# Review & Outlook

## Fourth Quarter 2025

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### Review and Outlook

The final quarter of 2025 ended generally higher for the U.S. markets, though the enthusiasm from mid-year was curbed significantly. The S&P 500 was up a little over 2% for the quarter, Money Market Funds paid out almost 1%, and the 10-Year Treasury rate, which is relevant to the mortgage market and corporate financing, stayed within a fairly narrow range between 3.97% and 4.19%.

For much of the quarter (October 1st to November 12th) the Federal government was shut down, creating uncertainty, since collection and publication of important economic data ceased. With this in mind, the financial markets actually seemed to weather the quarter quite well.

Global markets continued the trend from earlier in the year, and significantly outperformed U.S. markets in the fourth quarter. This includes both developed markets (MSCI EAFE Total Return Index) and developing markets (MSCI Emerging Markets Total Return Index) which returned 3.75% and 4.26%, respectively. And some of the most dramatic increases this past quarter were observed in the price movements of gold (up 11.3%) and silver (up 50.1%).

**Index Performance Data**
**Total Return as of 12/31/2025**

| Indices[1] | Q4 2025 | Trailing 12 Months |
|---|---|---|
| CRSP U.S. Total Market Index Total Return | 2.45% | 17.15% |
| iShares MSCI ACWI EX-US Total Return | 3.26% | 28.70% |
| Bloomberg U.S. Aggregate Bond Index | 1.10% | 7.30% |

Taking a look at the available economic data for the fourth quarter, consumer prices continued to move up, with inflation hovering close to 3%, which is noticeably above the Federal Reserve's target of 2%. The labor market also continued to show signs of weakness, with unemployment increasing to 4.6%. While that figure is not high by historical standards, the move upwards was noticeable, and the headline measure may be a bit misleading. Demographics and changes in immigration patterns can mean fewer unemployed and/or fewer people looking for jobs. That is, the overall rate of unemployment is far from alarming; it is other indicators in the labor market that invite questions. For instance, the unemployment rate for college graduates is at levels only seen during recessions; hiring has been tepid, with wage growth slowing; and consumer sentiment continues to be dreadful.

While inflation is higher than target, the markets seem to feel that the Fed is still in a rate-lowering cycle, which provides a tailwind. Despite concerns about inflation and weakness in the labor, the stock market had a very positive year. The S&P 500 Index fell almost 20% from early March to the first week of April, but ended up gaining more than 16% for the year. The wealthy continued to spend freely, and one segment of the economy that kept spending even more freely was infrastructure and research related to AI.

With mixed signals in the data and historically high stock valuations in a number of sectors, there are legitimate concerns about how long the stock market can continue to march higher. As we enter 2026, consumption should be boosted by new tax cuts kicking in and stimulus spending by the federal government, which is running a multi-trillion-dollar deficit. The Federal Reserve is also expected to lower interest rates one or two more times in the coming year. As long as the U.S. government can sell Treasuries to finance its debt, the combination of deficit spending and lower taxes has historically been a powerful tonic for the markets.

S&P Global predicts that growth will continue into 2026, fueled by the aforementioned tax cuts and continued spending. However, growth forecasts are not universally positive; the Economic and Revenue Forecast Council in

Washington State anticipates no growth in 2026. They imagine recently announced layoffs in the tech industry, whether due to AI productivity gains replacing employees, or simply cost cutting measures, are likely to offset limited growth in other sectors. These different forecasts remind us that economic activity is not uniform across the country. Moreover, we have to keep in mind that the economy is not the stock market. Wall Street generally expects the strong performance we've seen from stocks over the past several years to continue into 2026. But that is more about momentum, where double digit gains one year tend to lead to gains, albeit more modest, the following year.[2]

As we noted in our last Review and Outlook, many businesses have been spending a lot of money on AI infrastructure and programs. No one wants to be left out or miss the changes sweeping across the business world. But current versions of AI models do not seem ready to generate revenue sufficient to justify the spending. Moreover, consumer spending is suspect. Imbalances between spending and stock prices do not have to correct immediately, but they do point to a period of more modest returns. High valuations are not generally useful as a near-term market timing tool, but they do tend to suggest lower future returns. In this setting, some sort of negative shock could trigger a correction. But we largely agree with Wall Street that absent any negative catalyst, business investment in AI could continue well into 2026.

In short, the economy has been surprisingly resilient, at least when looking at headline metrics like GDP growth and unemployment rates. In addition, the stock market has been impressive. Growth can continue, but there is an increasing sense of fragility about the overall environment, where an unexpected external shock could produce a significant correction.

**In Focus**

While forecasts generally see continued growth, we are concerned about a few disconnects we see in the economy that have the potential to negatively impact areas that have seen the strongest growth in the past year. For instance, we have concerns about the potential gap between the level of current spending on AI infrastructure and programs and the anticipated revenue from AI. A July 2025 study from MIT found that 95% of AI deployment failed to deliver value.[3] That is, only 5% of AI pilot projects deliver measurable value, highlighting the divide between spending and return.

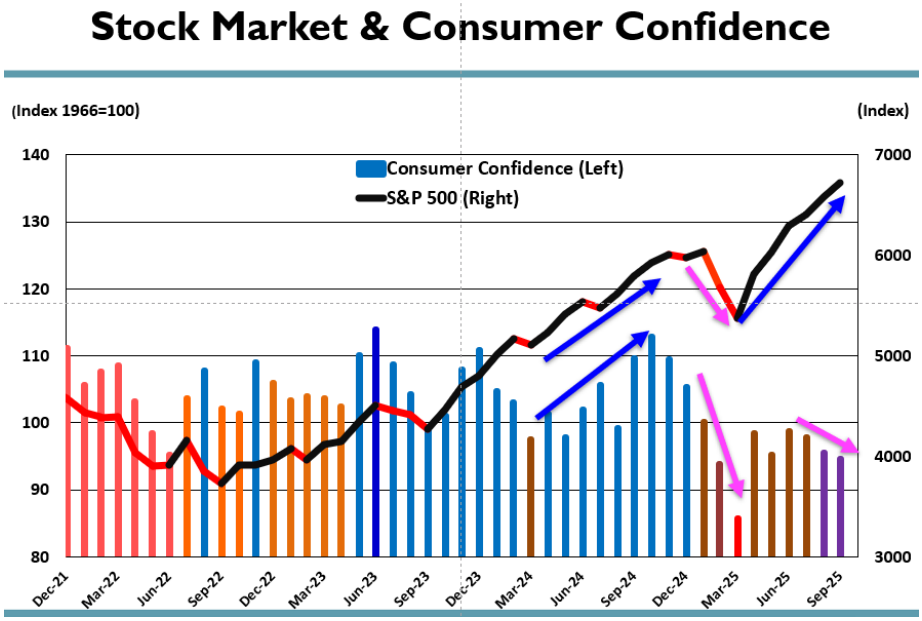
The challenge for investors is deciding whether AI models will improve enough to be valuable before the spending becomes a burden. As AI-related investment is increasingly being funded with borrowed money, this leverage in the system adds risk. Wall Street predicts AI spending will continue into 2026, pushing stock prices higher. Yet concerns are growing that the value is not there to justify the spending. Put another way, more people are starting to wonder if the evolution of AI can happen fast enough for true value to arise in the very near future. The MIT report notes the divide isn't inevitable, meaning the revenue versus spending divide does not necessarily lead to problems because the gap between revenue and spending can be bridged. But bridging that divide requires a significant shift in how we use AI, and will require new phases, or generations, of AI. Without the AI spending in the economy, both economic and market growth would have been significantly lower in 2025. If AI starts to meaningfully fizzle in 2026, a negative feedback loop of lower growth estimates leading to lower stock prices, with that associated negative wealth effects, could be very challenging to the stock price of many of the very large tech companies, and the valuation of the market as a whole.

Another disconnect is between general consumer sentiment and stock market performance, as illustrated in the graphic below.[4] This chart shows how the typical strong, positive correlation between sentiment and stock market performance has broken down recently. And while it may be due to different groups being responsible for the two series; with lower income households driving sentiment survey responses, and higher income households driving the stock market; it still seems that the two cannot diverge for very long. At some point, falling sentiment leads to reduced spending, even if for just lower- and middle-income households, which in turn results in lower earnings and lower stock returns.

A third area of concern is the housing market, where some markets are starting to reverse their post-COVID gains.

Inventories of houses for sale continue to grow, and many of those properties are taken off the market because buyers cannot afford such high listing prices. The disconnect here is that a lot of sellers may feel strongly that their house is worth more than buyers are willing or able to pay.

As insurance and property taxes continue to rise, wage growth stagnates, and mortgage rates remain high (particularly in regions of Florida), we might start to see home prices drop as sellers can no longer afford to wait. While forecasts for home prices are still generally positive, it is notable that the term "buyers' market" is showing up more frequently in market commentary.




And over the past several years, a large amount of single-family housing has been purchased by private equity. If the home buying companies start to become sellers, anticipating a price correction, this could accelerate the downward movement of home prices, which could push down consumption as people cut back in response to lower banked home equity.

While we always scan for areas of concern, over time, the markets and the economy continue to grow. The U.S. economy continues to be resilient and dynamic, and the worst-case scenarios have failed to play out. 2025 provided a great example of this, as especially negative market sentiment in early April was followed by enthusiastic market growth for months, as the doomsday scenarios for tariff-driven inflation failed to materialize. As we move into 2026, we are cautiously optimistic that we will have a solid year of growth, even if some of it is just residual momentum from the gains of the past three years. In particular, we believe that growth in many global markets will continue to be impressive.


1. Index performance data provided by ICE Data Services, and calculated by Black Diamond, an SS&C Advent company.
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3. "MIT Report Finds 95% of AI Pilots Fail to Deliver ROI, Exposing 'GenAI Divide.'" Legal.io, 23 Aug. 2025, https://www.legal.io/articles/5719519/MIT-Report-Finds-95-of-AI-Pilots-Fail-to-Deliver-ROI-Exposing-GenAI-Divide
4. Dhawan, Rajeev. Economic Forecast Chart. 2024. Unpublished chart.



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