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# Lessons for 2026?



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# Lessons for 2026?



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## A HIGH-ALTITUDE, PARTISAN REVIEW OF 2025

When we look back at its numbers, 2025 may seem dull: modest growth, stable if sticky inflation, falling interest rates, healthy profitability, positive returns on most assets. Beneath the headline stats, however, and at the counterfactual level of what almost happened, it has been remarkable. So what should we keep in mind as we lift and drop 2025's issues into 2026? Some of the points below will be familiar to regular readers...

### GEOPOLITICAL STRESS

The start of Trump's second term has defined the year, and the "Liberation Day" antics – and panicked responses to them – will be hard to forget. Polarised politics and looming mid-terms in 2026 mean that renewed federal shutdowns and lame duck government may be just around the corner (Ed: Is this a bit like criticising the restaurant with bad food for having "such small portions"?).

Many pundits still take Trump literally, not seeing that he may not be trying to communicate, but to provoke, to unsettle. They also forget that his focus – on the Beltway, unfair trade, economic migration, European defence, "culture wars" – reflect issues taken seriously by many US voters.

We may not be fans – among other things, the "MAGA" notion of reindustrialising the world's most successful big economy is surely misconceived – but from early in his first term we have suggested that an idiosyncratic US president need not lead to disaster. We have drawn parallels with Reagan, another

unconventional and (initially) derided US president. Now as then, belligerence and incoherence might yet produce constructive outcomes. As the year closes, where are the voices in favour of Europe not spending more on its defence?

Conflict has dogged the year (again). The IISS report that "The number of active armed conflicts worldwide, and their average duration, remain among the highest in decades". The ceasefire in the Middle East is fragile, and movements towards a Ukraine ceasefire remain tentative (that said, both are US initiatives, not Europe's).

While the human toll has remained grim, however, in the impersonal realm of economics and finance, the impact has stayed muted. Energy prices have been soft – oil prices are well below their real-term trend, European natural gas prices are close to pre-invasion trends – and shipping has been largely unimpeded.

Things could always deteriorate further, of course.

If China were to act on its non-negotiable claim on Taiwan, for example, all economic bets would be off. Even if armed conflict were avoided, the economic hostilities which would ensue would be daunting. Russia's economy is too small and isolated to have a big impact – even in the case of energy – but China's is huge and integrated.

Populists could take control in (more of) Europe. Governments in France, Germany, the Netherlands and even the UK have been shaky. Columnists are falling over themselves to draw troubling historical parallels. Might

the single currency be at risk? Will the social fabric – perhaps the commercial fabric too – be stretched beyond breaking point?

Overall, however, we continue to think China will remain patient, not because of altruism but because it recognises the risk to its own prosperity, and the logistical challenges, posed by drastic action. Meanwhile, the wider populist challenge may be misunderstood. Has a fifth of Western electorates really suddenly become nastier (or “deplorable”)? Or, as we suggested way back in 2016, is populism instead a classic protest, a case of “sticking it to the man”, with mainstream parties cast as “the man”?

More generally, we stay wary of fashionable “Big Picture” analyses. It is way too soon to write off liberal democracy and the mixed economy (despite all those books doing just that). Conflict is at multi-decade highs, but it has rebounded from more historic lows.

#### **BUSINESS AS USUAL?**

The economy was not the issue in 2025 – though it seemed like it could be.

Tariffs can be game-changers, downwards. On April 2nd it looked to many – taking that whiteboard literally – as if they were about to do just that. But so far, the shocks they are posing to business resemble those occasionally posed by (for example) exchange rate moves: bad, but not disastrous.

Re-escalation is certainly possible – but so are more conciliatory (or even expansionary) regimes. Remember the serious point here:

China, not the United States, is the most protected big economy.

At year-end, business surveys mostly remain in middle-of-the-road territory. Industry looks weaker than services, but there are still few signs of a looming downturn. World trade has been trending higher, at least to September, and at a faster pace than in 2024 (another irony is that UK-EU trade, after faltering in 2024, has stabilised and started to grow again – at significantly higher levels than when the UK was actually in the EU).

The bellwether US economy has probably grown only a little more slowly than usual in 2025, and its private sector – businesses and consumers together – was still running a financial surplus (that is, savings outpaced investment) in the first half of the year at least, despite massive AI-related capex (of which more below). As usual, the eurozone has been more sluggish, but has likely grown nonetheless, and by more than initially seemed to have been the case; meanwhile, the stimulus from that higher defence spending looms. China continues to struggle with its real estate hangover, but its economy is likely to have grown by another 5% in 2025.

The lesson here for 2026, perhaps, is (again) to keep an open mind. People talk often about the global economy’s fragility, but we are struck by its resilience. In the last six years it has withstood the forced closing and reopening triggered by the pandemic, the sharp “normalisation” of interest rates (remember all those forecasts of how borrowers wouldn’t be able to cope?), and now the biggest rise in tariffs for many decades.



More strategically, talk of the dollar being replaced as the world's reserve currency any time soon remains fanciful, not least because neither the renminbi nor the euro can easily assume that mantle while they have structural balance of payments surpluses...



Fiscal support has helped – particularly during lockdowns – and may continue to do so: there are few signs of budgetary hawkishness looming in 2026 (as noted, European public spending's contribution to growth is more likely to rise). But credit is due to two much-maligned players: the integrated global supply chain, and the US consumer.

#### **POLICY: WE NEED TO TALK ABOUT KEVINS**

Western unemployment has been rising, but gradually, and from low levels: if GDP continues to grow, stubborn inflation may be the more important macro risk for investors.

Admittedly, this is almost our default stance. After falling back quickly from the post-pandemic surge, UK inflation has stuck in the 2-4% range, as we'd thought it might: above a widely-shared 2% target, but not enough to do much commercial damage.

Will central banks react to this overshooting? Or will they opt for a quieter (and more popular) life and tolerate it. Is "3" the new "2"?

In the US, the situation is complicated by political interference. Trump has been publicly urging the current Fed chair, Jerome Powell, to lower rates further and faster. When Powell's term expires in May, the front runners to succeed him are Kevin Warsh and Kevin Hassett. Both are experienced and credible economists, but Hassett would be seen as a partisan appointment.

For what it's worth, we do not think that the Fed's decision to resume rate-cutting from August, after a creditable eight-month pause, has been due to Trump's browbeating. And even if the "wrong" Kevin gets the job, we doubt

that he will be dogmatic in practice (or able to carry the rest of the FOMC if they were to try).

That said, independent central banks are no guarantee of sound policy. We trust them to repeat their own mistakes (the SNB excepted of course). A potential rethink on interest rates is one of the macro concerns we take forward into 2026.

#### **VALUATIONS**

Most high-quality long-dated bonds currently have yields in firmly excess of targeted inflation rates, in marked contrast to the situation in 2020/21: valuations are reasonable, if not compelling. (That said, corporate bonds look expensive, at least in relative terms – their "spread" over government yields is close to record lows.)

Stock prices look very elevated in terms of recent or trend earnings, dividends and book values, and have only been noticeably more so back in 2000 (not a happy precedent). Against bonds they look less stretched – the general level of interest rates now is a lot lower than in 2000 – but are still on the dear side.

It can be a mistake to use valuations to tactically "time" the market (as we have noted many, many times). Even now, at these levels, there are upside risks. For example, geopolitics often (usually?) has little market impact, as noted, but a convincing deal in Ukraine could boost investor risk appetite, and also keep a lid on inflation (via lower primary costs) and lift output. As noted, we should keep our minds open – even as the most visible risk to valuations we think may point in the opposite direction.

## CURRENCIES HARD AND SOFT

A weaker dollar has hit global portfolio returns for non-US based investors in 2025. Most of the year's move – very roughly a 10% fall against the euro, as we write on December 15th – happened in the first half, since when it has been broadly stable. Intriguingly, there was a similar (ultimately larger) move in the first year of Trump (I), which was eventually mostly reversed.

Our conviction on exchange rates was low to begin with, and stayed so through the year, and for most of the year we've been thinking – in our “top down” fashion – that it may be time for another region to assume stock market leadership (though mostly for reasons other than currency-related ones: see below). That said, we remain undecided as to which region that might be – and as yet, none has stepped up. The dollar was expensive in late 2024; however, it was not outlandishly so, and we also felt (rightly) that US interest rates might fall more slowly than expected, which might have offered support.

More strategically, talk of the dollar being replaced as the world's reserve currency any time soon remains fanciful, not least because neither the renminbi nor the euro can easily assume that mantle while they have structural balance of payments surpluses (and capital controls in the case of China). Mr Trump may wish the dollar lower still, but it's not just up to him.

The weaker dollar, and falling interest rates, have added to the attractions of gold, which has surged by two-thirds in 2025, to a new real-terms high (finally topping 1980's peak). In contrast to the case for today's digital currencies (admittedly, future technologies may be more suitable), we can see a case for gold in long-term investment portfolios. It has intrinsic value, independently of governments and central banks, and the longest track record of any investment asset. However, that undoubted value is impossible to pin down precisely, and gold's long-term chart now looks exponential, leaving it vulnerable perhaps to a hawkish rethink on interest rates during 2026.

## ARTIFICIAL INTELLIGENCE...

Stocks-wise, this is what 2025 may be most remembered for. It won't show up in those tables, but this was the year in which people stopped referring to a “narrowly led market”

and began talking about a possible “bubble”. Increasingly, parallels are being drawn – some of them by us, as per “Market Perspective” – between the role played by Artificial Intelligence now, and that played by the internet and mobile comms in 2000.

Those parallels are still only partial. Still missing now is the surging corporate leverage, and frenzied, over-ambitious M&A, that we saw in 2000. And as noted, valuations – and the shape of the price charts – are a bit more subdued.

Froth is increasingly visible, however. Moreover, some of the revenues and cashflow underpinning today's elevated prices may be only one step removed from 2000's mirage. Much of it derives from capital and energy outlays which could yet evaporate if (when?) it becomes clearer that AI is not going to transform the outlook for business profitability outside the tech and communications sectors. Today's revenue is driven by the purveyors of the new technology, not grateful end-users. Whisper it quietly, but the internet, eventually, may have been more genuinely transformational.

The revelation may not be imminent, or sudden. Other, more positive developments may take away its sting (such as a more conventional cyclical upswing). But when the penny drops it could leave even some of the larger, currently cash-positive stocks looking a bit like Wile-E-Coyote.

Most business and investment problems – like those in life more generally – are not “computable”. They might be susceptible, instead, to non-algorithmic analysis, but the idea that such analysis will soon be provided by machines remains the stuff of science fiction – whatever our favourite TED talk says. It will come, for the foreseeable future, from the genuinely and generally intelligent, conscious entities such as the cheap, low-energy, wet-wired model known as “the human brain” (and perhaps predominantly from its right hemisphere...).

*“Is it not ‘obvious’ that mere computation cannot evoke pleasure or pain; that it cannot perceive poetry or the beauty of an evening sky or the magic of sounds; that it cannot hope or love or despair; that it cannot have a genuine autonomous purpose?... This is the kind of obviousness that a child can see...”*  
– Roger Penrose, “The Emperor's New Mind”, 1989



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