Market Matters: 4th Quarter 2025

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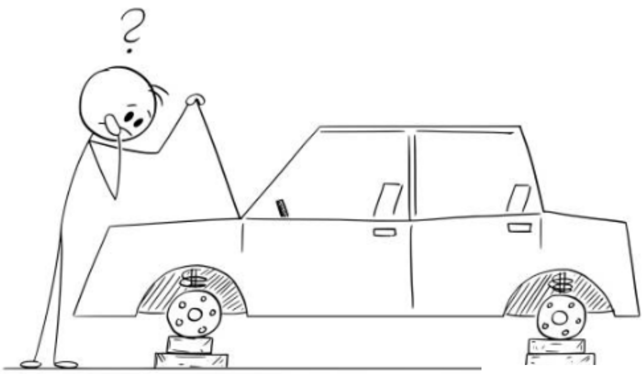
"A bend in the road, is not the end of the road…unless you fail to make the turn." – Helen Keller

- *Markets advanced despite high uncertainty.*
- *Fiscal investment and AI-driven capital spending remain powerful tailwinds.*
- *While inflation and labor market risks warrant monitoring, they do not yet signal a breakdown.*
- *Upside growth scenarios could extend through 2026 - particularly if trade tensions ease and investment remains robust - though they may delay interest rate cuts.*
- *Many downside risks appear focused rather than systemic, and the market cycle, though distorted, is not exhausted.*



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Under the Hood of the Markets

In 2025, financial markets once again demonstrated that surface-level stress can obscure underlying resilience. Political dysfunction, trade tensions, inflation anxiety, and affordability pressures dominated headlines. Yet equities posted strong gains, credit markets held steady, and economic activity—though uneven—was durable. Overall, 2025 showed the strongest cross-asset performance in over 15 years.[1]

Like in a car cruising at speed, investors often focus on the road ahead while overlooking the engine itself. This year brought traffic jams and work zones, but **under the hood growth machinery continued to turn.**

Assessing today's environment is complicated by the diversity of risks—political, geopolitical, economic, market, and idiosyncratic. These forces do not carry equal weight. Market risk ultimately reflects behavior. **Headline risk matters primarily when it alters behavior through incentives, labor or supply chain disruption, or forces policy responses that affect**

[1] Schroders Capital

inflation and rates. In 2025, despite macro stressors, the growth engine remained intact and propelled markets to new highs. What happens on the surface often matters little as long as the mechanicals are functioning. In the midst of macro stressors, the engine kept running and drivers of growth propelled us to new equity market highs and outstanding returns across fixed income.

2025: A Year of Contradictions

By many measures, 2025 was a year that should have been more hostile to risk assets.

- *A new U.S. administration enacted sweeping personnel changes and spending cuts.*
- *Tariffs surged to their highest levels in decades, an effective average somewhere in the double digits, and the threat of trade wars punctuated many points in the year.*[2]
- *The United States government endured its longest shutdown on record.*
- *2025 opened with brinkmanship and closed with escalating real-world conflicts.*
- *Job growth slowed to its weakest pace in fifteen years, while inflation and affordability pressures persisted across housing, healthcare, education, and basic necessities.*

And yet, equity markets rose. This dichotomy underscores that markets are first and foremost discounting mechanisms. **As long as earnings growth, liquidity, and capital formation are intact, markets can advance through stress**. In 2025, markets kept cruising.

The Core Forces Driving the Cycle

Two tailwinds defined the year. **Government investment**—through fiscal stimulus, infrastructure spending, and industrial policy—provided a stable foundation. At the same time, private-sector **investment in artificial intelligence** drove a surge in capital expenditures across data centers, energy, communications, and advanced manufacturing. Together, these forces offset softening consumer indicators.

Two headwinds remained firmly in place for U.S. investors. **Inflation** constrained monetary policy flexibility, while rising **unemployment risk** in a low-hire, low-fire environment raised concerns about late-cycle dynamics. Federal Reserve projections highlight downside risk potential in both higher inflation and unemployment, a combination that limits policy effectiveness.[3] Stagflation remains a dominant risk entering the new year.

Recessionary influences are not a single phenomenon. Housing remains in recession, weighing on sentiment and affordability. Commercial real estate has likewise gone through a downturn. Labor-market weakness is increasingly visible, though consumption has been buffered by high-

[2] Tax Foundation
[3] FOMC Minutes October 28-29, 2025, Federal Reserve.gov

income households that drive a disproportionate share of spending.[4] Consumers report recession-like conditions even as the economy falls short of formal recession definitions, evidenced by consumer sentiment falling to its lowest point in over a decade (below) and inflation expectations remaining high.[5] Markets, however, care less about labels than mechanisms—

profits, credit conditions, and liquidity. When inflation is unresolved, even strong growth can become destabilizing.

Acceleration and Bond Burnout

Resilience itself introduces risk. If the growth engine keeps running, it could overheat. If it starts to falter, the economy may stall.

One scenario involves a re-acceleration of U.S. growth driven by productivity gains and investment. Easing trade tensions and front-loaded fiscal stimulus from the *One Big Beautiful Bill* could boost activity in early 2026. Such a backdrop would likely push real yields higher to compensate for inflation risk. This would be supportive of corporate profits, restrictive for rate cuts, negative for long-duration bonds, and steepening for the yield curve. Structural investment booms are resource-intensive, not disinflationary in the short run.

Another upside lies in a global industrial renaissance. As countries pursue shorter and more aligned supply chains, investment in infrastructure, energy, defense, and logistics are expected to lift global growth. Capital spending tied to AI and infrastructure remains robust, and demand concerns remain muted across most global industries.[6]

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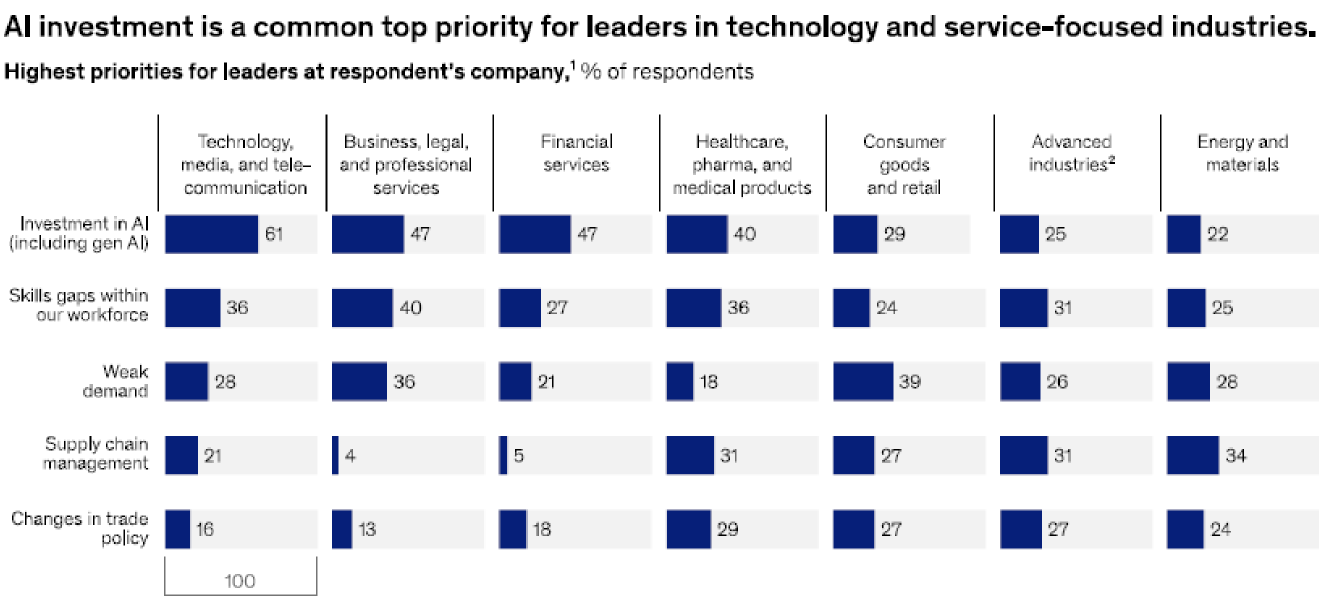
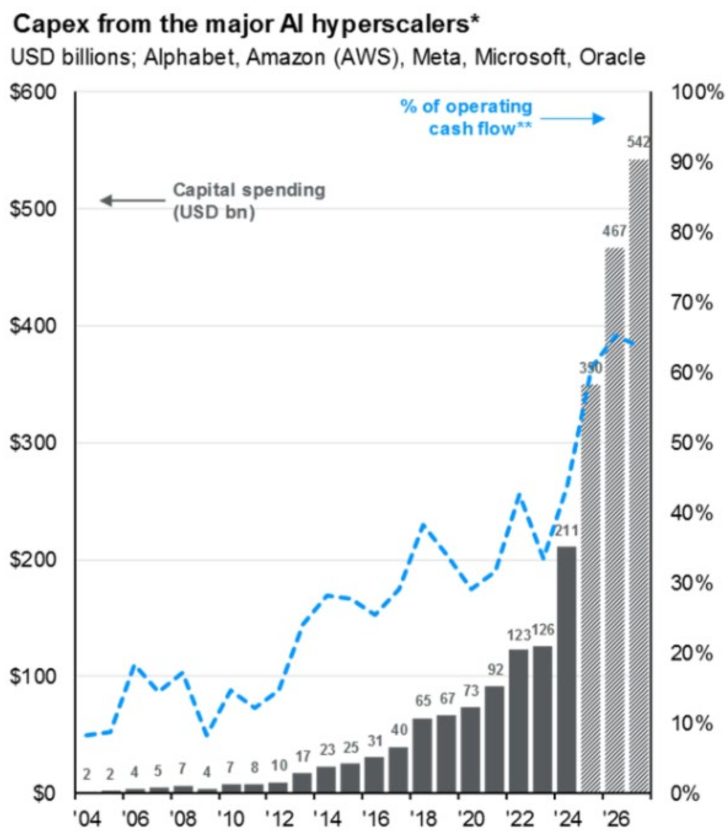
[4] Bloomberg, Federal Reserve Bank of St. Louis
[5] University of Michigan, Federal Reserve Bank of St. Louis. Chart below from FRED.
[6] See McKinsey's Economic Conditions Outlook (Dec. 2025), chart below from MicKinsey.



Potential Road Blocks

The most prominently light on the risk dashboard remains a pullback in AI-related investment. Market capitalization has become increasingly concentrated among a small group of mega-cap tech firms whose valuations assume sustained AI-driven growth. If AI investment disappoints due to weaker productivity gains, policy shifts, or renewed capital discipline, valuations could break down as well. The largest hyperscalers (Alphabet, Amazon, Meta, and Microsoft) have spent an estimated $350 billion in capital expenditures in 2025, with future investment forecast to reach trillions.[7] Putting the brakes on spending would ripple through construction, energy, and communications, among other sectors.



Policy error represents another critical risk. Monetary easing driven by political rather than economic considerations could reignite inflation at an inopportune moment. In such a

[7] Cambridge Associates, chart from JP Morgan's Guide to Markets.

scenario, Longer-dated Treasury yields could rise even as the base rate falls, the yield curve could steepen, and long-duration bonds would face renewed pressure.

Rising fixed-income supply compounds these concerns. Issuance is expected to surge in 2026, driven by expanding government deficits and heavy corporate borrowing. Without commensurate demand, increased supply places upward pressure on yields and spreads, hurting current values. Morgan Stanley estimates that a 10-year Treasury yield near 4% represents a floor for sustained investor engagement. If investors demand yields above this level, spreads may widen even as nominal rates decline. High-yield credit would be particularly vulnerable.[8]

Capital Markets Investment Framework

	OUR VIEW				
ASSET ALLOCATION	– –	–	=	+	+ +
Bonds					
Duration		●			
Credit		●			
Equities					
Risk Level			●		
Alternatives					
Private Markets				●	
Hedge Funds				●	
Commodities			●		
Transition					
Cash/Short Duration		●			

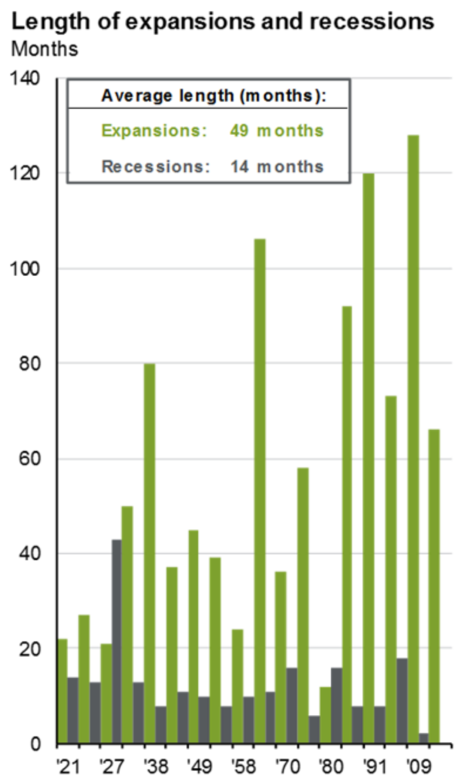
The Wheels are Still Turning

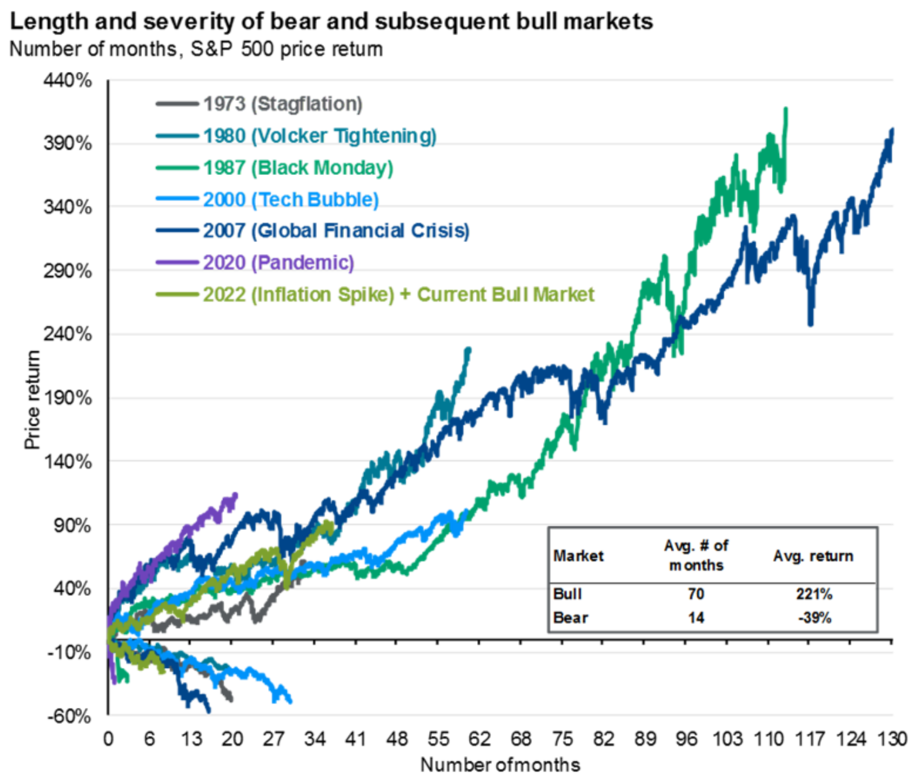
Despite these risks, consensus expectations remain constructive. Growth is likely to continue and the outlook remains positive. Fiscal stimulus is projected to be front-loaded into 2026 and 2027. Carefully calibrated monetary easing could stabilize labor markets, while deregulation could support domestic investment if implemented effectively.

Not all inflation is equal. Tariff-driven price pressures may prove transitory, and slowing employment growth should exert natural disinflationary pressure over time.

Traditional market cycles imply the neat loop of a racetrack from expansion to recession and recovery. Today's environment is more of a winding road with uneven terrain. Policy intervention, deglobalization, technological acceleration, and demographic shifts have distorted the classic cycle. Rather than asking where we are, the more relevant question is whether the engine is still functioning—and whether the accelerator is being pressed too hard, or not hard enough.[9]

[8] Morgan Stanley (incl. Chart Right).
[9] Chart below from JP Morgan's Guide to Markets.





What This Means for Investors

The primary risk ahead is miscalibration rather than collapse. We ought not confuse our current speed with stability.

Remain invested. Returns remain achievable, though the margin for error has narrowed. Disciplined risk-taking is likely to be rewarded more than broad, indiscriminate exposure.

Expect yield volatility. Inflation dynamics and heavy issuance may limit rate declines, favoring shorter-to-intermediate duration and flexible strategies.

Equity leadership may broaden, but concentration risk persists. AI and infrastructure spending continue to support growth, making valuation discipline increasingly important.[10]

Diversification matters more than timing. With upside and downside risks coexisting, balanced portfolios and all-weather risk management are likely to outperform directional bets.

[10] Apollo, 2026 Outlook.

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