

A Bank Built on a Strong Foundation

December 2025 Capital Markets Commentary

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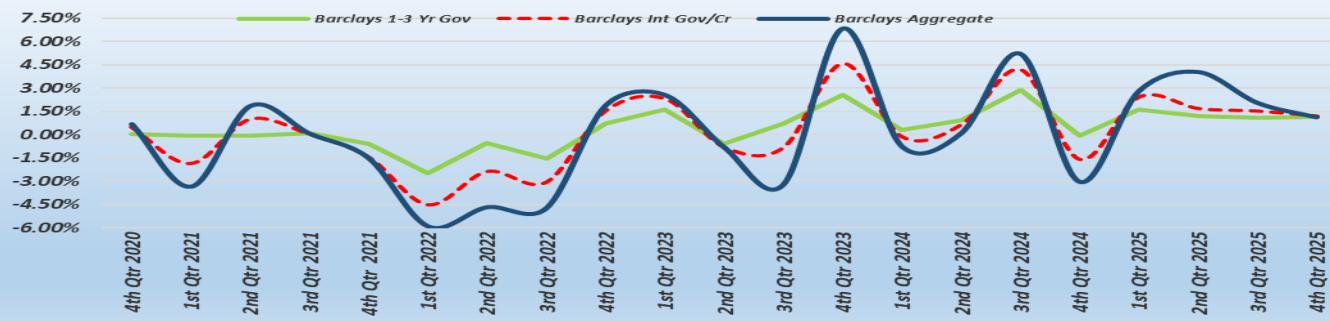
“A man always has two reasons for what he does – a good one, and the real one.” **John Pierpont Morgan**

Fixed Income

December 2025 ended with a whimper, but the 4th quarter, as well as the full year of 2025, had positive returns. This quarter was again characterized by geopolitical tensions – due to US tariffs, emigration tensions in the US, ongoing problems in the Middle East, the continued turmoil between Russia and Ukraine, and now Venezuela. That said, the bond market was positive to end the quarter. Also, for the full year, this was the strongest year in long term bonds since 2019. The Treasury curve yield was flat across the maturity spectrum during the 4th quarter with the 10-year Treasury closing at 4.18%. With the US Treasury curve rallying from its highs in January of almost 4.80% on the 10-year, spreads tightened on US Agency and Corporate securities to their tightest level since the late 1980’s. During the quarter, the Federal Open Market Committee (FOMC) did lower their overnight rate by 0.25% at their October and December meetings. As the quarter ended, in a year full of uncertainty over tariffs, trade, and global tensions, financial markets were thrown another curveball as the U.S. government shut down (again), for 43 days.

As yields stayed relatively low, returns were positive across all parts of the curve during the quarter. The Barclays U.S. Aggregate posted a +1.10% return for the quarter, and the Barclays Intermediate Index was at +1.19%. The short end of the yield-curve also saw positive returns, with the 1-3 Year Government Index at +1.13%. On the truly short end of the yield curve, you also saw positive returns. The 1-Year T-Bill returned +1.00% for the quarter. As for yields, the 10-year Treasury yield ended the quarter at 4.18%, the 5-year Treasury yield ended at 3.73%, and the 2-year Treasury yield ended at 3.47%. (As of the end of December 2025, yields were higher by 40 to 65 basis points across the curve.)

5 Year Quarterly Historical Return Comparison



Fixed Income Markets - Looking Ahead

At the most recent FOMC meeting in December, the FOMC again lowered the Fed Funds rate by 25 basis points. This was due in large part to the employment numbers, although as mentioned in September, political pressure probably had some weight.

2025 was a great year for most fixed income markets, but as we proceed, we enter 2026 with caution. All-in yields are still attractive for most markets, but spreads are narrow, and that suggests investors aren’t getting paid to take on credit risk currently. Federal Reserve (Fed) policy will be key in determining returns in 2026, but with a new Fed Chair expected by May, rate volatility will probably remain elevated. Every year, fixed income investors would reasonably expect to receive coupon-like returns, plus or minus price appreciation based upon changing interest rates. But expectations of a rangebound rate environment in 2026, could push returns to be primarily income-driven.

As we move through the 1st quarter, tariffs may still cause problems, but inflation’s persistence will influence monetary policy. However, tariffs can and probably will further undermine consumer and business confidence and raise prices while weighing on sentiment and activity.

For 2026, the Federal Reserve’s stance will be crucial to both the Fixed Income and Equity markets. The 2026 fixed income outlook may be in for a rangebound rate environment, due to a cautious Fed policy, and a modest increase in spreads within corporate credit markets. Expectations are that the Fed will lower the fed funds rate to around 3%. This will likely keep the 10-year Treasury yield between 3.75% and 4.25%.

Equity

Another positive quarter. The equity market, as measured by the S&P 500 Index, rose +2.65% in the 4th quarter.

In the 4th quarter of 2025, stock markets again delivered positive returns, with global equities reaching new highs and AI continuing to drive performance. The Federal Reserve cut interest rates twice and ended quantitative tightening. The S&P 500 had its third yearly double digit return in 3 years as the Federal Reserve (Fed) made three rate cuts in the last four months of 2025.

Stock markets hit all-time highs in the quarter, led by international stocks. US earnings continued to surprise to the upside. Neither the government shutdown, loss of immigrant labor, nor tariff policies seem to have derailed strong GDP growth. There have been few job losses, though hiring has slowed down and unemployment has ticked up. The Federal Reserve (“The Fed”) cut interest rates 0.25% in both October and December and announced they will no longer shrink the balance sheet. This has added acceptance to the market’s view that the Fed will abandon its fight against inflation and easy monetary policies despite higher-than target inflation, which is a positive in the short term for earnings growth.

For the quarter and the year, stocks were up across all major US market segments, non-US stocks continued to deliver positive results, and bonds added value. For the quarter, the S&P 500 gained +2.65%, slightly ahead of the +2.18% return from small caps (Russell 2000). Although the MSCI EAFE index outperformed the S&P 500 for the quarter, on a year-to-date basis the return on the MSCI EAFE is almost 15.0% higher than the S&P 500 Index. This seems to be a continuation of the U.S. dollar weakness in Europe.

All indexes were positive for the quarter. On the US side, the Dow returned +4.02%, the S P 500 Index returned +2.65%, the Russell 1000 Index ended with positive +2.18% return, and the Russell 2000 Index returned +2.18%. As mentioned, the international markets posted a positive return at +4.91% on the EAFE for the quarter.



The Economy

The Economy. Where do we go from here?

In the 4th quarter of 2025, the US economy continued to demonstrate continued resilience amid aggressive trade policies and increased geopolitical tensions.

In 2025, the US economy proved surprisingly durable, navigating a high-stakes environment of major policy shifts. After a rocky start to the year characterized by a sharp contraction in the first quarter, the economy rebounded strongly. By the third quarter, real GDP surged to an annual rate of 4.3%, driven by robust consumer spending and a massive wave of investment in Artificial Intelligence.

During the 4th quarter, the Federal Reserve continued its transition toward easing, having implemented additional rate cuts earlier in the second half of 2025. Policymakers continued to emphasize a data-dependent approach, supporting expectations for a gradual easing policy path into 2026. As the quarter ended, inflation continued to slow, labor conditions softened, and consumer spending remained resilient. However, the quarter did create headlines which caused political and tariff-related uncertainty, and although they did not substantially change market behavior, December returns in both the Bond and Equity markets took notice.

Amid the growing signs of weakness in the labor market, the Fed opted to cut rates 25bps to a range of 3.50% to 3.75% at the latest December FOMC meeting. There were, however, several Fed officials that voted for no additional reductions in December, underscoring a growing divide between those that fear the policy remains too restrictive and risks slowing economic growth while others caution that continued cutting could reignite inflation.

The Economy - Looking Ahead

Inflation? Economic Growth? Tariffs? Recession? Geopolitical problems?

As we begin the 1st quarter of 2026, we are almost in the same position we were at the beginning of the 4th quarter of 2025. There is a constructive but less optimistic economic outlook for the US. But indicators look favorable for the US economy with continued growth (albeit slower).

As 2026 begins, the Federal Reserve is stirring the pot to get a delicate balance between further monetary easing and maintaining inflation credibility. After rate cuts that brought the Federal Funds rate to the 3.50%–3.75% range, officials and market forecasters suggest that there may be a pause in the easing policy, with the potential for additional cuts later, depending on inflation and labor market data. Inflation does remains above the Fed's 2% target but is trending lower, supporting the cautious easing stance.

Minutes from the Fed's December meeting noted that most of the members of the Open Market Committee felt that rate cuts are likely to be appropriate next year if inflation eases over time. Still, policymakers were divided in their assessment of risks between higher inflation and unemployment, with a part of the FOMC displaying greater concern that the risk of inflation becoming entrenched may require higher borrowing costs, while others preferred additional rate cuts to curb signs of a softening labor market.

Going forward there is the problem of the pending transition in leadership, with Jerome Powell's term ending and potential successors under consideration. This adds a layer of uncertainty to Fed Policy. While some candidates are perceived as more dovish, there's also clear division within the Fed on how quickly and how far to ease policy. Still, inflation isn't going away just yet and might not fall significantly during the first half of 2026.

As we move through the year, this lingering inflation could complicate the Federal Reserve's rate-cutting strategy and keep long-term interest rates elevated longer than anticipated. That said, decisions will continue to remain highly data-dependent throughout 2026.

For 2026, the Federal Reserve's stance will be crucial to the markets. Expectations are that the FOMC will possibly cut rates to as low as 3% by year end 2026. However, the Fed (or the current makeup of it) still has the priority of inflation reduction and full employment. With tariff-related pressures emerging in the job market, full employment going forward may be hard to come by. Stay tuned, it could be a wild ride in 2026!

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