First quarter review and outlook 2026

A geopolitical shock jolted inflation and interest rate expectations in the first quarter of 2026.

Q1 2026

Marketing material.

Geopolitics and disruption to energy flows reshaped the investment landscape in the first quarter of 2026, pushing inflation and interest rate expectations higher and challenging the assumption that easing monetary policy would continue uninterrupted.

Rising tensions in the Middle East and disruption to shipping through the Strait of Hormuz drove oil prices sharply higher, reigniting concerns around inflation just as it had appeared to be moving closer to central bank targets. The scale and speed of the move was significant, with the largest monthly percentage rise in Brent crude on record in March.

At the start of the year, markets had been positioned for rate cuts as evidence built of cooling labour markets. That outlook shifted decisively during the quarter as policymakers refocused on inflation risks and the potential for higher energy and commodity prices to feed through more persistently. Interest rate expectations were revised higher across major regions and bond markets became more volatile, undermining a traditional plank of portfolio diversification.

Against this backdrop, equity leadership narrowed and rotated, with energy related stocks benefiting from higher prices while rate sensitive and growth-oriented sectors came under pressure. Assets typically regarded as safe havens delivered mixed outcomes, reflecting a market environment shaped less by broad risk risk aversion and more by uncertainty around inflation persistence and policy direction.

Equities

United States

US equities struggled overall during the quarter as shifting rate expectations and geopolitical uncertainty weighed on sentiment. Beneath the headline declines, however, market performance was far from uniform.

Technology and growth oriented stocks bore the brunt of the pullback as concerns mounted around the scale of capital expenditure required to support artificial intelligence infrastructure and the durability of expected returns. This triggered a sharp reassessment of valuations across parts of the market previously seen as long term growth leaders. By contrast, market breadth showed signs of improvement as investors rotated into less crowded areas, including smaller companies, which demonstrated relative resilience.

Energy stocks were the clear outperformers, benefiting directly from rising oil and gas prices, while consumer facing sectors weakened amid softer signals on household spending and employment. Financials also underperformed as concerns lingered around earnings momentum and exposure to less liquid areas of credit.

Overall, the quarter highlighted the importance of selectivity within US equities. While index level returns were negative, dispersion across sectors and styles remained high, reinforcing the value of active positioning.

About Cazenove Capital

- Owned by Schroders, a FTSE 100 company
- Assets under management over £65 billion[1]
- Offices across the UK in Birmingham, Bristol, Chester, Edinburgh, London, Manchester and Oxford
- Founded 200 years ago and built on lifelong partnerships with our clients
- Discretionary fund management for advisers

[1]Correct as of December 2024.

Richard Gould
Portfolio Director

Richard Gould is a Portfolio Director within the DFM Team. Having joined in 2007, Richard began his career in the City working for an executive search agency focusing on asset management firms. He then moved to Morley Fund Management where he worked on the Corporate Bond team before moving to the Private Equity desk. Richard has completed the Chartered Securities and Investment Institute Masters in Wealth Management.

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United Kingdom

UK equities proved relatively resilient against a challenging global backdrop. The market's sector composition – with meaningful exposure to energy, financials and healthcare – offered support as investors gravitated towards more value oriented and defensive areas.

Higher energy prices benefited the large oil majors, while defence companies were supported by rising expectations of increased military spending across Europe. Healthcare was another notable contributor, reflecting both company specific developments and the sector's defensive characteristics.

Economic data in the UK remained subdued, highlighting ongoing domestic challenges. Growth has been modest and confidence remains fragile. However, a more balanced monetary policy backdrop during the quarter provided some support for equity valuations, helping UK markets outperform many global peers.

Europe

European equities faced a more difficult quarter as higher energy prices and geopolitical tension weighed on sentiment. The region's continued sensitivity to imported energy meant inflation expectations rose quickly as oil and gas prices climbed, putting pressure on both consumers and corporate margins.

Energy and utilities were the standout performers, benefiting directly from price movements and their defensive qualities. Elsewhere, most other sectors delivered negative returns against a backdrop of ongoing uncertainty around global trade and growth.

The combination of elevated energy costs, structural economic challenges and limited policy flexibility continues to weigh on the European equity outlook. While valuations have adjusted, the region remains vulnerable to further shocks, particularly if higher inflation proves persistent.

Japan

Japanese equities delivered positive returns during the quarter, supported by a combination of domestic reform, improved corporate governance and a supportive currency backdrop.

Ongoing efforts to improve capital efficiency and shareholder returns continued to gain traction, driving increased buybacks and improved discipline around balance sheet management. A weaker yen also supported export oriented companies, helping earnings momentum despite a volatile global environment.

Overall, Japan continues to stand out as a market where structural change, rather than short term macro developments, is playing a more significant role in shaping returns.

Asia and emerging markets

Emerging markets experienced a mixed quarter, marked by wide divergence between countries and regions. Markets benefitting from higher commodity prices generally outperformed, while those most exposed to imported energy costs or elevated valuations struggled.

Parts of North Asia benefitted from improved conditions in semiconductor and technology supply chains, while Latin American markets were supported by rising oil and metal prices. By contrast, Chinese equities remained under pressure as challenges in the property sector persisted despite policy support, and Indian equities struggled amid rising input costs and concerns around global technology demand. The quarter reinforced the importance of differentiation within emerging markets.

Bonds

Bond markets endured another challenging quarter as rising energy prices and shifting inflation expectations pushed yields higher across most major regions. The move was driven less by changes to policy rates themselves and more by concern that inflation would remain higher for longer than previously anticipated.

Longer dated government bonds were particularly affected, reflecting the market's reassessment of future inflation risks and the reduced confidence in bonds' ability to act as a reliable hedge against equity volatility. Emerging market debt also faced headwinds as higher global yields and a stronger US dollar weighed on returns.

In credit markets, spreads widened as investors priced in increased uncertainty around growth, private credit exposure and geopolitical risks. Returns were negative across most segments, with more interest rate sensitive areas faring worst.

Commodities

Commodities were one of the strongest performing asset classes during the quarter, driven overwhelmingly by gains in oil and gas. Supply disruption, elevated risk premia and concerns around infrastructure and security combined to push prices sharply higher.

Precious metals also delivered positive returns, reflecting ongoing demand for inflation protection and diversification, although volatility increased later in the quarter as speculative positioning unwound and some central banks sold reserves.

Outlook

We entered 2026 against a backdrop of solid global growth, improving earnings momentum and broadly supportive financial conditions. That environment has been challenged, but not derailed, by the geopolitical shocks experienced so far this year.

It is impossible to forecast the precise path or duration of geopolitical conflicts. What is possible is to assess how markets are likely to perform across a range of plausible scenarios and to position portfolios accordingly. At present, we do not see sufficient evidence to make a prolonged disruption to global growth our central scenario. However, we believe markets may be underestimating the persistence of higher energy prices.

Outlook cont.

Damage to infrastructure, alongside higher insurance and security risk premia, increases the likelihood that energy prices remain elevated for some time, even in the event of de-escalation.

Against this backdrop, we have reduced risk and now have a neutral allocation to equities overall. We have cut exposure to regions more vulnerable to higher energy costs and reallocated towards markets and sectors better positioned to absorb these pressures. Within equities, this leaves us overweight Japan and the UK, where domestic drivers and sector composition offer support, while remaining underweight Europe.

A defining feature of the current environment has been the reduced effectiveness of traditional diversification. Structurally higher inflation risks reinforce our underweight to bonds. Instead, we continue to build exposure to uncorrelated strategies and gold.

Cazenove Capital

1 London Wall Place, London EC2Y 5AU, United Kingdom

T +44 (0) 20 7658 6000

cazenovecapital.com

For more information on key terms, scan the QR code for our wealth management glossary.