Market Strategy
by STRATEGAS A BAIRD COMPANY

BAIRD
Private Wealth Management

Market Gauge

January 2026

GAUGE NEUTRAL TO START YEAR

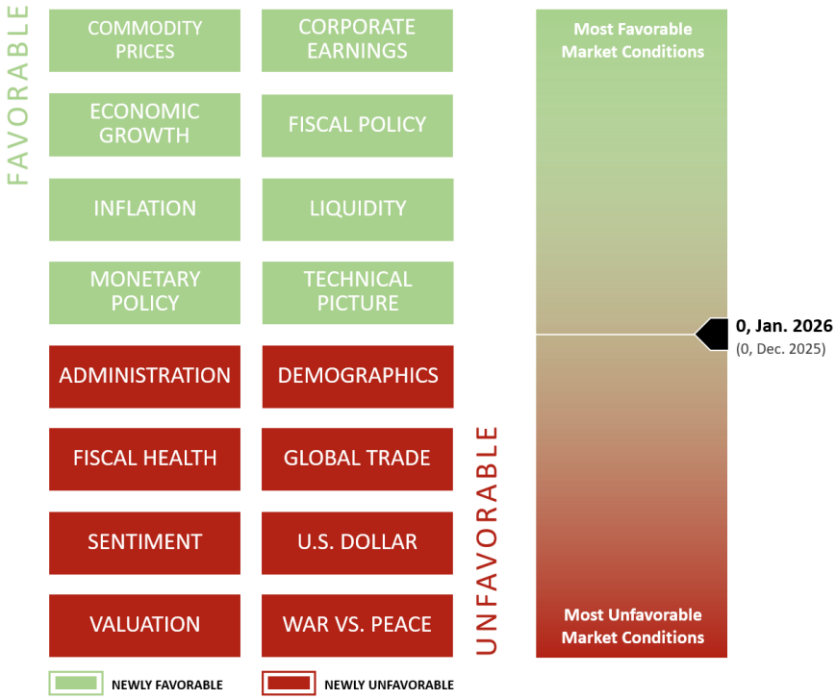
The Market Gauge remained Neutral in its latest iteration, following the December downgrade to Sentiment (which has heated up to a level of discomfort). Still, while neutral overall, we would tilt bullish given the relative import of the Favorable categories – notably, economic growth, earnings, and liquidity.

Today's environment seems to be a standoff of sorts between economic growth, profits, and profit margins to the plus side and valuation, sentiment, and the country's fiscal health to the negative. Over the last few years, we have noticed that valuation and sentiment have only seemed to matter to investors when the 10-year Treasury yield approaches 4.50% and beyond. Currently, the Treasury department is actively issuing bills to keep the supply of notes and bonds scarce, keeping long rates low.

This bit of financial engineering seems to be working – long-term rates have been stable, stock prices are near all-time highs, and mortgage rates have started to drift lower. But, as we all know, there is no free lunch. The escape valve for an economy that may be being overserved as far as fiscal stimulus is concerned appears to be the value of the U.S. dollar, especially versus precious metals like gold and silver.

Although we don't think the greenback is losing its reserve currency status, foreign central banks and other institutions with substantial holdings of financial assets appear to be diversifying their currency reserves beyond the dollar. While that might mean a bid in the price of Bitcoin for younger individuals, it appears to mean greater demand for hard assets among large institutional investors.

We have a high conviction that economic growth will be strong in 2026 but the year may present the conditions for a foot race of sorts between the country's deteriorating fiscal health and the productivity generated by the supply-side boosts of the One Big Beautiful Bill. If the hoped-for gains in productivity appear, high valuations for stocks may be both justified and sustainable.



FAVORABLE or UNFAVORABLE?

This table shows the 16 factors we monitor to understand the current environment for U.S. stocks. Eight factors in each group represents a neutral market environment. Our latest count puts the Gauge at **Neutral, or 0** (the sum of **+8** and **-8,** as seen in the table above). Positives include a solid economic growth backdrop, strong profitability, and ample liquidity. Negatives include valuation and bullish sentiment.

The Market Gauge is meant to be a snapshot of a moment in time, and not a predictive tool. ***See page two for more on our 16 building blocks, and what we look for to label each one "Favorable" or "Unfavorable."*** *This assessment is as of 1/1/20256.*

BREAKDOWN OF THE GAUGE'S FAVORABLE AND UNFAVORABLE ELEMENTS

COMMODITY PRICES ***(Do they reflect growth or contraction?)*** Crude is still relatively cheap, in line with policy goals, while Nat. Gas is higher. Metals have done well. Agriculture is largely weaker, apart from Soybeans and Coffee. There's concern that rising commodity prices could reignite inflation, but this is not the case today.

CORPORATE EARNINGS ***(Are they growing or falling? Are margins expanding or contracting?)*** S&P 500 EPS grew at a +15% y/y pace in 3Q, with all but two sectors exceeding their July 1 estimates. Full-year EPS growth estimates remain firm for 2025 and 2026, at +13% and +15% respectively. It's hard to get too negative on equities with the fundamental outlook still so strong.

ECONOMIC GROWTH ***(Is the economy growing? Are leading indicators rising or falling?)*** U.S. growth was choppy in 1H due to trade shocks. Geopolitical shocks are also a risk, but thus far have not been that impactful. 2026 has tailwinds from incentives in the recent tax bill, fed rate cuts, and possible deregulatory action.

FISCAL POLICY ***(Is gov't policy market-friendly?)*** Shock-and-awe fiscal policy stimulus is coming in 2026, due to the One Big Beautiful Bill Act. Consumers will receive an incremental $150bn of stimulus in the form of tax refunds, while ~$230bn in fiscal stimulus will come from the bill's business investment provisions, such as 100% expensing for capital goods, domestic R&D, and the building of production facilities.

INFLATION ***(Is it rising or falling? Is it near the Fed's target?*** The good news is that the first U.S. inflation wave appears over. History indicates a second wave could happen, but the time between waves 1 and 2 can be years. We're still in the lull, but tariffs will continue to affect pricing in future months if nothing changes.

LIQUIDITY ***(What do money growth, real rates, credit spreads, and financial conditions look like?)*** Credit spreads remain tight. The economy has been able to absorb higher real interest rates so far. Gov't policy has helped avoid a crisis. Thus far, despite some high profile bankruptcies, 2025 has not seen a systemic event.

What impacts market health the most?

Important
Administration
Demographics
Fiscal Health
Global Trade

More Important
Commodity Prices
Fiscal Policy
Inflation
Monetary Policy
Technical Picture
US Dollar

Most Important
Corporate Earnings
Economic Growth
Liquidity
Sentiment
Valuation
War vs. Peace

(ranking of categories is based on Strategas analysis and opinion)

MONETARY POLICY ***(Are interest rates accommodative or restrictive?)*** U.S. monetary policy has pivoted from restrictive toward neutral. The Fed remains in a rate cut cycle – there's likely more to go based on their dot plot forecasts and focus on employment concerns. Even if there is no rate cut at the January FOMC meeting, as we expect there may not be, a March rate cut remains on the table.

TECHNICAL PICTURE ***(What does price action tell us? What do market breadth, trend, and momentum look like?)*** Equity participation remains firm with the equal-weight S&P 500 index just a few points off a new high. Our sector rankings still skew cyclical and risk pairs are firm. New high data has expanded slightly recently, and we'll be looking for further improvement into 1Q26.

ADMINISTRATION ***(Is the White House "market-friendly"?)*** Trump's aggressive tariff regime led to financial market turmoil in 1H. Tariffs were subsequently reduced and delayed to provide time for the OBBBA to be enacted, but roughly $380bn in tariffs remain in place and tariff uncertainty lingers with additional tariff threats. On a positive note, we expect the administration to focus on deregulation moving forward. The White House will also be more focused on housing and energy policy as higher prices continue to be a concern for voters.

DEMOGRAPHICS ***(Are population trends growth-positive or -negative?)*** An aging population is a headwind for U.S. labor supply, creating pressure on the Fed via higher wages. Aging demographics also fuels investor preference for income over capital gains.

FISCAL HEALTH ***(Is the deficit growing or shrinking? Is federal spending in line with economic growth?)*** FY25 ended with a $1.8tn federal budget deficit, and the month of October ended with a $1.7tn deficit. Treasury's projections suggest a flat to slightly lower budget deficit over the first half of FY26. U.S. debt servicing cost remains elevated at over 18% of tax revenue, though it is down slightly from March.

GLOBAL TRADE ***(Are attitudes more "free trade" or more "protectionist"?)*** We have largely hit peak tariff. Tariffs remain just below $380bn on a 12-month basis and are expected to remain relatively near this level. As we look ahead to 2026, there could be some potential tariff increases on certain sectors and there could be some tariff cuts, such as on building products. The Supreme Court will rule on whether the admin. can use IEEPA to impose tariffs. However, the ruling will determine how, not whether, the president can impose tariffs.

SENTIMENT ***(Are investors optimistic or pessimistic? Pessimism is a positive.)*** Our sentiment composite continues to tread near new highs, reflecting bullish attitudes among market participants. Equity ETF inflows remain intense and levered fund ratios are at a new high.

U.S. DOLLAR ***(Is it strengthening or weakening vs. other currencies?)*** Global investors appear to have lost some appetite for the dollar. Even if that reverses, any flight to quality is likely to be a headwind for U.S. exporters and emerging market economies.

VALUATION ***(Are stocks expensive or cheap vs. historical averages?)*** Multiples remain high. The market trades at 25.7x trailing 12-month earnings, well above the long-term average of 16x since 1950. On a forward-looking basis, the S&P is valued at 22.7x earnings, again exceeding the historical average. Hard to say the market is cheap and expectations for significant multiple expansion should be tempered.

WAR vs. PEACE ***(Are tensions inhibiting global economic growth?)*** Despite some apparent progress between Russia and Ukraine, we expect geopolitical volatility to remain high into 2026, with tensions ramping on Venezuela, China/Taiwan, and trade with traditional allies.

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