

Q4 2025 Stock Market Update

Well, That Was Interesting...What Now?

This past year brought a dizzying series of events. We had DOGE, tariffs, the Middle East, the “Big Beautiful Bill”, the Fed and all things artificial intelligence (AI) give way to a dramatic swoon and even more dramatic recovery (oh and don’t forget a government shutdown that markets largely ignored). In fact, it’s truly hard to believe we fit everything into one year! Ultimately, all the action culminated in another year of surprisingly strong returns for the broader equity indices. The S&P 500® Index and Russell 2000® Index finished 2025 up 17.9% and 12.8%, respectively, while the NASDAQ® Composite finished up 21.1%.

To review, the market started the year on a rough note with first quarter declines of 4.3% and 9.5%, respectively, for the S&P and Russell. Policy uncertainty, specifically DOGE and tariffs, weighed on investor sentiment. Declines went into overdrive in early April after “Liberation Day” and the official proclamation of steep tariffs on trading partners. At one point, the market declined 12% in just four days and was down 18% from its high. We then staged a stunning rally as tariffs were softened and DOGE faded into the background. Subsequently, gains were furthered as the economy remained strong, Congress passed Trump’s BBB and the Federal Reserve resumed interest rate cuts. All the while, AI was in the background fueling massive capital expenditures and stoking investor excitement.

Speaking of AI, technology and AI-related stocks led the charge again in 2025. The tech and communications services sectors advanced 23.8% and 32.5%, respectively, trouncing the rest of the market. AI darling Nvidia (NVDA), which now represents 8% of the S&P, was up 38.9% after a 171.2% gain the prior year. A steady stream of huge spending announcements from tech leaders helped induce the gains. Ultimately, a gold rush mindset seemed to develop across the AI ecosystem and we saw the fervor spread to more speculative corners of the market. So called MEME stocks, which gain popularity on social media, and unprofitable AI/tech stocks posted explosive moves higher. As seen in other investment crazes, people started betting on “stories” with little regard for the price they were paying. Case in point, 18 of the top 20 performers in the Russell 3000® Index from April 1st through the end of November were unprofitable companies!

We don’t doubt the promise of AI. Advancement and deployment of the technology may accelerate from here and bring new applications that are currently unfathomable. However, there are many risks and unknowns for investors. What could go wrong? For one, investors may begin to question how the leading players will earn adequate returns on massive capital outlays for computing power. Gartner projects global AI spending will reach \$2 trillion in 2026. According to the Guardian, OpenAI is expected to spend \$1.4 trillion over eight years whereas the company’s current revenue expectation for the end of 2025 is \$20 billion. Much of the spending appears to be driven by FOMO (fear of missing out) and the path to returns is very unclear. Investor Howard Marks recently likened the spending boom to “building an airplane while it’s in flight.” We also note the landscape is rapidly shifting and many companies, including current leaders, could be upended by new business models as the technology advances. Whether it’s search engines, software or semiconductor companies, many of today’s winners could quickly become tomorrow’s losers (and vice versa). Hence, it seems foolhardy to think one can predict outcomes with a high degree of certainty.

We aren’t labeling this a bubble or calling for a top in AI-related stocks. While underweight technology in general, we own some of the large cap tech leaders and remain bullish on them. However, it does seem reasonable for this area, especially more speculative corners, to cool off after an extended run. While AI may be in the 1st or 2nd inning of development, valuations for many of the high-flyers appear to be in later innings and investor crowding seems extreme. We could either see a market rotation or broadening of returns. In other words, we could see investors gravitate to other areas of the market that have struggled. Many stocks, particularly in more economically sensitive areas, are beaten up despite the indices being near all-time highs. While the S&P 500, which has essentially become a large cap technology index, looks



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expensive at 22.1x forward earnings estimate, the equal-weighted S&P is much more reasonable at 16.7x. The stimulative effects of Trump's fiscal policy could fuel improvement in more cyclical industries that have lagged. The same could be said for ongoing support from the Federal Reserve. Also helping, in 2026 we won't have the noise of tariffs or DOGE, which seemed to cast a temporary pall over both consumer and corporate sentiment this past year.

We have been focusing much of our efforts on those stocks that have been cast aside as investors have focused elsewhere. It hasn't paid recently to have differentiated perspectives or be valuation sensitive. Jumping on momentum bandwagons has proven much more fruitful. However, we believe the market's sun could shine elsewhere some point soon and can't stomach the risk associated with many of today's highflyers. Our conservative approach has weighed on relative performance of late, but we've seen this type of market dynamic before (most notably in the late 1990s) and it ultimately paid to look where other investors weren't looking. Thank you for your trust and all the best in 2026!

Sincerely,



George L. Smith III, CFA®
Chairman, Investment Policy Committee

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