CMH Wealth Management, LLC

Issue 19

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Annual Returns Last 25 Years	
Year Ending	S&P 500 Index
2025	17.9%
2024	25.0%
2023	26.3%
2022	-18.1%
2021	28.7%
2020	18.4%
2019	31.5%
2018	-4.4%
2017	21.8%
2016	12.0%
2015	1.4%
2014	13.7%
2013	32.4%
2012	16.0%
2011	2.1%
2010	15.1%
2009	26.5%
2008	-37.0%
2007	5.5%
2006	15.8%
2005	4.9%
2004	10.9%
2003	28.7%
2002	-22.1%
2001	-11.9%
Average Annual-ized	**10.4%**

Table Source: Tamarac, S&P Dow

"The Future Isn't What it Used to Be"

Last year we reminded our readers that it remains important to "stay the course". Uncertainty is omnipresent in our daily lives and navigating it successfully can be rewarding in the long term. As Yogi Berra famously quipped, "The future isn't what it used to be"—a reminder that expectations and realities are constantly shifting. In today's environment, adaptability is essential as the pace of change in technology, economics, and policy continues to accelerate. The year 2025 reinforced the value of staying invested through uncertainty. Despite sharp market declines early in the year, equities rebounded to reach new highs. Market cycles often defy short-term fears and valuations alone do not dictate immediate outcomes. Robust earnings growth, strong corporate balance sheets, tax law clarity, and deregulation expectations have provided a solid foundation for continued gains.

A recent economic trend has been the impact of investment in data centers and infrastructure. According to Harvard economist Jason Furman, this accounted for a substantial portion of economic growth in the first half of 2025. Excluding these sectors, GDP growth would have been virtually flat. Regardless, the U.S. economy has shown resilience, with real GDP growth estimates for 2026 in the 1.8–2.3% range (consensus estimates).

Inflation, while still above the Federal Reserve's 2.0% goal, has remained contained even in the face of new tariffs. Year-over-year inflation rates have been moderating with expectations for further declines in housing-related inflation measures.

Meanwhile, the divide in household spending continues to widen, with higher-income consumers driving a disproportionate share of consumption. In addition, a labor market transition, concerns about exuberance in AI stocks, and ongoing tariff uncertainties have fueled recession fears.

The bearish narrative is countered by supportive monetary and fiscal policies. This includes lower interest rates, the passage of the One Big Beautiful Bill Act (OBBBA), expanded tax deductions, stimulus through higher tax refunds, and incentives for capital investment.

The OBBBA is expected to boost capital spending, particularly among small and mid-sized businesses, by allowing immediate write-offs for qualifying investments. This policy shift is designed to encourage growth and hiring, reduce the tax drag on capital expenditures, and support broader economic expansion. While this bill is expected to add $200-300 billion in stimulus for 2026, it is also projected to add $3.4 trillion to the deficit over the next decade, raising important questions about long-term fiscal sustainability. We will provide more color on the bill's details later in this newsletter.

While valuations and the longevity of the current cycle remain key areas of debate, strong artificial intelligence (AI) productivity improvements, supportive fiscal and monetary policy, and solid corporate fundamentals suggest continued opportunity as we move into 2026. Remaining flexible and attentive to changing risks will be key as new opportunities develop.

2026 Portfolio Positioning

Asset Allocation

We began 2025 with a small overweight to equities relative to fixed income as we were cautiously optimistic coming into the year after back-to-back 20%+ return years. As the new administration unveiled their global trade policy, volatility and uncertainty spiked. In the first half of the year we decided to tactically neutralize exposure to equities and fixed income. High quality bonds have continued to provide solid risk adjusted returns. While interest rates have declined and are still at high levels, real rates (rates adjusted for inflation) are now positive. These high rates should provide a ballast to portfolios during risk-off events in equity markets.

Equities

In addition to our constructive view on bonds, we also believe the long term opportunity in equities is extremely compelling. There is caution around U.S. equities based upon the higher than average price/earnings valuation level of 22.0 times vs the average of 17.1 times. It is important to remember higher earnings growth can justify higher valuations and returns. In 2025 75% of the S&P 500 return was justified by earnings. Multiple expansion and dividends drove the other 25% of 2025 returns.

We are also excited about the opportunities within certain sectors/industries exposed to disruptive companies, infrastructure buildouts, and a resilient consumer to name a few. We have built positions over the course of 2025 that we believe will be long-standing beneficiaries of the infrastructure and power buildout. These companies are positioned where demand for reliable power will accelerate as data center capacity scales to support increasing AI workload demands.

We continue to believe that keeping portfolios well diversified and carefully managing tactical weightings is more important than ever. For example, Microsoft has a large weighting in the S&P 500. It is a strong add from both a qualitative and quantitative perspective which typically means an overweight positioning vs the index. We reduce our overweight positioning when the index exposure is large. Microsoft is not a standalone example, but rather one illustration in the large cap equity portfolios.

The US market remains a dominant force with sound, predictable, and reliable rules and regulations. US stocks are still the largest equity exposure in portfolios. Entering a new tax year, we plan to take more profits in large cap US equities and increase the international equity positioning. International equity valuation and growth prospects look more compelling now than they have in prior years.

Asset Class	Current Tactical View
Cash	Neutral. Money market yields are falling but very attractive. While rates had been at the 4% level they are now drifting below 3.5% and may continue to decline.
Fixed Income **Investment Grade** **High Yield**	Neutral. Currently positioned neutral within fixed income in three ways. The current allocation is at longer term strategic targets; neutral interest rate risk; and a neutral allocation toward high yield (higher risk) exposure.
Equity **Large-Cap** **Small & Mid-Cap**	Neutral. Strategically neutral on equities and continue to favor domestic exposure. A slight overweight to domestic large cap equities. A neutral weight to Small & Mid Cap (SMID) equities.
International Equity	An underweight to international equities and maintaining exposure to both developed and emerging market sectors. This is the largest nominal position in years.

Transformational Technology Cycle

Transformational technologies, like AI, historically follow a reliable pattern: initial skepticism, rapid adoption, market enthusiasm, and eventual integration. The current wave of AI-driven investment echoes past capital expansions, such as railroads, radio, internet, and telecom.

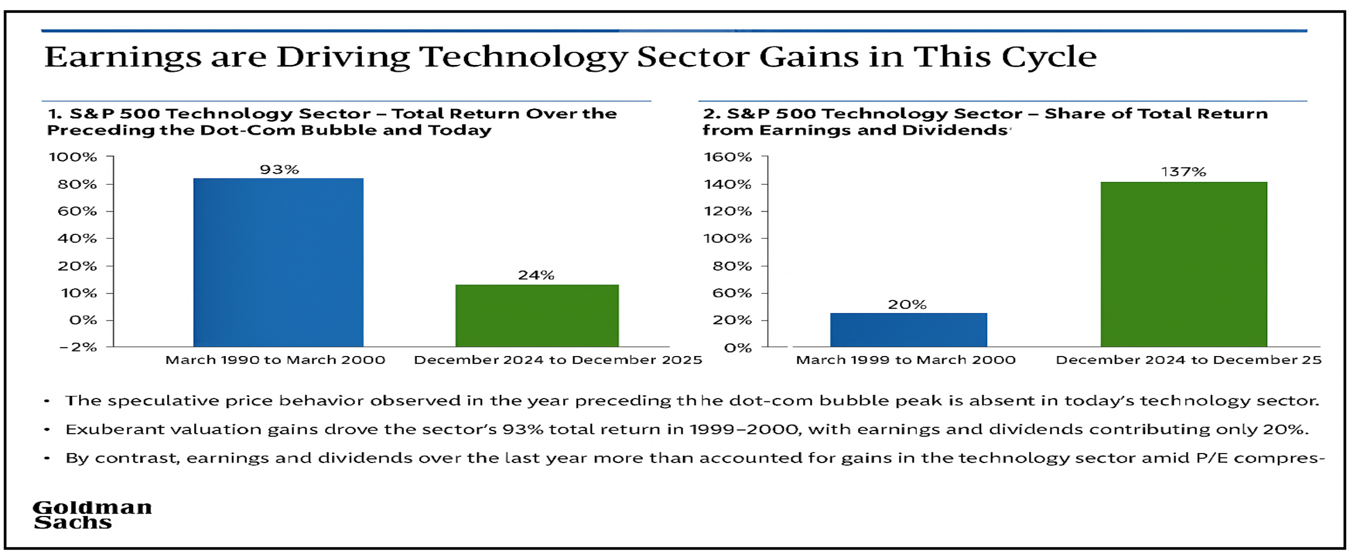
Part of AI's promise lies in productivity gains which are crucial as the US faces slower labor growth and a wave of retirements. Slower labor growth typically leads to less GDP growth over a long horizon unless productivity increases. Vanguard economist Joe Davis has observed that the year 2025 may represent an unprecedented milestone, with the largest cohort of Americans ever reaching age 65. He projects that approximately 16 million baby boomers will retire between now and 2035. The timing of AI's potential productivity gains could be the perfect complement to the ongoing labor force changes.

Historically, technology adoption takes time to impact productivity. For example, electric motors with such promise in their infancy still took decades to deliver measurable benefits. To quote a global economist and AI thought leader Erik Brynjolfsson, "Technology by itself rarely delivers productivity just when you plug it in". As it relates to AI, not all sectors use it uniformly. As usage rates increase, productivity will potentially increase which should impact GDP positively.

Goldman Sachs projects that AI adoption will continue to spread and estimates that it will contribute a 15% boost to U.S. productivity. Given the evident decline in labor supply (aging population, low birth rates, less immigration) a boost to productivity through AI adoption could lead to above trend U.S. GDP growth.

Valuations

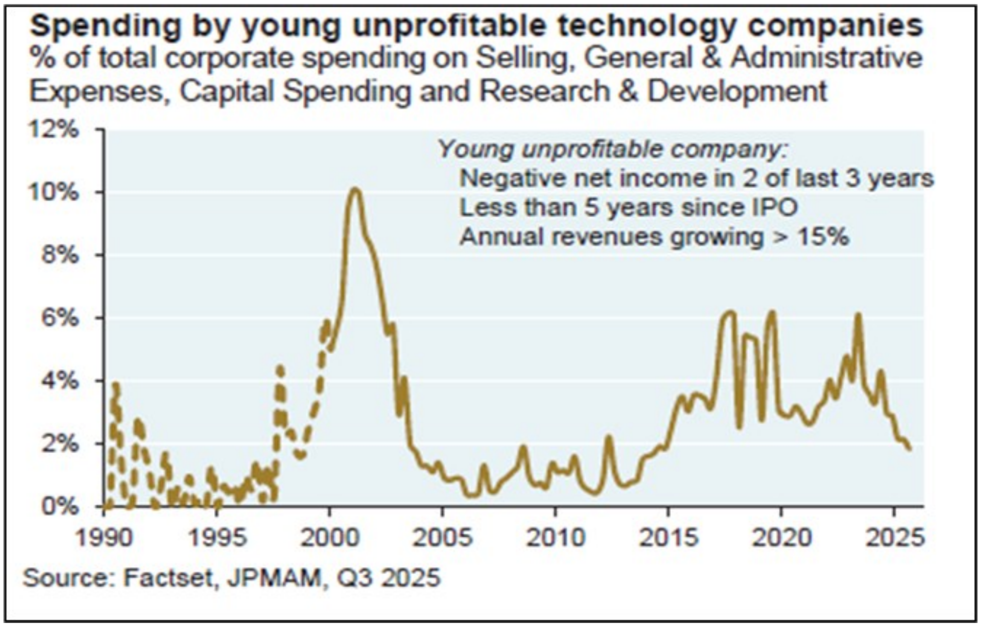
We understand from various sources and research that high momentum and high valuations remain a concern. The chart below highlights momentum is not necessarily at a peak (left side) as market returns are much lower compared to a prior momentum cycle (24% vs 93%). Also, the right side of the chart clearly shows profits and dividends still remain an important driver of recent returns rather than just P/E multiple expansion (137% vs 20%).



Valuations remain roughly half the levels seen at the dot-com peak. US tech PEG ratios (price to earnings relative to a companies growth) are only 1x-3x in recent years compared to 4x-8x in the dotcom era. PEG ratios are a way for investors to value the price of a company relative to its growth. The largest companies driving most of the spending retain healthy balance sheets, strong earnings growth, and continue to finance a majority of their AI spend with operating cash flow.

Transformational Technology Cycle (cont.)

Another way to measure if markets are getting over their skis is through "YUCs", aka young unprofitable companies. When capital spending broadens out to young unprofitable companies, the line between exuberance and speculation often gets blurred. Spending by YUCs is around 2% of all capital expenditures compared to 10% in the dot-com era (chart below). This shows profitable rather than speculative and unprofitable companies are still the driving force behind total spending. Profitable companies have flexibility to decrease spending and increase corporate profits when necessary.



AI has demonstrated the ability to be disruptive in most industries from helping financial services companies with fraud detection, to health care companies engaging in drug discovery, to everyday engagement with large language models like ChatGPT. We believe that we are still in the early innings of a technological supercycle that will be transformative. While the road may be bumpy at times, the buildout will last years and change the way in which humans are industrious. New ways of doing things will replace old, new professions will be created, and new investment opportunities will surface.

Future Winners & Industry Evolution

AI's rapid evolution means today's market leaders may not maintain their dominance. The force of "creative destruction", which we introduced in last year's newsletter, suggests that early leaders in transformative cycles rarely remain at the top. For example, Nvidia rose from the 380th largest S&P 500 company in 2013 to the largest in 2025, reaching a $5 trillion market cap. The next wave of innovation may come from companies that harness AI for productivity improvements, rather than those focused solely on infrastructure.

While the long-term potential of AI is legitimate, markets can overestimate how quickly profits will materialize. AI investment is reshaping the economic landscape, driving massive capital flows, and promising transformative productivity improvements. Risks do remain, including overinvestment, uncertain returns, and the need for broad workforce adaptation. The winners of tomorrow may look very different from today's headline leaders, as the industry shifts from building AI infrastructure to applying AI for real-world efficiency and growth. The narrative of AI may be shifting from "What's Possible" to "What's Profitable and Productive". We are already recognizing companies harnessing AI to increase efficiencies and more importantly reduce expenses while increasing corporate profits.

Strategic Asset Allocation

Introduction

Strategic Asset Allocation (SAA) is the cornerstone of long-term investment success for investors. The asset allocation decision is not only the primary driver of investment returns, but also a reflection of each investor's unique circumstances, goals, and risk profile.

Key Factors in Asset Allocation

1. **Investment Horizon (IH)** Assess how much and when distributions will be needed. For example, a client may require a 2% annual distribution starting in three years, or a 6% distribution immediately, or perhaps no withdrawals for 15 years. The investment horizon shapes the portfolio's time frame and liquidity needs.
2. **Financial Tolerance (FT)** Evaluate the proportion of liquid net worth represented by the portfolio, excluding real estate and business interests. Consider whether emergency funds are available and the rate of annual savings. A portfolio that constitutes 100% of liquid assets, with no emergency reserves, demands a more conservative approach than one representing just 10% of liquid net worth. Irrespective of income level, someone who saves 20% per year may have more financial tolerance flexibility than someone saving 0% or accumulating debt. In short, financial tolerance measures how much risk your financial situation can support.
3. **Risk Tolerance (RT)** Understand the investor's comfort and experience with market volatility. It's crucial to distinguish between theoretical risk appetite and actual behavior during market downturns. Investors can self-assess on a scale from 1 (conservative) to 10 (aggressive), considering their reactions to past declines. In market downturns, is your natural reaction to sell into declining prices or to purchase quality names at lower prices?

The Most Conservative Factor Drives the SAA Decision

Among IH, FT, and RT, the most conservative factor should guide the asset allocation. For instance, even if the investment horizon and financial tolerance allow for an aggressive strategy, a conservative risk tolerance may lead to premature selling during market declines, undermining long-term objectives. Conversely, an aggressive (high) risk tolerance and investment horizon with a conservative (low) financial tolerance (i.e., no emergency funds and tight budget) increases the probability of needing liquidity during downturns, necessitating a more conservative allocation. If financial and risk tolerance are aggressive (high) but the investment horizon is conservative (relying on portfolio for annual budget), the portfolio must be positioned for liquidity needs with a conservative strategy to get through downturns while minimizing principal spending.

Probability and Flexibility

Probability of unexpected expenses—medical needs, major purchases, or limited job security—should influence allocation decisions. Flexibility in spending (e.g., willingness to reduce discretionary expenses or reduce gifting during downturns) can extend the investment horizon and support a more growth-oriented allocation.

Client Goals and Changing Priorities

Goals act as an overlay to the allocation process. Even with high scores in IH, FT, and RT, some investors may prefer to reduce risk after reaching a certain wealth threshold, shifting directionally from aggressive growth toward capital preservation.

Additional Considerations

Real estate and business interests, while excluded from liquid net worth calculations, can impact financial and investment horizons and should not be ignored. The willingness to liquidate properties or rely on business income streams should be factored into the overall strategy. Some business income streams may be perceived as stable and steady, while others may be quite unpredictable and unreliable. These perceptions should feed into the SAA decisions.

Strategic Asset Allocation (cont.)

Relative Measures and Lifestyle Factors
A thoughtful asset allocation process for investors requires a nuanced understanding of the investment horizon, financial tolerance, risk tolerance, and personal goals. By prioritizing the most conservative factor and considering flexibility, lifestyle, and other external assets, advisors can craft strategies that are resilient, tailored, and aligned with long-term objectives.

The table below shows most of the SAA strategies we use:

Strategic Asset Allocation Strategies

Strategy Name	Equity / Fixed Income (%)	Focus / Goal	Risk Level (volatility)
Short Term Investments	0 / 100	Liquidity	Lowest
Current Income	0 / 100	Current Income	Low
Income Growth	25 / 75	Current Income	Low
Balanced Income	40 / 60	Income then Growth	Moderate
Balanced	50 / 50	Growth & Income	Moderate
Balanced Growth	60 / 40	Growth then Income	Moderate
Growth	75 / 25	Growth	Higher
All Equity	100 / 0	Capital Appreciation	Highest

Myths and Clarifications

Asset allocation decisions are made per account not per person. One investor can have multiple portfolios serving different purposes with different strategies. You may have a conservative/moderately positioned liquidity portfolio, a more moderate/higher risk retirement portfolio, a Roth IRA, or an irrevocable trust outside of your estate all with different strategies.

Distribution rates should be thought of in both dollar and percentage terms. A $40,000 distribution on a $1.0 million portfolio is 4%. If the portfolio becomes $900,000 or $1,100,000 will you take the same $40,000 or do you have the flexibility to increase / decrease the distribution rate? This gives you financial flexibility if you can adjust.

Age is not a determinant of your strategy and does not dictate being conservative or aggressive with your investments. Age leads to lifestyle questions; do you need money to buy a house? Do you have college debt or do you need to save for a child's college expenses? Will you retire soon and lose an income source? Will you ever spend these funds or are they for the next generation, etc?

High income does not automatically equate to a high financial tolerance; savings behavior and debt levels are critical on this topic. Does making $500,000 per year instead of $250,000 per year change your strategy? No. If you make $250k and can save 20% per year you may have a higher financial tolerance than making $500k but spending 100% of it or using a line of credit.

One Big Beautiful Bill Act (OBBBA) Highlights

The 2025 Federal Tax Reform: What It Means for Your Financial Plan

The One Big Beautiful Bill Act (OBBBA) enacted on July 4th 2025, introduces sweeping and, in many cases, permanent changes to the tax code. For individuals and families, the bill emphasizes certainty, expanded deductions, and targeted relief for retirees, working households, and business owners. Several provisions revive or enhance familiar tax benefits, while others introduce entirely new planning opportunities.

Deductions & Exemptions

- Personal exemptions permanently repealed
- Extra senior deduction (Temporary 2025–2028)
    - $6,000 per person in addition to standard deduction (Age 65+)
    - Phased out at higher income levels

Families & Education

- Child Tax Credit increased to $2,200 and indexed thereafter (2025)
- 529 plans expanded
    - Expanded eligible expenses to include workforce training and industry recognized licenses
    - $20k cap on eligible K-12 expenses for tax-free distributions
- "Trump Accounts" (new tax-exempt savings vehicle)
    - For children under age 8 at account opening
    - $1,000 federal seed credit (for children born 2025–2028)
    - $5,000 annual contribution limit; contributions end at age 18

Income & Business Planning

- Section 199A (QBI) deduction made permanent
    - 20% deduction preserved
    - Expanded phase-out ranges (mostly effective 2026+)
    - Roth conversion planning opportunities
- No tax on tips & overtime (temporary) Effective 2025–2028 (income phased)
    - Tips: up to $25,000 deduction
    - Overtime: up to $12.5 single/$25k MFJ

Estate & Wealth Transfer

- Federal Estate, Gift & GST Exclusion made permanent
    - $13.99M in 2025; $15M in 2026 (indexed thereafter)

Housing & Debt

- Mortgage interest rules made permanent
    - $750,000 acquisition debt limit retained
    - HELOC interest deductible only for acquisition or improvement
    - Mortgage insurance premiums deductible again
- Auto loan interest deduction (new)
    - New U.S.-assembled vehicles only
    - Up to $10,000 deduction (income-phased). Available 2025–2028

Charitable Giving

- Above-the-line charitable deduction
    - Up to $2,000 MFJ without itemizing
    - Cash gifts only; no DAFs or foundations
- Itemized charitable deductions enhanced
    - Cash gifts deductible up to 60% of income
    - Contributions must exceed 0.5% of AGI
    - Overall itemized deduction value capped at 35%

State & Local Taxes (SALT)

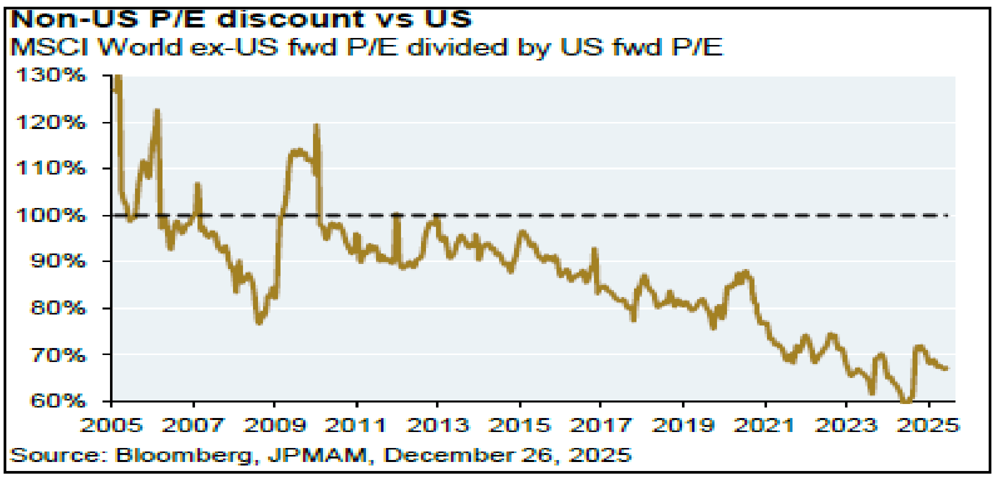
- Deduction cap temporarily increased:
    - $40,000 for years 2025–2028
    - Reverts to $10,000 beginning 2029
    - Income-based phase-out for high earners

Opportunities Ahead

The stock market has experienced a strong rally over the past three years following the 2022 lows. The S&P 500 delivered returns of 25.0%, 26.3%, and 17.9% from 2023 through 2025. This represents a remarkable recovery in a relatively short period of time.

Tactical asset allocation positioning is shorter term in nature. We manage these changes and make the overweight and underweight asset class decisions at the portfolio level. They consider relative value between asset classes and risk vs reward characteristics. They are focused on market characteristics over the next 1-3 years vs strategic decisions focused on 3-10 years. One of those tactical decisions is the recent increase in international equity exposure.

We leave you here with one final chart below. As the Price/Earnings divisor line drops below 100%, it reflects a cheaper global market based upon P/E alone (not taking into account growth expectations). While this measure of valuations shows the international equity asset class has been cheap the last 15 years, it is a reminder that valuations are not the only driver of short and long-term returns.



We enter 2026 with economic support from multiple layers including fiscal support through tax policy, monetary support through lower interest rates, productivity improvements, and strong corporate profit growth.

When you have the 'best-fit' strategic asset allocation for each of your portfolios, the return profile should match your expectations in most markets. This allows you to get through a down market with some cushion and then experience the upside in good markets as well.

Wishing you a Healthy and Happy New Year!

The CMH Wealth Team

Sources include: Rosenberg Research, Various 2025 Issues. Vanguard, *Economic and Market Outlook for 2026: AI exuberance: Economic upside, stock market downside*, December 2025. Howard Marks Memo, *Is It a Bubble?*, December 2025. Barron's, *Beyond AI: How Markets Can Keep Moving Up in 2026*, December 15, 2025. Barron's, *The US Economy Is Poised to Grow Faster in 2026*, December 15, 2025. Barron's, *How the Stock Marktet's Rally Can Keep Going in 2026-and What to Buy Now*, December 12, 2025. Barron's, *Can AI Make The US More Efficient? Not Fast Enough*, December 8, 2025. T. Rowe Price, *2026 Global Markets Outlook: Minds, machines, and market shifts*, November 2025. Goldman Sachs, *Investment Outlook 2026: Seeking Catalysts Amid Complexity*, November 18, 2025. Goldman Sachs, *Top of Mind, AI: In A Bubble?*, October 22, 2025. J.P. Morgan, *Year Ahead Outlook*, December 3, 2025. J.P Morgan, *Eye On The Market*, January 1, 2026. BlackRock, *2026 Global Outlook: Pushing Limits*, December 2, 2025. Kitces, *10 Charts Showing Top 10 Market Themes For Client Conversations In Q4 2025*, October 1, 2025. Irs.gov, One Big Beautiful Bill Provisions, December 29, 2025. Data source providers include FactSet, S&P Dow Jones, Tamarac, and providers to.