

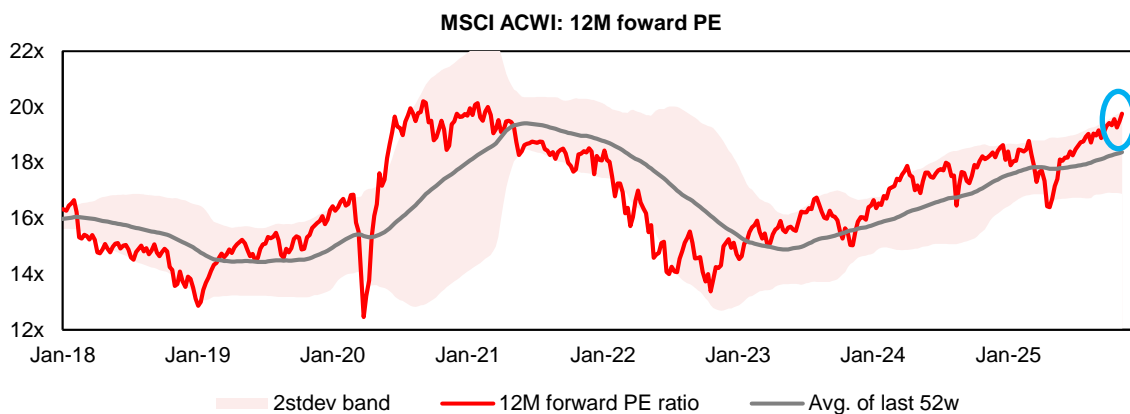
Not a bubble, not broken: why and how equities still work

- ▶ **Global equities remain resilient in late 2025, buoyed by solid macro conditions, strong earnings, and secular AI momentum. We view AI as a durable growth driver – not a bubble – and see recent US regional bank stress as isolated.**
- ▶ **At this stage, market pullbacks are healthy given elevated valuations. We would use them to incrementally increase equity exposure, with a focus on selectivity, quality, and global diversification. We don't see a bear market over the next 12 months as our central case.**
- ▶ **Structural momentum favors the US and Japan, while the Eurozone and UK offer value amid cyclical and political headwinds. India presents an opportunity within emerging markets, with Asia ex-India and LatAm riding recent strong gains.**
- ▶ **AI and healthcare remain core structural growth themes. Financials and industrials benefit from AI integration and cyclical support. We also see cyclical value in US homebuilders and long-term upside in quantum computing, albeit with high risk.**

Asset class outlook

The macroeconomic backdrop for equities through late 2025 is broadly supportive yet marked by nuanced risk factors. The global economic landscape is defined by a convergence of structural and cyclical forces that contribute to the resilience of equities. The US continues to lead among advanced economies, although its growth momentum has moderated from the post-pandemic highs. US real GDP is forecast at 1.6% in 2025, rising modestly to 1.8% in 2026, according to Federal Reserve projections. Despite this moderation, equities worldwide have advanced, buoyed by easing inflation, falling policy rates, and generally accommodative liquidity. However, headwinds come in the form of elevated equity valuations (exhibit 1) at a time when long-term rates are elevated too. Against this backdrop we see a potential 5-10% drawdown in global equity benchmarks as a healthy development. While a bear market is not our base case, we would use any pullbacks to add gradually with a 12–24-month constructive view.

Exhibit 1: Valuations have moved above their 2-standard-deviation band – a signal that has historically preceded equity pullbacks or corrections



Source: MSCI, I/B/E/S Global Aggregates, LSEG Workspace, and ADCB Asset Management

Globally, markets are transitioning from the acute inflation shocks of the pandemic era toward a phase of normalization. Across developed markets, headline consumer price inflation (CPI) has declined sharply from its cycle highs. US PCE price inflation is projected at 3.0% for 2025 and 2.6% for 2026. Similarly, inflation in the Eurozone and UK is moderating, supporting the potential for stable or lower policy rates into 2026. Japan remains an exception, with inflation slightly higher but policy rates still minimal. Central banks are carefully balancing lingering inflation concerns with the need to sustain output and employment. In emerging markets, especially in Latin America and parts of Asia, central banks have already started easing monetary policy, taking advantage of relatively contained inflation and stronger current account balances.

Kishore Muktinutalapati
Head - Investment Strategy
Tel: +971 (0)2 812 6457
kishore.muktinutalapati@adcb.com

Mohammed Al Hemeiri
Senior Specialist
Tel: +971 (0)2 812 6450
mohammed.alhemeiri@adcb.com

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Nevertheless, the macro environment is not without risks. Geopolitical uncertainties – most notably related to US-China trade relations – persist, while the inflation outlook remains uncertain with the tail risk of a potential tariff-induced shock. Additionally, divergent growth rates across regions and the uncertainty introduced by policy changes add to the complexity of the investment landscape. Especially, we see Chinese growth slowing in the next couple of quarters while still meeting its 2025 growth target. Other major economies could see a growth rebound from now into the first half of 2026. Yet, this growth is likely to be less labour intensive – especially in the US – meaning that better growth may not stop the labour market from cooling even further.

Following a period of aggressive global rate hikes, monetary policy has shifted. The US Federal Reserve has enacted several rate cuts, expected to bring the fed funds rate to 3.6% (median 2025 projection), with modest further cuts expected in 2026 and in 2027. European and UK rates have fallen, with the pace of future cuts tied to disinflation, progress, and fiscal discipline. Liquidity conditions are broadly supportive, with easing financial conditions, contained credit spreads, and robust equity and bond market participation. We expect Fed to cut again in December, and prolong the rate cut cycle with two reductions in 2026, and a more rate cuts in 2027 taking the Fed funds target rate below 3% eventually. For the ECB, we see the next move as likely to be a cut rather than a hike. BoE, after its November pause will likely resume its rate reductions.

Corporate earnings remain robust, especially in the US, where S&P 500 earnings growth for Q3 2025 reached 10.7%, marking four consecutive quarters of double-digit gains. Consensus forecasts anticipate full-year 2025 earnings growth of 11–12% for the S&P 500, rising to 14% in 2026. Profit margins are near record highs, supported by pricing power, digitalization, and AI-driven productivity, particularly in the technology and communications sectors. Overall, earnings are well supported by the cycle (exhibit 2). However, valuations have risen, with the S&P 500's forward P/E ratio at 22.9 – well above historical averages – driven largely by concentration in “Magnificent 7” tech mega-caps. This elevated valuation environment means that markets are highly sensitive to earnings surprises, reinforcing the notion that equities may be “priced to perfection.”

Exhibit 2: Earnings remain well supported by cyclical growth



Source: MSCI, I/B/E/S Global Aggregates, ISM, LSEG Workspace, and ADCB Asset Management | Notes: *Calculated as the simple average of ISM PMIs for manufacturing and services sectors.

Regional outlook

The global equity market outlook for late 2025 reveals a complex picture of opportunity and risk, shaped by macroeconomic stabilization and shifting regional dynamics. The US, Japan, the Eurozone, the UK, and emerging markets each present distinct investment landscapes, influenced by domestic factors, policy shifts, and global trends such as technological innovation and monetary easing.

▷ **US: leadership amid concentration**

The US equity market continues to outpace its global peers, driven by robust growth and innovation, particularly in technology, communication services, and consumer discretionary sectors. The S&P 500 has gained over 15% YTD, propelled largely by the "Magnificent 7" mega-cap tech firms (Microsoft, Meta, Alphabet, Apple, Nvidia, Amazon, Tesla). These companies continue to exert outsized influence on market returns and capitalization, signalling increasing market concentration. Macroeconomic conditions remain broadly favourable: inflation is moderating, labour markets are resilient though cooling, and the Federal Reserve is implementing gradual rate cuts. US corporate earnings are strong, with four consecutive quarters of double-digit growth and forecasts for continued momentum into 2026. However, stretched valuations (forward P/E at 22.9x) warrant investor caution. Despite elevated risks, the US retains its status as the premier global equity market, justified by its sectoral leadership, governance standards, deep liquidity, and ongoing AI-driven capital investment. This supports a continued overweight position for US equities in global portfolios. Although US equity valuations appear high compared to other regions and their earnings growth, they seem more justified when accounting for low earnings uncertainty (exhibit 3).

▷ **Japan: reforms drive recovery**

Japan stands out among developed markets for its significant equity gains in 2024 and 2025. Key drivers include improved corporate governance, shareholder-friendly reforms, and robust earnings, supported by wage-price negotiations and demographic changes that stimulate domestic demand. The Bank of Japan's gradual normalization policy has not dampened investor enthusiasm, while a weaker yen benefits exporters, especially in industrials and technology. Corporate reinvestment, buybacks, and capital efficiency are enhancing market performance, with the Nikkei and Topix indices outperforming global peers. Challenges remain, such as currency headwinds and export uncertainties tied to US trade policy, but the structural reforms and earnings recovery position Japan favorably, particularly in sectors linked to automation and capital expenditures.

▷ **Eurozone and UK: cyclical challenges, attractive valuations**

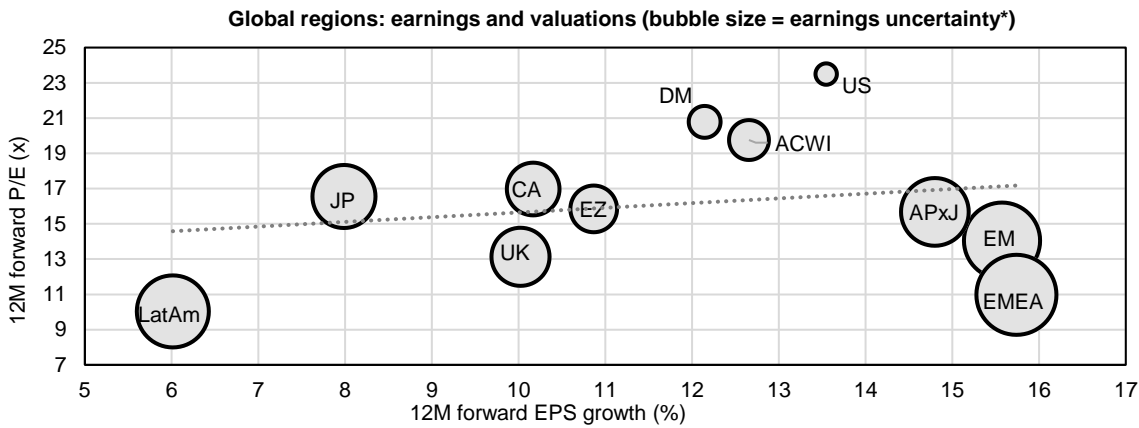
The Eurozone equity market has risen by about 13% YTD, buoyed by cyclical recovery, supportive monetary policy, and expectations of stronger earnings in 2026. However, the region faces persistent headwinds: weak consumption, fiscal tightening, tariffs, and political fragmentation. Earnings growth for 2025 is muted, but prospects for 2026 are brighter with anticipated 10%+ EPS growth as currency and trade challenges ease. Valuations are notably attractive, with MSCI Europe trading at a significant discount to the US, especially among small- and mid-cap stocks. The outlook remains neutral, balancing value opportunities against political and earnings uncertainty. UK equities have performed strongly, with the FTSE 100 at record highs and mid- and small caps recovering. Financials and defense sectors lead gains, and attractive dividend yields (above 4%) present selective opportunities. Nonetheless, concerns about growth, inflation persistence, and investor flows justify a neutral stance for now.

▷ **Emerging Markets: mixed results, India Favored**

This year, our overall underweight stance on EM benchmarks has not been in our favor. Also, emerging market equities have experienced varied performance in 2025. Latin America has led with impressive gains while Asian equity performance was helped by the spillover of AI related optimism in the region, and EM EMEA markets showed mixed performances. Looking ahead, India remains a structural overweight despite recent market softness; its fundamentals are strong, with GDP growth forecast above 6.5%, ongoing reforms, and robust domestic liquidity. Despite the recent underperformance, high valuations pose risks, but corrections may provide entry points given India's favorable trajectory. For a detailed cross-asset view on India, see our note [Deflator lift, tariff drift](#).

[India's balancing act, September 29, 2025](#). China's equities have seen near-term outperformance due to stimulus and tech sector strength, but structural challenges persist, including property sector stress, weak consumer confidence, and geopolitical tensions. Attractive valuations in China are offset by regulatory and currency risks, resulting in a cautious cyclical outlook. For a detailed cross-asset view on China, see our note [China Investment Strategy: Selectivity in a policy managed market, September 12, 2025](#). Elsewhere in emerging markets, Latin America stands out for its compelling valuations and cyclical recovery, though future gains depend on commodity prices and global growth conditions helping earnings growth to recover.

Exhibit 3: While US equity valuations remain elevated, they look more defensible once low earnings volatility is factored in



Source: MSCI, I/B/E/S Global Aggregates, LSEG Workspace, and ADCB Asset Management | Notes: *We assess earnings uncertainty by comparing the dispersion of analyst forecasts to their average – a higher ratio signals greater uncertainty.

Sector outlook

The global equity sector outlook as of late 2025 is shaped by several powerful trends, with a particular focus on AI and technology, financials, and a handful of sectors positioned for enduring outperformance. Despite concerns about valuation and concentration – especially in AI-related stocks such as the US “Magnificent 7” and leading global chipmakers – current evidence suggests that the sector is not experiencing a classic speculative bubble. Instead, these companies are engaged in a historic capital expenditure (capex) cycle, deploying significant resources into data center expansion, chip development, and cloud infrastructure. These investments are sustained by strong cash flows and strategic bond issuance, underpinned by profitability and well-established business moats, unlike the unproven tech firms of the dot-com era. AI and technology firms are generating tangible business value by integrating artificial intelligence into products and operations, resulting in noticeable gains in productivity and earnings. Unlike previous tech bubbles, today’s market leaders are highly profitable and resilient, with the capacity to weather higher interest rates and capital costs. While speculative excess exists in some early-stage startups and niche financial arrangements, broad market behavior remains disciplined, with little evidence of indiscriminate retail speculation or excessive leverage reminiscent of past bubbles. However, unlocking long-term returns from AI investments will depend on success in converting capital spending into monetizable revenue streams and productivity improvements.

Key risks to monitor include the sustainability of debt-funded capex, the profitability of large-scale “hyperscaler” infrastructure buildouts, and the inherent uncertainty in picking winners among early-stage AI players. Worth noting that powered by AI-enthusiasm, both information technology and communication services sectors emerged relative outperformers for the third consecutive year in 2025 but equally, the AI related rally appears to have extended beyond just tech to include industrials, utilities, and financials this year (exhibit 4). However, given elevated valuations, any correction in high-flying sectors should be viewed as a healthy outcome. In our note [Tech faces a near-term reality check, August 21 2025](#), we discussed the factors that could slow down the tech rally in the near-term. We remain constructive on the

medium to long-term outlook for AI as a theme and would recommend building exposures across the value chain rather than taking a concentrated bet. Even geographically, we think having exposures to both the US and Chinese tech is important (for details and discussion see our note [The DeepSeek effect, January 28, 2025](#)).

Exhibit 4: While IT and communication services continue to be the best performers, AI-enthusiasm appears to have also spread to other sectors including industrials, utilities, and financials in 2025

Legend	2017	2018	2019	2020	2021	2022	2023	2024	YTD*
Communication Services	40%	0%	45%	44%	31%	28%	50%	31%	28%
Consumer Discretionary	27%	-2%	26%	36%	26%	-7%	36%	30%	28%
Consumer Staples	23%	-7%	24%	22%	22%	-7%	28%	21%	22%
Energy	23%	-10%	24%	18%	20%	-8%	20%	19%	22%
Financials	22%	-10%	23%	14%	17%	-12%	20%	16%	19%
Health Care	21%	-11%	21%	13%	16%	-15%	12%	11%	19%
Industrials	18%	-12%	20%	10%	15%	-15%	9%	9%	17%
IT	15%	-14%	20%	6%	11%	-20%	5%	2%	10%
Materials	14%	-16%	19%	1%	10%	-27%	2%	0%	8%
Real Estate	11%	-16%	18%	-6%	9%	-32%	1%	0%	6%
Utilities	4%	-18%	16%	-9%	8%	-32%	0%	-1%	4%
ACWI	4%	-18%	9%	-32%	7%	-36%	-2%	-10%	4%

Source: MSCI, LSEG Workspace, and ADCB Asset Management | Notes: *Data as of November 05, 2025.

In the financial sector, systemic risk concerns have receded notably since the banking turmoil of 2023-2024. US and European banks are now among the most well-capitalized in history, with high Common Equity Tier 1 (CET1) ratios, strong profit buffers, and improved deposit stability. Regulatory stress tests indicate that the banking system can withstand significant shocks. Liquidity and funding conditions have also improved, aided by less restrictive monetary policy, resulting in manageable funding costs. Lending standards have tightened, but delinquency and loan loss rates remain below historical averages. Major banks are reporting robust earnings growth, although future profitability will depend on macroeconomic and credit cycle developments. While a few regional US banks have reported stress in their lending in recent months, we think this is not systemic.

Looking ahead, the preferred equity sectors for long-term overweight positions include AI-related structural tech themes (information technology, and communication services), and industrials, financials, and healthcare sectors (see our note [Three equity sectors that captured our hearts, February 14 2025](#)). Technology will continue to benefit from secular AI adoption, cloud computing, and automation, while industrials are set to gain from trends in re-onshoring, infrastructure spending, and decarbonization. Communication services giants like Alphabet and Meta leverage their dominance in data and digital advertising, with new AI-driven business models emerging. Healthcare is poised for structural growth driven by demographics, AI innovation, and rising global wealth, despite recent underperformance and political risks. Common characteristics among these favored sectors include strong cash generation, disciplined capital management, pricing power, and leadership in innovation. As valuation discipline grows increasingly important, these traits position them for long-term outperformance. Tactically, we also like US homebuilder equities (see our note [US Homebuilders: Positioning for the rate cut cycle, September 04 2025](#)). Thematically, we also highlight quantum computing sector as a potentially high risk-high reward proposition (for details see our note [From qubit to profit: cracking the code of quantum investing, July 2025](#)).

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