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MACRO PICTURE:

Market Outlook 2026: Equities, Bonds, FX and Commodities

By

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ROSA & ROUBINI ASSOCIATES

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Market Outlook 2026: Equities, Bonds, FX and Commodities

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Executive Summary

- Mega-cap–led AI enthusiasm is sustaining the equity rally but amplifying downside risks, prompting gold hedging, while monetary easing supports bonds, credit, and rate-sensitive sectors in an uncertain geopolitical backdrop.
- 2025 delivered a rare “everything rally” across all major assets, but the surge in equities and bonds has left financial assets historically expensive relative to real assets, signalling lower returns ahead and a growing case for diversification and real-asset exposure.

Equities: Elevated Valuations with Market Concentration

- Strong profit growth carried equities through 2025, yet U.S. valuations are historically elevated (Shiller P/E >40), meaning 2026 returns will depend more on earnings delivery than multiple expansion.
- AI-led mega-cap dominance has narrowed leadership, increasing downside risk from earnings disappointment, while better risk-reward lies in selective non-U.S. markets and high-quality, cash-generative firms across the value chain.
- Risk-reward looks more attractive outside the U.S., with valuation discounts, fiscal support, and broadening earnings growth favouring Europe, the UK, Japan, and emerging markets as global EPS growth accelerates and positioning becomes more balanced.

Bond Market: Policy Support amid Fiscal Constraints

- Positive real yields and expected rate cuts support government bonds as growth buffers, yet rising fiscal risks and inflation sensitivity make curve positioning, especially favouring the front end, crucial.
- In the US, treasury markets are anchored by expectations of further Fed easing, supporting the front end, while the long end remains constrained by fiscal uncertainty, elevated term premia, and heavy debt supply—pointing to continued curve steepening rather than a broad rally.
- Eurozone front-end rates are near equilibrium with the ECB close to neutral, but longer-dated yields face upward pressure from fiscal expansion, political uncertainty (notably in France), and structural flows such as Dutch pension reform, even as sovereign spreads gradually converge.

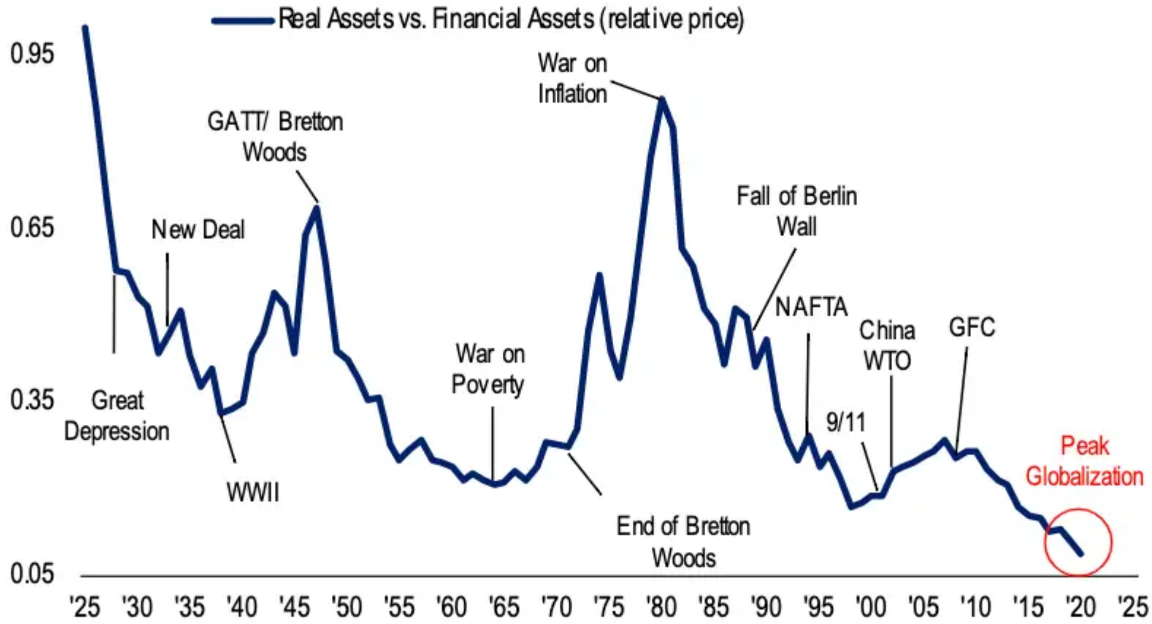
FX: Normalization After a Volatile Dollar Year

- The dollar fell about 10% in 2025, driven in part by under-hedged investors raising FX hedge ratios; with positioning now more balanced and volatility low, major currency moves are likely to remain contained in 2026.
- EUR/USD is expected to drift toward 1.10 as US growth resilience offsets euro-area fiscal support, the yen may edge stronger but remains capped by policy constraints, and the renminbi should see modest appreciation despite continued structural undervaluation.

Commodities: Lingering Policy Effects

- Gold is likely to consolidate with central bank demand providing support, while cyclical commodities face downside risks as rising oil, LNG, and copper supply meets softer global demand.
- OPEC+ market-share strategy, new LNG capacity, and expected oil surpluses outweigh geopolitical risks, leaving crude, copper, and coal more vulnerable than gold and supporting a bearish Brent outlook near $57/bbl.

Key Picture: Real Assets vs Financial Assets



Source: BofA Global Research; Note: Real Assets (Commodities, Real Estate, Collectibles) and Financial Asssets (Large Cap Stocks, Long-term Gov't Bonds)

Introduction

Financial markets in advanced economies continue to surge, led by U.S. technology stocks and optimism around artificial intelligence. Expectations that AI will deliver broad-based productivity gains have underpinned risk appetite, but they have also inflated what increasingly resembles an AI-driven financial bubble. A meaningful shortfall in returns could trigger a sharp market correction—one reason investors have pushed gold prices higher as a hedge against downside risk.

The current rally is heavily dependent on a narrow group of mega-cap firms. The so-called Magnificent Seven are committing vast sums to data centres, semiconductors, and AI models, increasingly drawing down cash reserves and taking on debt to finance hyperscalers such as OpenAI. While AI remains a powerful structural theme, the scale of capital deployment raises execution and valuation risks as returns become more uncertain.

Equity markets themselves pose risk. After a long rally and with valuations elevated, a sharp sell-off would weigh on household wealth and corporate balance sheets, dampening consumption and investment. Still, the macroeconomic impact of market corrections is often overstated: even a 10% equity decline typically shaves only a few tenths of a percentage point off GDP. Falling asset prices alone rarely cause recessions without a deeper financial or economic shock.

Geopolitics adds a further layer of uncertainty. Markets absorbed shocks in 2025, but energy supply and pricing remain vulnerable. U.S. midterm elections in November 2026 could influence equities, rates, and the dollar, while political pressure on the Federal Reserve to ease policy risks unsettling inflation expectations, steepening yield curves, and weakening the currency. With Chair Powell's term ending in May, attention may soon turn to his successor.

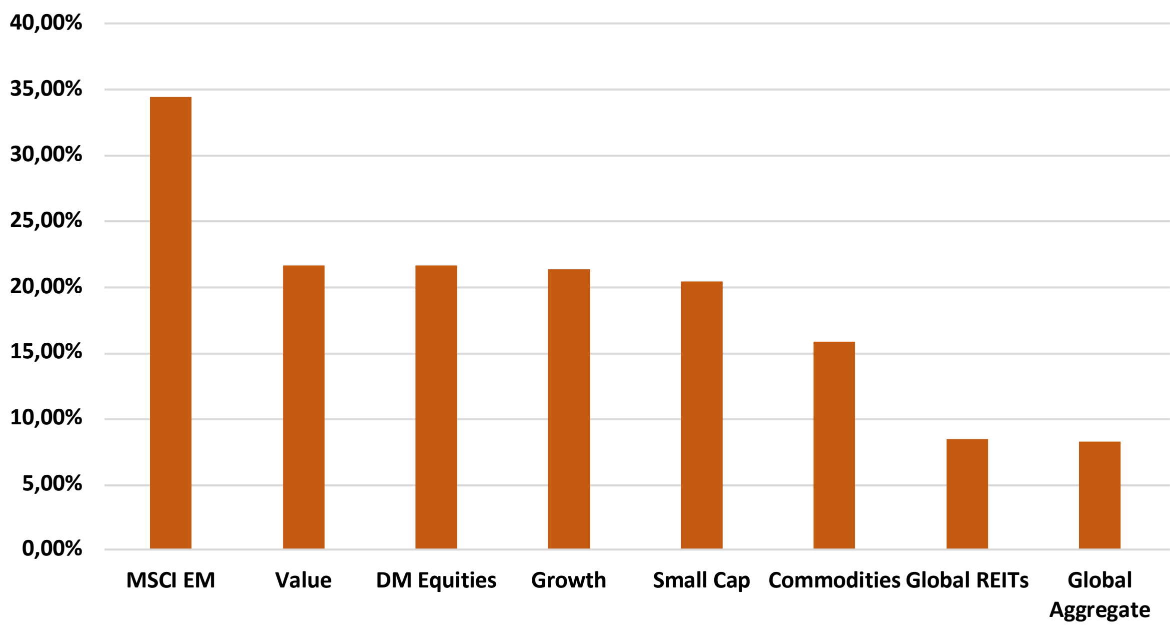
Against this backdrop, easing cycles still present opportunities across asset classes. Falling rates should support front-end Treasuries and investment-grade credit, where yields remain attractive. Rate-sensitive assets such as small-cap equities and commercial real estate may benefit, while emerging market bonds could gain as Fed easing enables local rate cuts without severe currency stress. Historically, the dollar tends to hold steady or strengthen during rate-cut cycles when no recession follows.

Performance of Asset Classes in 2025

2025 marked a broad-based "everything rally," becoming the first year since the pandemic in which all major asset classes delivered positive returns. Markets absorbed significant shocks, most notably a sharp sell-off in April triggered by aggressive US tariff hikes, before rebounding strongly as fiscal and monetary stimulus, easing inflation fears, and risk-on sentiment dominated the second half of the year. Developed market equities finished up over 20%, while emerging markets led globally with gains above 30%, reflecting both stronger growth dynamics and a weakening US dollar (**Figure 1**).

Performance leadership shifted meaningfully. Precious metals were the standout asset class, with gold benefiting from central bank demand and silver posting exceptional gains, lifting overall commodity returns despite falling oil prices. Equities saw AI remain the dominant theme, but market leadership narrowed: only a few mega-cap tech firms outperformed, while US equities lagged other regions for the first time in two decades. Currency moves played a decisive role, turning Europe into a top performer for euro- and sterling-based investors as the dollar fell sharply.

Figure 1: Asset Classes and Style Returns in 2025



Source: JP Morgan

Fixed income also delivered strong returns, supported by high starting yields, Fed rate cuts, and resilient corporate balance sheets. Emerging market debt and credit outperformed, aided by currency appreciation and spread compression, while government bond performance diverged sharply across regions. US Treasuries and UK gilts benefited from rate cuts, while German and Japanese bonds suffered as fiscal expansion and policy normalisation pushed yields higher. In Europe, traditional "core–periphery" distinctions blurred, with French bonds underperforming amid political instability.

While 2025 was a triumph for financial portfolios, this outperformance has created a historic anomaly. As illustrated in the Real Assets vs. Financial Assets chart (**Key Picture**), the sustained rally in stocks and bonds has pushed the relative valuation of real assets (commodities, real estate, collectibles) to a 100-year low. Financial assets have essentially never been more expensive relative to hard assets—surpassing even the extremes of 1929 and 1999.

Bank of America argues this imbalance points to a potential regime shift. Financial assets now start from historically high valuations, implying lower and more volatile returns ahead, while real assets, backed by physical usefulness and inflation sensitivity, are unusually cheap. Historically, such extremes have coincided with periods of fiscal expansion, policy realignment, and rising wages—conditions that closely resemble today's macro backdrop. If this pattern holds, portfolios overly concentrated in financial assets may underperform, while real assets regain strategic importance in a higher-inflation, fiscally active world.

Overall, 2025 underscored the value of diversification—across regions, asset classes, and currencies. After a decade dominated by US tech and dollar strength, returns broadened globally, setting the stage for 2026 to be shaped by continued geographic convergence, European fiscal stimulus, moderate dollar weakness, and a greater need for active allocation beyond US-centric portfolios.

Equities: Elevated Valuations with Market Concentration

Equities enter 2026 with solid underlying support but rising dispersion. Strong earnings drove markets through 2025, with profits consistently beating expectations despite elevated valuations. Shiller P/E/ ratio climbed above 40, a level last reached in 1999, signalling historically stretched U.S. stock valuations (**Figure 2**). In the U.S., the S&P 500's P/E ratio is near 28, yet earnings momentum remains intact, underpinned by a resilient consumer and capital expenditure largely funded by cash rather than leverage. With the labour market still broadly balanced, corporate profits are expected to continue rising in 2026.

Figure 2: Shiller P/E Ratio

Source: Multpl

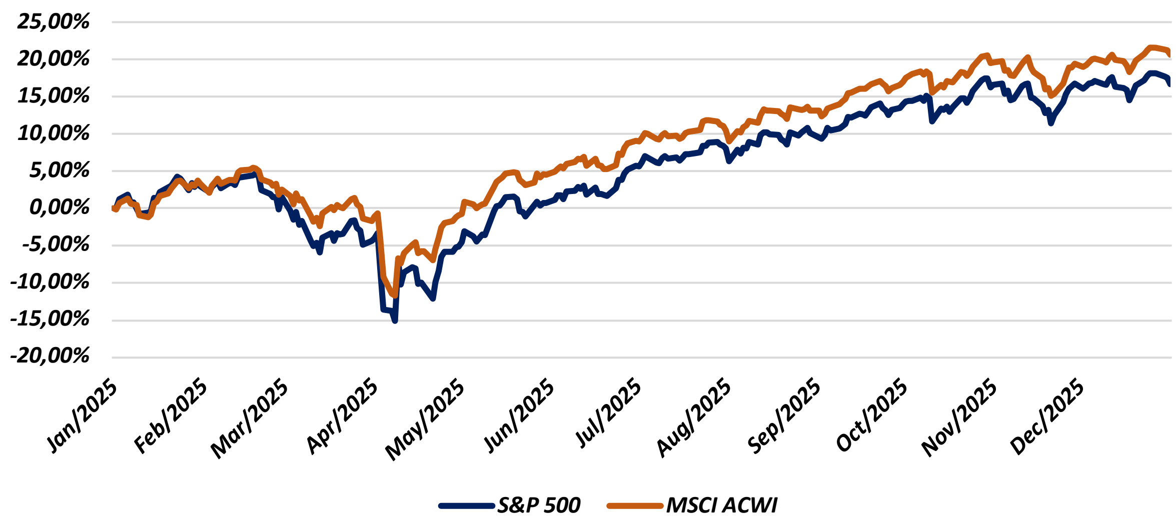
Macro conditions remain broadly supportive. Easing monetary policy, resilient earnings, and ongoing fiscal tailwinds provide a constructive backdrop, even as growth slows. Risks, however, are becoming increasingly concentrated. Market leadership has narrowed sharply, with mega-cap technology—particularly AI-related names—accounting for a disproportionate share of gains. The scale of AI-driven capital expenditure, benchmark concentration, and rising leverage to fund investment raise execution and valuation risks. While AI remains a powerful structural theme, the gap between winners and laggards is likely to widen as returns depend more on delivery than narrative.

AI reshaped markets in 2025, driving roughly 20% global equity gains led by technology and communication services. The Magnificent Seven alone accounted for more than 20% of global returns and over 40% of S&P 500 performance, leaving portfolios increasingly concentrated and more fragile.

Market concentration remains elevated, with the top ten U.S. companies accounting for roughly 40% of the S&P 500's market capitalisation. History suggests that periods of sector dominance can persist for long stretches without ending in crisis, but elevated concentration increases fragility. Recent gains in U.S. technology stocks largely reflect strong fundamentals and robust balance sheets rather than speculative excess. The key risk lies in earnings disappointment, which could challenge the sustainability of returns. Equity opportunities are best found among companies with high margins, strong balance sheets, and durable end markets. Further down the market-cap spectrum, small- and mid-cap "picks-and-shovels" enablers of the AI ecosystem appear increasingly attractive. Although AI investment has so far been largely self-funded, growing reliance on debt warrants closer scrutiny in 2026.

Outside the U.S., risk-reward dynamics look more compelling. Europe, Japan, the UK, and parts of emerging markets benefit from valuation discounts, fiscal support, and a broadening of global earnings growth. Global EPS growth to accelerate to around 11% in 2026, with more balanced contributions across regions and sectors. Positioning reflects this shift: UK and emerging markets appear most constructive, while U.S. exposure is rebuilding but with less exuberance than headline indices suggest.

Figure 3: Global Stock Markets Posted Double-Digit Gains in 2025



Source: Fred; MSCI

Valuations are entering a new phase. Global equities have delivered roughly 20% annualised returns over the past three years, driven primarily by multiple expansion rather than profit growth. With valuations stretched—especially in the U.S.—future gains are unlikely to come from further re-rating. Instead, performance in 2026 will hinge on earnings delivery, cash-flow durability, and balance-sheet strength.

Overall, 2026 is shaping up as a year of rebalancing rather than euphoria—favouring selectivity, diversification, and fundamentals over momentum and concentration.

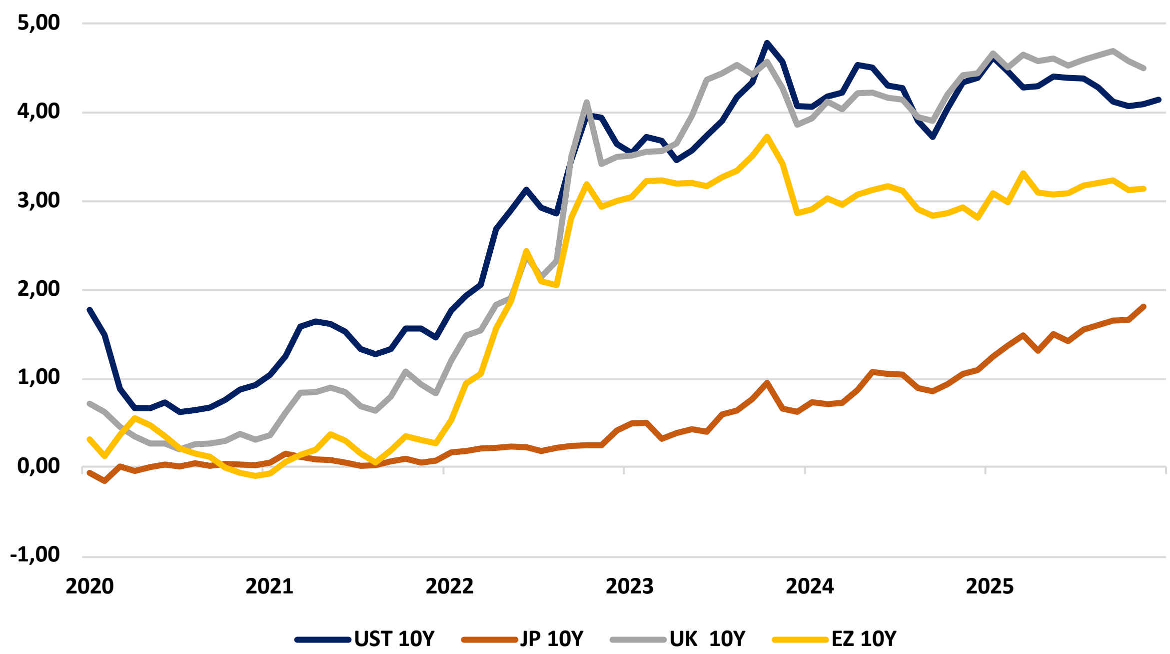
Bond Market: Policy Support amid Fiscal Constraints

Government bond markets enter 2026 at the intersection of supportive monetary dynamics and rising fiscal uncertainty. For investors, the fiscal backdrop has become a growing source of volatility, yet government bonds should continue to play a critical role in cushioning downside growth risks, particularly now that real yields are firmly positive. Recent episodes have reinforced this function, with bonds rallying during the March 2023 regional banking stress, periods of weaker labour data in 2024–25, and bouts of geopolitical tension.

That said, bond allocations must be managed dynamically. The correlation between risk assets and government bonds is not stable and can turn positive when inflation pressures or fiscal concerns intensify, weakening bonds' traditional hedging role. Curve positioning therefore matters. Front-end yields, which are more sensitive to central bank policy, tend to provide stronger countercyclical protection during economic slowdowns. By contrast, long-end yields are more exposed to fiscal sustainability concerns and inflation expectations, leaving them vulnerable to upward pressure and curve steepening.

Fiscal risk is highly context-dependent. There is no fixed debt-to-GDP threshold that automatically triggers a crisis: Japan has sustained ratios above 200% for years without destabilisation. Today's anxiety stems instead from the combination of slowing growth, higher interest rates, and the withdrawal of large-scale central bank bond purchases. These conditions make fiscal dynamics more market-sensitive than in the past.

Figure 4: Bond Market Wraps Up 2025 with Broad Gains



Source: Fred

In Europe, these pressures are most visible in France, where political fragmentation has complicated fiscal reform and sharpened investor focus on deteriorating public finances ahead of the 2027 presidential election. French 10-year yields have risen to match those of Italy. More broadly, fiscal pressures are mounting across advanced economies, driven by higher defence spending, climate transition costs, and rising healthcare and pension obligations linked to demographic ageing.

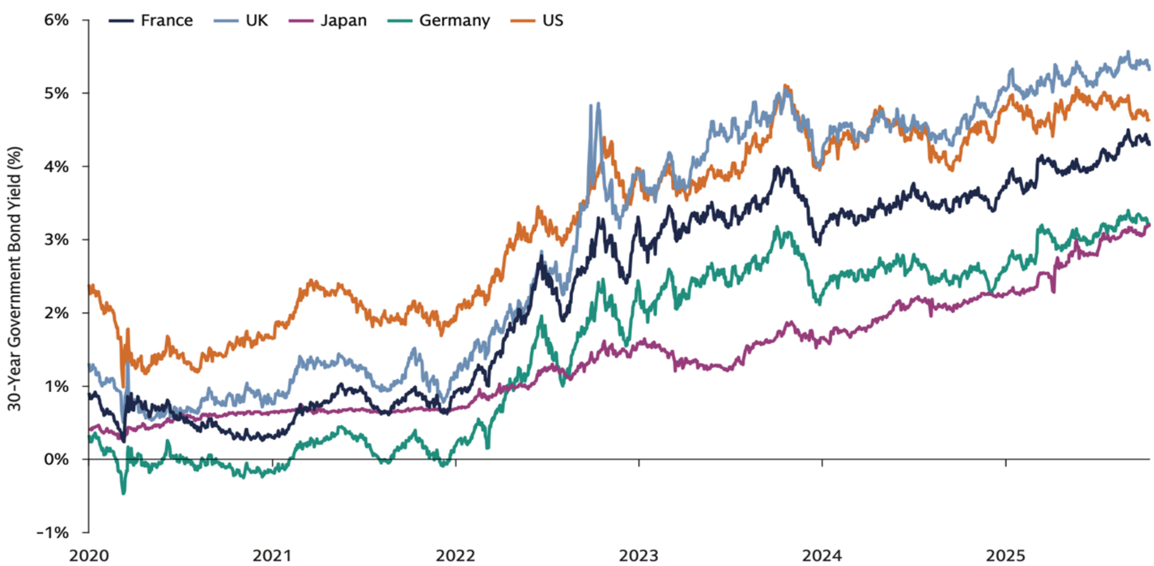
Central bank policy will remain the dominant driver of bond markets in 2026. With growth risks rising and inflation expectations easing, major central banks are expected to cut policy rates toward—or below—neutral. While the IMF's latest forecasts are slightly more optimistic than earlier in 2025, they still point to sub-trend growth across advanced economies, reinforcing the case for a more supportive policy stance as long as inflation remains close to target.

Despite persistent concerns over debt supply and inflation uncertainty, bond markets delivered strong returns in 2025. U.S. bonds posted their best performance since 2020, supported by roughly 75 basis points of Federal Reserve easing and resilient corporate fundamentals that kept credit spreads near historic lows. Treasury yields ended the year lower overall, even as periodic data surprises pushed them temporarily higher.

The 10-year yield finished around 4.16%, with the 2-year near 3.48%, after edging up late in the year following stronger-than-expected labour market data. This capped a highly volatile year for rates, shaped by uncertainty over President Trump's tariff policies, shifting expectations for Fed easing, and inflation that remained sticky but gradually trended lower. The 10-year yield swung sharply—falling below 4.1% after tariff announcements in April, rebounding above 4.5% shortly thereafter, and then oscillating around 4% following the Fed's first rate cut in September.

Fed minutes from December highlighted a closely divided committee, underlining uncertainty over the pace of further easing. Markets have since modestly increased bets on another rate cut later this year, reflecting the still-fragile balance between cooling inflation and a labour market that remains resilient.

Figure 5: Rising 30-Year Yields Partially Reflect Concerns Over Debt Sustainability



Source: Goldman Sachs Asset Management

Looking ahead, markets price roughly 60 basis points of Fed cuts in 2026, implying a more limited policy tailwind than in 2025. A sharper labour-market slowdown could justify deeper easing, while resilient consumer demand or greater clarity on trade policy could pause the cutting cycle. The most likely outcome is further yield-curve steepening, with front-end yields stabilising as policy rates approach neutral, while longer maturities reflect fiscal risks and rising term premia. In this environment, the 10-year Treasury is expected to trade mainly in a 4.25–4.5% range, potentially testing the upper end early in the year before easing modestly as inflation pressures fade. More extreme outcomes—a recession-driven drop toward 3% or a credibility-damaging overshoot toward 5%—remain tail risks rather than the base case.

In the eurozone, the curve already sits close to equilibrium. With the ECB largely on hold around 2%, front-end rates should remain anchored. However, improving growth prospects and Germany's fiscal expansion could push 10-year swap rates toward 3% in 2026. European sovereign spreads may gradually converge as Germany expands fiscally and others consolidate. A key structural theme in Europe is the Dutch pension reform starting in January 2026, which will trigger large unwinds of long-dated bonds and swaps. This is expected to add upward pressure and volatility at the long end of the curve, particularly in 30-year maturities, reinforcing a broader global trend toward higher term premia

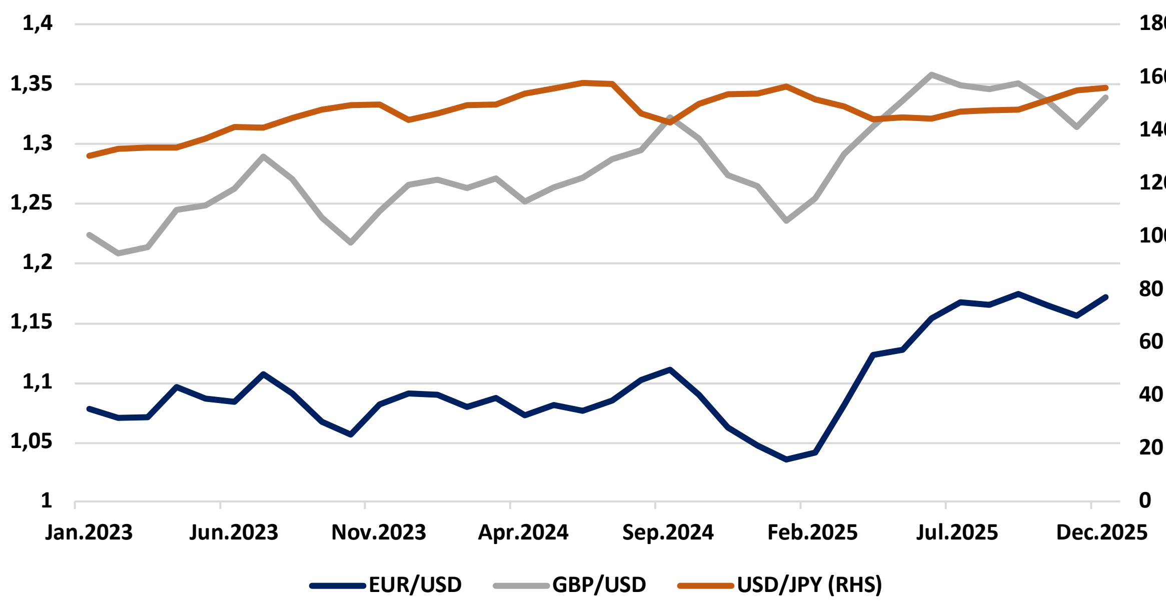
Overall, the bond outlook for 2026 remains constructive but selective. Elevated nominal and real yields provide an attractive starting point, but returns are likely to be more muted and uneven than in 2025. Success will hinge on curve positioning, careful duration management, and disciplined selection across government and credit markets as fiscal risks, policy uncertainty, and macro dispersion rise.

FX: Normalization After a Volatile Dollar Year

Exchange rates may re-enter the political spotlight as global imbalances persist, particularly around renminbi and yen undervaluation. Still, beyond rhetoric, major FX markets are likely to remain relatively subdued in 2026.

The dollar ends the year roughly 10% lower (**Figure 6**), weighed down by losses around "Liberation Day." In retrospect, much of the move appears driven by an under-hedged buyside raising FX hedge ratios on US asset holdings. Those hedge ratios now look more balanced, reducing one source of dollar pressure.

Figure 6: The Dollar Fell Rougly 10% In 2025, Its Worst Annual Performance Since 2017



Source: Fred

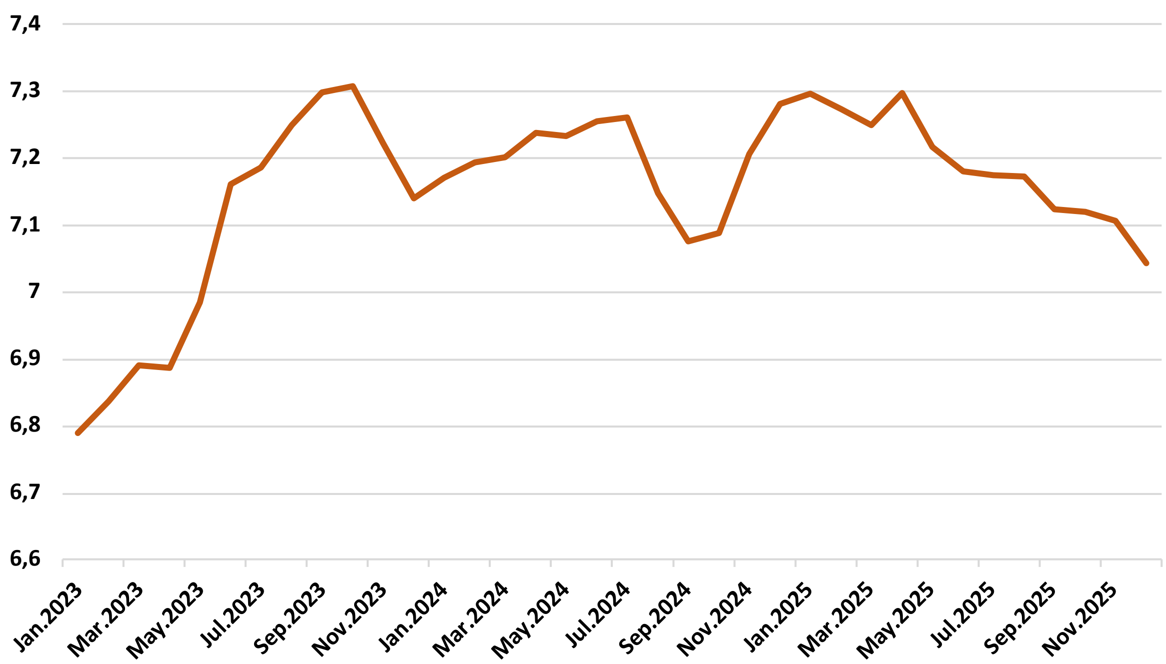
EUR/USD has retreated from September highs above 1.19. Dollar bears argue that Fed easing is fully priced and that euro-area growth will once again lag US exceptionalism. Bulls point to lower US hedging costs, stronger euro-area fiscal stimulus, and cheaper energy as supportive for the euro. FX volatility has fallen to its lowest level since mid-2024, with markets pricing continued calm into 2026 and sustained interest in carry strategies.

US–euro rate differentials may narrow slightly, offering modest support to the euro, though weak growth, fiscal constraints, and possible late-year ECB cuts limit upside. That said, EUR/USD is expected moving toward 1.10 by mid-2026, driven by cyclical rather than structural forces. Much of the good news is already reflected in the euro, while the AI-driven US growth story likely has further room to run.

The yen could appreciate mildly as the BoJ inches toward further tightening, but policy contradictions, fiscal concerns, and reliance on verbal intervention cap gains.

USDCNY largely traded within 7.00–7.40 forecast range in 2025 (**Figure 7**). While spot briefly dipped below 7.00 in the final sessions, USDCNY ultimately ranged between 6.99 and 7.35, with USDCNH trading slightly wider at 6.98–7.42. In the beginning of the year, USD/CNY has eased to 6.9857, but the currency remains structurally undervalued relative to China's external position. Market sentiment underwent a full reversal. Early 2025 was dominated by depreciation fears linked to trade tensions, but by year-end the narrative shifted toward CNY appreciation as a tool to support imports and domestic consumption. The CNY–CNH spread narrowed over the year, likely reflecting reduced speculative pressure and more effective offshore liquidity management and intervention.

Figure 7: The Yuan Enters 2026 Caught Between Market Momentum And Policy Control



Commodities: Lingering Policy Effects

Commodities were buffeted in 2025 by tariff shocks and policy volatility under President Trump, leaving prices driven more by headlines than fundamentals. While policy turbulence may ease in 2026, its aftershocks are likely to linger, reshaping relative performance across commodity markets.

Gold, the standout performer of 2025, is likely to consolidate in the absence of a new shock, though sustained central bank demand and fiscal risks should provide a floor. By contrast, downside risks dominate for cyclical commodities. Rising supply in oil, LNG, and copper—combined with softer global demand—points to weaker pricing, particularly if growth slows.

Trade policy remains a source of uncertainty. Trump's energy purchase commitments appear largely unworkable, raising the risk of renewed trade frictions, while copper markets may unwind U.S. stockpiling if tariffs materialise. In contrast, rare earths and critical minerals stand out as relative beneficiaries as the U.S. continues to invest in supply chains that reduce dependence on China.

Oil markets exemplify these dynamics. Prices fell in 2025 despite geopolitical risks, as OPEC+ shifted toward defending market share and demand growth remained modest. Structural forces—energy efficiency gains, electrification, and slower Chinese demand—continue to cap upside. Markets enter 2026 expecting a sizeable surplus, even as Russian supply remains vulnerable to sanctions and Ukrainian attacks.

European gas prices have also declined, reflecting weaker Asian LNG demand, increased global supply, and more flexible EU storage rules. While EU storage levels remain below last year and the five-year average heading into winter, significant new LNG capacity coming online over the medium term should keep both global and European gas markets adequately supplied.

The year has begun with renewed short-term supply uncertainty following the US arrest of Venezuela's president, but markets have reacted calmly. Some risk had already been priced in after restrictions on Venezuelan tankers, and ample global supply continues to dominate sentiment. Over the longer term, a political transition could eventually unlock higher Venezuelan output, though this would take years and require substantial foreign investment.

Overall, risks in 2026 tilt toward supply overhang meeting weaker demand, leaving crude, copper, and coal more vulnerable than gold as physical volumes, not policy headlines, reassert themselves as the primary market driver. The oil market is set to move deeper into surplus in 2026 as supply growth (~2.1 mb/d) far outpaces demand growth (~800 kb/d), keeping sustained downward pressure on prices, with banks forecasting Brent mostly in the mid-$50s to low-$60s range.