

What We Are Watching in 2026

Four themes shaping the economic and market regime

**GLOBAL
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As we enter 2026, Meketa's "What We Are Watching" framework focuses on four themes that we believe will do the most to shape portfolio outcomes:

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The outlook and state of the US economy.



The Federal Reserve's policy path as it tries to balance low inflation with maximum employment amid a leadership transition that adds communication and credibility risk.



A global monetary-policy divergence where major central banks are at different points in their cycles.



The Artificial Intelligence (AI)-driven concentration in US equities and what it implies for rotation, volatility, and financing conditions.

Taken together, these themes provide the lens through which we frame our expectations and our risks for the year ahead.

Against that backdrop, our base case for 2026 is continued normalization: growth slows but remains positive, inflation continues to cool but remains sensitive to tariffs and supply-side shocks, and the Fed eases cautiously while monitoring employment. In a more constructive outcome, the bull case is a cleaner disinflation path with only gradual labor-market cooling, enabling more predictable easing and broader market participation. By contrast, the bear case is a policy-mix shock: tariffs or supply constraints re-accelerate inflation at the same time unemployment rises, pushing markets into a higher-volatility regime and forcing difficult trade-offs for policymakers.

Stepping back, 2026 may be less about a single dominant macro narrative and more about the interaction of policy and markets; the Fed’s dual mandate can force trade-offs; policy divergence can move currencies and capital flows; and the equity market’s AI leadership can amplify both upside and downside outcomes. For that reason, we emphasize concrete indicators we are monitoring and how the distribution of outcomes could widen even if the “base case” remains benign.¹

US economy in 2026: resilient growth fueled by consumers and the AI boom

The long-anticipated US recession never arrived in 2025. Instead, as we enter 2026, the economy has a lot more underlying momentum than many expected just a year ago. A key driver of the resilient growth has been consumer spending as wages continue to rise, household balance sheets that remain healthy, and wealth effects from rising equity and housing markets. Despite some recent signs of weakness, the labor market is still relatively stable, further supporting consumption.²

¹ Source: Board of Governors of the Federal Reserve System, “Beige Book - November 2025”; International Monetary Fund, “World Economic Outlook,” Reuters, “The Tenuous Peace Between Trump and the \$30 Trillion US Bond Market”.

² Source: Reuters, Robust Consumer Spending, “Rising Exports Fuel US Economic Growth in Third Quarter,” December 23, 2025.

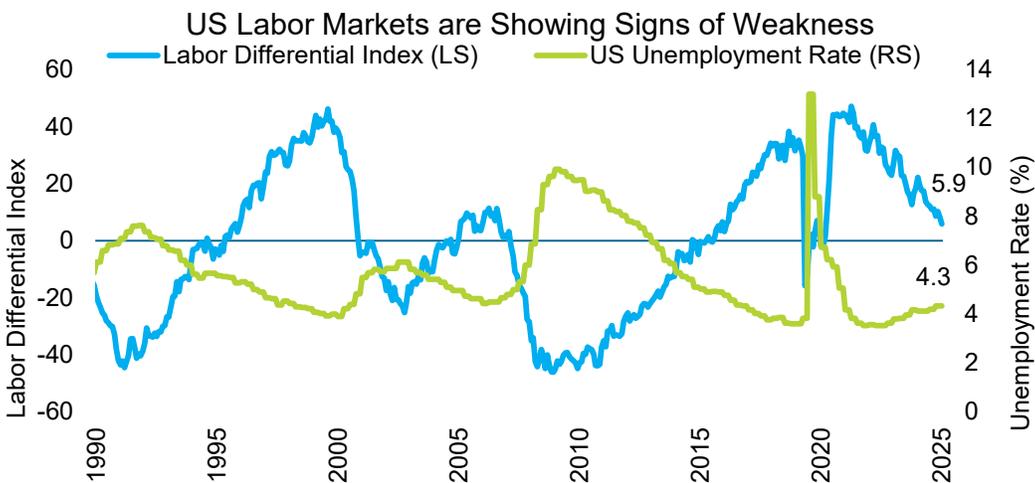


FIGURE 1
US Labor Markets Are Showing Some Signs of Weakness

Source: Bloomberg as of January 20, 2026. The labor differential index is produced by the Conference Board. It is a survey of consumers measuring the difference between those who find jobs “easy to find”, and those who find jobs “hard to find”.

Beyond the consumer, a second and increasingly important engine of growth has emerged. The massive amount of spending related to the buildout of AI infrastructure including data centers, semiconductors, and software has become a genuine growth driver and balanced some signs of cyclical slowing elsewhere.³ Some estimate that data center and high-tech investment in the US may have accounted for 80% of final private domestic demand.⁴ Preliminary growth estimates for 2026 and beyond suggest that this investment impulse could continue to support GDP growth in the US.⁵

³ Source: Wall Street Journal, “Big Tech Is Spending More Than Ever on AI and It’s Still Not Enough,” October 31, 2025.

⁴ Source: S&P Global, “Data Center Investments Are Increasingly Moving the Macro Needle,” November 4, 2025.

⁵ Source: JP Morgan, “2026 Outlook: Top 10 Macro and Market Considerations,” December 15, 2025. GDP estimates are lagging and subject to significant revisions.

With these forces in play, expectations for GDP growth this year range from around 1.5% to slightly over 2.5%. The Federal Reserve and International Monetary Fund (IMF) align closer to the consensus mid-range with forecasts of 2.3% and 2.1%, respectively.⁶ Given the strength of the US consumer and the likely continued significant AI capital expenditures (capex), the US economy may not just muddle through but could deliver upside to consensus growth expectations. Fiscal stimulus from the “One, Big, Beautiful Bill Act,” the potential for additional interest rate cuts, and the chance for tariff easing and improved global trade could all act as further tailwinds to the US economy. Stronger-than-expected productivity gains from AI and tech investment could also lift potential growth.⁷ (Figure 2)

⁶ Source: Board of Governors of the Federal Reserve System, “Summary of Economic Projections,” December 10, 2025 and International Monetary Fund, “World Economic Outlook,” November 2025.

⁷ Source: Federal Reserve Bank of Dallas, M. Wynne et al., “Advances in AI Will Boost Productivity, Living Standards Over Time,” June 24, 2025. Wall Street Journal, “Big Tech Is Spending More Than Ever on AI and It’s Still Not Enough,” October 31, 2025.

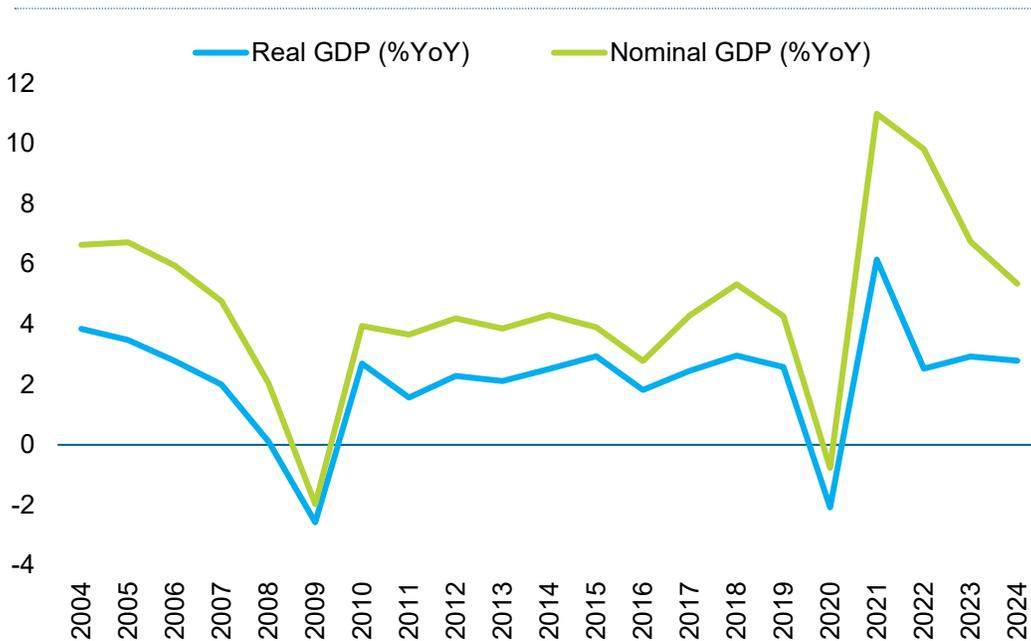


FIGURE 2
US Nominal & Real GDP Growth (% YoY)

Source: FRED as of January 2026. Annual GDP data for the full year of 2025 is not yet available.

This outlook does not come without risks though. A spike in inflation from an escalation in trade tensions, higher energy prices, supply issues in the housing market, or continued stickiness in services could lead to tighter financial conditions and test the consumers’ resilience. Also, an additional increase in deportations could further weigh on the labor force. Elevated fiscal deficits and rising interest costs leave little room for policy error, while geopolitical

shocks or a sharp correction in risk assets could dent confidence. Finally, the AI boom itself is a double-edged sword: misallocated capital or an abrupt pullback in tech investment would quickly expose how much recent optimism is tied to that single engine of growth.

For these reasons, our focus is on a set of indicators that help gauge the durability of both consumer strength and AI-led investment.

Theme 1: What we will be watching

- Consumer spending trends, as well as sentiment.
- Credit card, auto loan, and student loan delinquencies.
- Labor market slack at the margin (not just headline jobs). Key indicators include the Job Openings and Labor Turnover Survey (JOLTS), quit rates, hires, initial/continuing jobless claims, and prime-age labor force participation. Also monitor immigration trends.
- AI-related capital expenditure and productivity signals. Track hyperscaler capex guidance, semiconductor equipment orders, and early productivity metrics (output per hour in AI-exposed sectors).

The Federal Reserve: rate cuts, the dual mandate, and new Fed chair dynamics in 2026

As the Federal Reserve looks ahead to 2026, the dual mandate increasingly presents a true trade-off rather than a sequencing exercise. In a typical easing cycle, inflation has already returned to target by the time growth weakens materially. The current environment is more complicated. Inflation has moderated meaningfully but is not yet fully back to target, while labor market conditions are gradually cooling. The December 2025 Summary of Economic Projections underscores how policymakers are balancing inflation, unemployment, and growth under “appropriate monetary policy”, but it also highlights a wide distribution of potential outcomes—particularly if tariff-

related price shocks re-emerge or services inflation remains sticky.⁸ In this setting, policy decisions are less about following a well-worn path and more about managing competing risks in real time.

⁸ Source: Federal Reserve, "Summary of Economic Projections," December 2025.

That balance raises the likelihood of a stop-start easing cycle. The primary risk for 2026 is not simply the total number of rate cuts, but their sequencing. The Fed may ease policy, pause to reassess progress, and adjust again if inflation dynamics or financial conditions evolve in unexpected ways. The November 2025 Financial Stability Report flagged elevated asset valuations as a vulnerability, reinforcing the idea that easier monetary policy can, at the margin, encourage greater risk-taking even when macroeconomic signals are mixed. If inflation progress stalls due to renewed goods price pressures from tariffs or persistent services inflation, cuts could be delayed. Conversely, a faster-than-expected deterioration in employment conditions could accelerate easing. At the same time, an overly rapid loosening of financial conditions could make policymakers more cautious if inflation remains above target. (Figure 3)

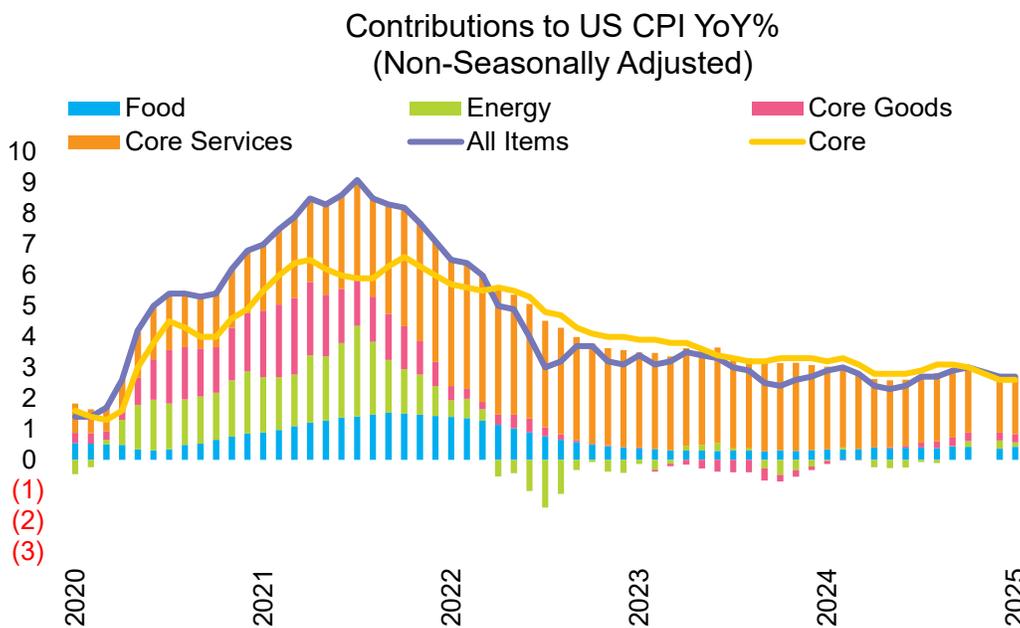


FIGURE 3
US Inflation

Source: FRED. Data is as of December 31, 2025. This represents the latest inflation data. The October report was canceled given the government shutdown. Core services includes: non-energy service categories like rent/owners' equivalent rent, medical care services, transportation services, education, recreation, insurance and tuition.

Complicating this policy calculus further is an important institutional dimension. Chair Powell's term as Fed Chair ends in May 2026. While policy is set collectively by the Federal Open Market Committee (FOMC), leadership transitions historically introduce a modest risk premium.⁹ Markets tend to price uncertainty around communication style, reaction function, and perceived independence. Reporting has already highlighted political engagement with market participants and public commentary around potential successors, reinforcing investor sensitivity to Fed leadership dynamics.¹⁰ Changes in forward guidance or tone alone—even without immediate policy shifts—can materially affect volatility, rates, and currencies.¹¹

⁹ Source: Reuters, "Trump Says Anybody That Disagrees With Him Will Never Be Fed Chair," December 23, 2025.

¹⁰ Source: Federal Reserve, J. Powell, "Statement from Federal Reserve Chair Jerome H. Powell," January 11, 2026.

¹¹ Source: Wall Street Journal, S. Goldfarb et al., "Wall Street, Former Fed Officials Slam Powell Probe," January 12, 2026.

More recently, the Justice Department's criminal probe into aspects of Federal Reserve operations has added another layer of complexity. While the investigation is not directed at monetary policy decisions themselves, it has heightened scrutiny around governance and institutional independence.¹² For investors, the risk is less about near-term policy results and more about confidence. Prolonged legal or political pressure could widen the perceived distribution of inflation and policy outcomes, raising term premiums and volatility even if economic fundamentals remain broadly intact.¹³

¹² Source: Bloomberg, "Pirro Defends Powell Subpoena, Saying 'No One Is Above the Law,'" January 13, 2026.

¹³ Source: Wall Street Journal, S. Goldfarb et al., "Wall Street, Former Fed Officials Slam Powell Probe," January 12, 2025.

In combination, these forces suggest that 2026 policy will be shaped as much by credibility, sequencing, and institutional confidence as by traditional macro indicators.

Theme 2: What we will be watching

- Inflation and labor "surprises" versus the Summary of Economic Projections (SEP) baseline.
- Tariff commentary in Beige Book and FOMC communications.
- Fed Chair nomination headlines and market reaction (rates, breakevens, the dollar).
- Financial conditions indices, equity valuation metrics, and credit spreads.

Global Central Banks: divergent cycles and the implications for global markets in 2026

Global monetary and fiscal policy in 2026 will be increasingly defined by dispersion rather than synchronization. Unlike prior cycles where major central banks moved broadly in tandem, the current environment reflects differing growth trajectories, inflation dynamics, and political constraints across regions. This divergence has meaningful implications for currencies, capital flows, and the relative attractiveness of fixed income exposure across global markets.¹⁴ (Figure 4)

¹⁴ Source: IMF, "World Economic Outlook," November 2025.

Nowhere is this divergence more evident than across the major economic blocs. In the euro area, economic activity has proven more resilient than earlier forecasts, allowing the European Central Bank to likely reach the end of its easing cycle. Inflation has moved closer to target, and policymakers appear comfortable holding rates steady rather than pursuing additional accommodation. As a result, euro-area rates have become more anchored, reducing volatility at the front end of the curve and limiting downside for yields absent a meaningful growth shock.

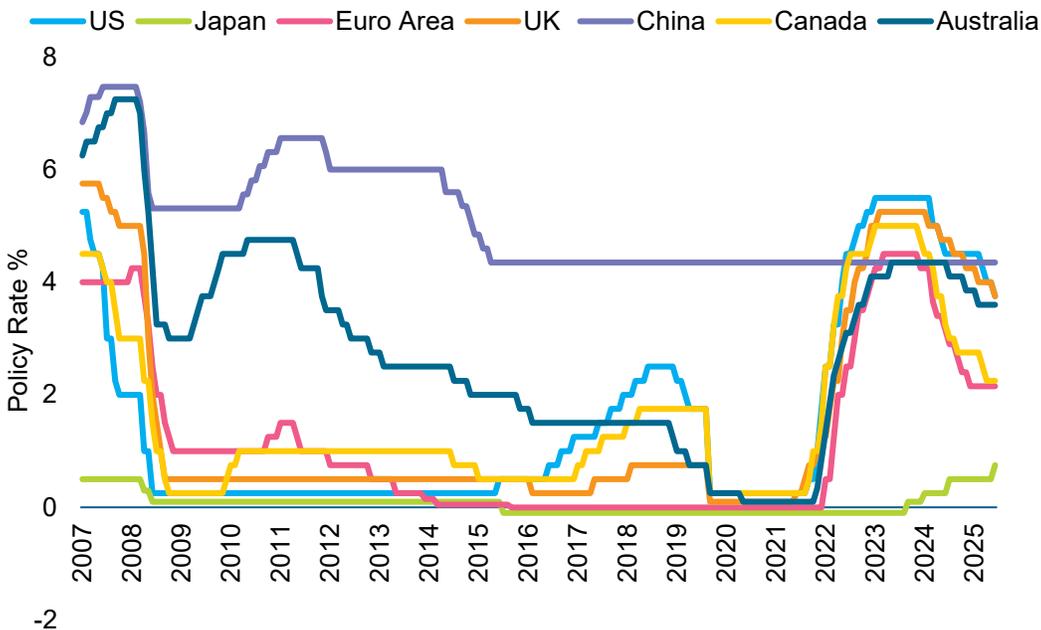


FIGURE 4
Global Policy Rates Have Started to Diverge

Source: Bloomberg. Data is as of December 31, 2025, except China which is as of February 28, 2025. United States rate is the mid-point of the Federal Funds Target Rate range. Eurozone rate is the ECB Deposit Facility Announcement Rate. Japan rate is the Bank of Japan Unsecured Overnight Call Rate Expected. China rate is the China Central Bank 1-Year Medium Term Interest Rate. UK rate is the UK Bank of England Official Bank Rate. Australia's rate is the Cash Target Rate.

Japan, by contrast, stands at the opposite end of the policy spectrum. After raising its policy rate to 0.75%, the Bank of Japan (BOJ) has openly debated the need for further rate increases as inflation remains above target and wage growth shows greater persistence. While policy remains accommodative by global standards, even incremental tightening represents a structural shift after decades of ultra-easy policy. Rising Japanese yields have implications not only for domestic markets, but also for global capital flows, as the risk-reward profile of yen-funded carry trades evolves.¹⁵ As the yen potentially continues to weaken alongside a rise in longer-dated Japanese yields, the unwind risk in yen-funded carry trades increases, potentially prompting a repatriation of capital and tighter global financial conditions.

¹⁵ Source: Reuters, "BOJ debated need for more rate hikes even after December move summary shows," December 29, 2025.

China's policy response is becoming increasingly fiscal rather than monetary.¹⁶ With domestic demand still weak and low inflation pressures lingering, authorities have signaled a more proactive fiscal stance in 2026 aimed at stabilizing growth and supporting consumption. While this may provide incremental support to activity, it also underscores the limits of monetary easing in the current

¹⁶ Source: Bloomberg, "China Vows More Efficient Fiscal Spending to Support 2026 Growth," December 28, 2025.

environment. It also highlights China's continued reliance on policy-driven demand rather than organic private-sector momentum.¹⁷

The United States, meanwhile, remains the focus of global markets. The Federal Reserve is navigating upside inflation risks while responding to signs of labor market cooling. Policy decisions are being shaped not only by inflation and employment data, but also by financial conditions dynamics and elevated fiscal issuance, which have kept term premia¹⁸ higher than in prior cycles. This combination has complicated the outlook for US rates and global fixed income exposure positioning.¹⁹

Policy divergence tends to express itself first through foreign exchange markets. Shifting interest rate differentials influence hedging costs, carry strategies, and cross-border flows, while changes in term premia can cause regional fixed income markets to decouple even when headline policy rates are unchanged.²⁰ For risk assets, these dynamics can drive geographic rotation, as currency moves increasingly influence returns for US-based investors. In this environment, monitoring foreign exchange (FX) volatility and relative rate movements remains critical, as they often provide early signals of broader shifts in global risk appetite.²¹

¹⁷ Source: Bloomberg, "China Vows More Efficient Fiscal Spending to Support 2026 Growth," December 28, 2025.

¹⁸ Term premia is the compensation investors require for bearing the risk that future short-term interest rates and bond prices may evolve unfavorably over the life of a longer-maturity bond, above and beyond the average expected path of short rates.

¹⁹ Source: Board of Governors of the Federal Reserve System, "Financial Stability Report - November 2025". November 2025.

²⁰ Source: Bank for International Settlements, W. Huang, et al, "Global FX Markets When Hedging Takes Centre Stage," December 8, 2025.

²¹ Ibid.

Theme 3: What we will be watching

- USD trend and global FX volatility as a barometer of financial conditions.
- BOJ communication, wage dynamics, and yen behavior.
- Euro-area wage growth and negotiated wage trends heading into 2026.
- China's fiscal/credit impulse and whether stimulus translates into domestic-demand stabilization.

AI, US Equities, and the Market Regime: potential rotation and volatility

AI continued to be a driving force of the markets in 2025. By year-end, however, signs of differentiation began to emerge even among the market's biggest beneficiaries. Alphabet (Google) returned 28.9% in the fourth quarter with Meta (-10.0%) and Microsoft (-6.5%) declining over the same period.²² Also, concerns started mounting toward the end of 2025 over stretched valuations for these companies, what the return on investment would be on the massive capex spent on data centers, and worries about the use of debt financing (e.g., Oracle).²³ What has been a rising tide is beginning to look more selective, which helped mitigate the outsized influence the Magnificent Seven had been having on the capitalization-weighted index. (Figure 5)

²² Source: Bloomberg as of December 2025.

²³ Source: Bloomberg, S. Patnaik et al., "Nvidia is Worth \$5 Trillion. Here's What it Means for the Market," November 2, 2025.

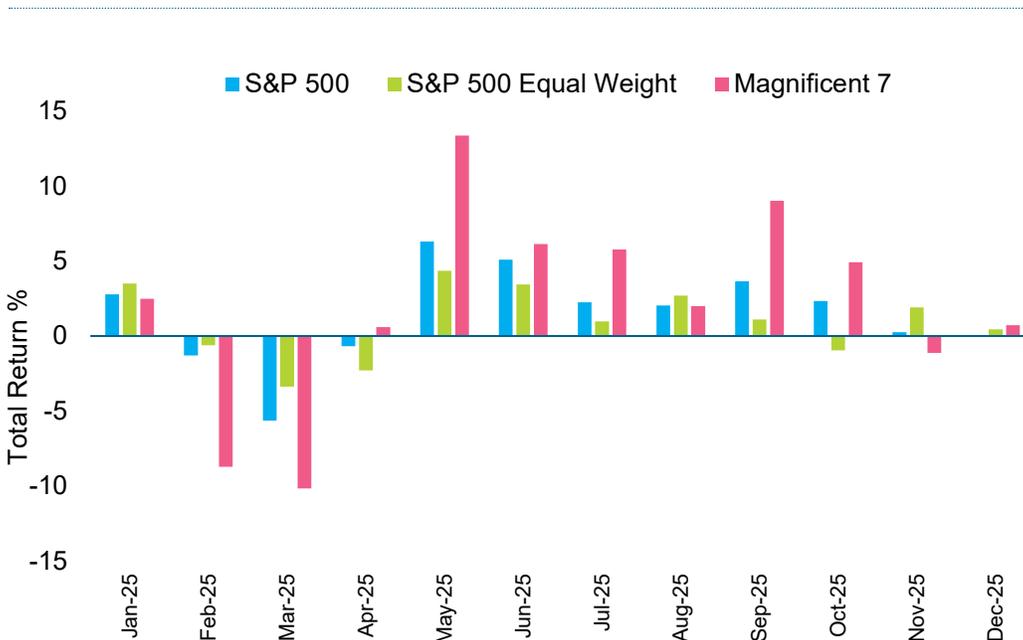


FIGURE 5
2025 Monthly Returns for Magnificent Seven Stocks, S&P 500, & S&P 500 Equal Weight Indices

Source: Bloomberg as of December 2025. Bloomberg has a proprietary on the Magnificent 7 tracker. Magnificent 7 includes Meta, Alphabet, Microsoft, Nvidia, Amazon, Tesla, and Apple.

As we move further into 2026, AI is likely to remain the defining investment and economic theme for this year. The initial phase of optimism over the technology and those involved in the infrastructure buildout will probably transition through to a more demanding stage where returns on that investment begin to matter. This sets the stage for sharper differentiation: not all AI spend will translate into durable earnings power. Even within the Magnificent Seven, the market is likely to reward firms that can convert scale and data advantages into monetizable products, while punishing those where capex growth outpaces revenue and margin expansion.

Importantly, this could also open the door for leadership to broaden beyond mega-cap tech as AI spreads across the economy. Sectors like software,

industrials, healthcare, and financials may benefit from productivity improvements. We could start seeing the focus shift this year related to AI from who spends the most to who integrates it most effectively.

Beyond AI, a mix of structural and cyclical forces could allow small-cap companies and non-tech sectors to perform well in 2026 (a trend we are already seeing in the first few weeks of the year). As the Fed is likely to lower interest rates this year, smaller companies, that generally use more leverage should benefit from the easing financing pressures.²⁴ Domestically focused small companies should also be helped by resilient growth in the US as well as from relatively attractive valuations and earnings compared to larger companies.

²⁴ Source: Federal Reserve, "Financial Stability Report," 2025.

From a sector perspective, lower interest rates, resilient growth, and potentially less tariff-related noise could broaden investor focus toward earnings durability and valuations. Profits for industries like financials, energy, industrials, and healthcare are less tied to emerging technology trends and more to replacing/improving infrastructure and equipment, servicing an aging demographic (healthcare), or pricing power and changes in regulations. These sectors have trailed technology given the recent run and their stocks are relatively cheap. Steady growth and clearer profits could attract investors looking for dependable businesses with real assets and more predictable demand.

Theme 4: What we will be watching

- AI monetization and margin progression among major spenders.
- The use of debt to help with the next stage of the infrastructure buildout.
- Sector and market cap level performance, performance within Magnificent Seven firms, equal-weighted S&P 500 returns versus market-cap-weighted.
- The breadth of AI-driven earnings and comments in earnings calls outside of mega-cap tech.
- Signs of productivity gains from AI as well as labor displacement signals.

Given these scenarios, the question is not only what we expect, but what would cause us to reassess quickly?

Signals that would most challenge our current views:

- A sharp and sustained deterioration in labor-market breadth (layoffs spreading beyond rate-sensitive sectors).
- A clear acceleration in tariff-sensitive inflation categories coupled with rising inflation expectations.
- A rapid rise in term premium or failed auctions that signals stress in the rates complex.
- A material change in Fed communication or perceived independence associated with 2026 leadership developments.
- A decisive break in equity-market breadth (either a broadening rally or a concentrated unwind).

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