

ECONOMIC OUTLOOK

Summary

As we enter 2026, the U.S. economy is defined by a sharp divide rather than a single trend. Sometimes referred to as a “K” shaped economy, one segment is buoyed by asset growth, stable employment and wage gains, while the other is increasingly weighed down by rising prices and mounting debt burdens.

The most encouraging economic development for all Americans has been the recent trajectory of inflation. November’s headline Consumer Price Index (CPI) fell to 2.7% year-over-year, well below the 3.1% consensus estimate. Core CPI (excludes food and energy prices) also surprised at 2.6% versus expectations of 3.0%. Base effects will likely continue to push inflation lower as elevated readings from early 2025 drop from year-over-year comparisons.

This progress on inflation, however, contrasts sharply with deterioration in the labor market. November’s unemployment rate rose to 4.6%, the highest since September 2021, and the three-month average job growth stands at just 22,000. WARN Act filings — which require companies to provide 60 days advance notice for mass layoffs — surged to their highest levels since 2020, indicating businesses are moving beyond hiring freezes to actively reducing their workforce.

Meanwhile, third-quarter 2025 GDP was revised higher to 4.3%, lifted by a spike in personal consumption. While this demonstrates underlying momentum, beneath the surface lies potential financial stress. This consumption appears increasingly financed by leverage rather than income growth, as credit card delinquencies exceeding 90 days climbed to their highest level since 2011, and the personal savings rate has fallen from 5.5% to 4.0%.

Looking ahead, the “One Big Beautiful Bill” provisions should provide household relief in early 2026. Larger tax refunds

driven by changes in the tax treatment of tips, overtime pay, social security income, auto loan interest and an increased standard deduction will inject cash into consumer wallets. Combined with infrastructure spending for the World Cup and America’s 250th anniversary, GDP growth in 2026 should remain resilient.

The economy enters 2026 with tailwinds offering a pathway to sustained growth. Policymakers at the Federal Reserve know that success depends on whether fiscal support offsets labor market weakness without reigniting pricing pressures. Ultimately, the trajectory of employment and household finances in the coming quarters will determine whether this K-shaped recovery narrows.

Positives

Third-quarter 2025 GDP revised higher to 4.3% (vs. 3.3% expected)

November CPI fell to 2.7% year-over-year, well below expectations (3.1%)

Initial jobless claims declined to 199k in late December

Negatives

The unemployment rate rose to 4.6% in November, the highest level since September 2021

ISM manufacturing remained contractionary for the tenth consecutive month (47.9)

University of Michigan Current Economic Conditions Index hits an all-time low (50.4)

EQUITY OUTLOOK

Summary

U.S. equity markets were relatively flat in December but delivered another solid year of gains in 2025. The S&P 500 Index rose just 0.1% for the month but capped off a year that saw the index rise by 17.9%. While growth stocks did outperform value stocks over the course of the year, it was still a fairly broad rally. The Russell 1000 Growth Index climbed 18.5% in 2025 while the Russell 1000 Value Index gained 15.9%. After underperforming for many years and partly due to a weak dollar, developed international and emerging markets outperformed U.S. equities in 2025. The developed MSCI EAFE Index rose 31.2% while the MSCI Emerging Markets Index added 33.6%.

The Federal Reserve's measured approach to monetary policy, maintaining rates in restrictive territory for most of the year before implementing two modest cuts in the fourth quarter, provided a backdrop of cautious optimism. After equity markets retreated in the spring, the pervasive response for the balance of the year was to buy the dip, which investors did like clockwork.

The outlook for 2026 presents equity investors with a complex landscape of crosscurrents though many of these variables were present throughout much of 2025. Continued corporate earnings growth has been a bright spot though investors will be closely watching the sustainability of those results particularly as it concerns the artificial intelligence boom. The Trump administration's policy agenda brings a heightened level of uncertainty, though the tariff rhetoric has largely quieted.

Valuation levels remain elevated by historical standards, suggesting more modest forward returns and heightened sensitivity to disappointments.

As we enter the new year, portfolio diversification and balance remain paramount given elevated valuations and geopolitical uncertainty. We remain committed to companies with strong balance sheets and pricing power to navigate potential inflation resurgence or economic weakness. The ongoing transition in monetary policy from restrictive to neutral or even accommodative should support risk assets but the path is likely to be uneven. Here is to a prosperous 2026!

Positives

Fed policy becoming less restrictive

Recession seems unlikely in the near term

Solid corporate earnings growth

Negatives

Equity valuations are historically stretched

Geopolitical tensions elevated

FIXED INCOME OUTLOOK

Summary

December was another month of suppressed volatility in bond yields. The 10-year Treasury note closed each trading day of the month within an exceptionally tight range of just 13 basis points (bps). For nearly four months it has closed within a total range of just 24 bps. For perspective, the monthly average high-low closing range is 33 bps. In a period with little official government data but quite divergent views expressed by strategists, economists, and even Fed officials, the stability in yields has been a bit surprising. The subdued action followed even after the Fed's December 10 Federal Open Market Committee (FOMC) meeting where there were three dissents to the 25 bp rate cut and a blowout third-quarter GDP report. The 2-year and 5-year notes also traded in 24 bp ranges for the past four months. Influenced by the Fed's rate cut, the 2-year Treasury note eased near the lower bound of its trading band and finished December 2 basis points lower at 3.47%. With the federal deficit and debt levels still plaguing the long end of the curve, the 10-year Treasury note ended near the high end of its range to close at 4.17%, up 15 bps for the month. The 30-year bond increased 18 bps to 4.84%. The 2/10-year yield curve steepened to its highest point of the year at 69 bps. Intermediate maturity Treasury notes delivered a positive return of 0.04% for the month. When maturities over 10 years are added, the overall Treasury market had a return of -0.33%.

New issuance of corporate bonds slowed to a crawl in December as usual, but the full year was the second highest total ever at just over \$1.64 trillion. This was only slightly less than the pandemic-fueled issuance in 2020 when \$1.76 trillion was issued. New issuance for 2026 will likely top the previous record as artificial intelligence (AI) infrastructure and mergers fuel the supply of new debt. Credit spreads narrowed a couple of bps for the month and ended little changed from the year's starting level. Investment-grade corporate bonds delivered excess returns to Treasury notes for December with intermediate corporate bonds returning 0.20%. For the year they returned 7.95% versus the intermediate Treasury note return of 6.51%. Overall, the Bloomberg Intermediate Government/Credit Index had a return of 0.09% for the month and 6.97% for the year.

Looking into 2026 we expect the Fed will likely lower rates an additional time or two in the first half of the year. Beyond that, the outlook becomes more uncertain as the rate will be nearing theoretical "neutral," and the economy may experience solid growth with stimulus provided through tax refunds. Shorter maturity notes should continue to grind lower as cuts approach. But even with the cuts, we are not expecting a significant drop in longer yields unless there is some sort of economic shock. Credit spreads should remain well bid even as some more mega-deals get issued to finance the AI infrastructure build. We remain neutral to benchmark duration and overweight high-quality corporate bonds.

Positives

Unemployment rate reached the highest level since 2021

Inflation data is coming in at or slightly below expectations

Many Fed officials think tariff inflation is "transitory" with more rate cuts ahead

Negatives

Inflation may become more problematic if economy remains robust

Corporate bond issuance continues to be heavy due to technology cap expenditures

Unknowns

Legality of tariff policies

Russia/Ukraine peace talks

Venezuela stability and progress
