2026 Investment Outlook

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2026: Blockbuster year ahead

- 2026 is promising to be a defining year. The AI investment boom currently dominates sentiment across financial markets while US economic growth outside AI-related sectors is coming into question. Confidence in 'American Exceptionalism' is potentially on the ebb. Geopolitical events drive the global news cycle. Governments risk intimidation from the bond market. And while Asia is looking to capitalise on fresh opportunities, Europe is stumbling.
- Looking back over the last five years, we've been through a pandemic, an inflation outbreak not seen in a generation, an aggressive shift in the interest rate cycle, a war in Europe, and the start of an AI-related capital investment boom. And yet, the global economy appears resilient, and global markets have delivered strong returns.
- With this backdrop in mind, we have set out eight trends for 2026 which guide how we are thinking about the world, how we are positioning our portfolios, and where we are looking for new investment ideas.

Eight trends for 2026

1. Steady economic footing
2. AI: discernment
3. AI's second-order: solving the constraints
4. US economic growth
5. US dollar: dominance or debasement
6. The 'Geopolitics' era
7. Governments vs bond markets
8. Asia's moment

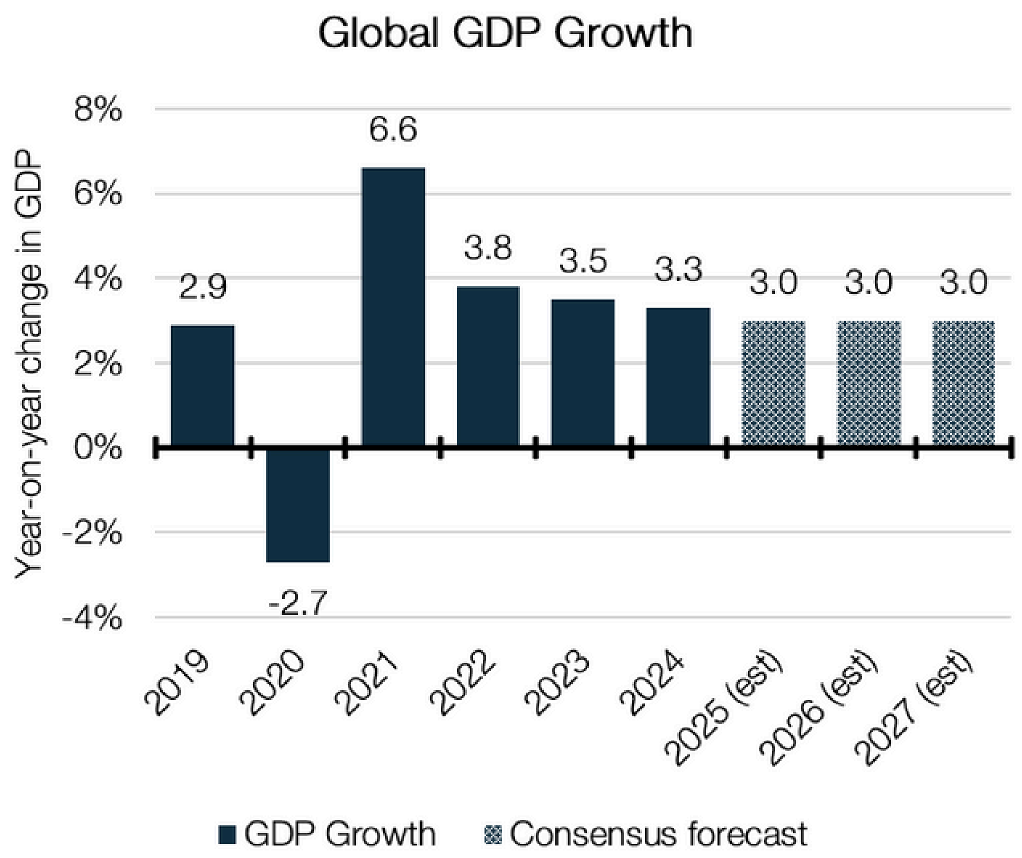
1 Steady economic footing

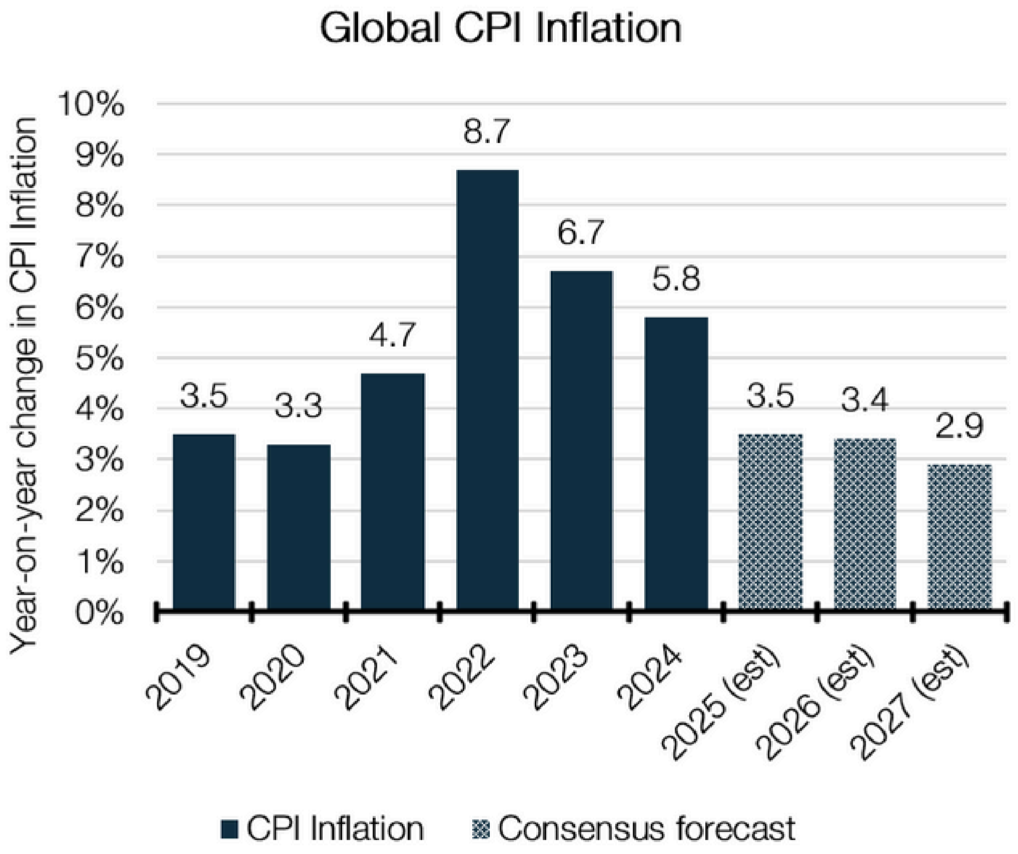
Sturdy expectations for global economic growth, a steady pace of US interest rate cuts, and an easing of price pressures all point to a economic backdrop.

The threat of further tariff announcements has receded, increases in global energy supply has contributed to softening commodities, while a rise in low-cost Chinese exports is likely to anchor any inflationary forces.

The UK Autumn budget and French political instability have all faded from their peaks, lifting sentiment in the market and allowing investors to re-focus on the economic outlook.

But while the economic outlook appears under control, some parts of the market appear detached from fundamentals. Intense investor interest in AI has led valuations upwards, raising the risk of market volatility in case of disappointing news, despite the global economy's underlying resilience.





Source: Bloomberg, EQ Investors.

② AI: discernment

Undoubtedly AI will continue as a major investment theme in 2026. AI has been a one-way trade since ChatGPT's launch in November 2022.

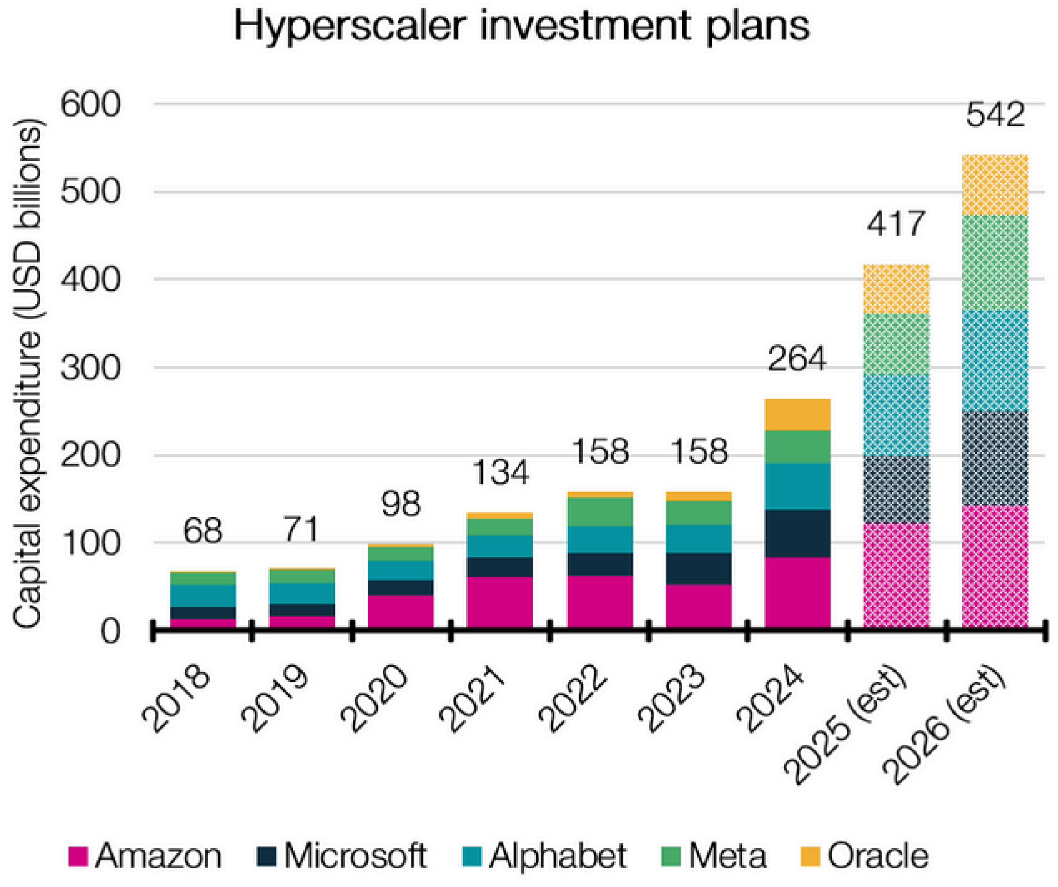
Following the meteoric rise of Nvidia to become the world's most valuable company, its quarterly earnings releases are now seen as more systemically important to financial markets than most countries' economic data.

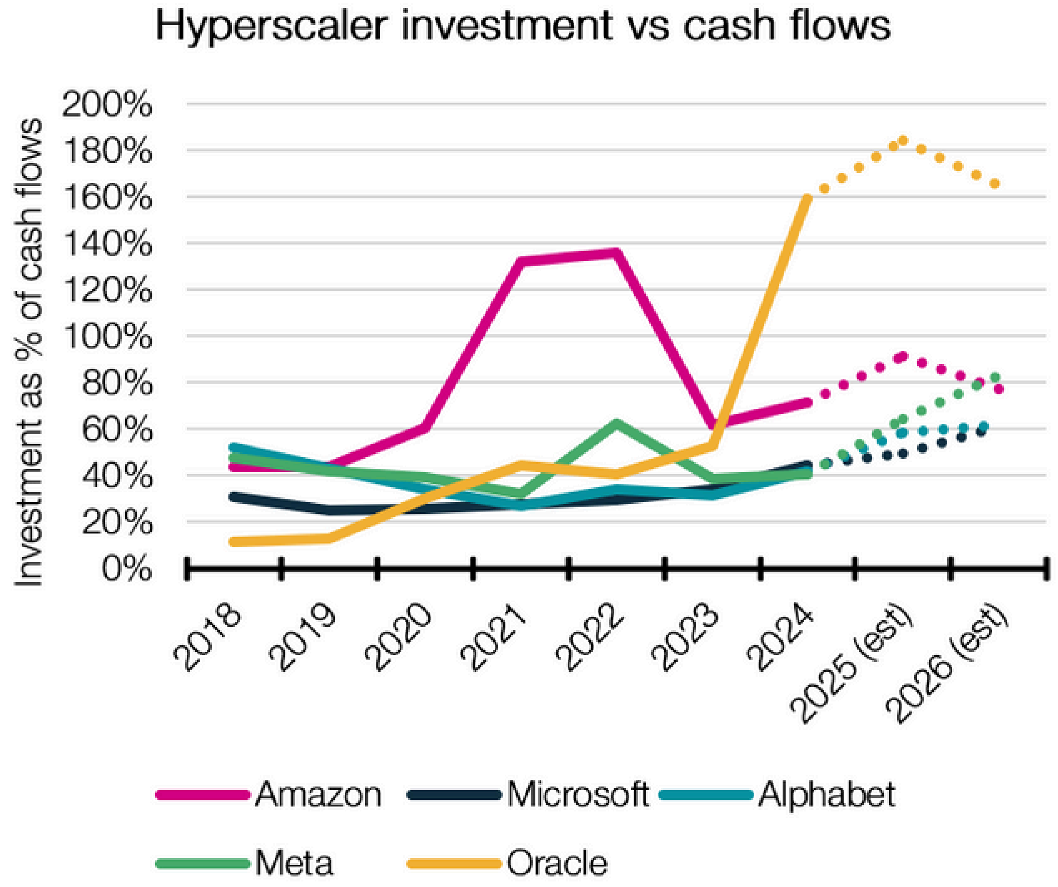
But with such optimism baked in towards the theme, there is little room in these companies' valuations for disappointment.

2025 has seen a marked intensification of the AI trade as several large US technology companies have announced data centre investment plans. These 'hyperscalers' are expected to spend around 1.5% of US GDP in 2026 alone to build new computing power in a bid to keep up in a highly competitive race.

Unlike previous investment cycles, a large proportion of this investment is due to come from these companies' existing cash flows meaning risks are relatively contained. But not all companies have the financial resources to keep up.

As such, we believe 2026 is likely to become the year of discernment when it comes to the AI trade. We have begun to see signs of this already. The market is looking less kindly on companies whose predicted growth is too optimistic or whose investment plans rely on rising levels of debt. Companies briefly seen as winners due to loose associations with AI have seen a fall in their share prices as investors scorn weak fundamentals. This signals a healthy return to fundamentals rather than speculation. This is where we believe our use of a specialist active fund manager to access the AI theme is hugely beneficial.





Source: Bloomberg, EQ Investors.

3 AI's second order: solving the constraints

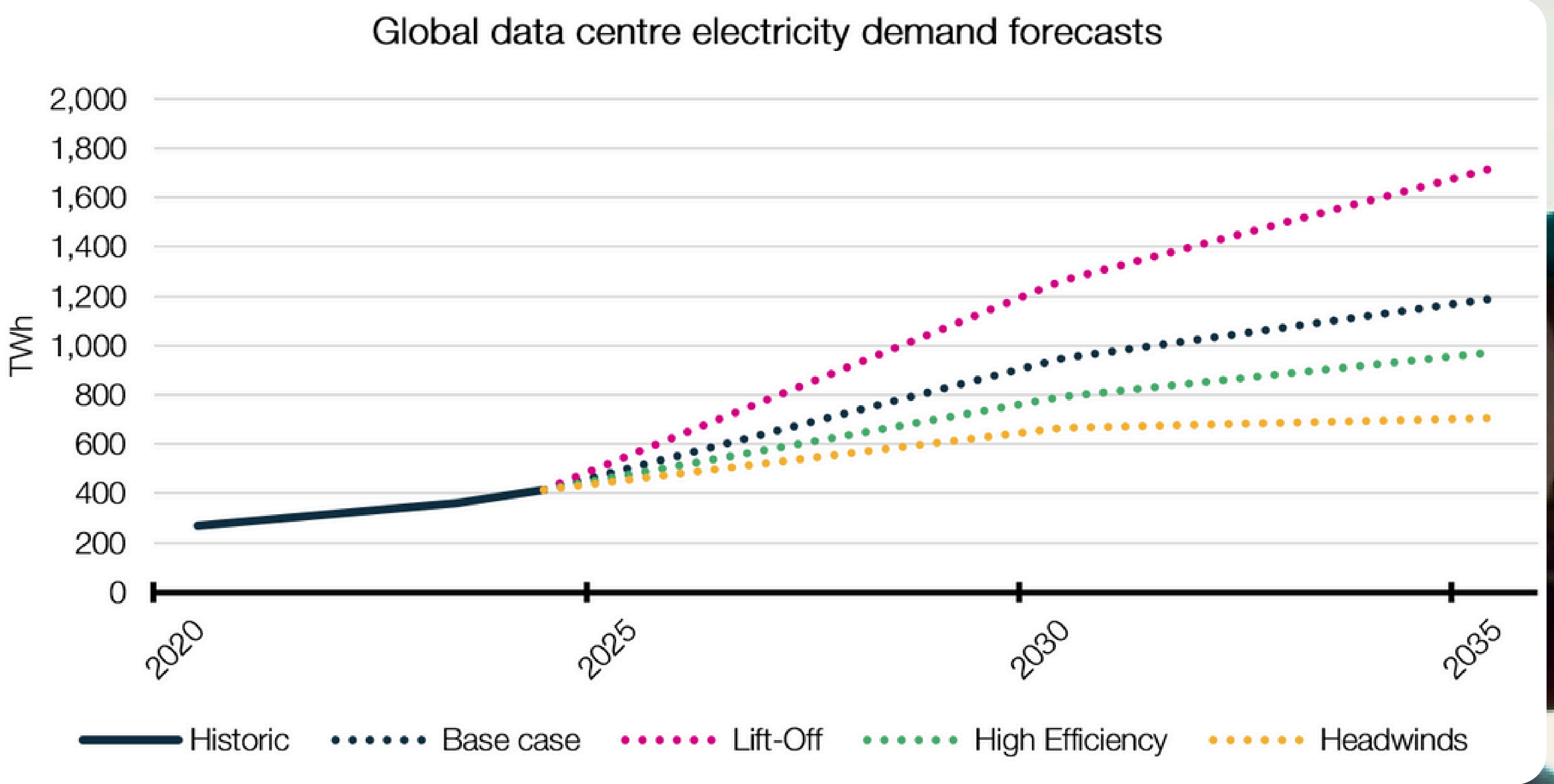
While many focus on the advanced chips designed by companies such as Nvidia as the key to leading the AI revolution, we believe something more fundamental has been overlooked. Basic resources such as energy and water are vital when it comes to building new computing power. It's no coincidence that when talking about how big data centres are, they're quoted in terms of GW (a unit of power) rather than FLOPS (a unit of computing power).

As it stands, the constraining factor on most data centres being built and brought online is access to power rather than the advanced chips themselves. From the manufacturing of semiconductors through to the cooling of the data centres themselves, highly processed ultra-pure water is needed in vast supply.

If AI is to continue developing at pace in 2026, the resource question will need to be answered.

Earlier in 2025, the IEA, an international energy think tank, put out four forecast scenarios for electricity demand from data centres over the next decade.

In its base case, it expects 10% annual growth in electricity consumption which would result in data centres growing to almost 3% of all the world's electricity demand. This is a level of demand growth beyond what current infrastructure can handle.



Source: International Energy Agency, EQ Investors.

4 US economic growth

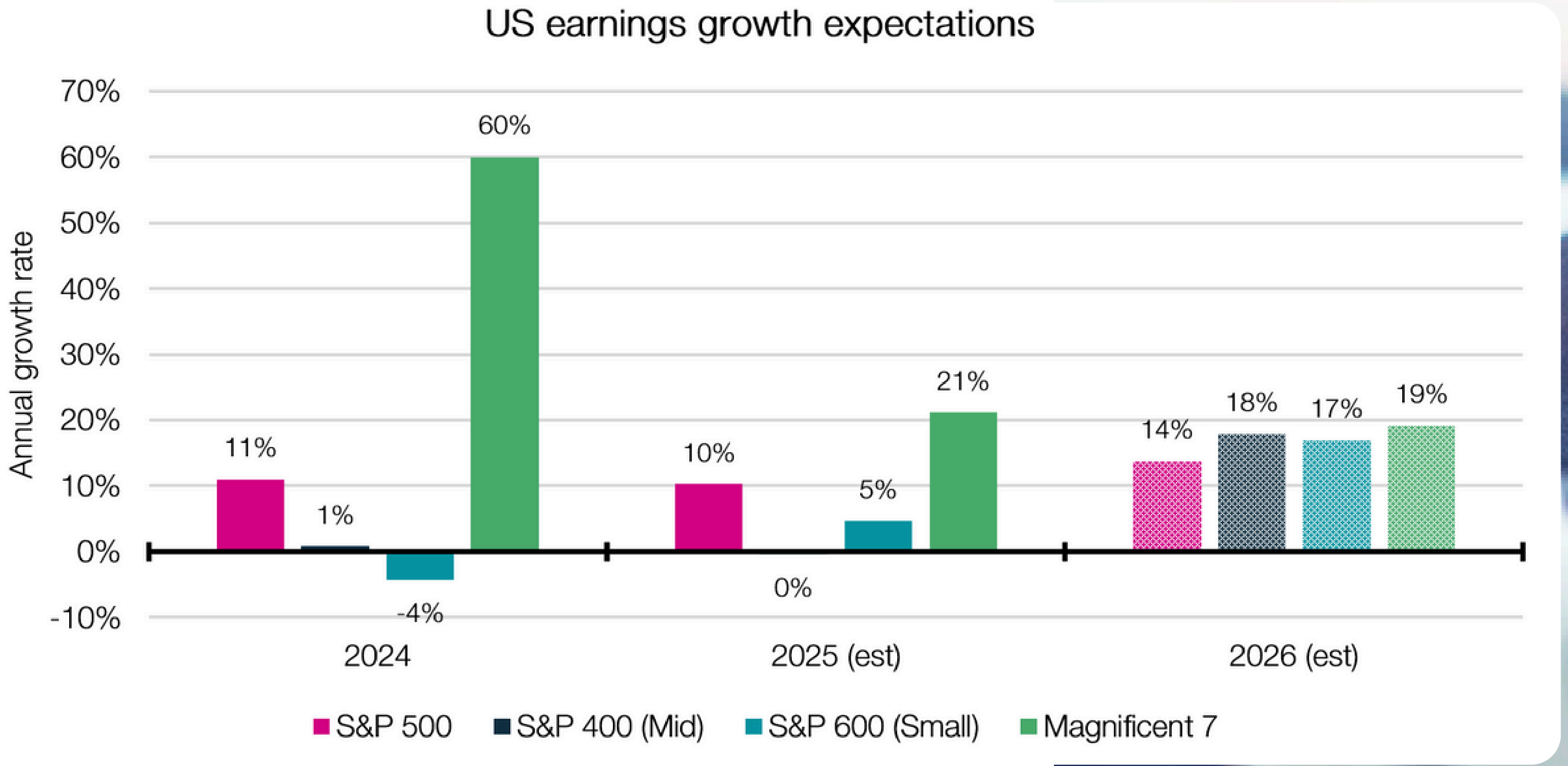
With so much excitement around the AI investment cycle, it's easy to overlook other parts of the economy. Despite being locked in a fierce rivalry with China, the US is still the world's largest, most dynamic economy and its health is vital for the rest of the world. One factor economists will be looking out for in 2026 will be just how resilient US growth is in the face of rising levels of unemployment.

As it stands, expectations for the US economy in 2026 are broadly optimistic, particularly as the effects from Liberation Day tariff announcements have passed through the system.

When we look at equity markets, the S&P 500, which represents large-cap US companies, has had resilient earnings growth over the last few years, supported by an exceptionally strong period by the so called Magnificent 7.

Meanwhile, the S&P 400 and the S&P 600, representing mid- and small-sized companies respectively, have seen anaemic earnings growth over the last two years.

A rosier economic landscape could, in the absence of any shocks, see a year where mid- and small-companies deliver.



Source: Bloomberg, EQ Investors.

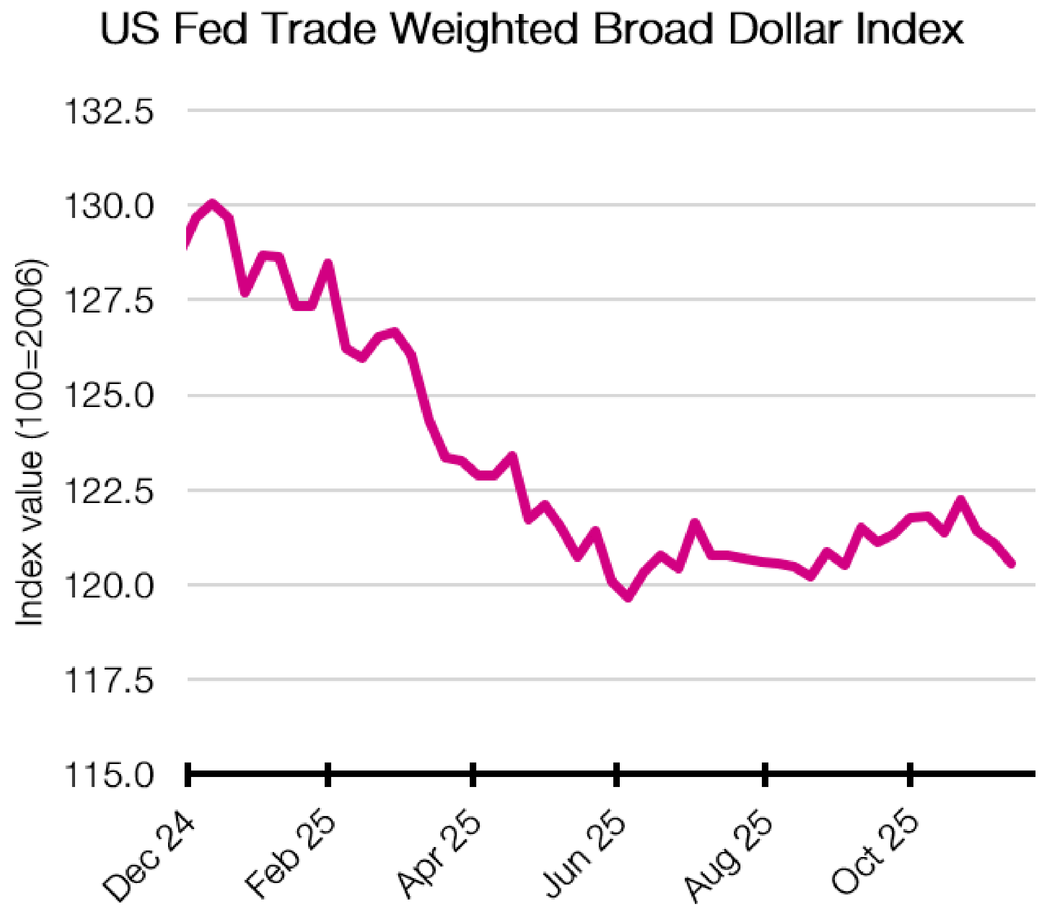
5 US dollar: dominance or debasement

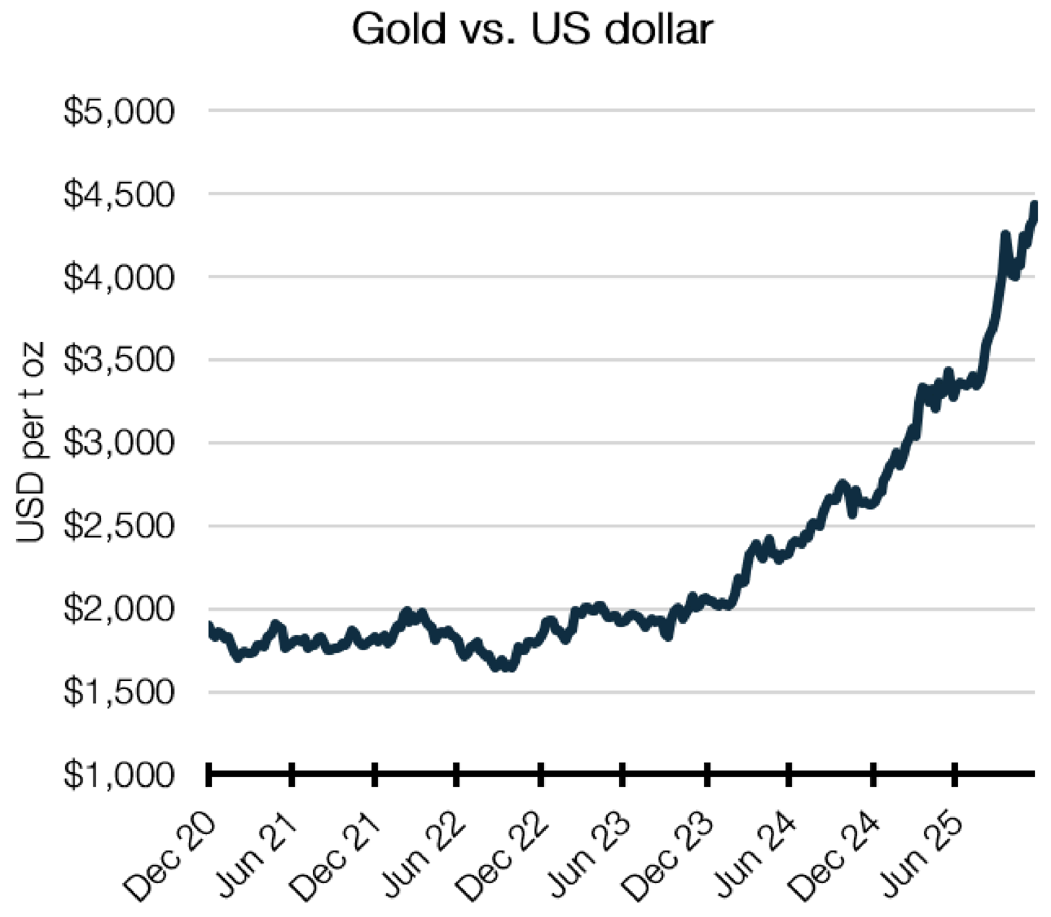
2025 was a year of two halves for the US dollar with its value stabilising, following a sharp devaluation at the start of the year. Meanwhile gold, a major winner throughout 2025, has seen its value increase circa 60% over the year. These two trades are related, with the dollar weakening and gold strengthening following shifts in confidence.

The Liberation Day tariff announcements, an administration eager to pursue currency-weakening policies, and the prospect of further interest rate cuts (the Trump administration has been firmly pushing for this) are all factors that have contributed to a weaker US dollar.

Meanwhile, gold's uptick over the last few years has been primarily driven by emerging markets central banks as they look to diversify their reserves away from US government bonds. Within portfolios, we have looked to diversify our own government bond exposure, with the introduction of European government bonds over the last year.

One question firmly in our mind is whether 2026 could see a modest strengthening of the US dollar, or whether it will be a year in which risks surrounding the US intensify and we see further dollar weakness. As it stands, the balance likely lies with a continuation of weakening, but at a slower pace, but any move by the Federal Reserve to delay further interest rate cuts could shift this dynamic. Gold, meanwhile, is likely to continue to be a beneficiary of the structural shift amongst central banks to diversify reserve assets regardless of which direction the US dollar moves. We gain exposure to this trend through physical gold and gold mining stocks.





Source: Bloomberg, EQ Investors.

6 The 'Geopolitics' era

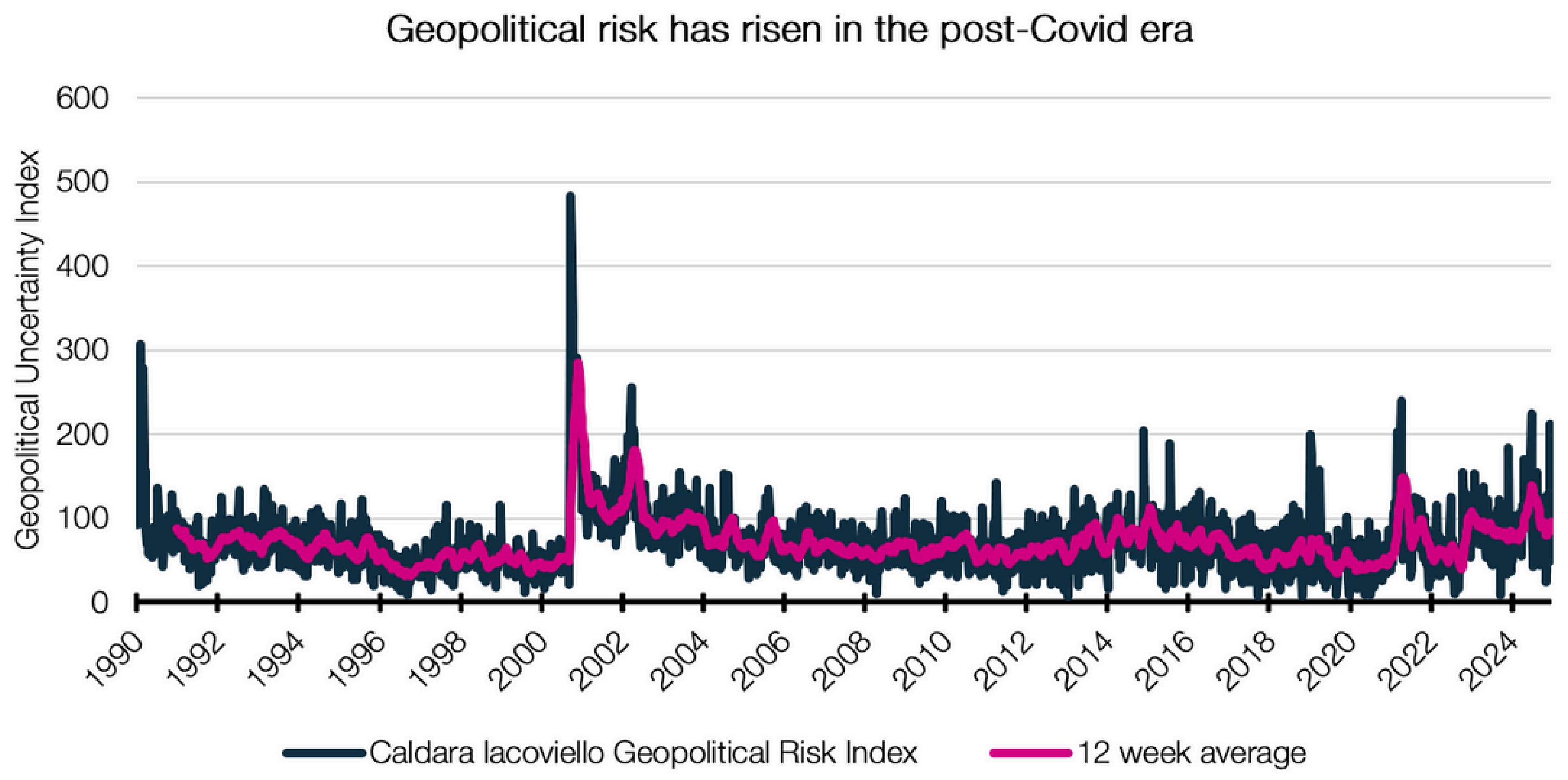
In the post-Covid era, the geopolitical landscape has changed. Inflation, government interventions, trade wars and geopolitical flashpoints now feel the norm. The Caldara Iacoviello Geopolitical Risk index, a measure of adverse geopolitical events and associated risks based on ongoing news flow, shows how perceptions of geopolitical risk have risen over the last five years. We don't see any reason why this trend will abate in 2026.

Geopolitics will continue to be a major factor for markets as the world's political tectonic plates shift and new alliances form. A new National Security Strategy launched by the US shows how its strategic priorities are shifting away from NATO, this leaves Europe to consider its own national interests with its international obligations.

As we look to 2026, we ask ourselves a number of questions: will the US attempt to shift its sphere of influence; how might the relationship between the US and China evolve; will President Trump's ambition to resolve the Ukraine conflict result in peace on European soil; what precedent will now be set with the US intervention in Venezuela; and, what could a breakdown in multilateralism in favour of multipolarity mean for global cooperation?

Ultimately these factors are beyond our control, but they do pose potential turning points for the global economy.

Our focus in portfolios is to continue building all-weather exposures that can sustain a spectrum of possibilities that will inevitably be thrown at markets.



Source: Caldara & Iacoviello, EQ Investors.

7 Governments vs bond markets

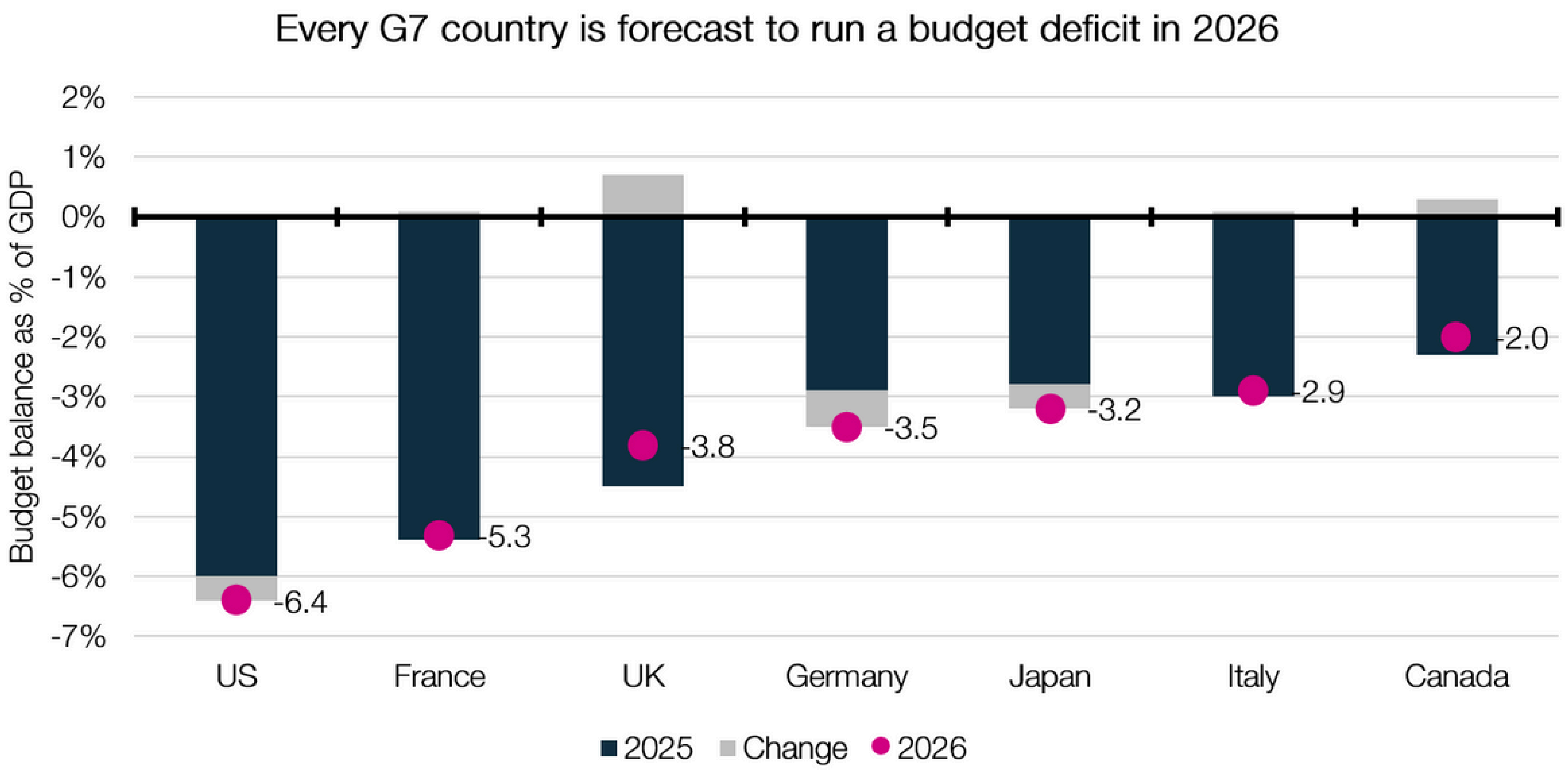
2025 was yet another year of large budget deficits and massive government borrowing amongst developed countries. 2026 is expected to continue this trend. European nations are experiencing increasingly stretched budgets, not only to cover existing social spending commitments but to bridge a widening gap in defence spending exposed by the US shifting its strategic priorities.

One major concern in 2025 was around how markets have reacted to rising levels of government borrowing.

The UK's own Autumn budget became a major market event as concerns around the future path of borrowing came to the fore. But the UK isn't alone. France is expected to run a deficit in excess of 5% of GDP in 2026 as its politicians lack consensus to cut spending. Germany, meanwhile, having announced a mammoth fiscal package at the end of 2024 to modernise its military and civil infrastructure, has shifted from its friendly conservative stance to start aggressive borrowing.

Major concerns around debt sustainability also surround the US which is running a budget deficit that is fast approaching 7% of its GDP. Following a record US government shutdown this year, we expect a fresh skirmish in Congress in January as temporary funding packages expire.

2026 could well be the year the bond markets start to assert themselves as an enforcer of spending discipline should one country exceed borrowing expectations. We have continued to favour exposure to short dated bonds within our portfolios to minimise these risks, though any volatility in bond markets may throw up new opportunities.



Source: Bloomberg, EQ Investors.

8 Asia's moment

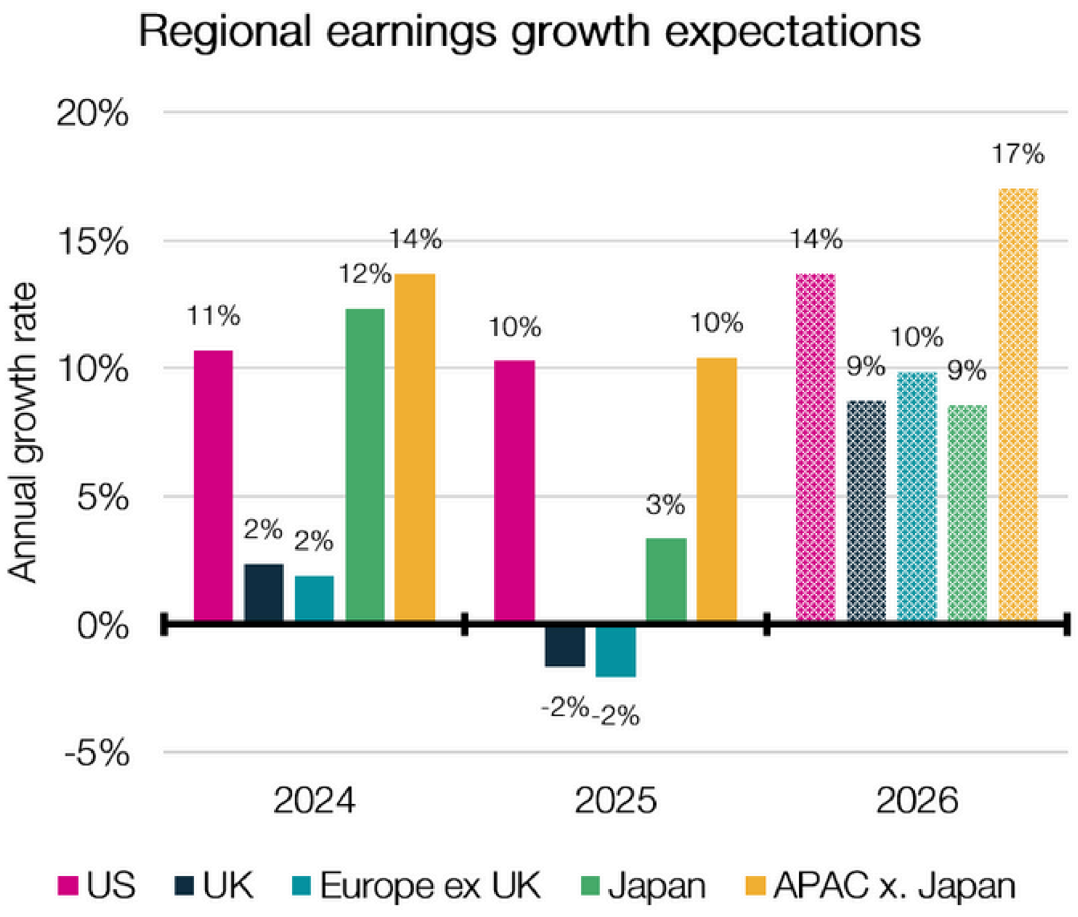
With US valuations at close to record levels due to excitement towards the AI theme, investors have begun scouring the world for investment ideas that offer relative value. We see two major stories that are set to propel Asian equities in the new year; the first in Japanese reflation trade and rising confidence in the wider Asia Pacific region.

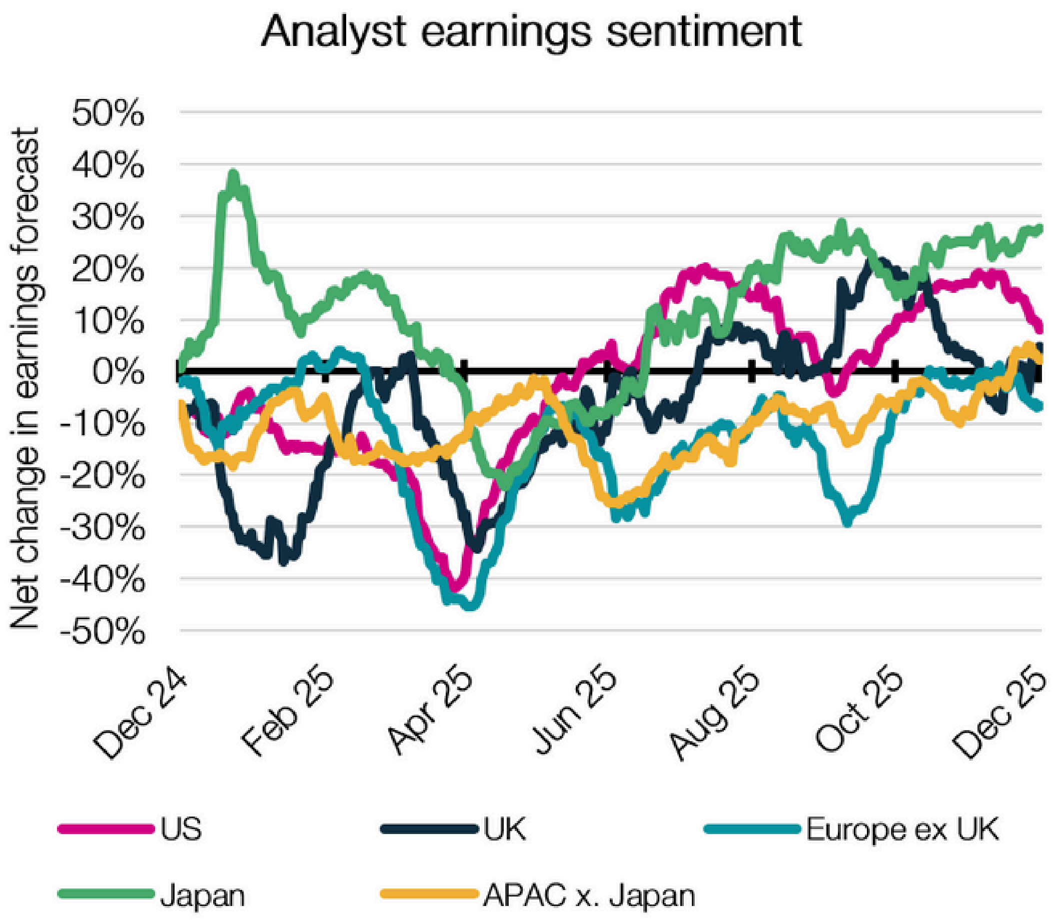
The second is widespread earnings upgrades in Japan are the product of rising inflation and interest rates in what represents a move to normalisation. This follows decades in which Japan flirted with deflation, leading government debt to GDP in excess of 200%.

In addition, there has been a major move to reform corporate governance in Japan in a bid to boost equity valuations which has been warmly received by investors. More recently, a new government has come in with the stated aim of injecting fresh fiscal stimulus to boost economic growth.

In the wider Asia Pacific region, a weaker US dollar, a temporary de-escalation of trade hostilities, and a pause in confrontation between the US and China provides a rosy outlook in the year ahead.

Valuations across Asia are not extreme, particularly considering the growth outlook, and structural market inefficiencies across the region make it ripe for active managers to generate out-performance. We have increased our exposure to both Japanese and Pacific Asia equities over the last three to six months as fundamentals have continued to improve. We continue to hold this favourable view into 2026 and are likely to continue looking at the region for ideas so long as valuations remain reasonable and the investment case stays intact.





Source: Bloomberg, EQ Investors.

Curveballs for 2026

While 2026 is set to be an eventful year, we have identified several potential surprises that markets are not pricing in which could fundamentally alter the investment landscape. We explore four below:

1

Inflation: Our outlook assumes a benign easing of inflation pressures. However, a material shift in either direction would break the current consensus. If inflation is lower than expected, we could well see a fresh "Goldilocks" easing cycle, fuelling a rally in global markets. If inflation is higher than expected, driven either by a fresh wave of supply chain shocks or lack of fiscal discipline, central banks may be forced to pause or even reverse cuts, resulting in sudden a change in market narrative.

2

Sino-American relations – Confrontation vs Cooperation: The market's expectation is for continued competition between the US and China as the two countries compete for economic supremacy. How the relationship between these two countries evolves could have a material impact on markets. A comprehensive US-China trade pact or a definitive geopolitical truce could be a materially positive development for markets, marking a large vote of confidence in risk assets. Alternatively, military escalation between China and Taiwan could risk an opposite "risk-off" event, putting at risk crucial global semiconductor supply chains that support the roll out of AI.

3

US Midterms – Gridlock vs Mandate: The November 2026 Midterm elections will be a pivotal event in the US political calendar this year. Markets are currently expecting that the Republicans will lose control of the House of Representatives, leading to legislative gridlock. If Republicans can somehow maintain their clean sweep and emerge from the elections unscathed, President Trump will have an unfettered two-year window to accelerate his agenda.

4

AI – Bubble or No Bubble: This is clearly one of the most talked about questions in the market at the moment. The curveball here will be whether we start to see material productivity growth. If the massive AI investment wave translates into measurable GDP growth or significant expansions in corporate margins, the current "high" valuations for these businesses will be retroactively justified and could transform what some describe as a speculative bubble into a structural bull market.

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