



## **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%.<sup>i</sup> 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.<sup>ii</sup> 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%.<sup>iii</sup>

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<sup>iv</sup>, 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.<sup>v</sup>

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.<sup>vi</sup> 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 |
|-------------|---------------|------------------|--------------------|-------------------|----------------------------|
| <b>Base</b> | <b>6916</b>   | <b>7800</b>      | <b>13%</b>         | <b>27.6x</b>      | <b>22.0x</b>               |
| <b>Bear</b> | 6916          | 5600             | -19%               | 27.6x             | 20.0x                      |
| <b>Bull</b> | 6916          | 9000             | 30%                | 27.6x             | 23.0x                      |

Source: Morgan Stanley Wealth Management GIO, Morgan Stanley & Co. Research, Bloomberg, FactSet.

Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

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.

---

<sup>i</sup> 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).

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

<sup>iii</sup> Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet.

<sup>iv</sup> Source: Federal Reserve Bank of St. Louis

<sup>v</sup> Source: <https://www.bankrate.com/banking/savings/emergency-savings-report/>

<sup>vi</sup> Source: <https://www.cnn.com/2026/02/05/layoff-and-hiring-announcements-hit-their-worst-january-levels-since-2009-challenger-says.html>

The views expressed herein are those of the author and do not necessarily reflect the views of Morgan Stanley Wealth Management or its affiliates. All opinions are subject to change without notice. Neither the information provided nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results.

This material contains forward looking statements and there can be no guarantees they will come to pass. The information and statistical data contained herein have been obtained from sources believed to be reliable but in no way are guaranteed by Morgan Stanley as to accuracy or completeness. There is no guarantee that any investments mentioned will be in each client's portfolio.

Morgan Stanley Wealth Management has no obligation to notify you when information in this presentation changes.

International investing may not be appropriate for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, and the absence of adequate financial information, and exchange and control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate. Interest on municipal bonds is generally exempt from federal income tax, however some bonds may be subject to the alternative minimum tax, accrued market discount taxes and / or capital gains taxes.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Equity securities may fluctuate in response to news on companies, industries, market conditions and the general economic environment. Companies cannot assure or guarantee a certain rate of return or dividend yield; they can increase, decrease or totally eliminate their dividends without notice.

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

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

---

The indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. For index, indicator and survey definitions referenced in this report please visit the following: <https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions>

This material is disseminated in the United States of America by Morgan Stanley Smith Barney LLC.

Morgan Stanley Smith Barney research, or any portion thereof, may not be reprinted, sold or redistributed without the written consent of Morgan Stanley Smith Barney.

Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors or Private Wealth Advisors do not provide tax or legal advice. Individuals should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trusts, estate planning, charitable giving, philanthropic planning or other legal matters.

Morgan Stanley Smith Barney LLC is a registered Broker/Dealer, Member SIPC, and not a bank. Where appropriate, Morgan Stanley Smith Barney LLC has entered into arrangements with banks and other third parties to assist in offering certain banking related products and services.

**NOT FDIC INSURED / MAY LOSE VALUE / NOT BANK GUARANTEED / NOT A BANK DEPOSIT / NOT INSURED BY ANY GOVERNMENT AGENCY**

The investments listed may not be appropriate for all investors. Morgan Stanley Smith Barney LLC recommends that investors independently evaluate particular investments and encourages investors to seek the advice of a financial advisor. The appropriateness of a particular investment will depend upon and investor's individual circumstances and objectives.

Information contained herein has been obtained from sources considered to be reliable, but we do not guarantee their accuracy or completeness.

This communication contains links to third party websites that are not affiliated with Morgan Stanley. These links are provided only as a convenience. The inclusion of any link is not and does not imply an affiliation, sponsorship, endorsement, approval, investigation, verification or monitoring by Morgan Stanley of any information contained in any third-party website. In no event shall Morgan Stanley be responsible for the information contained on that site or your use of or inability to use such site. Furthermore, no information contained in the site constitutes a recommendation by Morgan Stanley to buy, sell, or hold any security, financial product, particular account or instrument discussed therein. You should also be aware that the terms and conditions of such site and the site's privacy policy may be different from those applicable to your use of any Morgan Stanley website.

Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors or Private Wealth Advisors do not provide tax or legal advice. Individuals should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trusts, estate planning, charitable giving, philanthropic planning, or other legal matters.

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&P) 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.**

Investments and services offered through Morgan Stanley Smith Barney LLC. Member SIPC. Graystone Consulting, a business of Morgan Stanley.

