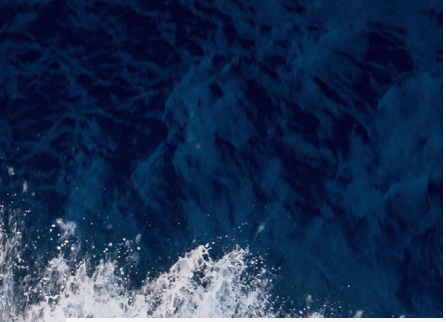
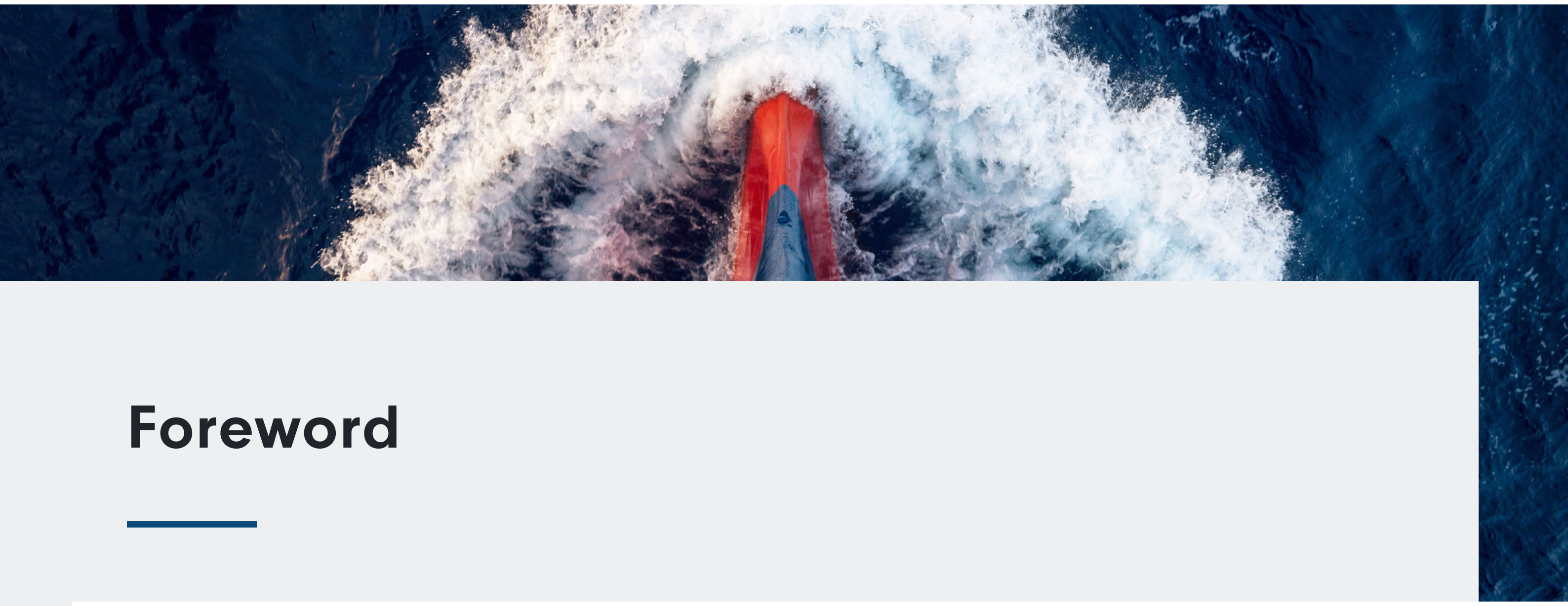
Mid-Year Outlook 2026
The shock absorbers

This is for investment professionals only and should not be relied upon by private investors



Contents



Foreword

Staying invested during volatility

Our Mid-Year Outlook sets out to address the questions we've been hearing from clients in the first half of 2026. In summary, our analysts are positive about the economic outlook and the returns that AI investment is helping companies deliver. But we also recognise the likelihood of further shocks for which investors need to plan. Inflation is expected to be a challenge in the second half of this year as the Middle East conflict continues to hamper oil supplies. Bond investors appear nervous. And there are concerns about equity valuations.

In my experience, investors often face two temptations at times like these. One is to retreat to cash and its sense of stability, albeit at the cost of losing real value through inflation and potentially missing future market gains. The other is to 'double down' on risk assets in the hope of capturing substantial returns. There are significant drawbacks to both courses of action.

In our discussions with clients, we've advocated a more balanced approach - one combining core income-generating allocations with selective exposure to long-term growth opportunities and a judicious approach to valuations. Well-chosen dividend-paying stocks, inflation-linked bonds, or short-dated credit can help mitigate risk while delivering above-cash returns. Simultaneously, real assets such as infrastructure and commodities, alongside targeted allocations to areas including defence spending and AI, can allow investors to participate in growth opportunities while maintaining portfolio diversification.

So while investors face a volatile outlook, shaped by technological change and geopolitical fragmentation, there are strategies available to mitigate shocks while focusing on long-term financial objectives.

In the pages that follow, our experts dig deeper into all of those issues. Fidelity's heads of macro and multi-asset consider a fragmenting global economy; our solutions team outlines practical steps to take for the next round of inflation; our equity analysts look at the best ideas for investing in AI; and the digital assets team surveys signs of progress on tokenisation. We're confident their insights will help you navigate the second half of the year.

Samantha Ricciardi
Head of EMEA

Global Outlook: The shock absorbers

Conflict in the Middle East has reaffirmed that we live in a fragmenting world order, which demands extra vigilance from investors. Nevertheless, we believe fundamentals should be supportive of risk assets through the second half of this year.

Henk-Jan Rikkerink
CIO Multi Asset,
Real Estate and Systematic

Salman Ahmed
Global Head of Macro
and Strategic Asset Allocation

Top convictions

- We are constructive on **equity risk overall**, but particularly in **Japan and select emerging markets.** We remain mindful of the strong rally markets have seen since April. We prefer to take risk in equities than credit, where spreads remain tight.
- **AI capex** has been the driving force for global markets and is supporting other themes like **energy scarcity and grid upgrades.**
- **Commodities** are boosted by geopolitical fragmentation and the AI capex cycle. Additionally, commodities, particularly those that are linked to energy, can provide useful diversification for geopolitical risk when traditional assets such as duration and gold behave less reliably.

Markets are growing accustomed to volatility as the first phase of the conflict in Iran draws to a close. They are starting to look through the short-term noise towards resilient fundamentals supporting asset performance through the rest of this year, while the AI capex cycle remains a powerful upward driver for markets across the globe. All of this results in a constructive environment for investors.

At the same time, an increasingly fragmented world order requires thinking about geopolitical factors in new ways. Traditional safe havens will not play the same role as they used to. And diversification will prove more important than ever (but harder to achieve).

With this in mind, we approach the second half of 2026 with the above convictions.

	US	China	Europe	Japan	UK
Base Case	Reflation	Controlled stabilisation	Energy shock offsets fiscal tailwind	Wage-led reflation	Stagflation-lite
Growth	2%	~4.5%	~0.8%	~0.7%	0%
Inflation	>3%	<2%	3%	>2%	3%
Policy Bias	Fiscal easing bias; no interest rate cuts in 2026	Fiscal easing bias and neutral monetary policy	Rate hikes - number determined by length of conflict	Gradual normalisation	Rates on hold, risk of hikes growing
Key Risks	AI unwind; Fed politicisation	External demand shock; weak confidence	Stagflation from higher energy prices	Stagflation; fiscal discipline	Fiscal/political uncertainty

Source: Fidelity International, May 2026.

Messy resolutions

The key macro variable for the near future is the energy supply shock caused by the closure of the Strait of Hormuz.

Our base case is for a 'messy resolution' to the conflict. Higher inflation and tighter monetary policy will drag on growth across most regions; energy markets will maintain a persistent geopolitical risk premium. Geopolitics will remain a pressing theme even if the US and Iran find a resolution, with question marks still hovering around the former's intentions towards Cuba and Greenland.

We think the European Central Bank is the most likely of the major central banks to hike rates this year as higher energy prices and their second-order effects force a reaction.

The winners and losers will become clearer as different economies feel different effects from higher energy prices.

Parts of Asia will feel this squeeze most, since countries here are particularly reliant on supply through the Strait. You can read more about our views on the situation there and the investment implications in our Asia Outlook.

Europe too is relatively exposed. We think the European Central Bank is the most likely of the major central banks to hike rates this year as higher energy prices and their second-order effects force a reaction. The conundrum for policymakers is that growth in Europe is also under strain, as higher energy prices erode real incomes and weigh on confidence.

The US should prove relatively resilient against the energy shock because it's less reliant on imported energy. All the while the AI capex cycle continues to support the economy, feed into strong corporate balance sheets, and drive earnings momentum.

However, the US is also beginning to see the direct impact of the energy shock feed through to headline inflation. There is a risk that sustained energy costs begin to influence expectations and pricing behaviour. If the war re-escalates, more rate hikes by the Federal Reserve could be priced in. Private credit presents risks too, which we cover below, and those could prompt

Strategy view: Sovereign bonds offer value amid market divergence

Mike Riddell
Portfolio Manager

The macro environment entering the second half of the year remains defined by sticky inflation, elevated geopolitical uncertainty, and increasingly divergent market pricing. While recent market moves have been interpreted by some as a sign of weaker growth expectations, we believe the latest sell-off in rates has been driven primarily by higher oil prices and renewed inflation concerns rather than a fundamental shift in the underlying macro regime.

Energy markets are exerting a powerful influence on inflation expectations and government bond yields. We think inflation and geopolitical developments will be the drivers of market sentiment for the next six months.

Against this backdrop, we believe markets are still too willing to extrapolate central bank hawkishness and underestimate the extent to which tighter financial conditions and geopolitical shocks are likely to weigh on growth over time. Developed market rate curves are pricing further tightening that we do not expect to fully materialise. This creates opportunities across sovereign bond markets.

As a result, we have moved to an overweight duration stance relative to benchmark, with increased exposure to UK rates at the front and intermediate sections of the curve. We're still cautious at the longer end, where fiscal concerns and elevated bond supply present a more challenging backdrop.

We also continue to see a significant disconnect in credit markets. Despite rising geopolitical tensions, tighter liquidity conditions, and persistent macro uncertainty, spreads across both investment-grade and high-yield credit remain relatively compressed. In our view, investors are not being adequately compensated for downside risks, particularly if current conditions begin to weigh more materially on corporate fundamentals.

Consequently, we're maintaining a defensive stance in credit through outright short exposure to both US investment grade and high-yield indices. This reflects one of our more cautious views on credit markets in recent years.

Inflation is another area where selectivity is becoming increasingly important. While we continue to hold inflation protection within the portfolio, particularly in the US, the sharp repricing in market-implied inflation expectations has led us to take profits and reduce some exposure following the recent rise in breakevens.

We increasingly seek diversification not only across asset classes, but also across macro drivers, regions, and sources of return. This includes combining developed market duration exposure with selective emerging market local rates and foreign exchange (FX) positions, where valuations are attractive and macro fundamentals appear stronger than in many developed economies.

Emerging markets currently present some of the more compelling stories in fixed income. We are constructive on EM FX where valuations screen attractively on both a real effective exchange rate basis and in terms of macro fundamentals. In particular, we've added exposure to currencies such as the Chilean peso and Colombian peso, where improving terms of trade and commodity support are not yet fully reflected in market pricing.

Managing downside risk remains central as markets oscillate between inflation concerns, geopolitical developments, and slowing growth dynamics. In this environment, a diversified and unconstrained approach across rates, inflation, currencies, and credit is essential. This should help protect capital and identify attractive risk-adjusted opportunities through the rest of the year.

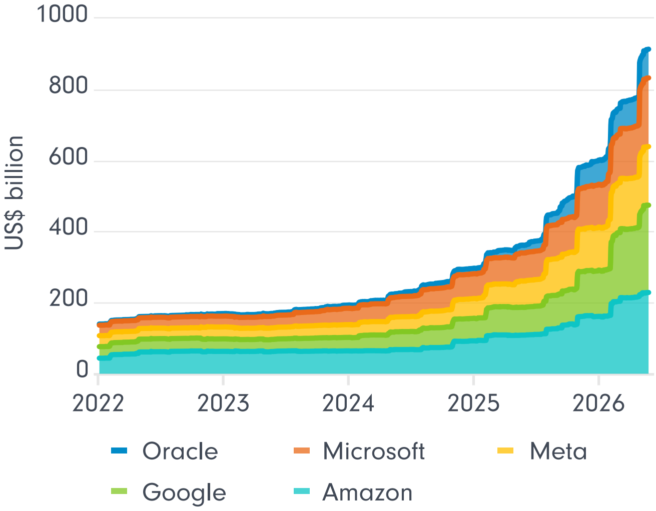
a swift policy response (with November's midterms providing a potential flashpoint).

Against this backdrop, the scope for the Fed to ease this year will be limited. Policymakers will most likely remain cautious in the face of above-target inflation, with Federal Open Market Committee members likely to blunt new Fed Chair Kevin Warsh's more dovish instincts.

A constructive environment

Resilient fundamentals are supporting markets, despite geopolitically-induced volatility. Most significantly, US tech behemoths are continuing to pour billions into AI development that is driving continued earnings momentum.

Big tech is going bigger on AI

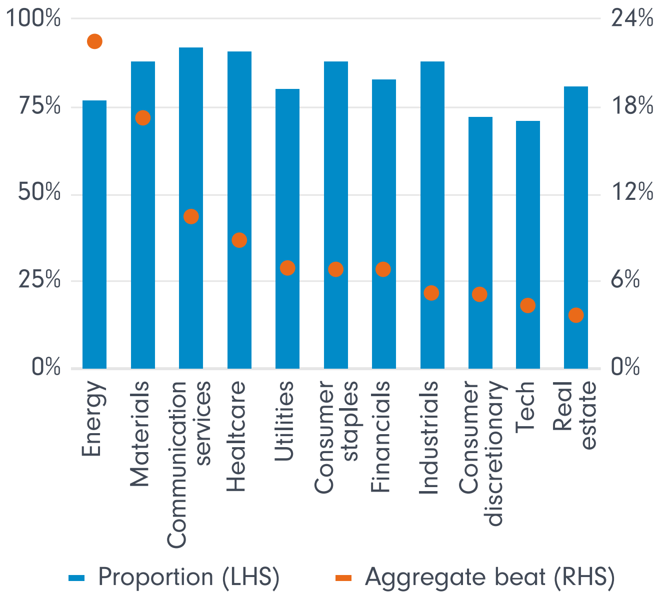


Source: Fidelity International, Bloomberg, May 2026. Chart shows Bloomberg consensus estimates for 2-year blended forward capex.

That immense capex spend is bolstering companies across the value chain, including the industrial enablers that support the building of datacentres and rising energy needs.

A wider set of US businesses are also starting to feel the impact of that AI-driven capex spend underpinning earnings and improving productivity. This broadening effect across the market presents enticing entry points while attention is focused on a small number of high-valued tech names.

A range of sectors in the US are beating earnings expectations



Source: Fidelity International, Bloomberg, May 2026. Note: "aggregate beat" shows the percentage by which all companies in a sector beat expectations, not just those companies that did beat expectations.

The earnings story remains strong globally, driven in part by AI capex, but also due to the partial unwinding of trade tariffs and resilient economies. Other structural themes will persist elsewhere, with Europe still investing in its defence sector, for instance, as conflict continues and policymakers strive to localise defence supply chains. Similarly, there is renewed focus on improving energy resilience, resulting in further investment by the US and Europe in their ageing grids.

The emerging markets split

That uncertainty also means it's important to be selective when allocating across regions. We are underweight European equities, which are more exposed to supply disruption and the prospect of stagflation. Meanwhile the AI trade and strong earnings are supporting US stocks, though parts of that market have already run a long way. Japanese equities continue to look attractive, with earnings strong and the policy backdrop favourable.

Emerging markets remain a high conviction allocation for us. EM equities benefit from broader tailwinds such as the AI cycle. A softer dollar and structurally improving policy credibility should also be positive drivers.

However, the conflict in Iran is having a divergent impact across the EM universe. Those that export commodities in Latin America are benefitting; those that import energy, particularly Asian economies that are reliant on supply that passes through the Strait of Hormuz, are suffering.

So a discerning approach by EM investors is required. Brazil for instance is one beneficiary from increasing energy prices with equities that are attractively valued and could do even better from an easing policy cycle. South Africa boasts compelling domestic fundamentals and commodity support. Parts of Asia Pacific too are compelling despite energy disruption - Korea, supported by the semiconductor cycle and corporate reforms, is one such example.

Rethink safe havens

As the macro environment changes, so does the way we think about diversification. Heightened geopolitical and fragmentation risks are putting a strain on traditional safe havens, which means investors can't rely on a single asset to support riskier elements of their portfolio. We have moved from a world that was defined by occasional growth scares into one of more structural instability. Varied sources of defence are necessary.

Strategy view: Geopolitics fails to derail emerging market equities

Christopher Tennant
Portfolio Manager

Whilst it was a strong start to the year for emerging market (EM) equities, robust headline performance tells only part of the story. Markets have been characterised by significant dispersion, with the conflict in the Middle East driving elevated volatility, rising geopolitical uncertainty, and concerns around higher oil prices. We expect this more uncertain and differentiated market backdrop to persist for the remainder of the year.

Despite this, we believe the outlook for EM equities is persuasive. Firstly, they've appeared relatively resilient in the face of geopolitical uncertainty. Although higher oil prices may be a problem for oil importing countries like India, central banks have been much more orthodox in this cycle, meaning policy rates are high and inflation is running well within target bands across much of the region. As a result, elevated oil prices are unlikely to materially alter the path of monetary policy in EM, with scope for further rate cuts in some countries.

The fiscal backdrop is also relatively robust, with cleaner budget balances than in previous cycles. Emerging markets have less dollar-denominated debt than in the past, making them less exposed to geopolitical risks. Taken together, this supports the case for EM as a diversification source versus developed markets, where fiscal conditions are becoming more strained.

However, investors shouldn't just think of emerging markets simply as a source of diversification. There are several structural growth drivers creating opportunities across the investment universe making EM an attractive portfolio allocation in its own right.

Take the AI supply chain. High-quality tech hardware businesses in Taiwan, for example, are benefitting from hyperscalers' AI capex. This provides a good way to access the AI theme without the elevated multiples seen in parts of the US. We also remain constructive on memory, given the attractive supply-demand backdrop, underpinned by tight capacity and growing demand for AI servers. Elsewhere, commodities look attractive over the rest of the year. We like copper, where accelerating grid investment is driving demand as supply tightens. There's significant value among gold miners, with many producers trading on double digit free cash flow yields at current spot prices and below. Strong commodity prices also support exporters, particularly in certain LatAm markets and South Africa.

Some EMs look well placed to benefit from the evolving geopolitical landscape over the medium term. Mexico, for example, is likely to benefit from nearshoring, as US businesses continue to move parts of their supply chains closer to home.

Shifts like this combined with periods of elevated volatility can provide rich hunting grounds for active stock pickers with a longer-term investment horizon. Broad de-ratings provide a chance to add exposure to high-conviction names at more attractive multiples. Taiwan's tech sell-off in March was just one such example.

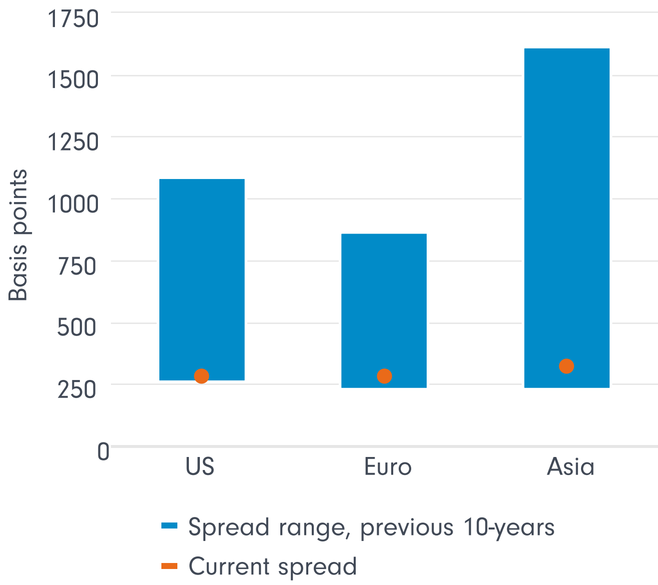
There are, of course, pockets of weakness. EM continues to be highly dispersed, with attractive opportunities for commodity names with AI supply chain exposure, but with several problem sectors too, such as Indian IT services or Chinese housing. With this differentiated backdrop likely to persist through the rest of 2026, investors should look for resilient structural growth stories and be wary of where pressures are unlikely to ease.

The dollar, for instance, does not look as attractive for the long term as it once did, owing to less predictable US policymaking. Gold has performed surprisingly poorly through the conflict but we remain positive on the commodity, owing to its supportive underlying drivers. It can perform strongly when inflation hurts bonds and serves as a diversifier when correlations between bonds and equities increase. Likewise, it can respond well to dollar weakness and falling real yields.

Exposure to commodities should support portfolios with inflation set to remain higher for longer, particularly those with energy exposure that can protect against geopolitical risk. They can also provide a hedge while duration suffers. Inflation reduces the scope for yields to fall materially and therefore diminishes the upside for duration, hence its poor recent performance. Were growth fears to re-emerge later in the year then duration would reprise its role as an equity hedge. You can read more on inflation protection in this Outlook.

We're similarly cautious on credit as spreads still offer limited compensation for the macro risks. High yield is more attractive than investment grade, particularly in the shorter and higher-quality ends, though primarily as an income asset. Fundamentals are strong but offer limited scope for capital appreciation.

High yield remains a carry play as spreads stay tight



Source: Bloomberg, Fidelity International, April 2026. Option adjusted spread, Bloomberg HY indices.

Safe-haven assets perform differently across market sell-off regimes

Scenario	Regime variable	Dollar	UST	Oil	Gold	JYP	CHF	Equities
Funding / Dollar squeeze	Dollar	2.10%	-0.30%	-1.00%	-1.90%	-1.10%	-2.20%	-2.30%
Growth scare	US Treasuries	0.00%	1.80%	-2.00%	-0.10%	0.80%	0.40%	-2.50%
Rates shock	US Treasuries	0.50%	-1.80%	0.50%	-0.20%	-0.30%	-0.60%	-2.10%
Inflation scare	Oil	0.00%	-0.10%	7.30%	0.70%	0.20%	0.20%	-1.50%

Past performance is not an indication of future results

Source: Fidelity International, Bloomberg, April 2026. Based on weekly returns from January 1977 – April 2026. Dollar: DXY Index. UST: returns implied from the 10y US Treasury index. Oil: Generic 1st Crude WTI, backfilled with Bloomberg Commodity index prior to 1990. Gold: XAU Curncy. JPY: JPYUSD Curncy. CHF: CHFUSD Curncy. Equities: MSCI World Index, backfilled with S&P 500 Index prior to 1999

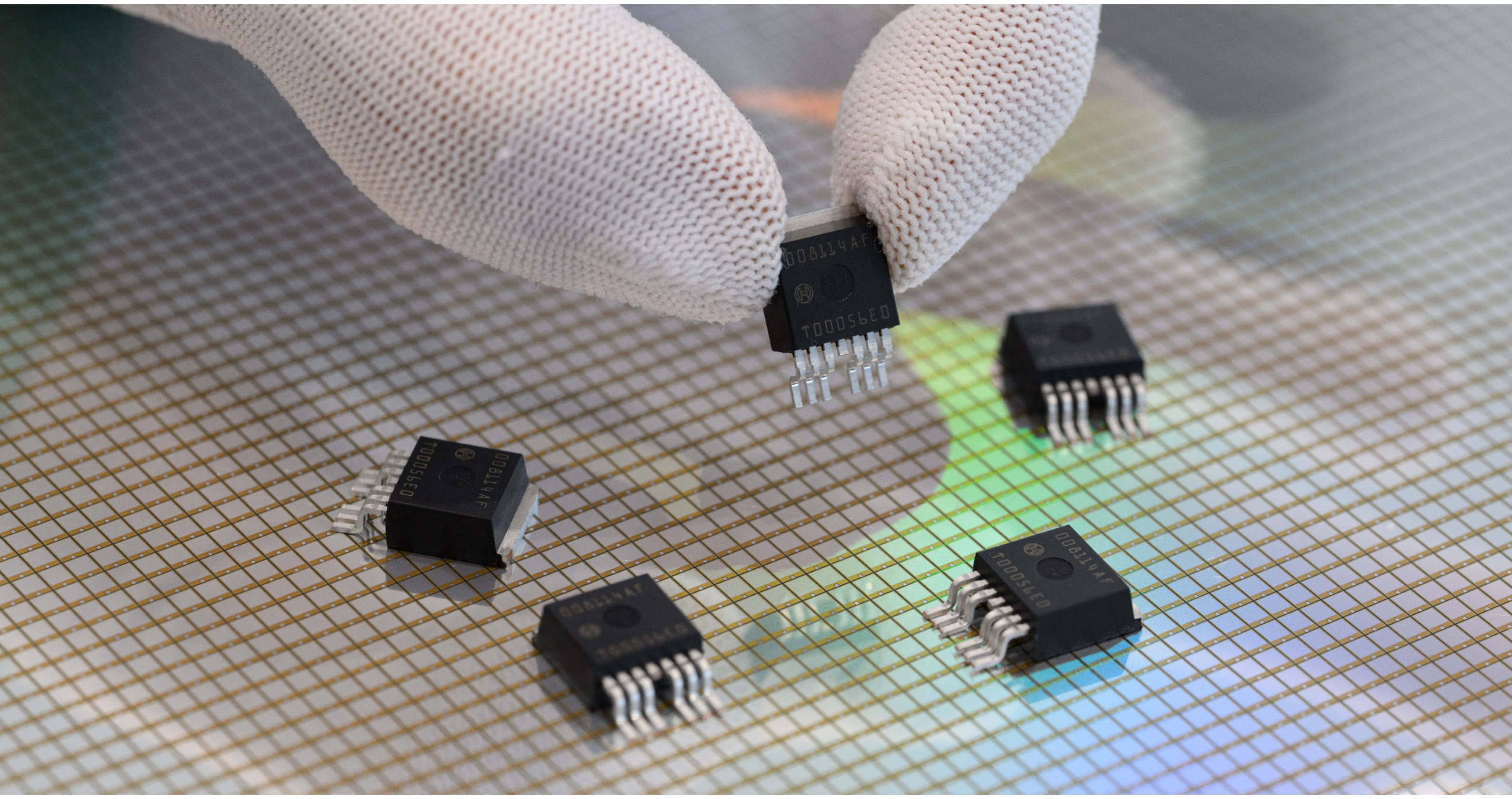
Finally, there's private credit. The asset class has come under pressure recently, mostly driven by a shift in the credit cycle towards higher default rates. But defaults are increasingly concentrated in specific parts of the market, and certain sectors like software and technology lending are of greater concern.

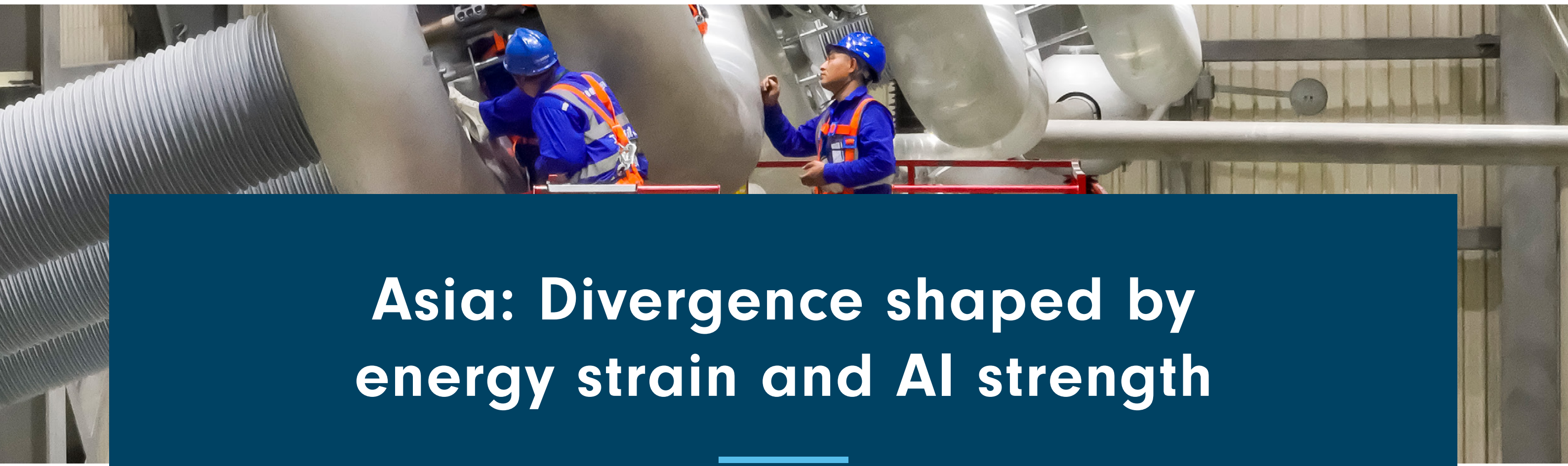
The overall picture for private credit is one of contained rather than systemic risk, with fundraising and fundamentals still healthy. More defensive areas such as mid-market lending with stronger covenants, experienced managers, and diversified asset-back lending, appear best placed to weather the near-term disruption.

Through the noise

Markets have proven impressively resilient against a volatile first six months of this year. But their steadfastness shouldn't be surprising. They've become well-versed in seeing through the noise and recognising upside. An immense AI capex cycle, strong earnings, and relatively strong fundamentals across markets have reassured investors that there's still plenty of alpha to be captured.

Now is not a time to shy away from risk, only to ensure it's balanced in a well-diversified portfolio that will cushion the inevitable shocks when they come.





Asia: Divergence shaped by energy strain and AI strength

Asia's outlook is being defined by two powerful trends: an energy shock and the artificial intelligence build-out.

Matthew Quaife
Global Head of Multi Asset

Peiqian Liu
Asia Economist

Top convictions

- **AI** will remain a dominant theme in Asia, further boosting the appeal of tech names in **South Korea**, **Taiwan**, and **mainland China**.
- **Japanese mid-cap stocks** are appealing, benefitting from recovering domestic demand and corporate governance reforms.
- We are positive about **commodities** as a hedge against inflation and a portfolio diversifier.
- The increasing focus on commodities, coupled with Australia's solid domestic economy and a hawkish Reserve Bank of Australia, is likely to support the value of the **Australian dollar**.

Asia, a region heavily dependent on the Middle East for energy, has been acutely affected by the fallout from the Gulf conflict. But the impact has been uneven, with energy importing nations facing supply shortages and higher costs, and exporting nations benefitting from rising commodity prices. The ability of different countries to cushion the shock has also varied widely. At the same time, surging AI capex is generating significant prospects for the region's chip hubs and tech giants. These two powerful forces will drive investment themes across Asia in the second half of 2026.

North vs South

Around 80 per cent of oil travelling through the Strait of Hormuz typically heads to Asia. The blockade has led to a considerable energy shock in the region, one that's being mitigated by a combination of fiscal and administrative measures with varying levels of demand destruction. The important divide lies between wealthier North Asia economies such as China, South Korea, and Taiwan, which are better able to weather the spillovers of the conflict, and those in the south and southeast such as India, Thailand, and the Philippines.

China has largely shielded itself from the shock with sizeable reserves and a diverse energy mix. As higher input prices are increasingly passed on to consumers, the impact of cost-push inflation may gradually become more visible and entrenched, easing deflationary pressures. The property market,

Strategy view: More valuation questions appearing in the AI trade

Jochen Breuer
Portfolio Manager

I am increasingly sceptical about valuations in a number of the tech plays we have seen doing well over the past couple of years. I'm not a full-blown AI bear at all, and as a dividend investor I do hold a lot of companies that are exposed to the theme, either through more reasonably priced AI enablers or through companies that are benefitting, for example from growing industrial automation. But I think increasingly the opportunities lie in companies that successfully use AI to improve their businesses, rather than just the pure picks and shovel names.

As an income investor I'm used to focusing on total shareholder returns backed by dividends and buybacks. The big hyperscalers were previously companies that were returning huge quantities of cash to shareholders. Now they are spending most of their cash flow on capex for a return which is as yet unclear. Just as importantly, previously they were all swimming in their own lanes. That is no longer the case: they are now competing with each other and not everyone can win.

There's a similar way of looking at the memory chip players in a couple of the markets I currently watch most closely. I've held some of these companies for a long time, but, for example, SK Hynix, Samsung, and Micron together next year are expected to generate around USD $600 billion in net income. That is higher than Microsoft, Apple, Meta, and Alphabet combined. While the memory supply-demand balance remains tight for the foreseeable future, the profit pool for these cyclical businesses looks unsustainable in the long run. This, combined with increasing retail investor participation in these stocks, makes me more sceptical about them in the medium term.

That is all worth bearing in mind when we look at the volatility of the past few months. There has been an equities market sell-off, but more than that: the recovery has been quite tightly about AI names, and many of them look richly priced given medium-term assumptions and the recognition that this is a cyclical industry.

In many ways that's a reflection of my investment experience more generally over the last couple of years: my aim is to keep pace in rising markets, but to do so with a lower level of volatility and drawdowns; to achieve that outcome at a time of such volatility in the overall market, and such (over)concentration, takes a lot of nimble, hard work and a lot of good investment ideas. Increasingly I find more and more of these in sectors that investors have neglected. Examples include healthcare, property, and selective names in the consumer space. That direction, along with what happens in the AI trade, may help shape the rest of the year.

which has grappled with a slump since 2021, is also showing early signs of stabilisation, reducing the need for any urgent, broad-based policy easing. Targeted stimulus remains the main policy lever to dispel headwinds from the energy shock. There probably won't be a sustained uptick in consumer sentiment until there's been further improvement in the property outlook. With domestic demand subdued, the economy will depend on exports and investment as sources of growth this year.

Japan's economic recovery remains intact, underpinned by an expansionary fiscal policy and recovering domestic demand. Given the country's reliance on imported energy, high oil prices are likely to weigh on real incomes and corporate margins, increasing downside risks to growth. But Prime Minister Sanae Takaichi's landslide election victory in February raised the probability of more fiscal support. We expect the Bank of Japan (BOJ) to normalise interest rates at a gradual pace, helping anchor inflation expectations without choking off growth.

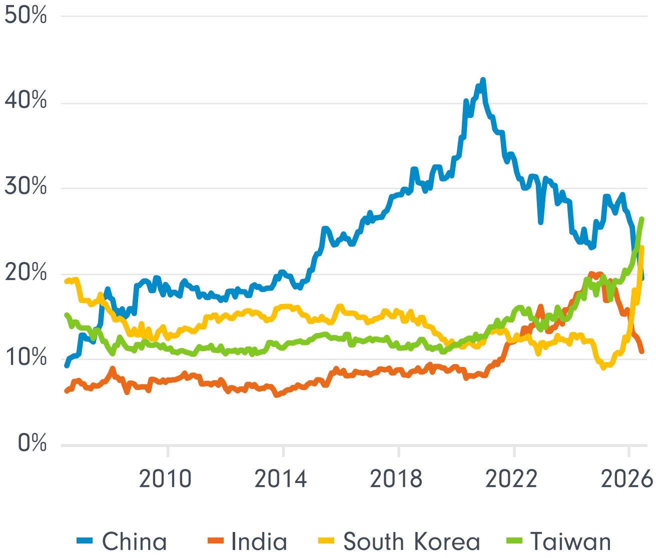
We are underweight those countries or sectors that are vulnerable to energy shortages, preferring instead to lean into more idiosyncratic structural themes.

Korea and Taiwan's chip boom

South Korea and Taiwan are dominating the global AI capex story, driven by intense demand for memory chips and semiconductors more broadly. Taiwan controls around 90 per cent of the most advanced chip manufacturing worldwide, while South Korea leads in the production of the specialised memory needed for artificial intelligence.

AI infrastructure spending continues to accelerate, with no peak in sight. And this spend has been converted into astronomical earnings growth for certain companies in Asia.

South Korea and Taiwan's surging weight in MSCI EM Index



Source: Bloomberg, Fidelity International, May 2026. Note: Market weights in MSCI Emerging Markets Index.

The pace of improvement in large language models has been astonishing, and AI is increasingly being adopted across applications and industries. Compared to past cycles where demand was driven by consumer electronics, the current 'supercycle' is being driven by a capex race between some of the largest companies in the world all competing for leadership in this space.

Still, with the stocks hitting new highs, there are growing concerns about the duration of the rally. With elevated earnings and market concentration, the sector is vulnerable to swings should AI demand soften or capital expenditure slow down. There is likely to be further upside but watch out for volatility in the near term.

China's growing tech prowess

We are starting to see better value in Chinese hardware firms, which have risen as a dominant force in the physical AI trade. Innovation is thriving, supported by rising R&D investment and China's vast pool of talent. Domestic giants, such as industrial robot makers and semiconductor manufacturers, have increasingly gained local market share from foreign rivals, helped by the government's push for self-reliance in technology and supply chains.

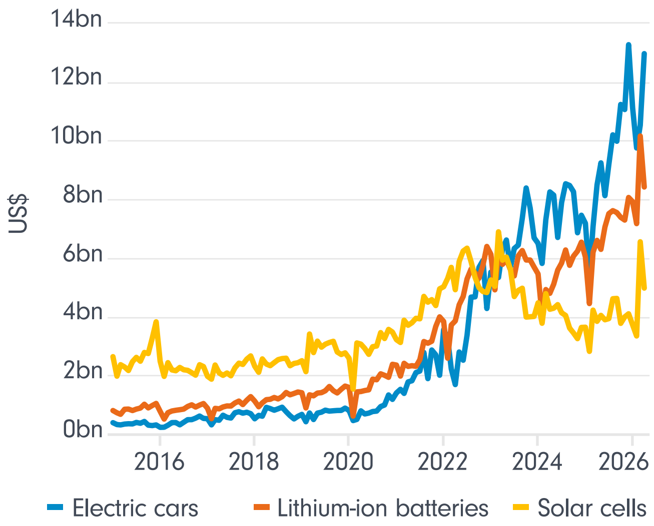
The pace of improvement in large language models has been astonishing, and AI is increasingly being adopted across applications and industries.

We favour mainland-listed tech stocks which have a concentration of hardware makers. They have clearer earnings visibility than the Chinese internet names listed in Hong Kong, which depend more on China's consumption recovery and whether the fierce competition that's characterised the sector will abate.

China is also a major part of the global basket that we invest in to capture the energy transition theme across the world.

Exports of batteries, solar panels, and electric cars from China have risen quickly – even before the Iran conflict. The crisis in the Strait of Hormuz is forcing governments to accelerate the transition to renewables in the medium term. China's structurally resilient green exports will do well from rising demand across the world. We are positive on China's electric-vehicle battery makers and manufacturers of power transmission equipment.

China's green exports accelerate on global energy transition demand



Source: General Administration of Customs China, Macrobond, Fidelity International, May 2026.

Japan midcaps: capitalising on domestic demand

Japan's smaller companies, which are less known to foreign investors than bigger peers such as automakers, are starting to outperform the broader market. Midcaps should do well: they are more domestically orientated so less affected by geopolitical noise and in a better position to capture recovering local demand. While the growth potential in profits is higher, their valuations are cheaper than the overall market average, increasing the stocks' appeal.

The smaller listed firms are also facing pressure from policymakers to bolster their stock valuations and improve shareholder returns. As Japan's corporate governance reforms deepen, we expect to see change across more companies, especially smaller ones.

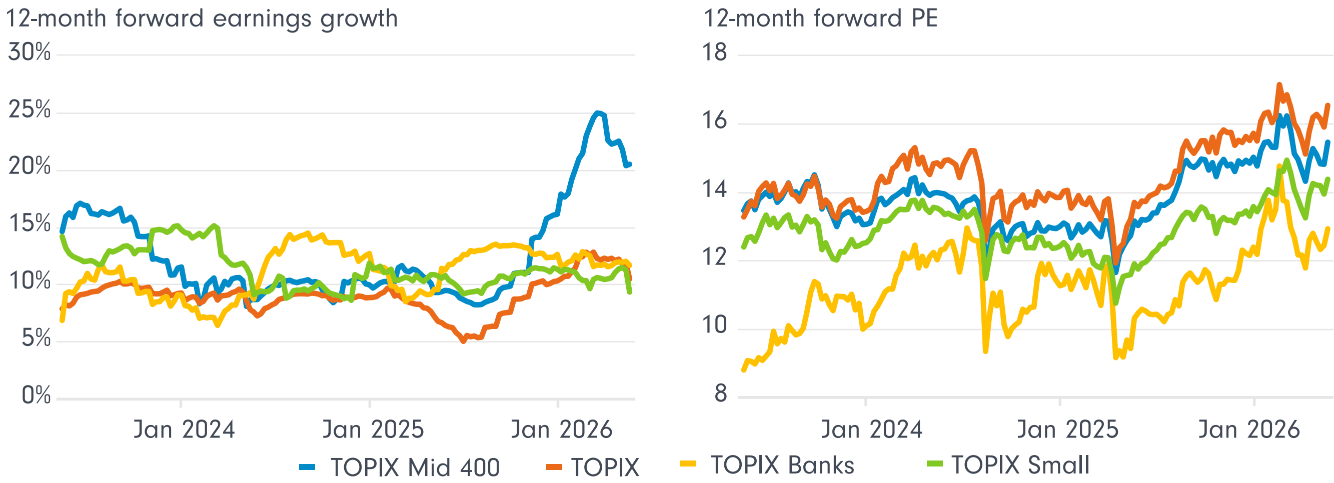
There are still challenges. Elevated oil prices add to uncertainty in the timing and scope of the interest-rate hikes. For example, there are festering concerns over Japan's debt sustainability and the BOJ's willingness to get in front of inflation, which could push up yields on Japan's government bonds. A sustained rise in yields could lift the equity discount rate, compress valuation multiples, and tighten financial conditions.

Commodities and the Aussie dollar

Commodities are able to serve as a useful portfolio diversifier while the correlation between equities and bonds is high and the macro outlook more uncertain. They also remain a crucial hedge against inflation.

Investors' increased focus on commodities will support the Australian dollar given the country is a significant net exporter of coal, liquefied natural gas, and other raw materials. The Australian dollar has been the best-performing G10 currency in the past six months.[1]

Japan's midcaps show higher earnings growth potential than the broader market



Source: LSEG Datastream, Fidelity International, May 2026.

1 Bloomberg data, as of May 27, 2026.

Strategy view: Asia high-quality bonds' increasing appeal

Belinda Liao
Portfolio Manager

Asia's high-quality bonds are becoming a bigger draw for investors seeking to diversify US exposure. This reflects the resilience of those economies in the region that have withstood the energy shocks from the Iran conflict, and a rising confidence in high-grade borrowers' balance sheets.

In the dollar bond market, yield premiums on Asia's investment-grade bonds have tightened 28 basis points (bps) in the past year, which is a 35 per cent tightening, outperforming their peers in Europe (22 bps/22 per cent) and the US (18 bps/20 per cent).[2]

Even local currency bonds, an asset class that's relatively new to foreign investors, are getting more attention.

Hong Kong's local bond market, for example, has quietly grown into a quality haven in Asia. The market has seen a burst of issuance, with lower borrowing costs than in the US drawing a slew of global issuers. Hong Kong's economy is experiencing a solid recovery, driven by resilient trade, a booming equities market, and its unique role as China's bridge to the world. Plus, the currency's peg to the dollar minimises exchange rate risk for US dollar-based bond investors. Even so, the market still needs to expand in breadth and depth to compete with Asian or global counterparts.

In Japan, decades of low interest rates have pushed domestic investors to seek returns abroad. But with Japanese government bond (JGB) yields rising, they may have more incentive to look closer to home. We expect to see a potential repatriation of capital in favour of Japanese government bonds. The possible inflows should also lead to an appreciation in the yen, increasing JGBs' appeal to foreign investors. The BOJ may continue to hike interest rates at a gradual pace, which could also support the currency.

Compared to long-dated or super-long JGBs, short-term bonds are more attractive as they are less sensitive to interest rate changes.

Like Japan, Australia has been in a monetary tightening cycle. The widening yield advantage over US Treasuries and the strong domestic economy are boosting the attractiveness of Australian bonds. The asset class is taking advantage of a strengthening currency and the fact that the country has been one of the few in the world to hold onto its AAA credit rating. While risks such as stronger-than-expected inflation could weigh on investor demand for both Australian and Japanese short-term bonds, for the time being we favour these instruments for their lower volatility.

The currency may also draw support from the solid domestic economy, the Reserve Bank of Australia's hawkish stance, and its policy difference with the Federal Reserve. Even so, we remain wary of rising risks to economic growth or softer-than-expected inflation, which could temper the rally.

Policy pathways

The road towards a resolution in the Gulf is likely to be long and bumpy. The biggest risk for Asia is a prolonged closure of Hormuz, which would fuel broad inflation in Asia and strain economies.

There is also uncertainty around the Fed's monetary policy. If the Fed hikes, it could complicate the picture for Asian central banks, which are already caught in a dilemma between cutting interest rates to support growth, and keeping them high to defend against currency depreciation and combat imported inflation.

In short, the divergent macro picture will continue in 2026, which creates distinct risks but also offers intriguing opportunities for investors in the region and beyond.

2 As of May 22, 2026, ICE BofA Bond Index

AI investment: The agents are coming

Fidelity International's research team is exploring the best ideas connected to agentic AI.

Punam Sharma
Head of Equity Research, Europe

The biggest investment theme of our generation is entering a new phase. You've probably heard the term 'agentic AI'. This is the idea that you can ask AI to do a task and it will break it down into smaller sub-tasks and work independently, using tools like search engines and databases, to complete the job without your supervision.

That ability to work unsupervised is why agentic AI promises big gains in productivity. There is, however, a problem. It's one thing for a large language model (LLM) to answer a series of single, human-generated queries in a few seconds or minutes each. It's quite another to have the model work autonomously for hours at a time, generating its own queries and building its own teams of sub-agents.

AI agents need a lot more compute, a lot more energy, and a lot more infrastructure than the applications most of us have used to date like chatbots. This explains the billions in capital expenditure going into building datacentres, power generation, and other AI-related infrastructure. Over the first nine months of 2025, investment in AI accounted for 39 per cent of US economic growth, analysis from the St Louis Federal Reserve shows.[3]

But how sustainable is the current rate of capex? Where is that capital flowing? And where are the best investment opportunities likely to appear next?

Is the current rate of AI investment sustainable?

A corollary of the ramp up in AI capex has been falling free cashflow among hyperscalers, which are the big cloud computing providers like Amazon, Microsoft, and Google. This has led to a situation where the current cash earnings structure is probably not sustainable.

"Either capex will need to come down or revenue and absolute free cashflow will need to go up," says Jonathan Tseng, a Fidelity analyst who covers the semiconductor market. "The underlying question is what spending from customers can be tapped, either enterprise spend or consumer advertising and subscription revenues, and whether LLM-based offerings can access it."

3 Tracking AI's Contribution to GDP Growth | St. Louis Fed.

Tseng sees good reasons to be optimistic that the question is resolved in favour of higher AI revenue as opposed to lower AI capex. He points to the rise of AI 'harnesses', which enable LLMs to turn their output into actions, for example by writing and executing code.

Tseng also notes the importance of Anthropic's decision to develop LLMs' ability to write code.

"If a model can write code then, by extension, the model can do anything a computer can do," he says. "Model harnesses like OpenClaw are the 'missing link' which turns this idea into reality."

The implications are profound and underpin the case for hyperscalers' free cashflow being restored via higher revenues rather than cutting capex. Most white-collar work is mediated via computers. So if an LLM can do anything a computer can do, it brings all that knowledge work into the realm of AI.

The total addressable market for LLM spending is no longer the IT budget but the broader wage budget of the business world.

"The total addressable market for LLM spending is no longer the IT budget but the broader wage budget of the business world," says Tseng.

There's also a strategic bias towards higher capex.

"Big Tech views AI as existential, favouring overinvestment to avoid being left behind," says Alex Grant, an analyst and portfolio manager covering communication services. "CEOs explicitly prioritise excess capacity over underinvestment, given the risk of competitive disadvantage. Scarcity of data centre resources creates a game theory dynamic, incentivising firms to secure capacity both for their own growth and to block competitors."

The appetite to invest at scale may be there, but there are hurdles to overcome that could slow the rate at which agentic AI can be adopted and monetised. Understanding where these bottlenecks are is helpful for judging where capital is likely to flow.

"The market's behaviour through this cycle has been notably consistent in one respect, in that it disproportionately rewards scarcity," says capital goods analyst Shreeji Parekh. "Capital has rotated toward every identifiable bottleneck in the datacentre build-out, from accelerator chips and electrical equipment in 2022-23, then air and liquid cooling and the wider server ecosystem in 2024, followed by power generation in 2025."

Memory chips are the most recent example of scarcity driving price increases. One constraint holding back agentic AI is that compute power has outpaced the speed at which the overall system can get data into and out of chips. The physical pathways between chips, known as interconnects, are typically made of copper and are hitting physical limits in terms of bandwidth, latency, and power efficiency - a problem known as the 'memory wall'.

"The memory wall is a key concern," says Tseng. "The bottleneck for expensive datacentre compute is increasingly down to connectivity. This will get worse as chips get more powerful. A beefier chip needs even faster interconnects to shovel data in and out of it and ensure it's fully utilised. Hence data connections within the datacentre will inevitably shift from copper towards optical interconnects."

Where the chips will fall

Looking forward, there are potential 'picks and shovels' plays to consider. For decades, computers have improved by making transistors smaller, thereby fitting more of them on each chip and improving computing power. Increasingly, though, the focus is shifting to overall system performance.

"How chips are bonded together is becoming much more important, necessitating more capital-intensive processes such as hybrid bonding and thermocompression bonding," says Austin Kelly, an analyst covering semiconductor capital equipment. "As a result, the assembly equipment market will go from a low-growth, cyclical market to a cyclical but structurally growing market."

But Kelly points out that datacentres also need a lot of less sophisticated analogue chips that process signals from the real world, for example to manage power delivery to servers.

"In 2027, I think there will be a realisation that AI demand will drive an exceptionally tight market in analogue chips," he says. "These dynamics will cause a huge squeeze on capacity, but one that only becomes evident once you have both end markets, non-AI and AI, moving in the same direction. The analogue stocks will rerate once these supply-demand dynamics become obvious."

Tseng sees similar potential for a demand crunch affecting other types of chips that are less sophisticated than the graphics processing units (GPUs) that LLMs rely on. This is because while an AI agent makes heavy use of GPUs, it also sends instructions to other tools, including long-established software programmes, that use older technology.

"A potential new area of shortage," he says, "could be server central processing units (CPUs), as increased agentic tool-use creates paradoxical demand for the legacy, non-accelerated compute that these tools primarily run on."

Elsewhere, our analysts see potential opportunities arising from the construction and operation of the datacentres needed to make agentic AI a reality at scale.

"Hyperscalers are increasingly shifting toward modular and prefabricated builds, shifting value toward companies that can offer full stack swift deployment rather than just supply components or systems," says capital goods analyst Parekh, who also sees scope for companies that supply heating, ventilation, and cooling (HVAC) and electrical equipment to carry on their strong performance that goes back to 2023.

Those barriers are being removed by the brute force of enormous capex.

Selected utilities meanwhile should also do well where they have exposure to datacentre growth and control the whole supply chain of power or water.

"Escalating NIMBYism across the US will drive datacentre growth to Texas, where there are no zoning laws outside cities and the state government and utility regulators are highly supportive of datacentres," says utilities analyst Srishti Sinha.

Preparing for disruption

We may not yet live in a world where we can delegate work to an LLM and trust the model to get on with it. Increasingly, though, the barriers to making that a reality are physical rather than technological.

One by one, those barriers are being removed by the brute force of enormous capex. Naturally there is some disquiet about whether the sums involved are sustainable, and what the return on investment will be.

Weighed against that is the enormous prize on offer if AI agents deliver on their promise. In that scenario, compute will remain constrained for years to come as AI takes over more and more of the economy - a favourable set-up for sectors and businesses supplying into that scarcity.

Building portfolios for an inflationary world

Not all inflationary episodes play out the same way. Context matters for allocators, especially as markets become structurally more unpredictable.

Katie Roberts
Global Head of
Client Solutions

Jihad Younan
Director,
Client Solutions

Max Stainton
Senior Global
Macro Strategist

The post-2020 investment landscape has been characterised by higher inflation, elevated yields, and a shift in policy regimes, all contrasting with the benign environment that dominated the 2010s. Shocks to markets then were largely demand-driven and occurred in a low-inflation, policy-supportive environment. For most investors, a 60/40 split between equities and bonds respectively worked in guiding them through any volatility.

Investors will now have to take many of these features into account when building defensive portfolios, none more so than higher inflation levels.

That has changed. Our view is that we're moving into an era of global fragmentation, characterised by lack of consensus around global trade and capital flows, elevated inflation and policy rates, fiscal expansion and debt accumulation, and higher geopolitical risk. The current energy-supply shock is both a symptom and driver of today's macro fragmentation, adding structurally higher prices and dispersion across markets (between those energy-exposed regions which will suffer from the disruption in the Strait of Hormuz, and those exporters benefitting from higher energy prices).

Investors will now have to take many of these features into account when building defensive portfolios, none more so than higher inflation levels. A simple split between bonds and equities will not protect investors through all the different inflationary regimes to come in this new era of investing. Instead, investors will want to consider:

- Looking across a broadened asset class universe, incorporating real assets and inflation-linked bonds which can hedge against inflation.
- The specific levels of their exposures, ensuring that there remains a steady buffer against inflation balanced with the risks they are willing to take on.
- Managing exposures more dynamically to suit a particular macro environment, reducing allocations to duration, for instance, when inflation looks set to rise.

Defining inflation regimes

Inflation is a complex risk because it is variable. It offers no one 'fix'. Instead, determining how to shelter portfolios relies on first establishing the particular inflation regime you are in, as well as the one you might be heading into. These regimes will be defined by questions of whether inflation is rising or falling, is high or low, and whether it is anchored or unanchored (i.e. are policymakers likely to bring it under control).

Moreover, inflation alone only tells you half the story. High levels of growth can support assets even through a high inflation regime, but if you combine rising prices with falling levels of growth then you have the sort of stagflationary environment that makes policymakers sweat. So to understand how different asset classes perform in an inflationary environment, we need to incorporate the growth picture.

The regimes outlined in the graphic below suggest broad patterns to inform allocation decisions based on the inflation trajectory. For instance, equities perform well when inflation is falling and growth rising, while nominal government bonds do well when growth and inflation are both falling.

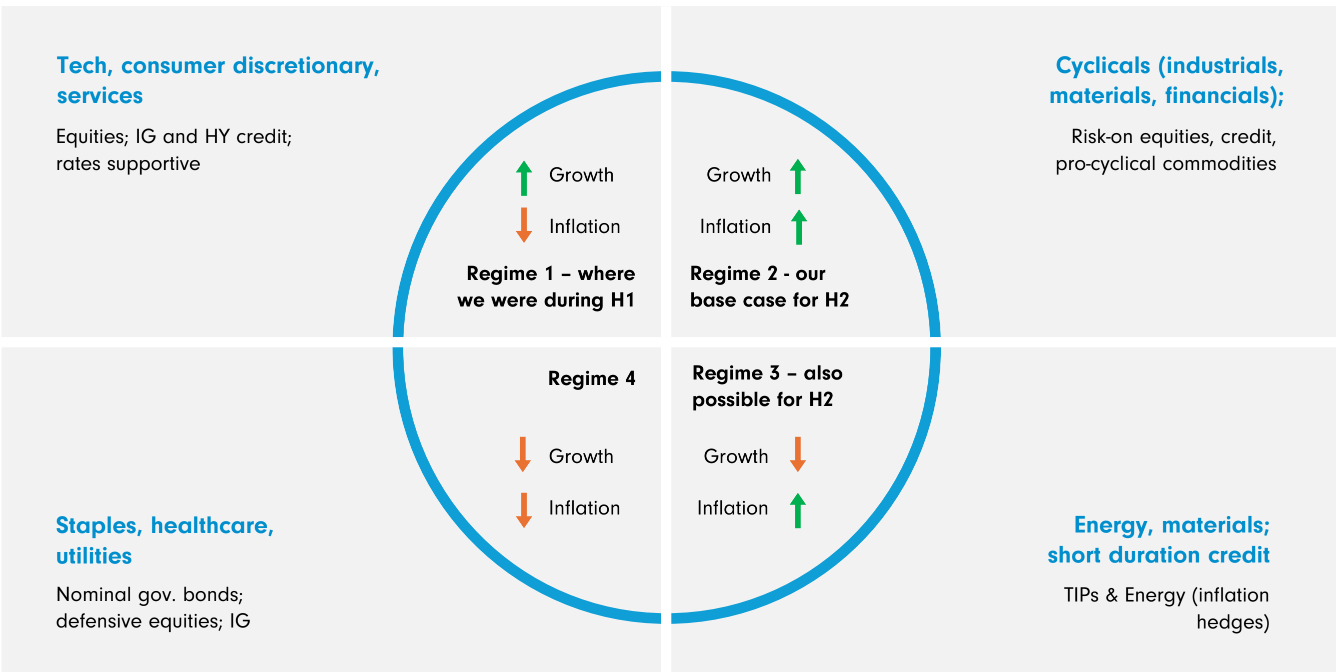
But a more useful application is to start with individual assets, and match those against the regime you believe we are in. Past performance won't tell you precisely how, for instance, emerging market hard currencies will perform through a particular regime. But it does suggest patterns of behaviour that can be useful for allocators constructing a portfolio to buffer against particular risks.

Our base case is that we are heading now into a more reflationary regime, one in which growth and inflation are rising, driven today by policy support and strong fundamentals. This would be positive for stocks were growth to remain resilient. But there are risks that the macro environment fluctuates between regimes two and three over the medium term, as geopolitical and fragmentation challenges persist. Investors wishing to guard against these risks will both hedge against inflation and also manage their allocations dynamically when the macro environment changes.

How different regimes impact portfolios

The crucial variable that determines how inflation evolves is the room central banks have to manoeuvre through a particular regime.

Macro regimes and the investments that should benefit



Source: Fidelity International, May 2026.

A high inflation regime renders central banks relatively impotent, since it diminishes policymakers' capacity to combat inflation without affecting growth. It removes the central bank 'put'. This environment is not conducive for risk assets, since inflation is eroding their value while the monetary environment is also less supportive.

On the other hand, real assets, like commodities, typically perform well in these environments.

"Exposure to commodities has historically helped protect investors through inflationary environments since these are real assets tied to rising input costs, and because of their lower correlations with other assets", says James Richards, a Fidelity fund manager with a close eye on transition materials. "For investors concerned about concentration in consensus trades, such as AI capex winners, commodities introduce differentiated return drivers, enhancing portfolio diversification."

Government bond performance, meanwhile, will vary according to the strength of the central bank put.

Returns on certain government bonds have been strong through high inflation regimes, which appears counter-intuitive given expectations of rising inflation usually drive yields higher and bond prices lower.

But in reality, duration performance has depended on the specific type of inflation. Central bank targeting means inflation usually reverts to the mean, bringing bond yields down at the same time. In those instances, high inflation periods have often been followed by strong duration returns. So if inflation appears mean reverting - typically because markets believe central banks can tighten appropriately - high inflation may precede favourable outcomes for duration.

But when inflation is persistent, it is more challenging. The near term outlook of structurally higher inflation, driven by global fragmentation and instability, suggests we are closer to the latter scenario.

There's also potential in shorter-duration fixed income, which is less exposed to changes in interest

rates, to offer stability for portfolios through its 'carry' - the steady income generated from holding a bond.

James Durance, a fixed income fund manager who focuses on short duration strategies, explains: "One of the key changes since 2022 is that fixed income once again offers meaningful income potential. In a structurally higher inflation environment, that carry can play a more important role in helping investors absorb market volatility and maintain real return potential over time.

"Within short duration credit markets, we continue to see opportunities to generate attractive income while maintaining a relatively defensive interest rate profile compared with longer-duration fixed income."

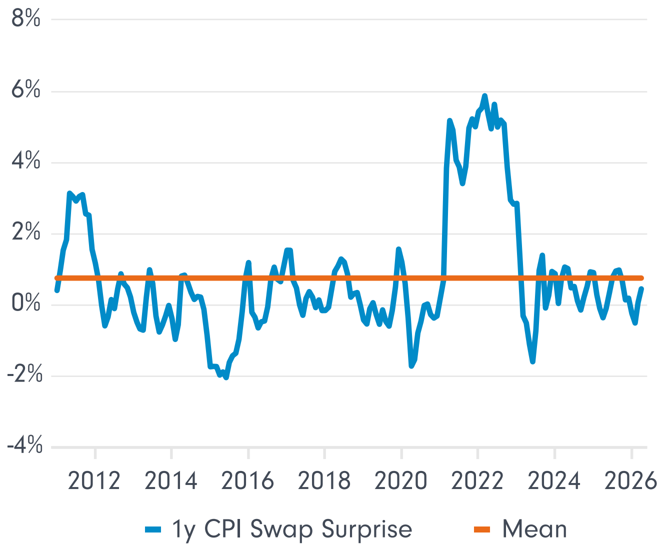
Inflation-linked bonds, meanwhile, can be useful for portfolios if you expect inflation to rise.

"With inflation set to remain above central bank targets and expectations likely to prove sticky, traditional fixed income is at risk of leaving investors exposed," says Ravin Seeneevassen, another fixed income fund manager.

"Inflation-linked bonds help close that gap by directly linking returns to realised inflation, providing a source of income that preserves purchasing power. Not only do inflation-linked bonds protect a fixed income allocation from erosion, but they also act as a superior diversifier to nominal bonds in a broader portfolio, exhibiting lower correlation to equities through the cycle."

It will be useful to hold a baseline of these assets. Even if inflation at any moment looks relatively low, we live today in an environment of greater instability, in which prices may move suddenly. As the following chart shows, inflation historically has taken investors by surprise. It makes sense to hedge against that surprise before it arrives.

Inflation usually takes markets by surprise



Source: Fidelity International, Macrobond, Bloomberg, May 2026.

The new 60/40

The traditional 60/40 portfolio was well suited to a world of stable inflation and deepening global integration, but it may struggle to achieve similar outcomes in a more fragmented and uncertain environment, where inflation is less predictable and equity-bond correlations remain high. This new world invites investors to look beyond traditional equities and bonds to a broader range of asset classes and adopt a more dynamic approach to portfolio management.[4] From there it is up to investors to decide how to implement these principles in line with their own objectives, risk tolerance, and views on the key risks ahead.

Whatever these might be, the direction of travel is clear: portfolio resilience is likely to require a wider toolkit than the traditional 60/40 allocation alone.

4 To learn more about our macro views on this new approach, read our papers on rethinking asset allocation, allocating to gold, and liquid alternatives.

Digital Assets: The line between crypto markets and blockchain-based finance is blurring

Crypto markets have steadied somewhat after a period of volatility, but their longer-term significance lies in their expanding role in financial infrastructure.

Giselle Lai
Director, Digital Assets Strategist, APAC

Emma Pecenicic
Head of Digital Assets Distribution

On the surface, digital assets still look under significant pressure. Markets have improved since hitting long-term lows in late February, but crypto prices remain far from last year's records and investor sentiment is materially cooler than during the last cycle.

Beneath the volatility, however, a more important structural transition continues to accelerate.

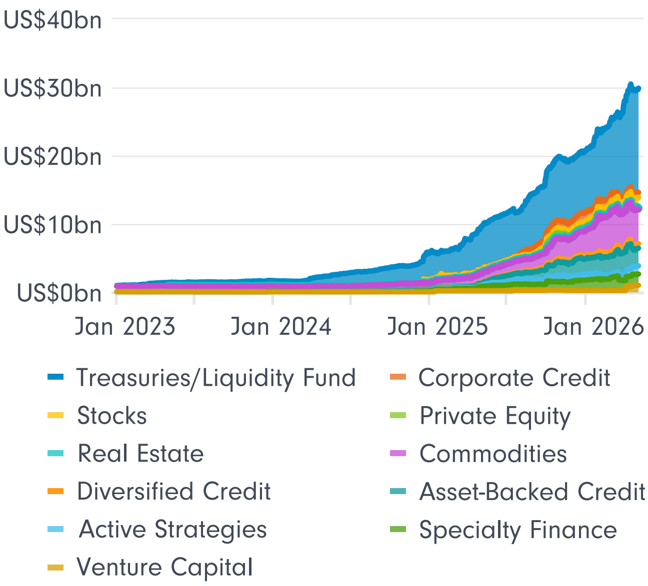
In our view, the defining development in digital assets today is the steady buildout of blockchain-based financial infrastructure. The discussion is increasingly shifting away from whether digital assets matter to how quickly institutions can adapt to the infrastructure transition already underway.

That shift is most visible in tokenisation.

Over the past two years, tokenised real-world assets have expanded roughly 27-fold to more than USD $33 billion globally, spanning Treasury products, private credit, commodities, and increasingly equities. While still small relative to traditional capital markets, the growth trajectory matters more than the absolute size at this stage of adoption.

Total RWA value

Tokenised real world assets



Source: rwa.xyz; Fidelity International, May 2026.

Regulatory progress and the infrastructure transition

Regulatory developments have helped accelerate institutional momentum. The Genius Act marked an important step to establishing a comprehensive

US framework for stablecoins, while the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission have clarified the treatment of several major blockchain tokens as digital commodities. More recently, the SEC approved Nasdaq to support the trading and settlement of tokenised equities and ETFs, reinforcing the direction of travel toward blockchain-enabled capital markets.

Importantly, tokenisation is now evolving beyond the simple digitisation of assets to what many market participants describe as 'composable capital' – a financial environment where tokenised assets can move more seamlessly across trading, collateral, and treasury activities.

However, tokenised finance cannot scale without tokenised liquidity. In our view, the next phase of tokenisation will therefore be focused on the liquidity infrastructure surrounding those assets.

Institutions increasingly recognise that digital cash solutions cannot sacrifice economics for convenience. As more financial activity migrates on-chain, tokenised liquidity solutions that combine real-time settlement with 24/7 trading may ultimately become the connective tissue linking traditional capital markets with digital asset ecosystems.

This is also where the distinction between 'crypto' and 'tokenisation' begins to blur.

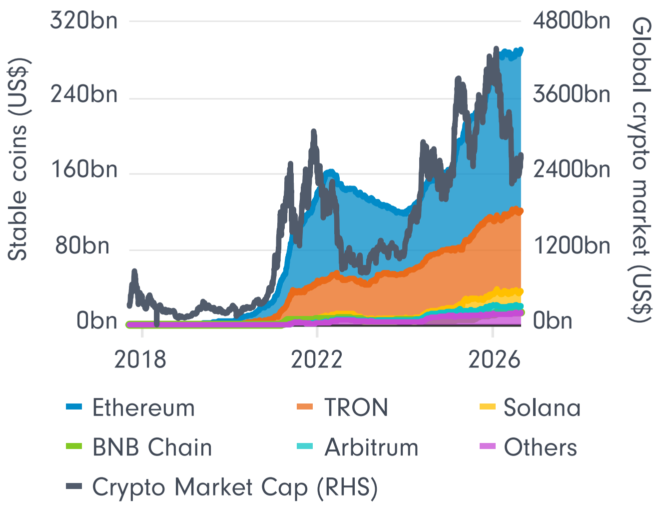
While tokenisation has become more of an institutional narrative, blockchain networks are the infrastructure layer enabling the movement of digital value, liquidity, and collateral across the ecosystem. In many respects, crypto is evolving from a primarily price-driven market into financial middleware.

That transition remains uneven, but there are signs of increasing utility across selected crypto assets. Ethereum remains the dominant infrastructure layer for tokenised assets and stablecoin activity due to its network depth, developer ecosystem, and institutional integrations. Other blockchain networks, including Solana, continue to gain traction by competing more aggressively on throughput and transaction efficiency, although institutional adoption remains comparatively earlier-stage.

Stablecoin dynamics also highlight the growing role of blockchain networks beyond trading activity, particularly across payments, settlement, and collateral mobility.

Since the deleveraging event in late 2025, stablecoin market capitalisation has remained near all-time highs at above $300bn, even as total crypto market capitalisation has fallen. This suggests that while sentiment has cooled, a meaningful share of capital remains on-chain rather than exiting the ecosystem entirely.

Stablecoin market cap vs crypto market cap



Source: rwa.xyz; Fidelity International, May 2026.

Rule for the future

The broader point is that while tokenisation may increasingly be the institutional narrative, blockchain networks are something more important than that: the infrastructure layer underpinning how digital value moves across the ecosystem. Cryptoassets are gradually evolving into components of a broader financial architecture that may ultimately reshape how assets are issued, transferred, collateralised, and settled globally.

For the institutions doing the implementation, it is important to remember a number of things at this stage.

First, there are no shortcuts. Specifically on fund tokenisation, we are effectively redesigning roles historically performed by transfer agents, fund administrators, custodians, and distributors — redesigning them around on-chain data and programmable workflows. That shift requires partners across those roles with genuine on-chain operating capability, backed by institutional-grade processes and controls.

Second, new infrastructure must be checked and verified. Institutions need to evaluate whether infrastructure is secure, resilient, and compliant, and whether it can integrate sustainably into the broader financial ecosystem. It must deliver a high-quality experience for institutional investors that goes beyond technical functionality.

This demands an extra degree of care from all those involved. Tokenisation introduces a multi-party environment where governance, accountability, and operational alignment become vital to avoid oversight gaps.

The long-term winners are unlikely to be determined simply by who tokenises assets first, but by who solves genuine investor and market inefficiencies most effectively. Digital-native operating models increasingly matter because they enable functionality that traditional infrastructure struggles to deliver efficiently — including real-time settlement, collateral mobility, programmability, and continuous liquidity. At the same time, the interconnection between tokenised assets, stablecoins, wallets, exchanges, and blockchain networks is becoming more critical. Fragmented systems and siloed building blocks ultimately limit the efficiency gains tokenisation is designed to achieve.

But the sheer fact that we are now examining and implementing this infrastructure at this level suggests strongly that while the market may still appear cyclical on the surface, underneath, the transition toward blockchain-based finance continues to advance.

Contributors

Judy Chen
Patrick Graham
Toby Sims
Ben Traynor
Investment Writers

Seb Morton-Clark
Managing Editor

Oliver Godwin-Brown
Graphic Designer

Mark Hamilton
Global Design Lead

Toby Sims
Production Lead

Image credits

Cover, page 2 and 3: The vessel's bow is pictured cutting through the waves.
Credit: PATRICK HERTZOG / Contributor, Getty Images

Page 4: Cadia Hill Gold and Copper Operation at Orange run by Newcrest Mining.
Credit: Fairfax Media / Contributor, Getty Images

Page 10: An associate presents micromechanical sensors over a 300-millimeter wafer.
Credit: picture alliance / Contributor, Getty Images

Page 11: Workers overhaul the equipment of the 800 kV converter station in Jiangsu Province, China.
Credit: NurPhoto / Contributor, Getty Images

Page 16: A detail of RoBee by Oversonic Robotics at Oversonic in Brianza, Italy.
Credit: Vittorio Zunino Celotto / Staff, Getty Images

Page 19: Escalator at the Monte Sant'Angelo metro station, on line 7 of the Naples metro Italy.
Credit: KONTROLAB / Contributor, Getty Images

Page 21: Escalator at the Monte Sant'Angelo metro station, on line 7 of the Naples metro Italy.
Credit: KONTROLAB / Contributor, Getty Images

Page 23: Touching colored lights related to the movement of particles at Museo OXO in Madrid, Spain.
Credit: Aldara Zarraoa / Contributor, Getty Images

Important Information

Fidelity
INTERNATIONAL