

Hymans Robertson Investment Services (HRIS)

Investment markets: Looking ahead to 2026

December 2025

As we approach the end of 2025, investors are already looking ahead to what 2026 might bring. In this article we explain the key themes that shaped markets this year and outline some potential scenarios investors may face in the year ahead.

Key points

- In 2025, markets swung from tariff-driven volatility to strong Artificial Intelligence ("AI") led equity gains, while political and fiscal developments shaped regional performance.
- In 2026, we expect AI to face growing investor focus. Credit markets may also go through additional periods of scrutiny. U.S. policy offers both support and risks including the Federal Reserve leadership transition. When building portfolios, we continue to draw on experience and learnings from when we've seen market conditions like this before.
- In terms of portfolios, performance remains strong. We maintain our diversification across sectors and regions, and continue to see return potential, especially where valuations are less stretched.

Key themes of 2025

This year has no doubt been dominated by two themes for investors – President Trump and his tariff policy, and AI. Markets stumbled at the start of the year, as Trump started to implement his high-tariff agenda. This culminated in one of the most striking periods of volatility that investors have experienced for years after the 'Liberation Day' (2nd April) announcements. At one point we saw markets swinging by up to 10% in one trading day. However, as trade tensions eased, attention shifted back to AI, a theme that has helped to drive equity markets higher for several years. This meant that, after a very shaky start, investors enjoyed a period of tremendous equity market gains. Let's hope England's Ashes campaign follows a similar trajectory.

Elsewhere, political drama added complexity, particular in government bond markets. The UK Budget kept the gilt market on edge, while France faced increasing scepticism from investors as hopes of fiscal reform faded. In contrast, investors welcomed the arrival of Japan's new leader, Sanae Takaichi. The Nikkei rose almost 5% on the day following her leadership victory. Meanwhile central banks maintained a cautious stance to cutting interest rates slowly, as inflation continues to hover above target in both the US and the UK.

Despite early turbulence, diversified portfolios delivered impressive returns over the year so far. Investors in our medium-risk portfolios would have generated returns of over 11% over the year to 30th November, with greater returns for higher risk investors. This year was an important lesson that assets can continue to deliver strong returns despite periods of heightened volatility and uncertainty.

Looking ahead to 2026

Time to take out the crystal ball. Even though it is impossible to predict events with precision, considering plausible scenarios and reflecting on past experience, is a valuable exercise. Doing this can help investors assess whether their portfolios are positioned to benefit from these possible outcomes, or at the very least avoid excessive risk on the downside. With that in

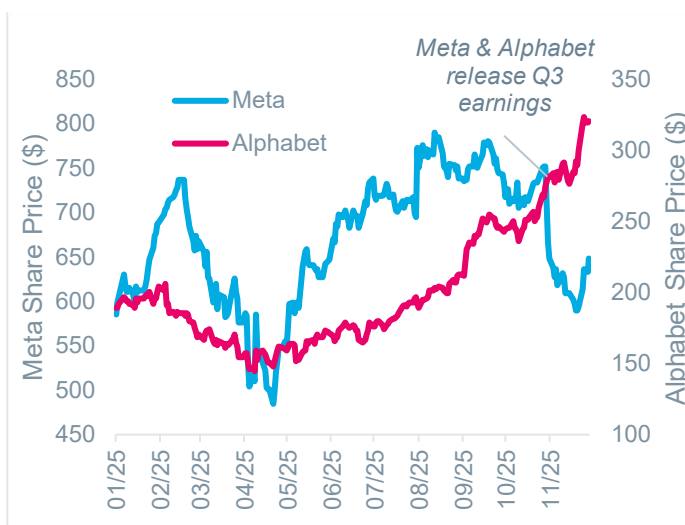
mind, we've outlined several possible developments for the year ahead, firstly by events we think will get most focus and then some less likely, but still possible, scenarios.

2026: Key areas in focus

Greater differentiation between AI stocks

AI-linked stocks continue to be a major driver of market performance, but we believe we may be starting to see a shift in attitude in recent months. Until recently, companies were rewarded simply for announcing large AI-related capital expenditure such as data centres and GPU (graphic processing unit) purchases. Now, investors want a clearer path to revenue growth. Firms that fail to articulate how these huge investments are going to deliver strong revenue growth have faced increased scrutiny (see Meta in Chart 1 vs Alphabet). The high level of concentration to the AI theme in market-cap weighted indices has driven strong performance over 2025. Looking forward we continue to believe AI will be a key feature of markets, but we expect this greater differentiation between AI stocks to continue. We believe a balanced exposure across regions and sectors, especially where valuations are less stretched, remains essential.

Chart 1: Meta and Alphabet share prices have diverged



Source: Morningstar

Credit market scrutiny

Credit markets may also face greater scrutiny in 2026. Through 2025 we saw high-profile bankruptcies in the US from Tricolor and First Brands, leading to credit losses and a warning from JP Morgan's Jamie Dimon that "when you see one cockroach there are probably more". The point investors are trying to grapple with are whether these defaults were idiosyncratic or a sign of broader stress in certain areas of the credit market. These defaults were centred around the private lending sector where strong demand has driven historically low credit spreads (the additional yield above government bond yields) and, in some cases, looser lending standards. This is not an area of the market that we invest in, but to manage against any risk of contagion we have been increasing the quality of our bond holdings over 2025.

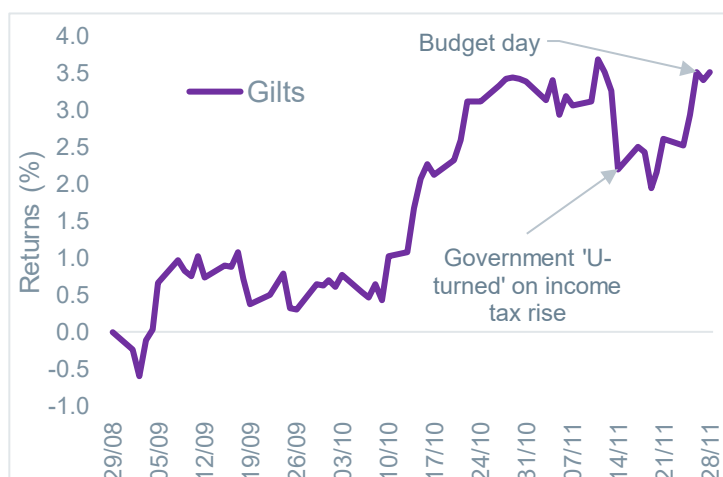
The US growth story

In the US, a major tailwind heading into 2026 is the twin-easing of fiscal and monetary policy. Tax breaks under President Trump's One Big Beautiful Bill are expected to keep the government deficit above 5% of GDP next year. A post-shutdown rebound is also expected early next year. At the same time the Federal Reserve (Fed) is likely to cut rates by another 0.75-1%. This could be supportive for both growth and markets. However, there are also headwinds, including the continuing economic impact of tariffs. The market effects were felt strongly in 2025, but US companies only began passing on most tariff costs to consumers in the second half of the year. We expect tariffs to continue pushing inflation higher and weighing on growth in the US in 2026.

The UK growth story

The UK economic outlook is more muted. Unlike the US, the UK government is raising taxes, albeit many Budget measures will not take effect for several years. Spending is front-loaded, offering a mild fiscal boost, but overall, the impact is far smaller than in the US. After the December meeting, the Bank of England may pause rate cuts, though a Q1 cut remains possible. The Budget has contained jitters in the gilt market for now, but any weakening of credibility on fiscal targets could quickly bring volatility back. It should be noted that the UK equity market had a stellar year in 2025, highlighting once again the disparity between the fortunes of the UK economy and equity market.

Chart 1: The Budget drove gilt markets in November



Source: Morningstar

New Fed chair is expected to be a “dove”

Finally, the transition to a new Federal Reserve (Fed) Chair could add uncertainty. The current Chair, Jerome Powell's, term ends in May 2026 but an announcement is expected early next year. The betting markets have Kevin Hassett, Trump's economic adviser, as the favourite. The key consideration for investors is how much influence and pressure Trump will continue to put on the Fed to cut interest rates aggressively. Investors will find a complete loss of independence for the Fed concerning. Trump's recent appointment to the Fed, Stephen Miran, has voted for a 0.5% cut in rates at every meeting so far (we call someone who wants to lower rates a dove). An alignment of the new Fed Chair with Trump's view will challenge investors' faith in the Fed's commitment to its inflation-fighting mandate, adding volatility to US Treasury yields.

2026: Lower probability but possible areas of focus

Some events carry lower probability but could have significant market implications. These scenarios are more uncertain. Some are binary, whereas others may play out in a number of different ways.

Supreme Court squash Trump's tariffs

There are several lawsuits questioning the legality of tariffs, particularly Trump's use of emergency powers to authorise them. One such case is currently sitting with the Supreme Court with a ruling expected in 2026. A successful challenge could allow importers to claim refunds on tariffs already paid. Even though this could be a big windfall for businesses, this may actually increase tariff uncertainty rather than provide clarity. There are other ways that the Trump administration could implement tariffs, through slower and less sweeping mechanisms. Either way, given that research suggests businesses are now passing more than half of tariff costs to consumers, any reversal would have meaningful economic and market effects.

Peace talks have started again

Might we finally see peace in Ukraine? Recent signs of progress toward a peace deal have raised hopes, though we should be cautious as previous attempts have failed. A resolution that ends Russia's exclusion from global markets could have significant implications for investors. Energy prices could fall if sanctions on Russian oil and gas are lifted, while European equities may rally as the geopolitical risk premium subsides (defence stocks may underperform). Investors may also be able to access Russian holdings that have been frozen to Western investors since the outbreak of the war.

Summary

2025 proved to be a volatile but ultimately rewarding one. Early market ructions driven by tariffs gave way to strong equity gains powered by AI, while political and fiscal developments shaped regional performance. Looking ahead to 2026, the outlook is mixed: AI remains a key driver but faces increasing scrutiny and expensive valuations, credit markets show signs of stress, and U.S. policy offers both tailwinds and headwinds. The UK picture is more muted, and uncertainty around Fed leadership could add volatility.

For investors, the message is clear: maintain diversification across sectors and regions and focus on quality in credit. While investors should stay alert to policy shifts and geopolitical developments, they should also understand that ultimately, markets tend to ride through most events, eventually returning to market fundamentals.



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