The ADVISOR

Focus on Community Banking Issues

First Quarter 2026

ECONOMIC ENVIRONMENT

A Balancing Act

Entering the new year, we see an optimistic, though increasingly nuanced economic landscape. Negativity in the labor market is being offset by heightened corporate investment and a resilient consumer, which creates a questionable path for monetary policy among a divided Fed. Inflation appears under control, but upside risks remain in place. We believe the U.S. economy will continue to exhibit strength, but the path may be less linear than in prior years.

'Low Hire, Low Fire'

The job market is clearly weakening, as late 2025 brought a hiring slowdown characterized by sizeable downward revisions to prior months. For context, last year's pace of job growth was the slowest non-recession year since 2003, with the revisions carrying added weight due to the government shutdown that significantly disrupted data collection. However, while this may sound scary at surface level, we believe conditions are far from dire. Unemployment only rose modestly in 2025 (4.0% to 4.4%), and wage growth continued at a modest pace, implying that employers are being more cautious with hiring rather than aggressively laying off workers. The prioritization of productivity and efficiency partly reflects increasing AI integration, which is prompting companies to reassess roles and workflows. Importantly, we do not believe this dynamic will cause permanent job destruction because much like the internet, AI adoption will likely lead to new jobs over time.

We expect this 'low hire, low fire' environment to continue, where the focus on efficiency gains will likely steer employers away from new hiring without widespread job loss. While this scenario avoids outright collapse or recession, it may give the Fed adequate justification to cautiously cut rates midway through the year.

EPG RATE OUTLOOK

January 2026

MARKET RATE	Actual (%) 12/31/2025	Projected (%) 12/31/2026	Yr1 Δ	Projected (%) 12/31/2027	Yr2 Δ
FedFunds	3.75	3.50	-0.25	3.50	0.00
Prime	6.75	6.50	-0.25	6.50	0.00
3mthTsy	3.67	3.55	-0.12	3.70	0.15
6mthTsy	3.59	3.60	0.01	3.80	0.20
1yrTsy	3.48	3.65	0.17	3.90	0.25
2yrTsy	3.47	3.70	0.23	3.95	0.25
3yrTsy	3.55	3.75	0.20	4.00	0.25
5yrTsy	3.73	3.80	0.07	4.05	0.25
10yrTsy	4.18	3.90	-0.28	4.15	0.25
30yrTsy	4.84	4.25	-0.59	4.50	0.25

RATE OUTLOOK DESCRIPTION:

This represents EPG's current view of interest rates.
Depending on the actual timing of the ALM meeting, the outlook may be altered and/or updated.
For the most accurate current rate outlook, please call EPG, Inc. at (781) 235-2666.

Features

Economic Environment:

- Overall, the Economic Outlook is Positive.

Fixed Income Strategy:

- Don't Expect Additional Aggressive Fed Easing.

Equity Strategy:

- Can the Run in Equities Continue into 2026?

ALM Strategy:

- Product Pricing Given an Uncertain Rate Outlook in mid'26.

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ECONOMIC ENVIRONMENT

Corporate Investment Provides a Backstop for GDP Growth

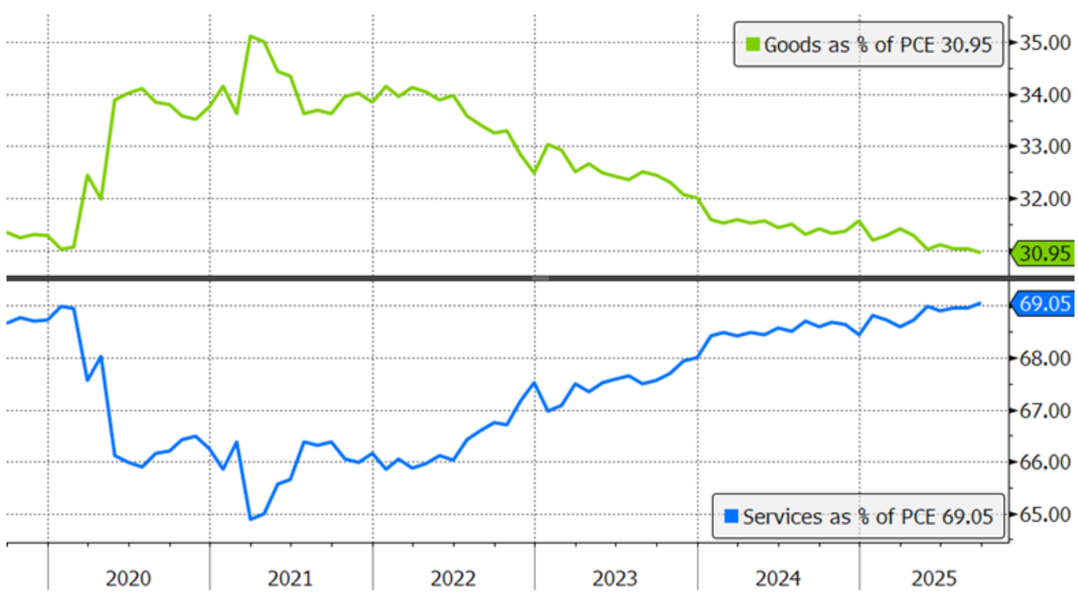
As signs of labor market cooling and potentially softer consumer momentum persist, one might ask why economists are still projecting sturdy GDP growth in 2026. The answer lies within a trend that began last year; corporate investment spending, particularly in the technology space, is taking over as the primary growth driver of the previously consumer-led economic expansion. This wave of investment is being driven by a unique alignment of technological need and accommodative fiscal policy. Massive demand for AI services, cloud computing, and semiconductors are forcing companies to invest in tech infrastructure to support increasing scale and productivity requirements. Additionally, fiscal policy is encouraging domestic investment through tax incentives and subsidies, causing companies to accelerate capital spending decisions. Overall, we believe the corporate investment influx reduces the risk that a declining labor market translates into recession by insulating GDP growth. Over the longer term, the incremental benefits of technological innovation should extend the period of economic expansion.

A 'K-Shaped' Consumer

Amid a backdrop of slowing job growth and mixed consumer sentiment, aggregate spending patterns remain strong, and economists are still maintaining a positive tone. But why? The most likely answer reflects the narrative of a 'K-shaped' economy, or the growing divide between higher and lower-income earning Americans. Years of strong stock market performance, rising home values, and concentrated equity ownership are creating a wealth effect that is sustaining discretionary spending for affluent households, even as wage growth continues to taper. Moody's Analytics notes that the top 10% of earners now account for 49-50% of all spending, a historically elevated percentage which shows the 'aggregate' consumer economy does not reflect reality for all Americans. Lower and middle income consumers feel the effects of cumulative inflation to a much greater extent and tend to own fewer earning assets, leading to more selective spending among these groups when the labor market contracts.

Simultaneously, consumer preferences continue to shift from goods (cars, appliances) to

Services Have Become a Larger Percentage of PCE Spending Since 2021



Source: Bloomberg

services (travel, entertainment, experiences). This points to more stability than explosive growth, as durable goods purchases are more sensitive to interest rates and consumer confidence than services spending. In conjunction with increased spending from a group less sensitive to labor market conditions, one could make the argument that the 'aggregate' outlook may be more stable than in past cycles, though likely slower growing as many households remain under financial pressure.

A Muddy Inflation Picture

While headline inflation has continued to moderate, the outlook for pricing pressures remains a key swing factor for both Fed policy and consumer spending. Year-over-year CPI is stabilizing in the mid-2% range, but hotter than expected PPI readings and upward revisions paint an uneven forward-looking picture in the context of renewed tariff threats. This divergence is likely to keep Fed officials in data-dependent mode for now, particularly as shelter costs and services inflation remain sticky. Furthermore, loose fiscal policy (deficit financing, spending bills, corporate tax subsidies) only adds to inflationary risk and could cause a cascading effect if the Fed simultaneously lowers rates. This being said, the Fed continues to reinforce that inflation is still high enough to limit rate cuts unless labor market conditions deteriorate significantly further.

EPG Rate Outlook

Growing dispersion of opinions among Fed voting members, the likelihood of a new Chair in May, and conflicting economic indicators point to a murky-at-best consensus for 2026 monetary policy, despite three consecutive 25-basis point rate cuts. Fed fund futures are currently pricing about 50 basis points of cuts this year, with the first coming in the June-July window. We expect one 25-basis point cut in June to achieve a terminal funds rate of 3.50%. Our outlook reflects a labor market continuing to soften modestly, relatively stable consumer spending, and controlled inflation, warranting cautious easing to prevent an economic downturn.

That said, the division within the Fed itself implies that any material shift in economic sentiment could sharply swing the consensus, which leads us to expect a heavily data-dependent posture going forward. We anticipate the broader yield curve to gradually steepen over time, with the monetary easing complemented by a rangebound longer-end as inflation remains anchored and investment-led growth supports demand without overheating the economy. ◆

FIXED INCOME STRATEGY

A Dissenting FOMC Panel, Political Interference, and Mixed Economic Data Could Taper Policy Expectations

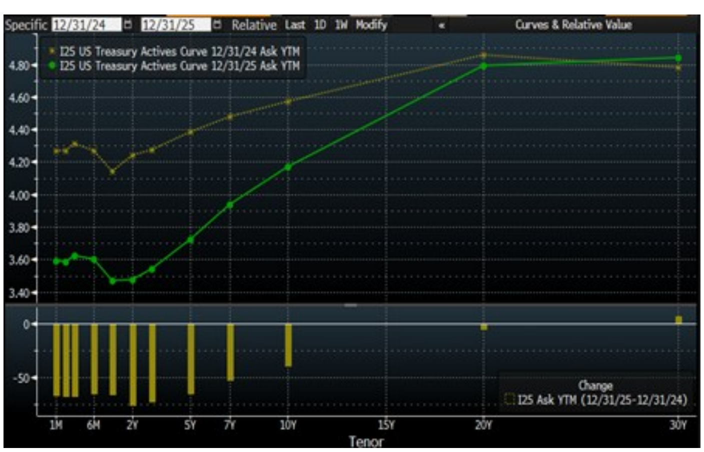
Even if politicians get what they want in a new Fed chair this year, it is quite possible they do not get the monetary policy adjustments they desire, as the Federal Reserve sets policy by consensus, not on demand. Given recent economic data and a split committee backdrop, aggressive easing appears unlikely in the coming months unless incoming data clearly justifies such a shift. While inflation has been trending lower over the last few months, it still remains above the Fed's long-term target. At the same time, the labor market has shown signs of cooling, but absent a meaningful deterioration. In this environment, the FOMC's default position with monetary policy will likely be a cautious approach. An interest rate cut appears to be on the horizon, but aggressive cutting seems like a stretch in the short term with Powell's hawkish bias. An economy that grew at a 4.4% annualized pace in Q3, well above initial estimates, suggests more optimism than economists and traders were anticipating.

There is a growing perception that the newly appointed Fed Chair taking office this May could immediately reset the path and direction of monetary policy. In practice, the Federal Reserve Chair does not have the authority to single handedly alter the framework established by the current Governors and the broader committee, as monetary policy is inherently a consensus, team-driven process.

While expectations suggest that a Trump-appointed Chair will likely adopt a dovish economic outlook, the current composition of the FOMC leans towards the hawkish side. Against that backdrop, any attempt to implement rapid rate cuts shortly after a leadership transition would be difficult to understand based on the current Committee's prevailing bias. Such a move would inevitably invite speculation about the independence of the institution and the degree to which political considerations could be influencing decision-making.

According to the December dot plot, policy makers only see one rate cut in 2026, followed by one additional rate cut in 2027. We were surprised there was no change with the dot plot in December, with the government shutdown expected to soften labor conditions further and weaken the U.S. economy. However, the unchanged FOMC rate outlook for 2026 infers that policy makers are comfortable with the level of rates and pace of easing. With this as the baseline outlook for the economy, it leads us to believe

Yield Curve 12/31/2024 - 12/31/2025



Source: Bloomberg

Yield Curve Change for 2025

Term	12/31/2024	12/31/2025	Change
2 Year	4.24	3.47	-0.77
3 Year	4.27	3.54	-0.73
5 Year	4.38	3.73	-0.66
7 Year	4.48	3.94	-0.54
10 Year	4.57	4.17	-0.40
20 Year	4.86	4.79	-0.07
30 Year	4.78	4.84	0.06

policy makers would need to see weaker conditions to validate more easing than is already priced into the market today.

The Investment Committee believes it would be difficult for a new chair to override the committee and pursue a more aggressive path of rate cuts, as doing so would raise further questions about the independence of monetary policy decision-making. Moreover, managing the dual mandate of maximum employment and price stability should remain the primary focus. While the labor market softened in 2025, it is far from collapsing. In fact, the unemployment rate unexpectedly declined by 0.2 percentage points to 4.4% in December, surprising many economists. The Fed is signaling limited easing, while leadership will be changing and Powell and committee are under intense political pressure to cut more.

Fannie Mae and Freddie Mac Give MBS a Boost with Purchase Program

In mid-January President Trump asked his representatives at Fannie Mae and Freddie Mac to purchase $200 billion in Agency MBS with the goal of lowering mortgage rates. Housing affordability has become problematic, according to the National Association of Home Builders. Home valuations have increased by nearly 55% nationwide since the first quarter of 2020 while mortgage rates have doubled during the same time frame and now hover near 6.0% after the announcement.

As a result of the purchase program, spreads across mortgage products have tightened, minimizing the additional risk premium that MBS offer over U.S. Treasury securities. Mortgages still offer relative value opportunities in comparison to other comparable high-quality sectors, as credit spreads remain firm. Looking ahead, it is likely that additional stimulus programs could be introduced in an attempt to further improve housing affordability and support lower mortgage rates.

Corporate and Municipal spreads remain on the lower end of their historical averages. At the same time, corporate bond issuance has accelerated to begin the year. With the longer end of the yield curve remaining above 4.0%, incremental investments at these levels should be accretive to existing balance sheets given current portfolio construction for many institutions. ◆

Historical 30 Year Mortgage Yield – 10 Year Treasury Spread Relationship

Source: Bloomberg

EQUITY STRATEGY

EQUITY STRATEGY

Equity Investing: 2025's Initial Uncertainty Ends With Exceeded Expectations

Despite the uncertainty that most investors felt in spring of 2025 due to tariff and policy actions that drove a decline in equity values, the markets recovered and provided attractive returns. Investors focused ultimately on the positives of stable and growing corporate earnings and the actual impact of tariffs being less than feared, to date. The market rebound of 2025 off of spring lows was impressive, with the S&P index returning over 16% for the year. This three-year run of double-digit gains sets the stage for 2026 market optimism.

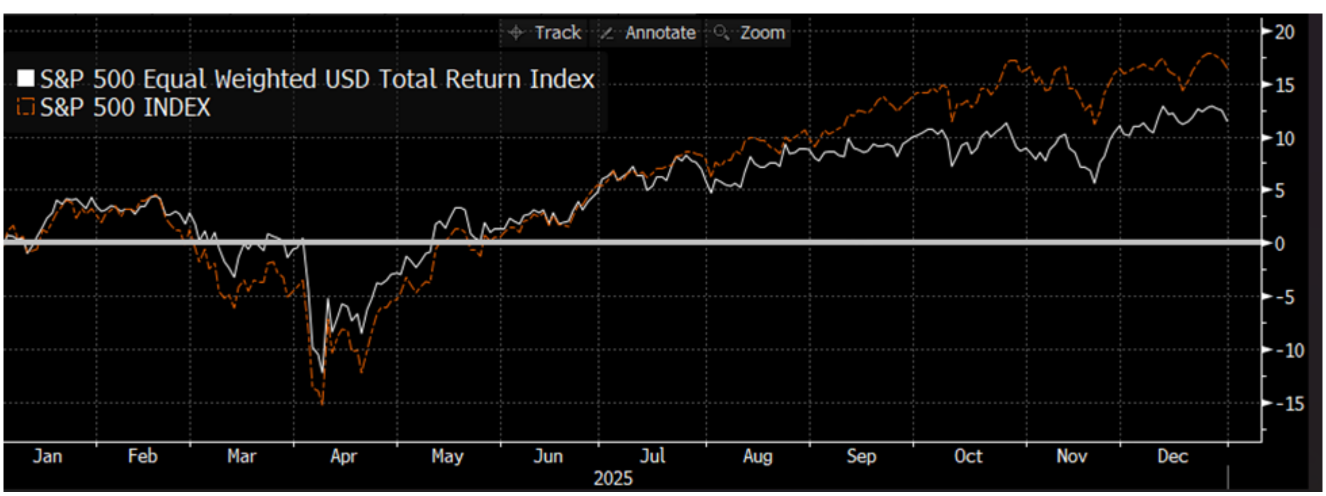
As we enter 2026, the economy is showing continued strength, albeit with rising concerns related to factors that could cause volatility and potential pullback. Market concentration in technology leaders with a particular focus on AI has contributed heavily to market index appreciation. These mega-cap stocks (the magnificent seven) have lifted index performance but even given this fact, the equally weighted S&P 500 performance has been positive as well, with the chart below comparing their 2025 performance. Price earnings ratios are a fundamental tool investors use to develop a view of where a company stock price may head. While 2025 created a valuation focus given the pullback initially experienced, actual earnings growth combined with growth that exceeds expectations continues to be an important focus point for investors.

Current valuations reflect an optimistic outlook for corporate earnings and with it, a "higher bar" that actual earnings must meet. This applies not just to a narrow band of "mega tech" companies but also to the broader market. In addition, interest rates matter. A continued easing posture by the Fed in 2026 is a scenario that many investors are relying on to help boost the market going forward. However, a reacceleration in inflation that keeps the Fed on the sidelines would put material pressure on equity markets and at a minimum, create volatility.

Broad Equity Participation

With economic data showing consistent momentum, attractive corporate profits and lower interest rates, positive earnings reports are expected to continue for a broad base of stocks. Favorable tax and monetary policy, continued productivity benefits derived

2025 Performance: S&P 500 vs. Equal-Weighted S&P



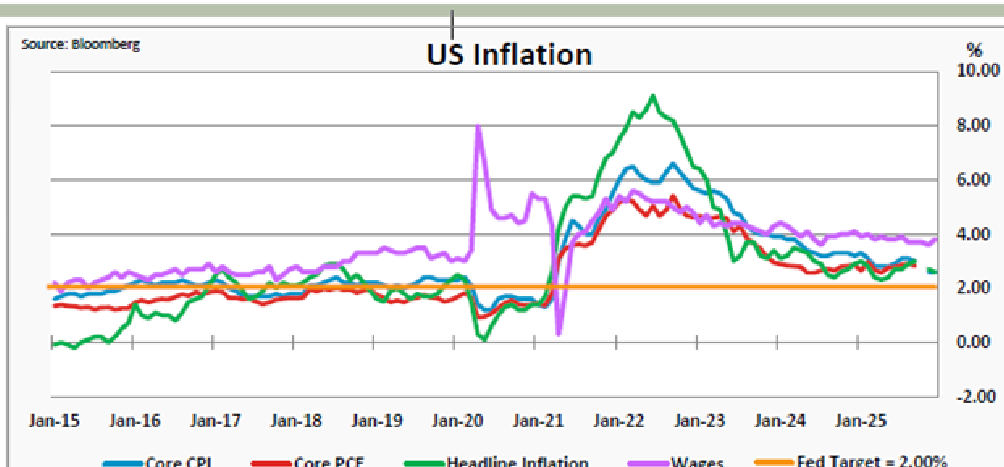
Source: Bloomberg

EQUITY STRATEGY

from technology and AI, and positive investor sentiment are factors noted further supporting positive equity price appreciation. Industrials, consumer discretionary, and health care stocks are showing this positive impact.

Profitable Growth is Key

Companies that are exhibiting not just growth, but profitable growth are taking center stage. Efficient, attractive margin models help ensure ongoing and measurable profitability. Technology will continue to partner with strong leadership and strong fundamentals to drive this model. As always, demand for products and services is the ultimate goal, and relies on consumer spending and sentiment. Several important factors that could create pressure on corporate earnings circulate around the consumer. Job growth is softening, with many suggesting this economy is a “jobless economy,” where productivity gains from technology and AI, combined with corporate cost cutting, diminishes the need to hire. Inflation resurgence would also create headwinds that could cause market volatility as concerns related to inflation’s impact on profitability and consumer spending would resurface. This resurgence could occur due to tariff related costs coming in higher than now assumed. Finally, geopolitical tensions and political uncertainty could contribute to a more defensive investor posture. If economic growth slows sufficiently to cause a renewed cautious focus on valuations and projected earnings growth rates, this would also likely create volatility and periods of equity markets stagnation. ◆



	Latest	Maximum		Minimum		Average	2025 Avg.
Core CPI (Dec'25)	2.60	6.60	Sep-22	0.60	Oct-10	2.49	2.92
Core PCE (Nov'25)	2.80	5.42	Sep-22	0.93	Dec-10	2.12	2.78
Headline (Dec'25)	2.60	9.10	Jun-22	-2.10	Jul-09	2.52	2.68
Wage Growth (Dec'25)	3.80	8.00	Apr-20	0.30	Apr-21	3.10	3.80

December 2025: Core CPI at 2.6%, equal to November.

ALM STRATEGY

ALM STRATEGY

The Implications of Fed Uncertainty on Balance Sheet Strategy

Yes, it does feel like we have been discussing Jerome Powell's exit from the Fed forever. However, we are not quite done yet, but we are quickly approaching that point, with the key question being:

Is the Fed nearly done, or will there be another significant move lower starting around mid-year?

This question has impacted CD pricing since at least the middle of 2025, as many institutions attempt to time their maturities to expectations of potential future rate cuts after Powell is replaced. The concern is that the farther the CD term extends, the more rates could decline, making the CD rate further and further above the prevailing market rate. This same dynamic is playing out with high yield savings and money market products, as banks and credit unions want their initial rate lock periods to be over by mid-year to provide flexibility to adapt to potentially changing market conditions. Whether there will be sharp rate cuts or not, most institutions are preparing as though there will be just in case.

How best to approach this from the loan perspective?

Given the current state of the yield curve, and what may transpire later this year, we feel that loan rates are attractive, and have been for quite some time. Based on recent information, CRE rates seem to be largely in the high 5% to low 6% range, with outliers driven by relationship, block size, or competitive concerns. This translates into roughly 200 basis points over the 5-year FHLB rate, which is a tighter spread than what institutions generally target. With that said, consider these two potential rate scenarios over the next 6-12 months:

- The new Fed Chair immediately initiates rate cuts, leading to a Fed Funds rate in the low 3% range by year end 2026, while the mid-longer end of yield curve behaves calmly: This could result in a 50-75bp decline in CRE rates, which makes today's rates appear very attractive in hindsight. In this scenario, the more the Fed cuts, the better today's deals look.
- Given how the Fed has already eased, combined with a relatively strong economy, the new Chair leaves rates relatively stable: As unlikely as this sounds today, if GDP growth remains strong and inflation remains just under 3%, the Fed may hold off. Under this scenario, we could see a modest decline at the longer end of the curve, as concern about a new, overzealous Fed chair prove unfounded.

In either of these scenarios, the answer is to keep lending. In fact, to arrive at the conclusion to stop lending would require a much more dire expectation, such as Fed easing that leads to runaway inflation and much higher rates at the longer end of the curve, or a recession that would lead to significant credit losses. However, making lending decisions based on either of those scenarios is likely not in the best interests of the institution.

How much of a concern is the proposed 10% cap on credit card rates?

As a community financial institution, when you first heard this, you may have thought that this does not impact us at all, as we (many community banks and credit unions, at least) are not in the credit card business. That may be true, but it doesn't mean that this does not affect you, just maybe not directly.

First and foremost, it is unlikely that this will actually be enacted as stated; it is meant to start a conversation / negotiation about an issue that impacts nearly half of U.S. credit card holders- according to Bankrate's 2026 report, 47% of Americans with credit cards carry a balance, totaling $1.21 trillion in aggregate. However, there is at least a decent possibility that this applies enough pressure to bring rates down without any actual legislation, but not nearly to 10%.

For the sake of this discussion, let's assume that this becomes law. What happens almost immediately? Access to credit cards dries up for most people, possibly with the exception of those with pristine credit, as this product would become unprofitable at a rate of 10%. Once this occurs, the following could send the economy into a tailspin:

- Consumer spending would decline significantly, almost immediately. According to Google, 41% of U.S adults rely on this funding source to pay monthly expenses, while 39% could not pay for a $2,000 emergency with a credit card.
- Assuming that people will not be able to cut their expenses back enough to pay for spending with cash, they will be forced to other sources, including payday lenders, personal loans, buy now pay later, title/asset lenders, etc. Some of these avenues could be considerably more expensive than a high-rate credit card, with more dire consequences if the borrower is eventually unable to pay.
- Taken a step further, a sharp decline in consumer spending, which accounts for about 2/3 of GDP, would likely lead to economic contraction and job losses, as well as impacting the stock market.

Although credit card rates do seem high, the economic impact of an across-the-board cut to 10% would be severe, which is likely the main reason it will not happen. The unintended consequences, as discussed above, could be disastrous, but could also lead to alternative lending opportunities for community financial institutions. Many already provide unsecured personal loans, but that service is generally a small slice of the overall pie, but it could, and should, grow rapidly if credit cards become largely unavailable. If we believe that a deal will be made, with a 'ceiling' rate in the 20% range, there will be some people (those with the worst credit) that will be shut out and need alternatives. If priced effectively given the elevated risk, this could be a profitable additional lending offering. ◆

EPG INCORPORATED

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The ADVISOR is a publication of EPG Incorporated

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