Equity Outlook: Broadening the base

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Key Takeaways

- Global equities delivered a strong first half (MSCI ACWI +11.2%), but June's Magnificent Seven sell-off exposed a two-speed market of macro caution versus AI conviction.
- AI remains the dominant driver, yet positioning is extreme. We favour broadening beyond the leaders, not abandoning AI.
- Earnings breadth is improving; Europe's narrow, AI-led leadership is starting to rotate into value and cyclical sectors, underpinned by a €2trn public spending cycle.
- In emerging markets, stripping out state-owned enterprises and screening for reliable dividends targets the governance failures that stop growth from reaching shareholders.
- Japan's structural case (governance reform, reflation, a household bid) remains intact despite a weaker yen, and the equity risk premium is thin only at the expensive top, not across the broader market.

Global equities delivered a remarkable first half despite repeated shocks. The MSCI ACWI Index rose 14.9% in US-dollar terms in the second quarter, reversing the first-quarter Iran-war oil shock to finish the half up 11.2%[1]. A US–Iran de-escalation pulled oil lower, corporate results proved resilient, and conviction in the AI investment cycle strengthened. Read the full Autumn Outlook **here**.

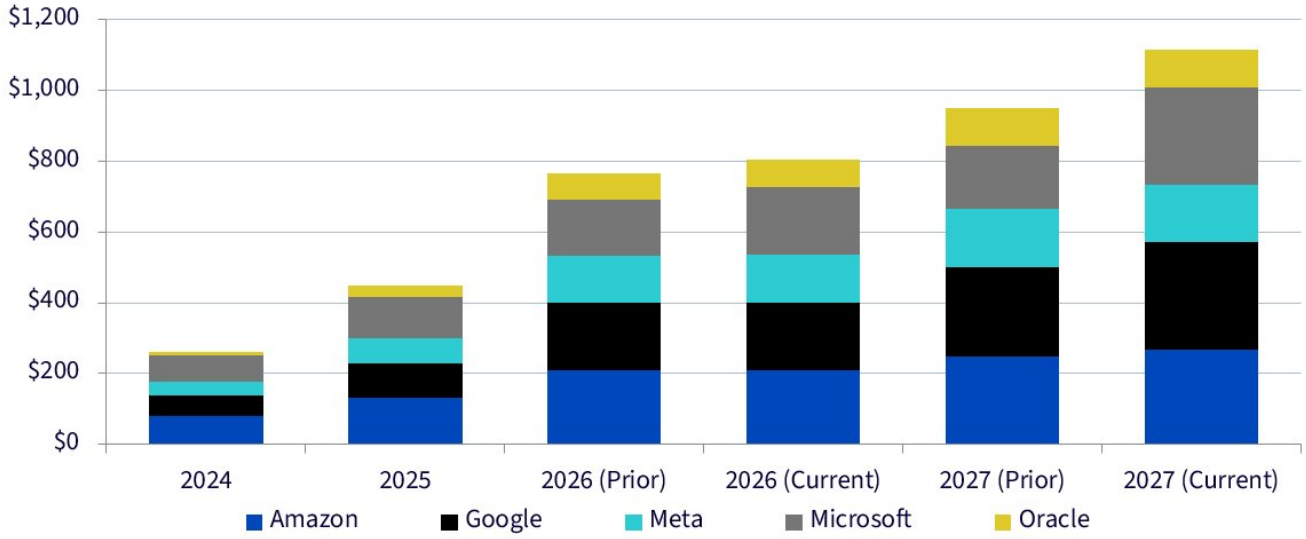
Yet the half ended on a discordant note. June brought a sharp sell-off in the Magnificent Seven that dragged the S&P 500 down 1% for the month, even as the S&P 500 Equal Weight Index rose 2.4%. That confirmed the two-speed market we flagged entering the third quarter: macro caution and AI conviction pulling in opposite directions, with crowded trades leaving little margin for error.

Our message for the second half is simple: broadening, not abandonment. We remain constructive on artificial intelligence (AI). The structural case is powerful and the direct beneficiaries keep delivering. One approach is to combine structural AI-capex winners while adding steady compounders and cheaper markets where fundamentals are improving. The aim is to participate if AI delivers, without depending on it.

From build-out to payback

The question entering the second half is whether massive capital spending will earn attractive returns. The five biggest spenders: Amazon, Microsoft, Alphabet, Meta and Oracle, are on pace to invest more than US$1trn in AI-related capex in 2027, a 33% increase on 2026[2]. For the first time, free cash flow for the hyperscaler cohort could turn negative.

Figure 1: Hyperscaler cash capex breakdown (US$ bn)



Source: Bloomberg Finance L.P., WisdomTree, to 30 June 2026. **Forecasts are not a reliable indicator of future performance.**

Two dynamics matter. Capex growth rates, which drive valuations more than absolute spending, look set to peak this year. Investors may increasingly reward earnings and cash flow over ambition. Positioning is extreme: technology and communications now account for around 46% of the S&P 500, yet only about 30% of its members beat the index in the second quarter[3]. Emerging markets (EM) look diverse but are nearly as concentrated, with three North Asian chipmakers alone making up about two-thirds of EM technology. Passive exposure increasingly channels investors into the same AI ecosystem, so the case for the next few quarters is to diversify deliberately beyond the leaders.

Earnings are broadening, and Europe leads the rotation

The most constructive development of the past quarter sits below the index. Earnings revisions are no longer confined to mega-cap technology. Growth has been robust in energy, materials and industrials too.

Figure 2: 3-Month 2026 earnings per share revisions by sector and region (%)

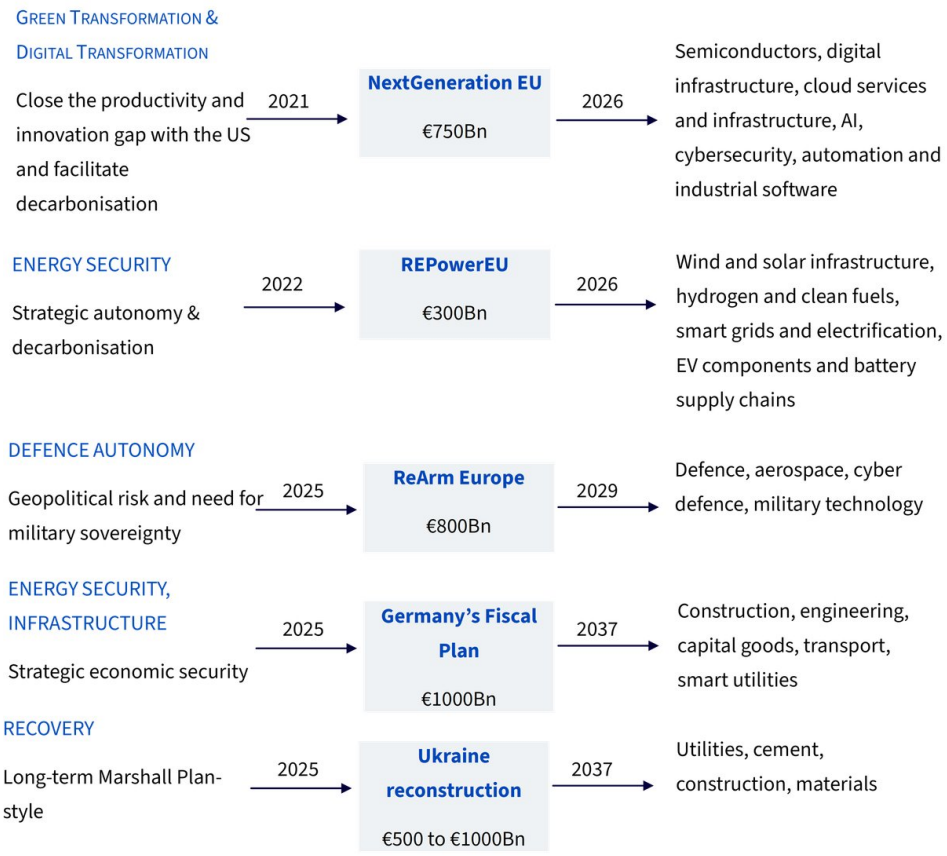
Sector	EM ($)	US	US ex-Mag7	Japan	UK	Europe ex-UK
Communication Services	-0.7%	8.9%	0.0%	-1.0%	0.2%	1.2%
Consumer Discretionary	-11.9%	3.9%	-1.0%	-8.3%	-3.5%	-6.2%
Consumer Staples	-6.9%	0.5%	0.5%	-1.4%	0.4%	-0.1%
Energy	**25.0%**	**61.1%**	**61.1%**	**16.2%**	**67.4%**	**68.2%**
Financials	-0.6%	1.4%	1.4%	3.8%	-1.0%	-0.8%
Health Care	-2.8%	-3.7%	-3.7%	2.4%	0.4%	0.2%
Industrials	8.4%	2.2%	2.2%	3.7%	1.3%	-0.3%
Technology	**39.8%**	**12.1%**	**21.4%**	**15.8%**	**7.5%**	**4.1%**
Materials	5.9%	11.4%	11.4%	-1.6%	11.5%	1.2%
Real Estate	-10.9%	1.0%	1.0%	-3.5%	-0.8%	-5.1%
Utilities	-10.0%	0.4%	0.4%	-0.8%	-3.0%	2.2%
Index	**12.8%**	**7.6%**	**7.6%**	**2.0%**	**7.8%**	**2.1%**
Index ex-Energy	**11.7%**	**5.5%**	**4.5%**	**1.8%**	**-0.5%**	**-0.5%**

Source: Bloomberg Finance L.P., WisdomTree, as of 30 June 2026. **Historical performance is not an indication of future performance and any investments may go down in value.**

Europe offers the clearest expression of the opportunity. More than 70% of MSCI Europe's year-to-date return has come from AI-capex sectors that make up only about 14% of the index[4], an unusually narrow engine. That narrowness is precisely the opportunity: our view is that leadership now broadens out of that engine and into the under-owned, value-oriented majority of the market. Europe's earnings breadth is already widening into cyclical, value sectors such as energy, metals and mining, and utilities.

What makes this more than a valuation trade is policy. A sequence of overlapping programmes channels well over €2trn toward the industrial backbone of the European economy over the coming decade.

Figure 3: Spending timeline - European macroeconomic objectives, policy tools and sectoral impacts



Source: European Commission, German Ministry of Finance, WisdomTree, as of 30 June 2026.

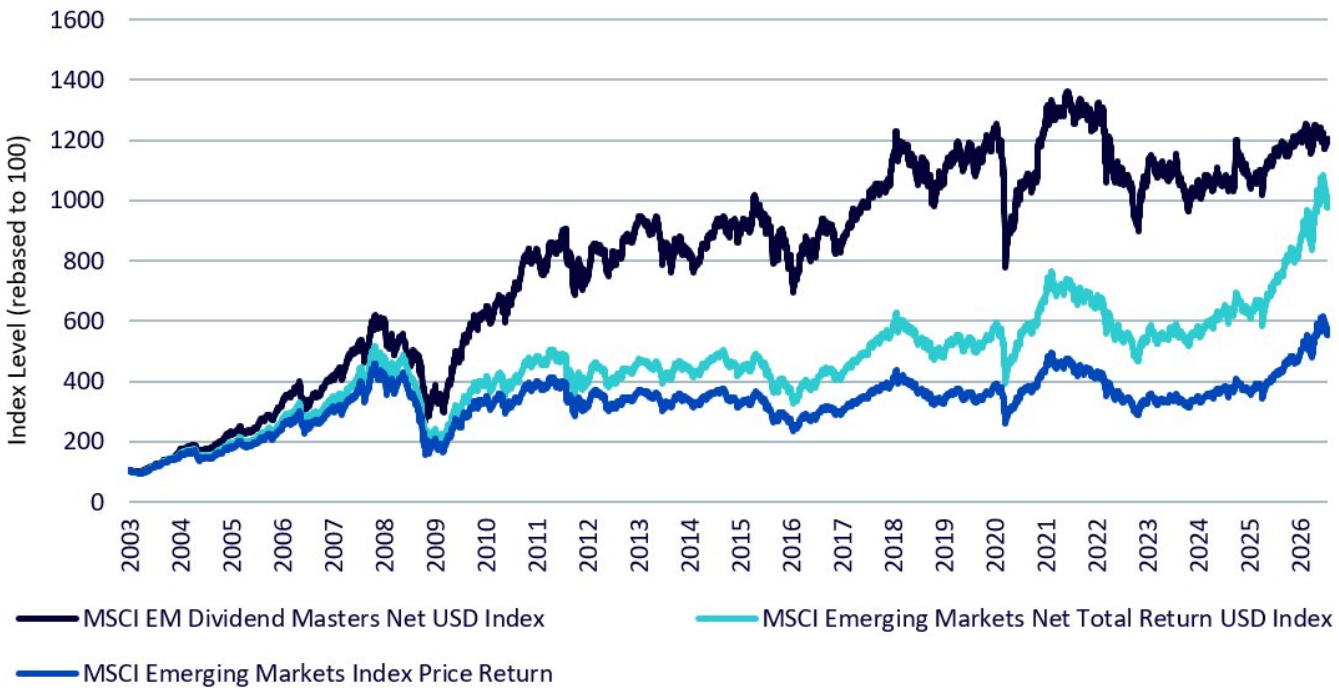
The beneficiaries: construction, capital goods, grids, defence and clean-power supply chains, map almost exactly onto the under-owned 85% of the market, and they are overwhelmingly value and cyclical. Fiscal policy could reinforce the rotation already visible in earnings, potentially providing a multi-year tailwind.

Emerging markets: strip out the state

Emerging markets offer a powerful combination in this outlook: structural growth, cheap currencies, attractive valuations and the strongest earnings-revision momentum of any region. Yet over the past two decades, EM has merely matched developed markets ex-US, despite far stronger GDP growth. The reason is governance: concentrated ownership and weak minority protection, most acute in state-owned enterprises, mean value too often fails to reach outside shareholders.

Two disciplines address this. Stripping out state-owned enterprises tilts toward companies run on commercial rather than political logic, and reduces exposure to state-directed regulatory shocks, from China's technology clampdown to the property sector's 'three red lines'. Dividends act as a governance filter: a sustained, growing distribution is a hard commitment that signals real cash and returns value to shareholders. The long-run evidence is striking.

Figure 4: EM 'dividend masters' vs the benchmark, rebased (2003 = 100)



Source: MSCI, Bloomberg Finance L.P., WisdomTree, 1 January 2003 to 21 July 2026. **Past performance is not a reliable indicator of future performance.**

A portfolio of EM 'dividend masters' has outperformed both the EM total-return benchmark and the price index over more than two decades. Together, these disciplines keep the structural growth and cheap valuations while tilting away from the governance failures that have historically capped EM returns. It is the difference between owning the emerging economy and owning the emerging shareholder.

Japan: from tailwind to test

Japan was among the best-developed equity markets in the first half, with the Tokyo Stock Price Index (TOPIX) around record highs near 4,000, and it remains a preferred exposure. The foundations are broader than the rally: an AI-linked earnings engine, a governance re-rating with years still to run, the return of positive real wages, and a household savings pool only beginning to move into equities. The near-term complication is that the same weak-yen, soft Japanese government bond backdrop that drove the market is shifting from tailwind to test. The pressure is a terms-of-trade squeeze, not a crisis of confidence.FY3/26 earnings were a clean record, aggregate TOPIX earnings grew 27%, and record shareholder returns (¥43.5trn) point to a multi-year, not one-off, re-rating. With equities just 14.5% of household assets against 25.6% in the euro area, the domestic bid is still in its early innings.

The risk premium: thin at the top, not throughout

Higher bond yields have compressed the headline equity risk premium, especially in US large caps. But the premium is thin only where valuations are highest: the gap between earnings and bond yields is far wider in the equal-weight US market, Europe, Japan and emerging markets. Investors are being paid

to broaden, not to concentrate. Equities also retain a durable claim on nominal growth, and shareholder returns provide a cushion as the cash-return engine shifts from the most expensive stocks toward cheaper parts of the market.

Conclusion: diversify within equities before diversifying away from them

The throughline across every region is the same: broadening, not abandonment. We are not calling time on the AI cycle, but positioning has grown too concentrated for comfort, and the reward for looking beyond the crowded trade has rarely been clearer. Europe's investment cycle, emerging markets stripped of state ownership, Japan's governance re-rating, and the wider risk premium outside mega-cap technology all point the same way. Portfolios built as a barbell with structural AI exposure alongside cheaper, broadening opportunities, help investors participate if the AI theme delivers, without depending on it. In our view, current market strength may provide an opportunity for investors to reassess concentration and diversification within equity allocations.

The case for broadening equity exposure is not without risks. A slowdown in AI investment or weaker-than-expected returns on capital spending could weigh on technology companies and the wider market. In Europe, the anticipated benefits of higher public spending depend on the timing and implementation of fiscal programmes, while weaker economic growth could challenge the expected earnings broadening. Emerging markets remain exposed to governance, geopolitical and currency risks, while Japan could be affected by changes in monetary policy, bond yields and the yen. More broadly, equity markets remain sensitive to changes in economic growth, inflation, interest rates and investor sentiment, and investments may fall in value.

[1]Source: MSCI All Country World Index from 1 April to 30 June 2026.

[2]Source: Bloomberg Finance L.P., WisdomTree from 31 December 2025 to 30 June 2026.

[3]Source: Combined weight of Technology and Communications sector in the S&P 500 Index as of 23 July 2026.

[4]Source: MSCI as of 30 June 2026.

IMPORTANT INFORMATION

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