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UK EQUITY MARKET OUTLOOK 2026

Market Commentary for UK Investors

Market Commentary
February 2026

EVALUATION COPY

Introduction

Something rather significant happened on the 5th of January this year. The FTSE 100, after forty-two years of existence, finally closed above 10,000 points. In the days that followed, it continued to climb, setting fresh records. These are round numbers, admittedly, and round numbers carry more psychological weight than analytical substance. But they do invite reflection on where we find ourselves.

The context matters here. Last year delivered gains of more than 21 per cent, the strongest calendar year since 2009. Yet this occurred not amid euphoria but during what can only be described as the normalisation of monetary conditions. Rates have risen. Inflation has cooled. The extraordinary has given way to something more ordinary. And that shift, perhaps more than any index milestone, shapes what UK equities offer going forward.

This commentary is particularly relevant if you hold UK equities within an ISA or pension and are wondering whether the environment that drove last year's gains is likely to persist, and what, if anything, you might discuss with your adviser.

This commentary examines how that regime change alters the things that matter most when evaluating UK equities: income, valuation, balance sheet strength, and capital discipline. None of these factors was ever unimportant. But for fifteen years, cheap money allowed investors to pay less attention to them than they probably should have. Those days have passed.

What follows is not a forecast. Forecasting equity markets over meaningful time horizons is frankly a difficult exercise, and anyone who claims otherwise is selling something. Instead, this is an attempt to frame the current picture clearly, so that you and your financial adviser can make informed judgements about how UK equities might fit within a broader portfolio.

The World Has Changed

Cast your mind back to early 2022. Bank Rate sat at 0.1 per cent, where it had been lodged since the pandemic panic of March 2020. Before that, it had barely exceeded 0.75 per cent since Lehman Brothers collapsed in 2008. An entire generation of investors and company managers grew up professionally in an environment where borrowing cost almost nothing.

That world no longer exists. Inflation hit 11.1 per cent in October 2022, the highest reading in over four decades. Energy prices spiked. Supply chains snarled. Pent-up demand from lockdowns collided with constrained supply. The Bank of England, like its counterparts elsewhere, responded with aggressive tightening.

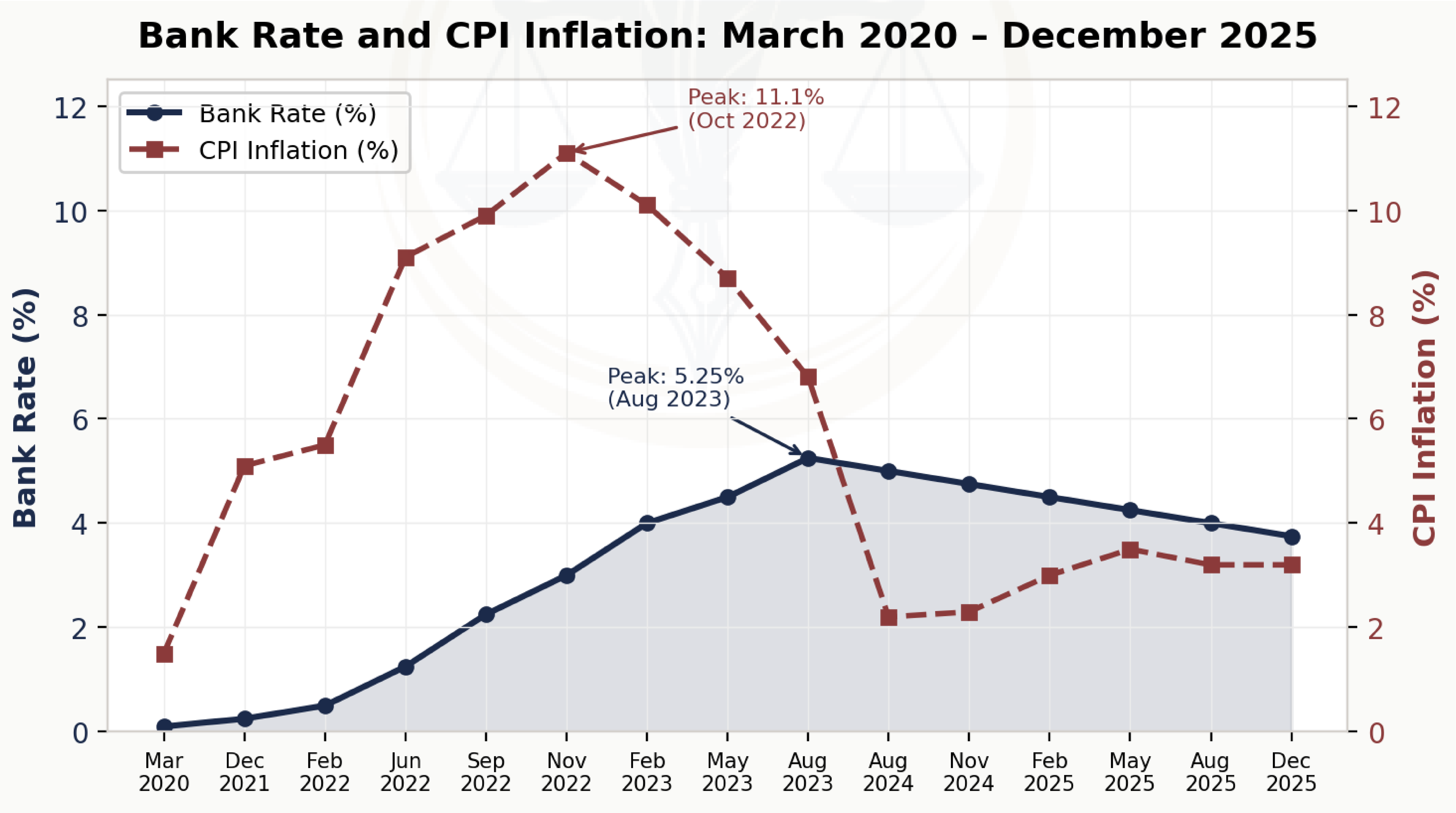

FIGURE 1: BANK RATE AND CPI INFLATION, MARCH 2020 – DECEMBER 2025

SOURCES: BANK OF ENGLAND, OFFICIAL BANK RATE HISTORY; ONS, CONSUMER PRICE INFLATION (CPI) BULLETIN SERIES. DATA AS AT DECEMBER 2025.

Bank Rate reached 5.25 per cent by August 2023. Consider that for a moment. In the space of eighteen months, rates moved from essentially zero to levels not seen since before the financial crisis. The era of emergency monetary accommodation, which had lasted a decade and a half, was definitively over.

Since then, inflation has retreated. The Monetary Policy Committee cut rates six times between August 2024 and December 2025, bringing Bank Rate down to 3.75 per cent. Further reductions are expected this year, with most economists pencilling in a terminal rate somewhere between 3.0 and 3.5 per cent. But here is the key point: **we are not going back to zero. The baseline has shifted permanently upward.**

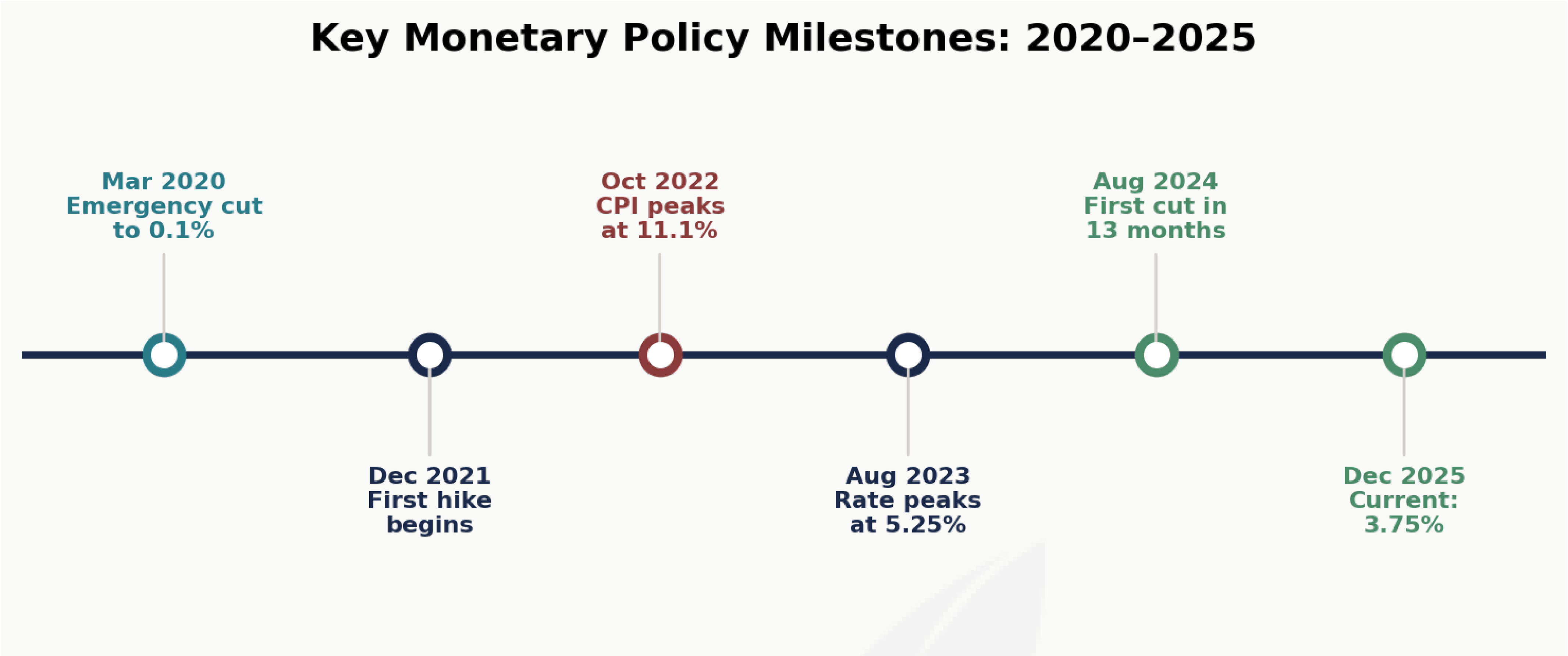

FIGURE 2: KEY MONETARY POLICY MILESTONES, 2020–2025

SOURCE: BANK OF ENGLAND, MONETARY POLICY COMMITTEE DECISIONS, 2020–2025.

What This Means in Practice

This matters enormously for how one ought to think about equities. When cash yields nothing, almost any positive return looks attractive. When gilts pay 4.4 per cent and money market funds offer similar, equities must justify themselves differently. The competition for capital has returned.

If your portfolio was constructed during the era of near-zero rates, it may be worth considering whether your current allocation still makes sense in an environment where cash and bonds offer genuine competition. Your adviser can help you think through the implications.

What the FTSE 100 Actually Is

Before discussing what UK equities might deliver, it helps to understand what the index actually contains. The composition of the FTSE 100 differs markedly from other major benchmarks, and these differences matter considerably.

Financials dominate, accounting for 23.1 per cent of the index weight. Banks such as HSBC, Lloyds, Barclays, and NatWest sit alongside insurers including Aviva and Legal and General. Consumer staples follow at 17.8 per cent, encompassing Unilever, Diageo, British American Tobacco, and Reckitt. Healthcare contributes 12.5 per cent through AstraZeneca and GSK. Energy adds 11.2 per cent via Shell and BP.

What the FTSE 100 conspicuously lacks is technology. Information technology accounts for barely 1 per cent of the index. Compare that with the S&P 500, where technology represents over 31 per cent of market capitalisation. This single difference explains much of the relative performance divergence over the past decade.

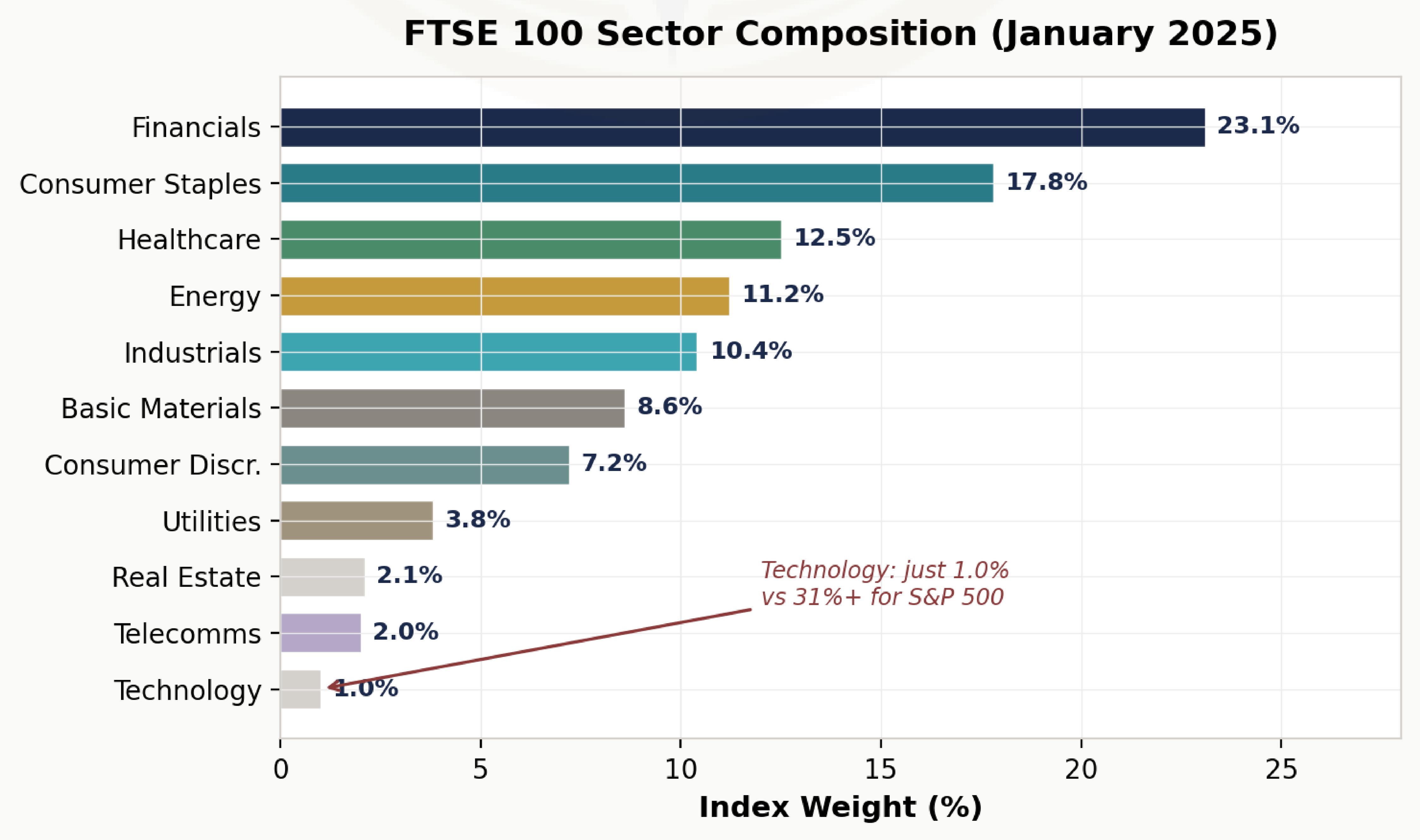

FIGURE 3: FTSE 100 SECTOR COMPOSITION BY INDEX WEIGHT

SOURCE: SIBLIS RESEARCH, FTSE 100 SECTOR WEIGHTINGS, AS AT 1 JANUARY 2025. S&P 500 TECHNOLOGY WEIGHTING FROM S&P DOW JONES INDICES.

When rates were falling and liquidity abundant, growth stocks flourished. Companies promising jam tomorrow commanded premium valuations because tomorrow's cash flows, discounted at near-zero rates, looked almost as valuable as today's. The UK, with its old-economy bias, lagged behind.

But regimes change. In an environment of positive real rates and scarcer capital, the characteristics that held UK equities back may prove advantageous. Companies that generate cash today, pay dividends, and trade at reasonable valuations face less headwind than those requiring years of growth to justify their prices.

International Exposure

Despite being called UK equities, the FTSE 100 is remarkably international. Approximately 75 per cent of aggregate revenues come from outside the United Kingdom. North America contributes around 30 per cent, continental Europe roughly 23 per cent, and Asia Pacific about 15 per cent. Domestic UK revenues account for just 22 per cent of the total.

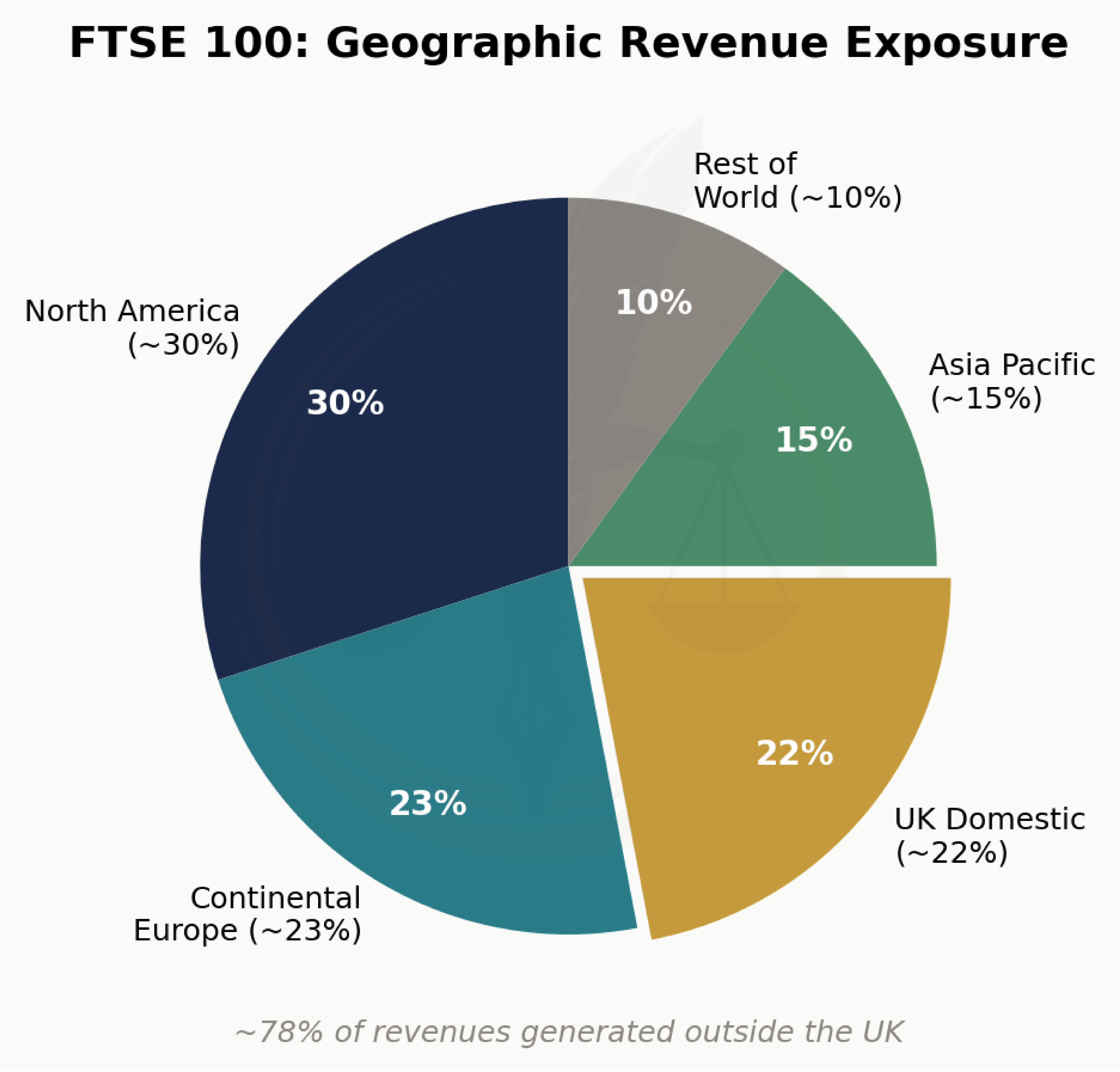

FIGURE 4: FTSE 100 GEOGRAPHIC REVENUE EXPOSURE

SOURCES: FTSE RUSSELL ANALYSIS, OCTOBER 2022; CAPITAL GROUP RESEARCH. APPROXIMATELY 78% OF FTSE 100 REVENUES ARE GENERATED OUTSIDE THE UK.

This has consequences for currency movements. When sterling weakens, overseas earnings translate into more pounds, flattering reported results. When sterling strengthens, the opposite occurs. The index's international character also means that UK domestic economic conditions, whilst not irrelevant, matter less than one might assume.

The Income Proposition

UK equities have long been associated with dividends, and this remains a distinguishing characteristic. The FTSE 100 currently yields between 3.1 and 3.4 per cent, depending on exactly when you measure. That compares with around 1.3 per cent for the S&P 500 and roughly 1.8 per cent for European indices.

But context matters here too. Ten-year gilts yield approximately 4.4 per cent. Cash deposits and money market funds offer 4 per cent or thereabouts. For the first time in years, equities face genuine competition for income-seeking capital.

The honest answer is that equity income no longer enjoys the clear advantage it possessed when alternatives yielded almost nothing. Investors must now weigh the higher but fixed income from bonds against the potentially growing but less certain income from equities. Neither answer is obviously correct. It depends on time horizons, tax positions, and individual circumstances.

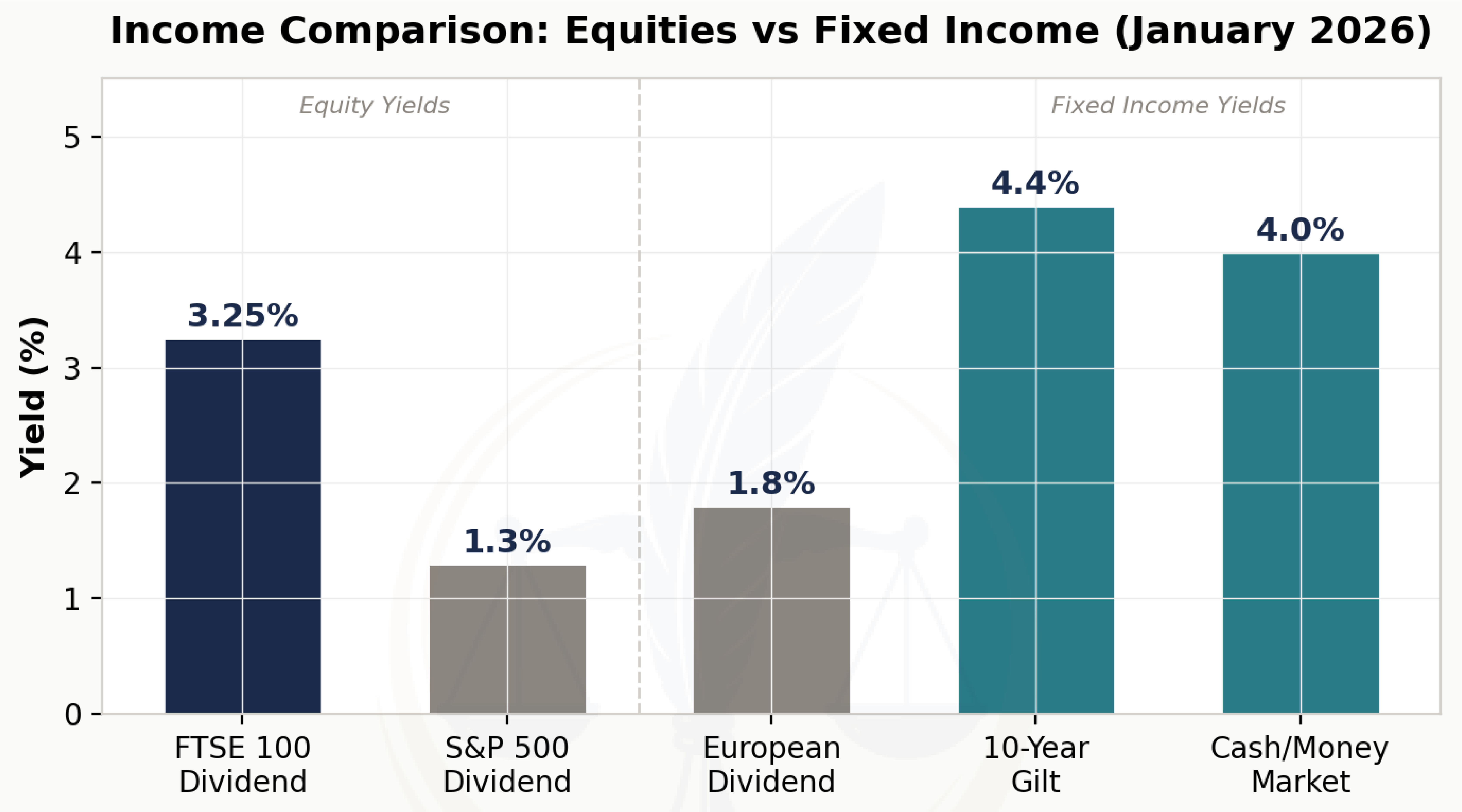

FIGURE 5: INCOME COMPARISON – EQUITY DIVIDEND YIELDS VS FIXED INCOME

SOURCES: FTSE 100 YIELD FROM FTSE RUSSELL; S&P 500 YIELD FROM S&P DOW JONES INDICES; GILT YIELDS FROM BANK OF ENGLAND YIELD CURVE DATA. ALL AS AT JANUARY 2026.

If you are holding UK equities primarily for income, the return of competitive yields from cash and bonds may warrant a conversation with your adviser about whether your current income strategy remains optimal for your circumstances.

What UK equities do offer is the prospect of income growth. Unlike bond coupons, dividends can increase over time. Companies with pricing power, strong market positions, and disciplined capital allocation have historically grown their distributions faster than inflation. This growth potential is what justifies accepting a lower starting yield than fixed-income alternatives.

Valuation in Context

UK equities look cheap. The FTSE 100 trades on a forward price-to-earnings ratio of approximately 13.35 times. The S&P 500, by contrast, commands a multiple north of 23 times. The Nasdaq 100 stretches beyond 31 times.

This valuation gap has existed for years, and simply being cheap has not prevented underperformance during the growth-stock boom. But valuation tends to matter more in environments where capital costs something. When money is expensive, paying a premium for distant earnings becomes harder to justify.

The discount to American indices reflects several factors: different sector composition, lower growth expectations, post-Brexit political uncertainty, and perhaps some structural neglect by global investors. Not all of these will reverse. But if even a portion of the gap narrows, UK equities could benefit disproportionately.

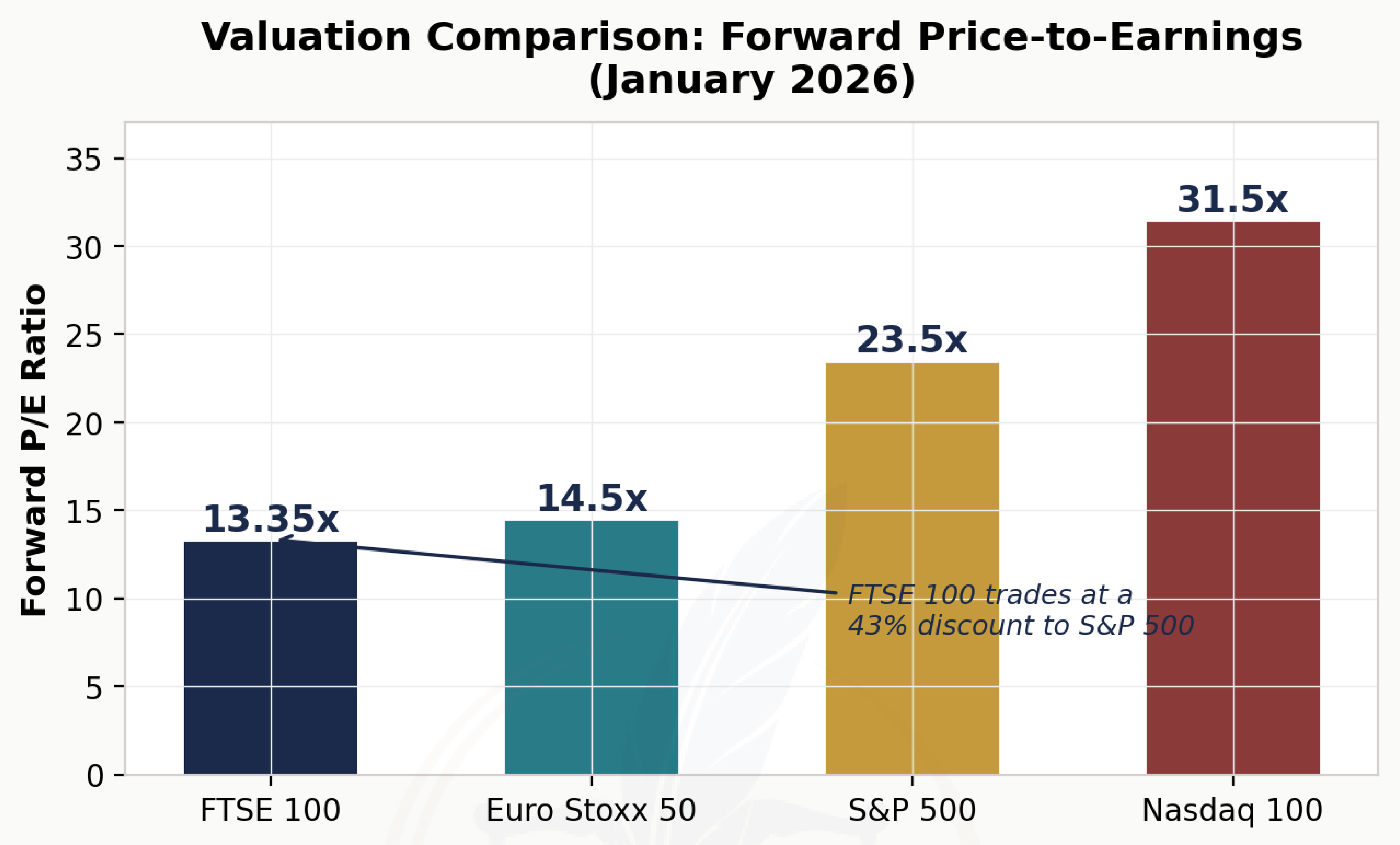

FIGURE 6: FORWARD PRICE-TO-EARNINGS RATIOS – MAJOR INDICES COMPARED

SOURCES: FTSE 100 FORWARD P/E FROM SIBLIS RESEARCH (13.35X AS AT 1 JANUARY 2026); S&P 500 AND NASDAQ FROM YARDENI RESEARCH AND BLOOMBERG CONSENSUS ESTIMATES.

What valuation provides is a margin of safety. Buying assets at reasonable prices means less can go wrong before you find yourself underwater. It does not guarantee positive returns, but it improves the odds and limits the downside when things disappoint.

Realistic Expectations

Given everything outlined above, what should investors reasonably expect from UK equities in 2026?

The honest answer is: modest returns with meaningful uncertainty around the central case. GDP growth forecasts from the OECD, IMF and OBR cluster between 1.2 and 1.4 per cent. Corporate earnings may grow modestly if global conditions cooperate, or may struggle if they do not. Dividends should provide a floor of sorts, but dramatic gains seem unlikely.

This is not a criticism. After years of extraordinary monetary accommodation, a return to ordinary conditions should be welcomed rather than lamented. Markets that reflect fundamental value rather than liquidity abundance are healthier in the long run, even if they feel less exciting in the short term.

UK equities offer a reasonable proposition for 2026: sustainable income at tolerable valuations, with exposure to global growth through an internationally diversified company base. They are unlikely to shoot the lights out. They are equally unlikely to collapse absent an external shock. That may be precisely what sensible portfolios need.

If you find yourself uncertain about what "realistic expectations" means for your specific situation (your time horizon, your income needs, your tolerance for volatility), that is often a useful prompt to have a conversation with your adviser.

What This Means for ISA and Pension Investors

UK equities have historically formed a core component of diversified portfolios within Stocks and Shares ISAs and pension arrangements. The characteristics discussed in this commentary, including dividend income, valuation support, and international revenue exposure, are relevant considerations when discussing asset allocation with your adviser.

For ISA Investors

UK equity income benefits from the ISA's tax-free treatment of dividends. The 3.1 to 3.4 per cent dividend yield from UK equities compares with around 4.0 per cent from competitive Cash ISAs, though equity investments carry greater risk to capital. The annual ISA allowance for 2025/26 remains at £20,000, frozen until 2030.

For SIPP and Pension Investors

UK equities' income characteristics may suit investors with longer time horizons who can tolerate short-term volatility. The sector composition (financials, healthcare, consumer staples, energy) differs markedly from US indices, which may provide diversification benefits within a global portfolio.

The pension annual allowance for 2025/26 is £60,000 (or 100 per cent of earnings, whichever is lower). Higher earners with adjusted income above £260,000 face a tapered allowance reducing to a minimum of £10,000. Unused allowances from the previous three tax years may be carried forward.

If you are approaching the end of the tax year and have unused ISA or pension allowances, or if you are unsure how UK equity exposure should fit within your overall tax-efficient arrangements, your adviser can help you think through the options.

Questions Worth Considering

As you consider UK equity exposure with your financial adviser, the following questions may help frame your thinking:

- Is your portfolio positioned for an environment where cash and bonds offer genuine competition for income?
- Can you tolerate periods of underperformance relative to growth-focused indices?
- Are you comfortable with concentration risk in a handful of sectors?
- Have you considered currency implications if your liabilities are not denominated in pounds?
- How does UK equity exposure fit within your ISA and pension arrangements?

If reading through these questions has raised more issues than it has resolved, that is not unusual, and it is often a useful signal that a conversation with your adviser would help clarify your thinking.

Conclusion

The UK equity market enters 2026 in a fundamentally different environment from the one that prevailed for most of the past fifteen years. Rates have normalised. Inflation, whilst retreating, remains above pre-pandemic levels. Capital once again costs something.

Within this new regime, UK equities offer characteristics that may prove valuable: reasonable valuations, sustainable dividends, and exposure to global revenues through domestically listed vehicles. These are not reasons for unbridled optimism, but they do provide a credible foundation for long-term investment.

What matters most going forward is realistic expectations. This is not an environment that rewards speculation or punishes caution. It is an environment that rewards discipline, patience, and attention to fundamentals. UK equities, with their income orientation and valuation support, may be well suited to precisely such conditions.

Your financial adviser will help you determine whether and how UK equities might fit within your overall investment strategy, taking full account of your individual circumstances, objectives, and risk tolerance.

Important Information

Risk Warnings: The value of investments can fall as well as rise and you may get back less than you invested. Past performance is not a reliable indicator of future results. These are educational materials and do not constitute personal investment advice.

Pension-Specific Warning: Pension investments are intended for retirement. You cannot normally access pension funds until age 55 (rising to 57 from 6th April 2028). Tax treatment depends on individual circumstances and may change.

Consumer Duty Statement (PRIN 2A): This material has been prepared to help you understand the UK equity market. It is intended to support, not replace, personal financial advice. Your financial adviser will assess whether investments in UK equities are suitable for your individual circumstances, objectives and risk tolerance.

This commentary is provided by **Al Miller**

For a conversation about your UK equity exposure:

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