

Policy Wildcard: Aerial Adjustments May Be Expected

Markets enter 2026 with remarkable resilience despite a year of significant policy and geopolitical shocks. Equity gains have been underpinned by confidence in a “perfect landing” scenario—one featuring falling inflation, steady growth, and robust earnings—yet expectations now imply three consecutive years of double-digit S&P 500 earnings growth, a rarity this late in the cycle.

Beneath the surface, risks are accumulating sticky inflation pressures, tariff driven goods costs, rising term premiums, and uncertainty around policy of all kinds, including transition of Federal Reserve independent leadership, all introduce meaningful late cycle friction. Meanwhile, the AI narrative—critical to market sentiment—shows signs of both powerful tailwinds and potential overbuild risk.

Financial markets may still stick the landing, but the margin for error is thin. As policy, valuations, and global realignments converge, even modest disappointments could trigger volatility—making portfolio discipline and preparation crucial.

Market & Asset Class Review

- **Equities:** U.S. and global equities delivered strong 2025 returns, with leadership broadening beyond megacaps as international markets outperformed on better valuations and a weaker dollar.
- **Fixed Income:** Bonds posted solid gains amid falling rates, though credit remains vulnerable to a softening economy and elevated issuance in certain sectors.
- **Real Assets:** Real assets performed well, led by gold, infrastructure, and select commodities, even as energy lagged on oversupply and weaker demand.
- **Diversifiers:** Hedge funds and private credit provided steady returns and downside protection, benefiting from dislocations, attractive spreads, and improving private market activity.

Portfolio Positioning

- **Lean into “creative diversification”:** Incorporate diversifiers such as hedge funds, private credit, and gold to offset equity factor concentration and provide resilience during policy driven volatility.
- **Maintain quality and liquidity:** Preserve flexibility within core fixed income to rebalance if long-term yields rise or AI linked volatility increases.
- **Expand global opportunity sets:** Increase exposure to non U.S. equities where valuations are more attractive, inflation dynamics differ, and long-term earnings drivers are broader.

Bottom Line

The path ahead may feature more friction than markets currently imply, but disciplined positioning—balancing liquidity, global diversification, and thoughtful risk management—can prepare portfolios for a wider range of outcomes. In a world unlikely to deliver a perfect landing, choreographing for imperfection is the most prudent strategy.

