Yardeni Research

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Morning Briefing

2026: Another Year Of Living Audaciously!

Check out the accompanying chart collection.

Executive Summary: The coming new year looks like another good one for stock investors. Dr Ed is adjusting his subjective odds of various stock market scenarios, including raising the odds of his base-case Roaring 2020s outlook to 60%. Associated assumptions for earnings and valuation levels produce an S&P 500 price target of 7700 by year-end 2026. Alternative scenarios include a bear case, triggered by a recession or recession fears (20% odds), and a stock market meltdown/meltup (trimmed to 20%). … Also discussed: Five winds at the economy's back that support a continuation of the Roaring 2020s and six potential developments that could blow it off course. … Also: Dr Ed reviews "Sovereign" (+ +).

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

2026 I: What Will Likely Go Right? The Roaring 2020s remains our base-case scenario. For 2026, we are raising our subjective odds of this prospect from 50% to 60%. We are less concerned about a meltup/meltdown scenario now, so we are lowering the odds of that from 30% to 20%. We are keeping our bearish scenario at 20%.

In our base-case scenario, real GDP should grow 3.0%-3.5% next year, following this year's likely gain of 2.0%-2.5% (*Fig. 1*). We expect the labor force to increase by only 0.5%, implying that productivity will rise by 2.5%-3.0% in 2026 (*Fig. 2*). Productivity-led growth should reduce unit labor cost inflation to 2.0% next year, bringing consumer price inflation (measured by either the CPI or PCED) down to 2.0% as well (*Fig. 3*).

In this scenario, we expect that S&P 500 companies' collective earnings per share will increase from $268 this year to $310 next year. By the end of next year, we expect the industry analysts' consensus to be $350 for 2027 (*Fig. 4*). The forward P/E range by the end of next year should be 18-22, resulting in our target range for the S&P 500 of 6300-7700 (*Fig. 5*). Our single-point estimate is the upper end of this range.

Our year-end 2026 target for the S&P 500 assumes that the economy and earnings will remain resilient. Our odds of a severe correction or a bear market, triggered by either recession fears or an actual recession, remain low at 20%.

We see several reasons why economic growth is likely to be strong, supporting our Roaring 2020s productivity story:

(1) *Trump is focusing on the affordability crisis.* President Donald Trump reportedly will be traveling around the country in coming weeks on a tour themed “Making America Affordable Again.” The goal: to highlight Trump’s economic agenda and address frustration with consumer prices. The tour is a direct response to the results of the November 2025 off-year congressional elections, as the cost of living was identified as a primary voter concern. It’s also part of a broader effort to drum up support ahead of the 2026 midterm elections, as recent polling has shown Trump’s approval rating on the economy has slipped due to persistent price concerns. Trump likely will focus on initiatives like his recent “Freedom Means Affordable Cars” proposal (unveiled on December 3) and efforts to lower energy costs. But Trump has sent mixed signals by dismissing the affordability crisis as a “Democratic hoax” in other recent appearances.

The affordability crisis became an overnight political game-changer when Zohran Mamdani won the New York mayoral race on this issue. Polymarket.com shows that the odds of the Republicans’ keeping their House majority dropped from about 40% just before the election to 21.5% currently (*Fig. 6*). If the Republicans lose the House, Trump said the Democrats will try to impeach him for a third time.

Trump repeatedly has proposed sending $2,000 “dividend,” or “rebate,” checks to Americans, funded by revenue collected from increased tariffs on foreign goods. He has specified that these payments would go to “low- and middle-income” citizens, explicitly excluding “high-income people.” During a December 2 cabinet meeting, Trump reiterated the plan, telling officials and the press that the government would be “giving a nice dividend to the people” in 2026 because the US has “taken in literally trillions.”

The President cannot unilaterally spend tariff revenue on checks; Congress must pass legislation to authorize the payments. No such bill has been passed or even introduced. If the Supreme Court were to rule against the administration’s tariff authority, the revenue source for these checks could disappear. Should that happen, administration officials claim they have a backup plan to raise revenue through tariffs. But since tariffs have increased the cost of imported durable goods this year, the administration may be forced to lower some tariffs to address the affordability crisis (*Fig. 7*).

(2) *OBBBA will be stimulative.* The "One Big Beautiful Bill Act" (OBBBA), passed in July 2025, will stimulate the economy in 2026 primarily through a massive wave of tax refunds and renewed business incentives. Because the bill passed mid-year but made many tax cuts retroactive to January 1, 2025, most workers did not see the benefits in their weekly paychecks. Instead, these benefits will arrive as lump-sum payments when Americans file their taxes in early 2026.

The OBBBA allows workers to deduct up to $25,000 in tip income. There's a deduction of up to $12,500 (single) or $25,000 (joint) for overtime pay. A new deduction allows write-offs of up to $10,000 in interest on loans for personal-use vehicles. There's an additional means-tested $6,000 deduction for individuals and $12,000 for couples over age 65. This provision was sold as "eliminating taxes on Social Security."

The bill restores several corporate tax advantages from the 2017 Tax Cuts and Jobs Act that were expiring or phasing out, aimed at encouraging companies to spend money on expansion in 2026. Companies can immediately write off the full cost of new equipment and machinery (rather than spreading it out over years). This is intended to incentivize heavy capital investment in 2026. It also restores businesses' ability to deduct domestic research and development costs immediately (retroactive to 2025), improving corporate cash flow.

The Congressional Budget Office estimated that OBBBA will boost real GDP growth by 0.4% in 2026 from 1.8% to 2.2%.

(3) *Baby Boomers will continue to retire and spend their nest eggs.* Baby Boomers will be 62-80 years old in 2026 (*Fig. 8*). They will continue to retire. They will be spending the retirement funds they have accumulated over their working years. The Baby Boomers are the largest and wealthiest retiring population cohort in history. Collectively, they have $85.4 trillion in net worth, accounting for 51.0% of the household sector's total net worth (*Fig. 9* and *Fig. 10*). They own $27.4 trillion in equities and mutual funds (*Fig. 11* and *Fig. 12*). So the bull market in equities is providing them with a powerful positive wealth effect on their consumption.

(4) *Monetary stimulus should kick in.* The Fed has cut the federal funds rate by 150bps since September 2024 (*Fig. 13*). In his October press conference, Fed Chair Jerome Powell stated, "Now we are 150 basis points closer to neutral, whatever that may be, than we were a year ago." He implied that the Fed has done enough to stimulate the economy.

Nevertheless, recent dovish comments by a few Fed officials have convinced the financial markets that another 25bps cut in the federal funds rate is coming following the December 9-10 FOMC meeting.

The Fed terminated its latest quantitative tightening (QT) program on December 1. The decision was announced following the FOMC meeting on October 29. This shift marks a transition from a policy of actively shrinking the balance sheet to a “neutral maintenance” phase. The Fed halted the balance-sheet decline at approximately $6.6 trillion by stopping the monthly runoff of Treasury securities (*Fig. 14*). Instead of letting these bonds mature without replacement as before, the Fed began reinvesting the proceeds into new securities to maintain the balance sheet's current size.

The move was largely preemptive, driven by indicators that banking reserves were approaching the lower end of “ample” levels and signs of emerging stress in overnight funding markets. This pivots the Fed from a “headwind” on liquidity to a neutral stance, which analysts have noted is intended to prevent a repeat of the repo market turmoil seen in September 2019.

Milton Friedman famously claimed that monetary policy has a long and variable lag on the economy. If so, then, the latest round of monetary easing should boost economic growth in 2026.

(5) *Technology boom & onshoring should fuel capital spending boom.* The “Magnificent 7” companies (Microsoft, Amazon, Alphabet, Meta, Apple, Nvidia, and Tesla) are projected to spend over $500 billion on capital expenditures in 2026. They’re not bound by any official commitment to spend that much next year, but their managements’ forward guidance to Wall Street analysts through late 2025 indicates plans to accelerate their aggressive investment in AI infrastructure. Most of the spending is expected to come from the four companies building the massive data centers required for AI—Microsoft, Amazon, Alphabet (Google), and Meta—all of which have explicitly stated that their 2026 spending will likely be higher than 2025.

Onshoring should be another source of strength in capital spending. Trump’s tariff negotiators have extracted commitments from foreign governments and companies to build manufacturing facilities in the US in return for lower US tariff rates. A White House *webpage* lists high-dollar private-sector investment commitments “[m]ade possible by President Trump’s leadership.” It claims that Trump secured almost $10 trillion in total US and foreign investments.

2026 II: What Could Possibly Go Wrong? We've lowered the odds of a stock market meltup scenario from 30% to 20%, as noted above. We are doing so mostly because everyone has been asking the same question in recent weeks: "Is AI a bubble?" The widespread concern is that the high valuations of AI-related stocks represent a bubble that might soon burst, with bearish consequences for the overall stock market (*Fig. 15*). In turn, the resulting negative wealth effect would likely depress consumer spending, triggering a recession. The economic downturn would be exacerbated if the hyperscalers are forced to slash their spending on AI infrastructure.

The selloff in stock prices in late November was triggered by such worries, but the market quickly rebounded in recent days. There are lingering concerns about the AI spending boom, but they reduce the likelihood of a meltup/meltdown scenario, in our opinion, as they put a lid on valuation multiples.

So what else could go wrong in 2026?

(1) *Bond Vigilantes could trigger debt crisis.* The OBBBA's tax refunds and tax incentives undoubtedly will swell the federal deficit in fiscal 2026. Doomsayers have long been predicting a sovereign debt crisis in the US. Might 2026 be the year they finally get it right? Maybe, though we doubt it.

The Bond Vigilantes are currently busy instigating sovereign debt crises in Japan and the United Kingdom. Soaring bond yields in those two countries could put upward pressure on yields in other countries with extremely high government debt-to-GDP ratios (*Fig. 16*). That might include the US. Indeed, the 10-year US Treasury bond yield has remained above 4.00% in recent days as short-term interest rates fell because the odds of another Fed rate cut on December 10 have increased.

Last year, the Fed cut the federal funds rate by 100bps from September through December, but the bond yield rose as much (*Fig. 17*). The Fed has been trying to be less restrictive, but the bond market is offsetting the Fed's intentions. Nevertheless, the bond yield isn't likely to spike next year since the US Treasury demonstrated in November 2023 that it is ready, willing, and able to practice yield-curve control by funding more of its debt in the Treasury bill market if necessary to bring bond yields down (*Fig. 18*).

(2) *Private credit market could blow up.* So far, the yield spread between high-yield corporate bonds and the 10-year Treasury bond isn't showing any sign of distress (*Fig. 19*). However, stock market investors recall that the Great Financial Crisis was caused mainly by

problems in the subprime mortgage sector of the credit market. Now, the widespread concern centers on the private credit market.

We aren't as concerned as many seem to be because the Fed is easing. That helps borrowers in that market to refinance their loans at lower rates. In addition, such loans are held by creditors who recognize the risks they are taking and have large and diversified portfolios of such loans. If a few default, that reduces the rate of return on their portfolios. The result isn't likely to be a systemic problem that triggers an economy-wide credit crunch and recession. Meanwhile, we will be monitoring the performances of a few of the private credit ETFs (*Fig. 20*).

(3) *Stock market could melt down.* In our Roaring 2020s scenario, the economy continues to grow through the end of the decade without a recession. If so, then the bull market in stocks should remain intact. However, we can't rule out a meltup/meltdown scenario like the one that occurred during the late 1990s and early 2000s. That experience demonstrated that a plunge in the stock market can cause a recession by depressing consumer and business capital spending.

(4) *American consumers could retrench*. Our optimism about the rest of the decade has been bolstered by the resilience of real GDP and corporate earnings during the first six years of the decade. Both continued to rise to record highs despite lots of challenges.

The latest challenge is the weak pace of employment gains (*Fig. 21*). Layoffs remain relatively low, but finding a job has gotten harder. That's depressing consumer confidence, as is the affordability crisis. So far, consumer spending has held up remarkably well thanks to discretionary spending by upper-income consumers and retiring Baby Boomers, as we anticipated. But we acknowledge that consumer spending's resilience will be tested in 2026.

(5) *Productivity could fizzle.* We are counting on productivity growth to be strong over the remainder of the decade (*Fig. 22*). There are skeptics, as discussed in an *article* in this week's *Barron's* titled "Productivity Is About to Slump—and AI Won't Come to the Rescue." They believe that recent gains in productivity are not sustainable. They question whether AI will have any significant impact on productivity anytime soon. They warn that technological innovations like AI can reduce productivity growth at first, before the benefits accrue years or even decades later. We aren't budging: We remain on the optimistic side of this debate.

(6) *China could invade Taiwan, and Russia could invade Europe.* Geopolitical crises usually create buying opportunities in the stock market. However, if China invades Taiwan or

Russia invades Europe, all bets are off.

Movie. "Sovereign" (+ +) is a disturbing 2025 crime thriller about a father and his homeschooled son who align themselves with an antigovernment ideology. It is based on the events surrounding the 2010 West Memphis police shooting. The father makes a living by hosting seminars to downtrodden folks, pitching his "don't tread on me" philosophy. The cast is excellent, especially Nick Offerman, who plays the father. (See our movie reviews *archive*.)

Calendars

US: Mon: None. **Tues:** NFIB Business Optimism Index 98.4; Job Openings 7.2 million (delayed report); Productivity & Unit Labor Costs 3.0% & 1.0%. (Source: FX Street)

Global: Mon: Germany Industrial Production -0.4%; Japan GDP -0.5%q/q, 2.8%y/y; RBA Interest Rate Decision 3.6%; Lombardeli; Taylor. **Tues:** China CPI 0.3%m/m, 0.7%y/y; China PPI -2.1%y/y; Nagel; Ueda; Mann; Dhingra. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 0.4% during the December 5 week to 0.4% below its record high on October 28. The AC World ex-US outperformed, with a 0.9% gain for the week to 0.7% below its record high on October 29. The AC World ex-US has been hitting new record highs since May 14—the first time it's had such a long streak of successive record highs since June 15, 2021. EMEA was the best performing region last week, with a gain of 1.6%, followed by EM Asia (1.5%), EM (1.4), EMU (1.1), and the AC World ex-US. EM Latin America was the worst regional performer, with a decline of 0.7%, followed by EAFE (0.7) and Europe (0.8). The Korea MSCI index, with a gain of 5.0%, performed the best among country indexes, ahead of South Africa (2.8), Australia (2.1), Spain (2.1), and Taiwan (1.9). The Brazil MSCI index was the worst performer w/w, with a decline of 2.0%, followed by India (-0.7), Hong Kong (-0.4), France (0.1), and the UK (0.1). In terms of ytd performance rankings, the 16.8% gain for the US MSCI index ranks as the third worst country performer and trails the 26.8% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 45.9%, followed by EMU (33.7), EM (28.8), EM Asia (28.3), Europe (28.1), and the AC World ex-US. EMEA is the worst ytd performer, albeit with a gain of 23.5%, followed by EAFE (25.2). Korea is the best ytd performer, with a gain of 83.4%, followed by Spain (69.4), South Africa (62.8), Mexico (46.4), and Brazil (42.1). The worst performing countries ytd: India (2.8), Australia (9.5), the US (16.8), Japan (22.0), and France (23.4).

US Stock Indexes (*link*): Forty-one of the 48 major US stock indexes that we follow rose during the week ended December 5, compared to all 48 rising a week earlier. The Dow Jones 20 Transports index was the best performer for the week, with a gain of 3.6%, ahead of S&P 500 LargeCap Transportation (2.8%), S&P 500 LargeCap Pure Growth (1.2), Nasdaq 100 (1.0), Nasdaq Composite (0.9), and Russell 2000 Growth (0.9). The Dow Jones 15 Utilities index was the worst performer, with a decline of 4.5%, followed by S&P 500 LargeCap Pure Value (-0.5), S&P 600 SmallCap Pure Growth (-0.3), S&P 500 LargeCap Value (-0.2), and S&P 600 SmallCap Pure Value (-0.2). All 48 indexes are now higher ytd. With a gain of 22.6%, the S&P 500 LargeCap Growth index remains in the top spot as the best performer so far in 2025, ahead of Nasdaq 100 (22.3), Nasdaq Composite (22.1), S&P 100 MegaCap (19.4), and Russell 1000 Growth (18.2). The worst performing major US stock indexes ytd: S&P 600 SmallCap Equal Weighted (3.5), S&P 600 SmallCap Value (4.9), S&P 600 SmallCap (5.1), S&P 600 SmallCap Growth (5.5), Nasdaq Industrials (5.9), and S&P MidCap 400 Value (5.9).

S&P 500 Sectors Performance (*link*): Six of the 11 S&P 500 sectors rose during the week ended December 5, and the same six were ahead of the S&P 500's 0.3% gain. That compares to all 11 S&P 500 sectors rising a week earlier, when only three were ahead of the S&P 500's 3.7% gain. The outperformers last week: Energy (1.4%), Information Technology (1.4), Communication Services (0.8), Consumer Discretionary (0.8), Financials (0.6), and Industrials (0.5). The underperformers last week: Utilities (-4.5), Health Care (-2.7), Materials (-1.5), Real Estate (-1.5), and Consumer Staples (-1.4). The S&P 500 is now up 16.8% ytd, with all 11 sectors positive ytd, and three are ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Communication Services remains the best ytd performer, with a gain of 34.9%, followed by Information Technology (25.4) and Industrials (17.0). These eight sectors are lagging the S&P 500 so far in 2025: Real Estate (1.0), Consumer Staples (1.9), Materials (4.7), Consumer Discretionary (5.4), Energy (6.3), Financials (10.8), Health Care (11.1), and Utilities (13.6).

US Economic Indicators

Consumer Sentiment Index (*link*): *Preliminary estimates* for December show consumer sentiment increased for the first time in five months. *Consumer sentiment* advanced to 53.3 in mid-December, after falling from 61.7 in July to 51.0 in November—which was the lowest level since June 2022. *Expectations* improved for the second straight month to 55.0 this month, after falling from 58.1 in June to 50.3 in October. It was as low as 47.3 in April. *Current conditions*, however, sank for the fifth consecutive month, from 68.0 in July to a new record low of 50.7 this month. *Turning to inflation*, year-ahead inflation expectations eased from 4.5% last month to 4.1% this month, the lowest since the start of this year, marking the fourth consecutive month of declines, while consumers' expectations over the next five years eased from 3.4% to 3.2%.

Global Economic Indicators

Eurozone Retail Sales (*link*): Eurozone retail sales have been fluctuating in a relatively flat trend since April. *Headline* sales were unchanged in October and have moved in a range between -0.1% and +0.1% the past four months. Spending on *automotive fuel* rose 0.3% in October after no change in September, following declines of 0.3% and 1.2% the prior two months. Spending on foods, drinks, and tobacco continued its up-and-down pattern, rising 0.3% in October following a 0.2% decline, a 0.4% gain, and a 0.7% loss the prior three months. *Non-food products ex fuel* dipped 0.7% during the three months through October, after a 1.2% gain during the two months through July. *Versus a year ago*, total retail sales rose 1.5%, led by gains in non-food products ex fuel (2.1% y/y) and automotive fuel (1.8), while food, drinks, and tobacco were up 0.9%. On a *month-over-month basis*, sales among three of the largest four economies were mixed in October—with Italy not reporting sales. Sales in Spain (0.0) were flat, while Germany (-0.3) and France (-0.1) reported declines. On a *year-over-year basis*, Spain (3.9% y/y) posted the largest gain, followed by France (2.1) and Germany reading (0.9).

Germany Factory Orders (*link*): German factory orders were stronger than expected in October on robust domestic demand. Orders climbed 1.5%, triple the consensus estimate of a 0.5% gain though slowing slightly from September's upwardly revised 2.0% increase. *Domestic orders* soared 9.9%, while *foreign orders* contracted 4.0%, as orders from *outside the Eurozone* sank 6.5% while orders from *within the Eurozone* barely budged, ticking up 0.1%. *Leading the gains* in orders during the month was an 87.1% jump in orders for aircraft, ships, trains, and military vehicles, followed by an 11.9% jump in basic metals. *Partially offsetting these gains* was a 16.2% plunge in electrical equipment orders. *By sector*, capital goods orders jumped 4.9%, while intermediate (-3.4%) and consumer (-2.2) goods orders posted declines. *Excluding large-scale orders*, overall billings climbed 0.5%.

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