

What 2025 Tells Us About 2026

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One of the biggest surprises this year has been the Teflon-like performance of the US economy, in the face of a spike in import tariff rates. Economic growth has been better than most developed countries and inflation rates have stabilised. Understanding why is the key to working out what may be in store for 2026. We see three factors behind this benign inflation outcome. First, the drawdown of “old” inventories that predate the rise in tariffs. Second, lower than feared tariff rates. Third, and most importantly, companies not passing on the full tariff increase and hence taking a hit to their profit margins.

So, is that it? Well, no. We expect the tariff effects to show up more in 2026, crimping growth and lifting prices. Still, the AI boom is likely to offset some of this by boosting spending and putting downward pressure on wages and prices, as AI is more fully applied by businesses. All in all, this is still likely to lay the foundations for interest rates in the US to move down further, which is positive for high quality bonds.

In 2025 a stronger economy did not translate into US equity outperformance. Rockstar Korea surged over 70% while Emerging Markets had high returns, from Brazil to China. South Africa has also quietly been one of the stronger equity markets this year. Even the unfancied UK with no IT or AI proxies, had higher returns than the US. This breaks the pattern of US exceptionalism most investors are used to. Within the US, IT still outperformed as the AI theme captivated investors leaving non-AI stocks neglected, including small companies and healthcare.

What does this mean for equity returns in 2026? “Normal” equity returns are 4-6% p.a. above the rate of inflation, so the recent returns of 15%- 20% are unusual. Last year’s gains came mostly from investors becoming more optimistic or less concerned about risk. The boom in AI-related spending and mega dealmaking has played a key role. This has left valuation levels higher, so we should expect lower returns next year, though history shows it is possible to have several years in a row of higher than usual returns.

We are becoming more wary of highly valued companies that are highly sensitive to swings in AI spending or are seeing huge capital spending erode profitability. The probability of disappointment has increased given the huge outlay and huge rise in sales needed to just sustain current profitability. This is why we hold less than usual across IT and AI plays. It’s also why there is better value in markets like the UK and Brazil, and sectors like healthcare and consumer staples.

Some investors have taken this further and become concerned about media mentions of market “bubbles” and references to prior market sell offs. Some humility is in order at times like this, even when it seems “obvious” what will happen next. Markets have a long history of prices reaching extremes for longer than most people expect. The world is complex and random, and there is a long history of failed forecasts about bubbles, booms and busts.

Just like 2025, 2026 will see shocks and surprises and that means swings in asset prices. The best strategy for investors to reach investment goals is still to stay the course, basing asset allocation on capacity to take risk rather than speculation and swings in emotions. There are still many good opportunities, such as Brazilian equities, and investments to diversify economic risks, such as inflation linked bonds.

To get the complete picture on 2026 you can access Morningstar’s full set of [Outlook](#) research papers, covering everything from dealing with geopolitical uncertainty, AI, the fate of the US Dollar, and hidden gems.

Risk Warnings

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