January 2026

Pragmatic Perspectives

2026 Investment Outlook

By Habib Moudachirou, FRM

Executive Summary

The 2026 investment landscape opens with a paradox; markets continue to press toward new highs, while the macroeconomic environment, the (geo)political context, and valuation signals foreshadow less rosy economic conditions.

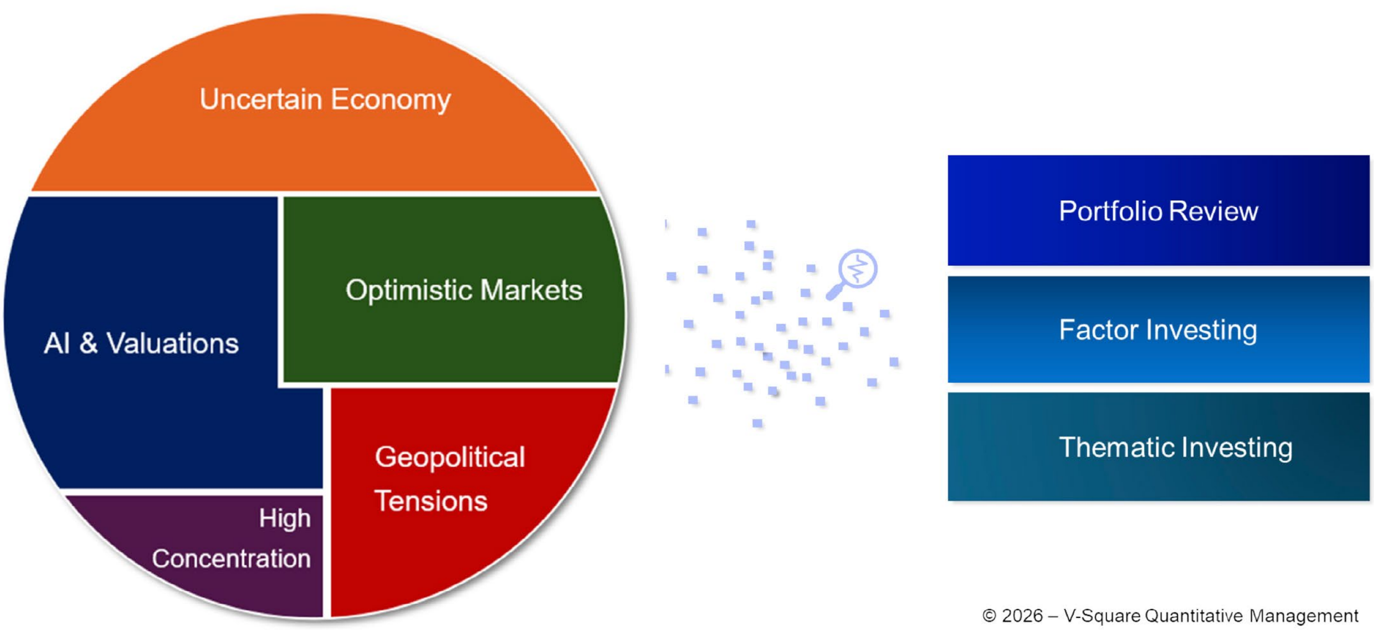
The past two years of artificial intelligence (AI) driven productivity enthusiasm, combined with resilient U.S. growth and a general disinflation trend, have produced one of the strongest momentum regimes since the mid-1990s. However, as valuations stretch and geopolitical realignments accelerate, investors may be entering a phase in which dispersion, factor rotation, and thematic investment matter more than mere broad market exposure.

We approach 2026 with a framework centered on systematic resilience, factor diversification, and thematic opportunities. We believe the next phase of returns will be earned, not by passively replicating broad indexes, but by navigating the growing internal fractures within equity markets and recalibrating overall portfolios.

Our 2026 trends to watch are Factor Investing, AI and Valuations, and Thematic Investing within Geopolitical fragmentation, with considerable implications for investment portfolios.

What lies ahead

How we navigate



How High Can We Go?

The 2026 market opens in a place that feels both positive and fragile. Equities have climbed on the back of resilient U.S. growth, disinflation progress, and an AI-driven productivity narrative that lifted investment returns in 2025. Looking back on the representative index over the last 10 years, all asset classes delivered positive returns for the first time since 2019, with international and emerging market equities, natural resources, and global infrastructure being remarkable winners.

However, perhaps signaling fragility beneath the surface, risk premia are compressed, valuations are stretched in key industries, and the macroeconomic regime is shifting from "beta play" to "earned returns." We consider that rather than asking whether markets can go higher, we should be more nuanced and ask how far they can rise before the underlying fundamentals, liquidity conditions, and geopolitical risks force a repricing.

From a macro perspective, 2026 looks less like a classic late-cycle peak and more like a "soft plateau." Growth is slowing from postpandemic highs but remains positive in most developed markets. At the same time, inflation has finally moderately come down, although services and wage dynamics keep central banks cautious rather than outright dovish. The labor market showed signs of cooling, prompting the Federal Reserve (Fed) to cut rates by 25 bps three times in the second half of 2025, bringing them to the 3.50%–3.75% range. The Fed is signaling more easing, but the path to more cuts remains uneven and data-dependent. This environment encourages broad optimism for continued economic growth and equity gains, but the outcomes are increasingly uneven: high concentration in the potential positive returns of specific themes and sectors, while downside risk is more likely to emerge through sharp, episodic corrections than through a slow and orderly drift lower. A potential bubble in AI stock valuations, the circularity of AI-related investments, increasing geopolitical tensions, and the lack of clarity on tariffs are among the risks most pay attention to. Market volatility will likely remain elevated due to those uncertainties, as well as uncertainties on future U.S. economic policies.

Returns Across Asset Classes

Higher Returns ↑ / Lower Returns ↓

2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Nat. Resources 28.2%	EM Equities 37.8%	Intl. Bonds 3.2%	US Large Cap 31.4%	US Large Cap 21%	REITs 43.1%	Nat. Resources 15.8%	US Large Cap 26.5%	US Large Cap 24.5%	EM Equities 34.3%
US Small Cap 21.3%	Intl. Equities 27.2%	T. Bills 1.9%	Gbl. Infra 28.7%	US Small Cap 19.9%	Nat. Resources 27%	T. Bills 1.3%	US Small Cap 16.9%	US Small Cap 11.5%	Intl. Equities 32.4%
US Corp. HY 17.1%	US Large Cap 21.7%	US Gov. Bonds 0.9%	REITs 25.9%	EM Equities 18.8%	US Large Cap 26.4%	Gbl. Infra -6.6%	Intl. Equities 15.6%	Gbl. Infra 9.9%	Nat. Resources 31%
Gbl. Infra 12.5%	Nat. Resources 18.3%	US Corp. HY -2.1%	US Small Cap 25.5%	Intl. Equities 10.7%	Gbl. Infra 19.9%	Intl. Bonds -9.8%	REITs 13.7%	REITs 8.8%	US Large Cap 17.3%
US Large Cap 12%	Gbl. Infra 15.8%	US Corp. Bonds -2.5%	Intl. Equities 21.5%	US Corp. Bonds 9.9%	US Small Cap 14.8%	US Corp. HY -11.2%	US Corp. HY 13.4%	US Corp. HY 8.2%	Gbl. Infra 14.1%
EM Equities 11.7%	US Small Cap 14.6%	REITs -4.5%	Nat. Resources 19.2%	US Gov. Bonds 8%	Intl. Equities 7.8%	US Gov. Bonds -12.5%	EM Equities 10.2%	EM Equities 8%	US Small Cap 12.8%
REITs 8.6%	US Corp. HY 7.5%	US Large Cap -4.8%	EM Equities 18.8%	US Corp. HY 7.1%	US Corp. HY 5.3%	US Corp. Bonds -15.8%	US Corp. Bonds 8.5%	Intl. Equities 5.5%	US Corp. HY 8.6%
US Corp. Bonds 6.1%	US Corp. Bonds 6.4%	Gbl. Infra -7.9%	US Corp. Bonds 14.5%	Intl. Bonds 3.9%	T. Bills 0%	Intl. Equities -16%	Intl. Bonds 8.3%	T. Bills 5.3%	US Corp. Bonds 7.8%
Intl. Bonds 4.9%	REITs 5.1%	Nat. Resources -8.7%	US Corp. HY 14.3%	Nat. Resources 1.6%	US Corp. Bonds -1%	US Large Cap -19.1%	T. Bills 5.1%	Intl. Bonds 5%	US Gov. Bonds 6.3%
Intl. Equities 4.5%	Intl. Bonds 2.5%	US Small Cap -11%	Intl. Bonds 7.6%	T. Bills 0.7%	Intl. Bonds -1.4%	EM Equities -19.8%	Gbl. Infra 4.5%	US Corp. Bonds 2.1%	T. Bills 4.3%
US Gov. Bonds 1%	US Gov. Bonds 2.3%	Intl. Equities -14.2%	US Gov. Bonds 6.9%	Gbl. Infra -7%	EM Equities -2.3%	US Small Cap -20.5%	US Gov. Bonds 4.1%	US Gov. Bonds 0.6%	REITs 2.9%
T. Bills 0.4%	T. Bills 0.8%	EM Equities -14.3%	T. Bills 2.3%	REITs -7.5%	US Gov. Bonds -2.3%	REITs -24.5%	Nat. Resources -1.1%	Nat. Resources -7.9%	Intl. Bonds 2.8%

V - SQUARE QUANTITATIVE MANAGEMENT

Index Total Return data retrieved from Bloomberg as of 12/31/2025.
Indexes shown are as follows (order of top to bottom for 2016): Morningstar Global Natural Resources Index, Russell 2000 Index, Bloomberg US Corporate High Yield Index, Dow Jones Brookfield Global Infrastructure Index, Russell 1000 Index, MSCI Emerging Markets Index, MSCI US REIT Index, Bloomberg US Corporate Bond Index, Bloomberg Global Aggregate ex USD Index, MSCI ACWI ex USA Index, Bloomberg US Treasury Index, Bloomberg US Treasury Bill Index.

Source: Bloomberg, Morningstar, Dow Jones, Brookfield, FTSE Russell, MSCI, V-Square Quantitative Management LLC. Data reflects indexes' total returns for each calendar year, December 31, 2016, through December 31, 2025. For each calendar year, indexes are arranged by total return in descending order (highest return at top, lowest return at bottom). Select indexes were chosen to serve as proxies for asset classes. Other indexes are available. It is not possible to invest directly in an index. Index returns do not reflect any management fees, transaction costs, or expenses. Past performance does not guarantee future performance. The information and opinions contained herein are for informational purposes only, do not purport to be full or complete, do not constitute investment advice, and may not be relied on.

Factors as a Key to Read the Markets

U.S. stocks are expected to continue their bull run, potentially outperforming global peers this year. U.S. monetary policy, fiscal stimulus, resilient earnings, and innovation remain supportive of growth in the year ahead.

The defining feature of the last several years has been the dominance of momentum and growth-oriented exposures driven by the Magnificent Seven (Mag 7). In factor lexicon, the market actor itself has been strong, but the behind-the-scenes developing story has been the persistent outperformance of high beta, growth, and AI-linked names. Decoding this within the Fama-French framework, we see a regime where the market excess return has been robust, the size factor has often favored larger, more liquid names over smaller ones, and the value factor has struggled relatively to the growth factor, despite occasional value factor rallies. The momentum factor, often proxied by a winners-minus-losers (UMD) factor, has been particularly powerful, exhibiting the persistence of trends in mega-cap technology and AI infrastructure.

Gross Performance as of 01/21/2026 in USD									
Index Name	1D	1W	1M	3M	YTD	1Y	3Y	5Y	10Y
MSCI USA Index	1.1%	-0.8%	0.6%	2.1%	0.5%	14.7%	21.9%	13.3%	15.9%
VOLATILITY MSCI USA Minimum Volatility Index	0.7%	-0.4%	0.2%	0.0%	0.1%	5.7%	11.1%	8.6%	11.2%
YIELD MSCI USA High Dividend Yield Index	1.4%	0.3%	4.4%	5.6%	4.4%	13.5%	11.7%	9.9%	11.4%
QUALITY MSCI USA Quality Index	1.1%	-0.3%	1.0%	4.0%	1.1%	15.1%	24.4%	14.1%	17.1%
MOMENTUM MSCI USA Momentum Index	0.9%	-0.3%	1.3%	1.2%	2.1%	13.8%	20.9%	9.0%	15.3%
VALUE MSCI USA Enhanced Value Index	2.7%	2.0%	7.3%	14.8%	7.3%	35.6%	19.1%	12.4%	13.4%
SIZE MSCI USA Equal Weighted Index	1.4%	-0.1%	2.9%	3.6%	3.3%	9.2%	13.7%	9.2%	12.8%
GROWTH MSCI USA Growth Target Index	1.0%	-0.6%	0.0%	4.6%	0.1%	20.9%	23.1%	12.1%	15.3%

Source: MSCI. All returns over 1 year are annualized.

Historically, momentum regimes tend to break when macro volatility rises, policy uncertainty spikes, or a new narrative displaces the old one. All three ingredients are present in 2026, but we believe that none has reached a tipping point yet. Corporate earnings expectations for AI-linked and high-quality growth companies remain optimistic, and the market looks to continue to reward profitability and scale. Investors should move toward more systematic risk controls, intentional factor diversification, and selective exposure to the value factor to avoid being blind spotted by a regime change.

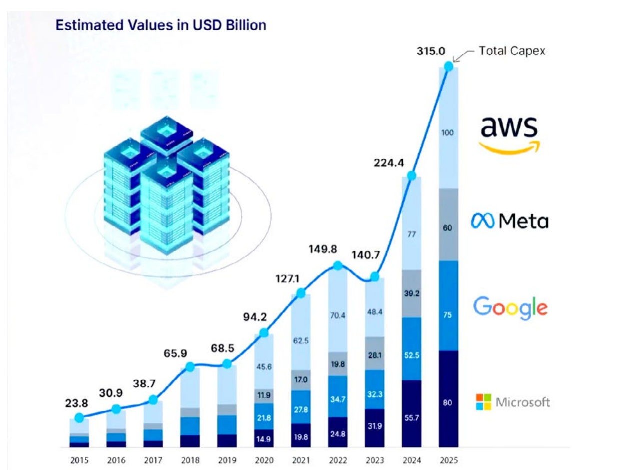
AI and Valuations: Promise vs. Future

AI has been the driving force for the last couple of years. AI adoption is reshaping capital expenditure decisions, productivity expectations, and competitive dynamics across sectors. However, market pricing of AI exposure is highly imbalanced.

The most direct beneficiaries of AI, including semiconductor designers, manufacturers, and cloud infrastructure providers, have experienced significant growth by many multiples already. AI-adjacent software and platform companies have also benefited from the boom. Nonetheless, the risk of AI-washing looms with the distinction between genuine AI integration and overstatements of AI integration, as well as the risk that the massive spendings do not return all its promises.

AI-focused equity benchmarks provide a useful illustration. Semiconductor-oriented Exchange Traded Funds (ETFs) such as iShares Semiconductor ETF (ticker SOXX) and VanEck Semiconductor ETF (ticker SMH) show concentrated exposure to the chip value chain and exhibit very strong but volatile performance, marked by sharp drawdowns during risk-off periods followed by rapid recoveries as the AI narrative reasserts itself. Broader AI and technology exposures, such as those captured by the Global X Artificial Intelligence & Technology ETF (ticker AIQ), have tended to follow a smoother but still growth-biased path due to more diversified holdings.

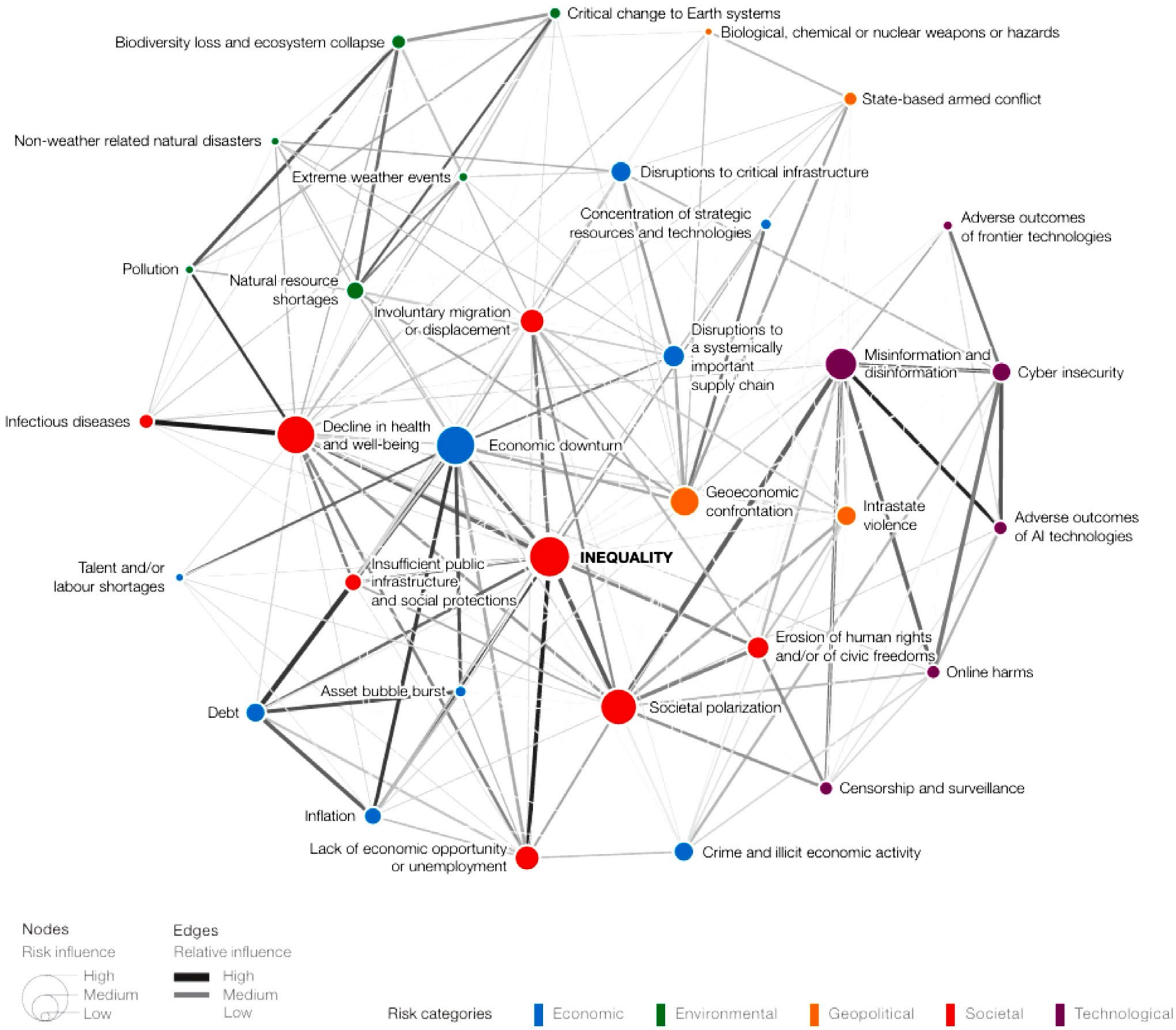
From a quantitative perspective, we caution investors not to treat AI as a single trade. Thoughtful investment requires a disciplined framework that integrates earnings revisions, capital efficiency, balance sheet strength, and valuation sensitivity to be able to distinguish durable compounders from cyclical beneficiaries and speculative investments.



Source: DC Pulse. Company Reports, Houlihan Lokey Report 2025. Capital Expenditure (Capex) is money a company spends to buy, maintain, or upgrade long-lasting assets with the goal of improving or expanding its business. Capex shown is the company total. Data are as of August 13, 2025.

Geopolitics and Thematic Investing

Layered on top of risk premium and AI dynamics is a geopolitical context that is structurally more fragmented than in previous decades. Strategic competition between major political powers, supply chain reconfiguration, energy security concerns, and short cycles of election-driven policy shifts are no longer tail risks. They are becoming core to the investment landscape we operate in.



Source: World Economic Forum Global Risks Perception Survey 2025-2026. This information should not be relied upon by the reader as research or investment advice regarding any funds, strategy, or security in particular.

With semiconductor companies at the center of AI talks, export controls, subsidies, and national industrial policies have weaponized chip supply chains into instruments of geopolitical strategy. As a result, it is no longer enough to understand company fundamentals; investors must also consider, now more than ever, relevant political dynamics, both locally and abroad.

Beyond semiconductor companies, themes such as energy transition, grid modernization, defense, cybersecurity, and critical minerals are being thrust back into the spotlight by geopolitical tensions and fragmentation. These themes present opportunities for investors, and we believe are best approached through a systematic and rules-based framework, to capture structural shifts while avoiding simple narrative chasing.

At V-Square, we do not consider thematic investments and exposures as standalone bets. In our view, they must be integrated components of a broader portfolio construction process, aligned with measurable fundamentals such as cash flow sustainability, capital intensity, and balance sheet resilience. The objective is always to enhance true diversification.

What it Means for Investment Portfolios in 2026

This V-Square 2026 Economy and Market Outlook support a posture of cautious offense. Markets may continue to advance, but the path forward is narrowing and more dependent on macroeconomic regime dynamics than in earlier phases of the economic cycle. History suggests that extended momentum-driven environments eventually give way to periods in which value, quality, and size factors reassert themselves, often through abrupt rotations rather than gradual transitions.

In practical terms, this calls for investment portfolios to retain exposure to dominant growth and momentum trends while being prepared for change, notably by maintaining allocations to quality and yield factors, keeping discipline within value and size factor exposures, and incorporating AI and geopolitically sensitive themes in their overall portfolio, within a defined risk budget.

Rather than giving a single numerical answer to the question "How high can we go?", we propose a more nuanced answer. We believe that markets will continue to move higher as long as earnings, liquidity, and narratives remain aligned, but the opportunity cost of ignoring the higher concentration, valuations, and geopolitical risk is rising. We believe that the opportunity in 2026 lies in embracing this new normal and deftly adapting, sooner rather than later. Quantitative tools are well-suited to utilize factor investing and thematic investment as surgical instruments to skillfully navigate evolving economic and market landscapes. The goal is always the same: construct balanced portfolios that participate in the upside while remaining resilient during the correction bursts that increasingly define modern market cycles.

[1]The "Mag 7" or "Magnificent Seven" stocks are a group of seven dominant, high-growth technology companies that have been significant drivers of the U.S. stock market's returns in recent years. The seven companies that comprise the "Mag 7" are: Apple Inc. (AAPL), Microsoft Corp. (MSFT), Amazon.com, Inc. (AMZN), Alphabet Inc. (parent company of Google, with share classes GOOGL and GOOG), Meta Platforms, Inc. (META, formerly Facebook), Nvidia Corp. (NVDA), and Tesla, Inc. (TSLA).

[2]The Fama-French three-factor model is a fundamental asset pricing model developed by Eugene Fama and Kenneth French in 1992 that expands on the traditional Capital Asset Pricing Model (CAPM). It explains stock returns using three primary factors: market risk, firm size, and book-to-market value (value vs. growth)

.[3]The "UMD factor" typically refers to the Up-Minus-Down (UMD) momentum factor in financial asset pricing models. The UMD factor is an addition to the Fama-French three-factor model (which includes market risk, size, and value factors) to create the comprehensive Carhart four-factor model, providing a more complete explanation for the cross-section of stock returns.

Pragmatic Perspectives

IMPORTANT INFORMATION