



Weekly Digest

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Fast forward

As the new year begins, investors could well be facing similar themes and patterns to last year, and another test of patience. We continue to believe those who can wait will be rewarded with longer-term gains.

One of the joys of a world where most of the catalogue is on demand is that you can binge-watch old TV programmes when the January social calendar is slow and there's nothing about the weather that makes you want to venture outdoors for long. My wife and I were latecomers to the cop show *Blue Lights*, set in Belfast, and had no difficulty bashing through the first three series in a week. Back in the day, we would still be anticipating Series One, Episode Two!

A Marshmallow Test for investors

But the trouble with this sort of world is that it makes everyone impatient. Where is the next hit going to come from? (We're holding off on *The Night Manager* until we can have a good run of episodes of that - I never took the Marshmallow Test as a child, but I think I would have 'passed'!) This mindset appears to apply equally to electorates, politicians and investors. Voters increasingly clamour for more handouts and politicians readily promise

Quick take

- The new year has picked up where the old one left off, with markets hitting new highs.
- More ups and downs on geopolitical tensions and genAI developments are likely.
- But we believe patient investors should continue to be rewarded.

them. Many investors are constantly searching for the 'next big thing' rather than relying on the longer-term compounding of steady returns. And increasingly using borrowed funds to accelerate the process. This may produce a short-term sugar rush, but it can come at the expense of long-term fulfilment. As investors this year we may be facing a Marshmallow Test, which we'll need to pass by balancing those timelines.

Here we go again!

A week or so into the new year, the market pattern feels familiar. Global (and many regional) equity markets (in the 'risk assets' bucket) have made new highs. But the traditional safe havens of gold and silver have also hit new peaks. Bond markets are relatively unmoved, as they were in 2025. We

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have already had a slew of geopolitical headlines, starting with US intervention in Venezuela, which led on to threats to other countries and territories including Colombia, Cuba, Mexico and, of course, Greenland. If markets seem somewhat flummoxed by the situation, maybe it's because there's no precedent for one Nato member potentially invading another one.

The Middle East is also back in focus, with the situation in Iran becoming increasingly unstable and the potential for the US to become involved in regime change. And over the weekend we had a new episode in the saga of the US government interfering in monetary policy, as grand jury subpoenas were issued to the Federal Reserve and its Chair, Jerome Powell. The charge is one of misleading Congress as to the nature and costs of renovations to Fed buildings. The irony cannot be lost on those observing the demolition of the East Wing of the White House, to be replaced by a ballroom. Already an unusual degree of opposition to this 'lawfare' is mounting among Congressional Republicans, potentially threatening President Trump's as-yet-unnamed nominee to replace Powell when his term ends in May.

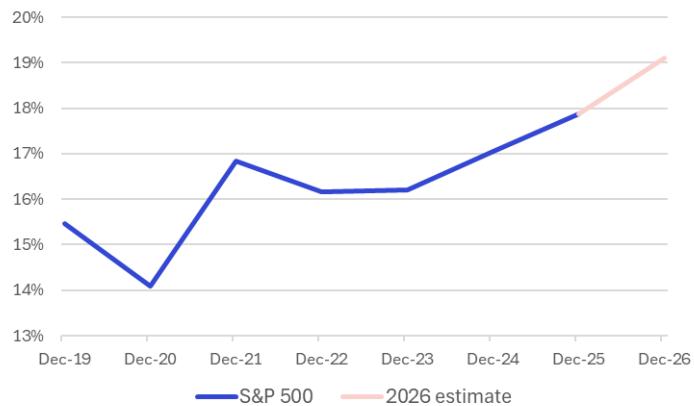
If you thought that 2025 was wearing, then the only consolation is that you are match-fit for more of the same in 2026 – with the added spice of US mid-term Congressional elections in November. I think we can take it as read that Trump will pull every lever available to drum up support. This year he has already asked federal agencies to purchase \$200bn of mortgage bonds and proposed outlawing institutional purchases of residential property to combat the poor affordability of homes (another reason for his pursuit of the Fed). He has also suggested a twelve-month 10% cap

on credit card interest rates (which tend to start in the 20s). Don't rule out cash handouts.

The bottom line

At the end of the day, equity investors must cut through the noise and focus on the profits companies are producing. Here the outlook is favourable, especially as the probability of a US recession remains low. Forecasts are for US earnings to grow by around 15%, with emerging markets delivering the same or better. Expected earnings growth for UK and European indices is closer to mid-single-digits, but potentially subject to upgrades if their economic cycles pick up. However, there's little optimism about domestic growth in the UK and much scepticism about Europe's ability to apply more fiscal stimulus or lower regulatory hurdles successfully.

Figure 1: Continued robust earnings in the forecast*



Source FactSet, analysts' consensus estimates, as of 13 Jan; *profits before interest and taxes

First, we must draw a line under 2025 as we head into the fourth-quarter earnings reporting season, starting with the big US financial services companies. This is one of the sectors that has made a new all-time high already this year. Merger and acquisition activity is on the up and there is the promise of more initial public offerings this year, with

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huge ‘tech-forward’ private companies including OpenAI, Anthropic and SpaceX potentially coming to the market. No doubt such activity has the potential to mark a short-term peak in sentiment, especially if it sucks cash from other parts of the market, but let’s get there first.

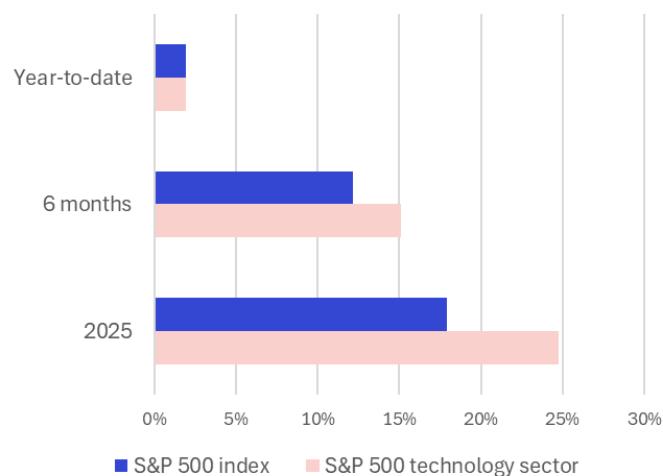
The development of generative AI is one big theme that will persist into this year. It’s pretty clear that capital expenditure on data centres will remain robust, at least for this year, with potential bottlenecks in, for example, energy supplies being a longer-term concern. A potential supply crisis at PJM, one of America’s biggest grid operators, is front page news in the *Wall Street Journal* today, for example. Even so, investors remain keen to see some return on this spending. That, in turn, will rely on more productive uses of AI tools by the users. Here I would focus more on corporate users than individuals.

One of the few companies explicitly to break out the benefits of AI is US logistics firm CH Robinson. It cited the automation of millions of manual tasks with fewer human errors, the ability to quote on new business in seconds (not hours or days), better customer service and the ability to optimise prices dynamically. Its shares rose 56% last year. Now that might not be on a par with AI-chip giant Nvidia’s almost thirty-fold gain over the past five years but imagine if more companies begin to report similar experiences. One of the key aspects of CHR’s success is that it created application-specific tools as opposed to using generic large language models. We would expect more companies to follow that path as adoption of the technology advances. Of course, competitive advantage means there could be losers too, and avoiding those will be key to investment success.

A little ‘aggro’ may be worth it

Investors appear to be contemplating some shift in market leadership this year (Figure 2 compares returns for the US tech sector and the wider index). Cyclically sensitive shares, those with lower valuations and smaller companies have started relatively strongly, especially in the US. And it’s positive and healthy that overall progress has been made despite a lacklustre performance from the Magnificent 7 leading technology shares.

Figure 2: US tech sector vs index total returns



Source: FactSet, Rathbones, as of 13 Jan

It’s very rare for equity markets to fall when earnings are rising strongly. That tends to occur when interest rates are going up because central banks are trying to rein in activity. But they’re generally in rate-cutting mode for now. The average strategist’s target is for a 10.5% gain in the S&P 500 by year-end. That even builds in a modest decline in prices relative to forecasted earnings, which is prudent. If returns in 2026 end up looking like 2025, we’ll happily put up with the aggravation.

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Economic highlights

UK. Downward revisions to the December PMI surveys of business activity confirmed the lack of momentum in the UK economy. Services dropped from 52.1 to 51.4 (numbers above 50 represent expansion), and manufacturing from 51.2 to 50.6. That left the composite reading at 51.4 vs 52.1. Businesses reported lacklustre domestic and foreign demand, as well as ongoing cost pressures, notably for labour and fuel. This will make it harder for the Bank of England to contemplate further rate cuts soon. Market pricing for interest-rate futures suggests either April or May for the next quarter-point reduction. Meanwhile, households rolling off five-year fixed mortgages are facing substantially higher refinancing rates, another headwind to economic growth.

US. The unemployment rate fell back to 4.4% in December from a revised 4.5% in November (previously 4.6%). That's not to say the labour market is strong. Another 50,000 jobs were created (versus 70,000 expected). Allowing for the reduction in immigration, that's roughly the number required to keep the unemployment rate stable. There were downward revisions to previous months, although they did cover the government shutdown and the final departure of many government workers who had been on notice for several months. Healthcare and social assistance accounted for the lion's share of job creation. Sadly, these tend not to be high-paying jobs, nor especially productive. Even so, annualised non-farm productivity growth of 4.9% in the third quarter was more positive, suggesting that some areas of the economy could be benefitting from AI. It also helps to explain the persistent strength of corporate profitability. Overall, last week's data was not weak enough to suggest any need for the Federal Reserve to cut interest rates at January's meeting.

Europe. There was a mixed bag of data from Europe, and a similarly unexciting growth trajectory. The final PMI readings were revised lower here too, with services at 52.4 (vs 52.6) and manufacturing at 48.8 (vs 49.2). The latter continues to struggle from US tariff hangovers, weakness in China (a key destination for exports) and an influx of cheap Chinese imports (which could be construed as 'dumping' and might yet lead to the EU imposing more of its own tariffs).

The silver lining was a reduction in headline inflation from 2.4% to 2.3%, with the core rate (excluding volatile food and energy prices) falling to 2.0%. Even so, there's limited expectation of the ECB cutting the deposit rate below the current 2.0% in this cycle.

China. China's consumer price inflation (CPI) picked up modestly in December, while factory-gate prices continued falling, capping another year marked by weak domestic demand and persistent deflationary pressures. December's CPI came in at 0.8% (in line with consensus estimates and up from 0.7% in November), while the produce price deflation was less bad, at -1.9% (better than the -2.0% forecast and up from -2.2% in November). GDP is reportedly growing at close to 5%... But it doesn't feel like it.

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