

Anatomy of an “almost bubble” and why global equities now offer “something for everyone”



February 2026

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Whilst geopolitical uncertainty continues to create short-term volatility, investors currently seem quite sanguine about the state of the global economy and, by extension, the resilience of stock markets. This shouldn't be a surprise as the playbook of the past few years has been simple: ignore the noise and stay on the bandwagon.

Nevertheless, some cracks in the big tech momentum trade started to appear towards the close of last year and it's easy to overlook the fact that there were many other ways to make money than owning seven massive US stocks. At the time of writing, the cooling in speculative enthusiasm that was evident towards the end of last year appears to have carried through to 2026. This broadening in participation is encouraging, supporting the idea of an orderly rotation away from the dominant winners of recent years rather than rupture.

Despite these positive signals, we have always side stepped the temptation to forecast the year ahead. Instead, we spend more time attempting to back-out what is already priced in and what could go wrong. A year ago, we were concerned about a bubble building (it didn't, although more on that later), geopolitics and Trump's trade tariffs. 2025 instead offered a salutary reminder that investors ultimately care about transmission mechanisms more than headlines. In other words, markets can tolerate political noise as long as macro conditions – growth, inflation, and liquidity – remain supportive. That framing sets up the year ahead as an exercise in scenario analysis rather than narrative prediction.

This year the key questions being asked are elemental: are we in a bubble, and what happens next if AI disappoints? On the bubble question, the consensus tone is “probably not and certainly not in the broad, system-wide way that typically matters.” On the “what next?” question, we would similarly offer the anti-climactic response that it also doesn't matter, because the opportunity set is now sufficiently wide that there is “something for everyone”. This should not be regarded as complacency. It is instead a reframing of how risk may be expressed in the year ahead – less as a single market crash narrative, more as a contest between regimes, leadership rotations, and the ability of portfolios to absorb shocks without forfeiting upside.

In this paper, we reflect on the broader market backdrop to provide context before considering the potential anatomy of a market rotation. We have very limited historical precedents to draw upon but we like the comparison with the Nifty Fifty experience of the early 1970s. The key lesson from any bubble though is that valuation always matters in the long run. Fortunately, there are plenty of attractive places to hide today that don't require jumping off the bandwagon and running for the hills. **Our main message is that it will be critical to build in portfolio resilience through diversification during the year ahead.**

Late cycle, not end of cycle

After another strong year for equities, markets continued to edge higher, though geopolitical risks in January and concerns related to technology in early February introduced bouts of caution. The current US bull market is the second longest and second strongest in at least 100 years so it may not be wise to expect more of the same. However, it's not hard to do exactly that, particularly if the focus is primarily on the favourable economic environment and central bank support. Historically, it's clear that rate cuts delivered near equity all-time highs have been beneficial.¹ This makes sense because if equity markets are close to their highs, the global economy is rarely in trouble and policy easing is more likely to be precautionary or aimed at sustaining expansion rather than averting a collapse. Such a backdrop would also be consistent with a mild reacceleration of economic activity – helped by Federal Reserve (Fed) easing and fiscal expansion in Europe, Japan, and China. This is all very encouraging but importantly the tone is not “new cycle boom”, but “broad-based resilience”.

Against this benign backdrop, recent surveys of global fund managers read like a classic late-cycle behavioural setup with cash levels reported to be at multi-year lows alongside high allocations to stocks and commodities. Expectations for a stronger economy have also jumped, suggesting that a modest reacceleration is now consensus. **Despite this, other metrics of market optimism are not so bullish as to make us overly concerned about near-term returns, but it does raise the probability of greater fragility.** We have already observed in recent earnings seasons that good news is having a diminishing positive impact whilst negative surprises have created sharp downward moves. The lack of “dry powder” and fewer natural buyers on weakness may mean that this becomes the norm.

In a similar vein, according to the Bank of America investor survey, the most cited crowded trades in the monthly poll are being long mega-cap growth and long gold – an unusual pairing that signals both enthusiasm and hedging anxiety. A “disorderly rise in yields” remains another core fear, and private credit has recently emerged as a top-tier concern. We would add inflation resurgence as another underappreciated potential risk this year as global inflation rates appear to have settled into a higher range and may even be turning up again.

The point here is not that these risks are destined to crystallise; it is that investors are aware of them while simultaneously being heavily invested. Such a psychological mix often produces fast rotations rather than orderly repricing.

This tension – strong returns and improving breadth on the one hand (e.g. World ex US), crowded positioning and valuation discomfort on the other (AI/US Tech) – could ultimately determine the 2026 narrative: rotation and resilience.

We do not deny that surface valuations look demanding for equities, especially in the US, but we resist the simple conclusion that expensive equals either unstable or unsustainable. It would be fair to say that a big share of the current US market premium is justified by the superior quality of its constituents and a significant sector mix shift toward technology. **In this context, the headline S&P 500 multiple is as much an artifact of what the index has become as it is a measure of speculative heat.**

Moreover, in contrast to 2023 and 2024, AI exuberance did not in fact drive multiple expansion last year. The forward earnings multiple on the S&P 500 Tech sector was surprisingly stable during 2025 (in fact modestly de-rating thanks to strong earnings) whilst the index re-rated from 21.4x to 22.5x as the rest of the market started to catch up. **This distinction is an important nuance for 2026 as the next leg of returns is likely to depend even more directly on earnings delivery and cash conversion.** Fortunately, analysts are currently predicting greater breadth in earnings contributions across sectors which will help to justify re-rating in non-tech stocks.

Investors were nevertheless still becoming jittery towards the end of 2025 about the extent of capital expenditure (capex) being funnelled into AI projects by the hyperscalers, as well as the increasing use of circular financing arrangements. Higher volatility in the price of Bitcoin was as good a bellwether as any for tech sentiment. With these concerns in mind, **we now focus more closely on whether we are in an “AI bubble” and what this could mean for markets.** Whilst AI enthusiasm already appears to be cooling, which is a good thing, the way this plays out will have a huge impact on broader sentiment.

Anatomy of a bubble

Artificial intelligence has clearly been the dominant narrative in global equities since ChatGPT arrived on the scene in November 2022. Equity investors have enjoyed three consecutive years of double-digit gains since with most of the heavy lifting undertaken by a relatively narrow group of stocks, particularly in 2023 and 2024.

¹Based on data from 1980, there have been 17 occasions where the Fed has cut rates at the same time as the S&P 500 has been trading within 1% of an all-time high. On average across these periods, the benchmark has gained by ~15% over the subsequent year with no instances of negative absolute returns.

Whilst the winners were not just limited to the Magnificent-7, we will rather lazily use them as a proxy for the AI trade. By the end of 2025 they accounted for around 35% of the market capitalisation of the S&P 500 but explained well over half of the benchmark's 21.9% annualised return over the prior three years and contributed even more to earnings growth. Meanwhile, the "average" stock (as measured by the equally weighted S&P 500) "only" rose by 11% over the same three years.

Given this concentration, many commentators have noted that a potential AI-driven equity bust is the key downside risk to the global outlook. For example, Bank of America's survey of global fund managers in December 2025 suggested that 38% of investors see an "AI bubble" as the biggest "tail risk". This was lower than November (45%) but remained the most widely cited risk. Confusingly, at the same time, there is hardly a strong consensus that US Tech valuations have become excessive.

Whilst there is no widely accepted definition of a "bubble", on the empirical evidence, today's AI-driven equity regime shares many of the core features of past bubbles:

- Valuations for the overall US market and especially for AI-linked leaders are near the top of their historical ranges.

- Market concentration in a small set of mega-cap stocks exceeds dot-com levels (the top 10 stocks in the S&P 500 control 39% of index market cap, almost an all-time high, compared to a peak of ~29% early 2000).
- The growth of AI as a theme is being accompanied by large capex plans and strong narrative framing.
- Retail participation and derivatives activity in the leading names remain elevated, and index construction itself is increasingly dominated by AI winners.

Taken together, the current configuration is broadly consistent with historical episodes that are now uncontroversially labelled bubbles, but the metrics do not appear to be as extreme. Taking valuation as the easiest yardstick to compare across time periods, the table below suggests that the current forward P/E multiples of the popular stocks today (27x) are nowhere near as elevated as the TMT (52x) or Japanese bubbles (67x) and still not as stretched as the early 1970s (34x) – see table.

Valuation of popular stocks in prior bubbles

Magnificent 7 (2025)	Market weight	24m Fwd P/E	Japan Financial Bubble (1989)	Market weight	24m Fwd P/E
NVIDIA	7.8%	26.1	Nippon Telegraph & Telephone	6.9%	100.1
Microsoft	6.8%	27.2	Industrial Bank of Japan	4.6%	154.2
Apple	6.6%	29.1	Sumitomo Mitsui Banking	3.4%	49.2
Alphabet	4.9%	20.8	Bank of Tokyo-Mitsubishi	3.3%	49.8
Amazon	4.1%	24.9	Fuji Bank	3.1%	52.8
Meta Platforms	2.7%	21.2	Dar-Ichi Kangyo Bank	2.9%	44.0
Tesla	2.6%	135.2	Sakura Bank	2.8%	62.1
Mag-7 (2025) Aggregate	35.5%	26.8	Japan Financial Bubble (1989) Aggregate	27.0%	67.0

Tech Bubble Leaders (2000)	Market weight	24m Fwd P/E	Nifty 50 (1973)	Market weight	24m Fwd P/E
Microsoft	4.5%	53.2	IBM	7.1%	35.5
Cisco Systems	4.2%	101.7	Eastman Kodak	3.6%	43.5
Intel	3.6%	42.1	Sears Roebuck	2.7%	29.2
Oracle	1.9%	84.6	General Electric	2.0%	23.4
IBM	1.7%	23.5	Xerox	1.8%	45.8
Lucent	1.6%	37.9	3M	1.4%	39.0
Nortel Networks	1.5%	86.4	Procter & Gamble	1.4%	29.8
Tech Bubble Leaders (2000) Aggregate	19.0%	52.0	Nifty 50 (1973) Aggregate	19.9%	34.3

Source: Goldman Sachs "Why we are not in a bubble... yet", October 2025. Shown for illustrative purposes only and should not be viewed as a recommendation to buy or sell any financial instrument.

Back to the 1970s

Each bubble has its own peculiarities, and to be fair there are not many to choose from, but we think the Nifty Fifty episode (late 1960s/early 1970s) is a reasonable echo of the situation today². To recap, in the late 1960s and early 1970s, a group of US blue-chip growth stocks were the then darlings of the market, trading on superior valuations, as they were perceived as safe, secular growers that one could buy and hold indefinitely (sound familiar?). Against the backdrop of surging inflation and other macro shocks, valuations collapsed with the Nifty-Fifty falling by 60% from their peak in 1973, although many names fell by more (e.g. Polaroid -91%, Xerox -86%). As a group, they lagged the broader market by more than 30% cumulatively between 1973–1977.

The reason we like the comparison is that, unlike the TMT boom or the speculative frenzy in Japan in the late 1980s, most of the Nifty companies were high quality businesses that remained industry leaders for decades (e.g. Walmart, McDonalds, Procter & Gamble, Coca-Cola, Walt Disney, IBM, General Electric, Johnson & Johnson etc). With the benefit of hindsight, we can now work out how much of the Nifty Fifty bubble was speculative mania and how much was justified by strong fundamentals. Fortunately, the prominent US financial economist Jeremy Siegel undertook exactly this analysis more than 25 years ago, just as the TMT bubble was emerging. He pointed out that the Nifty Fifty's subsequent earnings growth averaged ~11% (about 3pp higher than the S&P 500), which broadly offset their much lower initial earnings yield.³

The key lesson we should take from the wreckage of the 1974 bear market is that despite the Nifty Fifty being fairly valued at the peak based on their superior quality, a loss of confidence by investors still sent them to dramatically undervalued levels. Siegal's conclusion from this is that you must pay for growth but don't "pay any price" and, most importantly, be diversified among various growth stocks and groups. More than a quarter of a century after the last big tech bubble, his advice seems as pertinent as ever.

We don't know yet whether the future earnings of the hyperscalers will justify the trillions of dollars of capex currently being funnelled into AI infrastructure, but the historical pattern suggests that even if a brand-new technology is genuinely transformative, future equity returns for the initial perceived leaders have often been modest or poor. Telecom stocks in the early 2000s offer a good case study of how too many networks got built too quickly as "capex" became the product.

On a more positive note, **the historical record also shows a clear pattern of leadership rotation when a bubble bursts.** In the early 2000s, global returns were driven by emerging markets, commodities and value stocks. In the 1970s, real assets and select cyclicals handled the inflationary shock better than the high-multiple growth franchises of the Nifty Fifty. Correctly timing such a rotation is the tricky part for investors. In an ideal world, there would be an orderly handover to downstream winners and AI adopters. Leadership would be different, and broader than it has been of late, but the market could still advance from current levels. A less ideal scenario would be more like 1973-74, which, regardless of the strong future growth prospects for the popular stocks, still saw dramatic declines and a decade-long wait for investors to get back to prior highs in nominal terms.

Building resilience through diversification

Given the uncertainty about the speed and extent of any rotation, the goal should be to introduce portfolio resilience through broad based diversification. Fortunately, **there are plenty of areas to select from that offer both compelling quality and attractive valuations.** After all, it's easy to forget that over the past four decades, the equally weighted S&P has notably outperformed its far more closely tracked cap-weighted parent, albeit with long and variable cycles. As a result, the "average" stock today is quite compelling, and the long-run trend of equal-weighted dominance suggests there is huge scope for renewed breadth over an extended period.

S&P 500 Equal Weight / Market Cap Weight



Source: Official S&P 500 equal-weighted index back to 1989. Prior to this, estimated using Topdown charts calculation from 1973 to 1989 for illustrative purposes only. **Past performance is not a guide to future results and may not be repeated.**

²As a test, we used the Enterprise version of ChatGPT 5.2 to build a "bubble probability" model using eight prior bubbles as the training data with seven features (valuation, concentration, leverage, narrative intensity, breadth, retail speculation and IPO mania). The model suggested we "look most like" a blend of 2000 dot-com (35% probability), Nifty-style concentration (23%) and the 2021 speculative meme mania (21%), with some tail resemblance to the even uglier bubbles (e.g. 1929 Wall Street Crash, 1989 Japan). The fact that the model is far more bearish than the consensus is perhaps another cautionary note.

³"Valuing Growth Stocks: Revisiting the Nifty Fifty" by Jeremy Siegel. October 1998.

In a world of still elevated uncertainty, Quality is a natural haven, particularly for the cheap defensives that have been left behind but opportunities can be found across the board. However, starting with the unloved defensives sectors, there will come a moment for a broad opportunity in consumer staples (e.g. falling inflation, weakening growth) but until then we prefer healthcare as it offers better value with less uncertainty. The key landmine to avoid within consumer staples is the far-reaching impact of changing diets and lifestyles. This is already widely reflected in the cheaper names whilst the better-quality stocks are still too expensive following a decade of rerating when bond yields were closer to zero.

Cyclicals are therefore more likely to be an initial beneficiary of a broader market rotation as they fit into the growth reacceleration story and investors will probably feel that it is less of a jump from technology. Japan offers many options if the goal is to diversify into both deep value and economic sensitivity, but investors will probably find it safer to instead sift through industrials in the US and Europe (e.g. construction, manufacturing). In the same vein, industrial metals look better placed to be invited to the precious metals party but even energy stocks may attract renewed interest as investors are materially underweight and it would only take a modest shift in sentiment to produce outsized flows.

Regionally, many of these diversifiers are outside of the US but we would take a more nuanced bottom-up view (whilst managing the top-down country risk) rather than making sweeping generalisations. Nevertheless, there are lots of emerging market stocks which are both high quality and attractively valued. Dollar weakness will probably not be the same tailwind it was in 2025, but it is unlikely to resume its prior strength if the Fed continues to cut, particularly as other countries are closer to the end of their easing cycle (the UK is the main exception).

China's positioning in the broader technology race should also be considered in similarly nuanced terms. The US remains ahead in core innovation layers – semiconductors, AI frameworks, cloud infrastructure, quantum – yet China is rapidly closing the gap or even leading in practical applications such as physical AI and robotics. It is also embracing the strategic pursuit of technological self-sufficiency more wholeheartedly than any other country. This matters because "AI exposure" is not a single-country bet. It is a set of supply chains, end markets, policy choices, and capex cycles that will distribute returns unevenly across regions and sectors. A portfolio built for 2026 should assume that technology leadership will be contested and that returns will accrue not only to the obvious platform winners but also to enablers – power, grids, materials, industrial automation.

From a style point of view, Value ex-US had a great run in 2025 and, as a cohort, is still priced cheaply relative to its history which bodes well for more of the same in 2026. Ultimately, there is a long tail of stocks that would benefit from a bubble deflation as the breadth of "good value" (i.e. sub 10 price/earnings multiples) is still very much evident despite recent re-rating. Value stocks are also lowly correlated with AI-stocks and have delivered significantly better outcomes in down-markets. However, as always, good stock selection will be crucial.

There is an implicit asymmetry here. If 2026 is a "good, not great" year for growth but policy is gently supportive, then the opportunity cost of looking beyond the concentrated winners falls sharply. Investors can own the US and AI beneficiaries while also reallocating toward assets that benefit from improving breadth, policy tailwinds, and cheaper starting valuations. That is the sense in which "it doesn't really matter" whether the AI trade is a bubble: even if AI leadership persists, the rest of the market may still offer comparable or better forward return potential simply because it is less crowded and priced more conservatively.

Alongside the AI-enablers, we shouldn't forget that across all sectors and regions it will be the firms that translate AI-enabled efficiency into actual earnings durability which will offer the greatest upside opportunities for investors. AI is increasingly becoming a cost of doing business and no company can afford to ignore it, but it will be those who are best at monetising it that benefit the most. For example, pharma is a fertile area for AI adoption (and an area that we like).

What could go wrong (and right)

What are the potential regime breaks that may determine whether 2026 is another easy year or one that will be written about in history books? One risk is straightforward **growth disappointment**. At the economy level, such a backdrop would most likely be a boon for the US and the dollar. Defensives would outperform while EM and cyclicals struggle. If growth also falls short of expectations in the hyperscalers and other big AI darlings, the concentrated nature of the market will also naturally lead to much poorer equity returns. The second is an **inflation surprise** – potentially driven by renewed trade conflict – where both bonds and cyclical/EM exposures also suffer. The third is the upside risk: **AI momentum re-accelerates** decisively, validating the concentrated leadership and making under-ownership of the US expensive. A fourth is **Europe-specific political risk** that could reintroduce currency and risk premia shocks. Another concern related to AI valuations is the sharp jump in **direct lending tied to the technology sector** which is making private credit managers newly cautious. **These all point to holding a broadly diversified portfolio focused on good bottom-up stock selection from both defensive and cyclical areas rather than expecting "beta" to save the day again.**

There are also several structural issues building in both the US and other major regions relating to solvency, but the stock market is typically myopic when it comes to longer-term forces. However, one structural risk which appears to be underappreciated is the availability of energy to power existing infrastructure and the incremental demands of AI data centres. This is a real-economy constraint that will shape winners and losers across utilities, energy, grids, and capex supply chains – and could also cap the market's willingness to pay for smooth "AI margin expansion" stories. This may have been the key motivation for Trump's recent foray into Venezuela, which will over time direct the country's abundant heavy oil reserves to US refineries.

Navigating an “almost bubble”

Looking in the rear-view mirror is not very helpful in terms of offering a prescriptive timetable for what may happen in 2026 but it does provide some broad guidance:

- In past episodes where equity markets exhibited simultaneously high valuations and extreme concentration in a dominant growth narrative, the subsequent 5–15 years have rarely (or never?) rewarded continued concentration in the same leaders.
- Global equity markets have nevertheless still generated acceptable long-run returns, but via rotation toward different sectors, styles and regions – Value over Growth, defensives and real assets over glamour sectors, EM and ex-US over the prior centre of exuberance.
- During the unwind phase itself, defensive sectors such as staples, healthcare and utilities have tended to fall less or even outperform, cushioning portfolio drawdowns.

It is well understood that **the main difference today versus the most relevant historical bubbles is that the market leaders now are highly profitable incumbents, not loss-making start-ups. On that dimension, they resemble the Nifty Fifty more than the average dot-com IPO. History shows that such companies can ultimately vindicate optimistic narratives at the business level – but that starting valuations still matter.** For investors who bought Nifty names or Japanese blue chips at peak prices, the next decade delivered low or negative real returns despite the survival of many franchises. Leading AI companies act like they are in an arms race but the real winners in the long run will also be the AI adopters.

It’s tempting to assume that past winners will continue to lead, but history suggests that turning points emerge when leadership concentration reaches extremes. However, the average correlation between members of the Magnificent-7 has recently fallen towards zero and performance dispersion is high. This is a healthy sign that investors are differentiating. Fundamentals matter.

Resilience in 2026 may depend less on “calling the top” and more on managing exposures that work across regimes – those priced for realism, not perfection. Historically, investors have been rewarded for not blinking when the market is at an all-time high, although this does not preclude rotation in leadership.

We suspect that **2026 will reward investors who treat “bubble risk” as a reason to diversify exposures, not a reason to abandon equity risk.** The market may not be in a classic bubble, but it has some of the hallmarks: elevated expectations and crowded positioning. But **it need not be all or nothing.** One strategy would be to maintain a foothold in the AI/US leaders while actively building resilience through breadth: cheaper non-US equities and deep value exposures alongside and sectors with either policy tailwinds or idiosyncratic catalysts. Even if the AI trade continues to perform, investors can rebalance toward more attractively priced opportunities. This strategy not only preserves return potential – it may also strengthen portfolios against volatility if AI leadership does indeed falter.

Our systematic process prioritises companies with attractive valuations and high-quality fundamentals – strong profitability, earnings stability, and prudent capital allocation. In this environment, we see this approach as particularly well suited to navigate the transition from concentration to broader market participation. It naturally biases us away from crowded trades and toward areas of the market where investor enthusiasm is yet to catch up with fundamentals.

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