Market Update: Q4 2025

The most overused stock market adage to describe the past year is that investors have "climbed a wall of worry." As we look back at a third consecutive year of outstanding returns, that wall looks more like a mountain. To help visualize this year's market, you might think of it like a determined hiker navigating a dense fog. While the fog of government shutdowns and economic data gaps made the path ahead feel uncertain and treacherous, the hiker remained focused on their compass and gained significant elevation.

The path to these returns took many twists and turns along the way. Early in the year, the U.S. market faced significant headwinds, declining nearly 19% from a February peak to enter correction territory by April. Yet, the market demonstrated remarkable resilience, rebounding sharply to reach new all-time highs on 39 separate occasions throughout the year. Despite constantly shifting trade policies, the longest government shutdown in U.S. history, a spike in job cuts, and concerns over the sustainability of massive tech spending, both stock and bond markets finished the year higher. This year served as a powerful reminder that the ability to tune out the noise of negative headlines and focus on underlying fundamentals is key to long-term investing success.

Key Takeaways

- Markets overcame volatility, political friction, and negative headlines in Q4
- AI continues to create economic impact, though investor sentiment is measured
- International markets showed renewed strength
- We enter 2026 with cautious optimism and continued discipline

TOTAL RETURN AS OF DECEMBER 31, 2025

INDEX NAME	Q4 2025	1 YEAR	ANNUALIZED 3 YEAR	ANNUALIZED 5 YEAR
S&P 500	2.7%	17.9%	23.0%	14.4%
Russell 2000 Small Cap	2.2%	12.8%	13.7%	6.1%
MSCI EAFE - International	4.9%	31.9%	17.8%	9.5%
MSCI Emerging Markets	4.8%	34.4%	17.0%	4.7%
Bloomberg US Agg Bond	1.1%	7.3%	4.7%	-0.40%

SOURCE: BLOOMBERG

A Fourth Quarter Ascent

The final three months of the year were defined by resilience in the face of political and economic friction. The 43-day federal government shutdown spanning October and November suspended some official economic data, resulting in a short-lived volatility spike in the stock market. Strong corporate earnings, private employment, and economic growth measures steadied the markets.

The S&P 500 rose 2.7% in the final quarter, pushing the 2025 total return to 17.9%. High tech valuation worries sparked modest late-quarter pullbacks, but the overall market tone remained positive. The index hit record highs in December, lifted by solid earnings growth and a more dovish turn from the Fed. As in prior quarters, the mega-cap technology and AI-driven companies known as "the Magnificent 7," which now make up over one-third of the S&P 500's market capitalization, continued to heavily influence index performance.

Bond markets also shifted as the Federal Reserve issued two 0.25% interest rate cuts in the fourth quarter, helping the Bloomberg U.S. Aggregate Bond Index finish the year with a 7.3% total return—its best calendar year since 2020.

An International Awakening

While U.S. stock markets performed well, international stocks handily outperformed the U.S. for the first time in years. This global rally was supported by several key factors:

- **Attractive Valuations:** Non-U.S. stocks began the year at multi-year discounts compared to historically expensive U.S. valuations.
- **Currency Tailwinds:** A weakening U.S. dollar boosted dollar-denominated returns for overseas investments.
- **Fiscal Stimulus:** A strong embrace of fiscal stimulus in Europe and Japan powered earnings growth higher in those regions.

Earnings growth is improving with positive revisions beyond the mega-cap U.S. companies. We are committed to finding growth opportunities across regions and market caps.

Economic Resilience and the Fed

The U.S. economy continued to demonstrate surprising strength, growing at a robust 4.3% annualized rate in the third quarter. This momentum was supported by strong consumer spending, particularly among high-income households, and continued business investment in AI.

Inflation, however, remained a stubborn participant in the economic story. While core inflation fell from recent highs, it ended the year at 2.7%, still above the Federal Reserve's 2% target. This led to a divided Federal Open Market Committee (FOMC), though they ultimately favored supporting employment by cutting interest rates three times in 2025. By year-end, the federal funds target range sat at 3.50%–3.75%, the lowest level since 2022. We expect the Fed to remain biased toward lower interest rates, which should be supportive of equity prices.

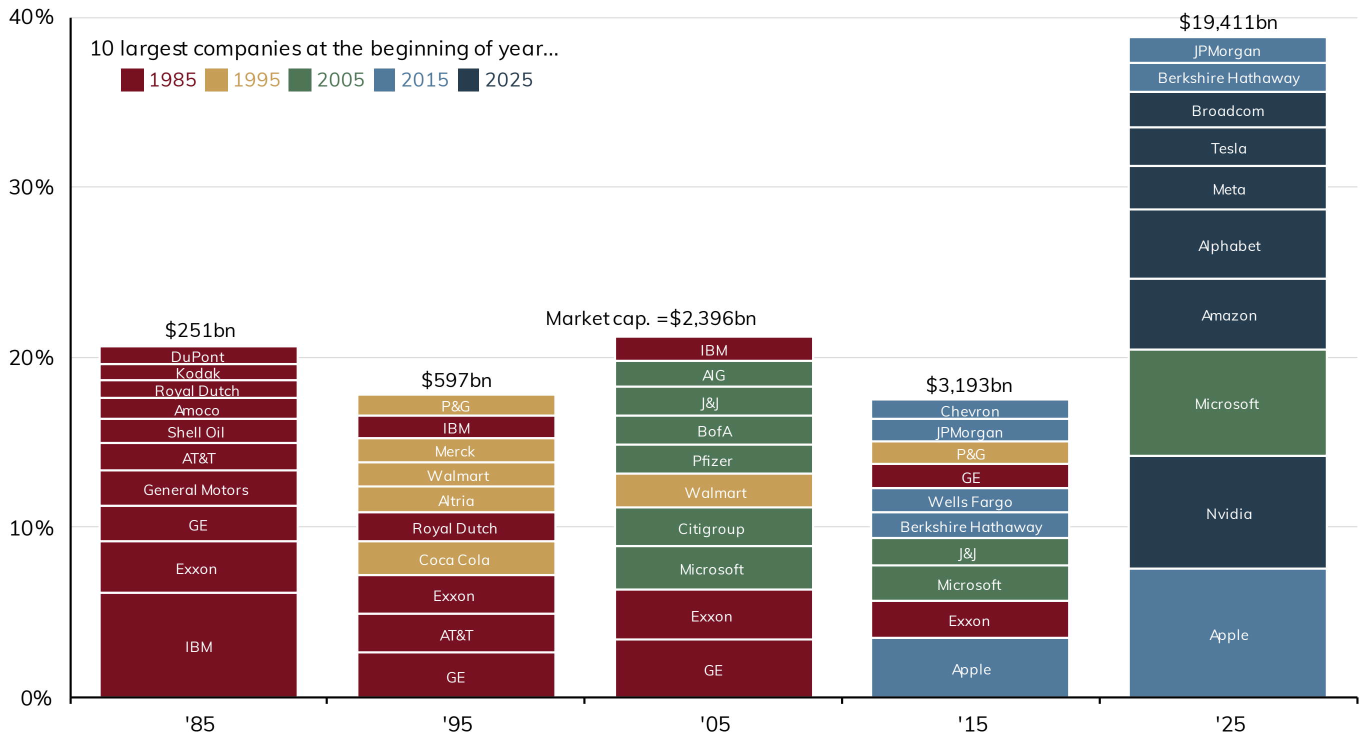
Artificial Intelligence Sentiment

In the United States, the narrative remains centered on Artificial Intelligence (AI). The current investment in AI technologies is on track to be the largest infrastructure investment in U.S. history. The massive investment from technology companies had a tangible impact on the economy, with AI data center investment responsible for almost all U.S. economic growth in the first half of 2025.

Skepticism around the AI trade is growing as memories of the debt-fueled telecom build-out of the 1990s and the dot-com era's 'irrational exuberance' linger in investors' minds. We remain optimistic about AI and its potential to

TOP 10 COMPANIES BY DECADE

PERCENT OF S&P 500 MARKET CAPITALIZATION AS OF THE FIRST DAY OF THE INDICATED YEAR



SOURCE: JP MORGAN GUIDE TO THE MARKETS, DEC. 2025

drive productivity and growth. That said, we do not dismiss the flashing yellow lights around AI's rapid growth and shifting sentiment. As articulated in the Q3 Market Update, our approach to AI remains focused on the individual fundamentals of one stock at a time.

Outlook

We enter 2026 with guarded optimism, as the fundamental backdrop remains encouraging. With fiscal and monetary support across the globe, plus deregulation and AI capital spending, growth should continue and may broaden in the coming quarters. Market breadth improved in Q4, with small-and mid-cap stocks benefiting from stronger earnings and accommodative monetary policy.

Geopolitical and policy uncertainty persist; but as 2025 showed, staying grounded and disciplined can yield solid results. We do not espouse aggressive portfolio overhauls based on shifting sentiment, and we will continue to take a rational approach to valuations and portfolio concentration.

Following three years of impressive equity returns, many portfolios now carry higher stock allocations and greater concentration in the 'winning' stocks. As such, we encourage discussions with your advisor to assess your three- to five-year liquidity needs, and to create a smart, tax-efficient plan to shift portfolio allocations.