

# City of Derby, CT Pension Plan Update

1/27/2026

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**John O'Connor**

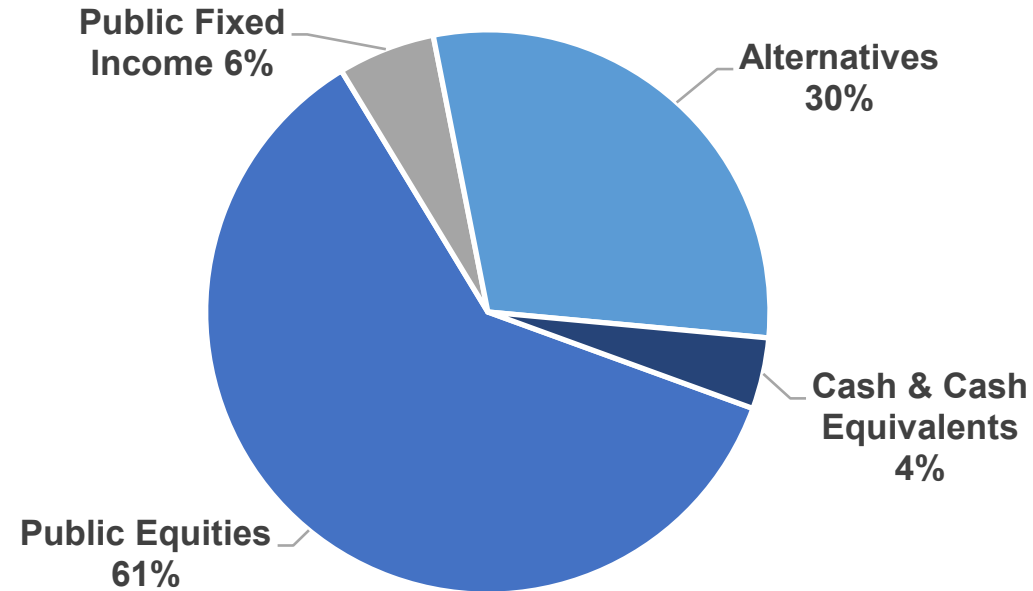
President

**Benjamin M. Lavine, CFA, CAIA, RICP**

Chief Investment Strategist

Freedom Investment Management, Inc.

## Derby Pension Plan Allocation



Total Assets: \$21.870 million

*\* Public Equities, Fixed Income, and Cash as of 12/31/2025. Alternatives as of 9/30/2025. Does not include cash held by TPA for benefit payments.*

- Publicly-traded securities (stocks, bonds, mutual funds, ETFs, cash reserves) custodied at Schwab totaling **\$15.40 mm** as of 12/31/2025
  - US Large Cap Value diversified portfolio: \$3.79 mm
  - US Large Cap Growth diversified portfolio: \$2.02 mm
  - US Small Cap Value diversified portfolio: \$0.47 mm
  - US Small Cap Growth diversified portfolio: \$0.50 mm
  - Global Equities diversified portfolio: \$6.51 mm
  - US Fixed Income diversified portfolio: \$1.22 mm
  - Money Market / Cash Reserves (Aggregate): \$0.89 mm

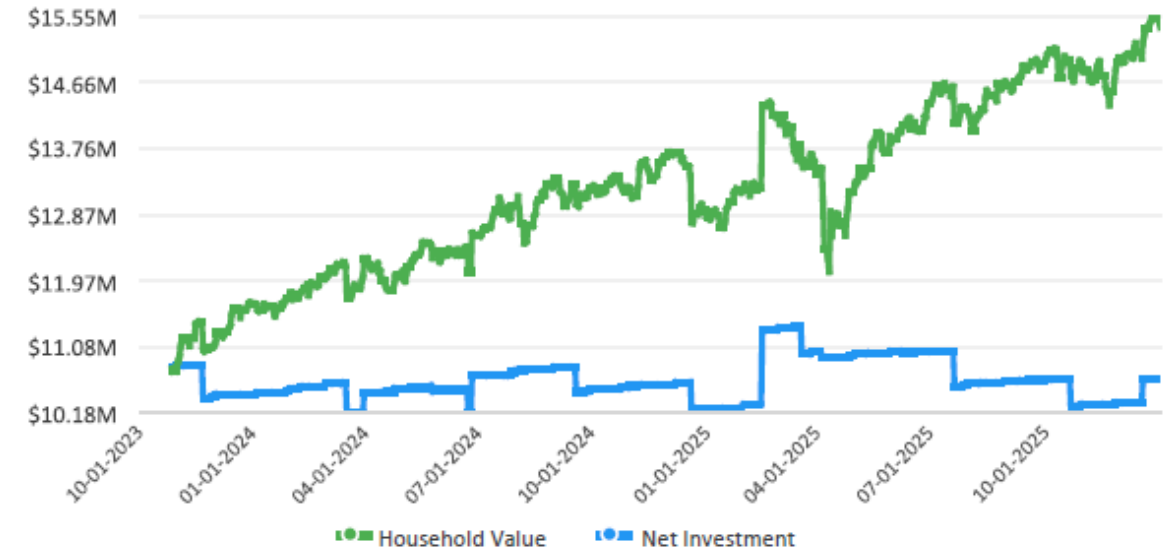
# Plan Performance: Public Securities



	Month To Date	Since Inception (AN)
Start Value	\$14,995,192.88	\$0.00
Contributions	\$320,994.48	\$13,873,927.54
Capital Appreciation	\$21,092.35	\$4,171,114.43
Dividend/Income	\$70,055.97	\$709,251.00
Withdrawals	\$0.00	(\$3,231,297.60)
End Value	\$15,401,868.61	\$15,401,868.61
Investment Gain (Loss)	\$85,681.26	\$4,759,238.67
Time Weighted Rate of Return (TWRR)	0.55%	18.53%

October 26, 2023 - December 31, 2025

Average Annual TWRR: 18.53%



Performance information on household and account levels is shown net of all fees and expenses, including your Firm's management fee, and performance information on individual position and portfolio levels is shown gross of fees. All performance numbers are annualized unless the period under consideration is less than a year. Past performance is no guarantee of future results. 'Since Inception' returns represent performance beginning from the earliest available performance record within the reporting engine. The earliest record is indicated by the start date above.

Asset	Allocation	Asset Value
Domestic Equities	69.93%	\$10,769,973.49
International Equities	16.35%	\$2,518,664.15
Domestic Fixed Income	6.32%	\$973,750.33
Municipal Fixed Income	1.59%	\$245,643.20
Cash	5.80%	\$893,837.45
<b>Total</b>	<b>100.00%</b>	<b>\$15,401,868.61</b>

Source: Freedom Advisors Household Performance Review as of 9/30/2025

# Plan Performance: Public Securities\*



Portfolio	Inception	Return Quarter To Date	Return Since Inception (AN)	Weight	Value
3D Fixed Income ETF Portfolio   Pension Trust   23563539	05/01/2024	0.83%	7.36%	7.96%	\$1,226,081.62
3D Global 100 Portfolio   Pension Trust   23563539	05/01/2024	3.53%	18.77%	42.47%	\$6,541,235.28
EQIS Large Cap Growth ETF   Pension Trust   23563539	05/01/2024	1.90%	28.25%	13.14%	\$2,023,743.57
EQIS Large Cap Value ETF   Pension Trust   23563539	05/01/2024	3.38%	13.71%	24.72%	\$3,807,624.21
EQIS Small Cap Growth ETF   Pension Trust   23563539	05/01/2024	0.40%	11.29%	3.26%	\$502,074.99
EQIS Small Cap Value ETF   Pension Trust   23563539	05/01/2024	3.21%	12.77%	3.10%	\$476,984.04
Unaffiliated Cash   Pension Trust   23563539	04/23/2024	N/A	N/A	0.00%	\$10.38
Schwab U.S. Treasury Money Fund ULTRA   Pension Trust   54526672	03/12/2025	1.20%	3.58%	5.33%	\$820,325.87
Unaffiliated Cash   Pension Trust   54526672	05/01/2024	N/A	N/A	0.02%	\$3,788.66
<b>Total</b>				<b>100.00%</b>	<b>\$15,401,868.61</b>

\* Performance information on the portfolio level contained within this Household Portfolio Breakdown is gross of fees. All household or account level performance within this document is net of fees. For fee information please visit the Household Fee Summary page of this report.

Returns displayed are presented using gross Time Weighted Rate of Return (TWRR)

\*Performance as of 12/31/2025. Note: there was a custodial switch from Fidelity to Schwab on 4/23/2024 that resulted in a break in portfolio-level performance tracking. We show portfolio level performance with an inception date of 5/1/2024 as a result of the custodial change.

# Overview of Plan Assets: Alternatives

- Alternative Investments consisting of private market strategies and non-traditional (multi-strategy hedge funds) totaling **\$6.87 mm** as of 9/30/2025 or as noted.
    - Arsenal III: \$1.03 mm (9/30)
    - Arsenal Growth Equity IV: \$0.59 mm (9/30)
    - Arsenal-Cart: \$0.27 mm (9/30)
    - Arsenal-Elevate: \$0.17 mm (9/30)
    - Arsenal-Sayari: \$0.27 mm (9/30)

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    - Boyd-Watterson GSA: \$1.35 mm (9/30)
    - Boyd-Watterson State Govt: \$0.36 mm (9/30)

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    - EnTrust Structured Income II: \$0.40 mm (9/30)
    - GoldenTree Distressed Fund: \$0.11 mm (9/30)
    - Golub Capital Partners International 12: \$0.64 mm (9/30)

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    - Greywolf Containership Opps Offshore Fund: \$0.43 mm (9/30)

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    - Verition International Multi-Strategy Fund: \$1.25 mm (9/30)
- } Venture Capital
- } Real Estate (Gov't Leasing)
- } Private Credit (CLO  
Equity, Distressed,  
Middle Market Lending)
- } Infrastructure (Shipping)
- } Multi-Strategy Trading

- Funds with Open-Ended Redemptions:
  - Boyd-Watterson GSA: \$250,000 increments with 60 days notice prior to quarter-end
  - Boyd-Watterson State Govt: \$250,000 increments with 60 days notice prior to quarter-end
  - EnTrust Structured Income II: Quarterly with 95 days notice
  - Verition International Multi-Strategy: Monthly subject to 8.33% gate with 45 days notice
  
- Funds with Hard Close Until Dissolution (Inception Dates):
  - Arsenal Growth Funds (Feb-2020, Feb-2023, Feb-2022, Sept-2022, Feb-2022)
  - Greywolf Containership Opps Offshore (July-2019)
  - GoldenTree Distressed (June-2015, extended July-2019)
  - Golub Capital Partners International 12 (July-2019)

# Overview of Plan Assets: Alt Summary



Firm	Strategies	Inception Date	Committed Capital	Capital Drawn	Market Value	As of Date
Arsenal	Arsenal III	Feb-20	\$ 500,000	\$ 461,351	\$ 1,028,408	9/30/2025
	Arsenal Growth Equity IV	Feb-23	\$ 750,000	\$ 554,799	\$ 594,369	9/30/2025
	Arsenal-Cart Investors II	Feb-22	\$ 100,000	\$ 100,000	\$ 272,782	9/30/2025
	Arsenal-Elevate Investors I	Sep-22	\$ 165,000	\$ 165,000	\$ 169,251	9/30/2025
	Arsenal-Sayari Investors I	Feb-22	\$ 100,000	\$ 100,000	\$ 269,892	9/30/2025
Boyd-Watterson	Boyd-Watterson GSA Fund, LP	Jun-15	\$ 2,000,000	\$ 2,000,000	\$ 1,345,548	9/30/2025
	Boyd-Watterson State Govt Fund, LP	Feb-18	\$ 375,000	\$ 375,000	\$ 357,282	9/30/2025
Verition Capital Management	Verition International Multi-Strategy Fund, Ltd	Dec-17	\$ 300,000	\$ 300,000	\$ 1,251,785	9/30/2025
Greywolf Capital Management	Greywolf Containership Opps Offshore Fund, LP	Jul-19	\$ 500,000	\$ 500,000	\$ 425,581	9/30/2025
EnTrust Global Partners	EnTrust Structured Income II	Jul-17	\$ 500,000	\$ 500,000	\$ 404,903	9/30/2025
GoldenTree Asset Management	GoldenTree Distressed Fund, LP	Jun-15	\$ 500,000	\$ 357,500	\$ 112,047	9/30/2025
Golub Capital	Golub Capital Partners International 12, LP	Jul-19	\$ 700,000	\$ 630,000	\$ 641,180	9/30/2025
Alternatives Total					\$ 6,873,028	

# Plan Performance: Alternatives

Firm	Strategies	Inception Date	Market Value	Weight	3Q2025 Net Return	Since Inception Net Return**	SI Net Return Source
Arsenal	Arsenal III	Feb-20	\$ 1,028,408	15.90%	-3.88%	24.57%	Manager
	Arsenal Growth Equity IV	Feb-23	\$ 594,369	9.19%	8.68%	28.34%	Manager
	Arsenal-Cart Investors II	Feb-22	\$ 272,782	4.22%	-0.09%	39.72%	Manager
	Arsenal-Elevate Investors I	Sep-22	\$ 169,251	2.62%	0.93%	4.11%	Manager
	Arsenal-Sayari Investors I	Feb-22	\$ 269,892	4.17%	-1.43%	39.23%	Manager
Boyd-Watterson	Boyd-Watterson GSA Fund, LP	Jun-15	\$ 1,345,548	20.80%	1.41%	4.94%	Manager
	Boyd-Watterson State Govt Fund, LP	Feb-18	\$ 357,282	5.52%	1.11%	4.46%	Manager
Verition Capital Management	Verition International Multi-Strategy Fund, Ltd	Dec-17	\$ 1,251,785	19.35%	1.69%	10.23%	Fund
Greywolf Capital Management	Greywolf Containership Opps Offshore Fund, LP	Jul-19	\$ 425,581	6.58%	6.28%	12.02%	Fund
Entrust Global Partners	EnTrust Structured Income II	Jul-17	\$ -	0.00%	2.73%	5.19%	Fund
GoldenTree Asset Management	GoldenTree Distressed Fund, LP	Jun-15	\$ 112,047	1.73%	3.87%	9.94%	Fund
Golub Capital	Golub Capital Partners International 12, LP	Jul-19	\$ 641,180	9.91%	1.80%	9.80%	Manager
		<b>Total</b>	<b>\$ 6,468,125</b>		<b>1.48%</b>		

\*\* Internal rate of return net of fund expenses if Since Inception annualized net return sourced from Manager; otherwise net annualized rate of return since client inception if sourced from the Fund. Net realized returns may be lower should the investments be quickly sold incurring higher costs due to the inherent illiquidity.



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**INVESTMENT POLICY STATEMENT**  
**DECEMBER 2023**

**CITY OF DERBY, CONNECTICUT**  
**PENSION BOARD**

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***Purpose***

The purpose of this Investment Policy Statement (“IPS”) is to establish a clear understanding between The City of Derby, Connecticut Pension Board (the “Board”) and the Investment Manager as to the investment goals and management policies applicable to The City of Derby, Connecticut Pension Plan Fund (the “Fund”). This Investment Policy Statement will:

- Establish reasonable expectations, objectives and guidelines in the investment of the Fund’s assets.
- Create the framework for a well-diversified asset mix that can be expected to generate acceptable long-term returns at a level of risk suitable to the City of Derby, Connecticut Pension Board, including:
  - Specifying the target asset allocation policy;
  - Establishing investment guidelines regarding the selection of permissible securities and diversification of assets;
  - Describing an appropriate risk posture for the investment of the Town of Coventry Retirement Fund;
- Define the responsibilities of the City of Derby, Connecticut Pension Board and the Investment Manager.
- Encourage effective communication between the Investment Manager and the City of Derby, Connecticut Pension Board.

This IPS is intended to be a summary of the investment objectives and investment management procedures that provide guidance for the City of Derby, Connecticut Pension Board and the Investment Manager. These policies will be reviewed and revised periodically to ensure they adequately reflect any changes related to the Fund, to the City of Derby, Connecticut Pension Board and/or to the capital markets.

***Note***

*This Investment Policy Statement will address the entire portfolio of investments of the City of Derby, Connecticut Pension Board including any assets held with or managed by parties other than the Investment Manager.*

### ***Investment Objectives***

The specific objectives for these assets shall be to achieve an annual rate of return, net of all fees and expenses for the aggregate investments under this Investment Policy Statement, in excess of the actuarial assumption currently in force with the Fund. The net target rate of return shall match the actuarial assumption assigned to the Fund. The net target rate as of July 1, 2022 is 6.50% per the FY2022 GASB 67 and 68 Report.

### ***Time Horizon***

The Board's investment objective assumes a 6- to 12-year holding period while the actual liabilities horizon is long term due to the nature of the Fund. Performance will be tracked monthly and reported to the Board quarterly, or more frequently as the Board may request.

### ***Risk Tolerance***

The goal is to achieve a total return that is in the top 33% of a representative universe of professionally managed assets, in good and in bad markets.

The Board may expect that during periods of extended adverse market conditions, total Fund returns will remain predictable and consistent with a loss exposure limited to negative 4% to negative 8%.

The Board is expected to enforce the goals outlined above, exercising reasonable patience. The Board does not expect to be reactive to short-term investment developments, recognizing that a complete market cycle must be considered before concluding quantitatively on management capabilities. The Board considers a 3 to 5-year period to be normal for such assessment but anticipates making interim qualitative judgments.

### ***Asset Allocation***

The Fund will employ a global asset allocation methodology, incorporating both traditional public market asset classes as well as alternative strategies invested in private market or illiquid assets, to manage unsystematic risk and will benchmark Fund composition and performance to appropriate global indexes such as the MSCI All Country World Index for equities and the Bloomberg Barclays US Aggregate Bond Index for fixed income. Therefore, asset allocations for the public-market equities and fixed income segments of the Fund are based on the makeup of these indexes with drift tolerances above and below specific asset class to allow the Investment Manager room to take advantage of certain valuation and/or opportunistic dislocations identified within markets. The alternative investment portion will be evaluated on a risk-adjusted basis such as a Sharpe Ratio above cash proxies such as Treasury Bills. The illustration below serves as a guideline for the Fund's asset allocation.

Asset Class	Index Weight	Allowable Drift
Equities*	55%	From 45% to 65% of Fund
US	34%	25% to 37%
Developed Foreign	14%	11% to 17%
Emerging Markets	7%	5% to 9%
Fixed Income	20%	15% to 25% of Fund
Alternative Investments	20%	15% to 25% of Fund
Cash Reserves	5%	3% to 8% of Fund

\* Includes REITs and Liquid (Publicly-Traded) Alternatives (Updated as of December 2023)

**Updated Allocations**

From time to time, it may be desirable to amend the target allocation policy or calculations. When the Board makes such changes, updates will be attached to this Investment Policy Statement as an *Appendix* and will be considered part of this Investment Policy Statement or this Investment Policy Statement may be superseded by a replacement IPS and recorded in the Board’s meeting minutes.

**Fund Rebalancing Procedures and Guidelines**

From time to time, market conditions may cause the Fund’s investment in various asset classes and overall stock and bond mix to vary from the established target allocation. To remain consistent with the asset allocation guidelines established by this Investment Policy Statement, the Investment Manager should continuously monitor the Fund and each asset class in which the Fund is invested.

On an ongoing basis the Investment Manager shall review the Fund’s actual allocation against the IPS target allocations of 55% stocks, 20% bonds, 20% alternatives, and 5% cash. Should the general asset allocation guidelines of the Fund exceed a variance greater than 10% from the IPS target allocation, the Investment Manager will rebalance the Fund back to the IPS target allocation. Liquidity considerations of non-traditional, alternative investment allocations should be taken into consideration with respect to rebalancing or changes to the long-term asset allocation.

In addition to reviewing the overall general asset allocation, the Investment Manager will also review the Fund’s actual percentage allocation of each asset class against the IPS target allocation. Should the asset class allocations exceed a variance greater than those indicated above, the Investment Manager will rebalance back to the IPS target allocation.

### ***Diversification***

With respect to the public market asset classes, investment of the Fund shall be limited to individual marketable securities or packaged products (for example, mutual funds or exchange traded funds) in the following categories.

#### ***Permitted Public Market Asset Classes***

1. Cash and cash equivalents
2. Fixed Income-Domestic Bonds
3. Fixed Income-Non-U.S. Bonds
4. Equities-U.S.
5. Equities-Developed, Non-U.S.
6. Equities-Emerging Markets
7. Equities-REITS
8. Liquid (Publicly-Traded) Alternatives

With respect to the alternative strategies investing in non-public market asset classes or non-traditional strategies (e.g. hedge funds), investment of the Fund shall be allocated to alternative investment managers (“Alternative Managers”), either through direct co-investments or limited partnership funds or 1940 Investment Company Act registered investment vehicles such as interval funds. Fund allocations to Alternative Managers will be subject to due diligence conducted by the Plan’s Investment Manager. Eligibility for consideration, subject to evaluation by the Plan’s Investment Manager, would include, but not limited to the following:

1. SEC registration as a regulated investment advisor.
2. Audited financial statements of the investment vehicles being considered.
3. Demonstrable capabilities to manage the underlying strategies, with considerations for firm history, investment personnel experience, operational infrastructure, and applicable performance track records.
4. Transparency around performance reporting and firm / strategy updates.
5. Terms of liquidity for capital commitments and withdrawal windows (if any).

Alternative investments of the Fund may encompass, but not limited to the following categories, either as co-direct investments, limited partnerships, or 1940 Investment Company Act registered investment vehicles such as interval funds:

1. Venture Capital
2. Direct Real Estate & Leasing
3. Purchases of Lettered Stock, Private Placements, or Direct Payments
4. Leveraged Transactions
5. Commodities Transactions
6. Structured Financial Products
7. Derivatives Transactions (Publicly Listed and Over the Counter)
8. Short Transactions
9. Non-Traditional Infrastructure Investments
10. Private Credit / Private Lending

## ***Investment Reviews and Communication***

### **Meetings and Communication Between the Board and the Investment Manager**

As a matter of course, the Investment Manager shall keep the City of Derby, Connecticut Pension Board apprised of any material changes in the Investment Managers' outlook, recommended investment policy, and tactics. In addition, the Investment Manager shall meet with the City of Derby, Connecticut Pension Board, either in person, virtually, or a hybrid of both, no less than semi-annually to review and explain the Fund's investment results and any related issues. The Investment Manager shall attend the meetings of the City of Derby, Connecticut Pension Board as requested by the Board. The Investment Manager shall also be available on a reasonable basis for telephone communication when needed.

Any material event that affects the ownership of the Investment Manager or the management of the Fund must be reported immediately to the City of Derby, Connecticut Pension Board.

## ***Duties and Responsibilities***

### **The Investment Manager**

The Investment Manager is expected to manage the Fund in a manner consistent with this Investment Policy Statement and in accordance with State and Federal law and the Uniform Management of Public Employee Retirement Systems Act. The Investment Manager is a Registered Investment Advisor ("RIA") who shall act as the investment advisor and fiduciary to the City of Derby, Connecticut Pension Board until the City of Derby, Connecticut Pension Board decides otherwise.

### **The Board**

The City of Derby, Connecticut Pension Board shall be responsible for:

1. Defining the investment objectives and policies of the Fund.
2. Directing the Investment Manager to make changes in investment policy and to oversee and to approve or disapprove of the Investment Manager's recommendations with regards to policy, guidelines, objectives and specific investments on a timely basis.
3. The City of Derby, Connecticut Pension Board shall provide the Investment Manager with all relevant information on its financial conditions and risk tolerances and shall notify the Investment Manager promptly of any changes to this information.
4. The Board recognizes that their role is advisory as to investment strategy and policy. Both determination and selection of specific investments and securities must be delegated to the Investment Manager. However, the Board may determine that certain specific investments and securities are unacceptable as assets of the Fund.
5. The Investment Policy objectives, goals and guidelines represent the Board's philosophy regarding the investment of the Fund. The Investment Policy Statement will need to be reviewed at least bi-annually following election of officers to ensure that the Investment Policy Statement continues to reflect the Board's attitudes, expectations, and objectives.

6. The Board retains the right to assign or change parties responsible for the following services, either in part or in whole, at any time: Actuarial, Investment Management and the Custodian.

***Adoption Agreement***

Adopted by the below signed:

This Investment Policy Statement was adopted by The City of Derby, Connecticut Pension Board on the \_\_\_ day of \_\_\_\_\_, 201\_\_.

\_\_\_\_\_  
Signature Date

\_\_\_\_\_  
Signature Date

The undersigned Investment Manager hereby accepts the responsibility to manage assets of City of Derby, Connecticut Pension Plan in accordance with the terms of this Investment Policy Statement.

\_\_\_\_\_  
John O'Connor, President  
Freedom Investment Management  
Signature Date

# Year End Commentary and Year Ahead Outlook 2025 / 2026

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## Summary and Implications

- The U.S. economy has remained strong, though emerging signs of moderation support the case for additional Federal Reserve rate cuts extending into 2026. The risk of an enduring recession remains at low probability levels. Global markets are enjoying a continued surge in risk appetite, especially for AI-fueled technology plays, and for hard assets that serve as the basis for a surge in infrastructure spending.
  - The current environment speaks to less attractive valuations across risk-based assets, namely U.S. large caps and corporate credit fixed income, despite more muted market volatility and expected lower interest rates heading into 2026.
- Equities: we remain diversified across regions and styles and favor tilting away from the U.S. Mag7. We seek opportunities in small and mid-caps that demonstrate resilient growth and profitability as well as growth opportunities in defensive sectors that have largely lagged the broader market advance.
- Fixed income: take advantage of high real rates and a steep yield curve for roll down premiums. We remain defensive on overall credit risk, preferring to allocate risk assets to equities and real/hard assets.

## Investment Summary and Outlook

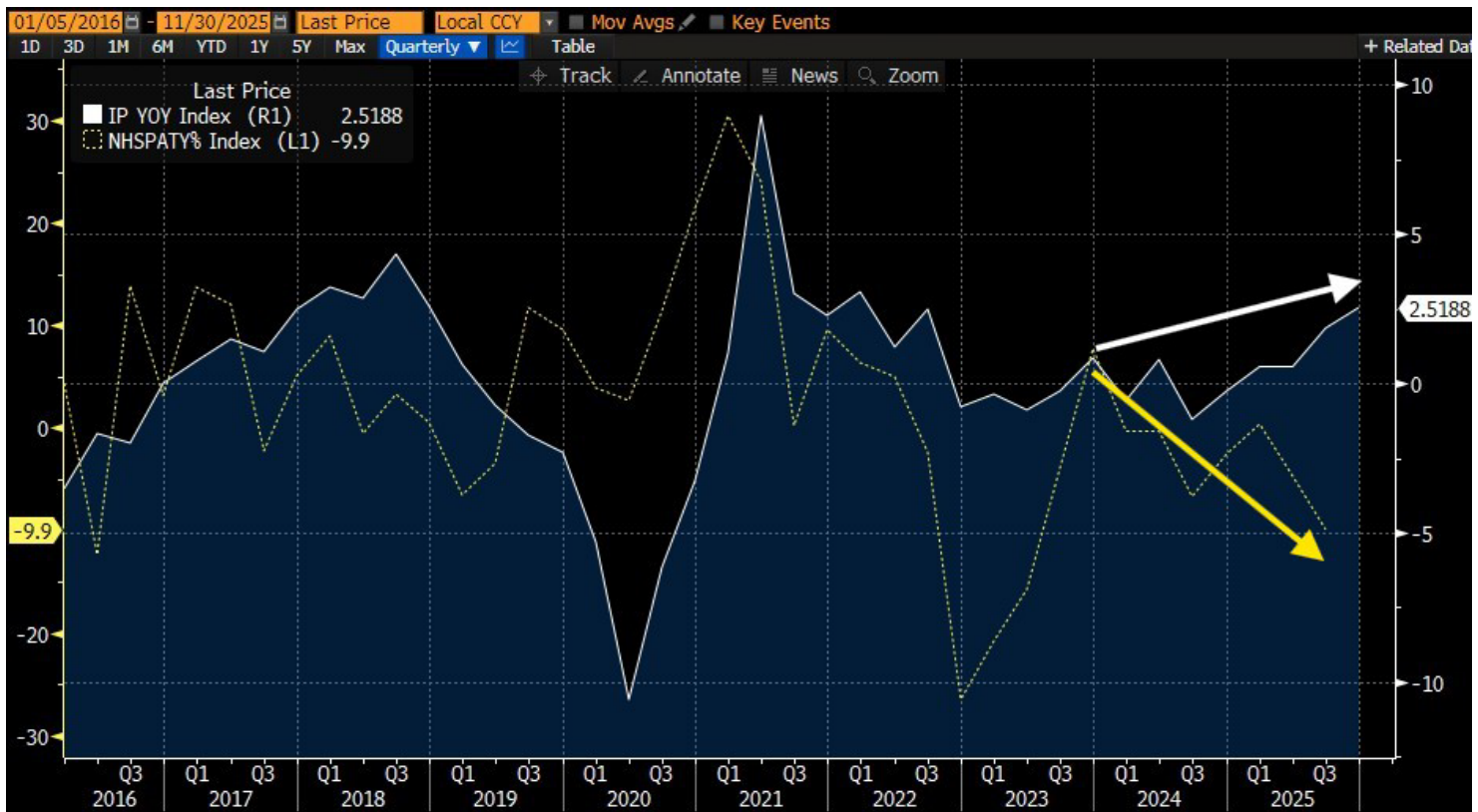
2025 proved a robust year for risk assets, with global equities, fixed income (particularly high-yield), and commodities—especially precious and industrial metals—delivering strong returns. This resilience persisted despite the ongoing shift from the post-WWII globalization era, marked by heightened trade tensions. Investors initially recoiled from President Trump's early-April "Liberation Day" announcement of reciprocal tariffs, but quickly regained confidence, pouring capital into risk assets and pushing valuations across equities and credit to multi-decade highs. The year closed strongly, buoyed by international stocks, which outperformed their U.S. counterparts for the first time in over a decade—a reversal driven in part by a sharp U.S. dollar decline (**Figure 1**).

**Figure 1 – International Stocks Outperformed the U.S. For the First Time Since 2009**



Yet 2025 was also defined by stark dichotomies. While market breadth broadened in international regions, U.S. equity performance remained narrowly concentrated, with mega-cap technology hyperscalers dominating overall market returns amid fervent AI enthusiasm. Investors remain fixated on the massive buildout of energy-intensive data centers, seen as vital for U.S. technological leadership and national security. This focus came at the expense of traditional infrastructure, evidenced by multi-year declines in new construction permits even as industrial production surged. (Figure 2).

**Figure 2 – Fueled by Data Center Buildouts, U.S. Industrial Production (White Line) Powers Ahead Juxtaposed Against the Contraction in Private Building Permits (Yellow Dotted Line)**

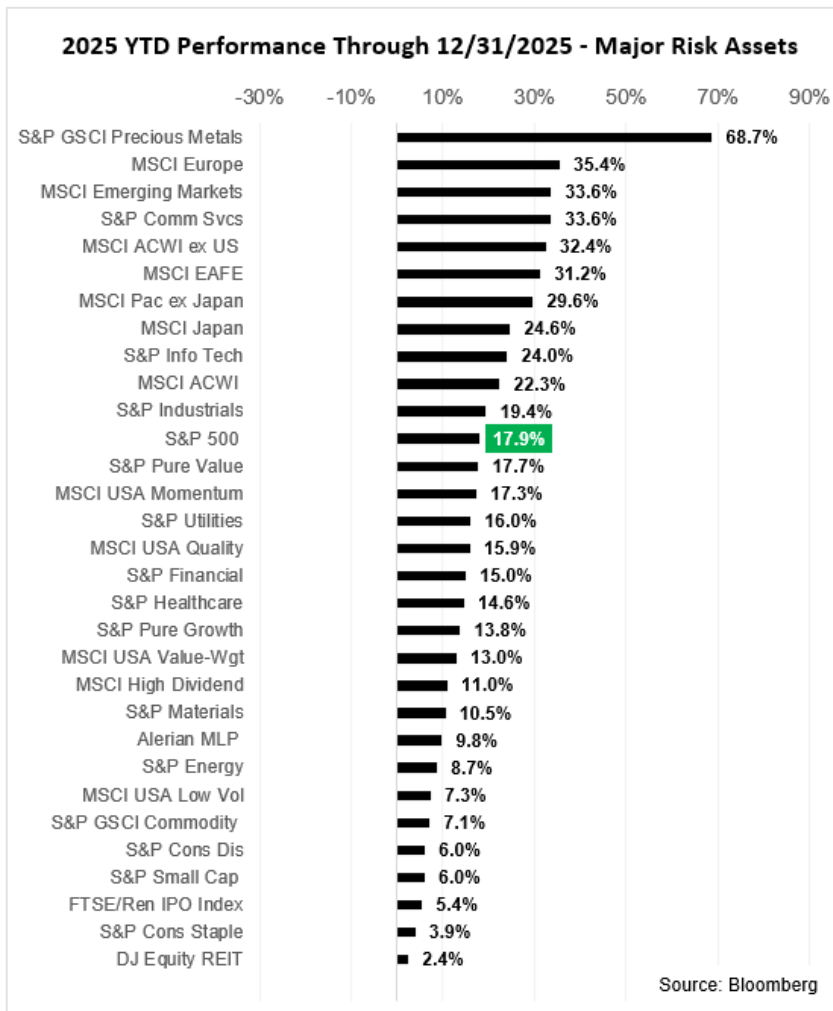


Source: Bloomberg

These performance divides stemmed from proximity to AI-related spending—encompassing computing power, industrials, energy production, and raw materials like natural gas and industrial metals. Sectors farther from this narrative, including consumer discretionary, staples, real estate, and commodities like oil and agriculture, generally lagged.

The performance table for 2025 equity sectors and regions underscores these contrasts, with the S&P 500 highlighted (Figure 3).

**Figure 3 – A Strong Year for Global Equities But Also Full of Dichotomies**



Key takeaways from **Figure 3** include:

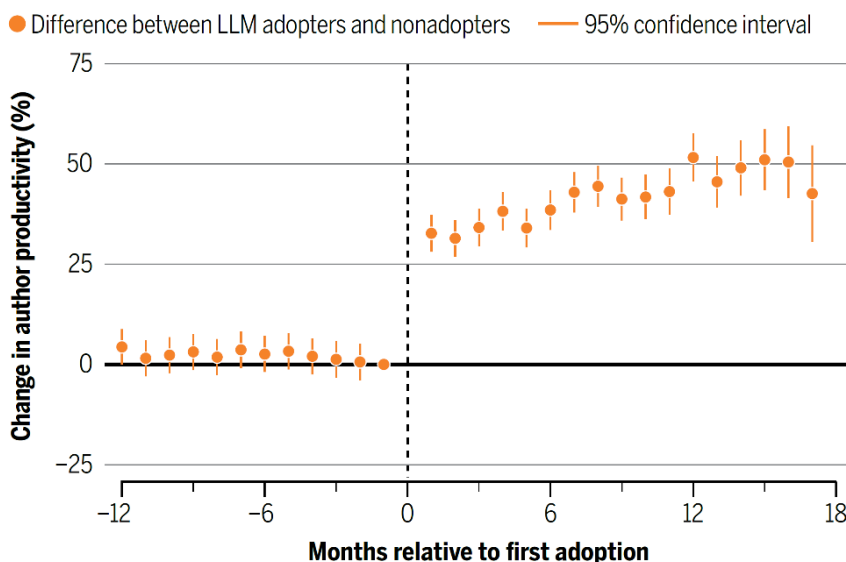
- 1) International markets eclipsed the U.S. after years of lagging, aided by improving fundamentals and U.S. dollar weakness.
- 2) In the U.S., large-caps—dominated by AI-benefiting mega-cap tech—continued to outpace small- and mid-caps. Outside tech and communication services, however, value stocks edged growth, snapping a streak dating to ChatGPT's late-2022 launch.
- 3) Pro-cyclical, high-beta segments—fueled by data center infrastructure buildouts (from semiconductors to construction and energy systems)—trounced defensives like high-dividend, low-volatility, or high-quality names. Passage of the "One Big Beautiful Bill" over the summer further incentivized capex and R&D.
- 4) Not all industrials thrived; energy underperformed amid oil prices retreating to post-COVID lows, despite resilient natural gas.
- 5) Cyclical leadership extended to factors, with momentum and value prevailing—though none matched the S&P 500's mega-cap tech dominance, posing challenges for active managers in a year of even narrower breadth (**Figure 4**).

**Figure 4 – Another Year Traditional Active Management Struggles Against the S&P 500**



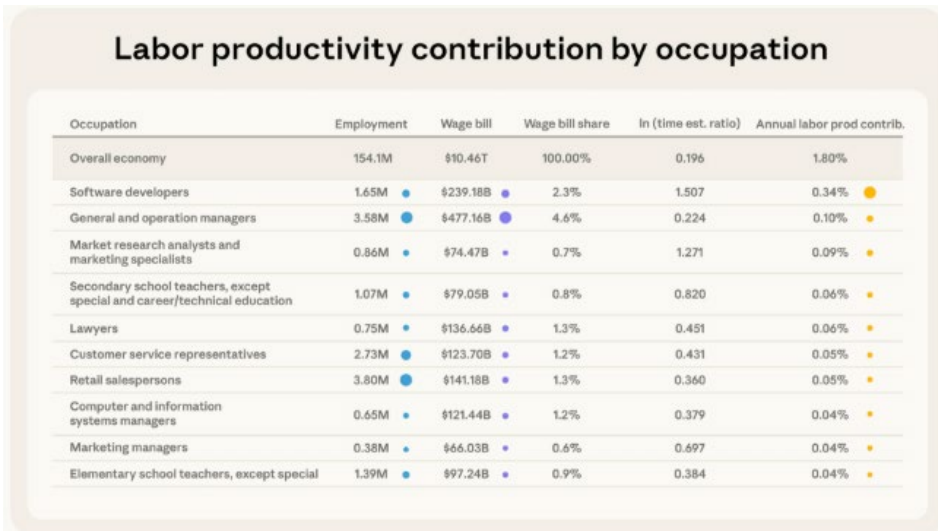
The AI infrastructure cycle is a multi-year endeavor, with estimates suggesting \$5–7 trillion in total spending by 2030 (McKinsey). Yet a reckoning approaches as investors demand strong returns and margins to justify scaling advanced models, especially when debt financing is involved. Early evidence of AI-driven productivity gains is encouraging (**Figure 5**), with the initial productivity impact falling on services (**Figure 6**). Anthropic projects a 1.8% long-term productivity lift, implying benefits for profitability, incomes, consumption, and fiscal health (e.g., potentially lowering debt-to-GDP ratios).

**Figure 5 – AI Productivity Boost Can Be Seen Among Academic Researchers (Through Summer 2024)**



Source: Kusumegi et al, Science 390, 6779, 1240 (2025) per [Sabine Hossenfelder \(@skdh\)](#)

**Figure 6 – Service Sectors Expected to Experience the Largest Productivity Boost Per Anthropic**



**US economy-wide labor productivity impact: top ten occupations.** Overall, Claude's estimates imply a 1.8% annualized increase (dotted line) in US labor productivity assuming current AI systems were adopted universally for all tasks we observe, driven by software, management, marketing, and customer service tasks. This corresponds to an implied 1.08% annualized increase in TFP. The average *ln(time estimate ratio)* represents the time-weighted productivity gain across all tasks in each occupation, where *time estimate ratio = time with AI / time without AI*. Labor statistics derived from OEWS 2024 data.

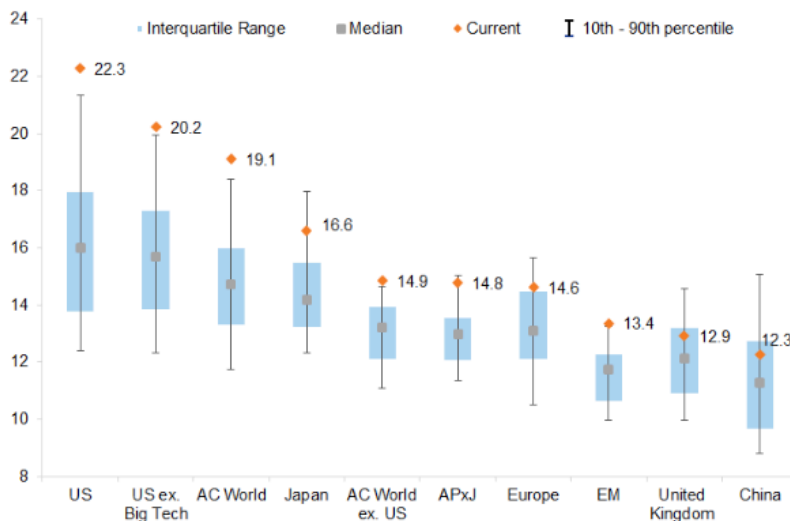
Source: <https://www.anthropic.com/research/estimating-productivity-gains>

And with worldwide stock market valuations trading near their 10-year highs on price/earnings multiples (**Figure 7**), further multiple expansion likely rests on further productivity gains, as strongly implied by investor expectations and consensus forecasts for operating margin expansion well beyond what has been historically achieved (**Figure 8**).

**Figure 7 – Worldwide Equity Valuations at Historical Highs, Embedding Optimistic Outlooks for Growth**

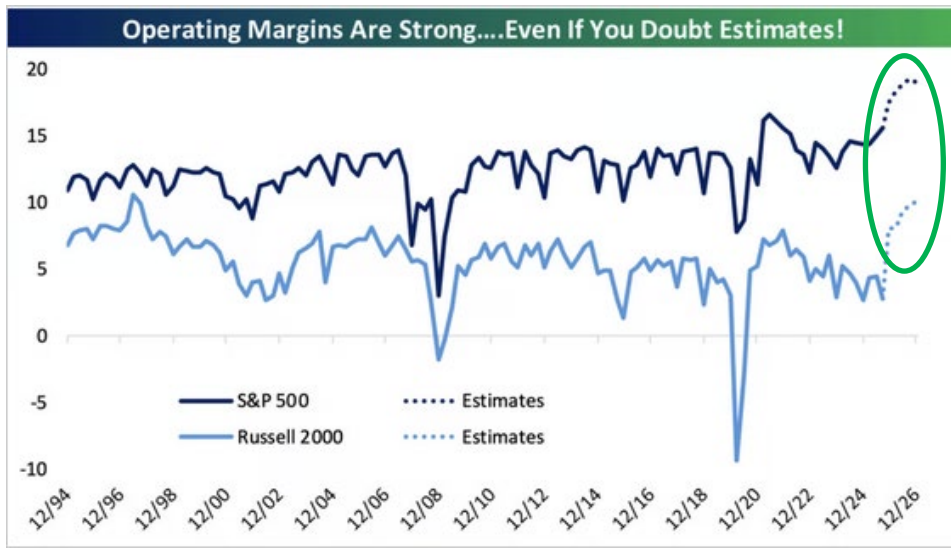
**Exhibit 6: Equity valuations across regions are now at historical highs**

12m fwd P/E multiple. MSCI Regions, STOXX 600 for Europe and S&P 500 for US. Data for the last 20 years.



Source: FactSet, Goldman Sachs Global Investment Research

**Figure 8 – Large and Small Company Profit Margins Expected to Rise Well Above Historical Levels in 2026**



Source: Yardeni Research

The Federal Reserve's December Summary of Economic Projections reflected optimism, upgrading 2026 GDP growth to 2.3% (from prior estimates) while lowering PCE inflation forecasts. Chair Powell highlighted strong consumer spending, AI investment, and fiscal support as drivers, enabling accommodative policy with reduced inflation risks. Markets initially cheered, though rate cut expectations moderated to 2–3 in 2026, with a terminal rate around 3% by 2027 (**Figure 9**).

Although the Fed enjoyed an initial bullish response from both equity and fixed income markets, the Fed is also signaling that further rate cuts will be slower and more deliberate, as some Fed governors expressed a desire to see more progress on bringing down post-pandemic/post-tariff-driven inflation. Short-term interest rate futures (**Figure 9**) tempered their outlook on the pace and magnitude of rate cuts through 2026, with two to three cuts expected in 2026 and a final terminal rate of 3% by the end of 2027.

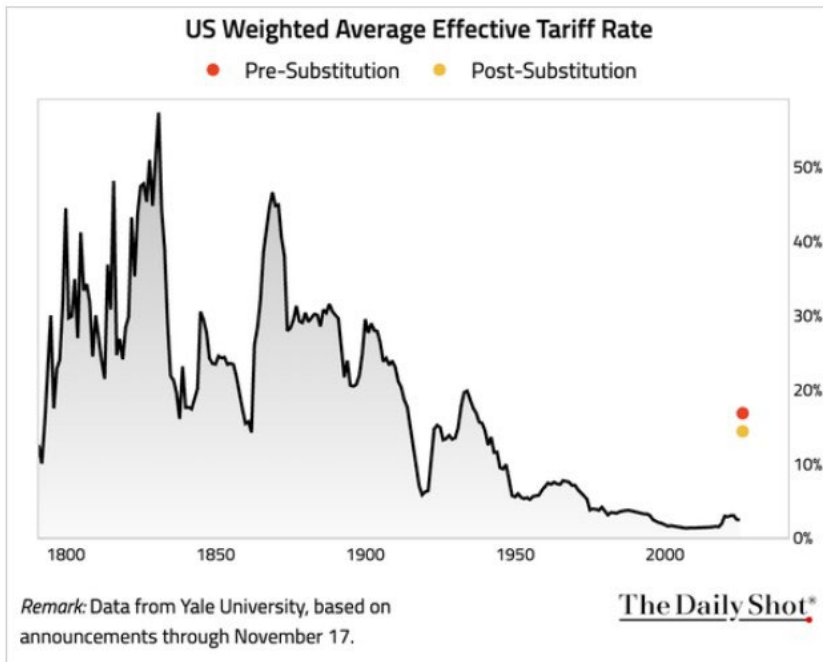
**Figure 9 – Two to Three Rate Cuts Expected in 2026 and a 3% Terminal Rate in 2027**

Region: United States »		Instrument: Fed Funds Futures »			
Target Rate	3.75	Pricing Date	12/31/2025		
Effective Rate	3.64	Cur. Imp. O/N Rate	3.635		
Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
01/28/2026	-0.149	-14.9%	-0.037	3.598	0.250
03/18/2026	-0.535	-38.5%	-0.134	3.501	0.250
04/29/2026	-0.789	-25.5%	-0.197	3.438	0.250
06/17/2026	-1.346	-55.7%	-0.337	3.298	0.250
07/29/2026	-1.669	-32.3%	-0.417	3.218	0.250
09/16/2026	-2.012	-34.3%	-0.503	3.132	0.250
10/28/2026	-2.189	-17.7%	-0.547	3.088	0.250
12/09/2026	-2.342	-15.3%	-0.585	3.049	0.250
01/27/2027	-2.339	+0.3%	-0.585	3.050	0.250
03/17/2027	-2.341	-0.2%	-0.585	3.050	0.250
04/28/2027	-2.289	+5.2%	-0.572	3.063	0.250
06/09/2027	-2.250	+4.0%	-0.562	3.072	0.250
07/28/2027	-2.219	+3.0%	-0.555	3.080	0.250
09/15/2027	-2.245	-2.6%	-0.561	3.074	0.250
10/27/2027	-2.139	+10.6%	-0.535	3.100	0.250
12/08/2027	-1.952	+18.8%	-0.488	3.147	0.250
01/26/2028	-2.339	-38.8%	-0.585	3.050	0.250

Source: Bloomberg World Interest Rate Probability as of 12/31/2025

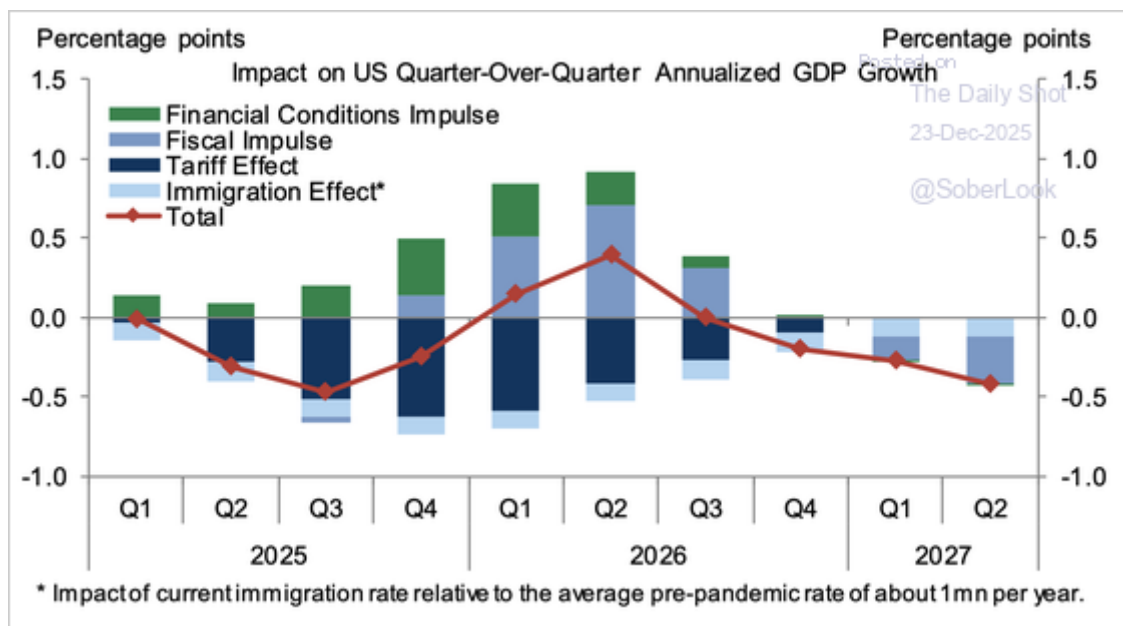
Tariffs remain a negative overhang on consumer demand and inflationary pressures, although we should see more clarity on the future direction of effective rates once the Supreme Court rules on the Trump Administration’s use of emergency powers to enact reciprocal tariffs. Even with trade agreements reached in principle with key partners and a delay on implementing the most punitive rates (especially on China), the effective tariff rate (**Figure 10**) is expected to rise well beyond what had been in place in the post-war period. Goldman Sachs expects ~1% negative impact on 2026 GDP growth, partially offset by fiscal stimulus (OBBBA) and loose financial conditions from lower rates (**Figure 11**).

**Figure 10 – Effective Tariff Rate Expected to Reach Close to 20%**



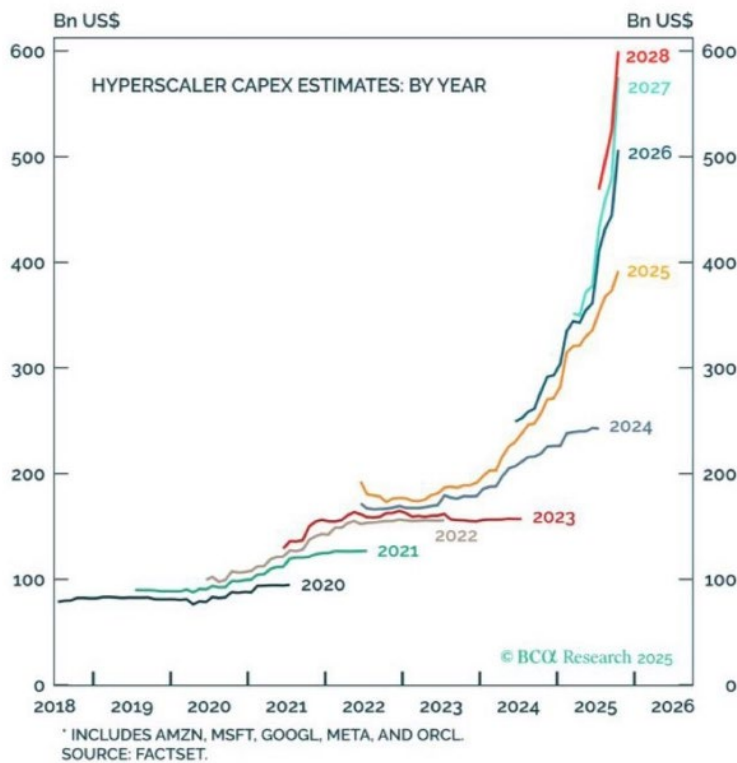
Source: Bloomberg Economics

**Figure 11 – Tariffs to Negatively Impact 2026 GDP Growth, Offset by Fiscal Stimulus and Lower Interest Rates**



The tech hyperscalers continue to drive an outsized contribution to worldwide capital expenditure as they rush to build out energy-intensive data centers to capitalize on the exponential growth of inferences feeding into AI large language models (LLMs). This rush to build out generative artificial intelligence capabilities through data centers, to the tune of an annual spend of \$500-600 billion through 2028 (**Figure 12**), has led to a surge in demand for computer hardware and cloud computing services, and increasingly, a need for electricity production to power these energy-intensive data centers. As mentioned above, 2025's U.S. stock and sector outperformers were largely a function of their close proximity to these data center buildouts.

**Figure 12 –Annual Capital Expenditures on Computing Power Expected to Reach \$600 Billion by 2028**



Valuations and geopolitical uncertainty aside, investors continue to give the benefit of the doubt to not only the blue-sky growth outlook afforded the AI computing story but also the enhanced productivity outlook to profitability and growth for AI adopters as these data centers come online and use cases start to grow. No doubt there will be leaders and laggards, but the power of AI will presumably shorten the gap between the two once all the heavy capex lifting has been performed.

Equity market valuations should continue to be driven by earnings (the 'E' in P/E) growth, but further multiple expansion should be driven by productivity gains via operating margin expansion and new avenues of revenue growth. Ahead of the 4<sup>th</sup> quarter earnings releases, the consensus outlook for S&P 500 company earnings growth is 15.0% in CY-2026 on revenue growth of 7.4% per Factset Earnings Insight (12/19/2025). With the S&P trading near 23x forward 12-month earnings, market valuations leave little room for error, but the equity outlook looks bright should the expected earnings growth and productivity gains come to fruition.

## Freedom Investment Management Capital Market Projections

We enter 2026 with a similar nominal and real (inflation-adjusted) interest rate backdrop to when we entered 2025 based on implied inflation expectations priced between U.S. TIPS vs nominal Treasuries. Despite the elevated real rate environment, higher interest rates did not stop consumers spending, businesses borrowing, and U.S. stocks rallying, as S&P 500 earnings are expected to grow 12-14% in 2025 based on expected 4Q results. Unlike the prior two years since the release of ChatGPT in late 2024, S&P price/earnings multiples hardly expanded in 2025 as they entered the year with a forward P/E of 21.6x and ended the year at 22.0x. Cash is still attractive with short-term cash vehicles yielding around 3.75% (opposed to 0% at the end of 2021), but cash rates have already dropped from peak post-pandemic levels as the Fed is expected to continue cutting rates throughout 2026 with a terminal 3% rate expected at the end of 2027.

The earnings outlook for 2026 looks rosy with sell-side analysts expecting 15% earnings growth for S&P 500 companies on top of nearly 8% revenue growth. The aggregate profit margin is projected to reach nearly 14%, a near historical high. So positive earnings growth should help equity valuations remain near their elevated levels (based on trailing 10-year history), but future productivity gains remain the key for further multiple expansion.

Freedom Investment believes that price matters over the long run and that what you pay today will influence the returns you realize over the long-term. Price can exert a long-term gravitational pull on expected returns. Long-term investors should remain fully invested as part of a strategic asset allocation built on risk-based investment programs. The current environment speaks to less attractive valuations across risk-based assets, namely U.S. large caps and corporate credit fixed income, despite more muted market volatility and expected lower rates heading into 2026. The Fed expected to continue cutting rates, albeit at a slower pace versus prior cutting cycles.

What follows is a series of forecasts for long-term expected returns across various asset classes. In the spirit of Fama/French and Jeremy Siegel (“Stocks for the Long Run”) from University of Pennsylvania’s Wharton School, Freedom Investment derives its long-term forecasts from valuations currently priced into equity and fixed income assets.

### Freedom Investment Management Long-Term Equity and Fixed Income Asset Return Forecasts

1. Start with MSCI All-Country World Index (ACWI) (Global Equities) and S&P 500 (US Equities) Price/Earnings Multiple Based on Consensus Next 12-Months Earnings (12/31/2025): 18.9x and 22.0x, up from 18.1x and 20.6x last year, respectively, per Bloomberg consensus estimates.
2. Invert the MSCI ACWI and S&P 500 P/E multiples to arrive at an earnings yield to generate a long-term real (inflation-adjusted) return forecast: 5.3% and 4.5%, slightly down from 5.5% and 4.6% last year, respectively.
3. Long-term inflation expectations implied by 5-year/5-year breakeven rates between U.S. Treasury Inflation Protected Securities (TIPS) versus Nominal Treasuries: 2.2% (unchanged from the prior year).
4. Long-Term Expected Nominal Rate of Return for global equities: 7.5% (5.3%+2.2%). For the S&P 500: 6.7% (4.5%+2.2%)
5. U.S. Fixed Income: Projected Yield-to-Worst on Bloomberg/Barclays US Aggregate Bond Index is 4.3% (down from 4.9% last year) and 2.1% on a long-term inflation-adjusted basis.
6. Projected Yield-to-Worst on Bloomberg/Barclays US High Yield Index: 6.4% (4.2% on an inflation-adjusted basis). The consensus 2026 default outlook from rating agencies ranges from 3.0-3.5%.

Hence, a **60/40 portfolio** consisting of Global Stocks and US Investment Grade Bonds is projected to return approximately **6.2% nominal return** (4.0% inflation-adjusted) over the long run based on year-end valuations. 5.8% (3.6% inflation-adjusted) for a 60/40 blended portfolio only including S&P 500 stocks. One can potentially increase returns by investing in riskier asset classes such as small caps and high yield, but one would also be introducing more risk into the portfolios, even when accounting for diversification benefits.

## U.S. Fixed Income Markets

Index Performance as of 12/31/2025	4Q2025	YTD	1-Year	3-Year (Ann)
Bloomberg US Agg Bond TR USD	1.10	7.30	7.30	4.66
Bloomberg US Treasury Bill 1-3 M TR USD	1.01	4.29	4.29	4.92
Bloomberg 1-5 Yr Treasury TR USD	1.15	5.84	5.84	4.50
Bloomberg Treasury 5-7 Yr TR USD	1.16	8.02	8.02	4.46
Bloomberg Treasury 7-10 Yr TR USD	1.12	8.40	8.40	3.69
Bloomberg US Treasury 20+ Yr TR USD	-0.48	4.59	4.59	-0.40
Bloomberg US Agency TR USD	1.14	6.38	6.38	4.90
Bloomberg U.S. Agg ABS TR USD	1.25	5.93	5.93	5.49
Bloomberg US MBS TR USD	1.71	8.58	8.58	4.90
Bloomberg US Corporate TR USD	0.84	7.77	7.77	6.10
Bloomberg US Corporate High Yield TR USD	1.31	8.62	8.62	10.06
Bloomberg Municipal TR USD	1.56	4.25	4.25	3.88

Source: Bloomberg

U.S. fixed income posted strong positive returns with the U.S. Aggregate Bond Index up 1.10% for the quarter and 7.30% for the year, making up earlier 1<sup>st</sup> half losses, as interest rates dropped from peak levels of last spring. Despite this past fall's government shutdown that affected the release of key economic data on labor and inflation, investors are increasingly convinced that the Fed may pull off a soft landing for the U.S. economy, a scenario in which Fed policy taps on the breaks through a deliberate rate cut policy characterized by intermittent pauses.

The 4<sup>th</sup> quarter saw broad gains across the fixed income space, except for ultra-long Treasury maturities, as the U.S. term structure (spread between short and long rates) continues to steepen, likely driven by the demand of higher risk premiums to compensate for long-term uncertainty around fiscal imbalances. Investment grade corporate bonds lagged as large capital expenditure commitments to build out expansive AI data centers prompted lenders to demand a steeper risk premium for borrowers leaning on debt financing to meet capital commitments.

High yield outperformed as spreads narrowed to near multi-decade lows as investors grew increasingly confident to lend to risky borrowers as long as the economic backdrop remains strong. Mortgage-backed securities (MBS) and asset-backed securities (ABS) also outperformed as borrowing spreads narrowed further with the decline in interest rate volatility.

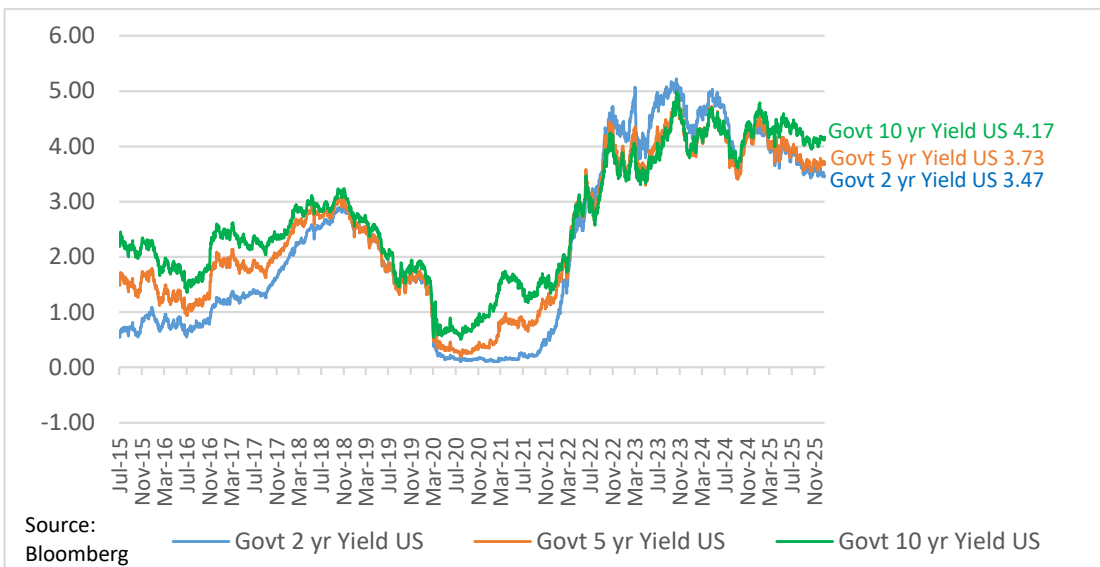
### Implications: Near Historically Low Risk Premiums Point Towards Bond Market Complacency

Investors continue to prefer intermediate maturities or the belly portion of the yield curve, seeking to navigate central bank easing with the uncertainty over long-term fiscal imbalances and stubborn inflation readings. Duration or Rate-Sensitivity was the clear contributor to positive performance even though ultra-long maturities underperformed.

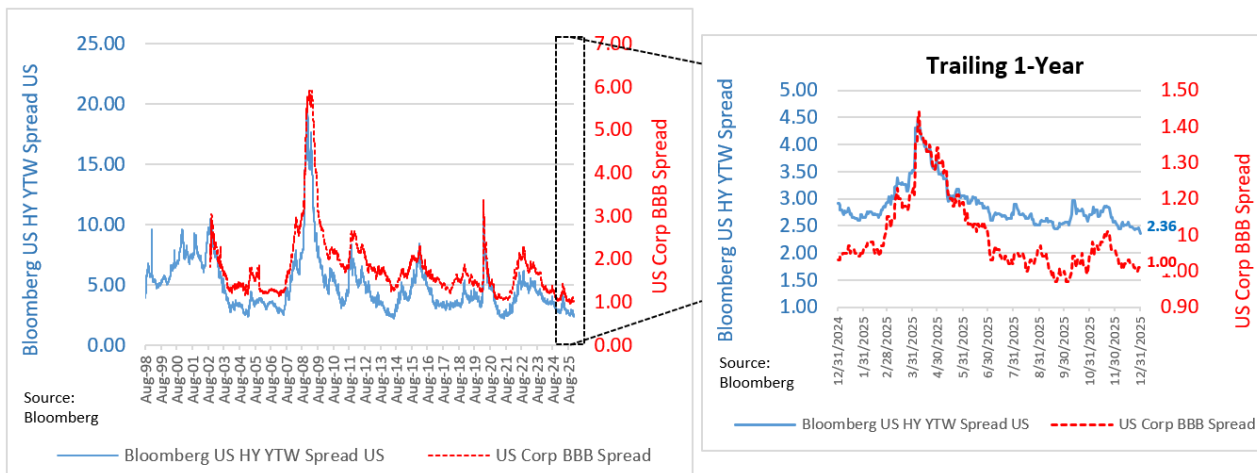
The 10-Year U.S. Treasury yield ended the 4<sup>th</sup> quarter at 4.17%, nearly unchanged from 4.15% at the beginning of the quarter and down from 4.57% at the beginning of the year. The spread between short-term and long-term borrowing rates widened with the 10-2 year Treasury yield spread at its widest level since the Fed started raising rates in 2022 as investors continue to hide out in the intermediate maturities, giving up attractive roll-down returns from holding longer maturities.

For outsized gains to continue, inflation-adjusted rates and borrowing spreads would need to drop further, closer to the 2010-2015 period; however, inflation conditions continue to improve, driven by slowing measures across shelter components. Even with reaccelerating inflation driven by fiscal impulses from the OBBBA posing as a risk to the soft-landing scenario, investors still have an opportunity to lock in moderately high real rates by extending the maturity profile of their fixed income allocation. For now, we would advise maintaining an investment grade posture, preferring equities and real assets for higher risk allocations, rather than reaching for yield in fixed income.

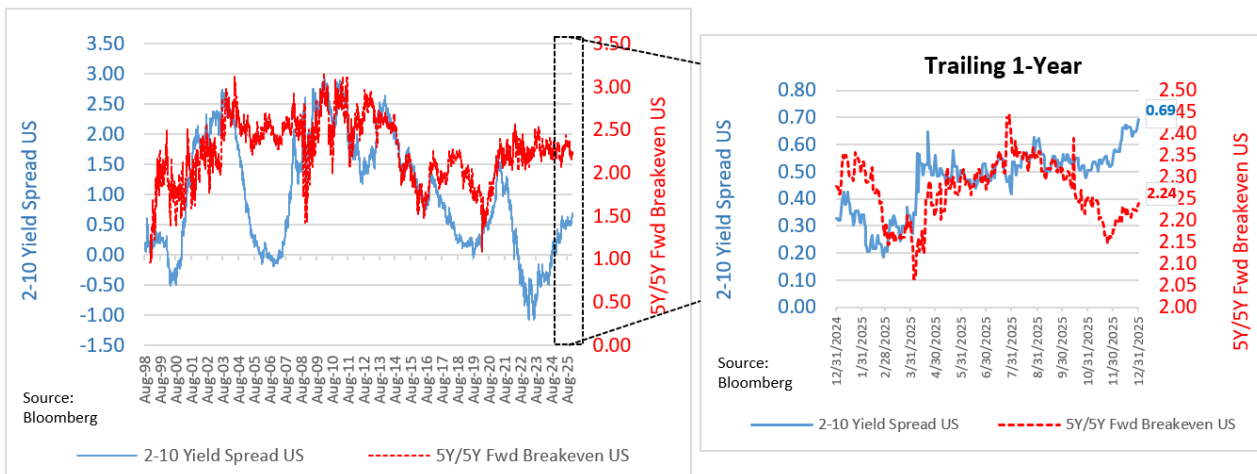
## U.S. Treasury Yields Lower from Beginning of Year Levels



## Corporate Credit Spreads at Multi-Decade Rich Levels



## 10-2 Year Yield Spread Steepened to Post-Pandemic Highs While Long-Term Inflation Expectations Are Range-Bound



## International Fixed Income Markets

Index Performance as of 12/31/2025	4Q2025	YTD	1-Year	3-Year (Ann)
Bloomberg Global Agg ex US TR USD	-0.47	8.85	8.85	3.29
Bloomberg EuroAgg TR USD	0.19	14.83	14.83	7.02
Bloomberg Asian Pacific Agg TR USD	-2.24	1.39	1.39	-1.37
Bloomberg EM Local Currency TR USD	3.85	21.65	21.65	10.38

Source: Bloomberg

In U.S. dollar terms (“USD”), international bonds underperformed the U.S. market in the 4<sup>th</sup> quarter, hurt by rising long-term rates, especially in Japan where the 10-year JGB yield reached 2.07%, a multi-decade high. EM local currency bonds fared better, benefiting from lower rates and U.S. dollar depreciation, and turned in a very strong year in USD terms. The Bloomberg Global Aggregate Bond ex US Index (USD) and the Bloomberg EM Local Currency Index (USD) returned -0.47% and 3.85% for the 4<sup>th</sup> quarter, respectively, and 8.85% and 21.65% for the year, respectively, outperforming the U.S. Aggregate Index, primarily driven by U.S. dollar depreciation (8-11% against major trading partner currencies), whose decline was driven by both the Liberation Day tariff announcements as well as the recommencement of Fed rate cuts over the summer.

Throughout 2025, investors sought higher-yielding assets, fueled by Federal Reserve rate cuts starting in mid-2025, with higher yielding emerging market debt a major beneficiary of Fed easing. Improving economic fundamentals in many developing countries (e.g., stronger growth trajectories and fiscal stability) also supported tighter credit spreads versus comparable developed market sovereign rates. Europe also benefited from U.S. dollar depreciation even though primary government borrowers such as Germany saw their rates rise in lockstep with the U.S. and Japan, as Europe expanded their fiscal policy to drive industrial spending, especially in aerospace and defense.

The 10-year government bond yields of Germany, France, the U.K., and Japan ended the year at 2.86%, 3.56%, 4.48%, and 2.07%, respectively, compared to 2.37%, 3.20%, 4.57%, and 1.10% at the beginning of the year. The yield-to-maturity on the JPMorgan Emerging Market Local Currency Bond Index dropped to 5.91% from 6.98% at the beginning of the year. The Bloomberg Dollar Index dropped 8.10% for the year, led by a 13.44% depreciation against the euro and 7.66% depreciation against the UK pound, but only 0.31% depreciation against the Japanese yen.

### Implications: Near-Term Bottom for the USD and Rich Valuation Levels for Higher Yielding Sovereign Debt

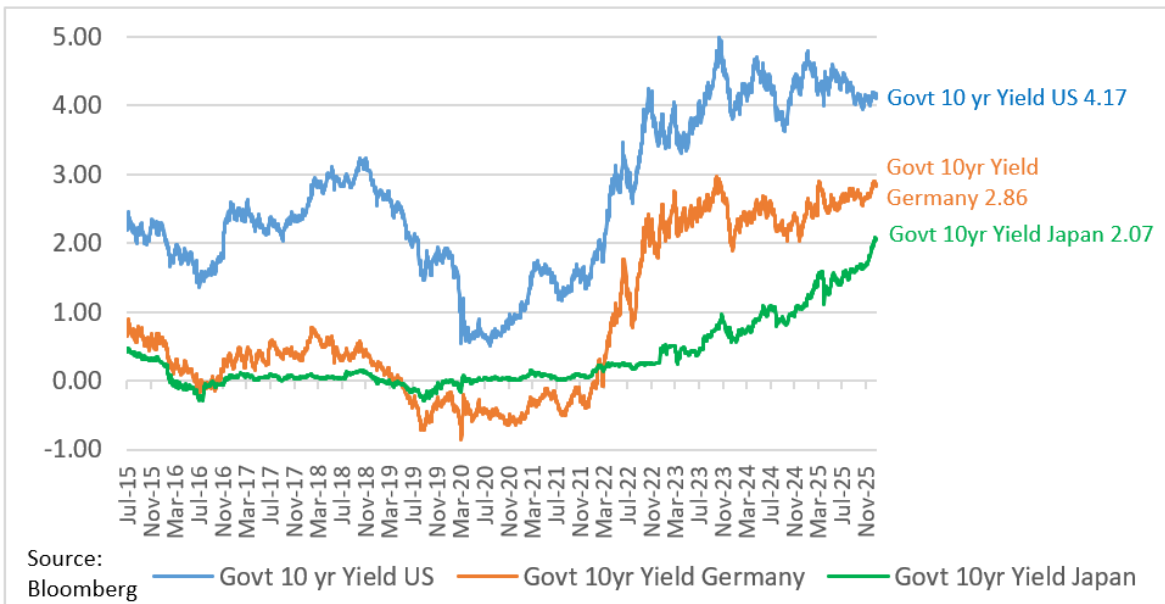
Should the U.S. economy reaccelerate in the first half of 2026, bolstered by the fiscal impulse from the One Big Beautiful Bill and sustained AI-driven data center investment, the trajectory for lower rates into 2026–2027 is likely to become more gradual. Markets now anticipate a more elongated cutting cycle, punctuated by intermittent pauses as the Federal Reserve assesses incoming data.

This slower pace of easing could provide meaningful support for the U.S. dollar, particularly if U.S. growth continues to diverge positively from major economies abroad. Upcoming catalysts such as 1) midterm elections, 2) evolving trade policy (including Supreme Court clarity on reciprocal tariffs and new bilateral agreements), and 3) a potential new Fed chair appointment, could further shape the outlook. While political pressure from the Trump Administration may push for more aggressive rate reductions, the Federal Reserve's institutional commitment to independence is likely to temper such influence.

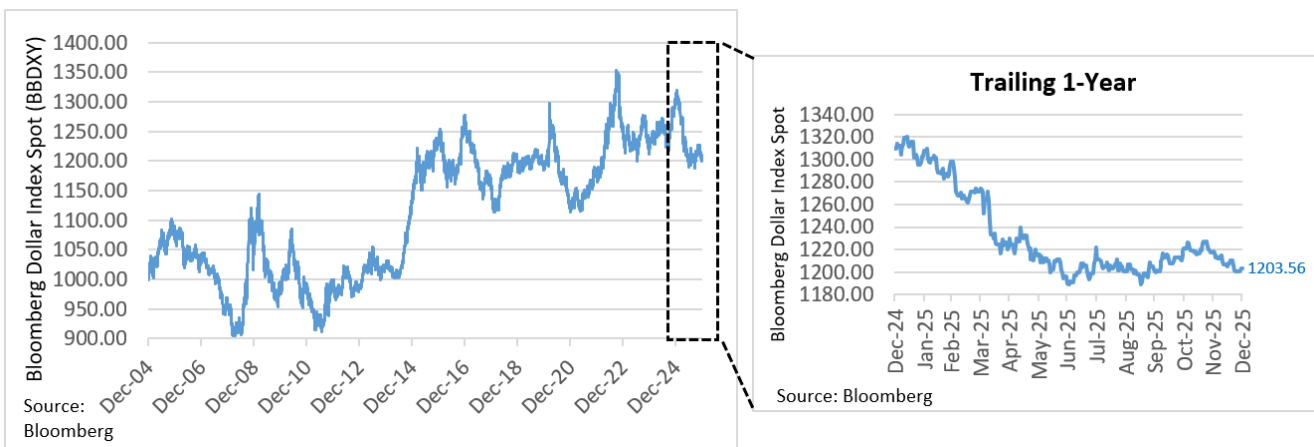
For investors with significant unhedged foreign currency exposure, the risk/reward now favors prudence. Locking in a portion of 2025's currency-driven gains, either through direct USD hedging or by rotating into U.S.-denominated fixed income, appears warranted. Interest-rate differentials and relative growth prospects still strongly favor the United States over most developed and emerging peers.

That said, China's ongoing fiscal and monetary stimulus may provide spillover support to trade-dependent economies, helping them sustain export competitiveness through currency weakness. This dynamic could limit outright dollar strength against certain emerging-market currencies, even as the greenback firms broadly. Overall, a selective approach to international fixed income exposure (favoring U.S. assets or hedged currency), positions portfolios more resiliently for the year ahead.

### Japan 10-Year JGB Rises to Multi-Decade Highs



### U.S. Dollar Depreciates Throughout 2025



## US Equity Markets

Index Performance as of 12/31/2025	4Q2025	YTD	1-Year	3-Year (Ann)
S&P 500 TR USD	2.66	17.88	17.88	23.01
Russell 1000 Growth TR USD	1.12	18.56	18.56	31.15
Russell 1000 Value TR USD	3.81	15.91	15.91	13.90
Russell Mid Cap Growth TR USD	-3.70	8.66	8.66	18.64
Russell Mid Cap TR USD	0.16	10.60	10.60	14.36
Russell Mid Cap Value TR USD	1.42	11.05	11.05	12.27
Russell 2000 Growth TR USD	1.22	13.01	13.01	15.59
Russell 2000 TR USD	2.19	12.81	12.81	13.73
Russell 2000 Value TR USD	3.26	12.59	12.59	11.73
S&P Comm Svces Select Sector TR USD	7.26	33.55	33.55	42.90
S&P Cons Staples Select Sector TR USD	0.01	3.90	3.90	6.26
S&P Consumer Disc Select Sector TR USD	0.71	6.04	6.04	25.26
S&P Energy Select Sector TR USD	1.53	8.67	8.67	4.27
S&P Financial Select Sector TR USD	1.90	14.51	14.51	18.37
S&P Health Care Select Sector TR USD	11.68	14.60	14.60	6.26
S&P Industrial Select Sector TR USD	0.88	19.42	19.42	18.34
S&P Materials Select Sector TR USD	1.12	10.54	10.54	7.54
S&P Real Estate Select Sector TR USD	-2.86	3.15	3.15	6.84
S&P Technology Select Sector TR USD	1.38	23.82	23.82	38.51
S&P Utilities Select Sector TR USD	-1.40	16.04	16.04	10.00
S&P 500 Dividend Aristocrats TR USD	1.72	7.28	7.28	7.60
S&P 500 Low Volatility TR USD	-2.19	4.36	4.36	6.29
S&P 500 High Beta TR USD	6.71	33.20	33.20	24.61
S&P 500 Momentum TR USD	-1.24	26.47	26.47	29.20
S&P 500 Quality TR USD	2.75	13.43	13.43	21.23
DJ US Select Dividend TR USD	0.56	12.12	12.12	9.91

Source: Bloomberg

Despite worries emerging over the accumulating financial obligations from the race to build out cutting edge data centers to meet demand for AI modeling, the U.S. market turned in another strong quarter of performance, led by traditional value stocks and the health care sector, propelled by a strong 3Q earnings season and deal flow acceleration within biotech. The S&P 500 returned 2.66% for the quarter and 17.88% for the year, while the Russell Mid Cap and Russell 2000 returned 0.16% and 2.19% for the quarter, respectively, and 10.60% and 12.81% for the year, respectively. U.S. equities continue to benefit from a resilient U.S. economy, strong earnings growth and profitability, and Fed rate cuts that restarted over the summer and into the fall. S&P 500 earnings are expected to grow 15% for all of CY-2025.

U.S. stocks continued to draw support from a resilient domestic economy, robust corporate earnings growth and profitability, and the resumption of Federal Reserve rate cuts through the summer and fall. Consensus expectations call for S&P 500 earnings to expand approximately 15% for calendar 2025.

That said, precious metals stole the spotlight in 2025, soaring nearly 70% on the year and capping off with parabolic fourth-quarter spikes in silver, palladium, and platinum. The rally was propelled by a potent mix of escalating geopolitical risks, trade frictions stemming from the April "Liberation Day" tariff announcements and sustained central-bank buying as institutions trimmed the USD share of their reserves. While easing geopolitical tensions could trigger a near-term pullback, industrial-demand-sensitive metals should retain support from ongoing global infrastructure initiatives.

Beyond health care, classic defensive areas (real estate, utilities, and factors such as high-dividend and low-volatility) continued to trail broader market gains. Speculative growth names experienced some moderation late in the year as rising debt-financing worries tempered enthusiasm for technology capex, yet high-beta (higher-risk) stocks emerged as the clear victors for 2025. This reflected the resurgent "animal spirits" that defined much of the year after the sharp April sell-off. Overall, growth edged value, though leadership remained uneven and heavily concentrated around proximity to the AI

theme, whether direct demand for computing power or the essential supporting infrastructure required to operate power-hungry data centers.

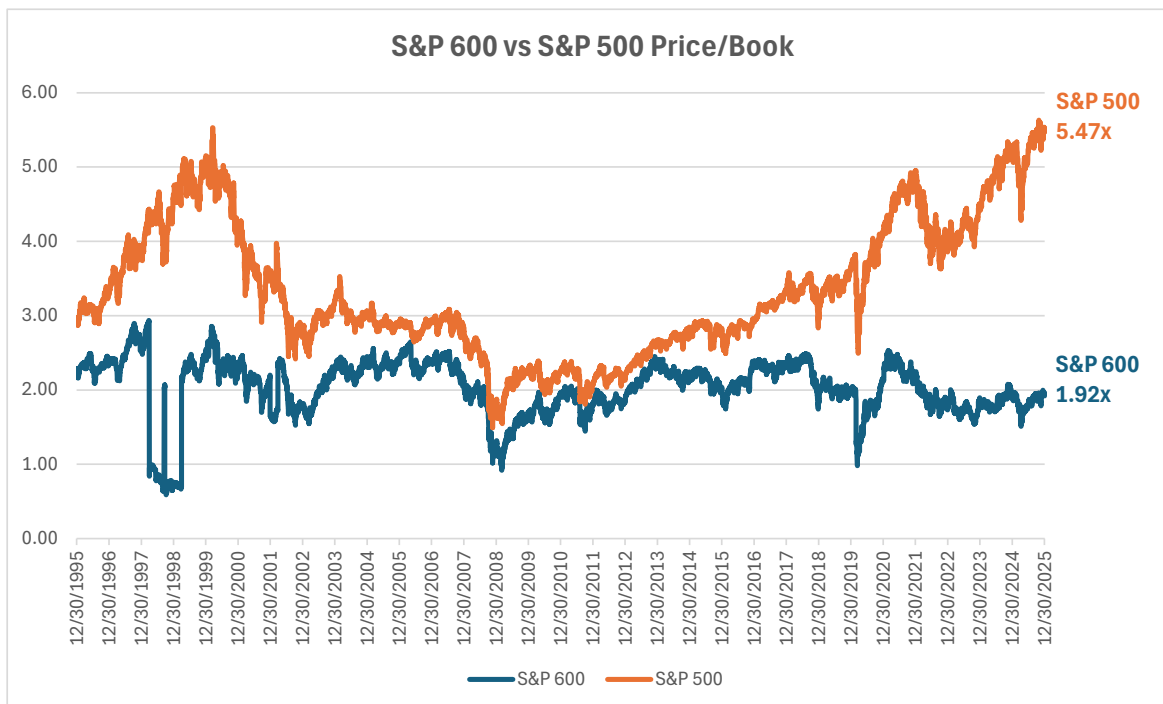
**Implications: Stick with High Quality and Value, Diversify Away from US Large Caps, Find Growth Opportunities Within Defensives, and Hedge Reacceleration Risk with Hard Assets**

Global investors continue to acknowledge U.S. equity exceptionalism, both in profitability and market dominance. The U.S. now commands nearly 67% of the MSCI All Country World Index, up sharply from roughly 45% two decades ago, reflecting sustained outperformance and capital inflows. The S&P 500 currently trades at approximately 22.0x forward 12-month earnings (Bloomberg consensus), near the upper end of its 10-year range. While elevated, this multiple could expand further if the Federal Reserve pursues a more aggressive easing path and corporate profit margins rise in line with optimistic sell-side forecasts. The valuation chasm between large-cap growth (14.7x price-to-book) and small-cap value (1.4x price-to-book) remains near historic extremes.

Encouragingly, the earnings growth narrative is beginning to broaden beyond pure AI-themed names, though the wait for meaningful rotation has at times felt like Waiting for Godot. A genuine widening of market breadth would validate greater portfolio diversification and foster healthier, fundamentals-driven price discovery as AI adoption translates into enhanced competitiveness and profitability across a wider swath of the economy.

At Freedom Investment Management, we believe we are in the later stages of the post-pandemic cycle. Accordingly, we maintain a preference for high-quality U.S. companies - those with resilient balance sheets, durable earnings power, and reasonable valuations. We hold a neutral stance on size (large versus small) and style (growth versus value) tilts. Additionally, we encourage investors to consider selective exposure to hard assets, including natural resources and real estate, as potential hedges against any reacceleration in inflation or rising term premiums driven by persistent fiscal imbalances.

**The Valuation Gap Between Large and Small Caps Remains Historically Wide**



## International Equity Markets

Index Performance as of 12/31/2025	4Q2025	YTD	1-Year	3-Year (Ann)
MSCI ACWI NR USD	3.29	22.34	22.34	20.65
MSCI ACWI Ex USA NR USD	5.05	32.39	32.39	17.33
MSCI ACWI Ex USA Growth NR USD	2.56	25.65	25.65	14.61
MSCI ACWI Ex USA Value NR USD	7.61	39.50	39.50	20.17
MSCI ACWI Ex USA Mid Growth NR USD	1.24	28.64	28.64	15.40
MSCI ACWI Ex USA Mid NR USD	3.26	31.92	31.92	16.57
MSCI ACWI Ex USA Mid Value NR USD	5.31	35.14	35.14	17.71
MSCI ACWI Ex USA Small Growth NR USD	1.65	26.16	26.16	14.08
MSCI ACWI Ex USA Small NR USD	3.50	34.07	34.07	15.77
MSCI ACWI Ex USA Small Value NR USD	4.27	32.41	32.41	17.16
MSCI China NR USD	-7.38	31.17	31.17	11.63
MSCI Japan NR USD	3.23	24.60	24.60	17.54
MSCI AC Asia ex Japan NR USD	4.29	32.26	32.26	16.21
MSCI Europe NR USD	6.25	19.39	19.39	14.51
MSCI EM NR USD	4.73	33.57	33.57	16.40

Source: Bloomberg

In USD terms, international equities decisively outperformed the U.S. in the fourth quarter and delivered one of the widest annual margins of outperformance in recent history. A strengthening of foreign currencies, particularly in Europe and emerging markets, combined with robust gains in technology sectors tied to the global AI capital expenditure boom provided powerful tailwinds.

The MSCI All Country World ex-USA Index advanced 5.05% in the quarter and an impressive 32.39% for the full year, sharply eclipsing the S&P 500's 2.66% quarterly gain and 17.88% annual return. Leadership was concentrated in Europe (driven primarily by financials) and pan-Asia (led by technology). China, however, lagged its emerging-market peers.

Within international markets, small caps trailed large caps, though value stocks outperformed growth for both the quarter and the year. Financials and industrials benefited from fiscal expansion and the supportive effects of U.S. dollar weakness.

Regional dynamics were equally compelling:

- Europe gained momentum from fiscal stimulus, rising defense budgets, and economic recoveries in Southern economies, all of which lifted growth and corporate earnings.
- Japan's continued rally drew support from ongoing corporate governance reforms, resilient domestic profits, and AI-exposed sectors such as semiconductors and construction, though sentiment was tempered by the Bank of Japan's policy normalization, which pushed interest rates to multi-decade highs.
- Emerging markets shone brightest, propelled by the pan-Asian semiconductor ecosystem, renewed Chinese fiscal and monetary stimulus, policy measures bolstering consumption and technology, and competitive advances in artificial intelligence and electric-vehicle batteries.

Overall, 2025 marked a resounding resurgence for international equities, underscoring a shift toward broader global leadership in both growth and value segments.

## Implications: International Markets Look Attractive from a Diversification Standpoint Should Geopolitical Risks and Trade Protectionism Subside

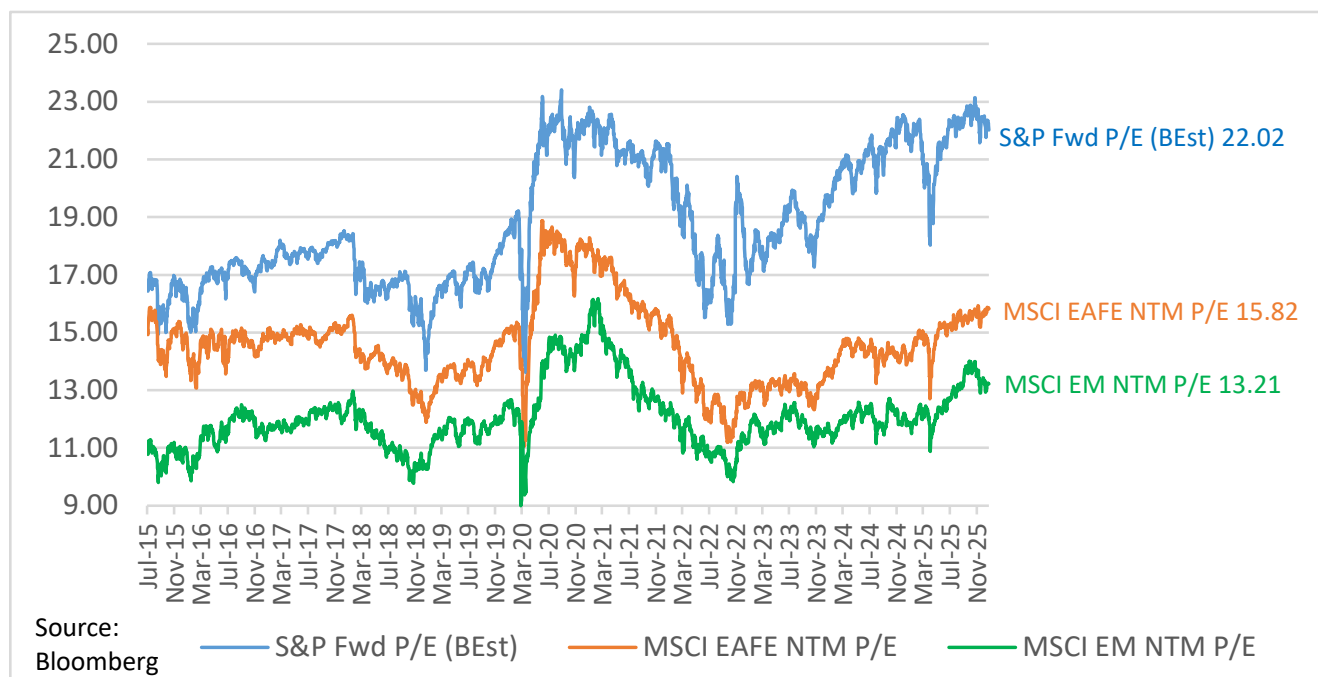
Global markets remain attractively valued relative to the U.S., with developed markets (MSCI EAFE Index) trading at 15.8x forward 12-month earnings and emerging markets (MSCI EM Index) at 13.2x, meaningful discounts to U.S. levels. Earlier in 2025, investors flocked to these regions, drawn by compelling valuations and signs of growth convergence, even as U.S. trade policy grew more restrictive.

Yet structural challenges persist. Unlike the U.S., most international economies still lack vigorous domestic demand engines and remain heavily reliant on exports and industrialization for incremental growth. While profitability trends are improving, they remain subdued compared to American counterparts.

These countervailing forces (attractive valuations tempered by softer fundamentals) lead us to maintain a neutral stance on regional allocations. Investors are rightly vigilant about escalating trade frictions and geopolitical risks in an increasingly multipolar world. Stronger-than-expected U.S. growth could also prompt the Federal Reserve to adopt a more deliberate pace of rate cuts, supporting renewed dollar appreciation and potentially pressuring unhedged international returns.

As in the U.S., we favor high-quality international companies with durable competitive advantages and reasonable valuations. In this environment, disciplined fundamental stock selection should offer active managers a meaningful edge as price discovery rewards differentiation over broad regional bets.

**Valuations Start To Coverge Across Major Markets**





# FREEDOM

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## INVESTMENT MANAGEMENT

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