



# Better a fox than a hedgehog

Report for the week ending 07 February, 2026

Dylan Smith

# Monologue

At the risk of tempting cliché, January has flown by, and 2025 already feels like a long time ago.

## **Time to take stock. We run through the state of macro below**

The themes and forecasts we made in our annual outlook still hold at the one-month hurdle (*wipes brow*). **Trump is doubling down** as we expected (and on the global stage, raising the stakes), **inflation risk is rising** (if not actual inflation yet), **the AI theme is evolving, not disintegrating** (more on that in this week's Market Monitor), the outlook for **private markets is only getting brighter** (this is the focus of this week's Memo), and we still think that **systemic risk in private credit is overstated** (again, more below).

And yet, clients tell me that **it's never felt more difficult** to allocate capital, commit to business investments, or trade markets. Every time we think we have a handle on the assumptions and patterns that define the emerging new world order – whatever that may be – we're proven wrong.

How to deal with this chaos? In this environment, **it's better to be a fox than a hedgehog**, to borrow Isaiah Berlin's classic analogy inspired by Greek fables.

**The hedgehog knows "one big thing,"** viewing the world through a unifying framework that simplifies complexity. She can operate decisively and confidently in challenging times. But if her framework turns out to be wrong, she's ruined.

**The fox has no such conviction, embracing nuance and uncertainty**, and engaging multiple perspectives on the same problem. Intellectual humility is the great strength of the fox, if she can overcome decision paralysis.

**We're in a world made for foxes.** Times of rupture are also times of opportunity, if you're flexible enough to adjust your views quickly, yet committed enough to weather temporary volatility.

The fox is capable of holding two contradictory thoughts in mind at all times: "**This time could be different**" and "**some things never change.**" Two different concepts of timeless truth. Both highly relevant at this juncture.

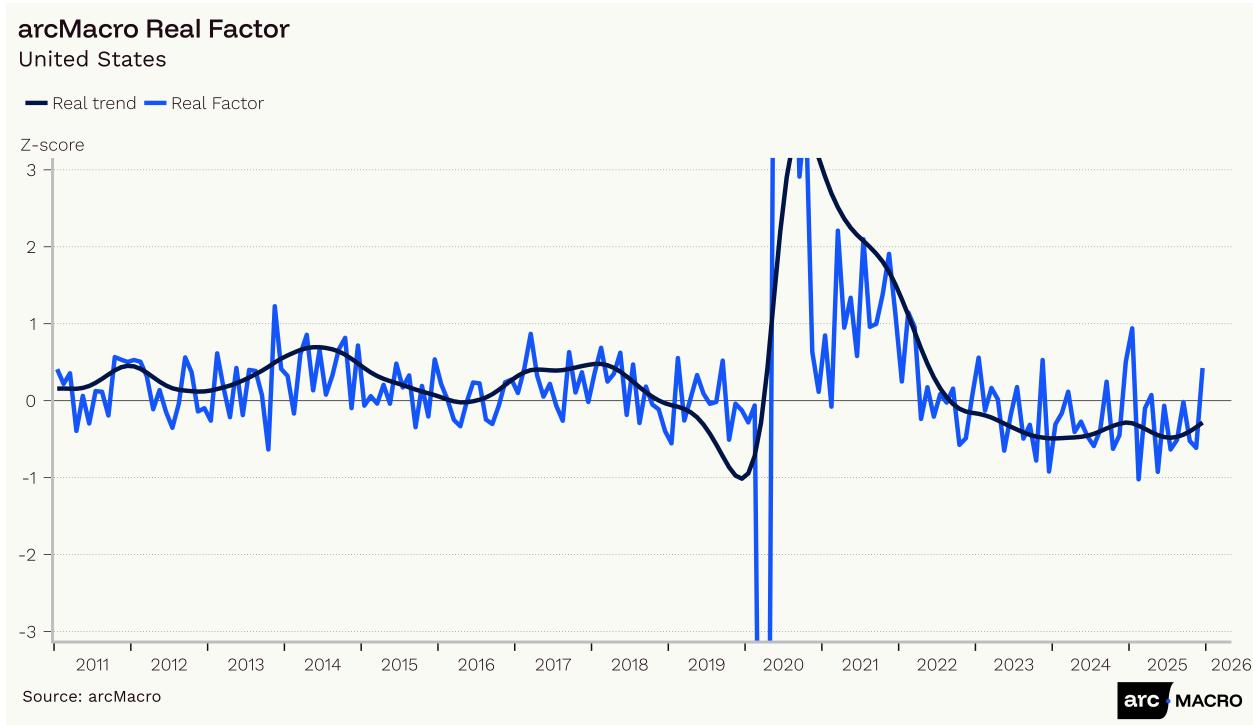
For every issue, the fox will assess which is "more true." Persistent above-target inflation? This time could be different. Breakthrough technology causing imbalanced investment patterns and overvalued assets? Some things never change. Gold as a speculative asset? This time could be different. And so on.

It's a good test, but it's not actual risk management. With the old correlations breaking down and prices on a hairline trigger, the benefits of diversification across asset classes and regions have never been greater. If you're a natural hedgehog, the proven math behind the benefits of **diversification is the "one big thing" you should know.**

### **With that, the macro/markets monthly stock-take**

**The growth outlook is improving.** Our arcMacro Real Factor, which summarizes momentum in general economic activity and labor markets in the US, is above its long-run average for the first time since late 2024. Other data complements this signal. The Atlanta Fed Q4 GDP nowcast stands at 4.2%, and the Citi economic surprise index is at a hefty 40 points above zero (having recently hit its highest level since 2003, indicating macro data have beaten projections significantly). The main drivers are fiscal stimulus, consumer resilience, easy financial conditions, the ongoing AI infrastructure buildout (see the [St Louis Fed's recent quantification](#)), and a pickup in other investment spending as uncertainty eases slightly. We see a genuine chance that the US economy will break out of its current "sluggish" economic regime this year.

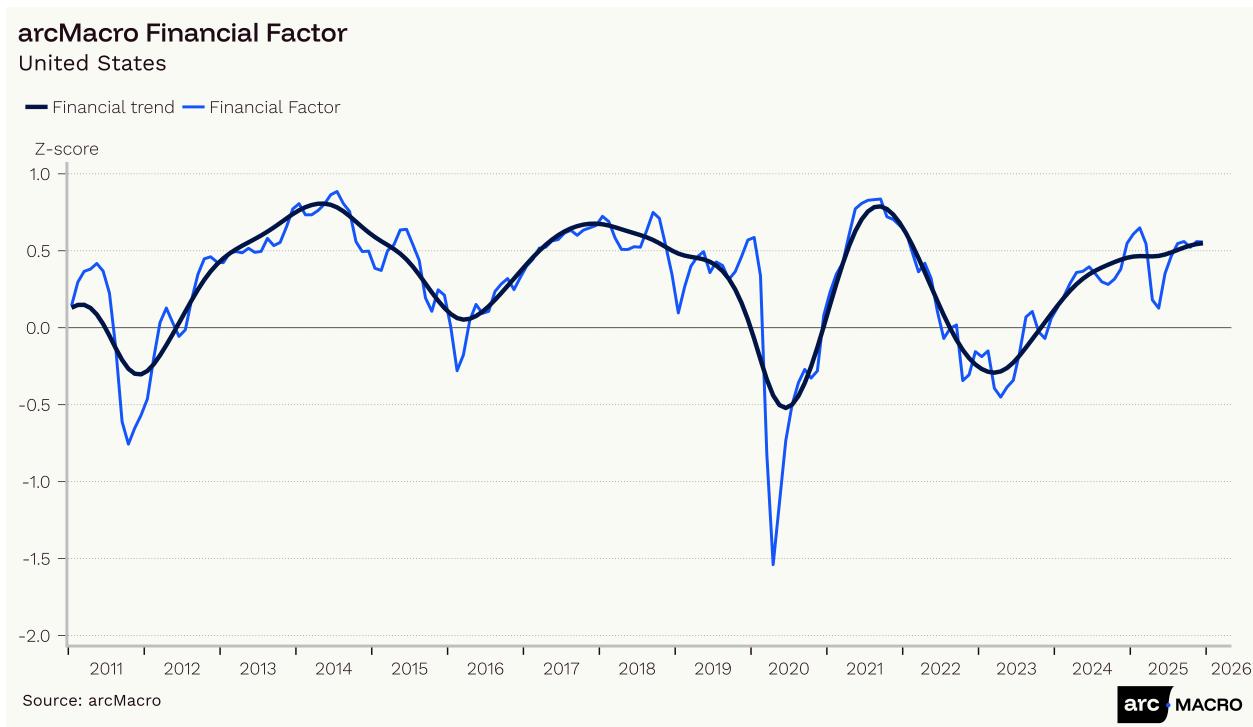
**The labor market is stabilizing.** The signals are not as clean as we'd like, but the highest-quality and most frequently updated indicator – weekly initial unemployment claims – has started the year better than in 2025 or 2024. From the totality of other official and private data for the US, it looks like the immigration slowdown and drop in hiring demand are roughly offsetting each other at present, with firms reporting plans to increase hiring going forward.



**Inflation is not falling.** Our arcMacro Price Factor is also above the long-run average and rising. Inflation softened a little more than expected in the final months of 2025, but CPI at 2.7% year-over-year is already above the target. Importantly, the outlook skews toward higher inflation. Wages are picking up, especially in industries that rely heavily on immigration. Most intermediate manufacturers are only now beginning to pass on tariff costs, having exhausted their ability to compress margins. Food and energy prices also carry substantial upside risk. In truth, the only thing keeping inflation from rising is lower shelter costs — a lagged reflection of housing market dynamics in the past two years.



**Financial conditions are very easy.** Our arcMacro Financial Factor is tracking conditions at highly accommodative levels. Put simply, nobody who wants it is struggling to access credit. The Federal Reserve has cut rates and appears poised to deliver more easing (and has gained a bit of a credibility boost with the selection of Kevin Warsh as the next Chair), credit spreads are at or near all-time lows, strong recent financial asset returns are supporting collateral-based borrowing, the dollar is weaker, and bank lending standards have eased significantly. No wonder M&A activity is on a roll.



**The tentatively bullish view on the economy is global.** It's worth pointing out that the improved macro mood music is not a case of "American Exceptionalism." Europe's economy has proved more resilient than expected, as has China's. South and East Asia are booming, and even down-in-the-dumps EM stories like Brazil and my beloved South Africa are picking up some optimism. Reflecting this, the S&P Global composite PMI is ticking along at an expansionary 52.5 level.

**Public equities hold the keys to the future.** Value stocks exposed to the improving macro backdrop are now outperforming growth stocks exposed to uncertainty about where AI value will accrue. A major loss of confidence in the heavy investment spending of the AI hyperscalers still poses a serious threat for the entire economy, as it would reverse the benign financial impulse and investment spending behind the growth pickup. On balance, I can see broad equity indices going sideways for a few months as supportive macro offsets the lack of a clear consensus view on the AI outlook across a range of exposed industries.

**The dollar faces cyclical headwinds, but gold is now a speculative asset.** The dollar is down around 1% since the start of the year, and 2.6% over the past three months. While the unsustainable US fiscal deficit is a long-run background concern, this move is more related to cyclical headwinds. That fiscal situation has been a major reason for investors to hold gold, but its volatility is such that we're now

willing to call the gold rush a speculative market. Leveraged short-term bets are driving the price action, and we expect sharp moves in both directions in the near future.

**Private markets are picking up steam.** This week's Memo goes deep on the asynchronous cycles in public and private equities. Just as public markets appear to have topped out and the 5-10-year return profile looks challenging, private markets are in the early phase of a capital renewal cycle with an improving outlook. More complete data now emerging for 2025 shows that exits, distributions to investors, and new investments all accelerated into year-end, and that momentum will carry through into the first half of 2026.

That's where we stand. Stay foxy.

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## Marginal Movers

### Rising

- **India:** Prime Minister Modi's strategic use of rising middle-power flexibility is working: He parlayed cheap Russian oil leverage into a US trade deal, supporting an already strong growth outlook.
- **Value:** US Equities in industries connected to the growth outlook are up 3.2% this week, according to S&P Global.

### Falling

- **White collars:** Anthropic's release of AI plug-ins for routine legal and financial tasks heightened fears of mass job losses in professional services.
- **White collar criminals:** The latest trove of Epstein files might land former UK ambassador to the US, Peter Mandelson, in jail for apparently leaking government information while on Jeffrey Epstein's payroll, which could bring down the government. One wonders what other skeletons are waiting to emerge.

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## Must-Reads

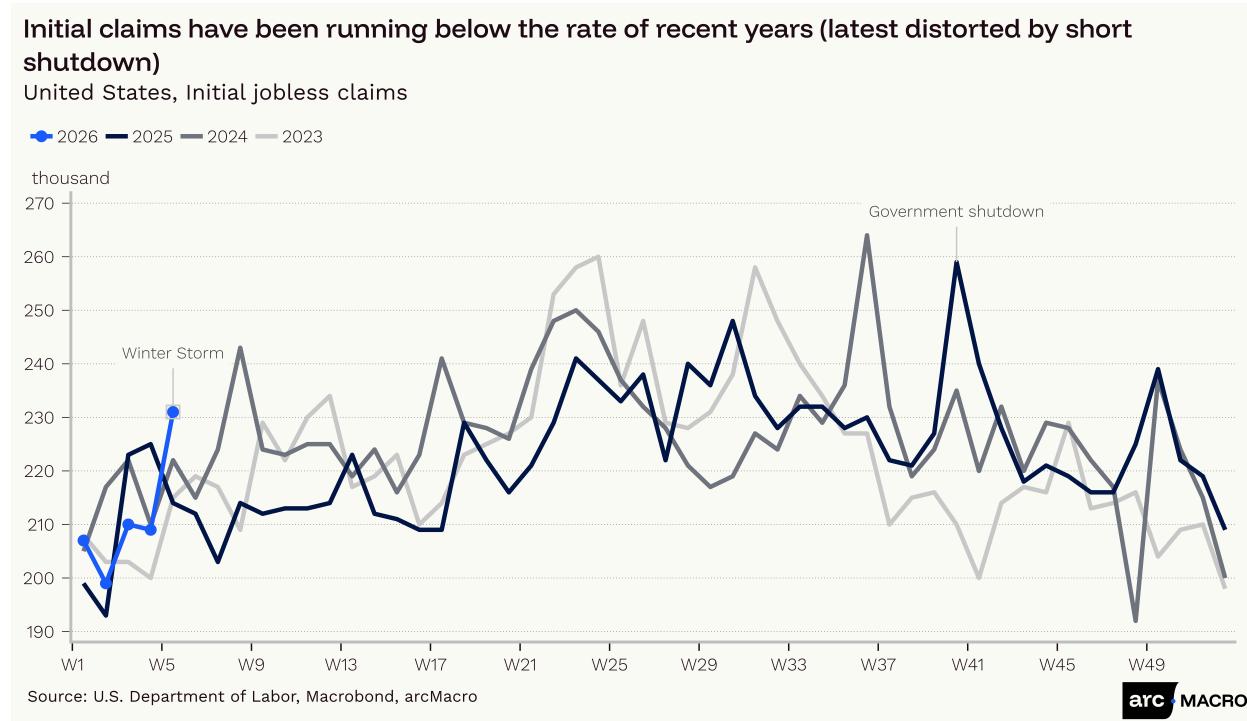
- **Monetary policy and private equity acquisitions: tracing the links**: The BIS has kindly taken a project off our plate by quantifying the links between policy rates and PE activity. Bottom line: short rates matter more than long rates, affecting both activity and valuations.
- **Measuring US workers' capacity to adapt to AI-driven job displacement**: A useful dataset quantifying both labor exposure and adaptability – a missing piece of the discourse thus far.
- **The Work-from-home Wage Premium**: If you want flexibility, it helps to be good at your job. According to researchers at the Federal Reserve Bank of San Francisco, "workers who work from home earn on average 12% higher hourly wages than fully on-site workers." Mostly because they're good workers who are trusted to stay at home.

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## Macro Monitor

US nonfarm payrolls were supposed to headline the week's macro data flow, but the mini-shutdown was just long enough to delay it to next week. The data we did see confirmed our current view on the labor market: that it's stabilized on aggregate, but with a fair amount of churn on the industry level.

With the headline labor market data becoming increasingly unreliable (low response rates, large revisions, frequent delays, shutdown distortions), we're paying more attention to the weekly unemployment claims data. These have signalled relative strength, with initial claims (i.e., the newly unemployed) starting the year stronger than in 2024 or 2025 (belying news headlines focused on individual layoff announcements, mostly in tech). That changed with a large surge in new unemployment claims last week, likely due to the winter storm that shut down businesses across the Midwest and Eastern US. We'll need to wait a week or two for a clearer signal.



### **Winners never quit and quitters never win**

Wise words from football coach (and labor market analyst?) Vince Lombardi, well timed for Super Bowl LX. Also, a good description of the state of the labor market.

One thing that often surprises us is the short memory of many macro commentators. This week's "JOLTS" data on labor turnover raised concerns about the declining hiring rate. Less emphasized was a still ultra-low layoff rate.

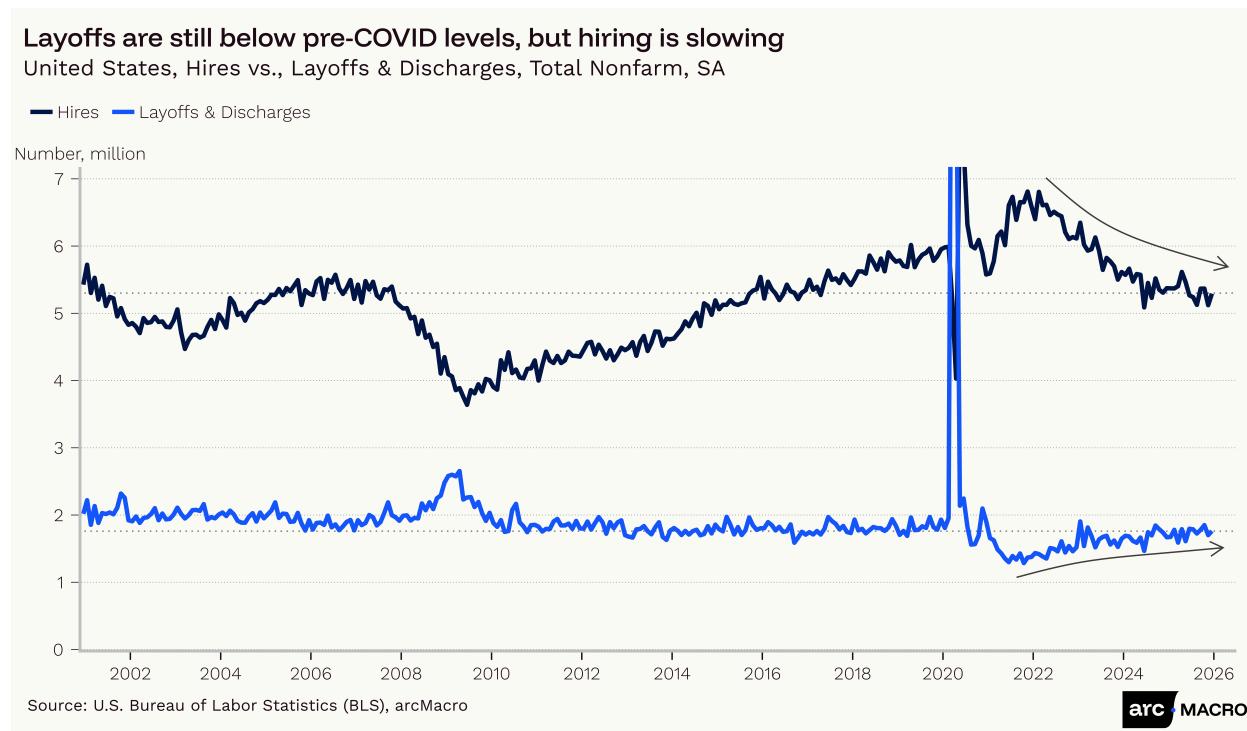
These dynamics are easy to understand. After a period of intense labor market churn and job switching in 2021-2023, the labor market has been normalizing. Having moved once or twice since the pandemic, workers are not ready for another change, partly because they're still settling into new roles and careers, and partly because they're not receiving the same tempting offers to move to greener pastures.

Their employers, remembering the labor shortages of 2022, are reticent to reduce headcount.

Another way to look at it: even as the adjustment resulting from the 2022 shortages continues, hiring is as strong as it was in 2015-18, and layoffs are running below where they were before COVID-19 (see chart). In that period, the labor market was considered historically tight.

Reading these dynamics as a "weak" labor market is simply incorrect; the 2022 trend was never going to last. Normalization is not the same as decline.

That said, the continued decline in job openings (not actual hiring) is a tad concerning, and perhaps the most important indicator to watch.



### The Whole truth on tech sector layoffs

Another slightly misleading feature of news coverage of labor market data is the focus on tech layoffs. Official data confirms that firings in the information industry are indeed rising, but the headlines are missing half the picture. There is a related hiring surge as IT firms seek out AI expertise.

**The full picture: Layoffs AND hiring in the tech sector**  
United States, Labor turnover, Information industry

— Layoffs & Discharges — Hires

Number, thousand



Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, arcMacro

**arc MACRO**

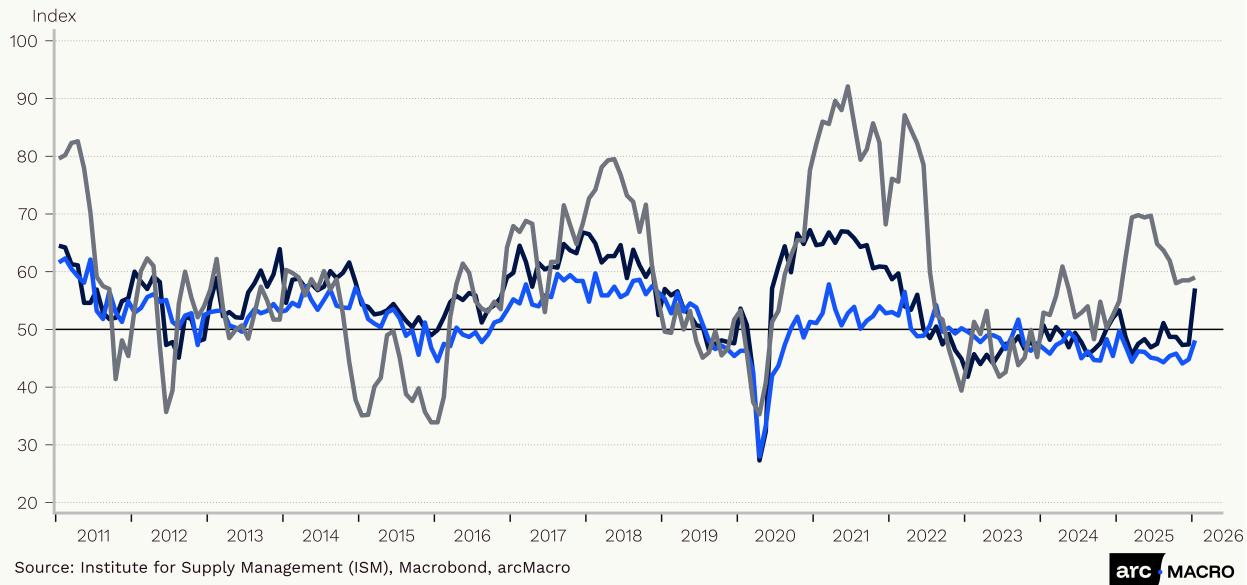
### ISM PMIs confirm predictions of 1st-quarter upswing

The ISM PMI reports for January confirm the general vibe that economic activity is picking up in the US. According to survey respondents, prices are rising meaningfully, and the mild decline in demand for labor appears to be over for now. But the biggest change in January was an improvement in demand.

### Manufacturers report a sudden rise in orders

United States, ISM manufacturing survey, balance reporting "higher", SA

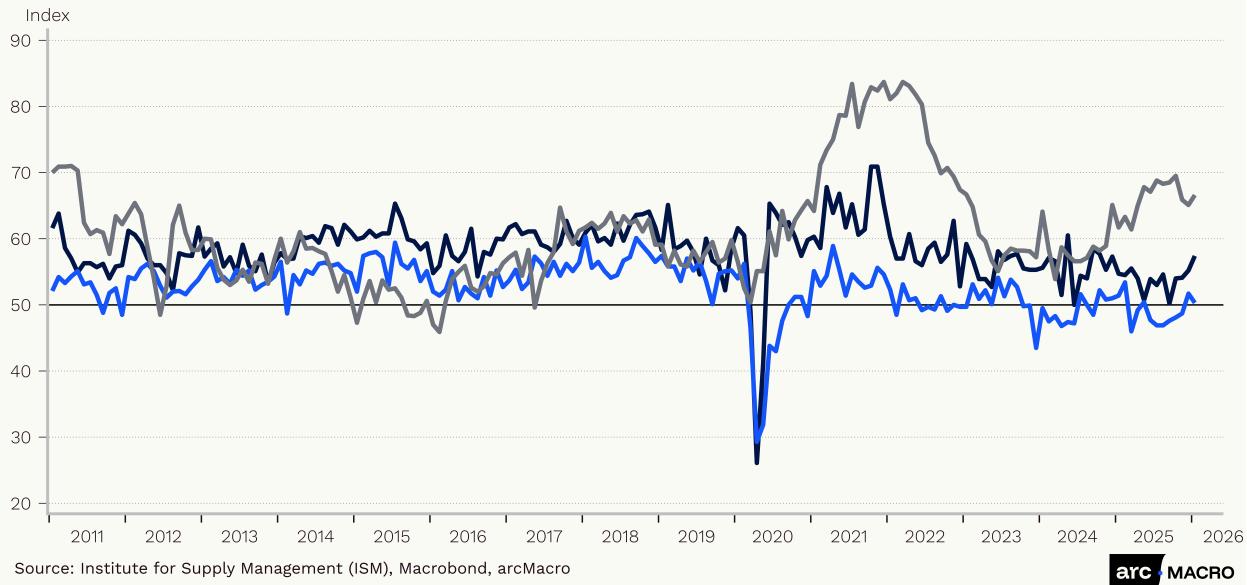
— Prices — Employment — New Orders



### Services businesses report "growthy" but inflationary conditions

United States, ISM non-manufacturing survey, balance reporting "higher", SA

— Prices — Employment — Business Activity



**Double european hold**

The ECB held its policy rate steady at 2.0% at this week's meeting, with stronger-than-expected growth (GDP rose by 1.2% at an annualized rate in Q4 2025) and a decline in area-wide core inflation to 2.2% (the lowest since 2021) supporting the decision. In her press conference, President Lagarde brushed off concerns over the strong euro (up 2.7% against the dollar in the last three months), setting a high bar for any future rate adjustments.

There were more fireworks from the Bank of England, where Governor Bailey voted with a narrow 5-4 majority to hold Bank Rate at 3.75%. Bailey and the hawks want to see more evidence that inflation is falling sustainably to target. Core inflation is trending down. However, at 3.2%, it's still well above the 2% target.

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See the appendix for *arcMacro* proprietary Factors and the Key Macroeconomic Indicators tracking chart.

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## Must-Watch

What we'll be keeping an eye on in the week ahead:

- *Monetary policy inputs bonanza (US)*: The delayed nonfarm payrolls and unemployment reports will be published this week, alongside the January CPI inflation report, which together may shift expectations for interest rate movements. Plus, retail sales.
- *Winter Olympics (World)*: With a particular focus on our founder's home countries of Canada, Switzerland, and South Africa (with its five brave athletes).

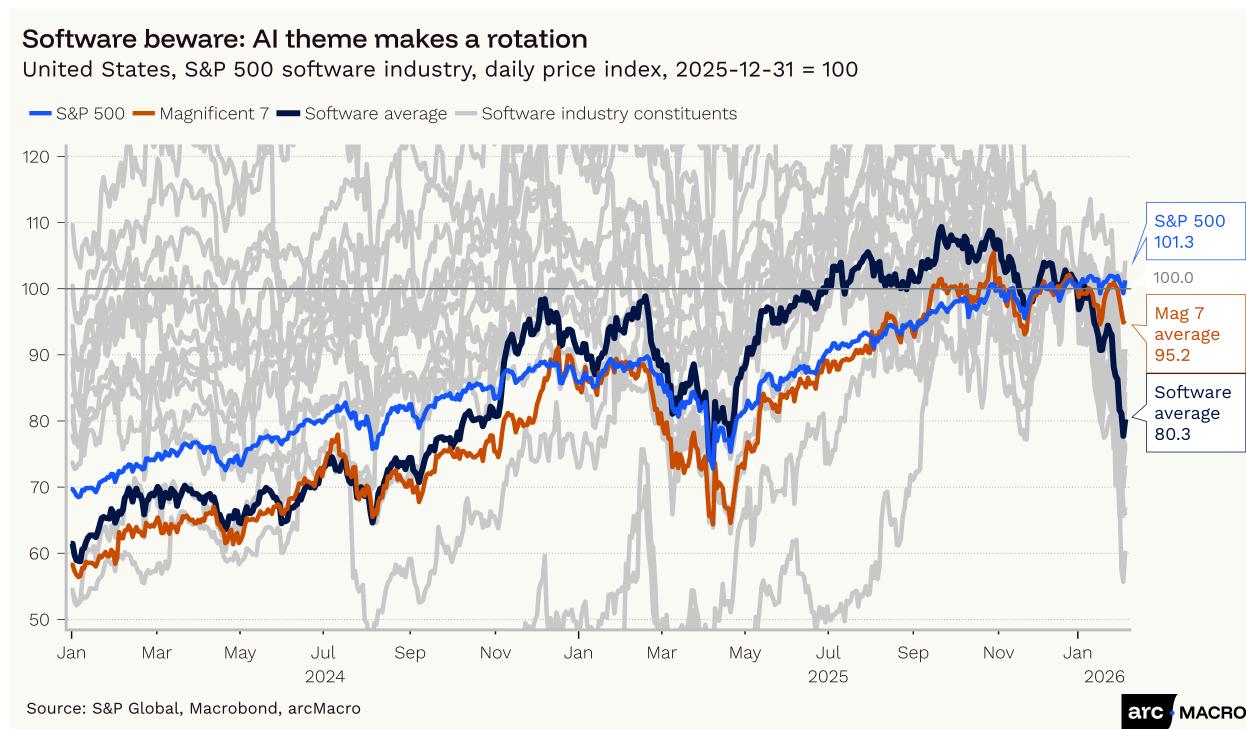
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## Market Monitor

### Public markets

The AI theme came back with a vengeance this week, taking over from global macro and geopolitical developments, which drove markets in January. A series of upgrades and plugins developed by Anthropic for its Claude AI assistant shook market confidence in the earnings prospects of the software industry. Yet Google's

announcements that it will be doubling already stratospheric AI spending improved the outlook for downstream component manufacturers and contractors.



The crosscurrents left the S&P 500 index essentially unchanged (-0.1%), while the software-heavy Nasdaq dropped -1.8% and the value-oriented Dow Jones Industrial Average gained 2.5%.

The continued ramp-up in AI-related capital expenditure, which now involves a heavy dollop of credit financing, pulled spreads off their historical lows. Spreads on A-rated corporate paper were up 2.1 basis points, while riskier B-rated leveraged loans rose by 9.3 basis points.

Meanwhile, it was a tamer week for the macro bloc. The dollar pared back some of last week's losses, gold fell \$40 to close below \$5,000 per ounce, and WTI crude oil dropped \$2 per barrel to \$63.3 as the US and Iran entered talks, reducing the odds of a blockade in the Strait of Hormuz.

## The new safe asset

If you lose confidence in tech stocks, especially software, where do you move your investments these days?

You'll put some in Gold, of course. But its recent speculative runup makes you nervous. Investors used to run to US Treasuries when they lost confidence in the outlook. But you know that Treasury Notes are a mug's game, having seen that chart of projected US Federal debt levels. Japanese Yen? Be serious, Japan is in an election that could precipitate an even worse fiscal outlook. Safe and stable countries like Switzerland or Sweden are a better bet, but they're expensive.

So you turn to macro fundamentals. The software rout has triggered a massive rotation in equities from growth to value. Economically sensitive stocks – shunned in 2025 due to tariff and recession risk – are making a comeback as nominal growth appears set to rise (inflation and real activity both contributing to the upward trajectory).

US value stocks, connected to the growth outlook, are up 3.2% this week, according to S&P Global. Growth stocks fell by -2.6%

The question now is: If we're all bullish on growth, but markets are broadly weak because investors are worried about AI, what does the Fed do? Will the swing votes on a Warsh FOMC still see the case for accommodation?

Assuming labor markets hold onto their stabilization, the inflation outlook will break the tie, so keep a close eye on it.

### **"Sentenced before Trial"**

That's the phrase JPMorgan's Toby Ogg used to describe the drop in software stocks this week. He's got a point. Blanket bearishness doesn't seem the appropriate response for the AI innovations that are hitting the market.

Sorting through the potential winners and losers from AI is getting harder, so investors are dumping stock *en masse*.

Will Claude's brilliant Excel-based tools unseat Microsoft, or further entrench the moat around its Office suite? Can an Accenture consultant be replaced by an in-house AI bot, or will firms increase their use of consultants to implement their AI transition? Will law firms become more profitable by integrating AI agents into tasks like contract drafting and document review, or is the profession headed for irrelevance?

The uniform AI narrative is fragmenting into a set of similar questions for every tech company and professional services firm in the index.

AI looks like it might end up a prime example of the **Jevons paradox**, which describes a situation where making something cheaper and easier leads to such a massive increase in its use that spending on total consumption offsets the projected savings. Reducing the cost of producing a contract might lead firms to write more contracts, the better to protect themselves from legal risk. Private equity firms might be able to diligence a target in a quarter of the time, but end up analyzing more than 4x the number of assets they did before.

These general equilibrium effects are important and often overlooked. They're also a fundamental reason that technological breakthroughs have made us richer, not poorer. Automating routine tasks enables us to do more of them, better.

What are the market implications of this week's action? In our view:

- Shift away from super high valuations, they're likely to correct at some point.
- Focus research on identifying AI winners, not studying the theme as a whole.
- Keep in mind that initial "losers" still have time to pivot or catch up, learning from early adopters.
- Venture capital and private equity are where the real future winners are currently growing.
- Be prepared to pivot quickly; no one envisioned "social media" when the internet began, and we don't know who the ultimate winners will be.

## **A Bitcoin of Schadenfreude**

We don't cover Bitcoin much, but it's worth noting its nearly -8% drop this week, bringing its price back below where it was when Trump was elected. Bitcoin's price is weakly and often inversely correlated with that of gold. Bitcoin offers protection neither from inflation nor bearish sentiment, and the Trump administration's reforms are failing to inject cryptocurrencies with any form of fundamental value.

### Gold and Bitcoin have a low and often negative correlation

World, rolling correlation

—

1 year

—

90 days



Source: Macrobond Financial AB, LBMA (London Bullion Market Association), Macrobond, arcMacro

**arc** MACRO

## Private Markets

Lost amid the public market turbulence and political scandal this week was some excellent reporting from a variety of sources on transparency issues in private credit. Bloomberg reported on [the worrying rise in ratings shopping in Canada](#), and PEI on [rising default rates among portfolio companies](#).

We're sticking to our view that credit risk is idiosyncratic and, as in the case of the First Brands default, limited to those with direct exposure. However, the rise in opaque and potentially circular asset-backed financing is a genuine concern. Amplified by an apparent loosening in credit rating standards, this *could* be a systemic risk. It's likely in its infancy, but we'll be monitoring this more closely going forward.

For what it's worth, spreads are close to record-tight levels, even accounting for the rise in credit-financed technology infrastructure investments bringing new supply onto the market (see Market Monitor table). Traders are not yet overly concerned about rising defaults among bad apples causing a systemic spike in credit risk.

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*We've moved it to the back of the publication for ease of reading— scroll down to see it.*

# Memo

## An Invitation to a Private Party

**Bottom line:** The cycle of returns in private and public equities is out of sync because of the drag of illiquidity in private markets. Publics have enjoyed several years of above average return while privates have struggled. This pattern is now on the verge of flipping.

**What it means for businesses and investors:** With valuations extended and the 10-year outlook for public returns challenged, now is the time to look to illiquid private markets to generate long-run value. For LPs, this means reviewing recent distribution challenges and embracing upcoming fundraising efforts. For GPs, it means staying focused on closing out funds and raising new capital. For everyone else, it means taking new ways to access private markets seriously. As the market matures, secondaries will remain important, but continuation funds and other less savory liquidity structures can be avoided.

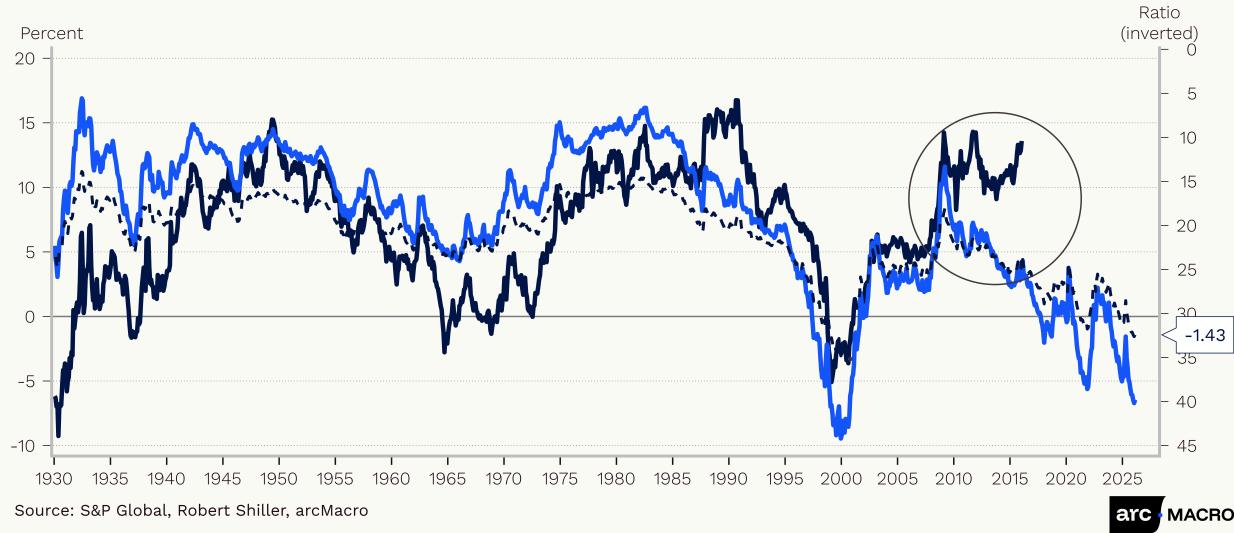
We believe that markets are at a turning point. Public equities have delivered stellar returns for three years running. By contrast, headwinds from the illiquidity and timing factors that define the private equity environment have meant that funds have struggled to deliver returns to investors on the usual timeline, stretching portfolio company hold periods to near record levels.

These dynamics are on the cusp of reversing. Here is the argument:

1. However you cut it, the outlook for five-to-ten-year-ahead returns in public equities is fairly dim (even when you make the appropriate adjustments).

**Current S&P 500 valuations imply negative forward returns**  
 United States, CAPE-implied 10-year annualized equity returns, annualized

— Actual 10-year ahead returns, lhs  
 — Cyclical Adjusted P/E Ratio (inverted), rhs  
 - - CAPE-implied 10-year ahead return on S&P 500, lhs



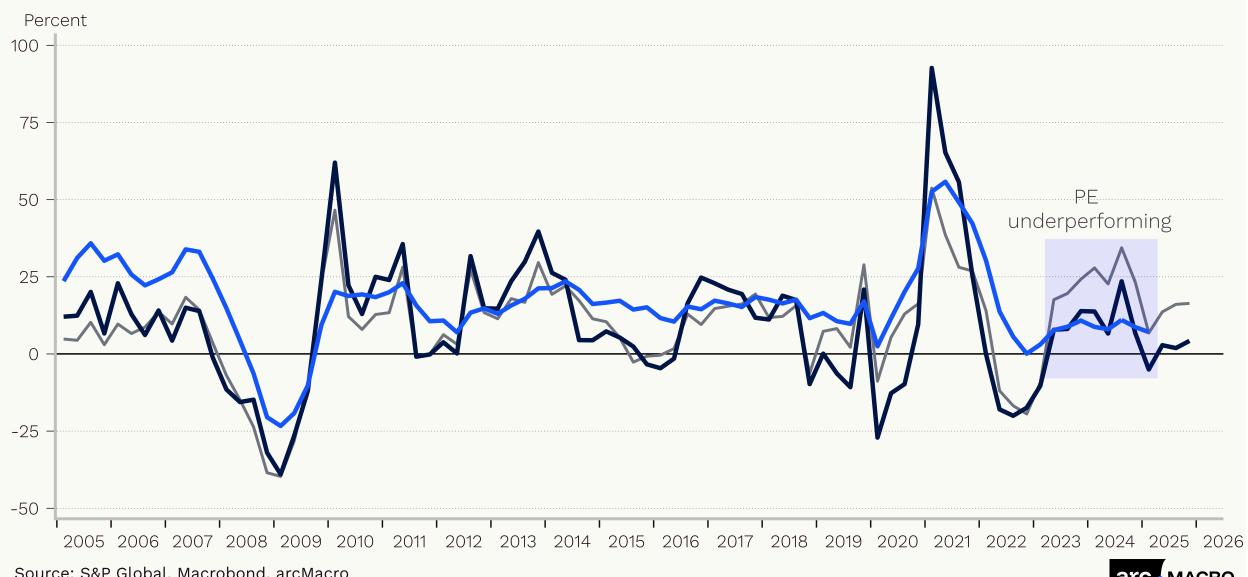
2. Private equity has been underperforming public markets in recent years.

Whether measured by quarterly NAV growth, one-year pooled IRR, or distributions to investors, the PE return environment has been highly pressured.

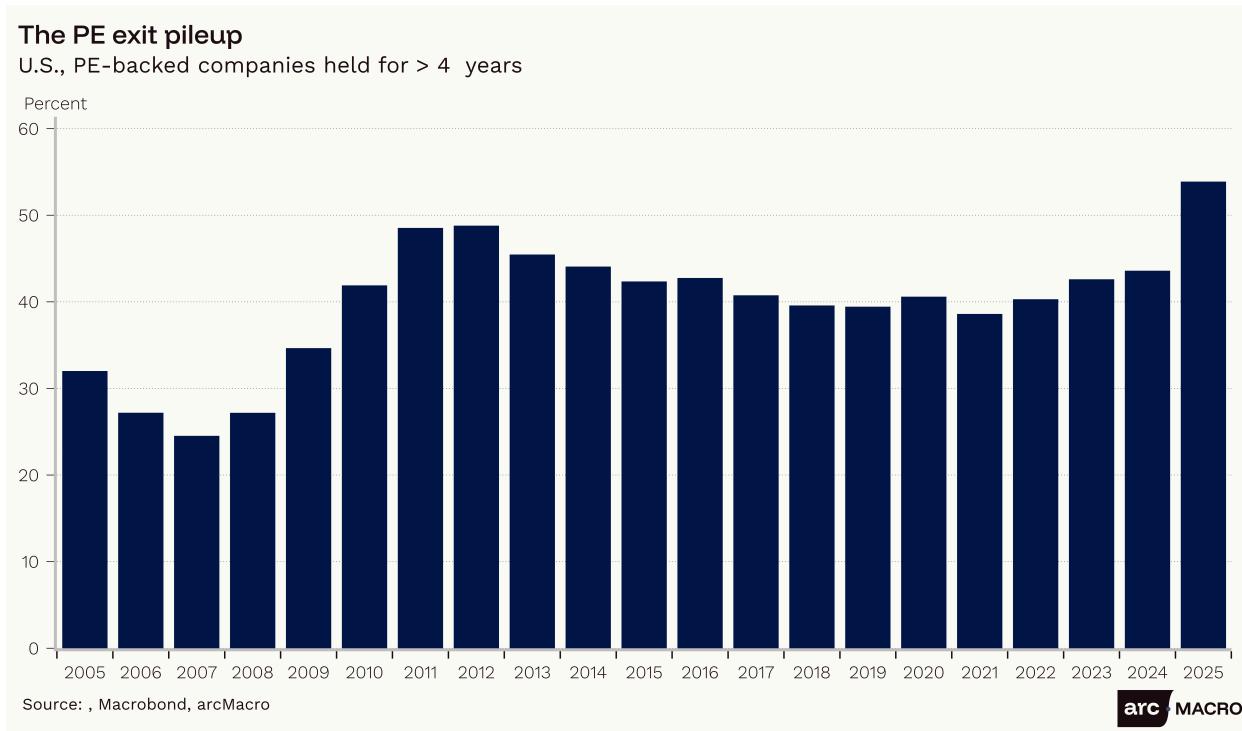
**PE has been underperforming public markets since the 2022 mini-crash**

United States, 1-year returns

— US Buyout 1-year horizon IRR — S&P 600 (small-cap) — S&P 500 (large cap)



3. The reason is simple: PE funds stocked up on assets in at high multiples during the 2021/2022 bull market. They're carrying those assets at high book value, and it's taking time to generate the growth required to find reasonable returns. Pressure to exit is now building.



4. Recognizing this, exits are rising along with general M&A levels. This is a necessary condition for beginning a capital renewal cycle. 2026 will be about an acceleration in exits. In 2027, fundraising will begin to rise meaningfully.

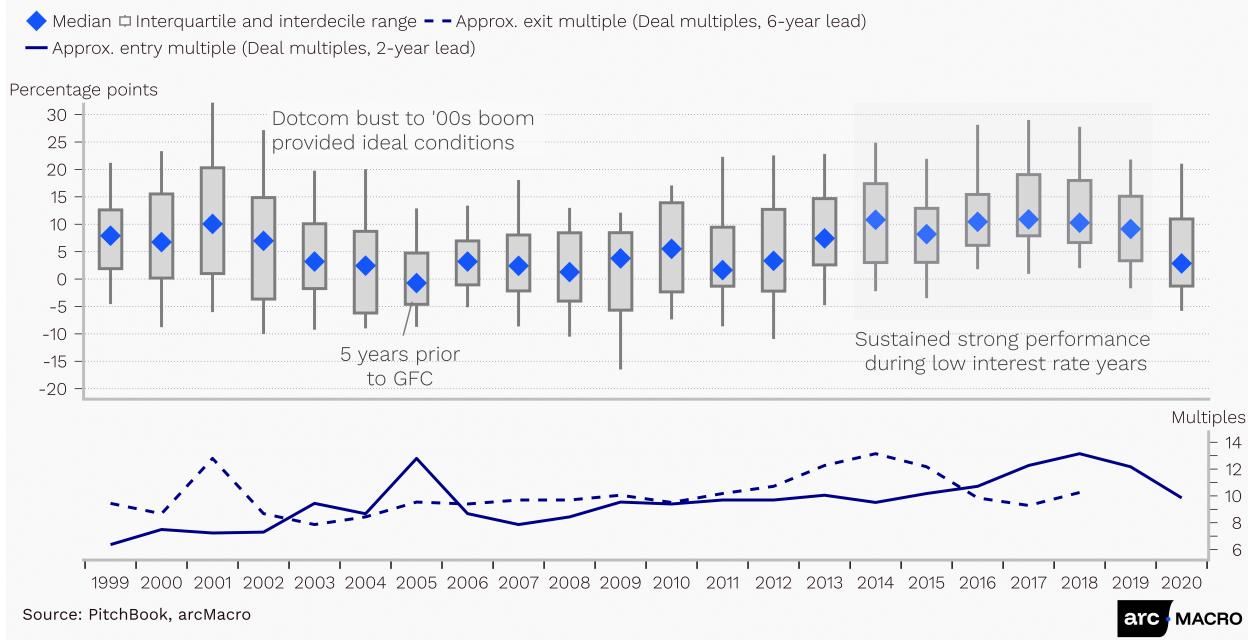
## M&A activity has accelerated through 2025



## 5. [Optional] long-run returns are not tightly correlated

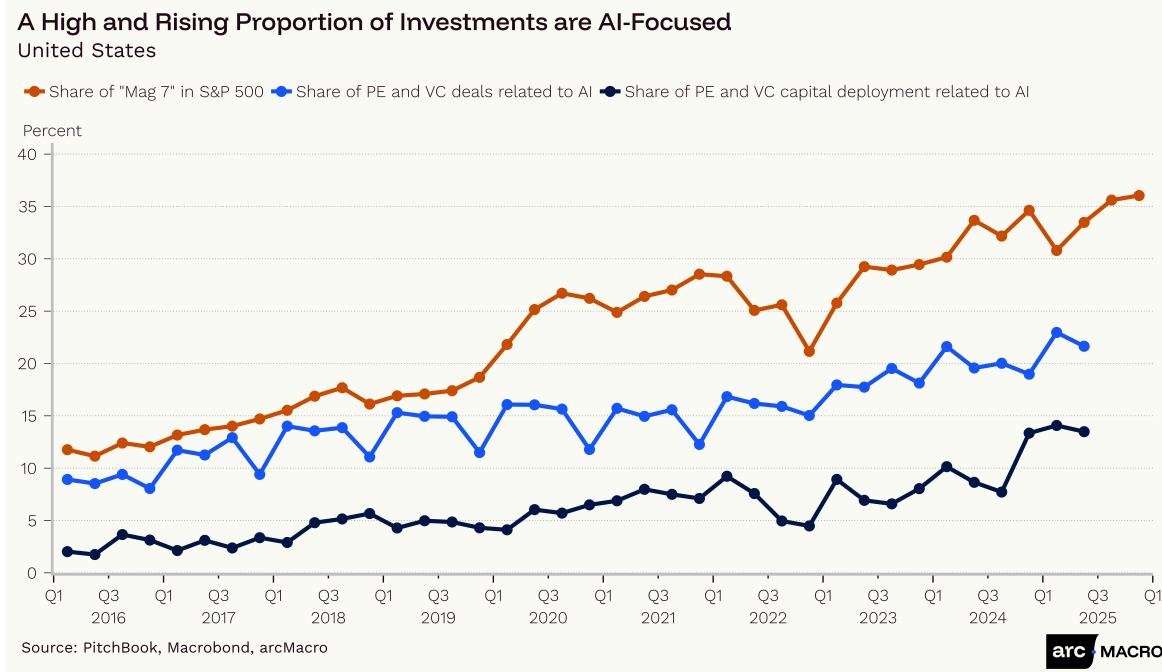
### Private equity performance depends on current and initial conditions

United States, Excess return by vintage year\*



## 6. A large share of the value from AI innovation will be captured in private, not

public markets.



It's tempting to write a permanent story for private equity based on the cyclical trough that the industry experienced in the post-COVID-19 period. That would be an error. The misalignment between the private and public market cycle is an important factor to get ahead of, and now is the exact wrong time for funds to trim allocations.

GPs should expect more caution from traditional PE backers who turn out to be less "evergreen" than they once thought – notably university endowments suddenly facing funding pressure. But this will be offset by the ongoing broadening of the funding base to traditional asset managers and the retail market.

## Appendix

### Proprietary Factor and Regime Model and Key Macro Indicators

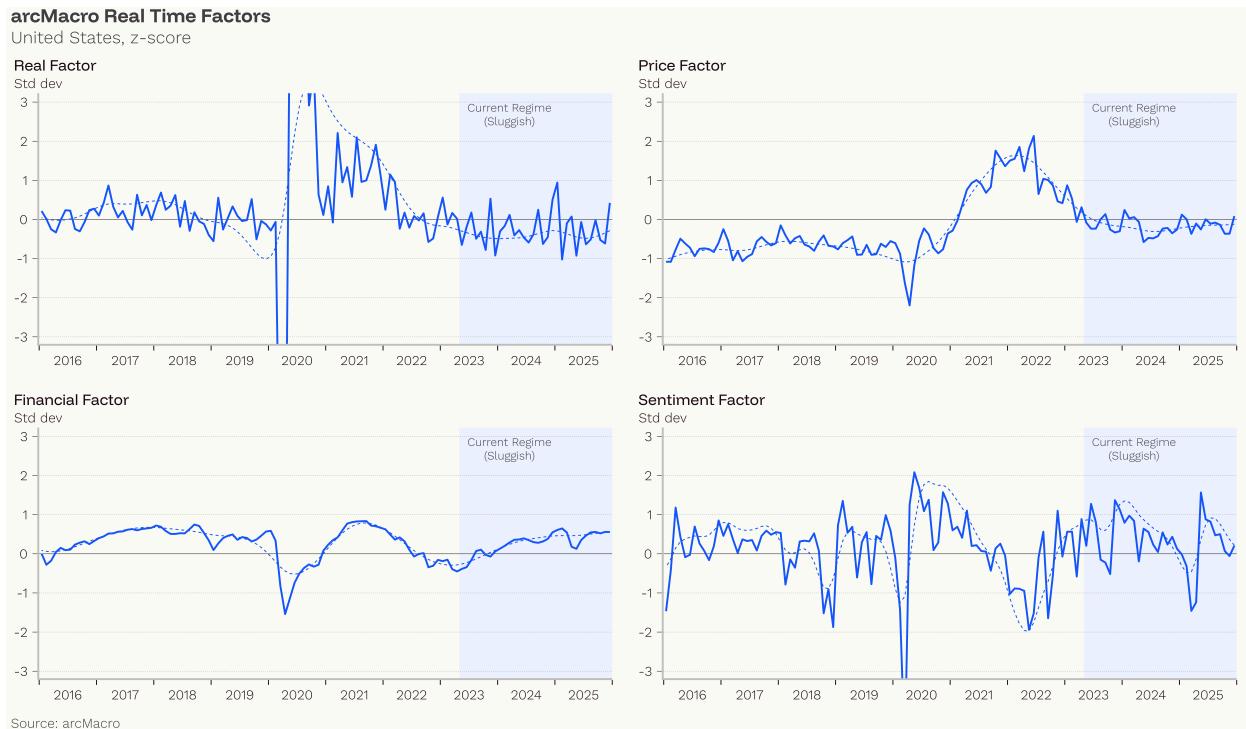
## The Week in Markets

	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 (%)
<b>Equity</b>							
S&P 500	6932	-6.73	-0.1	136	2.0	86.8	1.3
Information Technology			-1.4		-5.7		-3.0
Financials			1.5		3.1		-1.1
Consumer Discretionary			-4.6		-5.6		-3.0
Communication Services			-4.4		6.6		11
Health Care			1.9		8.3		1.7
Industrials			4.7		13.1		11.6
Consumer Staples			6.0		16.4		14.0
Energy			4.3		22.7		19.3
Utilities			0.2		-2.4		1.5
Real Estate			1.5		3.2		4.3
Materials			3.5		19.8		12.5
Nasdaq Composite	23031	-431	-1.8	-469	-2.0	-211	-0.9
Dow Jones Industrial Average	50116	1223	2.5	2805	5.9	2052	4.3
Russell 2000	6636	141	2.2	511	8.3	468	7.6
<b>Sovereign Fixed Income</b>							
US: 2-year Treasury Note	3.5	-0.02		-0.13		0.030	
US: 5-year Treasury Note	3.76	-0.03		0		0.030	
US: 10-year Treasury Note	4.22	-0.04		0.050		0.040	
FRA: 10-year OAT benchmark	3.45	0.02		0		-0.11	
GER: 10-year Bund benchmark	2.82	-0.03		0.17		-0.030	
CHN: 10-year CGB benchmark	1.81	0.00		-0.00250		-0.0371	
CAN: 10-year GoC benchmark	3.43	0.02		0.28		0.010	
<b>Corporate Bond Spreads</b>							
US: A-rated	65.7	2.1		-8.7		-4.1	
US: BBB-rated	101	4.8		-7.4		-3.8	
<b>Leveraged Loan Spreads</b>							
US: B-rated	427	9.36		26		35.4	
US: BB rated	266	0.395		3.8		10.5	
US: CCC-rated	1754	-0.808		363		190	
<b>Foreign Exchange Rates</b>							
DXY US Dollar Index	97.6		0.7		-2.6		-0.7
EUR/USD	1.18		-1.2		2.7		0.6
USD/CAD	1.37		1.0		-2.9		-0.4
USD/CNY	6.94		-0.1		-2.5		-0.8
USD/JPY	156		1.9		1.3		-0.2
GBP/USD	1.37		-0.6		4.4		1.9
USD/CHF	0.776		1.1		-3.8		-2.0
<b>Commodities</b>							
WTI Crude	63.3	-2.14	-3.3	3.8	6.5	5.98	10.4
Gold	4948	-33.9	-0.7	980	24.7	580	13.3
S&P GSCI Commodities			-1.8		6.1		71
S&P GSCI Industrial Metals			-1.9		13.7		3.4
S&P GSCI Agriculture			-0.8		-8.3		-2.6

\* 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, U.S. Bureau of Labor Statistics (BLS), Pitchbook | LCD, arcMacro

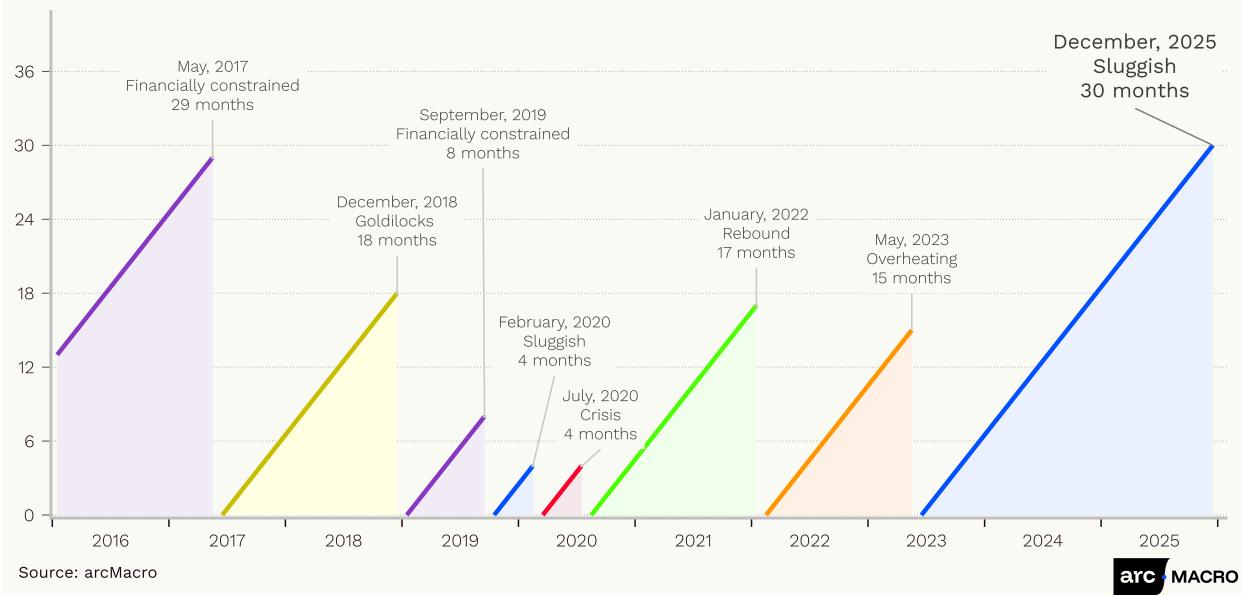




### arcMacro Regime Summary

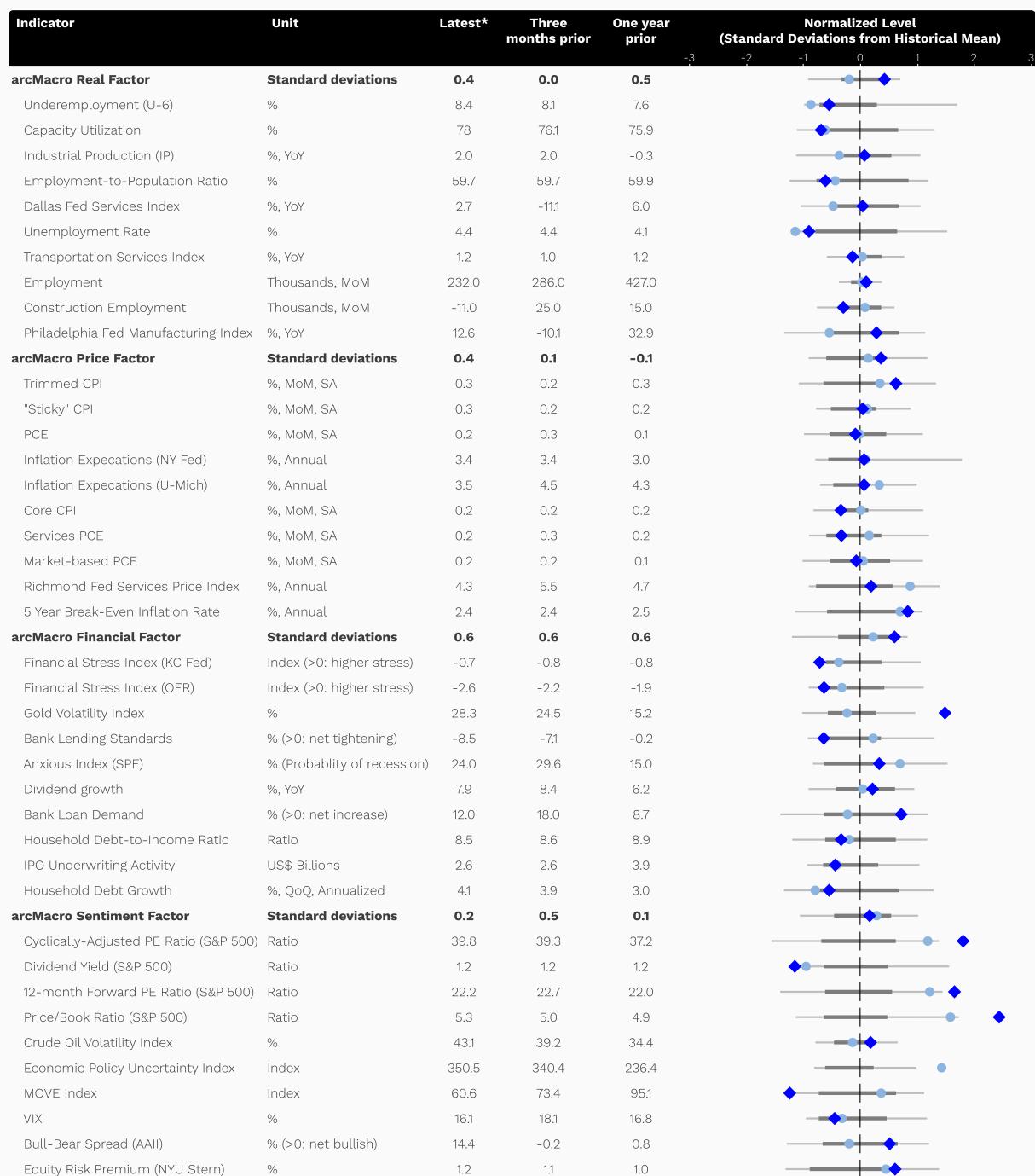
United States, Cumulative Months in Regime

— Stagflation — Sluggish — Rebound — Overheating — Goldilocks — Financially constrained — Crisis



## arcMacro Factor Input Monitor

Top 10 inputs by factor loading



■ 10th-90th Percentile ■ 25th to 75th Percentile ● Mean of past 5 years ◆ Latest Value

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 necessarily align.