

Quarterly Outlook

Perspectives on Markets and Economic Conditions

Portfolio allocations and investments are not adjusted in response to market news or economic events; however, we evaluate and report on market and economic conditions to provide our investors with perspective and to put portfolio performance in proper context.



Economic Growth Remains Strong Despite Slowing Job Market

Main Takeaway

The U.S. economy showed renewed strength in Q3, expanding at a robust 4.3% annualized pace¹, exceeding expectations, supported by solid consumer spending despite weak confidence. Inflation showed signs of moderation, with November CPI cooling to 2.7%² from 3.0% the prior month. However, labor market conditions remain a concern, as job growth slowed and the unemployment rate rose to 4.6%³, the highest level in four years.

Top Risks

The cooling job market continues to raise concerns, with the U.S. economy adding only 67,000 jobs over the three-month period ending in November and the unemployment rate rising to 4.6%³. Consumer confidence has also weakened, with the Consumer Confidence Index falling to its lowest level since April⁴. The Expectations Index, which reflects consumers' outlook for income, business, and labor conditions, remained well below 80, the recession threshold, for the tenth consecutive month.

Sources of Stability

The U.S. economy continues to hum along, posting a 4.3%¹ annualized growth rate in Q3. Consumer spending remains very strong, particularly amongst high income households, rising 3.5% in Q3, up from the 2.5% pace in Q2. More recent real-time indicators, including retail sales and card-swipe data suggest consumer spending continues to be robust. Despite ticking up slightly in November, unemployment remains low at 4.6%³ and the most recent inflation data showed some moderation.

ECONOMIC SPOTLIGHT:

Will Big AI Spending Translate to Outsize Returns?

Over the next five years, McKinsey estimates cumulative artificial intelligence investment will reach \$5.2 trillion. Much of this spending is going toward building data centers and manufacturing chips and servers, making today's technology firms look more like capital-intensive infrastructure companies than traditional software businesses.

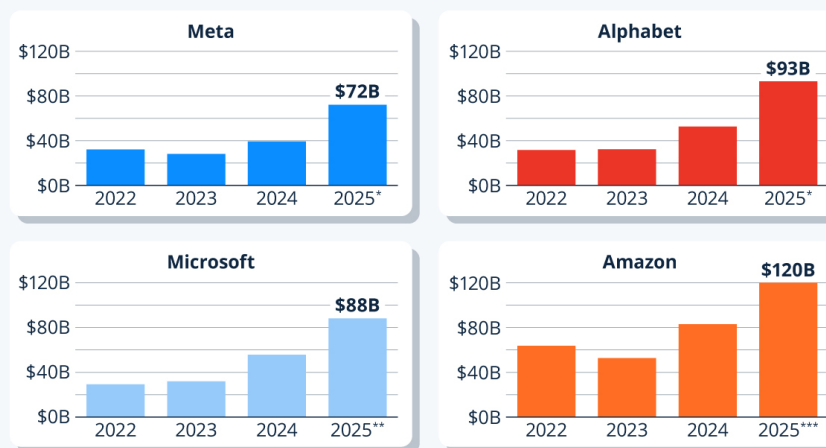
Kai Wu of Sparkline Capital notes that firms with high capital expenditures—or those becoming more asset-heavy—often underperform peers for several reasons. Infrastructure must be matched by sufficient demand to justify capacity. Asset-heavy models are also easier for competitors to replicate, increasing pricing pressure. In addition, shifting from an asset-light to an asset-heavy model typically reduces returns on invested capital.

This shift has significant implications for large technology firms, including the Magnificent Seven, which are transitioning from asset-light software companies into infrastructure operators. This does not imply inevitable underperformance, but it does suggest a changing risk profile.

For investors, two lessons stand out. The largest spenders will not automatically be the biggest winners. In the late 1990s, many firms invested heavily in fiber infrastructure yet failed to capture most of the internet's gains. Finally, even in AI, valuations matter.

Big Tech's AI-Fueled Spending Surge

Annual capital expenditure of Microsoft, Alphabet, Amazon and Meta



* Upper limit of latest company projection ** Microsoft's fiscal year ended Jun. 30

*** Trailing twelve months as of Sep. 30, 2025

Source: Company reports



statista

Source: Statista. "Tech's AI-Fueled Spending Surge" November 20, 2025

Key Areas to Watch



U.S. Economic Growth

U.S. economic growth remains robust, expanding at a 4.3%¹ annualized rate in Q3, thanks to a 3.5%¹ surge in consumer spending. Stripping out more volatile components such as inventories, trade, and government spending, real final sales to private domestic purchasers rose 3.0%¹, slightly above the 2.9% pace in Q2. Looking ahead, the Atlanta Fed projects Q4 GDP growth of 2.7%², with real final sales to private domestic purchasers moderating to 1.8%. Overall, economic growth remains solid.



Monetary Policy

As expected, the Federal Reserve lowered the federal funds rate by 25 bps at both their October and December meetings, bringing the target range to 3.50%–3.75%. The updated December dot plot⁴ signaled just one additional rate cut in 2026, contrasting with the market's expectation of two. In the press conference, Chair Jerome Powell struck a more hawkish tone, saying the decision to cut was a “close call” and emphasizing that policymakers are now well-positioned to “wait and see how the economy evolves.”



Inflation Trajectory

Although inflation remains above the Federal Reserve's 2% target, the most recent report was cooler than expected, with headline CPI rising 2.7% year over year (YoY) in November³ (monthly data were unavailable), down from 3.0% in September. Beneath the surface, the report was generally encouraging as housing inflation, CPI's largest component, slowed to 3.0% YoY, its smallest increase since 2021. In contrast, energy prices rose 4.2% YoY, led by a 6.9% increase in electricity costs.



Private Credit

Recent headlines have understandably raised concerns about potential losses in private credit. However, data from the Cliffwater Direct Lending Index (CDLI) indicate that realized losses and non-accruals remain at or below historical averages, easing fears of deteriorating credit quality. Importantly, private credit is primarily an income-driven strategy. Even during the worst 12-month period of the financial crisis, realized losses were 9.3%⁵, while income totaled 12.3%⁵, resulting in a positive return spread of just over 3%⁵.

Key Areas to Watch (Cont.)



Labor Market

The labor market is showing signs of stress, with the U.S. economy adding just 64,000¹ jobs in November while unemployment rose to 4.6%, its highest in four years. Additionally, October saw a decline of 105,000 jobs and August and September were revised lower by a combined 33,000. Furthermore, the U-6 unemployment rate, which also captures those who are employed part-time for economic reasons, rose to 8.7% from 8.0%. JOLTS data reinforces the slowdown narrative with hiring declining and quits at their lowest level since 2020².



Global Economy

Economic growth was mixed across Europe in Q3, with U.K. real GDP slowing to just 0.1%⁶ while the Euro Area accelerated to 0.3%⁷. Asia showed a similar split with the Chinese economy picking up slightly to 1.1%⁷, while Japan contracted by 0.6%⁷. Looking ahead to 2026, the IMF and OECD (Organization for Economic Co-operation and Development) expect global growth to remain steady but slow at 3.1%⁸ and 2.9%⁹ respectively, while the World Bank is more pessimistic, forecasting growth of just 2.5%¹⁰.



Consumer Spending

Consumer spending remained robust in Q3, rising 3.5%³, up from 2.5% growth in Q2. Real-time spending indicators point to solid consumption in Q4, with the Atlanta Fed projecting consumer spending growth to be 1.6% for the quarter. Consumer incomes have continued to outpace rising living costs, with U.S. real wage growth of 0.8%⁴ over the 12-month period ending in November. Regardless, consumer sentiment remains subdued, with U.S. consumer confidence falling again in December⁵.



Yield Curve

Treasury yields were mixed in Q4, with the two-year yield declining 13 bps to 3.47%, the 10-year little changed, rising just 2 bps to 4.18%, and the 30-year increasing 11 bps to finish the quarter at 4.84%. The path was far from smooth: yields fell through much of October amid expectations of more accommodative monetary policy, before repricing later in the quarter as incoming economic data and updated Federal Reserve forecasts shifted market expectations.

Economic and Market Snapshot

Global equity markets ended the year on a positive note, with U.S., international developed, and emerging market stocks all posting gains in Q4. On a year-to-date basis, non-U.S. equities were the top performers, with developed and emerging markets returning 32.2% and 31.4%, respectively. While U.S. equities trailed their international peers, they still delivered a strong 17.1% return for the year, led by large-cap growth stocks.

U.S. and international fixed income also generated positive returns in Q4, helping make 2025 a strong year for fixed income, supported by elevated income and a declining yield curve.

Major Asset Class Returns*

Q4 2025

		Quarterly Return	Past 12 Months
Stocks			
U.S. Stocks	▲	2.4	17.2
International Stocks	▲	5.0	32.2
Emerging Markets Stocks	▲	4.3	31.4
Bonds			
U.S. Government Bonds	▲	1.2	6.5
Global Bonds	▲	1.1	5.1

Key Economic Indicators*

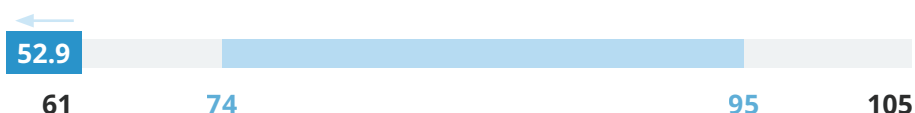
Real GDP Growth (%)



Core CPI (%)



Consumer Sentiment



Unemployment Rate (%)



Jobs Added (Thousands)



Investment Planning Implications

Where do markets go from here?

International Resurgence. International developed and emerging market stocks outperformed U.S. equities for the first time in more than a decade, posting gains of 30.4% and 30.0% respectively, about 13 percentage points ahead of U.S. markets. With U.S. valuations still stretched relative to international peers, non-U.S. stocks may be well positioned to outperform again in 2026.

Lagging value in the U.S. U.S. small-cap value stocks underperformed large-cap growth, particularly AI-related companies, for the third straight year in 2025 and in seven of the past 10 years. While small-cap value valuations remain near long-term averages, large-cap growth trades at roughly twice its historical valuation. That said, continued AI-driven earnings growth could allow large-cap growth to outperform in the near term.

Uncertain monetary policy. Given the economic backdrop of cooling job growth, elevated inflation, and potentially a new Fed chair in May, the future path of monetary policy is uncertain. This uncertainty is reflected in the growing dissent among both voting and non-voting FOMC members. As a result, markets are likely to experience heightened volatility around inflation and employment data in the months ahead.

What are the investment planning implications?

Tune out the forecasts. Investors naturally want to focus on forecasting the future (which is unknowable) instead of focusing on what they can control: the risk they are taking. The start of the year is the perfect time to assess your need, willingness, and ability to take risks to make sure your plan is still best suited to meeting your long-term goals.

Explore all of your options. With U.S. equity valuations elevated, geopolitical risks heightened, and monetary policy uncertain, incorporating differentiated sources of risk and return, such as alternative investments, can enhance portfolio diversification beyond traditional stocks and bonds. Strategies including private credit, reinsurance, and market-neutral approaches often exhibit lower correlations to public markets, which may help improve portfolio resilience during periods of equity and fixed income volatility.

Rebalancing is key. Strong equity market performance in 2025 has likely pushed many portfolios above their target allocations. Periodic rebalancing remains a simple yet powerful tool to manage risk, maintain strategic alignment, and systematically lock in gains from outperforming areas.

About the Focus Partners Team



Kevin Grogan, CFA, CFP®

**Chief Investment Officer,
Systematic Strategies**

Kevin helps lead the firm's Systematic Investing strategies, portfolio management, and fixed income teams. He has co-authored three books on investment topics and enjoys educating others on concepts that will have a tangible effect on their financial lives.



Jason Blackwell, CFA

Chief Investment Strategist

Jason is an important resource for clients and wealth advisors, assisting them in developing portfolios designed to support their goals and communicating the firm's investment strategy. He also serves on the Focus Partners Investment Committee and is a spokesperson for Focus Partners Investment Management.



Blerina Hysi

Director, Fixed Income

Blerina works with fixed income and advisory teams to help construct and maintain customized bond portfolios, with an eye toward finding the best way to implement comprehensive financial plans. Her duties include fixed income analysis, bond trading, and building tailored, client-focused portfolio solutions.



Brian Haywood, CIMA®

Senior Investment Strategist

Brian takes pride that in an industry where decisions are often driven by commissions and not conscience, he and his team spend their time customizing portfolios on behalf of clients, upholding their fiduciary responsibility by doing what's in their best interest.

Additional economic and investment resources are available at focuspartners.com/resources

Appendix

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- ¹ U.S. Bureau of Economic Analysis. "Gross Domestic Product, 3rd Quarter 2025 (Initial Estimate) and Corporate Profits (Preliminary)" December 23, 2025
- ² U.S. Bureau of Labor Statistics. "Consumer Price Index Summary" December 18, 2025
- ³ U.S. Bureau of Labor Statistics. "Employment Situation Summary" December 16, 2025
- ⁴ The Conference Board. "US Consumer Confidence Fell Again in December" December 23, 2025

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- ¹ U.S. Bureau of Economic Analysis. "Gross Domestic Product, 3rd Quarter 2025 (Initial Estimate) and Corporate Profits (Preliminary)" December 23, 2025
- ² Atlanta Fed GDPNow estimate as of January 5, 2026
- ³ U.S. Bureau of Labor Statistic "Consumer Price Index Summary" December 16, 2025
- ⁴ Federal Reserve. "Summary of Economic Projections" December 10, 2025
- ⁵ Cliffwater Direct Lending Index. "2025 Q3 Report on U.S. Direct Lending" September 30, 2025

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- ¹ U.S. Bureau of Labor Statistics. "Employment Situation Summary" December 16, 2025
- ² U.S. Bureau of Labor Statistics. "Job Openings and Labor Turnover Summary" December 9, 2025
- ³ U.S. Bureau of Economic Analysis. "Gross Domestic Product, 3rd Quarter 2025 (Initial Estimate) and Corporate Profits (Preliminary)" December 23, 2025
- ⁴ U.S. Bureau of Labor Statistics. "Real Earnings Summary" December 18, 2025
- ⁵ The Conference Board. "US Consumer Confidence Fell Again in December" December 23, 2025

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- ⁶ Office for National Statistics. "Gross Domestic Product" December 22, 2025
- ⁷ Trading Economics
- ⁸ International Monetary Fund. "World Economic Outlook: Global Economy in Flux, Prospects Remain Dim" October 2025
- ⁹ OECD. "OECD Economic Outlook, Volume 2025 Issue 2: Resilient Growth but with Increasing Fragilities" December 2, 2025
- ¹⁰ World Bank. "Global Economic Prospects" June 2025

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Major Asset Class Returns: The index representation for the Major Asset Class Returns is as follows: U.S. stocks are represented by the Russell 3000 Index, international stocks by the MSCI World ex U.S. IMI Index, emerging markets by the MSCI Emerging Markets IMI Index, U.S. government bonds by the Bloomberg Government Intermediate Total Return Index, and global bonds by the FTSE World Government Bond 1-5 Year Index. Past performance is not a guarantee of future results. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Information from sources deemed to be reliable, but its accuracy cannot be guaranteed.

Key Economic Indicators: Sources: Bureau of Economic Analysis (BEA) for real GDP growth. Real GDP is the annual rate of change of real gross domestic product, seasonally adjusted. Bureau of Labor Statistics (BLS) for core CPI. The core consumer price index (CPI) is the annual rate of change, seasonally adjusted, and excludes food and energy. Consumer sentiment is from the University of Michigan's consumer sentiment index. Unemployment rate is reported by the BLS, and jobs added is based on nonfarm payroll employment reported by the BLS. Retrieved from FRED, Federal Reserve Bank of St. Louis. For all indicators, the boxed number reflects the latest reading, and the line above the box shows the change since the last update. The shaded areas reflect normal readings compared to history (based on the 25th-75th percentile of historical measures), while areas outside the dark blue reflect more extreme readings compared to history. The ranges are based on the percentile values of historical readings for each economic figure. The lowest number reflects the 5th percentile value, the bottom of the blue range reflects the 25th percentile, the top of the blue range is the 75th percentile, and the highest value reflects the 95th percentile. All ranges are based on the full period available. To account for population and employment, the ranges presented for jobs added are based on the percent change in employment numbers, using December 2022 as the base year.

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