

Fourth Quarter 2025

Equity Markets Overview

Keys to watch:

- U.S. labor market data
- Impact of tariffs and trade policy
- Federal Reserve monetary policy

After strong growth in the second and third quarters of 2025, the U.S. economy showed modest signs of weakening in the fourth quarter, with key labor market data indicating a downward shift. Although no data were released in October because of the U.S. government shutdown, the unemployment rate was 4.5% in November and 4.4% in December, the highest level in years. Monthly nonfarm payroll numbers were their weakest in years as well, with a loss of 173,000 jobs in October and gains of only 57,000 and 50,000 in November and December, respectively.

Meanwhile, inflation appeared fairly steady at an annual rate of 2.7% in November and December, still stubbornly above the Federal Reserve's target 2.0% but not showing adverse effects from the widespread imposition of tariffs on goods produced abroad. The U.S. Federal Reserve responded to signs of economic weakness by cutting the federal funds rate by 0.25% at both its November and December meetings to a range of 3.50 to 3.75%, with expectations of two further quarter-point cuts in 2026.

International stocks led markets as U.S. stocks gained modestly

International stocks continued their 2025 market dominance by leading U.S. stocks in the fourth quarter while major bond indexes rose as well. Among U.S. equities, value stocks outperformed

growth while there wasn't much separation between large-cap and small-cap stock performance.

The Russell 1000 Index (a proxy for large-cap stocks) returned 2.41% in the fourth quarter, edging the small-cap Russell 2000 Index, which gained 2.19% for the period. Outperforming both was the technology-heavy NASDAQ Composite Index's 2.72% advance in a quarter featuring across-the-board modest stock performance.



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The S&P 500 Index returned 2.66% for the quarter, led by health care and communication services stocks. Also posting slight gains for the quarter were financials, energy, information technology, materials, industrials, and consumer discretionary stocks. Consumer staples had flat performance while the utilities and real estate sectors were in the red.

International stocks featured near-identical gains by developed and emerging market equities as the MSCI EAFE Index's return of 4.91% edged the MSCI Emerging Market Index's 4.78% quarterly return. For the full calendar year, the MSCI Emerging Market Index gained 34.36% while the MSCI EAFE Index returned 31.89%, roughly double the S&P 500 Index's 17.88% return for 2025 as investors decreased their exposure to U.S. stocks in the face of policy uncertainty.

Modest optimism continues

While unpredictable U.S. government policy has led to ongoing uncertainty over the past year, capital markets have remained buoyant, reflecting the surprisingly resilient U.S. economy, strength in overseas economies and markets, and positive expectations for the overall economic impact of artificial intelligence.

Going forward, corporations have maintained healthy profit margins along with positive earnings expectations. While AI-related stocks have helped to carry capital-weighted indexes higher for the past couple of years, signs of broadening participation across almost all sectors, investment styles, capitalization sizes, and geographies bode well for 2026.

However, the potential for geopolitical risks exists and has risen as 2026 began. Uncertainty regarding the ongoing independence of the Federal Reserve from political interference is a heightened concern as well.

Following the Fed's quarter-point rate cuts in November and December, the market has priced in two more rate cuts for 2026. While the economy remains resilient, weakness in employment has outweighed some ongoing concerns regarding

inflationary risks. Labor market weakness and inflationary risks continue to be worth monitoring.

As always, we advise using caution and taking a prudent, diversified approach to your investing.



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