Equity Outlook catching the tailwinds re-specting the headwinds

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Key Takeaways

- 2026 is a 'dispersion' year: regional and sector selection matters more than index beta, with leadership rotating underneath the surface.
- HALO is the Q1 signal: leadership is widening beyond tech into 'heavy assets' with durable cash flows, grids, infrastructure, defence and AI spending beneficiaries.
- Europe's fiscal turn and lower concentration risk, Japan's governance momentum, and selective emerging markets (EM) exposure offer a more balanced way to participate as the US market becomes more valuation sensitive.

The global economy entered 2026 in a comparatively supportive backdrop for equities: growth expectations stabilised, inflation anxiety eased and earnings stayed resilient. The global backdrop is shifting toward a form of modern mercantilism, a more adversarial multipolar system where trade, technology and security are increasingly negotiated as part of a broader strategic bargain.

Q1 2026 has reinforced the same message. Markets have become more selective and more rotational. Artificial intelligence (AI) is still a structural theme, but equity performance is increasingly driven by dispersion across regions, sectors and styles, rather than a single index trade. The shifting pattern of global equity market performance in 2025 is a useful precursor, reminding us that return dispersion across regions is likely to remain a defining feature of 2026.

Figure 1: Equity earnings growth outlook remains resilient to challenges so far

Region	P/E Fwd 12 mths	Earnings per share growth rate (%) 2025	2026	2027
World	19.0	12.0	14.1	13.8
US	22.3	11.5	15.0	15.2
Europe ex UK	15.6	14.5	11.5	12.4
UK	13.2	7.7	10.0	11.3
Japan	16.3	4.8	9.5	8.9
Asia Pacific ex-Japan	14.4	10.7	19.6	14.7
Latin America	10.5	51.8	2.3	14.3
Emerging Markets	14.9	14.0	14.1	12.8
World ex-USA	14.0	12.4	13.0	12.2

Source: MSCI, FactSet, WisdomTree as of 31 December 2025. Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.

US: Leadership broadens but the bar is higher

The US continues to set the tone for global risk appetite, but the internal market structure has become more important than the headline index. The defining shift is that the market is no longer rewarding 'AI exposure' in a blanket way. It is differentiating between AI enablers with clear earnings visibility and mega-cap growth, where expectations were already stretched. That matters because concentration remains a first-order risk. By late 2025, the top 10 names were roughly 40% of S&P 500 market capitalisation, amplifying index sensitivity to a small set of stocks and raising the probability of volatility even when the median company is behaving normally. This is one reason Q1 2026 has felt 'two-speed': the index can hold up, but leadership can rotate sharply underneath.

US equities can still do well, but the market is less forgiving. A high valuation and concentration backdrop raises the hurdle for another straightforward year of multiple expansion. The more robust approach is to lean into breadth: balance-sheet strength, cash-flow durability, and selectively cyclical earnings where pricing power and order visibility can carry through softer patches.

HALO: Why Q1 2026 has felt different

One of the most useful frames for what we've seen so far in 2026 is the HALO effect: Heavy Assets, Low Obsolescence. It captures the market's growing preference for capital-intensive businesses tied to capacity, networks, infrastructure and engineering complexity, areas where assets 'age' slowly, pricing is often supported by long-cycle demand, and competitive moats are physical rather than digital.

This matters because the AI cycle is increasingly a real-economy buildout: data centres, power delivery, cooling and grid investment. As investors become more valuation-sensitive around US tech, they've been more willing to pay for the 'picks-and-shovels' layer of AI and electrification. In other words, HALO is a mechanism that helps explain why leadership can broaden even when the AI narrative remains intact.

Europe: Fiscal impulse and a more balanced cycle

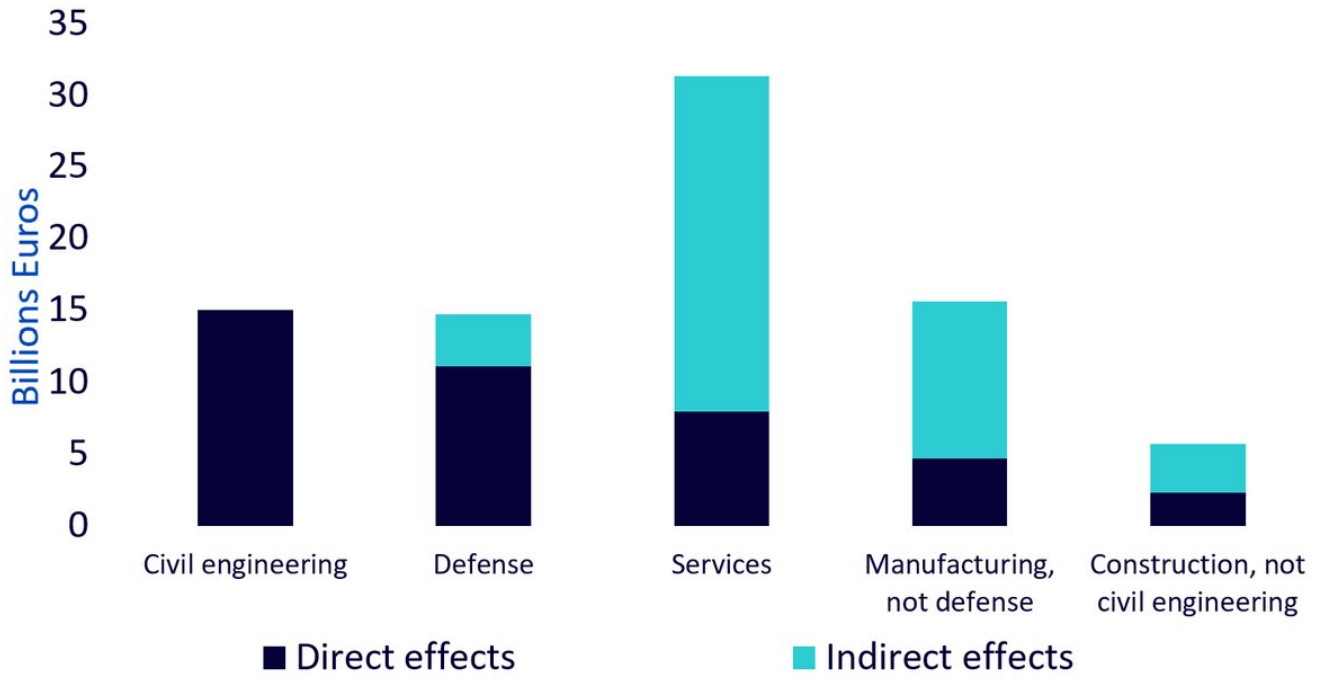
Europe entered 2026 pulled in two directions: external pressures (tariffs, currency strength, competition) versus more constructive internal forces, easier monetary conditions, a clearer fiscal turn, and gradual progress in structural reforms. The base case in the original outlook was that domestic forces would increasingly matter for earnings confidence, and Q1 has been broadly consistent with that. Europe's opportunity set looks more balanced than it has for much of the last decade. Europe also benefits from less concentration risk than the US, which becomes more valuable when dispersion rises.

On reform, progress is real but incomplete. The European Policy Innovation Council's (EPIC) tracking shows that only about 11% of Draghi's recommendations have been fully implemented, and a further 20% partially implemented, highlighting both upside (if delivery accelerates) and constraints (from political bottlenecks).

Fiscal: Germany's shift is the headline, but spillovers are the story

Europe's push for strategic autonomy is increasingly evident in fiscal policy. Defence spending is a key component, but the more investable implication is broader: industrial capacity, infrastructure, digitisation and innovation. Germany is central here. We expect the additional fiscal spending following the relaxation of Germany's constitutional debt brake could add roughly 0.4% to German growth in both 2026 and 2027, even with near-term bottlenecks such as approvals and labour constraints. The spillover potential is meaningful. Germany is a key trading partner for much of the region, and a turn from stagnation towards modest growth can lift confidence and spending beyond its borders.

Figure 2: Estimated revenue gains by sector from additional investment spending by the Federal Government in 2026



Source: Destatis, WisdomTree as of 31 January 2026. Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.

The UK offers a good hunting ground for yield

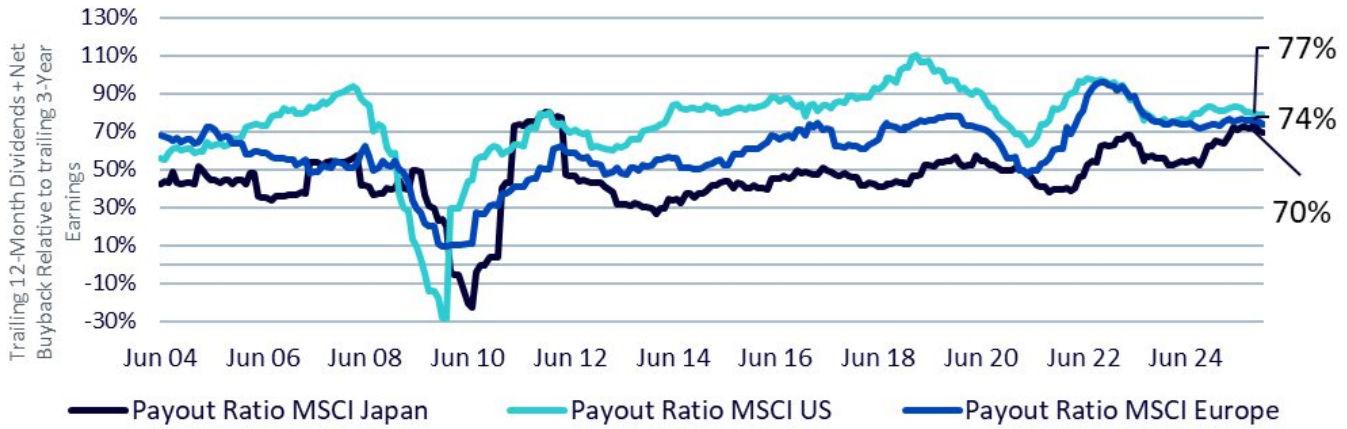
The UK equity investment case is still differentiated. Less about growth leadership and more about income, valuation support and rate sensitivity. The outlook argues that easier monetary policy can support areas like life assurance, property and construction, where starting valuations are depressed and dividend yields can compensate for uncertainty.

While the UK case is anchored in dividends and valuation support, Japan offers a different kind of appeal: a reform story that is becoming more embedded, supported by governance pressure and a clearer domestic policy direction.

Japan: Policy clarity meets governance momentum

Japan remains one of the more consistent structural stories in developed markets. It reflects a rare combination of policy clarity and governance momentum. Prime Minister Sanae Takaichi's success in the snap elections and the backdrop of the new growth strategy remain key tailwinds. And governance matters. The Tokyo Stock Exchange's push on cost of capital and valuation has accelerated corporate actions: higher disclosure, fewer sub-book stocks, and rising buybacks, all of which support breadth.

Figure 3: Payout ratios in Japan begin to catch up to the US and Europe



Source: FactSet, WisdomTree as of 31 January 2026. Historical performance is not an indication of future performance, and any investments may go down in value.

Emerging Markets: momentum is back, dispersion still rules

The emerging markets (EM) message is constructive but nuanced: macro conditions can help, but outcomes hinge on country selection and earnings durability through the AI and commodity cycles. The framework remains supportive, with an EM growth premium, easing inflation, improving earnings revisions and stronger external positions helping reduce macro risk premia.

Bottom line for H1 2026

The tailwinds remain in place, supported by resilient earnings and a constructive global backdrop. But the crosswinds are real, including policy uncertainty, geopolitics and a US market structure that remains concentrated and valuation sensitive. In that environment, diversification becomes more than risk control. It becomes a source of returns. Positioning for broader leadership, including the Q1-visible HALO rotation toward capital-intensive sectors with durable cash flows, may prove the most resilient strategy.

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