

Biweekly Investment Insights: We know this much at least: there's never a dull moment

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Volatility returns but base case remains

- Trade tariff & geopolitical uncertainties reemerge impacting equity volatility & government debt markets
- Economic fundamentals underpin a cyclical bias in equities, though it's a daunting task to unseat mega cap tech as the U.S. index leader
- Q4 2025 earnings off to a mixed start early in reporting season

Summary

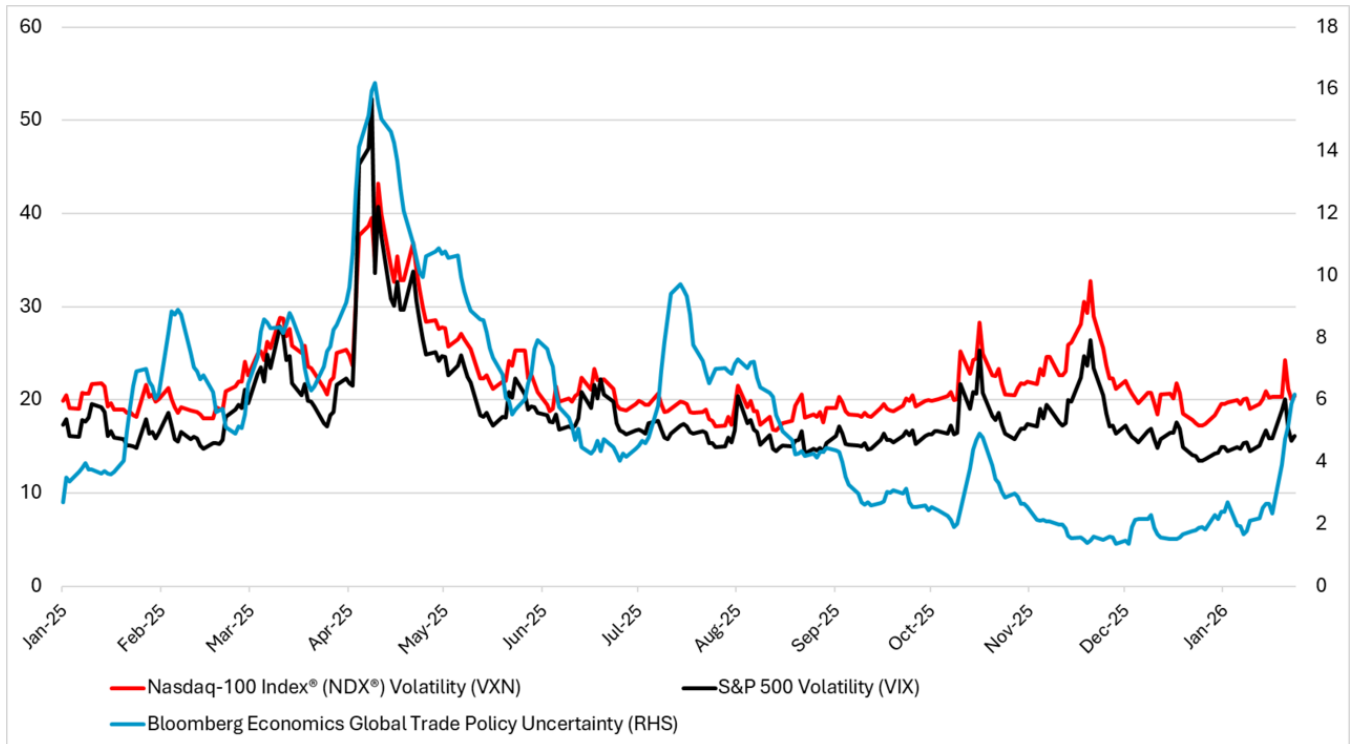
As we noted in our [prior piece](#), a key near-term risk to the broadly constructive outlook for the markets is, of course, a return of macro volatility. Amidst geopolitical concerns and the reemergence of trade tariff rhetoric, augmented by fiscal concerns centered in Japan, equity volatility and fixed income markets reflected this angst—e.g., Japanese 10-year government bond yields hitting their highest in 27 years.

The markets were whipsawed as they watched whether newly threatened U.S. trade tariffs of 10% on select European countries' imports would become a reality on February 1st or were more of a negotiation tactic due to the debate over Greenland's future. As of the time of this writing, it seems as if it is the latter as the U.S. announced that these tariffs will not be imposed.

Through the macro volatility, investors continue to focus on economic data and corporate trends. Fiscal policy is expected to be not only expansionary in the U.S. as the Congressional Budget Office (CBO) estimates that the One Big Beautiful Bill, passed in mid-2025, will add 0.9% to U.S. growth, but in Japan and Germany as well. Given their tendency to be more sensitive to the economic cycle, these dynamics likely bode well for the cyclical parts of the U.S. equity market which have outperformed since the end of October. This is reinforced by expectations of earnings broadening across U.S. sectors in 2026 (as we also noted in our prior report).

We expect that this broadening in earnings growth—underpinned by the aforementioned fiscal boost, accommodative financial conditions (with the usual caveats around the Federal Reserve's independence), and a resilient economy driven by the AI trend—will likely also permeate into broader equity returns. However, it will be very difficult to outright dethrone the mega cap tech space given its concentration in broader U.S. equity indices, and as the technology and communication services sectors are estimated to drive over half of corporate earnings growth in 2026.

Biweekly Charts in Focus: Global trade policy uncertainty at a 3-month high reflected in U.S. equity volatility measures



Source: Bloomberg. Notes: as of January 23, 2026. Global Trade Policy Uncertainty (TPU) Index measures the level of uncertainty surrounding global trade policy. TPU Index searches news feeds covering economics, research & government topics.

Details

Market volatility stirs

The “all everything” rally of 2025 continued into the first half of January. In tandem, risk indicators such as equity volatility and a proxy for global trade uncertainty hovered near or were at their lows of the past year. As a proxy for investors’ positive sentiment, Bank of America’s January global fund manager survey showed that investors were the most bullish since July 2021, that nearly half of the participants do not have protection against a sharp drop in equities—the highest proportion since January 2018—and that cash levels are at record lows going back to 1999.

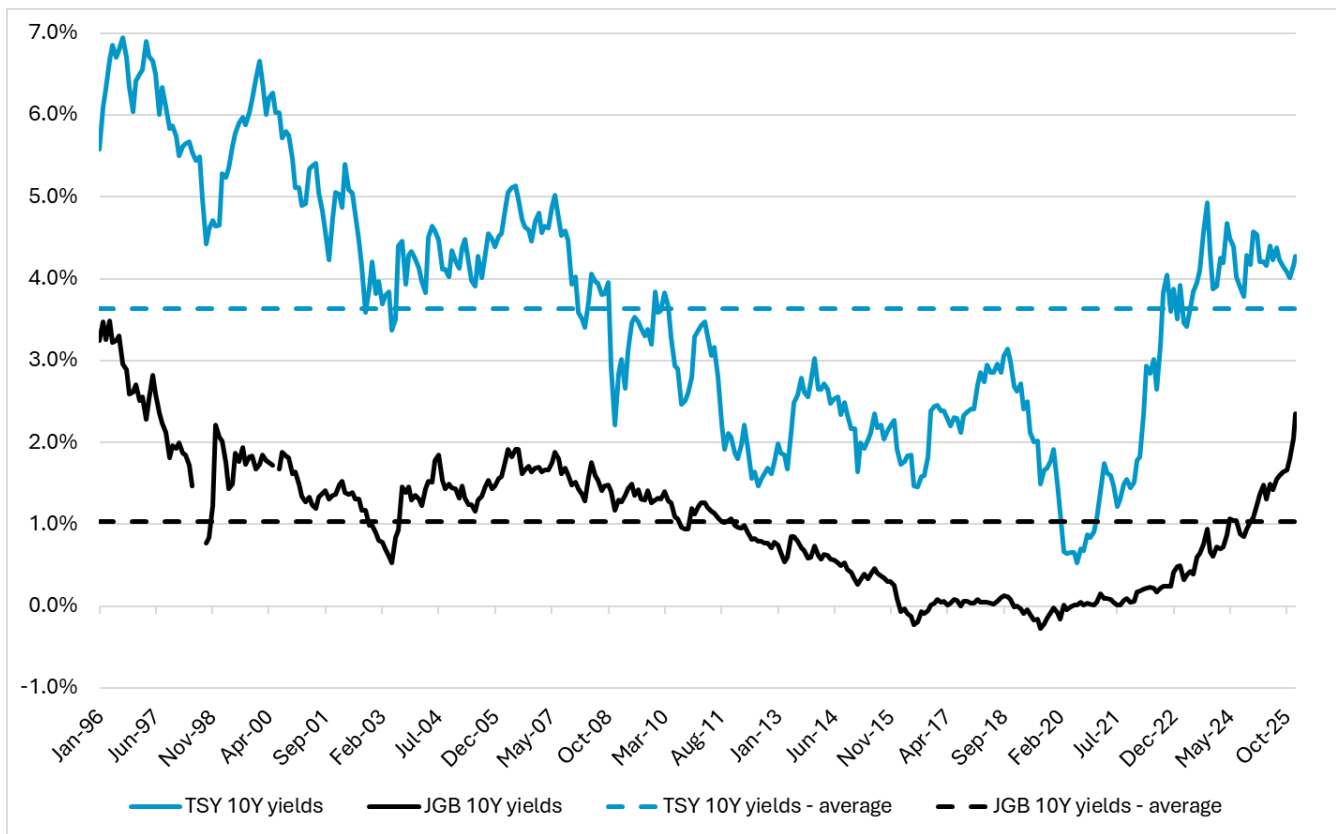
However, investors were quickly reminded of the impact which trade tariff and geopolitical uncertainties have on the complacency which has permeated in financial markets as 2026 began—see our Biweekly Chart in Focus above. The trade volatility du jour came with the U.S. threatening a 10% tariff beginning February 1st (rising to 25% on June 1st) on imports from those European countries and NATO allies which participated in a recent military exercise seemingly in opposition to the U.S. government’s desire to annex Greenland. Though the situation is fluid, these tariffs were then seemingly called off after a “framework” deal was reportedly reached.

Almost concurrently, Japanese Prime Minister Sanae Takaichi of the Liberal Democratic Party (LDP—larger member of the two-party ruling coalition) proposed that the government forgo sales tax on food for two years if she is re-elected in the country’s February 8th snap elections. UBS noted that the revenue from the consumption tax on food accounts for 6% of the total general account tax revenue and 0.8% of GDP. These

fresh concerns around Japan’s fiscal policies, coupled with uncertainties around the Bank of Japan’s (BoJ) benchmark interest rate’s path—currently at 0.75%, highest in 30 years—pushed investors to sell-off JGBs, particularly at the long-end of the yield curve. 30-year JGB yields spiked by 27 basis points alone on January 20th—the largest daily increase since data began in September 1999 and, per Bloomberg, equivalent to a z-score of 8.

The sell-off in JGBs has had a gravitational pull on bond markets globally with the likes of Treasury 10-year yields approaching 4.3%—a 3-month high (Figure 2). Treasury 10-year yields are now higher by over 60 basis points since the Federal Reserve began cutting rates in mid-September 2024. As we discussed in our [year-end piece](#), this is the first time since 1998 that Treasury 10-year yields have moved higher during a Fed rate cutting cycle.

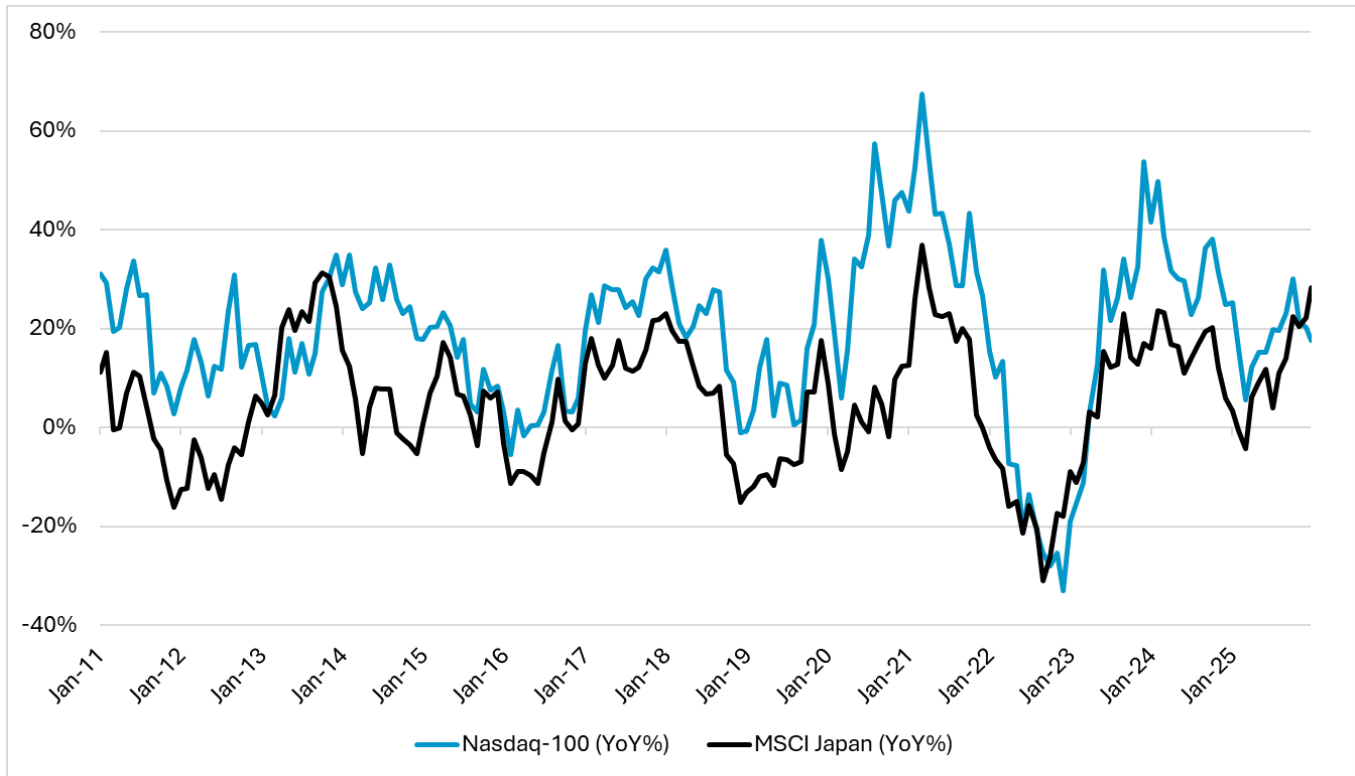
Figure 2: JGB 10yr yields at their highest since July 1997 (monthly)



Source: Bloomberg. Notes: Monthly. JGB 10-year yield data not available June – August 1998.

Despite the steady increase in JGB yields, removing the Covid-19 snapback period, Japanese equities are at their highest on a year-over-year basis since 2013 when Japan had embarked on its “Abenomics” policies and the BoJ’s massive quantitative easing (Figure 3). This time, though, the rally in Japanese equities has been primarily driven more by fundamentals than fiscal and monetary stimulus, including: solid economic growth, corporate governance reforms and shareholder-friendly measures, and exposure to the global AI trade. Additionally, the Yen is still hovering near its weakest levels in almost 40 years relative to the U.S. dollar which historically is beneficial for Japanese equities, particularly exporters.

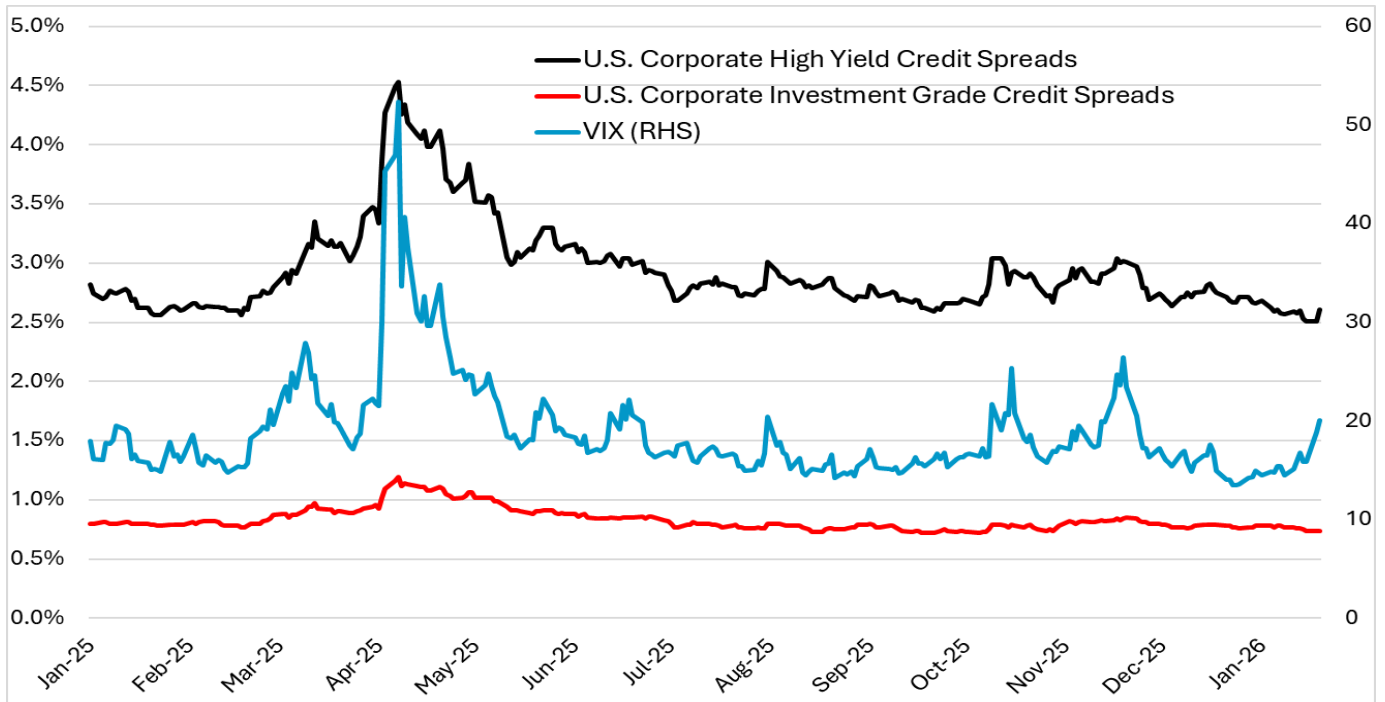
Figure 3: Nasdaq-100 vs. MSCI Japan YoY% (USDs)



Source: Bloomberg. Notes: Monthly, in USDs.

As a proxy for stresses in the U.S. corporate debt markets, Figure 4 shows U.S. corporate high yield and investment grade spreads relative to Treasuries. There was a very slight widening of high yield spreads off of their tightest levels since June 2007 alongside the recent rise in equity volatility. While likely reflecting some complacency and valuations are very rich at these levels, corporates credit spreads remain behaved given the ongoing fundamental tailwinds.

Figure 4: U.S. corporate credit spreads remain in-check



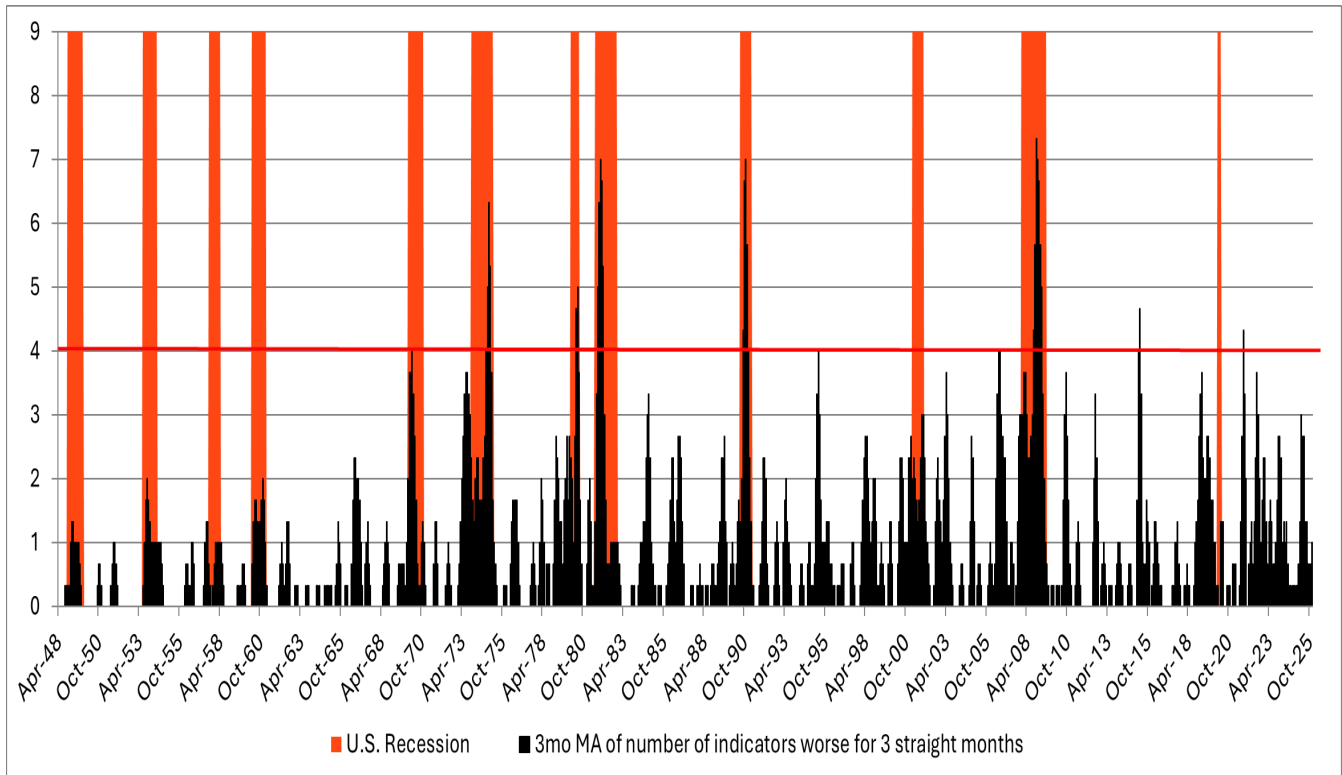
Source: Bloomberg. Notes: as of January 20, 2026.

Fundamentals are the ultimate driver

For now, we do not see the latest macro volatility and uncertainties which have permeated across equity and fixed income markets as likely to cause a shift in the fundamental outlook. Therefore, our base case remains in place as we continue to monitor the latest cross-currents: a solid corporate earnings backdrop, supported by a relatively resilient economy—albeit one with a softer employment picture—and the AI theme, fiscal stimulus in 2026, and ongoing deregulation. These dynamics are further supported by accommodative financial conditions and lower Fed rates.

Taking a step back to look at broader U.S. economic trends, Figure 5 analyzes the number U.S. economic indicators which have worsened sequentially for at least three straight months (across a mix of consumer and business indicators). This reading currently sits at one. Since the early 1970s when the U.S. began to shift even further to a services-led economy from a manufacturing-driven one, we usually see a reading of four before the proverbial red flags are waved.

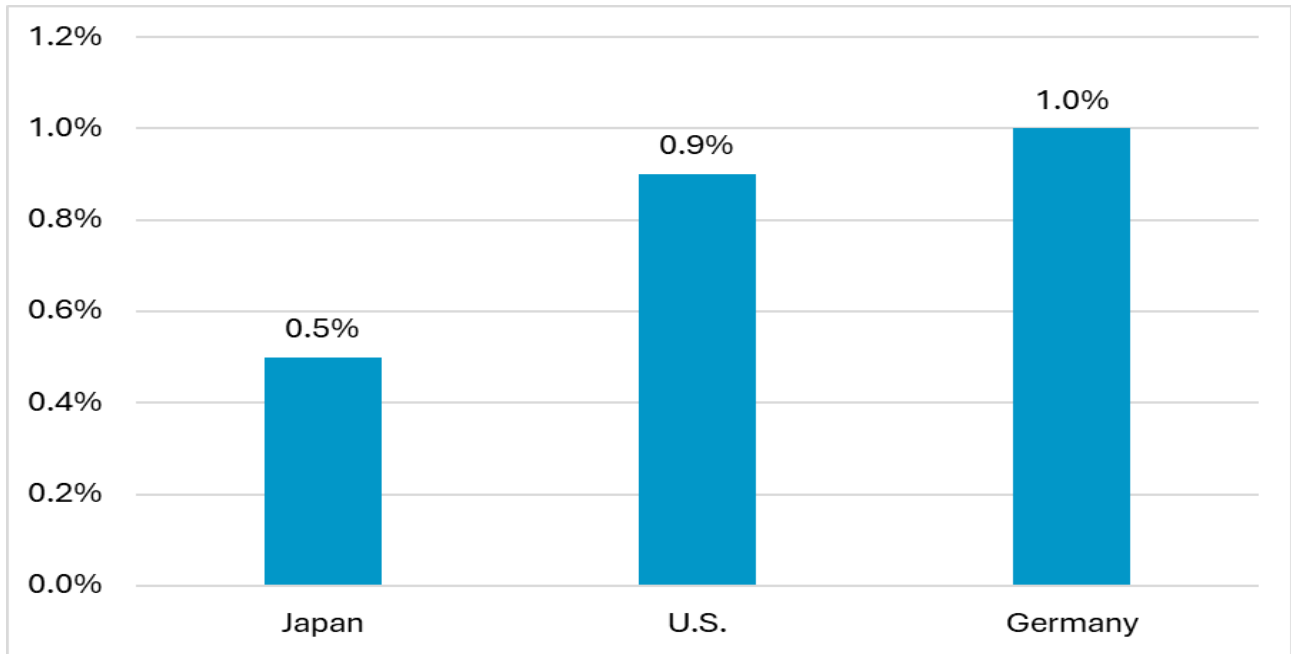
Figure 5: 3-month average of U.S. consumer & business economic indicators that have worsened for 3 consecutive months



Source: Bloomberg. Notes: monthly data as of December 2025. Mix of consumer (e.g., Conference Board consumer confidence expectations, initial claims, housing starts) and business (e.g., ISM new orders, regional Fed surveys, NFIB Small Business Confidence) indicators. Takes the 3mo moving average of the number of indicators which have worsened sequentially for 3 straight months.

Another dynamic that is expected to be a tailwind for economic growth in the U.S., as well as in Japan and Germany, is fiscal stimulus. Estimates are for the One Big Beautiful Bill to boost U.S. growth by 0.9% in 2026, and that fiscal policies will add 1% to growth in Germany and 0.5% in Japan (Figure 6).

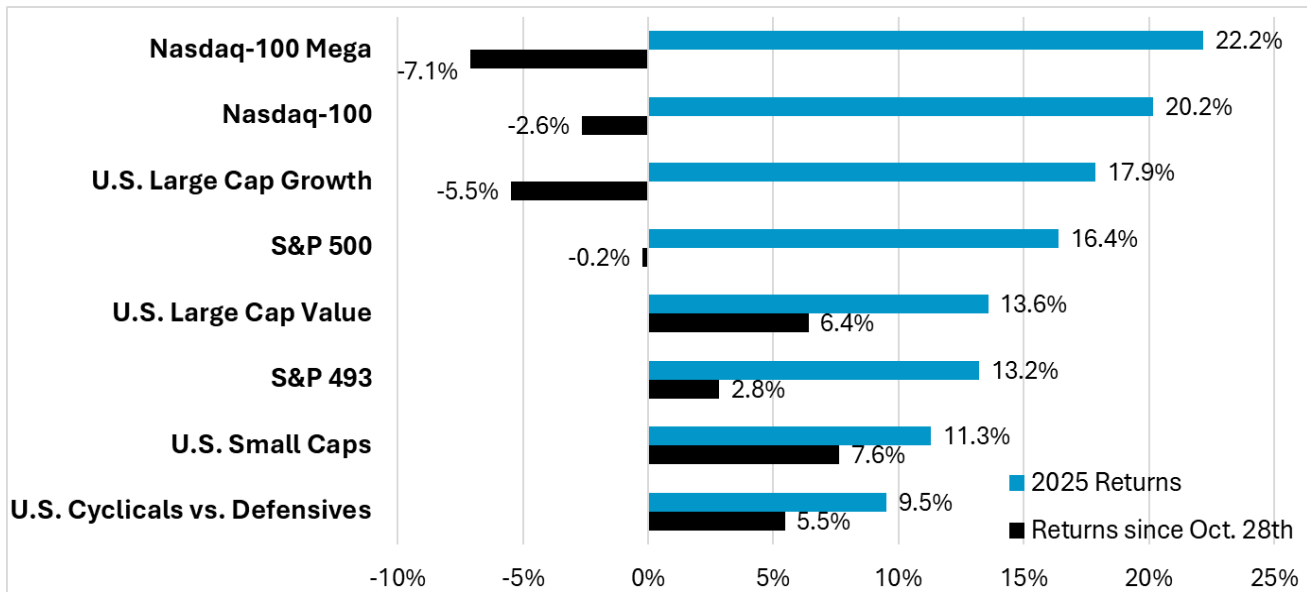
Figure 6: Notable fiscal impulses expected across G-3 economies in 2026



Source: Apollo, IMF, CBO

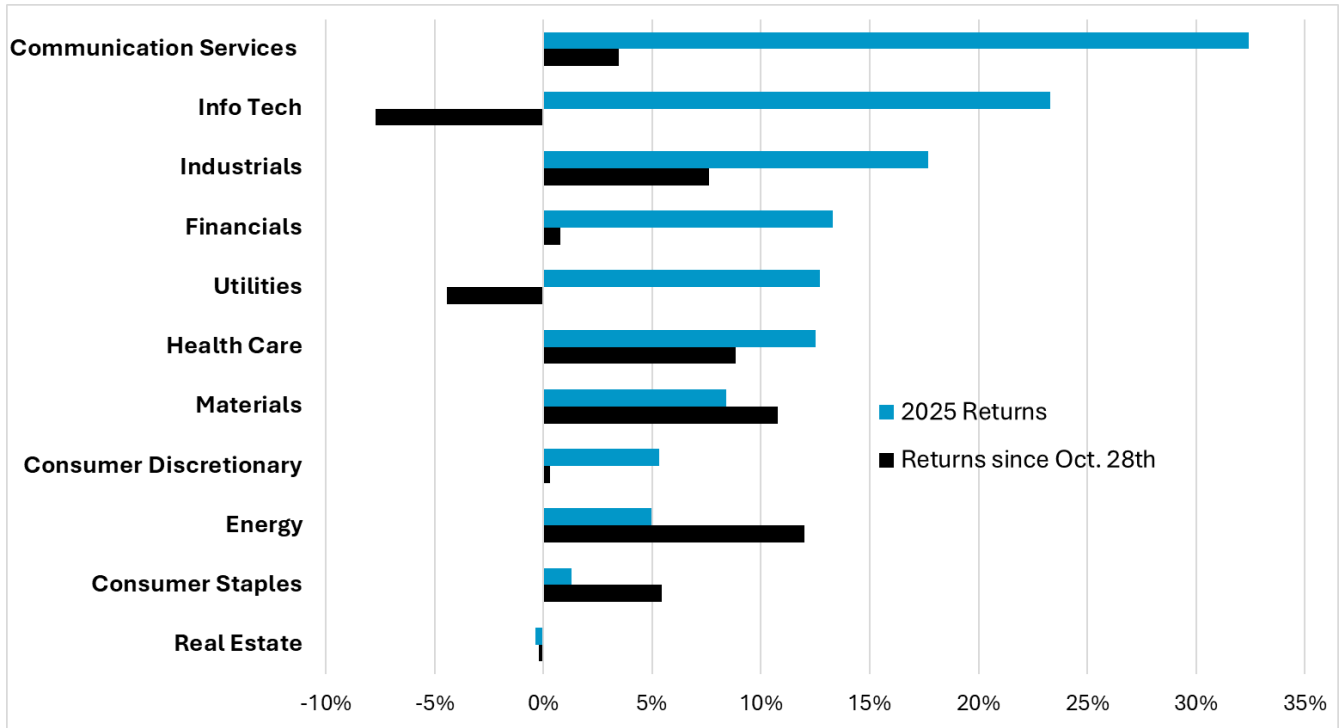
This lagged effect of fiscal stimulus in the U.S., in addition to the resilient economic backdrop, has likely helped more of the cyclical and value-oriented parts of the equity market since the prior highs in U.S. equities at the end of October 2025, per Figures 7 and 8. This outperformance is juxtaposed by the underperformance by those areas which have led U.S. equity indices the past three years—mega cap tech and the growth factor. Utilities, which benefited from the AI infrastructure build out theme in 2025, have notably underperformed amidst the back-up in rates given their historic role as a bond proxy and as some of the higher growth names geared to AI have sold-off.

Figure 7: U.S. equity universe returns in 2025 & since Oct 28th



Source: Bloomberg. Notes: uses Goldman Sachs U.S. Cyclical (long) vs. U.S. Defensive (short) ex-commodities. As of January 21, 2026.

Figure 8: S&P 500 sector returns in 2025 & since Oct 28th



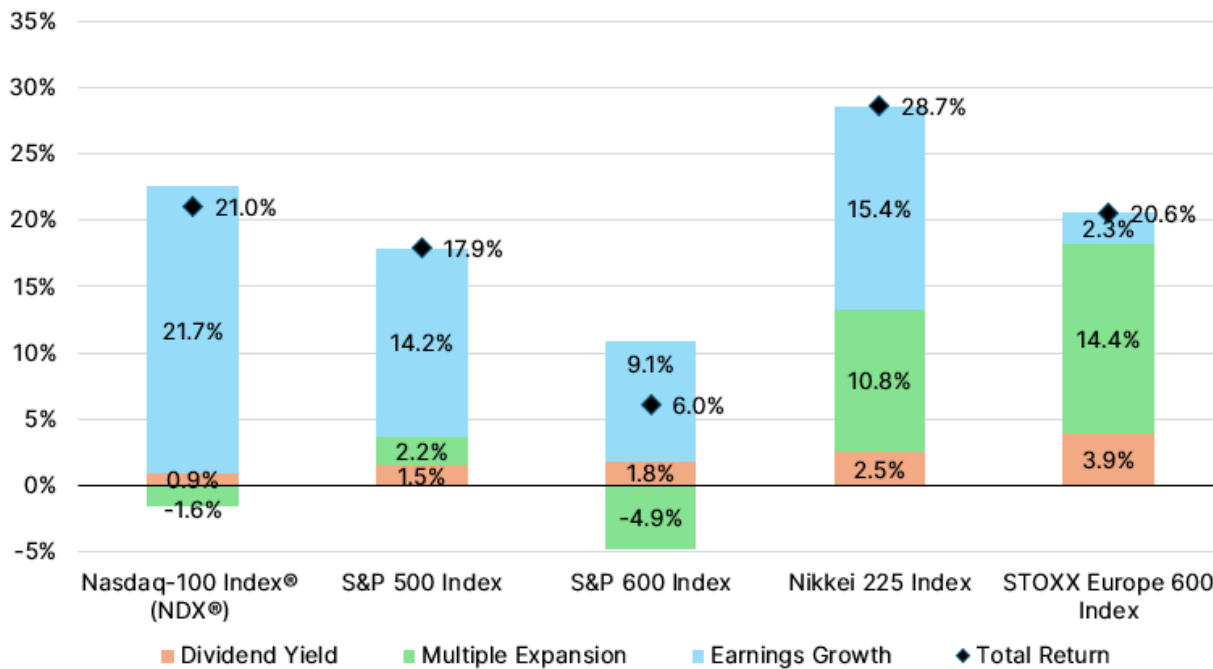
Source: Bloomberg. Notes: As of January 21, 2026.

While we expect U.S. equity returns to broaden, the math indicates that it will be very difficult for U.S. indices to move higher without the mega cap tech cohort leading. Per Citi Wealth, with tech and communication services having approached 40% of the S&P 500's market cap weight, the average sector return would need to be 16.7% across the remaining nine sectors and 60% index weight in order to produce a 10% index return—in-line with the average Wall Street strategist's forecast of 9% in 2026.

A look at early Q4 2025 earnings trends

Not only do tech and communication services account for such a meaningful market cap weight but, also per Citi Wealth, these two sectors make up 53% of S&P 500's 2026 expected earnings growth. And it is these strong fundamentals which propelled U.S. equity returns in 2025: per Figure 9, total returns of the Nasdaq-100 and S&P 500 were overwhelmingly driven by earnings growth. While international markets such as Japan and Europe outperformed broader U.S. equities on a total return basis in 2025, much more of their respective performance came from multiple expansion.

Figure 9: Deconstruction of equity index total returns in 2025

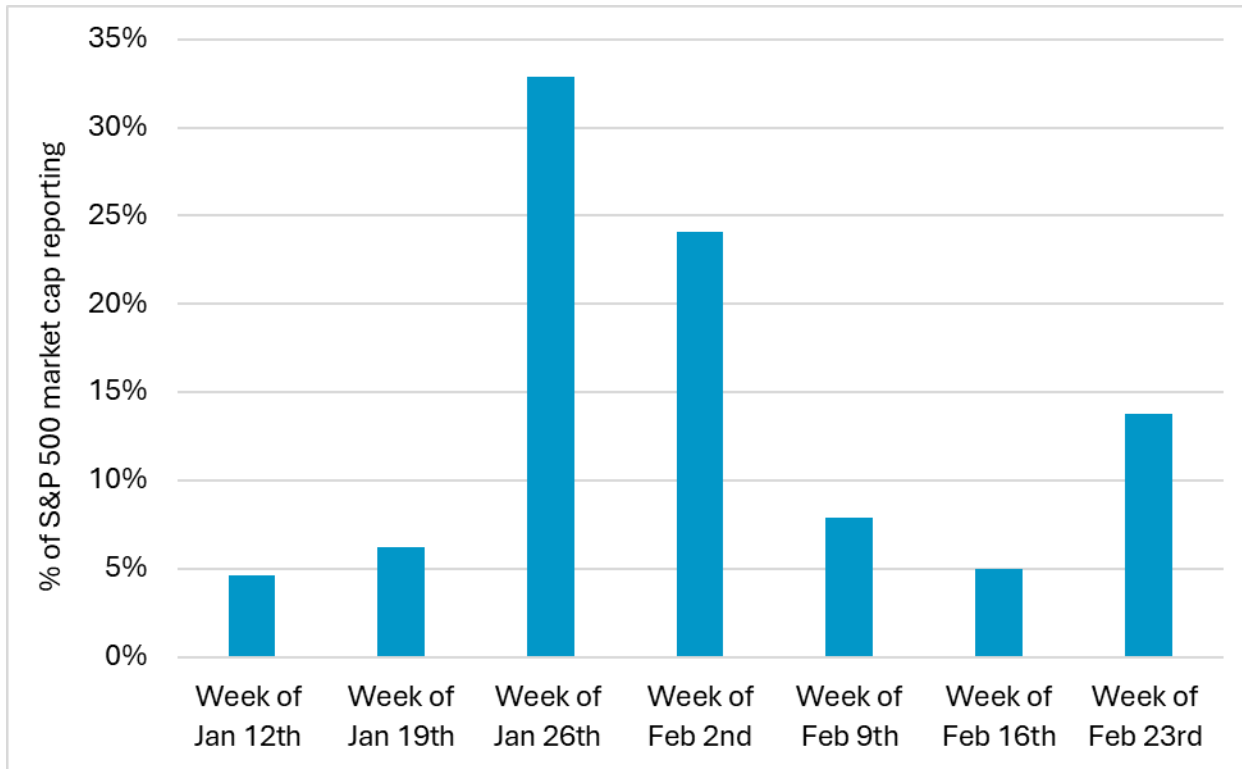


Source: FactSet. Notes: in local currency terms. Residual is allocated to Multiple Expansion.

Again, there are opportunities outside of U.S. equities given improved fundamentals, relative valuation discounts, and thematic stories, particularly amidst a shifting global economic backdrop. However, the earnings growth and strong free cash flow dynamics (e.g.) of the mega cap tech space—particularly those leading in the AI race—continue to make these best-in-class companies from a corporate perspective. We will have a better view into earnings trends in the upcoming two weeks when 57% of S&P 500 market cap is set to report (Figure 10). While it is early in Q4 reporting season with only around 11% of market cap having reported as of the week of January 19th, here are some near-term observations per FactSet thus far:

- 79% of companies are beating EPS estimates vs. the 5-year average of 78%.
- 67% of companies are beating revenue estimates vs. the 5-year average of 70%.
- Despite the proportion of companies beating EPS estimates being slightly above the 5-year average, the aggregate average earnings beats are +5.8% above expectations. This is notably lower than the 1-year average of +7.4% and the 5-year average of +7.7%. These weaker EPS beats are likely contributing to the markets punishing upward EPS surprises more than average: companies beating EPS estimates are experiencing an average price decline of -0.4% from the two days prior to the two days after their earnings release—notably below the 5-year average price increase of +0.9%.

Figure 10: S&P 500 earnings by market cap reporting during Q4 earnings season



Source: Morgan Stanley, Bloomberg

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