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PRIVATE WEALTH

Q1 of the 21st Century: A "Hal" of a Run

January 2026

The 2025 Brief

2025 was a year of two halves, the first of which was marked by pandemic-level volatility and a sell-off painful enough to approach an official "bear market". At its worst moment shortly after President Trump's Liberation Day in April, the S&P 500 was down over 20% from its mid-February high. Just seven days later, however, the president announced a pause to his tariff plans, which kicked off a relentless 41% rally spanning the remainder of the year.

Growth of the AI complex fueled this rally in the foreground, but in the background, the market enjoyed the tailwind of three Fed rate cuts, a ceasefire in the Middle East, seeming de-escalation in Ukraine, a more self-assertive Europe, a crippled Iranian nuclear capability, economic rapprochement with China and the end of the longest government shutdown in history. And, most importantly, earnings continued their quiet march upward across the vast majority of sectors. In fact, operating margins currently sit above five-year averages in seven of the 11 sectors of the market, not just technology.

Most of the year's gains in the S&P 500 occurred in the 2H, ending +2.6% for Q4 and +17.86% for the year. This comes on top of last year's 25% gain (including dividends). The reality is that as we conclude the first quarter of the 21st century, the S&P 500 deserves a toast. In our minds, the asset class winner so far this century is unquestionably the U.S. stock market, having compounded at a 8.06% annual growth rate—well above any other major market in the world, including China, which many will recall has been an economic miracle of the last 25 years. The same is true on a currency-adjusted basis. America's claim to nine of the world's 11 trillion-dollar companies is but one reason why.

Remember, though, that not only did the last 25 years begin on the heels of the "dot-com bubble" peak, but it also included the Global Financial Crisis of 2008 and the pandemic of 2020. Thus, it was a conservative representation of the long-term stock market experience, which has seen the market compound at 12% over 50 years, and approximately 10% over the last 100. Of course, on any given day, the market is a measure of fear and greed, but over the long term, it is a measure of our economic innovation.

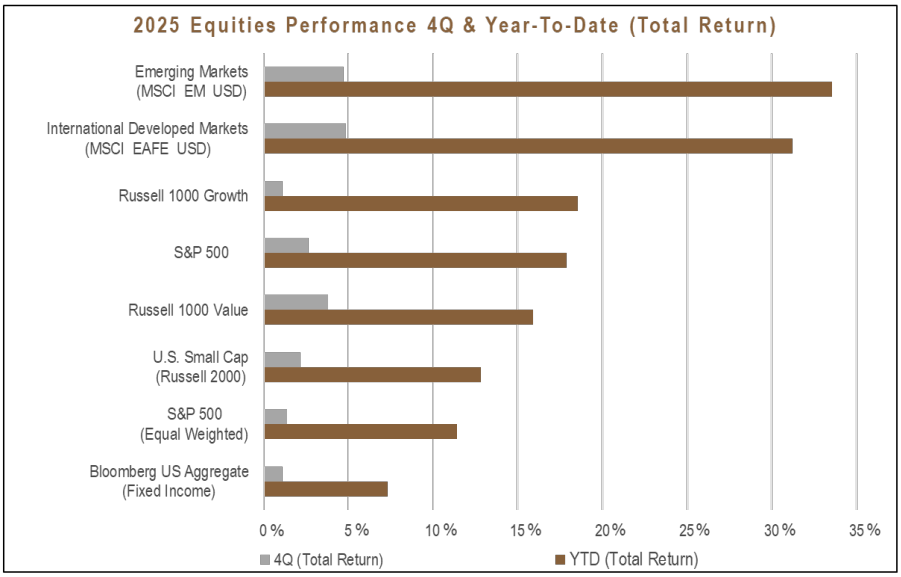
The question on everyone's mind today is whether, 25 years on, we are witnessing an echo of the dot-com bubble which closed the fourth quarter of the last century. It is an important question, and one we have well considered. It is true that pockets of the market exhibit exuberance, but in our estimation, these still do not rise to the definition of a bubble in a systemic sense. More than anything, we remain confident that markets will continue to reflect humanity's innate and irrepressible desire for advancement over the next 25 years.

2025 MARKET PERFORMANCES AND SECTORS

The S&P 500 closed the year +17.86%, yet again edging out its equal-weighted twin at +11.2%, as large-cap companies and ultra-cap (see the "trillion-dollar" club) continued their run of outperformance.

The 2025 rate cuts administered by the U.S. Fed and most other major central banks around the world had an unmistakable effect, notably fueling significant double-digit advances for nearly all countries around the world. Last year truly was a global

bull market, propelled by targeted rounds of stimulus in places such as Germany, Japan and China. Rate-cutting, along with resilient economic growth globally, helped most indices perform well. As a result, the Russell 1000 Value trailed the Russell 1000 Growth by only 265bps despite so much focus on AI. Similarly, small caps as represented by the Russell 2000 outperformed the Equal-Weight S&P 500.



Source: Neuberger Berman, Portfolio Insight. Information as of 12/31/25.

Even amidst this flurry of broad-based positivity, the U.S. Aggregate Bond Index (AGG) managed a respectable +7% gain. And while the next Fed Chairman will undoubtedly be more sympathetic to rate cuts, it is still unclear how much room he will have to cut, as inflation remains persistent and the U.S. deficit remains problematic. These are but two of the many reasons we continue to keep our maturities short.

Within the U.S. it is true that the trillion-dollar companies continued to crowd out the rest as they grew ever larger, increasing the concentration in the S&P 500 index to fresh records. The “Magnificent 7” within this group, have been generational in their value creation, but it has not come without volatility. In fact, they all exhibit volatility in excess of the market, as measured by “beta”, and each has experienced at least one period of at least 20% underperformance relative to the market within the last year. Amazon, Nvidia and Microsoft have experienced two such periods this year, and zooming out to five years reveals moments of significantly greater relative underperformance for each of them. Markets may “feel” exuberant, perhaps bubbly to some, but each of the “Mag 7” has climbed its own wall of worry in 2025. None more so than Google, which faced the existential risk of disruption from GPT no less than nine months ago! As we close the year, investors have exhibited rising skepticism around the sustainability of such elevated AI datacenter capital spending (capex). As such, Nvidia’s P/E ratio has compressed from 33x to 25x and sits near its lowest percentile in nearly 10 years.

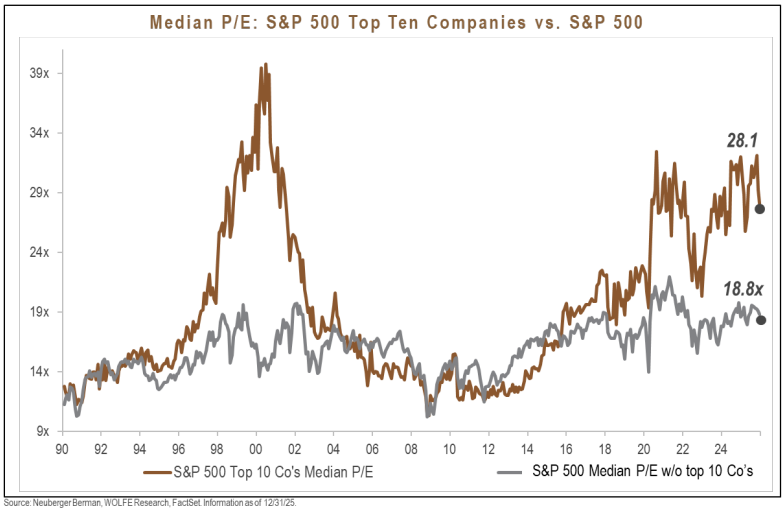
Unsurprisingly, the Tech sleeve of the S&P 500 was the top sector at +24.6% and now accounts for over 35% of the overall index. The tech sector was also the top-performing in the equal-weight S&P 500 index, up +22% across 64 companies. The buildout of the “AI complex” continued to act like a tide lifting many, but not all, boats. Utilities were among the best-performing sectors due to their significant role in providing new power to AI datacenters now under construction. Similarly, the Industrials sector benefited from its large number of construction and equipment providers.

However, large swaths of the industrial sector lacking any meaningful exposure to AI or those still reeling from a housing market that remains frozen underperformed. Even worse, consulting and business services companies, as well as many software-oriented businesses, were quite challenged as investors assessed the risk that AI could represent a major disruption.

While interest rates may be coming down, the all-important 10-year treasury yield has been stuck in a relatively tight range around 4% for a third year in a row. This has made it challenging for Real Estate and Consumer Staples companies, both of which were up less than 3% in 2025 as they are viewed as yield surrogates. Energy was not far ahead at +5%, due to a difficult near-term supply/demand picture. Absent the anomaly of 2020, a barrel of oil hasn't been this cheap relative to GDP in almost a decade.

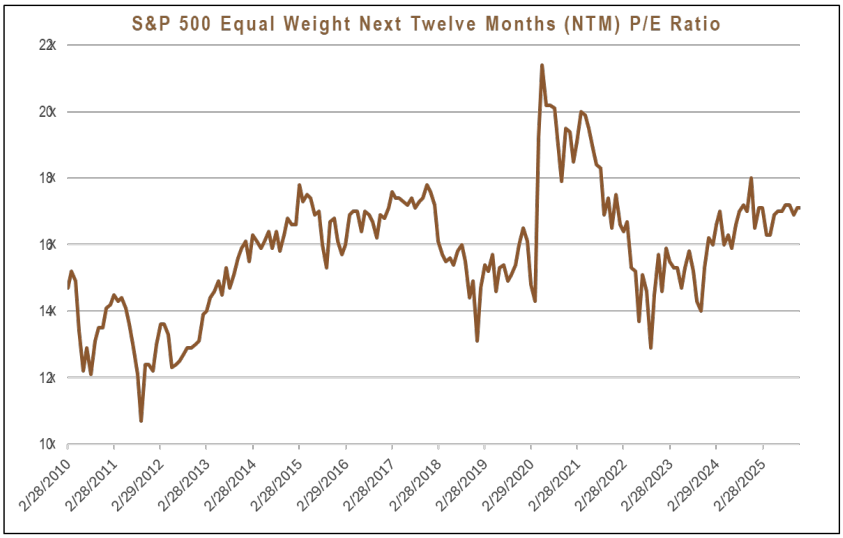
VALUATION

The P/E on the S&P 500 has drifted higher mainly due to rising concentration as the trillion-dollar companies account for an ever-greater share of the total. This has pulled up the S&P 500 valuation on a technical basis. Another way to view the market is by separating the top 10 companies from the rest. On this basis, we can see their median P/E has remained stable at their higher post-pandemic levels while the rest remain within their long-term range.



Source: Neuberger Berman, WOLFE Research, FactSet. Information as of 12/31/25.

Meanwhile, the forward P/E on the Equal-Weighted S&P 500 (RSP) has floated up slightly since 2022, but has remained essentially flat since about 2013. This tells us that, in broad terms, the market may still have frothy corners, but also places to hunt for interesting relative opportunities.



Source: Neuberger Berman, FactSet. Information as of 12/19/25.

THE MACRO ECONOMIC LANDSCAPE

Gold is not only represented in the material sector via the gold miners, it is also the ultimate read of the global monetary landscape. Gold was up nearly 65% this year, which puts it comfortably ahead of the S&P 500 over five years. While the move has been notable, we resist the urge to call it a bubble. In our minds, the seeds of gold's recent move were planted with the gargantuan money printing of the post-pandemic period while the war in Ukraine acted like regular watering and the Trump administration's unilateral foreign policies have acted like sunshine upon those seeds. While we see gold holding most of its gains over the medium term, and possibly moving higher, we think the U.S. economy can continue to perform against an upwardly rebased gold.

It is true that the employment picture has softened on the margin, but with unemployment still firmly in the mid-4% range, we see no cause for alarm. We also believe the media has woven a narrative around AI's impact on the labor market. Every year, Neuberger hosts up to 2,000 meetings with public company management teams, outside research analysts and industry experts. We have yet to hear anything beyond the most anecdotal evidence that AI applications are displacing actual workers. And judging by our own adoption of AI tools, we are still not seeing worker displacement. Rather, we believe current employment softening is simply a normalization of the post-pandemic overshoot, which saw the U.S. economy run at full employment for 43 consecutive months. According to Travis McCourt, macro-economist at Raymond James, that's the longest stretch since WWII.

While housing has played nothing more than a minor role in economic activity over the last few years, we have already highlighted that Americans own $20 trillion of equity in their homes, equivalent to half the government deficit, and well above the amount they still owe on their mortgages. As we've pointed out in past letters, the American consumer balance sheet has not been this solid since the 1960s. This is the primary reason why we believe the government deficit has yet to manifest itself in the treasury market with significantly higher yields.

In May, the next Fed Chairman will inherit a resilient economic backdrop, along with tight credit spreads and the tailwind from the Big Beautiful Bill, which is estimated to lift GDP growth by nearly 100bps in its first 2.5 years of implementation. In fact, GDP readings have already come in above expectations in the final weeks of December.

That said, even with the new Chairman's undoubtedly more dovish stance to rates, it may be difficult to justify more cuts, presenting markets with a reduced tailwind in 2026. Markets may also need to adjust to political momentum, which appears to be swinging from red to blue as Trump succumbs to the forces of un-affordability and his policies are curtailed or perhaps reversed. In fact, the Supreme Court is expected to rule on tariffs imminently.

Near-term macro tail risks could also include a repeat of the Japan yield shock, which wobbled global markets in the summer of 2024. After a generation of holding rates at rock-bottom levels, Japan is now feeling inflationary pressure to raise rates, and its messaging around how much and for how long have been cryptic. As a top-3 holder of U.S. Treasury debt, if Japanese savers were to reallocate to their now more attractively yielding domestic bonds, this would send more shock waves.

This is not a comprehensive list of potential near-term risks, but certainly, a slowdown in the pace of growth around the AI complex would be another important risk factor for markets in 2026. If you are exhausted from hearing about AI, we don't blame you. This has been the most high-profile topic of the market for more than two years. Realistically, we see it remaining center stage for a time as the pace and extent of adoption only increase.

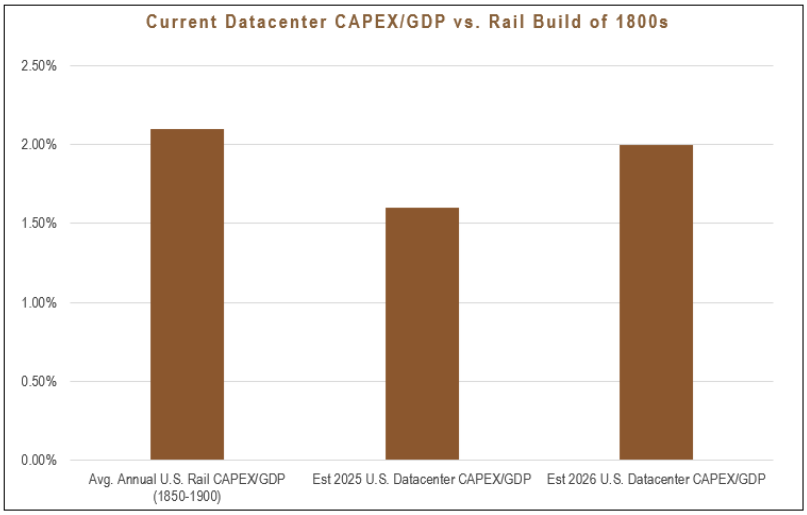
Is AI in a bubble? That appears to be the "trillion-dollar" question. As with gold this year, the media has been prolific with their use of the "B" word. Fears of a correction are normal after such impressive gains, and in media, fear sells. With AI's ever-growing importance to markets, we took another look at some of the numbers.

AI: MAINTAIN CONTEXT, CARRY ON

Railroads vs. Datacenters: revisited

$400 billion. That is the number you may have heard to describe the buildout of AI infrastructure by the large tech companies this year. It is a big, eye-catching number, and for many is more than enough to speculate about a bubble. Perhaps you've also seen the CEO of Nvidia, Jensen Huang, saying the market for AI infrastructure could reach $3 trillion in 2030. That does sound fantastical, almost outlandish, but without context, these numbers lack meaning.

We continue to believe that datacenters, including the "accelerated compute" that AI algorithms rely on are analogous to railroads in terms of their relative importance and impact to our economy. Recall from our June 2024 letter that the railroad buildout of the 1800s amounted to an average annual investment of 2.1% of GDP over a 50-year period. In some years, investment levels were far greater while in others, it was far less as overbuilding was absorbed, and bankruptcies parceled out. Ultimately, we believe 50 years is a long enough timeline to reflect society's true demand for rail investment.



Source: Neuberger Berman, Bloomberg. Information as of 12/31/25.

Today, four mega-cap tech companies have significant datacenter installations ("hyperscalers"): Amazon, Google, Meta and Microsoft. Together, they will have spent approximately $370 billion in total capex in 2025, up from $122 billion in 2020 and $50 billion in 2017. If we include non-hyperscale datacenter players like Oracle and Coreweave, the total capex figure for 2025 rises by another ~$100 billion to ~ $460 billion (hence the "$400 billion" figure we hear about in the media). That equates to 1.6% of 2025 GDP, well within the average 50-year average railroad buildout.

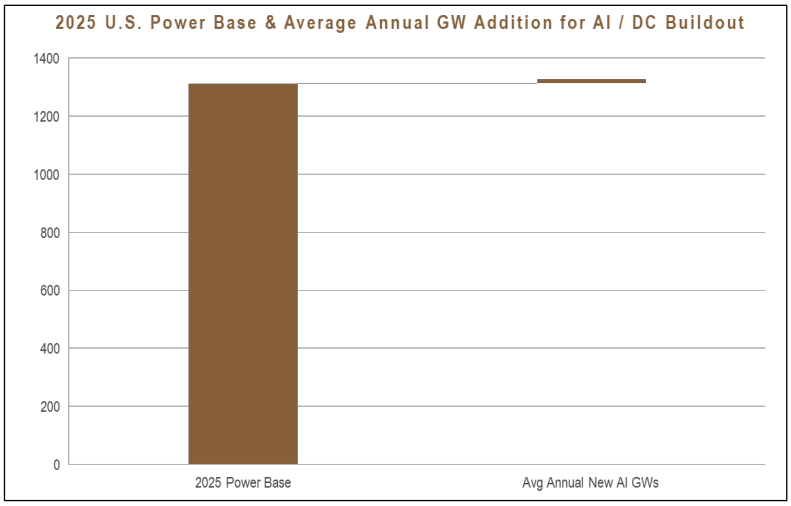
The consensus capex estimate for total U.S. compute infrastructure in 2026 is approximately $600 billion. That equates to 2.0% of the $30 trillion expected U.S. GDP in 2026, right in line with the 50-year smoothed-out railroad figure.

If today's datacenter buildout were also to last 50 years, running at an average rate of 2.1% of GDP, a cumulative $50 trillion would be invested in datacenters between 2026 and 2076. While Huang's, forecast of $3 trillion to $4 trillion to be invested in 2030 seems high, we would anticipate today's highly cash-flowing and capitalized tech behemoths to continue front-loading their investing.

Growth and share of the power base:

So, if the datacenter buildout runs at 2.1% of GDP, just as the 50-year rail buildout did, how much new electric power generation would we need? Datacenters are measured by how much power they are designed to consume. Currently an AI datacenter costs approximately $40 billion for each gigawatt (GW) of designed power usage. Let's assume that build cost remains flat thanks to efficiencies. Therefore, a $600 billion to $700 billion level of datacenter investment would translate to 17GW of power generation required to be added each year. Given that the current total U.S. power generation base is 1,312GW, such additions would equate to 1.3% annual growth just for datacenter usage. That may not seem like much, but it

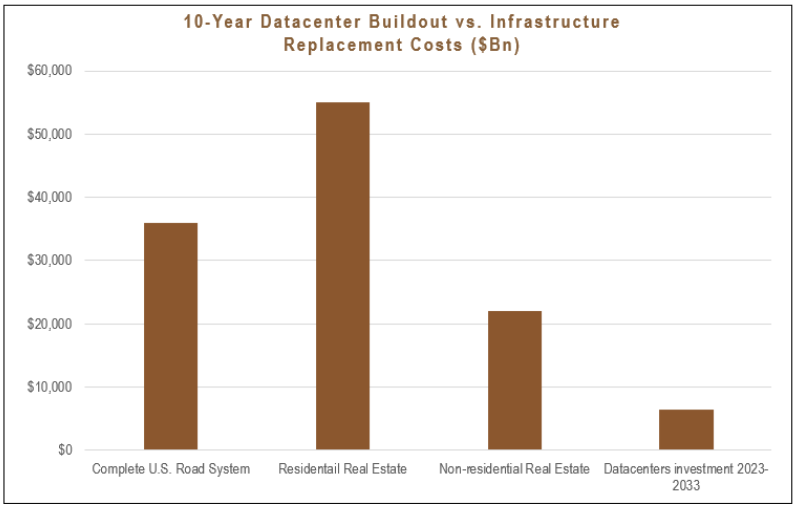
would essentially double the growth rate of the U.S. power generation base, which has been growing at a muted but steady 1% for the last decade. Despite the inflection, we believe it is achievable.



Source: Neuberger Berman, Bloomberg. Information as of 12/31/25.

Replacement values of large infrastructure bases:

If industrial-scale computing is to represent one of the most important industrial activities in the nation going forward, then we might contextualize it by considering the replacement cost of some of society's other large infrastructures. Consider that the replacement cost of the U.S. road network, using the current urban, suburban and rural construction costs per "lane-mile" would be $36 trillion (excluding all the vehicles). Relatedly, consider that the replacement cost for all residential structures in the country is approximately $55 trillion, using $200 national average construction cost/square foot. Add another $22 trillion for non-residential structures. Suddenly, the sums being contemplated for our compute backbone start to look less far-fetched.



Source: Neuberger Berman, Bloomberg. Information as of 12/31/25.

In the end, everything will depend on the ultimate monetization power of AI bots and their contribution to total economic growth. For now, LLM developers remain locked in a race to develop the most sophisticated and capable models. Ultimately, we believe there is scope for the most advanced and most productive bots to earn significant sums. Google and OpenAI are still early in charging consumers for unthrottled queries, and we expect advertisements to become a fast-growing component of AI monetization. Similarly, monetization in the enterprise domain remains early, with Perplexity and Anthropic exhibiting

substantial growth as well. We still see rapid advancement as models become increasingly specialized, and therefore increasingly productive.

CONCLUSION: Goodbye, penny. Goodbye, Buffet. Hello again, Barbarians.

As we bid farewell to the first quarter of the 21st century, there is something poetic that Warren Buffet, arguably the greatest investor of our time, is retiring alongside the humble penny. Markets are cyclical creatures, though. And in the back half of 2025, the market's animal spirits came alive again.

Even though crypto wasn't invited to the party this year, speculative corners of the market were reminiscent of 2021, and the AI complex grew ever larger while the M&A cycle kicked into high gear. While much of the M&A activity today is perhaps pent-up demand from the prior administration's relative hostility toward dealmaking, we cannot help but wonder if the pendulum may swing too far in some cases.

We recently re-read the 1988 Wall Street classic, "Barbarians at the Gate". It is a tale of the contest for RJR Nabisco, one of the largest companies of the 1980s and owner of RJR's prominent tobacco brands like Camel and Winston and Nabisco's leading household food brands like Oreo and Ritz. KKR, the victor in this particular contest, wound up regretful. Not only do we suspect the same will be true for a handful of the recently announced deals, but we can hear echoes today from this nearly 40-year-old story. There's the one-upmanship of ever-larger deals, the prolific use of leverage, now visible in areas of private credit, which has private equity players in a funk and even the ongoing travails of traditional food brands.

The last 25 years have taken investors from the end of the dot-com bubble through the Global Financial Crisis, a once-in-a-century pandemic, historic monetary experiments and the dawn of industrial-scale AI. Through all of this, the S&P 500 has compounded at over 8% annually, and America produced nine of the world's 11 trillion-dollar companies. The next 25 years will not look like the last, but we believe the same foundational forces will carry forward: America's capacity for reinvention, the drive for productivity, and humanity's innate desire to solve problems and improve living standards. As one chapter closes and another begins, our focus remains the same: building resilient portfolios that can participate in that long arc of progress while withstanding the inevitable storms along the way.

Thank you for your trust and partnership. Please reach out with any questions or if recent volatility has prompted you to reconsider your investment plan.

Sincerely,

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