What 2025 tells us about 2026

Mike Coop: Chief Investment Officer (EMEA) at Morningstar Investment Management 3/12/2025

Why the US Stayed Resilient – For Now One of the biggest surprises of 2025 has been the Teflon-like performance of the US economy despite a sharp rise in import tariffs. Their growth has outpaced most developed countries and inflation has stabilised.
Understanding 'why' is key to working out what may be in store for 2026 – there are three factors behind this inflation outcome:

- Companies drawing down older inventories
- Tariff rates coming in lower than many feared
- Firms choosing not to pass on the full cost increase, instead accepting a hit to their profit margins

We do not expect this to last, but instead expect the tariff effects to show up more in 2026, restraining growth and pushing prices higher.

At the same time, the AI boom in businesses is likely to offset some of these pressures, boosting spending but also putting downward pressure on wages and prices.

All in all, these forces still lay the foundations for interest rates in the US to move down further, which is positive for high quality bonds.

When the US Stops Leading the Pack

In 2025, a stronger economy did not translate into US equity outperformance.

Emerging markets, from South Africa to Brazil to China, delivered high returns – with Korea surging more than 70%. Even the UK, with none of the big IT or AI proxies that dominate US indices, outperformed the US – firmly breaking the pattern of US exceptionalism that most investors are used to.

Within the US, IT continued to dominate as the AI boom captivated investors, leaving non-AI stocks, including small companies and healthcare, neglected.

Why 2026 Won't Look Like 2025

So, what does this mean for equity returns in 2026? "Normal" equity returns average 4–6% a year above inflation, so the 15–20% levels seen in 2025 are unusual.

Last year's gains came mostly from investors becoming more optimistic or less concerned about risk. The surge in AI-related spending and heightened deal-making played a big role.

These factors have left valuations higher, meaning we should expect lower returns next year, though history reminds us that unusually strong returns can continue for several years in a row.

⚡ AI's Big Promise and It's Pressure

The ramp up in AI spending is expected to yield big benefits in terms of efficiencies and new use cases, as well as new sources of revenue for major players. But the payoff for investors in 2026 is tempered by higher valuation levels, after share prices jumped in 2025. Meanwhile the rise in capex means lower near term profitability in exchange for higher potential long term profitability. Market indices have also become less diversified, as the fate of businesses in IT, Consumer Discretionary and Communication Services industries become more and more intertwined, via customers and suppliers increasingly funding the big capex spend.

This is why we currently hold less than usual across IT and AI-related companies, and see better value in markets and sectors such as:

💡 UK
💡 Brazil
💡 Healthcare
💡 Consumer Staples

The significance of AI is also reflected in investor sentiment. In a recent LinkedIn poll, 69% of respondents selected AI as the key issue for investors in 2026, far ahead of concerns about the $US or geopolitical shocks.

What is the key issue for investors in 2026? (readers' votes)

- $US decline 9%
- Trade and geopolitical shocks 22%
- The impact of AI 69%

💵 Where the Real Value Still Lies

Some investors have gone further, drawing parallels with past market bubbles and market sell offs. But history shows that markets can remain at extremes for far longer than most expect. The world is complex and unpredictable, and there is a long history of failed forecasts about booms and busts. 📌 🔔