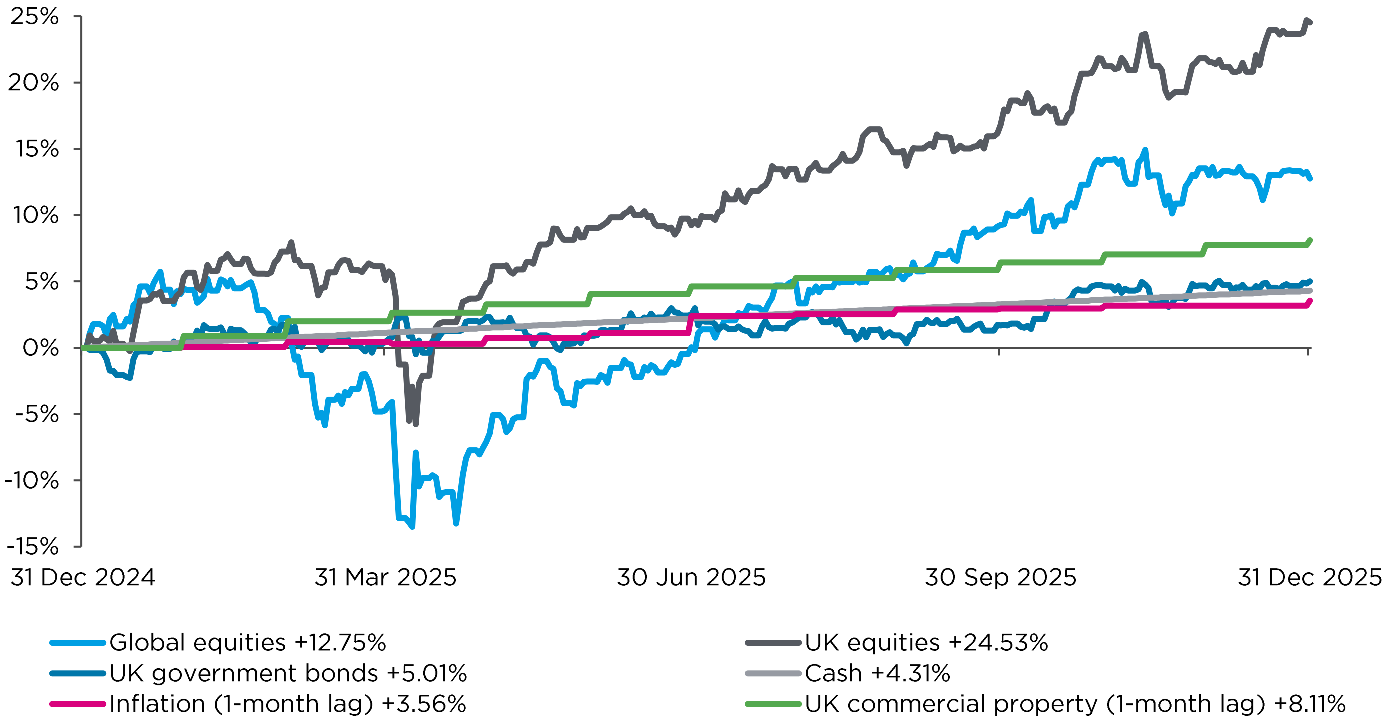
Market review

The headlines

- **World share prices rose in December. But investors became increasingly circumspect about artificial intelligence (AI)-related shares and about interest rate cuts.**
- **The Fed and the Bank of England cut interest rates in December, but US and UK bond yields rose, particularly for long-dated bonds.**

Market returns: share prices resumed their rally in December, but US shares lagged.



Sources: Bloomberg, in pound sterling, as of 31 December 2025. Daily data, except for inflation and UK commercial property, shown monthly. UK government bond returns as per Markit iBoxx £ Gilts Index. Inflation (31 December 2024=0%) as per the Office of National Statistics' UK Consumer Prices Index, with a one-month lag. UK commercial property as per MSCI UK Monthly Property Index, estimated for the most recent month. Cash returns as per Sterling Overnight Index Average (SONIA). Global and UK equity returns as per MSCI World Index and MSCI UK IMI Index, respectively. **Past performance is not a reliable indicator of future results.**

Economics and markets news

World share prices rose 0.8% over December, despite a fall in the middle of the month triggered by concerns over AI (artificial intelligence) spending at software firm Oracle.

US shares were at a standstill during December, UK shares rose 2.2% and eurozone shares advanced 2.4%, all in local currency.[1]

America's central bank, the Federal Reserve (Fed), cut interest rates for the third time this year and the Bank of England (BoE) for the fourth time, each by 0.25%. The European Central Bank held interest rates steady. In all three cases (US, UK and eurozone), long-term bond yields rose during the month, as inflation expectations rose somewhat.[2]

The US dollar weakened versus the pound sterling over the month, from \$1.32 per pound to \$1.35. This reduced returns on US dollar-denominated assets, translated into pounds.

United States

US share prices were at a standstill during December, with a dip in the middle of the month.

Financial groups including Citigroup led the US market. The basic materials sector also performed well, led by mining firms such as Freeport McMoRan. Consumer discretionary firms advanced, too, led by cruise operators Norwegian and Carnival. In all three sectors, strong financial results and these companies' positive outlooks were the main boosts to share prices.

By contrast, the information technology (IT) sector, as a whole, lagged the broader market, and some IT shares saw significant price falls. Microsoft suffered after OpenAI signed a $300 billion contract for computing power with its competitor Oracle. Google owner Alphabet's share price fell after news of two potential EU fines. The communications sector lagged, mainly because Netflix's share price fell after it offered to buy film and TV giant Warner Bros.

The US stock market fell in mid-December, after software firm Oracle reported lower-than-expected revenues in its cloud division. In addition, private lender Blue Owl Capital declined to co-finance Oracle's $10 billion data centre expansion. Both episodes raised investors' growing nervousness about the AI sector.

In addition, low share trading volumes exacerbated the market's mid-December weakness, a common occurrence in the run-up to the Christmas holiday.

More fundamentally, however, that dip reflected investors' concerns about the US economy and about how much farther the Fed might cut interest rates.

The Fed cut its main interest rate by 0.25% in December. As in recent months, however, its governors were divided (9-3): some voted to keep interest rates unchanged, while Trump-nominated governor Stephen Miran wanted a larger cut, by 0.50%.

The Fed continues to struggle with a weakening economy combined with above-target inflation. Consumer sentiment, jobs growth and leading economic indicators including the housing market have all weakened for most of 2025. (December's better-than-expected numbers on gross domestic product (GDP) growth, of 2.3% in the 12 months to 30 September 2025, came after the Fed's rate cut.)

At the same time, core personal consumption expenditure (PCE) inflation, the Fed's preferred price gauge, rose 2.8% in the 12 months to 30 November. Inflation remained steady versus October, but it has now been above the Fed's 2% target since 2021.

US inflation expectations for the coming two years, as derived from the bond market and surveys, rose above 2.7% for the first time since mid-2024. This rise may result from President Trump's pressure on the Fed to cut interest rates, despite above-target inflation. Trump has installed the chair of his Council of Economic Advisors, Stephen Miran, to the nominally independent Fed. And Fed Chair Jay Powell's term comes to an end in May 2026. President Trump is expected to nominate a successor who is less hawkish on inflation.

Despite the Fed's rate cut, however, 10-year bond yields rose from 4.02% at the end of November to 4.14% at the end of December. This rise reflected higher inflation expectations and continued concern about the US government's $38 trillion of debt.

United Kingdom

UK share prices rose 2.2% in December. Mining shares were the biggest gainers for a second month in a row, led by Fresnillo (gold, silver) and Antofagasta (copper).

Gold, silver and copper prices all posted record highs during December. All three benefited from industrial demand. Silver, for example, is used in electric vehicles and solar panels because it conducts electricity better than copper. At the same time, investors bought precious metals as safe-haven assets, as inflation expectations rose and the US dollar weakened.

On the downside, Diageo was one of the month's poorest performers, as its customers bought fewer and cheaper drinks. The weak share price performance of previously diversified industrial conglomerates DCC and Smiths Group also made headlines. Both businesses have made significant divestments this year, to focus on energy and engineering, respectively.

On the economic front, consumer price (CPI) inflation fell from 3.6% in October, year on year (yoy), to 3.2% in November, an 18-month low. Lower prices for food, alcohol and clothing were the main reasons for this fall.

Lower inflation and the Chancellor's late-November budget paved the way for the BoE to cut its Official Bank Rate from 4% to 3.75% in December. But only five out of nine members of the BoE's monetary policy committee voted for a rate cut. The dissenters either pointed to the fact that inflation remains above target, or to rising unemployment and a generally weak economy. UK GDP grew just 0.1% in the third quarter of 2025, a 1.3% increase over the preceding 12 months.

As in the US, UK bond yields rose during December. Yields on two-year gilts (UK government bonds) rose from 2.03% at the end of November to 2.12% at the end of December, and 10-year yields from 2.69% to 2.83%.

Other markets

Eurozone share prices advanced 2.4% in December. Metals and mining businesses such as Poland's KGHM and Belgium's Umicore were among the biggest gainers, as were clothing retailers LPP and Inditex.

The European Central Bank (ECB) kept interest rates on hold. Eurozone inflation fell back to 2.1% in October and November, close to the ECB's 2% target. The Bank expects 1.4% GDP growth in the eurozone this year, up from 0.9% last year.

In **China**, share prices fell another 1.4% in December, after significant falls in October and November. But the country's manufacturing purchasing managers' index

(PMI) rose to 50.1 in December, a return to momentum for industry. Chinese exports have been resilient, but domestic demand remains weak, held back by a property slump. China's next five-year plan, which starts in March, calls for boosting consumption, but the government's stimulus so far has proven insufficient.

Japanese share prices rose 1.0% in December. The MSCI Japan index has registered a 21.0% gain for the year, helped by strength in the semiconductor industry. Investors in construction stocks reacted positively to Sanae Takaichi's appointment as the country's new prime minister and her expansionary budget. On the monetary front, the Bank of Japan raised its key policy interest rate from 0.50% to 0.75% in December 2025, away from long-standing low rates and hoping to quell inflation, which rose to 2.9%, yoy in November.

(1) Source: MSCI (total return, net of withholding tax, in local currency), except where stated
(2) Sources: US Federal Reserve, Bank of England, European Central Bank

Looking ahead

At the start of 2026, share valuations continue to be high, particularly in the US. Based on their price/earnings ratios (P/Es), US shares are 10%-15% off their record valuations during the 2000 dotcom bubble. By comparison, non-US shares are modestly valued.

When the 2000 bubble deflated, share prices nearly halved over the next two years. History doesn't repeat itself, but it often rhymes.

- Liquidity appears abundant once again. In 2000, interest rates were low, venture capital was plentiful and online brokerages had democratised share trading. Today, interest rates have retreated from their peaks, the Fed has returned to quantitative easing, private capital is stoking AI firms' capital expenditure, and online brokers like Robinhood offer low-cost leverage to retail investors.
- Unlike in 2000, companies' profits are solid and expected to rise 15% over the calendar year 2026, higher than the 10-year trailing average. That would make 2026 the sixth consecutive year of profit growth and the third consecutive year of double-digit profit growth.[3] Company profits are a fundamental statistic of interest to investors, and where share price rises come from in the long run.

How do we position our portfolios when valuations indicate a bubble, but when companies' profits are rising?

- The best-performing shares of 2025 were volatile shares, shares of highly indebted firms and those of loss-making companies. In such a risk-prone market, the most successful investing strategy was momentum, i.e. buying shares that had performed well and selling those that had underperformed, often led by retail investors and 'day traders'.
- As a result of that momentum, ever fewer shares have come to make up a large proportion of the stock market.
- Quality shares, by contrast, are those of profitable companies, with stable earnings growth and low indebtedness. The premium that investors pay for those shares versus the overall market has fallen from 30% in mid-2024 to 14% at the end of 2025.

In the 2000-2002 dotcom crash, shares that had been overlooked in 1996-1999 in many cases performed well. Back then, 'new world' shares collapsed but a range of health care, financial and mining shares prospered.

We see significant differences between 2000 and today: valuations aren't as stretched as in 2000, most leading firms are cash-generative, and non-AI shares today aren't as cheap as 'old world' shares in 2000.

Our main concern, however, lies with the projected profits of AI firms. According to our analysis, some companies in this industry will not achieve the earnings needed to justify their current capital expenditure. In our analysis, therefore, our positioning in quality shares – including some in AI and others overlooked – is appropriate, in particular if the stock market corrects.

(3) Source: FactSet, CCLA

Glossary

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