CALADO CAPITAL

Week in review and ahead (vol.03-26)

Claudio Calado | Managing Partner

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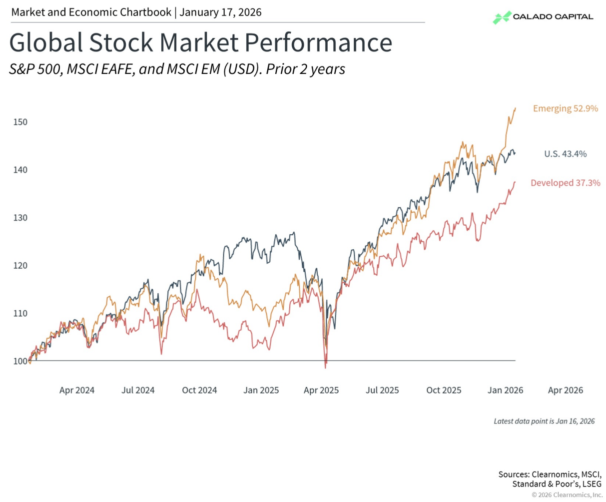
Markets were marginally lower for the week as headline risks returned with POTUS making numerous announcements that will have significant implications for the US economy if adopted as policy. Adding to the highly awaited inflation data that saw retail inflation (CPI) for December on headline in line with expectations, while wholesale inflation (PPI) on headline for November was higher sequentially and estimates, further supported last week's non-farm payroll report that the Fed will likely hold rates steady. Accordingly, treasury yields along the curve gaped up, with the 10-treasury yield closing above 4.2% for the first time since early September.

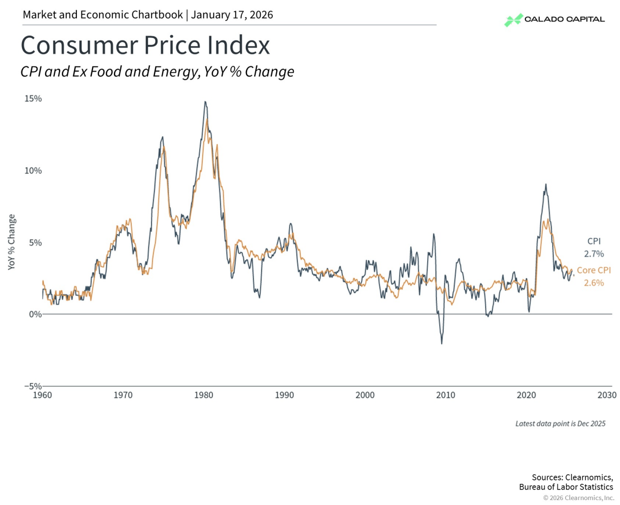
The S&P500, Dow Jones, and Nasdaq Composite were down -0.06%, -0.28%, and -0.26%, respectively. The tech trade that has been subject to some caution given elevated valuations advanced last week, following strong earnings by Taiwan Semiconductors Manufacturing Company ('TSMC') that offered the first glimpse that demand in the AI trade remains strong. The Russell-2000, an index of small cap companies, continued to outperform the major indexes, gaining another 2.43% for the week, and 6.76% on a year-to-date basis, closing the week just shy of its all-time high. The performance of the Russell-2000 since the beginning of the year reflects a pattern that is seen routinely when the yield curve steepens, however, given the macro data reported thus far, including growth expected to exceed 5%, may not support the Fed to cut rates, certainly not to the extent expected.

Internationally, major markets continued to see gains for the week, after a strong start to the year, with the exception of China's Hang Seng and France's CAC-40. While the Hang Seng declined mainly on profit-taking following a strong rally since the new year, the CAC-40 declined as concerns about consumer discretionary spending led to a stark selloff in luxury and consumer stocks. The continued discussions and concerns surrounding France's budget also weight on equities. Biggest gainer was Japan's Nikkei, advancing 3.8% on the week, on expectations that prime minister Takaichi may call for early elections seeking support for her pro-stimulus fiscal policies, a weaker yen and strong performance in semiconductors following TSMC's earnings.

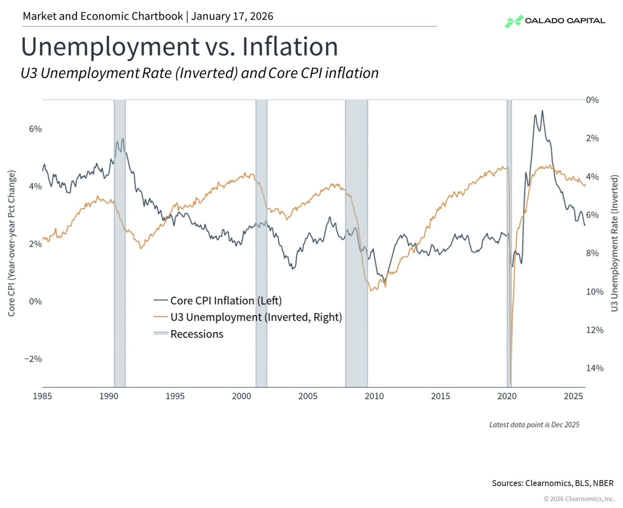


The markets began last week selling off following news Sunday evening that the Department of Justice (‘DOJ’) had served the Fed with subpoenas threatening criminal indictment related to Fed chair Powell’s testimony to Congress about the Fed’s building renovations. Surprisingly, Fed chair Powell released a video statement on Sunday evening in which he emphatically noted the action as pretense to undermine the Fed’s independence. Besides Powell, many former central bankers (including former Fed chairs and international central bankers) commented and issued statements pointing to risks that may jeopardize Fed’s independence. Similarly, many economists and bankers publicly came to Fed chair Powell’s defense and emphasize the importance of the Fed remaining independent. Despite markets rebounding Monday and POTUS reiterating on Tuesday he would not “fire” the Fed chair, which arguably he may not have the authority to do, concerns remain and likely will resurface as the DOJ may press the matter in the coming days and/or weeks.

The market’s focus shifted quickly, however, towards inflation, with reports on CPI for December released on Tuesday, followed by PPI for November on Wednesday. Headline retail inflation for December was in-line with expectations and sequentially unchanged, with month-over-month (‘MoM’) CPI growing at 0.3%, and year-over-year (‘YoY’) CPI at 2.7%. For core CPI, excluding food and energy, the rates were better than expected and as with headline, the same as reported for November, with MoM at 0.2% and YoY at 2.6%. As to wholesale inflation for November, headline and core were higher sequentially with headline and core both raising at 3.0% YoY and both exceeding expectations. On a MoM basis, headline PPI of 0.2% was in-line with expectations but higher sequentially, while core PPI surprised at 0%, lower sequentially and beating expectations. Besides CPI and PPI, the government released delayed data on import prices for October and November that rose 0.4% MoM, well above expectations of -0.2%, and higher sequentially (from 0.1%).



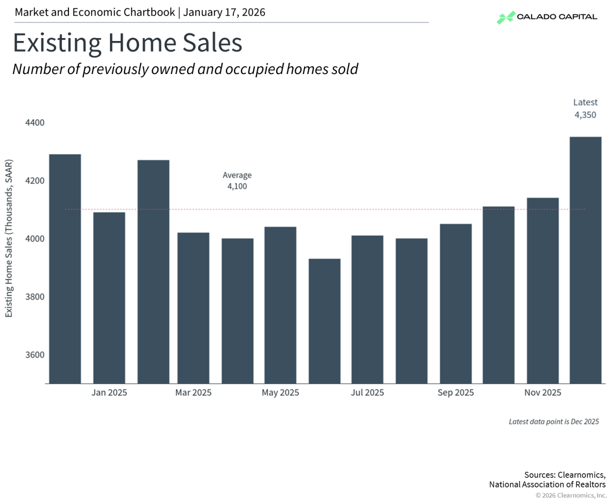
Given the mixed signals from the inflation report, combined with a lower unemployment rate in (November and) December, as reported last week, some are seeing rate cuts less likely even beyond the January's FOMC meeting. The dollar has been rallying on this notion as have yields, with shorter maturities in particular seeing greater increases after months of long-end steepening. The initial jobless claims on Thursday appeared to further support that notion, as claims were below 200K anew (at 198K), well below expectations of 215K and sequentially (from 207K).



In other macroeconomic news, the delayed release for November's retail sales showed that the state of the consumer remained strong with headline retail sales up 0.6% MoM, reversing a decline of -0.1% the month before and better than expectations of 0.4%. Similarly, core retail sales (ex-auto, ex-gas) were up 0.4% MoM, in-line with expectations but higher sequentially reversing a decline of -0.1% for the prior period.

The housing market that had been sluggish on higher rates and lower supply, keeping prices elevated, appears to see some signs of rebounding on falling rates, as existing home sales of 4.35M, the highest since March'23, exceeded expectations of 4.22M and were sequentially higher (from 4.14M, previously). Recent declines in mortgage rates appears to have led to the increased activity.

The Q4 earnings season, which unofficially began with most major banks reporting last week, is off to a mixed start. With 7% of S&P companies reporting last week, nearly 8 out of 10 have reported better earnings-per-share ('EPS') than estimated, however, the magnitude of the beats, or earnings surprises, are below recent averages, per FacSet. With respect to revenues, 67% reported better than estimated sales, which according to FactSet is below the 70% average for the last five (5) years.



Next week will be a holiday shortened trading week, as financial markets observe Martin Luther King Jr. day on Monday. The earnings season continues, with 35 S&P companies scheduled to report

On the macroeconomic front, markets will focus on the (delayed) release of the PCE data, including the Fed's closely watched PCE inflation index, for November, and the first revision to US Q3'25 GDP. S&P will release its estimate on the US economy with its flash readings for the manufacturing and service sector and the University of Michigan will release its final reading on consumer sentiment for January which is not expected to change from its first estimate.

Finally, expect geopolitical risks and concerns to resurface and likely add to market volatility including POTUS continued insistence in purchasing Greenland from Denmark, with the latest being threatening tariffs on (EU) nations that side with Denmark. Thus far geopolitical risks have somewhat been minimized by markets, except for reacting to headlines, but could take center stage as it threatens to upend agreements, including trade agreements, with the US closest allies, and jeopardize the NATO alliance.

If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at claudio@caladocapital.com.

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