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2026

Investment Outlook

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Fair to Partly Cloudy

By Bill Hornbarger, *Chief Investment Officer*

We enter 2026 after a third consecutive year of strong stock market gains, generally declining central bank rates, falling bond yields and a turbulent macroeconomic environment. The U.S. and global economy have shown remarkable resilience in the face of geopolitical tensions and trade wars, with the Bloomberg consensus world real year-over-year GDP forecast to be 2.0% for both 2025 and 2026. Equity markets have responded positively in this environment and as we head into the new year are vacillating between artificial intelligence-driven enthusiasm and concerns over valuations, which are stretched particularly in U.S. large-cap stocks where the indices are driven by the tech mega-cap names.

Here are some of the major themes we are watching as we enter 2026:

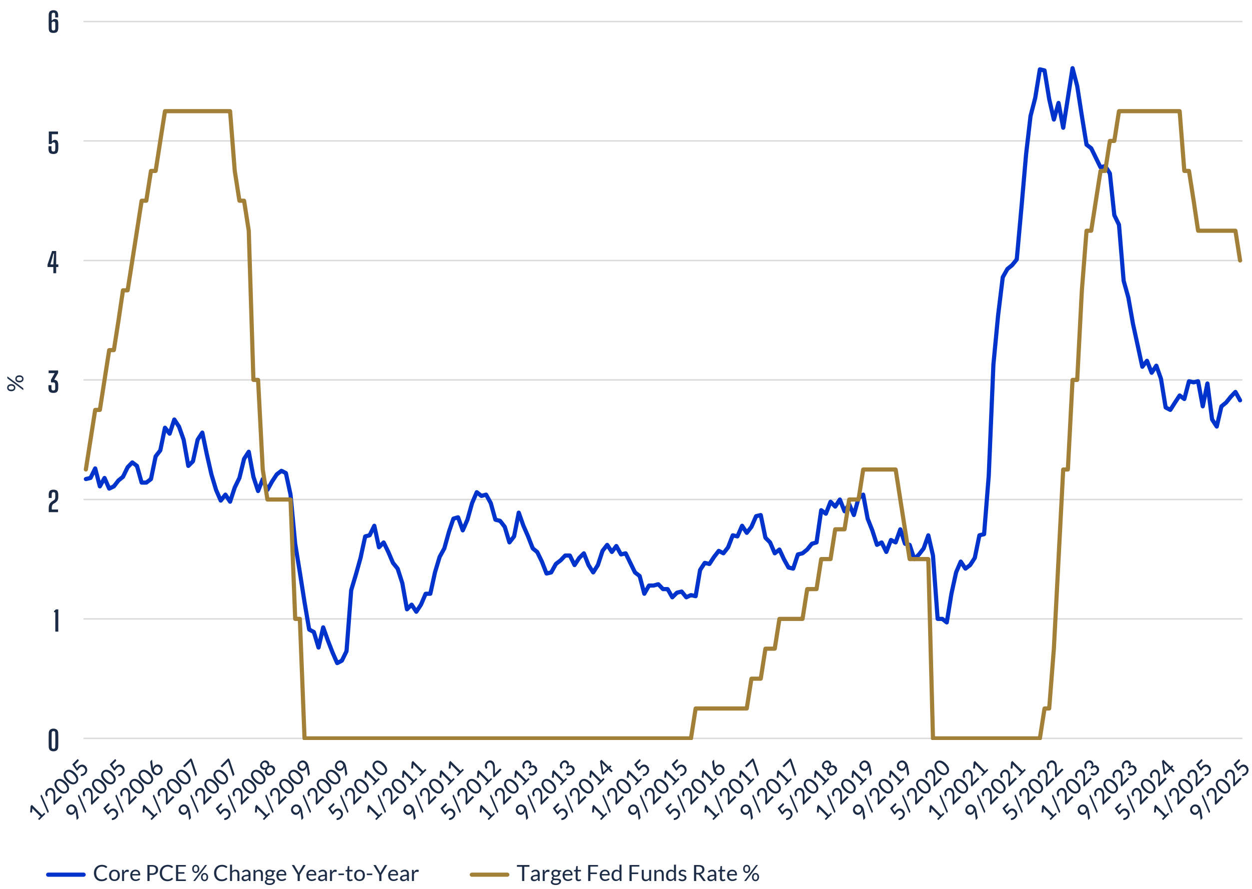
The Fed and Monetary Policy

The Federal Reserve (Fed) will be under new leadership with Jerome Powell's term as Chair set to expire in May. President Trump has indicated his desire to name a successor before then and has been consistent in his message that the Fed needs to lower rates. His most recent appointee to the Fed has voted for more aggressive rate cuts, and we would expect the same for his nominee for Chair, who will need to be confirmed by the Senate.

With that as a backdrop, the Fed finds itself in a difficult position. The Fed's dual mandate is to promote maximum employment and stable prices. The Fed's longer-run projection for maximum unemployment is 4.2%, very close to where it currently stands, and the Fed targets 2% core inflation over a market cycle. Core personal consumption expenditures have consistently stayed above that level, and both market and survey-based inflation expectations also indicate the belief of higher levels going forward. At the same time, the employment situation has deteriorated with the rate of change in unemployment consistent with previous soft patches/recessions, while wage pressures have eased. During the third quarter, the Fed shifted the balance of its risk assessment with the implication that it now sees deterioration in the labor market as a larger risk than higher inflation.

The Fed has responded by lowering rates, and the futures markets indicate additional rate cuts are expected in 2026. We believe the Fed will continue the path to lower rates, particularly with a new Fed Chair that will be nominated by President Trump. Where rates ultimately land will be contingent on several factors, most notably: can the Fed achieve the 2% inflation goal and how is "neutral" monetary policy defined? In the latest projection materials, the consensus longer-run forecast for federal funds was 3%, which we interpret as the 2% long-run inflation target plus 1%. With inflation expected to be sticky, we think the risk is that the Fed doesn't lower rates quite as much or as quickly as the consensus forecast.

Inflation vs. Fed Funds



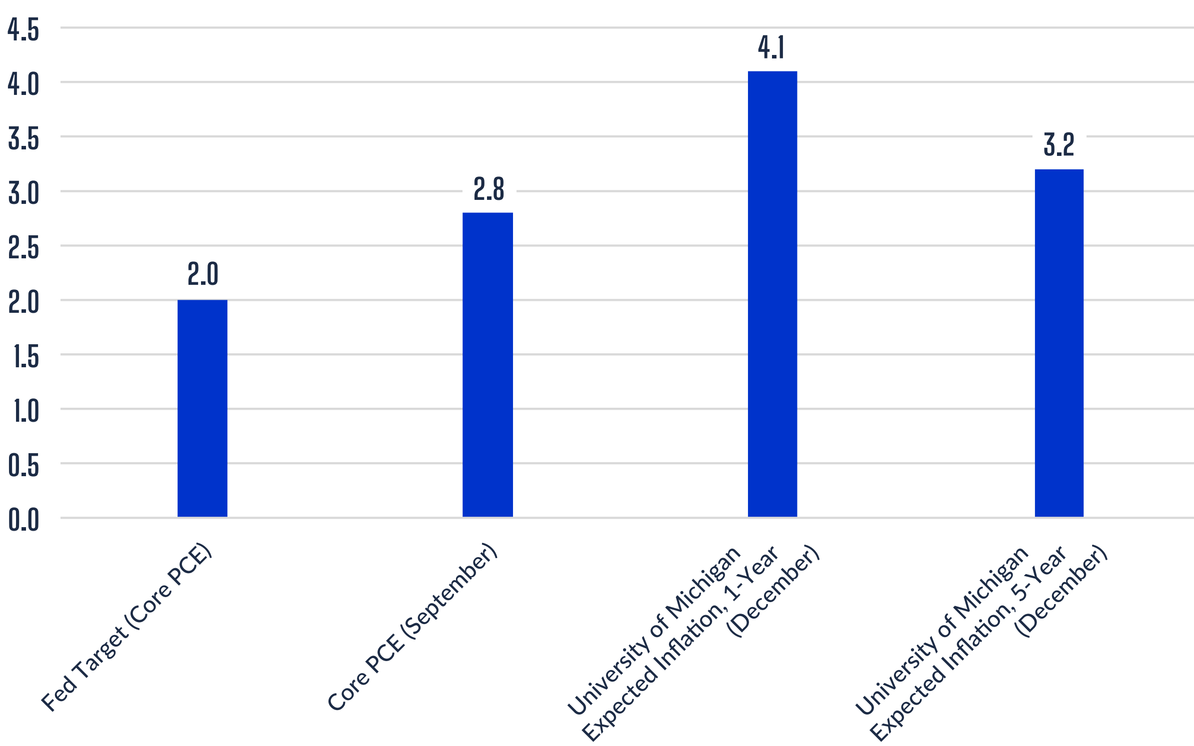
Sources: BEA, FRB/Haver

Inflation

Inflation has remained stubbornly above the Fed's 2% stated target, and the risk appears to be weighted towards it staying there, particularly with the potential for higher costs from tariffs still in the pipeline. Additionally, the weaker dollar and fiscal stimulus in the form of tax cuts from the One Big Beautiful Bill Act (OBBBA) argue that inflation will continue to linger above the Fed's stated goal. The other inflation worth mentioning is in asset prices, specifically home values and equities. The Consumer Price Index has increased 25% in the five years ended in September. Over that same time frame the median home price has increased approximately 36%, and the S&P 500 nearly doubled.

In a still growing economy with elevated asset prices, the higher-than-desired and expected inflation outlook would argue that the Fed would be more likely to keep rates unchanged. However, as mentioned previously, we expect the Fed to continue to cut rates in a measured way in 2026, which will likely result in inflation remaining above target in 2026.

Inflation Measures



Source: Haver

Debt and Deficits

We have written before about the return of the bond vigilantes (traders who sell bonds to signal their distaste with current fiscal and/or monetary policy). In late 2024 and early 2025 as the Fed lowered the overnight rate, longer-maturity bond yields increased, which is uncommon but not unprecedented. At that time there was significant discussion about the explosion of government debt levels. That talk subsided after Liberation Day, due both to the uncertainty on the economy and government finances and the flight to quality as equities endured a sharp bear market.

Developed countries around the world, including the United States, are in significant debt, and most of them are on track to remain that way for years to come without some type of significant reform. Growing deficits will crowd out other borrowers and spending as debt is serviced at higher yields. We expect intermediate and longer yields to be generally biased higher by the growing debt burden and the increased focus on it. Shorter yields remain captive to Fed policy, and the current inversion of the five-year (and shorter) Treasury note indicates expectations of more Fed rate cuts. The topic of tariffs is currently in the courts, and if tariff refunds must be issued, wider budget deficits can be expected. Even with the Fed set to cut rates further in 2026, we do not expect longer yields to fall in a one-for-one fashion, if at all.

> "In a still growing economy with elevated asset prices, the higher-than-desired and expected inflation outlook would argue that the Fed would be more likely to keep rates unchanged."

Trade

Trade terms remain uncertain. In the immediate wake of Liberation Day, many (including Benjamin F. Edwards) downgraded their views on the economy and had heightened concerns over inflation. The worst case was avoided, and the U.S. economy again showed its remarkable resiliency. Trade remains uncertain, and the threat of new tariffs is constant. However, the administration has pivoted to more targeted trade deals that appear to be the opening of negotiations. At the same time, the President's use of the International Emergency Economic Powers Act to issue tariffs has been questioned and has been taken up by the courts. The uncertainty surrounding trade policy has negatively impacted business sentiment, which can be seen in the small business survey, particularly as it relates to plans for hiring.

In Summary

It is a rare occurrence when there are no clouds surrounding the economic outlook, and current times are no exception. The stimulative impacts of the OBBBA from the extension of income tax cuts and the business investment incentives offset some of the drag from tariffs. Similarly, more accommodative Fed policy is aimed at reinvigorating job growth, which is faced with a stagnant labor pool (as evidenced by a declining labor force participation rate), significantly reduced immigration and the potentially disruptive impact of artificial intelligence. In the long term, a sound immigration policy would benefit the labor force, and sounder fiscal policies are needed to address the growing deficit.

We generally expect conditions to continue to be supportive of financial assets in 2026: more accommodative Fed policy, stable (although above target) inflation, maximum employment as defined by the Fed, and business and consumer confidence stable enough to encourage investment and spending. In the wake of the government shutdown, the economy lost some momentum but will likely finish the year between 1.5% and 2.0% and maintain that trajectory in 2026.

2025 Market Recap: AI Overpowers Tariffs, a Government Shutdown and Nervous Consumers

By Ben Norris, *CFA, Senior Investment Strategist*

As they neared the end of 2025, markets were stronger and more resilient to shocks than many investors might have anticipated, especially as stocks ended 2024 at elevated valuations relative to history. Through December 31, the S&P 500 was up nearly 18%, while the NASDAQ Composite (which is heavily weighted in growth stocks) was up 21%, and the small-cap Russell 2000 gained 13%. Returns overseas fared even better, with the MSCI EAFE (an index focused on developed international markets) up nearly 32%. The MSCI Emerging Markets Index was the year-to-date winner, however, with a gain of more than 34%, thanks to a resurgence of Chinese markets. The path to double-digit returns has been anything but smooth—investors have dealt with tariffs, shifting monetary policy, a record long government shutdown and depressed consumer sentiment, despite relatively robust economic growth.

Uncertain Beginnings

U.S. markets started the year on a tentative note with the S&P 500 finishing the first quarter down slightly more than 5%. Small caps and growth stocks fell out of favor, while value got a rare moment in the spotlight. The weak start to the year was spurred by renewed trade uncertainty, stubborn inflation and mounting geopolitical risks. President Trump began to tease the prospect of tariffs in the first quarter, but a lack of details on implementation drove the U.S. Trade Policy Uncertainty Index to record highs and ultimately weighed on consumer and business sentiment. Concerns that tariffs would put upward pressure on inflation and undermine economic growth pushed investors toward lower-risk investments such as gold, bonds and pockets of value available in international markets.

Just a few days later, President Trump announced a series of trade-policy changes that were significantly more aggressive than anticipated—the absolute level and broad nature of proposed tariffs roiled markets around the world. April 2 was termed “Liberation Day” by the Trump Administration and introduced a baseline 10% tariff as well as additional reciprocal tariffs that varied on a country-by-country basis, bringing the effective tariff rate to its highest level since the 1930s. Markets responded with a sharp drop in the weeks around the announcement, and the S&P 500 fell nearly 20% over 35 days, with 12% of that decline occurring over just four trading days.

The speed and magnitude of the move lower and subsequent recovery following Liberation Day was unlike anything we’ve seen in recent history. Markets bottomed out on April 8 and by late June had completely recovered and quickly began making new all-time highs. The swift recovery came thanks to two factors. First, the Trump Administration quickly began to walk back its most aggressive trade policies as foreign trade partners came to the negotiating table. Second, a massive wave of investment in artificial intelligence (AI) came to the forefront of investors’ attention and pushed much of the technology, industrial and utilities sectors higher.

AI Optimism Guides Markets Through Uncertainty

The market’s rise over the next several months was remarkably smooth considering the relatively noisy news cycle in the second half of the year. While there was some rotation under the surface, the S&P never fell more than 3% from its trailing high between July 1 and October 31. The summer was characterized by elevated trade uncertainty as trade deals were made, remade and ripped up—seemingly daily. Eventually, investors grew accustomed to ever-changing trade policy, assuming that much of the Trump Administration’s worst threats were mostly empty and designed to prod foreign trade officials into formal negotiations. September brought the first U.S. Federal Reserve (Fed) interest rate cut after months of pressure from the White House. Fed officials had been hesitant to cut rates as inflation trends remained volatile thanks to the uncertain effect of tariffs. At the same time, the U.S. labor market remained far stronger than many assumed in the face of economic uncertainty and growing concerns of AI-related layoffs. Each of these factors would typically work against easing monetary policy, but the Fed found cover in economic uncertainty to move forward. The longest government shutdown in U.S. history began on October 1 as politicians in Washington sparred over health insurance subsidies created under the Affordable Care

Act (ACA) and extended during the Biden Administration. Republicans advanced a budget proposal that was repeatedly blocked by Democrats when it became clear that ACA subsidies would not be part of the plan. During the government shutdown, federal employees went without pay and various "nonessential" agencies suspended operations. The shutdown created additional economic uncertainty and likely weighed on growth. The shutdown ended 43 days later after a handful of Democrats felt that the pain endured by furloughed government workers was too great. Historically, government shutdowns have had real impact on the American people, but little impact on markets, and this time was no different as the market managed a 2% gain from shutdown to reopening. Meanwhile, October 29 marked the second 0.25% Fed rate cut of 2025, bringing the target range to 3.75%-4.0%.

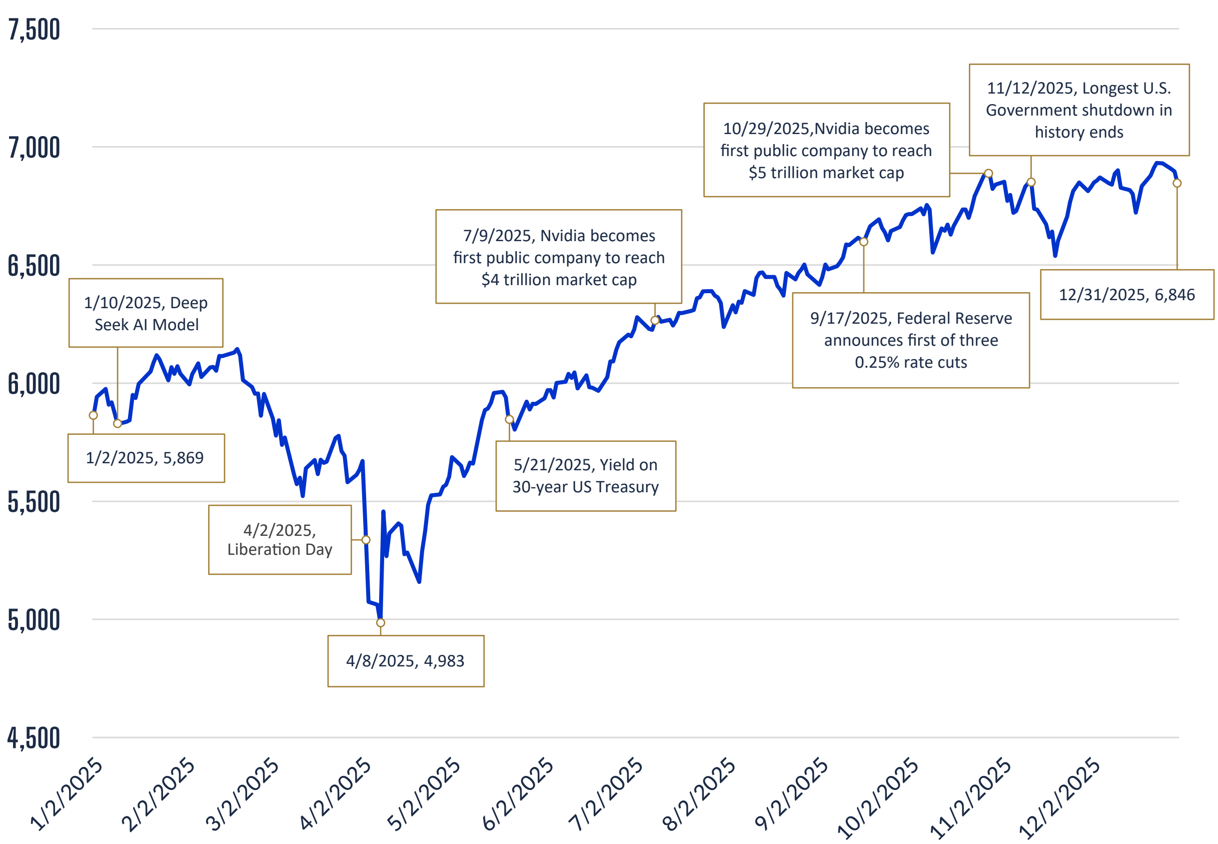
> "Markets proved once again that staying invested for the long term is one of the most powerful tools investors have to meet their financial goals."

Volatility Returns as Investors Ask, 'Is This Time Different?'

The final months of the year saw renewed volatility, albeit at a much less severe level than we experienced in April—from late October to November 20, the S&P shed just over 5%. Investors had grown increasingly uneasy about the market's valuation and concentration in mega-cap stocks, drawing comparisons to the late 1990s technology bubble. While the sell-off was mild by historical standards, declines in a handful of specific industries tied to AI were much deeper. The companies that faced the most pressure faced questions around the ultimate return on investment they might expect to receive on the huge sums they committed to AI technology. At the same time, an increasingly complex web of investment or "circular financing" between a handful of companies led to concerns that continuing investment in AI would be unsustainable. Circular financing is characterized by a loop where companies invest in each other and use the invested capital to buy each other's products like semiconductors or software. While this sort of cross-investment isn't unprecedented, the frequency and huge sums of money being committed raised red flags for some investors. The selloff was ultimately short lived as financial results from some of the companies in question reassured investors that their worst fears were overblown. As a result, the market took just three weeks to return to all-time highs.

The final weeks of the year have historically seen strong returns, and while there are several important economic datapoints scheduled for release, none are expected to have market-moving implications absent an accompanying Fed policy meeting. The strength of markets in 2025, both here and abroad, came as a surprise to many of us following strong returns in 2023 and 2024, but markets proved once again that staying invested for the long-term is one of the most powerful tools investors have to meet their financial goals. As we enter 2026 facing elevated valuations, uncertain economic policy and geopolitical turmoil, we think the old market adage is still as true as ever: Time in the market always beats timing the market.

S&P 500, 2025 Major Events



Exploring 2026 in Themes: AI, Deregulation and Diversification

By Jack Kraft, *CFA, Investment Strategist*

The bull market looks poised to extend into 2026, driven by a favorable macro backdrop featuring Fed easing, supportive fiscal policy through financial deregulation and a surge in capital investment targeting AI infrastructure. These tailwinds are reinforcing consensus expectations for another year of robust, potentially double-digit earnings growth. Although this backdrop is positive, it is important to acknowledge that this optimism does not come without caution amid elevated valuations, a consumer impacted by inflation and slowing labor market squeezed by AI.

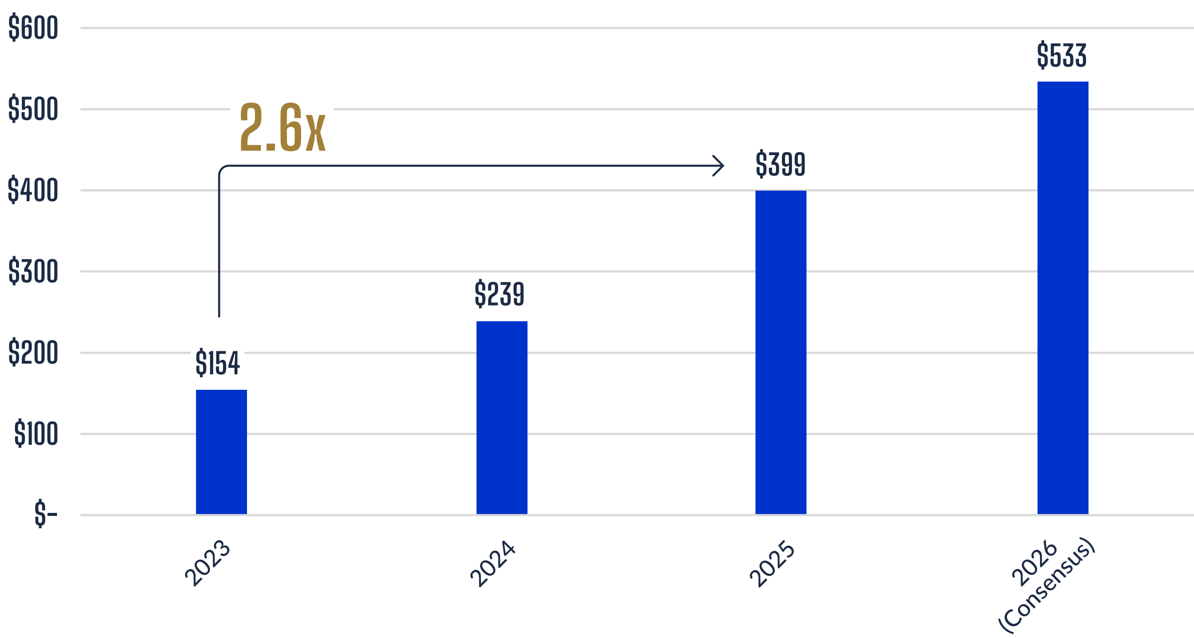
Let's dive into some of these themes to better understand what is in store for investors in the year ahead.

Artificial Intelligence Investment

A defining theme for markets in 2025 was the rapid expansion of AI infrastructure. This has rippled through the broader economy, impacting the energy grid, data center development, and semiconductor demand. This buildout looks likely to continue, with AI hyperscalers investing more aggressively than expected in 2025 and into 2026. In fact, during the third quarter, hyperscalers (Amazon, Google, Meta Platforms, Microsoft and Oracle) upwardly revised capital expenditure estimates for next year from $467 billion at the start of the season to $533 billion. This would indicate 34% growth over investments made in 2025 as firms race to scale AI capacity. In dollar terms, capital expenditures continue to climb, but it is important to note the growth rate on a percentage basis is decelerating.

While capital spending on AI infrastructure remains elevated, 2026 could mark a rotation in market leadership from AI infrastructure stocks, which have seen earnings benefit from the massive hyperscaler investment to companies positioned to gain from AI adoption. These companies have largely been overlooked the past year but stand to gain as automation drives productivity and profitability gains. Businesses with high labor costs and significant wage exposure to AI automation jobs are particularly well placed as AI beneficiaries.

Hyperscaler Capital Expenditure Spend



**Source: Goldman Sachs Investment Research Hyperscalers include: Amazon, Meta Platforms, Alphabet, Microsoft, Oracle*

Large technology companies have shown willingness to spend big on the AI infrastructure and are leveraging their strong balance sheets in order to do so. Originally, cash flows had been the source of funding for this large-scale buildout, but as investment has grown, these companies have tapped the bond market to raise capital. Albeit, debt levels at these hyperscalers remain at very healthy levels. Despite being well-capitalized, investor concerns are mounting over when these significant investments will begin to deliver returns.

Across the AI value chain, critical infrastructure investments are underway on the power grid, a key constraint for AI companies. Estimates indicate that data centers are on track to consume as much energy as nearly 40 million homes by 2030, driving annual power demand growth of 2.6%. If this materializes, data centers will make up 11% of total U.S. electricity consumption, up from 4% in 2023. This surge is catalyzing significant capital deployment into power generation and grid modernization aimed at mitigating potential energy bottlenecks.

Financial Deregulation

The financial sector is helping fuel earnings growth as the current administration pushes toward deregulation, aimed at stimulating economic and financial activity by freeing up capital for lending. This momentum gained credibility when the Federal Reserve and U.S. government publicly aligned on the need for deregulation, removing uncertainty and signaling policy support.

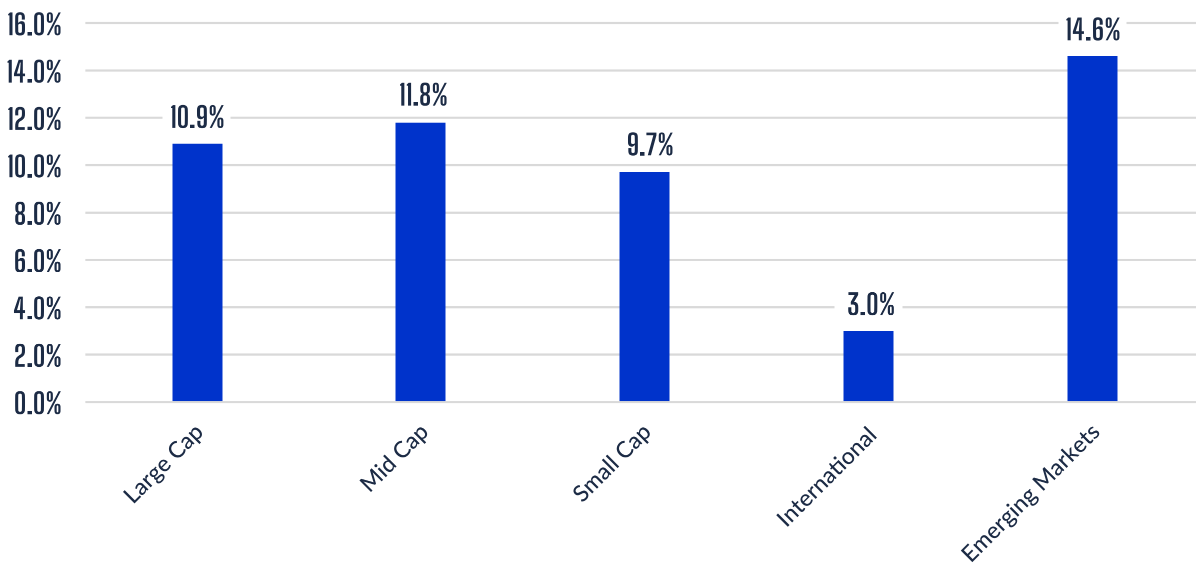
Proposed measures include relaxing capital and liquidity requirements, which could drive significant earnings growth and return on tangible common equity for large banks in the United States. These changes, combined with a rebound in investment banking, M&A activity and elevated trading volumes, position U.S. banks to be a contributor of earnings-per-share (EPS) growth next year. Overall, deregulation remains the primary catalyst for the sector, reinforced by more accommodative monetary policy.

Frothy U.S. Valuations Lead to Opportunities Abroad

> "Investors should view potential volatility in the year ahead as healthy consolidation and an opportunity to add risk, assuming economic growth remains intact."

The AI super cycle has contributed to investor exuberance to a degree with the S&P 500 trading near record valuations on a price-to-earnings basis. Higher valuations are not a reason to rush for the exits as growth remains strong with consensus expectations for the U.S. economy to grow gross domestic product at 2.0% in 2026. Furthermore, analyst consensus estimates are calling for 11% EPS growth next year, which remains above the historical average. Earnings growth is expected to accelerate across the broader market with large-, mid- and small-cap stocks all participating. In the past, growth has been mainly driven by the famed “Magnificent 7” group. This broader earnings growth should be supportive for both corporate buybacks and dividend growth in 2026, which are expected to grow in the high single digits.

2026 Consensus Earnings Growth Estimates



**Source: Bloomberg Consensus Estimates Indices used include S&P 500, S&P 400, S&P 600, MSCI EAFE, MSCI Emerging Markets*

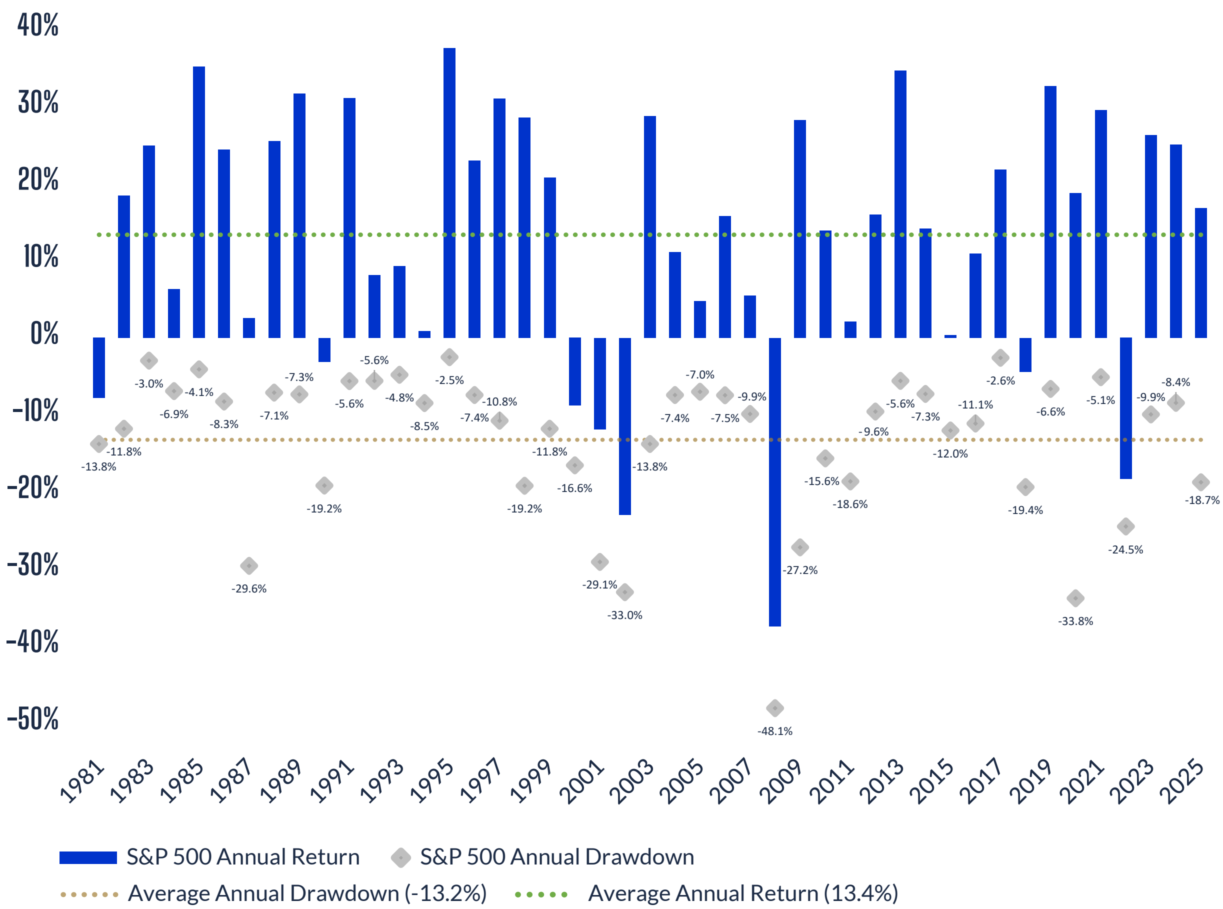
Valuations remain the most significant headwind for equity returns next year, even as economic growth persists. The S&P 500 reflects the bullish backdrop outlined earlier with a forward price-to-earnings ratio of 23x, placing it in the 95th percentile of historical expensiveness. As of now, the index is on track for its third consecutive year of double-digit gains, a rare achievement with only seven such streaks recorded since 1928. A fourth straight year would be even more unique, only having occurred three times in the past century.

Outside of the United States, investors should continue to get rewarded for global diversification. This year proved to be very beneficial for investors to have exposure to Europe and emerging markets with both indices outperforming U.S. equities. These pockets of the market remain under-owned by investors and look poised to continue to perform favorably. We anticipate a favorable environment for ex-U.S. equities to continue, supported by declining interest rates abroad, a weakening U.S. dollar, robust earnings growth and compelling valuations relative to the United States.

Year-Ahead Reminder

Over the last 20 years, an annual decline of at least 10% happened 50% of the time, with the average pullback being 15%. The chart below shows the impact of these pullbacks, but also the market's ability to rebound by year-end. Investors were reminded of this back during the April tariff shock when the S&P 500 fell nearly 19% in less than a month. Additionally, as markets approach mid-terms, uncertainty tends to pick up, and volatility typically follows. Remember to stay calm and stick to your long-term financial plan. Investors should view potential volatility in the year ahead as healthy consolidation and an opportunity to add risk, assuming economic growth remains intact. This point is underscored by the annual returns and drawdown chart, which reminds investors to capitalize on market pullbacks.

S&P 500 Yearly Returns and Maximum Drawdowns



Source: Morningstar 2025 return data 12/31/2024 – 12/15/2025

The Other 'AI:' There are Good Reasons for the Growing Appetite for Alternative Investments

By Pete Biebel, *Senior Investment Strategist*

In recent years, you probably have been hearing a lot more about "alts," or alternative investments. The alternative investment business has seen a rapid increase in both the number of new retail-accessible, investor-friendly funds, and also in the amount of money flowing into alts funds. Where historically topics like private equity and private credit were rarely discussed in the financial media, now nary a day goes by without one or more experts pontificating on alternative investments on one or more of the business channels.

Many investors and investment professionals are wary of this sudden democratization of alternative investments. They all know that large endowments, state retirement funds and high net worth family offices have benefited for decades by having healthy allocations to alternative exposures. But they fear that opening these investment exposures to the masses must surely be a sign that the end is nigh.

We believe that the rush into alts was long overdue, and that opening retail access to these exposures was a natural evolution that was also long overdue. Gone are the days when getting exposure to alts meant million-dollar minimums and reams of subscription documents to complete. Investors put up with all that bother to get into a private fund (that would inevitably have poor transparency and K-1 tax reporting) because it was the only way to get that exposure. It was the only alternative. Now, using the interval fund structure, almost anyone can invest in private equity, private credit and even hedge funds with a much smaller minimum investment, more favorable tax reporting and little or no paperwork.

In the olden days of the high-minimum private placement funds, exposures like private equity and private credit weren't even on the radar of most investors. That secret was restricted to the realm of ultra-high net worth investors. Most investors were limited to stocks, bonds and mutual funds. In much the same way that the spectacular growth of ETFs has been a result of their ease of use, tax-efficiency and low cost, the evolution of alternative investment structures has made getting access to those exposures much more convenient and user-friendly. Of course, as with any investment product, it's important to keep the potential benefits of alternative investment funds weighed against additional risks that come with these types of investments. In addition to possible exposure to higher fees and higher credit exposure, understanding the liquidity provisions is also critical.

> "We believe that one of the strongest arguments for increasing alts exposure now is the extremely expensive valuation of our stock market."

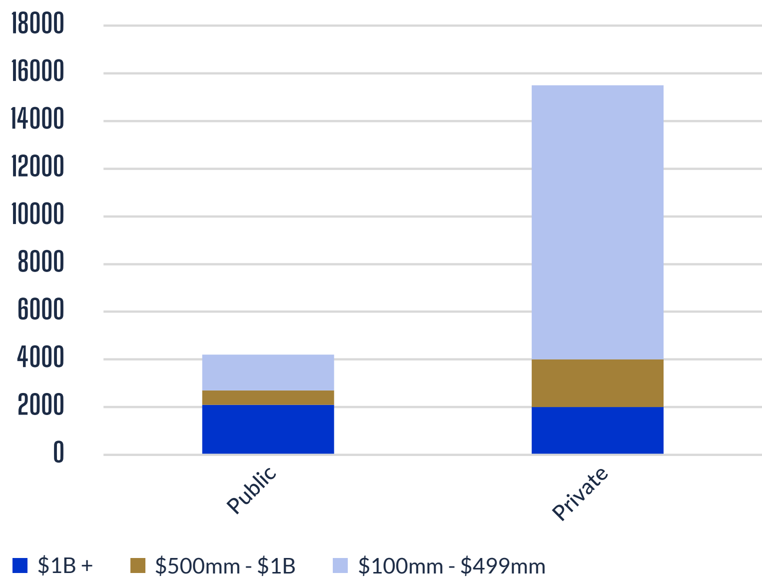
As we enter 2026, we will take a closer look at several of the most popular alts exposures and try to provide some insight into the current state of the market for each of them. However, before we dig into the individual exposures, one significant general point needs to be stressed. We believe that one of the strongest arguments for increasing alts exposure now is the extremely expensive valuation of our stock market. Broad valuation indicators like the Buffett Indicator, the CAPE ratio and the equity risk premium are all at record extremes. Those three indicators suggest that we should expect substandard returns from the stock market over the next several years. Some diversification out of traditional assets and into less correlated investments seems appropriate.

That begs the question: ***If the public equity markets are likely to underperform, wouldn't private equity also underperform?***

Think about the types of businesses the private equity funds are buying. They're small companies for which the manager will attempt to significantly grow revenues and increase profit margins. Yes, public companies also want to grow revenues and margins, but almost all of them are growing more slowly than the little private companies. Note also that the number and size of private companies continue to increase while the number of publicly traded stocks continues to shrink. And private equity funds have shown their resilience during past stock market drawdowns.

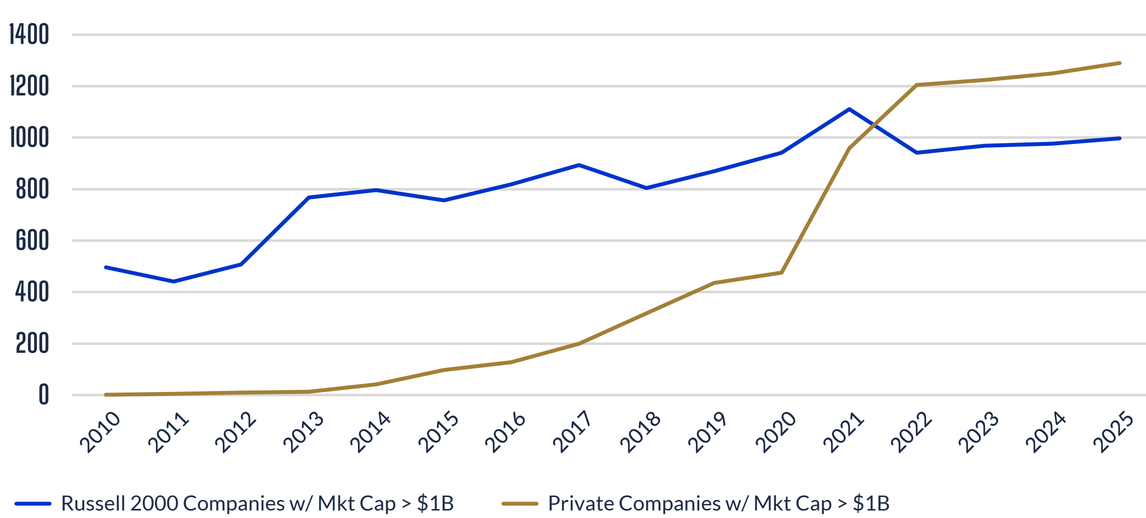
The histogram in the lower right below is revealing. It shows that the vast majority of a private company's value creation comes before its initial public offering (IPO). In fact, the size of the value creation prior to the IPO becomes a significant hurdle to that stock's performance when it does become a public company.

Number of Public vs. Private U.S. Companies with revenue greater than $100 million



Source: JPMorgan

Private Companies Continue to Prefer Growing Outside Listed Markets



Source: Bloomberg

The question for private credit seems to be: There has been a rapid expansion of funds flowing into private credit; *is that likely to result in reduced profitability and/or more lax underwriting standards?*

There is some consolation in knowing that the demand for nonbank loans is also increasing, offsetting some of the increase in the supply of capital for new loans. While we are less concerned that increased competition will have a significant impact on performance, we encourage less confident potential private credit investors to consider these two points:

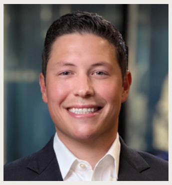
1. Consider established managers with a proven history, keeping in mind their behavior throughout varying economic conditions.
2. Different funds have varying degrees of exposure to private investments, so it's important to consider your goals and risk tolerance before deciding on an investment.

The private real estate sector has been pretty dull since the pandemic. *What are the factors that make the sector tempting in the years ahead?*

Perhaps the most tempting factor is that the sector is overdue for a revival. The post-pandemic office trauma is slowing in intensity. Occupancy in new buildings is strong, and the total volume of properties under construction is declining sharply. Vacancy rates are still at elevated levels, but much of that vacancy is concentrated in older “zombie” buildings. Current demand is highly concentrated in buildings completed since 2015, where vacancy rates are much lower.

Real estate valuations have cycles, just like the stock market. While we can’t be sure that the cycle will turn back up this year, we know that it will sooner or later. Despite the conditions of the real estate sector, many private real estate funds may continue to offer tax-advantaged income distributions.

Closing Out 2025: Industry Themes



By Tristan Detzel, *Vice President, Advisory Portfolios Strategist*

As we step into 2026, the mutual fund and exchange-traded fund (ETF) industry stands at a pivotal moment. Market dynamics, regulatory shifts, technological innovation and evolving investor preferences are reshaping the landscape at an unprecedented pace.

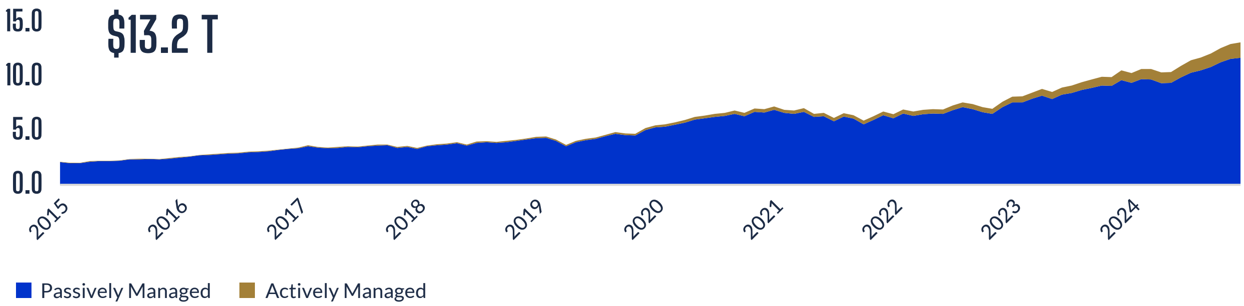
The ETF industry enters 2026 with robust momentum, fueled by steady inflows, expanding product innovation and a growing investor base. Global assets under management (AUM) have reached new heights, driven by rising equity markets, increased adoption of both passive and active strategies, and the democratization of investing through digital platforms. ETFs, in particular, continue to outpace mutual funds in asset growth, flexing their tax efficiency, liquidity and attractive fee structures. We believe ETFs will continue to make investing more accessible as asset classes that were once considered a poor fit for the ETF structure increasingly find their place within it.

The ETF Evolution

While ETFs originally gained popularity as passive, low-cost vehicles for tracking market indexes, the industry has evolved to include a wide range of actively managed strategies—similar to those found in traditional mutual funds. This shift has been driven by investor demand for more active solutions across asset classes, while still benefiting from the same operational efficiencies of the ETF structure. The tax treatment of ETFs, particularly their in-kind redemption mechanism, remains a distinct advantage over mutual funds in many markets.

ETFs use a unique creation and redemption process that helps keep their share prices closely aligned with the value of the underlying assets. Authorized participants (APs) work directly with ETF providers to create or redeem shares in large blocks called “creation units,” typically exchanged in-kind for baskets of the underlying securities. This mechanism provides liquidity and helps ensure that intraday prices stay near the fund’s net asset value, or NAV. By allowing APs to add or remove ETF shares from the market to meet demand, ETFs can offer greater efficiency and tighter tracking compared to traditional mutual funds. This unique process has helped ETFs become one of the fastest-growing investment vehicles available to investors in today’s modern world.

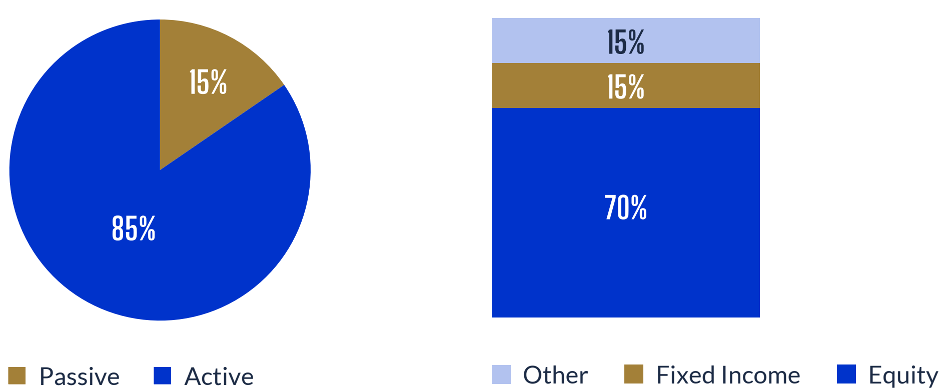
U.S. ETF assets under management (AUM)



ETF Growth Accelerates: Active Strategies Take Center Stage

The active ETF segment saw significant growth in 2025, with investors expected to encounter an even broader array of choices within the ETF space in 2026. Active ETFs accounted for over 85% of new ETF launches in 2025, which saw $1 trillion flowing into ETFs, with 35% of total flows allocated to active strategies. Of the ETFs launched over the trailing 12-month period, 70% are invested in equities, 15% are invested in fixed income, and 15% are invested in non-traditional asset classes such as crypto, commodities or defined-outcome products. Finishing the year, the ETF industry stands at roughly $13.2 trillion in assets. If the current trajectory is held, estimates for global ETF assets exceed $25-$30 trillion in AUM within the next three to four years. The proliferation of niche and thematic ETFs—covering areas like artificial intelligence (AI), nuclear energy, climate change and emerging markets—offers investors targeted exposure to high-growth sectors. Gold has also surged this year with investors clamoring for protection against inflation and currency volatility, leading to significant inflows into gold ETFs.

U.S. ETF assets under management (AUM)

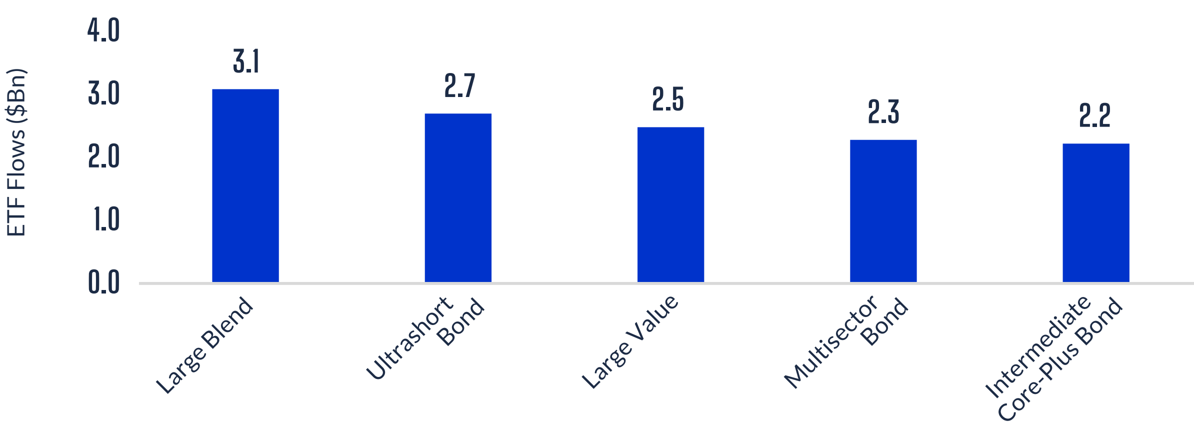


Since Vanguard's patent, which allowed it to create ETF shares from mutual funds, expired in 2023, the industry has evolved by a surge of interest in expanding the ETF structure. Over 70 fund managers have sought regulatory approval to bring active strategies into the ETF wrapper and to introduce mutual fund share classes within existing ETFs. In the fall of 2025, the SEC broke a long-standing deadlock by granting several issuers permission to add ETF share classes to its mutual funds—a pivotal decision that could open the door for a wave of similar launches and accelerate the shift from mutual funds to ETFs.

Asset Class Leaders: Equity Dominance with Fixed Income Rising

At the end of 2025, investor positioning continued to favor large-cap equities, with a noticeable tilt toward blend and value-oriented styles. This trend reflects growing caution around the sustainability of the AI-driven rally, as concerns about an "AI bubble" gain traction. The migration toward higher-quality, more defensive equities is unsurprising given the structural evolution of passive index products—most notably, vehicles like SPDR S&P 500 ETF or iShares Core S&P 500 ETF. Persistent flows into these passive strategies have amplified market concentration, with the 10 largest companies now accounting for more than 70% of the economic profit within the S&P 500.

Top 5 active category monthly flows ($Bn)



Such concentration poses challenges for active managers, who historically underperform benchmarks during periods of concentrated bull markets. Many remain underweight the so-called "Magnificent 7," citing diversification mandates, elevated valuations and competitive pressures as key reasons. While 2025 proved difficult for most active equity managers, it underscores the value of skillful stock selection. Managers who identify idiosyncratic differences—such as balance sheet strength, pricing power and innovation beyond AI hype—should be able to leverage information that is important when managing investments.

> "ETFs, in particular, continue to outpace mutual funds in asset growth, flexing their tax efficiency, liquidity and attractive fee structures."

Looking ahead, we expect active management to play a more prominent role in fixed-income ETFs. Categories such as multisector and intermediate core-plus bond funds continue to attract significant inflows. Beyond serving as a defensive allocation and source of yield, fixed income may offer fertile ground for alpha generation at a relatively low cost. With dispersion in credit quality, duration positioning and global rate cycles, active managers could potentially have an opportunity to outperform benchmarks—particularly as volatility in rates and inflation expectations persist into 2026.

Generational Shifts Driving Investment Preferences

Technology and demographics are reshaping the investment landscape. Advances in AI and machine learning are enabling asset managers to refine strategies, optimize portfolios and strengthen risk management, while digital platforms are making investing more accessible and personalized. These innovations are fueling ETF growth by lowering barriers and delivering tailored solutions aligned with individual goals. At the same time, shifting demographics are influencing preferences: Millennials and Gen Z favor transparency, digital engagement and values-based investing—often gravitating toward ETFs for their flexibility and low costs—while retiring baby boomers continue to seek stability and income through traditional mutual funds.

Looking Ahead to 2026: Opportunities and Risks

The mutual fund and ETF industry enter 2026 at a dynamic crossroads. While growth remains strong, challenges such as market volatility, geopolitical risks and macroeconomic uncertainty continue to shape investor sentiment and fund performance. At the same time, fee compression—driven by intense competition and regulatory scrutiny—pressures asset managers to innovate and differentiate. The expanding array of products adds complexity for investors, underscoring the need for clear communication and sound advice. In this environment, innovation, transparency, and client-centricity will define the winners. Partnering with trusted advisors and fund managers who prioritize education, robust research and responsible stewardship will be essential for helping clients navigate complexity and achieve their financial goals.

BENJAMIN F. EDWARDS®
INVESTMENTS for GENERATIONS®

One North Brentwood Boulevard, Suite 850
St. Louis, Missouri 63105
(855) 382-1600
www.benjaminfedwards.com

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There are special risks associated with an investment in real estate, including credit risk, interest-rate fluctuations and the impact of varied economic conditions. Distributions from REIT investments are taxed at the owner's tax bracket.

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