

Fourth Quarter 2025

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Highlights:

- AI moves front and center
- Government shutdown slows dataflow
- Unemployment increases, but still relatively low
- Growth robust, inflation persistent
- AI adoption outpaces other tech cycles
- 2026 should be interesting at the Federal Reserve

Introduction

Bill Veeck was an American original. A baseball impresario whose career extended across the mid-20th century, Veeck was the pioneer who catalyzed Larry Doby's career and the showman who brought us Eddie Gaedel. Google those names if you have a moment and do not already know them. Both, for different reasons, are etched in American lore.

Veeck's autobiography, *Veeck as in Wreck*, was published in 1962 and is still regarded as a classic of baseball literature. In addition to its great anecdotes and stories, *Veeck as in Wreck* reveals a man wrestling with the economics of baseball, even as the pastime was losing its place as our number one sport.

Sports historians identify the mid-1960s as the point when the NFL moved past professional baseball to take the top spot. Bill Veeck could see it coming. "Professional football's attendance has been going straight up in the same decade that baseball's attendance has been going straight down," he wrote, attributing it to the "unimaginative and vacillating" Ford Frick, baseball's commissioner at the time.

Sometimes, though, success does not come down to leadership. Sometimes, success has more fundamental causes. The typical baseball game has 80 plate appearances; the typical NFL game has 135 plays. Baseball is a sequential game, where the action concentrates on two or three players at a time. The action in football, in contrast, will flow across all 22 players on the field. In a word, football's circuitry involves much more "throughput" than baseball's circuitry.

In a sense, and not to overstate the analogy, Veeck's quandary back in 1962 is not unlike our situation with artificial intelligence today. More than anything, AI increases the volume of work we can achieve. For investors, this is obviously a big deal. The problem is that, while we understand the need for businesses to "operationalize" AI, we do not definitively know how this process will hit the broader economy.

According to a Pew study, only 17% of Americans think that AI will have a positive impact on the United States over the next 20 years. A recent Gallup poll says 80% think that government should regulate AI, even if it means slower economic growth. These days, it is difficult to find an 80% consensus on anything, but politicians as disparate as Democrat Bernie Sanders and Republican Ron DeSantis agree that something must be done to stop this "runaway train." With the mid-term elections approaching, politicians can be expected to prioritize the economic concerns of voters—and where AI is involved, the politics seem to point in one direction.

We also know that, as a strategic matter, our country is locked in an AI "arms race" with other countries, a race that, if lost, would heighten our vulnerability in a harsh world. As we note in our Equity Report below (which contains a more extended discussion of AI), the technology adoption cycle for AI has been more rapid than the adoption cycles for other major innovations. In any case, AI generates competitive advantages, not only for business investors and managers, but in the form of scientific advances, medical and engineering breakthroughs, and in strengthening national security.

No one—not the "tech bros," nor the politicians, nor the man on the street, nor even AI itself—has perfect clarity on the right way to operationalize AI. As a result, we cannot be blamed for feeling a bit like Bill Veeck, standing on ground which is changing beneath our feet, sensing the importance of it, identifying reasons for it, and wondering, with some degree of concern, what comes next. At Genter Capital, we cannot entirely mollify those concerns. We are in the same boat. But we can, as we always have, bring our investment expertise to bear on the matter: manage the risks, seize the opportunities, and remain vigilant to the evolving market landscape.

Quarter in Review

The story of 2025 has been surprising growth, rising unemployment, and stubborn inflation. The American economy has undertaken quite a bit this past year, including a new (and morphing) tariff regime, major tax cuts, a sharp decline in immigration, and significant deregulatory efforts, particularly in AI and the energy sector. We thought that 2025 would be a wild ride, and it was. We also thought, beyond the atmospherics, that there are sound fundamentals underlying this economy, and there were.

After posting negative growth in Q1 (-0.6%), GDP rebounded strongly in Q2 (+3.8%) and Q3 (+4.3%). Since we do not have the Q4 print yet, and since there is no assurance that the Q3 number will not be revised, it is difficult to project GDP for 2025. If we assume that the Q3 number is not revised, and that the Q4 forecast consensus is correct at +1.0%, then 2025 GDP should be near +2.1%. If the Q4 result is closer to the GDPNow projection provided by the Atlanta Fed, currently showing 2.7%, then the 2025 GDP would be closer to +2.6% (assuming the Q3 print holds constant). Given the backdrop of noise throughout the year, we think this is a fairly robust outcome.

Sentiment remains at depressed levels, and while top quartile consumers are doing fine, the rest have little capacity to increase spending, pointing to a “K” shaped economy. Subprime auto delinquencies, for example, are now worse than during the aftermath of the global financial crisis (GFC). But despite the tumult associated with policies today—the low level of consumer sentiment and the high level of civic divisions—some measures of uncertainty, such as the MOVE and VIX indexes, are now *below* their 5-year averages. While the recent strength (3.8% for Q2 and 4.3% for Q3) may not be sustainable, we do not expect growth statistics to plunge.

Unemployment has not increased as badly as expected, but it has increased, and the pace of deterioration has also increased. “Slow to hire, slow to fire” seems to drive the thinking of employers. Continuing jobless claims (perhaps the most important employment indicator) are still historically low but may have broken from their recent sideways range. While we are not overly concerned about the breakout, it merits watching. Certainly, and despite inflation remaining persistently

above target, the Federal Reserve is keeping a watchful eye on employment.

On the inflation front, the main indicators have all moved higher since hitting their 2025 lows in April. The latest batch of inflation numbers, delayed by the government shutdown, show headline CPI at 2.7% and core PCE, the Fed’s inflation benchmark, at 2.8%. The increase seems driven by merchandise susceptible to tariff inflation. Shelter inflation, at 3.4%, continues its downward trend, and there has been outright deflation in the clothing and communications sectors. Adding to the complexity, the new immigration policies can generate pricing impacts to both directions.

The Federal Reserve cut its target Fed Funds rate by 75 basis points in 2025, on the heels of 100 basis points of cuts during 2024. The Fed Funds rate has been lowered from a 23 year high of 5.50% to the current 3.75%. Are further rate cuts justified? Growth is decent and inflation remains elevated. The employment situation has slipped, but mainly on the government side. Private sector employment has increased. Still, we expect at least two rate cuts from the Fed this year.

We think there may be fireworks at the Fed in 2026, mainly around policy, personnel, and reforms. We will provide some guideposts in our Fixed Income Report below. For now, suffice it to say that low interest rates are an essential part of President Trump’s domestic agenda. With his professional background as a real estate developer, Trump has a strong sense of the importance of the cost of capital to economic outcomes.

The fourth quarter of 2025 saw the longest government shutdown in American history, reducing the reliable flow of macroeconomic data. No government surveys were collected for the October data, and the November data was spotty at best. It will likely take a few months before the data normalizes. But even prior to the shutdown, the response rate to surveys had been in a long-term decline. The good news is that there are alternative sources of data springing up, although they will require more vetting before being relied upon.

The shutdown also brought an aggressive fiscal strategy from the new Administration. In previous government shutdowns, the Treasury Department refused to prioritize payments, which reduced executive wiggle room; during the last shutdown, no bones were made about the fact that the Secretary of the Treasury was allocating government

funding to favored segments while allowing unfavored segments to languish. This new approach will inform our understanding of future government shutdowns.

As we look forward, we expect the tax cuts to provide a significant boost to the economy in the early months of 2026. We think the Trump Administration will continue to press its mandate for change, which will complicate investor calculations. The operationalization of AI will continue apace, even as we wrestle with the implications, particularly on employment. We are confident that businesses will have little hesitancy to use AI when it means increased profitability.

We do not think inflation will get out of hand, especially as the one-time price shock of tariffs is increasingly absorbed by the economy. And when selected tariffs are rolled back, pricing pressures will ease proportionately. We think 2.5% inflation might be a reasonable landing spot in 2026, a number which would not concern most officials at the Federal Reserve. We expect to see continued focus at the Fed on the employment statistics, and the seeming (AI induced?) anomaly that unemployment and growth can move in the same direction.

Finally, we think growth will outpace the more dire assessments, basically because the growth-restrictive elements, such as tariffs and reduced immigration, seem to be effectively counter-balanced by the unleashing of the “animal spirits” through tax cuts, fiscal and monetary support, and deregulation, as well as the sheer throughput enabled by operationalized AI. The fact that 2026 is an election year will further incentivize government to provide support to the broader economy. We think the consensus 2% GDP growth is probably close to accurate, although we do expect that, as in 2025, the atmospheric will provide a wild and zany ride to that middle-of-the road number.

Equity Report

American equity markets booked their third consecutive year of double-digit gains, with the S&P 500 total return index posting 17.9% for 2025. Earnings growth for the year has been tracking to 12.5% year-over-year, which is stronger than we expected. This growth has been largely driven by tech-related names, primarily leveraged to the artificial intelligence buildout. Away from a handful of booming Tech names, broader earnings growth was closer to the long-term yearly average of 6-8%.

Investor sentiment ebbed and flowed between Growth- and Value-oriented names, with Growth again edging out Value, but by a narrower margin. The Russell 1000 Growth index advanced 18.6% compared to the Russell 1000 Value index, which increased 15.9%. Multi-year differences have been well above average, though, with the 3-year and 5-year CAGR (compounded annual growth rate) for Growth at 31.1% and 15.3% respectively, compared to Value, which advanced 13.9% and 11.3% over the same periods.

Throughout the year, we saw several attempts at a broadening trade, with investors becoming increasingly concerned about the high degree of concentration. However, those attempts were generally short-lived as – like it or not – investors bid-up the P/E multiples for companies which were actually delivering strong earnings growth.

This concentration of returns is evident in the market-weighted S&P 500, returning 17.9%, compared to the equal-weighted S&P 500 rising only 11.4%. Beyond AI-related, mega-cap companies like Nvidia, Broadcom, and Alphabet, mega-cap stocks across sectors, including Healthcare, Consumer Discretionary and Communications, saw a similar concentration of returns. Investors were seemingly reluctant to stray too far from the clear leaders of industry.

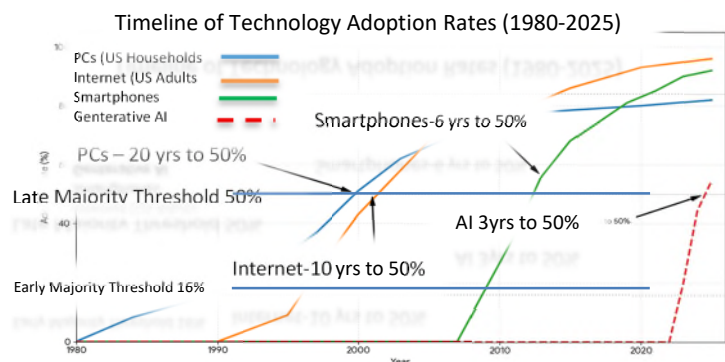
Despite longer-term rates being meaningfully higher over the past four years, and valuation metrics like the “Buffet indicator” trading more than two standard deviations above average, we saw the S&P 500 forward PE multiple expand further. And while we acknowledge the old Wall Street proverb that “bull markets don’t die of old age,” we also believe in the adage that “trees don’t grow to the sky.”

Our various equity portfolios have benefited from owning some of the pick-and-shovel names in AI that have driven the market rally over the past several years. Our continued focus on high-quality businesses selling at a discount to their intrinsic value has also been rewarded. While we continue to expect the AI buildout to persist into 2026, we have been taking profits in this area and increasing our exposure to higher-yielding and more attractively valued stocks.

With comparisons to the Tech Bubble of 2000 being discounted by many market pundits under the guise that “this time it’s different,” we would assure our clients that

we understand and appreciate the differences this cycle. We have invested alongside many of the AI winners of the past several years and believe that long-term growth will remain above average for the foreseeable future.

We should also note, however, that part of this strength is due to the very fast adoption of AI, which has outpaced all other technology adoption cycles over at least the past 50 years. The AI adoption occurred on the back of consumer adoption. For consumers, an accuracy rate of 75% is acceptable, whereas for enterprise adoption, 99% is needed.



In fact, enterprise adoption is critical to appease the growing drumbeat of investor demand to see evidence of a pathway to an acceptable ROI from their AI investments. The likeliest way for this to occur is through incremental revenue growth at software companies. To date, many independent software vendors have launched AI offerings, but few have seen incremental revenue growth. That would need to change in 2026 to sustain the capex spending and broaden it beyond circular spending between the few dominant companies.

We expect that 2026 could be a transitional year for AI. To see markets continue to drive higher, we think that the AI infrastructure boom needs to find the handoff to significantly higher marketplace adoption. This would be where businesses beyond the AI “arms dealers” find tangible economic value, that is, stronger topline growth and meaningful margin expansion, in operationalizing AI. Heretofore, this process has been largely confined to a small group of technology companies (both public and private).

We fully appreciate that the massive AI investment has stoked near term economic growth, and a wealth-effect from rising markets has reinforced solid consumer spending. We are also keenly aware of the history of

technology investment cycles (booms and busts), where the prospect for missed earnings expectations and investment slowdown only rises with longer and stronger upstrokes.

Since an entrenched negative sentiment shift can quickly deflate the AI bubble, we are vigilant to potential disappointment in the evidence supporting investment returns. Contrary to conventional thinking, it was not the recession in the early 2000s which caused the dot.com bubble to burst, but rather the bursting of the dot.com bubble which caused the recession. Still, a popped AI bubble is *not* our base-case assumption.

Away from artificial intelligence, we are very watchful for a resurgence in industrial activity as the Administration continues to pursue its deglobalization policies. We are entering the fourth year of an American manufacturing malaise and would view an acceleration in manufacturing activity quite favorably. The services side of the economy has been carrying much of the U.S. economic growth over the past few years. Moreover, an expansion of the manufacturing base would likely bolster higher-paying jobs at a time when the broader labor market appears to be cooling. Finally, manufacturing jobs have a higher multiplier impact on the economy than services jobs.

We enter 2026 on an optimistic note that the positive economic momentum can persist, helped by consumer spending that remains solid and infrastructure investment that is already in-flight and continuing to rise. We note that the full impact of the tax cuts will become more evident in the immediate months ahead, as taxpayers spend their increased refunds.

But we also recognize that 2026 expectations for S&P 500 earnings growth of 14.8% are already relatively high, driven by strong upward revisions in the Tech sector, Financials, and Utilities. Conversely, Energy, Comm Services, Healthcare, and Industrials have seen the largest downward revisions, setting up for easier hurdles.

For our **Core** portfolio, we are closer to sector-neutral than we have been in many years. We have trimmed our significant Tech exposure, and its strong outperformance, in favor of a broader exposure to economic activity. With a cautiously positive outlook, we remain overweight Tech but are looking for opportunities in Consumer Discretionary as well as in high-quality, pro-cyclical sectors and companies.

In our **Dividend Income** portfolio, we continue to champion increased stock selectivity, maintaining a more value-oriented view of the market as we enter 2026. We are overweight Healthcare and Energy, as these are the two sectors with the most attractive valuations. We think the recent downward revisions to near term outlooks ignore the long-term potential. We continue to have good exposure to the Technology and Financial sectors; these should perform well as the economy expands. We are underweight areas such as Industrials and Consumer Discretionary, primarily due to the below-average yields in the Industrial names and the below-average quality in the Consumer Discretionary names—at least among those names eligible for our dividend income strategy.

We remain watchful for an increase in excessive risk-taking, which always occurs during the latter phases of a bull market. Since the market is once again at heady levels on the broad indexes, investors should pay close attention to valuations. The new year brings no shortages of risks, including uncertain monetary policy, rising affordability issues for low- and moderate-income households, and growing questions about the sustainability of the AI/Tech investment cycle.

We continue to favor businesses and sectors with above-average cash generation selling below their long-term averages, as we see in the Healthcare sector. We also think that Energy offers good long-term opportunities, with well above average free cash flow yields and a much more disciplined industry from a supply/demand perspective.

Our equity portfolios enter 2026 well-positioned, with a good balance of inexpensive, high-yielding cash flow businesses and industry leaders with above-average growth prospects. The common denominator of all our businesses remains strong balance sheets, which can provide the dry powder to invest in new opportunities, or weather the storm better when there are bumps along the road.

Fixed Income Report

As we said in the Review and Outlook section, we expect to see a good deal of fireworks around the Federal Reserve this year. For starters, President Trump will soon announce his choice to replace Jerome Powell as the Chairman of the Federal Reserve. That decision, together with the confirmation hearings in the Senate,

will help define the shape of Fed policymaking in the years ahead. Powell's term expires on May 15, 2026.

Second, the Supreme Court will hear the case of Federal Reserve Governor Lisa Cook (*Trump v. Cook*), who was fired by President Trump “for cause.” The outcome of that case should play a large role in determining the extent to which the White House influences the Federal Reserve. While the Supreme Court carved out an exception for Fed independence in its *Wilcox* decision last year, and whatever one thinks about the allegations against Lisa Cook, the mechanism to dismiss Fed officials for bad behavior apparently needs to be better established.

Third, it is still an open question whether Chairman Powell will continue as a governor after relinquishing the Chair. It is his prerogative to stay on the Board until early 2028, since a governor's term is 14 years, even though the chair's term is only four. We think Powell's decision on this matter will largely depend upon who President Trump nominates as his successor. It may also hinge on the degree to which he feels embittered by Trump's verbal attacks (among other things, Trump has called him “a total and complete moron,” a “fool,” and a “stupid person”).

At 72, Powell is no longer young, and that surely weighs on him, but his historical reputation probably weighs on him as well, as it does with most people who have been vested with great power. We would point out that the one Fed official who kept his governor's seat after not being reappointed as chair was Marriner Eccles, the man whose name adorns the Federal Reserve Building in Washington. Eccles is remembered, and respected, for his fierce defense of Fed independence from meddling politicians.

Finally, in addition to the three successive rate cuts to close out 2025, the Federal Open Market Committee ended quantitative tightening in the fourth quarter. The Federal Reserve's balance sheet is now \$6.6 trillion, off its high of \$9 trillion in May 2022, but still well above the pre-Covid level (which itself was well above pre-GFC levels). Ending QT at this point is in keeping with the Fed's “ample reserve” doctrine, which dates formally to 2019, and seeks to buffer the money market from shortfall and seizure.

For our **taxable portfolios**, we expect to keep the strategies at near neutral durations relative to their

benchmarks. These positionings both reflect the uncertainties in the market and our conviction that the curve shape already represents current consensus expectations.

Given our outlook for slow (but positive) growth, high (but not out of control) inflation, and worsening (but not to recessionary levels) employment, we are comfortable maintaining our overweight allocation to corporate bonds. While we still see good relative value in individual credits and sectors, we recognize that the corporate bond market is not “cheap” and may look for opportunities to reduce our exposure.

The tightest credit spreads of the 21st century were seen last September, and we ended the fourth quarter five basis points off those tights. Bond market participants continue to purchase bonds at these tight spreads because the “all in” yield levels remain attractive. We are aware, though, that current spreads do not leave any room for negative surprises or fundamental credit erosion.

We maintain our overweight to Energy and Financials, preferring companies with high recurring revenue. Our Energy overweight, for instance, focuses on the MLP/Pipeline subsector and is less exposed to commodity price movements. Our Financial overweight is primarily expressed in GSIB (global systemically important banks), as large balance sheets with regulated capital levels better protect bondholder interests.

On the Treasury side, the yield curve “bull steepened” in 2025, with sustained Fed cuts and the market pricing a more dovish path. The belly of the Treasury curve rallied significantly, which provided strong fixed income returns, even with credit spreads remaining low for most of the year. Sticky inflation and still elevated budget deficits prevented the very long end of the Treasury curve from rallying. Those rates ended slightly higher in 2025.

Change in U.S. Treasury Curve

| | <u>YE '24</u> | <u>YE '25</u> | <u>Change bp</u> |
|------|---------------|---------------|------------------|
| 3mo | 4.27% | 3.63% | -0.64 |
| 2yr | 4.24% | 3.47% | -0.77 |
| 5yr | 4.38% | 3.73% | -0.65 |
| 10yr | 4.57% | 4.17% | -0.40 |
| 30yr | 4.78% | 4.84% | +0.06 |

For our **tax-exempt** portfolios, the bull steepener was in effect in the shorter half of the curve but assumed a more complex dynamic further out. This tied to the most

notable themes in the municipal bond market for 2025: the continuing record-breaking supply of new issuance and the behavior of the AAA yield curve.

The surge in new supply which defined 2024 continued into 2025. While 2024 set a record, and strong issuance was widely anticipated for 2025, few anticipated that tax-exempt new issuance would almost reach \$600 billion. Over the past two years, municipal new issuance has skyrocketed 56%, from \$372 billion in 2023 to roughly \$580 billion in 2025. More remarkable than the supply, perhaps, was the market's ability to digest it without significant disruption. This resilience is fueled by a seemingly insatiable appetite for tax-exempt income.

Although the new supply was digested in an orderly manner, it made its mark on the AAA yield curve. While the curve remained stubbornly inverted from one to six years, it steepened materially in the 9–20-year area. Unlike the Treasury curve, which was basically a bull steepener from toe to tip, the bull steepener for the tax-exempt yield curve became a bear steepener around the 16-year mark, decoupling from the steepener altogether with a parallel bear shift in the 20-30 year zone.

Bloomberg Municipal Bond Index

| | <u>YE '24</u> | <u>YE '25</u> | <u>Change bp</u> |
|-------|---------------|---------------|------------------|
| 1-yr | 2.95% | 2.47% | -0.48 |
| 2-yr | 2.80% | 2.42% | -0.38 |
| 5-yr | 2.88% | 2.37% | -0.51 |
| 10-yr | 3.11% | 2.71% | -0.40 |
| 15-yr | 3.32% | 3.26% | -0.06 |
| 20-YR | 3.59% | 3.89% | +0.30 |
| 25-YR | 3.74% | 4.07% | +0.33 |
| 30-YR | 3.82% | 4.13% | +0.31 |

The annual steepening between the 2-year and 30-year maturities is the largest in the past decade. The 2/30 spread widened from 102 bps at the end of 2024 to 171 bps by year-end 2025, an increase of 69 basis points. For context, the second-largest annual steepening over the last ten years occurred in 2018, when the 2/30 spread widened by just 25 bps.

Despite the dramatic dynamics within the Muni AAA curve, municipal bond investors managed positive returns across the *entire* maturity spectrum. Performance

was especially strong in the belly of the curve, with the 5–15-year tenors registering 5+% returns.

With the inversion on the short end and the steepening through the belly, we continue to structure with a modified barbell. Currently, on the longer end, there are relative value opportunities in the twenty-year segment as opposed to the fifteen. We will probably preserve the barbell approach until the curve steepens more on the short end.

We will maintain our focus on the primary market, which provides alpha and extra income to our clients. We continue to see value in pre-paid gas, AMT, airport, and housing bonds. Housing and pre-paid gas bonds are growing sectors of the tax-exempt market, and we will likely see continued elevated supply and attractive spreads there.

Fixed income was an adventure in 2025, with many twists and turns, but the Genter suite of fixed income strategies delivered. We stand poised and ready for the inevitable challenges of 2026. And while we do not necessarily foresee a repeat of the robust performance of last year, we do think that fixed income remains an indispensable part of the capital allocation decision.

Conclusion

In addition to failed leadership by his colleagues in baseball ownership, Bill Veeck attributed football's rising popularity to the increase in college graduates (whom he scornfully referred to as "that classic figure in American humor, the Old Grad"). Veeck thought that "football is the college man's sport," while "baseball is the workingman's game." Looking back, it seems odd that baseball's consummate showman would fail to appreciate the ways in which a workingman, and his family, might find professional football more engaging than professional baseball.

Today, our country is NFL crazy. Football is far and away the number one sport in the United States. Super Bowl Sunday is a virtual national holiday, and it is not uncommon for an early regular season game, even between two mediocre teams, to outdraw World Series games with everything on the line. Baseball may be as American as bourbon and the blues, but so too, it turns out, is football.

Americans were clever enough to invent a "carry and tackle" sport which, unlike rugby, allows offensive players to be positioned in *front* of the ball. This helps create fascinating strategic and tactical dimensions to the game. While some of us enjoy the "statistorian" ("statistician" plus "historian") aspect of baseball, it must be acknowledged that football is every bit as intellectually compelling. As for the emotional component, there is something about courageous young men, throwing their bodies into the fray, which commands our attention and earns our respect.

In retrospect, we can empathize with Bill Veeck, recognizing that he was undertaking an impossible fight. And without getting too caught up in the metaphor, it is reasonable to look at his experience and analogize it to our own experience with artificial intelligence. After all, if there is another thing as American as baseball, bourbon, and the blues, besides apple pie, it is *work*. The promise of America has always been that if one works hard, then his or her family will be rewarded with the type of prosperity rarely found in the old country.

Will AI put this promise at risk? Maybe—or maybe not. No one knows for sure. All we know, given the importance of work to the American Way, is that the changing face of work in America probably changes the face of America itself. We do not know what that means exactly, but we do know that, as working Americans, it could mean a lot. As investors, though, the challenge is to see football while everyone else thinks baseball.