SARANAC PARTNERS

The January Outlook

Market Stance

REVIEW OF 2025

Strong gains across many asset classes reflected a moderately benign global economic cycle, and a range of market themes beyond AI

Commentary

- Global economic growth was moderate, not weak – and corporate earnings growth remained firm
- Inflation and interest rates fell slightly
- Strong equity market gains were delivered across different regions and sectors: the US market underperformed, and global IT returns were exceeded in a number of other sectors

Upshot

- The starting point for markets in 2026 cannot be reduced simply to one of 'speculative excess'

EQUITY VALUATION BACKGROUND

The strong recovery in equity markets has pushed global valuations 20% above the longer-term norm

Commentary

- While US equities remain on the highest PE ratio globally, all regional multiples are above their historic norms
- AI exposures are partly but not solely at the core of this revaluation, as other more traditional sectors (e.g. banks) have also been re-rated
- An adverse shock to earnings is likely to be the catalyst for equity markets to de-rate, not simply the fact that valuations are extended

Upshot

- Valuation provides little or no guide to near-term returns, but long-term expected equity returns relative to other asset classes are low by historic standards – supporting the case for portfolio diversification

THE GLOBAL CYCLE IN 2026

The balance of positive forces and challenges for the global economy remains finely tuned

Commentary

- Supportive factors for the global economy are lower interest rates, expansionary fiscal policy, robust AI spending and continuing weak oil prices
- The challenges remain Trump-led supply-side disruptions, global geopolitical concerns, unsustainable fiscal positions and ongoing structural problems in China

Upshot

- Our central case is not that the macro background will be highly problematic for markets. However, risks to this seem asymmetric

SARANAC MULTI-ASSET POSITIONING

Conservative positioning in multi-asset portfolios reflects more subdued longer-term prospects for equities relative to other asset classes, not the expectation of an imminent market sell-off

Commentary

- The soft-landing narrative lends itself to higher risk asset exposure, the valuation background points in the other direction
- Given these different pressures, positioning remains risk-aware, but not pessimistic
- Equities remain the largest contributor to risk, but cash weights are also very low, reflecting the significant exposure to alternative assets

Upshot

- Portfolio structure reflects the need to maintain exposure to market risk, but with sufficient diversification to allow for adequate returns to be realised in a more challenging market environment

SARANAC PARTNERS

The Long Read

Economic and market themes for 2026

SNAPSHOT

In this article, we explore the transition from 2025 to 2026 and its implications. We start by challenging two misconceptions about last year: that the global economy was highly volatile and that equity gains were driven solely by US tech megacaps. In reality, 2025 delivered a moderately benign global cycle, with growth around 3.5%, easing inflation, and broad-based equity participation supported by firm corporate earnings.

Looking ahead, we assess the outlook for 2026: resilient but uneven global growth, driven by robust corporate investment and AI-related capital spending, alongside modest monetary easing and selective fiscal support. Risks remain asymmetric, with Trump-led trade policies, geopolitical tensions, unsustainable fiscal positions, and structural challenges in China creating potential headwinds. Inflation is expected to stay "low but sticky," limiting scope for aggressive rate cuts.

We also examine stretched equity valuations - global P/E multiples near 23x versus a long-term average of 18x - and narrow credit spreads, which signal low risk premia across asset classes.

1. Clearing the decks: economies and markets in 2025

Economic and market prospects for this year are dependent in part on the characteristics of the transition from 2025. The starting point matters. In this context, there are two widespread misconceptions about the evolution of economic and financial conditions last year.

- The first misconception is that the global economic background was one of high volatility, creating a challenging macro environment which has been problematic for fixed income and equity investors. The reality is that the global cycle remained more benign than generally perceived, and indeed generally expected.
- The second misconception is that the strong equity market returns last year were fundamentally speculative, and heavily reliant on a surge in the prices of a small number of tech-related megacap stocks in the US. In fact, there was broad participation across a wider range of sectors and countries, and the equity rally was supported in part by firm growth in corporate earnings.

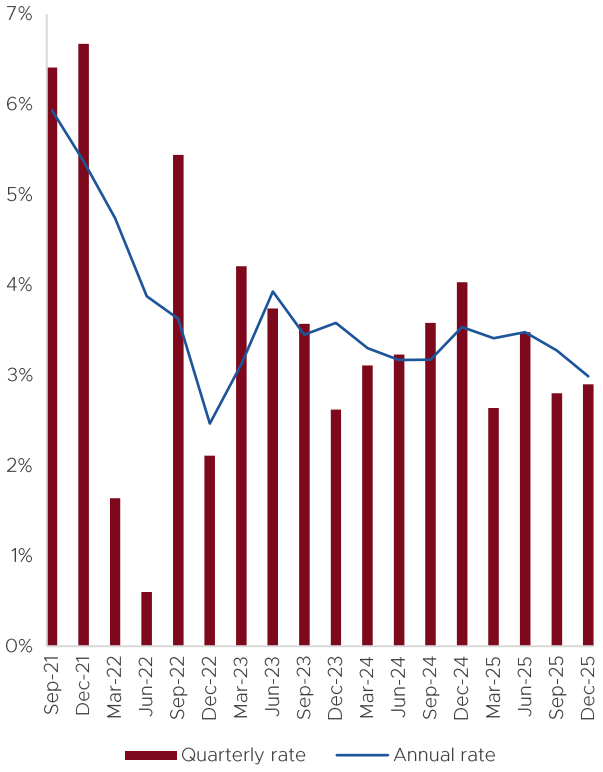
With the advantage of hindsight, 2025 turned out to be moderately benign in terms of the global economic cycle. The global economy - more relevant for the global companies which dominate equity market indexes than their local market alone - is likely to have expanded by some 3.5% last year, similar to the outturn in 2024, and with very limited volatility during the year (chart 1). There was some slight slowing towards the end of the period, with employment growth globally softening, but recession threats have remained in abeyance. As a point of comparison, the contrast with the sharp growth slowdown in 2022, which was so problematic for financial markets as energy prices spiked, is very apparent. Indeed, an important stabilising factor for the global economy last year was the fall in oil prices, which contained price pressures and supported personal and corporate sector incomes.

SARANAC PARTNERS

The Long Read

CHART 1

Global Economic Growth Stable in 2025



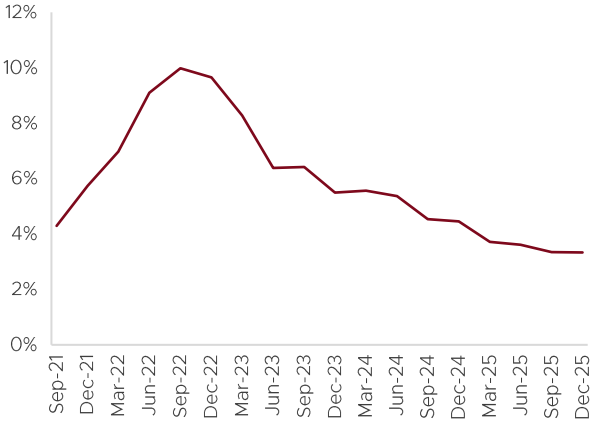
[1]Source: Bloomberg. Dec-25 is an estimate

There were two further trends which were supportive for markets last year. First, there was a further modest decline in global inflation, leaving the covid-related peaks still further behind (chart 2). While there have been concerns that inflation has become 'sticky' around prevailing levels, with the rate of decline less pronounced than in previous periods, this has not prevented a shift to slightly easier monetary conditions. Short-term interest rates in the major economies have on average declined over recent months (chart 3).

Of course, these global aggregates conceal greater variability in some local economic conditions last year, and also the evident 'shocks', notably the Trump tariffs imposed in April and escalating international political tensions across multiple domains. Nevertheless, these themes did not prevent a modestly benign global economic cycle from remaining intact.

CHART 2

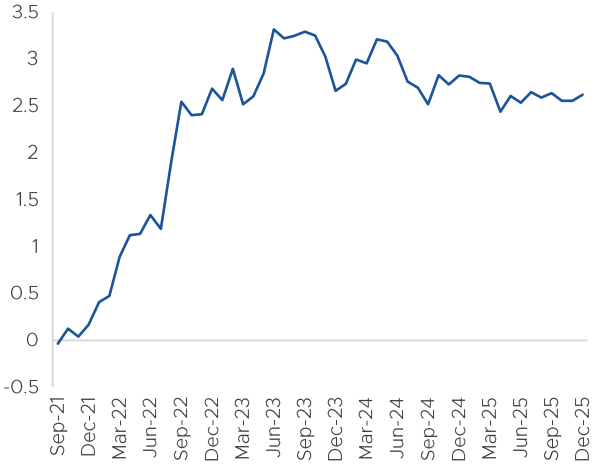
Global Inflation continued to decline last year



[2]Source: Bloomberg. Dec-25 is an estimate

CHART 3

2-Year yield average major economies



[3]Source: Bloomberg / Saranac

The Long Read

Neither was it the case that US megacap firms, notably the 'magnificent seven' dominated equity market returns. This group did rally strongly in the second half of the year, but this basically recouped the substantial relative underperformance in the spring (chart 4). In terms of global sector performance, utilities', financials', materials' and industrials' returns exceeded those in the IT sector (chart 5).

CHART 4

'Magnificent 7' and Global Equity Returns ($)

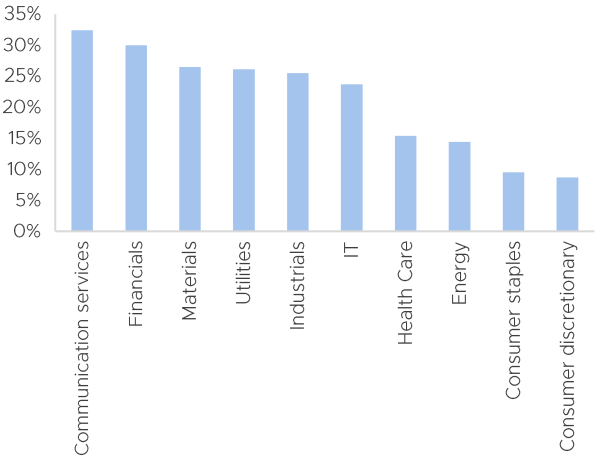
[4]Source: Bloomberg / Saranac

More generally, US equities were the worst performing of the major economic blocks, undermining the case that the period of US dominance of equity returns has remained intact (chart 6).

From this broader perspective, the main theme in equity markets last year was not market concentration, rather a rotation into a broader range of global sectors than simply IT, leaving only energy, healthcare and consumer-related sectors as clear laggards.

CHART 5

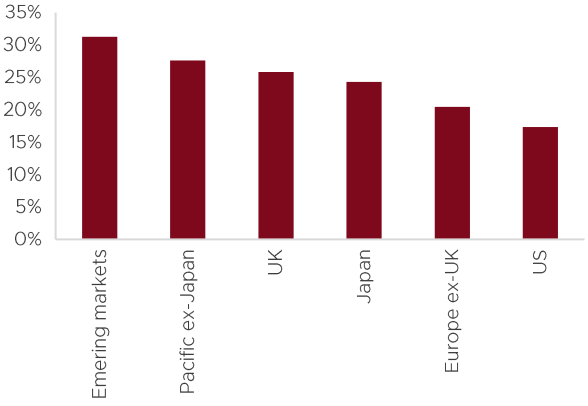
Global Sector Returns 2025 ($)



[5]Source: Bloomberg / Saranac

CHART 6

Regional Equity Returns 2025, local currency



[6]Source: Bloomberg / Saranac

To some extent these strong global returns do reflect a more concentrated AI theme: utilities, for example, have benefited from the surge in energy demand associated with data centres. Nevertheless, the equity market gains last year cannot be reduced to a frenetic 'one-trick pony'. Global corporate

The Long Read

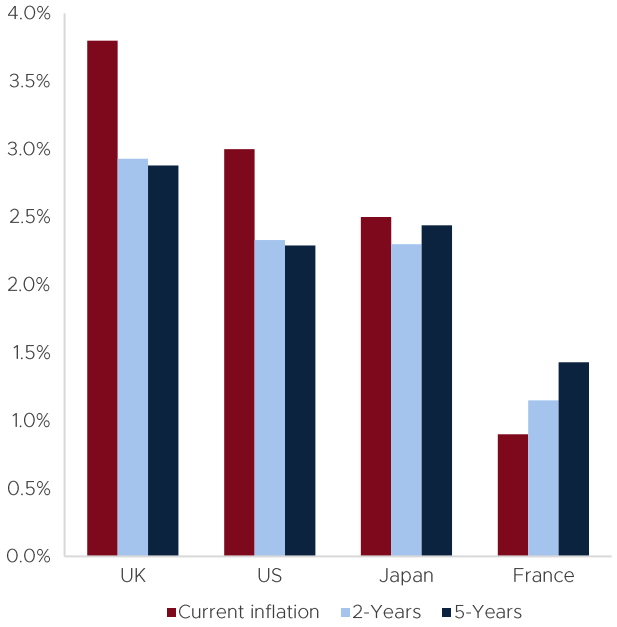
earnings rose by some 10% in 2025, a relatively strong outturn in a global context, accounting for around half of the overall market gain.

2. The global economy in 2026 – growth, inflation, interest rates

The global economic expansion is likely to be sustained in 2026, but with significant sectoral deviation. Corporate spending appears likely to remain more robust than consumer spending. Labour markets globally are weakening, while there has been a material boost to global economic growth arising from AI-related capital spending. Additional support for growth may emerge from the slight easing in global monetary conditions in recent months, combined with some potential boost from looser fiscal policy in the US, Germany and China in the first part of the year.

CHART 7

Market Inflation Expectations

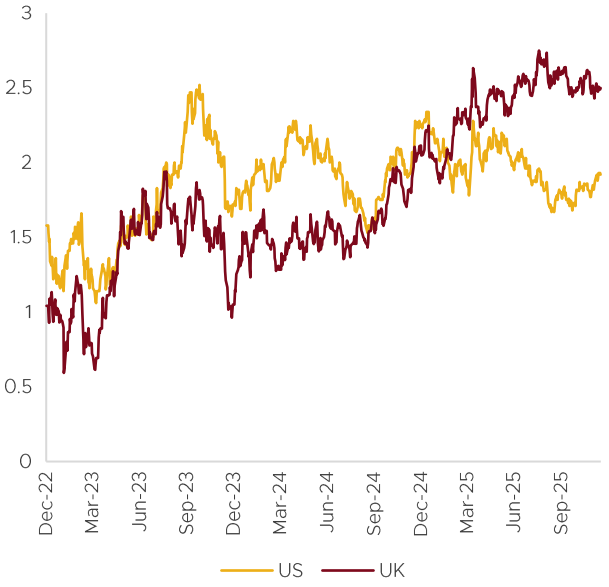


[7]Source: Bloomberg / Saranac

Our characterisation of the expected macro environment would be, as in 2025, that the global economy remains resilient, with growth remaining range-bound, not accelerating materially, or with recession risk being particularly elevated. A particular risk remains the policies adopted by the Trump administration, particularly the impact of tariffs and labour force repatriation. While the impact of these policies on the US economy to date remains limited, the 'slow-burn' nature of the effects mean that the potential adverse effects are likely to continue into 2026, and cumulate. The 'low but sticky' inflation theme is also likely to remain intact. Market expectations are in the main for inflation to edge closer to central bank targets, and we do not expect adverse inflation surprises to dominate financial market conditions this year (chart 7).

CHART 8

US and UK 10-year Real Interest Rate (%)



[8]Source: Bloomberg / Saranac

Given this expected macro background, we do not expect a major shift on global monetary conditions in the coming months. There may be scope for very

The Long Read

cuts in the US and the UK, and a slight rise in Japanese rates, with the ECB keeping rates on hold for an extended period, with risks shifting slightly to the upside. Chinese interest rates are likely to remain around the low levels reached over the course of last year. We do not envisage aggressive global monetary easing, as inflation is likely to remain somewhat higher than many central bank targets, in the US in part because of the continuing impact on inflation arising from tariff increases. In this environment, government bond yields are likely to trade in relatively narrow ranges. Real interest rates are at present around 2-2.5%, levels which we regard as sustainable (chart 8).

3. Equity and credit valuations

Equity valuations are demonstrably stretched compared to a historic yardstick. This does not, however, mean that there is a widespread 'bubble' in equity markets.

The facts are these. Global equities are on a multiple of prices to corporate earnings of almost 23x expected earnings for this year, significantly higher than the average value of 18x in the past decade or so (chart 9). To a material extent, this reflects high US equity valuations, particularly in IT-related megacap stocks.

However, non-US markets continued to re-rate last year (e.g. PE multiples rose) as they have done since 2022. The rise in equity multiples has not therefore been simply a US phenomenon. In the past three years, for example, the ~40% gain in the UK share prices has been the result of a much higher PE multiple, as aggregate earnings growth has been negligible. While (as is usually the case) other global equity markets trade on lower valuations than the US, PE ratios in all the major markets now are above their longer-term averages.

How should these valuations be interpreted? Importantly, the current position is different from the peak of the equity bubble in 2000. At that stage, it was not unusual for companies making losses to trade on exceptionally high multiples. In the current cycle, the companies with particularly high valuations have delivered extraordinarily strong cash flows and earnings, and continued to do so towards the end of last year. Apparently high valuations have therefore ultimately been supported by very strong earnings growth.

CHART 9

MSCI World PE Ratio Remains Extended

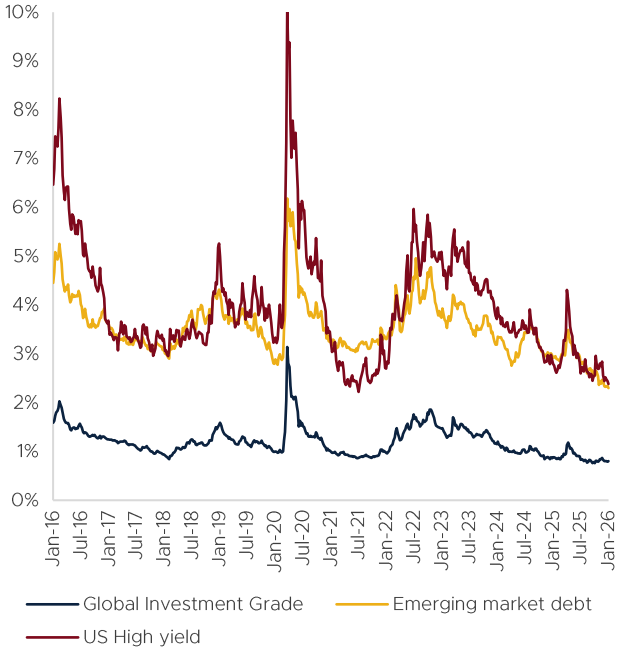
[9]Source: Bloomberg / Saranac

For example, the growth in earnings of one of the leading US tech firms has been around 50% over the past year, itself a slowdown from ~200% in 2024. The current PE multiple of ~40x appears very extended, but it would appear more sustainable if earnings growth this year were to match that achieved last year. From this perspective, the challenge is not so much the valuations in isolation, but whether or not the earnings growth which is supporting them is achievable. Bottom-up analysts' estimates, which were in general exceeded last year, continue to point to double-digit growth in corporate earnings for this year.

The Long Read

CHART 10

Credit Spreads Are Narrow



[10]Source: Bloomberg / Saranac

In previous periods of very extended equity multiples, it has been unusual for a high valuation in isolation to bring about a sustained and material correction in equity prices. A more typical catalyst has been a significant deterioration in the macro conditions, in particular much slower growth or much faster inflation, or a combination of the two. In our view, such a deterioration is not for now our central case, as noted above. In addition to the higher-level macro environment, a further risk comes from any weakening in the more specific AI theme. This has supported not just equity returns but also economic growth more generally. An industry-specific shock to this area could undermine both. Indeed, with a higher portion of robust IT capital spending financed by debt increases, there is increasing scope for an undermining of the AI growth theme to have an impact on credit as well as equity markets.

Credit spreads (the margin paid by private sector debt issuers over government bonds) ended last year at relatively low levels by historic standards (chart 10). The dominant theme in global markets is therefore low risk premia in a range of asset classes, not confined simply to IT-related large cap US companies.

4. Investment strategy for 2026

We do not believe that high equity valuations in isolation should lead to a multi-asset portfolio with highly constrained exposure to equities, particularly given the difficulties associated with timing precisely the peak of a bull phase in equity market returns. We continue to regard a very challenged global macro background as more of a risk scenario than a central projection for the coming year.

Our interpretation of current market pricing is that high equity valuations are likely diminish the expected outperformance of equities over other asset classes. From this perspective, the challenge facing investors is not so much a market collapse, but a longer period of weaker, but still-positive, equity market gains relative to other asset classes whose returns are less volatile. As a result, we hold less in equities in a multi-asset portfolio than we would do in a more typical market cycle, and more in fixed income and alternative assets. In this respect we retain a significant exposure to gold, and also to hedge funds whose returns have a low correlation with equities.

SARANAC PARTNERS

ABOUT SARANAC PARTNERS

Saranac Partners was founded in 2016 as a private office for investments and more. As an independent firm, we combine the capability of traditional financial institutions with a personalised approach that offers more. We serve a community of individuals and families across the UK, Europe and Middle East with specialisations in strategy, investments and financing.

OUR SERVICES

We start with the question. We listen and seek to understand. We don't make assumptions or force solutions. Rather we co-create a path with our clients.

Strategy
Planning, governance and oversight

Investments
Allocation and deployment of capital

Financing
Access to diverse sources of capital

Saranac Partners Limited
+44 (0)20 7509 5700
16 St James's Street London SW1A 1ER

Saranac Partners Limited is authorised and regulated by the Financial Conduct Authority Registered in England & Wales Company no. 09587905

This document does not constitute specific investment advice to buy or sell any investment or enter into any contract for investment services. Neither does this document constitute tax advice. Specific investment mandates may not permit some of the strategies discussed. Information contained in this document may not be distributed, published or reproduced in whole or in part or disclosed by relevant persons to any other person. The distribution of any document provided at or in connection with this document in jurisdictions other than the United Kingdom may be restricted by law and therefore persons into whose possession any such documents may come should inform themselves about and observe any such restrictions. In particular Saranac Partners is not registered with the SEC in the United States and does not provide investment services to US Persons. Saranac Partners Limited is authorised and regulated by the Financial Conduct Authority. Any personal data you disclose to Saranac Partners will be treated as confidential and will be processed in accordance with our Privacy Notice, which can be found at www.saranacpartners.com.