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Investing for a  
world of change



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# Beware the crowded trade

## How did Quality perform in 2025?

Events came thick and fast throughout the year, leading to shifting periods of style leadership. Until early April, changing political dynamics and heightened growth concerns following the ‘Liberation Day’ tariff announcements weighed on the Magnificent 7 and on momentum and growth factors more broadly. Given passive quality is tilted toward these factors, it too followed the market lower. In contrast, our fundamental quality approach, with its focus on resilient fundamentals, fared better, offering robust defence in the face of the sharp sell-off.

These dynamics changed after the implementation of tariffs was postponed and then substantially eased. Momentum factors led the market higher, and tech mega-caps reasserted their dominance. Towards the end of the year, when valuation concerns around the AI space led to an uptick in risk-off sentiment, Quality – particularly the purist quality approach we adhere to – again delivered smaller drawdowns than the broader market.

## How do you see the AI story developing in 2026?

While the AI revolution is undeniably real and the underlying technology is potentially more transformative than the early internet years, the current level of spending may have pulled forward years of future earnings and demand for infrastructure suppliers.

There will inevitably be digestion periods, inventory corrections, and a temporary halt or slowdown in the pace of the buildout. Businesses that rely on massive, coordinated capex plans from a handful of the world's largest companies are, by definition, cyclical. We must also not forget that GPUs have finite lifespans of a few years, versus decades for fibre optic cables, making overinvestment in computing far more painful. Yet for much of 2025, the market shrugged this off, with the very companies selling this infrastructure possessing the strongest short-term momentum. Investors chased safety in growth, convinced that the irresistible force of AI could defy global business cycles. However, history shows that capex cycles can reverse quickly, and a level of caution is warranted. If sentiment changes, the fallout could be significant.

### Do you expect market leadership to broaden?

On balance, we would expect this to happen. While money has poured into the hardware behind AI chips, data centres and cloud infrastructure, the market has indiscriminately de-rated a wide swath of high-quality businesses in software, IT services, and information services. The market's fear is simple: AI will automate their workers (services), disintermediate their product (software) or undermine their data moat (information services). Ironically, only a few years ago, these businesses were considered to be in pole position to be the primary monetisers of AI. Many now trade at or below market-level valuations, despite recurring revenues, high switching costs and asset-light financial models. Further, the high subscription retention rates of these businesses look more defensive and durable than the long-range forecasts of semiconductor companies. When the market re-focuses on fundamentals, we would expect some of these perceived 'AI losers' to come to the fore.

Major platform shifts tend to deliver broad societal benefits that extend well beyond the companies leading the charge, and yet one of the areas the market is overlooking is how AI could transform pharmaceutical companies. Consider the large players who spend heavily on R&D each year. If AI can be applied to improve R&D pipeline quality, accelerate drug discovery and reduce the funnel of uncertainty, these companies will deliver better outcomes for the same dollar of spend. This is an opportunity that is not captured in the valuation of many of these stocks, which have been out of favour based on the view that they are not technologically driven.

Finally, it is unlikely that this technological platform shift will occur seamlessly and painlessly. In this context, it is important to retain exposure to defensive companies that are less exposed to AI disruption risk. With the global macro environment becoming increasingly uncertain and consumer sentiment weak, traditional defensives such as consumer staples should thrive in such an environment. However, in 2025, they were caught between a rock and a hard place in a momentum-driven market, lacking the excitement of AI exposure and suffering from dependence on squeezed consumers. If investors turn their attention to the rising concentration and valuation risk present in the market and the AI theme becomes less dominant, the defensive quality attributes of select stocks should come back into favour.

## What are the main opportunities and headwinds facing global equity markets in 2026?

The investment landscape is suffering from cognitive dissonance. The weak consumer environment is at odds with the market bidding up the value of highly cyclical infrastructure suppliers to defensive status. Equally, there are fears around the transformative power of AI, yet the market is rejecting the companies with the most robust and predictable recurring revenue streams in corporate history. In our view, the great risk lies in the crowded trade: the conviction that the AI infrastructure wave will never crest. When the inevitable air pocket in capex arrives, the market will abruptly remember the cyclical nature of these businesses and high starting multiples will offer little protection.

True defence is not found in chasing momentum into cyclical extremes but in identifying where resilient cash flows are being offered at a discount because they lack a positive AI narrative. The current market has rewarded momentum, while stable, resilient quality attributes have lagged. History shows that when cyclicals are priced as defensives and defensives as cyclicals, a great rotation tends not to be too far away. The patient investor should seek shelter not where the crowd currently sees it, but where fundamental business quality is quietly being priced for failure.

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