Birch Hill
INVESTMENT ADVISORS

# Market View

## January 2026

## A STRONG FINISH TO 2025

US equity markets delivered another impressive performance in 2025. The S&P 500 Index posted its third consecutive year of double-digit returns (+17.9%), driven mainly by a concentrated group of technology and communication services companies related to artificial intelligence (AI). Encouragingly, participation began to broaden later in the year, helping the S&P 500 Equal Weighted Index return a solid +11.4%. International markets also posted substantial gains, benefiting from lower starting valuations and improving economic stability.

Looking to 2026, the economy is holding up well and policy support remains significant, however, markets are priced for continued success. In this environment, thoughtful positioning matters more than bold market calls.

## WHY WE'RE OPTIMISTIC ABOUT 2026

Several factors continue to work in investors' favor.

**Resilient Economy.** Despite years of higher interest rates and inflation, US growth has proven surprisingly durable. Consumer spending has held up, corporate earnings have exceeded expectations and recession fears have not materialized. Experts predict continued expansion. The Federal Reserve now estimates US economic growth of +2.3% in 2026, up from +1.7% in 2025.

**Fiscal Tailwinds.** Ongoing government spending reduces the odds of an abrupt slowdown, although it doesn't eliminate economic risk. Multiyear infrastructure initiatives, incentives for domestic manufacturing and reshoring, elevated defense spending and targeted tax benefits for corporations and consumers are poised to sustain economic activity.

**Monetary Easing.** With inflation and the labor market cooling, the Fed has room to lower interest rates. We don't expect rates to return to the last decade's ultra-low levels, but gradual rate reductions should support financial conditions, housing, capital markets and business investment.

| Market Indicators | | 12/31/2025 |
|---|---|---|
| TOTAL RETURN | | |
| US Stock Markets: | 4th Qtr | 2025 |
| S&P 500 Index | 2.7% | 17.9% |
| S&P 500 Equal Weight Index | 1.4% | 11.4% |
| DJ Industrial Avg. | 4.0% | 14.9% |
| S&P 400 Mid Cap | 1.6% | 7.5% |
| Russell 2000 Small Cap | 2.2% | 12.8% |
| International Stock Markets: | | |
| ETF Returns in US$ | | |
| EAFE Index (Europe, Australia, Asia, Far East) | 4.7% | 31.6% |
| Japan (MSCI Index) | 4.5% | 25.9% |
| China (FTSE 50) | -5.9% | 28.9% |
| Emerging Markets Index | 3.9% | 34.0% |
| US Fixed Income Yields: | 12/31/2024 | 12/31/2025 |
| 6-Month US T-Bill | 4.24% | 3.59% |
| 2-Yr US T-Note | 4.25% | 3.47% |
| 10-Yr US T-Note | 4.58% | 4.18% |

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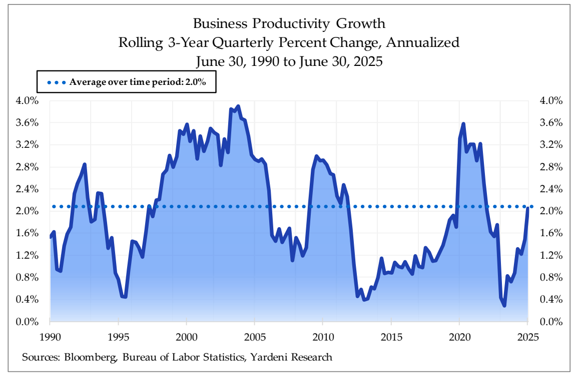
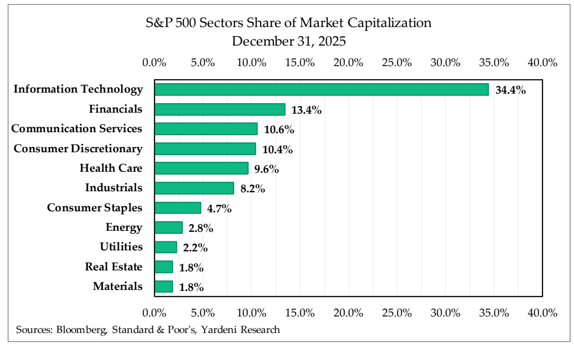
**Productivity from AI.** Investment in AI remains robust, spanning data centers, semiconductors, software and power infrastructure. While near-term benefits are uneven, even modest productivity gains could boost real growth and offset inflationary pressures in the longer term. Signs of improvement are encouraging (see chart to the right), though it's too early to say how much progress is directly due to AI.




## WHY WE'RE BEING CAREFUL

The market may be vulnerable to bad news.

**High Valuations and Market Concentration**. Equity valuations are elevated and market leadership remains narrow. As shown in the chart to the right, technology and communication services stocks now account for over 40% of the S&P 500 Index. This concentration, paired with a high earnings growth forecast (+13% for 2026), leaves the market vulnerable to any disappointment in AI.




**Uneven Business Investment**. Outside of the tech sector, business investment remains muted. Higher financing costs, policy uncertainty and uncertain consumer demand are weighing on decision-making. If this caution persists, it may delay a more durable expansion in market leadership.

**Policy Uncertainty Remains a Wildcard**. Fiscal negotiations, regulatory shifts and evolving trade dynamics could introduce volatility. A pending Supreme Court decision on trade authority raises the risk of renewed tariff volatility while an upcoming Federal Reserve leadership transition adds uncertainty to the future direction of monetary policy.

**Cooling Labor Market**. Hiring has slowed and wage growth is moderating. This is positive for inflation, but softer labor conditions could deter consumer spending.

## WHAT THIS MEANS FOR PORTFOLIOS

In this environment, investment discipline is essential.

**Favor Balance Over Extremes**. We believe diversified exposure across sectors is prudent. If economic growth and productivity gains persist, market leadership should continue to broaden.

**Emphasize Quality**. Companies with strong balance sheets, consistent cash flows and durable business models are better positioned to navigate earnings uncertainty and periods of volatility.

**Stay Anchored to Long-Term Goals**. After several years of strong equity performance, portfolio allocations may have drifted. Rebalancing by trimming outsized winners and maintaining appropriate liquidity can help manage risk without sacrificing long-term return potential.

## POSITIONING FOR OPPORTUNITY AND VOLATILITY

The 2026 outlook offers reasons for both optimism and caution. Economic momentum and policy support are real, but markets are priced for continued success. We believe it is most effective to remain diversified, focus on quality and stay aligned with long-term objectives. This allows investors to participate in continued growth while preparing for inevitable periods of volatility.

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