

# Investment Review

**Q1/26**

**“As we know: 1) There are known knowns. There are things we know we know. 2) We also know there are some things we do not know. 3) But there are also unknown unknowns – the ones we don’t know we don’t know.”**

– Donald Rumsfeld

Political deception or just gobbledegook, no one is quite sure. The (tenuous!) link with financial markets going into 2026 is that we know there are risks, but we do not know how these will play out and it is classically a risk emerging left field – not yet discounted in prices, which will most shock markets. After a strong 2025, there is an air of complacency going into this year, a consensus “more of the same”. We hope, of course, this is the case and that it's another strong year – but vigilance, proactivity and diversification (the only free lunch in investment) are our best defence if not.

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# Introduction

“Life doesn’t get any easier or more forgiving, we get stronger and more resilient” – Steve Maraboli

Scanning the many post-mortems covering financial markets in 2025, the word that crops up most is ‘resilient’. In the face of many and varied headwinds, countries, companies and consumers proved surprisingly ‘resilient’.

Biggest amongst these headwinds, ‘**Liberation Day**’ **tariffs** that were much higher than expected, prompting a short sharp global market crash early April but which substantially reversed within days when the President announced a 90-day pause. Lesser but ever-present headwinds included escalating levels of government debt and elevated geopolitical tensions.

As regards the latter, it seems Trump got out the wrong side of the Presidential bed on 1st January, first authorising the capture of Venezuelan President Maduro, talking tough about “taking” Greenland, and then seizing a Russian-flagged tanker in the Atlantic – all within the short space of a week.

Rarely do geopolitical events have meaningful impact on markets (outside of World Wars), but **Greenland is different**. Pitching Trump’s resolve, “we have to have it”, against Europe and the rest of NATO. For Europe, this is a matter of principle. But principles can be expensive if Trump threatens to implement new trade tariffs. [Stop press: this has happened!]

This has been an unwelcome distraction when we should be celebrating a good year in 2025 for investors across the board. It has been the first year (since the pandemic) that **all major asset classes delivered positive returns globally**. Finishing the year with a flurry too, every equity region trading above its 200-day moving average is confirmation of a global trend.

Particularly pleasing and long overdue, we have witnessed strong UK performance: the FTSE 100 up 21% in capital terms, plus c.4.5% from dividends, summing to total shareholder return of over 25%. Second only to Europe amongst the major regions (up 27% in sterling), but substantially ahead of the US (both S&P 500 and Tech focused NASDAQ), where sterling returns were hurt by the weak dollar. Because the US is dominant in global equity indices, the relatively weaker US return dragged the World equity index down to a still impressive c.14% increase.

That was yesterday, but what about tomorrow? Ironically, the overwhelming consensus a year ago was buy the US. But as we warned at the time “the consensus is generally wrong for the simple reason that if everyone thinks it, it is already in the price.” By contrast, there is little consensus this year at the country/regional level, but nonetheless a

general view that markets remain “risk on” and will rise further.

Pessimists are hard to find – especially worrying that permabear Albert Edwards (who coined the term ‘Ice Age’ as long ago as 1996), is recently quoted saying “I struggle to see an imminent macro trigger for a major bear market” – last bear turns bull, and that’s often never a good sign!

The one area where we do see consensus is a **further softening** of the US dollar, with US political unpredictability prompting efforts by investors everywhere to wean themselves off the world’s reserve currency. It is weaker also because of fears regarding Fed (US central bank) independence and the new Chair being seen as a Trump puppet. Whilst the dollar has weakened short-term, a longer-term perspective (see chart below) shows it is still near secular highs and, therefore, has scope to fall further.



After the strong year just enjoyed, a third consecutive year of double-digit equity global equity returns, we are moderately more cautious entering 2026. Our **focus remains on valuation and ‘what is in the price’**. It fared us well last year, and even more than usual, we extol the virtues of a broadly diversified portfolio by asset class and geography.

# Market data

Group/Investment	Cumulative Performance %					Annual Performance %				
	3m	6m	1yr	3y	5y	2025	2024	2023	2022	2021
<b>UK</b>										
UK Large Cap Equity	6.9	14.9	25.8	48.9	84.7	25.8	9.7	7.9	4.7	18.4
UK Mid Cap Equity	2.9	5.7	13.0	32.0	27.4	13.0	8.1	8.0	-17.4	16.9
UK Small Cap Equity	6.4	13.7	24.0	46.5	73.9	24.0	9.5	7.9	0.3	18.3
UK All Cap Equity	4.6	6.8	14.4	35.1	43.7	14.4	10.7	6.7	-13.6	23.0
<b>Global</b>										
Global Equity	3.5	13.5	14.6	58.9	76.7	14.6	19.8	15.7	-7.3	20.0
<b>North America</b>										
US Equity	2.7	13.1	9.8	66.4	99.4	9.8	27.3	19.2	-7.8	29.9
US Tech Equity	2.6	13.8	12.7	111.4	107.1	12.7	28.1	46.4	-23.9	28.7
<b>Europe</b>										
Developed Europe ex UK Equity	6.5	11.9	27.9	52.4	65.8	27.9	2.8	15.8	-7.5	17.6
<b>Asia Pacific &amp; EM</b>										
Emerging Equity	1.9	14.8	17.8	39.1	31.5	17.8	14.8	2.9	-6.4	1.0
China Equity	-6.8	14.8	23.0	24.9	-12.5	23.0	21.8	-16.6	-12.2	-20.2
Japan Equity	3.1	13.9	17.1	46.0	42.4	17.1	10.1	13.3	-4.8	2.5
<b>Fixed Interest &amp; Cash</b>										
Global Government Bonds	0.7	1.3	3.7	11.6	-6.0	3.7	2.0	5.5	-13.8	-2.4
UK Gilts	3.1	2.5	5.0	5.3	-23.9	5.0	-3.3	3.7	-23.8	-5.2
UK Index Linked Gilts	3.3	1.9	1.3	-6.2	-35.1	1.3	-8.3	0.9	-33.6	4.2
Bank of England Lending Rate	1.0	2.1	4.4	15.1	16.8	4.4	5.3	4.8	1.4	0.1
<b>Other Assets</b>										
Global Real Estate Equity	-0.4	5.8	3.4	10.7	18.3	3.4	3.4	3.6	-14.0	24.2
Global Energy Equity	3.7	11.7	9.2	12.3	123.4	9.2	4.2	-1.4	47.7	34.7
Gold	12.2	33.7	53.1	112.6	132.8	53.1	29.8	7.1	12.4	-2.6

Note: Data as at 31 December 2025. Index returns are shown in GBP

The indices used are the following: UK Large Cap Equity: FTSE 100, UK Mid Cap Equity: FTSE 250, UK Small Cap Equity: FTSE Small Cap, UK All Cap Equity: FTSE All Share, Global Equity: FTSE All World, US Equity: S&P 500, US Tech Equity: NASDAQ 100, Developed Europe ex UK: FTSE AW Dv Europe ex UK, Emerging Equity: FTSE Emerging, China Equity: FTSE China, Japan Equity: FTSE Japan, Global Government Bonds: FTSE WGBI (Hdg GBP), UK Gilts: FTSE Act UK Cnvt Gilts All Stocks, UK Index Linked Gilts: FTSE Act UK Index-Lnk Gilts AS, Bank of England Lending Rate: SONIA, Global Real Estate Equity: FTSE EPRA Nareit Global, Global Energy Equity: FTSE AW Ind/Energy. Gold: S&P GSCI Gold Spot.

FTSE WGBI: The FTSE World Government Bond Index provides exposure to the global sovereign fixed income market, the index measures the performance of fixed-rate, local currency, investment-grade sovereign bonds.

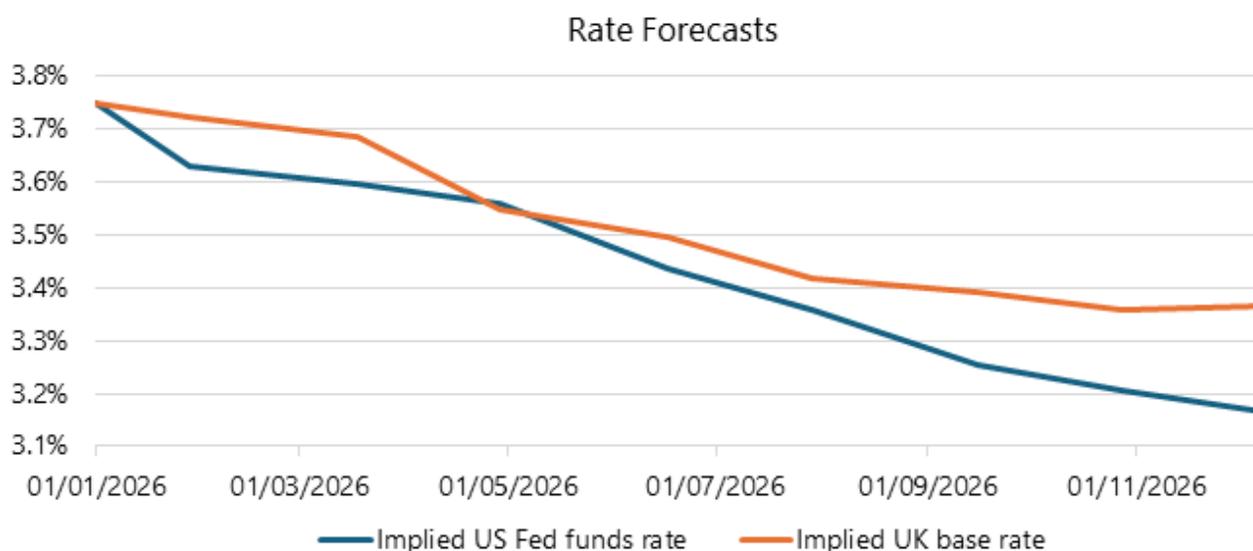
FTSE Act UK Cnvt Gilts All Stocks: The FTSE Actuaries UK Conventional Gilts All Stocks Index provides exposure to all British Government Bonds quoted on the London Stock Exchange.

FTSE Act UK Index-Lnk Gilts AS: The FTSE Actuaries UK Index-Linked Gilts All Stocks Index provides exposure to all index-linked British Government Bonds quoted on the London Stock Exchange.

FTSE EPRA Nareit Global. The index is designed to represent general trends in eligible real estate equities worldwide. The index covers Global, Developed and Emerging Markets.

FTSE AW Ind/Energy includes all companies in the FTSE World Index that are categorised as Energy in the ICB sector breakdown.

# Sturdy growth, stagnant jobs and stable prices



## The feeling of resilience

Following Donald Trump taking office as US President in January, a flurry of measures that commentators predicted would be economically, socially and legally catastrophic for the globe followed. Yet a year later, global growth is rising meaningfully into 2026 (thanks Swifties for adding \$5bn to US GDP), inflation is moderating and interest rates are moving downwards.

Economic resilience, benefiting from stimulus measures, acted as the bedrock of most asset class performance over the year. But it did not come without its challenges. Notably the longest US government shutdown on record, scrutiny around AI investment (remember DeepSeek?) and multiple escalating conflicts. Volatility is likely to remain heightened going into 2026 and diversification across asset classes remains crucial to navigating the unknowns.

## The battle of the Fed

The Federal Reserve closed 2025 with a widely anticipated 25 bps rate cut in December, but the decision highlighted growing divisions within the committee. Two members voted for no change, while one pushed for a deeper 50 bps cut. Markets are pricing in two cuts in 2026 (shown above) but likely to be followed with a bout of market volatility as President Trump does his best to influence monetary policy, both verbally and legally.

## Something is brewing in UK equities

In Britain, a stagflation-lite scenario is likely to endure, growth is lacklustre and businesses find themselves with increasing red tape. UK interest rates were slashed four times in 2025, yet the cuts had no real economic impact. The market remains positive about the inflation outlook and market consensus is one cut for 2026 – but it is a close call as to whether we could get two.

Little growth did not hamper UK large-caps in 2025 which saw the best performance in 16 years – reaching new highs 41 times in the process and are even expected to see profits rise by 14% in 2026. It is these fundamentals which are attracting overseas buyers who have appreciation for world class old-economy companies trading at cheap valuations – most recently a fifth bid for Beazley from Zurich Insurance.

## Inflation moderates but policy risk lingers

The backdrop is increasingly dependent on benign inflation which moderated through 2025 with Core CPI in the US hitting the lowest level in four years, falling from 3% to 2.6%. Markets remain confident that future inflation is well anchored, with shelter (1/3 of the US CPI bucket) on a trend downwards and no sign of any significant tariff passthrough. However, the risk to consensus is fiscal policy in the form of stimulus from the Trump administration – pushing up wage prices and even causing a U-turn on rate cuts.

# Record breaking resilience



## Markets climb the wall of worry

Overall, equity markets were supported by solid earnings growth, easing inflationary pressures and expectations that major central banks – led by the US Federal Reserve (Fed) – would continue to lower interest rates in 2026. Large-cap technology continued to shape index performance, though leadership was less assured. Parts of the AI complex came under pressure as investors reassessed valuations and competitive dynamics, leading the main US indices to lag the rest of the developed markets in GBP terms (as shown above).

## The rise of the machines

AI remained the defining theme of equity markets in 2025, driving significant gains for US hyperscalers and related sectors. Strong earnings and optimism around AI's transformative potential fuelled momentum. AI-related capex contributed 1.1% to US GDP growth, surpassing consumer spending. That being said, concerns overstretched valuations and unsustainably high capital expenditure is mounting.

Surging advances in artificial intelligence (AI) have created a more concentrated US stock market than at any point since 1926. The top 10% of stocks now account for 78% of total market cap, surpassing past peaks of 75% in 1932 and 73% in 2000. Retail flows into concentrated passive and leveraged strategies have amplified risks, leaving the sector more vulnerable to sharp corrections. Any disappointment could reverse wealth effects and weigh on consumption, creating ripple effects across broader markets.

## Breadth – not just resilience

While US large-cap had a decent year, the breadth of geographic and sector dispersion grew meaningfully. In the S&P 500, only one of the 'Magnificent Seven' stocks were among the S&P 500's top twenty performers in Q4. None made the cut for the year. Healthcare (+11.7%) led sectors as flows followed more positive sentiment.

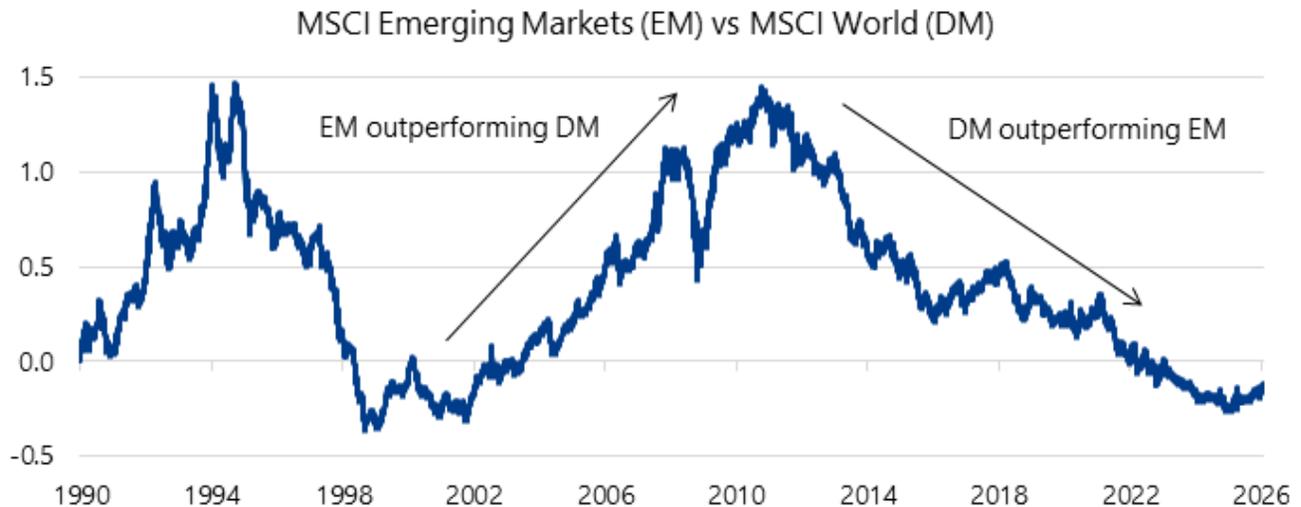
Outperformance of ex-US equities were driven by three primary factors: Firstly, the US dollar depreciated nearly 10% against a basket of other major currencies. The second was the unprecedented stimulus in Europe, primarily around defence spending. Third is valuation, with the 'Magnificent Seven' sitting on a multiple of 31x earnings, versus 18x in Europe and 15x in the UK.

## Europe's equity renaissance

European equities ended the quarter near record highs, delivering their strongest annual performance since 2021. Markets were supported by easing rate expectations, Germany's fiscal stimulus and a rotation away from expensive US technology stocks towards more attractively valued opportunities (including defence), while a weaker euro boosted exports. The European Central Bank kept rates on hold through Q4 and indicated policy is likely to remain steady, with inflation moderating and growth proving resilient – a supportive backdrop for risk assets. Spain was the standout performer, posting its best annual return since 1993 – helped by limited exposure to US tariffs, a heavy weighting to banks and strong domestic economic momentum.

# Emerging markets defy the consensus

*Against expectations of continued US dominance, emerging markets staged a notable revival benefiting from improving fundamentals and relative valuation support.*



## The Trump card

The consensus for 2025 was overwhelmingly negative for emerging markets (EM), with most major banks and asset managers forecasting another stellar year for US equities at the expense of the rest of the world. This view was underpinned by Donald Trump's return to the political spotlight and expectations that his "America First" policies would once again be enacted on the global stage.

## The start of EM's revival?

Fast forward a year and the MSCI EM index entered 2026 more than 12% ahead of the developed market (DM) MSCI World index. This is particularly impressive given a backdrop of heightened geopolitical uncertainty, and of headline-grabbing tariffs that disproportionately affected EM. This outperformance was driven by two key factors: firstly, a strong year for EM equities, and secondly, a notably weaker year for the previously dominant US market.

## The winners

Although often grouped together, EM is a highly heterogeneous region, spanning all four corners of the globe. As a result, dispersion amongst constituents was broad. South Korea was a standout performer, finishing the year up nearly 90%. Following a strong 2024, China finished the year up over 20%, Taiwan rose around 30% on the back of semiconductor demand, and Brazil impressively just shy of 40%.

Overall, a strong year for four of the five largest markets in the index.

## The loser

The second largest index constituent, India, was the most notable detractor of the year. Having been the previous market darling, it ended 2025 in negative territory, underperforming its major EM peers and falling short of investor expectations..

## Valuations matter

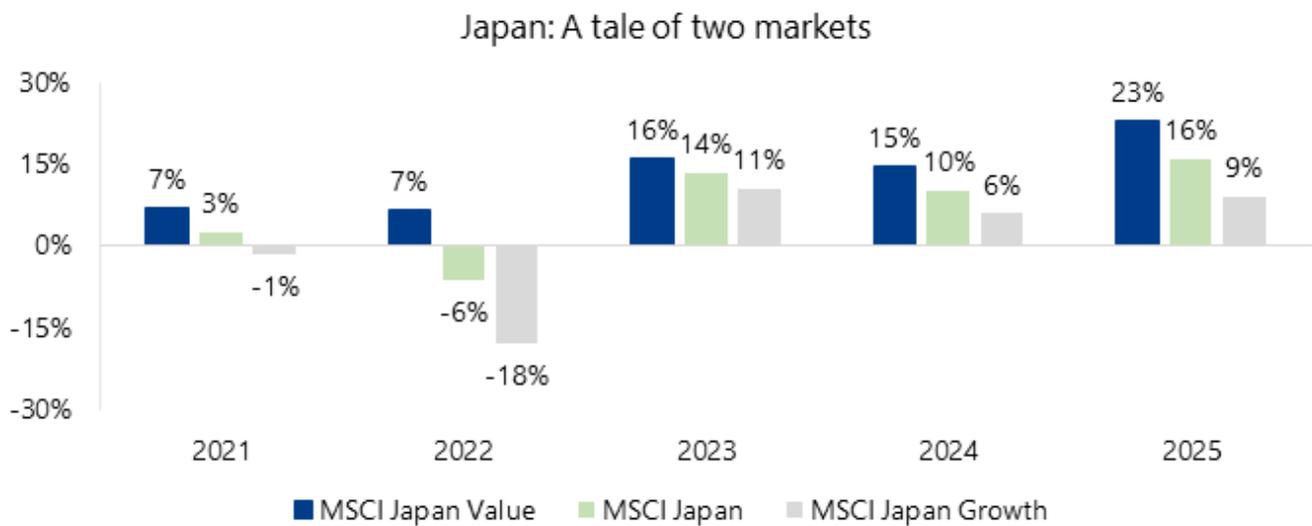
This is not surprising given it entered the year as one of the world's most expensive equity markets, leaving it with little margin for disappointment. That said, India's long-term structural story remains compelling, supported by favourable demographics, strong domestic capital flows and robust GDP growth.

## Still a long way to go

Despite last year's strong relative performance, EM still has a considerable way to go in reclaiming its previous decade highs against its DM peers. However, the outlook remains positive. As developed markets contend with high debt burdens, modest growth prospects and relatively expensive equity valuations, the balance of risks increasingly appears to be shifting towards EM.

# Concentration, politics and policy risks

Market concentration, elections and currency dynamics remain important considerations across developed and emerging markets.



## Concentration levels are not just a DM problem

Market concentration is often discussed in the context of US tech stocks, but EM is not immune. Taiwan Semiconductor Manufacturing Company (TSMC) – a key beneficiary of the AI boom – is the largest constituent of the EM index, which contains nearly 1,200 stocks. Despite this breadth, TSMC represents around 11.5% of the index. As diversification rules cap individual holdings at 10%, active managers are structurally forced to run an underweight position relative to the benchmark.

## EM heads to the polls

This year brings a fresh round of elections across the EM universe. South America, Brazil, Colombia and Peru will go to the polls, alongside elections taking place in Thailand and Hungary. While the immediate market impact may be limited, an environment of elevated geopolitical risks and shifting alliances keeps political developments firmly in focus.

## Takaichi calls election

It's not just elections in EM. Three months after winning her party's leadership contest on a stimulative mandate of growth and reform, Sanae Takaichi appears to have won over Japanese equity markets, which rallied after she called a snap election to strengthen her position and expand the party's majority. An interesting aside: the literal translation of her name, Taka "high" and Ichi "market", may prove to be an appropriate signal for Japanese equities should she secure victory in the upcoming vote.

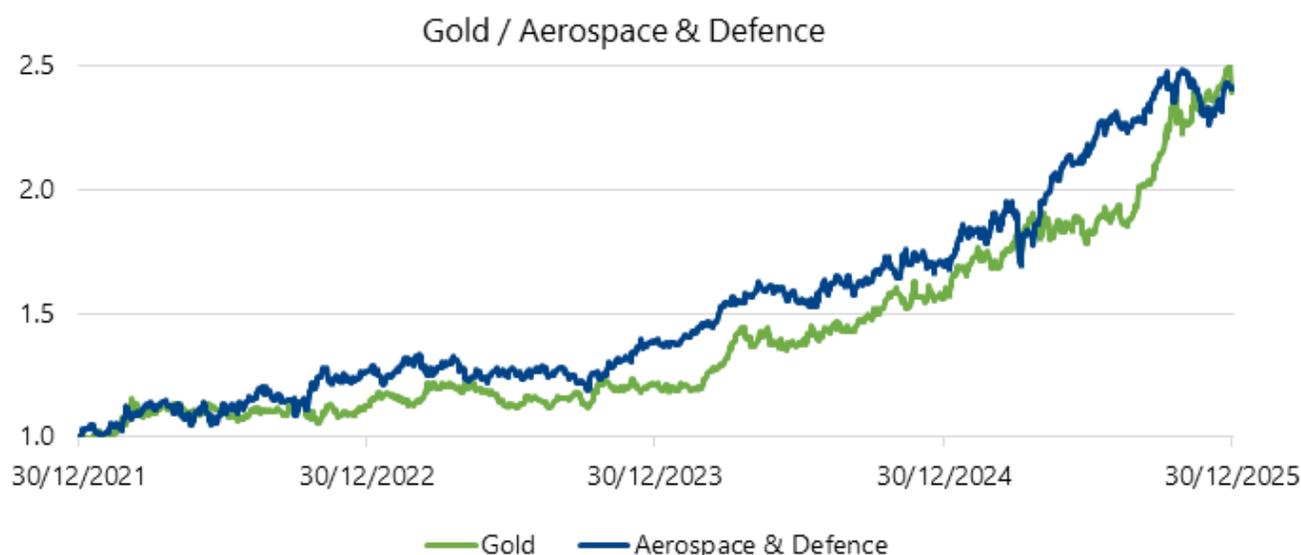
## Value trumps growth

Japan enjoyed another consecutive year of double-digit returns, finishing up 16% and pushing through all-time highs. However, performance varied significantly across styles. Value stocks led the way, rising over 23%, while growth stocks lagged, returning just 9%. This divergence has been a feature of the Japanese market since 2021 and reflects two key drivers: Firstly, the ongoing corporate reforms targeting typical value traps, and secondly, a persistently weak yen boosting the earnings of export-oriented companies.

## The currency factor

Following a brief period of strength last year, the yen has continued to weaken following the Takaichi regime change, moving back towards the dreaded ¥160 level against the dollar. This level has historically prompted market intervention from Japan's finance ministry. However, on this occasion, reports are also pointing to potential coordinated action from the US Federal Reserve and Treasury as they seek to improve US currency competitiveness.

# A convergence in correlation



## Gold's relationship with defence

Gold has just recorded its strongest year since 1979, with the rally initially linked to excess liquidity, US dollar debasement concerns, and steady central bank buying – a narrative with some merit. Since then, prices have pushed to new highs as risks have multiplied, from geopolitical instability to questions over Fed independence. Gold benefits as a store of value and hedge against uncertainty, while defence stocks gain directly from rising government spending, and with both reflecting a growing geopolitical risk premium. As noted last quarter, rising inflows into gold ETFs suggest speculative retail interest, echoing the peaks of 1980 and 2011 and which ended badly for those who bought at the top.

## Bottlenecks in the global energy shift

Industrial metals also had strong performance. Copper climbed to record highs and closed out a landmark year, supported by persistent supply constraints, a softer US dollar and rising demand linked to electrification, grid investment and data-centre expansion – particularly in China. Lithium likewise ended the year higher, reflecting continued growth in battery storage and electric vehicle demand.

## Supply glut fears mount for oil

In contrast, energy prices remained weak, with oil dropping a further -12.5% in the final quarter of the year, as the glut in crude oil persists. West Texas Intermediate crude ending 2025 at \$57 per barrel. That represented a nearly 20% drop for the year – the sharpest annual decline in oil prices since 2020. The weakness reflected a combination of global oversupply, expanding production from both OPEC and non-OPEC producers.

## One eye on inflation

As previously discussed, we are wary of the potential of fiscal changes to trigger a resurgence in inflation. Tax rebates from Trumps' One Big Beautiful Bill and possible further stimulus ahead of midterms, could stimulate demand driven price pressures. In this scenario we could see the Fed halt rate cuts, even implementing rate hikes to maintain credibility. Real assets would offer the best protection during an acute inflation shock, traditional inflation diversifiers (such as real estate and bonds) could underperform as capital losses impair income, but the commodity heavy FTSE 100 Index would likely outperform other equity markets.

## Digital assets

The fourth quarter opened with record flows into crypto exchange traded products after a bullish Q3, but ended with the asset class nursing one of the most volatile quarters in history. The quarter was defined by a major leverage reset, with Bitcoin falling 24% in the fourth quarter, whilst a basket of the largest 10 cryptocurrencies fell 27%. The market is maturing rapidly but we cannot overlook the fact that cryptocurrencies trade similarly to a geared play on US tech, remaining considerably speculative in nature.

# “We need to talk about Kevin”

*The title of a disturbing but brilliant prize-winning best seller written by Lionel Shriver in 2003. We use the words here in the context of the slightly less unsettling world of the US Federal Reserve, where we need to talk about two Kevins – Chair of the Council of Economic Advisers, Kevin Hassett, and former Fed Governor, Kevin Walsh. Anytime soon one of them is odds on to be chosen by the President to succeed Jerome Powell whose term as Federal Reserve Chair ends in May.*

**Powell has long been under pressure from the President to cut rates**, calling him names stolen from the playground like “numbskull” and “knucklehead.” The ante was raised further recently when Powell disclosed that the Fed had been subpoenaed in a DOJ investigation into the \$2.5bn renovation of their headquarters.

**Central bank independence is critical**, allowing the institution to make decisions always in the best interests of the long-term health of the economy and not, for example, in the short-term political interests of boosting popularity ahead of midterm elections (heaven forbid)! Policy rates held lower than they would otherwise be **risks higher long-term inflation and monetary policy uncertainty** – short-term gain for long-term pain.

Returning to our two Kevins, they top the President’s nomination list by pledging to cut rates. Remember however that the FOMC, (the rate-setting committee), has twelve members and whilst typically there is little dissent from the Chair’s vote, December’s three-way split was the highest since the late 1990’s. Normalising dissent shields the overall credibility of the Fed from a Trump yes-man chair.

Efforts to stack the FOMC with monetary doves also overlooks the fact that it is not the actual rate that matters most, but how the Bond market reflects this in the 10-year Treasury yield – the benchmark for determining key borrowing rates for mortgages, cars, etc. We have already seen Trump back down in the face of a rebellious bond market immediately following his ‘Liberation’ day tariff showbiz event. The bond market cannot be bullied or threatened with legislation – it does what it wants.

Overall, last year was a good year for bond markets globally. 23 of the 27 currencies in the Global Aggregate (the benchmark global bond index) delivered positive local returns, driving the best annual return since 2020. It was a year of interest rate cuts by central banks globally, as inflation eased from multi-decade highs.

What then is the outlook for inflation this year? **Of all the risks facing financial markets in 2026, this is the one of most concern.** Another year of robust market gains relies on inflation, interest rates and bond yields continuing their gentle downward trajectory. But inflation on both sides of the pond has remained stubbornly higher than target.

In the UK, anaemic growth and the annualization of big public sector pay rises, should ease pressure. But fiscal profligacy in the US, the one big beautiful bill, other tax cuts and rebates (together expected to add \$3trn to debt over the next decade), and a near absence of low-wage workers from across the border, risks sending **demand-pull inflation** higher.

Contrary to expectations, the c.7-fold increase in import tariffs appears to have had little impact on prices (thus far)! But there is growing evidence that having stockpiled early, companies have so far passed on only a small element of the tariff cost increases, the remainder becoming due this year and adding to **cost-push inflation**.

The consensus as we enter 2026 is that consumer prices will drift slowly lower, growth remains robust, and markets enjoy another ‘Goldilocks’ setting for financial assets. The alternative **‘stagflationary’ environment, is not discounted in forecasts**, but is a bigger risk than now discounted and, therefore, one that we are alert to and have prepared for.

# “When you see one cockroach, there’s probably more.”

*Jamie Dimon, long-standing and highly respected CEO of JP Morgan, America’s biggest bank, made this remark back in October in the wake of the bankruptcy of two lenders in the auto industry. It was a warning that the failure of these firms was a likely indicator of more hidden problems in the private credit and broader financial system. “We’ve had a benign credit environment for so long, I think you may see credit in other places deteriorate more than people think.”*

The focus of Dimon’s concern was the **private credit market** – an area that has seen massive growth since 2011. Tighter capital regulation following the global financial crisis constrained banks from lending money, resulting in other money managers stepping in and offering direct loans with bespoke terms but limited liquidity. The sector is **less regulated than public markets and operates with less transparency than traditional bank lending**, but has rapidly grown to an estimated \$3 trillion in assets under management.

When asked about private credit, Howards Marks, renowned bond investor, replied: “The investment environment had been mostly benign over the years since 2011, meaning – to echo Warren Buffett – the tide has never gone out on private credit, i.e. it hasn’t been tested.” Recent months have seen global watchdogs weigh in on the sector. Amongst them has been Andrew Bailey, Bank of England Governor, warning that troubles in the asset carry “worrying echoes” of the 2008 GFC and could be the “**canary in a coal mine**” for issues elsewhere.

As regards public credit markets, our view of the sector last year was that there was too little compensation, spread/premium over the yield on government debt, to warrant the extra risk in owning non-government backed securities. But in a ‘risk on’ year for financial assets, our underweight was wrong – **credit had a good year, with spreads narrowing to their lowest level on record.**

That view has not changed. We believe we are late in the corporate credit cycle. We see default rates rising from current historic lows, and **huge extra supply coming from giant AI-related tech firms (the hyperscalers) as they shift from internal cash funding to heavy debt issuance.** The Credit asset class is huge. We are underweight but still invested in it with a sharp focus on quality.

An area within fixed income which we have warmed to and see long-term structural opportunity is **emerging market debt (EMD)**. Traditionally investors have regarded EMD as low-quality, high-yielding, and high-risk, reflecting a past characterised by volatile politics, fragile institutions and currencies prone to sharp devaluation. But many of these macro risks have now inverted – a combination of emerging economies developing and developed economies regressing.

The fiscal position of many developed market (DM) economies has sharply deteriorated since the GFC and Covid. According to the IMF, debt-to GDP has grown to 112% in DM compared to c. 70% in EM. At the same time, political risk has risen, with **Moody’s October US debt downgrade citing a worsening in US governance.** Structurally, EM (85% of world population) benefits from a younger and growing population (not everywhere, China’s population is falling), plus crucially a rise in local investors, pension funds, insurers, and sovereign wealth funds who want domestic debt.

A broad inversion in so many macro and market conditions **challenges conventional wisdom that EM debt should trade at a discount**, but yields remain materially higher than those in DM – and that is the opportunity (see chart below).



# Asset class views

Asset Class	Sub Asset Class	--	-	=	+	++	Change	Description
Preference by asset class	Equities	○	○	●	○	○	-	Policy support and fiscal expansion will continue to underpin growth, but valuations remain high and policy uncertainty elevated.
	UK	○	●	○	○	○	↓	Earnings momentum is subdued and growth remains weak. Large discount to global peers and currency weakness offers support.
	U.S.	○	●	○	○	○	-	Earnings remain strong, but valuations are full and policy uncertainty keeps US exceptionalism in question. Tilt to mid & small caps.
	Europe ex UK	○	○	●	○	○	↑	Valuations are fair and political risks persist, but German fiscal spending supports selective opportunities.
	Japan	○	○	●	○	○	-	Takaichi's pro-growth agenda supports a relatively positive outlook for Japanese equities, though a volatile yen and rising bond yields pose risks to returns.
	Emerging Markets	○	○	○	○	●	-	US trade tensions remain a concern, but increasing intra-EM trade, attractive valuations, a weaker dollar, and rate cuts all support a positive outlook
Preference by asset class	Fixed Income	○	○	●	○	○	-	Any fall in growth likely supportive for government bonds, less so for corporates. Attractive yields on offer but preference for higher quality.
	Global Aggregate <sup>1</sup>	○	○	●	○	○	↑	Concerns around structural debt dynamics in developed markets and the risk of resurgent inflation. Contrast with attractive opportunities in EM, where higher real rates offer greater policy flexibility.
	UK Gilts	○	○	○	●	○	-	Gilts offer good value and fundamentals are starting to look supportive as inflation shows signs of loosening, allowing the BoE to cut.
	Global Index Linked	○	○	●	○	○	-	Short-term inflation expectations are elevated but yet to feed into medium or long term. Less attractive given budget deficit concerns in US.
Preference by asset class	Global High Yield <sup>2</sup>	○	●	○	○	○	-	Spreads are historically tight but defaults remain low. Balance of risks skewed to the downside despite demand for the asset class remaining strong.
	Diversifiers	○	○	○	●	○	-	A higher inflation environment should be supportive for infrastructure and supply disruption continues to support asset prices within commodities.
	Cash	●	○	○	○	○	-	Cash returns continue to fall as central banks continue their rate cutting regime.

1 Global Aggregate refers to investment grade bonds which could be government or corporate.

2 High Yield refers to corporate bonds with a higher default risk as decided by the ratings agencies.

Up/down arrows indicate a positive (↑) or negative (↓) change in view since the prior Investment Quarterly Review.

# Equities

## What we think

2025 was a strong year for equity markets. An ‘everything rally’, with those who held their nerve being amply rewarded. Global markets enjoyed a third consecutive year of double digit gains, a fourth would be exceptional - last happening prior to the GFC.

Markets shrugged off negative news flow throughout the year. After reaching all-time highs in February, stocks experienced a significant test in April amid tariff concerns, yet recovered to all-time highs by mid-June, within just 80 trading days. Underscoring the markets structural strength.

Risks to markets were overshadowed by resilient earnings growth and unprecedented fiscal stimulus. In the US, Trump signed the OBBBA (One Big Beautiful Bill Act), estimated to add \$3 trillion to the mounting fiscal deficit. In Europe, Germany implemented debt-financed expansion to boost stagnant growth, implementing a spending programme of €500 billion on infrastructure and defence.

Economic conditions globally are generally favourable. We saw most developed central banks cut rates throughout the year (Bank of England and ECB four times, the US Fed three times), with the exception of Japan. Consumer and corporate finances are in good shape, unlike those of many governments, and purchasing manager surveys have picked up recently.

While the breadth of performance is a healthy sign, valuations are at historical highs across the board. The dominant US stock market remains richly priced and concentrated in a few companies. This leaves us with a cautious approach to equity allocation going into 2026.

## What we have done

All things considered, we are minded to keep our overall equity exposure unchanged, all portfolios at their long-term strategic asset allocation levels. Our focus on valuations and what is in the price has steered us away from a consensual long in an expensive US, and towards an historically cheap and under owned UK and EM, our two biggest overweight’s. Along with Europe (where we are neutral) the three top performing areas last year (for a sterling investor).

Within this, we are implementing only two minor tweaks. The first is a small trim from our All World allocation across the portfolios, reinvesting the proceeds into Europe. Expensive US large-cap provides asymmetric downside risks to this allocation, whilst Europe trades more attractively and has seen robust economic growth in the short term, benefitting from lower rates and stable inflation.

The second, trimming UK small caps and switching the proceeds into the RWC Next Generation EM fund. The former sees some headwinds in the near term given lacklustre economic growth in the UK. Whilst the latter looks to benefit from rerouting of exports from China in the face of US tariff targeting. We also see conditions that powered the last emerging market cycle – cheaper currencies, firmer commodities and a relative growth advantage, are beginning to re-emerge.

# Fixed interest and diversifiers

## What we think

A good year for global fixed interest securities, with virtually all subgroups delivering a positive return. This reflected good starting positions across the board, elevated yields “paying you to be patient”, combined with central banks typically in interest rate cutting mode as inflation ticked steadily lower. Corporate credit markets outperformed government debt, mirroring financial markets for most of the year in ‘risk on’ mood and company fundamentals in robust health.

As last year progressed, we became more cautious in our fixed interest positioning, reducing corporate credit in favour of government debt. In hindsight, we proved too cautious, missing out a little on credit’s outperformance. But we are not minded to change this now, believing that we are late in the credit cycle and that defaults will inevitably pick up from a low base.

We referenced above that warnings from global and regulators regarding private credit markets have intensified of late. It is not an area that we directly invest in, but the risk is that troubles here spill over and infect regular corporate credit markets. This, and a turn in the default cycle, will see investors demand greater compensation for the extra risk.

After three years of double-digit returns in global equity markets, we are explicable more cautious entering 2026. Typically, greater caution here would prompt a de-risking of portfolios by increasing the proportion in fixed interest. However, given that our biggest fear is that (US) inflation disappoints on the upside, the asset class is not guaranteed to provide the desired safe hiding place.

An area within fixed interest that we have warmed to is Emerging Market (EM) debt. It is a subgroup that suffers from a perception that it is far riskier than the equivalent in developed markets (DM) – and because of this, trades at a yield typically twice as high. But as we talked about in the previous section, many of the key differences between the two are inverting, DM deteriorating and EM improving. We are conscious of the fact that DM debt had a good 2025, but believe for expert active managers, there is still huge opportunity in a rapidly growing and very diverse area.

## What we have done

We have kept the overall Fixed Interest percentage across portfolios the same but have initiated a small starting position in the Morgan Stanley Emerging Markets Debt Opportunities fund. This fund was chosen at the conclusion of an extensive deep dive into the Emerging Market debt subcategory. From a universe of 195 relevant funds, we filtered down to a final short list of three, had excellent meetings with all of them, but then unanimous in our preference for the Morgan Stanley fund.

The team has a 30 year history of investing in emerging markets, and as the name suggests, pursue an opportunistic approach across hard (typically US dollar or euro) and local currency emerging markets – providing exposure to sovereign credit, corporate credit, currencies and local interest rates.

The fund combines fundamental country-level economic and political research with disciplined valuation analysis. The decentralised investment team splits itself across three principal regions, positioning it to add significant exposure to off-benchmark countries. The long-term performance track record is strong and combines this with best-in-class risk characteristics, volatility, and drawdown.

To fund this new position, we have trimmed the Vanguard Global Bond Index fund – a big position in lower risk portfolios, tracking the benchmark index for global investment grade fixed-rate debt markets.

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