NBC | SECURITIES

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The 1997 Echo:

Navigating the AI Build-out in a Post-Tariff Economy

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Performance Review & Outlook

1997-Style AI Phase
The AI boom appears analogous to 1997,where transformative technology was real but capital intensity and infrastructure overbuild created hidden investment risks.

Seven-Month Win Streak Snapped
The S&P 500 snapped its multi-month winning streak, but the pause came alongside a healthy rotation in market leadership rather than a deterioration in underlying fundamentals.

AI as a Utility
AI is becoming a universal productivity tool, with the biggest long-term winners likely to be traditional firms using AI to structurally improve margins rather than pure AI sellers.

Yield Curve Normalization
December saw wider yield spreads as the Fed cut rates by 25 bps, pushing short-term yields lower while intermediate and long-term rates moved higher—continuing the long-discussed normalization of the yield curve into year-end.

Disciplined Playbook
The recommended strategy is participation with rigor—maintain target allocations, rebalance gains, and emphasize quality beneficiaries over speculative "arms dealers."

Rates Enter 2026 on Firm Ground
Despite a divided Fed and lingering policy uncertainty, long-term yields rose within forecasted ranges, leaving U.S. bond markets on solid footing and a normalized curve that offers greater flexibility heading into 2026.

Executive Summary

As we transition into 2026, the parallels between the current Artificial Intelligence (AI) boom and the technology cycle of the late 1990s have moved beyond mere observation to a structural framework for portfolio management. While the market faces stretched valuations and macro "fog," the core question for investors is no longer if AI is transformational, but where we sit in the cycle. By examining the "Efficiency Trap" of 1997 and the tactical rebalancing needs of 1999, we provide a roadmap for navigating a phase that demands both participation and extreme discipline.

The "1997 Phase": Innovation vs. Investment Reality

Our central thesis is that we are likely in a "1997-style" phase of the cycle. This is a period where the fundamental promise of a technology (the Internet then, AI now) is being realized, but the infrastructure "arms race" creates hidden risks for investors.

A critical historical parallel is the collapse of Global Crossing. They were correct that internet traffic would explode, but they failed to account for a supply-side breakthrough: Dense Wavelength Division Multiplexing (DWDM). This invention expanded fiber capacity by nearly 10,000% per cable, commoditizing bandwidth overnight. The investment case vanished even as the technology won.

In 2026, we see a similar risk. The "Magnificent Seven" are projected to invest $450 billion in AI infrastructure this year. However, a "DWDM-equivalent" breakthrough—such as a massive leap in algorithmic efficiency or specialized "edge" silicon—could suddenly expand compute capacity to a point where the unit price of AI processing collapses, challenging the returns on these massive capital expenditures.

The Universal Beneficiary: Every Company is an "AI Company"

Just as the late-90s boom eventually led to the realization that "every company is a tech company," we are now entering an era where AI is not a standalone sector, but a universal utility.

- The Productivity Multiplier: Our research has already identified a notable rise in productivity as firms leverage technology to optimize SG&A and improve margins. This is the "hidden" bull case: the greatest long-term winners may not be the companies selling the chips, but the "traditional" companies—in healthcare, manufacturing, and services—that use AI to structurally lower their cost of doing business.

- The "Netscape" Risk: We expect a shakeout similar to the early 2000s. While we will all be beneficiaries of the trillions spent on AI infrastructure, many "AI-first" startups (the Netscapes and Pets.com of this era) will likely disappear as their specialized functions are absorbed into broader platforms like Alphabet's Gemini or internal corporate tools.

The 25-Year Warning: Cisco

We've recently highlighted that S&P 500 valuations at 23x forward earnings are nearing levels last seen during the late-90s. The cautionary tale remains Cisco (CSCO). In 2000, Cisco was the indispensable backbone of the internet, yet it has taken 25 years for the stock to return to its March 2000 highs.

While today's AI leaders have "fortress" balance sheets and are driving real GDP growth (contributing ~0.6 percentage points in early 2025), the Cisco lesson is clear:

> *Winning technology does not always equal a winning stock price if the entry multiple assumes perfection.*

Macro Crosscurrents: The Tariff "Fog"

Unlike the 1990s, the 2026 cycle must navigate the "reciprocal" tariffs we first analyzed in April 2025. These measures act as a "tax on trade" that can catch markets by surprise and introduce headwinds to growth.

We continue to "drive in the fog" due to disrupted government data and diverging views within the Fed. If the AI build-out is met with rising hardware costs due to trade friction, the "digestion period" for this cycle could be more volatile than the mid-90s boom, favoring companies with the pricing power to pass through these costs.

Tactical Conclusion: 1997 or 1999?

The ultimate question for 2026 is one of timing.

- If this is 1997: We may have several years of a substantial, albeit volatile, "run" ahead of us as the technology truly begins to scale.
- If this is 1999: The cycle could stop suddenly as the gap between expectations and reality closes.

The Investor's Playbook

The appropriate response is not to exit the market, but to "play the game" with institutional rigor:

1. Stick to Target Asset Allocations: Do not let the "Fear of Missing Out" (FOMO) drive you into an over-concentrated equity position.

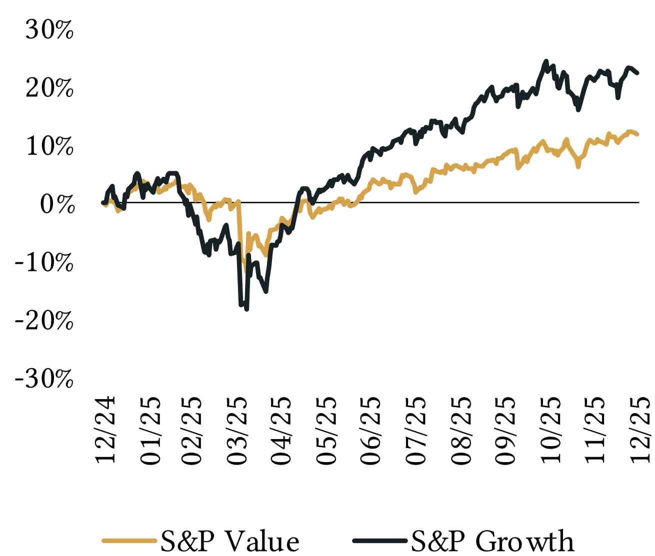
2. Take Gains Along the Way: If you have a position that has moved up 100%, harvest a portion of those gains. Rebalance back to your long-term targets. A good reminder is that a portfolio combining the S&P 500 Value and the Nasdaq 100, initiated in 1996 and rebalanced annually, was approximately 30% larger by 2003 than a comparable portfolio that was never rebalanced.

3. Emphasize Quality: Focus on the "beneficiaries" with proven balance sheets and the ability to leverage AI for margin expansion, rather than just the "arms dealers."

Equity Market Overview:

In December, the S&P 500 and Nasdaq showed modest volatility after a strong year, with both indexes dipping slightly late in the month amid thin, holiday-light trading and cooling tech enthusiasm. The rotation that began in November continued this month, with value and cyclical sectors outperforming growth.

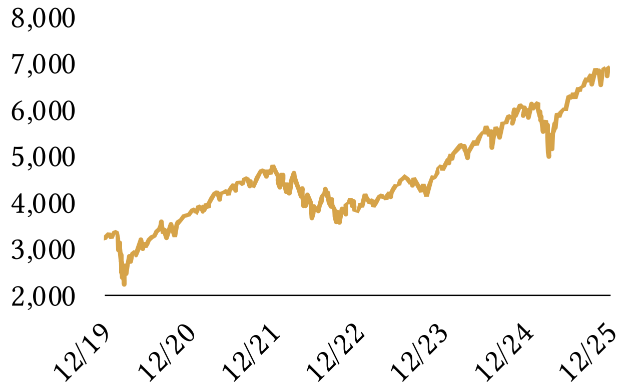
Growth vs. Value



For the full year, equities delivered strong gains, with the S&P 500 up roughly ~17% and the Nasdaq rising about ~21%, extending the multi-year bull market following strong 2023–24 returns and capping a year of record highs despite periodic volatility and macro uncertainty. Growth leadership was concentrated in technology and AI-related mega-caps, which drove much of the market advance and helped the Nasdaq outperform the broader market, though rotation into value and cyclical sectors occurred later in the year as investors weighed stretched valuations and shifting narratives.

We believe the late year rotation is a healthy sign of increasing breadth in the underlying strength of markets.

S&P 500



Sector and Index Performance

The S&P 500 lost momentum late in the month, snapping its seven-month winning streak as thinner holiday trading and cooling enthusiasm weighed on returns. Despite the late-year pause, the index still finished 2025 up nearly 17%, capping a strong annual performance.

Top Index Movers

-0.1%	S&P 500
+0.7%	Dow Jones Industrial Avg.
-0.7%	Nasdaq Composite

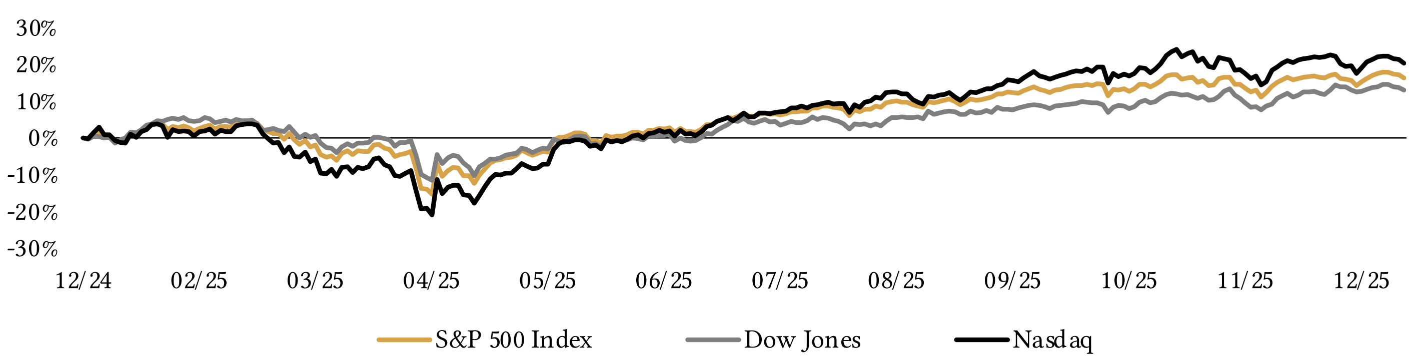
Outperforming Sectors

+3.9%	Financials
+2.7%	Industrials
+2.4%	Materials

Underperforming Sectors

-3.0%	Utilities
-1.8%	Consumer Staples
-1.4%	Real Estate

Index Returns YTD



Fixed Income Market Overview:

The final month of 2025 saw U.S. bond markets experience wider yield spreads, driven in part by the Federal Reserve's decision at the final FOMC meeting of the year to cut its target rate by another 25 basis points, bringing the federal funds target range to 3.50%–3.75%. This widening of spreads is particularly notable as we close out the year.

While short-term U.S. rates (one year and in) declined following the Fed's decision—as anticipated in previous publications—intermediate and long-term rates moved higher. The U.S. 10-year Treasury note began the month at 4.00% and closed December at 4.16%, representing a notable rise in yields despite a Federal Reserve rate cut. Similarly, the U.S. 30-year Treasury bond closed the month at 4.85%, up from 4.65% at the start of December. Both moves remained squarely within our forecasted ranges of 4.00%–4.50% for the 10-year and 4.50%–5.00% for the 30-year.

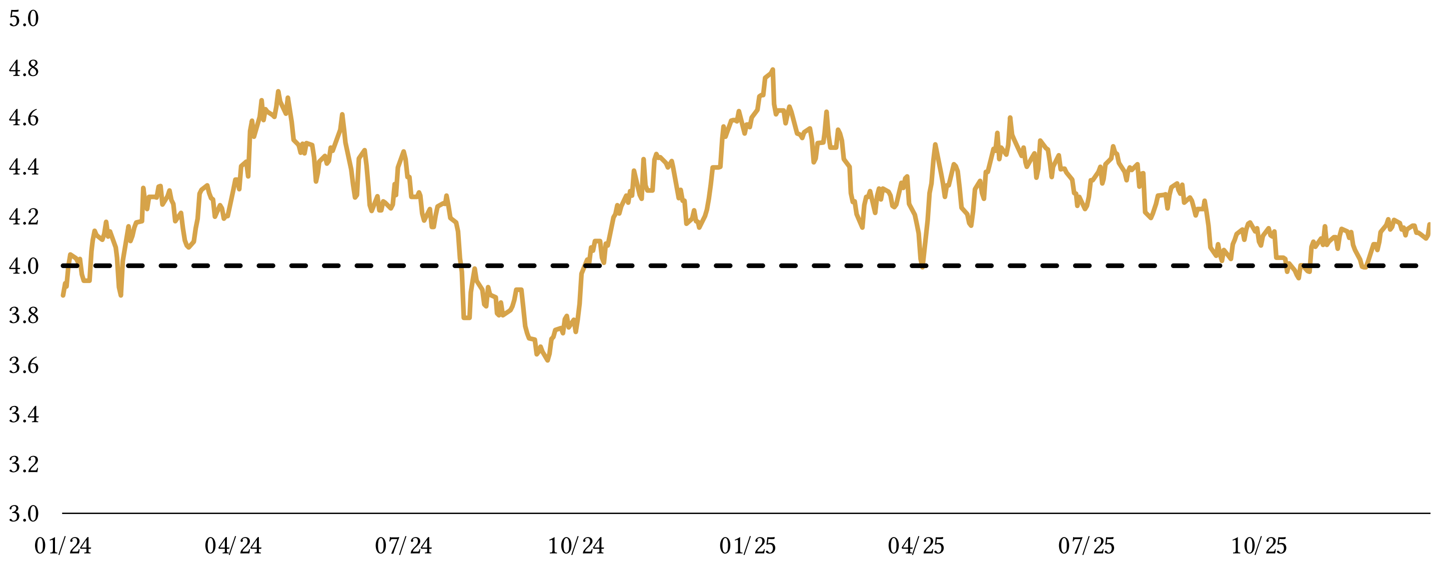
> *This widening spread reflects what NBCSAM has discussed throughout much of 2025: the ongoing normalization of the yield curve.*

Although the Fed did proceed with a rate cut in December, Chair Jerome Powell emphasized that the decision came amid the most divided Federal Reserve in recent years. Powell characterized the move as a "close call," noting that he "could make a case for either side" of the policy decision. In addition, as announced in October, the Fed officially ended its quantitative tightening program, resuming Treasury purchases totaling $40 billion. Powell stated that these purchases would "remain elevated for a few months," and then reduce thereafter.

Looking ahead to 2026, attention has increasingly turned to the future direction of monetary policy and speculation surrounding who President Trump may appoint as Powell's successor. The President has been vocal in his desire to see interest rates fall further. In his post-FOMC press conference, Chair Powell commented, "I really want to turn this job over to whoever replaces me with the economy in really good shape."

As the market enters 2026, the outlook for rate policy remains uncertain, shaped by the competing forces of a softening labor market and renewed inflationary pressures. These dynamics may now be further complicated by political considerations as Powell's term concludes in May 2026. Regardless of the eventual appointment, NBCSAM views the continued normalization and widening of the yield curve as a positive development heading into the new year. A normalized yield curve provides both markets and policymakers with greater flexibility to adjust rate policy as needed to address economic weakness or rising inflation. From a rate perspective, U.S. bond markets enter 2026 on solid footing.

10 Year U.S. Treasury Yield (%)



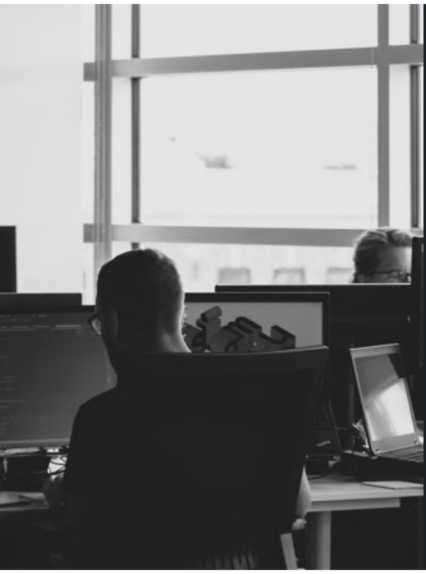
12-Month Percentage Change of Indices

Index (Local Currency)	Level	December	YTD	12 Month
S&P 500	6845.5	0.1%	17.9%	17.9%
Dow Industrials (DJIA)	48063.29	0.9%	14.9%	14.9%
Nasdaq	23241.99	-0.5%	21.2%	21.2%
Russell 2000	2481.907	-0.6%	12.8%	12.8%
U.S. 2yr Treasury	3.473	-0.5%	-18.1%	-16.3%
U.S. 10yr Treasury	4.167	3.8%	-8.8%	0.0%
Gold (NY Spot $/oz)	4319.37	1.9%	64.6%	63.4%
Silver (NY Spot $/oz)	71.6633	26.8%	148.0%	134.0%
Copper ($/metric ton)	9560.24	-14.9%	10.5%	7.5%
Oil (WTI Spot/bbl)	57.42	-1.9%	-19.9%	-15.6%
Oil (Brent Spot/bbl)	60.85	-3.7%	-18.5%	-16.6%
Natural Gas ($/mmBtu)	3.686	-24.0%	1.5%	9.6%

Data as of December 31, 2025. Source: FactSet/Bloomberg

Economic Overview

Key Economic Indicators



JOB MARKET

Employment Report
November non-farm payrolls rose by 64,000, beating economists' median forecast but following a steep 105,000 drop in October that was driven largely by a 157,000 plunge in government employment linked to delayed DOGE-related federal workforce cuts. The unemployment rate unexpectedly climbed to 4.6%, its highest since September 2021. While private-sector hiring has picked up to an average of 75,000 jobs per month since September, gains remain narrowly concentrated in health and education, as manufacturing employment has stagnated since March and now sits at its lowest level since March 2022.

HOUSING MARKET

House Prices
The S&P Cotality Case-Shiller U.S. National Home Price NSA Index showed a ~1.4% annual gain in October, reflecting a persistently sluggish pace of U.S. home price growth in the back half of 2025 and little change from the prior month's ~1.3% increase. This marks one of the weakest annual gains in more than two years, underscoring how elevated mortgage rates and affordability pressures have tempered price appreciation compared with much stronger gains earlier in the cycle.

PERSONAL INCOME & SPENDING

Personal Income & Spending
The PCE report was not released due to the U.S. government shutdown.

Economic Overview

Key Economic Indicators

ECONOMIC GROWTH

GDP Growth
The U.S. economy grew at a robust annualized rate of 4.3% in the third quarter, well above consensus expectations and the prior quarter's 3.8% pace, driven by strong consumer spending, exports, and government outlays despite a decline in investment.

Overall, this report marked the fastest GDP expansion in two years, signaling underlying economic resilience even as the data delays from the government shutdown complicated the release.

INFLATION

Consumer Price Index (CPI)
U.S. inflation cooled more than expected in November, with headline CPI rising 2.7% year over year and core CPI at 2.6%, the lowest since early 2021. A federal government shutdown disrupted data collection, eliminating official monthly figures, though two-month data suggested very modest core inflation. Despite the favorable readings, Fed Chair Jerome Powell and several economists urged caution given data reliability concerns.

Personal Consumption Expenditures (PCE) Price Index
The PCE price index was not released due to the U.S. government shutdown.

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