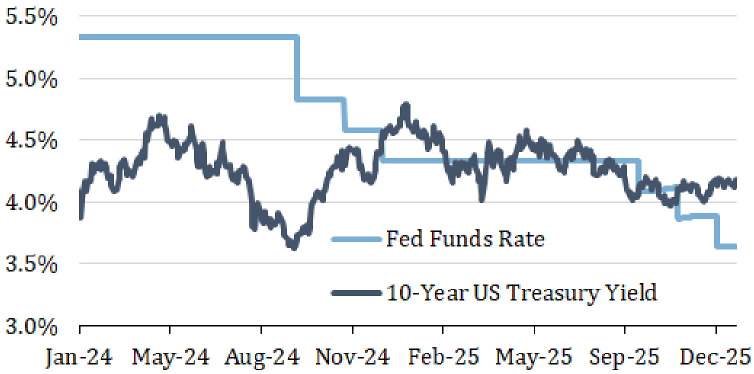
GLOBAL MARKETS

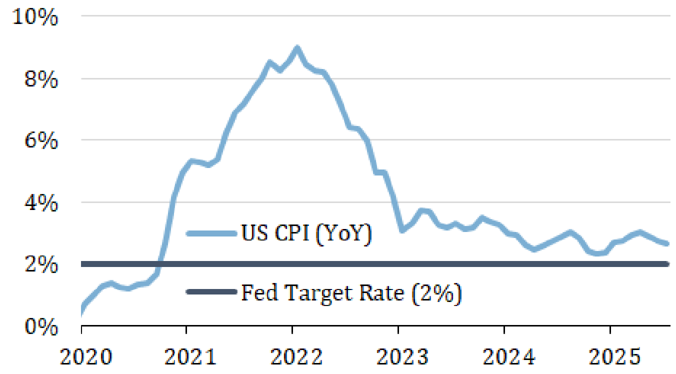
Q4 UPSIDE COMPLETES ANOTHER DOUBLE DIGIT YEAR FOR GLOBAL EQUITY MARKETS

Global equity markets produced another positive quarter despite continued top-down noise, with the MSCI AC World Index gaining over 3%. Fed rate cuts in October and December helped calm investor concerns about increasing US political tensions, as did another quarter of strong earnings reported by US companies. In addition, worst-case tariff concerns have largely subsided, with inflation settling in the 2-3% range. While still above the Fed's 2% target, stable prices have allowed the Fed to back away from above-average interest rates to support employment and growth. Looking ahead to 2026, the market is pricing two to three additional rate cuts in 2026; however, the path is much less certain relative to this time last year, with longer-term bond yields reflecting this uncertainty as the 10-year closed the year above 4% and 30-year above 4.8%.

Two Rate Cuts in Q4, but 10-Year Remains Above 4%

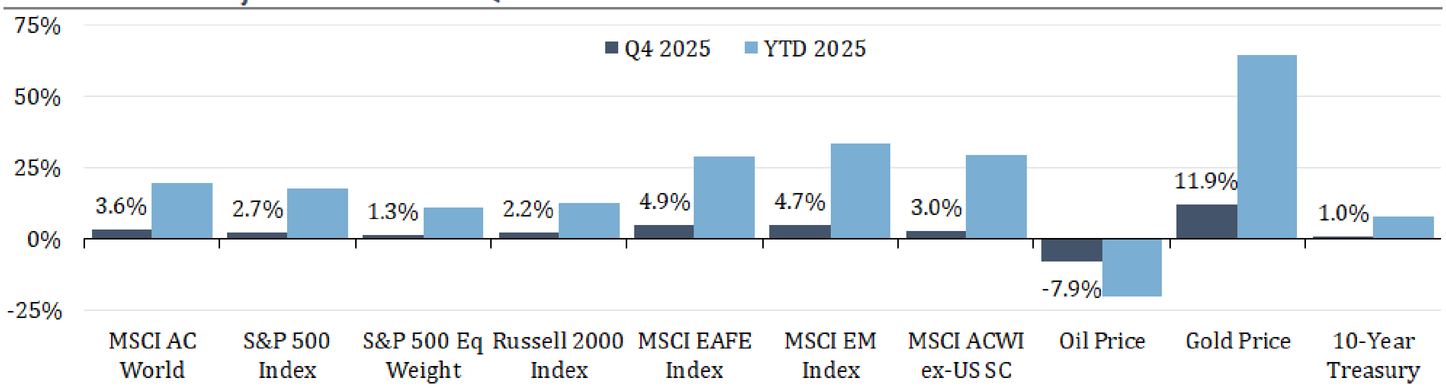


US Inflation Remains Above Target



Similar to last quarter, rate cuts and positive earnings created a favorable backdrop for higher beta stocks in AI-related themes and other "risk-on" markets such as biotech. In addition, relaxed regulatory restrictions helped boost the US banking sector to a 9% gain after a relatively sluggish first nine months of 2025. Areas of strength in the US were tempered by high expectations, elevated valuations, and political turmoil, resulting in underperformance of the US relative to the rest of the world.

Performance of Major Market Indices: Q4 and Full Year 2025



International stocks in both developed and emerging markets gained over 4.5% during Q4 to bring full-year results above 30%. Top performers included the UK (led by banks), Canada (mining), Korea (AI memory components), and Taiwan (AI hardware). One notable underperformer was China, which declined 7.4% in Q4 as AI optimism moderated and led to a partial giveback of early year gains, especially for top index heavyweights such as Tencent (-10%), Alibaba (-19%), and Xiaomi (-27%).

SMALL CAP FOCUS

US: Speculative Stock Rollercoaster

The Russell 2000 Index gained 2.2% in Q4, roughly 50 basis points behind the S&P 500 Index. Unlike last quarter when highly speculative, heavily shorted stocks produced significant upside, Q4 saw those stocks reverse significantly. This reversal coincided with a 23% decline in the price of Bitcoin and included popular retail investor favorites such as GameStop (-26%) and Hims & Hers Health (-43%). Losses in these stocks were offset by the continued resurgence in the biotech sector, which gained 29% in Q4. Since June, the Russell 2000 Biotech Index is up 75%, which has helped recover most of the sector's prolonged drawdown that began in early-2021.

Europe: Value Outperformance

Themes within the European small cap market have remained remarkably consistent throughout the year, with value/cyclical companies significantly outperforming growth/defensive stocks. The primary driver of this divergence has been lower rates and a weakening US dollar, which continues to benefit local infrastructure and financial companies. For the quarter, the MSCI Europe Small Cap Value Index gained 5.0% vs. a gain of 1.9% for the growth index. For the year, value outperformed growth by nearly 13%.

Japan: Yen Decline Drives Value Resurgence

After a strong start for growth stocks in 2025, the past two quarters have seen a significant reversal where value stocks have taken over. Much of this shift has been top-down in nature driven by political changes that have resulted in a significant drop in the Japanese yen. Further complications have arisen in Japan's relations with China, where an increasingly strained relationship has deteriorated. This has been a significant negative for tourism, resulting in losses for Japanese retail stocks. With the yen in decline, exporters were the top contributors to performance leading to the industrials and materials sectors contributing the vast majority of upside for the index in Q4.

Canada & Australia: Gold and Silver Drive Upside

The surge in precious metals continued to dominate Canadian small cap indexes, leading to the best year for the MSCI Canada Small Cap Index (+54%) since the post-crisis recovery of 2009. Mining stocks contributed approximately two-thirds of the index return in 2025 and represent 43% of the index heading into 2026. In Australia, a double-digit rally in mining stocks was offset by broad declines across the rest of the small cap universe. Underperformance came from growth-oriented themes, most notably consumer, health care, and technology stocks.

Emerging Markets: AI Leads the Way

Small caps in emerging markets continued to lag their larger cap peers but still gained 1.6% in Q4 to finish the year up 18.6%. High levels of divergence between countries was the theme throughout the year, with Q4 being no exception. AI beneficiaries Taiwan (+9.0%) and Korea (+6.4%) led the market's upside, a trend that persisted for most of the year. Negative contributions came from China (-12.8%) and Saudi Arabia (-11.5%). In China, momentum in growth-oriented themes faded in Q4, resulting in sharp reversals for top performing areas of the market in the first part of the year (most notably in health care). In Saudi Arabia, persistent declines in energy prices led investors to question the government's commitment to domestic growth stories.

2025 REVIEW

At a high level, 2025 resembled the past two years, with mega cap tech stocks driving another 20% up year for the MSCI AC World Index. However, this year's market environment differed significantly from the past two, with a sharp momentum reversal in Q1 that culminated with a surprise tariff announcement which caused a brief market panic in April. This was followed by a broad-based rally led by a diverse group of stocks across sectors and geographies.

Three key themes defined global markets in 2025:

1. Decoupling and the Rise of Local Themes
2. AI Momentum > Valuation Concerns
3. Market Broadening

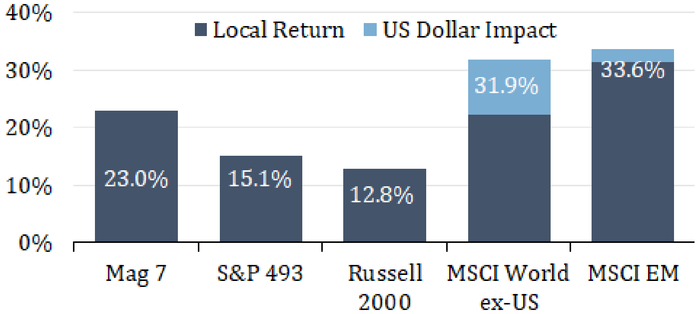
Below is a summary of each key theme from 2025 and our (brief) outlook for 2026.

2025 THEME #1: DECOUPLING AND THE RISE OF LOCAL THEMES

From 2010-2024, US large caps have dominated the rest of the world, with the S&P 500 Index outperforming the MSCI AC World ex-USA Index by over 9% annualized (13.9% vs. 4.7%). This run saw US large caps outperform in 12 of 15 years, with a combination of mega cap tech and dollar strength at the forefront. Periods of non-US outperformance were shallow and short-lived, while US markets regularly outperformed by 10% or more per year.

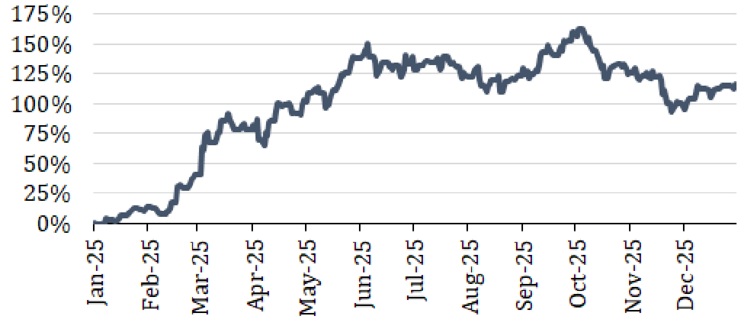
2025 shifted significantly, not from a position of US weakness, but rather non-US strength. The Mag 7 combined to gain over 20% in 2025, but lofty valuations and high expectations limited upside despite exceptional earnings. And while the dollar weakened versus the euro and pound, the DXY index finished 2025 similar to where it was trading in late-2023. In fact, the dollar contributed less than 2% to the MSCI EM's 33.6% gain in 2025. Overall, the strength of non-dollar assets was driven more by a decoupling effect, with cheap valuations and tariffs as the likely triggers.

Non-US Outperformance



**Source: Bloomberg, MSCI*

European Defense Stocks Gain >100% in 2025



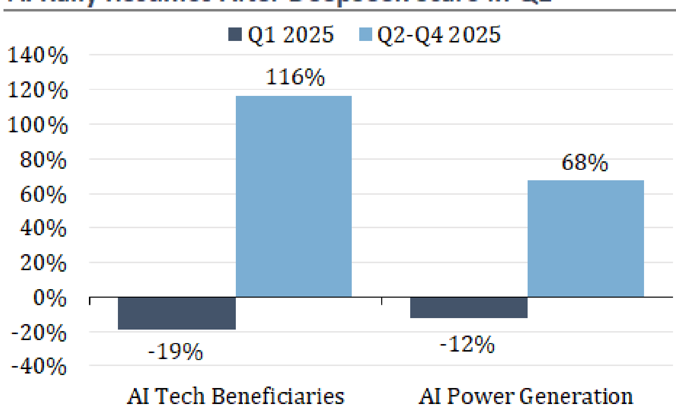
**Source: Goldman Sach Custom Basket (GSSBDEFE)*

Tariffs were a central part of President Trump's economic policy, and true to form, his administration acted quickly to announce substantial rates on major trading partners in early-April. What followed was quite different than expected, as investors realized that tariff impacts were less damaging than initially expected. This change in US policy touched a variety of market segments but generally resulted in a rally among domestic-oriented themes. A prime example was in the European defense sector, which gained over 100% in 2025 due to increased spending to make up for the US policy shift away from NATO. Emerging market stocks also shrugged off tariff concerns, with many of the top performing countries like China, Mexico, and Brazil seeing substantial tariff increases have limited impact on local stocks. We expect this trend of decoupling to be a major theme in 2026, with a combination of cheap valuation and increased growth from locally focused companies boosting non-US markets.

2025 THEME #2: AI MOMENTUM > VALUATION CONCERNS

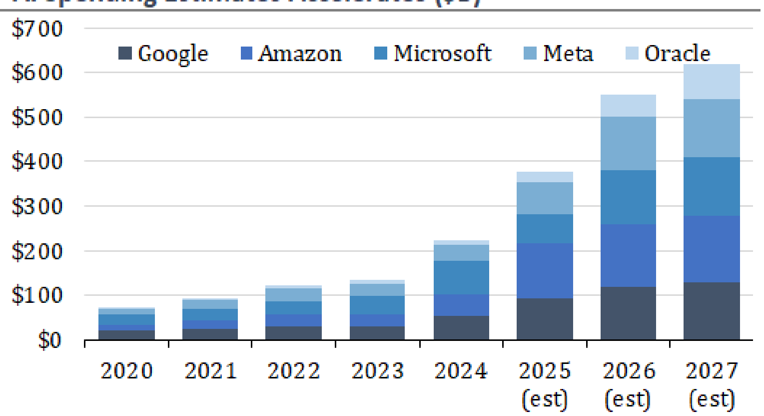
Another area of strength was AI. High valuations did not deter investors in 2025, as stocks connected to the AI theme were among the top performers for the year. This performance was not without risk, as AI stocks had a significant scare in late-January, when Chinese firm DeepSeek's large language model showed performance comparable to top U.S. models at dramatically lower training costs. This caused a major rotation out of AI themed stocks that persisted through the Liberation Day tariff announcement. The initial sell-off proved to be somewhat of an overreaction, as the cost savings were overstated and safety gaps were wider. Perhaps more important to the shallow drawdown and substantial recovery of AI stocks was the commitment from hyperscalers to meaningfully increase AI CAPEX spending in the future. This boosted all AI-related themes from LLMs to hardware components to power generation.

AI Rally Resumes After DeepSeek Scare in Q1



**Source: Morgan Stanley Custom Baskets (MSXXAIB, MSXXAIPW)*

AI Spending Estimates Accelerates ($B)



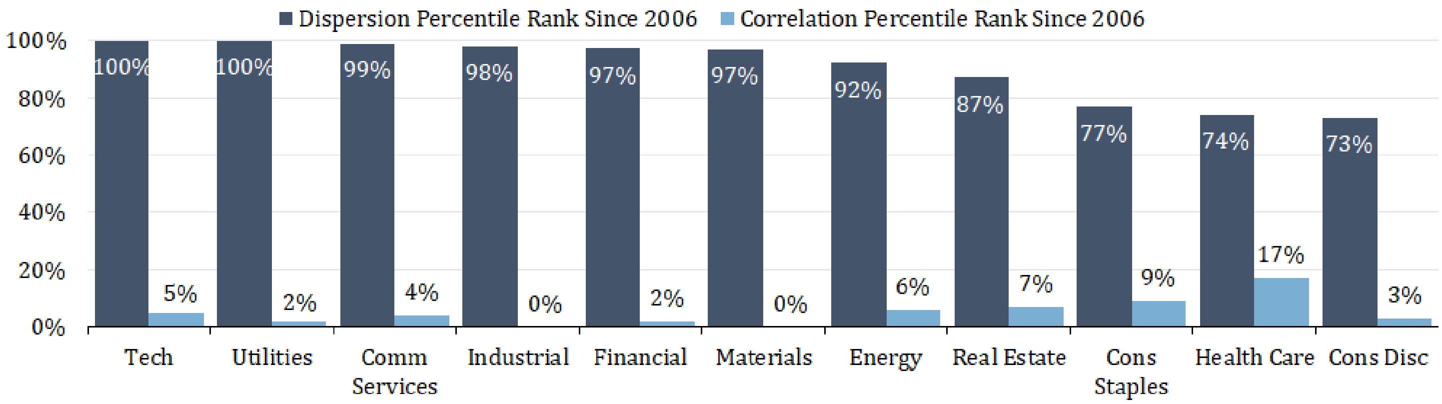
**Source: Goldman Sachs, JPMorgan Eye on the Market | Outlook 2026*

The boom in AI touched all regions and contributed to astronomical gains in certain segments, most notable of which were memory chips from Korea for data centers (MSCI Korea +100%) and late-stage private LLMs. Each of the four largest private LLM companies (OpenAI, X.AI, Anthropic, and Perplexity) raised new rounds from private investors at substantial premiums to prior rounds. Overall, we anticipate continued volatility across all AI themes due to the lofty valuations, but with realized growth rates well above other industries, opportunities for significant upside will remain for the best-in-class companies in 2026 and beyond.

2025 THEME #3: DIVERSE CONTRIBUTIONS ACROSS MARKET SEGMENTS

As an active equity manager, ABS has had a front row seat to the challenge of delivering excess returns during a prolonged period of a mega cap outperformance. However, we have been encouraged by a shift in the underlying market structure recently. Most specifically, the second half of 2025 saw a significant increase in stock dispersion and reduction in correlation between stocks.

High Dispersion and Low Correlation Across All Sectors in the Second Half of 2025



**Source: Morgan Stanley QDS, Altimeter Capital. Dispersion and correlation of S&P 500 constituents measured each 6 months from 2006-2025.*

These two features do not always translate directly into alpha, but they increase the ability for skilled managers to be rewarded for their active bets. And this was the case in 2025, where managers across a wide variety of styles and sector focus delivered alpha. In addition, the normalized interest rate environment has significantly improved short alpha participation in recent years, leading to a strong year for long/short and extended equity strategies relative to both cap-weighted and equal-weighted indexes.

2026 OUTLOOK: DECOUPLING AND DISPERSION

We believe the shifts in market structure that took place in 2025 will provide a compelling opportunity set for skilled active managers in 2026 and beyond. The advancement of AI is a disruptive force that is likely to increase dispersion between stocks, while divergent global policy has opened the door to local companies for increased growth in the future. Specialized active managers are likely to benefit the most from this shift in market structure, as their depth of knowledge within specific sectors, styles, and regions should provide an edge relative to backwards-looking passive indices.

DISCLOSURES