



2025 Fourth Quarter Wrap-up

Key Updates on the Economy & Markets

Markets navigated a complex environment in Q4. The quarter started with a U.S. government shutdown, which lasted 43 days and delayed key economic data releases. The lack of timely information made it difficult to assess the U.S. economy’s strength and contributed to periods of volatility as the market reacted to incomplete information. The Fed cut interest rates by 0.50% but signaled a pause, hinting that it could cut less than the market expects in 2026. Investors remain excited about the potential of artificial intelligence, but they’ve become more focused on which companies are best positioned to turn AI demand into near-term profits. Against this backdrop, the S&P 500, Nasdaq, and small-cap stocks each set new highs. In this letter, we recap the last quarter’s defining themes and events, review performance across key market areas, and look ahead to 2026.

Government Shutdown Creates a Data Fog

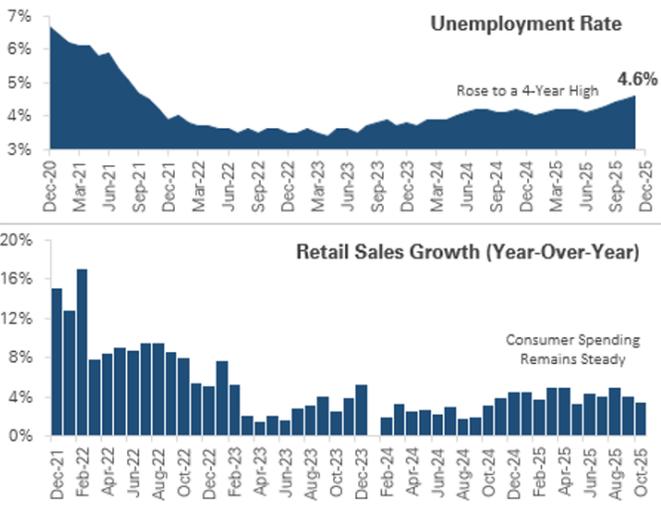
The main story in Q4 was the government shutdown and its impact on U.S. economic visibility. The shutdown started on October 1st and immediately disrupted the release of key reports on employment, inflation, and growth. To fill the data gap, the market and economists turned to corporate earnings reports and surveys from non-government sources. The shutdown lasted through mid-November, making it the longest in history, and it left behind a data backlog that is still being cleared as the new year begins.

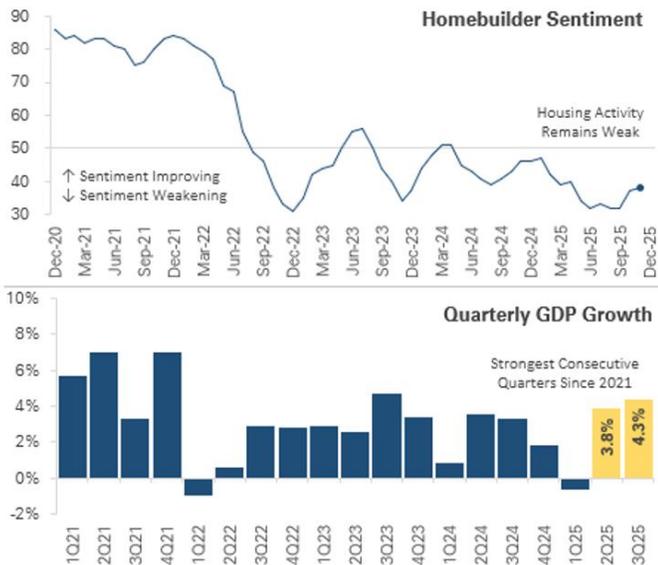
The stacked charts in Figure 1 over the next two pages provide an update on the U.S. economy using labor, consumer spending, and housing data released after the shutdown. The top chart shows labor market conditions continued to soften in Q4, with unemployment rising to a four-year high as hiring slowed. The second chart, which graphs the year-over-year growth rate of retail sales, highlights the consumer’s resilience. Consumer spending

has cooled since 2022, but it remains steady despite affordability challenges and persistent inflation. The third chart graphs the homebuilder sentiment index, where readings above 50 signal positive sentiment. The index ticked higher in recent months, but it remains below 50, an indication that housing activity continues to run below the pre-pandemic trend. The bottom chart shows GDP growth rose to 4.3% in Q3, up from Q2’s 3.8%. Those are the strongest consecutive quarters of growth since 2021.

The data reveals a late-cycle economy that is slowing but not breaking. Labor market conditions are soft, consumer spending is slowing, and housing is under pressure, but the economy shows few signs of significant stress. The strong Q3 GDP reading indicates the U.S. economy reaccelerated after slowing in Q1, suggesting consumers and businesses altered their behavior in 2025 due to shifting trade policy and tariffs. Now that the trade policy uncertainty has eased, there’s a debate about where economic activity will settle in 2026. The uncertainty explains the Federal Reserve’s cautious tone and the market’s heightened sensitivity to new data.

FIGURE 1 – The State of the U.S. Economy Entering 2026





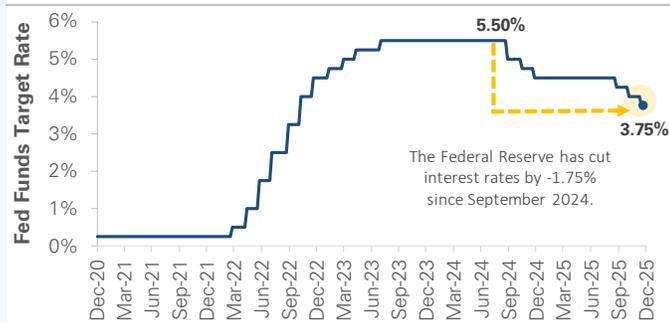
Source: Department of Labor, U.S. Census Bureau, NAHB, & U.S. Bureau of Economic Analysis. Time Period: December 2020 to December 2025. Latest available data as of 12/31/2025.

Figure 1 (continued)

Fed Cuts Twice but Signals a Pause in Early 2026

The Federal Reserve (Fed) continued its rate-cutting cycle in Q4, but policymakers delivered a more nuanced message than simply lowering rates and offering forward guidance. Figure 2 below shows the Fed has cut interest rates by a total of 1.75% since starting its rate-cutting cycle in September 2024. Two of those cuts came in Q4, with 0.25% reductions at the October and December meetings. However, the messaging behind the two cuts changed. Officials have grown more cautious and divided, with several voting members favoring either no cut or a larger cut, and they've emphasized that future rate cuts will depend on incoming data.

FIGURE 2 – Federal Reserve Cuts Interest Rates Twice in Q4



Source: Federal Reserve. Time Period: December 2020 to December 2025. Latest available data as of 12/31/2025.

By comparison, the Bank of Canada here has lowered its targeted overnight rate now by a total of 2.75% since June 2024, with our current rate now 1.5% lower than in the U.S.

Uncertainty around Fed policy led to wide swings in market expectations. Investors flipped between pricing in multiple rate cuts and a slower, cautious rate-cutting cycle. Fed officials themselves appeared divided, with some warning that policy remains too restrictive and risks slowing economic growth while others caution that cutting too soon could reignite inflation. The shutdown added to the confusion by delaying key economic data, making Fed policy a source of near-term uncertainty and market volatility.

The question is what happens next. By quarter-end, Fed officials made clear that the threshold for additional rate hikes is high, but they also stressed the need for flexibility and patience. The current backdrop is a mix of cooling inflation, a soft labor market, and a still-expanding economy. Looking at Figure 2, the setup is similar to late 2024, when the Fed cut multiple times before pausing for nine months. This time it's the shutdown data fog making it difficult for the Fed to forecast policy. The Fed has signaled that it will pause in early 2026 and potentially cut fewer times than the market expects. The prospect of additional rate cuts and lower interest rates is supportive in principle, but the policy outlook is now more sensitive to incoming data. That sensitivity contributed to the Q4 stock market volatility, and it will likely remain a market driver in early 2026.

The AI Trade Becomes More Selective

Artificial intelligence remained a key global investment theme in Q4, but the narrative matured. AI stocks entered the quarter with strong momentum, powered by robust earnings, a boom in data center construction, and a growing list of large-scale infrastructure investment projects. Investors were optimistic that AI capex would translate into growth and increased profitability, and many AI-related stocks benefited from broad enthusiasm toward the industry.

Midway through the quarter, the market's focus shifted. Earnings reports continued to signal strong demand for AI-related computing power and data centers, and leading tech companies reported large, growing backlogs. However, investors started to look beyond headline growth and focus on AI's economics. Questions emerged about the capital needed to build and maintain data centers, the impact of aggressive capex spending on balance sheets, and whether companies could maintain the current pace of AI infrastructure spending without pressuring cash flow.

The market became more selective. Companies involved in large-scale AI projects faced increased scrutiny, especially where spending plans outpaced near-term cash flow or relied on external financing like debt. Strong earnings and

ambitious spending plans were no longer enough to push a company's stock price higher, and sector leadership shifted toward firms demonstrating pricing power and a path to profitability. The changing AI narrative created periods of volatility and rotation within the tech sector, but it doesn't necessarily mean the end of the AI trade. As with many transformative technologies, the initial excitement appears to be giving way to a focus on execution and profitability rather than broad enthusiasm and growth at any cost.

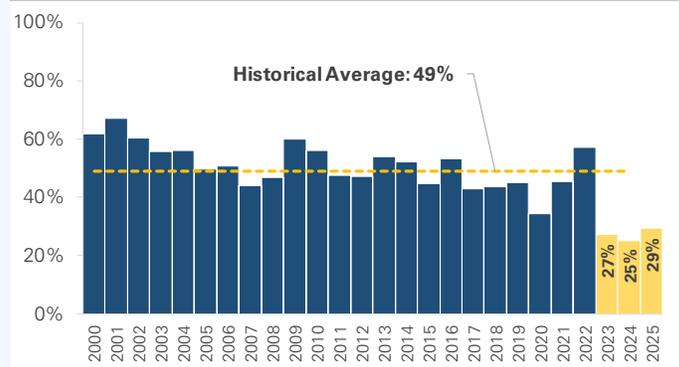
Equity Market Recap – Stock Market Ends the Year Near All-Time Highs

Stocks closed out the year with another quarter of gains, building on their momentum from earlier in the year. The S&P 500 Index gained 2.7% in Q4, bringing its 2025 calendar year total return to 17.9% (12.4% in CAD). The headline return was constructive, but the main development was a shift in market leadership. Large-cap value proxies led the market in Q4, with the Dow Jones Industrial Average and the Russell 1000 Value Index each gaining approximately 4%. The Russell 2000 (U.S. small caps) gained 2.2%, with small-cap stocks rallying to new highs as the Fed cut twice.

Meanwhile, the S&P/TSX Composite gained an even larger 5.6% in Q4, raising its 2025 total return to a very strong 28.2% for its best year since 2009. The primary strength for the Canadian stock market was the S&P/TSX Capped Materials Index, which returned a jaw-dropping 100.6% in 2025 which was by far the largest calendar year return ever for the sector. This index is comprised of Canadian companies in the Materials industry, including those in metal and gold mining, base metal production, and the production of chemicals, construction materials and forest materials. However, the largest constituents of this sector are major precious metals companies like Agnico Eagle, Barrick, Wheaton, Franco-Nevada and Kinross. This may not be a surprise to some, with the price of gold and silver up a whopping 65% and 151% last year.

Despite solid gains across North American stock markets, the pace of the rally in the U.S. continued to slow from the second and third quarters. Q4 sector breadth also remained narrow, with only two S&P 500 sectors outperforming the broader index. Health care was the top-performing U.S. sector, benefiting from renewed interest amid increased AI scrutiny and a pause in tech leadership. The sector's defensiveness and improved earnings stability were catalysts, but the quarter wasn't defined by a flight to safety. The defensive trio of real estate, utilities, and consumer staples were the weakest sectors, signaling limited investor concern about the economy.

FIGURE 3 – Percentage of S&P 500 Stocks Outperforming the Index



Source: MarketDesk. Data represents the percentage of S&P 500 stocks that outperformed the index each calendar year. Time Period: 2000 to 2025. Latest available data as of 12/31/2025.

The shift in market leadership was modest, but it was notable. As shown in Figure 3 above, the percentage of S&P 500 companies outperforming the index has hovered around 30% in the past three years. Those are significantly below the historical average of 49% and the three lowest years since 2000, illustrating how a small group of stocks has driven the S&P 500's gains. The Q4 rotation occurred as the Fed cut interest rates twice, a move that the market believes will ease pressure on companies. Meanwhile, the AI trade in the stock market is becoming more selective as it enters its fourth year. The combination of lower interest rates and increased AI scrutiny could create opportunities for new leadership. If more companies start to outperform, it will represent a significant trend change in the market.

International stocks continued to outperform U.S. stocks, extending their gains from earlier in the year. Both developed and emerging market indices gained well over 3% in Q4 in CAD. For the full year, they returned 25.1% and 27.3% in CAD and outperformed the S&P 500 by double digit percentages. Their outperformance isn't a case of U.S. weakness, with the S&P 500 gaining nearly 12.4% in CAD, but rather broad international strength. A weaker U.S. dollar played a significant role, with the softness driven by rising trade tensions, policy uncertainty, and a rotation toward international stocks.

Credit Market Recap – Bonds Trade Sideways

The overall bond market was relatively quiet in Q4. As discussed earlier, the focus centered around the Fed's rate cut plans. Yields on shorter maturity U.S. Treasury bonds fell as the Fed cut twice, while longer maturity yields ended the quarter modestly higher as economic activity remained solid and inflation remained stuck near 3%. Overall, the U.S. bond market has transitioned from a source of volatility during the Fed's 2022-2023 rate-hiking cycle to relative stability and a source of income in 2025. Changing rate cut expectations

and economic uncertainty have triggered periodic volatility, but the overall path has been smoother.

Corporate bonds traded higher in Q4. Credit spreads widened during periods of stock market volatility, but the moves were orderly and short-lived. The investment-grade and high-yield bond markets showed few signs of stress, and default expectations remained low. Both U.S. investment-grade and high-yield bonds gained roughly 1% for the quarter, capping off strong full-year returns of approximately 8%. Domestically, bond markets returns were generally weaker, with the S&P Canada Aggregate Bond Index returning 2.5% last year. The Canadian investment-grade and high-yield corporate bond markets gained 4.2% and 6.5%, respectively.

As the new year begins, credit spreads remain tight by historical standards. Investment-grade and high-yield spreads are at their tightest levels in decades, signaling investor confidence in corporate fundamentals and the economy. While spread tightening has supported corporate bond returns, it means valuations are no longer cheap. Corporate bonds offer compelling yields for income-focused investors, but they also come with important trade-offs. When spreads are this tight, there's less margin of safety if earnings or economic growth disappoint. For investors, it's important to balance the income potential with credit risk.

2026 Outlook – Market Strength Raises the Bar

Before we turn the page to 2026, it's worth reflecting on a year that was both eventful and remarkably calm outside of some heightened volatility in March/April. The year began with the stock market hitting new highs in February, only to reverse sharply as trade policy uncertainty triggered a nearly 20% sell-off. However, the sell-off set the stage for one of the strongest recoveries in decades. Fueled by AI enthusiasm, rate cut expectations, strong corporate earnings, and resilient economic growth, the S&P 500 set more than 35 new highs through year-end.

North American equity markets enjoyed their third consecutive year of double-digit gains. It's been an impressive post-global pandemic run that included aggressive rate hikes and the rise of AI. Through it all, the stock market's gains have been supported by solid economic growth and strong corporate earnings. Looking ahead, the bar is now higher. Today's starting point is very different than a few years ago, or even last year. Stock valuations are

more expensive, credit spreads are near their tightest levels in decades, and expectations for earnings and economic growth are high. None of these are red flags on their own, but they frame a market that already prices in rate cuts, strong earnings, solid economic growth, and the AI industry's growth. The combination doesn't necessarily signal a stock market sell-off, but it leaves less room for positive surprises.

Despite the higher starting point, there are many positives. The tech sector is experiencing a wave of innovation not seen since the internet era of the late 1990s. Companies are generating record profits. The S&P 500's earnings grew by double digits the past two years, with expectations for solid growth in 2026. Consumers, the engine of the U.S. economy, continue to spend. Interest rates are coming down, which could unlock economic activity that higher rates delayed the past few years. Financial markets are open and functioning, and there's no clear sign of systemic stress.

As we turn the page to 2026, it's important to keep the big picture in mind. Markets have delivered impressive returns over the past few years, but each year brings its own surprises. The market's recent strong advance and the steep correction earlier last year, are a good reminder that investing is a marathon, not a sprint. We can't predict what lies ahead, but we believe a disciplined approach focused on long-term goals, diversification, and risk management is the best way to navigate the market. Our team will continue to closely monitor incoming economic data and evolving market trends to help ensure portfolios remain aligned with your long-term objectives, regardless of what the market does in the short term.

Thank you for your continued trust in Milestone and for the opportunity to assist you in working toward your financial goals. We understand the risks and opportunities facing the markets and the economy and are committed to helping you effectively navigate all investment environments by maintaining a globally diversified portfolio designed to weather the market's swings, aligned with your long-term goals. Market volatility can be unsettling, but it's a normal part of investing. Therefore, it's critical to stay invested, remain patient, and stick to the plan, as we've collaborated with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

Here is our Milestone Quarterly Market Report on economic data, capital markets, commodities, and currencies through December 31st, 2025:

Economic Data*				Equity Markets			Fixed Income		
Canada - Key Indicators				Canada			Bond Indices		
	<u>Level</u>	<u>Report Date</u>	<u>Prior Quarter</u>		<u>Level</u>	<u>YTD Chg (%)</u>		<u>Level</u>	<u>YTD Chg (%)</u>
Real GDP (Annualized %)	2.6	30-Sep	-1.8	S&P/TSX Composite	31713	28.2	S&P Canada Aggregate	520	2.48
Headline CPI (YoY%)	2.2	28-Nov	2.2	S&P/TSX Small Cap	1197	47.0	S&P Canada Inv-Grade Corporate	365	4.21
Core CPI (YoY%)	2.9	28-Nov	2.9	U.S. (USD)	<u>Level</u>	<u>YTD Chg (%)</u>	S&P/TSX Preferred Share Index	2446	16.03
Unemployment Rate (%)	6.5	28-Nov	6.9	S&P 500 Index (CAD)	7261	10.9	U.S. High Yield (ICE BofAM)	1867	8.50
Consumer Confidence	47.4	28-Nov	46.0	S&P 500 Index	6846	16.4	Government Bond Yields	10-Yr Bond	30-Yr Bond
Retail Sales (YoY%)	2.0	31-Oct	3.1	S&P 500 Equal Weight Index	7764	9.3	Canada	3.44	3.86
S&P Manufacturing PMI	48.6	31-Dec	47.7	Dow Jones Industrials Average	48063	13.0	U.S.	4.14	4.84
House Price Index* (YoY%)	-2.8	30-Nov	-2.5	Nasdaq Composite	23242	20.4	Policy Rates		
U.S. - Key Indicators	<u>Level</u>	<u>Report Date</u>	<u>Prior Quarter</u>	Russell 2000 SmallCap	2482	11.3		<u>Target (%)</u>	<u>Next Mtg</u>
Real GDP (Annualized %)	4.3	30-Sep	3.8	International (Local)	<u>Level</u>	<u>YTD Chg (%)</u>	Bank of Canada	2.25	28-Jan
Headline CPI (YoY%)	2.7	30-Nov	3.0	MSCI World	3434	16.9	U.S. Federal Reserve	3.50 - 3.75	28-Jan
Core CPI (YoY%)	2.6	30-Nov	3.0	MSCI EAFE	2893	27.9	European Central Bank	2.15	5-Feb
Unemployment Rate (%)	4.6	30-Nov	4.4	MSCI EM	87315	28.3	Currencies		
Chg NonFarm Payrolls (000s)	64	30-Nov	108	Shanghai Composite	4161	18.4		<u>Rate</u>	<u>YTD Chg (%)</u>
CB Consumer Confidence	89.1	31-Dec	94.2	Commodity Prices			US Dollar (per CAD)	1.3729	-4.6
Retail Sales (YoY%)	3.5	31-Oct	4.2		<u>Level</u>	<u>YTD Chg (%)</u>	Euro (per CAD)	1.61013	8.1
Housing Starts (000s, saar)	1310	31-Aug	1380	Crude Oil WTI (US\$/bbl)	57.26	-21.0	British Pound (per CAD)	1.8455	2.5
Case-Shiller House Price (YoY%)	1.3	31-Oct	1.4	Natural Gas (US\$/MMBtu)	3.69	1.7	US Dollar (per JPY)	156.876	-0.3
ISM Manufacturing PMI	47.9	31-Dec	49.1	Gold (US\$/troy oz)	4325	64.7	US Dollar Index	98.32	-9.4

Source: TD Asset Management, Trading Economics, Market Watch, CNBC, FRED, Google Finance

*Teranet & National Bank National Composite House Price Index™

Note: Equity returns are price returns not total return

Disclosure:

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Sources: Bloomberg, Barchart, TD Asset Management, Trading Economics, Teranet & National Bank of Canada, Barchart, MarketDesk Research LLC, S&P Global, Russell Indices, MSCI, U.S. Department of Labor, U.S. Federal Reserve, U.S. Census Bureau, NAHB & U.S. Bureau of Economic Analysis

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