Composition Wealth

From The CIO's Desk

Market Commentary | Q1 2026

Quarterly Market Perspective

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The final quarter of 2025 provided modest upside from stocks and bonds, resulting in a year of above-average returns for most asset classes. The stock market's primary barometer, the S&P 500, returned 2.7%[1] during the fourth quarter. Healthcare, which had been the worst-performing sector through September, rebounded 11.7%[2] during the fourth quarter, finishing as the top-performing sector. Returns among small-cap companies were up, similar to large, rising 2.2%[3]. International stocks performed slightly better, rising by 5.1%[4]. For the year, the S&P 500 gained 17.9%[5] while a portfolio of global stocks appreciated by 22.3%[6].

Bonds continued to benefit from modestly lower interest rates. During the quarter, the bond market bellwether, the Bloomberg Aggregate index, added 1.1%. For the year, taxable bonds finished with an attractive 7.3% return.

The direction of the economy during the quarter was less clear. The Federal government shutdown resulted in a lack of economic data being released. When it was provided, it showed employment conditions remained soft, while inflation was more tepid than anticipated. In addition, a delayed third-quarter GDP release showed that the U.S. economy grew at an astounding 4.3%[7], higher than economists had expected.

The degree of resilience of the economy caught most economists, and us, by surprise. The imposition of meaningful tariffs by the U.S. has not led to an uptick in the pace of inflation, nor slowed the velocity of consumption, at least in aggregate. However, we have seen lower and middle-income consumers pare back the volume of their spending. Further, employers have pulled back on hiring. Lastly, orders for large-ticket items have been anemic, outside of the substantial spending on artificial intelligence infrastructure.

As we look ahead to 2026, high-income consumers appear likely to continue their spending patterns. Additionally, indications from technology firms suggest that spending on artificial intelligence capabilities is likely to extend beyond 2025 levels. We believe the pillars of consumer and AI spending provide an element of stability for the economy. Our expectation is that policy actions in the One Big Beautiful Bill Act (OBBBA) will be stimulative and broaden the range of economic growth. In particular, we expect a boost for lower-income consumers through tax breaks on tip income, overtime pay, and Social Security income. Furthermore, the OBBBA will incentivize business investment through tax incentives that allow companies to accelerate the depreciation on capital investments.

Aside from the large investments in AI-related capital spending, businesses have been reinvesting less capital back in their businesses in recent years. The new tax incentives, combined with lower financing rates given recent interest rate reductions by the Federal Reserve, should drive an uptick in capital investments in facilities and equipment.

The supportive economic environment provides a stable backdrop for markets as we begin 2026. However, above-average returns in 2025, along with a favorable five-year period during which the S&P 500 has achieved an annualized return of over 14%[8], appear to have already factored expectations of a constructive economy into current prices. As we look ahead to the next five years, we foresee a higher probability of moderation in equity returns.

This doesn't mean we don't foresee upside to stocks; however, we expect limited incremental benefit to come from investors willing to incorporate even higher valuations into equity prices.

As we anticipate a moderation in return expectations in the year(s) ahead, we recognize that this new regime requires us to think differently. Part of this is following the Wayne Gretzky adage of skating where the puck is going, and we've already begun adjusting portfolios to achieve that. The second is being aware of where elevated risks are and managing exposure around them. The way we adjust portfolios depends on each client's unique circumstances. However, in general, our thoughts around portfolio positioning and risk management are as follows:

PORTFOLIO POSITIONING

1. Enhance Diversification – with markets as concentrated as we've ever seen, we recognize the need to have a more diverse portfolio of assets that are not reliant on the same economic and business conditions.

2. Value of Asset Selection – as returns moderate, the value of being able to deliver differentiated returns increases. Discerning among assets with higher upside potential and greater likelihood of success becomes increasingly important in such an environment.

3. Lean Into Thematic Trends – we see above-average long-term growth potential from thematic trends around energy infrastructure, growing defense spending, higher for longer interest rates, favorable demographics in India, as well as AI infrastructure and adoption.

RISK MITIGANTS

1. Avoiding Lower Credit Quality – the additional yield one can earn from owning lower quality bonds is at the narrowest level on record. As such, investors are not sufficiently compensated for owning the riskier segments of corporate bonds. We prefer to maintain high quality and avoid unnecessary risk.

2. Knowing the Unknowns – while we are excited about the long-term prospects around AI, the timeline for meaningful adoption could be longer than expected. Furthermore, the ultimate winners are less clear, and we don't want to favor one set of beneficiaries over the others. Recognizing uncertainty and avoiding undue risk from uninformed views is prudent in the current climate.

3. Data Center Exuberance – we see an increased amount of speculative investment in data centers, driven by insatiable demand. Furthermore, the uncertainty surrounding competitive dynamics also adds to the uncertainty surrounding the long-term needs of each respective hyperscaler.

CONCLUSION

Downshifting from above-average toward more moderate returns creates a natural opportunity to review your approach to navigating an evolving environment with your Composition Wealth advisor. Now is an ideal time to discuss the amount of return you need to seek to meet your financial goals. Given a moderation in expected stock and bond returns, it's also an opportune time to review your comfort with risk. Lastly, after an extended bull market, many investors are sitting on an above-average level of unrealized gains in their portfolios. We can review your tax status and assess whether alterations to your investment approach, tax planning, or estate structure may be prudent.

We wish you all a happy and pleasant New Year. We are here to support the needs of our clients through frictionless advice and purposeful investment solutions. Please reach out where we can offer support, guidance, or clarification.

Sources: [1]Bloomberg. [2]Bloomberg. [3]Bloomberg, based on the Russell 2000 index. [4]Bloomberg, based on MSCI All Country World Index ex USA. [5]Bloomberg. [6]Bloomberg, based on MSCI All Country World Index (ACWI). [7]Bureau of Economic Research. As of December 23, 2025. [8]Bloomberg.

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