



Key Points

- This is the time of year when Wall Street strategists perform the annual ritual of projecting a target price for the stock market for the coming year.
- Typically, most of these forecasts imply a total return for the new year in the range of 9% to 11%, which aligns comfortably with the long-term historical return for stocks of approximately 10%.
- Ironically, the historical record shows that a return of 9% to 11% is highly *unlikely* in any given calendar year – it happened only five times in the last 100 years, for example.¹
- Individual years have typically been much better or much worse, with 22% of years showing gains between 20% and 50%, and 26% of years being negative.²
- This data suggests that an investment strategist seeking to be right, rather than comfortable, should either predict a really great year, or a clunker.
- In recent decades the opposite has been true when forecasting the economy.
- We have illustrated in past commentaries that the U.S. economy is approximately 90% less volatile than it used to be, which implies the smartest forecast is to simply extrapolate the status quo.³
- However, we believe it may be time to think differently about the range of potential outcomes for the U.S. economy over the next several years, with implications for financial markets.
- We found a lot to agree with in a recent book by Joseph Davis called, “*Coming into View*,” which suggests that a continuation of the status quo might be the *least likely* outcome for the U.S. economy over the next decade.⁴
- Instead, potential outcomes on either side of “normal” may be far more likely.
- Under this framework, the fork in the road is the result of two megatrends pushing in opposite directions: Artificial Intelligence (AI), and structural fiscal deficits.
- On the optimistic side, AI innovation could significantly boost productivity to enable faster economic growth, which in turn might stabilize our fiscal deficit problem.
- In the pessimistic scenario, AI might fail to meet expectations, resulting in the national debt burden from continued fiscal deficits reaching a breaking point that could require material sacrifices from American citizens.
- These diverging scenarios imply different outcomes for financial markets and optimal investment strategies.
- We currently believe the optimistic scenario dominated by AI innovation is the most likely future pathway, but it is far from certain.
- We therefore feel it is important to design investment portfolios that can navigate either future with acceptable results.

¹ Source: S&P Global for the 100 calendar years from 1926 to 2025

² Source: S&P Global for the 100 calendar years from 1926 to 2025

³ Source: Strategic Economic Decisions, Inc.; www.sedinc.com; Decade-by-decade standard deviation of GDP dropped from 8.5% to 0.4% from the 1930s to the 2010s

⁴ Source: Joseph H. Davis, “*Coming Into View: How AI and Other Megatrends Will Shape Your Investments*”

Something's Gotta Give

The notion of a potential fork in the road for the U.S. economy and financial markets rests on the premise that America's fiscal position is approaching a tipping point where something must change. To be clear, we are not alarmists on this topic. We do not believe a crisis is imminent. We also recognize the U.S. has levers it can pull in an emergency to support any crisis response plan that might be needed. For example, the U.S. government owns 261.5 million ounces of gold valued on its balance sheet at its historic cost of \$42.22 per ounce, even though the current price of gold is roughly 100-times higher.⁵ If this gold were marked-to-market at its recent price of roughly \$4,300 per ounce, it could give the U.S. Treasury more than \$1 trillion in budget capacity with the stroke of a pen.

However, just because the U.S. has tools at its disposal to respond to a crisis doesn't mean there is nothing to worry about. Annual budget deficits in the range of 6%-7% of GDP cannot be sustained indefinitely. Financial markets eventually riot. If the political will does not emerge to impose necessary sacrifices in an *orderly* way, asset markets may eventually impose austerity in a *disorderly* way.

How to Solve a Debt Problem

When a nation accumulates too much debt relative to the size of its economy there are four primary pathways to a resolution, three of which are detrimental to the standard of living of its citizens to varying degrees. The most disruptive remedy for financial markets is outright default – i.e. choosing not to repay creditors in full. It is beyond the scope of this report to chronicle the potential ramifications of the world's largest economy and issuer of the global reserve currency defaulting on its debt. It is also unnecessary because a country like the U.S. that can create its own currency need never default in this manner.

Another unpleasant option is currency debasement – i.e. repaying creditors in a currency that has lost a significant portion of its purchasing power. This can be accomplished through manipulation of the currency exchange rate, chronic inflation, or a combination of both. You don't need to be an economist to recognize that losing the purchasing power of your income and savings reduces your standard of living. It tends to make people angry and pessimistic about the future. In extreme cases, it can lead to social and political unrest.

Deliberate political action is a third alternative. Sacrifice cannot be avoided through political action – indeed, asking people to accept sacrifice is the whole point – but at least there is a degree of self-determination when lawmakers design an austerity program themselves, rather than having it imposed upon them by a crisis. This pathway remains possible today “in theory,” but we currently assign almost zero probability to its occurrence. We would love to be proven wrong.

⁵ Source: U.S. Bureau of Economic Analysis (BEA); General Accounting Office

We Need a Productivity Miracle

The *least* disruptive pathway for rightsizing an unsustainable fiscal position is to outgrow it. When the annual growth rate of a nation’s economy exceeds the yearly budget deficit, the debt-to-GDP ratio can drift downward over time *without* imposing significant sacrifices on the standard of living of its citizens. This is where AI might be transformative because *it offers the potential for a step-change higher in productivity*.

Why it Matters...

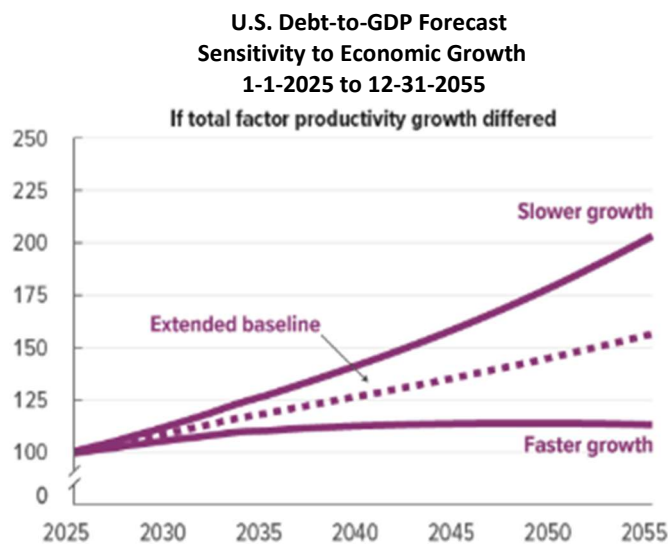
Economic growth is determined by two variables – population growth and productivity. How many people are available to make the pizza, and how many pizzas can each person make?

$$\text{GDP} = \text{Population} + \text{Productivity}$$

Population growth is relatively stable and predictable, so the variability of economic performance among different nations, and across different time periods, is primarily determined by productivity.

The Tug-of-War Between AI Innovation and Debt

The graph below provides a concise illustration of the potential impact of productivity on the U.S. fiscal position. The lines reflect long-term projections for the U.S. debt-to-GDP ratio under three scenarios for productivity, as calculated by the non-partisan *Congressional Budget Office (CBO)*. For purposes of this discussion, the future landing spot of each forecast is less important than the magnitude of change that results from relatively minor differences in estimated productivity for each forecast.



Source: Congressional Budget Office (CBO), May 2025; Total factor productivity assumed at 1.6% in the baseline forecast, and plus or minus 0.5% from baseline in the faster/slower growth projections

The Case for Optimism

The hopeful message from the *CBO* analysis above is that a relatively modest uptick in productivity – 0.5% per annum in this illustration – can go a long way toward stabilizing the U.S. fiscal position. Yet 0.5% may be too conservative of a guess. If AI innovation turns out to be as transformative as many believe, a multi-year jump in productivity of *more than 0.5%* per year seems likely, in our opinion.

We say that because it has happened before. Note in the table below that productivity averaged 3.0% per annum for a decade during the adoption phase of the internet-based innovation cycle beginning in the mid-1990s. A similar stretch of productivity growth today would deliver much more than a 0.5% annual improvement versus the baseline forecast in the *CBO* projections.⁶

U.S. Labor Productivity Growth (Output per Hour, Nonfarm Business Sector)

01-01-1889 to 12-31-2024

<u>Period</u>	<u>Avg. Annual Growth</u>
1889-2019 (full history)	~2.1%
1947-1973 (post-WWII boom)	~2.8%
1973-1995 (slowdown)	~1.4%
1995-2004 (tech-driven surge)	~3.0%
2005-2019 (post-IT plateau)	~1.4%
2019-2024 (recent experience)	~2.1%
CBO Baseline Estimate 2025-2055	1.6%

Source: Congressional Budget Office (CBO); Bureau of Labor Statistics (BLS)

If AI Innovation Disappoints...

If AI innovation fails to live up to expectations, an era of tougher choices might be in store. Without faster economic growth to generate more tax revenue, America's aging demographics will likely keep government spending indefinitely higher than revenue, requiring more government borrowing and ever-increasing national debt as a percentage of GDP.

⁶ Source: Congressional Budget Office (CBO); The CBO baseline forecast for productivity for the period 2025-2050 is 1.6%, while the optimistic forecast is 0.5% better at 2.1%; Productivity during the internet adoption cycle was higher still at 3.0% (1995-2004).

Investment Implications

The need to solve the chronic mismatch between U.S. government revenue and spending sets up a dynamic where the budget deficit might be resolved the easy way or the hard way, but we don't yet know which it will be. As one might imagine, the optimum investment strategy for each potential pathway is not the same.

If deficit spending continues unabated, we may face an extended period of stubborn inflation, higher interest rates, and sluggish economic performance. A financial market riot cannot be ruled out in this scenario if policy makers push investors' patience past the breaking point. We do *not* believe a market riot is eminent, but the odds would likely rise with each passing quarter that Washington fails to address the problem.

In a "deficits dominate" scenario, investors may want to favor a more conservative asset mix in terms of the stock-bond ratio in their portfolio. On the equity side of the portfolio, it might help to emphasize dividend stocks, value stocks, and international equities, with less focus on the so called, "Mag-7" tech giants that have been leading the stock market for most of the past decade (note: we are *not* advocating for zero exposure to global tech leaders in any scenario). On the fixed income side of the portfolio, high quality bonds in the short-to-intermediate maturity range should do well, while longer-term bonds and lower credit quality securities may not justify their risk.

In the more hopeful scenario, tech innovation and AI might unlock a productivity boom that leads to a best-of-both-worlds period with faster economic growth, lower inflation, and rising tax revenue to halt the steady climb of our national debt relative to GDP. This scenario would likely favor a more equity-heavy asset allocation with continued leadership from companies that either enable AI or harness it to improve their competitive position and value proposition in the marketplace. High quality bonds would still provide stability and a safe income stream in the short-to-intermediate range of the yield curve, with added leeway to stretch a bit further in terms of duration and/or credit risk in certain fixed income mandates.

Our Best Guess...

As we see the world right now, we would place the highest odds on the AI innovation scenario winning out – perhaps a 55%-65% probability, in our view. A future in which deficits dominate seems like a 25%-35% probability, leaving the remaining odds for something stuck in the middle of these two opposing forces, or completely out of the blue, like a geopolitical shock or a pandemic.

Current Design of Our Investment Strategies⁷

The remainder of this report addresses the current positioning of each of our investment strategies under current macro conditions. The specific design of *your* portfolio is customized to match your return objectives and risk tolerance. **For a refresher on how your portfolio is designed, and why, please reach out to your Wealth Advisor any time.**



ASSET LEVEL	Based on your investment objectives and risk tolerance, we set parameters for an optimal stock/bond mix. Instead of keeping your portfolio at a stagnant allocation, we have the ability to change the stock-to-bond-to-cash ratios as market conditions change.
PORTFOLIO LEVEL	By understanding the types of portfolios/accounts we're managing, we structure each portfolio to fit its stage in the investment life cycle (accumulation vs. distribution). We also take into account legacy positions and/or outside assets.
STRATEGY LEVEL	By understanding your optimal asset allocation range and the types of portfolios being managed, we determine how our specific strategies should be combined. We utilize both fundamental and tactical strategies to help take diversification one step further.
SECURITY LEVEL	Our team of CFA charter holders performs deep research behind each security selected and provides rationale for trades. We strive to position your portfolio for prevailing market conditions to participate in long-term trends.

Managed Equity Strategies

Given our base case, here is how we are positioned — while remaining risk-aware. Our 2026 outlook is based on these two pillars:

- 1) Valuations are high IF the economy falters or financial liquidity declines.
- 2) The innovation cycle is historic – no IFs involved.

Both can be true at the same time.

Valuations

Equity market valuations bottomed in the 2008–2009 Financial Crisis and have generally remained above their long-term median (roughly 17x earnings) since 2014.⁸ While valuation discussions often focus on headline multiples, long-term equity value is ultimately driven by future cash flows. Balance-sheet strength, margin durability, competitive positioning, management quality, and capital allocation are among the key drivers of those cash flows. In 2026, valuation risk is less about absolute multiples and more about management expertise and whether markets continue to underwrite future cash flows.

⁷ The portfolio strategy discussions in this section are supplemental to a compliant GIPS Report. A complete list of Capital Advisors' portfolio models and compliant presentations are available by contacting Capital Advisors.

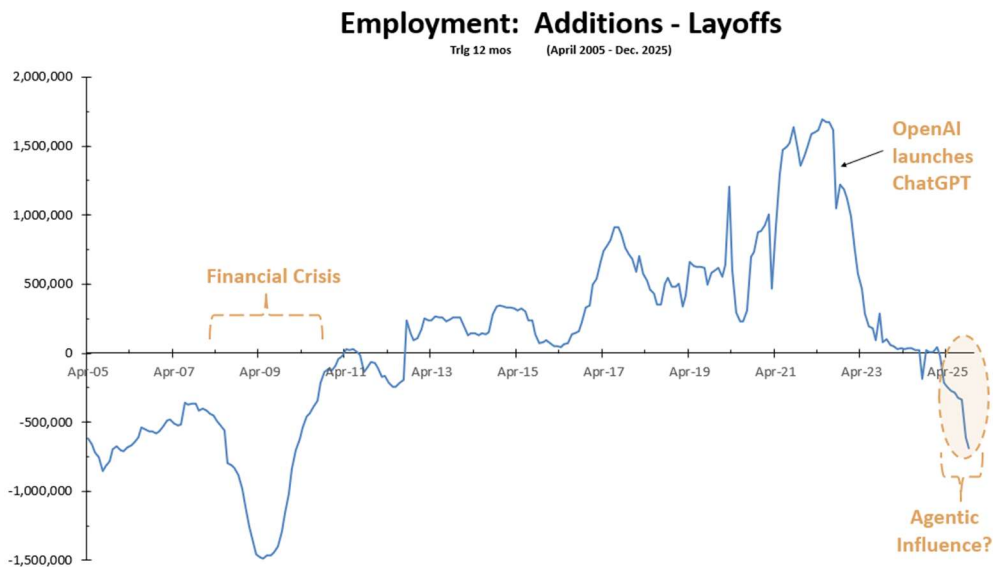
⁸ Source: Bloomberg

Economic Implications for Equity Markets

Two economic dynamics matter most for equity markets entering 2026. For one, AI is already affecting employment. The key distinction is whether companies primarily use the technology as a near-term cost reducer or evolve toward using it as a productivity-enhancing force multiplier. To date, cost reduction has dominated. We expect 2026 to provide greater clarity as corporate strategies evolve toward broader productivity gains.⁹

The second risk runs through household behavior. Consumer spending has remained resilient, supported in part by the “wealth effect” from higher asset values. Spending can withstand routine market pullbacks, as it has repeatedly done in recent years. The greater risk would arise if households reassess the sustainable level of their asset values, which would amplify a spending retrenchment. While disposable personal income growth remains below inflation and the personal savings rate is low, asset values continue to provide support. A meaningful shift in perceptions around household wealth would therefore be the primary transmission mechanism for broader consumer weakness.¹⁰

There is a potentially elevated consumer spending risk related to the employment picture, especially in the near term among recent college graduates who may be experiencing the brunt of the AI replacement cycle.



⁹ Steve Jobs coined the impact of technology’s capability-enhancing attributes the ‘bicycle effect.’ Microsoft’s Satya Nadella recently discussed the bicycle effect vs. undisciplined AI commentary as a necessary turn in AI-related thought leadership. Warren, T. (2026, January 2). Microsoft CEO Satya Nadella is now blogging about AI slop. *The Verge*. <https://www.theverge.com/>

¹⁰ Disposable personal income is currently growing below the inflation rate which exacerbates the affordability issue. The personal savings rate is also well below the historic norm. The Bureau of Economic Analysis’ savings rate data includes contributions to retirement accounts - like 401ks and IRAs - but not the value of those accounts. Therefore, the missing element supporting consumer spending is likely the value of savings accounts. If consumers began to perceive that value could be impaired, they could change their behavior.

Systemic Liquidity

Financial market liquidity has expanded meaningfully since the Financial Crisis. Higher liquidity tends to support asset prices and speeds recoveries following market drawdowns, which helps explain the V-shaped recoveries of recent years.

The primary risks come from either too much liquidity fueling inflation or a broken piece that drains the system. Importantly, global central banks have repeatedly shown a willingness to re-liquify markets during periods of stress.

The stock market may have largely discounted the systemic liquidity outlook. For one, U.S. monetary authorities already ended quantitative tightening activities at a systemic liquidity level at or above the already-elevated pre-COVID heights.

Second, significant liquidity events are in the offing. Perhaps the largest is that the Fed is reducing the supplemental leverage ratio (SLR) – a post-Financial-Crisis regulation that required large banks to keep particularly high reserves – rather than loan or invest that capital. The coming year also features lower tax rates and higher refunds (due to the tax cuts being made retroactive for 2025, so many people overpaid). The House Ways and Means Committee expects refunds to increase \$91 billion over 2025 levels, and consumers to keep an extra \$30 billion due to reduced withholdings.¹¹ Large financial institutions, like **JPMorgan (JPM)** and **Morgan Stanley (MS)** should benefit from deregulation freeing up capital to reinvest at higher rates. This deregulation is freeing these (formerly called) “money centers” to compete more effectively in the large and expanding AI infrastructure buildout opportunity – more on that to follow.

AI Development Cycle – Financing

Companies and nations are building AI infrastructure at speed, which is inherently uneven. Financing is shifting from hyperscalers’ operating-cash structures, through their balance sheets, and into circular deal structures that increasingly involve private credit. These structures bear little resemblance to the balance sheet credit that technology companies extended to barely existent firms during the Tech Bubble. Still, the interlinks do raise the value-at-risk in a contagion scenario. This phase of the AI cycle matters not because of innovation risk, but because of how financing structures mold systemic value.

¹¹ Ways and Means Committee. (2025, November 17). *Big, beautiful success story: 2026 tax refunds projected to be largest ever*. Washington, D.C. Retrieved from <https://waysandmeans.house.gov/2025/11/17/big-beautiful-success-story-2026-tax-refunds-projected-to-be-largest-ever/>

The current financing phase is simply more complex and involves less transparency than when hyperscaler operating cash flows were the primary source, in our view. Although important companies shaping the AI infrastructure buildout – like **Microsoft (MSFT)**, **Alphabet (GOOG)**, and **Amazon (AMZN)** – generally possess world-class operating cash flow structures and balance sheets, the buildout costs exceed how much they want to spend from internal funds. With money center banks still hamstrung by post-Financial Crisis regulations, private equity and credit firms are playing a pivotal role.¹²

In the *Dividend Income Strategy*, companies like **Blackstone (BX)** and **Blue Owl (OWL)** participate in this financing ecosystem primarily with secured and asset-based financing deals. Regulatory changes in 2026 may allow traditional banks to compete more directly, supporting the *Growth Strategy's JPMorgan*, and the *Dividend Strategy's Morgan Stanley*.

Are all companies hitting the mark with their capital allocation strategies? Might new technologies disrupt markets? Barring massive fraud or unforeseen geopolitical events, we view the answers to those questions as more company-specific than systemic, creating opportunities during periods of market volatility that require active monitoring and disciplined risk management.

Historic, Multi-Year Innovation (Value Creation) Cycle AI Evolves Through an Agentic Phase and Toward Artificial General Intelligence (AGI)

Agentic AI involves software systems designed to perform specific tasks, with the ability to adapt to changing conditions as they operate. This capability is already reshaping how corporations deploy AI. Artificial general intelligence (AGI) refers to a more advanced stage in which AI systems approach or exceed human-level performance across a broad range of tasks. The agentic phase accelerated meaningfully in 2025, and we expect it to continue evolving through 2026 and beyond.

The *Managed Equity Growth* strategy includes companies positioned to benefit from this evolution without relying on AGI outcomes, including **Nvidia (NVDA)**, **Microsoft**, **Google**, and **Amazon**. The next 12 months should feature several non-native AI companies visibly benefiting from the technology. This trend should give investors the opportunity to benefit from adding the right “quality” names to their growth-oriented portfolios, increasing diversification.

¹² Hyperscaler capex has historically run at 10–15% of revenues; today it exceeds 20% and may rise slightly further before stabilizing. CFOs attempt to keep capex below roughly 50% of operating cash flow, but the ratio now sits above 60%.¹² As a result, they increasingly rely on external financing to maintain strategic competitiveness — the *Red Queen effect*.¹² That includes debt issuance, circular financing, greater participation from non-bank lenders, and more recently, increasing participation from traditional money center banks.

Key features we highlight include the ownership of large, high-quality, customer-oriented datasets; the ability to automate core products; standardized, repeatable workflows and high operating leverage that can use AI as a force multiplier; firms in complex, multi-variate decision making environments; and firms that own significant platforms which can benefit from other companies' AI investments and advancements - **Apple (AAPL)** and **Microsoft**, and **Amazon** could be examples there. Advisory companies, such as **Accenture (ACN)** and **IBM (IBM)**, are positioned to help non-native AI companies understand, implement, and profit from the technology

Taken together, these developments support our view that innovation-driven value creation is likely to unfold over multiple years, with uneven progress across technologies and industries, rather than a single, linear outcome.

AI-Enabling Technologies: Energy

Energy remains one of the most important constraints on AI's expansion. Efficiency improvements help, but the scale of AI workloads continues to pressure power generation capacity. We view nuclear energy as a critical long-term solution, particularly as new reactor technologies mature later in the decade. In the near term, upgrades to existing facilities and natural gas generation play an essential role. Even with the increasing use of energy-efficient fiber optics (such as those provided by *Managed Equity Dividend's Corning (GLW)*), specialized lower-power semiconductors, and more efficient "inference" models, we expect the scale and breadth of AI-enabled workloads and connected intelligent systems to keep the energy bottleneck at the forefront. The *Managed Equity Growth Strategy* addresses this bottleneck through exposure to **GE Vernova (GEV)**, **Cameco (CCJ)**, and **Constellation Energy (CEG)**. These companies lead in gas and nuclear upgrades and benefit from long-term contracts that support profitability as AI infrastructure demand grows.

AI-Enabled Automation

AI-enabled automation should be a growing theme in 2026. Autonomous mobility networks are progressing from experimentation toward clearer adoption paths across passenger and goods delivery. Key participants include **Tesla (TSLA)**, **Alphabet (Waymo)** and **Amazon (Zoox)**, **Uber (UBER)**, and **DoorDash (DASH)**, with platform aggregation emerging as a potential long-term value driver.

Humanoid robotics are perhaps the most exciting aspect of AI-enabled automation. Do not expect to have a robot servant in the house this decade, but the key technology necessary to create useful humanoid robots should surface in the coming year including agentics and much faster, miniaturized processing capabilities. **Tesla** is among the companies that could be a significant player.

Industrial and logistics automation has the potential to offer a more immediate impact. Companies such as **Rockwell Automation (ROK)**, **Amazon**, **MercadoLibre (MELI)**, and **Sea (SE)** are among those pioneering the use of AI-driven robotics to improve efficiency, safety, and scale. Healthcare automation also continues to advance. **Intuitive Surgical (ISRG)** remains the global leader in robotic surgery, while **Stryker (SYK)** holds a leading position in orthopedic robotics and is expanding into spine applications. Over time, AI-enabled automation has the potential to meaningfully enhance procedural outcomes and system efficiency.

Augmented and Virtual Reality

Fully immersive virtual reality remains a longer-dated opportunity, but augmented reality should become more relevant over the 2026–2028 period. Consumer adoption is emerging through wearable devices, while industrial applications improve design, automation, and maintenance. Already, **Meta** claims its *Ray-Ban* and *Oakley* AR glasses were standout holiday-season successes (especially the more capable *Ray-Bans*). **Apple** has a higher-end AR/VR visor and is coming at the market from the *AirPod* direction by adding intelligent features to the earpiece, signaling a multi-pronged, longer-term strategy. On the industrial side, **Rockwell Automation** embeds AR/VR into selected key products to help customers design, operate, and maintain complex production systems more efficiently.

“New” Finance

The global financial system constantly evolves and adapts, but technological advancements are making the visible window somewhat special. AI and blockchain are converging to create new forms of digital assets, smarter financial systems, and more secure, efficient crypto platforms. Emerging market companies are using AI to open a potentially lucrative market opportunity. **MercadoLibre** and **Sea Ltd.** are using their deep expertise and datasets regarding South- and Central American customers to develop a banking system that evolves what used to be called microlending.

Crypto and Precious Metals

In developed Western markets, younger demographics are aging into a fundamentally different financial system than their parents and especially grandparents are used to. In 2000, ~84% of U.S. transaction value happened with cash and check, while only 16% was digital (mostly credit card).¹³ **Visa (V)** and **Mastercard (MA)** were private associations at the time. By 2024, ~83% of transactions were digital like credit cards.¹⁴ Visa and Mastercard currently have over a trillion dollars in market cap. Today, roughly 1% of transactions happen in crypto, mostly stablecoins.¹⁵

¹³ Federal Reserve System. (2002). *Retail Payments Research Project*.

¹⁴ Federal Reserve Financial Services. (2025, May). *2025 Diary of Consumer Payment Choice*.

¹⁵ TRM Labs. (2025, October 21). *2025 Crypto Adoption and Stablecoin Usage Report*. trmlabs.com/reports-and-whitepapers/2025-crypto-adoption-andstablecoin-usage-report

Crypto also has the potential to serve as a solution set to the inexorable shift from a monopolar global economic system - centered on the U.S. post-WWII - to a multipolar one. Time frame is vitally important here. Crypto is not evolved enough yet to serve as a standardized medium of exchange, so the multipolar stress on the U.S. dollar is primarily reflected in precious metals such as gold and silver (the latter of which is also a better electrical conductor than copper). We recently launched precious metals and crypto investment strategies that can be used separately or in conjunction.

The Managed Equity Strategies include **Southern Copper (SCCO)**, **Rio Tinto (RIO)** – both in the *Dividend Income Strategy* – and **Freeport McMoRan (FCX)** in the growth strategy – all of which have significant copper and meaningful gold operations.

In *Managed Equity Growth*, at present, the most meaningful crypto holdings are **Visa** and **JPMorgan**. Visa is building a meaningful crypto stablecoin capability (cryptocurrency that could be used in economic transactions), actively focused on crypto as a new rail for payments, rather than speculation. JPMorgan stands out as the leading big-bank crypto innovator, leveraging blockchain for real-time institutional settlement and driving tokenization of deposits and assets. While crypto is still early-on in terms of global adoption, it represents another area where we may be active in 2026, upon opportunity.

Space

Space-based infrastructure is an emerging enabler of AI through improved data transmission and potential long-term cooling advantages. While still early, the Managed Equity Strategies currently maintain measured exposure through **Lockheed Martin (LMT)** in the *Dividend Strategy* and **Boeing (BA)** in the *Growth Strategy*. We expect the opportunity set to broaden over time.

Quantum

We continue to believe quantum technologies can revolutionize socioeconomics at least as much as AI. While commercialization remains early, progress accelerated in 2025 and should continue in 2026. The Managed Equity Strategies maintain diversified exposure across the quantum ecosystem. This includes pure-play participation through **IonQ (IONQ)**; ownership of a leading private quantum platform through **Honeywell (HON)** and its planned Quantinuum spinoff; and development efforts at well-capitalized technology leaders such as **Alphabet, Microsoft, Amazon, Nvidia, and IBM**.¹⁶

¹⁶ IBM Quantum is a leader in “superconducting” quantum technology which requires temperatures colder than outer space (a key limiting factor in commercialization). Superconducting enables the full set of quantum capabilities – at least in theory. We believe IBM is making significant headway in the technology’s development and has several systems already installed with customers. IonQ and Quantinuum are key leaders in “trapped ion” technology which can operate in normal temperatures but lacks the full spectrum of theoretical quantum capabilities. With a broad brush, trapped ion quantum is closer to wider commercialization though, again, IBM appears to be making significant headway. All quantum technologies currently remain in development stages.

Summary *Managed Equity* Remarks

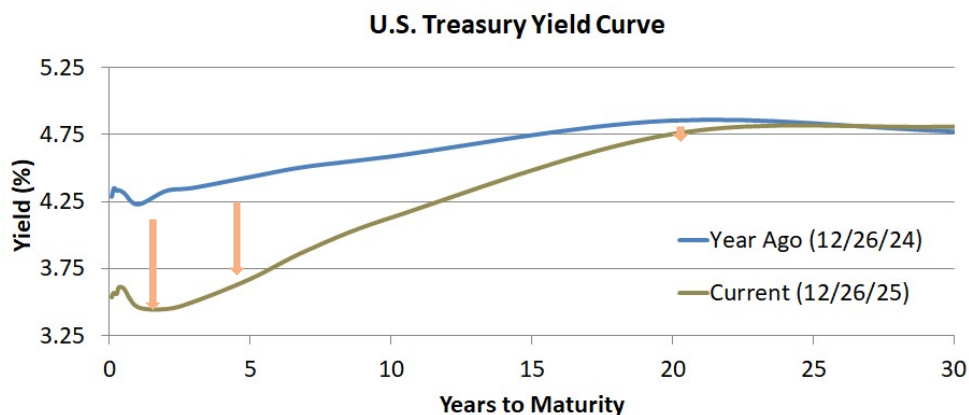
The *Dividend Strategy* features a yield over 4% and a track record of more than 6% annual income growth. It has also traditionally been a significant equity risk diversifier, and it offers a total return proposition including a bird-in-the-hand cash return component and meaningful equity market exposure. Secular trends such as AI serve both as return enhancers and risk diversifiers.

The *Growth Strategy* places greater emphasis on innovation-driven opportunities while remaining disciplined in risk management. We expect to be selectively active in this strategy throughout 2026 as opportunities and risks evolve.

Fixed Income Strategies

Interest rates continued their gradual decline over the course of the fourth quarter, mirroring the first three quarters of 2025. Moderating inflation and a slightly weaker labor market prompted the Federal Reserve to cut interest rates three times, or 0.75%, in the final four months of the year, now sitting at an effective Fed Funds rate of 3.64%.¹⁷ As we move into 2026, it remains to be seen how much more rates will be reduced as well as how quickly. As of this writing, the Fed Funds futures market implies between two to three cuts of 0.25% by this time next year.¹⁸

What is most interesting about this year's bond market is the relative change in rates in the short end of the curve relative to the longer end of the yield spectrum. The part of the market we traditionally overweight our clients' bond portfolios, 2-year to 5-year maturities, saw market rates decline between 0.70% and 0.80% (and bond prices rose), year over year. However, 20–30-year bonds witnessed barely any move at all as concerns of budget deficits and continued uncertainty with tariffs caused that part of the market to lag (see chart below).¹⁹ Due to this yield curve steepening, slightly longer maturities offer an attractive alternative to their shorter maturity counterparts, and as such, we are adding more securities out the yield curve (8-12 years), where appropriate, to lock in what is still an attractive yield entry point.



Source: Bloomberg

¹⁷ Source: Bloomberg, 12/30/25

¹⁸ Source: Bloomberg, World Interest Rate Probabilities, 12/30/25

¹⁹ Source: Bloomberg, as of 12/30/25

Managed Credit Strategies

Within our *Managed Credit Strategies*, we continue to orient the portfolios toward better credits, with roughly 75% of our clients' exposure to companies currently rated A- or better, on average.²⁰ We believe our BBB exposure has better balance sheets than the broad market, but we are willing and able to further reduce this allocation should we see any specific situations worsen. We also hold a modest allocation to U.S. Treasuries, where applicable, to provide further credit diversification. Our overweight to investment-grade corporate credit outperformed Treasuries in 2025 while our slightly defensive duration profile did not keep pace with broad markets following the modest price increases from falling rates. On a go-forward basis, portfolios are now yielding between 3.8% and 4.4%, depending on one's yield curve positioning.²¹

ETF Bond Models

Our *Aggregate Bond* ETF strategy remains 100% invested in "defined maturity," investment-grade corporate bond ETFs, which somewhat positively impacted the model's performance relative to the benchmark in 2025 as corporate credit outpaced Treasury returns. Today, there is a relatively conservatively positioned laddered maturity structure of ETFs ranging between 2027-2032, and the model carries an average net acquisition yield of approximately 4.1%.²²

The *Income Bond* ETF strategy has focused on maximizing cash flows within the priority of balancing risks, most notably through sector diversification. In 2025, "AAA-rated" Agency Mortgage-Backed securities, which accounted for approximately one-third of assets, proved to be the strategy's top performer. Investment-grade corporates, nearly 50% of the model, also performed admirably in the year. Today, the strategy carries an average net acquisition yield of approximately 4.4%.²³

Municipal Bonds

Our *Municipal Bond* portfolios continue to focus on "A" and above credits with strong debt coverage and liquidity profiles. We have also intentionally over-weighted essential service revenue bonds (water & sewer, utilities, etc.), and general obligation bonds with an average portfolio credit quality of "AA." Municipals only slightly trailed taxable bonds on the year due to elevated tariff worries, elevated bond supply, and possible tax law changes. However, 2026 looks to be a slightly more attractive landscape for some of these factors, potentially creating favorable conditions for municipals versus their taxable counterparts. Municipal bond portfolios are now yielding between 2.6% and 3.1% tax free (*between 4.4% and 5.2% at the highest marginal federal tax rate*)²⁴ depending on one's yield curve positioning.

²⁰ Source: ORION

²¹ Source: Bloomberg, ORION, as of 12/31/25

²² Source: Bloomberg, iShares, State Street, as of 12/31/25

²³ Source: Bloomberg, iShares, State Street, as of 12/31/25

²⁴ Source: ORION, Bloomberg, highest marginal tax rate of 40.8% = 37% federal plus 3.8% net investment income tax, as of 12/31/25

Tactical Global Growth Strategy

This strategy was well positioned in 2025 with a healthy allocation to international equities and emerging markets, both of which performed admirably throughout the year. In November we made a change to the allocation to add direct exposure to the value factor in both international equities and U.S. small caps. This change is consistent with the framework for the market outlook we described at the beginning of this report, and it has been helpful this far since implementation. The new positions in the strategy are the **iShares MSCI International Value ETF (IVLU)** and the **Vanguard S&P 600 Small Cap Value ETF (VIOV)**.

Tactical Global Growth Strategy Model Portfolio 1-1-2026

<u>Investment Vehicle (Ticker Symbol)</u>	<u>Asset Market</u>	<u>Portfolio Weight</u>
iShares MSCI ACWI ETF (ACWI)	Core Global Equity	40%
Schwab International Equity ETF (SCHF)	Developed Int'l. Equity	20%
Vanguard Emerging Markets ETF (VWO)	Emerging Markets	20%
iShares S&P 600 Small Cap ETF (IJR)	U.S. Small Cap	10%
iShares MSCI International Value ETF (IVLU)	International Value	5%
Vanguard S&P 600 Small Cap Value ETF (VIOV)	U.S. Small Cap Value	5%

The current portfolio design seeks to orient the strategy toward sub-sectors of the global equity market with higher long-term return expectations, as illustrated by the 10-year capital market assumptions of 27 institutions representing many of the largest asset managers and investment banks in the world, presented below.

Capital Market Assumptions 10-Year Return Forecast Estimates for the Period 2025 to 2034²⁵

<u>Institution</u>	<u>Equity Market Sub-Sector</u>			
	<u>U.S. Large-Cap</u>	<u>U.S. Small/Mid</u>	<u>Developed Int'l.</u>	<u>Emerging Markets</u>
Horizon Actuarial	6.4%	7.0%	7.2%	7.6%

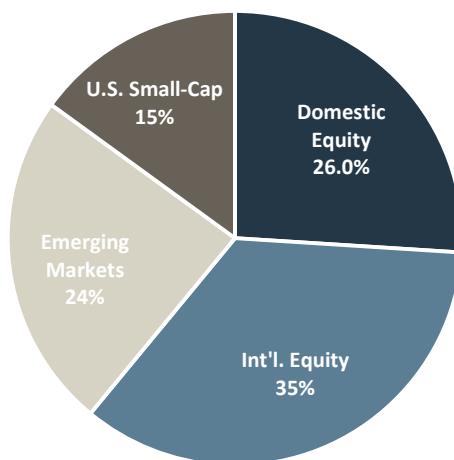
Past performance may not be indicative of future results

²⁵ Source: Horizon Actuarial, "Survey of Capital Market Assumptions – 2025 Edition"

Although the methodology for deriving long-term capital market assumptions varies by institution, the building blocks for each approach are similar, comprised of the starting dividend yield, a long-term earnings growth estimate, and an assumed net change in the valuation multiple over a 10-year time horizon. Institutional investors frequently use long-term return forecasts like these as an input for designing investment portfolios or modeling future scenarios in a comprehensive financial plan. We use Capital Market Assumptions in the *Tactical Global Growth* strategy to help inform its asset mix across the dimensions of domestic vs. international equities, large-cap vs. small-cap, and developed vs. emerging markets.

The current geographic diversification of the portfolio is reflected below, including the “look-through” allocation within the global equity ETF (ACWI), which includes holdings from each of the U.S., international, and emerging markets.

**Strategy Model
Geographic Exposure
01-01-2026**



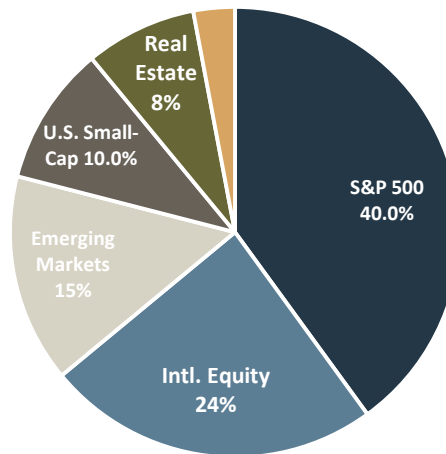
Dynamic Allocation Strategy

After a few fits and starts in the first half of the year this strategy accumulated a solid low-double-digit return for the full calendar year. Like the Tactical Global strategy, the Dynamic strategy was a beneficiary of the strong performance of international and emerging market equities in 2025. The asset allocation will begin the new year fully invested in risk markets across the five broad categories of U.S. Equity, International Equity, Emerging Markets, U.S. Small Cap, and Real Estate.

We believe the *Dynamic Allocation* strategy can play a helpful role in the risk management discipline of a balanced portfolio. Each of the five equity market index funds (ETFs) within the strategy has an automatic sell discipline tied to its moving average trend line. In English, this means each sector will be sold when its trend line turns downward. Consequently, money allocated to this strategy can be expected to shift out of risk markets and into short-term U.S. Treasuries whenever downside volatility in the equity markets picks up.

Despite having the flexibility to shift almost entirely into short-term U.S. Treasuries during times of market stress, the strategy can capture a large portion of the upside whenever global equities experience a sustained advance.

**Dynamic Allocation Strategy
Allocation as of 01-01-26**



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The investment return and principal value of an investment will fluctuate so that an investor’s portfolio may be worth more or less than its original cost at any given time. Due to differences in portfolio timing and position weightings, the returns for any individual portfolio managed by Capital Advisors may be lower or higher than any performance quoted.

Investing in bonds involves risk, credit and default risk, call risk, and liquidity risk.

The **S&P 500 Index** is a stock market index based on the market capitalizations of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor’s. The index is calculated on a total return basis with dividends reinvested and is not assessed a management fee.

The **Russell 1000 Growth Index** seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit growth characteristics.

The **Russell 1000 Value Index** seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit value characteristics.

MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI EAFE Small-Cap Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of small- and mid-cap stocks in the developed markets, excluding the U.S.

Vanguard High Dividend Yield ETF is an exchange-traded fund that seeks to track the performance of the FTSE High Dividend Yield Index, which consists of common stocks of companies that pay dividends that generally are higher than average.

Morningstar Dividend Yield Focus aims to track high-yielding, qualified dividend-paying, U.S. based securities screened for companies with financial health. The Index is calculated on a total return basis with dividends reinvested and is not assessed a management fee. It is not possible to invest directly in an index.

Bloomberg Aggregate Bond Index is an unmanaged index made up of U.S. Government, corporate, mortgage-backed and asset-backed securities rated investment grade or higher. The index is designed to measure the performance of the domestic investment-grade bond market.

Morningstar Dividend Yield Focus Index: A selection of 75 US stocks with relatively strong dividend yields and financial quality.

FTSE US High Dividend Yield ETF: Represents the performance of stocks characterized by above-average dividend yields based on the FTSE US High Dividend Yield Index.

Vanguard High Dividend Yield ETF: A passively managed ETF that seeks to replicate the FTSE US High Dividend Yield Index.

S&P US REIT Index: Defines and measures the investable universe of publicly traded real estate investment trusts domiciled in the United States.

S&P US Utilities Index: Defines and measures the investable universe of publicly traded utility companies domiciled in the United States.

S&P 500 Dividend Aristocrats Index: Designed to measure the performance of S&P 500 index constituents that have followed a policy of consistently increasing dividends every year for at least 25 consecutive years.

S&P High Dividend Yield Aristocrats Index: Measures the performance of the 50 highest yielding companies within the S&P Composite 1500 that have increased their dividends every year for at least 20 years.

Fidelity High Dividend Yield ETF: Tracks the performance of large- and mid-capitalization dividend-paying companies in the Fidelity High Dividend Yield Index that are expected to continue to pay and grow their dividends.

Schwab US Dividend Equity ETF: Tracks the Dow Jones US Dividend 100 Index with companies characterized by financial quality and high dividend yields.

Estimated portfolio yield represents the 12-month run-rate of interest and/or dividend payments in a strategy divided by the market value of the securities and cash reserves invested in the strategy. Estimated interest/dividend payments and market values are calculated by a portfolio accounting system from *Orion* using a single client portfolio that Capital Advisors believes to be representative of clients' portfolios invested in the same strategy. The actual portfolio yield for any single client portfolio may be lower or higher than the yield quoted. The underlying holdings of any presented portfolio are not federally or FDIC-insured and are not deposits or obligations of, or guaranteed by, any financial institution.

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Items of Note Regarding Exchange Traded Funds: An Exchange Traded Fund (ETF) is an investment company that typically has an investment objective of striving to achieve a similar return as a particular market index. The ETF will invest in either all, or a representative sample of the securities included in the index it is seeking to imitate. Like closed-end funds, ETFs can be traded on a secondary market and thus have a market price that may be higher or lower than its net asset value (NAV). If these shares trade at a price above their NAV they are said to be trading at a premium. Conversely, if they are trading at a price below their NAV, they are said to be trading at a discount.

The information provided is supplemental to a fully compliant GIPS Report. A complete list of Capital Advisors' composites and performance results is available upon request. The actual return and value of an account will fluctuate, and at any time the account may be worth more or less than the amount invested.

Additional information, including management fees and expenses, is provided on Capital Advisors' Form ADV Part 2, available upon request or at the SEC's Investment Adviser Public Disclosure site, <https://adviserinfo.sec.gov/firm/summary/104643>

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