

Quarterly Market Insights: Discernment and Discipline

The investment environment entering 2026 reflects neither crisis nor euphoria, but rather a complex landscape requiring discernment and discipline.

OVERVIEW

As we enter 2026, the investment landscape presents a study in contrasts. Data suggests the US economy is demonstrating underlying resilience, yet a cooling labor market, elevated equity valuations, and ongoing policy uncertainty create legitimate tensions that we believe demand disciplined navigation rather than complacent optimism.

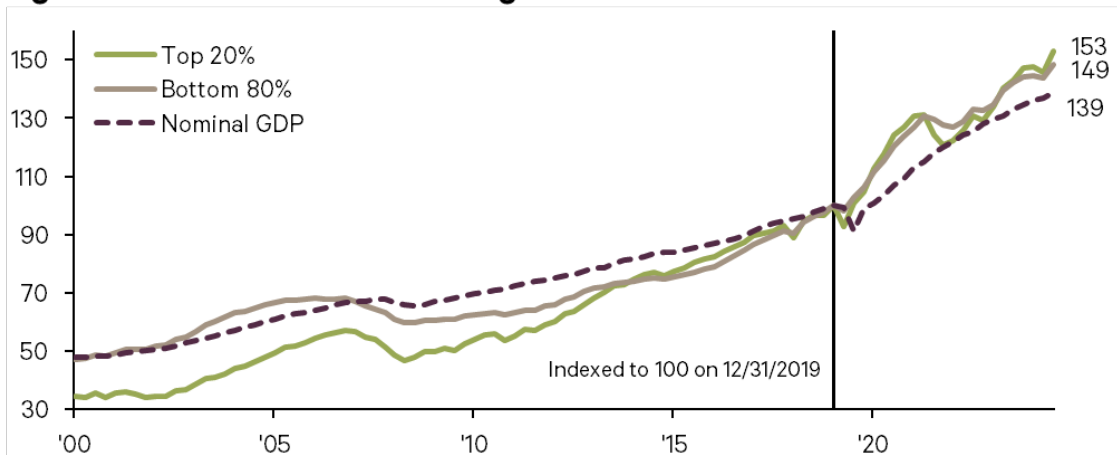
In this environment, we would remain anchored to fundamentals, maintain perspective across asset classes, and resist the impulse to react to every policy pronouncement or market fluctuation.

This is a summary of our Quarterly Market Insights report. The full report is available to Pathstone clients upon request.

US ECONOMY: STRENGTH BENEATH THE SURFACE

The US economy demonstrates notable resilience as we kick off 2026. Consumer balance sheets appear healthy, with household leverage reaching a 40-year low of just 12.3%, nearly half the levels observed entering the 2008 financial crisis, according to data from the Bureau of Economic Analysis (BEA).

Fig. 1: Consumer Net Worth Rising Faster Than Nominal GDP

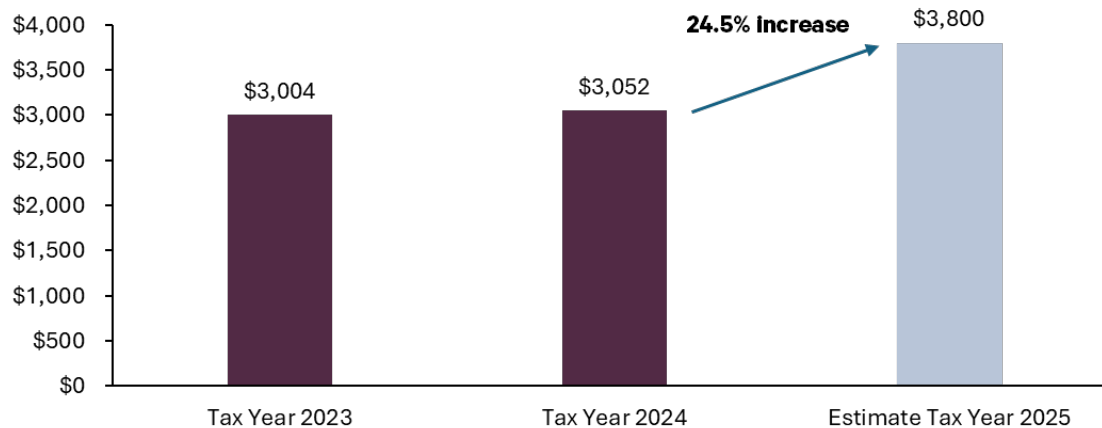


Source: Pathstone, Bloomberg, Federal Reserve, BEA. Data is through Q2 '25.

Nominal GDP – The total value of all goods and services produced within an economy measured at current prices, without adjusting for inflation. *Consumer Net Worth* – The total value of household assets minus liabilities, representing the overall financial wealth and balance sheet strength of consumers.

Net worth growth has accelerated beyond the pace of the decade preceding 2020, supported by equity market appreciation, debt reduction, and supportive fiscal policy. Near-term catalysts include the 2025 tax cuts, which are projected to deliver \$300 to \$1,000 in larger tax refunds during early 2026, providing additional support to household finances (Fig. 2).

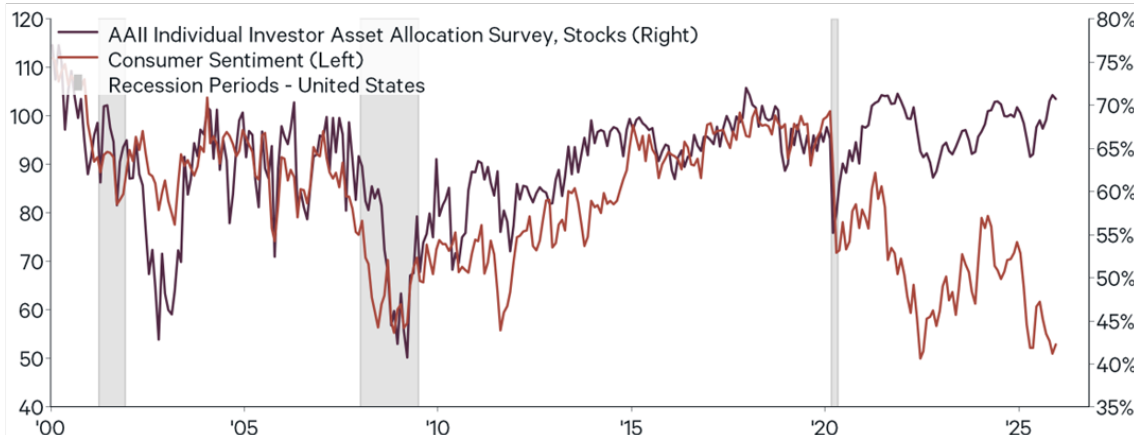
Fig. 2: Estimated Boost in Tax Refunds Coming



Source(s): Pathstone, Bloomberg, Tax Foundation

While consumer sentiment remains subdued due to persistent inflation concerns and policy uncertainty (Fig. 3), actual spending and investment behavior presents a more constructive picture. Consumers continue to engage robustly with the economy, suggesting that sentiment surveys may be capturing frustration with price levels rather than signaling imminent pullbacks in economic activity. This divergence between perception and behavior represents a key dynamic to monitor throughout 2026.

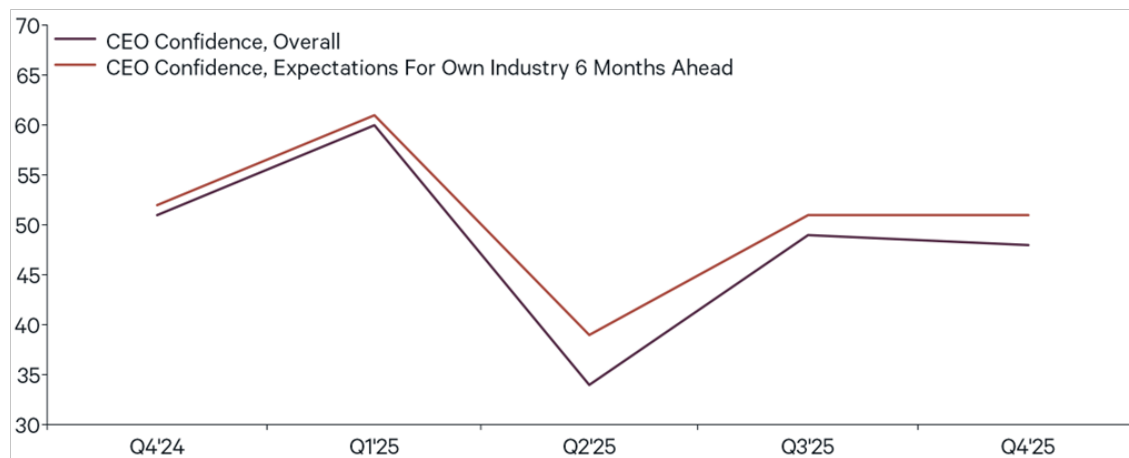
Fig. 3: Consumer Sentiment Diverging Lower



Source: Pathstone, FactSet, American Association of Individual Investors (AAII), University of Michigan.

University of Michigan Sentiment Survey – A monthly survey that measures consumer sentiment regarding current economic conditions and future expectations, including views on inflation, income, and spending. *AAII Survey (AAII Investor Sentiment Survey)* – A weekly survey conducted by the American Association of Individual Investors that tracks the percentage of retail investors who are bullish, bearish, or neutral on the stock market over the next six months.

Corporate confidence has strengthened as businesses gain greater operational clarity (Fig. 4). Many firms are benefiting from tax incentives and supply chain adjustments that protect margins against tariff induced cost pressures. Productivity is showing particularly encouraging signs of improvement, with AI investments beginning to translate into measurable gains (Fig 10). Companies are expanding output without proportionally increasing headcount, suggesting that substantial technology spending may finally be generating tangible returns — a development with significant implications for economic growth potential and profit margins.

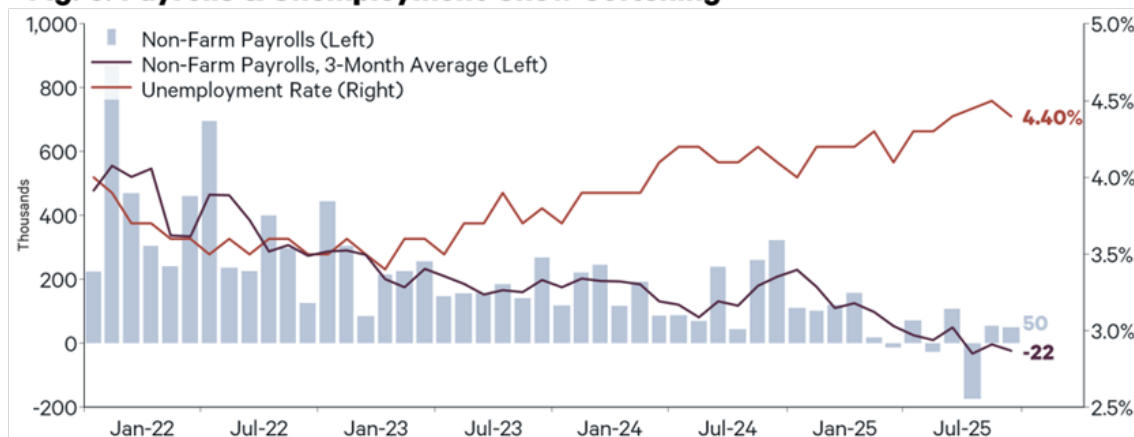
Fig. 4: CEO Confidence Improving


Source(s): Pathstone, Factset, Conference Board.

Conference Board CEO Confidence – A survey published by the Conference Board that measures chief executives' views on current and expected economic conditions, capital spending, and hiring plans.

TENSIONS AND HEADWINDS

Despite these strengths, legitimate concerns warrant attention. The labor market is cooling noticeably (Fig. 5). The three-month moving average for job growth has turned negative at -22,000, despite December's temporary improvement. The unemployment rate has risen to 4.4%, representing a meaningful increase from recent lows. Real wage growth is compressing, particularly for lower-income workers, creating a troubling bifurcation in economic outcomes that could eventually impact consumption patterns.

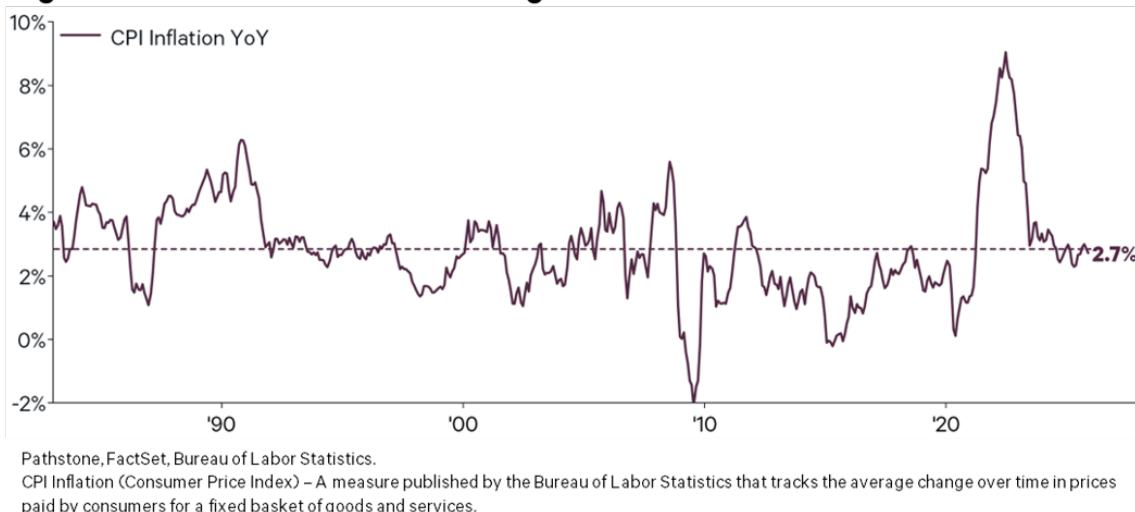
Fig. 5: Payrolls & Unemployment Show Softening


Source(s): Pathstone, FactSet, Bureau of Labor Statistics.

Non-Farm Payrolls – A monthly Bureau of Labor Statistics report that measures the net change in U.S. employment, excluding farm workers and certain government and private-sector categories. Unemployment Rate – The percentage of the labor force that is unemployed and actively seeking work, serving as a key indicator of labor market conditions.

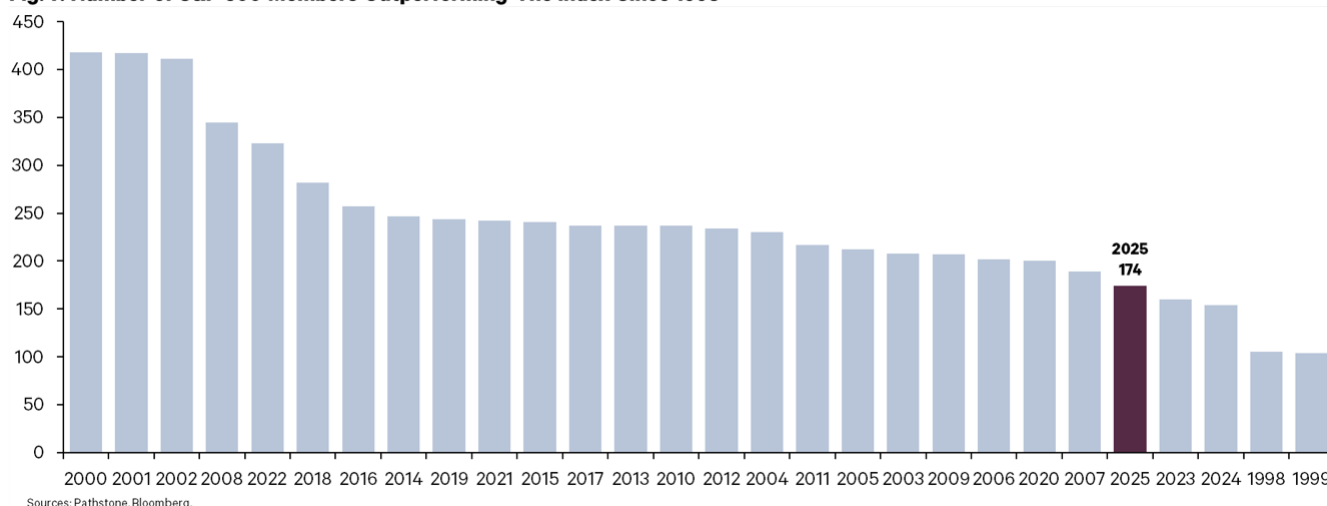
Inflation remains above the Federal Reserve's 2% target, though it continues to run below the 40-year average of 2.9%. This persistent elevation complicates monetary policy decisions and maintains pressure on household purchasing power. Policy uncertainty continues to generate market volatility, with ongoing legal challenges surrounding tariff authority, potential shifts in trade policy, and questions about Federal Reserve independence all contributing to an unstable backdrop for planning and allocation decisions.

Fig. 6: Inflation Near 40+ Year Average



US equity valuations remain elevated by historical standards, with the top ten stocks comprising over 40% of the S&P 500 — a concentration level that raises concerns about market resilience and the potential for meaningful corrections should leadership narrow further or reverse.

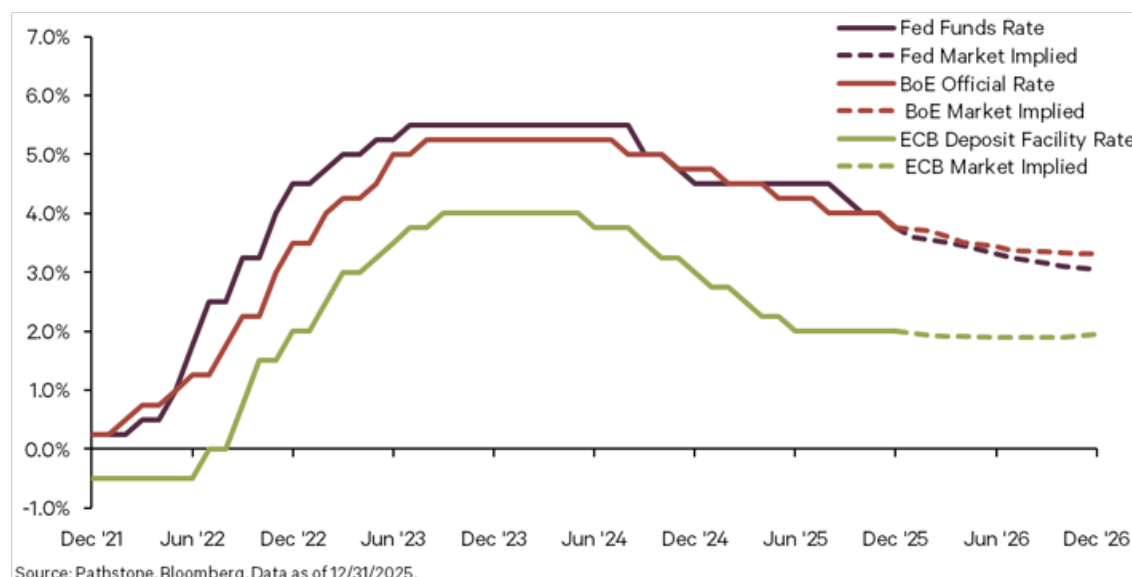
Fig. 7: Number of S&P 500 Members Outperforming The Index Since 1998



FEDERAL RESERVE POLICY: MAINTENANCE, NOT EMERGENCY

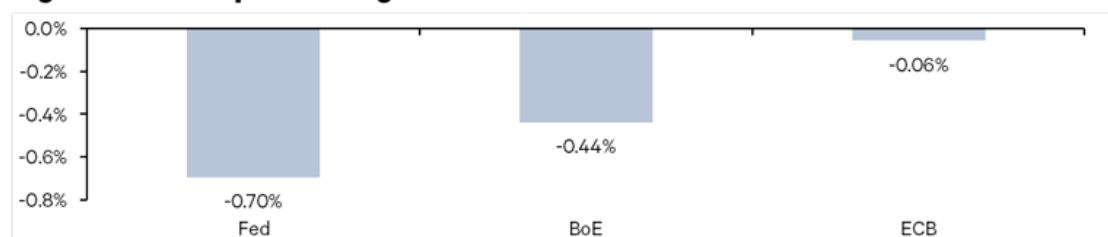
Despite these headwinds, Pathstone maintains a measured optimism regarding the economic trajectory. The Federal Reserve appears willing to tolerate slightly elevated inflation and has signaled continued monetary easing, with markets currently pricing in approximately 70 basis points of rate cuts throughout 2026. Importantly, these represent “maintenance cuts” designed to sustain expansion rather than emergency measures to rescue a failing economy — a critical distinction for understanding the policy environment.

Fig. 8: Central Bank Rates and Market Implied Estimates



The Fed has also pivoted toward balance sheet re-expansion through reserve management purchases, supporting liquidity conditions and maintaining accommodative financial conditions. This technical adjustment, while receiving less attention than rate decisions, provides meaningful support to market functioning and credit availability.

Fig. 9: Market Implied Change in Central Bank Rate in 2026



Source: Pathstone, Bloomberg. Data as of 12/31/2025.

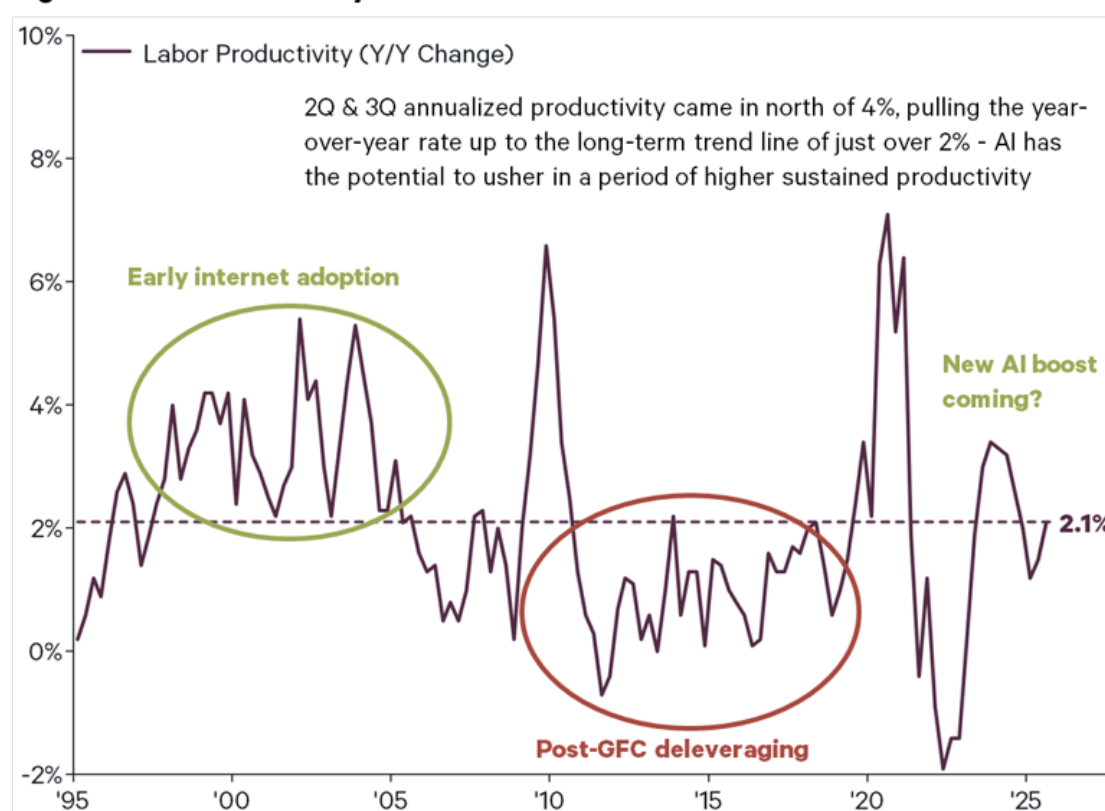
Bank of England (BoE) – The central bank of the United Kingdom, responsible for setting monetary policy, issuing currency, and maintaining financial stability.
European Central Bank (ECB) – The central bank for the euro area, responsible for monetary policy, price stability, and oversight of the euro currency system.

THE PRODUCTIVITY CATALYST

Productivity gains offer perhaps the most compelling reason for constructive positioning. If AI and automation can sustain above-trend productivity growth, the economy could deliver solid output expansion even with modest employment gains. This dynamic would allow for healthy GDP growth without the inflationary pressures typically associated with tight labor markets — a scenario that could extend the economic cycle and support corporate profit growth.

Combined with increased business capital spending, productivity improvements could enable growth to broaden beyond the technology sector. However, realizing this potential requires that productivity gains prove sustainable rather than transitory, and that businesses continue to invest in technologies that enhance efficiency rather than merely cutting costs through workforce reduction.

Fig. 10: Labor Productivity



Source(s): Pathstone, FactSet, Bureau of Labor Statistics.

Labor Productivity – A measure of economic efficiency that calculates output per hour worked, used to assess gains from technology, capital investment, and workforce efficiency.

GFC (Global Financial Crisis) – A severe worldwide financial crisis from 2007–2009 marked by the collapse of major financial institutions, a housing market crash, and a deep global recession.

CONCLUSION

The investment environment entering 2026 reflects neither crisis nor euphoria, but rather a complex landscape requiring discernment and discipline. The foundation for continued economic expansion appears intact, supported by healthy consumer balance sheets, emerging productivity gains, and accommodative fiscal and monetary policy. However, challenges persist in the form of labor market cooling, elevated valuations, and policy uncertainty that could generate near-term volatility.

At Pathstone, we remain focused on monitoring key economic indicators, maintaining diversified exposure across opportunity sets, and positioning portfolios to weather potential volatility while participating in continued economic and market expansion. The path forward may not be linear, but the fundamental building blocks for positive outcomes remain in place.

Disclosure

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