Fourth Quarter 2025

Economic and Market Commentary

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Like this author, our man Bobby grew up in New York City. Born in Manhattan into a musical family, he saw his father become the first black man to sing for the fabled New York Metropolitan Opera. His mother, Sara, was also a professional singer who performed as a soloist and eventually became a college professor of music.

You might say Bobby was born into music. His family eventually moved out west and settled in Los Angeles where he attended Cathedral High School and eventually moved on to Sacramento State. During his early and mid-twenties, he purposely avoided listening to other singers in order to develop his own unique musical style and not be influenced by others. His reputation grew as a horn player, saving his voice for future fame.

Bobby didn't record his first vocal album until Age 31. He filled the days doing television and movie voice-over as well as conducting coral groups and playing jazz festivals. His musical life changed dramatically when in 1988, he recorded the first A Capella song to rise to the number one spot on Billboard Magazine's top 100 list. For many years after, he called San Francisco home with his wife and three children.

DON'T WORRY, BE HAPPY

Here's a little song I wrote
You might want to sing it, note for note
Don't worry, be happy
In every life we have some trouble
But when you worry you make it double
Don't worry, be happy
Don't worry, be happy now.

Of course, I've been talking about the musical genius of Bobby McFerrin and if any U.S. equities market took Bobby's advice to heart, it was the theme of the equities market of 2025.

WHAT RESILIANCE

Think about it. This past year was fraught with conflict both domestically as well as globally. The largest war in Europe since WWII raged on for its third straight year. Fighting and starvation continued through much of the year in the Middle East. Relations between the U.S. and its' NATO allies hit rock bottom. Chinese aggression in the South China Sea and elsewhere became more and more belligerent with two of America's staunches allies Japan and Taiwan. You get the picture and I won't belabor the point with more examples. There certainly is no shortage.

On the domestic front, the year started off with devastating fires in Southern California causing hundreds of billions of dollars in damage, human suffering and losses of life. Inflation continued to be persistently sticky and in early April, the President declared "Liberation Day" announcing the new global tariffs that would take place immediately sending U.S. equities markets into a tailspin that from peak to trough represented a 19% decline in the broad-based markets before rebounding.

As the year went on, civil discourse between opposing points of view became all but extinct and the division of power between the three branches of government was often hard to find. Immigration issues were and continue to be an extremely controversial problem. A problem that requires both secure borders as well as deportation of criminal and predatory illegal aliens balanced with respect for the law and the Constitution. An approach that would continue to allow us to be that "*bright and shining*" city on a hill to so many people around the world. Not just for the poor and indigent seeking a better life but also for the inventors, the academics, and professionals that add to both our country's intellectual as well as its fiscal capital. As though the list isn't long enough (and it is a whole lot longer than I've outlined here.) add to it America's longest government shutdown which, when finally ended, did not put any long-term fixes in place. So, the question begs to be asked; with all the negative occurrences just outlined, why 2025 was such a resilient and positive year relatively speaking in the U.S. equity markets? It's my belief there were 4 main drivers that overcame the negative. They are as follows:

- Strong economic growth. In spite of a lack-luster first quarter, the economy grew at a very robust pace throughout all of the second and third quarters resulting in above average GDP growth for the year. Bottom line, companies were building more things and providing more services.

- Accommodative monetary policy: After several years of relatively restrictive monetary policy, the Federal Reserve began to implement a more accommodative money policy through several interest rate cuts with the most recent one having come in December.

- Strong earnings growth: For the past several up years in the market, prior to 2025, stock prices grew based on "valuation expansion." In other words, investors were willing to pay more for a stock's actual earnings which in turn increases the stock's P/E ratio.

- The past year's growth in equities was due to fundamentals. Corporate profits grew substantially, particularly in the technology sector. 2025 was a fundamental-driven year not a year solely based on valuation expansion.

The 800-pound gorilla in the room---- Artificial Intelligence. It's still in the very early innings for the AI boom and record capital expenditures and productivity gains were made across various sectors. This is a scientific breakthrough that will ultimately prove to be the next industrial revolution. That's not to say many companies in or trying to break into the AI space won't go by the wayside, they most certainly will. Will AI be a disrupter? It is already in the most positive way in fields like medicine and automation of repetitive work, on the other hand it is also fraught with danger. Geoffrey Hinton, Nobel Prize winner and commonly referred to as the Godfather of AI is constantly calling for regulation to prevent AI's deceptive capabilities and loss of control by our having invented something soon to be smarter than we are.

Obviously, AI deserves thorough discussion and its own dedicated commentary which will be the topic of my next quarterly. Am I fearful AI will replace humans or diminish our potential? Definitely not.

SIXTEEN TONS

"I was born one morning when the sun didn't shine
I picked up the shovel, and I walked to the mine
I loaded 16 tons of number 9 coal
And the straw boss said, well a-bless my soul.
You load sixteen tons and what do you get?
Another day older and deeper in debt."
By Merle Travis

THE DECLINE IN THE NEED FOR PHYSICAL STRENGTH

When historians talk about the Industrial Revolution, they are referring to a transformative period of world history that basically spans the late 18th Century into the early years of the 20th century. Mechanization reduced the need for physical strength whether it came from oxen, draught horse or man and replaced it with new energy sources like steam and coal and later electricity.

Mass production made goods like clothing and tools more affordable. This revolution led to urbanization because that's where the factories and jobs were. The standard of living improved dramatically for millions of people.

The AI revolution is often compared to the Industrial revolution because the industrial revolution was about machines amplifying human muscle and the AI revolution is about amplifying intellectual muscle.

LET ME BRING IT HOME

Not long ago, I was reading an article in a medical journal that explained how AI is now being used in radiology. I learned that the use of AI is enabling images to be read in just a fraction of the time it previously took with a far greater degree of accuracy. It's like having 10,000 radiologists on call 24/7 all viewing the same image. Now my first thought was this was going to cause quite a few radiologists to look for other jobs. After a little further reading, I came to learn that quite to the contrary there was now a severe shortage of radiologists. I started thinking about how that could be. It turned out that the explanation was really quite simple: Rather than being burdened down with the time-consuming job of interpreting these images, these highly trained doctors had more time to spend with their patients, develop treatment plans and more closely monitor the plans success and make adjustments, as needed. This is just one example in one field where AI is proving that if developed properly, it will amplify our intellectual muscle. You'll be hearing of numerous other examples next quarter.

CONCLUSION

Amongst the analysts I follow closely, it seems the overwhelming general consensus is that equity markets should fare well this coming year. With that said, and barring a black swan type event, greater volatility is expected. The first half of the year should be quite telling as to the year's overall results. What analysts will be watching most closely between now and late second quarter are:

- The Federal Reserve rate cut policy. Are they slowing down who will take Jerome Powell's place come May?

- Labor market strength. Will the slowdown in job creation we saw late in 2025 continue? Will unemployment remain below 5-1/4%, which many consider a tipping point?

- What path will inflation take? Will "affordability" be the buzzword leading up to the mid-term elections?

- Will consumers continue to do their part? Of particular concern will be the spending trends of lower wage earners. 2025 saw almost half of all consumer spending spent by the top 10% of wage earners.

- AI and productivity. With incredible amounts of capital already spent and will continue to be spent on AI infrastructure, how close are we to seeing broad-based productivity gains across the economy as hoped for?

All and all, the outlook for 2026 appears to be guardedly bullish with positive fundamentals, stable monetary policy, fiscal stimulus—at whose expense we're not sure, resilient earnings along with heightened market choppiness and continued innovation.

As I said, the first 6 months of the year will be a very good tell as to what type of year 2026 will prove to be.

My best wishes for a happy and healthy new year.

As always, with best regards,

Ray