

Investment Views

January 2026

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Artificial Intelligence Scales the Wall of Worry

Fixed Income:

Steady Markets Amid Shifting Undercurrents

Equities:

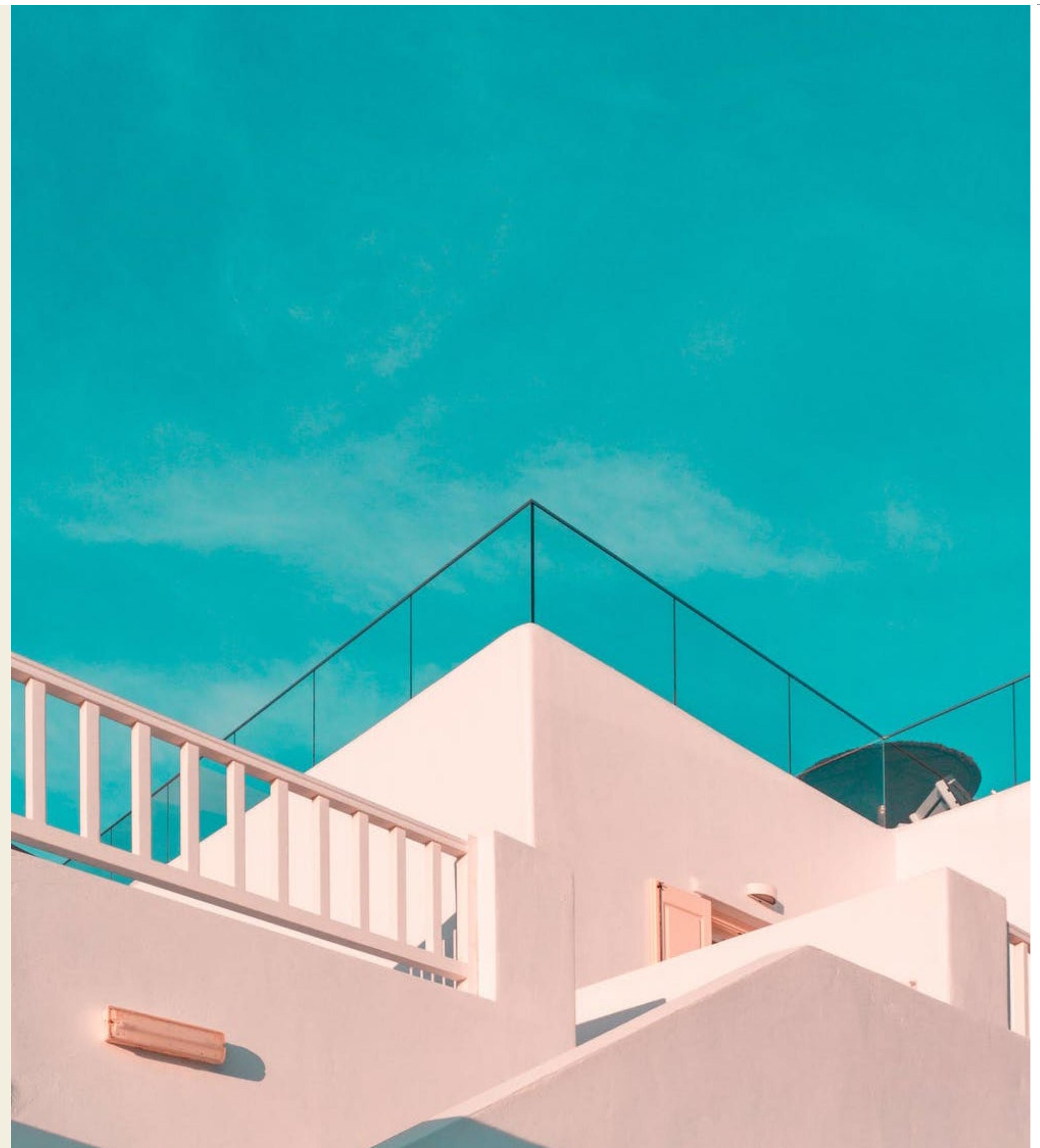
Solid End to a Strong Year

Artificial Intelligence Scales the Wall of Worry

- US trade tariffs lower than headline rates
- AI spending still going strong
- Gold shines again

It was another strong year for global equity markets, with the MSCI World Index rising 21.1% in US dollar terms. The dollar weakened by 8.1%, which offset some of the returns for global investors, for example, the MSCI World returned 12.7% for sterling-based investors. Global bonds performed well, supported by interest rate cuts in all major regions other than Japan, while corporate borrowing costs fell.

Global growth held up better than expected in 2025. There was an apparent disconnect between negative news flow and strong stock markets. Trade policy uncertainty, tariffs, a slowing US labour market, lingering inflation in the UK, uneven growth in Europe and China, and geopolitical unrest all made for a challenging backdrop.



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Markets are often said to “climb a wall of worry”, and that feels like an appropriate summary for the year.

The resilience of the global economy was due to a number of factors. The US imposed trade tariffs on trading partners and the rates fluctuated during the year. The announced rate was around 18%, but actual tariff rates have settled at a much lower 12%. Multiple exemptions help explain why actual tariff rates have been lower than expected. Other factors include re-routing of trade and supply chain management, for example, the utilisation of the United States-Mexico-Canada Agreement (USMCA). More than 70% of total US imports are facing higher tariffs than they did at the end of 2024, but large companies in particular, which dominate stock markets, have been adept at managing these challenges.

Another reason why stock markets managed to overcome US trade tariffs was the lack of retaliation from other countries. Most countries did not retaliate and negotiated frameworks for trade deals. This meant an all-out trade war was avoided with the exception of China. China retaliated immediately and the situation escalated with tit-for-tat tariffs but negotiations soon began. Tariffs have led to a material fall in Chinese exports to the US, with imports from China falling from 22% at the end of 2017 to close to 8%.

One of the key risks from tariffs was inflation. A tariff is essentially a tax paid by the importer, but it can show up in the system in different ways. The tax can either be passed on to consumers (inflation), be absorbed along the supply chain (hitting company profit margins), or exporters can lower their prices. A recent study has shown that US companies and consumers are paying 94% of the tariffs and foreign countries only 6%.

Some companies have been quick to pass higher costs onto consumers, while others have been more reticent. The annual inflation rate for household furnishings was 2.6% in November, up significantly from -1.0% in November 2024. The US core PCE inflation rate was around 2.8% in 2025, which is higher than the

12%

The rate US tariffs have settled at.





STRATEGY

central bank target. Goldman Sachs estimates that, excluding tariffs, the underlying inflation rate is back to 2.3%, which helps to explain why the Federal Reserve felt confident enough to cut interest rates by 0.25% three times in 2025.

An investment boom in Artificial Intelligence is another reason why stock markets performed so well in 2025. We have recently passed the three-year anniversary of ChatGPT, the AI powered chatbot. This was the catalyst for a wave of new investment into semiconductors, data centres, and power infrastructure. This has benefitted companies in a number of different sectors including Technology, Communication Services, Industrials, and Utilities.

A lot of this investment comes from the large technology companies like Alphabet, Amazon, Meta, and Microsoft, who are collectively spending around \$380 billion on AI infrastructure this year. Companies like Facebook, owned by Meta, have already been using and benefitting from AI to target content and advertising more efficiently. A lot of money is being spent, but profitability remains uncertain. AI can be used across every sector of the economy, but markets are closely watching whether all of the AI spending will translate to profit growth. Broadly speaking, our equity portfolios have had significant exposure to the AI investment theme, which helped drive returns in 2025.

Alternative Investments also performed well. Gold returned 11.9% in the fourth quarter, and 64.6% in 2025. Gold has benefitted from geopolitical risk, with global central banks accumulating gold in recent years. Lower interest rates in the US and Europe have also been supportive of gold. Base metals rose, with the copper price in particular strong. Copper is widely used in the grid buildout and upgrade to support electrification, while miners have been cautious with new exploration, which limits supply. Hedge Funds had a reasonable, but unspectacular year, with the HFR Global Hedge Fund Index returning 7.2%. Coming into 2026, we maintain equity allocations in line with our benchmarks and are optimistic for the year ahead, while always keeping an eye on the risks.

Steady Markets Amid Shifting Undercurrents

- Buoyant growth outlook underpins risk assets
- Policy clarity diminished on US government shutdown
- Japanese interest rate normalisation continues

The last quarter of 2025 saw mixed market behaviour. US bond yields were mostly unchanged, but inflation expectations fell, and the US yield curve steepened further. This helped to keep the credit cycle buoyant and was particularly helpful for financials. There were also several pressure points. The US government shutdown earlier in the quarter left a hole in key data releases, driving policy uncertainty and raising the odds of an unpredictable end to the year from a US growth perspective. Overall headline volatility in fixed income markets fell, and this capped a solid year for bond market returns.

The data that we do have indicates that the global economy improved in the fourth quarter, led by the US, Europe, and Japan.



Europe's data surprised to the upside, Japan's improved even more, and China's picture stayed mixed, with better surprises at the margin but weaker underlying momentum. The US remained the standout, as the economy grew by 4.3% on an annualised basis. Nominal growth (real growth plus inflation) ran close to 8%, which is a reminder that financial conditions remain supportive.

The Federal Reserve, Bank of England, and Reserve Bank of New Zealand each delivered 25bp cuts in the fourth quarter, while Japan moved the other way with a 25bp hike. This was another step in Japan's long exit from very low interest rates. However, outside the UK and US, the global easing impulse now looks increasingly close to an end. New Zealand has explicitly signalled it is likely at, or close to, the end of its cutting phase, and sentiment in Europe has shifted too. Japan remains the outlier and is still the most hawkish developed market central bank. Interestingly, this posture failed to stabilise the yen, which weakened meaningfully through the quarter.

Bond markets told the divergence story clearly. US short-dated yields fell, while Japan and Australia saw sharp increases in long-dated yields. This was consistent with higher term premium, which is the element of yields not explained by interest rate expectations. In the UK, gilt yields fell as the budget tightened the outlook for government spending and reinforced a growth-sapping backdrop that is supportive for gilts near-term. However, longer-dated supply/credibility questions haven't gone away. Corporate credit stayed resilient, with investment-grade and high yield spreads (premium that companies pay to borrow) essentially unchanged.

Oil prices fell over the quarter, which fed directly into lower realised inflation pressure and improved sentiment. In the US, regular gasoline prices dropped to an average of \$2.83 a gallon by quarter-end, which is good for consumers. Gold continued to rise, supported by US interest rate cuts, central bank buying and geopolitical risk. Within commodities, Silver was the star, rising by over 50% to \$84 per ounce, its highest level on record. Silver benefitted from a rare alignment of momentum flows, investment demand, and from being pulled into the US critical minerals conversation. Currency markets

4.3%

US economy annual growth

were comparatively muted in broad terms. The US dollar ended slightly higher, with the yen a clear exception, weakening sharply as Japan's rate rises were deemed insufficient to support the currency.

Geopolitics mattered more through confidence channels than through direct price shocks. The situation in Ukraine remains uncertain, while pressure around Venezuela built as the US increased focus on the region. This is relevant mainly via energy risk premia and the market's broader sensitivity to oil supply. The more immediate issue for markets was the US shutdown and its aftermath. Lost or delayed data releases clouded the outlook and pushed investors back toward narratives and positioning, rather than clean macro signals. One upside in the US inflation story is what didn't happen. Tariffs have only partially translated into consumer price inflation, with companies generally sounding cautious on aggressive price increases.

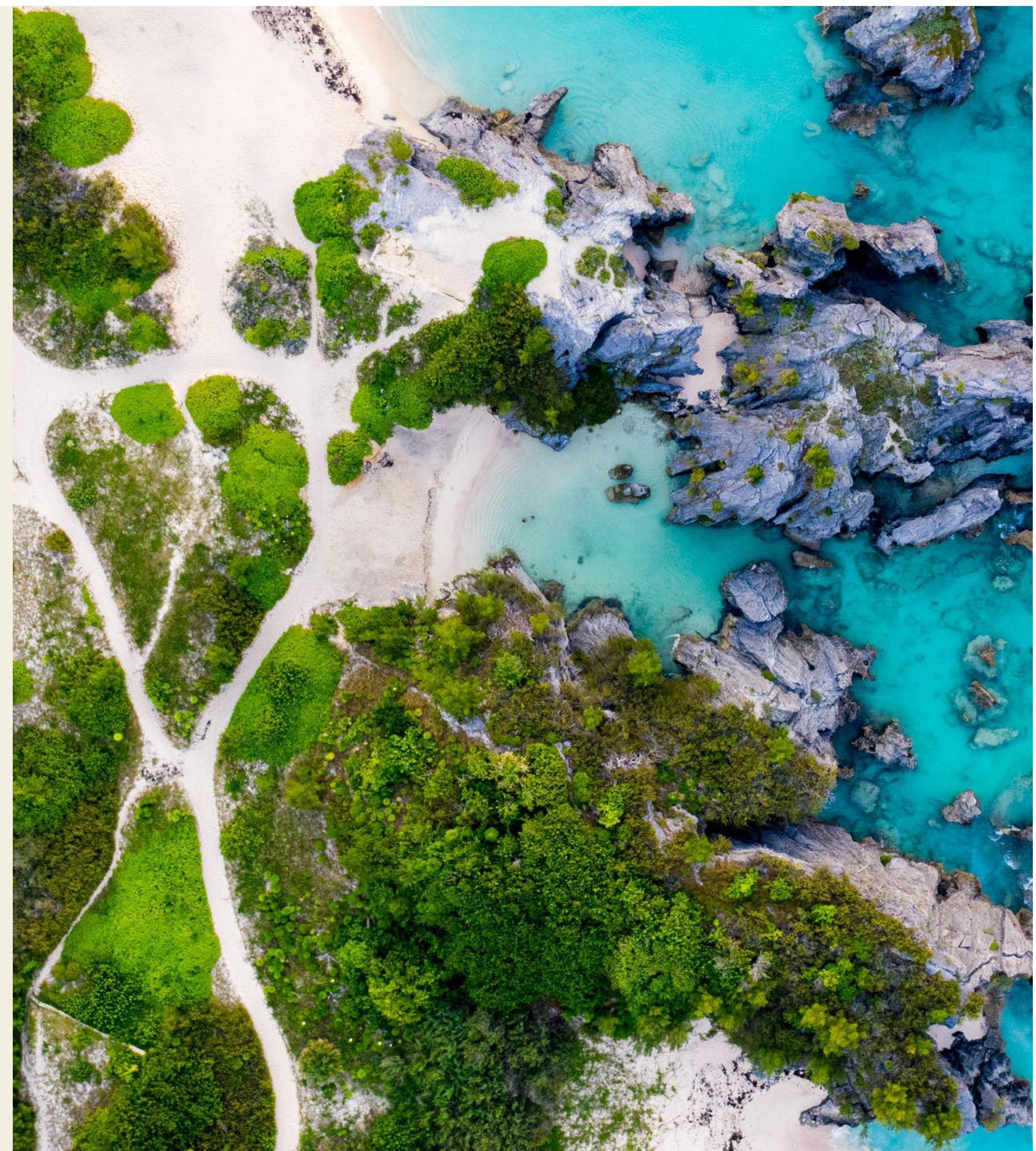
Looking ahead to 2026, the set-up for growth still looks good. Higher government spending is expected across the US, China, and Europe, while the mix of low interest rates and a more deregulatory US stance is supportive of risk assets, even if valuations remain rich. Despite tight credit spreads, we remain invested for now, with a neutral duration stance. Although short-dated US yields already fully price several more US interest rate cuts, the bar to not deliver those cuts looks high given a cooling labour market and the political incentive to keep the economy going into the mid-term elections.

Solid End to a Strong Year

- UK Equities lead the way
- Emerging Market equities benefiting from AI
- Software and professional services struggle again

The fourth quarter was another positive one for global equity markets. The MSCI World Index returned 3.1% in US dollar terms, with stock markets in all major regions generating positive returns. UK equities led the way, returning 7.0%, helped by strong performance in Health Care, Materials, Financials, and Utilities. UK equities expressed in US dollar terms generated positive returns every month of the year, the first time this has happened since at least the late 1960s.

After a challenging start to the year for global equities, they recovered well from the low point in April. The MSCI World fell 1.79% in the first quarter, followed by a strong 11.5% in the second quarter and 7.3% in the third quarter. Over the full year, global equities returned 21.1%, which follows the two previous years of



strong returns and is meaningfully higher than the long run average.

Global equities were supported by healthy growth in corporate profits. Earnings were up around 10% in 2025, with Technology and Communication Services leading the way, up 26% and 18% respectively. At the other end of the spectrum, earnings for companies in the Energy sector fell around 4%, while Consumer Discretionary earnings fell 3%. Earnings for Consumer Staples were flat, but all other sectors saw positive earnings growth. Earnings were supported by resilient global growth and the theme of Artificial Intelligence, as discussed above.

The fourth quarter saw a lot of dispersion in stocks linked to Artificial Intelligence. A lot of money is being spent on building out the infrastructure to provide the computing power to fuel the AI revolution. While profits for some firms, such as Semiconductor firm Nvidia, have soared, for other firms the returns are expected to show up in future years. The equity market has become more discerning around the future profits, which has introduced some volatility. A lot of the early money spent on AI was from the profits generated by the large technology firms, but last year saw an increase in borrowing. This isn't inherently bad, but does raise the risk.

Facebook owner Meta, saw their share price fall in October after releasing their earnings results. Meta is already benefiting from deploying AI to target content and advertising more efficiently, but they are also spending a huge amount of money with the aim of building a "leading frontier AI lab". The market focus earlier on in the year was the benefits that Meta was already seeing from using AI, but has shifted towards the risk from all the spending. Conversely, Google's parent Alphabet saw strong gains the fourth quarter linked to the impressive rollout of their latest AI model, Gemini 3.

4%

The amount the Energy sector fell

33.6%

EM equities growth in US dollar terms

There has been concern among investors around which businesses are at risk of being disrupted by AI. The two key industries in focus have been Software and Professional Services. Both underperformed notably in the fourth quarter. The software industry enjoys healthy profit margins, but AI has the ability to write computer code, so there is a risk that Software companies will see their profit margins eroded by increased competition. Replacing widely deployed software packages in large companies is very difficult, but the market is reflecting increased possibility of a move in that direction. AI's ability to analyse data, images, and patterns presents a risk to firms offering professional services. For example, we have seen the share prices of companies offering services to legal firms fall as the market worries about competition.

Other notable performance moves in the quarter were European Financials and Emerging Market equities. European Banks were out of favour for many years, but have since repaired their balance sheets and have benefitted from interest rates being well above the negative level seen between 2014 and 2022. This has seen returns on equity recover and share prices have benefitted accordingly. Emerging Market (EM) equities are again an area that spent a lot of time out of favour, but resilient global growth and a weaker dollar were supportive in 2025. EM equities were the best performing region last year, with a gain of 33.6% in US dollar terms. South Korea's Kospi index returned an impressive 82.7% in 2025. The region has a lot of exposure to technology companies, which are benefitting from the AI revolution.

Equities are expensive compared to history based on price to earnings ratios, but corporates have demonstrated an impressive ability to deliver profits, which supports valuations. The market is very exposed to the AI theme, which is based on certain assumptions around demand for computing power and real-world productive growth. We are watching these trends closely, but earnings growth and advances in technology are both positive for equity markets.

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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy

