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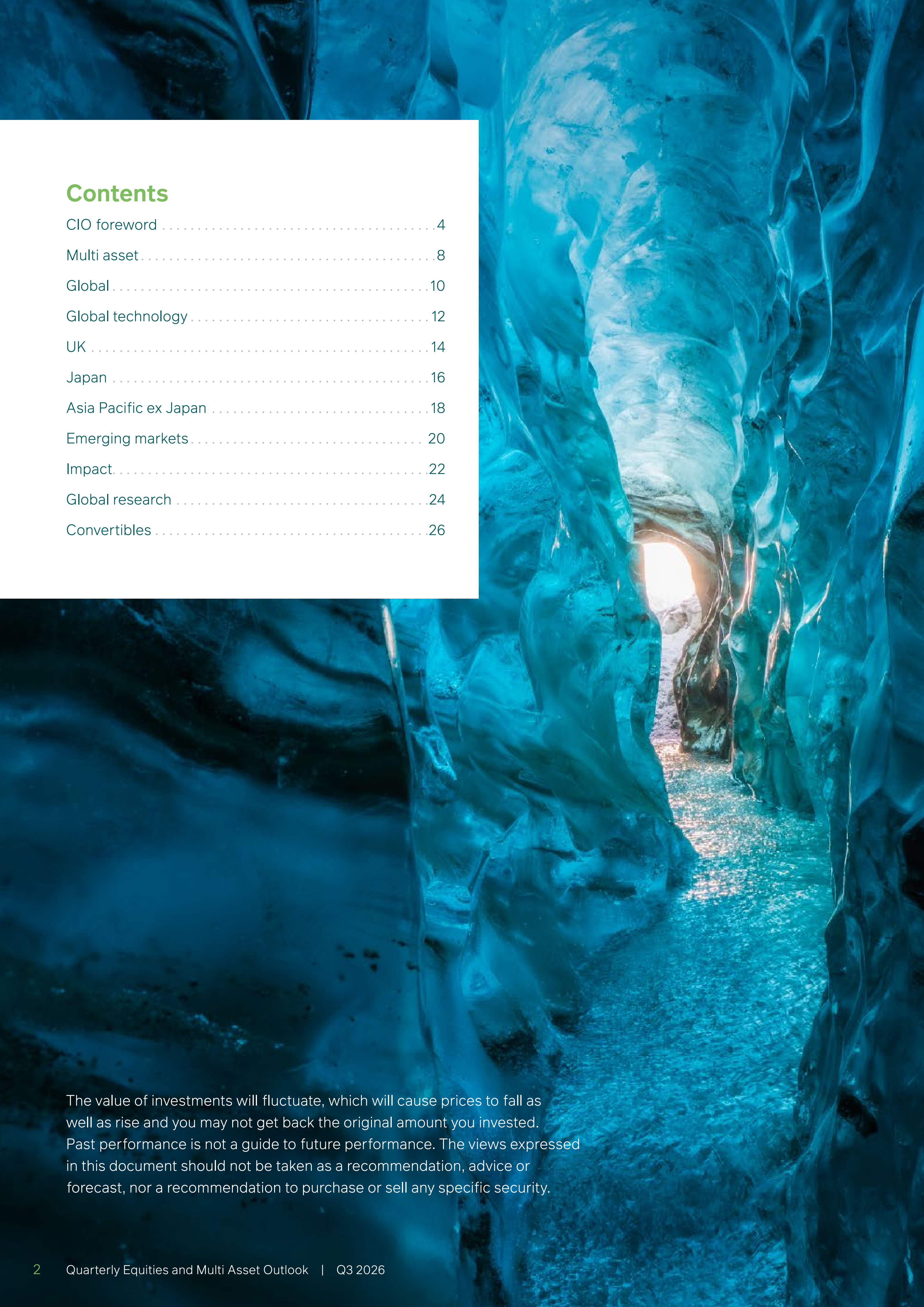
M&G Investments

Quarterly Equities and Multi Asset Outlook

Conundrums and complex choices

Q3 2026



Contents

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Conundrums and complex choices

Key takeaways

We are experiencing an ever-increasing concentration in equity market performance, alongside a remarkable rise in the magnitude and velocity of price movements. Companies are winning big, they are winning fast, and there are fewer and fewer of them.

In fixed income markets, long-dated developed government bonds have not shown the consistent positive performance that would have been expected in the past in response to heightened geopolitical risks and growth concerns.

Current market conditions are casting doubt on the benefits of portfolio diversification. Diversification remains paramount to building resilient portfolios. It means owning securities with uncorrelated drivers where there is a clear gap between pricing and intrinsic value and where we believe we have a unique perspective.

At some point, we are likely to have an abrupt change in the narrow market leadership – we need to invest in tomorrow's leaders when few are paying attention to them.

While we still like some AI-enablers, we see opportunities beyond the most crowded beneficiaries of AI capex, in themes such as electrification, power infrastructure and enabling industrial technologies, as well as a broader set of AI beneficiaries. Our Multi Asset portfolios currently have an overweight duration position, with a preference for government bonds over credit.

Concentrated markets, diversified portfolios

Markets are changing. Markets change all the time. Recognising which changes are transient and which are structural will determine the long-term performance of a portfolio.

Some of the changes that we are witnessing at the moment are creating significant challenges to portfolio construction. In equity markets, we are experiencing an ever-increasing concentration in performance, alongside a remarkable rise in the magnitude and velocity of price movements.

At the same time, from a multi asset perspective, the traditional 'rules of thumb' that appeared to govern the behaviour of bonds versus equities are now being challenged. Consider the traditional correlation between equities and bonds, where equities would suffer at times of heightened geopolitical risk while bonds would benefit. This is not the behaviour that we witnessed at the height of the US-Iran conflict. With mounting levels of government debt in developed countries, long-dated developed market bonds (including US treasuries) appear to have lost their safe haven status.

Tacking back to equities, the current concentration in equity market performance is truly staggering.

In 2024, the MSCI All Country World Index (ACWI) rose a respectable 18.0%. It took US stock AppLovin a solid 712.6% return to top the list of the best performing stocks in an index with 2647 constituents. In 2025, to deliver an ACWI return of 22.9%, the top 100 stocks delivered anywhere between 153.1% and 616.5%. This year to the end of June, for an 11.5% return from the ACWI, stocks had to work almost as hard in only six months to be in the coveted top 100. Japanese memory maker Kioxia delivered an impressive 726.1% performance to take the top spot. And the 100th best performing stock was up a respectable 98.1%. And all of this in six months[1].

The above has meant that equity market performance has been increasingly concentrated in a smaller number of names. In the US, 13 stocks drove c.80% of the S&P 500 Index's 10.2% return in the first six months of the year. In Asia, the MSCI AC Asia Pacific ex Japan (Net Return) Index returned 23.9% in the first half of 2026; c.80% of that return was generated by just three companies out of the index's 1,048 members.

The characterising market feature in 2026

Meanwhile, extreme price moves in equity markets, where stocks can rise several-fold over a matter of weeks, and potentially drop just as quickly thereafter, have become a feature of this year's markets.

Needless to say, the vast majority of this year's winners have been AI-enabling technology stocks, plus a few companies in other sectors that investors perceive will benefit from investments in AI.

Frankly, looking at which "theme" is driving equity markets is almost beside the point. The fact that markets are so concentrated, and the magnitude of price moves and divergence in performance are so staggering, is the real crux.

Don't get me wrong, the power and potential pervasiveness of AI has a lot to do with market behaviour. The current investment in, and use of, AI is creating unprecedented revenue and profit growth. Available data on Anthropic shows an annualised revenue run rate that grew from US$100m in 2023 to US$30bn by April 2026[2].

Nvidia, Samsung Electronics and SK Hynix are all showing profit growth that is unprecedented for companies of their size, with the government of Korea currently deciding how to best deploy the windfall in tax flows coming from the country's two largest corporates. These levels of growth are eventually extrapolated into market expectations and pricing behaviour.

[1] Source: Bloomberg. Total returns in US dollar terms.
[2] Source: OfficeChai, 'Anthropic's ARR Has Touched $44 Billion, Says Semi Analysis Report', (officechai.com), May 2026.

Recognising what is transient and what is likely to be structural

AI is a powerful transformative force in the way we work and go about our daily lives. In that, AI certainly feels like a structural change. But, however powerful and structural AI is, the concentration of market performance in AI-enablers is likely to be the transient part of the equation.

Whether it be due to supply bottlenecks or capital expenditure (capex) slowdown or just coping with capacity, some companies will struggle to deliver continued growth aligned with current market expectations, and price performance will reflect this. Ultimately, in time, there will be other companies replacing today's market leaders.

The structural change in equity markets is not 'which' companies are winning, but 'how' they are winning. They are winning big, they are winning fast, and there are fewer and fewer of them.

Ubiquitous and relentless newsflow, fast-moving narrative-driven quantitative strategies and an increase in active retail participation in equities and derivatives, are all likely to remain key contributors to the higher levels of market concentration and 'whipsawing' share-price moves that market participants are having to grapple with.

Granted, the current AI capex buildout is such that earnings expectations (and often delivery) is exceptional. Perhaps the next theme will not allow for the same extraordinary revenue and earnings growth multiples and, hence, will not lead to the same degree of market concentration and excitement.

Adapting to the new normal

Current market behaviour poses a challenge to portfolio construction, given the higher stakes of finding oneself on the wrong side of the smaller winning cohort of stocks. So, what to do? Turning to broad passive exposures doesn't appear to be the best course of action, in our view, as the US market has taught us this year.

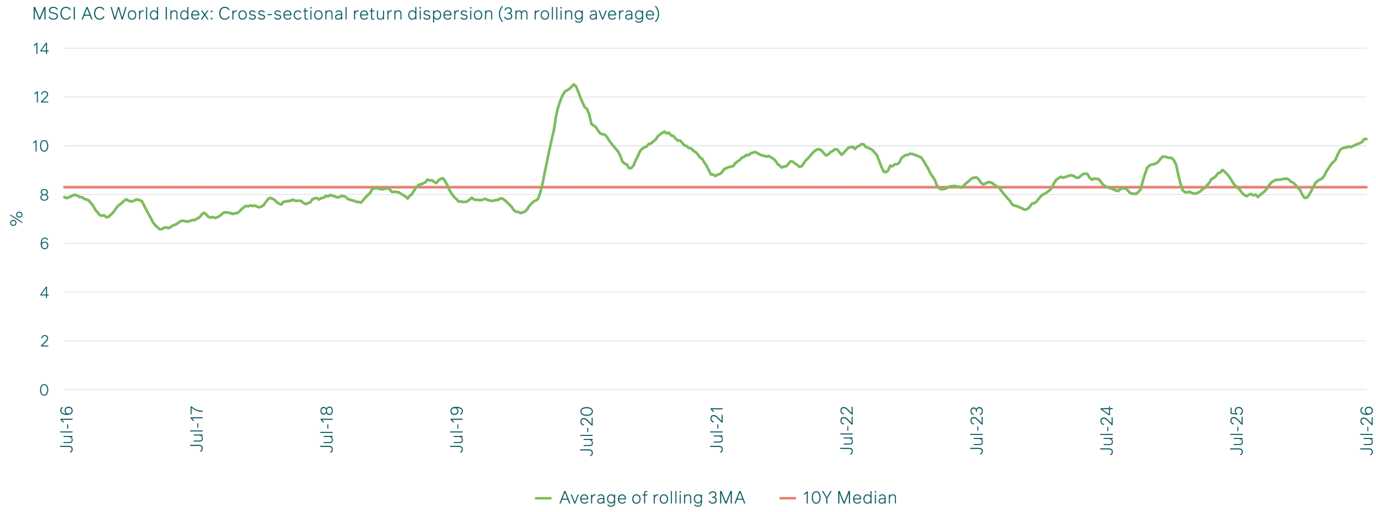
Despite the stellar price action of a number of US stocks, the performance of the broader S&P 500 Index has been dampened by a flattish Mag-7 cohort. How much worse could it be if all the Mag-7 stocks, which account for more than a third of the index, were to fall as a collective?

Of course, you could buy an equally-weighted index, but given the large return dispersion between stocks you may also face a high opportunity cost. Year to date, the median return of the top 100 best performing stocks, excluding the Mag-7, in the S&P 500 Index was 40.1% versus a less impressive 7.5% median performance of the overall S&P 500 Index excluding the Mag-7[3].

> "Portfolio diversification is ever more relevant and is paramount in managing the market's whipsawing behaviour"

[3] Source: M&G, Bloomberg, 30 June 2026. Analysis based on absolute returns of constituents of the S&P500 Index. Top stock bands defined by total returns in US dollar terms.

Return dispersion is trending well above its 10-year median



Source: Bloomberg, 30 June 2026. Past performance is not a guide to future performance.

So, active asset management and stock picking still appear to be the best course of action, in our view, to uncover mispriced opportunities and deliver attractive risk-adjusted returns.

But when it comes to portfolio construction, given the current hyper-concentration in market leadership, one would be forgiven for wondering if the benefits of diversification have been thrown out of the window. The answer is unequivocal. Portfolio diversification is ever more relevant and is paramount in managing the market's whipsawing behaviour.

While concentration around the AI winners theme has been extreme, dispersion across the whole market, and also within the technology sector, is the highest it's been in five years, as the market attempts to differentiate between the winners and losers[4].

Even if we were to expect market leadership to remain narrow, history suggests that the identity of those leaders will eventually change. The companies that define one cycle are not always the companies that define the next.

To be clear, diversification does not mean owning a vast number of positions randomly chosen across countries and/or sectors. It means owning a selected number of securities that have been carefully chosen, where we believe there is a clear gap between pricing and intrinsic value, and where we believe we have a unique perspective that enables us to identify such gap.

Importantly, many of these holdings will have uncorrelated drivers, allowing for more resilient portfolios at times when we witness an abrupt change in the narrow market leadership – investing in tomorrow's leaders when few are paying attention to them.

Diversification can, and should, be rooted in careful selection; avoiding grandstand calls on where to bet the house. Over many years we have learnt the perils of being all-in or all-out, and the importance of having balanced views.

Opportunities in AI and beyond

In this spirit, we continue to recognise the transformative power of AI. In our exposures, we favour companies with established business models, visible cash flows, credible funding and valuations that do not already discount a perfect outcome. While we still own and like some of the well-telegraphed AI enablers, we are increasingly finding opportunities beyond the most crowded beneficiaries of near-term AI capex and looking towards longer-cycle demand themes such as electrification, power infrastructure and enabling industrial technologies.

We also see opportunity in stocks outside of technology that are likely to see their businesses improve thanks to the use of AI. These are companies across different sectors, including energy, industrials, healthcare, finance and even consumer.

[4] Source: M&G, 3 July 2026. MSCI AC World Index, 3m rolling average stock return dispersion relative to 10-year median.

> [For us] diversification [means owning securities where] there is a clear gap between pricing and intrinsic value, and where we believe we have a unique perspective ...many of these holdings will have uncorrelated drivers

The recent polarisation in price behaviour has meant that some of these stocks have seen unwarranted share price falls or – at best – have been ignored by investors and left to languish.

From a regional perspective, we continue to find opportunities in emerging markets (EM), where Chinese technology is increasingly showing its global competitiveness; in Europe, where much-needed investment in areas such as infrastructure and energy security will continue to dominate; and in Japan, where corporate change continues to broaden and enhance value.

By no means does this signal that we are ignoring the US market. Given its size in global indices, we often find ourselves with relative underweight positions, finding compelling opportunities in other areas around the world. That said, we continue to find new opportunities in US companies, particularly at the forefront of innovation.

Multi Asset allocation

Taking a broader lens, our Multi Asset team trimmed equity exposure during the second quarter in markets such as Korea, where they felt the price action was due for a pause. This has left them with equity positions that are neutral to slightly underweight, and where the focus has been on the underlying components of such exposure rather than the broader allocation, in line with our equities views. The portfolios have an overweight duration position, with a preference for government bonds over credit given the tightness of spreads. Bond markets may have taken less of the spotlight than equities over recent months, but have been no less complex to navigate.

Rather than showing a consistent positive performance in response to heightened geopolitical risks and growth concerns, as might be expected from a perceived safe-haven asset, long-dated government bonds have been shaped by inflation uncertainty, shifting expectations for central bank decisions, and policy impact on public debt burdens.

The volatility we experienced over recent months has allowed the team to tactically scale exposure in and out of government bonds, particularly in areas such as US 30-year treasuries and UK 30-year gilts. We continue to like EM local currency bonds and maintain positions in Colombia, Brazil, Mexico and South Africa.

Over the following pages, our investment teams will discuss how performance concentration, extreme price moves, and the breakdown of the rulebook of expected behaviours across asset classes are affecting their respective investment universes. They will speak to the steps they are taking to manage their portfolios and where they continue to find attractive opportunities.

Whatever conundrums we are faced with, generating alpha in this environment requires a combination of sticking to well-proven investment processes and adapting to what we believe are structural changes unfolding.

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

Fabiana Fedeli
Chief Investment Officer, Equities, Multi Asset and Sustainability

Multi asset

Maria Municchi
Fund Manager, Multi Asset

Market conundrums: government bonds and the lost diversification

Government bonds sit at the centre of one of the more complex debates in markets today. They no longer provide the same reliable diversification benefits that investors once relied upon, yet they now offer yield levels that are materially more attractive than at any point in the last decade. This leaves investors balancing a more compelling valuation backdrop against a macroeconomic environment that remains uncertain, particularly from an inflation perspective.

Bond market: still doing what it says on the tin?

Recent price action has underscored the complexity of today's bond market. Rather than showing consistent positive performance in response to heightened geopolitical risks and growth concerns, as might be expected from a perceived safe-haven asset, long-dated government bonds have been shaped by inflation uncertainty, shifting expectations for central bank decisions, and policy impact on public debt burdens.

Much of the repricing has occurred at the short end, where markets have reassessed the path of policy rates. The long end has been more range-bound: yields declined earlier in the year, rose during periods of geopolitical stress, and then retraced as risks eased. While this may appear less supportive, bonds have broadly behaved in line with the macro backdrop – resilient growth, supported by strong capital expenditure (capex) trends such as AI investment, alongside renewed inflation risks linked to energy volatility.

The volatility observed over recent months has allowed us to scale exposure in and out of government bonds, particularly in areas such as US 30-year treasuries and UK 30-year gilts.

Central banks are diverging

While all central banks are navigating inflation uncertainty, the divergence in economic growth rates, inflation drivers and starting policy levels is resulting in increasingly differentiated policy paths.

The US economy continues to show relative resilience, allowing the Federal Reserve (Fed) to remain on hold while prioritising inflation control. The ECB, despite softer growth, has tightened policy from a lower starting point, while the Bank of Japan is gradually normalising from highly accommodative settings, supported by modest growth and rising wages.

At the same time, central banks are reducing forward guidance, while relying more explicitly on scenario analysis and incoming data. In his first press conference in June, Fed Chairman Kevin Warsh highlighted this shift, noting that forward guidance is "not well suited to the current policy conjuncture," and he refrained from offering any projections as part of the dot plot.

This shift might continue to increase market sensitivity to economic data. A recent Bank Underground study[5] shows that sensitivity of gilt yields to inflation data – particularly services inflation – has risen materially since 2022, with data surprises playing an increasingly important role between policy meetings.

[5] Source: Bank Underground 'Financial markets point to very data-dependent monetary policy' (bankunderground.co.uk), 21 May 2026. Bank Underground is a blog written by Bank of England staff.

A broader opportunity set

This evolving environment has widened the opportunity set across developed market government bonds. Different regions now offer distinct combinations of yields, curve dynamics and policy outlooks, reflecting diverging economic and fiscal conditions.

Across our portfolios, we express this through a diversified allocation to long-dated government bonds, spanning the US, Euro area, UK and Australia. In some of our funds, we have also more recently added to Japanese long-dated government bonds, reflecting both valuation opportunities and evolving domestic dynamics. This cross-market approach allows us to capture relative value opportunities rather than rely on a single macro outcome.

Elevated yields provide a stronger income cushion, while negative sentiment toward long duration assets has created more attractive entry points in parts of the market. In our view, this broader opportunity set supports a selective approach to fixed income, and underpins a preference for government bonds over some areas of credit, where valuations appear more compressed.

But what about diversification?

The question of diversification remains central. In an environment shaped by inflation shocks, the traditional negative correlation between bonds and equities has been less consistent than in the past. However, this does not mean bonds have lost their role within multi asset portfolios.

In recent years, investors have been keen to explore alternative sources of diversification in assets such as gold or bitcoin. We have, instead, focused on building diversification through a balanced and well-calibrated allocation across and within asset classes. This includes favouring areas such as emerging market debt and currencies over credit, and maintaining a preference for Asian and emerging market equities over US equities, reflecting both valuation and diversification considerations.

Government bonds remain a central component of that framework. They offer contractual cash flows, deep liquidity and the potential to perform in scenarios characterised by weaker growth or easing inflation.

More complexity, less predictability

The government bond conundrum reflects a more complex market environment rather than a contradiction. In our view, bonds are more attractive on valuation and income than they have been for many years, but their behaviour is less predictable than in the past. Regional differences matter more, and the ability to differentiate across markets, both strategically and tactically, is increasingly important when constructing portfolios.

We continue to see value in long-dated developed market government bonds: we are maintaining exposure where yields remain attractive, while adjusting tactically as markets respond to inflation risks, geopolitical developments and shifting policy expectations.

> **“This evolving environment has widened the opportunity set across developed market government bonds”**

Global

Shane Kelly
Fund Manager, Global Value Equities

The Tech Conundrum: When the biggest opportunity becomes the hardest decision

Technology has rarely been more important. Or more difficult.

The sector now accounts for roughly a third of major global equity indices. Performance has become increasingly concentrated in a narrow group of companies and themes.

For investors, that creates a new challenge. Not whether to own technology, but how to manage exposure to a part of the market that continues to grow in size, influence and expectations.

Narrow markets, exceptional outcomes

Recent market leadership has been extraordinary. Historically, high-momentum technology stocks have delivered strong returns, albeit with periods of volatility. What we have witnessed recently is different in both magnitude and concentration. Market returns have increasingly been driven by a relatively small part of the opportunity set.

The challenge is no longer finding winners. It is deciding what to do after they have won.

When one dominant theme drives a large share of market returns, the market itself starts to become less diversified than it appears. Investors may own broad indices, but a growing proportion of their outcome is often being determined by a smaller number of companies exposed to a narrower set of expectations. Eventually, investors are no longer simply making a decision about technology. They are making a decision about concentration, diversification and portfolio balance.

This is where the conundrum begins.

Beyond the obvious winners

Recent markets have drawn a clear line between perceived AI winners and those seen as being left behind. In some cases, that has created remarkable gains. In others, entire segments have been sold indiscriminately, with little regard for business fundamentals or long-term prospects. Such periods can create both opportunities and difficult choices.

For active investors, preserving discipline becomes increasingly important. Realising profits from successful investments is often straightforward. Deciding where to redeploy capital is considerably harder – particularly when the dominant sector continues to lead market returns.

What began as a gradual rotation has become a more active rebalancing exercise. The strength of recent gains has accelerated decisions around profit-taking and capital redeployment. That has increasingly meant looking beyond the market's AI winners towards overlooked areas of technology, sectors such as healthcare, and regions that have lagged the market's leadership.

Moving away from the market's largest winners inevitably brings investors to areas that have received less attention. This can be uncomfortable. Buying what is not popular, not widely owned, or not currently rewarded by the market rarely feels easy at the time. It often means accepting a period in which the investment case is less obvious, the narrative less compelling and the near-term validation less immediate. But this discomfort is often part of the opportunity. Discipline is not only about selling when valuations rise. It is also about having the patience to look for opportunities where others are not.

History suggests that narrow leadership rarely remains narrow forever. And even when markets continue to be led by a small number of stocks, the identity of those leaders can change. The companies that define one cycle are not always the companies that define the next.

Market leadership broadens. Expectations reset. New opportunities emerge in areas that have received less attention. Our task is not to predict precisely when that transition occurs. It is to ensure portfolios remain balanced enough to benefit when it does.

Technology remains an important source of innovation and investment opportunity. But good portfolio construction has always required looking beyond the obvious winners. In a market increasingly defined by concentration, maintaining that breadth may prove one of the most valuable disciplines of all.

> "The strength of recent gains [around AI trades] has accelerated decisions around profit-taking and capital redeployment"

Global technology

Jeffrey Lin
Senior Technology Analyst

Computing capability, Capital and Capex

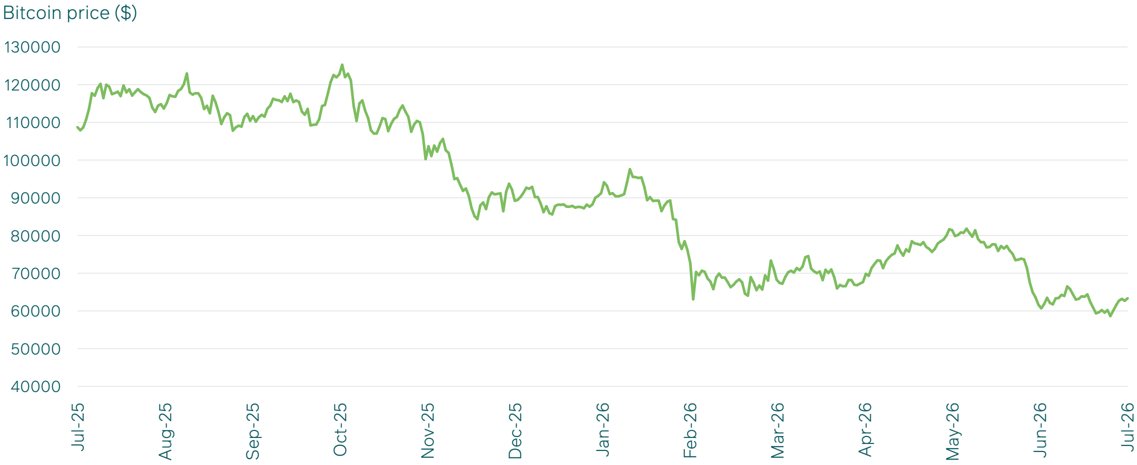
We continue to believe that, as the capabilities of computing increase, new addressable markets for computing are created. This has been the case since the introduction of the microprocessor, enabling the 4-function calculator in the early 1970s. In the last three years, there has been an acceleration in computing capability that has driven demand for computing technology and the supporting products, and the need to build out AI data centres.

We continue to be amazed by aggregate capital expenditure (capex) for AI infrastructure, and the availability of capital to fund it. The recent massive capital raises were done quickly, implying low cost of capital for the issuer and excitement for the future. In the past quarter, among many other capital raises in the public and private equity markets, we have seen Space Exploration Technologies (SpaceX) launch a US$86 billion IPO (initial public offering), quickly followed by a US$25 billion bond offering, and Alphabet raising US$80 billion via an equity offering.

Anthropic and Open AI are also set to list shares in the second half of 2026 and we believe the capital raises will be in a similar range to Alphabet and SpaceX.

The big question is where is the capital coming from? We believe the source of funds has come from industries perceived to be 'AI losers' as well as cryptocurrencies (crypto). We believe crypto investors are highly risk tolerant and may have reallocated capital to AI-related opportunities.

How have investors been fuelling AI-related investments?



Source: Bloomberg, 30 June 2026. Past performance is not a guide to future performance.

This implies that the cost of capital has increased for companies that are perceived to be less at the forefront of AI, and valuations have decreased. We think this creates attractive investment opportunities in those companies that are able to emerge as survivors and/or can perhaps enhance their businesses through the use of AI.

The availability of capital for the longer-duration opportunities means that more ambitious business plans are possible. Investors implicitly believe that the capex will lead to new addressable markets with defensible moats.

As active investors, this is an exciting opportunity to make key choices that have the potential to generate alpha, but it does create a conundrum: Do we choose to invest in quality companies at attractive valuations and expected returns, but with possible obsolescence risk? Or do we invest in promising longer-duration, capital-intensive opportunities with high expectations embedded into the valuations, but with enormous future growth potential if business plans succeed?

Addressing the conundrum

Analysing these opportunities requires a longer-term outlook to understand the threats and opportunities. Analysis using multiples on near-term metrics is insufficient to measure whether or not an opportunity is attractive.

This is where active investors can provide an edge; using their expertise and industry experience to identify mispriced companies among the perceived 'AI losers', that are actually likely to prevail and become long-term winners.

Having a long-term view helps, and understanding the implications of technological change is also important, to know where the opportunities and threats for incumbents lie.

When dealing with such complex – often narrative-driven – markets, we believe a focus on portfolio construction becomes increasingly important; this means building a balanced portfolio with attractive overall risk/reward characteristics, and managing execution risk of longer-duration opportunities through position sizing and higher hurdle rates. One needs to believe that the ultimate upside opportunity exceeds the risk-adjusted required rate of return. We welcome the challenge and believe this an extremely interesting time to be an active investor.

The future space

We are just at the beginning of AI's capabilities, and technology is capable of providing the solutions to address the issues of building more AI capacity.

We expect ongoing volatility in the third quarter, as the longer-term view of opportunities fluctuates widely, but we do believe the economic tailwind of AI will be further realised with, for example, robotaxis becoming more common, Agentic AI gaining wider adoption, humanoid robots moving closer to reality and the potential for AI data centres in space to become the solution to the energy shortages for new AI data centres on earth.

> **"When dealing with such complex markets, we believe a focus on portfolio construction becomes increasingly important"**

UK

Michael Stiasny
Head of UK Equities

Conundrums and Parallels

At times during the second quarter, it felt as though UK investors were operating in a parallel universe. While global markets remained captivated by the AI super-cycle, with its extraordinary returns and increasingly concentrated leadership, UK investors were focused on a very different set of issues: the evolution of the US-Iran conflict, the relentless pace of M&A activity, and the imminent arrival of Andy Burnham as the latest UK Prime Minister. Yet beneath the surface, the forces driving global markets are going to create opportunities in the UK as well. Against this backdrop, the FTSE All-Share Index delivered a respectable return over the quarter.

AI: an opportunity broader than the headlines suggest

In the third quarter, we do not expect these themes to change materially. AI will remain top of mind for global investors and, of course, the UK does not really live in a parallel universe. The influence of AI is increasingly pervasive across our investment universe, although the opportunities often look very different from those dominating global market headlines.

We continue to see meaningful opportunities within the UK market: in the mid-cap space, among the "picks and shovels" businesses facilitating AI adoption; among FTSE 100 companies, particularly those with valuable data assets that have significantly de-rated despite their strategic importance; and across the largest UK corporates, where AI has the potential to drive material cost savings and productivity improvements over time.

M&A activity: value validated, but at what cost?

Corporate activity will inevitably continue given the persistent discount at which UK equities trade relative to international peers. Activity in the second quarter extended further up the market-cap scale into the lower half of the FTSE 100 Index, with approaches for Intertek, DCC and Segro. Although every situation differs, we believe UK domestic policy needs to do more to counter the adverse consequences of ongoing de-equitisation for the wider UK corporate ecosystem and the potential second-order effects on the UK economy as a whole

Politics takes centre stage

The biggest UK-specific focus in the coming quarter will almost certainly be the transition to an Andy Burnham-led Government. "Manchesterism" is the guiding philosophy[6], drawing on Burnham's experience as Mayor of Greater Manchester, although policy detail to date remains limited. Encouragingly, the commitment to operate within existing fiscal rules has kept markets calm, alongside a more centrist and business-friendly orientation than is often portrayed in the wider media.

The market reaction has been benign, with the FTSE 100 and FTSE All-Share indices up 1.3% and 1.1% respectively since Burnham's by-election victory on 19 June 2026, while 10- and 30-year gilt yields have barely moved through to 30 June 2026[7]. That said, market composure since Burnham's return to Parliament may partly be coincidental. A sharp fall in the oil price should help ease inflationary pressures on the UK economy and could support a more dovish path for interest rates.

[6] 'Manchesterism' incorporates ideas such as devolving power and resources from Westminster and redistributing the proceeds of growth into local communities through greater regional control over housing, transport, utilities and education.
[7] Source: LSEG DataStream. Return period: 19 June 2026 – 30 June 2026.

Does Andy Burnham have the magic touch or is it just a coincidence?

Source: LSEG Datastream, 2 July 2026.

Does this mean Burnham is a lucky general? Perhaps. His luck could even extend to his formal appointment around 17 July, which could coincide with England winning the World Cup the same weekend. More importantly, a moderation in inflationary pressures could support rising consumer confidence and improve the outlook for domestic-facing businesses as we head into 2027. Key to this will be a smooth transition to the new government and the avoidance of the sort of damaging speculation we saw ahead of last year's Budget.

To some extent, UK equities appear insulated from the AI-driven market concentration that has come to dominate US and Asian markets. However, that interpretation overlooks the extent to which AI is already creating opportunities across the market.

This is perhaps the central conundrum facing investors today. Much of the market's attention remains fixed on a narrow group of global AI champions, yet some of the most compelling AI-related opportunities may lie outside the spotlight, in markets such as the UK where valuations remain attractive and expectations remain low.

For long-term investors, we believe UK equities continue to trade at compelling valuations relative to global peers, offer attractive shareholder returns and dividends for income-seeking investors, while also providing exposure to AI-related growth without the concentration risks increasingly embedded in global markets. The apparent parallel universe may not be so different after all.

> **"Corporate activity will continue given the persistent [relative] discount [offered by] UK equities"**

Japan

Carl Vine
Co-Head of Asia Pacific Equities

Japan: staying broad when markets narrow

Since generative AI emerged as the dominant market narrative in late 2022, Japanese equities have not depended as heavily as the US, or some other Asian markets, on a small group of AI-linked winners. The case for Japan has been broader: corporate governance reform, balance-sheet efficiency, rising capital returns, restructuring, wage growth, reflation and the normalisation of domestic interest rates.

AI and the portfolio-construction problem

Whilst that breadth still exists, 2026 has so far shown that Japan is not immune from the same conundrum facing equity markets globally. AI-linked companies now account for roughly a quarter of the Japanese benchmark[8]. In parts of the market, price action has become extreme, with moves that once represented a solid annual return now compressed into days or weeks.

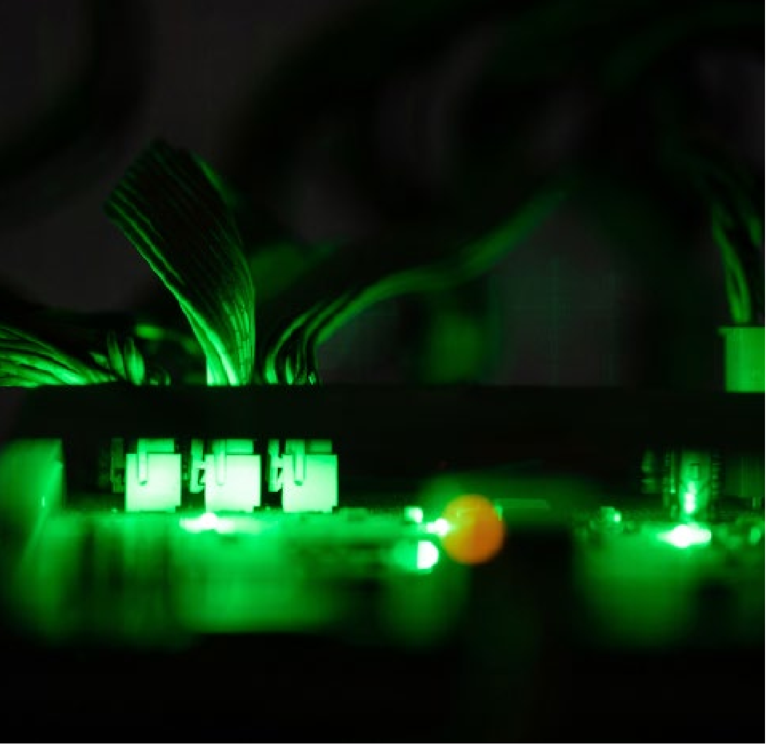
Kioxia, a computer memory manufacturer, was the most striking example. Listed only 18 months ago, at a market capitalisation of a few billion dollars, at one point during the quarter Kioxia surpassed Toyota to become Japan's largest company by market capitalisation, while reaching around 7% of our small-cap benchmark and 4% of the MSCI Japan Index[9].

This raises not just a single-stock or valuation question. It creates a portfolio-construction problem. The issue is not simply whether AI is real, or whether demand for compute, memory and power is entering a new structural cycle. The more difficult question is how much of a portfolio's risk budget should be allocated to a cluster of companies where the range of plausible outcomes is unusually wide, the technical debate is unusually specialised, and the share prices increasingly depend on the claim that this time really is different.

As we described in our June piece, "Equities and the epistemic bottleneck", this technical dimension of AI-linked semiconductor performance matters. Markets do not become fragile only when everyone is optimistic. They can also become fragile when too few participants are capable of disagreeing intelligently. The more technically complex the AI infrastructure debate becomes, the more it rewards specialists, but also the more it narrows the population of investors able to challenge the prevailing price signal. That does not mean the signal is wrong. It does mean investors should be careful about treating it as complete.

> "Our alpha comes from finding esoteric asymmetries in the pricing of risk"

[8] Source, M&G, 7 July 2026; bespoke buckets based on M&G analysis.
[9] Source: Bloomberg, 30 June 2026. Small-cap benchmark is Russell/Nomura Mid-Small Cap Index.



Our approach is therefore deliberately balanced. We are broadly neutral versus the benchmark in AI-linked stocks. To be materially underweight a basket that now represents such a large part of the market would itself be a major top-down call. Equally, we do not want the portfolio to be pulled passively into euphoria simply because the benchmark has changed shape. Within that broad neutrality, we are expressing overweight and underweight positions where we believe we have a differentiated perspective on risk, competitive position, cyclicality, capital discipline or valuation.

The temptation to make a heroic call on the whole AI complex is real and, at times, seductive. However, discipline is required. Our alpha comes less from grandstand calls and more from finding esoteric asymmetries in the pricing of risk. Where we see euphoria, yes, we are willing to bet against it. But we are doing so in a controlled way, as part of a diversified risk-budget allocation.

Corporate change dynamic

Importantly, the amount of oxygen AI is taking out of the room is masking, and perhaps even creating, opportunity elsewhere. The corporate change dynamic in Japan has not stopped; if anything, it continues to broaden. Capital efficiency remains a live issue, with cash-rich balance sheets, cross-shareholdings, buybacks and return on equity (ROE) discipline still pushing management teams to think differently.

Governance pressure continues to rise, including around minority-shareholder treatment and the logic of complex group structures. Business restructuring remains an underappreciated source of value, from simplification and cost-out, to margin recovery and portfolio reshaping.

Nominal growth also matters: a world of wages, pricing power and positive inflation is changing corporate behaviour after decades in which deflation shaped both management psychology and investor expectations.

This diversity is crucial. Japan still offers a broader menu of potential return drivers than a simple AI-or-not-AI framework suggests. In a market where the loudest narrative is increasingly concentrated in a handful of semiconductor-linked stocks, the more interesting opportunities may be in quieter parts of the market where corporate behaviour is changing, expectations are less crowded and the price signal is less distorted by thematic urgency.

So the complex choice in Japan is not whether to own the AI theme or reject it. It is how to respect its importance without allowing it to dominate the entire investment process. We want to participate where the risk/reward is attractive, resist where pricing has become euphoric, and continue to spend most of our analytical effort on identifying exploitable gaps between price and intrinsic value, where a debate or controversy on which we have a perspective sits at the scene of the mispricing crime.

Asia Pacific ex Japan

David Perrett
Co-Head of Asia Pacific Equities

Navigating heightened correlations and volatility across Asian markets

In equity markets, complexity is usually associated with fundamental analysis: assessing whether a new semiconductor product could reshape an industry, untangling a byzantine corporate structure, or adjusting for accounting practices that obscure true cash generation. It is less often linked to market dynamics and their implications for portfolio construction. Yet through much of 2026, and particularly in the second quarter, Asian equities presented exactly that challenge for active fund managers.

Our approach is to build portfolios in which returns are primarily driven by idiosyncratic, stock-specific alpha. Central to that objective is controlling unintended risks so they do not dominate relative performance versus the benchmark. Put simply, we want outcomes driven by stocks where we have a differentiated view, while limiting exposure to risks we have not deliberately chosen.

For context, our Asia ex Japan portfolio typically owns around 70 stocks, while its benchmark contains c.1,100[10]. At first glance, that makes risk control sound almost impossible: how can a portfolio mitigate exposure to more than 1,000 companies it does not own? In normal conditions, the task is manageable.

The stocks we own represent a significant proportion of benchmark weight, while many benchmark constituents we do not own are individually small positions. As long as these smaller stocks do not move in a highly correlated fashion, their aggregate impact on relative performance tends to be limited.

In recent years, clusters of stocks have become more correlated, including EV (electric vehicle) battery names, defence companies and rare-earth plays. These periods were uncomfortable, but narrow, temporary and manageable.

Rising scale and intensity of market moves

The AI-related moves year to date, especially in the second quarter, have been almost unprecedented in scale and intensity. The MSCI Asia Pacific ex Japan Index rose c.25% in the second quarter of 2026, with 66% of that return generated by just three companies – all key AI enablers and owned by M&G. At the same time, correlations rose across a wider set of perceived AI beneficiaries. In the second quarter, 46 stocks rallied by more than 120%, all viewed as potential 'AI winners'.

By contrast, many consumer stocks fell by more than 20% as investors labelled them 'AI losers', resulting in negative relative returns of 45% plus[11]. What would normally have been a diversified collection of stock-specific outcomes increasingly behaved like a single thematic trade.

For an active fund manager, higher correlation and larger price moves create a difficult dilemma: mitigate the emerging risk, or assume the episode will prove temporary and allow valuations to mean-revert?

AI's broad potential economic impact makes that question harder to answer. AI is real, and we owned the three stocks that contributed most to index returns during the quarter.

[10] Source: M&G, 30 June 2026. Internal limits are shown for illustrative purposes and are subject to change.

[11] Source: Bloomberg, 30 June 2026. For all returns quoted in this section: total returns in US dollar terms.

The potential for narrative reversal

Market history provides useful discipline. Over the past 20 and 30 years, Asian equities have delivered annualised returns of approximately 8.7% and 6.5%, respectively[12] – outcomes broadly consistent with long-term economic growth.

The recent pace of appreciation in parts of the market is therefore exceptional, not normal. While some companies will benefit materially from AI demand, the technology, competitive landscape and investor sentiment remain highly fluid. In a powerful thematic market, where correlations are rising and investors are eager to identify the next winner, many candidates may fail to justify elevated expectations. The post-COVID experience of former 'winners' is a useful reminder of how quickly narratives can reverse and winners become losers.

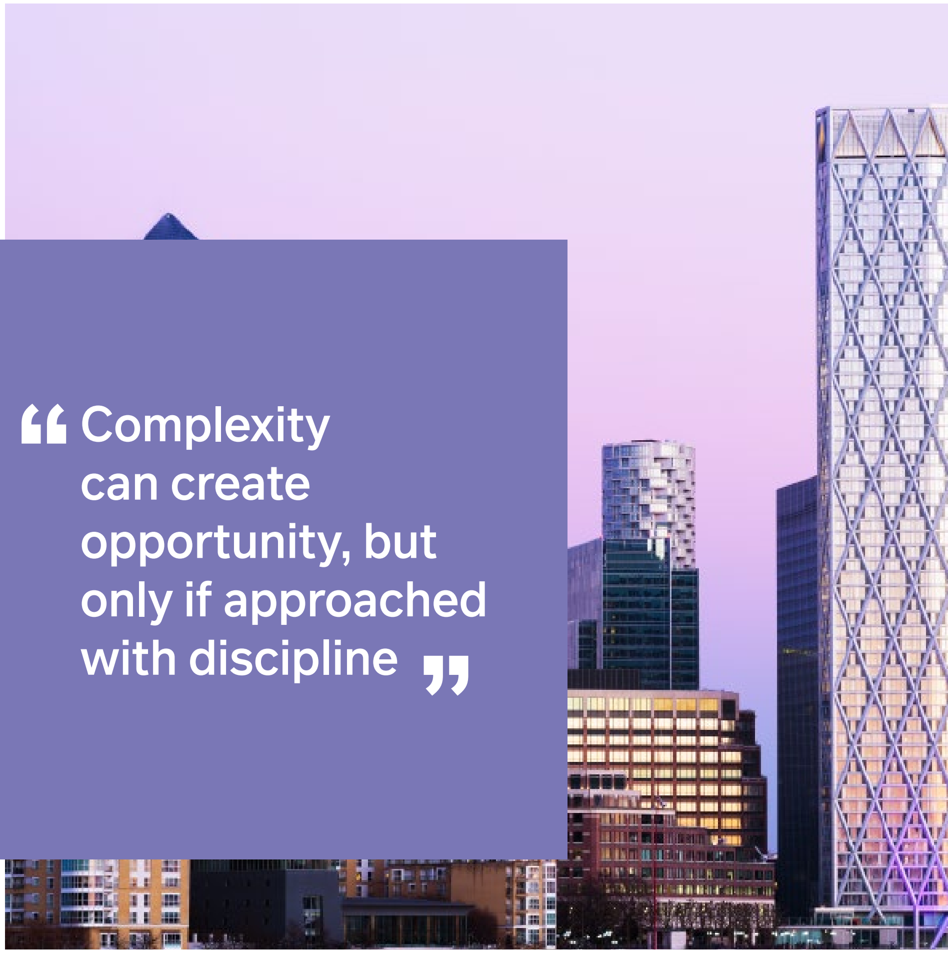
Managing the complexity

Our response is to manage this correlation risk deliberately rather than ignore it. Where possible, we seek exposure to companies that should benefit from AI, but which we know well and can underwrite on their own merits at current valuations, without relying on large AI revenues far in the future. We also remain invested in selected larger AI-related index constituents, with close attention to relative valuation as well as absolute returns.

At the same time, we are prepared to take advantage of opportunities among perceived AI losers where share prices have overshot meaningfully to the downside. However, adding to these stocks may temporarily increase AI-related risk in the portfolio. Our focus is, therefore, on companies with idiosyncratic sources of growth or alpha, and businesses that we believe are relatively insulated from direct AI disruption.

The conclusion is that complexity can create opportunity, but only if approached with discipline. Higher correlations driven by thematic investing make portfolio construction harder because they can overwhelm stock-specific fundamentals in the short term. Yet those same conditions can sow the seeds of future alpha. When correlations eventually fall and fundamentals reassert themselves, the gap between share prices and intrinsic value can become unusually attractive.

For disciplined stock pickers, the challenge is not to predict every twist in the theme, but to construct portfolios resilient enough to navigate volatility within an acceptable performance range, and flexible enough to capitalise when stock-specific factors again dominate market returns.



> "Complexity can create opportunity, but only if approached with discipline"

[12] Source: Bloomberg, 30 June 2026. Annualised returns in US dollar terms.

Emerging markets

Michael Bourke
Head of Emerging Market Equities

Dealing with AI dominance

Emerging market (EM) equities enter the third quarter under a cloud of unresolved macroeconomic tensions and increasingly narrow market leadership, even as headline risk assets remain broadly supported. The MSCI Emerging Markets Index continues to outperform developed peers, rising 24.0% year to date, but with over 100% of that performance being driven by the 'AI trade' of Taiwan and Korea[13]. Meanwhile, the equal-weighted index was up 9.7% over the same period[14].

One of the conundrums facing EM investors is the narrowness of this performance – the AI rally is sucking investor attention and capital from almost all other EMs. This divergence in performance is problematic for portfolios but also provides choices for investors seeking to diversify their AI exposure.

Waning impact of dollar strength on EM

Dollar strength reasserted itself at times over the quarter as investors reassessed the probability of higher US rates, but the relationship between a firm US dollar and EM pressure has become less linear, with current account positions, local real yields and domestic investor biases providing better buffers in several large markets. A number of central banks, India and Indonesia for example, raised rates to stem local currency weakness and insulate their economies from inflation risks associated with energy price pass-through.

Meanwhile, index level returns masked stark divergences: North Asia was solely driven by the AI and semiconductor investment cycle in Taiwan and Korea, while China disappointed, declining 6.6%[15] over the second quarter, and more domestically-oriented markets in Europe, the Middle East and Africa (EMEA), and Latin America (LatAm) traded off local rate expectations, fiscal credibility and commodity sensitivity. The result was an EM rally that delivered great returns, but not for a coherent, index wide reason.

What does EM beta now represent?

The second-quarter pattern of dispersion also highlighted structural questions about what 'EM beta' now represents. The MSCI EM Index is heavily skewed to a small group of countries and companies – with China's ongoing de-rating, Korea and Taiwan's cyclically powerful (but structurally volatile) tech complex, and a cluster of idiosyncratic stories in India, Brazil and the Gulf.

For allocators, this has created a conundrum: traditional broad EM exposure increasingly delivers a mix of policy risk, tech cyclicality and momentum factor crowding that may not align with the original diversification thesis. At the same time, pockets of genuine earnings momentum and capital discipline exist beneath the surface, demanding more granular country level analysis and individual stock selection rather than simple index tracking. This is potentially a good set-up for the active investor, in our view.

> "The third quarter in EM looks like a series of complex portfolio construction choices"

[13] Source: M&G, Bloomberg, 30 June 2026. Refers to the combined contributions of AI-related stocks in Taiwan and Korea to index level returns. Overall index returns will be a function of both positive and negative constituent returns. The sum of positive contributors can exceed 100% of index returns, as these can be offset by negative contributors. All constituent returns combine to deliver 100% of index level returns.
[14] Source: LSEG Datastream, 30 June 2026. Total returns in US dollar terms.
[15] Source: LSEG Datastream. Period: 31 March 2026 – 30 June 2026. Total returns in US dollar terms.

Moving forward: a finely balanced backdrop

Looking into the third quarter, the backdrop is finely balanced. On the supportive side, real policy rates remain positive in many EMs, giving room for selective easing should growth data roll over, while several central banks are already ahead of the developed market cycle.

Earnings revisions in AI-linked hardware, foundry and memory are still trending up, anchoring parts of North Asia and offering a conduit for the global capex boom, but risks are rising as valuations extend and more challenging questions arise regarding the Return on Investment (RoI) from such investments in the face of ferocious cost inflation.

Alongside the tailwinds, the headwinds are equally clear: still-elevated global policy rates, periodic dollar strength, lingering geopolitical risk and the overhang of China's structural growth slowdown all have the potential to weigh on a broad-based re-rating.

Optimism despite complexity

We enter the second half of 2026 optimistic about the outlook. The third quarter in EM looks less like a directional macroeconomic call and more like a series of complex portfolio construction choices. One axis runs between embracing the AI and semiconductor upswing via Korea and Taiwan versus leaning into cheaper, more cyclical value in commodity exposed LatAm and EMEA.

Another runs between leaning into China exposure in the hope of policy-driven mean reversion and an associated pick-up in consumer sentiment, or continuing to migrate capital toward India, ASEAN[16] and select frontier markets where demographics and reform trajectories look clearer but valuations are richer.

The MSCI EM Index has never been so concentrated and the more compelling opportunities may sit in deliberate deviations from it, with risk budgets allocated to country, sector and factor tilts rather than simple beta. In that sense, EM in the third quarter is defined less by a single macroeconomic narrative and more by the art of navigating its conundrums and taking on complex choices.

Crucially, this is an earnings-led market, not one driven by a re-rating. Forward EPS estimates have risen around 40% year to date, outpacing the index itself, leaving the market cheaper than it was in January, with the price-to-earnings (P/E) multiple falling from 13.5x to around 11x. Consensus forecasts point to profit growth of roughly 55% this year and 20% next, providing fundamental support for further upside.

Support for broadening leadership

The conditions for a broadening of leadership are also falling into place. The US–Iran agreement has reduced tail risks around oil and growth – benefiting large oil importers such as India, where lower energy prices and easing Indian rupee pressure are improving earnings prospects, as well as rate-sensitive markets like Brazil and South Africa.

South African equities have corrected to near multi-year lows, which looks excessive against gold and rates, while we think quality domestic names in Brazil offer value ahead of October's elections. In China, valuations remain conspicuously undemanding, in our view, with names like Tencent and Alibaba looking attractively valued on a relative basis.

This is precisely the environment in which our approach has historically done well: a broadening market, driven by earnings and valuation rather than augmented momentum exposure in a handful of index heavyweights.

[16] The Association of Southeast Asian Nations
[17] Source: Bloomberg, 30 June 2026. Multiples and data points refer to the wider MSCI EM universe.

Impact

John William Olsen
Head of Impact Equities

Complexity through a Quality lens

Two topics sprang to mind when I contemplated the title for this quarterly outlook piece, both rooted in the complexities of prudent risk management and the conundrums involved in our mandate: to generate better-than-average returns for our clients while carefully weighing the risk we take on their behalf to achieve them.

Value versus narrative

The cornerstone of our approach is to invest in companies that we assess to be worth more than the share price reflects. That may sound obvious, but it is fundamentally different from trying to forecast stock price movements, which is what traders and investors with shorter time horizons typically attempt. We have written extensively in previous quarterlies about today's narrative-driven markets, where investors hunt for the latest 'trade' rather than assessing long-term fundamental value.

The conundrum arises when speculative animal spirits attach themselves to a long-term narrative. An example is SpaceX which attracted a great deal of capital. We reviewed the SpaceX IPO for our strategy and, given our investment process and objectives, we found it difficult to justify the listing valuation on the basis of current risks and cashflow expectations. While this could be a strong franchise, the market is currently using (very) long-term thinking and expectations to justify short-term trades.

The same mindset has been applied in reverse to software leaders such as Autodesk, Manhattan Associates, Intuit and Adobe, which are now trading on extraordinarily cheap valuations despite continued business momentum and genuine AI optionality within their own operations. We have owned more of the latter types of companies, and that has not helped relative performance this year.

This bifurcation would be perfectly reasonable if AI winners and losers were easy to pick, and if strong ambitions were met with flawless execution. History does not support that level of confidence. The value of a company remains the probability-weighted range of its future cash generation; that range simply widens during periods of technological disruption.

Paradoxically, this uncertainty often breeds higher conviction, as investors 'choose sides' and investing becomes a matter of believing or not believing. This dynamic feels more extreme than at any point in my 30 years in fund management. Nervousness around AI economics, combined with genuine technology bottlenecks, drove unusually sharp single-stock volatility in the second quarter, and we expect that to continue as both the technology and the economics evolve... which leads me to conundrum number two.

> “Risk perception has become increasingly relative...at a time when absolute risk is arguably higher than it has been in decades”

Relative versus absolute risk

Risk perception has become increasingly relative, measured against equity benchmarks, at a time when absolute risk is arguably higher than it has been in decades. Investor leverage is elevated, valuation dispersion is pronounced, and aggregate free-cash-flow valuations sit at decade lows, the result of enormous investment in the hope of future productivity gains. Social media-led investing, momentum and the rewards of aggressive dip-buying, have made the fear of missing out (FOMO) the dominant emotion of market participants, diverting attention from the less exciting, lower-risk companies with a broad margin of safety built into their share prices that we prefer to own.

Like most investors, we are convinced that AI is a transformational technology that is in its early stages. Our portfolio holds high-quality companies with sustainable business models that we believe will benefit from it, while we steer clear of frothier names where earnings are likely near cyclical peaks or technology risk is high. We balance those with more predictable businesses that are very unlikely to be disrupted, alongside a few disruption-threatened companies where we think the odds are heavily stacked in our favour.

Shifting investor attention

Investor focus will probably shift towards policy ahead of the US mid-term elections, along with inflation signals and further mega-IPOs. More importantly, we think this unusual environment offers access to high-quality companies at cheap valuations and with below-average risk. That is an attractive setup for a quality portfolio like ours where higher-than-market compounding returns are met with free-cash-flow discounts rather than premiums. Our sustainability focus may not be in vogue with every investor group either, but it can help mitigate long-term environmental, social and governance risks. It doesn’t feel like a bad time to be a contrarian investor.

Global research

Catherine Lock
Global Consumer Analyst

Traditionally-defensive sectors: adapting to a new normal

Active investors are facing the conundrum of how to manage market concentration alongside an additional complexity: how to appropriately diversify a fund. Healthcare and staples have traditionally delivered reliable earnings growth as well as offering a portfolio defensive characteristics in a down market. However, over the last three years the MSCI AC World – Consumer Staples Index has underperformed the broad global market by 47% and healthcare has underperformed the market by 38%[18].

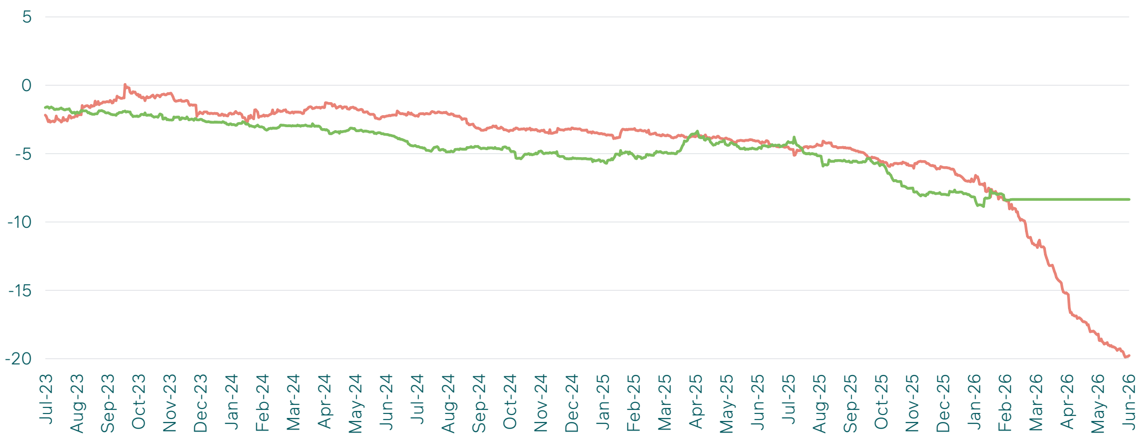
This is not just the result of relative de-rating but realised earnings growth has slowed. The relative cost of holding 'defensive' assets has risen.

Earnings per share (EPS) growth for the MSCI World – Food, Beverage and Tobacco Index has been 3.5% pa over the past five years vs. 5.8% pa over the previous 15 years, and vs 10.5% for the broader MSCI World Index[19].

We have also seen consistent downgrades to earnings expectations, with consensus expectations of earnings growth falling in absolute terms and relative to the market over the past three years.

Consumer Staples: consistent downgrades to earnings expectations

MSCI ACWI Consumer Staples Index/ MSCI ACWI Index: EPS Growth (YoY%)



Source: Bloomberg 30 June 2026. MSCI AC World Index (ACWI). EPS = Earnings per share.

Evolving landscape

GLP-1[20] therapies and broader health-and-wellness trends appear to have reduced demand in the US food and alcoholic beverages sector and this has, understandably, raised questions about long-term demand across adjacent categories and geographies.

At the same time, stretched consumers increasingly shop across channels, promotions and pack-sizes either to meet a hard budget limit or optimise price per use.

[18] Source: Bloomberg, 30 June 2026, MSCI AC World – Consumer Staples Index; MSCI AC World – Healthcare Index (total returns in US dollar terms).
[19] Source: Bloomberg, 30 June 2026. Rolling annual total returns.
[20] Glucagon-like peptide-1 receptor agonists (GLP-1s or GLP-1RAs) are medicines that help people feel fuller by mimicking a natural hormone released after eating.

Demographics are less helpful

Lower birthrates and slowing immigration to developed markets are a drag on volume growth. These fundamentals are overlaid with a higher-rate environment; the market's willingness to pay for stable-but-low growth has diminished. The result has compounded lacklustre earnings growth with valuation contraction.

These headwinds have not disappeared. Consumers remain selective, health trends continue to evolve, and price elasticity may be higher than was historically the case. Running a consumer business has become significantly more complex. Communication channels have proliferated, retail channels are evolving and these require different skills to 'win'. A sharper understanding of data, consumer segmentation and agility in allocating capital are necessary. The best companies are not simply spending more; they are learning faster.

We see these traits at select staples companies, particularly within consumer health. Companies such as Haleon and Kenvue can benefit from both consumer willingness to spend and bottom-up self-help. At such companies, management teams are improving efficiency, reinvesting in brands that can win and sharpening innovation pipelines to drive growth, while margin expansion also underpins shareholder returns.

Meanwhile, there are larger companies like P&G and L'Oreal demonstrating greater agility than smaller peers by using their scale and advanced digitalisation to accelerate growth; harnessing consumer willingness to spend, such as expanding premium haircare ranges. Consistently identifying, innovating and marketing to meet consumer needs can persistently widen the gap in their operational performance.

As market leadership becomes increasingly concentrated around a handful of AI beneficiaries, investors face a growing tension between participating in momentum and maintaining diversification. Rather than treating consumer staples as a homogeneous defensive allocation, it makes sense for active investors to focus on those companies that are delivering continuous innovation to meet their customers' evolving needs.

> "The best companies are not simply spending more; they are learning faster"

Convertibles

Leonard Vinville
Head of Convertibles

Concentration, correlation and valuation risk

The narrative-driven AI trade dominated convertibles in the first half of the year, driving strong returns but also increasing concentration, correlation and valuation risk. The balanced FTSE Global Focus Index gained 7.7%, capturing around 72% of the 11.5% return of the MSCI AC World Index, while the broader FTSE Global Convertible Bond Index rose 16.1%, helped by a higher delta and greater exposure to fast-rising AI-related names[21].

The key difference between indices is their composition. AI-related exposure is now substantial across markets, but convertibles are tilted towards higher-volatility, smaller-cap AI enablers in areas such as memory and storage, cloud infrastructure, networking and semis, with only limited exposure to hyperscalers and Mag7[22] stocks.

Deteriorating new issue terms for investors

Over the second quarter, we saw less favourable terms as high-growth issuers opportunistically monetised elevated realised volatility, enabling issuances at higher conversion premiums. While these convertibles were generally priced at implied volatilities in line with or below recent realised levels, the sustainability of such elevated volatility over a 3–5 year horizon remains uncertain, particularly if revenue growth slows or stalls.

Disruption in the AI narrative remains the key downside risk

The main risk is that the AI-led rally becomes vulnerable to disappointment. Many AI enablers are valued on expectations of sustained multi-year growth, leaving little margin for error. Even modest disappointments could trigger multiple compression, sharp share-price corrections and a widespread and correlated sell-off.

For convertibles, that could mean a triple whammy from falling equities, wider credit spreads and lower implied volatility.

Selective, risk-controlled AI participation remains essential

Avoiding AI exposure altogether also carries risk, given the scale and duration of the infrastructure buildout. The answer is not to abandon the theme, but to participate more selectively.

We favour companies with established business models, visible cash flows, credible funding and valuations that do not already discount a perfect outcome. This points beyond the most crowded beneficiaries of near-term AI capex and towards longer-cycle demand themes such as electrification, power infrastructure and enabling industrial technologies, where convertibles can offer upside participation with a clearer bond floor.

Beyond AI enablers: diversification and active management

The AI narrative remains dominated by the direct beneficiaries of hyperscaler capex, but the next phase may be broader. Less attention is being paid to AI adopters: companies that can use the technology to improve productivity, enhance products and protect margins. This is particularly relevant for software and cybersecurity names, many of which now trade on valuations that appear to discount disruption but little potential benefit from AI adoption.

[21] Bloomberg: 30 June 2026, Total returns in US dollar terms.
[22] Magnificent 7 stocks: Amazon, Apple, Alphabet, Microsoft, Meta, Nvidia and Tesla.

The opportunity set also extends beyond the technology complex. China and Hong Kong have de-rated materially. In our view, Europe offers good-quality issuers at undemanding valuations in electrification and power infrastructure, along with selected opportunities in consumer staples and real estate. Healthcare and biotechnology convertibles provide company-specific catalysts that are less correlated with the AI trade. We think these areas offer better starting valuations, less crowded positioning and stronger downside characteristics.

Prioritising bond floors, diversification and controlled equity sensitivity

In this environment, diversification, valuation discipline, credit quality and bond-floor protection should become more important drivers of asymmetric returns. The objective is not simply to own balanced convertibles, or add or reduce beta to the AI theme, but to manage the portfolio actively across regions, sectors, issuers and bond profiles. That means avoiding weak credits, rejecting aggressive new issues whose apparent balanced technical characteristics rely on optimistic volatility assumptions, and prioritising convertibles where the downside is supported by a credible bond floor.

Portfolio construction should, therefore, matter more than broad market exposure. With volatility likely to remain elevated, the focus should be on relative value, diversification and risk control. We prefer structures with solid bond floors, acceptable credit support and lower vulnerability to a volatility sell-off. The aim is not to eliminate upside participation, but to compound returns more consistently by limiting drawdowns and improving risk-adjusted outcomes.

> "Avoiding AI exposure altogether…carries risk. The answer is not to abandon the theme, but to participate more selectively"