

The 2025 market narrative has been shaped by cooling economic momentum, ongoing inflation challenges, and a more complicated trade landscape. Yet, equities are still tracking toward strong double-digit gains, and fixed income is on course for its best year since 2020. Against that backdrop, the natural questions are what powered returns in 2025—and what might lie ahead for 2026?

Global growth has slowed meaningfully in 2025, with advanced economies, including the U.S., expanding at a more measured pace, even as emerging markets have shown resilience. Rising tariffs, geopolitical frictions, and shifting supply-chain structures deepened a broader trend of “trade fragmentation,” adding to macro headwinds.¹ In the U.S., inflation has remained sticky at around 3 percent, above the Fed’s 2 percent target. Elevated federal debt is nothing new, but evolving perceptions around U.S. fiscal policy and monetary outlook weighed on the dollar.

Despite these pressures, U.S. mega-cap technology companies stepped in as a powerful offset. Massive investment in Artificial Intelligence (AI) infrastructure fueled a surge in capital expenditure that supported both GDP growth and investor confidence. Policy support from the Trump Administration’s “One Big Beautiful Bill,” including tax relief and investment incentives, added further lift, reinforced by the Fed’s continued rate easing.

Even so, 2025 was far from a straight-line increase. Markets weathered several sharp pullbacks that exposed underlying fragility. Early in the year, euphoria around AI was punctured when China-based DeepSeek released a lower-cost large language model (LLM), raising doubts about the durability of U.S. AI moats and triggering a correction in tech-heavy indices. In April, sweeping new U.S. tariffs under the “Liberation Day” banner sparked another sell-off, pressuring multinationals and supply-chain-sensitive firms. The Fed’s caution that tariffs could contribute to stagflation further unsettled markets. Then, in October, the longest government shutdown on record created a data vacuum as concerns increased around an AI bubble. Tremendous capital flows into a few dominant players, and extreme sensitivity to Fed signals sent volatility sharply higher into November. Through it all, we navigated volatility with discipline and confidence.

We anticipate stronger U.S. economic growth in 2026, supported by rising productivity, moderating inflation, and further Fed rate cuts in support of a cooling labor market. In many ways, 2025 may prove a turning point for the post-pandemic global order. The reconfiguration of supply chains, the emergence of regional alliances, and the formation of new trade blocs all signal a world in transition. At the same time, the balance between AI-powered growth and underlying economic fundamentals will likely determine whether markets can sustain their momentum or face more turbulence. Steering through 2026 will require precision and watchfulness.

2026 U.S. and Global Macroeconomic Outlook

As we look toward 2026, the defining theme for the U.S. and global economy is normalization. Growth is stepping down from the unusually strong post-pandemic years, inflation is starting to drift back toward central bank comfort zones, and interest-rate volatility is receding. The environment is shifting away from crisis management and back toward fundamentals, an adjustment that tends to favor long-term investors.

¹Whiting, K. (2025, August 5). *7 Charts that explain the global inflation points of 2025, so far*. World Economic Forum.
<https://www.weforum.org/stories/2025/08/inflection-points-7-global-shifts-defining-2025-so-far-in-charts>

United States: Slower, More Balanced Expansion

The U.S. remains the world's economic anchor, even as it downshifts to a more sustainable pace. Forecasters expect real GDP growth of 1.8 percent in 2026², a pace consistent with a steady, though not booming, economy. Inflation is expected to settle into the low-to-mid 2 percent range by year's end on the Fed's preferred Personal Consumption Expenditures (PCE) measures, with core PCE running around 2.25 to 2.50 percent, close enough to the Fed's 2 percent target to allow a more predictable policy stance than we've seen since 2021.

Beneath the top-line numbers, the labor market is undergoing an important, healthy reset. Businesses are no longer hiring at the breakneck pace of the reopening phase. Walmart, the nation's largest private employer, offered a clear window into this dynamic on its third-quarter earnings call. Management emphasized steady sales growth, improving margins, and continued strength from higher-income households. The company is making significant investments in automation and generative AI designed to boost efficiency rather than expand headcount³. We see this as labor-demand normalization rather than a sign of broad-based distress.

Labor supply is shifting as well. Demographics alone are powerful: roughly 11,000 Americans turn 65 every day⁴, and the aging of the baby-boom generation will continue through the end of this decade. That doesn't mean all of them retire immediately, but it does mean the pool of experienced workers is shrinking faster than in prior cycles. At the same time, immigration and enforcement policy have become a meaningful swing factor. These changes can modestly tighten labor availability in sectors that rely heavily on immigrant workers.

Put together, you have a job market where slower hiring does not automatically translate into a sharp spike in unemployment. Economists' probabilities of a negative GDP quarter in 2026 cluster around the mid-20 percent range, a one-in-four chance, which historically looks more like a mid-cycle wobble than the onset of a recession⁵.

A key support to this adjustment is productivity. Corporations have spent the last two years investing aggressively in AI, automation, cloud infrastructure, and workflow technologies. Even modest productivity gains are a powerful counterweight to inflation pressures and an important support for corporate margins when revenue growth slows.

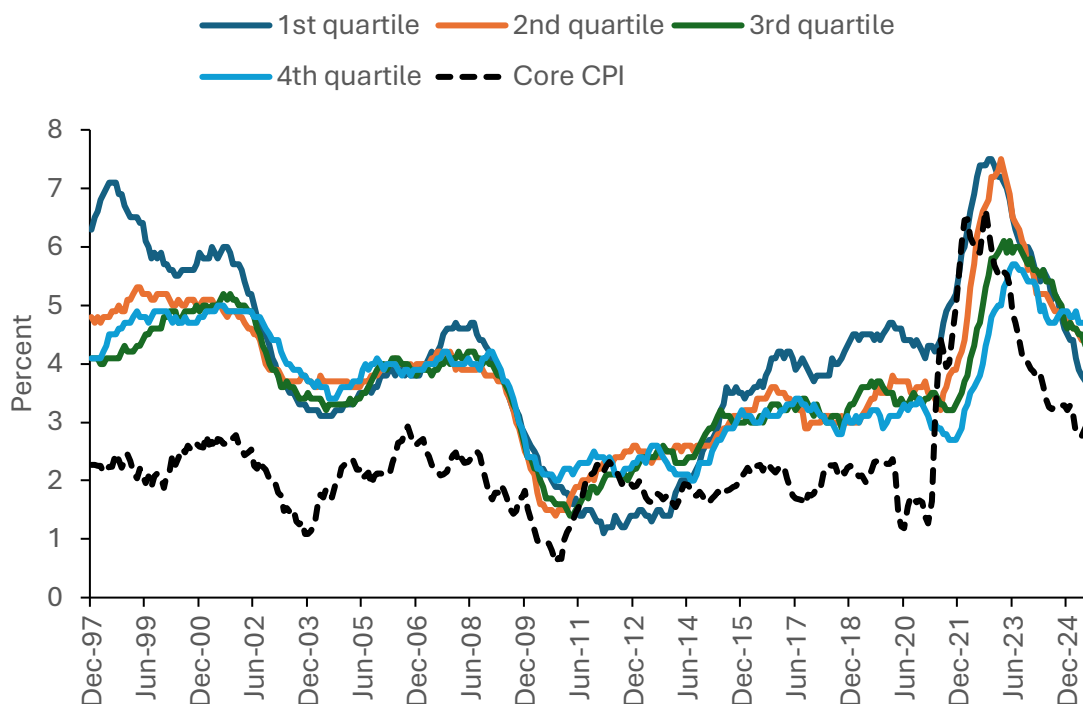
These developments intersect with a K-shaped economy. Higher-income households, who drive a disproportionate share of total spending, remain financially strong, supported by stable employment, rising net worth, and attractive yields on cash and bonds. Lower-income households are more stretched, pressured by elevated prices for essentials and a cooling pace of wage gains. This divergence helps explain why overall spending remains resilient even as survey-based sentiment remains soft. For the broader economy, the strength among top earners continues to provide meaningful stability.

^{2,5} (2025, November 17). *Fourth Quarter 2025 Survey of Professional Forecasters*. Federal Reserve Bank Philadelphia. <https://www.philadelphiafed.org/surveys-and-data/real-time-data-research/spf-q4-2025>

³ (2025, November 20). *Walmart Release Q3 FY26 Earnings*. Walmart.com. <https://corporate.walmart.com/news/2025/11/20/walmart-releases-q3-fy26-earnings>

⁴ (2024, November). *It's retirement time in America*. Visa.com. <https://usa.visa.com/partner-with-us/visa-consulting-analytics/economic-insights/retirement-time-in-america.html>

Wage Growth by Wage Level



Sources: Federal Reserve Bank of Atlanta, U.S. Bureau of Labor Statistics

Altogether, the U.S. enters 2026 with slower but sturdier momentum: moderating demand, constrained supply, easing inflation, and a more predictable interest-rate regime than the past two years. It is not a zero-risk environment, but it is far more balanced.

Global Outlook: Divergence Defines the Cycle

Beyond the U.S., growth paths diverge more clearly. The IMF's latest World Economic Outlook projects global growth slowing from 3.3 percent in 2024 to 3.2 percent in 2025 and 3.1 percent in 2026, with advanced economies growing at 1.5 percent and emerging and developing economies just above 4 percent⁶. While hardly booming, it is still a pace consistent with ongoing expansion rather than global stagnation.

Europe continues to recover slowly from its energy shock and inflation surge. Growth is likely to remain subdued, around 1 percent in 2026, but inflation is easing decisively, and the European Central Bank is expected to stay on pause for most of 2026. The region is not a high-growth engine. Still, it is moving toward a more stable equilibrium.

China is navigating a structural transition rather than a purely cyclical slowdown. The IMF and other forecasters see growth slowing to roughly 4 to 4.25 percent by 2026, reflecting weaker property and demographic dynamics, but still solid output

⁶ (2025, October). *Global Economy in Flux, Prospects Remain Dim*. International Monetary Fund. <https://www.imf.org/en/publications/weo/issues/2025/10/14/world-economic-outlook-october-2025>

in high-tech manufacturing, exports tied to the green transition, and targeted fiscal support⁷. The old playbook of broad, credit-driven stimulus is giving way to something more selective and, by design, more modest.

Emerging markets (EM) present a more constructive picture. Many EM central banks tightened earlier in this cycle and now have room to support activity. The IMF expects EM and developing economies to grow just over 4 percent in 2026⁸, with countries such as India, Mexico, Indonesia, and Brazil benefiting from younger demographics, improving institutions, and the redirection of global supply chains. These forces create the potential for growth that exceeds that of the developed world over the next several years, albeit with the usual EM volatility.

A Changing Environment, not a Faltering One

As we've mentioned, across economies, 2026 looks less like an inflection point and more like a cooling into trend. The post-pandemic extremes, both positive and negative, are fading. Inflation is moderating, the labor market is adjusting without breaking, productivity is emerging as a new contributor, and global growth is diverging rather than deteriorating.

For investors, this backdrop rewards discipline, thoughtful positioning, and staying engaged in markets. It is an environment where being selective, across companies and across economies, matters more than ever, and where the foundations for continued long-term growth remain firmly in place.

AI, Earnings Growth, and New U.S. Equity Leaders to Watch

Three years, an inflation scare, multiple Fed pivots, and a couple of pullbacks later, the U.S. equity bull market is still quietly ahead of schedule. Year one (2023) rose about 21 percent—muted for a new cycle—before year two's 32 percent gain. A third year that usually delivers an average of 5 percent instead produced a mid-teen gain through November. As we look toward 2026, U.S. equity market returns should rely less on rising valuations and more on continued earnings delivery. Profits already did more of the work in 2025, and we expect AI investment, a more predictable Federal Reserve, and a broadening earnings cycle to remain the key drivers of equity returns.

AI remains the most powerful force in the market. In 2026, the hyperscalers (Alphabet, Amazon, Meta, Microsoft, and Oracle) are expected to boost AI-related capital expenditures to \$520 billion, a roughly 30 percent increase from 2025⁹. That would represent 1.6 percent of U.S. gross domestic product, making AI a critical economic driver. Those dollars are expected to support productivity gains, better corporate margins, and contribute to the double-digit earnings growth expected for the equity market.

At the start of December 2025, the S&P 500 trades at 22 times forward earnings, a premium to its long-term average of 19 times, with consensus calling for about 14 percent earnings growth next year, more than double the historical trend. The "Magnificent Seven" are still doing a lot of the lifting, with expected earnings growth of about 19 percent, accounting for 34 percent of the index's total earnings growth, and a forward P/E ratio of around 29 times. That means that well over half of the aggregate earnings expansion is now coming from the rest of the market, marking a meaningful shift from the past few years when mega-cap tech carried almost the entire load.

^{7,8} (2025, October). *Global Economy in Flux, Prospects Remain Dim*. International Monetary Fund.

<https://www.imf.org/en/publications/weo/issues/2025/10/14/world-economic-outlook-october-2025>

⁹ (2025, October 13). *CSP CapEx to Soar Past US\$520 Billion in 2026, Driven by GPU Procurement and ASIC Development, Says TrendForce*. Trendforce.

<https://www.trendforce.com/presscenter/news/20251013-12741.html>

As leadership broadens and earnings drivers diversify, we expect changes in overall equity returns to be increasingly tied to individual-company fundamentals rather than a narrow group of index heavyweights. In our view, investors will migrate toward sources of growth that are not yet fully reflected in stock prices. We are focused on identifying companies with strong balance sheets, clear competitive advantages, durable pricing power, and the ability to sustain resilient profitability across different policy and interest rate environments - businesses we believe are well-positioned to attract capital in 2026.

AI spending now touches far more than technology. Financials benefit from capital raises, deal activity, and higher equity valuations, much of it anchored by AI-related leaders. Industrials are supplying the power, cooling, networking, and automation needed to stand up new data centers and retrofit existing infrastructure. Regulated utilities are seeing rising electricity demand and increased grid investment as AI workloads scale. By contrast, many of last year's laggards (Consumer Staples and parts of Health Care) are areas where investors struggle to see a clear AI-driven earnings tailwind.

The phrase "AI bubble" has gone mainstream, and comparisons to the dot-com era are routine. Our view is more balanced. Valuations in some parts of the AI ecosystem are clearly full, and execution risk is rising, especially if large projects fail to deliver expected returns as hyperscalers reinvest cash flows. But we also see genuine demand to support today's spending plans. We are watching a set of leading indicators closely, including GPU rental prices, token growth, and whether scaling laws (more compute leading to better models) continue to hold, for signs that the economics are shifting.

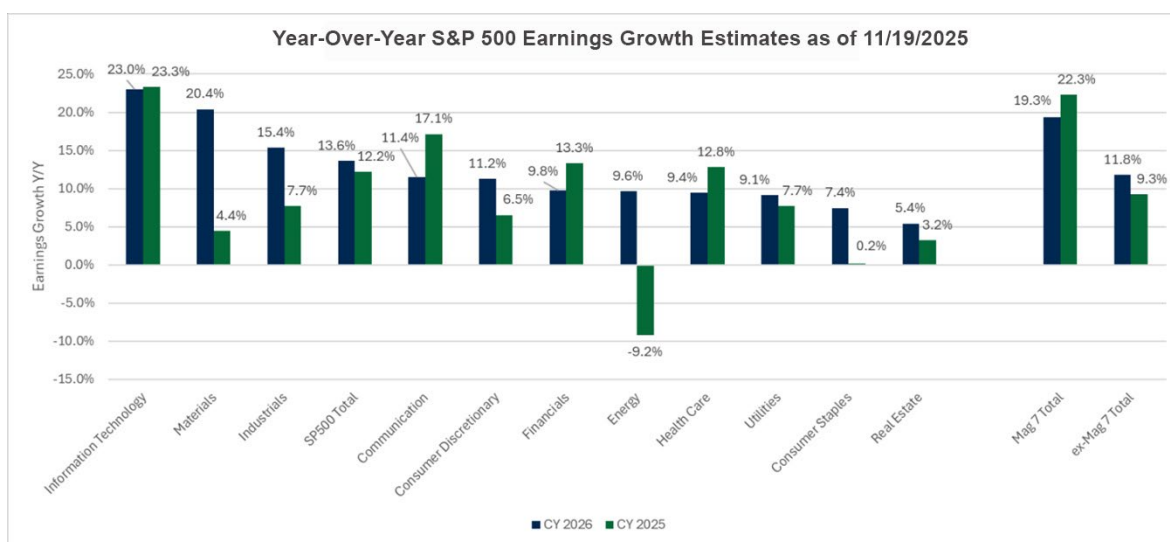
That dynamic makes AI both the cornerstone of the equity story for 2026 and a key risk: markets are more dependent than ever on this theme, but they are also being reshaped by the real cash flows and profit pools it is creating. We've written in past outlooks that big technology waves usually play out in stages. We think AI will follow that pattern. Phase one has been all about GPUs and the big cloud providers. Phase two is about what happens after the processors are installed—how you connect, power, cool, test, and scale all that compute. Our research and our portfolios are increasingly focused on later-stage beneficiaries: the networking equipment, fiber, transformers, power gear, cooling, and test equipment that sit behind the scenes.

For anyone who doesn't live in the data-science world, think of each chunk of generative AI output as a unit of compute that represents text or an image. A year and a half ago, we compared the data center to a giant factory, with processors churning out compute that becomes more valuable as AI software can deliver outsized productivity gains. While demand for compute continues to surge as AI software improves, power is increasingly the biggest variable cost of running these factories. As such, the next wave of the AI factory buildout is likely to focus on maximizing performance per watt. On this front, we're seeing the largest surge in networking investment in more than 15 years as hyperscalers upgrade connectivity—inside and outside the data center—with advanced optics that both boost performance and cut power use.

Outside of technology, sector performance next year may hinge on where the end-demand is most resilient, and we see several durable themes that diversify portfolios. In aerospace and defense, higher NATO commitments, evolving threats, and the integration of autonomy and AI into surveillance and missile systems should sustain demand through 2026 and beyond. Across cyclicals, we favor companies with scale, diversified manufacturing footprints, and pricing power that can navigate tariffs and supply chain frictions. Targeted fiscal measures, such as the "One Big Beautiful Bill," can affect both corporate profits and household spending, though the benefits will be uneven across industries and income cohorts. For example, the bill makes permanent the immediate expensing of research and development costs, potentially pulling forward spending due to tax advantages.

On the consumer side, lower-income households remain structurally pressured by elevated prices on essentials, while middle-income consumers continue to spend, with a clear pivot toward value. We expect to see evidence that higher prices and wage pressure will benefit companies associated with trade-down goods. Higher-income households, which account for the majority of total consumption, remain stable and continue to support travel, premium dining, and services. We believe expected tax benefits are more likely to show up as incremental demand for value-oriented retailers, quick-service restaurants, and affordable small luxuries, rather than creating demand for big-ticket discretionary categories.

We also continue to like long-term real-asset stories that sit outside the AI spotlight: water infrastructure, where scarcity and aging systems require ongoing investment, and home construction and building materials, where structural housing shortages and an aging housing stock support demand. We would also highlight strategic assets such as fertilizer, where food security and national security are driving investment in reliable, long-duration capacity regardless of the economic cycle.



Source: FactSet

In retrospect, 2025 confirmed our core views, while exposing a few to meaningful tests. We expected AI to broaden beyond a handful of early leaders. We also anticipated that higher-for-longer rates and a more fragmented geopolitical environment would favor companies with strong balance sheets, pricing power, and diversified supply chains—characteristics that proved to be the right side of the trade. What surprised us was the path markets took to get there. Tariffs, political risk, and “Liberation Day” headlines produced more short-term volatility than we expected, particularly in globally exposed industrial and consumer names. Health Care became a lightning rod for policy concerns. Proposals to trim the National Institutes of Health budget, reimbursement and insurance pressure, and a weaker biotech funding environment weighed on the sector for much of the year.

Finally, concentration risk grew even more pronounced. A small group of AI-exposed leaders dominated not only U.S. returns but also global equity benchmarks. Diversification in U.S. large-cap equity has not been rewarded over the past few years, and we were not immune to that headwind. Even so, we remain convinced of its long-term benefits, and our process continues to look across industries and economic sensitivity. Part of our job in 2026 is to participate in the AI opportunity while staying vigilant about areas of concentration and continuing to build exposure to durable themes and high-quality businesses whose growth is not yet fully recognized by the market.

2026 Outlook: Non-U.S. Equities

We expect non-U.S. equities to enter 2026 from a position of renewed strength. After a long period in which U.S. mega-cap growth dominated global equity returns, 2025 saw a meaningful rotation toward international markets, supported by a weaker dollar, better relative valuations, and early signs of policy easing outside the U.S. International developed and emerging markets (EM) should again be competitive return sources in 2026, but against a backdrop of slower global growth and elevated geopolitical and trade risk.

We believe the coming year will support maintaining or selectively adding to diversified non-U.S. equity exposure, tilting toward countries with credible policy frameworks, while avoiding heavy concentration in any single macro or political outcome.

From a macro perspective, the IMF projects world GDP growth of about 3.1 percent in 2026, with advanced economies around 1.5 percent and emerging market and developing economies slightly above 4 percent¹⁰. The World Bank is more cautious, expecting global growth to weaken to roughly 2.3 percent in 2025 with only a modest recovery through 2026 and 2027¹¹. Within non-U.S. markets, the Organization for Economic Co-operation and Development (OECD) projects the euro area to grow at roughly 1.0 percent in 2025 and 1.2 percent in 2026 as real incomes improve and Recovery and Resilience Facility (RRF) funds support investment¹². With emerging markets projected to grow just above 4 percent in 2025 and 2026, Asia remains the main growth engine¹³. India is expected to grow around 6.6 percent in 2025 and 6.2 percent in 2026. China's growth is projected to be near 4.8 percent in 2025, with some moderation in 2026¹⁴.

Important for international equities, inflation in most developed markets is expected to be near central bank targets next year, which should allow further, measured rate cuts in the euro area, the U.K., and parts of developed Asia, as well as many emerging markets. The OECD expects headline inflation in G20 advanced economies to be around 2.5 percent for the next two years¹⁵. This environment of slower but positive growth, moderating inflation, and a gradual shift toward easier policy is broadly supportive for non-U.S. equities, particularly in regions where starting valuations are undemanding.

After strong relative performance in 2025, non-U.S. markets are no longer deeply neglected, but valuations remain attractive. The MSCI ACWI ex USA and MSCI EAFE Indices both trade around 15 times the next 12-month expected earnings, putting both below their respective 10-year averages and at a substantial discount to the S&P 500¹⁶. The discounts do not guarantee outperformance in any single year. Still, they raise the hurdle for U.S. outperformance and provide a valuation cushion for international markets if earnings expectations adjust to slower global growth.

Continental Europe and the U.K.

Within developed markets, Europe and the U.K. remain a core building block of non-U.S. exposure, offering reasonable valuations and diversified sector exposure despite modest growth. European equities enter 2026 with supportive tailwinds: cheaper valuations relative to the U.S., improving real income growth, and modest policy easing. Surveys of equity

¹⁰ [World Economic Outlook, October 2025: Global Economy in Flux, Prospects Remain Dim](#)

¹¹ [Global Economic Prospects -- June 2025](#)

¹² OECD (2025), *OECD Economic Outlook, Volume 2025 Issue 1: Tackling Uncertainty, Reviving Growth*, OECD Publishing, Paris, <https://doi.org/10.1787/83363382-en>.

¹³ [World Economic Outlook, October 2025: Global Economy in Flux, Prospects Remain Dim](#)

¹⁴ [Asia's Economic Growth Is Weathering Tariffs and Uncertainty](#)

¹⁵ OECD (2025), *OECD Economic Outlook, Interim Report September 2025: Finding the Right Balance in Uncertain Times*, OECD Publishing, Paris, <https://doi.org/10.1787/67b10c01-en>.

¹⁶ FactSet, Bloomberg as of November 26, 2025

strategists point to mid-single to low-double-digit upside for key European indices through 2026, driven more by earnings growth and modest multiple expansion than by re-rating to U.S. levels¹⁷.

That said, the macro-outlook is only moderately positive. The euro area is projected to grow by 1 percent in 2025 and 1.2 percent in 2026, with investment held back by elevated uncertainty and slower external demand¹⁸. Structural headwinds in Germany, including weak productivity and adverse demographics, remain unresolved, even as increased public investment supports a gradual recovery¹⁹.

Japan and Developed Asia

Beyond Europe, Japan and the rest of developed Asia offer a different mix of catalysts, with corporate reform and sector leadership in technology playing a larger role than macro growth alone. Japan continues to provide a differentiated story with corporate governance reform, shareholder-friendly capital allocation, and moderate inflation supporting nominal earnings growth. While GDP growth is expected to slow toward 0.4 percent in 2026, corporate earnings can still grow faster than the economy as companies improve margins and capital efficiency²⁰.

Elsewhere in developed Asia, markets such as Australia and Korea are levered to commodity dynamics, Chinese growth, and global tech cycles. With tariffs and industrial policy reshaping supply chains, we see potential opportunities in onshoring beneficiaries and semiconductor ecosystems, but dispersion between winners and losers may widen.

Emerging Markets

In contrast to developed markets, emerging economies offer higher structural growth, but that opportunity set comes with greater dispersion, policy risk, and sensitivity to external financing conditions. Emerging market equities staged a notable comeback in 2025, helped by a weaker dollar, improving inflation dynamics, and increased investor interest in diversifying away from U.S. mega caps. Sentiment has also improved due to lower valuations, better earnings prospects, and expectations of broad-based monetary easing across EM central banks.

Within this context, we see a few distinct regional narratives. Emerging Asia is forecasted to grow around 5.2 percent in 2025, easing to the high 4 percent range in 2026, still well above global averages²¹. India remains one of the fastest-growing major economies, with forecasts around 6 to 6.5 percent through 2027²². Reforms in tax, digital infrastructure, and manufacturing incentives support medium-term earnings growth across the financial, consumer, and industrial sectors, though valuations already discount much of this story. China continues to grapple with property-sector stress and weak private investment, but modest stimulus and industrial policies in high-tech and green sectors are stabilizing activity. IMF projects around 4.8 percent growth in 2025, easing toward the low 4s thereafter, implying slower but still meaningful expansion²³.

In Latin America, Brazil and Mexico could benefit from nearshoring and commodity exposure as part of a broader global supply chain re-orientation²⁴. Lastly, frontier markets are more heterogeneous. Countries emerging from crises, such as

¹⁷ [Relatively cheap European stocks set for another 11% gain in 2026: Reuters poll | Reuters](#)

¹⁸ OECD (2025), *OECD Economic Outlook, Volume 2025 Issue 1: Tackling Uncertainty, Reviving Growth*, OECD Publishing, Paris, <https://doi.org/10.1787/83363382-en>.

¹⁹ [Germany's Merz sees signs economy turning corner, IMF says mid-term prospects constrained | Reuters](#)

²⁰ OECD (2025), *OECD Economic Outlook, Volume 2025 Issue 1: Tackling Uncertainty, Reviving Growth*, OECD Publishing, Paris, <https://doi.org/10.1787/83363382-en>.

²¹ [World Economic Outlook, October 2025: Global Economy in Flux, Prospects Remain Dim](#)

²² [Asia's Economic Growth Is Weathering Tariffs and Uncertainty](#)

²³ [People's Republic of China and the IMF](#)

²⁴ [Latin America economic outlook | Deloitte Insights](#)

some frontier Asian and African economies, may offer high return potential but with substantial political and liquidity risk. In aggregate, we emphasize diversification across regions and careful consideration of corporate governance and liquidity.

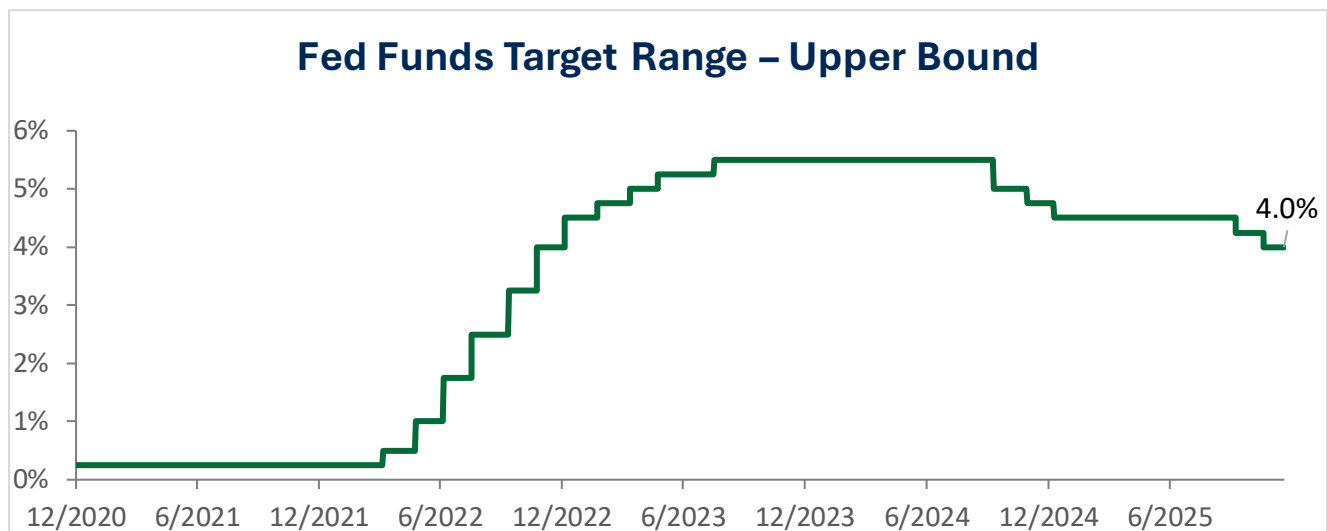
Key risks to the 2026 non-U.S. equity outlook center on a renewed round of trade and tariff escalation, the chance of central bank policy mistakes (including premature easing), and the possibility of a harder-than-expected landing in China that would pressure Asia, commodities, and global manufacturing. Geopolitical tensions, energy disruptions, and policy swings around major elections in Europe, emerging markets, and the U.S. could also push up volatility and risk premiums. Finally, a stronger U.S. dollar would tighten financial conditions for emerging markets and reduce translated returns on foreign assets for U.S.-based investors.

For a diversified multi-asset investor, we recommend maintaining a strategic allocation to international developed and emerging markets equities, given still-favorable valuation differentials versus the U.S. and a persistent growth premium in select emerging markets. Additionally, avoiding over-concentration in any single macro-narrative, such as a single-country recovery or a binary view of U.S. policy, and maintaining flexibility to adjust exposures in 2026 will be key as political and policy events unfold.

Fixed Income Outlook 2026

Slower economic growth and a weaker but still healthy labor market in 2025 pressured U.S. Treasury yields lower across the yield curve. As of November 21, 2025, the 2-year and 10-year U.S. Treasury yield closed at 3.51 percent (down 73bps on the year) and 4.06 percent (down 51bps on the year), respectively. Credit concerns started to pick up in the fourth quarter, starting with the First Brand and Tricolor bankruptcies, followed by the AI-related debt issuance binge. Interestingly, credit spreads were trading only modestly higher through November 21, 2025, with investment-grade credit spreads closing at 85bps (5bps higher YTD) and high-yield credit spreads closing at roughly 301bps (14bps higher YTD).

The Federal Reserve (Fed) has cut the federal funds target range by 50 basis points to 3.75 percent and 4.00 percent through November 2025, while maintaining its bias for further interest rate cuts as we turn the corner to 2026.



Source: Bloomberg as of 11/30/25

We believe additional rate cuts are in the cards for 2026 as the Fed continues to normalize monetary policy. In our view, bringing the federal funds target range more in line with the Fed's 3.0 percent neutral rate is appropriate given our expectations of easing inflation towards 2.0 percent in 2026 while economic growth and the labor market remain healthy.

The Fed will take a cautious approach to monetary policy to ensure the risks to achieving its dual mandate of price stability and maximum employment stay in balance.

U.S. Treasury yields may continue to fall further in 2026, with the front end leading the way. Short-term Treasury yields will likely follow the same path as the federal funds rate, while longer-term yields will also reflect the large stockpile of U.S. Treasury debt. It's expected that long-term maturity U.S. Treasury bond issuance will increase in 2026, which could act as a headwind to lower yields. We believe a fair trading range for the 10-year U.S. Treasury yield at the end of 2026 is 3.50 to 3.75 percent. This represents a federal funds rate around 3.00 percent, while the term premium adds another 50 to 75 bps to yield, roughly where it is today.

In the corporate bond sector, investment-grade and high-yield credit spreads trended higher in October and November as investor concerns about credit deepened amid fraud-related bankruptcies and elevated levels of debt issuance by AI-related issuers. Although the trend is concerning, current credit spreads remain within a healthy range for a corporate bond market. Overall, corporate fundamentals remain healthy and are expected to remain so in 2026. However, default rates could trend higher given our expectations of a slowing economy, along with the length of the current credit cycle. We believe credit spreads will be volatile in 2026 but anticipate continued investor demand will support the sector when valuations materially cheapen.

Emerging market debt was a strong performer in 2025. The asset class provided investors with an additional 250 basis points of yield compensation over U.S. Treasuries as of November 21, representing 50 basis points of spread tightening since the beginning of the year. Diversification outside of the U.S. was a common theme in 2025 and one we believe will continue into 2026. Current valuations are stretched, which could prevent any material tightening in the emerging market space next year. However, within an environment of slowing global inflation, supportive global economic growth, and still attractive absolute yields, we believe a modest allocation to emerging market debt is appropriate.

Within developed international fixed income, opportunities in 2026 should be weighed against factors such as central bank policies, macro and credit environments, and fiscal policies, given the different geographical yields relative to the U.S. For example, we expect the U.S. central bank to remain in a rate-cutting cycle in 2026, while the European Central Bank may very well be near its end. The former could have a more positive influence on the debt market, with bond prices appreciating as yields decline.

Interestingly, Japan is operating under a different playbook, with its main policy rate expected to continue increasing in 2026. Japan's 10-year government bond has been trending higher in recent years, closing at 1.80 percent on November 28, 2025. Although we don't currently have a material allocation to international fixed income markets, we are actively looking for an opportunity to add exposure when we believe the timing is appropriate.

Tax-free municipal bonds will remain a reliable source of tax-free income for those in high marginal tax brackets. The 5- and 10-year AAA municipal bond yields closed on November 22, 2025, at 2.42% and 2.74%, respectively, both lower on the year. Healthy fundamentals combined with expected positive economic growth should support issuer revenues in 2026. States have done a respectable job building cash reserves, which should support budgets next year as well. Valuations are reasonable, although bond issuance could pressure yields higher as issuers look to replenish COVID-related monies. High-yield tax-free issuers add additional diversification while carrying more credit risk. A modest allocation may be appropriate depending on an investor's risk tolerance. We believe absolute yields in the municipal bond space should keep investor demand strong.

Overall, we expect fixed-income portfolios to continue to generate material income for client portfolios in 2026. Interest rates could stay elevated as the Fed targets a more normal policy stance, and a slowing U.S. economy could create volatility in fixed income spread sectors. Balancing reinvestment and price risk will remain a focus in portfolios, while seeking opportunities to add to credit exposure when valuations become more compelling.

Alternatives: The case for diversifying with Real Assets

In a world dominated by technology, investors have increasingly overlooked real assets. Until recently, many had all but forgotten them. A notable shift is underway back toward the real estate, precious metals, commodities, and infrastructure that make up the real asset universe. The investment case for real assets, historically viewed as inflation hedges and valuable diversifiers, has resurfaced. This is driven by stronger fundamentals, including more attractive valuations and powerful policy tailwinds, and a changing portfolio regime, defined by high market concentration and uncertainty surrounding inflation and interest rates.

The combination has created a compelling backdrop. We believe real assets offer more valuation upside than many other market segments at a time when the macro environment is increasingly supportive. For investors who believe equity markets are relatively expensive, interest rates may gradually decline, inflation remains a lingering risk, and global capital will continue to flow into infrastructure and commodities, real assets could provide meaningful and asymmetric upside potential.

The gold market exemplifies this shift. Once viewed primarily as a hedge, gold is emerging as a legitimate long-term driver of returns for diversified portfolios. And if infrastructure and real estate begin to outperform, supported by policy initiatives, capital inflows, and superior yields, real assets may take on a far more significant role in next-generation portfolio construction.

Bringing these themes together, we see real assets not as a tactical trade, but as a structural complement to traditional stock-bond portfolios. Thoughtful allocations to gold, real estate, commodities, and infrastructure can help diversify equity risk, add potential income and return, and provide a measure of resilience if inflation or policy surprises re-emerge.

Conclusion

This year's rally leaned heavily on AI optimism and expectations for policy easing, but meaningful risks linger beneath the surface: policy uncertainty, elevated valuations, and concentrated U.S. equity-market leadership. Investors gravitated toward large, cash-rich tech giants—the "Magnificent 7" and the like—who wield outsized influence, meaning any stumble, policy shock, geopolitical flashpoint, or valuation reset could ripple across broader markets. Meanwhile, more speculative AI names and export-exposed companies faced greater stress. Selectivity remains essential.

The AI-driven capex cycle is a genuine secular force, but markets are wrestling with how much future growth is already priced in and how dependent that growth rate is on stable policy and liquidity conditions. Against this backdrop, investors should increasingly emphasize diversification across asset classes, geographies, and sectors as well as thoughtful hedging and a blend of growth, defensive, and real-asset exposures. With market volatility settling at a higher baseline, the value of a balanced approach is more evident than ever.

In 2025, the BMTA Chief Investment Office marked a pivotal year of rebuilding. We strengthened the organization across the board, expanding U.S. equity research, adding depth to multi-asset research, and enhancing our alternatives and manager-selection capabilities. Just as importantly, we refined our multi-asset investment framework around fundamental client objectives—income, stability, and growth—and launched a suite of corresponding multi-asset ETF portfolios.

We also formalized and systematized our investment process across strategy, solutions, trading, and advisor engagement, creating a more consistent, transparent, and repeatable approach. Across the organization, upgrades were aimed squarely at providing actionable guidance, fast responses, and consistent portfolio implementation. With this momentum, we are confident in our ability to support our advisors and clients even more effectively in the year ahead.

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Certain information contained in this communication constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "believe" or other comparable terminology. Due to various risks and uncertainties, actual events or results may differ materially from those reflected or contemplated in such forward-looking statements.

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