

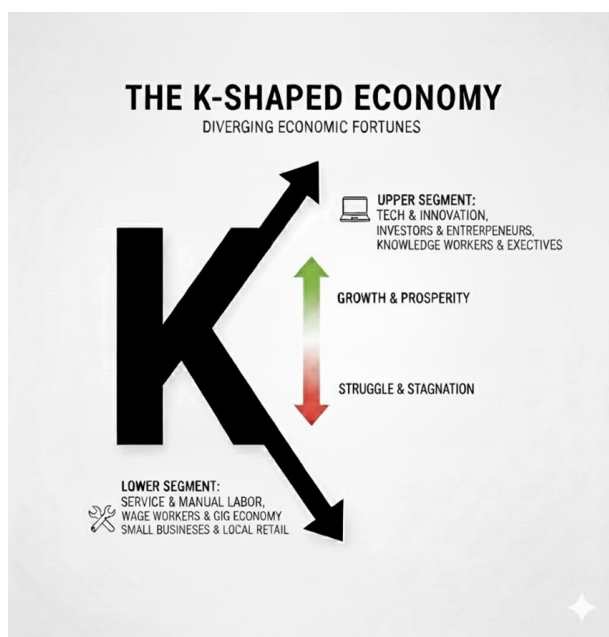
VIEWS FROM THE ROAD

The Year of Divergence: Navigating the K-Shaped Economy

With a new year underway, we are assessing an investment landscape defined by economic unpredictability and geopolitical tension. It is a world where two parallel economies—and markets—are running at different speeds. This may prove to be The Year of Divergence: divergence in the economy, in consumer behavior, and in stock market performance.

The K-shaped consumer economy is arguably the defining feature of the current economic cycle. On the high-end of the “K”, rising wages and surging prices of housing and financial assets have created a sense of permission for continued discretionary spending, which is powering the economy. Conversely, the low-end of the “K” is defined by a struggle for affordable essentials. Even as inflation moderates, the cumulative multi-year impact of price increases weighs on consumers who are navigating cash flow needs, managing credit card balances, and worrying about job security.

While GDP growth has been strong and unemployment has remained low, economic indicators like the consumer sentiment index and manufacturing PMI have been soft. We have begun to see a shift to corporate headcount austerity, with companies either pausing new hires or shedding jobs altogether. This dynamic appears driven less by recessionary fears than by persistent trade policy uncertainty, immigration enforcement actions, and corporate pragmatism regarding the impact of AI, which has put future business staffing needs in question.



Market Breadth: Beyond the Concentration

Despite the uncertain backdrop, the S&P 500 is hovering at or near all-time highs after three years of robust double-digit total returns. Over this period, the S&P 500’s performance has been narrowly concentrated in a small group of companies, including the tech focused “Magnificent 7”, which now constitutes 34% of the S&P 500’s total market capitalization. These market concentration levels have officially surpassed all major historical peaks, including the Dot-com bubble and the “Nifty Fifty” era of the 1970s.

Investors are beginning to scrutinize the sustainability of technology-related spending levels on AI infrastructure, which has largely powered the Mag 7 constituents. There are also growing levels of investor skepticism and a rising burden of proof that these companies will be able to achieve an adequate ROI (return-on-investment) on their unprecedented capital outlays.

The current market landscape—marked by extreme concentration and the fact that 70% of S&P 500 constituents have trailed the benchmark—suggests a prime environment for a leadership rotation in 2026. As skepticism regarding the ‘AI trade’ mounts and valuations approach Dot-com-era peaks, investors may pivot toward overlooked pockets of value. Specifically, sectors that remained on the sidelines during the past three years may now offer the most compelling risk-adjusted returns.

Increased market breadth would be favorable to the relative performance of our portfolios, which remain more diversified in comparison to the S&P 500 and reflect a wider swath of the global economy.

The Return of Dealmaking and IPOs: Signs of Life

While the spotlight has shone intensely on AI, we would note there has also been material pickup in corporate M&A and IPO activity outside of the immediate AI sphere.

A lighter regulatory touch is expected to further catalyze banking activity, lending, and mergers across a variety of traditional sectors. Despite macro uncertainty, we are seeing a vote of confidence as boards deploy capital for strategic growth in technology, media, healthcare, financial services, and industrial sectors.

Furthermore, the IPO market, after years of stagnation, is finally thawing. A rebound in new issues—from fintech to life scienc-

VIEWS FROM THE ROAD

es—indicates that capital markets are embracing a broader range of companies beyond the mega-cap tech giants.

The Tariff Test: Sustainability and Strategy

Despite the headwinds from the Liberation Day tariff announcements last April, many firms demonstrated significant cost discipline, leading to earnings beats and expanded margins in 2025 as robust revenue growth outpaced rising expenses.

However, the full impact of these trade policies is still working its way through the system, with the pass-through of tariffs to consumer prices expected to peak in the first half of 2026. The ability for companies to maintain their edge is now a matter of balancing operational flexibility with long-term strategic planning needs.

Laggards and Traditionally Defensive Sectors

Large parts of the U.S. economy have been experiencing recession-like conditions over the past two to three years, including commercial construction, housing, freight, and industrial production. We firmly believe that activity levels in these industries cannot remain muted indefinitely.

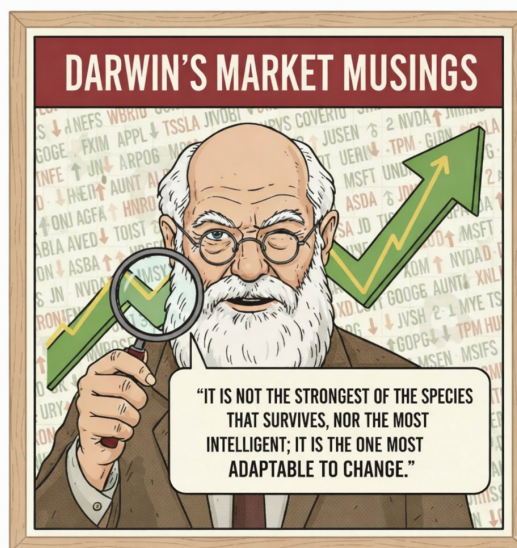
The cyclical weakness in these areas has been oddly coupled with uncharacteristically soft demand for stocks in traditionally defensive areas like Healthcare and Consumer Staples. These sectors are experiencing pressure from government policy shifts, disruptive innovation, as well as unfavorable price-volume dynamics. These phenomena have created a period of underperformance in these classically defensive plays, but both should be well-positioned for attractive returns through earnings growth, multiple expansion, and dividend income.

The Fed Reserve: Great Expectations

Market valuations already largely reflect the expected interest rate easing cycle, with futures pricing the Fed Funds rate to fall from 3.65% today to roughly 3% by late 2026.

However, the “Fed Put” remains a potent backstop. The market expects the Trump administration to appoint a notably dovish Fed Chair successor, which could accelerate rate cuts if the labor market—particularly AI-displaced white-collar roles—deteriorates.

Any further monetary easing could be a meaningful boon for the stock market and interest rate sensitive sectors like real estate, durable goods, and small business formation.



Conclusion: Adaptability is Key

In his study of evolution, Charles Darwin famously noted that “it is not the strongest of the species that survives, nor the most intelligent; it is the one most adaptable to change.”

In the business world of 2026, we believe this principle has never been more relevant. In this backdrop of divergence, the winners in our portfolios will likely be those companies that:

- **Effectively Leverage Technology:** Deploying technology not just as an add-on, but as a foundational pillar to help rewire cost structures, streamline operations, and enhance customer experience.
- **Capitalize on Supply Chain Advantages:** Positioning operational footprints to capture market share in the post-tariff environment.
- **Offer Premium or Value:** Serving either the high-end consumer or the highly cost-conscious consumer.
- **Possess Defensive Characteristics:** Staples, Healthcare, and REITs will likely experience stable demand and provide attractive dividends while the broader market rotates.

We continue to believe a diversified, long-term approach to investing is essential for navigating this complex environment. While volatility will undoubtedly persist, it will also produce attractive opportunities to invest in the companies positioned to lead the next leg of this multi-speed economy.

We wish you and your families a happy and healthy 2026.

VIEWS FROM THE ROAD

About DCLA:

Douglas C. Lane & Associates (DCLA) manages approximately \$8 billion in total assets for high net worth individuals, institutions, trusts, pension and profit sharing plans and endowments through customized, individually managed portfolios. Based in New York City, DCLA is a core investment manager that creates customized portfolios of common stocks and bonds using tax-efficient strategies based on individual client needs. Investments are a result of our own fundamental research. Portfolios are not style constrained and hold large and small cap, growth and value, domestic and international stocks. The personalized nature of our client relationships enables us to complement investment results with a full suite of wealth management services.

Disclosure:

The information presented herein is for illustrative purposes only. It does not constitute an offer or solicitation of securities or investment services or an endorsement by DCLA of any company or its products or services. It should not be assumed that recommendations made in the future will be profitable. All investments carry a risk of loss, including the possible loss of principal. There is no assurance that any investment will be profitable. This commentary contains forward-looking statements, which are provided to allow clients and potential clients the opportunity to understand our beliefs and opinions in respect of the future. These statements are not guarantees and undue reliance should not be placed on them. Forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual results in future periods to differ materially from our expectations. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.