

MARKET SIGHT LINES



Our Second Half Outlook: The Rewiring of Growth Creates Some Heat

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When we published **Outlook 2026: Rewiring Growth** in January, our base case was constructive: easing inflation, a supportive policy backdrop, and a powerful artificial intelligence capital expenditure cycle driving continued economic resilience. As we finish the first half of the year, much of our base case remains intact – the economy has proven resilient, the AI buildout continues to broaden, and equity markets are already trading near our year-end objective. But the balance of risks has shifted. Inflation has firmed due to the energy effects of the Middle East conflict; the labor market remains solid; and the Federal Reserve, now under Chair Kevin Warsh, has signaled a higher bar for further rate cuts. Together, these developments reinforce our **“Higher for Longer” theme**. In this Sight|Lines, we share our second-half outlook – adjusting several of the forecasts from our annual Outlook (summarized in Exhibit 1) and explaining what the shift means for inflation, the Fed, growth, and markets.

THE TAKEAWAY: OUR SECOND HALF OUTLOOK REMAINS POSITIVE ... WITH SOME RISKS

Our base case remains constructive, but we are raising our inflation and interest rate expectations while maintaining our outlook for growth. In summary:

- We are maintaining our U.S. real GDP forecast of 1.75%-2.5% and lean toward the upper half of the range.
- We are raising our core personal consumption expenditures (PCE) inflation forecast to 2.75%-3.25%, though we see strong potential for cooling.
- We now expect the Fed to remain on hold, with worries about hikes fading as inflation begins to cool.
- We continue to expect a positive equity return for the year, driven by earnings rather than multiple expansion, and leave our S&P 500 price target of 7,450 unchanged.
- We are lifting our 10-year Treasury range to 4.25%-4.75%, consistent with a higher-for-longer theme.
- We are lowering our investment-grade spread range to 75-125 basis points and high-yield spread range of 300-350 basis points, which still implies modest widening.
- We still expect 15 Market Pulse publications for the year, reflecting some volatility.

IN-DEPTH: OUR SECOND HALF OUTLOOK REMAINS POSITIVE, BUT WE SEE SOME RISKS EMERGING

Our second half outlook reflects much of our base case from **Outlook 2026: Rewiring Growth** but now incorporates a firmer inflation and interest rate environment. Going deeper:

- We are maintaining our U.S. real GDP forecast of 1.75%-2.5% but lean toward the upper half of that range:
 - The AI capital expenditure supercycle continues to broaden beyond hyperscalers and into the physical economy.
 - One Big Beautiful Bill Act fiscal support and a resilient, if uneven, consumer offset still-restrictive monetary policy.
- While we see strong potential for inflation to cool, we are raising our core PCE inflation forecast to 2.75%-3.25%:
 - Energy pass-through from the Middle East conflict has lifted near-term inflation.
 - Other structural forces – nearshoring, sustained investment demand, and geopolitical fragmentation – will likely keep inflation above the Fed’s 2% target.
- With worries about Fed hikes easing as inflation starts to cool, we now expect the Fed to hold rates steady:
 - Firmer inflation and a still-solid labor market have reduced our original case for near-term easing.
 - Under new leadership, the Fed is emphasizing inflation credibility and price discovery over forward guidance.
- We continue to forecast a positive 2026 equity return:
 - We see solid earnings growth and a broadening of leadership and maintain our S&P 500 target of 7,450.
- The higher-for-longer environment leads us to raise our 10-year Treasury range to 4.25%-4.75%:
 - We’re mindful that a deficit-focused **Fiscal Trajectory** may keep the term premium elevated.
- As the credit cycle matures, we see the risk of modest widening in credit spreads, but lower our base case ranges:
 - We are lowering our investment-grade spread range to 75-125 basis points.
 - We are also lowering our high-yield spread range to 300-350 basis points.
- We expect some volatility and are maintaining our expectation of 15 Market Pulse publications during the year:
 - We’ve published four Market Pulse publications in 2026, on days the S&P 500 moved more than 2%.

WHAT WE THINK

Our second half outlook represents a modest recalibration, not a change in direction. The base case from *Rewiring Growth* remains in place: A resilient economy and a multi-year AI investment cycle continue to support growth and corporate earnings. But inflation has proven firmer than we expected, and with the labor market still solid, we see the Fed holding rates steady. In this higher-for-longer environment, we expect equity returns to be driven more by earnings than by multiple expansion, and we continue to look for a broadening in market leadership. We see the environment favoring high-quality companies – those with pricing power, strong balance sheets, and the ability to turn AI investment into profit growth. In fixed income, attractive starting yields offer durable income even as deficits pressure long-term rates. Risks remain – AI monetization, the consumer, and policy will shape the year. For now, the economy’s resilience leaves us constructive, even as firmer inflation and higher rates suggest the potential for more volatility ahead.

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OUR SECOND HALF OUTLOOK	
U.S. Real GDP	1.75% – 2.5%
Core PCE Inflation (4Q/4Q)	2.75% – 3.25%
Federal Funds Rate (Upper Bound)	3.75%

OUR SECOND HALF OUTLOOK	
S&P 500	7,450
10-Year Treasury (%)	4.25% – 4.75%
Market Pulse Publications*	15
Investment-Grade Spreads**	75 – 125 bps
High-Yield Spreads	325 – 350 bps

* The Stifel CIO Office issues a Market Pulse publication when the S&P 500 closes up or down by at least 2% on a given day.

** bps is basis points

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The Bloomberg software Index is a price-weighted index of software companies located or doing significant business in the Silicon Valley. The Bloomberg 500 Financials Total Return Index tracks the financial sector within Bloomberg 500 Universe. This index includes 87 constituent companies spanning various financial services sectors. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. The MSCI EAFE Index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains. Volatility is measured by calculating the standard deviation of the annualized returns over a given period of time. Core PCE is the PCE Price Index excluding volatile food and energy prices, revealing underlying inflation trends.

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