

2026 Economic & Market Outlook

Raising the Curtain

January 2026



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Key Takeaways

- + Despite mixed labor market data, the underlying fundamentals of the U.S. economy remain resilient, warding off recession fears.
- + The Fed is a “house divided,” with “risk management” rate cuts now turning to a more deliberate, data-driven approach.
- + 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.
- + We remain constructive on global equities, maintaining an emphasis on the Quality and Value factors, along with U.S. small caps.

The Macro Backdrop

A ‘No Hire, No Fire’ Economy

During the summer months, there was no question that the labor markets had experienced a visible cooling in activity. Interestingly, while certainly far from complete, post-government shutdown data is highlighting more of a somewhat mixed employment setting and has given rise to an economy that is experiencing a “no hire, no fire” aspect.

Looking ahead, we continue to see the leading economic indicator, weekly jobless claims, residing at levels that are about 100,000 below where they were historically prior to a looming recession. In fact, a recent reading for claims placed the figure at a three-year low. That being said, new job creation has slowed, and the markets have witnessed a modest uptick in the unemployment rate.

That is the conundrum for both the Fed and the markets and begs the question: Will the 2026 trend follow the 2024/2025 episode, where the cooling in labor market activity that led to this rate-cut cycle back in September 2024 actually proved to be the “low point” for the jobs data?

In terms of the underlying economy, the consumer has remained stalwart, continuing to provide positive contributions. Once again, investors are still waiting for complete data, but the key cylinders of economic growth, consumption and investment have remained in solid territory. Also, it is distinctly possible the economy could receive a tailwind of sorts as the One Big Beautiful Bill’s impact comes more into focus in the new year.

While the impact of tariffs and cooling in new job creation needs to be watched closely, it has become more apparent that the U.S. economy may be able to avoid investors’ post-Liberation Day worst fears, i.e., an outright recession.

Inflation: Searching for Tariff-Induced Inflation

The “other shoe” the markets have been waiting to see drop is whether tariff-induced inflation will rear its ugly head. Thus far, there has been no surge in price pressures, but there have been signs that the spring bout of disinflation may now be over. Although key inflation readings should not necessarily be deemed worrisome, they have moved a bit further away from the Fed’s +2% target.

Where should investors look to see if tariffs are playing a role in future price pressures? The goods component. Service-related inflation has managed to stay relatively calm, which is good news. However, from the goods side of the ledger, prior unchanged or negative monthly readings earlier in the year are now on the plus side, albeit remaining somewhat modest. Going forward, any tariff-related price increases would be more likely to show up in the goods sector of the economy, while services could be more neutral on overall inflation trends.

The potential challenge will be to see if the markets can look through any tariff-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: Recalibrating the “Recalibration”

As was widely expected, the Federal Open Market Committee (FOMC) implemented another 25-basis-point (bp) rate cut at the December FOMC meeting, bringing the new Fed Funds trading range down to 3.50%–3.75%. With the resumption of rate cuts now at round three, and Chairman Powell referencing the resumption of rate cuts as a “risk management” approach, the more pertinent questions are: what will the Fed have in store for the markets in 2026, and will the voting members recalibrate the “recalibration”?

If you may recall, when the FOMC began this rate-cut cycle back in September 2024, Chairman Powell referred to it as a “recalibration” of monetary policy. With the Fed now implementing 175 bps of rate cuts over the last 15 months, it appears as if the broader sentiment within the U.S. central bank may now be to “wait out the data” to see if any potential easing in policy is warranted at this stage.

This point has been underscored by many of the regional Fed bank presidents, creating an impression of the Fed being a “house divided.” Based upon the broader economy pre-government shutdown, there apparently didn’t seem to be a need to go into an “accommodative phase” for policy just yet, but perhaps just get back to “neutral.” This is a point Powell & Co. have been making as well. Now, what is a neutral Fed Funds Rate? That is the key question. If you believe it begins at perhaps 3.50%, then we are essentially at neutral.

“If neutral begins around 3.50%, we are essentially already there.”

However, the Fed and, of course, the money and bond markets are now back to being highly data-dependent. The Fed Funds Rate has already been cut by 75 bps over the last three months, so you can make the case that the Fed may now be far less behind the curve than it was pre-September. Thus, future rate cuts will hinge directly on incoming economic reports. With inflation still visibly above the Fed's own 2% target, the FOMC will need to see additional cooling in the labor markets to spur additional rate-cutting action.

Bottom line: With the less consensus-driven rate cut among the voting members now "in the books," the bar has probably been raised for future rate cuts, to some degree. Besides the public dissenters for no rate cut at the December FOMC meeting, there were also four other 'silent dissenters' who saw no decrease for the final 2025 convocation according to the dot plot. That makes up about one-third of the Fed. Against this backdrop, it's now up to the data from here on out to get the more "hawkish" members on board.

Searching for GeoAlpha

If 2025 was a year dominated by commentary, concern and fretting around the Ukraine War and U.S. tariff announcements, 2026 is going to be much of the same. The war in Ukraine continues, with negotiations around a ceasefire and an eventual end currently underway. Tariff announcements have subsided, and the Supreme Court is set to rule on the legality of many of the Trump administration's incremental tariffs soon. That means the uncertainties around particular levies, previously largely behind us, may be set for a comeback. The Trump administration is not going to shy away from one of its core tools for the implementation of its economic policies. The dynamics will change. That trajectory will not. For markets, this places the peak of tariff uncertainty squarely in the rearview mirror and in oncoming traffic. Much of the impact has been mitigated by U.S. businesses.

The war in Ukraine continues with the Trump administration moving to put additional pressure on the primary revenue source of the Russian Federation—oil. Under traditional circumstances, this would be highly positive for oil. That has not been the case, as the market remains well-supplied, and OPEC+ (which awkwardly includes Russia) has increased its production. Combined with the pressure the U.S. is putting on Venezuela, oil prices remain subdued. On the domestic front, the U.S. government has increasingly made strategic investments in industries deemed necessary from a national security perspective. This—like tariff policy—will continue to be a hallmark of the administration's push for onshoring production, and more announcements are likely in the coming months.

There are certainly going to be further headlines related to tariff policy going forward. The Supreme Court is going to rule on the legality of the IEEPA tariffs soon, and that could cause some noise around the outlook for various policies. But it will be just that—noise. Tariffs are a favorite tool for implementing policy, and they are not going away. They are evolving.

When it comes to the outlook, it is important to do just that—look out for the pivots in the narratives and understand that they are changing, but only a bit.

"Tariffs aren't going away; they're evolving."

Equities: Mean Reversion is Thematic for 2026

As we head into 2026, one of the stock market's primary concerns from a few months ago has faded from focus: the "cockroaches" concept. It was not long ago that Jamie Dimon circulated his view that the bad-debt debacles at First Brands (from alleged fraud) and Tricolor (a shoddy subprime auto loan book) could be like household pests: if you see one or two, look behind the drywall and there will be many more.

The vision of cockroaches infesting private credit was, for a spell, a primary sentiment driver and a key reason for the market's mini comeuppance in November. However, as things stand now, there hasn't been much in the way of new bad debt revelations. Maybe that will change, but for now, latching onto the cockroaches for a general bear thesis has lost its muscle.

Another concern in some circles is the backup in Japanese government bond yields. Beyond the effect on that nation's economy, a reasonable theory has been that Japan could drag the U.S. Treasury market along with it. That would, as the theory goes, adversely affect the bull case for global equities.

The 10-Year JGB yield has started to flirt with 2%, up from around 1% in early 2025. Thus far, the U.S. bond market has not reacted, and equities have not shown concern. So long as the repricing of the JGB market remains orderly, we are also okay with it, but this is an area we will be watching in 2026.

In equity asset allocation, we favor small caps, along with the Quality and Value factors. In the case of Quality, we have some performance charts that are touching extremes last seen in 1999 and 2000.

For example, inside small caps specifically, the junky Russell 2000 Index just witnessed its boldest nine-month outperformance bout over the better-quality S&P 600 Index since 1999. On a reversion-to-the-mean basis, it makes complete sense to round up investment committees to scrutinize exposure to unprofitable firms and low-profitability holdings in small-cap mandates.

For an idea of how bold such a mean reversion could be across the market, we calculate that the S&P 500 outperformed the S&P 500 Quality Index by 11 percentage points in the six months off the April 8 broad market lows. The last time this happened was in 1999. Not much was rectified on this front in November or December, either.

In other words, you don't have to look far to find froth. Thirteen of the 15 largest S&P 500 Tech sector components can't get past a <5x sales screen, while eight of them are above 10x sales. Taking it further, check for >30x sales, and we still count four of those 15. It's a market that is priced with what appears to be absolute certainty that Silicon Valley's AI promises will necessarily come true.

"The 10-year JGB yield has started to test the 2% level."

As things stand, the Magnificent 7 is putting its money where its mouth is, aggressively. The group goosed its collective capital expenditures by 61% in the year through the most recent earnings season. At the same time, net cash flow from operating activities only grew 22%, resulting in a collective decline in Mag 7 free cash flow. FCF also declined in 2022, a year that witnessed the Tech sector sell off to the tune of 27.6%, while the S&P 500 fell 18.1%.

We understand quite well why free cash flow growth is turning negative: Everyone in the AI game is attempting to set their own foundation for the future, when the promises of the technology will change the world. But here and now, the Mag 7's price-to-free cash flow ratio is 52.6. That figure will seemingly rise in 2026 if capital expenditures once again handily outpace operating cash flow growth, which is essentially the universal consensus.

Because of such firms' overbearing size in an index such as the S&P 1500, the total U.S. stock market now has 60% of its market capitalization in firms that trade for more than 35x forward earnings. Generally, when looking for the other 40% of firms, the investor will move down the sector list to the down-and-outs. The bottom five YTD performers are Energy, Consumer Discretionary, Materials, Real Estate and Consumer Staples.

Consider an outperformance case for two of those five: Consumer Discretionary and Consumer Staples. These two tend to show up in size when we run buyback screens and, in many cases, Value screens. We are okay with the U.S. consumer in 2026 because we believe the general ill health of the middle class is exaggerated.

For example, the National Retail Federation anticipates holiday shopping season sales will grow 3.7%–4.2% this year. Our “real world” inflation measures, on a year-over-year basis, have been clocking in below 2% this winter. If our inflation metrics are accurate, and we believe they are, that means the typical person will buy more presents for loved ones this year than they did last year. That defies the storyline of the busted consumer.

Additionally, the news focuses on specific pain points, such as electricity, coffee and red meat, each of which has come to be outrageously priced. But we are a little stunned that the collapse in unleaded gasoline gathers little attention as a household budget offset.

With the national average gas price under \$3 per gallon, down from \$5 in mid-2022, we calculate that the combination of price, modern-day fuel economy and average hourly earnings above \$31 makes the current situation very close to the lowest household auto fuel burden on record.

If we have it right, the “troubled, but not busted” consumer theme could provide relief for both Staples and Discretionary sectors relative to the S&P 500 in 2026.

“The resilient consumer theme could provide relief for both Staples and Discretionary.”

In developed markets, we want to check for correlations to the market's primary risk, the U.S. Tech sector. Since that group skews toward mega-cap growth, it is little surprise that mandates with a Value bias and exposure to smaller firms tend to show up as having the lowest correlations to U.S. Tech. Interestingly, in developed markets, we are finding that screens for both quality and dividends are clocking in with lower correlations to it than our screens for dividends alone.

In emerging markets, we find that deep value concepts have had a historical tendency to snap into outperformance mode after the calendar years in which they woefully underperformed beta.

For example, we saw emerging markets' value and deep value struggle particularly badly relative to cap-weighted indexes in 2015, 2017 and 2020. The years subsequent to those (2016, 2018 and 2021) each witnessed bold snapback outperformance by the group relative to cap-weighted baskets. Like those three episodes, 2025 was a particularly bad year for the group; contrarians take note.

To engage emerging deep value is to be content with heavy exposure to Financials, Materials and Energy at the expense of Tech, and Chinese tech specifically. Given the question mark we are presenting on the AI capex build-out, such positioning seems reasonable, as hunt-for-yield concepts inside emerging markets have considerably lagged U.S. large-cap growth since the October 2022 lows.

Fixed Income: Chasing Duration Has Been a Fleeting Strategy

So, where can Treasury (UST) yields go in this environment? The age-old question in fixed income is: when should I go long duration? Over the last two years, this has been an ongoing query for investors, and more recently, with the Fed's recent rate cuts, it has come back on the front burner, for sure.

Trading activity in the U.S. Treasury (UST) market has been rather volatile over the last two years, with large absolute yield level movements occurring (roughly 100-bp swings from highs and lows) against the backdrop of a broader "sawtooth" pattern.

Going "long duration" inherently means you believe the economy is headed toward a recession with no inflationary pressures, and the UST 10-Year yield is going to decline to the 2024 low of 3.60%, at a minimum. However, an economic backdrop of moderate growth and no meaningful upward price pressures puts the UST 10-Year yield in a fair-trading range of 4%–4.50%.

Although the Treasury yield curve has "un-inverted," it remains historically flat. Following the Fed's most recent 25-bp rate cut, the spread between the new Fed Funds mid-point and the UST 10-Year yield is roughly +50 bps. The long-run average for the Fed Funds/UST 10-Year spread is about +130 bps, or a hefty 80 bps above its current level.

"A fair trading range for the 10-year sits closer to 4%–4.50%, not the recession-level lows."

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 “going long duration” trade, and see the path of least resistance for the Treasury yield curve as being more than likely to steepen in 2026.

Fixed Income Allocation: Saying Goodbye to 2025, Embracing 2026

It has been a strong year for fixed income. Interest rates moved lower, with the 10-Year Treasury yield on track to post its first annual decline in five years. Credit spreads have narrowed and are now tighter on the year, fully reversing the pre-Liberation Day anxiety that weighed on corporate bond markets in the first quarter. Income, duration and credit have all contributed positively in 2025.

The Bloomberg Aggregate Index is up 7.06% year-to-date, marking its best annual result in five years and placing 2025 in roughly the top quartile of bond market returns so far this century. Emerging market local debt, as measured by the JP Morgan GBI-EM Global Diversified Index, has returned 18.56% year-to-date, its strongest performance, since 2009. Even municipal bonds, which came under pressure during the fiscal debate in the first four months of the year, rebounded sharply and went on to deliver some of the highest returns among U.S. fixed income sectors in the second half.

During the fourth quarter, returns remained positive but slowed noticeably. Treasury note yields were confined to a narrow range, and an early widening in high-yield credit spreads, following the “cockroach” comments, quickly reversed. Market behavior resembled a good party winding down: the energy faded, the refreshments ran out (i.e. new data dried up) and most participants wrapped up the year feeling satisfied while turning their attention to what comes next.

Looking at valuations compared with a year ago, yields are lower, the curve has steepened, and credit remains fully valued. Our economic outlook is broadly consistent with last year’s, though with the prospect of less support from the Federal Reserve and more moderate labor-market growth. As a result, income is expected to be the primary driver of fixed income performance. With lower starting yields, expectations for overall returns should be somewhat tempered heading into 2026: still positive, but likely more modest, supporting a steady allocation to fixed income.

We maintain a neutral stance on duration, with selective over-weight positions in securitized debt and corporate credit, focused on higher-quality issuers.

“Income—not duration or Fed support—is expected to drive fixed income performance in 2026.”

Income Remains the Focus

Securing diversified sources of income remains a key priority. Within U.S. taxable markets, securitized debt continues to be our preferred avenue. We expect continued support for higher coupon agency residential mortgage-backed securities and broadening interest in other areas of the securitized market. Deregulation and freed-up bank capital could help drive stronger demand from banks, while progress towards re-privatizing Fannie Mae and Freddie Mac could offer additional support.

In corporate bonds, we recognize that current valuations leave less room for missteps, but fundamentals still provide support for today's yield levels. Careful selection and discipline are essential. In both high-yield and investment-grade markets, we favor issuers with stronger balance sheets and more resilient business profiles. Within investment-grade, we are watching the recent wave of issuance tied to artificial intelligence and assessing its potential impact on spreads. In high yield, we continue to prefer low-duration bonds over senior loans, given their broader sector diversification.

Outside the U.S., emerging market local debt continues to offer appealing income opportunities, supported by a geopolitical landscape that is less disruptive than last year and by improving inflation trends in many countries. While the boost from a weakening U.S. dollar has diminished, we still see value in the higher-yielding bond markets across Latin America.











Despite the strong rebound in municipal bonds during the second half of 2025, we continue to see meaningful value in the sector for tax-aware portfolios. Yields remain appealing, both in absolute terms and relative to taxable alternatives, and credit quality remains solid. Strong coupon reinvestment in January should also provide additional technical support.

Within the municipal market, we favor revenue-backed sectors, such as public utilities and water and sewer systems, over lower-yielding general obligation bonds.

WisdomTree Asset Allocation Views

Equities











- + Our model portfolios remain overweight U.S. equities, with an overweight to mid and small caps, which have seen improved earnings growth and stand to disproportionately benefit from cheaper short-term financing conditions.
- + 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 12/31/25. 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

- + We are maintaining a neutral duration stance with an expectation for ongoing rate volatility and Fed policy decisions that will remain data-dependent into next year.
- + We have an overweight to securitized credit, where we see more attractive valuations and a greater scope for active managers to deliver excess returns via coupon/security selection.
- + Within Tax Aware portfolios, we recommend an overweight to municipal bonds.

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 12/31/25. 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			

Source: WisdomTree, as of 12/31/25. 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.**

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