

November 2026

Insight into Fidelity's capital market assumptions

Recalibrating for a world of higher interest rates and profit margins

Fidelity INTERNATIONAL

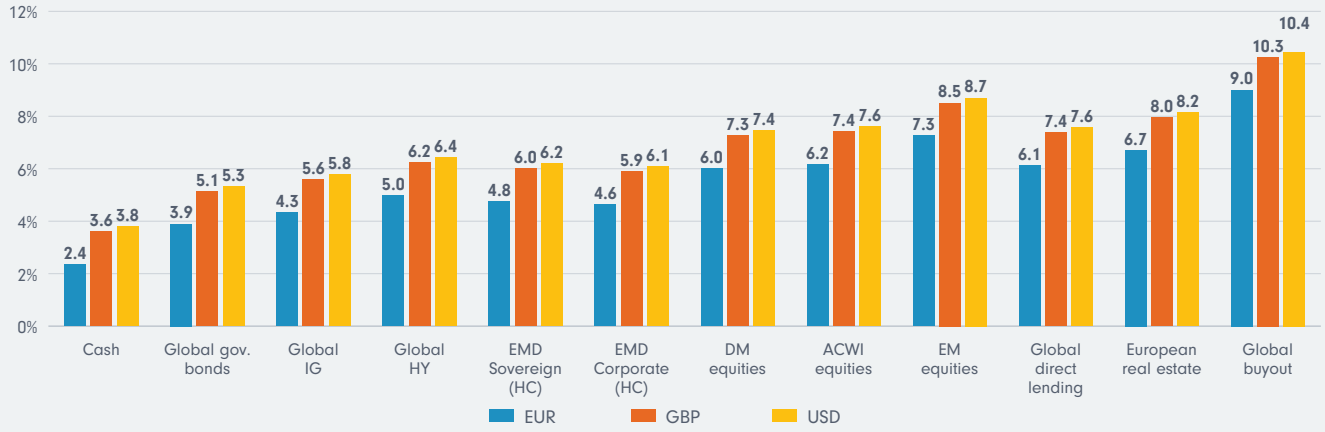
Executive summary

The below summary of expectations applies to our standard 10-year strategic capital market assumptions (CMA) forecast period, from the latest periodic six-month cut-off date of 30 September 2026:

- **Macro:** Our updated assumptions point to a world in which stronger productivity potential coexists with persistent inflation risks. Geopolitical fragmentation, more politicised economic policy, the AI revolution and climate-related disruptions are likely to keep inflation structurally higher and more volatile than in the post-GFC decade. AI-related investment is adding to near-term demand for capital and energy, while productivity gains should emerge gradually and unevenly across economies. Growth remains relatively resilient, particularly in the US, but higher interest rates could weigh on activity. We therefore expect policy rates to remain materially above their pre-pandemic levels.
- **Fixed income:** Overall, we remain constructive on the strategic role of fixed income, while recognising that higher yields come with a different risk profile. Inflation shocks and elevated term premia are likely to sustain greater bond volatility, making duration management increasingly important. Shorter-duration bonds offer attractive income and resilience, while longer-duration sovereign bonds should retain their ability to diversify recessionary shocks, although they may provide less protection when inflation drives market volatility. In this new environment, capturing the opportunities offered by higher yields requires a more differentiated approach to fixed income investing.
- **Equities:** Equities remain the principal engine of long-term portfolio growth. Although our expected returns have increased, we see a wider range of potential outcomes as AI reaches a crossroads between substantial investment and uncertain monetisation. Our base case assumes positive but gradual productivity gains, constrained by the pace of adoption, supporting revenue growth and potentially higher margins. These benefits will vary across regions, sectors and companies. With profitability gains increasingly driven by expanding operating margins, an investment approach grounded in company fundamentals can help identify businesses with sustainable competitive advantages and attractive valuations. Capturing opportunities will require selective, diversified exposure across regions and sectors, including both AI enablers and adopters.
- **Private assets:** Private assets continue to offer attractive long-term returns for investors willing to accept illiquidity. However, higher financing costs and increasingly complex market structures are changing how those returns are generated, making manager selection and disciplined risk management more important than ever.
- **Portfolio construction:** The market-cap-weighted frontier remains flatter than its historical counterpart, suggesting less incremental reward for taking additional risk. As traditional equity-bond relationships become less reliable, investors may need a broader toolkit. Absolute-return and derivative strategies could provide differentiated protection, while selected private assets may broaden long-term opportunities for investors able to tolerate illiquidity.

Expected total returns across asset classes and currencies

Projected average annualised geometric nominal returns over ten years (%)



For illustrative purposes only. Assumptions are based on proprietary modelling, reflecting the views of investment professionals at Fidelity International.

Source: Fidelity International, 30 September 2026. IG: investment grade; HY: high yield; EMD: emerging market debt; HC: hard currency; DM: developed market; EM: emerging market; ACWI: All Country World Index.

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Introduction: A more complex landscape

Recent equity market volatility has brought the economics of AI into sharper focus. After a powerful rally, investors are questioning the returns on unprecedented investment and the cash flows needed to justify valuations. Higher government bond yields since our previous Capital Market Assumptions (CMA) update add to the pressure, raising questions about the transition ahead.

AI offers substantial long-term potential, but realising it requires broader adoption. Energy bottlenecks, regulatory requirements and cyber risks can slow deployment, raise costs and extend payback periods. Our base case remains a positive but gradual contribution to growth, with market scrutiny potentially encouraging more disciplined investment through a volatile transition.

These tensions sit within a broader structural shift. Since 2021, we have argued that inflation would prove persistent and more volatile. Geopolitical fragmentation, increasingly politicised economic policy and climate risks reinforce this view, while AI investment adds demand for capital, energy and scarce resources.

Inflation in an AI-driven and fragmented world

The conflicts in Ukraine and the Middle East are reshaping energy trade, infrastructure and national security priorities. Governments are seeking more reliable suppliers, diversified supply routes and domestic capacity, embedding energy security into long-term investment decisions. AI's growing power requirements add to these demands. Building more resilient energy and technology systems entails substantial upfront costs, supporting inflationary pressures even as AI's productivity gains gradually emerge. Over time, broader adoption should improve efficiency and exert a disinflationary influence. The transition nevertheless reinforces our expectation that inflation will remain structurally higher and more volatile than in the post-global financial crisis (GFC) decade.

Government bond yields have returned towards pre-GFC levels, against a backdrop of much higher public debt and elevated valuations in some equity markets. Persistent inflation risks and competition for capital could keep yields structurally higher, even as weaker growth periodically pulls them lower. The questions for investors are how sustainable these levels are alongside greater leverage, and what they imply for returns, volatility and diversification.

Our CMA framework is designed to answer these questions. Inflation, real rates and term premia are core building blocks in our estimates of the long-run fair value of government bond yields; those yields, in turn, help shape our assumptions for equity valuations and profit margins.

Similarly, we model AI through its effects on productivity and growth, which feed into real rates and corporate revenues, and through the components of profit margins. We weigh potential operating-margin gains against higher depreciation and financing costs, and possible corporate tax increases if employment or labour's share of income declines. Together, these channels allow us to assess competing forces and test alternative scenarios.

The same logic applies to risk. Our assumptions for volatility and correlations combine historical information with greater weight on periods that are more representative of the macro regime we expect ahead. The post-GFC experience, characterised by low inflation, low inflation volatility and repeated quantitative easing, is less useful as a standalone guide to a world in which inflation shocks are more frequent. This helps explain why we expect bond volatility to remain higher and the equity-bond correlation to be less reliably negative than it was for much of the post-GFC period.

A broader approach to diversification

Against this backdrop, our updated CMAs reinforce the case for a broader approach to diversification and a renewed focus on fundamentals. Equities remain the principal long-term engine of portfolio growth. However, elevated valuations and market concentration risks strengthen the case for selective diversification across regions and sectors, rather than relying on capitalisation-weighted benchmarks. Higher yields have also restored the strategic appeal of fixed income, with carry doing more of the work in expected returns, although investors should expect greater rate volatility and a less dependable diversification benefit during inflationary shocks. This reinforces the relative attractiveness of shorter-duration exposures.

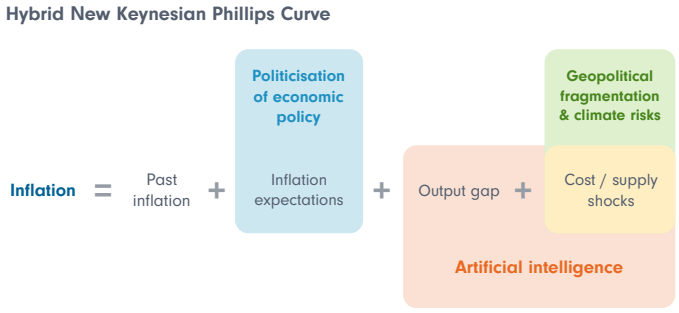
Periods of elevated uncertainty and market dislocation can create attractive investment opportunities but capturing them requires both a top-down understanding of the macro regime and bottom-up analysis of fundamentals. While sentiment can dominate market pricing over shorter horizons, macro conditions, valuations and corporate fundamentals remain central to long-term investment outcomes.

The macroeconomy: four key structural forces behind persistent inflation

Four interconnected structural forces are increasingly shaping the global economy: geopolitical fragmentation, the politicisation of economic policy, the AI revolution and climate-related risks. Their interaction matters as much as their individual effects, particularly as economic security and strategic independence become more important priorities for governments.

A useful way to understand these dynamics is through a hybrid New Keynesian Phillips Curve, which relates inflation to its own persistence, inflation expectations, the output gap and supply-side shocks. Today's structural forces affect each of these channels (Figure 1). Greater fiscal activism can sustain demand, while political pressure on central banks may complicate the anchoring of inflation expectations. At the same time, geopolitical fragmentation, from military conflicts to trade restrictions, is reshaping global supply chains and increasing production costs. Climate-related disruptions add further pressure, particularly through food and energy prices. These shocks are difficult to forecast individually, but their increasing frequency reflects a structural change in the global economic landscape.

Figure 1. The structural macro trends driving inflation today



Source: Fidelity International. For illustrative purposes only.

The AI revolution adds another dimension. In the near term, unprecedented investment in data centres, semiconductors and energy infrastructure is creating additional demand for capital and scarce resources, adding to inflationary pressures. Over time, however, broader AI adoption should improve productivity and exert a disinflationary influence. The timing of these effects is crucial. While we expect AI's long-term net impact on inflation to be relatively balanced, the transition could generate considerable volatility, particularly as competition for energy, critical minerals and technological leadership becomes increasingly intertwined with geopolitical tensions.

Taken together, these forces reinforce our expectation that inflation will remain structurally higher and more volatile than in the previous decade. Yet this is unfolding against a backdrop of relatively resilient economic growth, particularly in the US. As discussed in our H1 CMA update and recent AI research, we have already raised our long-term GDP growth assumptions to reflect the potential productivity benefits of AI. We nevertheless expect these gains to materialise gradually, with the growth transmission constrained by factors including labour market disruption, energy availability and the pace of adoption.

Regional views

These global trends will play out differently across economies, reflecting their economic structures, policy choices and exposure to technological change.

In the US, growth remains relatively resilient, and we expect it to stay close to trend over the medium term, increasingly supported by AI-related investment and productivity gains. Nevertheless, structurally higher interest rates could weigh on activity, marginally increasing recession risks in the short term. Our 10-year average inflation assumption remains at 3%, supporting our expectation of a higher-for-longer policy-rate environment.

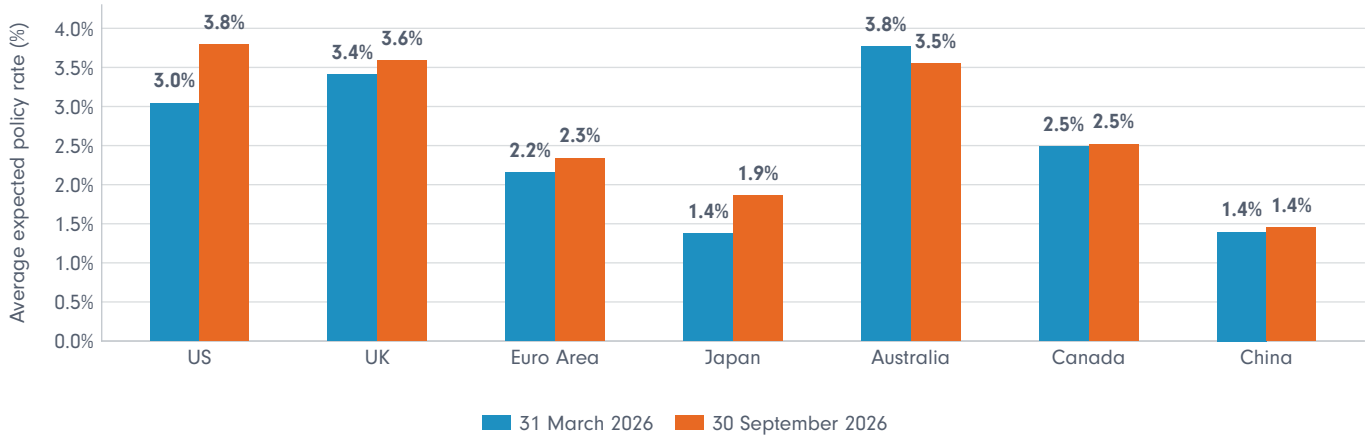
Across the euro area and UK, the outlook is for resilient but relatively subdued growth, accompanied by more persistent inflationary pressures. We expect further monetary tightening, with the European Central Bank likely to raise rates further and the Bank of England potentially resuming its hiking cycle. Over the longer term, productivity gains should provide some support to growth, while our ten-year average policy-rate assumptions remain structurally above pre-pandemic levels, at 2.3% for the euro area and 3.6% for the UK.

Asia presents a more differentiated picture. In China, inflationary pressures should remain relatively subdued as economic policy continues to favour supply-side expansion over domestic demand. Greater energy security and supply-chain resilience also provide some insulation from rising global costs. We have nevertheless become more constructive on China's long-term growth outlook as we expect AI adoption and technological progress to gradually support productivity, partly offsetting the structural drag from the property sector.

Japan, meanwhile, is experiencing a more sustained reflationary shift, supported by domestic wage growth and higher global input costs, and we have raised our long-term inflation assumption to 2%. Investment and AI adoption should also support potential growth, although demographic headwinds are likely to limit the magnitude of these gains.

Overall, our updated assumptions point to a world in which stronger productivity potential coexists with persistent inflation risks, keeping expected policy rates materially above those of the post-GFC decade (Figure 2).

Figure 2. Policy rates over the next 10 years to remain materially above levels seen in the decade following the GFC



For illustrative purposes only. Assumptions are based on proprietary modelling, reflecting the views of investment professionals at Fidelity International.

Source: Fidelity International, 30 September 2026.



Fixed income: new regime shifts return drivers

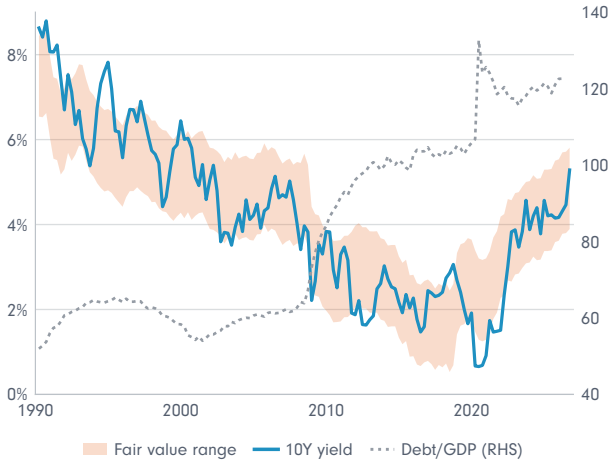
The government bond market has become one of the clearest expressions of the structural changes reshaping the global economy. Since our previous CMA update in April 2026, yields have risen substantially across major markets. This has been a largely global phenomenon, reflecting the strong interconnectedness of sovereign bond markets, although countries facing greater fiscal and political uncertainty have experienced more pronounced pressure.

The scale of this repricing raises an important question: how much further can yields rise, and where might they settle long-term? To answer this, we need to look beyond recent market movements and understand the macro forces that have historically shaped government borrowing costs.

Our research shows that structural movements in 10-year government yields have largely reflected two fundamental variables: inflation and real interest rates, the latter closely linked to economic growth. Our macro fair-value model, which uses long-term inflation and real GDP growth trends as proxies for these components, provides a useful perspective.

Looking at the US since 1990, it captures the transition from higher yields pre-GFC, to the exceptionally low levels of the following decade, and finally to the higher-rate environment that has emerged since 2021 (Figure 3).

Figure 3. Higher inflation and resilient growth have driven the recent increase in the US 10-year yield



Source: Fidelity International, Bloomberg, 30 September 2026.

Today's yields are therefore broadly consistent with the macro regime we are experiencing. At the end of September, the US 10-year yield was towards the upper end of the range justified by our model. Yet the comparison with the pre-GFC period reveals an important difference: government borrowing costs have returned to similar levels, while public debt relative to GDP has roughly doubled. This raises questions around the sustainability of higher yields and how economies and financial markets will adjust.

While structurally higher inflation is central to this shift, the recovery in real interest rates is equally important. Resilient economic growth, particularly in the US, expectations of a higher policy-rate environment and increasing competition for capital have all contributed to lifting real rates from the post-GFC lows.

The AI revolution adds an important dimension to this story as the investment required to deliver economic growth and productivity gains is already reshaping demand for capital. Technology companies are turning to debt markets to finance their expansion and, at the same time, governments face growing investment needs in defence, energy security and industrial policy, alongside the challenge of refinancing historically elevated debt burdens.

This backdrop creates increasing competition for capital between sovereign borrowers and the private sector. So far, corporate balance sheets remain relatively healthy, particularly among large US companies, with generally robust earnings and cash-flow generation. Nevertheless, rising debt issuance, together with more complex financing structures, including off-balance-sheet arrangements, introduces vulnerabilities that investors will need to monitor closely.

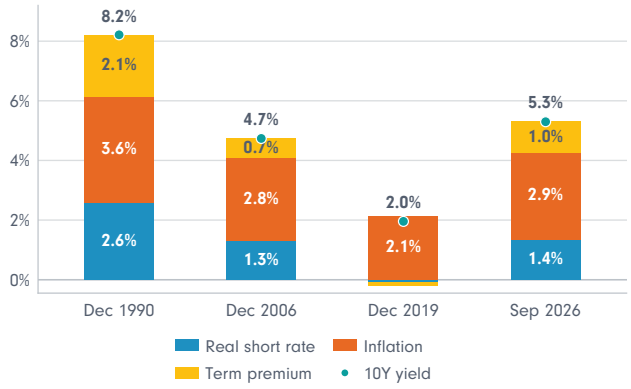


These forces are likely to remain relevant over the coming decade, although there are limits to how far yields can rise sustainably. Some investors may be concerned about ten-year US yields moving higher, even towards 8%. Such levels are possible during periods of exceptional geopolitical or financial stress. However, within our framework, sustaining yields around 8% would require a materially different macroeconomic environment, potentially involving inflation persistently around 6%, assuming other components remain broadly unchanged. This would likely trigger a restrictive monetary policy response, eventually weakening growth and putting downward pressure on yields.

Inflation and real rates are not the entire story

A third component has become increasingly important: the term premium, which compensates investors for uncertainty around future inflation and interest rates. This marks another significant departure from the post-GFC era, when term premia were often close to zero or negative, partly reflecting central bank interventions and strong demand for safe-haven assets (Figure 4).

Figure 4. US 10-year yield decomposition: real rates, inflation expectations and the term premium are now in line with pre-GFC levels



Source: Fidelity International; D'Amico, Kim, and Wei (2018). 30 September 2026.

Our research suggests that the forces pushing term premia higher are structural. Persistent fiscal deficits and rising debt ratios increase the supply of government bonds, while the gradual withdrawal of price-insensitive buyers, including central banks, changes the demand backdrop. Meanwhile, greater macro volatility and declining confidence in the stability of sovereign bonds increase the compensation investors require for holding duration. The normalisation of Japanese interest rates could reinforce these pressures by reducing Japanese investors' incentives to purchase foreign bonds. Bringing these factors together, our model points to term premia of around 1% in the US and UK, and somewhat lower levels in the euro area and Japan.

The recent developments in France illustrate how these structural pressures can be amplified by domestic political and fiscal uncertainty. With public debt approaching 120% of GDP, persistent deficits and uncertainty ahead of the 2027 presidential election, investors have demanded higher compensation for holding French government debt. So far, markets have continued to distinguish France from countries with stronger fiscal fundamentals, limiting the risk of broader contagion. Moreover, the European banking system is considerably more resilient than during the previous sovereign debt crisis, and the European Central Bank has additional tools to address disorderly market fragmentation if pressures spread.

Our real rate assumptions have increased

Bringing together our forward-looking assumptions for inflation, real rates and term premia allows us to estimate long-term equilibrium yields across major markets. In this update, we have marginally increased our real rate assumptions for the US and Japan, reflecting the prospect of more persistent inflation and, particularly in the US, stronger growth supported by AI. Our estimated 10-year yield equilibria now stand at approximately 4.7% for the US, 4.4% for the UK, 2.9% for the euro area and 2.7% for Japan. While these are below market yields at the end of September, the key message is that yield levels are likely to remain elevated along with volatility as global inflationary pressures continue (Figure 5).

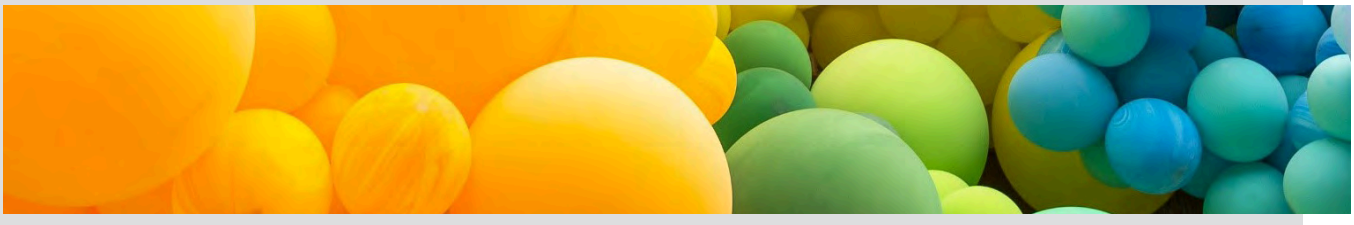
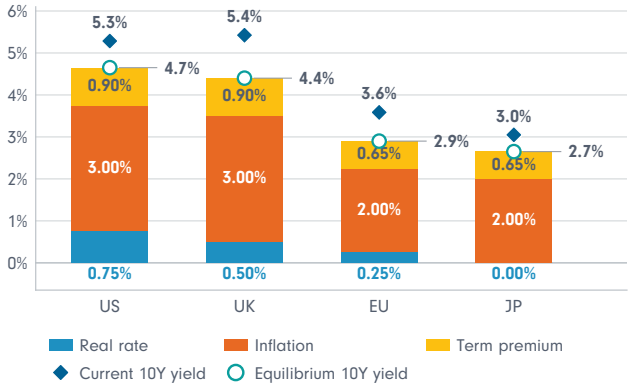


Figure 5. 10-year yields are now marginally above our long-term equilibria



For illustrative purposes only. Assumptions are based on proprietary modelling, reflecting the views of investment professionals at Fidelity International.

Source: Fidelity International, 30 September 2026.

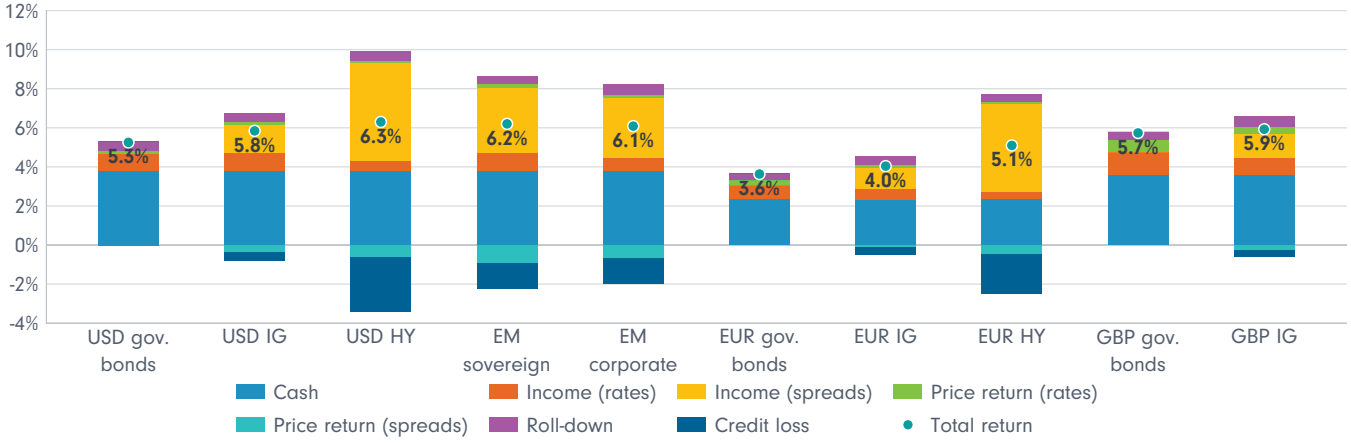
Income and carry to drive fixed income returns from here

For long-term investors, this creates an interesting combination of opportunities and risks. Higher starting yields have substantially improved expected fixed income returns, restoring the importance of bonds within strategic portfolios. Crucially, however, the composition of those returns has changed. Unlike the post-GFC decade, when falling yields generated substantial capital gains, our forecasts now suggest that income and carry will account for most fixed income returns over the next 10 years (Figure 6).

Credit markets offer attractive all-in yields too, although spreads remain relatively compressed, limiting compensation for additional credit risk. Corporate fundamentals are generally resilient, but higher financing costs, growing issuance and greater differentiation between issuers strengthen the case for fundamental analysis and selectivity. This is particularly relevant with government bonds set to compete more with corporate credit for investors' capital.

Overall, we remain constructive on the strategic role of fixed income, while recognising that higher yields create different risks. Inflation shocks and elevated term premia are likely to sustain greater bond volatility, making duration management increasingly important. Shorter-duration bonds offer attractive income and resilience, while longer-duration sovereign bonds should retain their ability to diversify recessionary shocks, although they may provide less protection when inflation drives market volatility. In this new environment, capturing the opportunities offered by higher yields requires a more differentiated and nuanced approach to fixed income investing.

Figure 6. Cash and income are the main components of our forecast 10-year returns



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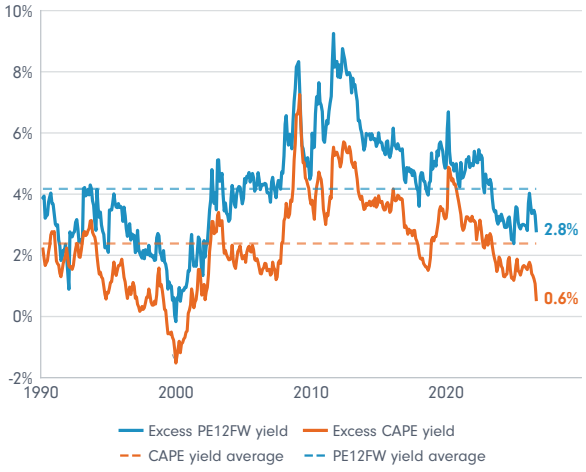
Source: Fidelity International, 30 September 2026.

Equities: higher rates, elevated valuations and AI transformation demand discipline and diversification

Equity markets have continued to advance since our previous update, even as government bond yields have risen and volatility has resurfaced. This divergence captures one of the central tensions facing investors: higher real rates are challenging valuations, while resilient corporate earnings and the AI revolution continue to support expectations of future growth. Understanding how these competing forces interact is central to our long-term equity assumptions.

A useful starting point is the relationship between equity valuations and real bond yields. We compare earnings yields, estimated using both the cyclically adjusted price-to-earnings (CAPE) ratio and 12-month forward earnings multiples, with real 10-year government yields. CAPE smooths cyclical earnings fluctuations but can be slow to capture structural changes in profitability, making forward multiples an important complement. This approach builds on the familiar Fed model, while recognising that real, rather than nominal, yields are the relevant comparator (Figure 7).

Figure 7. Excess yields of the US market: at current real bond yields, valuations can continue to grow (and earnings yields to contract) as long as risk appetite remains constructive



Source: Fidelity International, R. Shiller database, Bloomberg. Excess yields are defined as earnings yields (1/PE) minus real 10Y yield, where real 10Y yield is defined as in Shiller et al. (2021); PE12FW is the 12-month forward PE; CAPE is the Shiller PE.

Continued US multiple expansion is unlikely over the long term

In the US, both excess earnings-yield measures are below their post-1990 averages, suggesting that equities are expensive relative to bonds at prevailing real rates. Yet they remain above the extremes reached around the dot-com bubble. Valuations could therefore rise further while risk appetite remains constructive, but continued multiple expansion is a less plausible foundation for long-term return expectations.

Interest rates, however, are only part of the valuation equation. The discount rate investors apply to future earnings also includes an equity risk premium, which can dominate the effect of real yields. Indeed, higher real rates driven by stronger growth can coexist with rising valuations, whereas inflation uncertainty can depress valuations even when real rates fall. Our fair-value framework therefore combines forward-looking real interest rates with macro volatility, which we use as a proxy for the risk premium embedded in equity valuations.

Our estimates suggest that lower real rates and macroeconomic volatility than in the pre-1990 era have lifted equilibrium valuations, particularly in the US. Current valuations in some regions, especially the US, exceed these higher equilibria, although we do not see bubble-like conditions. Multiples in the euro area, UK and Japan are closer to equilibrium. We expect US valuations to normalise over time, potentially through earnings outpacing prices rather than an abrupt correction. The timing of this convergence remains key for tactical asset allocators.

Corporate fundamentals and AI - a nuanced picture

This shifts attention towards the more durable drivers of equity returns: revenue growth and profit margins. Lower corporate tax rates and financing costs have supported corporate profitability for decades, but since 2020 improvements across major markets have been driven primarily by expanding operating margins (Figure 8).

The rise of scalable, intangible-intensive businesses, stronger pricing power following the pandemic and greater discipline on costs and capital allocation have all contributed. Japan's shift towards greater price pass-through and shareholder returns has also been important, while higher rates have supported financial sector profitability in Europe and the UK. Unlike the largely exogenous tailwinds from lower taxes and interest rates, these improvements are more closely linked to company-specific factors, such as business models and operational efficiency, creating greater opportunities for

active managers to identify businesses with sustainable competitive advantages.

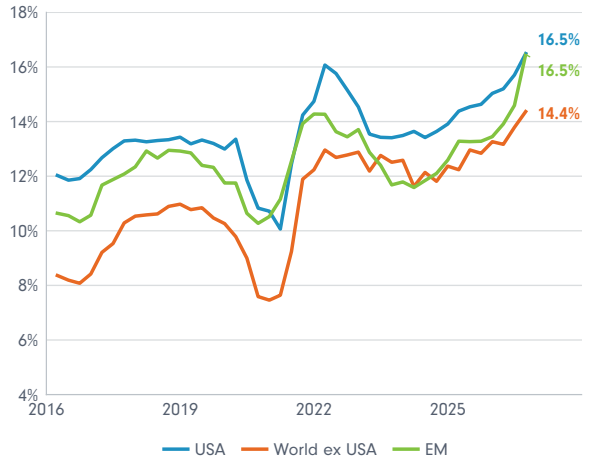
The AI revolution could extend these operating margin gains through automation, innovation and productivity improvements. Capturing those gains, however, requires substantial investment in computing capacity and energy infrastructure, bringing higher depreciation and financing costs as technology companies increasingly rely on debt. These costs can limit the improvement in net profits. Competition may further dilute the benefits by passing productivity gains to customers through lower prices, while higher wages or corporate taxes could absorb another share. Accounting choices around AI-related investment add further uncertainty to reported profitability.

The scale of this investment, concentrated heavily in data centres, also brings local infrastructure constraints into focus. As discussed in our recent AI research, aggregate resource availability can mask acute pressure on individual electricity grids and water systems where new capacity is concentrated. For the households and businesses sharing that infrastructure, the associated costs are becoming a growing concern. How spending on additional power, grid connections and water infrastructure is allocated therefore matters increasingly for project economics.

These affordability concerns gained further prominence during the US midterm elections on 3 November, as governors-elect in Texas, Ohio and Georgia campaigned on tighter controls or pauses in development. With all three states important centres of planned capacity, their policy choices now warrant close attention: temporary moratoria, stricter approvals or cancellations could delay projects and raise costs. While we expect AI adoption to continue, these constraints could lengthen payback periods and increase the returns required to justify new investment.

Longer payback periods, in turn, make it more important to assess return on investment (ROI) alongside the source of financing. Investments that earn more than their cost of capital can support shareholder value, but the funding mix matters more when those returns remain uncertain. Existing cash reserves provide flexibility to absorb delays, whereas debt adds interest and refinancing obligations before the benefits are established. Markets are likely to scrutinise that combination of uncertain returns and additional financial commitments more closely in a higher-for-longer rate environment, particularly where investment spending runs ahead of monetisation.

Figure 8. Global markets' operating margins are continuing to increase.

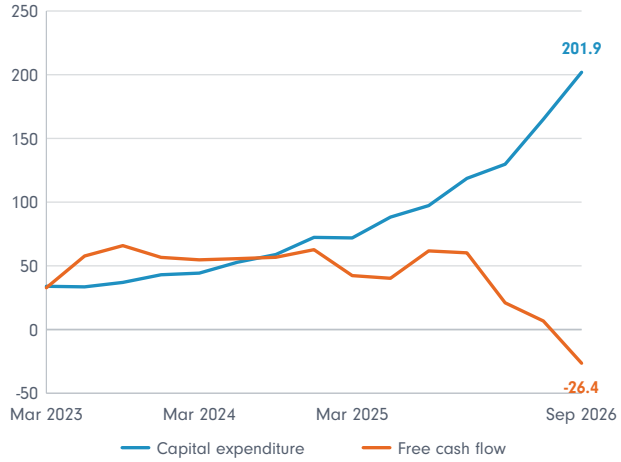


Source: Fidelity International, Bloomberg, 30 September 2026.

The financing question is becoming more pressing. In Q3 2026, Microsoft, Alphabet, Amazon and Meta reported aggregate capital expenditure of US$201.9bn, while quarterly free cash flow fell to minus US$26.4bn after a prolonged positive run (Figure 9). Investment therefore required funding beyond cash generated that quarter, making the persistence of this funding gap an important indicator to watch.

Figure 9. Big Tech capital spending is rising as free cash flow turns negative

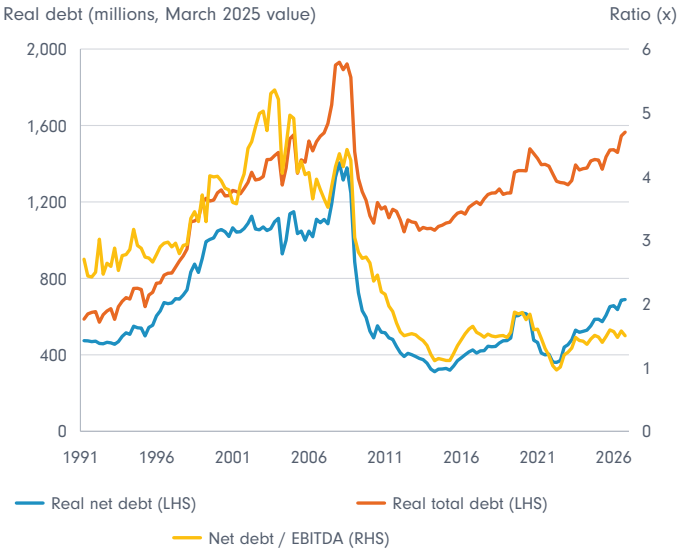
Quarterly, US$bn



Source: Fidelity International, Bloomberg, 2 November 2026. Microsoft, Alphabet, Amazon and Meta; quarterly data to September 2026.

Research: Fidelity International, Artificial Intelligence and the Global Economy, July 2026, p. 27.

Figure 10. Real value of debt and Net Debt / EBITDA of US large cap companies



Source: Fidelity International, Bloomberg. 30 September 2026.
US large-cap companies; debt expressed in real March 2025 terms.

For now, the substantial cash reserves accumulated by the largest technology companies provide flexibility to absorb these quarterly shortfalls. This resilience extends to the broader US large-cap market, where real net debt remains below pre-GFC peaks, despite rising from post-pandemic lows, and net debt/EBITDA is towards the lower end of its historical range (Figure 10).

The durability of this resilience will depend on how cash reserves and leverage evolve. Investors should therefore monitor the direction, speed and acceleration of those changes alongside monetisation, as markets can reprice a deteriorating funding mix well before debt reaches historically high levels.

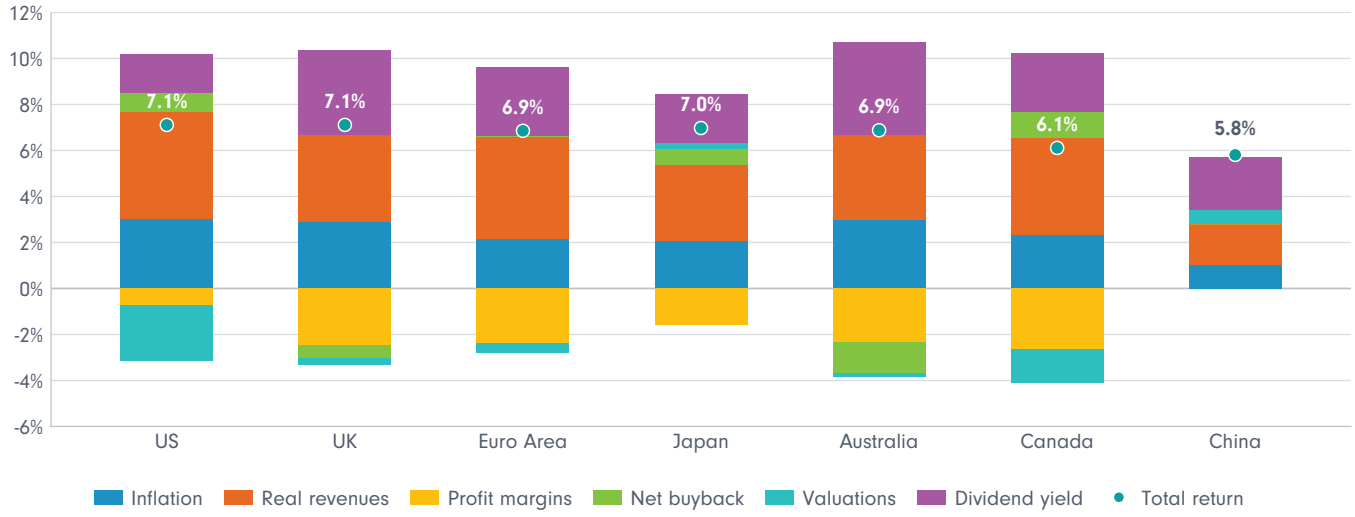
Balancing AI's productivity potential against these investment and financing demands, we assume a gradual positive contribution to margins. Alongside this, the productivity gains reflected in our long-term GDP assumptions should support corporate revenue growth, with the benefits varying across regions and industries.

Long-term equity returns still attractive

Bringing these assumptions together, our 10-year expected equity returns remain attractive across major markets, albeit below their historical averages (Figure 11). In the US, future returns depend increasingly on earnings growth as elevated valuations limit the scope for further multiple expansion. In the euro area, UK and Australia, dividends account for a larger share of expected returns. For more financials-oriented markets like Europe and the UK, the higher-rate environment is likely to improve revenue prospects relative to the post-GFC decade.

Overall, equities remain the principal source of long-term capital growth in strategic portfolios. However, higher interest rates and rapid technological change reinforce the importance of looking beyond traditional indices. Capturing the opportunities ahead will require diversification across regions and sectors, including both AI enablers and adopters, alongside a disciplined assessment of the corporate fundamentals underpinning valuations.

Figure 11. Attractive expected equity returns, although below historical averages.



For illustrative purposes only. Assumptions are based on proprietary modelling, reflecting the views of investment professionals at Fidelity International.

Source: Fidelity International, 30 September 2026.

Private assets: selectivity more important than ever

Private assets continue to offer attractive long-term returns for investors willing to accept illiquidity. However, higher financing costs and increasingly complex market structures are changing how those returns are generated, making manager selection and disciplined risk management more important than ever.

European real estate remains attractive, but persistently elevated long-term interest rates are reshaping return drivers. Income and rental growth, rather than significant yield compression, should increasingly underpin performance. Limited high-quality supply in selected markets supports occupancy and rental growth, while higher refinancing costs reinforce the importance of asset selection and active management.

AI introduces additional uncertainty. Demand from technology companies could support certain office markets, while automation may improve logistics efficiency. However, the longer-term implications for employment and occupier demand are uncertain, reinforcing the need for selectivity across sectors, locations and assets.

Elsewhere, we have revised our global private equity (buyout) long-term return expectations upwards, reflecting the same forces supporting public equities. Nevertheless, elevated borrowing costs, substantial dry powder and intense competition for quality assets present challenges. With less scope for returns driven by cheap leverage and multiple expansion, operational value creation, earnings growth and disciplined entry valuations will increasingly determine outcomes.

European direct lending continues to offer attractive carry and an illiquidity premium, although increased competition has narrowed its advantage over public credit. Higher debt-servicing costs underpin the importance of rigorous underwriting and borrower selection. Meanwhile, growing interconnections with banks, opaque valuations and layered leverage could amplify future stress, even if current fundamentals do not suggest an imminent broad-based dislocation. The expansion of complex AI-related financing adds another potential vulnerability to monitor.

Strategic asset allocation implications: a broader toolkit for diversification

Our efficient frontiers tell a story of opportunity tempered by uncertainty. Since April, higher starting yields have lifted bond return expectations, while stronger profit margins have improved our equity forecasts. Yet the market-cap-weighted frontier remains flatter than its historical counterpart (Figure 12), suggesting less incremental reward for taking additional risk.

The range of potential outcomes has also widened as inflation, geopolitics and AI reshape market relationships. Investment horizons matter too: our 10-year assumptions incorporate valuation and margin normalisation, whereas longer-term equilibrium expectations are driven more by structural macro forces, a distinction particularly relevant for pension funds and insurers.



Key questions for asset allocators

Could government yields rise further? Geopolitical tensions, fiscal pressures and higher term premia could push yields higher. However, sustaining substantially higher levels would likely require a different macro environment, as rising debt-servicing costs and weaker growth could eventually impose constraints.

Are bonds an opportunity today? Higher starting yields suggest more attractive long-term returns, even if timing the peak remains challenging. However, the journey could be volatile. Duration management remains important, while compressed credit spreads reinforce the case for issuer selection.

Can bonds still protect portfolios when equities fall? Much depends on the nature of the shock. Longer-duration sovereign bonds could continue to offer protection during recessions, but may struggle when inflation is the dominant risk. Shorter-duration bonds appear to offer an attractive combination of income and resilience.

Where else can investors find diversification? As traditional equity-bond relationships become less reliable, investors need a broader toolkit. Absolute-return and derivative strategies could provide differentiated protection, while selected private assets may broaden long-term opportunities for investors able to tolerate illiquidity.

What about gold? Modest allocations may help diversify geopolitical and monetary risks. However, volatility and lack of income warrant caution.

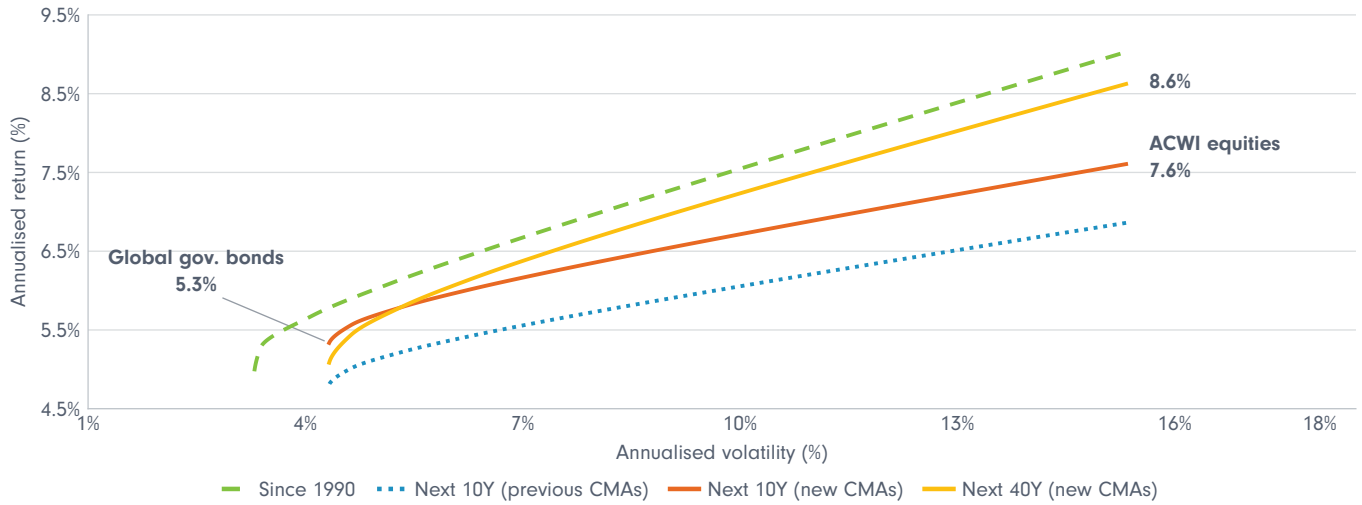
With equity valuations elevated, is it still worth investing? We believe equities should remain the main engine of long-term growth, although opportunities may increasingly extend beyond concentrated market leaders. Diversification across sectors and factors can help broaden opportunities and manage concentration risk. As AI adoption broadens, identifying businesses capable of translating productivity gains into sustainable earnings will become increasingly important.

Is the AI rally over? Our base case remains for a contribution from AI to growth that is positive and gradual, rather than explosive, given regulatory and other constraints. Broader adoption must deliver ROI that justifies spending. Market scrutiny could improve investment efficiency over the long term, although the transition will be volatile and costs, including data-centre construction, could exceed expectations.

Could higher US yields change the dollar outlook? Higher US yields point to a more balanced dollar outlook, warranting caution over further depreciation. Over the longer term, we do not expect the dollar to provide the strong return tailwind seen in the previous decade.

Ultimately, the principles of long-term investing remain unchanged, but implementation practices need to evolve. Successfully navigating this environment calls for a research-driven approach that combines an understanding of macro forces with rigorous analysis of underlying fundamentals.

Figure 12. Flatter market-cap-based efficient frontier over the next 10 years compared with history.



For illustrative purposes only. CMAs are expressed in USD. Assumptions are based on proprietary modelling, reflecting the views of investment professionals at Fidelity International.

Source: Fidelity International, 30 September 2026.

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