

## The Great Rotation in stocks

24 February 2026

**Just when things seemed to be calming down on the US policy front, global trade uncertainty flared back up. More selling of AI-threatened stocks also followed, yet lots of shares keep going up.**

The strapline for the film Jaws 2 could apply to equity markets, “Just when you thought it was safe to go back in the water...”

A few weeks with no big policy statements from President Trump had seen a modicum of calm settling over financial markets by the end of last week. But that peace was shattered on Friday afternoon by the Supreme Court of the US (SCOTUS) ruling that the ‘liberation day’ tariffs imposed under the 1977 International Emergency Economic Powers Act (IEEPA) were unlawful. Cue more uncertainty around global trade.

As with lots of political events in the US, this drew attention from other matters, but that won’t stop me from fulfilling last week’s promise to say more about what’s been going up in markets while AI-threatened sectors and stocks have been falling out of bed.

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### Quick take:

- Trump tariffs were ruled illegal, spurring new trade uncertainty.
- A fresh wave of selling also hit companies perceived to be threatened by AI.
- But plenty of other stocks and sectors are still going up.

### Trump overruled

The 6-3 SCOTUS ruling was notable for the fact that two of the three justices who were considered to be more politically aligned with the President, yet voted against him, were Trump appointees. There’s hope yet for an independent judiciary to uphold the Constitution of the United States.

However, we knew immediately that this would not be the end of tariffs as other means are open to the President (see figure 1 below). These were originally enacted to address issues such as national security, unfair foreign trade practices and discrimination against US commerce. Indeed, the first two are already in force against some countries.

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In the event, Trump went straight for section 122 of the Trade Act of 1974, initially with a 10% universal tariff, which he quickly raised to the upper limit of 15%. This tariff has a shelf life of 150 days before it needs to be approved by Congress, which takes us to 23 July. That's still three months or so short of the mid-term Congressional elections. It might give the President a chance to extend, but only if no Republicans vote against it. We should prepare for lots of horse trading and browbeating and expect to see more action on other tariff measures left available after the Supreme Court ruling.

**Figure 1: Avenues still available to Trump**

Law / Section	Status after SOTUS ruling	Uses and core limitations
IEEPA (1977)	✗ Cannot be used for tariffs	No tariff authority
1974 Trade Act §122	✓ Available; implemented by Trump following SOTUS ruling	Current account imbalance 15% cap, 150 days
1974 Trade Act §301	✓ Available	Unfair trade practice US Trade Rep investigation
1974 Trade Act §201	✓ Available	Protection from import surges Product-specific, investigation
1962 Trade Expansion Act §232	✓ Available	National security Commerce dept investigation

Sources: relevant statutes, US Federal Reserve, Bureau of Economic Analysis

Trump also laid out plans for a deeper investigation into section 301 tariffs (unfair foreign trade practices), requiring an investigation by the office of the US Trade

Representative, with China likely the main target. Even so, there is no great expectation of immediate action on that front as Trump appears to be taking a softer tone with China at the moment. He and President Xi are due to meet in Beijing in April. Meanwhile, he'll have to balance his 'make America great again' rhetoric with the need to keep the domestic economy firing on all cylinders.

To which end, any reduction in tariffs potentially takes a bit of inflationary pressure off US household budgets and provides extra support for corporate profits, although it of course also increases the fiscal deficit. The full implications are as yet unclear, not least because any decision about refunding tariffs already collected (around \$175bn) has been deferred to a lower court.

Outside the US, this could mean lower tariffs on imports from China, but it's probably too early to assume that the new rate is the final outcome given the policy volatility over the last year. For now, countries that had enjoyed 10% rates, which include the UK and Australia, will lose out from the new 15% rate.

The overall market reaction was relatively muted, partly because there was a high expectation (75% in betting markets) that SCOTUS would deliver this ruling, although the timing was always going to be uncertain. But it does remind us not to be

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complacent when it comes to US politics. And the volume will only increase ahead of November's mid-terms.

### Who is winning in the stock rotation?

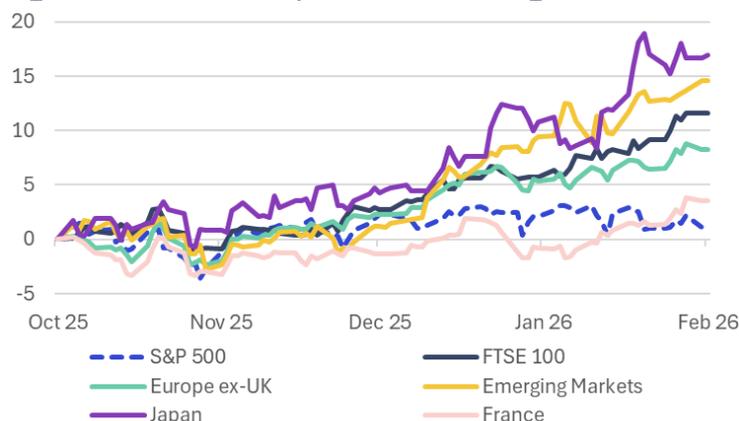
As I commented last week, the relative surface-level calm in major equity indices and balanced portfolios masks the wild gyrations that are occurring beneath the markets' surface. The rot set in at the end of October when investors began to question in earnest the future returns on current AI-related capital expenditure.

Since then the market's former leaders, the Magnificent Seven group of mega-cap technology stocks, have fallen a not-so-magnificent 7% as a group. But software services companies and those that rely on huge troves of data to provide their services and products have borne the brunt of the selling. The MSCI Software & Services index has fallen 27.5% in those four months since the end of October.

However, fears that such a sell-off would bring overall markets down haven't come to fruition. Over the same period, the MSCI World Index is up 3.4% (in dollar terms) while the S&P 500 has risen 0.7%. One way of observing how gains have broadened out is to look at the equal-weighted version of the S&P 500 (which as the name suggests gives an equal weight to each company, rather than weight them by the size of the company). This is up 8.9%.

In local currency terms the FTSE 100 is up 11.6%, MSCI Europe ex-UK 8.2% and Japan's TOPIX 16.9%, while the MSCI Emerging Markets index is up 14.5% in dollar terms (all figures are total returns). Several of those ended last week at all-time highs, which might come as a surprise to many given the media's predilection for doom-laden headlines. Even politically challenged France has scaled new peaks.

Figure 2: Non-US equities at new highs



Sources: FactSet, total returns in local currency (EM in \$); rebased to 0 from 24 Oct '25, as at 24 Feb '26

### Real stuff versus artificial intelligence

There are two factors at work here. One is a rotation into the companies that produce real stuff and not intangible intellectual property. Some of this is down to the lower likelihood of their products or services being disrupted by AI. Sectors such as Healthcare (9.5%) and Consumer Staples (13.3%) were often largely 'under owned' by active managers and there has been a rebalancing of positions.

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But the bigger winners have been companies benefitting from the AI-related capital expenditure and also the willingness of many governments to dial up spending on things like defence and infrastructure. The global materials sector has risen 23.9% with industrials up 13.5%. And don't forget geopolitical tension, which has put a bid under the price of oil again. The energy sector is up 21%.

New investment money has also been favouring non-US markets rather than being attracted to the large cap US magnet as it has been for several years. This is partly down to the more favourable sector exposure outside the US. There has also been a bit of buyers' strike on US financial assets in the current political climate, although we have not seen a

headlong exit. The wheels of asset allocation tend to turn very slowly for large US institutions such as pension funds and endowments, and they really haven't had to contemplate this sort of situation for many years. Home bias had paid off. Not so much now. It would be reasonable to expect more allocations to head abroad from the US.

It might *not* be reasonable to expect *similar returns* to be repeated over the next few months, but the aphorism that "the only free lunch in investing is diversification" seems to be holding true again. We try never to 'bet the farm' on narrow outcomes. Sometimes, that can mean lagging the most positive returns, but it provides a lot of comfort in more testing times.

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## Weekly Digest Regional highlights

**UK.** The government achieved a £30.4bn surplus in January as self-assessment tax payments for the 2024/25 tax year poured in. This was £16bn higher than in 2025 and also above the OBR's forecast of £24.1bn. The freezing of income tax thresholds played some part in this bonanza, as did a bumper haul of capital gains tax (CGT) receipts. The latter reflect asset sales made as long ago as autumn 2024 when investors were concerned that the Chancellor would raise the CGT rate to a much more punitive level. That surge is unlikely to be repeated. Although revenues were stronger than expected, spending shows no sign of being reined in. January's month-on-month increase of 1.8% in retail sales pointed to a more positive start to the year than expected, with sales volumes now at their highest level since August 2022. Even so, a rise in the unemployment rate to 5.2% suggests that we should not get too carried with this piece of good news either. GDP growth forecasts for 2026 are huddled around 1%.

**US.** Headline fourth quarter GDP growth of just 1.4% on an annualised basis caused a bit of a stir, being down from 4.4% in Q3 and less than the 2.5% rate expected. We caveat that the quarterly beats and misses can often look bigger than they really are, being multiplied by four to get the annualised rate. There are lot of moving parts in the GDP data at the moment owing to tariff-related effects. Inventory movements of pharmaceutical products and precious metals, for example, have been volatile.

The government shutdown which extended into Q4 also affected the data as services were not delivered and workers left unpaid. Away from the distortions, personal consumption rose 2.4%, as did final private demand. These are perfectly respectable figures. Business investment rose by 3.7%, with AI-related spending a key feature that will continue to be a growth driver at least through 2026. Stickier-than-hoped-for inflation was a concern, with the Core PCE price index rising from 2.8% to 3%. This is the Federal Reserve's preferred price measure and so potentially reduces rate-cut expectations.

**Europe.** All eyes are focused on whether Germany can regain its status as the powerhouse of European growth. Encouragingly, the Ifo business index rose for the first time in four months to reach a six-month high. German businesses' assessment of current conditions and expectations for six months ahead both improved in February by similar amounts, with current conditions reaching a 19-month high. Gains were broad-based across sectors. The services business climate improved for the first time in three months, with expectations driving the solid gain at the headline level. The construction index rose to its highest level since the start of the war in Ukraine. Data for manufacturing was more mixed with current conditions driving a second consecutive overall gain, but expectations posted a setback. This echoed a one-point rise in the composite PMI index of business activity to 53.1.

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