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Strategists See Higher Levels in 2026

Strategists see higher targets in 2026, despite some political trends, which appear to be leaning further to the left. Some of them advocate for higher taxes and making the "rich" pay their "fair shares." Gee, where have we heard that before?

Financial markets finished last year on a high note, showing impressive resilience despite a volatile start to the year. Investors contended with tariff uncertainty, the longest US government shutdown in history, concerns around unemployment and interest rate policy, tax policy unknowns and worries about potential overspending in artificial intelligence (AI).

The S&P 500 saw a 19% decline from its February peak to its low on April 8th on the heels of "Liberation Day." Following this, the S&P 500 index recovered 38% through year end fueled by better-than- expected economic growth and solid corporate earnings. The reminder here is to not let headlines or near term uncertainty interrupt your long term investment plan.

For the year, the S&P 500 posted a total return of 17.9% after impressive gains of 25.02% and 26.3% in the prior two years. As in past years, the largest stocks contributed the most, with the "Magnificent 7" accounting for close to 40% of the index gains. If we include some other AI related stocks such as Broadcom, Palantir and Micron, these 10 stocks accounted for 54% of the index returns, according to the UBS strategy team. Their leverage may not create such a happy event when they head into a correction phase. There should be no surprise particularly when higher velocity performers correct. It can be very swift and painful.

A notable difference from past years was the outperformance of international stocks highlighted in the table below. The MSCI All Country World ex-US, a global stock market benchmark that excludes US stocks, gained roughly 33%. Investors looked to diversify globally amid US trade policy uncertainty, cheaper valuations and a weaker US Dollar, which has historically helped international stocks.

Sentiment abroad was supported by various factors such as fiscal stimulus and improving economic fundamentals in Asia and parts of Europe. Technology shares in China, Korea and Taiwan benefited from the US-led technology theme.

In January, a China based private company, DeepSeek, released an open-source Artificial Intelligence model that surprised the western world as its performance in standardized tests rivaled ChatGPT and other top American AI companies. These models use older technology, came at a fraction of the costs and used much less energy than its western counterparts. This called into question US leadership in AI and helped ignite the AI race between the US and China, in what's being seen as a potential new cold war among the world's two largest economies.

US bonds also posted mid-single digit returns as the Federal Reserve cut short term interest rates three consecutive times toward the end of 2025. When yields go down the prices of bonds rise, adding some appreciation on top of the income you receive from the stream of coupon payments.

	4Q 2025 (%)	YTD 2025 (%)	YTD 2024 (%)
Dow Jones Industrials	4.03	14.92	14.99
Standard & Poor's 500	2.66	17.88	25.02
NASDAQ Composite	2.72	21.14	29.57
Russell 2000	2.19	12.81	11.54
Russell MidCap	0.16	10.60	15.34
Russell 1000 Growth	1.12	18.56	33.36
Russell 1000 Value	3.81	15.91	14.37
Barclays Capital Govt./Corp. Bond	0.90	6.88	1.18
Barclays Capital 5 Year Municipal Bond	0.50	5.03	1.17
MSCI AC World ex US	5.11	33.11	6.09
MSCI AC World	3.37	22.87	18.02

Source: Morningstar

As we enter 2026, our CIO team continues to see a favorable backdrop for stocks. Our US Strategist, David Lefkowitz, expects fourth quarter earnings growth of 12%. The Mag 7 companies should grow earnings around 25% for the fourth quarter while earnings for the remaining 493 companies in the S&P 500 are expected to grow 10%. While larger technology companies have shown impressive growth, smaller companies are starting to benefit as well.

Lefkowitz forecasts S&P 500 earnings per share growth of 12% in 2026, or $310 per share, due to strong technology trends continuing and policy support. He raised his index target for the S&P 500 to 7,700 by year end, which is about 12% higher than its current level. The potential to see equity prices trend higher by year end is likely to encourage some of the cash on the sidelines to be deployed.

The overall economic backdrop remains supportive as the unemployment rate remains low and real wages are stable. This should support consumer spending, which is the biggest driver to the US economy. The One Big Beautiful Bill Act (OBBBA) will provide additional incentives for companies to make capital investments that should support further growth in the US.

Interest rates will also help business activity as lower rates, typically on a lagged basis, have a positive effect on spending that can help spur lending to individuals and businesses. UBS currently expects two additional rate cuts this year with the first one happening by March.

AI related investment will continue, though investors are more closely watching a company's path to profits, or monetization, given the huge amounts that have been invested so far. The enormous revenue growth and profits generated by the largest companies, or "hyper-scalers," like Google, Amazon, Microsoft, Facebook (Meta) and Apple so far have eased concerns about overspending.

Higher prices accompany the optimistic outlook for technology shares. The S&P 500 forward price to earnings multiple is around 23x, which is above the 10-year average of 18x, according to FactSet and UBS research, implying potentially more moderate stock returns in the coming years.

As we mentioned in past letters, diversification is your friend, as different types of investments such as growth stocks, value stocks and international stocks react to different factors. Bonds are an anchor to windward providing income and stability for portfolios. For certain investors hedged strategies or private investments can also play a role.

The team, as always, would like to express our appreciation for the confidence and trust that you place in us.

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