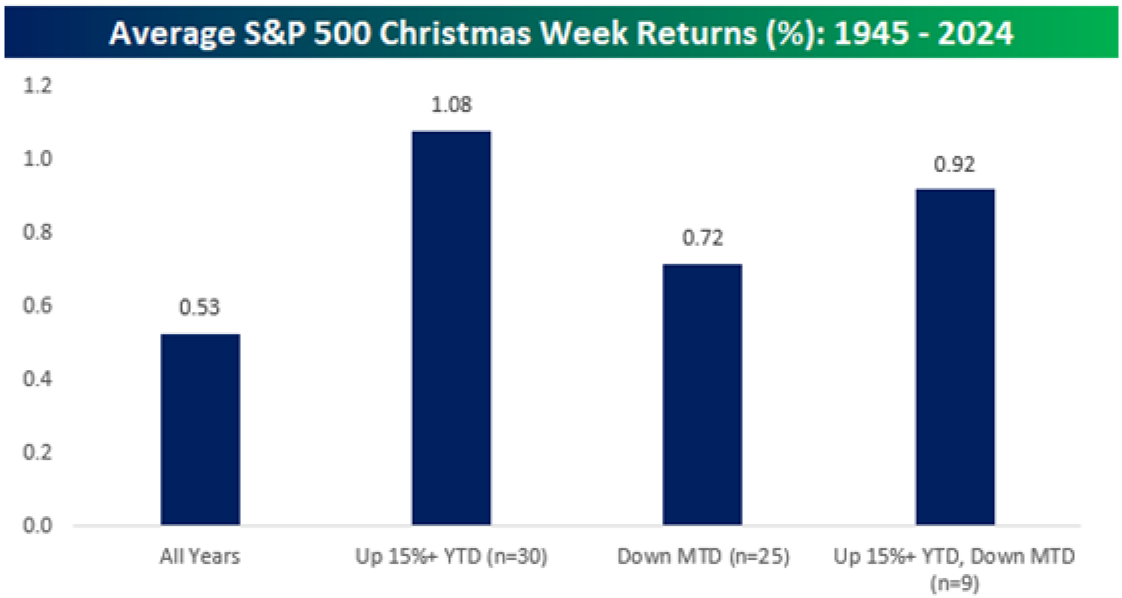
Stocks rallied last week into Christmas Day – the S&P 500 posted a 1.4% gain through the first three trading days before a flat Friday. Company-specific news is currently light given that most are in their quiet periods ahead of year-end. While the upside third quarter GDP surprise (released last Monday) was a welcome sign, there have been few other recent data points of significance on the economic front. In short, we are currently in the typical lull period around the holidays ahead of the new year.



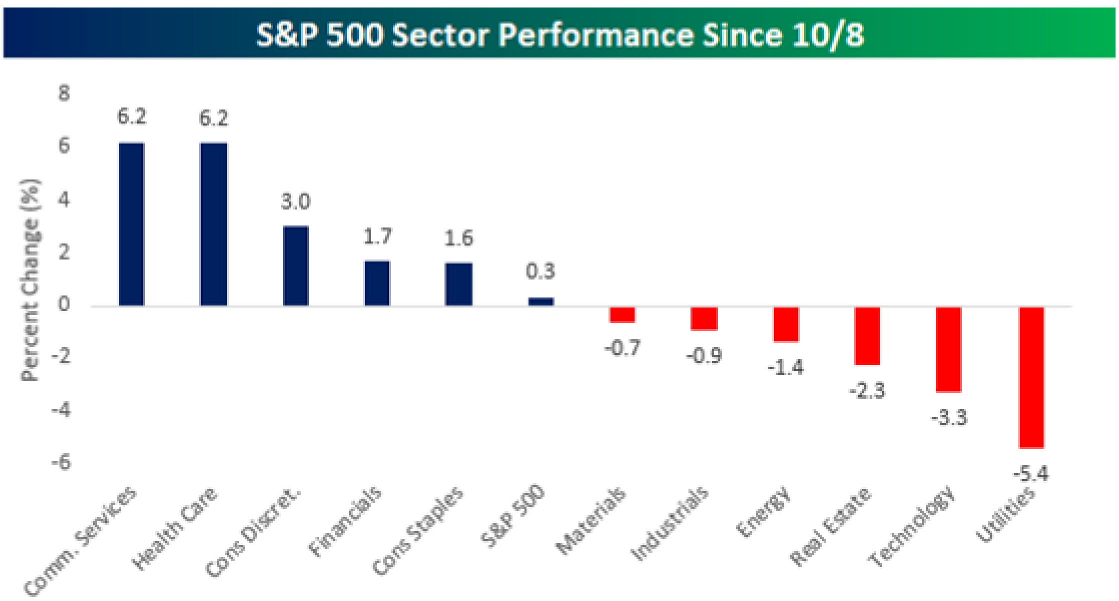
Source: Bespoke Investment Group

Investors are keenly focused on what lies in store for 2026 and beyond. The key questions that market participants are currently pondering include:

- Does the unprecedented level of capital spending to support the AI infrastructure buildout continue to ramp higher as expected?
- Will AI adopters ultimately realize a healthy return on their investments to justify the high level of spending to support these initiatives?
- Are somewhat elevated valuations justified given earnings growth expectations?
    - And, by extension, are 2026 & 2027 earnings estimates reasonable?
- Will the bull market, which started in 2022, meaningfully broaden across sectors?

I strongly believe the answer to the first two questions is yes. Capital budget forecasts continue to accelerate across the hyperscalers while we are already witnessing early signs of productivity gains for AI users as profit margins continue to expand. Furthermore, if anything, I believe earnings estimates during the first half of 2026 may be too conservative given the roughly 8% beat we saw (for the S&P 500 as a whole) for the third quarter. This suggests, in my view, elevated valuation levels are reasonable given that earnings growth is likely to remain well above the historical average for the foreseeable future.

We are also now seeing signs that the positive fundamentals which have carried the bull market since its late 2022 inception are broadening outside of large-cap technology companies. Since early October, while gains across the S&P 500 have been muted, there has been meaningful rotation beneath the surface as previously underperforming sectors such as healthcare and financials have shown relative strength.



Note: Through Friday, December 19, 2025

Source: Bespoke Investment Group

Excluding the top seven S&P 500 companies, which are expected to generate 25% forward earnings growth (weighted average), the remaining businesses which comprise the index are forecasted to grow profits by roughly 12% next year – not too shabby considering the 7-8% average earnings growth rate historically. Should growth expectations materialize, driven by expanding margins and revenue acceleration, this should put upward pressure on stock prices across other sectors at more modest valuations.

As a reminder, outside of the 1987 crash, we have not experienced a meaningful bear market that hasn't also been accompanied by an earnings recession since the mid-60s. I expect that to remain true now; while corrections are a fairly common occurrence throughout secular bull markets, I believe we are currently in the middle of a multi-year expansionary period fueled by robust capital investment and productivity acceleration. As long as that continues, this bull market likely has a long runway ahead.

I believe we will witness further fundamental strength through profit expansion, robust capital investment, and productivity gains in 2026. Companies which demonstrate the ability to drive higher revenue and operating efficiencies while successfully redeploying free cash flow and earning robust returns on invested capital are best positioned for success. These types of businesses are generally the winners within their respective sectors and what I target when scanning the investment universe for attractive buying opportunities.

I wish all of you and your families a Happy New Year and best wishes for a prosperous 2026!

Andrew P, Kerai, CFA®, Chairman & Managing Partner

Capital Ideas, Inc.

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