Never Saw It Coming

Global equity markets produced stellar results in 2025. The MSCI ACWI ex-US index gained more than 33% last year. Even more impressive, that nearly doubled the return of the S&P 500 (~18%). Most close followers of global markets are aware that US stocks have consistently bested their foreign counterparts for more than a decade, thus one could argue that such a reversal was overdue. But that claim has been asserted for years without much evidence to support it. So, what does the future hold? Will non-US equities continue to outperform the US stock markets? What are we to expect from stocks in general going forward?

The last three years have seen US stocks compile a 23% annualized return. Developed non-US stocks have gone up 18.4% during that time while Emerging Markets have averaged 17%. Those are among the best of three year runs. However, when we expand out to a five-year view to get the perspective of a full business cycle, the returns are more pedestrian. Can we expect markets to continue rallying, or are there matters lurking which should concern us? And if so, what are they?

Mark Twain once said, "It ain't what you don't know that gets you in trouble, it's what you know for certain that ain't so." With due respect to the father of American literature, we beg to differ. Whether you call them black swans or blind spots, the outcome is the same, it is the unexpected, unforeseen events which catch market participants unaware that cause the greatest disruptions. And if the problem is in fact a failure of imagination, how can this be avoided? There was once a market prognosticator who every year at about this time would come up with a list of events that while not completely off everyone's radar were definitely not highly likely outcomes, but they were just likely enough that they ought not be ignored and they were significant enough that should they occur, they could unnerve markets. We list a few such events below.

A Return of the Bond Vigilantes

Bond vigilantes impose fiscal discipline on governments by refusing to buy their bonds until the policies of the issuer meet the vigilantes' demands. With fiscal discipline a problem in many developed markets, bond vigilantism remains a significant risk. The UK, the US, France and Japan are particularly vulnerable, given their debt loads. Currently, market expectations are for the US Treasury 10-year yield to follow the Fed Funds rate downward and to end this year at 3.75%, from 4.2% today. The massive new issuance to come out this year required to fund America's deficit could, along with a weakening of the Fed's independence, push US Treasury yields up to levels that threaten the orderly progress of US equity markets. In the UK, low growth and even lower confidence could lead to fears of tax hikes resurfacing, stifling what remains of aggregate demand. Yet, another risk would be the possible resignation of the Prime Minister, potentially after a particularly poor showing in the upcoming local elections. If a more left-leaning PM came in to weaken the fiscal guardrails, even promising increases in public spending, there could be a spike in yields perhaps as high as 5.5% on the 10-year gilt. Again, higher gilt yields will cast a pall over UK stocks.

A Public Mess Created by Private Markets

The retailization of alternatives describes how private wealth clients, Defined Contribution funds, and perhaps someday soon even 401(k)s, are making a significant shift towards private markets. This phenomenon seems to be gathering pace at least in the US. We are all familiar with the risks associated with private investments: illiquidity, a lack of transparency, higher counterparty risk, and valuation uncertainty, as the investments are not consistently, reliable marked-to-market. Last year saw some cracks appear in private credit markets. These were marked by rising defaults (like Tricolor Auto which rapidly descended into bankruptcy in September), increased use of risky loan features (such as PIKs being forced on debtholders who were expecting cash coupon payments), and investor-unfriendly fund actions (exemplified by Blue Owl which restricted redemption of capital), that make some observers nervous about potential systemic risks and defaults. Significant losses for mom & pop investors new to the private investment space and unprepared for the associated volatility could lead to a large enough public outcry as to require government intervention.

An implosion at NATO

The US President has expressed an interest in Greenland. A Republican congressman from Florida, went so far as to introduce a bill to make Greenland the 51st US state. The level of support for NATO from the US has of late become a function of who is in the White House. While no one wants to seriously consider a break between the US & its NATO allies, even the threat of such an outcome has forced the Europeans to deepen their commitment to each other and their common defense. European defense spending has doubled over the last five years. This has led to a significant change in the stock market leadership in Europe as investors, in anticipation of sustained high demand for military equipment and increased procurement, bought the leading defense stocks of Europe. German weapons maker Rheinmetall saw its shares triple, while the shares of Leonardo the Italian military aircraft specialist, doubled. BAE Systems, a maker of British military aircraft among other things, is globally diversified now and less focused exclusively on European defense and thus saw its shares rally a “mere” 63%.

A(nother) Graveyard of Empires

This was actually a nickname for Afghanistan owing to its history of being the place where powerful foreign invaders, from the British to the Soviets, even the US struggled to achieve military/political success and often faced costly defeats. With NATO in disarray facing the potential “implosion” referenced above and the Brits, Russians and Americans distracted by the Russia/Ukraine war, China could decide to invade Taiwan. Meanwhile, with the Middle East again in flames from Gaza to Tehran. And the US threatening regime change there, Iran could respond by disrupting the shipping of oil through the Strait of Hormuz. Oil prices would rise, putting a serious dent in global economic growth and sparking general bearishness.

Any of these outcomes while unpleasant would not likely bring global equity markets to a standstill, though they could result in a serious correction. Our position as a firm is still as it has always been to invest our clients’ assets in Quality stocks which are trading at a discount to their underlying valuation.