



## There is more to this than meets the eye

By James Penny Chief Investment Officer at TAM Asset Management Ltd

So much has been made recently of the seemingly bulletproof performance of the stock market. Its ability to shrug off macroeconomic shocks while continuing to climb to new highs has genuinely caught even the most seasoned investors by surprise. With every move higher comes an ever-louder chorus calling the top of this euphoric rally, only for the market to push through those warnings time and again.

Depending on who you ask, this rally is being driven by a combination of an investment culture that continues to buy through uncertainty which previous markets would have balked at. The widespread availability of sophisticated trading platforms, giving millions of retail investors access to trading tools once reserved for institutions. All underpinned by a stalwart belief that artificial intelligence is the only game in town. While there is truth in these arguments, they only tell part of the story.

Could today's companies simply represent a fundamentally different generation of profitable

innovators than those that came before them? If so, perhaps this remarkable rally deserves a different explanation.

Given it's the world cup, lets try a sporting analogy. In 1998, cyclist Marco Pantani set a world record for cycling up the infamous Plateau de Beille, completing the climb in 43 minutes and 28 seconds. We now know that performance was fuelled by EPO and blood transfusions. This record stood for twenty eight years, celebrated for its speed but forever tainted by the way it was achieved.

Then, in 2024, Tadej Pogacar climbed the same mountain in just 39 minutes and 44 seconds. He did not simply break Pantani's record. He destroyed it, and he did so clean.

Modern elite sport has become an exact science. Every aspect of performance is optimised through training, nutrition, equipment and an extraordinary depth of data. Athletes today are surpassing records that previous generations could only reach through artificial means. Companies today may be going through a remarkably similar transformation to the chagrin of those who came before them.

The first quarter earnings season for US companies in 2026 has been genuinely historic. Around 84 percent of companies exceeded earnings estimates, comfortably ahead of the ten year average of 76 percent. More importantly, many exceeded expectations by more than 20 percent, compared with a ten year average surprise of around 7 percent.

Like Pogacar, they did not simply edge past expectations. They obliterated them. The momentum has continued beyond the first quarter. Earnings reported through May have continued to exceed forecasts, prompting analysts to raise earnings expectations for 2027. That represents a notable departure from the usual pattern, where companies often beat expectations only to see forecasts revised lower as optimism fades. This time the opposite is happening. FactSet described the 2026 earnings season as one of the strongest in two decades.

Much of this strength revolves around artificial intelligence and its growing integration into everyday business. AI is injecting fresh productivity into companies that were already producing ahead of expectations. What is perhaps even more interesting is that adoption remains far from complete. Only around 60 percent of large companies have meaningfully integrated AI into their operations, with adoption falling to just 44 percent among smaller businesses. There remains considerable scope for further productivity gains and earnings expansion.

Corporate profit margins have, depending where one looks, steadily increased from around 5 percent during the 1980s to more than 10 percent today. During the 1990s, over 40 percent of major stock market indices consisted of capital intensive businesses that relied heavily on factories, machinery and vehicle fleets. Today that figure has fallen to between 15 and 20 percent. Source: Factset

In their place are businesses with lighter balance sheets, greater flexibility and significantly higher returns on capital. Advances in data analytics, targeted cost management, customer engagement, innovation, tax incentives, streamlined operations and a generally supportive regulatory environment have enabled businesses to strengthen competitive advantages while expanding margins. It is no coincidence that free cash flow margins have increased from

around 4 percent during the 1990s to more than 10 percent today.

When these structural improvements are combined with resilient consumer spending among higher income households, the continued growth of passive investing, tax reductions through President Trump's Big Beautiful Bill and unprecedented access to global markets for investors, it becomes easier to understand why equities have continued to perform so strongly. Importantly, this story is not simply about valuations. It is about stronger businesses producing stronger fundamentals.

Looking ahead, valuations are undeniably elevated, particularly among companies leading the AI revolution. However, rather than expecting a broad market correction, we believe the more compelling opportunity may lie in businesses that continue to deliver exceptional earnings growth while remaining attractively valued and still in the early stages of adopting AI. This is precisely where active managers can add real value. Many are quietly holding businesses that combine outstanding fundamentals with compelling valuations, yet those opportunities have been overshadowed by the extraordinary attention given to a handful of AI leaders. History suggests that markets eventually broaden, and when they do, quality businesses have an opportunity to shine.

Active management and high quality investing remain central to our commitment to clients. Our focus has always been on identifying funds and managers capable of creating enduring value for clients, regardless of where market attention happens to be. Just as today's athletes are achieving feats that previous generations could only accomplish through artificial means, today's businesses are delivering earnings growth that many once believed impossible. That gives us every reason to remain optimistic about the future, and excited by where the next generation of exceptional companies and sectors might come from and what records they may achieve.

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