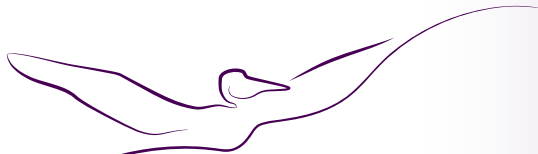

OUTLOOK 2026

ROYAL LONDON ASSET MANAGEMENT

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The CIO view: What has changed, really?

Will Nicoll
Chief Investment Officer



Introduction

The end of 2025 does not feel as different from the end of 2024 as we might have expected or hoped. Trade policies – and many other policies – from the US administration continue to appear with little warning, making it difficult to judge the state of global trade and of geopolitics. The war in Ukraine is still going on and despite lots of hope it is still not obvious how it will stop or be stopped. Governments, particularly in the West, continue to rack up large deficits and are stuck in a vicious cycle with their electorates. So, what has changed? Everything has gone up. Equities are hitting all-time highs, some credit spreads are at multi-decade tightns and gold has continued to drive ever higher.

Worries, what worries?

It is worth noting that almost every concern an investor could have had at the start of 2025, came true. The worries were well-founded, and geopolitical volatility did not let up throughout the year. Despite this, however, most major economies have held up sufficiently well for this not to get in the way of a strong corporate story. The volatility we have seen has almost been ignored by the financial markets.

Indeed, given that the risks in 2025 were meant to be geopolitical, it is interesting that by the end of the year much of the volatility in asset pricing was aligned with a single set of results from Nvidia.

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It is worth noting that almost every concern an investor could have had at the start of 2025, came true.

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Where does this leave us?

A simplistic view is that we find ourselves in the same position as the start of the year, except that markets are all more expensive. If we were nervous 12 months ago then in theory we should be more so now. However, it is clear that markets are not thinking the same way as they were at the end of 2024. Then, we were fearful of the impending volatility and nervous of geopolitical actions around the world. Now we can see that all predictions of high volatility have come true and yet the markets have not increased their risk premia – indeed, in many cases these are now lower. This shows that markets are in a very different frame of mind. Still nervous, but now around valuation rather than volatility or fears of US policy.

So, everyone ‘knows’ that the US equity market is highly concentrated on an AI theme and is heroically valued. Credit spreads are also tight historically and not offering as much value as previously. However, even ignoring the fact that there is no obvious catalyst for values in those assets to fall, there are reasons to be cheerful. Government bonds offer value in a world where rates have been falling and may continue to fall. Inflation-linked debt can give investors protection against an unexpected inflation spike at a much cheaper rate than we have seen for many years. Property remains on a completely different cycle and it looks like the promised increased spend in infrastructure will come through in the next few years offering opportunities.

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We can see that all predictions of high volatility have come true and yet the markets have not increased their risk premia.

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Where will 2026’s volatility come from?

The US President will not change his nature. An economy being captained by someone who is entirely focused on deal-making will continue to see bouts of volatility and an element of chaos. We cannot rely on lower volatility to drive returns.

There is also the factor of debt-to-GDP ratios sitting at numbers that would have given an economist in the ‘90s a panic attack. Some of the largest democracies do appear to be living beyond their means, making it important to ask: how long can this type of government spending continue?

We can expect more volatility – this time more concentrated in markets – as sentiment flicks from exuberance and excitement around AI to geopolitical gloom. Which is the correct side to be on? The answer, as always, is the side of diversification.

“ Although volatility should favour active management, if that volatility is driven by relatively random factors then it is less useful for rational long-term investors. ”

Active management is vital

What these market conditions tell me is clear: diversification is king. Any portfolio has to be positioned carefully and not focused solely on overvalued parts of the market. Diversification and active management should always be best friends to a long-term investor.

It has been a difficult environment for active management in equities. Although volatility should favour active management, if that volatility is driven by relatively random factors then it is less useful for rational long-term investors. Similarly, we believe that diversification is without doubt the best way to invest in the long term but if returns are heavily concentrated in a small group of US equities then investors can be tempted to narrow their investment horizons. The kind of concentration in the equity markets that we have seen recently has not usually ended very well. Similarly, the amount of leverage being offered to funds – whether public or private – is at a high level and that has also often not ended particularly well.

In my view, uncertain markets create opportunities for active managers, where investment decisions can respect a difficult backdrop but not be dominated by it.

Ai = All



Mike Fox
Head of Equities

Equities

We might all be fed up with the amount of time spent discussing the potential of artificial intelligence (AI) and the number of column inches given over to speculation about the AI endgame. But this is a trend that isn’t going away in 2026. In fact, it’s only likely to grow. In my view, the fate of AI will very much continue to dictate the performance of the world’s stock markets and corporate behaviour in the coming year.

This fact is inescapable when we look at the current state of the market. At the time of writing, all of the top ten stocks by market capitalisation in the MSCI All Country World Index are plays on AI in some form. These include the chip makers powering the revolution, such as Nvidia and Broadcom, and household names like Amazon, Apple and

Microsoft, which are at the forefront of AI usage to drive innovation and productivity. In short, if AI continues to perform, the stock market continues to perform. If AI does deliver, US equities will probably do better than the UK and Europe. But if AI starts to disappoint, this could be a significant problem at some point next year.

Artificially inflated?

Given the rapid pace of growth in AI, there is certainly a chance that growth will moderate. Since the public unveiling of OpenAI’s GPT models in November 2022, the speed of AI adoption has been phenomenal. OpenAI alone has reached 800 million users in less than two years, a pace that dwarfs the early growth of the internet and other transformative technologies. This rapid rollout has been enabled by the infrastructure

such as smartphones, cloud platforms and global connectivity. Ironically, much of this infrastructure is a result of the vast amounts investors ploughed into technology over the last 30 years. Similar to the original late-90s tech boom that spurred this splurge, could we see a bust of a similar magnitude again?

To answer this question, it's probably worth looking outside the 'Magnificent seven' stocks and assessing how AI will affect companies such as the other 493 members of the S&P 500. Sectors ranging from industrials and healthcare, to retail and financials are rapidly integrating AI into their operations, seeking productivity gains, cost efficiencies, and new avenues for growth. Morgan Stanley estimates that AI adoption could translate into annual net benefits of \$920 billion for S&P 500 companies, representing about 28% of consensus pre-tax earnings for 2026.¹ And according to the Stanford AI Index, 78% of organisations globally now report using AI in at least one business function, up from 55% in 2023.²

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Sectors ranging from industrials and healthcare, to retail and financials are rapidly integrating AI into their operations.
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Silicon stimulus

Looking at the effects of the AI industry on the wider economy, data centre construction in the US is estimated to account for almost all the country's GDP growth in the first half of 2025.³ Encouragingly, the longer-term benefits across the economy should prove inherently deflationary. As companies reduce costs and do more with less, productivity benefits should widen out from the economic boost that is coming from the AI sector itself.

So, with AI making our daily lives easier, boosting corporate profits, supporting markets, and lifting global economic growth, perhaps this time it really is different?

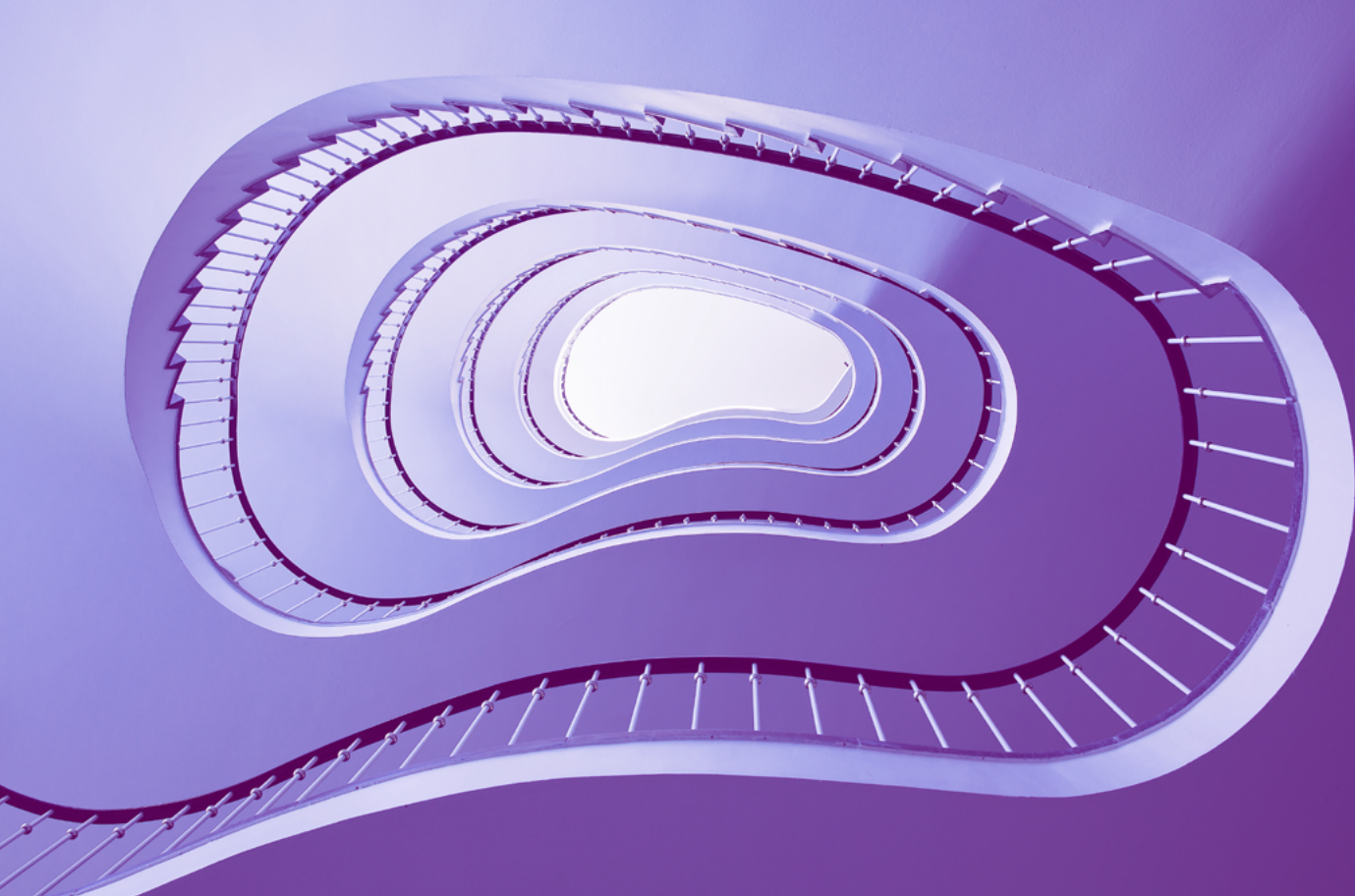
Of course, in reality there are always reasons not to be completely bullish. We are already seeing that there will be winners and losers from the AI boom. After all, one firm's cost savings often equals another's revenue losses. AI tools can now perform tasks that once commanded high fees at a fraction of the cost. At the moment the collapse in pricing is most acute among certain knowledge-based services. As one finance director put it, "What used to cost \$1,000,000 now costs \$200,000 with Accenture, and ChatGPT can probably do it for \$10,000."⁴ This year we have seen share prices of various consultancies and software providers prove vulnerable and this trend is likely to broaden across sectors in the coming year.

¹Morgan Stanley Research: AI Could Affect 90% of Occupations ²Stanford HAI 2025 AI Index Report (official) ³Nearly all US growth in 2025 tied to AI and data center-related capital spending | TechSpot ⁴AI sets up Kodak moment for global consultants | Reuters

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We are already seeing that there will be winners and losers from the AI boom.
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Farewell to freeware?

From the perspective of investors, the question most will be asking is 'how soon will we see a return?' The ability to monetise AI is its biggest uncertainty. While Nvidia and Broadcom have found profitable niches in hardware, most AI applications and services remain loss-making, with unclear revenue models. The emergence of Chinese models such as DeepSeek, which offer advanced capabilities at lower cost and are often given away for free, has further complicated the outlook. At some point somebody's going to have to pay for all of this investment, but who and how isn't clear yet.



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At some point somebody’s going to have to pay for all of this investment, but who and how isn’t clear yet.

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Outside the AI industry, there appears to be a growing scepticism about business leaders’ ability to foresee the ways in which AI will affect their operations, and to direct investors’ capital accordingly. In the UK, estate agency Rightmove was recently punished when it announced a large-scale uptick in AI spending. Its shares lost a quarter of their value due to doubts that AI would enhance the experience of house buyers sufficiently to create the kind of returns forecast by management.⁵

From an economic perspective, the energy consumption required to power data centres is driving up electricity prices, particularly in the US, where they now consume about 4% of total electricity generated – a figure expected to rise sharply by 2028.⁶ Labour costs are also increasing, as the construction and maintenance of data centres require skilled workers, many of whom are in short supply.

For 2026, investors must weigh the optimistic case – of productivity gains, new products, and value creation – against the challenges of monetisation, inflationary pressures, and sectoral disruption. If the positives outweigh the negatives, then the ‘Magnificent seven’ could once again leave the rest of the market in their wake.

But what seems more likely is that there will be something of a shakeout, both among AI companies and in the wider economy, as we get more clarity around the AI winners and losers. During this period, investors will have to position portfolios accordingly and stock picking is likely to come to the fore. Companies best positioned to harness AI’s potential or adapt to its disruptive effects are likely to become more obvious. But the avoidance of certain areas will be as critical as finding the winners.

I’m afraid the only thing that is certain is that you’re going to carry on reading at least as much about AI in the coming year.

⁵AI’s awfully exciting until companies want to use it: Rightmove edition ⁶Data Center Energy Demand Could Triple by 2028, Government Report Warns – Newsweek

Resilience as strategy

Paul Schofield
Head of Global Equities



Global equities

Navigating a world of constant disruption

As we look to 2026, we are leaving behind a year in which investors were initially unnerved by tumultuous global events. The issues that caused this volatility haven’t gone away. But one of the reasons for the subsequent rise in markets has been a growing faith that companies can take these challenges in their stride and will prove more resilient than investors had been giving them credit for.

This marks a distinct change in focus. Efficiency was once the holy grail of corporate strategy. For decades, firms focused on lean operations, cost reduction, and supply chain optimisation to deliver superior returns. That model thrived in an era of relative stability. Today, resilience commands the premium. A series of shocks including pandemics, trade disputes, regional conflicts, and cyber threats has exposed the fragility of hyper-efficient systems and forced a fundamental rethink of what drives value. For investors, this is not a passing trend; it is a structural reset that may shape risk and reward for years to come.

Global logistics have been repeatedly disrupted, turning single-source supply models into single points of failure. The pandemic revealed how brittle just-in-time inventories can be, while extreme weather and cyber incidents have added new layers of operational risk.

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The question has shifted from ‘How lean can you be?’ to ‘How shock-proof is your business model?’

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The question has shifted from “How lean can you be?” to “How shock-proof is your business model?” Companies that build redundancy, optionality, and faster response cycles may incur higher upfront costs, yet they are better positioned to protect cash flows through volatility.

Resilience comes at a price. Multi-sourcing, onshoring or nearshoring, and cybersecurity upgrading are capital-intensive. In the near term, these investments can compress margins and widen the gap between balance sheet haves and have-nots. Investors will need to distinguish between management teams making strategic, well-sequenced resilience investments and those spending tactically without a coherent plan. The former can widen competitive moats; the latter risks diluting returns while achieving little.

Policy and government action

Industrial policy is reinforcing this shift. In a striking break with past practice, the US government took an equity stake of roughly 10% in Intel in August 2025, converting part of previously awarded CHIPS Act support into ownership to accelerate domestic advanced chip capacity.¹ This move underscores how strategic technologies tied to AI and national security are being backstopped

with public capital, not just grants or tax credits. Washington has also moved to secure critical minerals and reduce supply chain risks through new frameworks with allies, including a US-Japan agreement focused on sourcing critical minerals. Additional deals with partners such as Australia aim to de-risk processing and refining.²

Energy security is now central to resilience. In October 2025, the US government announced a strategic partnership with Westinghouse and its owners, Brookfield and Cameco, to deploy at least \$80 billion of nuclear reactors.³ The goal is to increase dependable low-carbon power supply and support data-centre growth. The structure includes profit-sharing mechanisms and potential future equity participation, signalling a long-term public-private commitment to power security.

The energy transition is becoming a resilience play. Europe offers a clear example: the region has accelerated its shift toward renewables to reduce dependency on imported fossil fuels, strengthening both energy security and price stability. Investments are increasingly focused on grids and storage, which are essential for a system that can withstand shocks and maintain reliability.⁴

Digital infrastructure for resilient operations

Digital transformation is also being reframed as a resilience imperative. AI-driven demand forecasting, digital twins (virtual copies of real-world systems that help businesses test scenarios and spot problems before they happen), and blockchain-enabled traceability allow companies to anticipate disruptions and reroute faster. Cloud architectures reduce dependence on single physical sites, while cybersecurity is now a core operating expense. The investable takeaway is clear: providers of security, data integrity, observability, and predictive analytics should be structural beneficiaries as enterprises rebuild operating stacks for reliability rather than pure efficiency.

¹ U.S. Government Takes Historic 10% Stake in Intel, Signalling New Era of Industrial Policy | FinancialContent ² United States - Japan Framework for Securing the Supply of Critical Minerals and Rare Earths through Mining and Processing – The White House ³ Brookfield Press Release | Westinghouse Nuclear ⁴ 10th report on the state of the energy union - Energy - European Commission.



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In a world where uncertainty is the baseline, firms that invest in adaptability will command a premium.

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Diversifying supply chains

Supply chains are being re-routed, and not just to one place. Southeast Asia continues to benefit from “China-plus-one” strategies as firms diversify assembly and component sourcing into Vietnam, Indonesia, Malaysia, and Thailand. Foreign direct investment (FDI) and export data confirm the trend, with Indonesia and Vietnam prominent in greenfield manufacturing and electronics. ASEAN-wide FDI has been resilient, supported by favourable policy and infrastructure upgrades that deepen the region’s role in electronics, automotive, and renewables supply chains.⁵ For investors, that creates multi-year opportunities in logistics, power, and industrial automation across these corridors.

Sustainability meets resilience

Sustainability and resilience are converging. What began as ESG compliance is increasingly a hedge against physical and regulatory shocks. Renewable power agreements insulate against fossil fuel price spikes. Circularity reduces input volatility and waste. Ethical sourcing mitigates geopolitical and legal risks. In Europe, sustained growth in wind and solar has cut import bills and lowered power-sector emissions, illustrating how climate alignment and resilience can reinforce each other. I expect markets to reward firms that internalise transition risk with higher valuations, particularly where decarbonisation dovetails with operational reliability.

Investment implications

The sector implications are clear. Manufacturers with multi-node networks and nearshored capacity can shorten lead times and cushion shocks. Industrials and logistics players stand to gain from capital expenditure in infrastructure and warehousing. Semiconductor ecosystems should benefit from localised production and packaging investment, though capital intensity and execution risk remain high. Consumer companies built on ultra-lean inventories may need to rebuild buffers or re-think product offerings, sacrificing some margin to stabilise availability. Software and cybersecurity vendors that offer observability, threat detection, identity, and AI-assisted planning are positioned to monetise the shift in corporate priorities.

All of these factors have implications for investors. In my view, portfolio construction must now incorporate resilience as a core lens, while balance sheets matter again. Companies with ample liquidity can bridge the investment period needed to rewire supply chains. Pricing power is critical: firms that can pass through higher costs without losing share will protect returns. Regional allocation also shifts – the US and Europe are likely to keep outspending on cyber, grids, and clean-firm power, while Asia, especially India and Southeast Asia, should remain a magnet for diversified manufacturing and infrastructure buildout.

Resilience is not replacing efficiency; it is redefining it. The winners will blend lean operations with redundancy where it matters, digital visibility, and credible energy and sourcing strategies. In a world where uncertainty is the baseline, I believe that firms that invest in adaptability will command a premium, and portfolios that overweight those models should be better placed to perform through the next cycle.

⁵ ASEAN Investment Report 2025 | UN Trade and Development (UNCTAD)

Lessons from 2025 and prospects for 2026

Richard Marwood
Head of UK and European Equities



UK equities

Q What important lessons did you learn from 2025?

A The first observation is one that perhaps sits uneasily in an outlook piece – that even with perfect foresight of economic and geopolitical events, investors might not necessarily make the right call as to how markets might react. At the start of the year, being told that we would be in a world with ongoing large-scale military conflicts, a growing realisation that the finances of many governments are seriously stretched and that the US President would be intent on upending the existing global trade status quo, would an investor be expecting to be sitting on UK equity market gains comfortably into double digits? Probably not. That is why, within our equity team, we spend the majority of time analysing the fundamentals of companies, rather than trying to predict macroeconomics.

The general gloom around market news contrasted with market returns highlights

an important point: It is always important to remember to detach narrative from valuation. Investment is not just a question of looking for stocks with a great story – what you pay for that story is also crucial. A critical determinant of how successful an investment is the price you pay for it in the first place.

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Q In what way will 2026 be different from 2025?

A That is extremely hard to predict, but we can be certain that it will be different. 2026 will be my 30th year working in the financial markets – a period that has seen the dotcom boom and bust, 9/11, Global Financial Crisis, Brexit and Covid, to name but a few of the market fuelling and market shaking events. The market always finds new things to throw at investors, but these events are part and parcel of equity investing and over time this volatility creates opportunities as well as challenges.

Q What is your view on UK equities?

A I have never subscribed to the view espoused by some, that the UK is a dinosaur market, devoid of interesting business. Our market continues to contain plenty of world-leading businesses with interesting products, technologies and market positions. Compared to many other markets, lots of these businesses are attractively valued too.

To reiterate an earlier point, mood music and returns are not the same thing. Over the last five years there has been plenty of gloomy rhetoric about the UK equity market, yet over that five years investors have seen average annual returns in double digit percentages – in fact the FTSE All-Share index has almost 15% per annum over the past five years.¹

¹Source: RLAM as at 31 October 2025.

Q What are your expectations for inflation and interest rates next year?

A While I feel that interest rates will probably edge down a little, I also believe that inflation is likely to remain sticky and higher than long-term targets. This is in part due to my view around how indebted many governments are. With debt there are two ways to clear it – pay it off or default on it. Most governments are not in a position to do the former and as they run deficits and therefore need to take on further debt, cannot do the latter. There is a third way – borrow today a pound and pay it off with a somewhat devalued pound in the future. That is the mechanism of inflation and something that we all witness every day. What we can buy with £5 today is significantly less than what we could buy with £5 only a few years ago.

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Q What does the landscape for UK equity dividends look like?

A Dividend payments remain very healthy in the UK. The market offers an attractive dividend yield of over 3% and the levels of those dividends has risen over time. Growth in dividends is part of what can help equities offset the impact of inflation on savers.

In recent years, in addition to dividends, investors have also benefited from share buybacks. UK companies have been huge buyers of their own shares. Every morning, I read the regulated news service that provides investors with their official news about companies and dozens of these news items are titled “Transaction in own Securities” – announcements of how many of its own shares a company has bought and cancelled. In the long term this can help augment future dividend growth, as the future profits of a business are spread across a smaller number of shares.



Diversify away from the obvious

Trevor Greetham
Head of Multi Asset



Multi asset

Diversify away from the obvious hot spots to seek value and improve portfolio resilience

The world economy is enjoying moderate, if patchy, growth with relatively low inflation when compared to recent years. America’s trade wars and sudden policy swings grab the attention, but in the background central banks have been steadily cutting interest rates and this bodes well for growth in 2026. Governments are heavily indebted, but the corporate sector is in good health with technology-related earnings particularly strong.

Stretched valuations on Wall Street and in parts of the global credit market raise the risk of disappointment should things turn out differently. We’re tactically positive on global equities, including the US technology sector, but our broadly diversified and active approach to asset allocation balances exposure to the obvious hot spots with value plays in government bond markets, UK real assets and commodities.

Business cycle indicators have been moving rapidly in recent months. It’s not beyond the realms of possibility that growth and inflation both end up stronger than expected in 2026. A shift from monetary easing to monetary tightening would strengthen the parallel with the later stages of the dotcom bubble of the late 1990s.

Lessons from the past

History never repeats itself, but sometimes it sure does rhyme. Technology companies are once again engaged in an arms race to become the biggest and best with investors cheering them on. Traditionally cash-generative businesses are suddenly having to raise capital to fund eye-watering investments in artificial intelligence infrastructure. Wall Street is willing to provide cheap finance via generous stock market valuations and opaque private debt structures. We saw the same in the late 1990s, though the telecommunications and media sectors offer a better comparator for today's technology giants than the frothy internet start-ups, most of which had never turned a profit.

Is this a boom or a bubble? History suggests probably a bit of both. Artificial intelligence is undoubtedly a game changer. But as a comparison, few could dispute the transformative impact of the internet on business over the last quarter century and yet equity investors lost half their money in the three-year bear market after the bubble burst. Losses in the technology, media and telecommunication sectors were larger.

For now, there may be tactical opportunities in US equities and technology, but with US stock valuations at their highest level since 1999/2000 and credit spreads tight, we think it makes sense for investors to diversify more broadly.

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Diversification in practice

We believe that value and resilience can be improved by adding government bonds, UK real assets and commodities to a global portfolio. In late 2021, 10-year gilts were yielding 0%, with index linked gilts offering a real yield of minus 2%. We were paying to lend money to governments with the risk of capital losses if and when yields normalised. The 2022 bond market crash was a major reset. Now real yields are closer to plus 2%. This makes life harder for finance ministers, but government bonds are paying their way once more and could provide portfolio resilience in a deflationary shock.

UK equities remain good value, with cycle-adjusted valuations around half the level of the US market. The FTSE’s low exposure to growth sectors could make it resilient in a tech shake out. Indeed, the UK was one of the best performing major stock markets in 2022.

Real assets also have a place. Commercial property has recovered from the interest rate shock of 2022 and the asset class offers a decent yield with steady total returns. UK property was hit hard in the financial crisis of 2008 but it’s worth remembering that it sailed through the dotcom crash, posting good returns in each year of the bear market.

Lastly, commodities, including gold, may be seen as a hedge against unexpected inflation and geopolitical risk. One thing you can say for sure about AI is that it’s resource hungry.

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Country-specific risk under the second Trump presidency has risen significantly, posing a challenge to the dollar.

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Compression and commoditisation

Paola Binns
Head of Credit



Sterling credit

Navigating 2026 in sterling credit

Sterling credit markets have shown remarkable resilience in 2025, weathering external noise and tightening spreads. Despite elevated interest rates and persistent volatility, investment grade credit still offers attractive yields underpinned by robust fundamentals. The commoditisation of the market, driven by new buyers like insurers and ETFs, brings opportunities for active managers to add value through research-led approaches. With sound corporate health and well-capitalised banks, selectivity and discipline remain key. As we look to 2026, navigating compressed spreads demands a focus on fundamentals to uncover income potential and manage risks in sterling credit.

The story of 2025 was one of persistent external noise that generated headlines but did not ultimately undermine credit markets. In our view, despite relatively low credit spreads in an historic context, credit continues to compensate investors for fundamental risks and provides potential for attractive income generation. While volatility seems to be the new normal, credit markets have shown a remarkable ability to cut through the noise. Although we believe this resilience will persist, built off relatively robust corporate fundamentals, tighter credit spreads demand discipline and selectivity.

The year in review

At the start of the year, concerns around heightened volatility—particularly following Donald Trump’s inauguration as US President—were front of mind for many investors. Yet, credit has largely held firm. Market fundamentals have reasserted themselves, with spreads tightening and income generation continuing to underpin performance. While political headlines have dominated the narrative, credit markets have demonstrated their ability to absorb shocks.

Sterling investment grade spreads reduced over the year from 0.86% at the start of January to 0.77% (iBoxx) by the end of the third quarter and also compressed — with the additional spread for owning riskier credits falling further. However, we have seen renewed, strong demand for the asset class.

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Navigating compressed spreads demands a focus on fundamentals.
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Interest rates have remained elevated for longer than expected, pressured by sticky inflation. While investment grade credit continues to offer attractive all-in yields, the composition of those yields has shifted. Credit spreads have tightened significantly in recent years, and contrary to expectations, government bond yields have not fallen as many expected they would. As a result, a greater proportion of the total credit yield now stems from the underlying government component. Recent volatility in fixed income markets has largely been driven by underlying government bond yields responding to geopolitics and macroeconomic uncertainties and we expect this to remain a factor next year.

Compressed credit spreads demand fundamental discipline

Clearly, there is a lot of uncertainty ahead from a political and economic perspective. Combined with tighter and more compressed credit spreads, effective credit investing requires a foundation built on strong fundamental analysis. Given the importance of banks to both economic activity and credit markets, this feels like the right place to start. The sector, at a broad level, is well capitalised, liquid, and operates within a supportive regulatory system. There are also few immediate signs of stress in banks’ loan books.

Looking at corporates more widely, profitability is relatively healthy, leverage is not spiking, and balance sheets remain liquid and diverse. As ever, with cycles extending, risk is increasing but there are limited early signals of significantly rising default rates to imply that investment grade credit spreads no longer compensate for fundamental loss risk.

Commoditisation of the credit market

The relative recent strength of credit markets has, in a large part, been due to the emergence of significant new buyers of corporate bonds, such as insurance companies managing annuity liabilities and ETFs. As well as pushing spreads tighter, this also leads to further commoditisation of credit — with marginal buyers matching their prescriptive investment requirements by favouring more generic bond characteristics. In an asset class that has always been welcomingly idiosyncratic, this dynamic creates real opportunities for active managers, with a fundamental, research-led approach, focusing on bond specifics to build better credit portfolios. In our view, one area that is particularly fertile in this respect remains secured credit, where fundamental attractions are often under-appreciated by the market.

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Effective credit investing requires a foundation built on strong fundamental analysis.
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In an asset class that has always been welcomingly idiosyncratic, this dynamic creates real opportunities for active managers.

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Navigating the new normal

Even if spreads widen, attractive income generation should still be available. Based on future rate expectations, 10-year gilts seem a good entry point at current levels (read the thoughts of our Head of Rates & Cash, Craig Inches). So, although spreads are near to historically tight levels, the potential for strong returns built on all-in credit income looks attractive. It is up to us to find the best ways to access it in our portfolios.

Active management has always been critical in credit due to enduring inefficiencies. Moving into 2026, it feels the driving forces of compression and commoditisation mean that it is more important than ever. Building portfolios with allocations to secured corporate bonds materially in excess of typical bond benchmarks, while maintaining higher yield and income than the index through bottom-up selectivity and appropriate diversification, should continue to give us a strong base for navigating clear headwinds.



Where income meets volatility

Stephen Tapley
Senior Fund Manager



High yield

For those seeking attractive yields, the high yield market continues to offer a compelling case, especially when complemented by resilient risk management, in a rapidly evolving world.

As we look ahead to 2026, the global economic landscape is marked by persistent uncertainty. Global growth is forecast to decelerate to the slowest pace since the pandemic, amid ongoing geopolitical tensions, shifting trade policies, and the risk of policy missteps. From conversations with investors, a common concern that keeps being raised is the combination of worries over expensive valuations in the market and fear at missing any further potential upside.

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Where do we sit?

Central banks are expected to continue easing, but the path of rates is clouded by inflation volatility and fiscal pressures, especially in the US and Europe. The US Federal Reserve and Bank of England are projected to cut rates further, but the pace and depth remain highly data dependent. Euro area rates are near neutral, with limited room for further cuts unless growth falters.

Fiscal support is likely to remain robust, particularly in the US and Europe, with increased spending on infrastructure and defence. Elevated volatility and policy uncertainty are expected to persist, reinforcing the need for defensive positioning and careful risk management.

What areas within high yield offer an attractive option?

As such, with those conditions hovering in the background, where can investors look in high yield markets? In our view, a short duration bias, focusing on bonds being redeemed in less than two years, can offer a defensive stance in a mature high yield market. This approach minimises exposure to interest rate and spread volatility, which is especially valuable as we look at central banks on different rate paths in 2026, unlike longer-duration strategies that are more vulnerable to negative returns in such environments.

Historical data can show that focusing on short duration high yield can deliver similar total returns to the broader high yield market, but with significantly lower volatility and drawdowns. As bonds approach maturity, price volatility diminishes, and the ‘pull-to-par’ effect helps insulate portfolios from market swings. Despite tighter spreads, we feel yields in the short duration segment remain relatively attractive and above historical averages.

A strategy that focuses on ‘battle-tested’ bonds, those nearing maturity, should mean default risk is lower, and also benefit from a higher proportion of higher-rated sub-investment-grade securities.

Another aspect to consider is the self-liquidating nature of a strategy that focuses on short duration bonds. It should see constant cashflow from positions being redeemed, allowing for a somewhat organic re-positioning opportunity as market conditions evolve, as you re-invest and tilt and tweak positioning.

“ We are seeing private debt markets grow in size, hoovering up lower rated companies. ”

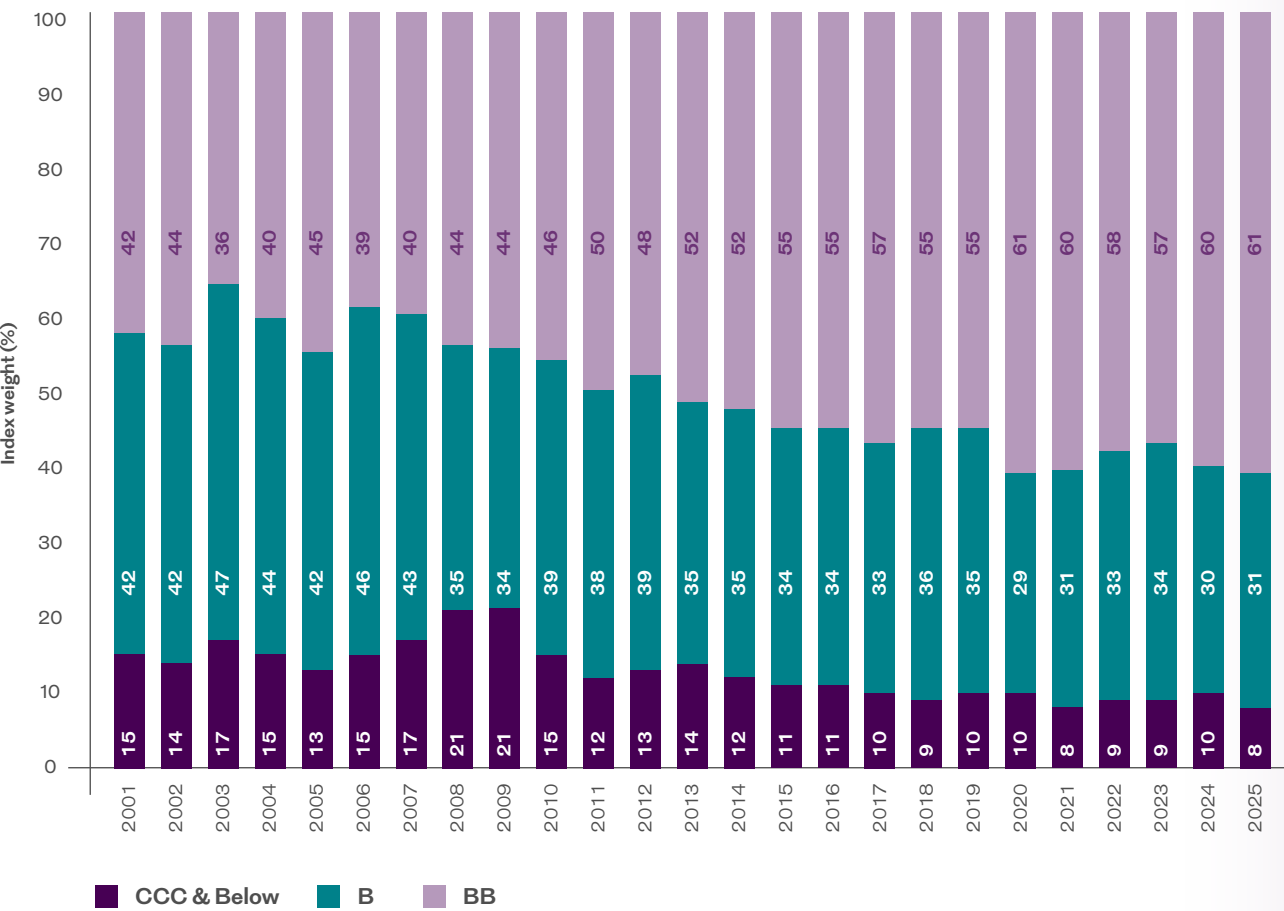


The high yield market has matured, with BB rated bonds now making up a larger share, and some lower-quality issuers have exited the market (chart 1). This has been brought about by the ever-growing presence of private debt. We are seeing private debt markets grow in size, hoovering up lower rated companies. This results in public markets being left in a structurally stronger place. As the CCC portion of the market continues to diminish, taking the most stressed part of the market out of public hands, we can see clear signs of why default rates remain so low.

Is now the right time?

Heading into 2026, could a short duration bias offer a reliable and repeatable process? We believe so, as it is ultimately an evergreen strategy. Whether entering or exiting a slowdown, a short duration high yield strategy that provides defensive positioning and access to high coupon bonds from resilient issuers could protect investors from the expected volatility that next year may bring.

Chart 1



Source: ICE Data Indices LLC using ICE BofA Global High Yield Index (HW00) as at 31 October 2025. Percentages subject to rounding.

What we got right... and where we missed

Craig Inches
Head of Rates & Cash



Rates & cash

2025 delivered on the big calls: rates fell, inflation eased but stayed sticky, and central banks continued cutting. Yet, the pace of disinflation lagged expectations, exposing the resilience of global demand and the willingness of consumers to absorb higher costs. This stickiness now limits how far central banks can go – a critical question for 2026.

Issuance dynamics are shifting. After a surge in long-dated supply early in the year, the fourth quarter saw a sharp pullback as governments acknowledged the unsustainable cost of locking in high yields. You can now expect a glut of short to medium-dated issuance ahead, with curve flattening likely as long supply remains constrained.

Looking forward, we think inflation should grind lower, but growth risks loom. Central banks are nearing the end of their easing cycles, and any uptick in unemployment or wage weakness could unsettle risk assets. For investors, the environment demands flexibility: global diversification, active curve positioning, and inflation hedges will be key. Opportunities lie in global sovereign strategies and index linked bonds – not just to weather volatility, but to exploit it.

Did we get it right?

We began 2025 expecting policy rates to fall and inflation to ease but stay sticky – and that broad call held. Major central banks moved further into their easing phases, while inflation moderated from its peaks without returning to pre pandemic norms.

Where we misjudged was the pace of disinflation in the second half. The global economy proved more resilient than consensus, with wage dynamics and protectionist trade policies slowing the descent of core inflation. The International Monetary Fund’s July update framed the growth backdrop as “tenuous resilience” with inflation drifting down but still above target in key economies, particularly the US.

This stickiness matters: as long as underlying inflation hovers above neutral, policy space for deep cuts is limited. That’s why 2025’s easing moves by the US Federal Reserve, European Central Bank and Bank of England came with heavy caveats about the path ahead. The Fed delivered back-to-back 25bps cuts in September and October but explicitly pushed back on the idea that December easing was “a foregone conclusion,” and it announced quantitative tightening (QT) would stop, a liquidity signal as much as a policy one.

The question for 2026 is whether inflation proves mostly transitory from here or evolves into a structural issue driven by tariffs, fiscal looseness and supply-side frictions. That debate will define rates, term premia and cross market relative value next year.

“

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Issuance: the elephant in the room

Sovereign borrowing remained enormous through 2025, pushing debt to GDP ratios higher and increasing the share of budgets devoted to interest costs. The OECD’s Global Debt Report flagged record sovereign issuance and a marked rise in interest to GDP across much of the OECD. When supply is heavy and inflation uncertain, term premia re-price as investors demand more compensation to hold the long end. We saw that drama play out most clearly in the UK, where the Debt Management Office (DMO) executed an “important shift” away from long-dated issuance in March and April, cutting the long bucket to its lowest share in about 35 years and redirecting supply toward the front end and UK treasury bills.

Markets welcomed the signal that selling 15-year and longer duration at yields above likely nominal growth is not a sustainable funding strategy. By the fourth quarter, that stance was even more visible in primary calendars. The DMO’s revised 2025/26 remit kept overall gilt sales near £299bn but trimmed long-dated supply and boosted short and unallocated buckets to maintain flexibility – a clear attempt to flatten curves at the margin by easing long end supply pressure.

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When supply is heavy and inflation uncertain, term premia re-price as investors demand more compensation to hold the long end.

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More of the same, or a turning point?

Lower inflation and more rate cuts are likely in 2026, but the path won't be smooth. The Fed cut 50bps across September and October, bringing the target range to 3.75–4.00%, and halted QT from 1 December; a liquidity pivot that matters for term funding. The ECB held steady in the fourth quarter after earlier cuts, citing “broadly unchanged” inflation risks, while the BoE eased twice but warned on sticky services inflation.

The first US hurdle into winter is the aftermath of the shutdown. The Senate backed deal to end the record long shutdown reaffirms back pay for federal workers and unwinds reductions in force (RIFs); once the House vote and presidential signature complete the process, back pay should flow “at the earliest date possible” under the 2019 law. Whether households spend or save those lump sums will matter for consumption momentum.

Meanwhile, labour dynamics bear watching. If unemployment ticks up and wage growth cools while tariffs keep goods prices sticky, we could face a tricky mix of softer growth and persistent inflation, forcing slower, stop start easing cycles and renewed dispersion across countries.

Yields on the move: Where do investors go?

Government bond yields fell from their mid year peaks as the market priced a slower growth glide path and the end of QT, but moves were uneven across the curve and regions. In the US, the curve oscillated between ‘bull flattening’ (front end leading on cuts) and ‘bear steepening’ (long end leading yield increases) driven by term premium rebuild, fiscal supply and tariff risks. Strategists highlighted that in cutting cycles the curve often steepens, but today's mix of policy, fiscal and trade uncertainty makes the path jagged.

In the UK, long yields briefly traded at levels last seen in the late 1990s before retreating as the DMO curtailed long supply. The DMO's pivot, plus the BoE's measured easing, has nudged investors to re assess duration and the balance between short strategies and all maturity exposures.

In our view, the message is straightforward: you should look to diversify interest rate risk. Concentrated single country funds leave you exposed to one macro call, whether it is the US term premium or UK issuance, and to local policy pivots. A global, active approach can rotate across curves, regions and relative value expressions, targeting disparate sources of alpha.

Elsewhere, investors should consider global index linked exposure. With sticky services inflation and tariff uncertainty, short to intermediate linkers have outperformed at points this year as inflation accruals and high real yields did the heavy lifting. Allocations to linkers can hedge upside inflation surprises while adding diversified duration.

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The uptick in the unemployment rate will be of concern to the UK and US.

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What we’re watching into 2026

Simple, the labour market. The uptick in the unemployment rate will be of concern to the UK and US. If this begins to break the 5% level materially, we could see some more urgency on rate cuts.

There is inflation’s ‘last mile’ to watch. The IMF and private sector forecasts see headline inflation drifting down, but core (especially services) and tariff pass through keep risks two sided. Whether the stickiness proves cyclical or structural will determine the depth and pace of further cuts.

The issue of fiscal issuance and discipline will also need to be monitored. Where treasuries emphasise short end over long end supply and communicate consistent frameworks, curves should flatten and volatility should moderate, with the UK offering a real time case study.

And finally, geopolitical posturing is worth watching. European budget concerns in France, continuing tariff tensions and trade talks in the US, as well as underlying global conflicts will continue to create volatility for both risk assets and sovereign bonds.

One thing is certain

The next 12 months will not be quiet. Investors who embrace flexibility, global diversification, and active management across curves and instruments should be best placed to navigate, and capitalise on, volatility across rates, inflation, and policy regimes. In our view, the right mix is a globally diversified government bond core, selective index linked exposure, and the ability to lean into relative value when issuance, policy and liquidity regimes create dislocations.



Challenges, concerns... and optimism

Kevin McCauley
Head of Strategy & Property Research



Property

UK real estate remains a key asset class for many investors – both in the UK and globally. Looking at the prospects for this area in 2026 means looking at underlying fundamentals, but also why this may remain attractive over the longer term.

Key lessons learned from 2025

The property market underwent a significant value correction that started in the middle of 2022 and continued into 2023. The subsequent recovery has been notably slow and, at times, seemingly appeared to stall altogether. This experience served as a crucial reminder that recoveries in the property sector are often gradual, with investors typically adopting a cautious approach. As risks become more apparent, investor confidence can waver,

further prolonging the recovery period.

Another important lesson from 2025 was the persistent and sometimes unbridgeable gap between buyer and seller pricing expectations. This disparity has frequently resulted in a reduction in the number of completed transactions, as parties struggled to agree on valuations.

Despite these challenges, one positive development has been the pronounced competition for high quality assets. This strong demand for prime properties has played a significant role in establishing market pricing benchmarks.

Finally, the influence of macroeconomic conditions on investor activity was particularly

evident in 2025. Even in the face of robust rental growth and healthy occupier demand, many investors have remained hesitant, and the market has not witnessed a large-scale return of investment activity. While there have been isolated areas of intense transactional activity, a consistent and broad-based recovery is yet to materialise.

In what way will 2026 be different from 2025?

If the coming months bring greater clarity around the UK’s fiscal position, this could support a reduction in gilt yields and overall debt costs. Such conditions may improve investor sentiment and encourage increased transaction activity in the months ahead.

Should debt become more accretive under these circumstances, debt-backed investors are more likely to re-engage, helping to drive a sustained rebound in capital values across sectors. Combined with continued robust rental growth, these dynamics would create strong total return opportunities for investors.

Outlook for UK real estate

Our overall outlook for the UK real estate market is broadly positive. While optimism is gradually becoming more widespread, there are still some notable challenges. Concerns surrounding public finances and the complexities of the current inflationary environment continue to create a degree of uncertainty, making the landscape less clear-cut.

We anticipate that the differences in performance across various sectors will be less pronounced compared to the previous cycle. Rather than expecting a rapid upturn, we predict a steady and measured recovery. With limited potential for further inward yield movement, it will be essential for investors to focus on proactive asset management and the realisation of income growth to generate positive alpha.

There is currently robust occupier demand in most sectors, coupled with a shortage of prime space. This dynamic is expected to support ongoing rental growth, which in turn will drive cashflow growth for investors. Performance will increasingly be determined by asset-specific factors, with prime and well-located properties forecast to outperform the broader market. We think this trend is expected to be particularly evident in the office sector, where prime assets are likely to lead the way.

What makes UK real estate so attractive to overseas investors?

The UK is a leading destination for overseas capital, consistently attracting a significant share of international investment. Over the past decade, overseas capital has accounted for approximately 50% of the market, with some years reaching as high as 60%. London stands out as the principal performer within the UK, regularly drawing more overseas investment than any other city on the global stage.

There are several compelling reasons why international investors are drawn to the UK, many of which extend beyond the property sector itself. The English language, cultural familiarity, and longstanding educational connections – many investors were educated at UK universities – contribute to the country’s enduring ‘soft power’ and appeal. Confidence in the UK’s legal system further underpins this attraction. While political stability was historically a crucial factor, its significance may have shifted somewhat in the post-Brexit era.

From a real estate perspective, the UK offers a range of benefits that are highly valued by overseas investors. These include a transparent and liquid property market, a track record of robust total returns, and the historic use of upward-only rent reviews – though it should be noted that the government is considering legislative changes to this practice. The scale of opportunity is also a major draw, with London ranking among the world’s largest office markets. Additionally, the planning system, while challenging for developers, serves to constrain supply and thereby helps support rental growth, which is attractive to investors seeking long-term value and stability.

Overseas investors continue to look at the UK

Many of the key factors that have historically attracted international capital to the UK remain firmly in place and are expected to persist for the foreseeable future. In the context of political uncertainties across the continent and globally, the UK’s reputation for stability may once again become an appealing attribute for overseas investors.



At present, the most compelling aspect for international investors is the UK's current position within the property cycle. Occupier markets across most sectors have shown remarkable resilience, with robust rental growth observed in the post pandemic period. While this rate of growth is expected to moderate, it is anticipated to remain above historic averages, providing continued support for income growth and cashflow stability.

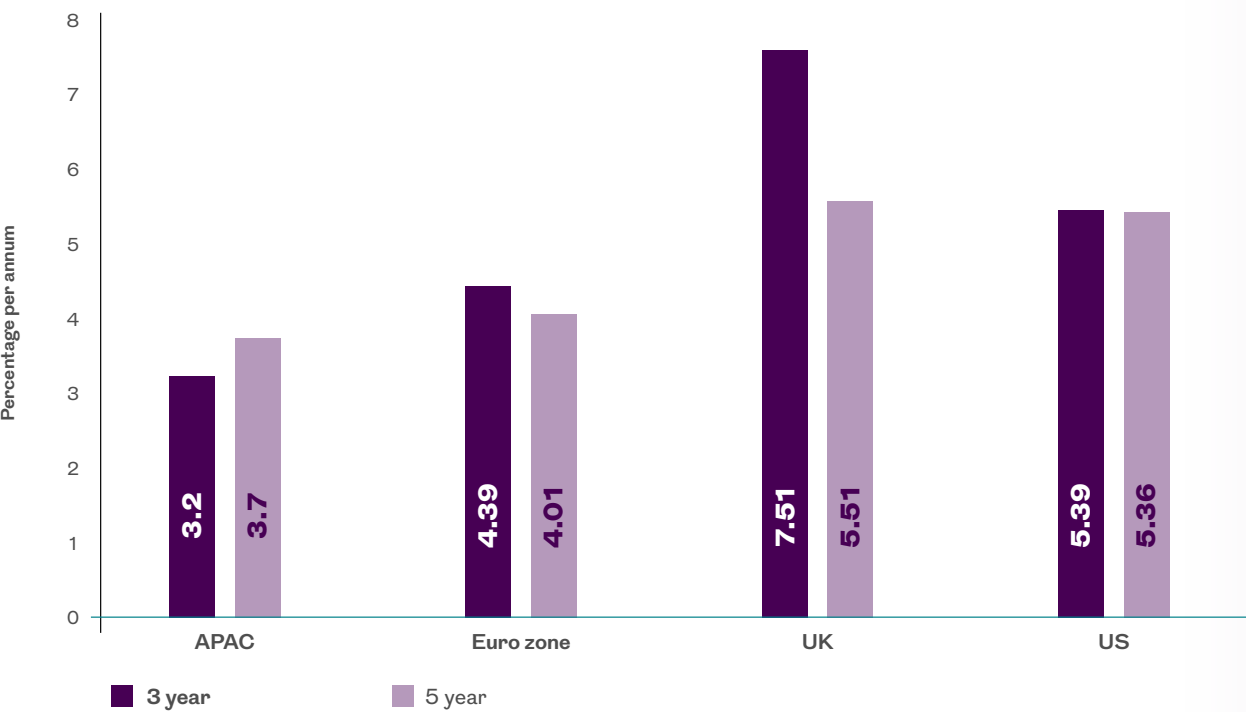
The UK is set to be the second-fastest-growing of the world's most advanced economies this year, according to recent projections from the International Monetary Fund. The UK economy is forecast to achieve annualised GDP growth of 1.3% this year and next, outpacing other major European economies such as France, which is projected at 0.8%, and Germany at 0.5%. This economic momentum is expected to underpin occupational

markets and further enhance the appeal of UK real estate for international investors.

One notable factor absent from the recent recovery has been a sustained improvement in investor sentiment, which is essential for a consistent increase in capital values. However, it is anticipated that we are at a turning point, with a full capital value recovery expected to commence. Capital Economics forecast UK total property returns of 7.5% and 5.5% annualised over the next three and five years respectively¹ – figures that outperform other markets. This robust performance is projected to be evident across all real estate sectors.

Overseas investors are acutely aware of these emerging opportunities and it is our view that 2026 could see this awareness translate into increased activity within the UK market.

All Property predicted total returns, 2026-30



Source: Capital Economics, Global Property Returns & Valuations, October 2025 . Forward looking statements are subject to certain risks and uncertainties. Actual outcomes may be materially different from those expressed or implied.

¹Source: Capital Economics, Global Property Returns & Valuations, October 2025.

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