

FRIDAY, JANUARY 9, 2026

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Well, hello. Happy New Year. Welcome to the Dividend Cafe, our first Friday Dividend Cafe of 2026, where we are going to jump right into our annual Year Behind, Year Ahead special. We're going to do an extensive review of everything that was 2025. We're going to do a report card on ourselves, the themes we set for 2025, and how those actually played out.

And then we're going to set some themes—forecast perspectives for 2026—and give you our preview of the year ahead. This has become an annual tradition at The Bahnsen Group. I actually debate how many years we've done it because it started back at Morgan Stanley, and I just don't have the records and can't remember exactly the very first year. But it's somewhere between 13 and 15 years now that we've been doing this.

The goal is to give you a really comprehensive assessment of what just was, but give you something actionable, something contemplative, something useful as we think about the year ahead. I'm going to cut the introduction there 'cause I know I can ramble on and on and we have so much to go through, but this is going to be a very fun Dividend Cafe.

I am actually—literally—not going to read from the white paper itself, but I'm sitting here holding the actual paper, and I'm going to try my best to go through so that those of you that are listening on the podcast or watching the video are going to get the same information that everybody gets by reading the PDF of the white paper.

Now, of course, the charts and things will be up on the screen as much as possible as I go through for those of you watching the video. But let's get right into it and see if you can't get the same experience listening as I intended for readers to get.

The first thing I want to say is: I invite you to flash back one year. Just think about January of 2025 and tell me if any of these types of questions or conversations or themes would've sounded familiar. And I'm going to read exactly what it is that I said here:

What's going to happen with the Trump tax cuts from 2017 that are set to expire? What is going to happen with trade and tariff policy? How is that going to impact the economy and markets? Are these valuations in the stock market sustainable? What will AI top-heaviness mean for the overall market?

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So, from the impact of tax cuts to the impact of tariffs to the valuations and AI situation in the market, those would've been three big themes, questions, issues that most investors were wrestling with one year ago.

And I would say to you, without any *déjà vu*: if you were doing the exact same thing right now, wouldn't the questions, themes, and major issues be something like: What will the impact be to the economy and markets from the new tax bill that did pass back in 2025? What will the impact be to the economy and markets from the tariffs that were implemented in 2025? Are these valuations in the stock markets sustainable with AI? Top-heaviness means something for the overall market.

So, that's the point I'm making: a year later, the major issues, the major questions are largely the same. Now, they've developed a year—there's a year more of information instead of the hypothetical of what was going to happen with the tax bill or with tariff policy. We now have seen that go through, and now we have to evaluate in '26 what it's going to mean.

But we're not dealing with this major new paradigm shift, from at least the high level of what the major, most significant questions are that face investors. These categories, if you will, of uncertainty are about the same now as they were a year ago—albeit with a little more color and a little more information.

I think that it was, in 2025, a really remarkable year in a lot of ways. I'm going to go through in succession here in a moment, but let me just preface it by saying that I believe you could argue if you said at the beginning of the year, "I have a crystal ball: the Fed is going to cut rates a little bit near the end of the year. Earnings are going to grow double digits. And we are not going to go into a bilateral global trade war," that you could make an argument: okay, well, that's a pretty good environment for risk assets to do well.

And yet if you had said, "Hey, there is going to be a ton of uncertainty about tariffs, and we're going to end the year with an applicable tariff rate that—albeit much less than some have feared—is going to be something in the range of four to five times higher than what it had been. The Fed is not going to cut rates all the way until September. They're going to stay flat from January until the ninth month of the year. And earnings are not going to do better than they're going to expected they're going to do—at what's expected," you could also have made an argument: oh, that doesn't sound like a great environment.

So, the push-pull of these things obviously ended up netting out to being a very positive year for risk asset investors. But when we think about the year that just was, there's so much correlation with the political calendar and with public policy.

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There are years where public policy is the major driver of capital markets. There are years where it's almost entirely economic recessionary, corporate activity. There are years where the Fed and monetary policy are a major issue. But because of the first year of a new administration—and so much, I guess, reversal of public policy and implementation of new policy—it's not surprising that a lot of the way we think about the market correlated with the way the news cycle went throughout the year.

So, obviously, the first event to 2025 was the inauguration of the Trump 2.0 administration. And it's an odd way to word it because it was a reelection, but not the immediate reelection. And we haven't ever had that in our lifetimes. It's only happened one other time, going back to Grover Cleveland in American history.

But nevertheless, there's both the continuity—because we had a Trump administration four years earlier—and the discontinuity, because it was not a reelection, but a replacement. And so there's something somewhat unique about that, obviously.

But I think that the first quarter largely was a byproduct of: first, does China really have a significant AI competitor? Is DeepSeek real? We had a big sell-off in late January, early February. Some of that big tech stuff that sort of foreshadowed this vulnerability—or at least at that time called into question—the assumptions that exist that AI has an impenetrable dominance in the United States, not going anywhere.

And then starting in late February, early March, we began to get this kind of back-and-forth social media, public pronouncement, but nothing substantive in policy yet—the flexing around tariffs.

And initially it was the president threatening this huge escalation in tariffs on Canada and Mexico, and markets dropped huge. Then the president said, “Okay, now I'm not doing it. I'm going to suspend it for a month 'cause we're negotiating on both of them.” And that was the very first validation for those of us who had come into the tariff vulnerability and ambiguity believing that there was a Trump market put—because the president had no tolerance for high market volatility.

And so if that was the presumption going in, it was the actionable thesis throughout his first term. It was my belief after his election and into the inauguration. And then almost immediately the first test of the thesis passed: that, okay, here he is—he's not really going forward with this.

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Then as we went on into March, there was more hemming and hawing and threatening, but this big kind of question. And they teed up that on April 2nd they were going to have a Liberation Day and announce an entirely new platform around tariffs.

The expectation that markets had was that, first of all, nothing ultimately shock-and-awe oriented to markets would be allowed to happen because of the very thing I just mentioned. And the administration had largely circulated that they were about to go get reciprocity—that the objective was, “We’re just trying to get a kind of even playing field.”

And people could agree with that as a public policy, or disagree, or not believe them, or not really know exactly what it means. There’s plenty of good and bad to say about it. But that was at least what markets were expecting.

And then on April 2nd, as we go into the second quarter of the year, the shock and awe came: it had nothing to do with reciprocity. And they were basically threatening almost \$800 billion of taxes to American importers. That was far and away more severe than what had been expected and even what had been previously threatened.

And so the next five days saw the markets drop thousands upon thousands of points. It felt like utter free fall, and the expectation was certainly that you were going to get retaliatory tariffs from other countries. That did not end up happening. And the president, five days later, said, “No, never mind. I’m going to put these on hold and we’re going to be negotiating with all of these different countries.”

So, in a moment I’m going to be report-carding what our themes were for 2025, and we’re going to talk about how that sequence of events played in rather conveniently to what our whole take was going in. But that was by far the most violent moment.

We didn’t quite get a 20%—on a closing day basis—drop in the S&P. Intraday we did. So you could call it a bear market that lasted for four hours. But you had a very violent drop peak to trough—the S&P down about 20, the Nasdaq down more—and then the president abandoning that course.

So, after the Liberation Day surge, we weren’t totally out of the woods. There were still big questions about what was going to happen with China. They were in full-blown retaliatory tariffs. There was a freeze-up of trade.

But the threat of a pretty obvious recession coming because we had almost stopped economic activity—that ended up not happening as the president reversed course.

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Throughout the rest of the second quarter, you had more volatility around whether he was going to fire Jerome Powell at the Federal Reserve. There were plenty of issues. But the markets caught their legs. They certainly saw their bottom in April, and that bottom would hold for the rest of the year.

The third quarter launched with another market rally. The trade war issues at this point were largely in the rearview mirror. There were still a lot of questions about what the deals with individual countries would be. But that very severe \$780 billion threat was off the table. And now we were going country by country.

And the market at this point had regained the market put: that, okay, President Trump's not going to let something happen that causes the market to fall like this. And so that part—that left-tail risk—was off the table. But there was still not certainty as to what the specific policies were going to be, let alone what the impact of those policies to markets would be.

Bond yields dropped. That certainly enabled a better valuation maintenance for risk assets. The 10-year had been back to 4.5% in early July, and it came all the way down to 4% by mid-September. So that helped boost assets.

But the big story in the third quarter was in August, the job revisions—where all of a sudden we had assumed that there was a very healthy employment picture in June and July in the unemployment markets. And then it turned out: no, they revised that and we actually even went negative.

Not only did we not add the six figures' worth of jobs each month that had been reported, but it was much worse. And going back all the way into the last several months of the Biden administration—the 2024—the year-long number got trued up and turned out to be about a million jobs off. So it really called into question what the actual and accurate state of the labor markets would be.

So, the market closed September up on the month, but there was late-month volatility—early signs of some rotation in the market. Some of the cyclical, some of the technology things sold off; some of the defensives did better.

But the Fed did cut rates in September for the first time, and you started seeing small cap do real well. It was up about 10% in the month of September. You'd had a major gap all year between large cap and small cap, between growth and value, and those things started to narrow in the second half of the year.

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But that labor story—I'm going to put a chart up real quick to just illustrate what I mean, why I think it was the big story of Q3 and one of the big economic stories of the year. You see here this really low number for new jobs created in May, and going negative in June. You see that it was pretty small in July and teeny tiny August.

So, that labor picture. And then by the end of the year, the far right of the chart gets murkier 'cause the government shut down. But the point being that well before government shutdown, with very reliable data coming through, it was very clear from this chart—and what we began to see in August and September—that there was a lot of vulnerability in the labor market.

That became the big story as we got into the latter portion of the year. There's more and more questions about the AI story. Some of the big AI names dropped huge. Some dropped a little. But the bigger issue is the conversation changed: Is this CapEx sustainable? Is there an ROI coming for our current capital expenditure level in the artificial intelligence space?

I think that you had a couple bouts of downside volatility—nothing like we saw in April. But again, the S&P still ended up closing the year up 16%, not at, but very near its all-time high.

The economy by the end of Q4 was reporting for Q3: very nice recovery. Now, again, it had been so low earlier in the year—and even negative in Q2 through the height of the tariff issues—that on the year, we may very well, when we get the Q4 number, and at 2% it looks like it's ended up being about 1.9% real GDP growth, which is much better than had been forecasted—especially at the peak levels of trade uncertainty earlier in the year.

But nevertheless, an economy that muddled through—not a disaster, and certainly not anything to write home about.

There's a couple charts that we'll put up that indicate the schizophrenia that some like to refer to about the U.S. consumer, where on one end you see consumer confidence dropping a great deal, but then on the other hand you see consumption going up.

And this to me is no surprise, is why I put absolutely no credibility in consumer confidence and never have, because essentially all this is consumers telling you they don't feel good about the spending they're about to go do. Ultimately we believe Americans spend money and do so regardless of what their conscience tells them.

So, as we move forward a little bit, we will wait and see. I mentioned, by the way, some vulnerability in the trade data. And in the GDP results, imports, exports—what they refer to as net exports—is a major part of how GDP is measured.

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And there's a chart we want to put up here showing that you had a big surge of imports as people were trying to front-run tariffs, and then that dropped a great deal. So it skewed both one direction and the other the way the GDP number is measured.

What is really pertinent for actual economic health is total trade. But because of this sort of data anomaly—and you see it here in the chart of a big surge of imports and then a big drop-off—it distorts it.

And that's why a full-year picture is so much more helpful than a quarter-by-quarter. And just so you know: everybody reporting on the state of the economy knows this.

So when people will say something like, "Q2 was a recession," or "Q3 means we're just back up and running again," neither thing is true. And anyone saying it knows it, and there's likely some sort of political bias going on—just being as apolitical as one could be about it.

Objectively, what I'm telling you is that that lumpiness that I put up in the trade data is why the GDP number requires annual smoothing versus quarter-by-quarter analysis.

So, to move things along into the 2025 markets: gold was the largest performer of the year, up 64%. Emerging markets—China, Japan, Europe—all next: 32, 31, 26, 22. And then you get to U.S. markets, which still did just fine: the Nasdaq up over 20, the S&P up with dividend 17, the Dow up about 14 and a half, the Russell 2000 small cap up about 12 and a half.

And we'll put this chart up here real quick so you can just see there's nothing negative other than if you were just buying oil futures. The oil market was down over 9% on the year. The dollar relative to a basket of other currencies was down 9%.

But even that depends on what your counter-trade would've been—what the currency you're buying is against the dollar—because the yen was down, but relative to dollar euro was up, Chinese yuan was up. But the dollar against a trade-weighted basket of securities—the DXY—was down.

So apart from dollar currency traders, oil futures traders, and then Bitcoin, almost everything on the planet was up last year. That's why I refer to it—whether it's conservative investors, you see all the bond indices up, or risk assets, both U.S. domestic and international, having a great year.

On the bond front, we'll put a chart up here on investment-grade spreads, because it's one thing to say, well, the 10-year went from—I think it started the year about 4.6% and ended the year in between 4.1 and 4.2—and there's no credit risk there. So all you're really getting is: as

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interest rates go down, the price of those bonds goes up, plus you get the carry of that 4% to 5% coupon.

And that's one of the great things about the bond market when you're at a place of normalized rates. In order to be down on the year, the rates have to go up more than the amount of what you're receiving in coupon, where when the coupon's only 1% or 2%—which was the case starting 2022—it was very easy to lose money because yields went way up, which brought the prices of bonds down, and you didn't have the offsetting coupon from the bonds.

But look: the conservative bond market was up 7% last year. And not just because of rates dropping in treasuries, but you look here at investment-grade spreads—very tight. Again, these are the really boring bond corporates doing quite well on the year.

Credit itself doing fine as well—high yield, bank loans. There was no negative performance in the U.S. fixed-income space.

I would say to you that risk-on versus risk-off wasn't really the narrative because both risk-on and risk-off did well: bonds and stocks. The U.S. and international did well. Traditional and alternative asset classes did well.

So, when you look at the major categories of investment narratives, both sides all did pretty well in 2025. But then you got nuance within each category—particularly sectors of the U.S. stock market.

So I'm going to put a chart up real quick here and then give you some commentary along these lines. But you see the top-performing sector in the U.S. stock market year was technology at 25%, and then communication services right below it at 23.

And there's certain AI adjacents in both of those, but then on a heavily cyclical basis industrials up over 19, utilities up 16. I'm going to come back to that in a moment. Financials up 15, and then the defensives were a mixed bag.

Let me start with defensives. Healthcare ended the year up 14.5%. It had been down most of the year. A lot of people thought there were going to be concerns with the new HHS administration, with threats of tariffs. But in the fourth quarter, the healthcare sector rallied dramatically—pharmaceuticals, biotech, et cetera.

And also within the defensive categories, utilities—it was up 16%. It was up like a cyclical. A lot of that because utilities right now, in a lot of cases, have some connectivity to the data center story. So they're almost trading more like a growth stock than a value stock.

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But then at the bottom of the list, you see consumer staples and real estate investment trusts up 1.5% and 2.5%. So even though they were positive, those areas of defensives did poorly.

Financials, I mentioned being up 15% on the year, but you had big banks hitting all-time highs. And some of the leading household names of big commercial banks and investment banks were up 35, 40, 45% last year. And then you had asset managers that were largely down on the year, particularly alternative asset managers. So there was just a lot of nuance within the space.

That would apply to technology as well. Though you look at the Mag Seven, only two of the names in the Mag Seven were up more than the market. Three of the names were up right around the market, and two were up much less than the market. Now, all seven were up, but you really only had two names in the Magnificent Seven that were big, huge performers.

And so, again, it just speaks to the fact that there wasn't a lot of monolithic story in any of these different elements of the market.

In terms of the place where I guess you could say there was a pretty harmonious return environment, it would be international—China, Japan, emerging markets. A lot of this is because of the dollar being down that gave a certain return backdrop to all of these spaces.

A lot of it would be because of structural common ground and where they were on different sides of trade deals. Their valuations were nowhere near as high entering the year as U.S. risk assets. So you probably could have thrown a dart on the wall and done about the same in anything international last year.

But that is not true within the U.S., where things were much more selective. On the bond market, we have a chart of the 10-year Treasury yield here. And again, you could see that it had the fortune—just from a coincidence of the calendar year—of starting the year at a higher number, dropping a lot. It zigged and zagged up and down as it normally does, but you can see the downward trend. And that led to positive price returns, particularly for longer-duration elements of the bond market.

So our key market takeaway is here real quick, and we're getting ready to wrap up 2025. We're going to move to our report card.

Risk assets and safety assets were almost all up in 2025. The heavy delta between large cap and small cap, as well as between growth and value, compressed a great deal in the last few months of the year. It had been much further apart mid-year, and then it really converged quite a bit by the end of the year.

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U.S. stock market indices were all up, as well as all U.S. stock sectors. Eleven out of eleven of the S&P 500 sectors were up, but with very dispersed results under the hood.

And then bond investors saw positive returns in safety as well as in credit, meaning you had declining rates, which boosted the price of safe bonds, and then you had tight spreads, which boosted the results in credit.

So, with the predictions we made last year, the themes and so forth: first of all, one of the things we said was that tariff volatility was underappreciated and that tariff pandemonium was overthought. And this was a way of me saying that there are two far tail risk events that could take place.

One is that there's no tariff issue at all—or even better, they get rid of tariffs—and there's just this global harmony that breaks out in the new administration, and everyone is thinking it's going to be bad and in fact it's going to be great.

And then the other was: it's going to be so bad we're going to be subject to a Smoot-Hawley 1930s-style global trade war.

And my belief was that both of those scenarios were not just wrong, but profoundly wrong. And obviously there were a week or two in there in late March and early April where you could argue that was threatened. But the reason I'm giving myself an A+ on this is that it is basically exactly how it played out.

There didn't prove to be that appetite or tolerance or willingness at all for a severe market impact to what they were doing with tariffs. And yet no one can say nothing happened. The total tariff rates went up substantially. They had to go negotiate case by case. Then they had to give carve-outs like crazy—exemptions and waivers—and by the end of the year even take back tariffs on certain things like bananas and coffee and sugar and other grocery items.

We have a chart here to show the up-and-down story, where there were different tariffs being added—a so-called fentanyl penalty to China—and then the threats against Canada and Mexico, and then all kinds of new tariffs, but then the technology exclusions, and then we worked things out with China, and then it would go up and down, up and down.

When all said and done, it ended out right in this middle of the road where the tariff rate is definitely higher. There's a much bigger cost to the economy. I believe it's going to be something around \$300 billion a year. That is not remotely close to a rosy scenario, yet all of that pandemonium concern went away. So this particular theme played out exactly how we would see it.

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Now, when I say it is not all rosy, stock market's still up, but I'll put a chart up here showing you what I think is the real issue. I wrote a Dividend Cafe about this back in August: the longer-term impact—not month by month, what are egg prices doing this month, or what are the jobs situation do this month, but do we have structural issues in the economy?

You look at the point of the April tariff announcement and how that impacted small business hiring. That is not the entirety, obviously, of the labor situation, and we understand that there's been huge carve-outs given to gigantic technology or semiconductor or iPhone companies and things like that.

But from a small business standpoint, you can see that there's definitely been layoffs and less hiring. And that's where we think the economic vulnerability from tariffs lies: where those companies are that are paying the tariffs, but not in a position to get exceptions. So that's a theme we'll talk about more into '26.

Okay. Number two: those tax bills were the policy reality that mattered most—more than tariffs. Are they going to be able to get some supply-side benefits done?

I never had any doubt that they were going to extend the individual tax rates that were set to sunset. They'd been cut in 2017. Those reductions were set to go away at the end of 2025. And after the election went the way it went, there was never any doubt in my mind that they were going to extend it.

The question was: would they have other business tax benefits in this tax bill that ended up becoming called the One Big Beautiful Bill Act—O-B-B-B-A?

And I'll give myself an A on this one because it was a significantly important part of the tax bill. A: they didn't wait till November, December to pass it. That was our concern. I wrote about a year ago: Speaker Johnson, with a lot of political navigation, got the thing through the House, got a budget reconciliation window open in March, kept it open Q2, got the Senate and House on the same page, and they were able to get this thing done much earlier in the year than even the first Trump tax bill that was done in 2017.

And it did include key supply-side provisions. There's a lot in the bill I don't like, and I wrote a whole Dividend Cafe about it. But nevertheless, I would say that it ended up being a very positive bill and answered some questions of uncertainty.

All right then, number three was the theme that the China relationship was set to improve, not worsen. And this was probably one of the more contrarian—and I would argue bold—calls, and absolutely one I will give myself an A on.

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Just consider this: now, I'm well aware that at one point in the middle of the year it didn't look like it. And if you had to grade me on this at the height of some of the tweets and things that were happening real time in April or May or what have you—and it went on into the summer a bit.

But look: in 2018, the Trump administration banned U.S. agencies and contractors from doing any business with Huawei, which was China's leading information technology company. There was heavy pressure on other private companies and allies in the United States not to do business with China's 5G network companies. The U.S. had the CFO of Huawei arrested.

You could talk about the public spat over tariff rates and soybean imports and things like that back in 2018. But there was an embargo being created in U.S.-China relations.

And really, if you fast forward to 2025, the way things went last year around export controls, around Nvidia chips, around Chinese rare earth minerals—every one of those highly vulnerable, volatile, and key categories liberalized, increased, improved—did not go the other way whatsoever.

Now, does China's control of rare earth minerals give them a certain leverage? I'd say so. Does President Trump crave a diplomacy with President Xi more than he wants conflict that's going to hurt the economy? I think so. So you could argue this all tracks.

But my point is: the administration approved Nvidia selling its H200 processors to China; significantly eased export controls, technology restrictions. This TikTok deal was big. It was supposed to congressionally pass—ban TikTok in the United States. They ended up basically doing a big joint venture where they're all partners together in TikTok.

And the National Security Strategy Report released in December undeniably softens the language and really refers now to China less as an existential threat and more as a strategic competitor.

My intent is not to say that any of this is good or bad, per se. I have all kinds of thoughts about all of it—both economically and geopolitically. But predictively, I think that that was a theme that, if one was on the other side of really believing you were looking at a worsening dynamic with China in 2025, you'd be in a very different position in capital markets. And so that theme was definitely one we believe we deserved an A on.

Number four: financial deregulation to be an underrated catalyst for growth. I'm giving myself a B+ here, even though all the things I wrote about kind of played out. They dismantled the Consumer Financial Protection Bureau. The Basel III Endgame capital requirements were

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rejected in the United States. Banks have a lot more flexibility on their capital requirements, which is good for their own profitability. Federal Reserve stress tests are much less dramatic than they were.

In the sake of time, I won't get into details of all this, but all of those things played out. I'll put a chart up here showing you that banks grew their loan books at the fastest pace since the financial crisis. Banks were lending more money, and that is a byproduct of a lot of regulatory relief.

So why a B+, which is still a pretty darn good grade, but when everything else seems to pan out?

One of the things I said last year that catalyzed this theme was that there was a huge need in the financial sector for exits in the private markets—a lot of M&A that was going to come from private equity.

I'm going to argue in a moment that I got some of this right for the wrong reason. The bottom line, though, is it was a great year for big banks. That was evidenced in their financial results and performance. We'll look at more ramification for M&A here in a moment.

Number five: earnings disappointment, a bigger risk than earning surprises. Well, I'll give myself the A here right away, but I just want to read word for word what I said a year ago. This is an especially lame theme for those who want to treat these themes as predictions, forecasts, or market calls, because by definition there's no way to measure or verify by assertion that falling short of 15% profit growth has more implications than if we somehow exceed it.

It was always immeasurable or non-falsifiable. So this was sort of cheating, if you will. But given the market response, anytime there was a threat to those earnings growth expectations, it seems rather obvious I was correct.

Earnings growth of roughly 12% on the year allowed markets to advance in line with that earnings growth. There was only a small attribution to total return last year from multiple expansion. It was mostly because we got the earnings growth that had been forecasted.

But setting a theme that something would be a bigger risk if it happens than it would be a reward if it doesn't happen—that strikes me as somewhat disingenuous of a theme. But I'll take it because I do believe I was right on the merits.

Number six: corporate activity to skyrocket. I'll give myself a B+ here. I'll give you some data real quickly.

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Global mergers were \$4.5 trillion of value in aggregate transaction size last year. It's the highest in history—50% higher than the year before. So I'd say that corporate activity skyrocketed.

Even just in the United States: \$2.23 trillion. That's about half of the total global activity. Massive 54% increase over 2024 levels. We'll put a chart up here showing the number of deals that were done at a \$10 billion value or more. You see an all-time high. So not only a lot of M&A, but a lot of big M&A.

There were 144 SPAC IPOs in 2025, which is two and a half times more volume than the year before. And total IPOs were 33% higher than the year before.

So again, with mega M&A, with IPOs, with SPACs, why am I doing a B+ here instead of an A? Because the private equity exits were not as much of a driver here as I had believed they would be. They were up, and yet they were only 20% to 25% of total M&A activity last year. And that's not exactly how I see it happening.

And so even though I use the analogy of I made the three-point shot, but I didn't call bank—I made it a little differently than I expected. So there's a little dockage in the grade on this one, if you will. Private activity in private market activity in 2025 was strong enough but also soft enough to leave it on the table for 2026. So you're going to see that theme coming up again.

Number seven was that the deficit would be lower. Again, this was totally contrarian. There were very few people who believed the deficit for the fiscal year would be different.

Now, one thing I didn't do was specify calendar years versus fiscal years. Our fiscal years run from Q4 of the preceding calendar year through the third quarter of the next calendar year. So the fiscal versus calendar years are off a little bit. But on both fronts, I ended up being right.

Now look: \$1.83 trillion deficit in the fiscal year '24 to \$1.78 trillion the next year. That's not very much reduction. However, I did not say that this reduction was coming because of fiscal discipline. I said the exact opposite. I said it's going to come despite a lack of fiscal discipline—that we were not putting government on a diet.

The reason this happened was because revenues increased. You could say, well, DOGE was cutting expenses, but it didn't. We spent \$6.7 trillion in 2024; we spent \$7 trillion the next year. So even with a lot of government layoffs and reduction of federal headcount, we still spent more money.

However, how did the deficit come down despite that? Because revenues increased by \$300 billion year over year, which was exactly the basis I offered for the call that I was making.

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So the collections—largely, by the way—driven in additional capital gain tax revenue. I believe that's likely to repeat itself again, versus CBO estimates. You're still running a substantial deficit, far higher than any of us should be tolerating. Yet, nevertheless, it's equalizing right now anyways because revenue is cooperating.

Number eight: the easiest one—easy A+—and I was really confident that this would play out that way a year ago. As I said: quantitative tightening would end.

I had said the exact same thing the year before and it didn't. And then I said it again this year and it did. So I went from an F last year to an A+ this year.

And I'll put a chart up here of the Federal Reserve balance sheet. While I was right that quantitative tightening was going to end by the end of the year, I do think it's fair to say that I didn't—and nor almost anyone who I respect, read, and follow—believe that we were going to see the Fed get their balance sheet down by over \$2 trillion from the middle of 2022 to the end of 2025, and that there would be no real disruption in financial markets, in credit markets, in credit spreads along the way.

So what the chart shows is they basically got all of that second phase of COVID quantitative easing off the balance sheet. The very first explosion is still on the Fed balance sheet, but that second level they got off—and did so without much disruption to credit markets.

Why did they stop tightening at the end of the year? Because there was no question that with the reverse repo market and the state of financial liquidity, they had pushed their luck as far as they could.

So the summary of our 2025 themes and how I'd see it playing out: I gave myself two Bs, four As, and two A+s. You're more than welcome to say I'm cheating here. I'm the one who picked the assignment. I'm the one who did the assignment. I'm the one grading it.

But look: last year I had—I think, was it two Ds, three Bs? There were plenty of things problematic in other years as well. So I do believe, in all fairness, that we're pretty objective about it year by year.

We'll see how 2026 goes, and that will be our segue now to close out this year's Year Behind, Year Ahead with our major eight themes going into 2026.

Despite the fact that there's two full pages in the white paper about the first one, I'm going to try to not spend a ton of time here with you on number one because it's a theme that I've already written about and talked about so much—and we'll continue to do so.

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But I wanted to put it front and center and be somewhat bold and on the record, stating that in 2026, number one theme is that we believe AI vulnerabilities will become much more evident to markets.

I am perfectly willing to be wrong about this. And what I mean by that is: early, I do think it is very, very unlikely that I'll end up being wrong. But if I'm wrong, I think it is more because '26 may not end up being that year.

And I don't know how exactly it plays out, but I'm wording this very carefully: that AI vulnerabilities will become more evident to the market.

On one hand, that includes the concern that there is an excessive amount of capital expenditures relative to a reasonable expectation for return on such investment. And I think that is a concern that people need to take more seriously.

I believe that there's going to be transformative stories coming out of AI, but that they right now are largely unknown, unclear, and uninvestible in terms of the specificity of what some of those things are going to be, and that as the growth rate of AI CapEx declines, it will end up becoming infectious.

Some of this is so easy because it's already happened. When you take some of the biggest household names—everyone's familiar with names like Nvidia and Google—out, but then you look at other names that became major AI success stories in '25, like CoreWeave and Oracle, and then see what's happened to them peak to trough, that much of this has already played out.

But my argument that we have to see some return on investment besides the companies making the chips continues to be my theme.

And that while the classic circularity problem has now at least been talked about, it has not been thoroughly discounted into markets—that circularity problem being hyperscalers doing deals with companies that build large language models. And that as those LLMs do deals to buy high-end AI chips, those chip companies and hyperscalers are themselves investing equity money in the large language model companies—so that there is this circularity, people basically paying companies to give them orders.

And I can provide you a dozen or more high-profile examples. They're totally legal. They're certainly well known. And in some cases you could argue they're rational. But I would not argue that it bodes well for what the future investment result will be.

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Now, what is something that will catalyze an unwinding of this story? And I don't know that this will happen in '26. I believe it's very, very likely. I would not bet against it. But at some point, hyperscalers blinking.

I don't mean surrendering or getting out of the market—ceasing to invest altogether—that's not going to happen. But some sort of slowing the pace of investment not only seems likely to me, but inevitable.

The other vulnerability that I have not written a lot about yet, that I'm going to spend more time talking about in 2026, is a cultural, social, and even political pushback.

And I don't think people appreciate enough the aggressive use of intellectual property that's been granted to LLMs—regulatory favors being granted to big tech companies. I think there's going to be a far greater scrutiny of the social cost from AI as various new narratives take hold. That so far has not been a major headwind for the space. I think you're going to start seeing more of that surface.

I would also say that, in addition to the net capital expenditure issues—the whether or not the ROI makes sense or can be rationalized in that whole ambiguity—the idea that it's priced as if everybody's going to win, but everyone's spending money as if only one can win.

And so the question of: is it really a winner-take-all, which is the rationale for this level of CapEx, then why are we pricing it as all will be winners? It can't be both. So that represents another vulnerability.

China's announcements in the space—we saw a precursor of this in January of last year—of their own large language model development, their own ability to generate sufficient computing power domestically. I think we continue to operate as if there's no threat from China there. And I don't know that there will be, but that changes some of the global dynamic and profitability dynamic of U.S. companies that has not been priced in, in my opinion.

And then also, not only the circularity of the CapEx story, but the financing itself. If you start seeing more go into debt financing versus equity, that changes the risk profile a great deal.

So that's the kind of summary of where we see AI vulnerability. I probably spent more time on it than I said I was going to, but this is number one theme for a reason.

Number two: the economy is in a tug of war between two unknowns.

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Look, I think that you more or less are going to see roughly \$300 billion of cost to the economy because of tariffs, and you're going to more or less see about \$200 billion of benefit to the economy from the supply-side provisions of the tax bill—expensing of factories, capital expenditures, bonus depreciation, more favorable expensing for R&D, favorable deductibility of interest costs for investment.

Those things are meaningful and they are supply-side pro-growth. And they will, in my estimation, add about \$200 billion of benefit to the corporate economy. That's up against the headwind of what I think could be \$300 billion to tariffs.

Now, the issue is that we more or less know how to measure the benefit side. We don't necessarily know how to measure the cost side because the president can—and in fact has announced on a whim multiple times—peel back of some tariffs.

It's very possible that the Supreme Court gives an announcement in the coming days or weeks that blocks a lot of the tariffs, and that the White House chooses not to try to re-implement with a different rationale.

So there's ambiguity about it. But ultimately what I know is that capital goods have largely dropped outside of AI. Capital goods investment—we're going to put a chart up here showing that the tax savings from the new tax provisions allow for capital goods investments to about double. All right?

And so you're going to see a meaningful increase, I think, where you need it. But are tariffs going to get in the way of that? That's why there's two unknowns here.

That we have a labor market that seems somewhat frozen. We do not see a ton of layoffs, but we do not see a ton of new hirings. And the way to get new hirings is to see a lot of capital investment—a lot of productivity.

And AI has done some of that, but it can't do all of the lifting. So with the new tax bill, there's a lot of opportunity, but then with the cost of tariffs it's pulling the other way. That, to me, is the economic story of 2026: how that tug of war plays out.

Theme number three: the midterm elections.

I like doing political prognostications about as much as I like having my head kicked in. It is very difficult to do. It is very humbling. And it is not my day job.

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With that said, I think as it pertains to markets that the consensus view—that there is a very high likelihood that the House, after the midterms, will flip back to a Democrat Party control, and that the Republicans will keep the Senate majority—that is the view I would have, and therefore expect no real impact to markets from the midterms as a result of that.

Now, if something were to happen where the margin is far bigger with the Democrat majority in the House than expected, and it even calls into question the second forecast—that the Republicans would hold the Senate—the reason why I would forecast Republicans holding the Senate is just basic, pedestrian political analysis that the map very much favors them.

The Democrats have a lot more work to do to be able to flip seats mathematically than the Republicans have to defend. And so it's an easier time for Republicans in the Senate in '26. That's different in future cycles.

My point being that this is not largely market relevant because the markets are already pricing in those two expectations.

Number four: this is a very important one. I think housing will get cheaper this year. I'm saying that is a good thing. I think there will be problems if it does not.

I want you to look at the chart here we're going to put on the screen of the number of houses that have been sold, and you see how it has dropped almost half since COVID. And that number was very high before COVID, and we're just plugging along at this much lower level.

There is an economic relevance because of how much in our economy is adjacent to housing—both in finance and renovation and construction and commodities. There's a lot of things that touch housing, and it hasn't really spilled over yet, but I believe it will if you do not see an increase in activity in housing.

And you really can't get an increase in activity without prices finding some equilibrium 'cause they're too darn expensive. So I expect certain things to try to happen on the policy front.

When I say try to happen, they could be things that just get thrown out as trial balloons. I'm hoping that's what the silly 50-year mortgage thing was. But there may be other policy ideas that get front—that get floated—that are more viable, but it also just may be market forces.

But I think you basically had no home price appreciation nationally in 2025. And I would expect that you'll have modest home price depreciation in '26. And I say that as a good thing towards the greater goal of getting housing activity to resurge.

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Number five: small cap earnings growth will outpace S&P 500 earnings growth. And that's really what we would call a base-effect prediction—that earnings growth has already been so high in the S&P that it's still going to be humming along at a great level, but it's just coming off of a much higher number, where small cap is coming off a much lower number.

And so this is not a very bold prediction, but may very well be relevant to the breadth of markets this year and how small cap does relative to big cap.

Number six: foreign appetite for U.S. assets to stay strong. You can look at this chart here and just see how—by trillions of dollars between equities, bonds—foreign appetite increased in '25 versus '24.

This is a bullish argument. If I'm right, that will continue. But if that current account deficit drops because of imports dropping—now, I don't believe imports are going to drop in the end. I don't really believe that our exports are going to go a lot higher relative to imports, which was the claim of the tariff policy advocates.

If that were to happen, then I think that would undermine foreign investment. But more or less, I can't see a particular theme or catalyst that interrupts the heavy foreign appetite for U.S. investments.

Number seven: and I do think this is a pretty contrarian play—energy sector to be a contrarian opportunity for investors. The U.S. energy sector for equity is a very good opportunity in 2026.

Now, you could argue I'm cheating a little bit 'cause it's already started off this way at the beginning of the year. But I wrote this before the calendar year even started.

And also the chart we're going to put up here shows part of the theme is just simply that it's gotten too low as a percentage of the S&P.

You look back to where it had last gotten to only being about 3% of the S&P. The entire energy sector was back at the COVID level, and it subsequently doubled from there. But it's now come back to only 2.9% of total S&P weighting.

So I just think, if nothing else, energy is underweight relative to the rest of the market. And both within midstream and upstream—even apart from Venezuela and other things that have already surfaced—I think the energy sector is a contrarian opportunity.

And then number eight: M&A. Again, I forecasted this last year. There is still this same situation around IPOs, SPACs, more favorable regulatory environment to approve mergers and

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acquisitions, but also that ongoing theme that there's a lot of pent-up demand for exits in private markets.

So allow me—I know we've gone a full hour here to recap '25, to forecast '26—but there was a lot to cover and this was very purposely meant to be a kind of special issue.

But I want to conclude with just a couple thoughts. This may seem, for someone who's always trying to be contrarian and careful, cautious and prudent, a surprise for one of the things I want to conclude with.

But I want to be abundantly clear that I believe there is upside risk in the economy in 2026. That the economy—with the Fed cutting rates, with the Big Beautiful Bill Act stimulus side, with potential diminishment of the negative impact of tariffs, with certain foreign appetite coming in the U.S., and what I hope will be a boon to CapEx and productivity through greater capital goods investment—there are certain stars that could align that, if our labor markets are not as vulnerable and weak as some of the data suggests, could very well push the real economic growth higher than expected.

I pray that happens. It is not my prediction. But when I talk about an economic outlook, I want you to understand why this has nothing to do with being Harry Truman's metaphor—he wanted a one-armed economist because everyone he talked to was, on one hand this, and on the other hand that.

And there are a lot of people who hedge and a lot of people that don't have convictions, and I can see why President Truman would've been frustrated. That's not what I'm doing here. I'm being humble, but I'm being honest.

And I would desperately want a two-armed economist advising me right now because this is an on-one-hand-and-on-the-other-hand moment.

There are perfectly legitimate reasons to argue for upside risk to the economy, but there are very big vulnerabilities with the tariff threats, with the labor market.

And I accept the premise that with the economy growing—albeit not robustly—with some supply-side stimulus coming in from the Big Beautiful Bill, with earnings growth expected to be over 10%, and with possible enhanced productivity from AI, and then a central bank easing at the same time, that all those things could lead to a really great environment for risk assets.

But there's a lot of geopolitical uncertainty, and there is an S&P already pricing so much of the good stuff as we enter the year at 23 times forward multiple.

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So you could go through a half-empty scenario or half-full scenario and all of that. My point is that I think a conclusion going into '26 that does not make your investment thesis reliant on knowing which one plays out—on having a more economically agnostic view—and I believe dividend growth and asset allocation capture this very, very well.

So that if things are going along swimmingly well, you're going to be just perfectly happy with a good environment in risk assets. And if there is a bit of a piper-to-be-paid year—maybe not as severe as 2022, but something more moderate, something more of a correction—that you're going to be defensively positioned.

I think it's the right place for most people's portfolio most years. But this year it does feel to me that, to the extent markets take P's and Q's from the economy—which they don't always do—I believe that it is a very humble and honest viewpoint as we enter the next 25 years of this century: cautious, excited, optimistic, and ready.

We enter 2026 humble because we have learned to be so. To that end, we work.

Thank you for bearing with me through a very long, but hopefully useful, constructive Dividend Cafe. Thank you for listening. Thank you for watching, and thank you for reading. Look forward to being back with you in the Dividend Cafe next week.
