2025 Year In Review & 2026 Outlook

TURTLE CREEK

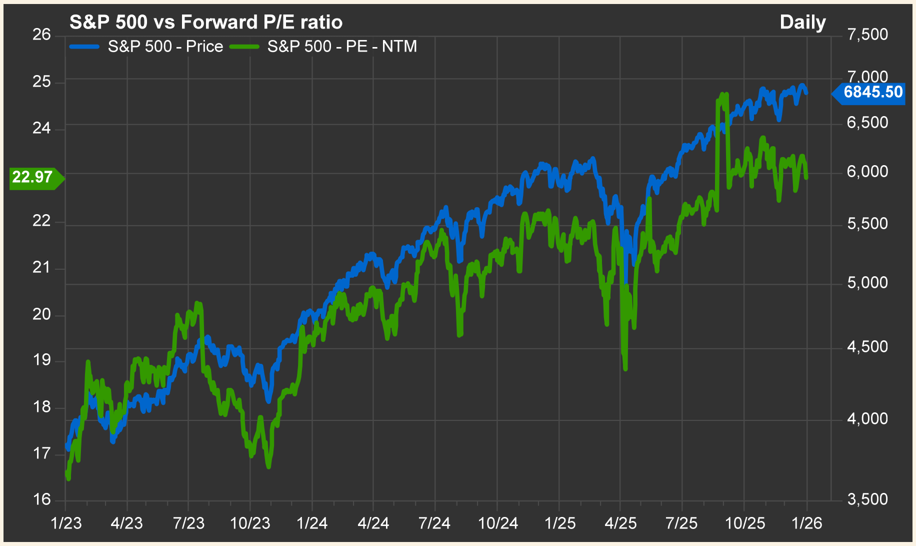
Financial markets produce excellent returns in 2025—can the good times continue?

Index	MTD	QTD	YTD	2024	2023	2022
S&P 500	0.06	2.65	17.88	25.02	26.29	-18.11
Dow Jones Industrial Average	0.92	4.03	14.92	14.99	16.18	-6.86
Russell 2000	-0.58	2.19	12.81	11.54	16.93	-20.44
NASDAQ Composite	-0.47	2.72	21.14	29.57	44.64	-32.61
Europe, Australia, & Far East (EAFE)	3.01	4.91	31.89	4.35	18.85	-14.05
MSCI Emerging Markets	3.02	4.78	34.36	8.05	10.27	-19.78
Bloomberg Barclays U.S. Aggregate Bond	-0.15	1.10	7.30	1.25	5.53	-13.04
Bloomberg Barclays U.S. Corporate High Yield	0.57	1.31	8.62	8.19	13.45	-11.19

As of 12.31.2025; Returns in percent

FINANCIAL MARKET PERFORMANCE

Despite heightened volatility in the first 4 months of the year, US equities were broadly higher in 2025. Major market indices notched their third straight annual gain; the S&P (+17.88%), Nasdaq Composite (+21.14%), and the small cap Russell 2000 Index (+12.81%) each saw their seventh double-digit rise of the past nine years. Note that the S&P 500 has now risen by more than 80% over the past three years alone while the forward P/E ratio has risen from under 17x to almost 23x (see below).

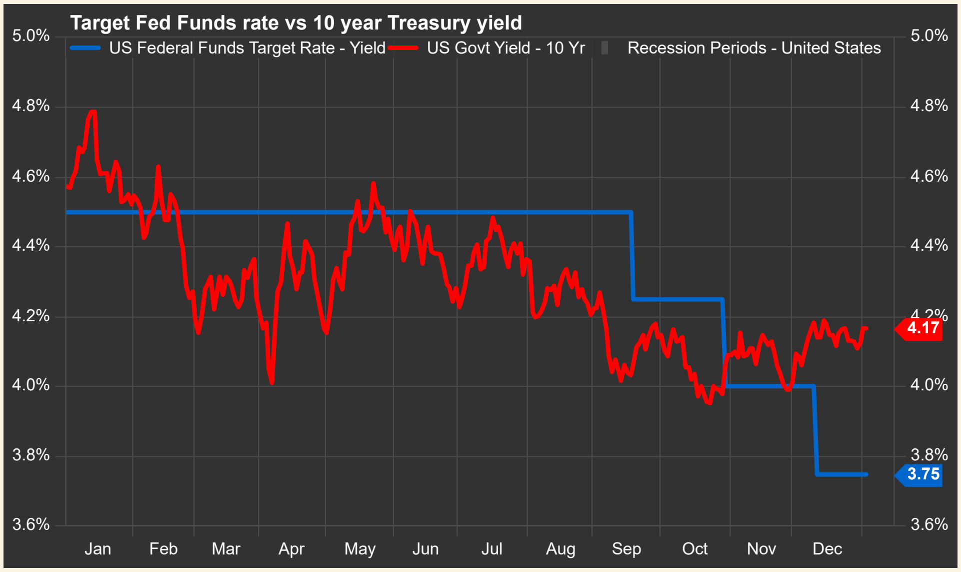


Source: FactSet As of 12.31.25

There was once again an issue of gains concentrated around many of the large-cap tech names, with the equal-weight S&P trailing the cap-weighted index by more than 700 bp. The Mag 7 names were broadly positive, with Alphabet +65.4% and Nvidia +38.9% the notable gainers in that group. The AI space was also a major market driver this year; AI chipmakers and AI infrastructure firms were among the market's best-performing areas. Retail investor favorites had a very strong year, with this group repeatedly stepping in to buy dips. The most shorted S&P 500 stocks also handily topped the benchmark.

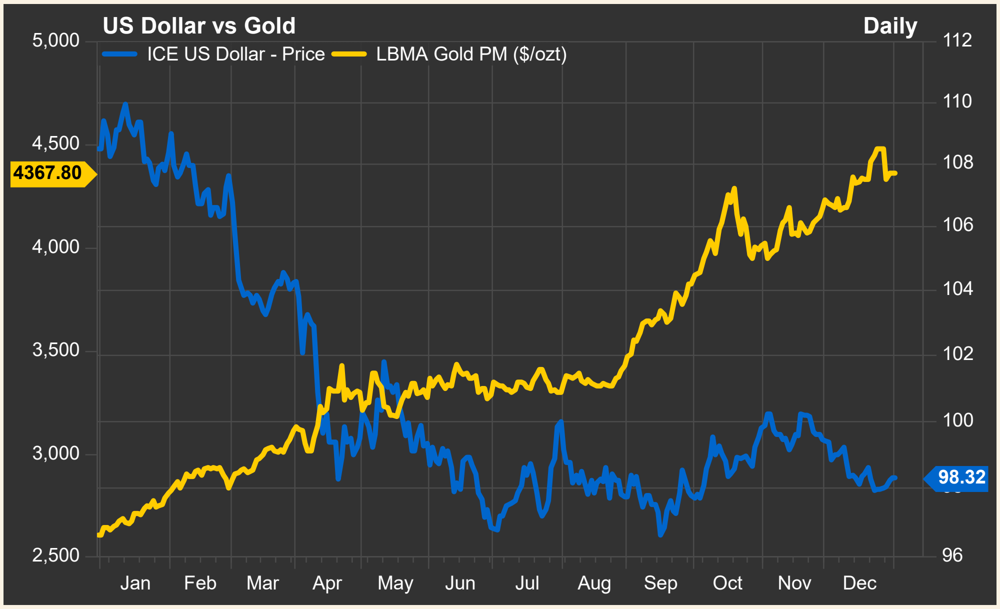
Foreign equities posted even better returns, with the MSCI EAFE index rising 31.89% and the MSCI Emerging Markets index gaining 34.36%. The weaker dollar combined with the perceived negative impact of the tariffs on the US economy and more attractive valuations in foreign stocks drove capital into these markets in 2025.

Bonds rallied as interest rates fell. The Bloomberg Aggregate Bond Index rose 7.30% while the High Yield Bond index gained 8.62%. Falling inflation and lower Fed Funds rates played a part in the decline in rates during 2025. The 2-year Treasury yield dropped 77 bp over the course of the year and the 10-year Treasury yield fell 40 bp. Despite the fall in rates in 2025, investors voiced some concern that increased federal spending, and deficits, will lead to greater Treasury debt issuance and higher rates over the next few years.



Source: FactSet As of 12.31.25

The dollar logged its worst calendar year since 2017, falling 9.5%. Analysts flagged pressures from a volatile trade war backdrop, and Fed rate cuts at a time when many global central banks have begun to maintain rates at current levels, both of which helped undermine demand for the US dollar. Fears about a worsening US fiscal situation also caused the dollar to retreat. While the market has worked through initial trade shocks, forecasts for the dollar in 2026 look for further weakness to come.



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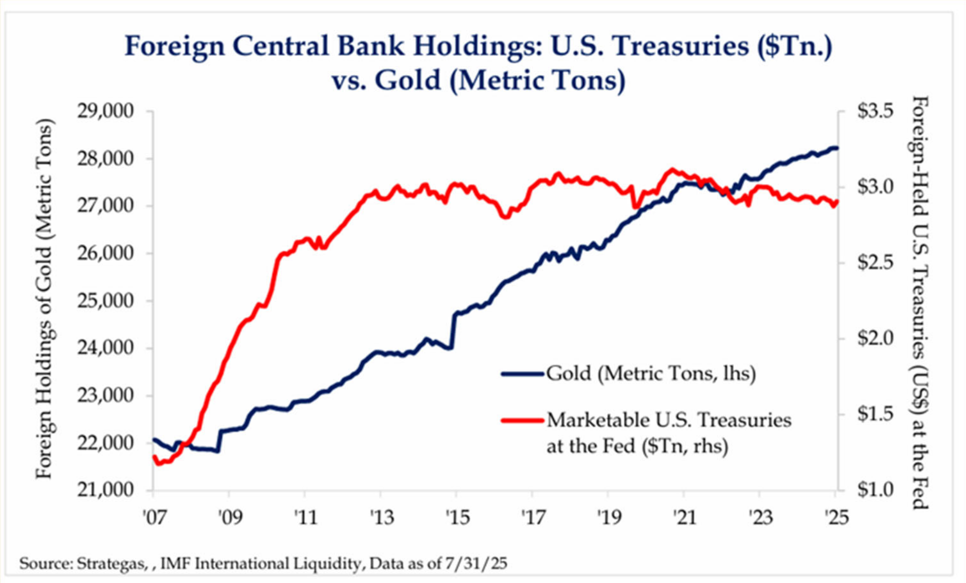
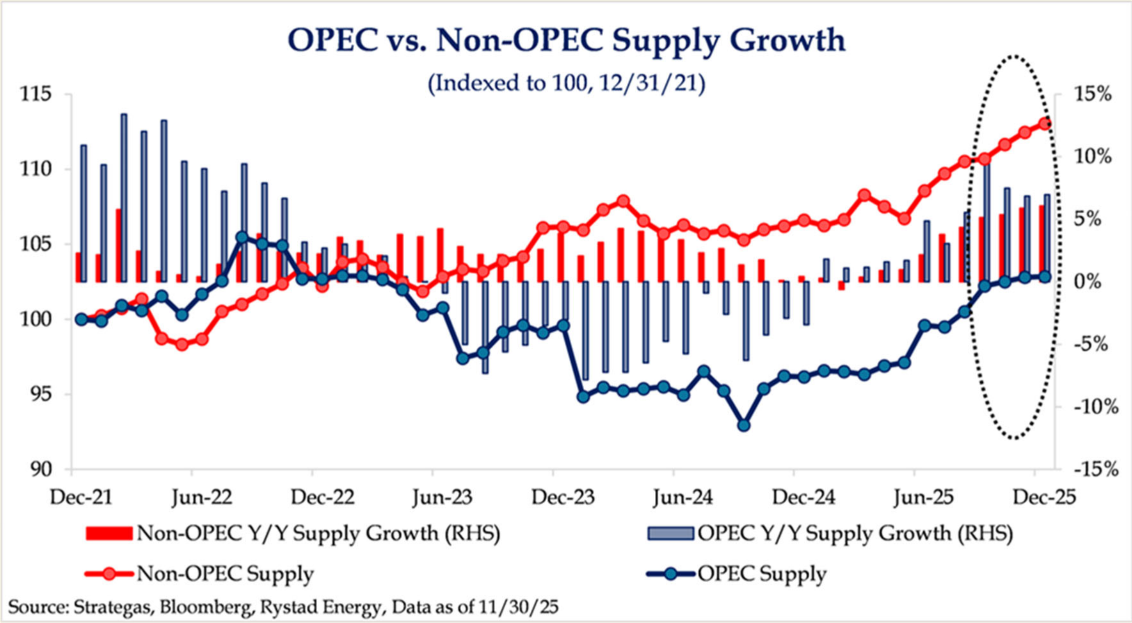
It was a banner year for metals. Gold ended the year at $4,341/oz, just shy of its record above $4,500 but up 64.4% from 2024's close. It was Gold's strongest annual performance since 1979. A key factor in the rise was the increased investment in the metal by foreign central banks, who have reduced US Treasury holdings by a similar amount. Silver settled up 141.4%, also its best year since 1979; analysts noted some help not only from safe-haven demand but also from the metal's broad industrial applications (including in electronics). Copper was similarly in demand, rising 40.1% for the year. Bitcoin futures were down 6.8% in 2025. It was a volatile year for bitcoin futures, which dropped as low as $74,635 amid April's Liberation Day market drawdown, hit record highs above $127,000 in October, then again fell to $80,000 later in November, demonstrating the risk asset and volatile nature of cryptocurrency.



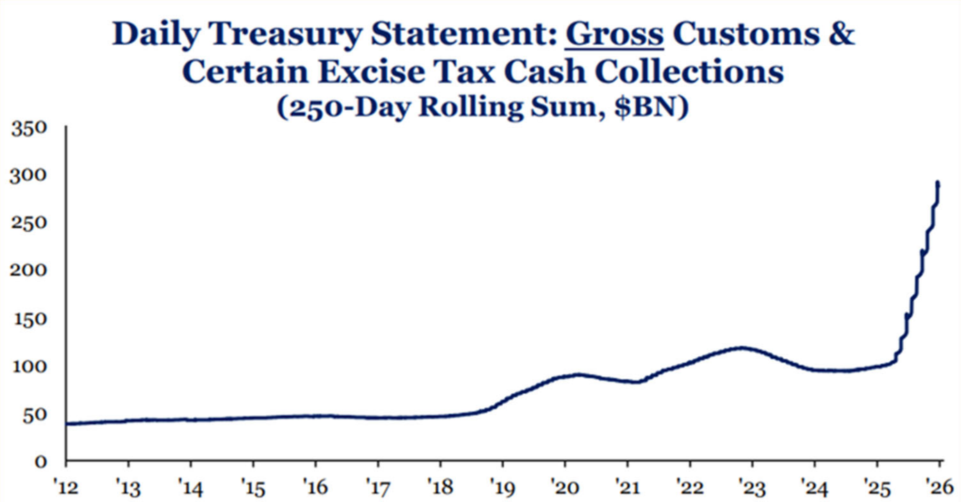
WTI crude oil dropped 19.9% in 2025, with oil having its worst year since 2020. Crude also dropped during the spring's tariff concerns but recovered when the US struck Iran's nuclear facilities in June. Despite some geopolitical shifts late in the year (prospects for a Russia-Ukraine ceasefire, US seizing Venezuela-linked tankers in the Caribbean), the market remained focused on forecasts for oversupply in 2026. Specifically, U.S. crude output has hit a record this year of +13.6 mb/d (million barrels per day). Efficiency gains have been the key, propelling this production growth in light of a -14% Y/Y drop off in oil rigs (i.e., doing more with less).



PERFORMANCE DRIVERS

Global trade was a central focus this year as one of President Trump's signature priorities. Anxiety and uncertainty were high early in his administration, with tariffs on major trading partners Canada, Mexico, and China announced, then delayed, followed by a comprehensive "reciprocal" tariff plan launch on April 2nd "Liberation Day." This was the market's most challenging period of the year: between February 19th and April 8th, the S&P 500 dropped 18.9% while the Nasdaq shed 23.9%. But implementation delays (creating space to strike bilateral deals) and the "TACO" narrative (Trump Always Chickens Out) put an end to the slide and offered some increased confidence conditions might not be as bad as feared. Trade relations with China rocked back and forth, with Trump repeatedly raising and lowering rhetorical pressure while holding a series of international meetings (with rare-earth exports a notable topic) that ultimately punted many issues into 2026 or beyond.

Throughout, Trump trumpeted the benefits to US coffers from increased tariff revenues, with more than $200B collected in 2025 and perhaps $2.3T over the next decade at current tariff levels. The president has said this income will help address the federal deficit, fund future income-tax cuts, and lead to $2,000 tariff "dividend" checks for Americans in 2026. Businesses worked hard to navigate the volatile tariff backdrop, employing multiple mitigation strategies but also passing costs through to consumer prices or weathering margin compression. The question of whether tariffs would represent a one-time price adjustment or an ongoing challenge to bringing inflation back to the 2% target remained a key monetary policy debate. The future shape of tariffs remains unsettled given a pending Supreme Court decision on whether Trump's use of emergency powers to implement them is justified (though administration officials stress they have other tariff powers at their disposal).



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The evolution of AI was front and center this year amid rising corporate adoption, accelerating computing demand, and political prioritization by the White House. Capex on AI projects is estimated to top $400B in 2025, with some analyst estimates at $525-575B for 2026. But the year's enthusiasm and optimism also brought some significant scrutiny and sparked many comparisons to the dot-com bubble. Questions were raised about the scope of the AI infrastructure buildout, particularly the degree to which it may be funded by debt; Oracle Corp (+17.0% for the year but down 30.7% in Q4) was the poster child for these worries, having issued nearly $26B debt this year and being noted for its reliance on OpenAI for future revenue growth. A related issue was AI "circularity," with larger firms making investments in firms so that those firms could become customers. There was also a broad debate about monetization, with AI seen as a definite aid to efficiency with less-clear prospects for future revenue streams.

The Fed kept rates on hold for much of the year, with members acknowledging some labor-market softness and moderating growth but also voicing some concern about inflation remaining above the 2% target and observing restrictive policy did not seem to be holding back growth. The balance began tangibly shifting in a dovish direction with July's meeting, in the face of a weaker job market. The Fed ultimately cut by 25 bp in September, October, and December, though the latter two meetings saw dissents. The obvious divergence in policymaker opinions was a major topic in the narrative, and analysts see a likelihood for a more dovish trend in 2026, especially with Trump choosing a replacement for Chair Powell (whose term as chair ends in May). At present, the market is pricing in at least one 25 bp cut for 2026, expected to begin in March.

Corporate earnings remained strong in 2025, with current forecasts calling for a 13% annual increase for the calendar year, which would be the fifth consecutive year of earnings growth and well ahead of the 10-year average of 8.6%. Big tech companies were a big driver of the overall increase, with Nvidia, Alphabet, and Amazon three of the top five contributors to 2025 earnings growth. However, the 493 S&P constituents outside the Magnificent 7 are forecast to report earnings growth of ~9% for the year, a growth rate that is still above average.

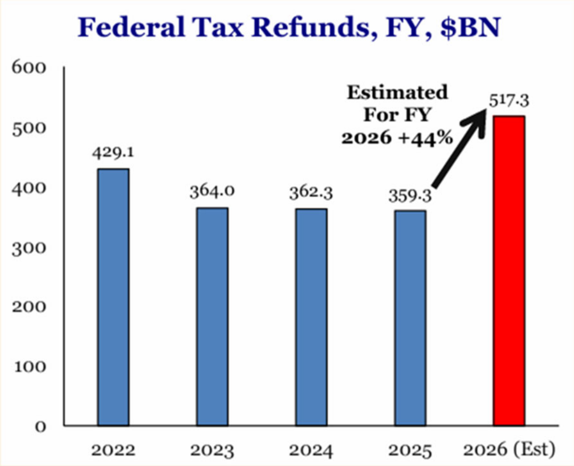
The Republican party's central legislative achievement this year was the very narrow passage of the One Big Beautiful Bill Act (OBBBA), which permanently extended the tax cuts from 2017's Tax Cuts and Jobs Act, which were scheduled to expire at year's end. The bill also boosted the debt limit by $5T and incorporated several other provisions pitched as pro-growth (though estimates suggest it could boost federal debt by $4T+ over ten years). Trump also put Elon Musk in charge of the "Department of Government Efficiency" (DOGE), aimed at cutting government spending and shrinking federal employment. While the results of the former were limited, BLS noted in its November report that federal employment is down 271K jobs since peaking in January. Finally, while the market was not terribly concerned about economic damage from the record 43-day government shutdown from October 1st through November 12th, the disruption in the flow of economic data has proven a major challenge (with agencies not yet caught up with the backlog).

2026 OUTLOOK

We are relatively bullish on the markets in 2026. Specifically, we remain supportive of an overweight to equities because (i) there are several compelling tailwinds, (ii) we do not see onerous near term risks, and (iii) while high beginning P/E valuations (such as those we have today) are correlated to lower 10-year forward returns, they are not highly correlated to 1-year forward returns.

The tailwinds include:

- **Potential upside** to the expected 14% earnings growth and 2% - 3% GDP growth is possible due to both monetary and fiscal stimulus in the system. The Fed has already cut the fed Funds rate by 1.75% over the past year and a half, while the expectation is for another 1 -2 cuts this year. In addition, they've ended Quantitative Tightening, which adds further stimulus to the system. And finally, the One Big Beautiful Bill passed last year will provide an additional $160B in tax refunds to consumers this year.



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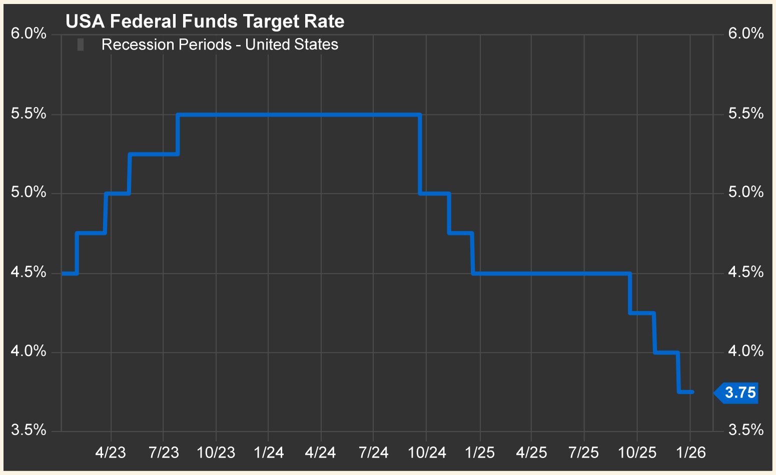

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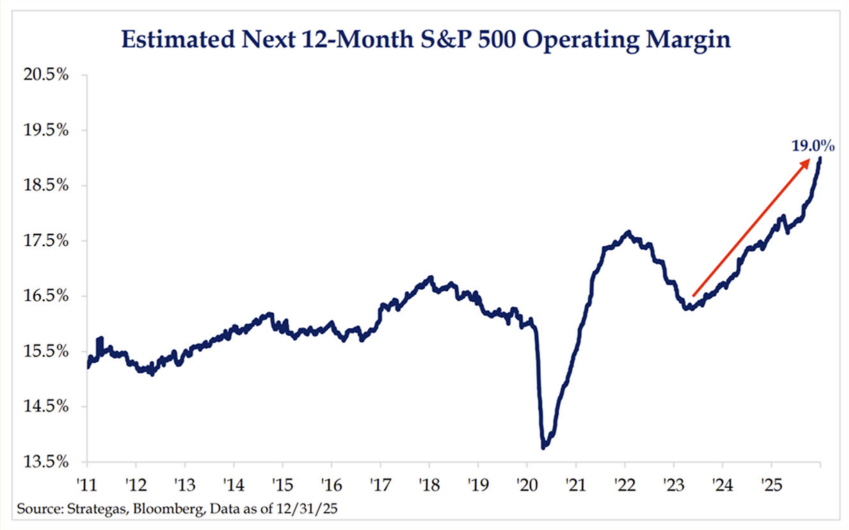
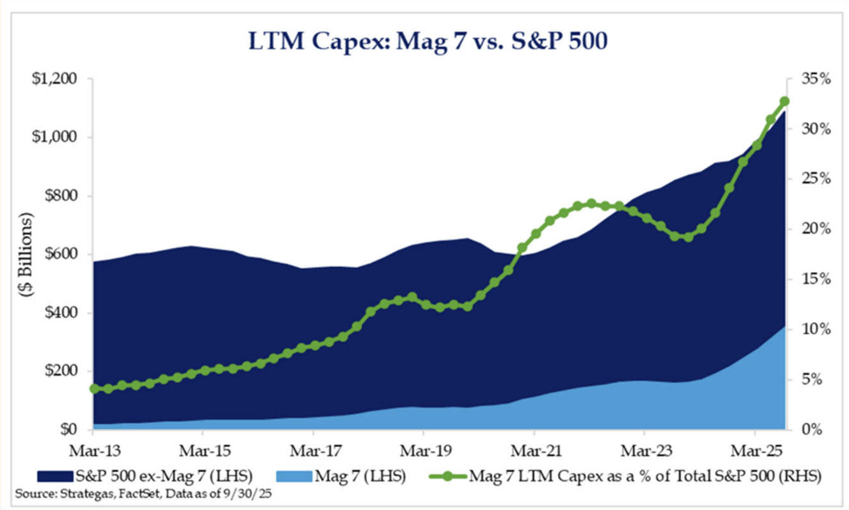
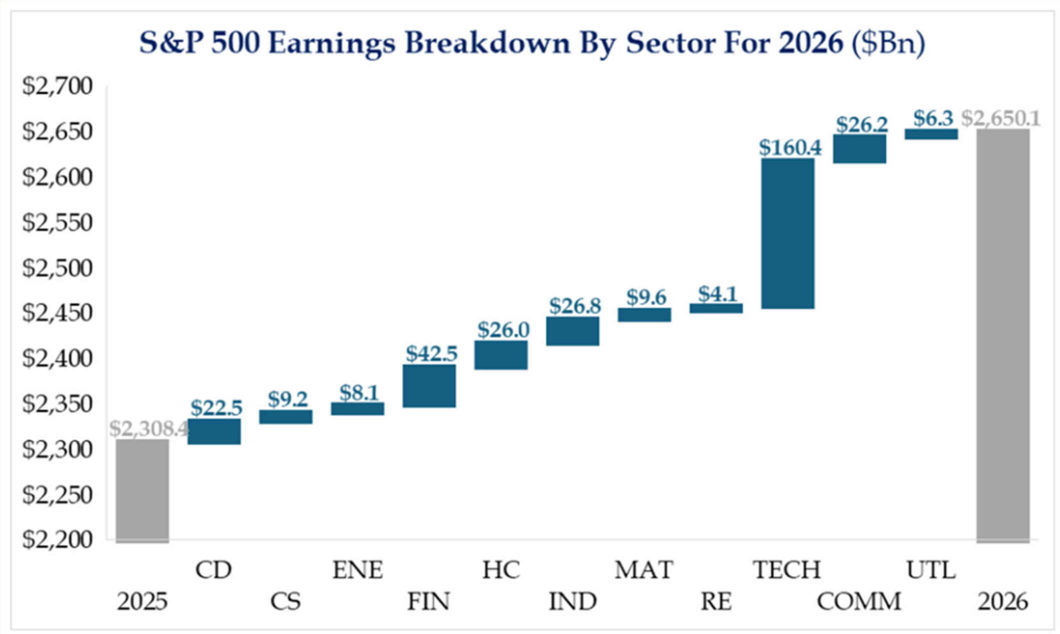
- **Strong corporate earnings** - Earnings are expected to rise by 14% this year, following a 13% gain in 2025. In addition, operating margins are expected to increase to 19% this year, a new all-time high and a key driver of earnings growth. Over time, earnings growth is the key factor in stock price appreciation. Also, don't discount the potential for an uptick in M&A and capital markets activity given improving sentiment and pent-up demand for deals. Such a trend would be positive for Private Equity and Private Credit as well as public securities.



- **The growth in Artificial Intelligence** - AI continues having a broad impact on GDP and corporate earnings growth. Despite the late 2025 scare that spending on AI was declining, we've continued to see data that supports continued powerful growth for AI technology. In fact, capital spending by the Mag 7 companies, which is heavily focused on AI, has accounted for 33% of all capital spending within the S&P 500 over the past 12 month. We believe there could be second-order beneficiaries of AI by non-tech companies looking to improve efficiency.



Also, note that the Technology sector is expected to account for almost 50% of 2026 earnings growth, so the economy and market remain highly dependent on Mag 7 and AI earnings.



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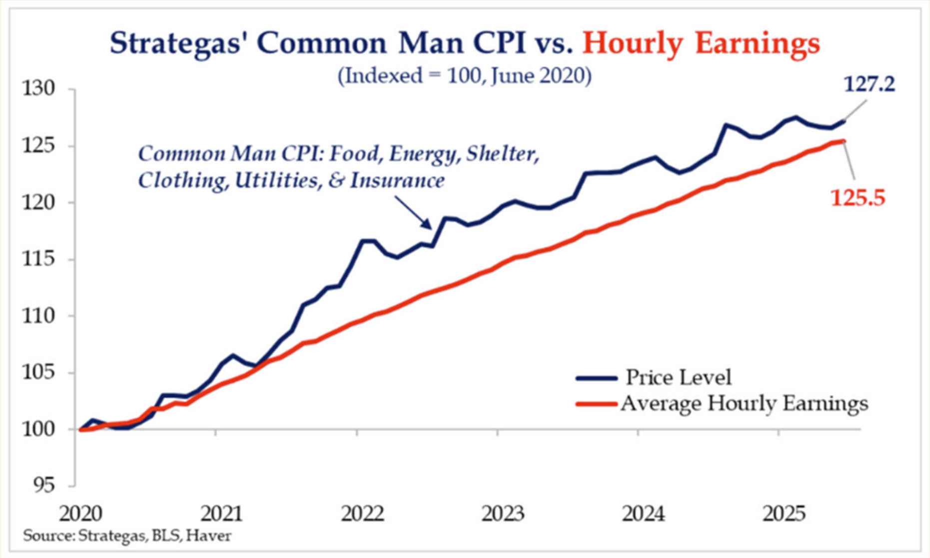
- **Consumer is resilient** – Despite a decline in consumer confidence and some weakness in employment, consumer spending has remined solid and should continue to expand as interest rates, including mortgage, auto, and credit card rates, fall as the Fed Funds rate drops.
- **Increase equity demand possible** – As the Fed cuts rates and money market fund yields decline (already down by roughly 200bp from the peak) we'd expect investors to move capital from money market funds into equities in order to generate a more meaningful return. This occurred when the Fed cut rates to zero following the 2008 Financial Crisis and we saw capital flow into equities, helping to push the market higher.
- **Fixed Income remains attractive** – Following a strong year for investment grade fixed income, we still find the asset class attractive. In fact, municipal bonds are trading at especially good yields today. A stable to falling interest rate environment benefits bonds, while high quality fixed income serves as a good cushion to potential equity volatility.
- **Where we see additional opportunities** (primarily accessed through private investments);
    - *Energy* – countercyclical investments at depressed valuations with solid near term cash flows
    - *Real estate and real assets generally* – historically real assets are less correlated to the public equity market and act as an inflation hedge, while the large commercial real estate debt maturity wall creates opportunities
    - *Lower and middle market Private Equity* – lots of resilient businesses with low hanging fruit for improvement in which you can buy ownership for a discount to the multiples offered in public markets, then apply structure to manage risk and access inefficiencies

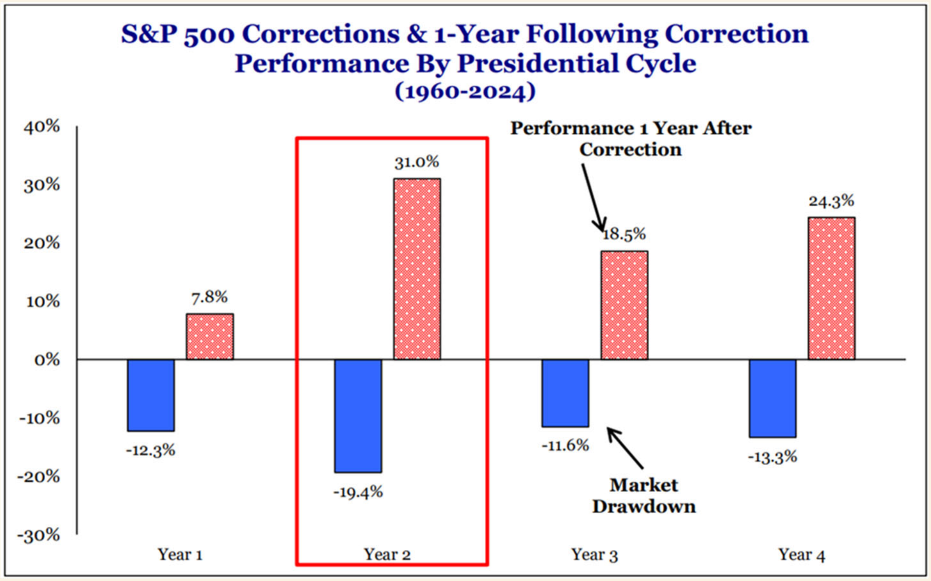
THE BEAR CASE

Clearly, there remain a number of headwinds faced by investors as we move into the new year. Employment has shown some signs of weakness, with the unemployment rate rising to 4.6% in November, and geopolitics, specifically China and the Mid East, continue to create angst.

Also, sticky inflation has made “Affordability” a front and center issue. See the chart below which demonstrates that key consumer expenses have climbed by 27.2% since 2020, while wages have risen only 25.5%.



Also, it’s prudent to note that the S&P 500 suffers, on average, a 19% drawdown in the second year of a presidential term (although this has historically resulted in a good buying opportunity).



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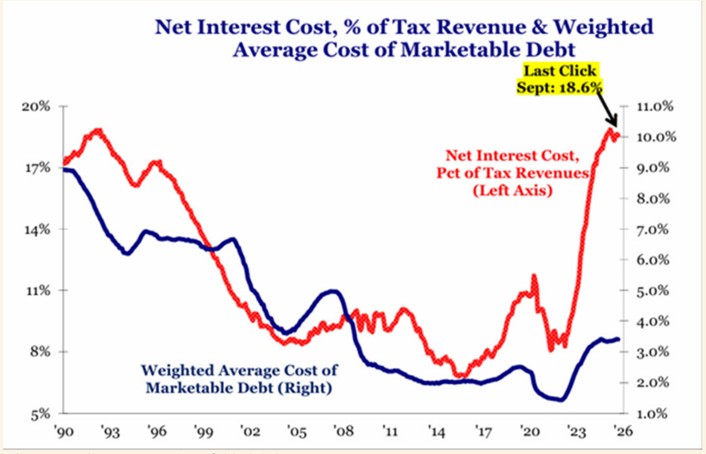
The ugly fiscal situation in which the US finds itself today poses a risk. Given the rapid rise in spending over the past years, as well as the rise in interest rates beginning in 2022, interest expense on the debt now exceeds defense spending and almost 19% of tax revenue. Such a growth in debt servicing expense is not sustainable and requires a constant flow of new treasury issuance which will keep interest rates artificially high. This is not a good formula for economic success, but it likely doesn't have a significant impact on 2026 market returns.



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Finally, we think the fall in the US dollar could continue into 2026. The powerful rise in both gold and silver during 2025, combined with continued fears about the decline in US exceptionalism and the very strong performance of foreign equities last year may lead investors to seek opportunities in non-dollar assets this year. Such a trend is a good reason to diversify your portfolio into a variety of asset classes.

WHAT TO EXPECT & INVESTMENT PORTFOLIO IMPLICATIONS

Markets have been very robust for the past several years, and as we all know, stocks cannot go straight up forever. However, no one can predict when the next downturn will occur, so prudent investors should hold a well-diversified portfolio to mitigate potential loss and benefit from a variety of asset classes. We believe that such a strategy, which includes holding US and foreign stocks and bonds as well as Private Alternative investments, is the best way to achieve long-term investment goals.

Thank you for your support of Turtle Creek. We are committed to helping the families we serve meet their long-term financial goals. Please contact us if you have any questions or thoughts about this market update or if we can help in any way.

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