

Investment Views

MAY 2026

Tempering Great Expectations

In our March edition of Investment Views, we explored a phenomenon that often feels counterintuitive: the tendency for equity markets to decouple from geopolitical turmoil. We noted that the S&P 500 has historically traded higher one year after a major crisis in 85% of cases. As we navigate the opening of May 2026, so far this thesis is passing the test once more.

Global equities sit at record highs, seemingly unperturbed by the lack of resolution in the Iran conflict or the persistent oil price shock that has kept Brent crude in a volatile upper range. While geopolitics inevitably informs our broader market view, it is not the most potent ingredient in the investment mix over the long term. Headlines drive daily sentiment but they rarely derail the structural machinery of global corporate earnings—at least not in the absence of a direct hit to the global credit transmission mechanism. To understand the investment climate, therefore, we must look beyond the noise of the news cycle to the "signal" found in valuations and the increasingly steep curve of earnings expectations.

The Gravity of Returns

It is prudent to begin with an acknowledgment of our starting point. Risk markets have enjoyed a strong run. The FTSE All-World Index has compounded at an impressive 17% annually over the last three calendar years (14.5% in GBP). Even when factoring in the significant drawdown of 2022, five-year annualized returns sit at a robust 10–11%.

History teaches us that double-digit returns of this magnitude do not persist indefinitely without periods of mean reversion. To some extent we may have been playing catch up with a fallow prior period, but we should recognize that we have also probably "borrowed" returns from the future. The "risk" in the risk-reward trade-off—though seemingly dormant during the rapid, liquidity-fuelled recoveries of recent years—is a structural inevitability of the market. While the current bull run may well extend for another 12 months, perhaps even bolstered by a rumoured "melt-up" ahead of the US mid-term elections, the "cost of entry" has risen. The hurdle for achieving above-average future returns is higher today than it was a year or two ago.

The Valuation Hurdle: Price vs. Value

This hurdle is comprised two primary elements: starting valuations and earnings delivery. When we examine valuations, we are essentially asking: "What is the market already pricing in?"

Currently, the S&P 500 trades at approximately 21x forward earnings. While this is far from the "euphoric" extremes such as the 25x+ levels seen during the late 1990s or the post-

pandemic peak, it is elevated relative to the long-term average of 17-18x. The Market Cap to GNP ratio, frequently referred to as the "Buffett Indicator" because he called it "probably the best single measure of where valuations stand at any given moment", stands at 227%, also suggesting the market is overvalued. The Equity Risk Premium (ERP) - the excess return investors demand for choosing the volatility of stocks over the "risk-free" certainty of government bonds, is approximately 0.5%, well below the historical 2%+ cushion.

Other metrics paint a rosier picture. The PEG ratio, which compares valuations with forecast growth rates, is a reasonable 1.2x, whilst the S&P 500 Equal Weight Index—which dilutes the outsized influence of the "Magnificent Seven"—is on a more palatable 17.5x earnings. Small and mid-cap stocks continue to trade at significant discounts to their larger-cap peers. Thus, while the overall "market" may be expensive, the "average company" remains reasonably priced.

The Earnings Hurdle: Mathematical vs. Psychological

The second part of the equation is growth expectations. If valuations are the "price" of the hurdle, earnings are the "muscle" required to jump over it.

Forecasts suggest earnings growth of 18% this year and another 18% in 2027, before settling into a still high 13% by 2028. To put this in perspective, the long-term average for earnings growth is around 6–8%. We are currently projecting higher growth than the historical norm, and we are doing so from a high base rather than emerging from a recession, with profit margins already hovering near record levels.

It is helpful to understand the "manufacturing process" of these estimates. They are pieced together by "sell-side" analysts who model every line item of a company's balance sheet. But earnings modelling is as much psychological as it is mathematical. History shows that analyst accuracy decays rapidly beyond the immediate 90-day window. In fast-paced industries (such as technology and AI), a three-year forecast is often little more than an aspiration. Analysts often fall victim to "herding"—staying close to the consensus to avoid career risk—which can lead to a collective blindness when the cycle eventually turns.

The AI Ecosystem: Not Looking a Gift Horse in the Mouth

The engine driving these ambitious growth forecasts is indeed the "AI Infrastructure" boom. The Philadelphia Semiconductor Index recently enjoyed a remarkable 18-session winning streak, and April 2026 stood as the best month for the broader US market since the rebound caused by the Covid vaccine breakthroughs of 2020.

Since the March bottom, just seven stocks (6 of the "Mag 7" plus Broadcom) have accounted for roughly 60% of the S&P 500's total gains. And as Bloomberg aptly put it, "An entire ecosystem of suppliers hinges on Big Tech's continued largesse."

AI is a powerful trend and we should not "look a gift horse in the mouth". If Big Tech continues to demonstrate (or at least forecast) that massive CAPEX spend is resulting in actual productivity gains and revenue growth, the rally can extend and broaden to those reasonably priced "average companies". However, we are currently in the "build-out" phase of this cycle; the true "application" phase—where AI translates into bottom-line profits for the non-tech sectors—is still in its infancy.

Potential "Crunch Points"

Despite the AI euphoria, we must remain vigilant for things that could disrupt the bullish earnings narrative:

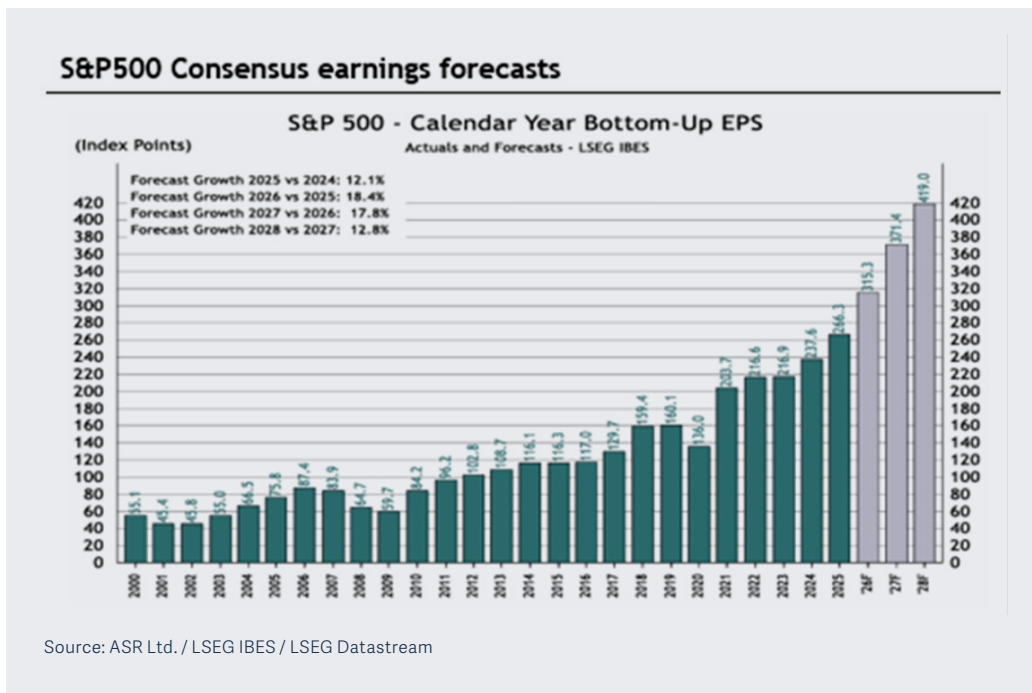
- The Energy Tax: Triple-digit oil prices act as a direct tax on both consumers and corporations. Higher energy costs increase input and logistics prices, which directly erodes the margins that analysts expect to expand.
- The Private Credit Shakeout: After years of unchecked growth in private lending, we are seeing real signs of stress as "higher-for-longer" interest rates and the AI revolution finally catch up with over-leveraged and over-optimistic mid-market firms.

- The "Saasocalypse" Narrative: In the software sector, we have witnessed a brutal shift from "growth at any cost" to "efficiency at any cost." These "old guard" companies such as Microsoft are in many cases the primary funding source for the AI "new guard".

Conclusion: Moderate, Not Great

The environment remains favourable but the path has undoubtedly become narrower. Our counsel to you remains rooted in discipline: stay invested. The mathematics is unforgiving. Missing just the ten best trading days over a thirty-year cycle can cut a portfolio's terminal value in half. Market timing is a game where the odds are perpetually stacked against the player. The only sensible answer is to not play that game, even if the siren sound of geopolitics beckons. Instead of trying to time the "top," implement a strategy that resists emotional "action" for its own sake. Success in this phase of the cycle requires the fortitude to remain invested during inevitable pullbacks, while strategically tilting the portfolio toward those areas—such as Healthcare, China and Cat bonds—where the valuation hurdle is lower, the margin of safety is higher and the correlation with other assets is limited.

As we review our core equity themes and alternative allocations—detailed updates of which are available on the client portal—we remain focused on your real objectives. The key message for the second half of 2026 is one of tempered optimism: while your long-term investment goals remain perfectly achievable, near-term expectations are moderate rather than great.



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