

MARKET INSIGHTS

2026 Key Themes

01 DECEMBER 2025 | MFS MARKET INSIGHTS TEAM

SUMMARY

As investors look to 2026, a number of key themes — from global policy stimulus to geopolitics to AI — are expected to shape macro and market conditions. In the US, the policy environment will support economic growth through rate cuts and fiscal stimulus, especially in the first half of the year. Likewise, Europe, China, and Japan are expected to carry out fiscal stimulus programs, and there may be opportunities in growth assets within countries pursuing these measures. Meanwhile, geopolitical risks are likely to impact markets: US-China economic decoupling continues to reshape supply chains, while the global race for AI supremacy and rising populist politics add complexity. Western nations face growing debt and deficit challenges, affecting fiscal policies. Diversification and a focus on resilient companies should be considered.

We believe that AI valuations remain broadly reasonable. Despite rising valuations in major tech firms, current price-to-earnings ratios are below dot-com bubble peaks and are supported by strong fundamentals. AI is transformative across sectors, but cautious monitoring is still necessary due to risks of over-optimistic adoption forecasts and complex financing arrangements within the AI ecosystem. Separately, we also discuss AI enterprise adoption. AI is reshaping business value creation, though enterprises are proceeding with caution due to governance and security needs. Overcoming data and cultural challenges will accelerate progress, enhancing productivity and innovation across industries such as health care and logistics. Investors should consider targeting companies with strong AI R&D and strategic partnerships.

Despite persisting geopolitical risks, the macro and market environment should remain supportive of risky assets in 2026. ▲

Through the first three quarters of 2025, non-US equities have outperformed US stocks, driven by market volatility and a weaker dollar. Growth in Europe, reforms in Japan, and innovation in emerging markets highlight global opportunities, making this a potentially attractive moment to diversify equity exposure beyond the US. Meanwhile, we believe that global fixed income diversification is key: macro volatility and policy divergence make a global investment approach essential. The US faces challenges, including a weaker dollar and policy uncertainty, while emerging markets and global credit offer attractive opportunities to us. Rebalancing portfolios away from the US and embracing global credit and emerging market debt can help enhance diversification. Finally, corporate credit fundamentals seem likely to improve. With expected rate cuts in 2026, corporate credit fundamentals like interest coverage and cash balances are set to strengthen, supporting tight credit spreads similar to mid-1990s conditions. We think that investors should maintain credit exposure, consider global credit diversification, and monitor stress in private credit.

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The Year of Global Policy Stimulus

In the US, accommodative monetary and fiscal policy are expected in 2026. The heavy lift will come from the Fed, with several rate cuts in the pipeline. But the fiscal side of the policy mix will also contribute stimulus, particularly in the first half of the year. Indeed, next spring, an estimated \$60 billion in tax refunds will flow into the coffers of US households under the One Big Beautiful Bill Act (OBBBA), which we anticipate will support the US consumer. The higher refunds will come from a higher SALT deduction cap, write-offs for overtime

and tips, a senior citizens tax deduction and an increased child tax credit. For businesses, the bill provides support primarily through bonus depreciation and R&D expensing, among other, smaller tax benefits.

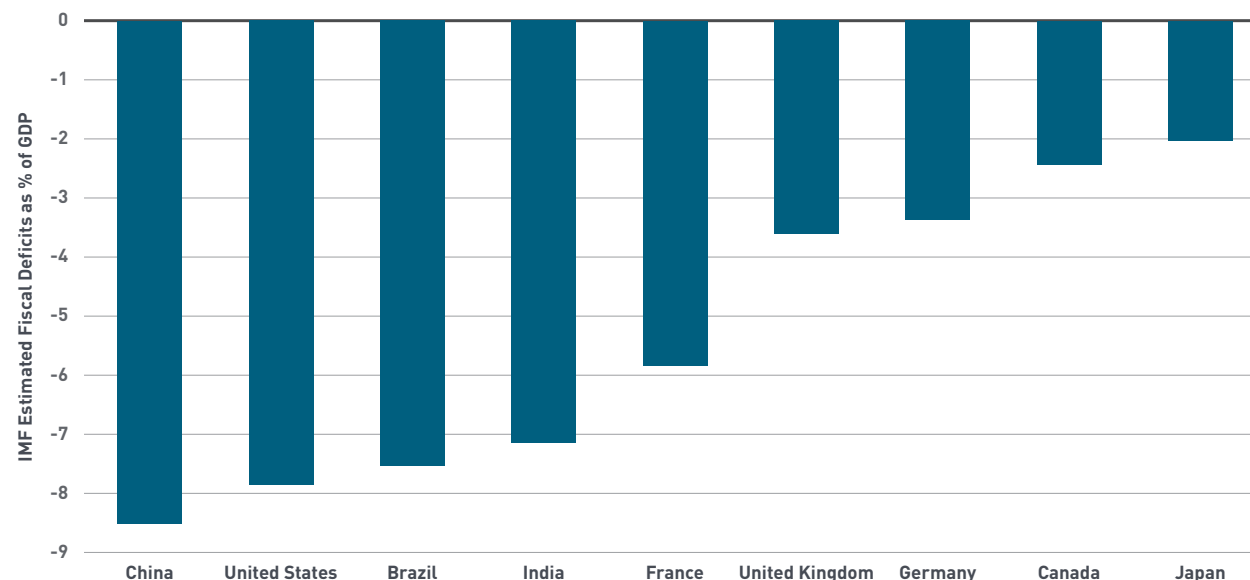
However, the fiscal outlook will likely become more uncertain in the latter part of the year. Tariff impacts remain the largest headwind to the economy. For now, we await the US Supreme Court's decision on the validity of IEEPA as a basis for many of President Trump's tariffs, and it is unclear whether the effective tariff rate will settle lower than current levels. Additionally, some consumers will also face challenges including cuts to Medicaid, changes to the Supplemental Nutrition Assistance Program (SNAP), adjustments to student loan eligibility and resumed collections on defaulted loans.

Most of the rest of the world will be stimulating policy, too. In Europe, fiscal policy is taking over from the ECB as the main source of growth-supportive policy, compliments of Germany's fiscal bazooka. But let's not forget that the eurozone will likely continue to benefit from the lagged effect of past rate cuts. Another country that stands out on the global policy stimulus radar is China, where both monetary and fiscal levers will likely be put to work to try to stimulate an economy that continues to face deflation risks. Finally, in Japan, some modest monetary policy tightening is expected, but the newly-elected Prime Minister Sanae Takaichi is prioritizing economic growth via an ambitious, multi-year approach to government spending, which should result in a supportive policy mix.

ACTIONS TO CONSIDER

- ➞ Consider positioning for a stronger US consumer in the first half of 2026.
- ➞ Watch the legal proceedings in the US to assess the magnitude of tariff headwinds.
- ➞ Consider exposure to growth assets in countries where policy stimulus will be credible and impactful.
- ➞ Exercise country selectivity, as lower-credibility countries running large fiscal deficits and elevated debt ratios may be subject to upward rate pressure.

EXHIBIT 1: ESTIMATED 2026 FISCAL DEFICITS



Source: IMF, October 2025 World Economic Outlook. Note: Japan's expected fiscal deficit estimate prior to the election of Sanae Takaichi as prime minister. Japan's fiscal deficit may become more stimulative once more details on her policies becomes clear.

Navigating Geopolitical Risks

US-China decoupling. The ongoing economic decoupling of the US and China continues to impact the global economy, compelling many nations to address the fallout of this significant shift. China's recent (though now suspended) export controls on rare earth minerals and related technologies have accelerated efforts among Western countries to diversify supply chains for these critical resources. To bolster national and economic security, countries are focused on derisking critical industrial sectors such as semiconductors, pharmaceuticals, nuclear energy and technology. While a

one-year US-China trade truce offers temporary relief, it may be insufficient to fully restructure supply chains, leading to increased input costs as access takes precedence over affordability.

AI Supremacy. The global race for AI dominance is poised to reshape multiple sectors. The ability to economically produce large amounts of energy to power advanced data centers will be critical and may require countries to reconsider their climate commitments. Additionally, the rise of sophisticated cyber threats necessitates robust countermeasures to safeguard against malicious actors.

Populist Politics. The days of genteel disagreement between center-left and center-right political parties look to be a thing of the past. Political landscapes are shifting as established parties lose ground and

electorates become more polarized. Economic discontent, institutional distrust and algorithmically-amplified social media echo chambers are fueling this trend. Notable examples include the election of Democratic Socialist Zohran Mamdani as New York City's mayor and the UK Independence Party, led by Nigel Farage, topping polls in Britain. This polarization could lead to more volatile policymaking.

Debt and Deficits. Western nations, including the US, face growing debt burdens amidst public resistance to austerity. Germany has abandoned its long-standing fiscal conservatism to prioritize rearmament and infrastructure, while Japan, despite its high debt-to-GDP ratio, has embraced an expansive economic agenda. Although it is hard to predict when and if a debt crisis will take place, current fiscal trends are concerning.

ACTIONS TO CONSIDER

- ➔ Diversify portfolios across geographies and sectors to help mitigate risks.
- ➔ Focus on resilient, adaptable companies with strong management.
- ➔ For bond investors, select emerging markets that may offer opportunity given better fiscal fundamentals.



Is the AI Premium Too High?

Despite some significant uncertainty, current valuations do not raise major red flags to us.

This isn't 1999. The price-to-earnings (P/E) ratios of today's largest tech firms remain well below the heights reached during the dot-com bubble. For example, Nvidia's forward P/E is roughly 28x, compared with Cisco's 126x in 2000. Although valuation indicators have climbed, they have not reached a point that signals an imminent risk of correction, especially given the robust earnings outlook. Aside from elevated valuation metrics, the fundamentals of the megacap technology

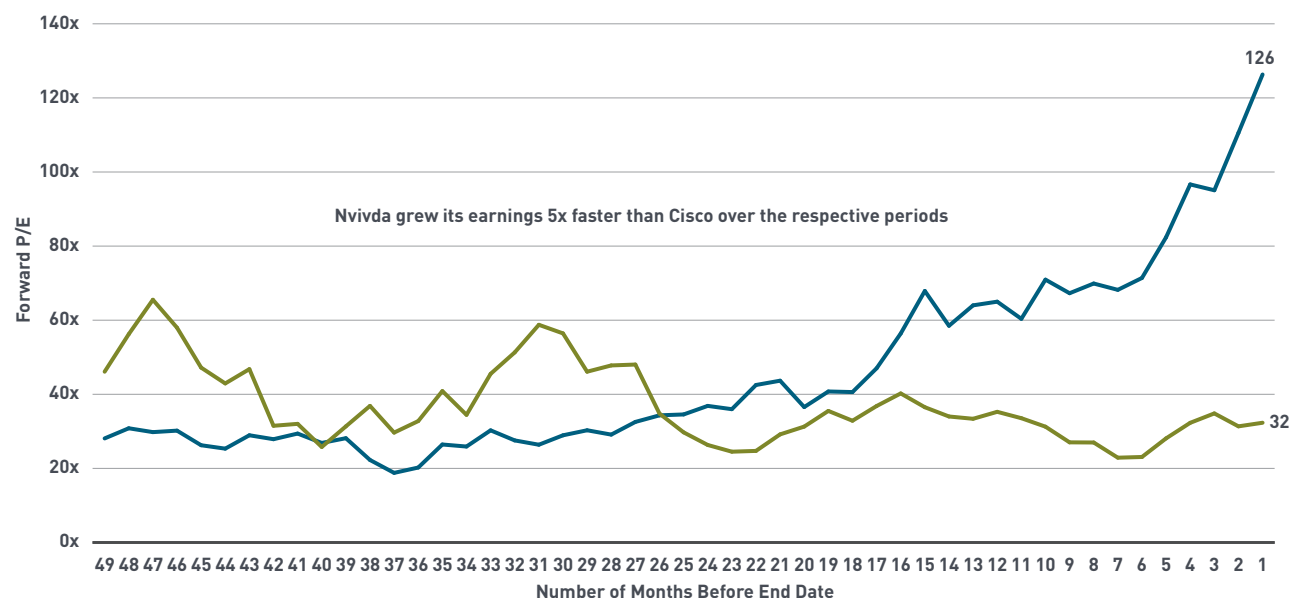
names today are considerably stronger than they were a quarter century ago, with strong balance sheets, positive cash flow and high profitability. Furthermore, the recent surge in AI-related capital expenditure has not yet reached levels that would be cause for broader economic concern.

AI is transformational, in our view. Artificial intelligence promises to enhance productivity and drive innovation across multiple sectors, including health care, pharmaceuticals, manufacturing, autonomous vehicles, robotics and logistics. The structural changes AI may bring to cost structures and business models are likely to boost profitability for the winners.

But vigilance is required. There is the risk that forecasts for AI adoption may be too optimistic, raising doubts about whether demand will materialize as quickly as expected. This could lead to an investment bust and a sharp hit to profits. According to our investment team, OpenAI is a pivotal player in the ongoing capital expenditure surge; thus, its revenue trajectory will be essential to monitor. The company projects that it will reach \$200 billion in revenue by 2030, up from \$15 billion today, but even this extraordinary growth may not fully address its financing needs, absent a successful IPO. Additionally, the circular financing arrangements within the AI ecosystem of chipmakers and hyperscalers have raised many eyebrows, although some analysts suggest these are justified as ways to create captive demand and manage competition.

EXHIBIT 2: NVIDIA VS. CISCO

■ Nvidia: 2021–2025 ■ CISCO: 1996–2000



Source: FactSet. Forward P/E data from 30 September 2021 to 30 September 2025 (end-date) for Nvidia and 29 March 1996 to 31 March 2000 (end-date) for CISCO. Forward P/E = next 12 months. **The information included above as well as individual companies and/or securities mentioned should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS product.**

ACTIONS TO CONSIDER

- ➔ Know what you own and be selective, as there will be winners and losers.
- ➔ Favor exposure to names that display sustaining quality characteristics and diversity of customer exposure.
- ➔ Promote a diversified investment approach as an AI risk management strategy.

From Hype to Impact: How Enterprise AI Adoption Can Drive Investor Returns

Artificial intelligence is not just a technological evolution; it represents a paradigm shift in how businesses create value. Its diffusion across industries is reshaping workflows, enabling innovation, driving productivity and unlocking growth opportunities. We believe that understanding the breadth and depth of AI's impact is essential for positioning portfolios to capture potential long-term growth.

Enterprise adoption is a complex journey, marked by immense promises and significant hurdles.

While consumer AI applications have advanced rapidly, enterprises are progressing more cautiously due to the need for robust governance, security and data privacy. These factors are critical in sectors such as finance and health care, where regulatory compliance and ethical considerations are paramount. Reliable and predictable

outputs are essential, as AI tools that compromise the customer experience or the company's reputation (e.g., chatbots recommending competitors) are unacceptable. Consequently, enterprises are lagging behind the consumer in adopting new technologies. However, history shows that once foundational barriers are addressed, progress accelerates. Companies that successfully integrate AI can enhance efficiency by automating routine tasks, optimizing supply chains and improving decision-making. They can also drive innovation, develop new products and capture market share by responding faster to change.

Many organizations need significant groundwork before deploying AI solutions. Challenges such as data readiness, legacy systems, and cultural resistance all slow progress. This explains why many pilot projects fail to transition into production — a common phenomenon for transformative technologies. We believe over a three- to

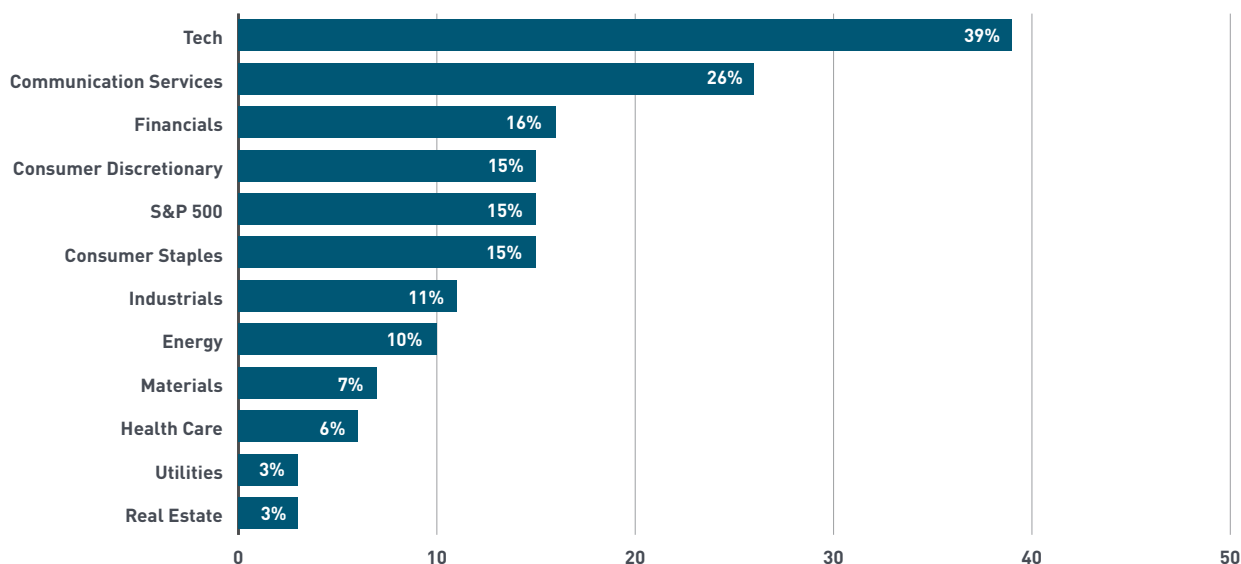
five-year horizon, setbacks are expected before relatively substantial gains are realized.

Despite the challenges, AI's transformative impact is already evident across industries. Anecdotal evidence suggests companies using AI agents for coding are seeing software developers becoming five to ten times more productive, leading some to rethink hiring plans. As a horizontal technology, AI is set to permeate all aspects of business, driving economy-wide benefits by enhancing efficiency and competitiveness. In our view sectors such as health care, finance, manufacturing and logistics are particularly primed for AI-driven transformation, with innovations such as AI-powered diagnostics, algorithmic trading and autonomous supply chains reshaping industries. Companies with scalable platforms, proprietary data, and strong partnerships are likely best positioned to thrive, while those lagging behind may risk obsolescence, in our view.

ACTIONS TO CONSIDER

- ➞ Focus on innovative companies that target R&D spending on AI advancements and have strategic partnerships that leverage proprietary data to unlock efficiencies.
- ➞ Target sectors where AI adoption strengthens margins through pricing power, not those where efficiency gains are passed to customers.

EXHIBIT 3: % OF COMPANIES WITHIN S&P 500 SECTORS MENTIONING QUANTIFIABLE BENEFITS FROM AI ADOPTION



Source: Morgan Stanley, as of 30 September 2025. Copyright 2025 Morgan Stanley. The information included above should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS product.

Think Global, Invest Global

Over the past decade, US stocks have dominated, soaring to over 60% of global market value on the back of the Magnificent 7, while non-US equities trailed behind.¹ But 2025 has flipped the script: international equities are now outperforming US ones for the first time in years, fueled by heightened US market volatility and a weaker dollar. With compelling catalysts at play, we believe now may be an opportune time for investors to diversify into global ex US equities.

ACTIONS TO CONSIDER

- ➔ Within European equities, consider banks and industrials: Banks seem likely to maintain their outperformance amid improving loan growth; industrials are expected to benefit from ramped-up infrastructure investment.
- ➔ Look for possible opportunities in undervalued Japanese companies, as they are seemingly well-positioned to benefit from shareholder-friendly policies and economic momentum.
- ➔ Security selection in emerging markets is key, with a focus on companies leading technological and supply chain advancements, particularly in Taiwan, South Korea and China.

Structural and fiscal reforms are set to drive growth and boost earnings.

Across Europe, increased defense and infrastructure spending is supportive of growth, while ongoing structural reforms — including a savings and investment union and favorable tax incentives — are designed to retain capital and encourage European investors to pursue more ambitious investment strategies. In Japan, shareholder-friendly reforms and large cash reserves are likely to boost capital returns, driving dividend growth and buybacks. Meanwhile, emerging markets are advancing innovation in areas such as AI, manufacturing and renewables, while a weaker US dollar attracts capital and supports commodity demand.

Diversified revenue exposure offers a degree of protection against higher tariff costs and a weaker dollar.

With less than 20% of non-US companies' revenues coming from the US, these firms are relatively shielded from the impact of increased tariff costs.² Additionally, limited US revenue exposure helps protect earnings from currency fluctuations.

The non-US-US equity valuation disparity has the potential to shrink, suggesting that now may be a good entry point for international equities.

Non-US stocks are currently trading at nearly two standard deviations below their long-term average, a significant discount relative to US equities.³ Looking ahead, Europe and Japan are expected to see improved earnings growth, which should help close earnings and valuation gaps with the US.

EXHIBIT 4: NON-US EQUITIES OUTPERFORMING US EQUITIES IN 2025



Source: FactSet. Daily data from 31 December 2024 to 17 November 2025. Returns are net for MSCI ACWI ex USA and gross for S&P 500, and in USD.

Investors Without Borders in Fixed Income

The case for global diversification has never been stronger. Think about the challenges global investors face: macro volatility, policy uncertainty, complexity, geopolitics and technological disruption. A global approach to investing appears necessary not only from a risk management standpoint, but also to pursue attractive opportunities in other parts of the world.

ACTIONS TO CONSIDER

- ➔ Favor a global approach to investing in the face of increased macro divergence and a challenging market environment.
- ➔ Consider rebalancing away from the US to take advantage of the negative outlook for the USD.
- ➔ Take advantage of the diversification that asset classes such as global credit and emerging market debt offer.

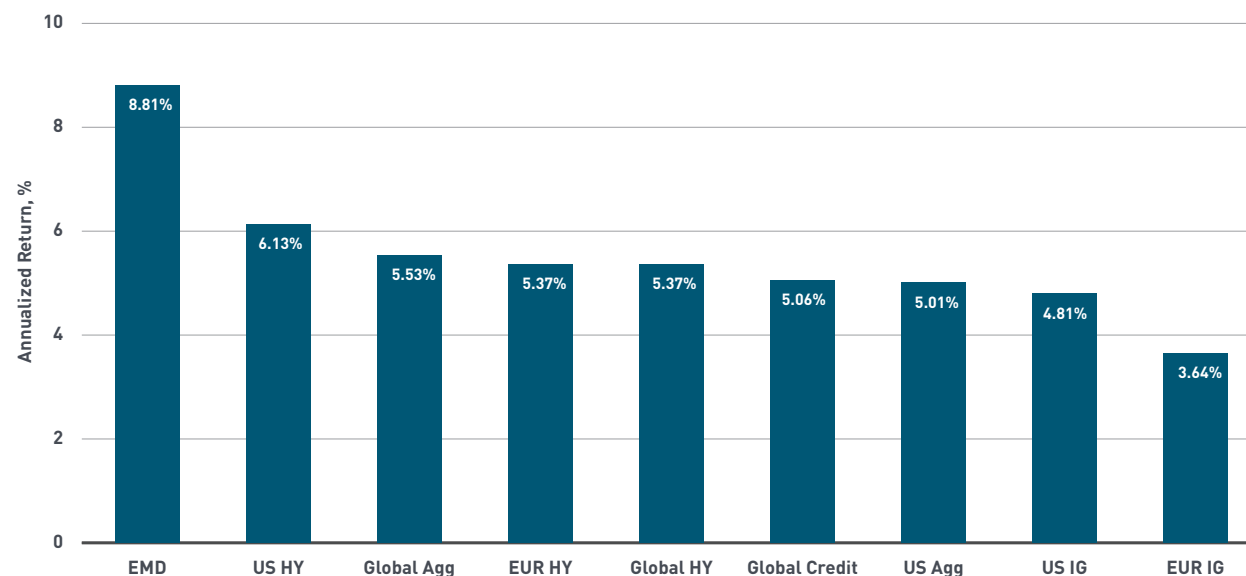
Macro decoupling means more opportunities for global investors. We are facing an unusual level of global macro divergence. For a start, Fed and ECB monetary policies are unsynchronized. While the Fed is likely to cut rates meaningfully over the next 12 months, the ECB easing cycle may have already ended. This has implications for currency markets as well as global duration positioning. Downside risks to growth in the US are contrasted with a recovery in the eurozone, while emerging markets are the primary driver of global growth. In our view, only a global approach can take advantage of this differentiation in macro fundamentals.

US exceptionalism has been challenged. While the US remains the most important market, it has also become a major source of macro volatility and policy uncertainty, as exemplified by the ongoing political pressure on the Fed. This, among other factors, has caused the dollar to come under downward pressure.

At the same time, the US Treasury market has lost some of its safe-haven characteristics in the face of US-based risk aversion shocks. The outlook for a weaker dollar, together with concerns over the US' macro policy framework, reinforces the case for rebalancing away from the US.

There are many attractive global opportunities. Given the resilience of global macro fundamentals, we believe that global credit is well positioned to perform in the period ahead. Meanwhile, emerging markets (EM) should continue to benefit from robust macro fundamentals, attractive yield valuation and downside pressure on the US dollar, although selectivity is key (Exhibit 5). Finally, for risk-tolerant investors, global high yield and EM local currency debt appear likely to provide a relatively attractive alternative to equity risk with lower volatility.

EXHIBIT 5: MEDIAN 5-YEAR RETURN WHEN STARTING YIELD IS +/- 30 BPS FROM TODAY'S



Source: Bloomberg, J.P. Morgan. Monthly data from 31 January 2000 to 31 October 2025. Yields are measured on a yield-to-worst basis, returns are in USD. EMD = J.P. Morgan EMBI Global Diversified. US HY = Bloomberg US Corporate High Yield Index. Global Agg = Bloomberg Global Aggregate Index. EUR HY = Bloomberg Pan-European High Yield Index. Global HY = Bloomberg Global High Yield Index. Global Credit = Bloomberg Global Aggregate Credit Index. US Agg = Bloomberg US Aggregate Index. US IG = Bloomberg US Corporate Index. Euro IG = Bloomberg Euroagg Corporate Index. Past performance is not a reliable indicator for future results.

Corporate Credit To Party Like It's 1996

Credit fundamentals seem set to improve in 2026.

Corporate credit's strong performance in 2025 was driven by attractive yields, but 2026 is expected to shift focus to improving fundamentals. As central banks, including the Fed, continue cutting rates, global yields are declining, which may reduce fixed income's appeal. However, lower yields will enable corporations to refinance and issue debt on better terms, easing balance sheet pressures caused by high rates. Key fundamental metrics like interest expenses, cash balances and interest coverage ratios should improve. Caution is advised for private credit fundamentals, as some areas show signs of mounting stress.

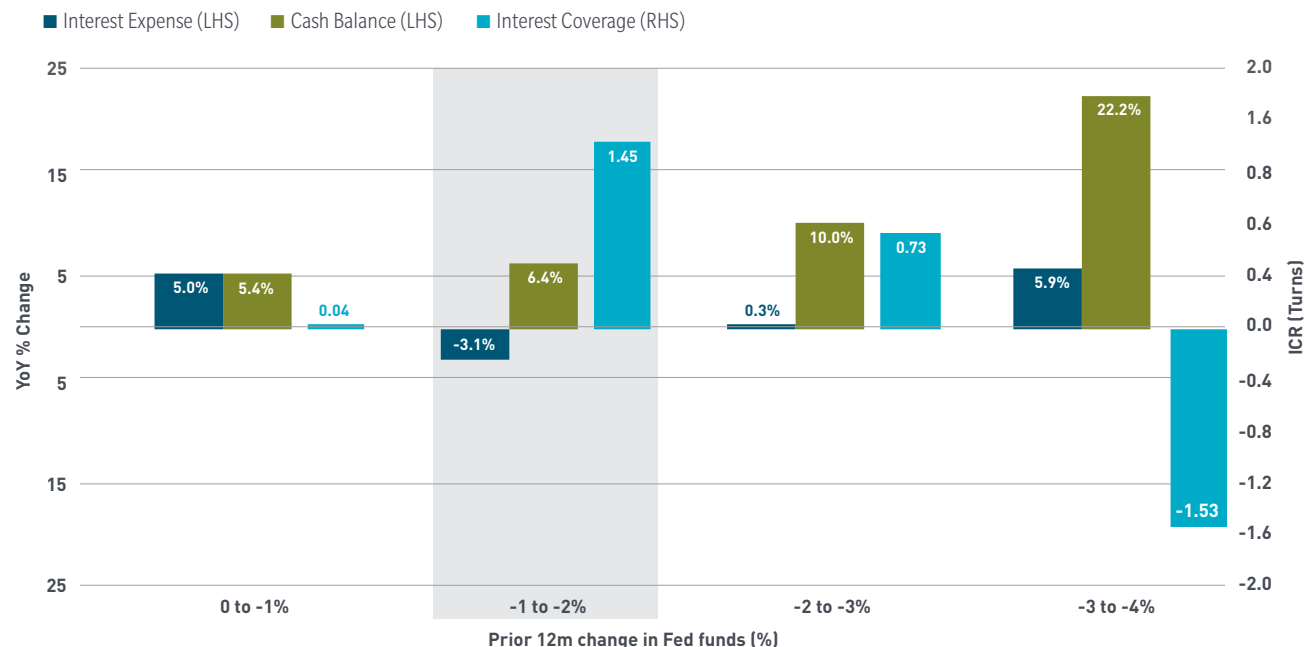
ACTIONS TO CONSIDER

- ➡ Maintain exposure to credit, as improving corporate fundamentals can help support tight spread valuations.
- ➡ Beyond the US, consider raising exposure to global credit to help optimize global diversification.
- ➡ Continue to watch for signs of mounting fundamental stress in some pockets of private credit.

The rate-cut sweet spot for corporate credit. To understand how these metrics might shift through a rate-cutting cycle, we have averaged the historical 12-month forward changes in those fundamental measures versus the 12-month change in Fed funds (Exhibit 6). Historically, corporate fundamentals have seen the greatest improvement when policy rates fall by 1% to 2%; any less, and there does not seem to be much impetus for corporations to refinance, and anything above that likely signals panic cuts from the Fed and elevated recession risks. Given recent rate changes, we believe the current backdrop corresponds to the 1%–2% bucket environment. Today, it appears that we are going through a mid-cycle rate adjustment and normalization of monetary policy rather than panic.

We're back to the mid-1990s, when tight spreads were well supported by the positive impact of rate cuts. The current market backdrop is very similar to the credit environment of the mid-1990s, where a 1995 mid-cycle adjustment from the Fed helped support fundamentals and ultimately allowed corporates to trade at very tight spread valuations for a prolonged period. In 2026, macro policies may again help drive healthier corporate fundamentals, which we think will in turn help support tight corporate valuations.

EXHIBIT 6: 12M FORWARD CHANGE IN CORPORATE FUNDAMENTALS BASED ON 12M CHANGE IN FED FUNDS



Source: J.P. Morgan, Federal Reserve, Bloomberg. Quarterly data from 31 March 2004 to 30 June 2025. Fundamental changes calculated 12 months forward depending on prior 12-month change in the Federal funds rate.

2026 KEY THEMES

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¹ Source: FactSet, S&P 500 market cap divided by MSCI ACWI market cap. As of 31 October 2025.

² Source: FactSet, as of 31 October 2025. Non-US companies based on constituents in the MSCI ACWI ex-USA index.

³ Source: FactSet, as of 31 October 2025. Valuation discount = MSCI ACWI ex-USA (non-US stocks) Forward P/E divided by S&P 500 (US stocks) Forward P/E minus 1. Forward P/E is next-twelve-months. Long-term average and standard deviation are based on 20-years of monthly data ending 31 October 2025.

⁴Source: FactSet. As of 31 October 2025. Mid-cap = Russell Midcap index. 2026 eps growth expectation = year-over-change between 2025 and 2026 eps estimates.

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