

Seven Investment Themes to Consider for 2026



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The stock market appears set to achieve double-digit gains for the sixth occasion in seven years. The sole exception during this period was the inflation-induced decline of 2022, leaving many portfolios in strong positions.

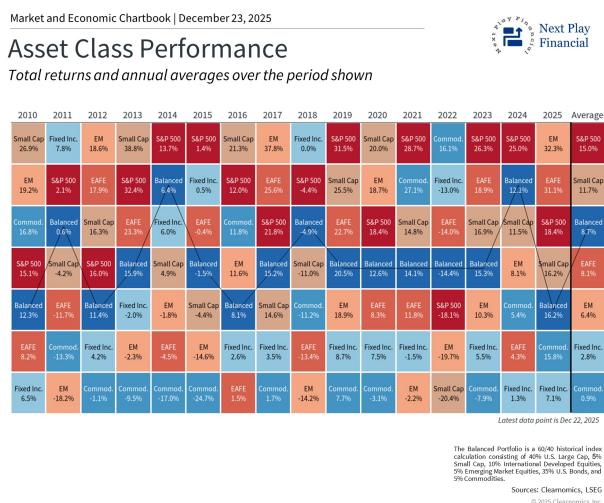
There's a common saying that anticipating something often exceeds experiencing it. While investors naturally welcome robust returns that benefit portfolios and financial objectives, anxiety can emerge once these gains materialize. This concern intensifies when major indices reach record levels and valuations climb toward heights last seen during the dot-com era.

Throughout 2025, significant developments occurred across various challenges that have occupied investor attention in recent years. Inflation has settled near 3%, continuing to impact households but showing stability. Trade policies, though elevated historically and driving market fluctuations in 2025, have not triggered the economic disruption many anticipated. The Federal Reserve has maintained its rate-cutting cycle while economic expansion has proceeded at a solid pace.

Taking a broader view, a crucial insight heading into the new year is that anticipated worst-case scenarios frequently fail to occur. The recession that many forecasted since 2022 never arrived. Historical patterns indicate that for every authentic market disruption, such as the 2020 pandemic or 2008 financial crisis, numerous feared "black swans" - unexpected, rare occurrences - simply do not happen. The real test for long-term investors involves maintaining discipline and perspective regardless of market conditions rather than attempting to predict specific outcomes.

Looking toward 2026, the investment environment offers both potential rewards and obstacles. Headlines will likely focus on topics including the midterm election, Federal Reserve leadership transition, artificial intelligence developments, lending concerns, dollar movements, and additional issues. The critical factor isn't forecasting every development, but ensuring portfolios can withstand uncertainty while capturing long-term appreciation. Seven essential themes can help frame investor thinking for the upcoming year.

Multiple asset classes are strengthening portfolios heading into 2026

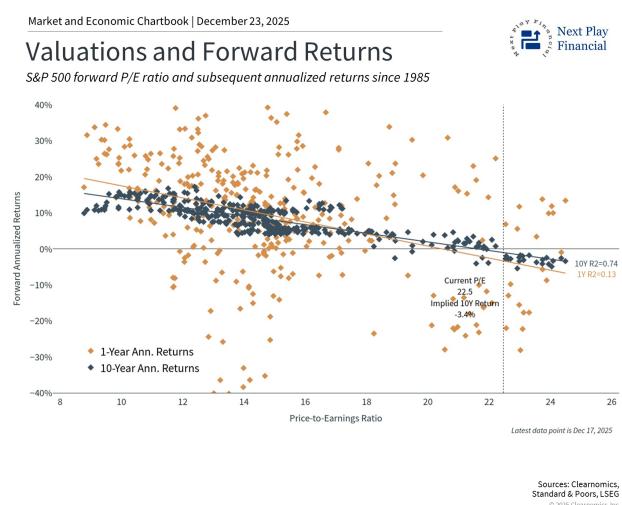


A significant development for investors approaching 2026 is that numerous asset classes are contributing to portfolio performance. This marks a shift from much of the preceding decade when U.S. equities dominated global markets. Throughout 2025, international equities have surpassed U.S. performance, with developed market stocks (MSCI EAFE) and emerging market stocks (MSCI EM) both advancing approximately 30% in dollar terms. Two primary drivers explain this: enhanced growth projections across various economies and dollar weakness, which amplifies returns for U.S.-based investors.

Fixed income has also fulfilled an essential stabilizing function within portfolios. The Bloomberg U.S. Aggregate Bond Index has risen 7% year-to-date as the Federal Reserve pursues rate reductions and inflation shows stability. Higher-quality bonds have delivered on their purpose by generating income and buffering equity market volatility during uncertain periods.

For the year ahead, this reinforces the value of balance and diversification. While headline-driven portfolio adjustments may seem appealing, investors who maintain their financial strategies are positioned to benefit.

Valuations are climbing toward dot-com era territory



A consequence of several years of strong performance is that equity valuations continue their upward trajectory. The S&P 500 currently reflects a price-to-earnings ratio of 22.5x, nearing the record high of 24.5x established during the dot-com bubble. This indicates that investors are paying more for each dollar of prospective earnings compared to recent periods.

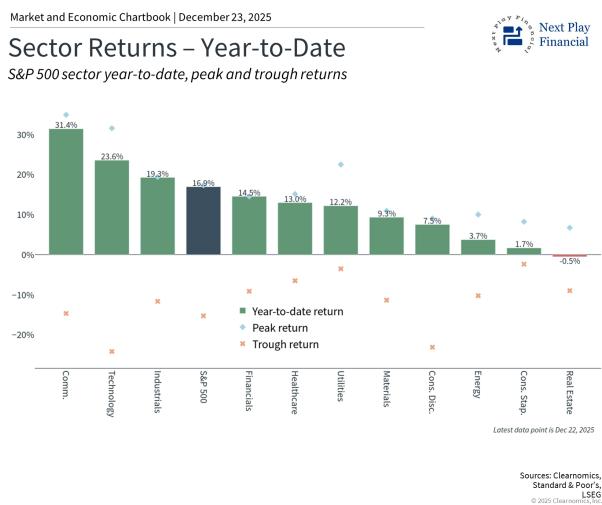
Valuation concerns typically arise when prices become detached from underlying fundamentals. During the dot-com bubble, for instance, historic valuation levels far exceeded revenues and earnings as investors favored any company associated with the "new economy." Though

valuations appear expensive today amid AI enthusiasm and continued economic expansion, corporate fundamentals remain solid. Earnings have increased at a healthy rate, with expectations for continued growth according to consensus estimates data by LSEG.

Understanding what elevated valuations reveal and what they don't is essential. Valuations don't necessarily signal imminent market corrections since markets can sustain expensive levels for prolonged periods. While concerns about an "AI bubble" exist, not every bubble bursts dramatically. Some deflate gradually as fundamentals align with expectations. This distinguishes the dot-com collapse of the late 1990s and early 2000s from the gradual expansion of cloud computing over the past decade.

Nevertheless, elevated valuations suggest potentially more moderate future returns, as markets have already incorporated anticipated growth. This can also heighten market sensitivity to disappointments. Investors often describe such markets as "priced for perfection," where even small earnings or economic data misses can trigger volatility. This means selectivity and maintaining balance across various market segments - encompassing asset classes, sectors, sizes, styles, and more - becomes increasingly important.

Artificial intelligence continues fueling growth and performance



No trend has commanded investor attention quite like AI. Capital spending on AI infrastructure reached exceptional levels in 2025, with total investment easily reaching trillions of dollars. This encompasses constructing data centers, acquiring equipment including GPUs, and recruiting AI researchers.

Some investments involve arrangements that appear circular. For instance, Nvidia invested up to \$100 billion in OpenAI, which subsequently purchases millions of Nvidia's chips. These interconnected relationships have sparked questions about the AI ecosystem's sustainability should enthusiasm diminish.

These patterns illustrate that AI demands infrastructure few companies can fund independently. The central question is whether the technology will ultimately create sufficient value to warrant the massive expenditures. Currently, AI investment represents a substantial contributor to the broader economy.

Survey data indicates businesses are increasingly incorporating AI into operations. According to the Census Bureau's Business Trend and Outlook Survey, the proportion of businesses reporting AI use more than doubled from 4% in September 2023 to 10% in September 2025. The share of businesses anticipating AI use over the next six months increased similarly, from 6% to 14% during the same timeframe.¹ While these figures have jumped, considerable growth potential remains.

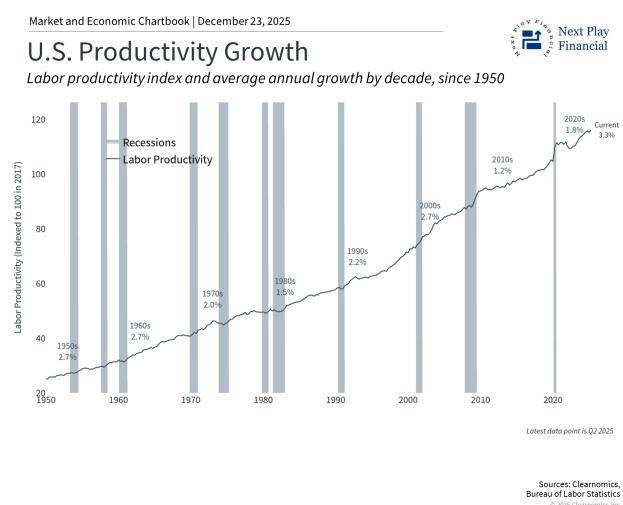
For investors, AI presents both opportunity and risk. The Magnificent 7 technology companies continue driving markets higher, supported by infrastructure investments and expanding AI tool adoption. However, this concentration creates vulnerability. These companies now comprise roughly one-third of the S&P 500, meaning most investors hold substantial exposure, whether recognized or not.

The question isn't whether AI will reshape the economy - it undoubtedly will. Rather, it's whether

current valuations appropriately reflect realistic timelines for returns on these substantial investments. History spanning from the 1860s railroad boom to the 1990s dot-com era demonstrates that transformative technologies often follow comparable patterns: initial skepticism, rapid adoption, market enthusiasm, and eventual integration into the wider economy.

The essential lesson is that markets frequently overestimate profit generation speed. Most investors likely hold AI exposure either directly or through major indices, making awareness of this concentration and adherence to an appropriate asset allocation aligned with long-term objectives crucial for the coming year.

Economic expansion is moderating but remains constructive



Economic growth patterns have decelerated yet remain stronger than many anticipated. U.S. GDP experienced a minor negative movement in the first quarter of 2025, but recovered swiftly as tariff uncertainty subsided. The 3.8% growth rate in the second quarter not only surpassed expectations but represents one of the most robust quarterly growth rates in years.

Regarding global GDP, the International Monetary Fund projects growth could ease marginally from 3.2% in 2024 to 3.1% in 2026. Advanced economies are projected to expand around 1.5%, while emerging markets are forecast to sustain growth

above 4%.²

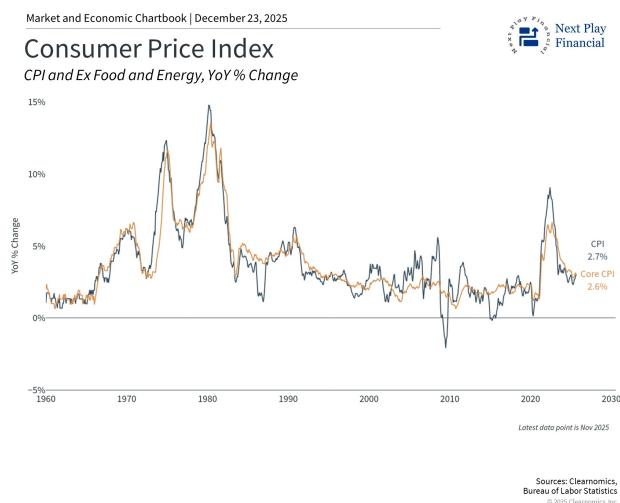
Although positive overall, economic growth has been uneven across income groups and sectors. This concept is frequently described as a "two-speed" or "K-shaped" economy, as some experience expansion while others face challenges.

In the current economy, this divergence primarily stems from technology trends, since those positioned to capitalize on AI growth could encounter better job prospects than those in traditional industries. However, factors beyond AI, including consumer debt, auto loan delinquencies, and other financial pressures, can determine whether individuals benefit from economic growth.

Regarding long-term economic expansion, perhaps the most significant question involves whether productivity will increase due to recent technological advances. Productivity measures how much, in quality or quantity terms, a worker can produce within a given timeframe. Historically, improved equipment, training, and education have driven greater productivity, which fuels genuine economic growth.

As the chart illustrates, productivity growth averaged merely 1.2% annually during the 2010s. The promise of AI and new technologies is enhanced worker output. However, this often requires more time than expected and won't necessarily benefit everyone equally. For investors, the prospect of improved productivity means profit margins can expand, supporting the wider economy and investor portfolios.

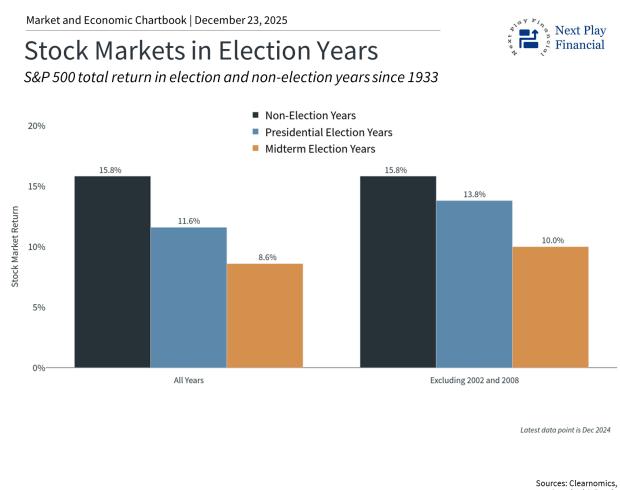
Tariff implications remain unclear



announcements. Finally, robust consumer spending, fiscal stimulus, and healthy growth in AI-related sectors helped counterbalance any negative impact on overall growth. Additionally, the Supreme Court may rule in 2026 on the legality of the economic justification employed for these tariffs.

For long-term investors, these recent developments, combined with the initial trade negotiations in 2018, emphasize that tariffs represent part of the government's toolkit. Rather than viewing these tariffs as a fundamental shift, they instead constitute tools for the administration to advance broader policy objectives. While tariffs aren't disappearing, their impact on daily market activity may diminish.

Midterm election and fiscal debt will command attention in 2026



from larger tax refunds due to OBBBA provisions including full expensing of research and development.

While tariffs drove primary stock market volatility in 2025, their economic effects have been mixed. In fact, one ongoing puzzle involves how minimal immediate impact tariffs have had on inflation and growth. Despite tariff costs rising tenfold compared to prior year averages, measures including the Consumer Price Index have increased only marginally.

Several explanations may account for why tariffs have not produced anticipated effects. First, many announced tariffs were rapidly paused or reduced. Second, numerous companies absorbed initial tariff costs by maintaining stable prices and importing goods ahead of tariff

Beyond trade policy changes, 2025 also witnessed a historic 43-day government shutdown and persistent concerns regarding budget deficit size. Simultaneously, the recently enacted One Big Beautiful Bill Act (OBBBA) tax legislation has provided increased clarity for investors and taxpayers.

The new year will commence with additional Washington uncertainty as the short-term funding bill expires at January's end. This could trigger another round of negotiations potentially resulting in another government shutdown. Subsequently, some investors anticipate households and businesses will benefit

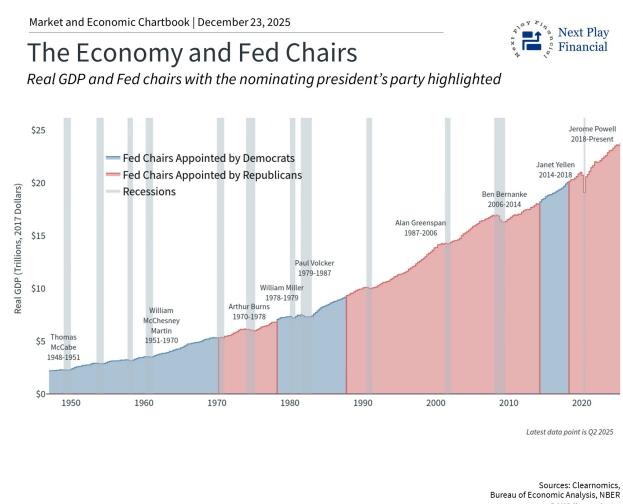
Looking further ahead, investors will likely redirect attention to the midterm election and its potential implications for tariffs, regulation, government spending, and additional matters. The chart demonstrates that midterm elections have historically delivered healthy returns, averaging 8.6% since 1933, even if slightly below non-election and presidential election years.

Nevertheless, the primary concern for many investors involves the continually expanding national debt. The reality is that the historically elevated national debt, hovering around 120% of GDP for total debt, or exceeding \$36 trillion, is unlikely to be resolved soon. In fact, estimates suggest the OBBBA could increase the national debt by over \$4 trillion in the next decade. Currently, the national debt amounts to over \$106,000 per American.

For long-term investors, recognizing what we can and cannot control is important. For example, the national debt has posed challenges for decades, yet investing based on these concerns would have resulted in incorrect portfolio positioning. While U.S. federal debt sustainability may have implications for economic growth and interest rates, history demonstrates this should not be the primary portfolio driver.

Instead, what investors can control in the near term is understanding key tax legislation changes and their impact on long-term planning. These include the fact that lower tax rates from the Tax Cuts and Jobs Act are now permanent, estate tax exemption levels will remain elevated, SALT deduction caps have increased, and numerous other provisions. This represents an ideal time to review tax strategies to ensure full advantage of these new rules.

The Federal Reserve will continue supporting economic conditions



The Fed resumed rate reductions in September after pausing earlier in the year. Entering 2026, the monetary policy trajectory could become less predictable. This is because runaway inflation risk may no longer be the primary concern as a weakening job market has gained importance. This requires policy rate adjustments rather than dramatic shifts like those witnessed in 2022.

An additional complication involves Fed Chair Jerome Powell's term ending on May 15, 2026, creating opportunity for new Federal Reserve leadership. The White House is expected to appoint a successor who may support additional rate cuts to

advance the administration's economic agenda of lower interest rates.

The chart illustrates that the economy has performed well under Fed Chairs appointed by both parties. It's important to recognize that the Fed only controls the "short end" of the yield curve, meaning interest rates closely tied to the federal funds rate. Long-term interest rates depend on numerous other factors, including economic growth, inflation, and productivity. Therefore, rather than tracking the Fed's every action and analyzing every statement, investors should continue focusing on these longer-term trends to understand the impact on interest rates and bonds.

Maintaining perspective throughout 2026

Entering 2026, investors confront a familiar challenge: balancing concerns with the reality that markets have consistently rewarded patient, disciplined investors over time. The list of worries persists, yet history indicates that for every crisis disrupting markets, many more feared events have failed to occur. What distinguishes successful long-term investors isn't predicting which concerns matter most, but maintaining balance throughout all market cycle phases.

The bottom line? Markets have produced strong returns, but elevated valuations and moderating global growth suggest tempering expectations for 2026. Rather than attempting to time the market based on any single concern, investors should focus on maintaining balanced portfolios positioned for various outcomes.

References

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