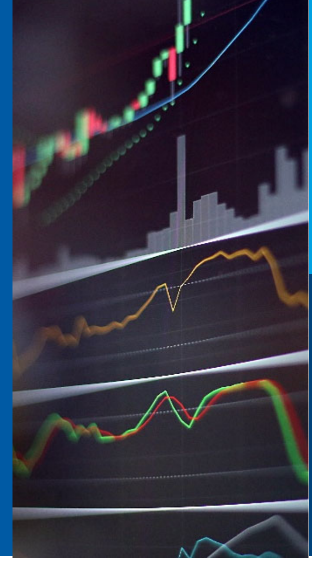
Morgan Stanley
INVESTMENT MANAGEMENT

2026 Equity Outlook



2026 EQUITY OUTLOOK | APPLIED EQUITY TEAM | December 2025

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The following views and perspectives are formed by the work of the Applied Equity Team in managing assets for investors.

After three stellar years of returns in US equities, I do concede the bull market has entered the later stages.

But I believe there is more to come in 2026.

Therefore:
Late cycle? Yes?
End of cycle? No!

1 In my view, there are four main reasons why 2026 will be another positive year for US equities:

1) *Historical precedent*
Not all bull markets last four years, but if they do, the fourth year has always been a positive year.[1]

2) *Monetary policy is accommodative*
Equities historically do well when the Federal Reserve is cutting rates.[2]

3) *Fiscal policy stimulus is coming*
The OBBA will generate an estimated $170 billion of consumer aid in 2026.[3]

4) *Consumer sentiment is cautious*
Historically, returns for equities are quite healthy when there is no ebullience in spending.[4]

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[1] Since inception of S&P 500 in 1950 December 2025. Bloomberg.
[2] S&P 500 performance 1950 – November 2025. Bloomberg.
[3] Strategas.
[4] 1952 – 2024 based on University of Michigan Sentiment Index and S&P 500 average 12-month forward returns. Source: Strategas.
The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

2 2026 is however a mid-term election year and historically, there is a sizable correction in that year.[5]

As I counseled into the April 2025 downdraft, we would be buyers into any meaningful weakness.

3 The obsession with whether an Ai bubble exists is keeping valuations compressed.

That's a good thing!

In our view, the Ai rollout remains in the early stages and ultimately the productivity boost to the "other 493" could allow the S&P 500 equal-weighted time to catch up to the S&P 500 cap-weighted.

4 Other equity opportunities are emerging, which augurs well for global markets beyond just the S&P 500.

1) Emerging markets tend to perform well when the dollar weakens.
   That was the story of 2025, and we expect that to continue.

2) Japanese companies have embraced more shareholder friendly policies.

3) European banks are also benefiting from some deregulation as are US banks.

   Plus, they are substantially cheaper.

5 So, what's the risk to this relatively healthy outlook for 2026?

For that I am reminded of one of the more famous Wall Street adages:

"Bull markets don't die of old age; they get killed by the Fed".

While not all bear markets are caused by a Fed turning more restrictive, most of them have been.[6]

With the current path of the Fed seemingly dovish, this appears unlikely, but to be clear, a more hawkish Fed pivot would upend my 2026 optimism.

Andrew

[5] Since 1950. Bloomberg.

[6] Of the last 11 -20% or worse bear markets, 6 were caused by inflation surging causing the Fed to pivot. Bloomberg.

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RO 5079731 Exp. 12/31/2026