Osprey
PRIVATE WEALTH

January 2026 Commentary

As we end 2025, we think it is a good time for "peaceful reflection" both on a personal level and on an economic and market level. There are many things to be thankful for, including the S&P 500 index that finished the year up nearly 18% after two previous years of roughly 20% returns!

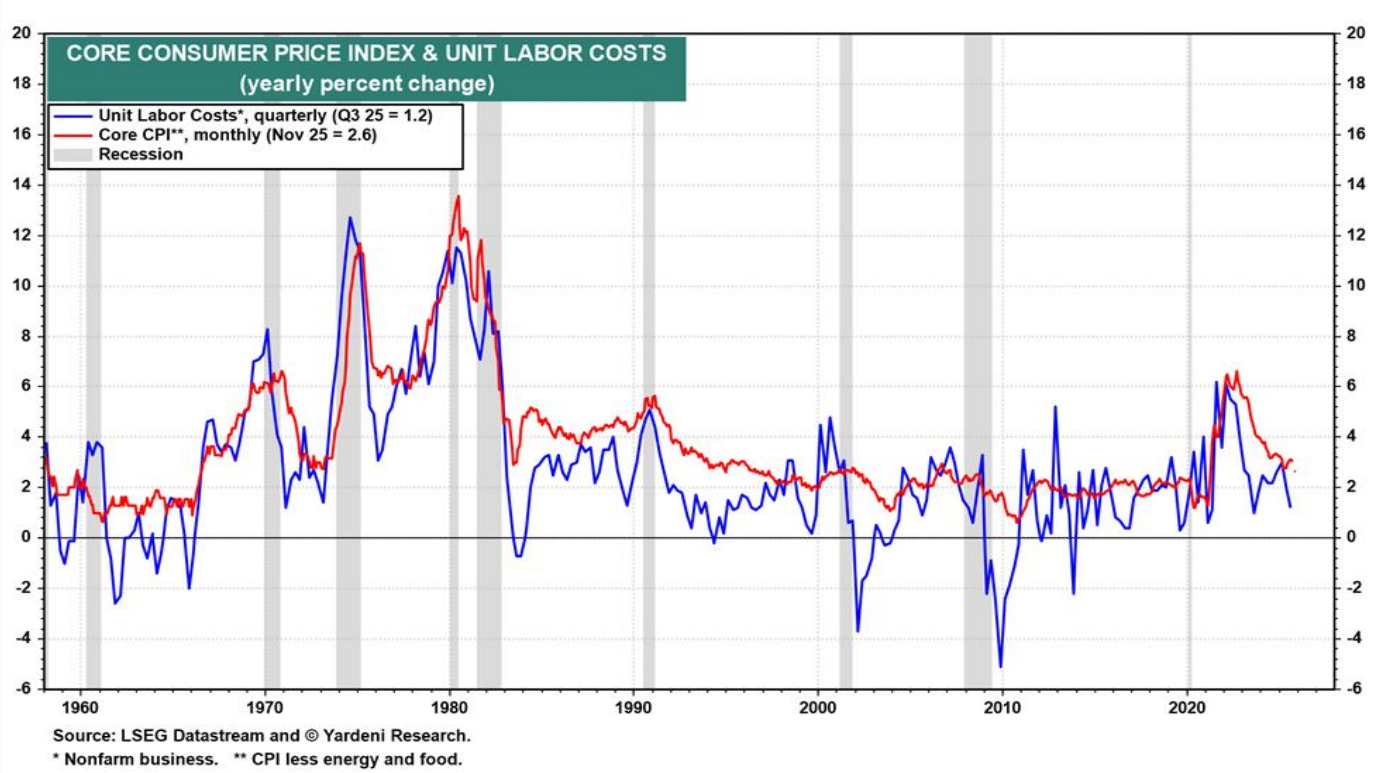
The stock market continued along its upward path in the fourth quarter with a total return of 2.7% for the S&P 500 index, driving the full year return to a healthy 17.9%. There were two pullbacks in the stock market during the fourth quarter, one in mid-October as concerns grew regarding the impact of a government shutdown and the escalating tariff threats ahead of the U.S.-China trade meeting at the end of October; a second pullback took place in the weeks prior to Thanksgiving. The second pullback corresponds to the time when a noted short seller began his campaign claiming Nvidia's accounting inflated its earnings and that there was an AI bubble, and the week leading up to the release of the November 19th minutes from the Fed's October meeting. The minutes assuaged fears about the path of future rate cuts, as seen by the dramatic increase in the odds of a cut at the December meeting in the week following the release – and the strong upward move in the stock market following the release of the minutes.

Inflation

Since peaking at 9% in late 2022, inflation (CPI) has been trending lower and for the past 18 months, settling in a range between 2.3-3%, not quite to the Fed's preferred 2% target. Core CPI, which removes the more volatile prices of food and energy, has been range bound between 2.8-3.2% during that time. While the November reading of 2.6% would appear to be a move in the right direction, the data was regarded as suspect by some economists. Reasons given included the missing October data set due to the shutdown, as well as some one-time distortions that may have skewed the figure to the downside.

The Cleveland Fed, regarded as the Fed's inflation research hub, has forecasted core CPI for December and January of 2.64% and 2.45%, respectively, which would seem to confirm the downtrend in the November data. If accurate, these forecasts would be welcome news for the Fed, which has been cutting rates since September of 2024 given its belief that inflation is trending lower. A downward path for inflation would allow the Fed more leeway in future rate cuts, since cutting rates in a backdrop of rising inflation is generally viewed as throwing fuel on the fire. In addition, lower inflation (and rates) would be well received by investors since past rate cut cycles have generally acted as a positive stimulus for the stock market.

CORE CONSUMER PRICE INDEX & UNIT LABOR COSTS (yearly percent change)



As of early January, fed funds futures are discounting two additional rate cuts in 2026, although the Fed's "dot plot" indicates just one cut. If the Cleveland Fed's views come to pass, additional rate cuts may be on the horizon as the year progresses. The recent upward revision of second quarter productivity from 3.3% to 4.1%, along with new third quarter productivity data showing an increase to 4.9%, may help strengthen the case for rate cuts. These strong productivity figures reduce inflationary pressure from labor costs, which should help improve the odds of the Fed achieving its 2% CPI target (see chart above).

Taxes

The impact of tax policy is likely to provide an economic boost in 2026. Leading up to the midyear passage of the reconciliation bill last year (colloquially known as the "One Big Beautiful Bill Act" or OBBBA), there were concerns that provisions from the 2017 legislation known as the TCJA (Tax Cuts and Jobs Act) would expire, leaving Americans facing income and capital gains tax increases in 2026. The bill's passage helped catalyze a strong second half for the stock market and has investors and corporate management teams looking forward to a more favorable tax regime this year. Importantly, the bill also "permanently" increased estate and gift tax exemptions to $15 million per person, allowing for substantial tax-free generational wealth transfers.

Many Americans are expected to see tax relief, in the form of tax refunds (from the bill's tax cuts which are retroactive to January 1, 2025), as well as tax reductions on overtime pay, tips, and for senior citizens. The bill also increased the deductibility of state and local taxes for many individuals. Economists are predicting that these tax reductions could boost 2026 GDP by between 0.5-1%. The trick will be to achieve this economic benefit without reigniting inflation.

Affordability

The latest political buzzword is affordability, given the significant inflationary pressure we've seen since the passage of the American Rescue Plan in March 2021. CPI in that month was 2.6%, and over the next 15 months inflation surged to a peak of 9% in June 2022. While inflation has trended lower since, the destructive effect of compounding means that those years of higher prices are now firmly embedded as part of the basic price structure of our economy, even as the annual rate of increase has declined to a lower rate.

If there's good news on this front, it's that hourly wage growth has outpaced CPI since mid-2023, meaning real wage growth is positive. However, the compounded price increases since the early years of the COVID-19 pandemic have pushed up prices for many big-ticket items (homes, autos) to the point of being unaffordable. Since those goods are typically purchased with credit, this is another reason why trying to reduce borrowing rates is a key goal for the administration.

To help combat the affordability pressures facing consumers, the administration recently removed tariffs on a number of different imported food categories, such as coffee, beef, and bananas, and postponed tariff increases on some other items including furniture and kitchen cabinets.

The decline in the price of crude oil globally and the resultant drop in gasoline prices from a year ago should help reduce pressure on the consumer. In addition, over the past week the administration has taken several steps to improve home affordability by seeking to drive mortgage rates down and the supply of homes up.

U.S. Budget Deficit

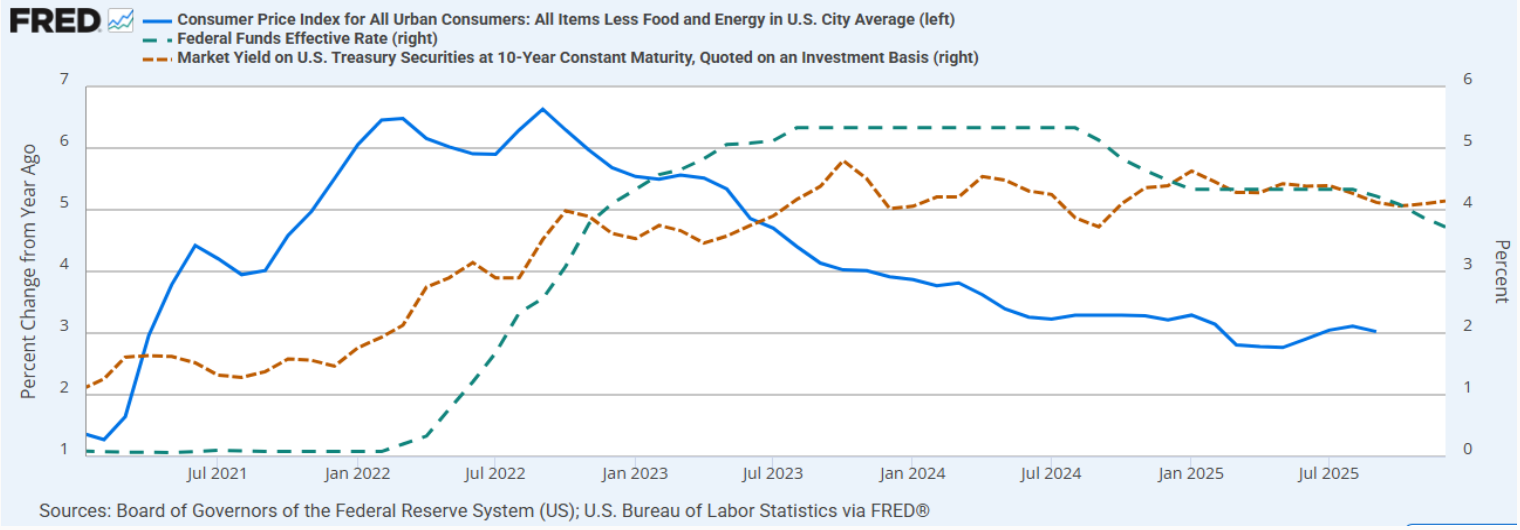
Economists have been warning about the national debt for many years; it now sits at $38 trillion, a figure that is so large it is difficult to wrap one's mind around. Already, interest on the national debt is the second-largest line item for the government budget after social security disbursements. As this debt burden grows larger and larger, it acts as a drag on the growth potential of the economy, utilizing funds which could have been put to use investing in productive assets such as infrastructure and equipment.

While it doesn't get a lot of press, in the most recent fiscal year that started October 1, the cumulative budget deficit through the end of November (the most recent data available) is 19% lower than the same time in 2024. This is the result of revenues being 18% higher (tariffs plus higher individual income tax collections on higher wages), and outlays rising by just 1%. Lower outlays have partly been the result of reduced disaster spending from the government shutdown, as well as lower spending by some government agencies as they reverse spending increases embedded in the 2022 Inflation Reduction Act.

Whether this two-month pattern is an anomaly or something which is more of a new philosophy with its roots in the effort to cut government spending in 2025 is still to be determined. But for now, the upward path of government spending appears to have inflected somewhat lower, so as to better match revenues.

Lower government spending in the first few months of the fiscal year may help explain why longer-term bond yields have recently stopped increasing. In the week before the Fed initiated its rate cuts on September 18, 2024, the ten-year Treasury yield touched 3.65%, but nearly four months later it had risen to 4.76%. A rising ten-year yield is not what the administration wants to see while short term rates are being cut by the Fed. Treasury Secretary Bessent subsequently made some comments which, along with mild inflation data, were soothing to bond investors, sending rates lower again.

Since then, as shown in the chart below, the ten-year yield has fluctuated between 4-4.5%. This yield is an important metric to monitor, because the bond market will show the administration its views regarding the budget deficit by the yield it demands from the government in order to keep buying Treasurys, driving yields higher if they deem spending levels as unsustainable. These so-called "bond vigilantes" in the bond market effectively keep pressure on the administration to keep its spending from getting further out of control.



Sources: Board of Governors of the Federal Reserve System (US); U.S. Bureau of Labor Statistics via FRED®

Economy

The U.S. economy finished the year on a tear, rising an impressive 3.8% in the second quarter, followed by a blistering 4.3% in the third quarter. The fourth quarter GDP release is not expected until late February, but the Atlanta Fed provides a "nowcast" which is a forecast updated every time new data is released. The most recent forecast is for over 5% growth in the fourth quarter! These strong growth rates, and the forecast for even stronger growth, are notable given the view of many economists that the imposition of tariffs would lead to economic headwinds or worse for our economy.

Trade flows were a material contributor to growth, as exports increased and imports decreased, leading to a smaller trade deficit. The sharp decrease in imports for the second quarter was a reversal of the first quarter's import surge, in anticipation of the expected tariffs. The trend continued in the third quarter and may persist this year, depending upon the Supreme Court ruling on the legality of tariffs due later this month.

Other material drivers of these quarterly growth rates were spending related to artificial intelligence, consumer spending, and government spending. Healthcare spending also drove growth in both the second and third quarters.

While the recent rates of growth have been surprisingly good – and we wonder if any early AI-induced productivity benefits may be playing a role – we would not be surprised to see a modest economic slowdown to a still-healthy 2.5-3.5% range for GDP in 2026. There are a number of key drivers of the economy for 2026 which we see as enabling this sort of growth.

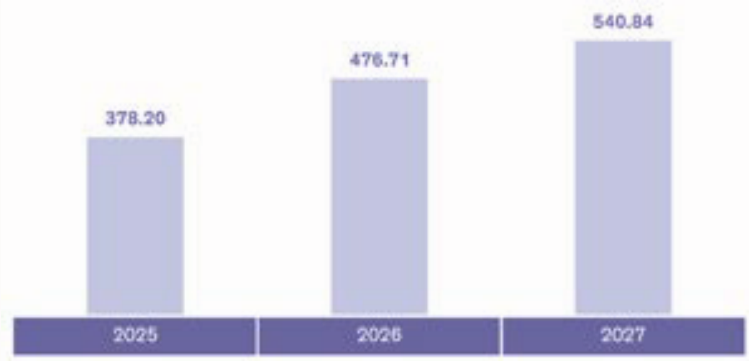
First, the impact of the OBBBA as mentioned above, is very likely to provide a boost to growth. This boost will come in the form of tax refunds resulting in consumer spending, in addition to capital expenditure incentives relating to re-shoring of manufacturing facilities. Second, rate cuts by the Fed have historically boosted economic activity 12-18 months after the cuts occur, due to lower corporate borrowing rates. The cuts began in September 2024 followed by one each in November and December 2024, and again in those same three months in 2025. Therefore, throughout 2026 the economy should experience some degree of uplift as the effects of these rate cuts take hold.

U.S. trade policy provides a third potential source of growth in 2026, as pro-export and pro-manufacturing policies more broadly continue to exert their influence on the economy. Artificial intelligence provides a fourth driver of growth, as the data-center buildout continues in 2026, along with the related effort to boost electricity generation in the U.S. Lastly, a fifth growth driver for the economy in 2026 will be the base effect tied to the government shutdown in the fourth quarter of 2025. Since there was at least a modest negative impact from the shutdown, which ended in November, the resumption or snapback of spending which was delayed during the shutdown may boost economic activity into early 2026.

AI Buildout

As the Magnificent 7 companies (Nvidia, Alphabet, Amazon, Apple, Meta, Microsoft, and Tesla) and other key players such as Oracle and OpenAI, position themselves to be significant players in the artificial intelligence industry, the companies are spending staggering amounts of money. As shown in the chart below, since spending $150 billion in 2023, the industry is expected to spend over $500 billion in 2027, an increase of 233% over four years, a sum which (according to J.P. Morgan) accounts for about one quarter of all capital spending by U.S. companies. This spending ramp will, again this year, contribute notably to GDP.

Consensus Capex Projections for the Major AI Company
Billions



Past performance does not guarantee future results.
As of October 31,2025
Note: The chart covers Apple, Google, META, Microsoft, Oracle and Amazon. Source: Bloomberg and Alliance Bernstein (AB)

In addition to the big AI suppliers, corporations are also spending on AI tools to help improve productivity at their companies. While it is not always straightforward to measure the return on investment from AI spending, a recent survey showed that over two-thirds of U.S. 350 public company CEOs planned to spend more on AI in 2026 than they did in 2025. Potentially worrisome longer term, less than half of AI projects generated a positive return on investment.

This massive amount of spending to date on AI without a positive return as of yet, has some people asking, "Where's the beef?" While the tools such as Chat GPT, Grok, and Gemini are indeed impressive, it cannot yet be demonstrated that a massive boost in productivity can be directly tied to increased utilization of artificial intelligence across the U.S. economy. A possible exception to this is the use of AI in advertising, where Alphabet, Meta, and Amazon are seeing significant benefits.

This return on investment question is an item to watch for 2026, as investors grow increasingly nervous about the massive spending by the providers of AI tools. A related concern is whether the buildout and subsequent utilization of data centers will drive an increase in electricity prices. If so, there could be an uproar by consumers who are paying more – but not seeing any financial benefit – from AI.

It's worth mentioning, as an offsetting argument about AI, that the penetration of AI into corporate enterprises remains in the low single digits in the U.S., and this could mean that we are still extremely early in the investment cycle.

Thematic Tailwinds

In addition to the direct beneficiaries of AI, there are plenty of companies which are secondary and tertiary beneficiaries of the billions of dollars being spent on the buildout. Data centers use a lot of electricity, so for every one that is built, up to 100 megawatts of energy (the equivalent of roughly 100,000 homes) may be required. Larger data centers are being designed which could each require up to 2,000 megawatts (2 gigawatts).

Utilities that are able to provide this power either through spare generating capacity or newly built capacity will benefit from this demand. As an example, a tertiary beneficiary, such as a supplier of gas or wind turbines (or solar panels and utility-scale batteries), would be expected to benefit from the uptick in demand for electricity. Companies providing transformers and transmission lines to transport electricity from the generation plant to the data center are seeing demand increase for their products. Engineering design and construction firms are experiencing robust orders for their services. Asphalt and aggregates will be needed to build the data center foundations as well as the roads and parking lots into the data centers, and so on.

Moving away from artificial intelligence, if longer-term rates decline and bring about a meaningful drop in borrowing costs for mortgages and car loans, this could spark buying activity by consumers and a revitalization of both the housing and auto industries. Homes and cars have become unaffordable for many consumers, but if borrowing rates decline, pent-up demand could be unleashed. During this rate cutting cycle, short term rates have declined by 1.75 percentage points, but longer rates (which are used in setting borrowing rates by banks) such as the ten-year Treasury have remained stubbornly high, near 4.2%, almost half a percentage point higher than before the first rate cut in September 2024.

Wild Cards

There are a handful of issues that could potentially present headwinds to the stock market this year. While no definitive date has been set, the Supreme Court is expected to issue a ruling on the lawfulness of tariffs imposed by the Trump administration. At issue is whether such tariffs can be imposed by the Executive Branch, or if they are part of the constitutional authority granted to the Legislative Branch. Many legal experts believe the Supreme Court will hold that the tariffs (as imposed by the IEEPA, or International Emergency Economic Powers Act) are unconstitutional.

While the Trump administration believes it has legal workarounds in such a scenario, which would allow it to simply re-impose tariffs under different rules, such a finding by the Court could create a chaotic period where the path forward for tariffs is unclear. The potential exists for the ruling to have an impact on corporate earnings, inflation, trade flows, the deficit, and could even require the refund of already paid tariffs.

Venezuela also has the potential to become a flashpoint for the stock market. While to date the impact of the Maduro extraction has been extremely mild and even hard to discern from a normal trading environment. However, it is possible that if the situation deteriorates in the coming weeks or months, the market will view such developments in a more negative light.

Inflation is another watch list item for the stock market this year. At present, both the Fed and the investment community appear to be content with the current glide path of inflation. However, some economists believe that tariffs may yet create upward pressure on inflation, even though to date the impact has been muted. It's also not clear how the Supreme Court will rule on tariffs, and consequently, how that ruling might impact inflation. The productivity data discussed above, if it continues into 2026, should help keep inflation under control.

Since artificial intelligence has been a significant driver of the economy and the stock market in recent years, we are also closely monitoring developments in this area. What typically happens in technology cycles is that breakthroughs in processing and efficiency tend to drive even more demand as prices fall for the product or service. This 'virtuous cycle' will eventually end, but the timing is hard to predict and could last for several years or more.

Earlier this month, Nvidia CEO Jensen announced the company's next wave of products – the Vera Rubin servers - to train and operate the models used by providers of AI services. These new servers have the ability to train such models with just one fourth the number of chips needed when compared with Nvidia's prior generation of semiconductors, known as the Blackwell chips. The company also said that Rubin provides a 10-fold cost reduction compared to Blackwell with the added benefit of consuming significantly less power.

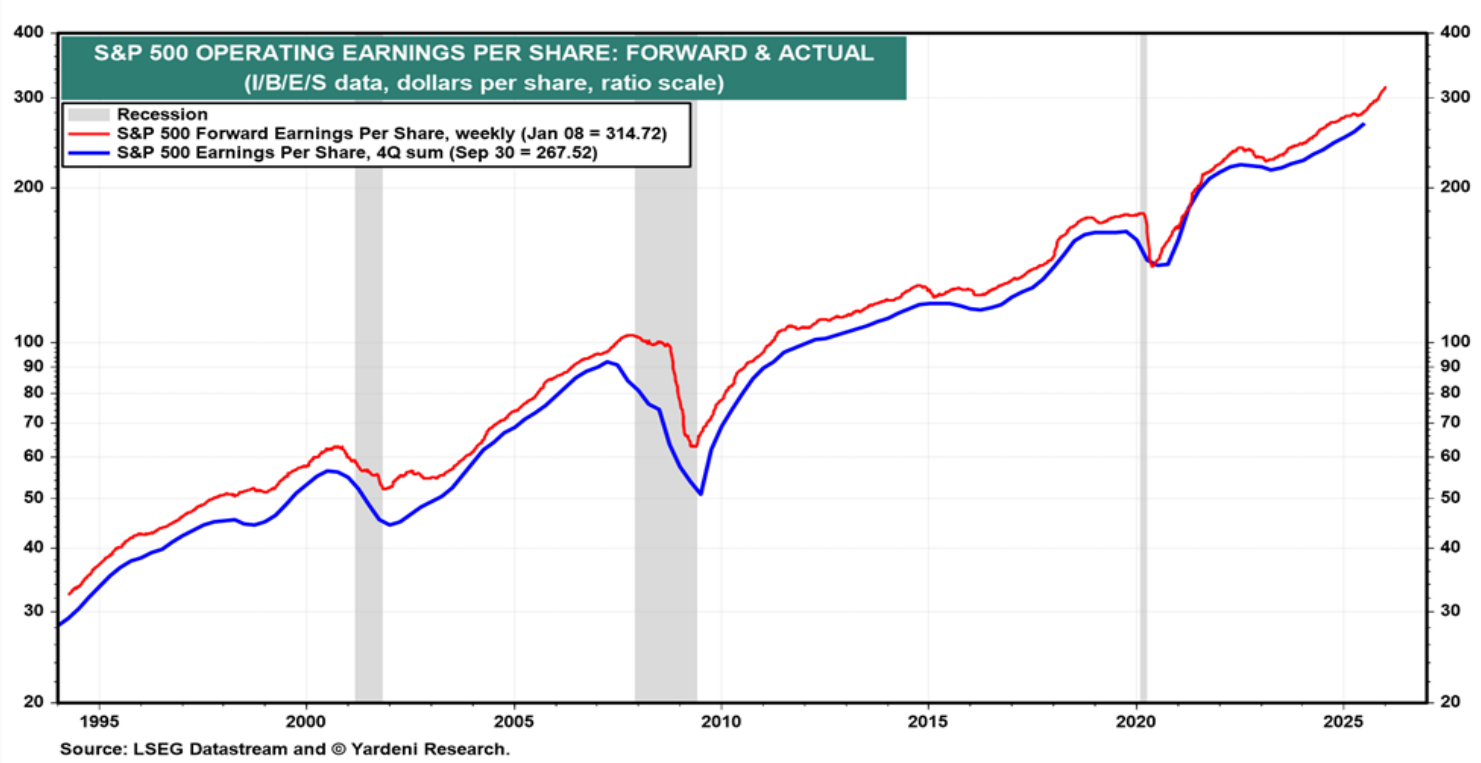
If such breakthroughs in processing power and efficiency continue, we may not require as many data centers, which would then feed through to a lower requirement for electric power. So, while these processing and efficiency breakthroughs are positive, they could ultimately have negative implications for the entire food chain of companies currently involved in the buildout of data centers and the supply of electric power to them. Alternatively, a reduction in the price of Nvidia chips could drive an increase in demand that more than offsets the potential for reduced data center buildout.

2026 Outlook

One is tempted to hold the view that after three phenomenal years in the stock market, perhaps it's time for a breather. However, as we assess the fundamental underpinnings of the U.S. economy and the underlying strength of corporate earnings, the outlook remains favorable in our view. While the stock market is near record highs, so are corporate earnings.

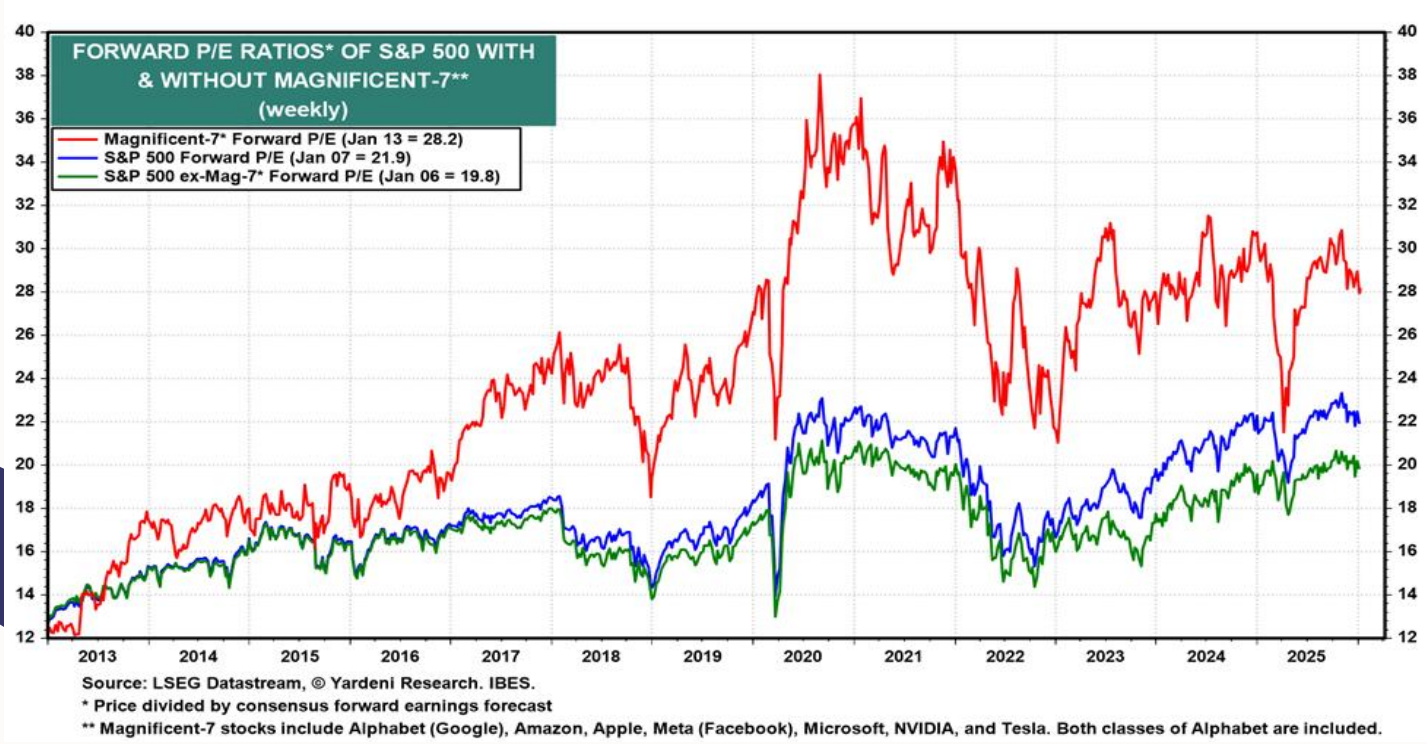
In fact, the consensus view on Wall Street of earnings twelve months into the future ("forward earnings") is that they will also be at record highs. With the exception of the brief "tariff tantrum" pullback last April, forward estimates for both the Magnificent 7 (hereafter Mag 7) stocks as well as the other 493 companies in the S&P 500 index have been edging higher nearly every week over the past few years. As of early January, earnings estimates for this year and next have continued to rise (see chart below).

S&P 500 OPERATING EARNINGS PER SHARE: FORWARD & ACTUAL
(I/B/E/S data, dollars per share, ratio scale)



As shown in the chart below, the S&P 500 index trades at approximately 22 times the consensus forward estimate of operating earnings of Wall Street strategists. While this is somewhat elevated, it is below the peak forward multiple of about 25 times back in late 1999. Looking at just the Mag 7 stocks in isolation, their forward multiple is 28 times. If we exclude the Mag 7, the S&P 493 multiple falls to about 20 times. We feel it's important to point out when making these comparisons to history, that both profit margins and growth are higher today than they were then.

FORWARD P/E RATIOS* OF S&P 500 WITH & WITHOUT MAGNIFICENT-7(weekly)**



In the period between 2014 and 2019 (so as not to include the pandemic), forward profit margins for the Mag 7 stocks ranged between 17.5 to 20%, while today they are nearly 28%. Over the same time frame for the S&P 493, forward profit margins ranged from 10 to 12%, and now they are above 12% and appear to be trending higher. Forward estimates of revenue growth are also higher than at any point over the past 13 years (excluding the pandemic period which distorted normal growth rates). So perhaps higher valuations are warranted if we assume these forward estimates of profitability and growth are accurate.

In addition to the favorable corporate earnings outlook and the valuation picture, we have the very strong productivity data from the bureau of labor statistics that we addressed above. This data could be an early indicator of the impact of AI on the U.S. economy, or it could simply reflect that there was less hiring last year despite the backdrop of a growing economy, and so the overall economic output per worker rose. If this strong productivity trend continues, it should provide a tailwind for corporate earnings in the form of higher profits, and as a result, additional support for the stock market.

The late Marty Zwieg, a successful investor and Wall Street pundit, coined the phrase "Don't fight the Fed." In other words, when the Fed is cutting rates and in easing mode, one should have more exposure to the stock market, and when the Fed is hiking rates and tightening, one should be more risk averse. The Fed has been telling us by their words and actions that at least for the time being, they are in easing mode. Should the economy falter, this should provide some comfort that the Fed is on our side as investors.

Given the backdrop of the Fed being in our corner as well as the favorable outlook for corporate earnings, improved productivity and margins, and fairly reasonable valuations, another year of gains for the stock market may lie ahead. One should always expect volatility in the stock market, as there are always things to be concerned about, just as there are always things to be grateful for and optimistic about.

As we kick off the new year, we look forward to the potential for another year of growth for the economy, the market, and for Osprey Private Wealth. As always, we remain grateful to all of our clients and trusted advisors for the confidence you place in us. We wish everyone a happy, healthy and prosperous New Year!

~ The Team at Osprey

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