Seth D. Rosenthal, CFA
Brent A. Osborn, CFA
Mark T. Harvey

ACADEMY ASSET MANAGEMENT

Market and Economic Update

February 2026

The outlook for 2026 remains supported on the growth side. The U.S. economy continues to demonstrate strength, with Q3 2025 GDP revised to 4.4% annualized, driven by consumer spending, exports, and government outlays. The personal saving rate slid to 3.5% in November, a three-year low, reflecting a spending-driven dynamic rather than an income shortfall. Households are drawing down savings amid larger tax refunds tied to 2025 withholding mismatches, policy stimulus, and still-resilient consumption supported by wage gains.

Q4 2025 growth projections remain strong and above 3%, supported by November retail sales up 0.6%, exceeding forecasts, and durable goods orders surging 5.3%. Major technology firms continue aggressive AI-related capital spending, with more than $3 trillion in additional investment planned over the next three years, sustaining broader economic activity even as questions grow around returns and potential overcapacity. In addition, the administration's consumer-centric agenda is likely to extend into the midterm elections, with Fannie Mae and Freddie Mac directed to purchase $200 billion in MBS to lower mortgage rates and improve affordability, potentially unlocking housing demand in a still-tight market.

The January employment report showed nonfarm payrolls rising 130k, well above expectations. However, the continued decline in JOLTS job openings and an increase in layoffs suggest the labor market may be cooling. A sustained strong labor market remains critical to maintaining consumer spending.

On inflation, the trend remains lower but at a slow pace. Headline CPI fell to 2.4% year over year in January, with core at 2.5%, the lowest level since May 2025. Shelter and services inflation remain sticky, so any reacceleration driven by refunds, stimulus, or AI-related demand could reignite price pressures just as the Fed attempts to normalize policy without triggering volatility.

Equity markets continue to embrace the optimistic scenario. The S&P 500 notched fresh records in January. However, the "Mag 7" dragged performance amid AI spending scrutiny and mixed earnings, underperforming the broader S&P 500. Market pricing now reflects 50 to 75 basis points of Fed cuts over 2026, with investors still skeptical of aggressive easing given sticky inflation and revised higher dot-plot projections.

We continue to hold the view that a more dovish Committee composition later this year, combined with labor-market slack, could lead to 100 basis points of easing. That divergence remains a key theme. However, Kevin Warsh's hawkish track record introduces risk. He is expected to frame any rate cuts around a productivity-driven narrative tied to AI, outline a medium-term balance-sheet approach centered on QT in exchange for rate cuts, and Powell's anticipated continued service as a Governor could temper a shift toward a more dovish. As a result, uncertainty around the policy path has increased and warrants close monitoring.

US Personal Saving Rate (%)

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Product Views

Rates: The Treasury curve has rallied and flattened year-to-date, with the back end outperforming (10-year down ~40–50 bps) and the curve flattening. The last six months, however, have seen the 10-year trade in an unusually tight 30 basis point range. GSEs will delta-hedge their $200 billion incremental MBS exposure, so their purchases are unlikely to drive rates or volatility materially lower. We retain preference for duration in the front end and belly as the long end remains vulnerable to fiscal concerns and potential reflation.

Credit: Underlying fundamentals remain strong, but we are increasingly concerned that large private credit managers are beginning to pull back, with a shift toward a more risk-off posture and recent write-downs signaling pockets of stress among leveraged and AI-exposed borrowers. Looming AI-related supply exacerbates technical supply/demand imbalances. Further pressures on spreads include debt growth exceeding earnings and the leveraged-finance segment outpacing high-quality issuance. We retain an underweight stance in IG credit, favoring selective high-quality allocations.

Securitized: Agency MBS has been the strongest performer in the Agg YTD (1.57% vs. 1.24% for corporate credit). Readers of our pieces have heard us beating the drum on this. We see upside diminishing though as spreads have tightened. However, we continue to prefer MBS over credit on policy support and attractive risk-adjusted carry. Security selection and collateral analysis remain are increasingly important in this environment.

Foreign Debt: Local currency debt has broadly outperformed the Agg year to date, led by Australia at 5.30% and Sweden at 3.20%. With additional Fed easing expected that is not yet fully priced by markets, further U.S. dollar weakness could support continued outperformance of local currency bonds.