Winter 2026

market outlook.

Brought to you by the Investment Management Team

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contents.

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The UK Economy

The UK equity market had a notably strong year in 2025, with the large-cap FTSE 100 ranking among the best-performing global equity indices. This momentum has carried into the early part of 2026, supported by the index's international earnings exposure, attractive dividend & buyback yields and relatively undemanding valuations. In a world where growth has been uneven and geopolitical risks persist, the FTSE 100's blend of defensiveness and income has continued to appeal to investors.

By contrast, UK mid- and small-cap equities delivered more modest returns last year and lagged the large-cap index. Investor preference remained skewed towards larger, more liquid companies, while AIM-listed stocks in particular were held back by changes to tax incentives and a more cautious domestic growth outlook. That said, there are early signs of a turn in sentiment, with both mid and small caps making a good start to 2026 as valuations look increasingly compelling and expectations reset.

The Autumn Budget, regardless of views on individual policy measures, acted as an important clearing event for markets. With fiscal plans set out and uncertainty reduced, both investors and company management teams have greater visibility, allowing them to plan capital allocation, investment and hiring decisions with more confidence. Historically, this type of clarity tends to be supportive for risk appetite once the initial reaction has passed.

Politically, despite persistent media focus on party defections and leadership tensions, the UK has remained relatively stable when compared with many other major economies. Over the past year the government progressed a number of trade agreements and began 2026 with renewed diplomatic engagement, including a high-profile visit to China. This relative stability has helped reduce one potential source of risk premium attached to UK assets.

From a macroeconomic perspective, the data backdrop is gradually improving. GDP growth remains positive, inflation continues to trend lower, and while unemployment has started to rise, this is easing pressure in the labour market. Taken together, these factors create scope for several interest rate cuts during 2026. Lower borrowing costs should support consumers, while falling cash rates may encourage savers to redeploy capital into spending or investment, providing a further tailwind to domestic economic activity and UK-focused companies.

The European Economy

Europe delivered solid performance in 2025, though gains were front-loaded and later lagged other major markets. The outlook remains uncertain, but lower interest rates and potential fiscal expansion offer some support, albeit with caveats. Political uncertainty continues to complicate policymaking, particularly in Germany, where coalition dynamics have slowed fiscal rollout, and discontent within French politics. Even so, the overall fiscal stance is improving. Germany's €500bn infrastructure fund, including €127bn allocated for 2026, alongside increased defence spending across the region, could provide a meaningful tailwind to European growth.

The EU is increasingly recalibrating its global strategy away from a protectionist stance towards a more collaborative and diversified trade approach, reflecting a growing recognition that reliance on the US, particularly as a key defence and economic partner, can no longer be taken for granted. This has led to renewed engagement with China on trade and supply chains, alongside efforts to broaden international partnerships, including talks to ease tensions over EV tariffs. At the same time, the EU is strengthening ties with other strategic partners, notably India, where a landmark free trade agreement will remove tariffs on over 90% of goods traded. Overall, this signals a more pragmatic EU strategy focused on resilience through diversification rather than dependence on any single ally.

The European Central Bank's Deposit Facility Rate remains at 2.00%. After holding rates steady since June 2025, the ECB is unlikely to cut rates much further if at all in 2026. Uncertainty continues to shape the policy backdrop, driven by geopolitical tensions, particularly the war in Ukraine, and the risk of renewed trade frictions. Inflation is expected to remain close to the 2% target despite continued pressure from services prices, while euro-area growth has proven more resilient than previously anticipated. This supports a base case for reduced monetary stimulus with the ECB retaining flexibility to respond should conditions deteriorate materially.

Inflation across the euro area is broadly under control. At the same time, economic growth has proven to be muted yet more resilient than expected, helping to reduce near-term downside risks for European assets. However, the manufacturing outlook remains challenging, with Purchasing Managers Index surveys pointing to a prolonged period of weakness and ongoing competitive pressures creating structural headwinds for the sector. Looking ahead, household consumption is expected to remain the primary driver of euro-area GDP growth in 2026, even as consumer confidence stays subdued and savings rates remain high. With interest rates likely to stay low and broadly stable, fiscal policy is becoming an increasingly important determinant of the outlook for European growth and equity markets. This supports a cautious but constructive stance, with selective opportunities emerging despite persistent political and industrial risks.

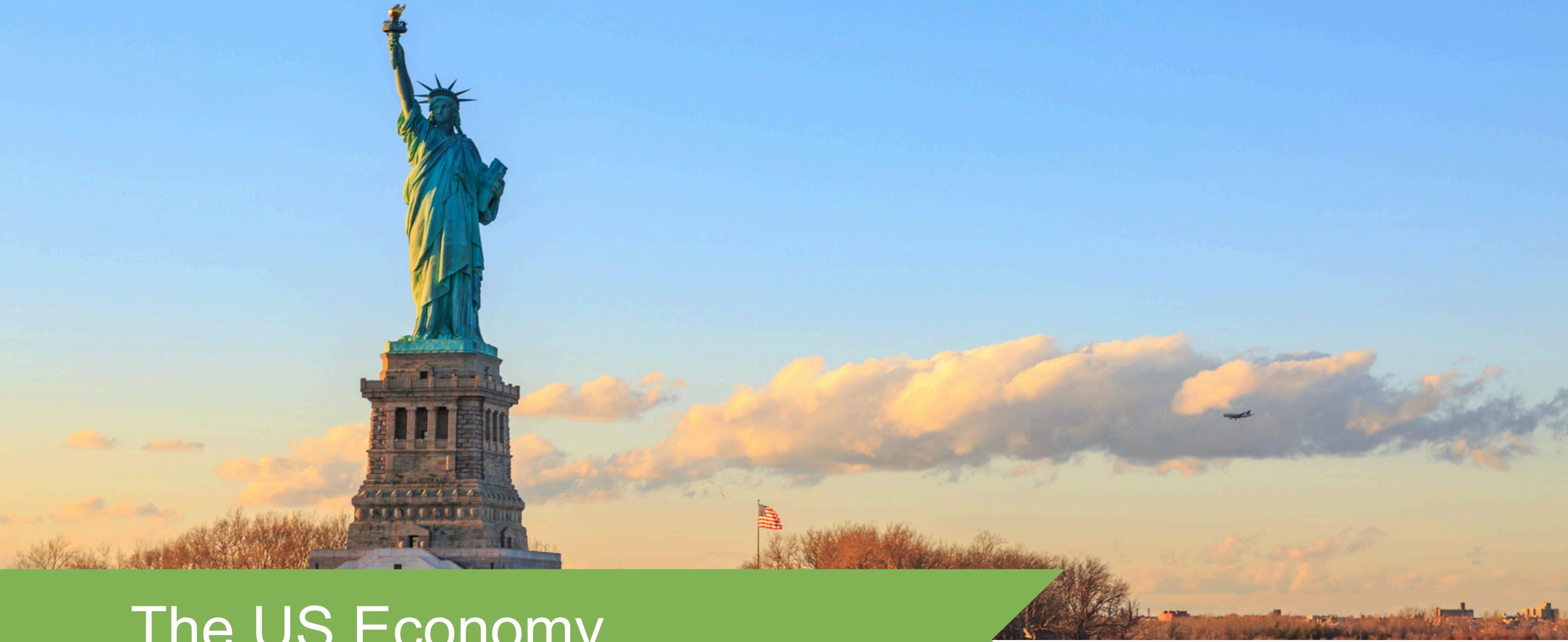
The US Economy

The pattern of tariff threats followed by rapid reversals has already re-emerged in 2026, consistent with what markets have come to call the "TACO" trade ("Trump Always Chickens Out"). President Trump announced tariff hikes on a range of trading partners, including threats of levies on European economies resisting the US bid to acquire Greenland, only to retreat shortly thereafter. As expected, these measures proved to be more posturing than policy, serving primarily as negotiation tactics. As in previous episodes, markets rebounded quickly once measures were withdrawn, reinforcing the view that such volatility creates short-term noise rather than lasting macroeconomic impact. One can be forgiven, however, for stepping back amid the noise, keeping some cards off the table until it subsides and opportunities re-emerge.

The US economy enters 2026 on solid footing. The Federal Reserve is expected to proceed with gradual, data-dependent easing, offering a supportive backdrop for both equities and consumers. Despite political pressure for faster rate cuts, the Federal Reserve's independence remains intact, and the leadership transition in May is unlikely to disrupt its disciplined, evidence-based approach. With Powell expected to remain on the Board and retain equal voting rights, a material shift in policy direction appears unlikely. A declining rate environment, improving real income growth, and a more balanced labour market together underpin a constructive outlook for 2026, supporting consumption, stabilising margins, and lowering the cost of capital for businesses.

AI and broader technology sectors remain central to US equity leadership, even as the pace of capital spending moderates. The narrative is shifting from infrastructure build-out towards productivity gains driven by AI adoption. This transition is broadening the opportunity set beyond the bigger companies in the US to include mid- and smaller- companies positioned to benefit from downstream integration and efficiency gains, supporting a more diversified equity outlook.

The US dollar has weakened steadily over the past year, with a sharper correction in January; however, this does not signal any loss of confidence in its role as the world's reserve currency. The dollar remains dominant in global trade, reserves, and cross-border finance, with past pullbacks typically cyclical rather than structural. While a weaker dollar can be mildly inflationary through higher import costs, it also supports US multinationals via stronger overseas earnings and improved export competitiveness, while easing financial conditions for global borrowers. For investors, dollar weakness remains a normal part of the cycle, creating both risks and selective opportunities rather than a structural concern.



The US Economy

Approval ratings for President Donald Trump have declined sharply during his first year back in office, increasing the risk of heightened political noise as the November mid-term elections approach and raising the possibility that Republicans could lose control of the House of Representatives. In theory, any weakening of the Republican Party, while headline-grabbing, could be constructive for markets by reducing the scope for abrupt policy changes. Historically, such environments have tended to create selective opportunities rather than prolonged market weakness.

At the same time, fiscal policy remains supportive. The re-introduction and expansion of tax cuts under the One Big Beautiful Bill Act could boost after-tax corporate cash flows, household disposable income, and investment incentives. This pro-growth fiscal backdrop, alongside easing rates and AI-driven productivity gains, should support GDP and earnings growth over the next 12–18 months.

The Japanese Economy

Political momentum supports a pro-growth market backdrop. The “Takaichi trade” refers to the market rally that followed new Prime Minister Sanae Takaichi’s appointment in October 2025, driven by expectations of a dovish macro stance and a renewed focus on growth through tax cuts and subsidies. While her ability to fully deliver will depend on coalition negotiations and the outcome of the February snap election, fiscal policy is likely to lean more expansionary regardless. This should remain supportive for domestic demand into 2026.

The labour market remains exceptionally tight. With the jobs-to-applicants ratio around 1.18, meaning there are more jobs than applicants. Whilst this has supported nominal wage growth and helped underpin household consumption, real wage growth has fallen steadily over the last year as persistent inflation continued to outpace salary growth, limiting the strength of the consumption rebound. While the upcoming spring wage negotiations (Shunto) may deliver further nominal pay increases, these are expected to moderate from 2025 levels and are unlikely to materially support real wage growth. As such, they point more to stabilisation than to a meaningful catalyst for domestic demand.

External tailwinds continue to support Japan’s earnings outlook, with the weaker yen boosting overseas profit translation and US tariff reductions providing welcome relief for manufacturers. Japan has also benefited from the global surge in AI-driven investment momentum, which has supported capital-goods demand and helped offset softer export volumes. Even so, exports and industrial production remain broadly flat, and manufacturing margins face pressure from lingering tariff friction and global demand uncertainty, underscoring the need for selectivity in a still-supportive but risk-aware environment.

Emerging Markets & Asia Economy

Despite dramatic headlines around U.S.–Venezuela relations this year, including actions by President Donald Trump targeting President Nicolás Maduro market impacts have remained contained, with investors largely viewing events as geopolitical signalling rather than a disruption to global capital flows. While the rhetoric underscored Washington's willingness to take controversial steps in Latin America to secure strategic interests such as energy, Asia and Emerging Markets have had a strong start to the year (seemingly immune to the noise).

India remains one of the most compelling structural growth stories in emerging markets, with GDP expected to expand by 6.8%–7.2% in FY2026/27. Improved U.S. trade relations, deeper engagement with the EU, and sustained foreign direct investment into digital and physical infrastructure continue to reinforce India's expanding role in global supply chains. Recent reductions in U.S. tariffs on Indian exports to 18% further ease external headwinds. Large-scale technology investments, favourable demographics, and ongoing policy reforms support strong earnings visibility and long-duration equity growth. A weaker U.S. dollar has broadly supported emerging markets, though continued rupee underperformance remains a modest headwind for local-currency returns.

Trade diversification is quietly reshaping economic dynamics across Asia and Emerging Markets, with implications for commodities and regional winners. Talks between China and Canada, alongside deepening ties with Brazil and growing Chinese investment in Peru, highlight a gradual shift away from exclusive dependence on the US increasing trade across China and the LATAM block. For markets, this supports stronger demand for agricultural and industrial commodities, helping underpin metal prices and select LATAM exporters. It also suggests that shifting geopolitical dynamics may create pockets of opportunity rather than a uniform drag on EM performance.

China's recent stimulus has lifted confidence across Asia and Emerging Markets. Targeted support for the property sector and tax incentives to boost spending show policymakers are focused on strengthening domestic growth. This has also made China less exposed to external risks, such as U.S. trade tariffs, by shifting growth toward local demand and easing financial pressures on businesses. Interest rate cuts signal a clear willingness to act if needed, helping stabilise Chinese equities, credit, and broader regional markets. Looking ahead, expanding access to China's commodity markets could be a structural tailwind, especially for battery-related metals. Although broader participation may lead to higher volatility, it strengthens China's role in global price discovery and underscores its growing influence in strategic supply chains.

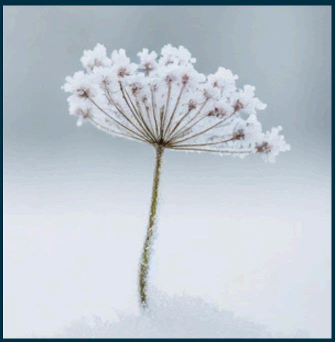
Fixed Interest

Corporate balance sheets have entered 2026 in solid shape, tight credit spreads illustrate a resilience that underscores investors' confidence in firms' financial strength.

All-in yields on corporate bonds remain appealing. While markets will always latch onto individual events (such as last quarter's UK budget) the more important trend is the steady cooling in inflation. With price pressures easing, moderate rate cuts are expected this year, and the UK curve, which is already steeper than many developed-market peers, stands to benefit.

We are mindful that government deficits may put a floor under yields. At the same time, spreads are tight, so we do not expect a rapid decline in yields (nor a corresponding rise in prices). Nevertheless, while spreads remain compressed, economic forecasts point to a year of low but positive growth, an environment that is typically supportive for corporate credit.

To reiterate, starting yields are attractive, and while spreads are relatively tight, there are still pockets of value within the corporate space. Corporate bonds can deliver good returns even in the absence of a catalyst causing a shift lower in yields.



If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 01423 501 401, Monday to Friday 9am-5pm or you can email us at info@mzltd.co.uk

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