

Outlook for 2026: Magnificent 7 in last chance saloon?

Alasdair Gill, Partner and Head of Equity Research at XPS Investment recaps on 2025, and outlines some pointers for investors to consider in 2026.

Last year we expected markets to be “kept on their toes” with Donald Trump re-entering the White House in the USA, and we were not wrong.

Economies in general did continue to grow steadily, and the continued strong performance of equities surprised many - whilst bond returns were more muted. However, inflation started to come under control in many of the major economies, and the path of interest rates started to fall.

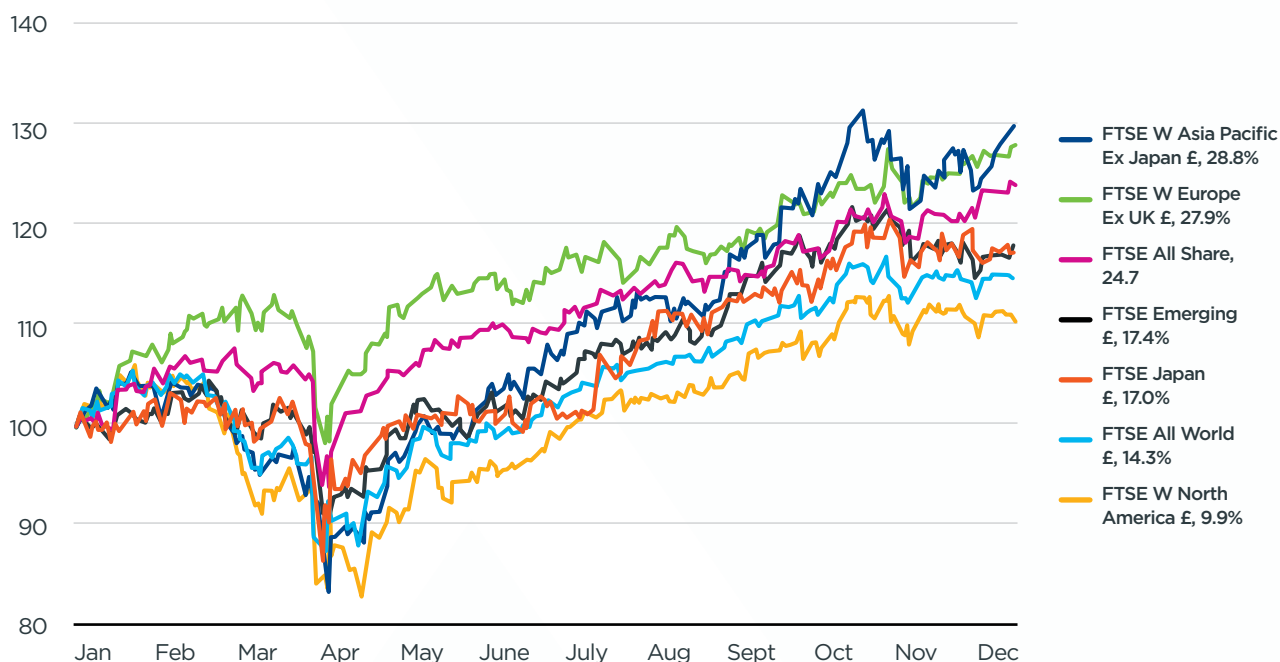
So what to expect in 2026? In this piece we will consider whether the Magnificent 7 have run their course and what new acronyms we will be talking about. Has inflation been tamed, enabling central banks to cut interest rates further? Where can investors look to diversify, given the elevated global equity market valuations? And finally, as geopolitics look to continue to be “front and centre”, how can investors build in resilience into their portfolios?

Recap of 2025

So back to 2025, which surprised many by delivering another strong, if volatile year for equity markets, with unhedged global equities up 14.3% in sterling terms.

In our 2025 outlook, we believed there was scope for equities to deliver more muted returns. They did outperform our expectations, despite a material pull back in early April on “Liberation Day”.

Chart 1: Global FTSE Equity - Total Return Indices - £
Year (to 31/12/2025)

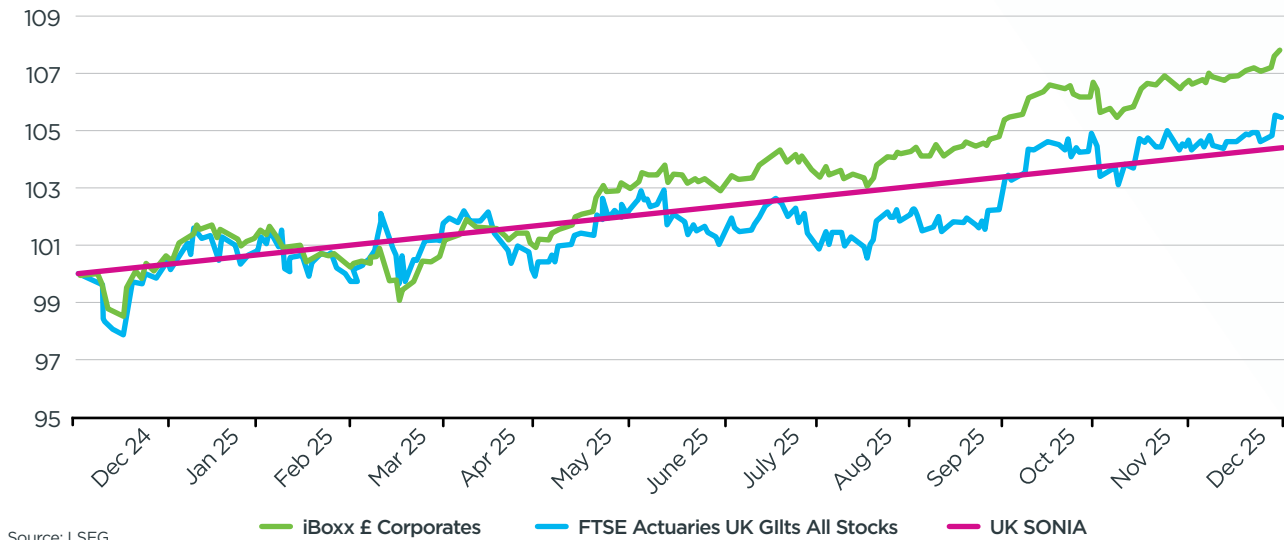


Source: LSEG

Although the large US tech stocks continued to perform well, 2025 was notable for the broadening out of returns across the regions. Major UK, European, and emerging market indices all delivered returns north of 20% for sterling investors, outpacing the 9.9% delivered by North America for unhedged investors. The UK market shone with the FTSE All Share Index rising by 25% over the year, its best performance since 2009, led by sectors such as mining and defence.

Over a 10-year period, global equity markets have now delivered a cumulative return of over 350% for sterling investors (with dividends reinvested), or over 13% per annum - that is almost 10% per annum **after** allowing for inflation - this is well beyond longer term average levels.

Chart 2: Sterling Bonds and cash, 2025



Bonds

Bonds, by contrast, delivered a flatter return in 2025. There was a steepening of the UK government bond yield curve as yields at the short-end fell, whilst longer-dated bonds more widely favoured by UK DB pension schemes ended the year where they started at around 5.0%. In both the US and UK, rate cuts finally started to emerge towards the end of the year as the persistently sticky inflation data started to tick down and expectations for further cuts grew. This helped bond markets end the year strongly.

High quality corporate bonds had a decent year with a return of around 8%, however this means that the additional yield now available has continued to slide to a multi-year low, below 1%.

Chart 3: Sterling Credit Spread (Option Adjusted Spread, or OAS)

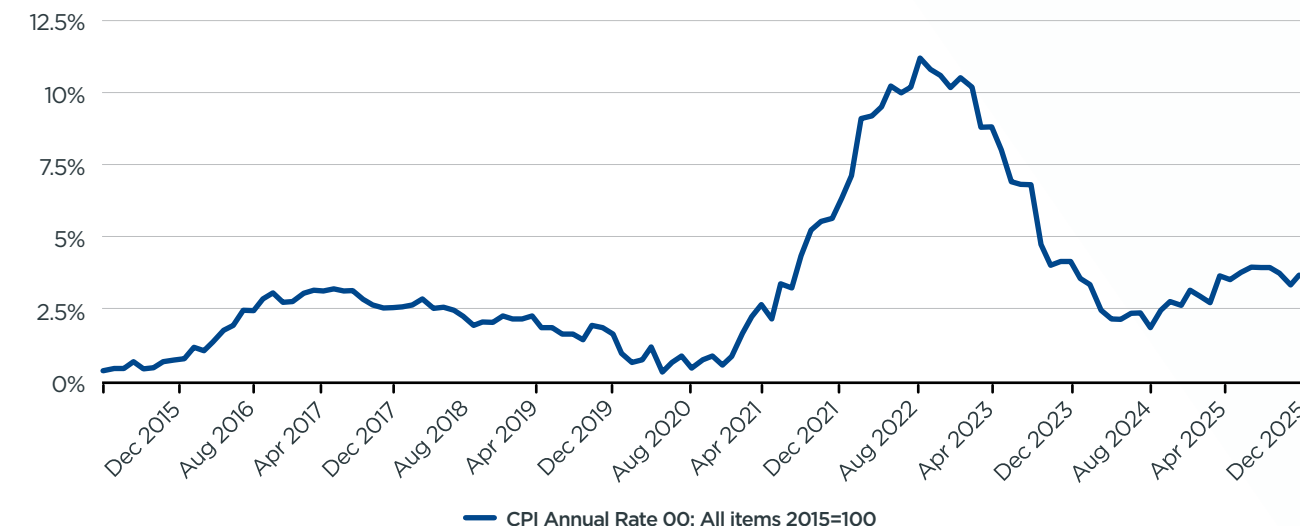
ICE BofA Sterling Corporate Index



Inflation

Inflation has been more benign in 2025, and although it ticked up during the year, it is looking more under control; indeed the Bank of England expect it to fall further back towards their target of 2% by April 2026, hence the rate cut in December 2025.

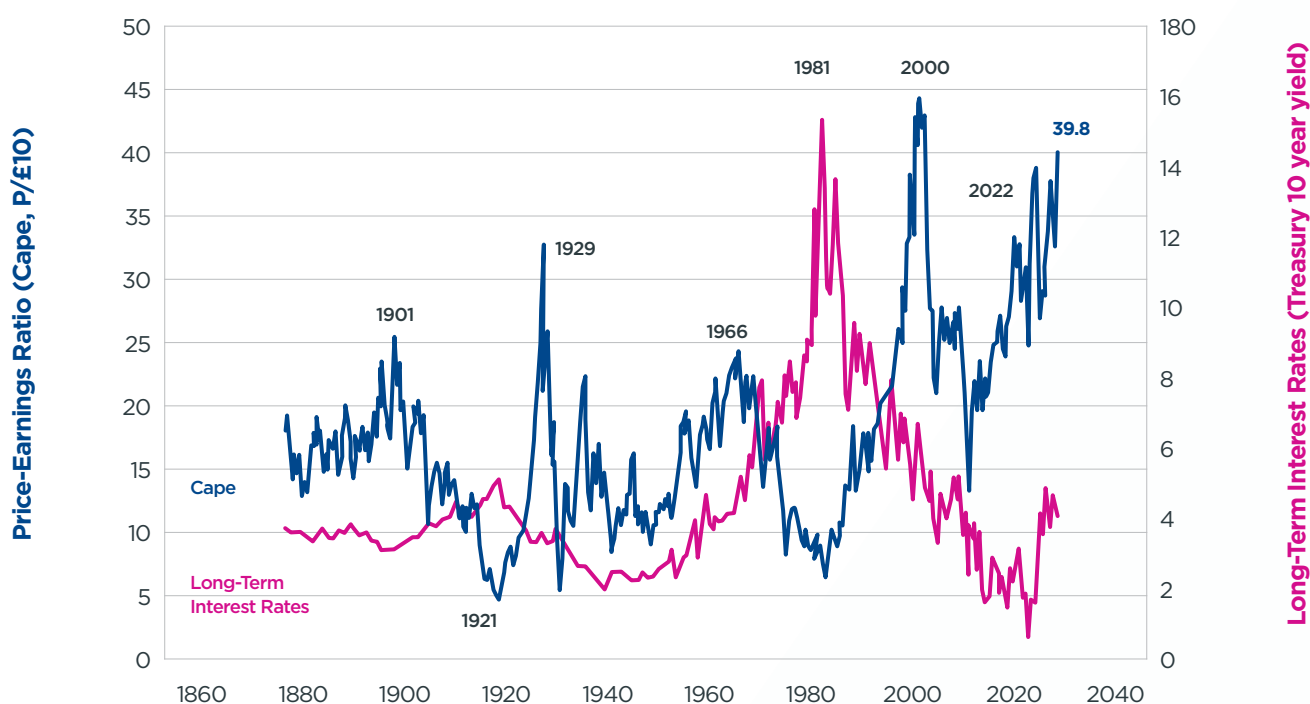
Chart 4: Inflation to end December 2025



Pointers for 2026?

Despite a broadening of returns across 2025, the Magnificent 7 still have a 23% share of global equity markets. While their earnings are continuing to surprise on the upside, increasing talk of an AI bubble has emerged over 2025 driven by concerns over the circular nature of some of the substantial capital spending within the sector, and whether end-user revenues are going to be sufficient to pay for all this spend. We see the concentration of returns in this sector as a key risk to equity investors in 2026, and this is most acute in the US market, where valuations continue to be stretched (see chart 5 below).

Chart 5: Schiller CAPE and US Interest rates



We have used this chart before: in our 2022 outlook, we highlighted the Schiller Cyclically Adjusted Price Earnings Ratio (CAPE), as a measure of how expensive the market is. Although not a perfect measure it does illustrate that we are at multi-year highs (although not as high as the dot com bubble, but higher than 2022), and we would concur that the US market in general is unattractive at these levels. Added to the valuation argument, the imposition of tariffs and the increasingly unpredictable nature of Donald Trump's interventions into geopolitics and trade have arguably added risk to investing in the US, and so to shift allocations (as many companies are adjusting their supply chains) would seem to make sense to us.

Whilst our outlook is neutral for developed market equities in aggregate, this is because in developed markets our concern about US valuations is counterbalanced by better value markets elsewhere.

GRANOLAS anyone?

In contrast, prospects do look brighter for other regions: UK and Europe are set to benefit from elevated capital expenditure from governments (such as Germany) on infrastructure and defence (the ratio of capex to sales in Europe is now at the highest level since the global financial crisis¹). In addition, shifting trade patterns can benefit Europe markets and economies absorb the impact of tariffs on global trade and look to reduce the reliance on the US.

Valuation multiples in Europe remain around 35% below the US² but the earnings growth gap has been narrowing. While the Magnificent 7 get most of the attention, investors should not overlook the lesser-known GRANOLAS³ - a dominant set of 11 stocks that represent around 20% of the European market, covering sectors including pharmaceuticals, luxury and consumer goods. These stocks in aggregate offer:

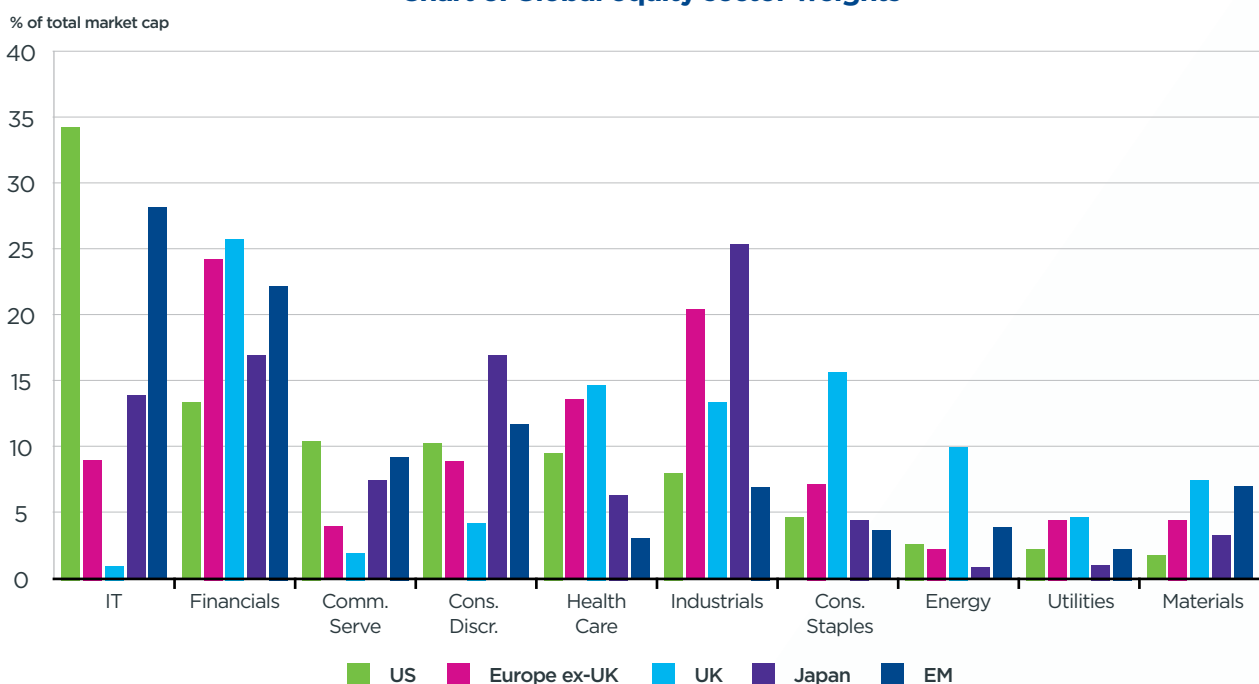
- ▶ Lower volatility vs the Mag 7
- ▶ Lower valuation (around 30% vs Mag 7)
- ▶ Higher dividend yield (average 3.0% vs 0.3% for Mag 7)

In today's volatile climate, this combination has much to commend it in equity portfolios.

Emerging Markets emerge from the gloom

In addition to the strong showing from UK and European equities, last year saw emerging markets outperform developed markets in aggregate for the first time since 2020. Despite this strong return, valuations remain around 40% below the US market, and earnings growth forecasts continue to rise. In addition, the segment has the second largest tech sector to the US (see chart 6), and so is a cheaper way than the "Mag 7" to build a weighting to this important sector in portfolios. Moreover, many of these businesses are set to benefit from other economies avoiding the tariff barriers imposed by the US.

Chart 6: Global equity sector weights



Source: LSEG Datastream, MSCI, S&P Global, JP Morgan Asset Management. Indices are MSCI except for US, which is S&P 500.
JP Morgan Guide to the Markets - UK. Data as of 31 December 2025.

For institutional investors however, how do we diversify effectively in long term equity portfolios without becoming too granular in our approach? A more regional structure could help.

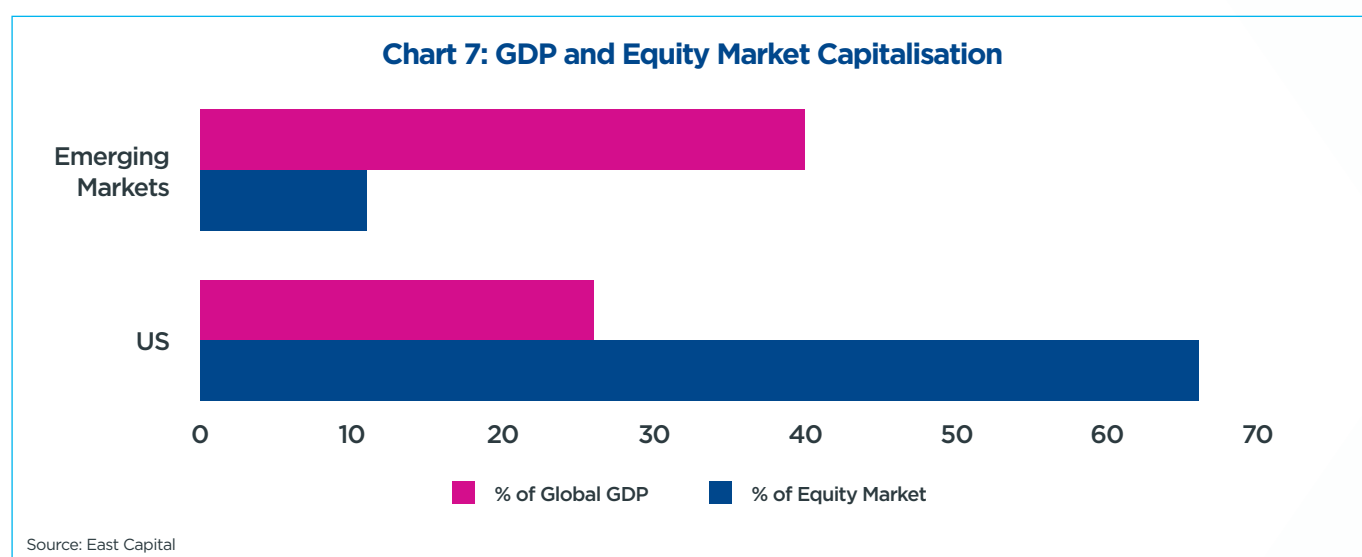
The return of regional weightings?

Many pension schemes in 2000-2020 had historically held regional allocations to the main trading blocks within their equity portfolios, often splitting between domestic and equal regional weightings overseas.

As equity allocations fell, and markets became more dominated by the US, many schemes moved to simplify the allocation using a market capitalisation approach.

Whilst this had many benefits, the key drawback that we have mentioned before is the concentration of a large portion of a global equity portfolio in a small number of highly valued US tech stock as highlighted above. In addition, many global equity indices used are “developed markets” only and have therefore excluded Emerging Markets, which are around 10% of global equity market capitalisation, whilst contributing around 40% to global GDP.

One solution is to rebalance portfolios to a more regional approach, and introduce (or re-introduce) at least a market (i.e. 10% weighting) to emerging market equities. This approach would also reduce the reliance on the US, which has around two-thirds of equity market capitalisation, whilst representing only around 25% of Global GDP (see chart 7).⁴



Incidentally, this approach does not need to be at odds with using passive investment management within equity portfolios. Any portfolio, no matter how it is managed, involves active decisions - the move to a regional approach simply represents the active decision-making moving one tier down from asset class to region, and can still be managed passively. We would also highlight the importance of currency hedging to manage volatility - this is often most easily implemented using passive funds.

We expect renewed interest in a more regional equity approach in 2026, in particular among DC Pension schemes, and those DB schemes that are retaining an equity allocation for the purposes of running on.

¹ Source: Goldman Sachs Asset Management

² Source: JP Morgan

³ This term was coined by Goldman Sachs back in 2020 but is not as well known as the “Magnificent 7”. The acronym uses some poetic licence to refer to 11 European stocks: GSK, Roche, ASML, Nestle, Novartis, Novo Nordisk, L’Oreal, LVMH, AstraZeneca, SAP and Sanofi

⁴ Source of GDP stats, www.eastcapital.com/insights

Other equities - Private Equity goes mainstream?

Privately owned companies are no longer small, niche businesses waiting to grow big enough to float on the public markets. Most of us are encountering these companies on a daily basis (eg Asda, Morrisons, Pret a Manger, Evri) or on holiday (Heathrow Airport, CenterParcs). Why would you not want such companies in your asset portfolio?

The main drawback of private markets has historically been cost and illiquidity, and that remains an issue, given that you can only own such businesses via private equity funds that are not easily traded. However, in recent years more funds have been developed with an “evergreen” structure and limited liquidity, and indeed the relatively new Long Term Asset Funds (LTAFs) are now available to retail and Defined Contribution pension investors which offer highly diversified exposure to private equity at a more reasonable cost.

We continue to believe that private equity can have a place in portfolios for investors with a long time horizon (15 years +) - this would include DC pension investors, and not just the under 50s: with members increasingly choosing drawdown strategies in retirement, there can potentially be a place for equities (both public and private) within “guided retirement” portfolios. This could mean less of a “cliff edge” when members start taking their pension, and private markets could potentially be used for members well into their 70s.

Portfolio resilience

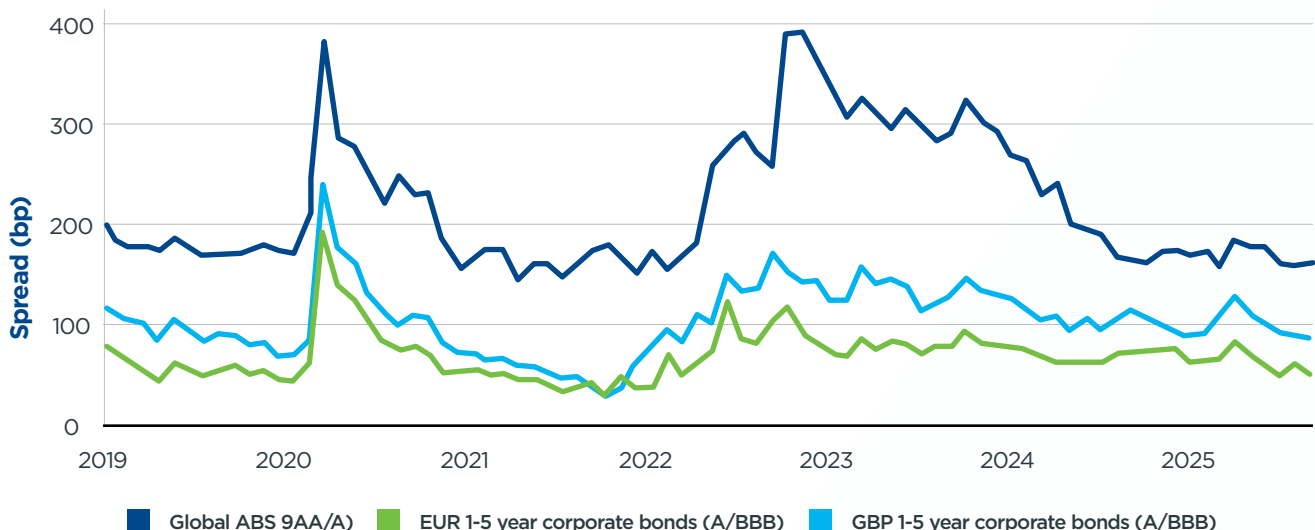
So far, we have highlighted options for the growth portfolio that aim to deliver returns, however we have also alluded to some key risks as we enter 2026, in particular the unpredictability of US policymakers. Hence it does make sense to build in resilience to your investment portfolio, by ensuring that you have some diversification and allocations to assets that could help dampen any volatility, particularly from equity markets.

We highlighted gold in our last outlook which has continued to perform very strongly, but it does suffer some disadvantages as a hedge against downside risks. It has also become a lot more expensive in the last year. We have also covered Crypto currencies, and again these tend to be correlated with risk markets so are not a good hedge (or indeed investment) for long term investors (as well as offering no income or justifiable expectation of capital appreciation).

Those with multi-asset portfolios should have some diversification across other asset classes built in that should help dampen returns in any down scenarios, but for those constructing their own portfolio, some possible diversifiers would be:

- ▶ UK Government bonds (particularly index-linked) can deliver a positive real return and should perform relatively well in a “risk off” environment.
- ▶ Higher quality asset backed securities could also deliver some benefit in turbulent markets, as although the additional yield on credit is historically tight, asset backed securities still command a reasonable additional yield over cash, and in excess of corporate bonds (see chart 8).
- ▶ Other diversifiers such as real estate and infrastructure can also provide some bedrock to a portfolio in turbulent times, if liquidity constraints allow - and can potentially be picked up for a discount to NAV on the secondary market.

Chart 8: Asset Backed Securities spreads versus corporate bonds



Source: Insight Investments

In addition, currency exposures do also need to be considered - for Sterling investors, we believe that hedging this exposure when it is cost effective to do so makes sense, as losses from overseas investments can be compounded by currency moves.

Summary

Overall, we expect that the US administration will continue to dominate the news agenda, and there is clearly a risk of policy mis-steps that could harm global growth and investment markets. That said, there remains value in many equity markets and changes to supply chains could result in subtle changes to equity leadership. We expect that other geographies and sectors will continue to challenge the US and the “Magnificent 7” who will face a challenge to keep up with market expectations.

We believe that more geographical diversification to Europe and emerging markets, and an allocation to private markets can all help improve the prospects for growth portfolio returns.

In addition, given the increasing risks to the downside, in particular geo-political risk, we would also encourage investors to consider their portfolio’s resilience to market shocks and ensure there are allocations to assets that would maintain a reasonable return even in challenging circumstances, such as government index-linked bonds and asset backed securities. Infrastructure and real estate can also help dampen returns in troubled times.

Find out more

For further information, please get in touch with Alasdair Gill or speak to your usual XPS contact.



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