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# Quarterly Equities and Multi Asset Outlook Polarisation

Hype and Hesitation

Q1 2026

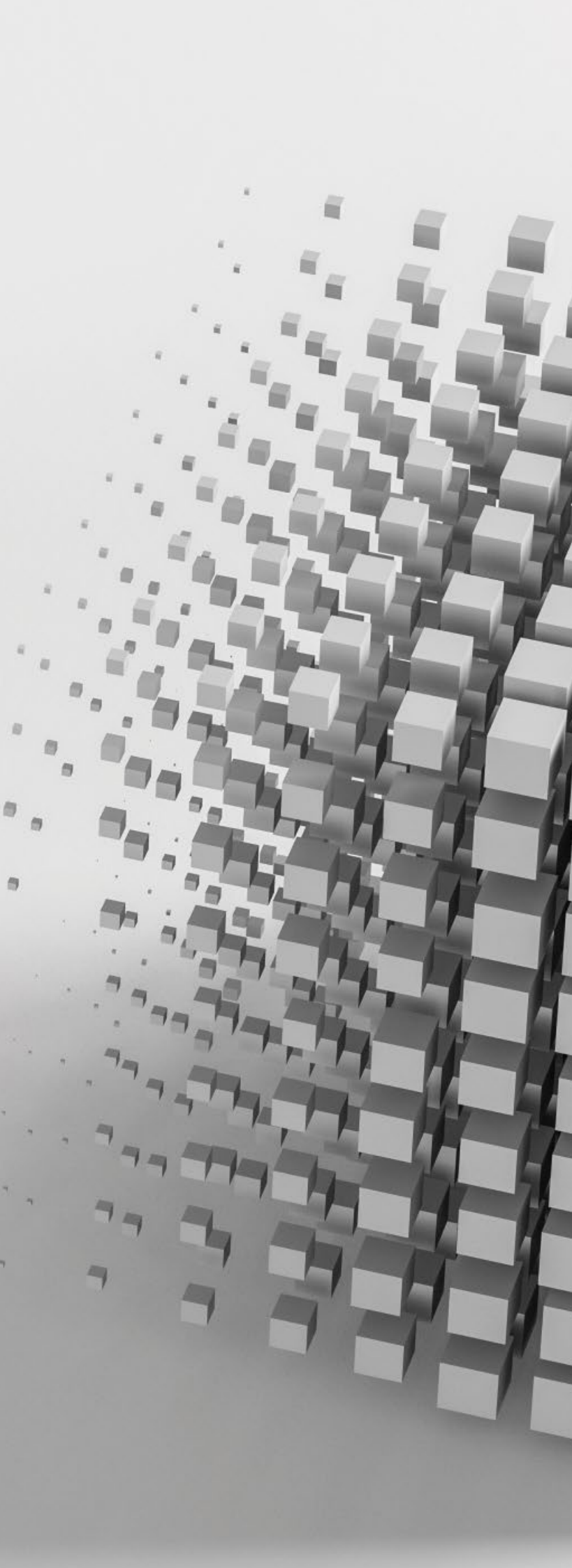


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## Polarisation

Markets have become increasingly polarised with investors ricocheting between hype and hesitation in response to the geopolitical and economic landscape.

Globally, the real loser of 2025 has been Quality, with stocks suffering their worst relative decline in developed markets in more than two decades.

The seemingly polarised behaviour is leaving opportunities on the table for those willing to look through the hype and hesitation.

We have been taking advantage of the market shunning quality stocks and, in 2026, we expect AI-related investment opportunities to broaden to encompass an increasing number of companies that stand to benefit from capital-fuelled AI advancements.

# Harvesting alpha between hype and hesitation

Markets are becoming increasingly more polarised. Investors appear to be crowding one area of the market, while dismissing the rest of it with the same apparent conviction.

In US Equities, 2025 has witnessed one of the widest valuation gaps between US Growth and US Value in decades, while Value has performed better in other regional equity markets – most notably Europe and the UK. Globally, the real loser of 2025 has been Quality. High-quality companies with high return on capital and good long-term defensive characteristics suffered their worst relative declines in developed markets in more than two decades<sup>1</sup>. Some of these stocks got caught up in tariff, policy or the ‘tech-losers’ narrative, often with little or no foundation. Meanwhile, two of the best performing markets over 2025 have been Emerging Market (EM) Equities (+34%), with a whopping +83% for South Korea’s KOSPI (total returns in USD terms) and Gold (+65%). The animal spirits of team ‘hype’ met the bet-hedgers of team ‘hesitation’.

Both teams performed well, and the final match tally may have been a draw – but it was a nail-biter. We have talked in the past about how the velocity of market moves has increased. Sudden sizeable movements (many retracing almost as quickly as they happen) are increasingly becoming the norm. Recall the extreme spike of the S&P E-mini on 9 April 2025, which gained c.US\$2.5 trillion market cap in a matter of few minutes, only to fully retrace within the hour. In Spring 2025, Japan’s Topix Index registered its fifth largest short-term volatility spike since 1975. It lost 18% in 11 days and recovered fully in just over seven weeks. This happened only a few months after the third largest short-term volatility spike in the Topix Index, which occurred in Summer 2024.

Since then, both the S&P 500 and the Topix indices have proceeded to climb higher. So what, in the past, would have been a signal (a large, sudden drawdown) could now just as easily just be ‘market noise’.

Investors’ ricocheting between hype and hesitation is likely a response to the new geopolitical and economic landscape we are living in – more volatile foreign and domestic policies alongside increased developed government debt, set against continued resilience in corporate earnings growth for many areas of the market; whether driven by policies (such as US deregulation or increased European defence spending) or by powerful technological advancements.

Whatever the trigger for this seemingly polarised behaviour, it is leaving plenty of spoils along its path. As asset managers, our job is to adapt to changing market circumstances and exploit any opportunities that are flagged up, to deliver the performance our clients expect.

Adaptation becomes key when the old ‘rules of thumb’ of asset allocation don’t hold anymore: the equity/bond correlation is erratic at best and both US treasuries and the US dollar have lost their safe haven lustre. Will these understood rules of thumb ever be restored? Perhaps... but, for now, many of the circumstances that brought about their breakdown (fraught geopolitics, increased levels of government debt and potentially persistent inflation going forward) still remain in 2026.

<sup>1</sup>Source: Bloomberg, 31 December 2025. MSCI World Quality Index relative to the broader MSCI World Index – total returns in USD.

## Asset Allocation: tactically managing the long-end

M&G Investments' Multi Asset strategies have made few changes in the fourth quarter and remain relatively neutrally positioned between fixed income and equities.

In equities, we recognise the frothiness of valuations in some areas of the market, and the increased valuation at an index level, but we are also aware that such valuations are skewed by index concentration and, at a more granular level, there is still value in the market. As an example, the 22 largest stocks in the S&P 500 Index account for 50% of the index by weight. Excluding those 22 stocks, the average earnings yield of the index is closer to 6.0% than 3.9% for the wider S&P 500 Index<sup>2</sup>.

We see both headwinds and tailwinds facing the market, which will affect each company differently. Hence, we believe that selectivity and diversification are the best recipe to build a resilient portfolio.

Our exposure to equity markets is characterised by a preference for Asia and Europe versus the US. Across a number of our portfolios, we hold a separate exposure to technology at a global level, to reflect the power of the changes we see in this area.

“Investors [are] ricocheting between hype and hesitation [in] response to the new geopolitical and economic landscape”

In fixed income, we recognise the value at the long end of the yield curve, and – in the US and the UK – the likelihood of the US Federal Reserve (Fed) and the Bank of England (BoE) to further cut interest rates, but we are mindful of the volatility that geopolitical events, debt concerns and the question marks on Fed independence can bring.

We maintain a preference for government bonds over credit, given the relative valuations. We hold both long-dated developed and emerging market government bonds. We continue to manage the long end of the US treasury curve by repositioning around yield changes (buying when yields rise in unwarranted panic and selling when they fall in the hope of less likely blue skies), remaining nimble and embracing the volatility rather than keeping our exposure static.

Within our neutral allocation across both asset classes, we ascribe far more emphasis to the content of each allocation than the headline allocation itself.

This is in line with our belief that this is a market of low macroeconomic and geopolitical visibility, where we believe investing in idiosyncratic elements is far more rewarding than broad macroeconomic bets.

## Opportunities in Quality stocks

Across our equity strategies, we have also been taking advantage of the market shunning Quality stocks. In the US, Europe, UK and Asia we have found opportunities in stocks, which would have previously been perceived as quality, steady growth companies in sectors that span from consumer staples to telecommunications to niche industrials. These stocks have de-rated materially in the last 18 months, despite steady earnings delivery. We believe that the de-rating was not driven by fundamentals, but rather by a change of prevailing narrative in the market, as these prior ‘darlings’ have been replaced in the mind of investors by AI-related stocks and, thus, have seen a dramatic shift in their relative risk premia and valuation. Some of these stocks were richly valued in the past and, following the derating, valuations have become attractive.

<sup>2</sup>Source: Bloomberg, 31 December 2025.

## Actively approaching AI

Embracing some of the opportunities left by the Artificial Intelligence (AI) frenzy doesn't mean that we are turning our backs to the world of AI.

As our Global technology investment team reminds us, in 2025, the AI euphoria lifted many boats. 2026 could well be a time of reckoning for companies now trading on frothy valuations that are unable to deliver on the future earnings growth discounted by current valuations. There still are a number of companies where the true upside driven by AI is underappreciated. Selectivity is key.

In our recent piece entitled 'Are we in an AI bubble? That's the wrong question' in the **M&G Investment Perspectives 2026 Outlook – Searching for value amid the euphoria**, we argued that the future trajectory of earnings of the AI winners in 2025 will depend on supply bottlenecks and the displacement potential of new technologies. This means that for some of them, current valuation multiples are justified, but not for all. As the tide that lifted all boats starts to recede, this is the time to let go of passive exposure to AI stocks and take a more active investment approach. Letting go of AI exposure altogether is not an option. As our Head of Convertibles points out, while AI stocks carry inherent risks, not investing in AI is a risk too.

In 2025, AI-enablers enjoyed strong capital appreciation driven by strong growth in revenues and margins. We believe AI-enablers will remain attractive going forward, as long as the pace of increasing levels of computing performance continues.

At the same time, we expect AI-related investment opportunities to broaden to encompass an increasing number of AI-beneficiaries and AI-providers, who stand to benefit from the financial tailwinds associated with the use of technology that has been made available through the AI capital investments of others.

## Convertible bonds as a building block

One area that we have highlighted in the past, and we believe to be a compelling building block for portfolios with lower tolerance to market volatility, is convertible bonds. During market downturns convertibles have historically outperformed broad equity markets; by capturing more of the upside than the downside –

shielded by the inbuilt protection of the bond floor and supported by the upside of their equity component<sup>3</sup>. Incidentally, in a strong year for equities such as 2025, convertibles delivered a respectable upside equity participation of 67%<sup>4</sup>.

## Impact of geopolitical risks

Last but certainly not least, following the events in Venezuela and the increased US rhetoric on Colombia, Greenland and Mexico, clients have asked for our thoughts on portfolio positioning should geopolitical relations deteriorate.

As we have discussed in the past, geopolitics tends to impact risk markets only if it impacts company earnings on a broad scale. Think of the conflict in the Middle East over the past two years; while tragic from a humanitarian perspective, it had no impact on broad market earnings and, hence, on global risk markets.

Government bond markets tend to be more affected and are likely to become more volatile as a result of the heightened geopolitical risk. In the particular case of an escalation of US aggression to other countries, the outcome could be binary. If the events remain confined to Venezuela, even with some noisy sabre rattling on Colombia and Greenland, it is unlikely that risk markets will be impacted – as long as the positive earnings trend persists.

However, tail risks undeniably exist. Given the different fronts that are currently in play, including Greenland, the South China Sea and Taiwan – an 'accident', which could turn into a broad military conflict, would put us in a completely different situation. In such a scenario, besides gold, we can't think of much else in terms of true safe havens. And while a long-term structural case can be made for investing in gold, preparing now for such a scenario, could imply missing out on more lucrative investments. Given the possible opportunity cost, I don't believe this is the time to prepare for such an Armageddon scenario.

<sup>3</sup>Source: M&G, Bloomberg, FTSE Global Focus Index and MSCI World Index, total returns in USD. Selected historical periods back to 2002.

<sup>4</sup>Source: Bloomberg, LSEG, January 2026. Convertibles represented by the Refinitiv Global Focus Index (USD). Global equities represented by the MSCI AC World Gross Total Return Index (USD). Past performance is not a guide to future performance.

## Seizing opportunities vs. making predictions

Our Multi Asset investments team reminds us that we have to make the most of what we have. Polarisation was the defining feature of 2025 markets and as we enter 2026, the new year is likely to be just as complex. Equities and bonds are already sending conflicting signals, driven by geopolitical tensions, President Trump's pressure on the Fed, private credit concerns, and the noise surrounding the upcoming US mid-term elections.

As our Head of Impact Equities stated, we don't believe in our ability to predict the outcomes of these events, nor the market's reactions. Rather, we have learnt that the best course of action is to maintain an opportunistic mindset when sentiment seems exaggerated and the short-term noise overshadows long-term fundamentals. Between hype and hesitation, there is alpha to be harvested.

In the next few pages, our Equities, Multi Asset and Convertible Bonds investment teams will explain how they are tackling markets and where they see the opportunities.

I wish you an enjoyable and – hopefully – interesting read.



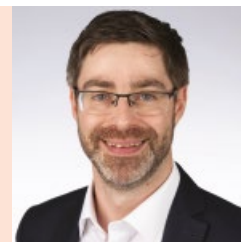
**Fabiana Fedeli**

Chief Investment Officer, Equities,  
Multi Asset and Sustainability



# Multi asset

**Stuart Canning**  
Fund Manager, Multi Asset



## K-Pop: The K-shaped economy and what it tells us

The most striking demonstration of polarisation from a macroeconomic standpoint in the final quarter of 2025 was the emergent narrative of the 'K-shaped' economy in the US.

A quick look at Bloomberg 'story count' for the term 'K-shaped', saw mentions skyrocket from 126 at the end of June 2025 to 3,583 by the end of December 2025<sup>5</sup>. The term suggests a polarised, two-speed economy – the two arms of the letter K reflecting divergent paths – and has been applied in two main areas:

In the real economy ('Main Street'):

- In the US, lower-income households saw smaller wage and spending increases than higher income peers. Research from the Bank of America (BofA) Institute calculated that lower-income versus higher-income households' spending growth was 0.7% versus 2.7% respectively, year-on-year (YoY) through October 2025. Meanwhile, BofA aggregated consumer deposit data showed YoY wage growth of -1.0% versus 3.7% for lower-income versus higher-income households respectively<sup>6</sup>.
- Headline GDP has been strong in spite of signs of job market weakness, with losses concentrated in smaller firms.

In financial markets ('Wall Street'):

- In 2025, large-cap stocks – particularly the 'Magnificent Seven (Mag 7)' (+24.9%) – outperformed small caps (+12.8%) and the broader market (+17.9%) – total return in USD<sup>7</sup>.
- Equity returns were strong despite signs of economic fragility and uncertainty around tariffs, government debt and geopolitics.

### What isn't new...

Many of these dynamics are not a puzzle, or even particularly new:

Inequality between the 'haves and have-nots' has been a decades-old theme, amplified post-financial crisis (though partially reversed during Trump's first term).

Stock divergence in 2025 wasn't unusual, nor was the outperformance of certain higher growth stocks in bull markets.

Even when it comes to the Mag 7, it is true that two stocks (Alphabet and Nvidia) decimated the broader S&P 500 Index returns, but the other five actually underperformed the index.

And lastly, markets rarely mirror Main Street in modern developed economies: the stock market is forward-looking, multinationals earn globally, and discount rates often drive short-term returns just as much as profits.

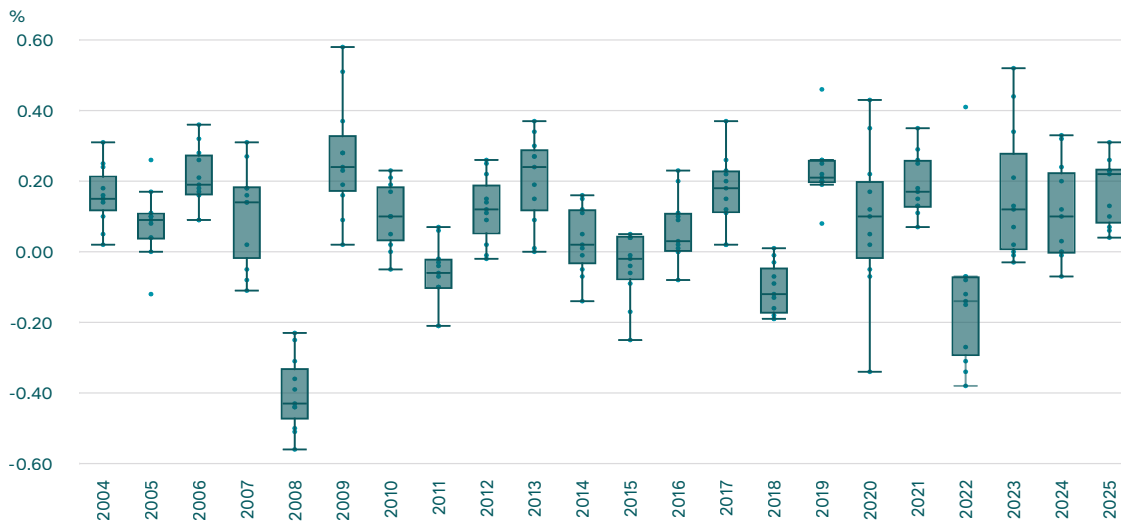
<sup>5</sup>Source: Bloomberg, January 2026.

<sup>6</sup>Source: Bank of America Global Research, 23 November 2025: Year Ahead 2026: K-shaped economies with K-shaped risks.

<sup>7</sup>Source: Bloomberg, 31 December 2025. Annual total returns in USD of the Bloomberg Magnificent 7 Total Return Index, Russell 2000 Total Return Index and S&P 500 Total Return Index.



## S&P 500 Index – sectoral dispersion by calendar year



Source: M&G Investments, Bloomberg, 31 December 2025. The dispersion chart shows the dispersion of returns across global sectors ie, the relationship between financials, communication services, utilities, industrials etc. In the chart, the 'box' represents the interquartile range (the middle 50% of values), while the 'whiskers' represent the rest of the distribution from minimum to maximum values, less any potential outliers.

## ...and what is new

The difference today is, unsurprisingly, the role of AI – and its impact reaches beyond a single quarter:

- AI-related investment accounted for much of US GDP growth in 2025, and may have flipped corporate capital expenditures from negative to positive.
- Profit margins rose for the Mag 7 but fell for the rest of the market<sup>8</sup>.  
Labour market weakness is not seen as a threat to AI profits. While AI didn't cause most of 2025's softness, many expect future gains to come with job erosion.

## Why it matters

The K-shaped narrative may signal deeper changes in how macroeconomic conditions link to asset prices. Historically, Main Street and Wall Street diverged; now 'Cloud Street' adds a structural layer. Employment trends may become even less predictive of profit growth as AI creates near-zero marginal cost substitutes for labour in services. Meanwhile, monetary policy aimed at cushioning jobs could unintentionally inflate valuations in the AI economy.

**“Historically, Main Street and Wall Street diverged; now “Cloud street” adds a structural layer”**

## Redrawing the investment landscape?

Despite the intensification of the K-shaped narrative in the fourth quarter, volatility across most assets was very low and value signals relatively neutral. As such, M&G's Multi Asset strategies made few changes in the quarter and remain relatively neutrally positioned. They maintain a preference for unloved long-dated government bonds in the developed world, as well as long-dated government bonds in emerging markets, an underweight to credit, and neutral exposure to equity markets, with a preference for markets outside the US. Looking ahead, if the K-shape reflects more than a temporary divergence, investors may need to rethink traditional rules of thumb – because in an AI-driven world, the old rules of macro-market linkage may no longer apply.

<sup>8</sup>Source: Bloomberg, Apollo research. Link to data available here: [Apollo Academy](#).



# Global

**Daniel White**  
Head of Global Equities



## The Great Divide: Navigating polarisation in US equities

Global equity markets are living through a paradox. Indices continue to notch record highs, yet beneath the surface lies a stark structural divide.

In US equities, in particular, a 'K-shaped' performance reality has upended traditional investing principles of valuation discipline and diversification. In this new era, narrative-driven strategies and concentrated bets have been the winning formula.

### US Divergence: (AI) Growth vs. Value (and everything else)

At the heart of this polarisation is the widest valuation gap between US Growth and US Value in decades<sup>9</sup>.

The most recent catalyst? The Artificial Intelligence (AI) Supercycle.

A handful of US technology mega-caps have propelled US Growth stocks to unprecedented premiums, dominating market returns and investor attention. Meanwhile, US Value stocks have languished in what can only be described as a 'sentiment desert'.

Historically anchored in cyclical sectors such as energy, financials and industrials, Value is now a much broader and more attractive opportunity set.

Why? Because so many stocks and sectors have been sidelined as capital floods towards the perceived 'limitless' potential of AI.

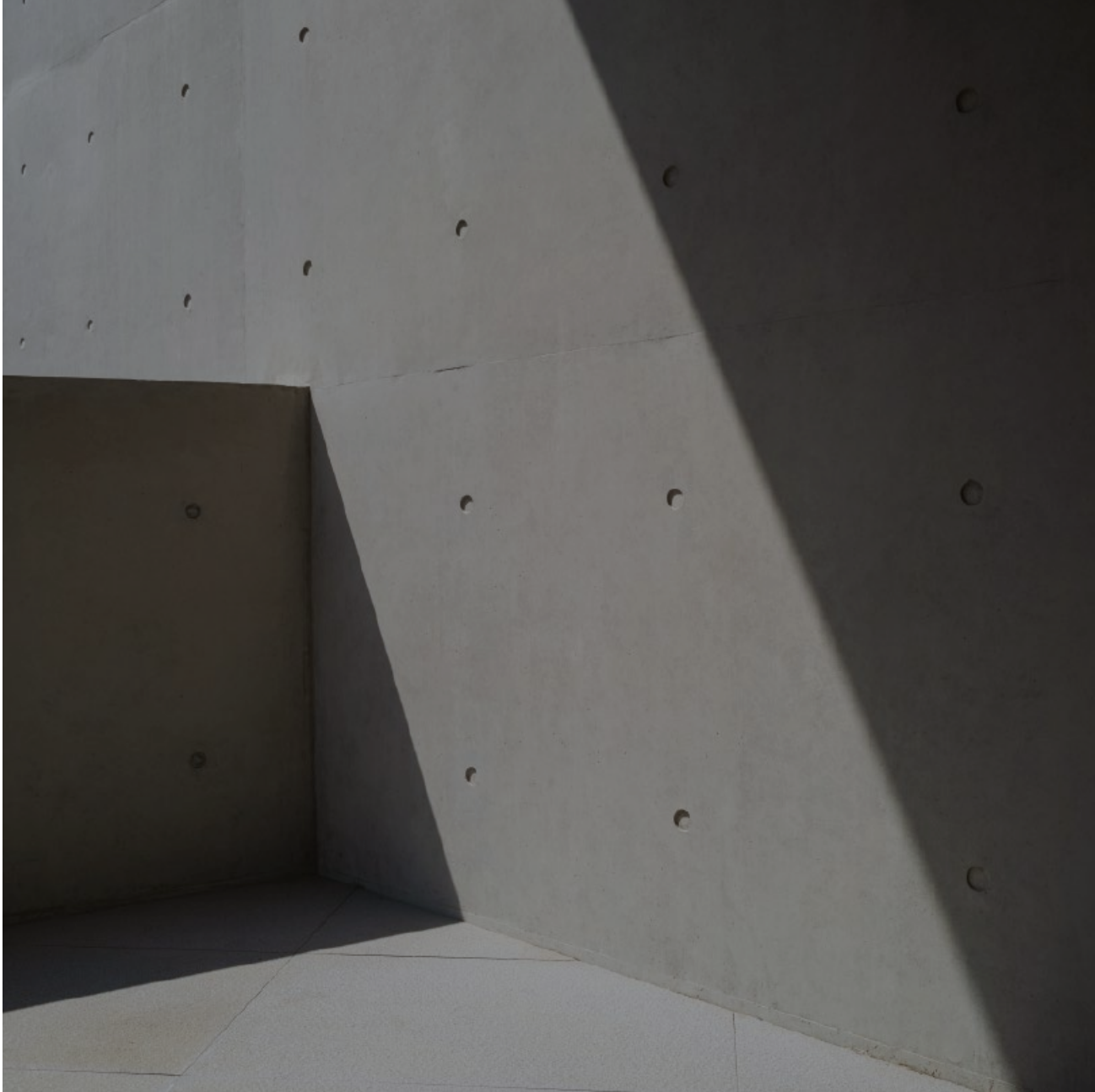
### Risks: Concentration and 'Winner-Takes-All'

This extreme bifurcation introduces significant concentration risk. With a few dominant players accounting for an outsized share of returns in US equity markets, any earnings disappointment or sentiment shift in AI could spark violent market volatility.

The crowded nature of the US Growth trade amplifies this risk. Minor tremors could trigger sharp corrections.

“The crowded nature of the US Growth trade amplifies [concentration] risk. Minor tremors could trigger sharp corrections”

<sup>9</sup>Source: Refinitiv DataStream, 30 September 2025. S&P 500 Index: price-to-book spread between 25 and 75 percentile.



## Opportunities: The rebalancing play

Where there is extreme polarisation, we believe there is opportunity.

'Wide valuation spreads generally mean revert' is not a theoretical statement. There is plenty of historical evidence, and **we've witnessed the Value renaissance across broader regional equity markets in 2025** – not least in European equities, where the investment pendulum has shifted back in favour of Value.

**Increasing breadth in US equities:** As AI moves from 'builders' (the chips) to 'users' (the industries), we are beginning to see a 'broadening out', where traditional sectors have finally begun to capture productivity gains. This could potentially spark a US Value catch-up in 2026.

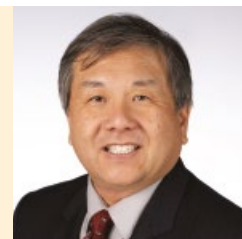
**'AI winners vs AI losers':** We think this characterisation is overly simplistic and prone to large, rapid shifts in sentiment. Take, for example, Alphabet. At the beginning of 2025, it was viewed as an AI loser...until, suddenly, it wasn't. It is these sorts of misconceptions that we think will continue to create attractive bottom-up opportunities as we move through 2026.



# Global technology

Jeffrey Lin

Head of Global Technology Equities



## Jumping to conclusions prematurely based on narratives

Innovation is increasing at an accelerating rate and information travels faster than ever. Capital markets are responding instantaneously to incremental news flow, but conclusions are often incorrect, creating opportunity for thoughtful analysis to separate truth from misunderstood narratives.

Such information flow can change growth expectations positively or negatively, and can increase or decrease cost of capital assumptions, resulting in wide swings in equity values.

In 2025, AI euphoria has lifted many boats, and 2026 could be a reckoning for companies now trading on frothy valuations that are unable to deliver on future earnings growth. Despite the rerating, we believe there are still a number of companies where the true upside driven by AI is underappreciated.

Stocks of companies that are perceived to be threatened by AI quickly see equity values decline as the potential risks are reflected in a higher cost of capital and/or lower growth expectations. If, however, the threats are overstated, this creates an opportunity for above-average returns. In contrast, stocks of companies that are perceived to be AI winners, quickly embed higher long-term growth expectations and/or lower cost of capital assumptions, leading to higher valuations.

## Adding alpha amid fast-changing narratives

Our fundamental investment process remains unchanged. We look for companies with durable long-term growth prospects, and high returns on capital at valuations that offer attractive risk-adjusted returns. We embrace this era of fast-changing narratives, as we believe it provides opportunities to add alpha through more thoughtful analysis, and to differentiate ourselves from passive strategies.

Understanding narratives requires more than simply reacting to 'sound bites', it involves understanding the underlying technology as well as its path to market, and potential revenue models.

An example of this is the DeepSeek 'moment' from early 2025. The narrative was that DeepSeek had developed AI capabilities using significantly fewer computing resources than others building Large Language Models (LLMs), and that this would be negative for AI-enabling companies, as less computing resources were needed. It was also a perceived negative for others developing AI.

Our analysis, however, came to a different conclusion. Our long-term fundamental thesis in computing, is that the addressable market for computing increases as computing power increases and becomes more powerful. Usually, we think of faster semiconductors as the driving force of this dynamic, but more efficient software also increases the power of computing.

We believed correctly that an improvement in utilisation of computing hardware (through better software) would lead to increased demand for enabling hardware, as the capabilities can increase at a higher rate. We also noted that others developing AI were also experiencing improvements in performance through software.



## Tech beyond 2025

Entering 2026, we continue to believe that AI is a durable multi-decade investment opportunity, but security selection will continue to be important to determine which companies will be the actual long-term winners that create long-term wealth.

AI euphoria has attracted capital from investors globally and, while we do expect broad long-term economic tailwinds from AI, there will be companies that will not deliver on the future earnings growth that is embedded at current valuations. A dose of caution and selectivity are warranted. We only seek opportunities where the risk/reward dynamics are favourable over a long-term investment horizon, based on our assessment of a realistic future value if the company can execute.

We believe there are three broad AI investment categories:

- 'AI enablers' that provide the foundational technology for AI. These companies are concentrated in the semiconductor industry.
- 'AI providers' which sell AI products and services (often software companies), and
- 'AI beneficiaries' which sit outside of traditional technology in sectors such as consumer, healthcare, industrials, financials, energy and others. These companies utilise AI to drive better financial results in terms of revenue growth and returns on capital.

## Beware the pitfalls, but the AI revolution continues apace

**Step change in AI capability:** Generative AI evolved into Agentic AI in 2025, with computers now able to think and reason. Going forward, we expect 'Physical' and 'Robotic AI' to be possible by the end of the decade. We are seeing an early glimpse of both, with the fully autonomous Taxis operated by Alphabet's Waymo in multiple cities in the US. We believe humanoid robots are likely to be commercially available in the next two years and have the potential to address physical labour shortages in commercial and consumer applications.

**Improving compute performance:** The technology announcements at the CES trade show in early January 2026 further bolster our enthusiasm for continued gains in computing performance, which will increase the addressable market for computing and AI. The semiconductor industry is using extremely clever engineering to increase compute performance at a higher rate than transistor density improvement by eliminating performance bottlenecks in processing, memory bandwidth and networking interconnect between computers. For example, Nvidia's Vera Rubin GPU, announced at CES, offers 5x better inference performance and 3.5x better training performance with just a 1.6x increase in the number of transistors.

In 2025, AI-enablers enjoyed strong capital appreciation driven by strong growth in revenues and margins. We believe AI-enablers will remain attractive going forward, as long as the pace of increasing levels of computing performance continues.

Over the next few years, we expect AI-related investment opportunities to broaden to encompass an increasing number of AI-beneficiaries and AI-providers, who stand to benefit from the financial tailwinds associated with the use of technology that has been made available through the AI capital investments of others.

We believe all these areas offer upside potential for patient, discerning active investors. And, as we move through 2026, we expect these opportunities to broaden beyond the AI winners of the past few years.

“2026 could be a reckoning for [some] companies now trading on frothy valuations, [but] there are still companies where the true upside driven by AI is underappreciated”



# UK

**Michael Stiasny**  
Head of UK Equities



## Meaningful polarisation below the surface

By the end of 2025, UK equity markets settled into a familiar but increasingly polarised pattern. The overall performance of the FTSE All Share Index was globally competitive, but outcomes beneath the surface diverged meaningfully. Dispersion was evident not only between large and small caps, domestic and international earners, but increasingly within these sub-indices themselves, reflecting the growing importance of valuation for investors. Notably, dispersion extended beyond traditional style dispersion of Value versus Growth, with meaningful polarisation emerging within the UK's quality cohort too.

The FTSE 100 Index outperformed the more domestically focused FTSE 250 Index by c.13% over the year<sup>10</sup>, but this headline performance masked dispersion within the large-cap index. We saw strong performance from sectors such as defence and financials, with more predictable earnings (and even earnings upgrades in many cases).

At the same time, concerns around AI-driven disintermediation contributed to sell-offs in a number of long-established UK quality names, even where underlying fundamentals remained resilient. In many cases, this reflected a reassessment of cash flow duration rather than a deterioration in earnings, as investors questioned the longevity of returns – often for companies that had previously been trading at premium valuations.

More broadly, concerns around policy, regulation and UK demand continued to hang over more domestically-oriented mid- and small-cap companies, reinforcing a market defined by an underlying polarisation in the perception of investors: international companies versus domestically focused ones.

The UK Autumn Budget added another layer to this polarisation. Fiscally cautious in tone, it prioritised credibility with the gilt market. This led to a notable post-Budget relief rally in domestically-exposed companies, which reflected the extremely low starting valuation of that cohort of companies.

**“ In a global market increasingly driven by a [handful] of expensive growth stocks, [UK equities] provide a differentiated and less concentrated source of return ”**

<sup>10</sup>Source: Bloomberg, total returns in sterling, 31 December 2025.



## In 2026, perception will continue to shape valuations

Looking ahead to 2026, it's likely that perception will continue to shape valuations, sometimes more powerfully than fundamentals. Last year, fears around AI-driven disintermediation led to notable sell-offs in a number of UK quality 'darling' names such as RELX, Experian and the London Stock Exchange Group, despite limited evidence of near-term earnings impact.

For investors prepared to look through the narrative, this may start to present opportunities to own high-quality businesses at lower valuations than have historically been seen. Importantly, the case for UK equities in 2026 does not rely on a resurgence in economic growth, but on valuation and diversification. The UK market offers access to globally diversified businesses and exceptionally lowly-valued domestic companies. In a global market increasingly driven by a small number of expensive growth stocks, this can provide a differentiated and less concentrated source of return.

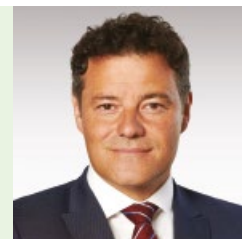
We remain cautious where hype has driven share prices way ahead of the likelihood of delivery, and constructive where investor hesitation has resulted in low valuations versus bear-case fundamentals. In a polarised market, it remains likely that returns will be driven less by broad market momentum and more by disciplined stock selection. Over time, we hope that continued delivery from UK-listed businesses – both international and domestic – will help draw investor attention back toward a UK market that remains differentiated and attractively valued.



# Japan

**Carl Vine**

Co-Head of Asia Pacific Equities



## Japan: Where hype meets execution

In a global market increasingly defined by polarisation, Japan stands out for a different reason. It is one of the few major equity markets where enthusiasm for long-term technology themes is being matched by concrete execution, corporate self-help and balance-sheet change.

Artificial intelligence (AI) sits at the centre of today's global investment debate. Adoption and application are likely to broaden meaningfully in 2026, token<sup>11</sup> demand should accelerate and AI-linked revenues will, in our view, continue to surprise on the upside.

Investor hesitation is nonetheless understandable. A large share of global market capitalisation has already coalesced around a narrow set of AI champions, and parts of that valuation stack look fragile. The tension between a technology still in its early innings and markets that have already priced a great deal of success is a defining feature of the current environment.

Japan offers a useful counterpoint. Whatever the debate around valuation elsewhere, Japan remains a fundamental beneficiary of AI deployment without being narrowly dependent on it. Its listed companies are embedded across the physical supply chain of AI: semiconductors, testing, advanced materials, precision machinery, power electronics and factory automation. As AI moves from model training to real-world deployment, these enabling layers matter more, not less.

Crucially, Japan's equity performance has not been narrowly dependent on this theme. Since the launch of ChatGPT, AI and semiconductor stocks have accounted for less than 30% of the increase in the MSCI Japan Index<sup>12</sup>, less than half the concentration observed in the US. The market has remained broad, rewarding a wide range of structural and company-specific developments beyond

AI. That breadth is one reason Japan's strength in 2025 did not resemble a speculative rerating driven by narrative alone. Equity returns reflected a rare alignment of earnings resilience, capital discipline and structural reform.

### Multiple catalysts for 2026

That same breadth underpins our constructive outlook for Japanese equities in 2026. Corporate behaviour continues to evolve in ways long anticipated but only recently delivered. Share buybacks, balance-sheet optimisation and the unwinding of cross-shareholdings are now commonplace rather than exceptional.

“ [Japanese] equity returns [reflect] a rare alignment of earnings resilience, capital discipline and structural reform ”

<sup>11</sup>In AI, a 'token' is the fundamental unit of text (or data) that models process, acting as a linguistic building block that can be a word, part of a word, punctuation, or even a space, allowing models to understand and generate language by breaking down complex text into manageable pieces. Demand for AI compute is discussed in terms of token demand.

<sup>12</sup>Bloomberg, M&G Investments, 31 December 2025.





“ [In Japan]...  
exposure to  
global technology  
investment is  
grounded in physical  
demand rather  
than speculative  
adoption curves ”

Inflation, once a chronic headwind, is acting as a catalyst, forcing capital out of idle cash and into productive use. Combined with rising wages and a gradual recovery in corporate confidence, we believe this repair of animal spirits within the corporate sector is supportive not just of index-level returns, but of a fertile environment for alpha-oriented stock pickers.

### Opportunities and risks in 2026?

A particularly important extension of the AI theme is robotics, which we see as a growing beneficiary of AI technology and a clear area to watch in Japan in 2026. Labour scarcity, demographic pressure and rising wage costs are no longer abstract issues in Japan; they are operational constraints. The response is accelerating investment in automation, sensing, control systems and intelligent machines. Japan's depth across industrial robotics, components and precision manufacturing, positions it unusually well to monetise this shift, translating AI capability into real-world productivity gains.

Policy remains an important backdrop. Fiscal support has been tilted toward strategic capacity building rather than indiscriminate stimulus, while the Bank of Japan has begun to normalise policy without undermining growth or financial stability. Late in 2025, markets were also reminded of Japan's geopolitical position and how that may evolve under new political leadership. This bears watching, alongside the inevitable debate around rates and foreign exchange.

Risks remain. Japan is not insulated from a global slowdown, an abrupt currency move or a sharper rise in bond yields. But the starting point is materially stronger than in prior cycles. Nominal growth has returned, corporate incentives are better aligned with shareholders, and exposure to global technology investment is grounded in physical demand rather than speculative adoption curves.

In a world oscillating between hype and hesitation, Japan offers something rarer: a market where long-term themes are being translated into broad-based, near-term outcomes. That does not eliminate risk, but it does support a solid fundamental case for Japanese equities as we move into 2026.



# Asia Pacific ex Japan

David Perrett

Co-Head of Asia Pacific Equities



## Strong regional returns in 2025, but sharply divergent returns by market

2025 was a strong year for Asia Pacific ex Japan equity markets with the MSCI Asia Pacific ex Japan Index returning c.21% (total returns in sterling terms) and c.30% (total returns in USD terms). Index returns were driven by large cap technology companies, with leading semiconductor manufacturer SK Hynix rallying c.279% (total returns in local currency terms), while Samsung Electronics advanced c.130%. As a result, the Korean KOSPI Index was the best regional market rising more than 78%<sup>13</sup>.

The MSCI China and Taiwan indices both rose more than 30% (total returns in US dollar terms), again led by technology heavyweights like TSMC and Alibaba, which rallied more than 45% and close to 80% respectively (total returns in US dollar terms). In contrast, a number of South East Asian markets such as Thailand, the Philippines and Malaysia ended the year in low single digits or down (total returns in local currency terms). Across South East Asia, domestic demand was a little softer than expected, but the lack of technology exposure in their indices was the main drag. Australia and India also materially lagged broader regional performance. Technology was one factor driving the divergence in returns but, ultimately, earnings delivery compared to expectations was key in 2025.

### Earnings delivery was key in 2025

Technology stocks, especially semiconductor-related names, saw strong share price performance, but this was driven by huge earnings upgrades through the year. Initially, earnings strength was driven by demand for High Bandwidth Memory chips used in AI data centres but, as the year progressed, prices for legacy semiconductors also began to rise sharply.

This explains why Samsung Electronics, despite strong share performance, is trading on c.10x 2026 consensus earnings and SK Hynix trades on a little over mid-single digit multiples<sup>14</sup>. Earnings upgrades were also delivered by the likes of TSMC, Hon Hai and Delta Electronics in Taiwan.

In China, the picture was more mixed, with Tencent seeing consistent earnings upgrades, while Alibaba did not – although the latter started from a valuation and sentiment position which was relatively depressed and, thus, did not require too much good news to rally.

What is interesting is that a number of non-technology stocks also rallied strongly through 2025. There were a cohort of industrial stocks that started 2025 under a Trump tariff-related cloud, despite their core businesses performing well and being largely unaffected by trade policy changes. As the year progressed, and these companies met or exceeded earnings expectations, these stocks performed strongly.

In addition, a number of companies were able to adapt their business models to changing consumer tastes, especially in China. Operationally, these companies were executing well, but it was only when they delivered strong earnings that the market looked beyond near-term negative macro-related headlines and focused on profit delivery. In contrast, companies that struggled to deliver earnings in 2025 saw their share prices lag. Earnings delivery versus expectations will likely be the key driver of performance again in 2026.

<sup>13</sup>Source: Bloomberg, 31 December 2025. All returns in this section are total returns in local currency unless otherwise stated in text.

<sup>14</sup>Source: Bloomberg, 5 January 2026.



“ Technology was one factor driving the divergence in returns but, ultimately, earnings delivery compared to expectations was key in 2025 ”

### **Polarised expectations create bottom-up opportunities**

As we enter 2026, earnings momentum from a number of technology stocks remains very strong. While earnings-based valuations, in some cases, appear undemanding, the reality is that many businesses are enjoying peak or close to peak margins driven by a sharp jump in pricing. At some point there is a real risk that higher prices will lead to demand destruction, as customers balk at paying higher prices for everything from consumer electronics to PCs and mobile phones. The companies, and markets more broadly, are aware of this demand risk, but the allure of an extended cycle can be very powerful to all involved, heightening risks for investors.

In contrast, across Asia Pacific ex Japan there are a number of stocks, which would have previously been perceived as quality, steady growth companies in sectors like consumer staples, telecommunications or niche industrials, that have been de-rated materially in the last 18 months, despite steady earnings delivery. One senses this de-rating has been partly a reflexive move, as these prior ‘darlings’ have been replaced in the mind of investors by AI-related stocks and, thus, we have seen a dramatic shift in relative risk premia and valuation. Importantly, these previous darlings have done nothing wrong in terms of earnings delivery; their crime has been to simply fall from investors’ favour.

Historically, the valuations of these companies were a little too rich for our liking, but that is no longer the case today, where the set up around the risk of ownership now looks attractive – with steady earnings delivery at a time when investor expectations have been ratcheted down materially. A set up that feels in stark contrast to the current sentiment toward many technology stocks, providing fertile ground for alpha generation opportunities.



# Emerging markets

**Michael Bourke**

Head of Emerging Market Equities



## Polarisation: Hype and Hesitation in Emerging Markets

**Polarisation is no longer a peripheral feature of emerging market investing – it has become the defining driver of markets today.** This is not merely a thematic observation about political fissures or geopolitical divides, though these certainly exist. Rather, it describes a structural fragmentation of emerging markets into radically divergent value regimes, growth trajectories and narrative-driven performance paths. The year 2025 crystallised this reality in ways previous market cycles obscured.

Consider the data: whilst the MSCI Emerging Markets (EM) Index posted its strongest return in seven years at c.34% (total return in USD terms), this headline figure masks profound dispersion. China staged a double-digit rally fuelled by targeted stimulus and artificial intelligence (AI) optimism (eg, DeepSeek). In some areas of the market, the share price uplift was warranted. For example, this was the case for a number of semiconductor-related companies backed by strong earnings, along with those evolving and adapting their business models to changing consumer tastes. However, underlying earnings in aggregate remained under pressure, with household consumption stubbornly weak.

India, the second-largest EM economy, underperformed materially as foreign capital fled and valuations, once celebrated as structural compounders, came under scrutiny. The Rupee was the weakest Asian currency over 2025 (-4.75%)<sup>15</sup>, despite the dollar weakness feeding EM currency strength elsewhere.

Korea experienced its strongest year since 1999, with the KOSPI Index up 78% (total return in local currency terms), propelled by the twin engines of AI and 'value-up' corporate reforms. In a single year, divergence – not convergence – became the defining characteristic of emerging markets.

### Fragmentation extends beyond geography

Within single countries, the market obsessively chased AI narratives, sending mega-cap technology stocks skyward on productivity stories, whilst undervalued real estate, utility and industrial companies languished.

When Alibaba surged more than 50% (total return in USD terms) in the month of September following an AI-related announcement, the market priced euphoria rather than fundamentals, as the heightened sensitivity to upside surprises met depressed fundamentals. A 20% earnings decline and a rapid expansion of capital expenditure with undefined RoI (Return on Investment) seemed irrelevant to momentum here.

These are not marginal dislocations in our view; they represent a market increasingly stratified between 'hype' and 'hesitation' – between narratives that command premium valuations and opportunities that demand contrarian conviction. The gap between the sector leaders and laggards in 2025 (total net returns in USD) – materials (+62.5%) and technology (+54.3%) versus real estate (+5.4%) and consumer staples (+6.6%) – is stunning.

<sup>15</sup>Source: Bloomberg, 31 December 2025. Spot rate versus US dollar.



**The narrative dimension is material to valuations.**

The valuation gap between the S&P 500 Index at c.22.1x forward earnings and MSCI EM at c.13.4x<sup>16</sup> remains substantial, yet this discount has compressed meaningfully whilst earnings growth remains modest: +1-2% revisions despite the equity outperformance. This suggests markets are pricing narrative momentum and USD weakness rather than earnings acceleration.

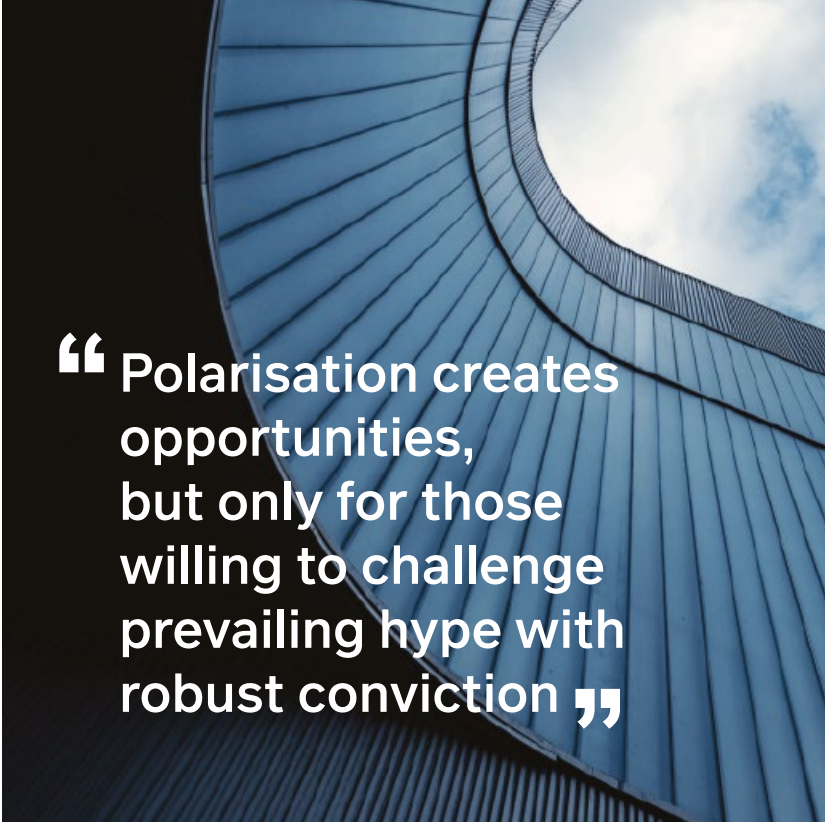
**Our approach to navigating this polarised landscape rests on three pillars:**

First, we reject broad-based EM beta exposure. Treating emerging markets as a homogeneous asset class invites severe mismeasurement of risk. Instead, we conduct granular inflation-adjusted RoIC (Return on Invested Capital) assessments across companies, recognising that geopolitical, policy, and commodity dynamics create fundamentally different return distributions across markets. Stripping the nominal noise associated with currency exposures isolates the real value creation and enhances comparability across borders. Taiwan and South Korea deserve entirely different risk frameworks from Turkey and Argentina, given the radically different inflation conditions in the latter duo.

Second, we remain highly attentive to narrative traps. The AI enthusiasm offers instructive lessons: whilst the AI capex cycle will genuinely shape medium-term productivity and earnings, markets have priced these gains indiscriminately into mega-cap technology stocks trading at stretched valuations with uneven earnings support. The contrarian opportunity often lies in underappreciated narratives – Latin American equities benefiting from political reform cycles or financials and real estate names benefiting from emerging market monetary easing as the dollar fades and the Federal Reserve comes under rising pressure from the White House to cut interest rates.

Third, we position for non-linearity and regime shifts. Polarisation implies that smooth, concurrent trends across emerging markets are no longer reliable. Elections, geopolitical shocks, policy pivots, and commodity swings will drive radically different outcomes across markets and sectors. We position for low correlations and seek high idiosyncratic risk/reward through active, dynamic portfolio management – not static exposures.

The emerging markets that will outperform in 2026 will likely be those where we've identified genuine misalignment between market narratives and fundamental trajectories. Polarisation creates precisely such opportunities, but only for those willing to challenge prevailing hype with robust conviction.



**“Polarisation creates opportunities, but only for those willing to challenge prevailing hype with robust conviction”**

<sup>16</sup>Source: Bloomberg, 5 January 2026. 12 month forward price/earnings.



# Impact

**John William Olsen**  
Head of Impact Equities



## Shifts in politics and technology shaping market behaviour

Shifting narratives have been shaping and shaking valuations in the most dramatic fashion since the late 1990s. More recently, rapid and erratic changes in US government policy messaging, coupled with an evolving Artificial Intelligence (AI) technology shift, has led to a shortening of investment time horizons and extreme momentum-driven stock price movements. We have all observed the market noise and extraordinary volatility of 2025, so rather than providing a recap, I will focus on both the consequences and the opportunities.

Policy changes and a shifting technology landscape create increased volatility, and it can be difficult to navigate them in the short-term, but they also open up opportunities.

### The evolution of hype and hesitation

Uncertainty would normally lead to risk aversion and shrinking multiples, but a general appetite for speculative investments, an ample supply of liquidity and risk-willing investment capital, coupled with hardware bottlenecks and lofty expectations for some technology areas, have brought about this hype and hesitation phenomenon.

The average holding period in our concentrated Sustain and Impact strategies remains close to ten years, which affects our ability to target short-term relative performance, but our process sets us up well to take advantage of longer-term risk/return opportunities when fear and greed take control and momentum becomes self-reinforcing.


One part of the market that has been left behind is the somewhat unexciting, high-quality companies with high return on capital and good long-term defensive characteristics. Even more so, if stocks got (unjustifiably) caught up in a tariff, policy or tech narrative. In 2025, Quality companies suffered their worst relative declines in developed markets in more than two decades<sup>17</sup>. This is happy hunting grounds for our team, and we rarely see this part of the market underperform for a prolonged period of time.

We have taken advantage of the volatility over the course of 2025, adding opportunistically to some technology and healthcare exposures earlier in the year – while staying away from areas of the market that exhibited exuberance. In the final quarter of 2025, we added exposure to some European internet commerce companies with, in our view, strong market positions, an ability to overcome disruptive threats, high free cash flow yields, and compelling valuations – with the potential to become much larger companies in the future.

### Key market influences in 2026

We expect an equally lively year in 2026, where technology bottlenecks will tighten or inflect negatively. Geopolitical tensions, private debt rumblings, and news flow on mega IPOs (initial public offerings) have the potential to affect sentiment – along with the added noise from mid-term elections in the US in the latter part of the year. We don't believe in our ability to predict the outcomes of these events, nor the market's reactions, but we will maintain an opportunistic mindset when sentiment seems exaggerated and the short-term noise overshadows long-term fundamentals.

<sup>17</sup>Source: Bloomberg, 31 December 2025. MSCI Quality Index relative to the broader MSCI World Index – total returns in USD.



“ [In 2026] we will maintain an opportunistic mindset when sentiment seems exaggerated and the short-term noise overshadows long-term fundamentals ”



# Global research

**Edward Morris**  
Global Financials Analyst



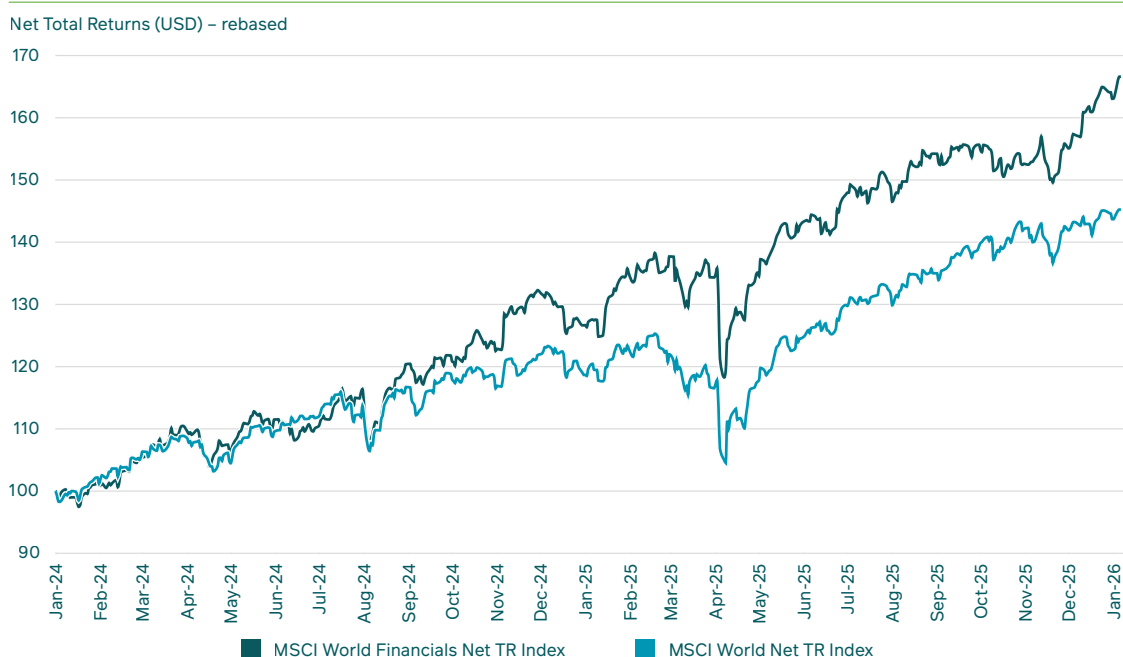
## Regime change in Global Financials

Global Financials have gone from unloved to 'must own' in recent years, owing much to the benefit of higher interest rates. Banks' net interest margins have been reinvigorated, insurers have seen their investment returns transformed, and return on equity across the sector has vastly improved.

For other parts of the sector, the experience has been more mixed. Real Estate investors have had to contend with sharply higher financing costs, and so too has Private Equity, resulting in subdued exit activity across the industry and a more selective fundraising market.

With interest rates now on a downward path, it begs the question of whether some of these sector dynamics will start to unwind. The actual inflection point in rates occurred some time ago of course, but in practice it can take time to fully transmit and, in many cases, the effects are yet to be felt.

### Global Financials have outperformed over the past two years



Source: Bloomberg, Net Total Return Indices in USD. Rebased to 1 Jan 2024. Past performance is not a guide to future performance.

The dilemma for many financials investors is to determine how long to enjoy this period of supernormal returns before pivoting to a more neutral sector stance. Or is the change sufficiently large that a more dramatic repositioning is required? Not yet, in our view, but one area where the balance may have tipped is in global P&C (Property & Casualty Insurance)<sup>18</sup> markets, where weak pricing trends are also weighing on the returns outlook.

<sup>18</sup>P&C is a broad term used for all the types of insurance that are designed to protect your physical assets or cover your liability. Separate from life and health insurance designed to cover only the insured individual.





“ We see scope for... attractive buying opportunities [among private markets managers], and for dispersion between manager performance to become wider ”

### Market polarisation may offer opportunities

Last year demonstrated how rapid changes in market perceptions can be. The financial sector sold off sharply during the post-Liberation Day period, with some of the largest drawdowns coming from the private markets managers. This is a group arguably more at risk of shifts in 'sentiment' given the lack of directly observable prices for their assets.

Latterly, the concerns for this sub-sector have been more focused on Private Credit. This is an area where profitability has benefited from higher rates, given its largely floating rate nature. Tighter regulation of banks increased the market size, which will remain significant even after the US relaxation of Basel III<sup>19</sup> bank capital requirements. Investor demand has been driven not only by a search for yield from traditional fixed income investors, but also in some cases a desire to de-risk from concentrated equity allocations.

Direct lending portfolios attract much of the attention and, contrary to general perception, loss experience in these portfolios has so far been remarkably benign. The spreads available – a multiple of those available in public High Yield markets – are such that periodic defaults are to be expected. With many new entrants in the market it seems likely that the next five years will be more eventful than the last.

This need not be overly concerning, as key protections stem from diversification, capital structure seniority, and strong covenants that allow problem assets to be managed for value. Nevertheless, as public market investors we need to be mindful of how future headlines may be perceived. Where credit events have occurred they have generated significant media hysteria and, historically, some attractive buying opportunities.

We see scope for this to recur, and for dispersion between manager performance to become wider. Our preference, when valuation permits, is for the most experienced private markets managers that have successfully navigated past credit cycles.

<sup>19</sup>Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision and risk management of banks.



# Convertibles

**Leonard Vinville**  
Head of Convertibles



## Aim to fly high but don't forget your parachute

We expect the Convertibles market in 2026 to continue to evolve along multiple fronts, with artificial intelligence (AI) remaining a dominant theme. Given the bifurcated market backdrop, with geopolitical and macroeconomic uncertainties on the one hand, and euphoric valuations on the other, our strategy focuses on achieving asymmetric returns while protecting against market volatility through investments in businesses with strong fundamentals, solid credit quality, bond floors, moderate valuations and attractive convertible terms.

### Convertibles market polarised along multiple lines

Last year, we witnessed strong momentum in many US growth names fuelled by euphoria around AI 'builders'. Investments by the large hyperscalers flowed into data centre providers and equipment makers and boosted capital expenditure in IT infrastructure based on high expectations for future demand.

Valuations in this area grew increasingly frothy and questions remain around the monetisation of AI investments, the ability to fund such investments and the potential growth opportunity. At the same time 'AI application providers' have not yet fully articulated their business models and demand. While clear 'AI beneficiaries' have been slower to emerge, the market has already punished, often unjustifiably, firms seen to be at danger of being replaced by AI, offering cheap valuation opportunities.

### Preference for established and reasonably-priced AI plays

We believe that AI is set to permeate nearly every aspect of life. While AI stocks carry inherent risks, not investing in AI is a risk too. We aim to invest selectively in the AI space in companies with clear, sustainable business models and secured funding, particularly those benefiting from AI infrastructure build-outs.

In 2025, leading stock performers in convertibles included Lumentum (optical networking), IREN, Applied Digital, Nebius (HPC data centres), Bloom Energy (alternative energy), and storage/memory makers like Western Digital, SK Hynix and Seagate. We favour firms with solid fundamentals and earnings support rather than speculative ventures reliant on long-term bullish assumptions.

We believe the current AI capital expenditure spree is unsustainable and will eventually moderate. In addition, we see opportunities in indirect plays beyond pure tech, such as electric cable manufacturers, utility efficiency providers, and engineering services for nuclear power to support rising AI-driven electricity demand.

“We favour firms with solid fundamentals and earnings support rather than speculative ventures reliant on long-term bullish assumptions”

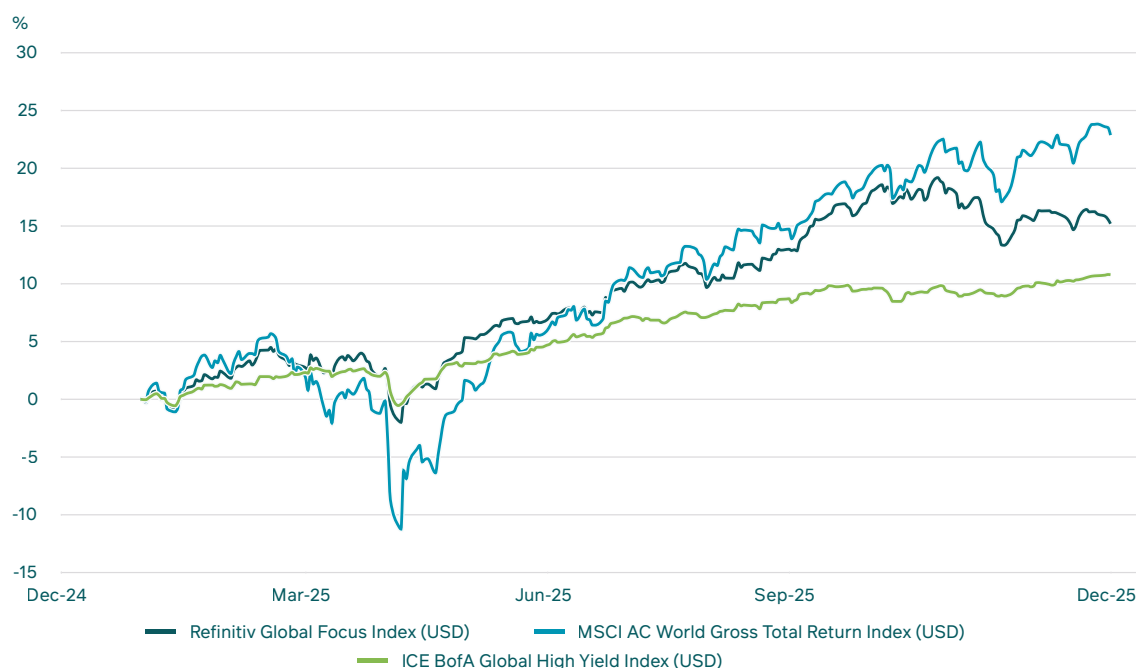
## Seeking value amid euphoria and momentum

We believe market momentum, FOMO (fear of missing out), and euphoria will persist in 2026. We target companies leveraging AI operationally and those undervalued due to perceived AI competition risks. We note that software valuations appear broadly more attractive than hardware/semiconductors. Beyond the US, we identify compelling opportunities in Asia tech and in Europe across defensive, undervalued sectors such as real estate, consumer and healthcare. Also within healthcare, we see strong potential in idiosyncratic biotechnology companies with proven drugs and not yet fully-priced diversified pipelines.

## Don't forget your parachute – maintaining downside protection

Convertibles delivered robust equity participation (67%) during 2025<sup>20</sup>. In 2026, amid divergent markets, we aim for similarly high equity upside participation while ensuring we are sufficiently protected against equity downside. Given our expectations of further market volatility in 2026 and sizeable dislocations, it is important for us to be highly selective in choosing the most appealing convertible characteristics: focusing on fundamentals; having strong credit quality and bond floors; seeking cheap or moderate valuations less vulnerable to changes in market sentiment. Our overarching goal is to pursue asymmetric investments where potential upside significantly outweighs downside risk.

### 2025 convertibles return was a high 67% of global equities



Source: Bloomberg, LSEG, January 2026. Convertibles represented by the Refinitiv Global Focus Index (USD). Global equities represented by the MSCI AC World Gross Total Return Index (USD). Past performance is not a guide to future performance.

<sup>20</sup>Gross total returns, FTSE Global Focus Convertible Index, MSCI ACWI index, in USD.



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