TERRA NOVA
ASSET MANAGEMENT

December 2025
Market Highlights

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In Brief

The S&P-500 Index ended November with a modest advance of 0.25% (17.8% year-to-date) despite significant intra-month volatility triggered by heavy Bitcoin selling. The Nasdaq declined as mega-cap tech and AI-exposed names faced valuation pressure early in the month, though sentiment improved sharply toward month-end, as expectations for a December Federal Reserve rate cut strengthened and Treasury yields stabilized. Sector rotation unfolded, with investors shifting from concentrated tech exposure toward retail, energy, industrial, and defensive sectors, while market breadth remained narrow as many smaller and mid-cap companies continued to lag. Liquidity stayed abundant, but concerns persisted about the long-term return profile of aggressive AI-related capital spending. The U.S. bond market rallied as Treasury yields declined across the curve, with the 10-year yield falling from 4.11% to 4.01%, driven by continued disinflation, softer labor-market data, and growing expectations of a December rate cut. Investment-grade spreads tightened, high-yield bonds benefited from improved risk sentiment, and Treasury auctions were well absorbed as investors positioned for a more accommodative policy stance heading into year-end.

Economy

The U.S. economy in November continued a soft-landing trajectory, with inflation easing across both headline and core measures. The Bureau of Economic Analysis revised Q2 real GDP growth upward from 3.0% to 3.8%, indicating strong productivity trends. Labor-market conditions moderated but remained stable, with slower, but sustained job creation, low unemployment, and easing wage growth. Consumer spending held firm, led by services, though lower-income households showed early signs of strain. Manufacturing remained weak amid soft new orders and global trade uncertainty, while business investment was concentrated in AI-related and data-center projects. Housing showed mild stabilization as mortgage rates drifted lower. Financial conditions eased toward month-end as Treasury yields declined, supporting risk appetite. Overall, November reflected a cooling, but expanding economy, with disinflation allowing greater Federal Reserve flexibility.

Monetary Policy

Monetary policy developments in November were dominated by rising expectations of a December rate cut as disinflation continued and labor markets softened at the margins. Fed officials signaled increased confidence that inflation was moving sustainably toward target while acknowledging that restrictive policy was cooling economic activity as intended. Short-term rate futures priced a high probability of a 25-basis-point cut, and markets began anticipating a more accommodative stance in early 2026 if inflation momentum continues to weaken. November marked a transition from a stance focused strictly on restraining inflation to one preparing for gradual easing.

Corporate Earnings

Corporate earnings in November reflected a mixed, but stable backdrop with widening dispersion between mega-cap technology firms and the broader corporate sector. Large technology and AI-exposed companies continued to post strong revenue growth, though margins were pressured by elevated capital expenditures and higher operating costs. Outside tech, earnings were more subdued, with consumer-facing companies noting cost pressures and early signs of demand softening among lower-income households. Industrial and energy firms delivered steadier results, supported by resilient service activity and stable commodity prices, while financials benefited from improved liquidity as yields declined. Earnings reinforced narrow market leadership concentrated in a handful of large technology firms.

Thoughts

Despite tariffs and inflation raising prices, U.S. consumers enter the holiday season in stronger financial shape than sentiment suggests. Employment remains high, wage growth steady, households are not overleveraged, and wealth has been boosted by record equity and home prices. Yet market performance in Consumer Discretionary has been weak, up only 1.2% year-to-date, largely due to company-specific issues at Amazon, Tesla, Home Depot, and Lowe's. By contrast, Walmart's 15.2% gain and the 21% rise in the S&P Apparel Retail index point to ongoing consumer resilience. The National Retail Federation expects holiday sales to rise 3.7%to 4.2% year-over-year, though surveys show planned spending slightly below last year amid low confidence. Job gains continued, 119,000 in September and 42,000 in October, despite layoff spikes in warehousing and tech. Debt levels have reached new highs, but inflation-adjusted balances have been flat for five years, and debt-service ratios remain near 20-year lows. Additional consumer support is expected in 2026 from President Trump's "One Big Beautiful Bill Act", which raises the SALT deduction to $40,000, expands senior tax deductions, and enhances tax relief for workers with tips, overtime, and auto-loan interest. Retail earnings showed selective, but resilient spending, and AI adoption has accelerated, with 30% to 40% of consumers using generative AI for shopping research and AI agents such as ChatGPT and Amazon's Rufus driving higher conversion rates.

Stock Market Outlook

The outlook for December is shaped by expectations of a Federal Reserve rate cut, ongoing disinflation, and easing financial conditions. Equity markets enter the month with momentum, but remain sensitive to earnings quality, particularly among mega-caps where valuations are elevated. Bond markets are positioned for further yield declines if inflation continues to soften, though volatility may rise if economic data surprises on the upside. Consumer spending during the holiday season will be a key indicator of household resilience. Overall, December should deliver a constructive but data-dependent environment, with markets focused on the Fed's policy path, inflation trends, and whether economic cooling remains orderly.

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