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In Brief

December trading was marked by light holiday volumes and modest profit-taking after a strong year, yet the S&P-500 closed 2025 up 17.9%, reflecting resilience in earnings, technology and AI leadership, and constructive investor sentiment. Large-cap stocks continued to attract inflows, while smaller caps lagged, suggesting selective rather than speculative risk-taking, and the traditional year-end seasonal rally was muted by positioning ahead of 2026 rather than weakening fundamentals. Markets enter the new year supported by expectations of continued earnings growth, stable-to-easing monetary policy, and manageable geopolitical risks. Bond markets in 2025 marked a turning point after several years of rising interest rates. As inflation gradually eased, interest rates stabilized, reducing the sharp price swings that had previously weighed on bonds. Shorter-term bonds benefited first from higher yields and limited price volatility, while longer-term bonds began to recover as expectations for future rate increases diminished. Entering 2026, the bond market outlook is more constructive: yields remain relatively attractive, providing meaningful income, and bond prices could benefit modestly if inflation continues to cool or interest rates decline gradually. At the same time, longer-term bonds remain more sensitive to inflation surprises and government borrowing needs, which may cause periodic volatility. Overall, bonds are once again positioned to provide income, diversification, and stability, with different maturities offering distinct roles depending on time horizon and risk tolerance.

Economy

The U.S. economy in 2025 proved more resilient than many expected, supported by steady job growth, continued wage gains, strong consumer spending, and ongoing business investment, particularly in technology and productivity-enhancing areas. Real GDP grew at a strong annualized pace of approximately 4.5% in the third quarter. Inflation continued to moderate over the year, easing pressure on household budgets, while interest rates stabilized at levels that slowed, but did not derail economic activity. Entering 2026, the economic outlook remains generally positive, but more balanced: growth is expected to continue at a moderate pace, driven by innovation, investment, and consumer resilience, while challenges include higher living costs for some households, fiscal constraints, and ongoing geopolitical and trade-related uncertainty. The most likely scenario is continued expansion rather than recession, though periods of slower growth or volatility are possible as the economy adjusts to higher interest rates and global uncertainty. Overall, the economic environment supports cautious optimism, with an emphasis on stability, adaptability, and long-term fundamentals rather than rapid acceleration.

Monetary Policy

Monetary policy in 2025 marked a clear inflection point as the Federal Reserve shifted from a restrictive stance to a gradual easing cycle. As inflation decelerated and real rates became increasingly restrictive, the Fed began lowering policy rates, signaling confidence that disinflation was sufficiently entrenched to support a gradual normalization of monetary conditions. This easing reduced downside risks to growth and helped stabilize financial conditions without reigniting inflation pressures. Entering 2026, policy is expected to remain data-dependent and measured rather than aggressive; additional rate cuts are possible if inflation continues to trend lower and labor-market tightness eases, while the Fed is likely to pause if growth reaccelerates or price pressures re-emerge. Overall, the policy framework reflects a late-cycle balancing act aimed at sustaining expansion, preserving credibility, and avoiding both premature stimulus and unnecessary restraint.

Labor Market

The labor market in 2025 gradually shifted from the exceptionally tight conditions of prior years' toward a more balanced state. Job growth slowed, hiring became more selective, and wage increases moderated as employers focused on retaining existing staff rather than expanding aggressively. The unemployment rate edged higher to 4.5% from historically low levels of around 3.7%, reflecting normalization rather than stress, while labor demand remained supported in areas such as healthcare, construction, and skilled services. Looking ahead to 2026, the labor market is expected to remain stable but less dynamic, with modest job growth, steady participation, and more contained wage pressures. Structural factors-including demographics, immigration trends, and increased use of automation and AI are likely to shape employment patterns across sectors. Overall, employment conditions are expected to support continued economic activity, even as the pace of hiring and wage growth settles into a more sustainable range.

Corporate Earnings

In 2025, corporate earnings proved more resilient than expected, supported by steady demand, easing cost pressures, and productivity gains driven by technology and automation. Profit growth was not limited to a small group of companies, although leadership remained concentrated in sectors benefiting most from innovation and scale. Looking ahead to 2026, earnings growth is expected to continue at a solid pace, supported by ongoing investment, improving financing conditions following interest-rate cuts, and gradual efficiency gains rather than rapid revenue acceleration. At the same time, expectations are elevated, and outcomes will depend on the sustainability of margins, labor-market dynamics, and the broader economic environment. Overall, the earnings cycle remains intact, but results are likely to vary more widely across sectors and companies as growth normalizes.

Thoughts

The economic effects of tariffs to date have been partly absorbed and are unlikely to intensify materially under the most probable legal and policy scenario. While some tariff impacts, such as higher input costs, selective price increases, and supply-chain adjustments, were felt relatively quickly, longer-term effects have largely been mitigated by business adaptation and supportive domestic demand. Importantly, the U.S. Supreme Court is expected to clarify limits on the executive branch's authority to impose broad tariffs without explicit congressional approval, which would constrain the scope for new, large-scale tariff actions going forward. Under this scenario, future tariff policy would likely require greater congressional involvement, reducing the risk of sudden or expansive trade measures. As a result, while tariffs remain a structural consideration, the likelihood of significant delayed or second-round economic drag is low under this scenario, supporting a more stable outlook for growth and pricing dynamics.

Stock Market Outlook

The stock market outlook for 2026 remains broadly constructive, though returns are likely to be more uneven than in recent years. Equity markets continue to be supported by a combination of economic expansion, solid corporate earnings, and easing monetary policy, which together provide a favorable backdrop for business growth. At the same time, market expectations are higher following strong prior-year performance, while valuations in certain segments leave less room for disappointment. As a result, periods of volatility are likely, particularly around economic data, policy decisions, or geopolitical developments. Overall, the environment favors steady participation rather than rapid acceleration, with market outcomes increasingly shaped by company fundamentals and sector-specific developments rather than broad market momentum. Sustained productivity gains, robust corporate investment, and real GDP growth of roughly 3% to 3.5%, support a 60% probability of double-digit earnings growth and an S&P-500 target of approximately 7,700 by year-end 2026. However, we also anticipate that there is a risk of a market correction along the way, as well as a 20% risk of recession, underscoring the importance of diversification, valuation discipline, and active risk management as portfolios are positioned for long-term objectives heading into the new year.

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