



Quarterly Recap – December 31st, 2025

The year ends with nearly every asset class higher for the year, and most major equity indexes at all-time highs. Uncertainty was high entering the year. Equity valuations were stretched, interest rates were unpredictable and volatile, and a new presidential administration was shaking things up. Tariffs were specifically disruptive, causing a panicked selloff in markets in April. With the exception of tariff angst, however, equities have had a quiet positive year, while interest rates moved gradually lower.ⁱ

Economic concerns have lingered in the background for much of the year. Inflation remains higher than desired, buoyed by tariffs and housing costs. The labor market slowed by many metrics. But it's difficult to disentangle the effects of a shrinking federal workforce and net-zero immigration combined with ramping deportations. The most recent GDP data shows an economy growing by 4.3% in the third quarter. This growth comes with a continued divergence in consumer spending in a so-called “K-shaped” economy. The wealthiest are doing well, while others feel the weight of inflation eroding their purchasing power. Much of the most recent data could be considered tainted by the shutdown of the federal government.ⁱⁱ

Equity markets have performed well since the selloff in April, with little volatility and few drawdowns. Early in the year we saw international and smaller companies outperform for the first time in a while. That changed following the “Liberation Day” selloff, as the largest technology companies once again resumed their leadership. Equity markets remain expensive and increasingly dependent on the promise of AI.ⁱⁱⁱ

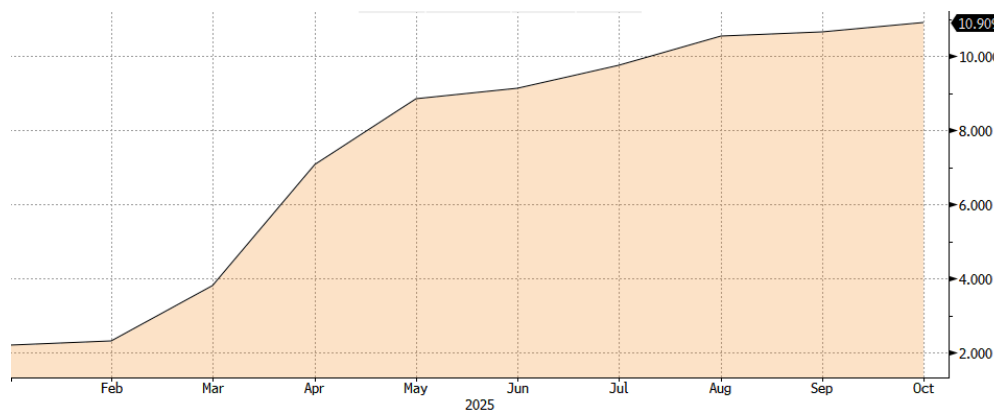
The Federal Reserve lowered rates by another half point in total during the fourth quarter and projects one more cut before May. As a result of President Trump’s attacks on Chairman Powell, as well as confusing economic conditions, the Federal Reserve has become increasingly divided on the path of policy. We argue that diversity of opinion is a positive development long-term. The transition from Powell to an undetermined future Chairman nevertheless represents a risk to markets and the economy.

Markets have done well for three years in a row and valuations are stretched. Irresponsible deficit spending and sticky inflation will persistently pressure long-term interest rates for as long as they remain in place. However, the new year brings fresh stimulus from the One Big Beautiful Bill, the hope of lower short-term interest rates, and an economy that continues to defy fears of a slowdown. There is no need to apologize for reducing portfolio risk, but also little reason to fear an imminent selloff.

INDEX RETURNS ^{iv}	4 th Qtr	2025	2024	TREASURY RATES ^v	12/31/25
MSCI All Country World	3.4%	22.9%	18.0%	Fed Funds	3.63%
S&P 500	2.7%	17.9%	25.0%	3 Month	3.63%
Dow Jones Industrial	4.0%	14.9%	15.0%	2 Year	3.47%
Russell 2000	2.2%	12.8%	11.5%	5 Year	3.73%
EAFE	4.9%	32.0%	4.5%	10 Year	4.17%
MSCI Emerging Markets	4.8%	34.3%	8.0%	20 Year	4.79%
BC Aggregate Bond Index	1.1%	7.3%	1.3%	30 Year	4.84%

Economic Developments

Investors were on edge at the start of 2025. When the “Liberation Day” tariffs were announced, economists and investors warned that it would spark a global economic downturn. Stock markets reacted quickly, with many indexes diving more than 10% in response to the announcements. A ninety-day delay on most of the tariffs was welcome, but many investors were nevertheless resigned to the reality of a trade-driven recession at some point in 2025. Ironically, the only truly weak GDP data point came in the first quarter, as a result of importers buying materials and products ahead of the then-unknown tariff policy changes.^{vi}



That -0.6% GDP number was followed by +3.8% in Q2 and the most recent reading of +4.3% for Q3. If anything, the economy is slightly accelerating.^{vii} It's possible that without the tariffs these readings would be even higher.

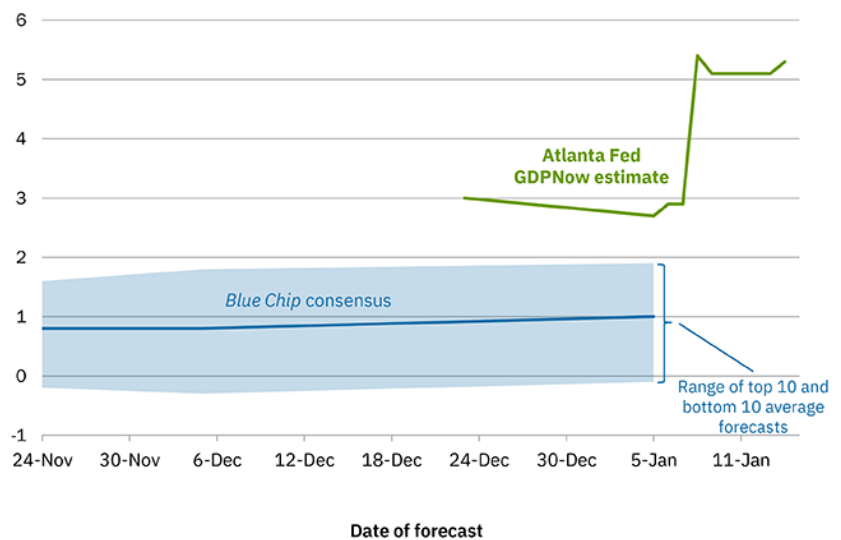
The actual tariff rate for goods entering the US climbed steadily through the year and now sits near 11%.^{viii}

It's also possible (almost certain, we'd say!) that the tariffs in their original form, without the subsequent delays and amendments would have caused significant economic disruption. But at this point the US has collected hundreds of billions in revenue without majorly crimping GDP.

During the post-Covid period we have seen multiple disruptive events that could have caused a recession – the Ukraine War, 2022's rate hikes, the 2023 banking crisis, and tariffs – and the US economy has overcome them all without succumbing. The (very early) GDPNow estimate for Q4 is an incredible 5.3%!^{ix}

That's not to say that everything is rosy. Moody's Analytics recently released a data point indicating that the top 10% of earners drove 49% of consumer spending in the second quarter.^{xi} This is a trend we've highlighted, and it's only gotten more extreme as markets continue

Evolution of Atlanta Fed GDPNow real GDP estimate for 2025: Q4
Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

The current GDPNow estimate for the fourth quarter is over 5%.^x

to perform well while inflation remains stubborn. Owners of assets such as houses and stocks benefit from rising asset prices and are comfortable spending. Renters and borrowers, meanwhile, are frustrated by the cumulative effect of inflation reducing their overall purchasing power. This so-called “K-shaped” economy (high earners going up, low earners going down) is a major reason why GDP can perform well while consumer sentiment is low.

While the top 10% might be disproportionately supporting the economy with their spending, there are a larger number of people who are struggling to keep up.

Inflation has become less important to investors, as it remains entrenched in the high-2%’s – higher than we’d like, but not by much.^{xiii} But as a political talking point it’s becoming more salient. For example, after winning the Democratic Party mayoral primary, new NYC Mayor Zohran Mamdani campaigned nearly exclusively on “affordability.” The bottom line is that wage growth has not kept pace with price increases, and the gap cannot be reversed overnight. We’ll need multiple years of wage growth outpacing inflation to make up the difference – a difficult outcome to achieve if inflation stays where it is.

The labor market is extremely difficult to understand at the moment. On the surface it appears to be weakening substantially. In a recent press conference Federal Reserve Chairman Powell compounded the weakness, stating that payrolls are overstated by 60k per month since April. The Bureau of Labor Statistics models the creation and destruction of small business using a “birth/death” model, since these companies don’t report directly to the government. We’ll get their exact adjustment in February, but it appears that they’ve been overestimating jobs substantially for much of 2025. Adjusting recent months downward by 60k jobs puts the US in negative job growth for the last six months. Historically, 10 of the 11 times that this has happened the US economy was in a recession.^{xiv} So why is the economy shrugging it off right now?

Wallets Open

High-income Americans are behind roughly half of all US consumer spending, up from about a third in the early 1990s

✓ Share of Spending By Consumers in Top 10% of Income Distribution

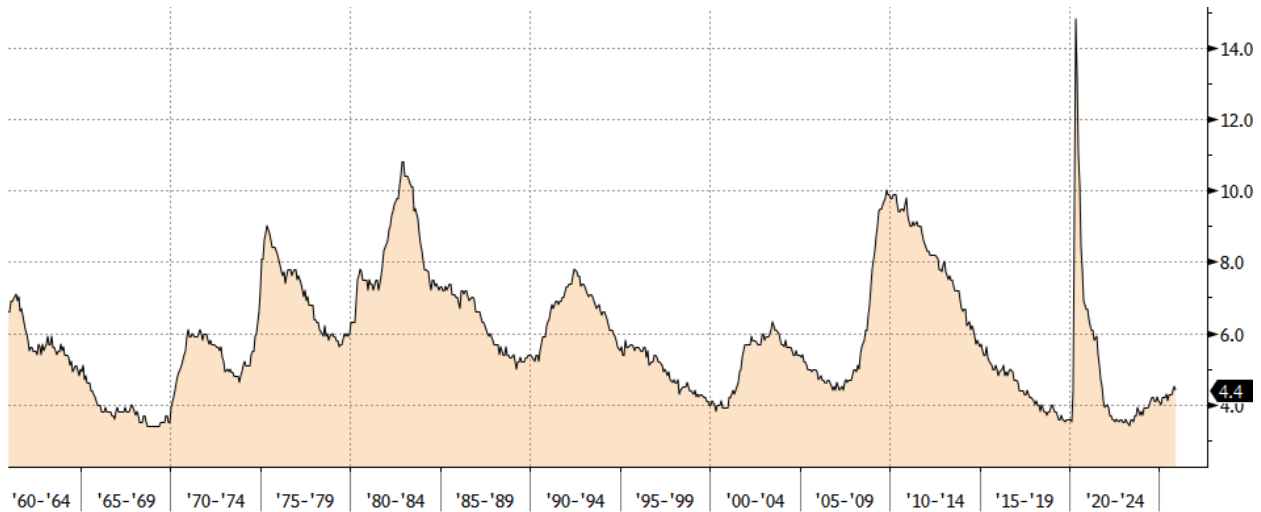


Source: Moody's Analytics review of Federal Reserve data

Bloomberg

High-income consumers are spending, while lower-income consumers are struggling to keep up with inflation.^{xii}

The main offsetting factor in the current environment is population growth. 2025 was possibly the first and otherwise-only time since the Spanish Flu when the US population shrank. Even the years of the Civil War saw an expanding US population. A combination of net-zero immigration and low domestic birth rates has reduced the need for job creation to what would normally be crisis levels.^{xv}



The unemployment rate has been trending higher since 2021. But when compared with previous periods, 4.4% unemployment is unexceptional.^{xvi}

The unemployment rate has also slowly been rising, another potentially worrisome sign for the labor market. The current rate of 4.4% is quite a bit higher than the lows of 3.5% in 2022 & 2023, and it's also the highest level since the recovery from the pandemic. When we zoom out, though, this level is lower than the rate was during strong economic periods such as the late 90's and mid-00's.^{xvii} Further, the current unemployment rate is seeing pressure from systemic issues. The Trump administration offered federal employees the opportunity to voluntarily resign at the end of September. Combined with other ongoing headcount reductions from DOGE, this has resulted in a noticeable decline in government employment.^{xviii} There has also been a divergence between employment rates for recent male and female graduates, with men disproportionately struggling to find work. This is largely due to early effects of Artificial Intelligence on the workforce. Entry-level jobs in heavily-male fields such as software engineering are being replaced by AI, while heavily-female careers such as teaching or nursing are unaffected. While these societal trends are worth monitoring, it is difficult to prescribe a policy antidote.^{xix}

The political news cycle for 2026 didn't miss a beat as Trump announced the capture of Venezuela President Nicolás Maduro on the morning of January 3rd. This follows months of military footsie during which the administration attacked alleged cartel drug-running boats and seized oil tankers. The capture of Maduro is a vivid demonstration of American military competence, a shot across the bow for other troublesome dictators, and a noteworthy change in geopolitical control of oil reserves. While Venezuelan reserves are rumored to be exaggerated in size, and viscous in quality (difficult and expensive to transport and refine), the Venezuelan government was deliberately ignoring global sanctions with their exports.^{xx} It will be difficult to convince American oil companies to once again invest in infrastructure to extract this oil after their wells were confiscated by Hugo Chávez in 2007. But at least the current export capacity is now in more-friendly hands. It remains to be seen whether this portends further US adventurism in Colombia, Cuba, Greenland, or elsewhere.

The tariffs have been a major plot point of 2025, but are threatened to be overturned in 2026 as they are legally challenged in front of the Supreme Court. The President has touted them as a revenue generator, but used them as a geopolitical weapon. This blurs the line between taxation, which Congress must legislate, and foreign policy, where the President has autonomy. Trump has heavily used “taxation”-style rhetoric as he promotes the ongoing revenue generation. Safer language would have been emphasizing that the tariffs are “sanctions” which incidentally generate revenue, but that also would have implied that the tariffs are largely temporary until the United States gets what it wants.

As we edit this draft on January 13th, savvy pundits believe that the tariffs will be overturned in their current form, which will certainly be a noteworthy headline. It will be interesting to see how that plays out if so. First, it’s not clear whether the tariffs will need to be refunded, and if so, how? Second, the administration has alternative methods for implementing tariffs, which it will certainly pursue. The cleanest way for this to be resolved is for the Supreme Court to overrule the tariffs, but put the responsibility for oversight in Congress’ hands. This would largely uphold the status quo, as a Republican-majority congress will be unlikely to provide much pushback on the Republican executive. Regardless, it represents a major risk to markets, potentially causing significant ongoing volatility depending on the text of the ruling and the resulting political maneuvering.



The likelihood that the Supreme Court rules in favor of Trump’s tariffs is currently 32%. It fell dramatically during questioning in November. But there’s still a meaningful chance that they will stand. Even if struck down, it’s not clear what the legal remedy will be.^{xxi}

While midterms are still nearly ten months away, we are seeing some indications of what the major messaging will be. “Affordability” is likely to stay a dominant message from the Democrats, and for good reason. More worrisome is the proposed 5% wealth tax on “billionaires” in California but which could be repurposed later to “centi-millionaires” and so on. It’s similar to the tax on unrealized capital gains which Presidential candidate Kamala Harris proposed in 2024, and which was partially responsible for the exodus of Silicon Valley support to the Republican party. It’s beyond the scope of this newsletter to delve into this policy in detail. But suffice to say that the friendly taxation on start-ups is a key reason that the United States is so entrepreneurial. We are receptive to the idea that billionaires are gaming the system when they borrow money against their significant wealth in order to avoid realizing capital gains. But there are certainly other ways to close that specific loophole without setting new precedents for tax policy.

Preserve – Interest Rate Commentary

The Federal Reserve lowered interest rates twice more during the fourth quarter, making three cuts in a row, and lowering rates 1.75% in total since September of 2024. There's one more cut anticipated in the first half of 2026. The most recent vote was a contentious 9-3. Usually the votes are 12-0 in order to signal conviction, even if the Fed disagrees internally. It's not just notable that there were three dissents, but also that the dissents went in two different directions. New Trump-appointee Stephen Miran favors more aggressive rate cuts, and publishes regularly on his website outlining his rationale. Meanwhile two other voters thought it was more appropriate to leave rates unchanged.^{xxii}



The "Dot Plot" shows where members of the Federal Reserve expect interest rates to be at the end of various years. The most recent update shows a wide variety of opinions.^{xxiii}

In December the Federal Reserve also released their "Summary of Economic Projections" which includes the "Dot Plot." The Dot Plot shows the projections for each of the nineteen members of the Federal Reserve – not just the twelve voters – regarding interest rates, inflation, GDP, unemployment, and other data points. The most interesting of these is the path of interest rates, since the Fed has direct power over where short-term interest rates end up. The Dot Plot confirms that the Fed has deep disagreements over current policy. Regarding interest rate policy for 2025, six of the nineteen indicated that the interest rate cut in December was not appropriate, and three believe that we should have kept it unchanged through 2026 as well... and two of them think it should have stayed there through 2028! Meanwhile Stephen Miran thinks a 2% rate is appropriate by the end of 2026 (vs. 3.5% right now), and other members fall at different levels between those extremes.^{xxiv}

Now that Fed voters are willing to dissent, Trump's attacks on Powell are much less effective. Long-term, this is a good thing for the Federal Reserve, and it aligns them with the behavior of other central banks, as well as institutions such as the Supreme Court. Sometimes a 12-0 vote makes sense because everyone's on the same page. But a 12-0 vote is less credible when we know the environment is uncertain, and *especially* when voting members of the Fed voice their concerns to the public on a regular basis. Dissenting voices would also demonstrate that the Fed isn't falling prey to groupthink. Finally, allowing for dissent also encourages heterodox thinkers to join the Fed. Smart economists should love serving in such a role, but they might be discouraged from joining by the impression that they'll have to behave academically dishonestly. Normalizing dissent as a healthy part of discourse is a good thing, especially in a science like economics where cause and effect can be so murky. Finally, dissent is useful for signaling to the public. A 12-0 vote to lower rates hides dissent, meaning that we don't know how much farther rates will eventually go. A 9-3 or 7-5 vote to lower rates has the same effect of lowering rates, but also signals that further rate cuts are unlikely.



Kevin Hassett being nominated for Federal Reserve Chairman was a near certainty in December. However, market pushback led Trump to reconsider. Hassett and Warsh are the current frontrunners.^{xxv}

Federal Reserve Chairman Powell's term is over in May of 2026. He was originally nominated by Trump in his first administration, but Trump soured on him relatively early. Powell's tenure was later renewed by Biden. During his 2024 campaign Trump criticized Powell, especially when the Federal Reserve lowered interest rates before the election. It's been a foregone conclusion that Powell would not serve another term as Chairman. Very recently the Department of Justice dramatically escalated the situation by serving Powell with a criminal subpoena. The move has been criticized, including by some senators whose votes might be needed to confirm Powell's successor. It is typical for the outgoing Chairman to resign his post, but it's also possible that Powell will stay until his term ends in 2028 in order to further frustrate

Taylor Rule Fed Funds Prescription Heatmap for 2025:Q4

Export

Measure of gap (consistent with Congressional Budget Office)

	Fed U-3 Gap	U-3	ZPOP	U-6	Emp-Pop	GDP
2%	4.79	4.96	4.92	4.77	5.51	6.36
FOMC Longer-run	3.79	3.96	3.92	3.77	4.51	5.36
HLW 2017 model	3.88	4.04	4.00	3.86	4.60	5.45
LW 2003 model	4.36	4.52	4.48	4.34	5.08	5.92
LM 2015 model	4.94	5.11	5.07	4.92	5.66	6.51

Inflation target: 2.0 percent
 Inflation measure: Core PCE inflation, 4-quarter
 Fed funds rate: Current target fed funds rate, midpoint of range (3.625)
 Weight on gap: 0.5
 Interest rate smoothing: 0
 Source: Atlanta Fed

the President in retaliation.

It's still not clear who will be appointed to follow Powell. For months investors have tracked prediction websites to follow the action playing out behind-the-scenes. At the moment Kevin Warsh and Kevin Hassett are the leaders, though there's still a 20% chance it's someone else. At one point Kevin Hassett was nearly 85% certain. But it's apparent that investors want to see a nominee who is not

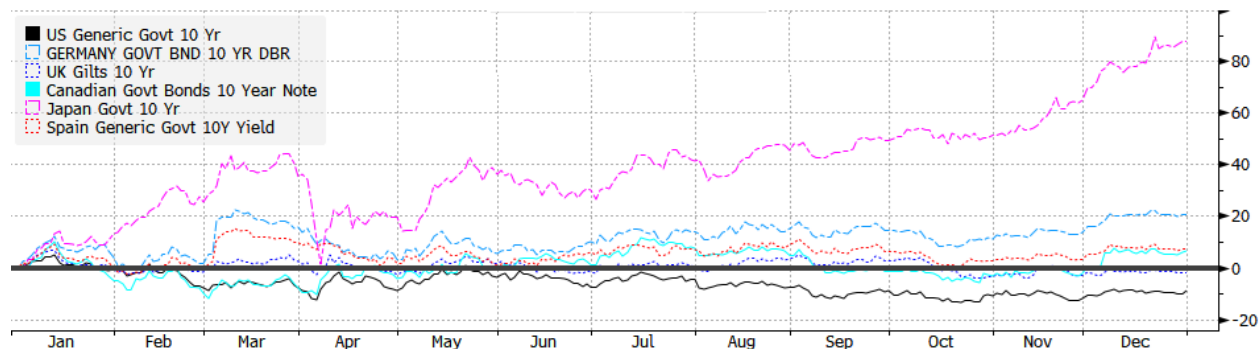
Federal Reserve Bank of Atlanta

This graphic from the Federal Reserve Bank of Atlanta compares different models for interest rates with the current level of interest rates. Right now every model indicates that interest rates are, if anything, already too low.^{xxvi}

going to do the bidding of the President. As we prepare this newsletter, Trump has once again said that he's chosen someone. While Trump wants someone who aligns with him ideologically, investors want to be sure that the nominee is independent, and the rest of the Federal Reserve is prepared to dissent against a nominee who they believe is acting imprudently. One thing's for certain: the new Fed Chairman will have a tricky landscape to navigate with a dubious investing public, a contentious Federal Reserve, and a hot-headed President.

Earn – Bond Market Commentary

The bond market was quiet during the fourth quarter, returning roughly 1%. During the year the Bloomberg Aggregate index returned 7%, outearning inflation and acting as a relatively uncorrelated complement to stocks. Short- and long-term interest rates fell during the year. Short rates are largely controlled by the Federal Reserve, so interest rate cuts led to lower rates. Long-term rates are difficult for the Fed to control. They trade in sympathy with inflation and economic growth. Of all developed nations, only the US had noticeably lower 10-year interest rates in 2025.^{xxvii}



The US (black) is the only developed country whose 10-year interest rate fell meaningfully during 2025.^{xxviii}

There's no obvious reason why the US was an outlier compared to other nations. Inflation is still uncomfortably high. Growth is solid and potentially accelerating. The fiscal situation for the federal government has hardly improved, despite the initial budget cutting exercise led by DOGE. And the stimulus in the One Big Beautiful Bill mostly goes into effect this year. It's possible that the reason the 10-year interest rate has fallen is because it's an explicit focus of the current administration. Treasury Secretary Scott Bessent said early in his tenure that they should be judged by the behavior of long-term interest rates. Indeed President Trump is the only major leader criticizing his central bank and taking an intense interest in its decisions regarding monetary policy.^{xxix}

“He [President Trump] and I are focused on the 10-year Treasury.”

Credit markets were largely quiet

-Secretary of the Treasury Scott Bessent, February 2025

during the fourth quarter. Spreads between corporate bonds and Treasuries remain narrow. This reflects broad comfort with credit conditions – understandable considering that the economy is growing, markets are rallying, and interest rates are moving lower.^{xxx} We don't anticipate imminent credit concerns. However, we note that when credit spreads are tight, upside is limited. An investor is essentially only able to collect the coupon, while any hiccup in the economy can cause a selloff in the price.

Private credit was the major story of the fourth quarter. This area of the market has been hot for several years. In the wake of the 2008 Great Financial Crisis, banks were understandably required to tighten lending standards significantly. This raised the cost of

lending, opening the door for other lenders to undercut them. This prompted the growth of private credit, where asset managers collected assets to lend, rather than lending deposits from a bank. This can take the form of hedge funds, interval funds, or publicly-traded business development companies (BDCs). On the one hand, it's better than a bank because the money could not be withdrawn, but a major drawback was the relative lack of oversight compared to the highly-regulated banking sector.

Private credit has grown greatly over the years, from less than \$100 billion in 2007 to as much as \$1.7 trillion in 2025.^{xxxii} A major reason for the growth has been the consistent strength of the economy during this period. With the exception of Covid, the economy has not been through a credit cycle since private credit's growth started in earnest. This has been great for managers who have continued to offer the product to a growing range of investors. But many have been cautious, worried that the captive investor base would react poorly when the environment soured. In September we got our first taste of that. Two auto loan companies defaulted in quick

succession, tanking the value of those loans.^{xxxii}

Private credit is illiquid by its nature. So it's difficult to get out of

these investments, and it's also difficult to get a real-time price. The best proxy that we have is BDCs, which are publicly-traded and update their book value on a quarterly basis. When these defaults happened, BDC prices moved lower, and continued to sell off as investors processed the news. At their worst, BDCs traded roughly 15% lower, a move that typically happens following major negative market news, such as the selloff in April following Liberation Day.^{xxxiii}

A few months have passed, and it appears that these credit defaults were idiosyncratic and not indicative of economic weakness or lax underwriting standards. We've gradually seen investor angst dissipate. This is another example of the hidden dangers of private investments. While returns can be impressive, volatility is typically dramatically understated and liquidity can be nonexistent.

Mortgage-backed securities (MBS) are one of the few asset classes which are not trading at historically expensive levels. The real estate and mortgage market have been quiet



The MVIS BDC Index fell meaningfully during September and October due to concerns about private credit. The magnitude of the loss was similar to declines from major economic events in the past.^{xxxiv}

"When you see one cockroach, there are probably more."

-JP Morgan CEO Jamie Dimon, October 2025, commenting on recent bankruptcies in the private credit market

since the rapid interest rate rise in 2022, as many homeowners are currently enjoying below-market-rate mortgages. In early 2026 we've seen MBS rally as Trump investigates ways to make homes more affordable, including instructing Fannie Mae and Freddie Mac to purchase \$200b worth of MBS.^{xxxv}

Closed-end funds (CEFs) were trading actively during the fourth quarter. Many of these funds traded lower in sympathy with the news in private credit. Further, while the funds mostly had solid performance, their high distribution rates mean that many investors still show them at a loss for the year based on their share price. This makes them appealing assets to sell before year end to harvest the tax loss, especially at the end of a year when most other assets appreciated in value. Many CEFs traded noticeably lower as a result of this tax dynamic.^{xxxvi}

CEFs have a lot of tailwinds coming into the new year. A steeper yield curve (low short-term rates and higher long-term rates) benefit them, as they borrow at low rates and can invest at higher rates. These funds often compete with money market funds for flows, so declining money market yields could drive cash into CEFs. Finally, the end of the year brings an end to tax loss harvesting. Now that the significant selling is done, these funds are likely to appreciate in price again. January is historically the best time of year for CEFs for this reason. Underperformance from selling in September through December turns into January outperformance as investors buy the funds back in the new year.^{xxxvii}

Flexible Income Portfolio^{xxxviii}

The Flexible Income Portfolio (FIP) was slightly positive during the quarter. This lagged its main benchmark slightly. The portfolio had a 2025 return in the high single digits, roughly matching most major bond benchmarks. Its high level of income was consistent throughout the year and actually increased during the fourth quarter. Considering that opportunities were sparse through the year, we are happy with the performance.

As credit spreads narrowed during the summer, we took the opportunity to derisk the portfolio. We didn't necessarily expect a negative credit event, but we did project that there would be better entry points. In the meantime we could earn income in safer asset classes.

The concerns in private credit gave us a decent opportunity to increase our credit exposure. The opportunity was exacerbated by tax loss selling during the final months of the year. This allowed us to increase our exposure to BDCs and a diverse group of CEFs.

The increased exposure to high yield bonds has come at the expense of our short-term bond holdings. These holdings have very little credit risk but were also some of the lowest-yielding investments in the portfolio. As the Federal Reserve continues to cut interest rates, we've seen the yield on these investments move lower.

Infrastructure holdings have largely taken a break this year. Utilities are a small part of the portfolio. They've rallied as a beneficiary of the AI theme. But pipelines and REITs have not participated in the rally to the same extent. We've maintained exposure to these asset classes through the year. We expect pipelines to benefit from the AI trade again at some point. Despite oil trading near multi-year lows, pipelines have held firm. This is a big change from a few years ago when pipelines had a much higher correlation with the price of oil.

We are optimistic about the prospects of this portfolio as we enter 2026. The tax headwinds from late 2025 will turn into tailwinds in 2026. We've already seen this dynamic playing out in early January, but expect quite a bit more from the so-called "January Effect" which makes January the historically best month of the year for CEF returns. As short-term interest rates fall, that will give relief to leverage costs. There is a risk that funds could reduce their distribution rates, but that's been the case for a while and we haven't seen it play out yet.

We typically try to own funds with stable distributions, and when distributions are decreased it's often a good buying opportunity.

Grow – Stock Market Commentary

The stock market added more gains during the fourth quarter and closed near new all-time highs. The S&P 500 was 18% higher during 2025. This is the third year in a row that the index has logged double-digit returns. Global markets did even better. The main global index finished 23% higher in dollar terms, boosted by a declining dollar during the first half of the year.^{xxxix}

The year started in a strange way, as international stocks outperformed as part of a so-called “Sell America” strategy. The declining dollar, unclear implementation of tariffs, and general instability of the Trump Administration prompted investors to look elsewhere. Valuations for foreign companies are substantially lower than domestic companies, and they've also lagged in performance for years (or decades, for some markets).^{xi}

Markets adjusted following the panicked Liberation Day selloff. The largest technology companies again led the market higher. International markets stopped outperforming, and the discussion about “Selling America” mostly came to an end. Since early summer stock markets have grinded higher without any substantial pullbacks.^{xii}

Instead of “Sell America,” we now hear discussion of the “Debasement” trade. In the last two years the price of gold has doubled. Silver has doubled in price since September! This isn't unique to the US Dollar; precious metals have appreciated against every major currency. These commodities do have a history of trading irrationally at times. Silver's current rally certainly looks like a bubble. But gold has been following this trajectory for years. The rally started in early 2024, which is around the time it became clear that the Federal Reserve would start cutting interest rates despite troublesome inflation data. It kicked into overdrive shortly before the Fed continued cutting interest rates this fall.^{xlii}



The price of gold has shot higher over the past two years.^{xliii}

The theme of Artificial Intelligence (AI) remains the biggest question in markets. The most interesting development during the quarter was the release of a new Gemini model, which by many metrics outperformed the most recent model of ChatGPT. It's common for new models to be released, but in this case the improvement shattered expectations. The developer of Gemini has rallied nearly 50% since its release just months ago. The developer of ChatGPT isn't a public company, so we can't directly measure the offsetting loss in value. Many public

companies have exposure to one AI model or the other, though. Comparing how these baskets of stocks performed show that this new model greatly changed investor expectations.^{xliv}

This is a change in how markets are treating the AI story. When AI was more uncertain, any impressive development in AI technology resulted in all the AI stocks rallying together. Every improvement increased the perceived Total Available Market (TAM) of AI. So even if one model or another one weren't improving at that exact moment, they were still a piece of an ever-expanding pie. This is similar to the environment in 2021 with Electric Vehicles (EVs). At that time, each company was trading at valuations that implied that they would eventually be the sole provider of EVs to the market. Obviously the situation eventually normalized, and a few EV manufacturers survived while others have largely disappeared. Excitement around a technology eventually gave way to a more of a zero-sum dynamic.^{xlv}

It seems that we've now entered a similar paradigm with AI, where we assess winners and losers from each improvement in AI and each new model. This has big implications for the market if it continues. Because the largest stocks mostly have different AI models that they developed, they might no longer consistently rally as a group. This will be a better environment for stock pickers. At the same time, a passive investor in the index can no longer rely on bullish AI narratives to relentlessly increase their investment's value.

As the AI theme matures, we have started to look for leadership in other parts of the market. Despite the market's solid gains for the past three years, we are cautiously bullish for the year ahead for several reasons.

While valuations are high, the largest stocks disproportionately affect that valuation measure. We've highlighted the CAPE ratio before – Cyclically Adjusted Price to Earnings ratio. When the CAPE is over 40, as it is now, returns over the next ten years have historically been zero or negative. That doesn't mean that they'll go down in value imminently; it just means that it will take time for actual earnings to catch up with current prices.^{xlvii} Small stocks and international stocks are more reasonably priced.

Falling interest rates will also benefit smaller stocks, as they are disproportionately hampered by borrowing costs. Interest rates are now lower than they've been for the previous three years.^{xlviii}

The new year brings a variety of stimulus measures from the One Big Beautiful Bill. The expanding national debt is arguably an existential risk that must be dealt with eventually. But in

OpenAI vs Alphabet

Stocks in orbits of OpenAI and Alphabet have diverged

Alphabet exposed basket OpenAI exposed basket



Source: Bloomberg, Morgan Stanley

Data is normalized with percentage appreciation as of January 2, 2025.

Bloomberg

Stock prices for companies exposed to different AI models used to rally together. The most recent release of Gemini caused a notable divergence.^{xlvi}

the meantime, additional stimulus from the government tends to find its way into the stock market, or sometimes chases yield in the bond market. Either way, asset prices are likely to rise as a result. The last time we saw a similar influx of stimulus spanned from Covid's onset to early 2021. This was a period that saw the birth of "meme stocks," an explosion of options trading, and one (of many) impressive ramps in the value of cryptocurrencies. The current situation is not as surreal – we aren't stuck at home without entertainment, and interest rates aren't at zero – but it does look similar in some respects.^{xlix}

We expect the current rally to broaden in 2026. We will start to see the AI trade benefit other industries in the form of actual use cases. That is, we'll start to see solid evidence of increased worker productivity and perhaps reduced white-collar hiring. The emphasis on deregulation and incentives for mergers & acquisitions will benefit more traditional areas of the economy, such as financials and industrials.

ETF Portfolioⁱ

The ETF portfolio experienced a mildly positive quarter. It increased in the low single-digits, slightly trailing its global index.^{li}

We have added exposure to a diverse portfolio of smaller domestic companies. We expect this to benefit if the market's rally does broaden. We've also added to holdings in pipelines. We have been looking for underappreciated ways to invest in AI. We have investments directly in AI developers, though we have been mindful to keep exposure at an appropriate level for diversification purposes. Our investments in nuclear energy have done well, but have also become increasingly volatile. We don't have much direct investment in utilities, but that sector has become expensive and dependent on future growth rather than current earnings. Pipelines, in contrast, were a participant in the AI trade in 2024 but took a break in 2025. Natural gas will likely be an important "bridge" energy source for AI as new power plants are constructed, but energy demands rise in real-time. As we discussed previously, pipelines have become robust against the price of oil. If the risk from falling oil prices has declined, then when compared to other yield-generating assets, pipelines have room to appreciate. Finally, as real assets they are naturally resistant to inflation, and their contracts typically have built-in inflation adjustments as well.

While we are cautiously bullish, we are also mindful that a lot of good news is "priced in." The market expects stimulus from the OBBBA, interest rate cuts, solid GDP growth, and continued progress on AI. These seem like reasonable expectations, but it's important to acknowledge that disappointment on these could send markets lower. There are a variety of risks geopolitically (Russia/Ukraine), domestically (midterms, domestic strife), and economically (resurgent inflation, deteriorating employment) which could also have severe consequences. As we've been emphasizing for at least a year, by many metrics forward returns are likely to be muted overall. If day-to-day volatility is making you squeamish, bonds are offering a high enough yield to offer a competitive alternative to stocks.

From the Desk of Jenny, Tracy, Yaelle, Tess, Sophie & Trey **Tax reporting dates**

Forms 1099R will be available by January 31st. All other 1099s will be on a rolling schedule beginning January, running through mid-February. Some 1099s (for the Flexible Income Portfolio, for instance) will come in the form of "*draft*" pending final classification information from issuers. These forms will roll out March 15th – March 19th.

Required Minimum Distributions – Clients turning 73 years old

If you turn 73 years old this year, it will be your first year to take your Required Minimum Distribution. We will communicate the necessary steps to you during your review, however, please feel free to contact us with any questions.

Qualified Charitable Distributions – New IRS Code

Beginning 2025, the IRS has created a separate distribution code for all IRA distributions issued to charities. This will help to distinguish your actual taxable amount from your IRA.

Best regards,



320 S. Canal St.
Suite 2975
Chicago, IL 60606
312-763-9662

Frank DeVincentis, CFP®
Founder, Managing Partner
Financial Advisor
NMLS # 1255537

Craig Eyler, CFP®
Founder, Managing Partner
Financial Advisor
NMLS # 1270172

Molly Girard, CFP®
Partner
Financial Advisor
Branch Manager
NMLS # 2359441
312-763-9673

Jennifer Huns, CFP®
Group Director
Executive Vice President
Senior Registered Client Administrator
312-763-9602

Scott Tucker, CFA
Chief Investment Officer
Executive Vice President
312-763-9651

Tracy Weidman
Director of Client Analytics
Senior Vice President
Senior Registered Client Analyst
312-763-9652

Yaelle Kimmelman
Marketing Director
Vice President
Senior Registered Client Associate
312-763-9603

Tess Kearns
Branch Administrator
Registered Client Associate
312-763-9605

Sophie Spence
Registered Client Associate
312-763-9604

Trey Plummer
Client Associate
312-763-9653

Portfolio is current as of the date shown and is subject to change without notice. As PIM portfolios are separately managed the individual client account holdings will vary, perhaps significantly, from those listed on this factsheet. Information, such as industry sector allocation percentages and market capitalization allocation percentages, will also vary from the information listed on this factsheet. A client opening an account today may, or may not, be invested in securities or sectors based upon the percentages shown on this factsheet. The mention of specific securities is not a recommendation or a solicitation for any person to buy, sell or hold a particular security. Since no one investment program is appropriate for all types of investors, this information is provided for informational purposes only. For the most recent portfolio composition please contact the PIM Manager. Fees for the Private Investment Management program include Advisory services, performance measurement, transaction costs, custody services and trading. Fees are based on the assets in the account and are assessed quarterly. The fees do not cover the fees and expenses of any underlying packaged product used in your portfolio. Advisory accounts may not be appropriate for all investors. During periods of lower trading activity, your costs might be lower if our compensation was based on commissions. Please carefully review the Wells Fargo Advisors advisory disclosure document for a full description of our services, including fees and expenses. The standard minimum account size for this program is \$50,000.

All investing involves risk, including the possible loss of principal. There are no guarantees that a strategy's objectives will be met.

Wells Fargo Advisors Financial Network did not assist in the preparation of this report, and its accuracy and completeness are not guaranteed. The opinions expressed in this report are those of the author(s) and are not necessarily those of Wells Fargo Advisors Financial Network or its affiliates. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Additional information is available upon request.

Past performance is no guarantee of future results.

Exchange-Traded Funds are subject to risks similar to those of stocks. Investment returns may fluctuate and are subject to market volatility, so that an investor's shares, when redeemed, or sold, may be worth more or less than their original cost. Exchange Traded funds may yield investment results that, before expenses, generally correspond to the price and yield of a particular index. There is no assurance that the price and yield performance of the index can be fully matched.

Investment products and services are offered through Wells Fargo Advisors Financial Network, LLC (WFAFN), Member SIPC. Verismo Financial, LLC is a separate entity from WFAFN.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The MSCI All Country World Index (ACWI) captures large and mid cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries.

The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of 21 developed markets, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of 23 emerging markets.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

-
- ⁱ Bloomberg
 - ⁱⁱ Bloomberg
 - ⁱⁱⁱ Bloomberg
 - ^{iv} Bloomberg
 - ^v Bloomberg
 - ^{vi} Bloomberg
 - ^{vii} Bloomberg
 - ^{viii} Bloomberg
 - ^{ix} Federal Reserve Bank of Atlanta
 - ^x Federal Reserve Bank of Atlanta
 - ^{xi} Bloomberg
 - ^{xii} Bloomberg
 - ^{xiii} Bloomberg
 - ^{xiv} Bloomberg
 - ^{xv} Bloomberg
 - ^{xvi} Bloomberg
 - ^{xvii} Bloomberg
 - ^{xviii} Bloomberg
 - ^{xix} Bloomberg
 - ^{xx} Bloomberg
 - ^{xxi} Bloomberg
 - ^{xxii} Bloomberg
 - ^{xxiii} The Federal Reserve
 - ^{xxiv} Bloomberg
 - ^{xxv} Bloomberg
 - ^{xxvi} The Federal Reserve Bank of Atlanta
 - ^{xxvii} Bloomberg
 - ^{xxviii} Bloomberg
 - ^{xxix} Bloomberg
 - ^{xxx} Bloomberg
 - ^{xxxi} Bloomberg
 - ^{xxxii} Bloomberg
 - ^{xxxiii} Bloomberg
 - ^{xxxiv} Bloomberg
 - ^{xxxv} Bloomberg
 - ^{xxxvi} Bloomberg
 - ^{xxxvii} Bloomberg
 - ^{xxxviii} See disclosures
 - ^{xxxix} Bloomberg
 - ^{xl} Bloomberg
 - ^{xli} Bloomberg
 - ^{xlii} Bloomberg
 - ^{xliii} Bloomberg
 - ^{xliv} Bloomberg
 - ^{xlv} Bloomberg
 - ^{xlvi} Bloomberg
 - ^{xlvii} Bloomberg
 - ^{xlviii} Bloomberg

^{xlix} Bloomberg

^l See disclosures

^{li} Bloomberg