



MONTHLY MARKET PULSE – JANUARY 2026

HIGHLIGHTS

- **Strong 2025:** Despite mixed performance toward year-end, the S&P 500 logged another year of double-digit gains, marking its third consecutive year.
- **Fed Pause:** The Federal Reserve (Fed) has cut rates by 25 basis points at each of the past three meetings; however, investors expect the Fed to pause in January.
- **AI Needs the Debt Market:** Artificial intelligence and the data center buildout are not just affecting equities; they are also impacting fixed income markets. In this month's *Spotlight*, we take a closer look at the current environment and our expectations for the years ahead.

MACRO INSIGHTS

Flat Month Caps Another Strong Year

U.S. equities delivered a mixed performance in December, reflecting a period of consolidation after an extended rally. The S&P 500 (price return) slipped slightly, snapping a seven-month winning streak, while performance beneath the surface was more dispersed. Leadership continued to rotate away from crowded mega-cap themes, with selective pockets of strength emerging even as several formerly dominant areas lagged. While much of the Magnificent Seven trade softened, Nvidia and Tesla posted gains, highlighting the increasing dispersion across large-cap technology. Rate-sensitive and defensive sectors, along with several consumer-facing cyclical, underperformed during the month.

Despite the modest pullback, December capped an impressive year for U.S. equities. The S&P 500 returned 17.9% in 2025, again led by Communication Services and Information Technology, as AI-related investment, resilient earnings growth, and expanding profit margins supported valuations. While leadership rotated late in the year, full-year performance reflected broad confidence in U.S. growth assets.

Macro developments in December were largely supportive but increasingly nuanced. The Fed delivered a widely expected 25-basis-point rate cut at the December Federal Open Market Committee (FOMC) meeting, bringing total easing to 50 basis points over the final two months of the year. Policymaker commentary emphasized emerging labor market softness—with unemployment edging up to 4.6%—alongside renewed disinflation progress, while maintaining flexibility around the future policy path. Treasury yields were mixed, with modest curve steepening, the dollar weakened further, and gold extended its rally, signaling ongoing crosscurrents beneath headline growth resilience.

Economic data reinforced a “soft-landing-plus” narrative. Inflation continued to cool, helped by housing, while consumer spending proved resilient through the holiday season. At the same time, labor market indicators showed signs of gradual normalization, underscoring the increasingly bifurcated nature of economic

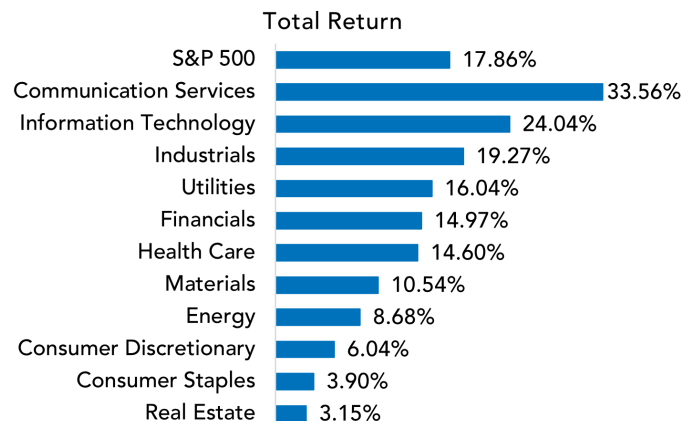
outcomes. Investor focus also remained on AI, where scrutiny around capital intensity and execution risks grew even as long-term demand fundamentals remained intact. AI is not just a story for the equity market—a subject we explore further in this month's *Spotlight*.

Overall, we view December's consolidation as healthy digestion following a strong run, rather than a deterioration in fundamentals. Entering 2026, easing financial conditions, resilient consumers, and improving policy clarity remain constructive, though greater dispersion and heightened selectivity argue for balanced positioning after another impressive year for U.S. equities.

S&P 500 Again Led by Technology Sectors in 2025

While leadership broadened late in the year, 2025 returns were again led by the communication services and technology sectors.

2025 Total Return by Sector



Source: Bloomberg.

Christopher D. Shipley

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MONTHLY SPOTLIGHT: AI's Impact on Fixed Income

Author: Steven F. Garrett, CFA

See page 2

WHAT TO WATCH

The FOMC has cut rates by 75 basis points over the past three meetings. Investors will continue to monitor inflation and labor market data for implications for future rate decisions. In addition, questions around the strength of the consumer persist, and sentiment surveys as well as spending data will provide signals for future consumption.

- ▶ The next FOMC meeting is on January 28. Investors expect the Fed to pause following three consecutive 25-basis-point cuts. Upside risks to inflation have given some Fed officials hesitation regarding the future path of rates.
- ▶ Job growth has remained weak as small- and mid-sized companies face headwinds, and employment gains have been concentrated in health care and education. Private-sector ADP data and nonfarm payrolls from the Bureau of Labor Statistics (BLS) will both be closely analyzed to assess whether the employment picture could broaden in 2026. The ADP Employment Report will be released on January 7, and the Nonfarm Payrolls report will be released on January 9.

MONTHLY SPOTLIGHT



STEVEN F. GARRETT, CFA

Senior Credit Analyst

AI's Impact on Fixed Income

The growth of artificial intelligence has had significant impacts across the economy and investment markets. While investors often hear about its effects on equity markets—where a relatively small number of AI-related companies are driving returns and index concentration—many overlook the impact AI is having on fixed income markets.

AI is highly capital intensive, with substantial upfront costs related to data centers, semiconductors, energy, and other infrastructure. Estimates for newly developed data centers are approximately \$35 billion per GWh (gigawatt hour), and roughly 200 GWh of new capacity

is planned across approximately 3,300 data centers that are either under construction or have been announced.¹ As firms undertake these multiyear buildouts, many are turning to fixed income markets to fund these projects. Issuance by hyperscalers (Google, Meta, Microsoft, Amazon, and Oracle) has been significant over the past year, totaling roughly \$120 billion, and we expect annual supply to increase to more than \$200 billion in 2026. While at first glance this additional issuance will increase the technology sector's footprint in fixed income indices, it also carries broader implications for fixed income investors.

First, the rise in AI-related debt issuance is increasing issuers' interest burdens, placing pressure on free cash flow and pushing leverage higher. In some cases, this has already resulted in spread widening, or cheaper valuations, as markets incorporate the pro forma impact on fundamentals. For example, Oracle has experienced spread widening tied to increased leverage expectations, as well as higher lease commitments and concerns over customer concentration. Separately, hyperscaler issuance has been skewed toward longer maturities—often 10 years or longer—affecting relative value across individual issuers' credit curves.

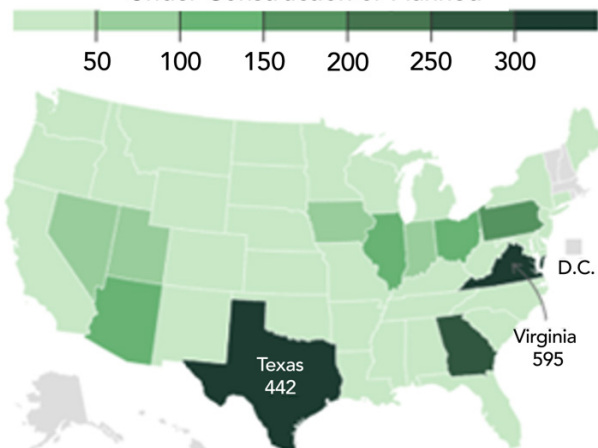
Technology is not the only sector affected by the capital demands of AI investment. Within corporate credit, utilities and power generators have also seen increased issuance, as data centers require substantial and reliable energy. Estimates suggest that approximately 30% of the total cost of a new data center is related to energy infrastructure.¹ Beyond corporates, we expect growing volumes of securitized and infrastructure debt tied to AI development. These financings are often structured around specific projects, such as Meta's Louisiana data center. Importantly, not all companies are funding these ventures in the same way. In Meta's case, much of the financing is expected to be off balance sheet, with Blue Owl issuing private debt to support its commitment to the project. These structural nuances are particularly important for investors evaluating the growing volume of AI-related issuance.

AI-related debt is likely to continue growing as a share of fixed income indices due to the reinvestment cycle—the useful life of chips is typically four to six years—and continued investment to improve models (scaling laws). While many of these investments have the potential to drive future revenue growth, a loss of confidence among credit investors could materially impact future development.

In our view, relative value should be a key consideration when evaluating these opportunities, particularly because data-center-specific issuance carries idiosyncratic risks related to both the evolution of AI and the economic significance of individual projects. Given current valuations and the expected increase in AI-related debt issuance in the years ahead, we believe more attractive opportunities to add value exist elsewhere in fixed income.

Data Center Construction

Under Construction or Planned



Sources: ¹Bernstein. Chart: American Edge Project and Technology Councils of North America. Map: Axios Visuals. Data as of October 29, 2025.

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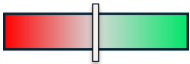

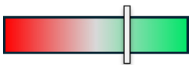

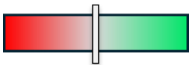


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CURRENT OUTLOOK

Topic	View	MoM Change	Commentary
Macroeconomic Views			
Economic Growth		—	<ul style="list-style-type: none"> U.S. economic growth is expected to soften in Q4 following an upside surprise in Q3. Growth expectations for 2026 are improving as tariff headwinds dissipate, and easier financial conditions should contribute to a broadening of the economy. The lack of job growth over recent quarters presents downside risks to the current economic expansion, as the unemployment rate has risen to 4.6%. Uncertainty remains elevated amid U.S. trade policy, geopolitical tensions, and pending court decisions. While government data has resumed, recent releases remain volatile following the shutdown.
Inflation		—	<ul style="list-style-type: none"> Market forecasts project that inflation is plateauing and will decline gradually toward the mid-2% range in 2026. Service inflation continues to cool, and we expect that trend to remain intact over the coming quarters. Goods inflation remains the primary source of concern for any upside inflation surprise. The tariff-related impact on consumers has been limited so far, as companies are absorbing part of the cost. Whether companies protect margins and raise prices over the coming quarters remains a key question.
Monetary Policy		—	<ul style="list-style-type: none"> The Fed cut rates by another 25 basis points in December, aligning with market expectations and bringing total easing to 75 basis points over the past three meetings. However, markets currently expect the Fed to pause in January. FOMC members are balancing their dual mandate of stable prices and full employment. The December decision, along with each Fed official's forecast, shows a division among members over whether to prioritize the upside risk to inflation or the downside risk to the labor market. Shifting growth estimates, tariff concerns, and executive-branch actions have resulted in volatile expectations for the path of monetary policy. Current pricing implies a terminal rate of around 3% in 2026.
Fiscal Policy		—	<ul style="list-style-type: none"> The Big, Beautiful Bill (BBB) is expected to provide a boost of approximately 0.5% to 1.0% to GDP growth in 2026 through two primary avenues: individual tax cuts and accelerated depreciation. We believe larger-than-normal tax refunds should provide some relief to households next year and support consumption. Flexibility within fiscal policy remains low, as federal debt levels continue to increase and higher interest costs consume a larger portion of government outlays.
Market Valuations			
Rates		—	<ul style="list-style-type: none"> Longer-term rates moved higher over the month while short-term rates declined as the Fed continued cutting, resulting in a steeper curve. We anticipate that the timing of expected rate cuts will continue to shift, with new labor market data serving as a primary driver. Both short- and long-term rates are within our expected fair-value range, presenting a largely balanced risk-reward profile at current levels.
Credit		—	<ul style="list-style-type: none"> Credit spreads tightened marginally during December and remain expensive relative to historical averages. We believe the risk/reward is skewed to the downside, although strong corporate fundamentals should help support spreads. Investment-grade spreads (10-year BBB industrials) ended the month at their 11th percentile, and high-yield spreads (single-B corporates) ended at their 4th percentile since the 1990s.
Equity		—	<ul style="list-style-type: none"> Despite the S&P 500 exhibiting some volatility toward the end of the year as investors rotated away from crowded mega-cap names, the index returned a robust 17.9% in 2025. Equity valuations remain above long-term averages, largely due to elevated multiples on mega-cap technology companies, which continue to increase their share of economic profits. Market fundamentals remain healthy—most of the S&P 500's return in 2025 was driven by earnings growth rather than valuation expansion.

MARKET DATA & PERFORMANCE | AS OF 12/31/2025

U.S. Snapshot	Current	6 Months Prior	1 Year Prior
Core Inflation (YoY%)	2.8	2.8	3.0
Unemployment Rate	4.6	4.1	4.1
Real GDP (YoY%)	2.3	2.1	2.4
Retail Sales (YoY%)	3.5	4.4	4.6
30-Year Mortgage Rate	6.2	6.8	6.9
10-Year Treasury	4.2	4.2	4.6
US Corporate IG Yield	4.8	5.0	5.3
US Corporate HY Yield	6.5	7.1	7.5

TOTAL RETURNS

Asset Class	MTD	QTD	YTD	1 Year	3 Years*	5 Years*
Equity						
Russell 3000 Index	0.0%	2.4%	17.1%	17.1%	22.2%	13.1%
S&P 500 Index	0.1%	2.7%	17.9%	17.9%	23.0%	14.4%
S&P Midcap 400 Index	0.1%	1.6%	7.5%	7.5%	12.6%	9.1%
Russell 2000 Index	-0.6%	2.2%	12.8%	12.8%	13.7%	6.1%
MSCI World Index	0.8%	3.2%	21.6%	21.6%	21.7%	12.7%
MSCI World Excluding US	3.0%	5.3%	32.5%	32.5%	18.3%	10.0%
Fixed Income						
Bloomberg US Aggregate	-0.1%	1.1%	7.3%	7.3%	4.7%	-0.4%
US Corporate Investment Grade	-0.2%	0.9%	7.8%	7.8%	6.0%	0.0%
US Corporate High Yield	0.6%	1.3%	8.6%	8.6%	10.1%	4.5%
Emerging Market Debt	0.5%	3.6%	13.1%	13.1%	10.3%	1.6%
US Treasury (7-10 Year)	-0.6%	0.9%	8.0%	8.0%	3.6%	-1.5%
Cash	0.3%	1.0%	4.3%	4.3%	4.9%	3.2%

Source: Fort Washington and Bloomberg. *Returns longer than 1 year are annualized. Past performance is not indicative of future results.

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