NB PRIVATE WEALTH

BKS Select Investment Group

Resilient Markets Amid Policy Shifts and Technological Transformation

Equities: The Bull Market Continued Amid Episodic Volatility

The S&P 500 Index ("S&P 500") ended the fourth quarter and full year of 2025 close to all-time highs, with total returns of 2.7% and 17.9%, respectively. This was a remarkable outcome, particularly given the new tariffs and the fact that it followed returns of greater than 20% in each of the previous two years. The market continued to be driven by a narrow subset of large-cap technology stocks for most of the year, particularly those seen benefitting from artificial intelligence. During November and December, however, other sectors of the market, such as healthcare, financials and basic materials outperformed the large cap technology stocks. For the full year, broader measures of market returns lagged the S&P 500, with the S&P 500 Equal Weight Index advancing a more modest 11.4% for the year.

Notwithstanding the market's double-digit gains, there was significant volatility during the year, highlighted by the "tariff tantrum" earlier in 2025, which drove a decline in the S&P 500 of close to 20% from peak to trough. Additionally, uncertainty created by concerns about weak job growth, inflation, a government shutdown, restrictive monetary policy, and ongoing geopolitical tensions impacted the stock market at various points. However, economic growth and corporate earnings ultimately proved more resilient than many feared, and that fundamental strength drove the U.S. stock market to comfortably surpass the pre-tariff highs.

Monetary Policy: Gradual Easing, a New Fed Chair, and the Path Forward for Rates

During the fourth quarter, the Federal Reserve (the "Fed") cut rates for the third time in 2025, bringing the federal funds rate down to 3.75% from 4.50% at the start of the year. Longer-term interest rates also moved lower, with the 10-year U.S. Treasury yield ending the year down nearly a half-percent at 4.15%. This combination of lower short- and long-term rates eased financial conditions, supported equity valuations, and reduced borrowing costs for consumers and businesses.

Entering 2026, the Fed's own December projections point to only about one additional cut, but many economists anticipate at least two additional cuts during the year. The outcome for rates will depend on incoming data, particularly the trajectory of inflation and the unemployment rate, but the overall direction has shifted from tightening to gradual easing. This transition is occurring against a backdrop of heightened political attention to monetary policy, including the appointment of the next Fed Chairman, who is expected to take over from Jerome Powell in May. Investor perceptions about the Fed's independence from the Trump administration under Chairman Powell's successor could significantly affect long-term interest rates this year.

Tariffs and Trade: Policy Uncertainty, Supreme Court Review, and Global Supply Chains

The nearly 20% tariff-related decline between February and April underscored how sensitive markets can be to changes in tariff levels and trade relationships. While equities ultimately recovered, as earnings and economic data improved, periodic headlines around tariffs contributed to sharp, though short-lived, swings in risk assets.

Looking ahead, a long-anticipated ruling by the Supreme Court on the legality of most of the new tariffs is expected to be a key policy event. Although the timing and precise outcome remain uncertain, markets are likely to focus on whether the decision reduces or reinforces executive power with respect to trade measures. However, even if the Supreme Court rules that the President exceeded his authority, alternative mechanisms to enact tariffs exist, so elevated tariff levels are likely to persist.

Recent Economic News: Fiscal Stimulus, Tax Refunds, and the Impact of Tax Policy Changes

As we move into 2026, we see a market environment likely to be shaped in the near-term by a dynamic political environment and the path of interest rates. Historically, midterm election years can introduce periods of short-term volatility as investors react to changing expectations around control of Congress and the potential implications for regulation, spending, trade, and taxation. However, ultimately, markets have tended to be more sensitive to the underlying economic and earnings backdrop than to any single political outcome. That backdrop is quite encouraging at this time.

Last year's tax bill is expected to provide significant economic stimulus in 2026. Tax refund payments, driven by lower individual tax rates, along with reduced withholding are likely to support consumer spending and help offset some of the headwinds from still-elevated prices in certain categories. Corporations are also expected to benefit, since they will be able to deduct 100% of eligible capital and research and development expenditures, improving cash flows and encouraging additional investment. For businesses that have delayed investment plans over the past several years, the combination of somewhat lower interest rates and more favorable tax treatment could be a catalyst to move forward with productivity-enhancing projects.

Artificial Intelligence: Rising Capital Intensity and Opportunities Across Semiconductors and Other Enablers

AI remained one of the most powerful and disruptive investment themes in 2025 and continues to shape the opportunity set as we look into 2026. The current phase of AI adoption is heavily focused on building the infrastructure required to train and deploy increasingly sophisticated models.

Certain large cap technology companies which provide cloud-based services, have in recent years generated enormous cash flows enabling them to invest in their businesses, return capital to shareholders, and make selective acquisitions. Today, these hyperscalers' need to fund AI and related infrastructure is consuming a much larger share of that cash flow. Some of these companies are also borrowing aggressively to finance data center buildouts and broader growth initiatives. As these businesses become more capital intensive, and because the ultimate returns on these investments are yet to be determined, valuations have contracted from peak levels for these AI-related stocks. That multiple compression may create attractive entry points for long-term investors.

At the same time, this spending by cloud service providers has driven strong demand for semiconductors and related components needed for the build-out of these AI-capable data centers. While there is ongoing debate about which types of chips will capture the most value—ranging from general purpose to highly customized designs—the explosive demand has thus far benefited nearly all AI-related semiconductor providers. The expansion of large-scale data centers is also driving a significant increase in power requirements, creating, in our opinion, opportunities for utilities as well as a range of industrial and energy companies that supply equipment, infrastructure, and services critical to the AI buildout.

Importantly, AI spending remains robust even as competition intensifies and markets increasingly debate who will ultimately monetize the productivity gains. From a portfolio perspective, careful security selection will be critical, and we are focused on discerning which companies are best positioned in this dynamic competitive environment.

Looking Ahead: A Balanced Outlook, Driving Our Portfolio Positioning

Market valuation remains elevated and is slightly higher than it was at the beginning of 2025. Accordingly, investor expectations already embed a fair amount of good news and leave little room to withstand negative surprises. At the same time, solid economic growth is expected to continue, with productivity close to record levels, supporting a constructive outlook for corporate profits. Consensus forecasts call for S&P 500 earnings to grow approximately 15% in 2026. If realized, such earnings growth combined with stable or somewhat lower interest rates, could create a favorable backdrop for another year of market appreciation. That said, we also recognize that returns are unlikely to be linear; periods of volatility driven by election headlines, economic data, and shifting expectations around Fed policy are likely to persist.

Against this backdrop, our focus remains on owning high-quality businesses with durable competitive advantages, strong balance sheets, and the ability to compound earnings and cash flows over time across a range of economic and policy environments. We continue to selectively add to positions where transitory concerns have created attractive valuations and to trim or avoid areas where expectations appear overly optimistic relative to underlying fundamentals.

While there is always uncertainty regarding the path markets will take in the short-term, we are confident that a disciplined, long-term approach—grounded in fundamental research and thoughtful risk management—remains the most effective way to help you achieve your financial objectives.

We appreciate your continued confidence and partnership. Please reach out with any questions or to discuss how recent developments may affect your long-term objectives. We welcome the opportunity to review your portfolio and its alignment with your goals and risk tolerance.

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The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The "500" is one of the most widely used benchmarks of U.S. equity performance. As of September 16, 2005, S&P switched to a float-adjusted format, which weighs only those shares that are available to investors, not all of a company's outstanding shares. The value of the index now reflects the value available in the public markets.

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