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# Market & economic outlook

July 2026  
Mid-year update

Making Sense

# Making Sense Team

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# Where we are

The first half of 2026 delivered a solid rate of economic growth and record-breaking corporate earnings despite one of the largest geopolitical risk events in decades.

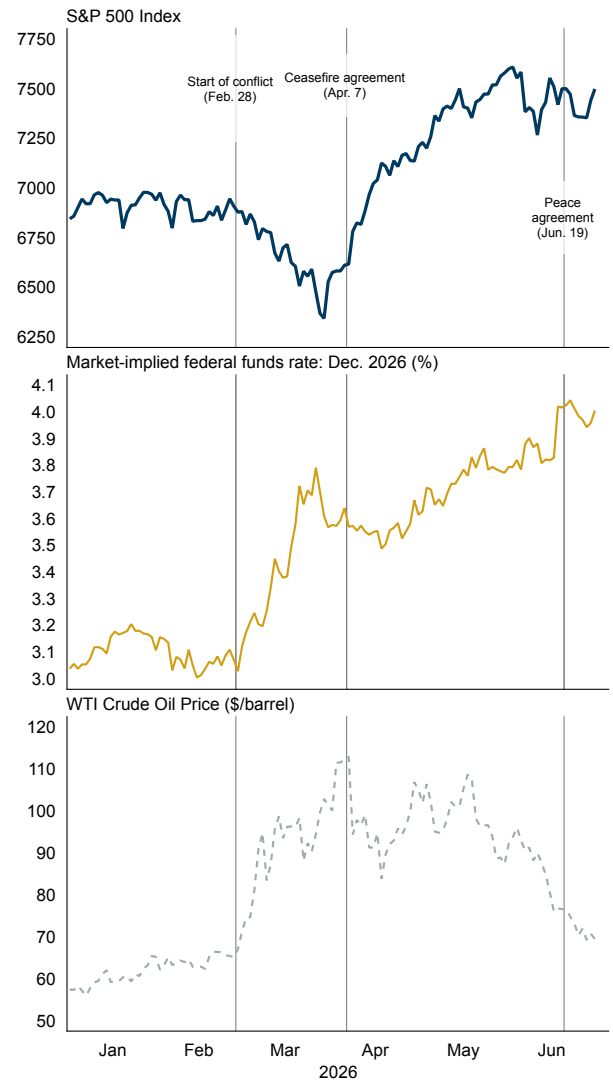
The economy is on track to grow 2.1% in 2026 – little changed from the outlook six months ago, as stronger AI-related investment offsets softer household spending amid higher inflation. The labor market has remained resilient, with unemployment staying close to 4.3% and job growth showing modest improvement from last year’s anemic pace.

Equity markets in the United States and across the globe are notching new all-time highs. The S&P 500 is up 9% year-to-date and 18% from its late-March low during the peak of the Iran conflict. Valuations were a key concern earlier this year, but equities appear less expensive today despite the rally. How is this the case? Blockbuster corporate earnings – especially, but not exclusively among mega-cap technology firms – have outpaced price gains, pushing price-to-earnings ratios lower compared to six months ago.

These trends unfolded against the backdrop of a major Middle East conflict that triggered the largest supply disruption in the history of the global oil market. Roughly 20 million barrels of oil per day – or about one-fifth of global supply – stopped flowing through the Strait of Hormuz. Oil prices rose sharply, but the increase was far less severe than a disruption of this magnitude might imply, reflecting the historic buffers in global oil reserves and excess supply.

The resulting energy shock has boosted energy and commodity prices, pushing US and global inflation rates – and bond yields – higher, driving investors to drop their expectations for rate cuts. Central questions for the second half of the year are whether these shocks and price pressures normalize, and whether central bankers – particularly the Fed under new Chairman Kevin Warsh – respond with rate hikes to counter what may be a supply driven inflation shock.

**Exhibit 1: Stocks moved higher, oil prices reversed, and markets now price rate hikes**



Source: Bloomberg  
Data as of: 6/30/2026

“ Central questions for the second half of the year are whether these shocks and price pressures normalize, and whether central bankers – particularly the Fed under new Chairman Kevin Warsh – respond with rate hikes to counter what may be a supply driven inflation shock. ”

# 2026 mid-year outlook

Halfway through 2026, the economy held up, and markets are hotter

FULL-YEAR ECONOMIC FORECASTS				
	Forecast on January 1	Latest Forecast	Direction	
GDP growth	2%	2.1%	▶	The economy withstood shocks, buttressed by powerful AI spending.
Unemployment rate	4.5%	4.3%	▶	The labor market remained in low-hire, low-fire setting.
Monthly job growth	68k	80k	▶	Job growth remained subdued and concentrated in some sectors.
CPI inflation	2.8%	3.4%	▲	Higher energy prices kicked off a round of higher inflation.
YEAR-END MARKET PROJECTIONS				
	Forecast on January 1	Latest Forecast	Direction	
S&P 500 Index	7,500	7,800	▲	Earnings growth surprised massively to the upside.
Federal funds rate	3.0%	3.8%	▲	With higher inflation, markets see rate hikes, not cuts, as likely.
10-Year Treasury Yield	4.10%	4.46%	▲	Higher inflation and more uncertainty are keeping yields elevated.
Crude oil price	\$57	\$70	▲	Markets see oil retreating substantially but not entirely to pre-war levels.

Source: Bloomberg

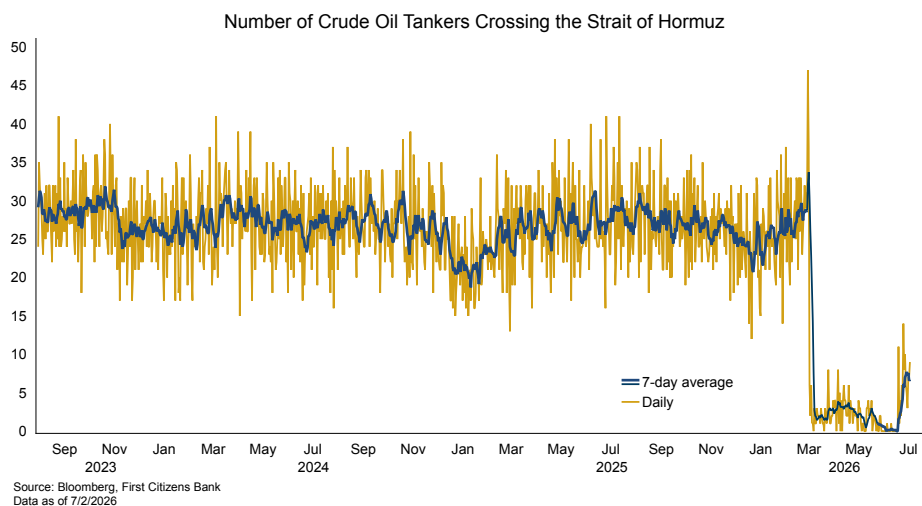
Note: Economic forecasts, S&P 500, and 10-year Treasury are median professional forecast. Federal funds rate and crude oil price are implied by futures prices.

# Three things we've learned

## 1. Geopolitical risk is back, but shocks are again proving short-lived

For the second consecutive year, global markets experienced – and absorbed – a major geopolitical shock. Last year, new trade policies pushed the average US tariff rate to its highest level in a century, far exceeding expectations for only a modest increase. Yet within six weeks, US equities had fully recovered the entire 19% drawdown, posting one of the fastest rebounds on record as investors quickly refocused on still-robust market fundamentals.

Exhibit 2: The war triggered a historic global oil supply disruption

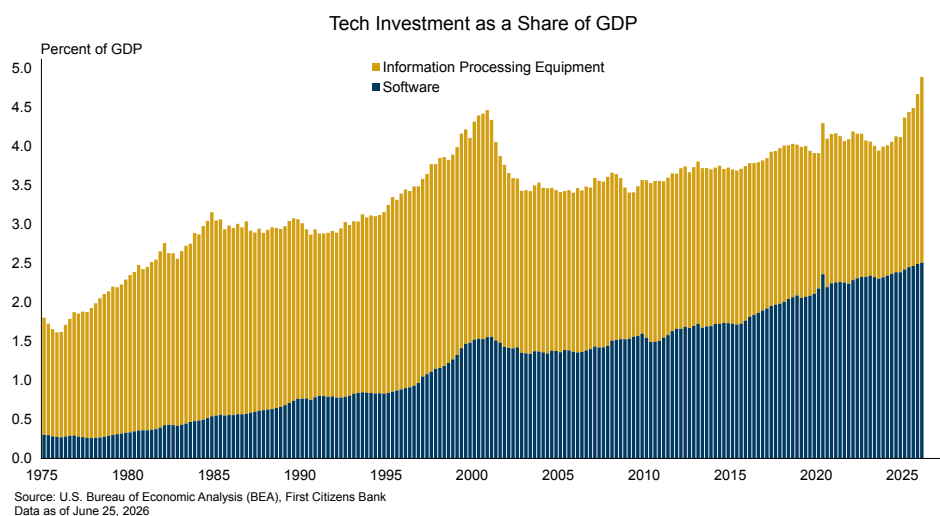


The pattern repeated in 2026. The war in the Middle East ranks as the second-largest geopolitical risk event since 9/11, according to a quantitative model we track<sup>1</sup>. The closure of the Strait of Hormuz triggered the largest global oil supply shock in history. The 10-year Treasury climbed a 16-month high near 4.7%, and inflation expectations moved sharply higher as markets priced in a prolonged conflict.

However, just one month later, a ceasefire agreement was announced. Equities rebounded, oil prices retraced, inflation expectations eased, and bond yields declined.

We think markets appear increasingly conditioned to absorb geopolitical risk events, particularly as a large and growing share of equity index earnings is driven by sectors with limited exposure to geopolitical risk. So while geopolitical risk is back, perhaps the geopolitical risk premium is not.

Exhibit 3: Tech now holds a large and growing share of the US economy



## 2. Little can stand in the way of the powerhouse that is US mega-cap tech

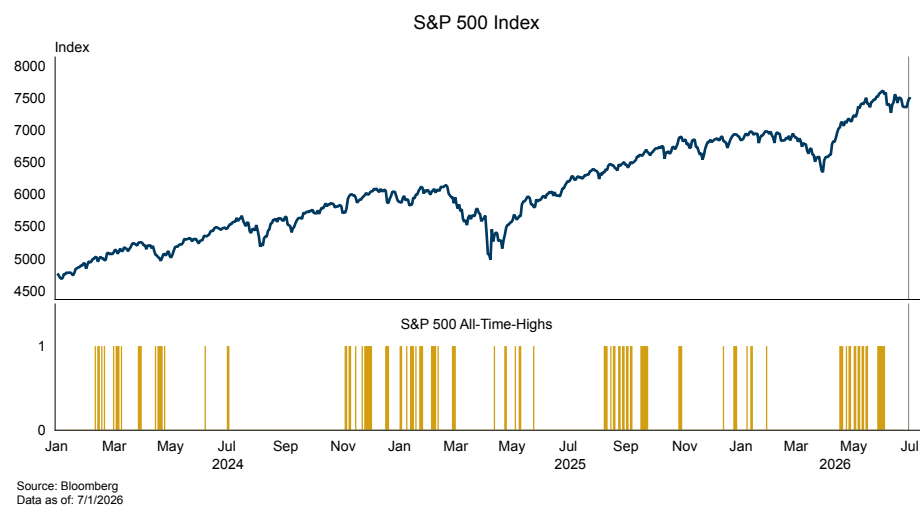
US stocks – particularly the largest technology firms – continue to surprise markets with exceptional earnings growth, margin expansion, and resilience.

Earlier this year, the largest technology companies had announced around three quarters of a trillion dollars of capital expenditure to build out AI infrastructure. Previous large capex

<sup>1</sup> Source: Caldara, Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk," American Economic Review, April, 112(4), pp.1194-1225. <https://www.matteoiacoviello.com/gpr.htm>

# Three things we've learned

Exhibit 4: After a Q1 selloff, stocks quickly rebounded to all-time highs



cycles – like telecom in the 1990s and shale oil in the 2010s – have raised concerns about future returns and ultimately destroying value before generating it. Yet markets are taking a more mixed view today. Today's hyperscalers have traded with significant volatility this year, up as much as 10% year to date but now trading 5% lower than six months ago. Unlike prior capex cycles, today's spending has so far been funded largely by substantial existing cash flows, but increasingly firms are starting to rely on external financing such as debt and equity issuance.

Earnings trends this year have so far reinforced this narrative. At the start of this year, analysts expected S&P 500 earnings growth of 14.7% in 2026. Since first-quarter earnings season, analysts haven't been able to sharpen their pencils fast enough. Q1 earnings grew 28.6%, the fastest pace since 2021, and full-year earnings growth is now projected at 24%. Large tech firms printed even stronger numbers. About half of S&P 500 earnings growth is coming from just nine large companies and one-third from three chipmakers. Despite this concentration, the rest of the index is still posting solid results,

and margin expansion has been widespread as the powerhouse-tech story lifts the rest of the market. High expectations are easier to disappoint, but up until this point, it has been a costly strategy to stand on the sidelines, let alone bet against these companies.

### 3. Equities didn't need rate cuts to reach new all-time highs

At the start of the year, equities were expected to post another year of solid results. That outlook rested in part on the assumption that financial conditions would stay easy as the Fed continued cutting interest rates. That assumption is gone, but equities have had no issue reaching new heights.

At the start of the year, futures markets were pricing in at least two quarter-point rate cuts for 2026. Today, the Fed has been on hold for six months, and markets are now priced for rate hikes over the next twelve months. Such a reversal in expectations would normally be a headwind for equities, but stocks have pushed to new all-time highs anyway. What filled that gap?

We think the answer is quite clear: the Q1 earnings season. It turns out equities held up not because of expectations for cheaper money, but because earnings kept coming in exceptionally strong. When the corporate sector is doing the heavy lifting, the Fed might matter less at the margin that it usually does.

The Fed is no longer the only game in town, but it still matters. Rate cuts in the first half of the year would likely have supported multiple expansion. But a market that's up 9% this year in the face of a war, rising yields, and a full reversal in Fed expectations is a clear sign of something else: earnings and fundamentals are powering this rally, not just sentiment and liquidity.

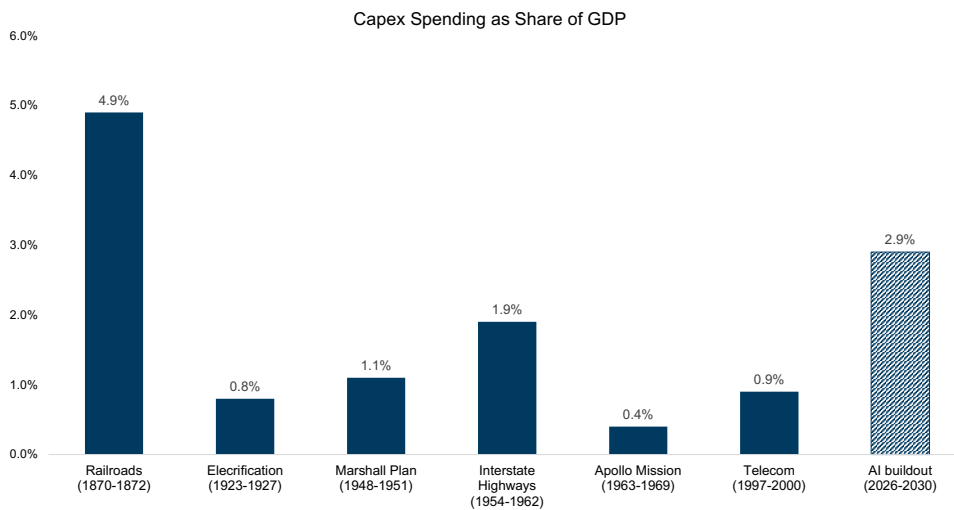
“ But a market that's up 9% this year in the face of a war, rising yields, and a full reversal in Fed expectations is a clear sign of something else: earnings and fundamentals are powering this rally, not just sentiment and liquidity. ”

# Four themes we're considering

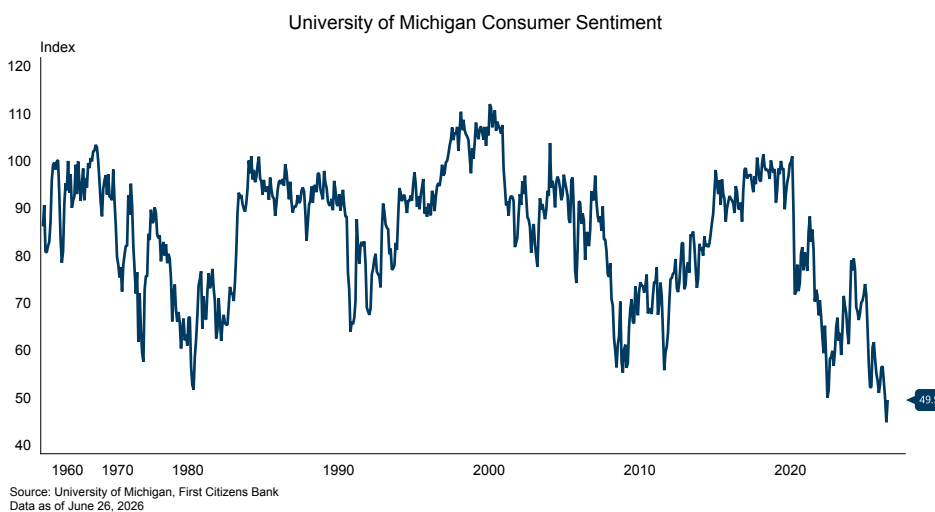
## 1. A generational bet on a new technology

The artificial intelligence capex buildout is shaping up to be the most expensive project since the railroad boom 150 years ago. Previous transformative technologies – electrification in the 1920s, the Interstate Highway System in the 1950s, and telecom in the 1990s – each cost roughly 0.5-1% of GDP annually. Today analysts expect the largest technology firms to spend close to \$1 trillion per year, or about 3% of GDP on AI in the coming year.

**Exhibit 5: AI is the most expensive capex project in 150 years**



**Exhibit 6: Households have soured on economic conditions**



What this technology ultimately changes – across the economy and markets – is impossible to know with certainty. But what is clear is that the largest US companies are making a generational bet that returns on this spending will be just as large. Whether that bet pays off is likely one of the defining questions for markets over the next decade or longer.

## 2. A bifurcating economy

Stocks are at all-time highs, yet consumer sentiment sits near its lowest level in its 74-year recorded history. Households with meaningful exposure to stocks or home equity have likely seen their net worth rise substantially in recent years, providing a cushion even as income growth moderates. Those without that exposure – or who entered the housing market more recently – face a very different reality.

The cost of living – especially for childcare, healthcare, and housing – is outpacing inflation-adjusted wages, particularly in rural areas and among low- and middle-income households.

A 2% GDP growth rate increasingly looks like the average of two different economies – and it does a poor job describing either side very accurately.

## 3. The last mile is always the hardest

Inflation has now run above the Fed's 2% target for more than five years. Consumer prices are 28% higher today than in 2020, versus a roughly 13% increase under a steady 2% inflation path.

# Four themes we're considering

Policymakers have pointed to a rotating set of drivers over this period: housing, vehicles, healthcare, and more recently energy and AI. But for at least two years, a simpler idea has gained traction: the last mile of disinflation is fundamentally harder than the first five.

The latest step higher in inflation reflects supply disruptions extending beyond oil into chemicals and raw commodities with the potential to flow through to food, manufacturing, and other consumer prices. At the same time, some analysts argue the AI buildout itself could prove inflationary before becoming disinflationary.

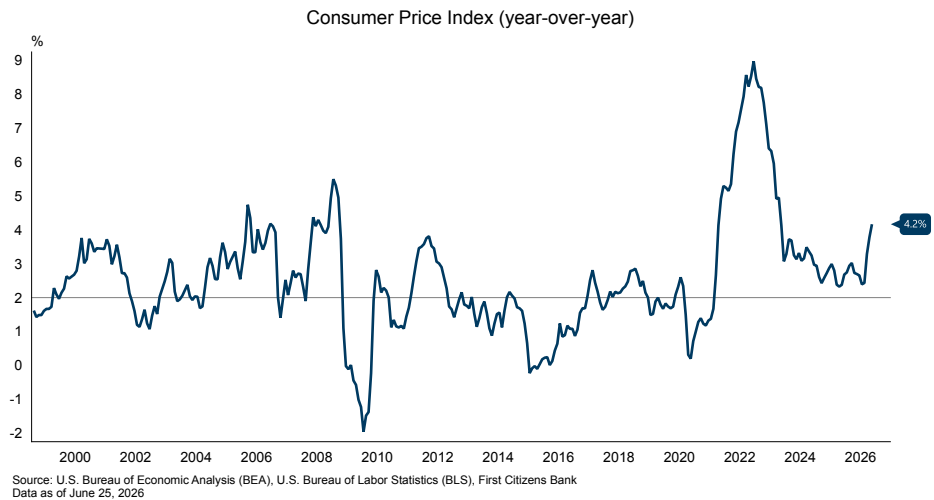
Our view is more straightforward: after running at roughly 1.5-2% in the 2010s, inflation may now settle closer to 2.5-3% in the 2020s. That's high enough to meaningfully raise the cost of living and doing business – but not necessarily high enough to force a sharp monetary policy response. This leaves inflation in an uncomfortable equilibrium – still too high for policymakers to declare victory, but not high enough to be a clear and present danger.

## 4. Higher for longer

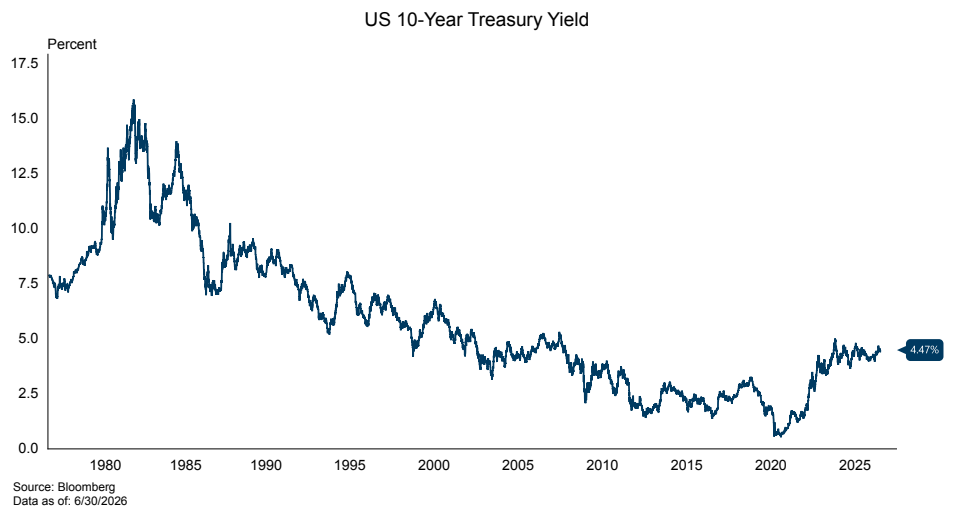
The 10-year Treasury yield has climbed back to about 4.5%, dampening hopes earlier this year that lower rates might support fixed income returns while also reducing borrowing costs for businesses, homebuyers, and the federal government.

Part of this move reflects a repricing of Fed expectations, but that is not the whole story. Yields are rising higher further out on the curve, not just at the short end where central bank policy affects yields, pointing to broader forces beyond near-term monetary policy.

**Exhibit 7: Inflation remains above target**



**Exhibit 8: 10-year Treasury yields are elevated but within longer-term averages**



Many investors and homeowners still appear to be waiting for rates to “normalize” – that is, to return to the levels of a few years ago. But the backdrop has changed: inflation remains above target, growth is holding up, investment demand is strengthening, and governments are running enormous budget deficits even in conditions of low unemployment, economic expansion, and relative international accord.

As long as those forces persist, we think it is reasonable to expect rates to remain moderately higher for longer.

# Six questions we're asking

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## 1. Earnings breadth vs. market concentration

The equity market rally has broadened in the first half of 2026. But leadership is still concentrated in the small number of technology firms driving earnings growth along with AI investment. Will that strength continue to spread across the broader market? Investors will watch for signs that AI spending is translating into profits, and the wave of mega IPOs will test the market's appetite for ultrahigh valuations and capital absorption capacity.

## 2. Which turn will household incomes take?

Household spending is holding up, but incomes – especially after adjusting for inflation – are notably softer. We think upper-end households are fueling consumer spending partly through the wealth effects of appreciating stock portfolios. But if real wage growth rebounds, more households could join this trend. If not, declines in an already downward-trending household saving rate may expose a few more cracks.

## 3. Inflation is back, but it looks narrow. Will pressures broaden and persist?

The latest inflation pop is largely a result of higher oil and commodity prices. A major question is whether those pressures remain contained or spill into core categories. Forecasters have penciled in a swift return to pre-war inflation trends, which makes sense given the abrupt reversal in oil prices. But inflation has proved notoriously difficult to predict this decade, and policymakers will likely tread carefully.

## 4. Will markets keep looking through geopolitical risk?

Geopolitical shocks have been frequent – and severe – this decade. But the market impacts have been short-lived. After tariffs, conflict in the Middle East, and even the pandemic, investors have swiftly refocused on fundamentals – with haste. If global tensions and policy uncertainty remain high, will this pattern hold for the next shock?

## 5. How much higher...for how much longer?

Markets have repriced away from rate cuts and now hold a slight rate-hiking bias. But at least as important is the story further out on the curve. Persistent inflation, solid growth, renewed investment demand, and enormous fiscal deficits are all pushing rates in the same direction: higher. How long rates stay elevated, and what this implies for the economy, is one of the most important questions today.

## 6. Tight spreads vs. budding risks

Credit spreads – the premium investors demand to hold corporate debt instead of Treasuries – remain near their historical tightness. Meanwhile, household delinquencies are up, and private credit markets continue to expand but haven't been fully tested. As markets look through near-term risks, the second half of 2026 may show if that reflects resilience or complacency.

## Looking ahead

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The outlook for the second half appears optimistic, but complex. The first half of 2026 was defined by geopolitical disruption, uncertainty, and shifting expectations – but also resilience. For the next six months, markets expect strong corporate earnings growth will continue to underpin the market rally. Markets will be watching closely to ensure these high expectations are likely to be met – particularly in the mega-cap technology space, where trillion-dollar investments in AI will likely be called upon to deliver at least a path forward to profitability.

We maintain that balance in portfolios and a long-term, disciplined approach will help investors navigate markets in the second half of 2026 – and beyond.



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