After the Surge:

Rethinking Risk in a Complacent Market

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As 2025 comes to an end, it's an appropriate moment to step back and assess the market environment heading into 2026. Investors have now experienced three consecutive years of extraordinary returns. From October 2022 through October 2025, the S&P 500 delivered an annualized return of 22.6%, while the Nasdaq 100 surged an astonishing 32.4% per year. Aside from brief volatility sparked by unexpected tariff announcements in April, this period has been remarkably strong.

Some might argue the bull market never truly paused after the 2009 GFC lows. Each downturn over the past decade and a half has been short-lived, quickly followed by new highs. Equity investors have faced little sustained risk, and the most common regret has simply been not owning enough.

The prevailing instinct to "buy the dip" has weakened discipline, encouraged performance chasing, and reduced emphasis on risk management.

This extended episode of U.S. equity dominance has been so powerful that some investors now advocate allocating 100% of a long-term portfolio to equities. Diversification and systematic rebalancing—long-standing pillars of prudent portfolio construction—have acted as a performance drag relative to concentrated exposure in megacap technology stocks. Today, looking at Bloomberg data, the S&P 500 is unusually top-heavy: more than 39% sits in the top 10 names, and over 47% in semiconductor, internet, software, and computer-related industries. The Nasdaq 100 is even more narrowly dependent on megacap tech leadership.

A generation of younger investors has only known markets that compound at 15–20% annually. Algorithmic systems trained in the past decade reflexively buy weakness. And few traders on Wall Street today lived through the GFC, let alone the 1987 crash. That collective lack of lived experience raises an important question: what vulnerabilities might underlie the current market regime?

Several tailwinds that fueled U.S. equity outperformance since the Reagan era deserve careful scrutiny: falling interest rates, declining corporate tax rates, favorable demographics, globalization, and rising valuation multiples. The trajectory of each is deteriorating.

"Such a period of strong returns and (relatively) low volatility inevitably breeds complacency."



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Inflation offers a clear example. The surge of 2021–2022 revealed the cost of a decade of easy money. Many expected inflation to fade once supply chains normalized. Yet five and a half years after the pandemic, consumer price inflation remains at 3% — 50% above the Fed's target. Prices are more than 25% higher than in 2019, with several categories rising far more. Financial assets have never been more expensive when measured by the number of work hours required to purchase a share of the S&P 500.

Investors expecting a return to near-zero borrowing costs may be disappointed. While few expect a revival of 1970s-style hyperinflation, sustained inflation of 4–5% or higher remains plausible if the economy reaccelerates.

Fiscal policy presents additional challenges. Persistent deficits will eventually demand action. Corporate taxes, which fell from roughly 5% of GDP pre-1960 to 1.5–2% in the 2020s,[1] have little room left to decline. Relative to other developed economies, the U.S. collects a far smaller share of revenue from corporations versus individuals. Even with strong lobbying influence, corporations may not be shielded from future tax increases, reducing a decades - long tailwind.

Demographic trends also point to slower growth. Developed economies face falling birthrates and aging populations. The rising cost of childcare — estimated at over $310,000 by Brookings (2022) and nearly $389,000 by LendingTree (2023) — contributes to the decline. Immigration policy has tightened, slowing labor-force growth. While Baby Boomer retirement spending offers some offset, slower population growth ultimately limits economic expansion.

Globalization represents another fading driver. Although free trade lifted millions from poverty and reduced costs for corporations, domestic middle- and working-class wages stagnated. Rather than recalibrate how the benefits of trade are shared, the U.S. has turned toward restricting it. But rebuilding domestic manufacturing capacity will take decades and may add inflationary pressure. Tariffs and trade barriers will weigh on growth as long as they remain in place.

Then there is valuation. The S&P 500's current earnings yield is just 3.6%, below the 10-year Treasury yield of 4.14%. Comparing earnings yield to the 10-year TIPS yield of 1.85% results in a real earnings yield of only 1.78% — the lowest since the dot-com era. While real yields can turn negative under certain assumptions, today's figures suggest optimism is running ahead of fundamentals. With many long-term equity drivers deteriorating, this decline may reflect speculative enthusiasm rather than rational forecasts of stronger growth. Looking ahead, the outlook for U.S. equities over the next decade is likely weaker than the rearview mirror suggests.

Resetting expectations, remaining disciplined, and preparing portfolios for a more challenging environment may be prudent. Investors should consider reinforcing risk-management practices, reassessing diversification, and ensuring their portfolios are designed to weather a wider range of outcomes. For those concerned about portfolio risk or positioning heading into 2026, your Summit Global advisor can help evaluate next steps.

Footnotes:
[1] Peter G. Peterson Foundation, https://www.pgpf.org/article/six-charts-that-show-how-low-corporate-tax-revenues-are-in-the-united-states-right-now/

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