

# Different Worlds

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## 2026 Mid-year Global Investment Outlook

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# Foreword



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# Foreword from our Chief Investment Officer

Welcome to our mid-year 2026 Global Investment Outlook: *'Different Worlds'* reflecting a market environment in which the macro and market signals no longer tell a simple, single narrative.

In the first half of 2026, markets treaded a path harder to read, but as we approach mid-year, they are now telling a different story. Equity indices have reached new highs, credit spreads remain tight, volatility is subdued, and emerging markets have held up better than many traditional risk-off playbooks would suggest. Markets are absorbing a fresh set of shocks but are balanced with unusually powerful offsets. Supply shocks, particularly in energy, are tightening financial conditions and weighing on growth expectations, especially for energy importing economies.

At the same time, China's industrial competitiveness continues to exert disinflationary pressure on global goods markets, while a once in a generation investment cycle in artificial intelligence is supporting profits, driving capital expenditure, and sustaining market momentum.

What stands out is how narrow, yet powerful, this cycle remains. A relatively small part of the economy, largely AI related investment, is contributing disproportionately to growth, particularly in the US. Elsewhere, consumer demand, non tech investment and parts of the labour market appear more fragile.

This creates a K-shaped dynamic that helps explain both the resilience and vulnerability of the current cycle.

The central point is therefore not the economy's aggregate strength or weakness. It is where strength is concentrated, whether it can broaden, and how long markets can look through shocks if profits continue to validate valuations.

This is why the broadening out theme remains important. The case is no longer simply about non-US markets catching up after years of underperformance.

It is about whether earnings strength can extend beyond a narrow AI led core into emerging markets, industrials, commodities and other parts of the global equity universe.

Fixed income faces a similar recalibration. Higher oil prices and renewed inflation pressure have led markets to reassess rate paths, particularly in Europe and the UK. Yet even as policy expectations have shifted, long term real yields have not risen enough to undermine valuations outright. Moreover, higher nominal yields are creating income potential across rates, credit, and emerging market debt that is fundamentally different from the ultra-low rate environment of the 2010s.

Against this backdrop, the key question for investors is not whether risks exist, they clearly do, but how they interact. The balance between shock and expansion, concentration and broadening, resilience and vulnerability will define the next phase of the cycle.

In the pages ahead, we explore these themes in greater depth and assess how markets are pricing this complex environment. We examine how credit transmission operates in a supply-constrained world, how energy shocks are reshaping Asian markets, and what is driving the next phase of equity performance broadening.

I hope you find this outlook a useful resource for navigating these different worlds.

**"We are no longer reading a single market narrative; we are navigating different worlds that coexist in the same cycle."**



**Xavier Baraton**  
Chief Investment Officer

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# Macro outlook and market implications



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# Macro outlook and market implications

The second half of 2026 begins with a gap between what the economy is facing and what markets are pricing.

Oil prices have risen, commodity supply is less secure, geopolitical risks remain elevated, and central banks are again being pulled between inflation concerns and weaker growth. Fiscal policy is also playing a larger role across many developed economies as governments increase spending on defence, renewables and energy security.

At the same time, China's export strength in advanced technology and higher value manufacturing is helping to absorb some inflationary pressures, but it is also putting pressure on competitors' margins. Add to this the scale of AI related investment in the US, and the disconnect between the economy and markets becomes easier to understand.

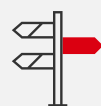
In other words, the global economy is being shaped by two supply side shocks and one offset. The oil shock hurts growth and adds to inflation, especially for energy importing regions such as Europe and parts of Asia. China's export strength is a disinflationary force, but also a competitive challenge. The AI boom is the offset, supporting growth, profits and market leadership, even as parts of consumption, labour markets and non tech investment look less convincing.

That has made profits and discount rates especially important in the current cycle. Markets have stayed resilient because earnings have been strong, particularly in technology and AI related sectors, while real yields and discount rates have not risen enough — despite higher bond yields — to undermine valuations. This has given markets room to look through some of the macro noise, but the next test is whether the AI boom spreads further.

We still think the broadening out theme can work, but it needs to be more targeted than last year. This is not simply about non-US markets catching up. It is broadening beyond borders, where spillovers from the AI buildout spread into adjacent areas such as infrastructure, utilities, materials, and industrials, while selected emerging markets benefit from technology exposure, resources, cheaper valuations and stronger domestic investor bases.

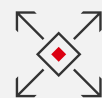
In such an environment, diversification has to work harder. More active fiscal policy, more volatile inflation and less reliable stock-bond correlation make simple duration exposure less dependable than in the last cycle. However, higher yields also create a better income backdrop. That is the shift from yield to opportunity, using income more deliberately rather than relying only on equity gains or multiple expansion. The playbook, while narrower, therefore requires more selectivity.

## Key themes



### Two shocks and a boom

Economy shaped by supply-side shocks and the AI boom



### Broadening beyond borders

A different, more selective, kind of broadening out in 2026



### Yield to opportunity

In a fragmented world order, which diversifiers can investors rely on?

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## Scenarios

Our scenario framework explores three possible paths, depending on whether the oil shock fades, the AI investment cycle spreads, or supply side risks intensify.

In our central scenario, Broadening out, the oil price shock recedes broadly in line with futures pricing, limiting the damage to growth. Energy prices remain volatile in the near term but gradually stabilise. Central banks remain cautious, particularly in Europe and the UK, where markets have priced a more hawkish policy path.

However, weaker growth limits how far policy can tighten. In the US, inflation remains above target for now, but services inflation has eased, and wage growth does not appear to be creating a renewed inflation cycle. This leaves room for modest policy easing once energy and tariff effects fade.

In this central case, AI capex continues to support growth and profits, but the benefit spreads selectively. Equity leadership broadens but remains focused on areas linked to the AI boom and its spillovers. That includes semiconductors, infrastructure, utilities, industrial supply chains and selected emerging markets. Europe and parts of Asia remain more exposed to higher energy costs. This is neither a return to US exceptionalism nor a broad rotation away from the US. It is a targeted, profits led broadening.

An upside scenario sees the AI boom develop into a broader investment led expansion. Capex becomes large enough to lift corporate confidence, widen productivity gains and allow US growth to rise towards 3%. This would be a strong environment for risk assets, with regions linked to AI supply chains, energy infrastructure and industrial capex likely to benefit most. However, stronger growth could eventually revive inflation pressure and limit central bank flexibility.

The downside scenario, Shockwave, would occur if supply side risks intensify. Oil prices stay elevated, shipping disruption persists, or inflation pressure proves more lasting. Higher energy costs would squeeze margins, weaken consumption and weigh most heavily on energy importing economies. Central banks would then face a harder balance between protecting inflation credibility and avoiding unnecessary damage to growth. For markets, the damage to risk assets could be significant, especially because valuations and credit spreads already assume a relatively benign outcome. In this environment, some traditional hedging strategies may also prove less reliable.

These scenarios are not entirely separate outcomes. Elements of each are visible today but the key question is which force becomes dominant from here. That is why the outlook is less about making one bold macro call and more about identifying where earnings are resilient, where AI related growth is still spreading, and where valuations leave too little room for disappointment.

Figure 1: Macro and market scenarios

|        | Shockwave<br>Pessimistic scenario   | Broadening out<br>Baseline scenario  | Boom boom<br>Optimistic scenario   |
|--------|---|--|--|
| Macro  | <ul style="list-style-type: none"> <li>Driving forces: Supply side shocks collide with unbalanced growth</li> <li>Growth: Sharp slowdown as households retrench and profits disappoint</li> <li>Inflation: Uncomfortably high inflation but recession destroys demand</li> <li>Policy: Initially more cautious Fed, but then big easing amid growth damage</li> </ul> | <ul style="list-style-type: none"> <li>Driving forces: AI strength gradually broadens out, oil shock moderates</li> <li>Growth: US growth around 2.0%, becomes more balanced. Other DMs strengthen into 2027</li> <li>Inflation: US core rate around 2.5% but easing. Approaching target in many DMs/EMs</li> <li>Policy: Fed cuts to neutral (3.25-3.75%). Modest easing across many DMs/EMs</li> </ul> | <ul style="list-style-type: none"> <li>Driving forces: Surging AI investment and wealth effects create broader economic boom</li> <li>Growth: US reaccelerates to around 3.0%. Animal spirits and AI boost global growth</li> <li>Inflation: Strong, broad-based demand keeps US core inflation around 2.5-3.0%</li> <li>Policy: Easing cycle cut short but Fed accommodates above-target inflation</li> </ul> |
| Market | <ul style="list-style-type: none"> <li>Stocks: Historic SPX bear market. Cyclical most vulnerable. VIX spike</li> <li>Fixed Income: Curve steepens as longer-dated yields sticky. Credit spreads widen</li> <li>Emerging markets: EMs hit, but find support if Fed can cut and US yields fall</li> </ul>  | <ul style="list-style-type: none"> <li>Stocks: Broadening out of market leadership amid AI spillovers, episodic volatility</li> <li>Fixed Income: Range-bound yields. Some upside risk to credit spreads. IG as bond substitute</li> <li>Emerging markets: EM bull market on Asia tech exposure, strong growth, and low valuations</li> </ul>  | <ul style="list-style-type: none"> <li>Stocks: US outperforms. SPX 8000+. Korea/Taiwan/high-beta stocks shine</li> <li>Fixed Income: Some upside risk to yields as growth remains strong. Credit spreads still tight</li> <li>Emerging markets: EM gains on +ve risk appetite/Asia tech but limited by USD performance</li> </ul>  |

Source: HSBC AM, June 2026. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target. The level of yield is not guaranteed and may rise or fall in the future. For informational purposes only and should not be construed as a recommendation to invest in the specific country, product, strategy, sector, or security.



## Market implications

Markets have stayed resilient despite a more difficult macro backdrop, but the opportunity set is becoming narrower and more selective.

The Middle East conflict, volatile oil prices and more hawkish central banks are not an easy backdrop for a broad market rally. However, the AI capex boom continues to provide an important offset. The first stage of this boom has been led by the most obvious AI winners, but the next stage is likely to depend on whether the benefits spread into adjacent areas. Infrastructure, utilities, selected industrials and parts of the power and energy system are all central to the AI buildout, and some of these areas also offer more defensive growth characteristics in a less predictable macro environment.

In equities, this argues for selective exposure rather than a wholesale rotation. Momentum in the leading AI names remains powerful, but crowding risk is also higher. A broader approach across quality, income and selected AI adjacent sectors may offer a better balance. Equity income also has a role, as dividends tend to be less volatile than profits during more uncertain periods.

Emerging and frontier markets are also an important part of this broader opportunity set. They should not be seen simply as another technology trade, even though North Asia benefits from the AI and semiconductor cycle. EM equities trade on much lower multiples than the US, positioning remains relatively light, and a weaker dollar would provide further support. There is also greater diversification within the asset class than in previous cycles, with Korea benefiting from AI chipmakers, Latin America from resources, and India lagging because of valuation concerns and oil sensitivity. That dispersion creates room for active selection.

The same argument applies in fixed income. EM debt continues to offer attractive diversification and return potential, particularly outside the Asian economies most exposed to oil price spikes. In developed markets, higher US and European yields create opportunities, especially where policy rate expectations already look demanding and duration can rally if growth disappoints.

On the credit side, more selectivity is required. Spreads are tight, but defaults and rating migration remain subdued, profits are strong, and balance sheets are generally solid. That supports an income first approach across public credit, while private credit, trade finance and NAV finance can potentially offer attractive yields with lower duration.

Overall, the market backdrop still supports risk taking, but the playbook is narrower. It needs focus on durable profits, reasonable valuations, diversified income and areas where structural themes are supported by real cash flow.

Figure 2: Views per asset class (▲ Positive / ↔ Neutral / ▼ Negative bias)

| Equities               |      | Government bonds       |      | Corporate bonds         |      | Commodities, alternatives and FX |      | Asian assets              |      |
|------------------------|------|------------------------|------|-------------------------|------|----------------------------------|------|---------------------------|------|
| Asset Class            | View | Asset Class            | View | Asset Class             | View | Asset Class                      | View | Asset Class               | View |
| Developed markets (DM) | ↔/▲  | Developed markets (DM) | ↔/▲  | Global investment grade | ↔/▲  | Gold                             | ▲    | Pan-Asia government bonds | ↔/▲  |
| US                     | ↔    | US10yr                 | ↔/▲  | USD IG                  | ↔/▲  | Oil                              | ▼    | Asia ex-Japan equities    | ▲    |
| UK                     | ↔    | UK10yr                 | ▲    | Asia IG                 | ↔/▲  | Private credit                   | ▲    | China                     | ▲    |
| Eurozone               | ↔    | German 10yr            | ▲    | Global high-yield       | ↔    | Infrastructure                   | ▲▲   | India                     | ▲    |
| Japan                  | ↔/▲  | Japan                  | ▼    | US HY                   | ↔    | Hedge funds                      | ▲▲   | Hong Kong                 | ▲    |
| Emerging markets (EM)  | ▲    | Inflation-linked       | ↔    | Asia HY                 | ↔/▲  | Private equity                   | ▲    | Asia FX                   | ▲    |
| LatAm                  | ↔/▲  | EM (local currency)    | ▲    | EM hard currency        | ▲    | US dollar                        | ▼    | CNY                       | ▲    |
| Frontier               | ▲    | India                  | ▲    | Securitised credit      | ▲    | EM FX                            | ▲    | JPY                       | ▲    |

Source: HSBC AM, June 2026. House view represents a >12-month investment view across major asset classes in our portfolios. Views reflect our long-term expected return forecasts, our portfolio optimisation process and actual portfolio positions. These views are for general information purposes only and do not constitute advice or a recommendation to buy or sell investments. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target. Diversification does not ensure a profit or protect against loss. The level of yield is not guaranteed and may rise or fall in the future. For informational purposes only and should not be construed as a recommendation to invest in the specific country, product, strategy, sector, or security.

# Top of mind



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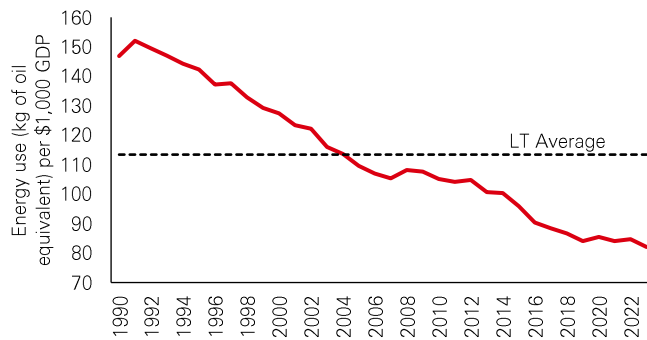
# Top of mind

## Does tighter energy supply and recent underperformance change the case for Indian equities?

The Middle East conflict has brought India’s energy sensitivity back into focus. As a large energy importer, India is exposed to higher crude prices through inflation, the current account, the rupee and corporate margins. That makes the near-term backdrop more complicated, particularly after a period of foreign outflows and relative underperformance versus AI led North Asian markets.

However, this is not simply a higher oil story. India’s oil intensity has fallen over time, meaning the economy is less exposed to each dollar increase in crude than in previous cycles. The more important risk may be energy availability, especially gas, if supply disruption persists.

**Figure 1: Oil intensity for India (constant 2021 PPP)**



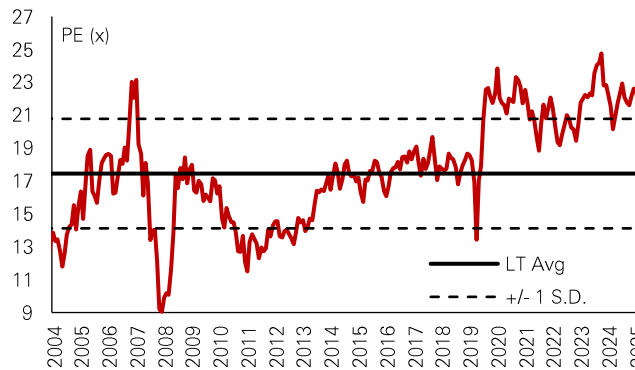
Source: World bank group data, HSBC AM, data as of June 2026

**Past performance does not predict future returns.** Source: HSBC AM, June 2026. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target. For informational purposes only and should not be construed as a recommendation to invest in the specific country, product, strategy, sector, or security.

At the same time, India’s gradual shift toward a more diversified energy mix, including faster renewable capacity addition, should help reduce the structural vulnerability over time.

The equity market setup has also become more balanced. MSCI India’s 12 month forward P/E has moderated to around 20.0x, while its premium versus Asia and EM has moved closer to medium term averages. That does not make India cheap, but it reduces one of the key headwinds that previously constrained returns.

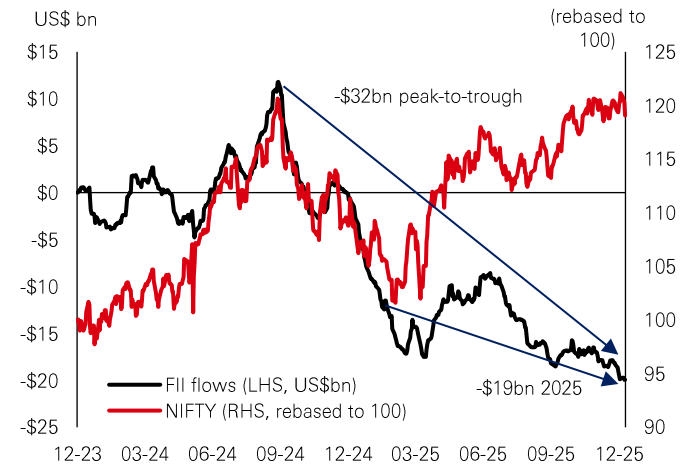
**Figure 2: MSCI India 12m forward P/E (x)**



**Past performance does not predict future returns.** Source: MSCI, Goldman Sachs, data as of March 2026

Positioning also looks less crowded. Foreign institutional ownership is near a 15-year low, and India appears under owned in global and EM portfolios.

**Figure 3: Cumulative FII flows in Indian equities (US\$ bn)**



**Past performance does not predict future returns.** Source: Goldman Sachs, data as of December 2025

That means any stabilisation in oil, earnings revisions or the rupee could create room for renewed foreign participation. At the same time, domestic flows remain an important shock absorber, helping offset external selling.

The view is therefore constructively neutral. While higher energy prices are a risk, but lower oil intensity, valuation moderation, domestic liquidity and lighter foreign positioning leave India better placed than headline concerns suggest. At the same time, selectivity remains key, with preference for financials, domestic cyclicals, infrastructure linked sectors and high-quality exporters.

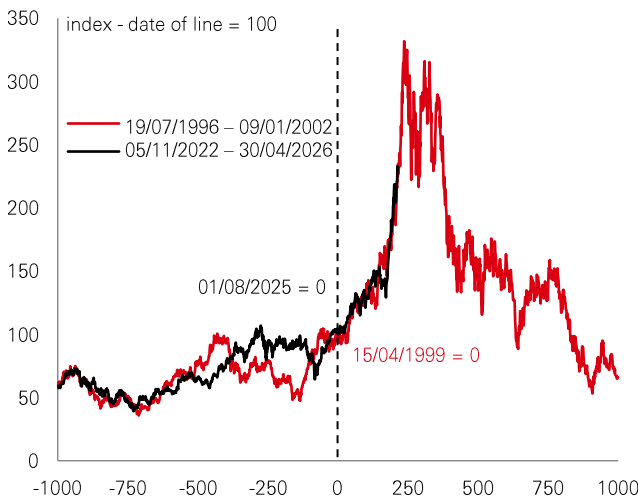


## Can global equities keep absorbing higher yields and fuller valuations?

Equity markets have pushed to new highs even as the macro backdrop has become more complicated, and that naturally heightens investor concern that markets may be looking past obvious risks. The core issue, however, is not simply whether valuations look elevated in isolation, but whether profit growth can continue to justify those valuations in an environment of higher interest rates.

There are clear signs of exuberance, particularly in AI linked technology, where momentum is powerful and market leadership remains unusually narrow. Recent price action in some semiconductor and AI hardware names has begun to echo late cycle episodes from the past.

**Figure 4: PHLX semiconductor sector index**

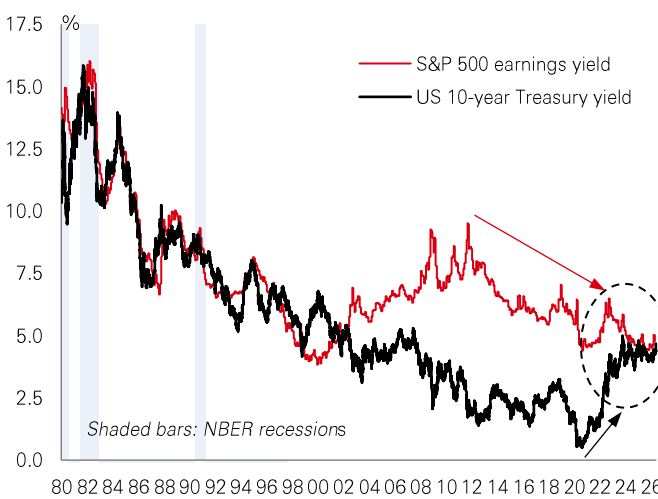


**Past performance does not predict future returns.**  
Source: HSBC AM, June 2026

On traditional measures such as trailing P/E, P/B and longer term cyclically adjusted ratios, valuations now look full by historical standards. Yet the current environment does not resemble a classic, unanchored bubble. Forward earnings expectations have been revised higher rather than merely hoped higher, the equity risk premium, while compressed, is not as extreme as it was during the dotcom period, and the AI investment cycle is already feeding through into visible revenue and profit growth. In other words, there is exuberance, but it is tied to genuine earnings delivery.

The more important test for equities may come from bond markets. Equities usually struggle when yields rise for the wrong reasons – specifically, when real rates move higher without a corresponding improvement in growth.

**Figure 5: 10-year treasury yield vs 12 month forward earning yield**



**Past performance does not predict future returns.**  
Source: HSBC AM, June 2026

That was the dynamic in 2022, when a surge in inflation forced a sharp reset in real yields, discount rates rose faster than earnings could adjust, and equity valuations had to adjust downwards.

By contrast, the current move in yields looks more manageable. Most of the repricing has occurred at the short end of the curve, as central bank policy expectations have shifted, while long term yields and, importantly, real yields have not risen enough to break the valuation story. At the same time, expected earnings growth is still outpacing the rise in discount rates. In that sense, this is closer to a yield rise that markets can live with, supported by resilient nominal growth and strong profits rather than a pure tightening of financial conditions.

That said, the foundations of the market are not without vulnerabilities. Liquidity remains a key risk that is if policy tightens more than currently anticipated, or if term premia rise sharply, higher real yields could begin to bite, forcing a de-rating even if earnings hold up. Leadership is also concentrated, which leaves markets more exposed if profit delivery in that cohort disappoints. With optimism and positioning already elevated in these themes, the scope for negative surprises to have outsized effects is significant.

Taken together, this suggests that global equities can continue to absorb higher yields and fuller valuations, but with less margin for error than earlier in the cycle. It argues for a neutral overall stance on equities rather than an aggressively risk on position, combined with careful, selective exposure.

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## How has EM performance moved beyond US dollar weakness?

Emerging market performance has historically been framed as a leveraged play on US dollar weakness or on market beta, but the asset class is increasingly being driven by its own fundamentals and structural growth engines.

While the depreciation of the dollar in 2025 and early 2026 reduced the local currency burden of USD denominated debt and supported export competitiveness, especially for commodity producers, this was a catalyst rather than the core driver of the EM story. Many EM sovereigns have reduced external debt to GDP, built FX reserves and shifted away from heavy reliance on dollar funding, lowering sensitivity of local yields and currencies to dollar swings and global risk off episodes.

Monetary policy credibility has also improved. EM central banks generally tightened earlier and more aggressively post Covid than their developed market counterparts, helping to re-anchor inflation more quickly and create room for policy easing as disinflation progresses. This combination of healthier inflation dynamics, improved current accounts and stronger fiscal positions has reduced vulnerability to external shocks and diminished the extent to which EM is simply a trade on dollar weakness.

At the same time, EM is now central to several structural themes. North Asia – particularly Taiwan and Korea – sits at the heart of the global AI hardware supply chain, with highly concentrated exposure to chipmakers and related technology platforms.

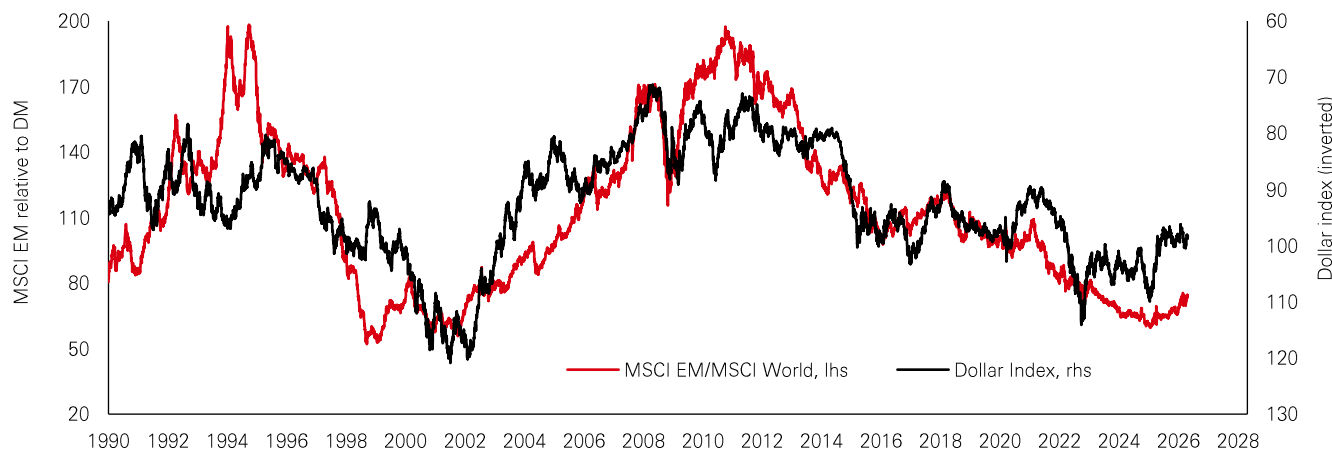
China spans multiple AI sub themes, from hyperscalers and data infrastructure to robotics and health care applications, as it pursues greater AI independence.

India and parts of the Middle East are positioning as data centre and AI hubs, seeking to attract hyperscaler capex and build domestic digital infrastructure.

Metals provide a second structural pillar. Precious and industrial metals have benefited from tight supply and long-term demand linked to urbanisation, electrification, energy transition and AI driven data centre build out. EM producers in Latin America, Africa and Asia are key suppliers of copper, bauxite, rare earths and nickel, while EM FX and local bonds can be supported through improved terms of trade, stronger fiscal revenues and lower risk premia.

These developments have pushed EM beyond a monolithic “risk on” bloc. Oil importing Asian economies, AI hardware champions, and metals exporting countries now exhibit very different macro profiles and shock sensitivities, particularly to energy prices and trade chokepoints. As a result, EM performance in 2026 looks less like a simple reflection of US dollar weakness and more like a dispersed, fundamentals driven universe that requires a higher degree of selective consideration.

Figure 6: Correlation between US dollar and EM equities



Source: Refinitiv, MSCI, HSBC AM, May 2026.

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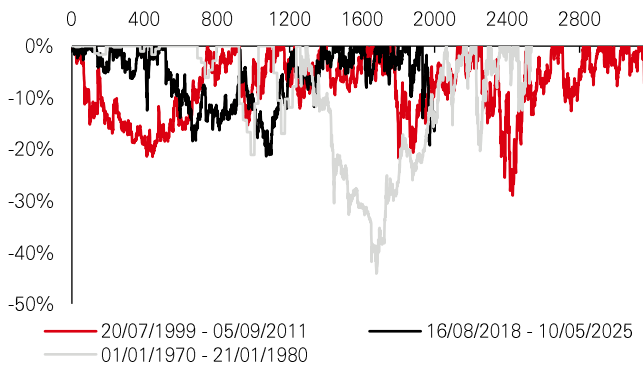


## Is gold still a reliable hedge in a world of supply shocks?

Gold is often treated as a safe haven, but its market behaviour has been more complicated than that label suggests. Unlike equities or bonds, it has no cash flow, no earnings stream and no obvious valuation anchor. Its value depends heavily on the narratives investors and reserve managers attach to it, including inflation protection, currency debasement, geopolitical insurance and independence from the US centred financial system.

That does not make gold fragile, but it does make it resemble more like a cyclical risk asset. Over the last half century, gold has experienced three major secular bull markets, each of which included multiple declines of more than 20%. In the 1970s, gold fell by around 40% during a broader bull market. During the global financial crisis, it entered the episode with strong momentum but still lost close to 30% before recovering. Seen in that context, a 20% drawdown is uncomfortable, but not unusual.

Figure 7: Gold drawdowns during bull markets

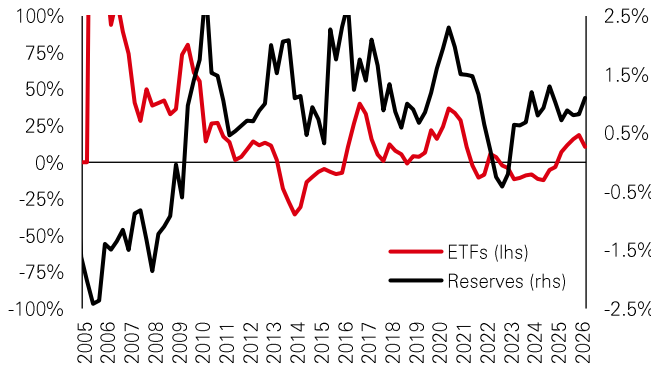


Source: Bloomberg, HSBC AM, data as of May 2026.

Its performance during stress episodes has also been mixed. During the dotcom bubble, it initially fell alongside equities before later establishing a more durable uptrend. In 2008, it eventually recovered and moved higher, but only after a significant drawdown. During the pandemic, gold rose early, then stalled and traded sideways for several years. Moreover, correlations with equities and the US dollar have been unstable across these episodes. That makes gold a useful long-term store of value but complicates its role as a dependable and systematic short-term hedge in every risk off episode.

However, the current backdrop does not invalidate the strategic case. Central banks have continued to buy gold, reinforcing its role as a reserve asset outside the dollar system. That matters in a world where concerns about currency debasement, geopolitical fragmentation and the long-term role of the US dollar remain live. Gold still carries an insurance value that is difficult to replicate through conventional financial assets.

Figure 8: Gold holdings year on year (%)



Source: Bloomberg, HSBC AM, data as of May 2026.

Yet, the supply shock environment introduces a more nuanced risk. In a world where countries are more worried about access to oil, gas, critical minerals and food inputs, reserve managers may begin to ask whether gold is the only reserve asset they need. In an extreme stress scenario, gold may need to be sold to obtain the commodities an economy actually requires.

In fact, if the stress in the system is no longer only about financial liquidity, but also about access to physical supply, then the definition of a hedge also needs to widen. Investors and reserve managers may increasingly ask not just what protects purchasing power, but what provides exposure to the commodities, infrastructure and strategic capacity that economies actually need in a shock.

This shows that access to energy, commodities and critical inputs matters more than simply holding financial reserves and the investment implications, thus, extend beyond bullion. Strategic stockpiling, energy security and the shift from just-in-time to just-in-case supply chains could support commodities, industrial metals, critical metals and selected real assets.

The better way to think about gold is therefore not as an unconditional safe haven, but as a narrative driven reserve asset with useful long term diversification properties and meaningful short-term volatility. Its case remains strongest as protection against debasement, geopolitical fragmentation and reserve diversification away from Treasuries. However, in a supply constrained world, gold should sit alongside broader real asset and commodity exposures rather than be relied upon as the single hedge against every form of macro stress.

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# Credit transmission in a supply constrained world

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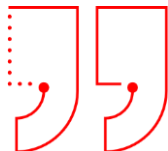
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# Credit transmission in a supply constrained world

“The Middle East conflict is becoming a credit event not because of direct regional exposure alone, but because of the way disruption travels through global supply chains to issuer fundamentals.”

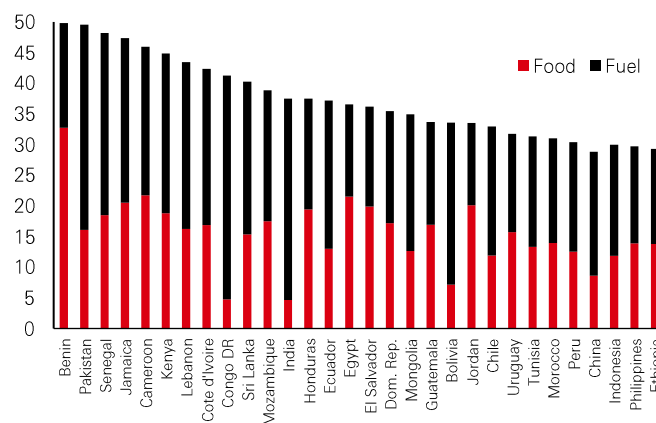


The Strait of Hormuz is typically framed as an oil chokepoint, but its relevance is far broader. It is a critical conduit for LNG, refined products, fertilisers, helium, petrochemical feedstocks and a range of raw materials used across industrial production. For credit markets, this means the transmission mechanism is more complex than a simple oil price shock; it is a test of how exposed issuers are to bottlenecks in essential inputs and trade routes.

This matters because the first order impact of the conflict is visible in energy prices, while the second order impact is where credit analysis becomes more important. Higher oil, gas and refined product prices feed into input costs, logistics, working capital and consumer demand. Disruptions in naphtha, LNG or helium can depress utilisation in petrochemicals, semiconductors and broader manufacturing.

Higher fertiliser prices can also reinforce food inflation, especially in emerging markets where households spend a larger share of income on essentials. As a useful rule of thumb, a 10% increase in energy prices can translate into a 3–6% increase in food prices, depending on the region.

Figure 1: Oil and food imports across EM (% of total imports)



Source: HSBC AM, Bloomberg, June 2026.

The region's importance also extends beyond goods trade. The GCC is the world's second largest source of remittances, at around US\$140 billion, making it an important source of external income for countries such as Egypt, Lebanon, Sri Lanka and Pakistan. That reinforces the broader point that this is not a localised geopolitical shock. It is a global transmission event.

In this context, duration becomes the critical variable. A short-lived disruption can be managed via inventories, alternative sourcing, hedging and temporary margin compression. A prolonged disruption is different. It shifts the risk from price to availability, and from earnings volatility to operational continuity. The key credit question then becomes not only whether an issuer can absorb higher costs, but whether it can continue to produce, deliver and fund itself without material balance sheet deterioration.

## Not all winners from scarcity are equal

The most immediate beneficiaries are in energy and energy linked sectors, but the credit implications are not uniformly positive. In May, the conflict has effectively removed an estimated 10 million barrels per day (mb/d) of crude and oil products from the market, around five times the scale of the Russian supply loss. Alternative routes exist, but they are constrained. Saudi Arabia's East-West pipeline normally carries around 2–3mb/d and can theoretically rise to around 7mb/d, while the UAE's Fujairah pipeline can add roughly 0.5mb/d. These routes help, but they can't fully offset the scale of disruption. Inventories have also been drawn down sharply, with floating storage close to exhaustion and global oil inventories at more than decade low levels. Even if the Strait of Hormuz reopens, the oil system may take two to three months to normalise, assuming limited infrastructure damage and a gradual reopening of shipping insurance, port capacity and trade flows.

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Against this backdrop, upstream oil and gas producers remain clear beneficiaries where higher realised prices more than offset any production disruption.

However, the more interesting credit story is not crude. It is where scarcity becomes most binding. Refining margins have expanded faster than Brent because the pressure is concentrated in consumer facing products such as diesel and jet fuel. Europe is particularly exposed, with around 70% of jet fuel imports at risk, while parts of Asia face pressure through diesel, naphtha and petrochemical feedstock availability. Integrated downstream names can benefit, but only where they can secure feedstock and sell into constrained product markets. The same disruption that lifts margins for one refiner can impair utilisation for another.

Petrochemicals are an even clearer example of why scarcity winners need to be differentiated. Asian petrochemical producers rely on the Middle East for around 60% of naphtha supply. Disruption has already contributed to force majeure declarations and lower utilisation at some plants. This has rapidly shifted parts of the sector from bottom of cycle conditions, defined by overcapacity and weak margins, toward near top of cycle conditions in one quarter.

The feedstock split is crucial. US ethane-based producers are particularly well positioned as their feedstock is secure and relatively cheap, while selling prices into Asia have risen sharply. European companies with meaningful US assets can also benefit, though Europe's own chemical sector faces a more mixed backdrop given elevated energy costs and a softer macro environment.

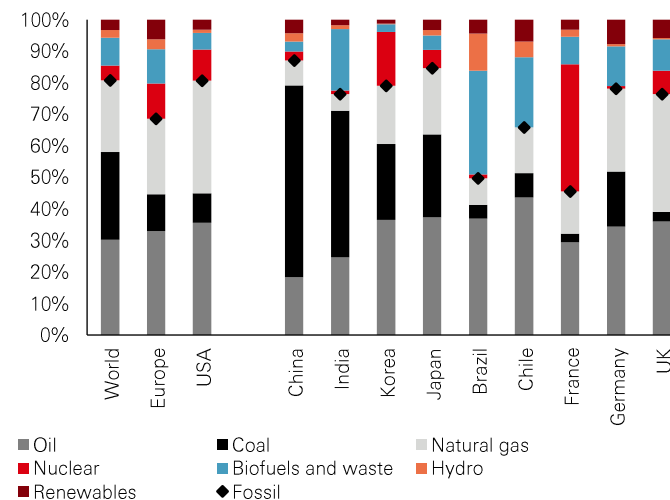
However, petrochemicals remain deeply cyclical. Margins can spike quickly, but they can also normalise quickly as supply routes reopen, inventories rebuild, or higher prices begin to destroy demand. Fertilisers are similarly nuanced. Prices have risen sharply, but producers also face higher energy and transport costs, limiting the extent to which the price move translates cleanly into credit improvement. The preferred exposure is therefore to issuers with advantaged feedstock, strong liquidity, flexible operations and pricing power rather than to scarcity beneficiaries in general.

### Pressure points shift from costs to continuity

Utilities and manufacturing show how the nature of the shock changes if disruption persists. In the early phase, the issue is mainly cost i.e. higher oil, gas, freight and feedstock prices. Over time, the risk becomes more operational. Companies need to secure inputs, maintain production, manage working capital and protect free cash flow. This is where the distinction between a short disruption and a prolonged one becomes critical.

For utilities, the impact depends on the power mix, LNG exposure and the strength of pass-through mechanisms. LNG is likely to have a longer tail than oil. Qatar accounts for around 20% of global LNG supply, and damage to Qatari LNG facilities means global LNG markets could remain tight for around three years. That is a very different adjustment profile from oil, where logistics may normalise within a few months if routes reopen and infrastructure damage is limited.

Figure 2: Total energy supply<sup>1</sup>



Source: IEA, HSBC AM, May 2026

The regional differences are important. The US is relatively insulated as a net LNG exporter. Europe is better positioned than during the Russia gas crisis because it has diversified supply, increased LNG imports from the US and hedged a significant portion of utility and industrial gas needs for roughly one to one and a half years. The risk for Europe is therefore less about immediate volume shortage and more about a higher and more volatile cost base. Asia, by contrast, is more exposed to both price and continuity risk. Around 90% of Qatar's LNG exports go to Asia, and several economies maintain a high share of gas fired power. Korea is particularly vulnerable because of its gas heavy power mix, reliance on Qatari LNG and weaker cost pass through record.

1 - Total energy supply includes all the energy produced or imported in a country, minus the energy that is exported or stored. It represents all the energy required to supply end users in that country.

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For integrated Korean power and gas utilities, higher input costs could translate into rising leverage and receivables if tariffs do not adjust sufficiently. China's power generators are less exposed because gas represents only around 3% of the power mix. Over the longer term, these pressures reinforce the strategic case for electrification, renewables, nuclear, storage and grid investment. China's energy transition illustrates the scale of change already underway as the country added close to 450GW of solar and wind capacity last year, roughly twice as much as the rest of the world combined. For credit investors, that reinforces the structural importance of regulated networks, grid infrastructure and issuers aligned with energy security and transition themes.

Manufacturing reveals the same shift, but in a more granular way. Autos have limited direct Middle East exposure, yet prolonged high fuel prices could weaken consumer confidence, delay purchases and push demand toward smaller, lower margin vehicles. This is a timing and mix risk rather than a simple cost issue. It is manageable for some mass market producers with efficient platforms, but it adds cyclical pressure to a sector already facing Chinese EV competition and structural transition.

Steel and aluminium face more direct energy and logistics pressure. Higher thermal demand can lift input costs, while shipping disruption raises freight rates and reduces delivery reliability. Aluminium is especially exposed to shipping dependence, while steel faces both energy intensity and potential bottlenecks in industrial chemicals used in processing. Trade protection and local production can partly offset these pressures in the US and Europe.

Technology is the clearest example of continuity risk. Semiconductor production in Korea and Taiwan depends on stable electricity and specialised inputs, particularly helium.

Qatar produces roughly one third of global helium, which is critical for semiconductors, aerospace, healthcare, optical fibre and data centre supply chains. The mitigating factor is that leading chipmakers are better prepared than during previous supply chain disruptions, with several months of inventory, more diversified sourcing from regions such as the US and Algeria, and improving recycling processes. Even so, the credit issue is not simply whether margins compress. It is whether production can continue without yield loss, downtime or expensive restarts.

### Regional and sector dispersion


The regional implications are uneven. Emerging market debt has the highest direct exposure through GCC issuers and the dependence of several Asian countries on imported energy and food. Asia feels the supply chain shock earlier and more broadly because its manufacturing base is tightly interconnected and its reliance on Gulf energy and feedstocks is greater, even though many US dollar corporate issuers remain fundamentally resilient.

Latin America, by contrast, is relatively better insulated through geography and commodity endowment. The US also appears well positioned, benefiting from domestic energy, stronger supply chain resilience and trade protection in some industrial segments.

Europe sits between these poles being less exposed than Asia to direct Gulf supply, but more vulnerable than the US via higher energy costs, weaker growth and pressure in selected industrials.

At the sector level, this is equally a dispersion story. The most vulnerable sectors are those where higher input costs, logistics disruption or weaker demand can erode margins and free cash flow. The best placed sectors are those with pricing power, strategic relevance, robust balance sheets or exposure to scarcity driven earnings upgrades. For now, the conflict does not warrant a broad defensive repositioning across credit. It does, however, demand greater selectivity. If the disruption persists, the associated credit risk is likely to become nonlinear. The shock would then evolve from being primarily price led – where costs rise, margins adjust and markets reprice – to one driven by depleted inventories, unreliable delivery and potential production rationing. At that point, analysis must move beyond earnings sensitivity to focus on liquidity, working capital management and the durability of free cash flow under stress.

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# Energy shocks and Asian markets

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# Energy shocks and Asian markets

“The Middle East conflict’s real market impact in Asia is higher correlation and sharper differentiation.”



The Middle East conflict has had far reaching ramifications for the global economy, and Asia is very much at the centre of it. The Strait of Hormuz is a vital passage for many Asian countries to access imports of oil and other key commodities. The sensitivity of these economies to the strait’s closure varies significantly, as do those of different asset classes in the region.

While inventories cushioned the initial shock, drawdowns have been rapid, increasing the risk that a prolonged disruption tightens physical supply conditions. For Asia, this amplifies the terms-of-trade hit for net importers and reinforces the divergence between economies able to secure alternative supplies and those more exposed to shipping chokepoints.

## Oil and energy price shock

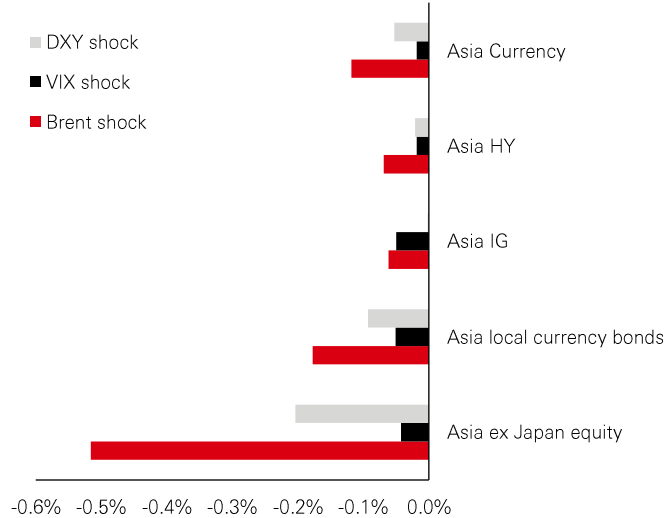
The surge in oil prices following the start of the conflict initially hit the markets and economies of major oil-importing Asian countries but if oil prices remain elevated for an extended period, most countries will likely be exposed to the shock.

Examining the daily returns for major Asian equity, credit, FX and local-currency bond indices during past oil shocks can help to uncover where the largest vulnerabilities could lie in these markets. Our results showed a one standard deviation oil shock is associated with around a 0.5% decline in the Asia ex-Japan equity index on the following day. Asian investment grade credit appears more resilient, reflecting its lower-beta nature, while local currency bonds and currencies sit between credit and equities in terms of sensitivity.

At the country level, Korea and Taiwan stand out as the most sensitive equity markets to oil, volatility and US dollar shocks, while China, Malaysia and Singapore have been notably more resilient. In rates and FX, Korea, Thailand and Australia appear most negatively affected, reflecting pro-cyclical profiles, dollar correlations and the weight of energy in inflation baskets.

Domestic policy capacity is also a key differentiator in how the same oil move translates into markets and the real economy. Where governments can credibly smooth the shock (for example through targeted subsidies, tax adjustments or strategic reserve releases) and central banks have room to stay patient, the episode is more likely to be treated as a temporary terms-of-trade hit. Where fiscal space is tighter or inflation is already uncomfortable, the risk is a faster pass-through into broader prices and a more defensive policy response – raising the probability of weaker growth alongside tighter financial conditions.

**Figure 1: Impact of oil, dollar and volatility shocks to Asian assets**



Source: HSBC AM, Bloomberg, April 2026

## The importance of market expectations

The 2022 oil shock showed that the key driver of asset prices is the effect of oil price moves on inflation and growth expectations. Forward 12-month inflation forecasts only began to rise meaningfully about three months after oil prices started climbing in late 2021 and continued to increase for three to five months after oil peaked in June 2022, underscoring that inflation expectations can be both sensitive to oil and sticky on the way down.

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Growth expectations adjusted more slowly. GDP forecasts were still being revised up as oil prices rose, then began to be marked down three to four months later, continuing to fall for about two further quarters after the oil peak.

The 2022 episode also highlighted how uneven these adjustments can be across Asia. India and Thailand saw some of the largest upward revisions to inflation forecasts, reflecting high energy weights in consumer baskets, while the Philippines experienced one of the longest periods of elevated inflation expectations. On the growth side, India, Malaysia and the Philippines endured some of the deepest downgrades to GDP forecasts, whereas China's projections proved more resilient and Hong Kong's recovered relatively quickly, underscoring the role of domestic buffers and policy space in absorbing external shocks.

In the current episode, nominal oil prices are comparable to 2022 and past high oil regimes, but real oil prices are significantly lower, and the global economy is less oil intensive, suggesting that the magnitude and duration of the inflation and growth impact may be more contained than in previous shocks – even if the burden is unevenly distributed across Asia.

Higher income, energy resilient markets such as Australia, Singapore and China tend to hold up better when oil prices are elevated, while Korea, Taiwan, Thailand and Indonesia have proved more sensitive to swings in oil, volatility and the US dollar. For Korea and Taiwan, the main issue is their markets' high sensitivity to global risk shocks rather than a heavy domestic energy burden, whereas lower income oil importers like Thailand, India and the Philippines are more directly squeezed via high energy shares in consumer

spending, raising the risk that higher fuel costs erode disposable income and weigh on confidence.

Underlying fiscal and external positions add a second layer to this picture. Developed Asian economies such as Hong Kong, Singapore, Australia and Japan generally have smaller fiscal deficits, stronger current account positions, solid reserve buffers and higher credit ratings, leaving them better placed to absorb prolonged shocks. Korea and Taiwan also look robust on these measures, helped by export driven surpluses and relatively low public debt burdens. By contrast, much of ASEAN (excluding Singapore) and India enter this period with weaker public finances and external accounts, making them more vulnerable to portfolio outflows and currency pressure when risk sentiment deteriorates. China's headline numbers place it only mid pack, but its strong tax collection capacity, large stock of public assets, predominantly local currency debt and sizeable oil reserves suggest a more resilient underlying position than simple deficit and debt ratios imply.

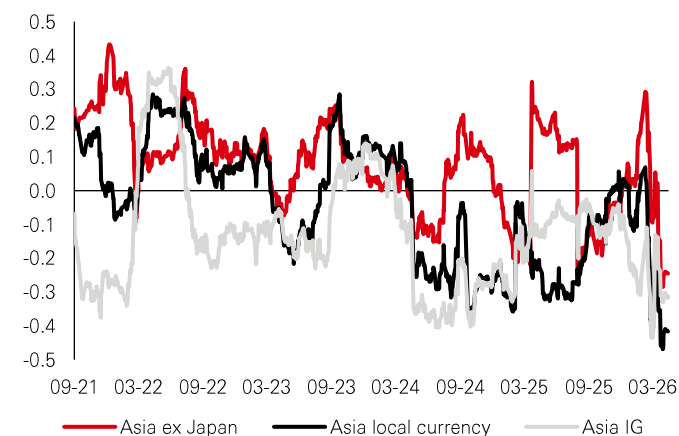
### The oil shock's effect on correlations

Correlation patterns present an additional challenge for multi-asset investors. As the conflict escalated, correlations between Asian growth assets and oil fell, particularly for fixed income. At the same time, correlations among Asian asset classes themselves rose, with many pairwise coefficients above 0.5, limiting intra-regional diversification just when it is most needed.

Practically, this means portfolio construction gets harder at exactly the wrong time: when correlations within the region

rise, switching between Asian equities, credit and local rates may not reduce drawdowns as much as expected. It also raises the bar for diversification, increasing the value of exposures that can behave differently in an oil-driven risk-off regime.

Figure 2: Rolling 90-day correlation with Brent oil prices



Source: HSBC AM, Bloomberg, April 2026

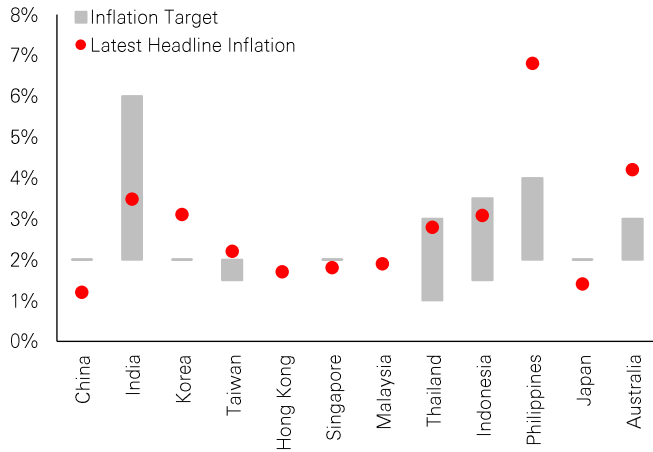
### Policy implications

Policy responses have so far been cautious. Most Asian central banks initially signalled a desire to look through what they hoped would be a temporary oil shock, yet some countries – such as the Philippines and Australia – have already raised rates as inflation moved well above target ranges. Singapore and Japan are proceeding with broader policy normalisation rather than acute inflation fighting, while Indonesia and Korea may be next in line to consider tighter policy, albeit for different combinations of inflation, growth and FX-stability concerns.

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Figure 3: Inflation versus targets across Asia



Source: HSBC AM, Bloomberg, April 2026

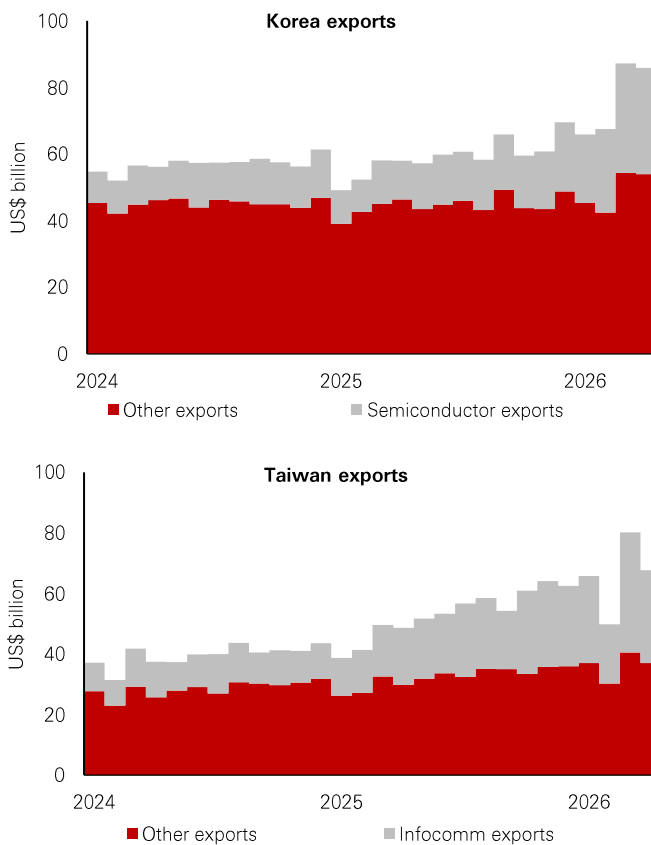
Governments have leaned on subsidies and price controls to blunt the immediate impact of higher fuel costs, but the fiscal burden is beginning to strain. Thailand has suspended some subsidies as deficits widened, India has begun lifting caps on petrol and diesel, and Indonesia plans to maintain fuel subsidies at the cost of cuts elsewhere to meet deficit targets. The key risk is that persistent energy shocks eventually spill over into broader prices and services, unanchoring inflation expectations if central banks move too slowly, or undermining growth if they respond too aggressively.

**Structural themes in Asia**

The Middle East conflict is not the only driving force for Asian markets. There are several structural themes that are reshaping Asia’s medium-term investment landscape.

The AI and semiconductor cycle has become a major driver of exports and growth for Korea and Taiwan, while electronics exports from Singapore, Malaysia and Thailand have also risen sharply over the past two years, supporting activity.

Figure 4: Semiconductor becoming more prominent exports in Asia



Source: HSBC AM, Bloomberg, April 2026

Up the value chain, US hyperscalers’ capex plans and strong cloud revenue growth is reinforcing confidence in the monetisation of AI investment. Further downstream, AI diffusion among end users remains far below the penetration of smartphones and the internet, suggesting substantial runway for adoption. In China, new industries such as AI hardware, batteries, EVs, renewables and biotech are attracting significant investor attention and policy support, with related indices outperforming the broader market.

**Conclusion**

Taken together, the Middle East conflict has clearly raised the risk premium on Asian assets via energy, supply and policy channels, but its impact is being filtered through a region that is simultaneously benefiting from powerful structural drivers in technology and energy transition. The resulting picture is one of heightened dispersion – between exporters and importers, stronger and weaker balance sheets, and cyclical pressures and structural growth – which is likely to remain a defining feature of Asian markets as the geopolitical backdrop evolves.



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# The next phase of broadening

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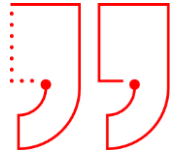
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# The next phase of broadening

“Equity markets have entered the second half of 2026 with an unusual mix of elevated macro and geopolitical risk alongside remarkably strong profits.”



The closure of the Strait of Hormuz, an oil price spike above US\$100 per barrel and ongoing uncertainty about the inflation and interest rate path have not derailed equities, largely because earnings, rather than liquidity, have become the primary anchor for valuations. More specifically, profits linked to artificial intelligence, semiconductors and related infrastructure have been strong enough to justify part of the market’s elevated valuation structure.

It is highlighted by the latest earnings season in the US which has been exceptional by historical standards. Around 82% of S&P 500 companies beat earnings expectations, while aggregate earnings growth reached roughly 23% year on year. That kind of momentum is more commonly associated with early cycle, post-recession recoveries than with an environment of energy disruption and policy uncertainty. Unusually, consensus earnings expectations for both this year and next have been revised higher as the year has progressed, rather than being marked down from optimistic starting points.

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Beneath the strong headline, leadership is narrow. Sectors with clear pricing power, robust demand visibility and direct or second order exposure to the AI investment cycle have done most of the heavy lifting, supported by improved energy profitability as oil prices have risen. In fact, the top ten contributors in the S&P 500 account for more than half of recent earnings upgrades, underscoring how concentrated the profit engine remains.

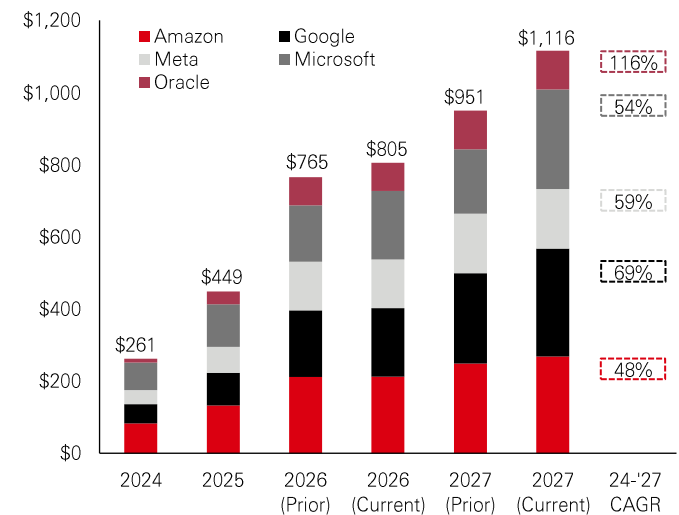
This earnings strength helps to explain why the usual macro driven playbook has struggled. Valuations that appear stretched on simple price-to-earnings metrics look more reasonable once one recognises that the earnings base is being revised higher, and empirical work shows that earnings surprises now explain a much larger share of individual stock price moves than macro surprises. However, resilience is conditional, and the market’s stability depends on continued earnings delivery from a relatively narrow group of beneficiaries.

### AI cycle, narrow core

The AI investment cycle remains the central pillar of the current equity narrative. Hyperscalers have repeatedly upgraded capital expenditure plans, forcing analysts to revise up both the magnitude and duration of the cycle and prompting comparisons with previous “mega cycles” in technology and infrastructure. Data centre revenues now account for around 90% of growth at leading AI chip manufacturers, and US hyperscaler capex is expected to exceed US\$1 trillion by 2027, underscoring how dependent

current earnings momentum is on this investment continuing to run at pace.

Figure 1: Hyperscaler cash capex breakdown (US\$ bn)

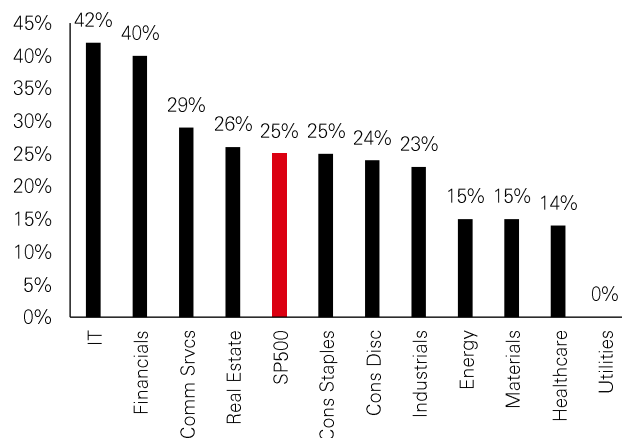


Source: Company data, Morgan Stanley Research estimates, May 2026

Adoption data confirm that AI is moving from concept towards monetisation. In 2023, only about 4% of S&P 500 companies discussed quantifiable benefits from AI on their earnings calls; that figure is now closer to 25%, signalling rapid broadening in corporate engagement and significant remaining headroom. AI is therefore no longer just a capex story for a handful of infrastructure providers. Instead, it is gradually becoming a productivity, revenue and margin story for a wider corporate base.



Figure 2: S&P 500 sectors reporting quantifiable AI impacts



Source: Morgan Stanley, HSBC AM, May 2026.

Even so, the distinction between adoption and earnings contribution is critical. AI infrastructure and adjacent semiconductor companies still account for a disproportionate share of S&P 500 profit growth, and while the contribution from the Magnificent 7 has declined relative to recent years, leadership is best described as a widening within the AI ecosystem rather than a fully diversified equity market.

This concentration creates a clear investment tension. If AI capex remains strong and continues to be monetised, earnings can support the market and justify elevated valuations. However, if investors begin to question the return on that spending, the durability of monetisation or the availability of financing as hyperscalers hit funding and concentration limits, the market’s strongest support could become its key vulnerability. Valuation signals in US

technology capture this ambiguity. Reported price-to-earnings multiples have compressed as earnings have surged, but price-to-cash earnings and price-to-book ratios have moved higher and now sit well above early 2000s levels, prompting calls for neither an “all-in” nor an “all-out” stance on AI linked equities.

**Oil shock fault lines**

The recent oil price spike following the closure of the Strait of Hormuz adds a second layer of complexity. Thus far, markets have largely treated the disruption as manageable. Energy earnings have been upgraded, and there is little evidence at the index level of a broad downgrade cycle. Top-down models for the US, using PMIs, CPI, PPI and the dollar as inputs, suggest that even under a downside scenario of prolonged disruption, earnings growth would likely slow or flatten into year end rather than collapse outright.

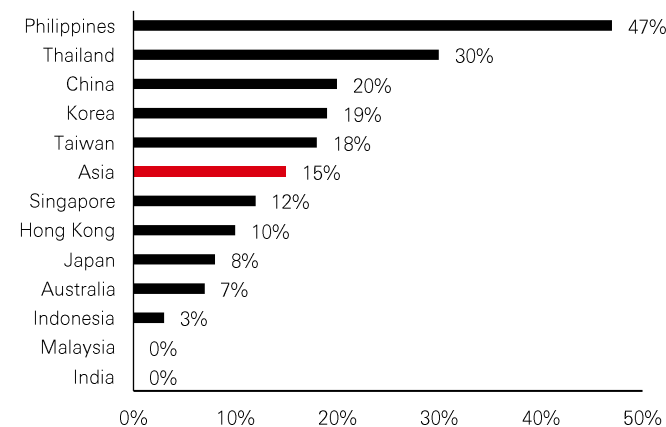
However, the aggregate picture hides important dispersion. Equal weighted US consumer discretionary earnings expectations have already been revised lower as higher energy prices and inflation passthrough weigh on household sensitive segments, even though the cap-weighted sector — dominated by Tesla and Amazon — appears more resilient.

Europe faces a more challenging equation. The region has seen modest earnings upgrades of roughly 2–3% in recent months, supported in part by energy, but lacks the same scale of AI linked earnings support as the US and is structurally more exposed to higher input costs and weaker activity. Top-down models indicate that in a downside

scenario characterised by a persistent PPI–CPI wedge and weaker PMIs, European earnings could come under meaningful pressure as early as the third quarter, reflecting their empirically higher sensitivity to supply side shocks. Valuations remain supportive and selected companies retain strong cashflow characteristics, but the regional earnings story is more fragile and requires greater selectivity.

Across Asia, the impact of higher oil prices is being mediated by policy choices. While benchmark crude prices are up roughly 50–60%, retail fuel prices have risen by closer to 15% on average, with countries such as India absorbing more of the increase fiscally and others, including the Philippines and Thailand, passing through a larger share to consumers. The implications for inflation, real incomes and corporate earnings are therefore highly country specific.

Figure 3: Domestic gasoline price rise since February 2026 (%)



Source: CEIC, GlobalPetrolPrices.com, Morgan Stanley Research, May 2026.

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## EM profit broadening

Against this backdrop, the most compelling ‘broadening out’ story is in emerging markets. Earnings have held up well across parts of Asia and EM, led by North Asia, particularly Korea and Taiwan, where semiconductor and AI supply chain exposure remains a powerful driver. Latin America and parts of EMEA are benefiting from commodities and materials, while India delivered more resilient earnings despite valuation concerns.

At the sector level, technology, materials and industrials are carrying the bulk of upgrades, whereas consumer-oriented sectors remain weaker, reflecting pressure on households.

Hence, valuation signals require careful interpretation. Taiwan trades near the upper end of its historical range, reflecting strong semiconductor earnings and high index concentration, while Korea appears inexpensive on forward P/E of around 7x but its price-to-book ratio, near 3x, now sits at the top of its historical range and close to India’s. This underlines that headline multiples can be misleading when earnings are moving aggressively. The key question is not simply whether a market looks cheap, but whether the earnings behind that valuation are sustainable.

Flow dynamics add another layer of nuance. Foreign investors have withdrawn capital from major Asian markets, approximately US\$53 billion from Korea, US\$9 billion from Taiwan and US\$23 billion from India year to date. While domestic retail investors have stepped in aggressively, providing inflows of around US\$26 billion in Korea, more than US\$30 billion in India and roughly US\$3 billion in Taiwan. This tug of war suggests that market

resilience is increasingly underpinned by local investor bases, which are becoming important shock absorbers in markets where leverage and derivatives can amplify short term moves.

## EM in the global innovation and IPO cycle

Globally, 2026 is shaping up to be one of the largest IPO fundraising years on record, led by high profile US listings such as OpenAI, Anthropic and SpaceX, which could command a valuation in excess of US\$1.5 trillion. Whether in the US, China or other EM regions, the underlying story is similar — fast growing, technology and innovation driven businesses are tapping public markets to fund scale. Moreover, global investors are keen not to miss out on these growth opportunities.

China, for instance, has already raised more IPO capital than any other region in the first quarter, with AI related companies alone raising around US\$22 billion, roughly double the amount raised by US AI IPOs so far this year. Hong Kong has a record pipeline of about 500 prospective listings, many tied to AI, semiconductors, robotics and medtech. Europe’s largest IPO this year has also come from an EM issuer, and multiple fintech unicorn IPOs are expected in Africa and Latin America.

This issuance is reshaping EM indices and the nature of their earnings. Historically, EM benchmarks were dominated by commodities, state-owned banks and industrial cyclicals. Today, the share of innovative companies has risen from around 10% a decade ago to nearly 40%. Earnings are becoming less dependent on traditional commodity cycles and external demand, and

more anchored in domestic consumption, technology adoption, healthcare provision and financial inclusion.

Yet valuations do not fully reflect this shift. On a forward price-to-earnings basis, EM still trades at roughly a 40% discount to the S&P 500, close to decade low relative valuations, and on price-to-book metrics non-US markets, and EM in particular, remain at about one-third of US levels. For active managers, combination of these factors creates a compelling, though selective, opportunity set.

## Selective broadening

From a global perspective, profits are growing at roughly three times their long run average, with EM participating strongly in the same innovation led profit cycle that is driving earnings in the US and elsewhere.

At the same time, non-US markets, and EM in particular, appear structurally under owned. Equity markets are therefore best characterised as profit led and selectively broadening, rather than liquidity driven and universally buoyant. Hence, the sustainability of the cycle will depend on whether profit growth can diffuse beyond a narrow AI core into a wider set of sectors, regions and companies.



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