INVESTMENT OUTLOOK
JANUARY 2026

Entering 2025, investors prepared for a challenging year amid looming tariffs, geopolitical tensions, persistent inflation and elevated US interest rates. But ultimately markets proved resilient. Global equities delivered a return of around 21 percent in USD terms, while USD-hedged investment-grade bonds gained nearly 5 percent.

Equities were not even the top-performing asset class in 2025 after the initial shock from widespread US tariffs in April quickly faded. In fact, gold outperformed all other assets, rising by more than 64 percent in USD terms. While equities benefited from AI-driven investments and improving earnings expectations, and bonds enjoyed attractive yields and a gradual shift toward monetary easing, gold appeared to price in a broader set of geopolitical, fiscal and institutional risks. For investors, reconciling these contradictory developments required tolerating a degree of cognitive dissonance.

US economic growth slowed during 2025 but remained more resilient than anticipated, given the elevated uncertainties and policy disruptions. US GDP expanded by around 2.3 percent year-over-year by the end of the third quarter, broadly in line with its long-term trend. However, behind this stable facade, imbalances have developed. AI-related capital expenditures accounted for an estimated one-third of US growth, masking the growing disconnect between private demand and employment. Consumption increasingly relied on higher-income households, while lower-income groups were disproportionately affected by tariffs, still-elevated inflation and a weakening labour market. Employment growth slowed throughout the year, and unemployment might have climbed higher had the labour supply not contracted due to tighter immigration enforcement. These stagflationary tendencies should intensify if employment softens further and as the temporary front-loading effects of tariffs fade further.

This environment has become increasingly challenging for the Federal Reserve. Political pressure has altered perceptions of its independence, while the balancing act of the Fed's dual mandate of containing inflation while supporting a cooling economy has become more delicate. At the same time, concerns around fiscal sustainability have surfaced. In the second quarter, following "Liberation Day", the US dollar depreciated even as US Treasury yields rose, the higher yields reflecting the growing fiscal and institutional concerns. That said, market reactions have remained orderly: risk premia on US Treasuries are still below historical averages, and absolute yield levels look attractive relative to US equity dividend yields, particularly with further rate cuts still in view.

Nevertheless, valuation risks have increased, especially in US equities and gold, both of which, according to the BIS, exhibited "explosive" price dynamics in 2025. Historically, such patterns have often been followed by significant corrections. In addition, recent fund flow data indicates that retail investors have driven inflows into US equities and gold while institutional positioning has remained cautious. A reassessment of AI expectations, data-centre overcapacity, a more hawkish Federal Reserve or an external shock could act as a catalyst for a correction. The resulting negative wealth effect would weigh on consumption, a key pillar of US growth. That said, while valuation excesses are often readily identifiable, they can persist for extended periods as momentum feeds on itself.

In sum, against this backdrop, we maintain a neutral stance on global equities and we refrain from increasing our gold allocation despite its strong momentum. We avoid procyclical increases in risk exposure at current valuation levels and we continue to emphasise broad global diversification, rigorous investment discipline, and the importance of maintaining a strategic liquidity buffer to capitalise on future rebalancing opportunities.

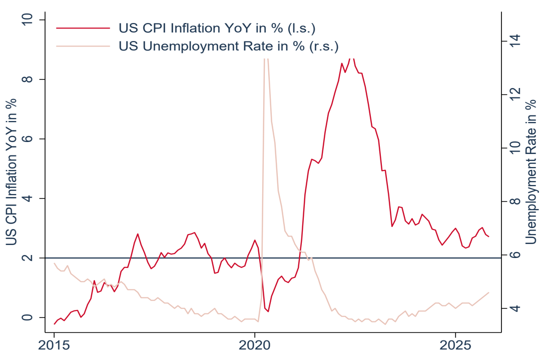
- US GDP expanded robustly in the third quarter, although growth probably slowed in the fourth as the six-week government shutdown likely trimmed at least half a percentage point from output. The *Hutchins Center* projects a negative fiscal impulse of 1.5 percent in Q4, followed by a temporary boost of 2.8 percent in Q1 2026 as interrupted federal spending resumes. This rebound should help offset the usual seasonal dip early in the year before the fiscal drag resumes later on.

- Despite tariffs and policy uncertainty, overall growth proved surprisingly resilient. Beneath the surface, however, momentum looks uneven. Employment and consumer spending growth cooled, while AI-related capital expenditures likely added 0.5 to 1 percentage point to GDP in 2025, according to various estimates. This trend may persist into 2026, but consumption—particularly among lower-income households—faces headwinds from weaker labour demand, fading consumer confidence, tariffs acting as a regressive tax, and persistently elevated inflation.

- According to the *Peterson Institute for International Economics* , based on Federal Trade Commission data, tariffs covered roughly 10 percent of imports by late September, less than headline rates due to various exemptions. Still, the tariffs contributed to higher prices. Core goods inflation rose from zero in March to 1.4 percent year-on-year in November, adding to sticky core services inflation at 3.0 percent. For context, core goods inflation hovered near zero for years after China joined the WTO in late 2001 – with Covid-19 pandemic supply shocks exempted. Overall, Personal Consumption Expenditures inflation, the Fed's preferred metric, held near 2.8 percent in September, clearly above the Fed's price stability target, intensifying the Fed's monetary policy dilemma. Nevertheless, signs of labour market weakness prompted the Fed to cut rates twice in Q4, bringing the fed funds rate to a range of 3.5 to 3.75 percent.

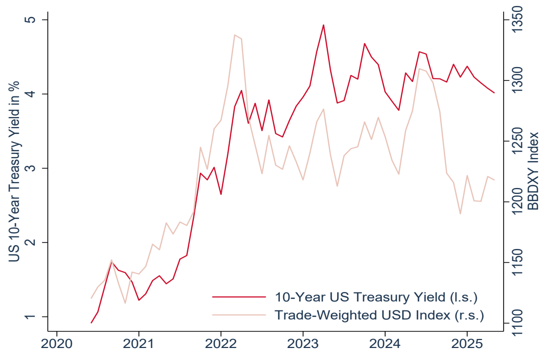
- Meanwhile, fiscal dynamics remain challenging. The federal deficit reached 5.9 percent of GDP in fiscal year 2025 , pushing gross federal debt to 125 percent of GDP and driving an 8 percent increase in interest outlays versus 2024. This trajectory looks increasingly unsustainable and may further heighten the already severe political pressure on the Fed to maintain an easing bias to reduce the federal government's financing costs. Against this backdrop, we expect that the currently positive real interest rates are likely to turn negative again over the long term.

Stagflationary pressures mounting



Source: LSEG, MFO

USD weakens despite attractive Treasury yields



Source: Bloomberg, MFO

1.2 EUROPE

- After the US tariffs left their mark on Q2, Eurozone GDP growth accelerated in Q3, albeit still remaining below early-2025 levels, as investment and net exports recovered from their Q2 dips.

- Business sentiment improved in Q4, with the *Eurozone Composite PMI Index* rising from 51.2 at the end of September to 51.9 points in December, driven by stronger growth in services, whereas manufacturing activity continued to contract.

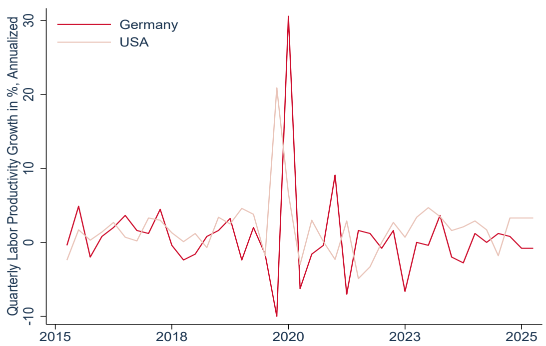
- Consumer confidence, which never recovered from the sharp decline in 2022 that followed Russia's invasion of Ukraine, stayed subdued, ending 2025 near where it began, signalling only moderate consumption growth. The labour market remains supportive, with unemployment at 6.4 percent in October, close to its historical low, though a declining vacancy rate suggests cooling labour demand ahead.

- Inflation edged higher in the second half of 2025, climbing from 1.9 percent in May to 2.1 percent year-on-year in November, mainly on stronger services prices, which were close to the ECB's medium-term goal of 2 percent. After four rate cuts in early 2025, the ECB has held its main refinancing rate at 2.15 percent since June, a level considered accommodative. Given transmission lags, current monetary conditions should increasingly support economic activity.

- Fiscal policy is also expected to provide a positive impulse in 2026, notably in Germany and at the EU level. However, significant structural challenges persist, including heavy regulation, weak productivity growth, ageing demographics, political polarisation and chronic underinvestment. A key risk is that the political will to deregulate falls short and that public funds are channelled disproportionately toward consumption and redistribution rather than toward productivity-enhancing investments with durable, positive multiplier effects on potential GDP.

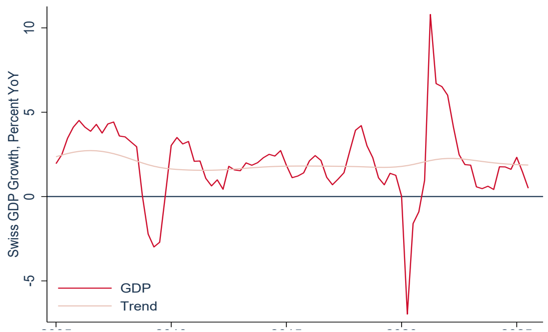
- The Swiss economy contracted by 0.5 percent in the third quarter as steep US tariffs weighed on exports, particularly in chemicals and pharmaceuticals, compounded by services weakness. However, December's agreement to reduce tariffs to 15 percent, aligning Switzerland's tariffs with those on the EU, served to stabilise the outlook. Looking ahead, an eventual recovery in the EU and Germany, combined with accommodative monetary conditions—the SNB has kept its policy rate at zero since June 2025—should provide additional support.

Germany's productivity challenge



Source: Bloomberg, MFO

Tariffs stall Swiss growth



Source: LSEG, MFO

- Composite business sentiment cooled slightly in EM economies and China in Q4. Services activity remained robust but growth slowed in manufacturing as trade-policy uncertainty remained high, though below its previous extreme levels.

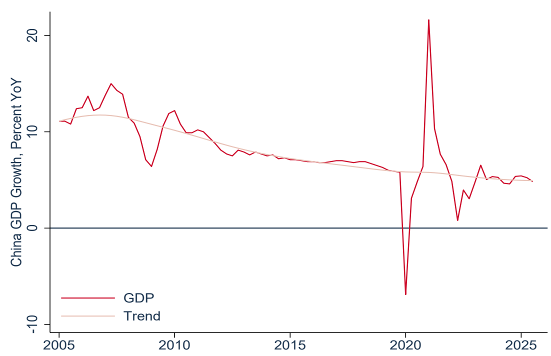
- The expected further decline in tariff uncertainty should help global economic conditions to stabilise. In addition, a potential resumption of the US dollar's depreciation trend, observed in the first half of 2025, could contribute to more favourable funding conditions for EM economies.

- *Yale's Budget Lab* projects that the new US tariff regime, based on currently valid tariff rates, will shave about 0.1 percent off of global GDP permanently, with winners and losers. The EU, the UK and Mexico are expected to make marginal gains, while China is expected to experience the biggest long-term GDP loss of all US trading partners, amounting to about 0.2 percentage points, which is still less than the 0.3 percent GDP loss expected for the US. Given average tariffs of about 24 percent for China, which compare to 14 percent for the rest of the world, the projected GDP impact looks negligible. Overall, China has weathered the trade war with the US extremely well. In November, exports were roughly 8 percent above the previous year's level in nominal CNY terms, as rising exports to other markets offset declining exports to the US.

- Despite this resilience, the outlook for China's domestic market is anything but rosy as it struggles with overcapacity, a rapidly ageing population and wary consumers, while public finances increasingly appear to be reaching their limit. Faster growth would require a revival of private consumption, which is a challenge given the population's currently glum mood. On the other hand, large-scale public investment programs would only exacerbate the problems of overcapacity and rising public debt. Therefore, China's growth trend should continue to slow significantly. Even though Asia's giant remains one of the world's fastest-growing economies, it risks being stalled in the middle-income trap.

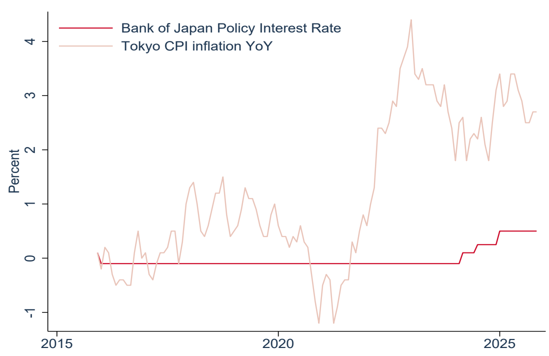
- Japan saw a weak third quarter, but improving business sentiment in the services sector should provide tailwinds going forward. With policy rates at 0.75 percent and a yearly consumer price inflation rate of 2.0 percent in December, Japan presents deeply negative real interest rates and very accommodative funding conditions despite the Bank of Japan's ongoing tightening stance. Additional support arises from planned fiscal measures and healthy labour market prospects.

China – a long way down



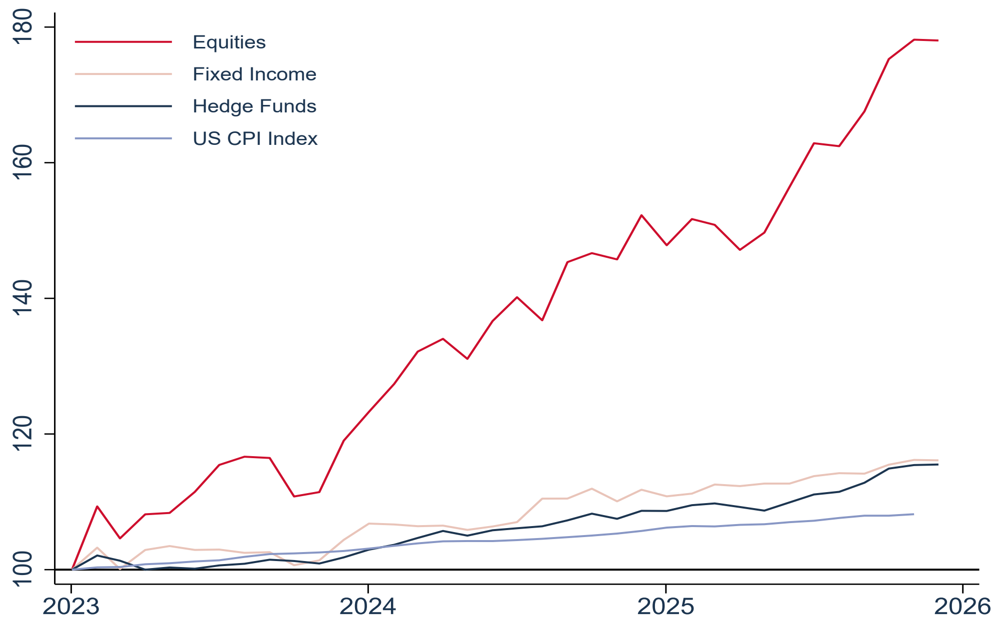
Source: LSEG, MFO

Japan's bold monetary stance



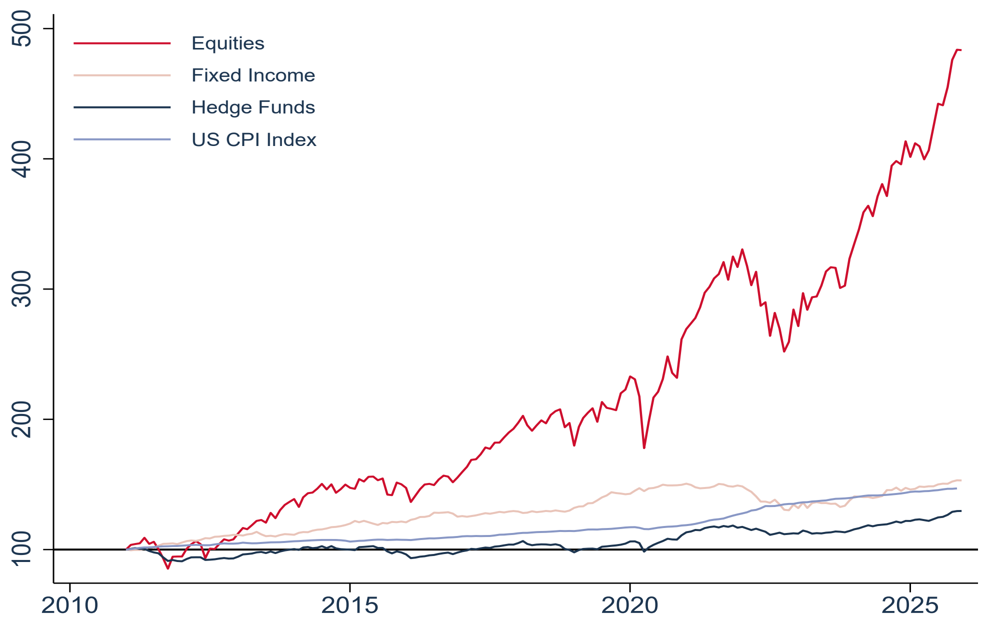
Source: Bloomberg, MFO

Medium-term market developments



Source: LSEG, MFO

Long-term market developments



Source: LSEG, MFO

2.1 EQUITIES

- Global equity markets got off to a strong start as the fourth quarter began. Major markets set new all-time highs in October, extending their recovery from the April tariffs-driven sell-off, responding to a prolonged monetary easing cycle and rising earnings expectations. However, November and December saw equity markets soften, with growing concerns about the vast scale of AI investments contributing to increased volatility.

- Market concentration remains a problem, with just five stocks accounting for more than 50 percent of the *S&P 500 Index*. In late October, the Tech sector reached a record 36 percent weight in the *S&P 500 Index*. This degree of market concentration makes it difficult for active managers to beat their benchmarks.

- Over the course of 2025, equity markets delivered broad-based gains, led by strong performance in Japan and Asia, with the *Nikkei 225* returning 28.6 percent in JPY terms and the *MSCI Asia ex Japan Index* gaining 29.2 percent in USD terms. US equities also performed well, as the *Nasdaq 100* rose 21 percent and the *S&P 500* returned 18.2 percent in USD terms, while Europe and Switzerland posted solid advances, too, with the *MSCI Europe Index* up 20.9 percent in EUR and the *Swiss Performance Index* gaining 17.8 percent in CHF terms.

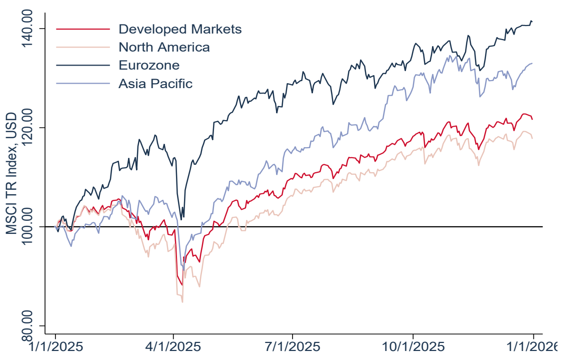
- Momentum remained supportive going into the fourth quarter of 2025, as European equities outperformed, with the *MSCI Europe Index* up 6.4 percent and the *Swiss Performance Index* gaining 8.8 percent, while the *Nikkei 225* advanced a further 12.2 percent.

- Resilient corporate earnings were a key factor supporting the ongoing strength of equity markets in 2025. As of 12 December, the *S&P 500 Index* posted an estimated year-on-year earnings growth rate of 8.1 percent, up from 7.2 percent at the start of the quarter, according to *FactSet*. This marked the tenth consecutive quarter of year-on-year earnings growth for the index, underscoring the continued strength of corporate earnings.

- Nine of eleven sectors are expected to show year-over-year earnings growth in 2025 , led by Information Technology and Materials. Only two sectors, Consumer Discretionary and Energy, are likely to report year-over-year earnings declines.

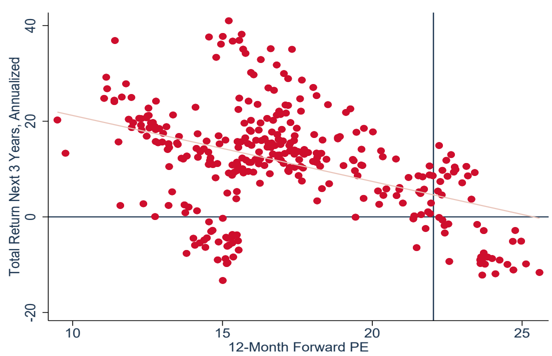
- Despite the positive market momentum, we choose to maintain our neutral allocation to equities. Elevated macro risks, together with valuations at levels that warrant caution, argue against greater enthusiasm at the moment.

Rally continues...



Source: LSEG, MFO

...but valuations call for caution



Source: LSEG, MFO

2.2 FIXED INCOME

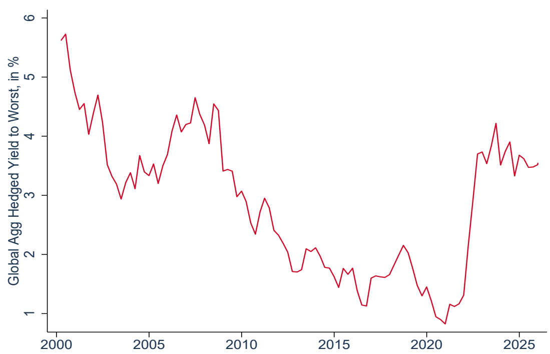
- Global bond markets closed 2025 on a strong note, delivering a full-year return of 4.9 percent, as measured by the *Bloomberg Global Aggregate Hedged USD Index*. This performance was primarily driven by declining yields and corresponding price gains in US Treasuries throughout the year, while other major regions, such as Canada, the Eurozone and Asia-Pacific, faced rising yields and price losses. The index's yield to maturity declined slightly, from 3.7 percent to 3.5 percent, remaining close to the highest levels observed since 2009. Credit quality continued to be assessed positively by the leading rating agencies —S&P, Moody's, and Fitch— with 70 percent of the 2248 rating changes in 2025 being upgrades, underscoring the resilience of North American and Western European investment-grade issuers.

- Monetary policy developments were a key driver of market dynamics. The US Federal Reserve extended its easing cycle during the third and fourth quarters in response to a softening labour market and announced the end of its quantitative tightening policy in October. Following their interest rate cuts in June, the European Central Bank and the Swiss National Bank both reached the bottom of the interest rate cycle for the time being, according to current market expectations.

- Credit markets remained robust throughout 2025. Spreads on US investment-grade bonds widened slightly from their ten-year lows in the third quarter, reaching 0.8 percent, while US high-yield spreads closed at 2.8 percent, as measured by *ICE-BofA* indices. These movements reflect balanced risk appetite supported by solid corporate fundamentals.

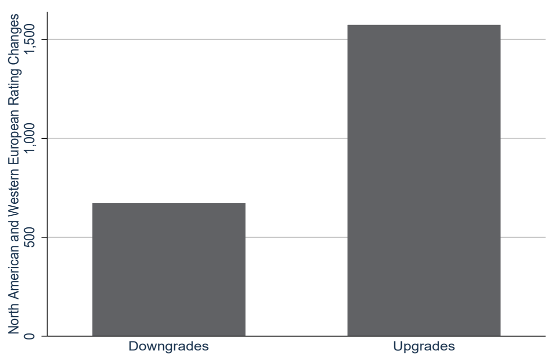
- Current yields continue to offer attractive income and a buffer against volatility as markets absorb a moderate easing path. Most issuers maintain strong balance sheets, reinforcing credit stability and investor confidence. Looking ahead, we maintain a neutral allocation to fixed income while focusing on portfolio adjustments during 2026. Our priority is to extend durations in high-quality bonds to capture potential benefits from an expected decline in US yields, while selectively increasing credit exposure only where valuations provide adequate compensation for risk. This disciplined approach aims to balance income generation with risk management.

Global yields remain attractive...



Source: Bloomberg, MFO

...while credit fundamentals stay strong



Source: Bloomberg, MFO

HEDGE FUNDS, PRIVATE MARKETS AND COMMODITIES

- Hedge funds ended 2025 on solid footing, posting positive returns in Q4, as they did in the three previous quarters of the year. Managers successfully navigated a mix of risk-on and risk-off factors, including rate cuts, ongoing debates around AI and technology valuations as well as tariff policy uncertainties. While October was relatively calm, November saw heightened volatility for risk assets, which led to increased dispersion among managers, but the month was still positive for most strategies. Over the course of the year, equity long/short and global macro strategies stood out. Equity long/short profited from a positive market backdrop and generated meaningful alpha on the short side. Global macro capitalized on the volatility around "Liberation Day" in April, with many funds profiting from the sharp USD selloff.

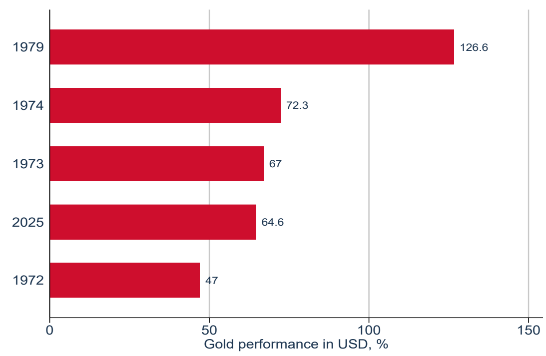
- In October, for the first time ever, gold rose above the USD 4000 per ounce mark. After a brief retrenchment in the second half of the month, the yellow metal quickly regained momentum and briefly traded above USD 4500 per ounce after Christmas. Gold's ascent was supported by questions surrounding the Federal Reserve's independence, sustained ETF inflows, ongoing geopolitical tensions and expectations for further policy rate cuts. In Q4, gold gained around 12 percent against most major currencies. For the year, gold's returns were exceptional: up 65 percent in USD, and about 45 percent in CHF and EUR, cementing it as the best-performing asset class of 2025. For gold itself, it was the third best year since 1970.

CURRENCIES

- After its sharp depreciation during the first half of 2025, the USD continued its sideways trend in Q4, resulting in a depreciation of about 8 percent in total in 2025. Against JPY, CNY, and GBP, USD continues to look overvalued from a purchasing power parity perspective, whereas it seems close to fair value vs CHF and EUR. While the ECB and the SNB are likely to stand pat, the Fed could deliver two more rate cuts in 2026, bearing potential for further dollar weakness as the interest-rate differential narrows between the US and other currency issuers.

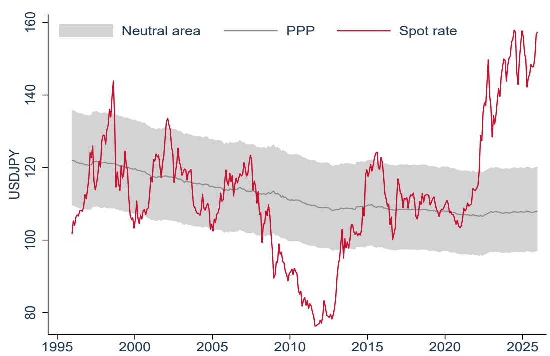
- The Bank of Japan's ongoing tightening stance should support the heavily undervalued JPY. Market expectations about rate hikes from the current 0.75 percent to 1.2 percent by December appear dovish given the current inflation rate of 2.0 percent. A hawkish surprise, with a BoJ raising rates more than currently priced in, could spark a revaluation of the cheap yen, in our view.

Gold's best year since 1979



Source: LSEG, MFO

JPY: could a hawkish BoJ spark a revaluation?



Source: LSEG, MFO

3. INVESTMENT VIEWS

- We kept our neutral stance on equities throughout Q4 as market momentum stayed positive despite brief volatility spikes. Our fundamental concerns are also unchanged. We continue to see high valuations and extreme concentration in the US market as major risks. Meanwhile, the dividend yield on the *MSCI US Index* is near 1.6 percent, which compares to a yield to maturity of 4.4 percent for investment-grade US bonds. Together with increasingly frail macro fundamentals, we think market vulnerability to any type of shock, be it a hawkish central bank surprise, another geopolitical shock, or disappointing macro data, remains elevated. But, while valuations are a good guide for returns over the medium term (three to five years), they are poor timing signals. Cutting equities exposure prematurely is usually not advisable, as rallies can persist longer than expected. Instead, we prefer maintaining discipline – with a clear strategic anchor and strict rebalancing procedures – while retaining a cash buffer to exploit rebalancing opportunities as they arise.

- We also keep our neutral stance on fixed income. Yields remain attractive and, at least in the US market, bonds still benefit from the Federal Reserve's accommodative stance. However, structural risks remain high for several reasons, including the worsening US fiscal outlook, a policy mix that is both stagflationary and potentially negative for the US dollar's stability. The rising US government debt also creates an incentive to return to negative real interest rates at some point, while granting that they are currently solidly in positive territory.

- As we've previously pointed out, all this would, in theory, provide support for gold. However, in real terms, as proxied by its price in USD divided by the US Consumer Price Index, gold's rally in 2025 pushed it to inflation-adjusted levels that substantially surpass those of its previous peak, at the end of the 1970s. That high point was famously followed by a decline lasting almost two decades, during which gold investors had to stomach a cumulative price drop of about 70 percent in nominal USD terms. We continue to value the yellow metal's properties as a portfolio diversifier, but we avoid procyclical increases in the portfolio at the current high prices.

- We also maintain our neutral stance in our diversified hedge fund allocation, which uses equity long/short, uncorrelated, convex, and alternative fixed-income strategies. These strategies met our expectations in 2025, a year in which simple long-only portfolios delivered decent returns. We expect hedge funds will continue to provide needed diversification at a time when risk assets are exhibiting lofty valuations.

Overview

	Equities				Fixed income		Alternatives			Liquidity
	North-America	Europe	Asia-Pacific	Emerging Markets	Duration	Credit	Hedge Funds	Commodities	Precious Metals	
Macro	↘	→	→	→	↗	→	→	→	→	→
Market	↗	↗	↗	↗	↗	↗	↗	↗	↗	→
Valuation	↘	→	↘	↘	→	↘			↓	→
Sentiment	↗	→	→	↗	→	↘	→	→	→	→
Aggregate	→	→	→	→	→	↘	→	→	↗	→

Source: MFO

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Editors
Nadja Bleuler, n.bleuler@mfo.ch
Mauro Eichin, m.eichin@mfo.ch
Christoph Orschel, c.orschel@mfo.ch
Philipp Stokinger, p.stokinger@mfo.ch

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Bellerivestrasse 36
8008 Zurich
Switzerland

Phone +41-(0)43-344 6000
info@mfo.ch
https://www.marcuardfamilyoffice.com/

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