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Market Review Commentary

JAN
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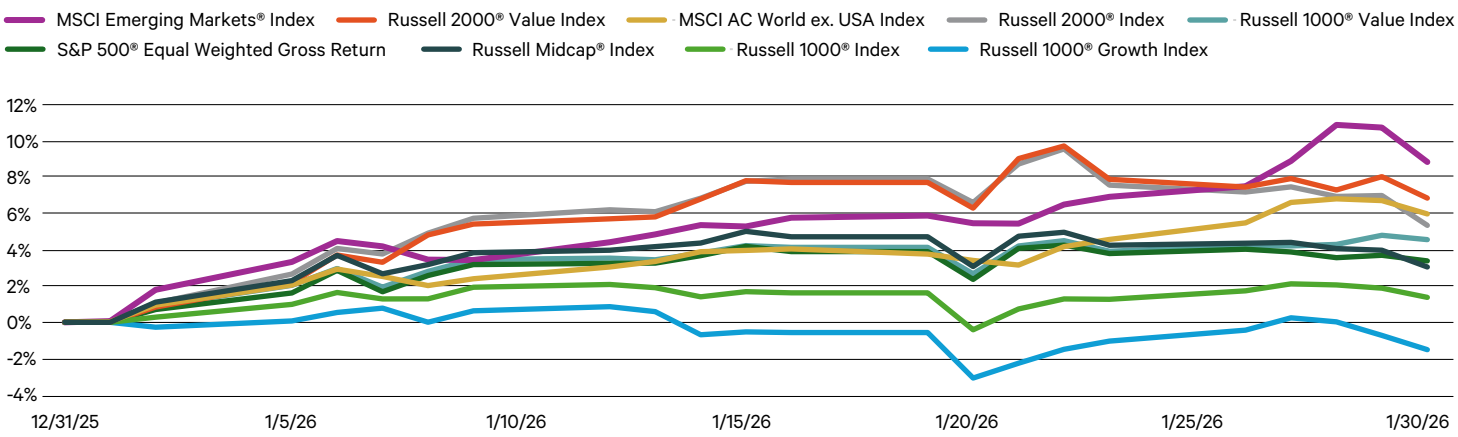
January 2026 defied broad stock market themes that have persisted for much of the past few years, such as "large cap beats small cap," "growth beats value," "U.S. beats non-U.S. developed equities," and "emerging markets lag". This past month, small cap stocks outperformed large cap, value trounced growth, and emerging markets beat everything.

Here's what markets delivered to investors for the month of January:

FIGURE 1: CUMULATIVE RETURNS – SELECTED MARKET INDICES



Data presented is as of January 30, 2026, is obtained from FactSet and is assumed to be reliable. The indices are not actively managed and do not reflect the deduction of any investment management or other fees and expenses. It is not possible to invest directly in an index. Please see the end of this commentary for important information regarding the indices. ***Past performance is no guarantee of future results.***

Indulging in some Monday-morning quarterbacking, we can identify pressures that could justify these outcomes. These might be concerns about AI overbuilding, Fed independence (a lack thereof could fuel inflation in the U.S.), the valuation gap between U.S. large caps and non-U.S. developed markets, etc.

A few observations about what this graph of January's index returns contains:

- Large cap growth stocks underperformed every other segment of the U.S. equity market. Questions about when AI optimism will translate into earnings growth impacted many tech stocks. For example, after beating revenue and earnings estimates, Microsoft lost $357 billion in market cap (more than the entire market value of the stock markets of Greece, New Zealand, and Portugal, combined) due to worries about AI-related capital expenditures and slightly lower-than-expected growth in guidance.
- Value stocks—particularly small cap value—outperformed. In January, the Russell 2000 Value Index traded at a notably lower P/E (13.3x) than the Russell 2000 Growth Index (20.2x), reflecting more attractive valuations for value stocks.

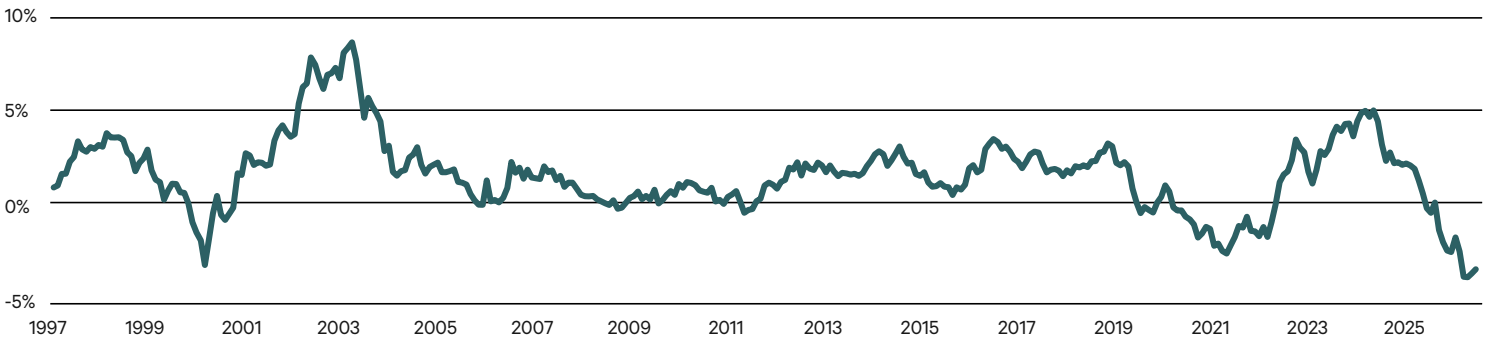
- The equal-weighted version of the S&P 500, where AI and other mega-cap tech stocks each have the same weight as every other large cap stock, returned 3.39% in January vs. 1.45% for the S&P 500 index.
- A declining U.S. dollar makes returns generated outside the U.S. more attractive when converted into USD. For U.S. investors, that has boosted foreign stock returns. But for investors outside the U.S., it has made the healthy returns here less attractive when converted back into local currency. Other developed markets are also offering growth opportunities at lower valuation multiples than much of the U.S. market. Europe's economy is expected to benefit from increased defense and infrastructure spending, and Japan has been attracting a lot of investor interest, as continued corporate governance reforms are aimed at increasing returns on equity.
- Investors poured buckets of money into emerging market stocks in January, responding to a weaker dollar and a desire to diversify away from the U.S. Meanwhile, emerging market equity funds posted one of their biggest weekly inflows on record at the end of the month.[1]

Has the Moment for Quality Small Caps Arrived?

We've seen many head fakes with small caps in the past few years; whenever it looked like the party was getting started, earnings disappointed. But analysts are finally predicting small cap earnings growth will outpace large caps', and this latest updraft for small caps has lasted a bit longer than other recent small cap rallies.

Still, investors have shown a clear affection for low quality in the small cap space. Roughly 40% of the Russell 2000 index constituents have negative earnings. The S&P 600 is a small cap index that excludes unprofitable companies. There have been several instances where low-quality assets outperform high-quality ones; however, these tend to be brief rather than sustained trends. This pattern is evident in the rolling three-year relative performance, as only two previous periods have seen the index lag behind the Russell by such a significant margin—namely, the early 2000s and mid-2020—both of which corresponded with unprofitable companies outperforming profitable ones.

FIGURE 2: 3-YEAR ROLLING RELATIVE PERFORMANCE (SMALL-CAP BENCHMARKS)
Russell 2000® Index vs. S&P 600® Index



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[1] *https://www.reuters.com/world/americas/emerging-market-stocks-rally-appears-intact-after-buoyant-january-inflows-2026-02-02/*

One can make an argument that lower interest rates will benefit even unprofitable small companies by lowering their cost of debt. However, we would avoid spending much time focusing on low-quality land, as it tends to be a risky, speculative, and trend-driven area of the market.

Regardless of whether January's trends continue, it's clear that earnings and their forecasts are what ultimately influence stock prices. Now that we're a third of the way through earnings season, there are positive signs of earnings growth across different market capitalizations. While the tech sector is doing some heavy lifting, financials are also showing double digit earnings growth. Considering the U.S. economy's resilience in 2025 and the upcoming wave of tax refunds, excessive pessimism seems unwarranted. Still, we would not be surprised to see more volatility going forward.

The Stimulative Impact of Tax Cuts Is Just Around the Corner but Could Be Short-Lived

In the coming months, tax breaks from the One Big Beautiful Bill Act (OBBB) will boost household incomes. At the same time, accelerated depreciation will reduce tax liabilities for businesses. Both are likely to increase spending. While this doesn't guarantee the stock market will keep breaking records, we believe it should support the markets in the near term.

The timing isn't coincidental: Well-known economist Claudia Sahm (creator of the recession indicator known as the Sahm Rule) notes the latest catch phrase is Big MAC—Midterms Are Coming. Much of the impact of the OBBB on consumers are front-loaded to early 2026, because cuts in personal income tax rates are applied retroactively to 2025 income, but few paychecks were adjusted when the bill passed. So, refunds will be higher and withholdings going forward will be lower. The Wall Street Journal says estimates show additional consumer spending could boost GDP growth in the first half of 2026 by as much as half a percentage point.[2]

At the same time, businesses are taking advantage of new depreciation rules that provide an immediate tax benefit from short-lived investments in equipment. We've already seen a huge wave of AI-related capital expenditures, and recent government data showed orders for non-defense capital goods excluding aircraft, a proxy for business spending on equipment, rose at a 9.5% annualized rate in the three months through November—the strongest since April 2022. In our view, all this spending should boost revenues and profits, at least in the short-run. As tax cut-induced cash flows into the economy, we believe there is a small risk of higher inflation, as we saw during the COVID-era stimulus payments. We would expect the Fed to be very thoughtful as a result with rate cuts, even under a new Fed Chair.

[2] *https://www.wsj.com/economy/trump-wants-to-run-the-economy-hot-theres-a-good-chance-hell-succeed-85244f23?mod=article_inline*

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The Russell 1000® Growth Index is a free float-adjusted market capitalization-weighted index of growth-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. All companies that have a weight greater than 4.5% in aggregate are no more than 45% of the Index and no individual company has a weight greater than 22.5% of the Index. The Russell 1000® Index is a free float-adjusted market capitalization-weighted index of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment. The Russell 1000® Value Index is a free float-adjusted market capitalization-weighted index of value-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. All companies that have a weight greater than 4.5% in aggregate are no more than 45% of the Index and no individual company has a weight greater than 22.5% of the Index. The Russell 2000® Index is a free float-adjusted market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The Russell 2000® Value Index is a free float-adjusted market capitalization-weighted index of value-oriented stocks of the smallest 2,000 companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. All companies that have a weight greater than 4.5% in aggregate are no more than 45% of the Index and no individual company has a weight greater than 22.5% of the Index. The Russell 2000® Growth Index is a free float-adjusted market capitalization-weighted index of growth-oriented stocks of the smallest 2,000 companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. All companies that have a weight greater than 4.5% in aggregate are no more than 45% of the Index and no individual company has a weight greater than 22.5% of the Index. The Russell Midcap® Index is a free float-adjusted market capitalization-weighted index of medium-capitalization stocks of U.S. companies. The index is calculated on a total return basis with dividends reinvested. All companies that have a weight greater than 4.5% in aggregate are no more than 45% of the Index and no individual company has a weight greater than 22.5% of the Index. The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 26 Emerging Markets (EM) countries. With 2,375 constituents, the index covers approximately 85% of the global equity opportunity set outside the US. The MSCI Emerging Markets Index captures large and mid cap representation across 26 Emerging Markets (EM) countries. With 1,387 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The S&P 500® Index is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The S&P 500 Equal Weight Index (EWI) is the equal-weight version of S&P 500 Index and includes the same constituents, but each company in the EWI is allocated a fixed weight—or 0.2%—of the index total at each quarterly rebalance. The S&P Small Cap 600® seeks to measure the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable. The indices are calculated on a total return basis with dividends reinvested. The indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment. This report is based on the assumptions and analysis made and believed to be reasonable by Advisor. However, no assurance can be given that Advisor's opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities. ***Past performance is no guarantee of future results.***