Investment Update

January, 2026

2025 Fourth Quarter Update and 2026 Outlook

Review: Most major asset classes continued to deliver positive returns in the fourth quarter. The S&P 500 closed out 2025 with a 17.9% total return for the year. International stocks outperformed, with returns greater than 30% that were partly boosted by the decline in the US dollar. Fixed income returns for the year were solid, with the Bloomberg US Aggregate Bond Index returning 7.3%. Bonds were aided by three consecutive rate cuts by the Federal Reserve.

	4Q25	3Q25	2Q25	1Q25	2025
S&P 500	2.7%	8.1%	10.9%	-4.3%	17.9%
MSCI EAFE[1,2]	4.9%	4.8%	12.1%	7.0%	31.9%
MSCI Emerging Markets[2]	4.8%	10.9%	12.2%	3.0%	34.4%
Bloomberg U.S. Aggregate Bond	1.1%	2.0%	1.2%	2.8%	7.3%
Bloomberg Municipal Bond	1.6%	3.0%	-0.1%	-0.2%	4.2%

[1]Europe, Australasia, Far East

[2]MSCI returns are in U.S. Dollars

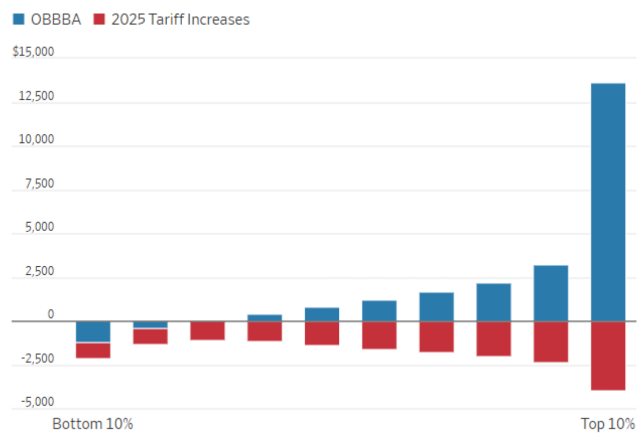
Let them eat brioche?

In the past few quarterly updates, we have noted that lower income households are showing signs of financial stress, seen in metrics like debt delinquency data and in management commentary about consumer trends. However, because overall spending held up better than expected over the past year, we believe some investors are disregarding these trends. We would argue that this is a mistake for two key reasons: 1) ignoring underlying consumer trends can lead to economic (and political) surprises; 2) a growing dependence on upper income households to drive spending increases the sensitivity of economic growth to the stock market.

On the first point, it is not clear to us that the situation for lower income households will improve in 2026. The current job market has been described as “low hire, low fire”, with the unemployment rate rising slowly. Additionally, wage growth among lower income household lagged all other households last year, according to the Atlanta Fed. Lastly, as the chart on the next page shows, it is estimated that the net impact from tariffs and last summer’s budget bill (OBBBA) will be negative for many US households, and most negative for lower income households. It is possible that the job market will improve and inflation will decline more than expected. If not, however, the consumer may be a source of downside risk that does not appear to be priced into stocks at the current level.

On the second point, the top 10% of households by income represent ~half of consumer spending, and stock market returns are a key factor in their sentiment and behavior. J.P. Morgan estimated that ~80% of the S&P 500 return from Nov 2022 (ChatGPT launch) through Dec 2025 was driven by AI-related stocks. If AI stocks disappoint and are not sufficiently offset by a broadening out of the rally to other industries, a market decline could lead to a reversal of the wealth effect, which would have negative implications for economic growth due to this segment's outsized impact on spending. Also note that although the chart indicates that they stand to benefit the most from the OBBBA, higher income households also have the lowest marginal propensity to consume, making it less likely that the additional dollars will flow through the economy to support growth.

Estimated Annualized Effect of OBBBA and Tariffs by Income Decile, 2026-34



Source: Wall Street Journal 01/04/2026 (original source cited as the Budget Lab at Yale)

Outlook: The current estimate for US GDP growth in 2026 is 2.1%, comparable to the current 2.0% estimate for 2025. In addition to consumer spending, we are also monitoring business investment trends. AI data centers provided some much-needed economic growth in 2025, and although data center investment growth is still expected to be strong this year, it will likely be at a slower pace. Investors appear to be anticipating that at least some of the deceleration in AI-driven investments will be offset by business investments in other sectors, supported by incentives in the OBBBA—e.g. accelerated depreciation, which is meant to encourage capital spending by businesses.

International growth will likely continue to be mixed. Consensus estimates suggest decelerating growth for developed economies in 2026 and comparable growth versus 2025 for emerging economies. US dollar weakness provided a tailwind last year, and the market appears to expect some weakness in 2026 as well.

Strategy: The S&P 500 appears to be fully valued with a forward P/E multiple of 22x at year end, leading us to continue to seek out higher quality growth stocks at reasonable valuations balanced by exposure to traditionally defensive sectors. The risk-reward in fixed income continues to appear relatively attractive. Overall market volatility has been relatively benign recently, but it may increase in the near term as companies report Q4 earnings and forward guidance and, potentially, the Supreme Court rules on tariffs.