

DIAMOND HILL

INVESTED IN THE LONG RUN

Out With the Old, In With the New

Dec 2025

Markets concluded the year positively in December, rising 3% as measured by the MSCI ACWI ex USA Index. For the full year, markets were likewise positive, climbing the proverbial wall of worry in the face of a multitude of potential headwinds, including global trade policy, monetary policy and geopolitics. Regionally, every area was in the black in December – with European stocks providing the biggest tailwind to the index, rising nearly 4%, while the Asia & Pacific region gained 2%. While many of the month's headlines fell under the same categories as they have for most of the year, there were a few interesting variations on themes to conclude the year.

Whereas previous months have seen positive trade developments, more seemed to fall apart than come together in December. For example, the US-Indonesia deal could fall apart as Indonesia has reversed course, saying it could not implement some aspects of the previously agreed pact. Following this development, the US also suspended its technology deal with the UK, allegedly over the UK's unwillingness to address non-tariff barriers in the food and industrial goods industries. Meanwhile, Mexico imposed an up to 50% tariff on Chinese cars and other goods in a bid to win US favor ahead of 2026's review of the US-Mexico-Canada free trade agreement reached during President Trump's first term. China announced it would charge a 42.7% levy on European dairy imports following a 16-month review of alleged EU subsidies.

Also in Europe, the EU-Mercosur deal – a 25-year work in progress between the EU and the South American trade bloc – is on the verge of falling apart as some individual EU countries, like France, have second thoughts and risk blowing up the existing deal set to be signed. As of this writing, signing has been delayed to early January to give Italy and France more time to get its farmers on board. And as of January 1, the EU has begun charging carbon border taxes in a bid to shield its own companies, who have to pay carbon taxes, from foreign competitors, many of whom do not.

On the monetary policy front, the picture remains as murky as ever. Among the major central banks globally, the US and the UK cut rates 25 basis points (bps) each, to a range of 3.50%-3.75% for the US and to 3.75% for the UK, while the ECB held rates steady at 2.00% and Japan remained alone on the global stage in raising rates 25 bps to a 30-year high of 0.75%. While arguably relatively benign moves across the board, the economic pictures underneath the individual countries' surfaces vary widely and in some cases seem contradictory.

For example, while the Federal Reserve cut rates, US GDP expanded at a 4.3% annualized rate in Q3, bolstered by consumer spending on health care and computing. The unemployment rate ticked up to a four-year high of 4.6%, even as job openings hit a five-month high. And US inflation ostensibly fell sharply to 2.7% in November – though economists have warned the government shutdown could have majorly dampened a more accurate reading. Given its dual mandate of maintaining low unemployment and low inflation, it's hardly surprising the December Fed meeting was reported to have been highly contentious as officials disagreed on the best course of action.

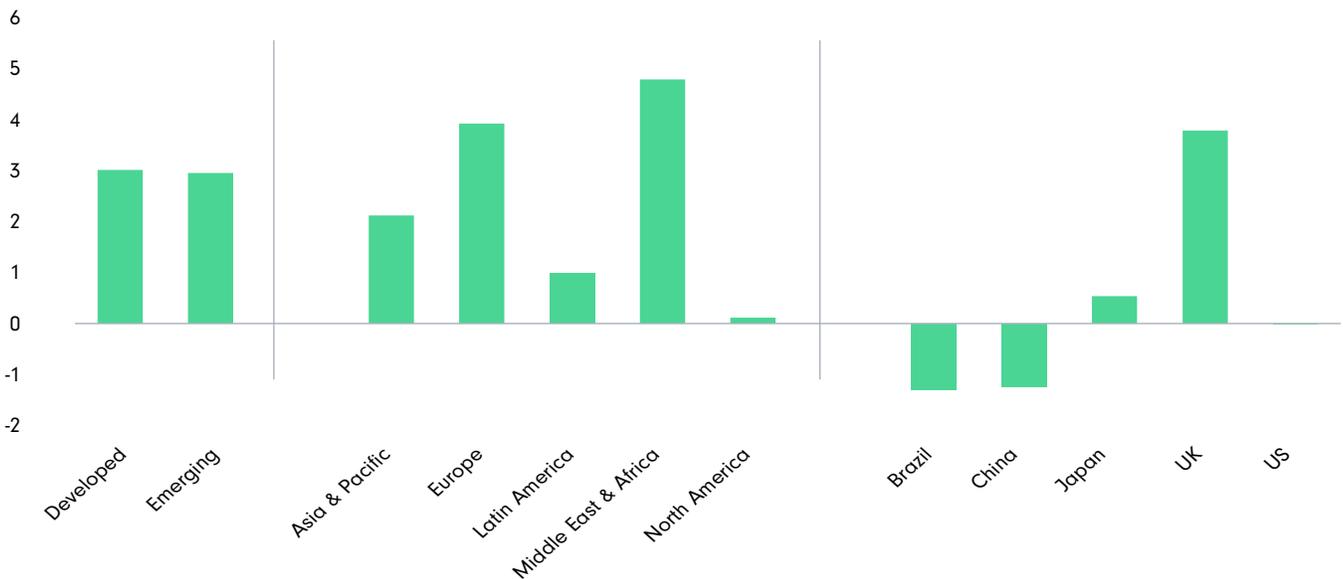
Data remain likewise contradictory in other major economies, including the UK, where the economy contracted a modest 0.1% in October but inflation also fell more than expected in November to 3.2%, giving the Bank of England breathing room to effect a rate cut. In Europe, inflation rose unexpectedly in November to 2.2%, but the economy has shown sufficient resilience, even as trade tiffs persist, that the ECB felt confident in holding steady. Japan remains a global outlier – though given its recent economic history of malaise, that is hardly surprising. And its bid to increase interest rates may be bolstering its stock market, which closed 2025 at a record level (as measured by the Topix) amid investor enthusiasm for AI-related stocks and the economy's resilience in the face of global trade and geopolitical tension.

China was another focal point of several storylines in 2025, and December was no different. Investment declined further, while retail sales hit a three-year low – as President Xi called out local governments to “pursue genuine growth without exaggeration” as the country still struggles to shrug off a recent property sector implosion. However, as the month concluded, data showed factory activity resumed growing in December, beating analysts’ expectations. And while President Trump announced the US would allow Nvidia to export high-value semiconductor chips to China, President Xi added domestic chip-makers to the country’s official procurement list for the first time in a bid to goose domestic production and better compete with US counterparts. Further complicating the issue, the US simultaneously accused China of unfair trade practices in the chips market following a year-long investigation but announced it wouldn’t raise tariffs until 2027 at the earliest – highlighting the complex nature of the current state of affairs between China and much of the rest of the world, notably the US.

Perhaps the biggest China twist in the month was geopolitical, when the country performed military exercises surrounding Taiwan and launching practice missiles closer than usual to the island. The exercises were ostensibly a response to the US’s offer of \$11 billion in military support to Taiwan and represent another move in the long-running geopolitical chess game. Elsewhere on the geopolitical front, a deal to end the Russia-Ukraine war remains elusive, though Presidents Trump and Zelensky met in December to continue discussing a proposed 20-point peace plan.

Regionally, the biggest positive contribution in December came from European stocks (+4%) on the back of strength in the UK (+4%), Switzerland (+5%) and Germany (+4%). The Asia & Pacific also contributed positively, rising +2% as Taiwan (+6%) and Korea (+13%) delivered outsized returns, countering China’s -1% return in the month. Latin America rose nearly +1% and the Middle East & Africa rose nearly +5%.

Exhibit 1 – December Returns for Major Markets (%)



Source: FactSet, as of 31 December 2025.

From a sector perspective, financials (+5%) were the biggest positive contributor, while technology (+6%) and industrials (+3%) also provided a relative tailwind. Conversely, communication services (-1%), consumer staples and energy were in the red, the latter two sectors each declining less than -1%.

It seems fitting that the storylines that dominated much of 2025 continued through December and seem poised to persist into 2026 – though as we write, geopolitical upheaval in the form of the US’s deposing of Venezuela’s illegitimate leader President Maduro could take events in a sharply new direction. Or it could not – as with all things, only time will tell. Likewise, the duration of the current bull market – which grows longer in the tooth by the year and continues embodying Mark Twain’s humorous comment that “reports of [its] death are greatly exaggerated” – remains an open question which is no doubt top of mind for many investors as we enter a new year and forecasts abound. In our view, though valuations in areas of the market are undoubtedly stretched, we believe investors are well-served by a philosophy grounded in identifying high-quality companies which are trading at compelling discounts relative to their estimated intrinsic values. Such a bottom-up approach can, over time and without regard to the near-term fluctuations of the market and global economies, deliver superior long-term returns to disciplined investors. With that, we look forward to the new year and its impending, inevitable twists and turns.

MSCI ACWI ex USA Index measures the performance of large- and mid-cap stocks in developed (excluding the US) and emerging markets. The index is unmanaged, market capitalization weighted, includes net reinvested dividends, does not reflect fees or expenses (which would lower the return) and is not available for direct investment. Index data source: MSCI, Inc. See diamond-hill.com/disclosures for a full copy of the disclaimer.

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