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2025 ECONOMIC AND FINANCIAL MARKETS REVIEW

Stocks performed very well in 2025, as the stock market overcame a significant spring decline and some late-year volatility to post its third consecutive positive year. The springtime bear market was triggered by the aggressiveness and uncertainty related to the Trump administration's announcement of tariffs on imports from other countries. The later-year volatility was caused by concerns that large, artificial intelligence-focused company stocks were becoming overvalued and that the Federal Reserve Board might lower interest rates more slowly than expected going forward. However, although longer-term impacts remain to be seen, investors' concerns related to tariffs, high valuations, and monetary policy ultimately abated enough for the stock market to overcome its initial fears. As a result, the S&P 500 Index ended 2025 up 16.39%, while the Dow Jones Industrial Average gained 12.97% last year. The Bloomberg Intermediate U.S. Government/Credit Bond Index increased by 6.97% during 2025.

Ironically, the same factors that led the stock market to recover from the depths of the early-year decline were the cause of the market's trepidation later in the year. The enthusiasm surrounding artificial intelligence and the billions of dollars invested in the potential of its emerging technology propelled stock prices much higher over the summer. Later, worries that the artificial intelligence trade became too overheated led investors to sell and take their profits, sending stock prices down. Additionally, the market rose from the April lows to all-time highs as excitement grew over the Fed lowering interest rates. Lower-than-expected inflation and simultaneous concerns about the economy led the Fed to lower rates several times in 2025, as they felt they could do so without risking a meaningful rise in inflation. The Fed also felt that keeping rates too high for too long would be a substantial risk to the economy, particularly the seemingly weakened labor market. However, late-year hawkish comments by some Fed officials led many to fear that the pace of future rate cuts may be slower than expected. This uncertainty caused the markets to cool off as well.

Despite some negative economic data, such as consumer sentiment indicators and a slowing job market, consumers continued to spend money during 2025, which helped the economy to grow. When consumers spend more money, corporate profits typically increase. Increasing corporate profits usually leads to higher stock prices. One reason consumer spending may have increased last year was due to lower interest rates, which made borrowing easier. Consumer spending makes up approximately 70% of the country's gross domestic product, underscoring the impact that low interest rates can have on the economy and the stock market.

Although it is positive for stocks and the economy that the Federal Reserve Board has been lowering interest rates, the future direction of the Fed's monetary policy remains uncertain. Future data surrounding inflation and the economy will play a large role in the Fed's decision-making. If interest rates do not decline as quickly as investors expect, this could negatively impact the economy and stock prices going forward. Furthermore, some of the optimism surrounding future rate cuts may have already been priced into the financial markets. It will be very important to monitor developments in the Fed's interest rate policy throughout this year.

Finally, there are continuing concerns that some stocks are overvalued after several years of significant gains and positive corporate earnings. In particular, there is a small group of very large technology companies known as the "Magnificent Seven" that have led the technology and artificial intelligence boom. These companies have grown so large that they now account for approximately one-third of the S&P 500 Index's market capitalization. If these stocks falter this year, the entire stock market will likely decline, as they carry such a significant weighting in the primary market indexes. It will likely take even better earnings growth from these artificial intelligence stocks this year to support such high prices. Therefore, the stock market may not perform as well this year as it did in the last several years.

Last year, we generally kept our investment philosophy simple by overweighting large-company U.S. stocks while investing very little in small-company stocks, emerging markets, and other volatile asset classes. We did increase our exposure to large, developed country foreign stocks for certain investors. These stocks ended up having a very good year. This year, we may prioritize less volatile, value-oriented U.S. stocks if exposure to riskier areas of the market becomes problematic. We continue to favor short-term bonds over long-term bonds because they provide a better risk/reward profile. We may also add additional exposure to bonds if circumstances warrant it.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg on January 1, 2026.*