

# 2026 Market Outlook

Constructive, but cautious | December 2025

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## Making Sense

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### Five key takeaways

1. We believe the economy can remain resilient in 2026, delivering another year of steady employment, income, and output growth. However, economic fundamentals – while still fairly solid – are not as strong as they were a year ago.
2. A cooling labor market, above-trend inflation, and elevated economic and policy uncertainty puts the Federal Reserve in a quandary. As we enter 2026, both we and futures markets believe the Fed will start the year in wait-and-see mode.
3. We remain cautiously constructive on US equities. The S&P 500's more than 100% return since bottoming in 2022 has been powerful, and with a 12-month ahead price target of 7,200, we see reasons to expect further upside.
4. With bonds still yielding over 4%, we continue to see fixed income as an attractive diversifier in global multi-asset portfolios.
5. Attempting to time equity markets can permanently impair a portfolio. Equities are by their nature volatile, but a thorough financial plan can shield investors from the permanent impairment caused by being forced to sell at the wrong time.

## 2025 Lookback

After weathering a tumultuous start to the year, the US economy and financial markets are ending 2025 fairly close to the consensus expectations from one year ago. Growth expectations collapsed this spring following the spike in tariff rates and trade policy uncertainty, but the disruption to prices and domestic demand was milder than many expected. Real GDP growth is now expected to finish 2025 at a roughly 2% pace.

**Exhibit 1: Economic data missed the mark slightly in 2025, but stocks outperformed**

	Forecast on Jan. 1	Latest	Direction	Notes/Drivers
<b>GDP growth</b>	2.10%	1.95%	➡	Tariff tantrum + policy uncertainty and deceleration of consumer spending growth
<b>Unemployment rate</b>	4.3%	4.6%	⬆	Policy & economic uncertainty + cooling labor demand
<b>Monthly job growth</b>	122k	22k	⬇	Policy & economic uncertainty + cooling labor demand
<b>CPI Inflation</b>	2.5%	3.0%	⬆	Trade policy + persistent services inflation
<b>S&amp;P 500 Index</b>	6,600	6,816	⬆	AI euphoria + strong earnings results across the board
<b>Federal funds rate</b>	3.9%	3.6%	⬇	Increased downside risk to labor market + slower overall economic growth
<b>10-Year Treasury</b>	4.12%	4.18%	➡	Persistent inflation + growing concerns over U.S. fiscal deficits

Source: Bloomberg, First Citizens Bank. Data as of December 15, 2025.

The labor market weakened slightly more than expected this year as the unemployment rate moved up to 4.6% and the pace of job growth stalled. Forecasters expected CPI inflation to moderate to a more satisfactory 2.5% rate, but instead, price growth settled in at about a 3% pace. (The Federal Reserve's official target is 2%.)

Equity markets powered higher in 2025, rallying 37% from the bottom of the tariff-induced selloff in April and returning 17% year to date. The Federal Reserve delivered three quarter-point rate cuts, one more than expected a year ago, and the 10-year Treasury yield is trading close to the 4.1% consensus view at the start of 2025.

## Economic Outlook

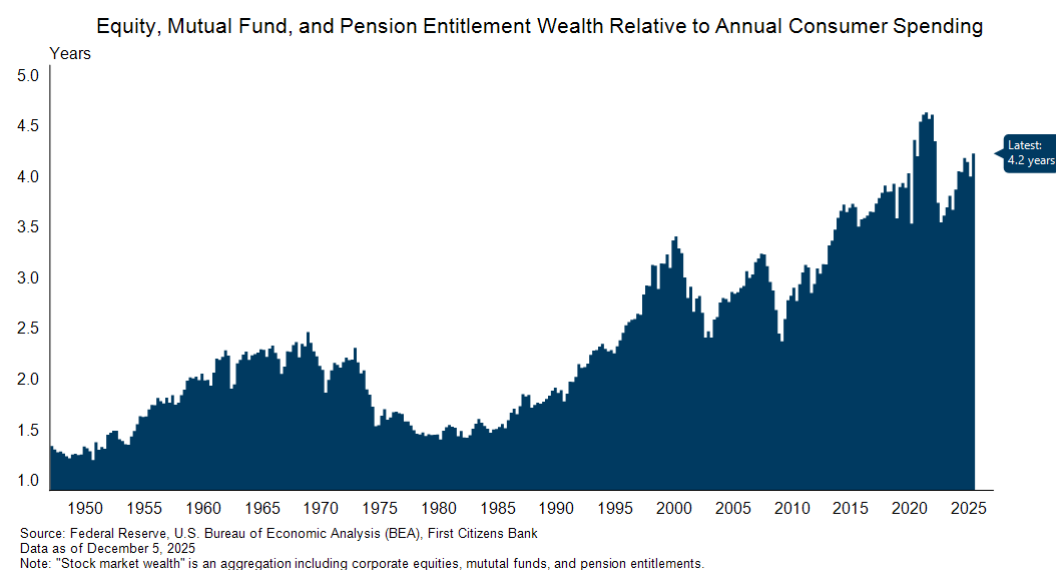
We believe the economy can remain resilient in 2026, delivering another year of steady employment, income, and output growth. However, economic fundamentals – while still fairly solid – are not as strong as they were a year ago.

### 1. Wealth effects could support further household spending

Household net worth is at an all-time high, driven by a 65% gain in real estate assets, 98% in stocks, and 44% in broad financial assets since 2019. Economists believe that in normal times, each additional \$1.00 of household wealth drives about \$0.05 to \$0.15 of additional spending, with that number tapering off at the higher end of the income spectrum. We think this “wealth effect” has buttressed – and in some cases, propelled – household spending in recent quarters. The value of US households’ stock-market portfolios in aggregate is now worth over 4.2 years of annual personal spending, up from 3.8 years just before the pandemic and 3.2 years on average in the 2000s.

So long as equity market valuations – and thus household portfolios – remain elevated, we think households with these equity market gains will continue to support domestic demand. However, about a quarter of households, generally with lower incomes, own few or no equity assets. We think this cohort will come under further pressure in 2026, especially given their income growth has slowed more quickly than average this year.

#### Exhibit 2: US Households Hold 4.2 Years of Annual Spending in Stock Market Portfolios

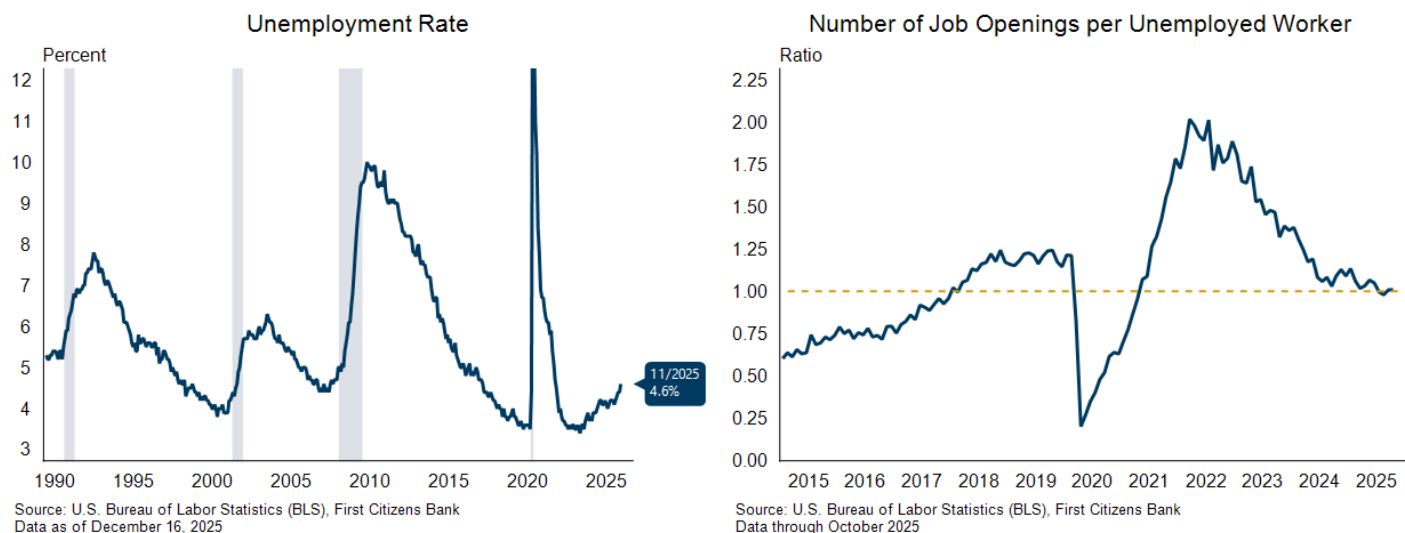


### 2. Softer labor market conditions are a central feature of the outlook

The unemployment rate moved up 0.6 percentage points to 4.6% through November of this year and stands 1.2 percentage points higher than the cycle low in April 2023. This is the most the unemployment rate has risen in history without an economic recession – a significant, broad, and lengthy decline in economic activity. Perhaps this is because for at least the last 18 months, several trends have worked to postpone if not counteract economic weakness. First, the Federal Reserve has lowered interest rates by 1.75%. Second, the government passed substantial tax cuts, incentivizing capital expenditures for businesses and lowering tax liabilities for households. Third, massive capital investment from large technology firms has boosted GDP growth. Fourth, easy financial conditions from lower interest rates and higher stock prices have delivered a positive impulse to growth.



## Exhibit 3: The unemployment rate has moved higher, and there are no longer more jobs than unemployed workers



Nonetheless, it appears hiring demand has slowed, with the number of new job openings no longer exceeding the number of unemployed workers. Looking under the hood, there also appears to be a degree of labor market mismatch, with the youth unemployment rate rising markedly, and the number of available jobs in some sectors – particularly in technology – having fallen much more sharply than the average. As we start 2026, the economy will operate with more labor market slack and less turnover than usual, but it is far from clear how this pattern evolves. In the upside scenario, the economy accelerates, hiring demand rises, and labor market dynamism improves. But in a downside scenario, firms may slow their hiring further or increase the rate of layoffs, leading to higher unemployment, lower aggregate incomes, and weaker broad economic activity.

### 3. Inflation is still too high

Prices are rising at a 3% pace, a full percentage point – or 50% - faster than the Federal Reserve’s official 2% target rate. Many forecasters are optimistic that inflation will slow in 2026, particularly as the recent flattening – or in some markets, outright declines – in real estate prices makes its way into rents. We share this optimism about inflation moving in the right direction, but we have also seen markets, forecasters, and policymakers struggle in recent years to predict inflation trends with much accuracy.

The effect of tariffs remains a major unknown. In 2025, companies’ tariff pass-through to consumer prices was real but modest. But some analysts believe firms may offload more of their tariff burden to consumers in 2026 after several months of swallowing the cost and allowing profit margins to compress, particularly if household spending remains durable.



## 4. Conflicting signals have the Federal Reserve in a tough spot

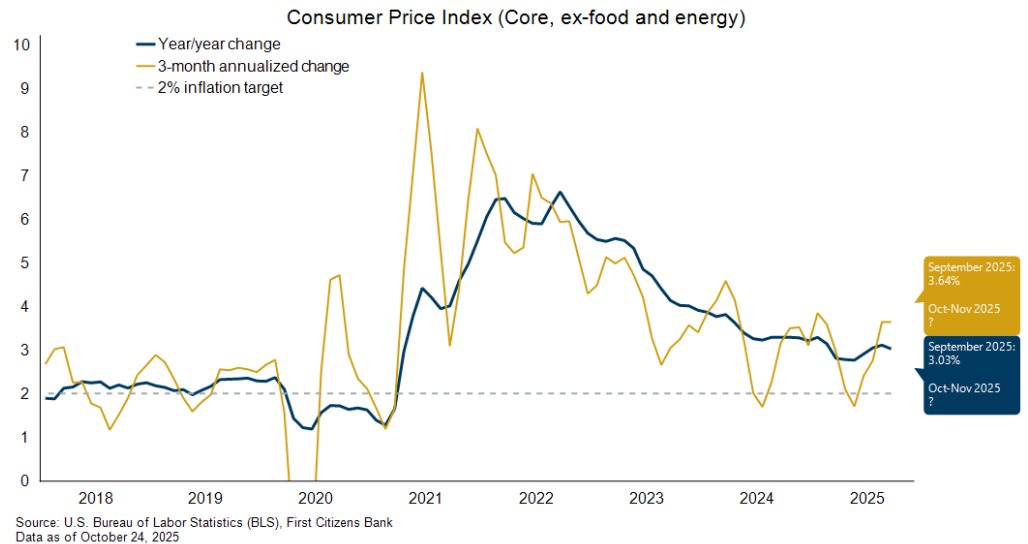
This constellation of a cooling labor market, above-trend inflation, and elevated economic and policy uncertainty puts the Federal Reserve in a quandary. The central bank's mandate from Congress is to deliver both maximum employment and stable prices. In most periods when the Fed intervenes in the economy, the signal is fairly clear. Both employment and inflation may be running too hot,

leading the Fed to raise rates or, as Fed Chairman William McChesney Martin said in 1955, to "order the punch bowl removed just when the party was really warming up." In the other direction, if employment and inflation both are too soft, the Fed lowers rates to stimulate the economy and financial markets. Unfortunately, with employment softening but inflation rates above target, today's scenario does not fall cleanly into either category.

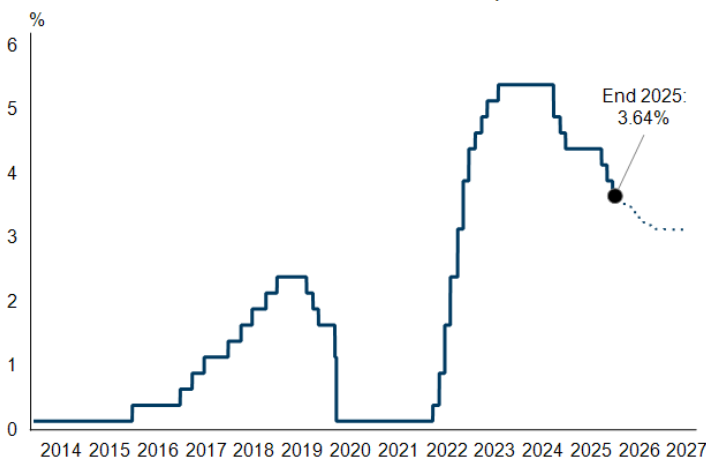
As we enter 2026, the Federal Reserve has lowered interest rates to what it sees is a neutral setting, and markets believe they will start the year in wait-and-see mode. In the meantime, all eyes will be on the monthly employment and inflation data, as this will be what directs the Fed's next interest-rate moves.

## Exhibit 5: The Fed has lowered interest rates by 1.75% this cycle, but uncertainty about the outlook makes future rate cuts difficult to predict

Exhibit 4: Inflation is running at 3%, well above the Fed's official 2% target

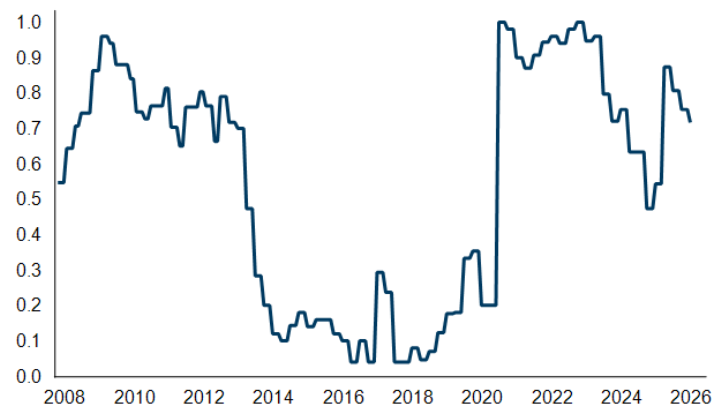


Federal Funds Rate and Market-Implied Path



Federal Reserve Policymaker Uncertainty Index

Average of Uncertainty Diffusion Indices for GDP Growth, PCE Inflation, and the Unemployment Rate



Source: Federal Reserve, First Citizens Bank  
Data as of December 10, 2025

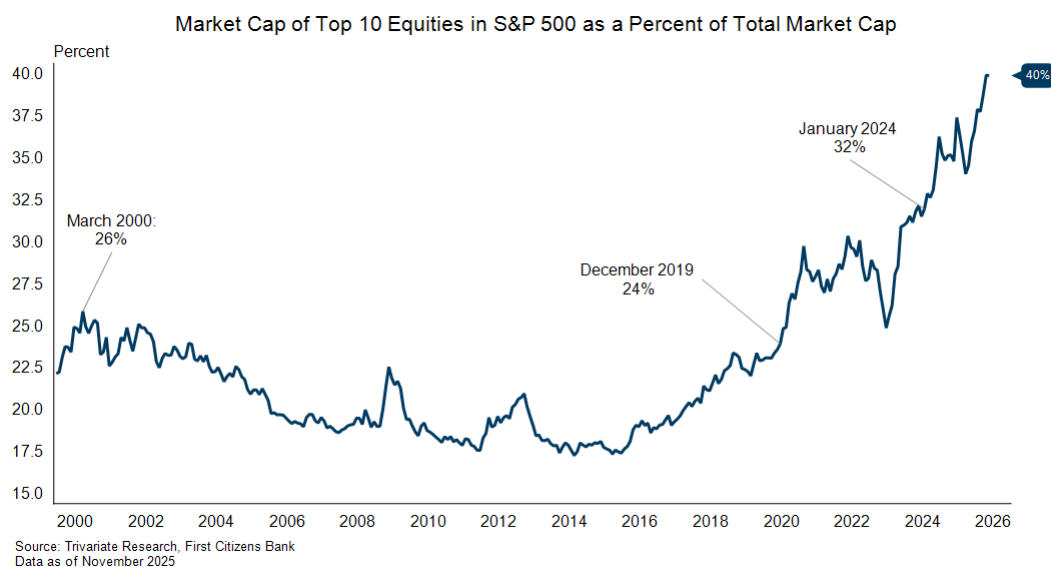
## Market Outlook

We remain cautiously constructive on US equities. The S&P 500's more than 100% return since bottoming in 2022 has been powerful, and with a 12-month ahead price target of 7,200 we see reasons to expect further upside. At the same time, we continue to emphasize balance in portfolios as fixed income yields, while lower this year, remain attractive.

### 1. US equity markets are highly concentrated

Much of the total return of S&P 500 over the last few years has been driven by the largest names. The S&P 500, which is weighted by market capitalization, has returned 48% over the last two years, but an equal-weighted index of those companies has returned 27%. The biggest companies have been dominating the index at an increasing rate for several years, but this trend has picked up dramatically in the last couple years with the top 10 firms accounting for 40% of the S&P 500, compared to 24% before the pandemic and 32% just two years ago.

#### Exhibit 6: The S&P 500 is heavily concentrated in the largest 10 stocks



Extreme concentration could be a sign of more fragile equity markets, with the health of the index dependent on the performance of a few mega-cap firms trading at higher valuations. But there are a few reasons why today's highly concentrated markets may be less cause for concern. First, the top 10 firms command not only a vast share of the index's market cap, but they also deliver a vast share of its

profits: the top 10 names account for 32% of S&P 500 earnings, compared to 24% two years ago. Additionally, the median profit margin of the top 10 is currently 35%, compared to 18% for the rest of the index. Second, many of these mega-cap firms appear to have durable competitive advantages. Third, the S&P 500 is constantly evolving over time, with companies coming and going from the top 10 list. In fact, only one company in the top 10 today was on that list in 2000.

Looking beyond the Magnificent 7 companies, we see potential reasons for optimism in the other 493 companies in the S&P 500. In the most recent earnings season, over 80% of S&P 500 companies beat expectations, while 71% of Magnificent 7 companies exceeded earnings estimates. Additionally, while the 493 earnings growth (9%) trailed the Mag 7 growth (22%) in 2025, their earnings growth is in excess of the long-term average (7.6%), and on the valuation front, the 493 trade at a notable



discount to the Magnificent 7. We don't want to overstate these differences, but potential remains for broadening outside of the largest companies in the S&P 500.

## 2. US equity markets are also trading at stretched valuations

The S&P 500 is currently trading at multiples only reached during the euphoria of the late 1990s and in 2021. This has many investors concerned about the possibility of a market correction and lower future returns. While we don't dismiss these concerns, we see several important factors to keep in mind.

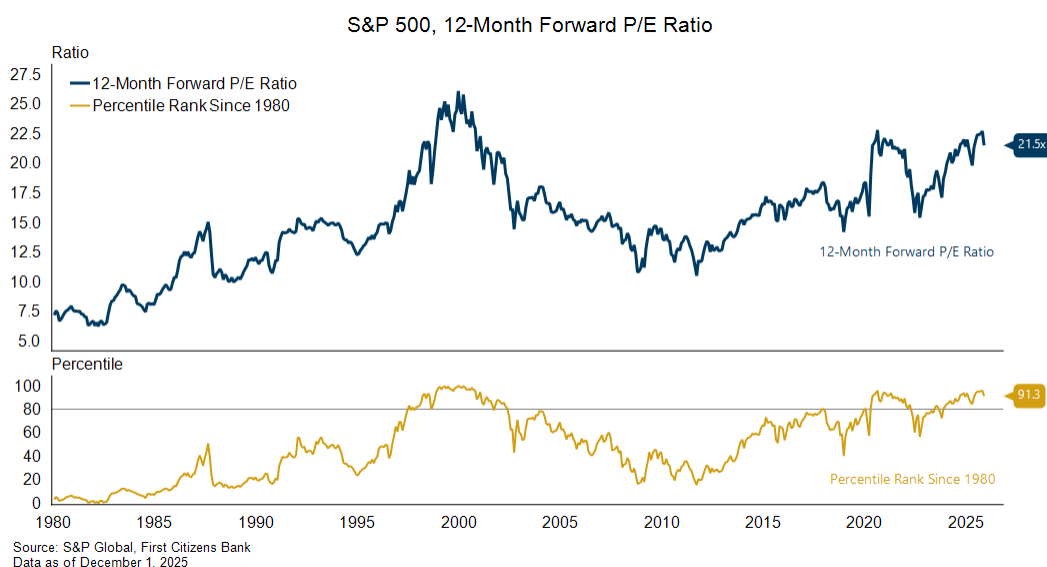
1. **Valuation ratios are poor predictors of near-term returns.** The relationship between the forward price-to-earnings ratio and returns over the next twelve months is statistically insignificant over the last 50 years.
2. **The S&P 500 is top-heavy but with firms that have superior fundamentals and profitability.** This differs from the 1990s when leading companies had lower profit margins, slower growth rates, and inferior balance sheets with less cash.
3. **Higher P/E ratios are an expression of expected future growth and profitability.** So, if profit margins are structurally higher today compared to previous decades, elevated multiples may be justified.

## 3. Expensive equity markets can rally further

It is common to see comparisons between today's markets and those of the late 1990s. Like the 2020s, the late 90s saw a rapid rise in equities, largely driven by optimism around technological innovation and productivity growth. In December 1996, Fed Chairman Alan Greenspan posed the rhetorical question of how to know when "irrational exuberance" had unduly inflated asset values, a comment many

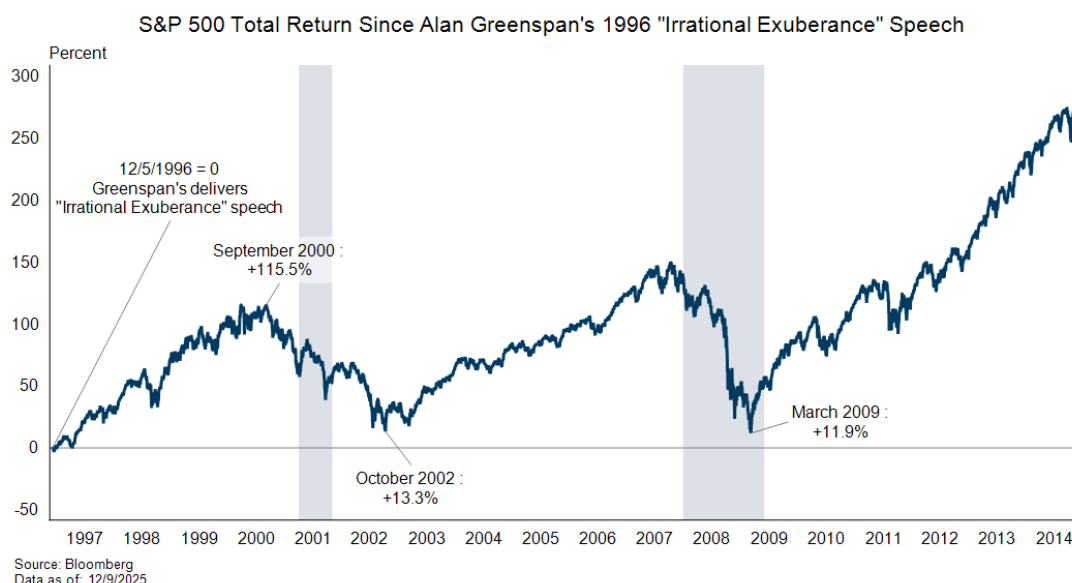
saw as a warning that stocks were overvalued. However, markets only powered higher, and the S&P 500 went on to return over 100% in the subsequent three years. Although the dot-com bubble did finally burst in March 2000, investors who heeded the early warning and sold stocks in December 1996 would have foregone substantial gains. In fact, the S&P 500 was higher at its trough in 2002 after the crash than at the time of Greenspan's speech.

**Exhibit 7: Valuation ratios for the S&P 500 are very high compared to history**





## Exhibit 8: The S&P 500 rallied over 100% after Fed Chairman Greenspan argued US equity markets were irrationally exuberant



## 4. Our S&P 500 price target is constructive, but cautious

We expect the S&P 500 will deliver solid gains but at a more modest rate compared to the last few years. Our base case target is for the S&P 500 to close 6% higher twelve months from now, just shy of the 10% average gain over the last 30 years. Our outlook is based on an expectation for continued economic expansion and earnings growth, but it also takes into account the risks mentioned above.

A bull case scenario where economic growth is firmer than expected, financial conditions remain accommodative, and large technology firms continue to deliver better-than-expected results could drive the index 14% higher, roughly matching this year's gains. However, there is more room in our downside scenario, where economic growth weakens, earnings growth slows, profit margins compress, and valuation multiples contract. In each scenario, we do not expect a straight line to the target—given current market valuations, we expect volatility over the next year.

## Exhibit 9: In our base case, we see the S&P 500 delivering moderate gains in 2026

### Next Twelve-Month S&P 500 Price Target

	Next Twelve Months Price Level	Percent Change from 12/15/25
Bear	5,200	-23.7%
Base	7,200	5.6%
Bull	7,800	14.4%

Source: FactSet, Bloomberg

## 5. Fixed income yields are lower but still attractive

We continue to emphasize maintaining a balanced portfolio is essential. Equity markets have delivered substantial returns to client portfolios in recent years, but with bonds still yielding over 4%, we continue to see fixed income as an attractive diversifier in global multi-asset portfolios.

**Exhibit 10: Bond yields are still fairly attractive even after moving lower in 2025**

Fixed Income Indices			
	Yield to Worst		Total Return Year to date
	12/31/2024	Latest	
Aggregate bond	4.9%	4.4%	+6.8%
Intermediate Government/Credit	4.6%	4.0%	+6.5%
Municipal Bond	3.7%	3.6%	+4.0%
Investment Grade Corporate Bond	5.3%	4.9%	+7.4%
High Yield Corporate Bond	7.5%	6.7%	+8.0%

Source: Bloomberg

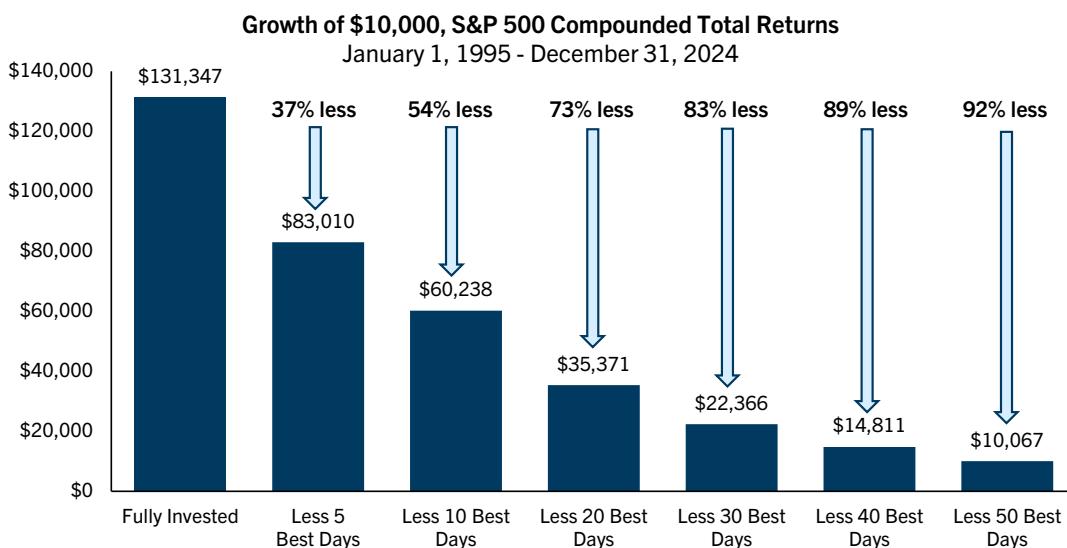
## Investing for the long term

### Attempting to time equity markets can permanently impair a portfolio

A popular aphorism on our floor in recent months is that more money is lost in anticipation of potential equity market bubbles than in the actual market corrections that follow. As we mentioned above, equity markets can rally much further after they are alleged to be expensive.

However, foregoing gains on the way up – and the subsequent compounding – tells only half the story. Being uninvested for just a few of the best days over decades can permanently impair the value of a portfolio, and many of these best days occur in the earliest innings of a bull market. Thus, we remind clients that the dangerous game of attempting to time markets actually requires two perfect plays: first, selling at the very peak, but also second, reinvesting at precisely the trough. We believe investors are much better served by allowing their equity market positions to compound as long-term assets. We also emphasize that investors should follow a financial plan, ensuring that equities are positioned in their portfolio as long-term investments, rather than assets that might be needed in the near term. Equities are by their nature volatile, but a thorough financial plan can shield investors from the permanent impairment caused by being forced to sell at the wrong time.

#### Exhibit 11: Missing the market's best days makes for compounded losses



Source: Strategas, First Citizens Wealth, NDR Research

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