Courtville Partners – Investment Outlook, January 2026

Summary of the key points in this quarter's Investment Outlook

- Now that the US and China have buried the hatchet, we're all living in a G2 world.
- The mismatch between China's economic might and its representation in global market indices offers opportunity backed up by both valuation and long-run underperformance.
- Consensus expectations for both inflation and economic growth in 2026 could well turn out to be too low, which ought to be positive for equities in general (and bad for bonds).
- The pharaonic levels of investment in AI assets already look like an example of serious capital misallocation.
- We see good prospects for companies involved in upgrading electricity grids almost everywhere regardless of generating mix.

"We're not in Kansas any more." That's not what President Trump actually said after the US/China summit in Busan last October. Instead, he described his meeting with Xi Jinping as a "G2 moment". Not long afterwards came a report by the RAND Corporation (a US Government-funded think-tank) arguing for a more constructive relationship with China. This was followed by the rehashed National Security Strategy, in which China was downgraded (or perhaps upgraded) from "existential threat" to "strategic competitor". Investors have seen plenty of action over the last 12 months. But public acknowledgement by the US of China's peer status may prove to be the event with longest-lasting effects. If so, the implications for portfolio investment may be profound.

The economies of the US and China resemble each other not at all. Although China's GDP is two-thirds that of the US, its manufacturing capacity is almost twice as big; and, as we have observed before, Chinese engineering and technology have overtaken their Western counterparts in almost every field. Yet China's stock markets remain pygmies next to their US equivalents: the combined capitalisation of Shanghai, Shenzhen and Hong Kong of $16trn is enough to rank second globally, but still a far cry from Wall Street's $70trn. And the renminbi may never challenge the US dollar's status as the blood within the world's financial arteries.

None of this is new. What *would* count as new is the advent of a world in which Washington and Beijing rule the geopolitical roost together. It's been a long time coming. We won't recycle Mao's apocryphal take on the French Revolution. All the same, it took a ruthless long-term strategy to guide China's economy from 2018's US semiconductor embargo through to the "G2 moment" in Busan. Over seven years China has weaned its industrial supply-chains off most Western components and technology (not least in semiconductors), tightened capital controls and directed bank lending away from consumer sectors towards manufacturing. This may have put Chinese equities beyond the pale for the duration; but the upshot is near-total industrial self-sufficiency. More than this, China's economy has emerged with unrivalled prowess in fields that may yet be crucial competitive advantages in the years to come, ranging from power stations (of all types) and industrial robots to EVs. Consider the possibility that cheap and plentiful electricity may be the secret sauce for the AI era, not Nvidia's hyper-expensive chips.

This is why China was confident enough to face down Trump's tariff threats (with some help from a near-monopoly in the rare earths indispensable for US armaments production). In response, the US has opted for an accommodation with China – an option far more palatable, not to say achievable, than purging its own supply-chains of Chinese inputs. We note also that Trump and Xi are due to meet four times this year – a frequency for which there is no precedent.

Should investors trust China? Many of our readers will have their own views on this. We would make two points. First, the modern history of China from the mid-19th century to the beginning of Deng Xioaping's regime (1978) is one of almost unremitting human misery and social upheaval. A good case can be made that the overriding domestic priority for China's leaders is social stability. Second, China represents a paltry 3.1% in the MSCI ACWI index (versus 65% for the US). So even, say, a double weighting to the world's second largest economy and second largest stock market is hardly betting the farm. As a bonus, it would also rank as a non-consensus view. (Quite why China is still classified as an emerging market is beyond us.) Buying Chinese equities now is not an attempt to catch the proverbial falling knife: the MSCI China A Shares Index rose 22% last year (in dollars) and stands 57% above its February 2024 low. On the other hand, the same index is actually down 9% over five years and up a relatively modest 40% over 10 years. Valuation looks reasonable too: prospective P/E 13x and P/BV 1.9x versus 19x and 3.6x, respectively, for global equities.

Markets were kind to investors in 2025. The dollar's 9% depreciation took some of the gloss off returns in other currencies. But almost all major indices rose, many of them handsomely, leaving global equities up 23% for the year in dollars (limited to +14% in sterling). Even bonds offered modestly positive returns. Above all, 2025 was the year in which the bull market broadened out. Decent returns from US equities (+18%) were outpaced for the first time in more than a decade by those from Europe, Asia, Japan, LatAm and other emerging markets, not to mention gold (+65%) and other precious metals. The capitalisation-weighted and equal-weighted global equity indices ended the year neck-and-neck, which we see as another sign of greater breadth. Our model portfolio returned +15.7% (beating its benchmark by 4.2%). Asset allocation generated +5.6%, offset by -1.4% from currency. Both our longstanding preference for equities (real assets) over bonds (IOUs) and our tilt away from US equities towards Asia and emerging markets served us well, as did some of our thematic investments (e.g. nuclear +70%, gold +50%).

We have always been sceptics when it comes to end-of-year crystal ball-gazing. 2025 offered yet another reminder that investors' best interests are normally served by combining patience and equanimity: the panic induced by US tariffs in early April ("Liberation Day") quickly evaporated. We should treat the next market spasm, whenever it comes, as the opportunity that it is likely to be (to buy good companies at lower prices). Volatility is the cool-headed investor's friend. Easy to say, though much harder to put into practice, we admit. Since 1949 the typical US bull market has lasted more than five years and generated an average return of +254%, whereas bear markets on average have lasted just one year and produced losses of -31%.

Many see AI as the most likely source of the stock market's next major correction. After all, doesn't boom always turns to bust? AI fervour has certainly created a boom. We have no worthwhile opinions on the long-run utility of AI and its applications; but we agree that conventional valuation metrics struggle to justify the $30trn (or 75%) added to the US stock market's capitalisation since ChatGPT was released in late 2022. On its own the staggering capital-intensity of AI infrastructure disqualifies any comparison with the dotcom boom of the late 1990s. Investors will applaud capital spending, on however grand a scale, as long as they can see credible cases for future revenues and profits. In the case of AI, however, we seem to be fast approaching the point at which benefit and doubt go their separate ways. Bain & Co, for example, reckons that AI-derived revenues must reach $2trn p.a. "soon" in order to make sense of current capex levels. (By way of comparison, the global advertising industry's revenues are roughly $1trn p.a.) Nvidia may be making fat profits from selling its sophisticated chips (or GPUs); but its customers have yet to find ways to make money from Nvidia's product. Add in nagging worries about revenue recognition, depreciation policies, electricity shortages and cross-shareholdings – and the result is a fear that some of the world's best (and best managed) companies may be misallocating huge amounts of their shareholders' capital. We'll find out soon enough.

It's not all AI-generated doom and gloom. Far from it. We see some powerful cyclical forces working in investors' favour this year. Both inflation and economic growth are arguably mispriced, especially in the US. The two are linked to some extent, of course. We have long suspected that inflation in developed economies would prove stickier than the consensus believes. In the US, we've just had the spectacle of the Federal Reserve cutting interest rates and re-starting quantitative easing (aka money-printing) even as GDP growth hits a two-year high (+4.3% annualised in 3Q25). Monetary policy could scarcely be more accommodative in the circumstances. Yet investors' collective expectations, as expressed by breakeven spreads between nominal and inflation-linked bonds, are that US inflation will coincide perfectly with the Fed's 2.0% PCE target over the next five, ten, 20 and even 30 years. This simply doesn't square with a PCE that is currently running at 2.8% and has been stuck in a 2.7-3.0% range for the last couple of years. Nor does it sit easily with several inflationary features of the macroeconomic landscape: deglobalisation/protectionism (including tariffs), tighter labour markets (if only from lower immigration) and soaring electricity prices. If these were not enough, both fiscal and monetary policies remain decidedly lax in almost all developed economies, including the US. As a result, economic growth could well be stronger than expected this year – in both nominal and real terms – across the board. (The OECD sourpusses see global growth this year retreating to +2.9% from +3.2% in 2025.) If we're right to think that both inflation and growth could come in higher than consensus, then equities are still a sensible proposition. A resumption of dollar weakness may be a bothersome corollary for non-US investors. The gargantuan US current account deficit will still have to be fed with foreign capital; and currency depreciation will be required eventually (even if it wasn't already this Administration's aim).

Which other assets could turn out to be mispriced? Like many, we are agog at the extent of the Yen's undervaluation – about 40% on a PPP (purchasing power parity) basis. But we don't have nearly enough conviction to place an explicit bet on a stronger Yen and are content to stick with our overweight position in Japanese equities, at least for now. We feel on firmer ground by arguing that many listed energy companies offer attractive risk/reward profiles. Such has been the consistent underperformance of oil and gas companies over 15 years that they now account for only 3% of the S&P 500 and not much more of the global aggregates. At that level no portfolio manager is obliged to have a view on, let alone a weighting in, oil stocks. Yet oil and gas account for more than four-fifths of the world's primary energy consumption – a level essentially unchanged for many years and likely to remain unchanged for many years to come (as even the IEA admitted in its recent *World Energy Outlook*). This mismatch in status – economic lifeblood versus stock market invisibility – makes energy stocks tempting for those looking for portfolio diversification. Government bonds have largely lost their diversifying properties – so there is a vacancy. In an increasingly energy-hungry world, energy stocks offer good value (at least on a relative basis), strong balance sheets and a record of capital discipline. And, as ever with energy, there is plenty of scope for geopolitical chaos (Venezuela, Russia, Iran, to name but three).

The new thematic addition to our model portfolio (First Trust NASDAQ Smart Grid Infrastructure ETF) also concerns energy, but its transmission in particular. After decades in which greater efficiency offset higher volumes, demand for electricity is growing again (and not just because of AI datacentres). Not many would bet against this trend continuing for many years. The snag is that transmission grids everywhere lack both the capacity to meet this rising demand and the resilience to cope with renewables' inherent intermittency. In many cases the grids are simply worn out after long periods of under-investment. Regardless of how electricity is generated in future, the need to upgrade grid infrastructure will become much more prominent.

COURTVILLE PARTNERS

Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	10.0	12.4
International Equities	56.0	51.0
Fixed Income	13.0	24.7
Alternatives	14.0	7.3
Commercial Property	1.0	0.1
Cash	6.0	4.5
Total	**100.0**	**100.0**

Courtville Partners Model Portfolio	ETF	Weight (%)	Changes this quarter	Weighted OMC (%)
UK Equities		**10**	**0**	
UK	VUKE LN	8	0	0.09
UK	VMID LN	2	0	0.10
International Equities		**58**	**2**	
Global	IWQU LN	2	0	0.30
US	VUSA LN	7	0	0.07
	XDPG LN	9	0	0.09
	EWSP LN	9	0	0.20
	IUVD LN	3	0	0.20
Euro	VERX LN	5	0	0.12
	XDAX LN	2	0	0.09
Japan	VJPN LN	4	0	0.19
Asia ex-Japan	VAPX LN	5	1	0.22
Emerging Markets	VFEM LN	9	0	0.25
Emerging Markets ex-China	EXCS LN	1	-1	0.18
China	CNUA LN	2	2	0.24
Fixed Income		**11**	**0**	
UK	IGLT LN	3	0	0.07
US	IDTM LN	2	0	0.17
EM	SEML LN	4	0	0.50
China	CNYB NA	1	0	0.35
US	CORP LN	1	0	0.20
Alternatives		**14**	**0**	
Gold	PHAU LN	4	0	0.39
Oil	WEL5 GY	2	0	0.18
Infrastructure	INFR LN	2	0	0.65
Electicity Infrastructure	FGRD LN	2	2	0.63
Uranium	NUCG LN	2	0	0.55
Water	IH20 LN	2	0	0.65
Carbon Allowances	CARB LN	0	-2	0.35
Commercial Property		**1**	**0**	
Global	IWDP LN	1	0	0.59
Cash	XSTR LN	**6**	**-2**	0.15
Total		**100**		**0.22%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2025 YTD	15.7%	11.5%	4.2%
Since inception(1/1/2015)	140.2%	122.8%	17.4%
CAGR	8.3%	7.6%	0.8%

The value of your investments can fall as well as rise. You may not get back all the money you invested.