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Minot DeBlois Advisors LLC – Year in Review and Investment Outlook
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The multi-year trend of the U.S. stock market's strong growth being led by mega-cap technology and related stocks continued in 2025, and the stocks that have come to be called the Magnificent Seven[1] again accounted for the majority of the S&P 500's return, as they did in 2024 and 2023.[2] Despite a litany of cautionary signals – downward revisions to U.S. growth prospects, fiscal concerns related to the deficit, continued geopolitical turbulence, sharp policy shifts from a new U.S. Administration, and tariffs & trade policy contributing to dollar weakness – U.S. stocks produced strong returns last year. The S&P 500's return was driven by substantial revenue and earnings growth, especially from major technology companies continuing to invest in, and beginning to show profits from, Artificial Intelligence (AI) products and services.

At the outset of 2025, a new Administration introduced substantial tariffs on imported goods, a break with long-standing free trade policy that caused a sharp drawdown in the markets. As clarity was reached and the more pessimistic forecasts failed to materialize, U.S. stocks recovered from their early April declines to return 18% for the calendar year. Though domestic returns were strong, for the first time in several years foreign stocks outperformed, especially for U.S.-based investors, in part due to the dollar's decline of approximately 10%. The global economy grew modestly in 2025, despite ongoing conflicts in Ukraine and the Middle East and turmoil related to the renegotiation of longstanding trade policies. In the U.S., inflation hovered around the 3% level, above the Federal Reserve's long-term target of 2%.

Benchmark	Total Return One Year	Annualized Return Five Years	Annualized Return Ten Years
S&P 500 (U.S. Large Cap Stocks)	17.9%	14.4%	14.8%
MSCI EAFE (Foreign Developed Large Cap Stocks)	31.2%	8.9%	8.2%
Barclays Aggregate Bond Index (U.S. Investment Grade Bonds)	7.3%	-0.4%	2.0%
US Short-Term Treasury Bills (U.S. Government Money Market Fund)	4.3%	3.2%	2.2%

The S&P 500 Index is a broad measure of US large capitalization stocks; the MSCI EAFE Index is a broad measure of mid-large capitalization stocks in developed international markets; the Barclays Aggregate is a broad index of US investment grade fixed income securities; the 90-Day US Treasury Bill represents short-term government money market funds. Returns are provided by sources deemed to be reliable but are subject to change or revision.

The consensus outlook for U.S. large cap returns in 2026 remains quite positive in light of a growing economy, booming corporate profits, resilient consumer spending, and the possibility of further declines in interest rates. Importantly, the consensus view is that AI spending will continue to grow, and employment starts the year from a place of strength. Tax cuts will likely be a tailwind in 2026, furthering the narrative of continued economic expansion. Said differently, the business cycle appears supported by fiscal (government spending), monetary (lower rates), and financial (no sign of credit concerns) factors. Generally, Wall Street believes that U.S. stocks will be "boosted by the triumvirate of easy fiscal, monetary and regulatory policy, along with AI tailwinds".[3]

This narrative has resulted in the S&P 500 reaching a price-to-earnings ratio of nearly 26 times, well above its 19x long-term average, which by traditional metrics would suggest that the U.S. stock market is over-valued or possibly even in bubble territory. It is important to remember, however, that stock market bubbles can persist for extended periods

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[1] The Magnificent Seven are: Alphabet (Google), Amazon, Apple, Meta (Facebook), Microsoft, Nvidia, and Tesla. These stocks' combined market cap now represents almost 40% of the total value of the S&P 500.

[2] The strong performance of technology stocks over the past three years has resulted in an approximately 40% outperformance return differential between the market-weight S&P 500 index and the equal-weight index, which is the largest return disparity since the creation of the equal-weighted index in 1990.

[3] *Financial Times* December 5th article: "U.S. stocks set for double-digit gains in 2026, say Wall Street banks: Bullish forecasts come despite recent investor jitters over tech spending and potential bubble in AI sector".

without necessarily bursting, and bubbles can also deflate in other less dramatic ways. A high price-to-earnings ratio may ultimately normalize through sustained earnings growth or a period of returns below historical averages. We do not believe that the current stock market mirrors the dotcom bubble of the late 1990s, as, unlike the internet era, during which the leading companies often had no real earnings, today's AI market leaders are highly profitable, generate substantial cash flows, and maintain robust balance sheets.

Over the course of 2025, we grew more confident in AI as a technology and in its business prospects and financial durability, and we continue to focus on this key new economic driver. In many accounts, we have had significant exposure to AI-related investments for some time, and over the past year we have maintained or increased that exposure where appropriate. We are conscious, however, of the many uncertainties surrounding the long-term trajectory of AI and would not over-weight exposure to this trend.

While the continued success of productivity enhancements promised by AI is the foremost focus of investors, other important factors are also at play. Inflation must remain contained and interest rates well behaved, budget deficits must not become an economic millstone, and trade policy or other unilateral government action must not shake faith in the capital markets or long-standing American institutions. Other areas of traditional economic concern that merit monitoring include those related to the U.S. consumer, notably declining consumer confidence and slightly rising unemployment, along with more acute difficulties for low- and middle-income households.

Given valuation levels and the risks outlined above, we deviate from the consensus view and believe that long-term investors should treat U.S. large cap stocks with some caution. It is vital to recognize that U.S. stock returns over the next decade will likely be significantly lower than those of the last ten years, and we advise against using recent gains as a blueprint for the future. Instead, long-term investors should focus on protecting assets and prioritize capital preservation following a period of significant appreciation. As we begin 2026, we believe that the range of possible economic, financial, and political outcomes has widened, and thus a broad reduction in risk may be appropriate. While we have had a long-standing bias toward U.S. large cap stocks, given the disparity in valuations and the weakening of the dollar, we began incrementally allocating more toward foreign stocks over the past year. Should current trends persist, we may recommend further reductions in U.S. large cap stock exposure in favor of both international equities and bonds.

We realize that, with stocks having performed well, selling securities can be an expensive proposition for taxable accounts, but disciplined rebalancing of portfolios lays the groundwork for superior risk-adjusted returns over longer time horizons. Should stocks continue to appreciate, we will rebalance back toward our long-term allocation targets and invest proceeds in risk control assets such as cash, Treasury Inflation Protected Securities (TIPS), and short- to intermediate-term bonds, all of which appear attractive both for their current yields and their protective qualities in a downturn.

As we embark upon a new year, we also want to take a moment to express our deep appreciation for your continued confidence in us. We remain committed to our disciplined approach of protecting capital by investing in stocks of durable companies with reasonable valuations and mitigating risk through diversification across sectors and geographies.

We wish all our clients, friends, and colleagues a **healthy and happy new year**.

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