ARGUS ECONOMIC COMMENTARY

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The 2026 Outlook: Wartime Economy

Investors remain optimistic that the war with Iran can be resolved or can at least transition into a period of wary co-existence on all sides. With the war in a truce phase (at least as of this writing), U.S. stocks as of mid-April had shaken off March weakness and even touched new all-time highs. As of the 4/17/26 close, the S&P 500 was up 4.5% on a year-to-date total-return basis. The Nasdaq Composite had moved in front with a 5.5% gain for 2026; and the Blue Chip DJIA was up 3.4%. Despite spiking bond yields as the war intensified, the Barclays Bloomberg U.S. Aggregate Bond Index was positive for 2026 at mid-April, holding a 0.8% gain.

The war with Iran has exceeded the four- to six-week timeline forecast by the administration. As we discuss below, we believe the U.S. economy can continue to move forward given solid underlying fundamentals. But stocks will likely continue to be whipsawed by news flow and by the volatile level of energy prices.

The Outlook for 2026

The S&P 500 advanced 16.4% for all of 2025, following capital appreciation of 24.2% in 2023 and 23.3% in 2024. The 2026 trading year is off to a challenging start, amid signs of tariff-related inflation in the pre-war period, weak GDP growth to end the 2025 year, disruption in the administration's tariff schedule, and concerns that war-related energy inflation will ripple through shipping, agriculture, and other parts of the economy. The 2025 trading year was aided by optimism that the new administration in Washington would be more business-friendly. For 2026, investors and businesses remain optimistic that tax cuts under the Big Beautiful Bill will partly offset tariff impacts and higher consumer gasoline costs resulting from the war.

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. Success in the Venezuelan operation may have influenced the president's assessment of the risks of attacking Iran. Geopolitics has become more of a factor in 2026 than in recent years. Conversely, the focus on Iran could potentially lessen pressure on NATO member Denmark to surrender Greenland. As the geopolitical focus shifts away from Europe and Asia to the Middle East and as the U.S. continues to focus on its own hemisphere, Russia and China may seek to expand their respective spheres of influence.

In 2025, we issued key forecasts for 2026 related to economic growth, employment, interest rates, earnings growth, and the outlook for the ongoing bull market. We have adjusted some of these forecasts due to the war with Iran, while maintaining our overall outlook. We expect the U.S. economy to continue growing in 2026, fueled by an employed and resilient consumer and solid corporate investments led by AI adoption. Inflation and high financing rates continue to weigh on consumer spending, particularly for those on the bottom leg of the K-shaped economy who are disproportionately impacted by war-related energy cost inflation. More-prosperous consumers on the upper leg of the K continue to benefit from past and ongoing appreciation in financial assets and home values.

The St. Louis Fed estimates breakeven employment growth, required to hold the unemployment rate steady, is in the sub-50,000 per month range given slowing population growth due to immigration policy and a declining native-born birth rate. Federal employment is expected to remain relatively stable, and the overall employment environment is less likely to see outsized impacts from policy changes such as the

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DOGE cuts of winter and spring 2025. Altogether, we look for nonfarm payrolls growth to average about 50,000 per month in 2026 and believe the unemployment rate could remain near 4.5% or lower 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 partially 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. Argus Chief Economist Chris Graja, CFA, reduced his GDP growth forecast for 2026 to 2.3% from a prior 2.5%. The decrease primarily reflects new pressures on consumer spending due to spiking energy prices, which could be offset partly by higher tax returns.

Even before the war with Iran began, the Fed was in a tough spot trying to honor its dual mandate of keeping the work force fully employed and holding inflation near it 2% target range. The double-digit shock in energy prices has made the Fed's job even harder. Energy inflation is fully revived, and shipping and food inflation are likely soon to follow, while the economy has shown signs of slowing. The Fed lowered the fed funds rate to the 3.5%-3.75% level in December 2025, and we continue to expect that to be the final rate cut before Chairman Powell's term ends in May 2026. The White House, which has been vocal about wanting lower rates, has proposed inflation dove Kevin Warsh as the new chairman of the Federal Reserve.

The two's-10's slope in the yield curve tightened to 51 basis points (bps) at the end of March 2026 from 69 bps at year-end 2025 – the steepest since 2021, before the Fed began its fight against inflation. The still positively sloped yield curve is a good indicator for economic growth. The majority of central bankers continue to support one rate cut each in 2026 and 2027, although the war has made the outlook fluid. That would lower the target rate to 3.0%-3.25%, for a half-point to one-point cushion over the pre-war rate of inflation.

Amid geopolitical and economic cross-currents, we believe corporate earnings trends and increasingly favorable stock valuations can support a positive year for stocks. S&P 500 earnings from continuing operations posted low-double-digit growth in 2025 to approximately our $270 estimate. For 2026, we look for mid-teens growth in corporate profits to $315, raised in winter 2026 from our earlier $300 forecast. We are modeling S&P 500 earnings from continuing operations for 2027 of $363 per share, which assumes annual EPS growth of 15% from 2026.

U.S. companies appear to have adapted to tariffs by shifting supply chains to local sources and replacing fixed costs with 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 was signaling that stocks were reasonably valued entering 2Q26 as they pulled back from all-time highs on concerns over the Iran war. Our Stock-Bond Barometer is indicating that the two major asset classes are trading near parity on valuation. 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. The current valuation is a 0.43 premium for stocks – not a discount, but comfortably within the fair value range. The forward P/E ratio of 20-times for the S&P 500 is within the normal range of 15-24 and down from low- to mid-20s readings in 2024-25. On price/book, stocks are priced at the high-end of the 5.5-1.8 historical range, no surprise given that technology stocks with low capital bases predominate in the major indices. The ratio of the S&P 500 price to an ounce of gold is 1.4, within the normal range. And the gap between the S&P 500 earnings yield and the 10-year Treasury yield is 350 basis points, compared to the historical average of 400. These valuation measures suggest that the broad market (the S&P 500), which thus far remains in the bull market dating to October 2022, is not in danger of entering bubble territory.

The current bull market is now more than three years old. Over this period the S&P 500 has risen over 95% as the rally withstood high inflation, economic uncertainty, implementation of tariffs, a government shutdown, major shifts in the direction of U.S. domestic and foreign policy, and now the war with Iran. 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). In addition to the risks noted above, the S&P 500 in 2026 faces the statistical difficulty of sustaining forward momentum after three straight years of double-digit gains. 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 late in 2025 as concerns mounted about an AI bubble. They took profits again early in 2026 on fears that AI would cause massive corporate upheaval and job displacement. 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, and with the war now in a fragile truce phase, we are modeling GDP advancing in the

2% range, unemployment remaining the mid-4% range, and corporate earnings growing at low- to mid-teen percentage rates. The war has mainly introduced uncertainty into the inflation outlook. We no longer expect core PCE inflation to work down to the mid-2% range by year-end, but we do not expect it to explode higher to 4% or above. On that basis, we do not expect the Fed to raise rates in 2026 or 2027. In our base case, we see room for further appreciation by both traditional growth leaders and by rotation beneficiaries in inflation-hedge, rate-sensitive, defensive, and cyclical categories.

Our forecast for 2026 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 Mag 7 and adjacent stocks. In our base case, the S&P 500 advances for another year in 2026 but by a below-average 5%-10%, within a broader and more balanced market.

Conclusion

The truce between the U.S. and Iran was holding of April 20, 2026, as was the truce between Israel and Hezbollah within Lebanon. U.S. asset markets have responded to the temporary cessation of hostilities with a stout rally. But that rally appears to be at risk in a rapidly evolving situation.

Record pre-war oil inventories continue to be worked down, and both sides claim to be keeping the Strait of Hormuz closed to shipping. The U.S. stocks market slipped lower on 4/20/26 when a hoped-for meeting between U.S. and Iran negotiators fizzled. The U.S. military hobbled and seized an Iranian-flagged cargo ship, prompting fresh warnings from Iran and causing another spike in oil prices.

U.S. stocks reached new all-time highs in mid-April 2026, but those highs appear to be as fragile as the truce that is winding down to its expiration date. Neither side wants war at this point, but neither side wants to blink. In this uncertain environment, we believe underlying strengths -- including the high level of U.S. employment and lessened global reliance on petroleum-based energy -- should enable the U.S economy to move forward, albeit at a subdued pace.

Jim Kelleher, CFA,
Director of Research

KEY ECONOMIC FORECASTS

- The $31 trillion U.S. economy remains on course for productive long term growth, powered by corporate investments in AI and outsized spending by wealthy households. Nvidia CEO Jensen Huang estimated, in November, that $3 - $4 trillion will be spent on AI infrastructure in the next 5 years.
- Real Potential GDP – the sustainable speed limit of the US economy is poised to increase to 2.1%, on average, through 2030 according to the Congressional Budget Office. AI is likely to raise productivity, offsetting slower growth in the labor force from an aging population and reduced immigration.
- The war in Iran is affecting millions of lives. Oil supply disruptions are a risk to affordability. We recently raised our 2026 oil price forecast to $75 per barrel from $60.
- The U.S. economy has become more resilient, more diversified and less oil dependent, but it is managing additional supply headwinds from tariffs and reduced immigration. This triumvirate could raise inflation, slow growth, and complicate Fed policy. Tax benefits and AI should help the economy.
- A simple rule of thumb: National gasoline prices above $4.00 begin to hurt consumer spending.
- We are monitoring financial conditions and high-frequency indicators including Nowcasts and weekly jobless claims. We recently reduced our 2026 forecast for GDP growth to 2.3% from 2.5%.
- Argus expects S&P 500 EPS to rise almost 16% to $315 in 2026 and increase about 15% to $363 in 2027. EPS is helped by an increase in operating margins to about 18.0% this year, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 47% and 60% 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 slightly stronger in 2026 driven by foreign demand for shares of innovative U.S. companies and economic resilience.
- Gold is likely to remain at elevated levels. The ancient safe-haven asset recently reached an all-time record above $5,000 an ounce. We expect gold to trade in a range of $4,000 - $6,000 in 2026.
- Despite economic-and-policy “uncertainty,” the Misery Index, which is the Consumer Price Index (CPI) inflation rate plus the unemployment rate, is well below the average of 9.2% since 1949. Unemployment is low but an energy-driven jump in the March CPI to 3.3% raised the Index to 7.6%.
- What could go right? Big tax refunds, spending by wealthy consumers, strong S&P earnings, capital investment, productivity gains, inflation expectations remaining anchored, and ongoing innovation.
- Risks: Elevated Inflation, high fuel prices, weak housing market, low income consumers are struggling, spending by affluent may depend on stock market gains, AI may reduce entry-level hiring.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
16-Apr	Industrial Production	March	**1.2%**	1.8%	NA	**0.7%**
	Capacity Utilization	March	**76.1%**	76.4%	76.3%	**75.7%**
21-Apr	Retail Sales	March	**4.0%**	4.0%	NA	**4.0%**
	Retail Sales ex-autos	March	**4.0%**	3.1%	NA	**5.5%**
	Business Inventories	February	1.0%	1.2%	NA	**1.3%**
28-Apr	Consumer Confidence	April	91.8	91.0	90.0	NA
29-Apr	Durable Goods Orders	March	7.2%	-9.0%	NA	NA
	Housing Starts	March	1,487K	1,400K	1,410K	NA
30-Apr	GDP Annualized QoQ	1Q "Advance"	0.5%	2.0%	1.6%	NA
	GDP Price Index	1Q "Advance"	3.7%	3.9%	NA	NA
	PCE Deflator	March	2.8%	3.6%	3.5%	NA
	PCE Core Deflator	March	3.0%	3.1%	3.2%	NA
	Personal Income	March	3.7%	3.4%	NA	NA
	Personal Spending	March	5.3%	5.2%	NA	NA
	Leading Index	February	-0.1%	-0.2%	NA	NA
1-May	ISM Manufacturing	April	52.7	52.5	52.9	NA
	ISM New Orders	April	53.5	53.2	NA	NA

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