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THE SHIFTING INVESTMENT LANDSCAPE



THE INVESTMENT OUTLOOK FOR 2026



BNP PARIBAS
ASSET MANAGEMENT



**Investment
Managers**

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BNP PARIBAS
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The sustainable investor for a changing world

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**SANDRO PIERRI**

Chief Executive Officer, BNP Paribas Asset Management, AXA IM

Letter to investors

The coming year marks the beginning of a new chapter for BNP Paribas Asset Management.

By combining the expertise of BNP Paribas Asset Management with AXA Investment Managers and BNP Paribas Real Estate Investment Management, we will have created one of Europe's leading asset managers. It will be an organisation with breadth, expertise, and the ambition to serve our clients across every asset class and at every stage of their investment journey.

With total assets-under-management (AuM) of €1.6trn as at 30 September 2025, we are a European leader in long-term savings with €850bn of AuM – as well as Europe's number one alternatives asset manager, with AuM of €300bn.

Together, this gives us a vital and powerful differentiating factor, offering significant growth potential, underpinned by our highly skilled and renowned teams.

This merger brings together complementary strengths: deep investment capabilities, a strong track record across liquid and alternative strategies, and a shared commitment to delivering sustainable value. It expands our reach and sharpens our focus, positioning us to meet client needs with greater agility, expertise and insight.

New challenges, new opportunities

The environment in which we begin this new chapter is complex and fast-moving. Familiar debates on growth, inflation, and monetary policy remain central, yet other drivers of change are exerting influence on the investment landscape.

Four themes stand out as having the potential to shape the decade ahead: geopolitics, innovation, demographics, and environment. Strategic competition and industrial policy are redesigning the world of global trade and supply chains.

Declining birthrates in developed countries and China are coming to the fore and highlighting the retirement systems' funding gaps. In addition, the rapid adoption of artificial intelligence is transforming productivity, investment, and energy use.

Longer-term sustainability themes – climate change, biodiversity loss, and rising inequality – will continue to redefine risk in capital markets, placing long-term investment resilience under scrutiny.

Our commitment to meeting both societal and sustainability challenges is unwavering – be it in the transition to cleaner energy or the management of natural resources and social capital. These issues will redefine how economies grow and where investors find opportunity.

Looking to the future

For investors, these shifts bring both disruption and potential. Distinguishing what will endure from what will fade requires depth of analysis, active judgment, and the courage to think ahead of the consensus.

Our investment teams have remained focused on that mission. Throughout the integration process, they have continued to do what they do best: translate complex global trends into conviction-led views designed to deliver sustainable, long-term investment performance for our clients.

Our Investment Outlook 2026 captures that perspective. It explores how these global forces are reshaping markets, and where new sources of value – and risk – may emerge. Our goal is not only to interpret change, but to help investors navigate it with clarity, resilience, and purpose.

As we look to the year ahead, we do so with renewed scale, broader expertise, and a single ambition – to turn insights into sustainable performance for those who place their trust in us.

Executive summary

A resilient global economy

The global economy enters 2026 with surprising resilience. Growth forecasts have been revised upward – the International Monetary Fund now projects 3.2% global expansion in 2025, buoyed by a rebound in activity, despite ongoing trade frictions.

Across regions, the outlook is marked by diverging paths. Europe is regaining momentum; reduced policy uncertainty and a major fiscal reset in Germany are set to accelerate growth, supported by increased infrastructure and defence spending.

The US is navigating policy crosscurrents – it faces a complex macroeconomic environment shaped by new policy directions, including tariffs and a looser fiscal stance. These are likely to fan inflationary pressures that will not necessarily be countered by the Federal Reserve, which is now more focused on labour market risks.

In Asia, China's growth is expected to moderate further, with authorities relying on targeted stimulus and investment in advanced manufacturing rather than consumption.

Market outlook: Opportunities and risks in transition

Asset allocation in 2026 will be shaped by the interplay of monetary policy, fiscal dynamics, and evolving market structures.

Fixed income markets are poised to benefit from continued central bank easing, with lower interest rates anticipated in both the US and Europe.

While sovereign debt yields may face upward pressure from fiscal concerns, especially in advanced economies, the overall environment remains supportive for credit markets, with their attractive yields and solid corporate fundamentals.

Equity markets continue to be technology driven, with US technology company earnings expected to grow robustly as artificial intelligence (AI) fuels capital expenditure and productivity gains.

European equities offer compelling value, particularly as the region pursues greater strategic autonomy, potentially offering a broadening set of opportunities for forward-looking investors.

In emerging markets, nations with strong technology sectors stand to benefit from lower US yields and a weaker dollar, though export-oriented economies may face headwinds.

Investment themes: Flexibility, sustainability, and structural change

Key themes for 2026 include the need for flexibility in fixed income strategies, as investors navigate economic growth challenges and an uncertain inflation outlook. We believe opportunities exist across defensive sectors, real estate, and high yield, but a nimble approach is required.

Private assets, particularly alternative credit and real assets, continue to attract capital, supported by resilient fundamentals and policy tailwinds, though selectivity and rigorous credit analysis are increasingly important.

Sustainability remains a central focus – as regulatory frameworks evolve, European and Asian investors are leading the charge on green bonds, decarbonisation, and climate solutions, even as political headwinds emerge in some regions.

AI's transformative potential persists, with robust fundamentals supporting valuations and innovation driving new opportunities across sectors, while in Europe, the commitment to strategic autonomy signals a long-term trend toward greater resilience and diversification.

Ultimately, in 2026, flexibility and selectivity will be essential for investors as markets adapt to greater fragmentation across the global economy.

MACROECONOMIC OUTLOOK



RICHARD BARWELL

Head of Macroeconomic Research and Investment Strategy,
BNP Paribas Asset Management

Surprisingly resilient

The global economy has proved surprisingly resilient in 2025. In the immediate aftermath of Liberation Day, the IMF forecast that the global economy would grow by 2.8% in 2025. It now expects global growth of 3.2% this year.¹

The bellwether of economic activity that the market typically relies upon to gauge the current cyclical position of the economy – Purchasing Managers' Indices (PMI) – points to a recovery in activity that began in early summer and has persisted beyond what could plausibly be attributed to a temporary burst of activity as companies tried to bring forward production and trade to avoid the tariffs. So, we move into 2026 with markets in a much more positive frame of mind about the growth outlook than was the case at the start of April.

The Eurozone economy is likely to accelerate in 2026. The headwind to growth from increased uncertainty over trade policy should fade. Companies are likely to have put capital expenditure on pause back in the spring, but now that there is greater clarity over future trading arrangements, investment should recover. Meanwhile, a new tailwind from fiscal policy should emerge, lifting growth.

1. IMF – [Global Economic Outlook Shows Modest Change Amid Policy Shifts and Complex Forces](#)

The structural shift in the fiscal stance in Germany is the single most important piece of macroeconomic news in Europe this year. The increase in spending on infrastructure and defence should filter through into higher activity next year, lifting the German economy and to some extent the rest of the Eurozone too. The fiscal reset also includes other measures, like a permanently lower VAT rate on restaurant bills and subsidies on energy bills, which might have a more immediate impact on consumer spending.

But when it comes to prices, we see scope for further disinflation over the next couple of years, where rising global trade frictions could potentially play a meaningful role. The recycling of cheap Chinese exports into European markets could represent a new disinflationary impulse that we suspect has been largely ignored by the consensus. We expect inflation to fall below target in 2027, which will prompt the European Central Bank to deliver a couple more interest rate cuts by the end of 2026 – more than is currently factored into market pricing.

**“Expect the Fed to cut US rates
further over the next few years than
the market currently anticipates”**

US President Donald Trump’s policy agenda dominates the US macroeconomic outlook. There is room for debate about the quantitative impact of each strand of that policy agenda, but we believe the direction of travel is clear. An increase in tariffs, a looser fiscal stance and tighter immigration policy are all likely to add to inflationary pressure in the economy, even if the net impact on activity is less clear-cut. The Federal Reserve (Fed) is currently talking about a one-off increase in the price level (or what used to be known as transitory inflation), but we believe that inflation is likely to remain persistently above target over the next couple of years.

More importantly, we believe the Fed’s reaction function is evolving. Going forward, we expect the Fed to place more weight on outcomes in the labour market and correspondingly less weight on inflation data. In our view, this shift will lead the Fed to cut a little further over the next couple of years than the market currently expects, against a backdrop of financial conditions that are already easy by historical experience.

We expect China's pace of economic growth to slow over the coming years, to below 4% by the end of 2027, even with the benefit of additional policy stimulus. We do not expect a bazooka package from the authorities, but we do anticipate front-loading of bond issuance quotas, further policy rate cuts – 10 basis points (bp) per quarter from the fourth quarter (Q4) of 2025 to Q2 2026 – and additional targeted support for strategic sectors.

The reality is that China cannot rely on net exports and property investment to sustain growth at the pace required to meet President Xi Jinping's target of doubling per capita GDP between 2020 and 2035. We do not share the confidence of most China-watchers that consumption will pick up the slack. Instead, we think officials will continue to rely on an investment-heavy growth strategy, focused on the "new productive forces", namely advanced manufacturing and technology.

To conclude, the story for 2026 varies from place to place. In Europe, having weathered the storm, the economy looks set to regather momentum. In the United States, there is genuine uncertainty about how the Fed will navigate the economic crosscurrents and political backdrop under new leadership. And in China, the focus will remain on medium-term growth prospects and the extent of any rebalancing away from investment-driven growth.

**"Expect Europe to regain momentum,
the US to face uncertainty,
and China to focus on medium-term growth"**

MARKET OUTLOOK



CHRIS IGGO

Chief Investment Officer, Core Investments,
AXA IM

Fixed income: Monetary policy should bolster markets

- **Bond markets should potentially enjoy solid central bank support in 2026**
- **Sovereign markets will remain at risk of increased investor concern on the fiscal side**
- **High yield and emerging market bonds continue to be interesting from a total return perspective**

Fixed income markets should benefit from continued central bank easing in 2026. We expect lower interest rates in the US as policymakers respond to weaker labour market trends, and lower rates in Europe because of further declines in inflation. A resilient global economy and policy measures should keep fiscal concerns in check, allowing yields across the curve to reflect the growth and inflation outlook. The core scenario is positive for credit markets notwithstanding tight credit spreads and signs of increased leverage.

Central bank policy, as always, remains key to the bond market outlook in 2026. Major central banks are forecast to take short-term interest rates to or below estimated neutral levels in response to growth risks and falling inflation expectations. The International Monetary Fund's recent growth forecasts were better than those made earlier in 2025 but still suggest advanced economies will struggle to meet long-term average growth rates in the years ahead.

That implies a more supportive stance from central banks as long as inflation remains close to targets. For next year, this suggests substantial reductions in US interest rates to below 3%. Additional US Treasury market yield curve steepening is likely to result. However, demand for yield remains strong, not least from the US insurance sector which has become a significant source of structural demand. Long-term yields are unlikely to significantly deviate from the trading range established in 2025.

Europe's potential

The European Central Bank lowered its deposit rate to 2.0% in June 2025¹. Further cuts are possible should inflation undershoot the official target. This limits the potential for higher yields in European government bonds. However, once Germany's ambitious spending programme gets underway there will be more supply of debt in the Eurozone's biggest bond market, which could pressure markets at times. A steeper rate curve in the Eurozone is likely.

Outside of the bloc, the UK offers potential for attractive returns as markets only expect limited Bank of England easing. Lower inflation and tighter fiscal policy should drive UK gilt yields lower in 2026.

Despite this benign rate outlook, sovereign markets will remain at risk of increased investor concern on the fiscal side. The last year has seen government bond yields rise relative to equivalent maturity interest rate swap rates – a sign of increased risk premiums. Despite rate cuts, long-term yields have moved higher than their end-2024 levels.

The long-term trend for government debt levels is not encouraging in advanced economies, posing further scope for risk premiums to rise. However, the benign outlook for nominal growth and government attempts to take policy steps to appease bond market investors should limit any cases of 'fiscal panic'. Steeper yield curves will at least offer investors potentially higher carry-driven returns in longer-duration strategies than has been the case for a while.

Credit bounce

Credit market activity has remained buoyant in 2025 with credit spreads narrowing over the course of the year despite elevated levels of issuance. Excess returns have been positive and underlying corporate fundamentals remain solid. Looking forward what will determine credit market performance is whether investors continue to value diversified exposure to corporate risk more highly than balance sheet-challenged sovereign debt. In which case, prevailing yields in credit markets are attractive and should deliver attractive income-driven total returns.

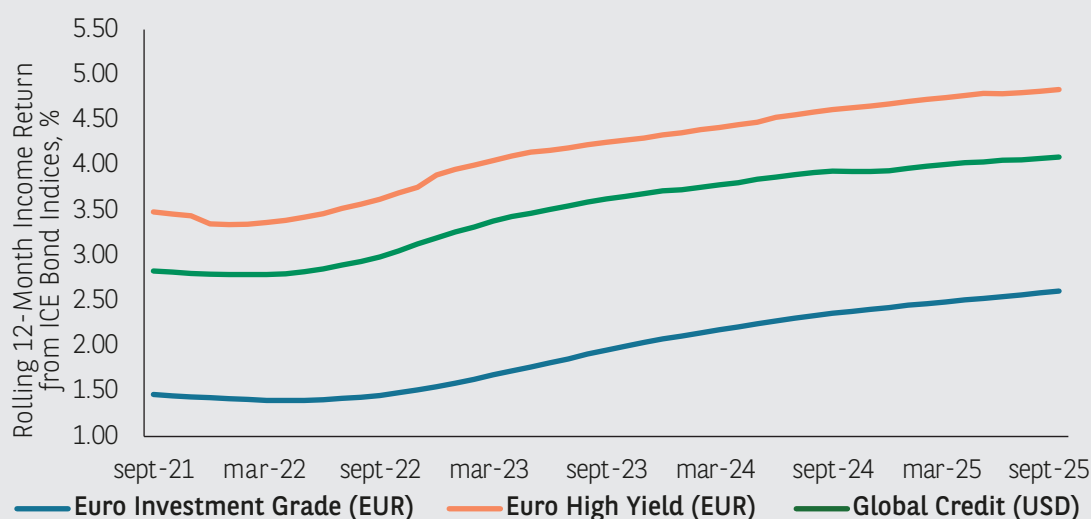
1. European Central Bank, [Key ECB interest rates](#), November 2025

However, from a credit spread point of view, current valuations are tight, and the key risk is credit markets will experience periods of underperformance relative to government bonds. Catalysts for this are weaker economic data, equity market volatility or evidence of growing credit stresses in either private or public markets.

Geographically, US markets are most at risk from any deviation from the benign core scenario. Tariffs and the impact of immigration controls on labour supply could combine to keep inflation higher for longer. This not only complicates the Federal Reserve's decision-making but also reduces expected real returns from US fixed income. It could also negatively impact the dollar. Any sense of increased politicisation of monetary policy (fiscal dominance) will tend to increase inflation expectations, steepening the US yield curve further and underpinning inflation break-even levels. If growth also turns out to be weaker, investors could also focus on the US fiscal outlook, again widening spreads in the US rates and credit markets.

In the absence of a growth or credit shock, carry will be a major theme for bond investors, delivering most of the total return. As such, high yield and emerging market bonds continue to be interesting from a total return perspective. Again, after a robust performance in 2025, investors need to be mindful of valuations but improved credit quality in high yield and better macroeconomic performance in emerging markets are positives for those markets. Significant drawdowns in fixed income markets tend to only occur in response to a growth or credit shock. Neither is in our core scenario for 2026 which means investors should be able to benefit from solid bond income returns.

Exhibit 1: Income returns from bonds for selected fixed income indices



Data as at 30 September 2025. Source: ICE Bond Indices; Bloomberg

MARKET OUTLOOK



DANIEL MORRIS

Chief Market Strategist,
BNP Paribas Asset Management

Global equities: The great divide

- We believe technology company earnings can continue to appreciate in 2026 as AI drives ongoing capital expenditure
- Europe is becoming more autonomous after the US-led disruption to the international order, while its equity market offers value
- The greatest potential for profit growth in China is centred in its technology sector as the domestic economy continues to face challenges

US equity market returns are likely to continue diverging along the lines of technology and the rest of the market: the Nasdaq 100 index delivered a 50% return from the post-Liberation Day lows to the end of October while the Russell 1000 Value index rose by less than half that. That outperformance continues a long-running trend (see Exhibit 1).

We believe technology company earnings can continue to appreciate at a robust, albeit slower, pace next year as the artificial intelligence (AI) revolution continues to drive heavy capital expenditure — and eventually profits across all sectors.

AI's greatest impact will ultimately be in the other parts of the economy as companies implement the technology to drive earnings growth. This will partly come from reducing labour costs; and the US labour market's flexibility suggests AI will be integrated more fully, and more quickly, in the US than elsewhere.

The Nasdaq's strong 2025 gains have been roughly in line with earnings growth, meaning that valuations, while high, have not meaningfully increased. By contrast, the Russell index's gains have outpaced earnings, leading to an atypically high price-earnings (P/E) multiple (see Exhibit 2).

If AI is indeed a bubble set to burst, valuations will quickly fall, but interest rates should not prompt a downturn like they did in 2022 as the Federal Reserve is looking to lower the policy rate next year instead of increasing it.

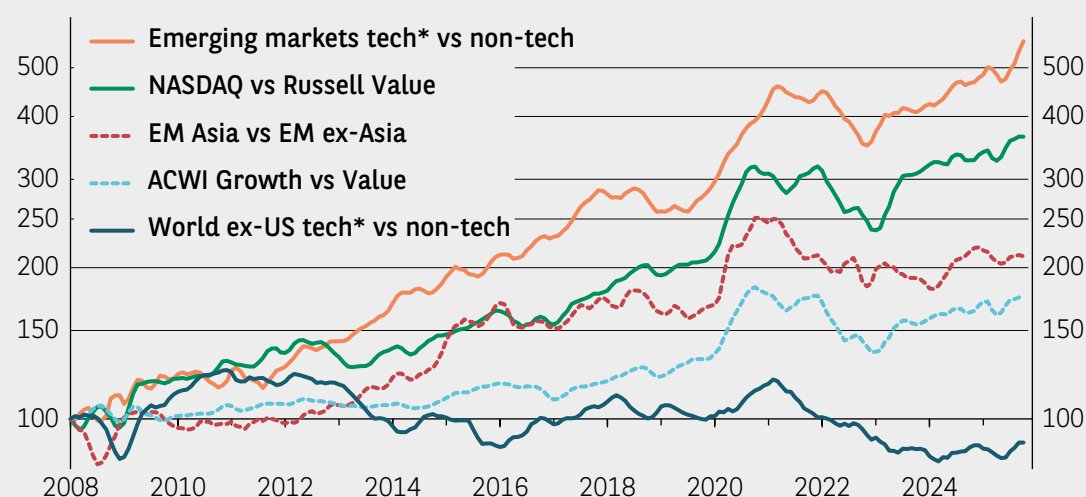
A benign way that the index multiple could revert towards its mean would be for the index price to appreciate less than the gain in earnings. With forecasts of 15% earnings growth for the Nasdaq in 2026, there is still room for potentially good investment returns even as multiples compress.

This dynamic of prices rising at a slower rate than earnings would also reduce the high multiple for the US small cap index. The Russell 2000 forward P/E is quite elevated, but earnings growth is also very strong, forecast to advance by over 20% next year.

Given the US's positive macroeconomic backdrop — deregulation, more mergers and acquisitions activity, rising business investment, wage growth, falling policy rates, and low energy prices — we are optimistic these earnings expectations can mostly be realised.

Exhibit 1: Tech is the factor driving outperformance in both the US and emerging markets

Relative performance; log scale



Data as at 11 November 2025. *Technology, Broadline Retail, Interactive Media & Services.
Sources: FactSet, BNP Paribas Asset Management.

US small-cap stocks are nonetheless unlikely to sustainably best the S&P 500 due to the weight, and long-term superior performance, of the technology sector. But small caps offer another way to access US economic growth without increasing exposure to the tech sector.

Europe's autonomy

European corporates have struggled in the face of US tariffs, a stronger euro, and increased Chinese imports. The disruption to the international political and economic order unleashed by the new US administration has spurred Europe to try and reduce its dependence on the US, for example by increasing its capabilities in defence — an initiative called Strategic Autonomy.

Many investors are looking for fiscal stimulus directed to infrastructure and defence to boost corporate profits. Indeed, earnings for the MSCI Europe Aerospace & Defense index are forecast to advance by over 25% next year. We believe this initiative will help the region to offset the US tariff drag and assist the reorientation towards a less export-dependent economic model.

To balance growth exposure in portfolios, investors have the choice of the US Russell 1000 Value index, MSCI Europe or MSCI Japan, which all have a similar sector composition. Expectations for earnings growth are also similar for 2026 at 8%, 12% and 13%, respectively.

While there is little difference in the growth rates, Exhibit 2 shows there is a significant gap in valuations. Both US value stocks and Japan have P/E ratios well above average, while Europe seems to offer the best value.

Exhibit 2: Forward price-earnings ratio z-scores

Market	United States	Japan*	Russell Value	Developed Markets	US Small Cap	NASDAQ	EM Broad Tech**	EM ex-Broad Tech	Europe
P/E	1.6	1.5	1.5	1.4	1.2	0.5	0.5	0.3	0.2

Data as at 11 November 2025. *Calculated from 2010; for all other indices calculated from inception.

** Technology, Broadline Retail, Interactive Media & Services. Sources: IBES, Bloomberg, BNP Paribas Asset Management.

Emerging markets potential

Low US Treasury yields, and a weaker US dollar, are typically positive factors for emerging market equities. Export-oriented countries, however, may struggle compared to those that can rely on a large, growing domestic market to generate profits.

As in the US, however, it is primarily the technology sector which is generating superior returns within emerging markets. As Exhibit 1 illustrates, the sector has outperformed the rest of the market by an even greater degree than the Nasdaq has outperformed the Russell Value index.

Of the three countries with the largest technology sectors — South Korea, Taiwan, and China — the latter offers greater diversity than the semiconductor-focused markets of Taiwan and South Korea. We believe China's technology sector has the additional advantage of being somewhat protected from the current trade tensions between the US and China. Technology companies derive a greater share of their revenues from services rather than goods and so are less affected by tariffs. Given the size of China's domestic market, its high level of engineering talent (for example, the developers of DeepSeek), and desire to develop its own technological ecosystem, we believe technology companies can generate meaningful future profit growth, despite the challenges facing the domestic economy.

"The tech sector has been generating superior returns in emerging markets."

FIXED INCOME



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MICHAEL GRAHAM

Head of US High Yield,
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US Fixed Income
Investment Specialist, AXA IM

Why flexibility will be key for fixed income investors in 2026

- Fixed income returns were largely positive in 2025, though the asset class faces potential headwinds in the coming year
- There is much uncertainty over monetary policy, inflation and growth – therefore a flexible approach to bond investing will be essential
- We continue to see potential investment opportunities across a wide range of industries and sectors

Despite no shortage of challenges and obstacles, returns across fixed income asset classes have been largely positive in 2025, with income levels a major contributing factor.

However, as we enter the coming year, markets face potentially slower economic growth, alongside questions over the direction of monetary policy and inflation, as trade policy uncertainty dominates the discourse.

What is certainly clear is that investors will need to be more malleable in their investment approach going forward – flexibility will be paramount to ensure they can steer through the market unpredictability.

Four fixed income experts share their views on what to look out for in markets in 2026.

By BNP Paribas Asset Management, Head of Global Aggregate and Absolute Return, James McAlevey

Over recent years investors have had to navigate a plethora of challenges – geopolitical uncertainty, central bank resetting and more recently a spate of US trade tariffs.

However, we are amid a very different setting to the interest rate recalibration period of 2022-2024, and the environment continues to evolve at pace. Many central banks are now cutting interest rates – good news for traditional bond strategies – but uncertainty remains ever-present.

The depth and speed of future interest rate cuts remains in question. Inflation is proving more stubborn than anticipated in many economies – and US tariff policies could push prices higher in 2026. We may be entering a new era of structurally higher inflation, meaning that interest rates may not fall as far in the current cycle as many hope. This, combined with a weaker outlook for economic growth, puts central banks in a difficult position.

And while fixed income has become much more attractive now that yields have risen from their ultra-low levels of five years ago, the outlook is far from straightforward. But as we move into 2026, what is more certain is that a flexible, diversified and dynamic investment approach to bond investing will be key.

And while markets can always be turbulent, volatility brings with it opportunities – and right now we are seeing investment potential across global bond markets. For example, the trend towards a weaker US dollar is particularly favourable for some issuers in the local emerging market universe where relatively high yields offer compensation commensurate with the associated risk. In developed markets, current coupon US agency mortgage-backed securities currently offer a pickup in yield relative to US investment-grade corporate debt with lower credit risk.

Looking ahead, given the complications surrounding cross-border trade, alongside the high levels of government debt – plus ongoing geopolitical tensions, it seems logical that investors will require additional compensation for holding longer maturity government debt. That would mean steeper yield curves. The unconstrained nature of our absolute return opportunity set enables us to position portfolios to benefit from steeper yield curves, another example of the advantages of being able to both overweight and underweight fixed income assets.

This economic uncertainty continues to cloud the fixed income market outlook. Fundamentally, we believe that significant risks remain for investors pursuing traditional, less flexible, fixed income strategies. Higher volatility has widened the gap between the best- and worst-performing areas of the fixed income universe. In today's shifting and uncertain economic landscape, something which will no doubt spill into 2026, a global, flexible approach will be as essential as it ever has been.

By AXA IM, Head of Euro Investment Grade and High Yield Credit, Boutaina Deixonne

European markets have been far from immune to the numerous volatility spikes of recent years, but despite a challenging environment, corporates have been able to adapt – even flourish.

But as we head into 2026, there are few issues to consider – the two most pertinent being potentially softer GDP growth and the possible implications for monetary policy.

Central banks may likely continue to cut interest rates, and inflation may trend lower, but it may still be a more challenging period, especially considering the potential impact of US trade tariffs. Investors will need to take a flexible, unconstrained approach and adopt strategies which aim to help them manage credit spread and duration risk.

Despite the numerous headwinds – either already present or potentially on the horizon – we see plenty of opportunities across a wide variety of industries including more defensive sectors such as utilities and telecommunications as well as real estate, which enjoys inflation-beating rental growth projections.

These sectors remain robust and tend to demonstrate strong balance sheets, while valuations are very attractive compared to more cyclical areas. In addition, the banking and financial sector is also very attractive. Banks, due to strict regulatory requirements, are already in strong health and boast good margins, and robust capitalisation. Indeed, banks' profitability is likely to continue to be supported by asset-gathering fees.

Flows into European credit have been very buoyant as the search for yield shows no signs of easing. And with European investment grade bonds boasting yields of circa 3% to 3.5% and high yield around 5%, we anticipate this trend will continue well into 2026, as the attraction of cash instruments and money markets will likely be lower.

Fundamentally, European bond markets are offering decent income levels and demand is likely to rise as investors look to lock in attractive yields. European issuers' credit quality remains in good health, which should help buffer them against a potential economic slowdown. But given the plethora of macroeconomic uncertainties concerning growth, government deficits, inflation and monetary policy, we believe going forward it will be essential that investors adopt a nimble, flexible approach to asset selection when navigating the current climate.

By AXA IM, Head of US High Yield, Michael Graham, and US Fixed Income Investment Specialist Jack Stephenson

For the best part of three years, the US economy has defied expectations for a recession and has continued to outperform other developed market economies.

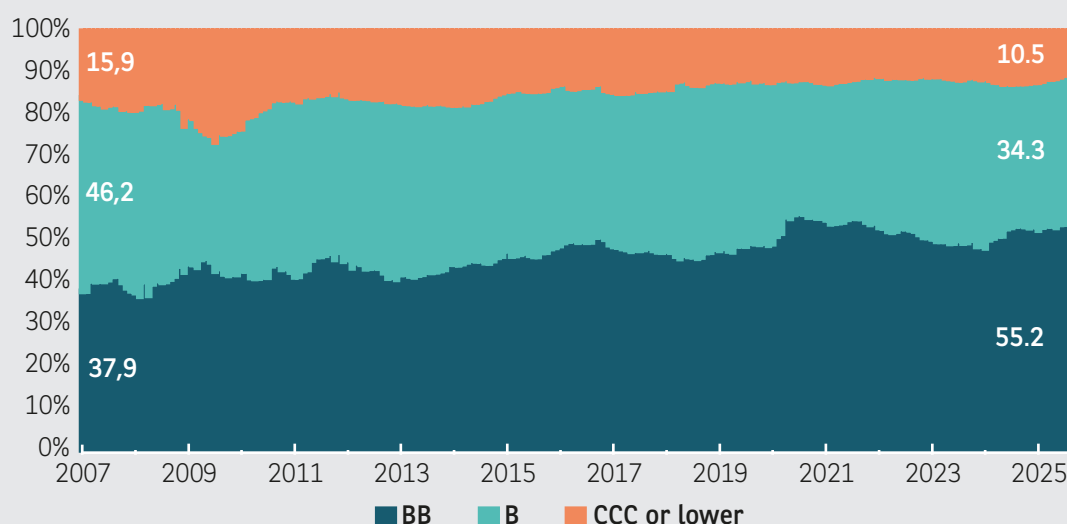
For US high yield, despite bouts of volatility related to interest rates, regional banks and tariffs, this period has been defined by strong investment returns reflecting fundamental strength, very low defaults and an abundant supply of capital to issuers underpinning a strong technical across all leveraged finance.

Reflecting this healthy backdrop, spreads have continued to tighten, leading to questions about how much more room to run there may be in 2026. It is worth remembering that, whilst spreads appear low in a historical context, they are much less so when adjusted for today's US high yield market composition. Current spread levels are supported by a near record high percentage of BBs; a near record low percentage of CCCs; a record high percentage of secured bonds (35%); and record low duration and low bid/ask spreads (i.e. better liquidity).¹

Still, the abundant supply of capital has led to increased corporate leverage in pockets of the global leveraged finance universe, particularly the lower end of the credit spectrum in the broadly syndicated loan and private debt markets. Recently, there has been greater attention to some notable default stories and investor concern regarding contagion risk across credit markets.

¹ Bank of America September 2025

Exhibit 1: Composition of the US high yield bond market by selected ratings



Data as at 30 September 2025. Source: Bank of America, HY Research

Although we expect the theme of liability management exercises to remain prevalent in 2026, overall default activity in high yield should remain modest and will likely continue to be driven by idiosyncratic credit stories. In that context, an active and disciplined approach to investing within lower credit quality markets may be warranted.

Despite macroeconomic uncertainty, we expect high yield spreads to remain in a relatively tight range, supported by continued investor demand from yield buyers focused on the overall total return potential on offer as cash rates decline. We believe that short duration securities will remain attractive given the ability to mitigate both interest rate and spread volatility, whilst offering access to the most liquid part of the market. For investors seeking higher total returns within US high yield, any market weakness like we saw in April 2025, could provide potentially attractive buying opportunities further up the risk spectrum.

To benefit from the full range of opportunities, in 2026 investors may want to consider a flexible and targeted approach to investing in the high yield market, harnessing its unique diversification benefits to complement an overall asset allocation.

**“We expect high yield spreads
to remain supported by investor demand
as cash rates decline.”**

US EQUITIES



PAMELA HEGARTY

Senior Portfolio Manager, ESG Champion,
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DEREK GLYNN

Portfolio Manager,
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Artificial intelligence: Not a bubble... yet

Artificial intelligence (AI) is the most impactful digital transformation theme since the development of the Internet. The public launch of ChatGPT in November 2022 catalysed a wave of investment and innovation that continues to build momentum. As excitement about the potential for this new technology builds toward very high expectations, investors and industry participants are questioning if we are entering a bubble. Our current conclusion is that AI is not a bubble...yet. We are carefully monitoring risks and similarities to the Internet and telecom bubble (the “dotcom era”).

Risks and similarities include:

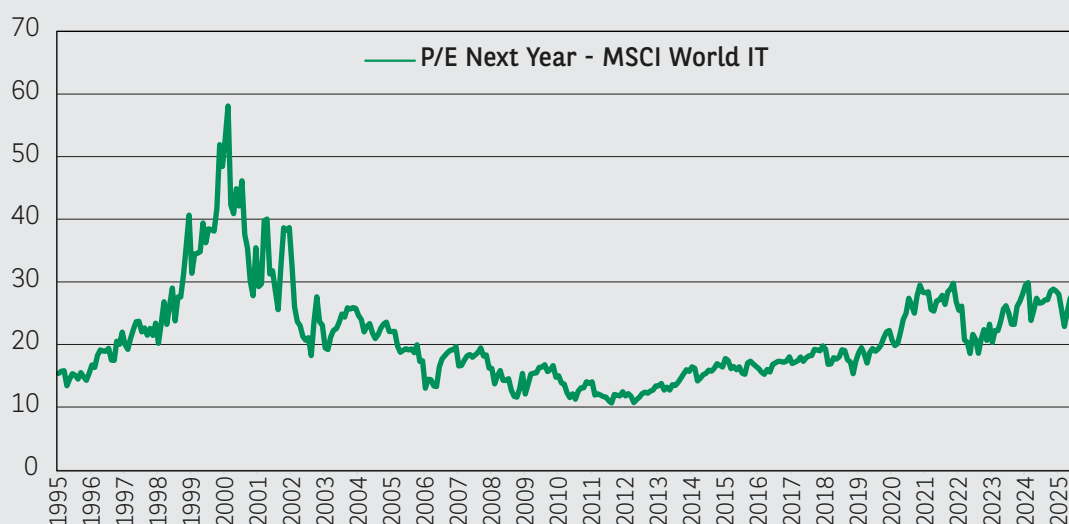
- **The desire to be first to market** with leading AI models is creating an arms race that may result in an overbuilding of infrastructure, as not all players will be successful.
- **Massive up-front investment** is required for training and running AI models, with revenues and earnings expected at some future date. This creates uncertainty about the return on invested capital (ROIC) for many AI initiatives.

- **The emergence of debt financing including the use of private credit and off-balance sheet structures** (joint ventures and special purpose vehicles), and the reported use of Graphics Processing Units (or GPUs, these are fast-depreciating assets) as collateral in some cases, introduces significant risk.
- The existence of **circular relationships** among suppliers and customers is a red flag. We are concerned about the systemic risk associated with the interrelated financial dependencies.

On the positive side, there are several mitigating factors that make us confident we are not yet in bubble territory.

- **The leading cloud service providers (CSPs) are large, rational companies with strong balance sheets and positive free cash flow generation.** To date, they have self-funded their AI capex primarily through operating cash flows. During the Internet and telecom bubble of the late 1990s, the companies bearing the brunt of the infrastructure investment were primarily debt-funded and did not have stable cash-generating business segments to support them through the cycle.

Exhibit 1: Valuations of the MSCI World Information Technology (IT) Index are far from dotcom bubble levels

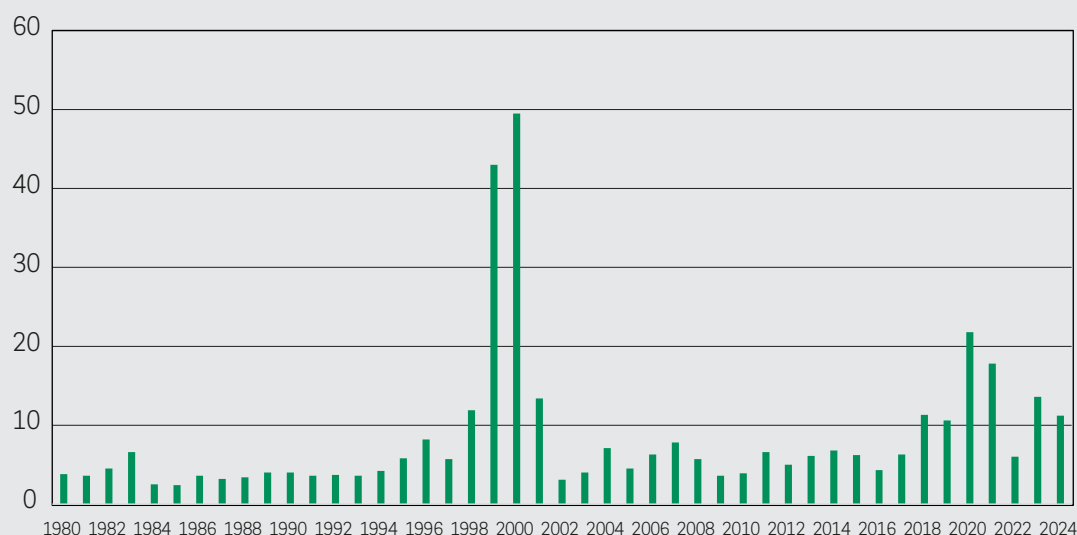


Data as at 30 September 2025. Source: MSCI, Bloomberg

- **It is still very early in terms of the adoption of AI, and potential use cases are expanding.** A recent survey found that while 78% of enterprises are using AI in at least one department, only 16% have deployed it across five or more¹. Agentic AI holds the promise of enabling new use cases where autonomous agents, powered by AI, will reason, plan, and act across IT systems and data, and thus automate many tasks. Physical AI is also on the horizon as AI converges with robotics and other consumer devices. In technology adoption cycles, it is not unusual for steep investments to occur ahead of widespread monetisation.
- **The infrastructure exists (in the form of high-speed Internet access, smartphones, and other connected devices) to immediately deliver AI-based applications to end users.** That was not true during the Internet and telecom bubble, as the fibre buildout occurred well ahead of the existence of the “last mile” networks that provide broadband access, and well before the availability of smartphones. This enables innovators to achieve faster time to revenues and returns. For example, ChatGPT has already reached 800 million weekly active users in less than three years, as of October 2025, compared to 13 years for Internet adoption.

1. Source: McKinsey & Company, March 2025. The state of AI: How organizations are rewiring to capture value

Exhibit 2: Tech sector Initial Public Offerings (IPOs), median price/sales multiple by year



Data as at 29 September 2025. Source: Initial Public Offerings: Updated Statistics, Jay R. Ritter, University of Florida, table 4a.

- **Valuations of publicly traded technology stocks are not nearly as stretched** as in the late 1990s. While expectations are high now as they were then, the valuations are still reasonable for many leaders in AI. In a bubble, valuations become untethered from reality, with investors paying high multiples on heightened forecasts. We believe some of the more speculative valuations in AI today are concentrated in the private markets, with most AI companies staying private for longer, thus insulating the public equity market.

Today we have reasonable multiples on high expectations. Higher multiples compared to 10 years ago reflect higher profit margins and returns on equity (ROE) of growth companies.

During the Internet/ telecom bubble, high multiples were placed on high expectations. For example, the median price to sales multiples of tech sector initial public offerings (IPOs) spiked to 43x in 1999 and 49.5x in 2000.

In conclusion, we believe the AI theme is not yet in bubble territory. Expectations for the leaders of AI are high, but valuations remain reasonable. However, we are aware of and monitoring several risk factors going forward and are watching for signs of a digestion period in the spending cycle. It is possible that industry consolidation and disruption will occur over time as winners emerge from the arms race. We remain intensely focused on bottom-up fundamental research at the company level to identify winners and avoid losers, and on monitoring developments closely as the adoption of AI progresses.

EUROPEAN EQUITIES



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European strategic autonomy: A long-term investment opportunity

- Europe is allocating billions of euros to defence with investments expected to continue to grow
- The sector's valuation is attractive and growth is well above that of other areas
- Industrial and technological resilience remain a key policy focus and boast multiple potential long-term investment opportunities

Europe is deepening its quest for strategic autonomy. What began as a post-pandemic policy slogan has evolved into a financial reality, with tangible investment implications – Europe now allocates billions annually to defence, industrial resilience, and key technology sectors.

Once an afterthought, now a priority, the money being put into European defence has significantly increased since 2022, amid the Russia/Ukraine conflict and more recently because of US President Donald Trump's pressure on NATO members.¹

1. Defence Expenditure of Nato Countries [250827-def-exp-2025-en.pdf](#)

But this is only the beginning. At the June 2025 NATO Summit in The Hague, allies made a commitment to investing 3.5% of GDP annually on core defence requirements and 1.5% of GDP on defence- and security-related spending by 2035.²

These ambitious targets were met with some prudence by the market, with some countries more reluctant than others to spend so much while already struggling with high public spending. However, the path is clear: several plans exist to help with this target, notably the European Union's (EU) €800bn ReArm Europe Plan/Readiness 2030.³ Security spending will rise for years to come, which could create potential new opportunities for investors.

Investable market

The total addressable market for European investors should grow 29% per year until 2030, according to the European Defence Agency⁴. Its study uses a hypothesis of 3% of GDP spending on defence by 2030 (versus the 3.5% agreed by NATO members and 2% previously), taking progressively into account the 65% target of components from European companies⁵, adjusting slightly higher also the proportion of spending on equipment versus staff.

The sector has significantly re-rated since 2022, but its valuation is still below that of US peers and its growth is well above that of the other European sectors:

2. [NATO – Topic: Defence expenditures and NATO's 5% commitment](#)

3. [EU defence funding | Epthinktank | European Parliament](#)

4. [European Defence Agency Report, Defence Data 2024 – 2025.](#)

5. [SAFE | Security Action for Europe – European Commission](#)

Exhibit 1: Valuation ratios for selected equity indices

Valuation ratios by FactSet consensus, data as of 21/10/2025	PEG – NTM	P/E – NTM	FCF Yield – NTM	P/Sales – NTM
MSCI Europe	1.695	14.64	4.81%	1.66
MSCI Europe Aerospace & Defence	1.545	30.77	3.19%	2.67
MSCI World Aerospace & Defence	1.97	32.26	3.16%	2.81
MSCI World	1.934	20.39	3.71%	2.65

NTM: Next Twelve Months, PEG: Price Earnings Growth Ratio, P/E: Price-to-Earnings Ratio, FCF: Free Cash Flow, P/Sales: Price to Sales. Data as at 21 October 2025. Source: FactSet

When looking at the subsector's valuation ratio, accounting for its growth, the sector is still cheaper than the rest of the market.

In the short term, investors should be prepared for potential volatility, due to contradictory news on the probability of a ceasefire between Ukraine and Russia. But recent financial reports and order books have reassured the market; for example, TKMS (the recent marine spin-off from ThyssenKrupp) boasts backlogs extending to 2040.⁶

At the same time, the reorganisation of the European defence landscape is underway, evidenced by several changes: TKMS' spin-off, Rheinmetall's acquisition of Naval Vessels Lürssen, the Bromo satellite project combining the space businesses of Airbus, Thales and Leonardo – which all create potential additional opportunities to invest in the sector.

Industry, IT, utilities and basic resources: The long way to sovereignty

The industry, information technology, utilities and basic resources sectors are pillars to address vulnerabilities in supply chains, notably in chips, energy and critical raw materials essential for the green and digital transitions. Several policies and plans exist to support this:

- The EU's REPowerEU programme which aims to divest from Russian energy imports before 2030⁷: supported by €300bn of funding, notably through the Recovery and Resilience Facility⁸
- Approximately €100bn to be mobilised by 2030 to support decarbonation of energy-intensive industries⁹
- Germany's "Schuldenbremse" (debt brake) reform, approved by parliament in March 2025, enabling the creation of a special €500bn fund to be deployed over several years (€83bn for 2026) dedicated to investments in infrastructure (transportation, energy, digital networks) and the green transition¹⁰
- The EU's Critical Raw Materials Act which establishes benchmarks for EU extraction (10%), processing (40%), and recycling (25%) by 2030. It does not have a dedicated budget but aims to soften the administrative burden and timeline for permits.¹¹ This initiative becomes more and more important with the Chinese government restricting rare earth material exports
- At the European level, the Chips Act is mobilising over €43bn in public-private commitments through 2030¹²

6. [Major order of € 800 million for submarine modernization – TKMS Group Website](#)

7. [RE PowerEU](#)

8. [Recovery and Resilience Facility – European Commission](#)

9. [Clean Industrial Deal – European Commission](#)

10. [Federal Ministry of Finance – Fiscal foundations for the coming years: German government adopts 2025 federal budget, benchmark figures to 2029 and implementation of the €500bn investment package](#)

11. [Critical Raw Materials Act – Internal Market, Industry, Entrepreneurship and SMEs](#)

12. [European Chips Act – European Commission](#)

On an even longer-term note, the Multiannual Financial Framework proposed by the European Commission in July 2025, covering 2028–2034, provides for a budget of €2trn aimed at strengthening the EU’s strategic autonomy and resilience. This is equivalent to 1.26% of EU GDP over the seven-year period, doubling the €1trn of the previous 2021–2027 budget.¹³ The plan establishes a European Competitiveness Fund of €409bn, intended to support strategic technologies in clean energy, digital transition, biotechnology, and defence.

In addition, €175bn is allocated to Horizon Europe, the EU’s flagship research programme, which aims to support innovation from conception to scale-up. This additional spending will likely open up new investment opportunities across these industries and potentially beyond.

A long-term investment trend

Europe’s strategic autonomy could solidify by 2030, with defence spending representing a significant 3.5% of the region’s GDP, not even taking into account the indirect 1.5% of GDP spending from the NATO commitment. Even if the full NATO engagement is not met, we believe this is a structural trend that is here to stay. Defence clearly dominates Europe’s balance sheet, while industrial and technological resilience remain smaller but fast-growing components as well. Sustained efforts are essential for a robust Europe, improving visibility for European companies, while creating potential long-term opportunities for investors.

13. [EU budget 2028–2034](#)

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