

2026 Annual Outlook

Economic Resilience Meets Elevated Expectations



Cetera® Investment Management LLC

Economic Resilience Meets Elevated Expectations

As we look ahead to 2026, the U.S. economy presents a mix of challenges and opportunities that require investors to thoughtfully navigate. Both fiscal and monetary policy have shifted and continue to influence the economic environment. On the fiscal side, retroactive tax cuts and evolving trade dynamics are altering the landscape. On the monetary side, the U.S. Federal Reserve has ended quantitative tightening and is gradually lowering short-term interest rates.

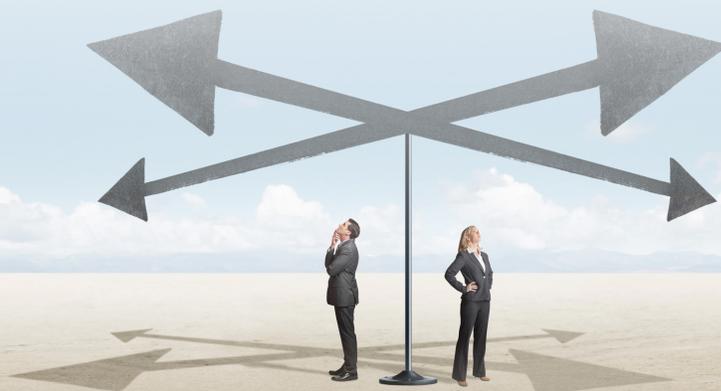
While tax cuts and trade adjustments may dominate headlines, it's the quieter, persistent forces—like automation and AI—that are steadily redefining the economic terrain, much like a river carving a gorge over time. These trends may not show up in quarterly data, but their long-term impact is profound, influencing labor dynamics, supply chains, and competitive positioning.

It's not always easy to connect today's data with tomorrow's structural realities—but that's exactly what this outlook aims to do. We see the U.S. economy on track for moderate growth in 2026, supported by tax-driven consumer strength, demographic spending shifts, and solid household finances. While labor market risks linger, structural forces like automation, AI, and evolving trade dynamics are quietly guiding the economy toward greater domestic resilience—offering long-term opportunity amid short-term uncertainty.

Our outlook for the economy is constructive, but risks remain—particularly in equity markets, where valuations are elevated. While high valuations can persist, investing around them is challenging. We recommend mitigating risk through diversification, especially given the concentration risk in large cap market-cap-weighted indexes. Earnings expectations for 2026 are high, and valuations vary widely across sectors, industries, and regions—creating pockets of opportunity where elevated valuations may be justified.

Fixed income could play an even more important role as a diversifier in this environment. With bond yields offering attractive return potential and volatility buffering, we expect yields to remain range-bound, with a greater likelihood of drifting lower by year-end.

Explore the full 2026 Outlook for a deeper dive into our thinking and the forces shaping the economy and markets.



2025 At-A-Glance



The S&P 500 fell nearly 20% between mid-February and early April, amid rising trade tensions and tariff announcements.



Markets rebounded sharply, with the S&P 500 reaching new all-time highs by late June—marking one of the quickest recoveries in recent history.

Tariffs dominated headlines earlier this year. The effective U.S. tariff rate surged from low single digits to over 15%, reaching levels not seen since the 1930s.

After months of anticipation, the Federal Reserve began cutting interest rates in September as labor market risks overtook inflation concerns.



In early September, the Bureau of Labor Statistics issued a preliminary downward revision of job growth by 911,000 jobs over a 12-month period through March 2025. Furthermore, job growth weakened into the summer.



Bond markets saw early volatility in 2025 as long-term yields surged—partly contributing to the Trump administration's decision to ease tariff pressure. But yields began to ease as investors anticipated Fed rate cuts, leading to solid fixed-income returns and renewed portfolio stability.



Economy

Coming off a year of stabilizing inflation and moderating economic growth, the U.S. economy may be at a crossroads in 2026. Aside from a post-pandemic inflation surge, it appears policymakers and central bankers have engineered a soft landing, albeit at an above-target level of inflation. Now the economy is returning to fundamentals as it has been largely weaned off the pandemic stimulus. As such, the Federal Reserve is reversing its restrictive policy stance and has started cutting interest rates. It has also stopped its quantitative tightening—letting bonds run off their balance sheet. Entering 2026, questions around the labor market loom, inflation is still running hotter than the Fed's 2% target, and yet the consumer remains healthy.

Overall, economic growth as measured by gross domestic product is widely expected to be consistent with that of 2025, however, we think that it is more likely to surprise to the upside than the downside for several reasons. Let's discuss.

Fiscal Dynamics & Consumer Spending

First, the tax cuts that were enacted in July were retroactively applied going back to January 1, 2025, and the IRS has not adjusted 2025 withholding tables to reflect the changes. Thus, many workers are withholding too much income. This should create a tailwind for consumers in the first half of the year as taxpayers receive larger refunds than last year.

Additionally, first-quarter GDP is typically weaker for several reasons, one of them being colder weather. 2025 was no different as GDP growth was negative in the first quarter due to the impact of tariffs, with companies importing more goods trying to front-run tariff effects. There were also spending cuts related to the Department of Government Efficiency (DOGE), which cut government spending. And consumer spending moderated due to rising costs and weather. While we can't predict the weather, we can forecast some of the other factors.

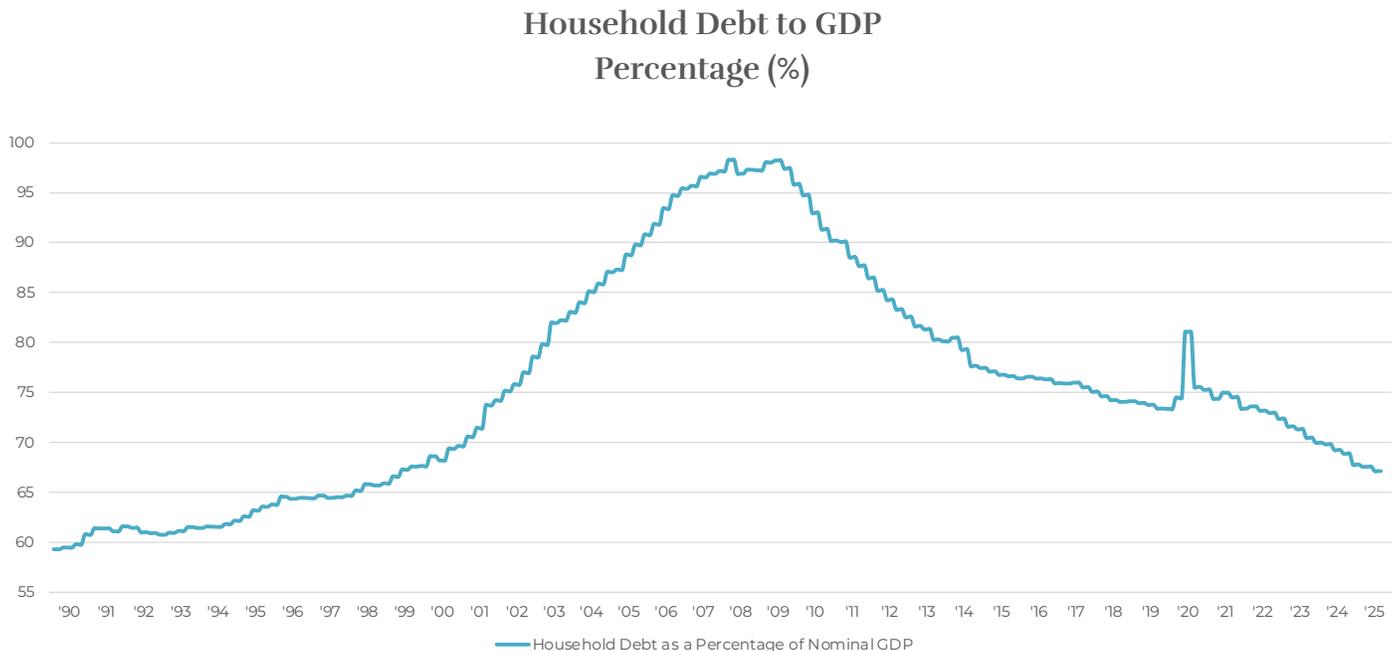
Now that tariffs have been largely implemented companies are less likely to create a surge of goods to build inventories ahead of potential tariffs. The surge we saw in imports should be a one-time effect. The DOGE cuts have already occurred, and consumers are getting increasingly used to higher prices, while wage inflation should be helping them, too.

Consumer spending makes up roughly 70% of GDP in the United States, making consumers critical to economic performance. If we analyze the consumer and what might derail spending, there are some risks but also some silver linings. Let's start with the good news.

Our quarterly outlooks provide a narrower window for us to focus on, while annual outlooks offer longer-term perspectives. One of these topics is demographics. As one might expect, older people have saved more money as they have had more time to work, save and grow their assets. Baby boomers now hold roughly 50% of the nation's wealth. Because baby boomers make up a huge part of the population, roughly 20%, and are now older, they are in spending mode. They no longer need to save money and are enjoying their retirement. This demographic tailwind should continue for some time. Eventually, assets will create a spending boom for younger generations who stand to inherit this money. While this seems like a natural part of the demographic cycle, it's relatively new as baby boomers' parents likely had pensions that didn't get passed down to future generations. The Revenue Act of 1978 created the 401(k), which became the primary retirement-savings vehicle for Americans. Depending on your age, this is a relatively new creation that just became available as the baby boomers came of age.

The financial health of consumers is also relatively good. You may have read that household debt is at an all-time high, but this is somewhat sensational. Inflation rises over time, so we would expect household debt to rise over time. We would also expect GDP and household wealth to increase as well, and they are both currently at all-time highs. When we look at numbers like this, we must look at them on a relative basis. In **Figure 1**, we see household debt relative to GDP is much lower than in the past. When analyzing this sort of data, the question we seek to answer is whether households can afford their debt. If they can't and have to deleverage or pay off their debt, that will affect spending. That is one reason the aftermath of the Financial Crisis was so tough. Households deleveraged for many years, which created a drag on the economy.

Figure 1: Households Have Deleveraged



Source: Cetera Investment Management, FactSet, U.S. Bureau of Economic Analysis. Data as of 6/30/2025.

Automation & Labor Market

Sticking to demographics, there are also some headwinds. Population growth has a significant impact on GDP growth over time. Like many other developed countries, population growth in the United States continues to weaken as fertility rates are declining and fewer children are being born. Immigration can offset declining birth rates, though near-term trends show slowing net immigration amid stricter border enforcement and rising deportations.

Technology is another offset to slow population growth, more specifically, robotics and artificial intelligence (AI), which combine to create another long-term theme with tangible short-term impacts. AI and robotics increase productivity (output per hour worked), another factor for GDP growth and allow us to produce more with less. This has implications for the labor force as perhaps we don't need as much population growth and workers.

This brings us to potentially the biggest economic risk factor for 2026: the labor market. While baby boomers will likely continue to spend money regardless of what happens in the labor market, others are more impacted. If workers fear losing their jobs, they tend to spend less. This is a downward cycle because if consumer spending drops, less goods and services are needed, and one would expect a rise in layoffs. While we will be following labor market developments closely in 2026, the current standstill of labor market growth may simply be part of the overall economic moderation that we were expecting. Right now, we are at equilibrium with around one job opening for every one person looking for work.

As robotics and artificial intelligence continue to advance and become more cost-effective, the economic rationale for offshoring diminishes. In fact, these technologies are increasingly outcompeting both foreign and domestic labor, reinforcing the momentum behind onshoring and reshoring of production. When production comes back to the United States, it eliminates shipping costs and tariffs.

An added advantage of domestic automation is that it also helps circumvent tariffs, further enhancing the cost competitiveness of onshoring. Tariffs may speed up the push for robotics and AI.



Tariffs – Uncertainty & Inflation?

Tariffs caused a lot of uncertainty in 2025, but this uncertainty is possibly behind us now. Tariffs added inflationary pressures that were hard to assess. The good news is that these price impacts from tariffs were one-time events. Inflation is the change in price, meaning it is a percentage increase in prices. Many were confusing high prices with inflation, because we already had high prices due to pandemic-era stimulus and supply shortages. Relatively modest inflation caused by tariffs was painful for many consumers because prices were already high. Unfortunately, prices are unlikely to come down, but the inflation caused by tariffs appears to be stabilizing.

Inflation during the pandemic was largely demand-driven, fueled by stimulus payments, pent-up consumer spending, and supply chain bottlenecks. In contrast, tariffs contribute to inflation from the supply side — by raising the cost of imported goods, they restrict supply and push prices higher, even as demand may be cooling.

Thus, the longer-term impact from tariffs is deflationary, as all tariffs are taxes, and taxes are a form of fiscal tightening, which would curb inflation and economic growth. This could be good news for Fed officials as their dual mandate of keeping prices stable and full employment was becoming tricky with potential cracks in the labor market starting to emerge.



Global Landscape

The United States could continue to be the bright spot as it relates to economic growth for developed countries. While the economic consensus for U.S. real GDP growth is to be closer to 2% in 2026, other developed countries are expected to be closer to 1%. Emerging markets such as China and India are expected to have growth rates around 7% and 5%, respectively.

China's economy is the second largest in the world, only behind the United States. Tariffs hit the country at a bad time as the Chinese economy was already struggling due to a property market recession. The Chinese government is enacting stimulus aimed at promoting consumption, but consumption has still lagged as would-be consumers are choosing to save their money instead of spending it due to low confidence in their economy. The government has a long-term plan to move away from an export-led economy and transition into a domestic consumer economy like the United States, also emphasizing technological self-reliance and local brands made in China.

Onshoring and self-reliance are not just themes for the United States but global themes. Automation is disrupting global trade and the foundational concept behind comparative advantage that you may remember from economics classes in high school. Offshoring production to other countries for lower labor costs, abundant resources, and specialized skills to achieve more efficiency and lower costs may be less of a factor with new technological advancements.

Summing It Up for the Economy

The U.S. economy in 2026 is poised for moderate growth, supported by retroactive tax cuts that boost consumer refunds, demographic tailwinds from baby boomers shifting into spending mode, and resilient household financial health. Risks remain in the labor market, but equilibrium in job openings suggests stability for now. Long-term themes like automation and AI are reshaping production, reducing the need for offshoring and encouraging domestic manufacturing. Tariff-related inflation appears to be behind us, and the U.S. may continue to outperform other developed economies, with China and India leading among emerging markets despite China's ongoing consumer confidence challenges.

With decent economic growth and a weakening yet stable labor market, we wouldn't expect many Fed rate cuts in 2026, unless economic conditions deteriorate. For those hoping for more rate cuts, it could end up being a "be careful what you wish for" situation. As we move toward an economy not as reliant on fiscal and monetary support, the Fed should be less of a factor.

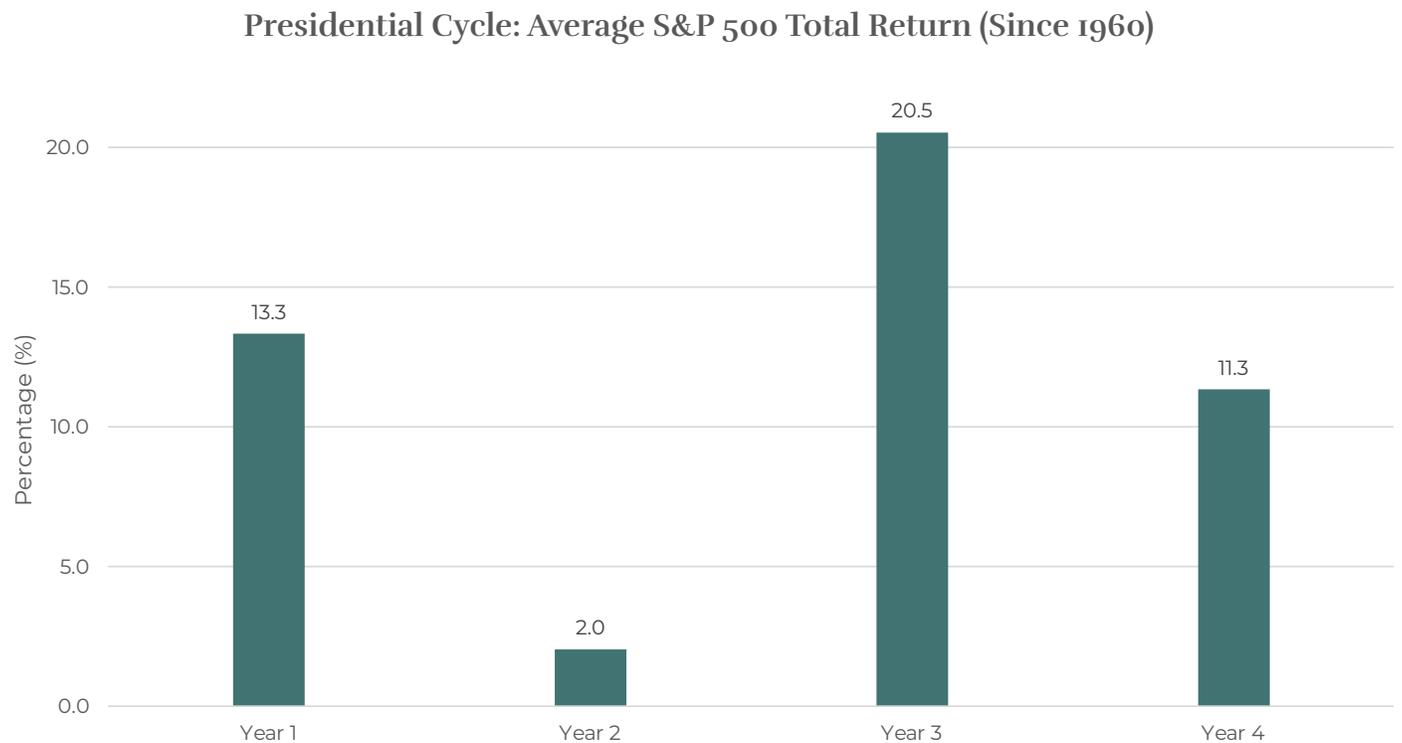


Equity Markets

A constructive 2026 economic outlook bodes well for the equity market, though the connection between equities and the economy is more nuanced. Investors are forward-looking, and while they have different viewpoints, collectively, the consensus outlook is that economic growth in 2026 will be consistent with 2025, with many of the risk factors falling away. Thus, stock markets have done well this year in anticipation of that. What stock markets do in 2026 will, in part, depend on investors' views of 2027 as we get more data to shape their views on the labor market, corporate earnings, and the Fed, to name a few factors. We spoke about broad economic factors including the labor market and Fed, and will discuss earnings more in this section, but before we get into that, let's take a step back and discuss presidential cycles.

Mixing politics and investing is not a good idea as there are broader forces at play than what political party controls the administration. We have analyzed how markets do when either party is in office and when you consider all the factors involved, it is a wash. However, it is worth noting, regardless of who holds power, the second year of a presidential cycle tends to bring weaker stock market returns. Since 1960, stock market returns in the second year of a presidential term have only averaged 2%, as seen in **Figure 2**. More recently, the S&P 500 was down -4.4% in 2018 and -18.1% in 2022, the second year of the last two presidential terms. However, in both of those years the Fed was in an interest rate hiking cycle.

Figure 2: Presidential Cycle Returns



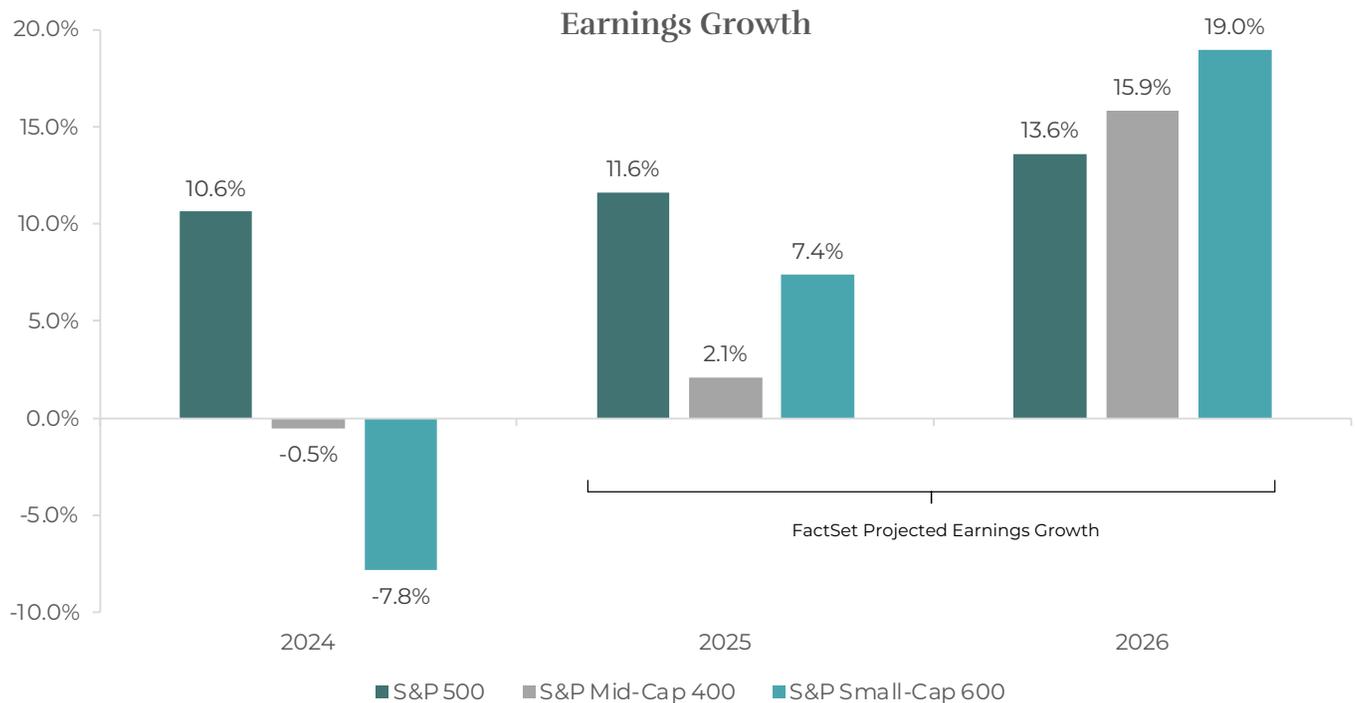
Source: Cetera Investment Management, FactSet, Standard & Poor's. Returns shown are S&P 500 total return, which includes dividends. Investors cannot invest directly in indexes. Data as of 12/31/2024

The first year of the presidential cycle can boost markets because of bold policy moves that fade in the second year. The second year of a presidential cycle can bring policy uncertainty as mid-term elections can shift the balance of power in Congress.

While this could be a potential headwind, investors should take this with a grain of salt as some other causes of this weakness were skewed by the oil embargo in 1974, the tech crash in 2002 and pandemic-related inflation in 2022. There were also five times since 1960 when returns in the second year of the presidential cycle were over 15% (16 data points).

At the end of the day, investors care about earnings and expectations are high. If we look at the forward price-to-earnings (P/E) ratio for the S&P 500 it is currently trading near its post-pandemic highs when stimulus money was pushing markets higher. The average S&P 500 forward P/E ratio over the past 20 years is around 16.5 and the current P/E ratio is 23. Markets seem priced for perfection, pushed higher on optimism around artificial intelligence. Earnings growth projections for next year are also rosy. The projected earnings growth for the S&P 500 is 13.4% and even higher for mid-cap and small-cap stocks, as seen in **Figure 3**. Since the P/E ratios factor in growth expectations, if earnings miss estimates, this will likely cause equity market volatility.

Figure 3: Earnings



Source: Cetera Investment Management, FactSet, Standard & Poor's. Earnings growth is represented by the year-over-year change. 2025 and 2026 figures are projected by FactSet. Data as of 11/5/2025.

The major driver of high valuations in large-cap indexes is the AI-focused “Magnificent Seven” stocks, which make up over 35% of the S&P 500 because of their large market capitalization, or size. By comparison, the other 493 stocks in the S&P 500 make up 65% of the index and have more reasonable valuations. Additionally, mid-cap and small-cap stocks have valuations that are not as stretched. Coming off a few years of great equity returns, it is even more important to be diversified across equities, avoiding too much exposure in one sector or sub-asset class. One should also not shun the Magnificent Seven, as expectations are high due to all the things we discussed in the economic section. AI and automation are the future, and these stocks encompass many of these long-term themes, though expectations can veer from fundamentals. Not having all your eggs in one basket is prudent. One should be aware of the concentration risks in indexes such as the S&P 500 because it may not offer the diversification that many are anticipating.

International Equities

The same themes we have been discussing apply to international markets. AI is playing a big role overseas, but relative to the United States, there aren’t as many companies in this space. The United States is much more technology-focused and that is a large reason valuations are so much higher domestically. Growth potential is much higher for these tech companies. So, investing abroad provides sector diversification away from technology-heavy U.S. indexes like the S&P 500.

U.S. dollar weakness has benefited U.S. investors who invested abroad in 2025 due to currency effects. If this reverses, it would be a headwind for international stocks. It is hard to predict dollar strength and weakness, but if economic growth is stronger in the U.S. and the Fed cuts rates less than other major global central banks, we could expect the dollar to strengthen in 2026. Again, predicting currency valuations is difficult, as there are many contributing factors. A strategic allocation to international equities could provide diversification benefits for U.S. investors where domestic valuations seem expensive.

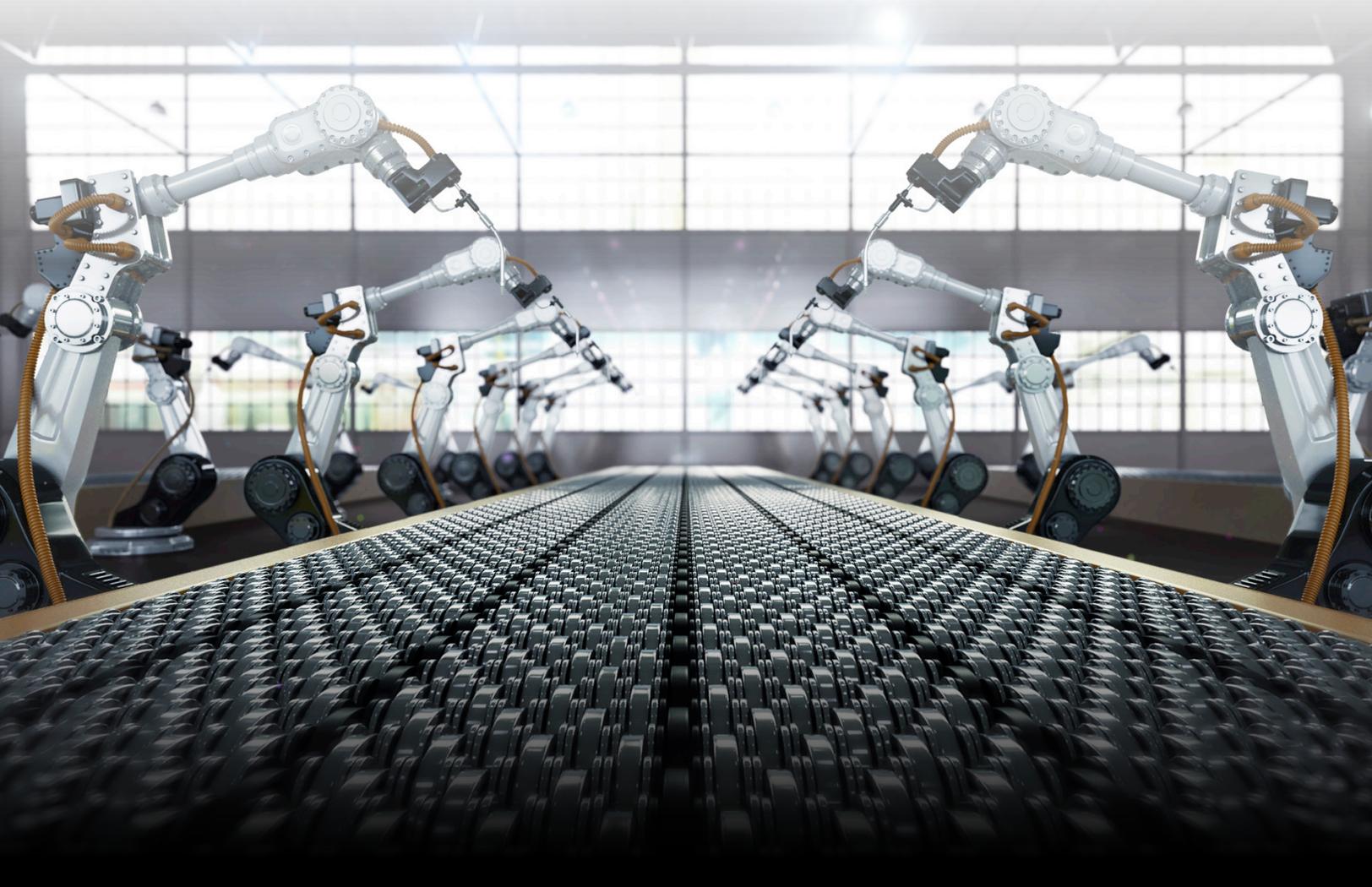


Fixed Income

So, what does this all mean for bonds? Predicting the direction of long-term bond yields can be difficult and involves conflicting factors. For instance, our outlook for potentially stronger-than-expected economic growth and tax cuts boosting spending would be supportive of higher bond yields. If the U.S. Supreme Court decides the current implementation of tariffs is unconstitutional, bond yields could also be pushed higher as it would cause federal deficits to increase. When bond yields move higher, bond prices move lower, so this would negatively impact bond indexes.

However, there are probably more factors that would favor lower bond yields in the future. Lower-than-expected inflation, the potential for increased equity volatility, an aging population and a weakening labor market should support lower bond yields.

Automation, such as AI and robotics, is even more tricky to account for. Automation can cause deflationary pressures due to reduced costs and downward pressure on wages, while productivity gains can increase GDP. Adding the fiscal response to all this, it becomes very difficult to understand what automation will do to bond yields in the long run.



Focusing on 2026, the net impact of all this will vary depending on the magnitude of each factor and what happens, but we would expect bond yields to be range-bound with a higher likelihood that intermediate and long-term bond yields fall from here, which would give bond investors some price appreciation on top of the yields.

Looking at short-term bond yields, the Fed has more control as short-term bond yields are more closely tied to the Fed Funds rate. We have three ways to estimate where the Fed Funds rate will be at the end of 2026.

- 1 The CME Fed Watch Tool gives the latest probabilities of the Fed Funds rate implied by Fed Funds futures prices. The Fed Watch Tool currently shows a wide range of probabilities, with the largest probability for the Fed Funds rate to be 3%-3.25% by year-end 2026, down from the current range of 3.75%-4%.
- 2 The Federal Open Market Committee (FOMC) is the committee responsible for setting the target range for the federal funds rate. They release a summary of economic projections each quarter with the members' median projections. In September this summary had a median projection of 3.4% for the policy rate at the end of 2026.
- 3 The 2-year Treasury yield can be seen as what bond investors think the Fed Funds rate will be one year in the future. Currently, the 2-year Treasury yield is 3.625%.

As of this writing, the target range for the Fed Funds rate is 3.75% to 4.00%. This implies that short-term bond investors anticipate rates to be just 0.25% lower by the end of 2026, while the FOMC and futures markets project rates to be 0.50% to 0.75% lower. All this is consistent with our expectations. With economic growth relatively steady and a stabilizing labor market, we don't feel the Fed would need to cut rates much more in that environment, especially if inflation keeps running in the 2.5%-3% range.

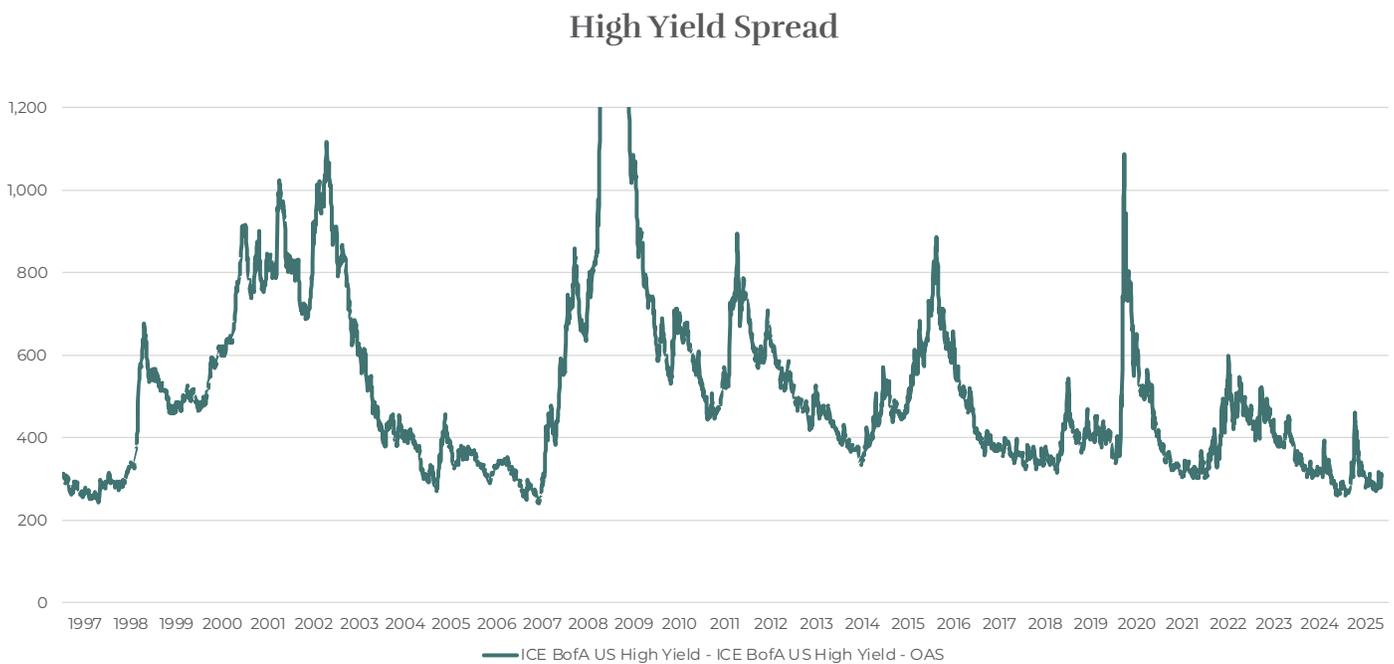
Looking at yields, the aggregate bond market currently has a yield of around 4.25% right now and that index is heavily weighted toward government bonds. The high-grade corporate bond market has a yield closer to 4.75% and the high yield bond market has yields close to 7%. Of course, the higher the yield, the higher the risk of downgrade or default, but the point is, bond yields are relatively attractive given our economic outlook.

Higher-quality bonds will provide more diversification from equities. As bonds become lower in credit quality they will correlate more with stocks. With high equity valuations and strong equity returns in the last few years, having bonds in a portfolio may provide a good hedge and return potential. Long-term capital market assumptions are also generally low for equities compared to historical averages right now.

From a valuation perspective, corporate bonds of all grades are generally expensive as measured by their spread over risk-free treasuries (**Figure 4**). The higher the spread, the higher the compensation for risk of default or downgrade. The good news is that it tells us bond investors are not signaling a recession soon. Bond investors can sometimes give us good clues into the economy.

Because of tight spreads, we are cautious on high-yield bonds, although we also don't expect a deterioration in the economy that would cause spreads to blow out. The yield is sufficient to buffer a lot of volatility in price. Being diversified in fixed income is just as important as being diversified within equities.

Figure 4: High Yield Spreads



Source: Cetera Investment Management, FactSet, Bank of America Merrill Lynch. Data as of 11/5/2025.

We mentioned earlier that the U.S. may reverse course and strengthen. If that does happen, that would be a drag for international bonds issued in local currencies. A stronger dollar would also attract assets away from foreign bonds, driving their yields higher and Treasury yields lower. Again, diversification is the key here, as well. Having small exposure to developed international and emerging markets bonds could be prudent in a diversified portfolio.

The Bottom Line

In 2026, the U.S. economy is expected to remain resilient, supported by retroactive tax cuts, steady consumer spending, and continued productivity gains from AI and automation. While structural challenges like demographic shifts and labor market softening persist, they are likely to be offset by policy support, continued AI capital expenditures, and companies shifting manufacturing back to the U.S. Inflation should moderate within a manageable range, allowing the Federal Reserve to maintain a relatively stable policy stance, with only modest rate cuts expected.

In equities, valuations remain elevated following strong performance in recent years, but opportunities still exist—particularly in sectors benefiting from fiscal tailwinds and technological transformation. Equity volatility may rise, reinforcing the importance of diversification.

Meanwhile, fixed income offers attractive yields across the credit spectrum, with long-term bond yields projected to trend lower or remain range-bound, in our view, providing potential price appreciation. High-quality bonds offer valuable diversification benefits, while tight spreads in high-yield warrant caution. A balanced allocation across sectors and asset classes remains key to navigating the evolving macro landscape.

Your Cetera financial professional can help you navigate any uncertainty, keeping you focused on your personal goals and objectives.

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Glossary

The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg US Aggregate Bond Index is a broad based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. Eligible bonds must have at least one year until final maturity, but the index holdings have a fluctuating average life or around 8.25 years. This total return index is unhedged and rebalances monthly.

The ICE BofA US High Yield Index tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the U.S. domestic market. Securities must have a below investment grade rating (average of Moody's, S&P, and Fitch) and an investment grade rated country of risk (average of Moody's, S&P, and Fitch foreign currency long term sovereign debt ratings). Each security must have greater than 1 year of remaining maturity, a fixed coupon schedule, and a minimum amount outstanding of \$100 million.

The MSCI EAFE is designed to measure large and mid cap equity market performance of 21 developed markets, including three regions (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted, covering 85% of the free float-adjusted market cap in each of the 21 countries.

The Russell 1000 Growth index is a subset of the Russell 1000 as measured by three factors: sales growth, the ratio of earnings change to price, and momentum.

The Russell 1000 Value index is a subset of the Russell 1000 as measured by three factors: the ratios of book value, earnings, and sales to price.