

Sound Thinking

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Top 10 thoughts for 2026

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Every year in early January we pull together a series of topics that we think investors should be thinking about as they approach a new year. Some of them tend to be market or economy specific forecasts, while others are more thematic. We try to make it clear what we define as success, and we try to make sure that the things we are concentrating on say something new – disagreeing with consensus where we think that is appropriate. At the end of each year, our Investment Committee chair – who otherwise is not involved in producing this document – evaluates our successes (and misses), in order to keep our yearend review as objective as we can.

We have a generally positive outlook for 2026. We think economic growth is likely to continue and that a broad risk-on bias is likely to be appropriate for most investors. At the same time, we are aware of the high valuations of risk assets (domestic assets in particular) and can see a number of areas where news flow may cause short term volatility for investors. We expect interesting times for domestic and global politics, and continuing pressure in the ESG space.


But first, let's take a look at our predictions for 2025 and how these forecasts fared.

2025: A Good Year for Investors (and for our forecasts)

We entered 2025 with many forecasters concerned. Most forecasters expected relatively poor economic growth and market conditions and thought that interest rates would likely fall rapidly. In contrast, we were relatively optimistic – a good number of our predictions were outside of consensus, and there was some trepidation within our investment team when we published our initial predictions as to whether we would be correct.

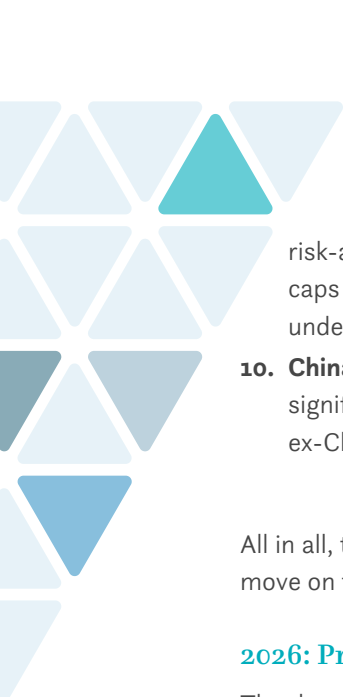
As things played out, 2025 was a much better year than expected, both for the economy and for portfolios – and indeed for our predictions, with 7 ½ of our 10 forecasts falling into the “correct” category. Our specific predictions, and how they turned out, are below.

- 1. Up not down: U.S. economic growth surprises to the upside. *This was correct*,** as GDP growth has surpassed expectations. Third quarter growth came in at an incredible 4.3% annualized rate, which followed a similarly impressive Q2 report. If Q4 growth is at least average in nature, 2025



will have shaped up to be a year of fairly average growth rather than slow or recessionary as many investors had initially expected.

2. **Up not down part 2: Continuing stubborn inflation. *This was correct.*** Continued economic strength as well as some tariff price pressure has kept inflation materially higher than most would like. We were also correct in our call that inflationary impacts from tariffs would be a smaller rather than larger effect.
3. **Higher not lower: normality resumes.** We forecasted that an expanding economy and hot inflation would keep interest rates higher than expected. ***This was a miss***, as the Fed did in fact pause rate cuts for most of 2025, but still managed to cut rates by a magnitude expected by investors. Longer interest rates also fell slightly during the year. However, we do note that timing matters here – Verus held this view through late 2024 when markets expected far more cuts in 2025 than what has occurred. Around the time that this document was written (December 2024) markets moved more in line with our *higher for longer* view.
4. **Tight for a reason: opportunities still available.** We predicted that credit spreads would provide investors with limited upside potential given their tight levels and would provide little cushion in the case of defaults. ***This was correct***, as credit spreads are effectively unchanged since the beginning of the year, and investors saw a notable drawdown during April market volatility.
5. **Seriously not literally: Trump 2.** Our prediction that investors should focus on the details of Trump policies once implemented, and that an approach of taking Trump “seriously but not literally” would be generally effective. ***We believe this was only partially correct.*** The administration pushed harder than expected on many policy areas but remained prepared to accept temporary partial success (putting Fed Chair Powell under significant pressure, rather than trying to fire him, and pushing for efficiency in Ukraine funding rather than cutting support completely, for example) in many of those areas of disagreement.
6. **Free(ish) trade: Putting the “if” in tariff.** In line with the “seriously not literally” approach outlined earlier, it appeared most likely that the use of tariffs would be considered and strategic, not unthinking and across the board. ***We missed on this call.***
7. **Active risk: global opportunities. *This was correct.*** We expected that U.S. equity indexes would remain very difficult for U.S. large cap actively managed funds to outperform, and the heavy weight of Magnificent 7 stocks in indexes have made that problem worse. The nature of standalone U.S. large cap equity mandates can incentivize active managers to overly-diversify their portfolios when trying to capture alpha in the market, in order to constrain tracking error. For this prediction, we said that the greater concentration inherent in active global equity strategies can help those global managers to generate U.S. security alpha. Year-to-date active global equity strategies outperformed U.S. large cap active managers by 75bps in terms of U.S. security selection performance, leading to our marking this call as accurate.
8. **Crypto clarity: the call is coming from inside the house. *This was correct.*** We said that once the regulatory agenda was clearly expressed and had begun to be implemented, investors with a higher level of risk tolerance may begin to consider whether crypto may have a role in their portfolios and what that role may look like. The crypto regulatory environment has changed significantly, and we have seen more institutional movement towards the space.
9. **U.S. small caps: strength matters. *This was correct.*** We predicted that investors with small cap allocations at a policy level should not necessarily expect small caps to outperform large caps on a



risk-adjusted basis or even on a total return basis. U.S. small caps have underperformed U.S. large caps in 2025, adding to their very long run of underperformance, and U.S. small caps have vastly underperformed in 2025 on a risk-adjusted basis.

- 10. China: is evitable even a word?** We said that the Chinese economy would continue to face significant structural headwinds and that there would be further interest from U.S. investors in ex-China mandates. **We count this as a success.**

All in all, then, 2025 was a fairly good year, and we can be happy with our forecasting record. So, we move on to the outlook for 2026: what are we expecting now?

2026: Prepare for Clarity & Surprises

The theme for this year is likely to be “surprise” – growth surprises, inflation surprises, data surprises, job market surprises, and political surprises. Most of that surprise is likely to be positive (on balance), but there are also likely to be some periods of increased volatility as the already richly-priced market processes the rapidly changing environment. We seem to be shifting towards an environment where different world views (on markets, on finances, on demographics and on politics) push harder against each other, and 2026 may prove to be an environment where these differences are confronted by clearer facts than have been available in recent years. That will mean clarity is provided on a number of important topics, but also with challenges, and potential short-term market volatility.

1. GDP – GROSS DOMESTIC PRODUCT, OR GROWING DOMESTIC PRODUCT?

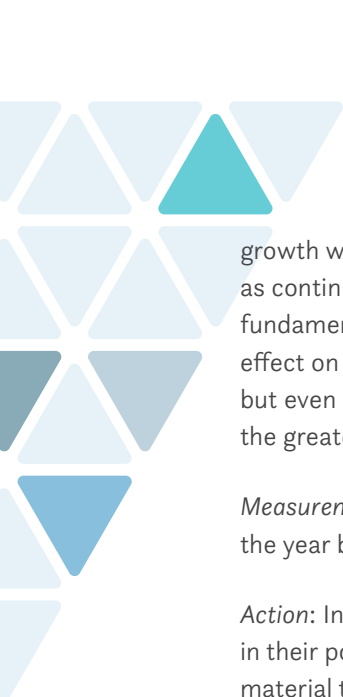
We believe GDP will come in towards the higher end of forecasters’ expectations: these are anchored around 2.0% real growth for 2026, while we believe a result closer to 2.5% is likely. The economy in the U.S. remains strong, even though there are individual metrics that can be pointed to as weak spots. The natural pessimism that forecasters can have during periods of positive growth is likely to continue, which may unreasonably bias expectations downward. The reality is that the U.S. economy remains resilient in most areas and is moving into an environment of lower taxes and broad fiscal easing, somewhat lower interest rates, and likely increased capital investments. Surprisingly positive economic growth should result: stagflation is highly unlikely without wholesale redefinition of the term to mean something quite different (the term “stagflation” was frequently misused during much of 2025).

Measurement metric: At the tail end of 2026, past 12-month real GDP growth will be materially above the current 2.0% consensus estimate.

Action: This positive economic surprise environment will likely be supportive for risk assets. Investors may be well-served by leaning into risk, and accumulating exposure during periods of weakness: investors should also be aware that there are likely to be one or more periods of heightened volatility as forecaster cognitive dissonance meets positive realities.

2. INFLATION – DOWN AGAIN BUT NOT ENOUGH

We believe that inflation will continue to drop, but that this drop will not be enough to bring it to the target level for the Fed. Ongoing inflationary pressure will be fueled by the continuing strong economic



growth we expect: somewhat warm inflation is less concerning in this context. This is better thought of as continuing strength-driven stickiness, not materially driven by ongoing trade issues nor by fundamental problems in the economy. A possible sleeper effect on inflation could come from the effect on residential rental real estate from immigration policy changes – we will discuss this later – but even if this causes downward pressure on inflation, it will likely affect CPI more than PCE, which is the greater focus for Fed policy.

Measurement metric: PCE during 2026 will remain above the Fed’s 2% target for at least 10 months of the year but will not increase again to recent high levels.

Action: Investors may be tempted by continuing inflation talk to focus on “inflation protection sleeves” in their portfolio – we believe this temptation should be resisted, both as inflation is unlikely to be a material threat in the near-term, and because inflation protection is better done in the context of the whole portfolio rather than through a small allocation to particular assets perceived as inflation sensitive.

3. INTEREST RATES – UNEXPECTEDLY UNINTERESTING

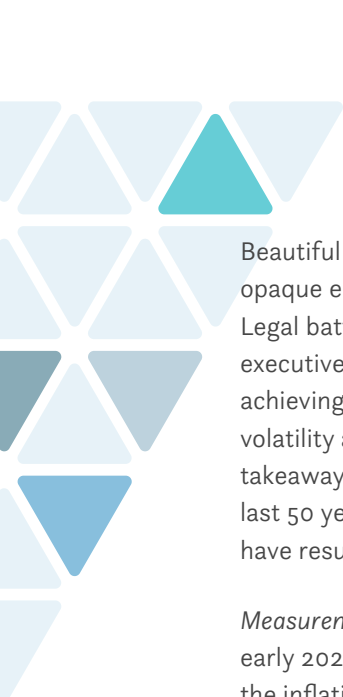
Many commentators are thinking of 2026 as a year where interest rate policy will be a hot topic – the final denouement of the Fed Chair saga, and many column inches and pixels spent discussing the effect of that change (and the other changes on the Board) on interest rate policy. We believe that reality will be less exciting. Market expectations for a couple of interest rate cuts by year end seems reasonable, the combination of stronger-than-expected growth and warmer-than-expected inflation is likely to continue, and while there will be plenty of discussion about interest rates, it seems unlikely there will be much new or surprising content to add to the discussion. Rates will likely come down in line with market expectations, long rates will stay higher than the administration would like, the administration will complain loudly about the level of rates, opponents of the administration will decry politicization of interest rate policy, actual interest rate policy will continue largely unaffected by the arguments, and the real economic excitement for the year will turn out to be generated elsewhere.

Measurement metric: The Fed Funds Rate will end the year close to 3% in line with market expectations, and long-term bond rates will stay close to their current level.

Action: Investors should not count on unanticipated interest rate changes, either at the short or the long end of the curve.

4. TARIFFS – THE ARGUMENT MAINLY SETTLED

During 2026 we will be provided with further evidence regarding the ultimate effects of Trump administration tariff policies. Initial fears of a dramatic inflation spike will continue to prove overblown: while some industries and goods will show some inflationary pressure, most supply chains will allow for flexibility without too much impact. The other side of the argument – that some of the supply chain adjustments will involve re-onshoring of manufacturing – will likely begin to produce positive evidence as discussions turn into plans which turn into action, helped by the tax benefits from the One Big



Beautiful Bill Act. These effects may be strong enough to allow the administration to claim success, but opaque enough for opponents to be able to claim the positive news was caused by other variables. Legal battles over tariffs will certainly continue, with ongoing litigation around the exact scope of executive branch power in this realm. The end result will probably be a mixed bag, with each side achieving some wins and losses. Variable news-flow may produce short-term positive and negative volatility as markets over-compensate based on the most recent headline. However, we believe the key takeaways for 2026 will be that tariffs have settled at a much higher level than they have been for the last 50 years, that inflationary effects are mostly contained, and that some onshoring of supply chains have resulted from this change.

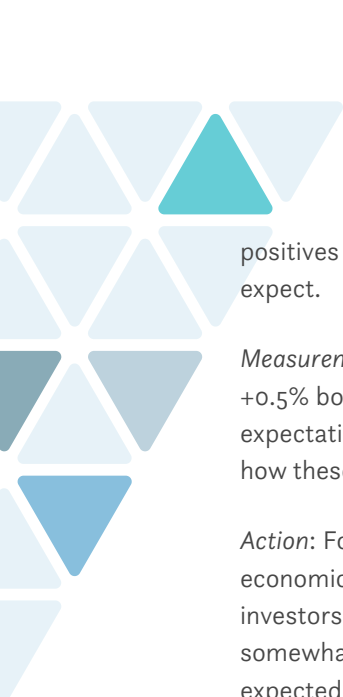
Measurement metric: Average tariff rates will continue to be materially higher than they were in the early 2020s for the year, while inflation due to tariffs will be minimal and will be mostly falling out of the inflation statistics by the end of the year.

Action: Investors should focus on the broad underlying drivers of the economy rather than be overly reliant on “tariff story” narratives.

5. THE YEAR OF THE UNSURPRISING SURPRISES

During the next twelve months, the One Big Beautiful Bill (OB BB) Act will come into full effect. Many commentators have identified a range of positives (tax benefits from rapid expensing of capital expenditures, for example) and negatives (cuts to many social benefits that will hurt certain household budgets, for example) that will likely exist as this legislation takes effect. As has been a common investment theme in recent years, investors will be well-served by leaving their political biases at the door and evaluating impacts of the OB BB Act in a dispassionate way. Based on the tone of news flow and discussions recently around this legislation, we believe that, similar to 2025 with the shift in U.S. trade policy and substantial overestimation by investors of the size of negative economic and markets effects from policy, investors may, on average, be tilting too pessimistically in their views for 2026. For this theme, we believe the near-term positive economic effects of OB BB Act legislation on the economy will likely be bigger than expected, and the negative economic components could be smaller than expected (we focus our forecast here solely on the near-term effects on the economy, and acknowledge longer-run effects such as a more strained U.S. fiscal situation would require separate evaluation).

Taking a look under the hood of this legislation reveals a variety of specific areas that could be incrementally positive for economic growth to a degree that surprises investors. First, no tax on overtime pay raises take-home pay while incentivizing more work hours, raising the overall disposable income of many blue collar and essential workers (ex: manufacturing, logistics, healthcare), possibly also helping to alleviate labor shortages in certain sectors while translating to stronger overall consumer spending. Next, no tax on tips will boost take-home pay for many Americans, once again allowing more discretionary spending to flow through the economy. Third, tax breaks for U.S.-made automobiles may boost American car sales, generating local revenues, spending and possibly jobs. We of course note that strong arguments also exist for why many of these initiatives may be distortive of markets and could come with unintended side effects; however, we suspect that on balance the



positives for growth in the near-term will outweigh the negatives more than commentators currently expect.

Measurement metric: Positive effects from the OBBB Act will ultimately be estimated at more than a +0.5% boost to 2026 U.S. real GDP growth, which is towards the higher end of the range of current expectations. Also, there will be a feeling of surprise amongst media members and investors regarding how these positive effects flow through to the economy and American businesses.

Action: Following 2025 and preparation by many in the media and investor community for certain economic calamity due to U.S. Administration policies (calamitous effects which were never realized), investors should be open to the idea that positive economic impacts from the OBBB Act will be somewhat greater than expected and negative economic effects will be real but less bad than expected.

6. IMMIGRATION POLICY EFFECTS CLARIFY

The first year of the second Trump administration involved significant changes in immigration policy enforcement, and this had an effect both on the number of people entering the country in irregular ways and on the number of people choosing to remain without full legal status. Understanding the scale and nature of this change is currently very difficult, both because the data involved is politically sensitive and because there are strong disincentives for those involved to report accurately due to concerns about how the data might be used. During 2026, we believe four key things will happen. First, the administration will expand the scope of their work on immigration, continuing to push hard on those in the U.S. without documentation while also expanding their focus on stricter enforcement of the legal immigration process and potentially making efforts to change the rules around legal immigration. Second, the number of people leaving the United States will increase, and this outflow will expand to include more affluent and educated individuals due to efforts to change the legal immigration process. Third, the effects of these changes will begin to be known as clearer data at the federal and state level is released, both in terms of the number of people involved and the economic impact. Fourth, there will be rising economic impacts from these changes: less demand for residential real estate in some markets due to lower population, increased demand for labor in certain sectors and locations that will likely cause increased participation rates from documented workers (due to decreasing supply of undocumented workers), and potential changes to public spending due to these dynamics. While the exact effects are currently difficult to predict, more clarity will allow for better assessment of the impacts. Those impacts will be a mix of both positive and negative for the overall economy, and many debates will be had regarding which of the effects are in fact “positive” or “negative” and for whom.

Measurement metric: U.S. population growth will be similar or lower to that observed in 2025, with the effects of this on the labor, and broader, economy beginning to be noticeable in a variety of areas.

Action: Concerns that continued immigration enforcement will significantly cramp economic growth are unlikely to be well founded. This supports the general acceptance of risk driven by domestic economic growth during 2026.



7. EMPLOYMENT & PRODUCTIVITY – A COMPLICATED STORY


A drop in immigration and a growing economy might lead one to think that the unemployment rate is bound to fall significantly, but we believe that this year will be more complicated than that, and that this complexity will spill over into the question of productivity. Unemployment is based on the number of people in “above the board” jobs relative to the number of people in the workforce (which of course excludes people who would be able to work but who are not looking for work). It seems likely the number of people working in *fully on the books* jobs will increase as the economy grows, and with even a small amount of onshoring. However, as was the case during the latter part of the Obama economy, one of the results of economic expansion is likely to be that more and more previously discouraged workers come back into the workforce – this increases the number of *available workers* in the labor force, which raises the unemployment rate all else equal. We may well see either a flat or slightly increasing unemployment rate over the year, therefore, despite good economic growth. Further, we expect this to coincide with a productivity conundrum. The introduction of AI across the economy is likely to drive genuine productivity improvements, and investors should expect to see this in the statistics. However, as more marginal employees come back to the labor force (those who have just begun to participate in the labor economy having previously been discouraged workers) there will likely be some counteractive negative impact on productivity, given that many of them must relearn job skills. We believe this will all result in a more complex story than investors are expecting – not enough to kill the AI productivity narrative but enough to cause confusion during 2026.

Measurement metric: Unemployment will be sticky and will likely rise slightly, driven by an increase in people looking for work. Productivity will likely increase although it will be less than those predicting large AI productivity impacts would like, and this will likely produce some headlines unfairly questioning the AI productivity narrative.

Action: Investors should not be overly worried about labor market numbers during the year and should instead focus on the real internal dynamics of the labor market. Particular attention should be paid to the degree to which non-engaged workers are moving into the workforce, and the degree to which jobs which had previously existed *off the books* begin to move out of the gray area and into the legitimate economy.

8. ILLIQUIDITY RISK – SELECTION STILL MATTERS

We have consistently warned about the dangers of illiquidity and made the case that illiquidity is always a risk: while illiquid asset classes can indeed be a source of excellent return, that return is driven by active investment management decisions made by the GPs of the vehicles used to invest in that asset class. There is typically no “free lunch” provided simply by investing in illiquidity. There are many institutional investors who have learned this lesson the hard way over the last few years – we believe that lesson will continue to be taught during 2026 and will become even more painful in many instances. Investors in private illiquid markets that are highly skilled in fund selection with proper access to top tier GPs will continue to be compensated during 2026, while the poor returns coming from poorly managed programs will weigh on the *average* returns of the private equity universe, and the liquidity problems caused by poor liquidity management will continue to cause practical challenges



for the effective implementation of many institutional investment programs.

Measurement metric: The return experience for private market investors in aggregate during 2026 will be below the average return over the last 25 years, and there will continue to be liquidity challenges for a material cohort of institutional investors who have overallocated to poorly performing programs. Successful programs will continue to perform well.

Action: Investors should focus hard on ensuring their private market programs are focused on true value generation at the GP level rather than simply financial engineering. Manager selection and liquidity risk modelling will remain the key to success in these programs and firms who are able to provide those skills will be in strong demand from investors.

9. NOISY BUT MORE PEACEFUL

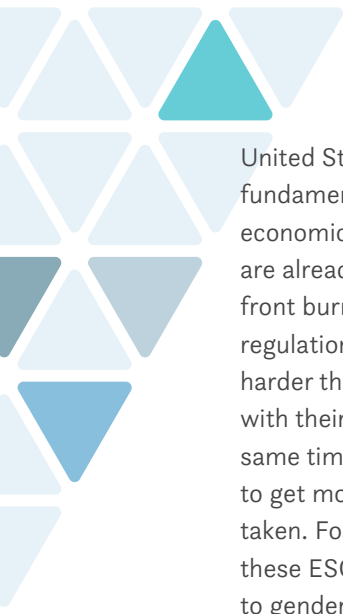
Geopolitical instability remains a market concern. The Ukraine conflict has not yet come to an end, China continues to assert their claim to Taiwan, and real peace in the Middle East remains elusive (also, 2026 news flow kicked off with the unexpected capture of Venezuela's Nicolas Maduro and his wife). However, there is reason to be broadly positive, and our expectation is that while the noise will continue, at least one or more of these flashpoint areas is likely to move materially towards resolution. It appears that both sides in the Russia / Ukraine conflict are nearing the end of their physical and emotional resources and a stable solution is increasingly in the interests of both sides – escalation events that happen in the meantime are likely positioning for a final conclusion than for a longer-term conflict. It also appears that there is increasing interest across the Middle East in creating a more stable set of relationships. Also, with the immediate Gaza problem more under control and the U.S. having been prepared during 2025 to apply limited targeted force against Iran, it is probable we see an expansion of the Abraham Accords process during 2026. China / Taiwan seems the stickiest issue, though we believe this is better viewed as a leverage tool for China regarding power positioning vis a vis the United States, rather than preparation for a hot war. In each of these cases, there will likely be plenty of non-traditional wording coming from the U.S. administration – but we expect some positive movement despite (or because of) that.

Measurement metric: A material improvement in two of the three friction points outlined above would count as success here. This could be a robust ceasefire in Ukraine, a real move towards the expansion of the Abraham Accords in the Middle East, or a de-escalation of military preparation by China relative to Taiwan.

Action: This supports the underlying theme of risk-on positioning. In particular, it suggests there will be the opportunity for risk-on moves to occur in markets outside the United States, not just domestically. A reduction in conflict may well provide an environment where oil prices remain somewhat weaker than expected on a neutral basis, allowing positive support for growth.

10. PEACEFUL BUT MORE NOISY

Counteracting our previous forecast for some geopolitical conflict resolution in 2026, we expect there to be significant escalation in an unexpected place – across the Atlantic between the EU and the



United States. While these are natural allies in many ways, and those alliances will remain fundamentally intact, 2026 is likely to be a year where the different approaches to free speech and economic regulation come to a boil. The two fundamentally different approaches to speech regulation are already clashing, and there are a series of rapidly escalating lawsuits which could move this to the front burner and cause the issue to have a potentially significant impact not only on the topic of speech regulation but also on broader regulation in general. European investors are also now pushing much harder than before on investment management firms to implement ESG in a way that is compatible with their values, but which clash with the values of significant portions of the United States. At the same time, pressure in the U.S. on ESG issues from the administration and from various states is likely to get more intense. We believe this pressure will begin to turn into demands for specific actions to be taken. For example, recent plans to increase U.S. regulatory scrutiny of proxy voting firms may push on these ESG issues and be combined with agency enforcement actions regarding hiring policies related to gender and race issues to make this area broadly more challenging for investors to navigate. These political clashes may spill over into economic issues and may throw sand in the recent renewed enthusiasm for European equity markets. While the underlying collective history and interests of these nations are strong enough not to make this an existential risk to the relationship, commentators and investors are likely to be surprised about the speed at which this becomes an issue and the depth of emotion it unlocks.

Measurement metric: One or more significant free speech regulation or ESG issues will surface as a major cause of international tension during the year between the U.S. and the EU and will be introduced into economic discussions as a core regulatory issue.

Action: This, particularly the free speech regulation issue, will shine a spotlight on some of the most important growth stocks in the U.S. in the technology space, as the terms under which they are able to do business within an increasingly regulatorily focused EU will come into question. While this will not likely challenge their continuing economic model fundamentally, it may cause some short-term volatility at times for some of the most exposed enterprises and may impact broader market behavior.

CONCLUSION

These ten thoughts mesh together into a view of the important narratives of 2026. We believe the good is likely to outweigh the bad, although stretched valuations and strong opinions are likely to cause periods of higher volatility. The United States remains poised for continued growth, and with the rise of clearer data some commentators may find themselves surprised and reassessing their thinking throughout the year. Like 2025, 2026 is likely to be a year where politics is important – and the outlook for the last month of the year and for 2027 is likely to be materially driven by the results of the mid-term elections. Investors, though, should look through political headlines and focus on economic behaviors and effects. All in all, we believe a mild, careful, risk-on strategy is likely to serve investors well.



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