ARGUS

ARGUS ECONOMIC COMMENTARY

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Market Outlook for 2026

The stock market in January 2026 is off to a positive start. The S&P 500, up about a point and a half with a week of trading left in January, appears unlikely to match the nearly 3% gain in January 2025, when the inauguration of President Trump drove optimism on relaxed regulation, lower taxes, and a business-friendly climate. January 2025 featured strong leadership from "Magnificent 7" and AI-related names in growth sectors including Information Technology and Communication Services.

Stock leadership in January 2026 is very different. Value stocks, which lagged growth stocks in 2025 and 2024, are leading growth by 3.5 percentage points. Geopolitical headlines have impacted some of the leadership shift. The seizing of Venezuelan President Maduro, along with U.S. dollar weakness, has driven a rally in Energy and Materials stocks, both up about 10% year-to-date through 1/23/26. Defensive (Consumer Staples) and cyclical (Industrial) sectors are both ahead of the market with mid-single-digit year-to-date (YTD) gains.

Meanwhile, the sector leaders from 2025 are struggling in 2026. Three sectors at the top of the leader board in 2025 -- Financial, Utilities, and Information Technology -- are at the bottom in 2026, with declines in the 1%-3% range YTD. If this pattern persists across 2026, with cyclical and defensive sectors on top and the AI trade subject to skepticism and waning enthusiasm, that could go a long way toward deflating the notion that AI stocks are "in a bubble."

4Q25 Environment and Review

The year 2025 was another good one for stocks, following capital appreciation of 24.2% in 2023 and 23.3% in 2024. The S&P 500 advanced 16.4% for all of 2025, or 17.7% on a total-return basis (including hypothetical dividends). Although the S&P 500 has put together two double-digit winning years in a row 16 times since 1960, third-year returns after two straight double-digit years have averaged just 3%. On that basis, 2025 beat the odds. The Nasdaq Composite rose 20.4% on a capital-appreciation basis in 2025 (21.2% total return), while the DJIA advanced 13.0% for the full year (14.9% total return). After tumbling following "Liberation Day" tariff announcements, the stock market rallied from April 2025 through October before flattening out in November and December.

The 2025 year began with uncertainty but also optimism that the new administration in Washington would be more business-friendly and would quickly move to lower taxes. President Trump, who in 2025 signaled a shift in focus from Europe and Asia to the western hemisphere, acted on that shift early in 2026 by seizing Venezuelan President Maduro and pledging to govern that country remotely. Geopolitics could become more of a factor in 2026 than in recent years, particularly if Venezuelan opposition balks at increased U.S. involvement and if the Trump administration ramps pressure on NATO member Denmark to surrender Greenland. As the geopolitical focus shifts away from Eastern Europe and the Middle East and as the U.S. looks more to its own hemisphere, Russia and China may seek to expand their respective spheres of influence.

Argus has issued key forecasts for 2026 related to economic growth, earnings growth, interest rates and the yield curve, and the outlook for the ongoing bull market. We expect the U.S. economy to continue growing in 2026, fueled by an employed consumer, solid corporate investment, and an attentive Federal Reserve. Inflation and high financing rates continue to weigh on consumer spending, particularly for those on the bottom leg of the K-shaped economy who have had to tighten their belts. More-prosperous consumers

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continue to spend. Consumers overall have benefited from rising stock prices and high home prices.

The St. Louis Fed estimates breakeven employment growth, required to hold the unemployment rate steady, is in the 32,000-82,000 per month range given slowing population growth due to immigration policy and a declining native-born birth rate. We look for non-farm payrolls growth to average about 50,000 per month in 2026 and believe the unemployment rate could remain in the 4.5% range for the year.

Corporate spending was super-charged by AI investments in 2025, and we believe capex can grow at least at the 4.5% historical average in 2026. We also look for corporate investment to partly offset tariff impacts, a weak housing market, and subdued government spending. Measures of the commercial and industrial economy -- including manufacturing PMIs, durable goods orders, and industrial production -- have moderated but remain consistent with ongoing growth.

We recently raised our estimate for 2026 GDP growth to 2.2% from 2.0%, following forecast 2.5% GDP growth in 2025. Our initial GDP forecast for 2027 is a conservative 1.7%.

The Fed has slowed inflation growth, although getting to the Fed's 2% target has proven to be challenging. Inflation trends were more important than GDP trends from 2022 into 2024 but have since been superseded by concerns about the employment economy. Month-over-month inflation readings moderated to the 2.5% range through mid-year 2025. We believe the annual change in core inflation ticked back to the high-2% range in 4Q25, although the government shutdown has delayed a full data release. The Fed lowered the fed funds rate to the 3.5%-3.75% level in December 2025, and that may be the final rate cut before Jerome Powell's term as Fed Chairman ends in May. The FOMC has resumed quantitative easing, and interest rates declined after this modest asset-buying program was announced.

During 2025, the 10-year yield declined by 44 basis points, and the two-year yield declined by 80 basis points. The two's-10's spread at year-end 2025 showed a positive slope of 69 bps -- the steepest slope in the yield curve since 2021, before inflation emerged and the Fed responded with aggressive rate hikes. We look for the slope to steepen further in 2026 as short-term rates continue lower and long rates drift down or remain near current levels. The more steeply-sloped yield curve has positive implications for economic growth. The White House, which has been vocal about wanting lower rates, will appoint a new Fed chair in mid-2026. The majority of central bankers continue to support one rate cut each in 2026 and 2027. That would lower the target rate to 3.0%-3.25% for a roughly one-point cushion over the prevailing rate of inflation.

Amid geopolitical and economic cross-currents, we believe corporate earnings trends and stock valuations can support a positive year for stocks. Assuming calendar 4Q25 EPS season plays out as expected, S&P 500 earnings from continuing operations are on track for low-double-digit growth for 2025 to our \$270 estimate. For 2026, we look for another year of low-double-digit growth in corporate profits to our \$300 forecast. Our preliminary forecast of S&P 500 earnings from continuing operations for 2027 assumes high-single-digit growth, to the \$325-\$330 range. We are encouraged by the quality of earnings, underpinned in recent quarters by high-single-digit revenue growth and operating margins above the midpoint of the historical 9%-14% range.

U.S. companies appear to have adapted to tariffs by shifting supply chains to local sources and flexing variable costs where possible. Given that large technology companies increasingly drive market EPS growth, we look for further margin expansion going forward. We take multiple approaches to equity valuation. Our Stock-Bond Barometer is signaling that stocks are trading approximately at parity with bonds. The output of this model is expressed in standard deviation to the mean, or sigma. Going back to 1960, the mean reading is a modest premium for stocks of 0.17 sigma, with a standard deviation of 1.07. Early in January, valuation was at a 0.30 premium for stocks – not a discount, but comfortably within the fair value range.

The forward P/E ratio of 23-times our 2026 S&P 500 earnings estimate is within the normal range of 15-24; the two-year (2026-27) forward P/E is 22-times. On price/sales, the current ratio of 3.2 is above the historical average of 1.8 but below the 4.0 multiple at the peak of the dot.com bubble. Price-based multiples are skewing higher given the rising preeminence of the tech giants, which tend to grow sales and earnings faster than the market. The ratio of the S&P 500 price to an ounce of gold and the S&P 500 dividend yield in relation to the 10-year Treasury yield are both near the midpoints of their historical ranges. All these valuation measures in aggregate suggest that the broad market (the S&P 500), despite being near record highs, is reasonably valued and not in danger of entering bubble territory.

The current bull market got underway in October 2022 and is now more than three years old. Over this period the S&P 500 has risen more than 90% as the rally withstood high inflation, economic uncertainty, implementation of tariffs, a government shutdown, and major shifts in the direction of U.S. domestic and foreign policy. The 13 prior bull markets since World War II averaged capital appreciation of 164% over an average span of 57 months, or just under five years. The five bull markets since 1980 have generated higher returns (about 240%) over longer periods (about six years).

Risks facing the market in 2026 include the statistical difficulty of sustaining forward momentum after three straight years of double-digit gains in the S&P 500. We also note that 2026 is the second year in the presidential cycle, traditionally the weakest stock-market year by far of the four years. Since the launch of ChatGPT in November 2022, the AI trade has driven the market. Investors took profits in AI stocks in the final two months of 2025 as concerns mounted about an AI bubble. Unlike past bubbles built on phantom metrics, the AI revolution is grounded in real infrastructure investment, particularly as spending broadens out from hyperscalers to large enterprise, sovereign, and neo-cloud customers.

In our base case for 2026, we are modeling GDP advancing in the low-2% range, unemployment remaining in the mid-4% range, and corporate earnings growing at high-single-digit to low-double-digit rates. We also expect core PCE inflation to work down to the mid-2% range by year-end, and we look for the Fed to maintain its go-slow approach to rate cuts. In our base-case scenario, we see room for further appreciation by both traditional growth leaders and by recent rotation beneficiaries in rate-sensitive, defensive, and cyclical categories. Our forecast is more in line with the S&P 500 equal-weighted index than with the broad index, where returns in recent years have been unduly influenced by Magnificent 7 and adjacent stocks. In this base case, the S&P 500 advances for another year by a below-average 5%-10%, but within a broader and more balanced market.

Conclusion

Investors typically are very bullish in January, and 2026 has not been an exception. The S&P 500 was up 1.5% for the year to date through 1/23/26. Since 1980, the S&P 500 has averaged a 1.0% gain in January. That is actually a middling performance, with April, July, and October through December all averaging higher monthly returns. January offers consistency, with stock appreciating about two-thirds of the time.

The first quarter also has been good for stocks historically, averaging 2.4% capital appreciation on the S&P 500 since 1980. But 1Q25 was challenging, with the S&P 500 tanking 4.6% as the countdown to April's "Liberation Day" tariffs culminated in sticker shock. Across 2025, tariffs were implemented in an uneven pattern, with rates on various countries and asset classes (metals, etc.) announced at high levels that were subsequently reduced.

In 2026, tariffs will have a full-year impact on prices; but they have faded as the leading topic on investors' minds. Geopolitics, and specifically the Trump administration's focus on the western hemisphere, has dominated the discussion so far in 2026. The mid-term election is looming, and a partial government shutdown is possible.

February historically has been a weaker month for the S&P 500, with only August and September faring worse in monthly average performance since 1980. Investors are counting on a strong 4Q25 earnings season to shake the February curse.

Jim Kelleher, CFA,
Director of Research

KEY ECONOMIC FORECASTS

- The $31 trillion U.S. economy remains on course for modest growth, powered by corporate investments in AI and outsized spending by the wealthiest households. Nvidia CEO Jensen Huang estimated, in November, that $3 - $4 trillion will be spent on AI infrastructure in the next 5 years.
- We recently raised our 2026 forecast for GDP growth to 2.2% from 2.0%. Unemployment remains low, the Fed has been stimulating growth by reducing the funds rate, and last year's tax legislation should result in healthy rebates for most families. We recently initiated a 2027 estimate for 1.7% growth. We still expect full-year GDP growth for 2025 to come in at 2.5%.
- U.S. consumers have been the engine of economic growth. That should continue with unemployment at 4.4%. We expect the jobless rate to remain between 4.3% - 5.0% in 2026. Fewer job openings and slower hiring may reduce wage growth.
- Inflation's downward progress has stalled above the Fed's 2% target. Core PCE has exceeded 2.5% since March 2022, rising to 2.9% in 3Q25. The median projection of Federal Reserve officials does not return to 2% until 2028.
- Argus expects S&P 500 EPS to come in at $270 in 2025 and increase by 11% to $300 in 2026. EPS is helped by an increase in operating margins to 18.0%, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 46% and 59% respectively while Dow stalwarts Walmart and Caterpillar earn 4% and 18%, respectively.
- Argus Fixed Income Strategist Kevin Heal expects the Fed to reduce the funds rate by 25 basis points in 2026 and by another 25 basis points in 2027 taking the target range to 3%-3.25%. We expect the dollar to be flat or slightly stronger in 2026 as foreign demand for shares of innovative U.S. companies and economic resilience offset monetary easing.
- As long as geopolitics are flaring and the global economy is wobbling, gold is likely to remain at elevated levels. The ancient safe-haven asset recently reached an all-time record above $5,000 an ounce. Our average target price in 2026 is $4,500.
- Despite last year's economic-and-policy "uncertainty," the Misery Index, which is the Consumer Price Index (CPI) inflation rate plus the unemployment rate, is 7.1%, well below the average of 9.2% since 1949. "Misery" could peak at 7.6% in 2Q26 with CPI at 3.1% and Unemployment at 4.5%. This is a consideration ahead of midterm elections.
- What could go right? Monetary easing, big tax refunds, spending by wealthy consumers, strong S&P earnings, capital investment, productivity gains, and ongoing innovation.
- Risks: Elevated Inflation, slow hiring, housing, and manufacturing are stalled, low income consumers are struggling, spending by affluent may be dependent on stock market gains.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
22-Jan	GDP Annualized QoQ	3Q "Updated"	4.3%	4.3%	4.3%	**4.4%**
	GDP Price Index	3Q "Updated"	3.8%	3.8%	NA	**3.8%**
	PCE Deflator	November	**2.7%**	2.7%	2.8%	**2.8%**
	PCE Core Deflator	November	**2.7%**	2.7%	2.8%	**2.8%**
	Personal Income	November	4.3%	4.7%	NA	**4.3%**
	Personal Spending	November	5.3%	5.4%	NA	**5.4%**
26-Jan	Durable Goods Orders	November	**4.5%**	8.0%	NA	**10.5%**
27-Jan	Consumer Confidence	January	**94.2**	90.0	90.1	**84.5%**
29-Jan	Trade Balance	November	-$29.4 Bln.	-$45.0 Bln.	-$44.2 Bln.	NA
	Factory Orders	November	2.2%	5.0%	NA	NA
	Wholesale Inventories	November	1.7%	1.3%	NA	NA
30-Jan	PPI Final Demand	December	3.0%	2.9%	2.7%	NA
	PPI ex-Food & Energy	December	3.0%	2.8%	2.9%	NA
2-Feb	ISM Manufacturing	January	47.9	48.0	48.3	NA
	ISM New Orders	January	47.7	48.0	NA	NA
4-Feb	ISM Services Index	January	54.4	54.0	53.0	NA
5-Feb	Total Vehicle Sales	January	16.1 Mln.	15.0 Mln.	NA	NA
9-Jan	Nonfarm Payrolls	January	50K	45K	50K	NA
	Unemployment Rate	January	4.4%	4.4%	4.4%	NA
	Average Weekly Hours	January	34.2	34.2	34.2	NA
	Average Hourly Earnings	January	3.8%	3.7%	NA	NA
	U. Michigan Sentiment	February	56.4	55.0	NA	NA

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