BM BROOKS MACDONALD

THE Quarterly Edit

2026 Outlook
& review of Q4 2025

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Q4 2025

Quarter IN REVIEW

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Global equity markets continued to advance in the final quarter of 2025, with several major indices reaching all-time highs despite heightened volatility.

The period was dominated by the longest US government shutdown on record, which curtailed economic data releases and left economists and forecasters with limited visibility on underlying trends.

This uncertainty coincided with signs of a late-stage economic cycle: unemployment edged higher while inflation remained clouded by tariff effects. A softer than expected Consumer Price Index at year-end helped ease concerns and reinforced expectations for further monetary policy support in 2026, following the Federal Reserve's (Fed) December rate cut.

Equity momentum remained resilient, supported by strong earnings and rising capital expenditure, particularly in the artificial intelligence (AI) theme. However, markets have grown more discerning, focusing on the sustainability of heavy investment and its ability to translate into long-term profitability. Geopolitical risks persisted in the background, with gold reaching a record high during the quarter. In bond markets, longer-dated yields moved higher, reflecting a mix of factors including growing concerns about fiscal sustainability and sticky inflation expectation. Central banks diverged in their policy paths: the US and UK continued easing, the European Central Bank held steady, and Japan raised rates for the first time in years.

As we enter 2026, our priority remains maintaining a balanced and diversified approach, positioning portfolios to navigate evolving economic and policy dynamics. We remain committed to a long-term strategy grounded in discipline and adaptability, aiming to deliver strong outcomes and help you achieve your financial goals.

US Federal Reserve to be a key driver in 2026

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, underscoring uncertainty around the economic outlook. Current guidance signals only one additional cut in 2026, yet bond markets are pricing in two, reflecting expectations of continued support as unemployment edges higher and inflation moderates. While we do not envisage the economy experiencing a deep recession, questions remain over tariff-related price pressures and potential inflationary impact of fiscal stimulus from President Trump's "Big Beautiful Bill." Political dynamics could further complicate the picture, particularly as a new Fed chair in May could catalyse potential policy shifts. For investors, the Fed's evolving stance will remain a dominant driver of risk assets and bond yields, reinforcing the need for flexibility and diversification as monetary policy navigates an uncertain path.

UK Budget brings clarity, but economic clouds remain

November's UK Budget eased fears of a severe fiscal gap, though additional tax hikes highlighted the government's struggle to balance revenue with growth. While the measures were less punitive than initially expected, economic data remains weak: October GDP contracted for a second consecutive month, unemployment ticked higher, and retail sales softened. Leading indicators suggest continued fragility, raising questions about the effectiveness of Labour's growth strategy. Gilt yields spiked around the Budget but ended the quarter near early October levels, supported by Bank of England rate cuts. The yield curve remains steep, reflecting short-term policy easing against longer-term fiscal concerns. For investors, selectivity is key as growth headwinds persist despite improved fiscal clarity. With UK-listed large-cap companies generating roughly 70% of revenues overseas, fiscal concerns that pressure sterling could actually boost translated earnings. Opportunities may emerge in defensive sectors and quality income strategies, but selectivity is warranted given the uncertain backdrop and potential volatility in sterling and bond markets.

No escaping the AI theme

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 but concerns over stretched valuations and unsustainably high capital expenditure are mounting. Retail flows into concentrated passive and leveraged strategies have amplified risks, leaving the sector more vulnerable to sharp corrections. While AI is a structural growth driver, sustainability is key: in the first half of 2025, AI-related capex contributed 1.1% to US GDP growth, surpassing consumer spending. Any disappointment could reverse wealth effects and weigh on consumption, creating ripple effects across broader markets. For investors, diversification remains critical. Exposure to high-quality AI leaders should be balanced with allocations to sectors benefiting from productivity gains, while avoiding over-concentration in thematic strategies that could amplify volatility during periods of market stress.

Equity strength spreads beyond mega-cap tech

Global equities delivered another year of strong gains, with the MSCI ACWI posting nearly +20% for the third consecutive year. While headlines focused on US mega-cap tech, returns broadened across regions and sectors. European markets gained over 20%, UK large caps and Japan advanced more than 25%, and emerging markets surged over 30%. Sector leadership rotated throughout the year, with technology, financials, energy, and even aerospace and defence contributing meaningfully as geopolitical risks shaped performance. This broadening trend reinforced our strategy to diversify beyond US mega-cap companies, capturing opportunities in attractively valued markets and sectors. For investors, the lesson is clear: while innovation themes like AI remain powerful, balanced exposure across geographies and industries can help mitigate concentration risk and enhance portfolio resilience. As we move into 2026, maintaining this diversified approach will be key to navigating evolving market dynamics and capturing global growth opportunities.

2026 OUTLOOK

Navigating Valuations and Policy Shifts in 2026

Forecasting markets is never straightforward, but disciplined investing remains our guiding principle. For us, this means building diversified portfolios with robust risk controls and adhering to the philosophy that valuations matter for long-term returns. After several years of strong equity gains, tighter credit spreads and elevated prices in alternative assets such as gold and silver suggests that opportunities are less abundant than a year ago. Current valuations embed optimistic earnings assumptions, making selectivity more important than ever. While we believe markets can advance further, momentum from 2025 may need to pause, and returns could moderate.

The US economy appears late-cycle, yet monetary easing and fiscal stimulus should help avoid a deep recession and support consumer confidence. The Federal Reserve's recent rate cut and expectations for further easing provide near-term support, while fiscal measures under President Trump's administration aim to sustain growth. However, these policies may introduce inflationary pressures, particularly when combined with tariff effects and deregulation. This balancing act, stimulating growth without reigniting inflation, will be a defining challenge for policymakers in 2026.

Globally, central banks remain out of sync: the US and UK are easing, the European Central Bank is on hold, and the Bank of Japan has begun tightening. These divergences create opportunities but also require careful currency and duration management within fixed income portfolios. Higher starting yields and potential rate cuts make bonds attractive, particularly in high quality and shorter maturity segments, which can help mitigate volatility.

Equities remain supported by structural themes such as AI and resilient corporate earnings, but elevated valuations and concentrated leadership call for caution. Diversification across regions and sectors, combined with selective exposure to long-term growth drivers, will be key. Alternatives can play a role in reducing portfolio risk, but pricing in areas like precious metals suggests limited upside.

Our outlook is cautiously constructive: risk assets may deliver positive returns, albeit lower than recent years. In our view, a balanced, strategic portfolio emphasising diversification, and active allocation, remain the most effective way to navigate 2026's uncertainties while positioning for long-term success.

Equity Regional Outlooks

UK

UNITED KINGDOM EQUITIES

UK equities remain attractive on a relative valuation basis with the core index trading close to 13x earnings with a dividend yield of over 3%. Mid and Small cap sectors of the market remain even more attractively valued and the FTSE 250 index now yields around 4%. The UK equity market continues to be a core exposure for us and such yields, coupled with share buybacks and deep valuation discounts, suggest a continued value rich opportunity ahead.

US

UNITED STATES EQUITIES

Consensus expects US equities to deliver mid-to-high single-digit returns in 2026, supported by resilient earnings growth (~10–12%) and ongoing AI-driven capital investment. Valuations remain elevated at ~21× forward P/E, implying limited multiple expansion. Dividend yields hover near 1.5%, so total return will continue to rely on earnings and buybacks. Key drivers include Fed rate cuts, productivity gains, and strong tech leadership, while risks centre on valuation compression, geopolitical uncertainty, and slowing consumer demand.

EU

DEVELOPED EUROPE EQUITIES (EXCLUDING THE UK)

European equities (excluding the UK) start 2026 with attractive valuations, trading near 14× forward earnings, well below U.S. multiples (~21×). Dividend yields average 2.5–3%, supported by strong balance sheets. Key re-rating drivers include ECB rate cuts, fiscal stimulus for defence and green infrastructure, and improving corporate margins as energy costs stabilise. Risks centre on geopolitical tensions, slower global trade, and earnings sensitivity to a soft eurozone recovery.

AP

ASIA PACIFIC EQUITIES (EXCLUDING JAPAN)

Valuations are reasonable, and dividend yields are healthy, offering some income support. Structural growth drivers, such as rising consumption, digitalisation, and green infrastructure, remain intact, particularly in India and parts of Southeast Asia. However, near-term headwinds persist. China faces slower growth amid property sector stress and cautious consumer sentiment, while trade uncertainty and tariff impacts weigh on export-oriented economies. Currency volatility and geopolitical risks, including tensions in the South China Sea, add further complexity.

JAPAN EQUITIES

Japanese equities remain attractive, supported by corporate governance reforms, strong shareholder returns, and a favourable macro backdrop. Policymakers maintain a reflationary stance, with the new prime minister implementing a ¥21.3 trillion fiscal package for cost of living relief, subsidies, and defence. Valuations are reasonable, dividend yields near 2% and share buybacks are at record levels. Key risks include rising bond yields from tighter monetary policy and potential capital flows back into the currency.

EMERGING MARKETS EQUITIES

Geopolitical concerns have historically limited direct investment in the region, with preference for indirect exposure via regional beneficiaries. Today, attractive valuations (~12× forward earnings) and 2.5% dividend yields, supported by structural growth drivers, enhance its appeal as a diversifier. Key positives include China's scope for policy easing, India's strong domestic demand, and commodity tailwinds for Latin America. Risks remain around geopolitical tensions, dollar strength, and uneven global trade recovery.

Outlooks defined: *We express positive, neutral, and negative outlooks across a range of asset classes. These are defined as our judgement as to the expected return compared to the relevant broader asset class benchmark over our central forecast period of twelve months.*

● POSITIVE ● NEUTRAL ● NEGATIVE

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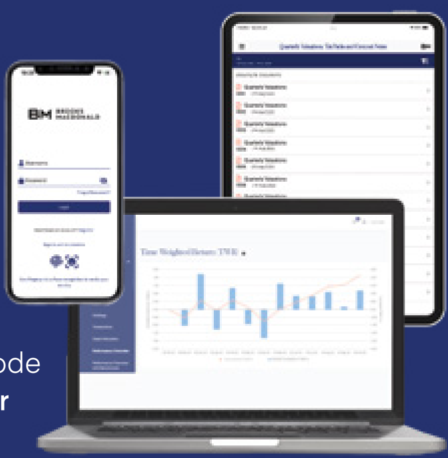

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The views in The Quarterly Edit are correct as at 31 December 2025. All information is current at the time of issue and, to the best of our knowledge, accurate.

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