

# Markets Year-End Rotations and Fed's Internal Division Dominates Markets to Shape the Path Ahead.

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The U.S. and European stock markets closed with mixed results as investors balanced year-end positioning, rising bond yields, and renewed strength in commodities. In the U.S., equity markets hovered near the flatline early Tuesday, to closed broadly lower with the S&P 500 on pace to close a third consecutive year with annual gains exceeding 15%. Market leadership remained narrow, with most sectors opening little changed, while energy stocks outperformed once again on firmer oil prices. Treasury yields moved modestly higher, with the 10-year yield closing at 4.14% and the 2-year yield at 3.45%, reflecting recalibration of rate expectations rather than a shift in inflation dynamics. Precious metals continued to build on strong year-to-date gains, with gold and silver extending their recent rallies.

Federal Reserve Minutes — Key Takeaways and Market Implications

## 1. Policy Decision and Internal Division

At the December meeting, the Federal Open Market Committee (FOMC) implemented its third quarter-point reduction in the policy rate for 2025, bringing the federal funds target range to 3.50–3.75%. The decision passed with notable dissent, marking one of the highest levels of internal disagreement in recent years. Three members opposed the move, either favoring no change or a larger cut, underscoring differing views on the relative importance of inflation versus labor market weakness.

## 2. Divisions Over Future Rate Path

The minutes reflect a broadly split committee on the outlook for future rate adjustments. While many participants indicated that further cuts could be appropriate if inflation continued to soften, a significant number signaled caution. Some officials argued for holding rates steady for an extended period to assess incoming data, especially given persistent inflation pressures above target and recent labor market softening. This tension suggests the Fed is less inclined toward aggressive easing in early 2026 unless key data materially improve.

## 3. Balance Sheet and Reserve Management

Minutes also highlighted discussions around financial market functioning and liquidity conditions. Policymakers judged that reserve levels had fallen back into the Fed's "ample" range, prompting a plan to begin short-dated Treasury bill purchases to support efficient interest rate control and money market functioning. This operational shift is not intended as a monetary policy stance change but rather to ease technical pressures in money markets.

## 4. Inflation and Labor Market Considerations

Committee members recognized that inflation had eased from recent highs but remained above the Fed's 2% objective. At the same time, labor market indicators showed signs of softening, with unemployment edging up and employment gains concentrated in narrower sectors. These mixed signals contributed to the committee's lack of consensus on how rapidly or deeply to reduce rates further.

## **5. Forward Guidance**

The minutes conveyed that future policy decisions will remain data-dependent, with an emphasis on incoming inflation readings and labor market reports. While some participants see the potential for additional easing in 2026, others cautioned against premature cuts, indicating that rate stability may persist into the early part of the year absent stronger evidence that inflation is sustainably returning to target.

### **Bonds reclaim leadership over cash**

After trailing cash in three of the past four years, U.S. investment-grade bonds have re-emerged as a leading asset class in 2025, posting returns of approximately 7.5% and outperforming cash by more than 3 percentage points—the widest margin since 2020. The improvement reflects a combination of cumulative Federal Reserve rate cuts totaling roughly 75 basis points, easing labor-market conditions, and a broad decline in yields across most maturities. Yield remains the dominant driver of fixed-income returns, and the yield advantage of investment-grade bonds over cash—currently near 70 basis points—sits close to the upper end of its three-year range. Looking ahead, expectations for one or two additional rate cuts in 2026 could further pressure short-term rates and reduce the attractiveness of cash. At the same time, persistent fiscal deficits and steady economic growth suggest limited downside for long-term yields, with the 10-year Treasury likely to trade in a 4.0%–4.5% range, potentially supporting another year of bond outperformance.

### **Housing market shows tentative signs of stabilization**

U.S. housing indicators are beginning to stabilize after a prolonged period of weakness. The FHFA home price index rose 0.4% in October, following declines in four of the prior six months. The S&P Case-Shiller 20-city index increased by 0.3%, well above expectations and marking its strongest monthly gain since January. Pending home sales reached their highest level since February 2023, while mortgage rates have eased from above 7% earlier in the year to roughly 6.5%. Residential investment has weighed on economic growth, contracting in five of the past six quarters, but easing financing costs could help revive housing activity and provide a modest tailwind to growth in the year ahead.

### **European markets extend gains; Asia remains under pressure**

European equities advanced to fresh record highs on Tuesday, led by strength in mining and defense stocks. The pan-European Stoxx 600 broke through the 590 level, while the FTSE, CAC 40, and DAX all posted solid gains, and Italy's FTSE MIB outperformed. Mining shares surged alongside sharp movements higher in precious metals, with gold and silver firmly in focus during the holiday-shortened trading week. Defense stocks rebounded after prior-session losses linked to ongoing peace discussions over Ukraine. In contrast, Asia-Pacific markets mostly declined overnight as technology shares continued to struggle amid concerns over stretched valuations and lingering uncertainty around the artificial intelligence investment cycle.

### **Inflation Throughout the World Economies**

We wanted to take a look at how different nations have dealt with inflation year-to-date in 2025, and the results highlight a highly uneven and fragmented global disinflation process.

At the upper end of the spectrum, Russia continues to experience elevated inflation, reflecting persistent structural pressures driven by geopolitics, fiscal stimulus, and supply constraints. Brazil and Mexico also remain above developed-market levels, underscoring the stickiness of inflation across key emerging markets despite restrictive monetary policy and currency-stabilization efforts.

Across advanced economies, inflation has broadly converged into a 2%–3% range. The United Kingdom, Spain, Japan, and the United States illustrate this normalization trend, suggesting that while headline inflation has moderated meaningfully, central banks remain cautious in declaring a full return to price stability.

Within the Euro Area, dispersion remains evident. Germany and Canada hover near target, while Italy and France now post sub-1.1% inflation, signaling softer domestic demand and a more pronounced disinflationary environment.

Importantly, Puerto Rico's inflation rate, at approximately 1.9%, remains below the U.S. mainland, reinforcing the narrative of easing local price pressures and improving real purchasing power for households on the island.

At the lower end of the distribution, China and India reflect subdued inflation dynamics, driven by weak demand, excess capacity, and policy-driven price controls—raising concerns about deflationary risks in parts of Asia.

Bottom line: 2025 is not a uniform disinflation story. Instead, it is a divergent inflation landscape, where regional fundamentals matter more than global average, reinforcing the need for localized policy responses and disciplined, selective capital allocation.

### **Birling Capital's Outlook for 2026**

Want to dive deeper into what's next? Check out our reports—9 Issues & 9 Answers: Ending 2025 with a Sturdy Global Backdrop and a Constructive Setup for 2026, and *Power, Capital, and Political Control: 2025 The Structural Shifts That Reshaped the Global Economy*—by clicking on the links below:

- <https://birlingcapital.com/publications/TS.9Issues9Answers.Ending2025withaSturdyGlobalBackdrop.pdf>
- <https://birlingcapital.com/publications/TS.PowerCapitalandPoliticalControl.2025TheStructuralShifts.pdf>

### **Economic Data:**

- **Case-Shiller Composite 20 Home Price Index YoY:** fell 1.37%, compared to 1.55% last month.
- **Case-Shiller Home Price Index: National:** rose to 327.64, up from 326.92 last month.
- **U.S. Retail Gas Price:** fell to \$2.97, down from \$3.024 last week.
- **Japan Housing Starts YoY:** fell -8.50%, compared to 3.16% last month.
- **China PMI:** rose to 49.20, up from 49.00 last month.
- **China Non-Manufacturing PMI:** fell to 49.20, down from 50.10 last month.

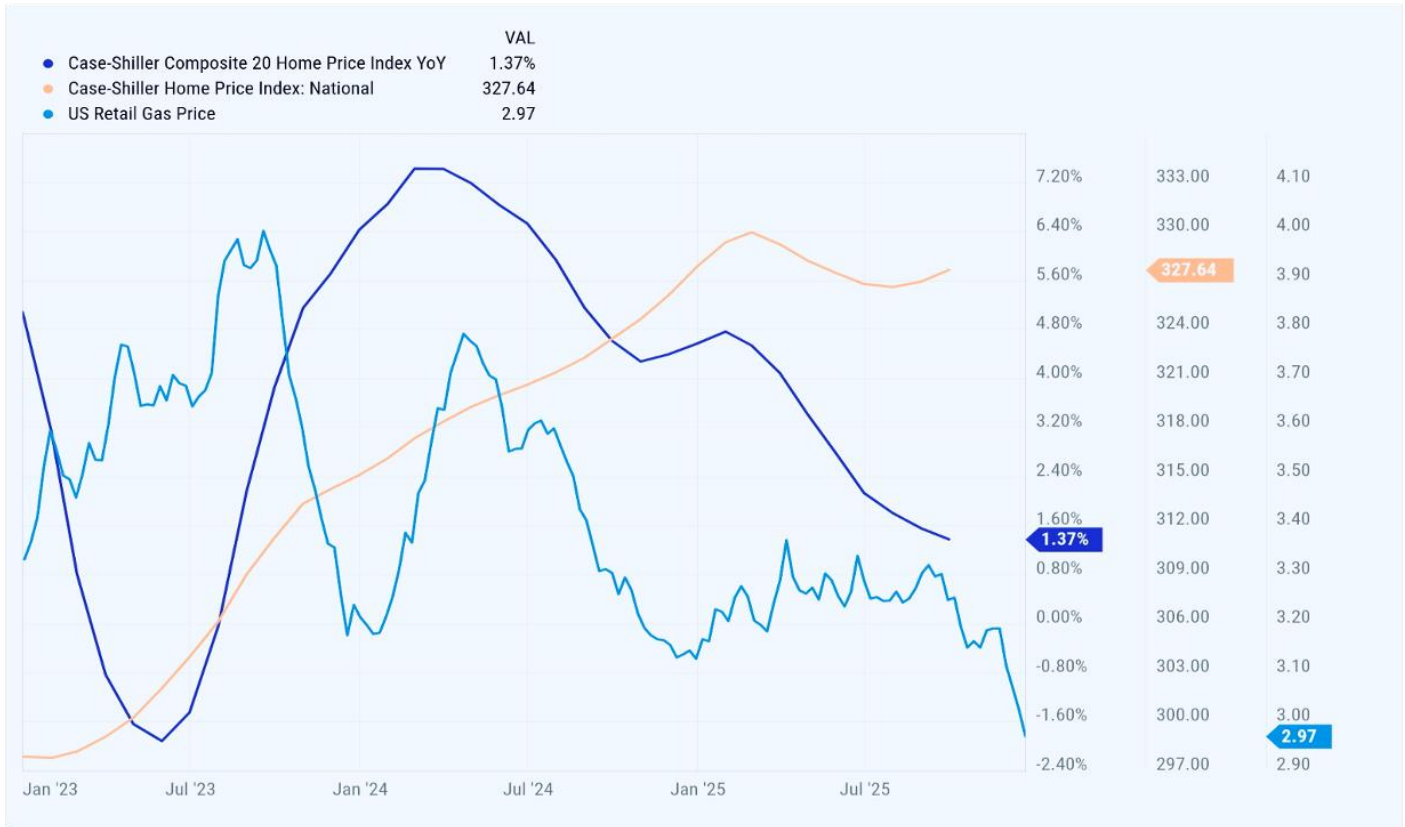
### **Eurozone Summary:**

- **Stoxx 600:** closed at 592.78, up 3.53 points or 0.60%.
- **FTSE 100:** closed at 9,940.71, up 74.18 or 0.75%.
- **DAX Index:** closed at 24,490.41, up 139.29 or 0.57%.

### **Wall Street Summary:**

- **Dow Jones Industrial Average:** closed at 48,367.06, down 94.87 points or 0.20%.
- **S&P 500:** closed at 6,896.24, down 9.50 points or 0.14%.
- **Nasdaq Composite:** closed at 23,419.08, down 55.27 points or 0.24%.
- **Birling Capital Puerto Rico Stock Index:** closed at 4,009.75, down 16.93 points or 0.42%.
- **Birling Capital U.S. Bank Index:** closed at 9,255.03, down 127.29 points or 1.36%.
- **U.S. Treasury 10-year note:** closed at 4.14%.
- **U.S. Treasury 2-year note:** closed at 3.45%.

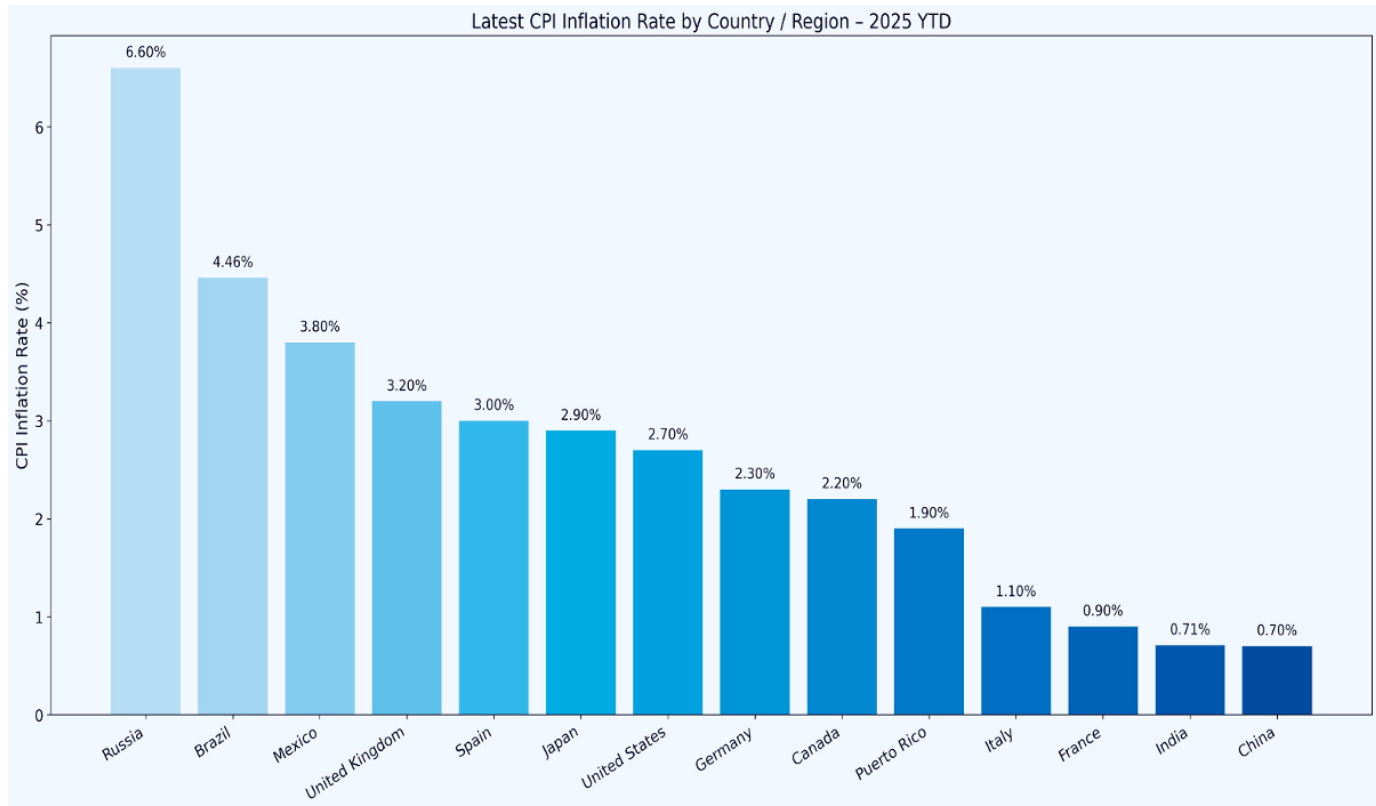
# Case-Shiller Composite 20 Home Price Index, Case-Shiller Home Price Index National & U.S. Retail Gas Price



# China's Manufacturing PMI, China's Non-Manufacturing PMI & Japan Housing Starts



# Comparative Analysis of Consumer Price Indices for the United States, Eurozone, Russia, Brazil, Mexico, China, India, and Puerto Rico.



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