QI 2026

Top (from left to right): Iraida Gonzalez; Chief of Staff, Dawn Mazzey, Business Development Director, Diana Patrascu; Director of Investments, Frank Powers, Group Director, and Katherine Khouri, Director of Business Strategy. Bottom (from left to right): Jeffrey Di Napoli, Financial Advisor, Janice Lynn Alexander, Financial Advisor, Fitzroy Whyte, Financial Advisor, Richard Frank, Financial Advisor, Corey Fleisher, Financial Advisor, and John Vessa, Financial Advisor.

2025 turned out to be another strong year in the market as well as in the economy. Despite policy uncertainty and geopolitical tensions, the S&P 500 managed to set its 38th record close for the year. Overall, the quality factor has underperformed beta and momentum for a large part of the year. Speculative and often profitless stocks related to quantum, rare earth, cryptocurrencies and other artificial intelligence related themes have rallied while dispersion amongst the Mag 7 has increased. Most recently, however, the market has shifted its focus to the members that have shown greater returns from the large amount of capital they have invested. On the economic side, U.S. GDP grew at 4.3% in the third quarter, surpassing both estimates and Q2 levels. Consumer spending, which accounts for roughly 70% of overall economic activity, rose at a 3.5% annualized rate, up from 2.5% in Q2, helping to fuel the stronger output. In other words, despite awful sentiment, consumer spending remained resilient. This is not surprising when we account for the fact that the top 40% of consumers drive 60% of consumption. US exports expanded 8.8%, while imports fell 4.7%. Government spending increased 2.2%, and investment in intellectual property, including artificial intelligence, grew 5.4%.[1] Inflation has been benign so far and has fallen since the start of the year. The US dollar has also weakened thanks to initial tariff uncertainties as well as shifts in global capital flows. This has helped ex-US stocks outperform US equities by the widest margin since 2009.[2] Geopolitical uncertainty, strong central bank demand, increased fiscal deficits and concerns around the path of inflation continued to support gold's outperformance. Meanwhile, bitcoin fell over 20% in Q4 despite a strong rally earlier in the year. The cryptocurrency market experienced sharp deleveraging as investors took a risk off stance in November and global liquidity tightened as the Bank of Japan hiked rates and the Federal Reserve took a hawkish tone. In December, the Fed cut rates by another 25 basis points and announced a new $40 billion monthly asset purchase program. The size and immediate implementation of the intervention was an upside surprise to markets, providing a boost to liquidity-sensitive parts of the market. The U.S. unemployment rate rose to 4.6% in November, as workforce participation outpaced new job creation, creating a "low-hire, low-fire" environment.[3]

Despite the strong finish to 2025, the market experienced strong bouts of uncertainty with accompanying pullbacks. First it was "Liberation Day," then it was the lack of data from the longest US government shutdown in history. While peak policy uncertainty may be behind us, we do recognize that the market will need to deliver against high expectations in the new year. Nevertheless, we see sufficient positive catalysts ahead that keep us optimistic.

Current Thoughts

- We believe that 2026 earnings will be driven by productivity gains, operating margin expansion, and positive operating leverage.
- We see opportunities in many of 2025's biggest laggards given their fading headwinds.
- We believe that provisions in the One Big Beautiful Bill Act (OBBBA) can catalyze a broadening out of capex beyond the tech sector.

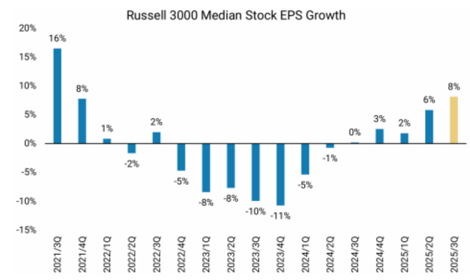
1 The Bureau of Economic Analysis - U.S. Department of Commerce; 12/23/25.
2 Morgan Stanley - The GIC Weekly; 12/22/25
3 (Morgan Stanley US Equity Strategy – Weekly Warm-up; 12/15/25.

- We expect the market to see a broadening out of performance outside of AI beneficiaries.
- We see deregulation as a positive catalyst to various industries as it likely reduces compliance costs, fast-tracks approvals and spurs increased lending.
- We expect to see a pick-up in M&A and IPO activity, benefitting private equity and financials.
- Consumption should reaccelerate in the second half of the year as benefits from the OBBBA flow to consumers.
- We expect to see a "low-hire, low-fire" labor market with unemployment rising slightly but remaining contained.
- We remain optimistic on international equities as Japan seeks to benefit from reflation reforms while Europe continues to benefit from increased fiscal spending.
- We expect corporate bond issuance to increase as debt financing for AI projects will continue on both the public and private side.
- We continue to overweight areas such as asset backed finance and infrastructure given their collateral-based cash flows.
- We look for opportunities in areas such as sports, media and entertainment investing given their low correlation to macroeconomics conditions.
- We view structured products and alternative investments as options to mitigate risk and diversify portfolios for eligible investors, where appropriate.

Markets

We believe that 2026 will be another positive year for U.S. equities driven by pro-growth policy provisions, improved profit margins, and an accommodative Fed. Many investors spent 2025 being overly pessimistic. In the first half of the year, many debated whether or not tariffs, immigration controls and DOGE efforts were going to result in a full-blown recession with a drastic surge in inflation. During the second half of the year, investors were busy questioning whether or not we were in an AI bubble. We believe that this level of pessimism actually kept a cap on multiples, which kept us bullish. What is most impressive is that corporate earnings have continued to surpass expectations this year, even as companies, at large, dealt with higher tariffs and poor sentiment. Despite all the headlines surrounding rich valuations, multiples are not much higher from the start of the year, proving that the market's gains have been driven by earnings growth and not valuations. This is in very sharp contrast to the dot-com bubble where many high-flying companies were unprofitable and had little tangible demand. In fact, based on the most recent readings, the S&P 500 is reporting its highest net profit margin in over 15 years.[4] While the AI enablers within the tech sector stood out the most in terms of their contribution to returns, we are very encouraged to see a steady increase in the share of companies seeing quantifiable benefits from AI adoption. We see this as a catalyst for improving market breadth. For Q3, the median stock in the Russell 3000 saw its best EPS growth in 4 years, and the S&P 500 revenue beat rate was running at more than double its historical average. The S&P 500 is currently on pace for 13% to 14% earnings growth, with corporate profits increasing across the board.[5]

Exhibit 15: Median Stock EPS Growth Is Continuing Its Rebound; Strongest Growth in 4 Years



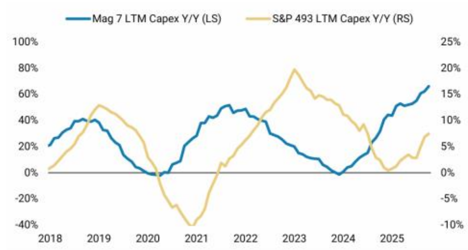
Source: Compustat, Morgan Stanley Research.

In 2026, we expect to see better returns for many of the lagging areas of the index. Once example is Healthcare. The sector has underperformed for the last two years, driven by policy uncertainty including Robert F. Kennedy Jr. appointment as U.S. Secretary of Health and Human Services (HHS), bipartisan proposals to lower drug prices including the "Most Favored Nation" approach, and negative headlines around managed care stocks. As policy headwinds have been largely reduced or priced into many stocks, we see opportunities for the sector to benefit from various factors including greater clarity, increased M&A as patent cliffs expire, improved efficiencies from AI as it pertains to drug discovery and optimized treatment plans, and increased GLP-1 drug adoption. Many software stocks have also traded cheaply based on fears that AI will indiscriminately disrupt the entire sector. We believe that companies that can continue demonstrating higher sales and traction in their AI offerings will be rewarded. Select enterprise software companies that are deeply engrained into business networks can also benefit as AI tools like agentic AI and Copilot features get rolled out on a much deeper level at many firms. Asset managers can also see tailwinds after a disappointing 2025. The group has lagged due to slower than expected private equity exits and capital markets activity on account of tariffs. We have already started to see a pickup in these areas with 3Q25 announced volumes up 43% and expected to rise. Even select retailers can seek to benefit despite a widening wealth gap. Black Friday saw record online spending of $11.8 billion, significantly boosted by AI-powered tools that helped consumers find deals faster, leading to both strong luxury buys as well as budget-conscious ones. We expect that winners in this space can benefit from increased pricing power as they gain more market share.

On the fiscal policy side, the OBBBA has boosted investment spending and increased corporate free cash flow thanks to incentives such as bonus depreciation and upfront R&D expensing. This has already started to drive a broad capex recovery that is finally starting to benefit many sectors outside of technology. The OBBBA's main benefits are expected to fully materialize in 2026 and 2027. We believe that increased investments are needed to spur growth via higher productivity, something that has been missing for the past 20 years.[5]

4 FactSet Insights; John Butters; 11/17/25.
5 Morgan Stanley US Equity Strategy – Weekly Warm-up; 11/17/25.

Exhibit 19: Capex Growth Is Improving for Both the Mag 7 and S&P 493



Source: FactSet, Morgan Stanley Research.

Another catalyst we see for productivity and margin improvement next year is de-regulation, especially for smaller and medium sized businesses. Excessive regulations cost smaller businesses much more per employee or dollar of revenue because they don't have the scale to diffuse these costs. A study by the National Association of Manufacturers estimated the total cost of regulations in the U.S. in 2022 was roughly $3.1 trillion or about 12% of GDP. That marked an increase of $465 billion from a decade earlier and includes the cost of compliance for businesses, individuals, and state and local governments. The cost of regulation increased under the Biden administration, at 6.5% of GDP over the course of his four-year term as a sizable chunk of this was driven by stricter auto emissions standards.[6] As powering data centers alone will demand increased energy needs, less regulation on the energy front will allow for more energy sources to be used. In the financial sector, deregulation could help banks increase lending if capital requirements are reduced. While some level of regulation is important in order to keep risks at bay and to protect both the consumer and the environment, a reduction in excessive requirements bodes well for margins.

One of the factors we will continue to monitor next year will be inflation. While we expect it to remain contained, we do expect a temporary increase in the beginning of the year, which should abate in the second half. Overall, businesses have adjusted their planning as they've gained more clarity on the tariff front. Many companies have cited different methods of tariff mitigations. Some have looked for alternative supply chains and/or have used automation and AI to cut costs elsewhere. Others have tactically absorbed costs in order to gain market share and volume growth. While tariffs remain an overhang for certain pockets, it's important to note that they do not impact every company and sector equally. We believe that companies with strong pricing power are now in a position to pass along an increasing share of tariffs if they choose to do so.

The consumer has thus far remained resilient, especially at the higher end. Strong market returns for the past three years have generated substantial wealth that has continued to support strong levels of spending. However, signs of strain are now starting to appear among lower-income consumers. This cohort can find some relief from the OBBBA's tax provisions such as deductions on tips, overtime pay and child credits. We believe that a portion of the tariffs will be partially offset by this in addition to a record high tax refund early in the year. It's estimated that federal tax refunds will increase by $160 billion, which equates to 0.5% of GDP.[7] Overall, while we anticipate a slowdown in the first half of the year, we believe the combination of strong consumer balance sheets, fiscal relief and lower borrowing costs should keep consumer spending positive.

We expect unemployment to pick up modestly but remain below 5%. The most recent unemployment number increased to 4.6% in November, higher than the 4.4% rate in September and above the Fed's estimate of 4.5%. The bulk of the job losses came from the government sector.[8] We believe this will give the Fed enough confidence to deliver another cut in January. Chair Powell has acknowledged that while the demand for workers has come down sharply, the lack of available workers is helping to prevent massive layoffs. This has been aided by immigration controls and deportations. Meanwhile, sticky inflation components continue to soften, especially housing, which may help the Fed look past tariff related inflation when cutting rates. We believe inflation risks will continue to diminish once tariff flow through is complete, and demand starts to fall. The adoption of AI has softened the near-term demand for labor. As a result, job growth has slowed sharply, which should keep the Fed easing in 2026. Furthermore, as past technological advancements have turned out to have deflationary effects, we believe that AI has the potential to keep inflation at bay in the long run.

What has changed the most since the last Fed meeting has been the Fed's decision to restart asset purchases. More specifically, the Fed intends to immediately begin buying $40B of T-Bills per month to ensure the smooth operation of financial markets. This was a timely infusion of liquidity at a time when it was starting to dry up. Given the size of the debt and deficit, the Fed has an additional responsibility to assist the Treasury in funding the government. At the Fed's October meeting, it indicated some concern about tightening liquidity. As a result, Chair Powell announced the Fed would stop quantitative tightening on December 1st to alleviate this pressure. Evidence of this tightness could be seen in the performance of various asset prices, including crypto, high momentum and profitless growth stocks that ran up too fast in September.[3] While the Fed's intention was not to support the performance of these asset classes, it does intend to provide stability in the bond, credit and funding markets. These purchases, whether in isolation or in combination with rate cuts, provide additional liquidity and are supportive of equity markets.

The Trump administration has been highly supportive of cryptocurrencies. It has established a Strategic Bitcoin Reserve, passed the GENIUS Act to provide a federal framework for payment in stablecoins and has promoted crypto adoption across various industries. This backing has fueled excitement in the industry, driving rallies in digital currencies and stock prices of such related businesses. Nevertheless, this has come with risks as bitcoin, in and of itself, has proven its sensitivity to liquidity and price swings.

6 Wellington Management; Juhi Dhawan, PhD; December 2025.
7 BNY Mellon 2026 Outlook
8 Bureau of Labor Statistics; U.S. Department of Labor; 12/16/25.

International Markets

2025 reminded us why we preach diversification. International equities outperformed U.S. stocks by over 1,000 basis points, something we haven't seen in a long time. A weaker dollar has benefited the earnings growth of both US multinational companies as well as international companies. Over the last decade, a strong dollar has dampened international returns. The Trump administration has been laser focused on increasing exports and has heavily relied on a weaker dollar in order to do so. This bodes well for international markets. So far, the winners in international markets have been domestic companies with low dollar exposure as well as value-oriented sectors that have benefitted from increased spending on infrastructure, defense spending and the energy transition. One of the most notable outperformers has been European banks, which are finally benefitting from positive yields and improved profitability. We continue to like having a core style preference in order to benefit from this theme while still having exposure to high quality blue chips in the growth space including semiconductors that are supporting the buildout of generative AI, top tier streaming and e-commerce companies, as well as luxury goods producers with strong pricing power. We are positive on the self-help stories occurring overseas and well as tailwinds from dollar weakness. With regards to Asia, we continue to like companies that benefit from their essential roles within the AI supply chain. We see tailwinds for international stocks continuing in 2026 as Europe will continue to benefit from the large fiscal spending package passed by Germany. To put it into context, this has been the largest fiscal spending package it has seen in more than three decades.[9] Japan is expected to benefit from new pro-growth policies and corporate reforms under new Prime Minister, Sanae Takaichi. These policies will continue to incentivize businesses to increase investments and shareholder returns.

Fixed Income & Rates

The Fed continues to see downside risks to employment but maintains a balancing act between labor market stability and short-term inflation flare ups. This is why we remain balanced within our fixed income allocation, although we have moved up duration. Most notably, we have overweighted multisector fixed income exposure, which has the ability to invest in both currencies and international and emerging market bonds. With U.S. credit spreads at historically tight levels, we prefer a flexible fixed income mandate. We still believe it is prudent to maintain some exposure to shorter duration fixed income as well in order to hedge against temporary pickups in inflation. We do encourage investors who are overweight ultrashort fixed income or cash alternatives to be mindful of reinvestment risk. One of the things we are watching for next year is the supply/demand dynamics of corporate bond issuance. 2026 is expected to see record issuance in the corporate bond market to the tune of about $2 trillion, driven by massive spending on AI, refinancing needs, and funding M&A.[10] So far, demand remains strong as investors continue to show a strong appetite for yield. At large, credit spreads remain well-behaved, and fundamentals continue to be supported by strong earnings and healthy balance sheets. We would stay up in quality and stick to stable issuers. We expect both public and private credit to help facilitate the massive funding needs we have referenced and would look towards disciplined managers with strong underwriting standards.

Outlook

To sum up, we remain optimistic in 2026 on account of corporate earnings growth aided by AI, capex, deregulation and pro-growth provision from the One Big Beautiful Bill Act (OBBBA). We expect to see a temporary pickup in inflation from tariffs increasingly hitting the lower end consumer in the first half of the year followed by a reacceleration of spending and lower prices in the second half. Risks we see include unemployment levels rising faster than expected without intervention from the Fed in additional to earnings growth falling short of expectations. We expect increased volatility around the appointment of a new Fed Chair as well as around midterm elections.

We would like to thank you all for your continued trust in us and wish you and your families a happy and healthy 2026!

The Harbor Group is proud to have been named one of America's Top Wealth Management Teams by Forbes for 2025. It was also recently announced that The Harbor Group was named to the 2026 Forbes Best-In-State Wealth Management Teams High Net Worth ranking. It's an honor to be recognized among these groups of outstanding professionals who consistently work to raise the standards in our industry. Thank you to our amazing clients for your continued trust and helping to make this recognition possible.

Source: Forbes.com (Awarded Nov 2025) Data compiled by SHOOK Research LLC based for the period from 3/31/24–3/31/25.
Source: Forbes (Awarded Jan 2026) Data compiled by SHOOK Research LLC based for the period 3/31/24-3/31/25.

Please refer to important information, disclosures and qualifications at the end of this material.

9 Charles Schwab - 2026 Outlook; 12/19/25.
10 Natixis 2026 Outlook

THE HARBOR GROUP *at* MORGAN STANLEY

John Vessa, CIMA®, CFP®
Managing Director, Wealth Management
Family Wealth Director
Financial Advisor
212-603-6293
John.vessa@morganstanley.com
NMLS: 1270033

Jeffrey Di Napoli, CFP®, CRPS®
Executive Director, Wealth Management
Private Wealth Advisor
212-603-6290
Jeffrey.dinapoli@morganstanley.com
NMLS: 1268401

Corey Fleisher
Vice President, Wealth Management
Financial Advisor
212-603-6205
Corey.s.fleisher@morganstanley.com
NMLS: 1724239

Richard Frank
Associate Vice President, Wealth Management
Financial Advisor
212-603-6231
Richard.frank@morganstanley.com
NMLS: 1913313

Fitzroy Whyte
Financial Planning Specialist, Wealth Management
Financial Advisor
212 296-6398
Fitzroy.Whyte@morganstanley.com
NMLS: 2599570

Janice Lynn Alexander
Vice President, Wealth Management
Financial Advisor
212-613-6771
Janice.Alexander@morganstanley.com
NMLS: 1479435

55 E 52nd Street, 7th Floor,
New York, NY 10055

fa.morganstanley.com/harborgroup

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For index, indicator and survey definitions referenced in this report please visit the following: https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions

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2025 Forbes America's Top Wealth Management Teams

Source: Forbes.com (Awarded November 2025). This ranking was determined based on an evaluation process conducted by SHOOK Research LLC (the research company) in partnership with Forbes (the publisher) for the period 3/31/24–3/31/25. Neither Morgan Stanley Smith Barney LLC nor its Financial Advisors or Private Wealth Advisors paid a fee to SHOOK Research LLC for placement on its rankings. This ranking is based on in-person virtual and telephone due diligence meetings and a ranking algorithm that includes: a measure of each team's best practices, client retention, industry experience, review of compliance records, firm nominations; and quantitative criteria, including: assets under management and revenue generated for their firms. Investment performance is not a criterion. Rankings are based on the opinions of SHOOK Research LLC and may not be representative of any one client's experience; investors must carefully choose the right Financial Advisor or team for their own situation and perform their own due diligence. This ranking is not indicative of the Financial Advisor's future performance. Morgan Stanley Smith Barney LLC is not affiliated with SHOOK Research LLC or Forbes. For more information, see www.SHOOKresearch.com.

2026 Forbes Best-In-State Wealth Management Teams

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