



2025 Year in Review & 2026 Outlook

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2025 Year in Review

MARKETS ADJUST TO A RAPIDLY CHANGING POLICY LANDSCAPE

David Lundgren, CFA

While nearly everyone expected meaningful policy changes following President Trump's inauguration, few anticipated the speed and magnitude with which those changes would arrive. Markets entered the year braced for adjustment, but the pace of execution across the administration's core policy pillars caught many investors off guard. Deportations, deregulation, tax reform, and tariffs all moved from campaign rhetoric to active implementation in short order, each carrying distinct economic and market implications. Together, these initiatives reshaped the policy landscape early in the year and reintroduced a level of uncertainty that investors had not experienced in some time.

Tariffs proved to be the most disruptive of these policy actions and arguably the single largest driver of market volatility in 2025. The much-anticipated "Liberation Day" tariff announcement sent shockwaves through equity markets, pushing the S&P 500 down nearly 20% off its February high in a matter of weeks. At the same time, inflation concerns resurfaced as tariffs threatened to reverse what had been a relatively calm and favorable inflation trend. For a market accustomed to stability and strong momentum, the combination of trade uncertainty and renewed price pressures created a challenging environment during the first half of the year.

Despite the disruption, markets began to look through the policy uncertainty and refocus on fundamentals. A pause and subsequent rethink around tariff levels and implementation timelines helped restore investor confidence, igniting a rally that gained traction through the summer and carried all the way into December. This advance persisted even as tariffs were reintroduced at levels not far from those initially proposed, underscoring the market's ability to look through near-term policy noise when earnings fundamentals remain intact. The S&P 500 finished the year up 17.9%, narrowly missing what would have been its third consecutive year of returns exceeding 20%. It is also worth noting that after dominating market leadership for nearly four years, the "Magnificent 7" lost a bit of their luster. While

they still outperformed the broader index—by roughly 5%—they no longer overwhelmed it as they had in prior years. Meanwhile, international equities finally enjoyed their long-awaited moment in the spotlight. Developed international stocks surged roughly 30%, with emerging markets and international small-cap stocks also posting gains north of 30%. A depreciating U.S. dollar and more attractive starting valuations relative to U.S. equities played meaningful roles in this resurgence. In contrast, the U.S. rally was driven primarily by earnings fueled by AI investment that came in far stronger than expected, aided by productivity gains, modest deregulation that helped rein in expenses, and the passage of the "One Big Beautiful Bill," which further supported corporate profitability and investor sentiment.

From an economic standpoint, 2025 began on shaky footing as tariff uncertainty weighed on business confidence and growth early in the year. However, as the year progressed and policy clarity improved, economic momentum stabilized. With fourth-quarter GDP still unknown at the time of writing, full-year U.S. growth appears likely to land near 2%. Inflation experienced a mid-year scare, with tariffs contributing to a temporary upward blip, but overall trends remained favorable. Price pressures appear largely range-bound in the 2.5% to 3% area, which is still above the Federal Reserve's 2% target but well below the highs of recent years. The labor market, however, felt the impact of immigration policy more acutely. Deportations materially changed the labor force, contributing to the rise in the unemployment rate even as certain industries continued to struggle with worker shortages.

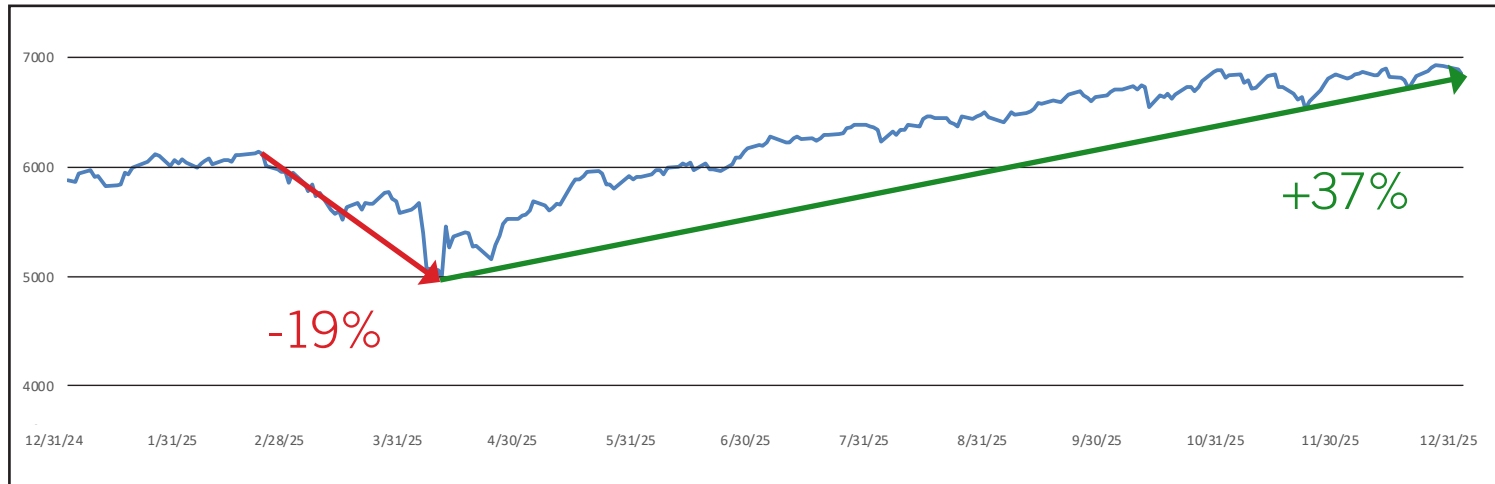
The Federal Reserve found itself navigating a particularly difficult crosscurrent in 2025. Persistent uncertainty surrounding the inflationary impact of tariffs kept the Fed on hold until September. As the year progressed and labor market data weakened, a policy pivot became increasingly necessary. The Fed ultimately cut rates three times heading into year-end, striking a balance between managing inflation risks and supporting a softening employment backdrop. Bonds, not to be completely outdone by equities, quietly delivered their best year since 2002. Intermediate, high-quality taxable bonds produced returns exceeding 7%, a welcome change after many years of portfolios earning coupons in the 2% to 3% range. A healthier income stream, an easing Fed, and steady inflation helped restore a more traditionally shaped yield curve and drove the solid bond returns achieved in 2025.

As it always does, the conclusion of one year sets the table for the next. Looking ahead to 2026, many unanswered questions remain. Who will be the next Federal Reserve Chair? Can equities deliver a fourth consecutive year of exceptional returns? Will another government shut down loom? Could the Russia-Ukraine conflict finally see resolution? How will the midterm elections reshape the political landscape? These questions, along with many others both known and yet unknown—await investors in the year ahead.

In the pages that follow, the Hancock Whitney Asset Management team attempts to address these questions and more as we share our thoughts on the economic and market environment in 2025 and provide our outlook for 2026. We hope that you enjoy.

2025 Year in Pictures

S&P 500 INDEX

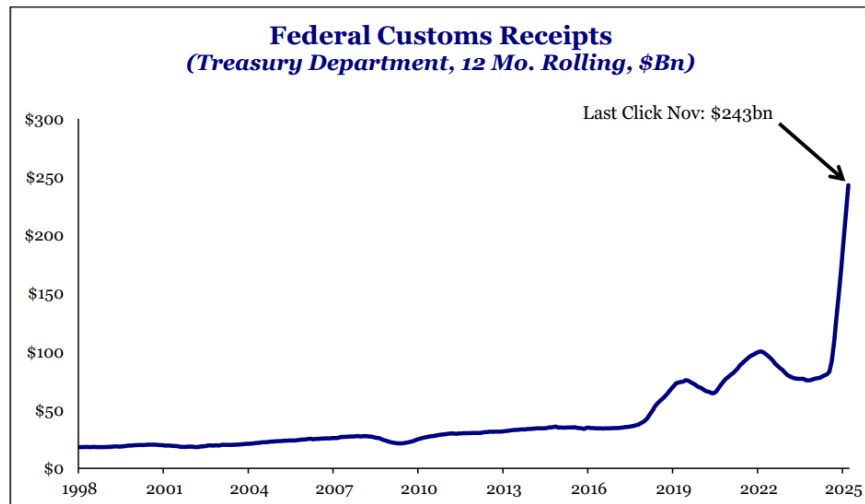


WHILE VOLATILE, THE S&P 500 PRODUCED ANOTHER YEAR OF STRONG RESULTS

After a shaky start around Liberation Day announcement, markets rebounded after a tariff pause, stronger than expected earnings, and more favorable economic data. Stocks finished up 18% for 2025 – the markets 3rd straight year of excellent returns.

2025 TARIFF RECEIPTS DWARF PREVIOUS COLLECTIONS

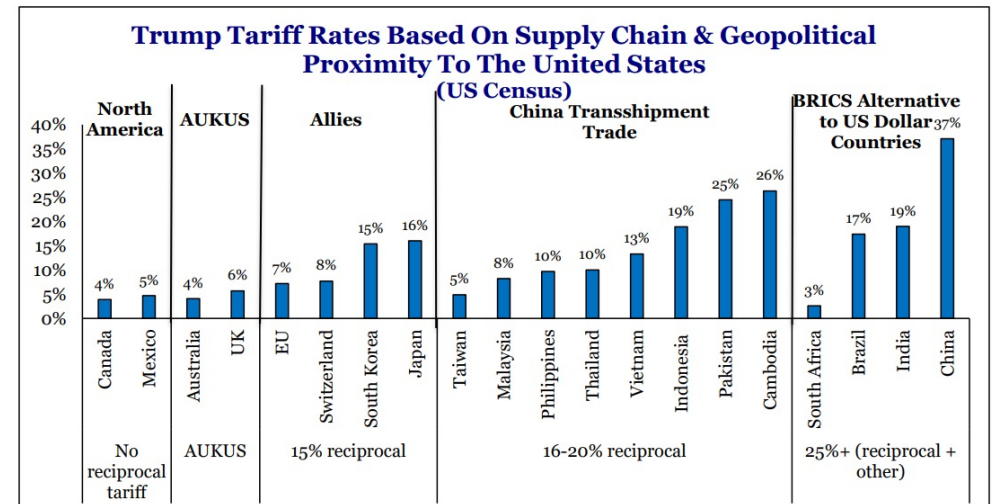
Tariffs were the largest source of market and economic uncertainty early in the year, but as companies and investors adjusted, revenues climbed well above historical norms, reaching roughly \$30 billion per month by year-end.



Source: Strategas

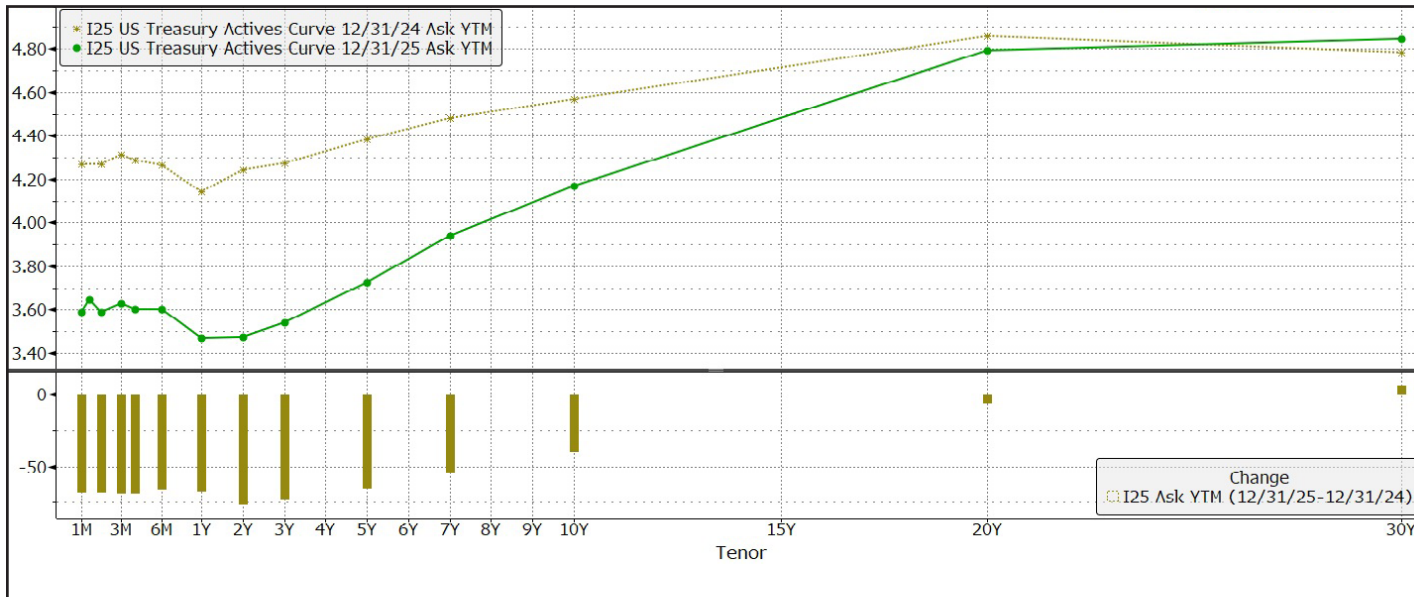
U.S. TARIFF RATES REFLECT STRATEGIC AND SUPPLY CHAIN RELATIONSHIPS

While the administration's tariff announcements were often perceived as chaotic or arbitrary, this Strategas chart suggests tariff policy followed a strategic logic: countries that were closer allies or more integrated with U.S. supply chains generally faced lower tariff rates.



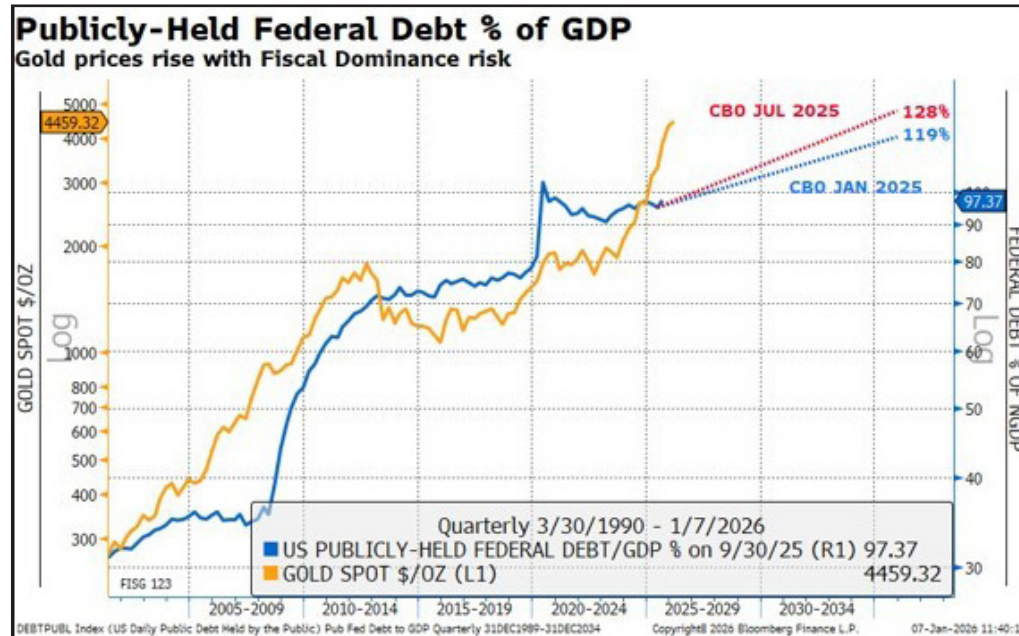
Source: Strategas

2025 Year in Pictures



THE EVERYTHING WORKED BOND RALLY OF 2025

Actual and anticipated Federal Reserve rate cuts, combined with signs of a loosening labor market, were the primary forces driving the yield curve back toward a steeper, more normalized shape. The resulting decline in interest rates—paired with attractive coupon income—propelled bond returns to their strongest performance in more than two decades.



GOLD SOARS 65% AS U.S. DEBT WORRIES CONTINUE

As U.S. federal debt has climbed to historically high levels relative to GDP, gold prices have trended higher, consistent with rising concerns over fiscal dominance and constrained monetary policy.

Source: Bloomberg Finance, L.P.



2026 Investment Themes

Here are some themes that we believe are likely to be important market considerations in 2026:

EQUITY MARKETS

- ▶ **No signs of slowing down** – The technology investment spending boom of 2025 will continue apace in 2026 and may even accelerate. Far reaching effects include equipment manufacturing, facilities development, support infrastructure construction, and job growth.
- ▶ **Productivity boom** – Businesses, and all technology users, will continuously find ways to utilize, implement, and build upon rapidly advancing technology, providing a strong boost to economic efficiency and labor productivity.
- ▶ **Consumer spending resilience** – Investment spending, combined with productivity enhancement, will drive benefits to workers and consumers, enabling consumers to maintain healthy spending levels.
- ▶ **Global economy will benefit from U.S. strength** – Global economic growth will be supported by the strengthening of the world's largest economy.

THE FED AND FIXED INCOME

- ▶ **The pause that refreshes** – After scoring the best total return performance year since 2002, the intermediate term U.S. bond market will likely return to moderate levels of volatility during the first half of 2026 while investors assess incoming inflation and employment data, the impact of Supreme court tariff rulings, and turnover at the Federal Reserve. The outlook for bonds improves in the back half of the year as the fog of uncertainty lifts.
- ▶ **A changing of the guard** – After 8 years, new leadership at the Federal Reserve in May will usher in some new perspectives, but Chairman Powell's successor will face the same policy challenges. An evenly divided committee leaning slightly more hawkish on inflation next year will make consensus building difficult, but ultimately 2-3 rate cuts appear likely.
- ▶ **U.S. debt clock keeps on ticking** – Another year of deficit spending will grow the mountain of U.S. Treasury debt ever larger in 2026, but outsized use of short-term Treasury bill funding and Federal Reserve purchases should keep the supply manageable. One glaring source of potential bond market disruption could be an adverse tariff ruling by the Supreme court early in the year.
- ▶ **Global capital demand on the rise** – A worldwide sovereign borrowing binge will keep longer term yields elevated across developed countries. A debt fueled shift toward increased defense spending and fiscal stimulus in European and Asian economies will require higher interest rates to compete for global capital.

ECONOMY

- ▶ **Labor constraints from tariffs and immigration may weigh on growth** – The overarching theme in 2025 was the Trump administration's disorderly rollout of the extensive tariff regime which roiled supply chains, boosted inflation concerns and set the U.S. on a course of slowing import demand. Simultaneously closing the southern border to illegal immigration and launching an aggressive campaign to reverse the Biden administration's open-door policy toward asylum-seeking migrants compounded the disruption to the U.S. labor markets, suppressing jobs growth to negligible levels since March. Heading into 2026, the persistence of these labor constraints raises the risk that national income growth will remain sluggish and consumer spending restrained.
- ▶ **AI investment to support profits while consumer and manufacturing risks persist** – Consumer sentiment reflects the most unsettled household sector in roughly 25 years, driven by concerns over job security and prices. While spending proved resilient in 3Q25, it shifted toward services and non-durables, leaving demand for big-ticket goods weak and dormant U.S. manufacturing trends in the second half of the year. Despite robust AI infrastructure investment, spillovers into broader commercial construction have been limited, while residential investment remains constrained by affordability pressures. Looking ahead, the sustainability of consumption will depend on a re-acceleration in income growth and a broader diffusion of AI-related benefits.
- ▶ **Tariff effects likely to remain disinflationary into 2026** – Unexpectedly modest inflation readings in the fall reinforced the view that tariff-driven price pressures have peaked, particularly in core goods categories. With monthly tariff collections stabilizing near \$30 billion, incremental upward pressure on prices has diminished, even as reduced import demand and substitution toward domestic sourcing persist. This environment supports greater policy flexibility in the months ahead but may also signal weaker demand dynamics rather than a benign disinflationary backdrop.
- ▶ **2026 growth outlook improving but dependent on fragile economic drivers** – Consensus forecasts anticipate modestly stronger growth in 2026, aided by expected fiscal stimulus. Bloomberg surveys project real GDP growth rising from 1.8% in 2025 to 2.1% by end-2026. Key risks include weak job growth, stalled income gains, labor shortages tied to immigration enforcement, housing affordability constraints, uncertain AI productivity benefits, and reduced foreign recycling of dollar flows into U.S. Treasuries amid elevated deficit financing needs.





POLICY AND POLITICS

- ▶ **Government overhaul** – The new administration moved swiftly to redefine the role of the President and the relationship among the branches of government. That will continue to play out as the courts, Congress, and the states respond to executive action.
- ▶ **Midterm elections** – Voters will weigh in on the direction of government in the midterms. It is still early to predict the outcome, but it is likely Democrats will recapture at least the House, potentially reshaping the environment in which the administration operates.
- ▶ **Government funding** – Congress failed to pass a true set of appropriations for fiscal year 2025, opting for a full year Continuing Resolution. The fight to set spending for fiscal year 2026 resulted in a record-breaking government shutdown with little clarity on a resolution for the upcoming year. Meanwhile, the 2025 budget resolution, formerly known as the One Big Beautiful Bill, kept individual income taxes at lower rates and set the stage for accelerated capital expenditures from businesses, potentially driving economic activity in the upcoming months.
- ▶ **Trade and tariffs** – The single most important change effected by the new administration has been redefining the trajectory of trade, raising barriers and driving domestic development while also increasing costs. The Supreme Court is set to rule on the authority under which many tariffs were imposed. While the administration may re-impose tariffs under different authority, a ruling from the Court could require a rebate of previously collected tariffs, potentially injecting hundreds of billions of dollars back into the private sector.
- ▶ **Immigration enforcement** – The White House has imposed new restrictions on immigration while aggressively pursuing deportation of individuals in the country illegally. The workplace enforcement actions are reshaping key sectors like agriculture and construction. While this is likely to help offset negative labor trends, it also may disrupt key economic drivers, while ongoing development in Artificial Intelligence (AI) presents both productivity gains and diminished labor demand.



Tariffs, Labor Slack and Falling Inflation: Macro Forces Defining the U.S. Outlook 1-5

Paul Teten, CFA

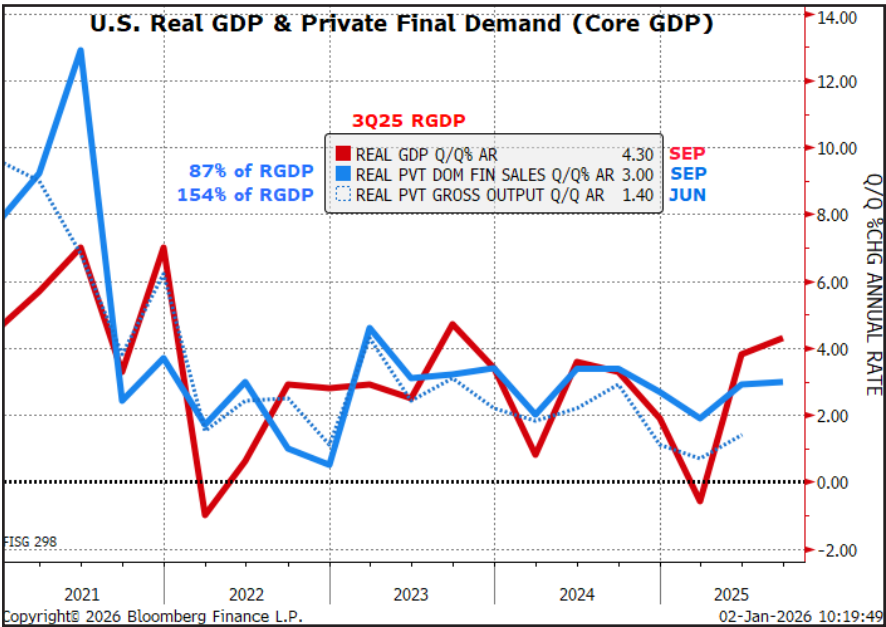
THE U.S. ECONOMY PRODUCED SOLID GROWTH IN 2025 DESPITE TARIFF HEADWINDS AND A DISRUPTED LABOR MARKET

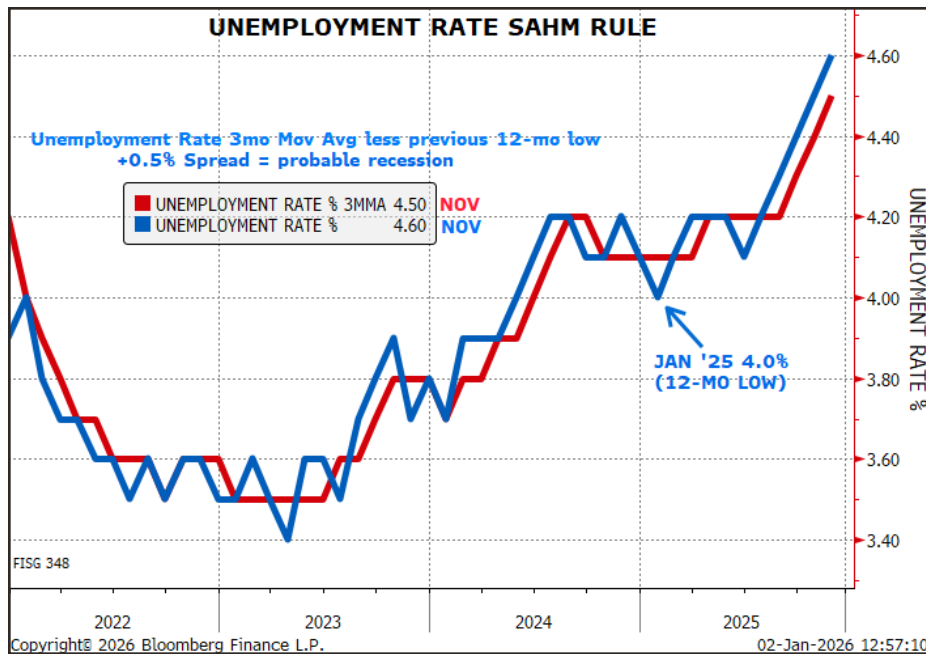
The overarching macroeconomic theme last year was the incongruous contrast between the body blows of tariff turbulence and immigration enforcement sustained by the U.S. economy, while the AI infrastructure buildout drove strong profit growth in the technology

and communications sectors which elevated major stock market indexes to all-time highs. Real GDP growth vacillated last year between a marginal -0.6% Q/Q annual rate contraction in 1Q25, a disturbance attributable to the anticipatory import surge ahead of the tariff roll-out, and stronger than expected growth of 4.3% in 3Q25, as household consumption stabilized and imports plunged. However, apart from the inventory and import swings related to the tariff regime and the gyrations in federal spending, private sector final demand continued to grow in the healthy 2-3% channel of recent years. A note of concern was found though in the real private gross output data, not yet updated for 3Q25, which through mid-year reported meager growth around 1%. The main difference between real gross output and real final sales is that the latter includes only consumed goods and services, whereas the former includes supply chain infrastructure and inventory investment. Our assessment is that real gross output is reflecting the supply chain disruption resulting from the chaotic tariff roll-out, which likely persisted into the fall months. 4Q25 Real GDP growth is expected to be reported later in January, with market expectations around 1.0% Q/Q AR, which would result in 1.8% Y/Y growth above 4Q24, the soft patch partially attributable to the federal government shutdown, and more pertinently to apparent consumer resistance to tariffed durable goods. Our expectations for 2026 are modestly better, Y/Y growth by December of 2.0-2.5% over 4Q25, owing mainly to stimulative tax breaks for business and consumers this year and stabilization in the supply chain.

RIISING UNEMPLOYMENT IN THE FALL COMMANDED THE FED’S ATTENTION

At the onset of 2025 the U.S. labor market was on track to reach an equilibrium between the supply of and demand for labor. The broad-based implementation of the tariff regime and simultaneous launch of workplace immigration enforcement interventions have substantially changed the character of the labor market, for the near term at least. Supply chains developed over decades of rising imports have been roiled and migrant labor dependent industries such as agriculture, construction and hospitality have been meaningfully disrupted. Corporate employers, after years of hoarding labor to rebuild workforces devastated by the COVID lockdowns, have largely reversed course and right-

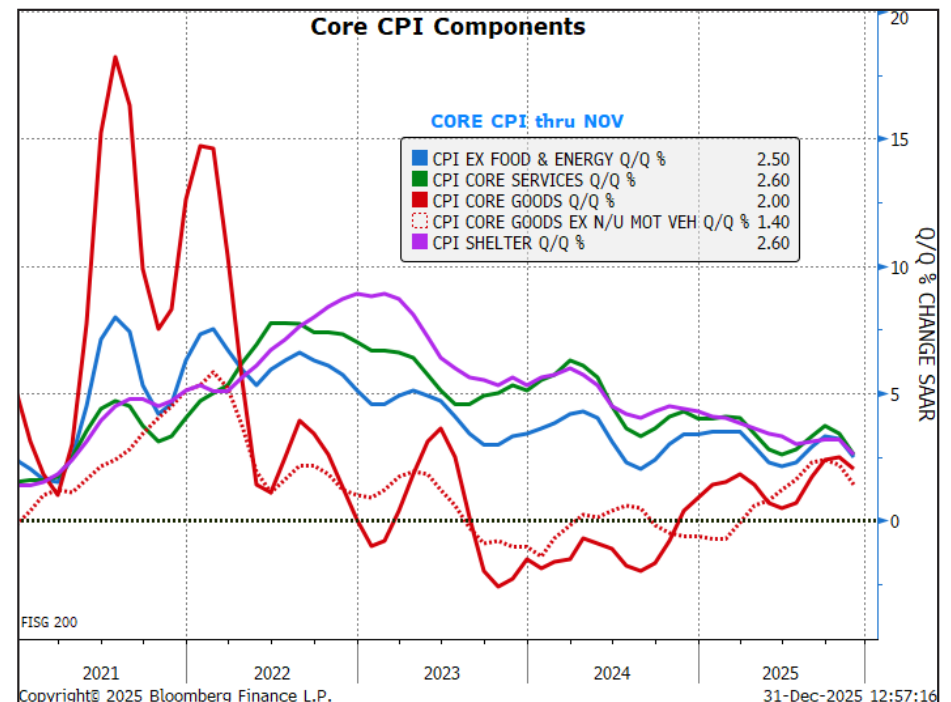




sizing to today's economy is the new/old HR mantra. Meanwhile, the unemployment rate has risen 1.2% above the cycle low of 3.4% in April 2023 to 4.6% in November, still a relatively low unemployment rate by historical standards. The rising rate occurred noticeably in two distinct intervals, the spring/summer months of 2024 and the summer/fall months of 2025, in both instances triggering the Sahm Rule Recession Indicator, named eponymously for its author, former Federal Reserve Board Principal Economist Claudia Sahm. The rule stipulates that when the unemployment rate's three-month moving average rises at least 0.50% above the monthly low point of the previous 12 months, recessionary conditions are likely present. The Sahm Rule has been noted in a variety of economic research publications, prominently including the Federal Reserve Bank of St. Louis' prestigious FRED platform (Federal Reserve Economic Data). Ironically, Dr. Sahm herself stepped forward in September 2024 to discount the Rule's red flag recession signal, on grounds of the extraordinary supply of migrant workers in the labor force with typically high unemployment experiences. A reverse discount to the rule may be appropriate now as well, with the immigration enforcement constriction of the labor force potentially magnifying the rise in the unemployment rate. Nevertheless, the Federal Open Market Committee apparently is paying attention to the Rule, having cut the Fed Funds rate 0.50% in September 2024, with the Sahm Rule also appearing to swing last month's vote to cut the Funds rate another 0.25%. 2026 opens with a dark cloud over the labor market that is likely to continue to draw the Fed's attention in the months ahead.

NEWSFLASH: TARIFFS APPEAR MORE DEFLATIONARY THAN INFLATIONARY!

After a nearly three-month blackout of official economic news during the federal government shutdown, the Consumer Price Index report for November released December 18 revealed a startling degree of disinflation in recent months. Critical to the inflation outlook, housing inflation continues to exhibit a slow, steady downward trend. But the big surprise was the reversal of last summer's acceleration in core goods prices, the most susceptible to tariff pass-throughs. Macroeconomic theory posits that a tax on imports would suppress demand for those goods, although that reality was mostly lost in the chaos of the tariff rollout that changed on a daily basis and included threats of retaliation and 145% tariffs on one of our most important trading partners, China. But lately we've been able to measure the substantial disruption to the import supply chain, and its workforce. And now the CPI update reveals the early stages of confirmation that the tariff impact on inflation may well be transitory, which is consistent with our observations that monthly customs tariff collections have stabilized around \$30 billion. We continue to expect that core inflation trends will drift lower this year, not higher; which, in tandem with meager jobs growth will likely keep the pressure on the FOMC to continue to drive short-term interest rates lower in 2026.



Resilience Through Volatility: Equity Markets, AI Investment and the Road Ahead ⁶⁻⁹

Martin Sirera, CFA

In the past 12 months, global equity markets took investors on a wild ride: unusual levels of volatility, a large springtime reversal, rotating leadership, a strong summer and fall rebound to new all-time highs, and finally a lackluster close of the year. Investors' collective psyches were marred by uncertainties surrounding the Trump Administration's tariff policies, by ongoing global conflict in hotspots like Ukraine and the Middle East, and by concerns about the impact of reforming overly loose border-control policies.

On the other hand, spirits were boosted by the seemingly relentless optimism surrounding the latest technological advancements in the fields of machine learning, large-language-models, the unironically named Artificial Intelligence, and the investment spending occurred by such advancements. They were also lifted by an economy that is much stronger than was expected at the onset of 2025 and which has been boosted by resilience of the U.S. consumer segment.

Going into 2026, investors' hopes are pinned on a continuation of some of the themes which have dominated the recent past. Investor fears will be stoked by a variety of sources, including but not limited to richly valued publicly traded equities, and changes in the composition of the labor force.

ANOTHER GOOD YEAR

2025 was the third year in a row of strong U.S. stock market performance. The S&P 500 Index finished the year with a total return of 17.9% which followed gains of 26.3% and 25.0% for 2023 and 2024, respectively. Large Cap Growth stocks dominated once again and Mid Cap and Small Cap shares in the U.S. trailed by wide margins. Investors did see one departure from the multi-year trend of Large U.S. companies outperforming everything else. Developed Market equities outside the U.S. robustly outperformed. The MSCI EAFE Index, which measures the performance of equity markets in developed markets around the world excluding the U.S. and Canada, delivered a total return of 31.8% for the full year, its best performance in a long time.

There is a caveat to the strong outperformance of non-U.S. equities: it was mostly a function of the decline in the dollar relative to the euro and other currencies. The STOXX





Europe 600 Index illustrates this well: in dollar terms, the Index was up 35.9%, but in Euro terms, the index returned only 19.8% . After a post-election rally in the dollar in the end of 2024, currency markets grew nervous about tariffs and declining U.S. short-term rates causing the dollar to decline more than 12% relative to the euro from mid-January to late June. Regardless of the reasons, for the first time in recent years diversification outside of the U.S. was a positive contributor to returns and a strong one at that.

The year was marked, much like the economy overall, by robust positive surprises over expectations. Each quarter saw aggregate analysts' estimates for quarterly S&P 500 profit growth gradually climb throughout the quarter and then get exceeded by actual results when reported after quarter-end. Rising expectations followed by better-than-expected results is a strong one-two punch for equity investors and was a key driver in stocks success in 2025.

Of course, the climb was not easy. The market hiccuped in the spring as the launch of the Trump Administration's tariff policy appeared to be somewhat tumultuous. After a sharp retreat, investors grasped that the introductions on Liberation Day were merely the first parry in give-and-take negotiations that eventually settled on reasonable changes to the existing global tariff structure. The result included surging revenues for the U.S. Treasury and tariffs being absorbed by producers and businesses and mostly not passed on to ultimate U.S. consumers.

All-in-all, it was an everything rally kind of a year and investors with patience and the ability to ignore distractions were rewarded with strong results.

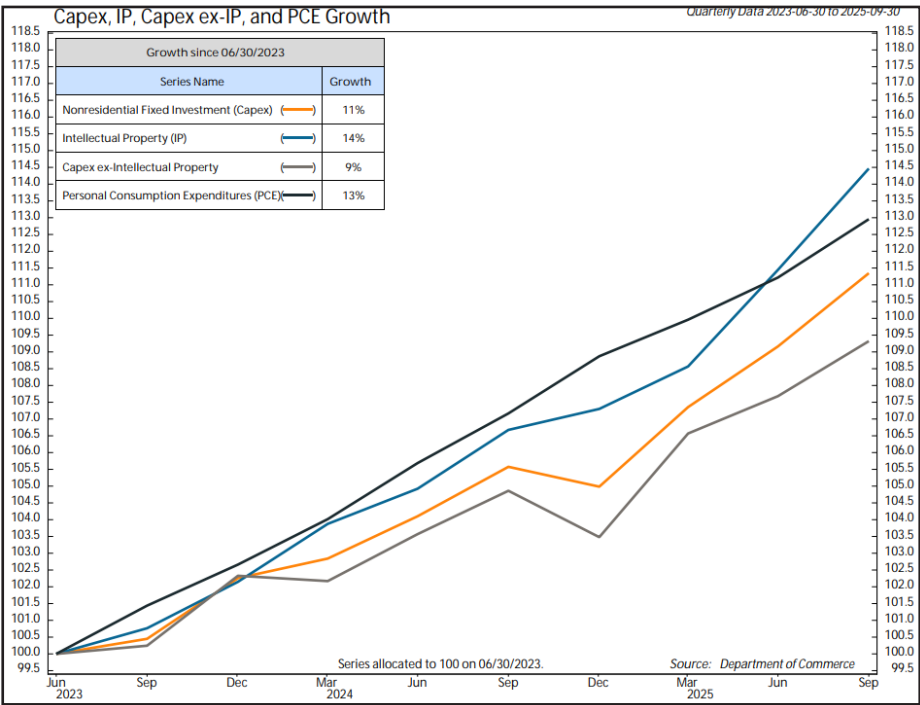
THE YEAR OF THE FIRE HORSE

2026, on the Chinese Zodiac calendar, is the Year of the Fire Horse, which is a symbol of energy and freedom. It is an apt symbol to consider for the coming year. Technology investment spending will continue to be energized. Technological advancement will continue to lead to improvements in economic efficiency and labor productivity freeing workers and businesses to innovate and develop. The ultimate impacts of these things include rising employment and rising wages and rising living standards. They will thus bolster the U.S. consumer raising the likelihood of a continuation of robust 2025

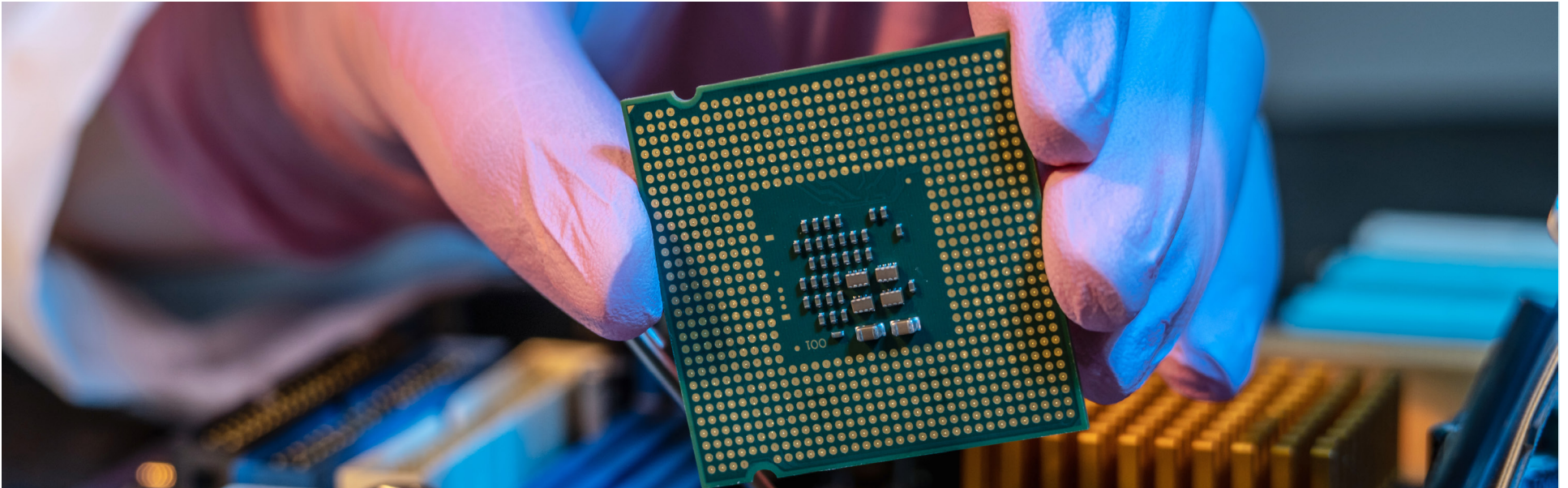
consumer spending performance. And U.S. economic strength will be contagious and contribute to spreading wellbeing around the global economy

BOOMING INVESTMENT

A Technology investment spending has been growing at rates faster than other forms of business investment for some time . In the more recent past, the spending has been much more focused on two things: 1) specialized Artificial Intelligence chips and associated processing equipment and, 2) vast and growing data centers to meet surging demand for the processing needs of AI. 2026 will see a continuation and likely and expansion of these trends. In their most recent quarterly update, Alphabet reported \$24 billion in capital expenditures. More importantly for the future outlook It also reported a \$155 billion backlog in orders for Google Cloud services.



Source: Ned Davis Research



The evolution of the information economy has made data processing centers the hottest ticket around the world. Gartner IT forecasts data center spending in 2026 to increase almost 20% from 2025 and surpass \$582 billion. These expenditures include not only chips and processing equipment, but real estate, buildings, HVAC systems, and electrical and plumbing systems. Ancillary spending includes transportation and electricity generation and transmission. All these things involve workforces, for

Underlying all this demand for AI information processing is the potential for tectonic shifts in labor productivity and economic efficiency.

development and construction, for operation, and for maintenance. The economic impact of this “Silicon Super Cycle” is broad and deep, bringing new sources of income to communities all around the country.

Underlying all this demand for AI information processing is the potential for tectonic shifts in labor productivity and economic efficiency. AI already serves businesses in countless ways, relieving employees from automatable activities and allowing them and their employers to turn to more creative and innovative ones, and to the support of those new innovations. Stoking fears of mass layoffs is an activity that has always accompanied technological change. This era is not going to be much different. Human ingenuity will continue to be the driver of change not new technology.

RESILIENCE AND SUSTAINABILITY

In 2025, the total number of people employed in the U.S. grew 2.0%. Neither a reorganization of global trade alignments, nor reform of immigration policy, nor the deployment of efficiency enhancing technology drove people, en masse, out of work. This is a key contributor to understanding that in 2026, the consumer will likely continue to resilient and continue to deliver positive surprises to expectations.

After a stall in late 2024 and early 2025, Household Net Worth surged 4.4% (not annualized), the highest quarter-over-quarter growth since mid-2021. Given strong stock market performance in the second half of 2025, it likely grew again at a healthy rate, leading to a strong full year run. Key to supporting consumer spending is growing household wealth.

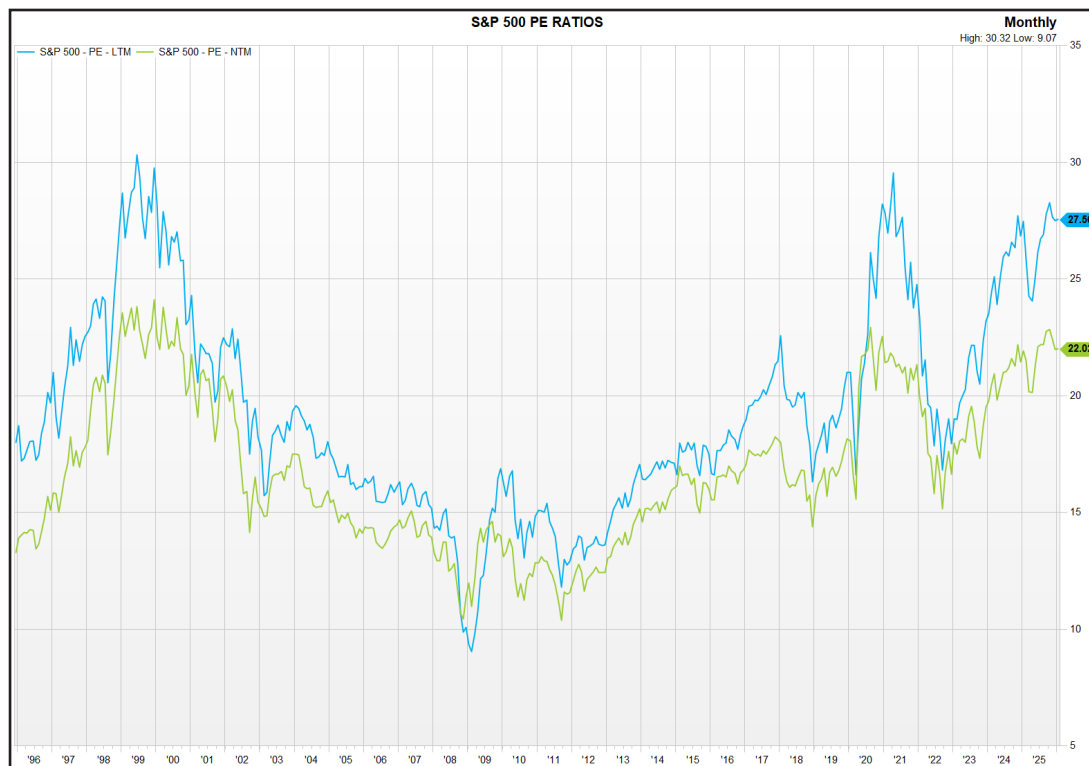
BROADENING SUPPORT

A healthy U.S. economy is a boon to global growth. As noted above, non-U.S. equity markets delivered robust results in 2025, even factoring out the boost from currency translation. With a base (i.e., local currency) return of 20%, and ending the year at or near all-time highs, European equities clearly reflect a growing confidence in future growth expectations. In fact, analysts' estimates in the aggregate have surged. While a bit behind the technology dominated S&P 500, current estimates point to nearly 12.0% growth of EPS for European equities in 2026. Many of the same drivers are at play: booming technology investment and productivity enhancements will contribute to economic efficiency and profit growth.

Non-U.S. equities persistently trade at a discount to U.S. given a number of structural disadvantages. In Europe, those disadvantages include a comparatively small Technology Sector, and an overly burdensome regulatory environment. One goal of the President's Tariff policies is to combat that regulatory burden, at least as far as U.S. multinational corporations are concerned. If effective, this can only be good for both foreign (i.e., U.S.), and domestic (i.e., European) companies, helping to give a further boost to aggregate growth.

RISKS

Risks to such a bright outlook as described above do indeed exist. First and foremost, valuations of publicly traded equities in the U.S. are rich, having risen over the last three years to near record highs. The S&P 500 Price-to-Earnings (PE) ratio, using forecasted earnings, currently sits at 22. It was higher than that only in mid-2021 and in 1999 and 2000. This rising valuation has been justified by surging profit growth. Nevertheless, valuation is an imperfect timing tool; that is, it does not accurately predict short term market movements. High valuations do not leave much room for errors or unexpected developments. In the current market environment, high valuations will contribute to volatility, and may even lead to short-term volatility spikes as seen in the spring of 2025. However, barring a meaningful economic reversal (i.e., recession), the likelihood of a negative surprise in profit growth is not high and any externally driven reversals would likely be short-lived.



Source: FactSet

The other major source of risk is a restructuring employment situation. Overall employment grew in 2025, and the growth rate of employment among the “Native Born” population has recently been higher than the overall growth rate, offsetting any temporary dislocations due to better enforcement of immigration policies. Job impacts from technological change are a permanent feature of a dynamic economy and also likely to be only temporary. However, headline risk exists, i.e., focusing on the unemployment rate as more people seek employment who previously elected to not even look for work. This headline risk can cast a pall over the narrative and paint a gloomier picture – which could shake investor confidence – than actually exists.

CONCLUSION

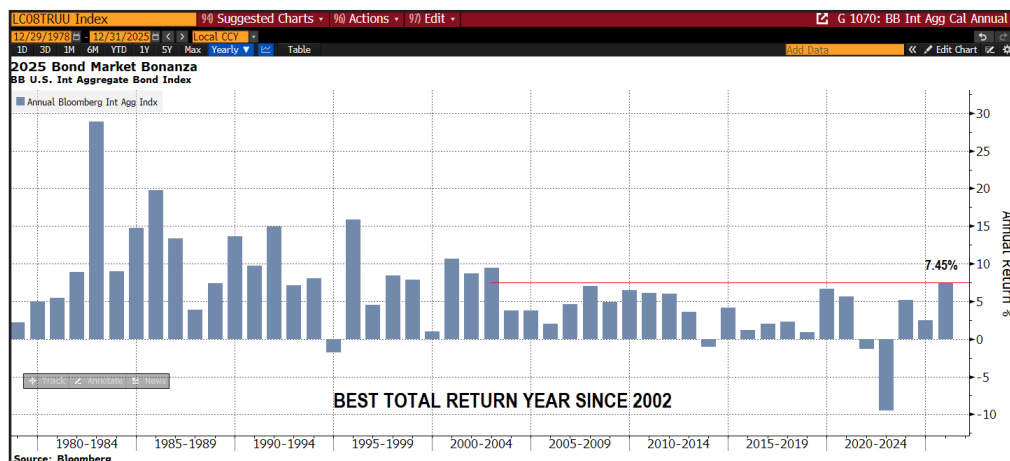
Overall, the near-term future is likely to continue to reward investors who can maintain focus. A strong economy driven by investment in efficiency and productivity enhancements which funnels profits to a growing labor force will provide solid fundamental support to equity price levels. Elevated valuations will keep a lid on returns, but barring an economic contraction, stock indexes will likely finish 2026 higher than they finished 2025.

Everything Worked: How Bonds Delivered Their Best Year in Decades ¹

Jeffery Tanguis

2025: THE EVERYTHING RALLY

The stars finally aligned for fixed income investors in 2025 to produce the best year for domestic bond market returns since 2002. The Bloomberg Intermediate US Aggregate Bond Index, a broad measure of high-quality bonds with maturities of 1-10 years, finished 2025 with a 7.45% total return. Coupon income generated 3.72% while capital appreciation tacked on an additional 3.73% return. It was a year in which there were almost no losers. High quality, low quality, long maturity, short maturity, corporate bonds, Treasuries and mortgage-backed securities all racked up generous gains. Everything worked. You might call it the “everything rally”. That is not to say, however, that it was an easy year. Occasional episodes of investor doubt brought on by Liberation Day tariff uncertainty, Federal Reserve independence questions, federal government shutdowns and often conflicting economic data regularly tested the intestinal fortitude of bond investors. The hallmark of 2025 was the “steepening” yield curve, a market environment where short term interest rates fall faster than longer term rates. Actual and anticipated Federal Reserve rate cuts against the backdrop of loosening labor markets were the principal drivers behind the yield curve’s journey back to a steeper and more normalized shape. For the year the U.S. Treasury 2 year note yield declined 77 basis points from 4.24% to 3.47%. The bellwether Treasury 10 year note yield experienced its first calendar year yield-to-maturity decline in 5 years falling 40 basis points from 4.57% to 4.17%. Falling interest rates last year translated into juicy bond market returns. The Bloomberg US Treasury: Intermediate Index finished 6.51% higher (total return)



Source: Bloomberg Finance, L.P.

for 2025. The Bloomberg US Intermediate Corporate Bond Index shined with a 7.95% total return. The Bloomberg US Mortgage-Backed Securities Index was the best performing fixed income sector returning 8.58%. In defiance of the “Sell America” bears, U.S. investment grade fixed income provided stability, diversification and strong results in 2025.

2026: THE ROAD AHEAD

The big picture – After scoring its best calendar year performance in 23 years, the U.S. bond market is due for a breather. Investors need time to assess incoming inflation and employment data now that the government shutdown induced dearth of information is winding down. The suppressed bond market volatility of late 2025 following the government shutdown will likely give way to more normal volatility as agencies return to the regular cadence of government sponsored economic data releases. In addition to the usual fare of inflation and jobs reporting several other potentially bond market moving events loom on the horizon. The expected Supreme Court rulings this month on the legality of the Trump administration’s tariff policies and attempted firing of Federal Reserve governor Lisa Cook are significant bond market concerns that bear following closely. Both events have the potential to spark big moves in either direction. The Trump administration’s replacement of Federal Reserve Chairman Jerome Powell in May will have reaching implications and is perhaps the single most important event of the year. Lesser and less likely events that still warrant attention are a potential partial federal government shutdown beginning this month and possible mid-term election related antics. The outlook for bonds improves dramatically in the back half of the year as more reliable data brings clarity to improving trends in inflation and economic growth. Labor markets will likely remain soft despite the tailwinds of Trump’s One Big Beautiful Bill. Stubborn unemployment alongside gradually moderating inflation will likely give Fed policymakers the necessary cover to lower the benchmark funds rate multiple times this year albeit at a slow and deliberate pace. The yield curve will continue to steepen similar to 2025. Intermediate and longer term yields will remain somewhat anchored by lingering concerns over rising Treasury debt levels and a return to more normal yield relationships. The improving economic outlook in 2026 is a positive one for the corporate bond market. Risk premiums, however, remain near historic lows reflecting high investor demand and little room for disappointment. Burgeoning corporate supply in response to the Artificial Intelligence data center buildout has some investors questioning the economics of the stampede into AI given the massive costs. While rising corporate debt levels could be a potential problem sometime in the future,



we believe the corporate bond market should be fine in 2026 so long as the economy remains firm. US corporations are remarkably adaptive and remain fundamentally strong. The mortgage-backed securities market looks like it is headed in the right direction in 2026. Relative value versus competing fixed income investments is fair while demand is solid and supply remains constrained.

A Federal Reserve changing of the guard – The Federal Reserve will usher in new leadership in 2026 for the first time in 8 years. In May current Chairman Jay Powell will turn over the reins to his successor who as yet remains unnamed. President Trump has teased the markets for 4 months now with possibilities and promises he is close to an announcement. The two leading candidates according to the betting markets and most opinion polls are National Economic Council Director Kevin Hassett and former Federal Reserve governor Kevin Warsh. Prediction markets say the two candidates are evenly favored to get the nomination. Market participants favor Kevin Warsh as the more serious candidate. While we do not know who will ultimately be confirmed as the next chairman we do know that person will preside over a policy committee more divided than any going back to the Great Financial Crisis of 2008. We also know Powell's successor will be under immense pressure from President Trump to deliver a series of interest rate cuts. Not an easy task given there are 11 other independent thinkers voting on monetary policy. Further complicating the matter, the newly seated 2026 voter rotation on the Fed's policy committee turns slightly more hawkish on the Fed's 2% inflation

target. In the meantime, the drama unfolds around current Fed governor Lisa Cook who awaits a ruling by the Supreme Court this month on whether President Trump has the authority to fire her under debatable circumstances as a Federal Reserve Board member. Critics of President Trump argue he is tampering with Federal Reserve independence. Trump and Treasury Secretary Scott Bessent argue the Federal Reserve is insular, lacks accountability and needs to consider broader perspectives. There is truth to both sides. What is also true is that the Fed will face key tests in 2026. The bond market vigilantes will be watching closely to determine if policymakers under new leadership are truly committed to returning to the Fed's 2% inflation target. Will the Fed again be truly data dependent. Thus far markets are giving the Federal Reserve the benefit of the doubt. Short and long term inflation expectations remain subdued and in line with historical norms. The federal funds futures market forecasts the next 25 basis point rate cut will come in June at the newly seated chairman's first meeting. A second cut is anticipated at the September or October meeting. A third cut is possible in late 2026 if the labor market remains soft as we anticipate.

Government debt and deficits – Treasury Secretary Scott Bessent is anxiously awaiting the Supreme Court ruling this month regarding the legality of President Trump's tariff policies. He has an enormous challenge ahead if the court rules adversely. A misstep could rattle markets and send longer term interest rates spiraling upward. A worst case ruling could require the federal government to write import tax refund checks totaling



hundreds of billions of dollars. Presumably other import taxes will be soon to follow replacing lost tariff revenue but in the interim the federal government would need to borrow much if not all of the funds. Secretary Bessent has mentioned on several occasions he plans to use short term Treasury Bills to fund the government's additional borrowing needs. The additional debt would be manageable but will add to the pile of existing debt and increase interest expense just as the government was starting to make headway on stabilizing the deficit. Multiple Federal Reserve rate cuts would go a long way toward offsetting the increased borrowing costs. The good news is there appears to be an almost insatiable global demand for short term Treasury Bills. One of the more recent sources of demand for T Bills comes from the passage of the Genius act last year that required stablecoins to be backed 1:1 by U.S. dollars or Treasury securities. The U.S Treasury is positioning stablecoins as a strategic new age tool to absorb the flood of government debt. Stablecoins were already the 3rd largest buyer of Treasury Bills in 2024. Elsewhere around the world other sovereign governments are experiencing debt and deficit challenges of their own. Increased defense and/or stimulus spending across Europe and Asia is straining budgets and sending longer term interest rates to their highest levels in years. In Germany, the long bond yield has risen to levels not seen since 2011 while Japan is struggling with the highest yields since 1999.

Patience pays – Bond returns in 2026 will likely remain attractive but pale beside the dramatic returns of 2025. Income will be the primary driver of performance in 2026. Given the favorable outlook for an accommodative Federal Reserve, moderating inflation and trendline economic growth investors might reasonably expect to earn their coupon interest rate plus modest capital appreciation as short term interest rates decline. Intermediate and longer term interest rates may prove sticky and range bound. Much of the gains will likely occur in the second half of the year as was the case last year. Investors should remain patient and focus on long term positioning.

Policy at Full Throttle¹⁰⁻²²

Stephen Morgan

CHANGING THE BLUEPRINT

Beginning on Inauguration Day, President Donald Trump and his team have moved at a dizzying pace with initiatives that could reshape the government at scale seen perhaps once in a generation. The policies seek to rearchitect the executive branch, the relationship among the branches, international affairs and global trade.

Within the executive branch, the Oval Office has sought to cut staff, delay or eliminate funding to many agencies, while establishing greater Presidential authority over regulatory agencies like the Federal Trade Commission, the Securities and Exchange Commission, and more. Many early headlines focused on the activities of the Department of Government Efficiency (DOGE), a special initiative President created by an Executive Order in January. The group, led by Elon Musk, coordinated investigation into government agencies while supporting digital initiatives. However, by November key functions had been absorbed into other agencies.

Executive orders such as those that created DOGE have been a hallmark of the President's second term, and by the end of 2025 he had already issued more of them than any President has done in a single term since Jimmy Carter. Several of those orders and other executive actions have triggered lawsuits from states, businesses and individuals claiming that he intruded on Congressional authority or relied an authority not actually granted by statute. We expect legal challenges to continue and that the Oval Office will continue to test the boundaries of Presidential authority.

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On the international stage, as Richard Chauvin will discuss in the Geopolitics section, the administration has rewritten the traditional relationships between the U.S. and its allies and rivals. In trade, as is widely discussed, the U.S. has aggressively acted to renegotiate old patterns, leaving businesses, consumers and trading partners scrambling to react. We expect both these to continue but with improving clarity on trade.

MIDTERM MELEE

Moving into 2026, the fall mid-term elections will become ever more the focus of elected officials. Both time on the campaign trail and the potential for controversy will limit what Congress is likely to accomplish until new legislators take their seats in 2027. Similarly, 46 states have regular legislative elections in the fall; while these may be less of impediment at the state level in some cases, the looming ballots will still influence legislative behavior.

While other issues will no doubt arise, we expect affordability, particularly in health care and housing, to remain important in the lead up to the election and may even prompt a notoriously divided Congress to take some action.

It is still too early to make accurate predictions about the outcome of the voting, but historically the President's party tends to lose seats. Given the paper-thin majorities in the House, Democrats have a high probability of taking back the chamber. Their outlook is dimmer in the Senate but with more Republican seats including more battleground



states (as identified by Ballotpedia) up for grabs, control of the chamber remains in question. Flipping one chamber would curtail some of the control President Trump has been able to exert on legislation. A change in both chambers could represent a much more significant setback for the second half of his term.

FEDERAL FUNDING

Congress failed to pass the 2025 budget in “regular order” with a dozen separate appropriations bills. Instead, an agreement was made on what was essentially a full-year continuing resolution (CR) to authorize government funding through the end of the fiscal year on September 30. That was enough to allow the subsequent 2025 budget resolution, also known as the One Big Beautiful Bill Act, a special class of legislation that bypasses a Senate filibuster. The key component of the legislation was the personal income tax cuts from the 2017 Tax Cuts and Job Act which were due to expire at the

The stand-off led to the longest government shutdown in U.S. history, creating havoc in both food support and air travel.

end of 2025, a development that would likely have rattled already nervous consumers. In addition, the bill included some pro-growth additions such as allowing 100% bonus expensing – in which businesses can deduct certain capital spending in the year it is made – and full deductibility of U.S.-based research.

The path to a fiscal year 2026 budget has shaped up to be even more dramatic. With no appropriations bills making their way through both chambers by the beginning of fiscal year, Democrats held out for long-term provisions addressing health care costs as part of a CR, Republicans demanded a cleaner version. The stand-off led to the longest government shutdown in U.S. history, creating havoc in both food support and air travel. It was finally ended by an agreement that included three full-year appropriations bills, an extension of other funding until January 30, and an agreement to hold a separate

Senate vote on extending enhanced Affordable Care Act subsidies. Democrats were unable to prevail in the subsidy vote and may be tempted to try again as we approach the end of January deadline to avoid a partial shutdown.

TARIFF TALK

Almost certainly the headline story for the financial press during the year, new U.S. tariff policies began to shake global trade patterns. Tariff announcements begun within the first days of the administration and included targeting not only of China, as expected, but also more aligned trading partners like Canada and Mexico. The pivotal moment was the April 2 announcement of broad-based reciprocal tariffs. Markets reacted negatively but began to recover a few days later as the administration signaled a more measured approach even as retaliatory measures were announced, notably by China with which a short-term trade war erupted for a “ceasefire” agreement was reached. Further tariffs were announced as the year continued and others delayed or adjusted. At the end of July, the administration issued an executive order that updated the rates initially announced in April. Meanwhile frameworks for trade deals were announced.

We believe that tariff uncertainty will continue through 2026 and beyond, but the hesitance to act by businesses and consumers will continue to dissipate as more agreements are developed. One particular milestone to watch for is a Supreme Court ruling on whether the International Emergency Economic Powers Act, which the President invoked to impose a broad range of tariffs, actually authorizes those actions. If the Court rules against the use, the administration will no doubt move swiftly to reimpose them under established authority; the Court would also likely order refunds of previously collected tariffs which could be a tailwind for economic activity in 2026.

IMMIGRATION IMPLICATIONS

Making good on a key campaign theme, the President increased border security and began to ramp up deportation actions. Initial deportation enforcement seemed to be focused on a “worst first” strategy of those with serious criminal convictions. However, in the second half of the year reports of workplace enforcement actions increased. Particularly in areas targeted for workplace and public enforcement, this seems to have had the expected effect of disrupting some commercial activity as people dropped out of the workforce. This has likely helped offset some developing labor demand, but specific industries may not find easily fungible laborers.





Geopolitical Update: Power Shifts and Policy Realignment ^{1,16,23-25}

Richard Chauvin, CFA

The release of the new National Security Strategy of the United States of America in November provides a stark reminder of how President Trump's administration is fundamentally reshaping the U.S.'s relationships with both its allies and adversaries around the world. The strategic competition between the U.S. and China remains the key geopolitical feature influencing investors' global outlook. However, there are other significant features that deserve investors' attention, and two of them are our focus in this quarterly Geopolitical Update.

EUROPEAN POLITICAL PARALYSIS AND THE RESET OF THE U.S.-EUROPE RELATIONSHIP

The Russia-Ukraine conflict has starkly revealed the U.S.'s reset of its relationship with Europe and laid bare the ongoing dysfunction in the EU's governance model. How Europe found itself in its current predicament has its origins in the geopolitical system that emerged after World War II. American foreign policy in the post - WWII era

operated from the assumption that U.S. dominance of the entire world was in the best interest of the nation. With that assumption in place, Europe was willing to assume that the U.S. would be its permanent protector. The new National Security Strategy makes the case this arrangement is obsolete and must change so the U.S. can focus on other priorities. A key priority is ensuring the Western Hemisphere "...is free of hostile foreign incursion or ownership of key assets, ... supports critical supply chains; and ... ensures our continued access to key strategic locations". This shift in priorities by the Trump administration has led to the belief that the U.S. has betrayed Europe, a sense that is exacerbated by the fact that Europe was wholly unprepared for this change and, because of the flaws in the EU governance model, faces major challenges in becoming prepared for the loss of its protector.

From the U.S. perspective, the Russia-Ukraine conflict provided a good opportunity to reset its relationship with Europe. It is important to remember that Russia's invasion of Ukraine has been a failed operation. Vladimir Putin expected to quickly take all of Ukraine but after more than three years has only managed to take some territory in the east, and at great human cost. The U.S. sees this failure as proof of Russia's weak, obsolete military. Thus, the moral obligation to defend Europe against Russia is also obsolete, and no longer necessary. The European Union's economy stands at about \$20 trillion in 2025, which exceeds the GDP of China. It should be capable of mustering sufficient resources to defend itself against Russia, whose economy is only around \$2.5 trillion. Unfortunately, Europe was collectively unwilling prepare for such a possibility until Russia invaded Ukraine, after which it became an urgent matter. However, there is no country named Europe, rather it consists of twenty-seven sovereign states that are often unable to make decisions for the benefit of whole block due to differing cultures, languages, and long-standing distrust.

This has left Europe in crisis. The creation of the European Union did not result in anything more than a loose economic alliance. It did not unite the continent fiscally or militarily. Unless Europe decides to take action to unite, each nation must decide how to raise its defense posture now that the U.S. security umbrella is no longer assured. It is laudable that many members of the bloc have corrected their delinquent status with NATO defense budget requirements by committing 2% or more of their GDP to defense. This year will be the first time all 32 NATO members will meet the 2% target. Earlier in 2025 the alliance increased the spending target to 3.5% of GDP on core defense and an additional 1.5% other security-related investments. These additional costs combined with ongoing profligate fiscal policies have exacerbated financial strains. Europe struggles with slow growth, an aging population, an expensive social safety net, and high regulatory costs. Dependence on imported fossil fuels, and the costly plan to

build a massive renewable energy infrastructure to replace fossil fuels has hampered economic growth and fostered a surge in the popularity of anti-establishment, right-of-center political movements.

The belief among national leaders, such as German Chancellor Friedrich Merz, is that a €500 billion (\$540-\$545 billion) debt package designed to fund climate projects, infrastructure and expand a domestic weapons manufacturing industry will ignite economic growth by attracting private capital. It is a wager that debt-driven stimulus will revive the economy slow-growth economy. However, these state-sponsored projects do not reflect market forces or real demand. Ultimately the debt must be paid with higher taxes. In Germany, which boasts the largest GDP in Europe, the state sector already comprises over half the economy, draining resources from the private sector.

In Germany and in other EU nations, there are calls for softening and delaying some of the mandates that burden industry, farmers and consumers.

In Germany and in other EU nations, there are calls for softening and delaying some of the mandates that burden industry, farmers and consumers. For example, the rules that would have outlawed internal combustion engines in autos by 2035 have been cancelled. However, automakers still complain that the requirements to use “green” steel, e-fuels and biofuels will raise sticker prices beyond what most car-buyers can pay.

While some investors place hopes on an economic resurgence sparked by capital spending from the defense industry, Europe remains on a path of very slow economic growth. We remain watchful for efforts to enact policies promoted by former European Central Bank President Mario Draghi in 2024 that would increase the dynamism of the economy through fiscal prudence, enhanced competitiveness, and a strengthened labor market. To date, we have seen limited evidence his recommendations are being heeded.





TRUMP'S "GUNBOAT DIPLOMACY" IN THE CARIBBEAN SEA

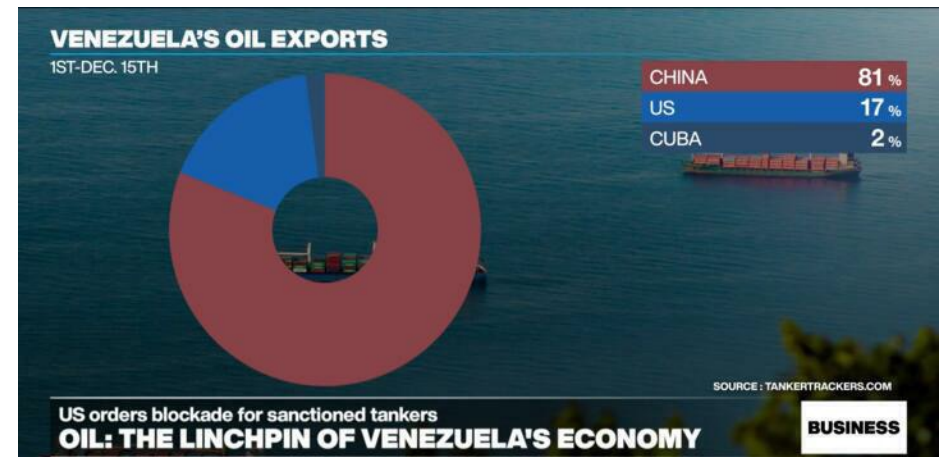
President Trump's recent actions near Venezuela can be understood in the context of the new National Security Strategy. The new strategy demands a more active role by the U.S. in the Western Hemisphere to assert U.S. security dominance and enhance the economic capabilities of Latin America. This will allow the U.S. to reduce its role in the Eastern Hemisphere. However, for that to happen, Latin American nations must become more politically stable and economically productive. The most problematic countries in that regard include Venezuela and Cuba. For now, we will focus on Venezuela.

Some Latin American countries such as Venezuela have economies that are significantly based on the export of narcotics, a process run by cartels. The presence of the

cartels makes it impossible for an economy to advance to a more diverse and vibrant level. Their presence also makes an economy inherently unstable. Thus, the Trump administration's new strategy mandates that Venezuela must be forced to change. The current operations, which include a two-month blockade to deny oil tankers passage into and out of Venezuelan ports, and as we write this, the capture and transport of Nicolas Maduro and his wife, Cilia Flores, to New York to face several charges, are steps in that direction.

The goals of Trump's actions are twofold:

- ▶ Weaken and destroy the cartels and allow the existing wealth of Venezuela in the form of natural resources to be utilized and,
- ▶ Act upon the principles outlined in the National Security Strategy, through which Trump is asserting his own version of the Monroe Doctrine, established by President James Monrow in 1823. Trump is asserting that the Western Hemisphere is under U.S. influence, and interference in the region by Russia, China and Iran is not welcome. In the weeks ahead, the reactions of these nations to the loss of their ally in Venezuela will determine if military operations in The Caribbean or over or just beginning.



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