BOV | ASSET MANAGEMENT
A MEMBER OF THE BOV GROUP

2026 Mid-Year Outlook: Beyond Monetary Fuel



Beyond Monetary Fuel: *The Physical Build-Out of the Industrial AI Economy*

Executive Summary

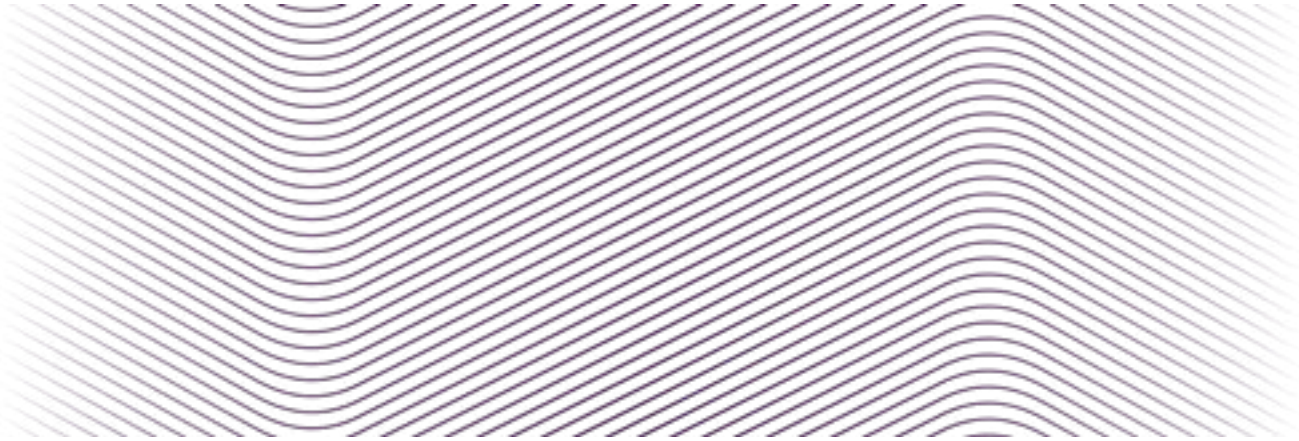
The global investment landscape has reached a definitive pivot point, marking the end of the post-Global Financial Crisis era where "monetary fuel" provided a reliable tailwind for all asset classes. We have entered a "multi-speed" growth regime defined by the industrialization of Artificial Intelligence and a structural shift toward fiscal dominance. We have moved into a new era defined by a shift from a global savings glut to what is now called a savings grab. This means that capital is no longer abundant or cheap. Instead, it is being pulled in many directions to fund a massive build out of artificial intelligence, the strengthening of national defences, and the rebuilding of supply chains that are no longer global in nature.

While the United States (US) remains a powerful engine of growth, the world is being tested by severe tensions in the Middle East and a world trade system that is splitting into competing parts. A major event in the first half of the year was the closure of the Strait of Hormuz. This small stretch of water is a single point of failure for the world economy because it handles 20% of the world petroleum supply and essential materials for making computer chips. Even though a diplomatic end to this conflict is expected, the damage to trade routes and the sudden jump in prices have forced central banks to keep interest rates higher for longer.

The Physical Build Out of Artificial Intelligence and Tech Dominance

The artificial intelligence sector has transitioned from conceptual interest into a massive $2.3 trillion physical infrastructure cycle. With capabilities doubling every four months, AI is projected to be 250 times more powerful by 2028. Data centres now operate as "factories" where revenue is directly proportional to computational capacity, and "tokens per watt" has emerged as the definitive efficiency metric.

The industry is currently undergoing an agentic transition toward autonomous systems capable of reasoning and independent execution. This shift will require exponential power increases and move professional roles from task execution to agent management. Geopolitically, the US leads in innovation through five dominant hyperscalers but faces significant power constraints. Conversely, China has pioneered a low-cost, efficiency-focused parallel AI stack, achieving comparable performance with significantly lower token costs than Western counterparts.



Deglobalisation and Country Fragmentation

The global economy has transitioned from seamless trade toward a permanent state of fragmentation, bifurcating into US and China-led blocs. This shift replaces low-cost globalization with a resilience premium, prioritizing supply chain security through friend-shoring and the cultivation of national champions for technological sovereignty. While Europe pursues strategic autonomy, Taiwan and South Korea remain indispensable nodes for AI infrastructure. Ultimately, this multi-speed economy rewards strategic alignment and resource control, creating an uneven landscape for regions facing geopolitical headwinds.

Earnings Resilience and Market Dynamics

Against a backdrop of heightened geopolitical tension and restrictive interest rates, global corporate profitability has demonstrated remarkable durability, serving as the primary anchor for equity markets. Global earnings surged by more than 22% in the first quarter of 2026, the highest growth rate in four years, underpinning a robust multi-speed expansion. This resilience is increasingly driven by a broadening profit cycle. While mega-cap technology and the AI-driven capex boom remain central, earnings momentum is expanding into industrials, materials, and financials. Despite elevated energy costs and a cooling labour market, institutional consensus suggests that sustained corporate profitability continues to fund capital expenditures and support consumption.



Fiscal Dominance and the Impact of Central Bank Policies

The global economy has entered an era of fiscal dominance, characterised by aggressive sovereign spending on industrial strategies that now eclipse central bank policies in influence. While this prevents deceleration, record bond issuance has pushed yields higher, with US debt exceeding 100% of GDP and interest obligations surpassing $1 trillion. Inflation has established a structural floor between 2.5% and 3.0%, driven by labour shortages and geopolitical volatility. Consequently, central banks are on divergent, restrictive paths: the Federal Reserve remains cautious, the European Central Bank (ECB) is hiking to combat energy inflation, and the Bank of Japan has adopted an aggressive tightening stance. This environment of massive debt and limited monetary synchronization challenges traditional valuations and increases global financial instability risks.

Equity

The world economy is currently defined by multi speed growth. The US is running a high-pressure economy where growth is strong despite high rates. Globally, growth is expected to be around 3% for 2026, representing a slight drop from earlier forecasts due to the energy shock.

Global equities are expected to remain constructive in H2 2026, yet the rally must broaden beyond the "Magnificent Seven" to be sustainable. The S&P 500 trailing return on equity reached a record high of 22% in early 2026, but this hides a deep divergence where the largest tech stocks generate 44% ROE while the median stock has suffered from rising interest expenses. As long as this earnings cycle remains intact, markets appear positioned to outperform fixed income.

The U.S. remains the core growth engine, but returns will increasingly be driven by earnings growth rather than multiple expansion. Equity markets remain constructive supported by a broadening earnings cycle that has extended from mega-cap tech to enablers in utilities and industrials. The artificial intelligence supercycle introduces further complexity; while it drives innovation, it is straining hyperscaler balance sheets through immense capital expenditure requirements.

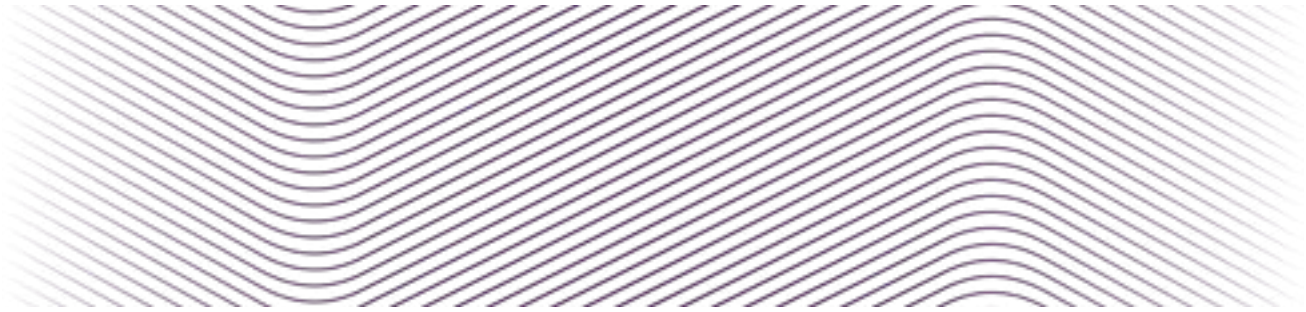
European equities are positioned as the "value" alternative to the U.S., trading at significant valuation discounts. Strategic autonomy is the primary catalyst here, with European defence contractors seeing multi-year order books. European banks are also highly favoured, as they return capital to shareholders via dividends at rates exceeding U.S. peers. China's outlook is more cautious; while reflation is occurring due to oil prices and exports remain firm, the housing downturn and weak private sector confidence remain key risks for the region.

Fixed Income

The fixed income landscape has transitioned to a "Return of Income" regime, where bonds are valued for carry rather than capital appreciation. The overwhelming consensus is a preference for credit risk over interest rate risk, and a tactical underweight on long-duration.

The US monetary policy has entered a period of heightened uncertainty as the Federal Reserve adopts a more reactive, data-dependent Warsh stance, abandoning predictable forward guidance and amplifying market volatility. The US yield curve is expected to steepen in H2 2026. Short-term rates may eventually moderate, but long-term yields will remain sticky due to the term premium, the extra compensation investors demand for the risks of holding debt in an era of record deficits.

Europe and the United Kingdom (UK) are more vulnerable to the Middle East conflict as energy importers. While German fiscal stimulus is a positive, the fiscal multiplier has been weaker than expected, leaving the region laggard. The UK is facing a situation called sticky inflation without growth. This makes it very hard for the Bank of England to decide whether to raise rates to stop inflation or lower them to help growth. Meanwhile, the European Central Bank (ECB) adopted a more restrictive stance, raising interest rates amid inflation concerns linked to Middle East-related energy shocks, leading to a repricing of European front-end yields despite softer growth expectations. Both European and US Investment Grade credit is favoured as corporate balance sheets are often healthier than the sovereign, having locked in low rates during 2020-2021.





Local

The Maltese equity and bond markets are entering the second half of 2026 from a position of relative strength, characterized by resilient growth despite a challenging broader global macroeconomic environment. While the international landscape remains uncertain due to geopolitical tensions, Malta's real GDP is projected to maintain a robust growth rate of approximately 3.7% for the year. This economic momentum is largely driven by domestic demand and private consumption, which is set to expand at a rate of 4.2%, supported by recent income tax bracket revisions that have boosted household disposable income. Investor confidence in the local equity market is further bolstered by high business sentiment and strong sectoral performance, particularly within the information, communication, and accommodation sectors.

The local bond market is also experiencing a period of significant activity, with 2026 expected to maintain the strong upward trend in new corporate issuances seen in previous years. However, the next six months will be heavily defined by a substantial wave of maturities, with over €240 million in corporate bonds due to be redeemed or refinanced. Notable entities facing these milestones include International Hotel Investments plc (IHI), MIDI plc, and Premier Capital plc. In this environment, maintaining a focus on issuers' underlying credit quality, financial flexibility and capacity to meet their obligations remains essential, particularly for companies facing refinancing needs or legal uncertainties. Meanwhile, the government bond market remains active, with the Treasury requiring roughly €1.9 billion in new Malta Government Stock (MGS) issues to finance the projected deficit and refinance maturing debt. Overall, the Maltese market presents a diversification opportunity compared to more volatile European counterparts through the end of 2026. While risks to growth remain due to potential external demand shocks and imported inflation, the domestic fiscal outlook is improving. The general government deficit-to-GDP ratio is projected to narrow to 1.9% in 2026, with the total debt-to-GDP ratio stabilizing at approximately 46%. This fiscal discipline, combined with a tight labour market and low unemployment rate of 2.9%, provides a stable backdrop for both equity valuations and the continued appetite for local fixed-income instruments.



Conclusion

The current investment landscape for 2026 demands a strategic shift toward active management to identify firms with robust pricing power capable of offsetting rising costs without sacrificing customer retention. Strategic value has migrated to the “picks and shovels” of the new economy, specifically hardware for artificial intelligence and next-generation energy infrastructure. Investors must navigate a unique paradox where technological optimism intersects with stagflationary shocks, rewarding disciplined navigation through headline volatility. Despite geopolitical risks like the Strait of Hormuz closure, resilient global earnings and American growth provide a constructive path for those embracing the complexity of this high-pressure economy.

This document is issued by BOV Asset Management Limited (“the Company” and/or “BOV AM”). Opinions, estimates and projections in this publication constitute the current judgement of the author as of the date of this publication, and should not be construed as investment advice. The Company has obtained the information contained in this document from sources it believes to be reliable, but it has not independently verified this information contained herein and therefore its accuracy cannot be guaranteed. The Company makes no guarantees, representations or warranties and accepts no responsibility or liability as to the accuracy or completeness of the information contained in this document. The Company has no obligation to update, modify or amend this publication or to otherwise notify a reader thereof in the event that any matter stated therein, or any opinion, projection, forecast or estimate set for the herein changes or subsequently becomes inaccurate. Furthermore, past performance is not necessarily indicative of future results. ESG is a set of criteria measuring the sustainability of companies from three perspectives - environmental, social and governance. To further demonstrate our commitment to ESG principles, the BOV Group is working to be ESG compliant in its offerings to its clients. BOV Asset Management Limited is licensed to conduct investment services in Malta under the Investment Services Act (Cap.370 of the laws of Malta) by the Malta Financial Services Authority. Issued by BOV Asset Management Limited, registered address 58, Triq San Żakkarija, Il-Belt Valletta, VLT 1130, Malta.