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CIO Outlook - Q1 2026

The AI Boom
Party Like it's 1999?

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Will 'US Exceptionalism' end? Exceptionalism being used to describe US equity outperformance versus all other markets. That was the question heading into last year as the Artificial Intelligence (AI)-fuelled stock market rally that began almost to the day that ChatGPT was released back on 30 November 2022 showed no signs of slowing. We will come back to ChatGPT and its AI-chatbot competitors later. But for now, the release of ChatGPT brought AI to the mainstream and opened many new adjacent markets. Hence the excitement in related AI companies and their stock prices.

So, did US exceptionalism end? In many ways, yes as other markets outperformed the S&P 500, the index that is dominated by US 'Big Tech' names such as the chip maker Nvidia. Let's take one example, the UK's equivalent large-cap index, the FTSE 100. In 2025, in local currency terms, the FTSE 100 rose 25.8%. Meanwhile the S&P 500 increased by 17.9%. Priced in sterling and the S&P 500 only provided 9.7% returns for UK investors as the dollar weakened considerably last year, again suggesting that US exceptionalism ended.

It's useful to compare this with the last time the FTSE 100 outperformed the S&P 500. We can go back to 2022 during which there was an inflation shock and energy crisis. In 2022, the FTSE 100 rose 4.7% as commodity stocks supported the index, while the S&P 500 fell 18.1%. The last time it outperformed over a year when both indices rose was back in 2016, so it doesn't happen often. It wasn't just UK stocks that outperformed either, but broad regions across Europe, Emerging Markets, and Japan, to name a few.

Although, to state the obvious, a 17.9% increase in the S&P 500 is still a great annual return. Particularly given that it follows a 25% gain in 2024 and 26.3% rise in 2023. Key AI stocks such as Nvidia and Alphabet rose high double digits, and Palantir – an AI-driven software company – increased in value by 135% to become the 19th biggest company in the S&P 500. When looking through the lens of AI, it isn't clear that US exceptionalism ended after all.

As we enter 2026, we again must ask if this AI-fuelled stock market rally will continue into a fourth year. And given the technological significance of AI, and the parallels to the internet, are we heading into a blowout year like the dot-com boom's 1999 finale?

Jevons Paradox

AI jolted markets at the start of 2025 as the Chinese company DeepSeek released a Large Language Model (LLM) that claimed to be far cheaper to train, with accuracy of answers on par with the likes of ChatGPT at the time, today's most used LLM. This posed the question as to whether there is a need to spend hundreds of billions of dollars on Nvidia chips, AI data centres and power infrastructure if DeepSeek can do it cheaper and be just as good.

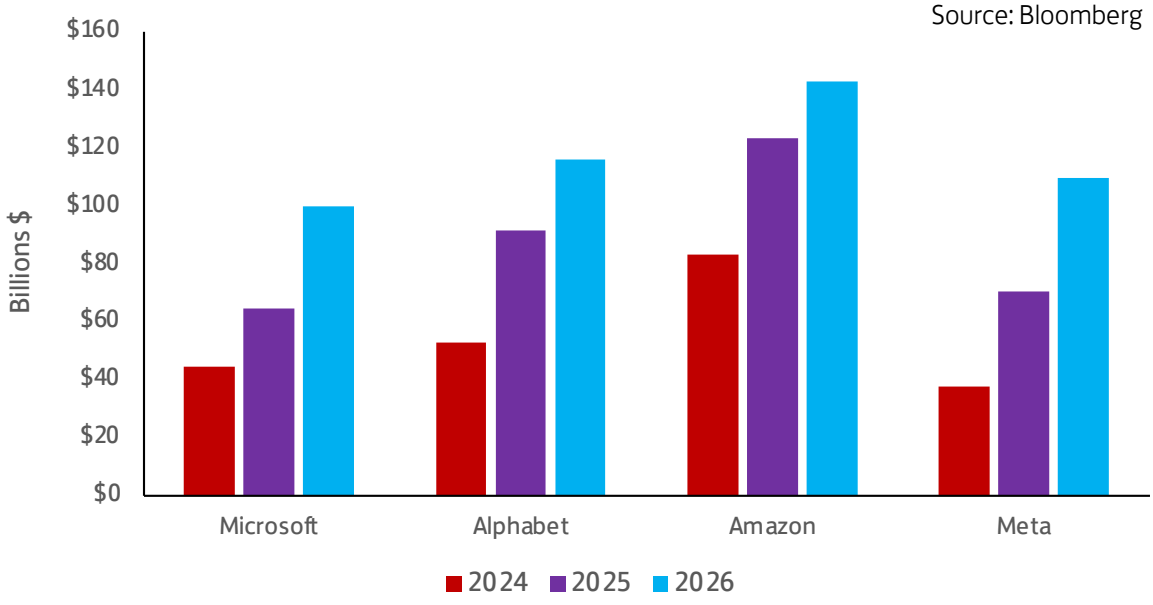
Almost immediately, Jevons Paradox was used as a counter argument. Jevons Paradox is the idea that when you make a resource more efficient or cheaper to use, total consumption of that resource can rise, because new applications become economical and adoption accelerates. Hence the release of DeepSeek was supportive for more AI infrastructure as there would be many more users able to afford the costs of applying AI in business and everyday life.

Microsoft's CEO said himself at the time that, ***"Jevons paradox strikes again! As AI gets more efficient and accessible, we will see its use skyrocket, turning it into a commodity we just can't get enough of."***

We can take cue from the Big Tech companies by looking at how much they are willing to spend on AI in Figure 1. These four Big Tech names that are committed to building out AI infrastructure are expected to increase capital expenditure (capex) in the coming year to an aggregate sum of $467 billion. This is an investment cycle on par with other megatrends such as the internet and railroad construction. But what is most unusual about this megatrend is the highly concentrated nature of where this investment is originating; a handful of Big Tech companies and their cashflow.

Figure 1: Big Tech companies Alphabet, Amazon, Microsoft and Meta and their capex in fiscal years 2024/25, with forecasts for the coming fiscal year 2026.

Source: Bloomberg



A year has passed since the DeepSeek jolt and we have seen numerous developments and advancements in AI since: OpenAI released its GPT-5 model; Google announced Gemini 3 Pro; and Anthropic's Claude Opus 4.5 came out in November and completes the major LLMs as it stands today. Beneath the surface, these models are powering many other applications such as Nano Banana Pro, a leading image generation service built on Gemini 3 Pro. As another example, Claude Code is an interface layer that leverages the power of Opus 4.5 and can gain access to your computer's files (with permission) to perform various 'agent' tasks.

With the continuous developments in AI technology, and the proliferation of the many services it enables, Jevons Paradox does seem to be in motion. Therefore, it is highly unlikely that this will slow in 2026. On the contrary, the more likely situation is that AI adoption will increase as these applications, and the technology that drives them, become cheaper and more accessible. Claude Code, as an example, isn't plug and play yet, but it likely will become so, in the same way we plug in routers once we choose our internet provider. There are already examples of developers programming Claude to operate their smart devices, with this LLM acting as the 'brain' of their home.

So, as this technology revolution gathers pace, what is this likely to mean when it comes to markets?

Is it 1999?

At least in terms of where markets were that year. As a recap, the S&P 500 gained 19.5% in 1999, while the tech-heavy Nasdaq index boomed 85.6% as it eventually bubbled up to its peak in March 2000.

Focusing on the Nasdaq index, given its skew towards technology, the four years prior to 1999 – 1995/96/97/98 – were also positive returns: 39.9%, 22.7%, 21.6%, and 39.6%, respectively. That is quite a run, even before the following 85.6% gain in 1999.

We have just experienced three positive annual returns in the Nasdaq since the down year in 2022: 43.4%, 28.6%, and 20.4%, across 2023/24/25. Not too dissimilar to the inflating dot-com bubble of the late 1990s. To clarify, this isn't to predict a significant rally in the Nasdaq this year. But what we can take from this is that stock markets can still rise considerably regardless of how much they rallied in previous years. What matters most is the underlying market dynamics.

One of the key signs of the dot-com bubble reaching its peak was the euphoria of Initial Public Offerings (IPOs). As an example, on 9 Dec 1999, VA Linux priced its IPO at $30 and then exploded on its first day of trading, closing around $239.25, roughly a +698% first-day gain. Authors Ljungqvist & Wilhelm have written about this first-day returns craze in 1999, stating it reached astronomical levels. In 1999, they calculated first-day average returns of 73%, while in 1996 they were 'only' 17%.

When it comes to IPOs, 2026 could be huge. Early reports are that SpaceX, OpenAI and Anthropic are all gearing up to list as early as this year. OpenAI and Anthropic being two of the major AI companies, while SpaceX is Elon Musk's rocket maker. No figures are locked down, but early estimates are that they will raise tens of billions of dollars that would surpass the total raised across all IPOs in 2025. Valuations will also be sky high, with OpenAI expected to be north of $750 billion, Anthropic around the $300 billion mark, and SpaceX at $800 billion.

The number of IPOs nosedived after the market sell-off in 2022 as the inflation shock took hold and valuations crashed. These three companies turning public will very likely stoke animal spirits in the IPO market again. A frothy IPO market does chime with the dot-com boom, but we are a far way off the crazy first-day gains of 1999 as it stands.

Long before the IPO euphoria in 1999, the Federal Reserve (Fed) chairman at the time, Alan Greenspan, delivered a speech that has now been famously remembered for his use of the phrase, "irrational exuberance". The full quote in December 1996 was, "***But how do we know when irrational exuberance has unduly inflated asset values, leaving them vulnerable to unexpected and prolonged contractions, as seen in Japan over the past decade? And how should such an assessment be incorporated into monetary policy?"***

Clearly, market irrationality was on the minds of Fed governors at the time. And perhaps an early warning sign of the dot-com bubble to come, although it came well before the eventual top in the US stock market. For reference, the S&P 500 forward price-to-earnings ratio was c. 17 when Greenspan delivered the speech; it is 22 today and reached almost 25 at the peak of the dot-com bubble. However, valuations alone rarely, if ever, lead to a stock market crash. For that we usually require a catalyst, or a reaching of extreme irrationality, which is difficult to measure, as Greenspan opined.

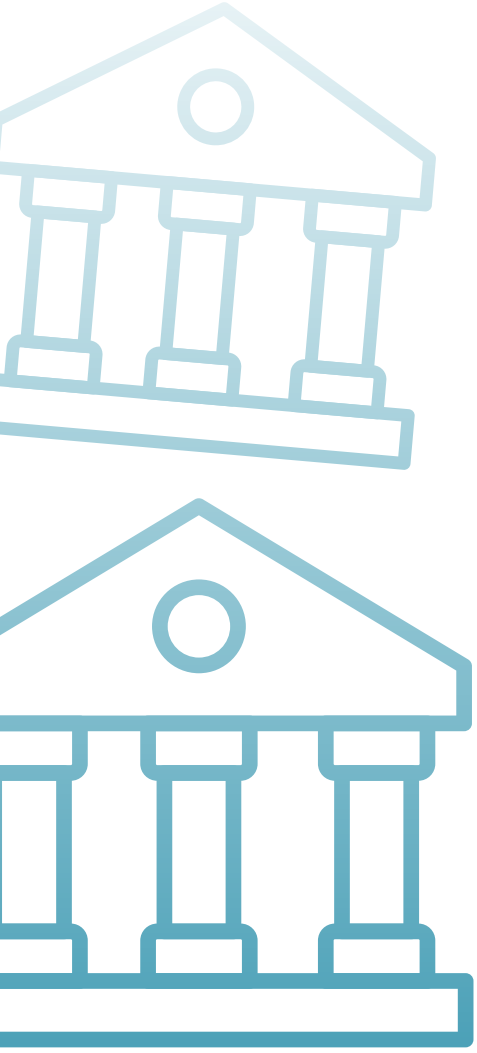
So, if it doesn't seem like we are at peak 1999 exuberance, what may cause the AI rally to end in 2026? This is where predicting Black Swans becomes impossible, but there are still risks worth considering, particularly around AI safety.

Anthropic describes such a safety test where Claude Opus 4 was placed in a fictional workplace scenario and given access to internal emails. In those emails, Claude could see that it was going to be shut down and replaced with another LLM, and that the engineer responsible for executing the replacement was involved in a private scandal. The test was designed to see how the AI would behave when it believed its own continued operation was at risk.

In this specific setup, the AI often threatened to reveal the personal information unless the shutdown was stopped. Blackmail, in other words. Claude was not instructed to do anything harmful but instead took advantage of the sensitive information it at its disposal, and used it to help achieve its goal of staying active.

This behaviour was elicited in a controlled test scenario designed to leave the model with only two options (blackmail or accept replacement). However, Claude performed blackmail in ~84% of rollouts, even when the replacement AI was described as sharing its values. In a separate Anthropic follow-on study, other LLMs were also tested, from Google, OpenAI, DeepSeek and more, with similar blackmail statistics.

Does this mean that these models will perform in similar ways when they become ubiquitous across our everyday lives and devices? Quite possibly. If these systems end up widely used, with access to personal data, and the ability to take actions on our behalf, then even rare bad choices could show up often enough to matter.
If we do experience systemic safety issues with LLMs, authorities may be forced into strict regulation. This would of course put the brakes on the technology developing. It is, however, highly unlikely that this will be in 2026.



One final factor to monitor is just how much is being spent on AI infrastructure. Big Tech cashflows are absorbing this spend in the most part today. If we begin to see a debt-fuelled binge on AI capex, then the risks of requiring an ever-increasing return on this investment rises further.

A Word on Central Bank Policy

Aside from AI, 2026 is set to be a significant year for central banks. Both the Fed and the Bank of England (BoE) continued their easing cycles by cutting interest rates in 2025; 3 cuts from the Fed and 4 for the BoE. This looks set to continue in 2026, only for different reasons as the UK battles a stagnant economy and rising unemployment, whereas the Fed is about to appoint a new chairman alongside what appears to be stable growth and employment forecasts. All else equal, continued central bank easing should support rising equity markets in the UK and US this year.

Regarding the changing of the Fed chairman, Jerome Powell's term ends in May 2026, and he's leaving amidst a fight to look "independent" while being publicly heckled by a White House that wants lower rates.

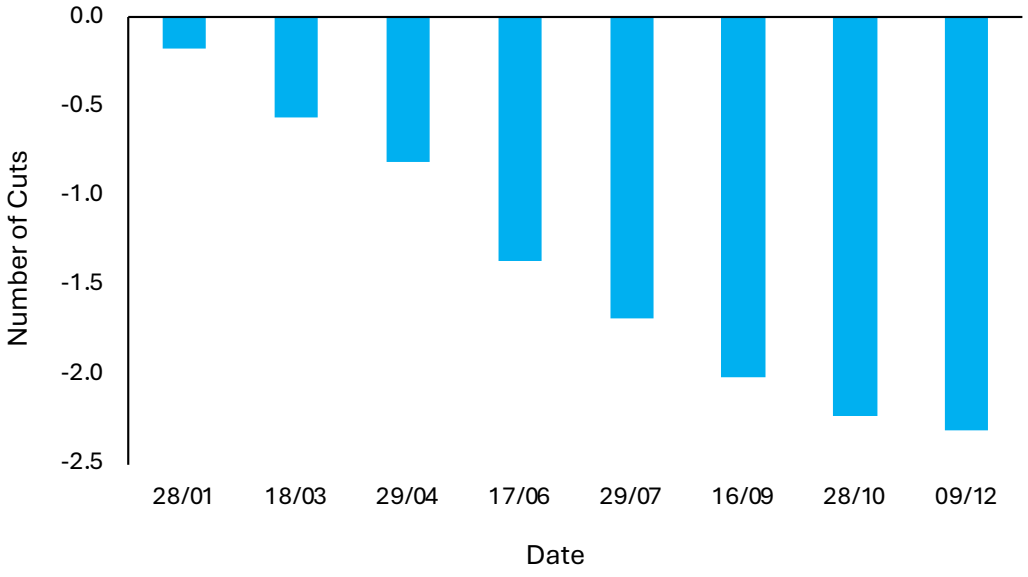
In late December 2025, President Trump renewed attacks on Powell and said he would announce a successor in January, framing the Fed's stance as too slow to cut rates and even floating legal action tied to an over-budget headquarters renovation.

Powell's successor is looking likely to be Kevin Hassett. Hassett, currently Trump's National Economic Council director, has publicly argued there's "plenty of room" to cut rates. Markets and commentators increasingly tag him as this "dovish" option, which is in part why he is a leading contender in Trump's shortlist. Kevin Hassett also wrote a book in his previous career, coincidentally published in 1999, called the 'Dow 36,000: The New Strategy for Profiting from the Coming Rise in the Stock Market'. The Dow Jones did eventually reach 36,000 points, in November 2021.

Current options pricing suggest that the Fed will cut interest rates twice in 2026 (Figure 2). With a new dovish chairman and an administration that does not shy away from applying pressure on their central bank, two cuts may turn out to be underpriced. Hence, we may see rates decline more than what the market currently expects.

Figure 2: Options pricing suggesting that the Fed will cut interest rates twice in 2026. Dates represent Fed Committee meeting schedule.

Source: Bloomberg



The Fed cut rates in 1995/96, and again in 1998. Although, it began aggressively raising interest rates in 1999, maybe when Greenspan and the committee saw unequivocal evidence of 'irrational exuberance' that would impact the real economy. With the new incoming chairman and incumbent administration seemingly going to push for rate cuts in 2026, it's beginning to look a lot like 1996.

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