



Investment Review & Outlook

2025 Year-End Investment Report – Reasons for Optimism

Another positive market year is in the books, marking the third year in a row for investors to be grateful for what the markets delivered.

A breakdown shows that just about every U.S. investment category experienced moderate to robust gains. Looking at large cap stocks, the widely-quoted S&P 500 Index of large company stocks gained 2.35% in the fourth quarter, to bring investors a 16.39% return for the year.

As measured by the Russell 2000 Small-Cap Index, investors in smaller companies received a 12.81% return for the year. The technology-heavy Nasdaq Composite Index gained 20.17% in 2025.

Foreign markets continue to deliver higher returns than the U.S. domestic indices. The broad-based EAFE Index of companies in developed foreign economies gained 4.54%, in dollar terms, in the fourth quarter of 2025, to finish the year with a remarkably robust 27.89% return. Emerging market stocks of less developed countries, as represented by the EAFE EM Index, gained 4.33% in dollar terms in the recent quarter, posting a 30.58% gain for the year.

In the bond markets, yields have fallen everywhere but at the longest durations, and it's still (this is unusual, but persistent) possible to get higher yields on some shorter-term bonds than longer-term issues. Treasuries of 3-month (3.63%) and 6-month (3.60%) duration are yielding more than government securities with 1-year (3.47%) maturities. 5-year Treasuries are yielding 3.73%, 10-year government bonds are yielding 4.17% and 30-year maturities are generating 4.84% annual coupon rates. Five-year municipal bonds are yielding 2.39% in aggregate, while 30-year munis are yielding 4.19%.

This is the time of year when you hear a lot of predictions, when economists look into their crystal balls and extrapolate current trends. The picture they're painting is short-term rosy, but less optimistic after 2026.

The One Big Beautiful Act lowered tax rates, especially for people in the higher tax brackets, which should drop up to \$150 billion into the wallets and pocketbooks of consumers. The people who benefit most—the higher earners—tend to spend a smaller share of their income, but overall consumers will pay less taxes and might, in the coming year, engage in the all-important consumer spending that makes up such a big part of economic growth.

After 2026, however, watch out. The U.S. government debt levels have already passed dangerous levels (\$38 trillion) and are increasing at ever-faster rates. U.S. household debt has risen to a record \$18.4 trillion, with credit card and auto loan delinquencies rising above pre-pandemic levels. At some point, the credit rubber band could be extended too far, forcing an increase in taxes just to pay the interest on the national debt, and a simultaneous decline in consumer spending as people focus on paying down their credit card obligations.

Another positive note for 2026: the new bill allows corporations to deduct 100% of their equipment purchases in the year they spend the money. The last time this was possible, after passage of the 2017 tax bill, corporate investment surged and raised the GDP level by nearly a full percentage point. At the same time, the U.S. Central Bank has been lowering interest rates, and a new Fed chairperson in May will have a clear mandate from the Trump Administration to cut rates further and faster. That would give corporations a sugar high boost to earnings that could last through the year.

Once again, however, this might not be a good long-term strategy. Dramatically lower interest rates could lead to a new surge in inflation in the years following 2026. It would take a long time for the Fed to rein in runaway inflation, particularly if, at the same time, the government is struggling to grapple with a runaway national debt.

What does all this mean for investors? The economy and American corporations seem to have successfully navigated the complexities of on-again, off-again, on-again-but-lower tariffs, delivering another good year for stock investors overall. The economy, by most measures, is growing. The consensus among economists and strategists is for a bullish 11% market gain over the next 12 months.

But in truth, the future is unknowable. Former Citibank chair Walter Wriston once complained that economists seemed to be born with 'too many hands,' because whenever he would ask them a straightforward question, they would respond with a plausible future scenario, and then say 'on the other hand,' and give him an (equally-plausible) opposite scenario.

We are in multiple-hand territory now. The enthusiasm for all things AI could cool, and the pell-mell construction of new data centers could lead to a lot of white elephants on corporate balance sheets. Or, on the other hand, the winds at the back of the market in 2026 could push it to new records, leaving the pundits to write new forecasts on their fortune cookies for the 2027 markets. This is a good time to celebrate our investing good fortune, and hope that we'll enjoy more of the same in the coming year.

As always, please reach out with any questions. If your circumstances have changed, please let us know and we can schedule a meeting to discuss.

The FAM Team