

MARKET INSIGHTS

DECEMBER 2025



Heading into year-end, the macro environment is back to Quad 1, with growth expected to positively inflect amid elevated but steady inflation. This followed a brief challenge of Quad 4 conditions that emerged in mid-to-late November. In our last issue, we highlighted the unfavorable outlook for 1-3 months, marking the second such occurrence this year, the first being in January before Liberation Day. If this signal holds, it suggests a risk-off phase transition isn't off the table.

The larger concern now is the Federal Reserve is increasingly falling behind the curve. Normally, Fed funds would be positioned roughly 100 to 120 basis points below long-term rates. Currently, they sit about 100 basis points above where market forces would suggest a neutral setting should be. The U-shaped slowdown in the latter half of 2025 provided the Fed with multiple data points justifying the continuation of last year's rate cuts. However, stubborn inflation has created internal disagreements, slowing this process. This conflict is evident in the wider range of perspectives seen in the Fed's "dot plot," which projects policy rates. If the Fed were on target, such divergent views might be constructive. However, their current lagging position means any hesitation may worsen their delay in response.

Previously, we discussed how the Treasury's record debt sales into a dwindling buyer pool would ultimately lead to the Fed monetizing that debt, a form of "QE" but under a different name. The recent introduction of Reserve Management Operating Purchases (RMOP) is a manifestation of this. The Fed will print bank reserves to buy Treasury Bills. Unlike previous Quantitative Easing, this initiative does not include long-duration assets but serves as a buyer for T-bills just as the Treasury's Quarterly Refunding Announcement indicates ongoing substantial bill issuance. Additionally, recent legislation requiring stable coins to be backed by T-bills contributes to this effect.

With spending cuts proving ineffective, the Administration aims to reduce the deficit through the interest expense channel by generating buyers for T-bills, lowering short-term rates, and having the Treasury issue as many T-bills as possible. Expect the Fed to carefully assert that RMOP is not a form of monetization but a measure to ensure system-wide financial stability.

While debt monetization can have long-term negative repercussions, the K-Shaped Economy—where the top 10% of income earners can save while 60-70 million households struggle—poses a more destabilizing threat. The persistent structural budget deficits lead the Treasury to crowd out private investment, exacerbating pressures on lower-income households. Although monetization may not be ideal, it can alleviate some crowding out.

For markets, breadth is improving, consistent with a Quad 1 environment, though the respect for the ongoing Quad 4 challenge necessitates risk discipline. Equities show rotation rather than deterioration, while fixed income favors short-to-intermediate duration and high-quality credit. Curve volatility may fluctuate depending

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on Fed communication clarity. The bottom line is clear: the outlook for 2026 is constructive, but December highlights that policy remains misaligned with market conditions. The Fed must catch up before it can engage in internal debates or shift to a more adaptable approach. Until that alignment is achieved, investors should anticipate mixed signals, inconsistent communication, and a continued focus on quality and liquidity.

ASSET CLASS SIGNAL STRENGTH:

ASSET CLASS	DECEMBER 2025	NOVEMBER 2025	1 - 3 MONTH OUTLOOK *
EQUITIES	OFFENSIVE LONG	OFFENSIVE LONG	UNFAVORABLE
FIXED INCOME	OFFENSIVE LONG	DEFENSIVE LONG	FAVORABLE
COMMODITIES	DEFENSIVE LONG	DEFENSIVE LONG	UNFAVORABLE
US DOLLAR	OFFENSIVE SHORT	OFFENSIVE SHORT	FAVORABLE
RFR (3M TBILL)	OFFENSIVE SHORT	OFFENSIVE SHORT	UNFAVORABLE
BITCOIN	OFFENSIVE LONG	OFFENSIVE LONG	UNFAVORABLE

PORTFOLIO SNAPSHOT *(current exposure relative to target range)*

MODEL	EQUITIES			FIXED INCOME		
	RANGE	DEC 2025	NOV 2025	RANGE	DEC 2025	NOV 2025
BOND	--	--	--	-25 to 100%	45%	45%
PEA CORE STOCK	100%	100%	100%	--	--	--
MODERATE ARM	30 to 60%	60%	45%	10 to 40%	35%	20%
DIVIDEND INCOME	30 to 60%	50%	45%	10 to 40%	40%	20%
MACRO PERSIST	-40 to 40%	20%	20%	-40 to 40%	40%	30%
SYSTEMATIC MACRO	0 to 60%	60%	30%	--	--	--
ALL ASSET	-25 to 100%	60%	40%	-25 to 100%	30%	15%
FOCUS	-100 to 300%	10%	10%	-100 to 300%	23%	23%
Special Situation Equity	0 to 100%	85%	85%	--	--	--

CURRENT MARKET REGIME: *current conviction score 88%*

Quadrant	MARKET REGIME	
	Current % Share	Previous % Share
GOLDSILKS / Quad 1	42%	41%
REFLATION / Quad 2	32%	31%
INFLATION / Quad 3	7%	7%
DEFLATION / Quad 4	19%	21%

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