

Markets in 2025: Key Themes and Developments Shaping the Year Ahead

Executive Summary

2025 was a year marked by heightened volatility, fast-moving headlines, and shifting policy dynamics. Markets navigated a complex mix of monetary, fiscal, and trade developments, alongside evolving geopolitical tensions and rapid technological change. While uncertainty often dominated the narrative, economic and market fundamentals proved more resilient than many initially expected. The following highlights summarize the key themes and developments discussed in this market review.

- **Market volatility defined 2025**, with periods of sharp uncertainty followed by renewed optimism, underscoring the non-linear nature of markets.
- **Headlines frequently outpaced underlying economic fundamentals.** Trade policy, DOGE-related disruption, Federal Reserve actions, fiscal uncertainty, and political developments all contributed to elevated headline risk, though the broader economic impact of many events proved relatively contained.
- **Trade policy uncertainty eased as the year progressed.** Proposed tariffs initially raised concerns around supply chains and earnings, but many were delayed, scaled back, or partially reversed, resulting in a manageable headwind rather than a structural economic shock.
- **Fiscal policy remained a source of volatility.** DOGE disruptions faded by late 2025, tax cuts were extended, and federal budget uncertainty resurfaced through a prolonged government shutdown, highlighting ongoing deficit and funding challenges.
- **Inflation moderated relative to expectations**, allowing the Federal Reserve to resume its easing cycle. While price pressures remained above pre-pandemic norms, affordability concerns became more prominent, and future policy decisions are expected to remain cautious and data-dependent.
- **The labor market cooled but remained resilient.** Hiring slowed and unemployment rose modestly, yet wage growth and employment stability supported consumer spending through much of the year.
- **Corporate earnings demonstrated resilience.** S&P 500 earnings growth exceeded expectations, led by large-cap technology and AI-related companies, though earnings concentration remains a key risk heading into 2026.
- **Market leadership broadened in 2025.** International markets outperformed U.S. equities, supported by earnings growth and dollar depreciation, with valuations outside the U.S. remaining relatively attractive.

- **Looking ahead to 2026**, key areas of focus include labor market conditions, consumer spending trends, earnings durability, the evolution of AI profitability, fiscal policy uncertainty, and potential dislocations in private credit markets.

2025 Market Overview

The markets challenged prior assumptions, rewarded a disciplined approach, and highlighted the importance of keeping a long-term investment perspective in 2025. The year unfolded amid a complex mix of shifting monetary, fiscal, and trade policies, evolving global geopolitical tensions, and rapid technological innovation. Investors experienced periods of intense volatility mixed with periods of renewed optimism, reminding us that the market rarely moves in a linear path, but over time, it benefits those who stay aligned with their financial plan.

Against this backdrop, we remained focused on investing with intention, managing risk thoughtfully, and seeking opportunities for long-term value rather than short-lived trends based on ever-changing headlines. The headlines of 2025 often moved faster than the underlying economy, with tariffs and trade developments, DOGE, immigration, actions by the Federal Reserve (Fed), government deficits, and even Supreme Court decisions all contributing to headline risk. Yet, the strong performance of risk assets underscored the resilience of companies, consumers, and markets to headline risks, and the economic impact of policy events ended up being relatively contained.

What follows is a recap of several major themes that shaped markets in 2025, along with an early look at factors expected to influence 2026.

Tariffs & Trade Policy

In 2025, the Trump administration proposed and partially adopted a sweeping set of new tariffs that initially rattled markets. Our initial concern was not that inflation would be the result, but that tariffs would ultimately cause an economic slowdown by creating a weaker job market, which would dampen consumer spending. While uncertainty dominated the early months of the year, conditions ultimately played out better than initially feared as tariffs were pulled back.

- The announced tariff increases pushed effective U.S. tariffs to levels not seen in decades, raising near-term uncertainty for companies that rely on the global supply chain, as many exporters and import-sensitive industries faced higher expected costs or potential supply-chain delays. There were warnings that full implementation could have a meaningful impact on S&P 500 earnings.

- As the year progressed, however, most of the initially announced tariffs were either delayed, scaled back, or partially reversed.
- While some industries experienced higher costs, the overall economic impact proved far less severe than feared during the chaotic rollout phase. Companies have so far been able to mitigate impacts through supply chain management and absorb most of the higher costs without a meaningful impact on profits. The tax bill passed in the summer also offset much of the potential impact of tariffs, as tax incentives in the bill immediately benefited companies.

For investors, this meant that, despite periods of volatility and headline risk, the tariff environment ultimately became more of a manageable headwind rather than a major structural shock. We expect trade headlines to recede in 2026 unless they become a specific point of leverage against another country. We believe the primary risk for 2026 is that the current one-year trade truce with China will have to be addressed once again.

Fiscal Policy & DOGE (Department of Governmental Efficiency)

In early 2025, DOGE triggered a wave of concern, including aggressive mass layoffs and budget cuts across many federal agencies, which rattled both public sentiment and investor confidence. Likewise, federal budget constraints led to the longest government shutdown in U.S. history.

- During the most intense period, reports showed thousands of job cuts across multiple agencies from DOGE. Many feared a long-lasting impact on public services and health services, consumer demand, and economic activity in affected areas, which could produce broader economic fallout for companies dependent on government support.
- As the year unfolded, DOGE-related disruption faded. By late 2025, DOGE was quietly shut down, well ahead of its initially scheduled end date. Many of the workforce reductions were reversed, and some agencies began rehiring staff or restoring former employees to their positions. As a result, the most severe potential economic effects did not materialize at scale.
- As DOGE was winding down, legislation was passed this summer permanently extending tax cuts that were set to expire at the end of 2025, potentially removing a downside risk and boosting the growth outlook for 2026.
- However, a lack of agreement on how to resolve federal budget deficits resurfaced quickly. On October 1st, Congress failed to pass appropriations legislation, and the federal government shuttered its doors in what was to become the longest shutdown in U.S. history.

We expect markets to remain volatile with respect to fiscal policy in the year ahead. While DOGE specifically should not present a material risk to the 2026 outlook, we expect the underlying issue – uncertainty over how to reduce federal spending amidst high fiscal deficits - may continue to present headlines as well as real economic risks in 2026. While the benefits of the 2025 spending bill may improve private sector growth prospects in the year ahead, another government shutdown is also possible as early as January, as Congress faces another funding deadline.

Inflation, The Fed, and Monetary Policy

Inflation remained elevated throughout 2025 but ultimately proved less disruptive than expected, allowing the Fed to resume its easing cycle that began in 2024. While prices continued rising at a pace above pre-pandemic norms, the feared tariff-driven surge in inflation never fully materialized.

- Affordability became the hot topic rather than inflation levels. As many tariffs were delayed, scaled back, or reversed, the pass-through into consumer prices was limited. For most companies, inflation became a challenge to be managed rather than a shock to be absorbed.
- Input-cost pressures persisted, especially in labor and select materials, but remained relatively stable. Tariffs contributed less to overall price increases than initially feared, thanks to partial delays and policy adjustments.
- Companies showed strong pricing discipline, using targeted price adjustments, supply-chain flexibility, and operational and labor efficiencies to offset cost pressures.
- The Fed started the year pausing 2024's easing cycle as the combination of elevated inflation, trade uncertainty, and concerns around government deficits created a delicate balancing act. As concerns about inflation eased, hiring slowed, and unemployment edged up modestly, the rate-easing cycle resumed in September, with three consecutive 0.25% rate cuts.

Looking ahead to 2026, we expect the pace of additional rate cuts to slow. Whether the Fed can afford additional rate cuts depends heavily on economic developments. If the labor market stabilizes or strengthens, with hiring picking back up and wage growth holding, the Fed may feel compelled to pause on additional cuts. If inflation remains sticky or begins to rise again, the Fed may also be forced to hold rates steady. For investors, this means the window for easier monetary conditions may be narrowing. However, if job losses accelerate, the Fed will likely vote for additional cuts. Over the medium term, the Fed's ability to cut further will likely be measured, data-dependent, and cautious.

Employment Trends

The labor market in 2025 showed clear signs of cooling; although growth slowed, it remained stable enough to help sustain consumer spending through most of the year.

- Early in the year, the U.S. economy added a respectable number of jobs, but as the year progressed, hiring momentum slowed considerably. Over 1.1 million announced layoffs have been reported in 2025, the most since the pandemic, and the unemployment rate now stands at 4.6%. However, initial and continued unemployment claims remained at the lower end of the range we have seen this year.
- Even with the slowdown, employment remained sufficiently resilient to support household income and consumer demand. Wage growth continued, and many workers who remained employed saw modest real-wage gains.
- Because companies largely slowed hiring rather than launching large-scale layoffs, many households retained stable paychecks. This supported consumer spending, particularly in the service sector and retail, thereby bolstering overall economic activity.

As we look to 2026, employment will remain a key indicator for the economy, as well as for the Fed. As immigration has declined, we will likely not see the same number of new jobs as in prior years, so companies will seek to continue innovations such as artificial intelligence (AI) to achieve productivity gains.

Corporate Earnings & Market Resilience

Despite the headwinds from tariffs, government disruption, and macro uncertainty, many companies delivered solid earnings, particularly the Magnificent 7 and other companies leveraged to the development of artificial intelligence.

- Even with the challenges presented by policy volatility, S&P 500 earnings growth is running in line with its average run rate of 13%. S&P 500 earnings were up nearly 13.5% in Q3 year over year, versus the 7.9% expected at the end of Q3. Q4 earnings are projected to be nearly 7.5%, bringing 2025 growth to just under 12%.
- Earnings themes and takeaways continue to revolve around favorable earnings guidance and upbeat revisions, elevated hyperscaler capex, AI adoption, and labor efficiency. Since 2023, earnings growth in the AI-focused tech and communications sectors has averaged 20%, 4x the pace of the rest of the S&P 500.

We believe the earnings backdrop for stocks remains supportive as we move toward 2026. As of the end of November, the next 12-month earnings growth consensus stands at 12.5%, the highest level since January. If there is one area of risk, it is the index's continued concentration. The top 10 companies account for about one-third of total earnings, meaning an earnings miss from any major large-cap contributors could significantly affect the overall earnings outlook. A broadening of earnings growth outside of technology could offer a welcome fundamental boost to the broader stock market.

A Sustainable Broadening

The S&P 500 has been outpaced by the broader international markets this year. Emerging markets are on pace for their best year ever since 2019, while developed international markets are set for a gain last matched in 2017. U.S. stocks have been outpaced by either emerging markets or developed markets in just two of the last 12 years, making 2025 appear as a relative anomaly.

- The S&P 500's high technology exposure has been a major driver of its strong performance relative to international indices in recent years. However, earnings growth supported many non-U.S. markets in 2025, and that may persist in 2026. While analysts expect U.S. growth to strengthen from about 10% this year to 13% in 2026, a strengthening earnings recovery in China could lift emerging-market growth even higher. Developed international markets are also projected to be about 13%.
- Dollar depreciation was also a major theme in 2025. It has historically correlated with excess global equity market returns. Easing policy at the Fed, escalating debt and budget deficits, and uncertainty over the trade policy landscape may all support continued dollar weakness in the year ahead.

We expect to start 2026 with solid fundamentals for international and U.S. stocks. International valuations still point to discounts available as compared to the U.S., and international markets will likely benefit if capital continues to rotate away from U.S. mega-tech and growth sectors toward more value and cyclical sectors. That trend should benefit the broader U.S. market and international markets next year.

Looking Ahead to 2026

Double-digit earnings growth, favorable financial conditions with three rate cuts delivered this year, and diminished trade uncertainty create a potentially attractive backdrop for risk assets next year. However, stock valuations remain at elevated levels, so much of the positive news has been priced in. After six total rate cuts since the fall of 2024, bonds are more likely to have a return closer to their current yield. We also have a midterm

election in November. Of the four years of a presidency, the midterm year has historically been the hardest for stocks. Given the current political environment, increased volatility can be expected until there is some clarity. However, as we have seen, gridlock is still a major theme regardless of the power setup in D.C, and remember, earnings drive the stock market over the longer term, and that is what we are focused on. Here are four themes that we will be monitoring in 2026 that we believe will influence the markets:

- The **unemployment rate** has risen 1.2% from its 50-year low of 3.4% in April 2023. The continued claims unemployment chart will be a key indicator of the strength of the consumer. Whether the jobs market weakens further will be a primary driver of any additional Fed rate cuts in 2026. So far, the Fed's story has been one of normalizing interest rates as inflation risks diminished. If it cuts rates due to true economic weakness (high unemployment), stocks and bond yields are likely to retreat from current levels. If the Fed can continue down the soft-landing scenario, stocks can move higher based on steady and broadening earnings growth.
- We have seen a divide in **consumer spending** as affordability issues continue to mount at lower-income levels, while upper-income levels have maintained spending power. While aggregate spending remains strong, it is likely due to higher prices rather than increased demand. If we see weakness in aggregate spending, either due to increased layoffs or delays in spending, it will directly impact corporate earnings and likely trigger a correction in stock valuations. Employed consumers spend; to date, that narrative remains intact.
- Investors will likely focus more on **profitability derived from AI capex spending** than just high investment and revenue from chip companies. We are still likely in the early innings of this AI cycle, but whether capital continues to flow to the concentrated mega-cap tech companies or to other sectors will likely be determined by which industries and companies can begin to tout improved earnings from AI implementation rather than just large-scale AI investment. This will be key not only for mega-cap tech stocks but also for other sectors that aim to benefit from their AI investments to increase productivity.
- We are closely monitoring the **private credit landscape**. The outlook for 2026 is characterized by a solid economic backdrop, continued market expansion and diversification, but also by credit quality concerns among the weakest borrowers. The asset class is becoming more mainstream, attracting a wide range of new investors. Any further dislocation in the private credit market could create opportunities, though conditions will remain highly manager- and structure-dependent.

As 2025 draws to a close, the year's market experience serves as a reminder that periods of volatility and uncertainty are an inherent part of market cycles. While headlines often dominate short-term narratives, longer-term outcomes continue to be shaped by fundamentals, discipline, and resilience. These dynamics will remain central as markets move into 2026.

If you have any questions or want to learn more, please visit hbwealth.com, call 404.264.1400, or send an email to info@hbwealth.com.

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