Fourth Quarter 2025 – Wealth Management Insights

Economic Overview

Steve Scranton, CFA, SVP, Economist

Economic growth in the 4th quarter appears to have slowed compared to the robust 4.3% annualized growth rate reported for the 3rd quarter. Much of that growth is tied to the government shutdown as the Congressional Budget Office projects that it alone subtracted one to two percentage points off of 4th quarter growth. Current estimates from the two Federal Reserve models project growth between 2 and 3%. The Atlanta Federal Reserve model is projecting 3.0% growth while the New York Federal Reserve model is projecting 2.1% growth.

What we do know is that this economic cycle continues to show an economy that is bifurcated. The new catch phrase being used by economists is a K shaped expansion. What private data and anecdotal evidence continue to show is that the upper income consumer and large businesses are prospering while lower income consumers and small businesses are struggling. Upper income consumers have benefited from the continued growth of their non-retirement investment portfolios outpacing inflation and big businesses have been better able to adapt to changing monetary and fiscal policy compared to small businesses.

Consumer spending appears to have remained solid during the holiday season as Mastercard's Spending Pulse report shows holiday retail sales increasing 3.9% from November 1 through December 21. The one message from the report is that buyers were being selective and actively seeking bargains. The "K" shape was evident as "main street" retailers offered sales while "high end" retails found no need to offer sales.

Corporate spending continues to be powered by the large technology companies and their spending on Artificial Intelligence (AI) and data centers. The strength in spending from these large companies is offsetting weakness in the manufacturing sector. Based on the private sector data from S&P and ISM, manufacturing orders slowed or declined during the quarter. The official durable goods orders from the Census Bureau also showed a decline in October.

Government spending is where the greatest weakness was seen. This was a direct result of the government shutdown as a drop in government outlays occurred. Some of this will be unwound in the 1st quarter.

Despite the difficulty of fully assessing economic growth, the private data that has been available still points to positive growth for the quarter. The most important point to emphasize is how bifurcated, or "K" shaped, the growth remains. Your own experience may differ from what the macro data is showing. If you are planning for 2026, you are probably best served to believe what you are experiencing versus what the media may be reporting.

Strategy Review

Derrick Wilson, CIMA®, VP, Portfolio Manager

Despite ongoing geopolitical uncertainty and shifting global dynamics, markets remained remarkably resilient in 2025. Most major asset classes posted strong returns, reinforcing the value of staying invested and maintaining a diversified portfolio. International equities and gold were standout performers, while bonds continued to provide important balance during periods of market volatility.

Global equities delivered another positive quarter, despite occasional bouts of weakness. While US mega-cap technology stocks dominated headlines, international markets quietly outperformed, with emerging markets the leader. The US dollar ended the quarter little changed, supported briefly by a strong October, before weakening into year-end. For the full year, the dollar declined 9.3%, creating a meaningful tailwind for international equities, which nearly doubled the returns of US stocks.

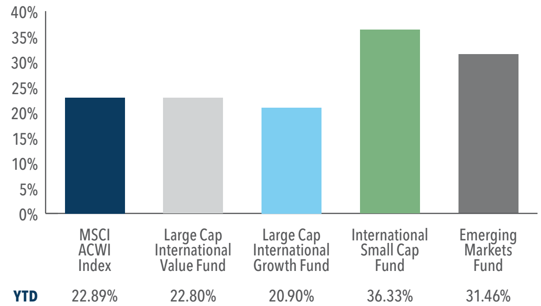
Fixed income continued to provide portfolio stability with another positive quarter and downside protection during equity selloffs. Price appreciation contributed as the Federal Reserve lowered interest rates further, while high yield bonds once again outperformed investment-grade credit amid historically tight spreads. Treasury Inflation-Protected Securities (TIPS) lagged as inflation expectations moderated. With US interest rates falling and the yield curve steepening, market conditions increasingly favored moving beyond cash and ultra-short bonds and extending modestly along the maturity spectrum. International bonds added further diversification, with emerging market debt delivering more than double the returns of domestic bonds for both the quarter and the year.

Diversifying assets and alternative strategies also performed well in 2025. Commodities rebounded strongly, with the broad commodity index rising 5.8% in the 4th quarter and 15.7% for the year. Precious metals led the gains, as both gold and silver reached new all-time highs. Gold rose more than 60% during the year, supported by geopolitical tensions and growing concerns around US fiscal sustainability, which drove increased demand for gold as a reserve asset. Silver prices surged nearly 140%.

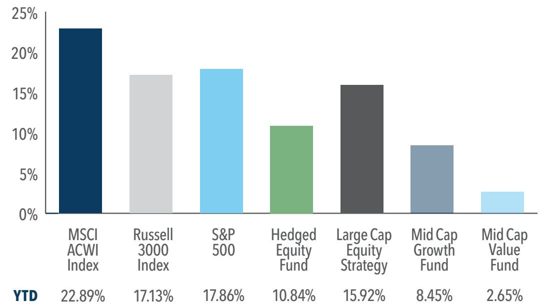
Other diversifying strategies added value as well. Global macro and managed futures strategies delivered low double-digit returns, while global infrastructure gained 22.5% for the year, supported by rising power demand and continued investment tied to artificial intelligence and infrastructure development. Real estate was the primary laggard, ultimately ending up 2.2% for the year after declining more than 2% in the 4th quarter.

Looking ahead, the investment environment remains constructive but increasingly nuanced. Opportunities remain across regions and asset classes but warrant a disciplined and selective approach. Maintaining diversification, managing risk, and staying focused on long-term objectives remain key as markets navigate an evolving global landscape.

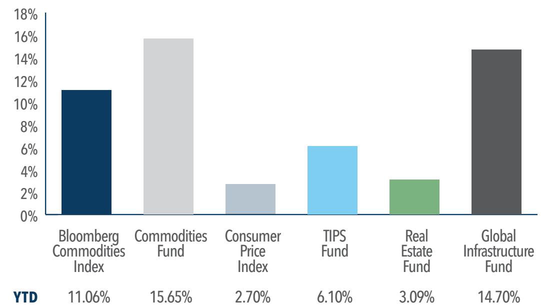
INTERNATIONAL DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



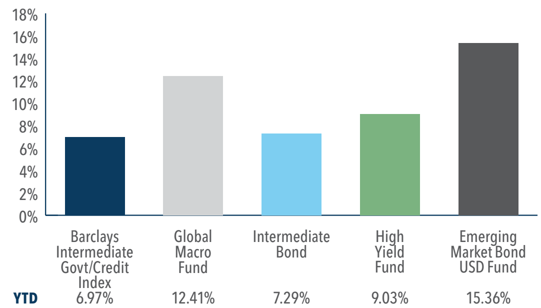
DOMESTIC DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



REAL RETURN (INFLATION PROTECTION) DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



INCOME DIVERSIFICATION
YEAR-TO-DATE PERFORMANCE



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Domestic Equities

Gayle Sprute, VP, Senior Portfolio Manager

Dear Newsletter readers, this year I am transitioning to a new role within our Wealth Management & Advisory Services division. Thank you for your readership. It has been my pleasure and honor to provide quarterly market updates. But I leave you in good hands. Starting next quarter, the equity market commentaries will be provided by my partner, Equity Portfolio Manager Allan Prins. Warmest Regards!

US stocks continued to work their way moderately higher in the 4th quarter, but the path was a bit rocky. October delivered modest gains, on better-than-expected 3rd quarter corporate earnings, continued Federal Reserve (Fed) interest rate easing expectations, and artificial intelligence (AI) optimism – despite the government shutdown which started at the beginning of the month.

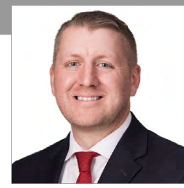
However, November brought a rise in volatility and a drawdown in stock prices. The major indices fell between 4.5% and 5.9% between November 12th and 20th. The data "blackout" that occurred due to the 43-day government shutdown left the Fed flying somewhat blind in regard to its "data dependence." Mixed messaging from some Fed members cast concern about the prospects for another interest rate cut in December. Additionally, AI-related stocks came under pressure as the market worried about whether the significant cap ex spending by companies such as Microsoft (MSFT), Alphabet (GOOGL), Meta Platforms (META), and Amazon.com (AMZN) would be successfully monetized – and whether a "bubble" might be forming. Although the Fed did lower rates by 0.25% in December, stocks essentially treaded water in December.

For the 4th quarter, the major equity indices' gains were as follows: Dow Jones Industrial Average (Dow) +4.0%, S&P 500 +2.6%, Nasdaq Composite +2.7%, Russell Mid Cap +0.1%, and Russell 2000 +2.2%.

Sector leadership in the quarter came from health care +11.7% and communication services +7.3%. The laggard sectors were real estate -2.5% and utilities -1.4%. Value was the surprise style leader, +3.2% versus growth's +2.2% gain.

What a year it's been. While the journey was tumultuous at times, the indices delivered double-digit gains across the board for 2025: Dow +14.9%, S&P 500 +17.9%, Nasdaq Composite +21.2%, Russell Mid Cap +10.6%, and Russell 2000 +12.8%. The equities market has been kind to investors. We've now been in a bull market for three years, since mid-October 2022, with three consecutive years of 15%+ growth for the S&P 500.

Looking into 2026, there are catalysts that could keep this bull market in place. However, disappointments relative to expectations on these topics could also trigger volatility. The market has become expensive during this multi-year run. The price/earnings (P/E) ratio for the S&P 500 is 21.8x forward earnings expectations, versus the 10-year average of 18.7x. Thus, the market is essentially "priced to perfection." With much of the good news already factored in, there is little room for disappointment. Some of the "moving parts" to keep in mind relative to expectations during the coming year include: 1) stimulus benefits from the "One, Big, Beautiful Bill", including a surge in tax returns; 2) the Fed's decisions on interest rate policy; 3) the path of inflation; 4) labor market trends; 5) economic data; 6) tariff negotiations and outcomes; 7) AI's growth and profitability trends; 8) the pace of corporate America's earnings growth; and 9) consumer spending patterns.



Fixed Income

Callen Young, VP, Portfolio Manager

The bond market in 2025 was shaped by shifting economic expectations, evolving government policy, and a Federal Reserve that moved cautiously before beginning to ease policy later in the year. By the 4th quarter, the US Treasury yield curve had become noticeably steeper, continuing a trend that had been in place for much of the year. Short-term interest rates declined as investors grew increasingly concerned about a slowing labor market and softer economic growth, a shift reinforced by the Fed's eventual rate cuts. At the same time, longer-term rates moved higher, reflecting concerns about stubborn inflation, rising government borrowing, and the longer-term implications of fiscal policy. Over the full year, the two-year Treasury yield fell roughly 77 basis points, the 10-year declined about 40 basis points, and the 30-year ended modestly higher.

The first half of 2025 was largely defined by policy actions from the new Trump administration and the Republican-controlled Congress. The rollout of tariffs in April, government spending cuts targeted by the Department of Government Efficiency, and early work on tax and spending legislation that later became the "One Big Beautiful Bill" introduced meaningful uncertainty for fixed income investors. Markets struggled to assess how these policies might affect inflation, economic growth, and federal borrowing. In the second half of the year, attention shifted to other developments, including the longest federal government shutdown on record, which delayed and distorted key economic data releases. Investors also focused on the rapid growth in AI-related borrowing, renewed efforts to reach peace agreements in Ukraine and Gaza, and the realization that actual tariff rates would be lower than initially feared.

Against this backdrop, the Federal Reserve remained on hold through the first half of the year, keeping its policy rate between 4.25% and 4.50%. Inflation progress appeared to stall early, with core PCE inflation beginning the year at 2.8%, while the labor market remained resilient, with solid job growth through mid-year. This combination supported the Fed's cautious, "wait-and-see" approach. By mid-summer, however, economic growth slowed, labor markets softened, and the inflationary impact of tariffs proved less severe than expected. The Fed delivered its first rate cut in September, followed by additional quarter-point cuts in October and December, ending the year with rates at 3.50%–3.75%. Over the course of the year, the unemployment rate rose from 4.1% to 4.6%.

Municipal bonds experienced many of the same dynamics seen in the Treasury market. Yield curves steepened, issuance reached record levels, and credit spreads widened modestly. Investors absorbed approximately $572 billion of municipal issuance in 2025, up 15% from the prior year, with supply concentrated in the first half. Credit fundamentals remain generally strong, supported by healthy tax collections, though higher operating costs and lingering inflation pressures have slowed improvement. As the market moves beyond its peak, careful security selection and disciplined portfolio management have become increasingly important.

Looking ahead, delayed economic data and growing disagreement within the Federal Open Market Committee have reduced clarity around the path of monetary policy in 2026. With rates now near levels many officials view as neutral and a new Fed chair expected in 2026, uncertainty is likely to remain a key driver of bond market performance.

International

Matthew Clarke, CIMA®, VP, Senior Client Portfolio Manager

It was a strong quarter and a decisively strong year for the international markets, which continued to reinforce the value of a globally diversified portfolio. Over the quarter, international stocks benefited from strong corporate earnings, improving fundamentals, easing trade tensions, and growing expectations of US interest rate cuts.

Over the course of the full year, **another significant contributor to international returns was a weaker US dollar.** The US Dollar Index (DXY) weakened by over 9% in 2025, the most since 2017. When the dollar falls, the value of foreign currencies rises in relative value, which enhances dollar-based returns for US investors. Admittedly, most of the dollar's decline occurred earlier in the year but remained weak enough through the full year to provide a significant tailwind for US investors. The country specific returns quoted in what follows are reported in local currency.

Within the 4th quarter, **the brightest area was emerging markets**, with the MSCI Emerging Markets index adding 4.8% and closing out the year with an impressive 34% return. This compares to the S&P 500's 2.7% in the quarter and 18% for the year. Notable strength in the quarter was found in Chile and the Czech Republic. They returned 17% and 16% in the quarter and 56% and 61% respectively over the year. Korea, albeit increasingly difficult to consider an emerging market, returned 23% in the quarter and 78% for the full year, boosted by spending on both artificial intelligence (AI) and defense. **China stumbled in the final quarter**, weighed down by concerns about slower growth, weak consumer demand and ongoing weakness in the property sector. Despite their year-end frictions, China still managed to shine over the course of the year with the Shanghai Shenzhen CSI 300 composite returning 21%, driven by stronger sentiment around economic stability.

Developed international stocks, as measured by the MSCI Europe, Australasia, and the Far East (EAFE) index, added 4.9% in the quarter bringing the full year's return to 32%. Both **Japan's Nikkei and the United Kingdom's (UK) FTSE 100 hit record highs in the quarter** and delivered strong returns for the year at 29% and 25% respectfully. The UK benefited from strong corporate earnings and expectations of a rate cut, which they got in December, while Japan continued to benefit from investment in AI and growing expectations of fiscal stimulus under their new prime minister, Sanae Takaichi.

Global (ex US) bonds as measured by the Bloomberg Global Aggregate ex-US index delivered negative returns in the quarter, but strong returns for the full year at -0.5% and 8.9% respectively. **Emerging market debt continued to shine** with the J.P. Morgan Emerging Market Bond Index (EMBI) returning 3.3% in the quarter and 14.3% for the year.

As we peer into our crystal balls and consider 2026, the backdrop appears to look increasingly supportive for long-term investors. Inflation is moderating, growth is positive, and policy is becoming more predictable. Still, the world is changing quickly and as it does, preparation, patience, and perspective will all matter more than perfect timing.

Additional and expanded information to this newsletter discussion may be obtained by contacting your relationship manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.

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