

A photograph of a large warehouse interior. High blue metal shelving units are filled with wooden pallets, many of which are stacked with cardboard boxes. In the foreground, two workers wearing yellow hard hats and light-colored shirts are in motion, pushing a wooden pallet loaded with boxes. The scene is brightly lit, and the floor is a smooth, light-colored concrete. A semi-transparent dark blue rectangular overlay is centered on the image, containing white text and a logo.

INVESTMENT STRATEGY GROUP

# OUTLOOK 2026

JANNEY MONTGOMERY SCOTT LLC

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# OUTLOOK 2026

## OVERVIEW

*Outlook 2026* offers the Janney Investment Strategy Group's baseline prognostications for the economy, the equity and fixed-income markets, their evolution, and investment implications in the New Year.

### Economy & Equity Markets ..... Page: 3

- Economic growth should persist, with a potential boost from the One Big Beautiful Bill Act, which would add incremental fiscal thrust via favorable tax treatments for individuals and businesses.
- Job growth has moderated but should continue to expand at a sufficient pace as to slow any near-term ascent in the unemployment rate, thereby keeping it below a confidence-destroying threshold.
- Businesses have undertaken measures to mitigate the impact of the tariffs imposed by the Trump Administration. While trade matters remain somewhat fluid, their uncertainty has receded.
- Corporate profits are projected to increase materially year over year, which should support an advance in stock prices. Easing monetary conditions will also lend a tailwind to equity markets.

### Fixed Income & Interest Rates ..... Page: 7

- After strong gains in 2025, our base case has fixed income markets generating slightly lower but still positive performance in 2026, with the 5- to 10-year part of the curve in the 5.7%-6.5% total return range.
- The Federal Reserve (Fed) is near the end of its stop-start normalization process, and policy should converge toward neutral this year, which would put 2-year Treasury yields in a 3.25%-3.65% band and 10 year yields in a wider 3.50%-4.25% range. The most significant risk to this outlook is the possibility of Fed "political capture."
- We are cautious on investment-grade (IG) corporate credit but expect the sector to generate positive returns. The two primary risks are the narrow starting point for spreads and the potential for \$100+ billion of "hyperscaler" bond issuance to add supply.
- Agency mortgage backed securities represent our top pick for a second year in a row, as spreads remain historically wide, bank demand is gradually returning, and supply will fade as new home sales remain stagnant.

# ECONOMY & EQUITY MARKETS



**MARK LUSCHINI, CMT**  
Chief Investment Strategist

President and Chief Investment Officer, Janney Capital Management

Mark Luschini serves as Janney's Chief Investment Strategist and leads the Investment Strategy Group, which sets the firm's view on macroeconomics, as well as the equity and fixed income markets. In addition, Mark is the President and Chief Investment Officer of Janney Capital Management (JCM), the asset management subsidiary of Janney Montgomery Scott. Under his leadership, JCM has delivered competitive results across its suite of investment strategies and grown its assets under management to more than \$3.7 billion.

Mark has spent more than thirty years in the investment industry. He draws on that experience to speak on topics related to macroeconomics and the financial markets at seminars, client events and conferences. He is frequently quoted in publications ranging from the Wall Street Journal and Barron's to the New York Times and USA Today. In addition, he regularly appears in various media outlets including CNBC, Fox Business News, and Bloomberg Television and Radio. He has an undergraduate degree in Psychology and an MBA in Finance from Gannon University and holds the Chartered Market Technician (CMT) designation from the Market Technicians Association.

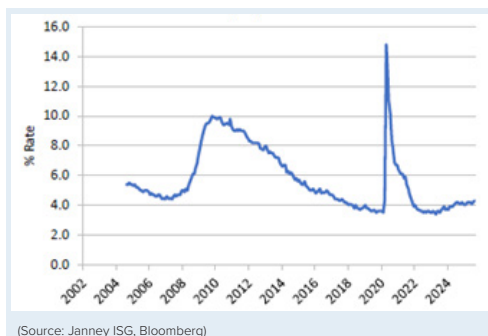
Although the government shutdown precluded a variety of economic reports from being released, including third-quarter Gross Domestic Product (GDP), data from other, more frequent and efficacious sources offer a reliable current assessment. For instance, a couple of the regional Federal Reserve Banks we often refer to, those in Atlanta and New York, post an updated estimate of growth trends in real time. Together, they show figures for the third quarter running north of 2% and for the fourth quarter as well. While those are certainly positive and suggest momentum encouraging the expansion's continuation, much will depend on the labor market's evolution.

Chart 1: US GDP



There has been a notable downshift in job creation, and the narrowness of the industries reporting increased hiring is somewhat worrisome. In fact, the annualized pace of payroll growth has fallen below 1%, usually a hallmark of an environment immediately preceding or in the early stages of a recession. Fortunately, the unemployment rate, while creeping higher, stands at 4.6% today, still near historically low levels.

Chart 2: US Unemployment Rate



If the economy grows at its projected pace of about 2%, it will require fewer new jobs to maintain the current unemployment rate. Therefore, the payroll slowdown may not be as threatening as it appears. More concerning is that a disproportionate share of recent job growth has been concentrated in the healthcare and leisure sectors. Notably, these areas notoriously offer wages that are at the lower end of the income scale. While any new job is arguably good for those seeking employment, the horsepower for consumer spending from those employed across these areas lacks the same force as that from those hired in manufacturing or professional services. Since household consumption is such an important driver of GDP, this pattern raises concerns about the pace and even the sustainability of this economic expansion.

Chart 3: US Initial Jobless Claims



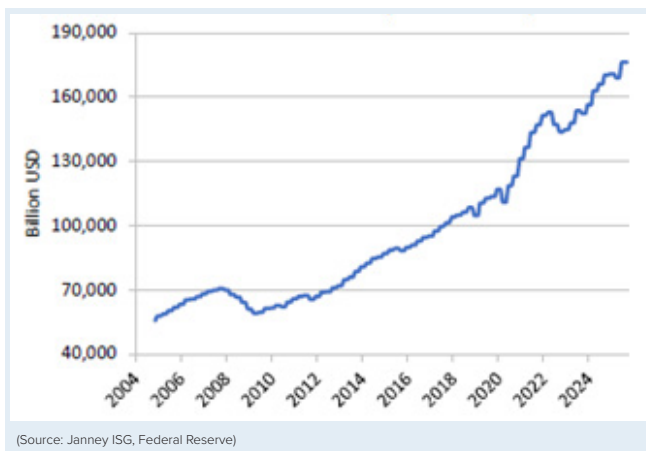
In the meantime, there is no evidence that companies are broadly relieving employees of their jobs. Jobless claims, calculated weekly and generally considered a leading indicator for the health of the labor market, have not risen in any discernible fashion. In fact, the tally has remained within a narrow range for the last four years and well below a level that would raise a red or even yellow flag, signaling the unemployment rate (a lagging indicator) was poised to surge higher. As a result, while job creation appears somewhat subdued, job losses have not yet shown signs of a meaningful deterioration in the labor market. This stasis condition is unusual, since the unemployment rate typically oscillates, either persistently trending higher or lower. The mounting job cut announcements of late have not translated to unemployment insurance claims, at least not yet, and may

never, so the almost sideways with a slight bias to the upside in the often-cited, headline-grabbing, unemployment rate is hardly on the verge of jumping to the 5%–6% area coincident with garden-variety recessions.

Better news on employment is found amongst some green shoots emerging that often foreshadow a strengthening labor market. A monthly survey of purchasing managers from the manufacturing and services industries, conducted by S&P Global, a major financial information gathering and credit rating company, shows hiring plans steady or rising. In addition, most of the regional Federal Reserve banks surveying industries in their respective districts show the same. Importantly, small businesses, which account for a large percentage of employment in this country, have reported that hiring plans have increased. Lastly, the Conference Board's monthly survey of consumer confidence noted in a recent report that more are feeling jobs are plentiful than those saying they are hard to get. This collection of "soft data" may not fully satisfy the need to see actual job growth perking up today, but it has often been a harbinger of what might likely follow.

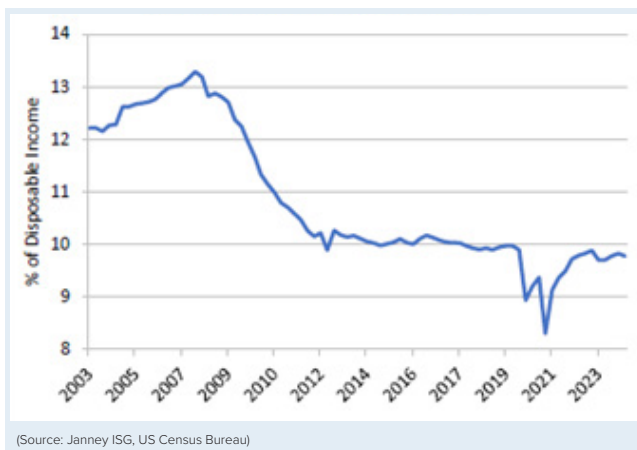
In aggregate, households are in a healthy financial position. Rising stock market and real estate prices have increased net worth to an all-time high. This certainly has accrued to the more affluent, who hold a larger portion of their assets in stocks than lower-income cohorts. The pace of spending by the top 10% of income earners accounts for over 50% of consumption, and it has been well above trend for several years. Their outsized contribution to spending, however, puts the economy at risk should stock prices fall precipitously, which in turn would dull the "wealth effect" (the historical record suggests that every dollar of net worth increases spending by approximately a nickel) induced by rising asset values. With aggregate household net worth today at \$176 trillion, up almost \$10 trillion over the past year through June 2025 (the last update from the Federal Reserve), that is a lot of nickels that could be spent!

Chart 4: US Household Net Worth (Nominal USD)



Wage growth has decelerated but remains near 4%. This is important since it has allowed households stretched by living expenses to realize positive inflation-adjusted gains over the last few years as inflation finally abated. Debt is still at a manageable level, and the cost to service that which is sitting on household balance sheets is very low. What had been a rising risk was the spiking delinquency rates on credit and auto loans. Still, those have stabilized and even turned lower, while other credit facilities, such as mortgages, show benign readings of duress. The lifting of the moratorium on student loan repayments also led to a surge in delinquencies, but that, too, has tapered off. In sum, the litmus test of the state of the consumer and their propensity to spend yields a positive reading. The labor market and consumers' sentiment about their job security will be the key determinants of the economy's vitality and the most important variables to monitor going forward.

Chart 5: US Household Debt Service Ratio



The business sector presents a more mixed picture. Manufacturing is still somewhat weak, with more than half the respondents to questions about their business activity reporting sluggish conditions. The services sector, on the other hand, is performing reasonably well. This, of course, is also due to the affluent's spending on travel, leisure, and entertainment at an unusually heady pace.

Generally speaking, the outlook from companies, big to small, has turned higher, which bodes well, and neither tariff nor inflation headwinds feature as prominently in their comments as they once did. Indeed, there are accumulating signs that the impact from deregulation, the full expensing feature in the One Big Beautiful Bill Act, and the incremental business accruing to those directly (semiconductor, tech-related, and hyperscalers/cloud companies) and indirectly (industrial and infrastructure-related companies) are beginning to have a positive impact on economic activity.

In particular, financial firms, capital-intensive businesses, industries facing the wave of onshoring/reshoring, and companies that benefit from the copious spending directed at the artificial intelligence-related tsunami stand out. Indeed, promise for the all-important manufacturing industry can be detected in the improvement in new orders for durable goods. Even though the manufacturing sector accounts for less than 15% of U.S. economic output, the multiplier effect of its high-paying jobs on ancillary vendors is huge. New orders for capital equipment not only spur overall activity but also signal that companies are optimistic about making often sizeable, usually long-duration investments.

Chart 6: US Durable Goods New Orders ex. Transportation



## CONCLUSION

The economy is expanding at a pace that is sustainable given the current state of consumer and business activity. The anticipated fiscal boost from additive tax benefits could accelerate growth. So long as inflation cooperates, giving the Federal Reserve confidence that it is returning to its 2% target, lower interest rates can be expected. Not only does that help lower borrowing costs, but it may also help resuscitate the moribund housing market, which, like manufacturing, has a large multiplier effect. A sturdy economy, fostered by a steady, if not improving, job market, will extend this period of economic growth through 2026 and perhaps well beyond.

## RISKS TO MONITOR

- The key on the domestic front is the labor market. The blackout due to the government shutdown prompted prognosticators to seek anecdotal sources of information to assess its condition. Given the downshift in job creation over the last few months, as evidenced by reports from reliable third parties, the pending release of updated government information could merit a rethink of its strength.

- Inflation continues to percolate above the Federal Reserve's target. Should it fail to fall sufficiently, policymakers may be in a quandary, balancing its labor-market goal with that of price stability. Market participants expecting the Fed's rate-cutting campaign to continue could be caught offside if policymakers turn more hawkish.
- Exogenously, the conflict in Eastern Europe is a well-known but potentially kinetic situation, and China's explicit desire to threaten Taiwan's autonomy will keep geopolitical risks simmering.

## INVESTMENT IMPLICATIONS

The positive economic backdrop we forecast underscores our constructive stance on risk assets. Below, we highlight areas of interest and opportunity to express our views in a portfolio.

- **Global Equity Markets** — Domestic stocks should advance predicated upon the expectation of corporate profit growth, which is estimated to increase by double digits over the next twelve months. Valuations are demanding, however, requiring good economic news to underpin that expectation. Solid economic growth, lower interest rates, and a positive fiscal impulse may warrant adding exposure to more cyclical areas. Small caps may be advantaged by lower rates and rising comparative earnings estimates, giving them a leg up.

Even after a year in which many foreign bourses significantly outperformed the U.S. equity market, the valuation disparity remains wide, making them compelling investments. Our expectation of the dollar's further decline over the coming year adds an additional lever for U.S. investors to benefit from currency exchange, which aids multinational corporate profits generated overseas. Favored areas include Europe and Japan. Emerging market equities are also an attractive diversifier.

- **Sectors** — The tech and tech-adjacent companies found in Technology, Communications, and Consumer Discretionary should continue to draw investor interest. Also, Industrials and Utilities benefit from fiscal spending directed at reshoring industries, building facilities to house the massive build-out of artificial intelligence, and the energy needs supporting technology data centers and electric vehicles. Favored secular themes include defense companies, cybersecurity, artificial intelligence, genomics, and robotics.
- **Commodities** — Industrial metals, such as copper and uranium, should benefit from expenditures on infrastructure, decarbonization, and electrification, both here and abroad. Rare earth metals have become highly prized as their importance to the U.S. across many leading industries has come into focus. Used as a hedge in a diversified portfolio, precious metals, namely gold and silver, may be employed in part to address the risk of a geopolitical event or inflationary shock.

## VARIOUS ECONOMIC SCENARIOS AND PROBABLE OUTCOMES

Our outlook for the U.S. stock market contemplates three potential paths, each driven by the economic scenarios that may unfold. We assign a probability to each, with the highest score given to the scenario representing our base case. In preview, we remain quite constructive overall. However, economic data withheld during the government shutdown, which will resume its usual delivery over the next couple of months, could alter our interpretation of alternative sources of data that we have used to inform our current views.

### Scenario 1: Optimistic

Aided by the fiscal boost from the One Big Beautiful Bill Act, which encourages business spending and benefits many workers through lower individual taxes, the economy expands more rapidly than expected. The lapping of tariff hikes initially imposed in April 2025 naturally reduces the pace of inflation, allowing the Federal Reserve to lower interest rates. The mid-term elections pass without a disorderly outcome, relieving a potential source of disruptive political discourse. Geopolitical tensions fail to erupt, and while issues remain unresolved, they do not consume the attention of investors. Faster economic growth, more predictable global trade activity, and lower borrowing costs spur rising business and consumer confidence levels. Corporate profits rise well above current projections of just over \$300 for S&P 500 companies, and market participants assign an above-trend multiple to them, driving the index to 7,900.

**Probability: 30%**

### Scenario 2: Central Case

The economy's expansion moderates, fostered by a downshift in job growth. Inflation falls further toward the Federal Reserve's target of 2%, allowing the monetary authorities to reduce interest rates, which helps to buffer the still-high cost of living afflicting less affluent households. The above-trend pace of spending by the top-earner cohort decelerates somewhat, leading to a step-down in overall consumption, the principal force behind the economy's direction. Trade policy uncertainty continues to cast a shadow over business and consumer behavior, negating the fiscal impulse from the One Big Beautiful Bill Act. Corporate profits grow solidly but fail to exceed expectations, and there is increasing skepticism that the enormous capital being spent on the artificial intelligence ecosystem will be monetized, weighing on big-cap tech valuations. Still, the S&P 500 advances, reaching 7,500.

**Probability: 60%**

### Scenario 3: Pessimistic

Companies continue to trim employees as some of the post-COVID employment binge is shed, and this is accompanied by a lack of vigor in new hiring. The unemployment level rises uncomfortably, leading households to retrench on their consumption habits to bolster savings. While inflation falls and the Federal Reserve cuts rates aggressively, the lagged impact of their benefit for the economy fails to support the near-term expansion. Meanwhile, the Trump Administration takes deliberate policy action to abate the impact of high costs on household goods, but neither is enough to forgo a mild contraction in economic activity. Corporate profit expectations are trimmed, creating a vacuum for lofty stock valuations to compress. Stocks are derated, and the market incurs a deep correction, taking the S&P 500 index to 5,800 before it rebounds to 6,500.

**Probability: 10%**

## BOTTOM LINE: ENSEMBLE FORECAST

Our weightings suppose a favorable outcome. Much as in the previous year, we assigned a 90% probability to the S&P 500 reaching a price above current levels. However, we acknowledge that labor market developments and, as always, an unexpected geopolitical event could alter conditions, presenting a small but non-trivial possibility of a less welcome path for investors.



# FIXED INCOME & INTEREST RATES



## GUY LeBAS, CFA®

Chief Fixed Income Strategist

Director of Custom Fixed Income Solutions, Janney Capital Management

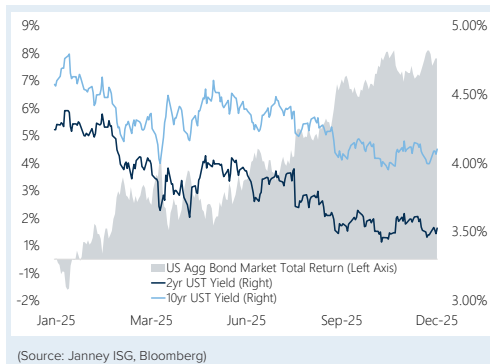
Guy LeBas is responsible for providing direction to the firm's clients on the macroeconomic, interest rate, and bond market investing climate.

Guy authors bond market periodicals which provide relative value recommendations across the fixed income spectrum. Bloomberg named him the most-accurate forecaster of the Treasuries market in 2015 and previously recognized him as a "Bloomberg Best" for his work in bond market forecasting.

Prior to joining Janney in 2006, Guy served as Interest Rate Risk Manager for U.S. Trust's bank asset and liability portfolios, a role in which he oversaw risk and return on an \$11 billion balance sheet. He received his education from Swarthmore College and is a CFA Charterholder.

We think the U.S. dollar bond markets are set up for an environment where *income, not big capital gains*, does the heavy lifting in 2026.

Chart 7: US Agg Bond Markets Delivered >7% Returns YTD as Yields Declined



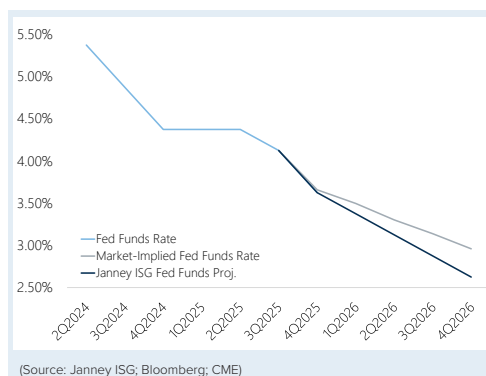
## FED POLICY: SUPPORTING JOB MARKETS

Economic growth will end in 2025 in the low-2% range, a deceleration from two years of above-trend expansion. The October government shutdown creates an unusually large blind spot for markets, but the unemployment rate should end the year at about 4.6%, up from 2024's 4.0%. Core PCE inflation, the Fed's preferred measure, will meanwhile finish in the 2.8%-3.0% range, still high but a deceleration from recent price pressures. For the coming year, we anticipate consumer spending will moderate, though remain positive; job growth will trend sideways; housing investment will contract; and tech-related corporate investment will drive growth on the margin. As the year-over-year effects of tariffs fade, the annualized pace of inflation should decelerate, with the core PCE falling to the low-2% range by the end of 2026. For bond investors, that mix argues for modest rate volatility around a mostly stable trend, barring political capture of the Federal Reserve.

There's a common view that the Fed manages the tradeoff between growth and inflation, but as Fed Chair Jay Powell has highlighted ad nauseam, Congress mandates that monetary policy should maximize employment, not growth. Today, there is ample evidence that employment conditions are deteriorating. An unemployment rate of 4.6% would sit right

at the level over which Fed officials have expressed concern. Moreover, Powell and colleagues have repeatedly treated tariff-induced price pressures as a minor inflation risk, thereby allowing policymakers to focus on the labor-market side of the mandate. With labor markets deteriorating for the moment, the Fed has cover to cut interest rates from its currently restrictive posture towards "neutral."

Chart 8: Janney ISG Projects 4x Rate Cuts in 2026



The level of neutral policy rates is a matter of considerable debate, though reasonable forecasts are in the 2.50%-3.25% range in the long run. The Powell Fed has been hesitant to plant a flag, but with overnight rates today at 3.625%, there is room to cut even under conservative assumptions. Moreover, it is all but certain that Jay Powell's replacement—the current chair's term ends in May 2026—will have a lower estimate of neutral and be more aggressive in pushing to neutral than Powell has been. As such, our base case for the Fed is four 25-bps cuts that bring the overnight rate to 2.625% in 2026. We have penciled in two cuts early in the year and two more under Powell's successor.

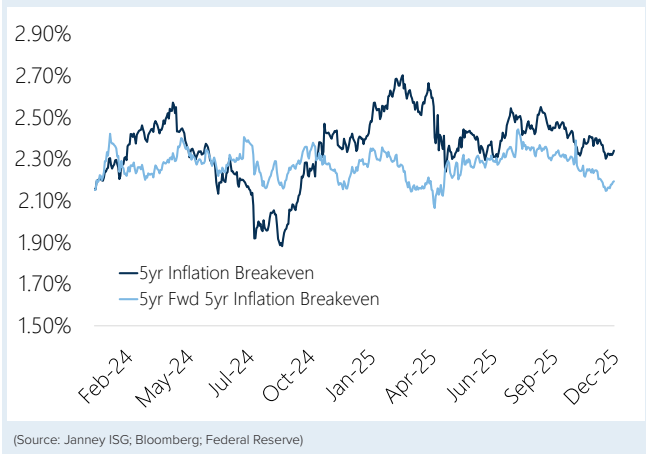
There is a considerable risk to this outlook, namely that the Trump Administration may move more aggressively to bring monetary policy under its purview. Such action could take several forms, from legal maneuvers to oust current Fed members and replace them with Administration-friendly picks, to attempts to restructure the regional Fed selection processes. Even something as simple as a new Chair re-tasking staff economists to skew research could have a long-term impact. In the

event the Fed succumbs to political capture, we can expect a bias towards more aggressive cuts—possibly another two in 2026 that will pull overnight rates to 2.00%–2.25%, thereby dragging 2-year and shorter Treasury yields down but pressuring 10-year and longer yields meaningfully higher.

INTEREST RATES: CONSTRUCTIVE FOR A THIRD YEAR

The 2-year Treasury is essentially the market’s best guess at the average fed funds rate over the next two years, plus a small premium. Given the policy backdrop above, our central view for 2026 is that 2-year yields decline slightly. In our base-case economic outlook, we anticipate the 2-year will trade in a 3.25%-3.65% range, ending the year below current levels. In the case of Fed capture, we could see 2-year yields decline further to the mid-2% area, reflecting a lower average policy rate over the subsequent years. Given that overnight yields will decline in either scenario as the Fed cuts rates, we would expect the 2-year part of the curve to outperform cash by a healthy margin.

Chart 9: Longer Term Market Inflation Expectations Have Traded in a Benign Range Despite Tariffs Pushing up Prices



While the 2-year is all about monetary policy, the long end of the curve is a muddle of not only the Fed, but also of economic growth prospects, inflation expectations, and fiscal math. We see four main forces shaping longer-term yields in 2026: still-anchored inflation expectations, a term premium supported by persistent deficits, and rising demand for safe assets. Inflation expectations—as measured by traded instruments—do not indicate any serious long-run concerns. The U.S. budget deficit is likely to measure 4%-5% of GDP in 2026, which means further long-term bond issuance in 3Q/4Q 2026. Against this backdrop, demand for the long end of the U.S. curve nonetheless looks strong. Net-net, we anticipate the 10-year to trade in a 3.50%-4.25% range for most of 2026, ending the year in the middle of that band.

Table 1: Interest Rate Forecasts

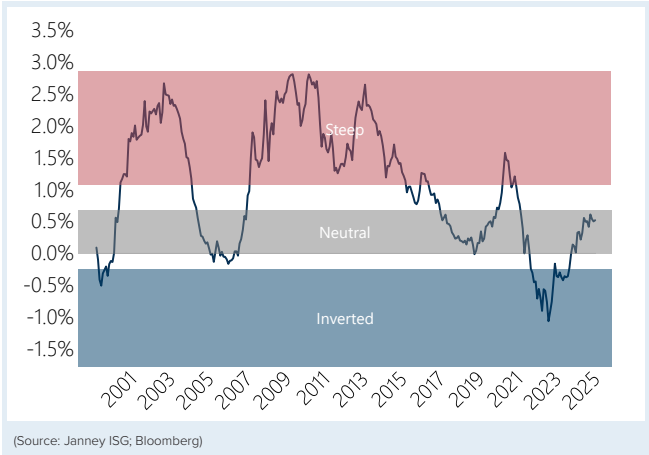
	4Q25 (Act)	2Q26 (Proj)		4Q26 (Proj)	
		Most Likely	Alternate	Most Likely	Alternate
Federal Reserve	3.63%	2x Cuts	2x Cuts	4x Cuts	6x Cuts
2yr UST	3.53%	3.40%	3.10%	3.25%	2.6%
10yr UST	4.10%	4.00%	4.30%	3.80%	4.5%
IG Spreads	80bps	90bps	95bps	95bps	100bps

Janney ISG; Bloomberg; Federal Reserve Board

Our base case setup suggests total returns will be “coupon plus a bit” for the 5- to 10-year part of the yield curve. Importantly, however, Treasuries have a role as portfolio insurance against an unexpected equity market shock. Recent intermarket correlations suggest that fixed income is acting as a partial hedge against equity weakness. With valuations in the stock markets full, having that insurance policy is particularly valuable.

Federal Reserve political capture remains our biggest concern for the U.S. yield curve. The said capture would mean lower overnight and 2-year rates. For points beyond five years (and especially further than 10 years), the markets might well rebel against aggressive rate cuts and price in higher long-run inflation risks. While not our most likely outcome, in this alternate “political capture” scenario, we would expect the curve to steepen, reaching the +2% differential between 2-year and 10-year Treasuries last seen in 2014.

Chart 9: 2yr/10yr Yield Curve Would Face Painful Steepening in a Fed “Political Capture” Scenario

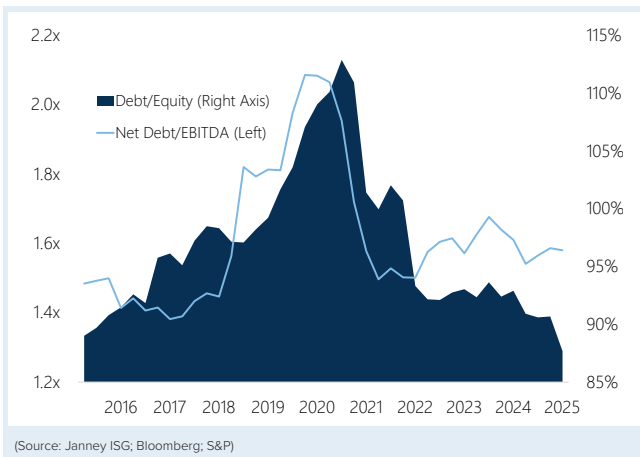




## CORPORATE CREDIT: HYPERSCALER WAVE COMES ASHORE

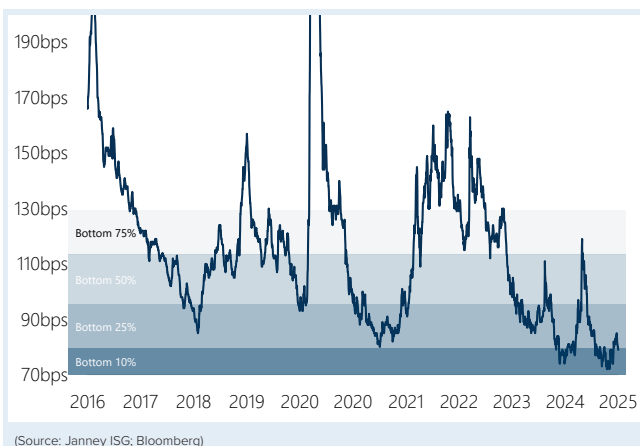
Our outlook for corporate credit in 2026 remains consistent with our outlook from the beginning of this year: fundamentals are decent, but valuations remain expensive. For S&P 500 companies in 2025 (three quarters of actual data and one quarter of projected), cash earnings should grow by about +7% and profit margins should widen by +2%. In sum, credit metrics among non-financial companies in the S&P 500 will be roughly unchanged, with the aggregate net debt/EBITDA ratio projected at 1.58x, a hair below 2024's levels.

Chart 10: Median Leverage Among Non-Financial Companies Remains at or Below Long Run Trend



As of publication, spreads of investment-grade (IG) credit over Treasuries measured +80 bps at the index level. While not so egregiously expensive as in early October, these spreads are historically tight. Based on 30 years of data, current IG spreads are in the 11th percentile, even stripping out the 2008 - 2009 Global Financial Crisis. Our interpretation of these tight spreads is that demand is simply outstripping supply in IG credit. As such, any increase in supply risks normalizing spreads to the +90 -100 bps range.

Chart 11: IG Credit Spreads Are on Lower End of Their Historical Range



Debt-funded data center builds are one potential source of IG bond supply. "Hyperscalers" is the (admittedly odd) name associated with large tech companies expanding into the artificial intelligence business. Historically, these companies have funded capital spending with profits. In today's era, however, capex is outstripping these companies' abilities to generate cash. To fund the build-out of massive data centers, these companies are increasingly relying on the bond markets. In 4Q25 alone, three hyperscalers issued \$63 billion in bonds; extrapolating this trend, the IG bond markets could see an incremental \$150 billion - \$200 billion in annual supply.

That dollar amount would increase IG corporate issuance to a record \$1.85 trillion – \$1.95 trillion, ending the era of undersupplied corporate bond markets and normalizing spreads. Still, credit fundamentals are solid, so we encourage buying in IG credit if spreads widen above +95 bps. Until that point, credit could underperform governments and Mortgage-Backed Securities (MBS).

## MUNICIPALS: ERA OF CREDIT IMPROVEMENTS AT AN END

Since the pandemic, municipal (muni) credit quality has repeatedly surprised to the upside. Rating agency reports from Moody's, S&P, and Fitch have repeatedly noted that upgrades have outpaced downgrades across U.S. public finance sectors since 2021, helped by robust federal support, strong tax receipts, and disciplined budgeting. While there's no evidence of outright deteriorating credit quality in aggregate, the tailwinds behind these credit improvements have abated. Nowhere is that more evident than in the Federal Government's willingness to reduce, divert, or condition state and local government support. In our base case, the upgrade/downgrade ratio remains positive in 2026, though likely at a more normal pace as the one time boosts from pandemic aid fade. Areas of relative vulnerability—standalone hospitals, smaller private universities, and some downtown dependent localities—will continue to see more downgrades, but they are a minority of the market.

Chart 12: Municipal Ratings Upgrades Have Slowed in 2025

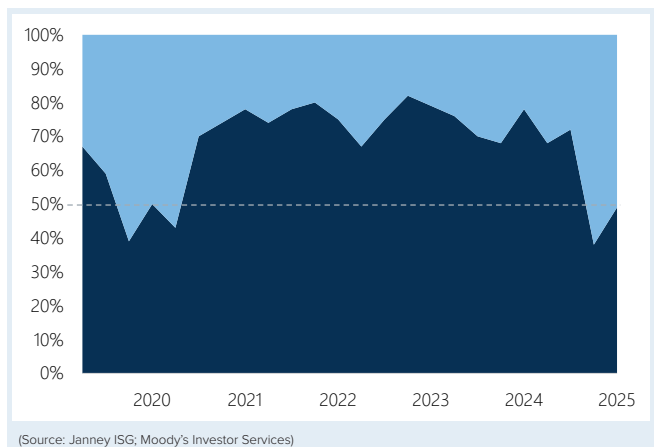
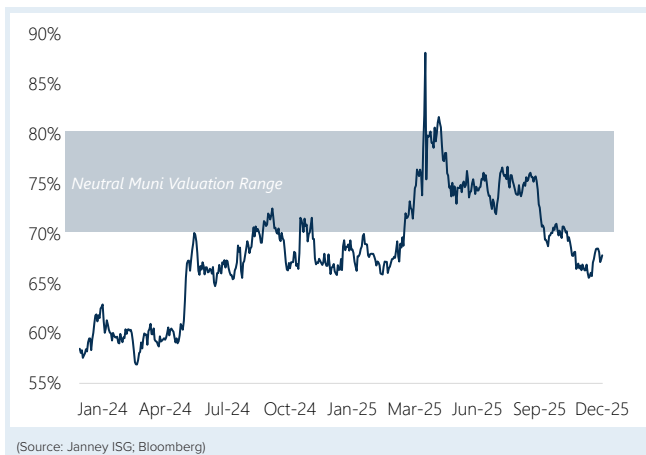
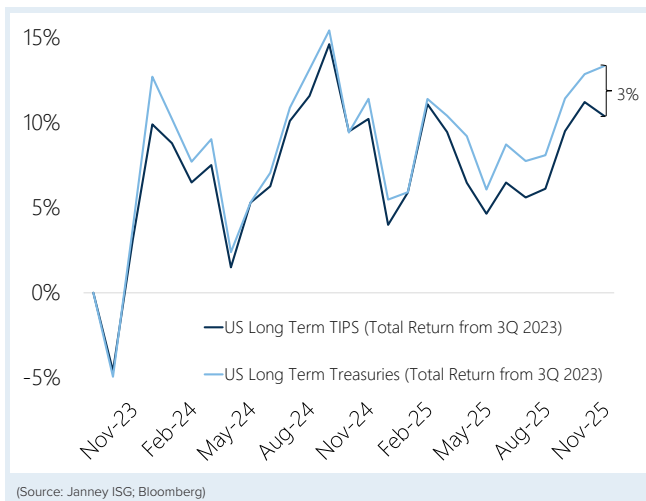


Chart 13: 10yr Muni/Treasury Ratios Signal Muni Markets are Slightly Expensive



In the post COVID era, the ratio of 10-year muni to Treasury yields has mostly fluctuated between ~60% and 90%. Increasingly, these ratio trends have been seasonal, with expensive markets in the fall and inexpensive ones in the spring. As we end the year, tax-exempt bonds are on the costly side of their ratio range, leaving us uninspired. If ratios widen back towards the 75% area, we'd be eager buyers in the 7- to 15-year part of the muni curve.

Chart 14: TIPS Have Underperformed Coupon Treasuries in 2025, but Politically Captured Fed Could Reverse the Trend



One area of concern in the tax-exempt credit market is the smaller college/university sector. The concern here is demographic. U.S. college enrollments are barely growing. For the 2026–2027 academic year and beyond, anti-immigration sentiment risks cutting the already slim enrollment growth to zero. Once we reach 2030, domestic demographics suggest schools will face outright contraction. This contraction will not affect highly selective schools, but smaller commuter, religious, and

non-specialty schools will face shrinking classes. Private higher-ed institutions comprise only 2%-3% of the muni market, so problems in higher-ed should not have a market-wide impact, but we suggest a note of caution.

## AROUND THE WORLD: KEY SECTORS TO WATCH

Beyond Treasuries, corporates, and munis, several other U.S. dollar bond sectors deserve a place in the 2026 conversation.

- Agency MBS spreads widened meaningfully during the 2022 rate shock and remained generous through mid-2025. In the months since, the sector performed well, and markets have come to price MBS more reasonably. Today, spreads are slightly below their historical averages, but still in the 25th percentile of post-Global Financial Crisis history, making them attractive to most other sectors.
- TIPS (Treasury Inflation-Protected Securities), are not particularly attractive at present, but could prove useful for covering a tail risk noted in our Fed outlook. If the Trump Administration manages to push a much more dovish monetary policy beyond what markets deem prudent, long-term inflation expectations will rise considerably. TIPS are the simplest hedge against higher inflation expectations.
- Private credit remains an attractive sector in general, not because of safety, but because of its coupons in the 8%-12% range. A substantial amount of private lending has gone to data centers and AI-adjacent technologies, and we anticipate meaningful defaults in that subsector. But that default wave is still two to three years off, and in the meantime, the high coupons cover a lot of risk. Blending a modest allocation to private credit with a high-grade portfolio is a better risk/reward tradeoff in our view than holding an all-IG corporate portfolio.

## FINAL THOUGHTS

In sum, the most likely 2026 environment for U.S. bond investors is one where returns are coupon plus a small incremental return from declining rates. Most sectors—namely IG credit and municipals—are expensive, though not egregiously so, and we continue to favor agency MBS and private credit as reasonably attractive sectors, though for vastly different reasons. Most significantly, the real value of fixed income in this environment is for portfolio construction and preparation for what might happen around, not in, the bond markets. High-grade bonds are once again providing an effective hedge against equity market weakness. With equity valuations steep, the odds of a stock market correction are higher than normal. Against that backdrop, a sleeve of high-quality government bonds can serve as feedstock for reallocation into risk assets in the event of such a correction.

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**Overweight:** Janney ISG expects the target asset class or sector to outperform the comparable benchmark (below) in its asset class in terms of total return.

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**Asset Classes:** Janney ISG ratings for domestic fixed income asset classes including Treasuries, Agencies, Mortgages, Investment Grade Credit, High Yield Credit, and Municipals employ the "Barclays U.S. Aggregate Bond Market Index" as a benchmark.

**Treasuries:** Janney ISG ratings employ the "Barclays U.S. Treasury Index" as a benchmark.

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