MARKET SIGHT LINES

Outlook 2026: *Rewiring Growth* Spotlight No. 3: Our Bear Case and Bull Case Scenarios for 2026

By Michael O'Keeffe, *Chief Investment Officer*

We've been discussing our annual outlook report, Outlook 2026: *Rewiring Growth* (full report, video summary, client webinar replay). Our positive base case economic and market outlook for the year is anchored in a rewiring of growth and the impact of artificial intelligence. Each year, we also push ourselves to model alternate scenarios, knowing that things can change throughout the year. In this week's Sight|Lines, we share some details about our 2026 bear case and bull case scenarios.

THE TAKEAWAY: THREE FACTORS MAY DEFINE 2026'S RANGE OF OUTCOMES

We complement our positive base case outlook with two alternate scenarios: a more negative bear case and a more positive bull case. In summary:

- We're positive in our 2026 base case, resulting in our expectations for cooling inflation, one or two Federal Reserve cuts, a positive economy, and a positive stock market.
- This year we anchored our alternate scenario analysis on three dimensions – AI Monetization, the Consumer, and the Policy Path in D.C.
- We call our bear case *Wires Crossed*, which can happen if earnings results disappoint when it comes to measuring and demonstrating the benefits of AI investments.
- Our bear case also factors in the possibility of a break in consumer activity, perhaps amplified by monetary or fiscal policy missteps in D.C.
- We refer to our bull case as *Wires Connected*, which captures the strong potential for meaningful AI monetization, with businesses firing on all cylinders when it comes to AI.
- Our base case also factors in the idea that consumer optimism may grow, possibly supported by effective monetary policy and less drama on the fiscal policy side in D.C.
- We've assigned probabilities of 60% to our base case, 25% to our bull case, and 15% to our bear case scenarios, reflecting that we lean positive in 2026.

IN-DEPTH: THREE SWING FACTORS MAY WELL DEFINE THE RANGE OF OUTCOMES IN 2026

While our base case 2026 outlook is positive, we also developed a more negative bear case scenario, *Wires Crossed*, and a more positive bull case, *Wires Connected*. Going deeper:

- We're positive in our base case view in 2026:
  - We expect inflation to cool to 2.25%-2.75%, and one or two Fed cuts later this year.
  - We expect U.S. GDP growth between 1.75% and 2.5%, and an S&P 500 total return of 10% in 2026.
- This year we anchored our alternate scenario analysis on three dimensions:
  - Realizing monetization of AI investments, or not, will be an important swing factor.
  - The consumer comprises about two-thirds of GDP, so consumer swings will affect outcomes.
  - D.C. policy – both monetary and fiscal – can have an impact on sentiment and earnings.
- Our bear case scenario, *Wires Crossed*, may unfold if the monetization of AI disappoints:
  - Productivity gains may be limited to certain sectors, rather than a broad-based outcome.
  - Overbuilding in data centers and chips can lead to a sharp capex pullback and valuation reset.
  - Power constraints could limit deployments, compressing margins and risking layoffs.
- In our bear case, we also consider cooling consumer engagement and the possibility of monetary or fiscal policy missteps in D.C:
  - Job losses and slowing wage growth can reduce demand sharply – even among higher-income consumers.
  - This can be amplified if the Fed responds too slowly to a weaker job market, undermining confidence.
  - Fiscal issues, like gridlock or a shutdown, can weigh on business and consumer sentiment.
- Our bull case scenario, *Wires Connected,* captures the strong potential for meaningful AI monetization:
  - AI adoption broadens rapidly with measurable productivity gains and faster earnings growth.
  - Infrastructure bottlenecks prove manageable, enabling even more capex to be deployed.
  - The "earnings story" broadens beyond mega cap tech, fueling returns across a diverse set of companies.
- In our bull case we also consider an improving consumer and effective policy execution in D.C.:
  - Inflation may ease faster than expected, with rising real incomes strengthening demand.
  - Any labor softening remains orderly, giving the Fed room to ease more than expected without stress.
  - The administration's fiscal/industrial/trade initiatives prove more growth-supportive, improving confidence as policy details and effects become clearer.
- Our probabilities for each of our three scenarios reflect that we lean more positive than negative in 2026:
  - We've assigned a 60% probability to our base case, with a 25% probability to the bull case and a 15% probability to the bear case.

CONCLUSION

In Outlook 2026: *Rewiring Growth* (full report, video summary, client webinar replay), we offer a constructive view of the year ahead. We assign a 60% probability to this base case scenario. But in our work, we also push our thinking to more negative and more positive places, which result in our bear case and bull case scenarios. This year we anchored this analysis on three dimensions – AI Monetization, the Consumer, and the Policy Path in D.C. The bear case *Wires Crossed*, to which we assign a 15% probability, could see AI disappoint, the consumer pull back, and policy missteps in D.C. We've assigned a 25% chance to our bull case Wires Connected scenario, which captures the potential for even better AI results, a fully engaged consumer, and effective policy implementation out of Washington.

Michael P. O'Keeffe, CFA
Chief Investment Officer
michael.okeeffe@stifel.com
www.stifelinsights.com

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