

# Ring in the New Year: Investment Thoughts and Musings from Berkeley Capital Management

## 'Tis the Season: Beware of Market “Experts” Bearing Gifts

“Every Wall Street Analyst Now Predicts a Stock Market Rally in 2026.”

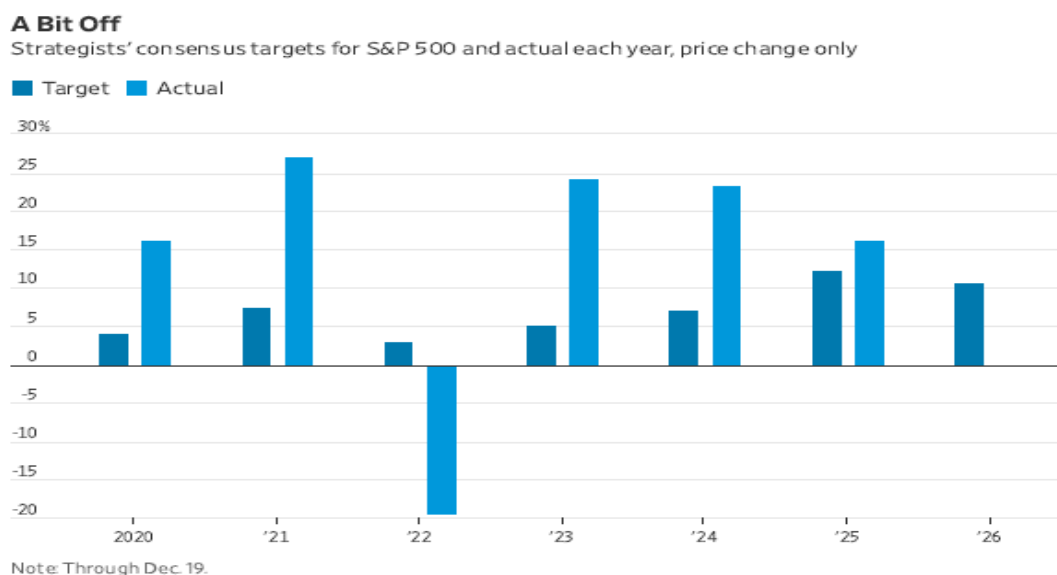
That was the subject of the email greeting me as I opened my inbox on the first business day of 2026. Bold. Confident. Comforting. And historically unreliable.

Market predictions have a way of arriving wrapped like holiday gifts—attractive, optimistic, and easy to accept. After all, who doesn’t want clarity about what markets will do next? Yet history reminds us that these forecasts often tell us more about human psychology than about future returns.

The timing of this email headline felt particularly ironic. Warren Buffett, the most iconic investor of the modern era, officially passed the baton to his successor on January 1, after more than 60 years as CEO of Berkshire Hathaway. Few voices have been more consistent, or more blunt, about the futility of predicting markets. As Buffett reiterated at Berkshire’s 2020 annual meeting, “I don’t believe anyone knows what the market is going to do tomorrow, next week, next month, or next year.”

His skepticism goes back decades. In his 1992 letter to shareholders, Buffett wrote, “We’ve long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie (Munger) and I continue to believe short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children.”

To illustrate, here’s how S&P 500 forecasts by Wall Street strategists have fared since 2020:



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Their consensus expectations call for a 2026 gain of around 10%. Not shocking in the least considering it's very near the typical strategist's historical prediction which is for markets to rise in the high single-digits for the upcoming year. After all, why bother jeopardizing your career by sticking your neck out when the market has risen around 9% on average for the past 50 years? The reason it's meaningless from making actionable investment decisions is because only twice in the past 30 years has the S&P 500 actually finished a year with a gain between 5% and 10%. "Average" is far from "common" in other words.

### If Not the Market, Maybe the Economy?

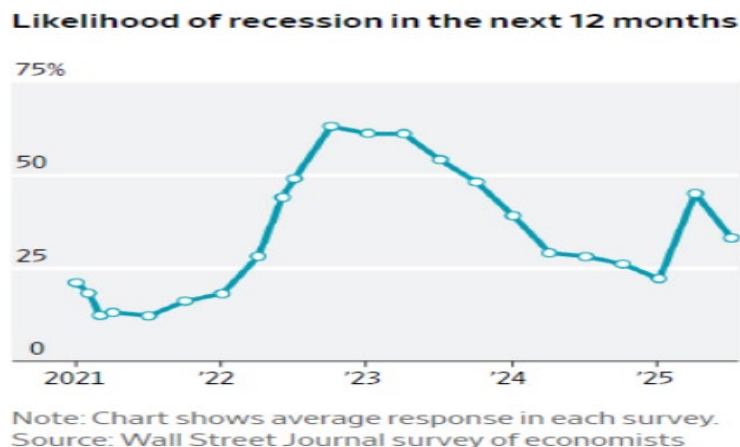
At this point, some investors concede the obvious: predicting stock markets is hard. But perhaps, they reason, we can at least forecast the broader economy—GDP, inflation, interest rates—and position portfolios accordingly.

Unfortunately, the evidence here is no more encouraging.

Aswath Damodaran, the NYU professor widely known as the "Dean of Valuation," recently put it succinctly on a recent podcast: "The historical record of macro forecasters is worse than abysmal. Macro forecasting makes us all feel better, but that's really it. It gives us a sense of being in control."

Economic forecasts are regularly revised, contradicted, and forgotten. Recessions are predicted that never arrive. Soft landings are declared just before turbulence appears. Entire investment strategies are mistakenly built around confident outlooks that unravel within months. The problem is not a lack of intelligence or data, rather it's that complex systems driven by human behavior resist neat predictions.

The old adage, "economists have predicted ten out of last two recessions" comes to mind. An example in 2022 is shown below. Inflation spiked, leading the Federal Reserve to aggressively raise interest rates. The logic calling for a recession made sense...it seemed the stars were aligned under such conditions. Yet, no recession. Employment held up, consumer balance sheets remained resilient and ongoing fiscal stimulus from COVID-19 aided the economy.



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Economies are dynamic, multi-faceted and impossible to predict. And yet, like clockwork, the forecasts keep coming.

## The Behavioral Trap of Forecasting

In an era of nonstop information and click-bait headlines, investors are constantly tempted to react. Predictions feel actionable. They invite us to *do something*—to shift allocations, chase themes, or retreat to the sidelines.

But reacting to forecasts often leads to emotionally driven decisions made at precisely the wrong time. Fear peaks near market bottoms. Greed peaks near market tops. *Economic and market forecasts often appear sophisticated and reliable. However, relying upon them can lead to costly mistakes and derail carefully crafted plans.*

## Time Arbitrage: The Overlooked Advantage

At Berkeley, we often talk about *time arbitrage*. Many institutional investors are judged on quarterly or even monthly performance. The scoreboard obsession of such short-term results encourages impatience and headline chasing.

Individual investors possess a meaningful edge if implemented: the ability to think in years, not headlines.

Time arbitrage means staying focused on fundamental value and long-term objectives, while others are distracted by short-term noise. It means having the discipline to hold investments through periods of volatility, uncertainty, and discomfort, precisely when less disciplined investors are forced to sell.

Markets have always been volatile. What has changed is the speed and intensity of information, which amplifies emotional responses. The ability to remain patient is not just a virtue; it's a competitive advantage.

Does that mean we completely tune out what equity markets and interest rates are doing and turn on autopilot? Definitely not. We firmly believe in being flexible and taking advantage of opportunities to buy and sell when markets overshoot. Those opportunities often mean we aren't afraid to zig when the momentum, short-term crowd is zagging. We follow a consistent investment process and philosophy. Like any philosophy, our approach can be in favor or out of favor, but it gives us a consistent framework for evaluating data, companies and investment products.

## The Berkeley Method: Rational, Fundamental Investing

At Berkeley Capital Management, we believe successful investing is not about predicting the future, it's about a consistent process and investment philosophy. This consistency applied over market cycles prepares us when opportunities arise.

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Our approach is rooted in rational, fundamental analysis across both equity and fixed income markets. We focus on valuation, cash flows, balance sheet strength, credit quality, and risk management; in other words, factors that matter over full market cycles, not news cycles.

Just as important, we pair this philosophy with experienced and credentialed investment professionals who understand both the technical and behavioral dimensions of investing. Discipline, patience, and perspective are not slogans; they are essential tools.

## Final Thoughts with One More Famous Quote

We kicked things off with a couple quotes from Warren Buffett so let's end this section with one more as he caps off a stellar career. One of the most cited of all his legendary quips is simply: "Be fearful when others are greedy and greedy when others are fearful."

Perhaps nothing can prove this point better than when the leading business network, CNBC, began airing a special "Markets in Turmoil" show in primetime whenever a market shock unnerved investors and heightened pessimism. The show tone was often concern and urgency. While some "experts" would call for staying the course, others would commonly advise seeking safe-haven assets like precious metals or shifting allocations out of stocks and into cash or bonds. Had you made major shifts out of stocks on CNBC's show air dates below...here is the market return you would have missed out on:

CNBC's "Markets in Turmoil" Special TV Show		
Air Date	Primary Reason	S&P 500 Return (1-Yr Later)
May 6, 2010	"The Flash Crash"	32%
Aug 8, 2011	U.S. Credit Rating Downgrade	23%
Aug 24, 2015	China Growth Fears	16%
Feb 11, 2016	Oil Crash / Recession Fears	27%
Dec 24, 2018	Fed Rate Hikes / Trade War	37%
Mar 16, 2020	COVID-19 Pandemic	78%
Jun 16, 2022	Inflation / Bear Market Lows	26%

Talk about a contrarian indicator!

Market forecasts will always be with us. They are headline-grabbing and meant to attract eyeballs. The real challenge for investors is not identifying the next rally or recession...it's resisting the urge to act on emotions or predictions that offer confidence without reliability.

As the New Year begins, the most valuable resolution investors can make is simple: ignore the noise, respect uncertainty, and commit to sticking with a disciplined, long-term process.

That philosophy has endured through bull markets, bear markets, and everything in between—and it remains the foundation of how we invest at Berkeley Capital Management.

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*(Note: At this stage we are going to shift gears and get into the weeds a bit about what has been happening in markets recently)*

## Investment Landscape Now: Can Small-Caps Regain Favor? The A.I. Cycle; Interest Rates

Large-cap stocks outperformed small-caps *again* in 2025, marking their fifth year in a row of relative outperformance. The only other time large-caps held the upper hand for that long was in the 1990s lead-up to the internet bubble. What happened after that unprecedented run for large caps? Small caps outperformed *each* of the next six years as highlighted below:

Annual Total Returns Comparison		
Year	Russell 2000 (Small Cap)	S&P 500 (Large Cap)
1999	21.26%	21.04%
2000	-3.02%	-9.10%
2001	2.49%	-11.89%
2002	-20.48%	-22.10%
2003	47.25%	28.68%
2004	18.27%	10.88%

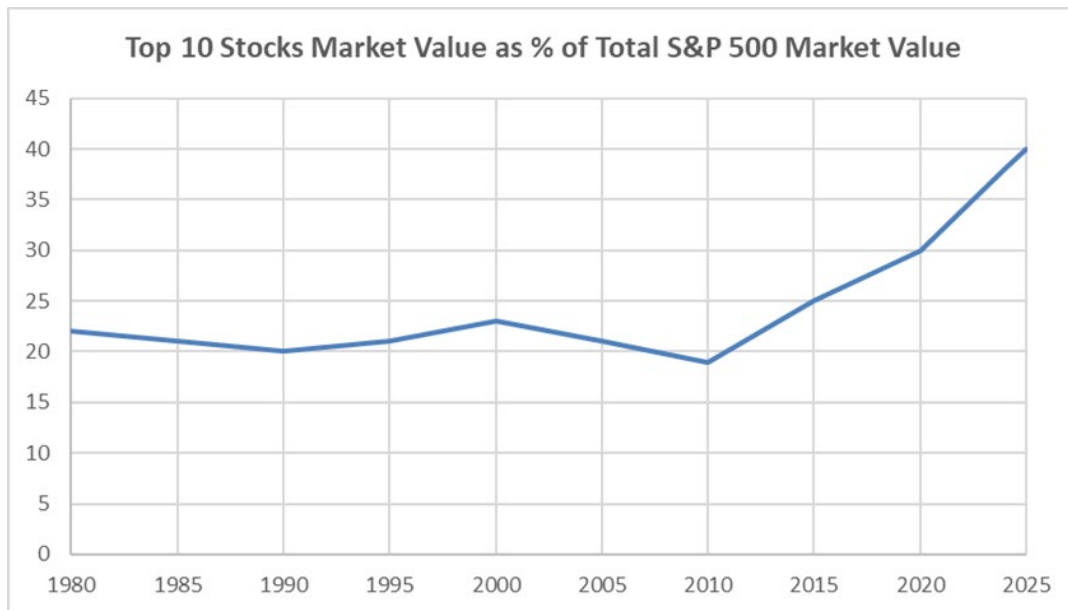
\$10,000 invested in the Russell 2000 Small-Cap Index would have grown to about \$17,300 by the end of 2004. Conversely, the same investment in the S&P 500 over that stretch would have grown to approximately \$11,100.

More seasoned investors probably recall the culprit causing the streak to end and subsequent three straight years of negative returns for the S&P 500: the bursting of the “Dot-Com” internet bubble and ensuing recession.

With all the hullabaloo around Artificial Intelligence and the dominant performance of the behemoth technology hyperscale cloud companies (ie. Amazon, Microsoft, Alphabet) and semiconductor companies supplying the computing power (ie. Nvidia, Broadcom), does this mean the market is headed for a similar fate?

Well, first the bad news. These companies, along with tech giants Apple and Meta Platforms, trade at an average price-to-forward earnings ratio of 31. That is a hefty premium to the broader S&P 500 forward P/E of 22. Additionally, as illustrated below, never in the lifetimes of any Berkeley employee has the market been close to this top-heavy.

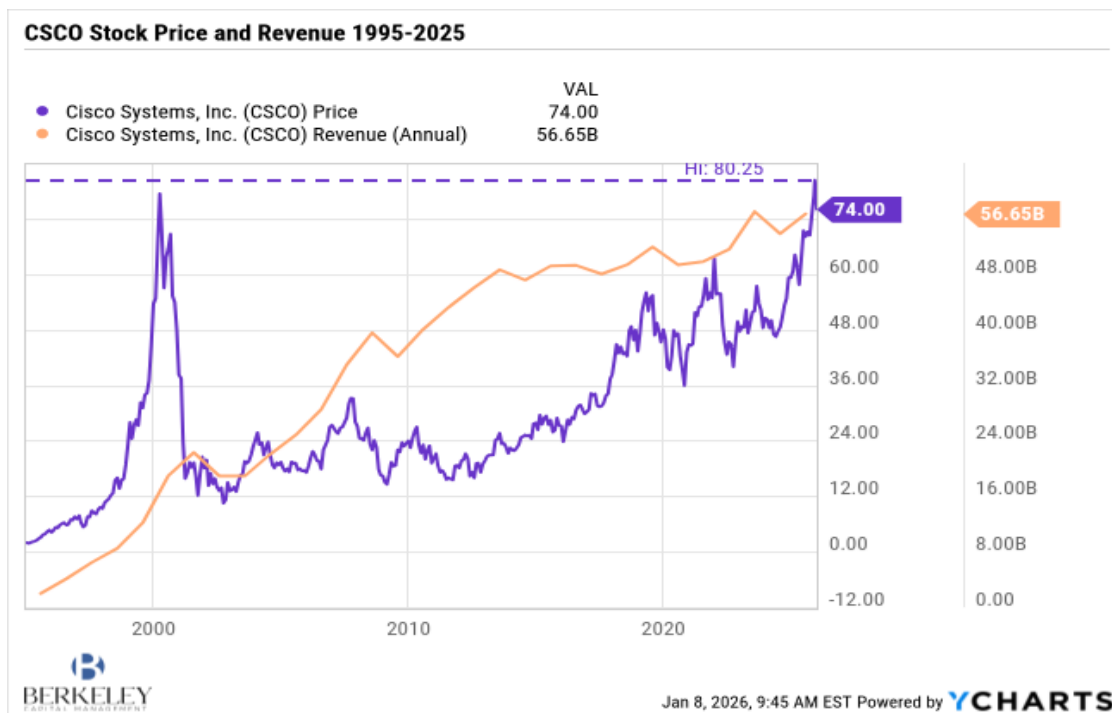
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The combined market valuation of the top 10 companies in the S&P 500 index represents about 40% of the index's total value, leaving just 60% for the next 490. In other words, as the stock performance of Big Tech goes, so goes large caps, at least using the widely quoted S&P 500 as a benchmark. Meanwhile, the forward P/E ratio of one popular small-cap index is between 15-16, or roughly half as expensive as the top 10 S&P behemoths. In other words, a lot of optimism around the data center build-out and the future of artificial intelligence is priced into the markets currently.

It's too early to know how closely this expansion parallels the overexuberance around fiber-optic networks in the late 1990s. Under the false narrative that worldwide internet traffic would double every 100 days, companies invested more than \$500 billion globally in laying millions of miles of fiber. Cisco was a stalwart and a huge shift in internet traffic did materialize. Cisco's revenue has risen 458% since 1999. Wow, the stock must have been a good investment since then, right? Not exactly. The current price of Cisco is still below its peak in March of 2000! Today, one narrative is that enterprise AI compute needs will at least *quadruple annually* through 2030 and global data center capital expenditure for AI in 2026 alone will reach at least \$400 billion.

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On the flip side, there are some positive key differences between today's frenzy and the Dot-Com bust. As a group, today's tech heavyweights continue to generate strong growth and high returns on invested capital. Alphabet (Google), Apple, Microsoft, Nvidia and Amazon over the past twelve months combined net income exceeded \$516 billion. This is a product of their dominant competitive advantages and in many cases network-based business models benefiting from economies of scale. Balance sheets are generally strong for this cohort, so dry powder to deploy large amounts of capital and grow if the economics make sense is still ample. And while high, their valuations relative to earnings are far from nose-bleed levels. The same could not be said of the market darlings in 2000.

Secondly, in terms of small caps, the average market valuation of a company in the Russell 2000 is about \$3.65 billion, which is multiple times higher than it was in the late 1990s. Generally, companies today are not going public as early in their life cycle for several reasons. The biggest of which is the ability to raise enormous sums of capital through private equity and private credit markets. This spigot did not exist 30 years ago to the degree it does today. The need to raise capital by going public isn't as urgent in other words. The result is individual investors often miss much of the highest growth phases of exciting upstart businesses. Only after valuations are much higher and private equity investors look to cash in their chips do these businesses go public. This presents an obstacle for small caps to match their historical return averages if this trend persists.

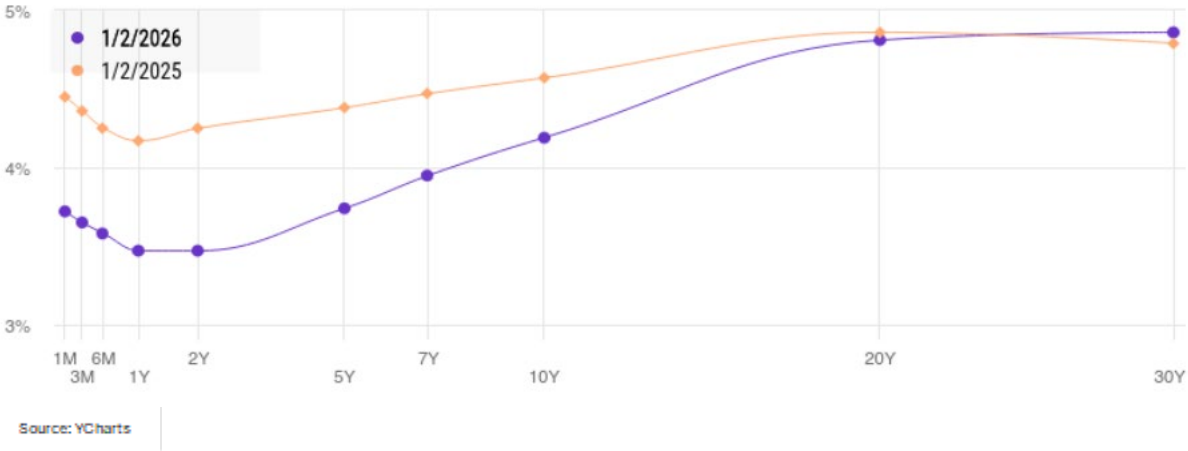
Bottom line: large caps are trading at a historically wide valuation premium to small caps. History suggests this divergence can't last forever and buying out of favor pockets of the market tends to work out well over the long-term. We are generally positive on small-cap stocks. But expecting a major and swift changing of the market leadership guard in favor of small caps

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because today looks all too familiar to the Dot-Com bubble misses some key differences between eras.

In fixed income, the most discussed change in the past year has been the FOMC continuing its campaign, started in September 2024, to reduce its overnight federal funds rate. As a result, short-term rates are lower, leading to a more positively sloped yield curve as longer-term rates have had a much less significant move.

**US Treasury Curve - January 2026 vs January 2025**

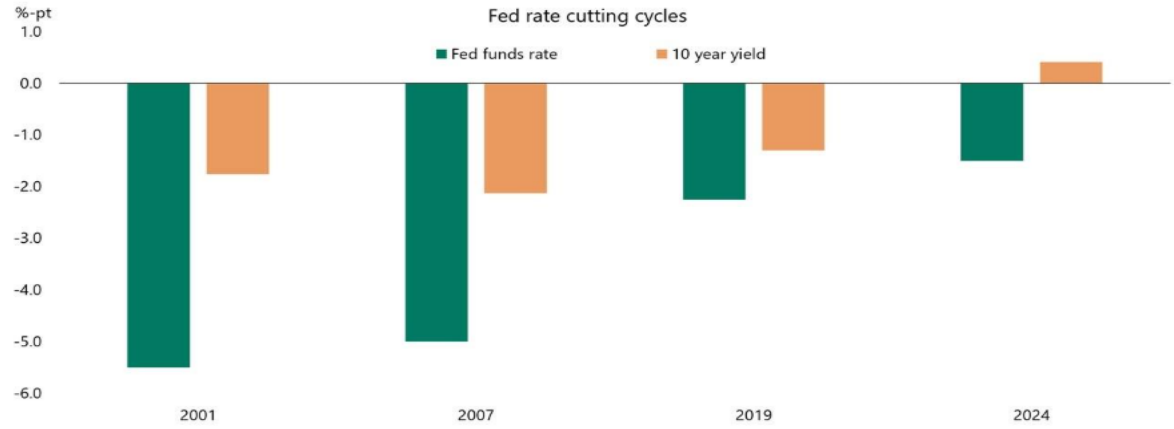


In most rate cutting cycles, the 10-year Treasury yield moves lower albeit to a lesser degree than short-term rates. In this cycle the 10-year yield has not yet followed this pattern and has actually increased.

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Normally when the Fed starts cutting, long-term interest rates also decline

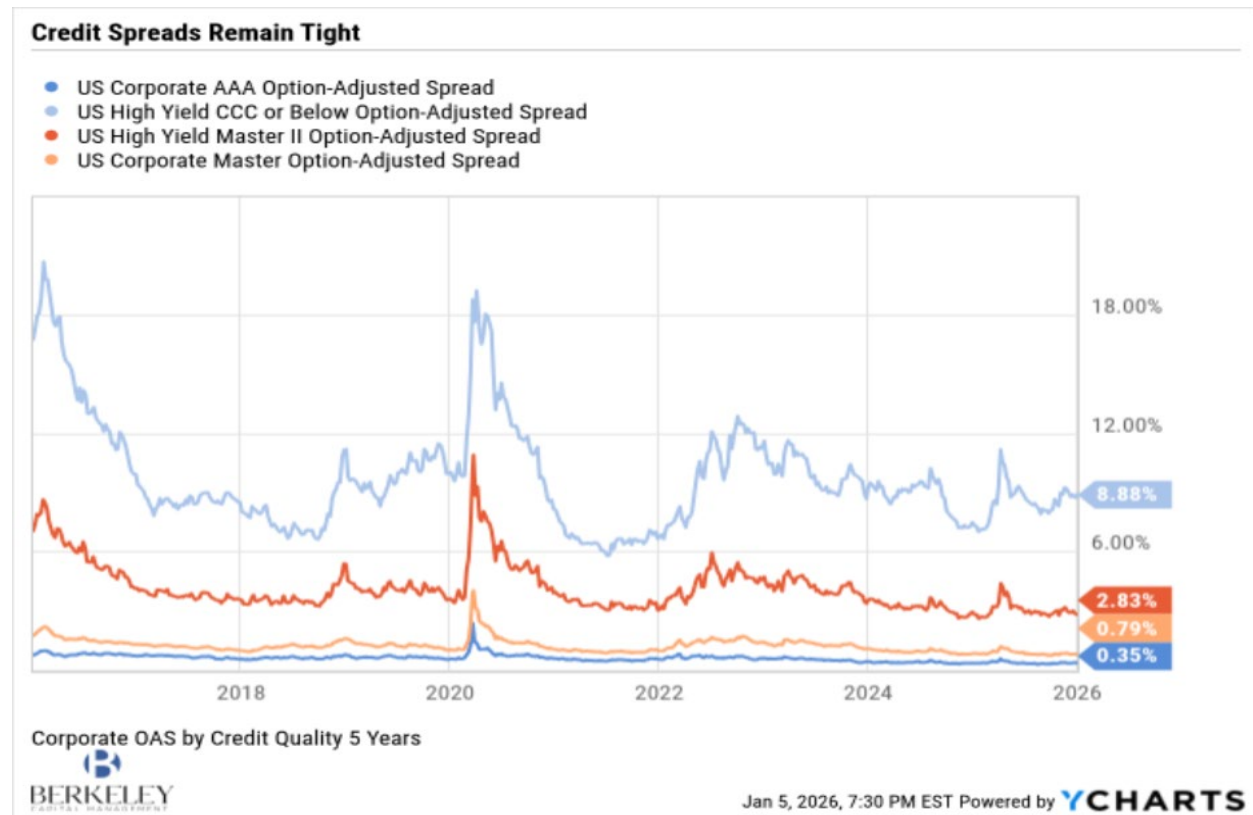


Inflation has fallen significantly from the surge in 2022 and 2023. While there is still debate about the future path of inflation, a noticeable divergence has emerged between recent CPI readings and the 10-year yield. In many historical periods prior to 2008 there was a spread between CPI and the 10-year yield. With CPI viewed as a floor for longer-term yields, and assuming some spread to provide return, the 10-year yield could easily move lower should inflation stay well contained.



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Credit markets continue to price in a very sanguine outlook on risk. Investors require a yield premium above the Treasury curve as compensation for taking credit risk in areas such as corporate bonds. The spread between the (perceived) risk-free borrowing of the Treasury and the risk of a corporate borrower can be a good reading on investor expectations.



Currently, credit spreads are relatively tight relative to historical standards, reflecting only modest compensation for taking additional risk. Corporate default rates recently have been low. A lot of optimism is priced in, so any economic shock could lead to lower bond prices as spreads widen and defaults follow more normalized patterns. We generally prefer taking risk exposure in equities and that is especially true in today's placid credit environment.

At Berkeley, we have navigated the current dynamics by modestly reducing short-dated fixed income products and repositioning into longer maturities in relatively safe sectors like government agency mortgage-backed securities, municipals and Treasuries. In the few instances we have taken on a slight amount of credit risk, it has been via active funds managed by portfolio managers with long-track records of good credit analysis and selection.

The only thing predictable about the markets is that they will be unpredictable. No matter what is in store for 2026, we will adapt and still be here to serve your investment needs.