

# INVESTMENT OUTLOOK

A PEAPACK PRIVATE PUBLICATION

## FOURTH QUARTER 2025: JINGLE ALL THE WAY

Oh, what fun! Investors enjoyed one heckuva ride, in the fourth quarter and in the year as a whole. Notwithstanding a plethora of challenges investors faced—not least among them trade policy volatility, political polarization, geopolitical tensions, and a record-long shutdown—risk assets appreciated crisply.



Perhaps it should be no surprise that Santa's sleigh was piled so high this year. The US economy grew at an above-average pace. Investment in all things artificial intelligence soared. Fiscal and monetary policy became more accommodative. And corporate profit margins and earnings expanded prodigiously.

## MARKETS CELEBRATE: FA LA LA LA LA

'Tis the season to be jolly, and investors joined with children around the world to celebrate a world full of toys and goodies.

The good times continued to roll in the fourth quarter. US stock market indices extended their strong run, only to be outdone once again by still juicier returns from overseas markets. Commodities, driven by skyrocketing precious metals prices, were the stand-out asset class, while bonds and cash performed well. Only real estate generated slightly negative returns.

Asset Class	Index	4th Quarter Results	Full Year Returns
US Large Cap Stocks	S&P 500 Total Return	2.7%	17.9%
US Large Cap Stocks	S&P 500 Equal Weighted	1.4%	11.4%
US Small-Mid Cap Stocks	Russell 2500	2.2%	11.9%
International Developed Markets Stocks	MSCI EAFE	4.9%	31.2%
Emerging Markets Stocks	MSCI EM	4.7%	33.6%
Real Estate Securities	MSCI US REIT	-1.7%	3.0%
Commodities	Bloomberg Commodities Futures	5.9%	15.8%
Bonds	Bloomberg Barclays US Aggregate	1.1%	7.3%
Cash	FTSE USBIG 1-Month Treasury Bill	1.0%	4.4%

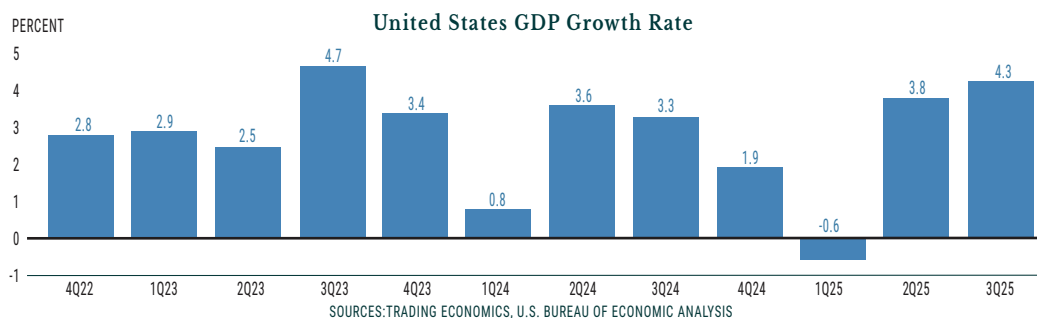
SOURCES: THE WALL STREET JOURNAL, STANDARDANDPOORS.COM, FTSE, MSCI, BLOOMBERG

For the year as a whole, most asset classes generated double digit returns—and it was the third consecutive year of double-digit gains for US equities. Remarkably strong returns from overseas markets were powered in part by US dollar weakness, but easier monetary policy and improved earnings outlooks also propelled international markets higher. Commodities benefited from the safe-haven status of gold in an environment of heightened uncertainty and from large government deficits in many developed countries. Bonds benefited from central banks' dovish monetary policies. Returns from real estate securities were suppressed by weak demand in the office and hotel sectors and mortgage refinancing concerns.

Not celebrating? Cryptocurrencies. The largest, Bitcoin, fell 6% for the year, and 30% from its all-time high. In the aggregate, cryptocurrencies lost more than \$1 trillion since early October. Also, the US dollar. The greenback fell 9.4%, in the wake of volatile trade policy, concerns about budget deficits, and narrowing interest rate differentials with other major currencies.

## A HOLLY JOLLY ECONOMY

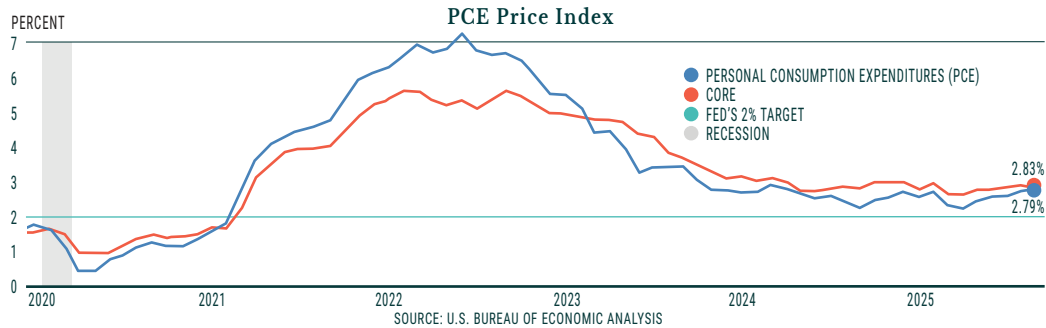
Undergirding robust financial markets, the economy soared above chimney tops, with third-quarter US GDP growth of 4.3%—the fastest in two years.



Once again, it is the American consumer driving the economy. Despite teeth-gnashing about the K-shaped economy, in which affluent households sustain spending while lower income households struggle, aggregate consumer spending rose 3.5%. (By some estimates, the wealthiest 10% of US households account for 50% of US consumer spending.) Also contributing to economic growth in the third quarter, exports rose sharply, aided by a weaker US dollar, and imports fell, in the wake of higher tariffs.

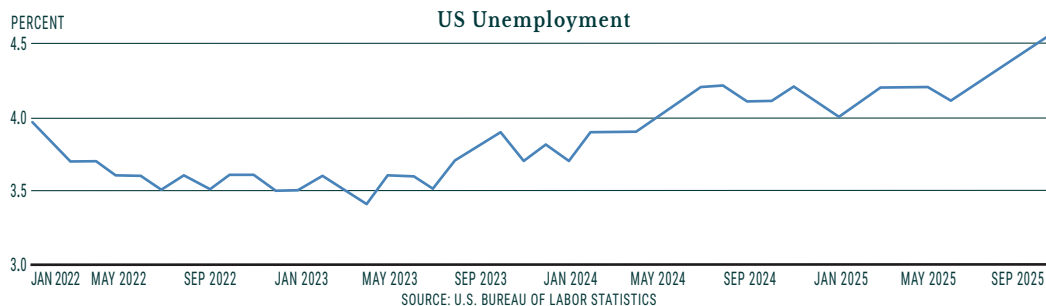
The Atlanta Fed estimates that fourth quarter GDP growth was 3%, a solid performance considering the historic 43-day government shutdown. This suggests considerable economic momentum entering the new year.

On the inflation front, the most recent data available, for September 2025, indicate that price increases have stabilized at just under 3% annualized.

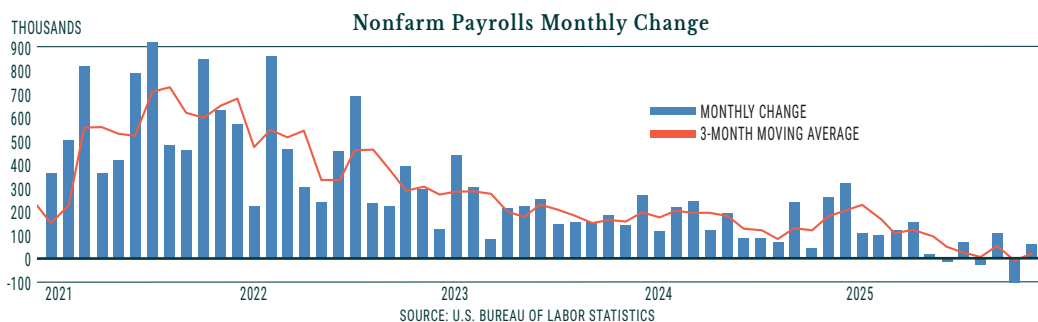


While it has been over four years since the FOMC managed inflation to its 2% target, concerns about tariff-induced price hikes have not, or at least not yet, materialized in the form of higher overall inflation. When the FOMC resumed its rate-cutting policy in September, it implicitly indicated that it sees the risk of higher prices as less likely than the risk of a deteriorating labor market. Or, as wags might have it, 3% inflation has become the new 2%—mission accomplished on the Fed's price stability mandate.

On the labor front, the unemployment rate climbed to 4.6% in November, the highest in four years.



While the 4.6% level is a historically low reading, it does represent a full percentage point rise from levels two years ago. The primary culprit for the adverse change is a dramatic slowdown in job creation, as is evident in the chart below:



Over the past three months, net new job creation has averaged a paltry 22,000 positions.

Another key indicator of softness on the labor front is continuing unemployment claims. The steady rise in such claims indicates that it is challenging for unemployed workers to find new jobs.

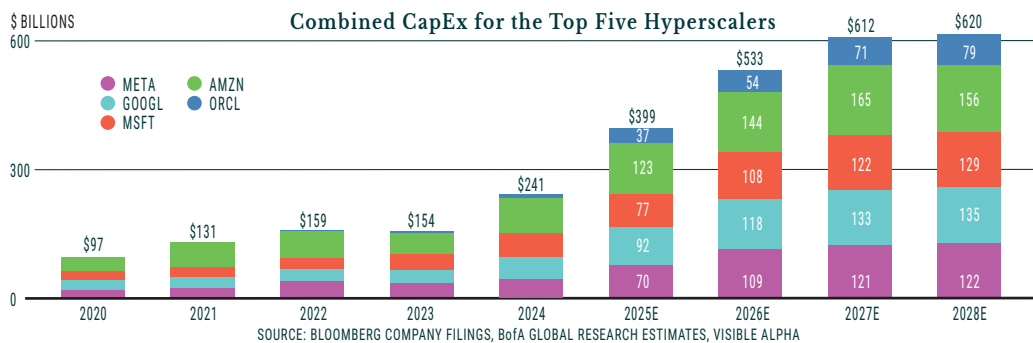
Small wonder that the FOMC enacted three rate cuts in the past four months, as it strives to avert an outright shrinkage in the labor market and meet its full employment mandate.

Continued Claims, Insured Unemployment



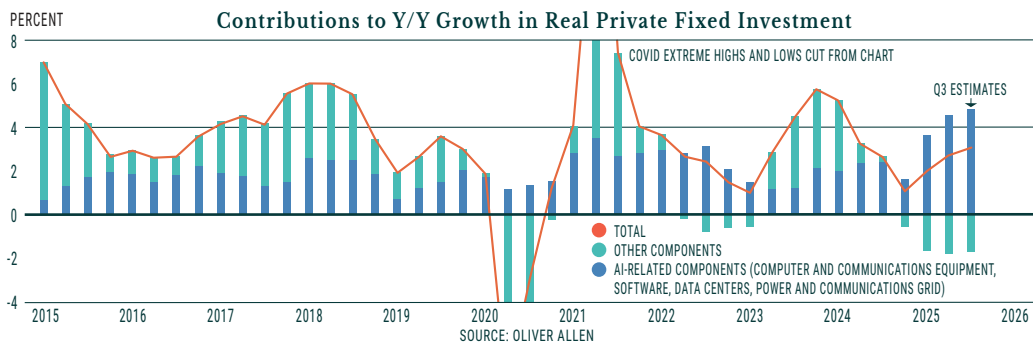
## INVESTMENT IN ARTIFICIAL INTELLIGENCE: IT DOESN'T SHOW SIGNS OF STOPPING

Facing unprecedented and rapidly rising demand for artificial intelligence applications, hyperscalers stuffed their capital expenditure (CapEx) stockings full of everything from data center construction, high performance GPUs (graphics processing units) and memory chips to networking equipment, infrastructure, and power generation capacity. Bank of America forecasts total annual CapEx for the top five hyperscalers to rise from nearly \$400 billion in 2025 to over \$600 billion in 2027, an enormous 53% increase in two years.



It's hard to overstate the significance for the economy of the investments being made in AI. According to Nationwide Economics, business investment in software, IT equipment and structures that consists significantly of artificial intelligence and data centers was responsible for an outsized 30% percent of GDP growth in the second quarter of 2025 and 20% of the economy's expansion in the first quarter.

The AI spending spree is considered the primary, and perhaps only, source of significant private fixed investment growth in the current environment.



Private business investment excluding AI-related categories has been largely flat since 2019, per Deutsche Bank, and Pantheon Macroeconomics suggests that all other private fixed investment is actually in decline.

## 2026: THE STARS ARE BRIGHTLY SHINING

With the benefit of hindsight, it's clear that in 2025 the stars were aligned for a strong economy—and for strong markets. A powerful combination of a favorable policy backdrop, the acceleration of artificial intelligence investments, and robust growth in corporate profits provided strong fundamental support for risk assets.

These drivers remain in place at the start of the new year. Upcoming changes in the composition of the FOMC are likely to lead to a continuation of monetary policy easing. Tax cuts enacted under OBBBA and ongoing high levels of government spending underpin stimulative fiscal policy. Deregulatory initiatives benefiting financial institutions, energy drillers, and utilities, among others, will contribute to higher corporate profits and greater merger and acquisition activity. Hyperscalers have already guided the markets to anticipate substantial further increases in their AI investments. And analysts are projecting a further double-digit increase in the profits of the S&P 500—as much as 14.2%, according to investment research firm Strategas.

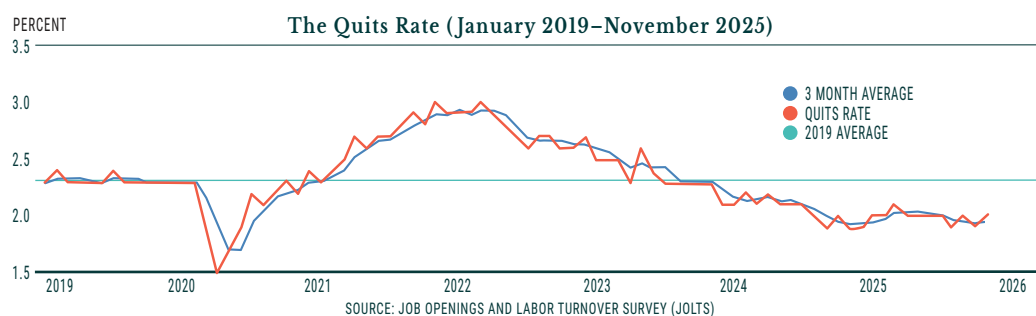


## ARE YOU LISTENING? WHAT COULD GO WRONG

We could go too far in repeating the sounding joy—sleigh bells ring, but so do warning bells. The message of good cheer—the ‘thrill of hope,’ if you will—can distract us from legitimate risks to the economic good-news narrative. We enumerate four, here.

**Labor Market Softness.** Consumption is the predominant driver of the US economy, and employment drives consumption. The data for the labor market are mixed at present, and somewhat sloppy due to the lack of data collection during the government shutdown late last year.

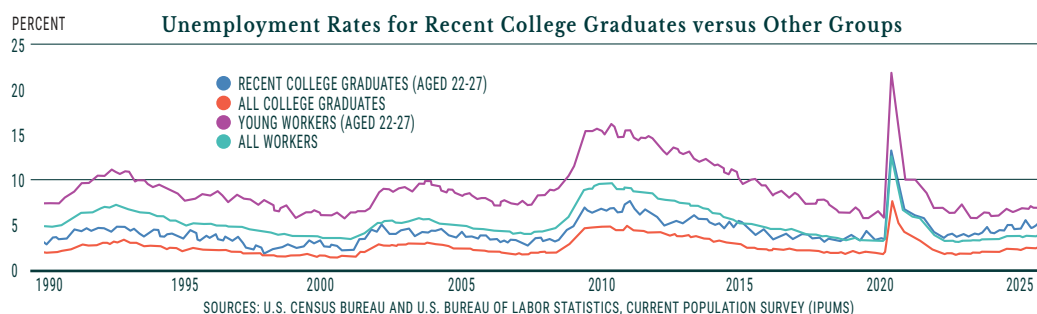
Constructively, weekly new unemployment claims—despite increased layoff announcements—exhibit no stress. The four-week moving average stands at 218,000. This level is in line with readings throughout the post-pandemic era and suggests companies are retaining, not reducing, staff.



Companies may not be firing workers, but they're not hiring them either. Job postings on recruitment site Indeed have dropped precipitously, back to pre-pandemic levels. Among other indicators of a softer labor market, wage growth has slowed, the 'quits' rate has fallen (suggesting workers feel less confident about finding a better job), and small businesses have reduced hiring plans.

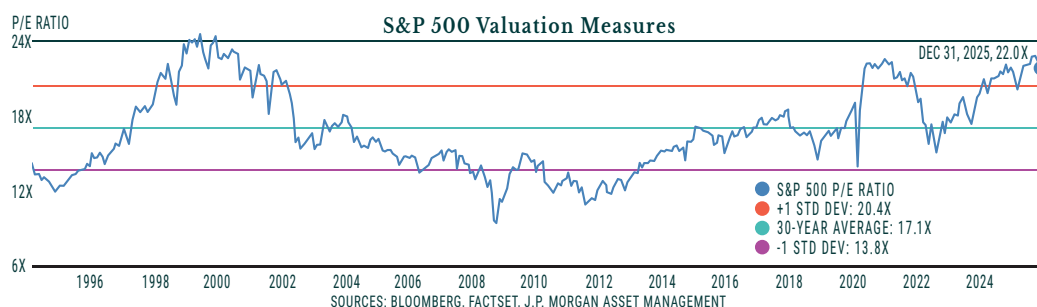
According to the Federal Reserve Bank of New York, unemployment rates for recent college graduates (5.8%) and for young workers ages 22-27 (7.1%) are notably higher than the general population (4.1%) and for all college graduates (2.9%).





A recent McKinsey Global Institute report suggested that AI could ultimately replace 40% of US jobs. Most other analyses are not nearly so dire—Goldman Sachs estimates that just 2.5% of US employment would be at risk of displacement if current AI use cases were expanded across the economy—and there's scant data to indicate that AI has had any significant effect on the overall labor market yet, but it's worth tracking such potential disruption.

**Valuations.** The S&P 500 stands at a multiple of 22 times expected earnings over the next year—a lofty level last reached during the Internet bubble. For statistics geeks, that's 1 ½ standard deviations above the 30-year average.



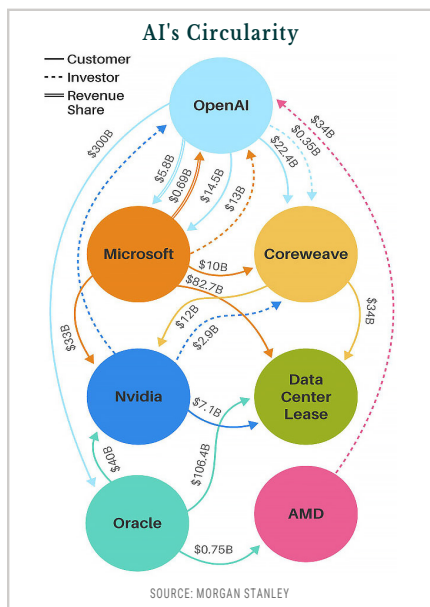
These elevated valuations reflect comparatively modest and falling interest rates, and optimistic growth expectations. According to FactSet, analysts project the corporate earnings will advance by 12.1% in 2026, following similar earnings growth in 2025. This compares favorably with average annual earnings growth of 8-10% over the past 30 years.

If earnings fail to meet investors' lofty expectations, it will mean that stock prices are too high, and they will correct to adjust to more modest expectations. The potential risks to earnings come from margin pressure, a weaker labor market, and a slowdown in spending from financially strained consumer households.

**AI Over-Investment.** AI promises to deliver substantial productivity gains for the American economy, by up to 1.5% annually according to some analyses. Such gains, if accomplished, might lead to faster, noninflationary growth.

Expectations are high: 68% of CEOs plan to spend even more on AI in 2026, according to advisory firm Teneo, and 53% of institutional investors expect AI initiatives to begin to deliver returns on investments within six months. At this stage, the most success with AI has been achieved in marketing and customer service, with challenges using AI in higher risk areas such as security, legal and human resources.

Use cases for AI are still being developed, and the payoff for the investments in this space is highly uncertain. According to a study by MIT, 95% of organizations are getting zero return on their AI investments. That's because employees are using AI resources like ChatGPT primarily to generate what the *Harvard Business Review* has dubbed "workslop," i.e., AI-generated verbiage.

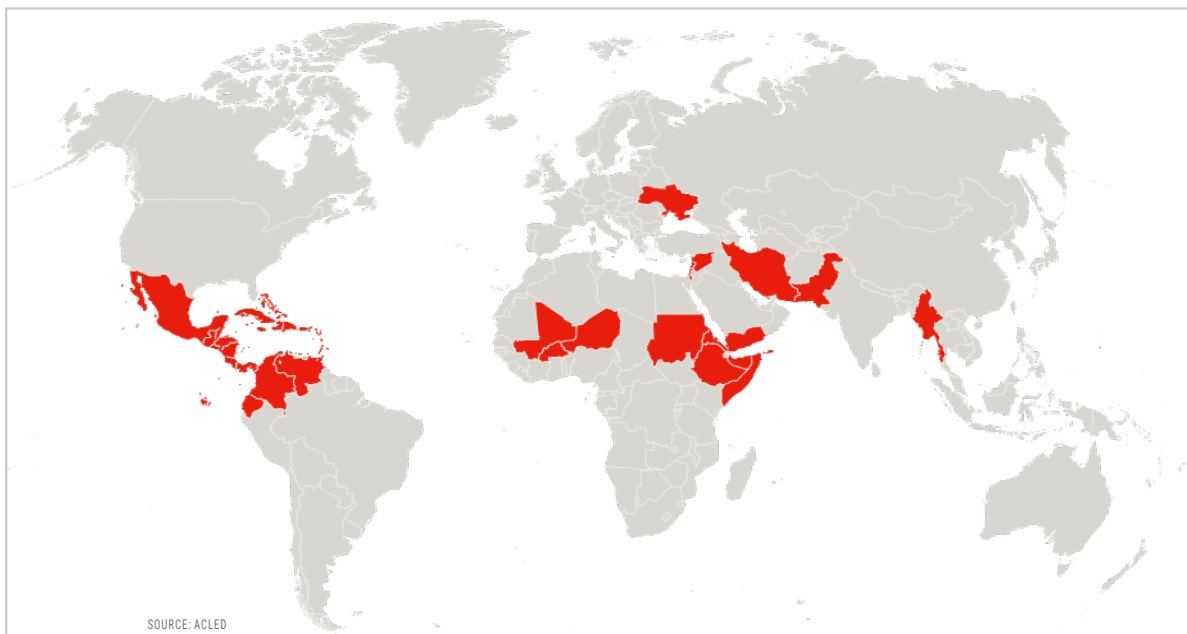


Total global investment spending on artificial intelligence is projected to reach approximately \$1.5 trillion in 2025 and exceed \$2 trillion by 2026. Some long-term forecasts suggest AI infrastructure spending could reach \$6.7 trillion by 2030. It's not credible to believe that there will not be a day when investors will demand to see a return on the capital invested in AI. When will that day arrive?

It's a fast-developing story, but it's worth remembering that ChatGPT recently celebrated just its third anniversary. ChatGPT's parent company, OpenAI, projects it will generate revenue of \$100 billion by 2028. That's boldly ambitious, considering that its annualized revenue run-rate in 2025 was \$13 billion. More importantly, the company lost \$12 billion in the last quarter alone. It is spending furiously in an arms race with competitors—spending today, well ahead of expected future revenues.

The inter-relationships of AI and data center companies are complex, and involve growing leverage and enormous multi-year multi-trillion-dollar lease and loan commitments. AI companies issued over \$200 billion of debt in 2025 to fund AI investments, and the circular financing shown in the chart is eerily suggestive of the final stages of the 1990s Internet bubble. Everyone's dancin' merrily, dancin' and prancin', but what happens when the music stops?

**Geopolitics.** Hotspots have always existed. The Middle East has been a center of conflict for many decades. Various nations in Latin America have been led by dictators over the last two centuries. China's ambition to re-take Taiwan dates to 1949, and Russia's territorial reunification quest dates to the fall of the Soviet empire.



Geopolitical flare-ups rarely have deep and lasting market consequences. But we are entering a new era. The Trump Administration is remaking the world order, one in which trade relations have been radically reset, alliances have been strained and replaced by unilateralism, and commercial interests have been prioritized, sometimes to the detriment of strategic and diplomatic interests. In short, it's an era in which uncertainty is heightened, and in which unpredictability is seen as a virtue rather than a challenge.

There are, of course, other risks. The housing market remains moribund due to low affordability levels. Cracks are appearing in the \$1.7 trillion private credit markets. Manufacturing activity has fallen for nine consecutive months, and is now in contractionary territory. Consumer sentiment remains depressed. Next year, alas, all our troubles will not go out of sight; we'll have to muddle through somehow.

## REINDEER GAMES WE PLAY IN

Deep down, inquiring minds may not want to know if reindeer really know how to fly, but may well be interested in how to position portfolios in the new year.

While rich valuations suggest some caution with regard to US large cap stocks, particularly in the technology sector, revenue and growth momentum warrant continued exposure. Potential economic acceleration and lower interest rates could also provide support to value stocks.

Such a set-up is also promising for US small cap stocks, which are bigger beneficiaries of reduced interest costs and generally more sheltered from tariff vicissitudes. Their discounted valuations relative to US large cap stocks make them attractive.

Also on the nice list are international equities, both developed and emerging markets. Valuations are substantially more modest than US stock market levels, and growth prospects are improving. The AI story resonates in Asia just as it does in the US.



The bond market should benefit from dovish monetary policy. In addition to earning coupon income, fixed income investors may experience some price appreciation. Extending duration would capitalize on such an opportunity. Elevated issuance in the tax-exempt arena has sustained comparatively attractive municipal bond yields.

All in, 2026 begins on a promising note for market participants, and everyone's telling you to be of good cheer. Here's hoping investors are gifted with another year of healthy returns. Joy to the world. May your days be merry and bright.



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