

The outlook for 2026

The expected diversification of returns began in 2025, with strong relative performance from equity markets in the UK, Europe, Japan and emerging markets. But the concentration of global markets among the US mega caps also continued, with market capitalisations reaching trillions of dollars. We were also reminded once again of the power of the bond markets and their diversification benefits. What should we expect from 2026? Liontrust's investment teams look ahead with a good deal of optimism

Samantha Gleave: Co-Head, Cashflow Solution team

Global equity markets have extended their recovery from the tariff-related volatility earlier in the year, and as we approach 2026 the European market remains in a constructive technical trend. While this rally has been strong – and has outpaced US equity performance – European valuations remain reasonable, particularly among companies generating attractive and sustainable cash flows.

Our investment process ranks the European equity universe using proprietary cash-flow metrics, enabling us to identify businesses with the strongest cash-flow dynamics. These companies form our Cashflow Champions watchlist, from which we select portfolio holdings. Despite recent market gains, we believe this watchlist has rarely been more attractively valued.

A further positive signal is the continued cash flow discipline being shown by corporate management teams. Against this backdrop, and given the evolving macro environment, we continue to favour a balanced style positioning across portfolios as we look into 2026.

Storm Uru and Clare Pleydell-Bouverie: Co-Heads, Global Innovation team

We are entering overlapping innovation cycles, from physical AI (robotics and autonomous systems) and accelerated computing to major advances in biotechnology platforms. By 2026, the breakthroughs commercialised over the past three years should begin to compound: software will automate more knowledge work through coding agents, infrastructure will scale through vast accelerated-computing clusters, and bio-platforms will increasingly industrialise parts of discovery and development. The result is a step-change in how quickly leading businesses can test, iterate and scale.

As we approach the end of 2025, investors cannot have missed the question dominating the headlines: are we in the midst of an AI bubble, or simply talking ourselves into one? Traditional bubbles are characterised by overbuild and overcapacity; in AI, the defining feature is the opposite. Compute, power and data-centre capacity remain constrained, and the supply response looks set to take years rather than quarters. That matters for 2026 because it supports a longer runway for investment and adoption, even as valuation discipline remains essential. It is also worth noting the difference in market leadership: recent gains in US technology have been driven more by profit growth than by multiple expansion, whereas advances in parts of Europe and Japan have been more valuation-led.

Healthcare is another area where the set-up is improving. After a deep three-year downturn, leaner and more focused organisations are beginning to reinvest, increasingly around platform-based approaches. These can

shorten development cycles and lower costs, and the integration of AI tools should further improve productivity across discovery, trial design and operations.

Looking ahead, we believe the winners of the next decade will not simply be the winners of the last. Each major technology platform shift reshuffles competitive advantage; we saw it with mobile and again with the move to the cloud. AI is a broader shift because it can permeate every sector. Rather than assuming incumbents remain unassailable, 2026 is likely to be a year when challengers with purpose-built AI-era products and superior unit economics start to take meaningful share. In this environment, we prefer companies that are demonstrably outgrowing their competitors because they are built for the new platform, not retrofitting legacy models to it.

Simon Clements: Fund Manager, Sustainable Investment team (equities and managed)

We expect economic growth to be more balanced as the delayed effect of interest rate cuts begins to help areas of the global economy that have been under pressure in the last few years, including housing and industrial end markets. We also expect the incredible growth in AI infrastructure build to continue, but the sheer scale of the funding needs will begin to create bumps in the road, as will the need to source the energy to run these assets.

Much of the volatility in markets over 2025 has been driven by a White House which is more than often chaotic. Markets will begin to adapt to this type of leadership, with the midterms highly likely to derail much of the President's ability to create the chaos he loves so much. This is likely to lead to more business confidence, as we move into the next economic cycle.

We also expect key sustainability trends to continue to provide growth opportunities, including increasingly scarce access to water and the decarbonisation of our energy systems. These sustainability trends span over multiple decades and provide patient investors with reliable tailwinds.

From a sector perspective, the healthcare sector is in a strong position after three years of below trend growth and disappointing performance. As demand normalises, and predictable growth returns, the political pressures have also abated. This provides a compelling starting point for a sector which has already turned a corner over the last quarter of 2025

We also have to consider where the "surprise" areas of the market come from. Over 2025, these were utilities and banks, with both sectors enjoying significant tailwinds which surprised many. Could industrials do the same over 2026? This is a sector which has remained cyclically challenged for the past few years but perhaps 2026 could be the year of the global industrial.

Mark Hawtin: Head of the Global Equities team

We see great opportunities for global equity markets in 2026 as growth remains robust and interest rates fall around the world, led by a dovish Fed. However, diversification must be the key mantra and is the price of staying fully invested.

We believe there are two primary drivers for the equity return outcome: macroeconomic uncertainty around economic growth, inflation and the path of interest rates, and uncertainty around the path of AI investment and returns.

We think that the US dollar will continue to come under pressure, the AI narrative will be volatile and unpredictable, and diversification away from the very biggest names in the market will offer the best risk/reward profile.

The market still seems too bearish on Europe, where we find plenty of strong investment ideas, and the prospect of a weak dollar is supportive of emerging market equities.

Europe is constantly under fire for being backward thinking on structural reform and investment, but this is changing. While a stronger Euro is not ideal for many of the quality names in the market, we believe that 25 years of underinvestment is reversing, led by defence spending and power infrastructure investment

Valuations are reasonable and the reverse of the Magnificent 7 effect is in play in Europe, with the largest cap names having underperformed for some time.

Emerging markets look well-set to extend 2025's outperformance, as domestic liquidity improves, driving a return of the earnings growth premium to developed markets. Cheap and under-owned after a near 15-year underperformance cycle, emerging markets are set for a recovery, with the Fed's impending easing opening the door to a near-universal reduction in interest rates across markets, whilst the end of dollar dominance removes a key headwind. India and Latin America offer two of the most compelling opportunities, albeit with very different drivers and characteristics.

Imran Sattar: Portfolio Manager, Edinburgh Investment Trust

The global economic outlook for 2026 remains mixed, complex and challenging. Underlying economic activity is subdued, particularly in Europe and China, while trade tensions and geopolitical risks continue to add uncertainty. Despite these headwinds, there are pockets of strength that could provide resilience and opportunities for investors.

One of the most significant tailwinds is the substantial investment stimulus in the US. Manufacturing activity has surged, driven by policies aimed at reshoring production and bolstered by large-scale spending from technology giants on data centres, AI chips and computing infrastructure. This investment cycle is creating ripple effects across global supply chains and supporting innovation-led growth.

However, elevated levels of government, corporate, and consumer debt remain a concern. While US debt as a percentage of GDP has moderated since the pandemic, it is still high by historical standards. This dynamic could constrain fiscal flexibility and amplify risks if economic conditions deteriorate.

The UK presents a mixed picture. Corporate and consumer debt have trended lower, improving balance sheet health. However, employment levels have been persistently weak for over a year, reflecting structural challenges beyond post-Covid normalization.

Short-term risks remain elevated across markets. In this environment, we believe it is crucial to focus on advantaged businesses that are well-positioned to deliver durable returns. These include high-quality companies with above-average returns on equity, strong growth prospects and prudent leverage structures. Building portfolios that are both economically and thematically diversified will enhance resilience against market uncertainties.

Natalie Bell: Fund Manager, Economic Advantage team

Now the Budget is behind us, we should be moving into a more stable political backdrop from a UK policy perspective. The Budget missed opportunities in our view, but expectations were set at a low level and the moves to review Stamp Duty, change the ISA regime to incentivise greater levels of equity ownership and introduce a three-year stamp duty holiday for new listings on the Main Market are welcome.

Given the current economic backdrop, it is likely that UK rate cuts will be forthcoming, which should provide a tailwind for stocks with quality characteristics – the mainstay of Economic Advantage portfolios. Despite the relative underperformance of the quality factor in recent years, we retain high conviction in our companies and their ability to perform well over the long term through consistent compounding of earnings growth.

On aggregate, we are observing healthy earnings growth and cash flow in portfolios, which should further support a long-term upside as that cash is productively re-invested at high returns on capital.

Meanwhile, valuations remain significantly depressed versus long-run averages and other comparable markets. We believe there is a broad-based valuation reversion opportunity for UK equities, particularly small and micro caps, albeit the timing and magnitude is difficult to predict.

James Klempster: Deputy Head of the Multi-Asset team

The US stock market is unusually concentrated and expensive. It is perfectly reasonable to be positive on AI's prospects without adhering to the perceived wisdom that the companies leading the charge today have sustainable valuations. The Magnificent 7 are priced very richly on once-in-a-generation levels of profitability; a heady mix that, through the lens of history, we see typically does not end well for investors.

How long it takes for this to happen remains to be seen but the good news for investors is that there are plenty of enticing long-term opportunities available outside the AI zeitgeist. While markets other than the US have moved from "cheap" levels, such as the UK and Asia ex-Japan, they are not expensive and we believe are at levels that justify allocations which are greater than would be attained through a naïve market capitalisation approach.

We also believe these offer excellent opportunities for active managers. While the value style has made up some of its lost ground against growth over 2025, quality stocks and smaller companies remain overlooked.

Fixed income markets continue to provide valuable diversification opportunities. The yield payable on UK government debt today is more than four times the lows of 2022 (4.5% compared to 1%) and a barely believable 26 times the levels they were five years ago (4.5% compared to 0.17%).

High yield and investment grade credit yields are higher today than five years ago. But because yield spreads are low, proportionately the increase on 2020 levels is relatively small – for example, global high yields have moved from 4.85% in 2020 to 6.71%. We believe the yields of over 6.5% are a worthy addition to a portfolio given the relatively elevated status of lenders to these businesses in the event of default.

The global economy is in reasonable shape: expectations for growth are still in the low-to-mid single digits, which, while unspectacular, is also not unhelpful. Inflation seems to have a lid on it, although there remain uncertainties as to whether tariffs in the US will eventually lead to an inflationary impulse in the US.

Donald Phillips: Head of Credit, Multi-Asset team

Credit spreads remain tight, meaning that income – rather than credit spread tightening – is expected to be the dominant driver of returns. In a 6.5% to 7% range, the overall yield on the high yield asset class remains attractive. With valuations (as measured by credit spreads) somewhat stretched, the market has become more sensitive to adverse news or idiosyncratic credit stress. Dispersion in the market is evident especially among weaker-rated issuers, where idiosyncratic risks are being more distinctly rewarded or punished.

A modest increase in default rates – particularly among lower-rated issuers – is not unexpected. However, large-scale systemic defaults are not anticipated under our base case scenario. In this environment, active management remains crucial to navigating rising dispersion.

Longer term, say over a five-year horizon, we believe high yield is capable of generating long-term equity-like returns, with a fraction of the drawdown risk.

That being said, in a world of potentially slower growth, credits with stronger fundamentals, sound capital structures, and defensive characteristics are likely to outperform. We will continue with a disciplined focus on idiosyncratic risk and avoidance of concentrated thematic or cyclical exposures, enabling us to target attractive risk-adjusted returns, avoid default concentrations and avoid the mistake of selling bonds meaningfully below par value during any periods of volatility.

Jack Willis: Investment Manager, Sustainable Investment team (fixed income)

We remain constructive on the outlook for investment grade corporate credit going into 2026, which we believe looks set to be another positive year for total returns.

Further rate cuts are expected in both the UK and US, supported by relatively modest growth outlooks, inflation trending back towards target and weakening labour markets. Against this backdrop, we continue to favour an overweight duration position in the UK, where we expect yields to fall as focus returns to economic fundamentals after the recent Budget allayed near-term fiscal concerns.

Whilst corporate credit spreads are in expensive territory relative to recent history, this is underpinned by strong credit fundamentals, improved credibility of corporates relative to governments and ongoing investor appetite for the asset class given the attractive all-in level of yield and income on offer. As such, we do not see any obvious catalyst for spreads to widen materially.

Given these favourable tailwinds for the asset class, we expect investment grade corporate credit spreads to trade in a relatively tight range over the coming year. In this environment, we believe that active management will play a crucial role in generating excess returns.

Ewan Thompson: Fund Manager, Global Equities team

Since the peak of the previous meaningful emerging markets outperformance cycle in 2010, they have largely struggled against wider markets, with single years of outperformance against the MSCI All-Country Index in 2012 and 2020, and even two consecutive years in 2016-2017, but otherwise lagging global returns. Given that 2025 has seen a material improvement in the fortunes for emerging markets – which is on track for a year of significant outperformance – all eyes are on 2026 to see if this trend can continue into a second year.

We believe that emerging markets can continue to outperform developed markets. Normalising inflation allows global central banks to cut interest rates further, with emerging markets benefiting from easier liquidity. Over two-thirds of emerging markets' central banks (GDP-weighted) are in easing mode. Brazil is the notable exception, holding rates at 15%, but consensus forecasts is for 2.5-3% of easing next year. This liquidity support can see both GDP growth and corporate earnings continue to accelerate. Dollar weakness throughout 2025 has been a material tailwind, and a capped dollar can allow renewed appetite for carry and risk. We anticipate drifting weakness as US growth and rates lose their exceptionalism – along with recognition of the US' net foreign debt increase (up from 9% of GDP in 2005 to 88% today).

Within emerging markets, Asia remains the structural growth engine, with India and ASEAN delivering domestic-demand-led expansion, China stabilising, and North Asia benefiting from AI capex. Latin America enters 2026 with real rates rolling over and scope for investment recovery.

We are most positive on domestic-demand recovery stories in markets such as India, where we see growth reaccelerating after a softer patch, as well as Latin America, where the rapid reversal in liquidity conditions and low starting valuations continue to offer attractive opportunities.

We see emerging markets being a prime beneficiary of an increasing diversification in investor portfolios in 2026.

Thomas Smith: Fund Manager, Global Equities team

Japan is seeing a decisive policy shift under Sanae Takaichi's new government, alongside structural economic changes that have been ongoing in recent years.

Prime minister Takaichi's agenda, dubbed 'Sanaenomics', blends aggressive fiscal action with a continuation of shareholder-friendly structural reforms – including supply-side reforms bearing similarities to 'Abenomics'. A substantial fiscal package focused on tax cuts, spending increases and measures to counter inflation is designed to boost sluggish middle-class consumption, alongside targeted strategies for cutting-edge industries (semiconductors/AI/quantum computing; critical minerals) and an accelerated timeline for defence spending increases and nuclear power plant restarts.

The transition from deflation to a cycle of sustainable, moderate inflation is fundamentally changing the Japanese economic landscape. Driven by tight labour markets and rising services prices, this is unlikely to be helped by Takaichi's restrictive stance on migration. Persistent wage increases lead to a new world of price elasticity, a new capex cycle and the need for productivity improvement.

Meanwhile, the Tokyo Stock Exchange's (TSE) campaign to improve capital efficiency continues to drive value creation. The momentum of share buybacks, dividend increases, and business restructuring continues apace, bolstering shareholder returns. Takaichi is a strong advocate for corporate governance reforms, specifically

targeting the effective use of retained earnings. This aligns with the TSE's ongoing push for firms to address low price/book ratios and improve return on equity.

For a comprehensive list of common financial words and terms, see our glossary at:
<https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms>

Key Risks & Disclaimer

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