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GLOBAL MARKETS ANALYST

Markets Outlook 2026: Some Like It Hot

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We recently laid out our 2026 Macro Outlook—Sturdy Growth, Stagnant Jobs, Stable Prices. We provide more detail on our Global Markets Outlook here, highlighting 10 core investment themes that drive many of our market views. More detailed outlooks for the individual asset classes are forthcoming in the new year.

1. **The cycle extends:** Sturdy global growth coupled with non-recessionary Fed cuts should be positive for global equities, but tensions with 'hot valuations' may increase volatility.

2. **A cyclical tailwind:** Our US growth view still looks higher than market pricing, but vulnerable to US labour market cracks.

3. **Disinflation back on track:** Inflation set to fall back to target levels by end 2026, as tariffs fade and medium-term forces (AI, China supply) come into view.

4. **More differentiation at the tail end of the global easing:** DM easing narrows to US, UK, and a bias towards lower rates, but better growth could challenge cut pricing.

5. **AI—markets ahead of the macro:** AI capex boom set to extend but valuations have run ahead, so higher volatility, wider credit spreads likely even with equity upside.

6. **The reverberations of China Shock 2.0:** China trade surplus set to grow to new records, putting gradual appreciation pressure on CNY.

7. **Fiscal worries dormant, not disappeared:** Benign inflation should limit upward pressure on long-dated yields. Fiscal positions still extended and fresh impulses could spark new worry.

8. **The cycle and FX—sturdy growth, shallow Dollar:** A more procyclical flavour to global FX, and still modestly USD bearish; hawkish Fed shift the main risk.

9. **EM—good after great:** A supportive backdrop from EM assets, rotate some risk from tech-sensitive markets to domestic exposures for balance.

10. **Late-cycle risks and hedges:** Alongside diversification, protection available in rates, FX, gold and equity volatility.

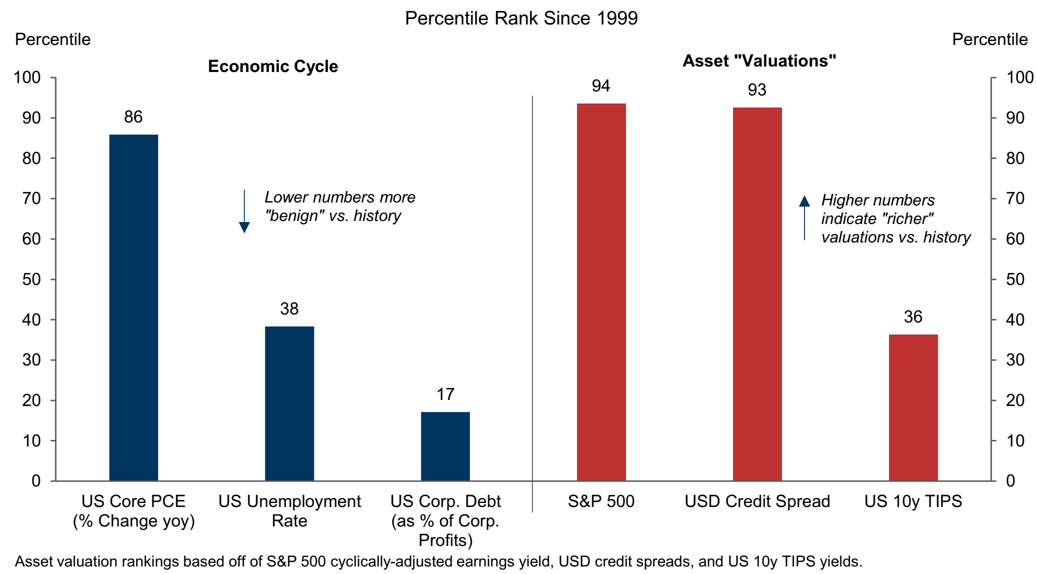
1. The cycle extends

- Sturdy growth plus non-recessionary Fed cuts should be positive for equities, EM assets
- A modest negative for the Dollar but a more cyclical tilt to FX
- ‘Hot valuations’ as markets have run ahead of the macro
- Positive cyclical backdrop should dominate but tension may increase volatility

Our baseline macro outlook is fairly benign. Despite stagnant job growth, we expect policy rate cuts to limit labour market weakness and help extend the economic cycle further. Rate-cutting trajectories are more mature, so while it is natural for markets to price a wider distribution of outcomes, low energy prices, fading tariff price pressures, and China’s low-cost exports should keep inflation anchored. That should allow for lower front-end yields in several markets, including the US, and restrain sell-offs in others. Taken together, another year of solid global growth coupled with non-recessionary Fed cuts should be a friendly backdrop for global equities and EM assets, and a modestly negative one for the Dollar.

But the challenge is that, in many respects, markets are well ahead of the macro—so there is a tension between ‘hot valuations’ in equity and credit markets and a macro cycle that does not quite show the imbalances and leverage typical of late cycles. Likewise, there is more debate about the market upside from AI-related investments, even as competition and leverage is picking up here too. Ultimately, if the economy weathers the near-term concerns around weak labour markets, the constructive cyclical backdrop should dominate valuation concerns, and equities should offer continued upside as better growth is realised. But the tensions here mean that we are likely to see volatility rise alongside equity price increases, and greater focus on re-leveraging could be more problematic for historically tight credit spreads. The deeper risk for richly valued assets is if dormant fiscal or institutional risks resurface and lead to steeper curves, or simply if economic growth or market overheating put the rate cuts we expect at risk and make rate hikes a realistic prospect. As a result, optimal portfolio hedges may need to oscillate between protecting the left tail and the right tail.

Exhibit 1: 'Hot' asset valuations contrast with a macro cycle that looks less stretched



Source: Haver Analytics, Goldman Sachs Global Investment Research

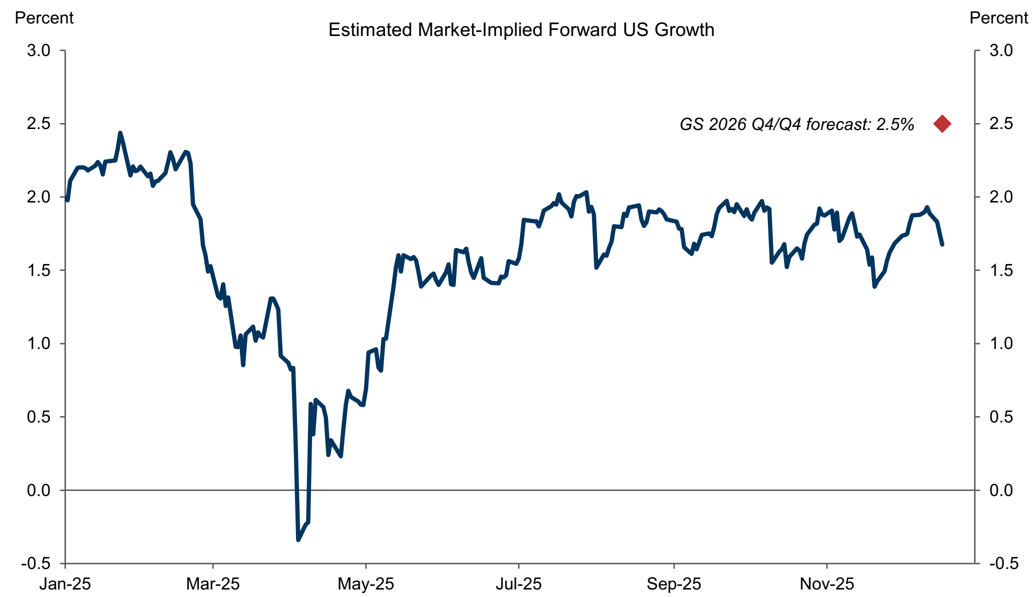
2. A cyclical tailwind

- Our US growth view still looks higher than market pricing
- Higher China growth more complex since driven by export supply
- Cyclical assets should see a tailwind
- But given low recession pricing, markets vulnerable to US labour market cracks

2026 is likely to be a year of healthy growth, both for the US and the world. As the tariff headwinds fade and fiscal policy turns supportive—not just in the US, but in Germany and Japan too—the growth backdrop should feel more secure. Our global growth views are meaningfully above consensus, driven most clearly by substantially more optimistic forecasts for the two largest economies, the US and China. As always, the critical question is the degree to which markets have already reflected this. Investors were quick to look through the growth pressures from tariffs; there are few signs of meaningful recession risk in market pricing of most assets; and, after a patch of worry in November, cyclical assets—including cyclical equities and copper—have been rallying again. But even after these recent moves, we think our more optimistic growth views are not fully reflected in markets. Our regular US growth benchmarking exercises put the current estimate of US GDP growth priced into bonds and equities at around 1.7%. This is well below our 2.5% 2026 Q4/Q4 GDP growth forecast, and further below our forecasts for the first half of the year. Our proxies for market views of China growth have also been rising. We have less confidence in our ability to benchmark those, particularly given the export-led nature of expected growth, but we still see good reasons to think our more optimistic growth view there is not fully reflected either.

If we are right that markets will need to upgrade their cyclical views, that should help to support risk assets in general. The composition of that upgrade likely favours assets that are geared to improving US demand, China's export engine and some recovery in global trade. European equities, which were the locus of cyclical optimism early in 2025, may lag this upgrade without fresh earnings optimism. By contrast, some cyclical assets that saw more weakness in 2025—including US housing and consumer-related areas—may also find more support in 2026 with a more secure growth backdrop. The main vulnerability remains a crack in the US labour market, if jobs softness tips into a more pernicious feedback loop. Because markets are only priced for limited recession risk, the impact of that on risk markets could be large, as we saw temporarily in August 2024 and April 2025.

Exhibit 2: Markets still have room to improve growth views towards our forecasts



Source: Goldman Sachs Global Investment Research

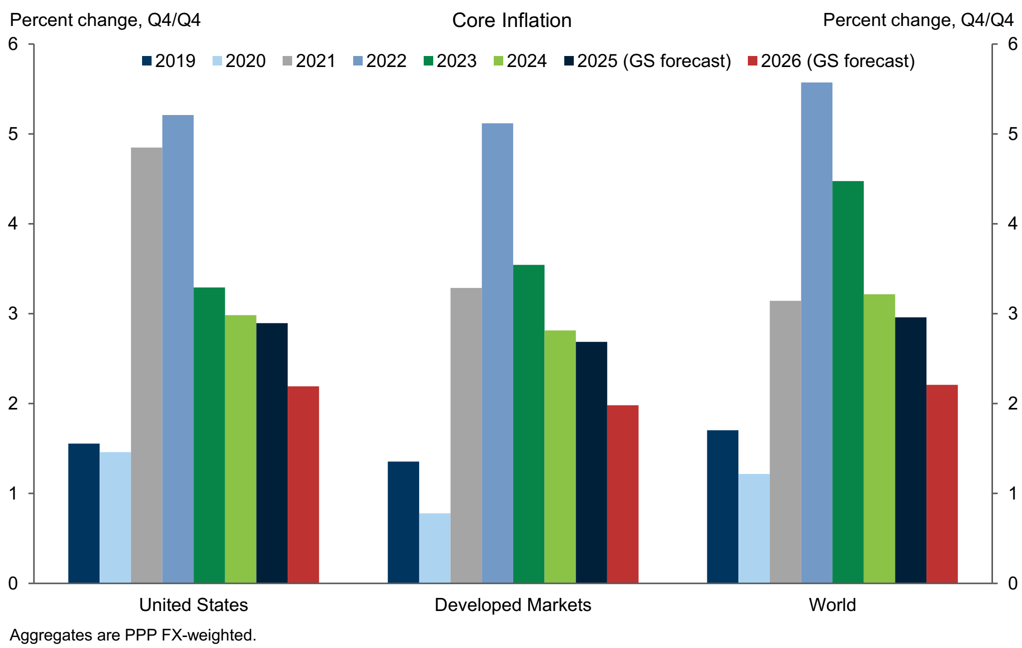
3. Disinflation back on track

- Inflation set to fall to pre-inflation surge levels by end 2026
- Medium-term forces (AI, China goods supply) also supporting disinflation
- Market pricing of inflation should remain benign even with better growth
- Risks from tighter labour markets, fiscal or Fed challenges

Alongside a sturdier growth environment, we expect further improvements in the inflation outlook too, as the impact of negative supply shocks fades and more positive ones take their place. We expect 2026 to be the year in which the long period of above-target global inflation that began in late 2021 is set to come to an end. For the US, fading tariff impacts should reveal an improving underlying inflation picture, while the declines in the UK are poised to be even sharper. But the story is a global one. We forecast that core inflation for the world as a whole and across most of the major DM and EM regions will end the year at its lowest levels since 2021H1. A soft US labour market should help to keep wage inflation in check, especially if the AI impact on the jobs market becomes more visible, while plentiful oil supply should keep energy prices in check. Longer-term dynamics—the AI shift and China's increasing trade surplus—are also bringing into view structural forces for disinflation.

As with growth, inflation markets already reflect a fairly benign view of inflation. Markets only briefly showed concern about persistent inflationary effects from US tariffs, and US inflation swap pricing for the next year or two has continued to decline. But our forecasts should still allow modest further room for inflation relief in the US and globally. If we are right that this can come alongside benign growth, this mix—and the better productivity growth story that it partially reflects—should reinforce a friendly environment for equities and would provide ongoing tailwinds for many EM assets. And a more benign US inflation picture could offset the upward pressure on US rates and the USD that might otherwise come from stronger growth. The main risks to this benign view stem from robust growth leading to tighter labour markets than we expect or—for longer-dated inflation expectations—from worries about the fiscal policy trajectory and central bank independence.

Exhibit 3: Disinflation gets back on track



Source: Haver Analytics, Goldman Sachs Global Investment Research

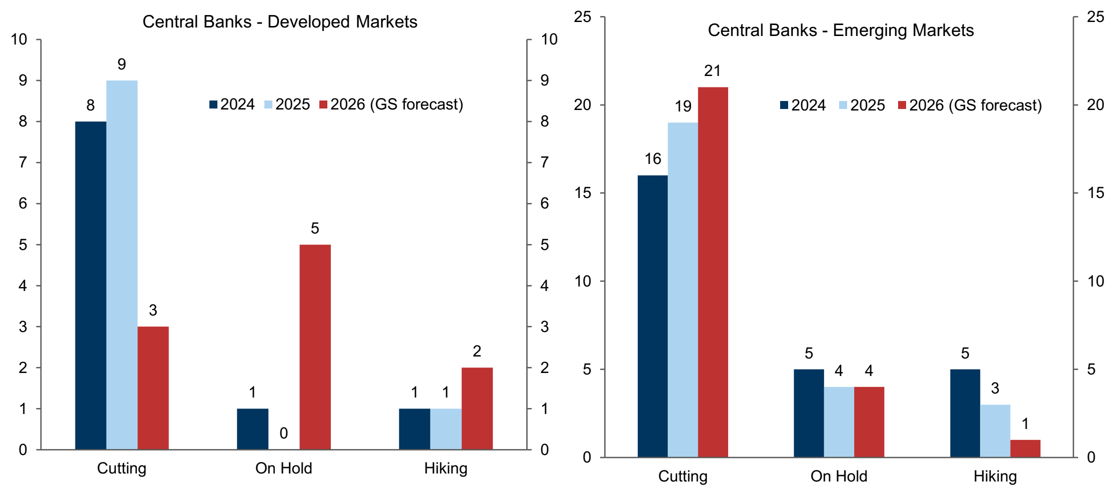
4. More differentiation at the tail end of the global easing

- DM easing narrows to US, UK, Norway
- More scope to ease in EM high-yielders
- Falling inflation keeps bias towards lower policy rates
- Falling unemployment rates could challenge rate cut plans

Falling inflation should keep the bias towards central bank easing, but the uniformity of this year's cuts is likely to be replaced by a more varied set of paths. With inflation on course to fall more sharply and labour markets still more fragile than elsewhere, we expect more cuts from the Fed, BoE and Norges Bank, which remain the three DM economies where our forecasts are clearly below the forwards. Easing inflation pressures should also allow many higher-rate EM economies to push policy rates materially lower. But across the world, we expect a larger number of central banks than in 2025 to stand pat, and there may be more differentiation across central banks than we have seen in the past 18 months.

The skew is still towards lower policy rates. We see scope for the market to price significant further Fed easing if the economy softens more than in our baseline, or the composition of the FOMC shifts more dramatically than we expect. And while inflation is set to return to 2021 levels, real policy rates are generally much higher than they were then. Those with higher real rates are likely, all else equal, to see more scope to nudge them lower, so there is a mild flavour of "convergence" in our policy rate forecasts. The threshold to hike seems high in the US and in many other economies. Japan is still the main exception to this general rule. We expect the gradual march higher in the policy rate to continue there, and fresh fiscal stimulus from the Takaichi administration should reinforce this dynamic. But the recent shift to pricing hike risk in Australia and Canada in the G10 and Czechia and Korea in EM (likely prematurely, in our view) illustrates that markets may be quick to lose faith in rate cuts whenever the growth/employment mix starts to improve.

Exhibit 4: More differentiation in central bank cycles in 2026, but still skewed to lower policy rates



Source: Haver Analytics, Goldman Sachs Global Investment Research

5. AI—markets ahead of the macro

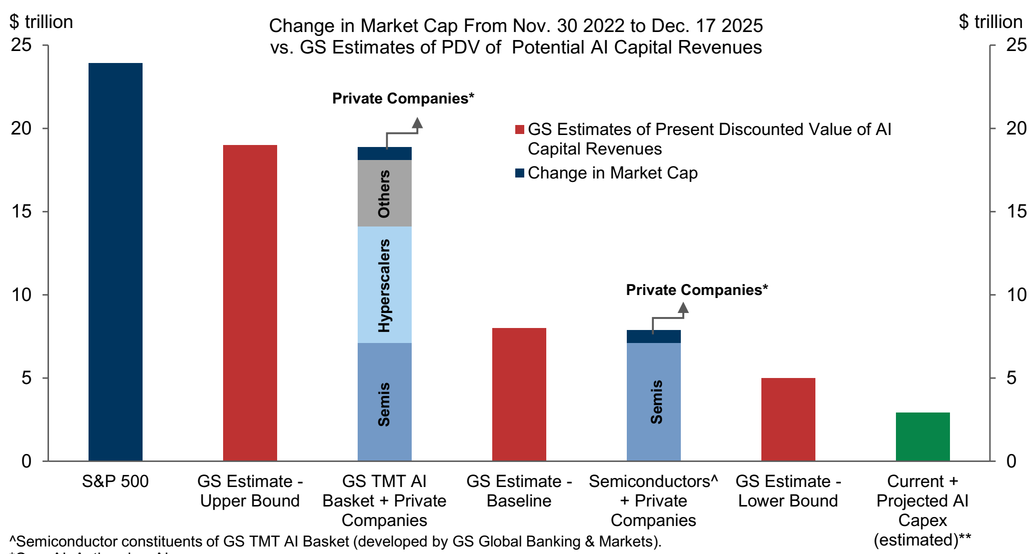
- AI capex boom set to extend and few macro imbalances yet
- But valuations have run ahead of the macro
- Debt financing of data centers increasing
- Higher volatility, wider credit spreads more likely ahead

The AI boom is likely to remain a central focus for markets in 2026. The good news is that the productivity benefits are probably only just beginning and there is room for AI investment spending to continue in anticipation of those benefits. The macro imbalances that contributed to the end of the late-1990s tech bubble are also less visible so far. Markets have (as is typical) run further ahead of the macro. Aggregate valuations are not as high as they were at the end of the tech bubble but are further along that path than the macro story. And the market has already built in significant benefits from AI into equity prices, especially in areas that are directly involved in the provision of models and related infrastructure.

As the capex boom extends, we think some of the imbalances that characterised the late

1990s may become a little more visible. Debt financing is becoming more important to the data center roll-out. And while corporate balance sheets remain quite strong overall, that strength is less exceptional than it was, and a tail of weaker balance sheet companies in the space is under more scrutiny. And as valuations have risen, there is more vulnerability to disappointment about the pace of innovation or monetisation, or to shifts in the technology that reduce the capital or energy intensity of AI model training. We think positive cyclical news is most likely to dominate elevated valuations (both for the economy as a whole and around the AI theme) and to result in further equity upside. But, as in 1998-2000, we think that rising equity prices are more likely to be accompanied by a shift higher in equity volatility and by (at least somewhat wider) credit spreads. Longer-dated US equity volatility has already been moving higher from its 2024 low point, and we think that trend can continue. Despite quite healthy corporate balance sheets, tight spreads make the asymmetry in US credit less attractive than in equities, in part because of the risks of higher leverage and more issuance ahead.

Exhibit 5: Significant benefits already built into value of AI-related companies



^Semiconductor constituents of GS TMT AI Basket (developed by GS Global Banking & Markets).
*OpenAI, Anthropic, xAI.
**Estimated based on stylized investment model and past investment cycles.

Source: Bloomberg, FactSet, Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

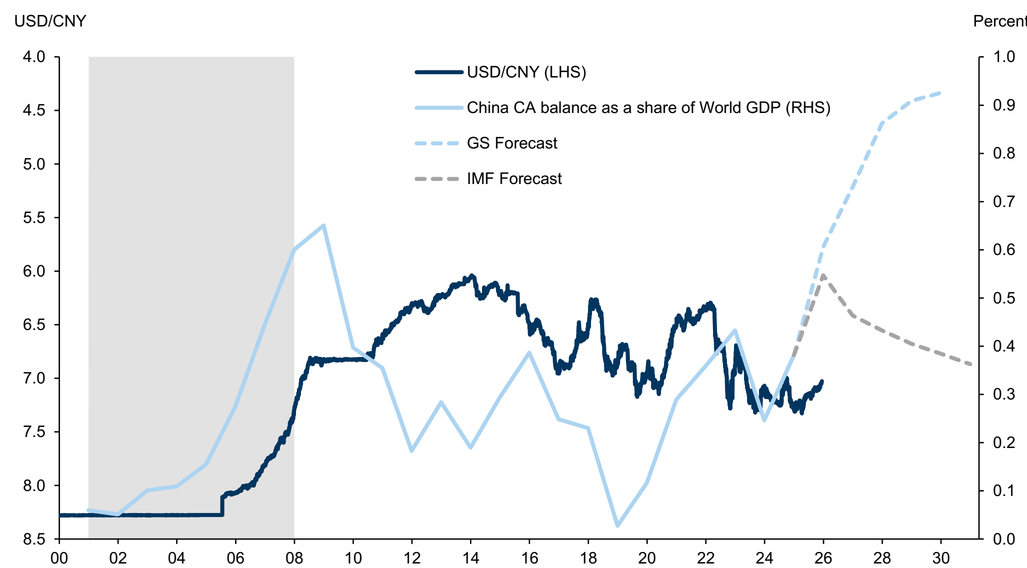
6. The reverberations of China Shock 2.0

- China trade surplus set to grow to new records
- Competitive pressures on Europe to increase
- A fresh disinflationary impulse and source of savings supply
- Gradual appreciation pressure on the undervalued CNY

The global implications of China's bifurcated economy—with deficient domestic demand but strong productivity and exports—are growing every year. Primarily, this is about scale: China's annual goods trade surplus exceeded $1 trillion for the first time in November and, as a percent of global GDP, our China team forecasts the current account surplus to exceed the levels last seen at the time of the first China shock in the mid-2000s. The attendant market share gains in global trade will likely result in both negative and positive spillovers to the global economy. On the negative side, the fact that China's manufacturing machine has moved up the value chain over the past 20 years means that there is greater export similarity and competition with Asian manufacturing economies and Europe, which also see little offsetting benefit from supplying intermediate and primary goods to China. But, equally, China's productivity advantage and overcapacity mean that producer price inflation is low and China will continue to export a strongly disinflationary impulse to the rest of the world.

The sustained export growth is a testament to the competitiveness of China's currency. As we have been highlighting, the degree of CNY undervaluation is also comparable to the period of the "China Shock" in the mid-2000s, and that was followed by large currency appreciation. We have already seen a shift towards CNY appreciation this year, with the USD/CNY fix gradually but steadily moving stronger since 'Liberation Day'. We expect that move to extend in the year ahead. Although the currency is tightly managed, policymakers should be comfortable with a gradual appreciation pace that helps advance RMB internationalisation while still leaving the currency cheap. Indeed, given the negative competitive impact on other countries, allowing modest but sustained appreciation is part of the equilibrating mechanism and can serve to ensure that the protectionist pushback is not too severe. A recycling of the current account surplus into global assets is another outcome but, given geopolitical and portfolio considerations, these investments may support a more diversified pool of global assets beyond US fixed income.

Exhibit 6: The last time China's external surplus was similarly dominant, it was followed by a large currency appreciation



Source: Haver Analytics, IMF, Goldman Sachs Global Investment Research

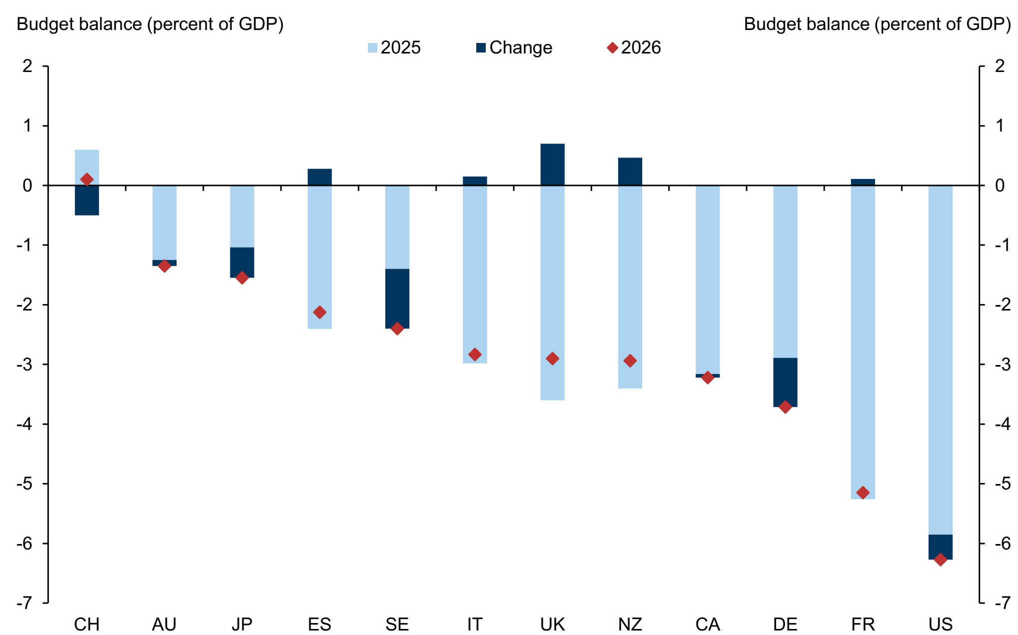
7. Fiscal worries dormant, not disappeared

- Fiscal risks have calmed since the summer
- Benign inflation should help limit upward pressure on long-dated yields
- But fiscal positions still extended and fresh impulses could spark new worry

Markets have worried less about fiscal risks since the summer, but the shift towards fiscal stimulus in Japan since the Takaichi election has reawakened some fears. That dynamic is likely to stay in place for much of the year ahead. Fiscal concerns tend to have the most market impact on bond markets when news around structurally stretched fiscal positions comes alongside cyclical shifts in inflation or growth, so it is not surprising to see fiscal concerns take a back seat given subdued inflation outturns. Anchored inflation through 2026 should continue to keep those worries in check despite fiscal impulses supporting growth most clearly in Germany (and we continue to expect Bunds to underperform), but also more modestly in Japan (where the case for rate shorts is becoming more balanced). In the US, higher growth and lower inflation push in opposite directions, and we expect yields to remain more range-bound in our baseline forecast.

That said, there has been little improvement in fiscal positions across major DM (and some EM) economies, and they remain worryingly stretched. This should keep long bond yields in a higher neighbourhood even with front-end rates moving lower. And this means that if new fiscal expansions are seriously proposed—such as the recently enacted supplementary budget in Japan or potential 'tariff rebate' cheques in the US—those are most likely to be the catalysts for fresh periodic tantrums across bond markets. But there are also possibilities of better fiscal outcomes. While the French budget (and government stability) is an ongoing risk, a path towards consolidation still seems achievable. In the UK, the much-anticipated budget was not a macro game-changer, but it did manage to walk the tightrope between fiscal, political and inflation risks. From here, we continue to think the softening trend in UK data and the prospects for faster-than-expected BoE easing will lead to further Gilt outperformance. And while fiscal concerns persist across EM as well, the sharp rally in SAGBs shows how quickly term premia can compress if a credible fiscal consolidation can be achieved.

Exhibit 7: Fiscal positions still stretched overall, but looking for improvement in UK, more spending in Germany



Source: Goldman Sachs Global Investment Research

8. The cycle and FX—sturdy growth, shallow Dollar

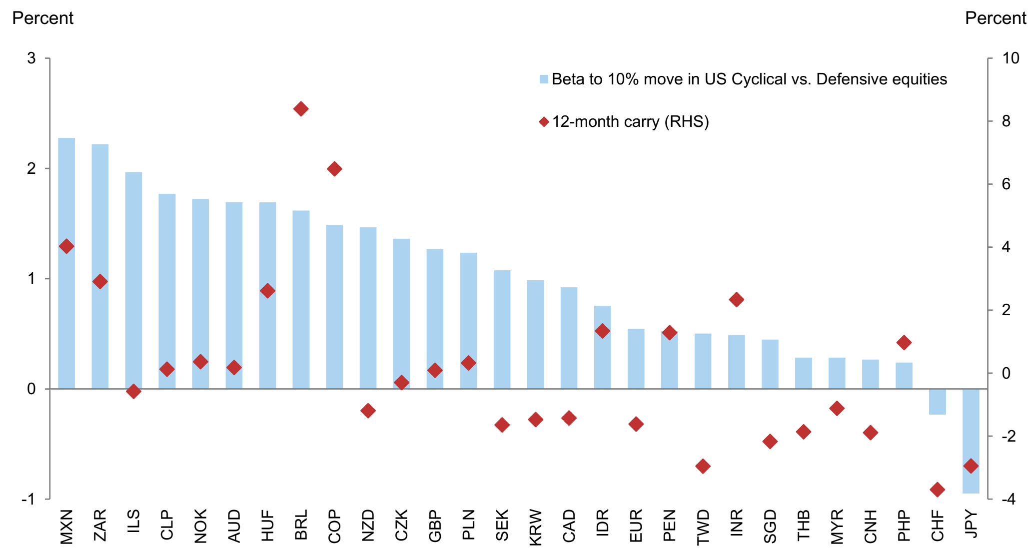
- A more procyclical flavour to global FX

- USD depreciation should continue but at shallower pace
- USD downside still offers protection against institutional risks
- Hawkish Fed shift the main risk to a weaker USD

The past year has seen a notable erosion in the Dollar's rich valuation from peak levels, reflecting less exceptional macro and market performance. At the same time, a meaningful shift in German fiscal policy led to a sharp reassessment in prospects for German growth and asset prices, with the Euro being a key beneficiary in H1. But with the Euro now having converged most of the way towards fair value of around 1.22, we see less reason for another sharp Euro-centric move from here. Rather, our baseline scenario of above-consensus growth in the US, China and much of EM, and positive equity sentiment, calls for a more procyclical flavour to global FX, with high beta G10 (AUD, NZD, Scandis) currencies the key beneficiaries. At this stage in the cycle, that likely comes along with new right-tail risks in the rates distribution, which probably shifts some of the performance away from the carry considerations that were so critical in H2, but cyclical EM currencies such as ZAR, BRL, KRW, and CLP should still see some beta benefits. By contrast, this type of macro backdrop would typically lead to Yen underperformance, especially if the local hiking cycle remains as reticent as this year, but lingering US labour market risks and already-elevated fiscal risk premia in the Yen probably make this a lower Sharpe expression at this point. It would also typically not be associated with strength in the tightly managed CNY but, as discussed above, we think a gradual appreciation in the highly undervalued CNY is warranted and likely.

The Dollar probably still depreciates against this backdrop of solid global growth, especially if the rate cuts we forecast in the US are delivered, especially as other central banks stand pat. But it is probably a much shallower move, and is probably not the central feature of the global FX outlook. Greater concern around a labour market recession, deeper cuts or a sharp derating in US tech exceptionalism could see a larger move lower given the prominence of demand for US equity exposure in supporting the Dollar in recent years. Markets have generally relaxed about institutional risks, but we still see an ongoing structural case for long gold positions—as central bank reallocations continue—and for deeper USD downside tails, where optionality looks quite cheap again. Relative to this baseline, a hawkish shift by the Fed would pose the clearest upside risk to the Dollar (and downside risk to alternatives such as the Euro, Yen and gold).

Exhibit 8: A procyclical backdrop for global FX



Betas estimated on weekly returns versus Dollar controlling for shifts in US 10-year real yields, oil, and copper prices over the last 10 years. We use GSPUCYDE to obtain data for US cyclical versus defensive stocks, ex-commodities (basket developed by GS Global Banking & Markets).

Source: Bloomberg, Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

9. EM—good after great

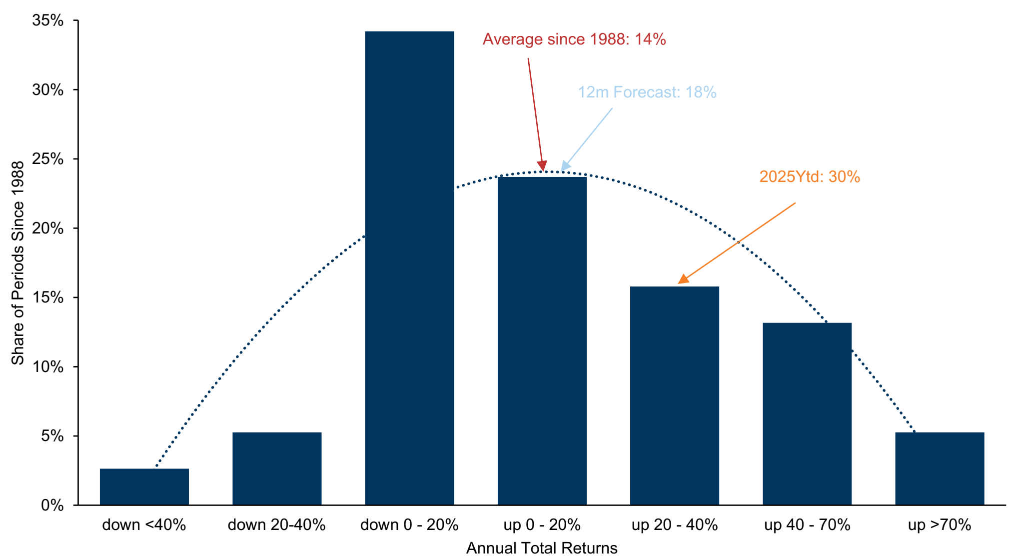
- A supportive backdrop from EM assets, amid less compelling valuation
- Main risks from return of US exceptionalism, more hawkish Fed
- Rotate some equity risk from tech-sensitive markets to Brazil, South Africa, India for balance
- Still good rate opportunities in more hawkish central banks

2025 is shaping up to be one of the strongest years across EM assets over the past decade, with double-digit gains across local and hard currency fixed income and around 30% gains in EM equities. So, valuations are now less compelling here too, with hard currency EM sovereign credit spreads at historical tights and carry currencies at the highs. But we think that a supportive macro backdrop of sturdy growth, Fed cuts and a soft Dollar should still yield good, if not great, returns. The main risks to EM performance also stem from the global side—a return to US exceptionalism and the prospect of fewer rate cuts or even US rate hikes that suck capital back from EM assets and into the US—so it would make sense to pair EM length in portfolios with US rate payers.

Setting aside global shifts, the improving macro fundamentals (solid growth, softening inflation) and the geographical breadth of EM exposures offer plenty of scope to build resilience. Within EM equities, which have also been supported by AI-related gains, while we still like the tech-sensitive equity markets across Korea, Taiwan and China, we prefer rotating some of the portfolio weights into the more domestic-oriented markets of South Africa, India and Brazil for better balance. Likewise, apart from broadening the funding mix, which can neutralise the risk- and dollar-beta of EM carry strategies, adding 2025 laggards INR and IDR can make carry baskets more resilient to pullbacks in

2026. And whereas most EM low-yielders are at the tail end of rate-cutting cycles, the more hawkish central banks across HUF, BRL and COP provide fertile ground for local rate opportunities given starting valuations and scope for deep cuts.

Exhibit 9: The regional diversification within EM assets should add up to a solid year, after a superb one
MSCI EM annual total returns (USD)



Source: FactSet, Goldman Sachs Global Investment Research

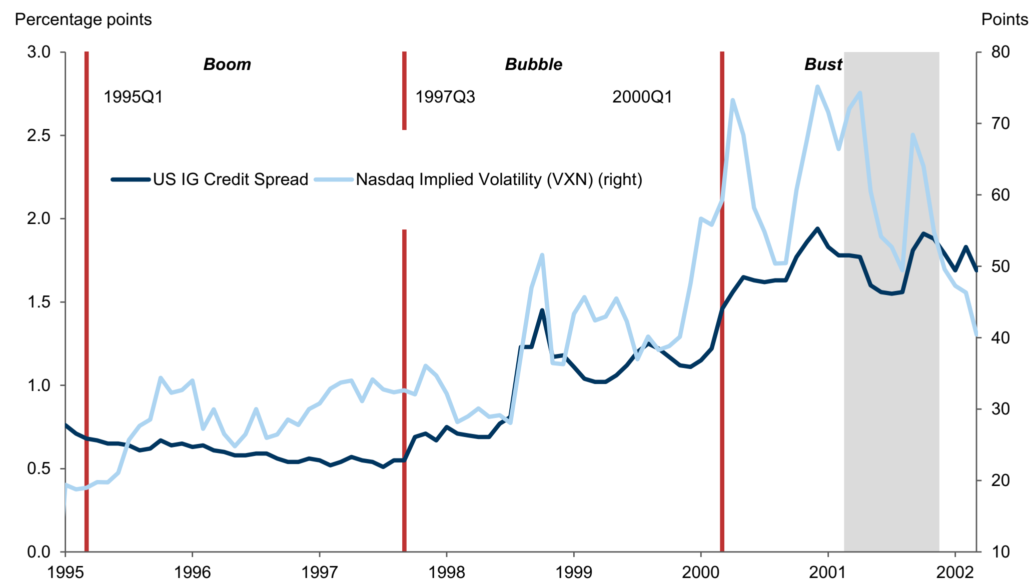
10. Late-cycle risks and hedges

- Risks from US labour market weakness in near term
- Better growth could lead market to challenge rate cuts
- AI theme unwind the other key market risk
- Alongside diversification, protection available in rates, FX, gold and equity volatility

Our macro baseline is a friendly one. But as the cycle extends and there is less of a buffer in valuations, there are macro and micro risks that need to be navigated through the year. The key downside risk is still the prospect that the US labour market deteriorates in a way that brings recession risk back onto the table. This would be the biggest macro challenge to risk markets, which are pricing low recession risk. With the market priced for less than a single Fed cut out to the April meeting, downside in the front end of US rate curves (and likely in the rate curves now pricing hikes outside the US) offer good protection against that outcome, as does USD/JPY downside. If that recession risk is put to rest on the back of better growth news, the focus is likely to be more on the risks from higher rates, as we have seen recently in Australia and Canada. For the US, 2027 and 2028 pricing (and 5-year rates on the Treasury curve) are most vulnerable to worries about the Fed's ability to cut further, supporting the case for front-end (Z6/Z7) steepeners. But optionality on higher longer-dated yields (in the US and elsewhere) should be more protective against renewed worry about fiscal sustainability and global spillovers. Both may have a role to play in portfolios.

Alongside these standard macro risks, the biggest micro risk to the US equity market is a challenge to the AI theme. The ongoing tension between high valuations and a friendly cyclical backdrop in the US reinforces our preference for diversified equity exposures both internationally (including to EM and Japan) and across sectors (to include some more classically cyclical sectors or cheaper defensive areas such as healthcare). Rate downside should again be protective against that risk, but we think positioning for higher longer-dated equity volatility, and possibly underperformance in credit, is a good late-cycle addition to a long risk portfolio.

Exhibit 10: Credit spreads and Nasdaq vol reset in 1998 even as equities climbed further



Shading indicates NBER recessions.

Source: Bloomberg, G. William Schwert, Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Kamakshya Trivedi, Dominic Wilson, Vickie Chang and Victor Engel, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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