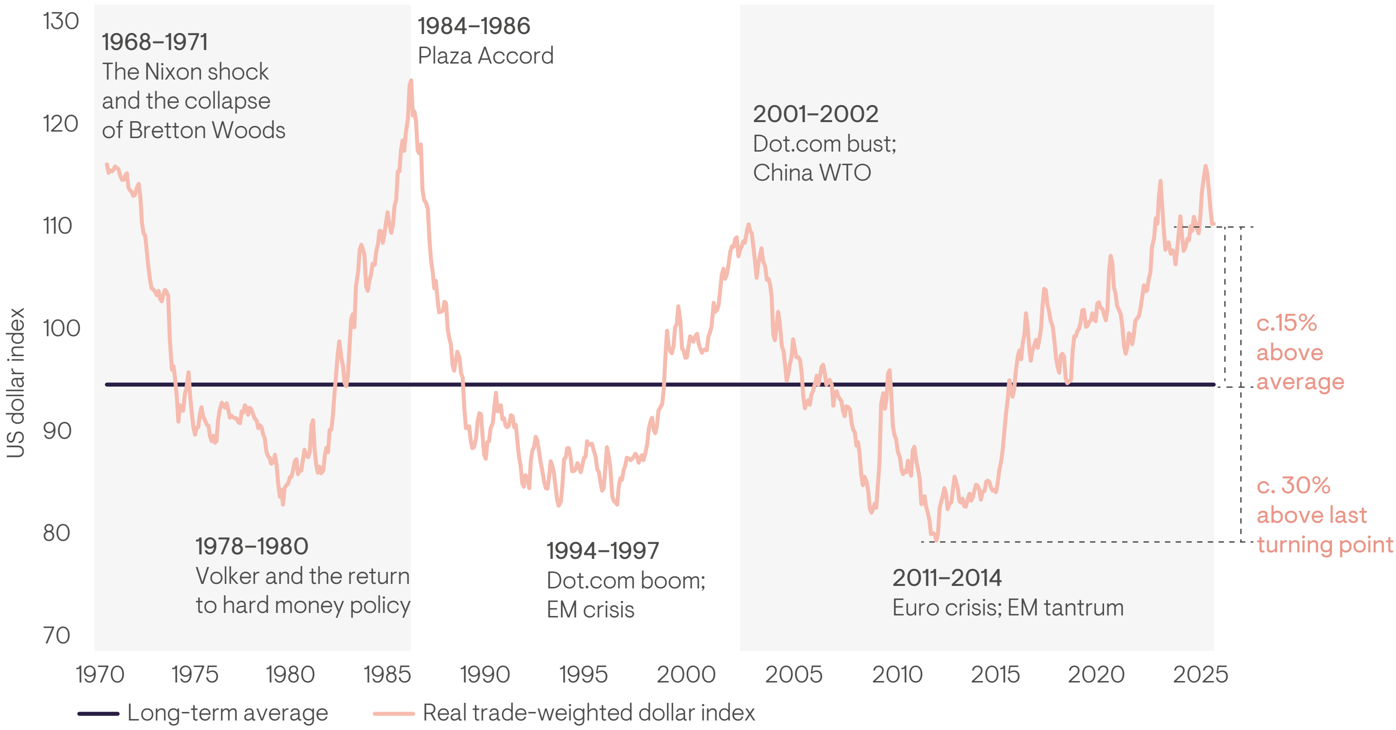


Source: Bloomberg, December 2025. Chart shows 2-year yield, 3m forward.

Non-US currencies, including those of emerging markets, are likely beneficiaries of much lower interest differentials between the euro and the US dollar, and the Japanese yen and the US dollar, which is likely to contain dollar appreciation. Indeed, despite US data rebounding in 2025, it is notable that rate differentials have continued to narrow. Dollar weakness could benefit emerging markets particularly, decisively reversing the situation of the 2010s when developing economies were stuck between the Scylla of a rising US dollar and the Charybdis of a weak yen and euro, which reduces liquidity and deflates the global economy.

Figure 4: The US dollar is above its long-term average

US dollar index



Source: Bloomberg, July 2025.

Summary: still goldilocks, but risks are two-way

In sum: given the health of private-sector balance sheets and an easing Fed, one might expect a classic reflation. However, due to the competing cross-currents in the economy, we might see something a bit more subdued but still quite healthy: firm real growth with inflation surprising lower for most of the year. There could be reflation-like flashes early in the year due to tariff pass-throughs, but the year-end destination is likely more moderate, with inflation ending close to target. Downsides to our view are a disorderly labour-market weakening and an AI-driven market correction (see 'AI outlook'). There is an upside case of AI-driven productivity gains, but it requires a specific evolution of AI productivity gains, one that favours higher revenues and not merely lower costs.

For a deep-dive on the outlook for developing economies, please see our **Emerging Markets Outlook**.

AI: waning risk

The risks of an AI crash or super-bubble appear to be waning. More likely is a necessary but modest correction that reprices risk and resets the economics of providing AI services.

For all the concern about an AI bubble towards the end of 2025, the more likely path remains a necessary but modest correction that reprices risk, resets unit economics and ultimately sets up the next leg of AI valuation, rather than a dramatic end of the boom.

Why are we placing a higher bar on the AI boom ending in 2026? For one thing, towards the end of 2025, the earnings trajectory of the market's AI leaders was actually becoming more certain, not less. Whereas NVIDIA typically released guidance only a quarter ahead, there is now a line of sight to about US$500 billion of AI-related revenue to H2 2026. NVIDIA was able to signal this because of demand visibility from hyperscaler purchasers, governments and large corporates. Of course, a key part of the bear case is that some of these purchases were being effectively funded by NVIDIA in circular transactions. Nevertheless, it is also true that some of the scepticism is in the price. NVIDIA's forward multiple is relatively constrained against history, suggestive of an unpopular rally, not a bubbly one, and a reminder that earnings have been as strong as the hype. Meanwhile, it is difficult to dispute the fact that consumer demand for AI products remains explosive: by October 2025, Google had processed a 135x increase in tokens vs. May 2024.

Healthy ecosystem

Talk of an AI bubble bursting has to be tempered against the visible reality of growing sales and usage, which augurs for a relatively healthy AI ecosystem in 2026. At the same time, in our view the risks of an AI 'super-bubble' are falling this year, as explosive price gains are constrained by a growing investor focus on AI unit economics, the looming shift from training to inference (more on which below), and the endgame of productivity gains.

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This is not a buy, sell or hold recommendation for any particular security.

What do we mean by unit economics? Essentially, whether there is a bubble in AI investment depends on whether in the future people will be willing to pay a price for tokens that is higher than the cost of producing them, including the capital investment. Currently, the equation does not balance. Because of the scale of the spending involved, we are probably past the point where investors can ignore AI's poor unit economics. There are many paths for these to improve. Nevertheless, relative to six months ago, investors are more likely to be in show-me mode rather than giving the benefit of the doubt.

The core problem is that usage growth has outrun cost declines. AI leaders correctly bet that cost-per-token (a pricing metric used by large language models to quantify the expense of AI workloads) would fall, but underestimated how many tokens would be needed to deliver outcomes. In some sense, they were not bullish enough on usage. Tokens per outcome have remained high because of faster enterprise adoption, but also because models run multiple internal passes to combat hallucination and provide the increasingly power-compute-heavy video and reasoning. It is not unusual to have negative unit economics for new technologies. For instance, Amazon and Uber had it in their early years. Nevertheless, the scale of AI spending and losses is more significant.

At some point the subsidy era, akin to Uber's £3 London cab days, will have to fade as investors demand more self-funded growth. That could come through higher pricing, as with Uber, or more likely with costs grinding lower, as with Amazon. Without higher prices, efficiency on power costs, datacentre architecture or algorithmic efficiency, unit costs will continue to be weak, constraining price gains of AI-linked stocks. The good news is that some of the key players are anticipating major efficiencies. For instance, while TSMC's capital-expenditure guidance is expected to increase in 2026, it has lagged, indicating the company expects more of the incremental AI-related compute-demand to be met through efficiency gains rather than a wholesale step-change in fab spending[1].

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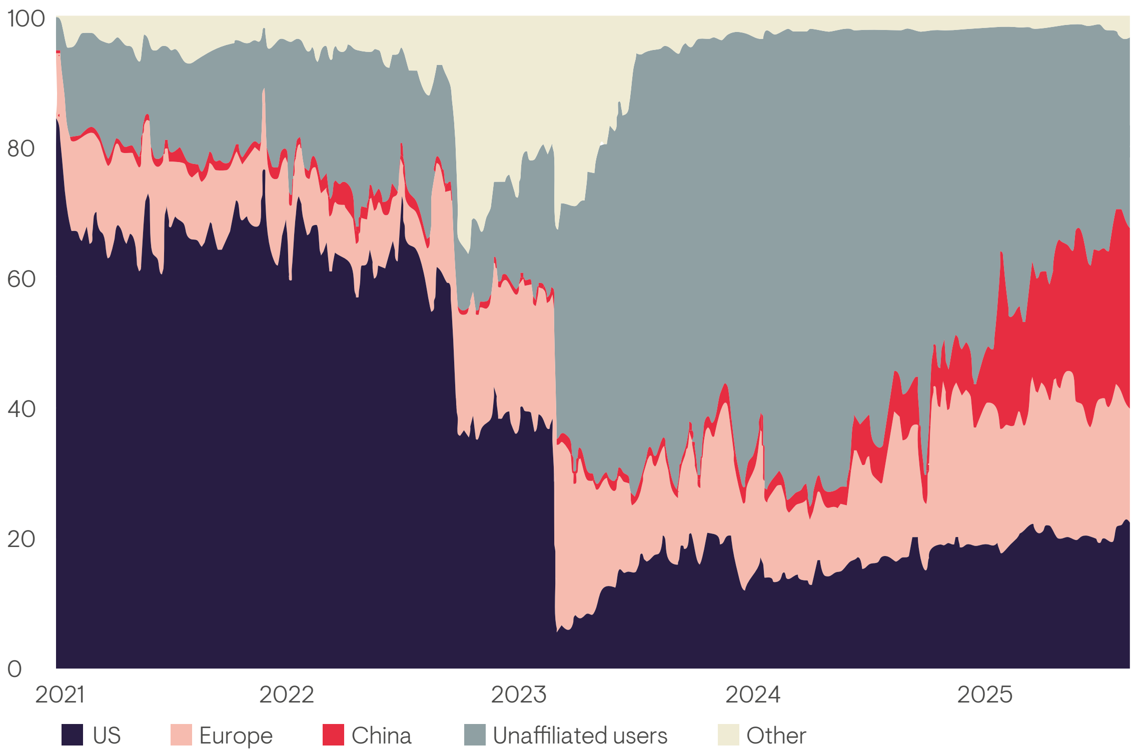
1. Unit profitability in AI is driven by the following formula. US$/token ≈ (US$/watt) x (watts/FLOP) x (FLOPs/token), where US$/token is a unit of computation, US$/watt is the cost of power capex, watts/FLOP is the energy required per unit of computation (architecture costs; effectively hardware + cooling costs), and (FLOPs/token) which is algorithmic efficiency..

Training to inference

Second, and related, as spending migrates from training to inference (i.e., using the model), costs per outcome are likely to fall across the AI value chain. Despite the continued improvement and focus on training in AI capital-expenditure, Chinese open-source models are making the case that major efficiency gains are possible through inference-based models. Good-enough open-source models – many now competitive and cheap – will pressure pricing and transform the AI value chain, creating winners and losers. For instance, to take advantage of shifting leadership from proliferating models, many enterprises are likely to prefer multi-model architectures, potentially disintermediating the model providers. Meanwhile, to keep costs down, the providers of workload solutions are increasingly vertically integrating so as to provide chips, systems and services all together. Separately, the shift to inference also puts pressure on NVIDIA, since its chips have a large relative advantage for training, not necessarily for inference. AI spending remains training-centric for now, but we think investors will try to anticipate the looming shift, constraining valuations.

Figure 5: China is gaining share of downloaded AI models

Weekly national download share (%)



Source: Hugging Face/Financial Times, November 2025. Chart shows share of downloads by region (unaffiliated users' location cannot be reliably identified). The step-change in regional shares in early 2023 marked the explosion in global interest in AI models following the release of ChatGPT in late 2022. Since early 2025, China's share of downloads has risen sharply.

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Finally, despite exploding use of AI, the technology's ultimate productivity gains remain unresolved. The datacentre capital-expenditure arithmetic is brutal. With realistic cost-of-capital assumptions, depreciation timelines and free-cashflow margins, the anticipated spending to 2028 will require cutting something like 5% of the entire global wage bill. Until investors see major labour efficiencies in more than a few AI use cases, likely starting with the software industry itself, it is difficult to imagine an AI super-bubble continuing to inflate.

What to watch

What should investors watch in 2026? First, unit pricing and economics. If unit prices hold up, improving the economics of AI would cause unit costs to fall. This could happen for several reasons: efficiency gains driving power costs lower, improvements in data centre capacity and architecture, or more efficient software/models[2]. In our view, we could see a productivity shock in the last two categories: software/models, or hardware/architecture. This would dramatically reduce costs, as well as required future capital expenditure. If unit economics get on a path to turning positive, the AI demand explosion suddenly becomes a benefit rather than a cost to most parts of the value chain.

Consequently, we are not especially concerned about bubble risk in the hyperscalers at this time because of where they sit in the value chain (and also because they seem to be offloading much of the credit risk onto alternative credit providers and specialist cloud providers). The hyperscalers are closest to consumer token demand. Were there to be a productivity shock in software/models and/or hardware/architecture, it is the parts of the market that are furthest away from the customer demand – on the infrastructure side – that would potentially be hit.

The next things to watch are funding rounds, governance structures and revenue guidance from the large AI players, including NVIDIA and OpenAI. Any slip-ups here would be bearish for the sector.

Finally, look out for consumer or enterprise applications that make the case for increased end-user productivity from AI. For token-use to keep rising, AI has to improve end-firm or end-user productivity. Every player in the ecosystem is incentivised to keep trying to boost productivity over time, and we think they will not give up trying to do so in 2026. So overall, we do not think investors should be too bearish on the AI theme this year at least.

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This is not a buy, sell or hold recommendation for any particular security.

2. Syncretica. 'AI Bubble or Not'. November 2025.

Geopolitics: US-China risks have peaked

Despite events in Venezuela and Iran, geopolitical risks between the major powers likely peaked in 2025, with the US and China entering a new era of détente. But relations between China and the EU could come under further strain.

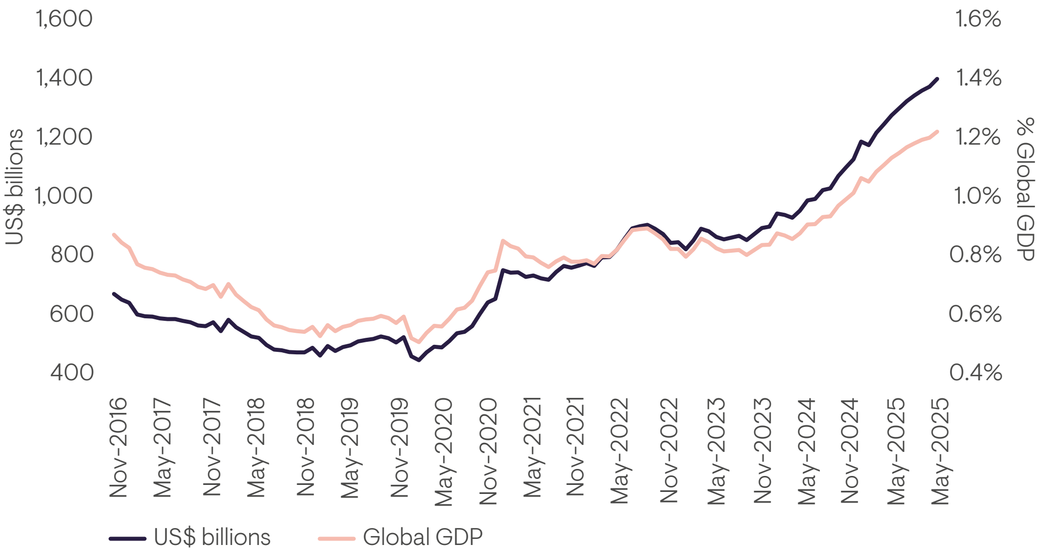
We believe that 2026 could be a year of détente, a term last coined in the 1960s when the US and Russia came to an accommodation after the Cuban missile crisis. The geopolitical tail risks for the year have consequently reduced materially.

The significance of developments in the US-China relationship last year is underappreciated. There was effectively a temporary truce between the two superpowers: a chips-for-rare-earths equilibrium. Effectively, President Trump revealed himself to be a realist, recognising China's strong negotiating position. The underlying cause of this shift has been China's transformation, in the space of just a decade, to become much more self-sufficient technologically, establishing leadership in a raft of key industries of the future – including electric vehicles, renewable energy and robotics. China's dominance of rare-earths (it controls >85% of processing and 70% of extraction) proved to be particularly decisive as a negotiating tool. Consequently, the US has been forced to delay any plan for rapid economic decoupling, while continuing to sign rare-earths and minerals deals with Saudi Arabia, Australia and small countries to boost supply.

President Trump's overriding priority for this year is securing a favourable midterm-election outcome (particularly in the House), while President Xi's priority continues to be stabilising the Chinese economy, including from external headwinds. We think there is therefore effectively a geopolitical 'put' on global growth. Several high-profile US-China engagements are scheduled in 2026, for which each side would prefer to have a strong negotiating hand. Moreover, the very fact that both sides are meeting should allow bilateral ties to stabilise in H1 as the market looks ahead to the prospect of a trade framework being hammered out. While partial decoupling over technology is baked in, on other fronts Beijing and Washington remain intertwined. Along with South Korea and Taiwan, China continues to be integral to global trade.

Figure 6: North Asian economies continue to grow trade surpluses

Trade surplus in US$ and GDP %



Source: Bloomberg, December 2025. North Asia = China, Taiwan, South Korea.

Strains in the EU-China relationship

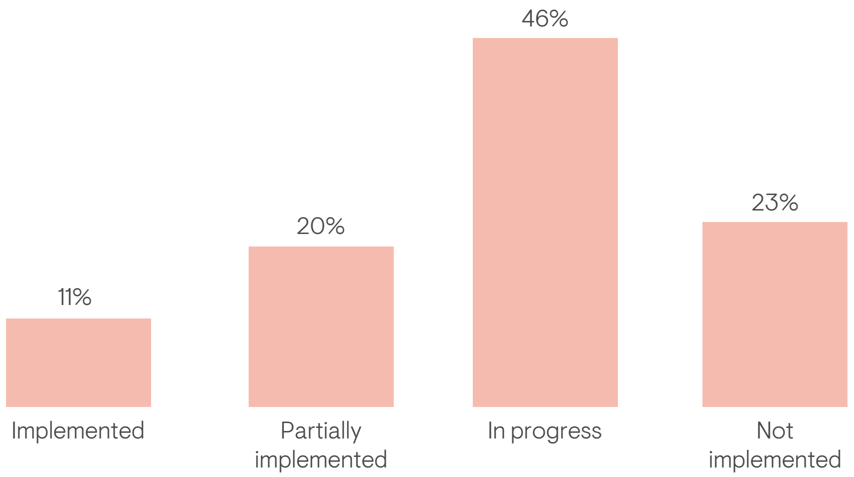
The big shift in geopolitics this year is likely to be between China and Europe. European scepticism towards China was already growing and is likely to increase. This is not just because of Russia's invasion of Ukraine, but also because of the growing realisation that China's economic development model, which represses consumption and subsidises investment, is bad for workers and jobs in Europe, Japan, South Korea, the US and nearly everywhere else. This will inevitably become a political question for many European governments, who are confronting political polarisation in their own electorates. The first so-called 'China shock' hit the US hard. With US tariffs now forcing a diversion of Chinese goods elsewhere, the epicentre of a second China shock is likely to be Europe.

How will China respond? Early in 2025, Beijing had high hopes of driving a wedge between the US and Europe as President Trump's relationship with the US' allies deteriorated. However, the Europeans did not welcome Beijing's overtures. More recently, Beijing has used a similar playbook on Europe as it did on the US: maximum pressure on trade and high-octane political rhetoric. Underlying China's approach is the view of the Chinese strategic community that European elites are unable to face the new geopolitical reality. Beijing is likely to challenge Europe for some time to come, while Europe is likely to continue to protect its market in whatever ways it can.

Tensions could come to a head over the EU's implementation of the carbon border-adjustment mechanism (CBAM), which begins this year. The CBAM would force major exporters to either adopt their own carbon price or pay the EU's at the border, thereby expanding the coalition of countries with credible carbon pricing. In a world where fossil-fuel demand is set to remain structurally high, and where electrification and renewables will only absorb new energy demand rather than replace existing fossil-fuel use, such mechanisms have become a focal point for tensions between emerging and developed markets. We expect political pushback and pressure to dilute or delay the CBAM, but we think it will go ahead.

Elsewhere, Europe is in the middle of a delivery phase in 2026: phasing out Russian gas by early 2028, scaling grid digitalisation/interconnectors, tightening critical raw-materials policies on processing and stockpiles, and pushing joint defence procurement (the target is for 40% of procurement to be joint contracts by 2030). At the same time, the famous Draghi Plan to revitalise the competitiveness of the European economy remains much praised, but much unimplemented. Of Draghi's 383 recommendations, including integrating capital markets, strengthening supply chains and aligning business regulations, an audit by the European Policy Innovation Council found only 11% had been adopted[3].

Figure 7: Draghi recommendations: only 11% have been implemented



Source: European Policy Innovation Council (EPIC), Apollo Chief Economist, September 2025.

3. Financial Times. 'Europe drags its heels on Draghi plan as global rivals surge'. September 2025.

Developed markets bonds: potential remission

Developed bond markets currently offer reasonable value, and at these valuations are likely to play diversifying roles in portfolios once more.

Sentiment was consistently poor in bond markets in 2025, partly reflecting persistent inflation concerns and the emergence of the 'debasement' theme – i.e., the belief that fiat currency nations were finally experiencing their comeuppance, with fiscal dominance as an art practised by governments beset with too much debt and not enough growth leading to an unofficial relaxation of inflation targets and sticky inflation. In many senses, these concerns reflected a need for new reasons to be short government bonds, even though the cost of capital had already been substantially repriced in global bond markets. While Japanese bond yields moved up sharply and the long ends of many markets came under pressure, the US Treasury market failed to confirm the narrative. Volatility progressively declined and 30-year bond yields fell from 5.1% in May to 4.6% at the time of writing.[4]

Looking ahead, this is likely to be a year of remission from the gloom. Developed bond markets offer reasonable value, especially if a better growth environment boosts government revenues and inflation remains subdued or even continues to fall. In the event of a growth shock, at current valuations developed market bonds are likely to play the diversifying roles in portfolios many investors have given up on. With the US Treasury market having done well, other markets that have lagged may still have scope to catch up, such as those of the UK. That said, we believe it is not yet time to switch from a tactical to a strategic investment approach, given that in our view we are in a longer-run regime of higher inflation rates and a higher cost of capital for both state and private-sector borrowers.

The scope for further steepening is limited: curves are already upward-sloping and policy rates are closer to neutral. We still expect a modest steepening, supported by a firmer growth backdrop and central banks maintaining a pro-recovery stance, but the asymmetry has diminished. The risk now tilts more towards a flattening, either because central banks remove their easing bias, capping downside in short-dated yields, or because growth disappoints, which would support demand for long-dated bonds at still-attractive valuations. Economies that saw the largest fiscal risk premia priced into curves in 2025, most notably the UK, now offer the greatest likelihood of a flattening move.

4. December 2025.

Developed markets equities: less exceptional

Global earnings remain solid, but valuations and concentration risk argue for rebalancing.

2025 proved to be a good year for equity returns, despite the 'Liberation Day' sell-off. Growth was sustained, and earnings and margins surprised more cautious expectations by being on the high side. Stock markets ex-US finally entered cyclical bull markets, by which time the US was well into its third year of one, and returns were boosted by a weaker US dollar. The AI theme went global, with the prices of hitherto 'uninvestable' Chinese digital-platform stocks such as Alibaba doubling and Korean and Taiwanese equities also performing strongly.

In many senses, the US cyclical equity bull market has fitted the historical pattern in terms of behaviour and performance. As it entered its third year in October 2025, the S&P 500 Index was up c.90% from the start of the run, with performance in 2025 largely driven by earnings. However, the valuation starting point was not as cheap vs. prior bull-markets, and the dominance of the top 10 stocks by market capitalisation has been unusual.

Potential for broadening markets

Looking ahead, the earnings picture is likely to remain supportive. However, valuations are already elevated and the AI theme is increasingly being questioned. While we see the cyclical economic picture in the US and globally as generally being supportive for corporate earnings, a derating of the AI theme would weigh heavily on the equity market, given the degree of concentration. In the US, it could be the turn of more cyclical stocks, and healthcare and interest-rate sensitive stocks, as investors seek to rebalance their portfolios and improve their resilience. Such a scenario would disappoint those seeking the drama of a collapsing bubble. But the fact that there is so much talk about AI derating is itself an unlikely precursor of an implosion. The AI boom has also papered over the cracks of interest-rate sensitive sectors suffering recessionary conditions as they struggled to adapt to the sharply higher cost of capital.

Rebalancing should benefit international stocks, many of which have more attractive relative-valuations and improving fundamental metrics. Market breadth ex-US is also healthier than in the US, and macroeconomic recoveries are occurring from deeper economic troughs.

While Europe has severe structural challenges – particularly levels of government indebtedness ex-Germany, excessive regulation and China moving rapidly up the value chain into former areas of European (especially German) dominance in manufacturing – the cyclical macro picture looks well set, with scope for upward surprises. Inflation and interest rates have fallen, German fiscal policy has pivoted, and employment levels and pent-up demand are still high, auguring well for European equities.

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This is not a buy, sell or hold recommendation for any particular security.

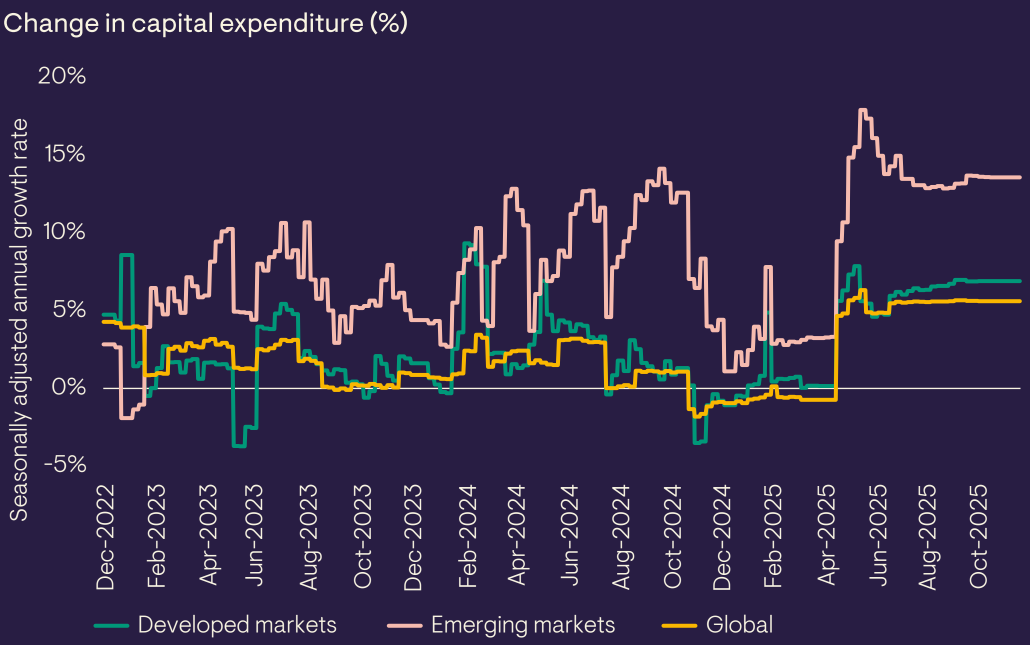
Emerging markets equities: positive breaks in the trend

The global backdrop is supportive for EM equities, especially if we see a material US-dollar downtrend, while net-issuance headwinds have faded.

2025 was an unusual year, featuring three simultaneous breaks in trends for EM equities. First, EM equities outperformed global equities for the first time since 2020, notching the largest calendar-year outperformance since 2009. Second, the US dollar dropped steeply, and finally Chinese equities recovered sharply.

The question for investors is whether 2025 was the start of a multi-year trend-break for EM equities, or merely an odd year. The proximate cause of EM outperformance was the benign macro environment, despite a negative growth impulse from President Trump's tariff policies. Instead, emerging markets benefitted from a weaker US dollar, accompanied by loosening global financial conditions supported by benign fiscal policy and significant earnings growth. Taiwan and, unusually, South Korea were stand-outs, propelled by an AI hardware upcycle in the context of low relative valuations and, in the latter's case, the prospect of corporate-governance reforms. China's policy stimulus and its substantial AI leadership underpinned gains in Chinese equities. While Indian equities were constrained by high starting valuations, they still ended 2025 in the positive single digits. Nearly every EM equity index ended the year in positive territory.

Figure 8: EM capital expenditure outpacing the rest of the world



Source: JP Morgan, November 2025.

A benign backdrop

How will EM equities do in 2026? Geoeconomics is no longer centre-stage, given that the negative tariff impulse from the White House is behind us, while the US-China détente has reduced tail-risks relative to the start of last year. A more conventional analysis of the macroeconomic environment is therefore a better starting point for thinking about EM equity performance in 2026. Typically, EM equities do best when the global macroeconomic and liquidity environment is benign; EM growth is outperforming developed markets growth; EM local rates are high; EM currencies are cheap; and volatility is expected to be low; at a time when sentiment and flows are improving; and developed markets growth is neither deteriorating or accelerating.

For the most part, a benign macroeconomic regime looks like the picture now. Advanced economies are likely to be in a regime of stabilising, if slowly rising, inflation. Growth is strong-ish, and policy rates in the US are restrictive but heading lower. Meanwhile, the emerging/developed market growth premium is likely to be stable at around 2.2-2.5%, justifying the perceived higher risk for developed markets investors allocating to EM equities. While this is not as high as the 4% of the early 2000s, it is high enough, and forecasts have been rising recently[5]. In such reflationary environments, the MSCI Emerging Markets Index has tended to generate positive single-digit returns.

Net issuance headwinds fading

The bear case for EM equities hinges on whether or not earnings growth will follow. As we have pointed out before, that depends on whether net issuance will contribute to returns. Despite solid revenue growth, EM equities were held back in the 2010s by heavy net issuance, which erased nearly six percentage points a year from returns as costly IPO waves – especially in China – and index-inclusion events diluted performance. These headwinds have now receded: China's net issuance has declined, and buybacks are rising. Also, IPO valuations are more reasonable, and index-inclusion pressures have generally normalised. With dilution no longer overwhelming fundamentals, EM returns can better reflect underlying revenue growth, especially given China's large index weight, improving governance and more shareholder-friendly capital management.

5. EMDM Forecast Revision Index - JP Morgan.

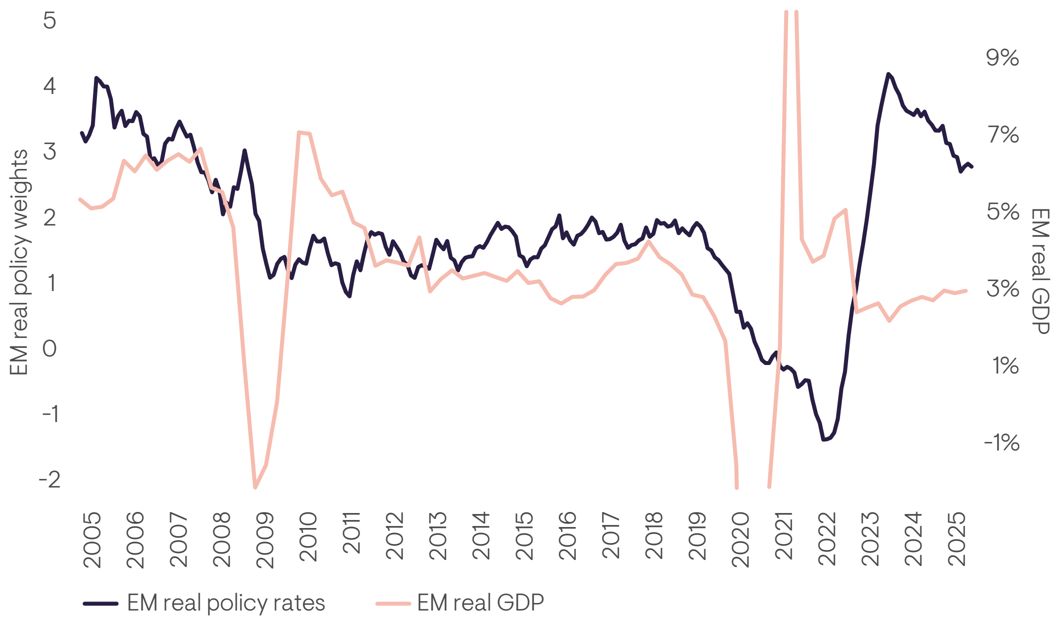
Upside risks

There is also potential upside risk to earnings if EM growth rates outperform expectations. This is because record-low EM inflation, particularly in Asia, affords flexibility for governments to manage any growth weakness. Strikingly high real rates, particularly in Latin America, provide a further cushion for investors. Real rates are high in emerging markets because investors have not quite anchored themselves to the new environment of structurally lower EM inflation, while there has also been a recent acceleration of inflation in a few countries like Mexico. As these issues settle, there is room for real rates to come down, which could happen in 2026. Should they decline by several hundred basis points, which is possible given the historical relationship between real policy rates and real GDP (see Figure 9), the outperformance of EM cyclicals could be steep. Many EMs are also going through sustained capital-expenditure booms as they build out infrastructure for energy, transport, technology and defence, further supporting growth.

Record-low EM inflation and the greater policy flexibility described above should also support operating leverage. MSCI Emerging Markets Index margins are expected to rise to 8.8%, with EM ex-China rising towards 10.2%, with low inflation helping top-line growth translate into wider margins and stronger earnings-per-share in 2026.

Figure 9: Real rates may be 'too high' in large parts of EM

EM real policy rates and GDP



Source: Haver, UBS, November 2025. Policy rates are deflated by sequential core inflation to get real policy rates. Both rates and GDP are weighted by country weights in the JP Morgan GBI-EM index.

Most of the returns for EM equities in 2025 came from increasing valuations as equity investors anticipated better earnings in the future. In absolute terms, the EM 12-month forward price-earnings ratio of 14x sits in the 90th percentile of its post-2011 history, which argues against a broad rerating. But against developed markets, emerging markets still trade at a deep discount (a 32% price-earnings discount vs. the MSCI World Index), a cushion that would support relative performance if earnings came through.

The current consensus is for earnings in emerging markets to reaccelerate in 2026 as margins rebuild. Earnings growth is expected to be just under 15% for 2026, with leadership expected from technology stocks (21% forecast earnings-per-share growth), and materials (19%), with healthcare and real estate close behind.

Diversify AI exposure

How should investors handle the risk to emerging markets from a potential reappraisal of the AI capital-expenditure trajectory? That matters because IT is the largest sector in the MSCI Emerging Markets Index and it is expected to drive outperformance. First, as a mitigating factor, AI beneficiaries in emerging markets – companies like TSMC, SK Hynix and Samsung – are generally more lowly priced than their Western counterparts, have falling not rising inventories and, for now, their capital expenditure is more disciplined. There are also entire segments of emerging markets, for instance companies from India and the ASEAN bloc, where earnings growth is not particularly driven by AI spending. Investors can take advantage of that dispersion and maintain a balanced exposure between AI and non-AI segments within emerging markets.

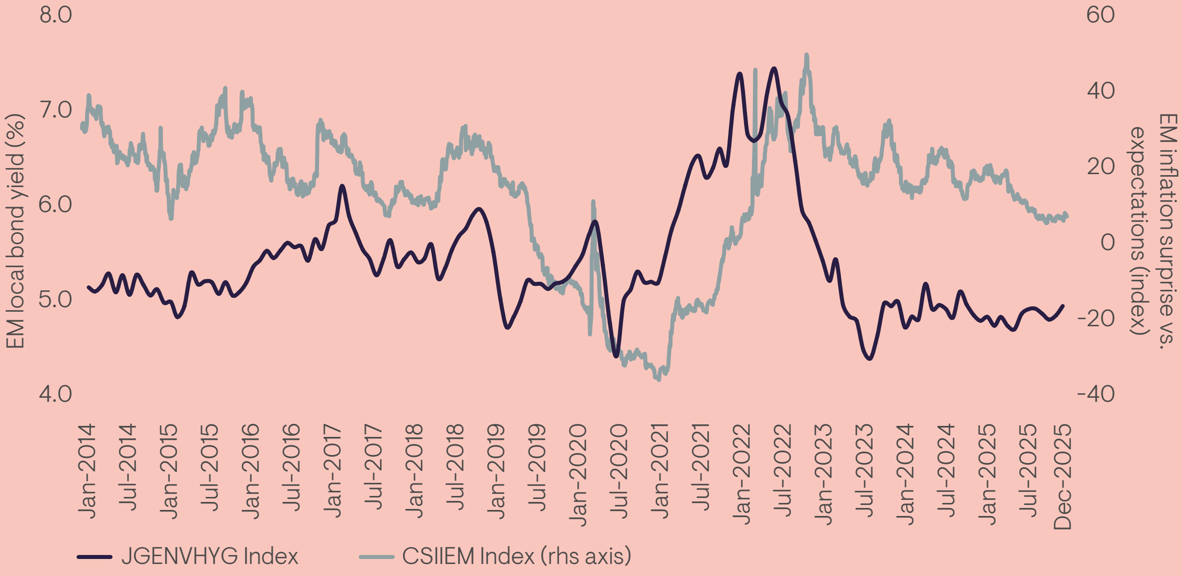
This is not a buy, sell or hold recommendation for any particular security.

EM fixed income: think local

Disinflation, high real policy rates and still-light foreign positioning create a constructive backdrop for local bonds.

The opportunity in EM fixed income is likely to favour local rates vs. hard-currency bonds on balance, given persistent disinflation in emerging markets while the Fed is cutting rates only gradually. The case for EM local bonds rests on relatively benign inflation and still-restrictive policy. Real policy rates (that is, monetary policy rates adjusted for inflation) remain near 20-year highs, giving central banks room to ease through 2026. While inflation remains above target in some Latin American and Central and Eastern European economies, it is also true these economies can 'work' at relatively higher policy rates. Foreign positioning in local debt has also not recovered to pre-2020 levels – powerful supports if sentiment improves. That combination – lowish inflation, high real yields and light foreign positioning – sets up a constructive duration story even if EM currencies only grind sideways.

Figure 10: EM assets will continue to benefit from falling inflation



Source: Ninety One, December 2025. Note: Inflation surprise reflects the difference between actual inflation outcomes and consensus expectations; negative values indicate inflation undershoots.

Strategically, we favour markets with credible monetary policy and high ex-ante real policy rates. These include Brazil, Mexico, South Africa and Peru. We are more cautious on parts of Central and Eastern Europe, where fiscal stances are looser and where EU fiscal spending can keep growth and term premia elevated.

In hard currency sovereigns and corporates, spreads tightened meaningfully in 2024-2025 and credit has 'priced out' a significant portion of US recession risk. However, EM sovereign yields remain competitive vs. other US dollar-denominated spread assets.

Our 2025 outlook made this point explicitly – EM hard currency debt could still deliver decent returns even with limited additional spread tightening because outright yields remain attractive and the post-COVID default cycle is largely behind us – and that logic still applies in 2026. Active risk is essential. Relative value remains better in many EM sovereigns than in parts of US high yield, and spreads in the EM bond index are not egregiously rich in the context of the macro drivers, keeping carry central to the total-return thesis. Position sizing should respect the fact that risk-appetite indicators are already elevated, which typically tempers forward excess-return expectations.

What could be a spoiler? A rampant US economy and a hawkish Fed is one straightforward answer. An opposite scenario of a much weaker economy and a much higher US fiscal deficit could prompt weakness in global trade and rising term premia, which would steepen yield curves and constrain risk appetite. 2025's April 'Liberation Day' shock would also be a spoiler: a policy driven tariff escalation and broader trade restrictions would tighten US financial conditions at the margin, complicate EM export cycles and mechanically support the USD: a headwind for EM currencies. Even though we think the risk of a tariff-driven escalation is falling, the risk from tariffs keeps us more disciplined on the foreign-exchange and biased to local duration where domestic disinflation dominates.

Credit: a tale of two markets

Public credit should stay resilient amid firmer growth, but more mainstream private credit markets will continue to be strained by leverage. A focus on quality issuance and specialist areas such as structured credit is appropriate. In private markets, less crowded markets such as EM, offer a favourable risk profile.

The bankruptcies of First Brands and Tricolor in September 2025 renewed concerns about developed market credit risk. But this was really a tale of two markets, public and private (the latter being home to First Brands and Tricolor). Public-market fundamentals should remain relatively healthy, with constrained supply and plenty of demand despite narrow credit spreads; whereas the private credit market continues to struggle in a higher cost-of-capital regime with the overhang of high leverage taken on during the era of abnormally low interest rates. Bifurcation within credit markets has been a defining theme over the past few years, both within and between public and private segments, as more leveraged borrowers have migrated into private credit markets, leaving public markets comparatively derisked. Improving cyclical growth should lend support to the public high-yield credit market. However, interest rates are unlikely to fall to levels that will provide sufficient relief to private credit markets to offset rising defaults.

Dispersion between high-yield and loan markets is likely to increase further. A focus on better-quality credits seems appropriate, in addition to some of the more specialist subsets of the market, including structured credit and select areas of hybrid capital markets.

In investment-grade bonds, although we expect fundamentals to remain healthy, we expect the technical backdrop – which has been very supportive for credit spreads – to moderate next year. That is to say, issuance is likely to rise meaningfully, driven primarily by tech-related funding for the AI capital-expenditure boom and a potential pick-up in M&A activity.

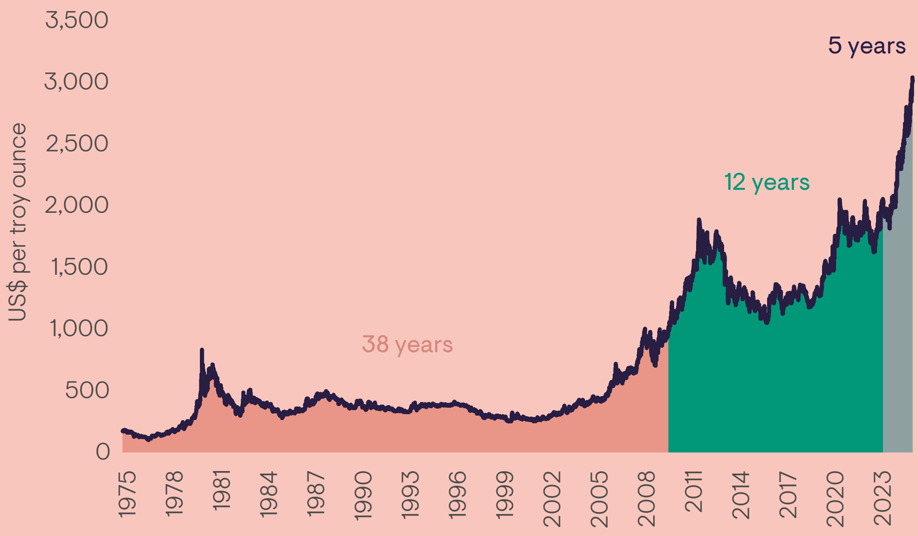
Commodities:
gold still shines; copper is tight

Mining and energy equities offer attractive valuations and diversification potential. Bull markets persist for some commodities, but oil is oversupplied.

Gold proved to be one of the stars of 2025. Its remarkable performance had been gestating since President Trump's first administration – which intensified geopolitical frictions and increased macro uncertainty – underpinned by increased gold buying by China. Gold's appeal broadened after Russia's foreign-exchange reserves held in the EU were frozen following the invasion of Ukraine, which caused more central banks to diversify away from both the euro and the US dollar. This arguably cemented gold's return in the popular perception as the ultimate safe haven.

Figure 11: Progression of gold price

Gold per Troy ounce



Source: Bloomberg Finance LP, as at December 2025.

So, once again, gold is seen as a stable asset during times of economic uncertainty, inflation and geopolitical turmoil. Gold has typically had little representation in portfolios. But this has clearly begun to change, with demand for both gold exchange-traded funds and gold-mining equities surging.

It took about 38 years for gold to surpass the US$1,000 mark, which it did in March 2008 during the Global Financial Crisis. The US$2,000 milestone was reached in August 2020, amid the COVID pandemic – a 12-year journey from US$1,000. In October 2025, gold broke through the US$4,000 barrier, doubling again in just five years. Each doubling phase took about two-thirds less time than the previous one, lending support to bulls.

Although we believe that gold will remain in a structural bull market, some of the shorter-term forces driving it are likely to moderate, with US-China tensions reducing and the 'debasement trade' ebbing. That said, gold mining stocks remain cheap relative to the gold price and should be supported by earnings, given their very substantially higher margins.

Tighter copper

Base metals were solid in 2025, led by copper with a 20% price rise and with iron ore delivering a more modest 10% gain. The copper price has been driven by solid demand and a raft of supply disruptions (in Chile, Congo and Indonesia). The 2026 outlook for copper is bright, with the market moving into deficit as supply outages bite and demand is likely bolstered by datacentre build-out and grid modernisation in the US. A stronger copper price could support aluminium in 2026 (as a copper substitute), but ramping Indonesian aluminium supply in 2027 clouds the outlook. Iron ore looks range-bound, constrained by higher supply with the ramp-up of the massive Simandou mine in Guinea this year. While the outlook for base metal commodities is mixed, the outlook for mining equities is brighter. Valuations are attractive, balance sheets are strong, dividend yields are high and a continuing wave of consolidation should unlock synergies.

Energy stocks have struggled against a background of an oversupplied oil market, and the oversupply looks set to continue in H1 2026. However, as OPEC spare capacity is exhausted and US shale runs into tougher geology, the foundation is being set for a stronger oil price in 2027 and beyond, especially as 'peak oil' demand gets pushed out further. In the meantime, some energy stocks offer defensive characteristics (a 10% distribution yield and strong balance sheets) so investors are being paid to wait for the eventual recovery in oil price.

From a broader portfolio perspective, we would flag that industrial mining stocks and energy stocks represent claims on real assets at attractive valuations, and offer useful diversification properties relative to the popular AI stocks, as well as a potential hedge against a higher inflation regime in the future.

> To explore more of our Investment Views 2026, including our Emerging Markets Outlook and forward-looking assessments from our portfolio managers, please visit www.ninetyone.com.

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