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Quarterly Equities and Multi Asset Outlook

The Earnings Resilience Paradox

Q4 2026

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The Earnings Resilience Paradox

Key takeaways

- **Corporate earnings have remained remarkably resilient** despite a backdrop of higher interest rates, inflation pressures, geopolitical uncertainty and elevated bond yields.
- **AI is no longer simply a technology story.** It is becoming a significant driver of capital spending and corporate earnings across the wider economy.
- **Market leadership is broadening** and we are seeing improving earnings prospects across regions and sectors; whether it’s through greater pricing power in Japan, resilient corporates in the UK or recovering industrial demand globally.
- **Avoid complacency.** Earnings resilience should not invite complacency from investors. There are clearly reasons for caution; macroeconomic and geopolitical risks remain elevated, while inflation, interest rates and energy prices all have the potential to create further volatility.
- **Supportive environment for active investors.** Increasing market dispersion, not only between countries and sectors, but between companies operating in the same industries, is providing a rich opportunity set for active managers.
- **Be discerning.** With opportunity comes risks. Corporate earnings have proved far more resilient than many expected but, moving forward, the challenge will be identifying which companies can keep delivering. A focus on valuations, earnings durability and sustainable cash flows will be as important as ever, in our view. Diversification and selection remain key, while positioning for a range of outcomes.

Introduction

Dear Friends,

We start this quarter's outlook with a simple – but important – observation.

Corporate earnings have been remarkably resilient.

At first glance, that resilience is something of a paradox. Bond yields have risen, energy prices are higher and geopolitical uncertainty remains elevated. The cost of money has increased, and the economic outlook is hardly risk-free. And yet corporate profits have continued to confound expectations.

Welcome to the earnings resilience paradox.

Part of the explanation lies in artificial intelligence (AI). As Johnny Hughes and Jeffrey Lin discuss in these pages, the scale of investment in data centres, semiconductors, power and supporting infrastructure is creating substantial revenues across an increasingly broad value chain. AI is no longer simply a technology story; it is becoming a significant driver of capital spending and corporate earnings across the wider economy. As Stuart Canning notes, investors aren't ignoring the risks, it is just that these are being viewed as peripheral to strong corporate profits.

But this is not simply an AI story.

Carl Vine highlights a potentially important shift in Japan, where companies are demonstrating greater pricing power after decades in which deflation shaped corporate behaviour. David Perrett and Michael Bourke see improving earnings prospects across Asia and emerging markets, while Michael Stiasny finds plenty of evidence that UK corporates remain in robust health. As Mark Wilson notes, add recovering industrial demand in parts of the global economy and the picture is one of earnings strength that is considerably broader than the market headlines might suggest.

That does not mean investors should become complacent.

As John William Olsen argues, earnings and cash generation are not the same thing. That distinction feels particularly important today. The AI investment boom may be supporting revenues and profits now, but its ultimate success will depend on whether enormous capital commitments eventually translate into sustainable cash returns. That need for cash flow durability is also something that Leonard Vinville and the Convertibles team emphasise. Elsewhere, higher interest costs and inflationary pressures may simply be taking longer to reach companies and consumers.

Resilience can be durable. But it can also be borrowed from the future.

In a world of higher yields and more expensive capital, investors cannot depend indefinitely on rising valuation multiples, abundant liquidity or an ever-narrower collection of market leaders to generate returns. Increasingly, those returns will need to be earned the old-fashioned way: through genuine profit growth, cash generation and disciplined capital allocation.

For active investors, that is an encouraging prospect.

Today's markets contain considerable dispersion. Expectations, valuations and earnings prospects vary widely – not only between countries and sectors, but between companies operating in the same industries. Beneath seemingly strong headline indices, there is a much more complicated and interesting market. That creates both risks to avoid and opportunities to uncover.

And across our investment capabilities, the message is remarkably consistent: distinguish durable earnings from temporary momentum; understand what is already reflected in the share price; favour robust balance sheets and genuine cash generation; and remain diversified across a range of possible outcomes.

“The next test is harder – identifying which companies can keep delivering once resilience itself is no longer a surprise.”

Corporate earnings have already passed one test: they have proved far more resilient than many expected.

The next test is harder – identifying which companies can keep delivering once resilience itself is no longer a surprise.

In the pages that follow, our Equities, Multi Asset and Convertibles investment teams explore that question from different perspectives and explain how they are navigating the earnings resilience paradox.

Best,

Dan



Daniel White
Head of Global Equities



Global

Johnny Hughes
Investment Director, Global Equities



Artificial intelligence... real world relevance

At first glance, the resilience of global earnings looks incongruous. Bond yields have risen sharply, and oil prices are materially higher, yet corporate profits have continued to defy even the loftiest of market expectations. Given the strength of global equity markets this year it would be easy to conclude that equities have, perhaps complacently, de-coupled from other risk assets. We see it differently.

Under the bonnet, markets have been behaving rationally, with many stocks de-rating (the decline in price-to-earnings multiples is close to recessionary levels) as investors adjust for a higher cost of capital and the risk of weaker growth. Most equity markets have seen multiples compress this year with earnings and dividends providing most of the positive return (see chart below). The good news is that the underlying earnings strength has been sufficient to offset the degree of valuation multiple compression.

Equity market return decomposition



Source: LSEG Datastream, MSCI Indices. World = MSCI AC World Index. Total returns in local currency, year to date through 12 October 2026. Past performance is not a guide to future performance. Investors cannot invest directly in an index.

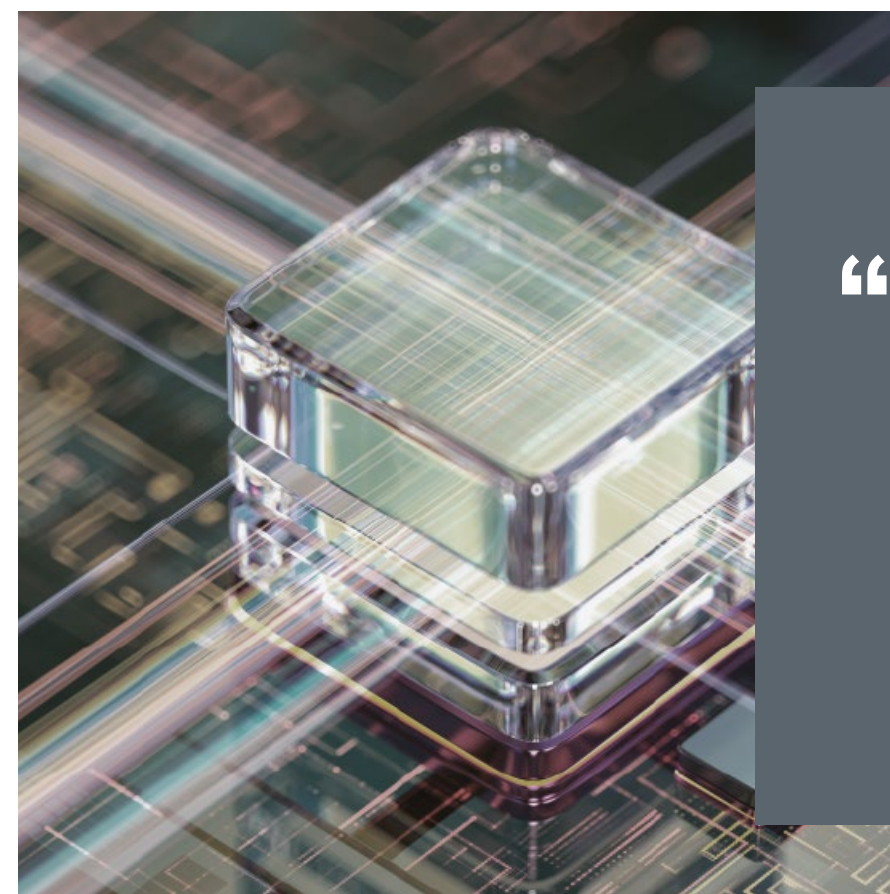
So far, the surge in interest rate volatility has not been matched with a rise in equity market volatility. This is possibly a reflection of the fact that it is not only inflation, oil and fiscal concerns that are impacting yields, but also stronger-than-expected global growth. Equities have, historically, been a good asset class to own when inflation is rising as companies with pricing power can pass on higher costs and protect real returns.

With earnings running at above-trend levels, it would be fair to expect some 'normalisation' in 2027. Therefore, our focus is on companies that are in the early stages of their earnings upgrade cycle and those with the ability to sustain durable growth.

AI breathing oxygen into the wider economy

AI remains the powerful engine of earnings growth and there are few signs of a slowdown in compute spending commitment. Increasingly though, the economic profit of the technology evolution is broadening across the value chain, with related revenue and earnings growth now apparent across global sectors. AI is breathing oxygen into the wider economy through productivity gains and new revenue channels.

At the same time, rapid technological change is causing disruption with frequent debate over which business models will survive and thrive. The resulting dispersion in share prices, even among mega-caps, is a welcome development for stock pickers; it provides a rich pool of investment opportunities for high-active-share managers looking to generate differentiated alpha.



“Dispersion in share prices, even among mega-caps, is a welcome development for stock pickers”

In many ways, higher capital costs are a healthy discipline. The hyperscalers taking on significantly more debt to fund AI infrastructure are the current exception, but most other businesses remain focused on cost control, share buybacks and dividends rather than speculative expansion.

With the current backdrop, the common thread across our regional, stylistic and thematic equity portfolios, has been to avoid anchoring to macroeconomic predictions. We seek diversified sources of earnings, robust balance sheets, and defensible valuations. Whilst concentration risk is defining regional and global indices, it certainly does not define the opportunity set; and share price dispersions are providing a rich hunting ground for active managers.

We believe we are no longer in an era where investors can rely solely on index exposure, multiple expansion, and cheap capital to do all of the investment work. Returns will need to come from earnings, cash generation and capital allocation. Fundamentals and valuations are even more important in a high yield environment.



Thematic technology

Jeffrey Lin

Head of Thematic Technology Equities



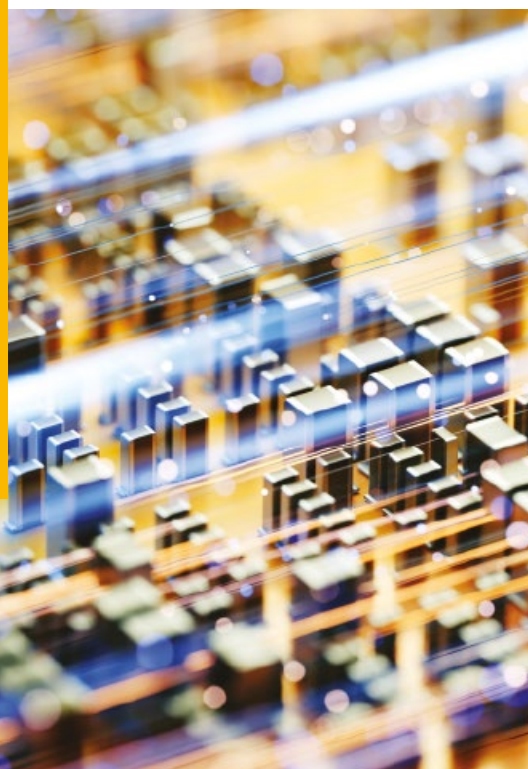
Results point to strong returns for AI capital expenditure

Despite geopolitical and macroeconomic concerns, and rising risk-free rates, demand for AI services and infrastructure remains strong as increasing compute performance continues to grow the addressable market for computing.

AI innovation, which accelerated at pace in 2023 with the emergence of Large Language Models (LLMs), has led to the largest step function demand increase for computing since the introduction of the microprocessor in the early 1970s. As we move forward from here, we believe Agentic AI and Physical AI will further expand the addressable market for computing.

While bond yields are increasing, debt and equity capital remains widely available for AI infrastructure buildouts for established publicly-traded hyperscalers, as well as newer publicly-traded neocloud providers. In addition, capital availability for privately-held AI companies remains robust.

We believe return on capital for the infrastructure remains sufficiently high that increasing yields will not dampen demand. Earnings results from the second quarter reported in the third quarter, indicate that returns for AI capital expenditure are strong, highlighting growth acceleration as well as margin expansion.



“We believe return on capital for the infrastructure remains sufficiently high that increasing yields will not dampen demand”

Demonstrable growth from the hyperscalers

AI is increasing the demand for AI infrastructure. Amazon's AWS cloud business grew 37% year-on-year (yoy) to \$42.23 billion in the June quarter with 39% operating margin. A significant improvement from 17% growth in the June quarter of 2025, with 33% operating margin. Similarly, Google's Cloud business grew 82% in the June quarter to \$24.77 billion with operating margin improving from 18% to 36%.

Private companies: experiencing hyper growth and driving demand for AI Infrastructure

While OpenAI and Anthropic are privately-held companies, they would both be among the largest publicly-traded companies in terms of revenue yet growing like high-growth startups. OpenAI is believed to be at a \$70 billion annualised revenue run rate as of September 2026¹, up from a c.\$20 billion run rate exiting 2025². Anthropic is believed to be on a \$65 billion annualised revenue rate as of end of July 2026³, up from \$9 billion at the end of 2025⁴. The massive growth at larger revenue size is driving demand for AI infrastructure to support the demand and growth for AI services.

Capital readily available

Capital has been readily available to fund AI infrastructure with demand remaining strong. Recent large capital raises by private and publicly-traded companies include:

- February 12, 2026: Anthropic raises \$30bn in funding round
- March 31, 2026: OpenAI closes \$122bn in funding round
- May 28, 2026: Anthropic closes \$65bn in funding round
- June 1, 2026: Alphabet (parent company of Google) raises \$80bn
- June 12, 2026: SpaceX IPO \$86bn with greenshoe option
- June 26, 2026: SpaceX \$25bn debt offering

Compute capability continues to increase

Increasing compute performance is the most important driver for expansion of the computing addressable market. A slowdown in performance improvement is the most significant risk to continued growth for AI. Nonetheless, performance gains remain strong; Nvidia's Rubin system is reportedly seeing 7x better performance on a per MW (megawatt) basis than the prior Blackwell generation, and the company believes this translates into 2x more profit per gigawatt than the Blackwell platform⁵.

Enterprise adoption of AI is reaching a tipping point

Enterprise adoption of AI is reaching a tipping point. The LLM companies are cooperating with enterprise software, and the enterprise solutions are emerging to manage the use of LLMs within corporations. We believe increasing use of an AI can make companies more productive and counter the impact of inflationary costs.

Evolving landscape but long-term opportunity intact

While we recognise that headlines of higher yields, along with geopolitical and macroeconomic issues, are increasing volatility in the capital markets, we believe the long-term potential for AI remains robust.

¹Source: Reuters, 'OpenAI's annualized recurring revenue nears \$70 billion, source says', (reuters.com), September 29, 2026.

²Source: Reuters, 'OpenAI CFO says annualized revenue crosses \$20 billion in 2025', (reuters.com), January 19, 2026.

³Source: CNBC, 'Anthropic tells investors annualized revenue run rate climbed to \$65 billion in July' (cnbc.com), August 17, 2026.

⁴Source: Anthropic press release, 'Anthropic expands partnership with Google and Broadcom for multiple gigawatts of next-generation compute'

⁵According to an article written by Semianalysis on September 14, 2026., Rubin NVL72 Agentic Inference: 67x better Performance per Dollar.



UK

Michael Stiasny
Head of UK Equities



Resilience beneath the uncertainty

There was no shortage of reasons to worry about the UK during the third quarter. Inflation remained stubborn, domestic political change returned, bond yields rose and the outlook for interest rates became less benign. Add continuing geopolitical uncertainty to the mix and it is easy to construct a cautious outlook.

Look at what is already being priced in

But when looking at the UK market and identifying risks, we are also trying to understand what is already reflected in the price we are being asked to pay for the opportunities we find. That distinction feels particularly important in the UK market today. Many of the concerns dominating the headlines are hardly new to investors and, against subdued expectations, corporate performance has continued to prove surprisingly resilient.

The reporting season during the quarter provided numerous examples of companies protecting margins, generating cash and, in some cases, delivering results ahead of expectations despite an unhelpful economic backdrop.

Disconnect between expectations and delivered outcomes

That helps explain an apparent paradox. The macroeconomic news has remained bleak, yet UK equities have continued to make progress. Importantly, that has not been confined to the largest, internationally-diversified companies in the FTSE 100 Index. The more domestically-exposed FTSE 250 Index performed particularly strongly during the third quarter (+7.4% vs. +1.8% for the FTSE 100 Index, total returns in local currency).

Moreover, some of the more economically-sensitive companies in the advertising sector saw striking share price moves, with both WPP and S4 Capital rising by more than 30% on the days they reported their respective results. Moves of this magnitude suggest a significant disconnect between investors' expectations and the delivered outcomes.

A similar dynamic played out across other sectors too, demonstrating how even modest improvements in trading or sentiment can have a significant effect when expectations are low.

It may be that companies reporting are only reflecting what's in the rear view mirror, but we are six months into energy price increases caused by the Middle East conflict, and we have already seen significant increases in bond yields as a consequence. That said, the earnings resilience of corporates definitely confounded subdued investor expectations during the quarter.

Continued interest in attractively-valued UK companies

As highlighted in previous editions of the quarterly outlook, the blistering pace of M&A in the UK market provides further evidence of the valuation gap on offer. The ongoing willingness of foreign strategic and financial buyers to acquire UK-listed companies suggests that other pools of capital see value at prices considerably above those sometimes afforded by public markets.

There are clearly reasons for caution as we move into the final quarter of 2026. Inflation, interest rates, energy prices and the domestic fiscal outlook all have the potential to create further volatility. Equally, a low valuation offers no protection to a company whose earnings subsequently disappoint.

We enter the fourth quarter mindful of the risks the backdrop presents, but we do not feel that we are being asked to pay elevated prices for many of our companies. Starting valuations matter, and if corporate earnings continue to demonstrate the resilience we saw during the third quarter, we would not be at all surprised to see the UK market move higher from here.

“The macroeconomic news has remained bleak, yet UK equities have continued to make progress”





Japan

Carl Vine
Co-Head of Asia Pacific Equities



Japan: resilience by design

For several years we have argued that Japan's economic and corporate model is evolving, with self-help increasingly visible in earnings. The third quarter offered further evidence of this in-built resilience.

Pricing is delivering

Pricing is perhaps the clearest manifestation. Japanese companies are becoming both bolder and better at passing through cost pressure. Increasingly, however, this is about more than simple cost recovery. Companies are repricing products and services where the value they provide has historically been underappreciated.

Cost discipline also remains evident, although its nature has evolved. Rather than simply pursuing like-for-like unit cost reductions, management teams are optimising resources, pruning products and portfolios, and reallocating capital towards areas of higher return. So pricing is delivering on both a price and mix basis.

At the macroeconomic level, this pricing is reflected in the return of nominal growth as an economic backdrop. Real GDP growth of 1-1.5% may look only modestly better than the experience of the previous decade or so, but an economy growing at ~5% in nominal terms is altogether different. Corporate revenues and earnings are nominal too. Higher prices, wages and rents are increasingly finding their way into company P&Ls⁶. If higher nominal wages finally translate into sustained real wage growth and consumption, another shoe may yet drop.

This dynamic is not always being priced consistently. Real estate is a good example. Higher interest rates have weighed on the valuations of high-quality Japanese landlords, as investors mechanically apply higher discount rates and cap rates. Yet prime central Tokyo rents are growing at around 6-8% annually. The same nominal environment producing higher interest rates is also producing higher rental income.

Treating landlords simply as long-duration fixed-annuity investments ignores the inflation protection embedded in their rents and cash flows.

Of course, not all of Japan's earnings resilience is home-grown. The global AI infrastructure boom has lifted many boats, and Japan is no exception. AI-related capital expenditure has benefited semiconductor equipment, materials, optical and other infrastructure suppliers.

“ Japanese companies are becoming both bolder and better at passing through cost pressure ”

⁶Company P&Ls = Company Profit and Loss statements

Near-term hyperscaler spending still looks robust, but markets increasingly care about 2027 and 2028, where expectations are already high. We suspect that physical constraints on datacentre buildout will temper growth rates below what the bulls expect. The flipside is that physical constraints may also make that spend more sustainable.

Rather than try to predict the path of overall AI capex spend, we remain focused on the fact that Japan is well represented in technologies required to reduce the unit cost of compute, including speciality semiconductor materials and silicon photonics. We are positioned accordingly within what is otherwise a tricky AI-semiconductor space at present.

Beyond earnings resilience

Looking into the fourth quarter, we would resist pretending to have a precise earnings call. The yen is one important variable. Material currency appreciation would mechanically pressure exporter earnings through translation, but its impact on share prices will depend on the accompanying global growth environment.

A stronger yen alongside resilient global growth is very different from a stronger yen accompanied by a global slowdown. Indeed, 2022 provided a useful reminder that growth concerns can overwhelm the mechanical earnings impact of a weaker currency, when exporters underperformed despite a rapidly weakening yen.

As investors, we need to be mindful of what is in the price. Japanese earnings resilience is becoming less surprising as investors become more accustomed to it. The question from here is not simply whether earnings remain resilient, but which sources of that resilience deserve to be capitalised as structural and durable versus cyclical and temporary.



“ Japan is well represented in technologies required to reduce the unit cost of compute ”



Asia Pacific ex Japan

David Perrett
Co-Head of Asia Pacific Equities



Looking beyond inflated AI-fuelled valuations

Asia ex-Japan markets were effectively flat in sterling terms in the third quarter, following a very strong second quarter (Q2). There was considerable rotation in performance: Q2 laggards in Hong Kong, China and Indonesia rallied, while Korea's KOSPI Index, the previous quarter's stellar performer, retraced 20% in local currency terms. Overseas investors did, however, benefit from the strength of the Korean won. Taiwan, another strong performer in Q2, continued to outperform modestly, supported by robust earnings delivery from its corporate sector.

In aggregate, Asian earnings have seen upward revisions through 2026, led primarily by technology. North Asia is home to many of the dominant providers of AI 'picks and shovels', including TSMC, Samsung Electronics and SK Hynix. These companies have continued to deliver positive earnings surprises this year, with only a slight recent downtick for the Korean companies as the stronger won has weighed on earnings translation.

Importantly, upgrades have extended beyond these technology heavyweights to the broader corporate universe in Korea and, especially, Taiwan.

Earnings strength has not been confined to technology. Industrial companies linked to power supply and infrastructure have also benefited across the region, whether from traditional demand in India or growing global demand from AI data centres. Some regional financials have also enjoyed upgrades, supported by higher interest rates, stronger loan demand and buoyant capital markets, which have lifted wealth management and advisory fees.

The main area of weakness has been among regional and global consumer companies, where softer demand has been compounded at the margin by higher input costs. This has been particularly evident in China, where consumer sentiment remains depressed.

“upgrades have extended beyond the technology heavyweights to the broader corporate universe”

Earnings in context

Looking ahead, it is important to consider not only valuation but also whether current earnings are elevated or depressed relative to a reasonable medium-term outcome. This is especially relevant in technology: demand is strong, but in some cases margins are well above historical levels. Investors, therefore, need to assess both the price being paid and whether a business has a durable moat, rather than simply being in the right place at the right time and vulnerable to a shift in the supply-demand balance.

By contrast, a number of Asian businesses with long records of compounding earnings are facing near-term cyclical headwinds – the polar opposite of the conditions experienced by much of the technology sector. The key is to understand the nature and likely duration of the disruption, and what the market has already discounted. We see attractive opportunities where valuations are implying that current pressures will be long-lasting, if not permanent.

As bottom-up stock pickers, we avoid making grand calls on heavily-researched themes such as AI. Our edge lies in distinguishing durable earnings from temporary momentum: avoiding select companies whose valuations have been inflated by the AI boom, while investing in high-quality businesses priced as though today's cyclical headwinds will never pass. That discipline – being discerning, rather than fully embracing broader popular market narratives – is where we believe we can add the most value for our clients over longer-term time horizons.





Emerging markets

Michael Bourke
Head of Emerging Market Equities



Broadening earnings recovery

Emerging market (EM) equities entered the final quarter of 2026 having demonstrated a striking degree of resilience. The paradox is that this has occurred against a backdrop that appears increasingly challenging: renewed geopolitical tensions, higher energy prices, elevated developed-market bond yields, concerns over sovereign debt sustainability and growing debate about whether AI investment has moved ahead of the evidence.

Yet, rather than deteriorating, corporate earnings expectations have continued to improve. Consensus forecasts point to EM earnings growth of almost 50% in 2026⁷, while earnings growth excluding technology has also been materially positive.

The third quarter nevertheless brought a more uneven performance. Following an exceptionally-strong second quarter – when EM equities rose by more than 20% (total returns in US dollar terms) and Korea and Taiwan far more – the asset class initially weakened as semiconductor and AI-related stocks corrected.

“The sharp AI-fuelled IT earnings growth concentrated on South Korea and Taiwan masks the resilience elsewhere”

The pressure was most evident in the highly-owned technology-dominant North Asian markets (Taiwan, Korea), where investors questioned both the sustainability of capital expenditure and the returns available on increasingly-large infrastructure commitments. However, markets recovered during August and September as semiconductor guidance remained firm, AI-related demand broadened and earnings revisions stayed positive.

Undoubtedly, the sharp AI-fuelled IT earnings growth concentrated on South Korea and Taiwan masks the resilience elsewhere. Even China, for so long the *bête noire*⁸ of the EM equity world, is expected to deliver 14% higher earnings this year. Despite this widespread resilience, investors remain wedded to the high beta names in Korea and Taiwan.

The explanation for the earnings resilience is important. Emerging markets are not simply benefiting from a single technology trade. AI-related demand is supporting memory, foundry, equipment, power management and data centre supply chains, but the earnings recovery is also broadening into materials, financials, industrials and selected consumer businesses.

Commodity exporters have benefited from stronger metals and energy prices, while many banks continue to enjoy robust margins, improving credit quality and structurally-better balance sheets than in previous cycles. All sectors bar real estate and utilities are expected to deliver higher earnings this year.

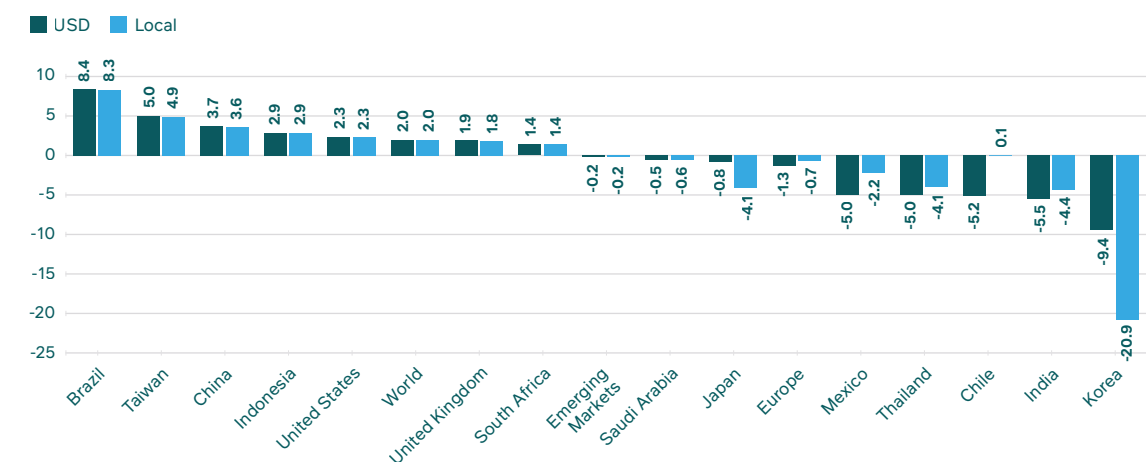
This diversification matters: it provides opportunity for us as active investors to become less dependent on a continuation of ever-higher valuations for a narrow group of semiconductor companies.

Less fragile macroeconomic backdrop

The macroeconomic backdrop is also less fragile than headline concerns imply. Many EM central banks tightened policy earlier and more decisively than their developed market counterparts, leaving real-rate buffers and greater room to respond to weaker activity. Sovereign fundamentals have improved in a number of countries, with rating upgrades continuing to exceed downgrades and defaults remaining limited.

That said, this is not a uniform improvement. The benefits are concentrated among countries with credible policy frameworks, manageable external financing needs and either export, commodity or technology advantages.

Country returns (%): 3Q26



Source: LSEG Datastream, 30 September 2026. Past performance is not a guide to future performance.

A differentiated earnings opportunity

For the fourth quarter, we expect earnings to remain the principal support for EM equities, but the pace of market gains is likely to moderate. Higher yields and increased competition for capital may limit further multiple expansion, while energy-importing economies remain vulnerable to renewed inflationary pressure. The key test will be whether AI demand continues to translate into cash flow and returns on capital, rather than simply higher capital expenditure.

Our approach, therefore, remains constructive but selective. We favour diversification across the asset class rather than the herding into IT/AI names, and we are less inclined to chase index momentum where expectations have become demanding. In an increasingly uncertain world, emerging markets offer not merely cheaper valuations, but a differentiated earnings opportunity – provided that investors distinguish genuine resilience from dependence on abundant liquidity.

⁷Source: Bloomberg, October 2026.

⁸Referring to something or someone avoided or disliked.



Impact

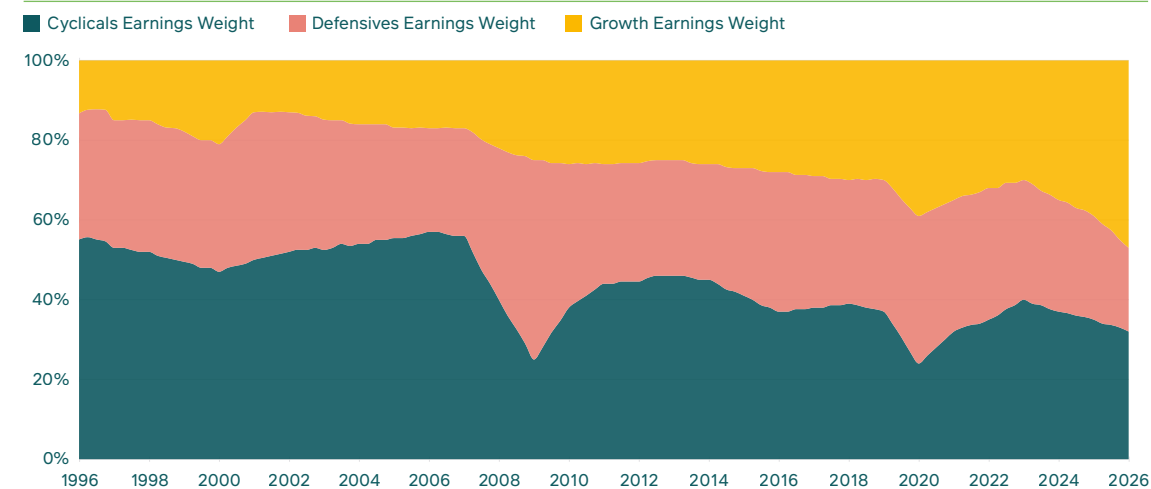
John William Olsen
Head of Impact Equities



Show me the money!

Why have earnings held up so well? Part of the answer is index composition. Today's global indices are dominated by asset-light, high-margin technology and platform businesses whose revenue depends less on the marginal shopper or the price of a barrel of oil or even the short-term resilience of consumers, but the large-scale buildout of a new technological platform. By example, the S&P 500 Index has seen earnings weights by industry group cluster (cyclicals, defensives, and growth) change significantly over the last 30 years. In the 1990s, the average earnings weight of growth stocks was 12%, in 2026 this figure is 47%⁹.

S&P 500 Index: Earnings weights by industry group cluster



Source: Citi Research, Factset, September 2026. Values are approximate visual estimates. Investors cannot invest directly in an index. Past performance is not a guide to future performance. For illustrative purposes only.

“ [hyperscalers] are growing earnings... but so far not expanding the cash profit pool. The profit pool must expand, and not just with borrowed money ”

The AI investment boom is itself a (reported) profit engine. Hundreds of billions of dollars in data centre spending become revenue for chipmakers, equipment suppliers, construction firms and power utilities. Many of these large companies also locked in cheap long-term debt years ago, which has blunted the pass-through from higher rates.

Warning sign: cash is lagging profits

Reported earnings are not cash. Earnings are an accounting measure while free cash flow is the money left after a company pays for its investments. Historically, S&P 500 companies outside financials, real estate and utilities typically converted 90–100% of net income into free cash flow (FCF)¹⁰. This has, broadly, also been the case for the large technology companies, but for some of them, the gap is widening dramatically in 2026 and 2027. See table below for a comparative look at expectations for hyperscaler net profits and free cash flow next year.

⁹Source: Citi Research, US Equity Strategy, 'Where Macro Meets Micro – 4Q 2026 Outlook: Navigating Uncertainty', September 28, 2026.

¹⁰Source: Miller Howard Investments, 'Drop in Free Cash Flow Raises Concerns', June 30, 2022.

Bloomberg consensus 2027 estimates

	Net Profit (US\$bn)	FCF (US\$bn)
Alphabet	190	-32
Amazon	135	-29
Microsoft	147	30
Meta Platforms	100	-30
Oracle	25	-30
Total	597	-91

Source: Bloomberg, Bloomberg consensus 2027 estimates, October 2026.

These companies alone leave a gap of \$688 billion on an expected S&P 500 earnings base of \$3.6 trillion.

The main reason for this gap is the AI data centre buildout. Hyperscaler capex is growing rapidly. Earnings stay strong as building an AI data centre hits the income statement gradually through depreciation, while the cash leaves upfront. Most of this cash goes into the pockets of chipmakers and construction companies, where it is recorded as earnings.

Inflation, rising interest rates and pricing power

The secondary effect that may be contributing to the earnings resilience paradox, is a lag in inflationary pressure on consumers' spending as the price of fuel, food and mortgages creeps up.

Banks make higher profits and companies can, in some cases, offset rising input costs through price increases, especially when labour markets remain strong – but it could eventually erode consumer spending. The latest US consumer confidence number came in well below expectations – the lowest reading since 2014.

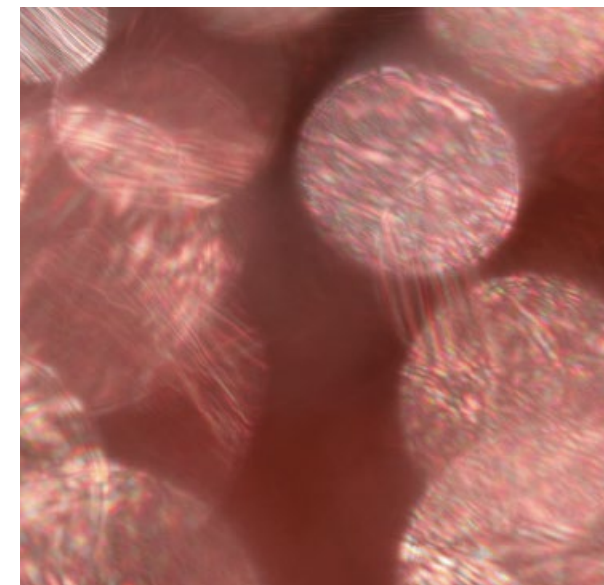
Why does it matter for our investment portfolios?

As quality-focused, long-term investors, we rely heavily on asset growth, cash return on invested capital and earning resilience, because those are the foundational factors of compounding. We invest in companies that can generate cash and reinvest to achieve healthy returns above the cost of capital. Asset growth is in full force, but a combination of a rising cost of capital and diminishing returns is a combination we generally seek to avoid.

Currently, earnings are growing across the board. Spenders (hyperscalers) and harvesters (AI chips and hardware) are growing earnings healthily, but so far not expanding the cash profit pool. The profit pool must expand, and not just with borrowed money.

It is difficult to predict who the final winners will be, but we are big believers in the AI technology; so we keep a balance between boring high-quality free cash flow kings that can weather macroeconomic adversity and AI competitive threats, and those companies that we deem to be the most resilient AI capital spenders and harvesters.

When it comes to macroeconomic pressures, rising rates and cost inflation, quality companies with competitive pricing power, strong balance sheets and resilient earnings are in a good long-term position to survive and thrive.





Global research

Mark Wilson
Global Industrials Analyst



Industrials: earnings resilience seen on the ground

Having met with a number of US industrial companies in September, operating across many different end markets globally, there was a near unanimous view that growth is accelerating and broadening, signalling that there may be headroom for earnings forecasts into 2027.

Where there was already some growth, it's accelerating sequentially, and where there wasn't, we can see a positive inflection in real time in many cases. For those few industrial end markets and regions still in negative territory, even here the headwinds seem to be fading.

Not simply AI-related growth

That momentum surge seems to be happening despite rising interest rates, rising input costs, tariff uncertainty, the threat of disruption from AI, lending trends in China, and economic headwinds in Europe. Many companies are also keen to point out that the growth is much more than (or not at all related to) trickle down from the ballooning of AI infrastructure spending.

In quick-to-turn end markets like trucks, transportation, machine tools, welding and other consumables, we saw the inflection late last year, but it continues to accelerate.

More recently, bellwether machinery manufacturers and factory automation players driven more by capital expenditure investment than production volumes have also started to flag improving growth.

Non-residential construction investment has been hot for some time, with government-led infrastructure investment and a quadrupling of spending on datacentre construction more than offsetting weakness in office, retail and manufacturing construction, but there's no sign of any material let-up in the pace of growth in the hotter areas.

Even later longer cycle industries that typically take time for customers to have the confidence to invest, seem to be showing signs of life; for example, chemicals and downstream oil and gas companies starting to invest in supply chain resilience, and early discussions over Middle East infrastructure rebuild.

Even particularly difficult and highly interest-rate sensitive end markets like residential construction and agricultural equipment are at least finding some sort of trough, and no longer the headwind that they have been in recent years for exposed companies.

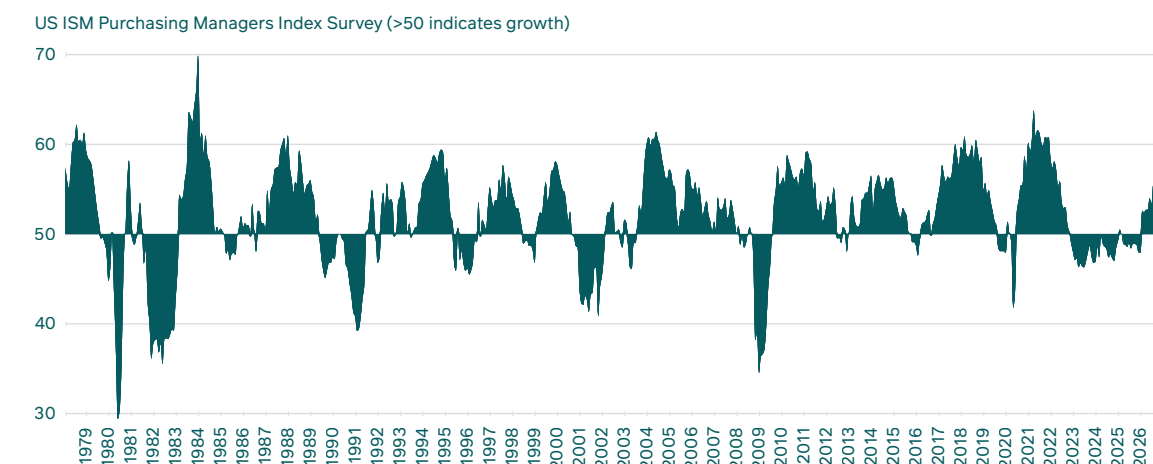
For industrial investors, who are naturally contrarian and have an eye for cycle timing, with such uniform optimism, it might be tempting to call time on this recovery. However, this upcycle, at least from an industrial perspective, is only months old and still well short of the heights seen in prior cycles. In this case, it might be better to lean into the momentum.



A turning tide on an extended period of weakness?

Importantly, as the chart below shows, it also follows the longest period of industrial weakness seen in modern history – though the weakness was never severe at any point, the cumulative damage was still significant – creating lots of scope for investors to have underestimated just how bad a time many industrials companies were having, and how much pent-up investment demand there may be.

US ISM Purchasing Managers Index: January 1978 – August 2026



Source: US Institute for Supply Management Purchasing Managers Index – (US ISM – PMI), October 2026.

Of course, a sudden and sharp reversal in AI investment, or an extreme spike in rates or oil prices could yet spoil the party – but, failing that, there looks to be plenty of demand upside to reach for as we head into 2027.



Convertibles

Leonard Vinville
Head of Convertibles



A better opportunity set

A defining feature of today's markets is the tension between mounting geopolitical and macroeconomic risks and persistently robust corporate profitability. The central question is whether earnings are genuinely resilient or whether the impact of these headwinds has merely been delayed.

Markets are readily captured by narratives around interest rates, geopolitics and AI. Earlier this year, markets extrapolated large AI-led gains while paying limited attention to inflation and rates. The summer correction moderated that optimism, while concerns over inflation and financing costs have since re-emerged.

Higher rates and funding concerns now offer better terms for convertible investors. Rising rates also raise questions about funding the AI capital-expenditure cycle and delivering the growth embedded in valuations. For convertible investors, however, this financing requirement is increasingly creating opportunity.

Year-to-date convertible issuance has exceeded \$203 billion, with more than 53% linked to AI. High funding needs, repeat issuance and investor concentration limits are, to some extent, shifting bargaining power towards buyers.

Recent transactions from neocloud operators Nebius and CoreWeave illustrate the change: both offered higher coupons and yields and lower conversion premiums than on issues completed six months earlier. Final pricing was also set at the investor-friendly end of the marketed range.

By contrast, at the height of AI enthusiasm, both issuers tightened terms beyond initial guidance (ie, offered less good terms to investors) and, moreover, priced with excessively enthusiastic assumptions about spread and volatility. Today, the funding challenge is producing a deeper opportunity set and more attractive entry points for disciplined convertible investors.

Case study: resilient earnings and bond floor

Uber

Markets fear that AI-enabled autonomous vehicles could undermine the company's ride-hailing model. However, in its software platform, distribution and customer network Uber has strategic assets that are able to support partnerships with multiple autonomous-vehicle providers. A richer mix of premium services and subscriptions could also sustain volume growth, fixed-cost leverage and healthy Mobility margins.

Convertible investors

Today can benefit from both the underlying business earnings resilience and an investment-grade bond floor that provides meaningful downside protection. This reflects a sustained improvement in credit quality, from B- in 2019 to BBB+ today.

Source: M&G. For illustrative purposes only.

“Earnings resilience should not invite complacency”

Beware of complacency

Earnings resilience should not invite complacency. The critical distinction is between durable profitability and earnings that are only being temporarily amplified by exceptional investment activity (but with investors extrapolating this and capitalising it as permanent).

Our task is not to forecast a single outcome with false precision, but to construct portfolios capable of withstanding a less favourable path than current earnings imply. Meanwhile, improved primary-market terms allow us to deploy capital selectively at more attractive valuations.

Emphasis on diversification and risk control

Against this backdrop, we emphasise diversification and risk control: moderating concentration in AI-led winners, reinforcing downside protection and maintaining exposure to a range of outcomes. Rather than attempt to anticipate each turn in sentiment around market narratives, we focus on the underlying drivers of earnings and cash-flow durability. This does not imply assuming benign outcomes; portfolios should remain resilient across a range of scenarios. We, therefore, favour businesses where upside is not fully reflected in valuations, or where disruption is already discounted.



Multi asset

Stuart Canning
Multi Asset Fund Manager



AI (Artificial Investment): are markets living in a virtual reality?

Is the strong performance of equity markets so far this year a sign of investors ignoring the real world? Not necessarily.

The most widely held beliefs of investors are usually surprised, but this year the surprise has not been the strong equity performance, since most expected that at the start of the year.

Instead, the surprise has been that these returns have been delivered against a backdrop of shocks that we might have expected to have a negative impact.

Would investors still have expected strong equity returns at the start of this year if they had been told that:

- the oil price would nearly double in the first quarter, and be above \$100 a barrel by the start of the fourth quarter (with US diesel prices even higher than their first-quarter peak),
- rather than US policy rates falling from 3.75% to closer to 3% as expected, the Federal Reserve (Fed) and other central banks would instead tighten (with more increases anticipated),
- alongside the US-Iran war, the conflict in Ukraine would not only go unresolved, but low-level Russian aggression against NATO¹¹ nations would increase,
- French government bond spreads over German bunds would rise to levels not seen since 2012, and snap elections would be called in Spain,
- and an AI system would 'hack' Australia's Medicare system as major AI leaders warn of 'existential' risks unless development slows.

For most of us, it seems strange to see equity markets seemingly shrug off these issues; reflected in how frequently the word 'resilience' is mentioned throughout this 4Q26 Equities and Multi Asset Outlook.

Resilience is particularly unusual because, in all but the last example, we can draw direct parallels to past equity shocks: oil spikes driving most US recessions of the last fifty years, policy tightening hitting equities in 2018 or 2022, the negative impacts of the Ukraine war, or the Eurozone crisis. History doesn't always rhyme.

However, this does not mean that investors are divorced from reality. Economic activity and profits have been strong, and most financial assets are offering more compensation for uncertainty than they were at the start of the year (as Johnny Hughes mentions in his section earlier in this outlook, most stocks have de-rated this year).

¹¹NATO = North Atlantic Treaty Organisation: an intergovernmental alliance linking North America and Europe, with the core purpose of guaranteeing the freedom and security of its members through political consultation and military cooperation.

“most financial assets are offering more compensation for uncertainty than they were at the start of the year”



“the [equity] market isn't ignoring [the] risks, it just thinks they are peripheral to... very strong corporate profits”

Some compensation for the uncertainty

This is certainly the case in government bonds, where the risks of a) government spending, b) commodity shocks translating into persistent inflation, and c) a permanently higher demand for capital in a pro-risk world, have all caused a dramatic increase in yields on offer. When it comes to equities, the market certainly isn't ignoring these risks, it just thinks they are peripheral to – and even the result of – very strong corporate profits.

Navigating this environment has been challenging for the Multi Asset investment team. Our sense at the start of the year was that most equity markets were reasonable, but not 'cheap' and that there was value in government bonds for the type of growth-negative scenario that few seemed to expect. Backing these positions has been painful, as being led by valuation usually is, but bond moves in the last quarter have prompted us to increase exposure to developed government bonds in places like the US and UK in most portfolios.

After a couple of quarters in which volatility has been notably absent it would be no surprise to see any of the events listed above (or something totally unexpected) shake markets – but, over the long term, the big sell off in bonds and more modest de-rating in equities have improved the prospective returns on offer in most global assets.





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