

Quarterly Outlook

At-A-Glance

Fourth quarter GDP growth was well below expectations, but it sets up a good start to 2026. The government shutdown shifted some economic growth from the fourth quarter to the first quarter of 2026.

Inflation was stubborn even before the war in Iran that started at the end of February. The PCE price index was 2.8% year-over-year as of January and stripping out food and energy was 3.1%.

The labor market hasn't been generating many new jobs, but unemployment remains relatively low at 4.4%

The ISM Manufacturing PMI increased to 52.4 in February, expanding in consecutive months for the first time since 2022.

The ISM Services PMI rose to a 43-month high of 56.1 in February.

Large cap growth stocks are being outpaced by value, small cap and international stocks as breadth in equity markets increases.

Energy represents less than 3% of S&P 500 earnings, compared with double-digit shares during past oil-driven inflation cycles.

The 10-year Treasury yield has spent most of 2026 in a 25-basis-point range, one of the tightest multi-month trading bands of the past decade.

Staying on Course Amid Geopolitical Uncertainty

As we move into 2026, the economic and market landscape remains largely on target despite elevated geopolitical uncertainty. U.S. economic growth could still be more resilient than expected, supported by deferred economic growth from last year's government shutdown, larger tax refunds, and solid underlying demand. Inflation early in 2026 has been stubbornly higher than expected, and higher energy prices have reintroduced near-term risks. The Federal Reserve (The Fed) has signaled that policy is near "plausible estimates of neutral," allowing it to remain patient as it balances inflation concerns against a labor market that appears close to equilibrium, but risks remain.

The labor market has cooled without showing signs of broad stress. Job growth has slowed, but labor force growth has slowed as well, limiting upward pressure on unemployment. These dynamic supports continued economic expansion without requiring aggressive policy easing. At the beginning of the year, investors expected multiple rate cuts; however, inflation risks, particularly from energy, have tempered those expectations. The Fed remains more likely to cut than hike, but policy may stay on hold longer than markets once anticipated.

Equity markets have taken recent geopolitical developments largely in stride. Valuations remain elevated in parts of the market, particularly among large-cap growth stocks, but leadership has continued to broaden. Value stocks, small- and mid-cap equities, and international markets have gained traction as investors rotate toward areas with more reasonable valuations. While equity returns in 2026 are unlikely to match the outsized gains of recent years, earnings expectations remain supportive.

International equities continue to offer diversification benefits, supported by lower valuations and more accommodative fiscal policy abroad. Risks remain elevated in China due to structural challenges, and globally amid ongoing geopolitical tensions, particularly for energy-importing economies. Outcomes are likely to vary by region, reinforcing the importance of selective, fundamental-driven investing.

In fixed income, yields have remained range-bound, reflecting a balance between resilient growth and lingering inflation concerns. With policy rates near neutral, the risk to longer-term yields appear skewed modestly higher, warranting more caution in extending duration. Credit markets remain calm, with spreads still tight and default expectations low. Overall, the outlook remains constructive but nuanced, underscoring the importance of diversification.

For a more detailed look at our views on the economy and markets, read the rest of our Q2 2026 Market Outlook.

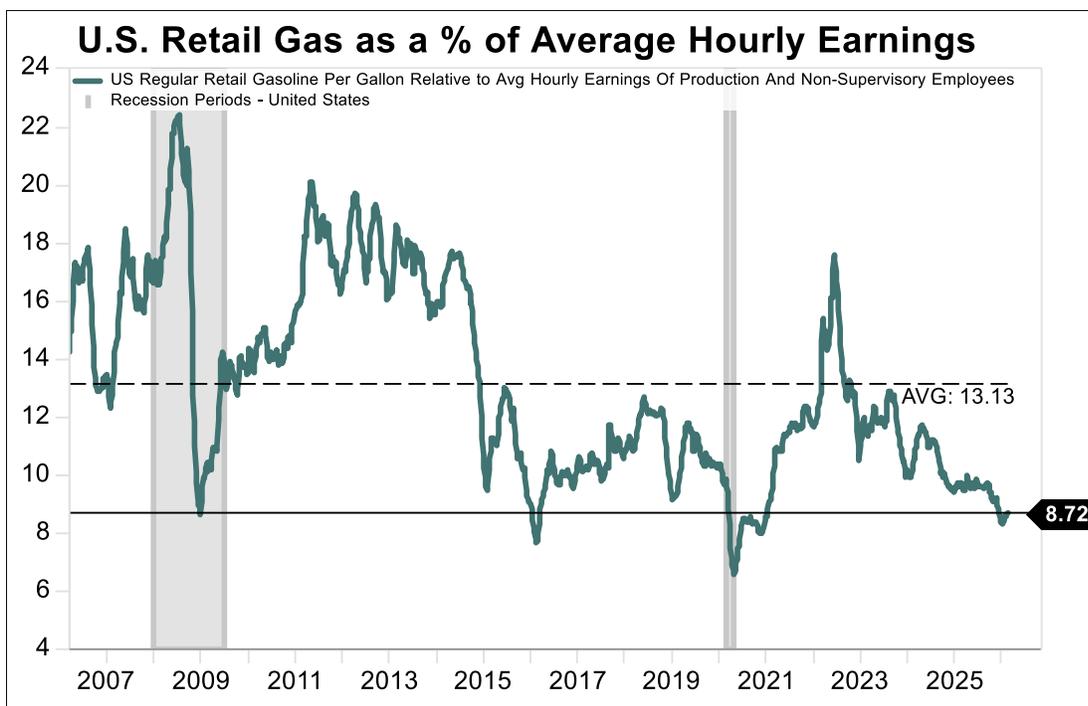
Economy

Entering the year, we expected stronger than anticipated economic growth in the United States. The government shut down in the fourth quarter essentially pulled forward growth from 2025 and carried it into 2026. Additionally, the IRS did not update its tax tables for the tax cuts that were approved in mid-2025. This means that taxpayers withheld more than necessary and are expected to receive larger refunds in 2026. Together, these factors support a strong case for solid GDP growth in the first half of the year, particularly if outsized tax refunds translate into increased consumer spending. At the same time, tariff uncertainty has been resolved, AI capex spending is accelerating, and the productivity gains from AI and automation are beginning to materialize.

The government shutdown proved to be more of a drag than expected in the fourth quarter, which saw GDP growth slow to 0.7% annualized. This should reverse in the first quarter, providing an additional boost to growth. The Atlanta Fed estimated first quarter GDP growth to be over 3% before the strikes in Iran began. Now, they estimate GDP growth to be closer to 2.3%.

The longer the duration of the Iran war and closure of the Strait of Hormuz, the greater the impact on the global economy, primarily through inflation caused by higher energy prices. We often think of higher gasoline prices as the main impact of higher oil prices, but their effects extend well beyond commuting costs. Cars have become more fuel efficient over time, and the price of gasoline relative to hourly earnings has come down significantly as seen in **Figure 1** below. Nonetheless, higher gasoline prices still pressure consumers' wallets and reduce spending in other areas.

Figure 1: Fuel Efficiency



Source: Cetera Investment Management, FactSet, U.S. Department of Energy, U.S. Bureau of Labor Statistics. Data as of 2/28/2026.

The bigger impact will be on oil byproducts or other transportation costs. Oil byproducts include diesel, jet, and marine fuel, fertilizers, pesticides, plastics, rubber, asphalt, synthetic fibers for clothing, and paints, to name just a few. This feeds into inflation, which was already above the Fed's target and appeared to be rising before the war even began. This could also prevent the Fed from cutting interest rates in the near term. Investors had been hoping for two to three rate cuts this year, but now expectations have shifted toward a single cut.

We will discuss this further in the fixed income section, but higher inflation expectations also mean higher bond yields, which raise borrowing costs, such as mortgages and business loans. This dynamic slows economic growth as consumers and businesses delay large purchases.

The opportunistic market scenario is that the Iran war is short-lived. The path of the conflict is uncertain, but as we will discuss in the next section, equity investors have already largely discounted the war. The risk would be if it persists longer than expected. While the dynamic seems sticky, there could be some opportunities for the United States to reduce its involvement.

We are not political analysts. That said, our assessment of potential outcomes and risks necessarily considers political incentives and constraints. With U.S. midterm elections approaching in November, political tolerance for a prolonged war involving Iran may be limited, particularly for Republicans who currently support President Trump's actions in the Middle East.

There is also precedent for oil prices to moderate after crises events, as seen in **Figure 2**. The oil market typically sees price increases following crises in oil-producing regions. Since 1990, WTI crude has risen an average of 10% one month after crisis events and 19% after three months. However, oil prices have generally stabilized within six months.

In that context, President Trump could plausibly declare victory and disengage from the conflict, especially given the absence of a clearly defined end goal. For example, the objective could be framed narrowly as degrading or dismantling Iran's nuclear capabilities rather than pursuing regime change. Such a definition would allow for a relatively flexible interpretation of success and provide political cover for an exit, even if broader regional tensions remain unresolved. Of course, there is no guarantee that Iran will halt disruptions to oil tanker traffic through the Strait of Hormuz.

Figure 2: Oil Prices After Crisis Events Impacting Oil Producers

Event	Date	WTI Crude Oil Price Change				
		1-Day	1-Month	3-Months	6-Months	1-Year
Kuwait Invaded by Iraq	8/2/1990	7.3%	22.8%	63.2%	-0.9%	-1.3%
Venezuelan Oil Strike	12/2/2002	1.3%	16.0%	36.1%	9.9%	11.4%
2003 Invasion of Iraq	3/20/2003	-4.2%	2.5%	-2.9%	-7.8%	28.1%
Arab Spring	12/17/2010	0.4%	4.4%	11.7%	8.3%	6.6%
Russia Invades Ukraine	2/24/2022	0.8%	24.8%	19.8%	1.8%	-18.1%
U.S. Airstrike in Iran	6/22/2025	-7.2%	-10.7%	-15.5%	-23.5%	N/A
	Average	-0.3%	10.0%	18.7%	-2.0%	5.4%

Source: Cetera Investment Management, FactSet, New York Mercantile Exchange (NYMEX). Crude oil price measured as West Texas Intermediate (WTI) crude oil.

The impact on other countries will depend on whether they are oil importers or exporters. While Europe is a net importer of oil, its largest economy, Germany, is implementing fiscal stimulus, which should provide some support for the broader European economy. China is the world's largest oil importer and sources more than 10% of its oil from Iran. Higher costs in China also feed through to the global economy, as China is the world's largest exporter of goods. The number of knock-on effects from higher oil prices is significant.

However, our base case is that the Iran war may be relatively short-lived and economic growth and inflation will not be severely impacted. Expectations for higher-than-projected GDP growth are still intact. Economic research firm, Capital Economics, estimates 2026 U.S. economic growth at 2.6%, with global growth closer to 3%. The Eurozone is estimated to be around 1%, so a prolonged war could easily tip the region into a recession. We will continue to monitor Middle East developments closely for signs of escalation or de-escalation and adjust our expectations accordingly. We also continue to monitor the labor market for weakness, as that was arguably the biggest risk factor before the war began.

Equity Markets

While our base case expects the Iran war to be relatively short-lived, equity investors may be pricing in a similar outcome. Before the strikes began, equity valuations were already elevated in many sectors. Equity markets have had a modest pullback but are clearly not pricing in a sustained war with persistently high energy prices. This creates additional downside risk for equity markets if the war persists for longer than expected. International markets have dipped further due to the war but also stand to recover more sharply if the war ends sooner than anticipated.

The Iran war is increasing near-term market volatility, but the market impact of wars and crises has historically been short-lived. The S&P 500 was positive one year after seven of the last nine major crisis events.

Figure 3: Stock Market Reaction to War and Crisis Events

Event	Date	S&P 500 Return		
		1-Day	1-Month	1-Year
Kuwait Invaded by Iraq	8/2/1990	-1.1%	-8.9%	12.8%
1993 World Trade Center Bombing	2/26/1993	0.2%	2.1%	8.3%
Oklahoma City Bombing	4/19/1995	-0.1%	3.1%	30.5%
September 11th Terrorist Attack	9/11/2001	-4.9%	-0.9%	-15.5%
Start of Iraq War (2003)	3/20/2003	0.2%	2.4%	29.2%
2004 Madrid Terrorist Attack	3/11/2004	-1.5%	1.5%	9.5%
Brexit Referendum	6/23/2016	-3.6%	3.1%	17.8%
Ukraine Invaded by Russia	2/24/2022	1.5%	5.6%	-3.4%
Start of Israel-Hamas War	10/7/2023	0.6%	1.4%	35.4%

Source: Cetera Investment Management, FactSet, S&P Global. Returns shown are total returns, which include dividends.

Looking out past the Iran war, we expect the shift in market leadership to continue. At the start of the year, leadership was already shifting from large-cap growth toward value, small- and mid-cap stocks, as well as international equities. Valuations were more reasonable in U.S. small and mid-cap stock and Europe stands to benefit from ongoing fiscal stimulus. It is even possible that energy prices, over the longer term, could stabilize at lower levels after some form of resolution in Iran.

Earnings estimates for the S&P 500 this year remain robust, with projections by FactSet Research in the double digits. AI capital expenditures and deficit spending remain a tailwind as well. While we don't anticipate equity returns around 20% plus like we have seen in the past three years, we still expect modest returns in 2026.

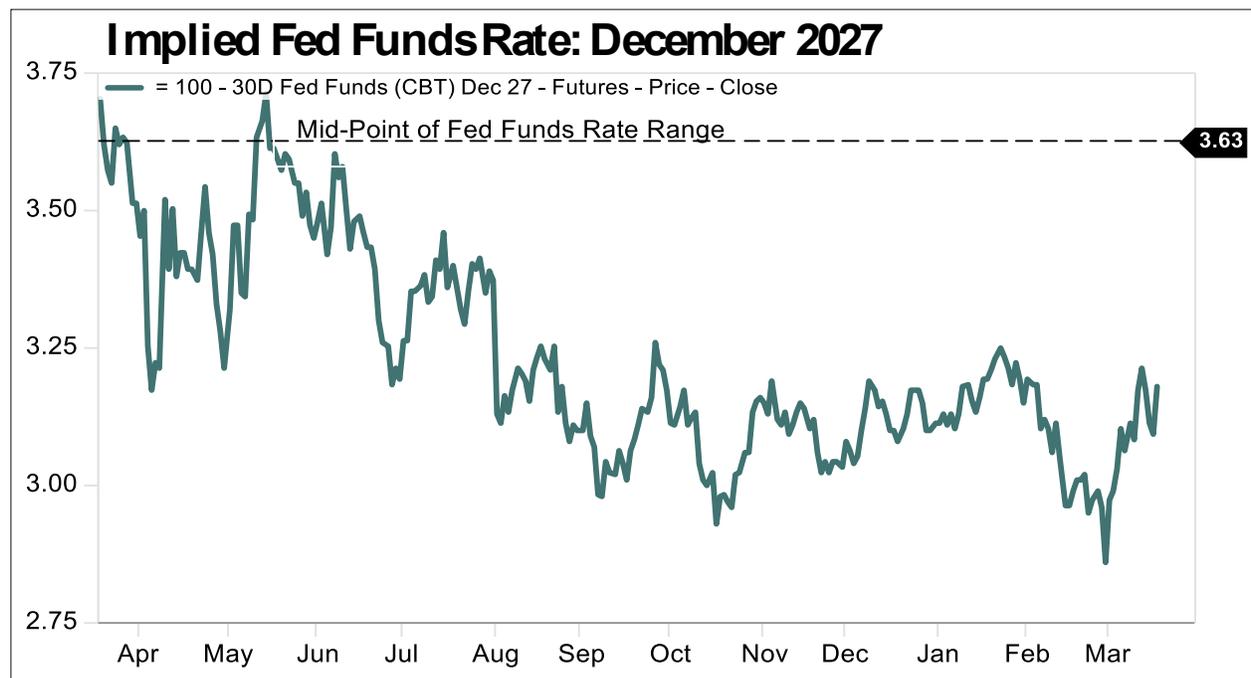
Fixed Income

Bond yields have been fairly range-bound in 2026 with the 10-year Treasury yield staying roughly between 4.00 and 4.30%. The low point was right before the strikes in Iran began. After the strikes, inflation fears drove the yield higher to around where they started the year at close to 4.20%.

The 2-Year Treasury is more closely tied to the federal funds rate and has climbed about 0.25% since the beginning of the year, which is consistent with market expectations that the Fed will cut rates only once this year instead of twice. Like equity investors, central banks appear to be looking past the war in Iran and viewing the inflation caused by the war as temporary or transitory.

At the conclusion of the most recent Fed meeting, Fed Chair Jerome Powell, stated that the Fed is already near "plausible estimates of neutral." With stable economic growth, the labor market at equilibrium, (limited job growth but also limited labor-force growth) and inflation running somewhat hotter, the Fed may remain on hold for a while. Labor market risks still outweigh inflation risks, leaving the Fed more likely to cut rates than to raise them. That said, Fed policy may already be near neutral, and investors may be overestimating how much further the Fed will ease rates. Even if they cut rates further, it may be limited to one or two cuts over the next few years, as implied by Federal Reserve projections and the futures market. Looking out to 2027, the implied federal funds rate is 3.10%, which suggests one rate cut in 2026 and one in 2027. The Fed dot plot is also consistent with this outlook.

Figure 4: Approaching Neutral Rate



Source: Cetera Investment Management, FactSet, CME Group. Data as of 3/18/2026.

High Yield investors have been demanding slightly higher compensation for the risks of default and/or downgrade, but not at the levels that are cause for concern. Credit spreads remain near historically low levels, signaling continued confidence in the economy.

Overall, we are cautious about extending duration risk, as the risk to yields is to the upside. If inflation does rise more than expected for a variety of reasons, long-term bond yields should rise and thus bond prices will fall. High yield bonds offer attractive yields that can offset some losses from credit spreads rising, but we are also cautious about these lower rated bonds as spreads are still relatively tight. We prefer to be around or below benchmark duration, and while having a strategic allocation to high yield bonds, we prefer investment-grade corporate bonds.

The Bottom Line

A short, contained war keeps our constructive base case intact—above-trend U.S. growth early in the year, moderating inflation later, and a gradual move toward neutral monetary policy rather than more aggressive easing. If the Iran war endures, sustained higher energy costs could pressure inflation and limit rate-cut expectations, adding volatility to risk assets and upward pressure on yields.

Diversification across styles, sizes, and regions, along with a disciplined approach to interest-rate and credit risk, remains prudent. Your Cetera financial professional can help align positioning to your goals while we navigate these evolving dynamics.

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