Equity Insights

The next phase of broadening

August 2026

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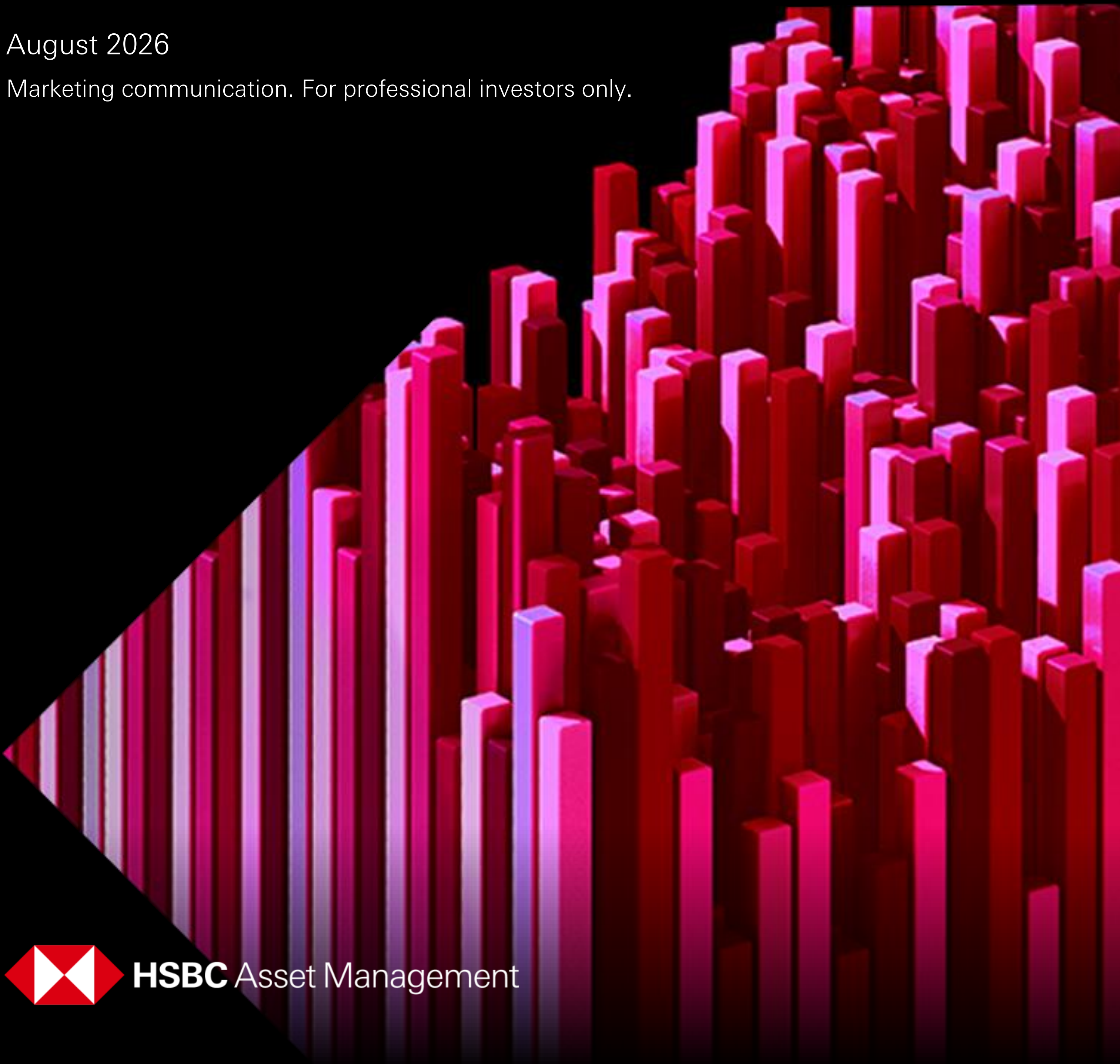

HSBC Asset Management

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Foreword

> In a market where AI enthusiasm is being tested by delivery, the next phase of equity broadening is likely to be more selective and more volatile.

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Welcome to the latest edition of our Equity Insights publication. Equity markets are navigating the second half of the year amid a more demanding backdrop. Geopolitical uncertainty and volatile energy prices continue to complicate the inflation and interest rate outlook, while AI and semiconductor stocks have recently experienced volatility. Profits remain an important support, but markets are becoming less willing to reward investment plans without clearer evidence of durable returns.

Much of the market's strength remains tied to artificial intelligence. The investment cycle has spread beyond hyperscalers and leading semiconductor companies into memory, data centres, power, cooling and industrial equipment. More companies are also beginning to report measurable benefits from AI. Yet recent volatility shows that the path will not be linear. Investors are testing whether the scale of capital expenditure can translate into recurring adoption revenues, stronger free cash flow and returns that justify current valuations.

At the same time, the oil shock is creating different outcomes across regions and sectors. While emerging markets remain an important part of the global profit story, the picture is more differentiated than it appeared earlier in the year. The region continues to benefit from exposure to commodities and materials, support from domestic investors, and the physical infrastructure behind the AI build out. However, Korea's sharp correction has shown how quickly concentrated semiconductor exposure and leveraged positioning can amplify market swings, even when reported profits remain strong. A strong pipeline of technology, healthcare and financial services listings is also gradually changing the composition of EM equity markets and the nature of their earnings.

This publication explores these ideas from several angles. It examines how the AI cycle is broadening while remaining concentrated at its core, where the oil shock is creating regional fault lines, and why innovation, capital expenditure and structural under ownership could support selected non-US and emerging equity markets.

We trust this publication provides valuable insights into the next phase of the equity cycle and the opportunities that may emerge as profit growth broadens across sectors, regions and companies.

In a nutshell

- Profits remain an important market anchor, but recent volatility in AI and semiconductor stocks shows that markets are increasingly differentiating between companies that can translate capital expenditure into durable revenue and free cash flow and those that remain more dependent on expectations.

- AI leadership is expanding beyond hyperscalers and leading chipmakers into the ecosystem around them, although a relatively narrow group of companies still accounts for a large share of earnings upgrades.

- Strong earnings growth has lowered reported price-to-earnings multiples, but cash based and balance sheet valuation measures remain elevated, arguing for participation in the AI cycle without taking an indiscriminate "all-in" position.

- The oil shock is creating clear regional and sector fault lines. US earnings appear relatively resilient, while Europe and parts of Asia are more exposed and the outcomes are more nuanced.

- Emerging markets are becoming a more important source of global profit growth. Diversified exposure to technology, commodities and selected industries is supporting earnings, while stronger domestic investor bases have helped offset foreign outflows.

- Structural under ownership, lower relative valuations and a widening global capex cycle support opportunities outside the narrowest US leaders. Investors should continue to focus on markets and companies where earnings delivery, real demand, competitive advantage and structural change reinforce one another.

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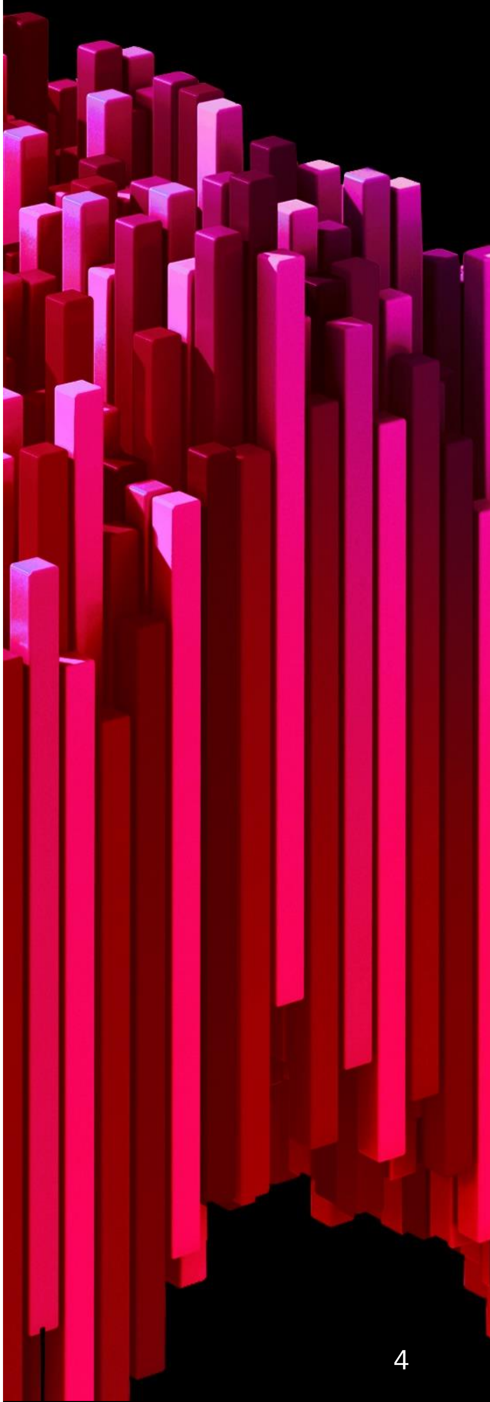


The next phase of broadening

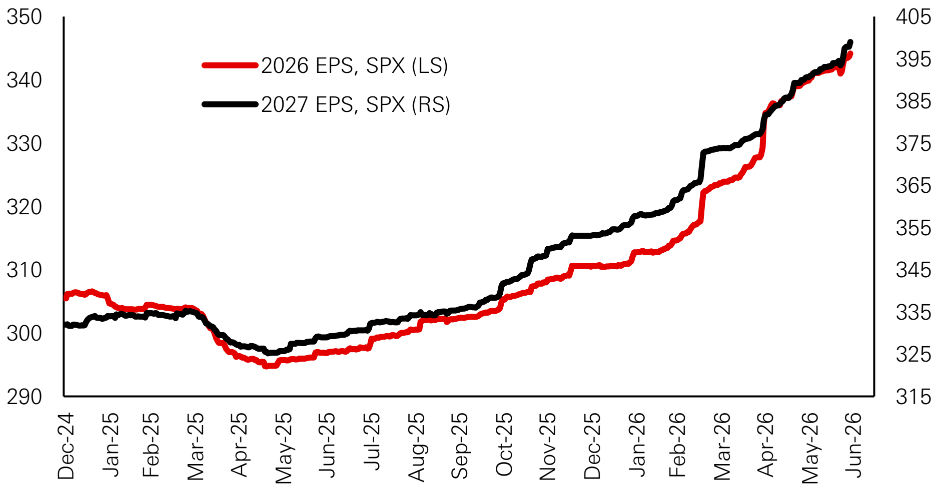
> The equity opportunity is widening, but investors are increasingly asking where capital spending is translating into durable earnings and cash flow."

The closure of the Strait of Hormuz and renewed volatility in oil prices have complicated the outlook for inflation and interest rates. For much of the first half, equities remained resilient because earnings, rather than liquidity, were the primary anchor for valuations. More recently, however, volatility in AI and semiconductor stocks has shown that this support is conditional. Investors are distinguishing more aggressively between companies delivering cash returns and those still dependent on continued capex optimism.

That shift is not a rejection of the AI theme. Demand for compute, memory and related infrastructure remains strong, but the market is reassessing how much of the expected value has already been priced in. The distinction between lumpy, capex driven infrastructure revenues and potentially more recurring adoption revenues has therefore become more important, particularly for hardware and memory companies whose earnings depend heavily on the next round of spending.

While the market is judging AI stocks more closely, consensus earnings expectations for both this year and next have continued to rise. This is unusual, because analysts typically begin the year with optimistic forecasts and gradually revise them lower. The upward revisions do not mean investors are looking through next year's earnings; rather, they raise the hurdle. Markets are asking whether future profits can grow quickly enough, and convert into cash reliably enough, to justify the capital intensity and valuations attached to the theme.

Figure 1: S&P 500 consensus earnings expectations for 2026 and 2027



Past performance does not predict future returns.
Source: HSBC AM, Bloomberg. Data as of July 2026.

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Beneath the headline upgrades, leadership is narrow. Sectors with clear pricing power, robust demand visibility and direct or second order exposure to the AI investment cycle have done most of the heavy lifting, supported by improved energy profitability as oil prices have risen. In fact, the top ten contributors in the S&P 500 account for more than half of recent earnings upgrades, underscoring how concentrated the profit engine remains.

This earnings strength helps to explain why the usual macro driven playbook struggled. In a more traditional risk off environment, a geopolitical shock, higher oil prices and a repricing of interest rate expectations would normally put broad pressure on equities. Instead, valuations that appear stretched on simple price to earnings metrics look more reasonable once one recognises that the earnings base is being revised higher. Moreover, earnings surprises have had a greater influence on market moves than broader macro surprises.

Yet recent volatility is a reminder that strong profits do not remove valuation or positioning risk. The market is increasingly differentiating between companies with recurring adoption revenues and those whose earnings are more directly tied to the next round of capital spending.

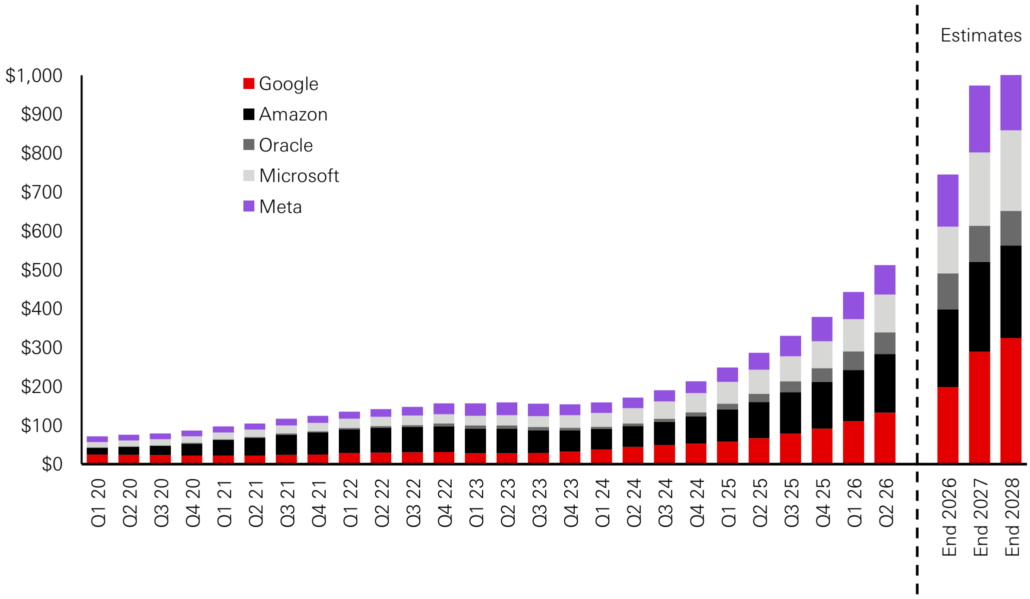
The narrow AI cycle

The AI investment cycle remains the central pillar of the current equity narrative. Hyperscalers have repeatedly upgraded capital expenditure plans, forcing analysts to revise up both the magnitude and duration of the cycle and prompting comparisons with previous 'mega cycles' in technology and infrastructure. The question now is not only how long the cycle lasts, but whether each additional unit of spending earns an adequate return.

AI adoption is widening, yet earnings remain concentrated in infrastructure and semiconductors.

Data centre revenues now account for around 90% of growth at leading AI chip manufacturers, and US hyperscaler capex is expected to exceed US$1 trillion by 2027, underscoring how dependent current earnings momentum is on this investment continuing to run at pace.

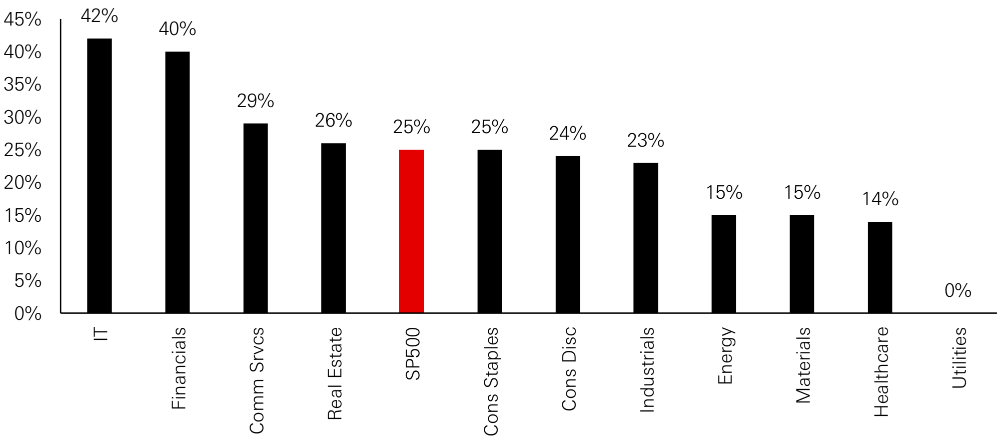
Figure 2: Rolling 12m trailing capex to end of quarter for Hyperscalers (US$ bn)



Source: HSBC AM, Factset. Data as of July 2026.

The AI story is no longer only about expectations. It has spread beyond the companies directly involved in building the technology. In 2023, only around 4% of S&P 500 companies discussed quantifiable benefits from AI on their earnings calls. That figure is now closer to 25%, signalling both faster adoption and considerable remaining headroom. Companies are moving from experimentation to budget allocation, from concept to implementation, and in some cases from implementation to measurable productivity, revenue or margin impact.

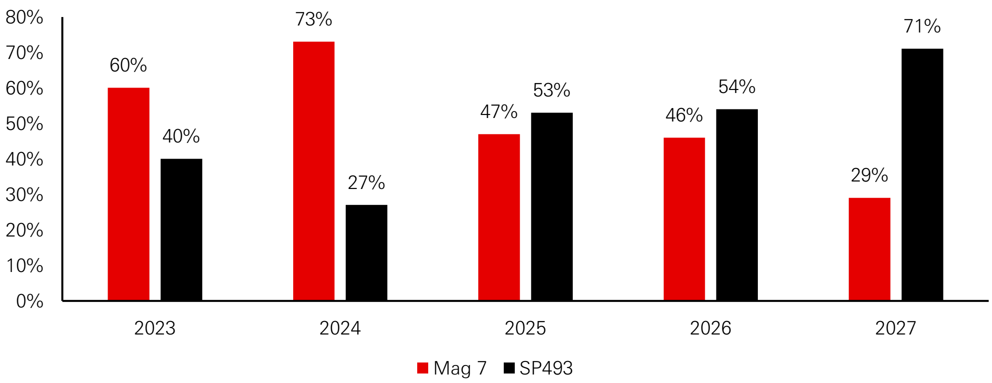
Figure 3: % of companies within S&P sectors mentioning quantifiable AI related impacts



Source: Morgan Stanley, HSBC AM, May 2026.

Even so, the distinction between adoption and earnings contribution is critical. AI infrastructure and adjacent semiconductor companies still account for a disproportionate share of S&P 500 profit growth. While the contribution from the Magnificent 7 has declined relative to recent years, leadership is better described as a widening within the AI ecosystem than a fully diversified equity market.

Figure 4: Net income growth (%)



Source: Company data, Morgan Stanley Research estimates, May 2026

This distinction highlights that the market is not simply moving from a small group of mega cap technology companies to the whole equity market. It is moving from the most obvious AI winners into a wider group of enablers, beneficiaries and second order exposures. These include semiconductors, memory, data centres, power, cooling, infrastructure, industrial equipment and parts of the capital goods complex.

To assess the next phase, it is useful to separate capex-based revenues from adoption revenues. The former are lumpy and depend on continued infrastructure budgets; the latter are potentially more recurring and provide better evidence that AI is improving productivity, revenue or margins across end users.

Recent volatility has brought this distinction into sharper focus. Concerns about hyperscaler funding, potential excess compute capacity, lower cost and open source models, slowing memory price gains and intensifying Chinese competition all raise questions about where pricing power and returns will persist.

The risk is therefore not that AI has stopped mattering. It is that the path from build out to monetisation will be uneven, with pauses, setbacks and larger gaps between the eventual winners and losers.

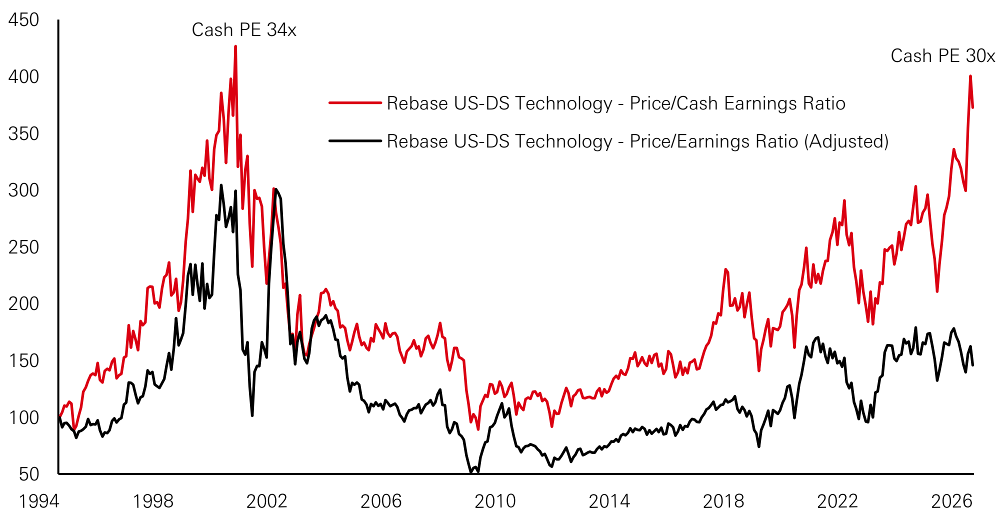
Valuation tension

Recent volatility shows how quickly support for some AI stocks can strengthen or weaken as investors reassess the return on spending, the durability of monetisation and the availability of financing, as hyperscalers encounter funding and concentration limits.

Rising earnings support valuations, but cash returns must justify heavy capital spending.

Valuation signals in US technology capture this dynamic. Reported price to earnings multiples have compressed as earnings have surged, but price to cash earnings and price to book ratios have moved higher and now sit near early 2000s levels. On simple price to earnings measures, parts of the market can look less stretched because the earnings denominator has grown so quickly. On cash based and balance sheet measures, valuations look more demanding.

Figure 5: Relative move in cash versus reported price-to-earnings (x)



Source: HSBC AM, Refinitiv. Data as of July 2026.

The result is a cycle supported by real revenues, real capex and real earnings upgrades, but one that still does not argue for an unqualified 'all in' stance. Strong reported EPS is less reassuring when cash earnings lag, particularly if the assets being built become obsolete faster than assumed. Equally, staying 'all out' risks missing one of the most important technology and investment cycles in decades.

The more balanced view is that AI-linked equities still deserve a central place in equity portfolios, but the bar for incremental upside is rising. Investors need to distinguish between companies already generating earnings, those where monetisation remains largely speculative, and those whose valuations leave little room for disappointment. However, the balance becomes harder to strike as the oil shock introduces a second test for earnings.

Oil shock fault lines

The recent oil price volatility following the closure of the Strait of Hormuz has added another layer of complexity. Thus far, markets have largely treated the disruption as manageable. Energy earnings have been upgraded, and there is little evidence at the index level of a broad downgrade cycle.

However, the aggregate picture hides important dispersion. Equal-weighted US consumer discretionary earnings expectations have already been revised lower as higher energy prices and inflation weigh on household sensitive segments. The sector – dominated by Tesla and Amazon – appears more resilient, but that resilience masks weakness in the broader consumer facing universe.

Energy volatility is creating sharper differences across regions, sectors and corporate earnings.

The market's reaction to oil has therefore been more surgical than broad based. Some stocks and sectors are already responding to higher costs and weaker consumer demand, but the aggregate index is still being driven by secular AI trends and strong earnings surprises.

The risk is that earnings forecasts still do not fully capture a longer disruption. Oil is notoriously difficult to forecast, and analysts are increasingly relying on scenarios rather than point estimates. Reopening assumptions have already been pushed back, with more pessimistic scenarios being introduced, but these have not yet filtered meaningfully into aggregate earnings forecasts or broad market performance.

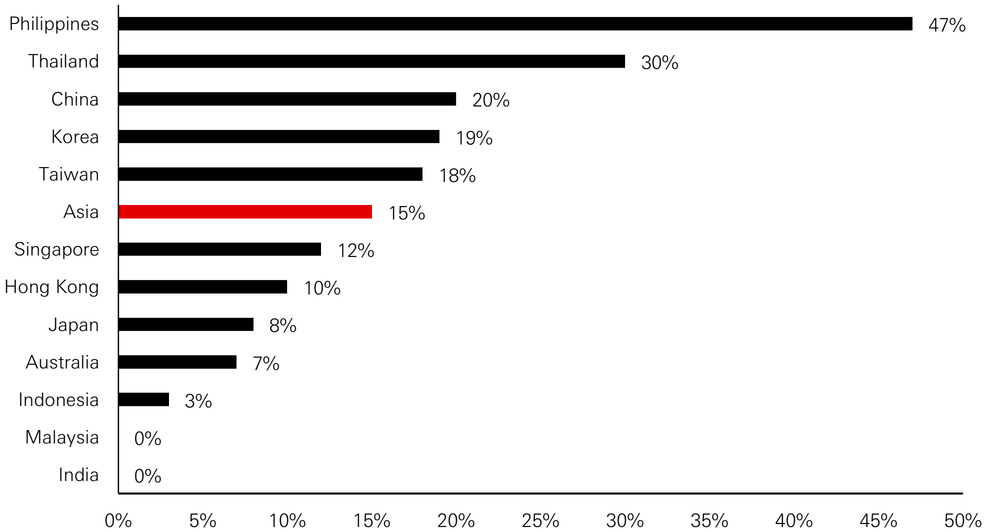
Using a top-down earnings model for the US, with PMIs, CPI, PPI and the dollar as inputs, a less disruptive scenario in which energy supply conditions gradually normalise points to a moderation in earnings growth after a very strong first half, but not a collapse. Under a more prolonged disruption assuming a resolution timeframe of around six months, sustained pressure on producer and consumer prices, weaker manufacturing activity and a stronger dollar would slow earnings more meaningfully. Even then, the model suggests that earnings growth would likely slow or flatten into year end rather than collapse outright.

That resilience reflects the unusual composition of US earnings. The US has large technology and AI-linked sectors, strong pricing power in parts of the market, and enough earnings momentum to absorb some macro pressure. A prolonged energy shock would still matter, but it may not be enough on its own to overturn the broader US profit cycle, unless it also disrupts AI capex or forces a sharper tightening in financial conditions.

Europe, by contrast, faces a more challenging equation. The region has seen modest earnings upgrades of roughly 2%-3% in recent months, supported in part by energy, but lacks the same scale of AI linked earnings support as the US. It is also structurally more exposed to higher input costs and weaker activity. Top-down models indicate that in a downside scenario characterised by a persistent PPI-CPI wedge and weaker PMIs, European earnings could come under meaningful pressure as early as the third quarter, reflecting their higher sensitivity to supply side shocks. Valuations remain supportive and selected companies retain strong cashflow characteristics, but the regional earnings story is more fragile and requires greater selectivity.

Across Asia, the impact of higher oil prices is being mediated by policy choices. While benchmark crude prices are up roughly 50–60%, retail fuel prices have risen by closer to 15% on average. Countries such as India have absorbed more of the increase fiscally, while others, including the Philippines and Thailand, have passed through a larger share to consumers. The implications for inflation, real incomes and corporate earnings are therefore highly country specific.

Figure 6: Domestic gasoline price rise since February 2026 (%)



Source: CEIC, GlobalPetrolPrices.com, Morgan Stanley Research, May 2026.

The oil shock, therefore, makes the playbook narrower. Energy importers, consumer facing sectors and regions with weak pass-through mechanisms need to be treated differently from markets with commodity exposure, AI-linked exports or stronger domestic demand buffers. These regional fault lines bring the broadening opportunity in emerging markets into sharper focus.

EM profit broadening

Against this backdrop, the most compelling ‘broadening out’ story is still in emerging markets, which have continued the strong outperformance seen last year. Even here, however, the picture is not entirely straightforward. Year to date performance has been concentrated in Korea and Taiwan and heavily driven by the technology sector, much like the narrow leadership seen in developed markets. In Korea, the surge in domestic retail participation and the use of leveraged ETFs have added another layer of volatility. This raises an important question of whether emerging markets can continue to outperform if market leadership broadens beyond AI.

There are good reasons to think they can. The first is valuation. Despite rising by around 13% year to date, EM equities have become approximately 30% cheaper on a forward price to earnings basis since the start of the year, as earnings upgrades have outpaced share price gains. This suggests that markets remain sceptical about the durability of the EM earnings recovery.

Even allowing for the possibility that forward earnings expectations prove too optimistic, there is still a meaningful valuation buffer. On trailing earnings, EM equities trade at a discount of more than 30% to developed markets, close to the widest level in a decade. Valuation alone is not an investment case, but it provides a more supportive starting point where company fundamentals and earnings delivery continue to improve.

The second reason is that the EM earnings opportunity extends well beyond AI. Emerging markets sit at the intersection of several powerful structural megatrends. They supply many of the critical materials needed for the global energy transition, benefit from rising credit penetration and financial inclusion, and contain companies that are moving further up the global value chains.

Emerging market leadership is widening beyond AI, supported by valuations and structural growth.

Figure 7: 12M forward P/E Asian equity valuations (x)

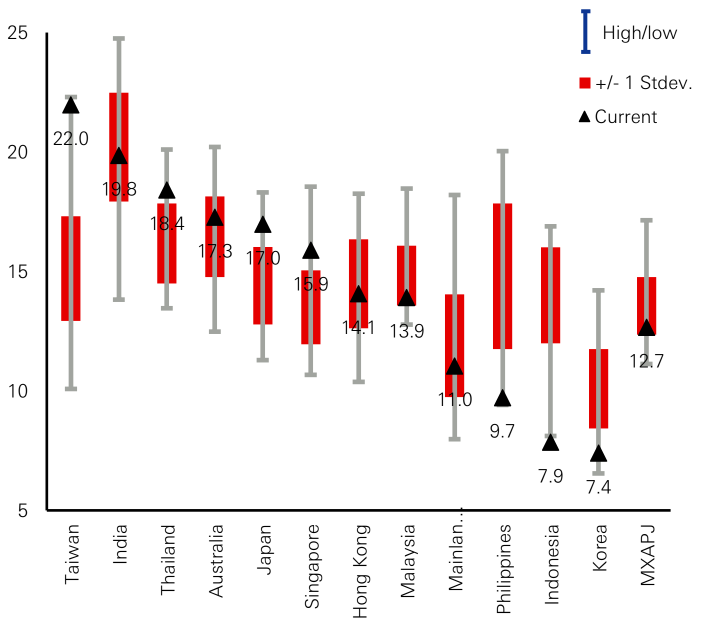
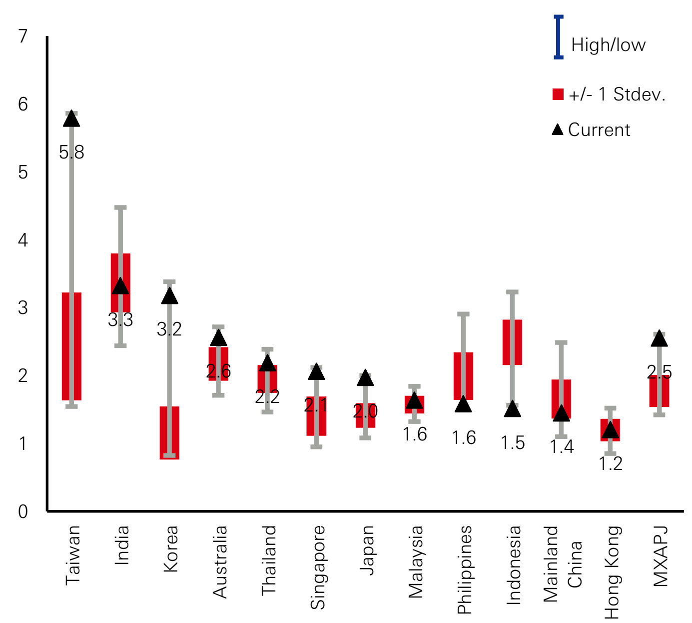


Figure 8: 12M trailing P/B Asian equity valuations (x)



Past performance does not predict future returns.
Source: HSBC AM, Goldman Sachs, MSCI. Data as of June 2026.

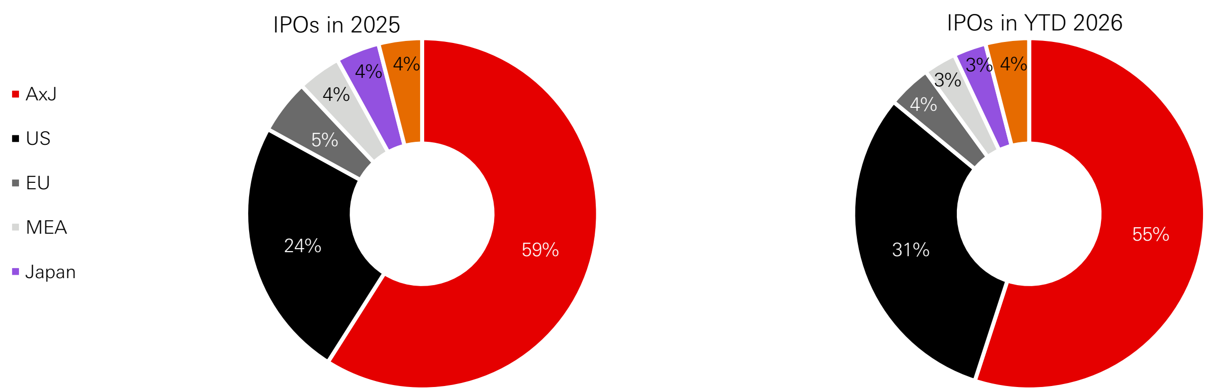
Innovation is also broader than the semiconductor cycle. Emerging market companies are building leading positions in biotechnology, new energy, fintech, robotics and other advanced industries. These businesses offer different sources of growth from AI hardware and memory, with earnings increasingly linked to domestic adoption, market share gains and company specific execution.

Encouragingly, market performance has begun to broaden since June, both across countries and sectors. EM markets are therefore not rising or falling together, and the region increasingly reflects a more differentiated mix of earnings drivers, positioning and market structure. The near term earnings story, however, is only one part of the EM case.

EM in the global innovation and IPO cycle

The second part of the EM story is structural as the region is also changing the composition of its equity markets. Globally, 2026 is shaping up to be one of the largest IPO fundraising years on record, led by high profile US listings such as OpenAI, Anthropic and SpaceX, which could command a valuation in excess of US$1.5 trillion. Whether in the US, China or other EM regions, the underlying theme is similar – fast growing, technology and innovation driven businesses are tapping public markets to fund scale. Global investors, meanwhile, are keen not to miss out on these growth opportunities.

Figure 9: Global IPOs breakdown for 2025 and YTD 2026 (%)



Source: HSBC AM, Refinitiv, Datastream. Data as of June 2026.

China, for instance, has already raised more IPO capital than any other region in the first quarter, with AI related companies alone raising around US$22 billion, roughly double the amount raised by US AI IPOs so far this year. Hong Kong has a record pipeline of about 500 prospective listings, many tied to AI, semiconductors, robotics and medtech. Europe's largest IPO this year has also come from an EM issuer, and multiple fintech unicorn IPOs are expected in Africa and Latin America.

New listings are reshaping emerging markets towards innovation led, domestically anchored earnings growth.

These issuances are reshaping EM indices and the nature of their earnings. Historically, EM benchmarks were dominated by commodities, state owned banks and industrial cyclicals. Today, innovative businesses spanning internet and software, semiconductors and technology hardware, pharmaceuticals, new energy, electric vehicles, fintech, media and defence account for nearly 40% of EM indices, up from around 10% a decade ago to. Earnings are becoming less dependent on traditional commodity cycles and external demand, and more anchored in domestic consumption, technology adoption, healthcare provision and financial inclusion.

The shift in composition has three important implications. First, it changes the quality of EM earnings. Businesses built around intellectual property, platforms and networks tend to have different margin profiles, capital intensity and growth trajectories from traditional cyclicals. The more these companies enter and grow within EM benchmarks, the less EM earnings behave like a simple commodity or global trade cycle.

Second, it changes the role of EM in global portfolios. If EM indices become more innovation heavy, they may still be volatile, but the sources of volatility and return will change. EM may become less about external demand alone and more about domestic consumption, technology platforms, healthcare, financial inclusion and the localisation of innovation.

Third, it creates a stronger role for active management. It takes time for new IPOs to enter indices. Active managers can access these companies earlier, but they also need to be selective because IPO cycles can create both genuine structural winners and overhyped listings. For example, the dispersion between innovative China listings and the broader MSCI China index shows how much difference stock selection can make.

Yet valuations do not fully reflect this shift. On a forward price to earnings basis, EM still trades at roughly a 40% discount to the S&P 500, close to decade low relative valuations. On price to book metrics, non-US markets, and EM in particular, remain at about one third of US levels.

It suggests that the market is not fully valuing the transformation in EM index composition or the possibility that EM earnings are becoming more durable than in previous cycles. It does not mean that EM should re-rate automatically, since governance, liquidity, policy risk and execution still matter. But the combination of changing fundamentals and wide valuation discounts strengthens the case for selective exposure.

Structural under ownership and selective broadening

Taken together, these developments point to a profit-led but bumpier and selective broadening equity cycle. AI remains at its core while an increasingly global set of beneficiaries is emerging around it. However, earnings delivery and cash returns will determine which parts of that ecosystem retain market support.

Under owned non-US markets offer opportunities where earnings, valuation and execution align.

Yet allocations remain heavily skewed. Since 2020, about US$1.7 trillion has flowed into US equities versus roughly US$350 billion into emerging markets, leaving non-US and EM assets structurally under-owned. Capex broadening can still form the bridge between AI and the rest of the market, but the opportunity extends beyond chips and cloud into power, grids, data centres, cooling systems, property, industrial equipment, copper, aluminium, memory, precision engineering and energy security.

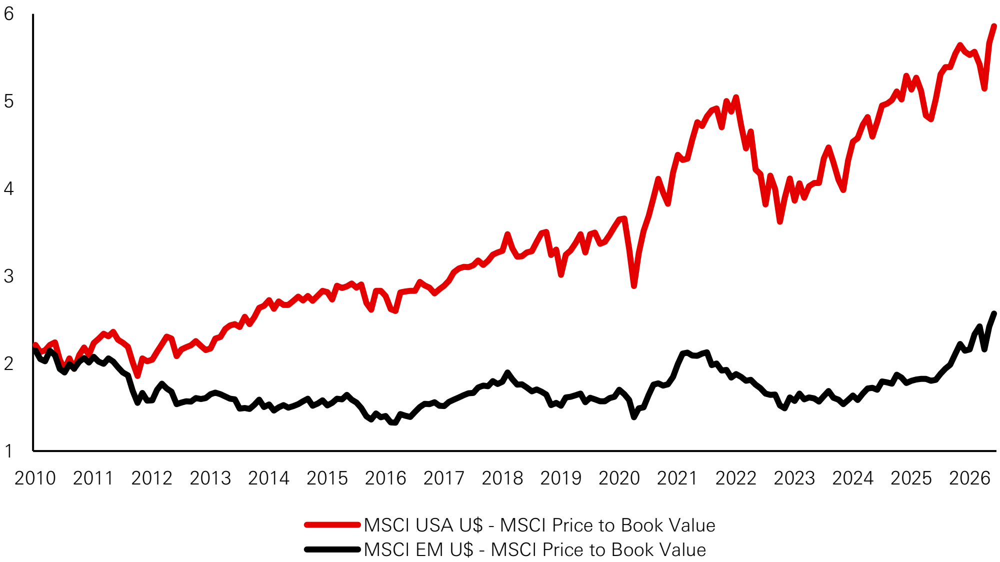
Materials, energy, industrials and utilities can therefore participate in the physical build out, while more balanced markets such as China and India offer diversification from the concentrated hardware trade.

This does not imply a simple rotation from the US to the rest of the world, nor does it mean that every cheap market is attractive. The opportunity is more specific. It lies where earnings are being revised higher, where capex creates real demand, where valuations are not already discounting perfection, and where structural change is improving the quality of the profit base.

Source: HSBC Asset Management, July 2026.

Relative valuations reinforce the diversification case, although they need to be interpreted carefully. The price to book gap between the US and the rest of the world, especially emerging markets, has widened to an unusual level. Higher US returns on equity explain part of the premium, but the gap appears wider than differences in profitability alone would suggest. The opportunity therefore lies in identifying individual companies and markets where valuations are supported by sustainable earnings, strong balance sheets and credible returns on invested capital — not in assuming that cheaper markets will automatically re-rate.

Figure 10: Price to book comparison of US versus emerging markets (x)



Source: HSBC AM, Refinitiv, Datastream. Data as of June 2026.

Overall, the US remains central to the earnings cycle but carries more valuation and concentration risk, while non-US and EM markets are cheaper and under-owned, but still require earnings confirmation to close the gap. The sustainability of this broader opportunity set will depend on whether AI capex produces recurring adoption revenues, whether second order beneficiaries convert physical demand into cash flow, and whether EM innovation and commodity linked profits remain resilient. The next phase is therefore less about choosing between the US and the rest of the world, and more about identifying where the profit cycle is still improving and where capital spending is earning an adequate return.

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