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# Equity Market Outlook

Q1 2026

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# Foreword



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**Global equity markets are on pace to deliver a third consecutive year of double-digit returns in 2025**, even as the path has been marked by some sharp swings along the way.

Stocks grappled with macro uncertainty related to interest rate policy, tariff resets and geopolitical unrest, as well as bouts of skepticism around artificial intelligence (AI). Still, AI-leveraged stocks have continued to anchor U.S. earnings growth, while several international markets quietly produced even stronger returns.

Momentum behind the AI buildout is accelerating. We expect large U.S. hyperscalers to invest roughly \$395 billion in 2025, up more than 150% over the past three years, with capital commitments likely to rise further in 2026 and beyond.<sup>1</sup> As AI capex spending becomes an increasingly important contributor to U.S. economic growth, some fear that any disappointment in AI adoption could reverberate through both equity markets and the broader economy.

These concerns are reasonable, and we take them seriously. Yet our outlook remains decidedly forward leaning. We see AI powering an intelligence revolution that is still in its early

stages. While periods of volatility and hesitation are characteristic of any innovation cycle, we believe the long-run trajectory is positive, with AI enabling new business models and unlocking meaningful gains in efficiency, productivity and process optimization across sectors.

Looking ahead, we expect doubts to ease as the market begins to identify and reward a broader set of AI beneficiaries, growing less reliant on a narrow group of outperformers. Our systematic research indicates that AI's impact is already creating performance dispersion across a broad universe of companies, and our fundamental researchers are finding new expressions of the AI theme in some less obvious places. We believe this widening opportunity set could make active research-driven approaches increasingly essential to capturing the next phase of AI-enabled growth.

We enter the new year constructive on global equities and confident in the potential for active and dynamic investing to deliver superior returns as the three-year AI driver potentially shifts gears. In our **Q1 Equity Market Outlook**, senior members of our alpha equity teams share their latest thinking on the opportunities and risks as the calendar turns to 2026.

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<sup>1</sup> BlackRock Fundamental Equities, with data from FactSet as of Nov. 24, 2025. See chart on page 4.

# Our take on the great AI spending debate



**Carrie King**

Global CIO, BlackRock  
Fundamental Equities

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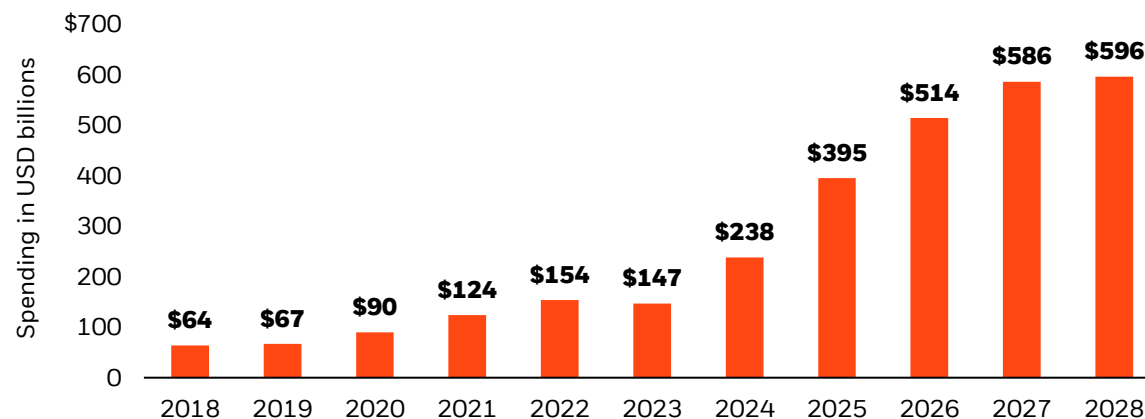
**At this stage, we would view bouts of AI-related market trepidation as a pause that refreshes.**

**There's no denying AI.** The outlook for the stock market and the economy is increasingly tied to artificial intelligence and its progress and permutations. AI spending as a percentage of U.S. GDP is rising exponentially. One estimate suggests it represented 35% of U.S. GDP growth in the second quarter of 2025 with potential to climb above 50% in the second half of the year.<sup>2</sup> Spending by the five big U.S. hyperscalers has doubled over the past three years and is on trend to double again in the next three, as shown below.

AI's share of total stock market capitalization has been on the rise since ChatGPT gained mainstream awareness in November 2022. S&P 500 Index earnings growth and price performance year-to-date have been driven by sectors dominated by AI and the buildout of data centers to support it, including technology, industrials, utilities and communications. And the November market pullback was also centered on AI — specifically, fears that the massive spending may not reap equivalent reward and that lofty stock valuations for AI-leveraged stocks are approaching a bubble.

## Great capex-pectations

Hyperscaler capex spending, 2018-2028



Source: BlackRock Fundamental Equities, with data from FactSet as of Nov. 24, 2025. Chart shows capex spending and spending intentions of the five largest U.S. hyperscalers (Amazon, Meta, Alphabet, Microsoft and Oracle).

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<sup>2</sup> [The AI-Capex Race and the Economic Implications](#), PGIM, Oct. 6, 2025.

# Our take on the great AI spending debate

## Money well spent?

Our outlook leans fairly sanguine. This is not 2000. We believe the earnings of many AI-leveraged companies today justify their higher prices, and in fact, it is earnings growth (not multiple expansion) that has been driving their returns. This was not the case 25–30 years ago when the dot-com bubble inflated and ultimately burst. Many high-flying companies of that era were unprofitable. And our review of the top 25 tech and tech-adjacent stocks by market cap in 2000 and 2025 shows the median valuation was nearly 85% higher then versus now.<sup>3</sup>

At this stage, we would view bouts of AI-related market trepidation as a pause that refreshes. AI is an innovation with transformative potential unlike any before and we do expect the market will ultimately accept and underwrite the capex. Examples over the past 10–20 years suggest companies that have spent large sums on custom acquisitions or capex in advance of expected returns have generally done well. As such, the market has become more conditioned to believe in the motto “build it and they will come.”

But the rubber really meets the road when users of the technology begin to reveal its worth, and we’re starting to see some green shoots in this regard. In a survey of 2,000 CEOs globally, 52% said their organization is realizing value from AI investment beyond cost reductions. 85% said they expect their investments in “scaled AI efficiency and cost savings” to reap positive return by 2027.<sup>4</sup> Another survey found that 9 out of 10 human resources leaders see AI reshaping jobs in 2026. And 61% said AI has already made their company more efficient.<sup>5</sup>

Some corporate leaders caution that the benefits will take longer to materialize, yet we find AI efficiency is earning attention among a growing number of companies. Our analysis of quarterly earnings calls showed a

100% increase in the number of companies mentioning “cost savings and productivity enhancement” from AI in their Q3 2025 earnings calls relative to the same quarter in 2024 (with thanks to AI for assisting with this analysis). While the vast majority of companies have not yet quantified the revenue or profit impacts of AI use to date, Q3 brought some early murmurs in areas such as financials:

**JP Morgan CEO Jamie Dimon on AI spending:** “We have shown that for \$2 billion of expense we have about \$2 billion of benefit.”

— Yahoo Finance, October 2025

**Citigroup CEO Jane Fraser:** “AI tools are freeing up about 100,000 development hours per week.”

— Reuters, October 2025

## Investing in the future now

The full benefits of AI capex spending may not be realized in the immediate term, but that does not alter the ample investment potential available right now, which we see manifesting in myriad ways. The current U.S. opportunity, for example, is heavily represented by the picks and shovels of the AI build, including the critical semiconductors. In Europe, much of the opportunity is available through investment in capital equipment to support AI. There are many unexpected places for AI exposure as well. One example: optical networking, where AI is helping to facilitate network traffic in data centers.

Given that this is likely to be a transformative and lengthy investment cycle, we would view any pullbacks as opportunities to assess the landscape for attractive entry points. As always, we continue to advocate for an active approach that can adapt and pivot to seize upon the opportunities as the technology and the uses of it grow and evolve.

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**3** BlackRock Fundamental Equities analysis of the largest 25 firms by market cap in the Russell 1000 Index as of March 31, 2000, and Sept. 30, 2025, filtered to those with forward P/Es above 25x, tech and tech-adjacent names only. **4** IBM Study: CEOs Down on AI While Navigating Enterprise Hurdles, Institute for Business Value survey of 2,000 CEOs globally, May 6, 2025. **5** CNBC survey of 21 CNBC Workforce Executive Council members, November 2025.

# When AI laggards play catch-up



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**AI remains a defining force in equity markets, but its influence is taking shape in new and sometimes unexpected ways.**

Mega-cap technology companies remained a driver of the market's AI-related gains, shaping much of the equity narrative in 2025.

Yet beneath that concentrated leadership, we see the AI transformation unfolding in ways that are creating dispersion across a broader universe of companies tied to the theme. One example is the expansion of deal activity that has created new linkages across the AI value chain through partnerships, supply agreements and shared capacity. In 2025, these developments fueled periods of sharp gains in companies previously considered laggards in the AI race, testing the adaptability of investors as the ecosystem has become increasingly circular and interconnected.

## Leaders, laggards and lessons

This highlights an important reality of investing in market themes: Skilled stock selection extends beyond the most visible, first-order effects. While the overweight trade toward AI leaders has been an obvious expression of the theme, identifying the *underweights* that matter is often far less clear. From a total-portfolio perspective, these positions play a critical role, both in how investors allocate to AI and in how risk and return contributions add up across the broader book.

As companies expected to lag sharply outperformed, it showed that even with overweights in mega-cap tech leaders, the stocks

an investor is underweight can still have a meaningful impact on overall performance. The chart on the following page illustrates this point through a series of long-short pair trades.

Each of the three baskets has long exposure to the large established technology companies that represent the first-order beneficiaries of AI innovation. Where they differ is in their short exposures, which shows how selecting relative laggards to those leaders can impact returns:

**Basket A:** The strongest-performing basket was short a diversified group of companies designed to balance concentrated long exposures. The strong results highlight the potential impact of effective stock selection beyond standard exposures to concentrated leaders.

**Basket B:** This basket was short the broad equity market, represented by the S&P 500 Index. Returns were largely flat, as the index's concentration in the same mega-cap AI leaders reduced the differentiation between the long and short sides of the trade.

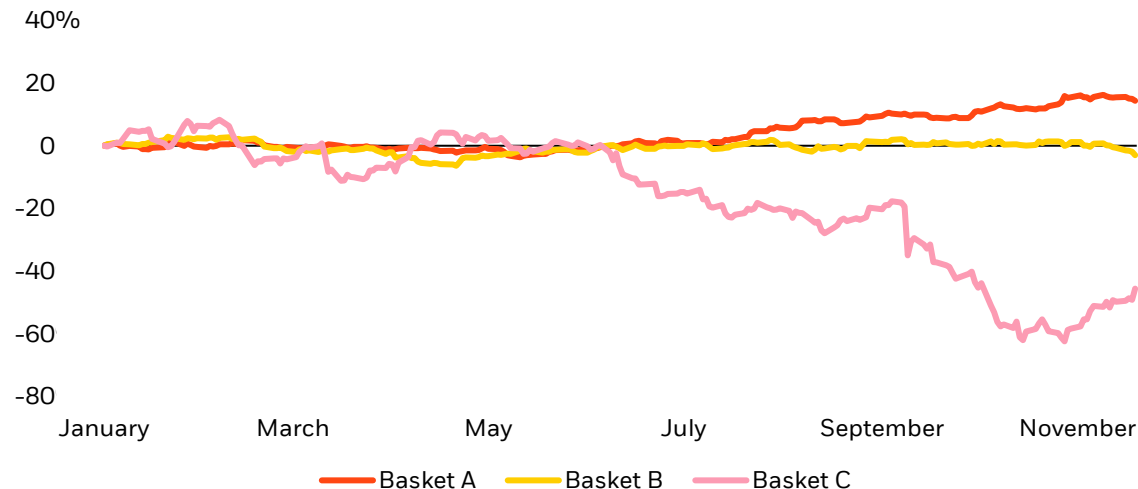
**Basket C:** The weakest-performing basket was short a group of “AI catch-up” companies — firms initially viewed as laggards within the theme that later rallied on renewed optimism following new AI partnerships and deal activity. That strength has started to fade more recently, with “AI catch-up” names lagging and the long basket outperforming.

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# When AI laggards play catch-up

## An evolving AI opportunity set

AI thematic baskets, 2025 year-to-date cumulative returns



**Basket A:** Long AI leaders, short a diversified group of companies designed to balance concentrated long exposures.

**Basket B:** Long AI leaders, short the broad equity market, represented by the S&P 500 Index.

**Basket C:** Long AI leaders, short perceived AI laggards that benefitted from AI partnerships and deal activity in 2025.

**The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Source: BlackRock Systematic, as of Nov. 20, 2025. Chart shows the returns of three expressions on the AI trade, as constructed by BlackRock Systematic. For illustrative purposes only.

While these baskets are constructed as long/short pair trades for illustrative purposes, the same concept applies in a long-only portfolio. If “AI catch-up” names were funding underweights for positions in the larger AI leaders, the relative outperformance of those underweights would have weighed on overall returns. This underscores that thematic investing is not just about gaining exposure to themes themselves, but about the skill required to refine those exposures and navigate them as they evolve.

## Forward focus: Navigating themes with precision

AI remains a defining force in equity markets, but its influence is taking shape in new and sometimes unexpected ways. In this environment, we believe active stock selection and adaptability are essential. Leveraging data-driven, real-time insights to understand how themes are affecting companies across the market can help investors better capture opportunities as narratives shift.

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# Six reasons to consider international equities in 2026



**Helen Jewell**  
International CIO,  
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**Europe, Japan and EMs show promising prospects in 2026 and, crucially, aren't reliant on AI momentum for stock market success.**

Much of the market narrative in 2025 focused on the AI race and the large U.S. companies that have already benefited from the AI boom.

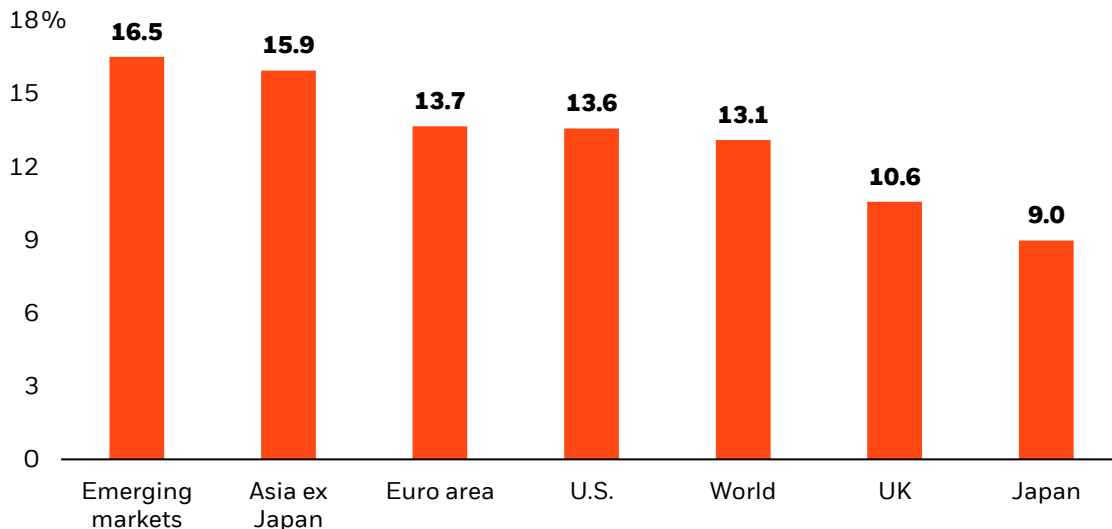
Yet the U.S. stock market was not the standout of the year. The top-performing country as of late November was South Korea (up more than 70%), followed by Spain (up nearly 50%), while the U.S. was in 20th place (up around 17%).<sup>6</sup>

International outperformance was an underappreciated story of 2025. Past performance is no guarantee of future returns, but we see many reasons why international equities could thrive again in 2026. Among them: improved earnings expectations, as shown in the chart below.

Beyond earnings, we outline on the following pages six more reasons for optimism in key global markets.

## Eyes on earnings

12-month earnings growth estimates



Source: BlackRock Investment Institute, Nov. 18, 2025. MSCI indexes used for each region. Forecasts/estimates may not come to pass. Indexes are unmanaged and one cannot invest directly in an index

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<sup>6</sup> BlackRock Investment Institute, with data from LSEG Datastream and MSCI, Nov. 21, 2025.



# Six reasons to consider international equities in 2026

## Europe

**Powerful forces at work.** A narrow set of sectors led the way in Europe in 2025. These included the banks, aerospace and defense companies, and industrial companies with data center businesses. We expect all three areas to perform positively again in 2026. The banks have demonstrated resilient net interest income, even as the European Central Bank (ECB) cut interest rates, and many offer attractive shareholder returns. In civil aerospace, the combination of a strong post-Covid recovery in air travel with limited number of new planes joining fleets has required older planes to fly for longer — a boost to companies offering engine aftermarket services. And defense companies are supported by long-term EU and NATO military spending plans, in our view — regardless of near-term fluctuations caused by geopolitical developments.

**Economic signs of life.** We believe these 2025 winners will be joined by a broader set of sectors in 2026, as the European economy is showing some green shoots of activity. Loan growth is picking up, the composite purchasing-managers' index is in expansionary territory and, within that, the manufacturing element is no longer shrinking. So, we believe some of Europe's cyclical companies could start to benefit. This may include mining equipment names that have already seen some uplift from higher commodity prices, construction companies that may benefit from lower rates in the U.S. and Europe, and truck makers, which have already reported improved orders in recent earnings statements. This cyclical expansion may be turbocharged toward the end of 2026 as Germany's €500 billion fiscal stimulus plan kicks in.

## Emerging markets

**A macro moment.** Emerging market (EM) equities had a strong 2025, with the MSCI EM Index up more than 30% as of late November.<sup>7</sup> And many of the drivers of this performance are likely to remain in place, in our view. There have been 125 global central bank rate cuts in 2025<sup>8</sup> — and many of these in large EM economies like Mexico and Turkey — while calmer inflation paves the way for Brazil to potentially cut early in 2026. This reduces borrowing costs and spurs economies. And with more cuts expected from the U.S. Federal Reserve over the next 12 months, the relatively higher rates in EMs appeal to international lenders. Part of this picture is a potentially weaker dollar — something the U.S. administration has said it wants. This could reduce financial stress for EM borrowers, attract foreign investment and support the prices of commodities produced in many EM countries.

**The world in three.** Rising geopolitical friction over the past few years has led to redrawn supply chains, trade lines and diplomatic alliances. The increased competition between East and West is an opportunity for those “neutral” EM countries in the middle to benefit, in our view. North Asia, the UAE and Latin America — especially Mexico — could be key beneficiaries of nearshoring and supply chain realignments. South Korea, for example, has increased its market share as the hub for battery and memory supply chains, and a broad set of sectors in the economy has benefited. We expect Dubai to continue to expand as a global financial center as people and money flow in from both East and West — and Dubai is likely to reinvest heavily in the infrastructure needed to support this influx.

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<sup>7</sup> Bloomberg, Nov. 25, 2025. <sup>8</sup> <https://www.cbrates.com/decisions.htm>.

# Six reasons to consider international equities in 2026

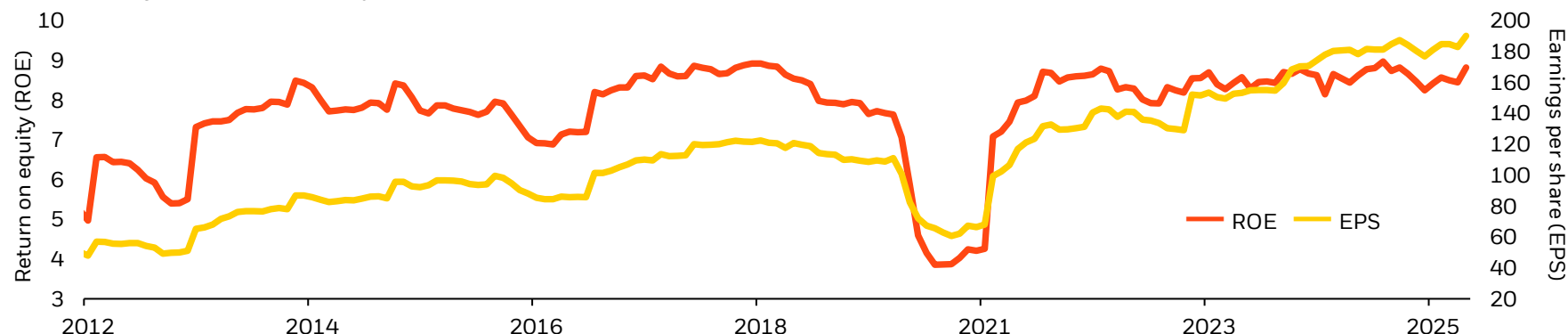
## Japan

**Invigorated investment.** Inflation is back in Japan, having been zero or negative for decades. This provides healthy impetus to the economy, but also some political volatility. On the plus side, inflation spurs investment. Cash holdings are eroded, raising the appeal of risk assets. More than 50% of household assets are held in cash,<sup>9</sup> but the adoption of new tax-exempt investment accounts — as well as inflation — could spur a change in investment mindset. More broadly, inflation encourages households to spend rather than hoard cash, and allows companies to raise prices, improving margins and return on equity. In the real estate sector, higher inflation means potentially higher rents and higher profitability.

**Corporate transformation.** A renewed focus on corporate profitability is also boosting return on equity in Japan. Dividend payouts and share buybacks have hit record highs and corporate restructuring has picked up.<sup>10</sup>

### Picture of improvement

Japan earnings and return on equity, 2012-2025



Source: BlackRock Fundamental Equities, with data from Bloomberg as of November 2025. Chart shows ROE (a measure of profitability) and EPS for Japan's TOPIX index. Indexes are unmanaged and one cannot invest directly in an index.

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<sup>9</sup> BOJ, Financial Balance Sheet Statistics, October 2025. <sup>10</sup> Nikkei, Bloomberg, October 2025.

We believe this could encourage international investment into Japanese equities, and our analysis shows that companies with credible corporate transformation plans can gain higher valuations. Examples of corporate transformation include a major rail company developing offices, hotels and shopping malls around stations and selling mature assets to fund this investment, or an industrial conglomerate selling non-core businesses to focus on growth areas such as energy supply.

We believe these three regions can flourish in 2026 and, crucially, aren't reliant on AI momentum for stock market success.

**Diversification may be key next year, which brings us to the UK.** The FTSE 100 has also outperformed the S&P 500 year-to-date, without any high-profile AI winners. We believe UK equities, in the hands of skilled stock pickers, can provide steadier returns unrelated to the fortunes of volatile tech stocks.

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