

INVESTMENT STRATEGY QUARTERLY

LETTER FROM THE
CHIEF INVESTMENT OFFICER
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2026 OUTLOOK

MISSION:

POSSIBLE

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Letter from the Chief Investment Officer

Mission Impossible

In honour of the 30th anniversary of the first *Mission: Impossible* movie, we're channelling its spirit for our Ten Themes for 2026. Like Ethan Hunt, the master of espionage and survival, we face a world of complexity, volatility, and unexpected twists. It's no secret that the coming year will not be easy. Markets will likely present more obstacles and question marks than the never-ending predicaments Tom Cruise encounters in his iconic role. Geopolitical tensions, shifting DC policies, lofty valuations, and evolving economic dynamics will test even the most seasoned investors. But here's the difference: our mission isn't impossible—it's very possible. By focusing on fundamentals, adapting to change, and seizing opportunities, we believe we will be able to overcome these challenges. This year, our mission—and we choose to accept it—is clear: turn uncertainty into advantage and make the seemingly impossible, possible.



THE ECONOMY: DEFYING THE ODDS, RESILIENCE CONTINUES

Just as Ethan Hunt has repeatedly defied the odds—emerging from unpredictable situations with grit and ingenuity—the US economy has shown similar resilience. Despite the turbulence of 2025, including trade conflicts and global uncertainty, the United States not only endured but continued to lead in growth, innovation, and capital markets.

Looking ahead, we remain constructive on the US economy. While near-term tariff-induced bumps may keep inflation elevated, we expect a longer-term disinflationary trend to take hold as shelter and oil costs ease. Consumers should see a boost from tax cuts, and companies will have fresh incentives to invest as the One Big Beautiful Bill Act (OBBBA) fully takes effect. These tailwinds support our forecast for US GDP growth of 2.2% in 2026, up from 2.0% in 2025—a mission that may be challenging, but is well within reach.



THE FED: THE IMPOSSIBLE MISSION FORCE (IMF) OF MONETARY POLICY

In *Mission: Impossible*, the Impossible Mission Force (IMF) works behind the scenes to help Ethan Hunt stabilise global crises. In the financial world, that role belongs to the Federal Reserve, the ultimate guardian of the US economy. In 2026, a new 'mission leader' will take charge as Jerome Powell's term expires. As head of the Fed, the incoming Chair faces a high-stakes assignment: steering policy through uncertainty while balancing data and political pressures.

The Fed's dual mandate—price stability and maximum employment—is its mission. Yet the window for rate cuts will be narrow as near-term inflation remains stubbornly above the 2% target. We expect only one cut in 2026. More cuts could signal that the mission is in jeopardy, and the economy is weakening. For now, the challenge is clear: maintain credibility, manage inflation, and support growth without triggering unintended consequences. The Fed will remain critical to completing this mission.

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VOLATILITY RETURNS: EXPECT UNEXPECTED PLOT TWISTS

Despite the dramatic headlines of 2024 and 2025, market volatility has been surprisingly subdued—but that calm may not last. We expect volatility to intensify across most asset classes in 2026 as valuations sit at historically elevated levels, leaving markets vulnerable to disappointment. Think of it like a blockbuster plot twist; disruptors can rewrite the script in an instant. Flexibility will be essential as investors navigate these challenges. While sentiment appears confident about economic growth and return prospects, a healthy dose of caution is warranted. Risks such as slower economic growth, sticky or unexpected inflation, earnings shortfalls, a disappointing IPO, abrupt political or regulatory changes, or geopolitical shocks could be lurking around the corner and challenge performance. We're not saying all these risks will materialise—but ignoring them would be a dangerous twist in the story. Your mission: stay agile, expect the unexpected, and prepare for volatility across the investment landscape.



BONDS: A STRONGHOLD FOR STABILITY

Every spy team needs a stronghold—a place to regroup and recalibrate when the unexpected happens. In *Mission: Impossible*, that's the secure 'fallback point' where the team regroups and plans its next move. For investors, that stronghold is the bond market: a source of stability and reliability amid uncertainty. For the most part, we do not expect dramatic bond market moves, with the 10-year US Treasury yield likely ending the year in the 4.25%–4.50% range. A break below that level would likely require a recession, while a move above 5% would suggest waning demand for US Treasuries. Both scenarios are outside our base case. Still, even this stronghold could face challenges in 2026 as Fed rate cuts remain a moving target. The yield curve remains biased toward steepening.

For fixed income investors, the mission is clear: focus on income rather than capital gains. With long-term rates poised to rise only modestly, coupon payments—not price appreciation—will drive returns. In this environment, we favour high-quality corporate bonds as the foundation of a resilient portfolio. Your mission: build a stronghold with quality fixed income—because stability matters when the plot thickens.



IDENTITY SHIFT: THE NEW FACE OF US EQUITIES

In *Mission: Impossible*, the spy never abandons the mission—but sometimes, they change their mask to adapt. The US equity market is doing the same. After an incredible run—six years out of seven with returns above 15% in US\$ terms, a feat not seen since 1930—the market's identity is changing. Valuations for the S&P 500 have climbed to the 95th percentile, meaning the old identity of P/E multiple expansion won't carry the next scene. As the mask comes off, the new face of returns will need to rely squarely on earnings growth. The good news? We expect earnings to rise about 12%, supporting our year-end S&P target of 7,250. That means the return profile shifts from blockbuster double-digit gains to mid-single digits. That said, the dossier for success is strong: solid economic growth, an easing Fed, stable long-term rates, and healthy buybacks and dividends. Your mission: Keep expectations in check for equity returns. With valuations still elevated and volatility likely to tick higher, the next identity for the US equity market won't be driven by multiple expansion—it will be all about earnings growth taking the lead.



CRACKING THE CODE: THE NEXT PHASE OF AI

Part of spy craft is code—secret words or phrases that deliver hidden messages. Over the past two years, the code for equity outperformance has been simple: AI. But the secret is out, and the market is evolving. While we remain confident of AI's transformative power, the next phase will demand greater discernment. The infrastructure build-out will continue, but leadership will broaden beyond the recent winners.

Our focus now shifts to the enablers—the companies driving data collection, cloud applications, and robotics, as well as industrials that provide the physical backbone of AI. Companies in the Technology sector, such as semiconductor suppliers and enterprise software developers, will remain a potent force for AI mainstreaming, but we also expect the next wave of beneficiaries to emerge in two somewhat lower-profile sectors: Consumer Discretionary and Industrials. So, our code word for this year is 'CIPHER' as we work to decode the next opportunities in the AI cycle. Your mission is clear: while the AI revolution isn't over, it is entering its next phase—which creates plenty of opportunities—and risks.

Letter from the Chief Investment Officer (cont.)



THE HIDDEN ALLIES: THINKING BEYOND THE OBVIOUS

In many *Mission: Impossible* films, the most trusted person often turns out to be the mole, while the real hero operates in the shadows. Investing can be like that. The sectors that dominate headlines and attract the most attention aren't always the best choices. That's why we're thinking like Hunt: question the obvious, dig deeper, and uncover allies.

Two sectors hiding in the shadows are Consumer Discretionary and Health Care. Consumer Discretionary has been struggling with headwinds from inflation-stressed consumers and tariff-driven margin pressures. Health Care has faced fears that earnings could be crimped by policy changes in Washington. But as we head into the new year, both sectors are ready to step into the light. Consumer Discretionary should benefit not only from its AI exposure (e.g., autonomous vehicles, robots, cloud computing) but also from a rebound in spending ignited by tax cuts from the OBBBA. A more confident consumer, improved supply chain management, and moderating input costs could help this unloved, contrarian sector surpass earnings expectations. Health Care, the most attractively priced sector by our metrics, has already priced in worst-case scenarios. If regulatory threats end up being more bark than bite, the sector should move higher to reflect its favourable earnings trajectory. Your mission: move beyond the comfort zone of sectors that have already priced in much of the good news—and look for hidden allies.



POWER SHIFT: SPOTTING THE DOUBLE AGENTS

In every *Mission: Impossible* plot, there's always a twist—like a double agent hiding in plain sight. Electric power is playing that critical role in today's economy. For years, oil was the driver of the energy story. Now, the data centre boom has flipped the script, shifting the focus to electricity. And with electricity prices on track

to outpace overall inflation, affordability is becoming part of the midterm election campaign trail narrative, just as 'high gas prices' had been in the past. But not everyone is who he or she seems. Utilities might look like the obvious choice, yet heavy regulation and stretched balance sheets make them an unreliable operative. Instead, the more dependable recruits in the electrification trend are found in Industrials—the companies making the proverbial 'picks and shovels' for this new energy era. This sector also includes defence contractors whose fighter jets, tanks, and cyber security solutions are helping keep us safe. Meanwhile, global oil demand remains sluggish, and with supply still abundant, prices are likely to hover near our 12-month target of \$55–\$60 a barrel. Your mission: know which agents to trust—and which to leave behind in the quest for more kilowatts rather than barrels.



GLOBAL ALLOCATION: YOUR NEXT ASSIGNMENT

Ethan Hunt's team never stays in one place. They accept assignments around the globe—Paris, Dubai, Vienna—and always coolly adapt to the mission. International investing works the same way: it's about going beyond borders to uncover opportunities. Diversification is the first benefit, but the real task is selecting regions that are most likely to deliver value.

In the developed world, our top choice remains the US, thanks to economic and earnings growth that continues to outpace the other G7 economies. That said, US market leadership could pause as tech stocks take time to digest their recent run. Equities in both Europe and Japan had a strong 2025, but we are proceeding with caution. Japan benefits from ongoing corporate reforms and AI-fuelled earnings growth, but faces headwinds from interest rates at multi-decade highs. The euro zone's economic performance is uninspiring—especially in its two largest countries: Germany and France. Germany's defence spending plans should help stabilise activity, but outperformance is unlikely. The wildcard: an eventual Russia/Ukraine peace deal could give Europe a boost.

“ This year, our mission—and we choose to accept it—is clear:
turn uncertainty into advantage and make the seemingly
impossible, possible. ”

We maintain our preference for emerging markets in Asia—especially India, which continues to post the fastest GDP growth among the G20 economies and should benefit from more reasonable valuations, favourable demographics, and foreign direct investments. It is always important to be mindful of outsized risks with emerging markets, such as currency volatility. Your mission: while the US is likely to remain the long-term outperformer, analyse global equity markets for potential opportunities in the near term.



ASSET ALLOCATION: YOUR BLUEPRINT FOR SUCCESS

Like any *Mission: Impossible* storyline, the mission is never truly over—there's always another challenge, another risk. Investing works the same way. Alongside your wealth manager, we help you stay prepared for what's next. After more than 40 years and multiple nominations, Tom Cruise finally earned his first Oscar in November 2025. But this accomplishment wasn't built on one blockbuster; it was a Lifetime Achievement Award due to his entire body of work in acting, producing, and pushing cinematic boundaries.

Likewise, strong portfolios aren't built on a single investment—they grow through diversification, reinvestment, and strategic compounding. Each asset class—stocks, bonds, cash—plays a unique role, just as Cruise's varied skills shaped his career. Asset allocation is your blueprint for navigating market twists and turns. Your mission: build a diversified portfolio that helps mitigate risk and weather market storms to maximize the probability of achieving your goals and objectives.

On behalf of Raymond James, I want to wish everyone a safe, healthy, and prosperous new year. Your mission starts now. This message will *not* self-destruct in five seconds.

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Less policy uncertainty, more economic growth

Eugenio J. Alemán, PhD, *Chief Economist*, Raymond James
Giampiero Fuentes, CFP®, *Economist*, Raymond James

One of the biggest risks the US economy faced in 2025 was the uncertainty brought about by the Trump administration's implementation of tariffs. Typically, uncertainty is one of the most important risks to economic activity, as economic actors react to policies. In general, the longer these uncertainties last, the higher the probability they could trigger a recession. But high tariff uncertainty was counterbalanced by an impressively strong surge in investment in data centres linked to the AI-driven burst that kept the economy from going under.

The outlook for the US economy, the engine of global growth, matters deeply for UK and other international investors in financial market assets. The US environment in 2026 will be more certain in many ways as some of the Trump administration's new policies will be behind us while others are expected to boost economic growth. This could still change early in 2026 because we are waiting for the Supreme Court to decide whether the IEEPA tariffs are constitutional. If, as we believe, they are found unconstitutional and the Court strikes them down, we may see some tariff uncertainty hitting the US and international economies again until the administration implements other tariff alternatives

based on different arguments and/or different statutes.

Apart from that temporary potential disruption, we expect the US economy to have a good year in 2026 although, as always, there will be plenty of risks, which we will point out later in this article. For the most part, some parts of the One Big Beautiful Bill (OBBB), which includes some front-loaded fiscal stimulus, will support economic activity during the year.

ECONOMIC GROWTH

We project the US economy to grow by 2.2% during the whole of 2026 and by 2.3% in 2027. Higher growth in 2026 will be the consequence of some of the provisions of the OBBB, which will subsidise investment through accelerated depreciation and have the potential, together with sustained AI-driven investment, to keep real investment in the economy strong. Although we don't expect the recent increase in AI investments to accelerate further going forward, we do expect it to remain relatively strong and supportive of the overall strength in real investment during the next several quarters.

While we don't expect a robust rebound in residential investment, we anticipate a modest uptick driven by slightly lower mortgage rates compared to 2025. Our expectation for lower mortgage interest rates

next year is based on a steady disinflationary process once the effects of tariffs are out of the system.

The front-loaded purchase of durable goods in 2025 due to the increase in tariffs will continue to keep growth in durable goods limited during 2026. At the same time, we don't see much growth coming from discretionary consumption, especially if income growth remains constrained by a weak labour market.

EMPLOYMENT AND INCOME GROWTH

We do not see employment improving markedly during 2026 and by extension incomes as well, thus consumer demand will remain challenged compared to the last several years. There are some tax advantages in the OBBBA that will help mid-to-lower income Americans. However, we do not see large employment losses and expect the rate of unemployment to remain low and supportive of growth in consumer demand.

From the supply of labour side, the Trump administration's immigration policies are going to continue to put pressure on the availability of workers. However, these pressures are not going to

We project the economy to grow by 2.2% during the whole of 2026 while growing by 2.3% in 2027.

be homogeneous across sectors. Although AI investment has the potential to reduce the need for workers in several industries (due to an increase in productivity from workers applying AI in their jobs, plus the elimination of some jobs due to automatisisation) there are sectors that benefit much less from the AI-productivity revolution. Sectors such as construction, leisure and hospitality, and retail, just to mention a few, are going to continue to struggle to find workers.

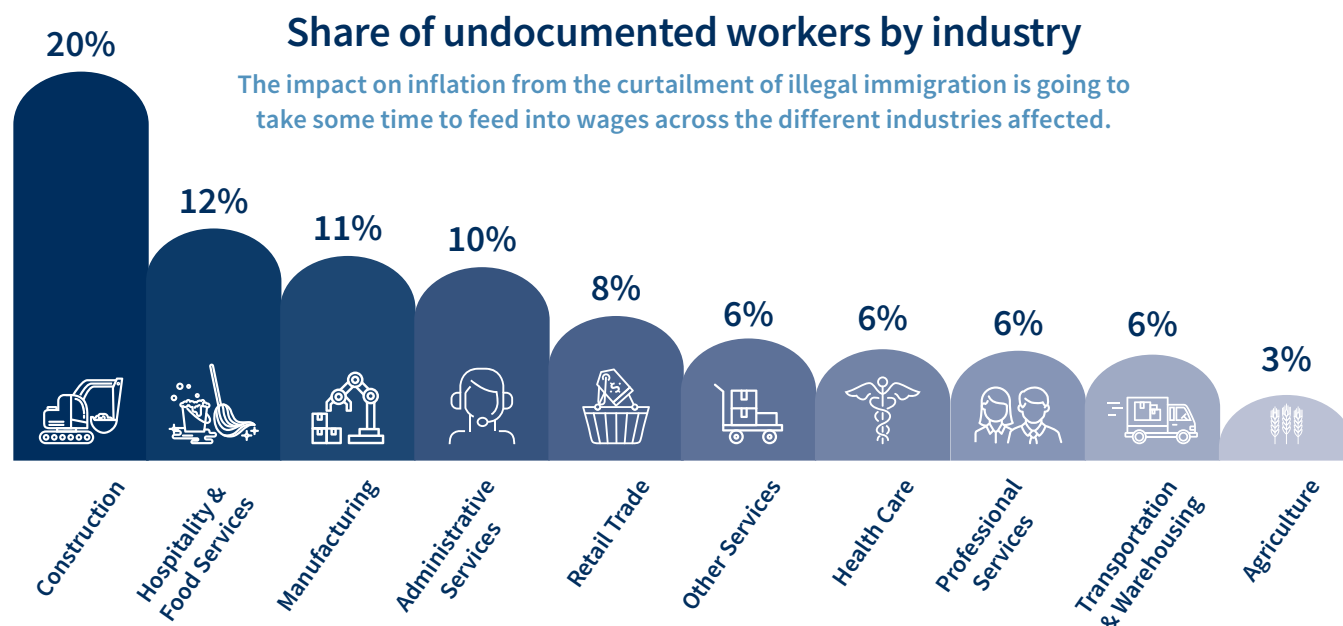
From the labour side, the administration's immigration policies have their own implications. Although one of the reasons for the crackdown on immigration is supposed benefits to American workers, it is highly unlikely that American workers would take the jobs that these groups of immigrants perform, likely due to low wages and poor working conditions. Furthermore, the reduction in immigration as well as the increase in deportations means that

Durable goods purchases spiked ahead of tariffs

After frontloading of goods ahead of tariffs, 2026 could see a slowdown.



Source: FactSet, as of 12/15/2025



Source: Center for Migration Studies, as of 2023.

those individuals will not be consuming, will not be renting, etc., and thus firms will not be able to hire more workers to support higher consumption coming from these sectors of the economy.

On the positive side, the lower supply of labour could mean higher wages and salaries for workers in some sectors as well as more competition from labour-competing sectors to hire a limited number of available workers. But we don't think these competitive pressures will generate significantly higher wages and salaries over the next several years.

INFLATION

We expect US inflation to be somewhat sticky during the whole of 2026 and remain above the Federal Reserve's (Fed) target as we expect more pressures coming from the effects of increased tariffs. Although we still believe the disinflationary process will remain in place, excluding the effects of tariffs, above-potential economic growth will limit the ability for inflation to come down faster. That is, we expect the underlying disinflationary process to remain in place, supported by further declines in shelter costs and very little pricing pressure from the services side of the economy. We were expecting shelter costs to continue to support the disinflationary process during next year, but the process is expected to accelerate later in the year due to the effects of lower demand for housing as a result of the slowdown in immigration, plus the effects of increased deportation.

FEDERAL RESERVE AND INTEREST RATES

Within this environment of higher economic growth, less supply as well as demand for labour, positive but relatively weak consumer demand growth compared to the recent past and a relatively strong investment profile, especially from the non-residential investment side of the economy, etc., we see little room for the Fed to lower interest rates more than once in 2026 because by cutting further the central bank risks pushing economic growth even higher, which could generate higher inflation.

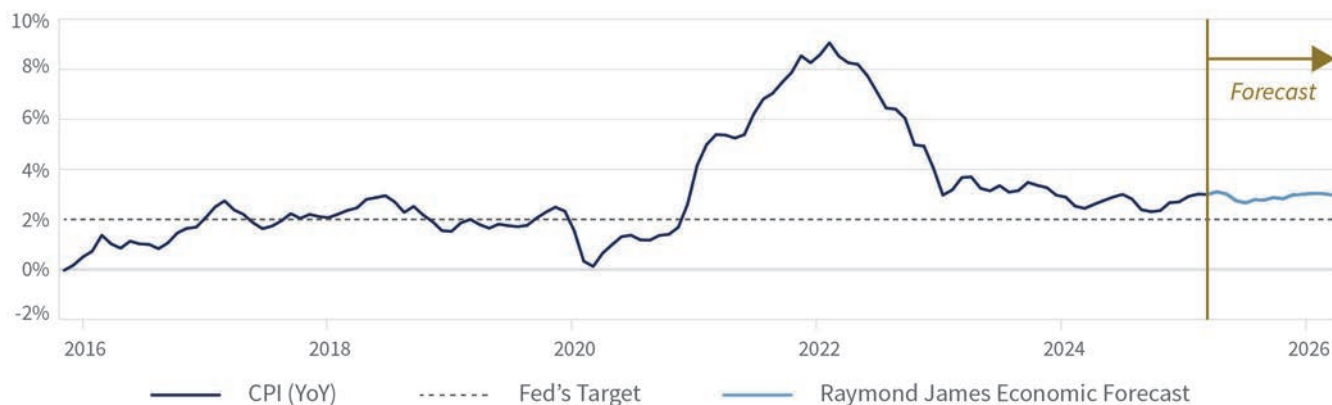
RISKS TO OUR FORECAST

As is always the case, our forecast is bound to be affected by various risks. These risks are often known risks, but not always. The known risks have to do with 'what if' our assumptions about growth, employment, income growth, inflation, etc., are not correct. These risks will be assessed as the year progresses and will push us to adjust our forecast as appropriate. These risks are typically manageable and tend not to disrupt economic activity. Sometimes they do affect financial markets temporarily but are not a recessionary threat.

One known risk going into 2026 that may be more damaging than the rest, however, is a potential sudden stop to non-residential investment. Non-residential investment related to AI has been carrying US economic growth as well as increased stock market valuations. Thus, a reversal in this important contributor to US economic growth during 2026 could potentially derail economic activity.

Inflation expected to remain sticky

Disinflationary trend remains, but pace will slow.



Source: FactSet, as of 12/15/2025

The unknown risks are different in nature, fundamentally because they are unknown but more so because they are unexpected. These risks have the potential to derail economic activity and could take the US economy into a recession, with major longer-term implications for financial markets. These unknown risks could include issues within the Financial sector, as we saw several years ago with runs on several banks that were unprepared for an environment of higher interest rates; geopolitical risks such as potential wars, a shock to petroleum prices, a natural disaster, etc. Another risk might be domestic and international investors avoiding US debt amid rising fiscal deficits. While unlikely, a scenario similar to the UK's September 2022 'bond vigilantes' episode could push yields sharply higher. For now, this risk is minimal, but the passage of the OBBB was a missed chance to address fiscal challenges. Another concern is the potential erosion of Fed independence. Our forecasts assume both Fed independence and an ongoing willingness on the part of all investors, including international investors, to continue to finance US fiscal largesse; if these assumptions change, then we would need to revise our projections.

BOTTOM LINE

Despite lingering tariff uncertainty and labour market constraints, 2026 is poised to be a year of solid US growth, supported by OBBB-driven fiscal stimulus and sustained AI investment. We forecast GDP growth of 2.2%, with inflation remaining above target and only very limited room for Fed rate cuts. While known risks are mostly manageable, unknown shocks—geopolitical, financial, or policy-related—could still derail the outlook. ■

KEY TAKEAWAYS:

- Economic policy remains a major uncertainty in 2026—however, we don't anticipate another 'Liberation Day' shock.
- We expect fiscal stimulus and AI investment to support the US economy, and the labour market to maintain an uneasy equilibrium as employers assess how AI is affecting their businesses.
- Given higher economic growth we see little room for the Fed to cut rates more than once.
- We believe the disinflationary trend will continue, even while inflation remains sticky. We expect shelter costs to come down, with little pressure on the services side of the economy. However, inflation may rise due to risks from tariffs (goods side).
- Our US GDP forecast for year-end 2026 is 2.2%, but we remain alert to risks that could prompt adjustment.



Don't expect a Washington DC policy slowdown

Ed Mills, *Managing Director*, Washington Policy Analyst, Equity Research

As we enter the new year, investors will be wondering whether 2026 will see Washington DC policy shape the markets in the same expansive way as it did in 2025. The answer will likely be yes, with a mixture of familiar themes (such as trade and tariffs, deregulation, the federal government taking stakes in private companies, and spending-related drama in Congress) and emerging themes (such as AI export support, permitting reform, comprehensive cryptocurrency legislation, and more) continuing to make headlines. Through the course of 2026, we expect to see these themes percolate through the market as attention increasingly turns to the Congressional midterm elections in the fourth quarter. While early to make predictions, the off-year elections in 2025 and ongoing redistricting battles should be viewed as providing momentum for the Democrats and a constantly shifting path to a majority (for both parties) respectively.

EXECUTIVE BRANCH THEMES

Trade and foreign policy will likely remain top of the agenda in 2026, with a decision expected in the Supreme Court case challenging the tariffs imposed through the International Emergency Economic Powers Act (IEEPA). While we expect at least some of the IEEPA tariffs to be struck down, we would emphasize that tariffs are here to stay. The administration retains an array of alternative authorities to implement tariffs; while they come with various procedural and rate-related constraints, they offer another route to upholding the duties. Sectoral tariffs will remain in place reflecting their more legally durable Section 232 underpinning, and we expect pre-existing trade deals as negotiated to largely remain intact.

Trade has been a key lever through which the Trump administration has conducted its foreign policy, using the power of the US economy

Trade and foreign policy will likely remain top of the agenda in 2026. ... we would emphasize that tariffs are here to stay.

to obtain policy concessions from trading partners. This theme will extend into 2026, with further trade talks involving China on the table—as well as a desire to keep a lid on tensions where possible, though escalatory risks always remain. An effort to end the Russia-Ukraine war could see the further US deployment of economic carrots and sticks to nudge the process along, while tensions in the Caribbean and Latin America will likely continue to elevate geopolitical risk in the background.

“ Financial and bank deregulation remains a priority, and 2026 will see further unification across the federal banking regulators (Fed, FDIC, and OCC) to deliver regulatory relief. ”

The administration’s comprehensive AI agenda will likely bring increased federal involvement in AI-infrastructure buildouts and the pursuit of pre-emption of state-level AI laws in 2026. The announcement of the Genesis Mission, a ‘Manhattan Project for AI’ will see agencies collaborate with leading AI firms to advance US AI capabilities, while the US AI Export Program could bring \$150-200 billion in government-financed AI export packages to allied partners. Advanced chip sales to China remain a key theme to watch, with the federal government demonstrating an increasingly open approach to the export of advanced US chips to China. Infrastructure initiatives to support AI data centres will likely combine energy generation with AI data centres, with nuclear energy deployment to power AI similarly proceeding on an aggressive timeline.

Financial and bank deregulation remains a priority, and 2026 will see further unification across the federal banking regulators (Fed, FDIC, and OCC) to deliver regulatory relief. Streamlined bank supervision will be focused on material financial risks, a lowered Community Bank Leverage Ratio, and easing stress tests and international capital standards. Combined, these focus areas should accelerate bank M&A activity, support loan growth, and increase capital available to be returned to shareholders.

Finally, a key pillar of the 2026 agenda will be around an anticipated ‘housing emergency’ executive order aimed at boosting supply, lowering costs, and reforming housing finance. While this will likely garner significant press attention, these changes will take a considerable amount of time to be realised. Reforms to zoning and building codes within states and municipalities will headline, using a ‘carrot-and-stick’-type approach, with federal funds as incentives (or penalties) to encourage states to adopt reforms to expand and promote housing supply. Other areas include using federal land for residential development, advancing manufactured housing to reduce costs and increase building speed, and modernising mortgage insurance. The potential still exists for lowered tariffs on building supplies to reduce cost pressures, similar to recent food product tariff concessions.

LEGISLATIVE BRANCH THEMES

Congress faces a busy legislative calendar in the new year following October’s record 43-day shutdown, with a January 30 continuing

resolution deadline triggering another short sprint to pass nine remaining appropriations bills. Holiday recesses and competing priorities will compound these pressures, increasing the risk of another shutdown if bills stall. Senate Budget Committee Chair Lindsey Graham is actively exploring a second reconciliation bill following the One Big Beautiful Bill Act, though legislative bandwidth remains constrained. If another late-January shutdown is triggered, markets could see volatility and other legislative priorities could be delayed through the first quarter.

Another ‘must-pass’ bill to watch will be the surface transportation bill, as the five-year bipartisan infrastructure law passed during the Biden administration expires in 2026. We are watching the surface transportation bill particularly closely as a potential vehicle for the passage of permitting reform. The permitting process for infrastructure, energy projects (including clean energy projects), and mines (such as those for critical minerals) remains very slow, and efforts have been made in recent years to try and speed things up. While initial progress was made in 2023, we see a strong desire by Republicans, Democrats, and industry alike to reform the process—especially the National Environmental Policy Act (NEPA). We are optimistic on the prospect for changes, but the ability to get Democratic support—and the bill over the finish line—will likely depend on issues like ‘permit certainty’, given concerns by Democrats over recent policy pressure/cancellation of existing permits for renewable energy.

Comprehensive digital asset market structure legislation will advance through Congress with strong bipartisan momentum and Trump administration backing. We expect the House and Senate to reconcile and pass a bill that refines the House-passed CLARITY Act, establishing the Commodity Futures Trading Commission (CFTC) as primary regulator of spot digital markets while introducing detailed custody standards and consumer protections. Comprehensive crypto legislation is most likely to reach the Senate in early 2026, with passage into law shortly after. Similarly, the expected confirmation of Mike Selig as CFTC chair signals aggressive support for digital asset reforms and expanded digital asset rulemaking.

Legislative priorities on financial regulation centre on deposit insurance reform, but proposals on enhanced deposit protections

for non-interest-bearing accounts face opposition. The future of the Consumer Financial Protection Bureau (CFPB) remains in the air, as funding reserves are set to run out by early 2026, unless Congress appropriates new funding. Community bank provisions including leveraged ratio reductions and tailoring reforms remain on track for implementation.

President Trump's proposed \$2,000 'tariff dividend' cheques signal the potential for pre-midterm fiscal stimulus, but face significant political and legal headwinds. Republican congressional leadership has expressed scepticism, prioritising reducing the deficit over direct payments, with Treasury Secretary Bessent suggesting relief comes via tax relief during refund season rather than new stimulus. The Supreme Court ruling invalidating Trump's IEEPA tariff could also complicate this process, especially if refunds are required, further limiting the funding available.

HOW TO THINK ABOUT THE MIDTERMS

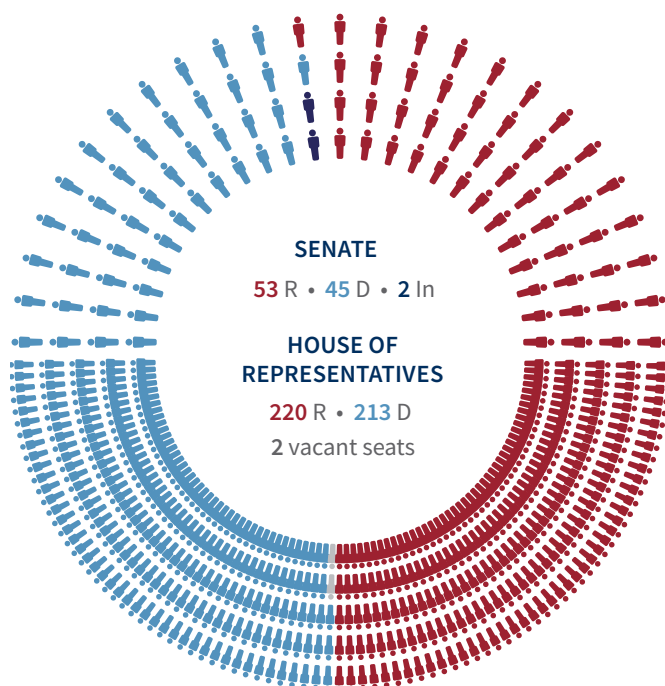
The 2025 off-year elections saw Democrats sweep in all of the most closely watched races. While too early to call the outcome of the 2026 midterms at this stage, the November 2025 results amount to positive momentum for Democrats. The latter would need to pick up just three seats in the House for a majority, placing a Democratic majority in the House within reach should the tailwind of the 2025 elections continue into the 2026 midterms. In the Senate, Democrats would have to net four seats out of the 35 Senate seats on the ballot. Winning a majority in the Senate will be a tall task for Democrats given this mathematics and particularly, the map of where pick-up opportunities exist.

A key factor in the race for the House is an ongoing mid-census redistricting fight, which is actively playing out in the courts and state legislatures. It remains unclear at this stage which party the final numbers will favour. However, we would also highlight one inevitability of redistricting: one party's vote being diluted as their

119th Congress

As of December 16, 2025

While premature to call the outcome of the 2026 midterms at this stage, the November 2025 results amount to positive momentum for Democrats.



Source: pressgallery.house.gov

base is spread around additional districts. Should a wave (such as that seen across Virginia counties) manifest next year, this effort could possibly backfire. This is not our base case, but we would emphasise that the redistricting issue will add to uncertainty. ■

KEY TAKEAWAYS:

- 2026 will be just as busy a year for DC policy as 2025. Familiar themes (such as trade and tariffs, deregulation, the federal government taking stakes in private companies, and spending-related drama in Congress) and emerging themes (such as AI export support, permitting reform, comprehensive cryptocurrency legislation, and more) will continue to make headlines.
- Trade and foreign policy remain at the top of the agenda.
- Financial deregulation will remain an administration priority.
- It's too early to call the midterms, but based on the results of November elections, Democrats have the momentum.



UK Outlook: Reasons to be cautiously cheerful

Prof Jeremy Batstone Carr, *European Strategist, Raymond James*

Economics is sometimes described, disparagingly, as the gloomy science. There can be no silver lining without a cloud to those in the profession focused on assessing the impact of macroeconomic adjustments on financial asset pricing. The Chancellor's Budget provides an easy target for critics primed to drive home sharpened knives following a series of controversial trial balloons prior to the event and the highly unfortunate pre-released details by the Office for Budgetary Responsibility (OBR). Yet for all the hand-wringing, financial markets gave Chancellor Reeves measures a cautious thumbs up, gilt-edged yields dipping across all maturities and sterling rising against both the dollar and the euro in knee-jerk response. Importantly, for an administration desperate to maintain credibility against a backdrop of very weak public finances, the more than doubling in fiscal headroom against fiscal rules which remain inviolable did much to restore market concerns. Furthermore, the Debt Management Office's decision to reduce issuance of longer-dated and inflation-linked gilts ensured that Ms Reeves did not fall into the Truss/Kwarteng mini-Budget trap of three years ago.

GROWTH COULD SURPRISE TO THE UPSIDE

While any Budget gives media headline writers much to get their teeth into the reality is that the Chancellor delivered less bad news than feared. Clearly, households will focus on specific tax measures, albeit very much weighted towards the end of the current parliament and beyond, by which time much might, and probably will, have changed. Markets see things differently, a commitment to tighten fiscal policy broadly as expected and by sufficient to keep the UK's deficit on a downward path doing much to convince investors that the government is serious about its intention to maintain an iron grip on the public finances.

In terms of the economic forecasts, the OBR was generous to the Chancellor. Admittedly productivity growth projections were lowered (2029 from 1.3% to 1.0%) and not much was said, or done, about boosting savings necessary to support future investment, but official government forecasts are now closely in line with independent

estimates (1.5% real GDP growth over 2025, broadly unchanged in 2026 and averaging 1.5% onwards). This may not appear an overly bold assessment, in part a reflection of the fact that global developments (including persistent weakness in the Euro Area economy) may impart negative pressure, but risks do not lie purely to the downside. While the US decision to suspend planned artificial investment (AI) in the UK is a setback, the technological cutting edge is more than capable of lifting productivity over the next decade.

Furthermore, inflation could surprise to the downside, encouraging the Bank of England to go further than the six rate cuts already in place since August 2024. The OBR estimates that the Chancellor's decision to freeze rail fares and fuel duty, while reducing household energy bills, will trim 0.4%-points off CPI inflation in 2026/27. This confirmation proved helpful in encouraging Bank of England Governor Mr Andrew Bailey to vote with the Monetary Policy Committee's four doves in December, taking the base rate down to 3.75%, its lowest level since February 2023.

Admittedly, the four hawkish Committee members remain concerned by inflation's persistence and the fear that higher prices might become embedded in households' expectations. Were their concerns to be realised this would certainly represent an upside risk to market expectations. But how real are these fears? Retained use of the phrase 'gradual downward path' in December's statement accompanying the rate cut implies that, whilst more nuanced, scope exists for further policy loosening and arguably by more than the single 0.25%-point rate cut anticipated by markets.

GILT-EDGED YIELDS TO FALL IN 2026

Additional rate cuts above and beyond that single policy easing already fully priced in by financial markets would be viewed favourably by investors in the gilt-edged market. A more dovish-than-expected Bank of England could help drive the yield on the 10-year benchmark security down to around 4.25% by year-end, not a forecast likely to shoot the lights out but certainly one which envisages that the bond component of a broadly diversified portfolio is doing what it says on the tin, reducing portfolio risk and augmenting overall returns over the medium/longer term.

But interest rates and inflation prospects are not the only factors serving to inform gilt-edged pricing. Investors demand a 'risk premium' reflecting other possible uncertainties. One such concern relates to waning demand for longer-dated bonds, the UK's historical over-reliance on pension fund purchases far exceeds G7 counterparts, but these purchases are now in structural decline. Beyond that, while Chancellor Reeves and Prime Minister Sir Keir Starmer dodged a bullet at the Budget it remains possible that May's local council elections could result in heavy losses for the administration. Such an outcome would inevitably lead to speculation regarding a new leadership resurfacing, a leadership driven by populism and less inclined to fiscal probity than their predecessors. In such circumstances a full-blown fiscal crisis, manifest in a sustained rise in borrowing costs, cannot be ruled out, potentially forcing the Bank of England to step in, just as it did in the autumn of 2022.

ANOTHER YEAR OF POSITIVE RETURNS FROM UK EQUITIES

2025 proved a strong year for the UK equity market, albeit that returns diverged notably between those of the more domestically focused index of 250 medium sized companies and the more internationally orientated FTSE 100 (12.8% and 25.7% respectively to a UK investor). UK-based investors remain attracted to the latter's strong free cash generation and reliable dividend payments while overseas investors have been attracted by the significant discount rating relative to the US and more particularly the relatively low weighting accorded to technology for those wary regarding the sustainability of the sector's lofty valuation.

The UK stock market benefited over 2025 from its heavy weighting to the financials and we expect that the sector will continue to perform if, as noted above, short-term interest rates fall further than those of longer

duration causing the yield curve to steepen. The industrial sector received a boost last year from the government's commitment to increased defence spending and may continue to enjoy investor support in 2026. In commodities and as argued elsewhere in this publication we are downbeat regarding prospects for energy prices, particularly in the oil market where a supply glut continues to exceed demand. In contrast, basic resources (materials) should continue to benefit from AI-related investment (both silver and copper, along with a host of other industrial metals, are key components).

Investor enthusiasm for larger, higher quality, companies could result in another year of underperformance from the UK's domestically focused medium and smaller sized cohort. Whilst a notable valuation discrepancy exists between the two there is no guarantee that the divergence will diminish. If larger company earnings continue to grow faster, in aggregate, than their smaller peer group investors will continue to pay a premium for that reliability.

The UK's discount rating to its US counterpart is nothing new. The gap first emerged in 2016 tempting investors to attribute it to Brexit. However, it is worth noting that a similar gap opened in the same year between the MSCI USA and World ex-USA indices, implying that the divergence cannot solely be down to the UK's decision to leave the EU. Clearly the dominance of US technology has played a major part, reinforced until recently by enthusiasm for all things AI-related, but if investors are now becoming more selective regarding perceived winners and losers in the behemoth US sector the valuation gap could narrow. While US exceptionalism, as it pertains to the country's enormous advantage in technology, was called into question over the latter part of 2025, investors will likely remain more upbeat regarding the long-term economic prospects of the US relative to those of the UK, ensuring that the valuation gap does not close completely, reason enough to be cautiously cheerful regarding prospects over the year ahead. ■

KEY TAKEAWAYS

- Whilst drawing numerous critical headlines the Chancellor's Budget was well received by financial markets.
- A doubling in the headroom over the Chancellor's fiscal rules and commitment to fiscal policy probity has reassured markets while the Debt Management Office decision to reduce longer-dated gilt-edged issuance is constructive.
- The benchmark 10-year gilt yield should drop to 4.25% by end-2026 boosted by further Bank of England rate cuts. Further downside will be capped in the near-term by uncertainty surrounding the outcome of May's UK local elections.
- 2026 will be another year of positive returns from the UK's benchmark internationally focused index, buoyed by an attractive valuation discount to US counterpart indices, strong free cash generation and reliable dividend payments.



International Outlook 2026: Economic and market cross-currents to dominate again

Prof Jeremy Batstone Carr, *European Strategist, Raymond James*

The global economy will make further progress in 2026 but growth will be uneven and dominated by numerous cross-currents similar to but differing in intensity from those which shaped economic activity and financial market performance in 2025. The outlook for and impact of the evolution of artificial intelligence (AI), already a hot topic for investors, will remain a key consideration but productivity benefits are unlikely to be distributed evenly. Central bank monetary policy, universally loosening everywhere outside Japan over 2025 will become more nuanced. Disinflationary pressures will remain in evidence in the Euro Area and in the UK as well as in Asia allowing for further rate cuts until terminal levels are reached as the next 12 months unfold. The combination of subdued, but positive, growth, fiscal stimulus (China and Japan), an easy monetary policy stance, together with AI roll-out will underpin corporate earnings growth and ultimately deliver another positive year of returns from financial markets. But gains are unlikely to be achieved in a straight line, numerous risks and uncertainties lie in wait over what will likely prove another demanding period.

GLOBAL ECONOMIC ACTIVITY AT AN IMPORTANT JUNCTURE

The slow but steady global economic expansion, remarkably resilient through the uncertainty surrounding US trade policy in 2025, will remain at a similar pace in 2026. Taking Beijing's growth estimates at face value real GDP is expected to grow by 3.2% this year, a broadly similar pace to that achieved in 2025. Assuming that a recession is avoided, the US will remain the world's growth engine, underpinning developed economy (35% of world share) activity of 1.7%, a similar pace to last year while front-loaded fiscal stimulus in China and continuing strong growth in India (albeit not at the breakneck pace recorded over H2 2025) will prove supportive to emerging economic activity, notably in Asia. The inflationary consequences of sub-par growth, particularly across developed economies outside the US (excepting Japan) will be very limited, disinflationary pressures in the UK and Euro Area reasserting sufficient to drive price pressures below central banks' 2% target. This will provide scope for further rate cuts in both locations a development likely to be received favourably by government bond markets.

Fiscal risks are likely to emerge from time to time, just as they did in 2025. The threat is greater in developed economies where it is now generally accepted that the public finances of both the UK and France are unsustainable while Italy's debt burden is also high and its underlying economic activity pedestrian. The big question is, how much debt is too much? There is no hard and fast answer, but pressure typically builds when an economic or political shock forces financial markets to reevaluate fiscal prospects. Of the two, the widespread rise of populism likely poses the greater threat to political fiscal policy orthodoxy, potentially destabilising government bond markets and potentially requiring central banks to step in to ensure prices remain anchored.

JAPAN

Japan is, as ever, an outlier. The country has its first female prime minister, Ms Sanae Takaichi and she has big plans for pulling the economy out of a decades-long fiscal trap including a vast 21.5 trillion (\$135bn) supplementary budget aimed at restoring growth and her

Liberal Democrat Party's flagging political fortunes. Simultaneously, the Bank of Japan is very cautiously raising interest rates to ensure that rising inflationary pressures do not get out of control. Both fiscal and monetary policy are demand management tools and conflicting usage is highly unusual (like stepping on the brake and accelerator at the same time). Entering 2026 the newly installed administration is working in tandem with the Bank of Japan to try and deliver 2% GDP growth and 2% inflation with interest rates at a roughly neutral rate to deliver the former. Easier said than done and financial markets have picked up on the inherent tension, reflected in a steepening sovereign bond yield curve and sharply rising medium and longer-term borrowing costs for the already deeply indebted economy. This adjustment has given rise to fears that a possible repatriation of assets currently allocated abroad and or an abrupt conclusion of the yen carry trade could destabilise global markets. Whilst cognisant of the risks, and certainly not complacent, we anticipate that Bank of Japan rate hikes, slow-paced as they might be, will ultimately flatten the bond yield curve, improving the attraction of overseas bonds for exchange rate hedged Japanese investing institutions. Meanwhile new bonds issued to finance Ms Takaichi's fiscal plans are likely to be of shorter duration, a development also likely to address the markets' immediate fears.

ASIA (EX-JAPAN)

No discussion of prospects for the Asian region is possible without considering China. The behemoth economy continues to be held back by profound structural problems, exemplified by a sprawling and troubled real estate sector, chronic over-capacity and persistent deflation, but it stands at the confluence of two key themes likely to frame the 2026 outlook, AI and US trade policy. Clearly, China has closed the gap and is now challenging the United States at the technological frontier as Beijing pushes to achieve self-sufficiency and dominance across the commanding heights of modern-day commercial activity. Details of the 15th Five-Year Plan will be unveiled in March including a new growth target likely to be 'around 5%' and similar to that of 2025.

While the global economy has proved resilient to the White House trade war, the truce struck between President Trump and his Chinese counterpart President Xi Jinping has not brought an end to simmering conflict. Indeed, for China and Asia more generally 2026 will be a year in which trade flows adjust to US tariffs on China lowered but at a still high 32%. Crucially, the mutually agreed 'sunset' clause runs out in late 2026 and if not augmented, risks creating yet another flashpoint adding to ongoing geopolitical tensions between the two superpowers. Meanwhile, supply chains for critical goods including tech-related exports will continue to shift away from China, to the benefit of satellite regional economies.

Since the beginning of the pandemic emerging economies, not just in Asia, have had to withstand a series of global shocks and broadly,

the resilience bearing testimony to far-reaching reform programmes and improved economic management. Financial vulnerabilities will remain low and currency-related risks, especially across the larger emerging Asian economies, are also expected to remain at epochal lows in 2026. While exogenous shocks can never be completely ruled out, markets will focus on further, cautious, interest rate cuts particularly over the first half of the year.

CONCLUSION

We are cautiously positive on the outlook for the global economy which will make headway despite numerous cross-currents. We are constructive on prospects for global equity markets, another year of ultimately strong returns supported by robust earnings growth, looser monetary conditions and a diminution in perceived (trade) policy headwinds. Emerging market equities, especially in Asia, are under-owned and offer an attractive valuation discount against developed market peers. China's increasing policy support, coupled with improving liquidity will percolate across Asia, while for investors seeking markets not dominated by technology the Indian reform programme remains one for longer-term investors. ■

KEY TAKEAWAYS

- The global economy will make headway in 2026 although growth will be uneven and dominated by numerous crosscurrents.
- Artificial Intelligence (AI) will remain a dominant theme although the headwinds associated with US trade policy will diminish.
- Outside the United States (and Japan) low (dis)inflationary pressures will remain in evidence across developed and emerging economies allowing for further widespread rate cuts, albeit not to the same extent as 2025.
- Corporate earnings will remain robust in 2026 across both developed and emerging markets, the latter delivering accelerated double-digit growth coupled with a marginal equity valuation re-rating, a reflection of supportive global and local trends including reform programmes.
- The key downside risk lies in tech exporters were AI demand to weaken, favouring markets such as India with its limited exposure. China's outlook will hinge on the detailed contents of the forthcoming 15th Five Year Plan and other possible measures to boost demand.
- Outside the US investors will overweight value and quality factors with a preference for larger over smaller companies.



Cautiously optimistic on bond market

Tracey Manzi, CFA, *Senior Investment Strategist*, Investment Strategy

Fixed income investors enjoyed a standout year in 2025, even as markets navigated volatility sparked by ballooning deficits, elevated issuance in the US Treasury market, and concerns about possible overseas selling in the US and possible Japanese institutional repatriation amid erratic policy shifts. Despite these headwinds, every major fixed income sector delivered positive returns, with some sectors—like emerging markets— achieving double-digit gains. The Bloomberg US Aggregate Bond Index advanced 7.3%, its strongest year since the pandemic. What fuelled the rally? Fundamentals. Slowing growth, a softening labour market and well-anchored inflation expectations gave the Federal (Fed) Reserve room to pivot back to rate cuts, reinforcing the downward trend in yields— particularly at the front end of the yield curve. Looking ahead, 2026 should deliver another year of positive returns in the US and certain other locations, though US gains are more likely to be modest and likely income driven.

THE MACRO BACKDROP

Economic growth is expected to regain momentum in 2026, supported by 175 basis points (bps) of cumulative rate cuts so far and fiscal stimulus from President Trump's One Big Beautiful Bill Act. Inflation, however, appears to be stabilizing above the Fed's 2.0% target, limiting scope for additional easing. Our base case calls for just one rate cut in 2026, barring an unlikely shift toward aggressive rate cuts under new Fed leadership. A gently improving macro environment and anchored inflation expectations should keep yields range-bound, making coupon income—not price appreciation—the primary driver of returns. We expect the 10-year Treasury yield to end the year modestly higher at 4.25%-4.50%.

A gently improving macro environment and anchored inflation expectations should keep yields range-bound, making coupon income—not price appreciation—the primary driver of returns.

REASONS TO REMAIN OPTIMISTIC

After a decade of artificially low rates, yields across developed markets are back at more normal levels. While in the US Fed rate

cuts have driven yields off their peak, yields remain attractive. Today, bond investors can still capture yields from 3.5% to 6.5% across the fixed income universe. For top-US income bracket investors, municipal bonds provide tax equivalent yields near 6.5%. These still attractive yields provide a strong starting point for performance. Remember, a bond's starting yield is generally considered the strongest predictor of future returns. Plus, elevated yields can help cushion portfolios against future interest rate volatility.

Despite concerns about Treasuries losing their perceived 'safe haven' appeal, US government bonds proved their worth in 2025, delivering stability, income, and risk reduction during periods of market turbulence. The resilience of the Treasury market amid multiple headwinds—namely fiscal and political risks—highlights that Treasuries' status remains intact. This is important given the central role that Treasuries (and sovereign bonds more generally) play in portfolio construction.

WHERE WE SEE OPPORTUNITIES

In an environment of range-bound yields and stable credit spreads, we find opportunities in intermediate Treasuries, municipal bonds, and investment grade credit.

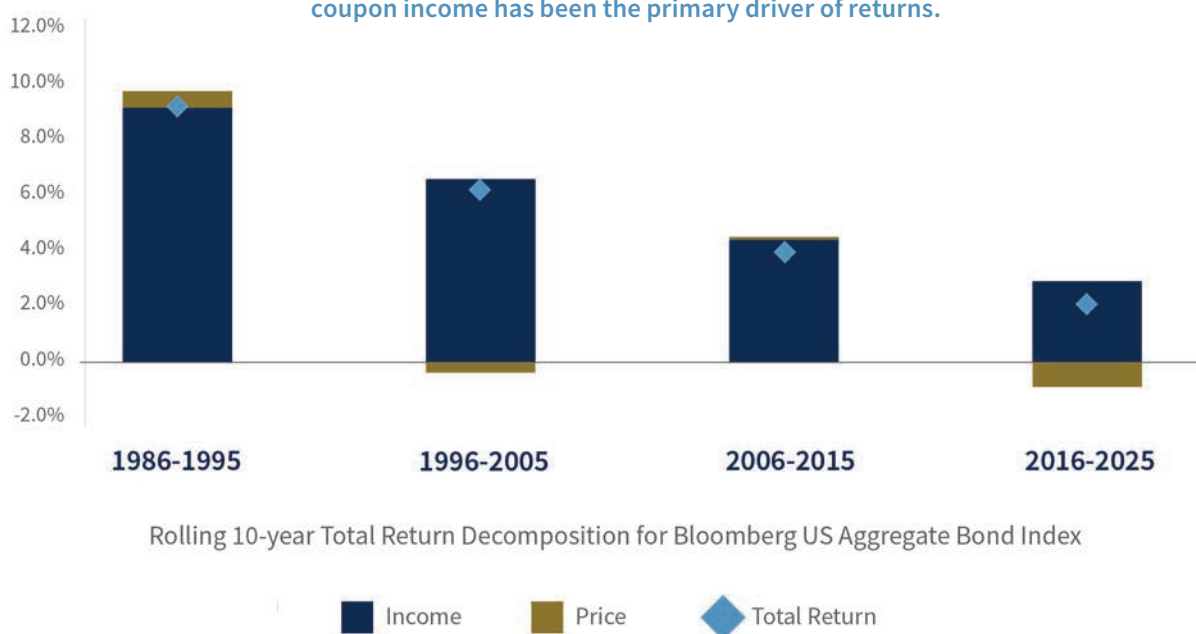
Elevated yields can help cushion portfolios against future interest rate volatility.

TREASURIES

Fed rate cuts have returned the Treasury yield curve to a more normal, upward slope after a long period of inversion (in which shorter duration to maturity yields are higher than longer-maturity yields). We expect the steepening trend to persist as Fed rate cuts anchor shorter maturity yields at lower levels, while longer-term yields remain elevated amid fiscal concerns and sticky inflation. We favour the 3-7 year area of the Treasury curve, which offers attractive yield with less duration risk (i.e., overall sensitivity to changes in interest rates) and will benefit from the 'roll down' return as bonds age—that is, the additional source of return investors receive as bonds appreciate in price as they move closer to maturity.

Coupon income is the primary driver of bond returns

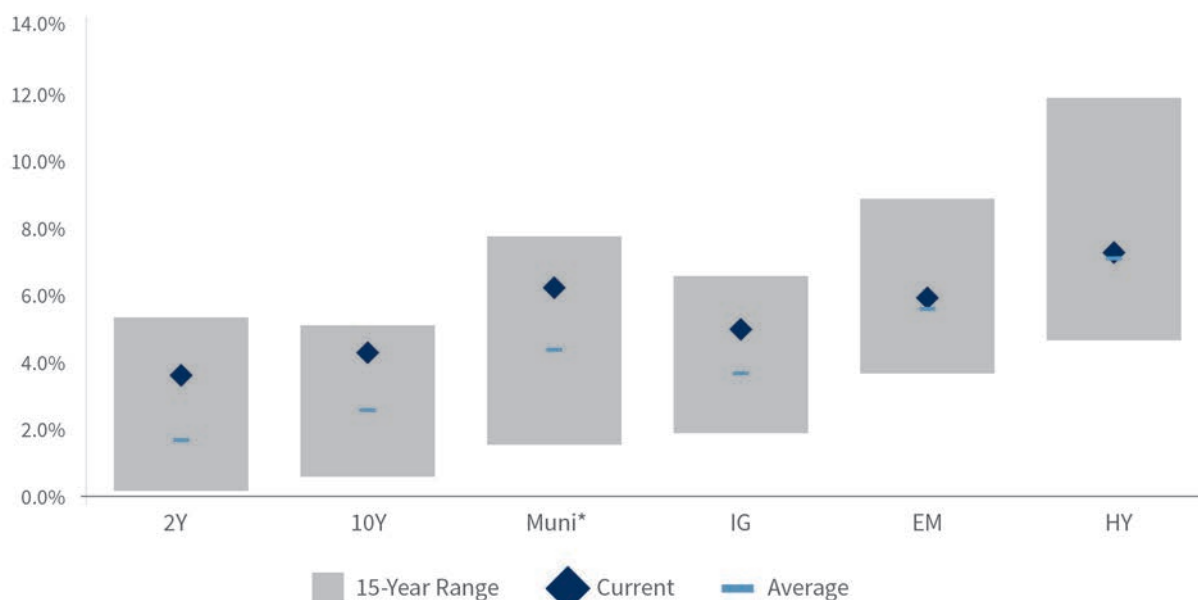
Price gains can dominate in any given year, but over longer periods, coupon income has been the primary driver of returns.



Source: FactSet, as of 12/15/2025

Yields on quality fixed income still look attractive

Yields have come down from their recent peak, but remain attractive—particularly for the highest quality sectors of the fixed income market.



*Tax-equivalent yield (assumes 40.8% tax bracket)

Source: FactSet, as of 12/15/2025

INVESTMENT GRADE CREDIT

While credit spreads remain historically tight, yields, not just in the US, are attractive—still trading above historical averages. With yields likely to remain range-bound, the additional carry from higher all-in yields will modestly augment returns. Meanwhile, an improving growth backdrop and healthy credit fundamentals—strong profitability, low leverage and solid interest coverage ratios—should keep credit risks contained. Elevated levels of issuance are likely to persist and can lead to periods of incremental spread widening to absorb the supply. Credit investors should look opportunistically at these potential dislocations as potentially good entry points. Notably, the credit quality of the investment grade index in the US is also modestly improving with the share of BBB-rated bonds falling from a peak of 52% in 2021 to 46%.

RISKS TO MONITOR

We enter 2026 cautiously optimistic, but there are a few risks on the horizon that could challenge our outlook as it relates to the US.

- 1. Another growth scare:** The 'low-hire, low-fire' environment has persisted for much of last year, but an unexpected acceleration in layoffs would force the Fed to cut more aggressively. This would have negative implications for the credit markets, particularly lower-quality credits, like high yield, leading to wider spreads and rising default rates. Though, Treasuries would likely be the main beneficiary.
- 2. Reaccelerating inflation:** The Fed has maintained a dovish bias despite inflation plateauing above its 2.0% target. For now, policymakers have been content to look through the tariff-related uptick in prices. But if structural issues—such as housing shortages, labour market constraints, shifting supply chains, and increased demand for energy—push inflation higher, this could cause a reassessment of the Fed's expected rate path.
- 3. Fiscal risk:** Growing federal debt levels, persistent budget deficits, rising debt servicing costs and heavy Treasury issuance remain the key upside risks for long-term Treasury yields, reinforcing the need for term premium—the additional compensation investors require to hold longer-dated Treasuries (and sovereign bond markets across the globe).

BOTTOM LINE

2026 should deliver another year of positive but more modest bond returns for fixed income investors. With yields likely to remain range-bound, returns should primarily be driven by income rather than price gains. Today's macro backdrop remains supportive of credit, and we prefer to stay up in quality, favouring shorter-duration investment grade credit and complementing it with longer-dated US municipal bonds. The improving growth outlook and the persistence of above 2.0% inflation should limit how much further yields can fall. Elevated starting yields, normalised yield curves, and resilient credit fundamentals provide a constructive backdrop for fixed income investors in 2026, albeit with selective positioning and disciplined risk management. ■

KEY TAKEAWAYS:

- Fixed income investors enjoyed strong performances in 2025 and positive returns should continue in 2026, driven by income.
- Yields should remain range-bound with the ten-year US Treasury yield ending the year at 4.25%-4.50%.
- Bonds proved their worth in 2025, delivering stability, income, and risk reduction during periods of market turbulence.
- The taxable-equivalent yield for municipal bonds is particularly attractive for high earners in the US.

International sovereign bond developments and prospects for 2026

Prof. Jeremy Batstone-Carr, European Strategist, Raymond James

After a roller coaster year which was characterised by periods of pronounced yield curve steepening in certain markets, notably Japan and the UK, we now believe that yields generally are establishing and settling into a new medium-term range above levels that prevailed in the exceptional period after the Great Financial Crisis and before the COVID pandemic. Although international sovereign bonds have experienced a year of turbulence, benchmark 10-year yields now stand at levels broadly consistent with where central bank interest rates are and where they should settle over the next couple of years.

In general terms an emerging consensus, reflected in prevailing pricing, anticipates neutral interest rates somewhat above those of the 2010s but below those prevailing before the 2008/09 crisis. In aggregate term premia (that part of a bond yield not reflecting interest rate or inflation prospects) are still quite low by historical standards, steepening yield curves more a function of the post-crisis and pandemic scarred 2010s and early 2020s.

However, concerns regarding fiscal policy risks are unlikely to diminish, and in key locations such as the UK and France may yet deliver periodic bouts of weakness.

In Asia the picture looks very different. The key focus for investors in 2026 will be on contrasting fortunes between Japan and China where yields are trending, but contrarily. In Japan yields are adjusting to the Bank of Japan's slow-paced rate hiking programme as inflation and nominal GDP growth normalises after several decades of abnormality. China is, in government bond market terms, the true outlier. Here benchmark yields have dropped below those of Japan for the first time in more than thirty years and are expected to fall further as the country's structural economic slowdown, now clearly apparent, continues, imparting a further sustained period of disinflation/deflationary pressure. ■



Selectivity in equities is a must

Mike Payne, *Investment Strategy Analyst*, Investment Strategy
Pavel Molchanov, *Senior Investment Strategist*, Investment Strategy

Notwithstanding the uncertainties surrounding the outlook for the US dollar over 2026, most UK and international holders of diversified portfolios of financial assets will have some exposure, either directly or indirectly through collective investment vehicles, to the US equity market. US exceptionalism will be under the microscope again over 2026 and here, Raymond James US specialists assess what to anticipate. To quote the former Secretary of Defence Donald Rumsfeld, there are two types of risks: ‘known unknowns’ (there is a sense of what may be coming) and ‘unknown unknowns’ (which lack any historical precedent). Over the past year, investors experienced an outsized number of risks of both types, but none of them were enough to torpedo what ended up being a third consecutive year of double-digit gains for the US benchmark S&P 500. So, is a ‘four-peat’ on deck? We think a healthy dose of caution is warranted. While we expect another ‘up’ year for the market, lofty valuations make selectivity especially important.

THREE YEARS OF ABOVE-TREND PERFORMANCE

Although not quite at the levels of 2023 and 2024, the S&P 500’s gain of 18% in 2025 marked a third year of above-trend performance, outpacing the long-term average of 10.5%. What makes 2025’s gain so notable is the fact that the market had fallen as much as 19% at the time of its April trough— marking the worst moments of trade war turmoil—before staging an epic rebound, and setting 39 daily closing highs along the way. While tariffs were the top source of volatility last year, market turbulence also intensified during the Israel-Iran war, the White House’s threats to Federal Reserve independence, periodic concerns about artificial intelligence (AI)

companies and at 43 days, the longest-ever government shutdown. Despite all that volatility, S&P 500 earnings are tracking to hit \$269 in 2025, equating to growth of 12%, and within a hairsbreadth of our forecast of \$270 from one year ago. Amid the highest US weighted average tariff rate in 90 years, corporate profitability was impressively resilient. Import substitution, efficiency strategies, and, yes, plenty of price hikes were all successfully utilised by companies to shield themselves from tariffs. Meanwhile, the S&P 500 also benefited from valuation expansion: the trailing P/E rose from 24.5x to 25.5x, whereas a year ago we had predicted that it would moderate to 23.5x.

We expect S&P 500 earnings to grow 12% in 2026, reaching \$300, which is slightly more conservative than the consensus estimate.

A TOUGH ACT TO FOLLOW

It's been nearly two decades since the S&P 500 posted more than three consecutive years of gains (2003 through 2007), so history would suggest that expectations for 2026 ought to be tempered. More importantly, our analysis is predicated on current fundamentals. We expect S&P 500 earnings to grow 12% in 2026, reaching \$300, which is slightly more conservative than the consensus estimate. So, does that mean that US equities are poised for another year of double-digit gains? We doubt it. As noted earlier, the S&P 500 ended 2025 at a trailing P/E of 25.5x, which puts it in the top 5% of valuations over the past 20 years. It seems overly ambitious for such lofty multiples to be sustained. To be more precise, we expect the trailing P/E to come down toward 24x by year-end 2026. We acknowledge that

a year ago we had underestimated how high multiples would become. However, we believe that call was early rather than wrong, and will continue err on the side of caution by assuming less lofty multiples in 2026. With that in mind, our base case target for the S&P 500 at year-end 2026 is 7250, which implies a price return of 6% from current levels.

ZOOMING IN: WHICH SECTORS DO WE PREFER?

As impressive as last year's overall S&P 500 gain was, investors could have achieved outperformance by overweighting the sectors with the strongest EPS growth, most notably Technology. Given the point we made earlier about multiple expansion having run its course (at least for now), earnings growth carries particular importance in 2026. Technology is set to lead the way again in 2026 EPS growth, keeping us upbeat on the sector—although we are keeping an eye on some emerging risks. We also remain positive on Industrials, a derivative on the data centre boom; as well as Health Care, a sector full of stocks trading on attractive valuations and paying juicy dividends. We are upgrading the Consumer Discretionary sector: a contrarian idea, having been among the worst performers of 2025.

S&P is trading at historically lofty multiples

With the S&P 500's current P/E ratio in the top 5% historically, we expect multiples to moderate in 2026.



Source: FactSet, as of date 12/15/2025



TECHNOLOGY: A CONSENSUS BUY, BUT STILL WORTHWHILE

The AI megatrend remains the preeminent driver of earnings in the Technology sector. The AI value chain can be divided into three segments—infrastructure layer, enablement layer, and application layer—

with all three growing robustly. While chatbots get disproportionate attention, businesses are increasingly relying on AI for everything from medical R&D to management of the electricity grid. The sector is also benefiting from other secular themes: quantum computing, Internet of Things, and digitisation of enterprise. Consensus estimates call for 2026 EPS growth of 26%, once again outpacing all other sectors—and are continuing to be revised upward—thereby supporting premium valuations. While our positive stance on tech is widely shared in the investment community, it's worth mentioning three emerging risks, all of them tied to the data centre buildout: 1) rising capital intensity, 2) associated debt issuance, and 3) public discontent with utility rates and resulting political pushback against data centre projects. We will be carefully watching these issues in 2026, but they do not detract from the fact that AI is steadily becoming more deeply ingrained into the economy and everyday life, likely sustaining the megatrend for years to come.

We remain positive on Industrials, ... as well as Health Care ... We are upgrading Consumer Discretionary



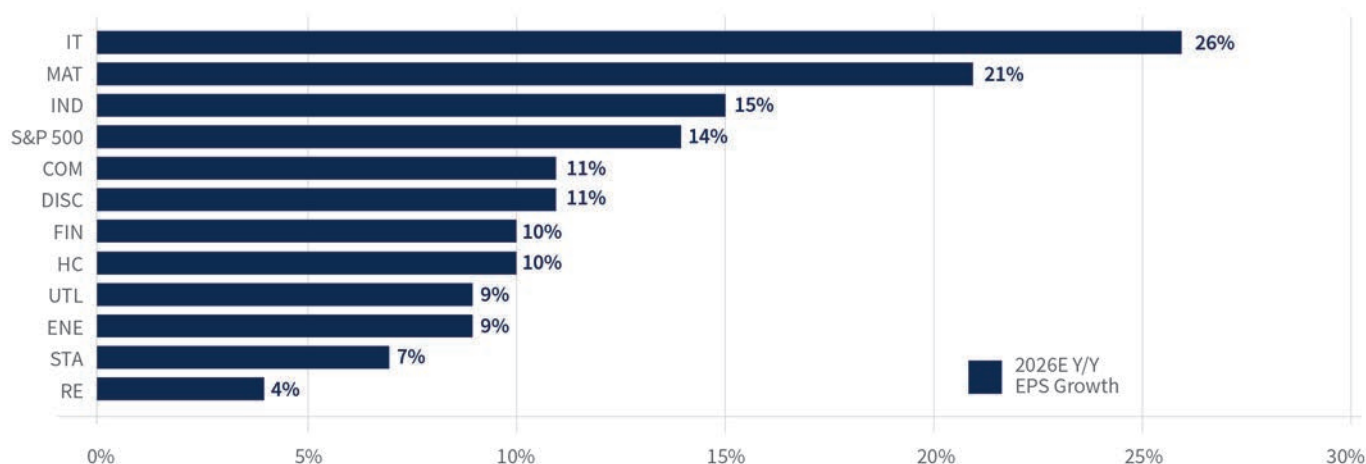
CONSUMER DISCRETIONARY: POISED FOR OPPORTUNITY

It wasn't quite the S&P 500's weakest performer of 2025—Consumer Staples and Real Estate were even worse—but the Consumer Discretionary sector was emphatically out of favour throughout the past year. A major culprit was tariffs,

which made everything from autos to children's toys more expensive. More broadly, as inflation-stressed consumers pulled back on spending, a wide range of manufacturers and retailers saw demand for their goods being pressured. There were bright spots—airlines and hotels, i.e., the 'experiential economy'—but the overall picture was problematic. But here's the good news, as 2026 gets underway: we think that Americans are about to

Earnings growth is key in 2026

Multiple expansion has run its course for now.



Source: FactSet, as of date 12/15/2025

“ As 2026 gets underway, we think that Americans are about to rediscover their inner shoppers. We project GDP growth picking up, translating into more hiring, while at the same time inflation should subside over the next 12 months. ”

rediscover their inner shoppers. We project GDP growth picking up, translating into more hiring, while at the same time inflation should subside over the next 12 months. Following flattish earnings in 2025, consensus estimates call for 2026 EPS growth of 11%, though our sense is that investor expectations are leaning less ambitious than that. Thus, any signs of improving consumer demand should translate into gains for the sector. Meanwhile, lower mortgage rates should spur recovery in the homebuilding industry. As we upgrade the sector from market weight to overweight, we nonetheless want to sound a note of caution: tariffs and other cost pressures are unlikely to disappear anytime soon.



INDUSTRIALS: A WIDE-RANGING INFRASTRUCTURE BOOM

The scale-up of AI requires vast numbers of hyperscale data centres, which are energy-intensive. To support the data centre boom, the electric power industry is building out generation and

transmission infrastructure. Companies in the Industrials sector are providing turbines, batteries, and other equipment to ensure that the electricity supply is both plentiful and stable. Water infrastructure is also in need of upgrading, partly for cooling data centres, but more broadly to deal with a long list of potentially dangerous contaminants. Concurrently, as companies engage in reshoring, US manufacturing operations are expanding, which creates demand for capital goods. Turning to Europe, widespread fears about Russia's intentions are resulting in a sustained defence buildup as countries aim to reach NATO's new spending target—3.5% of GDP—by 2035, European countries likely sourcing numerous armaments from the US. As the Russia-Ukraine peace process moves forward, it

may slow the momentum in European defence spending, but at the same time, the US and its allies in Asia (Japan, South Korea, Taiwan, Australia) are bolstering their capabilities amid threats from China. Putting everything together, consensus estimates call for 2026 EPS growth of 15%. While revenue could be a source of upside, we also need to watch the risk of margin pressure from raw material costs.



HEALTH CARE: STILL CHEAP, EVEN AFTER ITS RECENT BOUNCE

We continue to be supporters of the Health Care sector as a contrarian idea. After weakness in the first nine months of 2025, the sector ended the year on an upbeat note, though it still lagged the S&P 500. The sector's relative underper-

formance was due to two factors. First, 2025 was, on the whole, a risk-on year, which means defensive stocks generally lagged behind aggressive growth names. Furthermore, the Trump administration's first year was full of regulatory changes in Washington DC, creating periodic headline risk for pharmaceutical companies especially. As a result, the sector ended 2025 trading at a 16% discount rating to the S&P 500, one of the widest discounts over the past 20 years. Taking a longer-term perspective, the sector is propelled by growth in healthcare demand—drugs, medical devices, and services—from an aging population. Consensus estimates call for 2026 EPS growth of 10%. Although it doesn't create as many headlines as AI, healthcare R&D is progressing as well—as a textbook case study, consider the boom in obesity drugs in recent years. The main risk, as was evident last year, is the sector's sensitivity to government policies, which (needless to say) are always subject to change.

WHAT ABOUT SMALL CAPS?

Although we envisage moderate upside for the S&P 500 as a whole in 2026, we retain a preference for large caps over small caps. The fact that larger companies have more diversified and flexible supply chains means that they are better able to manage the ongoing cost pressures from tariffs. Large caps tend to have other advantages as well, such as stronger balance sheets and a lower cost of capital. Also worth noting, while the past year’s sharp decline in the US dollar is unlikely to be repeated, any future pressure on the dollar would mainly benefit large caps due to their multinational revenue mix.

BOTTOM LINE



After three years of above-trend performance we see 2026 as a year of consolidation for the S&P 500, with room for moderate gains. Our year-end target for the S&P 500 is 7250, based on earnings growing 12% to \$300 but the trailing P/E coming down to 24x. If multiple expansion were to continue, that could be a source of upside, but we are erring on the side of caution. Our favourite sector ideas are Technology, Industrials, Health Care, and Consumer Discretionary, and we retain a preference for large-cap stocks over small-cap stocks. ■

As a whole in 2026, we retain a preference for large caps over small caps.

KEY TAKEAWAYS

- We expect another positive year in the equity market; however, performance is likely to be muted and selectivity will be critical.
- Our target for the S&P 500 is 7250 with earnings of \$300 (12% growth).
- In terms of sectors, we favour Technology, Industrials, Health Care and Consumer Discretionary.

2026 Outlook

	EPS	P/E	S&P 500 TARGET	PROBABILITY
BULL 	\$310	25x	~7,750	35%
BASE	\$300	24x	~7,250	50%
BEAR 	\$285	23x	~6,555	15%

Source: Raymond James Investment Strategy



Power surge: As global oil demand slows, electricity takes centre stage

Pavel Molchanov, *Senior Investment Strategist*, Investment Strategy

The Technology sector's insatiable need for electricity dominated energy headlines over the past year. By contrast, oil remained on the proverbial backburner. We expect 2026 to be yet another year of intense focus on ensuring that data centres have sufficient power supply, without disrupting the rest of the economy. Even if you aren't directly invested in the electric power value chain, all of us are experiencing one of the side effects of the artificial intelligence (AI) boom, rising utility bills! This is the latest reminder, if any were needed, that technological progress comes at a cost.

OIL DEMAND UNDER PRESSURE

Aside from a brief price spike during the Israel-Iran war in June, there were no real surprises in the oil market last year. Global oil demand was up 0.7%, and we anticipate similarly subdued growth in 2026—the slowest two-year period since the Great Financial Crisis, setting aside COVID. Now that electric vehicle sales have surpassed a 50% share in China, the world's largest auto market is no longer the oil demand driver that it had been for decades.

We anticipate that oil prices will remain generally range-bound in 2026, near the lowest levels since 2021.

Demand in the US and Europe has long been flat to down. The question as to when global oil demand peaks is increasingly topical—and although countless moving parts are involved, we think a peak is likely prior to 2030. At the same time, OPEC has pivoted from propping up oil prices to grabbing as much market share as it can. Despite years of sanctions, Russian oil still has plenty of buyers in China and India. US oil production has plateaued near record highs, despite the past year's steep drop in drilling activity. Putting everything together, we anticipate that oil prices will remain generally range-bound in 2026, near their lowest levels since 2021. This implies West Texas Intermediate (WTI) and Brent crude averaging in the \$55 to \$60 per barrel range, with Brent crude at a modest premium to that.

US power demand is expanding as much in this three-year period as in the first two decades of the 21st century.

DATA CENTRES PROPELLING ELECTRICITY USAGE

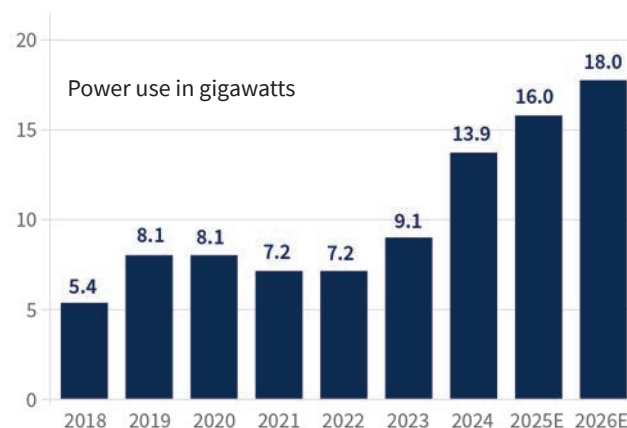
In contrast to the sluggish demand in the oil market, electricity demand is growing by leaps and bounds around the world—and the US is right in the centre of the action. The overarching trend of electrification encompasses electric vehicles, household heating, industrial processes such as steelmaking—and, last but certainly not least, data centres. While the history of data centres goes back to the early days of the internet, the newest type of data centre—known as hyperscale, and which are vital for artificial intelligence (AI)—can use as much power as a mid-sized city. The pace of global data centre installations has approximately doubled since 2020, and the US has more than 40% of the worldwide total. Northern Virginia alone has more data centres than many sizable economies. With that backdrop in mind, US power demand rose 3% in 2025, matching its pace from 2024, and we expect a similar increase in 2026. While 3% growth is mild compared to many other industries, US power demand is expanding as much in this three-year period as in the first two decades of the 21st century. Meanwhile, the International Energy Agency projects that global power demand will expand 40% by 2035.

UTILITY BILLS FEELING HIGH? YOU'RE NOT ALONE

Power prices vary widely from country to country, and in the US from state to state. Data centre development is located primarily in states with moderate power prices, such as Virginia, Texas, and Ohio— whereas projects in California and New England face the headwind of higher prices. However, there is no escaping the fact that the AI boom has an unpleasant side effect for just about everybody, not just Americans: rising power bills. As utilities build new power plants and modernise grid infrastructure, US regulators are approving steeper rate hikes. The national average of residential power prices was up 4% in 2025, and we expect further increases of 3% to 5% per year—outpacing overall inflation—through 2030. The silver lining is that consumers do not need to lose sleep over the prospect of widespread power outages due to AI. We are all paying more for power, but that means the utility sector is making the necessary preparations, well in advance.

Global data centre installations

Data centres can use as much power as a mid-sized city.



Source: visualcapitalist.com., as of 12/8/2025

The AI boom has an unpleasant side effect for just about everybody: rising power bills.

AN ALL-OF-THE-ABOVE STRATEGY

Where is all this additional power coming from? The power plant construction boom that's paralleling the AI boom comprises a bit of everything—but it always depends on the specific geography. Along the eastern seaboard, access to the giant Marcellus natural gas field means that gas-fired power plants are often the most obvious choice. In the midsection of the country, strong wind resources and low-cost land means that wind power is popular, as well as gas from Texas. In California and the Southwest, solar power is often the go-to option. Nuclear power has garnered an unprecedented amount of media and investor attention, but it may surprise readers to learn that there are zero nuclear reactors currently under construction in the US. A handful of previously retired reactors are being prepared to resume operations but all other plans have, so far, got no further than the drawing board. This speaks to the fact that nuclear power plants have the longest development cycles within the electric power industry. Mean-

while, coal continues to lose share within the US electricity mix, though at a slower pace, as the surge of demand has spurred many utilities to delay the retirement of their coal plants.

DON'T FORGET ABOUT H₂O

Data centres need another vital resource: water. As data centres guzzle energy, a portion of it is emitted as heat, and vast volumes of water are used for cooling. While the US as a whole faces less risk of water scarcity compared to countries such as India and South Africa—not to mention Saudi Arabia—our readers who live in parts of Texas and the Southwest, or in Southern Europe, need no reminders that water availability can be constrained. Just as electric utilities are boosting their capex, water utilities are following the same playbook. For consumers, the trade-off is similar: reliable water supply, but with higher bills. Water quality is another pressing issue that, despite plenty of frustrations along the way, is gradually being addressed. In 2025, the American Society of Civil Engineers gave the nation's drinking water infrastructure a C-minus grade, with wastewater trailing at a D-plus—so there exists ample room for improvement. Whether the specific culprit is lead pipes, PFAS (known as 'forever chemicals'), pesticides, or uranium, public health will be better served with cleaner water—and that's worth paying a bit extra.

NO NEED TO BE SO 'CRITICAL'

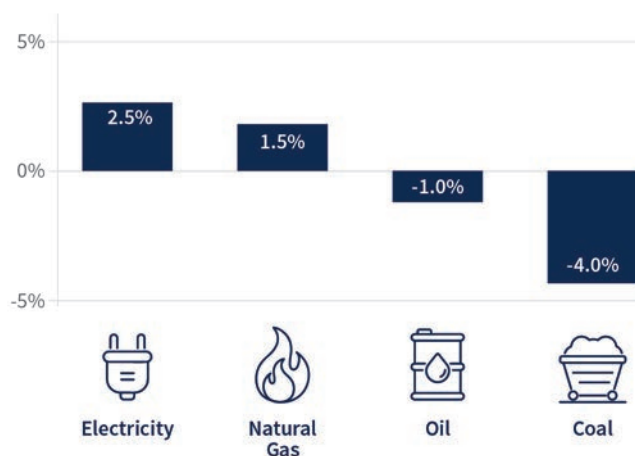
The past year also provided non-stop reminders that electrification requires a wide range of critical minerals. Amid the US-China trade war, a long-running saga has been China's use of rare earths for geopolitical leverage. What is not always appreciated is that the US already mines more than enough rare earths for the needs of the domestic economy. The constraint has been in turning those raw materials into magnets, but as more companies develop refining capacity, we expect the US to become self-sufficient toward the end of this decade. The US also imports significant quantities of copper (a key input for electric cabling), lithium and nickel (for EV batteries), and silver (for solar panels). The realities of geology are such that the US is unlikely to ever be self-sufficient in critical minerals across the board, but there are still ways to reduce dependence on China. Case in point: partnerships with allied countries, such as Australia and Ukraine. Nothing in the mining industry happens quickly, but China's weaponization of key metals—echoing Russia's weaponization of natural gas in 2022—has spurred a push to improve the security of supply chains.

CONCLUSION

Is electricity the new oil? Yes and no. It is certainly fair to say that electric bills have supplanted prices at the pump as a political hot-potato during US election season, with a growing likelihood that this will happen elsewhere outside the US in the not-too-distant future. On the other hand, power generation is less

Power demand growth outpaces other forms of energy

We expect US electricity demand to grow faster than oil, gas, and coal over next four years.



RJ Investment Strategy, as of 12/15/2025

vulnerable than oil supply from the standpoint of geopolitical risk. Investors also have a broader array of choices as to how to invest in the electric power value chain. The Utilities sector may seem the most obvious choice, but it is subject to high levels of regulatory scrutiny, and utility companies tend to have levered balance sheets. Our preference is for the Industrials sector, where a wide range of firms provide equipment and services for the power grid, though we need to be mindful of input cost risk. The critical minerals space—part of the Materials (Basic Resources) sector—is subject to its own risks, such as volatile metal prices. ■

KEY TAKEAWAYS:

- 2025 and 2026 will be all about the need for electric power in one form or another to power the engines of artificial intelligence.
- Oil demand in the US and Europe has long been flat to down. The falloff in demand and changes to OPEC's strategy have us forecasting West Texas Intermediate (WTI) and Brent crude to average in the \$55 to \$65 per barrel range.
- Electricity demand is growing by leaps and bounds; the International Energy Agency projects that global power demand will expand 40% by 2035.
- The downside of the AI boom is higher electric bills and pressure on the water supply.

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The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

The MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world. The MSCI China A Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region. The MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the US market. The MSCI Europe index is a European equity index which tracks the return of stocks within 15 European developed markets.

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