

What can we expect in 2026 from markets, what are the big issues and how should we be positioning portfolios? Start with the biggest issue, the AI boom: is it a bubble, are we on the verge of a collapse? My Think-Tank notes touch upon these issues.

1. AI boom to continue at pace and with far-reaching consequences, but it's a time for some caution after extraordinary hype

- » We are into the rapid adoption phase which has a long way to run.
- » And there is no let-up in capex, it's a classic arms race, maybe existential for some of the companies involved. Mark made a powerful point, the spending is being driven by demand and that is growing very rapidly.
- » McKinsey report says global capex on AI driven data centre infrastructure between 2025 and 2030 will be close to \$7tn, with 40% of that in the US, equivalent to around 1 1/4% pa of global GDP.
- » The capex is being funded mainly not by leveraged start-ups but by deep-pocketed incumbents, largely the biggest and most credit-worthy firms on the planet, using cash flows and reserves, in contrast to the dot-com bubble.
- » No bubble, but there are warning signs: valuations have increased a lot, and leave no room for disappointment. Mark Baribeau pointed out they're well below previous bubble levels and can be justified by expected earnings growth. I think that can be questioned, especially away from the hyperscalers.
- » And the concentration in markets alongside very high valuations are a concern, and increase risks of sizeable setbacks.
- » Second, as the capex race accelerates there is more issuance of debt to fund it, and an increasing number of circular deals with several of the big AI players committing to fund their customers in return for reciprocal purchases of services. Microsoft has taken a 27% stake in OpenAI's new 'for-profit' entity, which in return committed to purchasing \$250bn of Microsoft's cloud services; Meta raised \$30bn debt recently for its AI spend; OpenAI committed to spend \$1.4tn in computing infrastructure over the next 8 years, much of which will need funding; and at the riskier end, CoreWeave, the loss-making AI infrastructure operator, with a balance sheet of \$33bn and revenues of \$5bn, has taken on \$15bn of debt collateralised against, among other things, Nvidia chips, which could prove to be rapidly depreciating assets. The cost of insuring CoreWeave's debt has almost doubled in the past few weeks.
- » This might all end well, and probably will, but as Mark said, there will be winners and losers, and rapid changes in leadership in a fast-moving industry. The investment risks are clearly rising.
- » AI usage and benefits are accelerating and expected to bring significant productivity gains, estimated to lift productivity in the US by 0.5-0.75%, albeit with a wide range of forecasts and uncertain timing.
- » Increasing doubts about the return on the massive investments, but there is no doubt that the capex will continue and add meaningfully to growth in the next few years.

2. The US economy

- » Jenson Huang 'we are the economy' is not far from reality. AI capex of estimated \$500bn in the US in 2026 adds around 1.5% to GDP.
- » But tariffs, supply chain disruption and lower immigration have delivered a negative supply side shock with consequences still playing out.
- » Consumer is subdued due to cost of living, high mortgage costs, a stagnant housing market, softening labour market, some indicators pointing to more pain to come, e.g. car repossessions are running at the highest since the GFC.
- » According to a Moody's report in October, 22 US States with 1/3 of US GDP are either in recession or on the verge of one, another 13 are treading water; the rest, which includes the 3 States making the biggest contribution to growth, California, Texas and New York, are still growing, though momentum is fading.
- » Tax cuts, looser regulations and easier monetary policy along with the AI spend, should ensure growth next year but it's a 2-speed economy with an unhealthy dependency on a single sector which is betting so big on its capex programme that some disappointments and casualties are inevitable.

Inflation, the labour market, and Fed policy

3. Inflation

Upside risks

- » impact of tariffs flow-through to prices and supply chain disruptions
- » Labour shortages due to demographics and clampdown on immigration
- » Climate change disruptions to food supply
- » Pressures on electricity prices and commodity costs due to AI processing capacity build-out

Downside risks

- » Disinflationary impact of AI and advanced robotics leading to labour substitution
- » Soft global economy and weak consumer
- » Oil over-supply and price weakness
- » Chinese overproduction exporting disinflation globally

There is a lot of uncertainty, with the Fed's favoured measure of inflation, Core PCE, running at 2.9% in its latest release, still above the Fed's target rate of 2%, and sticky around the 3% level for the past 2 years, giving the Fed pause for thought.

4. The labour market

- » Mixed signals and limited recent data because of government shutdown, but increasing evidence that the jobs market is softening (job creation well down, non-farm payrolls less than 30,000 pm in past 4 months from 200,000 pm over previous 3 years; falls in job vacancies getting them back to pre-pandemic levels).
- » Early signs that AI is resulting in job losses
- » Unemployment has ticked up to 4.3% but is still low, and real wage rises have slowed but are still rising at about 1%.
- » There is considerable uncertainty for next year, but as long as inflation remains stable or ticking down, a softer labour market will give the Fed room to ease further.

5. The Fed

- » The balance of FOMC members is likely to shift to more dovish next year, as Powell's term as Chair ends in May.
- » Market pricing in 3-4 25bps cuts by end of 2026. But again there is a lot of uncertainty around this, and market expectations are quite volatile.
- » On balance, if the economy grows at around 1.5-2% next year and the unemployment rate doesn't rise materially, market pricing is likely to be on the optimistic side, and 2026 could well be another year when the Fed doesn't ease as much as the market predicts - but it will ease.
- » And the Fed cutting into a soft but growing economy is a much more favourable environment for corporate sector earnings than being forced into cuts because of recession.

6. Gold

- » What is it telling us
- » Has risen despite interest rates being high relative to post-GFC era
- » Since Russia's invasion of Ukraine, cut off from SWIFT payments system and FX reserves frozen, there has been a shift in central bank FX reserves from US Treasuries to gold, notably in China, which has probably not run its course.
- » The enduring strengths of gold - it can't be printed, frozen or subject to default, and a 2000-year history as a reliable store of value - make it a uniquely attractive asset.
- » As Sanisha explained, no fiat currency is a plausible substitute for the USD as the world's reserve currency, hence the rise of gold as US exceptionalism, the post WWII global order, Fed independence, are called into question - what Karim called policy risk.
- » On top of that, global geopolitics are as fragile as they have been since end of WWII.
- » As we have seen this year, gold has an important role to play in diversifying risk and protecting capital, and will continue to do so in the landscape we see ahead.

7. Other risks, two worth mentioning:

- » Debt sustainability is a simmering problem in a number of the world's biggest economies. At best it restrains fiscal flexibility, keeps bond yields higher than otherwise, risks crowding out the private sector, and acts as a dampener on growth. At worst it can lead to a financial crisis requiring deep cuts in public spending and recession. The US, UK, France, Italy and Japan are notable examples.
- » The US has the 'exorbitant privilege' of the world's reserve currency, enabling it to issue debt in dollars with ready demand. It is also raising over \$300bn from tariffs annually, \$4tn over next decade according to the CBO, which will help to contain the deficit.
- » The problem could carry on for years without a crisis, as we have seen in Japan, and it's impossible to predict if or when it becomes a real danger to stability, but it remains a headwind for growth and source of volatility.
- » Second, private credit markets are beginning to trouble investors; absence of liquidity and transparency, a big rise in issuance, and the higher risk of many of the borrowers, highlighted by the bankruptcy of 2 US auto lenders in September, are of concern .
- » Risks need to be kept in perspective: the lenders are institutions, capable of managing the risks, banks have low exposure; the market is relatively small, much smaller than the sub-prime mortgage market which triggered the GFC. But in a low/no growth economy ex AI, high borrowing rates can soon overtake companies. While not systemic, damage in the sector could trigger some contagion and a rush for liquidity and safety, but I don't think the risks should be over-estimated.
- » Concerns are limited to private markets; in public credit markets spreads are close to their lows and defaults are running around pre-pandemic norms. Banks have very strong balance sheets and are well positioned to absorb a pick-up in loan losses – and are not setting aside material increases currently.

8. China (2 countries, China, matters a lot, and the UK, which doesn't)

- » In its latest 5-year economic plan China has committed to building a modern industrial system based on advanced manufacturing and technological self-sufficiency. It is subsidising key industries to achieve global dominance – EVs, solar panels, wind turbines, batteries, robotics, and is very competitive in high-tech sectors. The IMF has assessed the cost of the industrial subsidies at about 4% of GDP, way above comparable figures in the US and Europe. And that doesn't take account of the fact that 60% of China's electricity is produced from coal, with power prices materially lower than in the US and Europe. It has a 90% global share of processing of rare earth elements crucial in manufacture of a wide range of hi-tech equipment, and the West has found itself with a critical and potentially destabilising dependency.
- » It's also dominant in industrial robotics, installed 54% of the world's total in 2024, with for the first time more than half of those made locally, and has 43% of the world total.
- » The strategic imperative of this is its demographic challenge, with its working age population forecast to decline at an average rate of around 10m pa over the next 25 years. Its race to de-carbonise is also strategically vital as it reduces dependency on fossil fuel imports and its vulnerability to US naval blockades.
- » Outside these growth drivers, real estate is in structural decline and consumers are cautious. The economy has been in deflationary territory through the past 3 years, prolonging the property bust and increasing the real burden of its public and private debt, which is almost 300% of GDP. With its overcapacity in manufacturing, it is exporting deflation globally and engaging in a managed currency depreciation to offset some of its impact. Don't expect that to change anytime soon.

- » None of this makes China uninvestible, and there are some valuation opportunities in the market, but Tom Naughton made a strong case for diversification across some of the smaller markets across the region.
- » We are well over the peak of China's extraordinary growth surge, and its economy has begun to shrink in nominal terms as a percentage of the US economy. Will this influence the timing of China's move to reunify Taiwan?
- » I suspect that China will continue to be patient, building up its military and advanced tech, and working towards ever closer economic ties with Taiwan.

9. The UK

- » The UK is in an almighty hole, largely of its own making, after a calamitous period of political leadership. Public spending and taxes as a percentage of GDP are the highest ever outside wars and pandemics; everyone agrees we have a bloated welfare state, but politicians seem incapable of tackling it. Interest on the debt is over £100bn, much higher than our defence spending - goodness knows how we will get to spending of 5% on defence.
- » The government has made all the wrong policy choices since it was elected 18 months ago. It has adopted high tax, high spending, collectivist solutions, and its narrative is completely at odds with reality.
- » The economy has stalled and confidence is low.
- » This is unlikely to end well, and the currency is likely to take the strain as the Bank of England cuts rates in the face of a stagnant economy, rising unemployment, and damaging tax rises.
- » But there are opportunities in UK equities, in companies which will benefit from public sector spending plans and among its big offshore earners which dominate the FTSE 100. Hugh Yarrow gave some good examples of these on attractive ratings, Unilever, Relx.
- » Perhaps the most optimistic thing I can say is to use the words of Adam Smith, the 18th century economist: 'there's a great deal of ruin in a nation'. We are doing our best to show what he meant, but we will emerge one day from this mess, I just hope it's in my lifetime!

10. Summary

Volatility, shorter cycle investing & diversification

- » Intense uncertainty in the macro environment around inflation, growth, AI disruption, geopolitical fragmentation, and transition to low carbon economy, all adding to volatility.
- » Extraordinary concentration of equity markets in a handful of highly rated tech stocks, making huge capex commitments with uncertain outcomes, increases portfolio risks. The momentum trade has been brilliant since April, but it won't always be like that, a correction is overdue.
- » The case for diversification across asset classes and within equity markets has rarely been stronger.
- » Although valuations across nearly all markets have increased this year, there are still plenty of opportunities in both the US and non-US markets.
- » A good example is in value stocks: Lyrical's global equity portfolio has a PE of 12 vs MSCI World PE of 20, with better eps growth prospects. Quality stocks have also underperformed and offer good long term value, as Evenlode showed us, and emerging markets are relatively attractive, with generally lower valuations, mostly robust fiscal and debt dynamics, stronger growth than the developed world, and with the tailwind of a weaker dollar in the past year.

Higher debt burdens

- » Government bond yields are at levels which offer reasonable income in both nominal and real terms, and have returned to more normal levels, but there is a wall of issuance ahead, and, absent a recession, it is difficult to see yields falling significantly, more likely they will be range bound in this uncertain environment. This provides opportunities for active management of duration, something which has added usefully to our performance this year.
- » Investors will continue to seek income beyond government bonds, but care needs to be taken as credit spreads are historically low, and careful security selection is necessary.

Real assets

- » Despite its strong rise this year, gold continues to play an important role in multi-asset portfolios, as an unrivalled safe haven and store of real value.
- » Infrastructure also has the attraction of reliable real rates of return, but use of leverage and idiosyncratic risks mean that careful selection and active management are vital.

Stock pickers market

- » Passive investing, with its low fees and certainty of delivering asset class returns, has a role to play in portfolio construction, and we use it to take exposure for shorter term opportunities, or where we think active management fees don't justify the performance risks.
- » But the environment we are in requires much more than a simple passive approach. Karim made a good point when he said that static factor exposure will get punished, and we should focus on industry and factor weightings rather than regional.

Conclusion

- » We remain broadly constructive about risk assets, and see markets higher by the end of 2026, but with a note of caution. The intense uncertainty around most of the big issues leads to volatility; combined with increasingly narrow markets, it makes the case for a laser-like focus on valuations, caution over the weighting in very highly valued tech stocks, and for greater diversification, increasing the breadth of the opportunity set.
- » It calls for active management, across and within asset classes, countries, sectors and styles, staying invested but nimble to take advantage of tactical opportunities, and keeping exposure to safe haven assets to protect against some of the storms inevitably ahead.

I wish you success and good fortune in navigating those storms in times which are extraordinarily unpredictable.

Glyn Owen - 20 November 2025

