

“What time is it?”

More than 50 years ago, an author described a euphoric bull market as a “splendid ball” that no one wants to leave. The guests know the ball will end in catastrophe, yet the ball is so splendid, they don’t want to leave while there is still time, but when they ask, “what time is it?”, none of the clocks have any handsⁱ.

Clearly there are parallels between this passage and today’s AI-obsessed stock market, and they are driving a recurring theme in this newsletter that there is a big difference between investing and speculating. But before we dive deeply into the ever-present question of “Is AI a bubble?” and other key considerations heading into the new year, we first look at how the market drivers of 2025 are carrying over into 2026 and what new drivers we expect to emerge.

What do the markets have in store for 2026?

- » **Midterm elections.** While we think the 2026 midterm elections drove much of the strategy behind last spring’s tariff announcements, as well as many other White House initiatives, we think the economic maneuvering ahead of the upcoming midterm elections will become increasingly urgent in its attempts to support the economy and “affordability.”
- » **Artificial Intelligence (AI).** Before discussing the midterms, we discuss the ongoing market mania around AI and what the increasing number of caution flags are telling us.
- » **Tariffs.** Last April, the U.S., in the words of some, “declared war on free trade.” It appears free trade is “winning.” Unlike the fallout from the Smoot-Hawley tariffs a century ago that devastated global trade volumes, global trade recovered from April’s chaos to actually grow 2.4% in 2025ⁱⁱ, with world markets quickly learning how to reshape themselves around U.S. tariffs, leaving U.S. consumers simply paying new taxes on goods they still need to import.
- » **Surprising stamina of the U.S. economy.** The U.S. economy continues to surprise with its strength, posting a 4.3% growth rate in Q3, 2025, and with many stimulative aspects of the president’s new tax bill and unabated AI capital expenditures, the economy enters 2026 with strong tailwinds once again.

It’s time for investing, not speculating

Is AI a bubble? Most likely. Does that mean it is a bad time to invest? No. It means it is a bad time to speculate.

Investing is evaluating the economic returns of an opportunity and deciding what is an appropriate price to pay for those returns. Speculating is paying today’s price simply because you think the price will be higher tomorrow. When the latter becomes the most prevalent behavior in markets, it is a bright caution flag.

...a recurring theme in this newsletter [is] that there is a big difference between investing and speculating.

i. Adam Smith, “Supermoney,” Random House, 1972

ii. World Trade Organization

Speculation does not heed valuations. For investors, it's not a question of whether companies like Nvidia are likely to be highly successful and experience rapid growth, it is a question of whether they can grow fast enough to justify the extremely high prices investors are currently paying. How high are these prices? Let's preview our discussion of AI by quickly examining a couple of the market-leading AI names who have shared a lot of headlines recently:

- » **Nvidia** – with the world's highest market capitalization at nearly \$5 trillion, along with increasing competition and constraints on marginal growth, a stock price near 25 times annual revenues seems priced for perfection, if not better.
- » **Palantir** – this year's best performing stock in the S&P 500, up three-fold to a market cap of \$400 billion, Palantir trades at more than 100 times revenues and about 400 times earnings!

We are not saying it is time for the ball to end, but it does seem to be getting late. However, "late" can still last a long time when the clock has no hands. Speculators, though, might want to start thinking like investors in 2026.

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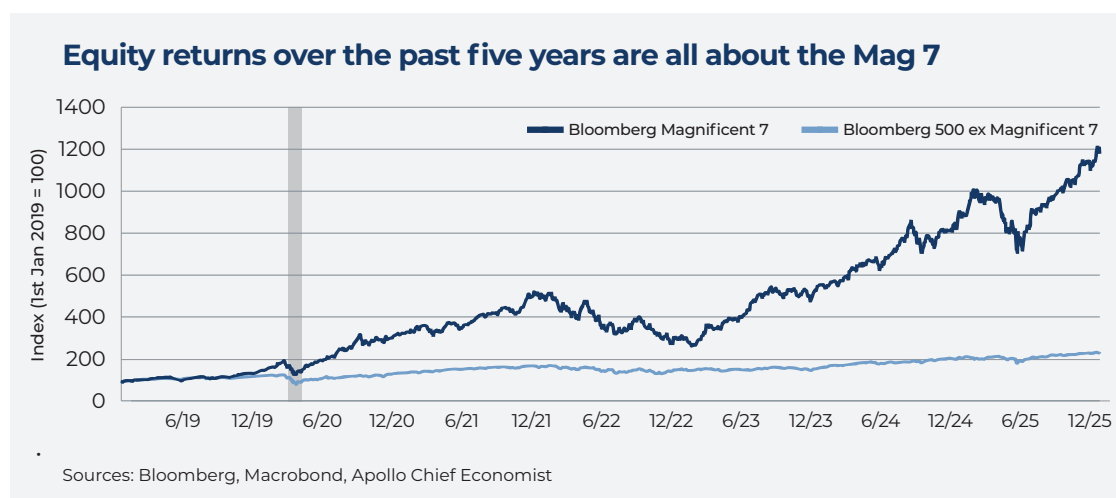
U.S. Equities

Index	Q4 2025	2025
S&P 500	2.7%	17.9%
Equal-Weighted S&P 500 Index	1.4%	11.4%
Dow Jones Industrial Average	4.0%	14.9%
Nasdaq Composite	2.7%	21.1%
Russell 2000 (Small Caps)	2.2%	12.8%

Source: Morningstar

Artificial Intelligence (AI)

The fortunes of AI-related companies dominated financial headlines again in the fourth quarter. With the top 10 stocks now accounting for over 40% of the value of the entire S&P 500, the index is becoming increasingly vulnerable to any slowdown in AI. As you can see from the chart below, the "Magnificent 7" tech stocks have accounted for the vast majority of U.S. large cap equity returns in recent years.



Analysts seem to be placing an increasing burden on the Magnificent 7 to carry the load for earnings growth in the S&P 500, even though the stock gains of most of the group are slowing down, leaving the heaviest lifting to very few companies to keep the rally going.

As you can see, only 2 of the Magnificent 7 stocks managed to outperform the S&P 500 in 2025...

Magnificent 7 Stocks

Stock	2025
S&P 500	17.9%
Apple Inc	9.0%
Tesla Inc	11.4%
Alphabet Inc Class A	65.8%
NVIDIA Corp	38.9%
Meta Platforms Inc Class A	13.1%
Microsoft Corp	15.5%
Amazon.com Inc	5.2%

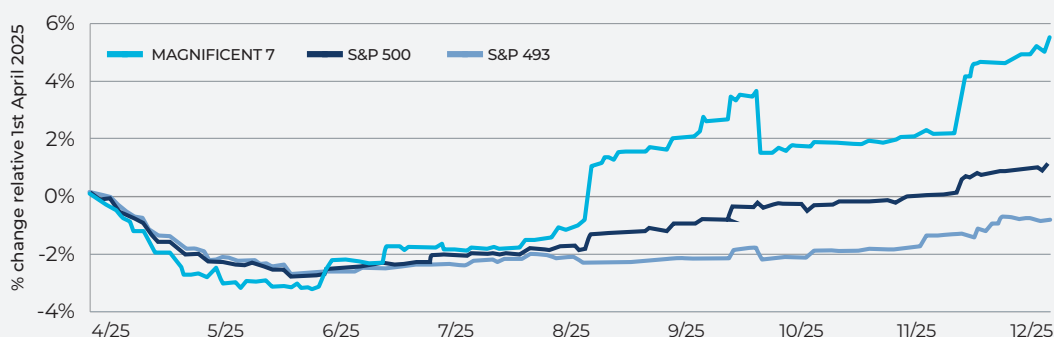
Source: Morningstar

...only 2 of the
Magnificent 7
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to outperform
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in 2025.

...yet since the April tariff announcements, those analysts have been banking on those same 7 companies to increasingly support earnings growth of the entire S&P 500.

2026 Earnings Expectations Revised up for Magnificent 7 and Down for Everyone Else

2026 EPS CONSENSUS ESTIMATES



More caution flags? We think so.

A couple of caution flags we cited last quarter involved OpenAI and Oracle, and both caution signals got stronger since we last discussed them.

**When a
profitless
company with
an increasingly
commoditized
signature
product can go
public at a \$1
trillion valuation,
we may be
getting very
late [in this bull
market].**

OpenAI

- » Last quarter, we discussed OpenAI's incredible \$500 billion valuation that was almost 40 times the size of its revenues of just \$13 billion while its signature product, ChatGPT, was facing an increasingly crowded field of competitors and was struggling to get free users to convert to paying subscribers. We also cited how OpenAI had just signed a deal to pay Oracle \$300 billion over the next 5 years for computing power despite OpenAI's expected \$44 billion in losses over the next 4 years.
- » In early December, OpenAI CEO Sam Altman declared a "code red" ordering employees to immediately shift resources from new initiatives to shoring up its core ChatGPT product that had just been surpassed on key metrics by Google's newly released Gemini 3 AI tool, helping Gemini to narrow ChatGPT's lead among users.
- » Meanwhile, OpenAI is currently trying to raise \$100 billion (presumably to help pay Oracle!) at a valuation of \$830 billionⁱⁱⁱ, and there is talk of a \$1 trillion IPO next year! When a profitless company with an increasingly commoditized signature product can go public at a \$1 trillion valuation, we may be getting very late at this "splendid ball."

Oracle

- » Last quarter, we cited how Oracle's stock value had climbed over 40% after the announcement of its \$300 billion deal with OpenAI despite it representing a commitment of a substantial share of its future AI computing capacity to an unprofitable company whose annual revenue was less than ¼ of its annual commitment to Oracle.
- » Oracle stock has since lost all its gain from the OpenAI deal announcement and then some, now sitting over 12% below where it was before the deal announcement. In addition to surprising investors with how much capital investment would be required to meet the terms of the OpenAI deal (which along with Oracle's other capital plans will require the issuance of new debt), the fact that the OpenAI commitment now accounts for the majority of its future contracted revenue backlog has investors concerned that Oracle may have tied itself to a client facing a surprisingly formidable competitor in Google's Gemini, does not have the revenue yet to meet the terms of the deal, and may never have enough revenue to pay for the computing capacity that Oracle is borrowing money to build!^{iv}

It certainly looks like AI will be a dominant market theme again in 2026, whether positive or negative, but it still has the wind at its back with a strong economy, the Fed cutting rates, fiscal stimulus from the new tax bill, and innovations that are astonishing users. We don't think the "splendid ball" is coming to an end just yet, but investors will want to make sure portfolios are prepared and durable with other sources of return by the time it does.

iii. Wall Street Journal, "OpenAI Looks to \$830 Billion Valuation," December 19, 2025

iv. Wall Street Journal, "Oracle Can't Escape OpenAI's Shadow," December 11, 2025

...the average effective [tariff] rate is...11.2%, much less than the bombastic 22% headline number from the April 2nd announcement.

Tariffs 2025: “We fought free trade, and free trade won”

OK, maybe that’s not exactly how the song went, but clearly the “bark was worse than the bite” of the April 2nd “Liberation Day” tariff announcements announcing new tariffs on over 90 countries at an average rate of 22%. After markets initially plunged in the week following that announcement and then experienced a month of volatility, the rest of the year was a relatively steady march upward as the true magnitude of tariffs turned out to be much more in line with the market’s initial expectations than the extremely aggressive posturing of the April 2nd announcements. In addition, the market plunge was largely based on concerns over a collapse in global trade, but free markets always seem to find a way, and it did not take long to mitigate and overcome the impact of tariffs on trade volumes.

As we explained in depth in [our first quarter 2025 commentary](#), we always thought the true objective of the new tariffs was to offset the budgetary impact of the new tax bill extending the 2017 tax cuts, not to greatly increase U.S. manufacturing or substantially reduce the U.S. trade deficit. As a services-based economy, the U.S. no longer has the manufacturing workforce that would be required to bring back the vast majority of the manufacturing that has moved offshore over the past 75 years, so the notion of greatly reducing our trade deficit was never credible.

Instead, what has happened is that some importing has shifted from higher tariff countries to lower tariff countries, but we are still importing those products. With China targeted with the most aggressive tariffs, direct buying from China has declined, but in some cases, we now simply import the same goods from Chinese-owned factories in other countries. In other cases (such as smartphones), Chinese components are simply shipped to another country (India) to be assembled and then imported to the U.S. from that country.

In fact, despite heralded announcements about manufacturing jobs coming back onshore, U.S. factory activity has contracted every month since the announcement of the tariffs^v. With U.S. budget deficits already at record high levels for peacetime, we simply could not afford President Trump’s signature tax bill without offsetting the budgetary cost with other taxes or very large spending cuts. Last April, we estimated that the average effective tariff rate in the U.S. would need to rise from 2.5% to at least 11% to offset the budgetary cost of the tax bill, and, according to The Tax Foundation, the average effective rate is now almost exactly that at 11.2%^{vi}, much less than the bombastic 22% headline number from the April 2nd announcement that panicked global markets.

Given how the reality of the new tariffs has turned out to be simply a consumption tax on American consumers to offset the President’s new tax bill, it is not hard to see how the markets have shrugged them off and retaliation from trading partners has been restrained.

Tariffs: What to watch in 2026

This January, the U.S. Supreme Court is expected to rule on whether the Trump administration legally applied the authorization granted by the International Emergency Economic Powers Act (IEEPA) to impose many of the new tariffs. At the November hearing on this issue, most of the Supreme Court’s justices appeared to be skeptical that this application of the IEEPA was legal. If the Court does indeed rule against the administration, there is a wide range of potential market implications.

v. Institute for Supply Management’s Purchasing Managers Index for Manufacturing

vi. Wall Street Journal, “Why Everyone Got Trump’s Tariffs Wrong,” December 14, 2025

Despite calls for a looming recession for the past few years, the U.S. economy sails into 2026 with continued tailwinds.

The markets have largely shrugged off the impending Court decision on the tariffs because it is widely assumed that the administration will simply revert to other legislative justifications for the tariffs, which is the expectation set by the administration. However, it is possible that the Court could order refunds for many of the tariffs already collected and that the other legislated authorizations for tariffs may not be as broad as would be required to replace all the existing tariffs (assuming they are also not struck down by legal challenges).

While the stock market would likely rally initially as any reduction in tariffs is essentially a reduction in a consumption tax and would likely be positive for consumer spending, the bond market would likely have the opposite reaction. Keeping in mind that the expected tariff revenues have essentially already been “spent” to pay for the new tax bill, such an outcome would mean an even larger budget deficit which would likely be penalized by the bond market forcing the government to pay higher interest rates. Despite the Fed’s ability to lower short-term interest rates, this potential market reaction would likely drive-up longer-term rates, including home mortgage rates. All this would take a while to play out, but it could end up being a significant source of volatility for both the stock and bond markets.

For now, the bond market is tolerating the record peacetime budget deficits and the promise that elevated inflation from tariffs is temporary, resulting in healthy fixed income returns for the year.

Fixed Income

Index	Q4 2025	2025
Bloomberg US Aggregate Bond Index	1.1%	7.3%
Bloomberg Global Aggregate Bond Index	1.1%	7.5%
Bloomberg Municipal 5-Yr Index	0.5%	5.0%

Source: Morningstar

The surprising stamina of the U.S. economy

Despite calls for a looming recession for the past few years, the U.S. economy sails into 2026 with continued tailwinds. Interest rates have stayed “higher for longer” because the economy has not needed the help from lower rates and inflation has remained well above the Fed’s target. With Q3 2025 GDP coming in at 4.3%, well above expectations of 3.2%, and inflation stubbornly remaining around 3%, 2026 may again see fewer Fed rate cuts than expected. There are a few key drivers propelling the economy into 2026:

- » **AI capital expenditures.** With AI capital spending from the Magnificent 7 alone possibly approaching \$1 trillion in 2026, this will continue to provide a significant boost to the U.S. economy.
- » **Fiscal stimulus from OBBBA (One Big Beautiful Bill Act).** With numerous stimulative measures, in addition to tax cuts, in the new tax bill, the Congressional Budget Office estimates that OBBBA will add 0.9% to GDP growth in 2026 alone. With stimulus for sectors beyond AI, this should help broaden economic growth.

v. Institute for Supply Management’s Purchasing Managers Index for Manufacturing

vi. Wall Street Journal, “Why Everyone Got Trump’s Tariffs Wrong,” December 14, 2025

As the world has moved quickly to recast global trade, the stock markets for nerly all our major trading partners outperformed the S&P 500 (17.9% for 2025) by a very wide margin.

» **“Wealth effect” from portfolio returns fueling consumer spending.** While younger and lower income households have been struggling over the last couple of years, the upper income households that largely drive consumer spending have experienced tremendous wealth gains in their investment portfolios that have helped support consumer spending and the broader economy.

The single biggest threat to the economy is likely the unwinding of the “wealth effect” – if the stock market and AI stocks see a serious decline, that fuel for consumer spending would likely dry up at the same time the AI stocks, in the midst of price declines, might reconsider their enormous spending plans, which could knock out two of the three key economic drivers listed above, possibly leading to the recession we’ve managed to avoid for so long.

International Equities

As the world has moved quickly to recast global trade, the stock markets for nearly all our major trading partners outperformed the S&P 500 (17.9% for 2025) by a very wide margin.

International Equities

Index	Q3 2025	2025
MSCI EAFE (Developed Markets)	4.9%	31.2%
MSCI Emerging Markets	4.7%	33.6%

Source: Morningstar

Specifically, our six largest trading partners saw stellar returns:

Largest Trading Partners

Country	2025
Mexico	56.9%
Canada	37.4%
China	31.4%
Germany	37.1%
Japan	25.1%
South Korea	100.8%

Source: John Hancock Investment Management

While the U.S. is fighting a trade war with more than 90 countries, those countries are generally just sparring with one, the U.S., so they are broadly cooperating to expand trade with each other and rebalance trade to minimize the impact of U.S. tariffs. With significantly lower valuations, generally lower interest rates and inflation, significant fiscal stimulus, and lower market concentrations in technology, many international markets are well positioned for the coming years. A few examples,

...we think this administration will use every lever at its disposal to provide any possible economic stimulus ahead of the midterm elections, including rolling back more tariffs...

- » Despite reduced trade with the U.S., China experienced record industrial production, record exports, and a record trade surplus.^{vii}
- » Germany's remilitarization initiative will be providing the greatest extended fiscal stimulus since its reunification in the 1990s.^{viii}
- » Under the new government of Prime Minister Takaichi, Japan is undertaking its largest fiscal stimulus in the past 20 years (excluding pandemic).^{ix}

2026 Midterm Elections: a bigger motive than most realize

Historically, midterm elections are very challenging for a newly elected president, and, given the razor-thin majorities in both houses of Congress, history would argue that the Republicans would be expected to lose control of one if not both houses at the midterm. We think this has been and will continue to be a significant strategic factor in virtually every major domestic policy initiative coming from the administration.

- » Our earlier analysis was that the "shock and awe" nature of the April 2nd "Liberation Day" announcements of new tariffs on more than 90 countries at a headline rate of 22% was to set the stage for what would seem like more reasonable tariff levels later, calming markets well ahead of the 2026 midterm elections. That does seem to be how events have unfolded.
- » The administration pushed hard for the new tax bill extending the 2017 tax cuts to be expanded into "One Big Beautiful Bill" that would include new tax breaks and other stimulative measures with an urgency to get it all passed in time to take effect for full year 2026, presumably giving a boost to the economy for nearly a year before the elections.
- » In November, due to increasing political vulnerability over "affordability" for consumers, the administration rolled back tariffs of up to 40% on staple food items including coffee, beef, and fruit.
- » On the last day of 2025, President Trump signed a surprise order delaying substantial tariffs on imported furniture and cabinets until after the 2026 midterms.
- » The White House has repeatedly proposed the idea of a \$2,000 "tariff dividend" to be paid to low- and middle-income Americans in 2026, although this would likely offset most, if not all, of the tariff revenue generated to date.

The point being made is not a political one, but merely that we think this administration will use every lever at its disposal to provide any possible economic stimulus ahead of the midterm elections, including rolling back more tariffs, and that is yet another tailwind for the economy and the stock market headed into 2026.

What does all this mean for client portfolios?

First, while it does indeed seem to be getting late at this "splendid ball" of a bull market, time is likely not up while the economy is still growing and the Fed is still cutting interest rates. In addition, there is still a lot of economic stimulus being provided by the government and AI capital expenditures, so while the markets head into 2026 with strong tailwinds, speculators would be well advised to start thinking more like investors as we progress through the year as there are yet more risks looming that could make for a tumultuous year:

vii. Wall Street Journal, "Despite U.S. Tariffs, China Enjoys Manufacturing Boom," December 9, 2025

viii. Eaton Vance

ix. Eaton Vance

We are often asked how the current market environment compares to the dot.com peak in 2000...

- » January's Supreme Court decision on the legality of many tariffs.
- » January's Supreme Court decision on President Trump's attempt to fire Fed Governor Lisa Cook, which could have serious implications for Fed independence and interest rates.
- » As stock market valuations keep climbing, we can naturally expect increased volatility when the AI theme faces challenges.
- » Stagflation concerns arising from continued, and possibly rising, inflation, which might require higher interest rates, when the economy might be slowing and needing lower rates.
- » Increasing geopolitical conflict.

We do think the single biggest risk is that a pullback in the stock market saps the "wealth effect" on consumer spending, which if it slowed the economy at the same time the stock market was pulling back, could trigger a more extended market downturn and recession.

We are often asked how the current market compares to the dot.com peak in 2000, and as you can tell from this newsletter, we think that, while it is getting very late, there are a lot of forces working to keep this "splendid ball" going for a little while longer. Accordingly, we compare 2025/2026 more to 1998/1999, meaning there still may be nice gains to be had in this bull market that we want to capture, but we also need to be prepared for any sudden turn toward a 2000 bear market environment. The theme of this newsletter has been the need to invest rather than speculate, and we can do that by building durable portfolios that recognize there are many options available to capture compelling returns in other asset classes that are not tied to the fate of AI or the S&P 500. Over the past few years, many clients have seen us gradually reduce their U.S. large cap holdings in favor of these other asset classes, and with an eye toward investment over speculation, we will continue to do so as it gets later and later at this "splendid ball" of a bull market.



Dennis Follmer
Chief Investment Officer
January 1, 2026

MONTIS COMPANY NEWS



We're pleased to share a new addition to our team:

CAROLYN DENISI joins the Montis team as a Client Service Associate. Drawing on her 20 years of experience supporting clients, she will play an important role in enhancing the Montis client experience and supporting the continued growth of our firm. In her spare time, she volunteers as a booster president for her two multi-sport student athletes.

Tax-Smart Charitable Giving

WHILE MANY OF OUR CLIENTS have used appreciated stock for charitable contributions for years, there are those for whom the current bull market is just now helping make this a worthwhile consideration.

Leveraging the tax code can allow you to be more generous by making gifts and donations less expensive on an after-tax basis. The simplest tax-advantaged giving strategy is to give appreciated stock, real estate or other assets from a taxable account instead of writing a check. This allows the donor to transfer the full value of the assets without ever having to pay capital gains taxes on the amount of appreciation.

Donors can also deduct their charitable contributions on these appreciated assets (generally limited to 30% of adjusted gross income). But keep in mind that if the donation--plus other deductions--don't exceed the high standard deduction (\$32,300 for married filing jointly in 2026), there is no tax benefit from the amount given. To solve this, a savvy donor could make a donation of several years' worth of planned donations into a donor-advised fund during a (preferably) high-income year. This pushes the contribution in the current year beyond the standard deduction, and then the donor could make his or her usual annual charitable gifts from the DAF.

Another tax-aware giving strategy is Qualified Charitable Distributions (QCDs). Those who are taking required minimum distributions (RMDs) from their IRAs can instead give directly to charities. In 2026, an individual can gift up to \$111,000 per year directly out of their IRA to a charitable organization, which would satisfy the RMD requirement, and avoid paying taxes on the distribution.

There are also a variety of charitable trust vehicles which offer tax advantages. You can set up these trusts to either benefit the charity now, with the remainder going to beneficiaries (a charitable lead trust), or to benefit the donor now, with the remainder going to charity later (a charitable remainder trust). You can obtain a partial charitable deduction in either type of vehicle, and you have some (limited) flexibility on how to structure these trusts.

The simple point here is that the U.S. tax code encourages and even helps leverage charitable activities. Tax-smart donors can give more, and have more impact.

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