Q3 2026 Market Review and Q4 Outlook

Our central view

We remain constructive as we move through Q4, but the margin for error has narrowed. Economic growth and corporate earnings continue to provide support, while the artificial-intelligence investment cycle is broadening into power, infrastructure, industrials and materials. At the same time, higher bond yields, elevated valuations and geopolitical risks argue for greater selectivity, stronger diversification and a renewed focus on cash flow, balance-sheet quality and valuation.

A resilient third quarter, but an increasingly nuanced backdrop

The third quarter was another positive period for equity investors, although the headline numbers disguised a considerably more complicated picture beneath the surface. The S&P 500 returned 2.3% during the quarter and had risen 12.75% for the year by the end of September, supported by better-than-expected economic growth, resilient corporate earnings and continued enthusiasm surrounding artificial intelligence and the associated capital-investment cycle. Global equities also advanced, while emerging markets remained one of the strongest-performing areas of 2026 despite making little progress during the quarter itself.

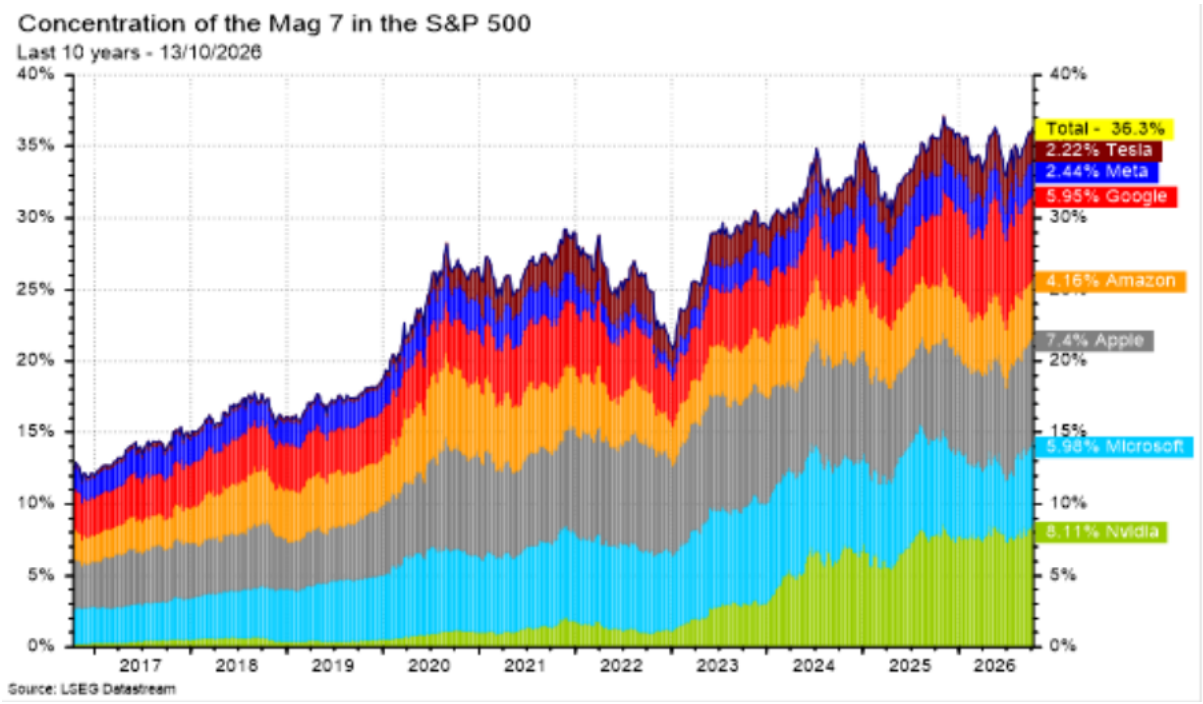
The experience elsewhere was less comfortable, particularly in fixed income, where stronger economic data, persistent inflation concerns and a more restrictive Federal Reserve pushed Treasury yields materially higher. The US ten-year yield increased from 4.47% at the end of June to 5.29% at the end of September, contributing to a 3.51% decline in the Bloomberg US Aggregate Bond Index during the quarter.

That divergence continues to encapsulate the investment environment as we move through the final quarter of the year. The US economy has proved considerably more resilient than expected, the labour market remains stable and corporate investment is strong, reducing the immediate risk of recession. However, that resilience is also complicating the path for monetary policy because inflation, while improving beneath the surface, remains vulnerable to renewed energy-price pressures.

Investors are therefore being asked to reconcile an encouraging earnings and economic backdrop with higher bond yields, tighter monetary policy and valuations that already discount a considerable amount of good news. We do not regard that combination as a reason to become defensive in itself, but it does suggest that the environment is less forgiving and that company fundamentals, valuation and portfolio diversification are likely to matter increasingly as the cycle develops.

Market concentration remains important, but breadth is improving

One of the defining characteristics of the equity market over recent years has been the extraordinary concentration of value within a relatively small group of US companies. The ten largest constituents of the S&P 500 now account for approximately 37% of its market capitalisation, almost twice their share in 2010, while the dividend yield available from the broader index has fallen towards 1%.



That concentration does not, in isolation, make us negative on US equities because many of the companies responsible for it remain exceptionally profitable businesses with strong balance sheets, significant competitive advantages and genuine earnings growth. Nevertheless, their success has raised expectations considerably, meaning that simply producing good results may no longer be sufficient when valuations already assume that exceptional growth can be sustained for a prolonged period.

There were encouraging signs during Q3 that the opportunity set was becoming broader. Performance between the largest technology companies and the remainder of the S&P 500 became more balanced, while improving earnings prospects became visible across financials, industrials and areas of the semiconductor industry outside the most obvious AI beneficiaries. The healthiest continuation of the current bull market would not necessarily require the existing leaders to fall. Rather, it would involve a wider range of companies participating as earnings growth spreads through the economy.

Artificial intelligence is evolving into a broader investment cycle

Artificial intelligence remains the dominant structural theme in equity markets, but the nature of the opportunity is changing in an important way. The initial phase was heavily concentrated in advanced semiconductors, cloud computing and the relatively small number of companies capable of providing the processing power required to train and operate increasingly sophisticated models.

The next phase is potentially far broader because the infrastructure required to support AI extends well beyond technology itself, encompassing data centres, electricity generation and transmission, cooling systems, networking equipment, industrial machinery and enormous quantities of physical materials. Estimates that total AI-related investment could exceed US$10 trillion by 2030 illustrate the scale of the capital cycle now under way and help explain why the consequences are increasingly visible across the wider economy.

There are also early indications that this expenditure is beginning to produce commercial returns. The economics of AI computing infrastructure have improved for hyperscalers and AI cloud providers, while a growing number of large US companies now cite a measurable financial benefit from AI adoption. That does not remove valuation risk, but it suggests the debate is moving away from whether AI can generate economic value towards the more interesting question of where that value will ultimately accrue.

We therefore want to retain exposure to the structural growth associated with AI while increasingly looking beyond its most obvious beneficiaries. Semiconductors remain important, but so do electrical equipment, power generation, grid infrastructure, industrial automation, engineering and the materials required to build this infrastructure.

Economic resilience is both a strength and a complication

The US economy continued to confound more pessimistic expectations during the third quarter. Second-quarter GDP growth was revised upwards to an annualised 2.2%, while first-quarter growth was subsequently revised to 2.5%. Underlying private demand was stronger still, suggesting that the economy entered the autumn with rather more momentum than previously assumed.

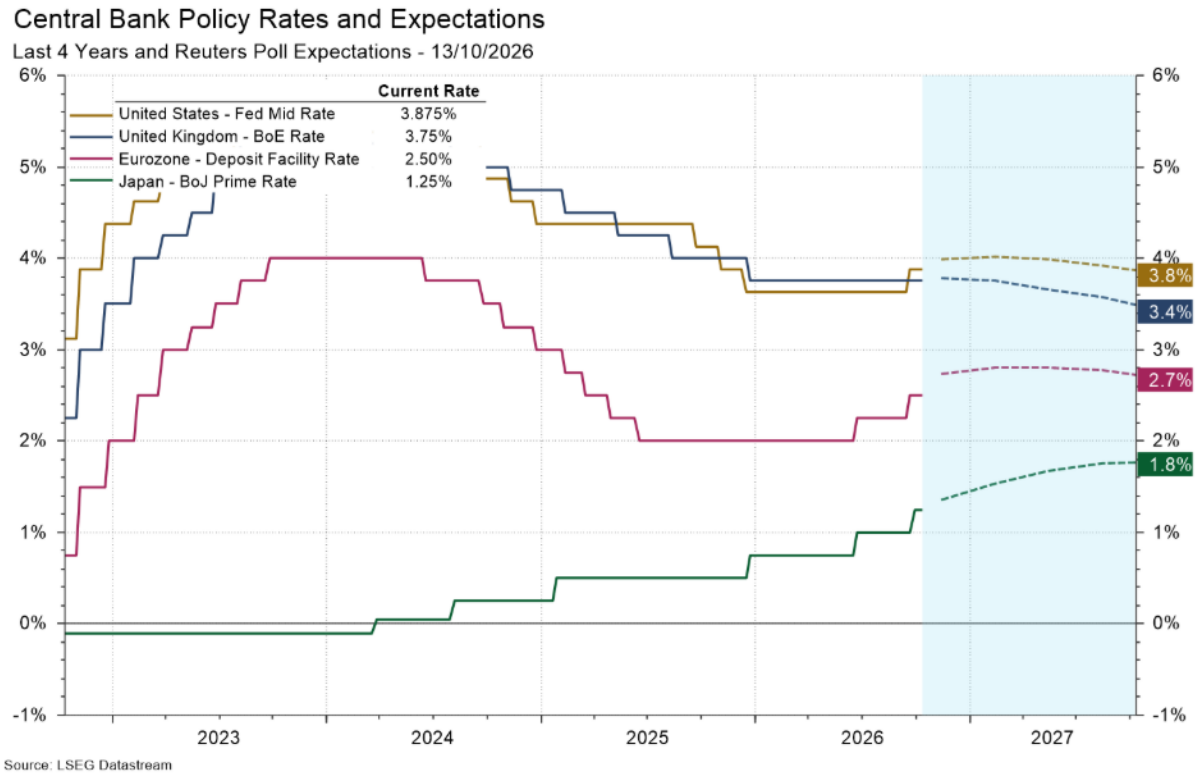
Employment conditions also remained comparatively stable. The labour market has therefore been better characterised as “low hire, low fire” than as one experiencing a conventional downturn, with employers displaying greater caution around recruitment without moving towards widespread job losses.

The consumer picture has been more complicated because resilient aggregate spending has sat alongside a marked deterioration in confidence. Higher-income households continue to benefit disproportionately from strong balance sheets and financial-asset values, while lower-income households remain considerably more exposed to food, fuel, rent and borrowing costs. As Q4 develops, we are therefore paying as much attention to the composition of consumption, credit conditions and household balance sheets as to headline retail-sales numbers.

Inflation is improving, but energy has complicated the final stage

There has been genuine progress on underlying inflation, with August core CPI falling to 2.4% year on year, its lowest level since early 2021, while core PCE moderated to 3.0%. Ordinarily, that improvement would make the direction of monetary policy easier to predict, but developments in energy markets have complicated the picture.

WTI crude ended September at $90.31, compared with $69.83 at the end of June and $57.42 at the end of 2025, while higher fuel costs placed renewed pressure on headline inflation and household finances. Against this backdrop, the Federal Reserve increased its policy rate by 0.25 percentage points in September, taking its target range to 3.75% to 4.00%, and left open the prospect that further tightening might be required. As per the below chat we have seen a meaningful increase in longer term rate expectations – the question is whether these implied rate rises actually occur.



For markets, the direction of oil prices remains almost as important as conventional economic data during Q4. A sustained easing in energy prices alongside continuing moderation in core inflation would give policymakers considerably more flexibility, whereas another upward move in crude could prolong restrictive monetary policy even if the underlying domestic inflation picture continued to improve.

Higher yields have made fixed income more volatile, but more interesting

The sharp increase in government bond yields created meaningful losses for fixed-income investors during the third quarter, particularly at longer maturities, but it also materially improved the prospective return available from bonds. The reset in yields means investors are now receiving considerably more compensation for holding high-quality fixed income than was available throughout much of the previous decade, restoring an important source of income and diversification within balanced portfolios.

We therefore see an increasingly useful role for fixed income, but not an indiscriminate one. Credit quality remains important, while maturity and the compensation received for assuming additional interest-rate sensitivity need to be considered carefully. Today's higher yields mean bonds can again make a significant contribution to portfolio returns without carrying the same economic risks as equities.

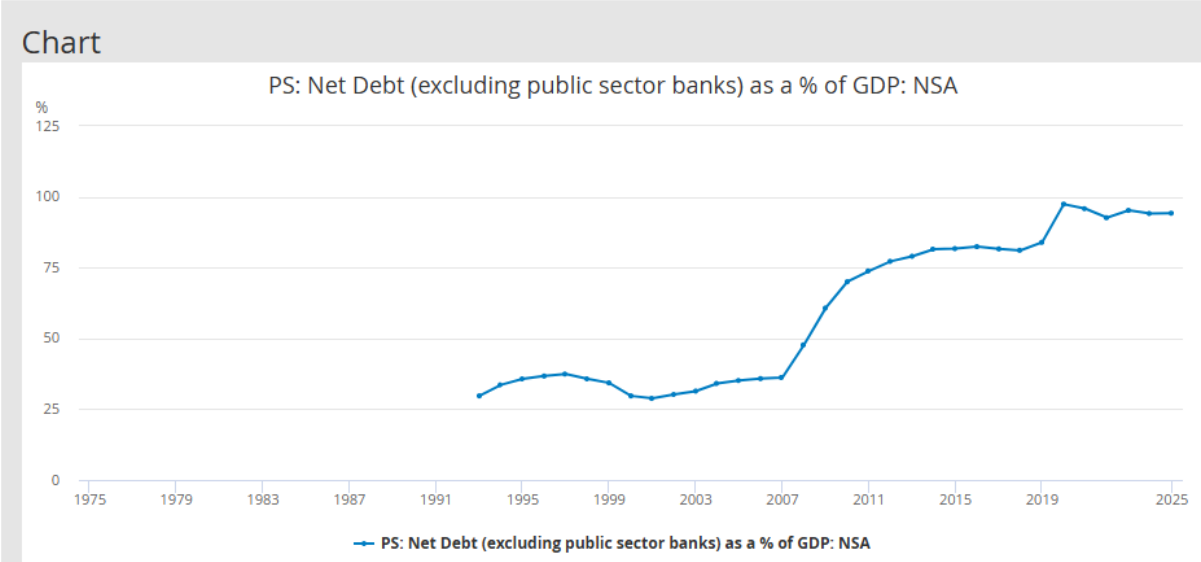
The UK Budget has now set the domestic fiscal direction

Closer to home, the Autumn Budget was delivered on 28 October and has now provided the Government's response to subdued growth, elevated borrowing, substantial debt-interest costs and competing demands for public spending.

The package was targeted rather than a broad tax-cutting Budget. Headline income tax, National Insurance and VAT rates were left unchanged, while near-term support was announced for household energy costs, fuel duty, selected business rates and first-home purchases. Revenue raising was concentrated on savings and property income, banks, selected businesses and tighter tax compliance.

For private clients, the most relevant planning changes include the two-percentage-point increase in the stated tax rates on savings and property income from 6 April 2027, the retention of the £20,000 cash ISA subscription limit, changes affecting first-time buyers, pension measures and the reduction in the Business Asset Disposal Relief lifetime limit to £500,000 from 6 April 2027. The Budget also maintained a substantial programme of gilt issuance against a backdrop of still-elevated inflation and higher debt-interest costs.

The key market question is now whether the combination of taxation, expenditure and borrowing is regarded as credible and sufficient to place debt on a sustainable path. The OBR forecast accompanying the Budget showed GDP growth of 1.2% in 2026 and 1.0% in 2027, with public sector net debt forecast to peak at 97.3% of GDP in 2028-29 as per the below chart. Fiscal headroom was stated at £15 billion against the stability rule and £24 billion against the investment rule in 2029-30.



For investors, the implications are mixed. The package is mildly supportive for lower-income households and selected sectors, but higher taxation of savings and property income increases the importance of ISA use, tax-efficient ownership and careful comparison of cash, gilts and other wrappers. Higher government borrowing and debt-interest costs also reinforce the need to remain selective across gilts, equity-income assets, property and highly leveraged businesses.

I have attached my UK Budget 2026 Review, which explains the principal measures, who is most affected and the implementation timetable in greater detail. Detailed legislation, consultations and HMRC guidance will ultimately determine how a number of the measures operate in practice.

Energy and geopolitics remain the clearest inflation risk

Geopolitical risk has become an increasingly direct economic variable because disruption in the Middle East affects not only market confidence but also the price and availability of oil, refined products and liquefied natural gas. The third quarter saw significant disruption to Gulf production and transport routes, sharp falls in inventories and substantial volatility across energy markets.

A meaningful improvement would represent one of the most constructive potential catalysts for the remainder of Q4. Lower oil prices would reduce headline inflation, ease pressure on household finances, lower transportation costs and potentially reduce the need for additional monetary tightening. The opposite is equally true, as further disruption could produce the uncomfortable combination of higher inflation and weaker real consumer purchasing power while simultaneously pushing bond yields higher.

Materials may be an overlooked beneficiary of the new investment cycle

One of the most compelling consequences of the AI investment cycle is that a seemingly digital revolution is creating very substantial demand in the physical economy. Data centres require large quantities of copper, steel, power capacity, batteries and transmission infrastructure, while electrification, grid modernisation and the increased focus on energy security are generating additional demand for many of the same resources.

At the same time, bringing new commodity production online has become more difficult. This mismatch between the speed at which demand can increase and the speed with which new supply can respond supports the case for selected materials and natural-resource companies. Rather than viewing them simply as a short-term hedge against higher commodity prices, we increasingly see them as participants in a long-duration investment cycle incorporating AI infrastructure, electrification, grid investment and energy security.

Opportunities outside the US are becoming harder to ignore

The US remains home to many of the world's best businesses, but the strength of American markets over recent years should not lead investors to assume that the best opportunities from here must come from exactly the same companies and regions.

Japan remains particularly interesting because the market combines ongoing corporate reform and a greater emphasis on shareholder returns with exposure to specialist materials and industrial technologies required by the global capital-investment cycle. Europe faces a more difficult macroeconomic environment, particularly because of its exposure to imported energy prices, but European markets contain energy, industrial and infrastructure businesses that may benefit from the physical investment cycle surrounding AI and energy security.

Emerging markets present an equally interesting, although highly diverse, opportunity. The initial AI story understandably favoured Taiwan and South Korea because of their central roles in global semiconductor supply chains, but earnings growth is increasingly extending beyond technology into materials, industrials, defence, shipbuilding, power equipment and selected financials.

What could determine the direction of markets during the remainder of Q4?

We continue to see a credible route towards a constructive end to the year, but it requires several pieces to fall reasonably well. The most favourable outcome would involve continued moderation in underlying inflation, some easing of energy-market pressures and an economy that remains strong enough to support earnings without forcing the Federal Reserve into significantly more tightening.

Corporate profits remain an important support. If earnings are accompanied by broader participation across financials, industrials, materials and international equities, the foundations

of the rally would look considerably healthier than if returns remained dependent upon further valuation expansion in a handful of US technology companies.

The downside risks are equally identifiable. Renewed disruption to Middle Eastern energy supplies could push oil prices and inflation expectations higher, forcing central banks to maintain restrictive policy for longer and placing additional upward pressure on long-term bond yields. Higher yields would be particularly challenging for richly valued long-duration equities, while weaker consumer confidence could eventually translate into softer spending. The scale of the capital commitment to AI also means investors will increasingly demand tangible evidence of revenues, productivity gains and cash returns.

Our current view

Against that backdrop, our view remains constructive, but with considerably more emphasis on selectivity and diversification than the headline performance of equity indices might suggest. We are not attempting to call the end of the AI cycle or move away from high-quality US technology companies simply because they have performed strongly, but neither do we think the investment case for portfolios should depend upon the same handful of businesses continuing to outperform indefinitely.

The more encouraging development is that the opportunity set appears to be widening, with improving prospects across financials, industrials, infrastructure and materials, together with selective opportunities in Japan, Europe and emerging markets. At the same time, higher bond yields have restored a meaningful role for fixed income and allow investors to generate income without relying exclusively upon equity-market appreciation.

For portfolios, that argues for measured optimism rather than complacency. Economic growth has proved more resilient than anticipated, corporate earnings remain supportive and the global capital-investment cycle associated with AI and infrastructure provides a genuine source of long-term growth. However, valuations are not universally cheap, government bond yields have risen substantially and geopolitical uncertainty remains capable of changing the inflation outlook quickly.

We therefore continue to favour portfolios with several independent sources of return: high-quality businesses capable of compounding earnings, exposure to the broader infrastructure and materials investment cycle, selective participation in markets outside the US and high-quality fixed income providing meaningful levels of income. The objective is not to forecast every short-term market movement, but to construct portfolios capable of participating if growth and earnings remain resilient while retaining sufficient diversification to cope if the environment proves more difficult.

That remains, in our view, the most sensible way to approach the remainder of 2026. We remain invested and fundamentally positive about the long-term opportunity, but recognise that the

margin for error has narrowed and that the strongest opportunities from here may not simply be a continuation of those that dominated the first part of the cycle.