INVESTMENT PERSPECTIVES

JANUARY 2026

Key Takeaways —

- AI and its impact on productivity.
- How executive policy drove the market in 2025.
- The January effect.

IS PRODUCTIVITY THE ANSWER?

Mark Luschini, Chief Investment Strategist

In 1987, Nobel Laureate economist Robert Solow was quoted as saying, "You can see the computer age everywhere but in the productivity statistics." A loose version of the same statement may be made today by substituting "artificial intelligence" for "computer age." While it is unequivocal that a copious amount of money is being spent to build out the ecosystem to support the computer, infrastructure, and artificial intelligence (AI) neural networks needed for large language model (LLM) architecture, it remains a bit slippery when attempting to draw a conclusion about it sparking a productivity boom, at least yet.

To be sure, there are some, including Federal Reserve board members, who speculate that the strength in the U.S. economy that seemingly does not square with the softening witnessed in the labor market may be attributed to an increase in productivity, generally defined as output per labor hour worked. In fact, at the press conference following its recently concluded Federal Open Market Committee meeting, Fed Chair Jerome Powell cited improved productivity as one factor driving the policy board's upgraded U.S. growth forecasts for 2026.

If that holds true, it would be good news, as it may allow the economy to grow, or even accelerate, without inducing a commensurate rise in inflation that might result from the need to hire and raise wages to deliver a similar level of output. Indeed, the pace of productivity growth has picked up somewhat over the last few years, but that may be a vestige of the COVID-induced lockdowns, which heightened the need for companies to adapt without workers by improving efficiency, installing autonomous manufacturing, and deploying robotic equipment. We suspect it may take meaningful further gains in AI adoption to drive a sustained increase in productivity.

In the meantime, at the very least, the news on that front is encouraging. A survey of companies with more than 250 employees reports that more than 20% plan to adopt AI, even though fewer than 15% have done so, and the trend is rising. On a more sober note, this suggests the AI revolution is still somewhat embryonic and may have a way to go before its installed base can drive a more rapid, sustainable pace of productivity growth.

Of course, the dark side of the AI movement is the potential negative impact on workers. Many aspirational cases for AI use involve job replacement rather than job augmentation, suggesting that widespread adoption is likely to weigh on the labor market, particularly employment and wages. So far, labor market indicators do not support the idea that a significant number of jobs are being shed due to AI, however.

While job creation has slowed meaningfully over the last few quarters and wages have decelerated, neither has collapsed to levels that indicate meaningful displacement. On the labor front, the National Federation of Independent Businesses' small business survey shows more companies increasing hiring plans than at any time in the past year. If history is a guide, the usual precedes actual job creation by about six months. More green shoots can also be found in other larger business surveys. Still, the amount and types of jobs open and filled will be further testimony to the productivity impulse coming from AI.

What does it mean for investors? If productivity has accelerated and non-inflationary economic growth is a byproduct, then companies can defend margins and improve profits all else equal. Having said that, the stock market, and more specifically technology stocks that dominate the AI sphere, are pricing in a bullish, long-lasting productivity outcome from AI. That deliverable is what rationalizes the hundreds of billions of dollars being spent on everything from semiconductor chips and equipment to data centers and power sources. It also demands that the monetization of those expenditures be forthcoming before investors lose patience to justify the rich valuations afforded to many tech and tech-adjacent companies that are floated by the AI narrative. Looked at another way, if growth stays steady or improves, a shift may take place in which cyclical areas of the market, such as Industrials, Financials, and pockets of consumer-facing and small-company stocks, challenge tech's sectoral leadership. ■

YEAR IN REVIEW

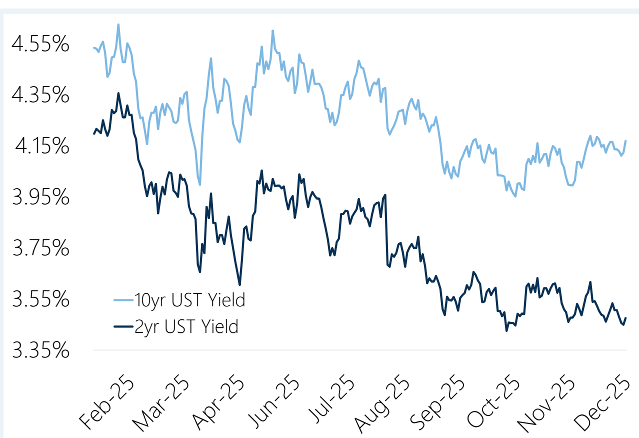
Guy LeBas, Chief Fixed Income Strategist

In continuation of our longstanding tradition, this first Investment Perspectives of the year will be a rundown of fixed income markets over the prior 12 months. In contrast to recent years, interest rate volatility was fairly muted in 2025, save for a few short-lived episodes. Ten-year Treasury yields finished the year at 4.16% after a decline of about 0.40% while 2-year Treasury yields ended at 3.47% after a 0.77% decline, leaving the yield curve somewhat steeper at year's end. These interest rate moves came in the wake of three 0.25% Federal Reserve (Fed) rate cuts in the back half of 2025.

The yield declines on the 10-year part of the yield curve were almost spot-on with our forecasts, though the declines on the front end of the curve were larger than we projected. As discussed in Janney ISG's Outlook 2026, we anticipate interest rates to trace a relatively narrow range in the coming year, with the primary risk to that outlook being political capture of the Federal Reserve.

In early 2025, the Federal Reserve shifted from a policy of preemptive rate cuts to caution amid temporarily elevated inflation readings. That period gave way to a few weeks of spring market chaos, touched off by the Trump Administration's announcement of widespread tariffs. Fears of economic contraction and foreign Treasury purchases caused short-term interest rates to fall quickly, while long-term rates remained elevated, steepening the difference between 2-year and 10-year Treasury yields by 0.30% in just three trading days. As the administration walked back a considerable amount of the tariff policy, markets normalized by summer, and yields traded in a narrow range. Finally, the Fed resumed interest rate cuts in late 2025 as labor markets languished.

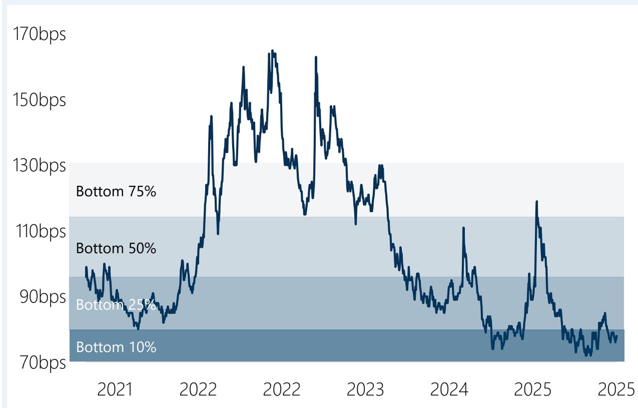
Chart 1: Interest Rates Declined and the Curve Steepened in 2025



Source: Janney ISG; Bloomberg

Credit conditions through 2025 proved remarkably resilient again. The year began with spreads on both investment-grade (IG) and high-yield (HY) corporate bonds unusually narrow; we held a cautious opinion at the time based on valuations. Spreads widened sharply amid the tariff-driven market upheaval, reaching well above their long-term averages, before declining along with interest rate volatility into the summer and fall months. As with equity markets, a "buy-the-dip" strategy proved the best option for returns in credit. Spreads finished 2025 about unchanged.

Chart 2: IG Credit Spreads Started Narrow, Spiked, and Ended Narrow in 2025



Source: Janney ISG; Bloomberg

If there were a single phrase to describe market drivers in 2025, it was "executive policy." That's distinct from the usual "fiscal policy" in that it wasn't so much spending and taxing decisions from the government as a whole, but rather unilateral policy from the administration that seemed to impact markets. Not only did tariffs generate swings in interest rates, but so too did public attacks on Fed officials, and even immigration policy, the latter through the handle of labor markets. In the new year, it seems likely that the tariff impact on growth and inflation will fade even as executive influence on the Federal Reserve proves an even bigger challenge for markets. The good news, however, is that U.S. consumers and private industry remain resilient to policy swings. While policy may cause short-term market swings, it's ultimately these private market forces that will dominate growth and inflation in the years to come.

MAY THE FOURTH BE WITH US

Gregory M. Drahuschak, Market Strategist

Our December Investment Perspectives issue noted that December is often a wonderful month for stocks—typically one of the three best months of the year for stocks. However, December 2025 was not one of them. In fact, the month ended with a 0.06% loss.

This year begins with three straight years on investors' minds, as the S&P 500 posted annual gains of 24.23%, 23.31%, and 16.39% in 2023, 2024, and 2025, respectively. The key question this year is whether a fourth straight winning year is on tap.

Since 1940, four straight-up years have occurred only four times (1942-1945, 1982-1989, 1995-1999, and 2003-2007), with average annual gains through the applicable years of 19.1%, 14.51%, 26.32%, and 11.25%. These four periods coincided with significant economic conditions.

From 1942 to 1945, the war effort drove a massive manufacturing force. The 1983 economy produced robust GDP growth, falling unemployment, moderating inflation, and declining interest rates, along with President Reagan's tax cuts that propelled the economy. A massive tech boom in the 1990s, a "peace dividend" from the end of the Cold War, rising productivity, and positive federal budget surpluses created one of the longest peacetime expansions in U.S. history. A strong recovery from the recession early in the first decade of the twenty-first century provided tailwinds for the 2003-2007 period, right before a major recession hit. Several tailwinds could help to extend the most recent three-year winning streak.

Deregulation could be a major positive for some industries. Capital spending could be a major economic driver due to the accelerated expensing for companies, while no tax on tips and Social Security could support consumer activity. Consumers could also get a lift as wage gains now exceed inflation. Spending on artificial intelligence may ease slightly in 2026, but it looks set to continue at a robust pace. Although there is debate over whether the recent cut to the Fed fund target range will be followed by additional interest rate reductions, we doubt this will be an impediment to the equity market. However, cuts in mortgage rates certainly could help.

Corporate earnings appear to be on track to provide a solid base for stocks. As 2025 ended, the consensus earnings estimate for the S&P 500 in 2026 was $309.36, up 14.5% from the 2025 estimate, with the Technology, Materials, and Industrial Sectors expected to show earnings gains of 29.9%, 19.7%, and 14.0%, respectively. Nonetheless, the 2026 estimate puts the S&P 500 at an elevated 22.1 earnings multiple.

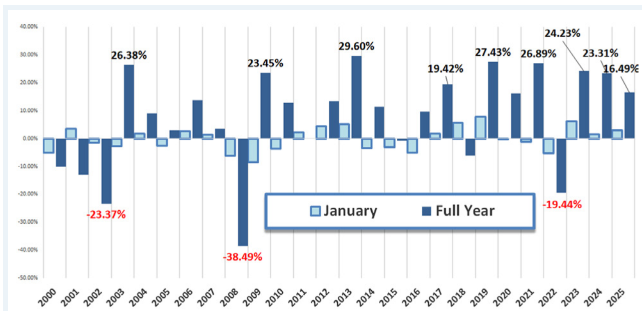
Chart 3: S&P 500 Large Cap Index

Source: Stockcharts.com; Janney ISG

The comparatively liberal market valuation is probably reflected in the S&P 500's difficulty in December. Although the S&P set new all-time intraday and closing highs, it could not convincingly top the prior resistance zone.

January has always been viewed as potentially being a bellwether month, but it does not always support the cliché, "as January goes, so goes the full year." Over the past 26 years, the S&P 500 closed January higher 14 times but ended the full year higher 18 times.

Chart 4: January and Full Year % Result for S&P 500 — 2000–2025



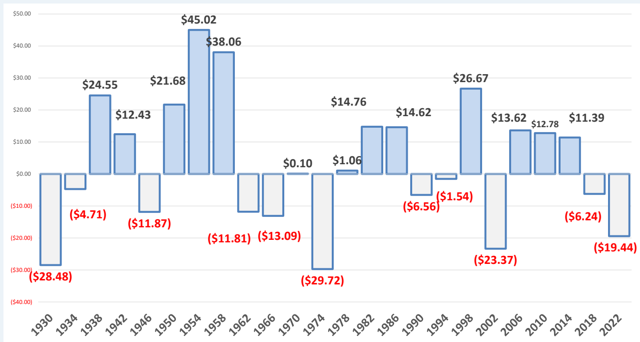
Source: LSEG T1; Janney Investment Strategy Group

Table 1: Presidential Election Cycle — S&P 500 Average % Results

1st Year	2nd Year	3rd Year	4th Year
7.44	4.71	16.61	7.83

It is worth remembering that this year is the second year of the presidential election cycle, but it has the worst record of the cycle. The potential composition of both houses of Congress will undoubtedly impact markets at various points this year.

Chart 5: S&P 500 % Change 2nd Year of the Presidential Election Cycle



Source: LSEG T1; Janney Investment Strategy Group

Despite the recent events in Venezuela and the resulting political turmoil, 2026 may produce a gain for a fourth straight year, the fourth time since 1950, when the S&P 500 originated as the primary U.S. equity market index.

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