

Broadening underway? 6 ways to think about equities in 2026



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Key points

- Despite geopolitical uncertainty, global growth proved resilient in 2025, thanks to accommodative monetary and fiscal policy alongside a sharp pickup in AI capex.
- While economic growth exceeded expectations during 2025, the benefits were unevenly distributed, creating a two-speed global economy. As such, a barbell pattern emerged in 2025 equity markets: growth-driven momentum outperformance in the US contrasted with strength in contrarian value strategies elsewhere.
- Supported by fiscal and monetary accommodation, deregulation and AI capex, growth should remain robust in 2026, fueling a broadening set of global investment opportunities.



INVESTMENTS

- We think 2026 will be shaped by six themes: the durability of the AI investment cycle, the broadening of earnings growth beyond mega-caps, the value of international diversification amid shifting correlations, Europe and Japan's transition to domestic-led regimes, the potential revival of emerging markets, and the growing need for equity investors to rethink risk hedging beyond bonds.
- Investors have a number of dynamics to juggle when positioning for the year ahead: balancing AI enthusiasm with discipline, adding exposure to overlooked sectors or regions, diversifying across geographies, assessing opportunities across Europe, Japan and emerging markets and expanding their risk-mitigation toolkit.

2025 saw the global economy and markets contend with rising trade tensions and tariffs, ongoing conflicts in Europe and the Middle East and persistent weakness in China. Yet despite these headwinds, global growth remained resilient, and inflation stayed relatively benign. Earnings growth exceeded expectations – most notably in the US – but also broadening to Japan and some emerging markets.

It would be overly simplistic to just characterize 2025 as a year where “the rich got richer.” Mega-cap tech leaders continued to thrive, but overlooked

segments of the economy got “less bad”: the narrative around narrow markets may be true within the US, but if you look outside the US, market leadership is already broad.

As we look toward 2026, equity markets continue to persevere in a world of heightened geopolitical uncertainty. Supported by fiscal and monetary accommodation, deregulation and the AI capex cycle, we anticipate further broadening of economic growth in 2026. Here are six themes we're monitoring closely for 2026.

1. No AI bubble...at least not yet?

In 2026, we believe there are clear reasons to be optimistic about AI. Continued technological developments could not only accelerate capital investment but also begin translating into meaningful gains in productivity and economic growth. That said, alongside this constructive outlook, we are mindful of several flashing “yellow lights” — such as rising debt-financed capex, increased interrelated-party transactions and financings, and more speculative activity in high-beta parts of the equity market (Figure 1). These will be important trends to watch throughout the year.

So far, most of the AI-induced equity market moves have been supported by strong fundamental trends. Unlike the debt-fuelled financing of the telecom buildout in the late 1990s, most AI capex has been funded from free cash flow, though this is beginning to change on the margin. From a valuation perspective, big tech valuations significantly trail those of the late 90s. Rising rates helped burst the last bubble — this time, the Fed is easing, not tightening.

Finally, the 1990s internet build-out was driven by a ‘build it and they will come’ mindset. In contrast, AI is delivering real consumer and enterprise use cases, with enterprise demand both for primary

enablers—such as power, labor, and natural resources—as well as the necessary infrastructure, such as data centers, compute, and GPU, already exceeding AI capacity supply.

Figure 1: An AI bubble”checklist”: what should investors look out for?

Valuations	Traditional valuations stretched (P/E, P/B)	Moderate	Valuations are high, but not extreme relative to market or growth prospects
	Alternate valuations stretched (Market Cap/GDP, Tobin’s Q)	High	Both measures at/near peak
Fundamentals	Over-investment in the ‘New Thing’	Moderate-High	Risk of data center overcapacity, but demand picture unclear
	GDP-level impact	Moderate	Impact of AI capex approaching 1% of GDP
	Market anomalies/dislocations	Moderate	US share of world market cap; IT share of S&P 500
	Unusual M&A or financing	Moderate-High	Circular financing; “off balance sheet” data center deals
Psychology	Cavalier attitude to risk (“can’t lose”)	Moderate	Market seems pretty engaged with AI risk
	“This time is different” mindset	Moderate	Lack of mean reversion across multiple markets
	Conversation meter and fomo	Low-Moderate	“Uber driver” index feels low (Bitcoin > AI)
	Corporate re-branding	Low	No widespread “.com” type name changes
	Frauds and scams	Low	Recent examples were not linked to technology
Liquidity	Ample liquidity for the “New Thing”	Moderate	IPO market still ramping up from a cold start; robust demand for private credit
	Easy conditions/low interest rates	Low	Catalyst in 2000 and 2008

Source: Wellington Management.

Investment implications

While so far, we don’t see a bubble on the immediate horizon, investors should watch for signs that one is emerging. It will be increasingly important to understand whether companies deploying AI capex are seeing returns, if today’s

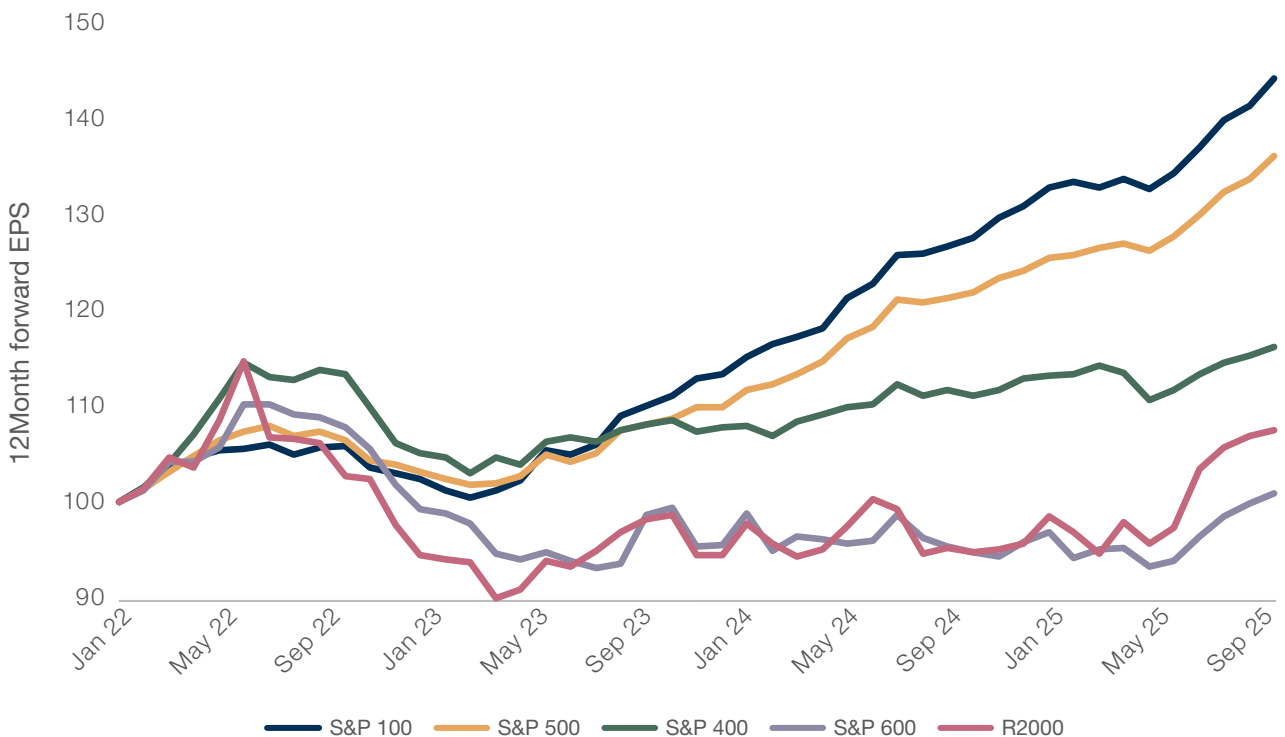
demand-driven supply and demand dynamics remain favorable and whether monetary policy and financial conditions stay accommodative, thereby continuing to support investment and lending.

2. Will the broadening keep broadening?

For the last three years, earnings growth has largely been confined to mega-caps. In 2025, US large caps continued to lead the way, but signs have emerged in recent months of broadening of earnings growth, both in terms of market cap and region (Figure 2). Positive earnings-per-share

(EPS) revisions across large-, mid-, and small-caps within the US, as well as within Japan and parts of emerging markets — particularly Taiwan and South Korea — point to the potential for a wider set of beneficiaries. A broader macroeconomic growth backdrop should further support this trend.

Figure 2: The US earnings outlook continues to broaden across market caps



Source: Bloomberg, Datastream. Data shows 12-month forward earnings per share (EPS) indexed to 100 as of January 2022. for the S&P 100, S&P 200, S&P 500, S&P 600, Russell 2000. Data as at 30 October 2025.

Investment implications

Earnings growth is broadening beyond mega-caps, with positive revisions across regions and market caps. We see the potential for a revival of earnings

growth in Europe and emerging markets more broadly, suggesting investors may wish to position for more diversified sources of growth.

3. Changing correlations are driving increased value in international diversification

Historically, globalization created a highly correlated and synchronized global economy. There was little scope for divergent cycles in an era when economies were closely interlinked and dependent on each other. In a world that tended to move in unison, markets were highly coordinated, and volatility, inflation, and interest rates remained low.

Investment implications

The growing desynchronization of equity market moves — evident in 2025 and likely to continue into 2026 — underscores the benefits of diversifying across geographies, industries, styles, and factors. Within styles, the dramatic lag of quality in 2025

This is now changing as the world deglobalizes — or at least reorders itself. We're increasingly seeing greater cyclical divergence between countries and the need for different central bank responses, leading to the reverse: lower correlations, less synchronization and increased volatility and inflation and structurally higher interest rates.

compared to the strength in beta and momentum may highlight an attractive entry point: Quality can offer both offensive and defensive attributes in a more volatile, less synchronized global environment.

4. Europe and Japan continue to transition to the “new regime”

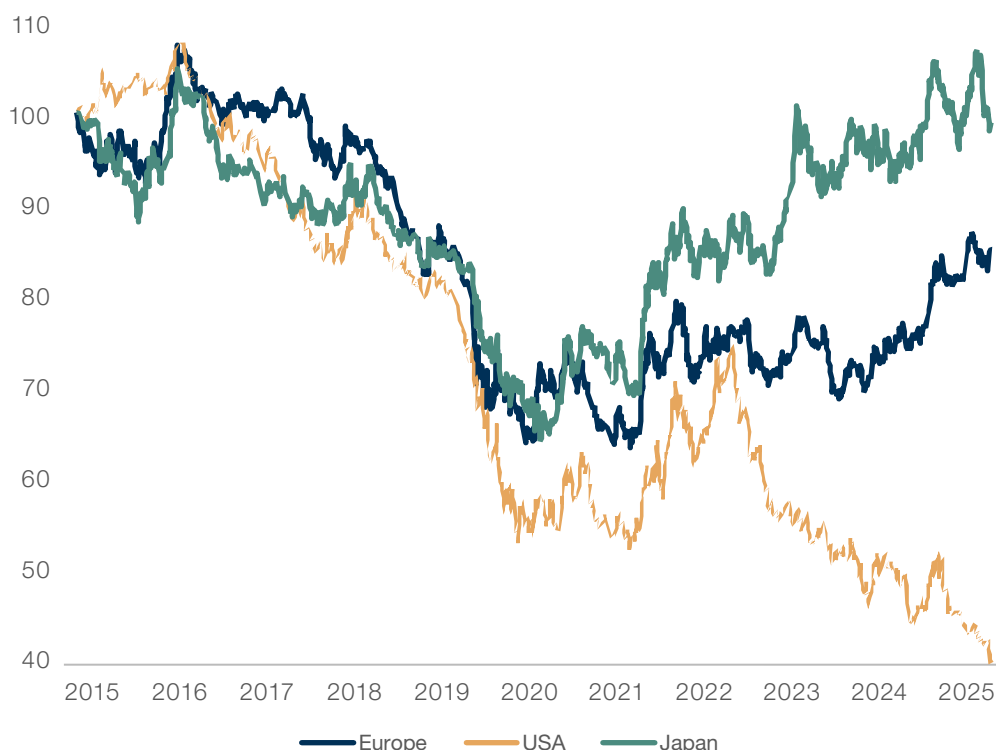
The US market is driven by the AI boom but, for once, Europe and Japan have their own idiosyncratic drivers — drivers that are differentiated enough to help keep global markets and economies desynchronized (Figure 3).

Things are starting to look quite different for Europe. Globalization is slowing and inflation is structurally higher, leading to higher interest rates. At the same time, the region is becoming more domestically focused and interventionist, with national security, economic resilience and competitiveness now all key priorities for European policymakers. We see the likely winners of the next regime as domestic value rather than international growth stocks. This leadership shift is likely to be supported by a recovery in European domestic demand.

An equally important shift is occurring in Japan. After decades of deflation and weak growth, Japanese nominal growth is finally accelerating. Inflation has broadened, wages are rising, and both companies and households are shedding their deflationary mindsets. Fiscal stimulus, easy monetary policy, and shifting demographics support these trends.

This shift matters for equity investors for two key reasons. First, nominal growth drives equity returns by improving corporate earnings and margins, making equities more attractive than cash for households. Valuation outlooks are also improving amid more predictable earnings. Second, corporate governance reform is enhancing shareholder value, making Japanese equities more attractive.

Figure 3: In Europe and Japan, value outperforms growth, unlike in the US



Relative performance of value vs growth equities in Europe, the US and Japan

Source: MSCI, Bloomberg. Data as at 4 November 2025. Indices used: MSCI Europe Value, MSCI Europe Growth, MSCI USA Value, MSCI USA Growth, MSCI Japan Value, MSCI Japan Growth.

Investment implications

Within Europe, investors may wish to avoid erstwhile winners in favour of domestically focused companies, with robust margins, that are aligned with regime-change beneficiaries. Along with sectors that are geared toward domestic demand, such as telecoms, banks, and construction, select defence stocks and utilities with high barriers to

entry may emerge as winners of Europe's transformation.

Within Japan, the combination of fiscal support and loose monetary policy should support domestic cyclicals. Two sectors that stand out are banks and services.

5. Is the time finally right for emerging markets?

Until 2025, emerging market (EM) equities lagged developed market performance for nearly 15 years amid the relative underperformance of EM EPS growth. But the narrative is shifting, with EM equities experiencing their strongest year-to-date performance in seven years.

Like the US, returns derived mainly from tech or AI-related mega caps, and while EM equity valuations are low versus the US, they are no longer particularly cheap relative to history. However, we expect broadening EM EPS growth in 2026, supported by several factors.

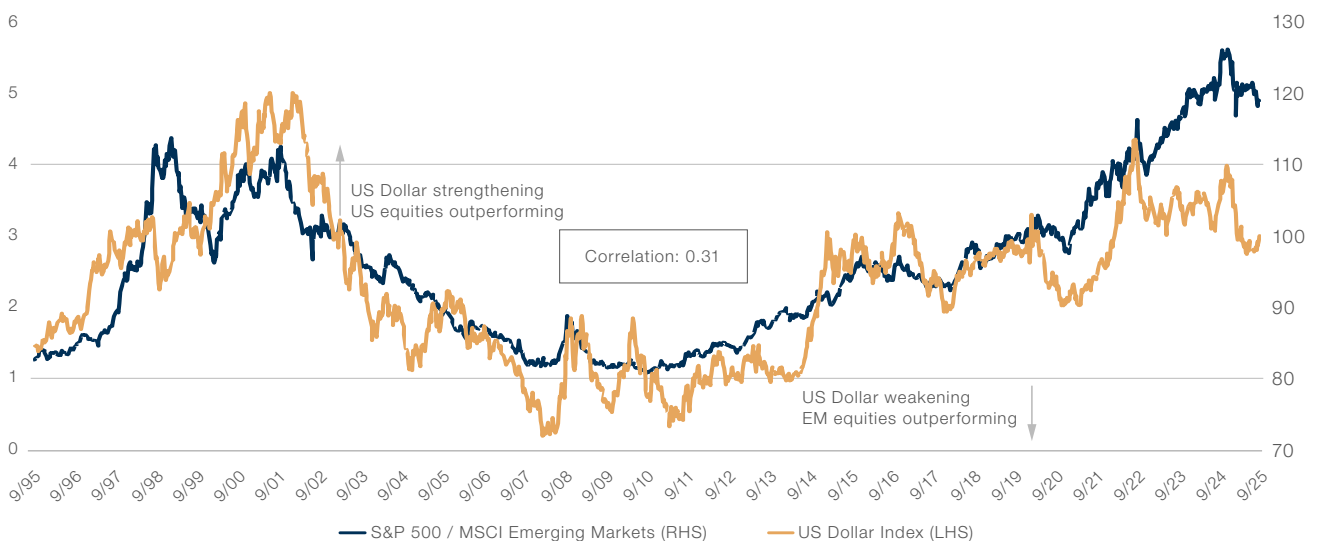
First, broadening global growth should benefit emerging markets. Second, the US dollar's reserve currency primacy is threatened by the US fiscal deficit, growth and inflation headwinds, and capital flows to other regions. Given that a weaker US dollar is advantageous for the US administration, further weakening could occur, which would augment returns for EM investors and support EM economies with dollar-denominated debts (Figure 4).

Meanwhile, a growing focus on shareholder value is driving increased capital discipline and prioritizing shareholder return. South Korea's equity valuations have been hit by its poor corporate governance record, but the government's Corporate Value-Up Program is making solid progress toward changing

corporate behavior and increasing shareholder value. China's anti-involution campaign — while different in scope — also exemplifies this new focus on reform, which should help to drive performance in emerging markets.

Lastly, the immediate impact of tariffs on EM growth has been milder than anticipated, and in several cases, policy responses have supported growth by prioritizing domestic markets and enhancing economic resilience. At the same time, lower central bank policy rates have been a meaningful net positive for financial conditions within emerging markets, with more rate cuts globally in 2025 than in any other year over the past two decades.

Figure 4: Is a weaker dollar a catalyst for Asia/EM outperformance?



Historically the correlation between EM and US dollar performance has been high

Source: Bloomberg, Wellington Management. Data from 10 November 2025.

Investment implications

After years of neglect, investors might wish to reassess their allocation to emerging markets within a global portfolio. However, there is high dispersion between countries for political, social, and industrial

reasons, and some may fare better than others. While emerging markets can potentially offer investors a rich opportunity set, selectivity is key.

6. Equity investors need to look beyond bonds to hedge market risks

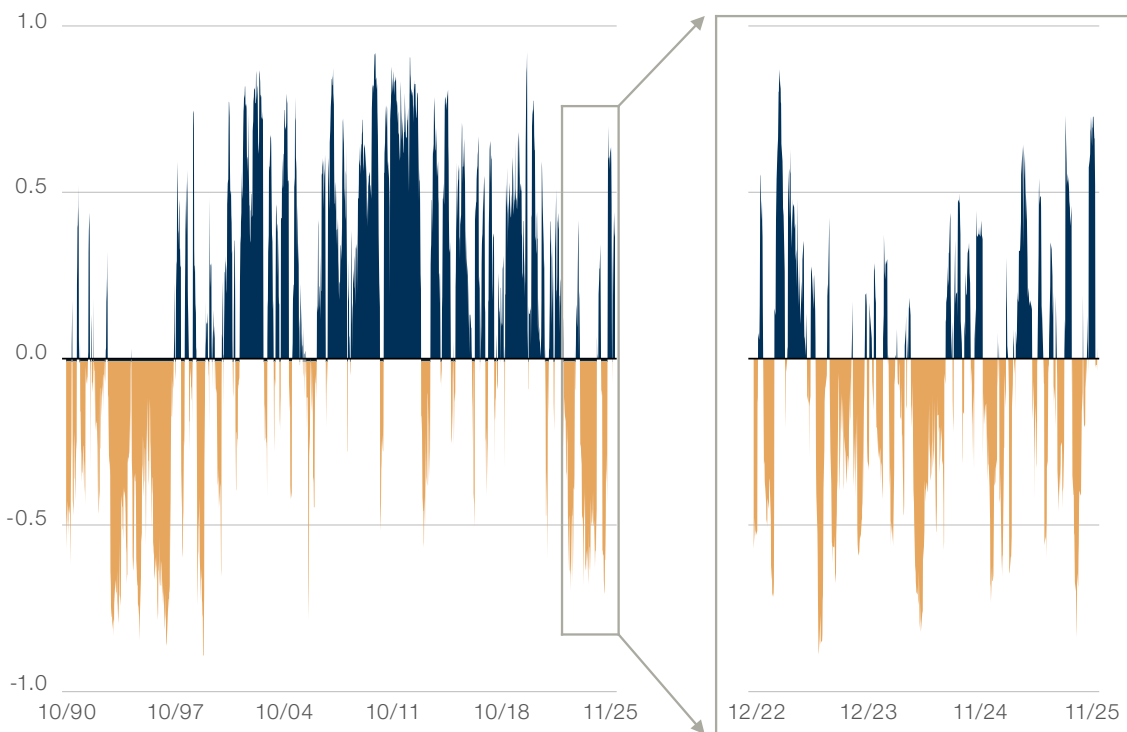
The sixth theme we're monitoring is, of course, what could go wrong.

Equity investors are increasingly focused on the growing challenge of hedging downside risks in a world of changing correlations. Stocks and bonds have become more correlated in recent years (Figure 5), which means bonds have lost some of their value as the “all-weather” risk mitigator and diversifier for equity exposures. And as long as US equities and the USD remain positively correlated,

the USD loses its historic safe-haven profile and becomes a risk-multiplier. In this scenario, downside risk for non-USD investors increases and currency hedging or alternative protection strategies become increasingly important.

The most challenging risk environment would be a reflationary scenario, which could drive interest rates higher and stock and bond prices lower in tandem (as we saw in 2022).

Figure 5: How might we hedge downside risk?



Correlation between the S&P 500 and US 10-year treasury yields

Sources: Wellington Management, using data from S&P and Bloomberg Index Services Limited. Data as at 5 November 2025.

Investment implications

To help protect against the downside, equity investors should consider the following risk-mitigation approaches:

1. Fund structures that can short, such as hedge funds or extension strategies
2. Portable alpha strategies
3. Stocks or strategies positioned to outperform in a higher-rate environment
4. Alternative asset classes or commodities that are positioned to outperform amid higher rates.

A broader opportunity set in 2026

Accommodative monetary and fiscal policy and sharply accelerating AI capex buoyed global growth in 2025. Looking ahead to 2026, growth should remain robust, but the investment landscape will be defined by broader earnings dispersion, shifting correlations, and regime transitions in Europe,

Japan, and select emerging markets. Against this backdrop, we believe equity investors will need to balance AI enthusiasm with discipline, diversify exposures across regions and styles, and expand their risk mitigation toolkit to navigate a more volatile, less synchronized world.

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