WEALTH MANAGEMENT 360
FARMERS TRUST COMPANY

MARKET UPDATE & OUTLOOK | Q1 2026

COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options. We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well. Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

MARKET RECAP

Investors enjoyed another quarter of strong asset return breadth in Q4 of 2025. The Federal Reserve (the Fed) lowered interest rates again in December, delivering a holiday gift for investors, who had plenty to show under their Christmas trees already. The equity market was led by the Health Care sector, which was up 11.7% for the quarter. The Communication Services sector followed as second, up 7.3%. Real Estate and Utilities were the only two sectors to finish the quarter in the red, down 2.9% and 1.4% respectively. Large-cap Value outperformed Large-cap Growth by 1% during the quarter, but Large-cap Growth was 9% ahead for the year. Small-cap stocks, represented by the Russell 2000 Index, were up 2.2% in Q4, finishing the year up 12.8%.

International equity was the star performer of the year as it finished the year with another solid quarter. The MSCI EAFE Index of developed markets was up 4.9% in Q4, taking its full-year return to 32%. Similarly, the MSCI Emerging Markets Index was up 4.8% in Q4, finishing the year up 34.3%. A weak US Dollar, which was down 9% last year, represented a meaningful tailwind for international equities.

The benchmark GSCI Commodity Index was up 0.8% in Q4 and up 6.2% for the year. However, commodity performance was bifurcated. Precious metals prices were up 20.7% for the quarter as per the Bloomberg Precious Metals Index and up 72.8% for the year. The energy complex struggled and the WTI Crude Oil futures contract was down 7.9% for the quarter and down 19.9% for the year.

Last year was a bounce-back year for the bond market, with positive returns showing breadth across various maturities and credits in Q4 as well as for the whole year. The Treasury bond yield curve steepened during the quarter as the Fed cut rates by a quarter point (25 basis points) at each of its last three meetings of the year. The interest rate spread between the 2-year yield and the 10-year Treasury bonds increased by 16 basis points to 69 basis points during the fourth quarter. The Bloomberg US Aggregate Index was up 1.1% for the quarter and finished the year up 7.3%.

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MARKET SCORECARD as of 12/31/2025	TOTAL RETURN IN USD	
	Q4	2025 TR
DOW JONES IND AVG	4.0%	14.9%
S&P 500	2.7%	17.9%
NASDAQ	2.7%	21.2%
RUSSELL 2000 INDEX	2.2%	12.8%
MSCI EAFE EQUITY (GROSS)	4.9%	32.0%
MSCI EMERGING MARKET EQUITY (GROSS)	4.8%	34.3%
BLOOMBERG GLOBAL AGG BOND INDEX	0.2%	8.2%
BLOOMBERG INTERM. TREASURY	1.2%	6.5%
BLOOMBERG INTERM. GOVT/CREDIT	1.2%	7.0%
BLOOMBERG 5 YEAR MUNI INDEX	0.5%	5.0%
BLOOMBERG HIGH YIELD CORP INDEX	1.3%	8.6%
ishares S&P GSCI COMMODITY TR INDEX	0.8%	6.2%
HFRX ABSOLUTE RETURN INDEX	1.4%	5.6%

Note: All returns include invested cash flows expressed in U.S. dollar terms.

KEY POINTS

- US economic growth has stayed resilient but momentum has weakened as we enter the new year. The consumer has remained strong but a cooling labor market raises risks.
- Inflation has been easing yet the future trajectory remains unclear given the cross-currents of easing monetary policy and U.S. dollar weakness pushing up commodity prices.
- Our investment outlook sees a broadening of equity performance away from the mega-cap tech sector into the other parts of the market, specifically cyclicals and defensives. We also see attractive opportunities in the mid-cap and small-cap space.
- International equities, specifically emerging markets, as well as alternatives, such as commodities and REITs, offer attractive risk/reward in favor of fixed income.

GLOBAL MACROECONOMIC REVIEW & OUTLOOK

As the US economy closed out the final quarter of 2025, data pointed to a mixed but resilient growth backdrop. We observed solid underlying demand, persistent but cooling inflation, a softening job market, and some key risks tied to policy uncertainty and global externalities. Headline GDP growth came in at 4.3% for Q3 and estimates for Q4 have showed stronger-than-expected momentum. Expansion has largely been driven by robust consumer spending and service activity as Retail Sales grew at a 6% annualized pace in November. On the business activity front, PMI readings show a picture of weakening growth. The U.S. manufacturing PMI for December remained in contraction (47.9) with the lowest reading of the year, while the services PMI remained in expansionary territory (52.5), but also exited the year at its lowest level.

The labor picture has remained relatively tight but is showing signs of softening. The pace of job gains has slowed relative to the post-pandemic boom. The unemployment rate continues to hover around 4.5%, indicating no acute slack in the labor market. However, hiring dynamics have been softer with job openings in November just over 7 million, which was the lowest number for the year. Moreover, US job numbers were revised down in all eleven months of last year for a total of -624k. In other words, each jobs report was revised down by an average of more than 56k jobs. That is concerning given the sluggish pace of current job creation, which was reported at 50k for the month of December and has yet to be revised.

One positive for the economy has been the trend of moderating consumer inflation on the back of easing energy and shelter prices. The December Core Consumer Price Index was up 2.6% year-over-year, which was below expectations of 2.7% and was also the lowest reading of the year. It remains to be seen how sustainable the disinflationary trend will be in light of easing monetary policy. Further evidence of moderating inflation will likely be needed in order for the Fed to move forward with additional rate cuts in 2026.

INVESTMENT OUTLOOK

We enter 2026 with a heightened degree of caution but also some green-shoots of optimism. The market is likely to find itself in the crosswinds of several key factors this year. Among those are uncertainty around the effects of tariff implementation, potential positive tax ramifications from the Big Beautiful Bill, and rising geopolitical uncertainty. What is encouraging is that we see some signs of strength in the US equity market that go beyond the Technology sector and the Artificial Intelligence (AI) trade. The key question remains if the extreme level of equity market valuation and concentration in the largest tech stocks may exert a negative gravitational pull on the rest of the market and indirectly on the economy itself via the wealth effect. That remains to be seen.

We continue to be focused on several key signposts to help us determine the likely trajectory for the market and the economy this year. Those include 1) the level and the shape of the US Treasury yield curve, 2) the Federal Budget's trajectory, and 3) the US dollar exchange rate. Incremental developments in those are likely to be a presage for the direction of the equity market and various asset classes. It is worth noting that long-term US bond yields (10-30yrs) remain sticky; above 4% on the 10-year rate. Those yields have risen by approximately 10bps since the Fed re-started its lowering cycle in September of last year. It is still not clear to us whether the steepening of the yield curve is a sign of future economic strength or simply a rising term premium to compensate investors for the uncertainty regarding inflation and the Federal budget. The latter has showed some incremental but inadequate signs of improvement, with the fiscal Q1 US Federal budget deficit coming in at $602bil and projecting to a whopping $2.4T or more than 7% of GDP for the year. Investors are projecting two quarter-point cuts in '26 as official inflation statistics have cooled off. However, new rate cuts promise to put additional pressure on the US dollar, which in 2025 had its worst year since 2017 and second-worst since 2007. A weaker US dollar would be a positive for commodities, which could in turn then further increase inflationary pressures.

Our underweight stance in US Equities relative to our benchmark remains, but is augmented by our preference for diversification away from the AI trade. We prefer a broader exposure to the equity market, including carrying an overweight in cyclicals (Industrials, Materials, Energy), defensives (Consumer Staples, Health Care, Utilities, Real Estate). This comes at the expense of the Technology and the Consumer Discretionary sectors, where we are underweight and see the biggest risk in the form of excessive valuation and earnings uncertainty, respectively. We also like the Small-cap and Mid-cap areas of the market, which we see as the biggest beneficiaries of the less cumbersome regulatory agenda of the Trump administration. We also favor Emerging over Developed international equities relative to our benchmark. We are underweight Fixed Income with a neutral duration target and a preference for short and intermediate Treasury securities. We favor a balanced approach to credit as yields have tightened significantly in historical terms but see value in the Mortgage-Backed part of the market. Commodities and alternatives (e.g., REITs) continue to appeal to us for their risk-reward relative to other asset classes.

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