



Q1 2026

QUARTERLY INVESTMENT OUTLOOK

FROM TRANSITION
TO TRACTION

ANNEX
WEALTH MANAGEMENT

Introduction

In 2025, inflation fluctuated as the economy adjusted to shifting price pressures. Goods prices, which had previously been falling, began to rise, while shelter inflation eased. Companies also adapted to a new tariff regime, which contributed to these changes. Tariff-induced inflation was less severe than many originally feared, but the fears are not completely gone.

Markets rallied with non-US markets advancing the most. In the US, the gains were broad, but they were biggest and most concentrated—again—in artificial intelligence (AI) linked companies. The Fed cut rates late in the year but signaled caution, highlighting the tension between employment risks and inflation still above target.

With massive spending by technology companies on the buildout of AI along with fiscal, trade, and monetary policy changes in 2025, it was a transition year. The year ahead is about getting traction—turning AI investment and policy shifts into growth.

From a big picture economic angle, we think there is a lot to like about the 2026 outlook. US real gross domestic product (GDP) growth could be around 2%, which is resilient, but not exuberant. We expect inflation to trend within a 2.5–3.0% range, with goods prices stabilizing as tariff effects fade and service price inflation gradually easing. While inflation may remain slightly above the Fed's target, the direction appears favorable.

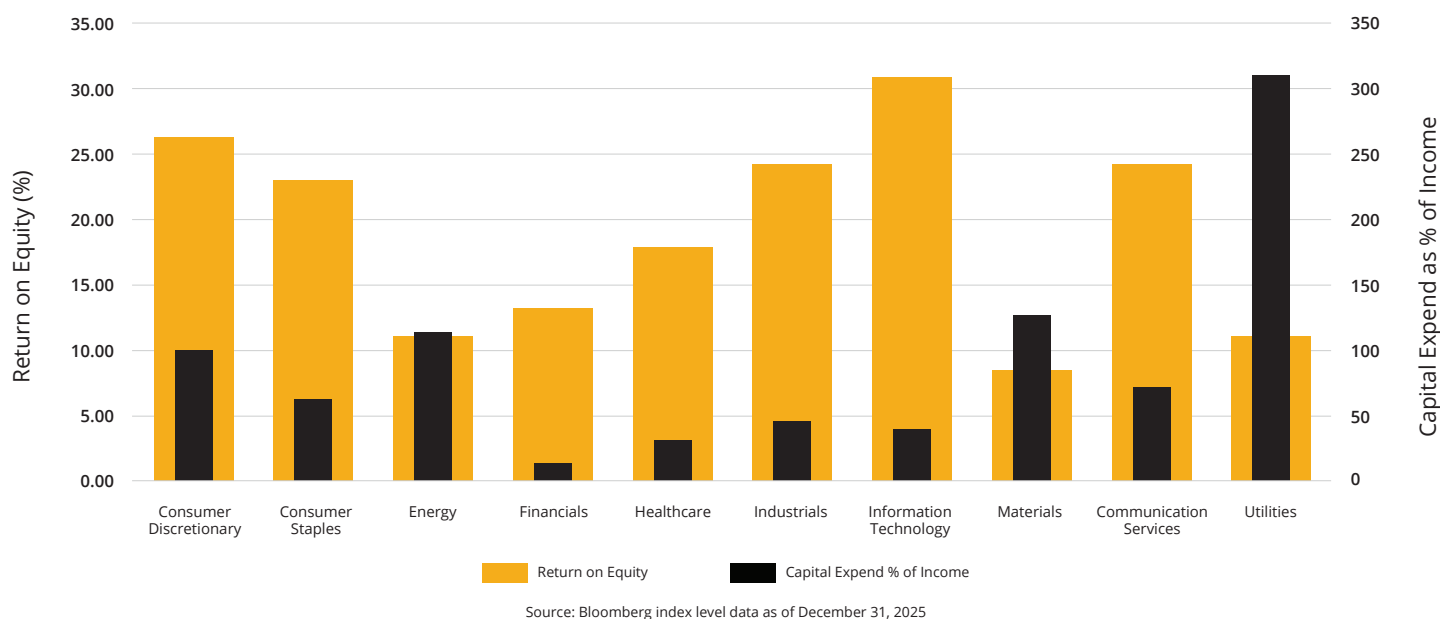
The Fed's rate decisions will depend on evolving economic conditions, and with leadership changes possible, multiple rate cuts cannot be ruled out. Against this broad macroeconomic backdrop, valuation support for stocks hinges on earnings delivery—especially from AI monetization—rather than multiple expansion.

EQUITIES: FROM BUILD TO RETURN

The AI narrative for the markets was mostly about the “picks and shovels,” drawing an analogy to the Gold Rush era in the mid-1800s. The ones who made the money weren’t necessarily the prospectors, but the ones who sold the picks and shovels to the prospectors. Semiconductors, memory storage, and other technologies were the picks and shovels of the AI-rush.

In 2026, the next chapter in the AI story could be about productivity and margin gains. Investors will reward firms that can quantify cost savings, productivity improvements, and revenue growth, not just “AI adoption” stories. Early leaders will likely be the biggest beneficiaries in terms of stock prices since most businesses will likely face longer adoption and monetization timelines. We expect that early success stories will be in areas like healthcare, supply chain planning, and finance.

Capital Spending and Return on Equity



The risk with this theme is that the best laid plans can go awry. Extended timelines, budget overruns, failed experiments, or any number of other things can reduce or eliminate the expected return on the investment. AI needs to “show me the money”: investors will likely favor adopters demonstrating productivity and margin gains over builders or buyers without clear paths to monetization. Investors do not want companies just throwing money at AI and hoping it sticks.

Earnings growth can help support expectations reflected in high valuations, but high valuations do create vulnerabilities where a small miss on growth expectations can have an outsized impact on stock prices.

Given current valuations, stocks outside of the mega cap seven that dominated the last couple of years may be better positioned to benefit from improving financing conditions, tax incentives, reshoring, and AI-driven productivity. While we see potential in these segments, our stance remains balanced and selective, focusing on companies with clear paths to growth.

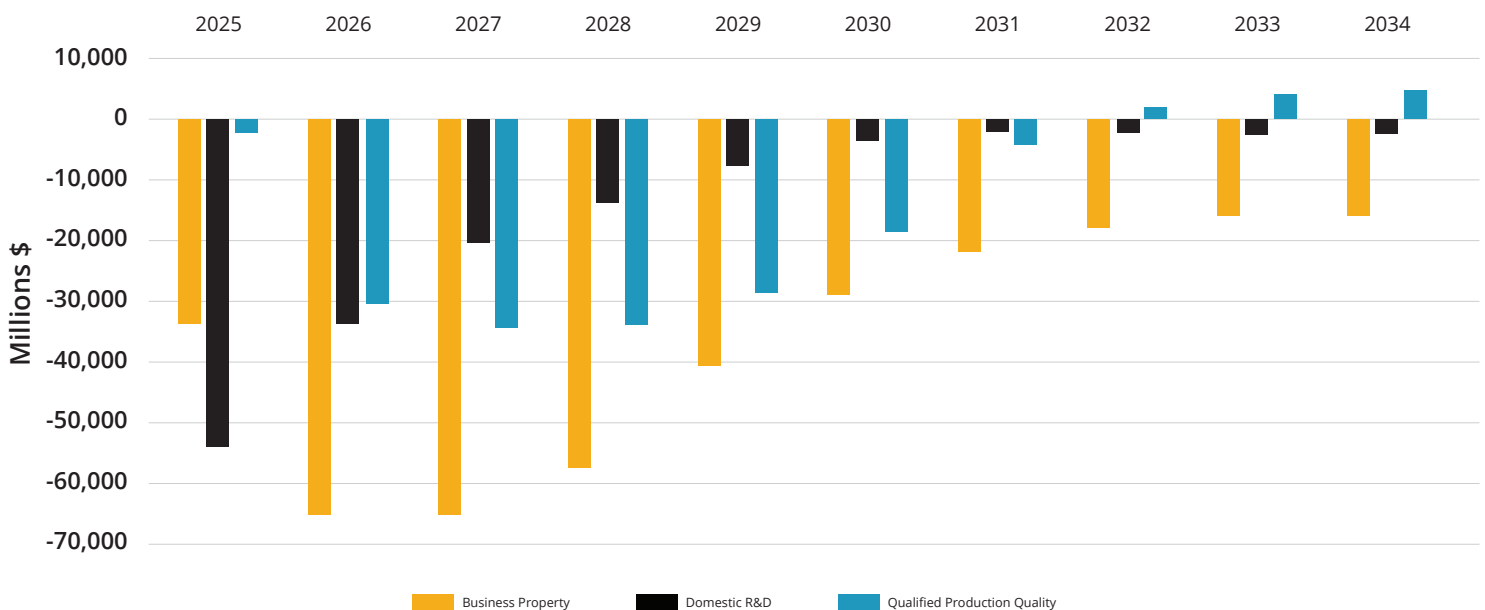
FIXED INCOME: FISCAL RISKS

Fixed income yields are attractive, but are they attractive enough for the risks on the horizon? Generally, yes, but we do not want to just assume that the path ahead will be without bumps and potholes. If inflation stays contained, as we believe it will, and if defaults stay low thanks to resilient growth, which we also believe, then yields seem to be at the right level.

However, the wildcard is the issuance of debt by the government. This is a global issue, not just a US issue. The private sector may have done a good job of keeping debt levels at prudent levels relative to assets and income, but public sector debt continues to grow.

Better economic growth can help raise revenues, but we think there's a risk that the long-term gains from growth will likely come at a short-term cost to the Treasury via the permanent 100% bonus depreciation in the 2025 One Big Beautiful Bill Act.

Budget Projections from Business Tax Incentives



Source: Congressional Budget Office

The Congressional Budget Office originally estimated that there would be roughly \$500 billion in extra investment spending over 10 years, providing a significant tax benefit to businesses making those investments. It would not be surprising if that \$500 billion estimate is a massive underestimation of how much spending it could spur.

Investment spending should lead to productivity gains, which should lead to stronger growth without inflationary pressures. Not only would that make the Federal Reserve's job easier since they're supposed to target full employment and stable prices, but it should benefit government finances eventually.

The tax incentives improve near term corporate cash flows, but it does risk widening fiscal deficits in the short term, increasing Treasury supply and possibly government bond yields. This is why we prefer investment grade corporate bonds and keeping the interest rate sensitivity (called duration) of portfolios a little lower than the broad market.

For investors who qualify and when it is appropriate, we think conservative private credit can still be a decent source of incremental yield without the interest rate sensitivity of many public market bonds.

DOLLAR DYNAMICS: WEAKER BUT NOT WEAK

The US dollar, relative to all of its trading partners, depreciated about 8% in 2025. While weaker, it is not weak. The trade weighted dollar is still 10% stronger than in 2021. The dollar has gone up in value in fits and starts ever since exchange rates started fluctuating in the 1970s.

Changes in expectations about growth, inflation, and interest rates are some of the biggest determinants of changes in exchange rates, but just like any market price, exchange rates fluctuate with flows of money. With the possibility of bond market volatility, that may outweigh good growth in pushing the dollar towards a downward bias.

Trade-Weighted Value of the Dollar



Source: Bloomberg daily data from January 1, 2000 through January 3, 2025

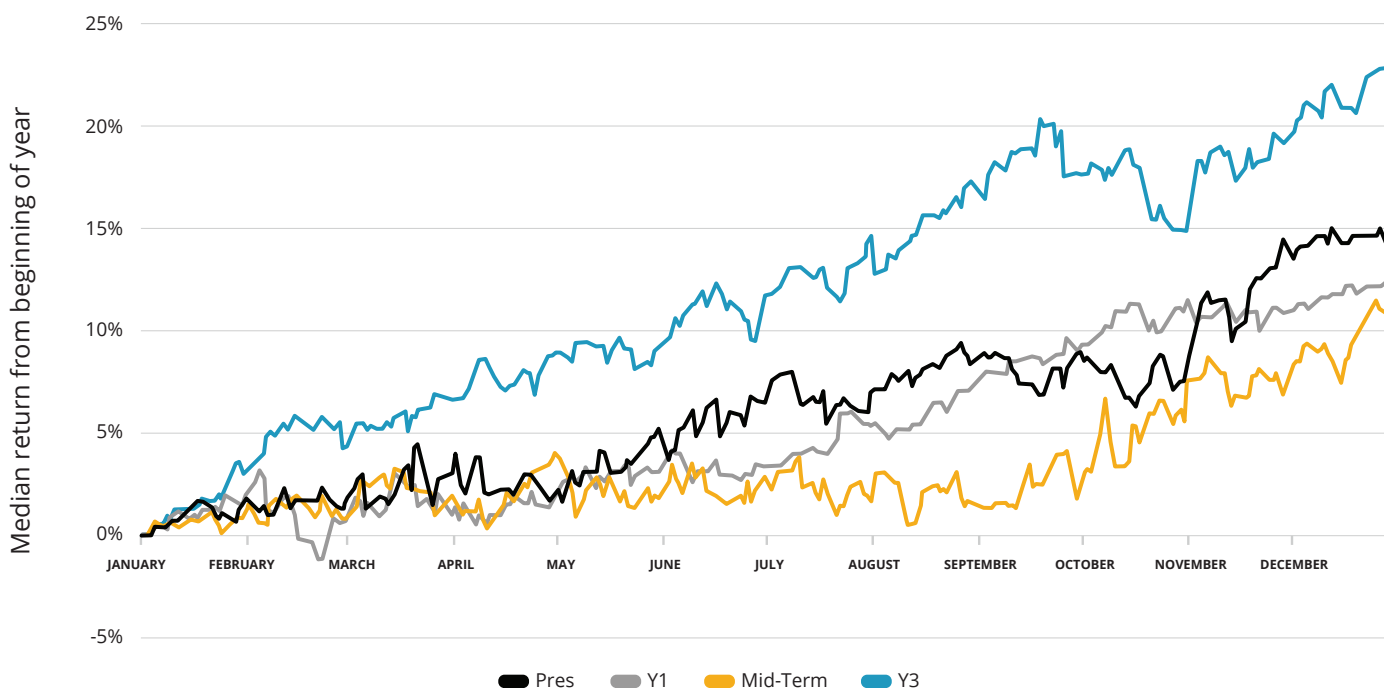
The Fed may be on hold for the first part of the year and engage in some “fine tuning” of its policy rate during the year, cutting twice in 2026. Foreign central banks are likely mostly done with their rate cuts and some are set to hike. Those changes in interest rates could give another reason to expect a weaker instead of a stronger dollar.

The investment implication is that this could serve as a modest tailwind to U.S. multinationals. It could also benefit US-based investors holding foreign stocks and bonds. Non-US equities outperformed US equities in 2025, so 2026 could be another year where investors are reminded of the benefits of global diversification.

MID-TERM ELECTIONS: AFFORDABILITY POLITICS & TACTICAL DISCIPLINE

The 2024 presidential election is barely behind us and we're already entering the mid-term election year. Historically, mid-term election years can be host to above-average declines for the markets. Thankfully, those drops have historically been followed by strong rebounds.

Market Performance During Different Parts of the Election Cycle



Source: Fama and French Database daily data from December 31, 1926 through December 31, 2025

There are a lot of possibilities, and the markets will move in anticipation of which outcomes are most likely. That may be why mid-term election years tend to be more volatile than other years. This mid-term election year may require an extra dose of patience or extra agility.

Early in the year there could be a boost to consumption via tax refunds from the One Big Beautiful Bill Act's enhanced deductions and credits. However, with wage growth slowing (though still positive), the affordability issue will likely resonate with voters throughout the year.

From an investing perspective, we think an adaptable and nimble strategy could be beneficial. Volatility will likely offer an opportunity to look through to the other side of a drop and position for a rebound.

Conclusion

While it isn't clear sailing ahead (because it never really is) it does look like inflation and growth should continue to get better. The government's fiscal situation has not improved and that could continue to affect bond markets more than usual. In an election year, politics will likely create a lot of noise.

2026 will likely be a "prove it" year, where outperformance will need to be earned. It likely won't be enough for corporate executives to talk about what they hope to achieve with AI or any other investment they make. They'll need to show tangible proof that they're delivering on the hope of more profits. We intend on staying disciplined, selective, nimble, and using any volatility to improve portfolios for the long-term.

The logo features the word "ANNEX" in a large, bold, black serif font. The letter "A" is stylized with three curved lines extending from its right side. Below "ANNEX", the words "WEALTH" and "MANAGEMENT" are written in a smaller, black, all-caps sans-serif font, separated by a wide space.

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