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INSIGHTS

2026 OUTLOOK: KEY THEME FOR INVESTORS

The past year has been positive for financial markets, even if it hasn't always felt that way for individual investors. What perspective is needed to properly position investment portfolios for the year ahead?

For the sixth time in the last seven years, the stock market is on track to deliver double-digit returns. This remarkable streak has left many investors in a positive financial position. In 2025, there were turning points across many of the issues investors have faced over the past few years. Inflation has stabilized around 3%. Tariffs, while high by historical standards and the main driver of stock market swings in 2025, have not resulted in the economic disruption many feared. The Federal Reserve has continued cutting rates, and the economy has grown at a healthy pace.

Perhaps the most important lesson to take into the new year is that what investors fear the most often doesn't come to pass. The challenge isn't predicting which events will matter but maintaining perspective and discipline across all market conditions.

As we look ahead to 2026, the investment landscape presents both opportunities and challenges. Topics likely to be in the headlines include the upcoming midterm election, a changing of the guard at the Federal Reserve, the future of AI, growing concerns around loans, the path of the U.S. dollar, and more. Here are six key themes that can help guide how investors think about the year ahead.

1. Many Asset Classes Are Supporting Portfolios Into 2026

Many asset classes are contributing to portfolio returns as we approach year end. In 2025, international stocks have outpaced U.S. markets, driven by improving growth expectations in many economies and the weakening dollar, which boosts returns for U.S.-based investors. Fixed income has also played an important stabilizing role in portfolios. The Bloomberg U.S. Aggregate Bond Index has gained 7% for the year as the Federal Reserve continues cutting interest rates and inflation stabilizes. Higher-quality bonds have been serving their purpose by providing income and offsetting stock market volatility during periods of market uncertainty.

Asset Class Performance

Total returns by year

2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Small Cap 21.3%	EM 37.8%	Fixed Inc 0.0%	S&P 500 31.5%	Small Cap 20.0%	S&P 500 28.7%	Fixed Inc -13.0%	S&P 500 26.3%	S&P 500 25.0%	EM 32.1%
S&P 500 12.0%	EAFE 25.6%	S&P 500 -4.4%	Small Cap 25.5%	EM 18.7%	Small Cap 14.8%	EAFE -14.0%	EAFE 18.9%	Balanced 12.1%	EAFE 28.8%
EM 11.6%	S&P 500 21.8%	Balanced -4.9%	EAFE 22.7%	S&P 500 18.4%	Balanced 14.1%	Balanced -14.4%	Small Cap 16.9%	Small Cap 11.5%	S&P 500 18.5%
Balanced 8.1%	Balanced 15.2%	Small Cap -11.0%	Balanced 20.5%	Balanced 12.6%	EAFE 11.8%	S&P 500 -18.1%	Balanced 15.3%	EM 8.1%	Small Cap 16.2%
Fixed Inc 2.6%	Small Cap 14.6%	EAFE -13.4%	EM 18.9%	EAFE 8.3%	Fixed Inc -1.5%	EM -19.7%	EM 10.3%	EAFE 4.3%	Balanced 15.9%
EAFE 1.5%	Fixed Inc 3.5%	EM -14.2%	Fixed Inc 8.7%	Fixed Inc 7.5%	EM -2.2%	Small Cap -20.4%	Fixed Inc 5.5%	Fixed Inc 1.3%	Fixed Inc 7.0%

Sources: Clearnomics, LSEG. Latest data point is December 10, 2025.

In the coming year, this underscores the importance of balance and diversification. While it may be tempting to make sudden portfolio changes based on headlines, investors who stay on track with their financial plans are likely to be rewarded.

2. Market Valuations Are Approaching Dot-Com Levels

The S&P 500 currently trades at a price-to-earnings ratio of 22.5x, approaching the all-time high of 24.5x reached during the dot-com bubble. By definition, this means that investors are paying more for each dollar of future earnings than in recent years.

Investors typically worry about valuations when they become disconnected from underlying fundamentals. For example, the dot-com bubble experienced historic valuation levels that far outpaced revenues and earnings, as investors rewarded any company related to the "new economy." While valuations are expensive today due to enthusiasm around AI and ongoing growth, corporate fundamentals remain strong. Earnings have grown at a healthy pace, with the expectation they could continue to do so according to consensus estimates.

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It's important to recognize that high valuations don't necessarily predict immediate market declines since markets can remain expensive for extended periods. While some worry about an "AI bubble," the reality is that not all bubbles pop. Instead, some deflate slowly as the fundamentals catch up. However, high valuations suggest that returns could be more modest going forward, since markets are already accounting for future growth. This can also increase the market's sensitivity to disappointments. This means that being selective and maintaining balance across asset classes, sectors, sizes, styles, and more - will only grow in importance.

3. AI Is Driving Economic Growth and Returns

Perhaps no single trend has captured investor attention more than AI. Capital expenditures on AI infrastructure reached extraordinary levels in 2025, with the total investment easily reaching trillions of dollars. This includes building new data centers, purchasing equipment such as GPUs, and hiring AI researchers. The question is whether the technology will ultimately generate enough value to justify the enormous spending. As it stands, AI investment is currently a large contributor to the overall economy.

For investors, AI presents both upside potential and downside risk. The Magnificent 7 technology companies continue to lead markets higher, driven by infrastructure investments and growing adoption of AI tools. However, this concentration creates vulnerability. These companies now represent one-third of the S&P 500, meaning most investors have substantial exposure, whether they realize it or not.

The challenge isn't whether AI will transform the economy - it clearly will. Rather, it's whether current valuations reflect realistic timelines for returns on these massive investments, given that markets often overestimate the speed at which profits can be generated. The reality is that most investors likely have exposure to AI stocks whether directly or through major indices, so being aware of this concentration, and staying true to an appropriate asset allocation that fits with long-term goals, will be needed in the coming year.

4. Economic Growth Is Slowing but Remains Positive

Economic growth trends have decelerated but remain stronger than many feared. Important to note, however, is that economic growth has been uneven across different income groups and sectors. This concept is often referred to as a "two-speed" or "K-shaped" economy, since some experience growth while others struggle. Today, this divergence is primarily driven by technology trends, since those positioned to benefit from the growth of AI could experience greater job prospects than those in traditional industries. However, it's not just about AI, since consumer debt, auto loan delinquencies, and other financial challenges can affect whether individuals benefit from economic growth.

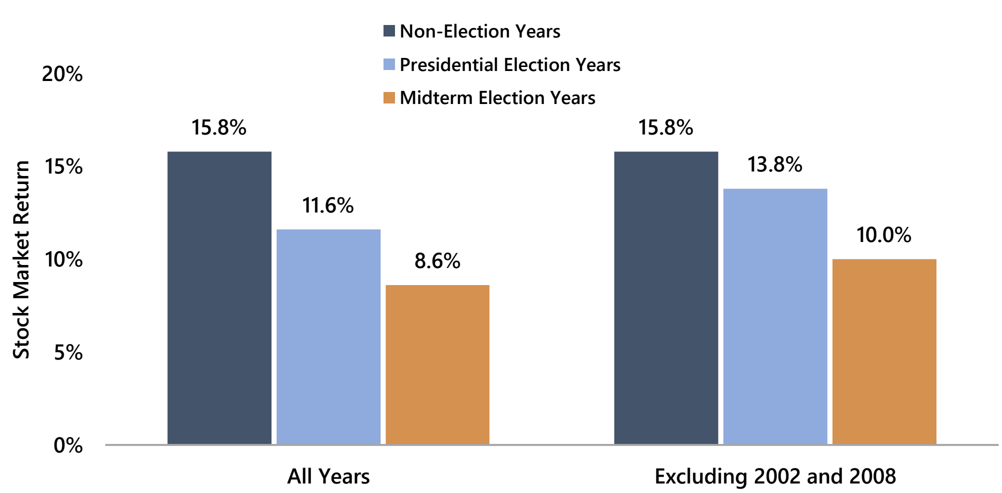
When it comes to long-term economic growth, perhaps the most important question is whether productivity will rise due to recent technological advances. Productivity measures how much, either in terms of quality or quantity, a worker can produce in a given amount of time. Historically, better equipment, training, and education have driven greater productivity, which drives real economic growth. For investors, the promise of greater productivity is that profit margins can improve, supporting the broader economy and investor portfolios.

5. Midterm Election and Government Debt Will Be at the Forefront in 2026

The new year will begin with renewed uncertainty as the U.S. Government's short-term funding bill expires at the end of January. This means there could be another wave of negotiations that could result in another government shutdown. Looking further ahead, investors will focus their attention on the midterm election and what it could mean for tariffs, regulation, government spending, and more. The chart below shows that midterm elections have historically experienced healthy returns, averaging 8.6% since 1933, even if they are slightly lower than non-election and presidential election years.

Stock Markets in Election Years

S&P 500 total return in election and non-election years since 1933



Sources: Clearnomics, Standard & Poor's. Latest data point is December 2024.

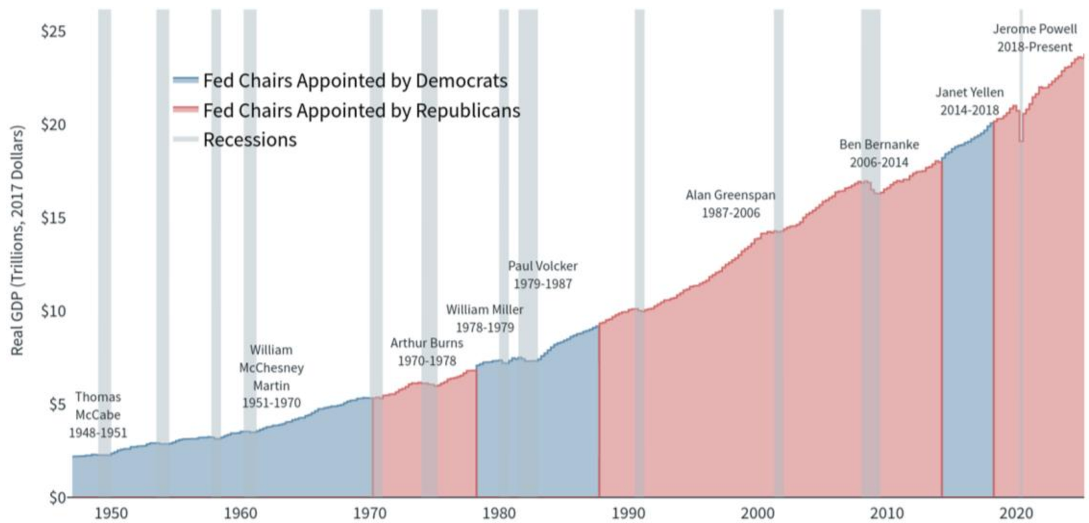
Still, the biggest concern for many is the ever-growing national debt, which is now around 120% of GDP for total debt, or over $36 trillion. In fact, it's estimated that the OBBBA could increase the national debt by over $4 trillion in the next decade. For investors, it's important to recognize what can and cannot be controlled while planning accordingly. What investors can control in the short run is understanding key changes to tax legislation and how it impacts long-term planning. These include the fact that lower tax rates from the Tax Cuts and Jobs Act are now permanent, estate tax exemption levels will remain higher, SALT deduction caps have risen, and many other provisions.

6. The Federal Reserve Will Support the Economy

As we enter 2026, the path of monetary policy could become less certain. This is because the risk of runaway inflation may no longer be the primary concern as a weaker job market has grown in importance. This requires smaller tweaks to policy rates rather than dramatic shifts, such as those seen in 2022. An additional complication is that Fed Chair Jerome Powell's term will end next May, paving the way for new leadership at the Fed. The White House is expected to appoint a successor who may favor additional rate cuts to support the administration's economic agenda of lower interest rates.

The Economy and Fed Chairs

Real GDP and Fed chairs with the nominating president's party highlighted



Sources: Clearnomics, Bureau of Economic Analysis, NBER. Latest data point is June 30, 2025.

The chart above shows that the economy has performed well across Fed Chairs appointed by both parties. It's important to note that the Fed only controls the "short end" of the yield curve, that is, interest rates that are closely tied to the federal funds rate. Long-term interest rates depend on many factors, such as economic growth, inflation, and productivity. So, rather than follow the Fed's every move and parse every statement, investors should continue to focus on these longer-term trends to understand the impact on interest rates and bonds.

Maintaining Perspective in 2026

As we enter 2026, investors face a familiar challenge: balancing concerns with the reality that markets have consistently rewarded patient, disciplined investors over time. The list of worries is ever-present, yet history suggests that for every crisis that disrupts markets, many more feared events have failed to materialize. What separates successful long-term investors isn't the ability to predict which concerns matter most, but the ability to stay balanced throughout all phases of the market cycle.

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