

# STRATEGY & OUTLOOK

# Market Update

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## 2026 Outlook - Batten Down the Hedges as Market Generals Slowly Surrender

The bullish early bird may catch the worm, but we'd rather be the second market mouse and get the cheese this year. Changing market leadership, complacent investors, inconsistent macroeconomic data and expensive valuations means the Funds are positioned cautiously as we enter 2026.

Our asset allocation is down at the lower end of the allowable ranges. Our equity holdings are concentrated in a combination of lower risk, higher quality sectors. Our fixed income holdings are overweight duration, that is to say they own longer dated bonds in greater numbers than their benchmarks. After almost three explosive years for markets, during which our multi-asset funds materially outperformed both their passive benchmarks and active peers\*, the overall beta of the portfolio, or market risk, is amongst the lowest it has been for a long time. We have materially rotated our positioning over the last three months.

The main source of underweight in the portfolio comes from our positioning in US and US tech like names in particular. We took the difficult decision in early Autumn to materially reduce exposure to almost all aspects of the AI theme. A brief recap from our Q3 outlook as a reminder of why we took this decision; ***“this is speeding up the arms race for other hyperscalers is also a problem. The current run rate of investment will see them invest ever increasing amounts of their free cash flow into capex, and perhaps even having to resort to other forms of financing. The weight of this***

***AI buildout may eventually begin to weigh on even the broadest of MAG 7 Share price shoulders in the form of multiple de rating. From hyper scaling to hyper spending. The risk profile therefore of this capex cycle is transforming from a public market cash fuelled one to perhaps a private market debt fuelled one. The implied capex, capital, and power requirements for the latter half of this decade post the recent news announcements seem in the short term unobtainable and ripe for short term disappointment.”***

With the risk profile of these market generals changing one has to naturally question the valuation premium the US market still enjoys. Entering 2026 this is about as expensive as the S&P500 has ever started a year. Current earnings growth will be strong, and more rate cuts are coming but we would argue these are required to keep the market here as opposed to being new catalysts. It is surprising that, according to various market positioning indicators we follow investors are carrying their lowest level of cash ever into 2026. This level of complacency belies the inconsistent and challenging macro and micro issues the market faces in early 2026. The performance of the regional darlings of

\*Source: Monemate & CFAM as at 31.12.2025.

## There is an inconsistency in the US economic data that makes one pause for thought.

2025, Emerging markets and Europe, was largely driven by re rating as opposed to earnings growth. This feels difficult to repeat in 2026.

There is an inconsistency in the US economic data that makes one pause for thought. The consumer slowdown is continuing and broadening away from just the lower end but should be helped by a one-off tax refund season that will be above average. Excess savings are now essentially depleted and back to pre-covid levels, but net household wealth is at an all-time high. Unemployment is slowly drifting higher however it could be driven by demographics and immigration policies. The jobs market at the moment is in a “no hiring but no firing” phase. Although the financing and further acceleration of the recent capex boom is under question, the actual spending levels are not and should continue to keep GDP elevated. Even though lead economic indicators continue to show weakness US GDP will continue to float around 3% for the first half of the year. There are no signs of credit stress in markets and bank earnings but the shadow banking sector is showing alarming if anecdotal issues.

The re-emergence of inflation as the political issue in the US at the end of 2025 was a classic example of Wall Street versus Main Street. Wall Street thrilled with inflation of only 2.9%. Main Street horrified that the price level is not only elevated above pre-covid trends but still growing at 2.9%. How this plays out ahead of the mid-terms could be a key catalyst for markets. There simply may not be the political room for the new Fed chair to cut rates as much as Trump would like as any escalation in inflation from here would be ballot box wipe out for the Republicans. Ironically, a credible new Fed Chair could be a risk to the market’s risk appetite. Recent polling indicates the electorate sees this inflation as Trump’s problem, with the tariffs front and centre to it.

The administration has been quietly tweaking some of the more consumer facing tariffs recently. Their reaction to the imminent supreme court ruling on tariffs will be interesting to watch. Equity markets, through higher sales growth have largely benefitted from the strong inflationary and nominal GDP backdrop that has characterised the post-covid investment environment. Continued falling inflation and the ensuing more favourable rate environment should be a tailwind but only up until a point. Pricing and margins may be too elevated for the consumer to withstand. Demand destruction and pockets of deflation, whether through overtly tight policy or a consumer recession are a risk in 2026 to lofty earnings growth expectations.

Another post-covid risk that has re-emerged in the latter half of 2026 is that of supply chains, or in particular the weaponisation of supply chains. Unprecedented price squeezes in things from Metals to Memory will begin to disrupt in early 2026. Some of these moves are policy driven and in particular a result of the tariff war moving into a broader trade war. Worrying about geo-politics for equity investors is the widow-maker of many a potential career but it is hard to ignore the global escalation in tensions recently. The US has blockaded Venezuelan oil, captured its Leader and bombed Nigeria over the Christmas Break. Russia/Ukraine appears further from resolution than ever, Iran is back making nuclear weapons amidst a sea of protests. China just enacted its largest ever mock invasion of Taiwan. On the flip side it looks like the US relented and is allowing Nvidia sell high end chips to China.

We are overweight long-dated bonds. Our concerns around fiscal sustainability have been abated as western governments have gone from trying to borrow their way out of the deficits into taxing their way out. Recent developments in the UK and France show no one wants to repeat the Liz Truss bond market meltdown. Increasing taxes to fund fiscal deficit’s (the US is essentially doing this through tariffs too) solves the bond market’s problem but creates one for equities as global growth and earnings at the margin are worse off. A global tax war may replace the trade war as the US threatens to reignite its section 899 threats from earlier in 2025. Allied to the fact of a global shift out of issuing long term bonds, from Europe, the UK and Japan into issuing shorter dated maturities should also help longer term yields fall as they slowly reflect the slowing growth and inflation backdrop globally. Long bonds look like a sensible investment to start 2026. In a low or falling inflation world the hedging characteristics of bonds versus equities should also reassert itself.

We are overweight defensive and high-quality equities. Given the macro backdrop we see for H1 this would seem sensible in and of itself however that is not the main driver. This portion of the equity market is where we currently see the most stability in earnings and relative attractive valuations. As the AI frenzy reached fever pitch, the relative valuation and positioning in quality stocks reached multi year lows, throwing up interesting opportunities for our active, style agnostic approach. We are overweight the UK and Europe, in particular their banks and utilities, both electrical and water. Water is a new theme for us in the portfolio with exposure to US industrials involved in the full water

life cycle. In the US we are overweight healthcare and software. Med-tech is of particular interest this year. We also have assembled a basket of mis-perceived “AI losers”, high quality companies that have materially de-rated. These are across multiple sectors ranging from financial services, publishing, consulting, and software. Some pockets of consumer staples look very interesting, especially those whose end markets are positively exposed to the second order positive effects GLP1s are having and the ongoing health and beauty

trends amongst consumers. Subscription services, especially those who own the IP content continue to be an overweight for us as that Quality IP should be worth more in an AI world. Impressed by the ability of traditional companies to maintain if not grow cash margins as the oil price fell, alarmed by the lack of any risk premium in the oil price given the geopolitical tensions, excited by future sources of energy, namely nuclear, energy is therefore also an overweight for us.

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