

2026 Economic & Market Outlook

Weighing the Impact of the Middle East War

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Key Takeaways

- + The war in the Middle East and the resultant increase in energy prices has created a layer of uncertainty for the macro backdrop, but our base case still sees continued moderate growth and near-term elevated inflation risk.
- + While the Fed is in a holding pattern as it awaits further data inputs, we feel the policymakers are near or at the end of this rate cut cycle.
- + The Treasury 10-Year yield is expected to remain at an elevated, “normal” level with heightened headline and data dependency producing continued volatility.
- + We believe the bond portfolio decision-making process could benefit from taking an active-passive barbell approach from a solution standpoint.
- + The S&P 500 started rolling over a few sessions prior to the February 28 onset of the Iran war, but consensus earnings estimates have surprisingly grown in that time. This stocks down/earnings up phenomenon has greatly aided the broad market’s valuation calculus.

The Macro Backdrop

The ‘No-Hire, No-Fire’ Economy Continues

The war in the Middle East has brought about an elevated uncertainty quotient when examining the U.S. macro backdrop. The resultant rise in energy prices is being looked at as both a potential ‘tax on the economy’ as well as a catalyst for a near-term elevation in inflation.

Against this backdrop, it is important to turn the calendar back to the late February, pre-war timeframe to try to garner some perspective on how the macro setting was performing at that time. The data that has been released as of this writing continued to show a somewhat mixed labor force backdrop, and a relatively solid consumer and investment landscape.

Looking ahead, the attention will be placed on not only any potential negative impact from higher energy prices, but also one needs to take into account the fiscal stimulus that should be provided by the One Big Beautiful Bill. In our estimation, these two forces may wind up essentially cancelling each other out, leaving us, once again, to focus on the state of the labor markets.

Although new job creation has slowed considerably, the unemployment rate still remains historically low and wages are growing above the rate of inflation. A continued positive development is the fact that the key leading economic indicator, weekly jobless claims, continues to reside at levels that are about 100,000 below where they were historically prior to a looming recession onset. So, for all intents and purposes, the “no-hire, no-fire” economy remains intact.

“The ‘no-hire, no-fire’ economy remains intact.”

If the Middle East war moves into a more permanent de-escalation phase, or ends, we would expect energy prices to decline in measurable fashion. However, the scope of disruption has moved higher, and energy prices may not be able to completely reverse back to pre-war levels in the months immediately ahead. Nevertheless, the underpinnings of the U.S. economy came into 2026 on a relatively solid note and should help keep overall growth moderately positive.

Inflation: Looking Through Higher Energy Prices

The Middle East war has created an environment where one would think that any potential tariff-induced inflation fears were being outweighed by concerns of any pass-through from higher energy prices. However, investors were learning that even though some measure of inflation, such as core CPI was returning to a more disinflationary pattern in recent months, but it still remained above the Fed's preference.

That brings us to the Fed's preferred inflation gauge, the core PCE deflator. Unlike core CPI, this measure has actually been trending to the upside on a pre-war basis. Indeed, the year-over-year reading stands at +3.1% as of this writing. This figure is not only more than a full percentage point above the Fed's target, but it is also at its highest reading in almost two years.

That brings us back to the energy component of the equation. As we mentioned earlier, even with a more permanent de-escalation or end to the Middle East war, energy prices should fall but may not get back to their pre-war readings in the months immediately ahead. Thus, the economy will be dealing with a higher energy and energy-related product (oil, gasoline, plastics, etc.) price backdrop than what was the case back in late February before the war began.

The potential challenge will be to see if the markets can look through any war-induced increases to inflation and focus instead on underlying demand pressures. In addition, as Fed Chair Powell has stated, another key factor to consider is whether any potential increase in prices will be short-lived or have more of a persistent impact.

Either way, the Fed's 2% target continues to be elusive.

Fed Policy: Between a Rock and a Hard Place

For the second consecutive policy gathering, the Federal Open Market Committee (FOMC) decided to remain 'on hold', keeping the fed funds trading range at 3.50%-3.75%. For the most part, this result was largely expected by the markets. Unfortunately for the Fed, the policymakers are in a challenging position of juggling incoming economic/inflation data as well as the uncertainties emanating from the Middle East war.

“The policymakers... remain in a data dependent mode.”

Against this backdrop, both the Fed and the broader investment community are left wondering what could come next from a monetary policy perspective. One thing to address upfront is that despite the surge in energy prices, the Fed will not be entertaining any potential rate increases. Rather, the voting members remain in a data dependent mode that should continue to argue for a more patient approach to the decision-making process. This last point is underscored by the fact that the FOMC just cut the fed funds rate by 75bp from September through December of last year. In other words, it's not as if the Fed is really 'behind the curve' at this point.

In our opinion, the Fed will attempt to 'look through' the recent surge in energy prices. Yes, this development has created a noteworthy shift in inflation fears, but the policymakers, at this point anyway, seem to be operating under the assumption that any elevation in price pressures from higher energy costs will not be a permanent development.

While the Fed appears to be in wait and see mode, the bottom-line takeaway is that the financial markets will be operating in a scenario where rate cuts are either near, or at the end, of this easing cycle.

Searching for GeoAlpha

There was Greenland. Then there was Venezuela. Now there is Iran. The first two were rather inconsequential for risk assets. Greenland led to the U.S. admonishing NATO relevance. That was nothing new. The Venezuela operation was over before most knew it started. These events were certainly gamechangers in their own ways. Venezuela is now a pseudo friendly petro state in South America. Greenland reinforced the need for Europe to continue to develop its own defense capabilities and technologies. But—to a significant extent—they were not radical changes to risk asset landscape. The U.S. had already been pressuring NATO. And Venezuela was sanctioned to the point of irrelevancy by the U.S. and Western allies.

Those two are fundamentally different from the conflict in the Gulf. War is not the same negotiation as Greenland, and Iran is not the same as Venezuela. This creates a different risk matrix going forward. Oil prices have spiked as crude exports have been limited, and Iran has attacked its neighbors. And—without the Strait of Hormuz fully open and traffic normalized—disruptions in the energy market will continue to ripple through the global economy. It is important to look at the most probable outcomes of the conflict, and what that means for allocations.

“Markets are moving from reacting to events to pricing in a sustained layer of geopolitical risk.”

Those outcomes are rather convoluted. But there are some common denominators. One of the more important is the rise in a geopolitical risk premium across multiple asset classes. That is likely to be “sticky”. While oil and its derivatives have declined with the announcement of a two-week ceasefire, there will also be a lingering geopolitical premium (for better or worse) priced into markets. That should be kept in mind. But that will also lead to a further resilience of supply chains and energy production. If there was one thing companies and governments learned from past issues (COVID, Ukraine, and tariffs), it was the necessity of derisking their business models. The current geopolitical backdrop is only going to reinforce this shift and accelerate it.

Equities: Quality Rebound in a Risk-Aware Market

The S&P 500 started rolling over a few sessions prior to the February 28 onset of the Iran war, but consensus earnings estimates have surprisingly grown in that time. This stocks down/earnings up phenomenon has greatly aided the broad market’s valuation calculus.

Consider where we were prior to the war: the S&P 500 briefly changed hands at levels north of 7,000, while a couple months ago the Street consensus for calendar 2026 earnings was \$310-\$315 per share. Use the lower end of that range: the market was trading for a 22.6x forward earnings multiple.

But according to Yardeni Research, the consensus is now looking for S&P 500 operating earnings of \$323 in 2026. Those extra few earnings dollars help, but what really aids the bull case is the bold rate of growth relative to 2025 results. If the market does in fact manage earnings of \$323 this year, that would be a 19% earnings boost over 2025’s earnings of \$271.

For 2027, the Street sees another 17% earnings growth on top of that, bringing the figure to \$377. At the current 6,378, the consensus P/E on 2026 and 2027 earnings is 19.8 and 16.9, respectively. For context, when the S&P was at 7,000 just a couple months ago, its trailing multiple was 25.8.

Meantime, it is our view that the Strait of Hormuz risks are being overamplified by the bears.

We say that because the U.S. industrial machine seems to be in satisfactory health; we have had some regional Fed surveys come out a couple weeks after the war started. Collectively, they weren’t half bad.

Additionally, the AI doom being prognosticated on the labor market is not yet showing up in the data, while stagflation forecasts from the Iranian war are premature when we consider other major military actions over the years. For example, the Vietnam War saw heavy fighting from 1965 to 1973, not to mention its foundations in the 1950s and spillovers to other parts of southeast Asia clear into the mid-1970s.

“Consensus earnings have risen—even as the market pulled back.”

Also, the economic backdrop supports a constructive stance on risk assets, so long as we acknowledge that the junky rally of 2025 is not likely to be reincarnated for the speculative-minded. Even with multiples having come down hard in the first few months of 2026, this is still a market that is closer to a heavy valuation than to some notable bear market low like 1982, 2002 or 2009. Heck, it's not even a bear market, to date.

Let's not mince words either: it is okay to be completely at a loss on what happens to the oil price from here. As recently as January, this was a group that was nearly universally loathed, with common macro discussions ruminating on the prospect of \$40 Brent crude, on account of burgeoning Venezuelan supplies post-Maduro. But fast forward just a few weeks to the March BofA Fund Manager Survey, where investors had become so universally convinced of the high-oil-forever consensus that only 4% of respondents predicted sub-\$60 crude oil by year's end. Never mind that sub-\$60 crude oil was where we were two months ago.

“The economic backdrop supports a constructive stance on risk assets.”

In concert with the near-doubling in crude oil, Consumer Discretionary has become the market's new pariah, registering one of the largest underweights in the BofA survey's history. With the VIX slightly north of 30 as we write, nobody will accuse a consumer discretionary sector long of throwing caution to the wind by overweighting it at this point.

There is a ton of fear in the market, and recession talk is in the air. We think nerves will ease this spring and summer, enabling Discretionary to outperform relative to the market. We are seeing the sector show up in many of our SMID Value and Blend screens.

We think this energy “shock” is a classic example of a lot of smart people failing to differentiate between real and nominal numbers. For example, draw a line through the 2022 Russia-Ukraine shock because it is so recent, and let's consider gasoline. The prior painful spike at the pump was in 2008.

That year, unleaded gasoline went above \$4/gallon during the summer driving season. When putting \$4 then against \$4 now, it goes beyond inflation-adjusting. It would be macro malpractice to disregard 18 years of fuel economy advancement and today's completely different wage scenario. Many don't know it, but average hourly earnings today are almost double what they were in 2008. Our household gasoline calculus concludes that, with today's modern cars and wages where they are now, it would require gasoline to hit \$9.56 in order to be the equivalent of 2008's low-\$4 back breaker.

We also think the consensus will likely be wrong on hawkish forecasts for several central banks. As we write, the Street says the Fed will do about half-of-one hike in 2026, while the European Central Bank will hike by about $\frac{3}{4}$ of a point and the Bank of Japan will do two quarter-point hikes. Before the Iranian war, most seers anticipated that the Fed and ECB would cut rates this year.

We have a simple question: who would tighten policy when the stock prices of the private equity majors are waterfaling due to fears that private credit made too many iffy loans to software companies? Also, as it pertains to the Fed, the U.S. housing market is ice cold and mortgage rates are in the mid-6% range.

If it comes to pass that 2026 proceeds with none of these big three (the Fed, ECB, and BoJ) hiking rates, the beneficiary is USD, because the Fed is the one with the least amount of rate hikes currently priced in.

With dollar strength “on” for the rest of the year, that turns the focus to the beneficiaries: mid and small cap stocks. Other beneficiaries in this scenario where central banks aren’t putting up rates include consumer groups. Another is real estate, which would be pleasantly surprised by interest rates taking a breather. One of the losers from dollar strength tends to be Tech, and in turn, Large Cap Growth.

Needless to say, we think the OECD’s expectation of 4.2% CPI for 2026 is too high. One reason is that indicators such as the Atlanta Fed Wage Growth Tracker will soon have a fourth anniversary of waning year-over-year growth in almost every single report. That measure peaked at 6.7% in summer 2022 and has been steadily falling ever since; it was 3.7% in the most recent report.

Also, we are calm, cool and collected on another metric: marginal propensity to lend, and its influence on inflation. To wit, among all commercial banks, their C&I loan books have grown 4.4% year-over-year in February. For some context, this metric has gone north of 10%, and sometimes stayed there, on five separate occasions since the Global Financial Crisis. If your name is Ben Bernanke, or Janet Yellen, or Jay Powell, or Kevin Warsh, you could make a case for tightening policy in many of those episodes. But right now? It is very hard to justify tightening policy when the banking system is behaving itself and when the private equity houses are doing PR overtime to tame fund redemptions.

Factor-wise, we think the rest of 2026 will see a snapback for Quality screens. At the end of last year, we tallied a cumulative 1,090bps underperformance for the S&P 500 Quality Index relative to the S&P 500 over a 9-month window.

That was the most extreme underperformance for the group since 1999. This year has brought some respite for the factor, but we think the rest of the year will see more mean reversion for the group.

Internationally, Japan has run so hard over the years that even we are sometimes surprised that the group hasn’t gotten wildly overvalued, owing to its stance as the sharpest earnings grower in the developed world over the last generation. For example, the MSCI Japan index has a shareholder yield (the sum of dividends and buybacks) of 3.3%. When we dividend-weight the whole country, our Value-tilted index has a shareholder yield of 4.1%. With the S&P 500 at 1.7% on this metric, the extra yield in the two Japanese indexes are in 91st and 92nd percentile, respectively, with high percentiles being the cheapest.

“We think the rest of 2026 will see a snapback for Quality.”

Fixed Income: Chasing Duration Has Been a Fleeting Strategy

The Middle East war has proven to be a bit of a conundrum for the Treasury (UST) market. Typically, in times of geopolitical uncertainty, Treasuries are viewed as a safe-haven asset to turn to. While Treasury Floating Rate Notes (FRNs) have seen flight-to-quality flows, the fixed coupon maturities have not. In fact, other than the FRN space, there has been no place to hide along the UST yield curve, as short, intermediate and longer-dated maturities have all seen yield levels rise in a visible fashion.

While the surge in energy prices has stoked inflation fears, other factors contributing to the sell-off have been reversing prior 'long' and yield curve positioning, as well as potential liquidation by Persian Gulf nations to raise cash to pay for infrastructure repairs that have been damaged by Iranian missiles and drones.

When the war in the Middle East shows signs of a more permanent de-escalation, or actually ends, our thesis for Treasuries remains one where yield levels will continue to reside at their elevated historical readings.

For those who continue to want to go "long duration" that inherently means you believe the economy is headed toward a recession with no inflationary pressures, and that the UST 10-Year yield is going to decline towards the 2024 low of 3.60%, at a minimum. However, our economic backdrop of moderate growth and above 'Fed target' inflation puts the UST 10-Year yield in a fair-trading range of 4%–4.50%.

Against this backdrop and given the track record for long duration over the last two-year period, as well as our macro-outlook and relative value analysis, we would recommend holding off on the "long duration" trade, and see the path of least resistance for the Treasury yield curve as being more than likely to steepen in 2026.

"Chasing duration has been a fleeting strategy."

Fixed Income Allocation: Positioned for Resilience, Prepared for Change

Over the last month, the conflict in Iran has evolved from a short-term market shock to one with pervasive impact for global markets and the global economy. The announcement of the two-week ceasefire brings hope, but it is as of now temporary. The conflict has also created economic distortions that will take time to work out. Investors need to remain vigilant in assessing not only their base case expectations but also the range and probability of alternative outcomes.

Our central view remains intact: U.S. growth continues to demonstrate resilience, and inflation expectations, while elevated, remain broadly anchored. However, the distribution of potential outcomes has widened. Both upside and downside scenarios now carry greater risk, increasing the cost of being wrong and raising the bar for high-conviction, off-benchmark positioning..

Current Positioning: Balanced and Intentional

Within fixed income, we remain comfortable with our current positioning, which reflects a deliberate balance between income generation and capital preservation:

- + **Duration:** We maintain a neutral duration stance, reflecting uncertainty around the path of interest rates and the timing of potential policy shifts. This positioning allows flexibility without overcommitting to a single rate scenario.
- + **Credit Exposure:** Our credit allocation remains aligned with an income-oriented approach but is intentionally skewed toward higher-quality issuers.
- + **Securitized Assets:** We hold a modest overweight to securitized credit, where structural protections and underlying collateral quality continue to offer attractive risk-adjusted returns.
- + **Municipal Bonds:** Within tax-sensitive accounts, we continue to prefer municipal securities, which continue to provide compelling after-tax income and strong credit fundamentals.

While our base case remains constructive, we are actively evaluating opportunities to adjust positioning on further developments in the geopolitical backdrop. Should the temporary ceasefire evolve into one of more permanence, we would expect risk assets to perform well, accompanied by a potential weakening of the U.S. dollar. In this case, select exposures such as emerging market local debt and gold could offer incremental value. Conversely, if the temporary ceasefire breaks down, risk assets would again become more vulnerable and safe haven investments like U.S. Dollar-Bullish currency strategies could offer resilience amid enhanced market volatility.

While the Iran conflict has dominated daily headlines, concerns about AI vulnerability for industries and the private credit market quickly resurface on slow news days. Recent discussions around artificial intelligence have highlighted potential vulnerabilities across certain industries, especially those heavily reliant on legacy software models. At the same time, segments of the private credit market have come under scrutiny, with isolated cases of fraud and redemption restrictions raising investor concerns.

Our assessment is that risks within private credit remain largely idiosyncratic rather than systemic. However, we recognize a growing disconnect between investor expectations of liquidity and the restrictions inherent in many of the private funds holding these investments. This gap has the potential to drive short-term volatility, particularly during periods of market stress.

As a result, we believe it is prudent for investors to reassess their exposure to areas with elevated sensitivity, including:











- + Debt linked to software and data center infrastructure
- + Financial institutions with meaningful exposure in lending to private credit markets

We prefer quality-screened high yield debt with lower exposure to the software sector than senior loans, which have often featured much heavier software exposure, and bank-dominated preferred securities, where exposure to financial sector dynamics and potential spillovers from private credit warrants a more measured approach..

WisdomTree Asset Allocation Views

Equities











- + Our model portfolios remain overweight U.S. equities, with an overweight to mid and small caps
- + Flows into U.S. equities have lagged those into developed and emerging international markets, while the valuation premium of U.S. stocks has compressed meaningfully relative to global peers
- + We hold a neutral stance between value and growth as neither valuations nor earnings momentum provide a clear advantage
- + In developed international equity markets, we believe a dynamic approach to currency hedging can mitigate risks while retaining flexibility when dollar volatility increases active risk vs. benchmarks
- + Within emerging markets, our long-term case for India remains intact, supported by favorable demographics, domestic demand, structural reforms, and valuations that are no longer stretched relative to history

Equities	Negative 	Neutral 	Positive 
Equities vs. Bonds			
U.S. Equities			
U.S. Large-Cap Growth			
U.S. Large-Cap Value			
U.S. Mid/Small-Cap			
Developed International			
Emerging Markets			

Source: WisdomTree, as of 3/31/26. Evaluations are subject to change as market conditions change. This is for illustration purposes only and does not represent investment advice. All evaluations are on a relative and not an absolute basis. Red = a negative relative evaluation; gray = a neutral relative evaluation; green = a positive relative evaluation. **Past performance does not guarantee future results.**

Fixed Income

- + Remain duration neutral and constructive on quality-screened corporate and securitized credit
- + Increasing high yield corporate exposure within income-focused mandates, funded primarily from preferred securities

Fixed Income	Negative 	Neutral 	Positive 
Duration			
U.S. Treasuries			
Investment-Grade Credit			
High-Yield Credit			
Securitized Credit			
Non-U.S. Developed Government Bonds			
EM Local Currency Debt			

Source: WisdomTree, as of 3/31/26. Evaluations are subject to change as market conditions change. This is for illustration purposes only and does not represent investment advice. All evaluations are on a relative and not an absolute basis. Red = a negative relative evaluation; gray = a neutral relative evaluation; green = a positive relative evaluation. **Past performance does not guarantee future results.**

Alternatives

- + For investors that are hesitant to reduce their allocation to equities and fixed income, efficient core strategies may provide an innovative solution to free up capital for alternative strategies
- + With the possibility that stock-bond correlations could remain in positive territory, we believe trend-following and other liquid alternative strategies can play an important role in multi-asset class portfolios
- + We continue to favor strategies which seek to generate uncorrelated returns in periods of heightened volatility

Alternatives	Negative 	Neutral 	Positive 
Liquid Alternatives			
Real Assets			

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