

2026 Outlook: From Concentration to Broadening Opportunity

Markets in 2025: Risks and Reality

As we look back to the end of 2024, the concerns investors carried into 2025 feel very familiar. Persistent inflation, debate over soft or hard landings in developed economies, uncertainty around Donald Trump's domestic and foreign policy agenda, and the fear that prolonged conflict in Europe would weigh on growth were all central themes.

Twelve months on, many of those risks have indeed materialised. Inflation has remained closer to 3 percent than the 2 percent target. Growth across developed markets has felt constrained. Geopolitical tensions intensified, with the ongoing war in Ukraine alongside further escalation in the Middle East. And yet, despite this backdrop, global equity markets moved steadily higher, repeatedly reaching new highs. Every pullback was shallow and consistently bought. In that sense, 2025 will be remembered less for the risks that emerged and more for the resilience of investor sentiment.

AI and Investor Behaviour

A defining driver of this dynamic has been the extraordinary enthusiasm surrounding artificial intelligence. AI is widely viewed as a transformational force for productivity and long-term economic growth. Whether or not that promise is fully realised, investor belief in the theme has created a powerful feedback loop. Strong performance has reinforced confidence, drawn further capital into markets, and encouraged increasingly aggressive risk-taking, including leveraged strategies in some areas.

This environment has also been supported by the wealth effect. Rising portfolio values have underpinned consumer confidence and spending, supporting corporate earnings and, in turn, equity markets. As a result, traditionally disruptive factors such as inflation surprises, weaker employment data, or geopolitical shocks have had little lasting impact on market direction.

Key Risk for 2026: Expectations and Concentration

Looking ahead to 2026, the key question is not what has gone right, but what could interrupt this strong appetite for risk. Our central concern lies in the evolution of AI investment and its translation into measurable economic returns. Investment in AI infrastructure already runs into the trillions of dollars. While much of this spending is funded through corporate cash flows rather than leverage, investors are increasingly focused on when and how those investments generate sustainable profits. The principal risk for 2026 would be a shift in perception around whether those future returns are as large or as imminent as markets currently assume.

This risk is amplified by market concentration. The largest AI investors now represent close to one fifth of the S&P 500. Any meaningful reversal in these stocks would make it difficult for the broader US market to generate positive returns. Given the dominant role of the US in global equity indices, the implications would be felt well beyond domestic portfolios. In such an environment, passive strategies would face particular challenges, while active managers would be better positioned to navigate volatility through selective exposure and risk control.

The Case for Broader Market Leadership

That said, there is a more constructive and, in our view, more likely path for 2026.

Beyond technology and AI, there is a wide universe of established businesses across sectors such as banking, healthcare, energy, consumer goods, and industrials. These companies stand to benefit meaningfully if AI adoption begins to improve margins, productivity, and operational efficiency across the real economy. A broadening of earnings growth beyond the narrow AI complex would help validate current investment levels, reduce concentration risk, and support a healthier market advance.

This is not a call for the end of the AI rally. For AI to truly succeed, its value must ultimately show up in the earnings of everyday businesses. If this begins to occur in 2026, it would validate the scale of current investment and allow markets to continue rising in a more balanced and sustainable way. For diversified client portfolios, that broadening is critical.

Economic and Policy Backdrop

From a macro perspective, we expect economic growth to remain reasonably resilient. In the US, tax savings from recent fiscal measures should begin to filter through to consumers, while interest rate cuts

later in the year provide additional support.

We expect US rate cuts to occur in the second half of 2026 rather than the first. Current policy settings remain broadly appropriate given inflation that is flat to slightly rising. The expected change in Federal Reserve leadership in mid-2026 adds an additional layer of uncertainty. Jay Powell is likely to prioritise stability while inflation and employment remain firm. A successor appointed by the President may take a more accommodative stance regardless of the economic backdrop, which could prove challenging for government bonds.

Fixed Income Positioning

Against this backdrop, we retain a cautious view on US government bonds, alongside a preference for corporate credit and inflation-protected securities. These assets offer, in our view, a more attractive balance between return and volatility. Continued dollar weakness and improving fundamentals across emerging economies support our ongoing overweight to emerging market equities and bonds, a position we expect to carry through into 2026.

Within fixed income, we also see value in UK government bonds. The recent Labour budget was received by markets as measured rather than expansionary. UK inflation is likely to return to target more quickly than in the US as the consumer remains under pressure from tighter fiscal conditions. This increases the probability of more aggressive rate cuts from the Bank of England. We see scope for three cuts in 2026, potentially four if conditions deteriorate, taking rates towards 3 percent or slightly below by year end.

Equity Opportunities by Region

Equity opportunities remain global in nature. In Europe, progress towards a peace framework in Ukraine would be supportive for sentiment after a period of underperformance. Defence and energy stocks may experience short-term volatility but should stabilise as defence spending remains a structural priority for the region.

In the UK, growth remains challenged, but internationally exposed large-cap companies should benefit from a weaker pound and reduced reliance on the domestic consumer. Our preferred access remains through high-quality global strategies with selective UK exposure. In the US, persistent inflation dynamics and a weaker dollar favour sectors such as healthcare, utilities, and industrials, alongside broader value-oriented themes that benefit from gradual AI adoption across the economy.

Downside Risks and Portfolio Protection

There are, of course, less favourable outcomes. If capital continues to flood into AI-related stocks at the expense of the broader market, concentration risks could reach uncomfortable levels. In that environment, any resurgence in inflation forcing tighter monetary policy could trigger a sharp market correction. Such a scenario would favour government bonds, inflation protection, alternative assets, and volatility-managed strategies, alongside a reduced exposure to equities and AI-related names.

Portfolio Implications and Outlook

Overall, we remain constructive on the outlook for 2026. Risks have increased alongside market

performance, but 2025 demonstrated just how resilient markets can be. Employment remains stable, consumers are in reasonable health, and the appetite to invest persists. Our central expectation is for a broadening of market leadership, which we believe is essential for delivering sustainable long-term returns.

As always, disciplined portfolio construction, diversification, and active risk management remain at the core of our approach. These principles have guided TAM for over twenty years and continue to underpin how we seek to grow and protect client capital across market cycles.

Finally, the team at TAM would like to thank you for your continued trust and partnership throughout the year. We wish you and your colleagues a very happy Christmas and a healthy and prosperous New Year. We look forward to working closely with you again in 2026.

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