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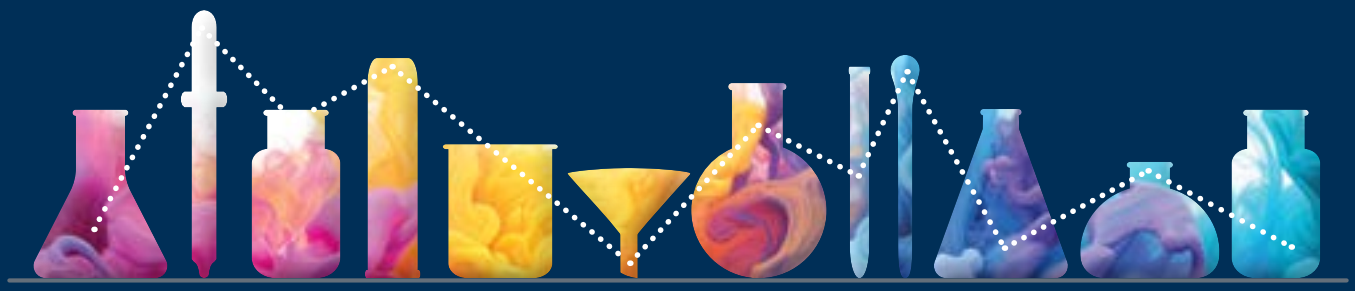
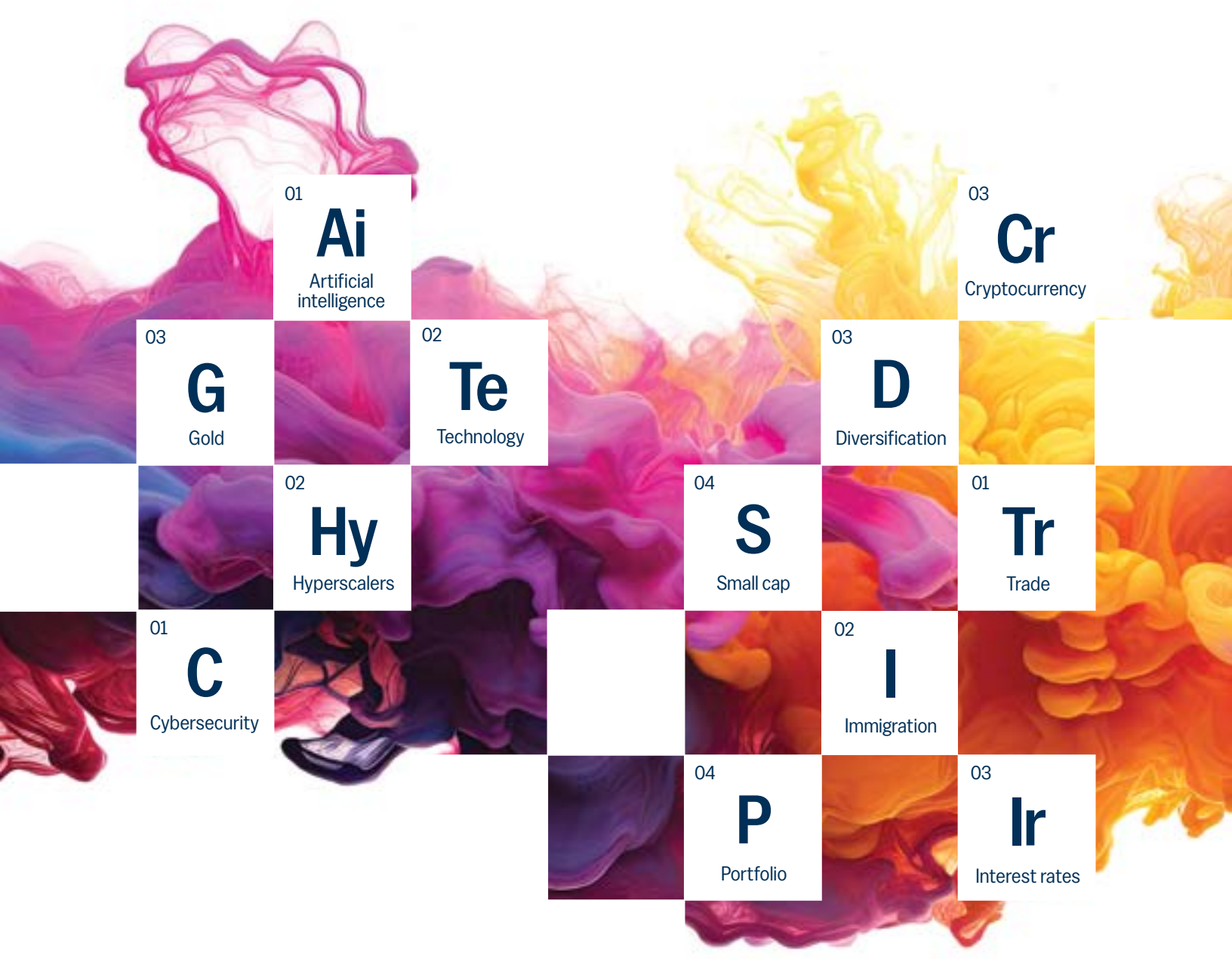
2026 Capital Markets Forecast



Economic Experimentation

Trade, Labor, and Debt Under the Microscope

2026 Capital Markets Forecast



Investing in a Period of Economic Experimentation

Tony Roth

Wilmington Trust
Investment Advisors, Inc.

Successful investing involves both art and science. The former is the "je ne sais quoi" that comes from an effective mixture of experience, intuition, and humility. You are lucky if you have it and, if you don't, there is little you can do to acquire it anytime soon.

The science of investing, by contrast, is available to all through the careful study of events and their antecedents. Fortunately, history rhymes and through the thoughtful framing of key economic factors and study of their effects, we can gain a clearer sense of what economic trends may hold in the future.

Experimentation is normal

Periodically, there is a deviation from economic trends or policy changes so significant that it can be analogized only to economic experimentation. We find ourselves in such a time today—making history less relevant and calling on a deeper understanding of macro theory and current observations to predict where the economy and markets may be headed.

Critical to our inquiry is appreciating that experimentation is a feature—not a bug—of an evolving economy. Much like science itself, there cannot be progress without testing new combinations of elements and interactions among variables.

History is littered with examples. These notably include withdrawing the U.S. from the gold standard in 1971; creating the euro in 1999; founding the World Trade Organization (WTO) in 1995 and granting China's membership in 2001; bailing out banks during the global financial crisis; and the Federal Reserve taking decisive action in times of crisis such as the pandemic that encompassed rock-bottom interest rates, balance-sheet expansion (i.e., quantitative easing), and the Fed's role as lender of last resort.

Many economic experiments have elevated nations, moved financial markets forward, and even saved lives. But as with science, not all experiments yield anticipated—or even positive—results. Some offer no material advancement, while others can go very wrong. Often, the results are known only with the benefit of many years of careful observation.

While the paradigm of scientific experiment involves controlled tests and the isolation of one experimental variable at a time, the real world is not a laboratory. Economic experiments implicate the unpredictability of human behavior and play out in a dynamic arena of infinite variables. Isolating any single factor at a time is simply not possible. We must combine the science of observation with the art of interpretation to best estimate how today's economic experiments will continue to unfold.

Themes for 2026

Our 2026 *Capital Markets Forecast* dives into some of the economic experiments occurring today, offers our insights and observations, and draws key connections to investment strategy. We place no normative judgment on the merits of the hypotheses being tested today, but rather strive to draw economic conclusions and identify investment opportunities—where we believe we have sufficient observational data points to do so.

A historically concentrated U.S. equity market could mean recommitting to both a thoughtful allocation to active management and diversification across all asset classes.

Our first theme takes on the experiment of tariffs at the highest rates in the post-WWII period, intended to redirect global supply chains back to the U.S. for purposes of economic prosperity and national security. We analyze the tariff policy's current and possible future impact on manufacturing activity, jobs, and budgetary revenue while highlighting some of the investment opportunities we see associated with the new trade regime.

The second theme looks at the shrinking of the labor force. Demographics, immigration policy, and corporate investment in artificial intelligence form a powerful concoction with potentially significant implications for long-term economic growth and tomorrow's stock-market leaders.

Third, we tackle a familiar topic: the U.S. debt trajectory. This experiment has been years in the making and shows no signs of changing. Can the U.S. borrow far above current debt levels, as is projected, without unleashing disastrous consequences? How can investors attempt to hedge against such risks?

Finally, we pull these strands together with what we believe matters most to our clients: a discussion of how the experiments are informing our investment and diversification strategies to start the new year. And as it relates to portfolio construction, we recognize that the equity market's current concentration in the shares of AI-related companies is an experiment in and of itself.

To reiterate, we believe that experimentation is not inherently negative, but that it takes us into unfamiliar territory, adding risk and, potentially, volatility to the investment landscape. It also can create a greater need for the art of investing, i.e., experience and inference to help anticipate which investments may prove to be successful diversifiers in the future.

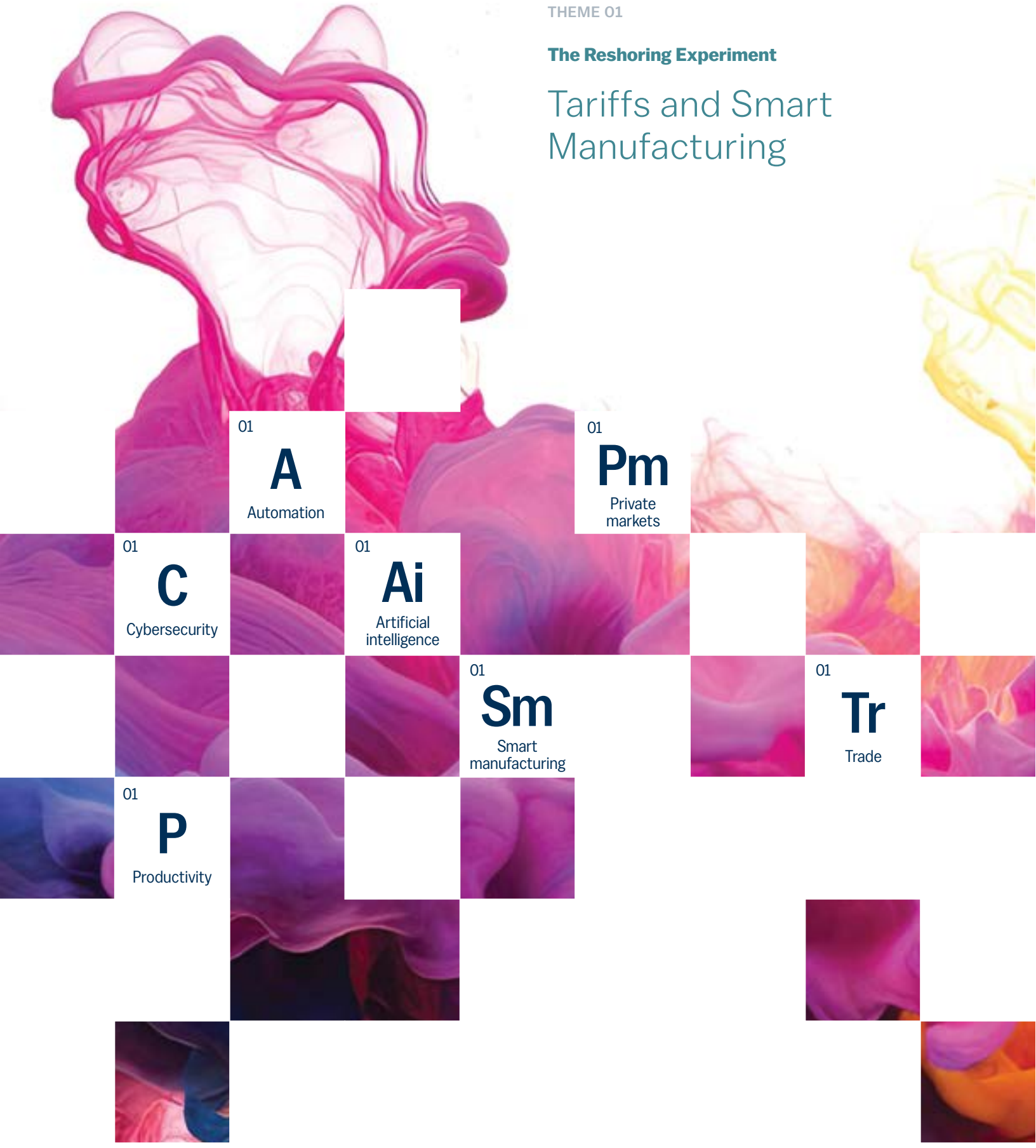
The scientific method at work in portfolios

We begin 2026 recognizing that the results of some economic experiments will become clear in the year ahead, but many will take more time.

We expect the U.S. economy to recover from its fourth-quarter slowdown, but it could take the balance of the year before we see growth return to a 2% annualized trend. Consumers likely will continue to operate in a two-speed economy wherein high-income consumers continue to spend but low-income consumers face strain. Overall, we see the U.S. expansion continuing in 2026.

From our themes, we seek to identify compelling investment opportunities in areas such as industrial capital goods, technology, and private markets.[1] However, a long investment horizon is necessary—and caution is warranted in the short term—as certain areas of the market are trading at frothy valuations.

Diversification against global fiscal risks may be partially achievable with opportunistic additions to precious metals and even cryptocurrency. The latter may not be appropriate for all investors, particularly the risk averse. Finally, a historically concentrated U.S. equity market could mean recommitting to both a thoughtful allocation to active management and diversification across all asset classes.



THEME 01

The Reshoring Experiment

Tariffs and Smart Manufacturing

01

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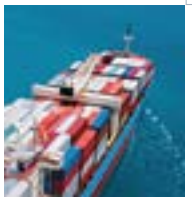
Tariffs



The Reshoring Experiment

Tariffs and Smart Manufacturing

The U.S. drive to reshore manufacturing activity and jobs via the use of tariffs is an experiment that, if successful, would unwind decades of movement to a globally integrated production and supply chain system. Importantly, the common narrative describes manufacturing job losses as a simple zero-sum game in which one country loses a job and another adds that job. The truth, though, is that much of historical manufacturing job losses stem from the ongoing automation of manufacturing processes that increase productivity and reduce the need for labor.

That said, overcoming the high relative cost of U.S. labor is a major challenge. In addition, higher-skilled labor is necessary to operate ever-more-sophisticated production methods.

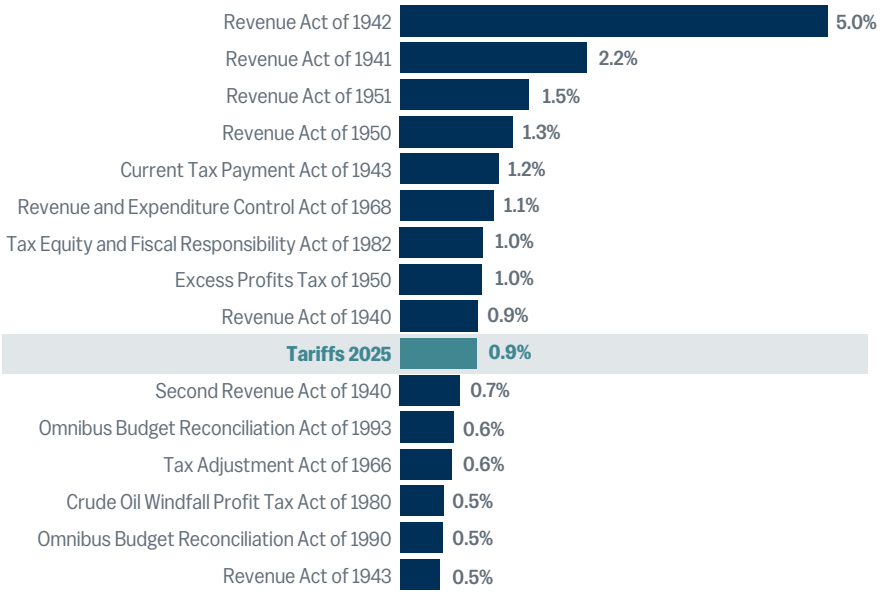
As we start 2026, our scientific observation indicates that the use of tariffs as the main tool to spur manufacturing reshoring does not yet appear successful. In the near term, we continue to see more economic risks than rewards from these tariffs as firms and trading partners struggle to adjust in an environment of continuing uncertainty.

Over the longer term, if heightened tariffs remain in place, we expect them to encourage some gains in domestic production, though not enough to overcome the labor-cost disparity and generate manufacturing job growth. Instead, we see increased production coming from accelerated capital-intensive methods using AI, robots, and smart manufacturing[1] techniques, all of which present investment opportunities.

Figure 1

Tariff hikes in 2025 among the largest shocks in U.S. history

Largest federal tax increases as % of GDP

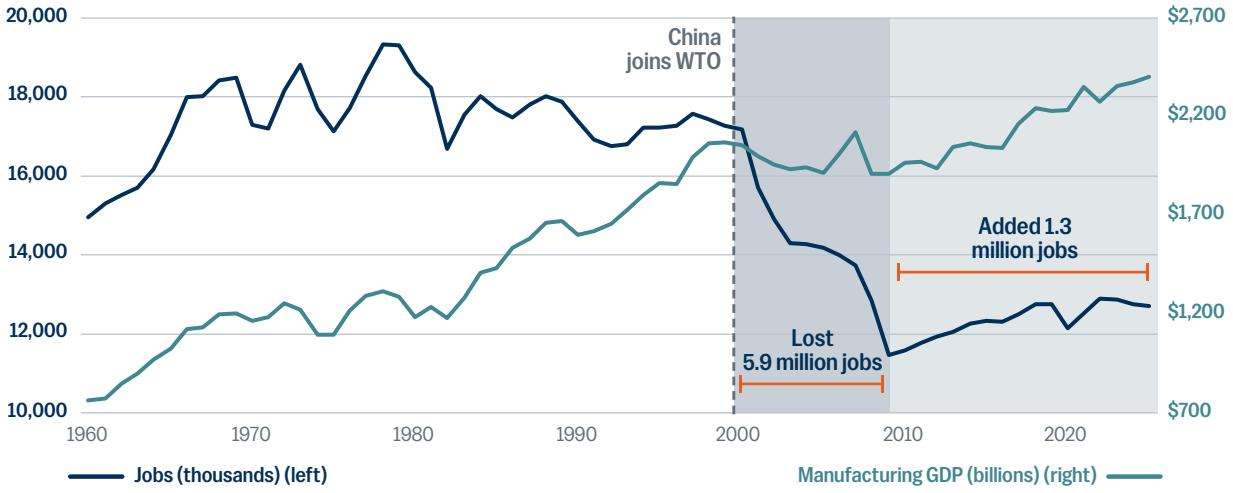


Sources: Tax Foundation, Wilmington Trust. Data as of October 31, 2025.

Figure 2

Manufacturing jobs hit by outsourcing and productivity

U.S. manufacturing jobs and real output



Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Wilmington Trust. Data as of November 30, 2025.

Tariff impacts in 2026

Tariffs created a drag on the U.S. and global economies in 2025 and continue to pose a threat to further expansion in 2026. If the tariffs announced by President Trump in the Rose Garden on April 2, 2025 had been fully implemented, it would have amounted to an eye-watering 30% effective tariff rate—up from 2.5% on January 1 and sufficient to push the economy into recession.

For a variety of reasons (e.g., postponements, trade agreements, voluminous product exclusions, implementation lags, rerouting of shipments through lower-tariffed countries, noncompliance), the effective tariff rate reached just 11% by the fourth quarter of 2025.[2] That is still a substantial tax hike of roughly $275 billion per year—equal to about 0.9% of gross domestic product (GDP) and among the largest peacetime tax hikes in U.S. history (Figure 1).

The tariff hikes are somewhat mitigated by tax cuts from the One Big Beautiful Bill Act (OBBBA). Corporate taxes could fall by $137 billion in 2026, with the manufacturing sector as the largest beneficiary.[3] That said, firms with substantial imports and low capital investment likely will see far less benefit. Consumers have been stung by higher prices on imported goods, leading to a slowdown in spending.

We expect tariffs to continue weighing on growth this year. OBBBA included personal income tax cuts that could help to soften tariffs' impact. The bulk of these cuts only make existing tax rates permanent and do not affect current income. The new cuts (e.g., higher deduction for seniors, deduction for auto loan interest, no tax on tips or overtime pay, and a higher deduction for state and local taxes) amount to roughly $30 billion per year.[4]

New manufacturing techniques require highly skilled workers, and the U.S.'s high domestic labor costs are a disincentive for firms to reshore.

Automation and the labor cost challenge

Figures 2 and 3 illustrate the challenges facing this experiment. Domestic manufacturing jobs took a hit just after China joined the WTO (Figure 2), as many labor-intensive, low-value industries (such as apparel) outsourced their production overseas. The U.S. lost nearly six million jobs over 10 years and two recessions, and has added about 1.3 million after the losses bottomed out in 2010.

However, manufacturing output rose steadily over these recent decades, revealing a shift to more highly valued industries as well as higher productivity for the sector. Total output for the sector increased 17% from 2000 to 2024 even with the dramatic reduction in jobs.[5]

Remarkably, the turn to higher efficiency and productivity also has occurred in China, which has reported more than 15 million jobs lost in goods-producing sectors—including manufacturing—over the past decade, while also raising output.[6]

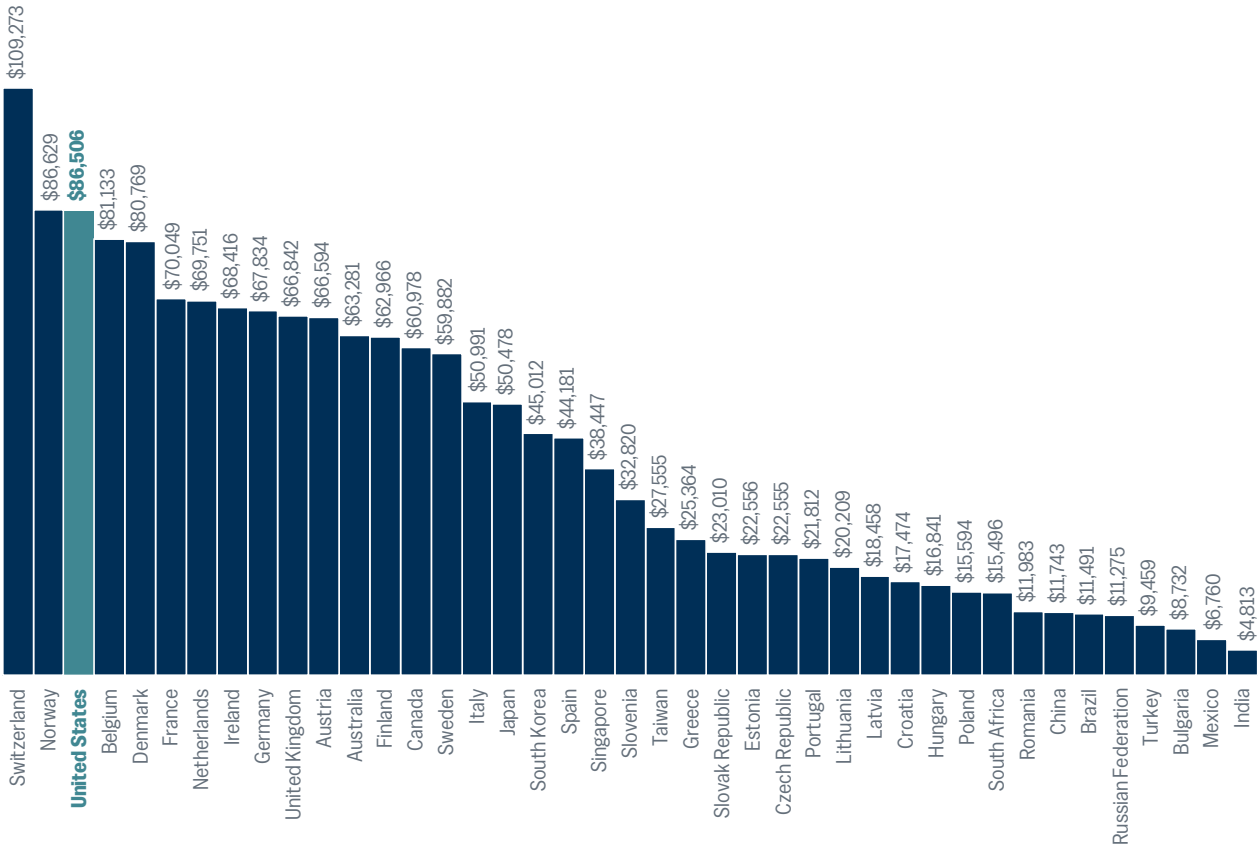
These dramatic increases in productivity are not unprecedented. One hundred years ago, about 25% of U.S. workers were farmers. Yet even as that number has shriveled to 1.5%, food production has more than quadrupled.[7] We do not expect manufacturing productivity gains to reverse, which would make the reshoring of jobs challenging.

New manufacturing techniques require highly skilled workers, and the U.S.'s high domestic labor costs are a disincentive for firms to reshore. Only Switzerland and Norway have higher total labor costs in the sector[8] (Figure 3).

Figure 3

High U.S. labor costs a hurdle for reshoring

Total manufacturing costs per employee (annual, USD)



Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Wilmington Trust. Data as of November 30, 2025.

Figure 4

Labor-intensive products more challenging to reshore

Equating production costs for shoes and semiconductors

Sources: Wilmington Trust and references noted in endnotes 9, 10, 11, and 13.
Data as of October 31, 2025.

The reshoring experiment

We do not observe or expect that tariffs alone will suffice to induce a significant shift of production, especially for more labor-intensive products. Figure 4 is a stylized example comparing production costs for a pair of sneakers made in the U.S. versus in Vietnam, and the same for a leading-edge logic chip, a critical semiconductor device.

The former is an example of labor-intensive textile manufacturing that contributes to large-scale offshore production. Much of sneaker production is either fully automated or machine assisted, but labor still plays a significant role.

Shoes like this may retail for $100 but cost far less to produce (around $30 when accounting for materials, wages, and other costs such as administrative expenses and profit margins).[9] Tariffs are levied based on the import value of the item, and in this case would apply to the $30 cost that the U.S. firm pays at the shipping dock. The current (as of November 2025) 20% U.S. reciprocal tariff rate on Vietnam would add another $6, bringing the total cost to $36, still well below the estimated U.S. production cost.

Labor costs are the critical differentiating factor making production in the U.S. more expensive. They have been reported at between $1 and $2 an hour for textile workers in Vietnam, while U.S. wages are 10 times higher[10]—bringing labor costs to $30 in this example and increasing the U.S. production cost to $63, or $33 higher than when outsourced (Figure 4). This implies that a 111% tariff would be required to equalize the cost of manufacturing a pair of shoes in the U.S. and Vietnam.

It would take a 100% tariff to make reshoring profitable on a per-unit basis, even before considering the higher fixed costs associated with construction of U.S. production facilities. At a reciprocal tariff level of 20% with Vietnam, it makes more sense for importers to pay the tariffs until the cost and scale of automated solutions for the labor-intensive steps of production are economically viable. Until then, these tariffs mainly serve as a source of government tax revenue at the expense of corporate profits and U.S. consumers.

Like textiles, semiconductors are a heterogeneous category that includes, for example, logic processors, memory chips, and analog components, each produced at varying scales and for distinct applications. For illustrative purposes, the example reflects the production of logic chips, which today occurs primarily in Taiwan, especially for the most advanced designs.

Manufacturing advanced semiconductors is highly automated and requires more skill, with smaller wage differentials between countries. For instance, production staff at TSMC, a leading chip producer, reportedly earn about $30,000 per year in Taiwan, while job postings for related roles at TSMC's U.S. foundry in Arizona pay close to $50,000.[11] These numbers place U.S. wages at roughly 67% more than those in Taiwan—a much smaller difference than the 10x wage gap in the textile example.

When all costs are factored in, manufacturing semiconductors in the U.S. is more expensive than in Taiwan, but the differential is less pronounced than in the case of textiles. A Goldman Sachs analysis found that operating expenses are 18% higher in the U.S. compared to Taiwan, and all-in expenses are 44% higher when factoring in other items, particularly the cost of capital expenditures (capex).[12] Use of tariffs could be sufficient to tilt the balance of costs in favor of domestic production, particularly if combined with capex incentives.[13]

The calculus for whether such an investment is realistic hinges on more complex factors (notably the wealth of specialized knowledge that Taiwan has accumulated over decades of producing the most advanced chips, plus the extensive nexus of supply chains developed to support it). It is possible for a similar industry to be built in the U.S., but it likely would be a multi-year, multi-stage process that requires businesses to feel relative certainty about the policy framework going forward.

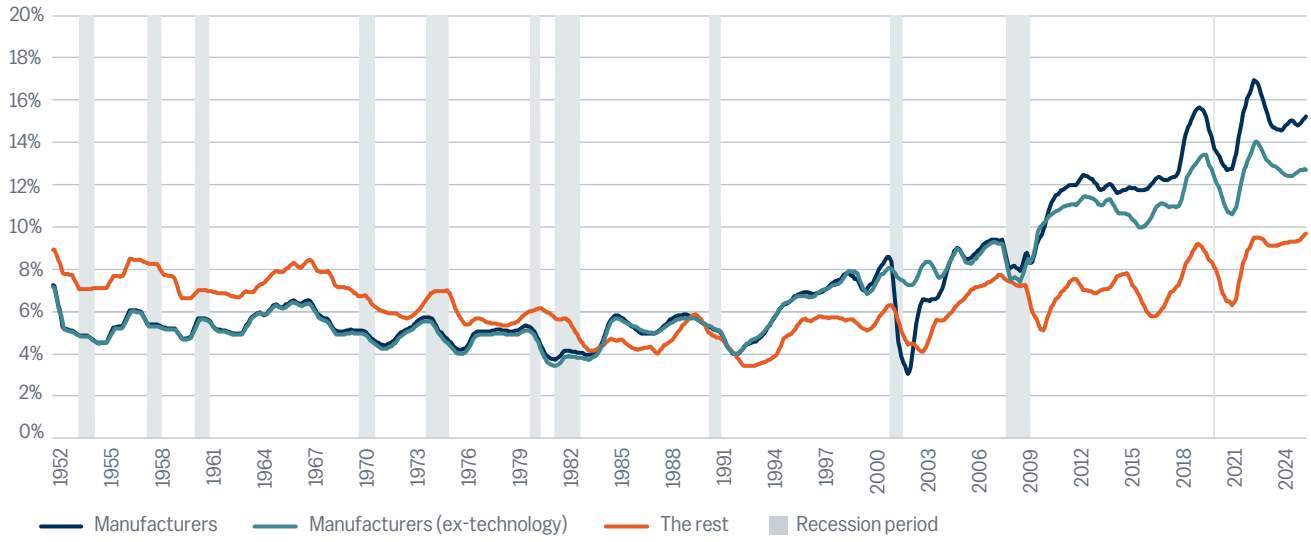
Based on the foregoing, products with very intensive labor input, such as sneakers, probably will remain imported goods and provide tax revenue. There are more capital-intensive products that could be reshored, but we think it would take new investments in smart manufacturing techniques and other innovations to overcome the labor-cost differential. We also expect reshoring to be a gradual process over many years as technology develops and firms replace existing capital.

Lastly, we must not overlook the impact that future tariff uncertainty could have on corporate decision making. As with most experiments, if the observed results are not considered favorable, the experiment may be terminated. This possibility, whether within the timeframe of the current administration or beyond, also has a strongly depressive effect on corporate America's interest in reshoring manufacturing.

Figure 5

Globalization has supported margin expansion for manufacturers

S&P 500 manufacturers' and all others' net profit margins 1952–August 2025



Source: Empirical Research Partners. Data as of August 30, 2025.

Excludes financials, real estate investment trusts, and utilities. Based on trailing four-quarter aggregate data smoothed on a trailing six-month basis. The large-cap stock universe is used prior to 1977. Gray bars represent recessions.

Smart manufacturing, productivity, and profitability

Manufacturers' net profit margins have accreted over the course of decades of globalization (Figure 5). We expect the clearing of regulatory and labor-cost obstacles for U.S.-domiciled manufacturing to depend heavily on smart manufacturing. Such technologies have taken a huge leap forward with generative and agentic AI. The latter builds on the power of generative AI's large language models (LLMs) by adding the ability to learn, adapt, and be more proactive in accomplishing goals. These are necessary skills for many enterprise applications.

The potential improvements in predictive maintenance, quality control, and cooperative work between humans and collaborative robots (cobots), sometimes without any human oversight, could yield double-digit productivity gains for the industry over time.[14] KPMG research projects a 20% reduction in production downtime, 15% increase in product quality, and 25% reduction in defect rates for manufacturers utilizing generative AI.[15]

However, investors may need to be patient. Researchers have documented a productivity J-curve—i.e., when initial investments result in a dip in margins before growth reaccelerates—that especially plagues manufacturing companies.[16]

01 **Cr** Collaborative robots

01 **IoT** Internet of Things

01 **S** Sensors

01 **A** Agentic AI

Use cases of AI and robotics in smart manufacturing[17]

Collaborative robots (cobots) work alongside human workers to enhance productivity and safety while handling repetitive or physically demanding tasks.

Internet of Things (IoT) generates data from sensors, programmable logic controllers, deep learning,[18] and AI algorithms to constantly update the digital model with live data and perform predictive maintenance.

Sensors can perform quality control with new precision.

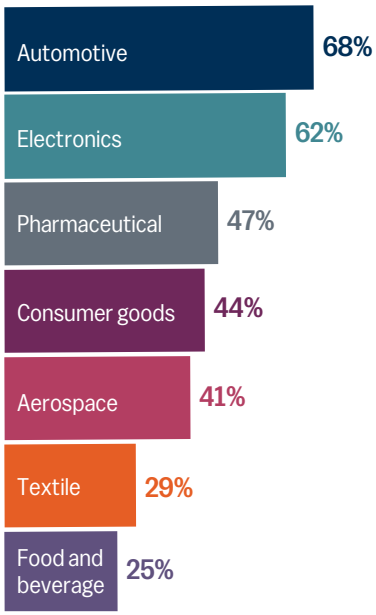
Agentic AI can manage supply chains and inventory, and schedule system optimization.

We expect to see the greatest benefit from smart manufacturing accrue to companies that have high capital intensity (i.e., spend more on fixed-asset investment) or high labor costs and complex, customizable products. It helps to already have production facilities in the U.S. that could be expanded to increase space and expertise. Deep balance sheets are a must as well. If companies can profitably bring manufacturing supply chains back to the U.S., consumers could benefit from better, U.S.-made quality and lower shipping costs.

Figure 6

Sophisticated, high-cost industries lead in smart manufacturing adoption

Percent adoption of smart manufacturing across industries



Source: *2025 Smart Manufacturing and Operations Survey: Navigating challenges to implementation*, Deloitte Insights, May 1, 2025.

The greatest adoption of smart manufacturing has been in the automotive, electronics, and pharmaceutical industries (Figure 6). National security objectives in the pharmaceutical, energy, chemicals, and rare earths sectors could provide additional incentive to manufacture domestically.

Investing in industry 5.0

There are several interesting investment opportunities associated with the smart manufacturing theme that we are implementing in client portfolios.

Industrial capital goods providers present a compelling avenue to invest in automation, robotics, and smart building solutions associated with upgraded domestic manufacturing. In fact, industrial companies may be in the early stages of a multi-year super cycle. Valuations for the sector are not cheap, but industrials are trading at a narrower historical premium to the overall market (Figure 7).

AI software, specifically inference applications that focus and direct the computing power of well-trained LLMs, has the potential to streamline inefficiencies in the production process. Agentic AI could usher in a real boost to manufacturing productivity.

While generative AI models create content based on learned patterns, agentic AI more proactively applies model output to accomplishing goals or completing more complex tasks. For example, an LLM could create a travel itinerary, but an agentic AI model could book the trip. In the context of manufacturing, agentic AI has the ability to autonomously adjust schedules, diagnose supply chain issues and proactively reroute inventory, and predict maintenance-related issues.

We believe we have only begun to scratch the surface of agentic AI applications and their use cases, and that there is a long runway for software companies producing this technology.

Cybersecurity stands to benefit from smart manufacturing and AI adoption more broadly. An astounding 91% of respondents to a recent Deloitte survey of manufacturers reported cybersecurity breaches in the last year—yet just 32% of those respondents cited cyber risk assessment as a top priority.[19]

The higher the technology intensity in manufacturing or any other business, the greater the need for cybersecurity. Valuations of many cybersecurity companies have skewed rich for years, but it is difficult to understate future growth expectations for the industry. The coming advent of quantum computing also might trigger a super cycle in cyber investment.

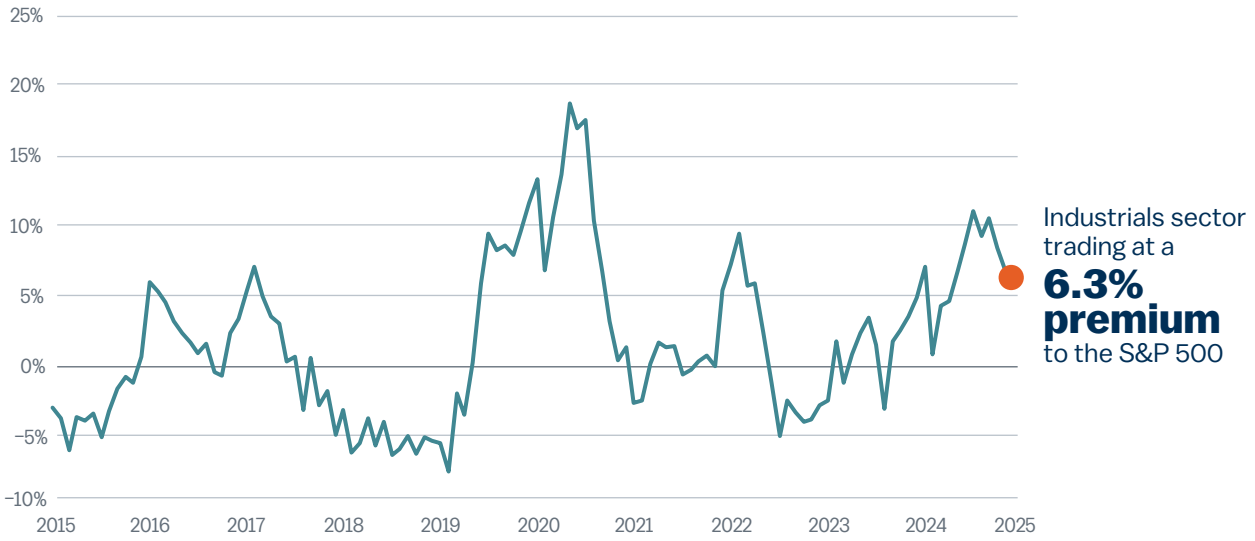
Lastly, **small companies** also can benefit from shifting supply chains back home. Often, such firms lack the capital required to take advantage of the latest technology by making the investments to retrofit, enhance, or expand manufacturing facilities.

In these cases, the **private markets** can be a solution. Investors in both private equity and debt could benefit from earlier access to these operational-turnaround stories.

Figure 7

Valuations for industrials look reasonable relative to the market

Price-to-earnings ratio for industrials sector vs. S&P 500



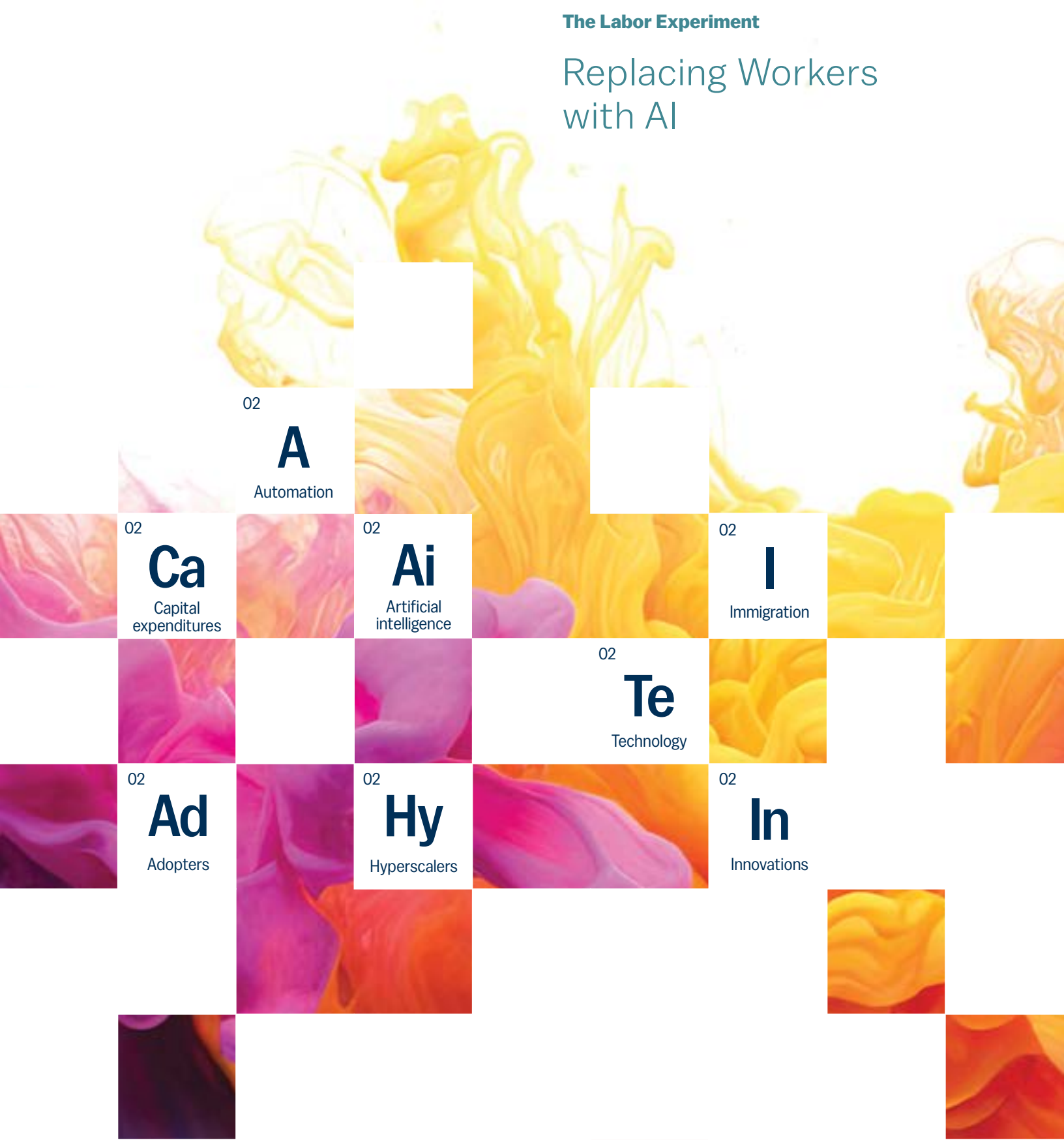
Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of October 31, 2025.

Presents a premium/discount valuation (measured by P/E ratio based on 12-month forward-looking consensus earnings estimates) relative to the S&P 500.

THEME 02

The Labor Experiment

Replacing Workers with AI



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Labor

The Labor Experiment

Replacing Workers with AI

The move to reduce immigration is perhaps the riskiest experiment underway, as demographic trends are famously challenging to reverse and immigration policies could have lasting impacts. A simultaneous experiment is occurring in the business community, with implementation of AI replacing workers in a handful of job types where automation has been achievable. Labor demand has been hit even harder across the economy by a cyclical slowdown, highlighting the challenges of scientific observation in a noncontrolled experiment.

It is early days in these dual experiments, but our observations thus far indicate greatly reduced supply and demand for labor. Technology's impact on labor demand is difficult to pin down and differs across industries and jobs—a truth seen throughout major past innovations, whether the steam engine, the automobile, the personal computer, or the internet.

Where a new technology acts as a substitute for labor—as AI has thus far—it puts people out of work. This is typical during the initial adoption phases. But as the new technology is integrated into business processes and new implementations are cooked up, it becomes a complement to workers, driving labor demand higher and increasing productivity.

We see the potential for a productivity boom emanating from AI, offering investment opportunities across the technology universe.

Near-term impacts of AI adoption

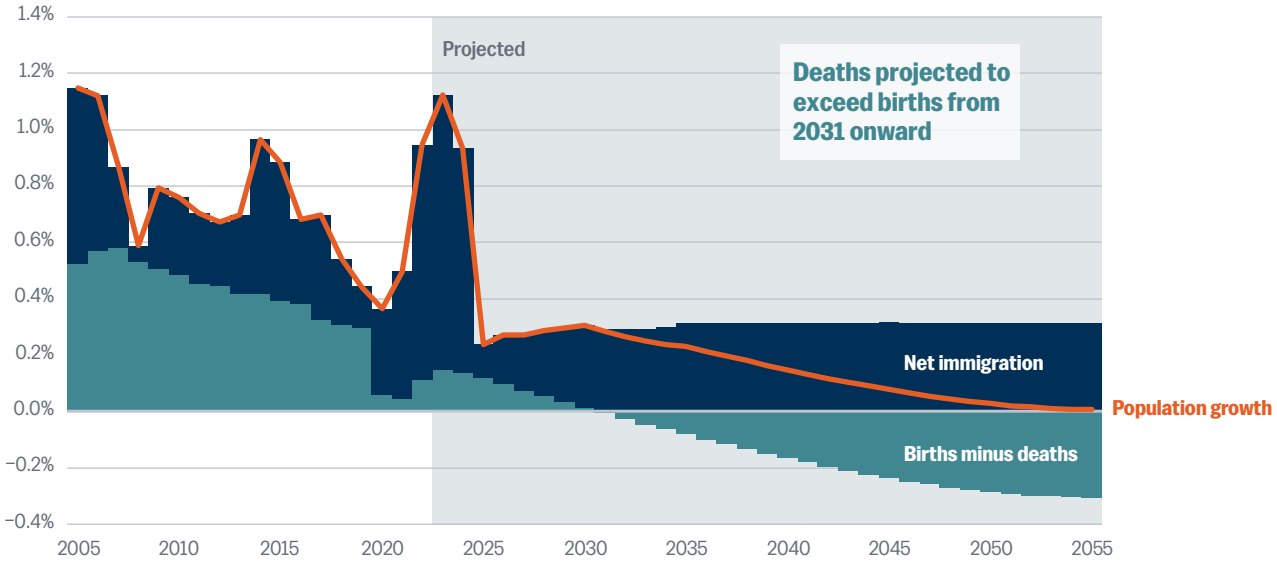
Concerns about AI replacing workers and hollowing out the labor force have run rampant since the release of ChatGPT. In our view, AI is a transformative technology that ultimately will create more jobs than it destroys, but there is mounting evidence that its impact thus far has been negative, especially in highly exposed jobs and for those early in their careers. In particular, AI may have replaced software engineers and customer service workers aged 22–25, reducing jobs by 20% and 10%, respectively, since late 2022.[1] By contrast, there has been little impact for less-exposed occupations such as production supervisors, health aides, and stock clerks.

The dynamic of new technologies dampening labor demand in the early stages of adoption translates to a downside risk for job growth and consumer spending in 2026. We maintain a cautious view on labor markets and job growth in the year ahead before considering the AI impact. On the more positive side, we expect the reduction of the labor force, particularly the anticipated lower issuance of high-skilled H-1B visas, to mitigate the labor-market effects of AI-driven job losses for exposed sectors.

Figure 1

Low birth rates and aging population lead to a declining native population within a decade

Population growth and contributing factors



Source: Congressional Budget Office. See www.cbo.gov/publication/61390#data. Data as of September 30, 2025.

Population refers to the Social Security area population, which includes all residents of the 50 U.S. states and the District of Columbia, as well as civilian residents of U.S. territories. It also includes federal civilian employees and members of the U.S. armed forces living abroad and their dependents, U.S. citizens living abroad, and noncitizens living abroad who are eligible for Social Security benefits on the basis of their earnings while in the United States.

Dwindling labor force and immigration

Prior to the second Trump administration, the U.S. already faced a dramatic slowdown in population and labor-force growth. Net natural increase, which is simply births minus deaths, has been heading downward for years as the population ages and fertility rates fall (Figure 1). In this context, immigration increasingly has been a saving grace as a key source of fresh labor supply, but it is now being sharply restricted.

Even work visas for highly skilled workers (especially H-1B holders) could face a sudden decline due to new fees. The latest projections indicate that the U.S. population could dip into decline starting in 2031.[2] The Congressional Budget Office (CBO) assumes that net immigration will average roughly 900,000 over the next five years, which may not materialize if current policies remain in place—meaning that population growth may turn out even lower than expected.

In fact, our calculations show that immigrants have almost entirely accounted for net job growth since 2022. That is not to say immigrants are taking jobs from U.S. nationals. Instead, it highlights the degree of slowdown and decline of the labor force's native-born population.[3] The unemployment rate for the native-born population was just 4.3%[4] as of September 2025, so there is very little spare capacity for nationals to fill jobs that immigrants otherwise would have taken.

A vital concern for the U.S. going forward is the ability to fill high-skilled positions that have long been filled not only by citizens, but also by immigrants through the H-1B visa program (Figure 2). Since 1990, the program has enabled U.S. employers to hire foreign workers with specialized skills on a temporary basis. But the Trump administration instituted a $100,000 fee for new applicants as of September 2025, which could reduce applications by as much as 30%.[5]

Strong productivity growth is not only achievable, but also is the most likely outcome. The magnitude of realized productivity growth will significantly depend on the success of AI. We see it as likely to define a new era in growth.

Drawing highly talented immigrants has long been a signature characteristic of the U.S. economy, one that has boosted U.S. innovation and productivity. Skilled migrants make up just 5% of the workforce but earn 10% of total labor income, reflecting the higher-productivity positions and industry concentration. Overall, immigrants comprise about 10% of the U.S. population but make up 23% of patent holders. More than 25% of U.S.-based Nobel Prize winners have been immigrants,[6] as are four CEOs of the so-called Magnificent Seven, the darlings of U.S. business and innovation.

Productivity boost needed

With the labor force slowing or perhaps even in decline, the U.S. economy is in dire need of stronger productivity growth. The simple math of long-term economic growth is that it equals the sum of the growth rates of the labor force and productivity. If immigration pulls back sharply enough that labor-force expansion is flat, it would take consistent 2% annualized productivity growth to achieve the current consensus estimate of 2% long-term economic growth. To put that in perspective, annual productivity growth was roughly 1% in the expansion between the global financial crisis and the pandemic. It was about 3.5% in the late-1990s and early-2000s boom.[7]

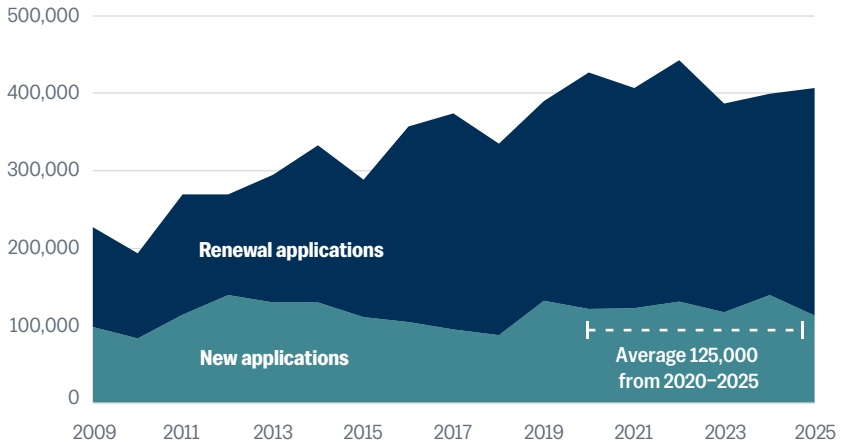
We believe that strong productivity growth is not only achievable, but also is the most likely outcome. A review of projections of annualized labor productivity growth from AI over the next 10 years yields a range of just +0.1% to +3.3%. That compares with the estimated +1% to +1.5% attributed to the internet boom of the 1990s. We expect a similar result from AI, boosting annual productivity by +1% to +1.5% over the next decade.

The magnitude of realized productivity growth will significantly depend on the success of AI. We see the new technology as likely to define a new era in growth, much like the adoption of electricity, the steam engine, the automobile, the personal computer, and the internet. But it also will be disruptive (as it already has been) for many industries and occupations. And we could be wrong, as the technology might fail to achieve its promise.

Figure 2

High-skilled immigrants a key source of labor

H-1B visa application approvals by fiscal year

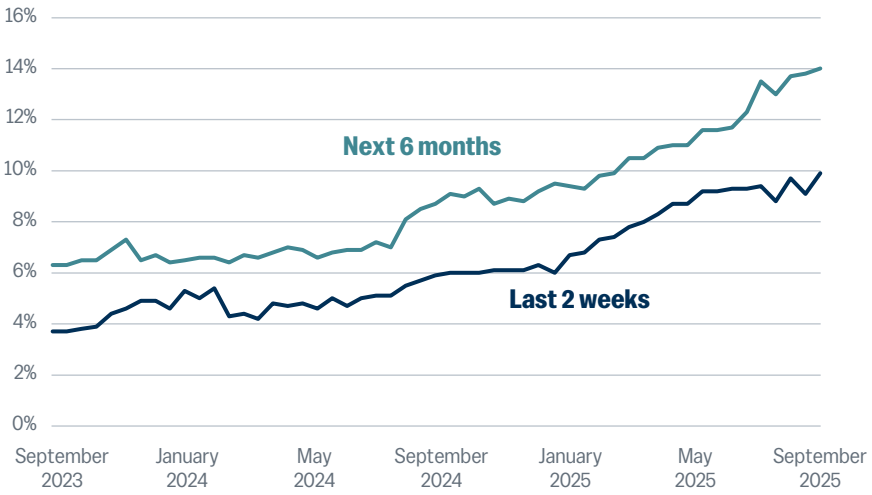


Sources: U.S. Citizenship and Immigration Service, Wilmington Trust.
Data as of October 31, 2025.

Figure 3

Growing share of firms look to adopt AI

Firms that have used AI in the last two weeks and plan to use in next six months



Source: "Business Trends and Outlook Survey," U.S. Census Bureau. Data as of September 30, 2025.

Adoption of AI is growing

While estimates vary, most signal that a high proportion of consumers have at least tried using AI.[8] On the business side, research focused on large firms found that more than 80% had explored or piloted an AI solution, and 40% had deployed some kind of tool[9] (Figure 3). A Census Bureau survey attempting to represent all firms showed much lower economy-wide usage, but rapid growth. Just 8% of firms had tried using AI as of October 2025, double the 4% from two years ago. Additionally, 14% indicated they plan to use AI at some point in the next six months.[10]

The data supports our view that AI Is likely to grow quickly, given the doubling of usage in such a short timeframe. But it also points to an experiment that still is in its very early stages, with a long road ahead before it is proven. We observe meaningful productivity gains at the microeconomic level, but do not expect to see economy-wide gains with a measurable macroeconomic impact until further down the road.

Early innings of the AI investment cycle

Productivity growth is dependent on AI living up to—or exceeding—the recent hype. The echoes of 1999 are ringing loudly today, and the debate over an AI bubble is even louder. For investors, the most pressing question today is where we are in the AI investment cycle.

Unfortunately, this simple question has a complicated answer. We see the AI investment opportunity as multifaceted, with the different layers of the AI ecosystem presenting different degrees of value to investors today. Ultimately, the opportunity is a function of long-term demand for the technology, which is unknowable but hotly debated. We believe that we are still in the early innings of the AI investment cycle while recognizing the risks associated with over-investment and investor exuberance.

The great bubble debate

Myriad signs abound of over-exuberance associated with AI investment. Private AI firms like Anthropic and OpenAI command valuations of approximately $350–$500 billion[11] with no profits yet to show. We have seen a flurry of deal announcements amounting to chipmakers and hyperscalers taking stakes in AI platform providers, who then use the financing to increase orders of chips and cloud storage from those same companies. These headlines echo the telecom vendor financing deals of the dot-com era.

Hyperscaler[12] capex has more than doubled since 2022,[13] when ChatGPT was first released. It is projected to grow another 50% by 2027 to $520 billion[14] (Figure 4), raising risks of over-investment that could be impossible to pay off.

But the opportunities, in our view, justify the risks. AI is not the internet. Adoption of LLMs has been immediate, and applications are barely scratching the surface. The productivity benefit could be larger and faster than that realized in the internet's early days.

AI-related capex is still modest compared to the overall economy's $6 trillion fixed investment.[15] It also is funded largely with cash, though debt financing is increasing for some companies. Hyperscalers in the public market continue to generate tremendous free cash flow. The physical infrastructure buildout needed for our technology economy is still in its infancy and has not yet resulted in a debt bubble.

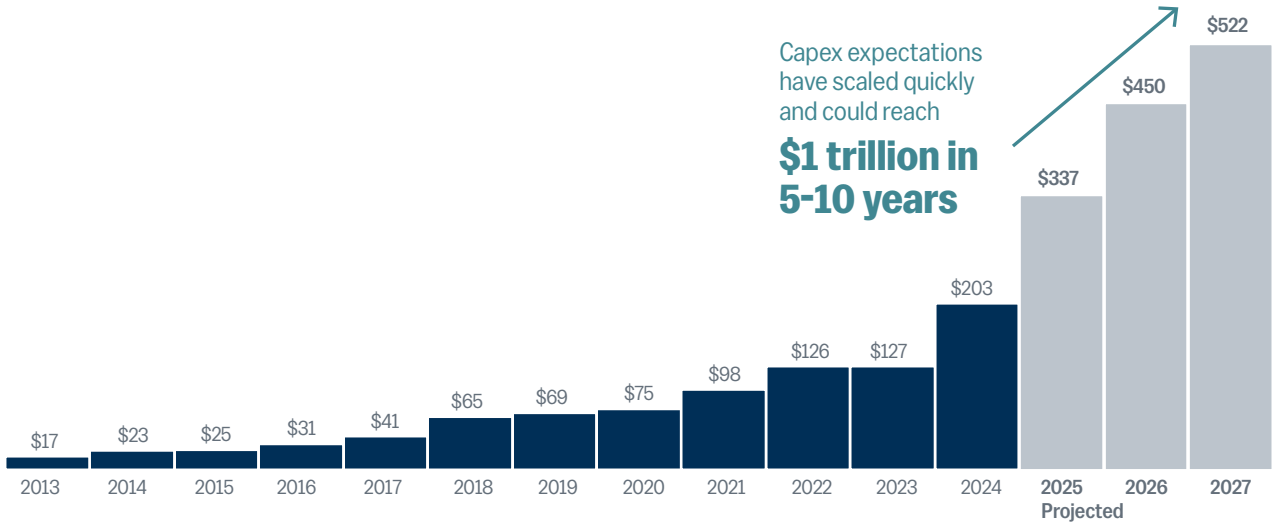
For all of the promise of this transformative technology, the stock market's robust performance compels us to approach AI investments with cautious optimism. The faster and higher valuations climb, the more attention and intention are required to maintain appropriate diversification (we discuss this in a later section).

For now, we think we are still in the early innings of this super cycle, broadly speaking. Higher productivity could create a virtuous cycle for enterprise demand, but monetization is key. There still is value for investors in various parts of the AI ecosystem, in our view.

Figure 4

Mega-cap tech capex has accelerated

U.S. capital expenditures ($ billions) for Alphabet, Amazon (AWS)*, Meta, Microsoft, and Oracle



Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of October 31, 2025.

* Amazon capex discounted for specific Amazon Web Services spending.

The AI ecosystem and portfolios

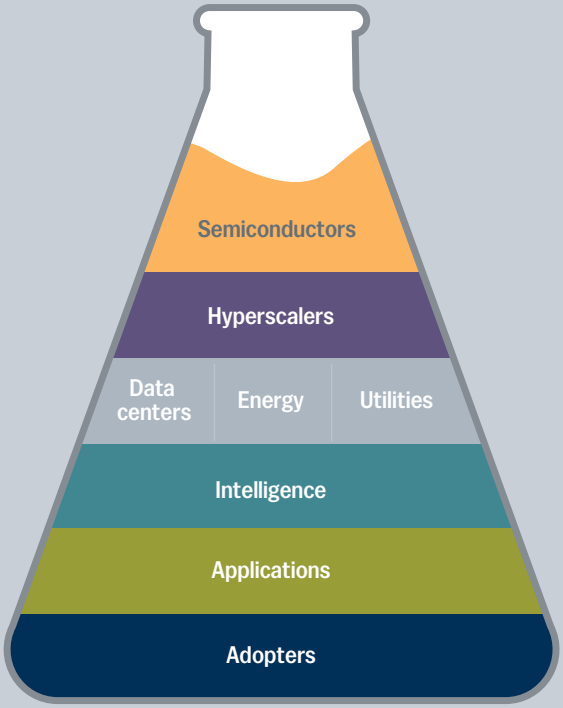
Infrastructure. The infrastructure layer of the AI ecosystem has been on the frontlines of investor enthusiasm, with capital flowing into semiconductors, hyperscalers, data centers, energy, and utilities.

Semiconductors may be among the more extended parts of the AI trade, at least in the near term. Demand is outstripping supply, and chip sales are on track to reach $1 trillion by 2030.[16] Future demand trends, however, are very difficult to predict and technological advancement can unexpectedly render inventory obsolete.

The combined market cap of the top 10 global chip companies has risen by a whopping 392% between mid-November 2022 and October 2025.[17] These large companies also face disruption risk, as AI chip startups have secured a total of $7.6 billion in global venture capital funding during the second through fourth quarters of 2024 alone[18]—a relatively small but growing figure.

Hyperscalers currently look appealing, as cloud infrastructure growth continues to accelerate while valuations are below prior peaks. The proportion of enterprise workloads in the public cloud has increased more than 60% since 2018 while their penetration remains just over 50%.[19] The overall market opportunity for cloud infrastructure could increase tenfold by 2040.[20]

Investing across the AI ecosystem



Source: Wilmington Trust.

Data centers, energy, and utilities are all related to the servicing of cloud and AI computing demand. Data centers have a development pipeline of 50 million square feet in the U.S. alone,[21] and leasing demand from hyperscalers is reaccelerating. Current vacancy rates of 2.3% represent a record low.[22]

At the same time, valuations are becoming stretched, over-investment risk is high, and energy is a major constraint. Many hyperscalers are building out their own data center capacity, leaving the investment opportunity more limited within real estate investment trusts and private real estate.

On the energy side, the U.S. Department of Energy estimates that data centers consumed 4.4% of U.S. electricity generation in 2023, a figure set to increase to 7%–12% by 2028.[23] Public and private liquid cooling solutions look compelling, as servers for AI model training expend 20x more heat per server than standard computer cloud servers.[24]

Intelligence. AI model providers exist in the private and public markets, and valuations of private companies appear stretched. In the public market, hyperscalers like Alphabet, Meta, and Microsoft also are investing in model development and offer more reasonable valuations with diversified revenue streams. Still, these companies have become quite large, and aggressive growth projections could be harder to meet as they get larger.

Applications. Software applications will augment the productivity benefits of inference models, particularly through agentic AI. As described earlier, agentic AI is more proactive, autonomous, and adaptable than LLMs. It presents the added value of not only answering a question or generating content, but also of performing a task to completion.

With estimates for active users in the low-single-digit billions (Figure 5), monetization (specifically through enterprise pricing) will be critical to margin expansion.

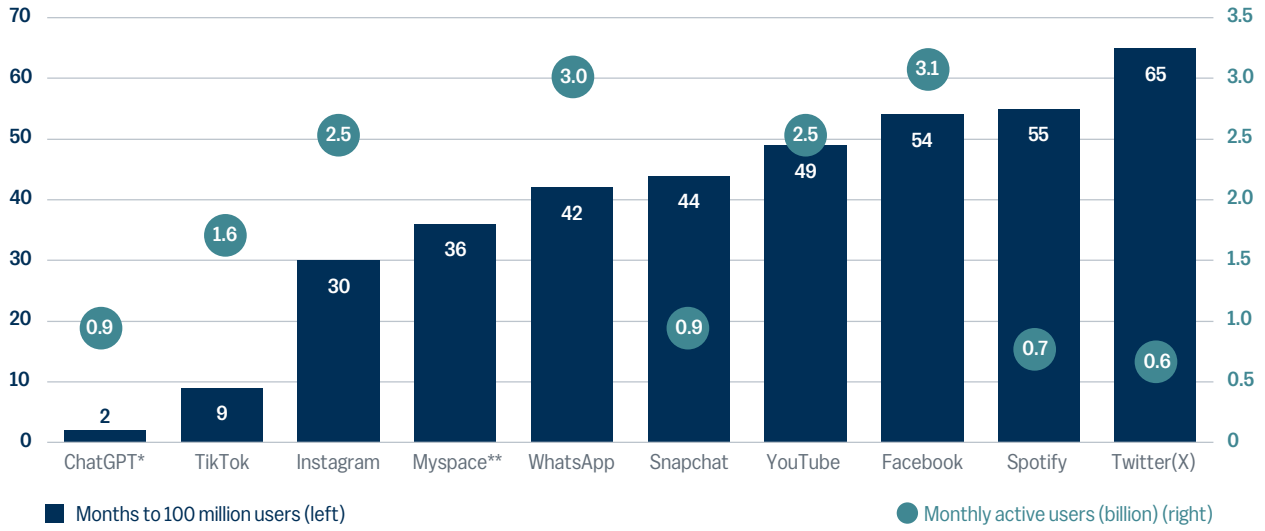
We see the investment opportunity within software applications as in its early innings—in fact, almost too early. While some large software companies are implementing agentic AI, disruption risk is very high and it is generally too early to assess which companies will emerge as winners.

Adopters. Perhaps the most nascent-yet-exciting investment opportunities related to AI are the adopters of AI, that is, the businesses deploying the technology to realize new levels of efficiency. As we mentioned earlier, a J-curve trajectory is common for realization of productivity benefits associated with AI adoption, as early investments require retooling of work processes to fully realize the efficiency of the new technology.

Figure 5

Growing user base and rapid adoption for AI applications

Monthly active users (billions) and months to 100 million users for popular apps



Sources: PricewaterhouseCoopers (company website and statements), Wilmington Trust Investment Advisors. Data as of August 2025.

* OpenAI does not publish monthly active users (MAU) for ChatGPT, but it does report weekly active users (WAU) (of 700 million). The figure above assumes that WAU represents 80% of MAU.

** Myspace no longer tracks monthly active users. At its peak, the website had 115 million monthly active users and that figure is estimated to be less than 1 million today.

Encouragingly, evidence does show that small businesses thus far have been the earlier and more agile adopters of AI,[25] suggesting greater productivity gains for the businesses that arguably need it most.

Ultimately, we think the AI investment opportunity still has long legs. As with all new technologies, investors should anticipate volatility and pullbacks along the way. For example, the unveiling of the DeepSeek LLM almost a year ago triggered a 15% selloff for the tech sector,[26] which has more than recovered.

We expect such pockets of volatility to persist as AI technology matures and new winners or threats emerge. In fact, the prior decade's winners rarely dominate the next decade, and we cannot rule out pain ahead for some of the largest and best-performing stocks of this cycle. As such, when economies realize transformative technological experimentation, fundamental analysis, active management, and diversification all assume greater import.

The Debt Experiment

Investing in a Debt Cycle

03
De
Debt

The Debt Experiment

Investing in a Debt Cycle

The third major experiment should surprise no one: a global sovereign debt burden fueled by ever-growing deficits with no end in sight. The U.S. is projected to continue running unprecedented budgetary shortfalls in an economic expansion, and many other large economies are following suit. This creates the risk of an unsustainable debt trajectory, and observation thus far shows investors demanding higher interest rates to take on higher risk.

That said, we see two possible mitigants: stronger-than-anticipated productivity growth (especially in the U.S.) and the burgeoning stablecoin industry. The latter may prove an important new source of demand for U.S. Treasuries that could help keep a lid on rates. Higher rates in the U.S. also are, for the moment, encouraging a carry trade where international investors buy Treasuries to take advantage of their higher yields, increasing demand. Overall, a worsening debt picture affects the path of interest rates, the U.S. dollar, precious metals, and cryptocurrency.

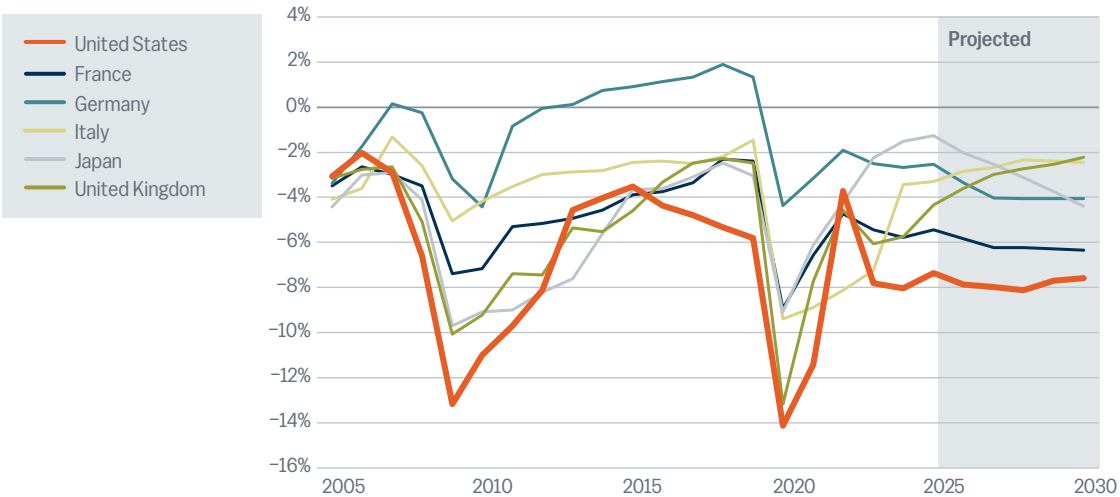
A widening U.S. budget deficit

Government budgets are expected to deteriorate for most countries over the next several years. The U.S. finished fiscal year 2025 with a $1.8 trillion budget gap, roughly equal to 6% of GDP (Figure 1). That is down from about 6.3% of GDP in fiscal year 2024, but is expected to expand to 7%–8% over the next five years.[1]

Figure 1

U.S. deficits projected to remain large

Deficits (% share of GDP) and IMF projections



Sources: International Monetary Fund, Wilmington Trust. Data as of December 31, 2024.

We think current fiscal outlooks for most countries have been priced into markets, but could be susceptible to adjustments in 2026. In the U.S., a change in tariff policy could reduce expected tariff revenue and drive deficits—and, therefore, interest rates—higher.

Continuing the trend from the past 20 years, the U.S. is projected to realize wider deficits than nearly all countries we consider in our investment process. The sum of projected U.S. deficits from 2026 to 2030 totals 39.2% of GDP, greater than all countries in developed and emerging market equity indices except for China.

Rising interest rates

The projected path for deficits and debt, all else equal, is likely to drive interest rates higher. There is considerable academic debate about whether annual deficits or total accumulated debt is more important.

Based on total accumulated debt, estimates across a range of studies find that each 1% increase in the debt-to-GDP ratio pushes long-term interest rates higher by two-to-three basis points (bps).[2] The International Monetary Fund projects that the U.S. ratio will rise by 18% from 2025 to 2030, which would correspond with long-term rates moving up by 36–54 bps.[3]

Research similarly finds that annual deficits drive interest rates higher, but the effects can be larger and more volatile. This makes sense, as the path of deficits can shift fairly quickly with a turn in the economy or a change in policy. Accumulated debt moves more slowly.

We think current fiscal outlooks for most countries have been priced into markets, but could be susceptible to adjustments in 2026. In the U.S., a change in tariff policy (either from a Supreme Court decision or trade deals) could reduce expected tariff revenue and drive deficits—and, therefore, rates—higher. A slower economy also would raise deficits and rates, while a stronger economy would help bring both down.

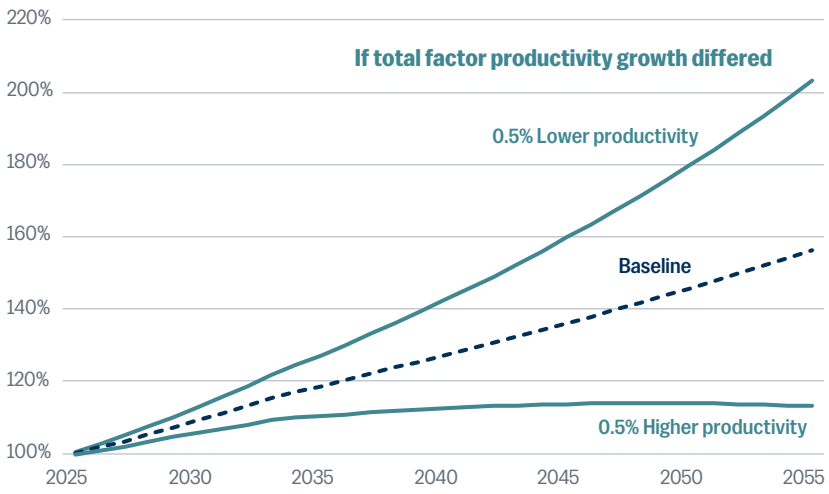
Productivity to the rescue?

The prospect of stronger productivity growth stemming from AI discussed in Theme 1 could have a profound impact on the U.S. debt outlook. The CBO currently projects debt to inexorably rise from 100% of GDP in 2025 to 109% of GDP in 2030 and 127% in 2040[4] (Figure 2).

Figure 2

Debt projections vary widely with productivity growth

Federal debt projections (% of GDP)

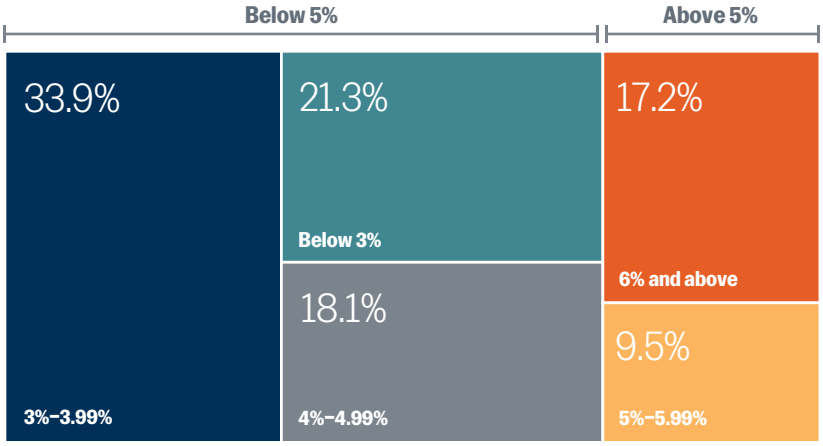


Source: Congressional Budget Office. Data as of May 31, 2025.

Figure 3

More than 70% of existing mortgages have an interest rate below 5%

Share of outstanding existing mortgage loans by mortgage rate



Sources: "17% of Homeowners With Mortgages Have an Interest Rate of at Least 6%, the Highest Share in Nearly a Decade," Redfin, February 6, 2025; Federal Housing Finance Agency, National Mortgage Database. Data as of September 30, 2024.

But current productivity assumptions underlying the extended baseline forecast average only +0.9% per year from 2026 to 2030 and 1.1% thereafter. If productivity growth is just +0.5% stronger, the faster-growth scenario results in a downward bend of the debt-to-GDP curve (the "higher productivity" scenario in Figure 2), all things equal. To stabilize debt, all that is needed is for nominal GDP growth to exceed the average interest rate on the debt.[5] That is achievable, and already the case, with the average interest on outstanding debt at 3.4% as of October 2025.[6] The CBO's baseline projection has nominal GDP growth falling from about 4.5% in 2025 to 3.5% over the forecast, but if AI is able to achieve the 1%–1.5% productivity boost that we expect and the primary deficit—the deficit before including interest payments—is small, then the government could run surpluses and pay down debt in coming years.

Should this come to pass, it will essentially mirror the late 1990s, when the personal computing and internet boom boosted productivity. In 1996, the CBO projected debt-to-GDP to rise from 50% to 52% over the next five years. But annual productivity surged to 3.5%–4%, driving strong economic growth and leading to budget surpluses. Debt-to-GDP fell to 31.5% by 2001.[7]

Rates and the housing market

One of the most important implications of the deficit and interest rates is their effect on the housing market. A housing market cycle starts with low interest rates, encourages purchases of new and existing homes, and helps consumers build wealth. It also leads to second-order purchases that support areas of the retail market (think home improvement) and the services economy.

Mortgage rates, which correlate with the movement of the 10-year Treasury note yield, declined in 2025 but are unlikely to fall below 4%–5% in the near term, absent a recession. (We cover more of our outlook for rates further along in this theme.) While lower interest rates and increased housing supply could improve affordability at the margin, more than 70% of existing mortgages have interest rates below 5% (Figure 3).

Figure 4

Stablecoin issuers a growing source of demand for U.S. Treasuries

Top 10 stablecoins by market capitalization (USD billions)

Stablecoin	Company	Country of incorporation	Market capitalization
USDT (Tether)	Tether Limited Inc.	El Salvador	$167.0
USDC	Circle Internet Financial LLC	United States	$67.6
USDe (Ethena USDe)	Ethena (BVI) Limited	British Virgin Islands	$11.6
DAI	Maker DAO	Cayman Islands	$5.4
USD1 (World Liberty Financial USD)	World Liberty Financial Inc.	United States	$2.2
FDUSD (First Digital USD)	First Digital Trust Ltd.	Hong Kong SAR	$1.4
PYUSD (PayPal USD)	Paxos Trust Company LLC	United States	$1.4
RLUSD (Ripple USD)	Standard Custody & Trust Company, LLC	United States	$0.7
TUSD (TrueUSD)	Techteryx Ltd.	Singapore	$0.5
USDD (USDD)	TRON DAO Reserve	Singapore	$0.5
Total			**$258.2**

Source: Center for Sustainable Development at Brookings. Data as of October 29, 2025. Total may vary slightly due to rounding.

As indicated, it probably would take a recession for mortgage rates to fall enough below that level to meaningfully loosen the supply of existing homes and boost demand from first-time home buyers. This means that a virtuous housing cycle, which would be a tremendous tailwind for the economy, remains elusive for the time being.

Stablecoins could benefit Treasury securities

A key emerging technology that could affect Treasury markets—and push interest rates lower through increased demand for Treasuries—is the advent of stablecoins. The market has grown substantially, and issuers of stablecoins backed by the U.S. dollar accumulated $258 billion of backing assets as of August 2025 (Figure 4).[8]

To put that in context, only 15 countries had larger stockpiles of Treasury debt[9] at that time. Stablecoin issuers purchased $40 billion of short-term U.S. Treasuries in 2024 alone, rivaling some of the largest money market funds.[10] If considered as a country, stablecoin issuers were the third-largest net buyer of Treasuries from the first quarter of 2024 to the same quarter in 2025, trailing only Belgium and the Cayman Islands.

We expect the fledgling stablecoin market to grow. Today's usage is dominated by cross-border payments, where stablecoins are estimated to have a penetration rate of 1.5%–1.9% as of the second quarter of 2025.[11]

To illustrate how stablecoin-based demand for Treasuries could grow from 2025 to 2030, if U.S. dollar circulation abroad grew by 5% annually and the stablecoin penetration rate grew to 10%, stablecoins would need $1.9 trillion of backing assets by 2030. What's more, if that $1.9 trillion were deployed into Treasuries, it would dwarf today's largest international holder (i.e., Japan at $1.1 trillion as of late 2025).[12]

Over the next year, we anticipate further steepening of the U.S. Treasury yield curve. We expect the Federal Reserve to cut interest rates toward neutral—the long-term policy rate that neither stimulates nor contracts the economy—which could continue to drag down prices of short-term Treasuries.

Research confirms that the advent of stablecoins is affecting Treasury yields. Inflows of $3.5 billion into stablecoins reduced the yield on three-month Treasuries by 2–2.5 bps over a 10-day window through associated Treasury purchases.[13] The flip side is true when stablecoins see outflows and issuers are required to sell Treasuries. In fact, observation reveals the negative impact of outflows to be larger than the benefit of inflows, at 6–8 bps for a comparable volume.

While short-term Treasuries are the primary backing asset, issuers also hold short-term backing assets such as overnight repurchase agreements, money market funds, cash and bank deposits, and non-U.S. short-term debt. Issuers additionally hold other assets such as corporate bonds, precious metals, cryptocurrency, and secured loans. As the market matures, issuers could move into additional assets or possibly longer-maturity Treasuries, which would affect longer-term yields and possibly add volatility.

Investing in a debt cycle

From an investment standpoint, the U.S. and global debt trajectory elevates risk in two main areas: upward pressure on sovereign debt yields and fiat-currency[14] debasement. The urgency of these risks increased in 2025 as the U.S., France, Germany, and Japan elected debt-tolerant officials or passed legislation to further expand their deficits.

Markets have taken notice. In 2025, U.S. and German 10-year yields hit their highest levels since the 2023 inflation scare, and the spread between German and French sovereign yields is the widest in 14 years.[15] Though meaningfully below developed-market peers, Japanese bond yields are trading at a 17-year high. The U.S. dollar took a tumble in 2025 from a confluence of debt- and trade-related concerns, though it is well within its historical trading range.

An eye on rates

Over the next year, we anticipate further steepening of the U.S. Treasury yield curve. We expect the Fed to cut interest rates toward neutral—the long-term policy rate that neither stimulates nor contracts the economy—which could continue to drag down the short end of the curve (three-month-to-two-year yields). As we write, the market is already priced for a fed funds rate of 2.75%–3% by the end of 2026.

We see the 10-year fulcrum of the yield curve as heavily influenced by current economic growth, Fed activity, and long-term government debt projections. Absent a recession, we expect the 10-year yield to trade between 3.5% and 4.25%, perhaps moving modestly lower from current levels as the Fed cuts rates. If there is a recession in 2026, the 10-year yield probably could dip well below 4% as the Fed cuts rates below neutral.

We expect the 30-year yield to remain attuned to any hint of increased Treasury funding needs or reduced investor demand, along with perceived threats to the Fed's independence. This should keep the long end of the curve in a range of 4.5% to 5%. As we discussed earlier, however, realization of higher productivity could nudge the 30-year yield lower toward 4.25%.

For investors seeking reasonably low-volatility carry, or income, this means that U.S. debt could remain attractive, especially compared to developed-market peers. A steepening yield curve warrants caution in extending duration,[16] and credit spreads for municipal and corporate credit—both investment-grade and high-yield fixed income—are at historically tight levels, meaning that credit valuations are rich (Figure 5). We remain focused on fundamental credit analysis and prefer investment-grade debt over high-yield.

Historically, a steeper yield curve has correlated with outperformance of cyclical and value stocks, but the Fed often has cut rates well past neutral and steepened the yield curve into a recession. This time around, due to the recent bout of inflation, we expect the Fed to cut to neutral—not below neutral—and see more limited opportunity for value or higher-beta stocks (i.e., those with high sensitivity to movements in the overall market).

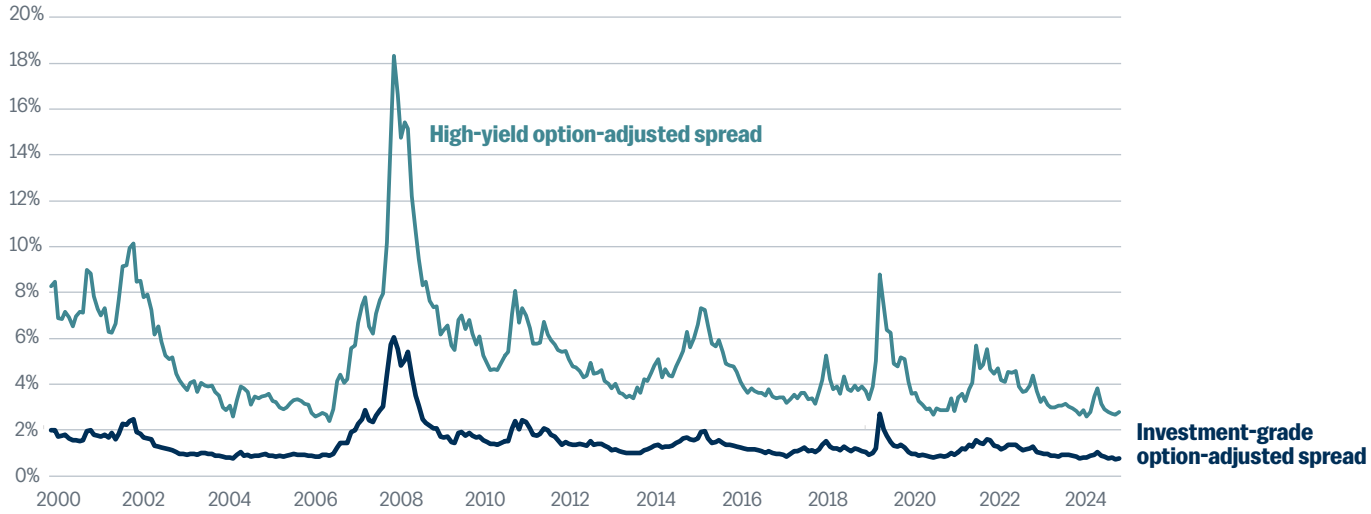
We retain an overweight to higher-quality companies, i.e., those with healthy balance sheets and consistent profits. This factor fell out of favor in much of 2025, but we expect these companies to deliver returns in 2026 that are more consistent with their long-term track record of adding value.

We additionally see a constructive outlook for bank profitability. The potent combination of a steeper yield curve, reduced regulation, and correspondingly higher deal volume could create a favorable environment for banks in 2026.

Figure 5

Credit spreads are historically tight

Investment-grade and high-yield option-adjusted spreads, 2000–2025



Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of October 31, 2025.

Figure 6

U.S. dollar remains within historical trading range

Trade-weighted broad dollar index, 2000–2025

Sources: Bloomberg, Federal Reserve. Data as of October 31, 2025.

Represents the trade-weighted nominal broad dollar index, which comprises a broad group of major U.S. trading partners including a 21% weight to the euro area, 15% weight to Mexico, 14% weight to Canada, 11% weight to China, and smaller weights to many other countries.

Deficits may bode well for metals and crypto

Persistent global deficits pose a risk to fiat currency generally and the U.S. dollar specifically, with precious metals and cryptocurrency as possible beneficiaries. The U.S.-against-the-world approach of imposing tariffs on all trade partners in April—combined with the deficit expansion included in OBBBA and an increase in rate-cut expectations—presented a trifecta for U.S. dollar weakness early in 2025.

The dollar has stabilized since then and remains well within its historical range on a trade-weighted basis (Figure 6). We assess the U.S. dollar's status as the global reserve currency to be secure in the near term. However, a transformed global trade landscape, new geopolitical alliances, and an unrelenting borrowing appetite could prompt investors and central banks to accelerate diversification away from the dollar.

Gold has long been viewed as a potential portfolio diversifier but, empirically, its contribution has been more about reducing asset correlations in the portfolio than adding to overall return. In fact, gold as an asset historically has stayed dormant for long periods, then produced outsized returns in very consolidated timeframes. We are on the heels of one of the latter periods, and gold's cumulative 102% two-year return[17] looks extended in the short term (Figure 7).

Of course, gold offers no yield and has a spotty track record of hedging against inflation, dollar weakness, and volatility. Notwithstanding the science, the art of investing suggests the mosaic of macro factors present in today's environment could make gold a more reliable contributor to portfolio return. We are watching a basket of precious metals (including some like platinum, palladium, and silver that have more industrial applications) for potential entry points to increase diversification in portfolios.

While cryptocurrency is volatile and speculative, it has fairly low correlations with other asset classes. We believe that a small allocation at the right price may add diversification benefits and longer-term returns for risk-seeking investors.

Cryptocurrencies such as Bitcoin and Ether are the other potential beneficiaries of a gradual shift from dollar dominance. After all, Bitcoin's founding was based on the philosophical premise of banking decentralization and diversification away from fiat currency. Ether, the second-largest cryptocurrency by market capitalization, trades on the Ethereum blockchain and has vast potential use cases in smart contracts. It also offers a yield through direct investment associated with the proof-of-stake method of validating blockchain transactions. For these reasons, Ether also is worth following closely.

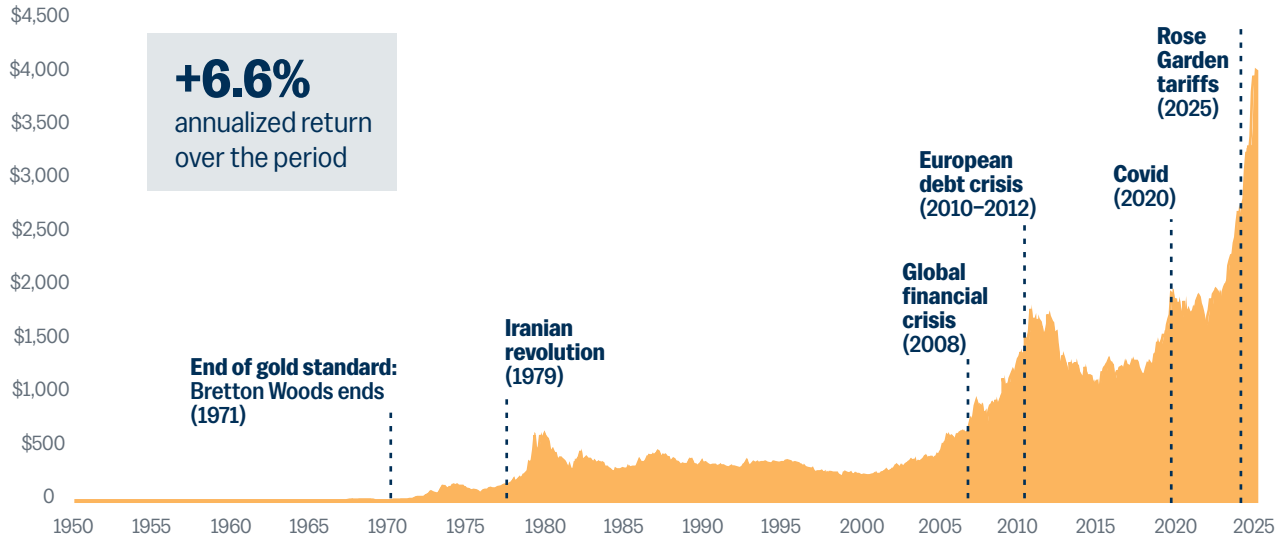
Much like gold, crypto has a fickle historical relationship with macro factors. It also has a relatively short history and is untested in the current new world order. Historically, crypto (focusing for now on Bitcoin) has not been the most effective hedge against the dollar, though an inverse correlation between these two assets has emerged in recent years. Crypto's ability to hedge the dollar could improve with continued regulatory changes that broaden investment access and increase crypto's staying power.

In the past year, we have seen more supportive regulation and even the establishment of a strategic crypto reserve by the Trump administration. Asset flows into crypto via newly created exchange-traded funds (ETFs) also have provided a significant tailwind. While crypto still is volatile and speculative, it has had fairly low correlations with other asset classes (Figure 8). We believe that a small allocation at the right price may add diversification benefits and longer-term returns for risk-seeking investors.

Figure 7

Gold's historical performance has been consolidated in short periods

Price of gold ($/troy ounce), 1950–2025



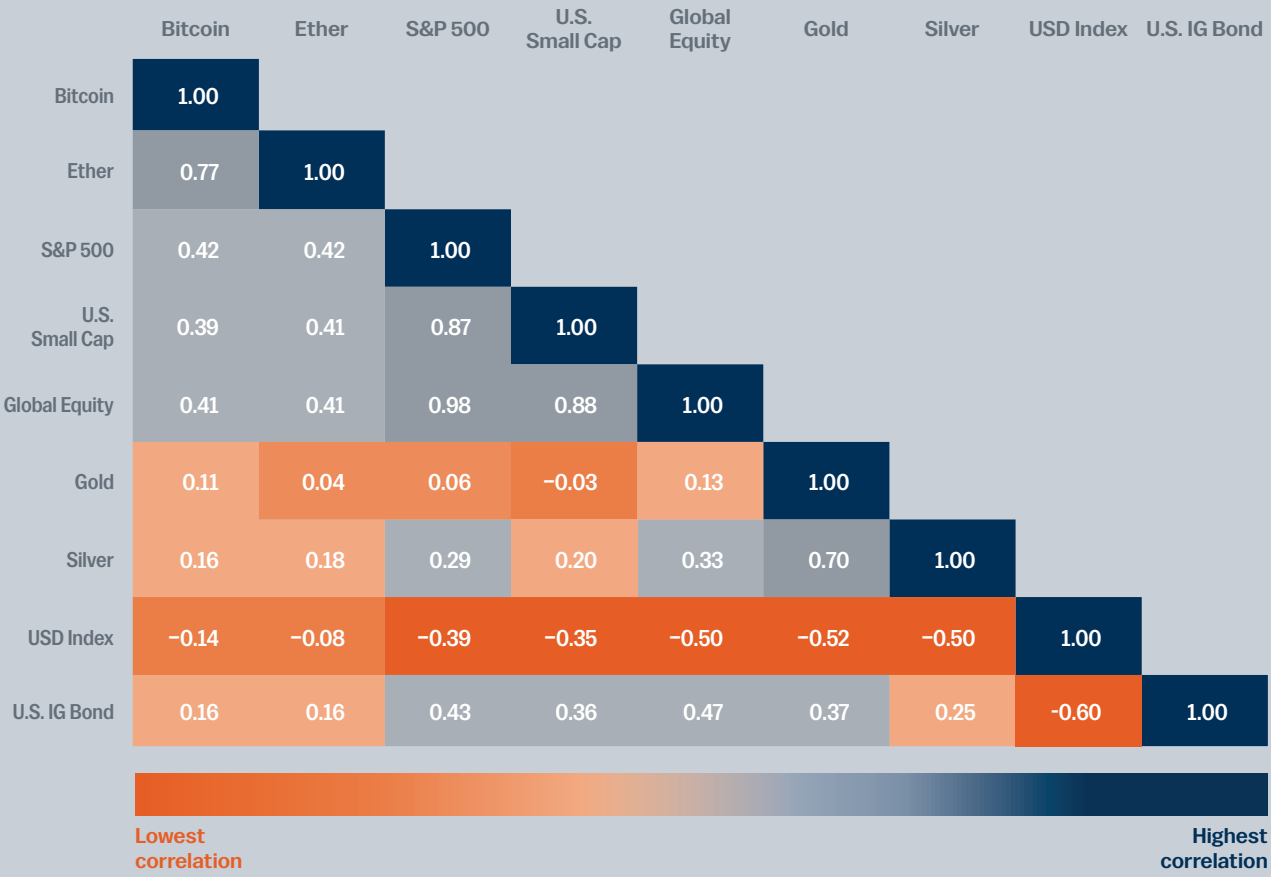
Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of October 31, 2025.

Investing involves risks, and you may incur a profit or a loss. Past performance cannot guarantee future results.

Figure 8

Crypto has fairly low correlations with non-equity asset classes

Correlations of Bitcoin and Ether vs. stocks, bonds, commodities, and the U.S. dollar, 2018–2025

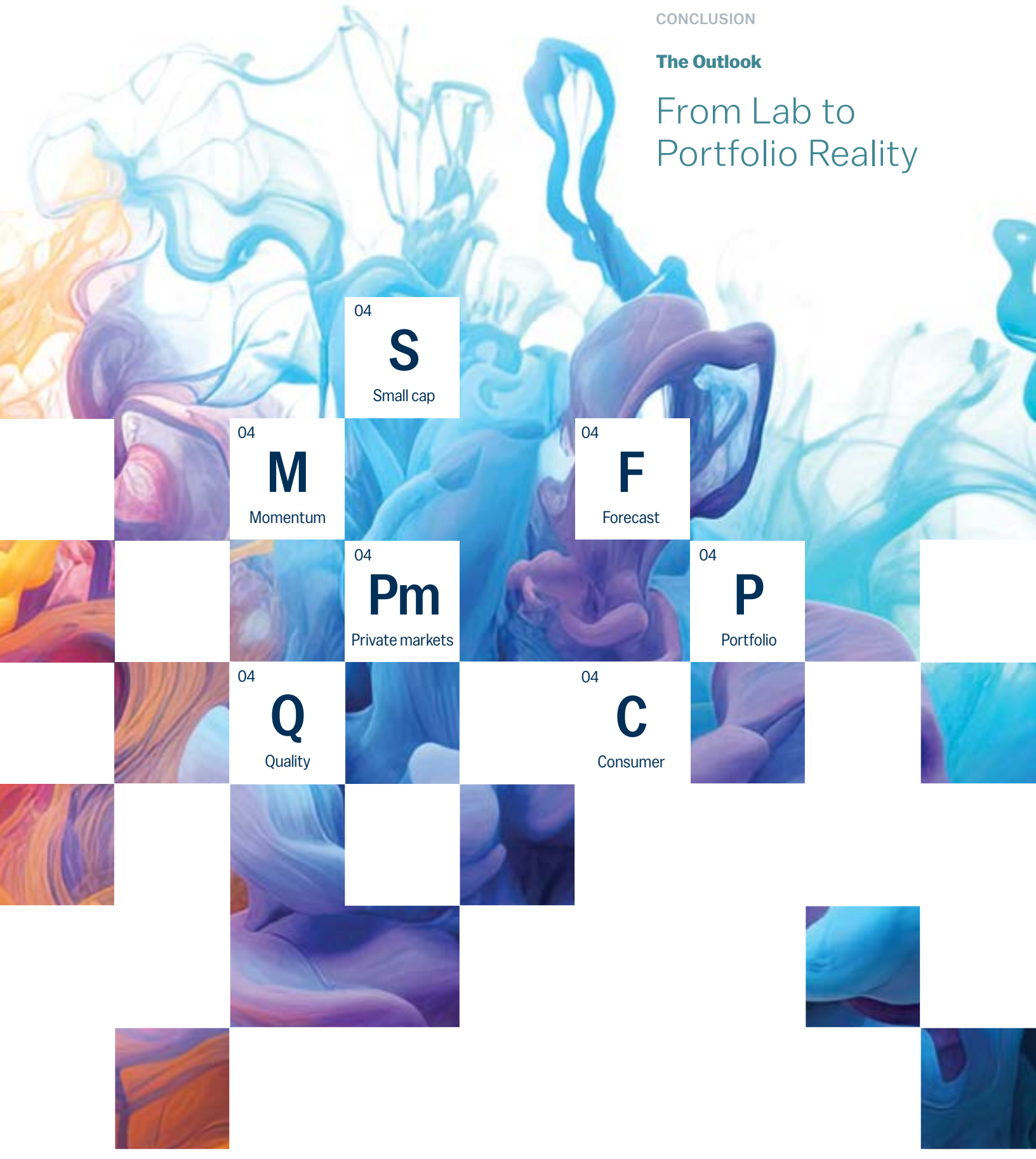


Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of October 31, 2025. Data set begins in 2018. Correlations are calculated using monthly data.

Bitcoin, Ether, gold, and silver are calculated using spot prices; U.S. small cap represented by Russell 2000 Total Return Index; global equity represented by MSCI ACWI Total Return Index; USD Index represented by the DXY—which indicates the general international value of the USD relative to a basket of major global currencies; US IG Bond represented by the Bloomberg U.S. Aggregate Bond Index.

The Outlook

From Lab to Portfolio Reality



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Outlook

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Economic experimentation requires investors to test new ideas, think outside of normal market constructs, and innovate. While the mixture of economic trends in global trade, labor-force growth, and debt require further observation as they play out over numerous years, these forces certainly inform our economic outlook and portfolio strategy in the year ahead.

Economic forecast

We have a cautiously optimistic outlook for the U.S. and global economies in 2026. Economic growth should slow to below 1% as the full impact of tariffs continues to weigh on consumer spending, job growth recedes, and capex outside of AI remains constrained. AI hyperscalers' expected capex is a critical boost for the economy as other industries navigate the new laboratory of experiments and uncertainty.

Helpfully, the slower economy should continue to alleviate inflation pressures and enable the Fed to continue reducing rates. The 2025 tariffs boosted price pressures for many imported goods and supplies, but we see that as a one-time price increase and not enough to generate ongoing upward pressure. Consumers likely will continue reacting by spending less on services, which creates downward pressure on prices.

We expect the Fed to continue to cut rates in early 2026 and reach our estimate of the neutral fed funds rate of 2.75%–3.0% by the middle of the year.

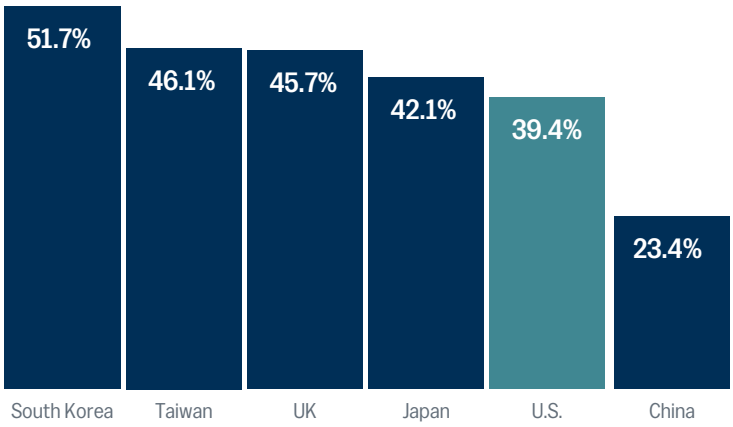
Portfolio strategy in a time of experimentation

Public equity-market concentration, society-transforming technology, ample private-market capital, and the emergence of new asset classes are mixing in a way that is forcing investors to take a fresh look at diversification strategies.

Figure 1

Markets are concentrated around the globe

% weight of top 10 names in market-cap-weighted index



Sources: Bloomberg, MSCI, Wilmington Trust Investment Advisors. Data as of October 31, 2025.

Countries represented by MSCI Korea Index, MSCI Taiwan Index, FTSE 100, Nikkei 225, S&P 500, MSCI China Index.

A relatively small handful of companies has led the U.S. equity market for a while now, which has resulted in an incredibly concentrated, top-heavy market: The top 10 stocks in the S&P 500 make up the highest share of the index since March of 2000.[1] A similar dynamic occurs in other regional markets, though their concentration tends to be less dominated by tech (Figure 1).

This market concentration has occurred at the same time as—and in large measure due to—the influx of capital into passive ETFs and other low-tracking-error vehicles. Such passive structures reinforce existing momentum, adding more money to the best-performing, largest companies in a capitalization-weighted index. These have been great companies—led by the tech giants—that have vastly out-earned the rest of the market and largely justified their premium valuations (Figure 2).

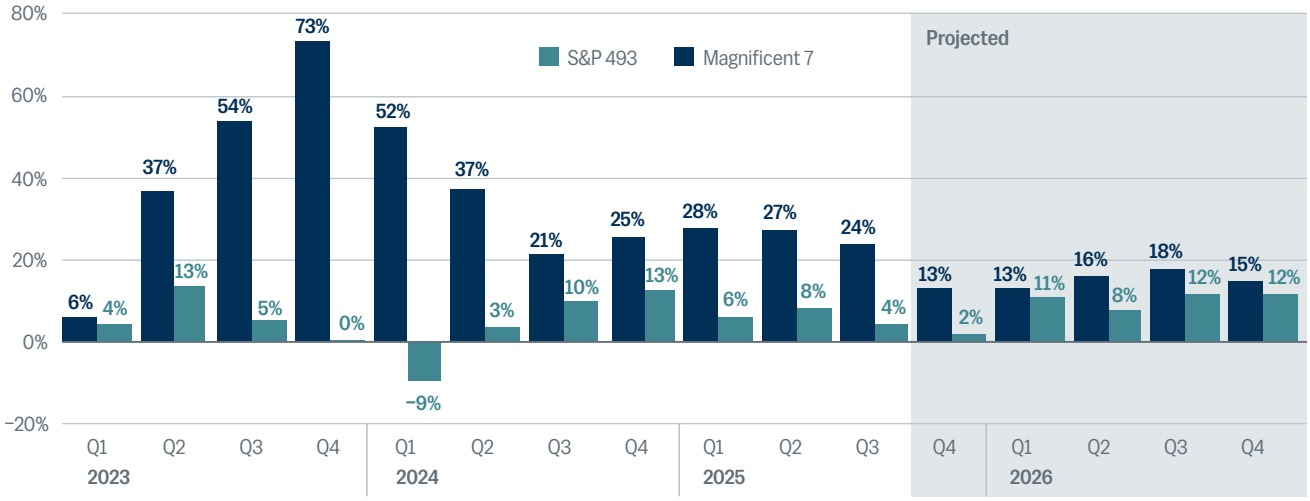
But concentration in anything creates risk. Because of their sheer weight, a turn of fortune for the largest 10 stocks, for example, will have a much more damaging impact on the market today than it would have 10 years ago. And it would be a rare occurrence to see the same stocks rank in the top from one decade to the next.

All of this suggests that passive investors may not be as diversified as they may suppose. By contrast, we could be on the cusp of an active management resurgence. Active managers in aggregate tend to underweight the largest names. There are many reasons for this, ranging from skepticism about future growth projections to mutual fund risk guidelines that restrict individual stocks from exceeding a given portfolio weight.

Figure 2

Mega-cap tech earnings vs. rest of the market

Magnificent Seven vs. S&P 493 year-over-year earnings growth 2023–2026P*



Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of November 19, 2025. * P = projected.

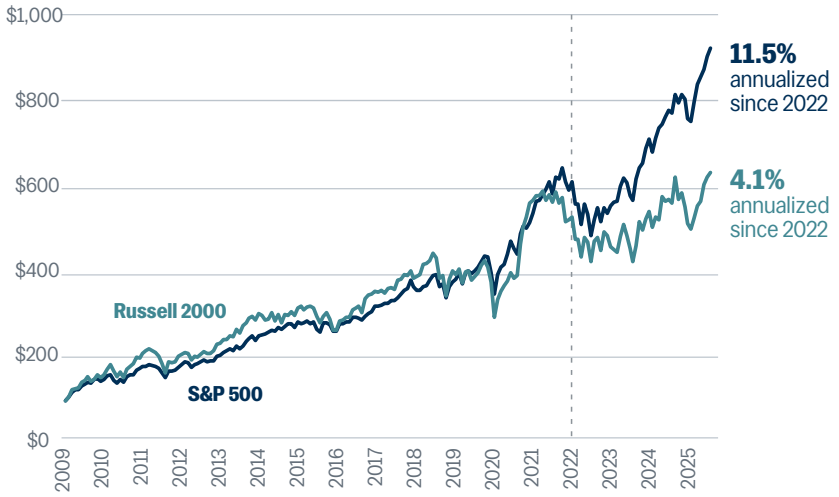
S&P 493 represents the S&P 500 index excluding Magnificent Seven stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla).

Investing involves risks, and you may incur a profit or a loss. Past performance cannot guarantee future results.

Figure 3

Small caps have meaningfully lagged large caps in the last four years

Cumulative growth of $100 since the global financial crisis (S&P 500 vs. Russell 2000)



Sources: Bloomberg, Wilmington Trust Investment Advisors. Data as of October 31, 2025 and begins on March 31, 2009.

Should the largest stocks fall out of favor, as they likely will at some point, active management is well positioned to potentially outperform. The active managers we find most compelling tend to invest in higher-quality companies. As mentioned earlier, quality is a factor we find particularly attractive today and over a long-term horizon. Accordingly, we believe seasoned managers could add significant value in the years to come.

Think small and private

Small-capitalization equities historically have provided textbook diversification. Compared to the largest names, they are thought to earn a return premium for the additional risk associated with smaller, higher-beta or riskier stocks and shine in different economic environments. But U.S. small caps have meaningfully lagged large caps in recent years (Figure 3), forcing a rethink on the best way to invest in the smallest companies.

The AI boom is leaving small caps behind. In the Russell 2000, a commonly cited small-cap index, the technology and communication services sectors collectively account for only 18%[2] of the index value, compared to 45%[3] in the large-cap S&P 500. The leading AI names thus far have been very large companies with massive balance sheets, equally impressive levels of cash, and the scale needed to compete in the technological arms race.

We also must consider the impact of private markets. Private-market capital has increased 220% in the last 10 years.[4] Such ample liquidity encourages the most successful companies to stay private longer instead of raising capital via initial public offerings. This also degrades the quality of the public small-cap market, since the best companies are either staying private or entering the public markets as large-cap "unicorns."

For qualified investors, we increasingly look to diversify portfolios by investing in small companies via the private markets. Multi-strategy, commingled vehicles can offer immediate diversification potential.

Fortunately, private equity is becoming increasingly accessible to investors,[5] in part due to the Trump administration's relaxation of the rules around private-market investment offerings in retirement accounts. For qualified investors, we increasingly look to diversify portfolios by investing in small companies via the private markets. Multi-strategy, commingled vehicles can offer immediate diversification potential in a market that can prove more challenging for building and diversifying exposure.

Observation in the real-world laboratory

Experiments rarely turn out exactly as anticipated, especially when they involve many variables. Shifting U.S. priorities could result in a more inward approach to policy, in turn calling into question the home bias (i.e., overweighting U.S. assets) we have employed—and benefited from—in portfolios. Our observational analysis thus far compels us to hold firm to our strategic asset allocations.

At the same time, it is imperative to continually challenge our investment assumptions. The role of crypto, precious metals, and other alternative assets in portfolios must be considered especially carefully today. For now, we do not recommend large allocations to crypto or precious metals (though our best thinking includes a modest allocation to commodities, of which precious metals are a portion).

We will continue to innovate our thinking, challenge convention, and prioritize risk management as stewards of your capital.

APPENDIX

ENDNOTES

INTRODUCTION

1 Private funds are available only to certain investors who meet the specific income, experience, and investable assets thresholds set forth by the U.S. Securities and Exchange Commission's definition of accredited investors and/or qualified purchasers as necessary. Investments such as private funds and mutual funds that focus on alternative strategies are subject to increased risk and loss of principal and are not suitable for all investors.

THEME 1

1 We define smart manufacturing as a general term used to represent tech-enabled automation with a focus on connectivity (Internet of Things, or IoT), cloud computing, and artificial intelligence.

2 U.S. Census International Trade Data, U.S. Treasury Daily Treasury Statement, Wilmington Trust calculations.

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5 Bureau of Economic Analysis, Bureau of Labor Statistics, Wilmington Trust.

6 National Bureau of Statistics of China.

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8 The Conference Board International Labor Comparisons, Wilmington Trust.

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10 "Garment industry improves productivity to reduce pressure from high labour costs," *Viet Nam News*, December 2, 2025; and "Pressers, Textile, Garment, and Related Materials," Bureau of Labor Statistics, December 2, 2025.

11 "TSMC average employee pay hits NT$3.57 million in 2024," *Taiwan News*, September 1, 2025; "TSMC Machine Operator Salaries," Glassdoor, November 11, 2025; and "Manufacturing Technician hourly salaries in the United States at TSMC," Indeed.com, November 11, 2025.

12 "Why the CHIPS Act Is Unlikely to Reduce U.S. Reliance on Asia," Goldman Sachs, October 26, 2022

13 Ibid.

14 *2025 Smart Manufacturing and Operations Survey: Navigating challenges to implementation*, Deloitte Insights, May 1, 2025.

15 *Intelligent manufacturing: A blueprint for creating value through AI-driven transformation*, KPMG, July 2025.

16 Burnham, Kristin, "The 'productivity paradox' of AI adoption in manufacturing firms," MIT Sloan School of Management, July 9, 2025.

17 "How Is AI being used in manufacturing?," IBM.com, September 3, 2024.

18 We define deep learning as a subset of machine learning driven by multi-layered neural networks whose design is inspired by the structure of the human brain. Deep learning models power most state-of-the-art artificial intelligence (AI), from computer vision and generative AI to self-driving cars and robotics.

19 *2025 Smart Manufacturing and Operations Survey: Navigating challenges to implementation*, Deloitte Insights, May 1, 2025.

THEME 2

1 Brynjolfsson, Erik; Chandar, Bharat; and Chen, Ruyu, "Canaries in the Coal Mine? Six Facts about the Recent Employment Effects of Artificial Intelligence," Stanford Digital Economy Lab, November 2025.

2 "An Update to the Demographic Outlook, 2025 to 2055," Congressional Budget Office, September 2025.

3 Bureau of Labor Statistics, Congressional Budget Office, and Wilmington Trust

4 Bureau of Labor Statistics.

5 "Welcome to Zero Migration America," *The Economist*, October 7, 2025.

6 Savchuk, Katia, "A new look at immigrants' outsize contribution to innovation in the U.S.," Stanford Institute for Economic Policy Research, April 14, 2023.

7 Bureau of Economic Analysis, Wilmington Trust.

8 Carolan, Shawn; Martin, Amy; Gong, C.C.; and Borja, Sam, "2025: The State of Consumer AI," Menlo Ventures, June 26, 2025.

9 "The GenAI Divide: The State of AI in Business 2025," MIT NANDA, July 2025.

10 "Business Trends and Outlook Survey," U.S. Census Bureau, updated November 20, 2025.

11 As of November 18, 2025. "Anthropic valued in range of $350 billion following investment deal with Microsoft, Nvidia," CNBC, November 18, 2025; and "OpenAI wraps $6.6 billion share sale at $500 billion valuation," CNBC, October 2, 2025.

12 We define hyperscalers as the largest companies operating and providing cloud services and computing resources for AI via significant scaling of data center resources.

13 Bloomberg.

14 Bloomberg.

15 As of 2024. Bureau of Economic Analysis.

16 *2025 Smart Manufacturing and Operations Survey: Navigating challenges to implementation*, Deloitte Insights, May 1, 2025.

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18 *2025 Smart Manufacturing and Operations Survey: Navigating challenges to implementation*, Deloitte Insights, May 1, 2025.

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22 "Data center market defies early 2025 turbulence," JLL, October 14, 2025.

23 *2024 United States Data Center Energy Usage Report*, Lawrence Berkley National Laboratory, December 20, 2024; and "Tracking the AI Capex Boom," BCA Research Global Investment Strategy, September 25, 2025.

24 "Why Liquid Cooling for AI Data Centers Is Harder Than It Looks," *Forbes*, June 30, 2025.

25 "The 'productivity paradox' of AI adoption in manufacturing firms," MIT Sloan, July 9, 2025.

26 Bloomberg. The tech sector actually fell 26% from February 20, 2025 through April 8, 2025, but the additional 11% was immediately after the announcement of tariffs on April 2.

APPENDIX

THEME 3

1 "Fiscal Monitor (October 2025)," International Monetary Fund.

2 A basis point is one one-hundredth of a percentage point.

3 Furceri, Davide; Goncalves, Carlos; and Li, Hongchi ,"The Impact of Debt and Deficits on Long-Term Interest Rates in the U.S.," International Monetary Fund working paper, July 2025; Neveu, Andre R. and Schafer, Jeffrey, "Revisiting the Relationship Between Debt and Long-Term Interest Rates," Congressional Budget Office working paper, December 2024; and Plante, Michael D.; Richter, Alexander W. ; and Zubairy, Sarah, "Revisiting the Interest Rate Effects of Federal Debt," Federal Reserve Bank of Dallas working paper 2513, April 2025.

4 "The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget," Congressional Budget Office, May 2025.

5 Blanchard, Olivier, "Public Debt and Low Interest Rates," National Bureau of Economic Research working paper 25621, February 2019.

6 U.S. Treasury Monthly Statement of the Public Debt.

7 Bureau of Economic Analysis, U.S. Treasury, Wilmington Trust.

8 Davidovic, Sonja; Ghani, Tarek; and Moszoro, Mariano, "The Rise of Stablecoins and Implications for Treasury Markets," Center for Sustainable Development at Brookings, working paper 195, October 2025.

9 U.S. Treasury International Capital System. Table 5: Major Foreign Holders of Treasury Securities.

10 Ahmed, Rashad and Aldasoro, Inaki, "Stablecoins and safe asset prices," The Bank for International Settlements, BIS working paper No. 1270, May 2025..

11 "The Rise of Stablecoins and Implications for Treasury Markets," Center for Sustainable Development at Brookings, working paper 195, October 2025.

12 Ibid.

13 Ahmed, Rashad and Aldasoro, Inaki, "Stablecoins and safe asset prices," The Bank for International Settlements, BIS working paper No. 1270, May 2025. The largest stablecoin issuers have stated that the three-month Treasury bill is their preferred maturity, though this could change as the market grows.

14 We define fiat currency as money issued by a government and designated as legal tender, but not backed by a physical commodity such as gold or silver. Its value is entirely based on the public's faith and confidence in the issuing government and the stability of its economy, rather than any intrinsic worth.

15 Bloomberg as of October 31, 2025. References 10-year sovereign bond yields.

16 We define bond duration as the measurement of a bond's sensitivity to interest-rate changes, effectively estimating the percentage change in its price for a 1% change in interest rates. A bond with a longer duration is more sensitive to interest-rate fluctuations, meaning its price will fluctuate more than a bond with a shorter duration.

17 Bloomberg as of October 31, 2025.

CONCLUSION

1 Bloomberg as of October 31, 2025.

2 iShares Russell 2000 ETF factsheet, September 30, 2025.

3 iShares Core S&P 500 factsheet, September 30, 2025.

4 "Outlook for private markets 2025: Interest rates higher for longer has important implications for private markets," Apollo Global Management, January 25, 2025.

5 Private funds are available only to certain investors who meet the specific income, experience, and investable assets thresholds set forth by the U.S. Securities and Exchange Commission's definition of accredited investors and/or qualified purchasers as necessary. Investments such as private funds and mutual funds that focus on alternative strategies are subject to increased risk and loss of principal and are not suitable for all investors.

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The gold industry can be significantly affected by international monetary and political developments as well as supply and demand for gold and operational costs associated with mining.

APPENDIX

DEFINITIONS

Capital expenditures (capex) refers to the money an organization or corporate entity spends to buy, maintain, or improve its fixed assets such as buildings, vehicles, equipment, or land.

Cyclically adjusted price-to-earnings ratio is a valuation metric used to assess a company's or the market's long-term financial performance.

Drawdown is a peak-to-trough decline during a specific period, quoted as the percentage between the peak and the subsequent trough.

Earnings multiples are used to quantify a company's growth, productivity, and efficiency, and make comparisons among companies in an effort to find attractive investment opportunities. A multiple may, for example, be used to show how much investors are willing to pay per dollar of earnings, as computed by the price-to-earnings (P/E) ratio.

Effective tariff rate is a weighted-average tariff rate that accounts for the tariff applied to the finished product and imported inputs.

"J-curve" is a plot of an investment's performance versus time where the shape of the plot initially dips to negative values and then recovers to increasingly positive values, thereby producing a pattern resembling the letter "J."

Large-cap stocks are those of public companies whose total market value, or market capitalization value, is more than $10 billion. They are generally considered less risky than small-cap stocks.

The Magnificent Seven stocks are a group of high-performing and influential companies in the U.S. stock market: Alphabet, Amazon, Apple, Tesla, Meta Platforms, Microsoft, and Nvidia.

Market capitalization (market cap) is the value of a company traded on the stock market, calculated by multiplying the total number of shares by the current share price.

Price-to-cash flow (P/CF) ratio compares a company's current market value to its operating cash flow. A lower P/CF indicates a potentially undervalued stock, while a higher ratio might suggest overvaluation.

Price-to-earnings (P/E) ratio measures a company's current share price relative to its earnings per share.

S&P 500 index measures the stock performance of 500 large companies listed on stock exchanges in the U.S. and is one of the most commonly followed equity indices.

S&P 500 Equal Weight Index (EWI) is the equal-weight version of the S&P 500 and includes the same constituents, but each company in the S&P 500 EWI is allocated a fixed weight, or 0.2% of the index total at each quarterly rebalance.

Small-cap stocks are those of public companies whose total market value, or market capitalization, is about $250 million to $2 billion. Small-cap stocks are generally considered riskier and more prone to wide market fluctuations than large-cap stocks.

Super cycle refers to a sustained period of expansion, usually driven by robust growth in demand for products and services.

From left: Meghan Shue, Tony Roth, Luke Tilley

PRINCIPAL AUTHORS

Tony Roth

Chief Investment Officer

Tony chairs the firm's Investment Committee and sets the strategic direction for our asset management activities. He oversees asset allocation, manager research, and portfolio construction to deliver tailored investment solutions for both wealth management and institutional clients. Tony is a frequent contributor to leading financial media outlets, including Bloomberg, Reuters, and Quartz. He also hosts *Capital Considerations with Tony Roth*, an award-winning podcast that explores innovations and trends shaping markets and investment strategy.

Meghan Shue

Chief Investment Strategist

Meghan helps shape Wilmington Trust's investment strategy and asset allocation process, overseeing portfolio construction and implementation across diverse solutions. A recognized thought leader, she regularly appears on CNBC and is frequently quoted by leading financial outlets, sharing insights on economic and market trends. In 2025, Meghan was named to *American Banker's Most Powerful Women in Banking** list, underscoring her influence in the industry.

Luke Tilley

Chief Economist

Luke leads Economics, Asset Allocation & Quantitative Services at Wilmington Trust, using economic insights to guide strategies for client portfolios and help shape the firm's investment approach. A former officer and economic advisor at the Federal Reserve Bank of Philadelphia, Luke is a recognized thought leader whose perspectives on markets and macro trends are regularly featured in top-tier outlets, including CNBC, MarketWatch, Yahoo! Finance, and *The Wall Street Journal*.

* *American Banker* chose and evaluated these female leaders based on their company's financial performance, the scope and impact of their role, their career achievements, and their influence within the finance industry.

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