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2026 Outlook

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Economy: The US Economy continued to deliver strong growth throughout 2025, after a brief slow period in Q1, with Hollencrest expecting more growth into 2026.

- Q3 saw 4.3% GDP growth, adding to the 3.8% growth reported by the BEA for Q2. The Atlanta Fed currently projects 3% growth in Q4 driven by strong consumption, as was the case in prior quarters. In addition to consumption, a bottoms-up analysis of the economy and earnings growth showed that investment related to technology, particularly artificial intelligence ("AI"), contributed strongly as well. In Q4 we did experience an unusual period where macroeconomic data was largely unavailable due to the prolonged US Government shutdown, creating some volatility in the data once reporting resumed.

- We suspect recent consumption strength may be demographically driven in that older generations that have amassed wealth are continuing to benefit from asset price inflation, allowing for significant discretionary spending. They are also able to transfer that spending power to younger generations (i.e. gifts/loans to children for a downpayment on a first home), supporting further spending. This dynamic reconciles some of our concerns about the "K-shaped" economy, referring to the bifurcation in outcomes and standard of living amongst different socio-economic classes that has been exacerbated by inflation in recent years. As wage growth struggles to keep pace with prices and those that live paycheck to paycheck find it increasingly challenging to maintain their standard of living, discretionary spending gets cut, leaving economic forecasters unsure how consumption continues to grow. This certainly creates an economic risk in the coming years as a pullback in asset prices (a significant market correction) could shut off discretionary spending and trigger a decline in consumption (recession). We do not see this as the most likely outcome as the boom in technology is boosting productivity, allowing economic growth to flourish with fewer hours worked. This boom is also driving investment and cap ex, and economic growth could become increasingly reliant on that investment replacing any slowdown in consumption.

- Although jobs data availability was impacted by the shutdown, the data that was released highlights the labor market as an area of concern in our current economic environment. Unemployment has crept higher despite strong, productivity-driven economic growth. Unemployment growth amongst highly educated and well-qualified entry level workers is of particular concern yet has no easy solution. Labor market dynamics have become more of a focus amongst policymakers. Easier policy boosts growth and, in theory, should cause businesses to see more opportunities to take risks, expand and hire. So far it seems the result has been more cap ex and greater utilization of technology than a rush to onboard new people. The economy and job market will likely adapt as AI displaces more and more jobs, however this will take time.

- Inflation drifted higher from April through September, when the last reliable data was made available. Although inflation did not behave as hoped, there is a high likelihood that this inflation was driven by tariff policies and could end up being transitory. We believe inflation may already be back at the Fed's target level of around 2% if not for those policies. Fortunately, crude oil prices have declined throughout the year due to excess production, inventory build and weak demand as OPEC nations have elected to maintain supply and keep/grow market share instead of shutting off supply to boost prices as has been done in the past. Crude prices are approaching levels where it becomes less economical to drill, so further disinflation in this area could be harder to come by going forward, however the lower price for this key input in so many materials we use daily has been incredibly helpful in keeping a lid on broad inflation. Although we are not overly concerned about inflation continuing higher, we do see inflation as a risk if a monetary or fiscal policy mistake is made. The bond market doesn't appear to be completely convinced that inflation risks have been eliminated as is discussed further below.

- Just as it felt like the re-opening of the IPO window was going to provide much needed support for the private markets, the government shutdown put all of that on hold with the SEC completely closed for IPO review and processing. Although it appears to have been a temporary hang up, we did observe that risk appetite in private markets seemed to pull back in Q4 - from an already modest level. Markets have maintained wide bid-ask spreads and lack efficiency and liquidity, leaving price discovery still a challenge.

Stocks: The S&P 500 added to its annual gain during Q4, ending the year at 6,845 and up 16.4%, its third straight year of double-digit returns.

- Q4 saw modest gains in stocks with some clear rotation occurring. This should be helpful going forward for the market as a whole. From April's lows through late October, AI-related stocks generally showed consistent and strong gains, trading largely in unison. Questions about valuation and uncertainty over future earnings caused winners and losers to begin to deviate in early November, a digestion period in this sector that continued through year end. Other sectors like biotech, industrials, financials and others took a greater leadership role alongside some of the AI stocks upon which the market continued to look kindly.

- Valuation was the biggest driver of the volatility in growth stocks. The S&P 500 has been trading at a multiple of about 22x earnings at its peaks in recent weeks, which is a very high multiple relative to where the S&P has been priced historically. The multiple has gotten so high because the heaviest weighted companies in the index hold very high forward earnings expectations due to potential growth from AI. During Q4 many of these companies issued very strong earnings reports but lacked clarity in their communication to the market of their forward expectations, causing uncertainty about the magnitude of profitability to expect down the road and the speed with which that profitability will be obtained. The market is incredibly efficient at re-pricing and discounting these companies when uncertainty arises, which we saw firsthand with companies like AVGO, PLTR and ORCL. We do expect AI-related companies to continue to grow, however successes will be less universal than in 2025.

- Going forward, the 22x multiple could act as a headwind, keeping returns from surging meaningfully beyond historical annual averages. However, we do expect the earnings part of the equation to continue its growth next year and, even with no multiple expansion, should push the S&P 500 to 7,750. The current high multiple could trigger a valuation-driven correction, which leaves us in a slightly cautious stance - partially hedged but with significant allocation to stocks - as has been the case the last two quarters. A period of renewed uncertainty over earnings could cause the market to dip lower briefly, in which case we would turn more aggressive absent a newly identified macro risk. There is an opportunity for additional upside if the market gains confidence in the mega cap tech stocks' AI earnings potential. There is no rule on how high the market's earnings multiple can go, and if an additional "turn" is added, moving the multiple to 23x, we could easily see the S&P 500 surpass 8,000 in 2026.

- With much of our exposure hedged and so much rotation occurring, we have added exposure to equal weight indices. We are also evaluating exposures to foreign/emerging market equities as they outperformed last year and could continue to do so, especially given the US Dollar's weakness. We maintain our position in gold and expect its uptrend to continue, looking to opportunistically add to this exposure via more aggressive mining stocks.

Bonds and Rates: 2025 demonstrated a clear yield curve steepening trend with short term rates steadily declining throughout the year and the "long bond" (30-year Treasury) trending higher in yield since Q1.

- The Fed continued their rate cuts in Q4. After holding off most of the year, deterioration in the job market pushed them to cut rates three times beginning in September, to a Fed Funds target range of 3.5% to 3.75%. With economic growth strong and inflation inching higher, they face mandates that are at odds with one another. While we are hopeful the job market deterioration corrects itself, we are not convinced lower Fed Funds will be a direct catalyst. Going forward, there is tremendous uncertainty given changing leadership at the Fed. We expect the new regime will cut rates and hope this is done in a thoughtful, responsible way so as to not overheat the economy and unnecessarily promote an increase in inflation.

- As mentioned above, the bond market's pricing of the long end of the yield curve suggests a lack of confidence that inflation is completely under control. The 30-year's yield is re-approaching the key 5% threshold that has caused issues and risk asset volatility in the past.

The 10-year's yield has now traded in a steady range of 4.1% to 4.2% for the past month but is at risk of breaking higher. We see the 10-year yield ranging between 4% to 4.75% as the most likely outcome this year, meaning the likelihood of a big drop in longer-term interest rates is low. Additionally, credit spreads remain historically tight in both investment grade and high yield, making bond investment with duration still very unattractive in our view.