

# Market Newsletter

## Fourth Quarter 2025

## **EXECUTIVE SUMMARY**

- US stocks performed well in 2025, helped by large technology companies, though performance broadened modestly toward the end of the year.
- Foreign stocks outperformed US stocks significantly, helped by a declining dollar, corporate reforms and improved profitability in Japan as well as fiscal stimulus in Europe.
- Fixed income delivered a solid recovery after several challenging years, helped both by higher coupon income and declining interest rates as monetary policy gradually eased.
- The U.S. economy continued to expand in 2025, though at a slower pace than in prior years.
- The Federal Reserve cut its benchmark federal funds rate during the second half of the year.
- Political developments played a visible role in shaping market sentiment during 2025.
- Corporate earnings continued to be strong as companies navigated the uncertain and unstable environment.
- US stocks are more expensive than foreign stocks in absolute and relative terms.
- There are elements of investor behavior and market pricing currently that rhyme with previous bubbles but there are key differences that seem to suggest we are not yet in a bubble.
- Investors should continue to focus on diversification to create resilient portfolios.

**Table 1: Market indices**

<i>(Returns include dividends reinvested)</i>	<b>Quarter to date</b>	<b>Year to date</b>	<b>1 Year</b>	<b>3 Year Annualized</b>	<b>5 Year Annualized</b>
S&P 500	2.65%	17.88%	17.88%	23.01%	14.42%
S&P Mid Cap 400	1.64%	7.50%	7.50%	12.56%	9.12%
S&P Small Cap 600	1.70%	6.02%	6.02%	10.17%	7.31%
MSCI Emerging Markets	4.78%	34.36%	34.36%	16.98%	4.67%
MSCI EAFE	4.91%	31.89%	31.89%	17.82%	9.7%
Vanguard Total Bond Market Index	0.96%	7.03%	7.03%	4.54%	-0.54%
Investment Grade Credit	0.66%	7.78%	7.78%	6.28%	0.11%
Non-Investment Grade Credit	1.34%	8.50%	8.50%	10.03%	4.50%
Bloomberg Commodity Index	5.85%	15.77%	15.77%	3.96%	10.64%
Dollar Index	0.56%	-9.36%	-9.36%	-1.70%	1.80%
10 Yr. Rate	4.16% 12/31/2025	4.16% 12/31/2025	4.57% 12/31/2024	3.88% 12/31/2022	0.92% 12/31/2020

Source: S&P Dow Jones, St Louis Fed, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

**Table 2: Vanguard Life Strategy (Asset Allocation) Funds**

	<b>Quarter to date</b>	<b>Year to date</b>	<b>1 Year</b>	<b>3 Year Annualized</b>	<b>5 Year Annualized</b>
Income (20% stocks)	1.33%	9.42%	9.42%	7.83%	1.92%
Conservative Growth (40% stocks)	1.83%	12.86%	12.86%	10.93%	4.24%
Moderate Growth (60% stocks)	2.32%	16.24%	16.24%	13.98%	6.49%
Growth (80% stocks)	2.79%	19.63%	19.63%	17.08%	8.76%

Source: Vanguard

**Table 3: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)**

As of 01/05/2026	Latest Release	Recent Trend	Notes
Non-Farm Employment	64,000	Negative	Jobs growth continues to be anemic and has shown little change since April, possibly caused by Tariff uncertainty. The unemployment rate has inched up to 4.6%, the highest level since September 2021.
Weekly Claims for Unemployment Insurance	199,000	Positive	Initial claims are low by historical standards. However, continuing claims are higher than they were last year, in line with a worsening jobs situation.
ISM Manufacturing Index (over 50 indicates growth)	47.9	Negative	Manufacturing activity contracted for the 10th month and fell to a 14 month low. Survey respondents singled out Tariffs as a major concern.

# SARSI

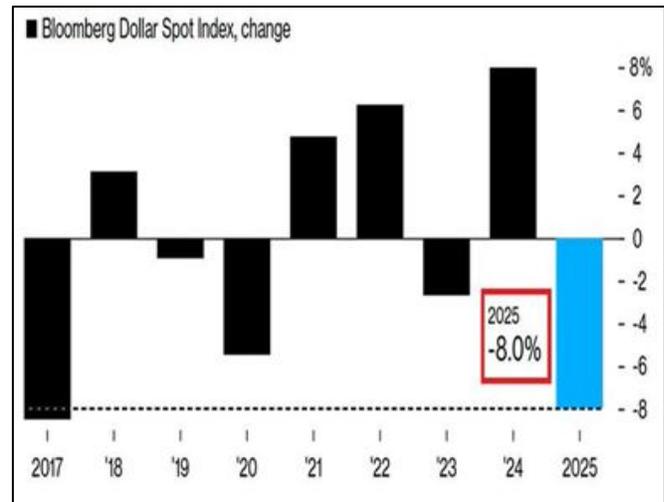
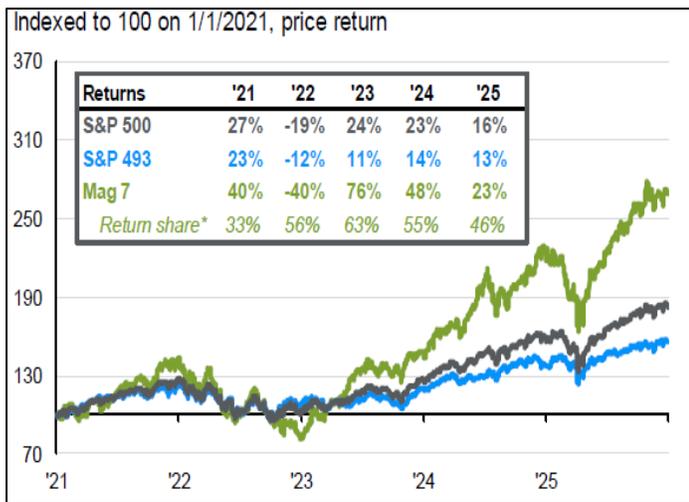
	Latest Release	Recent Trend	Notes
ISM Non Manufacturing Index (Over 50 indicates growth)	52.6	Positive	The services sector has been recovering recently and is at the highest level since March 2025. Under the surface, new orders and employment are weak, reflecting the uneven recovery.
Consumer Prices (Month over month change)	0.2%	Negative	Consumer prices increased by 2.7% in one year, better than expected and a drop from recent highs. However, it is higher than the level last summer and the level that the Federal Reserve is comfortable with (2%)
Producer Prices (Month over month change)	0.3%	Positive	Like consumer prices, producer prices increased by 2.7% year over year as of September. Tariffs and higher energy prices contributed to the increase. The release of recent number has been delayed by the shutdown.
Retail Sales (Month over month change)	0.0%	Negative	The shutdown delayed report showed that retail sales moderated in the fall, as consumers turned cautious in the face of fewer job openings and higher prices. However, subsequent reports by credit card processors Mastercard and Visa showed that consumer spending was healthy in the holiday season.
Consumer Confidence (Conference Board)	89.1	Negative	Consumer confidence weakened for a fifth consecutive month in December, with continuing concerns over jobs and business conditions
Durable Goods Orders (Month over month change)	-2.2%	Positive	This was the first monthly decline in three months. However, durable goods orders are up 4.8% from a year ago. Core capex, which strips out defense and aircraft orders, was up 0.5% for the month and is up a healthy 6.2% since last year.
Industrial Production (Month over month change)	0.2%	Positive	Industrial production surprised to the upside in November and is now at the pre-pandemic level. Mining output helped significantly.
Capacity Utilization	76%	Positive	Capacity utilization has slipped 3.5% below its long term average which could be because of the uncertainty caused by higher Tariffs.
Housing Starts	1.307MM	Negative	This data has not been released since September because of the shutdown.
Home Prices (Case-Shiller Home Price Index- Year over Year)	1.30%	Negative	Home prices continued to rise but at a much slower pace than the recent past. Low home affordability is dampening demand for homes.
GDP (Real, Annualized)	4.3%	Positive	The US economy grew at the fastest rate in two years in the third quarter. The growth was helped by consumer spending, exports, and government spending that were partly offset by a decrease in investment.

Source: Bloomberg, [www.federalreserve.gov](http://www.federalreserve.gov), [www.bls.gov](http://www.bls.gov), [www.ismword.org](http://www.ismword.org), [www.nahb.org](http://www.nahb.org)

U.S. equity markets delivered another strong year, helped by a combination of resilient corporate profitability, sustained investment in artificial intelligence, and a gradual improvement in financial conditions as the year progressed. While enthusiasm for technology-driven productivity gains remained a key influence, supportive macro conditions increasingly reinforced investor confidence. Equity leadership continued to be dominated by a small group of large technology and communications firms (Fig 1), although participation across the broader market improved somewhat in the latter part of the year. Foreign stocks handily outperformed domestic stocks by the widest margin in several years, helped by a declining US dollar. (A weaker US dollar as compared to foreign currencies makes foreign stocks more valuable in US dollar terms), corporate reforms and improved profitability in Japan as well as fiscal stimulus in Europe. The US dollar had its worst year versus foreign currencies since 2017 (Fig 2).

Fig 1: Magnificent 7 performance vs the rest of S&P 500

Fig 2: US dollar vs a basket of foreign currencies



Source: Bloomberg

Source: JP Morgan

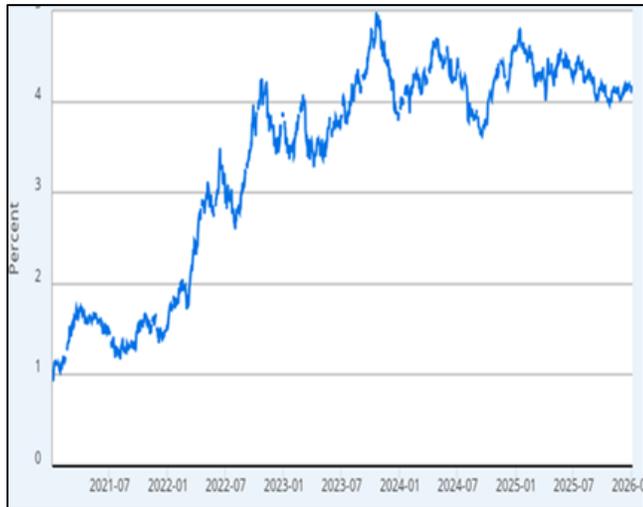
During 2025, fixed income delivered a solid recovery after several difficult years, benefiting from both higher coupon income and declining interest rates as monetary policy gradually eased. Broad U.S. bond benchmarks generated mid-single-digit total returns, while credit-oriented segments such as corporate bonds and emerging-market debt generally outperformed more conservative sectors. Yields that remained attractive by historical standards helped sustain investor demand throughout the year, reinforcing the role of bonds as a source of income and portfolio stability. Even with equities posting strong gains, fixed income contributed meaningful diversification benefits and reduced overall volatility for balanced portfolios. The 10-year US Treasury yield continues to hover around 4% (Fig 3) and should continue to help bond performance.

Commodities performed well, helped by a historic year for precious metals. Gold prices rose significantly, supported by inflation and currency concerns, central bank buying, and geopolitical uncertainty. Silver experienced one of its strongest years in decades, outperforming gold due to its dual role as both a precious metal and an industrial input.

The U.S. economy continued to expand in 2025, though at a slower pace than in the prior year. Real gross domestic product (GDP) grew at an estimated 2.0% to 2.3% for the full year, according to a range of government data and private-sector estimates. Growth varied by quarter, with stronger consumer spending and government outlays offset by softer business investment and housing activity. By comparison, U.S. GDP growth in 2024 was 2.8%, making 2025 a year of moderation rather than contraction. While growth slowed, the economy remained resilient, helped by employment levels that stayed near long-term norms, continued household spending and massive wave of business investment in Artificial Intelligence (AI).

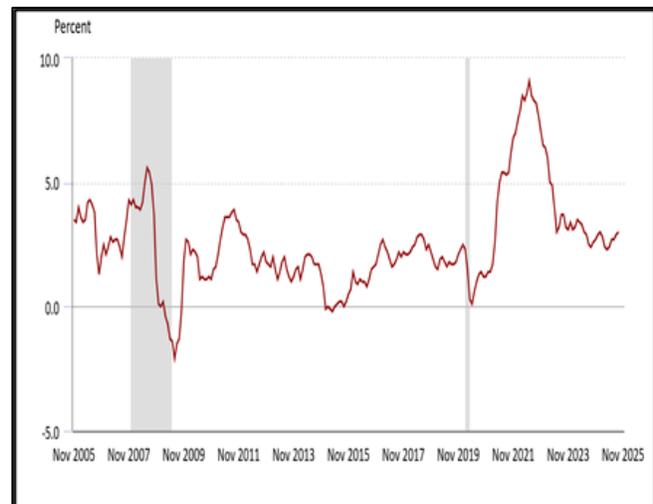
Inflation declined from its post-pandemic peaks but remained above the Federal Reserve’s (Fed) long-run target of 2%. (Fig 4) The Personal Consumption Expenditures (PCE) price index—the Fed’s preferred inflation measure—was 2.8% year over year in late 2025. Services inflation remained sticky, while goods prices were more stable than in earlier years.

Fig 3: 10-year US Treasury rate



Source: Federal Reserve of St Louis

Fig 4: US inflation rate



Source: Bureau of Labor Statistics

Fed policy was a central driver of market behavior in 2025. After holding interest rates at restrictive levels for an extended period, the Fed began cutting its benchmark federal funds rate during the second half of the year. By year-end, the policy rate stood at 3.50% to 3.75%, down from its prior peak. Policy decisions reflected the Fed’s effort to navigate a narrowing path—where inflation remained above target even as economic growth showed signs of cooling. The Fed also continued to manage liquidity in short-term funding markets, particularly around quarter-end and year-end, to ensure smooth market functioning. These actions were largely technical in nature rather than responses to financial stress.

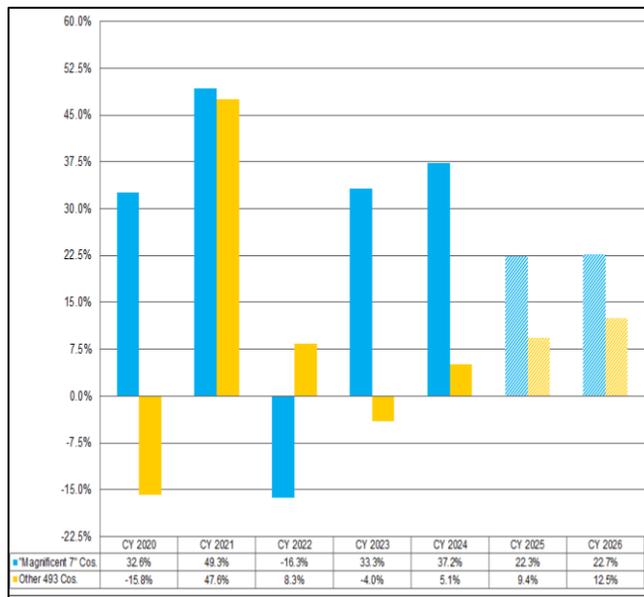
Political developments played a visible role in shaping market sentiment during 2025. A prolonged federal government shutdown in the fall temporarily disrupted some economic data releases and added uncertainty for businesses and markets. Ongoing debates over government spending, tax policy, and trade measures contributed to short-term volatility in certain sectors. The return of the Trump administration brought sweeping tariff measures that initially spooked markets in early 2025. While some of these measures were eventually moderated, they contributed to a "sticky" inflation level and high trade policy uncertainty throughout the year. While political events can influence market psychology, their effects tend to be uneven and often temporary, especially when underlying economic fundamentals remain intact.

Corporate earnings remained strong as companies navigated the uncertain and unstable environment. According to FactSet, the estimated (year-over-year) earnings growth rate for the S&P 500 in the fourth quarter of 2025 is 8.3%. Reaching this target would extend the streak of earnings growth to ten straight quarters. The earnings growth for the calendar year 2025 is expected to be 12.3%, helped by revenue growth of 7% and record profit margins of 13.9%.

Looking ahead, analysts expect the S&P 500 to report double-digit earnings growth for the 3rd straight year in 2026, as per FactSet. The estimated earnings growth rate for 2026 is 15.0%, which is above the trailing 10-year average (annual) earnings growth rate of 8.6%. Analysts are modeling a record net profit margin of 13.9% for 2026 as well, which would be the highest since FactSet began tracking the metric in 2008.

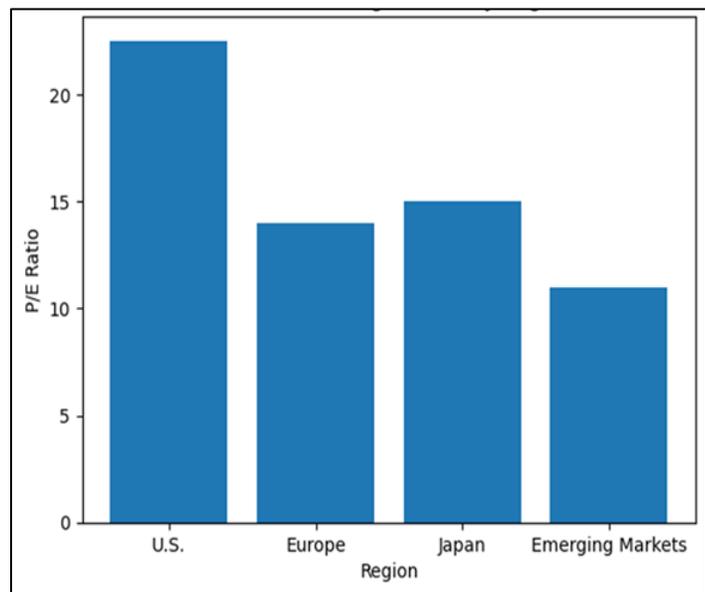
A key theme for 2026 expectations is the broadening of profits. Expectations for earnings growth have increasingly extended beyond the largest technology firms, with analysts raising forecasts for the broader group of S&P 500 companies outside the so-called ‘Magnificent 7’ upward to 12.5% (compared to the 9.4% they delivered in 2025).

Fig 5: US corporate profits- Mag 7 vs rest



Source: FactSet

Fig 6: US stocks are more expensive than foreign stocks.



Source: MSCI, Bloomberg, FactSet

The forward 12-month P/E ratio for the S&P 500 is 21.8. This P/E ratio is above the 5-year average of 20.0 and above the 10-year average of 18.7. Elevated valuation multiples suggest that investors continue to place a premium on earnings visibility, innovation-driven growth, and equities' perceived advantage over cash and fixed income—though such pricing also leaves less room for disappointment.

In contrast, despite significant outperformance in 2025, equity markets outside the US are cheaper as seen in Fig 6. Several factors help explain these gaps: U.S. markets tend to be more heavily weighted toward high-margin technology companies, which helps explain why profit margins for U.S. firms are generally higher than those of their international peers. At the same time, differences in economic growth prospects and political risk across regions play an important role in shaping investor expectations. Currency movements add another layer of complexity, influencing how overseas earnings translate back to U.S. dollars and are ultimately valued by U.S. investors. Taken together, these factors help explain why global markets can be deeply interconnected while still exhibiting meaningful differences in valuation.

## Bubble or not?

The unrelenting ascent of the US stock market, powered by a few large technology stocks, has led to fears of a bubble and the possibility that it could pop soon. It almost seems like there is a bubble in bubble prediction! When almost everyone is expecting a bubble, you can't be faulted for wondering if the consensus is right.

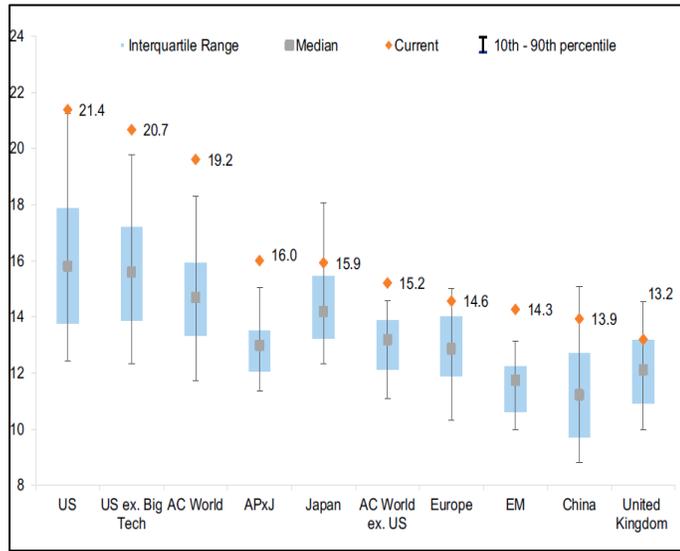
Market history shows that speculative bubbles typically form when excitement over a new, transformative technology outpaces its actual economic output attracting investors, capital and new entrants. Typically, bubbles exhibit rapidly rising asset prices, extreme valuations and significant systemic risks driven by increased leverage.

There are elements of investor behavior and market pricing currently that rhyme with previous bubbles, including the rise in absolute valuations, high market concentration, increased capital intensity of leading companies and the emergence of vendor financing.

However, there are key differences: First, the appreciation of the technology sector has, so far, been driven by fundamental growth rather than irrational speculation about future growth. Figs 7 and 8 show the relative valuations and the return on equity of stocks around the world.

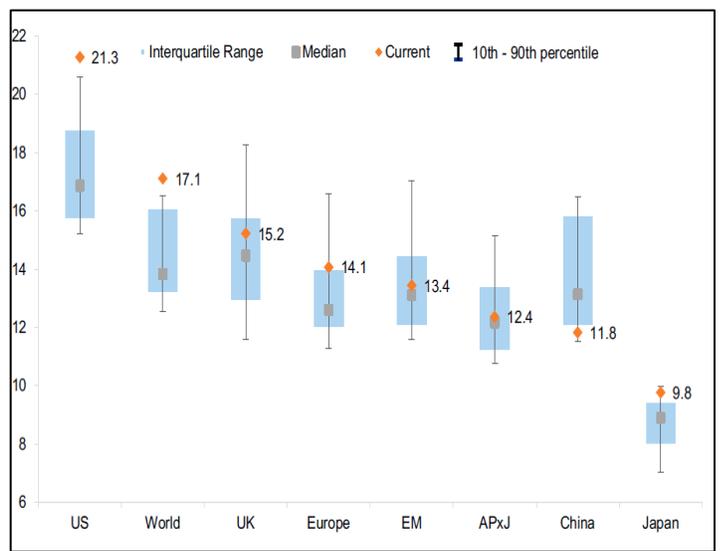
# SARSI

Fig 7: US stocks are expensive relatively & absolutely...



Source: Goldman Sachs

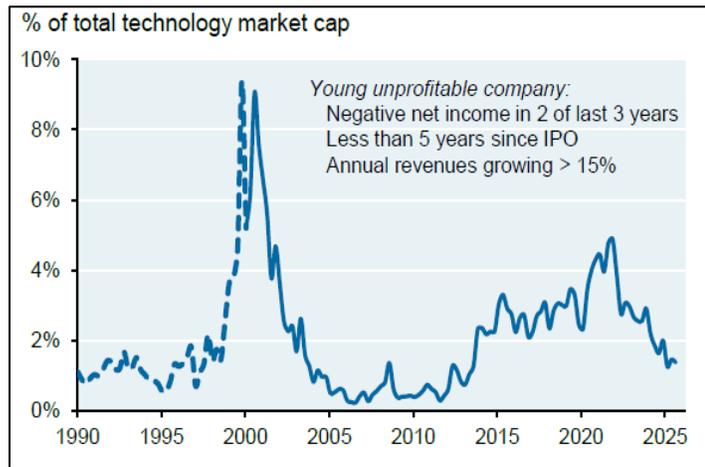
Fig 8... but US stocks are also very profitable (Return on equity)



Source: Goldman Sachs

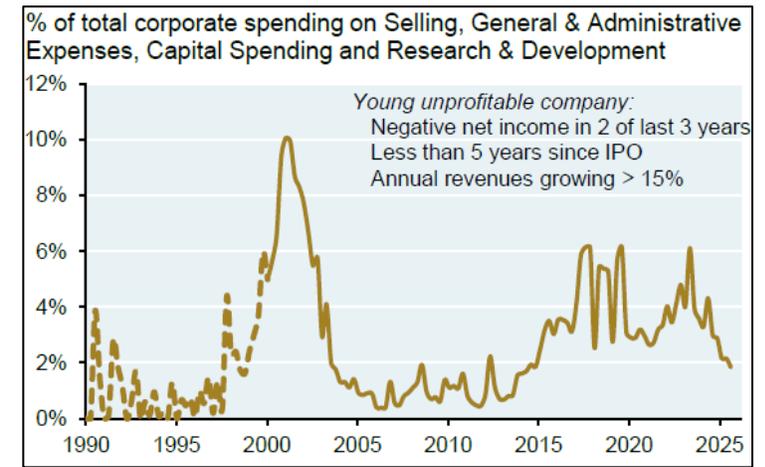
Second, the leading companies that have seen the strongest returns have unusually strong balance sheets. Young unprofitable companies that played a very active role in the 2000 bubble are playing a lesser role this time. Figs 9 and 10 show the market capitalization and spending by these young companies is depressed. Third, the AI space has, so far, been dominated by a few incumbents; most bubbles form in a period of huge competition as both investors and new entrants flock into the space.

Fig 9: Market Cap of young unprofitable tech. companies



Source: JP Morgan

Fig 10: Spending by young unprofitable tech companies



Source: JP Morgan

Importantly, bubbles tend to develop when there is a combined surge in stock prices and valuations to an extent that the aggregate value of companies associated with innovation exceeds the future potential cash flows that it is likely to generate. Valuations of the technology sector are becoming stretched but not yet at levels consistent with historical bubbles.

While it is possible we are not in a bubble yet, high levels of market concentration and increased competition in the AI space suggest investors should continue to focus on diversification to create resilient portfolios.