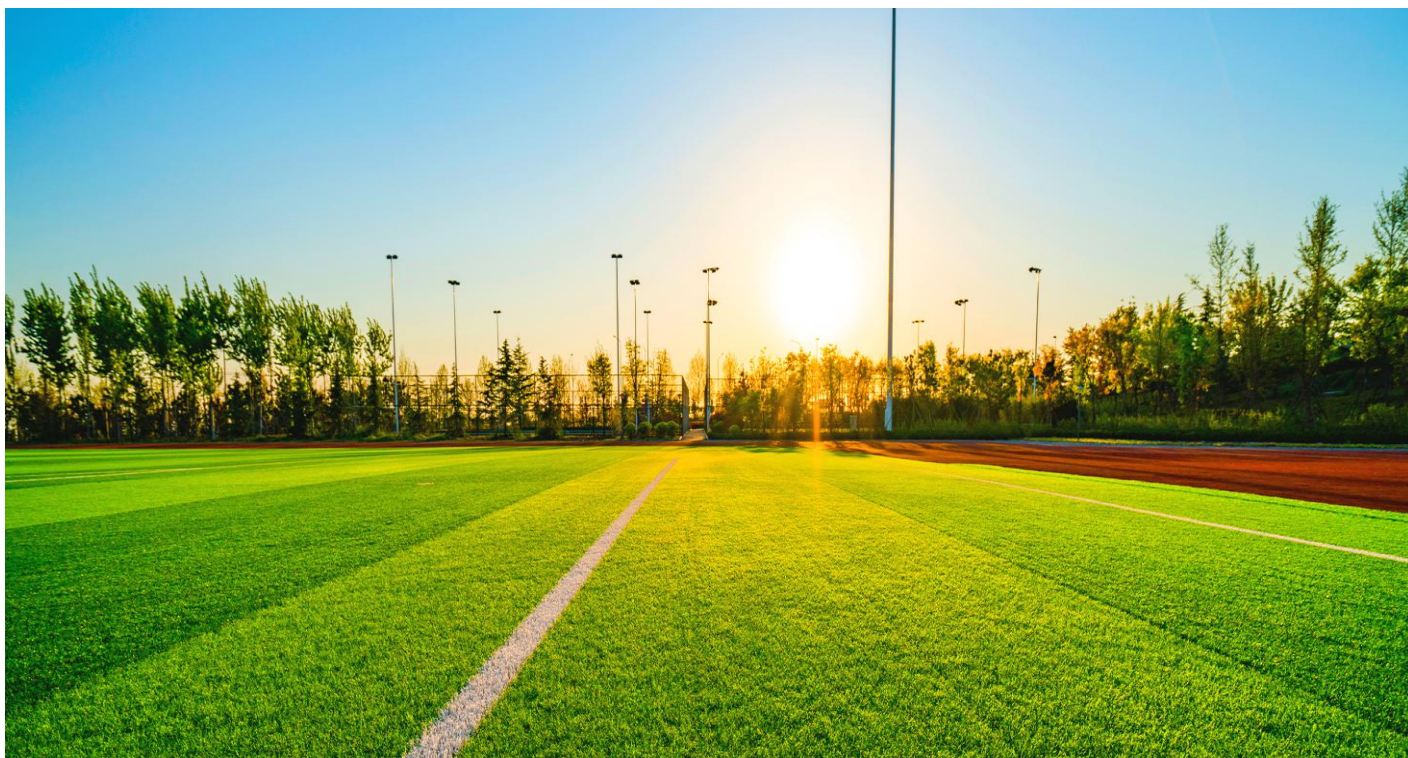


Mid-Year Outlook | 2026

Don't park the bus



As we approach the football World Cup, some teams could be accused of “parking the bus,” a passive strategy to put most players in front of the goal to avoid losing.

There are plenty of uncertainties facing the global economy. We have the ongoing conflict in the Middle East, potential central banks’ response to a return of inflation, possible shifts in the U.S. political and policy backdrop, and the rapidly changing landscape in AI (artificial intelligence) development. With a broad range of assets on our team sheets, being passive and hiding behind cash¹ is not the right strategy.

In our 2026 Mid-Year Outlook, we discuss a number of key market questions and what that means for investors.

1. How could the Middle East conflict evolve?
2. Global AI investment opportunities and risks: Concerns about concentration again?
3. China: Can AI help drive an equity turnaround?
4. Mid-term elections: How does a change in Congress change U.S. policies?
5. Central bank policy: How to balance between inflation and growth challenges?
6. The new diversification: Alternatives in an inflationary world
7. Value vs. Growth: Value to shine?

¹Cash proxied by U.S. short-term Treasuries.

1. How could the Middle East conflict evolve?

In brief

- We consider three scenarios of how the conflict in the Middle East could evolve over time. A reopening of the Strait of Hormuz would still keep short-term inflation high, but investors would look past that.
- An extended blockage of the Strait would shift global economic risk from inflationary to stagflationary.
- Sustained damage to oil and gas production and infrastructure would also pose a risk of a long-term downgrade in economic growth, while pushing governments to seek more permanent solutions to improve energy independence.

Developments in the Middle East remain the key determinant of economic and market performance in the second half of 2026. With the Strait of Hormuz still closed, the window for a quick reversal of the economic damage from disrupted oil and gas supplies is narrowing. A resolution could come at any time, but for now, neither Washington nor Tehran appears able to untangle the deadlock. Below, we outline possible scenarios and what they could mean for investors. We continue to view the first scenario—reopening the Strait—as the most likely outcome.

Reopening in the near term

Backdrop

Both sides maintain the ceasefire and agree to reopen the Strait of Hormuz. Shipping traffic returns to pre-war levels within 6–8 weeks.

Economic reaction

- Energy prices remain elevated (oil around USD 80–USD 90 per barrel) as governments and businesses rebuild inventories and strategic reserves.
- Shipping insurance costs may remain higher for longer and be passed through to energy prices.
- Headline inflation likely stays elevated through 2H 2026 and early 2027, then gradually declines.
- Consumption takes a modest hit as higher energy and food prices reduce disposable income.
- Corporate capital spending (capex)—especially on AI—remains solid.

Policy reaction

- The U.S. Federal Reserve (Fed) may hold rates steady and maintain a wait-and-see approach; rate cuts look increasingly unlikely in 2026.
- More inflation-focused central banks (e.g., the European Central Bank (ECB) and the Bank of England (BoE)) may implement modest rate increases to pre-empt inflation pressure. These moves could be reversed later if inflation expectations remain anchored near targets.
- Governments will likely continue supporting households and businesses through subsidies or income supplements. Fiscal deficits may rise, but bond investors may view these measures as temporary—limiting the risk of a sharp increase in government bond yields.

Market implications

- While government bond yields may stay elevated amid sticky inflation, the U.S. Treasury curve would likely steepen (front-end yields falling relative to the long end) as central banks focus less on further tightening.
- A return of risk-on sentiment could support global equities. Recent laggards—such as cyclically sensitive sectors—may catch up, broadening market performance.
- The U.S. dollar would likely depreciate versus major currencies as risk appetite improves.
- Improved clarity on global growth could support appetite for private credit and private equity.

An extended closure of the Strait of Hormuz

Backdrop

Despite the ceasefire, neither Tehran nor Washington is willing to make concessions to reopen the Strait. Shipping traffic in and out of the Gulf remains well below pre-war levels for much of 2H 2026.

Economic reaction

- Global inventories continue to be drawn down rapidly.
- Pressure extends beyond oil and natural gas; petrochemicals used for fertilizers and many industrial inputs are also affected.
- Rising oil and gas prices push inflation higher, while economic activity weakens due to rationing of raw materials and “demand destruction” (reduced demand because prices are too high).
- Asian economies are likely more vulnerable than the U.S. and Europe due to greater reliance on Gulf energy and raw materials. However, given Asia’s role in global supply chains, disruptions would have worldwide effects.
- Shortages in daily necessities could lead to public discontent and even political instability in some cases.

Policy reaction

- Central banks (including the Fed) may initially raise rates to address higher inflation. Over time, weaker growth—driven by shortages and reduced demand—could lead central banks to ease policy to limit business failures or prevent a housing downturn.
- Governments could expand fiscal support beyond fuel subsidies, including temporary cuts in taxes, fees, and charges to protect businesses and households.
- International coordination on energy and petrochemical supply may increase to balance distribution between “haves” and “have-nots.”

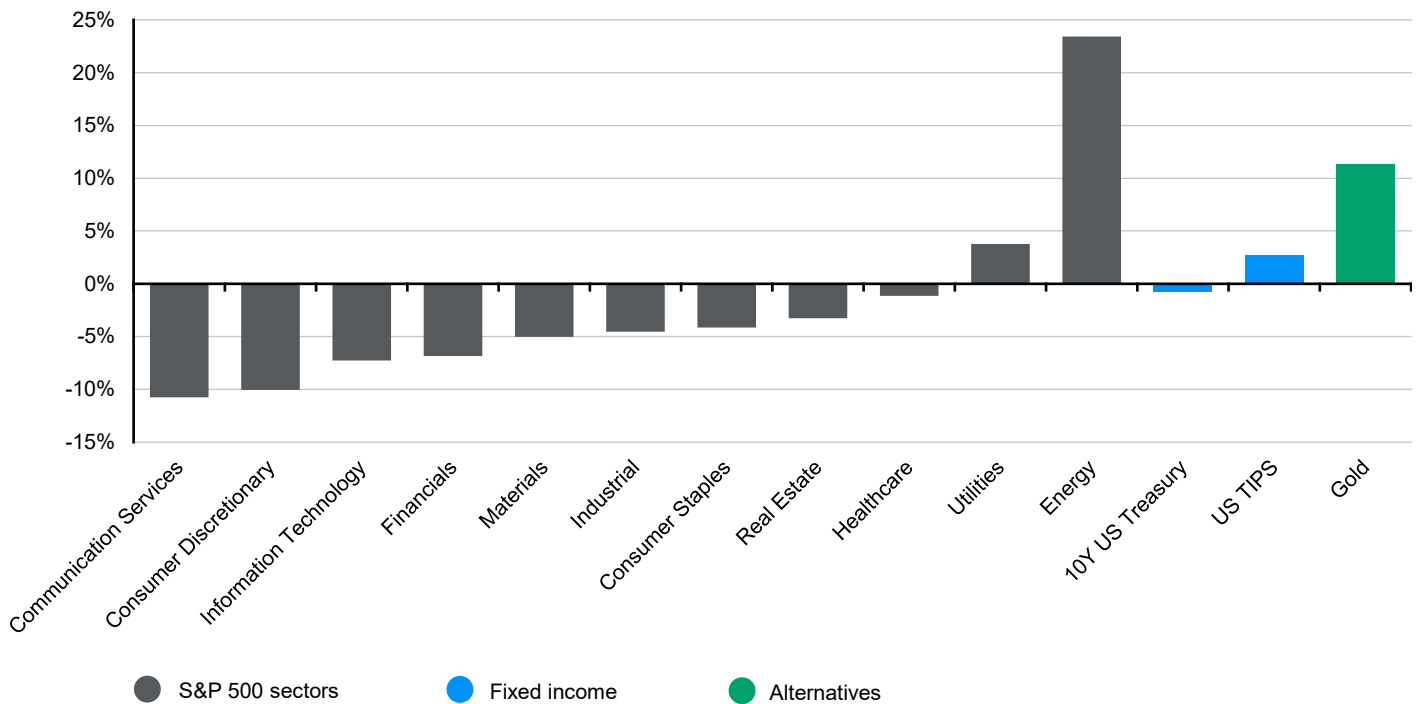
Market implications

- Stagflation concerns could drive a risk-off regime, pressuring both equities and bonds. There are few episodes to draw historical precedent from; **Exhibit 1** shows the onset of the Russia-Ukraine conflict as Russian supplies of oil and gas were disrupted by sanctions, albeit this was a relatively short episode while the global economy was recovering from the pandemic.
- Historically, inflation-linked bonds outperform nominal government bonds during times of inflation shocks. The government bond curve could flatten as growth momentum slows.
- Credit spreads would likely widen as weak growth raises default risk; high yield (ex-energy) would be more vulnerable.
- Within equities, energy and utilities have historically been more resilient in supply-driven energy shocks, while industrials, consumer discretionary, and technology may face greater headwinds amid higher yields and a cut back in consumption.
- Risk aversion typically supports a stronger U.S. dollar as investors favor liquidity.
- Gold has often performed well in rising-oil environments, though results have been inconsistent.
- Alternatives with long/short strategies (e.g., hedge funds) and income-generating real assets (e.g., transportation-related assets) may provide some resilience.

Asset performance as investors may worry about stagflation

Exhibit 1: Asset class performance from Jan 2022 to Mar 2022

Total return, percentage



Source: FactSet, J.P. Morgan Asset Management. Data reflect most recently available as of 08/05/26.

Re-escalation of military conflict across the region

Backdrop

The ceasefire breaks down and Iran resumes attacks on other Gulf states, focusing on energy production and processing facilities and transportation infrastructure. This results in a prolonged reduction in supply.

Economic reaction

- Damage to Middle East energy production and refining capacity removes supply from the market for an extended period. For example, if a major facility were damaged (e.g., a gas-to-liquids plant in Qatar), liquefied natural gas (LNG) output could decline materially for several years.
- The overall economic impact depends on the scale of the damage and the time required for repairs and reconstruction. This scenario assumes losses are not fully offset by spare capacity elsewhere and that restoring production takes at least 2–3 years.
- Energy prices would likely rise more sharply, and long-dated energy futures could also increase.
- Higher prices would weigh on activity and consumption, partially limiting further price increases over time.
- Demand destruction would resemble the extended-closure scenario, but governments and businesses may move more urgently to find alternatives. Renewable energy would be a natural path—especially in Europe and other developed economies. Some emerging markets (e.g., India) could expand coal use for power generation. Adjusting industrial processes to reduce reliance on petrochemicals may take longer.

Policy reaction

- Central banks are likely to prioritize growth and the functioning of the financial system, including providing liquidity as needed. The Fed could cut rates and potentially reintroduce asset purchases (quantitative easing), though willingness to expand the balance sheet may depend on the Fed's leadership and policy stance.
- Balance-sheet expansion could also limit excessive increases in government bond yields if governments run large deficits to support the economy (similar to the pandemic period).
- Governments may need to significantly step up fiscal support through tax cuts and higher spending. Some support would occur automatically through built-in stabilizers (e.g., unemployment benefits).
- Some governments may also increase investment in the energy transition described above.

Market implications

- Fixed income volatility could rise sharply as markets try to price a policy path that balances inflation risks against recession risks. If central banks re-engage in quantitative easing, declining yields would favor outright long-duration positioning.
- Initial risk-off sentiment could trigger an equity correction, but aggressive policy support could prompt a rebound (COVID-19 in 1H 2020 is a relevant reference point for the policy impulse).
- Sustained supply disruption could shift investor focus toward beneficiaries of energy-independence policies: non-fossil fuels (solar, wind, hydro, nuclear), battery storage, infrastructure to reroute supply chains, and electric vehicles.
- This investment-cycle shift could increase demand for transportation and related infrastructure, creating opportunities for investors with longer time horizons and lower liquidity needs.

2. Global AI investment opportunities and risk: Concerns about concentration again?

In brief

- AI remains a key market theme, but rising index concentration means that broad indices are becoming increasingly directional bets on uninterrupted AI momentum.
- However, market leadership within AI is evolving, shifting from hyperscalers to broader sector beneficiaries like semiconductors, equipment makers, and component suppliers, with end-users in sectors like financials and industrials potentially poised to be the next leg of the opportunity.
- Key risks include over-investment outpacing monetization, alongside regulatory complexity and the potential for earnings misses to trigger broad de-risking. The cost of tokens could also force businesses to ration staff access to AI and the scope of development.
- A broader exposure beyond mega-cap leaders to the wider AI ecosystem and region diversification, as well as private markets, may help in reducing the risks associated with concentrated markets.

Despite the geopolitical headwinds, markets remain sharply focused on AI, with U.S. large-cap tech stock performance underpinning robust S&P 500 returns and earnings in recent quarters. While AI disruption may bring future opportunities, investors should be mindful of risks associated with concentrated equity markets and consider geographical diversification and AI-related investment opportunities alongside private market exposure.

Opportunities: Identifying the winners of the evolving AI trend

The initial phase of the AI trend was concentrated in the physical infrastructure buildouts and capital expenditure. With the advent of Generative AI (Gen AI), the structural demand for compute has risen materially. Capital expenditure from the biggest AI hyperscalers is likely to reach USD 700 billion this year, up 70% from 2025. Even as the surging AI demand is driving up prices across the supply chain, profit margins of this subset of companies remain steady, as efficiency becomes a priority. Crucially, the recent rally has been supported by strong earnings, with the technology sector still firmly in the driver's seat and revenues underpinned by cloud sales and agentic AI subscriptions.

As AI drives demand for semiconductor and memory chips, the beneficiaries within the technology sector are evolving, as market leadership moves upstream in the AI supply chain. The year-to-date performance of semiconductors vis-à-vis hyperscalers reinforces the idea that relative winners of the AI trend are evolving. This also benefits parts of Asia's semiconductor supply chain, particularly Korea and Taiwan. Meanwhile, China's comparative advantage in mature semiconductor nodes and its push for domestic self-sufficiency are generating an AI innovation trajectory increasingly independent of the U.S. and broader Asian cycle.

Beyond the technology sector, earnings in other sectors have been strong. Financials have benefited from AI-driven financing demand and capital markets activity, while industrials are buoyed by data center expansion.

We have stressed that AI monetization through broader adoption by consumers and businesses will be key. While AI adoption rates are currently uneven across sectors, there is scope for structured integration with the objective of improving measurable productivity gains. This could partially narrow the margin gap between sectors such as financials, healthcare, industrials and software, which has commanded the highest profit margins in the market.

Risks: When a powerful theme meets fragile market plumbing

The clear risk in today's AI trade is that broad equity benchmarks have quietly become narrow expressions of a single theme. As of June 10, the Magnificent 7² accounts for 34% of the total market value of the S&P 500, turning it into an increasingly directional bet on uninterrupted AI momentum. Asia exhibits a similar dynamic: A handful of South Korean and Taiwanese semiconductor names are the drivers of their local benchmarks. Any revenue miss in technology or communication services could trigger indiscriminate de-risking across the AI-related portfolios. There are also reports that the high token costs are forcing users to set limits on staff access to AI models or the scope of tasks for development. Anticipated initial public offerings (IPOs) of leading AI architects risk further consolidating exposure into a narrow set of high-profile names.

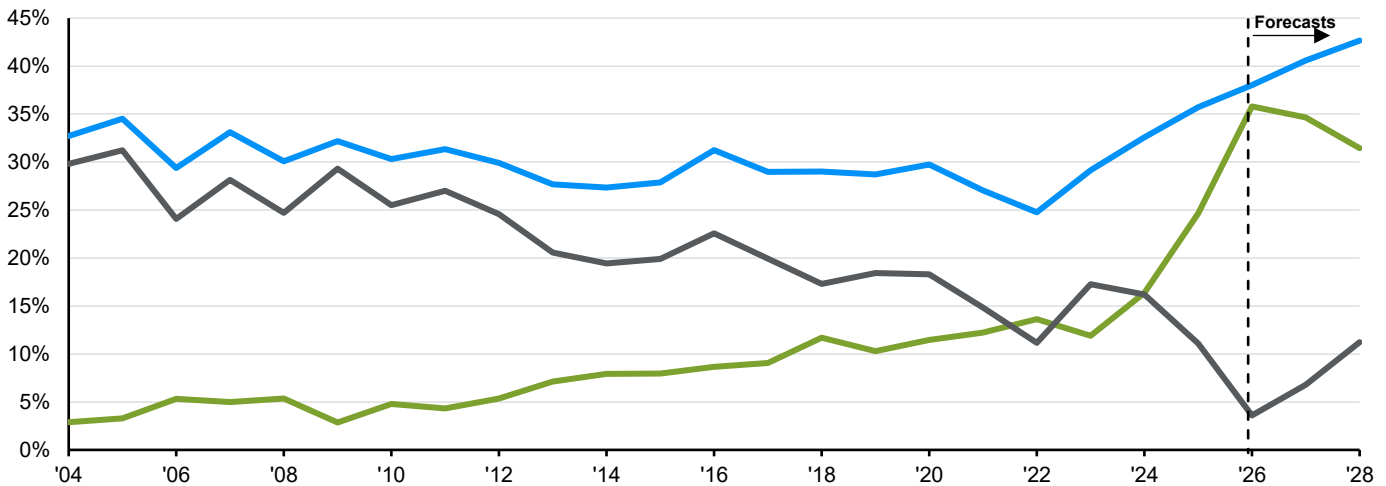
Competitive dynamics are pushing hyperscalers to keep accelerating spending on chips, compute, and power. Free cash flow is expected to begin rising as hyperscaler revenues increase, providing a forward-looking justification for the elevated capex cycle (**Exhibit 2, next page**). The risk is not that AI demand proves inorganic, but that the pace of investment outruns near-term monetization. If hyperscalers' earnings disappoint, capital expenditure commitments can be revised quickly, with downstream effects rippling down through the value chain.

The policy environment adds a third layer of complexity that investors may be underpricing at this juncture. Governments are actively building out governance frameworks around AI: the EU through its AI Act and AI Continent Action Plan, and the U.S. through a national legislative framework that addresses societal concerns ranging from child safety and community impact to AI-enabled fraud. These frameworks are not hostile to AI development; however, the expanding body of compliance obligations introduces operational complexity and legal uncertainty that can weigh on deployment timelines, and that cost is not yet fully reflected in valuations.

²Magnificent 7 (Mag 7) includes Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia and Tesla. The companies/securities are shown for illustrative purposes only. Their inclusion should not be interpreted as a recommendation to buy or sell. J.P. Morgan Asset Management may or may not hold positions on behalf of its clients in any or all of the aforementioned securities.

Hyperscaler investment remains strong, fueling growth across the AI ecosystem.

Exhibit 2: Hyperscalers' cash flow and capex
% of sales



Source: Bloomberg, J.P. Morgan Asset Management. Data for 2026, 2027 and 2028 reflect consensus estimates. Capex shown is company total. *Hyperscalers are the large cloud computing companies that own and operate data centers with horizontally linked servers that, along with cooling and data storage capabilities, enable them to house and operate AI workloads. Data reflect most recently available as of 19/05/26.

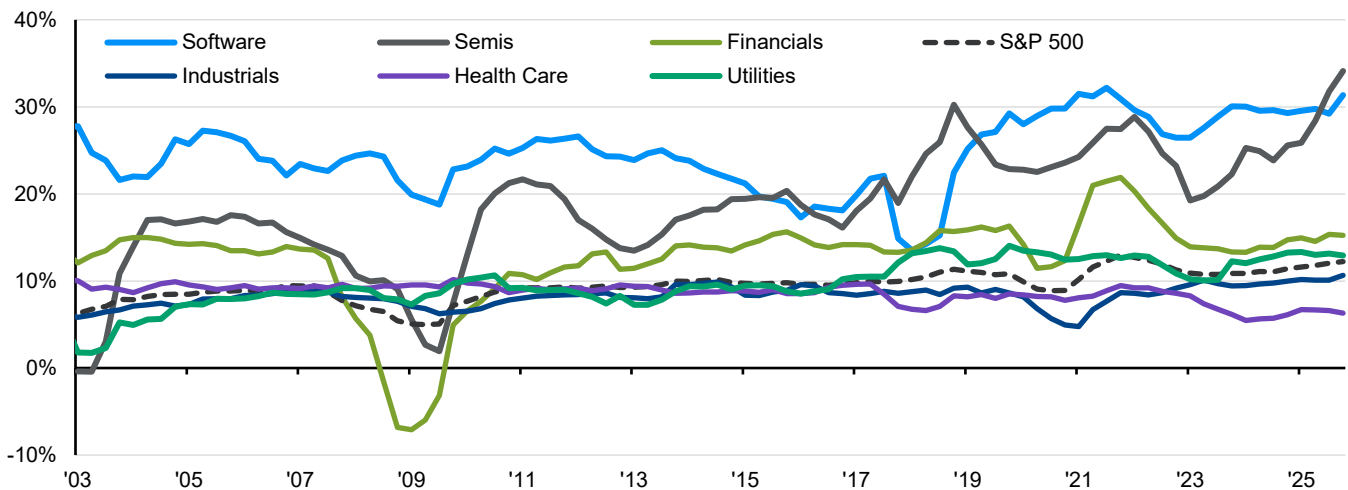
Investment implications: Participate in AI, but engineer resilience

The structural case for AI remains intact, but index-level exposure concentrates risk in a narrow set of mega-cap names. The most effective approach is to widen the opportunity set through active selection across the broader ecosystem by looking beyond hardware leaders to the infrastructure layer, including data centers, power grids, cooling systems, and enabling equipment, where demand can persist even as leadership rotates. AI adopters in healthcare, financials, and industrials offer productivity-driven margin expansion without the same valuation premium as the largest names. Utilities also benefit from AI-driven electricity demand and grid investment (Exhibit 3). The objective is not to avoid leaders, but to avoid over-reliance on them.

Private markets can complement public AI exposure by offering access to the buildout at earlier stages and in different parts of the capital stack, often with lower correlation to public equities and bonds and less day-to-day mark-to-market volatility. Meanwhile, income-generating exposures can provide ballast against equity drawdowns while keeping portfolios genuinely invested in the AI buildout.

Markets may find it challenging to price in the risk and opportunity from AI disruption.

Exhibit 3: Profit margins for select S&P 500 sectors
Net margins, last 12 months, quarterly



Source: FactSet, S&P Global, J.P. Morgan Asset Management. IGV = iShares Expanded Tech-Software ETF. SOXX = iShares Semiconductor ETF. Net profit margins measure total profitability after all overhead and expenses. Data reflect most recently available as of 19/05/26.

3. China: Can AI help drive an equity turnaround?

In brief

- Offshore China equities have lagged due to softer earnings momentum, weaker flows, a less favorable sector mix, and higher geopolitical sensitivity.
- A sustained catch-up likely requires domestic demand stabilization, easing platform competition, AI monetization, and policy follow-through.
- Investment opportunities may require active portfolio construction focused on company fundamentals, balancing AI-linked growth leaders with high-quality dividend yielders. Chinese AI companies could act as a diversifier from U.S. AI development.

China equity performance has diverged meaningfully year-to-date. Offshore China has lagged, with MSCI China down 10.8%, while the CSI 300 is up 2.0% and continues to make new highs. Hang Seng Tech is down by around 5%, underperforming MSCI AC World by roughly 14 percentage points.

This divergence reflects structural differences, not just positioning. Onshore indices benefit from industrial upgrading, hardware technology, power equipment, and policy-linked manufacturing. Offshore China remains exposed to internet platforms, consumption, financials, property, global liquidity, and geopolitical risk. Global investors have also favored Korea and Taiwan as more direct AI hardware beneficiaries.

Why has Hang Seng Tech lagged?

Hang Seng Tech's underperformance reflects sector mix, earnings pressure, and a shift in the AI narrative. Internet platforms, autos, and consumer names each face distinct headwinds: regulatory and competitive pressure, price wars, and weak demand.

The AI trade has also evolved. Markets have rotated from software optionality toward hardware enablers—chips, servers, power infrastructure, and North Asian supply-chain leaders. Large Chinese platforms are seen as being in a "heavy investment, light return" phase: AI capex and R&D are rising, but monetization through advertising, cloud, and AI applications has not yet accelerated enough to support a re-rating.

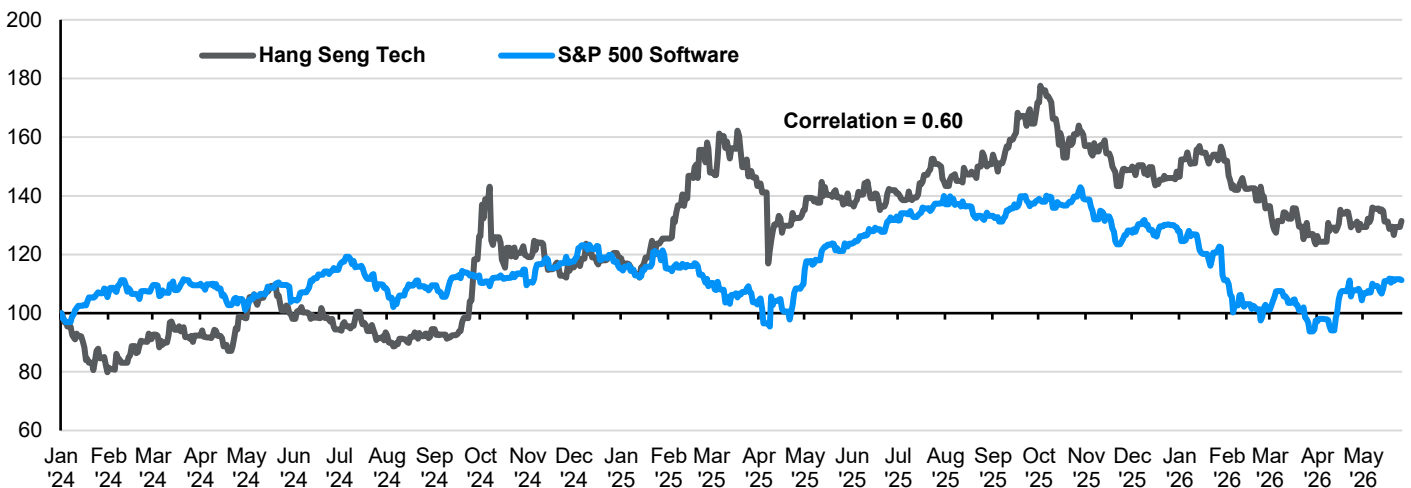
That said, the pullback does not signal fundamental deterioration. Leading platforms remain profitable, but investors have shifted from valuation re-rating to demanding earnings proof. A more constructive setup could emerge if AI investment begins translating into revenue growth, profit margin support, or new product adoption.

Investors should also watch whether the AI narrative broadens again. Hang Seng Tech has historically correlated with U.S. software (Exhibit 4), and sentiment may improve as markets distinguish between companies vulnerable to AI disruption and those positioned at the center of the buildout.

Hang Seng Tech's correlation with U.S. software suggests sentiment may improve as markets identify AI beneficiaries versus disruption risks.

Exhibit 4: Hang Seng tech vs. U.S. software companies

Price return, rebased to 100 = Dec 2023, local currency



Source: Bloomberg, Hang Seng, S&P Global, J.P. Morgan Asset Management calculations. Data reflect most recently available as of 31/05/26.

Flows, earnings, and geopolitics

Flows have added pressure. Southbound momentum has slowed while IPOs and secondary offerings have increased supply. Earnings revisions have deteriorated, with the technology complex seeing roughly 37% downgrades over the past 12 months, largely linked to food-delivery competition and subsidy intensity.

Early signs of easing exist. One leading platform indicated that food-delivery losses narrowed substantially quarter-over-quarter, suggesting competitive intensity may be moderating. Further confirmation in upcoming results will be important.

Geopolitics remains a major swing factor. H-shares carry higher beta to geopolitical risk, and emerging market (EM) selling following the Iran conflict likely weighed on offshore equities. U.S. restrictions on high-end AI chips continue to affect sentiment. This explains why H-shares can appear inexpensive yet still require earnings upgrades and lower risk premia to sustain a durable uptrend.

Macro and policy watchpoints

April macro data was weak. Domestic demand cooled, retail sales were nearly flat, and weakness broadened beyond autos into trade-in-subsidy-linked categories. Investment moved back into contraction, led by property drag and softer manufacturing activity—making the second-quarter growth path more challenging.

The picture is not uniformly negative. Services consumption remains resilient, policy-supported new-economy segments are holding up, and property transactions show improvement in some regions. The April miss may also pull forward targeted fiscal or administrative support. The key watchpoint is whether activity stabilizes in May and June.

Second-half catalysts

Geopolitics and policy will be central. Working-level U.S.–China discussions, trade and investment commitments, and potential AI-safety dialogue going forward are key. Any reduction in geopolitical uncertainty could lower the risk premium embedded in offshore equities.

Sector-level catalysts are also emerging. China's materials and industrials may be relatively insulated from global energy shocks given domestic coal availability and expanding renewables. Higher oil prices could strengthen the relative appeal of electric vehicles (EVs), benefiting domestic EV, battery, and related technology leaders.

AI infrastructure is a potential bright spot. Battery manufacturers are increasingly positioned not only as EV beneficiaries but also as providers of energy storage and integrated power systems for AI data centers. Power equipment companies could benefit from backup-power demand, while natural gas engines may serve off-grid or power-constrained AI sites—broadening China's AI opportunity beyond internet platforms into physical infrastructure.

For internet platforms, potential domestic large language model (LLM) launches, accelerating AI cloud adoption, scalable AI-agent deployment, and easing food-delivery competition could revive investor confidence.

Investment implications

H-shares remain more sensitive to geopolitics and global liquidity than A-shares, and sustained upside likely requires profit growth as well as positive earnings revisions. However, offshore China offers valuation and income support. Offshore Chinese banks yield above 5%, and MSCI China trades around 0.5 standard deviations below its historical relative average versus MSCI World.

A barbell approach—combining thematic growth leaders with high-quality yielders—is worth considering. Given wide sector dispersion, active portfolio construction remains critical. Within AI, focus can shift from capex announcements to monetization evidence. Shareholder returns and Chinese companies going global remain additional structural themes for the second half of 2026.

4. Mid-term elections: How does a change in Congress change U.S. policies?

In brief

- The U.S. mid-term elections in November could see the Democrat Party regain a majority in the House of Representatives, although winning the Senate is a longer shot.
- A divided Congress would likely see more constraint on the Trump administration’s ability to expand fiscal policy to boost growth.
- U.S. President Trump still has a number of tools at his disposal that could impact markets. Tariffs, regulation enforcement, and foreign policy are areas where the administration could still make an impact without collaborating with Congress.

On November 3, all 435 seats in the House of Representatives and 33 of the 100 Senate seats will be contested. While five months is ample time for public sentiment to shift, historical patterns and the current economic backdrop still offer useful guidance for investors. Ultimately, economic growth and corporate earnings will remain the dominant drivers of asset returns. However, the election outcome could constrain fiscal policy and increase reliance on executive action in the latter half of U.S. President Trump’s term.

A divided Congress

Midterm elections have historically served as a referendum on the sitting president. Over the past century, the president’s party has lost House seats in all but three midterms (1934, 1998, and 2002). With Republicans currently holding only a narrow four-seat majority in the House, historical precedent suggests a high probability that Democrats could regain control. Public approval for U.S. President Trump and his party has also been pressured by rising living costs, particularly the recent increase in gasoline prices.

In contrast, the Senate map is more favorable to Republicans. Given the specific seats up for election and the vice president’s tie-breaking role in a 50–50 scenario, Republicans still have a reasonable chance of retaining control.

A divided Congress would make it more difficult for the president to advance legislative priorities, especially on fiscal policy. That said, the Trump administration has already demonstrated a willingness to rely on executive authority to implement key policies, including tariffs and foreign policy actions such as its stance toward Iran.

Fiscal constraints

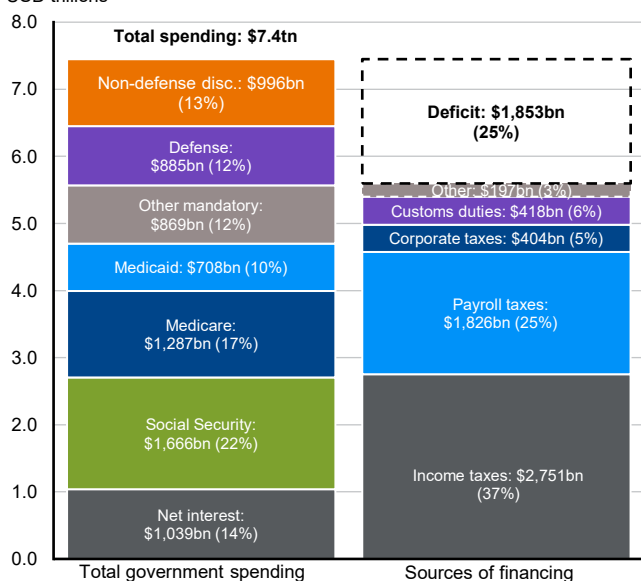
Recent administrations have relied on the budget reconciliation process to pass major fiscal legislation, as it allows bills to pass the Senate with a simple majority rather than the 60 votes required to overcome a filibuster. U.S. President Trump’s “One Big Beautiful Bill Act” (OBBBA) in 2025 is a recent example.

If Democrats take control of the House, even this budget reconciliation route becomes more challenging. Any fiscal package must first pass the House, requiring bipartisan support. Policies such as further corporate tax cuts, increased defense spending amid tensions with Iran, or reductions in social spending are likely to face strong opposition from Democrat lawmakers. As a result, the probability of additional fiscal stimulus would decline unless the economy deteriorates significantly, even though the Trump administration could redirect some of the approved funding to boost household spending.

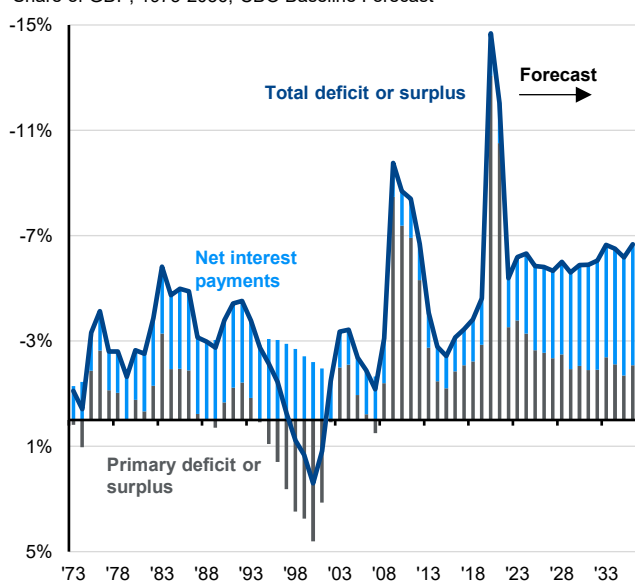
Although a Democrat-led House of Representatives would limit U.S. President Trump’s fiscal expansion, U.S. fiscal deficit is likely to remain high given interest expenses and spending with little room to cut.

Exhibit 5: United States: Federal finances

The 2026 federal budget



Federal deficit and net interest outlays



Source: BEA, CBO, Treasury Department, J.P. Morgan Asset Management. (Left) Numbers may not sum to 100% due to rounding; (Right) Estimates are from the Congressional Budget Office (CBO) February 2026 An Update to the Budget Outlook: 2026 to 2036. “Other” spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Years shown are fiscal years. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated. *Guide to the Markets – Asia*. Data reflect most recently available as of 31/03/26.

At the same time, a sharp reduction in the fiscal deficit also appears unlikely. A Republican-controlled Senate would probably resist tax increases needed to materially narrow the deficit. The spending required to replenish munitions used in the Middle East conflict and potential revenue losses from legal challenges to tariffs could also limit fiscal improvement. Finally, much of the fiscal deficit facing the U.S. federal government today comes from interest expense (**Exhibit 5, previous page**).

The debt ceiling adds another layer of uncertainty. The 2025 OBBBA raised the U.S. debt ceiling by USD 5trillion to USD 41.1trillion. Estimates from the Center on Budget and Policy Priorities suggest this limit could be reached by 2027. There is little doubt that the debt ceiling will eventually be raised, but the political posturing en route to this compromise could still keep the bond market on edge.

Greater reliance on executive action

With legislative avenues constrained, the administration is likely to rely more heavily on executive powers. Key policy areas such as trade and immigration largely fall within executive authority.

Although the Supreme Court has ruled that tariffs imposed under the International Emergency Economic Powers Act (IEEPA) are unlawful, alternative legal pathways are being pursued. Investigations by the Department of Commerce and the U.S. Trade Representative into unfair trade practices could provide a more durable legal basis for tariffs.

Immigration policy is also expected to remain restrictive, limiting labor supply growth. In foreign policy, the administration retains broad discretion, including the use of military force against economies deemed hostile, such as Iran.

Together, tighter trade and immigration policies present upside risks to inflation, which could in turn constrain the Fed's ability to ease monetary policy.

Economic fundamentals matter more

While the midterm elections will increasingly dominate headlines, the macroeconomic environment remains the primary driver of markets (**Exhibit 6**). Historically, volatility tends to rise ahead of elections due to uncertainty, then decline once results are known, regardless of which party prevails.

A potential fiscal stalemate could be supportive for long-duration government bonds, as it reduces the likelihood of a significant increase in deficits beyond current projections. However, debt ceiling negotiations could trigger periodic volatility in bond markets.

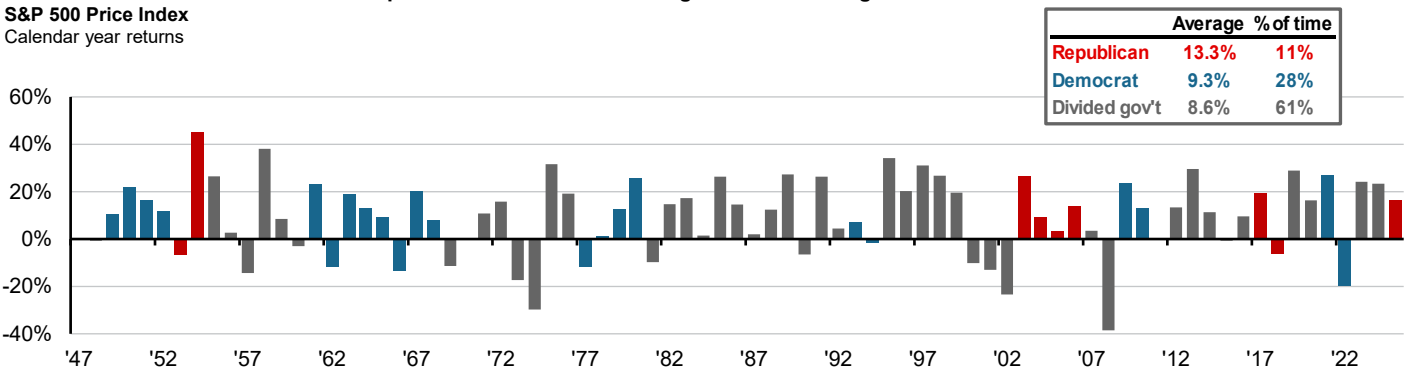
On regulation, some changes require congressional approval, particularly those involving new legislation. However, the administration retains meaningful flexibility through adjustments to agency rules and enforcement practices. For example, regulators could modify the stringency of bank stress tests without new laws. As a result, the overall regulatory trajectory may not shift dramatically based on the election outcome.

In sum, while political developments will shape the policy environment, their impact on markets is likely to be secondary to the broader economic cycle and earnings outlook.

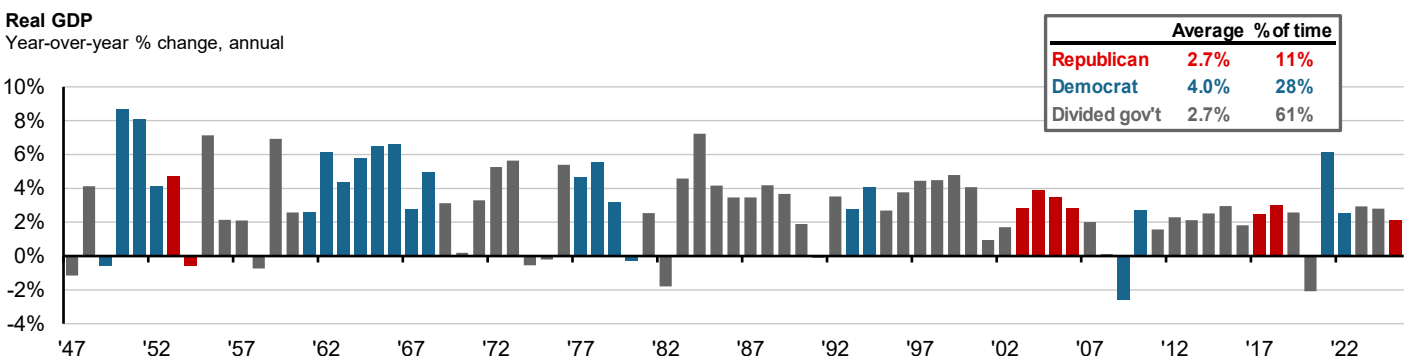
The economic backdrop matters more than the composition of executive-legislative bodies.

Exhibit 6: S&P 500 and U.S. real GDP performance under different government configurations

S&P 500 Price Index
Calendar year returns



Real GDP
Year-over-year % change, annual



Source: BEA, Standard & Poor's, FactSet, J.P. Morgan Asset Management. Data reflect most recently available as of 09/06/26.

5. Central bank policy: How to balance between inflation and growth challenges?

In brief

- Energy shocks have lifted global inflation risks, but central bank responses will vary due to local growth challenges, capital flows, and currency reactions.
- Softer underlying growth in the U.S. offers room for the Fed to stay put, while the ECB and the BoE may adopt a more proactive approach in pre-empting inflation risk.
- The Bank of Japan (BoJ) should remain on a policy normalization path, albeit with delays, while divergence in Asian interest rates is expected to widen ahead.

Amidst the ongoing Middle East conflict, disruptions to energy supply chains have meaningfully reshaped the global inflation and growth outlook, and in turn, expectations for central bank policy paths. Most central banks have since adopted a wait-and-see approach as the conflict's macroeconomic impact gradually becomes clearer. Markets, however, have taken a more hawkish view on interest rates. Compared with the start of this year, market pricings have shifted from more than two rate cuts in the U.S. to a full rate hike by year-end, with a similar repricing across other major developed markets.

While inflation rates have moved back above target in most economies, and prolonged supply side disruptions are likely to continue uniformly exerting inflationary pressures globally, the key differentiator for monetary policy will likely be how each central bank balances upside inflation risks against downside risks to growth. And with wide differences in domestic economic conditions and central bank reaction functions, interest rate paths are likely to diverge further in the coming months.

Behind the (Fed)cade

For the U.S., headline activity data appears to point to a robust economy—economic growth remains on track near trend rate level, and a steady unemployment rate suggests a broadly balanced labor market. However, underlying dynamics have hinted at a more subdued and uneven picture. Recent growth has been mostly concentrated in fixed investments in business, particularly in equipment and intellectual property, driven by AI upcycle-related spending. In contrast, real consumer spending growth has been relatively more modest, with mounting downside risks as higher energy prices gradually begin to erode households' real disposable income.

The labor market also displays an unusual dynamic. Despite muted labor demand as reflected in below-average hiring rates and softer job growth, lower net foreign immigration has structurally constrained labor supply, mechanically limiting upward pressure on the unemployment rate. As a result, while the headline unemployment rate still runs marginally above the Fed's long-run estimate—which typically bodes for a hawkish response during episodes of surging inflation—underlying labor market weakness likely sets a higher bar for rate hikes. Modest and decelerating wage growth, which has decoupled from the lower unemployment rate, further reinforces limited upside risks from a wage-led spiral into services inflation, and this may leave the Fed in no rush to adjust interest rates.

Hawks circling in Europe

In the UK and Europe, however, monetary policies could become notably more hawkish ahead. While both economies are prone to downside risks—a weak labor market in the UK and stalling economic growth in the eurozone, both central banks have expressed similar concerns over de-anchoring inflation expectations and have signaled the possibility of adopting a pre-emptive, proactive stance toward tightening policy. For the ECB, the June staff projections have implicitly factored in three rate hikes, and for the BoE, the April scenario analysis's "medium" scenario indicates at least one rate hike ahead. Also, with limited signs of supply chains normalization in the near term, the likelihood of materializing these scenarios has correspondingly increased. While downside economic surprises would still be welcome, such as the recent services-led drop in UK inflation, which could delay the timing of the next rate hike, the overall policy outlook could remain hawkish absent any meaningful resolution in the Middle East.

Policy divergence in Asia

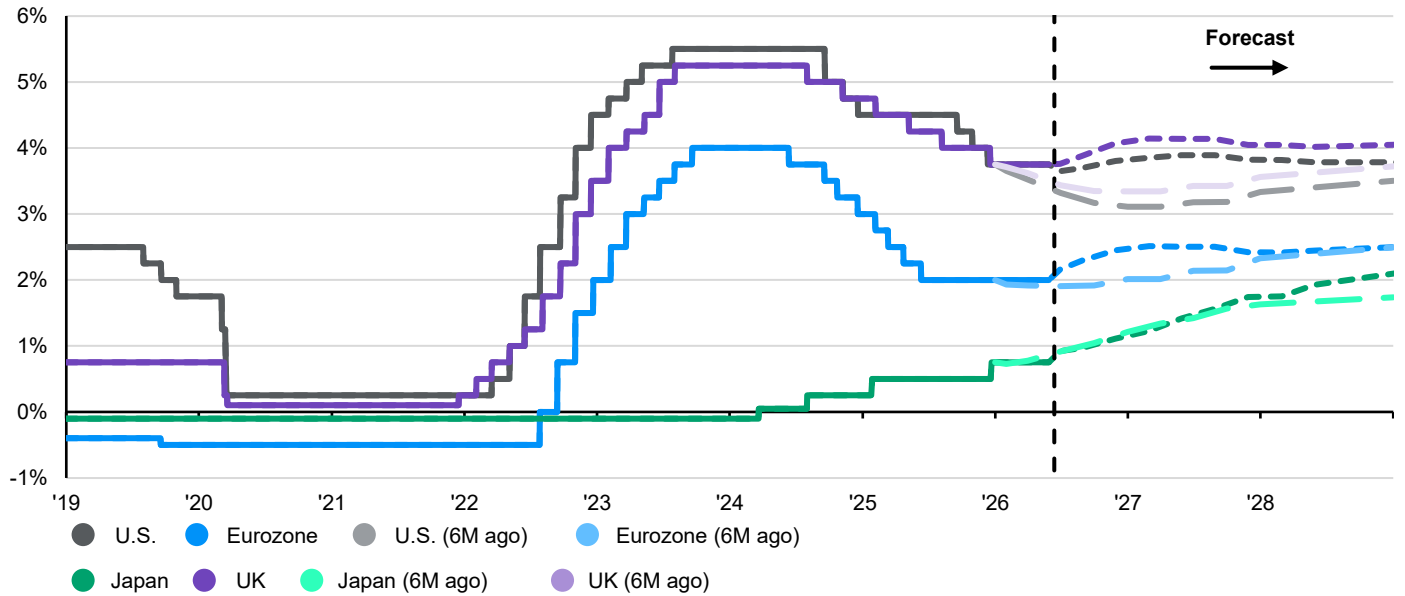
Japan remains the key outlier within developed markets. Higher energy prices, combined with a persistently weak currency, have lifted imported inflation and should normally point to a similarly more hawkish policy outlook. However, the BoJ's cautious reaction function and its asymmetric focus on growth over inflation have meant that external supply shocks may instead pose greater downside risks to domestic demand, clouding visibility on the underlying wage-led inflation trend, and thereby oppositely implying further delays to policy normalization. That said, while rate increases are likely to remain gradual in the near term, the risks of falling behind the curve have become more pronounced. With markets beginning to price in a higher terminal rate, this may prompt the BoJ to slowly accelerate its hiking schedule over the medium term, further diverging Japan's monetary policy path from other developed markets.

Divergence is also apparent within the rest of Asia. Economies with larger oil inventories, lower fuel weights in consumer price index (CPI) baskets, stronger current accounts, and AI-led growth offsets, such as parts of North Asia, could likely wait out the shock for longer. In contrast, markets with higher reliance on energy imports, weaker fiscal buffers, or greater currency vulnerability could however face earlier monetary policy responses, as seen in Indonesia and the Philippines, where tightening has already begun. However, the more prudent and proactive stance in these economies should help limit spillover into the broader inflation basket and reduce the aggregate tightening required before interest rates peak. Currency weakness also adds another layer to a hawkish bias in the near term, as higher rates help stabilize capital flows, restore confidence in local currencies, and prevent further depreciation-led imported inflation. We expect Asian central banks to set monetary policies based on their own domestic circumstances, instead of just tracking the Fed or developed market central banks.

Interest rate paths have been repriced sharply compared to start-of-year expectations, but with nuances on which central bank would realize correspondingly in the near term.

Exhibit 7: Key policy rates and market expectations*

Historical policy rates and market implied forward rates



Source: Bank of England, Bank of Japan, Bloomberg, European Central Bank, FactSet, U.S. Federal Reserve, J.P. Morgan Asset Management. *Expectations are based on forward swap rates. Past performance and forecasts are not a reliable indicator of current and future results. *Guide to the Markets – Asia*. Data reflect most recently available as of 28/05/26.

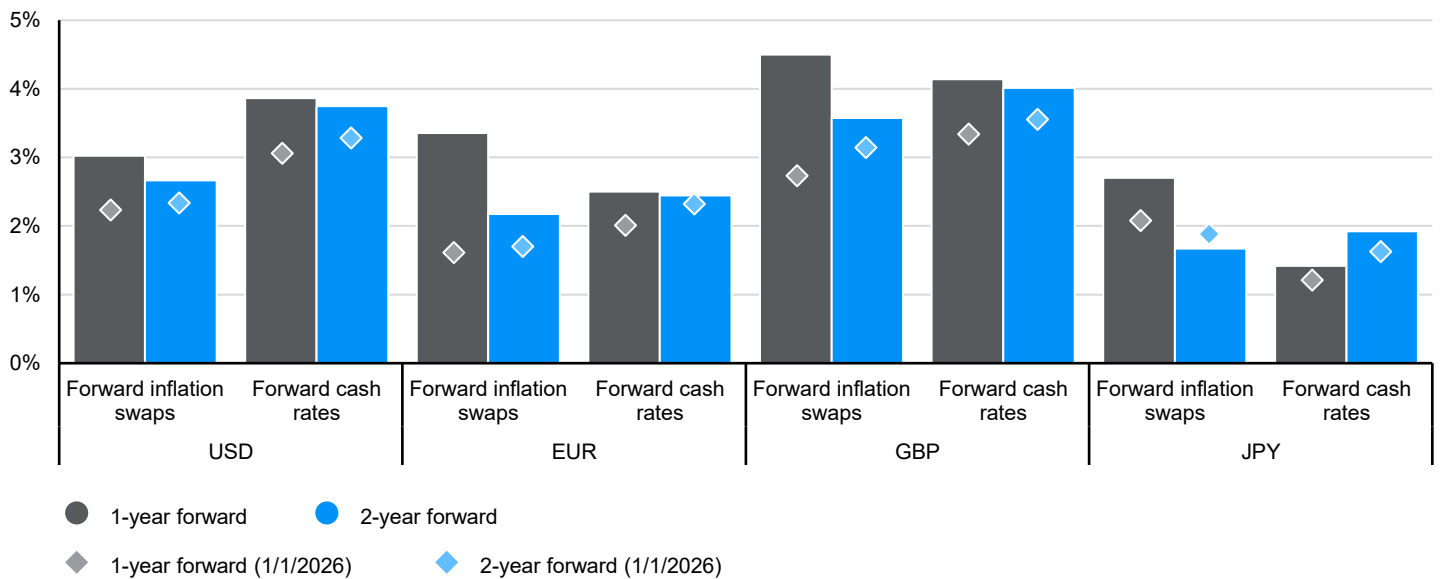
At any rate

Taken together, the key differentiators for monetary policy will remain differences in domestic economic conditions and central bank reaction functions, particularly in the balance each central bank strikes between inflation and growth risks. That said, uncertainty is likely to remain elevated in the near term, whether from known sources such as dynamics under a Warsh-led Federal Open Market Committee, or from unknown anomalies such as another geopolitics-led external shock. As such, while market repricing of forward rates and inflation expectations has remained largely front-loaded over the medium term over the next year, any additional pressure from more persistent inflation or structural shifts in reaction functions could point to sharp shifts in the rates market. Although this creates a more complex outlook that may be challenging for a static global duration view, this has turned more beneficial to a more proactive and selective approach to fixed income, with active duration becoming increasingly important.

Market repricings were mostly front-loaded on 1-year forward rates and inflation expectations, but risks of inflation spillover or external shocks may alter this.

Exhibit 8: Market implied forward rates and inflation swaps

Market implied rates



Source: Bloomberg, J.P. Morgan Asset Management. Past performance and forecasts are not a reliable indicator of current and future results. *Guide to the Markets – Asia*. Data reflect most recently available as of 28/05/26.

6. The new diversification: Alternatives in an inflationary world

In brief

- The macro environment in 2026 has shifted, with the threat of elevated inflation and fiscal imbalances driving a positive stock-bond correlation and altering portfolio risk profiles.
- Alternative assets, private equity, private credit, and infrastructure —offer return and diversification benefits through lower volatility and reduced correlation with public markets.
- Private equity is seeing robust activity, especially in tech IPOs and secondaries, while private credit faces idiosyncratic risks from software lending but offers attractive floating-rate income.
- Infrastructure investments provide steady, inflation-resilient cash flows and are increasingly vital for portfolio resilience.

The diversification dividend

Coming into 2026, expectations were for robust economic growth and fading inflation, which would allow central banks to modestly ease monetary policy. However, reality diverged sharply, echoing 2022, when both bond and equity markets fell together and the stock-bond correlation turned positive. While this spike in correlation may eventually prove temporary, the rise in bond yields reflects deeper structural changes in inflation, policy action, and fiscal imbalances, suggesting this regime may endure and alter portfolio risk profiles.

Alternative assets offer characteristics that can replicate or complement public market exposures, benefiting portfolios through low mark-to-market volatility and reduced correlation to public assets. These features are particularly valuable in today's environment, helping to address key pressure points.

Investors are also evaluating the impact of AI on private markets, not just public ones. This makes manager selection crucial for successful portfolio allocations.

Private equity: Spaced out

Private equity began the year strongly, with global M&A and IPO activity in the first quarter outpacing prior years. Tailwinds from lower funding costs in 2025 and steadier public markets provided a stable backdrop for exits. Although the second quarter may be choppy due to market turbulence, the outlook for the second half of 2026 remains robust, supported by several mega-deals.

The potential size of upcoming tech IPOs is staggering—the three largest could be valued at around USD 3.5trillion. If successful, these deals could have a powerful sentiment impact across private equity, given the asset class's relatively higher exposure to the tech sector.

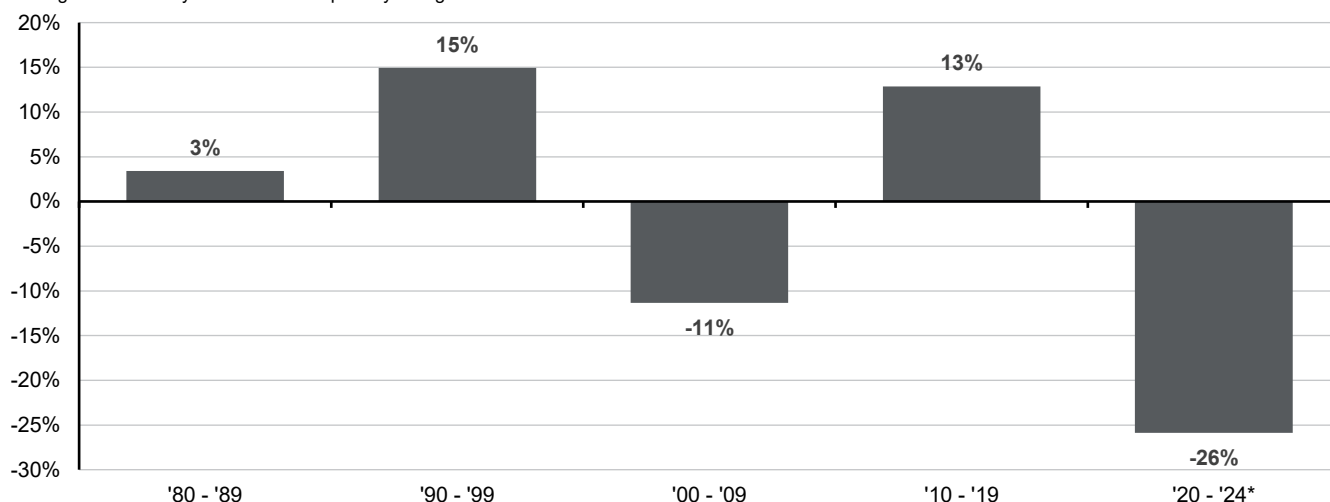
Private equity's weighting in technology at 36% is significantly higher than the Russell 2000 index (15%), representing both opportunity and risk. Poor performance in newly listed tech companies could create a negative feedback loop for private equity. Performance post-IPO is not guaranteed (**Exhibit 9**), and investing on the first day of public trading has mixed results. The opportunity lies in investing when companies are still private, as they are becoming larger and more profitable before going public.

Concerns around concentration risk in sector and size can be addressed through private equity secondaries, which generate liquidity and enable redistributions across managers. Prospects are emerging in both growth equity and co-investments as companies seek fresh funding or alternative exit strategies not tied to public listings. The secondaries market offers access to private equity with shorter duration and some de-risking through discounted prices to NAV.

2026 could be the largest year on record for IPO and post-listing performance may have a significant impact on overall PE sentiment.

Exhibit 9: Post-IPO stock performance by decade

Average annual one-year returns after publicly listing



Source: Bloomberg, Jay Ritter – Univ. of Florida, PitchBook Data, Inc., Standard & Poor's, J.P. Morgan Asset Management.

*2024 is the latest annual data available from the "Initial Public Offerings: Updated Statistics" report. Returns shown for post-IPO performance are the equally weighted average first-year returns measured from the offer price to the CRSP-listed closing price one year later. One-year post IPO returns are for companies that publicly listed during the listed period as tracked by the "Initial Public Offerings: Updated Statistics" report. IPOs with an offer price below \$5.00 per share, unit offers, small best efforts offers, natural resource limited partnerships, REITs, closed-end funds, banks and S&Ls, ADRs and IPOs not listed on CRSP within six months of issuing have been excluded. Past performance is not a reliable indicator of current and future results.

Guide to Alternatives. Data reflect most recently available as of 30/04/26.

Private credit: The cost of growth

Private credit filled the gap left by banks after post-global financial crisis (GFC) regulatory tightening, experiencing rapid growth in subsequent years. This expansion may have come at the cost of lower underwriting standards, leading to rising defaults, which could be the first real test for the sector.

Currently, defaults in private credit remain low, but signs of stress are emerging. Indicators such as rising use of payment-in-kind (PIK) and the level of non-accruals are directional signals for private credit. The use of PIK has been rising and is viewed as a form of cash flow stress, as payments are deferred to the end of the loan. But non-accruals—which indicate when a borrower has stopped paying interest or principle completely—are holding steady.

The real stress is in publicly traded business development companies (BDCs) which traded at lows not seen since 2022 earlier this year as investors sought to redeem capital from their untraded counterparts. Most private credit funds have a gating threshold of 5% quarterly redemptions to protect other investors. This limited liquidity means redemption requests are likely to continue and may weigh on overall sentiment.

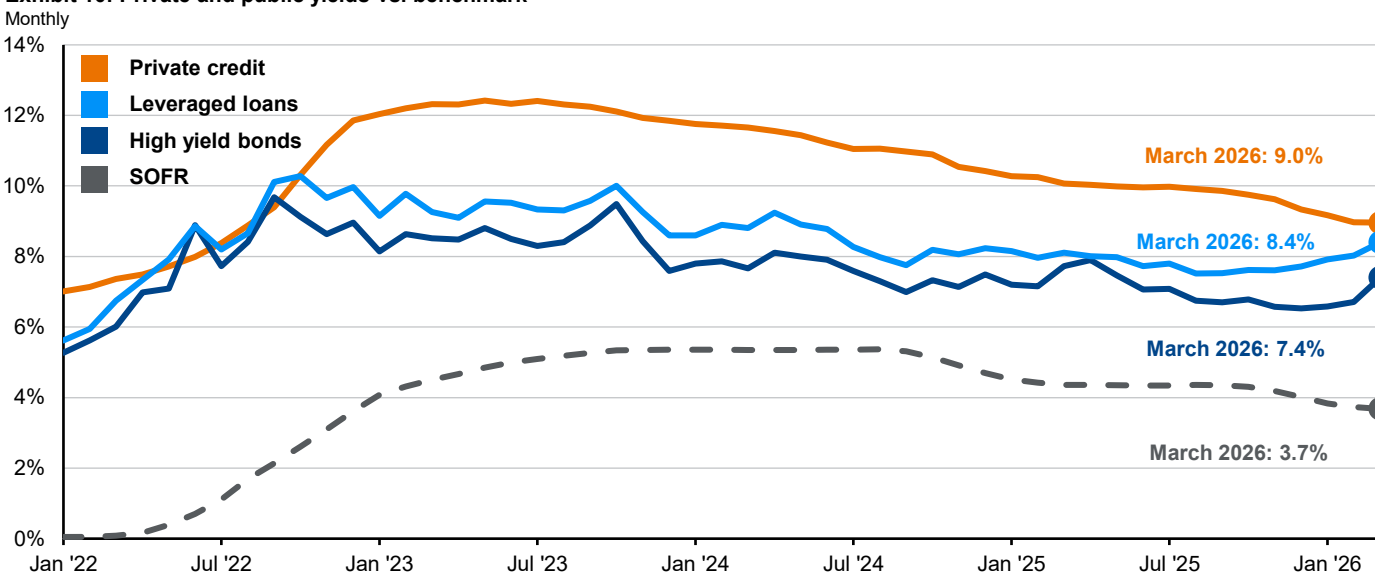
Risks in private credit are idiosyncratic, centered on software loans and potential AI-driven disruption, and are an area where BDCs have elevated exposures. Concerns about broad-based financial contagion are limited by the relatively small size of private credit within overall lending and manageable linkages to banks and public insurance companies. When it comes to software lending, the outcomes will likely be uneven, depending on whether the software is deeply embedded in business practices or more generic, leading to broader dispersion in the performance of private credit funds.

The appeal of private credit in the current environment is that most direct lending is floating-rate (Exhibit 10). Rising rates to combat inflation could boost income for investors, providing meaningful income with a degree of inflation protection if the underlying loans are of sufficient quality to absorb the higher associated costs.

Moreover, private credit is not a single asset class but comprises various segments across the risk spectrum—from asset-backed finance and direct lending to mezzanine and distressed debt. Positioning across these segments will be key to balancing income and risk.

Rising cash rates could mean more income for private credit investors.

Exhibit 10: Private and public yields vs. benchmark



Source: Bloomberg, FactSet, Federal Reserve Bank of New York, J.P. Morgan Credit Research, KBRA DLD, J.P. Morgan Asset Management.

Private credit: yield to maturity from the KBRA DLD Index. Leveraged loans: yield-to-maturity from the J.P. Morgan Leveraged Loan Index. High yield bonds: yield to worst from the Bloomberg U.S. Corporate High Yield Index. SOFR: 90-day average Secured Overnight Financing Rate. Past performance is not a reliable indicator of current and future results. *Guide to Alternatives*. Data reflect most recently available as of 30/04/26.

Infrastructure: Real power

Since 2008, global infrastructure has delivered approximately a 10% annualized return across various cycles and inflation environments. A key reason for this is the long-term contractual nature of investments, which allows for steady, inflation-resilient cash flow. The drive to electrify industries, ensure energy security, and satisfy AI demand means power may become a scarce commodity; power accounts for 58% of the global infrastructure benchmark.

Infrastructure's bond-like characteristics—steady income, low volatility, and low correlation to equities—make it a suitable complement to public bonds in a portfolio. However, high investor demand can mean there is a wait time for capital deployment in some instances.

Private market assets should be viewed as a complement, not a replacement, to public market assets in a portfolio. They can enhance returns, deliver income opportunities, and provide diversification. Private equity secondaries offer an entry point for new allocations, with liquidity optionality and vintage diversification. Meanwhile, private credit's floating-rate income can offset duration risk in traditional bond allocations.

The macro environment has structurally changed what a diversified portfolio needs to look like. Private markets are no longer a satellite allocation for only the most sophisticated clients—they are increasingly central to constructing resilient, inflation-aware portfolios.

7. Value vs. Growth: Value to shine?

In brief

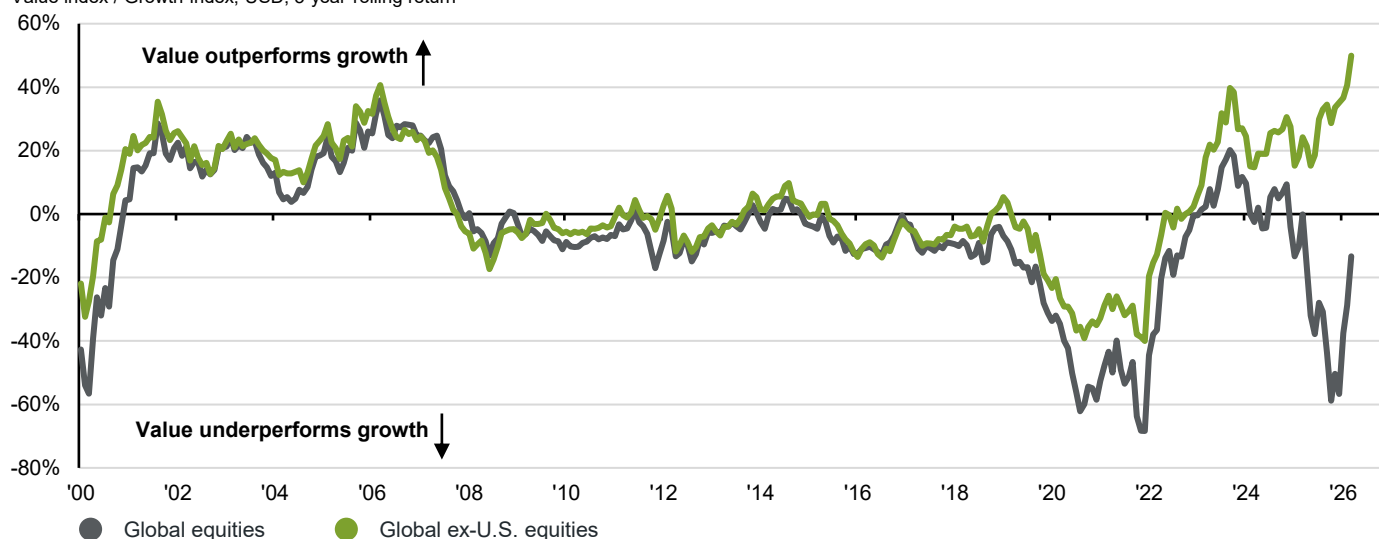
- Value has outperformed Growth outside the U.S. this year while the U.S. has stayed more Growth-led, making style performance more regional and driven by inflation/rates amid geopolitical disruption.
- With bond sell-offs pointing to a higher-for-longer rate backdrop, this could help to support Value stocks.
- Growth can still outperform when earnings momentum is strong, but active management is needed to select quality Value stocks to avoid the “value trap.”

So far this year, Value stocks have tended to outperform Growth stocks outside the U.S., while U.S. equities have remained more Growth-led, underscoring that the Value–Growth debate is increasingly regional and regime-dependent rather than a single global trade, as seen in **Exhibit 11**. Against a backdrop of geopolitical disruptions that are impacting the global economy and spilling through trade routes and energy markets, investors could consider the macro foundation that supports style performance, especially the path of inflation and interest rates.

Value has outperformed when removing the U.S. from the picture.

Exhibit 11: Value vs. Growth performance by markets*

Value index / Growth index, USD, 3-year rolling return



Source: Bloomberg, FactSet, MSCI, J.P. Morgan Asset Management. *Performance based on the MSCI World Value Index relative to the MSCI World Growth Index and the MSCI World ex USA Value Index relative to the MSCI World ex USA Growth Index. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Asia*. Data reflect most recently available as of 31/03/26.

Value stocks could help to hedge rising rates

On that macro channel, Value stocks look increasingly attractive as a defensive buffer during this time of uncertainty. Persistent sell-offs in long-dated sovereign bonds, notably in Japan and the U.S. (where 10-year yields have risen by around 60 and 30 basis points as of end of May year-to-date, respectively), are consistent with markets repricing toward a longer-lasting inflation/high-rate environment. That matters because higher and more volatile rates tend to be bad news for Growth stocks, which prefer lower rates for easier debt servicing and the ability to finance expansion cheaper. In regions such as Japan, where the interaction between the yield curve and style performance is drawing attention, the case is that Value may have room to regain ground if rates remain structurally higher and the curve dynamics stay supportive.

At the same time, the Growth story has not gone away. Expectations are still being reinforced by strong earnings projections in areas with durable long-term narratives, particularly software services and AI, but also in tangentially related areas such as energy-linked technology and infrastructure. Even if the macro story and interest rate environment are seen as less friendly, Growth can still win when earnings delivery is strong enough and when investors are willing to pay for long runway business models.

Value alone may not be sufficient

Valuations are the other pillar of the debate: Value is cheaper than Growth (**Exhibit 12, next page**), and has been for the last several years, current valuations are at a -42% discount. However, cheapness alone is not a catalyst, and investors should keep in mind that it can be a trap. The central risk is the classic “value trap,” where stocks can look statistically inexpensive, yet they are cheap for the wrong reasons, such as poor governance or structural headwinds. As earnings growth broadens, a practical way to participate without relying on a single style regime is to emphasize quality factors, where investors could focus on companies with stronger balance sheets and more consistent profitability to help filter Value (to avoid traps) or as a risk-control overlay on Growth (to dampen drawdowns when rates spike).

The cycle backdrop ultimately determines which narrative dominates. In an expansion/recovery phase, Value has historically been a top-performing factor set, and there is incremental support in parts of APAC from corporate reform efforts in economies such as Japan and South Korea, where programs aimed at better capital allocation and higher shareholder returns can drive re-ratings, where there is meaningful “multiple expansion” headroom. But in a slowdown phase, Value has historically tended to underperform as market breadth narrows and investors crowd into more defensive factors like low volatility and quality—a reminder that “Value works” is often conditional on not slipping into a Growth scare.

In terms of relative valuation, Value stocks are still cheaper than Growth stocks.

Exhibit 12: Value vs. Growth relative valuation

Value index / Growth index forward P/E ratios



Source: Bloomberg, FactSet, MSCI, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Asia*. Data reflect most recently available as of 11/06/26.

Geopolitics is acting less like background noise and more like a direct style driver. Tensions in the Middle East, particularly threats around key chokepoints like the Strait of Hormuz, can spark energy-led Value outperformance and create “geopolitical inflation scares” that weigh on Growth valuations via higher expected rates. The commodity angle cuts both ways: The payoff to commodity Value can be attractive under structural demand and supply disruptions, but it also introduces vulnerability for oil-importing economies like India and the Philippines, where energy shocks can pressure margins and debt-servicing capacity.

Given today’s combination of geopolitical risk and rate uncertainty, Value has a stronger near-term argument as a defensive anchor, especially outside the U.S. and in reform-driven APAC pockets. Ongoing tensions in the Middle East could benefit some Value sectors. Energy build-outs, infrastructure projects supporting industrials, higher interest rates benefiting banking, and increased defense spending are all expected to benefit from this current environment. The defensiveness of Value and higher dividends may help provide some cushion against volatility. Growth remains compelling where earnings expectations are exceptionally strong, such as AI-driven stocks. A balanced conclusion is that the “winner” is less about choosing a label and more about owning Value selectively, keeping exposure to structurally strong Growth earners, and using quality as the portfolio’s stabilizer, while staying honest about where we are in the expansion-versus-slowdown cycle.

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