CJ'S WEEKLY MARKET MEMO

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The economic foundation beneath equity markets remains surprisingly solid as we close 2025. Consumer spending continues to drive growth, with retail sales showing genuine strength even after accounting for inflation. The control group measure—which strips out volatile categories—is growing at 6.1% annualized, nearly double the pre-pandemic pace. This isn't just inflation-driven consumption; real purchasing power is expanding, supported by household balance sheets that feature record home equity levels and manageable debt service burdens.

Productivity gains have emerged as one of the year's most encouraging developments. Labor productivity has been running above 2% annualized—matching 1990s levels and well above the anemic 2010s. These gains are disinflationary by nature, allowing economic growth without stoking price pressures. Speaking of inflation, core CPI has declined to 2.5%, the lowest reading since March 2021, while inflation expectations remain contained within their tightest two-year range since 2020. Gasoline prices have stabilized in the low $3 range nationally, providing consistent relief to consumers. The Federal Reserve continues its measured easing cycle, with markets pricing in additional cuts through 2026. The three-headed monster of crude oil, Treasury yields, and the dollar all remain near the bottom of their 52-week ranges—historically one of the most bullish configurations for equities.

From a technical perspective, the market's internal structure shows continued resilience despite December's volatility. The S&P 500's 200-day moving average continues its steady upward trajectory, confirming the underlying bull market remains intact. Equally important, the cumulative advance-decline line made new highs alongside the index in December, demonstrating healthy breadth. The Philadelphia Semiconductor Index, which I've long viewed as the transports of the 21st century, maintained its uptrend from February lows despite a sharp correction, and its relative strength versus the S&P 500 held support levels. These technical indicators suggest the market's foundation remains sound even as mega-cap names consolidated recent gains.

Interestingly, some of the froth that characterized late summer and early fall has dissipated. Bitcoin entered a bear market, breaking below key support levels—typically a sign that speculative excess is being wrung out of the system. Google searches for "AI Bubble" spiked to all-time highs in November, while retail trading activity remains well below 2021's manic levels. This building wall of worry could prove constructive. Markets climb walls of worry; they slide down slopes of hope.

Looking toward early 2026, I'm constructive on equity markets despite acknowledging legitimate headwinds. Yes, we're entering the historically weakest year of the presidential cycle. Yes, valuations for the cap-weighted S&P 500 appear stretched. Yes, the mega-caps have stumbled entering year-end. But several factors suggest the bull market has further to run.

First, I believe we remain in early innings of the AI investment cycle. The Netscape-to-ChatGPT analogue that tracked remarkably well through 2025 suggests we're roughly at the equivalent of late 1997 in the internet boom—years before the peak. More tellingly, we haven't seen the surge of AI-related IPOs that typically accompanies a mature technology cycle. Until private AI companies rush to go public, we're likely pre-bubble rather than post-peak.

Second, productivity gains should continue accelerating as AI applications spread from builders to adopters. This progression will flow through to corporate earnings while keeping inflation pressures contained. The massive infrastructure investment in AI compute—now exceeding $150 billion annually—represents a bet on sustained demand growth, not a speculative bubble.

Third, the equal-weight S&P 500 offers reasonable valuations even if the cap-weighted index looks expensive. The equal-weight P/E and price-to-sales ratios remain near neutral levels, well below the frothy readings of 2021. If leadership rotates from mega-caps to the broader market, valuations become far less concerning.

Fourth, sentiment remains surprisingly cautious for a market up substantially over three years. The contrarian in me finds this encouraging. When even bears remain invested—as our year-end survey revealed—it suggests capitulation hasn't occurred. The path forward won't be smooth. Immigration policy changes have reduced labor force growth, potentially constraining GDP while tightening low-skill labor markets. Housing affordability remains poor despite recent improvements. The transition to a new Federal Reserve chair in May introduces uncertainty. Year two of presidential cycles historically deliver median gains of just 0.58%.

But I've learned over 55 years in markets that fighting the tape during established bull markets rarely pays. The 200-day moving average points higher. Breadth remains healthy. The economy continues growing. Productivity is accelerating. The Fed is easing. These are the conditions that sustain bull markets, not end them.

I expect 2026 to deliver positive returns, though probably more modest than 2023-2025's extraordinary run. A 10-15% gain would align with historical averages while allowing for normal volatility. The risks tilt toward disappointment if mega-cap earnings falter or if recession fears resurface. But the base case remains favorable for patient, disciplined investors willing to look past inevitable periods of turbulence.

Stay invested, stay diversified, and remember that bull markets don't die of old age—they require either recession or extreme valuation excesses we haven't yet reached.

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