



Market Review and Outlook

1st Quarter 2026

Global equity markets finished the final quarter of 2025 on a positive note. The MSCI EM, MSCI EAFE, and S&P 500® returned modest gains for the quarter and surged 33.57%, 31.22%, and 17.88% for the calendar year, respectively. Value stocks outpaced growth stocks during the fourth quarter, with the markets experiencing early stages of investment style rotation.

Within fixed income, long-duration bonds underperformed their shorter-duration counterparts, as the yield on the 10-year Treasury rose during the quarter. Among the spread sectors, emerging-market debt continued to outperform, ending the year up 14%. U.S. high-yield bonds also performed well in the final quarter, even as major tech companies increased issuance to raise capital for growth through mergers-and-acquisitions (M&A) activity and AI-related investments.

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Outlook

As we look ahead to 2026, change will be a common theme in global markets, economies, and geopolitics. President Trump's One Big Beautiful Bill Act (OBBBA) and related extensions to expiring Trump-era provisions should provide a boost for consumers. Individuals will see extensions to their already reduced income-tax brackets. For those in high-tax states, the state and local tax (SALT) deductions cap will remain at \$40,000 (up from \$10,000) for the 2025–2029 tax years. Other new and expanded deductions effective in 2026 include tips, overtime pay, and car loan interest as well as a higher child tax credit. Overall, these provisions should favor working families and individuals.

While the divide between high- and low-income households has contributed to the recent uneven and unconventional pattern of economic growth, Trump's tax provisions could help spending behaviors converge, which should boost the U.S. economy this year and beyond. A strengthening economy could encourage a conventional Fed to consider pausing the current easing if inflationary conditions start brewing. On the other hand, widespread usage of AI applications and a weakening labor market have the potential to ease inflationary pressures, which

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would justify additional rate cuts. The futures market currently expects two more cuts in 2026. While employment growth remains positive and initial jobless claims remain relatively subdued, much will depend on how executives identify opportunities and react to challenges. In particular, AI can represent both a prospect and a potential threat, and its future impact on the workforce is uncertain.

As more companies implement AI, the changing dynamics of work productivity will likely remain a key theme throughout the year. While significant capital has already been poured into AI implementation, more investment likely will be needed to improve the functionality and reliability of AI-related tools and applications. In these early stages of AI implementation and trial, productivity improvements likely will be modest until further enhancements are developed and energy becomes more readily available to handle the exorbitant data demands. Nevertheless, markets typically front-run the economy, and the full benefits of AI likely will remain unrealized for now.

Meanwhile, geopolitical events continue to erupt around the globe. In the Venezuela–U.S. conflict, the U.S. military made global headlines by capturing Venezuelan President Nicolas Maduro on drug trafficking charges. As Trump’s interest in Venezuelan oil illustrates, geopolitical events can stem from seemingly random regions over built-up tension. Therefore, geopolitical and domestic politics will likely impact the market throughout 2026, including Iran, Venezuela, global trade and tariffs, the U.S. midterm elections, Russia–Ukraine, and rising China–Taiwan–Japan tensions.

To recap, the S&P 500 index has experienced double-digit calendar-year returns every year since 2019. The only exception was 2022, when markets were hit with Russia’s surprise invasion of Ukraine and surging shelter inflation, leading to aggressive Fed rate hikes. Nonetheless, large mega tech companies have led the S&P 500 and other large-cap growth indexes to record levels. The following chart illustrates the widening divergence between price-to-sales multiples of large-growth indexes and other remaining segments of the domestic equity market.



Source: FactSet

The narrow market led by a few major tech players appears to be reaching its limits; valuations suggest higher return potential from segments outside the small cadre of recent market leaders.

International markets also have been neglected and overshadowed by U.S. tech giants. Their reasons for falling behind include continued weakness throughout Europe, which struggles with access to cheap gas due to the Ukraine–Russia conflict, as well as increased trade tensions with China and U.S. tariffs.

Despite the ongoing global trade tension, consumer inflation in the U.S. has so far remained contained, hovering close to the Fed’s 2% target. Although goods prices have accelerated, shelter (a contributor to the spike in the consumer price index (CPI) between 2021 and 2022) and other core service inflation have shown signs of moderating and/or decelerating.



Source: FactSet

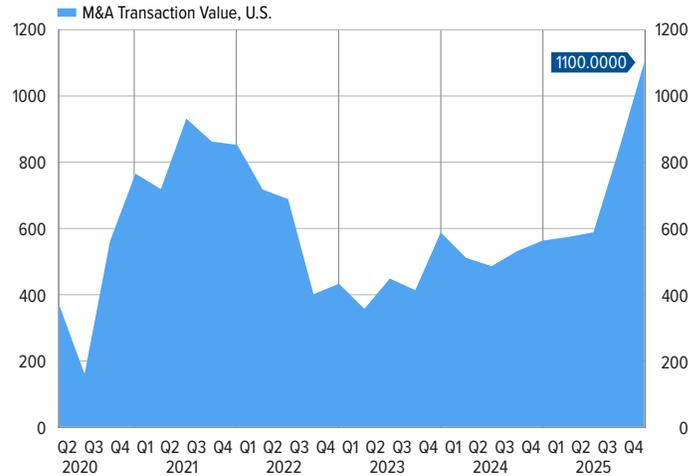
Consumer prices have remained stable because companies have strategically absorbed hits to profit margins to preserve market share. However, accumulating cost pressures may finally urge companies to hike prices to offset higher costs as commodity and producer prices begin to accelerate.



Source: FactSet

Success in properly managing pass-through to customers will become important in generating positive and accelerating earnings growth. Companies' effectiveness in the management of earning-growth dynamics will be a key influence on price multiples and determinant of market value.

The Fed will continue to monitor these inflationary-pricing dynamics as it considers monetary policy throughout the year. In turn, interest rate levels and the shape of the yield curve will impact the bond market as well as lending and borrowing activities. Companies in sectors such as biotech and technology will likely continue to engage in M&A activity to grow and compete with larger companies who have been investing in "moats" to protect their strategic positions. The following chart shows the increased M&A transaction value in the U.S.



Source: Bloomberg

Since Fed decisions can materially impact corporate decisions and the health of the economy, the political drama between Trump and Fed members (especially Fed Chair Jerome Powell) will likely continue. Kevin Hassett, current NEC Director and a proponent of rate cuts to spur economic growth, may become the new Fed Chair when Powell's term expires in May of this year. While this change does not guarantee additional interest-rate cuts, Trump's attempt to alter or otherwise influence the voting makeup of the Federal Open Market Committee (FOMC) could certainly shape economic growth and cause it to expand at an unstable pace.

As we look ahead, the investment landscape for 2026 could include several key changes. Business and earnings-growth fundamentals continue to remain relatively stable (for now), which could support the health of the overall market. However, valuations have become highly inflated for certain segments of the market, while others have become more interesting due to attractive valuations and an economy that will be supported by tax refunds later this year. Most importantly, liquidity remains abundant, and default risks remain low. Despite some of the expected positive changes, some anticipated changes remain highly uncertain. For now, we maintain a cautiously optimistic stance—ready to act on opportunities but careful enough to adjust exposures as risks arise and evolve.

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