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Market Overview

All three major averages experienced fourth quarter advances and another year of double-digit returns. However, it was the Nasdaq that outperformed, followed by the S&P 500, and the Dow Jones Industrial Average to close out the year. The S&P 500 continued to rally from the third quarter as the market broadened and rate cuts added fuel to the fire. The Dow Jones Industrial Average led the fourth quarter stock gains, finishing up 4.03%, with the Nasdaq and the S&P 500 gaining 2.72% and 2.65%, respectively.

During the fourth quarter of 2025 healthcare was the best performing sector, gaining 11.23%, followed by technology at 2.16%, and communication services by 1.67%. The best performing sectors year to date were technology, finishing up 24.60%, followed by communication services at 23.07%, and lastly, industrials, which finished in the green up 19.33%. The technology sector drove 60% of the S&P 500's return and earnings growth. The rally continued to broaden within the United States and globally as AI capital expenditures supported industrial, energy, and financial companies.

The Federal Reserve ("the Fed") decided to cut interest rates in the fourth quarter at their October and December meetings. The cut was 25 basis points (.25%) at each meeting leaving the effective federal funds rate at 3.50% to 3.75%. The interest rate decisions drove division among the FOMC committee with some members favoring more cuts and others not wanting to cut at all. The Fed is fighting a weakening labor market and at the same time long term inflation expectations have been increasing. During the fourth quarter of 2025, the 10-year Treasury yield reached a high of 4.20% on 12/10/2025 and a low of 3.94% on 10/22/2025. Yields remained relatively range bound throughout the quarter.

Turning to global markets, international and emerging markets experienced fourth quarter gains maintaining their outperformance over U.S. equity markets and outperformed U.S. equity markets for the first time since the global financial crisis. The U.S. dollar had a slightly positive return of 1.62% for the quarter but finished the year down 4.97%. Turning to commodities, gold continued its march higher during the quarter, nearly hitting $4550 per ounce at its peak and finishing the year up 63%. Precious metals ended the year on a high note with silver squeezing higher and risk on metals like platinum and palladium picking up steam. Oil continued lower throughout the quarter, where it eventually bottomed out at $55 per barrel.

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U.S. Equity Returns Table Source: Tamarac			**U.S. Treasury Yield Table** Source: Treasury				**Other Indices Table** Source: Morningstar		
Index	**Q4 2025 Returns**	**2025 Returns**		**12/2025**	**12/2024**	**12/2023**		**Q4 2025 Returns**	**2025 Returns**
Dow Jones	4.03%	14.92%	3 month	3.67%	4.37%	5.40%	Gold (GLD)	11.49%	63.68%
S&P 500	2.65%	17.88%	2 year	3.47%	4.25%	4.23%	Brent Oil (BNO)	-5.76%	-5.44%
NASDAQ	2.72%	21.14%	5 year	3.73%	4.38%	3.84%	U.S. Dollar Index (UUP)	1.62%	-4.97%
Russell 2000	2.19%	12.81%	10 year	4.18%	4.58%	3.88%	Int'l Equity Markets (EFA)	4.72%	31.55%
MSCI World	5.11%	33.11%	30 year	4.84%	4.78%	4.03%	Emerging Equity Markets (EEM)	3.93%	33.98%

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Will the U.S. Economy Achieve a Soft Landing—or Something Else?

Recent economic data highlights a U.S. consumer base that, while showing signs of fatigue, continues to demonstrate resilience amid trade, inflation, and labor market uncertainties. As a case in point, Q3 2025 Real Gross Domestic Product (GDP) increased at a 4.3% annual rate in Q3, easily beating the consensus expected +3.3%.[1] The largest contributor to the increase was consumer spending, which increased at a 3.5% annualized rate, split between goods (+3.1%) and services (+3.7%). Adjusting for prior tariff-related anomalies, **robust economic growth driven by strong core consumption patterns likely indicates an elevated likelihood of persistent near-term economic expansion**.

Despite these positive consumption figures, **consumer sentiment remains subdued**. The University of Michigan's Index of Consumer Sentiment (ICS) rose to 52.9 in December 2025, up from 51.0 in November, marking an improvement but still reflecting concerns over persistent inflation and job security.[2] An alternative sentiment measure, Conference Board Consumer Confidence Index (CCI), declined to 89.1 in December from 92.9 in the preceding month, the lowest since April 2025 when tariff fears reached their zenith.[3] The Expectations Index[4] within the CCI held steady at 70.7, marking the 11th consecutive month that the index has remained in recession-level territory.

Will consumer spending maintain its current pace or contract in line with gloomy sentiment? We believe the trajectory hinges on inflation trends and labor market dynamics. **Regarding the labor market, the outlook remains somewhat concerning with evidence of further deterioration only partially offset by positive trends elsewhere**. The Bureau of Labor Statistics (BLS) November report revealed non-farm payrolls grew by 64,000, above the expected gain of 50,000.[5] However, after considering negative revisions for October (-105,000) and September (-33,000), November payrolls posted a net decline of 74,000. In addition, the unemployment rate ticked up to 4.6% from 4.4% in September.

Likely reflecting the Trump Administration's efforts to trim government jobs earlier in the year, federal payrolls dropped 162,000 in October and then another 6,000 in November, the tenth straight monthly decline for a total drop of 271,000 since January. On a positive note, private sector payrolls posted an increase of 69,000 in November, or +120,000 including revisions to September and October. **We believe a significant driver of near-to-mid-term labor market data trends will be the absorption rate of unemployed former federal workers into private sector payrolls**.

Turning to consumer price trends, the November Consumer Price Index (CPI) appeared to show positive incremental progress on the inflation front. The November headline (core)[6] CPI increased 2.7% (2.6%) from a year ago, below both the consensus estimate of +3.1% (+3.1%).[7] However, the federal government shutdown created a gap in the data as consumer price data was not collected from 10/1/25 to 11/13/25. Consequently, **while both headline and core CPI declined markedly from the September readings, we believe the November CPI reading must be taken with a healthy dose of skepticism** for the following two reasons:

1. To fill in the October data gap, the U.S. Bureau of Labor Statistics had to impute prices by estimating based on prior trends or simply carrying September prices forward. This would effectively "zero out" inflation for October for certain categories, which may understate actual consumer price increases.

2. November price data collection only resumed on November 14th, which may have led to an overreliance on Black Friday and early holiday discounting from late November, creating a downward bias in goods inflation.

Consequently, **we believe that the true trend of inflation cannot be properly ascertained until these data gaps are closed and price level changes are once again calculated using actual rather than imputed pricing data.**

The Federal Reserve cut the federal funds rate by 25 basis points to 3.50%–3.75% at its December 2025 Federal Reserve Open Market Committee (FOMC) meeting, following two prior 25 bps rate cuts in September and October. In his comments following the decision, Chairman Jerome Powell noted economic strength but flagged labor market risks. Fed Funds futures are currently pricing in two additional 25 basis point rate cuts in 2026, which would bring the federal funds rates down to 3.00%–3.25% by the end of this year.[8] **Resurgent inflation could stall the pace of rate cuts while a marked deterioration in the labor market could accelerate the rate of monetary easing in 2026**.

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Will the U.S. Economy Achieve a Soft Landing—or Something Else? (continued)

In summary, as we transition into 2026, the market narrative continues to hinge on two interconnected forces: labor market stabilization and the trajectory of inflation. Current data shows a resilient consumer, persistent yet still-manageable inflation pressures, and a potentially softening labor backdrop that has meaningfully diverged from consumer spending performance. With the Federal Reserve now firmly in its easing phase following its late-2025 cuts, the key question is whether rate relief arrives rapidly enough to cushion labor softness without reigniting price pressures. Synthesizing these developments, we have refined our three core economic scenarios from prior updates, now tailored to Q1 2026 and beyond.

1. **Resilient Growth and Moderating Inflation (Soft Landing):**

- **Scenario**: Trade tensions remain contained as ongoing negotiations produce selective tariff relief, carve-outs, or implementation delays for key supply chains. Labor market deterioration slows rather than accelerates with unemployed former federal workers finding work in the private sector at a quicker than expected pace and rate cuts beginning to support hiring efforts. Inflation resumes its measured descent with headline and core inflation grinding closer to the Fed's 2.0% target and tariff passthrough largely offset by supply-chain diversification and competitive pricing pressure. The Fed can follow through with its telegraphed easing path.

- **Market Impact**: The S&P 500 could advance an additional 3%–5% from late 2025 levels, targeting the 7,100–7,200 range by quarter-end while the Nasdaq Composite may enjoy 4%–6% upside in Q1 2026. Some volatility around policy announcements and macroeconomic data release dates but fundamentals dominate, continuing to support an upward trend.

- **Likelihood**: Moderately high, with supportive macro data and earnings momentum.

- **Implications**: Broadly bullish for equities, with outperformance in growth areas like AI and sustainable infrastructure. Fixed income outlook is dependent on path of intermediate and long duration yields, which would likely be somewhat uncertain in this scenario.[9] Consequently, a barbell approach where the bond portfolio is exposed to both short and long-term bonds may be the most prudent approach in this outcome.

2. **Strong Growth with Resurgent Inflation (No Landing):**

- **Scenario**: Real GDP growth remains above 3.5%. Robust consumer spending persists, supported by real wage gains and improving private sector hiring as previously displaced federal workers are absorbed more quickly than expected. Business investment reaccelerates, particularly in technology, reshoring, energy infrastructure, and manufacturing capacity. However, the strength in demand contributes to renewed inflation pressures, with core inflation reaccelerating to the 3.5% range or higher. Trade policy remains mixed—tariff pressures do not collapse growth but contribute to price stickiness. The Fed is forced to pause cuts and signal potential hikes in late 2026 to prevent overheating.

- **Market Impact**: Robust Q1 2026 equity gains of 8%–12% in the S&P 500 (targeting 7,400–7,700) and stronger outperformance in the Nasdaq (10%–15% upside), initially driven by growth optimism. However, rising yields introduce late-quarter volatility and a possible correction, favoring rotations toward cyclical and value sectors.

- **Likelihood**: Moderate but could increase markedly if early 2026 labor and consumer spending data surprise in a positive direction and tariff passthrough proves more inflationary than currently assumed.

- **Implications**: This scenario argues for selective pro-cyclical equity positioning, a continued emphasis on quality and pricing power, and caution toward overly rate-sensitive growth sectors. Fixed income sells off with steeper yield curves. Inflation-protected or floating-rate securities may become more attractive. Real assets (e.g. real estate, precious metals) and commodity-linked equities provide hedges.

3. Slowing Growth with Resurgent Inflation (Stagflation):

- **Scenario**: Trade tensions escalate materially and new or retaliatory tariffs are implemented on a wider set of goods, pushing import prices higher and straining global supply chains. Core inflation re-accelerates above 3.2%, driven by tariff passthrough and stubborn services inflation, even as real GDP growth slows below 1%. The labor market weakens sharply with unemployment moving towards 5.0%. Despite labor market weakness, resurgent inflation causes the Fed to pause or reverse cuts, trapping the economy in a low growth/high prices phase.

- **Market Impact**: Sharp corrections of 15%–25% across the S&P 500 and Nasdaq Composite, with credit spreads widening and equity risk premiums surging.

- **Likelihood**: Moderately low but may increase materially with evidence of worsening labor market conditions, markedly lower consumer spending, and higher than expected tariff-related inflation trends.

- **Implications:** Broadly bearish, with both stocks and bonds under pressure. Safe haven investments limited to cash equivalents, Treasury Inflation-Protected Securities (TIPS), and commodities like gold. Selective equity exposure to inflation-hedged sectors (e.g., energy, materials, REITs) may offer relative protection.

As the above analysis underscores, the 2026 outlook remains tethered to trade policy evolution, the forward path of inflation, and the state of the labor market. Our base case envisions continued equity market momentum propelled by monetary easing and resilient fundamentals. In addition, even as the 2025 equity market advance has narrowed the field of undervalued growth stocks, we believe pockets of opportunity persist in undervalued cyclicals, beaten down defensives, and overlooked innovators.

Our growth at a reasonable price ("GARP") strategy is calibrated to harness selective growth pockets—such as AI infrastructure, power generation, and domestic manufacturing—while embedding downside protection through quality balance sheets and valuation discipline. We believe our diversified GARP portfolios are well-positioned to navigate episodic volatility, striving to deliver alpha in both grind-higher and corrective environments as markets scale the "wall of worry" in 2026.

Brent J. Miller, CFA® – Senior Portfolio Manager

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[1] https://www.bea.gov/news/2025/gross-domestic-product-3rd-quarter-2025-initial-estimate-and-corporate-profits
[2] https://www.sca.isr.umich.edu/
[3] https://www.conference-board.org/topics/consumer-confidence/
[4] The Expectations Index is based on consumers' short-term outlook for income, business, and labor market conditions
[5] https://www.bls.gov/news.release/pdf/empsit.pdf
[6] Core CPI excludes the more volatile food and energy categories
[7] https://www.bls.gov/news.release/pdf/cpi.pdf
[8] https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html
[9] Falling short-term yields and rising disinflation confidence could push intermediate and long-duration yields lower, which would be positive for bonds in general and mid-to long-duration fixed income instruments in particular. On the other hand, fixed income could face mild yield pressure as recession odds fade and international bond investors zero in on rising U.S. debt levels. In this scenario, short-duration bonds could remain attractive with opportunities to extend duration if intermediate and long-term yields begin to rise.

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