Graystone Consulting
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Capital Markets Commentary – February 2026

With just one exception, since 2016 US equities have dominated global market returns. In 2025, though, as solid as returns were, the US got its clock cleaned. Sure, US large cap stocks gained 17.9% last year (yippee!), but Europe? Europe was up 36.3%. Emerging markets were up 34.4%, Japan was up 25.1%, and the Pacific outside of Japan was up 20.7%.[i] You get the picture. What did particularly well in the US last year were the high beta stocks (that's Wall Street-speak for volatile) and momentum trades. In momentum trades, investors don't care whether or not earnings justify the stock price – they'll keep buying the thing as long as the hype keeps pushing up the price, fundamentals be damned. A momentum trade is fun while it works, but when it turns on you, Katie bar the door. It can sink faster than a lead bar in the ocean.

And speaking of hype, remember 2024 when all anybody wanted to talk about was the Magnificent 7? That trade did work in 2024, but how about 2025? It did well in 2025, too, but last year, the Mag 7 returned less than half of its 2024 number and underperformed plain old Europe by a whopping 1,330 basis points.[ii] A couple of points to make here: One, diversification across both countries and sectors can be your friend, and two, be very wary of hype in the absence of earnings. Diversification and fundamental analysis are not scintillating topics of cocktail party conversation, nor will they go viral on social media (and in any case, neither venue should be considered a wise source for investment advice). And yet, history suggests that combining diversification with sound analysis can help manage risks over time. In short, we believe quality matters.

We bring up the topic of quality because, while we feel reasonably confident that 2026 can be a positive year, it may not be a barnburner. There are potential speed bumps along the way. We hope we won't hit a single one of those bumps, but hope, as they say, is not a strategy. In a moment, we'll review some of what could go wrong in 2026 as well as what might go right, but first, let's look at the numbers for January.

January closed in the green across the board. In the US, returns may have been meh, but far be it from us to sneer at positive performance of any sort. Here, the Dow was the winner, gaining 1.8% followed by the S&P 500 which closed up 1.4% and the NASDAQ which eked out 1% as the tech trade cooled. Europe generally outperformed the US with the Eurozone's STOXX 50 ending the month up 4%. Asia, though, knocked the ball out of the park. For the month, Japan's Nikkei 225 gained 7.2% while Hong Kong's Hang Seng added 6.5%. Yields as measured by the US ten-year Treasury moved higher. The ten-year closed December at a yield of 4.16%, then moved to a high of 4.31% mid-month before settling back down 4.24%.[iii]

OK, so what worries us? The independence of the Federal Reserve is high on the list. Sometimes the Fed makes the right decision, sometimes they make a decision that markets deem less than optimal. That's not the point. The point is that global financial markets put their faith in the notion that the Fed's decision-making process is immune from political pressure. Should global financial markets lose that faith, they might grow less than eager to buy our debt, or worse, they can decide to dump our debt. You may have heard this referred to as the "Sell America" trade. When there are fewer buyers for Treasuries, interest rates rise and that can push all borrowing costs higher, which is exactly the opposite outcome the politicians are agitating to achieve. Domestic equity markets may not like it much, either.

Note, however, that it should not be considered a threat to Fed independence when a President nominates the Fed chair of his choosing…..every President does this. Furthermore, the Fed chair casts only one of twelve votes. While the chair is the public face of the Fed and his opinion may carry more weight with markets than other voting members, his vote counts the same. Some of us at Graystone Charleston go back to the Greenspan days – and believe it or not, there have only been three other chairs since. In our view, a Fed chair's ability to communicate clearly with investors may be even more critical than his or her ability to make the correct call on rates. Time will tell how markets assess Kevin Warsh, the nominee for Powell's expiring term, versus his predecessors. At this stage, we do not view the nomination itself as a market moving concern.

We worry that there's a lot of complex debt out there that relies on rates remaining stable or even falling. Issuers of floating rate debt with insufficient debt coverage and intricate leverage could find themselves in trouble, particularly if interest rates rise. A lower Fed fund rate might not be of any assistance to these folks assuming long rates do not also fall. The extent to which defaults in this space have grown tentacles into the banking system is difficult, if not impossible to know.

While we've been wringing our hands here over the relative health of the US consumer for some time now, consumer spending has held up quite well. Consumer spending accounts for approximately 70% of US GDP[iv], so it's a huge relief that folks are still heading out with open wallets, and we hope that continues. Nonetheless, it seems that spending has been increasingly driven by wealthier consumers and a survey conducted by Bankrate claims that 34% of Americans are living paycheck to paycheck.[v]

This isn't a problem as long as employment numbers remain steady. Through December 2025, the BLS reports an unemployment rate of just 4.4%. Any number under 5% is considered to statistically constitute full employment, but there may be cracks. CNBC reports that according to Challenger, Gray & Christmas, layoffs in January rose 118% versus January of '25, the highest rate since January of 2009. They report, too, that new hires in January were the lowest since January of 2009.[vi] We also cannot yet know to what extent artificial intelligence will negatively impact employment in the higher income brackets – think accountants, doctors, and software developers for example. Should unemployment accelerate at both ends of the income spectrum, consumer spending could be hit, and markets may need to make adjustments.

BUT, what if employment and the consumer do hold up? What if capital expenditures attributable to artificial intelligence continue apace? What if US tariff policy becomes more stable and predictable? What if earnings actually reaccelerate? These things can indeed happen. The spread between the bull case for the S&P 500 and the bear case reflects the fact that we cannot with any certainty predict whether or not the positive can outweigh the negative. Take a look at MS & Co.'s 2026 midyear estimates:

AS OF JANUARY 23, 2026

	Current Level	Dec.-2026 Target	Implied Change (%)	Current P/E Ratio	12-Month Forward P/E Ratio
Base	**6916**	**7800**	**13%**	**27.6x**	**22.0x**
Bear	6916	5600	-19%	27.6x	20.0x
Bull	6916	9000	30%	27.6x	23.0x

Source: Morgan Stanley Wealth Management GIO, Morgan Stanley & Co. Research, Bloomberg, FactSet.
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There's a world of difference between up 30% and down 19 % (although we'd be tickled pink to get that base case. So what's an investor to do? Especially in this environment, we believe quality counts. Quality balance sheets, quality earnings, quality credits. We can't overemphasize this. Investors may want to be cautious pursuing hype-driven momentum trades, and the temptation to reach for yield. We also believe maintaining diversification and avoiding overconcentration by sector or individual holdings can be important risk management considerations. Should we experience returns this year closer to that bear case than the bull case, are you prepared to sit tight until markets repair and recover? If not, let's talk now and review your objectives, time horizon, and risk tolerance, and discuss potential ways to align your portfolio accordingly. That is, after all, why we're here.

As always, should you have specific questions or concerns, we hope you'll never hesitate to call us. We look forward to hearing from you.

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[i] Source: Morgan Stanley Wealth Management GIO, FactSet. Indices for this analysis include US Large-Cap: S&P 500; US Mid-Cap: Russell Midcap; US Small-Cap: Russell 2000; Global: MSCI All-Country World; Europe: MSCI Europe (USD); Japan: MSCI Japan (USD); Pacific ex-Japan: MSCI Pacific ex-Japan (USD); and EM: MSCI Emerging Markets(USD).

[ii] Source: FactSet, Standard & Poor's. JP Morgan Asset Management. Mag 7 returns for 2024 were +48% versus 23% for 2025.

[iii] Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet.

[iv] Source: Federal Reserve Bank of St. Louis

[v] Source: https://www.bankrate.com/banking/savings/emergency-savings-report/

[vi] Source: https://www.cnbc.com/2026/02/05/layoff-and-hiring-announcements-hit-their-worst-january-levels-since-2009-challenger-says.html

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The NASDAQ Composite Index is a broad-based capitalization-weighted index of stock in all three NASDAQ tiers: Global Select, Global Market, and Capital Market. An investment cannot be made directly in a market index.

The Standard & Poor's (S&) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks. An investment cannot be made directly in a market index.

Dow Jones Industrial Average (DJIA). A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

Euro STOXX 50 Index: Provides a blue-chip representation of super-sector leaders in the Eurozone.

NIKKEI 225 Index: This price-weighted index is comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

This illustration is hypothetical and shown for illustrative purposes only. The illustration is not intended to predict the returns of any particular investment, which will fluctuate with market conditions. Actual results may differ from those depicted in the illustration.

Hang Seng Hong Kong: The Hang Seng Index is a free-float capitalization-weighted index of a selection of companies from the Stock Exchange of Hong Kong.

DAX Index: This index represents 30 of the largest and most liquid German Companies that trade on the Frankfurt Exchange.

Because of their narrow focus, sector investments tend to be more volatile than investments that diversify across many sectors and companies.