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Role Reversal

2026 Global Investment Outlook

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HSBC Asset Management

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Foreword

Foreword from our Chief Investment Officer

Welcome to our End-of-Year 2026 Global Investment Outlook: *'Role Reversal'*. This year's theme reflects the profound shifts underway in markets and economies, where traditional patterns are being reshaped.

The post-Global Financial Crisis era – characterised by US exceptionalism and predictable investment playbooks – is gradually giving way to a more balanced, multipolar global economy.

The US, grappling with sticky inflation, modest rate cuts, and a fragile labour market, now sees its growth forecasts converging with those of other developed economies. Meanwhile, emerging markets, particularly in Asia, continue to drive global growth, with countries like India, Indonesia, and parts of frontier markets standing out as key engines of economic momentum. Despite recent challenges, China also remains a pivotal player, leveraging targeted policy measures to stabilise its economy while advancing its leadership in technology and AI.

This evolving macroeconomic environment goes hand in hand with major structural changes in global markets. The era of broad US market outperformance – prolonged by the AI boom, its associated capital expenditures, and promised revenues – is giving way to the rising prominence of Europe and Asia.

The investment climate in 2026 also demands greater adaptability, as traditional assumptions about safety and growth are increasingly being challenged. The valuation-driven rally that defined much of 2025 has shifted to an environment where earnings growth, productivity, and investment cycles must validate current market pricing, which has grown visibly tight in some segments.

The remarkable surge in AI infrastructure investment exemplifies this trend, yet returns on investment remain to be confirmed, and benefits are unevenly distributed. This favours regions like Europe, Asia, and select emerging markets, where valuations are more appealing and catalysts such as policy support and trade normalisation provide additional tailwinds.

Equally transformative is the redefinition of safety in portfolio construction. Long-dated government bonds, once synonymous with defensive positioning, now face diminished appeal due to fiscal constraints, persistent inflation, and policy uncertainties. This has driven increased investor interest in alternatives such as private credit, infrastructure, and hedge funds, which can offer diversification and resilience. Private credit, in particular, continues to attract attention in high-quality, cash-generative segments. Similarly, listed infrastructure and real assets present compelling investment opportunities aligned with long-term structural trends such as renewable energy and urbanisation.

The dynamics of leadership across geographies, sectors, and asset classes are becoming increasingly fluid, demanding a broader perspective in asset allocation.

In the pages ahead, we explore these structural shifts, along with other key developments, with the objective of providing you with actionable insights as you prepare for the year ahead.

"2026 is a year to look beyond traditional market leaders and adapt to less directional conditions."

Xavier Baraton
Chief Investment Officer

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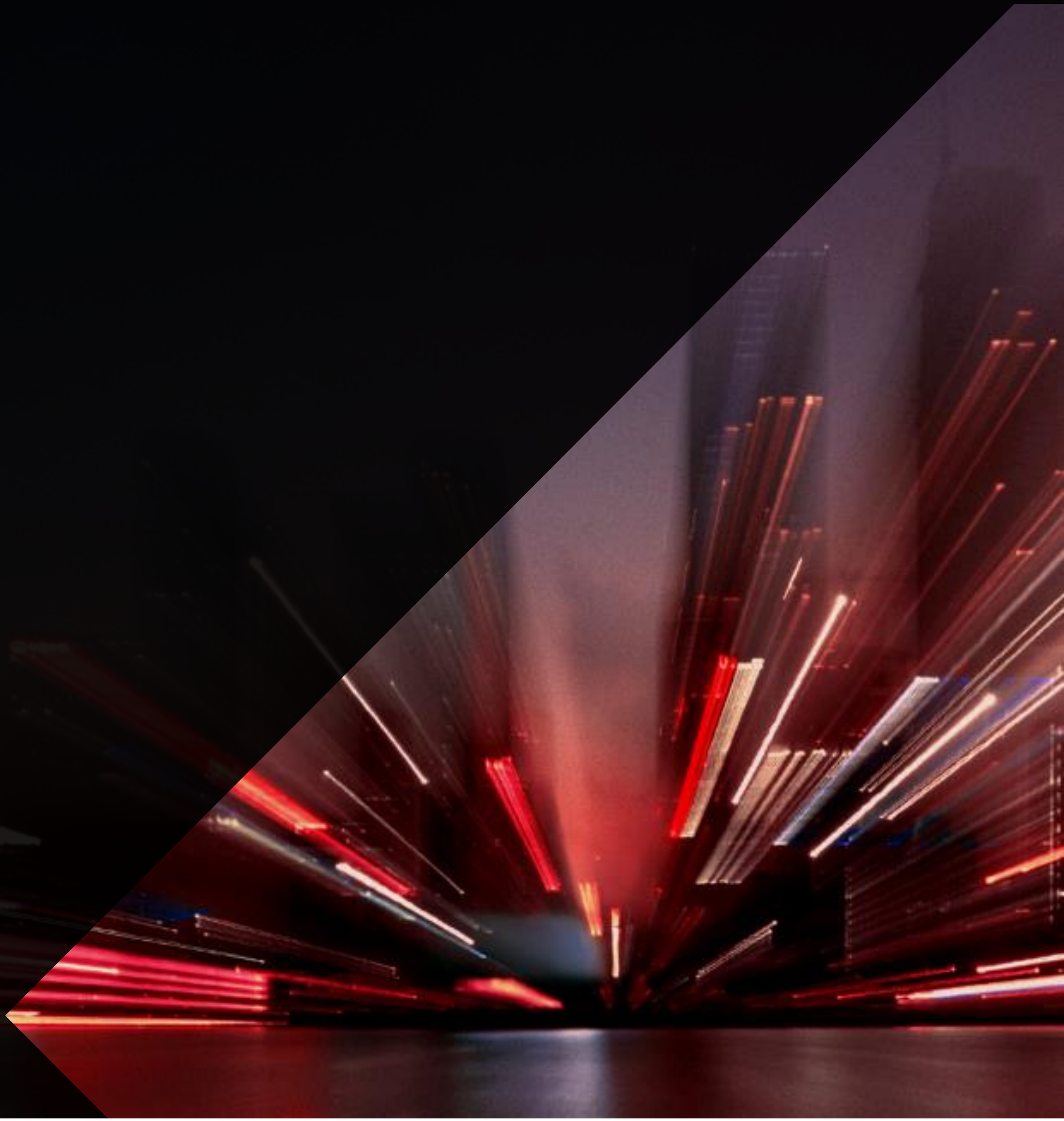
Macro outlook and market implications



Macro outlook and market implications

As we step into 2026, global markets are adapting to the initial stages of a more balanced and less US-centric expansion.

The post-Global Financial Crisis world, long dominated by US exceptionalism, monetary policy "on steroids", and a predictable investment playbook, is giving way to new intricacies. The investment landscape is now shaped by persistent inflation, modest rate cuts, and policy uncertainty – factors that challenge historical norms and require fresh thinking about risk, return, and portfolio construction.

The 'Role Reversal' theme reflects the shifting roles of different asset classes and regions. US assets, once the cornerstone of global portfolios, are being reassessed as investors explore more geographically and strategically diversified opportunities.

Emerging markets, often seen as volatile, are demonstrating improved resilience, driven by structural reforms and de-risking efforts. Asia continues to lead global GDP growth, with India's domestic-driven economy thriving despite global headwinds, while China stabilises through targeted stimulus and investments in AI and technology-driven industries. Meanwhile, Europe is undergoing a revival, with peripheral economies driving growth for the first time in years, supported by policy measures and the absence of past economic adversities.

The theme also incorporates the idea of 'Broadening Out', where previously lagging sectors and markets have the potential to further catch up, supported by a convergence of growth across economies. Markets outside the US appear positioned for stronger performance, underpinned by improved profit forecasts and synchronised global growth.

The AI investment boom exemplifies this trend, expanding its reach beyond the tech sector into industries such as healthcare, utilities, construction, and basic materials. Asian technology, particularly in China and India, is emerging as a competitive alternative to US tech, offering less valuation risk alongside robust innovation. This diversification of market drivers creates opportunities for historically underperforming sectors and regions to close the gap, shifting the focus from the dominance of US tech-heavy markets.

Finally, the call to 'Diversify the Diversifiers' highlights the importance of integrating alternatives into portfolios to navigate this evolving environment. Liquid alternatives, such as hedge funds and private credit, are providing resilience, while real assets and private equity present opportunities to capitalise on long-term growth themes like the energy transition, urbanisation, and demographic shifts.

Key themes

Role Reversal

There are major shifts under way in the macro and policy environment, and the performance and behaviour of key asset classes are changing too

Broadening Out

Market leadership is expected to 'broaden out' as US GDP and profits growth converge with other economies. EM and laggard sectors may catch up

Diversify the Diversifiers

Faced with a complex macro and market backdrop, investors can seek "bond substitutes" in liquid alternatives like hedge funds, real assets, and private markets

Source: HSBC AM, November 2025. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target. Diversification does not ensure a profit or protect against loss.

Scenarios

The macroeconomic landscape in 2026 will be shaped by the scope of capital expenditure, labor-market outcomes, and central-bank responses.

Our central scenario of "come together" envisions global growth holding a moderate but steady pace, supported by ongoing investment in technology and infrastructure, gradual improvement in trade flows and more stable conditions across major economies.

Inflation eases in many regions but does not fully return to previous norms, keeping rates in a higher range than before the pandemic. Monetary policy evolves cautiously rather than decisively, allowing markets to operate within a broadly supportive but still selective environment.

Under this baseline, the US grows close to 2% as AI capex offsets tariff frictions and a softer labour market, inflation drifts in a 3–3.5% band, and central banks move slowly on rate cuts. Europe has a stronger disinflationary impetus, while China's exit from deflation supports policy easing and a gradual rebound in domestic demand. This backdrop sustains a constructive, albeit higher-dispersion and selective, environment for risk assets.

A downside scenario emerges if labour-market fragility and the unbalanced nature of the current expansion becomes more problematic. Higher real rates have already reshaped business investment and balance-sheet behaviour. If labour market cooling intensifies, private consumption would weaken, corporate profits would decelerate, and tight risk premia could trigger broad market corrections. Safe-haven assets would provide only partial shelter given fiscal strains in developed markets, increasing the importance of broader diversification within portfolios.

The upside scenario is contingent on a broader diffusion of the current investment boom. For this outcome to materialise, the technology and AI-driven capex underway in the US and parts of Asia would need to spill more widely across industries, prompting stronger hiring, firmer consumption and a more durable acceleration in productivity. Under such conditions, productivity gains could sustain global growth closer to 3%, and limited inflation pressures would allow an accommodative stance from central banks. Equity markets would respond with renewed leadership from innovation-linked sectors.

Across all scenarios, the common thread is the shift toward a multi-speed global economy. Growth converges, but not uniformly. Policy eases, but not simultaneously. Earnings broaden, but not without differentiation. Hence, portfolio positioning should be for a regime where regional dynamics, policy flexibility and earnings credibility matter more than market direction alone.

Figure 2: Macro and market scenarios

	Cracks widen Pessimistic scenario	**Come together** Baseline scenario	**AI boom** Optimistic scenario
Macro	◆ **Driving forces:** Restrictive policy and unbalanced growth mean labour market cracks ◆ **Growth:** Sharp slowdown as households retrench and profits disappoint ◆ **Inflation:** Uncomfortably high inflation but recession destroys demand ◆ **Policy:** Initially more cautious Fed, but then big easing amid growth damage	◆ **Driving forces:** Tariffs weigh on US but some offset from AI capex. "Policy puts" in Europe/China ◆ **Growth:** US growth less exceptional at around 2.0%, despite strong AI investment ◆ **Inflation:** US peaks above 3% before receding. Approaching target in many DMs/EMs ◆ **Policy:** Fed cuts to neutral (3.00-3.50%). Modest easing across many DMs/EMs	◆ **Driving forces:** Surging AI investment and wealth effects create broader economic boom ◆ **Growth:** US reaccelerates to around 3.0%. Animal spirits and AI boost global growth ◆ **Inflation:** Strong, broad-based demand keeps US inflation around 3.0% ◆ **Policy:** Easing cycle cut short but Fed accommodates above-target inflation
Market	◆ **Stocks:** Historic SPX bear market. Cyclicals most vulnerable. VIX spike ◆ **Fixed Income:** Curve steepens as longer-dated yields sticky. Credit spreads widen ◆ **Emerging markets:** EMs hit amid weaker global growth and trade challenges	◆ **Stocks:** Broadening out of market leadership. SPX lags other markets. Episodic volatility ◆ **Fixed Income:** Range-bound yields. Some upside risk to credit spreads. IG as bond substitute ◆ **Emerging markets:** EM bull market on superior growth, Asia tech innovation, and low valuations	◆ **Stocks:** US outperforms. SPX 7000+. Korea/Taiwan/high-beta stocks shine ◆ **Fixed Income:** Some upside risk to yields as growth remains strong. Credit spreads still tight ◆ **Emerging markets:** EM gains on +ve risk appetite/Asia tech but limited by USD performance

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Market implications

2025 has been a banner year for investors in emerging market and other non-US asset classes. We think that strong performance in global markets continues next year.

That doesn't necessarily preclude the scenario of US stocks continuing to do well on the back of AI enthusiasm. But there looks to be plenty of reasons why investors could benefit from increased allocations outside of the US.

Europe and parts of Asia have improving earnings trajectories and less demanding valuations than the US. And policy support in Europe, progress on easing supply constraints and targeted investment agendas can help unlock this value.

In Asia, the technology supply chain remains a key beneficiary of data-infrastructure build-out, but the appeal extends beyond semiconductors. Economies where domestic reforms have strengthened financial systems and reduced volatility are now drawing both growth and defensive allocations. Select emerging markets fall into this category, where reduced inflation volatility, credible monetary regimes and maturing local capital markets distinguish them from past cycles.

In fixed-income markets, range-bound yields and limited scope for further spread compression shift the focus away from beta capture and toward income strategies.

High-quality credit increasingly serves as a substitute for traditional duration, particularly in jurisdictions where fiscal trajectories weaken the defensive characteristics of sovereign bonds.

Meanwhile, emerging-market local debt benefits from more stable inflation dynamics and increasingly domestic investor bases, which reduce the dependency on external flows.

This evolving hierarchy of risk and safety has also elevated strategic diversifiers traditionally viewed as tactical tools. Gold, alternative income and selective hedge-fund strategies are increasingly being treated as structural components of portfolio resilience rather than temporary hedges.

These shifts define an earnings-led cycle where selectivity, valuation discipline and new forms of defence sit at the core of global allocation. It means that in 2026, leadership is not about where growth is highest, but where certainty is strengthening.

Figure 3: Views per asset class (▲ Positive / ↔ Neutral / ▼ Negative bias)

Equities

Asset Class	View
Developed markets (DM)	↔/▲
US	↔
UK	↔
Eurozone	↔/▲
Japan	▲
Emerging markets (EM)	▲
LatAm	▲
Frontier	▲

Government bonds

Asset Class	View
Developed markets (DM)	↔
US10yr	↔
UK10yr	▲
German 10yr	▲
Japan	▼
Inflation-linked	↔/▲
EM (local currency)	▲
India	▲▲

Corporate bonds

Asset Class	View
Global investment grade	▲
USD, EUR & GBP IG	▲
Asia IG	▲
Global high-yield	↔/▼
US / Europe HY	▼
Asia HY	▲
EM hard currency	▲▲
Securitised credit	▲

Commodities, alternatives and FX

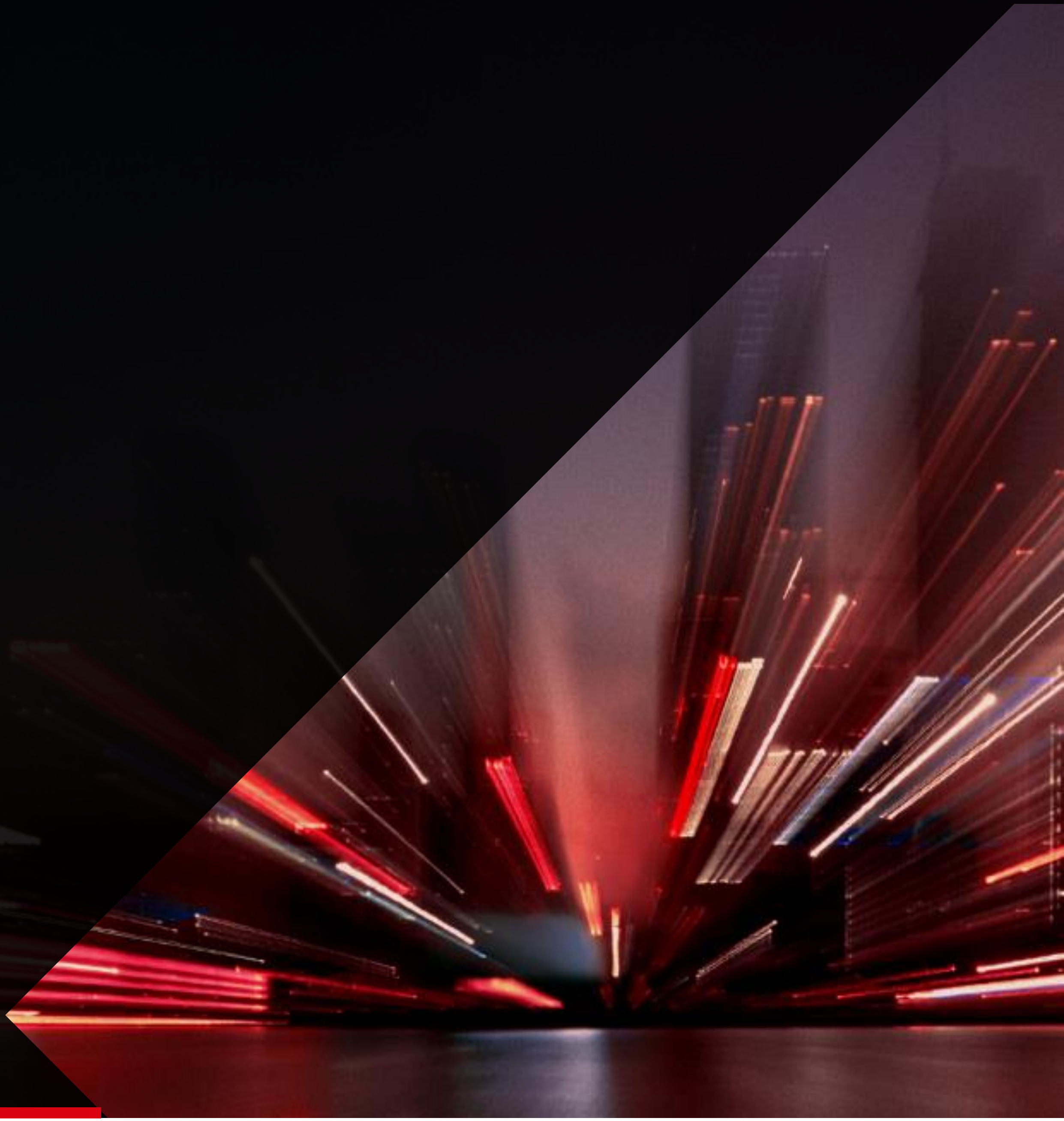
Asset Class	View
Gold	▲
Oil	▼
Private credit	▲
Real assets	▲▲
Hedge funds	▲▲
Private equity	↔
US dollar	▼
EM FX	▲▲

Asian assets

Asset Class	View
Pan-Asia government bonds	▲
Asia ex-Japan equities	↔/▲
China	▲
India	▲
Hong Kong	▲
Asia FX	▲
CNY	▲
JPY	▲

Source: HSBC AM, November 2025. House view represents a >12-month investment view across major asset classes in our portfolios. Views reflect our long-term expected return forecasts, our portfolio optimisation process and actual portfolio positions. These views are for general information purposes only and do not constitute advice or a recommendation to buy or sell investments Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target.

Top of mind



Top of mind

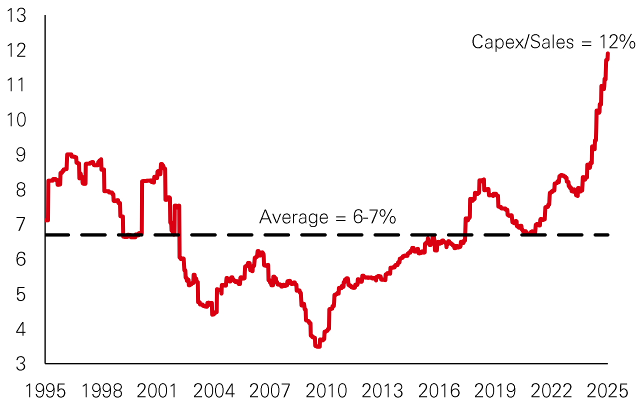
Why are markets priced for perfection, and what are the real risks in the AI story?

Global markets continue to behave as if the outlook is unusually benign. Major indices are at record highs, credit spreads remain tight, and volatility has been persistently muted. This happens while inflation hasn't returned to prior norms, fiscal paths remain uncertain, and capital expenditure cycles are heavily concentrated in one theme. The dissonance between risk appetite and underlying risks reflects a regime where returns have been supported by earnings resilience and expectations of easier policy, rather than by broad-based economic strength.

The US remains the anchor of this optimism. Earnings growth is still expected in the low-teens in 2025, supported by large firms, particularly those with pricing power, network effects, or capex plans supported by industrial policy, which could weather uneven consumer demand. Consumption is holding up, though more narrowly, and a softer labour market has not yet translated into lower margins. This has limited wage disinflation and kept inflation near 3%. With policy incentives underpinning investment and lower Treasury yields reducing discount-rate pressure, investors have tolerated higher valuations.

The key vulnerability, however, is the disproportionate dependence of the earnings story on AI-led investment. An extraordinary share of expected profit growth now hinges on AI infrastructure, data-centre expansion and compute capacity. Capex growth from hyperscalers and semiconductor firms has surged, amplified by tax incentives and industrial policy. But the business model remains unproven leading to increased scrutiny about whether spending on cloud compute can translate into revenue growth fast enough to protect returns. In fact, several firms are booking capex faster than revenues, implying that ROE compression is a real risk if demand does not ramp up. As incentives front-load spending, financial scrutiny will intensify in 2026.

Figure 1: US tech capex/sales (%)



Source: HSBC AM, Refinitiv, Datastream, October 2025

Meanwhile, the dominance of US tech is less insulated than before. China has become a close competitor in high-tech manufacturing, robotics, batteries, electric vehicles supply chains and nuclear energy. Even if geopolitical frictions limit cross-border flows, technology diffusion is accelerating through regional supply chains. This erodes the 'moat premium' traditionally priced into US tech valuations. Meanwhile, the broad US market has begun to show early signs of valuation fatigue, reinforcing the case for selectivity rather than a simple reversion to mega-cap leadership.

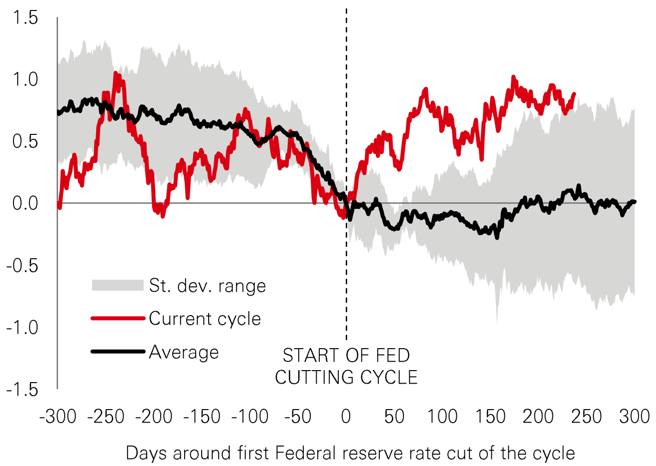
All of this suggests the need to differentiate between a thematic growth story and an investable earnings story. AI may remain a material growth driver, but investors should not pay the same premium for every business participating in the ecosystem. That underpins the case for moving beyond the US mega-cap cohort and towards companies with clearer capital efficiency, lower expectations embedded in valuation, and more diversified revenue drivers.

In other words, markets look priced for perfection not because risk has disappeared, but because earnings have not yet been challenged. When earnings delivery becomes the primary test, the pricing regime will reward firms and regions that can convert investment into profit, not simply those closest to the theme.

Can US Treasuries still be relied upon to diversify portfolios?

Treasuries have long been treated as the anchor hedge for portfolios, but that assumption is weakening. The regime that allowed US government bonds to reliably offset equity drawdowns was based on three conditions: inflation anchored near 2%, fiscal discipline that preserved sovereign credibility, and monetary policy capable of easing aggressively without constraints. None of these conditions fully hold today. Inflation appears settled closer to 3% as a floor, not a ceiling. Fiscal dynamics are deteriorating, and rate cuts no longer generate the same downward pressure on yields. Historically, when inflation is roughly above 2.5%, Treasuries hedge equities poorly which is the case today.

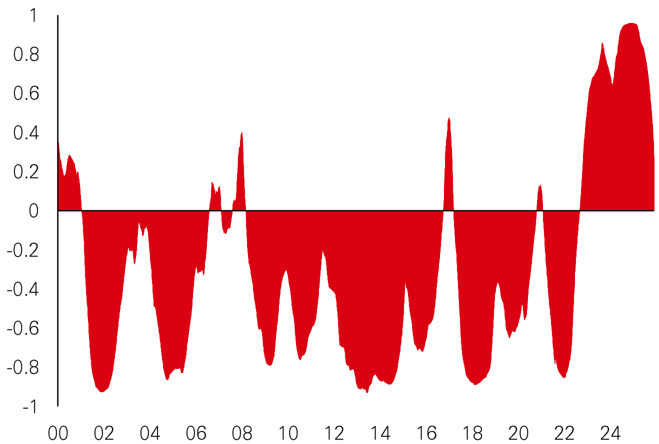
Figure 2: Difference in 30Y yield from time of first Fed cut (pp)



Past performance does not predict future returns.
Source: HSBC AM, October 2025. Covers period since 1989.

Furthermore, easing by the Federal Reserve has not produced the expected rally in long-duration bonds. Higher debt issuance, changing reserve behaviour by foreign central banks, and uncertainty associated with US trade policy have all contributed towards dilution of the defensive characteristics of Treasuries.

Figure 3: Rolling 18-month correlation for S&P 500 vs US 10Y



Past performance does not predict future returns.
Source: Macrobond, Bloomberg, HSBC AM, November 2025

Therefore, the need to diversify the diversifiers and look for substitutes that are not purely reliant on falling yields. High-grade corporate credit stands out. Many issuers have lengthened maturities, deleveraged balance sheets, and built cash buffers.

This makes parts of the investment-grade market more defensive than sovereign debt on a risk-adjusted basis, particularly when valuations in government markets are distorted by fiscal dynamics rather than fundamental demand.

Diversification across sovereign issuers is also increasingly becoming relevant. Swiss government bonds have gained traction as fiscal credibility becomes scarcer. Emerging-market sovereigns are also no longer homogeneous risk assets. Several EM countries now run orthodox monetary regimes, have improving inflation credibility, and possess deeper local investor bases making them more reliable as partial hedges than in previous cycles.

Finally, alternatives are no longer tactical but structural components of portfolio defence. Hedge-fund strategies that benefit from macro dispersion provide lower correlations precisely because policy is less predictable. Gold has re-emerged as a defensive asset not against volatility, but against policy uncertainty and eroding confidence in sovereign balance sheets. Private markets, by virtue of periodic valuation mechanisms, offer lower mark-to-market volatility, while income-anchored real assets such as infrastructure offer protection when rates fall gradually.

In this environment, diversification can no longer rely on duration alone. The defensive toolkit must expand toward credit, cross-sovereign exposure, and alternative hedging structures that reflect a world where the safety of an asset depends less on its label and more on the credibility of the regime behind it.

Past performance does not predict future returns. Source: HSBC AM, November 2025. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target. Diversification does not ensure a profit or protect against loss.

Are fiscal risks the next global macro shock?

The market has gradually begun to recognise that fiscal policy has replaced monetary policy as the marginal driver of growth, inflation and financial stability. The post-pandemic era is characterised by elevated structural deficits, politically sticky spending and constrained central banks forced to operate around higher nominal anchors. The consequence is a shift in sovereign debt pricing, safety assets' behaviour, and support for global demand.

Fiscal expansion is no longer counter-cyclical; it is structural. Ageing populations increase pension and healthcare obligations. Energy transition demands investment. National security and industrial policy create multi-year subsidy cycles. These commitments are not reversible without political cost. They embed new floors into government spending and therefore into deficits. The US exemplifies this trend as their fiscal deficits are high even at full employment, and industrial incentives accelerate capex even when demand is uncertain. The question is not how deficits will be reduced, but how they will be financed.

Crucially, this alters the defensive character of sovereign debt. When inflation floors shift to around 3%, rate cuts become less effective in reducing yields, especially when debt issuance rises. Fiscal risk is therefore not an emerging market problem, but it is a developed market challenge. While Japan and Switzerland maintain credibility, the US, UK and parts of Europe face a widening gap between spending mandates and political willingness to raise revenue.

This makes it unlikely for the next shock to be triggered by growth or inflation surprises, but by market repricing of sovereign risk in economies once treated as immune. Hence, the fiscal era does not end diversification – it redirects it.

Can China sustain its growth story?

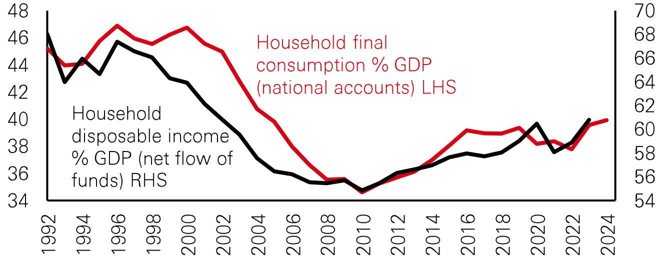
China has staged one of the strongest market performances of the year. Still this resurgence has not been driven by the underlying macro cycle, which still faces structural headwinds in the form of property deleveraging, subdued consumer sentiment and industrial overcapacity. Instead, investor enthusiasm has been anchored to China's structural transition from consumer-led growth towards strategic, high-tech, export-driven innovation.

China is gradually emerging from deflation into low single-digit inflation, creating space for targeted fiscal and monetary support without risking overheating. A return to mild positive CPI helps alleviate corporate pricing pressure and supports nominal growth, which stabilises profits even without an immediate consumption rebound. Unlike Western economies, this has positioned China to have fiscal measures become more targeted – backing innovation hubs, industrial upgrading and regional infrastructure – rather than broad stimulus aimed at short-term consumption. That allows policy to reinforce profitability where China has competitive momentum.

China's dominance in EVs, batteries, robotics and power storage reflects its supply-chain depth and applied innovation. In platform AI, China may lag, but in applied industrial AI and automation hardware, it is increasingly competitive. These are now export engines that can drive earnings even when domestic demand remains tepid.

However, that industrial story cannot stand alone. The risk is not China's competitive capacity, but a potential disconnect between industrial and household welfare. If wages, labour productivity and consumer confidence fail to improve, China could resemble a 'high-innovation, low-inflation' economy similar to post-1980s Japan. The emphasis on rebalancing toward consumption and the inclusion of 'anti-involution' in the plan signals a recognition of this problem that growth must also enhance household well-being, not only firm-level efficiency.

Figure 4: Household income and consumption as % of GDP



Source: CEIC, HSBC AM, October 2025

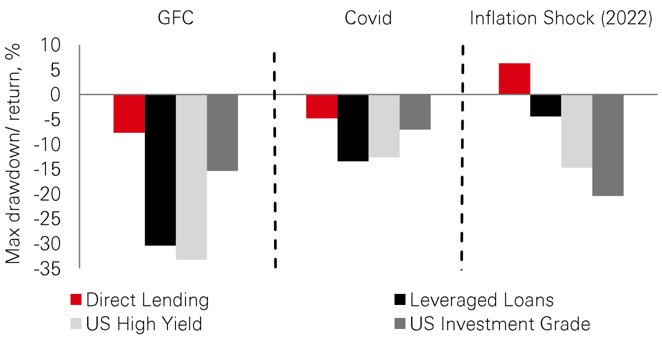
Thus, China is unlikely to deliver a broad macro boom, but policy-aligned strategic sectors can sustain profitability even without robust consumption. This will make earnings floor come from industry instead of households. The question, therefore, is not about whether China can sustain its growth, but which firms can monetise its industrial transition. The growth story will come from the durability of industrial innovation and the companies best positioned to profit from it.

Amid the breakdown of traditional diversification, why are alternatives becoming essential rather than optional?

For decades, a balanced mix of equities and bonds formed the backbone of portfolio construction. That compact has weakened post-COVID. Inflation shocks pushed bond yields sharply higher just as equity valuations compressed. Fiscal pressures, rearmament spending and tariff-driven industrial policy have raised questions about sovereign balance-sheet sustainability, eroding the reliability of government bonds as defensive hedges. Even the US dollar and Treasuries have struggled during episodes of policy-induced volatility.

This deterioration highlights a structural issue of diversification being built solely on government balance sheets which have become vulnerable to the same forces driving macro instability. In a world of higher equilibrium inflation, persistent supply-side constraints, and multi-polar geopolitical competition, alternatives can diversify not just across assets, but across economic engines of return. This 'traditional+' approach systematically complements equities and bonds with alternative return sources to restore diversification that the 60/40 model cannot guarantee. Direct lending is a clear example. It delivers equity-like income with senior secured protection and floating-rate features that preserve real returns. Throughout stress episodes, private direct lending experienced materially smaller drawdowns than leveraged loans or US high yield. The resilience comes from contractual control over covenants, collateral and lender influence. In a higher-rate regime where refinancing risk and dispersion rise, this form of credit behaves as a stabiliser rather than a pro-cyclical exposure.

Figure 5: Drawdowns on private versus public credit



Source: HSBC AM, Bloomberg, JP Morgan, Cliffwater, September 2025. Index used: JPM Leveraged Loan Index, Bloomberg US Corporate High Yield TR Index, Bloomberg US Corporate TR Index

Private equity and venture capital expand diversification further by accessing value creation at earlier stages of corporate growth. Public markets now represent a shrinking slice of global innovation with US-listed companies dropping by more than half since 2000.[1] On the other hand, private venture-backed firms have multiplied over twenty-five times.[1] Transformational developments such as AI infrastructure, precision medicine, clean-tech platforms are largely financed in private markets long before they appear in public indices. For long-horizon investors, this can potentially capture the full breadth of global growth.

Real assets anchor the defensive side of the 'traditional+' approach. These assets benefit from secular megatrends including energy transition, digitalisation and grid modernisation, rather than cyclical GDP surprises.

They offer both a hedge against inflation volatility, as illustrated by their last 10-year performance, and participation in the capex super-cycle reshaping the global economy.

Complementing this architecture are liquid alternatives like macro hedge funds and multi-strategy platforms. By monetising dispersion across rates, FX, commodities and cross-asset relative value, they introduce convex return profiles that can perform in both positive and negative market environment. In a regime defined by policy uncertainty, shifting risk premia and persistent volatility clusters, these strategies have the potential to provide diversification that bonds once provided.

What makes this evolution even more relevant is the broadening of access. Regulatory reforms across the UK, Europe and Asia, have lowered minimum commitments and improved transparency. While this does not simplify alternatives - manager selection, governance and underwriting discipline remain important – it does make them strategically investable. Hence, alternatives can be a suitable choice to restore diversification, capture structural growth, and protect portfolios from the macro forces eroding the traditional 60/40 model.

1 - 'Unicorns, Decacorns and Hectocorns: The Private Companies Primer', BofA Securities, Oct 2025

The credit impact of AI-driven power demand

The credit impact of AI-driven power demand

" With annual capex of $30 billion projected over the next five years to support AI-related power infrastructure in the US, data centres are expected to drive significant levels of debt issuance."

The rise of AI and the rapid expansion of data centres are increasingly impacting global electricity demand, with projections for consumption continuing to rise, particularly beyond 2030. Despite anticipated efficiency improvements, long-term forecasts have been revised upward, reflecting the rapid deployment of AI and its implications for energy infrastructure.

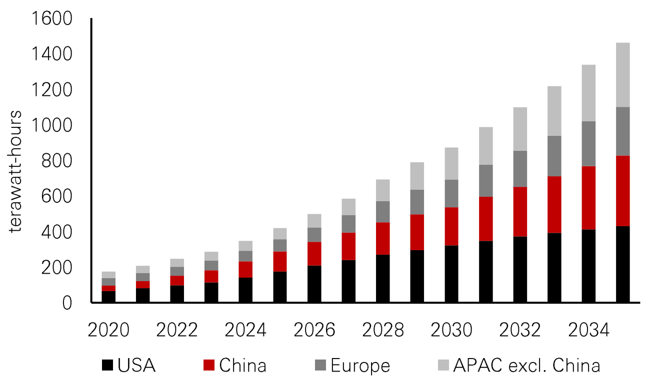
United States: A boom in debt issuance and infrastructure financing

The United States leads the global surge in AI-driven electricity demand, with data centres accounting for a significant share of new power requirements. Over the next five years, an estimated $30 billion annually will be spent on capital expenditures to support AI-related power infrastructure – excluding additional investments by midstream and upstream energy providers.

Natural gas plays a pivotal role in meeting this demand due to its reliability and ability to provide uninterrupted electricity, a critical requirement for data centres. By 2030, AI-related data centres are expected to account for up to 40% of new US electricity demand from natural gas. This dynamic supports the credit profiles of natural gas producers and midstream companies, while also fuelling demand for energy infrastructure bonds.

The urgency of AI deployment has made "time-to-power" a critical constraint for hyperscalers, alongside cost and reliability. As a result, diverse infrastructure solutions—including grid-connected, hybrid, and off-grid systems—are being adopted.

Figure 1: AI-driven power demand

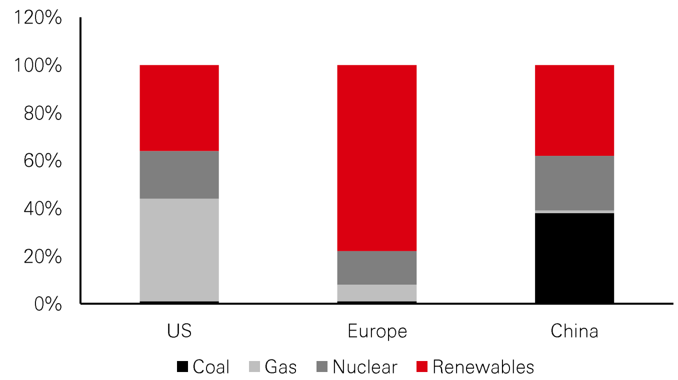


Source: HSBC AM, Bloomberg, November 2025

Financing structures are evolving to meet these demands, with off-balance-sheet issuers and project-specific agreements becoming more prevalent. These developments are bringing new participants, such as upstream and midstream energy companies, into the financing landscape.

However, affordability concerns persist, particularly for regulated utilities and on-grid solutions. In regions with regulatory or capacity constraints, hyperscalers are increasingly turning to off-grid or hybrid systems. Addressing affordability challenges may require regulatory reforms and frameworks tailored to large industrial users, such as data centres, to balance the financial impact on retail customers while ensuring sector stability.

Figure 2: Electricity mix for data centres in 2035



Source: HSBC AM, IEA, November 2025

Past performance does not predict future returns. Source: HSBC AM estimates based on company disclosure as well as IEA, BNEF, EEI, S&P, Moody's and Bloomberg data. November 2025. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target.

Across Asia, the effects of AI-driven electricity demand vary significantly by country. China is emerging as a key player due to its larger capacity base and structural advantages. In China, AI-driven electricity demand contributes a moderate 12% to domestic electricity-demand growth. This is manageable within the broader context of the country's focus on energy security and industrial expansion. China's power system benefits from high electricity reserve margin and upgraded grid infrastructure, enabling it to integrate new AI-related loads without immediate stress on the system. Policy initiatives, such as the “East Data, West Computing” initiative, are also pivotal in managing demand. By directing data-centre activity towards regions with surplus renewable power, these measures help to balance rising electricity needs while minimising reliance on new fossil-fuel generation. This approach aligns with China's net-zero commitments, with low-carbon power capacity expected to increase by 85% over the next five years. These structural and policy-driven factors make China better powered up for AI.

In contrast, Japan is poised to experience the most pronounced effects of AI-related electricity demand within Asia. AI-driven data centres are projected to account for over 60% of Japan’s future power-demand growth, marking a significant shift for utility sector that has faced declining demand over the past decade. The anticipated 5% increase in power demand over the next ten years could stabilise the credit outlook for Japanese utilities, particularly those with greater exposure to low-carbon power generation.

This growth represents a turning point, offering opportunities for utilities, especially in companies that also benefits from stable profit margins due to their focus on low-carbon energy sources.

Emerging Markets: Neutral Credit Impact with Sustainability Upside

In emerging markets such as Latin America, the Middle East, and Africa, the credit impact of AI-driven power demand is expected to be neutral. These regions account for a small share of global data-centre infrastructure, and their existing reserve margins are sufficient to accommodate additional demand. Latin America, in particular, is well-positioned to meet new power requirements with its abundant renewable energy resources. Similarly, utilities in the Middle East and Africa have incorporated AI-related demand into their long-term planning, minimising the need for additional capital expenditures.

Europe: Limited Credit Impact Amid Broader Grid Modernisation

In Europe, the credit impact of AI-driven power demand is expected to be minimal, at least in the short term. Data centres account for a low single-digit percentage of total electricity demand growth, and the region's utilities are primarily focused on modernising grids and integrating renewable energy.

This "investment supercycle" is being financed through capital markets, with more than $20 billion in capital raised recently and an additional $10 billion expected in the coming months. While affordability concerns could emerge as a political risk, particularly in regions with high electricity prices and capacity constraints, regulatory reforms and targeted tariffs for large industrial users may mitigate these risks. European utilities are well-positioned to manage the financial demands of grid upgrades without significant pressure on their balance sheets.

Conclusion

Overall, while AI is not the sole determinant of power-sector credit trends, it is influencing capital expenditure needs, reshaping project-financing structures, and contributing to a broader reassessment of how utilities and energy companies plan, fund, and deliver capacity. This underscores the importance of regional and sector-specific analyses to understand the varied implications of AI-driven electricity demand across geographies.

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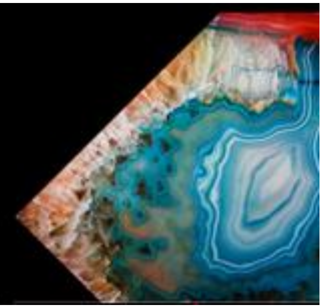

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The shifting role of gold

The shifting role of gold

"For decades, gold had a narrowly defined role in portfolios of a tactical hedge that outperformed during rising inflation or falling real yields. That role is now changing."

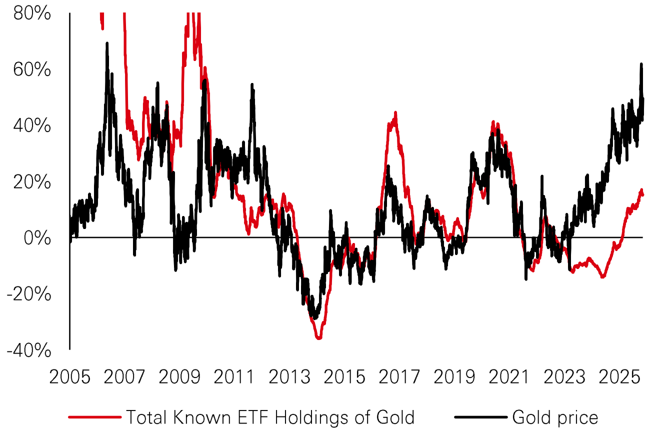
Historically, gold's attractiveness was framed through two cyclical conditions: rising inflation or falling real yields. When neither condition prevailed, gold's opportunity cost of holding a non-yielding asset became punitive, limiting its strategic relevance. However, gold's recent performance has challenged the long-held assumptions about how the asset should behave.

Gold makes up a quarter of central bank reserves

2024–25 has seen gold rally alongside risk assets, even as real yields remained high, and inflation rolled over. This unusual coexistence has raised questions about whether the drivers of gold have fundamentally shifted, and whether there is a need to rethink the asset's standing in long-term strategic allocations. Though, with prices up more than 50% year-to-date and central banks' increasing share of global gold reserves, it is clear that gold can no longer be evaluated solely through a cyclical lens.

The shift begins with the changing profile of gold's dominant buyer. Until 2023, ETF holdings and gold price moved in-sync exhibiting a correlation of ~60%. However, despite the massive rally in 2023, gold ETFs saw a drawdown which only reversed when gold broke above $2,700. The trend underscored that traditional investment flows – ETF positioning and private-sector hedging – have become secondary to persistent purchases from central banks, especially in emerging markets. These sovereign entities are not reacting to headline CPI or relative interest rates, but to reserve-credibility concerns, growing geopolitical fragmentation, and the vulnerabilities of storing reserves in foreign jurisdictions.

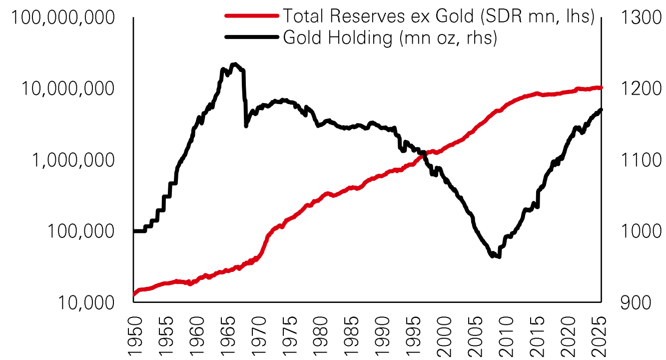
Figure 1: ETF holdings of gold vs gold price



Source: HSBC AM, Bloomberg, November 2025

With geopolitical blocs increasingly wary of exposing assets to sanctions, custody restrictions, dollar settlement dependencies, or discretionary policy actions by large reserve-currency issuers, gold has re-emerged as the only large-scale reserve asset independent of political architecture. Central banks now hold roughly a quarter of total global reserves in gold, and this is a demand base that does not react to price or positioning.

Figure 2: IMF world reserves



Source: HSBC AM, Bloomberg, November 2025

Evolving pricing dynamics

When gold's marginal buyer is a private investor, demand fluctuates with inflation expectations, monetary policy cycles, and relative yields. When the marginal buyer becomes a central bank, demand becomes price-insensitive, strategic, and persistent.

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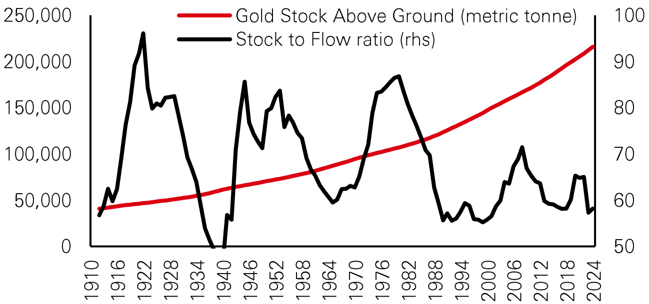
Because the physical supply of gold adjusts slowly – mine production cannot expand meaningfully over a short horizon – central bank accumulation removes tradable supply from a market not structured to replenish it quickly.

Figure 3: Gold stock and flow



Source: Bloomberg, HSBC AM, November 2025

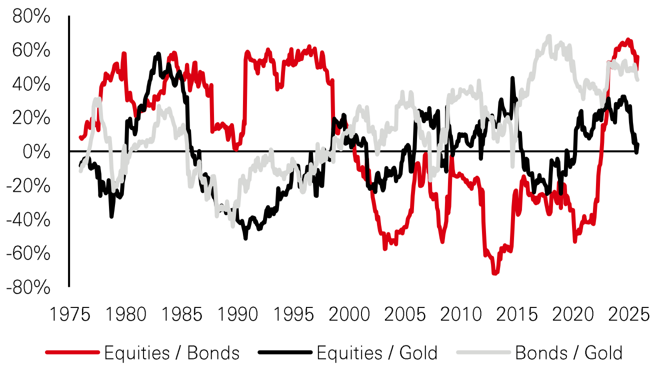
The result is the asset beginning to price like a finite reserve with limited float, rather than a commodity with cyclical elasticity. This helps explain why gold can rise even when real yields are historically elevated because its pricing dynamics have become less tethered to the opportunity-cost framework that defined previous cycles. In practice, this means gold retains a price floor independent of short-term macro sentiment, even as tactical investors trade around rate expectations or equity-market hedging needs. These structural forces also intersect with cyclical considerations in a way that amplifies, rather than contradicts, the trend. As the US enters a capex-heavy industrial investment cycle and embraces tariff-dependent fiscal expansion, concerns around medium-term inflation persistence and debt sustainability remain alive, even if headline inflation moderates.

Fed rate cuts in this environment do lower the explicit opportunity cost of holding gold, but they operate atop a structural floor already set by central-bank accumulation. The result is an asymmetry i.e. cyclical conditions accelerating gold's upside, but they are not required to justify its price level.

Correlation with risk assets

One factor complicating interpretation is gold's positive correlation with risk assets. Traditional intuition holds that if gold rallies alongside equities, it is being driven by speculative sentiment rather than portfolio hedging. In reality, this co-movement reflects investors hedging credibility risk, not macro downturn risk. Equities are benefiting from AI-driven capital deepening, resilient earnings and liquidity-accommodating policy signals. Gold is being accumulated against a different set of risks – reserve weaponisation, fiscal deterioration, and long-horizon inflation uncertainty.

Figure 4: Rolling 3-year monthly correlations



Source: Bloomberg, HSBC AM, November 2025

The simultaneous rise in both assets should not be read as behavioural exuberance; it reflects an asset-allocation environment where economic growth expectations and institutional distrust coexist.

Investment implications

While portfolio construction hasn't fully internalised this transition, the implications are straightforward. If gold's value is now derived from neutrality in a politicised reserve system, alongside its role as a hedge against fiscal credibility erosion, a tactical inflation-hedge allocation is inadequate. Government bonds still hedge growth shocks but are less effective against sovereign risk. Similarly, FX hedging mitigates currency volatility but doesn't address risks from reserve centralisation in a single monetary system. Cash protects against rate volatility but fails to defend against debasement in a structurally indebted world. However, gold hedges all three risks simultaneously, without counterparty exposure. Hence, the question of when to buy gold is reframed to how much one needs in portfolios exposed to the liabilities of sovereign issuers whose balance sheets are becoming structurally larger, older, and more politicised.

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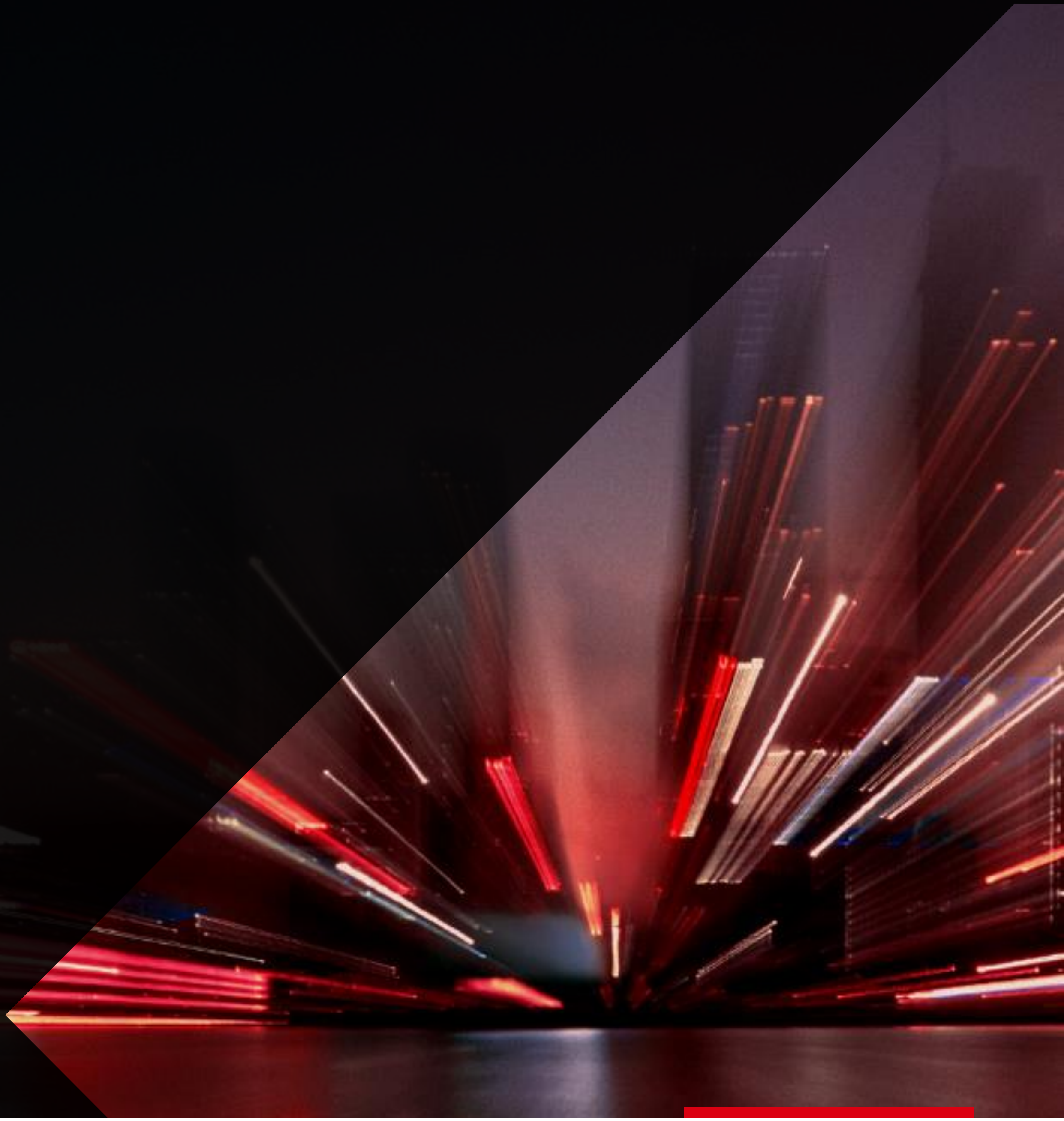
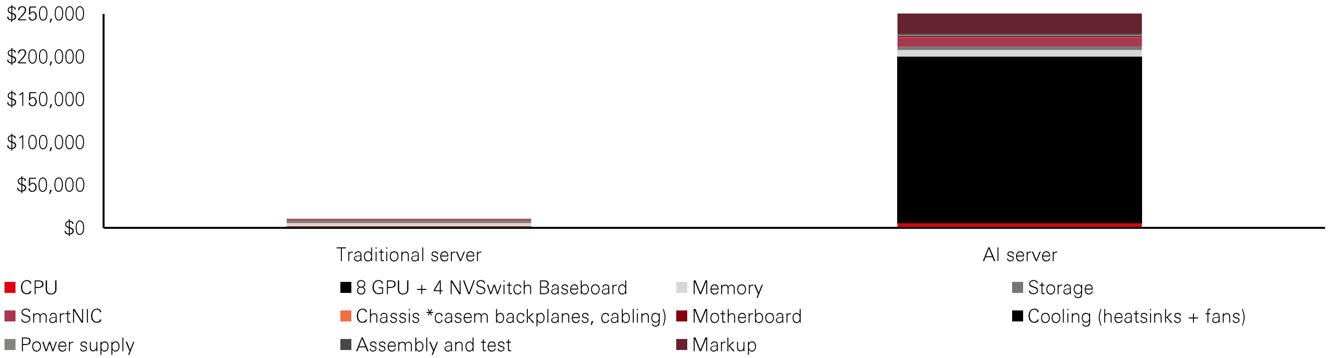
Redefining leadership in AI cycle



Redefining leadership in AI cycle

"Current cycle may have similarities to a bubble, but this phase of AI development is being driven by physical bottlenecks rather than user adoption curves."

Figure 1: AI datacenter economics[1]



Source: HSBC AM, November 2025

Global equity indices are at record high, yet market leadership continues to be narrow. A handful of US mega-caps dominate returns, earnings forecast for leading semiconductor manufacturers are being revised sharply higher, and valuations in parts of the AI ecosystem appear disconnected from near-term monetisation. On the surface, the setup resembles the early stages of the dot-com era.

While markets are clearly making long-dated assumptions about monetisation that remain untested, the current investment cycle is being driven by a foundation of real, measurable demand for compute. Hyperscalers are therefore spending at a scale comparable to utility-grade infrastructure projects – securing land, power access, transformers, grid connections and cooling systems – while relying on fabrication capacity upstream to meet compute ambitions. In comparison, previous technology booms saw market excitement often preceding tangible investment.

AI build-out and scarcity economics

Today, AI cannot be delivered without enormous upfront capital formation. A decade ago, a single rack of compute that cost US$20,000, now exceeds US$250,000.[1] Data-centre build-outs across the US, Europe and Asia are expanding at rates comparable to peak telecom infrastructure expansion in the early 2000s.

These developments imply that the infrastructure exists because the market believes the eventual use cases will be profound. Much of the visibility on software outcomes is still limited — which explains why software and consumer-exposed names have lagged — but the conviction behind future applications is sufficiently strong to unlock spending upstream.

In other words, the build-out reflects both real demand today and anticipated demand tomorrow.

The pricing power visible in certain segments, particularly semiconductors, exemplify this duality. For instance, Nvidia's markup is not being driven by sentiment; it is driven by limited fabrication and advanced packaging capacity. Yet, valuations embed expectations that scarce supply will smoothly translate into monetisable demand across industries. This scenario assumes that enterprises will absorb evolving AI tools fast enough to validate the capex already committed. It also assumes that economic bottlenecks — power, labour, data scarcity, supply chain constraints — will resolve without eroding pricing power.

1 - Dylan Patel and Gerald Wong, 'AI Server Cost Analysis – Memory is the biggest loser', May 2023.

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Global multipliers

Even if broader monetisation timelines remain difficult to forecast, rather than dismissing the cycle, it is important to recognise that the first phase of returns has accrued where supply cannot respond quickly. First, such, opportunity lies in power infrastructure. Data-centre demand is now consuming grid allocations faster than residential construction in several US states. Transmission and transformer shortages extend build-out timelines by years, strengthening pricing power for Korean and European high-voltage manufacturers, along with select US suppliers.

Another overlooked area is advanced packaging and server design. Taiwan dominates advanced packaging, while three firms alone, concentrated in Taiwan and China, control more than 90% of global server manufacturing. These companies are not beneficiaries of hype — they are indispensable enablers of the AI value chain

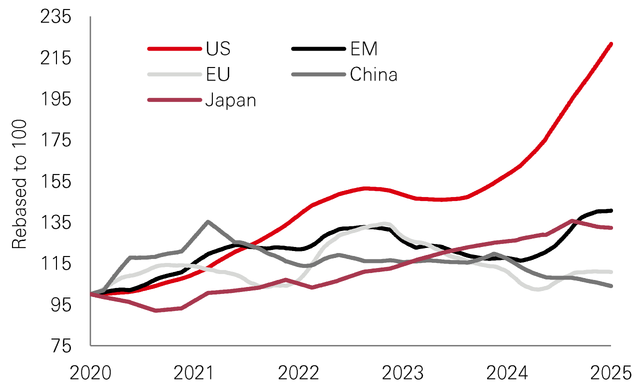
Commodities underpinning AI infrastructure expand the investment universe further. The compute and power intensity of AI increases demand for copper, silicon, rare earths, and platinum, much of which is extracted or refined in Chile, South Africa, Indonesia and China. Their importance rises as compute and energy intensity scales.

China advantage

Finally, China and broader emerging markets exemplify why looking beyond US mega-caps for the next wave can be beneficial. China, for example, is frequently underestimated in its AI potential, largely due to the perception that its capabilities are constrained by a lag in cutting-edge chip development and capex spending.

However, China's competitive playbook has never relied on technological first-mover advantage.

Figure 2: Regional Capex spend in Tech and Comms ($bn)



Past performance does not predict future returns.
Source: Refinitiv, Datastream, HSBC Asset Management, October 2025.

Instead, it competes through scale, cost disruption, state-backed industrial learning, and deep integration of AI into real-economy applications. This is critical in AI value capture which does not depend exclusively on building the most advanced model but relies on deploying models at scale across transaction-heavy ecosystems where monetisation is repeatable.

China operates closed-loop data ecosystems tied directly to transactions. Alibaba, Meituan, Tencent and ByteDance collectively control an end-to-end chain of consumer interaction, allowing monetisation per user to exceed Western platforms even with smaller models.

Cost structure reinforces this advantage. China's large language models are already priced at a fraction of their US and European peers, while offering increasingly competitive performance. For example, Baidu's autonomous operations undercut Western competitors by as much as 80% in unit economics, accelerating commercialisation timelines.

This mirrors past disruptions in solar, batteries, and EVs, where China closed capability gaps and reshaped global pricing. If AI follows a similar path, with adoption and cost outpacing innovation, China could define the economics of deployment even while trailing the US in frontier chips.

Chip restrictions are a constraint, but not a deadlock. China's policy mandating local chips for AI infrastructure supports domestic semiconductor growth, backed by its expanding cloud market, which could reach $1 trillion. This scale can foster a self-sufficient ecosystem to bridge cost and capability gaps.

Hence, while monetisation is happening, it remains uneven. For now, scarcity remains the most dependable source of returns. The next phase, where software and adoption begin to validate the build-out, will determine whether today's capital formation delivers acceptable long-term returns.

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