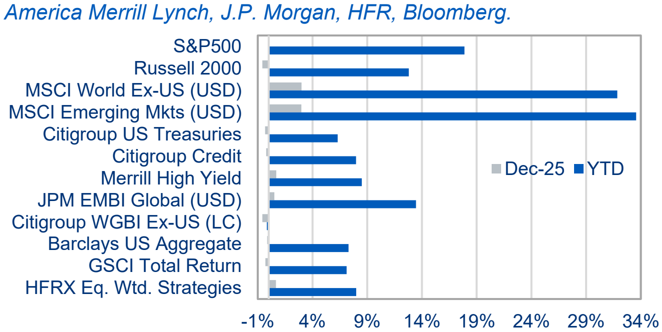
Global Market Review

Global equity markets rose in December to cap another year of double-digit gains, the third in succession. The supposedly limitless potential of AI remained the focus of speculation and a main market driver. In addition, strong corporate earnings, resilient economic performance, easing monetary policy, and the prospect of considerable fiscal stimulus ahead also contributed to the U.S. equity market's solid performance, despite the uncertainty created by sharp swings in trade policy. U.S. Treasury prices fell in December, as longer term yields rose. Nevertheless, yields across the maturity spectrum remained below their levels at the start of the year. Investment grade credit markets also declined in December, but high yield bonds posted further gains. Credit spreads across all ratings remain quite tight. The U.S. dollar fell in December against major currencies, bringing its annual decline to nearly 10%. Gold prices, in contrast, soared, rising 2% in December and 64% for the year. Plagued by oversupply, oil prices fell in December and closed the year down 19.9%.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



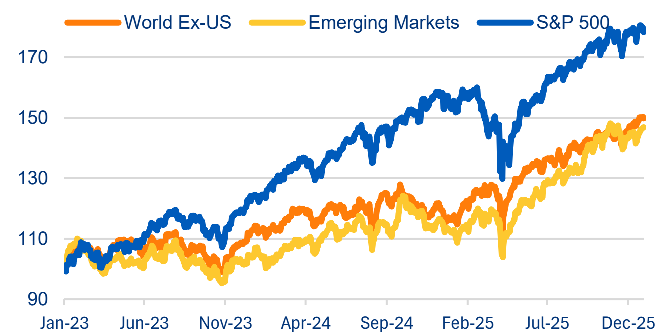
Global stocks record third year of double-digit returns.

U.S. Equities Extend Double-Digit Streak

The S&P 500 was little changed in December. For the year as a whole, however, U.S. equities rose 17.9%, notwithstanding high levels of uncertainty surrounding the scope and impact of tariffs and other major policy shifts. Over the past three years, the S&P 500 has generated an average annual return of 23%. Other advanced and emerging equity markets have also experienced stellar returns over this period (Exhibit 1).

Exhibit 1. Global Equities Streak of Double-Digit Returns

Source: Bloomberg. Index January 1, 2023 = 100.



Intense speculation surrounding the transformative impact of AI on productivity and the surging earnings growth of AI firms were the dominant market drivers. U.S. equities also benefited from the resilience of the U.S. economy, which was itself buoyed by massive AI-related capital expenditures that accounted for the bulk of U.S. economic growth last year. The Fed's continued easing of monetary policy provided further support to the market and the economy as did significant fiscal stimulus and the prospect of further stimulus to come in 2026.

Challenges to the Powerful Positive Market Momentum

The market has so far benefited from powerful positive momentum driven largely by the pervasive AI narrative and the prospect of further monetary and fiscal support. Momentum has remained positive despite a number of mounting risks. After three years of double-digit gains, U.S. equity valuations are near record levels. The S&P 500 cyclically adjusted P/E ratio is just below the all-time high reached prior to the bursting of the 2001 tech bubble. Market concentration is at all-time highs, increasing the risk that any disappointment of the lofty expectations for AI could have far-reaching repercussions.

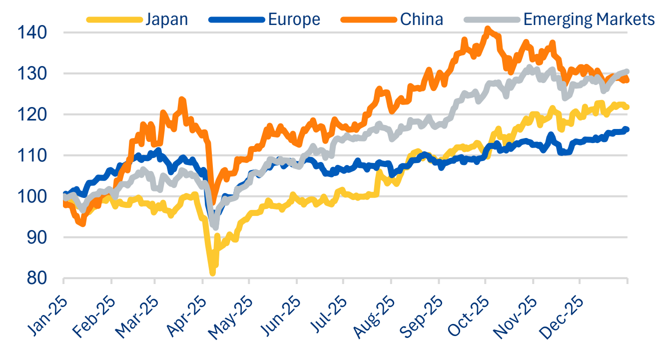
Macro policies pose a further risk to the market. The Fed appears committed to reducing rates further despite an economy operating near full employment and the easy financial conditions created by buoyant equity and credit markets. Moreover, concerns over the independence of the Fed could be rekindled if Fed Chair Powell is replaced by an overly malleable successor. Fiscal policy is a further worry. Federal debt dynamics are on an unsustainable path. The current fiscal deficit of 6% of GDP is way too high given the strength of the economy and is set to increase, accelerating the pace of debt accumulation. An overly stimulated economy and the lagged price impact of tariffs could trigger an unexpected spurt of inflation at a time when the Fed's credibility is in doubt.

Non-U.S. Equities Outperform U.S.

The MSCI World ex-US index of advanced non-U.S. equities rose 3% in December to bring its gain for the year to 31.8% (Exhibit 1). Japanese stocks closed the year at a record high buoyed by technology stocks as Japanese markets shared in the AI boom. European equities rose 3.9% in December and 35.4% in 2025 (Exhibit 2). Expectations for continued monetary and fiscal stimulus as well relatively attractive valuations and solid earnings growth contributed to the market's gains.

Exhibit 2. Non-U.S. Equity Markets Post Strong Gains

Source: Bloomberg. Index January 2025 = 100.



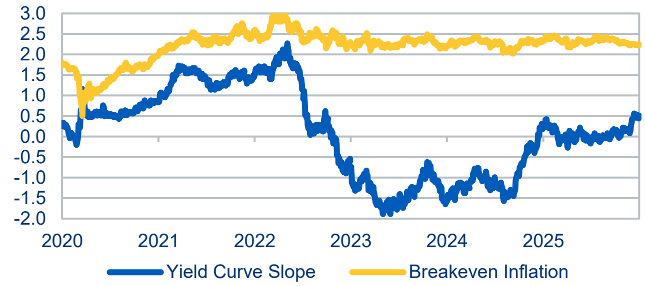
Emerging equity markets rose 3% in December, bringing their gain for the year to 33.6% (Exhibit 1). Korean equities surged 92% higher in 2025 on the back of huge AI-related gains. Despite declining 1.2% in December, Chinese equities closed the year up 31.2% (Exhibit 2). Shrugging off the high tariffs imposed by the U.S., the Chinese trade surplus reached an all-time high in 2025 well in excess of $1 trillion, equivalent to more than 6% of Chinese GDP. Faced with insufficient domestic demand, tremendous excess productive capacity, and the lingering effects of a property bubble, the Chinese economy remains in the grip of deflationary forces. Chinese policy makers nevertheless remain reluctant to reorient policies toward boosting domestic consumption. They have doubled down instead on an export-oriented growth policy, despite increasing resistance from trading partners. However, given the size of the Chinese economy and its preponderance across a wide range of manufactured goods, the sustainability of an export-driven growth is in doubt.

Long-Term Inflation Expectations Remain Stable

Although long-term U.S. Treasury yields are well up from their post-GFC lows, they remain at moderate levels. U.S. inflation expectations are well anchored and the slope of the yield curve, though once again positive, is not very steep (Exhibit 3). The Treasury market remains sanguine about the risk of inflation, despite rising debt levels and the risk of overheating.

Exhibit 3. Stable Inflation Expectations, Steeper Curve

Source: Fred. Yield curve slope is calculated as the 10-year minus the 3-month U.S. Treasury yield. Breakeven inflation is the spread between 10-year TIPS and 10-year Treasuries.

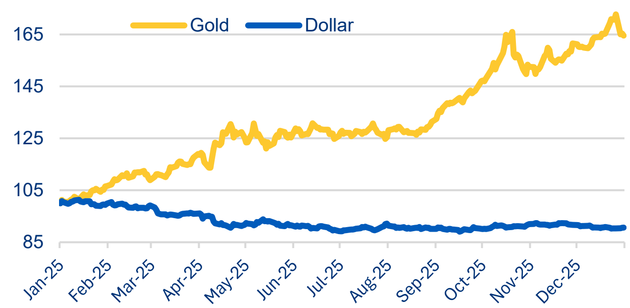


Gold and Stock Bubble?

Gold prices rose 64% in 2025 amid strong demand from retail investors and central banks fueled in part by concerns over the U.S. dollar (Exhibit 4). Recent analysis by the BIS suggests that the price surges recently experienced by gold and the U.S. stock market resemble the explosive price pattern of a bubble prior to a sharp correction. The BIS researchers note that this is the first time in 50 years that gold and U.S. equity prices have simultaneously displayed such price dynamics.

Exhibit 4. Gold Soars, as U.S. Dollar Slides

Source: Bloomberg. Index January 1, 2025 = 100.



Performance of Major Market Indices through 12-31-2025

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	0.1%	2.7%	17.9%	17.9%	23.0%	14.4%
Russell 2000	-0.6%	2.2%	12.8%	12.8%	13.7%	6.1%
MSCI World Ex-US (USD)	3.0%	5.2%	31.9%	31.9%	17.6%	9.5%
MSCI Emerging Mkts (USD)	3.0%	4.7%	33.6%	33.6%	16.4%	4.2%
Citigroup US Treasuries	-0.3%	0.9%	6.3%	6.3%	3.7%	-1.0%
Citigroup Credit	-0.2%	0.8%	8.0%	8.0%	6.2%	0.0%
Merrill High Yield	0.7%	1.3%	8.5%	8.5%	10.0%	4.5%
JPM EMBI Global (USD)	0.5%	3.0%	13.5%	13.5%	9.8%	1.7%
Citigroup WGBI Ex-US (LC)	-0.6%	0.0%	-0.2%	-0.2%	2.0%	-2.5%
Barclays US Aggregate	-0.1%	1.1%	7.3%	7.3%	4.7%	-0.4%
GSCI Total Return	-0.3%	1.0%	7.1%	7.1%	3.9%	14.6%
HFRX Eq. Wtd. Strategies	0.7%	1.5%	8.0%	8.0%	5.5%	3.0%