

## Reams Asset Management

# 2026 Investment Outlook

For those of us in the financial industry seasoned enough to be going gray, certain years stand out clearly in our collective memory. The painful ones linger for all the wrong reasons: 2008 for the Global Financial Crisis, 2002 for the Enron and WorldCom collapses and the dot.com bust, and 1987 for the infamous October market crash. Equally unforgettable are the years marked by seismic world events: 2020 for the COVID-19 pandemic, 2001 for 9/11 and the recession that followed, and 1989 for the fall of the Berlin Wall and the unraveling of the Soviet Bloc. Excellent market years are perhaps less ballyhooed but notable nonetheless: 2021, 2009, and 2003 for their sharp economic rebounds, and 1981, when interest rates peaked and U.S. Federal Reserve actions helped ignite a 20-year bull market in equities and a bond bull market that lasted more than four decades.

Today, we are inundated with a constant stream of information. Headlines roll across our phones, laptops, and other devices, and we are awash with social media and instant messages. It takes a concerted effort to truly “disconnect” and unplug from the outside world. One can be forgiven for thinking every piece of information arrives in bold capital letters screaming “IMPORTANT!” and that every morsel of news is labeled “unprecedented!” by commentators, both amateur and professional. Barraged by this voluminous input, distinguishing the forest from the trees can be challenging.

Without a doubt, 2025 featured its share of unprecedented and important headlines. But did this year’s brew of economic, political, and historical news mark a truly memorable year? Only time will be a fair arbiter, but the early returns suggest that for all the bluster, volatility, and headlines both big and small, 2025 will not be categorized as a “historic” year. The new Trump administration had substantive policy changes, particularly regarding ever-changing tariff levies that briefly spooked capital market investors in the spring of 2025. But this risk-off period was fleeting, and through the first 11 months of the year, the S&P 500 Index rose a robust 17.79%. While this is a solid increase and continues the trajectory seen over the past three years, it is still lower than the 2023 and 2024 calendar returns. Gross domestic product (GDP) is estimated to finish the year with 2.0% year-over-year (YoY) growth – hardly remarkable or alarming.

Meanwhile, interest rates crept lower, as seen by the yield on the 10-year U.S. Treasury note falling 56 basis points (bps) to 4.01% as of Nov. 30. The front end of the yield curve moved more dramatically, as increasing job weakness accelerated anticipation of Federal Reserve (Fed) cuts to the federal funds overnight rate. This helped broad fixed income markets to a reasonably strong positive 2025 total return. Risk spreads were more muted, but excess returns were still positive due to both spread compression and positive carry attributes. Overall, this has proven to be a benign backdrop for fixed income, validating its place as part of a balanced investment approach.

For the moment, capital markets are “risk-on” with mostly supportive economic data. Risks appear to be flourishing and perhaps rising, with late-cycle economic behavior beginning to percolate. The artificial intelligence (AI) boom has powered technology and other sectors to ever higher valuations but now requires massive debt funding and has an uncertain return on invested capital for investors. The general malaise and complacency have made Reams increasingly cautious on risk products broadly. Reams navigated 2025 with discipline and consistency, and keeping with our time-tested disciplined value approach, we remain focused on high-quality ideas while awaiting periods of volatility that allow us to invest opportunistically. While capital appreciation opportunities appear scarce, real rates remain attractive from a historical standpoint, which sets a conducive backdrop for solid fixed income investment returns.

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### Reams’ key themes for 2026

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The following provides our overview of the key economic data and issues we are monitoring, assesses where consensus estimates currently stand, identifies the tail risks to that consensus, and highlights potential opportunities ahead.

*Federal Reserve policy direction is highly uncertain heading into 2026. Will the Fed be pressured into rate cuts without supporting data?*

- The Federal Reserve enacted three 25-basis point rate cuts to the federal funds rate in 2025, but further cuts remain highly uncertain in both timing and scope. Even the last cut

in December 2025 was done via a 9-3 vote, and the Fed Board of Governors' "dot plot" of anticipated forward rates showed a wide degree of variance and dissention. While at least two 25-bp cuts are priced in for 2026, when considering key economic data, only recent modest weakness in employment data justifies the rate reductions already enacted, let alone future cuts.

- Complicating matters are the changing complexion and political influence on what has historically been an apolitical body. President Trump intends to appoint a new Federal Reserve chair to succeed Jerome Powell when his term ends in May 2026. The administration has made no illusions about its goal of lower rates to help revive a slowing housing market. This increases concern for policy error, and "bond vigilantes" may not play along in rates markets.

### *Can U.S. consumers continue spending, or will increased costs and lagged tariff impacts spoil the party?*

- S&P 500 companies reported year-over-year double-digit growth in earnings, with higher margins, despite a steep drop in consumer confidence measures and housing affordability nearing 35-year lows. Some have termed the economy a "K-shaped economy" due to the divergent fortunes of the stock ownership class (generally the top 20%) and subprime credits (lower 20%). Still, the middle 60% continues to consume – and will need to keep doing so to power further GDP growth.
- Inflation – as measured by the Consumer Price Index (CPI) – has moderated, and tariff concerns from spring 2025 simply have not fully materialized. The impacts of tariffs have been modest to date, and policy has been in flux. However, these lagged effects could weigh on consumers, and the recent uptick of core goods prices may signal a reemergence of inflation. This would clearly represent a major risk to economic growth and market consensus.

### *Will the AI boom and "hyperscaler" spending continue to power the economy, or will it end poorly?*

- Much of the GDP growth and S&P 500 returns can be attributed to the so-called "hyperscalers," mega-capitalization technology firms with critical influence on the artificial

intelligence (AI) buildout and infrastructure. An arms race has ensued to build massive and expensive data centers to handle servers and storage for AI solutions.

- This investment may indeed power AI monetization and represent a paradigm shift similar to that of the internet from 1994–2000. However, in the fourth quarter of 2025, the massive debt funding needs of these technology companies to finance the AI buildout began to be viewed more skeptically, with estimates of more than \$500 billion in capital expenditures projected for 2026. This concern is particularly acute in the debt markets, as the technical overhang of increased supply may weigh on sentiment. Can the AI-fueled growth persist, and if not, will another catalyst emerge?

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## What is the consensus viewpoint?

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For 2026, surveyed economists (per Bloomberg, as of December 10, 2025) collectively forecast U.S. GDP growth of +2.0%, which is in line with full-year 2025 estimates. Expected global growth of +2.9% ticks downward slightly and shows China and other emerging markets continuing to grow faster than developed countries. CPI is estimated to be mostly unchanged at +2.9%, still above the Federal Reserve's stated 2.0% target. Unemployment is expected to increase to 4.4%, a slight increase but not the historically low unemployment rates experienced in the post-COVID era. New home sale estimates are at +705,000, which is lower than prior estimates but marginally higher than numbers from last year. Mostly, this economic data settles in near prevailing levels, suggestive of a happy medium of economic growth.

Economists also forecast the federal funds rate, at 3.64% as of December 15, 2025, will fall to 3.08% by year-end 2026, the equivalent of 2.20 rate cuts of -25 bps each. The 10-year U.S. Treasury rate is estimated to end 2026 at 4.34%, which would represent approximately +30 bps of widening. Front-end rates may be more sensitive to policy moves, and continued curve steepening is now a base case estimate.

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## What are the tail risks to consensus?

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The most likely catalyst for a multiple standard deviation shift in rates, in either direction, is the unknown. That said, here are a few scenarios that we believe have the potential to disrupt the

prevailing status quo and cause significant movement beyond the consensus 30-bp increase to 10-year yields for the year ahead. Note these are not necessarily high probability events, but they are certainly conceivable.

- Scenario one: The politically accommodative Federal Reserve. In this scenario, the rate cuts occur largely at the direction of the White House. The front end of the curve obliges and drops precipitously, but more sober bond investors, the so-called “bond vigilantes,” fear a reprisal of significant inflation. The long end of the curve does not conform and results in a meaningfully steeper curve. Housing is not helped (as traditional mortgage rates are not reduced) and the Fed rate cuts are not supported by economic data, with the end result being policy error.
- Scenario two: The amplification of the rejection of the “U.S. Exceptionalism” theme. Central banks and sovereign funds deliberately reduce U.S. dollar holdings, weakening the dollar and collectively pressuring rates upwards, as concerns over 6+% annual U.S. deficits spook investors and require further Treasury funding at more onerous levels. Political rhetoric or fallout could be a leading cause here.
- Scenario three: The U.S. consumer falters. Household spending drops precipitously, the housing market craters or at least continues to show sluggish volumes, and the AI-related spending balloon appears to be premature at best. With consumer activity down, the U.S. moves toward a recession, and even the rate cuts to date are not enough to spur investment. The Fed would be behind the curve in such a scenario.
- Scenario four: An exogenous shock, likely a geopolitical event. Existing wars intensify or rising global conflicts (Taiwan/China i.e.) give investors pause. Market participants rush to U.S. Treasuries as a safe haven in a risk-off environment; rates (and likely equities) decline.

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## Global rates and currencies outlook 2026

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In 2025, soft U.S. labor data, monetary policy easing by the Federal Reserve, and trade policy uncertainty all contributed to a weaker U.S. dollar. Swedish krona had the biggest gains within developed markets, while Brazilian real stands out within emerging markets.

Looking forward, despite the adjustment in 2025, the U.S. dollar remains overvalued on most measures, which leaves room for further depreciation. The U.S. dollar is poised to lose its yield advantage in 2026, and a change in Federal Reserve leadership, along with a greater tolerance for inflation, further reinforces this view. Given this decline in hedging costs, foreign institutions may increase their hedging ratios, supporting further gradual U.S. dollar weakness.

Our preferred long positions are currencies that screen undervalued on key metrics and currently hold crowded short positions, which leaves them vulnerable to a corrective rebound. Our preferred short positions are in manufacturing-heavy economies in Asia and developed markets that also have low short-term interest rates.

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## Securitized sector outlook 2026

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For calendar year 2025, agency mortgages outperformed investment grade corporates for the first time since 2018. Further, we saw agency mortgages outperform corporates in a year when both sectors beat Treasuries, a combination that has not occurred since 1994. More broadly, other securitized product sectors performed similarly and contributed to overall returns.

The housing market and consumers continued to prove resilient during the year, supporting securitized product markets. Lending in autos, credit cards, and housing remained robust, despite a recent uptick in delinquencies in certain consumer credit segments. Further home price appreciation has made housing affordability a growing concern for consumers and policymakers. During 2026, we anticipate potential policy-related measures aimed at improving affordability. These may include the introduction of a 50-year mortgage or a portable mortgage. In addition to evaluating these proposed solutions, the ongoing debate around government-sponsored enterprise privatization may introduce volatility, but we do not expect long-term disruption to the mortgage market. Greater impact may stem from evolving prepayment risk, underscoring both the negative convexity in recently originated mortgages and the potential for increased demand resulting from reinvestment needs of mortgage investors.

During the second half of 2025, small cracks emerged in the asset-backed security (ABS) market due to idiosyncratic issues related to some lenders, including allegations of fraudulent activity.

These developments reinforce the importance of stringent risk management and disciplined security selection, especially when considering investments in certain bespoke sectors. In 2026, we may see an increased bifurcation in the credit quality of securities, driving additional focus on security selection, issuer selection, and underlying credit analysis. We maintain our emphasis on non-agency AAA-rated securities and government agency-backed securities, which offer attractive relative value income, strong underlying asset fundamentals, structural support, and liquidity.

Commercial mortgage-backed securities (CMBS) have been an area of caution in recent years. The market continues to navigate evolving demand for commercial property usage, which has focused on the office subsector. The market continues to experience increased vacancies, refinancing challenges, and lower property valuations. We expect these narratives to continue, along with concerns about overbuilding in the data center market and a potential shift in housing and office space usage within New York City, given policy uncertainty. While the bar remains high for investments in CMBS, we found value in some securities that align with our selection criteria.

In 2025, securitized products contributed to our positive performance, mostly in mortgages and ABS. Looking into 2026, we remain constructive on securitized products for many reasons, including:

1. certain sectors remain attractive on a relative value basis;
2. securitized products increase portfolio structural credit quality as we focus on agency-backed mortgage products and non-agency AAA-rated securities; and
3. our outlook for the fundamentals and credit quality for the consumer and housing sectors remains robust.

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## Corporate sector outlook 2026

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Another year of resilient earnings helped power corporate bonds to again post positive excess returns for calendar 2025. However, corporate spreads started to feel the inevitability of gravity and ended November unchanged from the start of the year, at +80 bps over comparable U.S. Treasury bonds. This translated to an excess return of +92 bps through positive carry.

Issuance through November exceeded \$1.5 trillion in investment grade new supply, surpassing 2024's calendar year total and modestly exceeding dealer estimates. The all-in yield remains compelling for issuing companies, and issuers continue to find a robust technical demand from market participants for new paper. The additional supply is driven by two significant factors: 1) a much anticipated increase in merger and acquisition (M&A) funding, which ramped up meaningfully in the second half of 2025 and will likely persist as a major theme for 2026, and 2) the dramatic increase in funding from AI "hyperscalers" that are rapidly investing in costly data centers and AI-related infrastructure. An insatiable demand to fund technology buildout related to AI will likely remain the primary driver of issuance before even more supply next year, with estimates of \$1.8 trillion for fiscal year 2026. This would be the largest issuance year since the post-COVID record years of 2021 and 2022.

At Reams, our view of the credit markets remains mostly unchanged from a year ago. We have continued to moderate corporate exposure, particularly among idiosyncratic, higher beta, weaker credits. With spreads hitting levels not seen since 1998, valuation is no longer attractive by any metric. Corporate balance sheets remain strong, but late-cycle corporate behavior (increased payout ratios, financial engineering, M&A) and resultant weakening balance sheets should now be considered the expected outcome for most high-grade entities. We acknowledge the continued run of solid earnings from the S&P 500 cohort, a largely resilient U.S. consumer despite the negative impacts of persistent though moderating inflation, and the paradigm shift of the AI boom fueling the rise of many of the largest entities (both by equity market capitalization and now by total indebtedness outstanding). All of these positives suggest that spreads will likely remain range-bound once again in 2026. The chief concern to spread levels would likely be the persistent need for new supply, which may pressure industrial spreads, as some time to digest the new issues may understandably be warranted. Less likely, but also on the risk side of the ledger, is inflation reigniting and economic conditions significantly worsening, perhaps from lagged effects of tariff policy.

Taken together, the base case is for modestly wider spreads, partially offset, from a total return perspective, by the positive carry provided by corporate coupons. As a result, we continue to favor defensive areas such as utilities versus industrials, with a

notable underweight to the technology/media/telecom subsector at the center of both M&A activity and AI-related debt issuance. We continue to auger for a meaningful place in most investors' portfolios for high-quality, short-term U.S. corporate debt.

While high yield demonstrates many of the same dynamics as the investment grade market, it is less vulnerable to M&A-driven balance sheet strain and ratings downgrades. It also faces less AI-related debt issuance, given that the hyperscalers reside firmly

within the investment grade universe. Thus, high yield appears marginally more attractive than higher beta investment grade. We believe in accessing high yield exposure through the Credit Default Swap High Yield Index, which we use for short-term, tactical positioning.

**For more information regarding Reams Asset Management, please contact us at 463.777.3900.**

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## Definitions

**Artificial intelligence (AI)** – A technology that enables computers and machines to simulate human learning, comprehension, problem solving, decision making, creativity, and autonomy.

**Asset-backed securities (ABS)** - a type of financial investment that is collateralized by an underlying pool of assets, usually ones that generate a cash flow from debt, such as loans, leases, credit card balances, or receivables. It takes the form of a bond or note, paying income at a fixed rate for a set amount of time, until maturity.

**Basis point (bp)** - Measurements used in discussions of interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.

**Bond vigilantes** – Investors who engage in trading activity that signals their disagreement with a bond issuer's monetary or fiscal policies. Bond vigilantes are said to enforce fiscal discipline by selling government bonds to increase yields and raise borrowing costs.

**Capital expenditures/capex** – Monies used by a company to buy, improve, or maintain physical assets such as real estate, facilities, technology, or equipment, and may include new projects or investments.

**Commercial mortgage-backed securities (CMBS)** - fixed-income investment products that are backed by mortgages on commercial properties rather than residential real estate.

**Consumer Price Index (CPI)** – Measures the change in prices paid by consumers for goods and services. The U.S. Bureau of Labor Statistics bases the index on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 households and 22,000 retailers.

**Coupon, coupon payment, coupon income** – The annual interest payment made to investors who hold a bond. It is calculated as a percentage of the bond's face value and is known as the coupon rate.

**Curve steepening** – occurs when the spread between short- and long-term interest rates along the curve gets wider.

**Dot plot** – a U.S. Federal Reserve chart summarizing the Federal Open Market Committee's (FOMC) outlook for the federal funds rate. Each dot represents the interest rate forecasted by one of the 12 members of the committee.

**Exceptionalism** - an idea centered on the notion that the United States is a unique and even superior nation as a result of historical, ideological, religious, and/or, in the context of finance, economic reasons. Proponents of American exceptionalism often expect or advocate for the United States to occupy or play a leading role in global affairs.

**Gross domestic product (GDP)** – The total value of goods and services provided in an economy during a specified period, often one quarter or one year.

**Hedging** – An investment or investment strategy that is designed to lessen the potential for losses in other investments. The price of an investment considered to be a hedge often moves in the opposite direction of the prices of the investments being hedged.

**Hyperscalers** – The largest cloud computing providers that can provide massive amounts of computing resources and storage at enterprise scale.

**K-shaped economy** – a situation where, following an economic downturn, different parts of the economy recover at different rates, creating a divergence like the letter "K."

**Portable mortgage** - a loan to purchase residential real estate that attaches to the borrower rather than to the property. Borrowers can transfer it to another house without having to apply for a new loan or incur additional fees. The terms of the mortgage stay the same despite the property transfer, providing an additional benefit to the borrower if interest rates are higher at the time of the transfer than they were when he purchased the first house.

**Securitized products** – Products, such as asset-backed securities (ABS) and mortgage-backed securities (MBS), that are created by pooling loans from a variety of sources and issuing bonds that are backed by these loans. Creditworthiness stems from the credit quality of the underlying loans, as opposed to corporate bonds in which creditworthiness is derived from the earning power of the issuing company. The primary risk of these securities is interest-rate risk. Rising interest rates might cause loan principal prepayments to slow, resulting in less available principal to invest at prevailing higher rates. Conversely, rate decreases might accelerate prepayments, leaving more dollars to invest at lower rates.

**Tail risk** – a form of portfolio risk associated with the increased possibility that an investment will move more than three standard deviations from the mean in a normal distribution. Left tail risks refer to unusually large losses. Right tail risks refer to unusually large gains.

## Indices

**Credit Default Swap High Yield Index** – benchmark representing a diversified collection of credit default swaps. It assesses the creditworthiness of a particular market or sector, allowing investors to hedge against default risks through a band of underlying assets.

**S&P 500 Index** – Measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

## About Reams Asset Management

Reams Asset Management is a fixed-income management firm that implements a consistent investment process across all of its strategies. Reams' mission is to provide the highest quality investment management expertise and unmatched client service in each of its product areas over the long term.

Additional information is available at [www.reamsasset.com](http://www.reamsasset.com).

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