

January Market Commentary | Growth, Inflation and the Policy Balance

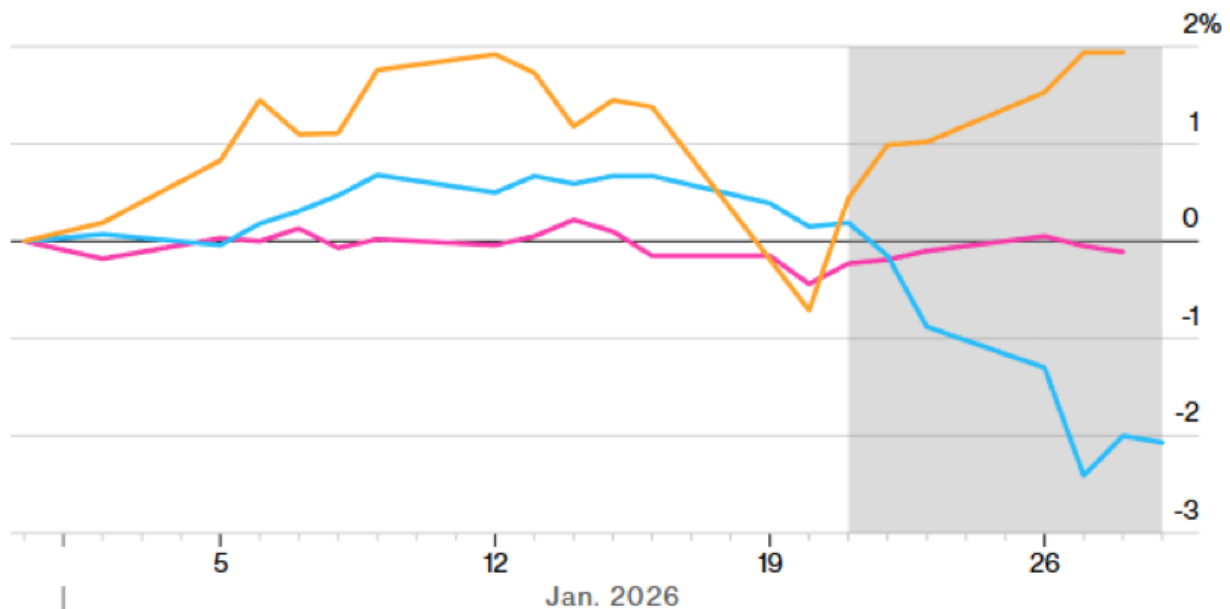
Based on the major indices, markets began the new year with positive returns and relatively low volatility. Large U.S. stocks, as measured by the S&P 500, returned +1.4% (total return in U.S. dollars), while Canadian equities, as measured by the S&P/TSX Composite Index, increased 0.8% (total return in Canadian dollars). In U.S. dollar terms, large-cap Canadian stocks were +1.9%, supported by a 0.8% appreciation in the Canadian dollar.

Fixed income was relatively unchanged from a return perspective, though bond volatility continued to trend lower. Credit markets reflected a similar pattern, with spreads and volatility near historical lows. The notable exception was the U.S. dollar. The Bloomberg US Dollar Index fell to levels last seen in May 2021.

US Stocks, Treasuries Resilient Even as Dollar Slides

Federated argues hedging, not "Sell America," behind currency moves

— S&P 500 Index — Bloomberg Dollar Spot Index — Bloomberg US Treasury Index

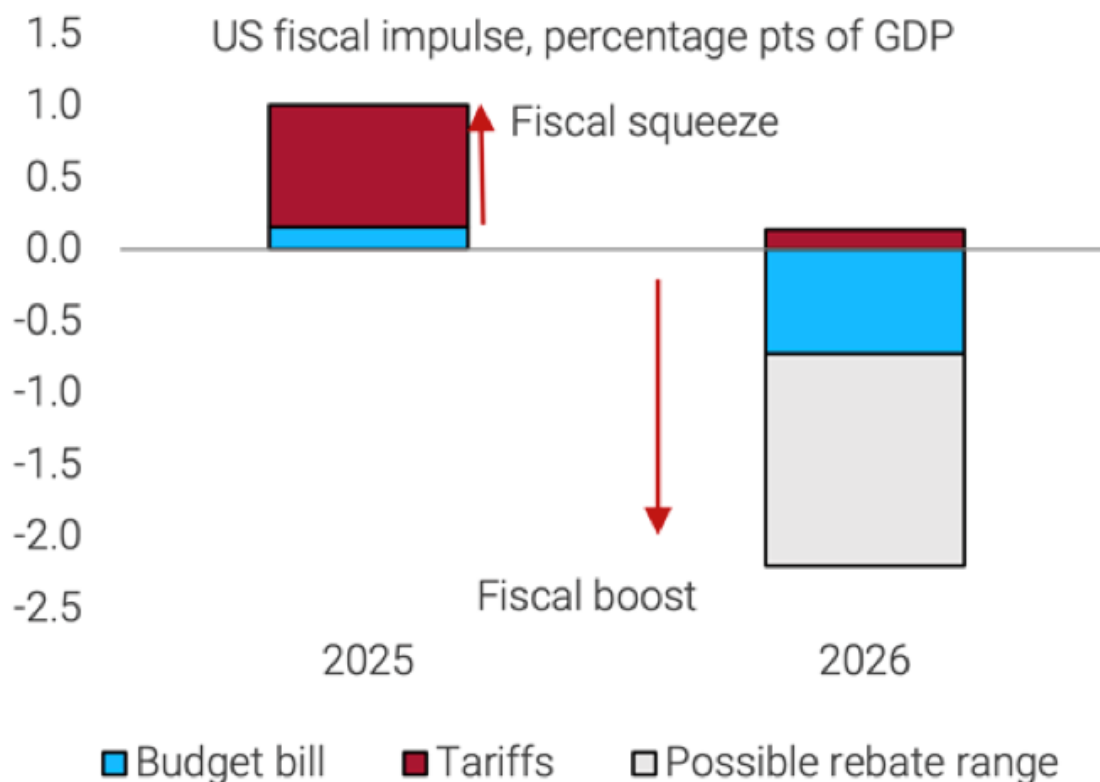


Source: Bloomberg

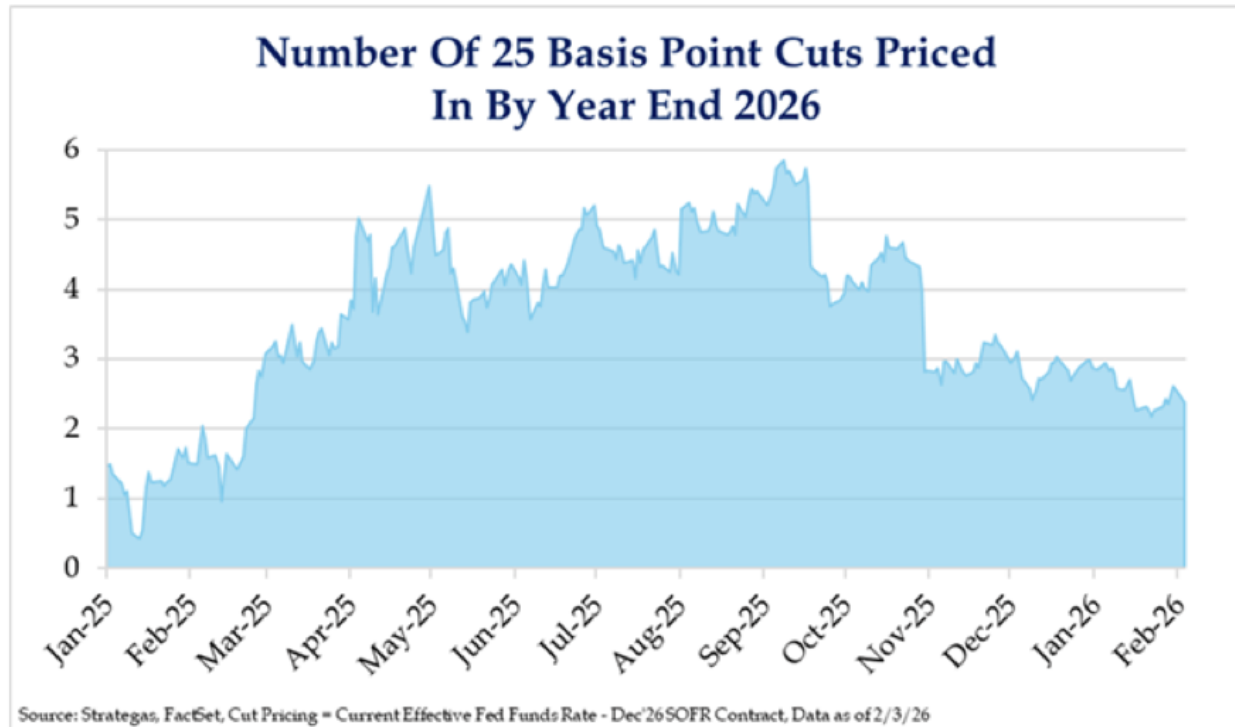
Fiscal and monetary policy continue to support growth expectations.

Resilient markets reflect an economy supported by stimulative monetary and fiscal policy. Central banks are generally cutting rates, and governments continue to spend. In the U.S., TS Lombard estimates fiscal policy could shift from a 1% headwind in 2025 to a tailwind of over 2% of GDP in 2026. Strategas data suggests the market expects at least two Federal Reserve rate cuts in 2026.

Chart 12: The big swing in US fiscal policy

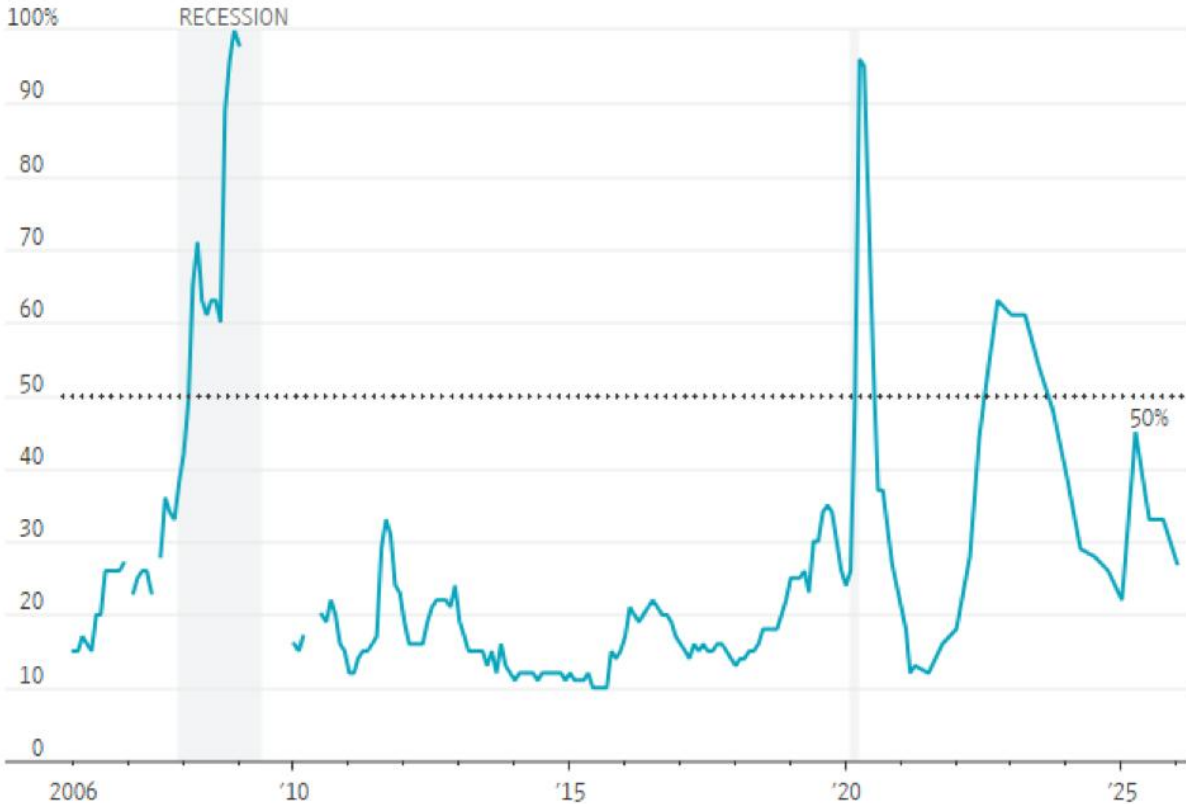


Source: TS Lombard estimates



Economists surveyed by the Wall Street Journal have raised their forecast for real U.S. GDP growth in 2026 to 2.3% and assign a 27% probability of recession over the next 12 months. Stronger growth supports corporate earnings and may help broaden the rally beyond a narrow group of stocks. Deregulation and continued artificial intelligence-related capital spending could also support further upside.

Probability the U.S. is in a recession in next 12 months including today



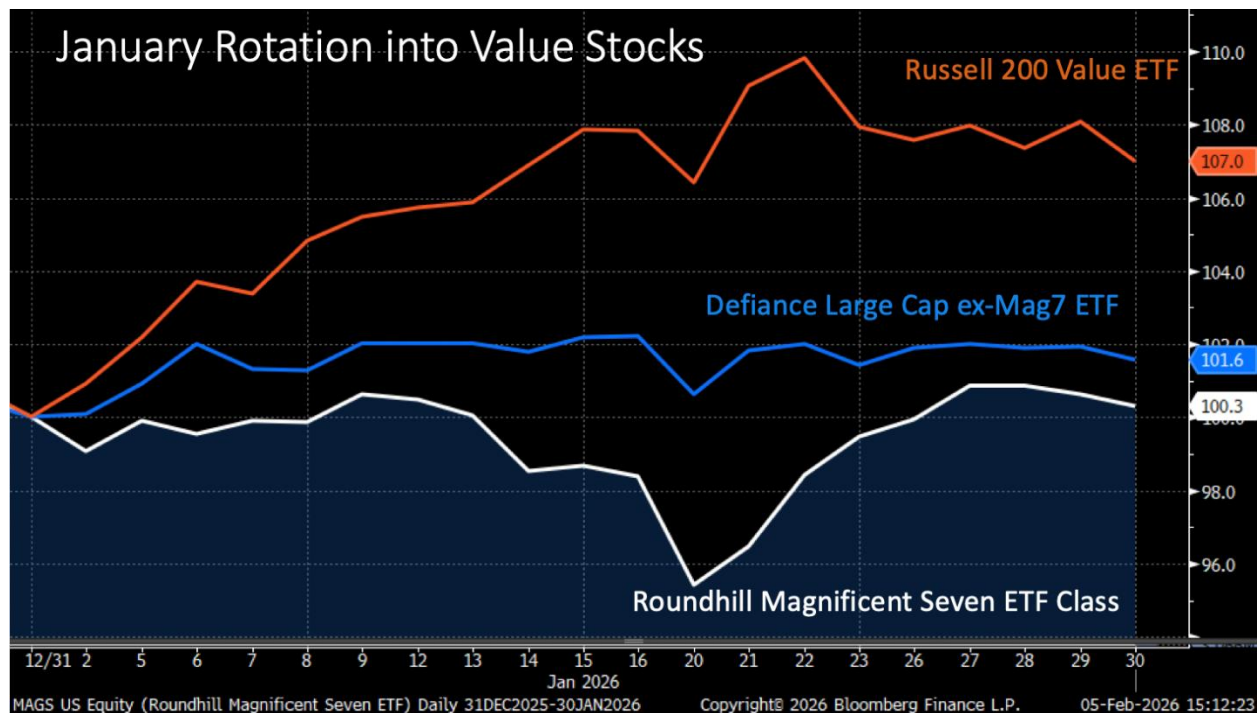
Note: Average of economists' answers. Gaps indicate question not asked or data unavailable.
Source: Wall Street Journal surveys of economists

Risks remain. If growth proves too strong, inflation could reassert itself, reducing the likelihood of additional rate cuts and potentially requiring tighter policy. Easy fiscal policy and rising government debt may also place upward pressure on rates, particularly if a weaker U.S. dollar discourages foreign buyers of U.S. assets. While headline growth appears solid, consumer sentiment and job growth have been less consistent. Uncertainty surrounding U.S. policy continues to add complexity for markets.

Earnings forecasts remain strong, but leadership is beginning to broaden.

For equities, particularly in the U.S., stronger expected growth is evident in profit forecasts. According to the Wall Street Journal, earnings for the S&P 500 are expected to rise 15% in both 2026 and 2027, following 13% growth last year. Goldman Sachs reports fourth-quarter earnings tracking +11%, above their earlier 7% estimate.

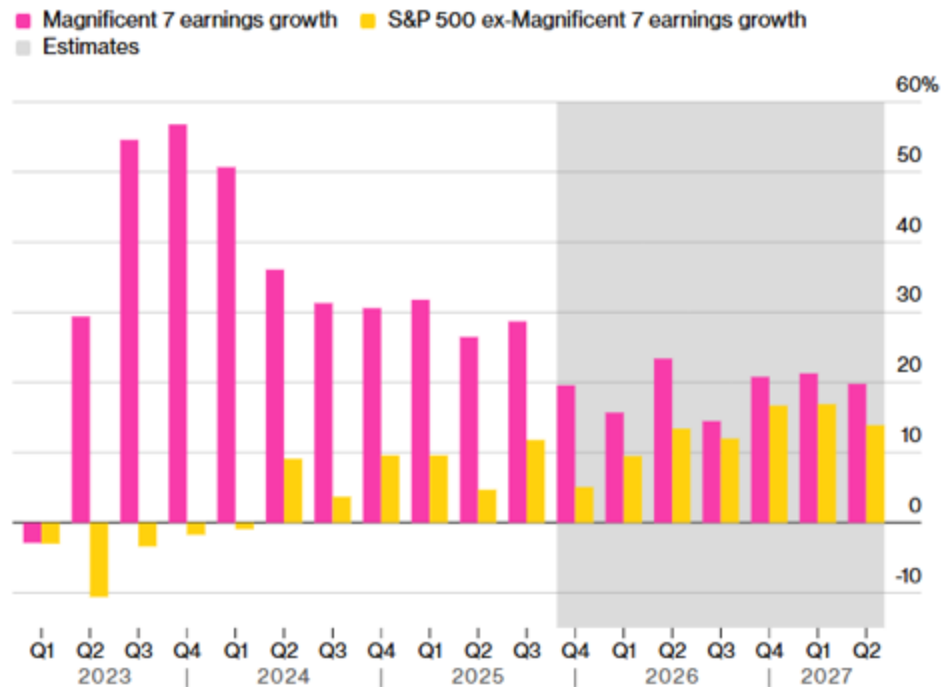
Historically, environments of accelerating GDP growth tend to favour value stocks. When growth is scarce, capital concentrates in a limited number of high-growth companies. In stronger environments, participation broadens and lower-valued companies can benefit. Recent performance suggests early signs of such rotation.



Broader participation has also been supported by more muted performance from the so-called Magnificent 7. In January, performance outside that group was comparatively stronger. While earnings for large technology companies remain solid, their relative earnings advantage over the remaining 493 companies in the S&P 500 is expected to narrow.

Big Tech's Earnings Advantage Is Narrowing

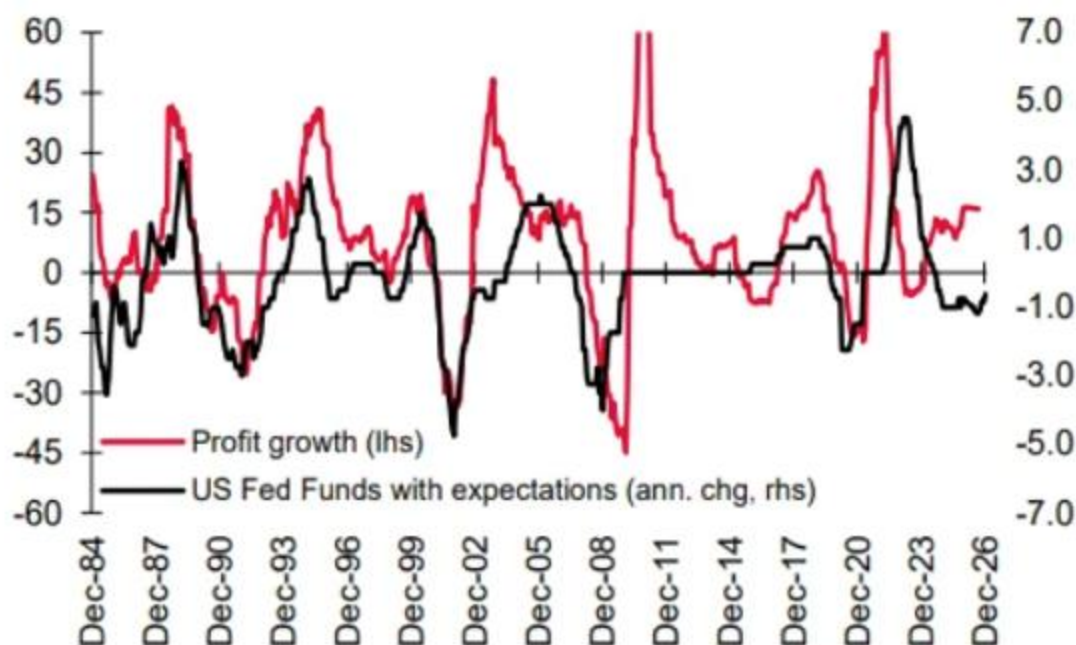
Profit growth is improving for the other 493 companies in the S&P 500



Source: Bloomberg

A broader rally is generally constructive. That said, it is unusual to see double-digit profit growth alongside anticipated rate cuts. According to futures markets, the Fed is expected to cut rates two more times in 2026, bringing overnight rates closer to an estimated neutral level of around 3%. As noted by Societe Generale, this combination of strong earnings growth and rate cuts is atypical, particularly given President Trump's appointment of Kevin Warsh as Federal Reserve Chair. Warsh has previously criticized what he views as overly accommodative monetary policy.

To see double-digit profit growth and interest cuts is highly unusual (US profit growth with expectations vs US rates)



Source: Societe Generale SA

Cutting rates into a strong economy risks reigniting inflation, which could ultimately require higher rates. Warsh assumes leadership of the Federal Reserve amid a delicate balance between economic momentum and inflation risks.

High inflation means high interest rates

Per cent

■ US 10-year Treasury yield ■ US federal funds rate ■ US CPI inflation

1 = Nixon closes gold window, 2 = First oil shock



FINANCIAL TIMES

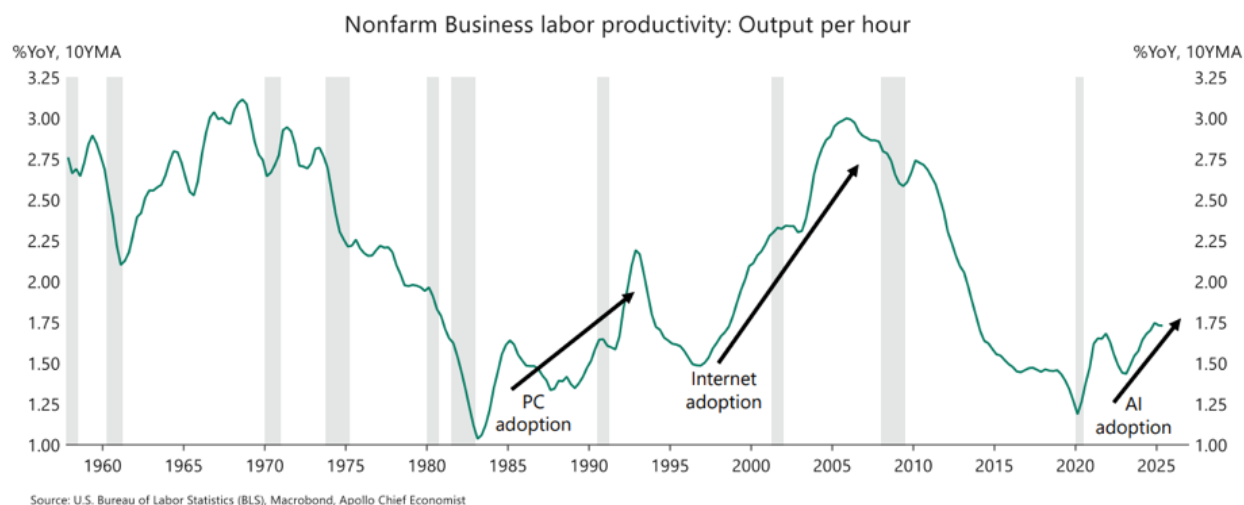
Source: FRED; BLS

Inflation and productivity will shape the policy path.

Warsh's views on monetary policy are more nuanced. Drawing comparisons to former Fed Chair Alan Greenspan in the 1990s, he has argued that productivity gains from artificial intelligence could allow the economy to run hotter without generating inflation. Rather than waiting solely for lagging economic data, he has suggested that broader indicators may signal early productivity improvements.

There are indications that productivity may be improving. However, it remains uncertain whether recent data reflects structural change or the final phase of post-pandemic normalization.

We are likely in the early stages of another productivity boom



Inflation remains above the Federal Reserve's 2% target. CPI has trended lower but remains elevated. Market-based indicators, including breakeven rates on inflation-linked bonds, remain mixed. Over longer time frames they appear contained, though shorter-term moves have been less reassuring.



Higher commodity prices are another consideration. The Financial Times recently highlighted renewed speculative activity in metals markets, and Bloomberg's Simon White has noted how broad-based the rally has become.

The new corner of speculative frenzy: metals

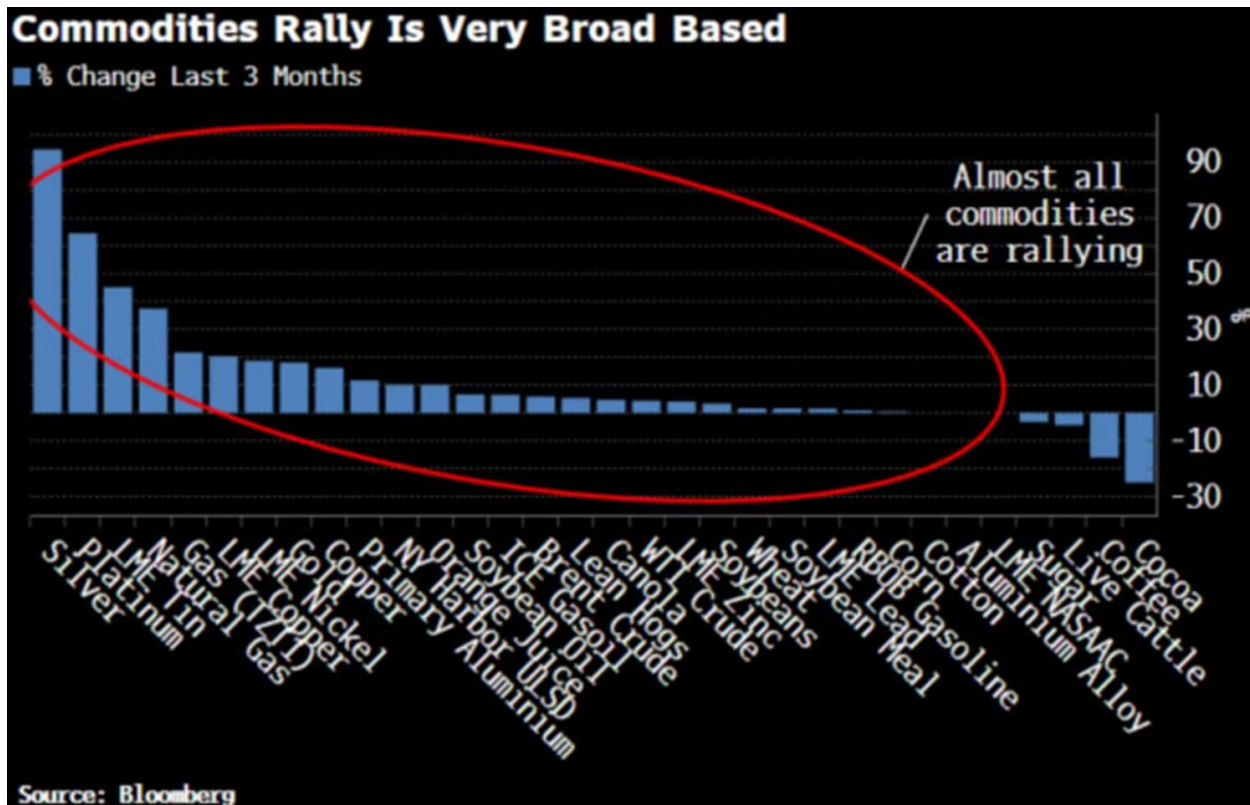
Rebased (100 = Jan 2024)



Graphic: Alan Smith, Hakyung Kim

Sources: Bloomberg; FT research

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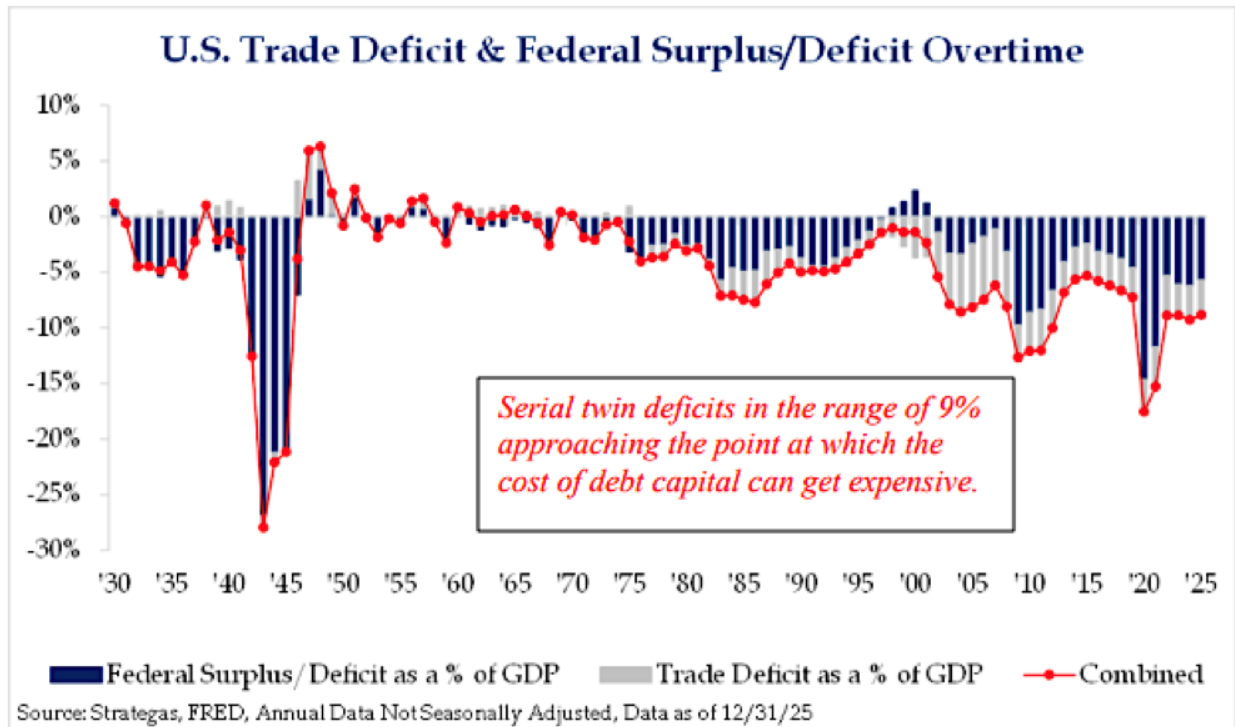
If inflation were to reverse course and begin trending higher again, Kevin Warsh would come under significant pressure to reconcile any perceived commitments to rate cuts with the realities of price stability. President Trump has publicly suggested he would not hesitate to challenge the Fed if rates do not move lower. Whether said in jest or not, comments have reinforced expectations for easing.

Another area where Warsh could diverge from the administration is his view on the size of the Federal Reserve's balance sheet and its past reliance on quantitative easing to manage market volatility. Warsh has argued that an expansive balance sheet helped finance government deficits and contributed to inefficient capital allocation. He has indicated that normalization should occur gradually and in an orderly manner.

Both Warsh and Treasury Secretary Scott Bessent have worked closely with macro investor Stanley Druckenmiller, reflecting their familiarity with capital flows and market dynamics.

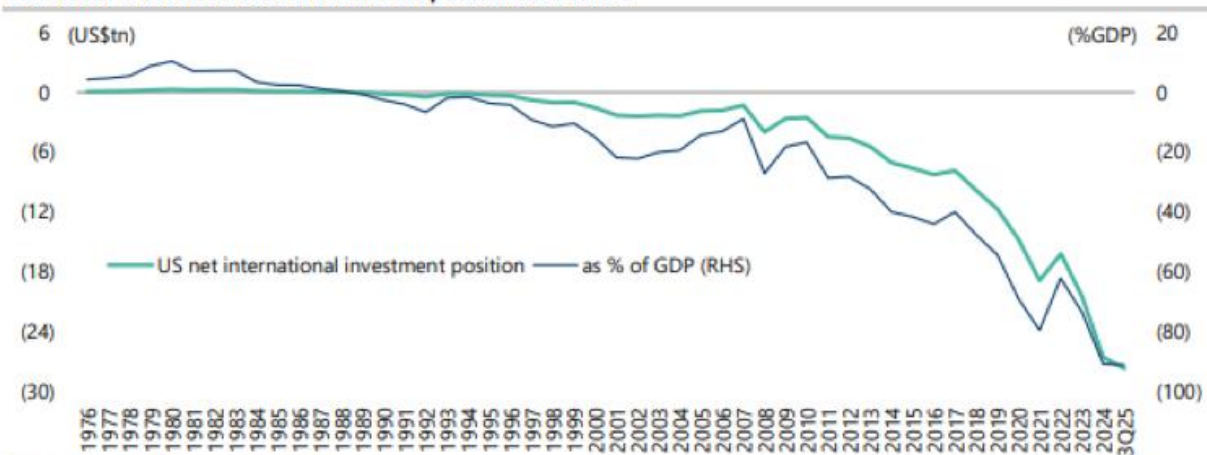
Rising debt levels remain a structural consideration for bond markets.

Strategas highlights U.S. federal debt outstanding of approximately \$38 trillion, with combined trade and budget deficits near 9% of GDP. This represents a significant and ongoing demand for capital that policymakers will need to manage in an orderly manner.



As noted by Jefferies Fear & Greed, it is not only the Federal Reserve and its balance sheet financing U.S. government spending. The U.S. remains highly dependent on foreign capital. At the end of Q3 2025, the gap between U.S. residents' foreign financial assets and foreigners' holdings of U.S. assets reached a record \$27 trillion, or 90.9% of GDP. Holdings of U.S. Treasuries have been steady, with most of the growth concentrated in foreign holdings of equities.

Exhibit 5: US net international investment position as % of GDP

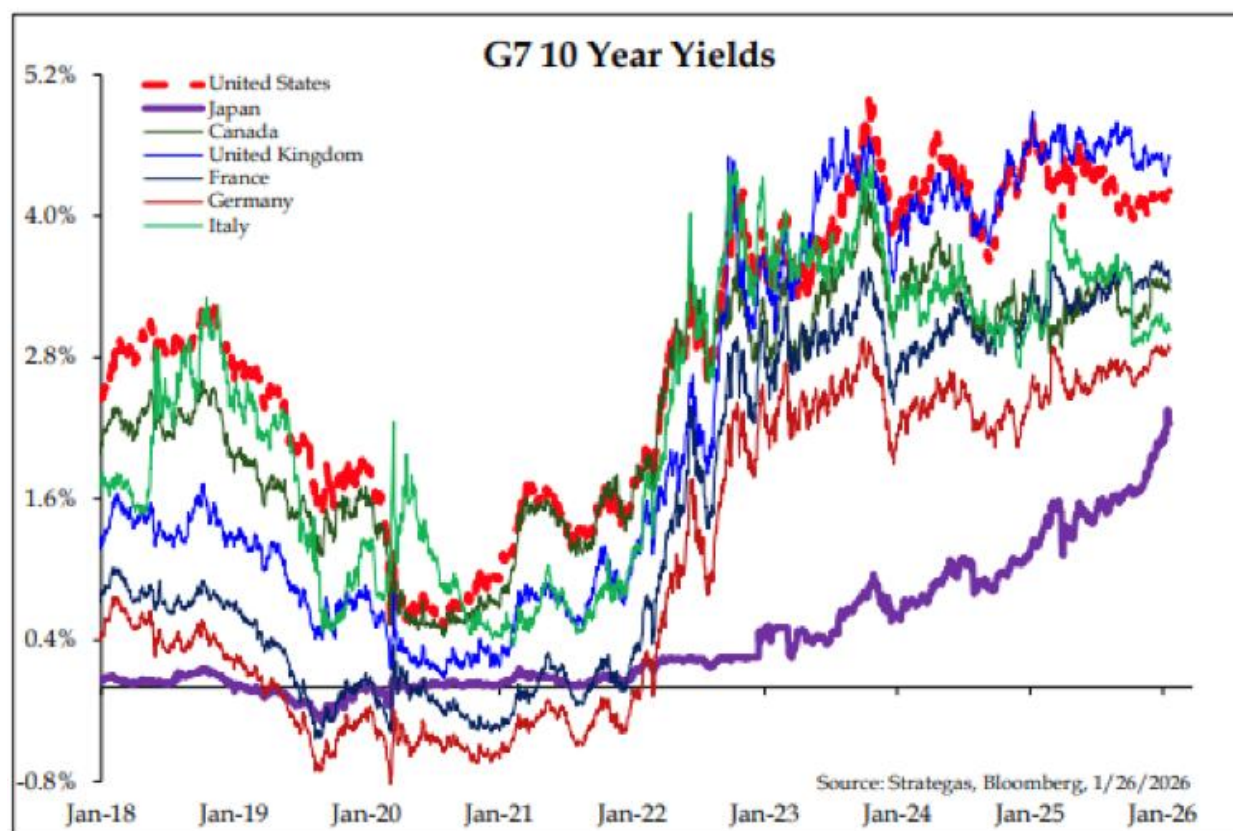


Source: Bureau of Economic Analysis

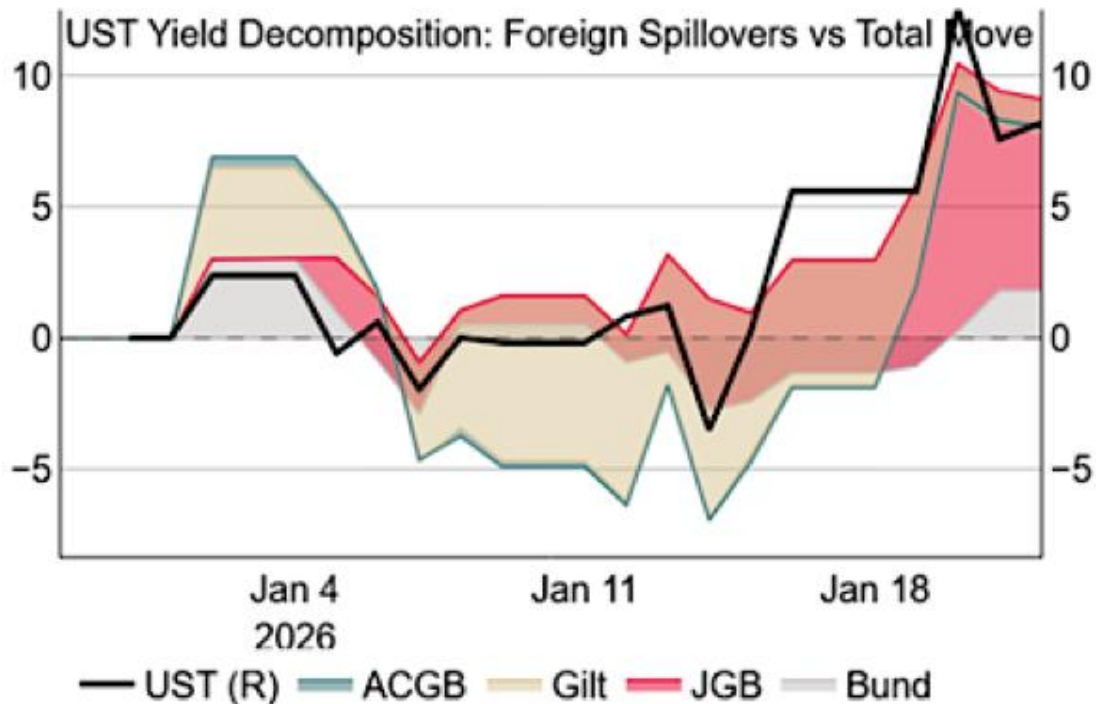
Higher deficits may influence bond markets, though stress remains limited.

Elevated debt levels and the growing burden of financing them could eventually weigh on the U.S. Treasury market, particularly as deficits are rising globally. Bond yields across developed markets have moved higher in response.

Bloomberg notes that long-term [U.S. yields have risen](#) even as the Fed has begun easing policy. Strategas charts show 10-year yields across G7 economies trending higher since 2022, with Japanese yields narrowing the gap with global peers. Bernstein suggests that much of the recent rise in U.S. yields may be attributable to higher Japanese rates rather than purely domestic pressures.

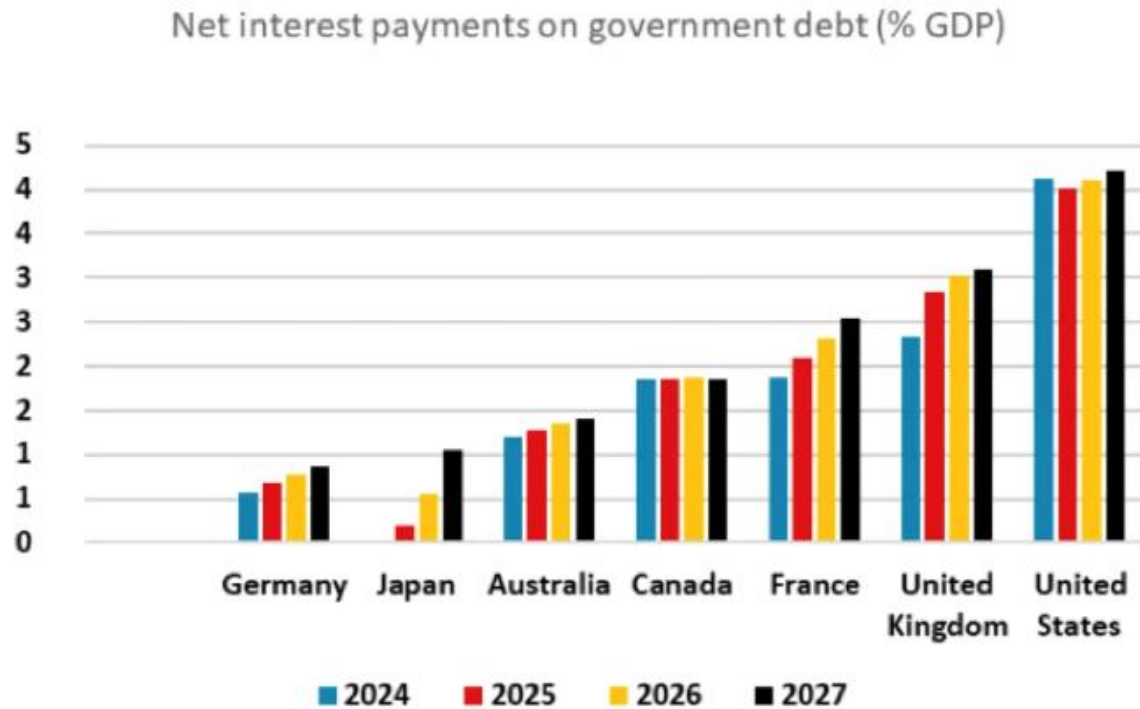


Graph 6. Japan explains most of the recent rise in Treasury yields (Cumulative yield change this year)



Source: SG Cross Asset Research/Rates, Bloomberg

Continuum Economics points out that the U.S. currently has the largest budget deficit among major developed economies and the highest net interest payments relative to government debt. Despite this, bond market volatility remains subdued and credit spreads remain near historically tight levels. For now, markets appear orderly.



Source: Continuum Economics

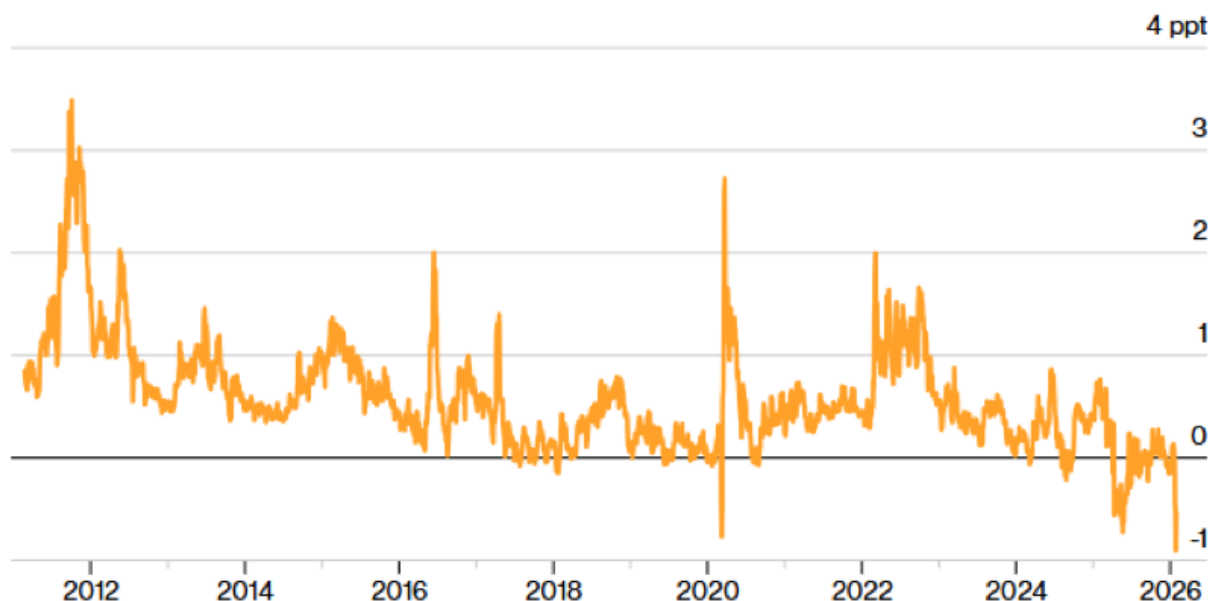
The U.S. dollar's decline raises questions but not structural alarms.

While bond markets remain stable, the U.S. dollar weakened meaningfully in January. Bloomberg reports that the dollar fell to a four-year low, even as U.S. yields remained broadly aligned with those in the U.K. and Europe.

Federated Hermes' John Sidawi argues that the [resilience of U.S. stocks and Treasuries](#) suggests the dollar's decline likely reflected hedging activity rather than a broad "sell America" trade. Bloomberg also notes that demand for short-dated options positioned for further dollar weakness has reached record levels.

Traders Are Most Bearish the Dollar on Record

One-month risk reversals on Bloomberg Dollar Spot Index



Source: Bloomberg

Reserve currency dynamics remain intact despite diversification.

Some [mean reversion](#) in the dollar would be consistent with the Trump administration's preference for stronger exports and easier financial conditions. A weaker currency can support growth. The greater risk would be sustained depreciation driven by concerns about long-term purchasing power.

The U.S. dollar remains the world's primary reserve currency, and no immediate alternative appears viable. If reserve status were to erode, it would likely occur gradually through shifting central bank allocations rather than abruptly.

Noteworthy is the recent strength in the Chinese yuan. As the world's second-largest economy, China is sometimes viewed as a potential reserve currency competitor. However, because China manages its exchange rate and restricts capital flows, the yuan is not a viable alternative to the U.S. dollar at this stage.

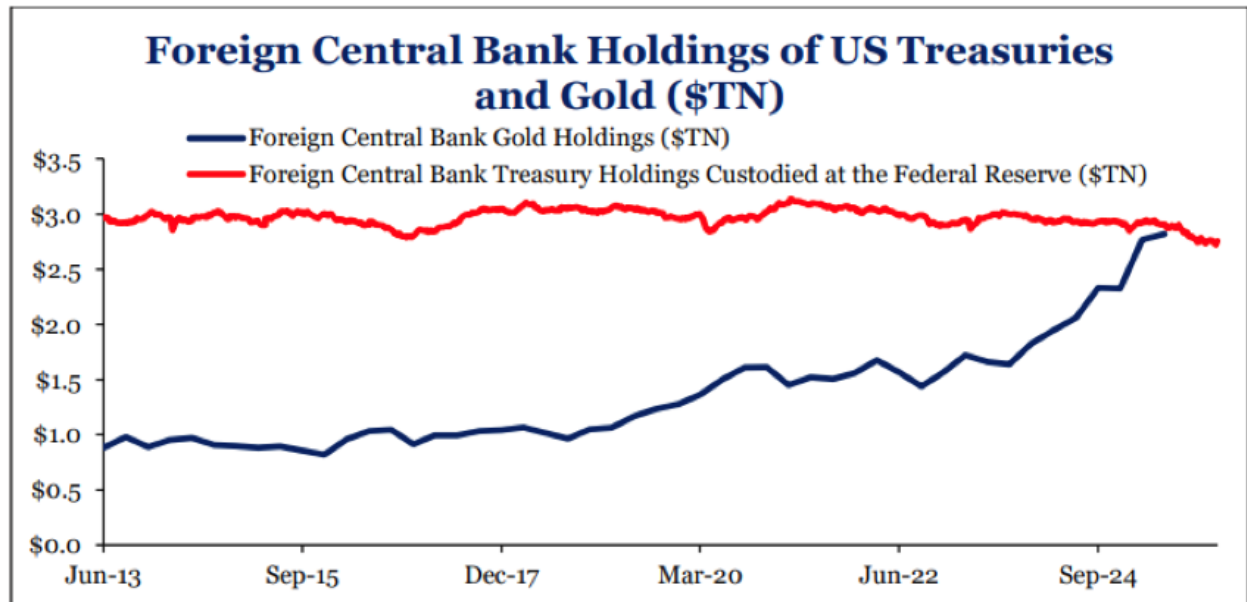
That said, China has made clear its desire to reduce reliance on the dollar, a position shared by several countries facing U.S. tariffs and sanctions. The yuan is now used in over 8% of global trade finance, and more than 50% of China's cross-border transactions are settled in its domestic currency.

Chinese currency's share of global trade finance



Source: Swift via Wind

Central banks have also increased allocations to gold as part of broader diversification efforts. Strategas notes that the decline in foreign central bank holdings of U.S. Treasuries corresponds with the rally in gold prices since early April. According to Strategas, foreign central banks now hold nearly as much gold as U.S. Treasuries.

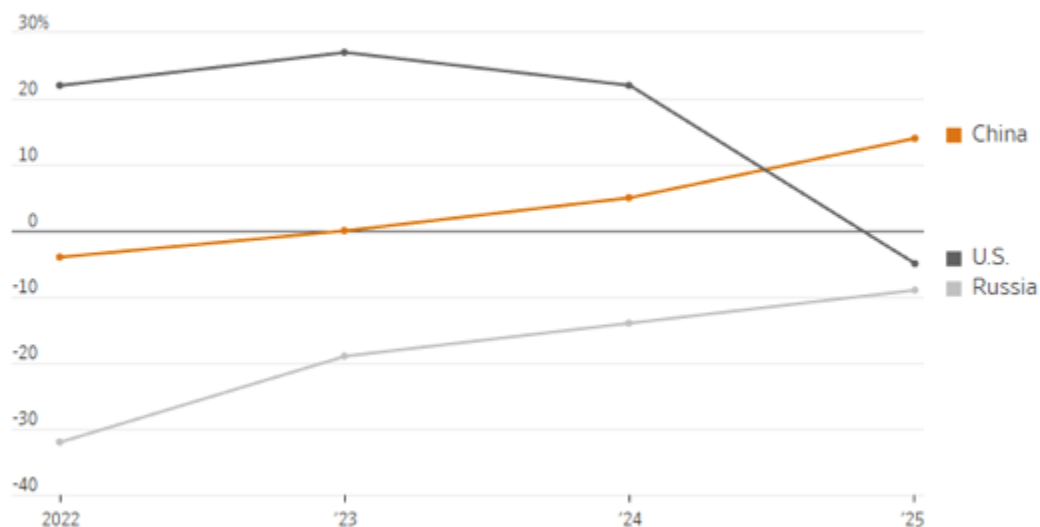


Political dynamics are influencing confidence and global perception.

President Trump's negotiating style has shaped global perceptions. A recent study by a Danish think tank found that China is viewed more positively than the U.S. in certain regions. Domestic surveys also reflect declining confidence in U.S. global influence.

A study on global public opinion published by a Denmark-based think tank shows China being viewed more positively than the U.S.

Net perception scores for global powers



Note: Scores reflect the percentage of respondents with positive perceptions of a global power minus the percentage with negative views

Source: Alliance of Democracies Democracy Perception Index

Figure 3. Most Americans believe the U.S. is becoming less powerful

How much, if at all, do you agree or disagree with the following statement: The United States is becoming less powerful in the world.

Strongly agree Somewhat agree Neither agree nor disagree
Somewhat disagree Strongly disagree



Source: Views on Global Power and Influence Survey, November 2025.

N=1,500

Note: Individual percentages will not necessarily add up to 100 given rounding.

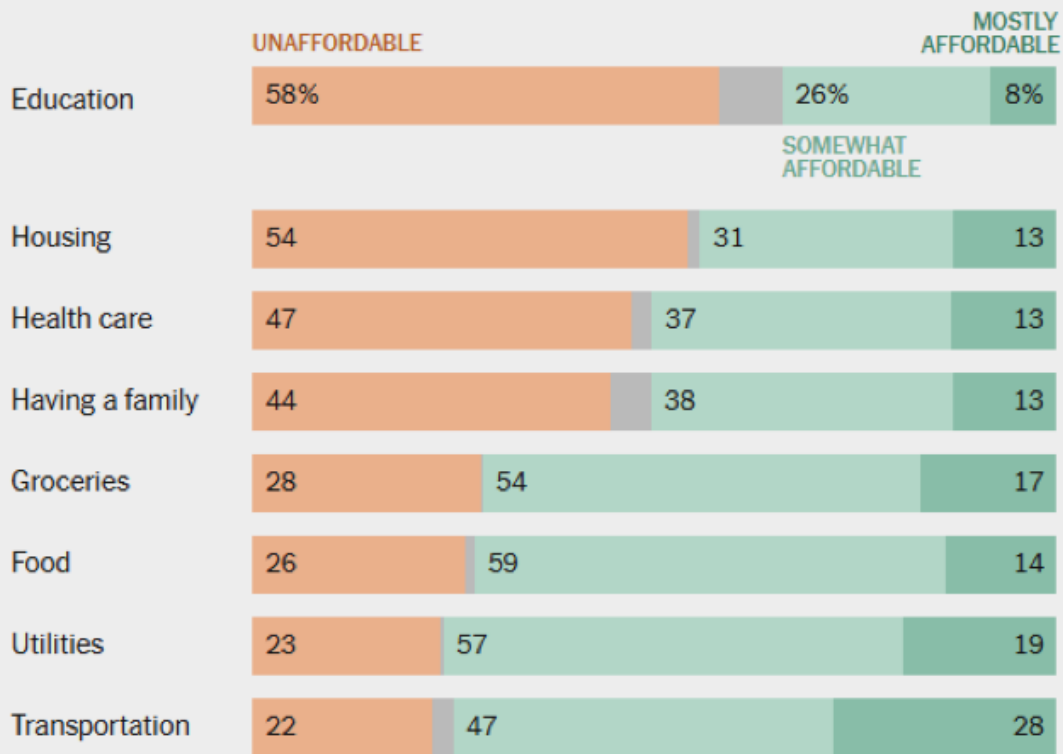


The Conference Board reports U.S. consumer [confidence at its lowest level](#) since 2014. University of Michigan data suggests Americans are [bracing for higher unemployment](#), while a New York Times/Siena poll highlights affordability pressures across housing, education and health care.

THE NEW YORK TIMES/SIENA POLL

Jan. 12-17

Voters' feelings about the affordability of the following items



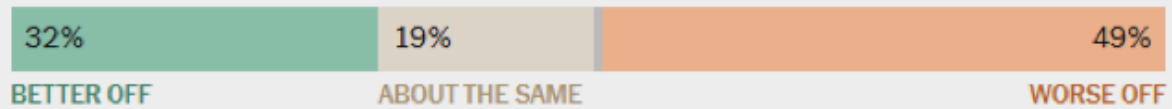
Based on a New York Times/Siena poll of 1,625 registered voters nationwide conducted Jan. 12 to 17. The gray segment is for voters who did not respond or said they didn't know. Question wording and response categories have been condensed. Martín González Gómez/The New York Times

Many respondents attribute these economic anxieties to President Trump. The same New York Times/Siena poll found that nearly half of respondents believe the country was better off a year ago. A recent [Fox News poll](#) shows Republicans are preferred on border security, national security and immigration, while Democrats are favoured on affordability, support for the middle class and health care.

THE NEW YORK TIMES/SIENA POLL
Jan. 12-17

Do you think the country is generally **better off** than it was a year ago, **about the same** or **worse off**?

All respondents



Democrats



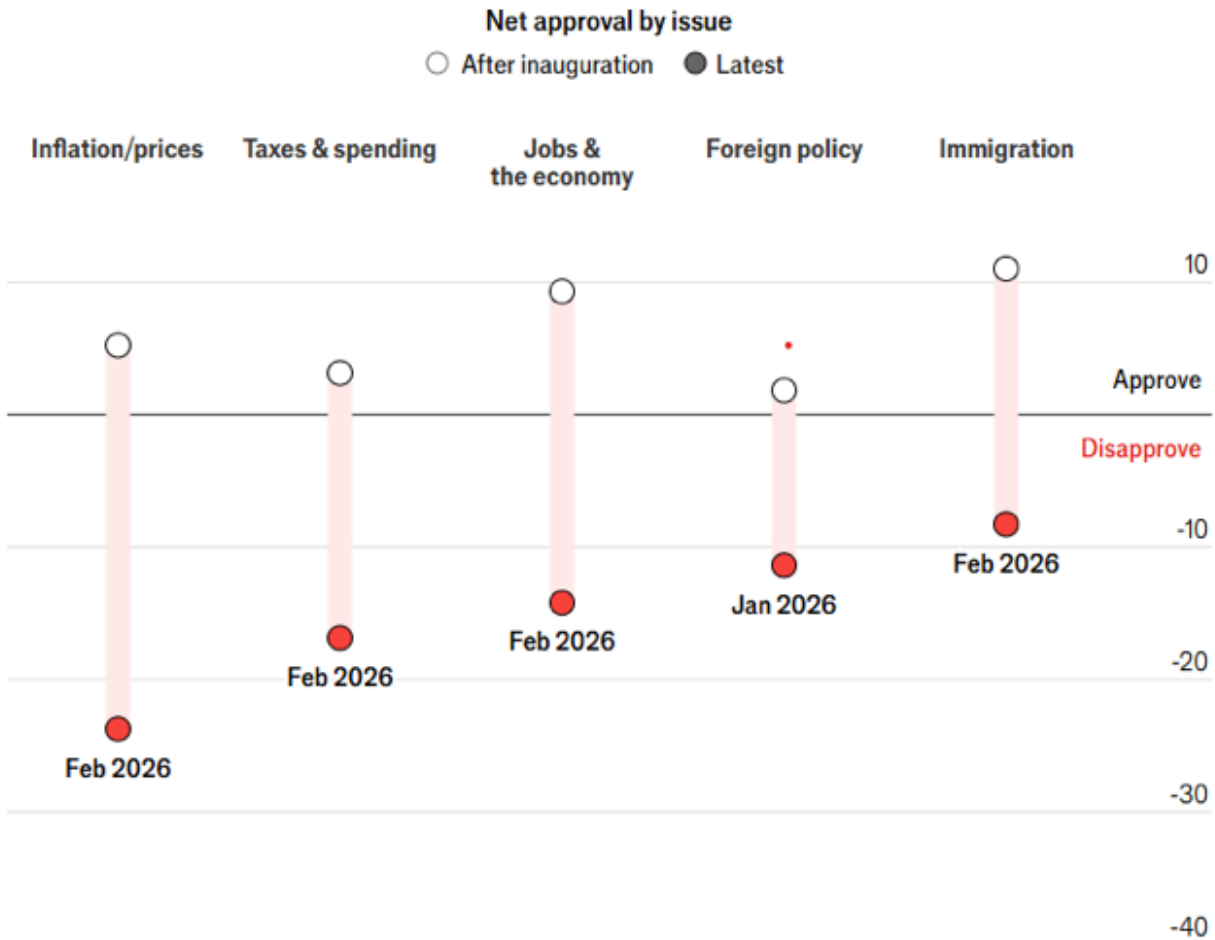
Independents



Republicans



According to The Economist, President Trump's net approval rating fell to -19% in January, with inflation and prices, particularly affordability, driving the largest decline since inauguration day.



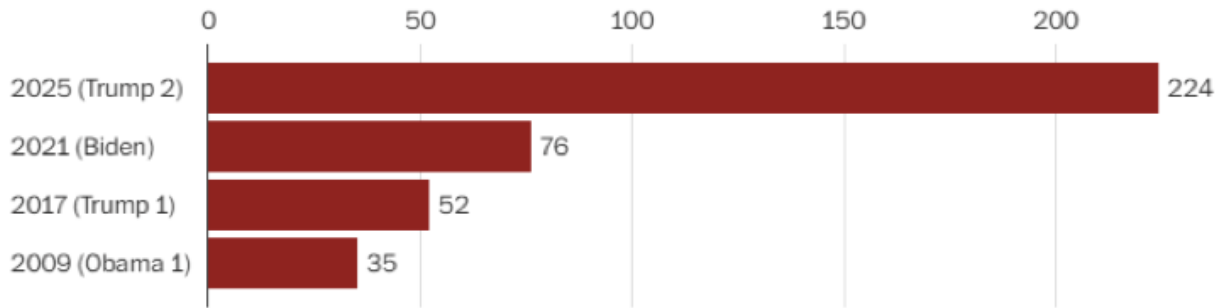
Source: The Economist

Political dynamics may influence legislative momentum.

These dynamics present challenges for President Trump and the Republicans heading into the November mid-term elections. Many expect Republicans to retain control of the Senate, while Democrats may regain the House. If control of the House shifts, legislative progress could slow during the final two years of the presidency.

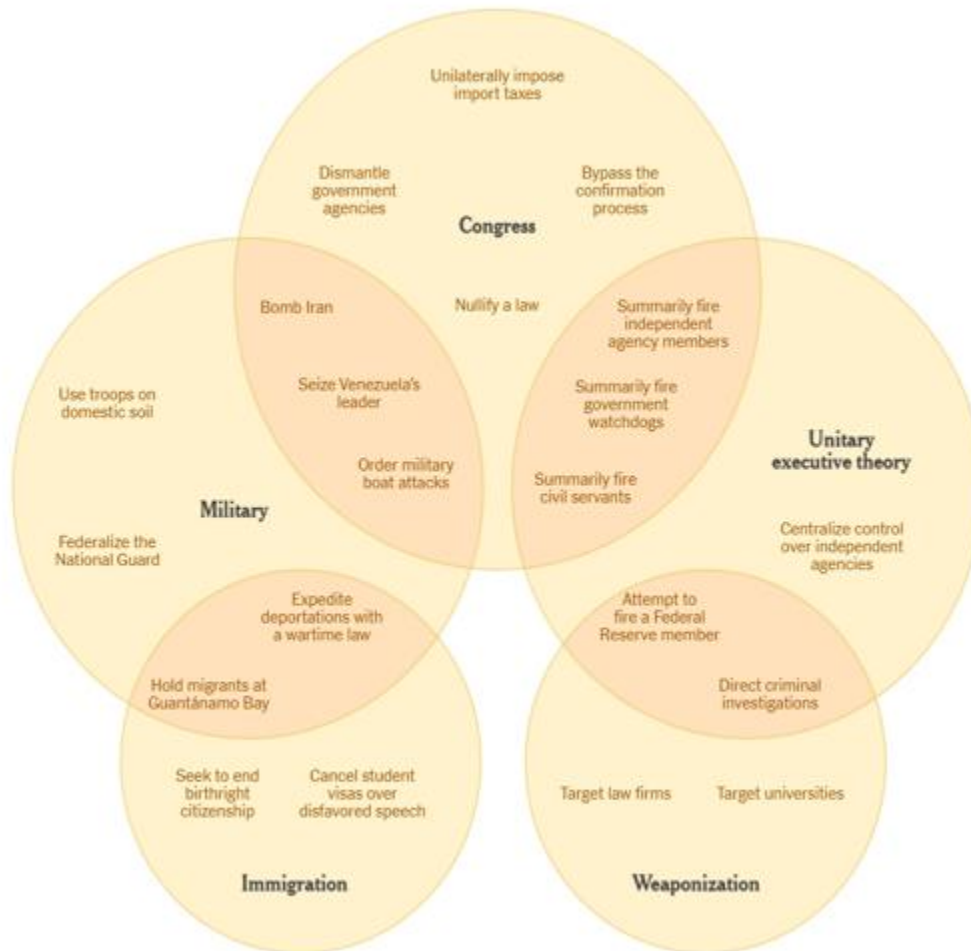
At the same time, the balance of power between Congress and the White House has evolved. Congress set a modern record for the lowest legislative output in the first year of a presidency in 2025, while President Trump issued more executive orders in 11 months than during his entire first term. A recent New York Times article notes that the [administration is seeking to expand](#) executive authority into areas not traditionally viewed as within presidential scope.

Presidential executive orders now replace congressional laws



Source: U.S. Chamber of Commerce, as of Dec. 22 each year

PAUL KANE / THE WASHINGTON POST



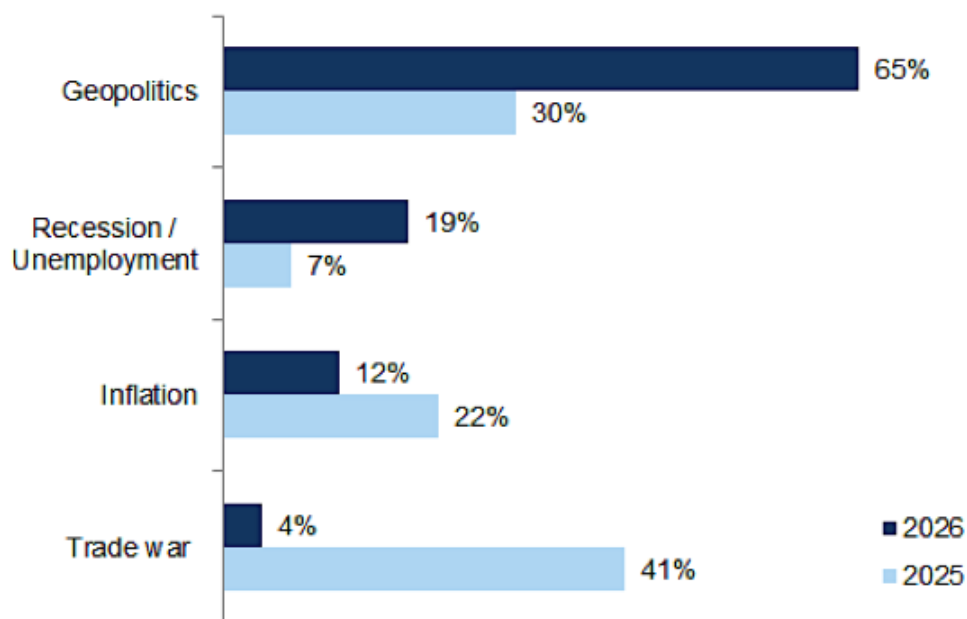
Source: The Financial Times

Geopolitical risk remains elevated but corrections are not unusual.

Foreign policy developments across Venezuela, Iran, Gaza, Ukraine and Greenland underscore the breadth of engagement since January 20, 2025. A survey conducted by Goldman Sachs at its January Strategy Conference identified geopolitics as the leading perceived risk to the global economy and markets in 2026. Morgan Stanley notes that similar levels of geopolitical risk have historically coincided with equity corrections of 10% or more.

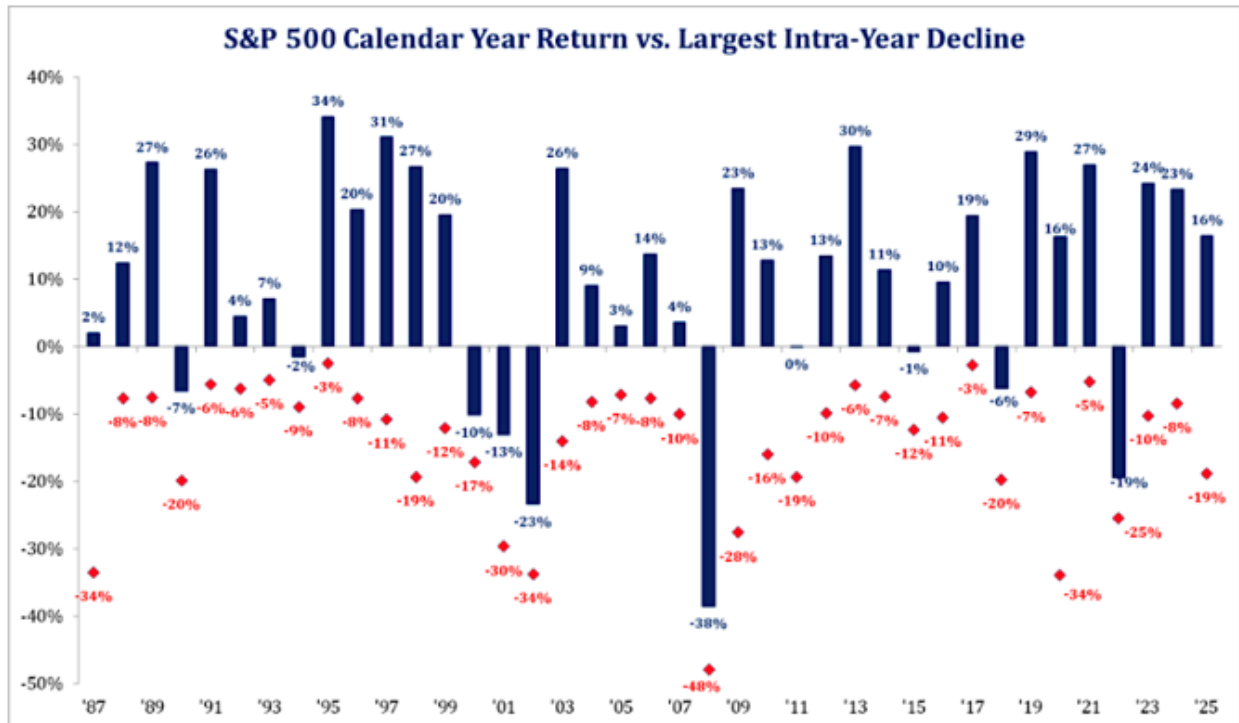
Exhibit 9: What is the biggest risk for the global economy and markets in 2026?

Based on respondents at our GS Global Strategy conference, London January 2025 and 2026



Source: Goldman Sachs Global Investment Research

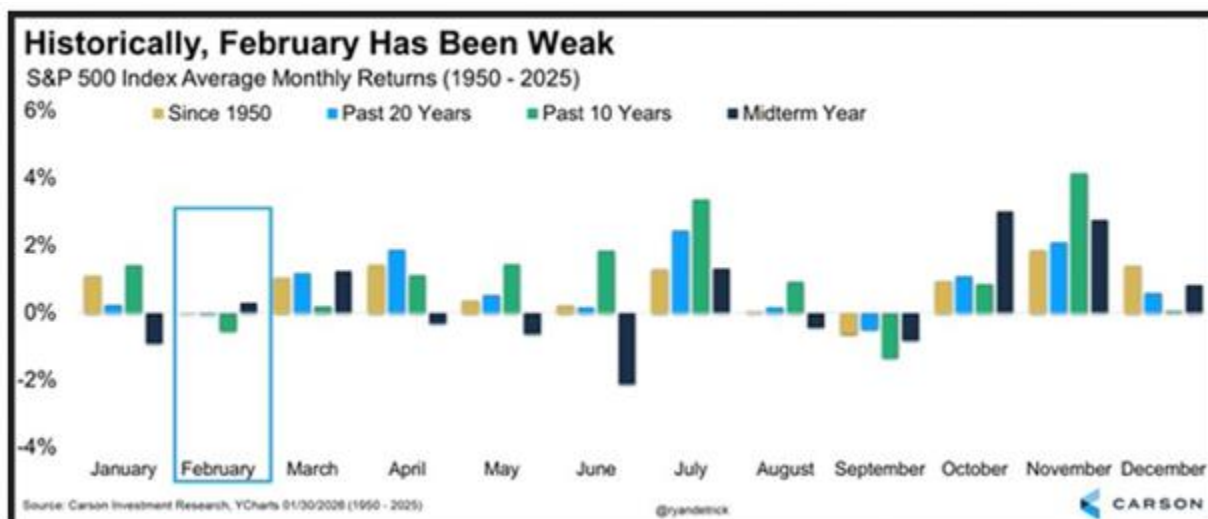
Don't get too alarmed, however, as pointed out by Strategas, large intra-year declines are actually quite common, averaging about -14% since the late 1980's.



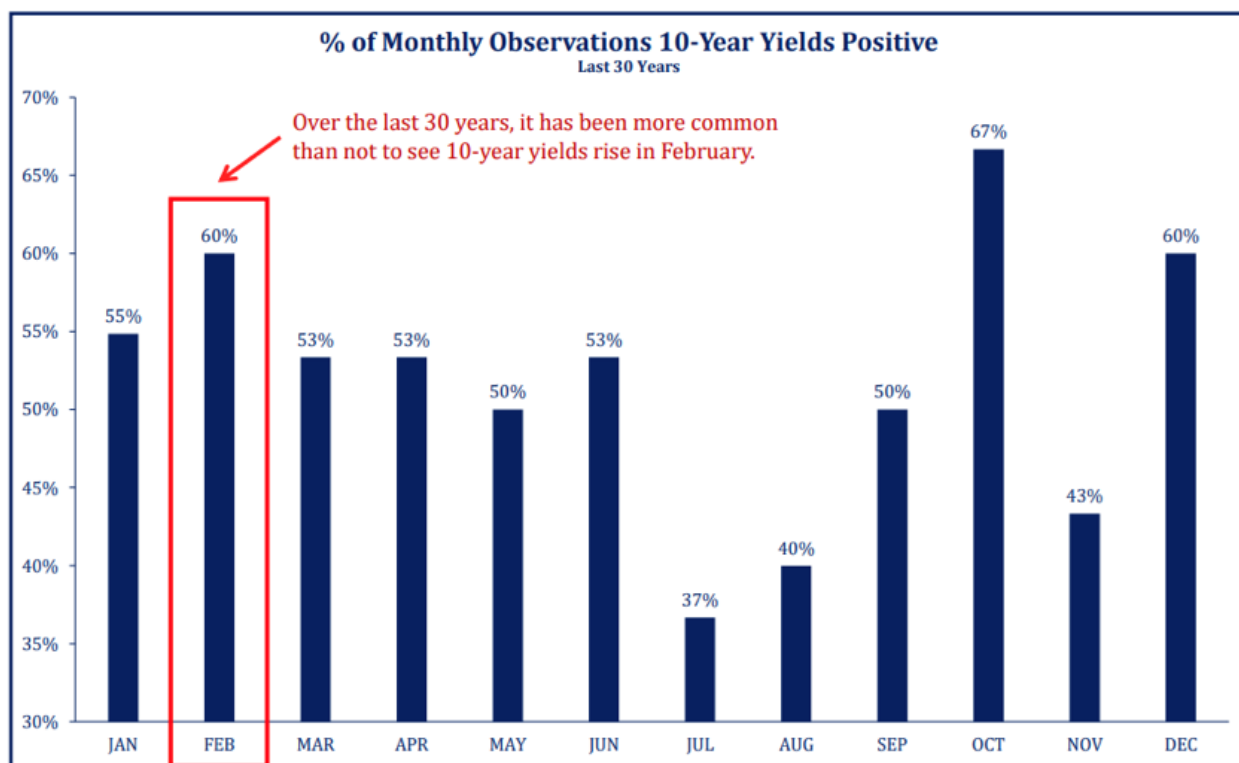
Source: Strategas

Timing a correction is difficult, particularly when driven by geopolitical shocks. As illustrated in Goldman Sachs research, equities have often recovered, sometimes meaningfully, once policies shift or uncertainty eases.

Seasonal patterns also warrant attention. Within the four-year presidential cycle, the [second quarter](#) has historically been weaker for equities. Carson Investment Research highlights that February is one of only two months since 1950 to average negative returns, along with September. February has also tended to be challenging for bond investors over the past three decades, with 10-year yields rising roughly 60% of the time.



DECENT SEASONALITY FOR YIELDS RIGHT NOW AS WELL

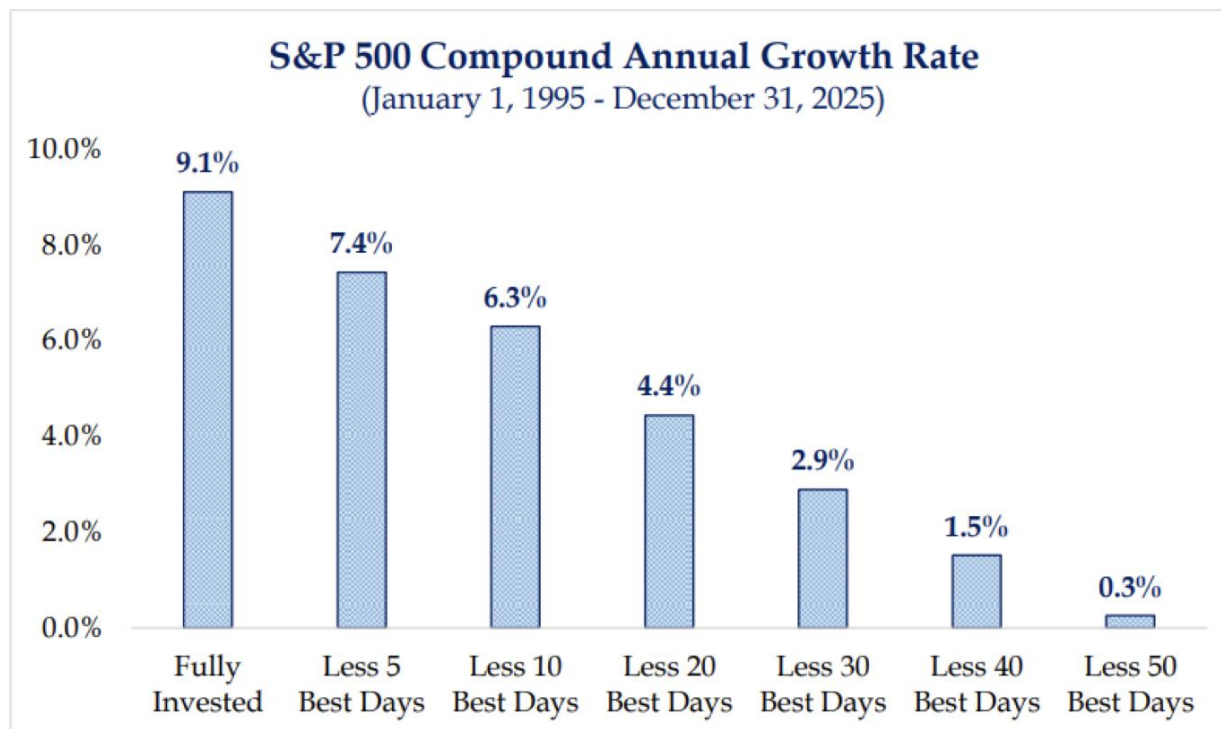


These patterns do not determine outcomes, but they reinforce that periods of volatility are not unusual.

Near-term stability coexists with longer-term structural questions.

In the near term, accommodative fiscal and monetary policy, deregulation and continued AI-related capital spending reduce the likelihood of an immediate recession. A softer labour market and declining consumer sentiment warrant monitoring, but any correction would more likely stem from inflation and interest rate concerns than from economic contraction.

Market corrections are a normal feature of investing. As Strategas notes, timing them is difficult, and missing even a small number of the strongest recovery days over long periods can materially affect outcomes.



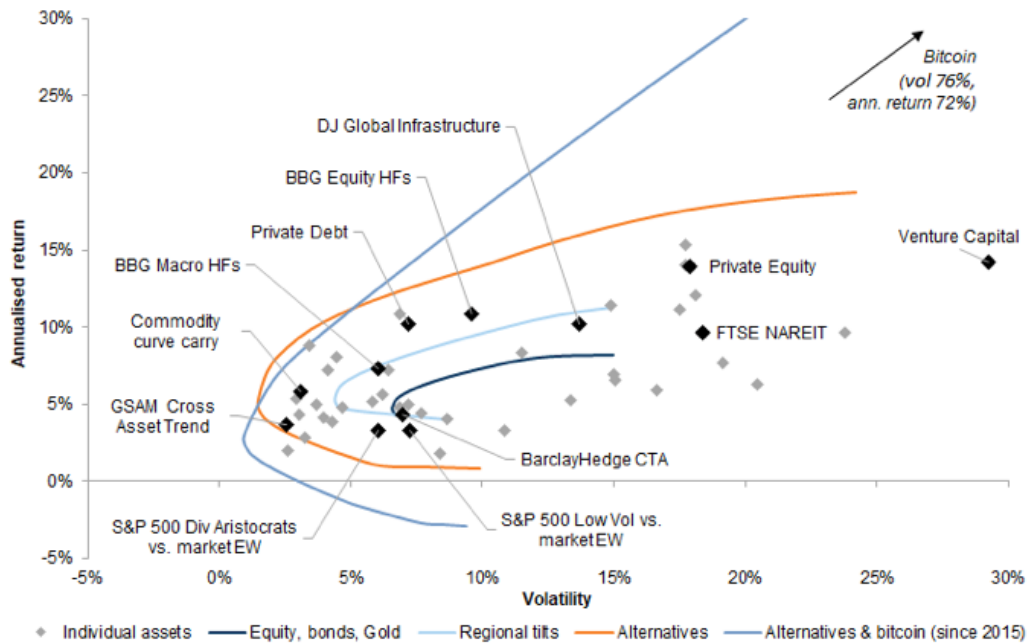
Source: Strategas

Stronger growth may continue to broaden participation beyond the Magnificent 7. Over the longer term, however, markets may be approaching more structural shifts in both the geopolitical and financial landscape. If AI delivers sustained productivity gains, the economy may be able to grow without reigniting inflation. If not, continued expansion of global government debt could eventually place upward pressure on inflation and yield curves, weighing on both equity and bond valuations.

In a higher-volatility environment, disciplined portfolio construction becomes increasingly important. A well-diversified strategic asset mix remains central to navigating market cycles. Morgan Stanley research illustrates how international exposure and alternative assets such as private investments and real estate can enhance efficient frontiers.

Exhibit 42: Smaller assets and alternatives would have enhanced the investment opportunity set and shifted the efficient frontier up

Data since 1990 (assets are added when data becomes available)



Source: Bloomberg, Datastream, Preqin, Goldman Sachs Global Investment Research

Recent performance has been concentrated in large-cap U.S. equities, but leadership evolves. Strategas highlights two prior “lost decades,” the 1930s and the 2000s, when U.S. equities delivered muted returns. Even during the 1930s, dividends contributed to positive total returns. Since 1930, dividends have accounted for roughly 60% of total equity returns.

Change does not have to be disruptive for prepared investors.

Dividend Contribution to Total Return					
Decade	Price Pct. Change	Dividend Contribution	Total Return	Dividends Pct of TR	Avg Payout Ratio
1930s	-41.9%	56.0%	14.1%	100.0	90.1
1940s	34.5%	100.1%	134.6%	74.4	59.4
1950s	257.3%	180.3%	437.7%	41.2	54.6
1960s	53.7%	54.2%	107.9%	50.2	56.0
1970s	17.2%	59.1%	76.4%	77.4	45.5
1980s	227.4%	143.1%	370.5%	38.6	48.6
1990s	315.7%	115.7%	431.5%	26.8	47.6
2000s	-24.1%	15.0%	-9.1%	100.0	35.3
2010s	189.7%	66.9%	256.7%	26.1	35.2
2020s	111.9%	20.4%	132.2%	15.4	34.4
Average	114.4%	87.8%	202.2%	59.4	52.5

Source: Strategas, FactSet, Data as of 12/31/25

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