CONGRESS
ASSET MANAGEMENT COMPANY

Economic and Market Outlook

| 1Q26

KEY TAKEAWAYS:

1. **Stock and bond markets saw healthy returns in 2025. The S&P 500 was up almost 18%, the third consecutive year of double digit returns, while the Bloomberg Aggregate Index was up over 7%.**
2. **The US economy remained resilient in 2025 despite fears of rising inflation, tariffs, and employment woes.**
3. **We believe the economy is primed for continued expansion in 2026, aided by a double shot of Fed stimulus, consumer resilience, an ongoing AI/datacenter capex boom, and productivity growth.**
4. **Stock market leadership should broaden as the AI arms race continues. Capex spending by megacap tech companies should continue to benefit companies that support the buildout across sectors.**

“Neither snow nor rain nor heat nor gloom of night stays these couriers from the swift completion of their appointed rounds.”

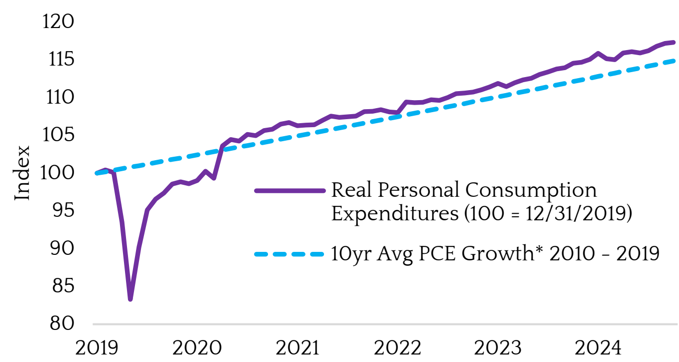
Much like the above quote from the ancient Greek philosopher Herodotus, the U.S financial markets delivered another strong year despite fears of rising inflation, tariffs, and employment woes. The S&P 500 was up almost 18% in 2025, the third consecutive year of double-digit returns. Bonds also rallied, with the Bloomberg Aggregate Index returning over 7%.

Corporate earnings growth, which is expected to top 12% for the year, explains some of 2025’s market returns. However, markets are also pricing in continued economic strength in 2026, fueled by Federal Reserve (Fed) easing, continued consumer resilience, a once-in-a-generation capital expenditure (capex) boom, and accelerating productivity growth.

The Fed cut short-term interest rates for a third time at its December meeting and announced a return to balance sheet growth after over 3 years of run-off. This rare “double-shot” of stimulus comes against a backdrop of solid economic growth. US GDP expanded at an annualized rate of 3.8% and 4.3% in 2Q25 and 3Q25, and 4Q25 estimates are currently tracking at 3.0% growth. The Fed’s decision to cut rates was influenced by increasing unemployment, most recently at 4.6% vs 4.0% at the beginning of the year. By acting now, the Fed hopes to offset any further weakness.

The American consumer continues to show resilience and personal consumption growth remains above its pre-pandemic trend, despite a rising unemployment rate and weakening sentiment surveys. Net worth is bolstered by stock and real estate prices while debt service, a combination of debt and interest rates, remains historically low. Further consumer support is found in the One Big Beautiful Bill (OBBB) passed last summer, which should provide additional spending power in the form of lower taxes. Goldman Sachs estimates that household consumption will grow over 2% in 2026 because of these factors.

Real Personal Consumption Expenditures (2015 -2025)



Source: Congress Asset Management, Bloomberg, US Bureau of Economic Analysis
*Trend PCE growth calculated using monthly average growth rate from 2010 - 2019

The capex boom, driven by the build out of data centers to support the use and expansion of artificial intelligence (AI), should be another tailwind in 2026. Data center spend is expected to total $3 trillion dollars between 2025 and 2028. This buildout should benefit a broad swath of companies across industries. The breadth of spending should increase as tangential industries benefit, and the favorable tax provisions enacted with the OBBB encourage further spending.

The final pillar is the notable improvement in productivity, in essence doing or making more with less. Many expected the robust productivity growth experienced in the pandemic to wane, but it has re-accelerated and is above pre-pandemic levels. Some observers now suggest we are experiencing a productivity boom, one that will escalate as more people incorporate AI into daily routines.

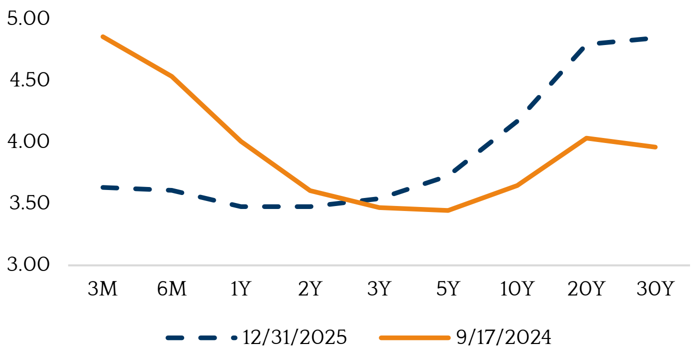
US Labor Productivity (2015 -2025)

Source: Congress Asset Management, US Bureau of Labor Statistics

The most obvious path forward for 2026 is also the simplest to explain - Fed actions support accelerating growth into an already strong economy. However, 2026 is likely to be a transition year for stocks, with returns increasingly tied to the path of interest rates and broadening market leadership.

The near-term risk is not growth itself but whether longer term interest rates, those that dictate mortgage rates and business loans, remain close to current levels or trend higher. While longer-term rates typically fall during cutting cycles, they have broadly increased since the Fed began cutting rates in September 2024. Higher interest rates generally result in lower stock multiples, irrespective of earnings growth or economic growth.

US Treasury Yield Curve (Sept. 2024 vs Dec. 2025)



Source: Bloomberg

Stock investors have also become overly reliant on large technology companies because of the potential game changing nature of AI. For example, the top 5 stocks in the S&P 500 accounted for over 40% of the total return in 2025. However, these companies are in an AI arms race and will likely continue to deplete their free cash flow. This spending is a revenue and earnings boon for companies that support AI and data center buildout across sectors, including industrials, energy companies, and other service providers.

We continue to believe stock market leadership will broaden, and investors will be well-served by holding a diversified portfolio that is not overly concentrated in a handful of stocks.

The fundamentals for bond investors remain generally positive as well. While we are unlikely to see materially lower interest rates in 2026, yields remain historically attractive and inflationary pressures appear muted as we enter the new year.

Investment Oversight Committee

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