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Macro
Memo

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2026 Outlook: A Wartime Footing

Looking Back: How 2025 Played Out

Before diving into our outlook for 2026, it is worth revisiting our expectations for 2025 and assessing how they held up.

Our 2025 Outlook argued that a year marked by political transition, beginning with a new administration in Washington, would likely usher in heightened volatility. We also suggested that hard assets, particularly commodities, were deeply undervalued relative to financial assets, and that incorporating them into portfolios could help mitigate risk in a changing macro environment.

As 2025 came to a close, those views largely proved correct. Portfolios with exposure to hard assets meaningfully outperformed traditional stock-and-bond allocations, particularly as geopolitical uncertainty and inflationary pressures resurfaced.

Setting the Stage for 2026

Looking ahead, it appears clear that the Trump administration will continue to pursue policies that disrupt the existing global order. Early signals point to a decisive shift toward reindustrialization, national security prioritization, and a willingness to use federal government power more aggressively.

One example underscores the magnitude of this shift: President Trump has publicly called for a 50% increase in the 2027 U.S. defense budget, from roughly \$1 trillion to \$1.5 trillion annually.

However, domestic policy alone will not determine outcomes. External geopolitical forces, particularly the evolving relationship between the United States and China, will play a defining role in shaping the economic and market landscape.



To better understand where these forces may lead, we turn to the 2025 National Security Strategy of the United States (NSS)¹, published by the White House in November.

The National Security Strategy: Ambition and Tradeoffs

The NSS opens with a striking admission: the era of globalism (roughly 1990–2020) hollowed out the American middle class and eroded the industrial base upon which U.S. economic and military power depend. The document explicitly aims to reverse these trends.

It also acknowledges a deeper issue, that since the end of the Cold War, the United States has lacked a clearly defined vision for its role in the world.

To address this, the NSS outlines several ambitious objectives, which include:

- A resilient national infrastructure
- The world's most powerful, lethal, and technologically advanced military
- The world's most dynamic, innovative, and advanced economy
- The world's most robust industrial base

Noticeably, some of these goals conflict with one another. Pursuing them simultaneously will require difficult tradeoffs. In practice, some objectives will need to be deprioritized for others to be achieved.

Our investment research process begins precisely here, by examining geopolitical realities, identifying which objectives are most likely to take precedence, and then assessing which macroeconomic and market outcomes are not yet fully realized in market prices, thereby presenting investment opportunities.

Geopolitics: A New Monroe Doctrine²

The most consequential foreign-policy concept introduced in the NSS is what could be described as a “Trump Corollary” to the Monroe Doctrine, a renewed assertion of U.S. dominance in the Western Hemisphere.



The administration wasted little time acting on this doctrine. On January 3, 2026, U.S. forces apprehended Venezuelan president Nicolás Maduro, transporting him to New York to face drug-trafficking and related charges.

While some observers framed this action as primarily about oil, a more compelling explanation lies elsewhere: strategic resource denial, particularly in relation to China and critical minerals.

China’s Control of Critical Minerals³

China currently holds a dominant position in the refining and processing of critical minerals essential to modern industrial, consumer, and military technologies.

In his essay “Critical Minerals: A Strategic Analysis,”⁴ Australian journalist and investor Craig Tindale highlights China’s share of global processing capacity:

- Gallium production (~98%) – critical for AESA radar systems and 5G networks
- Magnesium smelting (90–95%) – essential for aluminum alloying
- Rare earth separation (~90%) – vital for missile guidance, radar, and electronic warfare
- NdFeB (Neodymium-Iron-Boron) magnets (>90%) – the core of EV motors and defense actuators
- Tungsten processing (~83%) – necessary for armor-piercing munitions
- Antimony processing (~80%) – required for munition primers
- Aluminum smelting (~60%) – crucial for aerospace applications
- Copper smelting (~50%) – foundational for electrical and military systems

The implication is stark: U.S. defense capabilities are deeply reliant on supply chains controlled by China. In effect, the United States cannot sustain a prolonged military conflict without China’s “permission”.

China understands this leverage. After decades of strategic execution, it has moved to weaponize its dominance. In April 2025, China introduced export controls on rare earth elements, followed by stricter licensing requirements in October that effectively prohibit exports for military use.

Venezuela: Denying Feedstock, Not Winning the War

The Trump administration’s response has focused on denying China access to raw materials, even if it cannot immediately displace China’s processing dominance.

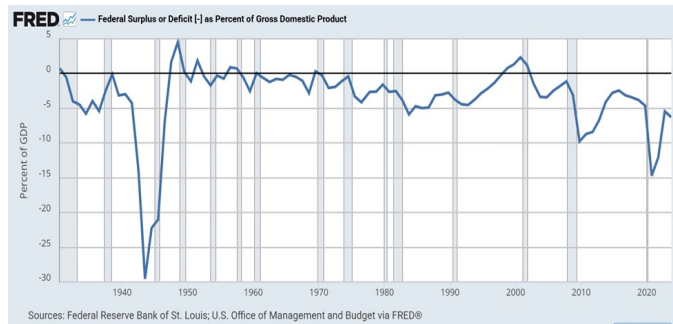
Venezuela, in addition to oil, is rich in rare earth minerals. By cutting China off from this feedstock, the U.S. cannot reverse China’s advantage, but it can slow its expansion. As the saying goes, when you find yourself in a hole, the first step is to stop digging.

That said, access to rare earth minerals does not equal access to rare earth elements. Refining requires an environmentally destructive, chemically intensive process involving toxic waste and radioactive byproducts. The U.S. offshored this industry decades ago due to environmental and labor costs, leaving it ill-prepared to rebuild capacity quickly.

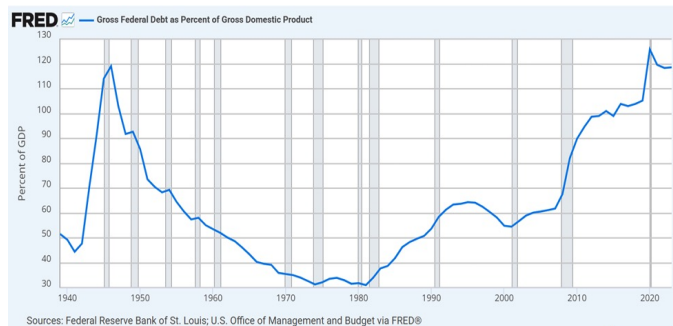
Reshoring or “friend-shoring”⁵ these supply chains will be expensive and time-consuming, requiring aggressive industrial policy⁶. To frame this challenge, Secretary of War Pete Hegseth has emphasized the need for a “wartime footing” to secure modern weapons and industrial inputs (raw resources)⁷.

Macroeconomics: The Cost of a Wartime Footing

Historically, wartime footing has meant massive fiscal expansion. During World War II, U.S. federal deficits reached roughly 30% of GDP⁸.



We are not suggesting a return to those extremes. However, it is reasonable to expect that current deficits will persist, and likely expand, on top of a national debt already exceeding World War II levels⁹.



Debt accumulation at this scale creates strong incentives for financial repression. As deficits persist and debt servicing costs rise, policymakers may increasingly rely on yield curve control (YCC) to cap borrowing costs, allowing inflation and nominal growth to erode the real value of government liabilities, as occurred in the 1940s following World War II¹⁰.

Financial Markets: Bonds, Equities, and Real Assets

The NSS explicitly references the dollar’s role as the world’s reserve currency as a strategic advantage. Yet persistent deficits, rising debt, and financial repression

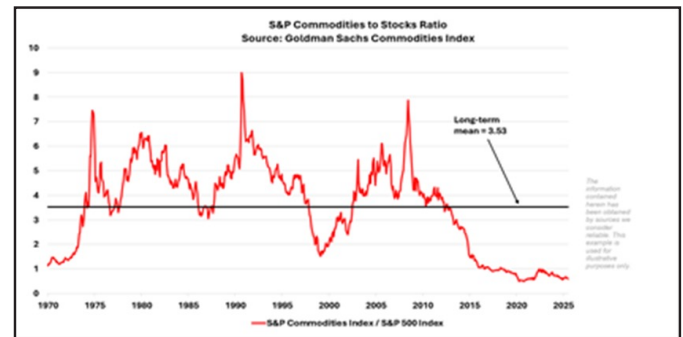
would make U.S. Treasuries increasingly unattractive to foreign reserve holders.

A wartime footing combined with YCC would likely:

- Debase the dollar in real terms
- Weaken its reserve-currency appeal
- Create a challenging outlook for bond investors

The outlook for equities is more nuanced. Inflationary environments tend to reward companies with tangible assets and pricing power, while penalizing long-duration, speculative growth.

Historically, value-oriented sectors and commodity producers have fared better during such periods. Notably, commodities remain historically cheap relative to equities, a disconnect that may not persist.



Summary: Navigating a Changing World Order

The global landscape is shifting rapidly as the United States and China engage in an economic war centered on control of critical resources. Establishing and sustaining a wartime footing to rebuild industrial capacity will likely require persistent deficits, higher inflation, and financial repression.

These forces threaten the long-term value of the dollar and traditional fixed-income assets, while elevating the strategic importance of hard assets and the infrastructure that they support.

As these dynamics continue to unfold, we believe disciplined exposure to real assets and select value-oriented investments may play an increasingly important role in diversified portfolios.

If you would like to discuss how these themes may apply to your investment strategy, we are always available to explore the opportunities, and risks, in greater detail.

DAN CAIRNS, CFP®, CIMA®, CPWA®, RICP®

Senior Vice President, Financial Advisor
(916) 581-7549 | dcairns@dadco.com

ERIN CAIRNS

Financial Advisor
(916) 744-7562 | ecairns@dadco.com



2901 Douglas Blvd., Suite 255 | Roseville, California 95661 | cairnswealthmanagement.com
CA Ins. Lic #0A12472 | D.A. Davidson & Co. member SIPC

¹ Follow this link to the 33 page PDF: <https://www.whitehouse.gov/wp-content/uploads/2025/12/2025-National-Security-Strategy.pdf>

² An 1823 declaration by President James Monroe essentially saying, "This hemisphere is our neighborhood, and all you non-western hemisphere nations (in 1823 that meant Europe) need to keep your hands off it"

³ We wrote about this topic in our July 2025 Macro Memo which can be read here: <https://www.cairnswealthmanagement.com/Macro-Memos.10.htm>

⁴ <https://x.com/ctindale/status/1997471488514134481>

⁵ A strategy where businesses and governments shift supply chains to politically and economically aligned "friendly" countries, rather than rivals.

⁶ Government industrial policy involves strategic state intervention, using tools like subsidies, tax credits, and trade barriers, to foster specific domestic industries, technologies, or sectors for national security reasons or other economic goals.

⁷ https://www.wsj.com/politics/national-security/hegseth-vows-to-put-u-s-weapons-production-on-wartime-footing-fe1bcb55?gaa_at=eafs&gaa_n=AWEtSQCHJO7mTrUrDEipSrJXSX7W90OIJDa6dCO-96L3a0DvUGFb0AeeKyR&gaa_ts=695bee1a&gaa_sig=ntYZbvujBtk1eF06UQuQrLSx_3L0cuBZmTLQo-exudxXSWzjTwsuwpmW0SNCvZoYq9H_w60-zPQTERIyePz2Fg%3D%3D

⁸ U.S. Office of Management and Budget and Federal Reserve Bank of St. Louis, Federal Surplus or Deficit [-] as Percent of Gross Domestic Product [FYFSDFYGDP], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/FYFSDFYGDP>, January 5, 2026.

⁹ U.S. Office of Management and Budget and Federal Reserve Bank of St. Louis, Gross Federal Debt as Percent of Gross Domestic Product [GFDGDP188S], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GFDGDP188S>, January 8, 2026.

¹⁰ The U.S. Federal Reserve implemented a form of yield curve control (YCC) starting in 1942 to help the Treasury finance World War II debt by capping interest rates across different maturities, from a low of 3/8% on T-bills to 2.5% on long-term bonds, a policy that lasted until 1951.

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