February Market Update

Last month, the U.S. economy continued its above-trend expansion, driven primarily by robust consumer spending and a resilient services sector. Housing showed renewed momentum as lower mortgage rates brought buyers back to the market.

Yet beneath these positives, challenges are mounting. Manufacturing activity has now contracted for ten consecutive months while inflation remains elevated despite recent moderation. Meanwhile, the Federal Reserve signals a cautious approach to rate cuts even as political pressure builds for more aggressive action.

Here's what unfolded in January, the dynamics behind the headlines, and where we're focusing our attention.

Major U.S. Stock Indices

Small-cap stocks finally had their moment in early 2026. Long overshadowed by the “Magnificent 7,” they roared back to life, with the Russell 2000 outperforming both the S&P 500 and Nasdaq for 14 consecutive trading sessions.

The rotation signals investors are venturing beyond mega-cap tech to hunt for value in domestic-focused companies with Main Street exposure and those that benefit from improving financing conditions.

Overall:

- The S&P 500 gained 1.37%.
- The Nasdaq 100 increased 1.20%.
- The Dow Jones Industrial Average outperformed, up 1.73%.

Economic Snapshot

- The economy entered 2026 with momentum. Q3 2025 Gross Domestic Product (GDP) hit 4.4% annualized, the strongest in two years, while

Q4 tracking models pointed to 3-4% growth. Yet, the trajectory has likely peaked. High-frequency data show growth narrowing, increasingly reliant on services and government spending rather than broad private demand. Forecasters expect normalization toward 2% trend growth through 2026 — healthy, but hardly booming.

- December payrolls rose just 50,000, well below 2024's monthly average of 168,000, with cuts concentrated in retail and manufacturing. Unemployment held at 4.4%, suggesting gradual cooling rather than outright deterioration. Wage growth has moderated, keeping real incomes positive and supporting consumer spending without reigniting inflation.
- The headline Consumer Price Index (CPI) came in at 2.7% year over year in December, approaching the Fed's target but not quite there. The bigger concern: producer prices posted their sharpest monthly gain in five months as tariff-related costs filtered through. The Fed held rates steady at 3.5-3.75% in late January and signaled at most one more cut in 2026, emphasizing data dependency and institutional independence amid escalating political pressure.
- The Institute for Supply Management's (ISM) manufacturing index remained in contraction for a tenth straight month at 47.9, with weak orders, shrinking inventories, and job losses amplified by tariff headwinds. Meanwhile, services sectors continue expanding, housing transactions jumped 5% in December due to lower mortgage rates, and credit spreads sit near historic lows, suggesting a bifurcated economy: goods producers struggle while consumers stay resilient.

Our Outlook

The current environment is defined by tempered growth, ongoing disinflation, and a Federal Reserve approaching the conclusion of its easing cycle. It's notable that market leadership is broadening. After years of mega-cap tech dominance, small caps and cyclicals are finding their footing, creating opportunities in areas that missed the prior rally.

That said, we're in a mature expansion where policy uncertainty and geopolitical tensions will create periodic volatility. We're balancing cyclical exposure with quality, maintaining valuation discipline, and preserving capital for opportunities. In environments like this, what you avoid matters as much as what you own.

As always, if you have any questions, your advisor is available anytime to discuss your portfolio or these market developments.

All the best,

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