Look Out for Those Outlooks

Report for the week ending Dec 20, 2025

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Monologue

There will be no arc_Tangents Weekly Note on the weekend of 27th December. We want to thank our early subscribers for your support and engagement. We look forward to resuming regular service on 03 January

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It's standard practice at year-end to evaluate how one's calls from the start of the year panned out. This is a no-lose exercise, which is why everyone does it. You either get to humblebrag correct calls, or you win credibility points for honestly admitting mistakes.

Having launched only a few months ago, we don't have the opportunity to exploit this little reputational arbitrage. If you think that's stopping us from participating in the annual retrospective party, recharge your eggnog and think again. We're having our own fun evaluating everyone else's consensus calls going into 2025, with an assist from GenAI. If we learned anything from the exercise, it's that the "Heisenberg Principle of Forecasting" – that you can predict the direction or timing of market/data movements, but never both – is true.

You can read that in the **MEMO** section of this week's note.

A serious note on the topic of outlooks: we've **published our 2026 Outlook**. Inspired (or maybe daunted) by the historical difficulty of year-ahead forecasts, we've avoided the typical prognostications and instead framed our thinking around **what we believe won't happen**. You could call it an **"anti-outlook."**

The document also includes our top out-of-consensus global calls, and the regular quarterly update to our medium-term (probability-weighted) scenarios; please read and share.

1. Trump won't back down. As pressure mounts and midterms approach, the President will trust his instincts and double down on signature policies. *Avoid complacency regarding downside risk scenarios, and leverage the short-term benefits of favorable financial and regulatory conditions while they last.*

2. Inflation won't fall. Emerging price pressures will prove more persistent than expected, and the Fed will find itself behind the curve. _Investigate and prioritize inflation robustness when assessing investments, particularly mid-market equity business models. In credit and fixed income, position for a steepening yield curve as inflation premiums rise relative to low front-end rates. Stay long real assets (but be mindful of elevated entry valuations). _

3. The AI bubble (probably) won't pop. But it's time to diversify. If tech stocks do crash, expect a shallow recession as AI investment slows. *Diversify aggressively (geographical, asset class, factor) and underweight mega-cap AI stocks. Within the AI investment theme, move the focus downstream to businesses with truly disruptive potential (e.g., world models in game development) or a clear case for AI-driven value creation (e.g., drug discovery and defense tech).*

4. Private Equity optimism won't be misplaced. For a change. The early phase of a cyclical recovery in the PE industry will gain traction. *Focus on exits, distributions and regeneration to be on the right side of the deployment/distribution spectrum. Bias toward action; don't bank on better conditions in 2027/28.*

5. Private Credit won't blow up. There are performance headwinds and idiosyncratic risks, but "cockroaches" are not eating the foundations of the global economy. *Focus on risk appetite and understanding of underlying credit quality, overweight lower-risk segments, and stress factor exposure within the portfolio.*

Top global calls

Looking beyond the U.S., we have identified three top global calls that will be prominent investment themes in 2026.

- **Europe: Another thing that won't happen.** The prospect of peace in Ukraine will not materially change Europe's geopolitical imperative to build its self-reliance. One manifestation of this theme, European Aerospace and Defense investments, is transitioning from a speculative macro bet to a stock-picker's market, favoring private equity and specialist investors.
- **Japan: Happening.** Economic normalization is on track despite demographic concerns, supported by rising labor force participation, strong productivity gains, and positive real interest rates that are unlocking corporate cash. We expect increased M&A activity and more foreign investment in 2026.

- **Canada: Could happen.** Structural underinvestment and trade headwinds have put Canada through the economic wringer, but accommodative BoC policy, ample fiscal space, and the Carney government's capital-focused budget position the country relatively well among G7 peers. Contingent on navigating USMCA talks this year, Canada is positioned to become the developed world’s rising star.

Medium-term Scenario Summary

Scenario 1: Stuck in the Muddle (45% weight) Sustained “Sluggish” regime over the 3-year horizon. AI investment and fiscal stimulus offset tariff and immigration headwinds, creating an unstable equilibrium in which growth remains below potential while inflation drifts above target. Difficult fundraising environment for private funds, slow middle-market deal flow, and elevated valuations requiring operational improvements and selective deployment. Software, financials, specialty retail, and utilities outperform.

Scenario 2: Sudden Stop (35% weight) The AI bubble bursts, triggering a short, shallow Crisis regime, followed by a Rebound. This phase proves inflationary, and after initially responding forcefully, the Fed must remain tight in a “Financially Constrained” regime. Counter-cyclical investing opportunities emerge, shifting focus to undervalued assets with strong balance sheets and quality businesses that can capitalize on repricing.

Scenario 3: Slow Stagflation (20% weight) Poorly timed Fed easing coinciding with tariff impacts, fiscal stimulus, and inflationary immigration curbs triggers an Overheating regime, which de-anchors prices and transitions into a Stagflation regime when growth eventually stalls. For investors, this means a narrow exit window during the overheating for maturing funds. The Stagflation phase favors assets with pricing power and inflation protection—utilities, transport, healthcare, specialty retail, and private credit outperform.

To see the detailed analysis, please download the report.

Reads of the Week

- Is 3% Inflation the New 2%? David Beckworth on how fiscal issues are a significant factor behind sustained above-target inflation. Pairs well with our Monologue on Federal Reserve independence last week.
- Learning curves: Post-COVID learning trajectories by cohort, subject, and state: We're far enough removed from the COVID-19 pandemic to have reliable data on how it has affected educational outcomes. The Brookings Institution makes it interactive. I'm very interested to see the pre-and post-COVID-19 results in a few years.
- Global brands seek private equity partners to save their China businesses. Partnerships between global brands and domestic capital networks highlight the contradictions inherent in a globalized economy with rising geopolitical tensions.

Market Monitor

Equities took a bit of a round trip this week, initially dipping on concerns over data center investment after private credit giant Blue Owl pulled out of a deal to finance an Oracle data center in Michigan. But a late Santa Rally, spurred by dovish jobs and inflation data (more on that below), took hold for the rest of the week. Fixed-income markets clearly looked into the reports and shrugged them off.

Oil prices continued their downward drift, with WTI crude trading below $57 per barrel. It's down $7.4 over the last three months and $15 this year. A huge supply glut is building as Guyana ups its exports, U.S. producers set new output records, and OPEC keeps the taps open. War in Ukraine and America's apparent attempts to stem Venezuela's exports are the only things supporting prices at current levels.

The Week in Markets

	Latest*	Change since last week (units)	Change since last week (%)	3-month change (units)	3-month change (%)	Year-to-date change (units)	Year-to-date change (%)
Equity							
S&P 500	6835	7.09	0.1	203	3.1	953	16.2
Information Technology			0.5		4.0		23.1
Financials			-0.2		1.3		13.1
Consumer Discretionary			1.0		1.1		6.8
Communication Services			0.1		2.3		30.7
Health Care			0.6		12.8		12.2
Industrials			-0.6		2.2		17.9
Consumer Staples			-0.9		-0.9		2.1
Energy			-2.9		-1.3		2.6
Utilities			-0.6		0.9		11.7
Real Estate			-1.4		-3.7		-1.2
Materials			0.6		-0.7		7.9
Nasdaq Composite	23308	112	0.5	837	3.7	3997	20.7
Dow Jones Industrial Average	48135	-323	-0.7	1992	4.3	5591	13.1
Russell 2000	6286	-54.8	-0.9	153	2.5	744	13.4
Sovereign Fixed Income							
US: 2-year Treasury Note	3.48	-0.04		-0.090		-0.77	
US: 5-year Treasury Note	3.7	-0.05		0.030		-0.68	
US: 10-year Treasury Note	4.16	-0.03		0.050		-0.42	
FRA: 10-year OAT benchmark	3.6	0.02		0.14		0.42	
GER: 10-year Bund benchmark	2.88	0.03		0.2		0.49	
CHN: 10-year CGB benchmark	1.83	-0.01		-0.0238		0.156	
CAN: 10-year GoC benchmark	3.4	-0.02		0.22		0.17	
Corporate Bond Spreads							
US: A-rated	71.5	0.1		-0.5		-2.6	
US: BBB-rated	107	0.1		6.1		4.6	
Leveraged Loan Spreads							
US: B-rated	396	0.523		1.51		-14	
US: BB rated	256	-1.1		1.32		0.0927	
US: CCC-rated	1568	38.8		185		297	
Foreign Exchange Rates							
DXY US Dollar Index	98.6		0.2		1.3		-9.1
EUR/USD	1.17		0.0		-1.0		12.8
USD/CAD	1.38		0.0		0.1		-4.1
USD/CNY	7.04		-0.2		-0.9		-3.5
USD/JPY	156		-0.2		6.2		-0.7
GBP/USD	1.34		-0.1		-2.0		6.6
USD/CHF	0.795		-0.2		1.0		-11.3
Commodities							
WTI Crude	56.5	-0.82	-1.4	-6.67	-10.6	-15	-21.0
Gold	4338	-9.35	-0.2	694	19.0	1729	66.2
S&P GSCI Commodities			-0.6		-1.4		-1.4
S&P GSCI Industrial Metals			2.5		12.4		19.7
S&P GSCI Agriculture			-2.3		-3.4		-12.1

* Weekly closing value. Color indicates positive (green) or negative (red) change since prior week.

Source: S&P Global, Russell Investment Group, Nasdaq, U.S. Department of Treasury, Macrobond Financial AB, Central Bank of Germany (Deutsche Bundesbank), Bank of Canada, Intercontinental Exchange (ICE), International Monetary Fund (IMF), LBMA (London Bullion Market Association), Robert Shiller, Chicago Board Options Exchange (CBOE), U.S. Department of Labor, Pitchbook | LCD, arcMacro

Macro Monitor

Soft spots

We finally got long-delayed official data on the labor market and inflation for the government shutdown-affected October-November months. Both were soft on the surface, but both also came with serious quality issues that make the numbers unreliable at best and misleading at worst.

Our main takeaway: wait until we have December and January data before taking any official government releases seriously.

Let's start with the Jobs report. The unemployment rate rose to 4.5%, the highest recorded level since 2021. November payrolls rose by +64k, only partially offsetting a massive -105k decline in October. "U6," the BLS' broader measure of underemployment and rcapacity in the labor market, dropped precipitously. At 8.7%, it's a whole percentage point worse than a year ago.

It's clear that the effects of furloughed government employees are still reflected in the data, as evidenced by an otherwise unexplained rise in temporary unemployment and in people working part-time for economic reasons. There may also be a small downward bias due to the missing survey weeks affecting sampling.

There will therefore likely be some give-back in December, meaning January will be the first "clean(ish)" jobs report.

Another reason to question this release is that weekly claims data over the same period has actually been stronger than we'd expect for a gradually cooling labor market (though there have been some seasonality issues here).

On the inflation side, there was a massive 4-standard deviation downside surprise to consensus expectations, with the year-over-year CPI inflation coming in at 2.7% in November (there is no number for October), against expectations of 3.1%.

The report was replete with problems. The BLS only started collecting November data on the 14th, meaning just as retailers were slashing prices for black Friday and the holidays. The BLS also had to impute numbers for categories it would usually sample directly.

It's fair to say the inflation report can be completely ignored. To the best of our knowledge, inflation is running somewhere just below 3%, with upside risk into 2026.

Central Bank Wrap

The Bank of Japan delivered on its promised rate hike, bringing the base rate to the highest level in 30 years, a stratospheric 0.75%. But Governor Ueda was not as forthcoming on how fast the BoJ will raise rates next year as markets hoped, prompting the Yen to weaken and longer-dated interest rates to rise. With inflation running above 3%, we expect further interest rate increases, furthering the incentive for Japan's corporations to put their cash piles to work.

Meanwhile, in a narrow 5-4 vote, the Bank of England trimmed rates by -25 basis points, bringing Bank Rate to 3.75%. Falling inflation will likely give the Bank cover for 1-2 more cuts in 2026, but the hawks on the committee are mindful that prices are still growing at a pace that is well above target (3.2% vs. 2.0% target)

Finally, the ECB held rates steady, pointing to "robust" growth and benign inflation.

Memo

Hits and Disses: What we Learned from Evaluating Everyone Else's 2025 Outlooks

Bottom line: We evaluated the ten highest-consensus calls from a sample of 2025 Investment Bank Year-Ahead Outlooks. Forecasters went 6/10 with a couple of foul-offs. Forecasters appear to underestimate how long structural changes can take to percolate.

We're too young to have produced a 2025 outlook, so we can't engage in the annual rite of claiming credit for our hits and humility points for acknowledging our misses.

That leaves us free to evaluate everyone else's and draw lessons from how the consensus calls performed.

To do so, we fed 13 annual reports from top global investment banks and research houses[1] and asked Claude Opus 4.5 to synthesize the consensus macro calls going into 2025. That's where the AI support ended. We then evaluated the performance of these calls and extracted what wisdom we could.

Here are the results.

1. US Equities Will Deliver Positive Returns

Consensus Strength: Very Strong (9/10)

Strategists uniformly expected the S&P 500 to post gains, with year-end targets clustered in the mid-6,000s. The bullish case rested on earnings growth, easing policy, and deregulation tailwinds, though elevated valuations meant returns would be earnings-driven rather than multiple-driven.

Verdict: Correct. *The S&P 500 is up 16.2% year-to-date, the Nasdaq Composite 20.7%, and the Dow and Russell 2000 just over 13%. Betting that U.S. equities will rise is almost always a winning strategy.*

2. US Equities Will Outperform International Equities

Consensus Strength: Very Strong (9/10)

"US exceptionalism" was expected to persist as superior growth and a favorable policy backdrop kept capital flowing to American equities. International markets traded at near-record valuation discounts, but structural challenges in Europe and tariff headwinds in EM were seen as preventing convergence.

Verdict: *__Wrong.__ The MSCI World All-Cap index has returned 20.7%, compared with 16.9% for the comparable

U.S. All-Cap index. Any broad index comparison shows a moderate outperformance by global stocks over the U.S. Perhaps "exceptionalism" is a mean-reverting property? Actually, that this call was wrong was a big win for valuation-based investing. European equities in particular went into the sorely undervalued, and those who spotted it came out on top.*

3. The Fed Will Deliver a Shallow Cutting Cycle

Consensus Strength: Strong (7/10)

Most expected the Fed to continue cutting into early 2025 before pausing near a terminal rate of 3.25%-4.25%—meaningfully higher than the prior cycle. Sticky inflation and potential tariff-driven price pressures were expected to constrain aggressive easing.

Verdict: Partially correct. *The Fed cut later than most forecasters expected, and the total 75 basis points of cuts was within the expected range. The Fed is still in easing mode, however, and has not settled at a terminal rate yet. Heavy reliance on current rather than forward-looking data is a major feature of the current Fed.*

4. USD Will Strengthen, EURUSD Approaching/Reaching Parity

Consensus Strength: Strong (8/10)

Widening rate differentials and weak European growth were expected to push the dollar higher, potentially to early-1980s levels. The euro was seen as particularly vulnerable, with forecasts calling for a move toward parity as the ECB cut more aggressively than the Fed.

Verdict: Wrong. *The DXY U.S. dollar index has fallen 8.7% year-to-date, and -13% against the Euro, from USD/EUR 0.96 to 0.85. Currency fluctuations are incredibly complex. Tariffs and the debasement trade weighted on the dollar, but the Euro strengthened for its own reasons (low inflation and resilient growth).*

5. Tariffs Will Be Implemented and Create Inflation/Growth Headwinds

Consensus Strength: Strong (8/10)

The incoming administration was expected to follow through on tariff threats, though below the most aggressive rhetoric. The inflationary impact was seen as a meaningful but transitory one-time price shock rather than persistent inflation.

Verdict: Partially correct. *Tariffs were implemented, though later softened. There is evidence of some impact on inflation and demand, but surveys point to most of the pass-through will arrive in 2026. Supply side shocks tend to propagate more slowly than people think because businesses adjust tactics in response*

6. Earnings Growth Will Broaden Beyond the Magnificent 7

Consensus Strength: Strong (7/10)

After two years of mega-cap dominance, earnings growth was expected to diffuse as the largest companies' profits decelerated while the rest of the index accelerated. Lower rates and extreme valuation spreads were seen as supporting rotation toward the average stock.

Verdict: Correct. *In all three quarters with data so far, "493" contributed more than the Magnificent 7, and the share rose over the course of the year. Seven stocks still constitute an astonishing share of large-cap earnings growth, but the market did technically broaden out. Lower borrowing costs played a big role, highlighting the importance of monetary policy.*

7. Credit Spreads to Remain Tight, Supported by Fundamentals

Consensus Strength: Moderate-Strong (7/10)
Spreads sat at their tightest levels in nearly two decades, leaving little room for compression. However, low recession odds and strong yield demand were expected to prevent meaningful widening absent a hawkish Fed pivot.

Verdict: Correct. *Credit spreads everywhere except distressed lending are close to historical lows. The logic has not changed going into 2026*

8. Oil Prices to Trend Lower

Consensus Strength: Strong (8/10)
A supply surplus was expected as OPEC+ began unwinding cuts, non-OPEC supply grew, and demand—particularly from China—remained subdued. Most expected Brent to drift into the $60s-$70s range.

Verdict: Correct. *And then some. The WTI crude price is $56.5 per barrel, down $15 year-to-date. That supply glut is still growing.*

9. Gold to Remain Supported/Make New Highs

Consensus Strength: Moderate (6/10)

Gold was expected to remain bid on central bank buying and geopolitical hedging, with most seeing modest new highs in early 2025. However, a strong dollar and higher-for-longer rates represented headwinds, creating more uncertainty than other calls.

Verdict: Correct. *And then some. The gold price has risen an astonishing 66.2% year-to-date. Precious metals have been easily the best-performing asset class this year. Momentum is a powerful investment tool.*

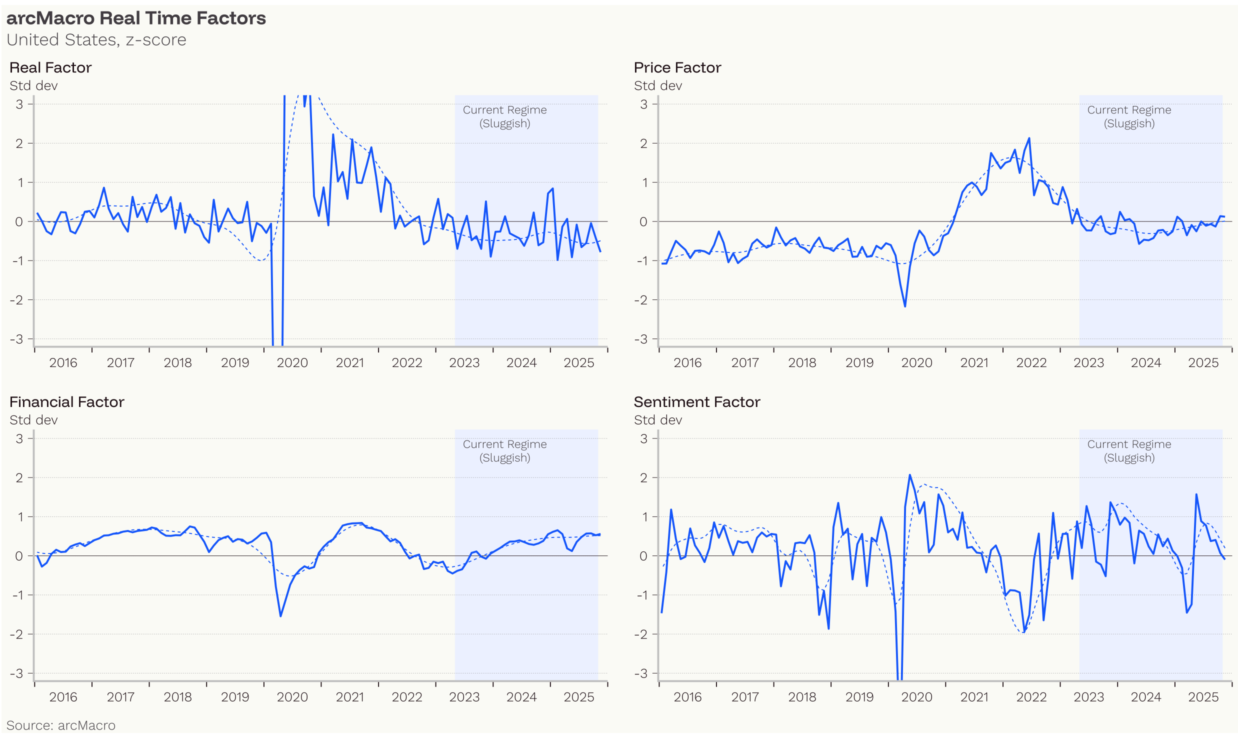
10. No US Recession in 2025

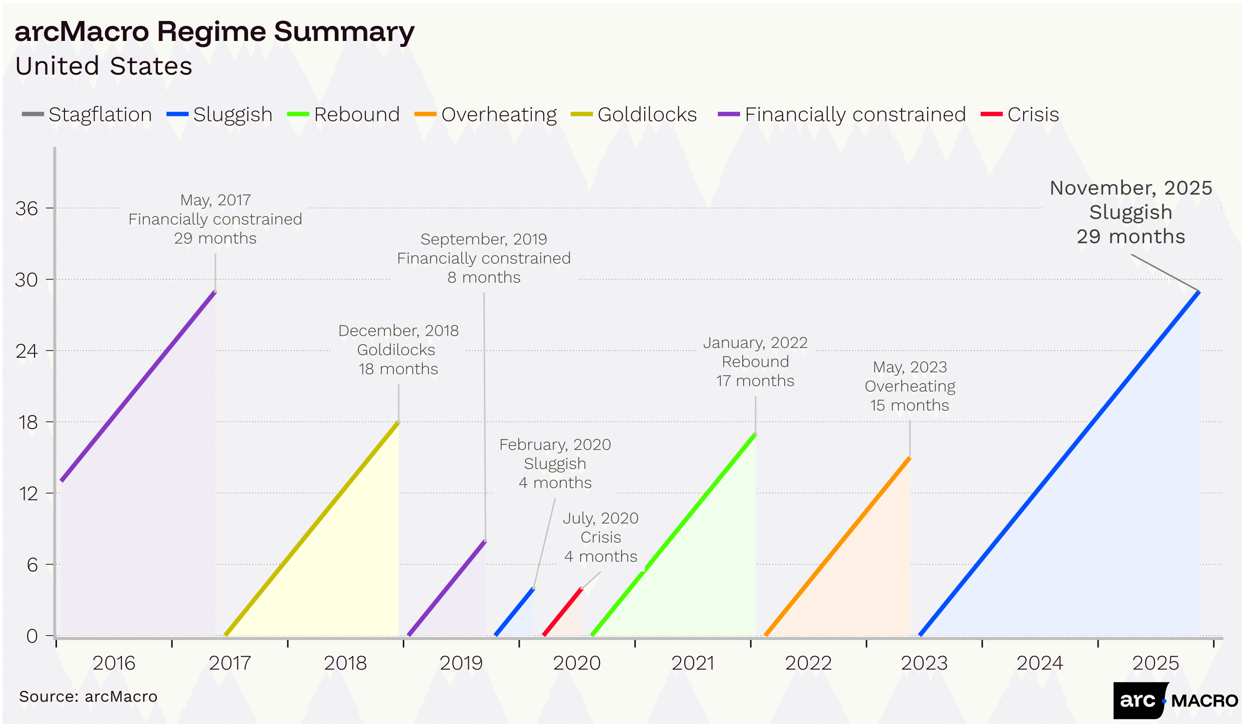
Consensus Strength: Very Strong (9/10)
The soft landing was expected to persist, with recession probabilities pegged at just 10-15%. The consumer remained healthy and policy—while uncertain—was not expected to tip the economy into contraction.

Verdict: Correct. *GDP growth is on track for around +2% year-over-year growth in 2025.*

Appendix

Proprietary Factor and Regime Model and Key Macro Indicators

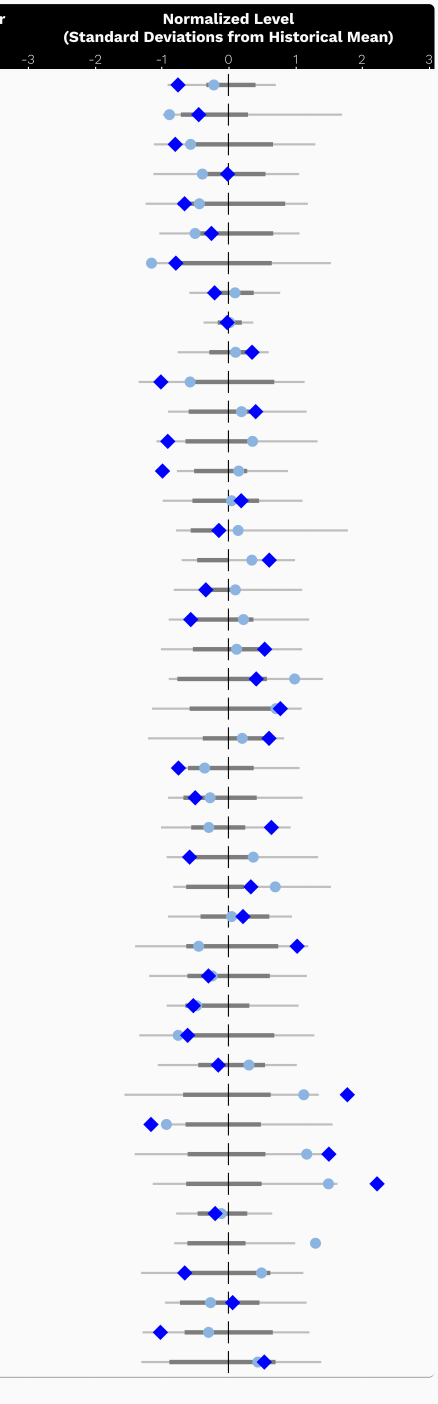



arcMacro Regime Summary
United States
Stagflation
Sluggish
Rebound
Overheating
Goldilocks
Financially constrained
Crisis
May, 2017
Financially constrained
29 months
September, 2019
Financially constrained
8 months
December, 2018
Goldilocks
18 months
February, 2020
Sluggish
4 months
July, 2020
Crisis
4 months
January, 2022
Rebound
17 months
May, 2023
Overheating
15 months
November, 2025
Sluggish
29 months
36
30
24
18
12
6
0
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
Source: arcMacro
arc MACRO

arcMacro Factor Input Monitor

Top 10 inputs by factor loading

Indicator	Unit	Latest*	Three months prior	One year prior
arcMacro Real Factor	Standard deviations	-0.8	-0.5	-0.5
Underemployment (U-6)	%	8.7	8.1	7.7
Capacity Utilization	%	78	76.1	75.7
Industrial Production (IP)	%, YoY	1.6	0.5	-1.2
Employment-to-Population Ratio	%	59.6	59.6	59.8
Dallas Fed Services Index	%, YoY	-2.3	6.8	10.2
Unemployment Rate	%	4.6	4.3	4.2
Transportation Services Index	%, YoY	0.7	-0.4	1.2
Employment	Thousands, MoM	96.0	288.0	-273.0
Construction Employment	Thousands, MoM	28.0	-20.0	6.0
Philadelphia Fed Manufacturing Index	%, YoY	-10.2	23.2	-10.9
arcMacro Price Factor	Standard deviations	0.4	0.2	-0.2
Trimmed CPI	%, MoM, SA	0.1	0.3	0.3
"Sticky" CPI	%, MoM, SA	0.1	0.3	0.2
PCE	%, MoM, SA	0.3	0.3	0.2
Inflation Expecations (NY Fed)	%, Annual	3.2	3.2	3.0
Inflation Expecations (U-Mich)	%, Annual	4.2	4.7	2.8
Core CPI	%, MoM, SA	0.2	0.2	0.3
Services PCE	%, MoM, SA	0.2	0.2	0.4
Market-based PCE	%, MoM, SA	0.3	0.3	0.2
Richmond Fed Services Price Index	%, Annual	4.8	5.1	4.7
5 Year Break-Even Inflation Rate	%, Annual	2.3	2.4	2.4
arcMacro Financial Factor	Standard deviations	0.6	0.6	0.4
Financial Stress Index (KC Fed)	Index (>0: higher stress)	-0.7	-0.8	-0.4
Financial Stress Index (OFR)	Index (>0: higher stress)	-2.0	-2.2	-1.7
Gold Volatility Index	%	22.7	16.0	17.5
Bank Lending Standards	% (>0: net tightening)	-7.1	-4.8	2.5
Anxious Index (SPF)	% (Probablity of recession)	24.0	29.6	15.0
Dividend growth	%, YoY	7.9	8.4	6.2
Bank Loan Demand	% (>0: net increase)	18.0	12.1	-4.6
Household Debt-to-Income Ratio	Ratio	8.6	8.9	8.7
IPO Underwriting Activity	US$ Billions	2.2	3.5	0.4
Household Debt Growth	%, QoQ, Annualized	3.8	1.8	2.8
arcMacro Sentiment Factor	Standard deviations	-0.2	0.3	0.4
Cyclically-Adjusted PE Ratio (S&P 500)	Ratio	39.4	38.6	37.7
Dividend Yield (S&P 500)	Ratio	1.1	1.2	1.2
12-month Forward PE Ratio (S&P 500)	Ratio	21.5	22.4	22.0
Price/Book Ratio (S&P 500)	Ratio	5.0	4.7	4.8
Crude Oil Volatility Index	%	35.9	35.6	41.3
Economic Policy Uncertainty Index	Index	340.9	291.4	217.5
MOVE Index	Index	76.1	80.4	107.4
VIX	%	19.9	15.8	16.1
Bull-Bear Spread (AAII)	% (>0: net bullish)	-9.4	-10.9	10.5
Equity Risk Premium (NYU Stern)	%	1.1	1.2	1.0



Source: arcMacro, BLS, Fed, Dallas Fed, DOT, Philadelphia Fed, Cleveland Fed, Atlanta Fed, BEA, New York Fed, University of Michigan, Richmond Fed, Macrobond, Kansas City Fed, The Office of Financial Research (OFR), CBOE, S&P Global, SIFMA, Robert Shiller, Economic Policy Uncertainty, ICE BofAML, LJKmfa, AAII
*Most recent published data point. Time period and frequency do not necesarily align.

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1. J.P. Morgan, Goldman Sachs, Bank of America, Morgan Stanley, Deutsche Bank, BNP Paribas, RBC Capital Markets, Macquarie, Wells Fargo, UBS, Mizuho, Jefferies, and Société Générale. ↩