



The Tatton Weekly

Volatility falls but it's still cloudy

20 February 2026

This week's topics:

Stable indecision

Life in Europe's fast lane

The US does a sterling job of de-dollarisation

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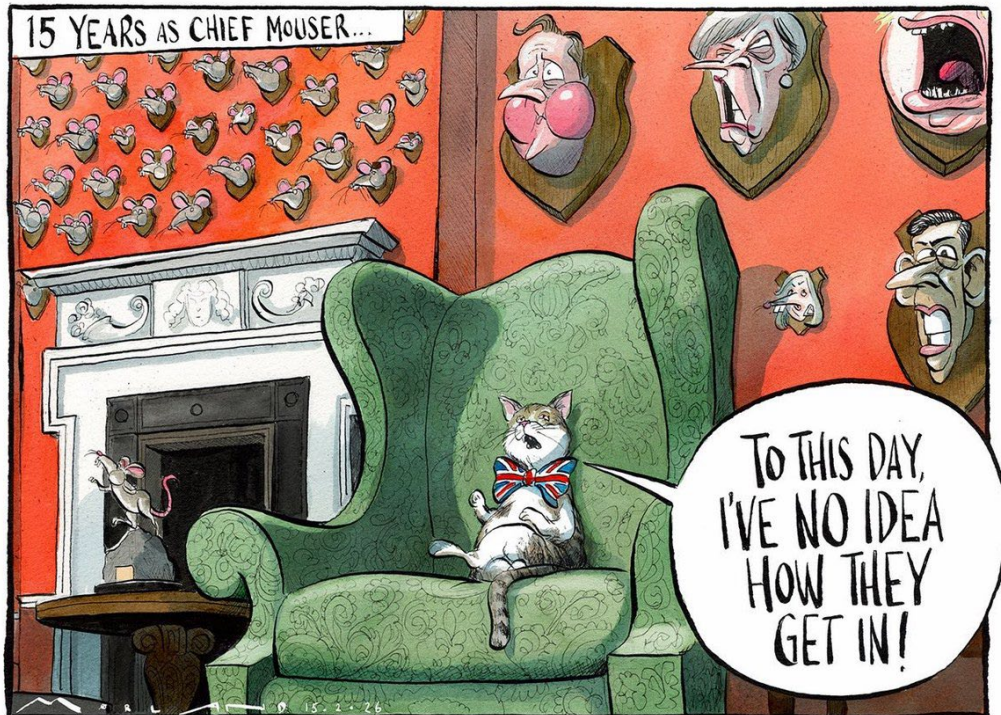
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On Larry the 10 Downing Street cat's 15th birthday, Morten Morland, 15 February 2026

Stable indecision

The US Supreme Court just announced that cannot use the Emergency Powers Act to impose reciprocal tariffs. Stocks rose, US government bond prices fell somewhat, and the dollar weakened slightly. The moves are positive but not yet meaningful. Much will now depend on Trump's likely attempts to reimpose tariffs by other means, the potential trade disruptions, and who might be eligible for tariff refunds.

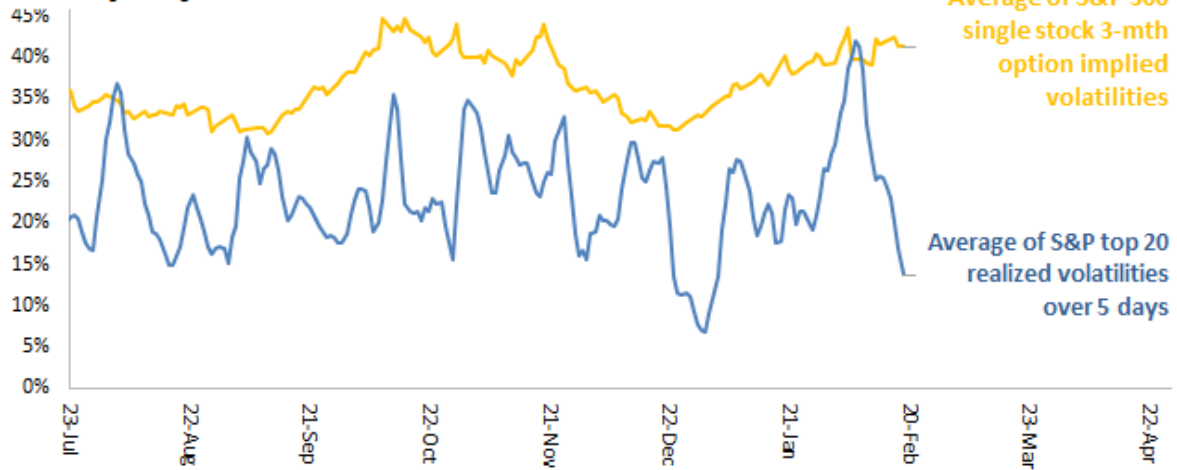
Markets were quiet up to that point. We wrote last Friday that individual stock-level volatility was significantly higher than index-level volatility, but stock-level volatility fell this week (chart below). Markets are still preoccupied with AI disruption and the underperformance of large cap stocks, relative to small cap, but selling pressures have dissipated, and the dollar bounced (before the tariff news) against most developed world currencies.

UK markets had a good week, thanks to a "Goldilocks" combination of economic data. January's unemployment rate rose to 5.2% but that probably caused consumer price inflation to fall to 3% year-on year (from 3.4%). CPI will probably hit the 2% target next quarter, allowing an interest rate cut in March. Still, January's retail sales were surprisingly robust and net tax receipts hit a record

£30bn. No one likes being taxed more but international bond investors see it as evidence of fiscal discipline.

A calming base to build on, but AI capex is becoming a drag

US equity volatilities



Source: Tatton IM, Bloomberg

19-Feb-26

Judging from high option prices, investors are still worried about stock volatility, but individual stock price swings are close to six-month lows. Microsoft and Amazon have been hurt by AI disruption stories, but their shares calmed down in the last few days. They still have not recovered, though, and there is no ‘buy the dip’ mentality.

That may not be a bad thing. Less stretched price-to-earnings valuations lay the ground for future gains. Unlike a few months ago, valuations are not being fuelled by market liquidity; stocks need stronger expected earnings growth to move ahead. The continued sell-off in cryptocurrencies and the rebounding dollar point to a market driven by fundamentals rather than speculation. That should be more stable.

US corporate earnings reports are okay, but some Q1 2026 forecasts have been downgraded. Tech firms are still spending big on AI infrastructure, but Absolute Strategy Research have pointed out that infrastructure costs are rising rapidly. Companies are committing more capital expenditures (capex) but not getting more from it. Capex inflation could prove to be a drag on future earnings.

This is not good news for the so-called AI ‘hyperscalers’, and it could reinforce the market rotation we have seen this year. The money stored up in big tech firms’ equity valuations is now being spent in the rest of the global economy. The recent strength of Asian chip manufacturers is testament to that.

Despite growing competition, Nvidia is a major beneficiary. The AI chipmaker will report its Q4 2025 results next Wednesday. CEO Jensen Huang will likely paint a rosy outlook for this year, given the AI industry's continued capex.

Still unclear if AI is eating jobs

In the US, JP Morgan's economists are forecasting strong 2026 US growth – while downgrading other regions – thanks to the wave of AI capex and looser fiscal policy. Upcoming tax rebates will help US consumers, but JP Morgan's own nowcasts (an estimate current economic activity) are somewhat lower than their bullish predictions.

Uncertainty about the US economy is reflected in a split amongst the Federal Reserve's voting committee. Hawkish members, led by chairman Powell, expect stronger consumption and inflation, fuelled by AI productivity gains. Dovish members either think those productivity gains will lower costs or raise unemployment. Stalling job numbers lead us to side with the doves, for now. We will have to watch the US household savings rate: consumers have been spending their savings, but might start tightening belts.

We still do not know whether AI is displacing jobs or not. Rising youth unemployment in the UK might suggest AI job losses, but you could also just explain that via higher costs for employers (minimum wage rises and employer NI). Falling youth unemployment in the US might be evidence against AI job losses, but that might be from tighter immigration. It is hard to untangle all these factors.

Get ready for more Trump disruption

Crude oil prices jumped 5% on Wednesday, after Russia trashed the slim hopes of a ceasefire with Ukraine. However, the major impetus comes from the US's pressure on Iran. President Trump has signalled readiness to strike Iran, although the prospects of a drawn out conflict look remote. Trump favours short sharp 'wins' in his foreign interventions. He might even try to bomb all targets identified by his military in Iran while markets are closed over the weekend.

Geopolitics are driving oil markets in the short-term, but global oil supply is still rising faster than demand. OPEC+ is ramping up production, and the International Energy Agency (IEA) is forecasting weaker oil demand (though the IEA's forecasts are lower than most others). All that to say, oil prices have room to fall if tensions calm.

It has been a while since Trump has been the centre of market attention. If his actions against Iran do not move markets, further tariffs might. Now that the Supreme Court has ruled against the president's tariffs, he will look for other ways to implement them, like sector-specific 'national security' measures. Those might be more disruptive for global supply chains than the current regime.

In their dealings with the White House, many nations are pursuing "strategic under-implementation", according to trade expert Sam Lowe. That means promising Trump what he

wants and then stalling, but nations will have to cough up something eventually, as Japan is now experiencing. Tokyo unveiled the first tranche of its \$550bn fealty pledge to Washington this week: a \$36bn investment in US oil and gas. With new tariff looming and other nations strategically under-implementing, markets might get another episode of the Trump show soon.

Life in Europe's fast lane

Some interesting proposals emerged from an informal meeting of European leaders last week. Although she announced the "One Europe, One Market" slogan, European Commission president Ursula Von der Leyen talked up the idea of a two-speed union: deeper integration for the willing, and slower integration for the unwilling. There are many hurdles to overcome, but we see this as a step toward structural changes that will benefit Europe's economy.

The E6 to push for capital integration

Last Thursday's retreat gave EU leaders space to talk about European competitiveness, alongside two former Italian prime ministers Mario Draghi (also the former ECB president) and Enrico Letta – both of whom authored reports on the subject in recent years. That included discussion of the Mercosur trade deal (signed but not ratified by the European Parliament) and the so-called 'Made in Europe' policy being pushed by Emmanuel Macron. Macron wants to give strong preference to European firms amid the continent's defence spending push, but others want a lighter touch.

Von der Leyen's comments about a two-speed Europe will have the most impact. The idea of a core group of nations integrating faster than the rest was suggested last month by German Finance Minister Lars Klingbeil, as a way to get around the roadblocks that come from getting 27 nations to agree. To that end, finance ministers from Germany, France, Italy, the Netherlands, Spain and Poland launched a coalition – dubbed the E6. The Commission president effectively endorsed that move: "where a lack of progress or ambition risks undermining Europe's competitiveness or capacity to act, we should not shy away from using the possibilities foreseen in the Treaties on enhanced cooperation."

Most EU legislation is already passed by qualified majority vote and the idea of a two-speed union is not new, but the recent experience of Russia-allied Hungary frustrating policies around Ukraine has added a sense of urgency. That urgency now extends to matters beyond purely defence.

One of the key goals of the E6 is to push through the proposed Savings and Investment Union (SIU – a rebrand of the stalled Capital Markets Union). Von der Leyen promises that this could "unleash up to €470bn of investment", but if not all 27 EU nations can agree, then a coalition of the willing could push through the SIU between them.

A fast lane is welcome, but it doesn't stop national interests

The two-speed union, if it comes about, will go a long way to breaking Europe's notorious deadlock. The SIU, in particular, could be transformative, as the lack of a single financial market is one of the

biggest barriers for EU investment and growth. Anything that gets closer cooperation on capital markets will open up opportunities. And anything that limits the veto power of entrenched national interests (or in Hungary's case, perhaps international interests) will make the EU more responsive to collective economic needs.

If a two-speed Europe is successful, peripheral nations will inevitably want to move into the fast lane. Indeed, fear of missing out on a more integrated and more economically vibrant group is one of the reasons similar proposals have been blocked in the past. You might not want to go to the party, but you definitely do not want everyone going without you. Poland is a good example: not long ago, Poland was a peripheral European nation flirting with an exit – but now it is one of Europe's largest economies and a member of the E6.

However, a two-speed union does not mean national interests go away. France keeps pushing for collectivised Eurobonds, for example, but Germany keeps saying no. A closer inner circle reduces the number of national interests that could potentially conflict, but if France and Germany disagree it does not matter how small the circle is. In fact, you could argue that concentrating decision-making power among the core nations only further entrenches the core national interests – exacerbating resentment in the periphery.

Pragmatism toward structural change

We see the two-speed approach as pragmatism from European leaders, rather than ideology. Faced with deadlock in the union's old structures, they feel the need to push for action over consensus building. If that pragmatism continues, we think it will benefit Europe's economy.

The 'Made in Europe' debate is a good example. France is pushing a hardline position that would favour companies from the European Economic Area when handing out key contracts like defence. This could violate trade agreements the EU has with other countries – possibly including the UK. That is why the UK is reportedly lobbying other nations to push back against the French line, toward Germany's suggestion of 'Made With Europe' (favouring European companies and those with which the EU has a free trade deal).

There is a limit to how much national leaders can be seen to give up on certain national interests, especially considering the domestic unpopularity of leaders like Macron and Friedrich Merz. It does not help that the losses that come from integration are short-term and very visible, while the long-term gains are subtle. But all parties recognise that, in an increasingly regionalised world, something has to change.

When Germany and the EU's defence spending packages were agreed last year, markets got excited about the economic boost. We wrote at the time that the more important impacts could be on long-term structural changes, particularly on capital markets. Those structural improvements now look closer than ever.

US does a sterling job of de-dollarisation

Donald Trump's second term has been marred by talk of so-called dollar debasement. Erratic policies and apparent US institutional decline have increased the perception of risk for US assets and moved some big investors to diversify away from the world's largest economy. The undeniable evidence is that the value of the dollar has fallen sharply and consistently over the last year. The debatable part is whether this is a longer-term loss of status for the dollar.

The best precedent for a reserve currency losing its dominance is sterling in the 20th century. Sterling served as the lynchpin of global trade and finance for a century, but was demoted to a supporting role by the 1970s.

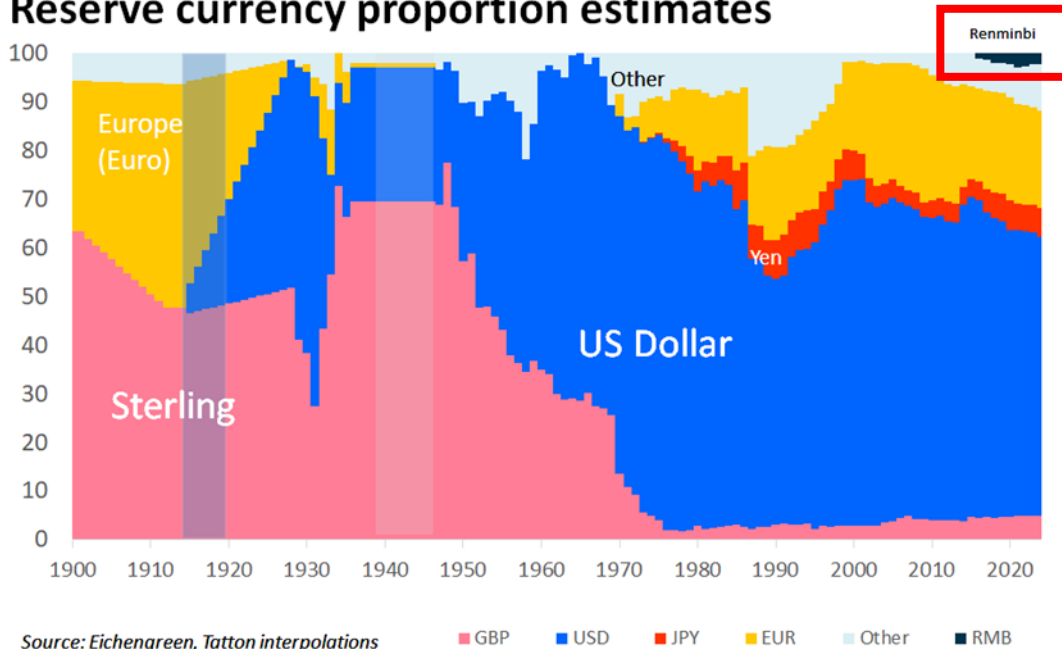
War ravaged sterling, but the decline started before

Sterling cemented its status as the world's reserve currency in the early 1800s. The British Empire was at the peak of its naval dominance, but was also at the forefront of global trade and industrial production (accounting for over 20% of global output). With transactions being settled in sterling, London became the centre of global finance. Confidence in the currency was bolstered by implementation of the gold standard, first at home and then across the colonies.

Sterling rapidly declined after WWII, with central banks switching their reserves to dollars. The switch to the dollar started earlier, though, as the US currency overtook sterling as a form of trade credit in the 1920s. That was partially a result of Britain's extensive public debt from WWI, its abandonment of the gold standard (at the outbreak of the war) and its turn to US for lines of credit. The latter helped establish New York as a financial hub rivalling London.

Underlying the financial shifts were long-term changes in global trade. The empire built its power partially through exports, but over the course of the 19th century Britain ran a trade deficit (exports minus imports) which was increasingly offset by its accumulated assets. Britain's asset wealth funded consumption but, all the while, the US was increasing its share of global trade. When the UK needed a surge of capital for the war effort, the realities of trade forced a reduction in demand.

Reserve currency proportion estimates



The irony of Trump's catalyst

A heavily indebted nation that relies on its highly valued assets and capital inflows to fund trade and budget deficits might therefore sound familiar. Many have warned about this 'twin deficits' problem in the US for decades.

Deficits can persist for a long time until major events jolt the system. It took two world wars to catalyse sterling's decline. Could the Trump shock to global trade really be enough to catalyse de-dollarisation?

We wrote last week that his policies are making purchasing power parity (PPP) matter more – which could benefit less highly valued economies. If the dollar were to adjust to PPP levels, it would have to fall much more substantially against global peers, for a much longer period, than it has already.

It would be ironic if Trump was the catalyst for de-dollarisation, considering that reducing the US trade deficit – a contributor to the dollar's long-term imbalance – has always been one of his top priorities. But, in the first instance, trying to address the trade deficit through tariffs just draws greater attention to the problem, like loudly announcing your plans to fix the hole in your wall. China already trades more with the rest of the world than the US, for example.

No clear alternative doesn't mean no alternative

To be clear, we are not saying that history will repeat itself. Sterling's decline is a precautionary tale for the dollar – not an investment prediction. We hear lots of talk from US investment managers that supposedly want to diversify from their own market, but such managers are repeatedly dragged back into the US stock market by the world-beating earnings growth of US companies.

It is notable that the dollar still dominates international trade settlements, without much sign of a sharp fall in the Trump era. And unlike during sterling's decline, there is no clear alternative. China's renminbi might be good for trade, but its asset markets are not trusted enough by international investors. Europe has more open markets, but its structural problems get in the way. Currency alternatives like gold or cryptos are wildly volatile.

Washington should not get too comfortable about the dollar's long-term future, though. JP Morgan researchers found last year that energy contracts are increasingly being priced in non-dollar currencies – with the renminbi gaining in particular. With the AI revolution expected to dramatically increase global energy demand, that is a worrying sign.

Extreme long-term global trends are messy, and rarely go in a straight line. Even if the dollar is on a long-term decline, that does not mean it will fall further from here in 2026 – much less that replacement currencies will rapidly gain. But, by the same token, relief rallies or bumps up in dollar trade volumes do not necessarily mean the long-term decline is not happening. Investors need to see both the wood and the trees.

Global Equity Markets		20-Feb		Technical		Valuations			
Market	Level	% 1 Week	% 1 Week (GBP)	Short	Medium	Div YLD %	LTM PE	NTM PE	10Y AVG NTM PE
UK FTSE 100	10696	+2.8	+2.8	↗	↗	2.9	15.7	14.3	12.7
UK FTSE 250	23717	+1.6	+1.6	↗	↗	3.8	14.3	12.5	13.5
UK FTSE All-Share	5748	+2.7	+2.7	↗	↗	3.1	15.6	14.2	12.8
FTSE Small x Inv_Tsts	6720	+0.4	+0.4	↗	↗	4.1	20.3	11.6	10.1
EU STOXX ex UK	800	+2.0	+2.5	↗	↗	2.8	18.4	16.3	15.1
France CAC 40	8479	+2.3	+2.8	↗	→	3.1	18.8	16.0	14.1
Germany DAX 40	25151	+1.2	+1.7	↗	→	2.3	18.1	15.8	13.3
US S&P 500	6865	+0.7	+1.8	→	↗	1.2	25.5	21.4	18.9
US NASDAQ comp	22714	+1.0	+2.1	→	↗	0.6	35.3	24.9	26.1
Japan Nikkei 225	56826	-0.2	-0.6	↗	↗	1.4	23.6	24.0	18.5
World Bloomberg	2426	+0.7	+1.8	↗	↗	1.6	22.4	18.7	16.6
China Bloomberg	1363	-0.7	+0.5	→	→	2.2	14.9	12.4	12.4
Emerging Bloomberg	1691	+0.5	+1.6	↗	↗	2.2	17.8	13.1	12.5
FTSE 100 Top 6		S&P Global Top 6		(GBP terms)		Global Sectors		(GBP terms)	
Company	%	Company	%	Sector	%	Sector	%		
BAE Systems	+9.0	Technology One	+24.0	Tech	+2.1	Staples	-0.5		
Compass	+8.4	Omnicom	+22.3	Financials	+2.2	Energy	+2.1		
Babcock Int'l	+8.2	Global Payments	+21.4	Health	+0.3	Materials	+1.2		
Antofagasta	+7.5	Moderna	+16.3	Discretionary	+1.4	Utilities	+0.4		
Airtel Africa	+7.3	Texas Pacific Land	+16.3	Industrials	+2.7	Real_Estate	+1.0		
NatWest	+7.0	Shopify	+15.5	Communication	+2.1				
FTSE 100 Bottom 6		S&P Global Bottom 6		(GBP terms)		Fixed Income			
Company	%	Company (GBP terms)	%	Govt bond	%Yield	1 wk chg			
BT	-3.4	Olympus	-20.4	UK Govt 5yr Gilt	3.78	-0.04			
SSE	-2.0	Genuine Parts	-17.9	UK Govt 10yr Gilt	4.36	-0.06			
United Utilities	-2.0	Pool	-16.3	UK Govt 15yr Gilt	4.78	-0.06			
Severn Trent	-2.0	EPAM Systems	-13.0	US Govt 10yr Treasury	4.08	+0.03			
Centrica	-1.9	Akamai Technologies	-11.4	France Govt 10yr OAT	3.30	-0.04			
National Grid	-1.8	Aisin	-8.4	Germany Govt 10yr Bund	2.74	-0.02			
				Japan Govt 10yr JGB	2.11	-0.10			
Currencies			Commodities			UK Mortgage Rate Estimates			
Pair	last	%1W	Cmdty	last	%1W	Rates (LTV c.75%, no fee)	20-Feb	21-Jan	
USD per GBP	1.348	-1.1	Oil Brent \$:bl	71.49	+5.9	UK BoE base rate	3.75	3.75	
GBP per EUR	0.873	+0.3	Gold \$:oz	5056	+1.1	2yr fixed	3.82	3.97	
USD per EUR	1.177	-0.8	Silver \$:oz	81.68	+5.5	3yr fixed	3.95	3.99	
JPY per USD	155.41	+1.5	Copper \$:lb	583.6	+0.7	5yr fixed	3.96	4.00	
CNY per USD	6.904	-0.0	Alumnm \$:mt	3041	+1.5	10yr fixed	4.55	4.52	
USD per Bitcoin	67,077	-0.9	Agriculture BBG	53.99	+0.9	Standard variable	6.77	6.77	

Prices taken levels at 14:45 where possible

LTM PE is the index price as a ratio of last 12 months earnings. NTM PE is next 12 months earnings.

Mortgage estimates are derived from sterling swaps markets and moneyfacts.co.uk

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Lothar Mentel

