THE FINANCE COUPLE™
TWO PERSPECTIVES WITH ONE FOCUS... YOU

A Review of 2025 and Preview of 2026

January 2026

"To expect the unexpected shows a thoroughly modern intellect." – *Oscar Wilde*

Well, what can we say other than, how fun was that?! Seriously, the equity markets, here there and almost everywhere, had a banner year, again. The S&P 500 went up almost 18%, the MSCI EAFE Index (international developed countries) went up 31%, and the MSCI Emerging Market Index went up 34%. I guess our optimism from twelve months ago was not misplaced; not taking credit for anything here, as the only ever hard fact is that the future is unknown and unknowable, but "the presidential election cycle, and/or FOMO (Fear Of Missing Out), and/or TINA (There Is No Alternative)" helped stocks continue to climb the so-called "wall of worry". What did *not* propel stocks higher, in our opinion, is valuation. And now, the S&P 500 is even more expensive; it trades for over 31 P/E (price/earnings; mean of 15 since 1870) and over 40 CAPE (cyclically adjusted P/E; mean of 17 and historical high of 44). Which is why, though we remain optimistic for the short(er) term, we are even more skeptical, and cynical, of the next few years.

Our skepticism and cynicism is because we believe there will eventually be a reversion to mean or long-term average. Take the P/E's quoted above; we believe sooner or later valuations will trend back down to their long-term averages. Similarly, after the S&P 500 has averaged 16% per year over the last five years, it may offer poor returns soon enough so as to revert back to its long-term average of 10-11%. The markets overseas make more sense to us; not only were they undervalued on a relative basis, and still are, but they've underperformed the S&P 500 for a long stretch of time – which could explain why they did so much better than the S&P 500 last year.

Collaterally, this is why we never vary from diversification principles, as no one knows when one market will inevitably outperform another; if we had told you twelve months ago that emerging market stocks were going to do twice as well as U.S. stocks you probably would have thought we're crazy! But again, valuations and averages do matter, eventually (by the way, currently the S&P 500's P/E is 50% higher than the S&P 600's P/E; the former are large cap stocks, the latter are small caps). A good example of this reversion to means and valuation comes from the 1990's. In December of 1996, former Federal Reserve chairman Alan Greenspan said there was irrational exuberance in the stock market; he knew full well the future is unpredictable but long-term averages tend to persist in the future. He wasn't wrong, he was just early – and we believe it's better to be early rather than late on this type of warning.

As for bonds, the other major asset class, we do not love or hate them; we simply believe different asset classes serve different purposes. With bonds, we believe they may act as a ballast against the volatility of stocks, but even more importantly they can provide an investor with the one and only thing we believe may reduce risk in stocks: time. If you use bonds, which most people think are boring, for your short-term needs, then you can allow your stocks to outperform (hopefully) over the long-term (which we define as 10 years or more). With that being said, we would not call bonds boring as they can be as volatile as stocks, especially when it comes to longer-term bonds (think 10-30 year maturities). And remember, the bond market (basically all bond investors) has a mind of its own, which is why James Carville wants “to come back as the bond market; you can intimidate everybody.”

Currently, the 10-year U.S. Treasury bond, (a barometer for 30 year mortgages) yields 4.22% and the 30-year yields 4.8% The difference between the 30-year rate and the current Fed Funds rate (a short-term rate set by the Federal Reserve, currently 3.6%) is pretty small by historical standards; if or when it widens, it is probably because long-term rates are going up. In the “careful-what-you-ask-for” category, remember that if short-term rates go down (due to any number of reasons), creating looser short-term monetary conditions, then long-term rates may actually go up as the bond market anticipates more inflation in the future (confusing, counterintuitive, and ironic all at once!). Add to the mix an uncontrollable and uncontrolled deficit, which should increase U.S. Treasury bond issuance (more supply brings lower values and higher rates), and we may get a very intimidating bond market. Sure, the politicians can talk a good game about controlling rates, but no one has successfully intimidated the bond market into submission.

Speaking of politicians, let’s talk about governmental policy and/or free market interference without chatting up or down either party (personally, we think politicians on both sides of the aisle are doing a terrible job). Republicans and Democrats alike have been trying to control free markets; Biden did it and Trump’s doing it. But they need to be cognizant of unknown or unintended consequences. For instance, there is a new push to cap interest rates on credit card debt, something Donald Trump and Elizabeth Warren agree upon (talk about irony!). The fact of the matter is that although it’s a worthy endeavor to help those with debt burden, this can only be seen as governmental interference in free markets; it may help some people in the short term, but it could have unintended consequences to the economy in the long-term.

At the end of the day - and not wanting to end this newsletter on a negative note - I can tell you we remain optimists. But it is balanced optimism; we know successful planning (financial or otherwise) is based on preparing for the known and unknown as best as possible and not getting caught off guard by the unexpected. We take our jobs very seriously, on your behalf, and will always seek to plan successfully.

Have a wonderful 2026, and thanks so much for your friendship, your trust, and your referrals!

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