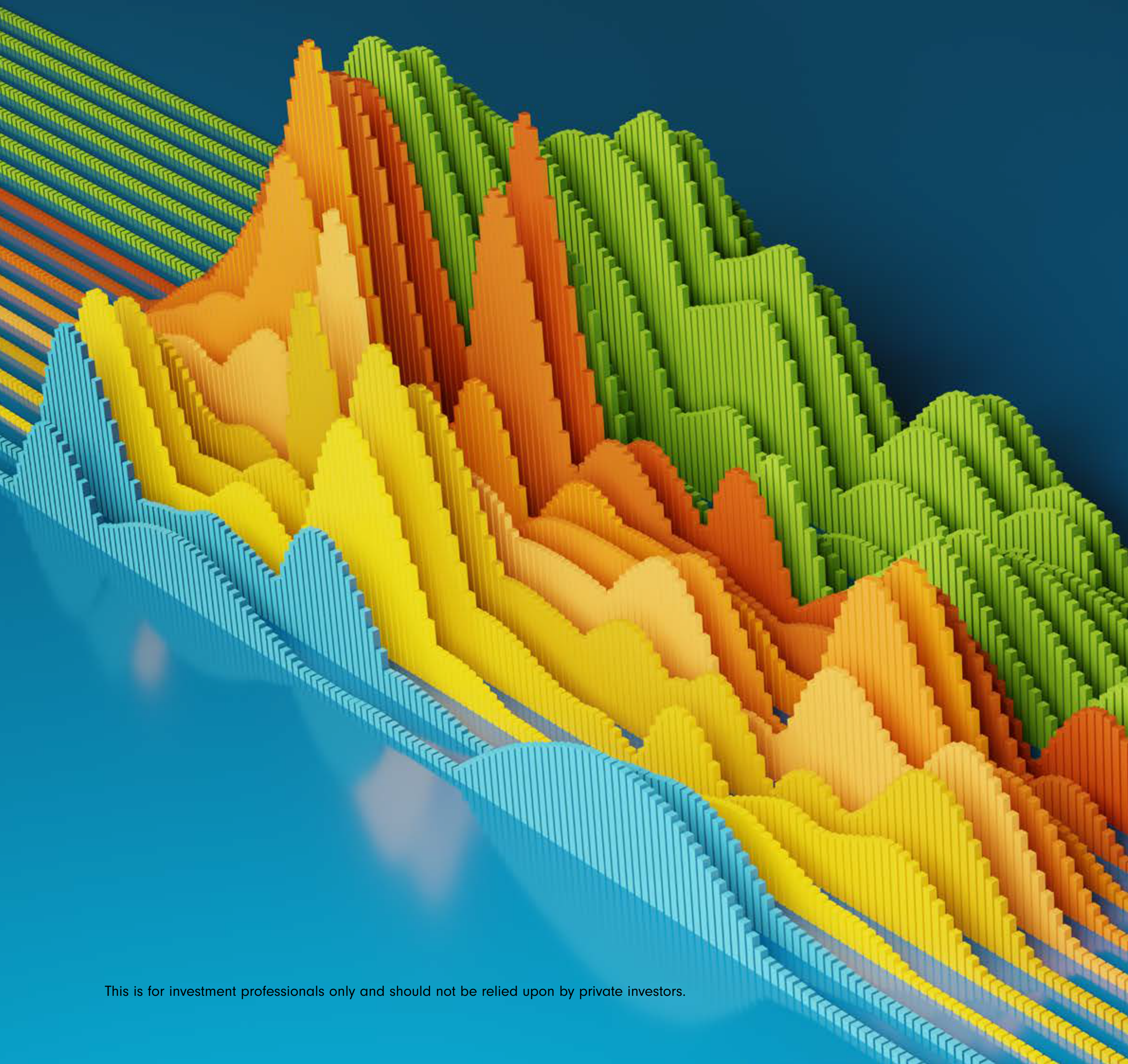
Outlook 2026

The Age of Alpha



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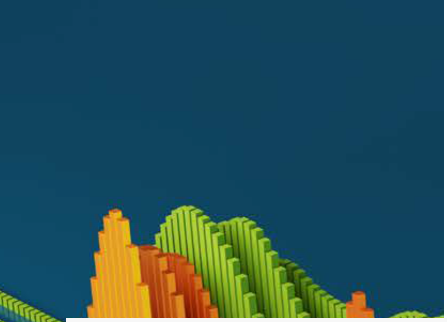
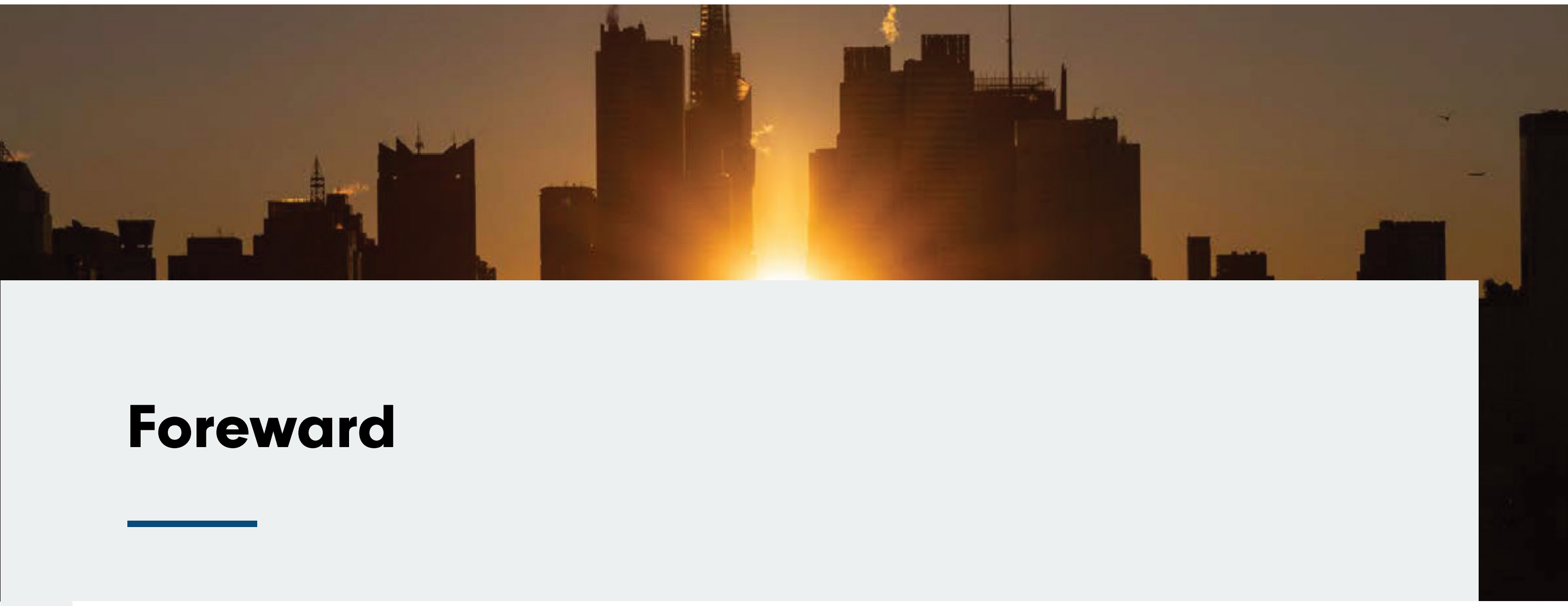


Contents

Foreward	3
Summary	4
Macro and Multi Asset: Time to broaden horizons	5
Equities: AI calculations dominate	10
Asia: Capitalising on technology and corporate reforms	14
Fidelity Analysts: AI is starting to make itself useful to businesses	19



Foreward

A warm welcome to Fidelity International's Outlook 2026.

After reading the following pages, you will have a firm grasp of the structural forces shaping markets as we head into the new year. We hope these insights, based on Fidelity's on-the-ground research, help you test and enrich your thinking.

Your local Fidelity team is ready to partner with you, bringing fresh ideas, thoughtful insight and proven expertise to help you achieve your goals.

And there is plenty to talk about. In 2026, investors will need to consider how to make sense of structural shifts that are playing out across economies, sectors and regions. From questions around whether the promise of AI has driven equity markets too far, to how to build portfolios that are resilient in a more multipolar world.

In particular, our 2026 Outlook grapples with three topics that should be on every investor's radar:

- Inflation is re-emerging as a core macro risk, at a time when growth is also under pressure. What will that mean for interest rates, credit risk and the strength of the U.S. dollar over the coming months?
- Asia is benefiting from a trend towards diversification, emerging as a destination for capital and innovation. Can it surprise to the upside in 2026?
- How long will the market wait for the AI story to bear fruit, and what might happen if patience runs thin?

Through it all, Fidelity's global research network continues to give us deep insight into how these forces are evolving on the ground. Our role is to translate that knowledge into perspective and partnership, helping you navigate change with confidence and a long-term view.

These are complex times, but they also bring extraordinary opportunities.
At Fidelity International, we're here to help you make the most of them.

Keith Metters
President

Summary

Macro and Multi Asset

There is a disconnect between the positive short-term environment for risk assets, and a broader structural instability. Global fragmentation, a depreciating dollar, U.S. Federal Reserve independence and AI capex trends are themes to watch in 2026 and beyond.

Convictions

Look to **emerging market equities and local currency bonds** which will benefit from supportive policy and dollar depreciation, and seek alternative sources of protection like **gold and absolute return strategies**.

Equities

AI will be the defining theme for equity markets in 2026. It should continue to propel stocks forward, and there is real substance to the underlying technology even as questions mount over its application. It is wise to understand those risks, and where best to diversify.

Convictions

Continue to invest in **the AI theme**, while also looking to build resilience through income plays and opportunities beyond the U.S., like **Europe, Japan and China**.

Asia

The region has developed a robust AI eco-system which means it is primed to benefit from the tech megatrend, as it did throughout 2025. Monetary and fiscal policies are supportive across Asia, with a number of countries also pushing ahead with shareholder-friendly corporate reforms.

Convictions

Asia tech should continue to perform, and **equities in Korea and Japan** look attractive. Macro drivers are likely to see interest grow in Asia **local currency bonds**. Asia **high yield** bonds look compelling with a more balanced pool of issuers.

Macro and Multi Asset: Time to broaden horizons

The environment heading into 2026 is constructive for risk assets. But there are structural shifts to watch: AI-led capex trends, global fragmentation, Fed independence, equity market concentration and a depreciating dollar.

Henk-Jan Rikkerink
Global Head of Multi Asset, Real Estate and Systematic

Salman Ahmed
Global Head of Macro and Strategic Asset Allocation

Top convictions

- Accommodative fiscal and monetary policy, and decent earnings, mean we are risk-on for equities. **Select emerging market equities** in particular look attractive for 2026.
- The depreciation of the dollar should continue to support **EM local currency bonds**; we target markets where elevated real yields offer attractive valuations.
- **Gold, absolute return strategies, and private assets** should provide diversified resilience for portfolios in the year ahead.

We enter 2026 amid a supportive macro environment. Growth should be resilient, and policy (both monetary and fiscal) is accommodative. Some of the concerns that plagued the past 12 months have receded – underlying inflation is still high but moderating, and the potential for a sharp, tariff-driven downturn has faded. Risks remain. Further deterioration in the labour market, an inflation uptick, U.S. central bank independence, and the strength of AI capex and earnings cycles all demand vigilance. For now, they appear manageable.

It is a positivity reflected in the bottom-up analysis of Fidelity International's investment analysts. "With rates starting to drop, I expect financing to become more accessible and cheaper," says Robert Glatt, a fixed income analyst who specializes in the retail sector.

Thomas Goldthorpe, a financials-focused equities analyst, points to "lower rates and more pro-business Federal government policies" supporting companies throughout 2026. Our analysts also anticipate stable cost increases on average at the companies they cover over the next six months, which could prove supportive for growth.

Stable cost increases could support growth

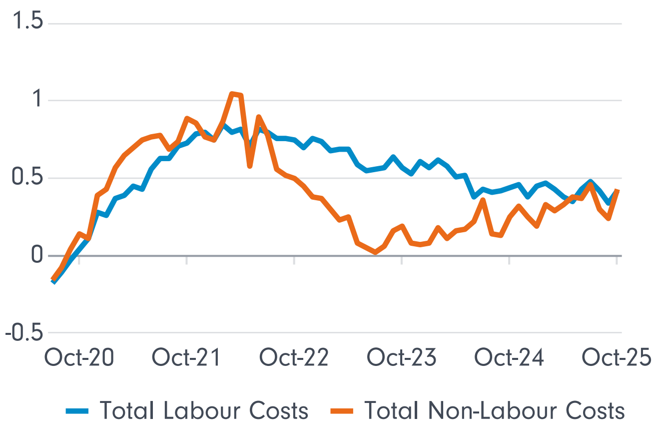
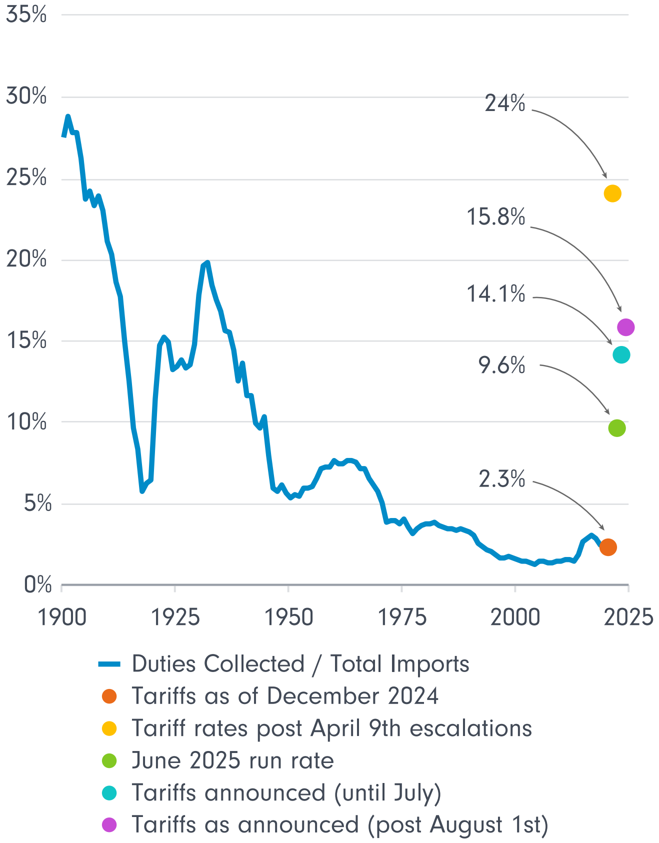


Chart shows proportion of responses from analysts reporting costs are increasing minus those reporting costs are decreasing; significant increases and significant decreases receive a higher weighting. Question: "What are your expectations for the following over the next 6 months compared to current levels?" Source: Fidelity International Analyst Survey, October 2025.

Yet the longer-term backdrop is more complex. Beyond the medium-term stability is a creeping global fragmentation, following years of progressive globalization and debt accumulation. U.S. President Donald Trump's Liberation Day was itself a manifestation of these structural shifts and has since accelerated a global splintering into regional blocs.

While President Trump has retreated from the maximalist position he laid out in the Rose Garden in April, the U.S. tariff and trade policy is now the most restrictive it's been since the Second World War.

The new abnormal



Source: Fidelity International, FIL Global Macro Team calculations, Macrobond, USITC, October 2025.

Accompanying that fragmentation will be further intentional weakening of the U.S. dollar. President Trump has sought to lower the U.S. trade deficit with the rest of the world, breaking the cycle of foreign capital recycling back into U.S. dollar assets. He would rather they invest in productive assets like factories and infrastructure projects, instead of unproductive Treasury bills, which are a favourite of foreign reserve managers.

The value of the dollar is now a strategic policy tool, and as a result we expect its value to depress over the coming years, especially as debates around Fed independence intensify in May when Chair Jerome Powell steps down.

Building resilience

These macro changes will require investors to adopt new thinking around holding U.S. dollar risk.

There will undoubtedly be more geopolitical volatility in 2026; gold should provide some protection in this environment. The euro is also looking more attractive, especially as the Fed comes under pressure to cut interest rates further than may be warranted. Fiscal easing and greater defence spending in Germany should support the euro.

Income strategies provide another way to buffer portfolios. As well as their more stabilized cash flows, dividend-focused investments will naturally diversify allocations beyond the growth-heavy tech stocks upon which investors have grown reliant.

Growth sentiment is improving in Germany and will support the euro

Source: Fidelity International, LSEG Workspace, September 2025.

A word on: Diversification

Becky Qin
Portfolio Manager

Strategies that offer allocation across geographies, asset classes, and investment styles help to provide a ready-made source of diversification – a vital tool for investors looking to manage market concentration.

Funds that focus on income, or income alongside growth, often lend themselves to these diversification benefits.

Naturally these funds tend to be less concentrated by style compared to the broad market, due to holdings that focus on high-quality dividend payers.

They're able to capture the strong tech earnings and AI momentum but also companies that benefit from growing demand for power and infrastructure, for instance.

We're looking to strategies that can harness cyclical stories, too – those that might benefit from the easier monetary and fiscal policies to come. For example, financial companies that will do well from deregulation, and small caps, which are likely to catch up over the year ahead as policy support filters down through the economy.

As a multi asset investor, I'm also free to look for regional diversification. I'm actively looking towards those countries in Asia like Korea and Japan, which are benefiting from improving corporate governance, and China for its policy support.

Beyond equities, this year we have preferred allocation to emerging market local currency bonds within fixed income. This allocation has benefited from benign inflation in major EM economies as well as the soft dollar. I'm able to be tactical around fixed income, moving nimbly to find the best risk-adjusted source of yield.

But as well as the upsides, investors should always be mindful of downside protection. Volatility can be managed with the tactical use of option strategies, for example. They proved their worth throughout 2025 when tariff-induced uncertainty exposed those with fewer defensive buffers. I expect volatility to feature throughout the next 12 months, even if the overall environment is positive for risk.

These shifting dynamics will play out well beyond 2026. Looking to the long term, given the weight of U.S. equities in global benchmarks, non-U.S. investors will want to keep in mind whether their current hedge ratios will serve them in a world in which the dollar comes under increasing pressure, not least from U.S. policy.

We also expect inflation to stay structurally higher, which implies higher equity-bond correlations. This supports the case for alternative sources of diversification, such as real assets, currencies, and absolute return strategies (see boxes).

Equities in places like South Korea and South Africa are re-rating higher, with improving fundamentals and attractive valuations.

Where to find risk

Any depreciation of the dollar should be a boon to emerging markets. EM assets are one of our central convictions for 2026.

Equities in places like South Korea and South Africa are re-rating higher, with improving fundamentals and attractive valuations relative to the rest of the world. China looks compelling for 2026 too with its ongoing policy support creating specific opportunities (see our Asia outlook on page 14 for more on this).

Likewise, EM local currency debt, particularly in Latin America, offers attractive real yields and steep curves. There are plenty of idiosyncratic pockets of interest, with Brazil being a particular favourite.

In the credit space, spreads remain tight, and we are approaching the later stages of the cycle in the U.S. This leads us to shorter-dated credit as a defensive way to extract carry. From a multi asset perspective, we generally prefer high yield to investment grade as credit fundamentals remain healthy.

A word on: Absolute return

Matt Jones
Portfolio Manager

Hiten Savani
Portfolio Manager

If 2025 taught investors anything, it's that they need to think actively about how they preserve capital through a period of global fragmentation and, consequently, increased market volatility. The old rules for doing so have been challenged. A 60/40 portfolio split between equities and bonds, for instance, serves little purpose when both asset classes perform similarly in the face of market disruption.

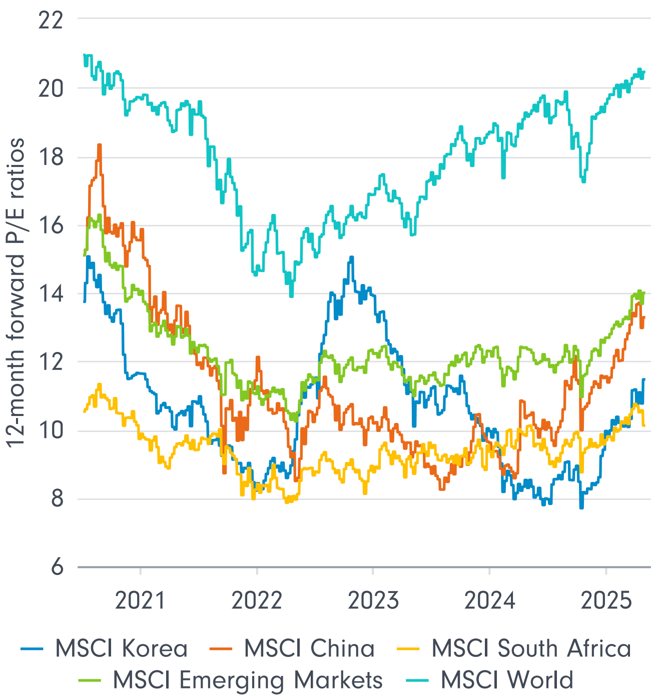
Absolute return strategies provide investors with an alternative way to seek protection when traditional assets like U.S. treasuries fail to provide it. The allocations of these funds are not constrained by any index or market weightings. This leaves them well-positioned to deliver returns that are uncorrelated with the majority of today's funds – especially passive index trackers.

The value of allocating towards uncorrelated alpha streams became evident following the aftermath of April's Liberation Day. Global equity markets fell around 20 per cent during the sell-off. Many investors realized how exposed their portfolios had become to such volatility, since they had grown progressively more reliant on U.S. equities. When the S&P fell, they had little room to hide. Absolute return strategies, by contrast, are designed to reduce volatility across a portfolio of holdings, by investing irrespective of market, benchmark, geography, style or other biases.

One way to achieve this is by focusing exclusively on bottom-up research, which can mitigate the impact of macro volatility that can disrupt entire regions and sectors. An absolute return strategy will not invest in a U.S. tech company just because it's a U.S. tech company and sits within a pre-defined investment universe, for example. A U.S. tech stock has just as much chance of appearing in an absolute return portfolio as an Indonesian textiles manufacturer or a German food producer.

Combine that diverse bucket of equities into one portfolio, unconstrained by style or geography biases, and you have a ready-made diversifier that could provide some shelter for portfolios primed for turbulence.

Many emerging markets are attractively valued



Source: Fidelity International, LSEG Workspace, September 2025.

AI alert

The AI story is clear: the technology promises to improve productivity and raise corporate margins. It's on this basis that the market is willing to sustain higher valuations across the AI chain.

Yet this chain runs far, and there are different ways to play the AI theme through 2026. As well as the well-known core developers, there are companies that provide the infrastructure and platforms without which AI deployment would be impossible, plus the chipmakers themselves.

Downstream of those is the 'physical' AI theme, which could boom through the next 12 months – companies producing AI-driven robotics and factory automation processes, for example (see our analysts' reporting on this topic on page 18). Then there are the huge electricity demands, which will require around US$21 trillion of investment in the power grid by 2050, resulting in nine million kilometres of additional transmission network.[1] Consider too the materials required to build all of this; metals like copper and uranium will be in high demand over the coming years.

We are looking to take advantage across all parts of the AI value chain, remaining invested in the hyperscalers and chip manufacturers, but also finding value among those underlying, cheaper beneficiaries that are just starting to catch up.

Creative destruction

This generally constructive environment for risk comes amid a structural disruption that will likely affect asset allocation well beyond the next 12 months. Much has been upended in 2025 and investors need to be more attentive to where they take risk in 2026. But this need not mean compromising on returns. The landscape has changed. We approach it risk-on, with a clear eye on market, macro, and geopolitical imbalances and their impact on portfolio design.

1 Global Net Zero Will Require $21 Trillion Investment In Power Grids | BloombergNEF

Equities: AI calculations dominate

The AI investment boom is a game-changing trend that will continue to push corporate earnings higher, but the rewards in some areas may not match the exuberance of both real world and stock market investors. For 2026 we widen the search for investment returns that will stay the course.

Niamh Brodie-Machura
Chief Investment Officer, Equities

Top convictions

- **AI-led surge will continue**, but monetisation is yet to be proven and there are growing risks.
- Need for diversification and rotation out of the U.S. will support **income plays**.
- Valuations point to **opportunities in Europe; Japan** is returning to growth, and a broader **bull market in China** may just be getting going.

What is the answer to the US$21 trillion question?[2] That's the current dollar value of the U.S. tech sector, although in reality the stakes may be higher. It is years since so much in the U.S. stock market has rested on one central idea and AI is without doubt that: an all-pervasive trend that will shake the future and which cannot be ignored. It demands investment in more than one sense, and the powerful earnings growth trend it has spurred will continue into 2026. But we have been here before and we know that revolutions rarely proceed smoothly.

Fidelity International analysts are working hard on the central tenets. The changes the new tech brings will be as dramatic as those of the internet in the 1990s, and in the U.S. tech leaders we have companies with the ammunition necessary to deliver the scale of investment required.

"AI needs to be seen in the context of broader AI businesses," says Jonathan Tseng, one of our tech analysts. "The correct question to be asking is not 'is AI in a bubble' it is 'are current hyperscaler businesses – including the ones generating hundreds of billions of dollars of cash and trading on a mid-20-times multiple – in a bubble?'"

In a time of major industrial and technological upheaval, investors sense the opportunity for outsized gains. These can be made from backing the first movers, the leaders of the new or revolutionized industry, as well as the companies that provide this generation's picks-and-shovels.

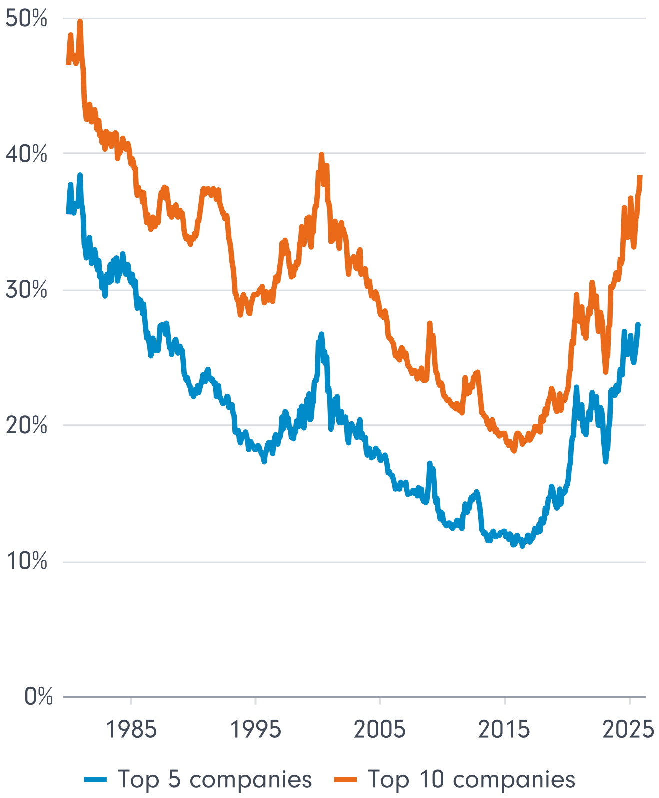
However, the high levels of uncertainty about how the future will actually pan out put a premium on pinpointing the real winners. Many ideas, projects,

2 The total market capitalization of the Mag 7 group of leading U.S. tech companies, excluding Tesla Inc, was US$21.438 trillion on Nov. 17, 2025. These values vary with intraday market movements. Source: Refinitiv Workspace.

and companies get funded and valuations have been bid up broadly, and not every company will end up generating the earnings and cashflow to justify it.

Most concentrated since the 80s

S&P top tier as percentage of whole market



Source: LSEG Datastream, Fidelity International, November 2025.

Something gotta give

The overall mood of the analyst teams that I work with is positive, and market valuations reflect that. As I write this in early November, the S&P 500 is trading at just under 24 times forward price-to-earnings.

Historically, we have found ourselves at these levels less than five per cent of the time.

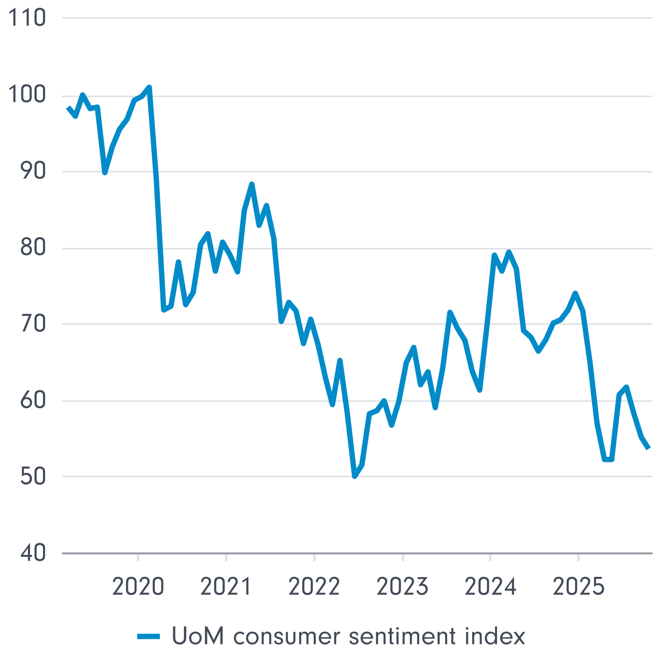
Tech and consumer discretionary stocks are more extreme; both trade in the low 30s multiple of earnings. Will that be justified by the reality of earnings in the quarters ahead? For tech, there are strong indications on the ground that the growth outlook is improving. When we asked our analysts this time last year whether they expected AI to improve profitability in 2025 only a quarter (26 percent) said yes. That figure has since doubled to almost half of the whole survey (read the analysts' report on AI on page 18 of this outlook).

In stark contrast, many of our analysts point to weakness in the U.S. consumer as a top concern over the next year and my feeling is that behind this are contradictions that will need to be resolved in the months ahead.

If AI is beginning to work as a business model for more companies – as our survey and the market valuations suggest – it will do so by delivering productivity gains. It is difficult to see that happening without some movement on corporate layoffs, of which there are already signs. More profits and more stock market gains are a positive story for the economy, but job cuts less so.

Secondly, consumer staples and discretionary may be only 21 per cent of the S&P compared to 46 per cent for tech and communications, but American consumers themselves account for nearly 70 per cent of U.S. GDP, so weakness here would have multiple effects. Will a combination of the capital gains from rising stock markets and the sheer scale of investment in tech be enough to fend off that weakness?

US consumer confidence is weakening



Source: LSEG Datastream, University of Michigan Surveys of Consumers, Fidelity International, latest available as at 30 September 2025.

Prices, pressure points

For now, the answer on balance seems to be yes, and we see real substance and optimism in the fundamentals underpinning the market. We expect the mid-to-high single digit earnings growth of 2025 to strengthen into double digits across all of the major regions we look at in 2026. That includes IT sector profit growth of 25 per cent.

There is, however, a need to diversify risk. Many of the investors I talk to are examining their geographical allocations in light of the political events of the past year. Any hiccups in the current generous growth expectations or from politics and policy would support actual moves in capital.

The case for Europe has strengthened considerably. Falling inflation, lower interest rates and fiscal support all provide a supportive backdrop for corporate investment and consumer confidence.

Aerospace and defence stocks are benefitting from the re-arm Europe trade. But European companies should not be seen as proxies for the region's economy. They are global businesses with resilient balance sheets and proven growth profiles.

A word on: Equity income and valuations

Aditya Shivram
Portfolio Manager

Fred Sykes
Portfolio Manager

The biggest tech companies in one cycle haven't always been the ones that win out in the end. We all know this. That is bound to generate nerves.

From a valuation perspective, if you look at the U.S. and long-term earnings expectations and sentiment, as well as whatever gauge of frothiness you want to pick, all now seem elevated. Whether it is AI or U.S. exceptionalism taking hold again, the market feels risky. Concentration is an issue and that is clearly just another leg of the AI narrative.

All of that speaks pretty strongly to a spot it's worth hitting as an investor: the delivery of strong risk-adjusted returns. If you can avoid the drawdown that a big sell-off of the assets you're holding entails, then that builds strength over time and, regardless of whether at any point you've seen stellar gains, the overall return will be strong. Dividends help here, but the heart of the game in frothy markets is identifying the businesses that are not overvalued, or better still, undervalued by the market.

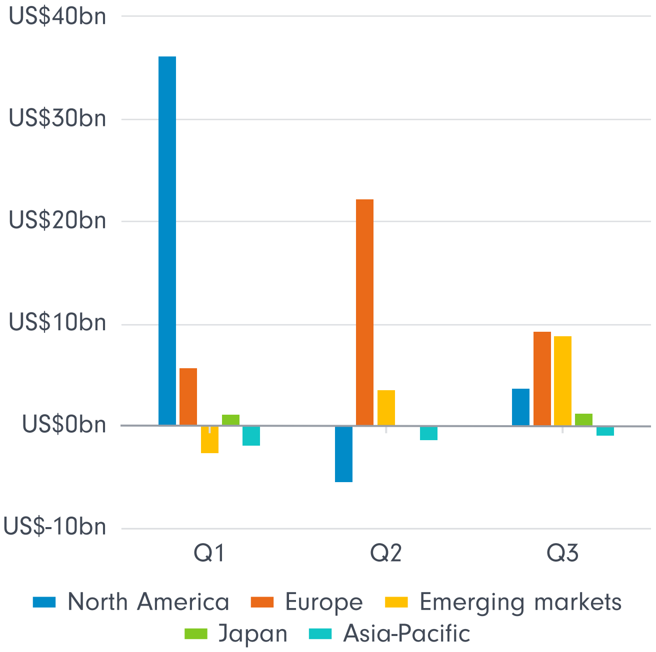
European and international companies that have strong businesses in the U.S. are trading at a discount while U.S.-domiciled companies, by contrast, trade at a premium despite having similar earnings exposures.

The best proxy for long-term value is free cash flow and growth in free cash flow, and there are niches of such value within the AI subset. One of the European electrification winners we've identified has a strong AI leg to its story, and it's been well managed outside the spotlight of all the market hype.

A handful of professional services companies have also been discounted on the idea that their businesses will suffer in the coming revolution. On examination, they look more durable; their solutions are sufficiently embedded into the workflow of their customers that it's harder than one would think to extract them.

They are all trends worth thinking about. Investors in the past 18 months have grown more interested in the idea of diversifying. In the next year it may well prove advantageous to have at least some of your money outside of the anointed set of companies that every fund manager owns.

Flows into European equities have surged



Source: Broadbridge GMI, Fidelity International, September 2025. Equity cross-border fund flows (US$bn) Note: Cross-border funds sold only.

China increasingly looks reminiscent of the U.S. market in terms of the progress being made by its companies on technology and innovation – but here positioning is not crowded and valuations are low. Worries about the trade conflict with the U.S. have cooled and it's clear that the government understands the importance of fiscal spending as a tool to reboot the market and the economy. Furthermore, the increased focus on ending blistering price wars can help corporate earnings inflect back to meaningful growth. The hints of a broader bull market are clear to see.

Japan stands out in our Analyst Survey as a source of optimism. The country is emerging from the staid years of low inflation and low interest rates. Wages are improving and consumer spending power is growing. Corporate governance reforms have fed the market too and helped spur a copycat process in Korea that is upending years of discount valuations and low dividend payments (see our Asia outlook on page 14 for more).

In short, while there is much to be concerned about, the sources of strong returns for the next year are out there. There may just be more variation than we have seen in the last 12 months.

A word on: Technology stocks

Hyun Ho Sohn
Portfolio Manager

The capital intensity of the AI investment we're seeing is very high. The hyperscalers – Meta, Alphabet et al. – are investing at what for them is an unprecedented rate and making significant use of external funding. Meanwhile the market has priced a lot into the value of semiconductor companies. For their value to keep rising, one would have to believe there's another upswing in investment to come. I'm not clear how that can occur.

I am not anti-AI in general. Rather, I'm looking for the parts of the market that may do better out of the development we'll see in the quarters ahead. There will clearly be benefits from all of this investment but not all of it will be profitable, and there are questions now about the circularity of what is happening.

I still believe in the hyperscalers themselves. They are very good businesses, but I have to look at things from a valuation perspective. Not all appear good investments to me through that lens.

A lot of software players are in a downcycle and the read for some of these companies has been that they will be disrupted by AI. But I think some of the existing software players, those that are embedding AI into their systems, will be very well placed to profit from enterprise adoption of AI.

There are semiconductor equipment manufacturers which have not benefitted strongly from the AI trade. All of these stand to gain from the likes of TSMC, Samsung, and others adding to capacity. Most of the chip production so far has come from existing capacity; ramping that up will involve investment flowing through more of those equipment businesses.

The opportunity set across technology remains broad and continues to evolve. Chinese tech players are trying to build their own infrastructure while the consumption recovery there supports lots of domestic names in areas like travel and e-commerce. Video gaming and music streaming look like compelling growth areas: engagement from users is high but, so far they're under-monetized.

Geographically, I'll keep looking for a spread of holdings in 2026. Tech changes are happening globally; the companies worth investing in are everywhere from China to Japan, from the U.S. to Korea.

Asia: Capitalising on technology and corporate reforms

Asian markets weathered 2025 better than expected. Amidst profound technological and geopolitical change, the region's resilience should not be underestimated.

Matthew Quaife
Global Head of Multi Asset

Peiqian Liu
Asia Economist

Top convictions

- The evolving AI story will unlock more value in **Asia's technology stocks**.
- Reforms to improve returns will bolster the appeal of **Korean** and **Japanese equities**.
- The diversification trade will benefit Asia's **local currency bonds**, and a structural shift makes **Asia high yield** compelling in 2026.

The whirl of tariff announcements from the U.S. in April clouded the outlook for export-reliant Asia. But in the months that followed, front-loading and incremental policy support helped countries in the region withstand the stream of tariff shocks. In the meantime, a diversification trend has pushed global investors to seek alternatives to dollar assets. The weaker dollar, a ballooning fiscal deficit in the U.S., and Asia's surprising domestic strength all sharpened the appeal of the region to investors in 2025.

While Asia is set to benefit from the diversification trade in the years to come, a series of structural themes are likely to stand out in 2026.

Riding the AI wave

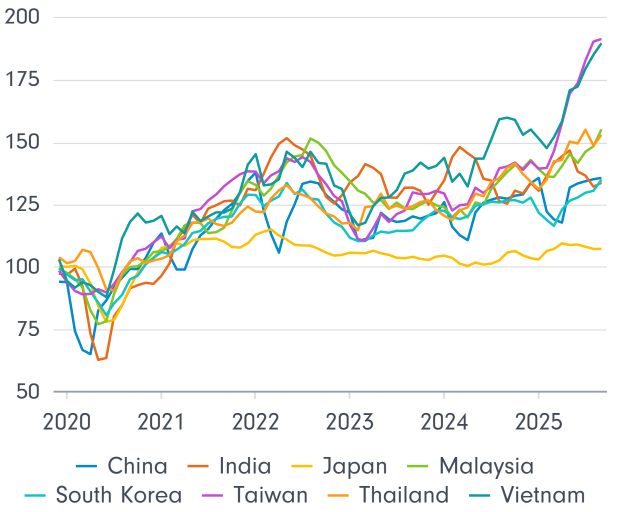
From China's DeepSeek and autonomous driving, to South Korea's memory chips, Asia has proved itself a leader in the AI race. Technological prowess will become an even more important driver of revenues in 2026 after the boost provided by the front-loading of exports fades. Continued strong appetite for AI servers, chips, and datacentre equipment should partially offset the downward pressure on exports.

The excitement over China's rapid catchup in AI capabilities has seen Chinese tech stocks shine in 2025 – not just offshore internet names but also domestic shares. The country has developed its own AI eco-system in response to trade restrictions, making it less dependent on the West. China's vast domestic market, policy tailwinds, and increasingly tech-savvy consumers will drive broader and faster AI adoption, supporting tech stocks in 2026 and beyond.

Markets backed by a critical position in the semiconductor supply chain are having their moment too. Taiwanese and Korean chip makers, for example, should do well in 2026 thanks to a strong upcycle evidenced by the sector's rising prices and sales volumes, driven by the AI boom.

Fidelity International's China and Japan analysts are the most confident in the world about AI's positive impact on corporate profitability over the next 12 months, according to the October survey of Fidelity's research team.[3]

AI demand and front-loading supported Asia exports in 2025



Source: Macrobond, Fidelity International November 2025. Note: Data are three-month moving averages of exports as of September 2025. Rebased to December 2019.

More accommodative

The overall policy stance in the region is likely to ease as higher effective tariffs and the fading momentum of front-loading weigh on growth. For most of Asia, inflation remains a non-issue supported by low energy prices. The resumption of cuts by the U.S. Federal Reserve should soften concerns about interest rate differentials with the U.S., prompting some Asian central banks to loosen monetary policy further.

As a result, Asia's local currency government bonds are likely to see a rise in demand, particularly high-quality sovereigns such as South Korea. They show low to moderate correlations with major global peers, making the asset class a good diversification tool.

Ongoing fiscal stimulus is expected to be rolled out across the region, as well.

A word on: Japanese equities

Min Zeng
Portfolio Manager

Mild inflation alongside gradual monetary normalization should drive improvements in Japan's corporate earnings in the new year.

Wage gains and price pass-throughs, as well as the proactive fiscal stance of the new Takaichi cabinet, will help boost domestic demand even as uncertainties in external demand remain. Meanwhile, with a nudge from the Tokyo Stock Exchange, Japanese companies will continue to enhance their capital efficiency through higher payouts and investments, while also reassessing unprofitable legacy operations.

Specific sectors I'm looking at closely for the year ahead include financials, construction, industrials, IT and engineering companies.

Japan's bank stocks have been overlooked for years because of their inefficient capital allocation and the country's ultra-low-interest rate environment. But there's exciting potential here now that things have turned around. Not only are they benefiting from rate rises by the Bank of Japan, but they're also stepping up dividend payments, share buybacks, and cutting back on cross-shareholdings.

It's a similar comeback story for construction companies. With modest inflation, Japanese companies have ramped up investment in research and development, M&A, and productive capex, instead of hoarding cash. Robust capex is driving an increase in demand for construction. Contractors have regained pricing power, which will continue to drive margin expansion independent of global macro developments.

Industrials, engineering, and IT companies will benefit from domestic digitalization and the energy transition. Japan is aggressively pursuing digitalization as artificial intelligence becomes a central force for growth and innovation. The country's ageing and shrinking workforce is accelerating the corporate adoption of AI. Major firms are investing in both AI and automation technologies to boost productivity and offset the demographic trend.

There are some interesting ideas across Japanese exporters too; in particular, those supplying the U.S. with hardware for its mass build-out of datacentres and the equipment needed for its related grid upgrades.

Risks from U.S. trade policy, the global interest rate path, and domestic politics could trigger pauses after a strong rally. Even so, from governance reforms to the return to mild inflation, a confluence of catalysts makes Japan a compelling hunting ground for active managers in 2026.

3 82 per cent of China analysts and 71 per cent of Japan analysts say AI will have a positive impact on companies' profitability over the next 12 months. The percentages are 48 per cent for North America, 33 per cent for EMEA/Latin America, 35 per cent for Europe, and 44 per cent for Asia Pacific (ex China, ex Japan).

Japan's transition to higher nominal GDP growth is further reinforced by the country's recent change of leadership. Fiscal policy is set to be pro-growth with more measures to boost domestic consumption, while the uplift in defence spending will be accelerated. We expect the Bank of Japan to continue its gradual rate hikes given inflation will be supported by both fiscal easing and a virtuous cycle of wages and prices.

The fiscal stimulus will benefit small and mid caps, which have a greater domestic focus than large caps and are relatively insulated from external shocks. Smaller companies, with valuations at historical lows, provide compelling opportunities to capitalize on Japan's economic growth.

China's campaign to rein in ferocious price competition is starting to bear fruit with deflationary pressures having eased off slightly. But without more aggressive demand-side policies, it will be hard for China to pull the economy out of deflation fully. Beijing may roll out additional measures next year, such as direct subsidies, to persuade cautious consumers to open their wallets.

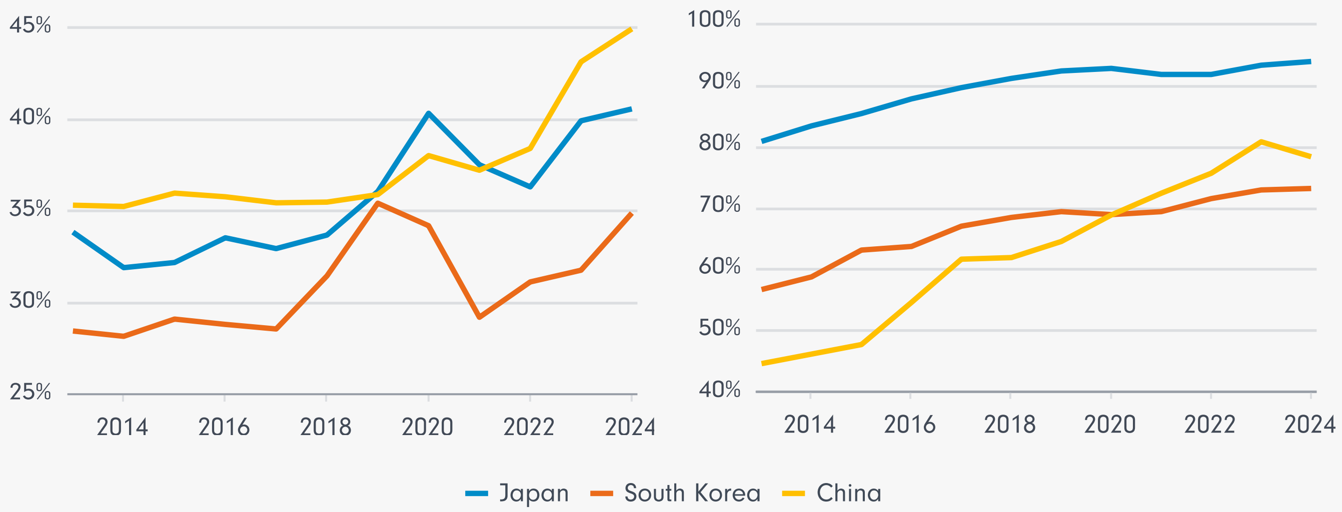
India will continue with its own pro-growth plans in 2026. Despite high U.S. tariffs on its goods, which are likely to be negotiated down, the Indian economy remains underpinned by robust domestic growth supported by its demographic dividend, as well as recent tax cuts. Benign inflation strengthens the case for further interest-rate cuts by its central bank. While the country has been eclipsed by other markets in 2025, 2026 could be a different story, especially for equities.

Evolving corporate reforms

From China to South Korea and Japan, where companies have long been criticized for poor corporate governance, we expect an increasing focus on shareholder returns in 2026.

Chinese, Japanese, and South Korean companies have stepped up dividend payments

Average dividend payout ratio **Percentage of dividend-paying companies**



Source: Bloomberg, Wind, Fidelity International, November 2025. Note: Covering 2,124 companies in the TOPIX index from 2013 to 2024, 827 companies in the KOSPI index from 2013 to 2024, and China A-share and H-share listed Chinese companies with a market cap over 5 billion renminbi.

In Japan, ongoing regulatory reforms and the streamlining of business practices such as cross-shareholdings are further enhancing capital efficiency and investor gains.

> The full impact of tariffs has not been felt yet and could surface slower than many expected.

Meanwhile, corporate fundamentals have improved, supported by de-escalating trade tensions and moderate inflation. Exporters are taking advantage of cost pass-throughs and a softer yen, while domestic sectors, particularly banks, communications, and construction, continue to deliver steady profit growth (see box on Japanese equities).

All eyes will be on whether South Korea can emulate Japan's success story after the new government renewed the country's 'Value Up' programme. Political stability should lead to further progress in corporate governance and an improvement in Korean stocks' valuations, which are cheaper than global and emerging market peers.

Last but not least, Asia's high yield bonds are set to draw wider attention. The asset class appears healthier than before, with a more balanced and diversified pool of issuers. It offers attractive risk-adjusted returns, supported by low default rates, advantageous monetary and fiscal policies, and investor demand for stable carry.

Keeping watch

The region has its fair share of challenges for 2026 too. The full impact of tariffs has not been felt yet and could surface slower than many expected. "The current tariff situation is leading to depressed earnings. This could be a challenge if the final outcome is not favourable," says Priyadarshee Dasmohapatra, an equities analyst covering textile companies in India.

It's uncertain whether the massive AI capex is built on a sound commercial footing. If we do end up in bubble territory here, capex could slow down, weighing on both Asian stocks and economic growth. In some parts of Asia, young workers are battling stubbornly high rates of unemployment, which could threaten future growth and stability. Domestic demand is still below pre-pandemic levels in many countries.

The global economic and trade landscape is shifting rapidly. Investors will need to be nimble and attuned to further volatility or geopolitical surprises. But supportive policy measures, technological advantages, and favourable macro conditions should hold Asia in good stead for 2026.

Fidelity Analysts: AI is starting to make itself useful to businesses

Our research team looks at what artificial intelligence means for company fundamentals.

Punam Sharma
Head of Equity Research, Europe

John Stavis
Head of Equity Research, Asia

Rebecca Motta
Director of Research, Fixed Income

- Fidelity International's global team of research analysts has been looking closely at how companies are **starting to monetise AI**, and what difference that investment is having on the ground.
- They also report on the **wider scope of the AI build-out**, such as datacentres, and who is set to benefit.
- The **knock-on effect on jobs and growth** remains a key consideration as the analysts assess what AI means for their sectors.

A year ago, most of Fidelity's investment analysts predicted AI would have a limited impact on companies' profitability in 2025. The logic was that it would take more time for most businesses in non-tech sectors to adopt the technology and start seeing material benefits.

However, many more analysts expected those benefits to start coming through beyond that one-year time horizon. And our latest survey of the research team suggests this shift is starting to happen.

Nearly half of our analysts say that they expect AI will have a positive impact on their companies' profitability in 2026, up from around a quarter last year.

"What has changed is the urgency of adoption," says Lee Sotos, who covers the U.S. banking industry. "A year ago, the use cases by banks seemed more like generalized bullet points, but now they are detailing real-world solutions."

How companies are monetizing AI

While most use cases so far have focused on reducing costs, Sotos notes that banks are becoming more creative in adding capabilities that generate revenues.

"So far we are seeing new sales and trading capabilities with a capital markets focus," he says. "But also in areas like prompting retail bankers for potential new product sales when a client comes in, or wealth management prompts on the best new ideas for a client."

AI's effect on the bottom line

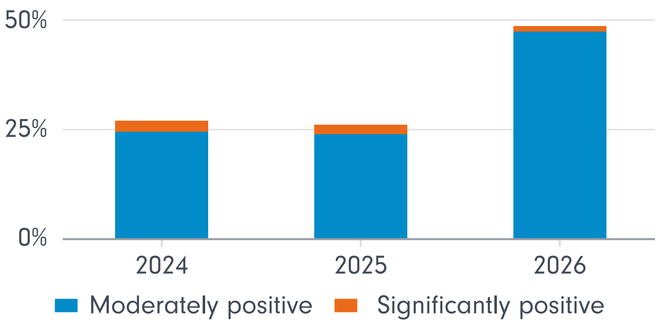


Chart shows the percentage of analysts responding to the question 'What impact, if any, do you expect AI will have on your companies' profitability over the next 12 months?' Source: Fidelity International, November 2025.

The ability to give customers more personalized offerings is emerging as one of the main AI use cases for banks in other parts of the world, helping deliver better operational efficiency, better customer experience and better fraud detection.

Some of these improvements, such as targeted marketing or detecting fraud with biometrics, rely on technologies that can be labelled AI but are less readily associated with the recent rise of large language models (LLMs).

LLMs are also starting to have an impact.

"Chatbots are already helping to replace front-end people," says Gaurav Jangale, a banks analyst focusing on the Asia Pacific region, citing conversations with C-suite members at leading banks.

Tightened operations

Financials is one of the top three sectors identified by analysts as expected to benefit from AI over the next 12 months.

Who will benefit in 2026

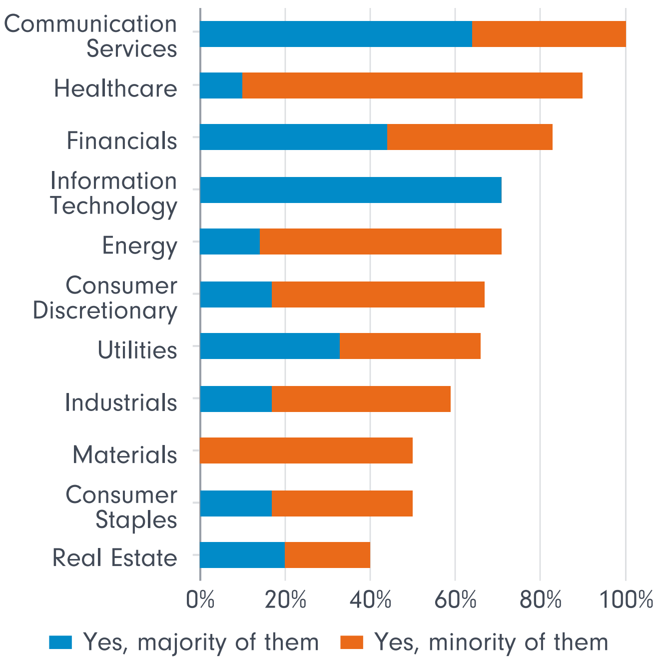


Chart shows the percentage of analysts responding to the question 'Do you expect your companies to benefit from the use of AI over the next 12 months?' Source: Fidelity International, November 2025.

In the top spot is communication services, with every analyst who covers the sector expecting AI to benefit at least some of their companies in the year ahead.

"Over the last 12 months I've gained more conviction through management discussions that AI can make telcos' operations more efficient," says Kazayuki Soma, a Japan-focused analyst.

"For example, with base stations, which are the servers on the ground enabling mobile telecommunication, AI can switch them on and off more flexibly based on usage, meaning more efficient power consumption."

Elsewhere, analysts are starting to see the use of AI to drive efficiencies in sectors ranging from oil and gas and mining to consumer retail.

Alex Dong, who covers consumer staples and sportswear in China, reports efficiencies ranging from designing sportswear to operational gains in fast-food restaurants.

Large tech companies like Google, Meta, Amazon, and Microsoft are also exploring how to use AI to drive consumer revenues.

"I can see a very easy way to transition existing advertising inventory and content and meld them with AI-generated content and AI-generated feeds," says Jonathan Tseng, who covers the semiconductor industry.

Given the size of these companies' user bases and the scale of their existing revenues, this is likely to be a material piece of the AI revenue puzzle, although it will be hard to isolate the impact AI alone is having.

Assuming AI's popularity with businesses continues to grow, we can expect the technology to have knock-on effects beyond the companies that use it.

Second-order effect #1:

The datacentre build-out

One such effect will come from building the datacentres and other infrastructure the technology relies on.

"The datacentres supporting AI are energy intensive and will require significantly more copper," notes Sam Heithersay, who covers Australian metals and mining companies.

"It seems evident to me that natural gas will have to be used to generate power as green sources have been overwhelmed by demand," adds energy analyst Randy Cutler.

Shreeji Parekh, who covers North American capital goods producers, concurs, reporting a renewed interest in plants that can generate steady power.

"A datacentre's 24/7 load profile better matches baseload – gas, nuclear, coal – than intermittent renewables, even with battery storage," she explains, noting that renewable battery storage available today maxes out at just four hours.

Second-order effect #2:

Jobs and wages

By and large, companies' near-term use cases for AI appear to be mostly focused on driving cost savings. And the biggest cost-saving prize is the wages companies pay people.

In the U.S. alone, annual wage spending is over US$13 trillion. If AI cannibalizes even a small part of this, that implies a lot of further scope to monetize the technology. And there are already signs of AI reducing reliance on labour as a factor of production.

"Companies I cover have been growing revenue by 15 to 20 per cent, without any increase in employee numbers," reports China healthcare sector analyst Lizheng Zhu.

"Companies I cover have been growing revenue by 15 to 20 per cent, without any increase in employee numbers."

Historically, weak job creation and rising unemployment has been seen as a bad sign for an economy. And while there are implications for government finances in putting taxpayers out of work, there are also those who argue that this time could be different.

A hit to humans' earning power, through job losses or downward wage pressure, would indeed reduce the ability of those affected to fund consumption.

However, richer members of society would experience a wealth effect as AI-driven efficiency boosts the value of their stock portfolios, potentially mitigating the effect on GDP.

What next for AI in 2026?

It's plausible that not all the AI projects companies have told our analysts about will deliver a desired return on investment.

And ultimately, all of the above rests upon one question: will AI models deliver what they are promising to deliver?

There's no definitive answer to that, at least not yet.

"Large enterprises are adopting agentic AI systems and adapting them to simplify existing business processes," says Tseng. "And that takes time. People and processes take time to change."

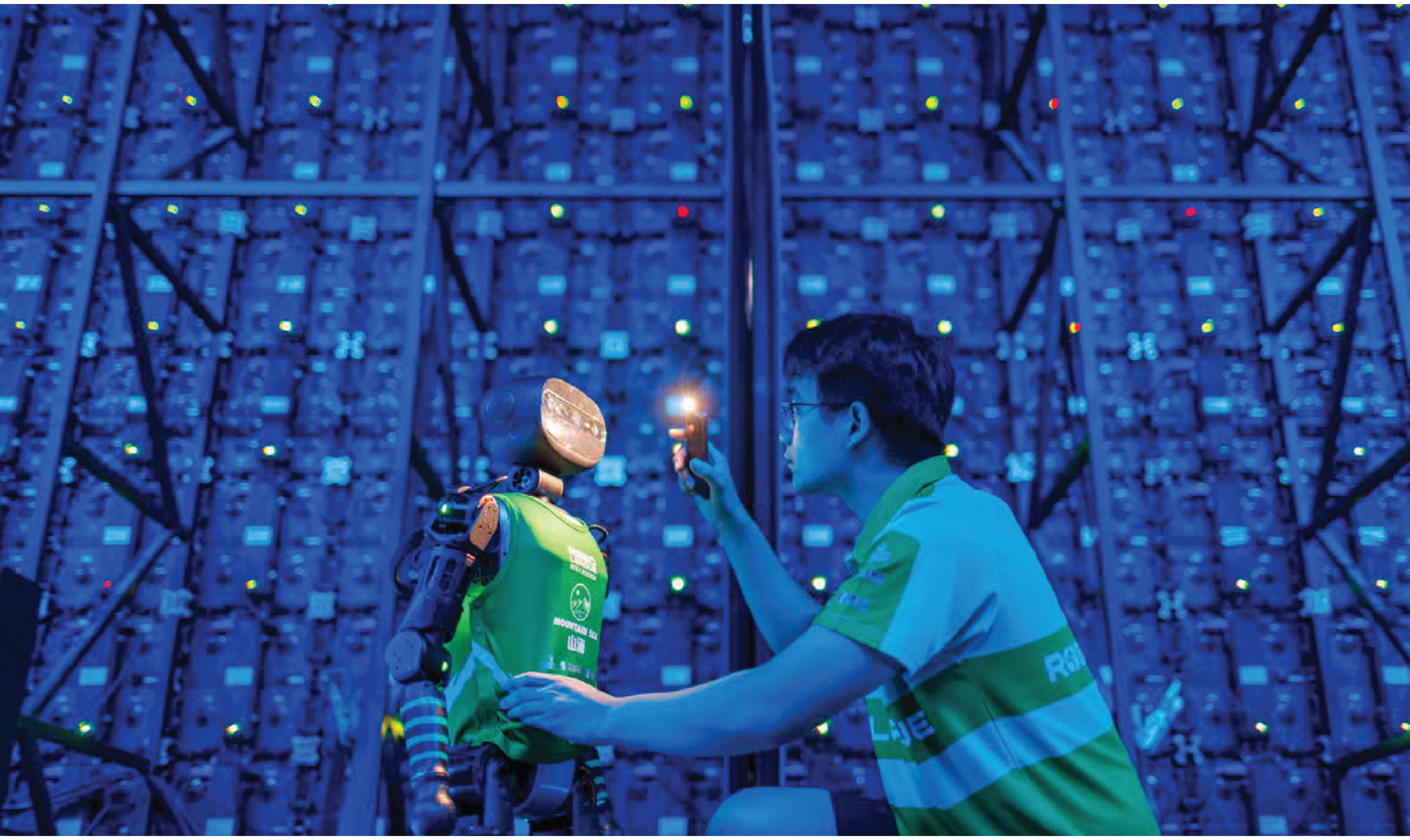
AI pessimists meanwhile fear that the capital expenditure on AI infrastructure risks destroying value by creating capacity that will sit unused.

And there are question marks over whether the companies that build and maintain the AI models can evolve into profitable businesses, given some of them have funding requirements that are multiples of their current revenues.

"If the spending commitments materialize, I don't see any realistic scenario they can break even," analyst Josh Han An Xin says of one of the big AI model companies he covers.

Yet staying on the sidelines also carries the risk of being left behind.

"So far," adds Tseng, "AI models continue to improve and productization is proceeding rapidly. If that works, then everything else will work. Trying to claim that you conclusively know that AI doesn't deliver value based on old data and old models is like looking at the Wright Flyer and deciding that mass air travel will never take off."



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