Wespath

A Message from Chief Investment Officer
Johara Farhadieh

Happy New Year! I hope your holidays were filled with joy and time with loved ones.

Global markets navigated an interesting backdrop in 2025: challenges like persistent inflation, a new administration, tariffs, rapidly evolving geopolitical tensions and questions about economic growth were contrasted by tailwinds like loose financial conditions and continued excitement about artificial intelligence.

The Magnificent 7 again dominated headlines, but their investment performance was more nuanced than in prior years (just two of the Mag 7 outperformed the Russell 3000 on the year). Concentration at the top remains a reality, and while flows into index funds reinforced that trend, we also saw promising signs of innovation beyond mega-cap tech. AI-related opportunities extended well beyond household names, reinforcing the importance of purposeful diversification and selective exposure.

Wespath's Year

At Wespath, we approached this environment with rigor and discipline, seeking to help clients tackle uncertainty while positioning their impactful missions for long-term growth. We delivered on key priorities like expanding choice for investors and strengthening our investment governance. And I'm confident that all our work—from re-reviewing equity fund strategies to launching a new international index product, formalizing new investment processes for clients, and more—has built a foundation that will serve our investors well in 2026 and beyond.

Going Forward

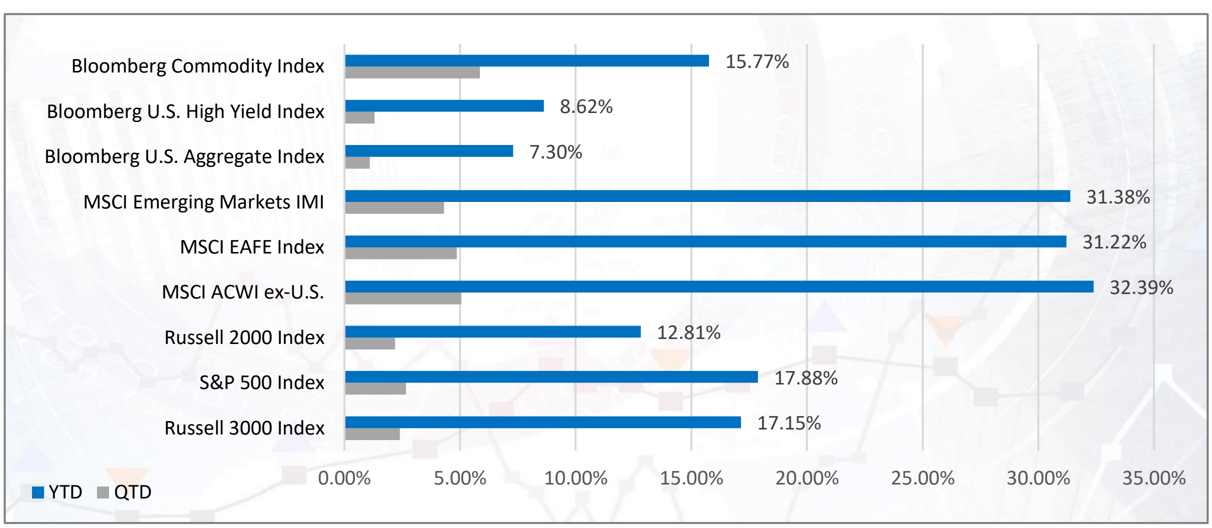
As we enter the new year, I'm thrilled to build on this momentum. Exciting focus areas for 2026 include opportunities in AI, the continued evolution of private markets, new equity fund launches and the expansion of our Positive Social Purpose Lending Program. Challenges and uncertainties remain, but our team and our disciplined approach position us to navigate what's next.

Thank you for your continued trust and partnership. At Wespath, we remain committed to helping you achieve your mission with confidence and care.

[1] *This letter is intended for institutional investor audiences. Wespath Benefits and Investments ("Wespath") is a general agency of The United Methodist Church, a 501(c)(3) tax-exempt organization. Wespath administers benefit plans and together with its subsidiaries, UMC Benefit Board, Inc. ("UMCBB") and Wespath Institutional Investments, LLC ("WII"), invests (or provides back-office services for) assets on behalf of benefit plan participants and beneficiaries, plan sponsors and other institutions controlled by, associated with or related to The United Methodist Church. The P Series funds are managed by UMCBB, and the I Series funds are managed by WII. As part of the Wespath organization, WII and UMCBB utilize certain shared personnel, including investment professionals. The shared personnel relationship is governed by the terms of a Dual Employee Agreement entered into by and among Wespath, WII and UMCBB. Unless otherwise noted, the firm referenced herein is defined to include Wespath, UMCBB and WII.*

Key Takeaways from Q4 and 2025

- **GDP:** U.S. GDP growth for the third quarter came in at annualized 4.3%, surpassing consensus estimates by 1.0%. A narrower trade deficit contributed to over one-third of the quarter's growth. The Atlanta Fed's latest GDPNow estimate is calling for Q4 growth of 3.0% (as of December 23, 2025).
- **Inflation:** Despite volatile tariff announcements and forecasts of rising inflation from many economists, inflation in 2025 declined in the year and stabilized near 2.8%.
- **Jobs:** The latest jobs report indicated a cooling labor market, with the unemployment rate increasing to a four-year high of 4.6%. That figure is 0.5% higher than the year-end 2024 result.
- **Government Shutdown:** Q4 witnessed a 43-day U.S. government shutdown, the longest in history. U.S. equities remained relatively stable during the shutdown, though volatility increased. Shutdowns can also have economic effects—primarily through labor market disruptions, delays in government data releases and heightened political uncertainty.
- **The Fed:** The U.S. Federal Reserve (Fed) delivered its third consecutive rate cut in December, lowering its target range to 3.50% – 3.75%. Futures markets now imply two to three rate cuts in 2026.
- **Stocks:** The S&P 500 gained 2.7% in Q4, bringing full year returns to 17.9%. International equities, as measured by the MSCI ACWI ex-U.S., gained 5.0% for the quarter and 32.4% for the year. This marked the first time since 2022 and only the third time in the last decade that international equities outperformed their U.S. counterparts. A decline in the U.S. dollar was a key driver of international equity's outperformance in 2025.
- **Bonds:** The U.S. Aggregate Bond Index rose 1.1% in Q4, ending the year with gains of 7.3%. Tight credit spreads and robust demand for attractive absolute yields were key drivers of performance throughout the year.



As of December 31, 2025

2025 Year in Review: A Tale of Two Halves

"It was the best of times, it was the worst of times."

In some ways, Charles Dickens' famous words capture the essence of 2025: The first half of the year tested investors with shocks and uncertainty, while the second half rewarded resilience and discipline. From tariff-driven volatility and stagflation fears to a rally fueled by rate cuts and global equity strength, 2025 reminded us that markets can pivot sharply—and that a long-term, diversified approach remains essential.

First Half: Policy Uncertainty

The opening months of the year were dominated by volatility and caution. Tariff announcements on "Liberation Day" in April triggered a sharp sell-off, with volatility spiking and the Russell 3000 plunging 12% in just a few short days. Trade tensions disrupted supply chains, fueled inflationary fears and weakened the U.S. dollar. Investor sentiment leaned defensive, with stagflation worries and geopolitical risks clouding the outlook.

Fixed income markets reflected this uncertainty: long-term U.S. Treasury yields climbed to 4.8% amid fiscal concerns, and credit spreads widened significantly. Meanwhile, equity markets showed signs of evolving leadership. New questions about a potential AI bubble emerged following the DeepSeek shock, and international stocks comfortably outperformed U.S. stocks.

Second Half: Resilience and Rotation

The second half of 2025 brought a notable shift in tone. While international equities ultimately outperformed U.S. stocks for the year, their leadership cooled later in the year as investor enthusiasm returned to the AI theme and U.S. mega-cap technology names regained momentum. At the same time, however, the narrative around artificial intelligence broadened beyond the mega-cap market leaders, and U.S. small-cap stocks emerged as a bright spot, returning 14.9% in the second half of the year as expectations for rate cuts grew.

Although tariff headlines continued to surface throughout the year, markets were far less reactive than in the spring. Instead, attention turned to the Fed's rate-cut cycle, labor market trends and broader economic resilience.

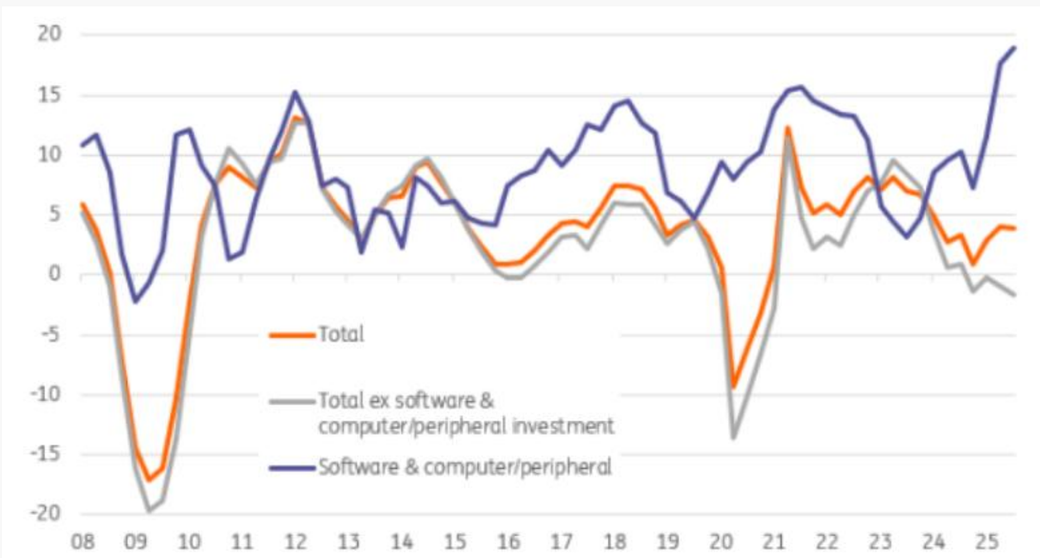
This pivot underscored a key lesson of 2025: headline risk can fade quickly when underlying fundamentals and liquidity conditions dominate investor attention.

Growth Posts Positive Surprise, Underscores Juxtaposition

The latest GDP read marked the sharpest annualized growth rate in two years, handily beating most economists' expectations. The Trump administration's trade policies were the primary driver of the beat, with lower imports (down ~5%) and higher exports (up ~9%) helping to narrow the trade deficit in the quarter. Consumer spending was another standout, rising 3.5% compared to consensus estimates of 2.7%.

The consumer spending data highlights a bifurcation in the household sector: The top 20% by income are spending strongly, while the bottom 60% are struggling. This explains why overall spending remains resilient even as consumer sentiment continues to be weak. The corporate sector shows a similar split: Business spending outside of technology has contracted, while an 18% year-over-year increase in computing and software lifted overall corporate expenditure.

Nonresidential Private Fixed Investment Growth (%, Year over Year)



(Source: [Macrobond, ING])

Still, the market's reaction to the latest GDP news was muted. Estimates for Q4 GDP indicate a healthy-but-slower 3% growth rate, owed in part to the month-long government shutdown. It is likely the tepid reaction to Q3's positive GDP surprise reflects some expectation that fourth-quarter results will not maintain this pace of growth.

From the Wespath Team: The Latest on AI's Opportunities and Risks

AI has emerged as a transformative force across global markets, influencing both investment opportunities and operational practices. And while AI-related headlines often focus on the mega-cap technology stocks, we recognize this is not a single-sector story; it is a systemic theme that spans industries, asset classes and geographies. Wespath's approach to AI emphasizes purposeful diversification across sectors and asset classes, rigorous manager selection, and strong governance frameworks that integrate risk management and stewardship. Building on this foundation, we note several guiding insights that shape how we consider AI across all asset classes:

- **Beyond the Magnificent 7:** AI exposure is not limited to the technology sector, let alone the handful of mega-cap tech companies commonly associated with the theme. Opportunities—and risks—extend to infrastructure, energy, utilities, industrials and more.
- **Active Where It Can Add Value:** AI adoption is uneven, and valuations in some areas already reflect significant optimism. While passive strategies are an efficient means to capture exposure to the mega-cap stocks, skilled active managers in various asset classes apply research-driven frameworks to identify underappreciated AI beneficiaries and avoid crowded trades, balancing opportunity with valuation discipline.
- **Governance and Risk Oversight:** AI's growth brings unique risks, including resource constraints, environmental pressures and the uncertainties of rapidly evolving technology. Strong governance helps ensure these factors are integrated into manager selection and portfolio construction, while a thoughtful approach to stewardship provides opportunities to engage productively on AI-related issues.
- **Operational Benefits:** Beyond the investment opportunity set, AI has significant potential to enhance investment decision making. Both Wespath and our investment managers are exploring use cases that can improve research efficiency and knowledge management, while maintaining strict privacy and compliance standards.

As AI continues to evolve, our values-aligned investment process helps us capture its opportunities responsibly, balancing innovation with discipline, governance and long-term risk management. Click below to dive deeper into our latest perspectives on AI, with insights and highlights from our Public Equity, Fixed Income and Private Markets teams:

More AI Insights from Wespath!

Recent Fund Enhancement Efforts: Learn More in Our Q4 Webinar!

Wespath's investment philosophy is intentional in emphasizing our client-centric approach, commitment to rigorous research, and belief in the complementary integration of active and passive management. Our latest work to support the equity fund lineup reflects all these themes, while maintaining the funds' core investment objectives and strategies.

In our upcoming quarterly investment webinar, we will dive deeper into these fund enhancements—from seeking efficiencies within passive allocations, to integrating new high-active-share opportunistic managers and preparing for additional fund launches in 2026. The webinar will also explore AI-related research and insights, market and fund performance, and more. Our Q4 webinar will be available on-demand later this month—subscribe here to receive the webinar in your inbox!

Looking ahead

Themes to Watch in 2026

As we enter 2026, our focus remains on delivering competitive long-term, risk-adjusted returns for our clients. While we are committed to that long-term perspective, we are constantly monitoring evolving market dynamics and the implications they may have for our investments. Here are a few themes we will be keeping an eye on in 2026:

1. **AI-Driven Market Opportunities and Risks:** AI will continue to transform industries and markets. While innovation offers compelling growth opportunities, elevated valuations and concentrated exposures require disciplined risk management. Any cooling of AI enthusiasm or notable earnings disappointments from the Magnificent 7 could shift sentiment quickly.
2. **Geopolitical Tensions and Shifts:** Global political dynamics remain a source of volatility. Long-term themes such as infrastructure modernization and energy transitions can withstand various political cycles, but the impacts of trade policy shifts and regional conflicts remain a source of near-term volatility, with potential for rapid escalation and uncertainty about their long-term effects.
3. **Global Deficit Spending and Accommodative Financial Conditions:** Loose fiscal policy and widespread deficit spending have supported both economic growth and asset prices. Nevertheless, with global government debt levels surpassing historic thresholds, investors need to be aware of how these dynamics create both opportunities and risks—and what potential scenarios may lead governments to reign in spending and reduce fiscal stimulus.
4. **Interest Rate Crosscurrents and Central Bank Policy:** Monetary policy remains in flux, particularly in the U.S., where a new Fed chair will take over in May. Short-term rates could drift lower under a more dovish Fed, while longer-term rates face competing forces from global debt and uncertain growth. Central banks around the world face similarly compelling policy and interest rate questions.
5. **Market Concentration and Active vs. Passive Dynamics:** Concentration in U.S. equity indices underscores the importance of diversification and thoughtful portfolio construction. The mega-cap tech companies remain healthy and with strong moats, but the latest trends point to broader momentum. Following a difficult stretch for active management in U.S. equities, active managers will be looking to capitalize on any additional periods of dispersion and emerging opportunities in less efficient corners of the market.
6. **Opportunities and Challenges in Private Markets:** Private markets continue to attract capital, driven by innovation and the search for differentiated returns. Yet liquidity trade-offs, the recent strength of public markets, and efforts to "democratize" private markets by making them more accessible to individual investors introduce unknowns and complexities. Still, we are compelled by value-adding opportunities, including the expansion of Wespath's Positive Social Purpose Lending Program.

Bottom Line: After several consecutive strong years for markets, 2026 begins with elevated valuations in certain areas, high concentration in the U.S. stock market, and a host of unknowns related to growth and geopolitics. Still, many tailwinds remain, including technologic innovation, the potential for lower interest rates and the continuation of loose financial conditions. We are confident that our commitment to strong governance, purposeful diversification and values-aligned investing positions us to navigate these dynamics with resilience and discipline.