

Earnings and Innovation: A Tailwind for Global Equities?

Alex Tedder examines reasons for optimism, even amid elevated valuations, while Tom Wilson explores the factors that could sustain emerging-market equity performance in 2026.

Investors in developed markets still face high valuations, policy uncertainty, and concentrated sector leadership, but we think supportive elements such as resilient earnings and advancements in AI could offer meaningful upside. Meanwhile, in emerging markets (EM), valuations remain reasonable, we expect earnings momentum to persist, and a resumption of US dollar (USD) depreciation could be a tailwind. As always, understanding the unique drivers and risks present in specific markets and sectors and with individual companies remains essential for navigating the global-equities landscape.

Global Equities: The Case for Cautious Optimism

By Alex Tedder, Portfolio Manager & CIO (Equities)

Notwithstanding market concentration, relatively high valuations, and rising fears about a potential AI bubble, the outlook for global equities isn't necessarily negative. Positive economic momentum, robust earnings support, and structural investment in new technologies may continue to underpin global markets for the foreseeable future.

Another Surprisingly Strong Year

In 2024, against a backdrop of macroeconomic and geopolitical uncertainty, global equities, as measured by the MSCI ACWI Index, delivered 18%.¹ Despite ongoing political volatility, global equity markets have again performed extraordinarily well, producing a return of 21.5% in dollars (as of November 30).¹

A few factors are at work. The US economy remains robust, supported by massive fiscal stimulus (e.g., the One Big Beautiful Bill Act); high levels of capital expenditure (capex),² particularly by big tech companies; solid wage growth; and low energy prices. President Donald Trump's tariff policies have accelerated domestic investment in the US and, so far at least, not led to higher inflation. The overall result has been strong earnings growth: Earnings for the S&P 500 Index are on pace to rise 13% year-over-year in 2025.³ It's not surprising, therefore, that investors have simply looked through the geopolitical noise and focused on the fundamentals.

In the rest of the world, optimism has also prevailed, with both European and Asian markets notching some of their best returns in many years. The drivers of return have so far been slightly different, however, as economic momentum and earnings growth have been much more muted in both regions. Re-valuation has been the primary factor. Investors are anticipating economic recovery in 2026 and consensus estimates are strong.

Insight from sub-adviser Schroders Investment Management



Alex Tedder
CIO Equities



Tom Wilson
Head of Emerging Market Equities

Key Points

- We expect robust earnings and investment in new technologies, especially AI, to support global equities in 2026.
- Elevated valuations may persist due to anticipated rate cuts and structural shifts, but risks of a correction remain.
- Emerging markets present selective opportunities, with attractive valuations and a potential tailwind from US dollar depreciation.

Valuations Are High but Could Stay That Way (For Now)

A valid concern is that markets are already more than discounting a growth scenario. Almost all markets around the world look expensive relative to recent history, trading at multiples well above their 15-year medians.³ Long-term fundamental measures such as the cyclically adjusted price-to-earnings ratio (CAPE)⁴ or the market-cap-to-GDP measure (favored by Warren Buffett) are flashing red.³ The doubters can certainly point to the fact that, historically, markets have always reverted to the mean,⁵ and this suggests significant downside from current levels.

While this risk rightly looms large in our daily debate, all the market dynamics we've noted here lead us to believe those elevated valuations may be sustainable for now. We think short-term interest rates in many countries could fall, providing support to market multiples, specifically in the US. As confidence levels in economies such as China, India, or Brazil begin to improve, there could be strong demand for assets in these markets, particularly given diversified risk exposure.

Structural factors, such as China's transition to becoming a technology giant (already evident in the electric vehicle, renewable energy, and robotics sectors), are also probably being underestimated by the market. Similarly, in Europe, structural drivers such as technology infrastructure and energy transition remain fundamentally underestimated, in our view. All these factors suggest that relatively high valuations can be sustained and could go higher still.

Concentration Isn't Inherently Bad

There's understandably a lot of focus on the degree of concentration in equity markets, particularly in the US. The 10 largest names in the S&P 500 Index now account for around 40% of the Index's market capitalization—a record high.⁶

Looking back in time, it's clear that every major phase of innovation has been characterized by prolonged periods of concentration. Unlike previous phases, the current technology-driven innovation wave is comprised of multiple innovation cycles, of which the most recent (and most rapid) is evident in the field of large language models, otherwise known as generative AI.

The share price performance of the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) has been driven by gigantic investment in AI infrastructure. Their rising capex in recent years represent a relatively small proportion of their operating cashflows (**FIGURE 1**). The biggest spenders have scope to increase spending quite a bit further if they deem it appropriate.

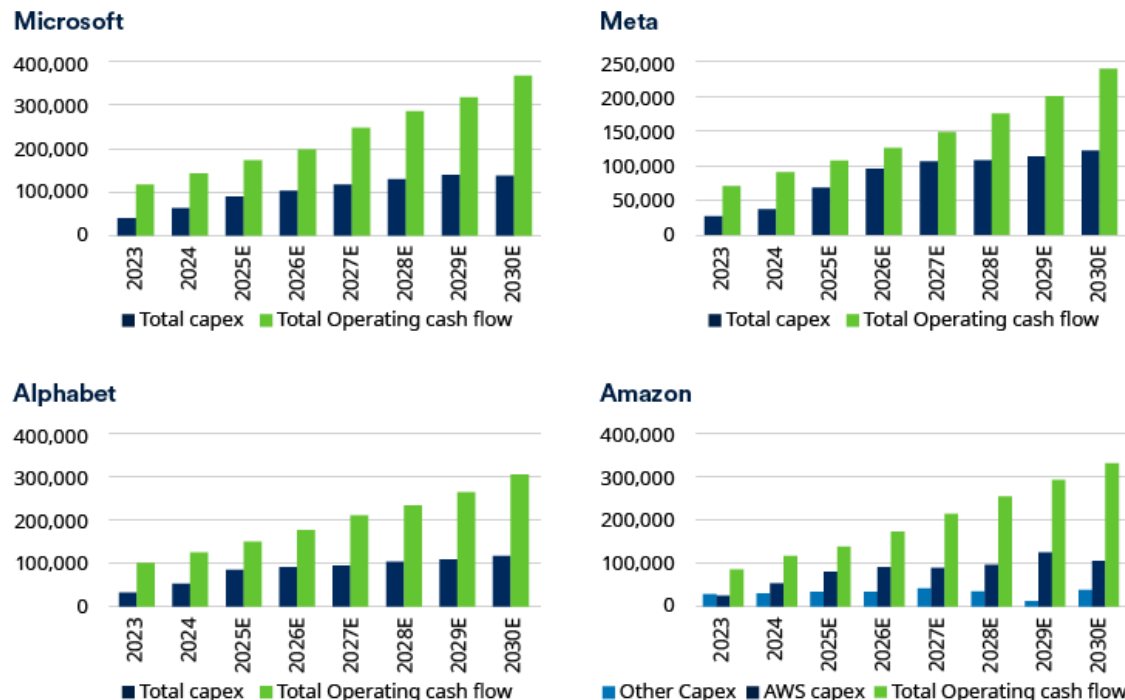
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Market dynamics lead us to believe that elevated valuations may be sustainable for now.

FIGURE 1

The Hyperscalers' Capex May Still Have Room to Grow

(\$ in Billions)



As of 7/31/25. Current economic and market trends are not a guide to future results and may not continue.

Figures are annualized; forward estimates are based on consensus estimates. Data Sources: Schroders and Bloomberg.

As the numbers have grown, so, too, have doubts about the likely return on investment and the circularity inherent in the current AI supply chain. With the largest firms accounting for more than 70% of the S&P 500 Index's total capex this year, it's no exaggeration to say that the fate of the US stock market, as a whole, depends on continued confidence in the future of AI.⁷

That confidence remains intact for now. There are some signs of irrational exuberance, as reflected in the outsized performance of AI-related companies with no earnings or even no revenues. However, the total market capitalization of those companies is small. The much more important question at this point is whether AI models can monetize at a rate that justifies their huge expenditures. There have been some encouraging signs in this regard, with Google parent Alphabet reporting a material contribution to revenue growth in cloud, search, and even YouTube from AI-related deployment.

Interestingly, ChatGPT itself is already generating revenue: About \$20 billion in 2025. Based on our analysis, ChatGPT models could generate revenues of \$200 billion by 2030.⁸ That puts the current \$500-billion market valuation of parent OpenAI into sharp context.⁹ If the company were listed, a not-unrealistic valuation would be 10 times forward sales, implying a \$2-trillion market capitalization. Given that AI-chipmaker Nvidia currently commands a \$5-trillion valuation, the enthusiasm for AI investment suddenly becomes quite rational.¹⁰

Proceed With Confidence, Invest with Caution

Our optimism about the outlook for 2026 doesn't diminish our awareness of the risks. If markets continue to rise as we expect, the risk of a major correction becomes more acute. That's particularly true with valuations already at stretched levels.

The old adage that bull markets don't die of old age is probably as valid today as it's ever been. It implies that there must be a catalyst for a substantial correction to take



If markets continue to rise as we expect, the risk of a major correction becomes more acute.

place. We don't currently see a clear catalyst for a correction. Sooner or later, however, a catalyst will come along, in our opinion, and we think it's most likely to come from the bond market. Trump's policies, while proving effective in the short term, are potentially storing up trouble in the form of higher inflation and rampant federal debt. Similarly, the UK economy, already struggling to find avenues for growth, may be overwhelmed by the weight of tax-funded government spending, eventually requiring a bailout.

There are several other potential catalysts, any of which could precipitate a reset in market valuations to more normal levels. In such circumstances, we think most assets will do quite poorly. Within equities, there's nevertheless a cohort of unloved, cash-generative, and well-funded companies that could do relatively well. Increased exposure to selective healthcare, consumer, and utilities stocks could offer useful diversification if a correction comes.

EM Equities: Can a Bull Case Still Be Made for 2026?

Tom Wilson, Head of EM Equities

EM equities have performed strongly in 2025, outperforming global equities (as measured by the MSCI EM Index and MSCI World Index, respectively).¹¹ After more than a decade of underperformance, are we at an inflection point? And to what extent can EM equities continue to deliver attractive USD returns in 2026?

EM aren't homogenous, so it helps to look at their constituent parts. Four countries make up more than 75% of the MSCI EM Index benchmark: China, India, Taiwan, and South Korea.¹²

China faces ongoing structural and cyclical economic headwinds: Investment remains too high a share of GDP, debt levels are elevated, and the economy suffers excess capacity, persistent deflation, and appears to be in a liquidity trap. A real-estate bust has materially damaged local government finances and continues to suppress household confidence. However, China's strong innovation and competitiveness, along with better product quality, is driving import substitution and boosting its share of global exports.

China's equity market is very broad, and we can find multiple idiosyncratic stock opportunities. Furthermore, in the near term, abundant liquidity is proving a stronger driver of share prices than nominal growth. Geopolitical tension will continue, but China's dominance in rare-earth processing and magnets has proven a key point of leverage that defends China against excessive US tariff and nontariff action. Valuations have lifted after being cheap 12 months ago, but are reasonable, and we remain constructive on China.

India has delivered soft USD returns in 2025 and has materially underperformed after a long period of outperformance. Equity valuations have improved, but while the valuations for financials are attractive, nonfinancials valuations remain expensive. Equity supply has been a significant offset to domestic fund flows in 2024 and 2025, and other parts of EM have offered better valuations and similar or better earnings growth. However, relative performance could eventually change direction.

The narrative of structural growth is well recognized. On a shorter horizon, low inflation and a soft dollar have facilitated monetary easing, and we've also seen some modest fiscal easing. We think this could support a recovery in nominal growth from relatively low levels. A further catalyst may come in the form of tariff relief as the US tariff premium on India's import of Russian crude may at some point be removed, even if there's ongoing risk around India's service exports to the US. Finally, if the AI theme rolls over, we think India could benefit from redirected investment flows.

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We think the most likely catalyst for a market correction will come from the bond market.

This brings us to Taiwan and Korea. Taiwan and Korea's benchmarks are currently 85% and 50% in technology, respectively.¹³ AI hardware spending has been a powerful performance driver in 2025. Commentary from corporate-management teams, positive earnings dynamics, and a further material increase in capex guidance have strengthened our conviction that AI-related tech demand will remain robust into 2026, but there's uncertainty on capex in 2027. There are outstanding questions on the timing of AI monetization, the dilution of hyperscaler returns, and potential power constraints. We currently think information technology warrants an overweight, given its strong earnings momentum, but valuations have risen, and we think investors should be disciplined in trimming tech companies that run ahead of fundamentals.

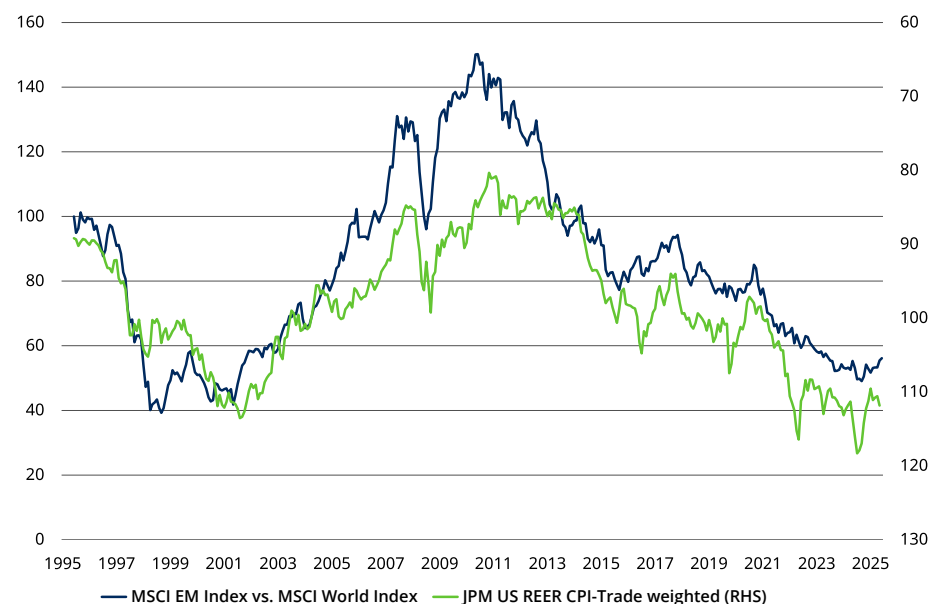
Finding Opportunities Beyond the Big Four

Given their scale, the four markets discussed above dominate EM beta.¹⁴ However, for active investors, we believe there are still plenty of alpha¹⁵ opportunities in the universe. We think favorable conditions warrant an overweight allocation to Brazil. Equity valuations are attractive, the real effective exchange rate is cheap, and real interest rates are very high.

Elections in Brazil in October 2026 may see President Luiz Inácio Lula da Silva lose to a center-right candidate. A more fiscally responsible center-right government would calm fears about fiscal sustainability and could drive a material compression in real rates. We believe this would reduce the cost of capital, drive a marked rerating, support the currency, and drive an uplift in domestic-equity allocations from low levels. While this is partly anticipated by markets, we believe the risk/reward lies in favor of investors. Meanwhile, low inflation could permit a degree of monetary easing in 2026, and we think Federal Reserve easing and a soft dollar could provide additional support.

FIGURE 2

USD Real Effective Exchange Rate and EM Equities Relative Performance



As of 10/25. Past performance does not guarantee future results. Please see last page for index definitions. Data Sources: Bloomberg, Schroders, Macrobond, and BEA.

This leads us to the USD and longer-term trends. We're inclined to anticipate USD depreciation on a structural basis, given its rich valuation, a diminished appetite for foreign funding of US deficits, and longer-term potential for fiscal monetization. USD depreciation could provide a tailwind to EM relative equity performance as it eases financial conditions and has a positive translation effect, benefiting dollar-nominal growth and earnings.

FIGURE 2 shows the historic inverse correlation between the USD and EM equity relative returns. This factor, combined with attractive relative valuations, could lead to a potential stabilization or improvement in relative return on equity.¹⁶ This is the bull case for EM but, as always, the outlook is uncertain. Meanwhile, key risks include a rollover of the AI theme, geopolitical tension, and policy volatility. Whatever the challenges, we believe EM equities continue to offer value and that investors could benefit from the diversification benefits and active investment opportunities that this market provides.

**To learn more about the opportunity in equities,
please talk to your financial professional.**

J.P. Morgan's Real Effective Exchange Rate (REER) measures the value of a country's currency against a basket of other major currencies, adjusted for inflation.

MSCI ACWI Index is a free float-adjusted market capitalization index that measures equity market performance across both developed and emerging markets. MSCI index performance is shown net of dividend withholding tax.

MSCI EM Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance in the global emerging markets. MSCI index performance is shown net of dividend withholding tax.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

¹ Returns cited based on the gross total returns of the MSCI ACWI Index. Data Sources: MSCI, FactSet, and Schroders.

² Capital expenditures are the money a company spends to buy or upgrade long-term assets such as buildings or equipment.

³ Projections are based on consensus estimates, as of 10/31/25. Data Sources: LSEG DataStream and Schroders. Forecasts are not guaranteed and should not be relied upon.

⁴ CAPE is an acronym for cyclically adjusted price-earnings ratio, a valuation measure that uses real earnings per share over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.

⁵ Mean reversion, or reversion to the mean, is a theory used in finance that suggests that asset price volatility and historical returns eventually will revert to the long-term mean or average level of the entire dataset.

⁶ As of 9/30/25. The 10 largest companies in the S&P 500 Index represent 39.21% of the Index's total market capitalization. Data Source: FactSet.

⁷ Data Source: Empirical Research Partners Analysis, 2018 through Q4 2024 estimated.

⁸ CNBC, "Sam Altman Says OpenAI Will Top \$20 Billion in Annualized Revenue This Year, Hundreds of Billions by 2030," 11/6/25.

⁹ Reuters, "OpenAI Hits \$500 Billion Valuation After Share Sale to Softbank, Others, Source Says," 10/2/25.

¹⁰ CNBC, "Nvidia Becomes First Company to Reach \$5 Trillion Valuation, Fueled by AI Boom," 10/29/25.

¹¹ As of 10/25. Data Sources: Bloomberg, Schroders, Macrobond, and BEA.

¹² Country weights for the four largest constituents: China (28.81%), Taiwan (20.04%), India (15.78%), and South Korea (12.16%), totaling 76.79%. Data Source: MSCI Emerging Markets Index (USD) factsheet, as of 11/28/25.

¹³ Information Technology weights: Taiwan (83.5%) and Korea (49.16%). Sources: MSCI Taiwan Index (USD) factsheet and MSCI Korea Index (USD) factsheet, both as of 11/28/25.

¹⁴ Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index.

¹⁵ Alpha measures how much an investment outperforms or underperforms its benchmark after adjusting for risk. In short, it shows whether a manager or strategy added value beyond what the market delivered.

¹⁶ Return on equity is the average amount of net income returned as a percentage of shareholder's equity over the past five years.

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