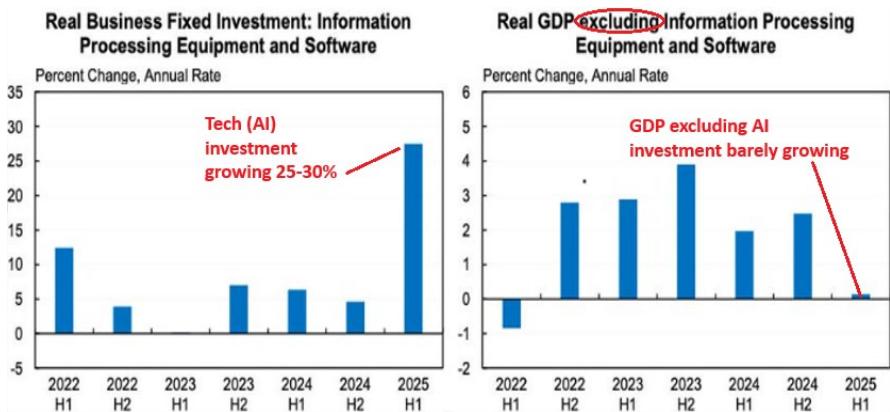


# LAURELHURST

## ASSET MANAGEMENT

### John's Market Outlook – December 19, 2025

Last Outlook, I said a “new rate-cutting cycle has started and the near-term outlook has improved”. 3Q earnings were positive, consensus estimates rose, the Federal Reserve cut again, and the S&P 500 is up so far in 4Q.



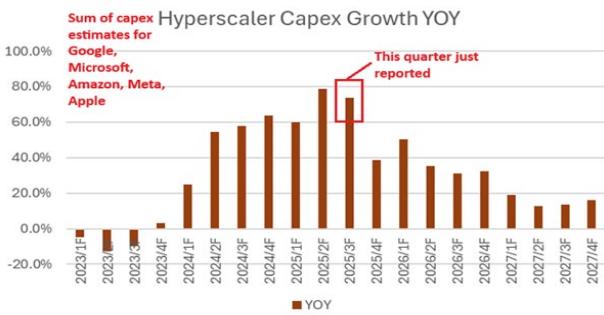
I am entering 2026 **more cautious**.

The US economy overall is growing about 2%<sup>1</sup>/. Excluding AI datacenter investment, the rest of the economy is barely growing. That growth is from consumer spending but low/mid income families are under growing stress. Employment is weakening, consumer sentiment is at record lows, and inflation is persistently too high. Spending is still solid from high income families supported by stock

market gains, with the top 10 AI/tech names nearly 40% of the S&P 500 index. *The 2026 question: whither the AI trade?*

The AI industry plans to invest \$5TR<sup>2</sup>/ in the next five years<sup>3</sup>/ which will require at least \$3TR of debt (bonds, private credit, securitization). With Big Tech’s capex growth set to slow (chart below), debt-funded spending is needed to sustain the industry’s growth. With growing debt, the AI industry must quickly become tremendously profitable. As much as \$0.5TR /yr AI earnings on \$2.5TR/yr AI revenue may be required in the next few years. For context, the entire S&P 500 has \$2TR/yr profit on \$18TR revenue and today AI is producing large losses on \$50BN revenue. Investors are concerned about the spending and payoff. OWL (#1 AI private credit funder) and ORCL (#1 AI debt issuer) are down -40% and -47% from highs<sup>4</sup>/.

As many big tech stocks have gone down in 4Q as have gone up.



With the S&P 500 near peak valuations from the Tech Bubble<sup>5</sup>/, the margin of safety is shrinking. Yes, AI may change the world. The internet *did* change the world. Yet in the early 2000s, when internet profits didn’t come quickly enough, stocks fell. A similar path for AI is possible. The weakening non-AI economy plus growing risk in the AI economy makes it prudent to reduce portfolio exposure.

<sup>1</sup> / 2% “real GDP” growth, or gross domestic production growth excluding inflation.

<sup>2</sup> / Mostly on datacenters, equipment, and power generation. \$5 trillion is larger than the GDP of Germany or Japan.

<sup>3</sup> / Estimates from JP Morgan “AI Capex – Financing The Investment Cycle” Nov 2025 and other sources.

<sup>4</sup> / As of 12/17/2025.

<sup>5</sup> / S&P 500 forward P/E 23X vs peak 25X March 2000.

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Our sector and stock positioning reflects the rate cutting cycle, these risks, and opportunities ex-US. At the same time, we maintain exposure to select AI names.

- I continue to hold bond duration quite short with securities such as a Floating Rate Bond ETF (FLOT), a short-duration TIPS ETF (VTIP), and a short-term corporate bond ETF (VCSH). Higher inflation usually pushes long rates higher, economic downturn usually pulls long rates down, and the Federal Reserve has some capacity to pull long rates down if forced to do so. Until there is more clarity on long rate direction, our longer duration holdings are limited.
- Gold (GLD) remains attractive. China and other countries are diversifying reserves from US Treasuries as part of building an alternative financial system beyond US control.
- Markets outside the US are much less expensive with lower concentration risk than the S&P 500, and have been outperforming the S&P 500 this year. Ex-US names are 30-40% of most portfolios' equity, with new names in 4Q including Brazilian iron/copper miner Vale (VALE), Central American warehouse store chain PriceSmart (PSMT), and diversified Japanese gas turbine name Mitsubishi Heavy Industries (MHVIY). We also have added to country ETFs for Japan (EWJ), South Korea (EWY), the Eurozone (EZU), and Latin America (ILF).
- China's growing military threat is driving Asian countries to raise defense spending, as the Russian threat is driving Europe to do the same. South Korea is a defense/industrial power (the North Korean threat never went away); I started adding an ETF of Korean defense companies (KDEF)<sup>6</sup>. Japan is doubling its defense spending and will likely allow weapons exports; Mitsubishi Heavy is also Japan's largest diversified defense company. I am trimming some existing US defense names on valuation.
- The US and Europe/Japan are accelerating efforts to build China-free supply chains for rare earths and other critical minerals. I have been adding Solvay (SVYSF), a Belgian rare metal refiner.
- We have exposure to AI equipment like Broadcom (AVGO) and Marvell (MRVL) for semiconductors, datacenter power names like Baker-Hughes (BKR), Mitsubishi Heavy, and EQT Corp (EQT), engineering and construction names like Jacobs (J), and several Big Tech/AI names such as Google (GOOG) and Microsoft (MSFT). I have reduced Oracle (ORCL), as the risk in its AI strategy is growing.
- The US housing market is weak, but enough rate cutting could stimulate housing construction. We have exposure building materials names like CRH Limited (CRH), Carlise (CSL) and James Hardie (JHX). If construction fails to recover, housing will revert to shortage, so I am still holding apartment REIT names like Essex Property Trust (ESS), which also pay decent dividends.
- There is a chance the Supreme Court may invalidate tariffs imposed under the IEEPA law. This would likely lift many stocks<sup>7</sup>, including consumer goods, food, and transportation names such as Columbia (COLM), VF Corp (VFC), Gap (GAP), Expeditors (EXPD), and CH Robinson (CHRW). The Administration will seek to re-impose tariffs using other laws, so the effect may be temporary.
- To reduce portfolio risk and increase income, I have been adding defensive, dividend-paying stocks such as Dominion Energy (D), Verizon (VZ), and Vale, and income-focused ETFs such as the JPM Equity Premium (JEPI) and Amplify Enhanced Dividend (DIVO) funds.

I would be happy to go deeper into this outlook and other investment topics than was possible in this brief summary. Please email [johnliu@laurelhurstasset.com](mailto:johnliu@laurelhurstasset.com) or call 510 847 0070. Thank you!

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<sup>6</sup> / Most South Korean stocks are difficult to buy directly and do not have US-traded ADRs.

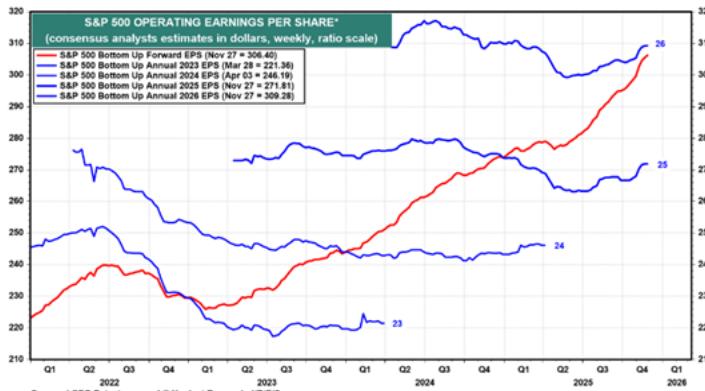
<sup>7</sup> / Lifting tariffs is equivalent to removing a tax on US businesses and consumers.

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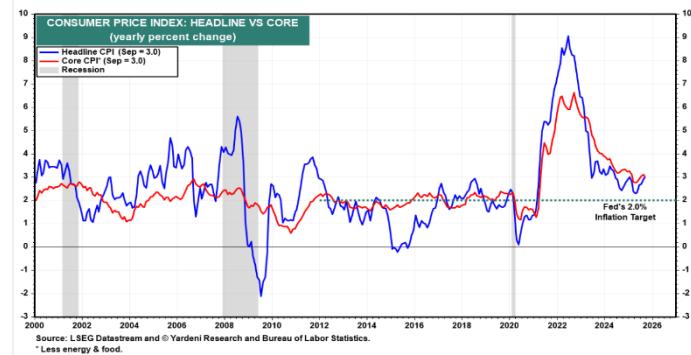
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## APPENDIX TO DECEMBER 2025 OUTLOOK – SELECTED CHARTS AND TABLES

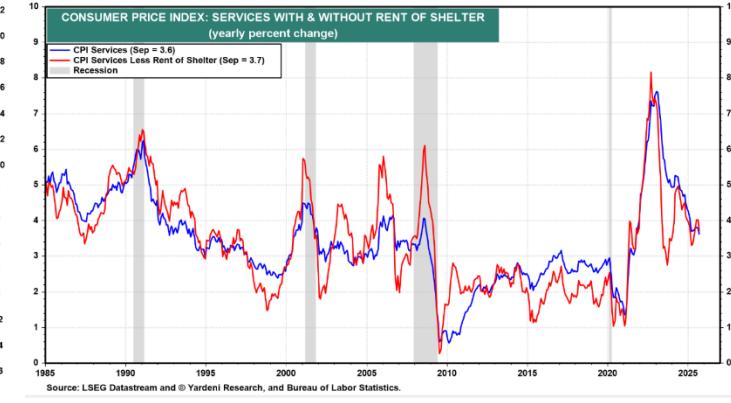
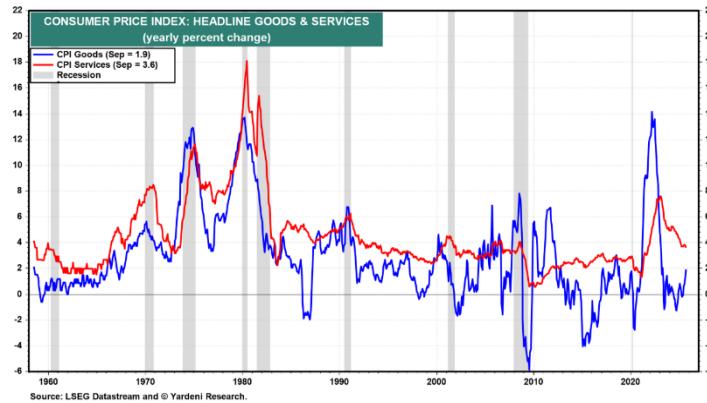


The improvement in current-year and out-year EPS estimates continued in 4Q (chart to left). These positive estimate revisions are a reason to maintain equity exposure, while shifting to less risky market sectors.

Progress on inflation has stalled and started to reverse<sup>8/</sup>, both headline (blue, in chart below) and core ex-food/energy (red).



Goods inflation (blue, in left chart below) is rising, partly from tariffs. Companies that absorbed tariffs in 2025 plan to raise prices in 2026. Services inflation (red, left chart below) is easing, but inflation in services ex-shelter is actually rising (red, right chart below). Slower growth in shelter prices are blunting inflation, but at a cost: weaker housing values weaken the economy.

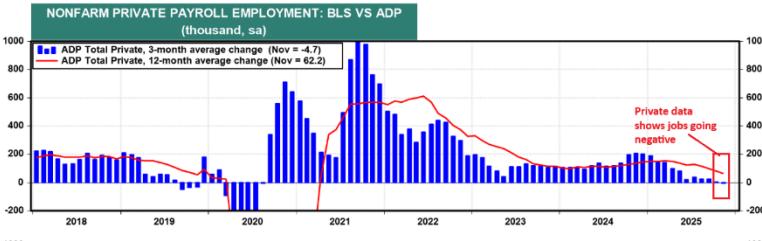


<sup>8/</sup> CPI inflation data may be uncertain going forward. Because BLS was not funded as “essential” during the Federal shutdown, it did collect data for October and much of November. October housing prices are treated as “unchanged” from April 2025. Housing is nearly a third of CPI and reported CPI may be artificially understated from the November 2025 report until, possibly, April 2026.

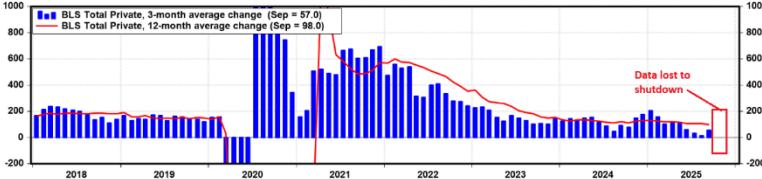
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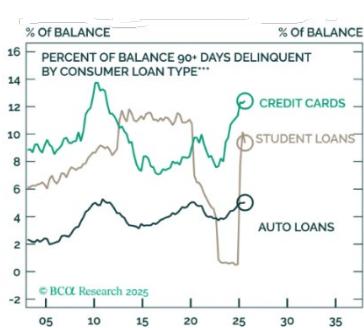
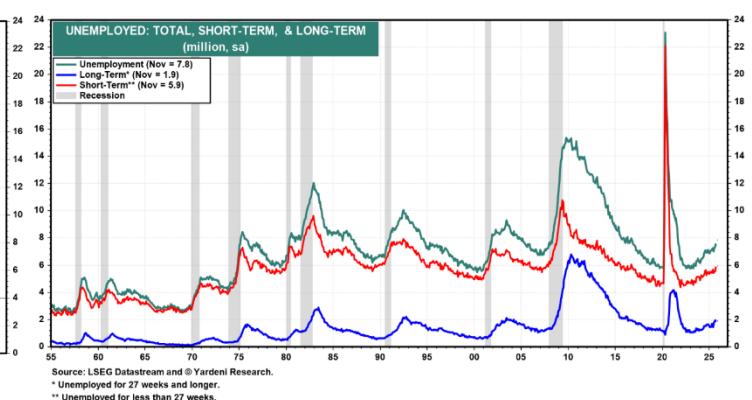
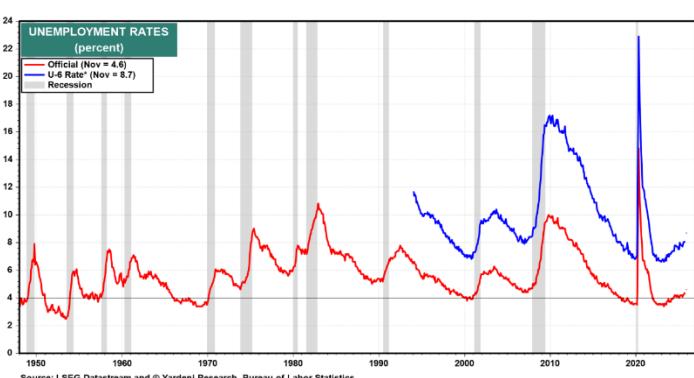


Private (ADP) jobs data shows job growth fading to zero/slightly negative.



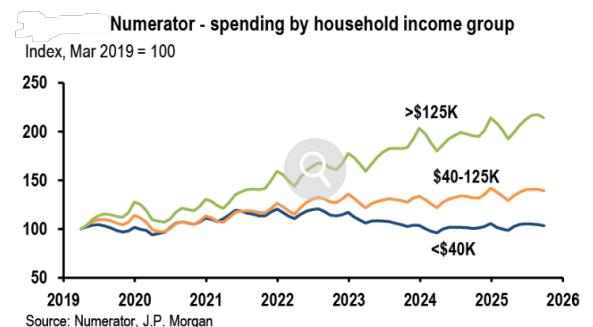
Government (BLS) jobs data was interrupted by the Federal government shutdown and has become less reliable.<sup>9/</sup>

The unemployment rate has climbed to 4.6%, the U-6 under-employment rate<sup>10/</sup> to 8.7%, and both short and long-term unemployment are moving up.



Consumer credit is weakening (left chart). Recent changes to healthcare funding will increase household stress in 2026.

So far, consumer spending is supported by higher-income households (right chart) who have more investment gains.



<sup>9/</sup> BLS jobs data is survey-based. Response rates are down and revisions up. BLS has also lost much staff resources.

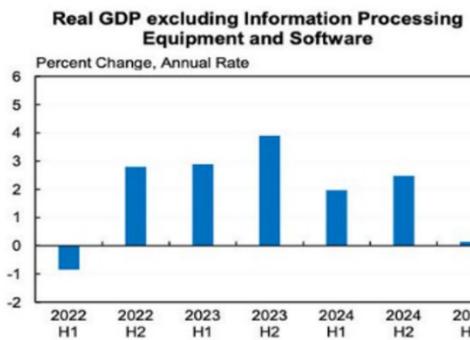
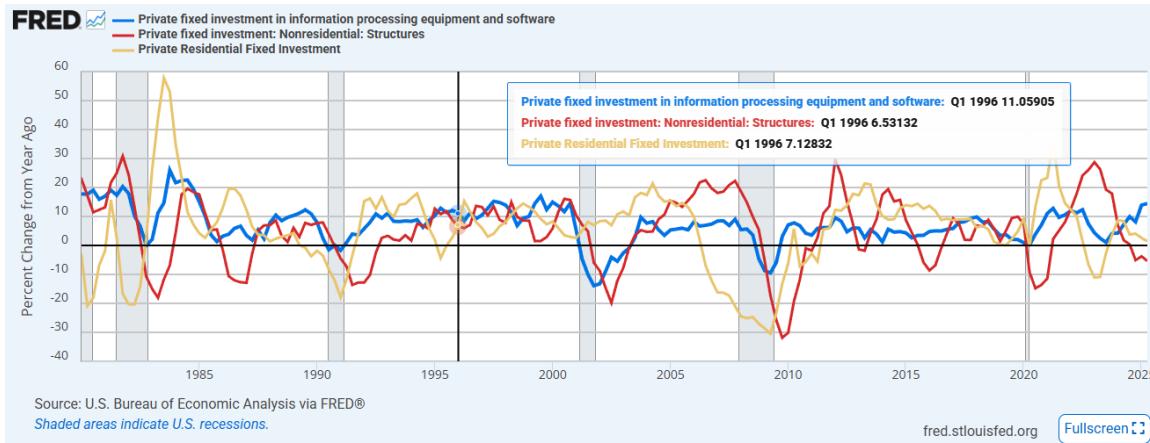
<sup>10/</sup> U-6 is unemployed, plus part-time who can't find full-time, plus discouraged job-seekers.

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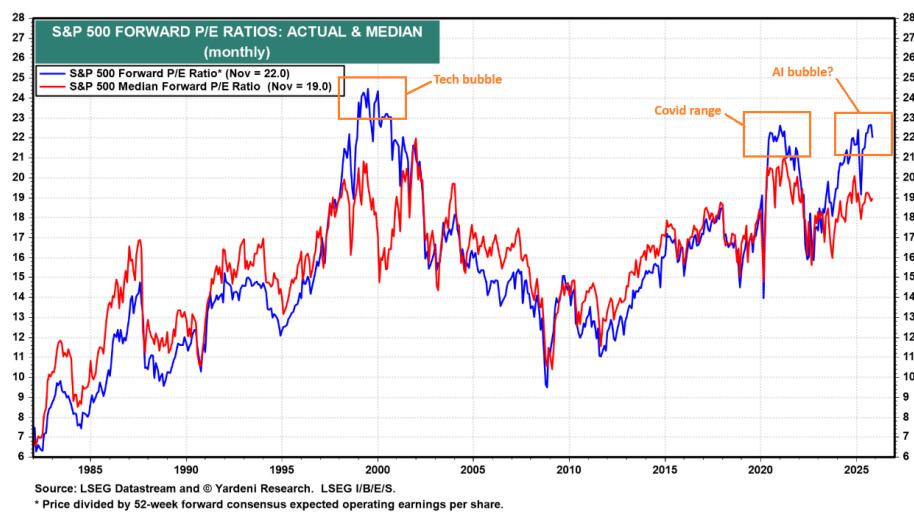
Investment in information tech (blue, chart below) has grown more than any time since the early 2000s, driven by AI datacenters. Investment in non-residential structures (red) is falling; this includes manufacturing and commercial facilities. Investment in residential (yellow) has slowed to zero growth.<sup>11/</sup>



The S&P 500's valuation (22X forward P/E) is approaching the 2000 Tech bubble range (chart below)<sup>13/</sup>. Markets at extreme valuations have higher risk.

Looking at GDP other than AI/tech investment, growth has slowed to almost a standstill (chart to left).<sup>12/</sup>

Growth in AI investment from the big tech companies who fund capex from earnings is set to slow, as noted above. To sustain high growth in AI investment and support GDP growth, other companies have to greatly accelerate their capex. Those companies have to fund capex with debt. We are starting to see negative market reactions to the highest-debt AI players.



<sup>11/</sup> Consumer spending + private fixed investment are the bulk of GDP.

<sup>12/</sup> If we disregard technology imports (imports reduce GDP), the "non-AI" economy's growth would still be at best 0.5%.

<sup>13/</sup> S&P 500 valuation is similar to late 2021 levels, before the 2022 market decline.

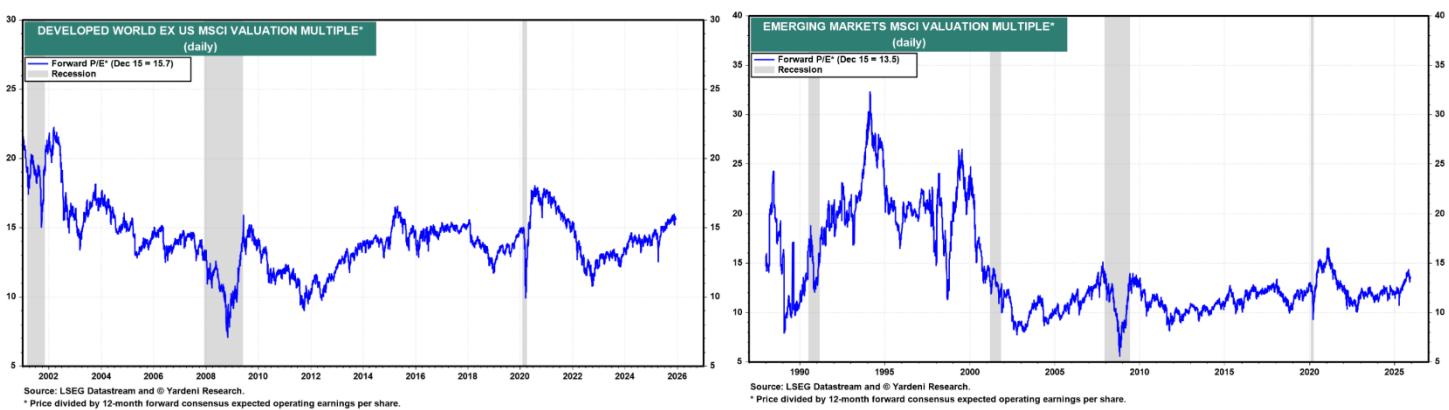
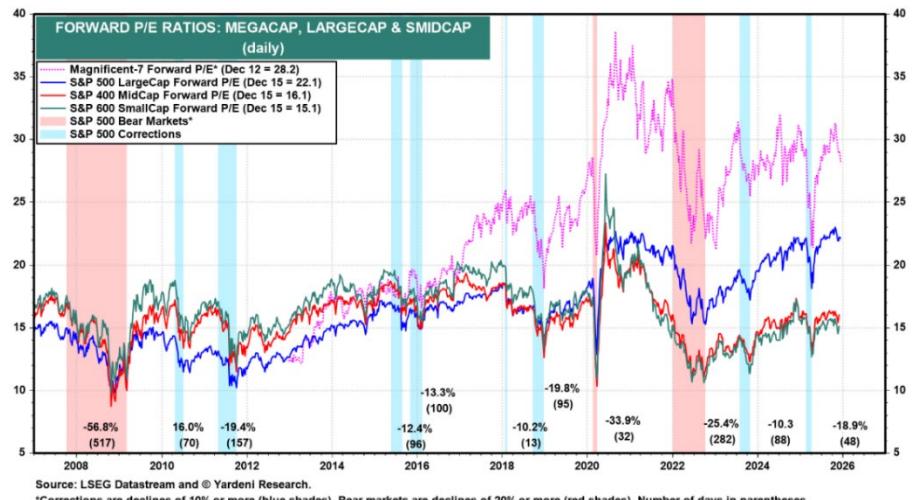
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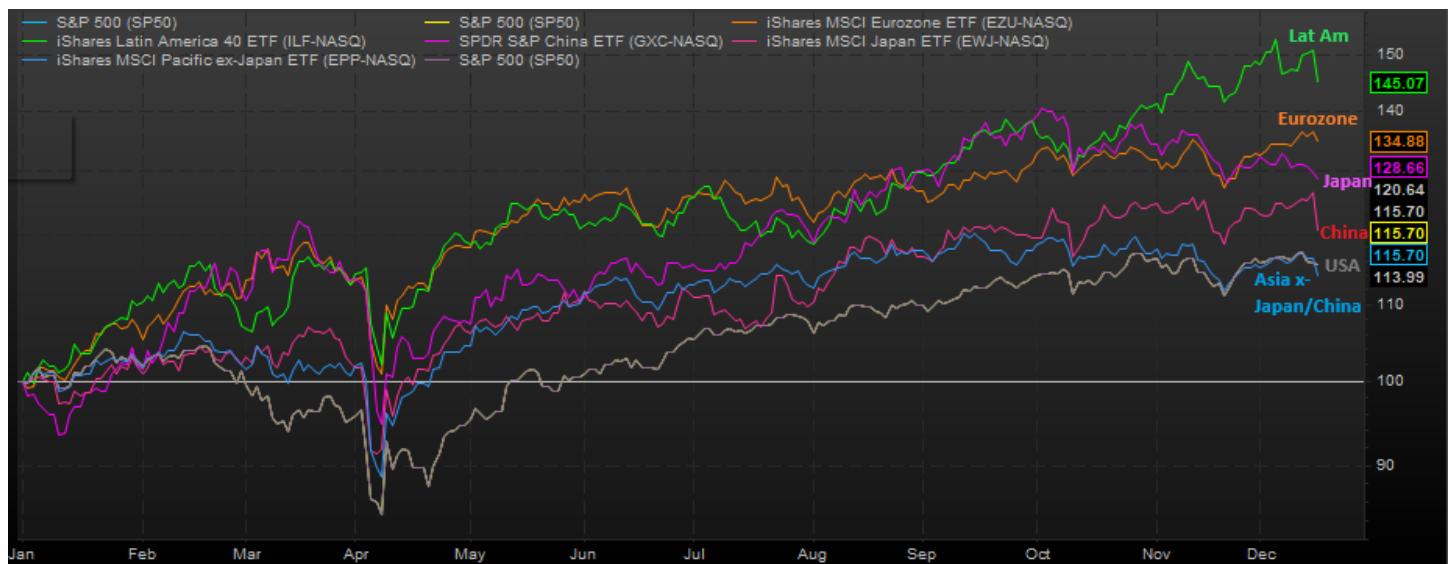
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Valuations away from big tech and the S&P 500 are more reasonable. Mid and small cap US stocks trade at about 15X. We are finding opportunity in smaller and non-AI stocks.

Valuations away from the US are more reasonable. Developed markets ex-US trade at about 15X, as do emerging markets.



Those non-US markets are outperforming the S&P 500 this year.



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