For professional clients and qualified investors only. Capital at risk.

Global outlook 2027

AI's next chapter



Foreword

With markets looking increasingly fragile, we examine the biggest forces set to shape the investment landscape next year.



Emiel van den Heiligenberg
Global Chief Investment Officer

As we head into 2027, AI unsurprisingly remains the dominant investment story. But the debate has shifted markedly in the months since our midyear global outlook.

Investors are asking less about the scale of the opportunity and more about its sustainability, as tech groups turn to cash to fund the build-out of data centres on a vast scale.

So far, the economic backdrop remains supportive. Global growth has proved resilient, supported by these multi-trillion-dollar capex plans, while labour markets remain relatively steady.

Mounting questions

Yet there is a growing sense that markets are on shaky ground. Investors must navigate the collision of higher interest rates with simmering geopolitical tensions, particularly in the Middle East, and turbulent domestic politics.

Add mounting questions over fiscal sustainability, brought into sharp relief recently by France, and the potential for a dramatic readjustment in the investment landscape is clear.

Within this outlook, we assess how these issues might play out and affect our clients' assets. Key takeaways include:

- Policy responses and energy constraints may dominate AI's next phase, especially in light of the US midterms
- Higher-for-longer rates are becoming a truly global story
- Decarbonisation holds the key to energy security, in our view

We also discuss the risks to global growth, how retail investors are reshaping markets, the next chapters for defined contribution and defined benefit pensions, and five possible investment surprises in 2027.

Are we in a bubble?

One of the most frequent questions I receive from clients is whether we are in an AI-driven bubble.

Readers of our blog will know I have long viewed bubbles through frameworks developed by Kindleberger and Minsky. Our own Bubble Index builds on that thinking, looking across five areas: credit expansion, macroeconomic conditions and disruptive change, speculative behaviour, valuations, and patterns in asset-price performance.

Assumptions, opinions, and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.



The first two flash warning signs today. But the other three suggest to me that we are not yet in bubble territory.

Sentiment indicators do not suggest widespread investor euphoria, most hyperscalers have de-rated – in some cases significantly – and non-profitable tech companies have recently underperformed.

AI and the liberation of the investor

Another, related question I hear frequently is: how are we using AI within L&G's Asset Management business?

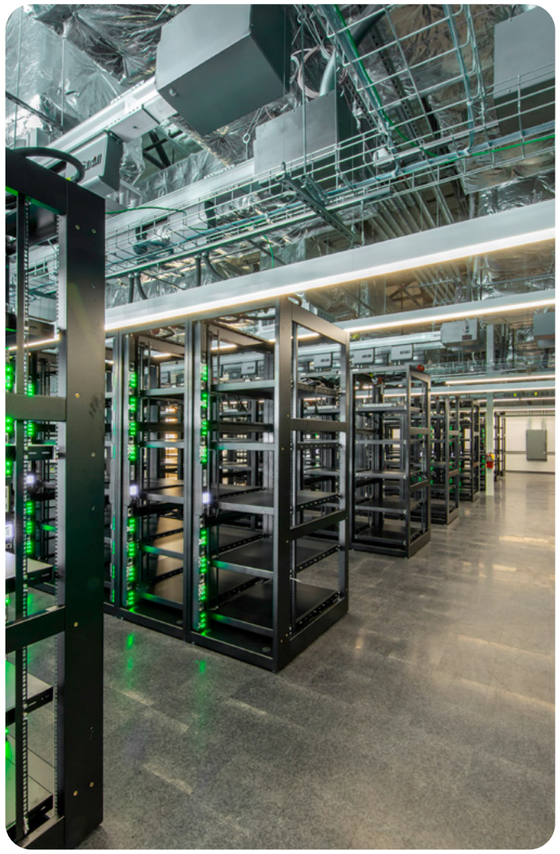
In short, the technology is transforming how we invest – freeing us from gathering and processing information, allowing us to spend more time on testing, challenging and applying judgement.

To make the most of this opportunity, and manage the inherent risks, we have rolled out a Global Toolkit for Investments (GTI)*, which comprises three interconnected "factories".

- **Data:** to make information easier to find and use
- **Software:** to build tools around real investment problems
- **Knowledge:** to connect our research and insights

Interestingly, we are seeing a blurring of traditional roles: investment professionals build technology around their own expertise, while software engineers working alongside them acquire a deeper understanding of markets.

These capabilities are ultimately aimed at helping us make better-informed decisions on behalf of our clients – and to chart a course through the complex market environment we explore over the coming pages.



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*The GTI is currently available (to different extents) within all investment teams globally. The intention is to expand the use of GTI over time to create a global, Investments-led technology toolkit to unify, modernise and scale investment management capabilities.

Economics

Still standing

Global growth has shrugged off an energy shock. Higher rates, fiscal strains and questions over the AI boom are likely to test its resilience.



Tim Drayson
Head of Economics

Considering the surge in energy prices, global growth has proven remarkably resilient in 2026.

This reflects in part AI investment spending, from which the US is benefiting the most and remains a relative winner – with real GDP growth expected to be just above 2%.

Indeed, consensus growth forecasts for 2027 have changed little in recent months and anticipate a similar pace of growth to continue even as inflation and interest rates have ratcheted higher.

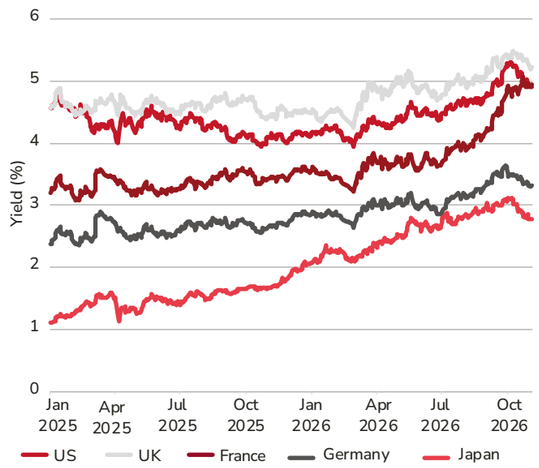
Europe is lagging, with real GDP unlikely to exceed much more than 1%. This is primarily due to its exposure to surging natural gas prices and lack of large-scale fiscal support to cushion the real income squeeze from rising utility bills.

China's growth is on track to hit its target, helped by government support and despite property weakness. Unemployment rates across the world generally appear steady, at close to full employment, with very limited signs of AI disruption at this stage.

What could go wrong?

Growth risks are relatively balanced. Further rises in energy prices could contribute to a broader inflation shock. The French presidential election, whose first round is in April 2027, adds to sovereign debt concerns. These could be amplified by an energy price shock and spillover into the European periphery.

Ten-year government bond yields



Source: Bloomberg as at 3 November 2026.

Past performance is not a guide to the future. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, and the investor may get back less than the original amount invested.

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There are also signs the market is beginning to reassess cash flow expectations from AI investment. The latest earnings reports from the hyperscalers revised up, once again, plans for such spending.

While this is supportive for growth in the near term, the large volume of AI debt issuance to fund the investment could lead to wider credit spreads and undermine equity prices. This could weigh on old economy investment and derail a consumer which has been supported by positive wealth effects.

Given the increasing size of equities in US household balance sheets, there is probably a greater sensitivity to any given percentage point decline in equity markets. Every era is marked by geopolitical uncertainty, but pressure on living standards has the potential to trigger social unrest, unexpected political responses and election results.

The bull case

There are also upside risks to growth:

- A resolution to the disruption in the Strait of Hormuz could lead to a rapid reversal in energy prices, supporting household real incomes
- Asset prices could renew their ascent on optimism and realisation of the productivity gains from AI adoption
- Central banks may deliver fewer rate hikes than the market currently expects, especially in the UK

The last of these looks most likely to us, as at the time of writing. While the world's monetary guardians must balance a multitude of factors, there is less pent-up demand to sustain growth than during the inflation shock of 2022, and more labour market slack. This should limit second-round effects on wages and more persistent inflation.

Portfolio perspectives – putting the ideas into practice

Regional equity exposure – Index and active strategies focused on specific geographies

Duration opportunities – Unconstrained bond strategies; short-duration bond strategies

Diversified approaches to AI – Thematic ETFs that aim to provide targeted yet diversified exposure

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AI

The next phase of AI

Artificial intelligence has spent the past several years primarily as a technology and investment story. In 2027 it may be defined more by energy constraints, policy responses and geopolitics.



Jason Shoup
Co-head of Fixed Income, L&G Asset Management, and CIO, L&G - Asset Management, America



Matthew Rodger
Economist

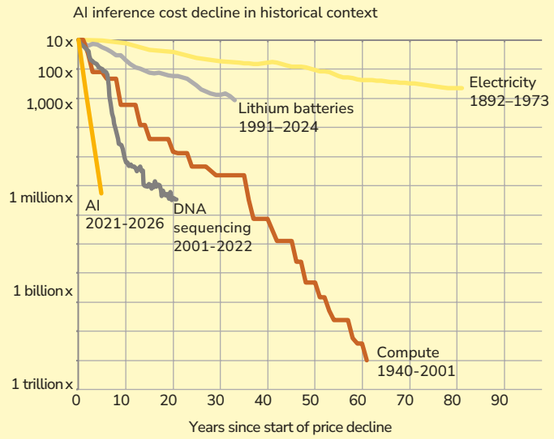


Matteo Colombo
Head of Digital Infrastructure Investments

As the AI boom reaches its fifth year, investors continue to wrestle with whether AI warrants cloud providers' colossal capital spending and whether current valuations reflect realistic revenue projections or excessive optimism. Even five years on, the pace of AI-related improvement shows no signs of slowing. As AI breaks out from niche appeal to wider distribution, its implications are being felt more broadly. This means the next phase of the AI cycle may be determined increasingly by forces outside the technology itself. AI's capabilities may continue to advance rapidly, but its trajectory will increasingly depend on whether the industry can secure sufficient energy, retain political support, navigate geopolitical competition and finance its expanding physical footprint.



AI's pace of improvement appears faster than that of past technologies



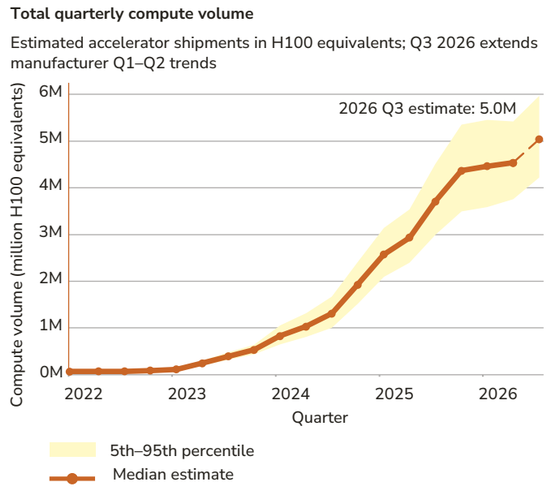
Source: Epoch AI, as at 22 October 2026.

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Much of the boom has played out in infrastructure. Chipmakers and power providers have seen substantial increases in volumes and prices as firms race to deploy servers that sustain AI models. Epoch.AI estimates that AI-driven computation volume has expanded roughly five-million-fold since 2022. AI-assisted programming is becoming the norm, and agents capable of multi-step digital tasks are proliferating.

Cloud demand, as opposed to AI demand, still underpins infrastructure demand, making up almost two-thirds of demand and growing at a 23% compound annual growth rate that jumps to 40% + when AI-related demand is included, according to Epoch.AI. Sceptics have expressed fears of overbuilding, but usage has surged, and constrained supply cannot keep up with cloud, let alone AI, demand. Physical buildout of infrastructure takes time: typically five-10 years to bring new infrastructure online. As a result, infrastructure vacancy rates are at record lows.

AI-driven computation volume has expanded roughly five-million-fold since 2022



Source: Epoch AI, as at 22 October 2026.

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Hitting limits

AI deployment is rubbing up against other constraints as well. Power, both supply and transmission, is proving to be a large bottleneck. As data centres expand in size, the volume of power they need has swelled, straining the grid's ability to supply them. Financial conditions are also tightening worldwide. Higher interest rates are forcing companies into more elaborate financing structures to sustain their capital spending.

The buildout is generating political and geopolitical frictions too, as public anxiety about AI's consequences rises. Many localities within the US are opposed to the ongoing deployment and are seeking to halt construction where they can and make approval for new infrastructure more difficult, raising project costs and timelines. Democrat victories in key gubernatorial midterm contests raise the prospect of political brakes being applied to at least some data centre development. However, at the same time, support for the AI infrastructure buildout crosses party lines. The previous Democratic administration also sought to accelerate construction, while Democrat-led states have actively attracted hyperscaler investment. The political debate is more about how to build than whether to build. Both political parties in the US want their country to lead China in the AI race, creating pressure to accelerate chip production, data-centre construction, permitting and access to energy, though they can't ignore the domestic costs of that race.

At the same time, AI capabilities now extend to levels previously only available to national governments. Frontier AI models can now be used to orchestrate mass cyber-attacks and could be used in the future to design novel pathogens or weapon systems. The key question is where and when these frictions and anxieties begin to constrain the AI investment cycle, alter the supply outlook and change the compensation required for AI-linked risk. As constraints mount, pressure for AI to produce substantial financial and societal returns could impede its rapid growth.



Nothing lasts forever?

Ultimately, the future of the AI buildout becomes a financing question. It increasingly depends on public bonds, securitised debt, private capital and hybrid structures. This year has shown that with risk-free yields elevated and AI deals receiving a choppier reception, capital is not unlimited. Equity and IPO funding can strengthen the cushion beneath creditors, but safety, political and return-on-investment concerns could undermine valuations.

These constraints underlie the risk of a wider unwind in both market sentiment and financing, similar to the end of the dot-com bubble. Indeed, research from the Bank for International Settlements finds the current boom could produce overcapacity, as happened during the server and fibre optic cable boom in the early 2000s. However, back then, new infrastructure was built speculatively. Today, most new infrastructure is being built to order, with demand exceeding supply and data centre development yields and capitalisation rates remaining strong and stable over the last several years despite cost inflation, according to Green Street and Citi Research.

Such cycles can run for years before correcting, and an end would require that supply starts outstripping demand. For now, supply constraints look likely to only further exacerbate the strength of infrastructure demand. In our view, ultimately there will be winners and losers within the AI ecosystem and a correction in spending or valuations would not invalidate the technology. From our perspective, AI success does not depend on any single company or application.



Portfolio impacts

For portfolios, this backdrop argues against treating AI as a binary bet. The technology may continue to diffuse even as returns migrate between model developers, chipmakers, cloud providers, power companies and users. The next phase of the buildout is likely to bring more differentiation among firms, particularly around exposure to political or infrastructure constraints.

Against this backdrop, we believe it's important to distinguish exposure to adoption from exposure to today's valuations, to favour firms with strong balance sheets and demonstrable revenue, and to diversify across both infrastructure providers and businesses using AI to raise productivity. The boom may have further to run, but the eventual winners will not necessarily be those spending the most today.

Portfolio perspectives – putting the ideas into practice

Diversified approaches to AI – Thematic ETFs that aim to provide targeted yet diversified exposure

Digital meets the real world – Specialist infrastructure strategies can aim to provide exposure to digital growth

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Rates

Higher for longer 2.0

Higher for longer is becoming a global story, as higher yields interact with different monetary, fiscal and debt dynamics across the US, Europe and emerging markets.



Anthony Woodside
Head of Multi-Sector Fixed Income & Investment Strategy, L&G - Asset Management, America



Simon Bell
Fund Manager



Raza Agha
Head of Emerging Market Sovereign Strategy

Higher for longer is taking on a new meaning. While investors debate how far the US Federal Reserve's renewed hiking cycle could extend, rising rates and global bond yields are also increasing pressure elsewhere, particularly where debt-servicing costs and fiscal dynamics are already challenging.

From the path of US monetary policy and sovereign debt stress in France to growing differentiation across emerging markets, the question is increasingly where higher yields could expose vulnerabilities, and what that means for global fixed income investors.

Is the Fed pricing too much, too soon?

Coming into the year, the market was pricing around 50bps of cumulative easing for 2026. The Middle East conflict, the scale of AI capex and stalled progress towards the 2% inflation target led the market to price in almost 100bps of hikes over the next 12 months.

Yet while inflationary pressures remain stronger than policymakers would like, we see evidence that core inflation has probably peaked. And while inflation expectations have moved modestly higher since the Iran war began, real yields have accounted for more than 90% of the increase in 10-year yields (see overleaf chart).

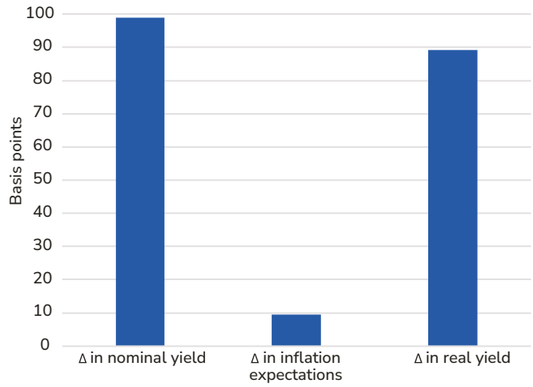
The impact of higher rates and energy prices on the economy is also still to filter through. This time, the consumer does not have tax cuts or as high a saving rate to fall back on to sustain consumption growth.

Following September's 25bps hike, the market is pricing in around a further 80bps of tightening over the next 12 months. We believe risks are skewed towards the Fed delivering less than this, with the tightening cycle likely to be limited to reversing the insurance cuts of 2025. Consequently, we have turned more constructive on the short and intermediate parts of the US yield curve.

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Drivers of rising US 10-year Treasury yields since end-February



Source: Bloomberg, as of 30 October 2026

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From monetary policy to sovereign stress

But central bank policy is only one part of the higher-for-longer debate. The rise in global bond yields is also putting pressure on sovereigns, particularly where fiscal challenges were already evident.

France is a case in point. Its long-term fiscal challenges are well known, but the latest widening in French government bond spreads was not triggered by a new political shock. Rather, rising global bond yields and higher debt-servicing costs have made an existing fiscal challenge harder to resolve. At current yields and across a wide range of plausible growth outcomes, the fiscal tightening required merely to stabilise debt-to-GDP is exceptionally large.

The question is increasingly whether France remains a chronic fiscal challenge that markets can absorb or evolves into a more acute concern. Higher rates, weaker growth or renewed energy price pressures could accelerate the move from a future problem to a present one.

And this is not simply a French issue. Other sovereign spreads have also started to rise, while, as the second-largest economy in Europe, France is too big to ignore. Recent European Central Bank (ECB) communications have taken a more dovish tone, suggesting it sees the balance shifting from a pure inflation shock towards increasing growth risks. This is likely to temper European yield rises relative to others should the move continue, although it does not guarantee lower yields. Sovereign stress could also make incremental ECB rate hikes increasingly difficult, reinforcing the potential for divergence between European and US rates.

For our active global aggregate portfolios, this environment highlights the potential benefits of bringing rates and credit decisions together within an integrated investment process. Our approach draws on multiple sources of alpha across rates and credit, with allocation, duration and individual opportunities considered together alongside their correlations at the portfolio level.

The asymmetric risks around France have also led us to introduce French curve flattener trades against Germany, reflecting our view that France itself may become a constraint on how far European yields can rise. These positions may change and are not recommendations for individual investors.

Emerging markets: stronger foundations, greater differentiation

Higher global yields are also creating a more challenging backdrop for emerging markets (EM), but the recent repricing looks more like a global rotation towards quality than an EM-specific deterioration.

Higher and more volatile US rates, a stronger dollar, elevated oil prices and weaker risk sentiment have driven EM spreads wider. Yet market access remains broadly intact, while foreign-exchange reserves remain close to record levels and sovereign rating momentum continues to be positive. At the same time, the capacity to absorb shocks varies considerably across countries as higher financing and energy costs test fiscal and external positions.

Importantly, quality does not simply mean investment grade. In EM, we think about quality in fundamental terms: credible policymaking, improving fiscal and external balances, adequate reserves and a sustainable path for debt. That can include high-yield sovereigns where reforms are strengthening creditworthiness and creating positive ratings momentum.

For our EMD portfolios, stronger fundamentals therefore do not mean buying EM indiscriminately. In our view, the opportunity increasingly falls into three themes: reform credibility, stronger external buffers and looking beyond sovereign debt.

Ultimately, the opportunity in EM is increasingly about relative value rather than broad beta. As markets mature, the investment decision is shifting from simply which country to own towards which combination of issuer, sector, capital structure and maturity offers the most attractive risk-adjusted expression of that view.

Portfolio perspectives – putting the ideas into practice

Rates and inflation views – Global rates strategies and global aggregate strategies; direct lending strategies

Regional EM exposure – EMD and equity strategies, accessed via both active and index options

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Energy security

The energy security premium: how decarbonisation can deliver resilience

Decarbonisation may strengthen energy security by reducing dependence on imported fossil fuels. However, outcomes will depend on infrastructure investment, system flexibility, technology availability and supply-chain resilience.



Nick Stansbury
Head of Climate Solutions

Dr. James Tyrell
Infrastructure Research Manager



David Barron
Global Head of Index and ETFs, L&G - Asset Management, America

Geopolitical shocks have brought energy security back to the forefront of government and investor attention.

Traditionally, energy security has meant securing access to globally traded hydrocarbons. But disruption to oil and liquefied natural gas (LNG) markets has exposed the vulnerabilities inherent in that model, particularly for countries reliant on imported fuels.

Regional conflicts and logistical bottlenecks can rapidly feed through into higher prices, electricity bills and pressure on energy-intensive industries. Replacing one overseas hydrocarbon supplier with another may diversify the source of supply, but it does not remove exposure to volatile international markets.

In an increasingly fragmented global economy, energy security therefore requires a broader consideration of how energy is produced, transported and consumed.



The limitations of gas

Natural gas has played an important role in this debate. Over the past decade, it has often been characterised as a "bridge fuel", offering a dependable source of power as economies build lower-carbon energy systems.

Yet recent geopolitical events have also demonstrated the exposure of international gas markets to severe price movements. As a result, we've seen that countries not dependent on natural gas (Spain, for example) have shown greater energy resilience than those countries exposed to gas price swings. Gas may remain important in balancing power systems during the transition, but continued reliance on internationally traded hydrocarbons leaves economies exposed to many of the geopolitical risks they are seeking to manage.

Decarbonisation potentially offers a structural response. Renewable energy resources can be developed domestically and, once the infrastructure is in place, do not require a continuous supply of imported fuel. Energy security and decarbonisation can therefore increasingly reinforce one another.

Electrification changes the demand side

The transition is also taking place on the demand side of the energy system. Electric vehicle sales across Europe and Asia are growing strongly,[1] contributing to a longer-term shift away from liquid fuels in transport. More broadly, electrification offers economies a way to reduce hydrocarbon dependence across areas including transport, heating and industry.

The scale of that ambition is significant. The European Commission's Electrification Action Plan sets an indicative ambition to increase electricity's share of final energy consumption from 23% today to 46% by 2040.[2] That potentially expands the investment opportunity beyond clean-energy generation to the technologies and infrastructure required to accommodate growing electricity demand.

AI and data centres add another dimension. The growth of AI could strengthen the link between electricity use and GDP because AI infrastructure relies heavily on electricity, which can be generated from a diverse mix of domestic, renewable and nuclear sources, reducing economies' reliance on imported oil and gas and potentially improving energy security. At the same time, AI may improve efficiency across grids, manufacturing and logistics. Growing computing requirements also strengthen the need for reliable power systems and the infrastructure needed to support them.



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1. https://www.iea.org/reports/global-ev-outlook-2026/trends-in-electric-cars
2. https://energy.ec.europa.eu/topics/eus-energy-system/electrification_en

From generating power to building the system around it

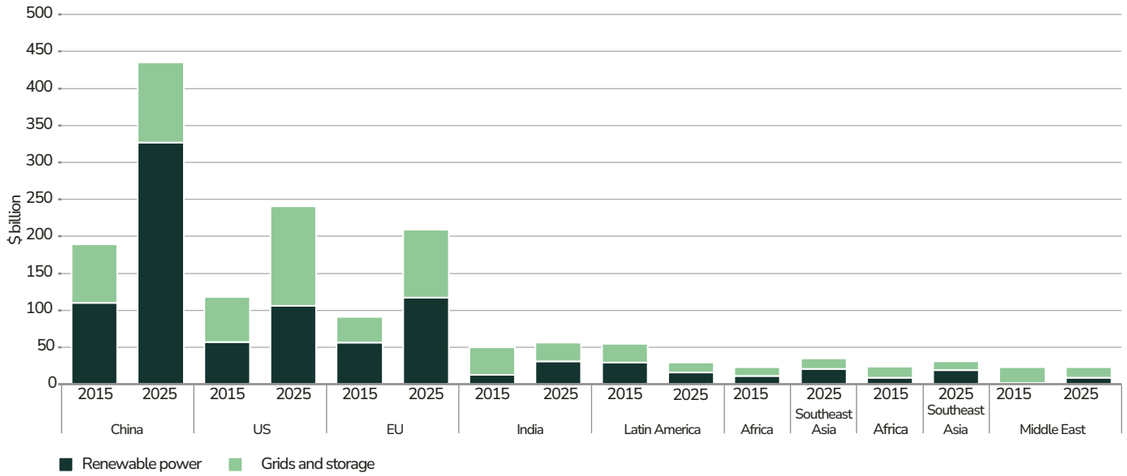
As electricity becomes more important to economies, the investment requirements of the transition are evolving. Renewable generation has represented an early response to both decarbonisation and energy-security concerns. As renewable penetration grows, however, variability in when electricity is generated can contribute to power-price volatility.

That creates a subsequent requirement for batteries, networks and other technologies capable of balancing supply and demand. Storage can move electricity between periods of abundance and scarcity, while grid investment can help manage congestion and connect new sources of generation and demand. Digitalised grids, automation, advanced sensors and demand-response technologies can provide further flexibility.

This progression from generation towards storage, networks and flexibility broadens the investable opportunity. It also reflects the ultimate objective of energy security: a power system that can meet growing electricity demand reliably while reducing dependence on imported fossil fuels.

There are new dependencies to consider. Clean-energy supply chains are themselves concentrated, with much of the world dependent on China for solar panels, batteries and power-electronics components. Diversifying manufacturing and supply chains is therefore becoming another element of energy security.

Energy investment across renewable power and grids/storage, 2015 and 2025



Source: IEA analysis, 2025.

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Investing across the transition

For investors, this argues for considering energy security as a system rather than looking for a single technological winner. The opportunity spans renewable generation such as wind and solar, equipment manufacturers, low-carbon hydrogen, electricity networks and smart-grid technologies, alongside battery storage and the wider battery value chain.

The precise opportunities differ across public and private markets. Within infrastructure, for example, the benefits of changing power prices depend on factors including location, technology, contracting arrangements and generation profile. Public-market strategies can potentially provide diversified exposure across different parts of the clean-energy and electrification value chains.

Ultimately, the investment case extends beyond any individual geopolitical crisis or commodity-price cycle. Electrification is increasing the importance of electricity to transport, industry and the digital economy, while renewable penetration is creating additional requirements for storage and networks.

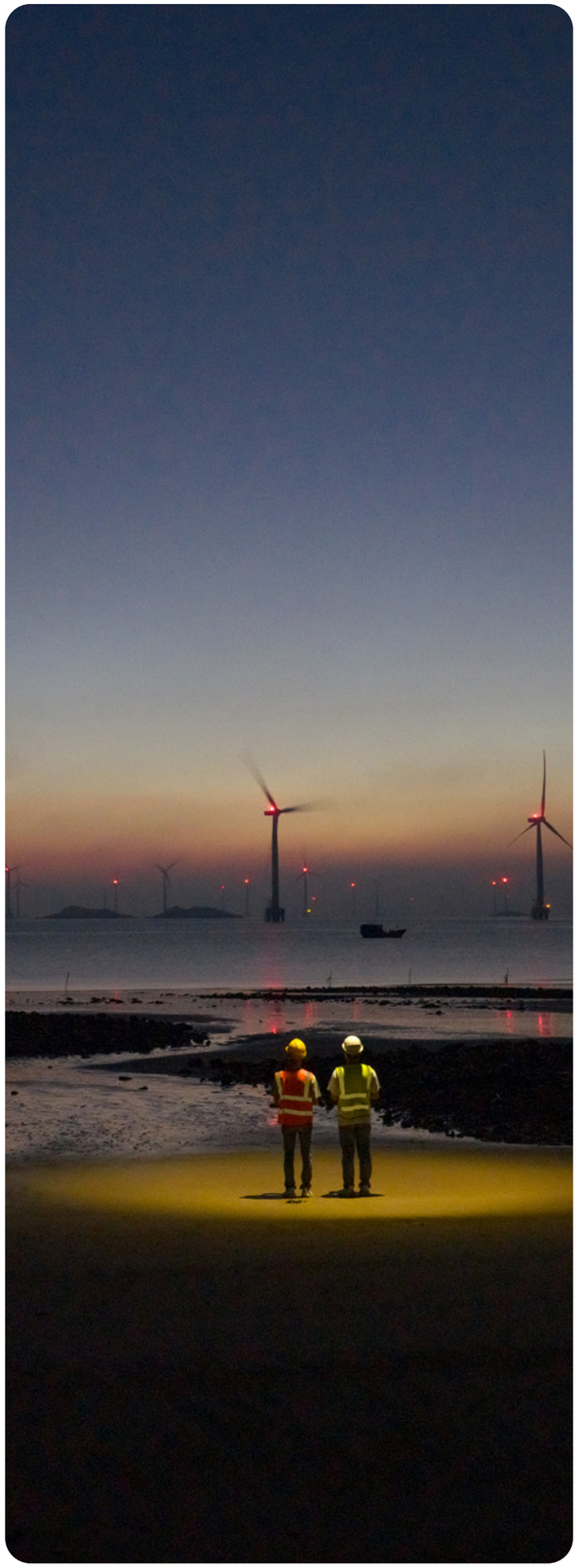
For investors seeking exposure to energy security, a diversified approach across these interconnected areas may therefore offer a way to participate in the longer-term reshaping of the global energy system.

Portfolio perspectives – putting the ideas into practice

Diversified clean energy exposure – Thematic ETFs that aim to provide focused yet diversified exposure; private markets funds targeting energy transition themes

Clean energy infrastructure opportunities – Clean energy infrastructure strategies may provide exposure to long-term energy transition themes. However, investments may be subject to liquidity constraints, valuation uncertainty, regulatory changes and project-specific risks. Daily dealing does not eliminate underlying asset liquidity risk.

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DC

Accumulation into decumulation: solving for retirement income

As DC matures and members move from accumulation to decumulation, the challenge is to help turn savings into sustainable, flexible retirement income.



Lesley-Ann Morgan
Global Head of DC

Jayesh Patel
Head of UK DC Distribution



If accumulation has defined the development of Defined Contribution (DC) to date, retirement income could define its next chapter.

In 2027, we expect greater focus on how policymakers, pension providers and the investment industry can help members turn a lifetime of saving into a sustainable retirement income.

Retirement is not simply accumulation in reverse. Once withdrawals begin, the sequencing of investment returns becomes critical. Market falls early in retirement, combined with withdrawals (especially if they are large), may have a lasting impact on the value of a member's savings and the income they can sustain. Inflation and longevity add further uncertainty, making the investment challenge, and indeed member understanding, increasingly complex.

During accumulation, DC savers can generally tolerate more short-term volatility in pursuit of long-term growth. In decumulation, the balance shifts: investments must continue generating returns while supporting withdrawals and retaining sufficient liquidity.

The challenge is to develop solutions that help members turn their pension savings into an income in a way that is easier to understand and manage. For some, the priority may be generating a sustainable income over the longer term while keeping part of their pension invested. For others, it may be accessing their savings more flexibly over a shorter period – but not cashing out in one go potentially due to tax reasons – to bridge the gap until their State Pension or a defined benefit pension begins.

These needs call for different approaches. Someone seeking an income over several decades may require a different investment and withdrawal framework from someone funding a shorter transition into retirement. Solutions should therefore provide flexibility where it is needed, while helping members understand the implications of their choices and how their income may need to adapt over time.

Portfolio perspectives – putting the ideas into practice

New products - Long-term and short-term drawdown solutions

Supporting retirement outcomes - Solutions designed using combinations of diversified return drivers and income sources, appropriate protection and flexibility to maximise returns, while considering longevity, sequencing, behavioural, market and other risks to support member outcomes.

International DC markets illustrate the challenge of designing for retirement. In the US, people predominantly withdraw from their account or leave it invested, although we are starting to see some in-plan retirement-income solutions emerging. In Australia, the Retirement Income Covenant came into force in July 2022 to encourage trustees to provide better solutions for retirees; while there has been some innovation, it is widely accepted that evidencing tangible improvements for retirees has been slow.

While there are interesting things to glean from other markets, we have to recognise the regulation, tax regime and indeed member behaviours and aspirations are not necessarily the same.

In the UK, the direction of travel is towards a broader retirement-income ecosystem, where drawdown, annuities and newer approaches offer different combinations of flexibility, certainty and investment exposure.

The accumulation era demonstrated the power of defaults, diversification and scale. The next phase of DC investment must retain those strengths while connecting fund design more closely to the income members ultimately need.

It should be noted that diversification is no guarantee against a loss in a declining market.



Prepare, don't predict

Five potential market surprises in 2027

We can't predict the next market surprise, but we can prepare for it. From US Treasuries to artificial intelligence, credit and real estate, here are five scenarios that could challenge some of the market's assumptions in 2027.



Chris Jeffery
Head of Macro, Co-Head of Asset Allocation

Bill Page
Head of Real Estate Research



Jason Becker
Head of US Credit Strategy and Senior Portfolio Manager



Dan Dreher
Solutions Strategist

US Treasury market reckoning

Since the middle of 2026, the market has started to fret about the French public debt trajectory. Despite very similar debt dynamics, the US government has escaped similar attention.

At prevailing interest rates, the size of the fiscal adjustment needed to stabilise debt/GDP is enormous. We conservatively estimate that the US needs to shrink its deficit by 5% of GDP over the course of a decade. Across the major advanced economies, that kind of discipline has only been seen four times in the last 45 years (see table below). Debt investors think that is merely implausible. If political developments make it appear impossible, then trouble could loom for the Treasury market. Alternative perceived safe-haven assets may be the beneficiary if the 'full faith and credit' of the US government is questioned.

Large and sustained fiscal adjustments

	Start of adjustment period	End of adjustment period	Change in deficit*
Sweden	1993	2006	10.50%
Canada	1981	2001	9.70%
Italy	1988	2000	8.20%
Spain	2008	2020	7.10%

*Change in the cyclically-adjusted primary fiscal balance as a share of GDP

Source: IMF WEO database (1980-2026). Universe consists of G7 countries plus Sweden, Australia and Spain. The table shows all episodes of fiscal adjustment of at least 5% of GDP.

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Aggressive growth asset rotation

The artificial intelligence (AI) trade has dominated global equity markets since the commercial launch of large language models (LLMs) in late-2022. The size of the capex build-up relative to GDP now rivals previous historical booms (see table below). There is no inevitability that it ends in an equivalent bust, but concerns about that scenario are building.

A rotation into the parts of the risk asset spectrum that have lagged behind the AI winners is likely at some stage. The potential surprise for 2027 is that rotation could happen in a relatively benign way as the AI ecosystem matures and earnings growth elsewhere continues to broaden. As well as benefiting non-US equities, that adjustment may be positive for mid-risk assets whose merits have paled in comparison with the rapid growth offered in the AI infrastructure buildout.

Historical booms

Capex boom	Geography	Peak date	Peak annual capex / GDP
Canals	US	1840	1%
Railways	UK	1848	7%
Electrification	US	1928	1%
Telecoms	US	2000	1%
AI infrastructure	US	**2027E**	**3-4%**

Source: H. Jerome Cranmer (1960), Canal Investment, 1815–1860, NBER/ Princeton University Press; MeasuringWorth; National Electric Light Association, Statistical Bulletin; FocusEconomics (2025), Railway Mania; Epoch AI (2026); L&G calculations. Figures are approximate and definitions are not fully comparable across episodes. 2027 AI figures are bottom-up consensus forecasts across the largest listed corporates.

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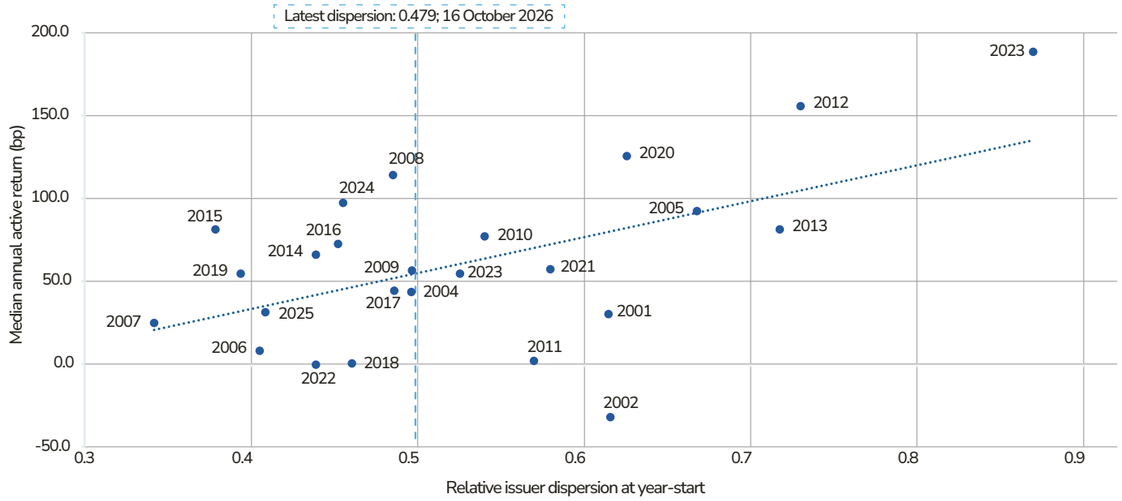
Quiet fragmentation returns to credit markets

Tight headline spreads are masking an increasingly differentiated credit landscape, a development that may catch markets off guard in 2027. Issuer dispersion has risen meaningfully since the start of 2026, even as aggregate spreads remain historically tight. Over the last 25 years, within-sector issuer dispersion has accounted for almost one-third of the year-to-year variation in median active manager alpha, highlighting that security selection can add meaningful value without requiring a directional call on overall spreads.

With so much of the market's recent attention tied to AI, it would be easy to assume AI is also driving a rise in dispersion. Yet, even excluding US hyperscalers, relative issuer dispersion remains elevated. Indeed, dispersion now sits in the top quintile across Communications, Autos, Retailers and Financials ex-Banks, suggesting that the real surprise for 2027 may be how much hidden complexity lies beneath the surface of credit markets.



Issuer dispersion and manager outperformance: US corporate investment grade, 2001-2025



Source: Nasdaq eVestment, Bloomberg and L&G calculations as at 16 October 2026.

Past performance is not a guide to the future. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, and the investor may get back less than the original amount invested.

Complexity, not credit risk, commands the premium

The surprise in investment-grade private credit may be that some of its potentially more attractive opportunities come not from taking more credit risk, but from being paid to navigate complexity and move quickly. We believe a financing with bespoke collateral, uncertain funding dates or an accelerated timetable can offer compelling relative value because few investors have the sourcing reach, underwriting resources and governance needed to execute it.

This opportunity is not confined to unfamiliar borrowers or thinly held names. Mars* financed its Kellanova* acquisition with a $26 billion Rule 144A/Regulation S bond alongside a $1 billion private placement, selecting different markets for different parts of the same capital need.[3] Chip financing provides a more complex example. Equipment may be delivered through multiple draws over a shifting schedule, potentially making upfront public issuance inefficient and creating negative carry before the assets begin generating revenue. Private investors can commit around those delivery dates; once funded and standardised, the notes may become DTC-eligible and resalable to qualified institutional buyers under Rule 144A.[4]

The counterintuitive point is that investors may not need to move further down the credit spectrum to potentially find attractive relative value. Instead, the premium may come from accepting complexity that others are unable or unwilling to navigate. Capturing that premium requires the ability to compare relative value across financing channels and determine whether additional spread adequately compensates for structural and execution risk.

In real estate, income resilience defies rate volatility

Real estate investors can perhaps spend too long trying to forecast market interest rates and hence property yields. These are important drivers of required and realised returns, but cannot be controlled.

What can be controlled, and is fairly unique to real estate, is income creation. Despite persistent rate pressure, it's possible to capture income by choosing markets where supply is tight and demand is predictable in addition to the sectors most likely to be in demand across cycles. Income creation can be driven by asset-level risk and operation. For instance, providing excellent occupier experience while preserving operational income is important; but improvements in technology, skills and experience will differentiate asset performance. With such income factors controlled, as far as is possible, we can have conviction in relative performance leaving room for 'uncontrollable upside' from any positive surprises on rates.

Portfolio perspectives – putting the ideas into practice

Diversified global equity exposure – Equal-weight index exposures available in ETF wrappers

Selective credit opportunities – Global bond strategies – benchmark

Real-estate income – Actively managed hybrid strategies investing in direct property and global REITs

It should be noted that diversification is no guarantee against a loss in a declining market.

*** For illustrative purposes only. Reference to a particular security is on a historic basis and does not mean that the security is currently held or will be held within an L&G portfolio. The above information does not constitute a recommendation to buy or sell any security.**

3. Simpson Thacher, Mars. 14 March 2025.
4. L&G 28 October 2026. SEC Rule 144A is a safe harbour regulation established by the US's Securities and Exchange Commission (SEC) in 1990 that permits the private resale of unregistered restricted securities exclusively to Qualified Institutional Buyers without full SEC registration.





Retail investors

Democratised or destabilised? How retail investors are rewiring the market

Retail participation has become a structural force in markets, widening access while amplifying the influence of short-term trading and leverage.



Ben Bennett
Chief Investment Strategist - Asia



Robert Griffiths
Global Equity Strategist



Elena Cardella
Head of Index & ETFs
Investment Specialists

For evidence of the rise of the retail investor, look no further than the adverts served on social media. Trading platforms now compete for public attention with gym memberships and package holidays.

In recent quarters, retail participation has surged from about 8% of cash-equity volumes to peaks of 25-30%.[5] Citadel Securities, the biggest US market maker, describes the shift succinctly:

> "Retail participation has evolved from a cyclical phenomenon into a structural feature of modern markets."[6]



5. https://memx.com/insights/retail-trading-insights
6. https://www.citadelsecurities.com/news-and-insights/global-market-intelligence/1h-2026-market-structure-flows/

What's behind rising retail participation?

One force behind this is the growing financialisation of household wealth. Equity holdings recently overtook housing as a share of household wealth in the US for the first time in 15 years.[7]

This change isn't confined to the wealthy: since 2010, equity and mutual fund ownership among the bottom 50% of US households has increased by over 570%, a bigger rise than across every other wealth cohort.[8]

Technology has also lowered barriers to participation. Alongside zero-commission trading, platforms such as Robinhood* offer intuitive interfaces that make it easier to buy and sell investments.

Speculative interest has also migrated, with weaker crypto asset performance redirecting attention towards equities. Meanwhile, social-media communities such as WallStreetBets have accelerated the spread of investment narratives around meme stocks.[9]

Leverage and market dynamics

Retail investors routinely express short-term views through single-stock leveraged ETFs and one-day options, which can magnify movements in the underlying asset. In the first half of 2026, assets in leveraged ETFs hit more than 4.5 times their 2020 level, reaching a record $218 billion.[10]

High volumes in derivatives can also interact with trading in the underlying shares. South Korean semiconductor company SK Hynix* has become the poster child of how these flows may contribute to sharper price movements.[11]

Whether speculative retail activity makes boom-and-bust cycles more likely remains open to debate. The use of leveraged products and one-day options attracts attention, but leverage is not new. More broadly, debt financing for AI infrastructure may be supporting parts of the current market upswing, while incentives within financial markets can encourage the build-up of leverage.

These factors do not establish that retail activity is driving the cycle, but they add to the channels through which moves can be amplified.

7. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4867401
8. https://www.citadelsecurities.com/news-and-insights/global-market-intelligence/1h-2026-market-structure-flows/
9. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4867401
10. https://www.citadelsecurities.com/news-and-insights/global-market-intelligence/1h-2026-market-structure-flows/
11. https://www.bis.org/publications/qr-202603/boom-and-bust-recent-silver-and-gold-rush-role-leveraged-retail-investors

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It's all in the price

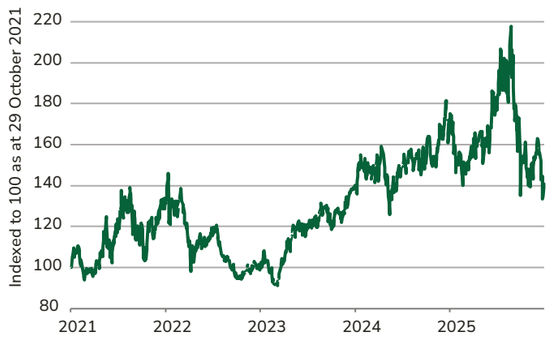
A further consequence of greater retail participation may be increased attention to price action relative to valuations and fundamentals. As prices become easier to trade, investors may give more weight to trends and narratives. That can reinforce moves already under way.

Research published in the Journal of Financial and Quantitative Analysis finds that clearer price trends are associated with stronger momentum returns and more intensive momentum trading. The findings are consistent with investors using readily identifiable trends when forming expectations.[12]

As retail participation grows, price action may therefore become a more influential input into investor behaviour alongside traditional measures of fundamental value. It may also be one of several factors that have supported momentum strategies in recent years.

Moreover, the narratives formed across social media can lead to high concentration in certain sectors and stocks. That crowding among retail investors means that when price trends reverse, moves to the downside can be dramatic.

Momentum works... until it doesn't: Morgan Stanley long/ short US momentum pair



Source: Bloomberg, as at 27 October 2026.
Past performance is not a guide to the future.

Long-term responses to retail demand

Investors need to address markets as they are, not as they might wish them to be. That means accessing the themes and outcomes retail investors are seeking today. However, the big swings in momentum we have seen in recent weeks highlight the risks and the need for a sustainable investment strategy. One option is to combine the liquidity of ETFs with exposure to investment themes, but with a nod towards greater diversification[13] and with less momentum and leverage.

For those seeking broad equity-market exposure, institutional-style strategies are increasingly available through ETFs. Multifactor approaches can seek to improve the balance between risk and return while applying defined risk controls.[14]

Income is another important objective. Dividend strategies, which can be accessed via ETFs, can provide a regular distribution and may broaden geographical and sector exposure compared with market-cap-weighted income approaches.

For investors seeking exposure to AI, diversification across the wider value chain may reduce reliance on a single company or sector. This does not eliminate concentration or valuation risk, but it can spread exposure across several potential sources of growth.

These examples show how investment strategies can respond to retail demand without relying solely on short-term or concentrated exposures.

Portfolio perspectives – putting the ideas into practice

Diversified exposure to key themes – Thematic ETFs

Equity income – Quality-screened dividend income strategies

It should be noted that diversification is no guarantee against a loss in a declining market.

12. https://jfqa.org/wp-content/uploads/2026/07/26353_Trended_Momentum.pdf
13. It should be noted that diversification is no guarantee against a loss in a declining market.
14. Risk management cannot fully eliminate the risk of investment loss.

DB

High rates and endgame optionality

Stronger funding positions are giving UK and US defined benefit plans greater freedom to choose their destination – and more reason to build portfolios that keep multiple paths open.



Robert Pace
Head of Delegated Portfolio Design



Christopher Wroblewski
Head of Solutions Strategy, L&G - Asset Management, America

Higher government bond yields have improved funding levels globally and expanded the choices available to defined benefit (DB) plans. In the UK, gilt yields have continued to rise, while in the US, higher Treasury yields and market movements have also helped many plans move into surplus. Across both markets, this improved position is widening endgame options and bringing the management of liabilities and surplus into sharper focus.

Keeping multiple paths open

Some plans are moving towards buyout or pension risk transfer; others are running on for now, preserving flexibility while weighing their options. Longer-term run-on is being considered by many UK plans, particularly larger ones, where scale can support the investment capabilities and governance needed. In the US, hibernation similarly involves retaining the plan and managing liabilities as they run off, while considering how surplus assets might support growth, benefit enhancements or other strategic objectives.

These choices need not require an immediate commitment to a single destination. For plans balancing continued operation with a potential future transfer, today's rate environment may offer an opportunity to strengthen liability management against a more conservative valuation basis and move closer to the cost of eventual risk transfer.

Building a portfolio around benefit payments

Across these paths, cashflow-driven investing (CDI) is becoming more important. Meeting benefit payments from investment income and maturing assets can reduce reliance on asset sales and provide greater certainty over future cashflows.

Yet higher government bond yields do not necessarily make corporate bonds attractive: tight spreads leave less compensation for taking credit risk, complicating decisions about where to invest. Many plans are therefore supplementing traditional sovereign and corporate bond portfolios with a wider range of cashflow-generating assets, such as securitised credit and private credit, as well as other alternatives. These can broaden the opportunity set, but their cashflows need careful assessment alongside credit quality, liquidity and structural complexity.

Building an effective CDI strategy is not only about deploying new capital; it also means deciding what role existing illiquid holdings should play in endgame portfolios. Plans can fold expected distributions into their cashflow management plans, or decide whether, when and how to sell, weighing secondary-market pricing against ongoing cashflow requirements and evolving endgame objectives.

Managing liabilities and surplus together

For plans considering longer-term run-on in the UK or hibernation in the US, the broad balance-sheet framework used by life insurers potentially offers a useful point of reference. It distinguishes between a portfolio focused on liability coverage and benefit payments, and a surplus portfolio invested according to the sponsor's objectives and risk tolerance.

The liability-focused portfolio can combine a broad range of assets designed to match cashflows, help deliver an attractive yield, and seek to protect against interest-rate and inflation risk. The surplus portfolio can then provide a buffer focused on preserving capital and maintaining resilience, while seeking to generate growth over time.

Crucially, these are complementary parts of one coherent, liability-aware portfolio, drawing on the full spectrum of investment opportunities available. Investments need to work together to meet benefit payments, protect hard-won surpluses, withstand market setbacks and maintain agility. For UK and US plans alike, the appropriate balance will depend on whether a plan is preparing for buyout or pension risk transfer, keeping its options open, or investing for long-term run-on in the UK or hibernation in the US.

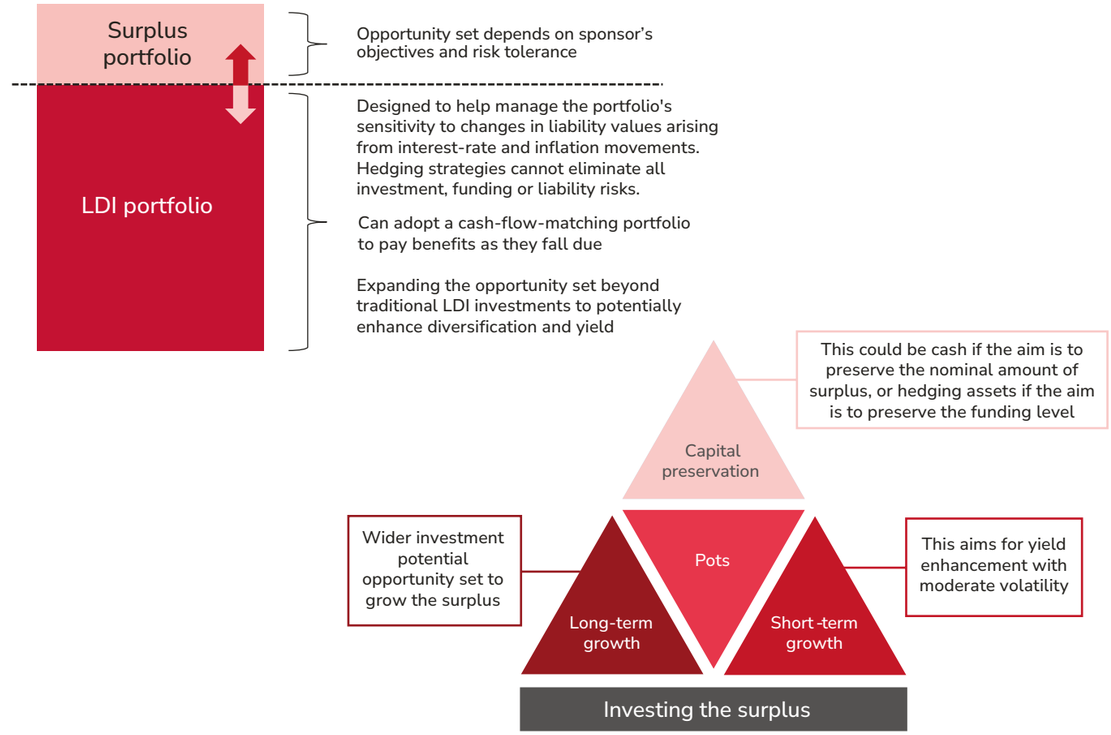
Portfolio perspectives – putting the ideas into practice

Strengthen liability matching – Aiming to optimise hedging exposure

Opportunities to broaden cashflow sources – Buy and maintain strategies

Options for surplus assets – Private markets exposure increasingly accessible via daily-dealing funds plus institutional options

Investing options for plans in surplus



Source: L&G
For illustrative purposes only.

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