NORTH STAR
Resource Group

MARKET UPDATE
FOR INFORMED INVESTORS
QUARTER 4 | 2025

Slowing growth and global outperformance in 2025

A record 43-day government shutdown defined the fourth quarter of 2025, delaying key labor and economic metrics and hurting consumer confidence.

The economy continued to grow, but at a slower rate than earlier in 2025. The Federal Reserve cut interest rates two more times in the fourth quarter, for a total of three rate cuts in 2025. A "K" shaped economy has highlighted the widening differences between strong upper-income spending and slower lower-income spending.

HIGHLIGHTS

- **Interest Rates:** The Federal Reserve has a dual mandate: Maintain full employment and control prices. The Fed lowered interest rates three times in 2025 to help stimulate a weakening job market. The Fed has been conflicted with higher inflation readings and a weakening labor market.
- **Inflation:** An inflation rate of 2.7% indicated prices rising faster than the Fed's goal of 2%, but lower than the 3% rate measured in September.
- **Jobs:** Job numbers weakened further in the fourth quarter, but those results may not be fully accurate due to the government shutdown. Unemployment rose to 4.6%, as government job cuts and immigration statistics began to influence employment data.
- **Tariffs:** Tariff uncertainty persisted. Companies reported absorbing 80% of tariff increases rather than passing them on to consumers in 2025.
- **GDP Growth:** The economy grew during Q4, but at a rate slower than the rest of 2025.
- **Stock Markets:** Stock markets continued to gain but saw some pullbacks at year-end due to profit margins and economic uncertainty. A small number of AI companies continue to drive the markets in performance and profitability in the U.S. Large Cap S&P 500. International stocks outperformed U.S. stocks by a wide margin, and Emerging Markets returns were double the U.S. returns at 34%. The weakening U.S. dollar contributed significantly to this outperformance.

2026 Outlook

The passage of the One Big Beautiful Bill (OBBB) will have a big impact on 2026 financial outcomes tied to 2025 taxes for consumers and corporations.

Much of the consumer savings will come from the increase in the SALT (State and Local Taxes) deduction. This change is expected to stimulate the economy in the form of higher spending and act as a growth catalyst for the first half of the year, although most economists expect a more pronounced slowdown in the second half of the year.

Corporations will also benefit from the OBBB through lower tax rates. Profit margins for corporations are expected to remain at a double-digit growth rate, especially for the Magnificent 7 and other AI-fueled companies. These profit margins will benefit from lower taxes, slowing wage growth, increased productivity, and the falling U.S. dollar.

Market prices and earnings continue to be elevated or expensive. Artificial intelligence and related capital spending, along with increased productivity, are seen as the key growth drivers. Should these factors become too stretched or slow down, we may see a significant market pullback because of elevated prices. The top 10 companies now make up 38% of the S&P market capital; historically, this number has been around 20%.

KEY TAKEAWAYS

Diversification will be the key to 2026 as the Fed looks to lower interest rates while economic uncertainty and weakening of the U.S. dollar are expected to continue.

- Economists expect two to three interest rate cuts over the next year. Along with potential inflation, this may cause bond values and fixed income products to remain neutral to muted.
- Mega Caps from the AI-fueled growth continue to remain expensive with hope for a broadening out of market sector performance.
- International stocks are expected to stay inexpensive compared to their U.S. counterparts. A weakening dollar will continue to drive their outperformance.
- Emerging Markets may also benefit from a weakening dollar as well as the demand for AI-fueled commodities.
- Recent additions of evergreen and interval products have allowed alternative investments to integrate these illiquid products into retail portfolios.

We do not expect a recession or significant slowdown on the horizon. Yet, with uncertainty around inflation, tariffs, Fed policy, unemployment, mid-term elections, and the geopolitical landscape, 2026 may create a more volatile stock market.

At North Star Investment Resource Center, we believe diversified portfolios and disciplined investment strategies continue to provide the best opportunities for those investors seeking long-term growth. A diversified portfolio can reduce risk, smooth performance over time, and protect against uncertainty.

We welcome investment discussions, should you have any questions or concerns. If there is a change in your investment time horizon or financial circumstances, please reach out to your advisor for more discussions.

Written by North Star Investment Resource Center

	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
S&P 500	17.88%	17.88%	23.01%	14.42%	14.82%
US Small Caps	12.81%	12.81%	13.73%	6.09%	9.62%
Int'l Stocks	31.22%	31.22%	17.22%	8.92%	8.18%
Bond Market	7.30%	7.30%	4.66%	-0.36%	2.01%

Returns over 1 year are annualized. S&P500 index, US Small Caps use Russell 2000 index, international stocks use MSCI EAFA NR USD, Bond Market use Bloomberg US Agg Bond TR USD.

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The Russell 2000 is a stock market index measuring the performance of 2000 small capitalization stocks. It represents the 2000 smallest companies in the Russell 3000 Index, which in turn represents the 3000 largest companies in the US. Thus, the Russell 2000 is a barometer of small-cap stocks. Though small, the companies represented by the Russell 2000 are not the smallest of the small as they are not penny stocks. The Russell 2000 is weighted by the market capitalization of the stocks.

MSCI EAFE – Designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted.

The Bloomberg U.S. Agg Total Return Value Unhedged, also known as "Bloomberg U.S. Aggregate Bond Index," formerly known as the "Barclays Capital U.S. Aggregate Bond Index," and prior to that, the "Lehman Aggregate Bond Index," is a broad-based flagship benchmark that measure the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).