

Window on
the World

JANUARY 2026

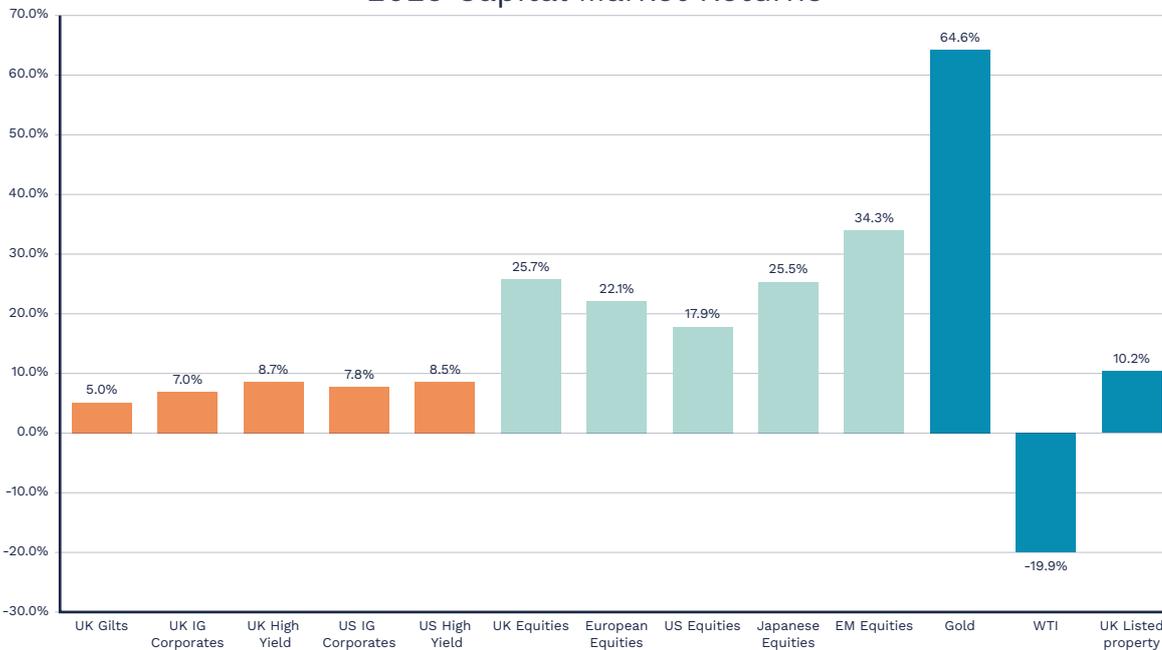
2025 was a good year for investors, so we have to consider the old adage that “All good things must come to an end”.

However, as we go into 2026, many of the conditions which galvanised this rally remain in place going forward – robust economic conditions, fiscal easing, and low interest rates, all of which provide a supportive backdrop for corporate earnings growth. So, for investors, 2026 is in a strong starting position. Yet, equity market valuations are higher than they were 12 months ago, and we think the likelihood of further interest rate cuts is diminishing; there will be some, but we’re likely entering the end of the interest rate-cutting cycle. We are therefore optimistic about the outlook for the year ahead, but with a degree of caution, and we will look to avoid areas of the market where valuations are extremely elevated or difficult to justify.



2025 in review

2025 Capital Market Returns



Source: Bloomberg, Verso Investment Management, as of end December 2025. Returns in local currency

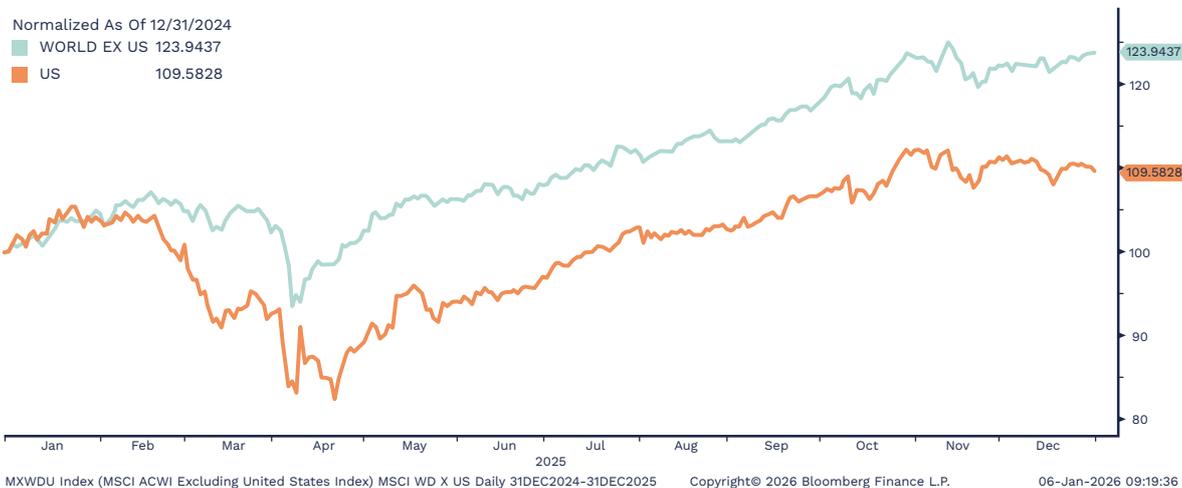
In 2025, all major asset classes delivered positive returns. Not surprisingly, equity markets led the way, despite a rocky start to the year amid fears that President Trump’s tariff policy would push the global economy into a recession. As we’ve learnt, Trump often winds back after his initial comments, and the subsequent relaxation of rhetoric in this area allowed investors to refocus on underlying macro factors that remained constructive, leading to a rebound in stocks as risk appetite improved. In sterling terms, global equities delivered strong double-digit returns over the year, while a move lower in global bond yields drove positive returns from fixed-income markets as well. But the standout performer of the year was gold and other precious metals, with gold rallying sharply as Central Banks bought heavily to diversify their reserves and, latterly, as investors followed suit.

We have often discussed the broadening of markets in Window on the World, and while much attention remains focused on Artificial Intelligence (AI) and technology, equity market returns show that dispersion was a key driver of performance over the year. For the first time in a number of years, U.S. equities were the worst-performing major market, while emerging market equities – led by China – delivered the strongest performance – quite a turnaround. With stronger performance from the U.K., Europe, and Japan, 2025 was a year when returns broadened out, something which benefitted our portfolios, with our preference for “rest of world” equities over the U.S.

2025 was also a year in which value as an investment style (buying companies where the stock appears undervalued) performed well outside the U.S., and markets that looked inherently cheaper than the U.S. benefited from this rotation. Within the U.S., the opposite was at play – with growth as an investment style (buying companies that might look expensive but are expected to grow faster than average) continuing to perform well – driven largely by technology stocks, although it is worth noting that within the Magnificent Seven technology stocks only two outperformed the broader U.S. equity market – a very different outcome to 2023 and 2024.



IN STERLING TERMS, GLOBAL EQUITIES OUTSIDE OF THE U.S. OUTPERFORMED U.S. EQUITIES BY AROUND 14% OVER THE COURSE OF 2025



Source: Bloomberg, 31 December 2025



The macroeconomic conditions that proved supportive for equities over the course of the year were multi-fold, including a resilient U.S. economy, high levels of capital expenditure in technology, ongoing monetary easing that further boosted liquidity, and the prospect of continued fiscal support. This drove strong and robust growth in corporate earnings. Other country or regional catalysts – including the prospect of significant fiscal spending in Germany, a favourable technology tailwind in China, and a new Japanese Prime Minister – provided a further boost to investor appetite. In the U.K., despite some of the gloom heading into the Budget, equities delivered strong returns, particularly from international earners, and the FTSE 100 surpassed 10,000 for the first time in the first few days of the new year.

As noted at the beginning of this update, fixed income markets also had a good 2025, with strong returns from investment-grade and high-yield credit, leading to spreads narrowing further. There is, however, an underlying concern about sovereign debt sustainability in major economies, which is at elevated levels. Anticipated interest rate cuts will put downward pressure on yields, which should drive positive returns from Government bonds. Over the course of 2025, the Bank of England cut interest rates by 1%, to 3.75%, and the Federal Reserve cut by 0.75%. The only outlier to global easing came from Japan, where the Central Bank continued to normalise monetary policy and hiked rates in response to higher inflation.

2026 outlook and thoughts

As humans, we like to compartmentalise things, and years are a good example; some are good for investors, some less so, but the underlying macro backdrop sees no dividing line.

As we move into 2026, many of the factors that supported a constructive backdrop in 2025 appear to remain in place: a resilient U.S. economy, significant AI capital expenditure, easing monetary policy, fiscal support, and strong corporate earnings. That said, with valuations in fixed income and equities more expensive than a year ago, and the interest rate-cutting cycle likely to have run its course by the end of the year, a key driver of returns in 2026 will be from underlying fundamentals, as opposed to a liquidity-driven rally. This is likely to be an environment in which the dispersion of returns across countries, sectors, and investment styles remains high, making it easier to construct well-diversified portfolios.



WHILE CONCENTRATION IN THE U.S. EQUITY MARKET REMAINS HIGH AND DOMINATED BY TECH, HIGHER VALUATIONS REFLECT HIGHER LEVELS OF PROFITABILITY AND EARNINGS GROWTH

Exhibit 14: Post the GFC, the US tech sector has expanded both its share of market cap and earnings

US TMT sector

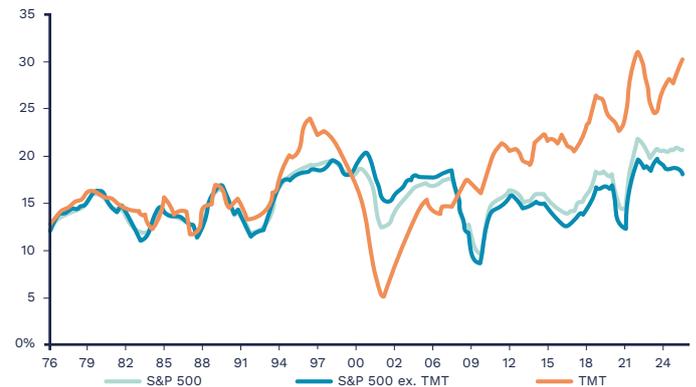


Source: Datastream, Goldman Sachs Global Investment Research

Source: Goldman Sachs

Exhibit 15: US TMT stocks are more profitable compared to the Tech Bubble and the rest of the market

Return on equity (ROE, %)



Source: Compustat, Goldman Sachs Global Investment Research

Looking ahead to 2026, a key driver of the global economy will remain the U.S. economy. Accelerating labour productivity, fiscal expansion and an acceleration in capital expenditure (both a function of the One Big Beautiful Bill Act in July 2025), combined with further interest rate cuts, should support consumer spending at the aggregate level and allow the U.S. economy to continue to perform well. One area that has continued to struggle is manufacturing, which may prove to be a source of weakness for the labour market.

Outside of the U.S., an acceleration in German economic activity as fiscal stimulus starts to kick in, a recovery in export demand, and follow-through from earlier easing from the European Central Bank should be supportive for Europe. In the case of the U.K., Government spending will remain a key driver of growth, but low business confidence may weigh on investment. U.K. consumers have high savings buffers, and in the near term, pent-up demand postponed until the autumn budget may provide a fillip. In China, a rapidly expanding new economy focused on AI, electric vehicles, and pharma should help offset weakness in traditional sectors such as real estate.

Inflation has been a priority on the radars of Central Banks and investors for some time, and while in developed markets inflation is likely to continue its gradual decline, we think it'll remain above target. Risks are likely to be skewed to the upside, due to tariffs, strong aggregate demand (a function of robust economic activity and high capital expenditure), and fiscal spending. And for all the talk about how AI will increase productivity, it is not clear at present if AI is a consideration for global inflation dynamics in 2026, and whether it could put pressure on the labour market and downward pressure on wages.

Alongside fiscal support, monetary conditions are likely to remain supportive through much of 2026, with further interest rate cuts expected from the Federal Reserve and the Bank of England. Presently, both are expected to cut rates twice in 2026, but there is policy risk around the Federal Reserve and its independence, given that Chairman Powell will be replaced in May. For now, it seems likely the European Central Bank is effectively done with its cutting cycle, and other Central Banks will conclude theirs this year. Looking towards the end of 2026, if economies perform well and inflation remains above Central Bank targets, rate rises could be in play for 2027, but this is a long way off and far from a current concern.

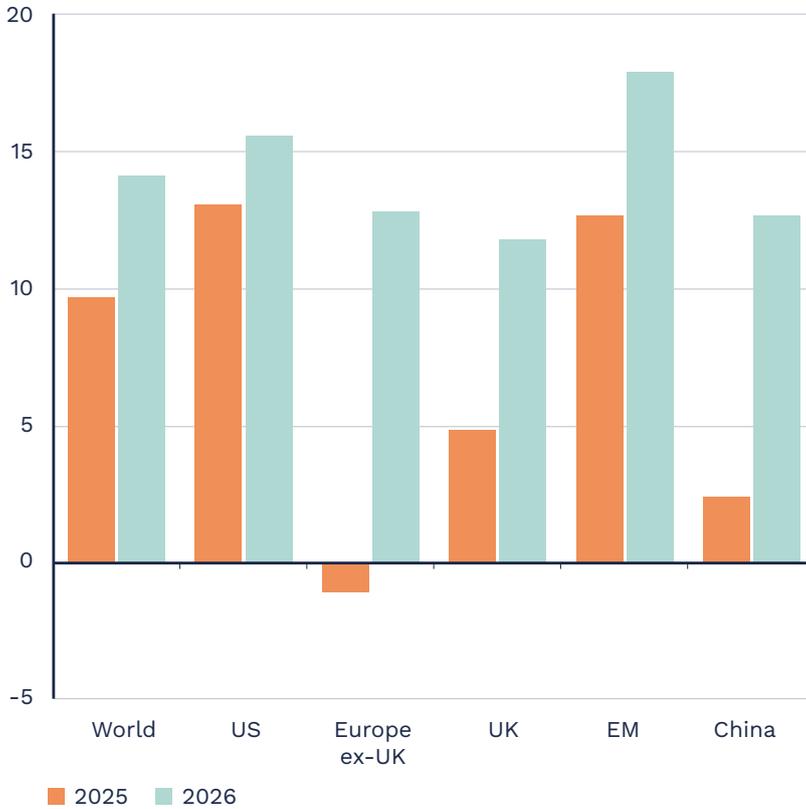
This combination of supportive fiscal policy, loose monetary policy, and robust nominal GDP growth provides a positive framework for corporate earnings, which are expected to climb in double-digit terms in 2026. Nevertheless, earnings growth will vary by region and sector. With aggregate equity valuations higher than a year ago, making further multiple expansion uncertain, we believe investors should focus on companies with strong, durable fundamentals and earnings growth that justify current valuations. The return of cash – be it through dividends or share buybacks – is also likely to be a key component of return from equities.



A FAVOURABLE MACRO BACKDROP LAYS A SOLID FOUNDATION FOR CORPORATE EARNINGS GROWTH IN 2026

Consensus estimates for global earnings per share growth

% change year on year

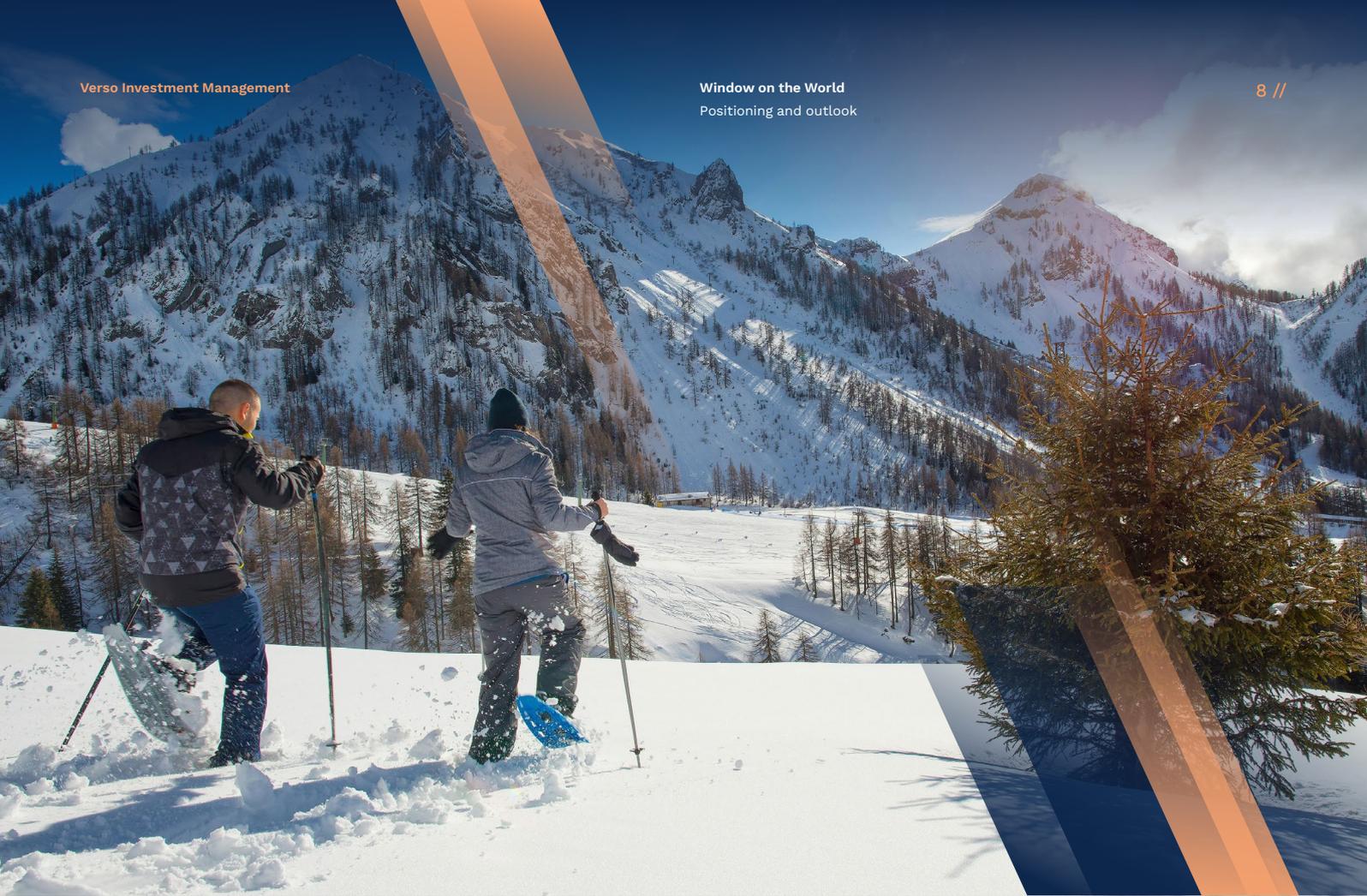


Source: Bloomberg, 31 December 2025

Within fixed income, there remain attractive absolute-yield opportunities in certain areas, such as emerging-market debt, asset-backed securities, and short-dated high-yield bonds. More broadly, spreads on investment-grade credit and high yield can remain tight in the absence of a recession and will continue to provide a degree of carry relative to Government bonds and cash alternatives. Concerns about fiscal deficit have led to steepening yield curves, and this is likely to persist for some time, leading us to maintain market duration or lower.

Although we see a nice positive backdrop for 2026, we have to consider what might cause things to turn out differently, usually referred to as tail risks. This may include a sustained move higher in bond yields (possibly on debt sustainability concerns), weaker than expected economic activity, a setback in the technology sector, a surge in bankruptcies in the private credit market (presenting potential systemic issues in the financial system), a resurgence in the trade war, and an escalation in geopolitical tensions. While none of these are baseline scenarios, they are risks which we will monitor closely throughout the year.





Positioning and outlook

With a backdrop that is supportive, we will maintain our core allocation to equities. That said, we recognise that valuations are higher in many markets than they were 12 months ago, and earnings delivery at the corporate level will be critical. As a corollary to this, we continue to avoid those areas where valuations are difficult to justify, or earnings expectations look elevated.



Source: Bloomberg, 31 December 2025

Regionally, we maintain a preference for equity markets where valuations do not look stretched, and as such favour 'rest of world' equities over the U.S. We have a particularly strong bias for emerging market equities, where growth potential is higher, and valuations are undemanding. Our allocation to the U.K. and European equities is neutral; both remain attractive because they trade at wide discounts to U.S. stocks and also have the appeal of an attractive dividend stream.

As we are likely entering the end of the global monetary easing cycle and do not expect interest rates to return to their pre-2022 lows, a significant compression in bond yields is unlikely, which will cap returns on Government bonds. Nevertheless, they still represent a good hedge if economic activity were to deteriorate, and we therefore retain exposure to U.K. Government bonds. Returns are more appealing in credit, particularly in high-yield and emerging-market debt. But with spreads tight, we are focused predominantly on the shorter end of the curve in these areas, reducing the sensitivity to any spread widening.

Wishing you all a happy and healthy new year.



Rory Smith
Chief Investment Officer





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