

December 2025

Consumer sentiment deteriorated to very weak levels in November but has shown a modest rebound in early December, with the University of Michigan index rising from 51.0 to 53.3 as inflation expectations improved slightly, although overall sentiment remains historically depressed. In contrast, the Conference Board's Consumer Confidence Index fell to 88.7 from 95.5 in October. The divergence reflects the broader crosscurrents running through the economy.

The PCE price index, the Fed's preferred inflation gauge, rose to 2.8% annualized year-over-year in September, up from 2.7% in August. While still moderate versus prior years, the recent firming, combined with core PCE holding above 2%, suggests that bringing inflation back to target will remain a challenge for the Fed. The government shutdown further clouded the picture by creating October data gaps, complicating the Fed's December assessment.

The private-sector labor market showed notable weakness in November, with the ADP report unexpectedly contracting by 32k jobs. With BLS data delayed due to the government shutdown, the Federal Reserve will likely rely more heavily on the ADP report as its primary gauge of labor-market conditions.

Tech companies continue deploying unprecedented sums into AI infrastructure. Google now expects more than \$90 billion capex in 2025, Microsoft has increased spending 74% to \$35 billion, and Amazon projects \$125 billion next year with further growth in 2026. Market participants are increasingly questioning the sustainability of this pace. Much of the spending reflects competitive pressure to keep up in the race for AI leadership. The central challenge is clear: firms must forecast multi-year demand with limited visibility, risking downside if returns lag. Misjudgments could create financial strain, and market concerns are already emerging, reflected in widening spreads and credit ratings pressure for companies like Oracle.

The Atlanta Fed's GDPNow model estimates Q3 GDP growth at 3.5%, indicating solid momentum. Yet the headline masks a bifurcated backdrop. Retail sales surprised to the upside in September, and consumer spending remains the primary driver, largely supported by higher-income households benefiting from strong financial-asset performance. There are emerging signs of softening among lower-income consumers, though we need more consistent confirmation before drawing firm conclusions.

The FOMC meets December 9-10. Market pricing now assigns over a 90% probability of a 25 bp cut, in line with our prior view; less than three weeks ago, odds were closer to 40%. We expect Chair Powell to manage expectations around the pace of future easing, and barring a substantial deterioration in employment, we think the Committee will pause over the following meetings. However, we continue to anticipate at least 100 bps of cuts beginning in June 2026..

AI Related Capex Spending by Fiscal Year



Product Views

Rates: Over the past month, Treasuries from 2 to 10 years have been largely unchanged. Markets are currently pricing in nearly one additional 25 bp cut in the first half of 2026 and roughly 2.5 cuts for the full year. We disagree with this outlook and expect the Fed to remain on hold until June, followed by about 100 bps of easing given the more dovish composition of the FOMC, with a new Fed Chair and potential non-reappointment of some hawkish Regional Fed Presidents. As expectations for early-2026 cuts are repriced, we see near-term opportunities to add duration.

We remain cautious on the long end of the curve. Given the current economic outlook, markets are likely viewing aggressive easing as unnecessary and potentially inflationary. These are conditions that favor a continued steepening bias. We also acknowledge that housing affordability and elevated mortgage rates are key priorities for the current administration. As a result, we could see net Treasury supply shift toward the front end, which is more closely tied to Fed policy, or the FOMC could even consider a version of "Operation Twist 2.0" to provide targeted relief to the long end.

Credit: Investment-grade and high-yield spreads tightened modestly in November as markets priced in a more accommodative Fed policy stance. Our view remains unchanged: we prefer to stay underweight the sector overall while focusing on higher-quality issuers and maintaining an upward credit bias.

Securitized: MBS have returned 8.04% YTD, outperforming credit (7.48%). We expect this trend to continue for the foreseeable future. Selective opportunities also exist across securitized assets, such as CMOs that remain attractively priced and securities backed by non-traditional collateral, where structural advantages or market dislocations can generate incremental returns.

