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ARGUS ECONOMIC COMMENTARY

August 17, 2026

Jobs, GDP Stumble, but Earnings Soar

The stock market fizzled in July but is off to a strong start in August. Since 1980, July has averaged a 1.4% gain on the S&P 500, making it the fourth-best month (after November, April, and December). But in topsy-turvy 2026, the broad market index closed down 0.1% in July. Since 1980, August has averaged a subfractional gain of 0.03%. This year, and with little more than a week gone by in the eighth month, the S&P 500 is up 3.6% — which, if that return were to be frozen into month-end, would be the best August showing since 2014.

So, with the market sizzling not fizzling in August, we can assume jobs growth is off the charts and the economy is booming. Yes? Not quite. July nonfarm payrolls were a dud, and prior-month revisions were substantial. Gross domestic product (GDP) growth for 2Q26 missed consensus and slowed from 1Q26. Granted, there were caveats and asterisks galore, but the bottom line is the U.S. economy grew well under 2% in 2Q26.

Earnings growth has been exceptional, but exceptional was expected. For the first time in a while, the U.S. stock market is in one of those weird "bad is good" phases, where soft economic and jobs data should force the Federal Reserve (Fed) to hold off on hiking interest rates. There is still plenty of time left in 2026 and plenty more chances to end the war with Iran, so nothing is set in stone.

Nonfarm Payrolls and GDP Soften

The advance (first) GDP report for 2Q26 indicated annualized growth of 1.5%, decelerating from 2.1% in 1Q26. Second-quarter 2026 GDP shows a resilient consumer economy rebounding from a weak first quarter but a commercial economy pulling back slightly from 1Q's aggressive spending on artificial intelligence (AI). President Donald Trump's tariff agenda was complicated by court rulings; the resultant pause in policy enforcement likely contributed to a surge in imports that pulled down 2Q26 GDP. And overall government spending was negative, as this category remains volatile.

Second-quarter 2026 Personal Consumption Expenditures (PCE) increased a surprising 3.2%, rebounding sharply from 0.5% in 1Q26. Consumer goods spending rose 5.2% in 2Q26, led by a 6.8% surge in durable goods spending. PCE contributed a strong 2.12 percentage points to 2Q26 GDP, after contributing just 0.37 point in 1Q26. Nonresidential fixed investment, the proxy for corporate capital spending, rose by 8.4% in 2Q26. PCE and nonresidential fixed investment contributed 3.27 percentage points to 2Q26 GDP growth. So why wasn't overall 2Q26 GDP growth stronger? Mainly because of negative trends in key categories of net exports-imports, private inventories, and government spending.

The Supreme Court in February 2026 struck down the use of the International Emergency Economic Powers Act (IEEPA) for tariffs, and the White House used Section 122 of the Trade Act of 1974 to implement blanket 10% tariffs. Many companies successfully sued for refunds of tariffs levied under the IEEPA. Tariffs levied under Section 122 of the Trade Act of 1974 expired in July after a 150-day window. The latest White House strategy, to levy 10% tariffs alleging widespread forced-labor violations, may fail in the courts. Global companies took advantage of tariff turmoil in 2Q26 to sharply ramp shipments into the U.S.

While exports rose 4.5% in 2Q26, imports rose 11.5%. Government spending also pulled back in 2Q26. Net exports-imports subtracted 1.01 percentage points from 2Q26 GDP, the change in private inventories subtracted 0.67 percentage point, and the decline in government spending subtracted 0.14 point. These three categories subtracted about 2 percentage points from GDP, leading to suboptimal 1.5% growth.

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After that dud of a GDP report, economists looking for a positive signal from the jobs economy were disappointed by July data. On August 5, 2026, ADP Inc. reported that private payrolls for July rose 44,000, below the 72,000 (midpoint) consensus estimate and down from a revised 95,000 for June. Then came the big shocker: July nonfarm payrolls showed a loss of 23,000 nonfarm jobs, badly missing the consensus forecast of 80,000 new jobs. June payrolls were revised lower by 37,000 to 20,000, and May was reduced by 66,000 to 63,000. As a result, the three-month average for new jobs fell to 20,000 for May-July from 111,000 for April-June.

Employment declined in local government, education, manufacturing, and retail trade. Healthcare continued to grow, but at a slower pace. Construction was one of the few growth areas. The unemployment rate declined to 4.1% in July from 4.2% in June, but that may mean that fewer people were looking for jobs. Average hourly earnings growth slowed to 3.2% year over year, which puts it below the annual change in inflation.

July nonfarm payrolls may have been impacted by the end of temporary employment for those working during the World Cup, but estimates of that impact vary widely and are inconclusive. Summer can also lead to hiring slowdowns. As for GDP, many economists believe that distortions in imports-exports and private inventories could moderate, allowing underlying strength in consumer and business spending to shine through. That is not a slam dunk, given ongoing uncertainty in tariff policy and the war with Iran.

Calendar 2Q26 Earnings Surge

The two biggest weeks of earnings season, spanning the end of July through the first week of August, are now in the books. With just under 90% of companies having reported, S&P 500 earnings from continuing operations for calendar 2Q26 are up an astonishing 50% from 2Q25, according to the tracking firms Bloomberg, FactSet, and Refinitiv. That range of blended estimates is based on both actual earnings data and estimates from companies yet to report. That 50% growth rate includes onetime gains from two GAAP-only reporting companies. Alphabet Inc. recognized a $98 billion onetime gain due to net unrealized gains on equity securities. And Amazon.com Inc. recognized a $53 billion gain from investments in Anthropic. Excluding those gains, the blended 2Q26 EPS growth rate is closer to 28% — still the second-best growth since 2Q21.

Among companies reporting earnings growth, 86% have surpassed prereporting consensus expectations – well above the 75%-80% range prevailing for the past 10 years. Heading into 2Q earnings season, the consensus of investors was anticipating 23% EPS growth. Backing out those AMZN and GOOGL onetime gains, EPS growth of about 28% is exceeding expectations by about five percentage points — in line with long-term averages. Even after backing out those onetime gains, the 11% EPS beat against expectations is well above the typical EPS beat range of 5%-8%.

AI is driving technology earnings growth, but it is not all Magnificent 7. The best AI-driven growth has been coming not from the hyperscalers but from the companies whose hardware — semiconductors, memory & data storage, and networking — supports the transition from generative AI to agentic AI. While AI captures the headlines, an equally important story in this reporting quarter is across-the-board earnings strength, with sectors such as Materials, Energy, Industrial, Financial, and Utilities delivering double-digit EPS growth.

In June 2026, we raised our forecast for 2026 S&P 500 earnings from continuing operations to $340 per share from a prior $315. Our 2026 estimate assumes 24.8% growth in continuing operations earnings from 2025. At that time, we also raised our 2027 forecast for S&P 500 earnings from continuing operations to $390 per share from a prior $363. Our 2027 estimate assumes 14.5% growth in continuing operations earnings from our 2026 estimate.

Conclusion

Investors use the terms “bad is good” and “good is bad” typically in the aftermath of economic data that will either compel the Fed to hold steady on interest rates or cut the Fed Funds rate. (It is fairly unusual for investors to be cheering for the Fed to raise rates.) In the “bad is good” environment we identified above, how good is the bad news for the broad economy, the employment economy, and stocks?

Fed Chair Kevin Warsh in July presided over his second Federal Open Market Committee (FOMC) meeting. The new chairman was championed and selected by President Trump, who would like to see more accommodative Fed policy (i.e., lower interest rates). The poor trend in inflation data would appear to argue for more restrictive policy (i.e., higher rates). The FOMC voted to hold rates steady; yet both the Fed chair’s postmeeting commentary and recent inflation data appear to support a rate hike.

Regarding the broad economy, we are willing to assume that distortions in imports and private inventories muted what was otherwise solid GDP growth. We are a little more wary regarding the jobs economy, which may be showing some concerning tendencies as AI begins to do more and more commonplace tasks.

“Bad is good” was enough to rally the stock market early in August. But with parts of the economy showing soft spots and with war uncertainty still percolating, “bad is good” is not a strong enough investment strategy into year-end.

Jim Kelleher, CFA,
Director of Research

KEY ECONOMIC FORECASTS

- The $32 trillion U.S. economy remains on course for productive long term growth, powered by corporate investments in Artificial Intelligence. Nvidia CFO Colette Kress estimated, on May 20, that AI infrastructure spending is on track to reach $3 - $4 trillion annually by the end of this decade.
- 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.
- Our 2026 gross domestic product growth forecast is 2.3%. Our 2027 forecast is 2.4% In the Monetary Policy Report to Congress, the Federal Reserve said, "Overall, economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East."
- National gasoline prices once again exceed $4.00 a gallon as tensions between the U.S. and Iran remain. Gas prices below $4.00 are important to consumers with the holidays around the corner. Inflation is likely to be a key issue in fall elections for control of the House and Senate.
- The Misery Index, which is the Consumer Price Index (CPI) inflation rate plus the unemployment rate is below the average of 9.2% since 1949, but it has risen to 7.5% from 6.9% in January. Unemployment is low at 4.1%. Inflation remains elevated, but CPI eased to 3.4% in July from 3.5% in June.
- We are monitoring financial conditions and high-frequency indicators. They show ongoing economic resilience and financial system stability that accommodates saving, borrowing, and investing.
- Argus expects S&P 500 EPS to rise almost 25% to $340 in 2026 and increase about 15% to $390 in 2027. EPS is helped by an increase in operating margins to about 19% this year, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 47% and 64% respectively while Dow stalwarts Walmart and Caterpillar earn 4% and 19%. Argus expects the S&P 500 to trade in a range of 6,730-8,225 over the next 12 months. Our year-end 2026 price target for the S&P 500 is 8,000 based on a multiple of 20.5-times our 2027 EPS estimate.
- The Federal Open Market Committee voted 9-3 in July to maintain the federal funds target at 3.5%-3.75%. Following the meeting, Argus Fixed Income Strategist Kevin Heal reiterated his expectation for the Fed to maintain the current funds target in 2026 and cut rates by 25 basis points in the second half of 2027. We expect the dollar to be slightly stronger in 2026 driven by foreign demand for shares of innovative U.S. companies, continuing economic growth, and elevated interest rates.
- Gold is likely to remain at high levels amid global uncertainty. The safe-haven asset topped $5,000 an ounce in 1Q. It has fluctuated on prospects for a deal with Iran and the probability of rate hikes by the Fed. Higher interest rates raise the opportunity cost for holding gold, which doesn't pay interest.
- What could go right? Low unemployment, spending by wealthy consumers, strong S&P earnings, strong capital investment in Artificial Intelligence, productivity gains, and ongoing innovation.
- Risks: Strains on affordability from years of elevated inflation, uncertainty related to hostilities with Iran, a lower 10-year Treasury yield could depend on deficit reduction, a weak housing market, low income consumers are struggling, spending by affluent may depend on stock market gains.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
6-Aug	Nonfarm Productivity	2Q	**0.8%**	0.7%	0.6%	**1.4%**
	Unit Labor Costs	2Q	**1.3%**	1.4%	2.1%	**1.3%**
	Wholesale Inventories	June	**4.2%**	4.4%	NA	**4.2%**
7-Aug	Nonfarm Payrolls	July	**20K**	80K	83K	**-23K**
	Unemployment Rate	July	4.2%	4.2%	4.2%	**4.1%**
	Average Weekly Hours	July	34.3	34.3	34.3	**34.3**
	Average Hourly Earnings	July	**3.4%**	3.5%	3.5%	**3.2%**
11-Aug	Existing Home Sales	July	**4.13 Mln.**	4.10 Mln.	NA	**4.06 Mln.**
12-Aug	Consumer Price Index	July	3.5%	3.4%	3.4%	**3.4%**
	CPI ex-Food & Energy	July	2.6%	2.5%	2.5%	**2.5%**
13-Aug	PPI Final Demand	July	5.5%	4.9%	4.9%	NA
	PPI ex-Food & Energy	July	4.7%	4.2%	4.1%	NA
14-Aug	Retail Sales	July	6.7%	6.1%	NA	NA
	Retail Sales ex-autos	July	6.9%	6.6%	NA	NA
	Business Inventories	June	3.1%	3.0%	NA	NA
	U. Michigan Sentiment	August	55.2	54.5	54.6	NA
18-Aug	Industrial Production	July	1.1%	1.3%	NA	NA
	Capacity Utilization	July	76.1%	76.2%	NA	NA
	Housing Starts	July	1,427K	1,325K	1,342K	NA
	Import Price Index	July	7.1%	7.2%	NA	NA
20-Aug	Leading Index	July	-0.2%	0.2%	NA	NA

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