

Quarterly Market Update

Key Developments

- ✓ U.S. and international stocks posted gains in Q4, capping off a strong performance in 2025.
- ✓ Market capitalization of the top 10 companies is now ~39% of the S&P 500.
- ✓ Investors are optimistic about AI innovation, but many wonder if companies will be able to generate the returns needed to justify their massive AI-linked investments.
- ✓ The Fed continued to cut interest rates, prioritizing the labor market over inflation.

Cautious Optimism Drives Markets in Q4

Lower borrowing costs and resilient investor sentiment helped move U.S. and international markets higher in Q4. Stocks of large U.S. companies modestly outgained stock prices of smaller companies, while international stocks outperformed U.S. markets for the full year. Bond markets were also up, as multiple Federal Reserve interest rate cuts led to higher bond prices.

During the quarter, we also saw market value continue to concentrate at the top. The 10 largest companies by market capitalization now represent ~39% of the S&P 500. It's also notable that the price-to-earnings ratio of the S&P 500 index is much higher than its historical average, meaning stocks are relatively expensive. These signs are often worrisome to investors; however, unlike previous speculative periods, today's leading companies are supported by strong earnings and balance sheets.

AI is a big driver of this recent growth at the top. AI-related infrastructure spending approached \$350 billion in 2025 and is expected to rise further. While investors are optimistic about the innovation AI can bring, recent "circular" financing deals, where major tech companies simultaneously buy from and invest in each other, has led some to question the sustainability of AI demand. However, sentiment remains stable as investors balance enthusiasm for innovation with caution on earnings and economic data.

Market Snapshot

Domestic

- The S&P 500 Index rose 2.66% in Q4, finishing the year with a total return of 17.88%.
- The Russell 2000 Index gained 2.19% over the quarter, amounting to a 12.81% gain for the year.
- U.S. Bonds, represented by the Bloomberg U.S. Aggregate Bond Index, gained 1.10% in Q4, bringing the total annual return to 7.30%, as 50 basis points of interest rate cuts in the final quarter helped drive bond prices higher.

International

- The FTSE All-World Developed Index (excluding the U.S.) rose 6.36%, posting a gain of 34.94% for the year.
- The FTSE All-World Emerging Index was up 1.85%, with the index up 26.48% for the year.
- The FTSE All-World Index Increased by 3.38%, up a total of 23.13% for the year.

No Risk-Free Path

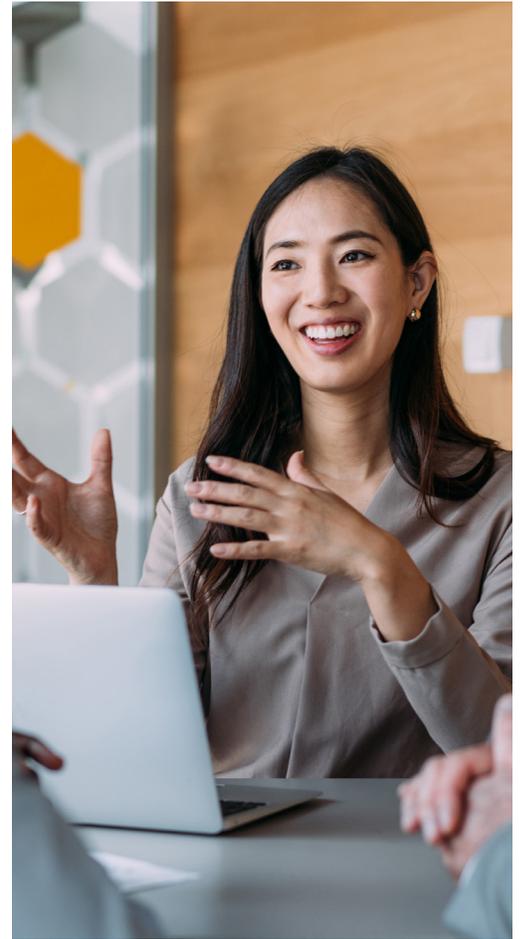
The Federal Reserve continued to lower interest rates, shifting its focus from inflation to supporting the labor market. With interest rates now close to neutral—a level that neither meaningfully restricts nor stimulates economic growth—the Fed is now in “wait-and-see” mode as employment reports show slower job and wage growth.

Inflation remains above the 2% target set by the Fed, so there’s tension between the dual mandate to keep inflation low while also keeping employment high. In his recent address to the public, Fed Chairman Jerome Powell continued to reiterate that “there’s no risk-free path”, noting that both raising and cutting rates carry trade-offs—higher rates risk weakening employment, while lower rates risk reigniting inflation.

Looking Ahead to 2026

Lower interest rates, fiscal stimulus from legislation such as the “Big Beautiful Bill,” and continuing innovation are likely to spur increases in spending and corporate investment, setting a supportive backdrop for additional market growth in 2026. As AI implementation continues throughout the economy, we’re likely to see increased efficiency, which could set the stage for strong earnings and economic expansion. Consumer resilience is also likely to continue as higher-income families support consumer spending, despite lingering price pressures.

However, a few risks remain heading into 2026. There remain concerns around inflation, and developments in tariff and trade policy are likely to remain volatile. The current soft labor market is also a concern, potentially leading to belt-tightening among consumers. Overall, disciplined, long-term investors remain optimistic as policy support and innovation provide a favorable foundation for growth.



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Sources: Bloomberg, FactSet, S&P Global, US Bureau of Labor Statistics, Chair Powell’s Press Conference 12/10/2025.

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