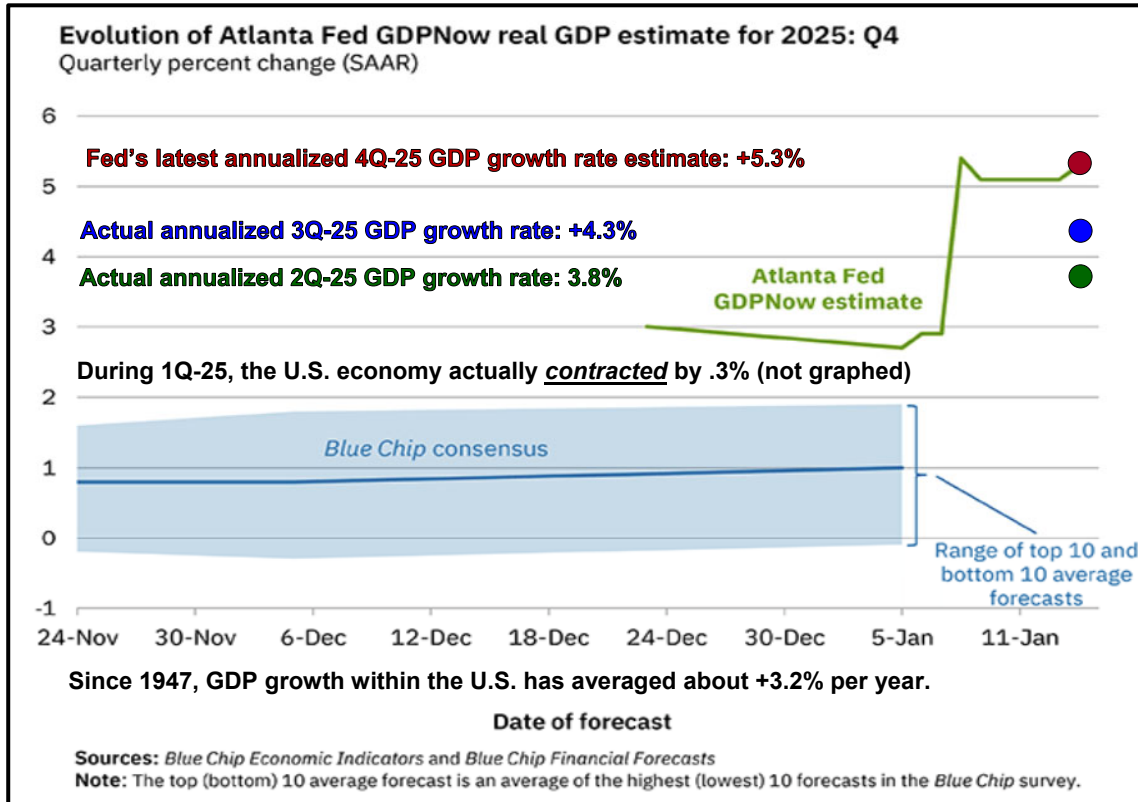


RESILIENCE IN AN ENVIRONMENT OF INSTABILITY

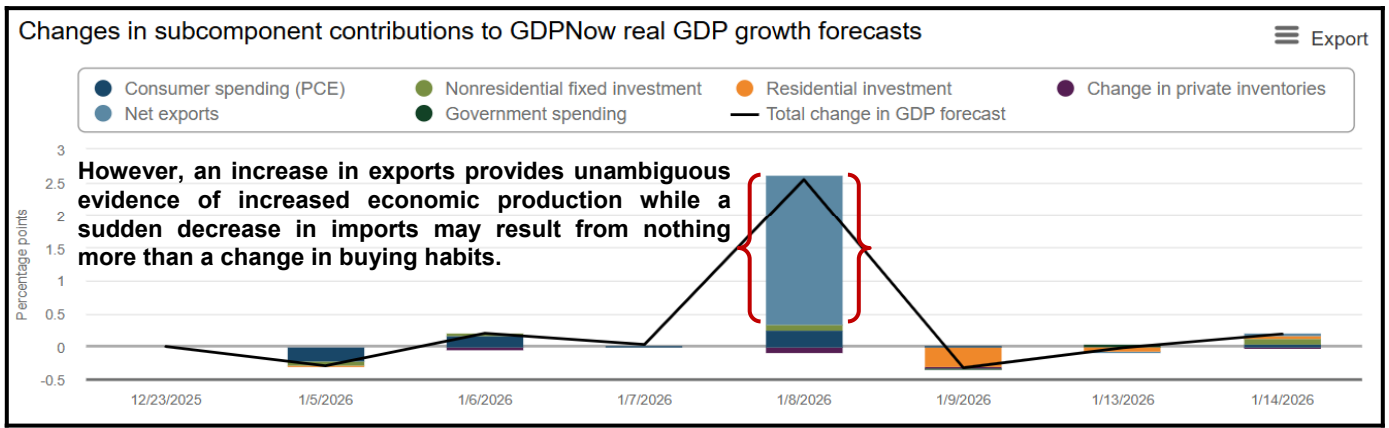
SURGE IN U.S. GDP GROWTH ESTIMATES ...

Over the course of 2025, the Federal Reserve Bank of Atlanta's GDP estimates have continued to surge. The latest, +5.3% run rate of estimated growth within the U.S. dwarfs the first quarter's contraction of .3%.



... MAY BE DISTORTED BY A TARIFF-RELATED DECLINE IN IMPORTS

The robust GDP figures shown above are driven by a sharp improvement in net exports which made its way into the Fed's 4Q-25 GDP estimate on January 8th (bracketed, below). A country's GDP rises when it exports more of its domestically produced goods, and falls when it imports more foreign goods. Mathematically, a given decrease in imports aids a county's GDP figure just as much as an increase in exports does.



CONFERENCE BOARD CONTINUES TO EXPECT A SLOWING

The Conference Board publishes the Leading Economic Index® (LEI) which is designed to provide advance notice of major inflection points in the business cycle. Of course, material changes in the business environment may reasonably be expected to impact the performance of companies in which investors invest.

In a December 9th press release, the Conference Board said, “Weakening expectations from consumers and businesses led the overall contraction in the index. **The LEI suggests slowing economic activity at the end of 2025 and into early 2026**, with GDP weakening after strong mid-year consumer spending and Q4 disruptions amid the federal government shutdown. Overall, **growth remains fragile and uneven as businesses adjust to tariff changes and softer consumer momentum**. The Conference Board expects GDP to expand by 1.8% in 2025, before falling to 1.5% in 2026.”

The Conference Board cites GDP figures that are far below the Fed’s estimate (top of page 1), so I suspect the Conference Board may have adjusted its GDP figures to eliminate the temporary distortion caused by the sharp reduction in U.S. imports. As was the case in my last note, negative contributions from non-financial components of the LEI (bracketed) continue to far outweigh positive contributions that result from rising stock prices and the ample availability of credit (boxed).

Most non-financial components and the yield spread continued to weigh on the LEI’s

The Conference Board Leading Economic Index® and Component Contributions (Percent)



Source: The Conference Board
 * Inverted series; a negative change in this component makes a positive contribution.
 ** Statistical Imputation
 LEI change might not equal sum of its contributions due to application of trend adjustment factor

INTERNATIONAL MONETARY FUND'S PROJECTIONS FOR 2026 & 2027

In its January 2026 release, the IMF sees “resilient” global economic growth of 3.3% during 2026 and 3.2% during 2027 as technology and adaptability offset trade policy headwinds. It anticipates steady overall global growth and it believes that surging investments in tech and favorable financing will continue to offset trade and other uncertainties.

Among advanced economies, the IMF regards the U.S. economy to have top relative prospects, along with Spain. The IMF expects emerging economies to continue to grow faster than more advanced economies with China and India continuing to outpace other emerging economies. While robust growth generally attracts investment, growth alone is insufficient without adequate legal protections. We saw that when Russia expropriated the assets of a number of foreign firms soon after it invaded Ukraine.

The IMF lists growing deficits and debt, and political uncertainty among the more prominent risks to global growth, but it also lists potential gains from artificial intelligence and easing trade tensions as possible offsets. The IMF expects global inflation to decline, but expects the decline within the U.S. to be more gradual.

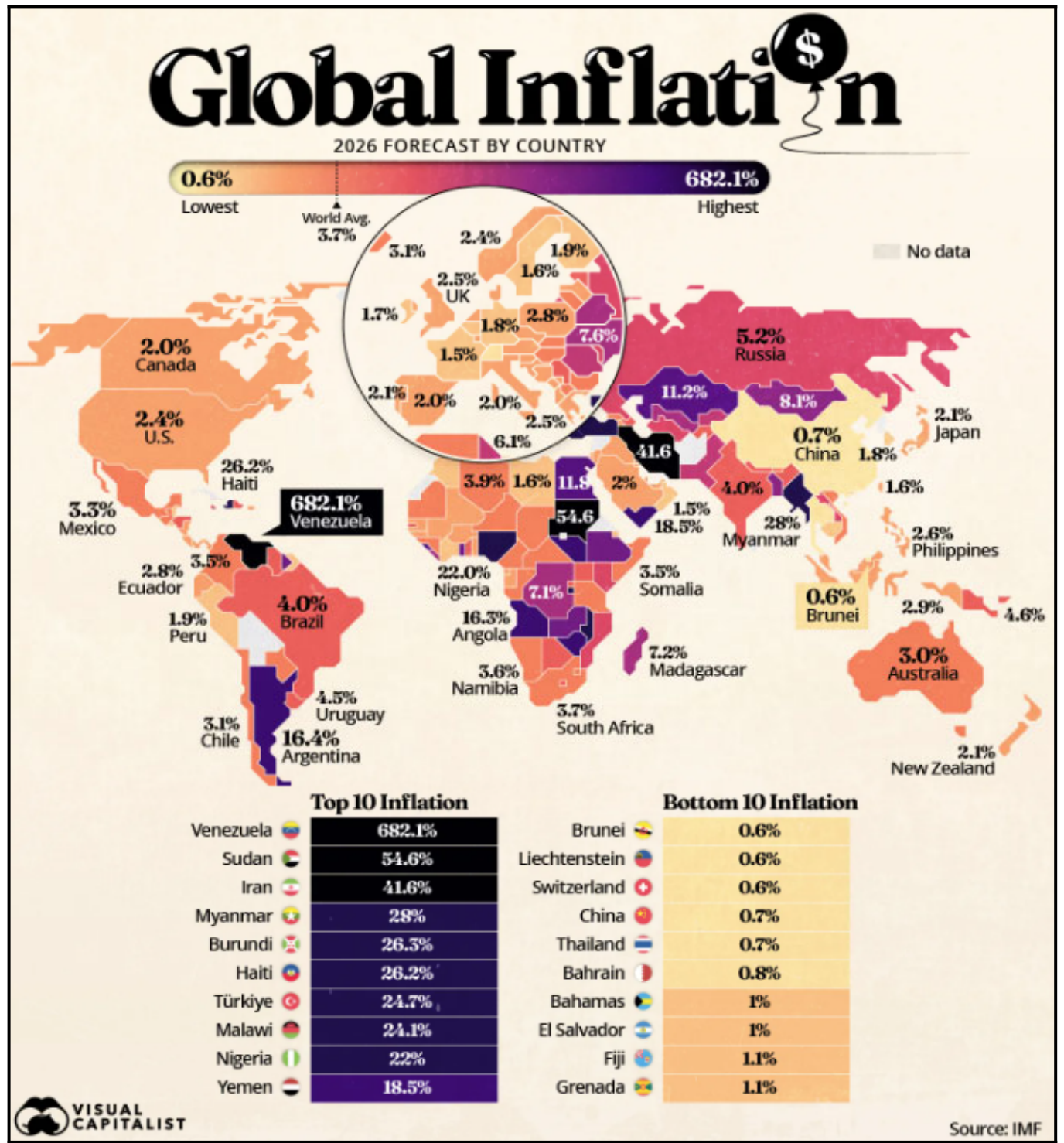
WORLD ECONOMIC OUTLOOK UPDATE			
World Economic Outlook Growth Projections			
JANUARY 2026	ESTIMATE	PROJECTIONS	
(Real GDP, annual percent change)	2025	2026	2027
World Output	3.3	3.3	3.2
Advanced Economies	1.7	1.8	1.7
United States	2.1	2.4	2.0
Euro Area	1.4	1.3	1.4
Germany	0.2	1.1	1.5
France	0.8	1.0	1.2
Italy	0.5	0.7	0.7
Spain	2.9	2.3	1.9
Japan	1.1	0.7	0.6
United Kingdom	1.4	1.3	1.5
Canada	1.6	1.6	1.9
Other Advanced Economies	1.8	2.0	2.1
Emerging Market and Developing Economies	4.4	4.2	4.1
Emerging and Developing Asia	5.4	5.0	4.8
China	5.0	4.5	4.0
India	7.3	6.4	6.4
Emerging and Developing Europe	2.0	2.3	2.4
Russia	0.6	0.8	1.0
Latin America and the Caribbean	2.4	2.2	2.7
Brazil	2.5	1.6	2.3
Mexico	0.6	1.5	2.1
Middle East and Central Asia	3.7	3.9	4.0
Saudi Arabia	4.3	4.5	3.6
Sub-Saharan Africa	4.4	4.6	4.6
Nigeria	4.2	4.4	4.1
South Africa	1.3	1.4	1.5
Memorandum			
Emerging Market and Middle-Income Economies	4.3	4.1	4.1
Low-Income Developing Countries	4.6	5.1	5.1

Source: IMF, World Economic Outlook Update, January 2026

Note: For India, data and projections are presented on a fiscal year (FY) basis, with FY 2025/26 (starting in April 2025) shown in the 2025 column. India's growth projections are 6.3 percent for 2026 and 6.5 percent for 2027

IMF PROJECTS EASING GLOBAL INFLATION DURING 2026

The International Monetary Fund expects the annual rate of global inflation to ease from 4.2% to 3.7% during the year. **Within the U.S. the IMF expects inflation to decline from 2.7% to 2.4%.** If the IMF's projections come to fruition, the Fed will have a somewhat freer hand to pursue accommodative credit policies which should lift the spirits of borrowers and investors alike. **Most capital asset values tend to rise as rates fall.**



EARNINGS GROWTH LOOKS GOOD THROUGH 2027

Corporate earnings is arguably the most important driver of stock valuations. Because earnings are so important, Zacks Investment Research gathers earnings estimates from over 2,600 analysts at more than 185 U.S. and Canadian brokerage firms and assembles them into an overarching view of prospective corporate earnings.

Projected earnings growth over the next two years was already pretty good when I wrote my previous letter, and they have improved a bit further since then. The green bars depict the actual and expected annual rates of earnings growth and the orange bars do the same for revenues. Earnings typically change more dramatically than revenues because a portion of the expenses incurred by companies are fixed in nature which results in a fair amount of earnings leverage. I've included estimates (in red), as they stood three months ago, to show that most estimates have improved since then.



PROGNOSTICATIONS FROM LARGE INSTITUTIONS

I've shared data from the Fed along with some thoughts from the Conference Board and the International Monetary Fund. However, having a sense of the economic backdrop is not quite the same as developing a further sense of which assets seem likely to bear worthwhile investment fruit during 2026 and beyond. With that, I thought it worthwhile to share some of the thoughts and ideas that have been put forth by a few large investment institutions. Certain phrases have been emphasized to aid readability.

Vanguard

⇒ **“The investment outlook favors bonds, value-oriented U.S. equities, and international equities.”**

“We see about a 60% chance that the U.S. economy will achieve 3% real growth in the coming years,” said Joe Davis, Global Chief Economist and Global Head of Investment Strategy Group. “But this future is not

quite now for 2026. **For now, how well AI investment will counteract negative (supply-side) shocks shapes our economic outlook.** Balancing these near- and medium-term views shapes Vanguard's investment outlook, which identifies somewhat unconventional, yet compelling investment opportunities for today's frothy financial markets."

United States economic forecasts				
	GDP growth	Unemployment rate	Core inflation	Monetary policy
2026 year-end	2.25%	4.2%	2.6%	3.5%

"Overall, **our medium-run outlook for multi-asset portfolios remains constructive, with positive after-inflation returns likely to continue.** In 2026, **U.S. technology stocks could well maintain their momentum given the rate of investment and anticipated earnings growth. But let us be clear: Risks are growing amid this exuberance,** even if it appears "rational" by some metrics. More compelling investment opportunities are emerging elsewhere even for those investors most bullish on AI's prospects. Our conviction in this view is growing, and it parallels investment returns in previous technology cycles. Our capital market projections show that **the strongest risk-return profiles across public investments over the coming 5-to-10 years are,** in order:

1. **High-quality U.S. fixed income**
2. **U.S. value-oriented equities**
3. **Non-U.S. developed-market equities"**

Asset Class	10-Year Return Expectations
U.S. Equities	4.0% - 5.0%
Ex-U.S. Equities	4.9% - 6.9%
U.S. Bonds	3.8% - 4.8%

"We maintain our secular view that high-quality bonds (both taxable and municipal) offer compelling real returns given higher neutral rates. Returns should average near current portfolio income levels, a comfortable margin over the rate of expected future inflation. That's the primary reason why **bonds are back, regardless of what central banks do in 2026. Importantly, U.S. fixed income should also provide diversification in a world where AI disappoints leading to lower growth.**"

"**We remain most guarded in our assessment of U.S. growth stocks.** Our muted expected returns for **the technology sector** are entirely consistent with our more bullish prospects for an AI-led U.S. economic boom. The heady expectations of U.S. technology stocks are unlikely to be met for at least two reasons. The first is the already-high earnings expectations and the second is the typical underestimation of creative destruction from new entrants into the sector which erodes aggregate profitability. **Our muted U.S. stock return forecast of 4%–5% average returns over the next 5-to-10 years is nearly single-handedly driven by our risk-return assessment of large-cap technology companies.**"

"**Both U.S. value-oriented and non-U.S. developed-market equities should benefit most over time** as AI's eventual boost to growth broadens to consumers of AI technology. Economic transformations are often accompanied by such equity market shifts over the full technology cycle." **"Long-term investors will continue to benefit from a portfolio consisting of fixed income and globally diversified equities."**



⇒ **“Barring any surprises the overall economic outlook appears strong.”**

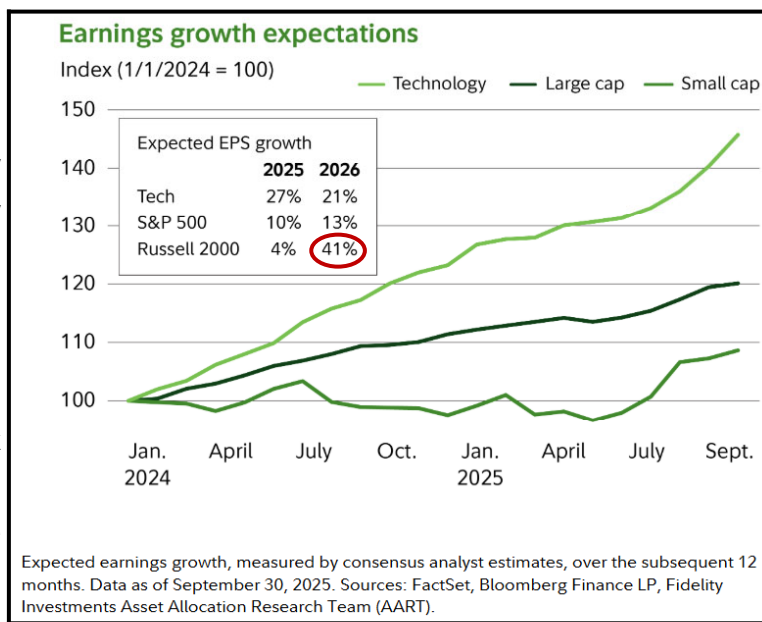
“2025 witnessed the reshaping of the political landscape, rippling shocks to the machinery of global trade, a steep correction in stocks, an overhaul of the US tax code, and the longest government shutdown in US history.” “Strong earnings might seldom make front-page news. But amid a turbulent year, **corporate earnings growth has been the stealthy motor driving the market**—compounding value and helping investors quietly build wealth.”

“As investors look to 2026 and beyond, there are no signs of turbulence subsiding. The global stage remains tense, and the US role on that stage is in flux. Domestic politics remain fraught and deeply polarized. The US federal government digs deeper into debt, with no easy way out. **Technology is evolving at a blinding pace**—with workers, investors, and companies racing not to get left behind.

And yet? **2026 could turn out to be another wonderful year to be invested.** The market has the wind at its back. Companies are only beginning to see the benefits of the new corporate tax breaks passed in 2025—which could add fuel to earnings momentum. **The Fed has been cutting rates, with more cuts on the table.** The economy has been continuing to grow. And **a renaissance in corporate investment** (i.e., capital expenditures, or “CapEx”) **has been laying the groundwork for future potential growth.**”

“For much of 2025, earnings growth was disproportionately driven by a very small number of large tech companies. In the second quarter, for example, the Magnificent 7 companies (Alphabet, Amazon, Apple, Microsoft, Meta Platforms, NVIDIA, and Tesla) generated 27% earnings growth, while profits at the 493 other companies in the S&P 500 grew by 8.1%. But that gap appears to be narrowing, with **stronger growth expected in 2026 for non-tech companies and for smaller companies.**”

“Fidelity’s director of quantitative market strategy notes that “earnings have already crossed a key threshold for this type of broadening: **Median-stock earnings growth finally turned positive in 2025, after a 3-year contraction.**” **“Until recently, this earnings recovery has looked strong at the top, but weak underneath.** This shift in median earnings growth marks a turning point in what’s been the narrowest earnings recovery in history.”





⇒ “Investors are navigating not just uncertainty, but an unstable environment influenced by tariffs and inflation, among other factors.” “ While volatility may increase, there is likely room for another solid year in 2026, especially for fixed income and international stocks.”

U.S. STOCKS AND ECONOMY: INSTABILITY

“The current environment isn’t just unclear, it’s fluctuating in real time. Uncertain environments still allow forecasters to build somewhat reliable probability models. **Unstable environments bring less-reliable probabilities because the underlying relationships are changing in real time. Uncertainty generally assumes unknowns: elections, wars, Federal Reserve decisions, etc. Instability stems from the inner workings of the system itself, such as:**

- Tariffs and their uneven application;
- Housing supply frozen because existing homeowners have locked in low mortgage rates and can’t move without taking out new mortgages at higher rates;
- Labor supply altered by immigration shifts;
- Fiscal stimulus and deficits decoupling from the business cycle;
- Oscillating inflation components;
- Stock market breadth—how many stocks are participating in an index’s move—narrowing and widening in sharper bursts.”

Key takeaways

- The current economic and market cycle is characterized by instability rather than mere uncertainty. Inflation is likely to remain elevated.
- We expect solid returns in fixed income markets in 2026, driven by central bank rate cuts in response to a weakening labor market.
- International stocks could be poised for another strong year as earnings and economic growth are expected to accelerate and international stocks are attractively valued compared with U.S. stocks in the S&P 500® index.

CONCLUSION

Although the economists and strategists at the Conference Board, the International Monetary Fund, Vanguard, Fidelity, and Charles Schwab differ with respect to the forces and factors with which they are concerned, there seems to be some agreement that: 1) **Inflation is not likely to worsen**, here or abroad. 2) **International equities continue to look relatively more attractive** than do U.S. growth and tech stocks. 3) **Bonds are expected to continue to provide returns in excess of inflation** and to be a good diversifier. 4) Stocks may be richly valued, but **analysts expect earnings to continue growing rapidly**. 5) **The U.S. has moved beyond the typical environment of uncertainty into a realm of instability, but AI-related advancements seems to be inducing investors to look past some of the increased risk.** — Glenn Wessel