

Week In Review

OLLI-GMU Investment Forum

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Today: AI was hot - until it wasn't

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Disclaimer: I am not a certified financial analyst.

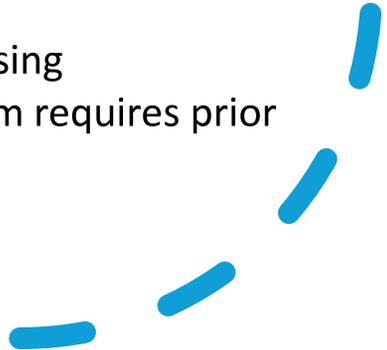
Any trading decisions you make are your responsibility

If you would like to acquire these slides, email me at:

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Economic Commentary

Good news and bad news

- We have the Goldilocks economy: not too hot, not too cold
 - Q4 2025 earnings have come in much better than expected
 - Earnings up 13% vs. 8.3% expected YoY
 - 5 quarters in a row of double-digit growth
 - Unemployment dropped to 4.3%; 130,000 new jobs in Jan
 - Surprise! Labor market is stronger than we thought
 - Inflation declined in January, now at 2.4% overall
 - Surprise! Housing, food, energy prices are the drivers
 - Tariffs are contributing about 0.8% to inflation
 - ISM Manufacturing PMI hit 52.6 in January; first expansion in 26 months
 - ISM Services PMI hit 54.7; strong expansion; 19 months growing
 - Some distress beginning to develop in home mortgages
 - Mortgage foreclosures rose to 3% for low-income folks
 - Steak prices are up 55% since 2020
 - 75-year low in cattle stock; cattle rustling rising
 - AI is coming to Medicare: “WISER” pilot program requires prior authorization for certain procedures
 - The K-shaped economy gap keeps growing
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K-Shaped Economy

Source:
NY Fed

This explains why aggregate retail sales have been strong, yet consumers are unhappy with the economy

Housing Market Showing Signs of Fatigue

Mortgage Delinquency Rates Return to Levels of Ten Years Ago

- Overall mortgage delinquency is 1.3% and rising, compared to 8% during the GFC.
- Rising delinquencies are strongly correlated to declining house prices
- Credit card & auto loan delinquencies steady
- Student loan delinquency is elevated at 9.6%

Source:
NY Fed

Loan Delinquencies Rising (NY Fed)

Total debt: ~\$19T

Source:
NY Fed

Market commentary

Flight to safety and dividends last week

- Reality check: AI was hot, until it wasn't
- How much damage will AI cause, and to whom?
 - Software, finance, logistics, insurance, real estate affected
- Mag 7 struggling
 - Financial gymnastics in progress: GOOGL, META
- Dividend stocks back in vogue
 - Verizon, JNJ, P&G, UNH, utilities did well last week
- BDCs getting clobbered again – software attack
 - ARES, OBDC others invested heavily (20%) in software
 - Hercules Capital (HTGC): great 2025 report, stock crashed
- Bitcoin is down 21% YTD; nobody knows why
- VIX: rose to 21: somewhat fearful
- CNN fear gauge: 36: fearful
- AAI investor sentiment: 38% bullish; 38% bearish
- Put/Call ratio rising to 2.2; very fearful
- Junk bond spreads: Rose to 2.9% from 2.5%; (FRED)

MAG 7+ Not So Magnificent
(Seeking Alpha)

Software Firms' Vulnerability in the Age of AI

We observe that major software firms have been hit hard in view of worries over AI, e.g. Microsoft, Oracle, Salesforce, Meta, Banks, BDCs

Three reasons:

- Speed of development is outpacing security review
 - Software is being developed faster than it can be reviewed
 - Testing, debugging and QA are removed prior to production/deployment
- Inexperienced developers using AI tools do not understand common security safeguards leading to serious security flaws
 - 30% of AI-generated code failed security tests (OpsMX)
- Vulnerabilities of AI tools themselves
 - Many security flaws in these tools continue to be identified
 - Malicious code has been found embedded in some AI tools

State Street Sector Performance YTD

Earnings don't matter anymore: AI effects?

Utilities (XLU) Suddenly In Vogue

Next Era Energy (NEE)

Now what?

- Expect maybe one Fed interest rate cut in 2026
- Emerging market stocks and developed markets--Ex US stocks expected to perform best this year
- US economy is strong but....with some geo-political uncertainty
 - Strong stimulants in place – OBBB tax relief
 - Consumer spending is split among haves and have nots; overall strong
- Labor market is stronger than expected
- Inflation seems to be under control
- Supreme Court to rule on tariff legality soon – long overdue
- Stock market is very expensive: Forward PE = 22
 - Diversify!
 - Protect yourself with automated stop loss orders; or put options as insurance
- **For good entertainment, movies to see: The Big Short, Dumb Money, Rancho Deluxe**