



# Capital Markets Review & Outlook December 31, 2025

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**STRATEGIC ASSET ALLIANCE**  
THE INSURANCE INVESTMENT SPECIALIST



# **REVIEW** - Summary Capital Market Commentary – Q4/2025

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## ❖ **Economic & Market Summary**

Q4 headlines described an economy that kept expanding, helped by the strength of Q3 real GDP (+4.3% annualized). Forward-looking estimates suggested Q4 growth would slow but stay positive—GDPNow started Q4 at 3.0%, then moved down with new data. By late December, major equity coverage had the U.S. market ending 2025 near record highs, despite headline churn around policy, geopolitics, and shutdown-related data quirks.

## ❖ **Interest Rates & Policy**

Q4 Fed policy boiled down to: **easing is back, but cautiously**. The Fed’s December 10 cut put the target range at 3.50%–3.75%. Separately, the Fed also signaled a pivot on its balance sheet approach—ending Treasury runoff starting December 1—a reminder that “plumbing” issues (market liquidity) can matter even when inflation is improving. Inflation headlines improved into year-end: Bloomberg flagged core CPI easing to 2.6% y/y in the November report.

## ❖ **Trade & Geopolitics**

Trade policy stayed a recurring swing factor. The St. Louis Fed’s work argued tariffs contributed measurably to 2025 inflation, keeping “cost pressure” on the radar even as broader inflation cooled. Ukraine remained a central geopolitical risk: The Economist described U.S. peace planning as disruptive, with shifting proposals and Russian resistance (AI enhanced drone warfare is advancing apace...). Energy headlines in Q4 leaned more “surplus” than “shortage.” OPEC+ framed early-2026 policy around pausing hikes after a small December increase, signaling concern about oversupply (which remains a concern even after the Venezuela situation).



# **REVIEW** - Summary Capital Market Commentary – Q4/2025 *(Continued)*

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## ❖ **Market Performance (November Direction Only)**

- **Bonds ↑** – Broad bond benchmarks were on track for one of the best years since 2020, reflecting the shift toward easier policy.
- **Stocks ↑** – Major U.S. indices finished the year near record highs; several late-quarter records were tech-led.
- **Currencies (USD) ↓** – Bloomberg noted the dollar’s sharpest annual retreat since 2017.
- **Gold ↑** – Safe-haven demand and rate-cut expectations helped push gold to record highs late in Q4.
- **Oil ↓** – Oil’s “geopolitical premium” faded and oversupply concerns dominated.
- **Other Commodities Mixed/↑** – Precious metals were strong; energy was weak; the rest was uneven.

## ❖ **Key Takeaways for Boards & Staff**

Q4 was “slower growth, not no growth.” Q3’s strength carried into year-end expectations, even as forecasts cooled.

Rate cuts helped, but policy uncertainty didn’t disappear. The Fed is easing, yet also watching inflation, jobs, and market function.

Tariffs stayed a wildcard for both inflation and business confidence.

Geopolitics remained a volatility trigger, especially around Ukraine and energy (and now Venezuela).



# REVIEW - Capital Markets' Performance (Simplified)

Asset Class	Index	Q1	Q2	Q3	Q4	2025
Cash/Cash Equivalent	Citigroup 3-month T-bill	1.10%	1.09%	1.11%	1.02%	4.39%
U.S. Fixed Income	Bloomberg U.S. Aggregate	2.78%	1.21%	2.03%	1.10%	7.30%
U.S. Fixed Income	Bloomberg Intermediate U.S. Government/Credit	2.42%	1.67%	1.51%	1.20%	6.97%
U.S. Fixed Income	Bloomberg U.S. Corporate Investment Grade	2.31%	1.82%	2.60%	0.84%	7.78%
U.S. Fixed Income	Bloomberg Municipal Bond	-0.22%	-0.12%	3.00%	1.56%	4.25%
U.S. Fixed Income	Bloomberg U.S. Corporate High Yield	1.00%	3.53%	2.54%	1.31%	8.63%
U.S. Fixed Income	S&P/LSTA US Leveraged Loan Index	0.48%	2.32%	1.77%	1.22%	5.91%
U.S. Equity	S&P Composite 1500	-4.49%	10.57%	8.01%	2.58%	17.01%
U.S. Equity	S&P 500	-4.27%	10.94%	8.12%	2.66%	17.88%
U.S. Equity	S&P MidCap 400	-6.10%	6.71%	5.55%	1.64%	7.50%
U.S. Equity	S&P SmallCap 600	-8.93%	4.90%	9.11%	1.70%	6.01%
International Equity	MSCI EAFE	7.01%	12.07%	4.83%	4.91%	31.89%
International Equity	MSCI WORLD ex USA	6.35%	12.33%	5.41%	5.26%	32.55%

**2025 was a year where Q1 reminded everyone why bonds and diversification exist, and then Q2–Q4 rewarded staying invested—with international equities consistently doing more of the heavy lifting than many expected.**

**Q1-2025 (A cautious start, with “safety” winning):** The first quarter had a “watch your step” tone. The Fed held rates steady, which kept borrowing costs high and uncertainty elevated. At the same time, the economic data looked weaker on the surface: BEA reported real GDP contracted slightly in Q1, and Reuters pointed to businesses pulling imports forward ahead of tariffs, which distorted the numbers and didn’t help confidence. In markets, that backdrop generally favored U.S. fixed income (steady/positive) while U.S. equities struggled (especially smaller companies). International equities did better, benefiting from a “not everything has to be U.S.-centric” quarter.

**Q2-2025 (Growth reasserted itself—even as geopolitics flared):** In Q2 the story improved materially: BEA showed real GDP rebounded strongly in Q2 with firmer business investment and consumer spending in the quarter’s GDP revisions—basically, the economy looked more durable than many expected. The Fed kept rates unchanged in June, but markets acted like the soft-landing path was back on the table. Geopolitics did its best to interrupt the mood—Reuters reported a sharp escalation between Israel and Iran in mid-June—but risk appetite held up anyway. In performance terms, U.S. equities bounced hard, U.S. fixed income was positive but less exciting, and international equities were again strong—helped by periodic bursts of trade optimism and global risk-on sentiment.

**Q3-2025 (Strong U.S. growth, broader market participation):** Q3 looked like the “momentum quarter.” BEA reported real GDP grew at a strong annual rate in Q3, driven by consumer spending, exports, and government spending (partly offset by weaker investment). With growth running hot, markets generally rewarded risk: U.S. equities extended gains and participation broadened beyond just the biggest names, while U.S. fixed income still delivered a positive quarter (helped by carry/income and a market that wasn’t panicking about inflation). Meanwhile, international equities rose too, though the pace cooled compared with the first half. Geopolitics remained a focal point as Ukraine negotiations continued, with Russia maintaining its territorial demands—ensuring that “headline risk” persisted even when market attention shifted to growth concerns.

**Q4-2025 (A softer finish, led by non-U.S. stocks and steadier bonds):** Q4 shifted from “how strong is growth?” to “how quickly does it cool—and what does the Fed do next?” The Fed moved into rate-cut mode, capped by the December 10 cut that lowered the target range to 3.50%–3.75%, and coverage emphasized the decision was unusually divided. The Atlanta Fed’s GDPNow started Q4 around 3.0% growth and later marked it down to 2.7%, which fits the quarter’s message: still growing, but less punchy. Trade policy noise persisted—with many importers continuing to pull shipments forward during a tariff “truce,” another reminder that tariffs can mess with planning and data. Ukraine remained a live issue with late-December peace framework discussions and the question of credible security guarantees. In markets, U.S. fixed income produced another modestly positive quarter (even though December itself was bumpier for longer Treasuries), U.S. equities ended up positive but noticeably slower than mid-year, and international equities led again—closing the year with a clear “diversification mattered” stamp.



# Outlook Summary

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- ❖ ***Big picture: Q4 ended with the U.S. economy still expanding but cooling from a very strong Q3. Inflation kept easing overall, yet the “sticky” parts (housing- and service-heavy categories) stayed stubborn. Markets generally behaved like stability would continue—while the risk list (policy, geopolitics, and a few true wildcards) stayed very real.***
- ❖ **Economic Backdrop:**

Q3 came in hot (~4.3% real GDP, annualized), but Q4 looked more like “steady, not surging,” with GDPNow drifting down to about ~2.7% as more data arrived. The underlying story in the component slides is that late-2025 growth had real supports (consumer spending and AI/infrastructure investment), but also real drags (tariffs, shutdown disruption, and softer immigration flows). Contrarian angle: shutdown timing and tariff-related trade timing can warp one quarter’s GDP—making the slowdown look either worse or better than the true trend.
- ❖ **Inflation Backdrop:**

The inflation story was less about energy shocks and more about shelter and services—areas that don’t cool quickly. The notes also flag that late-2025 inflation data had extra “noise” because of shutdown-related survey disruptions. Contrarian angle: inflation could fall faster if housing continues to soften and pricing power fades—but it could also stay higher if services costs (including insurance-related categories) don’t cooperate
- ❖ **Labor Dynamics:**

The job market looked like it was cooling in an orderly way: hiring slowed to small monthly gains, unemployment drifted into the mid-4% range, and wage growth cooled to just under 4%. The notes argue tighter immigration could cap the rise in unemployment by limiting labor supply. Contrarian angle: the same dynamic can also create pockets of labor shortage—supporting wages and making inflation harder to fully put away.

# Outlook Summary *(Continued)*

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❖ **Market Landscape:**

The “market mood” in Q4 was broadly consistent with a soft-landing narrative: investors appeared comfortable owning risk, but not blind to it. The component materials also highlight a key nuance for boards: some of the economy’s support looked top-heavy (upper-income spending + big investment themes like AI). Contrarian angle: if that narrow support weakens (equity markets wobble, hiring cools further, or business spending pauses), market confidence can shift quickly—even without a formal recession.

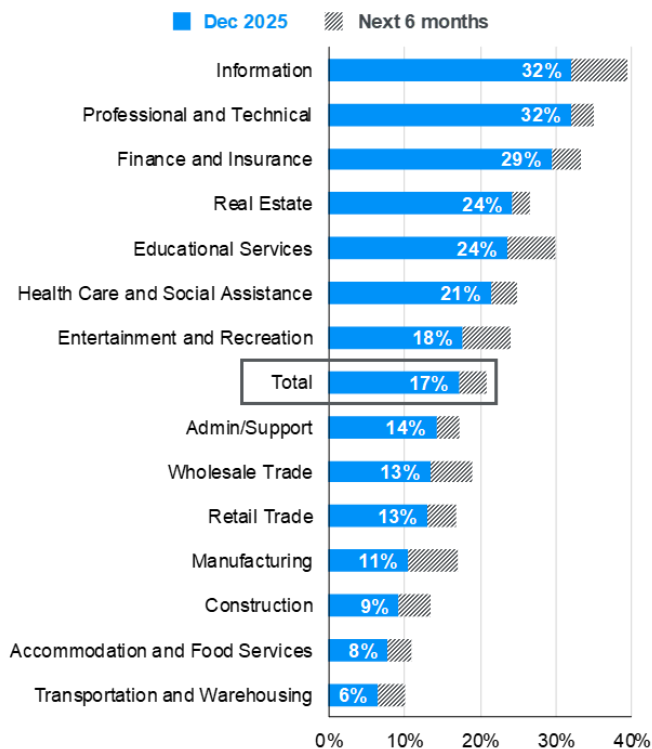
❖ **Black Swan Watch List:**

- **Geopolitical rupture:** escalation in a major region (Taiwan Strait, Middle East, or a new turn in Ukraine) that disrupts trade, energy, or supply chains.
  - The early-January 2026 Venezuela event matters less for Venezuela’s direct oil supply and more for what it may signal: regional flare-ups becoming bargaining chips in great-power competition (U.S. vs. China/Russia/Iran). The fast market transmission channel may not be “Venezuela barrels,” but sanctions/enforcement shocks, shipping/insurance stress, and spillover to bigger energy chokepoints (especially the Strait of Hormuz). A second-order risk is refinery fit: disruptions to heavy/medium crude flows can pressure product prices even without a global oil shortage. Net: the black-swan risk is a broader escalation or policy retaliation loop, not a standalone Venezuela story.
- **Cyber or AI shock:** a major outage, attack, or misuse event that hits financial markets or critical infrastructure.
- **Financial plumbing stress:** a liquidity event in money markets/ETFs that forces “safe” assets to reprice fast.
- **Policy shock:** tariffs/fiscal decisions or abrupt immigration changes that hit costs, confidence, or labor supply faster than forecasts assume
- **Climate or natural disaster:** Extreme weather or grid failure causing broad economic or insurance losses, especially in energy transition hubs.
- While Black Swan events are individually unlikely, such events could instantly reverse current confidence in disinflation, liquidity, and growth stability.

# OUTLOOK – Artificial Intelligence: Implementation

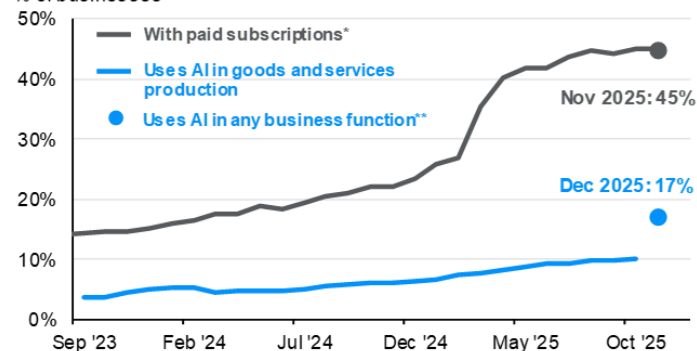
## Businesses using AI in any business function

% of all firms reporting use of AI applications



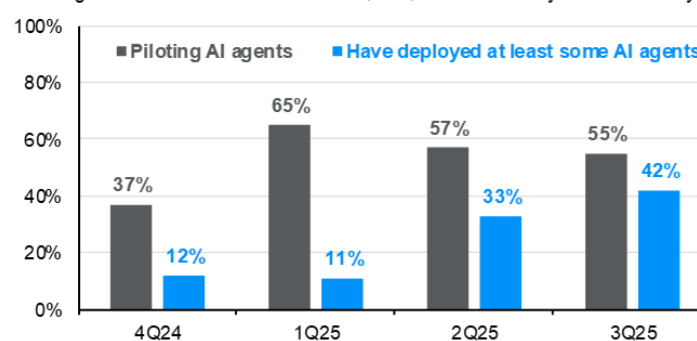
## Companies spending on AI models, platforms and tools

% of businesses



## AI agent deployment

% of organizations with revenues above \$1bn, KPMG Quarterly AI Pulse survey



### Key Takeaways:

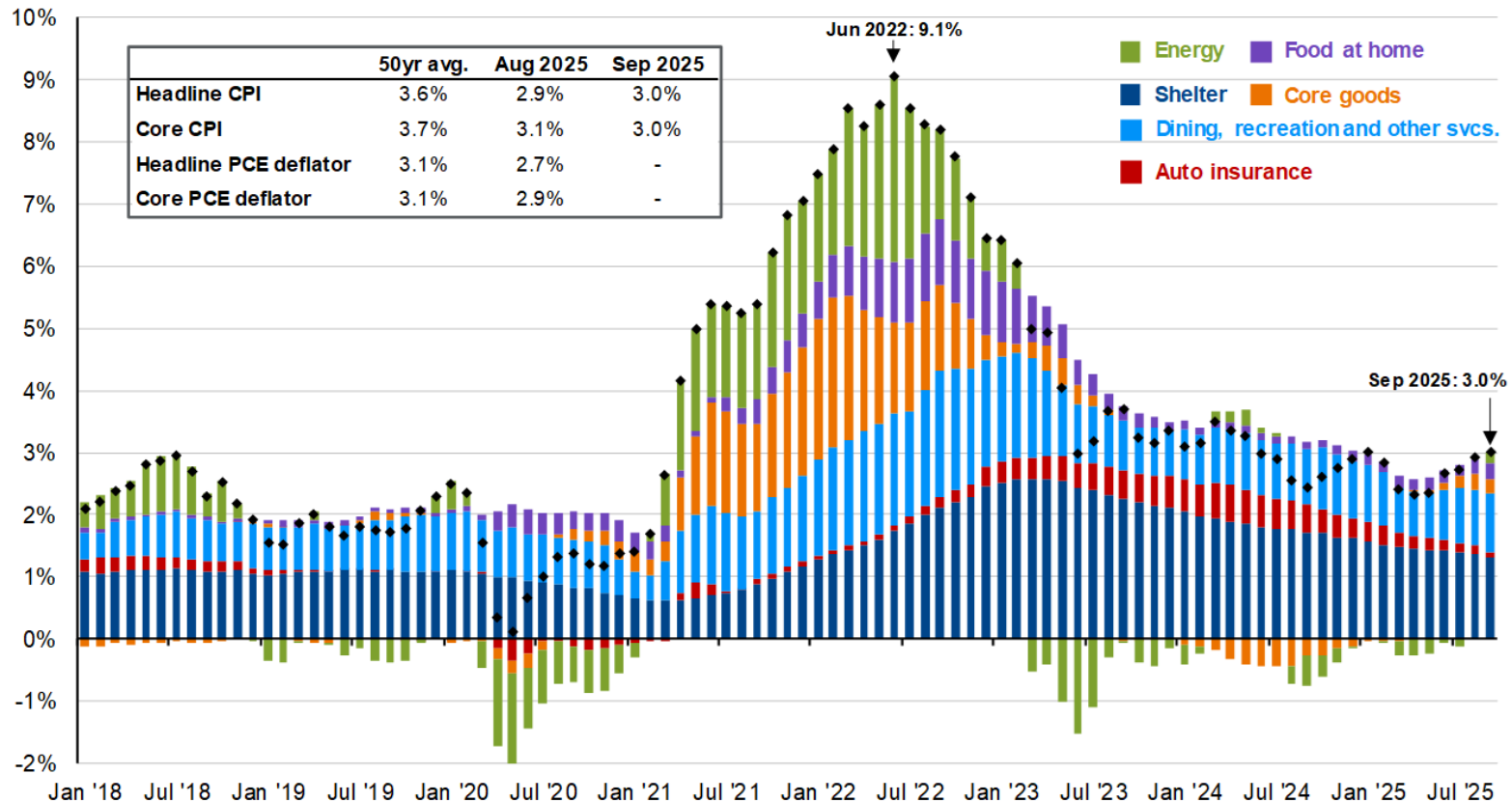
- ❖ **AI use is spreading—but it's still uneven across the economy.** The chart shows the heaviest reported usage in Information and Professional/Technical services (both roughly in the low-30% range), with Finance & Insurance not far behind, while sectors like Transportation/Warehousing and Food Services remain low. Translation: AI is moving fastest where the work is mostly digital.
- ❖ **The “big jump” in adoption is partly a measurement change, not a sudden surge of robots.** The Census survey wording changed in Dec. 2025 to “AI in any business function,” which mechanically lifted the reported total adoption rate (to about 17%). Contrarian angle: it’s easy to over-read this as a productivity breakthrough when some of it is simply a broader definition.
- ❖ **Paid AI spending and self-reported AI use are telling two different stories.** The graphic shows a much higher share of firms paying for AI tools (the Ramp-based measure) than the Census “using AI” share—meaning many businesses may be experimenting, buying a few seats, or using AI in limited pockets, without it being embedded in core production yet. Contrarian angle: if adoption is still shallow, the near-term productivity payoff may be smaller than the hype implies.
- ❖ **Large companies are moving from pilots to deployment—but “deployed” isn’t the same as “productive.”** The KPMG survey in the slide shows a rising share of \$1B+ revenue firms reporting at least some AI agent deployments by 3Q25 (while many still report piloting). Contrarian angle: real productivity gains usually come after workflow redesign, training, controls, and data cleanup—so the economic impact can lag the headlines by quarters (or years).

Source: J.P. Morgan Asset Management; (Left) Census Business Trends and Outlook Survey; (Top right) RAMP AI Index; (Bottom right) KPMG Quarterly AI Pulse Survey. \*Ramp data is based on anonymized corporate card and bill-pay transactions with AI vendors across over 50,000 U.S. businesses on Ramp’s spend platform to provide a spend-based measure of AI adoption that complements the self-reported AI use (which includes free and internal tools) in the Census survey series. The two measures differ in firm coverage and methodology, with Ramp data skewed towards digitally enabled firms. \*\*Starting Dec. 2025, the Census changed the wording of their survey question to capture usage of AI in “any business function”, broader language compared to their prior “in producing goods and services” question. Total adoption jumped from 10% to 17% of businesses because of this switch. AI agents refer to AI systems designed to autonomously execute specific tasks or workflows with minimal human intervention.  
Guide to the Markets – U.S. Data as of December 31, 2025.

# OUTLOOK – Inflation Components

## Contributors to headline CPI inflation

Contribution to year-over-year % change in CPI, non-seasonally adjusted



### Key Takeaways:

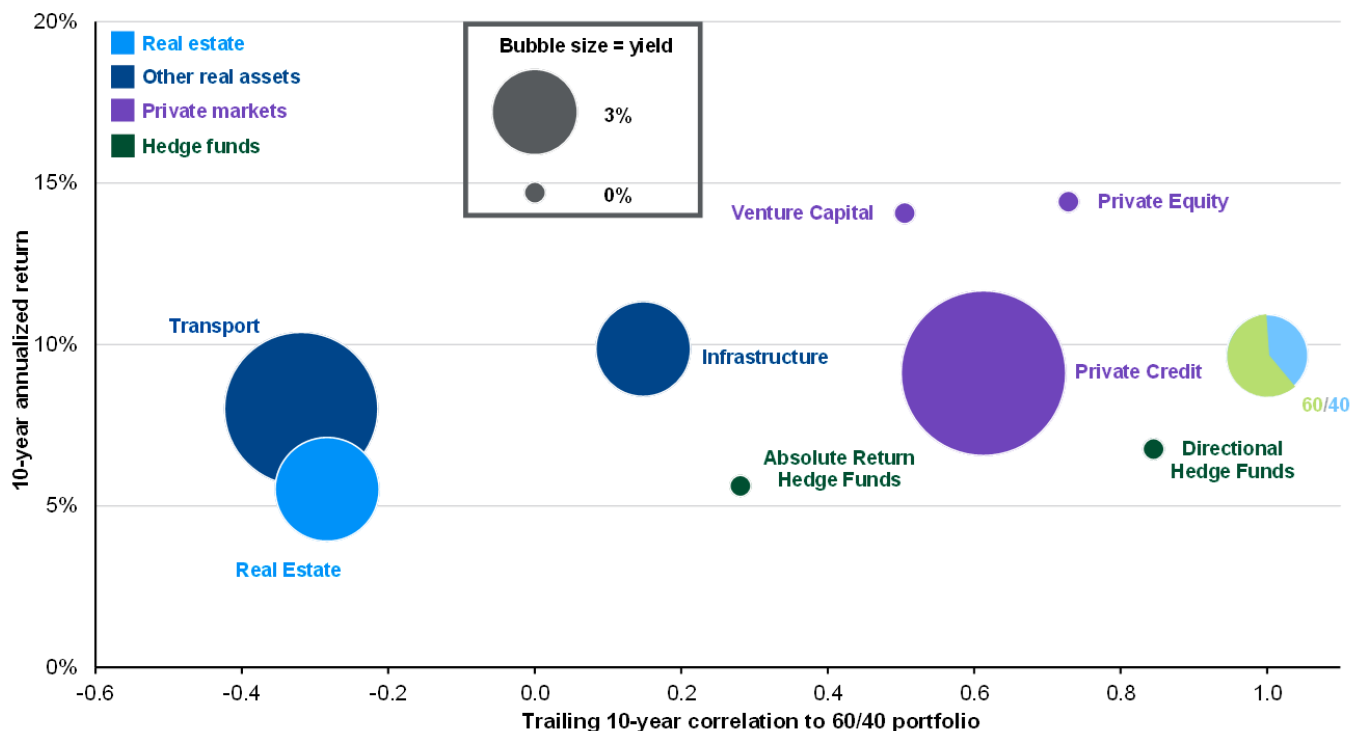
- ❖ **Inflation is no longer an “energy spike” story — it’s mostly a “shelter + services” story.** The chart shows the 2022 peak fading as energy and goods pressures cooled, while shelter and services became the steady drivers of inflation more recently. That matters because shelter/services usually cool slowly, not overnight.
- ❖ **Late-2025 CPI was harder to trust than usual.** The notes flag that the government shutdown disrupted the CPI process (October survey canceled; November collection delayed), which makes it easier for one month’s print to mislead people about the true trend. In plain terms: don’t overreact to one report when the data collection itself was messy.

Source: BLS, FactSet, J.P. Morgan Asset Management.  
Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. “Shelter” includes owners’ equivalent rent, rent of primary residence and home insurance. “Food at home” includes alcoholic beverages.  
Guide to the Markets – U.S. Data are as of October 31, 2025.

# LONGER-TERM OUTLOOK – Alternatives: Correlations, Returns and yields

## Correlations, returns and yields

10-year correlations and 10-year annualized total returns, 3Q15 - 2Q25



### Key Take Aways:

- ❖ **Alternatives can help—but for different reasons.** The chart is basically a “pick your trade-off” map: some areas lean toward diversification (lower correlation to a traditional stock/bond mix), others lean toward higher long-run return potential, and some lean toward income (bigger yield “bubbles”). The notes make the practical point: after several strong years for U.S. stocks and a bumpier bond hedge, many investors are looking for additional return/income tools beyond a plain 60/40 mix.
- ❖ **Private equity / venture capital may boost return potential, but they don’t look like “shock absorbers.”** On the chart, these sit in the higher-return zone, but with high correlation to the traditional portfolio—meaning they may behave more like “equity risk in a different wrapper” than a true diversifier when markets get stressed. Contrarian angle: that correlation can rise at the worst time, and reported returns can look smoother than reality because valuations update less frequently.
- ❖ **Private credit shows up as “income-first,” not “free diversification.”** The bubble size highlights that private credit is about yield/income, not magic. It may help meet income needs without relying entirely on public bonds, but it’s still tied to the economic cycle. Contrarian angle: when growth weakens, credit risk shows up quickly—so the key isn’t just “private credit,” it’s manager quality, underwriting discipline, and structure.
- ❖ **Real assets can diversify—but the headline numbers come with footnotes.** The chart suggests areas like transportation/real assets/real estate can offer lower correlation, which is why they’re often pitched as diversifiers. The notes also stress many of these are illiquid and should be treated as long-term positions. Contrarian angle: some “diversification” can disappear if leverage is involved or if capital markets freeze—so the board-level question is: “What happens in a bad year, and can we live with the lockups?”

Source: Source: Burgiss, Cliffwater, FactSet, MSCI, PivotalPath, J.P. Morgan Asset Management.

All categories are global, except for private credit, which is U.S. Correlations are based on quarterly returns over the time period indicated. A 60/40 portfolio is comprised of 60% stocks and 40% bonds. Stocks are represented by the S&P 500 Total Return Index. Bonds are represented by the Bloomberg U.S. Aggregate Total Return Index. 10-year annualized returns are calculated based on the time period indicated. “Absolute Return Hedge Funds” represent asset-weighted returns from the PivotalPath Global Macro and Relative Value indices. “Directional Hedge Funds” represent asset-weighted returns from the PivotalPath Credit, Equity Diversified and Event Driven indices. Private credit represents direct lending returns and yields from the Cliffwater Direct Lending Index. All other indices and data used for alternative asset class returns and yields are as described on pages 12 and 16 of the Guide to Alternatives based on latest data available. Transportation returns are shown on an unlevered basis and returns can be enhanced by adding leverage. Past performance is no guarantee of future results. This slide comes from our Guide to Alternatives. Guide to the Markets – U.S. Data are as of December 31, 2025.

# Portfolio Food for Thought – 2026

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- ❖ ***Big picture: Even if underwriting and reserving trends stay “as expected,” there are a few portfolio-side reasons that could justify the consideration of an allocation change coming out of December/Q4 2025. None of these require a dramatic market call; they’re mostly about income, resilience, and optionality.***
- ❖ **Your reinvestment window is still unusually good:**  
Even after some easing, reinvestment yields at year-end were still materially higher than the prior cycle. This is the “don’t waste the reset” argument.
- ❖ **Credit spreads looked tight — meaning you’re not being paid much for extra default risk:**  
Year-end spreads were below long-term averages. That’s a hidden signal: the upside from taking additional credit risk is smaller, while the downside if growth disappoints is larger.
- ❖ **Duration is back to being a feature, not a bug — but Q4 reminded you where it hurts:**  
Q4 showed a curve that steepened: short rates fell more than long rates. That means cash will likely become less rewarding faster than the rest of the curve. If your portfolio is heavy in cash/very short bonds due to 2022–2024 trauma, the hidden cost is income erosion as front-end yields roll down.
- ❖ **International equity leadership + high U.S. valuations = concentration risk, not just performance trivia:**  
International equities led in Q4 and much of 2025’s run. Meanwhile, many dashboards highlighted relatively rich U.S. equity valuations. For insurers/risk pools, the compelling takeaway isn’t “chase international,” it’s: if you’re over-concentrated in U.S. large growth, you’ve got a single-theme equity book.
- ❖ **The geopolitics update argues for resilience, not prediction:**  
The Venezuela situation is basically a reminder that shocks often hit through policy and plumbing (sanctions, shipping insurance, energy chokepoints), not just headline war risk. For a board, the actionable implication is usually: keep enough liquidity + high-quality collateral and avoid overbuilding exposures that need perfect markets to exit.
- ❖ **“Alts” are tempting — but Q4’s setup argues for selectivity (and possibly less, not more):**  
If alternatives are being considered because bonds “failed” in 2022, Q4/2025 is the counterpoint: bonds are paying you again. Meanwhile, some alts are effectively equity risk with slower-marking valuations. If your operational needs are steady, a compelling move may actually be to simplify.