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## 2025 Year End Review Rates and the Race to the Mid-terms

It was another year of positive returns for stocks and bonds. The Dow Jones Industrials rose almost 13%, the S&P 500 16%, the Nasdaq Composite 20%, and the Russell 2000 12.8%. Bonds rose approximately 4 to 5% in price while money market yields declined from over 5% in 2024 to about 3.5% by the end of December 2025. Precious metals did very well as the price of gold rose over 60%, and silver flew over 140% higher. Cryptocurrencies hit a record high in early October only to end the year down 6%.

2025 will be remembered as a year that tested investors' nerves. The market experienced extraordinary turbulence in early April following the announcement of sweeping tariffs (Liberation Day), which triggered a sharp sell-off across all major indices. The S&P 500 and the Nasdaq fell about 20% in one of the sharpest declines in memory (much like the one at the beginning of the Covid pandemic). The ensuing recovery was one of the steepest as well, gaining back the lost ground and firmly finishing in positive territory.

Our last quarterly letter was titled "Lower Rates Are Coming!" calling for investors to prepare for much lower yields on money market funds and treasury bills, as well as the ramifications stemming from that change. Even after another ¼ point Fed rate cut in December, the Federal Reserve and its chairman, Jerome Powell, have apparently not moved quickly enough to suit the administration. This weekend we learned that the Department of Justice has opened a criminal investigation into Chairman Powell regarding his testimony before Congress about renovations to the Fed's headquarters building. In what appears to be a thinly veiled attack on the independence of the Federal Reserve, the administration is pursuing another criminal prosecution against a perceived enemy. I think it is safe to say that short term interest rates, one way or another, will be coming down for the rest of this year.

Accordingly, we have been increasing positions in investments generating current income, especially for those clients with large cash reserves. Lower rates will likely benefit dividend-paying stocks as the income becomes more desirable. Corporate earnings can also increase due to the decline in borrowing costs, especially for smaller companies.

The investment mosaic is usually complicated, but the recent flurry of news and international developments has ramped up that complexity. There is a tariff war that may or may not be disrupted by a pending decision from the Supreme Court. The takeover of Venezuela was quite possibly more to blunt the growing Chinese, Russian, and Iranian presence so close to the US (along with its oil and rare earth minerals) than about drugs or anything else. The dramatic spike in silver and precious metals may be partly due to

China limiting exports of silver while the US limits the export of computer chips and increases tariffs on their goods. If the Iranian regime falls, China could find two of its largest sources of oil suddenly in less accommodative hands. In response, China may decide that it is time to take control of Taiwan just like the US took control of Venezuela, pursuing their own version of the Monroe Doctrine. Suffice it to say that investment risks may be rising just when the market appears to be relatively expensive.

President Trump obviously wants to reshape the role of the US in the international order, but he may only have until the mid-term elections with an unfettered hand to do so. If Democrats win a majority of the House of Representatives in November, President Trump will face real pushback to his expanded powers; powers which he has recently stated are constrained only by his own morality. We should not be surprised by a ramping up of relatively dramatic action, some of which may be in the name of plausible benefits, but all of which will carry the risk of unintended consequences. I'm old enough to remember when the invasion of Iraq was supposed to pay for itself in oil revenue while bringing peace and democracy to the Middle East. With so many targets identified for possible action, we hope that the US will not repeat the mistakes of the past in Venezuela, Iran, Greenland, or wherever the next move might be.

Despite these risks, the financial markets have proven resilient. There is still a plausible case for a continuation of positive market performance, at least for the near term. Interest rates will be coming down, mortgage rates just hit a three-year low, the Fed's money supply policy is changing from restrictive to accommodative (more liquidity provided to the economy may buoy asset prices), energy prices have dropped as oil remains plentiful, some inflation numbers appear to be moderating, corporate profits may remain healthy, and stock market "breadth" has improved as stocks beyond the "Magnificent 7" have recently been rising. In general, we should continue to invest while expecting the unexpected and adjust our positions as the year unfolds by assessing the risks of policies and events that may upset the apple cart.

Enclosed you will find your year-end reports. Please review them at your leisure and give me a call if you would like to make any suggestions or changes to your portfolio positioning. We appreciate the opportunity to work with you on your investments and look forward to navigating the coming year together.

Best regards,



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