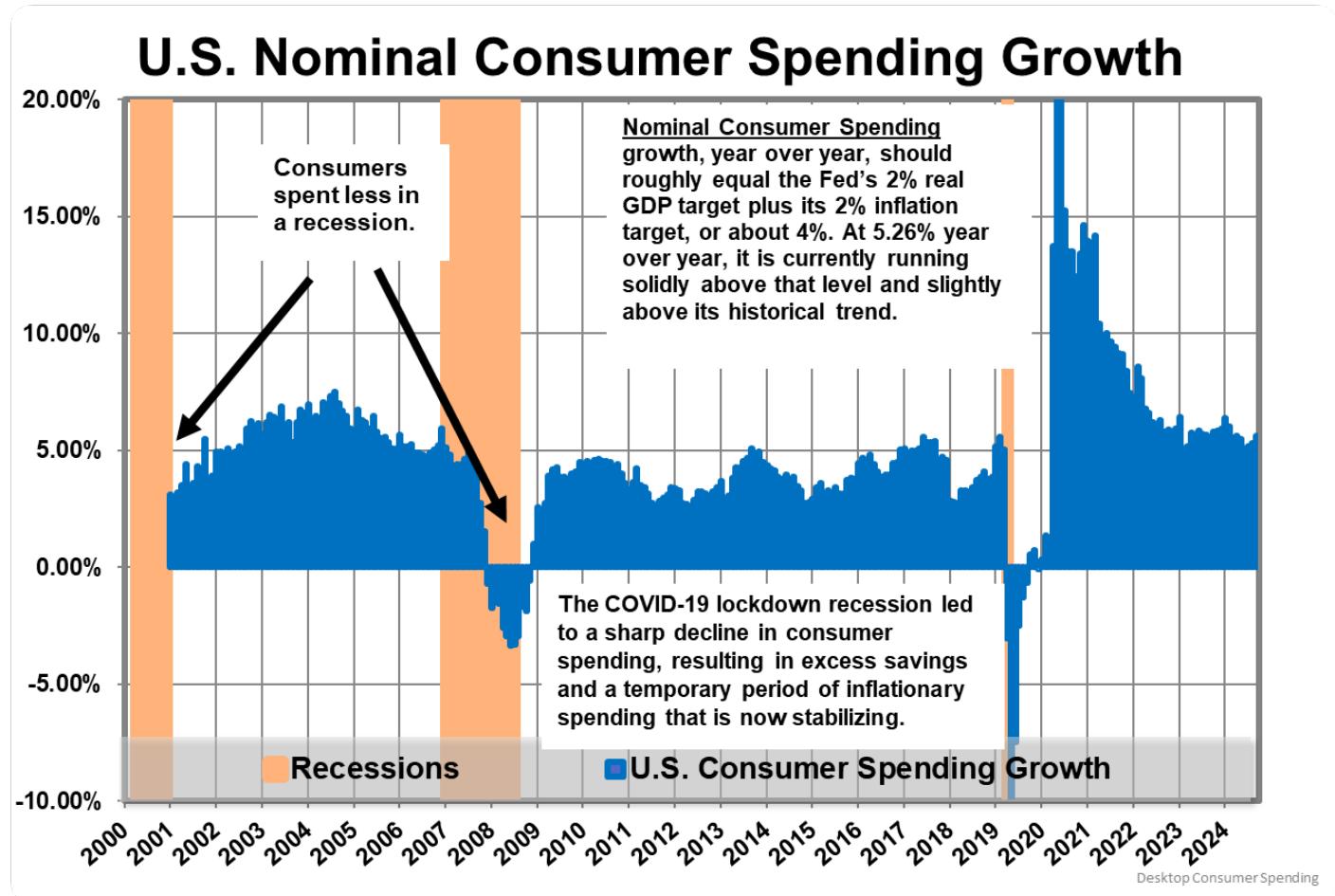


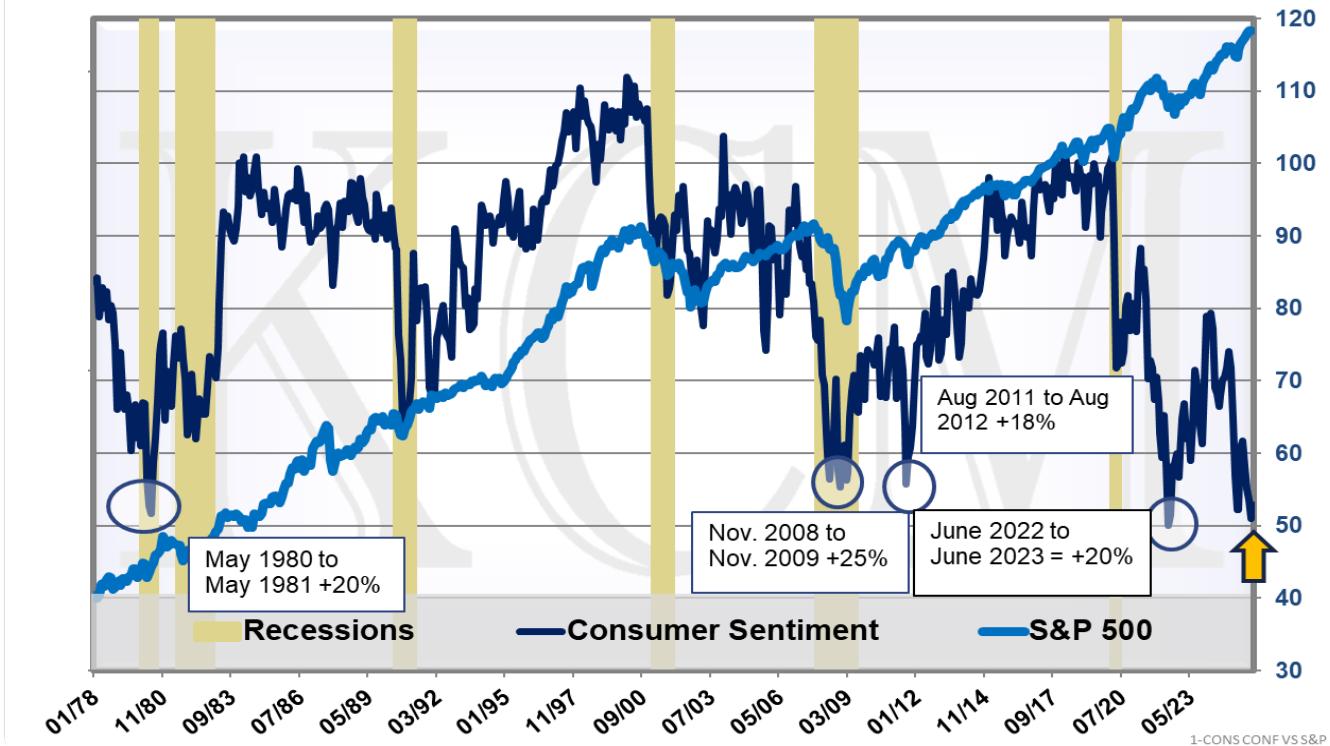
## 2026's Rare and Promising Investment Environment

The year 2026 is shaping up to be a landmark period for the United States economy and the financial markets. While many analysts spent 2024 and 2025 bracing for a downturn that never arrived, the emerging data points toward a rare environment: an economy that is growing steadily, supported by historic levels of fiscal stimulus, growing AI-driven productivity, and a central bank that has transitioned from an inhibitor to a primary driver of the bull market.

At the heart of the bullish thesis for 2026 is the American consumer. Nominal consumer spending, which traditionally accounts for approximately 60%-70% of the U.S. GDP, remains exceptionally robust. Despite years of fluctuating prices, the aggregate household balance sheet is healthy, fueled by a "low-hire, low-fire" labor market that has kept unemployment near historic lows while maintaining wage growth.



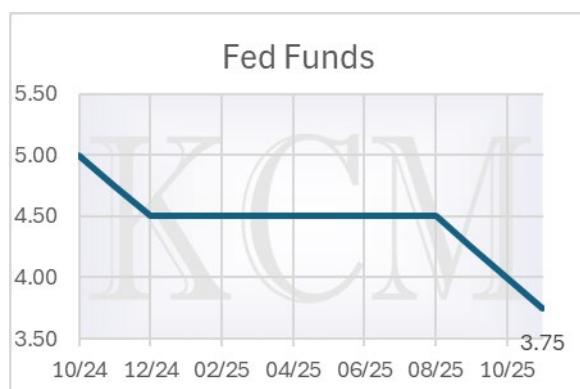
## University of Michigan Consumer Sentiment



Interestingly, the psychological landscape offers even more reason for optimism through a contrarian lens. The **University of Michigan Consumer Sentiment Index** has hovered near all-time lows for an extended period. Historically, such extreme pessimism among consumers is a powerful buy signal for the stock market. When sentiment is this low, the "wall of worry" is at its peak; bad news is already priced in, and any incremental improvement in reality can trigger upward revisions in stock prices. In 2026, as the gap between negative perception and economic reality becomes apparent, we expect a meaningful stock market rally.

### Monetary Policy: The Fed as a Tailwind

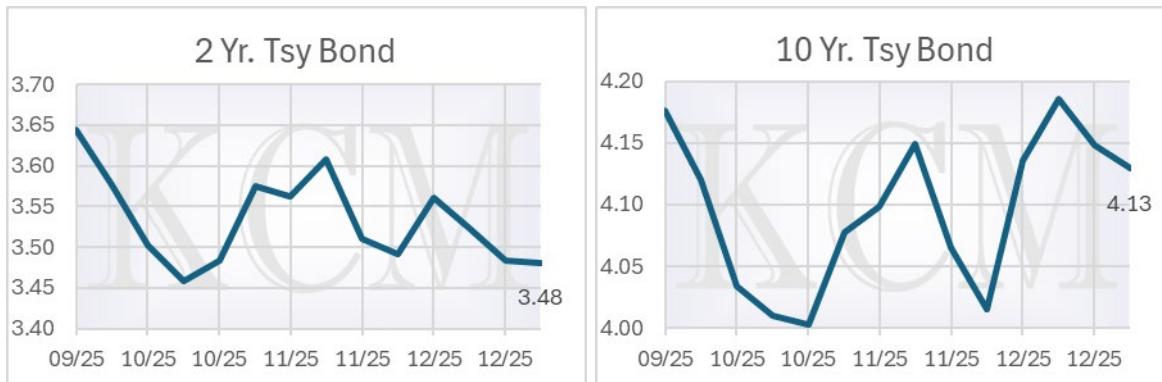
Perhaps the most critical transition for the 2026 outlook is the stance of the Federal Reserve. For the first time in years, and not because we are in a recession, the Fed is in a sustained **rate-cutting mode**. This trend is expected to accelerate as a new Federal Reserve Chairperson takes the helm in mid-2026. Historically, a Fed that cuts rates in the absence of a recession provides a boost for the economy and stock prices.



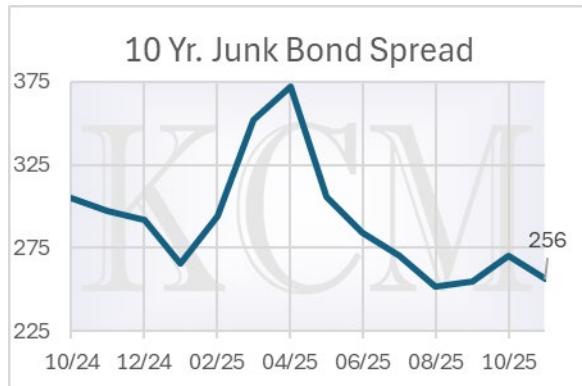
## The Impact of Lower Rates

**Lower Discount Rates:** As the risk-free rate drops, the present value of future corporate earnings increases, justifying higher P/E multiples, especially for non-dividend paying tech stocks.

**Yield Curve Normalization:** Bond yields on 2-year and 10-year Treasuries are moving sideways or downward. This reduces borrowing costs for corporations and mortgage rates for consumers.



**Credit Market Stability:** While worrisome "cracks" have been noted in private credit, overall credit spreads remain remarkably tight, allowing for new lending and refinancing, which frees up cash for dividends and buybacks, and indicates that the plumbing of the financial system is functioning properly.



## Key Fiscal Drivers

**A "Big, Beautiful" Economic Engine:** The 2026 economy will benefit from a unique "double dose" of fiscal policy. The implementation of President Trump's "One Big Beautiful Bill" acts as a massive pro-growth catalyst. This legislation is highly stimulative, particularly for the domestic industrial and tech sectors. Simultaneously, lingering infrastructure and green energy investments from the previous administration continue to filter through the economy.

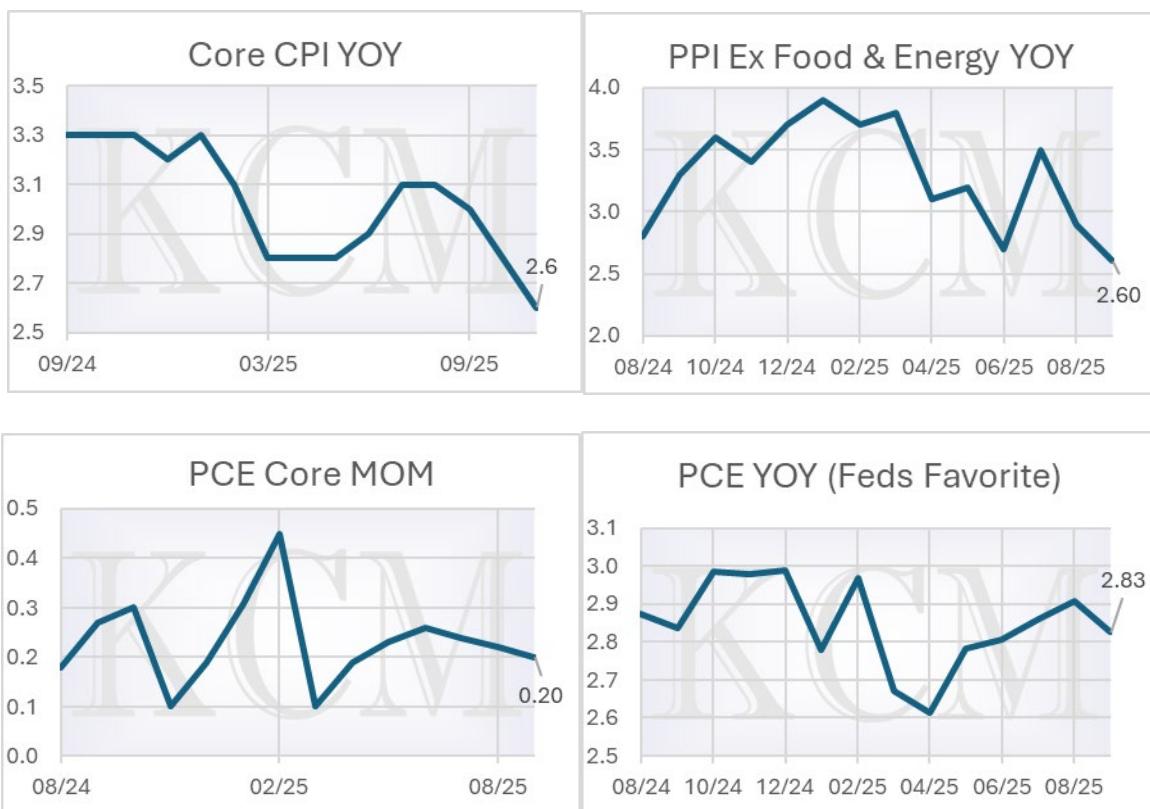
**Record Tax Refunds:** Due to retroactive tax breaks and structural changes in withholding, early 2026 is projected to see the largest tax refund season in U.S. history. Analysts at J.P. Morgan have likened this \$191 billion injection to the "COVID-era stimulus checks," providing a massive surge in discretionary liquidity for households.

**Corporate Incentives:** Businesses can now deduct 100% of equipment purchases immediately. This "bonus depreciation" incentivizes a massive wave of capital expenditure (Capex), encouraging companies to modernize and expand.

**Tariff Certainty:** While tariffs were a source of volatility in 2025, by 2026, the "peak uncertainty" will have passed. Markets will have adjusted to the new trade architecture, and businesses will move forward with clear supply chain strategies.

## The AI Productivity Miracle

Inflation, the boogeyman of the early 2020s, is in retreat. Indicators like the **CPI, PPI, and PCE** are either moving sideways or drifting lower, an ideal environment for risk assets. A major contributor to this disinflationary trend is the **soaring productivity** driven by Artificial Intelligence. As AI moves from the "hype" phase to the "implementation" phase in 2026, companies are seeing real-world efficiency gains that allow them to grow without needing to raise prices.



In 2026, the "AI Productivity Miracle" is moving from a speculative Silicon Valley narrative into a tangible driver of corporate earnings and national GDP. While 2024 and 2025 were the years of massive infrastructure spending (the "build-out" phase), 2026 is emerging as the year when businesses finally operationalize these tools at scale.



## The Shift from Chatbots to "Agentic" AI

The most significant shift for 2026 is the transition from generative AI (which suggests answers) to **Agentic AI** (which executes tasks).

**Autonomous Workflows:** Instead of an employee using a chatbot to draft an email, AI agents are now integrated into enterprise software (like Salesforce and ServiceNow) to manage entire multi-step processes—such as processing insurance claims, resolving IT outages, or managing supply chain logistics—without human intervention.

**The "Shadow" Workforce:** Analysts predict that by late 2026, many mature enterprises will have more AI agents than human employees in specific back-office departments. This doesn't necessarily mean mass layoffs, but rather a "hiring freeze" on mundane roles as AI absorbs the workload of 24/7 operations.

**Measuring the Productivity Spike:** Historical technological breakthroughs, like the adoption of electricity or the internet, typically saw a 10-year lag before productivity gains showed up in the data. Because of the speed of software deployment, the AI lag is much shorter.

## Economic Impact by the Numbers

**Labor Productivity:** Analysts from Vanguard and Goldman Sachs suggest AI could lift annual U.S. labor productivity growth by **0.3% to 0.6%** in 2026 alone. While that sounds small, in a \$28 trillion economy, it adds tens of billions in "free" output.

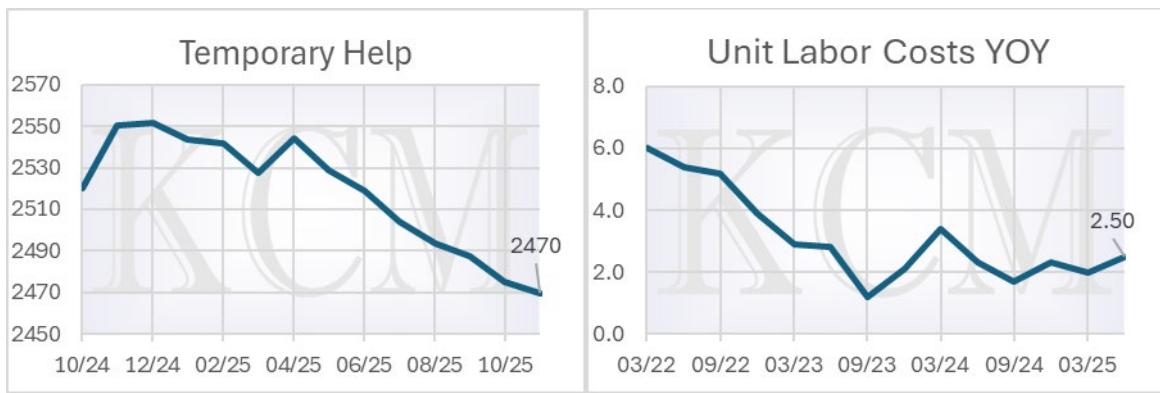
**GDP Acceleration:** This productivity surge is the primary reason many economists have upgraded their 2026 U.S. GDP forecasts to **2.25% - 2.6%**, significantly higher than the pre-AI trend of ~1.8%.

**Margin Expansion:** For the S&P 500, these efficiency gains are expected to drive a **12% rise in earnings per share (EPS)** to roughly \$305. Companies are producing more with the same (or fewer) labor hours, leading to record-high profit margins.

## The Disinflationary "Cooling" Effect

Productivity is often described as the antidote to inflation. When a company becomes more efficient through AI, it can absorb higher costs without raising prices for consumers.

**Lower Unit Costs:** If an AI agent manages a high percentage of customer service queries at a fraction of the cost of a call center and temporary workers, the company's "cost per unit" drops.



**Wage Growth Without Inflation:** Productivity allows businesses to pay their remaining human workers more (for higher-value strategic work) without having to pass those wage costs on to consumers, effectively "decoupling" wage growth from price inflation.

**Energy Efficiency:** AI is also being used to optimize the power grid and corporate energy usage, hopefully keeping utility costs stable even as demand for data centers grows.

### Corporate Strategy: The "Show Me" Story

In 2026, the stock market will likely no longer reward companies just for saying "AI" in their earnings calls. Investors are looking for **Return on AI Investment**, possibly putting price pressure on some high-flying AI stocks. As stated in *Industry Consensus*, Dec. 2025, "The time for counting AI pilots is over. In 2026, organizations must demonstrate that AI shortens release cycles, improves uptime, and captures market share."

The winners of 2026 should be the companies that have redesigned their workflows and thus can grow revenue at double digits while keeping headcount flat.

### The Stealth Tax Cut

Further aiding the inflation fight are energy prices. **Crude oil and gasoline** remain near their multi-year lows. Low energy costs function as a "stealth tax cut" for every American household and significantly lower the input costs for manufacturers and transporters, directly boosting corporate profit margins.



## The Weaker Dollar: A Double-Edged Sword



The U.S. dollar has declined in value as a result of the Federal Reserve's pivot to lower interest rates, concerns about Fed independence, tariff uncertainty, and questions about the long-term sustainability of U.S. debt. In the short term, a country's currency tends to weaken when its interest rates decline relative to other countries, as international capital flows toward higher yields elsewhere. This weaker dollar has distinct implications for corporate profits, stock prices, and consumer purchasing power.

### A Boon for KCM's Multinational BlueBloods Stock Portfolios

**KCM's primary equity focus centers on our "KCM BlueBloods" strategy**, targeting large-cap, U.S.-based multinationals that lead every sector of the economy. For 2026, we project these industry leaders—from tech giants to iconic consumer and industrial brands—will achieve 12%–15% earnings growth. We anticipate this will be driven by 7% revenue growth, with the balance fueled by AI-driven margin expansion, strategic cost-cutting, and share buybacks.

A critical driver of this growth is their global footprint, which provides a distinct advantage through the currency translation effect. When these companies earn revenue in foreign currencies like the euro or pound, those funds are converted back into U.S. dollars for reporting. In a weak-dollar environment, each unit of foreign currency converts into more dollars, directly inflating reported revenue and earnings even if local business performance remains steady.

### A Modest Pinch on Consumer Wallets

For the American consumer, the effect works in reverse. A weak dollar reduces purchasing power for imported goods. This can exert mild upward pressure on inflation for certain categories of consumer goods.

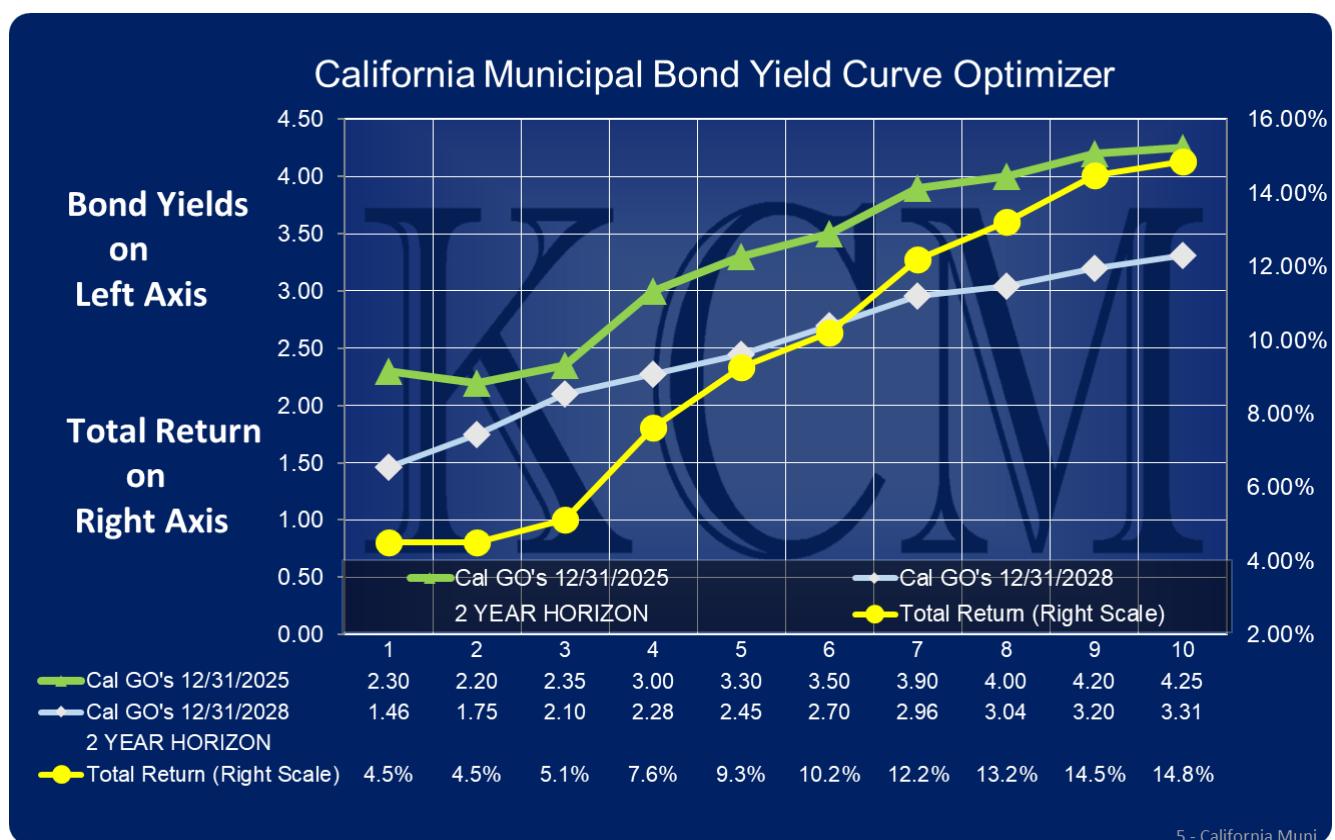
However, we believe that in the current environment, this effect will be muted. The disinflationary forces from evolving supply chains and the AI-driven productivity boom are more powerful than the inflationary impulse from a moderately weaker currency. The net effect remains positive for the economy, as the boost to corporate profits and U.S. export competitiveness outweighs the modest drag on consumer purchasing power.

## Market Technicals: The "Cash on the Sidelines" Story

Stock market performance is often a function of supply and demand for shares. Currently, there is a **record \$7.66 trillion of cash** sitting in money market funds, earning yields that will begin to look unattractive as the Fed continues to cut rates. This "sideline cash" represents a massive reservoir of potential buyers.

Furthermore, institutional and retail investors remain **under-exposed to stocks** relative to historical bull markets. With the S&P 500 forward P/E ratio sitting around 21x, the market is fairly valued—not "extremely high" like the dot-com bubble. When the "Fear Of Missing Out" (FOMO) kicks in as the S&P possibly hits new highs in 2026, the transition from money market funds to equities could also fuel a higher move for stocks.

## Fixed Income:



This graph is a financial analysis tool, the proprietary "KCM California Municipal Bond Yield Curve Optimizer," designed to identify the best place on the California municipal bond yield curve to invest in for a two-year period.

Cal GOs 12/31/2025 (Green Line): This is the yield curve for California General Obligation bonds as of December 30, 2025. A yield curve simply plots the interest rate (yield-to-call) you would get for lending money for different lengths of time. As you can see, bonds with longer maturities (e.g., 10 years) offer a higher yield (4.25%) than bonds with shorter maturities (e.g., 2 years at 2.20%).

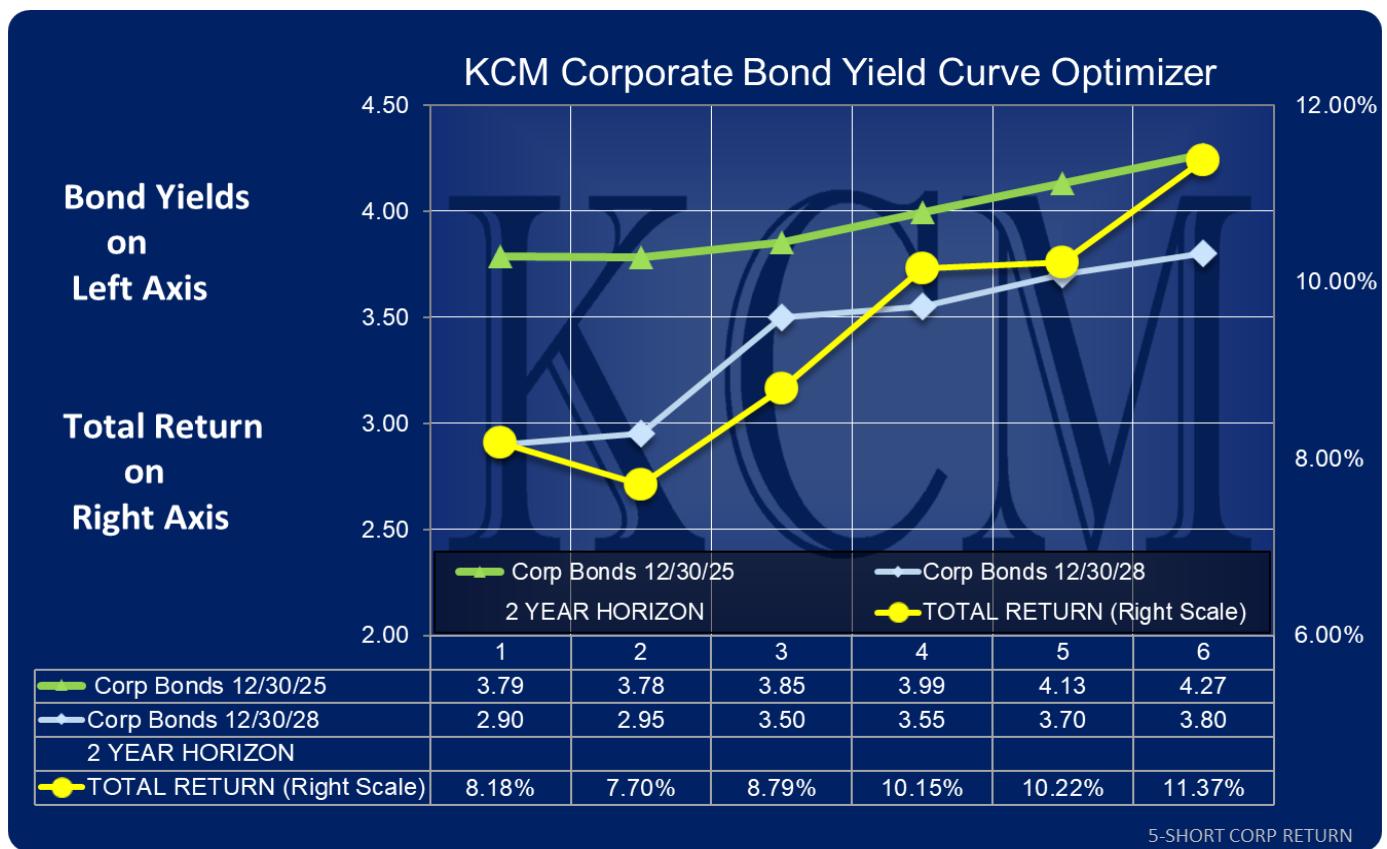
This is normal, as investors typically demand higher compensation for tying up their money for longer.

Cal GOs 12/31/2028 (White Line): This is a projected or forward yield curve for two years in the future (December 31, 2028). The chart assumes that interest rates will fall across the board over the next two years.

Total Return (Yellow Line): This is the most important line for the "optimizer." It calculates the estimated total return an investor could achieve by buying a bond today and selling it in two years (on 12/31/2028).

If you bought a 2-year bond today, your total return would be 4.5%. However, by looking at the peak of the yellow "Total Return" line, you can see the optimal choice. Buying a 10-year bond today and planning to sell it in two years is projected to yield the highest total return of 14.8%.

In summary, this chart demonstrates that even with a short investment horizon (2 years), buying a longer-term bond can sometimes provide a much higher total return due to the shape and expected movement of the yield curve. It identifies the 10-year bond as the optimal choice for this specific 2-year scenario.



The proprietary "KCM Corporate Bond Yield Curve Optimizer," graph is a financial tool used to decide which corporate bond offers the best potential return over a two-year period. It compares bond yields today with projected yields two years from now to find the optimal investment.

## What the Graph Shows

The graph plots three different data series against bond maturities ranging from one to six years.

**Bond Yields (Left Axis):** The green and blue lines show the yields (interest rates) for corporate bonds.

**Green Line (Corp Bonds 12/30/25):** This represents the current yield curve. It shows that longer-term bonds currently have higher yields. For example, a 1-year bond yields 3.79%, while a 6-year bond yields 4.27%.

**Blue Line (Corp Bonds 12/30/28):** This represents the projected yield curve two years in the future. The model forecasts that yields for most maturities will be lower in two years.

**Total Return (Right Axis):** The yellow line is the most important part of the analysis.

**Yellow Line (TOTAL RETURN):** This shows the calculated total return an investor could receive over a two-year investment horizon for each bond maturity. This return includes both the interest payments received and the change in the bond's price over the two years.

## The “Optimizer” Strategy

The goal is to maximize the total return, not just the starting yield. The total return is calculated by buying a bond today, holding it for two years, and then selling it at the price determined by the projected future yield curve (the blue line).

Here is the key insight: *when interest rates fall, bond prices rise.*

Let's look at the 6-year bond as an example:

An investor buys it today with a yield of 4.27% (green line).

They hold it for two years, collecting interest payments.

After two years, it is now a 4-year bond. The graph projects that a 4-year bond at that time will have a yield of 3.55% (blue line).

Because the market yield (3.55%) is now lower than the yield the investor locked in (4.27%), the bond's price has increased.

The investor's total return is the combination of the interest they received plus the capital gain from selling the appreciated bond.

## Key Takeaway

According to this model, the optimal strategy for a two-year investment horizon is to buy the 6-year bond. It is projected to provide the highest total returns, as shown by the peak of the yellow line. This strategy, known as "riding the yield curve," aims to profit from both the bond's interest payments and its price appreciation as it "rolls down" to a lower point on the future yield curve.

## Conclusion: 2026 Seems Notably Promising

The combined forces of a pro-growth Federal Reserve, powerful fiscal stimulus, and an AI-driven productivity boom likely position 2026 to be an unusually favorable year for the U.S. economy, the stock market, and **KCM's "BlueBloods" equity strategy**. Consumers remain the backbone of the expansion, supported by strong nominal spending, healthy balance sheets, and an additional boost from record tax refunds and low energy costs. Meanwhile, extreme pessimism in survey-based sentiment contrasts sharply with solid real-world data, creating a classic "wall of worry" backdrop in which even modest positive surprises can drive equity prices higher.

At the policy level, the pivot from restrictive to easing monetary policy—paired with tight credit spreads and still-accommodative fiscal policy—provides a rare dual tailwind that lowers funding costs, supports earnings, and justifies reasonable equity valuations rather than undermining them. Businesses and households alike both stand to benefit from cheaper capital, immediate expensing of investment, and greater clarity on tariffs and the trade regime. Layered on top of this is the rapid diffusion of AI, which is beginning to translate into measurable productivity gains, margin expansion, and disinflationary pressure, allowing growth to accelerate without reigniting inflation.

The historical precursors to a recession—rising inflation and aggressive Fed rate hikes—are nowhere to be found. Instead, the opposite is true: inflation is sideways or falling, and rates are being cut.

The market structure and positioning add substantial upside optionality. Valuations are elevated but not extreme. A relatively weak U.S. dollar is a tailwind for U.S. based, multinational company's earnings, and a record mountain of cash in money markets sits poised to reenter risk assets as yields fall and fear gives way to Fear Of Missing Out, (FOMO). In sum, 2026 offers a convergence of supportive fundamentals, policy, and investor positioning that historically has preceded durable advances in both economic activity and equity prices, making a constructive stance toward the U.S. economy and stocks not only reasonable, but compelling.

We know our forecasts will never be 100% accurate, and there will inevitably be bumps along the way—but we will be here to navigate and adjust through them with you. Once again, we thank you for your patronage. We wish everyone a happy, healthy, and prosperous 2026!

Referrals are always welcomed!

Jay Kellett

Founder & CEO

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