

## **Economic Commentary**

As 2025 comes to an end, the year was highlighted by another strong performance in U.S. equities alongside growing optimism that inflation could cool without derailing growth. Equity markets built on the gains of 2023 and 2024, with the S&P 500 rising 17.9% in 2025, marking a third consecutive year of double-digit returns. The year included a sharp pullback in early April, when the S&P 500 fell close to 19% amid new tariff headlines, but volatility eased as trade agreements reduced uncertainty, corporate earnings were stronger than expected, and enthusiasm around artificial intelligence remained a tailwind. Interest rates were also an important driver of returns, with Treasury yields moving lower overall as inflation expectations softened and the Fed reduced short-term rates. The 10-year Treasury ended the year at 4.17%, declining 40 basis points in 2025. Heading into year-end, Q4 market moves were shaped by expectations for additional rate cuts in 2026 and continued attention on trade policy, while disruptions from the government shutdown limited the amount of timely economic data available late in the quarter.

### **Domestic Fixed Income Markets**

Fixed income also delivered strong returns throughout the year. Treasury yields declined across most of the curve in 2025 as labor-market weakness and easing inflation expectations coincided with Fed rate cuts, and the 10-year Treasury ended the year at 4.17%, compared to 4.57% at the beginning of the year. Short-term yields also moved lower, with 3-month, 6-month, and 12-month Treasury yields ending the year in the mid-3% range, changing the strategy of investors who relied on high cash yields in recent years as the market shifted to a more typical reinvestment environment. Notably, long bonds briefly crossed the 5% mark for the first time since 2007. Intermediate-term investment-grade bonds benefited from the decline in yields, with the Bloomberg U.S. Aggregate Bond Index posting its best calendar-year return since 2020. Credit markets also held up well, with investment-grade corporates and high yield producing positive annual returns, which is consistent with a backdrop of slowing growth that did not tip into recession. Credit spreads remain at decade-level lows, reflecting confidence in credit quality despite macro uncertainty. Q4 returns were more modest than the full-year results, but the quarter still reflected constructive demand for income and stability, particularly as markets adjusted to lower short-term rates while longer-term yields remained influenced by inflation expectations and mounting government debt.

### **Domestic Equity Market**

U.S. equities completed another strong year, and Q4 added to that advance. The S&P 500 rose 17.9% in 2025 and gained 2.65% in Q4, extending a multi-year run of double-digit

annual returns and finishing the year with sustained momentum. The path was not linear. The index nearly entered a bear market in early April with a drawdown around 19%, then rebounded sharply into year-end as volatility eased and earnings results were stronger than expected. Several themes remained consistent through Q4. Artificial intelligence investment continued to support large-cap leaders, while market performance was more selective across sectors and styles. The “Magnificent 7” now makes up 31% of the S&P 500 and contributed meaningfully to the market’s performance. Small and mid cap equities kept pace with market returns in Q4, however large caps and growth remained the bellwether for overall index performance. International equities outperformed the U.S. in 2025, which was a notable shift after prior years of U.S. dominance. Post-2008 financial crisis, international equities have underperformed the S&P 500 72% of the time, beating the S&P by single digits four of those years, until this year, which outperformed by 14.82%.

## **Federal Reserve**

The Federal Reserve moved policy in a more accommodative direction during the second half of 2025. Beginning in September, the FOMC lowered rates by 25 basis points at three consecutive meetings, bringing the top end of the federal funds rate to 3.75% by year-end after a peak of 5.50% in 2023. The shift occurred as labor-market conditions softened, with unemployment rising into the mid-4% range and job growth slowing meaningfully compared to recent years. Inflation also continued to moderate, although it remained above the 2% target, and the inflation mix was uneven, with tariff-related pressure more evident in goods while services disinflation continued. Alongside rate cuts, the Fed halted balance sheet runoff and began buying about \$40 billion per month in short-term Treasury bills to keep bank reserves at comfortable levels and ensure smooth functioning in funding markets. These operations are technical rather than stimulative, and together with reinvestments of maturing securities, they help offset seasonal liquidity pressures. The Fed expects this elevated pace to continue into spring 2026 before gradually tapering.

## **Summary**

The year-end message from Q4 was consistent with the broader 2025 pattern of cooling but still positive growth, moderating inflation, and supportive market performance. Real GDP was estimated near 2% for the year, while the labor market softened, and inflation readings improved from their post-pandemic highs even as some categories remained elevated. As 2026 begins, incoming economic data, especially on employment and wages, should provide a clearer read on whether growth is slowing at a manageable pace or weakening more quickly. With equities finishing 2025 in a strong position and credit spreads still low, the extra income available in lower-quality bonds remains limited relative to the added risk. At the same time, attractive yields in high-quality fixed income continue to offer a meaningful source of income and a potential buffer if equity volatility returns. In this

environment, it remains a good time to revisit asset allocations and confirm portfolios are positioned appropriately for a range of outcomes, including a continued soft landing or a more pronounced slowdown if labor markets cool further.