

February 9, 2026

Leadership Shift: Our Monthly Survey of the Economy, Interest Rates, and Stocks

Hurt by a steep sell-off on the final day of trading, the S&P 500 in January 2026 rose a little more than 1%. That was in line with the roughly 1% average gain for January since 1980 but down from the 3% gain in January 2025. Whereas January 2025 featured leadership from Magnificent 7 and artificial intelligence-related (AI-related) names, the leadership shift underway in the fourth quarter of 2025 has accelerated in 2026 to date. Defensive, cyclical, and commodities-sensitive sectors have led the U.S. stock market in 2026.

Strong gross domestic product (GDP) readings for the middle quarters of 2025 and consistently strong corporate earnings have helped ease concerns about the slowing employment economy. After three rate cuts in the final four months of 2025, the Federal Reserve (Fed) will likely remain on the sidelines until Fed Chair Jerome Powell is succeeded in May 2026. As most of the U.S. remains in a deep freeze, the stock market remains reasonably warm, aided by the ongoing sector shift.

The Economy, Interest Rates, and Earnings

As another federal government shutdown hangs in the balance, investors now have access to most of the data delayed by the October 2025 shutdown. However, fourth-quarter 2025 GDP, which would normally be released late in January, is now scheduled for release on February 20.

The updated and final 3Q25 GDP report from the Bureau of Economic Analysis indicated annualized growth of 4.4%, a tick up from 4.3% in the preliminary report and representing continued expansion from healthy 3.8% growth in 2Q25 GDP. The updated report was stronger than already high expectations and appears to signal fundamental strength in the economy that superseded any challenges from tariffs, reduced immigration, and other factors.

The increase in third-quarter 2025 GDP reflected increases in consumer spending, exports, government spending, and investment. Imports, which are subtractive to GDP, decreased.

Third-quarter 2025 Personal Consumption Expenditures (PCE) increased 3.5%, better than Argus expectations in the 2% range. In 2Q25, PCE rose by 2.5%. Total spending on goods increased 3.0% in 3Q25 from 2.2% in 2Q25. Durable goods spending increased 1.6% in 3Q25 from 3Q24, while non-durable goods spending increased 3.9%. Durable goods spending was down from 2Q, while non-durable goods spending was up. Relative strength in non-durable goods spending likely reflects the much-discussed K-shaped economy, where lower-income consumers have focused spending on necessities. Services, which is the biggest spending category, at 45% of total 3Q25 GDP, rose by 3.6% in 3Q after a 2.6% gain in 2Q25.

Non-residential fixed investment, the proxy for corporate capital spending, grew at a 3.2% annualized rate in 3Q25, up from the 2.8% initially reported for 3Q25, though down from 7.3% in 2Q25. The AI boom drove 5%-plus growth in both equipment and intellectual property products, but corporate spending on structures declined 5.0%. PCE and non-residential fixed investment normally constitute 80%-85% of GDP. These two categories contributed 2.7 percentage points to 3Q25 GDP growth. Residential investment declined 7.1% in 3Q25, its fifth decline in the past six quarters.

Exports surged 9.6% in 3Q25, while imports contracted 4.4%. Both first- and second-quarter GDP featured outsized swings in the imports and private inventory categories due to trade positioning ahead of the implementation of tariffs. The third quarter of 2025 was expected to be the first period in which those two categories did not meaningfully distort

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ECONOMIC & MARKET COMMENTARY (CONT.)

overall GDP growth, but it appears that some trade-related impacts were still present. The net of exports and imports added 1.62 points to GDP growth, while the change in private inventories subtracted 0.12 percentage point. Going forward, Argus is modeling the net export-import balance as being slightly negative to GDP.

Government spending rose 2.2% in 3Q25 after being down 0.1% in 2Q25. Federal spending was up 2.7%, led by 5.7% growth in national defense spending. State and local spending increased 2.0%.

The core PCE price index (excluding food and energy) rose 2.9% in 3Q25, in line with the Argus estimate of 3.0%. The trend in core PCE prices is little changed from the 3.0% range prevailing since summer 2025.

Outside the GDP accounts, the U.S. employment economy showed signs of slowing in the third and fourth quarters of 2025. October payrolls fell by a revised 173,000, reflecting significant job losses tied to layoffs of federal workers whose severance had run out. U.S. employers added a revised 56,000 new non-farm workers in November.

According to the Bureau of Labor Statistics, the U.S. economy generated 50,000 new non-farm jobs in December, below the consensus forecast of 60,000. Based on December and November payrolls and the steep decline in October, non-farm payrolls averaged a decline of 22,000 for October-December, compared with an average gain of 22,000 for the September-November period. With federal employment now relatively stable, the total employment picture is less likely to see outsize impacts from policy changes such as those affecting October 2025 employment.

The unemployment rate eased to 4.4% in December from (revised) 4.5% in November. Average hourly earnings grew 3.8% annually for December, rising from a 3.5% annual rate for November; wage growth is still running ahead of inflation growth, but the delta is narrowing.

The break-even level of jobs growth, required to hold the unemployment rate steady, is now closer to the 50,000 level than to the 150,000 level in recent years because of trends in population growth. Job gains in the neighborhood of consensus estimates would likely keep unemployment stable. We also note that federal employment now appears relatively stable. Accordingly, the total employment picture is less likely to see outsize impacts from policy changes such as the DOGE cuts that affected October 2025 employment on a lagged basis.

Other reports delayed by the shutdown have now been released. The December all-items Consumer Price Index (CPI) rose by 2.7% annually, while the core CPI increased by 2.6% from a year earlier and was unchanged from November readings. The all-items CPI rose 0.3% month over month, while the core CPI was up 0.2%. Stubborn categories such as shelter (one-third of CPI inputs) continue to pressure prices.

Based on sentiment surveys and diffusion indexes, the business community appears guardedly optimistic while consumers are worried about new jobs scarcity. The Institute for Supply Management's (ISM's) Manufacturing Purchasing Managers' Index (PMI) fell from 48.2% in November to 47.9% in December, for a 10th straight month of contraction. ISM's Services PMI rose from 52.6% for November to 54.4% for December, which was the highest reading of 2025.

The Conference Board's Consumer Confidence Index fell to 89.1% in December from 92.9% (revised) in November. The University of Michigan consumer sentiment survey rose to 52.9% in December from 51.0% for November, while remaining down from 74.0% in December 2024.

Given the positive trend in GDP growth across the middle quarters of the year, Argus Chief Economist Chris Graja, CFA, has raised the Argus GDP growth forecast for 2025 to 2.5% from a prior 1.9%. Chris has also increased the Argus GDP growth forecast for 2026 to 2.2% from a prior 2.0%. The Argus preliminary GDP forecast for 2027 is for growth of 1.7%.

The Fed is tasked with the dual mandate of optimizing employment while keeping inflation in check. After raising rates aggressively throughout 2022 and early 2023, the Fed maintained its policy rate at 5.25%-5.50% from September 2023 until August 2024. Beginning in August 2024, the Fed cut rates by a cumulative 100 basis points (bps) over the next three Federal Open Market Committee meetings. It then moved to the sidelines for the first nine months of 2025.

The central bank cut the fed funds rate in September 2025 for the first time in nine months. It then cut rates again by a quarter point each at the end of October and in the middle of December. In January 2026, the Fed as expected left the fed funds rate unchanged. Two voting members, Stephen Miran and Christopher Waller, voted for a quarter-point cut.

The Fed appears to have determined that the balance of risks had shifted away from rising prices and toward weakness in the employment economy. The recent trend in monthly non-farm payrolls growth signals at best uncertainty and at worst weakening in the employment situation.

Many investors now believe the December 2025 rate cut will be the last under Mr. Powell. Late in January, President Donald Trump proposed Kevin Warsh as the new chair of the Federal Reserve; he would take over when Mr. Powell's tenure as chair ends in May 2026.

U.S. Treasury yields were little changed in September and October before moving lower in November in anticipation of a December rate cut. Rates continued moving lower at the short end in December while edging higher at the long end.

ECONOMIC & MARKET COMMENTARY (CONT.)

The bond market in January 2026 was impacted by geopolitical events as much as by economic events. Global holders of U.S. Treasury debt continue to reduce positions, contributing to the uptick in rates.

The 10-year Treasury yield was 4.24% as of the end of January 2026, compared with 4.14% as of the end of December 2025. The cycle peak for the 10-year yield was 4.9% in October 2023. The two-year Treasury yield was 3.53% as of the end of January 2026 versus 3.45% as of the end of December 2025. The cycle peak for the two-year yield was 5.2% as of October 2023.

Over the course of 2025, the 10-year yield declined by 43 bps, and the two-year Treasury yield declined by 80 bps. The two-10 slope in the yield curve at year-end 2025 was the most positive since year-end 2021, before inflation emerged and the Fed began its inflation fight. The two-10 spread, which was 69 bps at year-end 2025, steepened further to 71 bps as of the end of January 2026.

Argus expects short-term yields to move lower from current levels, although the pace of the decline could moderate if the Fed stands pat through the end of Powell's term. A more aggressive approach from a new Fed chair, however, could get short rates moving down again. Long yields over time are expected to widen their relative premium to short yields.

With the Fed now done for 2025, Argus Fixed Income Strategist Kevin Heal continues to model one quarter-point rate cut in 2026 and one in 2027. We see little likelihood of a first-half rate cut and an increased likelihood of a second-half 2026 rate cut as leadership changes hands at the Fed.

In the absence of government data, calendar 3Q25 earnings season had an outsize and largely positive impact on stocks. The annual growth rate for calendar 3Q25 earnings was in the mid-teens range, with different agencies reporting slightly different rates. More than 82% of companies reported earnings above the pre-reporting consensus, which is higher than the long-term 75% average. The magnitude of the EPS beat against expectations, in the high-single-digit range, was above the midpoint of the long-term range of 5%-9%.

Earnings season is now underway, and 4Q25 earnings are outpacing elevated expectations. With fewer than one-third of companies having reported, S&P 500 earnings from continuing operations for the fourth quarter of 2025 are up about 10% from year-earlier levels. Companies have delivered further expansion in non-GAAP operating margins as they navigate around tariffs and participate in the AI economy. Assuming the S&P 500 can sustain recent revenue growth exceeding 5% annually, we see room for further margin expansion ahead as volume leverage supersedes higher costs and tariffs.

Based on the positive 3Q and 4Q results, we are reiterating our forecast for S&P 500 earnings from con-

tinuing operations of \$270 for 2025. We continue to model continuing operations earnings of \$300 for 2026. And our preliminary forecast for 2027 earnings from continuing operations is \$325.

Domestic and Global Markets

The performance discussed herein captures the market status as of the end of January 2026. This data does not reflect what has happened in the market in recent days.

The major indexes began to shift away from growth and toward defensive, cyclical, and rate sensitive in the second half of 2025. The 2026 trading year is just one month old, but that shift has accelerated in the year-to-date. At the same time, the numbers coming out of the AI economy – deal sizes, revenue growth and projections, and margin expansion – are keeping that trade hot and in some areas even feverish.

The biggest change in 2026 to date is that value is beating growth. The FT Wilshire US Large Cap Value index is up nearly 4%, while the FT Wilshire US Large Cap Growth index is unchanged for the year. Another major change is that investors are finally rotating into smaller-cap names. The Russell 2000 Index is the best-performing benchmark year-to-date, with a 7% gain. The S&P 500 and Nasdaq are both up about 2%, and the Dow Jones Industrial Average is slightly ahead, with a 2.2% gain.

A 2% gain for the broad market in January is better than the 45-year average, which is for a gain of slightly more than 1%. Stock performance in January 2026 is similar to that in January 2025. In February and March of 2025, however, stocks tanked on uncertainty about the coming tariff regime. Tariffs are now mostly settled, although unpredictable geopolitical events could impact markets in the next few months.

The Bloomberg U.S. Aggregate Bond Index, which was up 6.9% in 2025, is up fractionally in 2026. Bond returns could continue higher in 2026, particularly if a new Fed chair adopts a more accommodative monetary stance.

The AI trade showed some cracks in the foundation during the fourth quarter of 2025. The combination of dollar weakness and deep cold in most of the U.S. has pushed the Energy sector to leadership, with a 13% year-to-date gain. Nearly all commodities are priced in dollars, so dollar weakness has also been positive for the Materials sector, which is up 11%. Industrials are up 7% as the long-dormant defense stocks rotate back into favor. Reflecting the rotation toward value, the defensive Consumer Staples sector is up nearly 7% in 2026.

Despite these big wins, the overall market is up just 2%. That's because about 50% of the market is in negative territory. Information Technology, with a 35% weighting, is down less than 1% year to date, and Financials, with a close to 15% weighting, is down 2%. Both of these sectors were at the top of the leaderboard in 2025.

ECONOMIC & MARKET COMMENTARY (CONT.)

Utilities, another leadership sector in 2025, has been subject to profit taking as the pace of Fed rate cuts slows. Communication Services is positive in 2026, but some of that momentum is in the slow-growth telco giants such as Verizon Communications Inc. (VZ) and AT&T Inc. (T). Consumer Discretionary, which struggled in 2025, is tracking the market as wage growth keeps consumer spending on a steady keel.

Redeployment of AI winnings during 4Q25 had the effect of smoothing the overall sector map for full-year 2025. As of the end of 2025, all sectors were positive. New leadership is in place for now. More diversity in sector leadership is positive for sustaining the bull market, in our view, even if the new sector leaders are slower growing.

The rise of generative AI is sort of turning every company into a technology company. But there are still a few sectors that sell the digital pickaxes to the AI gold rush. Information Technology has been the chief beneficiary of the AI economy. The Information Technology sector as of the end of December 2025 was 34.4% of overall S&P 500 market capitalization — up two percentage points in a year but down a point and a half in the last two months of 2025 amid AI profit taking and sector rotation.

Two other sectors, each of which include two Magnificent 7 stocks, have been major beneficiaries of the AI revolution. Communication Services has steadily grown since inception, even though the stock prices and market caps of the big telecom names (VZ, T) have not changed much in the past few years. The two Mag 7 names, Alphabet Inc. (GOOG) and Meta Platforms Inc. (META), are leaders in AI areas including large language models, model training, inference, and more recent growth opportunities including multimodal models, agentic AI, and physical AI. Communication Services ended 2025 at 10.6% of total S&P 500 market capitalization, up from 9.4% a year ago.

Consumer Discretionary is a multi-industry sector and also houses two of the Mag 7 giants in Tesla Inc. (TSLA) and Amazon.com Inc. (AMZN). Retailers and restaurants are suffering loss of business from lower-tier consumers in a K-shaped economy. Builders and automakers are being impacted by high financing costs and affordability issues.

Discretionary ended 2025 at 10.4% of S&P 500 sector weight, down from 11.4% at year-end 2024, as strength in TSLA and a flat AMZN were insufficient to offset weakness in retail, restaurants, lodging & gaming, auto original equipment manufacturers & parts, and homebuilders & builders supply.

Global stocks mainly did better than the U.S. market in 2025, and that pattern has persisted across the first month of 2026. All nine global bourses in our tally were positive for 2025, and all but two are positive early in 2026.

In terms of our themes, resources economies are ahead year-to-date, with a nearly 9% gain. Resources economies also won 2025, with a 32% gain. Americas markets are in second place in 2026, with a 7% gain; Americas advanced 30% in 2025, fueled by recovery in Mexico and Canada. BRICs-minus-Russia is up 4% in 2026, after rising 19% in 2025. Asia and Mature Economies are both up 3% in 2026 to date, after gaining 22%-23% in 2025.

Conclusion

Investors are usually bullish in January, but the market was rocky late in the month. The S&P 500 was up as much as 2% before slipping to a 1% gain for January in the final trading week of the month. Since 1980, January's performance has been about average, with April, July, and October through December all averaging higher monthly returns. The first quarter has also been good for stocks, averaging 2.4% capital appreciation on the S&P 500 since 1980.

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 in the year-to-date. The midterm election is looming, and a partial government shutdown is possible.

Unlike in 2025, when the Liberation Day tariffs loomed in April, investors early in 2026 can pay attention to economic fundamentals rather than worry about what's to come. But February has historically been a weaker month for the S&P 500, with only August and September faring worse on 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 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 \$300 in 2026 and increase by almost 17% to \$350 in 2027. EPS is helped by an increase in operating margins to 19.0%, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 47% and 59% respectively while Dow stalwarts Walmart and Caterpillar earn 4% and 17%, 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
29-Jan	Trade Balance	November	-\$29.2 Bln.	-\$45.0 Bln.	-\$44.2 Bln.	-\$56.8 Bln.
	Factory Orders	November	2.3%	5.0%	NA	5.4%
	Wholesale Inventories	November	1.7%	1.3%	NA	1.8%
30-Jan	PPI Final Demand	December	3.0%	2.9%	2.7%	3.0%
	PPI ex-Food & Energy	December	3.1%	2.8%	2.9%	3.3%
2-Feb	ISM Manufacturing	January	47.9	48.0	48.3	52.6
	ISM New Orders	January	47.4	48.0	NA	57.1
4-Feb	ISM Services Index	January	53.8	54.0	53.0	53.8
6-Feb	U. Michigan Sentiment	February	56.4	55.0	55.0	NA
	Total Vehicle Sales	January	16.1 Mln.	15.0 Mln.	NA	NA
10-Feb	Retail Sales	December	3.3%	3.1%	NA	NA
	Retail Sales ex-autos	December	4.3%	4.2%	NA	NA
	Import Price Index	December	0.1%	0.1%	NA	NA
	Business Inventories	December	1.4%	1.5%	NA	NA
11-Feb	Nonfarm Payrolls	January	50K	45K	60K	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
12-Feb	Existing Home Sales	January	4.35 Mln.	4.20 Mln.	4.25 Mln.	NA
13-Feb	Consumer Price Index	January	2.7	2.4	NA	NA
	CPI ex-Food & Energy	January	2.6	2.5	2.4	NA

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