February 21, 2026

CJ's Weekly Market Memo

The Economy: A Tale of Two Hemispheres

The global economy is sending mixed signals, but if you know where to look, there's more reason for optimism than the headlines suggest. Start with Europe, where the economic data has turned genuinely encouraging. Flash manufacturing PMIs for February came in stronger than expected across the board. Germany posted its first manufacturing reading above 50, indicating expansion, in nearly four years. Eurozone and UK manufacturing gauges hit their strongest levels since mid-2022 and mid-2024 respectively. UK retail sales surged 1.8% in January, blowing past the 0.2% estimate, and Spain's housing market is humming at activity levels not seen since the mid-2000s boom. This isn't a blip. Bespoke has been highlighting the European upturn for months, and the data keeps confirming it.

Here at home, the picture is cloudier. The advance reading of Q4 GDP came in at just 1.4% annualized versus 2.8% consensus. Before you panic, understand *why* it missed: the longest government shutdown in history hammered federal spending, subtracting a full percentage point from the number. Strip out the noise and look at real final sales to private domestic purchasers—the measure Fed Chair Powell himself favors, and you get a healthy 2.4% annualized growth rate. The consumer, which is the engine of this economy, contributed 1.6 percentage points to growth. Core domestic demand is ticking along just fine.

But Q1 is where it gets tricky. The December trade deficit ballooned to $70.3 billion 32.6% wider than the prior month, as companies scrambled to front-load imports ahead of tariff deadlines. This import surge is going to create a massive distortion in Q1 GDP, just as it did last spring when imports shaved a record 4.8 percentage points off Q1 2025 growth. Expect a weak headline number when Q1 2026 GDP prints. Don't confuse the accounting with the underlying economy.

On the inflation front, CPI has been moderating, but the Fed's preferred gauge core PCE came in hot at 4.3% annualized for December. Durable goods inflation posted its strongest monthly reading since 2021. Services prices remain stubbornly above levels consistent with the 2% target. The good news: Atlanta Fed business surveys show expected price increases at just 1.9%, matching the pre-Covid average, and the Cleveland Fed's consumer inflation expectations hit their lowest level since mid-2021. Businesses and consumers aren't panicking about inflation—yet. The Supreme Court's ruling striking down IEEPA tariffs adds another variable. While the President announced a new 10% global tariff under Section 122 powers (limited to 150 days without Congressional approval), effective tariff rates should decline even as the legal and policy landscape remains unsettled. The Tax Foundation estimates the remaining tariffs will reduce the effective rate to 4.5% in 2026 elevated, but well below the 2025 peak of 7.7%.

Market Technicals: Calm Surface, Churning Underneath

The S&P 500 closed last week right where it was trading in late October four months of nothing. The year-to-date trading range of just 2.7 percentage points is the second-narrowest in the index's history through mid-February. Only 1966 was tighter. It takes a mere 1.75% swing to move the index from overbought to oversold, which explains the seemingly violent oscillations that are really just minor tremors in an extraordinarily compressed range. The surface looks volatile; the reality is the opposite.

Beneath the surface, individual stocks are telling a very different story. Over 25% of S&P 500 components are already up or down more than 20% this year, while only about a fifth are within 5% of unchanged. The market is doing the work of separating winners from losers, even if the index itself is going nowhere. Semiconductors and software have diverged by a remarkable 76 percentage points semis surging, software getting punished as investors try to sort AI beneficiaries from AI casualties.

Sentiment is where it gets interesting. Consumer confidence has been firming, but investor sentiment is weakening. The AAII bull-bear spread dipped into negative territory for the first time since November, even as the S&P 500 sits within 2% of an all-time high. That's an unusual disconnect, though historically it's occurred at various points in the cycle and isn't automatically bearish. The real challenge for stocks is PE expansion which drives roughly 80% of major market moves and that's hard to come by in a midterm election year with a new Fed Chair arriving in May, unresolved tariff litigation, and emerging stress in private credit markets. Blue Owl's forced $1.4 billion loan sale this week, with the broader basket of private equity stocks breaking their long-term uptrend, is a crack worth monitoring.

The major underlying positive: the Dow Transports and the Philadelphia Semiconductor Index are both up double-digits year-to-date. These are the leading indicators for the physical and digital economies respectively. Since 1994, the only three other years when both were up over 10% through mid-February were 2013, 2019, and 2023. In all three years, the S&P 500 posted double-digit gains for the rest of the year. Bespoke's "three-headed monster" oil, the dollar, and Treasury yields is also supportive, with its combined reading in the 18th percentile. Historically, readings this low have been followed by average S&P 500 gains of 15% over the following year.

Looking Ahead: The Case for a Good 2026

The most important event this week is Nvidia's Q4 report after the close on Tuesday. Wall Street expects approximately $65.5 billion in revenue and $1.52 in EPS, with Nvidia having beaten estimates in twelve consecutive quarters. More critical than the quarter itself will be forward guidance consensus looks for about $71 billion in Q1 fiscal 2027 revenue. With hyperscaler capex plans now totaling $600 billion for 2026 (up $200 billion from early estimates) and Blackwell systems in full production, a strong guide could be the catalyst this range-bound market needs. Nvidia has become the bellwether not just for AI but for the entire market's direction.

For 2026 broadly, I see a market that grinds higher but with more turbulence than investors have grown accustomed to. The positives are real: a strengthening global economy (especially Europe), supportive readings from the three-headed monster, strong leading indicators from transports and semis, and earnings that continue to grow at a double-digit clip. The 19 prior years with similarly tight trading ranges through mid-February produced a median gain of 5.9% through year-end, with stocks finishing higher 74% of the time.

The risks are equally real. Midterm election years carry an average intra-year drawdown of 17.3% versus 13.7% for all years, with half of the 20%+ drawdowns since 1945 occurring in midterm years. The summer months, in particular, tend to be rocky. Add the uncertainty of a new Fed Chair, ongoing tariff litigation following the Supreme Court decision, and the private credit stress we're beginning to see, and you have ingredients for at least one meaningful pullback.

My advice: stay invested, stay diversified beyond mega-cap concentration, and keep some dry powder for the inevitable midterm-year dip. The broadening of the market away from the Magnificent Seven with equal-weight outperforming cap-weight by near-record margins and international stocks beating the S&P 500 by 7.6 percentage points is a healthy development that rewards active stock selection. The market has been resting for four months. Time to wake up.

CJ Brott
Chairman Emeritus
Capital Ideas

The information presented is for educational purposes only and is believed to be factual and up-to-date. All expressions of opinion reflect the judgment of the author(s) as of the date of publication and are subject to change. Nothing in this commentary should be construed as investment advice and does not take into consideration your specific *situation. All investments involve risk. Past performance does not guarantee future results. Advisory services offered through Capital Ideas, an investment adviser registered with the U.S. Securities and Exchange Commission.*