

## The bear case for stocks in 2026

By Jesper Rangvid

*Stocks usually rise over time, but in 2026 the list of risks is hard to ignore. The very forces that could support equities—expansionary monetary and fiscal policy in the US, together with massive investment in AI—could just as easily push inflation higher. If that happens, stocks would almost certainly suffer. Also, just a year ago, people might have looked at you in disbelief, thinking you were crazy, if you had argued that there was a real risk of a serious (political) conflict between the US and Europe. Today, this is something that cannot be ignored. Set against a highly concentrated market trading at elevated valuations, the risk of a meaningful setback is non-trivial.*

The start of a new year is a good time to reflect on what may lie ahead for stock market investments.

In my previous analysis ([link](#)), I examined the factors that could work in favour of equities in 2026—the aspects most commonly emphasised by Wall Street and investment houses. Far less often do we see a detailed discussion of what might go wrong. Although markets tend to rise over time—indeed, historically they have increased in roughly three out of every four years—looking ahead to 2026 reveals several meaningful risks that we need to discuss.

### Very low expected returns

We enter 2026 with many assets priced to perfection. Speculative assets such as gold and silver have enjoyed an astonishing, near-vertical run, while government bonds in

several countries have barely budged despite surging debt levels and increasingly reckless policymaking. Equities, that this post deals with, are trading near all-time valuation highs. The air feels frothy—and as history reminds us, sentiment can turn in the blink of an eye.

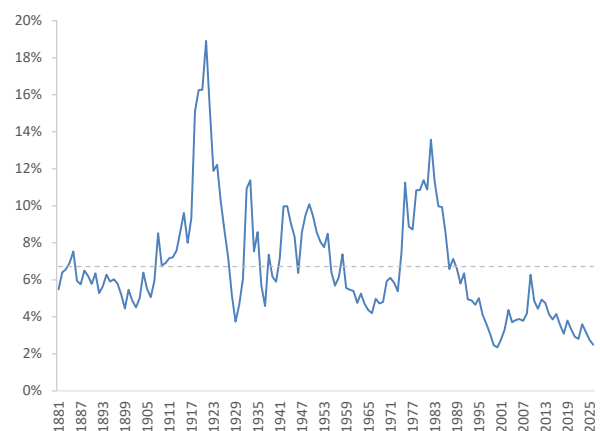
As I demonstrated a few months ago, the cyclically adjusted price-earnings ratio (CAPE) of the S&P 500 is close to an all-time high ([link](#)).

The price-earnings ratio indicates how much investors are willing to pay for one dollar of corporate earnings. Its inverse shows how much earnings are obtained for each dollar invested; this is known as the earnings yield.

Because earnings ultimately underpin company valuations, the earnings yield can be viewed as a proxy for the expected real return from the stock market.

Figure 1 illustrates the evolution of the S&P 500's earnings yield over the past 155 years. As the chart shows, the earnings yield is now close to a historical low.

**Figure 1.** *Cyclically-adjusted earnings yield from the S&P 500. Dotted line is the long-run average. Source: Shiller data and J.Rangvid.*



In my 2020 book ([link](#)), I discuss both the theoretical arguments and the empirical evidence for why the earnings yield can be viewed as a reasonable proxy for the expected long-run real returns on equities, such as over the coming decade.

Figure 1 suggests that real returns from the S&P 500 are likely to average around 2.5% per year over the next decade. That is not a lot.

The figure also includes the long-run average earnings yield, which stands at 6.7%. When investors are willing to buy equities at such low expected returns—or, equivalently, at such high prices—it points to a degree of market frothiness.

At some point, investors will demand a more “normal” expected return. There are only two ways this adjustment can occur: either corporate earnings rise substantially, or equity prices fall.

As an academic, I am shaped by the academic literature, which overwhelmingly suggests that valuations typically normalise through falling stock prices rather than surging earnings—at least in the context of the US stock market.

One important caveat here is that earnings yields are predictors of long-run returns. Even if the signal is correct and prices ultimately adjust, it does not imply that this must happen next year. Nevertheless, it is a risk worth highlighting—particularly given the extreme concentration of today’s stock market, which is my next point.

### **Stock market concentration**

I have written about this issue many times ([link](#), [link](#), [link](#)), but given that this post

focuses on the downside risks for 2026, it is worth revisiting it briefly. A very small number of stocks—largely concentrated within a single sector, that is, the tech-industry—are currently driving the US stock market and, by extension, global equity performance. This represents a clear risk, not least because evidence shows that highly concentrated markets tend to be associated with lower subsequent returns ([link](#)).

While the debate over whether we are in a bubble rages on, it is difficult to recall another period when valuations were so elevated and the market so concentrated. If even a few of the mega-cap AI-related companies were to disappoint, this could rattle the entire market. I believe this is a genuine risk. Whether it materialises in 2026 is, of course, uncertain, but it should be factored into the outlook.

### **Inflation risks**

Several factors point towards the possibility of an inflation resurgence in the US in 2026.

Inflation remains too high at around 3% and has shown little sign of sustained easing. The November data—showing a small decline to 2.7%—was likely distorted by missing information related to the extended US government shutdown. Until we get more evidence, I will not be reassured by this inflation number.

In my previous post, I highlighted several factors that could boost equity markets in 2026 ([link](#)). For example, loose fiscal policy could add further fuel to demand. Additional interest-rate cuts by the Federal Reserve—potentially influenced by a new chair more aligned with President Trump’s preference for lower rates—would also put upward

pressure on prices. A weaker dollar would raise the cost of imports, while further tariff spillovers would add to inflationary pressures.

At the same time, the US labour force may shrink due to deportations of immigrants. This could lead to higher wages and, in turn, higher prices. If these forces were to coincide, a renewed bout of inflation in the US would be highly likely, as I discussed in a post a few months ago ([link](#)).

A resurgence of inflation would be very negative for equities. The Federal Reserve would be forced to raise interest rates, risk aversion would increase, and investors would become more reluctant to hold risky assets. The experience of 2022—when markets fell sharply following an inflation surge—remains fresh in investors' minds. Should inflation rise again, equity markets would almost certainly suffer. Given today's degree of market concentration and investor froth/AI-hype, the fall would potentially be larger than in 2022. An inflation flare-up may be the biggest risk for equity markets in 2026.

### **Tariffs and household consumption**

In my previous post ([link](#)), I noted that tax cuts under the “One Big Beautiful Bill Act” are likely to boost household incomes in 2026. However, tariffs—another of Trump's policies—will raise prices of imported goods. Research by the Budget Lab at Yale has examined the combined effect of tax cuts and tariffs ([link](#)) and finds that, taken together, these policies are likely to reduce incomes for most households.

Moreover, the Fiscal Impact Measure constructed by the Hutchins Center—which

I highlighted in my last post—computes the fiscal impulse using a single marginal propensity to consume (MPC); how much people increase consumption when their income goes up. This assumption matters because research shows that high-income households typically increase their spending less than low-income households in response to a tax rebate ([link](#)). As I showed in Figure 4 in my last post ([link](#)), it is mainly high-income households that benefit from the OBBBA tax relief. As a result, the fiscal impulse implied by the Hutchins Center's analysis may be overstated.

### **What is the “normal” return on equities: 10% or 7%?**

In my previous post, I noted that equities have delivered returns of around 10% per year since 1970. This holds across US and global markets, whether one looks at data starting in the 1970s or focuses on the past two decades. Using this historical average as a benchmark, a 10% annual return does not appear out of the ordinary.

However, even a sample beginning in 1970—long as it may seem—may not be sufficient to fully capture the underlying distribution of equity returns.

Indeed, the post-Second World War period has been exceptionally strong for equities. Using Robert Shiller's data, the US stock market has returned around 13% per year since the Second World War, compared with only 8.6% before then (see Table 1).

There has also been a striking shift in the composition of equity returns. Since the Second World War, capital gains have been almost three times higher than in the

preceding period, while dividend yields have been markedly lower.

**Table 1.** Annual average dividend yield (DY), capital gain (CG), and total return from the S&P 500 over different periods.

Source: Shiller data and J.Rangvid.

	DY	CG	Returns
1870-1945	5.4%	3.2%	8.6%
1945-2025	3.7%	9.1%	12.8%
1870-2025	4.5%	6.3%	10.8%

This matters when forecasting the level of the S&P 500 at the end of the year—as discussed in my previous post—because the answer depends critically on whether one treats the pre- or post-Second World War period as the appropriate benchmark for what is “normal”.

In Table 1, I present simple nominal returns. One could instead examine real returns or the equity risk premium. The conclusion would be the same.

So, what is the “normal” return we should expect from equities? Eugene Fama and Kenneth French addressed this question in depth in their 2002 paper “*The Equity Premium*” ([link](#), [link](#)). They argued that the strong realised performance of the aggregate US stock market in the postwar period is unlikely to represent the historical norm. A substantial portion of the observed postwar equity premium, they concluded, reflects unexpected declines in discount rates—that is, valuation changes—rather than persistently high expected returns. Crucially, they inferred that future expected stock returns should be lower than those implied by postwar historical averages.

This conclusion does not imply that 2026 will necessarily be a poor year for equities—

that is not my point. Rather, the point is that the roughly 10% annual return often treated as “normal”, and which underpinned the baseline bull case in my previous post, may not be the right benchmark. If the world is characterised by structurally lower interest rates and a lower equity risk premium than in earlier periods, a more reasonable baseline expectation could be materially lower—perhaps closer to 6.5%. This aligns with the long-term forecast of the Council for Return Expectations, which I chair ([link](#)).

It is worth noting that Fama and French wrote their paper at the turn of the millennium. In the years since, equity returns have been high rather than low. In that sense, their prediction has not yet been borne out. But it may still prove correct in the long run.

### **A serious escalation of the conflict between Europe and the US**

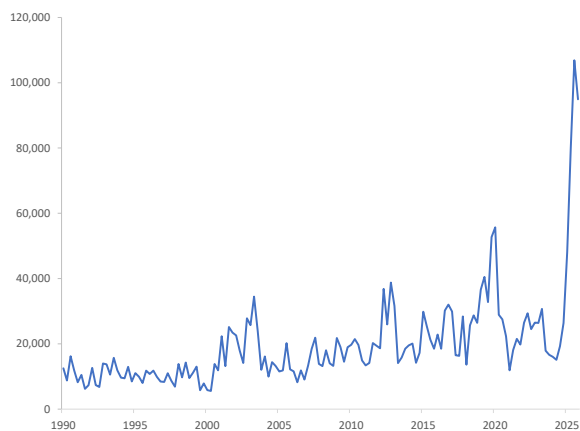
Finally, the point you don’t want to think about, but unfortunately must.

We live in unprecedentedly uncertain times. Figure 2 illustrates the Global Uncertain Index of Ahir, Bloom, and Furceri ([link](#)). Recent events suggest that 2026 could prove even riskier. A materialisation of these risks would rattle stock markets, like in spring 2025 ([link](#)).

With Trump’s repeated threats against a close ally (Denmark), and general dislike of Europe—you remember the “*The European Union was formed to screw the United States—that’s the purpose of it, and they’ve done a good job of it. But now I’m president*” quote ([link](#))—an escalation of tensions between Europe and the United States cannot be ruled out ([link](#)).

**Figure 2.** Global uncertainty index, 1990Q1-2025Q4.

Source: [World Uncertainty Index](#) and J.Rangvid



U.S. President Donald Trump wants Greenland. He reiterated this ambition shortly after the Venezuela episode, in which the United States used strong military force to achieve its objectives ([link](#)). The timing has prompted speculation about whether he might imagine taking a similar approach toward Greenland. Instead of rejecting such an idea as outright absurd, the White House has deliberately left it on the table.

Just think about it: a NATO member—the United States—is openly refusing to rule out the use of military force against another NATO ally ([link](#)). It’s hard to find words for how extraordinary that is. A year ago, such a scenario would have seemed unthinkable. And yet, here we are.

Europe finds itself in a very difficult position. On the one hand, it is reluctant to provoke Trump, not least because Europe currently lacks the military capacity to fully defend itself. On the other hand, constant threats tariffs, and intimidation cannot be tolerated indefinitely.

The tariff agreement reached in August was already seen by many in Europe as a

humiliation, as it involved largely accepting terms unilaterally imposed by Trump. If he continues to insist on “taking over” Greenland, and persists in bullying Europe, there may come a point at which Europe feels compelled to respond decisively.

Hopefully the situation de-escalates. But if it does not—and if Europe were to view this as a serious threat and respond collectively—it could retaliate by restricting exports of steel, pharmaceuticals, and shipping services to the United States, imposing tariffs or sanctions on imports of U.S. technology services, or limiting U.S. foreign direct investment. The United States would almost certainly respond in kind, and the result could be a serious trade confrontation.

Although this remains a low-probability scenario, its potential impact is severe, and the likelihood is unfortunately increasing by the hour.

Would this hurt Europe? Yes.

Would it hurt the United States? Yes.

Is it impossible? Unfortunately, no.

Would it hurt stock markets? Severely.

### Conclusion

It is usually a safer bet to predict that the stock market will rise rather than fall. Still, there are some serious risks in 2026 that warrant close attention. Chief among them is the possibility of an inflation resurgence, driven by strong economic stimulus from expansionary fiscal and monetary policy, alongside heavy investment in AI.

If inflation were to pick up and force the Federal Reserve to raise interest rates, equities—currently priced at elevated

valuations—would come under significant pressure.

Whether this or other negative scenarios materialise is, as always, uncertain. But it does suggest some caution before fully maximising exposure to equities in 2026.