

Invest Smarter. Live Better.

Bridge Over Troubled Water

Investing in 2025 was an exercise in focusing on major trends while maintaining constant vigilance. Discipline was required amid widespread uncertainty in the markets, the economy, and the geopolitical arena.

While headline equity markets delivered strong returns in 2025, the experience of investing through the year was far more uneven. Geopolitically driven market volatility arrived in sharp bursts, highlighted by the over 21% drop in the S&P 500 from February to April due to the administration's tariff policy announcements. The markets recovered as Donald Trump backed off or reversed many of his proposed tariffs. At a higher level, we are witnessing a global economic order that has defined a lot of our lifetimes give way to a new one.

The environment of disinflation, falling interest rates, and traditional portfolio diversification is being replaced by higher inflation risk and more frequent policy shocks as a new order is created.

Against this backdrop, Avalon client portfolios performed well. Portfolios benefited from meaningful exposure to precious metals as well as U.S. and International equity investments. Within the U.S., client portfolios benefited from stocks in the power, healthcare, semiconductor and technology sectors, as well as international exposure including both developed and emerging market equities. Our performance was further supported by sectors we deliberately avoided, including most real estate and long duration bonds.

Asset Class Returns for 2025



Uncertainty. Everywhere.

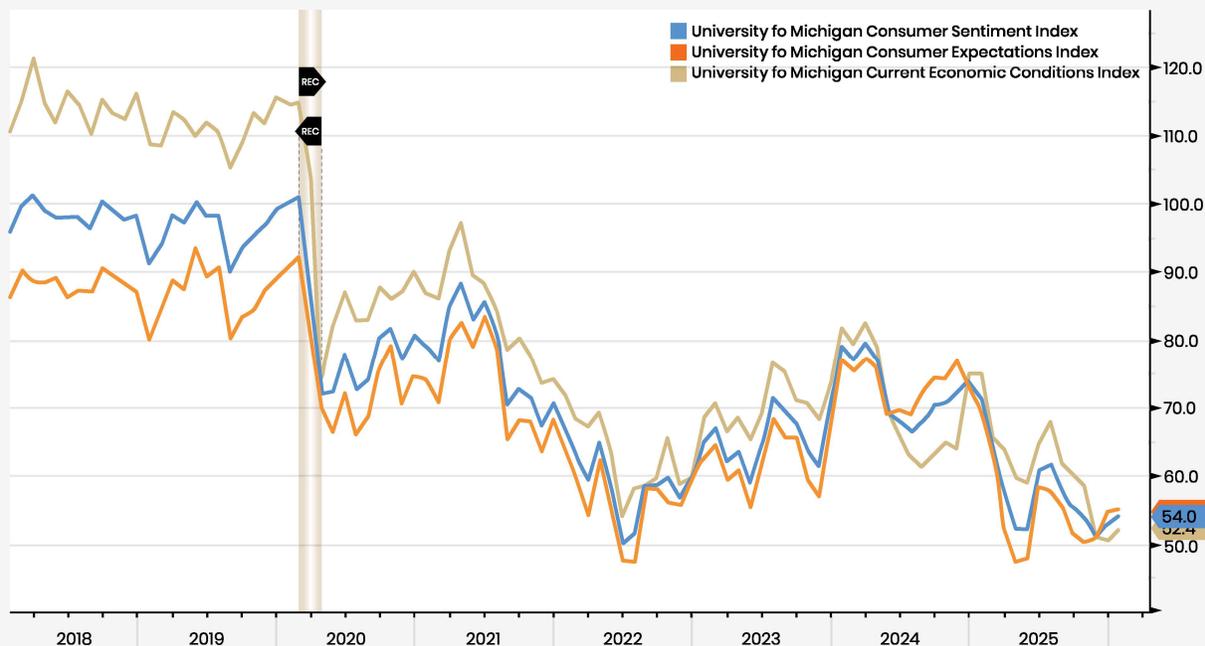
The first year of the second Trump administration has been mostly defined by aggressively smashing the status quo in unexpected ways. We seem to be witnessing the dismantling of the geopolitical structure that has served American interests for the last 80 years. There is an argument to be made that China has taken advantage of the post-World War II order and that the U.S. needs a reset to avoid losing our dominance. There are other narratives that focus on the transactional nature of President Trump and his disdain for both soft power and allies. Whatever the reason for our actions in Venezuela or for our potential involvement with Greenland and Canada, none of it is business as usual.

Both the military incursions and the administration's tariff policy are likely part of a broader plan. However, the market's reaction to these events has been quite different to date. While the market recently shrugged off the extradition of Venezuela's Maduro, one of the defining moments of the year occurred in April as investors reacted swiftly and dramatically

to the administration's Liberation Day tariff announcements. The massive sell-off from the announcement caused the S&P 500 to lose over 16% in 9 trading days. While most equities ultimately recovered, the episode highlighted the role that policy uncertainty will play in this administration.

From an investment perspective, the tariffs were both an unwelcome shock to the global economy as well as the administration's first broadside to accelerate the economic decoupling of the United States from China. We would note that the focus on trade issues has centered around critical national security areas such as semiconductors, rare earth metals, energy, advanced manufacturing, and defense-related supply chains. These are areas that the administration is likely to support (witness the January 8, 2026 announcement to raise the defense budget from \$1 Trillion to \$1.5 Trillion). What continues to be the case is that these actions have done little to positively address the sense of unease felt by most consumers. As measured by the University of Michigan Consumer Sentiment Index, consumer sentiment has decreased almost 30% from a year prior.

Consumer Sentiment Continued to Deteriorate Throughout 2025



Source: Bloomberg

CONSENT Index (University of Michigan Consumer Sentiment Index) Uni Mich Sentiment Monthly 01JAN2018-31JAN2026

This decoupling process is inherently inflationary. Decoupling prioritizes resilience over efficiency. It requires more capital, more redundancy, and higher-cost production. While these changes may support long-term national strategic goals, they also mark a shift away from the disinflationary forces that dominated the global economy for decades. For investors, the significance lies less in the immediate market reaction and more in what it suggests about the direction of the global economy: higher structural inflation, greater demand for real assets, and increased importance of owning businesses with great execution and pricing power.

Precious Metals: A Structural Shift

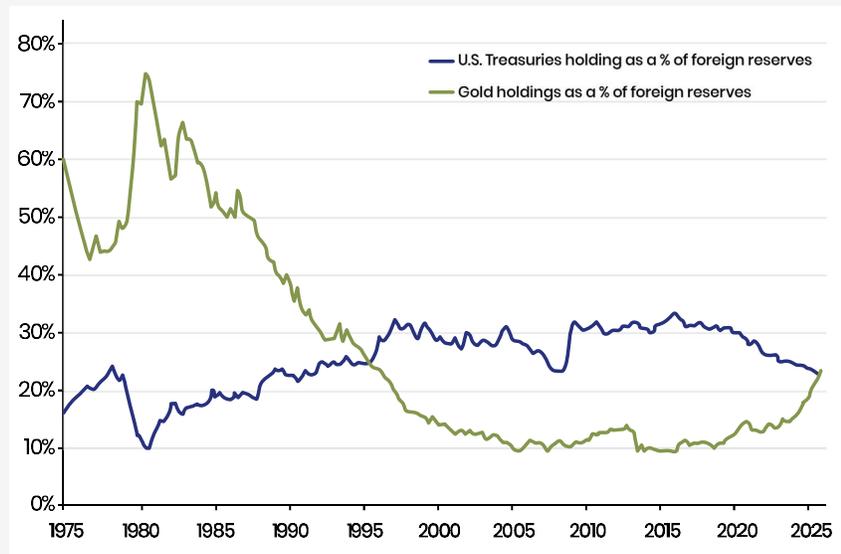
Largely informed by the response to this geopolitical uncertainty, precious metals were among the strongest performing asset classes in 2025. This type of uncertainty has historically been supportive of gold prices and last year's returns were no exception. Gold reached new highs during the year, while silver posted one of its strongest annual performances since the late 1970s.

This strength was driven largely by long-term buyers rather than speculative excess. Led by China, central banks continued to purchase gold at a pace well above their historical average. Similarly, central banks have been selling U.S. Treasuries, reflecting a deliberate effort to diversify reserves amid rising geopolitical tension, trade fragmentation, and expanding fiscal deficits. As the chart below reflects, for the first time in decades, central banks now hold a larger share of their reserves in gold than in U.S. Treasuries.

Despite this, retail participation in gold remains relatively limited. Western gold ETF holdings are still well below prior cycle peaks and represent only a small percentage of household financial assets. With much of gold's advance having occurred without widespread retail enthusiasm, any shift in retail sentiment could provide support for rising gold prices.

As we discussed in our Q3 strategy piece, [Not Our First Rodeo](#), gold continues to provide strong hedging and diversification benefits within our client portfolios.

Foreign Central Banks Hold More Gold Than Treasuries

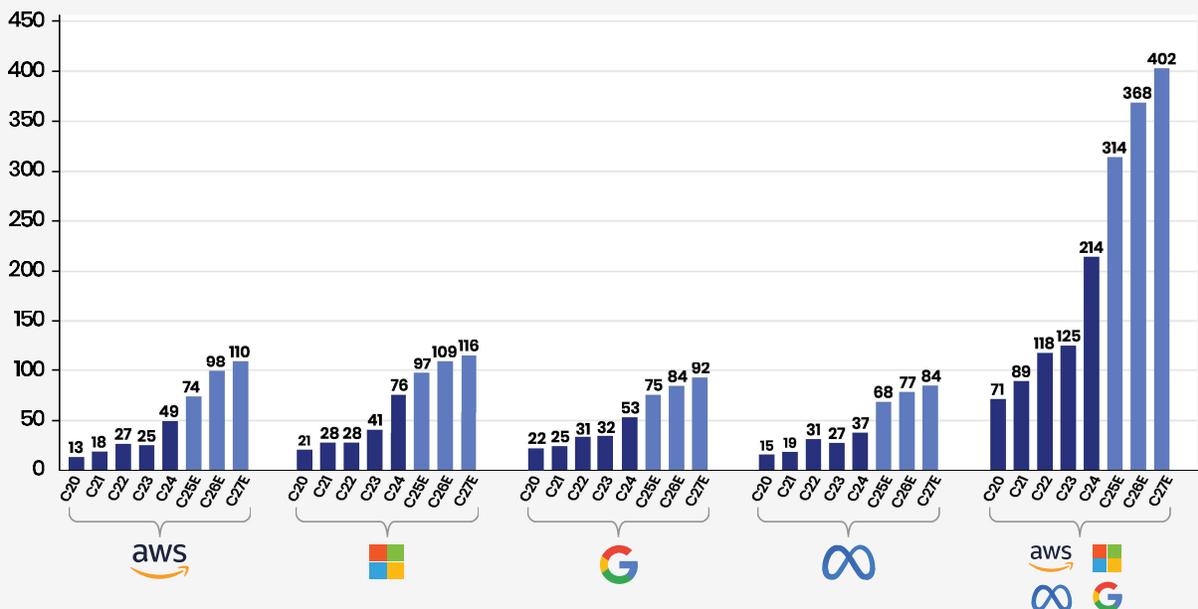


Source: Bloomberg, International Monetary Fund, and Federal Reserve Economic Data (FRED) as of 30 September 2025

Power and Compute: The Constraints Beneath the AI Narrative

Artificial Intelligence dominated market headlines in 2025. We have written about AI in the last several client letters and continue to invest in semiconductors as well as hyperscalers such as Alphabet (Google) that appear to be AI winners.

Hyperscalers Are Spending Massive Amounts in the Race to Win in AI



Source: Goldman Sachs, Company Estimates

AI is energy-intensive. Data centers, semiconductor fabrication, electrification, and defense systems all require large amounts of reliable power. As seen in the chart below, capital spending by major technology companies on data centers and related infrastructure reached record levels during the year and forecast continued increases in the future. While this raises the bar for the major technology companies to generate a return on their large investments, it will place additional strain on already-tight power systems.

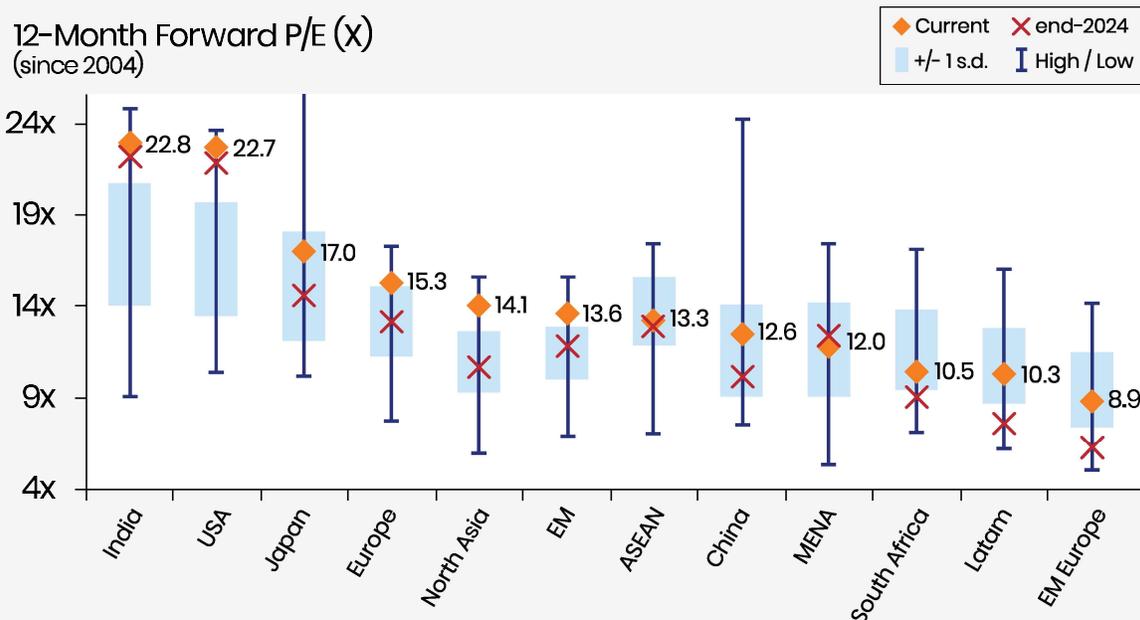
Trade friction and supply-chain reshoring should only intensify this challenge. Domestic production typically requires more energy, more capital, and more redundancy than offshore alternatives. These dynamic benefited assets tied to power generation, uranium, utilities, and energy infrastructure – areas where Avalon client portfolios maintained meaningful exposure.

International Markets: Emerging Opportunities and Currency Tailwinds

International equities played an increasingly important role in 2025, particularly in emerging markets. After more than a decade of U.S. market dominance, relative valuations outside the United States remain meaningfully lower, and earnings growth in several regions has proven more resilient than expected.

Emerging market stocks benefited from a combination of factors, including improving domestic demand, exposure to commodity production, and easing U.S. interest rate policy. In many cases, these economies entered the year with lower debt levels, younger populations and lower stock market valuations. While emerging market stocks broadly rallied more than their U.S. counterpart in 2025, most EM valuations are still well below the U.S., Europe and Japan.

While headline index valuation has increased over the past year, most EM pockets are still trading at a wide discount to U.S. equities and other key regions globally.



Source: FactSet, Goldman Sachs Global Investment Research

Foreign currencies are an important part of this story. As the U.S. dollar weakened over the course of the year, returns from international equities were amplified for U.S.-based investors. When foreign currencies strengthen relative to the dollar, gains in overseas stock markets translate into higher returns once converted back into dollars.

If the dollar continues to face pressure from rising fiscal deficits, trade imbalances, and policy intervention, foreign currency exposure may remain a tailwind for international stocks, particularly in emerging markets.

Pharmaceuticals: Durable Growth in an Uncertain World

Another important contributor within client portfolios during 2025 was healthcare, particularly large-cap pharmaceutical companies with deep pipelines and long product lifecycles. Companies such as Eli Lilly and Amgen reflect what we believe is an enduring theme. Aging populations, rising rates of chronic disease and obesity, and continued advances in biologics, oncology, and metabolic treatments have created sustained demand that is largely independent of economic cycles or trade policy.

In a year marked by tariff uncertainty, supply-chain disruptions, and geopolitical tension, healthcare revenues and cash

flows remained comparatively stable. These companies continued to invest heavily in research while maintaining strong balance sheets and disciplined capital allocation.

Looking Ahead

We began 2025 concerned about the uncertainty and volatility of the markets post Inauguration Day. As we move into 2026, the feeling is much the same. Although the markets ended the year on a high note, investors distrust their successes. While some have hailed the administration's reforms, the anxiety and uncertainty created is significant. Investors face a world that is becoming less efficient, more fragmented, and more capital-intensive. Innovation remains powerful, but the economic backdrop is meaningfully different from the environment of the last several decades. We continue to believe that investing experience matters the most in uncertain times, and portfolios built around large trends, real assets, and global diversification are well suited to this environment. We continue to follow our process, and if you have any questions or would like additional information about our analysis, please do not hesitate to contact us.

Thank you, as always, for your continued trust.



Clara Basile



Ross Revenaugh



VISIT OUR WEBSITE

The opinions expressed are those of Avalon Capital Management as of January 15, 2026 and are subject to change. There is no guarantee that the forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. Investment involves risk of loss, especially in volatile markets. Past performance is no guarantee of future results. Investing in foreign markets involves currency and political risks. Data contained here is obtained from what are considered reliable resources; however, its accuracy, completeness or reliability cannot be guaranteed. Indexes are unmanaged, do not incur fees or expenses, and cannot be invested in directly. Investment strategies such as diversification do not assure a profit and do not protect against losses in a declining market. Other than the research noted by footnotes, the research underlying this piece represents Avalon Capital Management's proprietary research activities. Most indices we mention are well known and full descriptions can be found at Wikipedia.