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2026 ANNUAL OUTLOOK

2025 Review

After a spectacular two-year run in equity markets and the early optimism surrounding the potential for economic growth, 2025 proved to be a year of recalibration for investors. Geopolitical risks rose, including a significant government shutdown and trade tensions, and interest rates remained elevated throughout much of the year. Yet U.S. stocks again delivered strong gains in 2025, as resilient consumer spending and corporate earnings helped equities power forward. The S&P 500 notched its *third straight year of double-digit equity returns.*

Equity Markets

- The **S&P 500** index set new all-time highs late in the year and closed 2025 up over 17%, finishing at 6,845.
- The **Nasdaq Composite** outperformed with a 20% gain, driven by continued enthusiasm around artificial intelligence and data-driven businesses.
- The **MSCI EAFE** index, a benchmark for international developed equities, returned 31.6% as currency gains, increasing government spending, and falling interest rates boosted foreign stocks.[1]

Monetary Policy

The Federal Reserve continued to respond to evolving economic conditions. After a long period of high rates, the Fed delivered multiple **interest rate cuts in 2025,** though policymakers remained divided on the path forward. A quarter-point cut in December was widely expected, with markets forecasting additional easing in early 2026. Despite easing, inflation remained above the Fed's 2% target, and unemployment data showed pockets of labor-market softness later in the year.[2]

Fixed Income

Bond markets were similarly volatile. Early expectations for rate cuts initially helped yields fall, but shifting economic data, persistent inflation, and political-policy uncertainty caused yields — including the 10-year Treasury — to fluctuate into year-end. Fixed-income returns were positive but modest compared with equities.

Geopolitical & Policy Backdrop

The political landscape continued to play a central role. Following the 2024 election, President Trump took office with continued Republican control of Congress. While this initially spurred expectations of pro-business legislative action**, the policy environment in 2025 featured friction,** including:

- A **lengthy federal government shutdown,** which disrupted economic data reporting and weighed on sentiment.
- Renewed **trade tensions and a tariff dispute** with Canada and Mexico, which triggered sharp but ultimately brief market corrections.
- Political challenges around Federal Reserve leadership and institutional independence

Despite political noise, markets shrugged off much of the uncertainty, and investor optimism returned as rate-cut expectations and healthy earnings supported valuations.

MARKET OUTLOOK

Economic Indicators

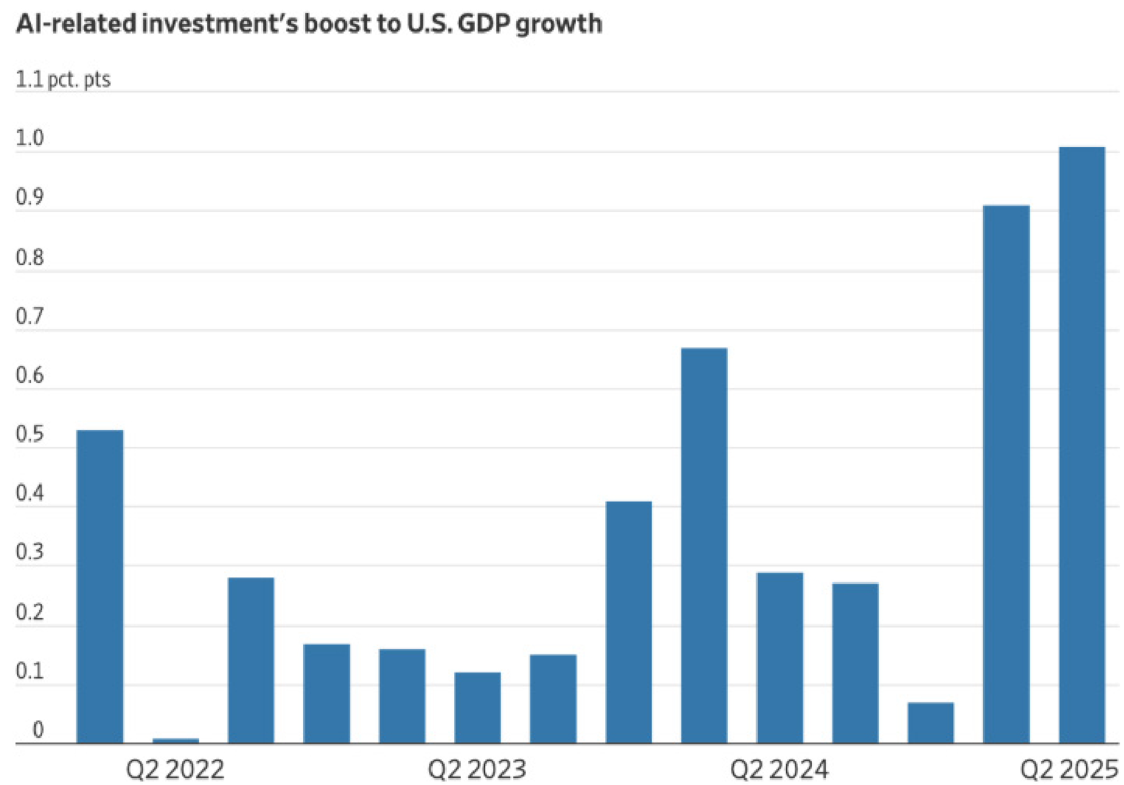
The U.S. economy continued to show resilience in 2025:

- Consumer spending remained a backbone of growth, helping U.S. GDP avoid contraction through most of the year.
- Labor markets softened but did not collapse, with unemployment rising modestly late in the year.
- Inflation, while trending lower from prior peaks, stayed above the Fed's comfort zone.

Looking Ahead

In our 2025 Annual Outlook, we asked whether recession was six months or sixty months away. By year-end 2025, recession fears had faded for many investors, though concerns linger over elevated valuations, geopolitical risks, and inflationary pressures linked to rapid investment in AI infrastructure. As we head into 2026, our goal remains to balance return opportunities with risk and update you on our perspective on markets, valuations, monetary policy, and risk management.

2026: The tailwinds are significant...



Note: Seasonally adjusted annual rate. AI-related investment includes software, computers and peripherals and data centers.
Source: Barclays

...but are they blowing up a bubble?

MARKET OUTLOOK

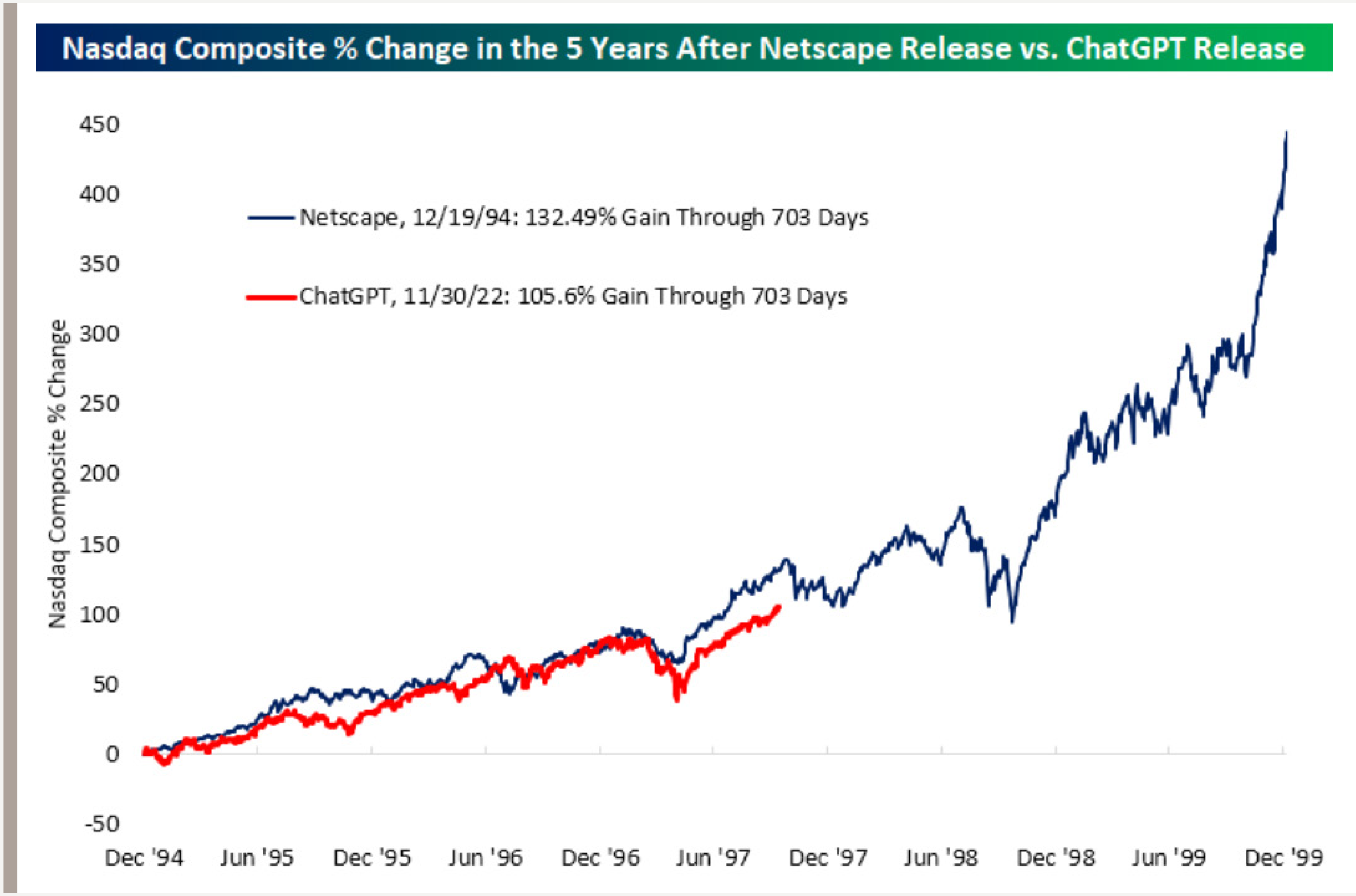


Chart Via Bespoke Investment Group as of 9/19/2025. Chart shown for illustrative purposes only. Past performance is not indicative of future results. You cannot invest directly in an index.

MARKET OUTLOOK

History Does Not Repeat, but it Rhymes

The artificial intelligence boom has remarkable similarities to the internet boom of the 1990's. Revolutionary technology, accelerating widespread adoption, and eye-popping equity market returns, as evidenced by three straight calendar years of double-digit gains for the S&P 500. The AI boom and the 1990s internet boom share speculative optimism and massive capital flows, but they differ sharply in maturity of technology, sources of funding, and speed of real-world adoption. Both are transformative, yet the AI wave is building on an already-connected, cloud-based world rather than inventing it from scratch.

In both eras, a powerful narrative drove investor enthusiasm. In the 1990s, the promise was universal connectivity: the internet would eliminate information barriers, change commerce, and democratize access to markets and media. Today, AI is framed as a general-purpose intelligence tool: software that learns, reasons, and automates cognitive tasks, potentially transforming every information-centric industry. The effects are not just felt in the technology space but across sectors as disparate as finance, health care, utility providers, and media players.

These narratives share several behavioral features. First, they both rest on the belief that a general-purpose technology, like AI or the internet, will touch *everything,* so traditional valuation anchors temporarily loosen. This means the market will be fueled by the core and adjacent companies while other areas will continue to rise modestly. The valuation of a stock like Procter and Gamble is not going see its valuation anchor loosen because toothpaste is a mature, slow growth business. However, when a company like Oracle announces cloud infrastructure growth at 68% in their most recent earnings report, you can see how valuations become untethered to the upside.

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Bank of America recently illustrated that as of the fourth quarter, on 20 valuation metrics that they track, the current S&P 500 index is cheaper than the tech bubble on 11 metrics and more expensive on 9 metrics. Whether you view this table as a caution or a reason for optimism almost does not matter – the parallels in valuations being expensive in *both* the internet and AI boom shine through.

Second, both eras create a fear of missing out (FOMO) among firms and investors. In the 1990s, companies added ".com" to their names to boost valuations; today firms emphasize "AI strategy" in earnings calls to signal relevance. Stories abound about the friend who purchased Nvidia 5 years ago, Tesla when it IPO'd, or those who owned Cisco or Amazon in the 1990s. "That was a no brainer stock to buy" is often remarked to bring the point home that if you are not participating, you don't have a brain. This creates the FOMO environment that leads to momentum across the stock market that we witnessed in the 1990s and in present day.

Third, each wave attracted capital beyond the traditional tech sector—into media, retail, logistics, and industrials—on the idea that incumbents who "don't adapt will die." FactSet examined conference call transcripts for all S&P 500 companies that held earnings calls from in Q4 of 2025 and found that the term "AI" was cited on 306 calls. This is the highest number of S&P 500 earnings calls on which "AI" has been cited over the past 10 years. By comparison, the five-year average of "AI" mentions on earnings calls is 136 companies and the 10-year average is 86 companies.[3]

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Exhibit 72: The S&P 500 is expensive vs. 2000 on 9/20 metrics we track

S&P 500 valuation metrics, today (10/25) vs. 2000

	Current	March 2000	Today vs. 2000
Trailing PE	26.5	29.4	Cheap vs. 2000
Trailing GAAP PE	30.7	29.4	Expensive vs. 2000
Forward Consensus PE	23.6	24.6	Cheap vs. 2000
Trailing Normalized PE	29.9	34.5	Cheap vs. 2000
Median Forward P/E	18.5	15.3	Expensive vs. 2000
Shiller PE	39.1	43.0	Cheap vs. 2000
P/BV	5.7	5.3	Expensive vs. 2000
EV/EBITDA	20.2	15.7	Expensive vs. 2000
Trailing PEG	1.9	2.1	Cheap vs. 2000
Forward PEG	1.7	1.8	Cheap vs. 2000
P/OCF	21.1	19.1	Expensive vs. 2000
P/FCF	39.4	55.3	Cheap vs. 2000
EV/Sales	3.7	2.9	Expensive vs. 2000
ERP (Market-Based)	577.0	232.0	Cheap vs. 2000
Normalized ERP	182.4	-87.2	Cheap vs. 2000
S&P 500 Div. Yld. vs. 10yr Tsy. Yld.	0.3	0.2	Cheap vs. 2000
S&P 500 in WTI terms	113.9	50.1	Expensive vs. 2000
S&P 500 in Gold terms	1.7	5.4	Cheap vs. 2000
S&P 500 vs. R2000 Fwd. P/E	1.5	1.3	Expensive vs. 2000
S&P 500 Market Cap/GDP	1.9	1.3	Expensive vs. 2000

Source: FactSet, BofA US Equity & Quant Strategy

BofA GLOBAL RESEARCH

MARKET OUTLOOK

In some ways, there is a fad element that many companies are just trying to ride the AI wave. But there is also the reality that many companies are exploring the benefits of having an AI driven, PhD-Esque research assistant via Claude, ChatGPT, or Co-Pilot, to name a few, on their staff that can aid existing processes and streamline new tasks. History is littered with companies who have not adapted to modern technology – Borders Books, Kodak, Blockbuster, etc. – and the reality of the AI boom is that the capital investment is so substantial that modern companies do not want to be ignorant of the technology nor the speed at which customer behavior and implementation are changing around them.

Those are some of the similarities between AI and the internet but the technological foundations differ significantly. The 1990s internet boom largely coincided with infrastructure construction: laying fiber, building data centers, standardizing protocols, establishing browsers and search. Much of the investment funded the basic plumbing of the digital world. Many business models implicitly assumed that broadband access, logistics, and secure payments would mature rapidly—and the crash came in part because adoption curves lagged investor optimism.

By contrast, the AI boom is layered on top of already-built digital infrastructure. Cloud computing, mobile access, global broadband connectivity, and enormous digital datasets already exist. This means AI diffusion is faster: models can be deployed almost instantly, and product integration can take weeks instead of years. The deployment bottleneck is no longer physical connectivity but compute, energy, and talent.

AI introduces a new form of infrastructure intensity. Rather than laying fiber, firms are racing to build GPU-dense data centers, expand energy capacity, and design specialized chips. Capital expenditure is therefore concentrated in fewer firms—cloud hyperscalers, semiconductor manufacturers, and model developers—whereas 1990s infrastructure spending was broader across telecoms and networking. Early value creation is more clearly concentrated upstream—in chips, data centers, and the owners of existing data sets - because these stages require immense capital and deep expertise. This is why earnings growth and concentration has occurred within the Magnificent 7 stocks, which are some of the largest companies in the world. Downstream application layers are more fragmented and competitive, reminiscent of the early dot-com landscape, where experimentation is abundant but durable moats are less clear.

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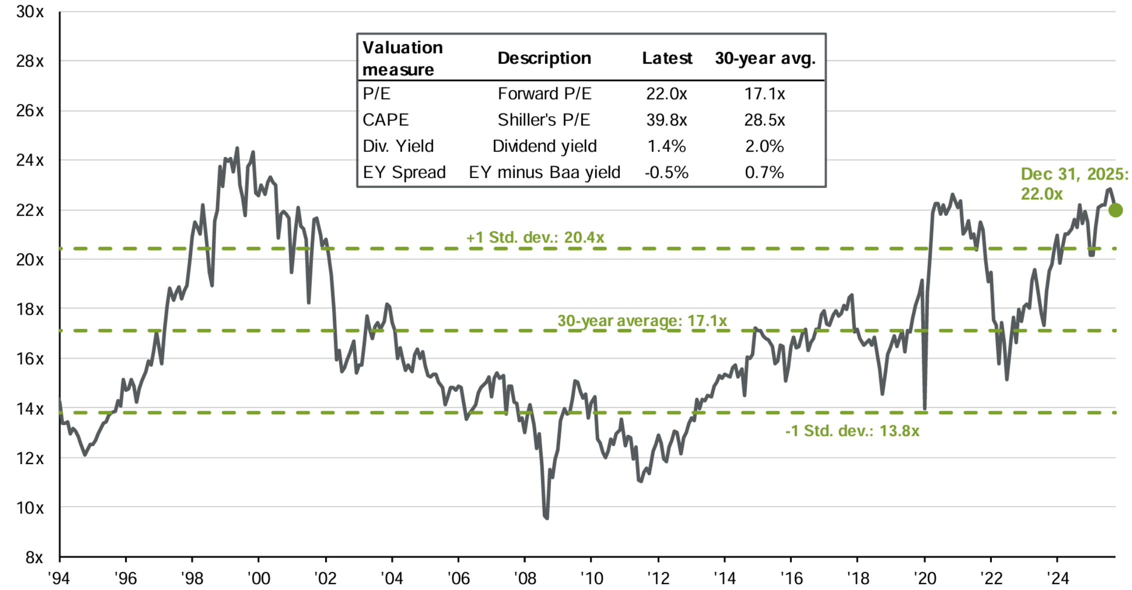
1997...or 2000

We noted in our 2025 annual outlook that that growth by itself does not necessarily lead to positive market outcomes. Markets jump when growth goes from "bad to less bad" or "good to great" and after three straight years of double digit returns from the S&P 500, there is no way to avoid it – stocks are expensive. Earnings have accelerated beyond expectations, which has kept valuations from setting new records, but the optimism over the AI boom has pushed the S&P 500's valuation to well above historical averages.

Stocks ended 2025 at very similar valuations to where they started the year, proof that in the short-term, elevated valuations do not necessarily predict poor short-term market returns. However, when we zoom out to a longer-term period, elevated valuations often portend to more modest equity returns in the future. Looking back at historical 10-year returns for the S&P 500, we observe that below historical average valuations (under 15x earnings) have led to the strongest 10 year returns. Valuations in a range of 15-20x have generally positive returns, with some in double digit returns.

S&P 500 index: Forward P/E ratio



Valuation measure	Description	Latest	30-year avg.
P/E	Forward P/E	22.0x	17.1x
CAPE	Shiller's P/E	39.8x	28.5x
Div. Yield	Dividend yield	1.4%	2.0%
EY Spread	EY minus Baa yield	-0.5%	0.7%

Source: Bloomberg, FactSet, Moody's, Refinitiv Datastream, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.

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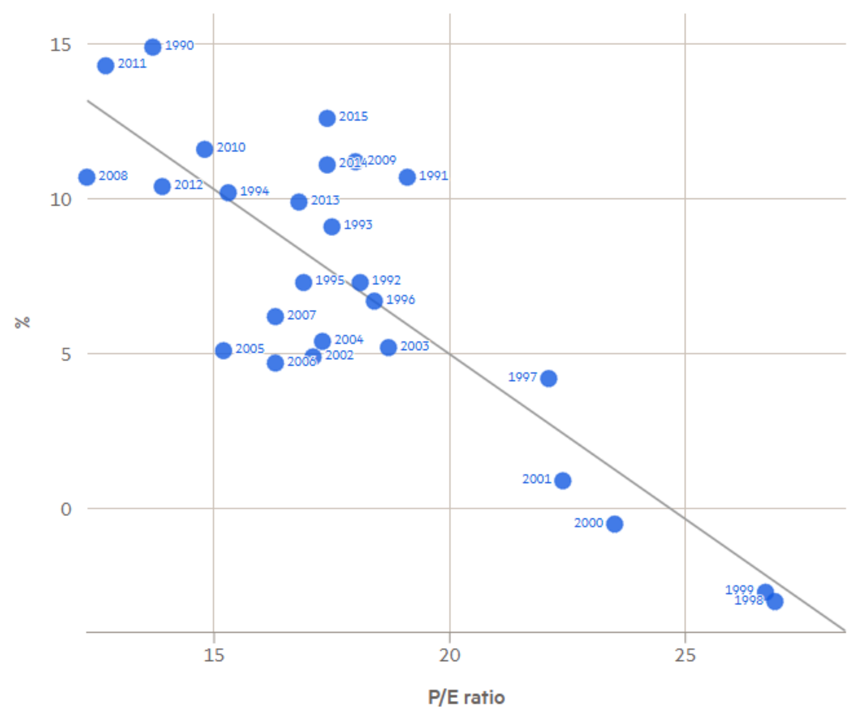
When valuations were over 20x earnings, returns from the S&P 500 were noticeably less attractive and in some cases (in the starting years of 1998, 1999, and 2000) were negative.

This short-term to long-term paradox is where much of our internal investment committee dialogue has focused over the last few years: valuations are elevated and that has historically meant investors should prepare themselves for lower future returns. However, we may still be in the middle stages of a historically significant investment buildout and there could be spectacular gains in the few years. We may be in a similar environment to 1997, where the trailing gains were very strong and the gains over the next two calendar years were also substantial. As evidenced by the Bespoke Investment Group chart on page 2, the Nasdaq continued its meteoric rise to close the decade. However, as you can see from the chart above, the *ten-year* returns starting from 1997 on were below 5%, annually, and were disappointing relative to other periods of investment history.

S&P 500 forward P/E ratios and subsequent 10-year annualised price returns, 1991-2015



©FT Source: Bloomberg • R-squared = 0.694

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MARKET OUTLOOK

We highlight all of this to caution investors against the wave of emotions they may feel at any one point over the next five years:

- You could see headlines of "The Next Palantir" and wonder why you don't own it.
- Markets may hit new all-time highs and you might think you are not participating enough.
- There may be a 20% correction, or worse, within a month (as there was following the 2025 tariff rollout) and you may wish your portfolio was better insulated.
- When extreme volatility hits, you may forget that these types of correction happen every couple years, regardless of whether it is due to AI froth or not.
- A tech company could experience a "WorldCom" type of outcome, the bubble could burst, and many will say "It was all so obvious this became too speculative."

Those may all happen over five years, in one year, or not at all. What we encourage investors to ask themselves is not whether they are generating strong enough returns but whether the risk they are taking, particularly given where equity valuations are at, is commensurate with the potential returns they may experience.

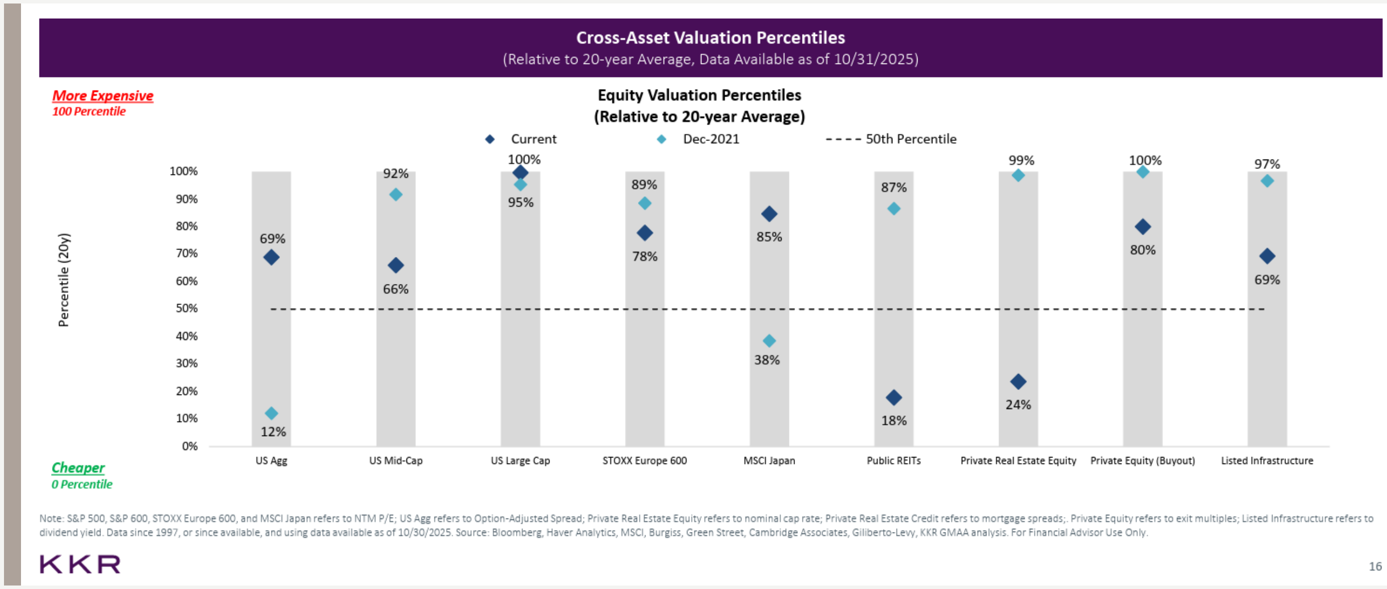
MARKET OUTLOOK

Other Assets Trade at a Discount to Large Cap

For those worried about rising valuations over the last five years, tactically lowering a portfolio's risk allocation to U.S. equities, growth stocks in particularly, has been a bad move in retrospect. That feeling may continue if large cap stock valuations keep extending well above their historical averages. FOMO is a strong force, yet as Sir John Templeton once said, "The only investors who shouldn't diversify are the those who are right 100% of the time."[4] Investors may benefit from broadening their field of vision to other corners of the market where expectations are more modest and valuations more reasonable. Some of these areas include mid and small-cap U.S. equities, as well as international stocks and alternative investments.

In particular, public and private REIT valuations have fallen significantly after trading at extreme levels at the end of 2021. Since then, as interest rates shot higher and have remained elevated, REITS have gone out of favor as yields within the fixed income and credit markets have been more attractive and the cap rates within the real estate market have increased. As the Federal Reserve continues to cut interest rates over 2026, REIT valuations could return to favor.

Listed infrastructure stocks, which would include companies that operate utilities, railroads, sea and airports, and toll roads, have seen their valuations fall significantly since 2021.



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Principal Asset Management notes that they expect U.S. utilities to sign more agreements to meet data center demand, which has the potential to drive earnings growth rates higher at some infrastructure companies. The U.S. natural gas outlook should also remain robust, with physical demand in 2025 supported by new liquefied natural gas export facilities coming online and planned coal generation retirements.[5]

As we have faced elevated valuations and increased bouts of volatility in public we have continued to explore options within the private market. We are not alone in this push as other investment advisors have faced the same portfolio allocation questions we have.

KKR recently noted that in their 2025 RIA Private Markets Survey, they surveyed “more than 100 RIAs how they are using private markets, which asset classes appear most attractive, and where they see challenges and opportunities. Nearly half said they currently allocate 10% or more of their assets under management (AUM) to private market investments, and 81% expect to maintain or exceed that level within five years.”[6] As flows continue to increase into private markets and competition pushes improvements in the space, we expect costs, liquidity, and transparency to all move in the direction of benefitting investors. This comes at an opportune time when public market valuations are elevated and diversification remains a pressing concern.

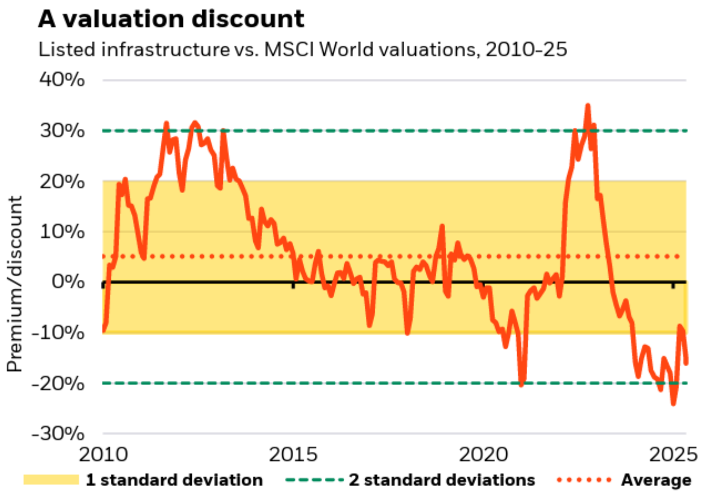
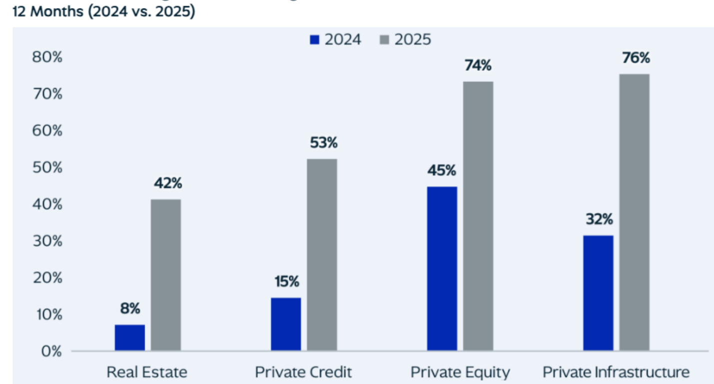


Chart Via Blackrock, as of 12/15/2025. Chart shown for illustrative purposes only. Past performance is not indicative of future results. You cannot invest directly in an index.

EXHIBIT 2A: Percentage of RIAs Planning to Increase their Allocation to Private Markets over the Next 12 Months (2024 vs. 2025)



Source: KKR 2025 RIA Survey. Data as of October 2025.

Closing Thoughts

In closing, we thank our clients for their trust and confidence as we managed their portfolios through yet another year with significant uncertainty and fluctuations in investment markets. We do not take our stewardship of your investment strategy lightly and strive to provide a financial plan and investment strategy that best meets your needs and goals.

The comparison between the AI boom and the internet boom ultimately leads to a familiar but important lesson: technological revolutions and market cycles rarely move in straight lines. Periods of rapid innovation can coincide with periods of stretched valuations, and both truths can exist at once. AI, like the internet, is likely to reshape industries, business models, and productivity in ways that are still difficult to fully quantify. But because markets tend to price in those expectations early, investors must distinguish between the long-term transformational potential of the technology and the shorter-term realities of valuation, cyclicality, and sentiment. History reminds us that even when the long-term story proves correct, the journey can involve sharp divergences between fundamentals and price.

Portfolio construction in this environment is less about predicting whether today is "1997 or 2000" and more about balancing optimism with discipline and marrying those two pillars to a well-constructed financial plan. Investors do not need to decide between being "all in" on AI leadership or abandoning growth entirely. Instead, they can acknowledge that leadership may continue in the near term while also recognizing that starting valuations matter for the next decade's returns. Emotions—FOMO during surges and fear during sell-offs—will almost certainly intensify as narratives around AI evolve. A thoughtful approach emphasizes diversification across styles, sectors, and geographies; seeks exposure to long-term themes without overpaying for them; and treats volatility as a feature of the markets rather than a bug.

In the end, the goal is not to perfectly time bubbles or breakthroughs, but to ensure we diversify our clients' portfolios so that we adequately balance the risk present with the targeted return. AI will likely join the internet, electrification, and industrialization as forces that permanently expand economic capability. Yet successful investors through past revolutions paired belief in innovation with respect for valuation, cash flows, and risk. By broadening opportunity sets beyond the most celebrated winners, maintaining discipline when narratives become loudest, and keeping time horizons aligned with financial goals, investors can benefit from the promise of AI without becoming captive to its hype. As always, we plan to closely monitor the investment markets and all of the cross currents that stand before us and look forward to working with you as we navigate another year.

DISCLOSURES

All data as of 12/31/25 via Morningstar, Bloomberg, Eaton Vance, St Louis Federal Reserve JP Morgan, the Wall Street Journal, and Bloomberg.

Charts via, in order of appearance, JP Morgan, Robert Shiller, Goldman Sachs, JP Morgan, JP Morgan, Fidelity, KKR, Bain.

(1) All data via Morningstar as of 12/31/2025

(2) **CME Fed Watch Tool -** https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html

(3) **Yahoo Finance -** https://finance.yahoo.com/news/earnings-calls-citing-ai-surge-122812349.html

(4) **Franklin Templeton -** https://www.franklintempleton.ca/en-ca/planning/investor-education/why-diversify

(5) **Principal Asset Management -** https://www.principalam.com/us/insights/listed-infrastructure/2025-global-listed-infrastructure-annual-outlook

(6) **KKR -** https://www.kkr.com/insights/2025-ria-survey