



Capital Markets Performance

Global equity markets had a strong 2025, with indices around the world ending the year near all-time highs, despite volatility associated with tariff fears and valuation concerns, especially for U.S. Large-Cap Growth stocks levered to artificial intelligence. The S&P 500 ended the fourth quarter up 2.7% and 17.9% for the year. 2025 was the third consecutive year of double-digit gains for the index. In 2025, growth stocks outperformed value stocks in large-caps and small-caps, while value stocks led growth stocks in the mid-cap segment of the market as market performance broadened. Large-Cap Growth stocks were the best performers for the year, up 18.6%. All eleven S&P 500 sectors were positive for the year, led by the Communication Services and Technology sectors. Real Estate and Consumer Staples were the weakest relative performing sectors.

International stocks outperformed the U.S. in 2025 as the MSCI All Country World Index ex USA gained 5.1% in the fourth quarter and 32.4% for the year, while the MSCI Emerging Markets Index was up 4.7% for the quarter and 33.6% for the year. International stock returns benefited from fiscal and monetary stimulus, as well as a weaker U.S. dollar. The USD dollar index fell by 9.4% in 2025 on Fed interest rate cuts, concerns over U.S. trade policy and a growing national debt level. The weaker dollar also contributed to gold prices, ending the year at record highs, while crude oil (WTI) fell by 20.0% for the year on higher global supplies.

U.S. Treasury yields fell in 2025 as markets priced in additional Fed rate cuts because of labor market weakness. The yield curve steepened as mixed signals on inflation and economic growth led to a greater decline in short-term rates versus the longer end of the Treasury curve. Credit spreads continued to tighten from historically low levels as investors grew more comfortable owning corporate debt amid strong corporate earnings reports. The U.S. Aggregate Index was up 1.1% in the fourth quarter and 7.3% for the year, with all six sectors recording gains led by Corporate Bonds and Collateralized Mortgage-Backed Securities. Lower rated bonds and intermediate term duration bonds were relative outperformers for the quarter and year. Interest rates moved higher in Germany as the European Central Bank concluded its rate cutting cycle and Germany's fiscal spending increased growth expectations. Rates in Japan increased on inflation expectations and expected rate hikes by the Bank of Japan.

U.S. Economy and the Federal Reserve

We anticipate that the U.S. economy grew by approximately 2.0% in 2025. This compares with annual real GDP growth of 2.8% in 2024 and 2.5% in 2023. Economic growth was supported by resilient consumer spending and business investment, especially in artificial intelligence. Higher tax returns because of last year's tax reform will be a boost to consumer spending and the economy in the first half of 2026. Any potential tariff rebate checks would provide additional support to consumer spending.

The U.S. job market softened last year, with both labor demand and supply slowing. Job gains averaged 49,000 a month in 2025 as compared with 168,000 last year. The unemployment rate drifted higher through the year, ending at 4.4%. We view the job market as frozen, with companies not looking to add or reduce staff because of policy uncertainty, tariffs, restrictions on immigration and productivity gains.

Inflation fell slightly over 2025, with the December Consumer Price Index (CPI) up 2.7% year-over-year as compared with 2.9% at the start of the year. This decline was despite the tariff rate on U.S. imports nearing 15.0% at year-end as compared with 2.4% in 2024. The potential tariff rate was feared to be over 30.0% following the April 2 announcement, which led to a sharp market sell-off in the following days. A pause in reciprocal tariffs then led to a strong rebound in the markets.

The U.S. Federal Reserve reduced its target federal funds rate by 25 basis points three times late in 2025, citing softness in the job market. This followed a nine-month pause after the Fed had cut rates by 1.0% in 2024. The Fed maintained its forecast for one 25 basis point cut in 2026. The Fed appears willing to allow inflation to remain above its 2.0% target with a focus on its maximum employment mandate. Current market expectations are for two 25 point rate cuts by the end of the year. We expect the Federal Reserve's terminal rate to be in the range of 3.0% to 3.25% by the end of the year, as compared with the current target rate of 3.50%-3.75%.

Outlook and Portfolio Positioning

As we head into 2026, consumer confidence and sentiment seem overly bearish, while market sentiment remains overly bullish, in our view. We expect the U.S. economy to grow in 2026, with the job market remaining soft and inflation moderating as tariff pressures and shelter costs ease year-over-year. Market positives include fiscal and monetary support, along with still strong corporate earnings. Market risks in the U.S. include elevated valuations, geopolitical tensions around the world and political and policy uncertainty as we head into the midterm elections later this year. History shows that market volatility tends to be elevated during midterm election years.

Market performance in 2025 illustrated the importance of being diversified across asset classes and geographies, as most major asset classes and regions saw strong gains. In 2026, we believe investors should maintain a disciplined and well-diversified approach. That is why we remain balanced in our equity exposures across growth and value styles, market capitalizations and global regions. Market rotation was evident last year, with international markets outperforming U.S. markets by over 10.0% percent. This represented the largest annual relative outperformance by international markets since 2005. A weaker U.S. dollar, fiscal and monetary stimulus and still attractive relative valuations remain catalysts for international equities, in our view. In the U.S., value and mid- and small-cap stocks remain relatively attractive versus growth and larger capitalization stocks.

We expect interest rates to remain range-bound in 2026 and believe investors should focus on the coupon return of their fixed income holdings. The current yield to maturity of the U.S. Aggregate Index is approximately 4.30%, which is a good starting point to think about potential fixed income returns. The ability to add additional credit and interest rate risk could boost returns.

Despite market uncertainty and volatility, it remains critical to stay diversified and committed to long-term investing. Market history shows that time in the markets produces better outcomes than attempting to time the markets.

As always, we thank you for your continued support and trust in Newport Capital Group.

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