Economic Navigator

Show Me the Money. We'll Deflate It Later.

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Executive Summary

- Nominal growth should approach 6% in the third quarter after growing 6.5% in Q2, supporting S&P 500 earnings per share.
- Spending on AI-related equipment, intellectual property, and nonresidential structures should continue to provide an important cushion for overall activity, pushing Q3 real GDP growth to 2.2%.
- We believe inflation should ease by year-end. We expect core inflation to moderate toward 2.7% by the end of 2026 if geopolitical tensions ease meaningfully.
- Unemployment should edge higher but remain historically low, rising to 4.5% by year-end as hiring stays subdued at 165,000 quarterly gains.
- The Charts: check out the supporting charts on rates, oil, trade, and other global macro factors.

Why the Navigator?

The macroeconomic context is a key component of the investment process. Every asset class — whether credit, equities, currencies, commodities, real estate, or infrastructure — responds to the forces shaping the global economy. Inflation trends, interest rate cycles, fiscal and monetary policy shifts, and economic growth trajectories all influence market behavior and risk-adjusted returns. Ignoring these dynamics means missing the bigger picture.

So, what will the drivers of growth be for the remainder of 2026 and what characteristics of growth are worth noting? How will Chair Kevin Warsh lead the Federal Reserve (Fed) and how will it impact policy?

In this edition of the *Economic Navigator*, we provide an update on our expectations for growth, inflation, and unemployment and what it means for businesses and consumers.

The Economy Grew 6.5% in Q2 From a Year Ago, Fueling Strong Earnings Outlook

That headline above may seem confusing. That's understandable since most reporters talk about so-called "real" economic growth, which deflates the nominal figures into inflation-adjusted ones. But we shouldn't ignore the nominal figures because they track the actual dollars businesses and households spend in the economy.

For corporate America, nominal GDP is a good macro anchor because company revenues reflect both volume growth and pricing. Other economic stats are nominal too, including retail sales, shipments of capital goods, and home prices. In other words, nominal GDP is the economy's income statement; corporate earnings are management's share of that income statement. Revenue growth tends to track nominal GDP, while earnings growth reflects how much of that nominal growth firms can convert into profits through margins and operating leverage.

To date, these reports are painting a good macro picture. The U.S. economy entered the third quarter with more momentum than many forecasters anticipated.[1] Small-business sentiment improved noticeably in July, with firms reporting a greater willingness to expand, hire workers, and increase capital spending. At the same time, the decline in inflation concerns marks an important shift in the business landscape. Less concerned about rising costs, firms are increasingly focused on finding qualified workers, a sign that demand remains firm and labor market conditions have yet to cool meaningfully. Small businesses are doubling down on their capital expenditure plans as they find themselves in a much stronger position than just a few months ago and the share of businesses planning to increase capital investment surged to its highest level since late 2024. This momentum in capital spending will likely extend into next year. Taken together, the surveys point to an economy that continues to grow in part from healthy capital spending despite geopolitical uncertainty and higher interest rates.

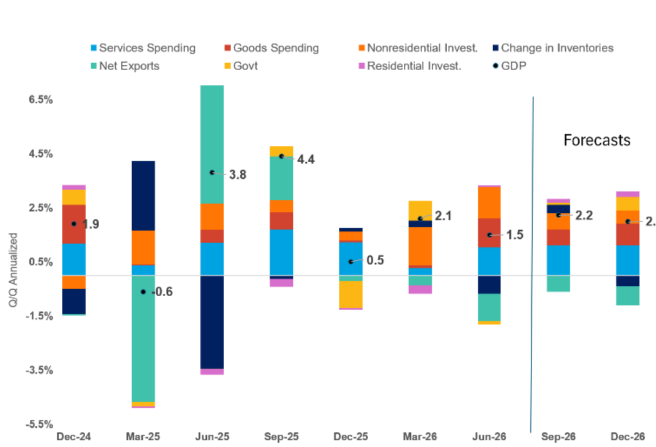
The ISM data reinforce that narrative. Services activity, which accounts for the largest share of economic output, continued to strengthen as new orders and business activity extended an upward trend that has been in place since the spring. Meanwhile, manufacturing showed tentative signs of improvement, particularly in employment, where hiring reached its strongest level in several years amid ongoing reshoring efforts. The reports also highlight an economy characterized less by broad-based weakness than by uneven performance across industries, with pockets of softness offset by areas of robust demand.

Geopolitical drama is creating mayhem, which means that the economy could grow faster if political headwinds go away. Conditions in the metals market remain unusually unsettled, with ongoing volatility and supply-chain distortions creating an environment that many view as even more challenging to navigate than the disruptions experienced during the pandemic. According to a quote from a business leader in the July ISM Report on Business: "*It makes me yearn for the coronavirus pandemic chaos, which was more manageable than whatever this is that we are in*." Volatility in new orders and broader business activity would likely be much lower in a more stable geopolitical environment. Still, the growth in business activity, especially for those in healthcare, is better than expected given the headwinds. An executive in the June ISM Report on Business said, "*revenue and activity across the board are up, and given the economic climate, this was an unexpected result*."

But it's not all good news. Executives in the construction sector reported that increased discounts haven't produced better sales numbers. If geopolitical tensions ease and firms move forward with inventory rebuilding and investment plans, current survey data are consistent with above-trend growth in the third quarter, with GDP expanding near the 2.2% pace and economic resilience remaining the dominant theme.

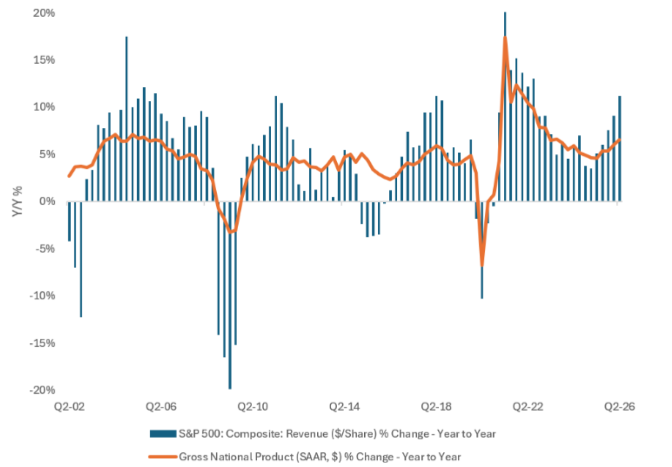
[1] NFIB Small Business Report and ISM Report on Business

Media Outlets Focus on Real Growth...



Source: LPL Research, Bureau of Labor Statistics 8/12/26

...while S&P 500 Revenue Follows Nominal Growth



Source: LPL Research, Bureau of Labor Statistics 08/12/26.

Past performance is no guarantee of future results. Economic forecasts may not develop as predicted.

Conditions Are Ripe for Core Inflation Easing to 2.5% By January 2027

Inflation pressures appear to be easing at a time when business confidence is improving. Inflation is no longer the top concern for small-business owners, a notable shift from recent years when rising input costs and pricing pressures dominated business sentiment. (See the small business survey.) Instead, firms are increasingly focused on expansion, hiring, and capital investment, suggesting that concerns over demand and growth opportunities are beginning to outweigh concerns about cost pressures. That transition is consistent with an economy in which inflation is moving toward a more manageable range, even as overall activity remains resilient.

For policymakers, the message is encouraging but not entirely definitive. The decline in inflation concerns among small businesses suggests that pipeline price pressures may be moderating, reducing the risk of a renewed acceleration in consumer inflation. At the same time, stronger business optimism, firmer investment plans, and a willingness to hire could support aggregate demand and limit how quickly inflation cools from here. Energy markets remain an important variable, but business owners' observation that "the world has plenty of oil" reflects a growing belief that supply constraints may prove less disruptive than feared. Taken together, the survey points to an inflation outlook that is improving gradually rather than deteriorating sharply, giving the Fed evidence that price pressures are becoming less pervasive even as economic growth remains on solid footing.

Our base case is that inflation pressures should moderate by the end of 2026, if geopolitical tensions ease, because the recent upside pressure has been driven disproportionately by energy and related supply-chain channels rather than by a broad-based reacceleration in underlying inflation. If geopolitical tensions de-escalate meaningfully, energy transit normalizes, and we don’t get major amounts of strategic stockpiling, the direct boost to gasoline and utility prices should fade, and the indirect pressure on transportation, freight, and input costs should begin to subside as well. We believe this would take us back to a 2.7% core deflator by the end of the year and 2.5% by early 2027. Inflation metrics based on the Consumer Price Index (CPI) look even better. That doesn’t mean the Fed will be inclined to cut rates in the near term, but at least it would likely keep the Fed from hiking.

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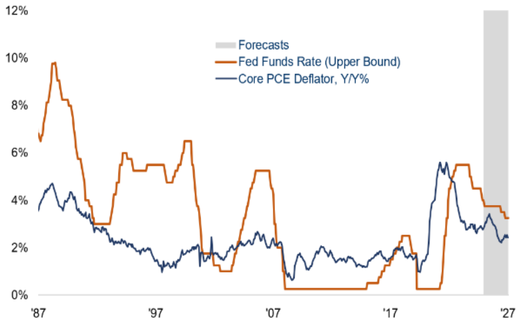
Expect Improvements By Q4...



...as Conditions Revert to Pre-Middle East Crisis

Inflation Dashboard (Y/Y%)	Feb-26	Mar-26	Apr-26	May-26	Jun-26	Jul-26
Import Prices	0.99%	2.26%	4.30%	6.60%	7.10%	
Producer Prices	3.35%	4.29%	5.67%	5.97%	5.51%	
Services Prices Index	63.00	70.70	70.70	71.30	67.70	70.30
Manufacturing Price Index	0.58	0.68	1.84	1.81	1.19	0.79
Global Supply Chain Pressure Index	0.58	0.68	1.84	1.81	1.19	0.79
Gasoline Prices: U.S. Average	2.93	3.70	4.13	4.50	4.05	3.97
Consumer Prices (CPI)	2.41%	3.26%	3.81%	4.25%	3.53%	3.36%
Consumer Prices (CPI) Ex Housing	2.15%	3.43%	4.05%	4.61%	3.58%	3.38%
Rent Prices (CPI)	2.68%	2.56%	2.79%	2.92%	2.84%	2.86%
PCE Deflator	2.87%	3.54%	3.79%	4.08%	3.67%	
PCE Deflator: Core Services Ex Housing	3.34%	3.53%	3.57%	3.89%	3.81%	

Sources: LPL Research, AAA, Bureau of Economic Analysis, Bureau of Labor Statistics, NY Fed 8/12/26
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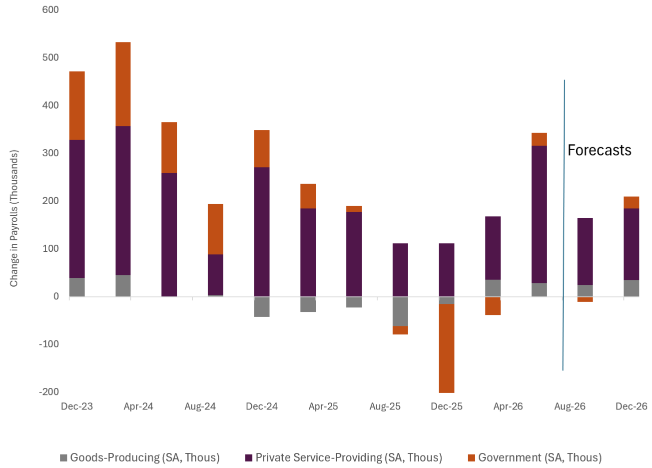
Unemployment Rate Will Likely Rise to 4.5% By the End of the Year

One reason the unemployment rate could drift higher in the coming quarters is not necessarily because layoffs are increasing, but because more people may begin looking for work. A key complication is the unusually large share of 20-to-24-year-olds who are currently outside the labor force (30% of them as of July 2026). As these individuals finish school, training programs, or other activities and begin searching for jobs, they will be counted as unemployed until they find employment. That dynamic could temporarily push the unemployment rate higher, even if job creation remains positive. In other words, a rising unemployment rate in this environment may reflect an increase in labor supply rather than a deterioration in labor demand, making the labor market appear weaker than it actually is beneath the surface.

Now, let's look at the latest data. The July employment report offered a mixed picture of the labor market, one that is likely to reinforce the view that hiring is slowing without signaling a meaningful deterioration in labor demand. While non-farm payrolls declined by 23,000, much of the weakness reflected a drop in local government education employment rather than broad-based layoffs across the private sector. Private payrolls still increased modestly, and the unemployment rate edged down to 4.1%, underscoring the economy's tight labor market. At the same time, job growth in sectors, such as healthcare, remained positive, while weekly labor-market indicators continued to show little evidence of mounting stress. The result is a labor market that appears to be cooling gradually rather than abruptly, a development likely to ease recession concerns while complicating the Fed's assessment of underlying economic strength.

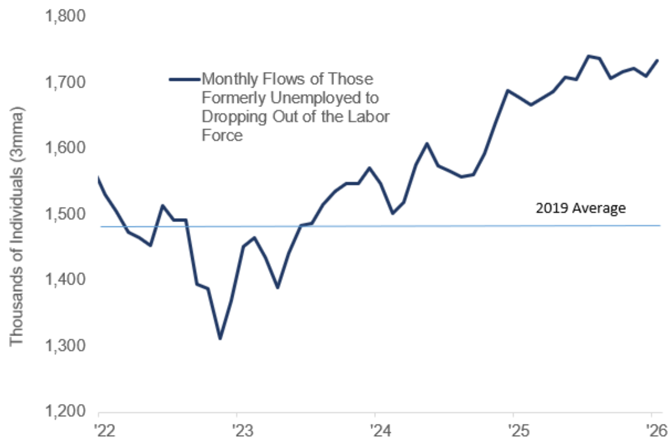
Other labor-market indicators suggest hiring has become more cautious than weak. The latest JOLTS data show both the quits rate and hires rate remain below pre-pandemic norms, indicating workers are less willing to leave their jobs and employers are taking longer to add staff. Those trends point to a labor market that is less dynamic than it was during the post-pandemic expansion, even as unemployment remains historically low. Some sectors are beginning to show renewed demand for workers, including the retail trade, but overall labor turnover continues to run below normal levels. Taken together, the data suggest the labor market is becoming more balanced as labor demand moderates. For policymakers, the combination of slower hiring and a low unemployment rate presents a familiar challenge: evidence of cooling that argues against additional policy tightening, alongside signs that labor-market conditions remain firm enough to keep concerns about inflation and wage pressures alive.

Job Growth Set to Continue ...



Source: LPL Research, Bureau of Labor Statistics 8/12/26

...but People Are Dropping Out of the Labor Force



Source: LPL Research, Bureau of Labor Statistics 8/12/26

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Fostering Moderate Long-Term Interest Rates While Keeping September in Play

The Fed left interest rates unchanged at its August meeting, but the more consequential message came from Chair Warsh's effort to redefine how the central bank establishes credibility. Despite pressure from three hawkish dissenters, Warsh resisted an immediate rate increase and instead emphasized a framework centered on commitment rather than action, including reinforcing the Fed's inflation objective before determining whether tighter policy is necessary. The decision suggested a preference for patience over shock therapy, a stance likely to reassure equity investors while disappointing those who had expected a more Volcker-like response to lingering inflation risks.

Still, the meeting raised as many questions as it answered but kept the September 16 decision in play. Warsh repeatedly pointed to higher bond yields, leaving investors uncertain whether he views the bond market as signaling the need for structurally higher rates or as already doing some of the Fed's tightening work. While he stressed that policy is not on "autopilot," his focus on underlying inflation, long-run challenges, and the need to avoid impatience did not sound like a chairman preparing markets for an imminent September hike. As a result, the Fed appears to be operating under a more flexible and less predictable strategy, one that keeps September in play but leaves future policy heavily dependent on incoming inflation data, energy prices, and broader financial conditions.

At issue is the Fed's objective to "foster moderate long-term interest rates" as described in the 2025 review of their strategy, tools, and communications.[2] Several key leaders, including Treasury Secretary Scott Bessent, are likely concerned about the trajectory of the 10-year Treasury yield and strong economic data along with uncertain geopolitics that could push yields uncomfortably high.

We think the decision to hike or to hold the fed funds target at the next meeting is a coin toss given the mixed inflation data, along with the inopportune timing of midterm elections. Investors need to be aware that the Fed may not be interested in adjusting policy at the October 27–28 meeting ahead of the midterm elections.

[2] https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-qas-2025.htm

The recent joint yen intervention by Japanese and U.S. monetary officials revealed the rising concern about that "fostering moderate long-term rate" objective. Japan, the largest holder of U.S. Treasuries, could trigger a bond market crisis if they had to raise cash to support the yen by selling Treasuries on the open market. The New York Fed allowed Japan to use an obscure facility to pledge its securities as collateral so Japan could raise dollars without risking putting upward pressure on U.S. Treasury yields. This is innovative currency intervention.

While currency intervention can spark sharp near-term rebounds, history suggests its effects often prove temporary unless accompanied by changes in underlying fundamentals.

Putting It All Together

The economy enters the second half of the year in a position that few would have expected several months ago: growth is holding up, inflation pressures are gradually easing, and the labor market is cooling without cracking. Survey data from small businesses and purchasing managers point to continued expansion in hiring, capital spending, and business activity, while nominal GDP growth of 6.5% over the past year underscores the strength of aggregate income and spending that ultimately drives corporate revenue and profits. At the same time, inflation is no longer the primary concern for many businesses, suggesting that pricing pressures are becoming less pervasive, even as demand remains resilient. The result is an economy that appears to be rebalancing, with third-quarter growth likely to remain above trend if geopolitical headwinds diminish and businesses follow through on investment plans.

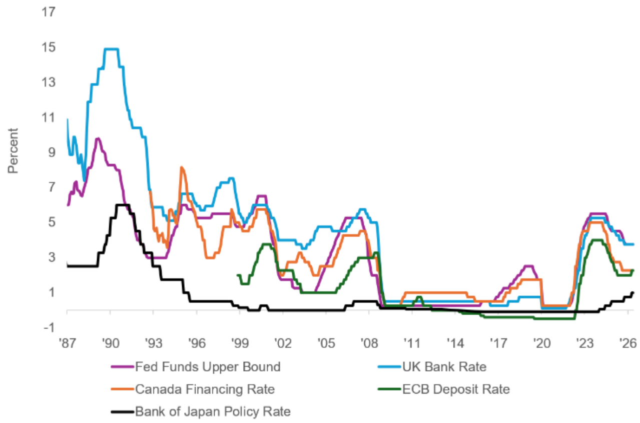
That backdrop creates a complicated challenge for the Federal Reserve. Labor-market indicators point to slower hiring but not meaningful weakness, and any rise in the unemployment rate over the coming months could be driven as much by labor-force reentry among younger workers as by deteriorating demand for labor. Meanwhile, easing inflation pressures reduce the urgency for additional policy tightening, but solid growth, firm labor markets, and elevated bond yields make it difficult for policymakers to declare victory over inflation. Chair Warsh's decision to hold rates steady while emphasizing credibility and patience reflects this tension. For now, the most likely outcome is an economy that continues to grow, supports a favorable earnings outlook, and gradually brings inflation lower, leaving the Fed with the flexibility to keep September in play without being forced into immediate action.

Key Takeaways

- Nominal growth should approach 6% in the third quarter after growing 6.5% in Q2, supporting S&P 500 earnings per share.
- Spending on AI-related equipment, intellectual property, and nonresidential structures will continue to provide an important cushion for overall activity, pushing Q3 real GDP growth to 2.2%.
- Elevated household net worth relative to income will continue to provide an important buffer for consumers against inflation pressures.
- We believe inflation should ease by year-end. We expect core inflation to moderate toward 2.7% by the end of 2026 if geopolitical tensions ease meaningfully.
- Unemployment should edge higher but remain historically low, rising to around 4.5% by year-end as hiring stays subdued.

Appendix: Supporting Macro Charts

Bank of Japan Finally on a Tightening Path



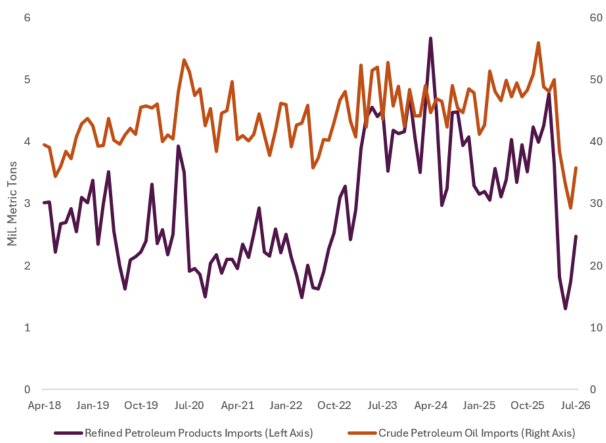
Source: LPL Research, BOC, BOE, BOJ, ECB, Federal Reserve Board 08/12/26

Global Purchasing Managers Composite Index

	Jul-26	Jun-26	May-26	Apr-26	Mar-26	Feb-26	Jan-26	Dec-25	Nov-25	Oct-25
Global	52.6	52.0	51.9	51.8	51.0	53.3	52.5	52.0	52.7	53.0
Developed Mkts	53.3	51.2	50.6	51.1	50.5	52.2	52.6	51.9	53.0	53.3
Emerging Mkts	51.2	53.0	53.6	52.7	51.4	55.1	52.3	52.1	52.3	52.4
U.S.	54.5	51.9	51.5	51.7	50.3	51.9	53.0	52.7	54.2	54.6
Eurozone	52.0	50.0	48.5	48.8	50.7	51.9	51.3	51.5	52.8	52.5
Germany	51.3	49.5	48.8	48.4	51.9	53.2	52.1	51.3	52.4	53.9
France	49.4	47.2	44.9	47.6	48.8	49.9	49.1	50.0	50.4	47.7
Italy	52.5	50.8	50.4	50.5	49.2	52.1	51.4	50.3	53.8	53.1
Spain	56.5	53.3	50.2	48.7	52.4	51.5	52.9	55.6	55.1	56.0
U.K.	52.2	49.3	49.7	52.6	50.3	53.7	53.7	51.4	51.2	52.2
Russia	49.6	48.9	49.2	49.1	48.8	50.8	52.1	50.0	50.1	50.2
Japan	52.7	52.8	51.1	52.2	53.0	53.9	53.1	51.1	52.0	51.5
China	50.8	53.6	54.0	53.1	51.5	55.4	51.6	51.3	51.2	51.8
India	54.3	57.1	59.3	58.2	57.0	58.9	58.4	57.8	59.7	60.4
Brazil	48.8	50.7	49.5	52.4	49.9	51.3	49.9	52.1	49.6	48.2

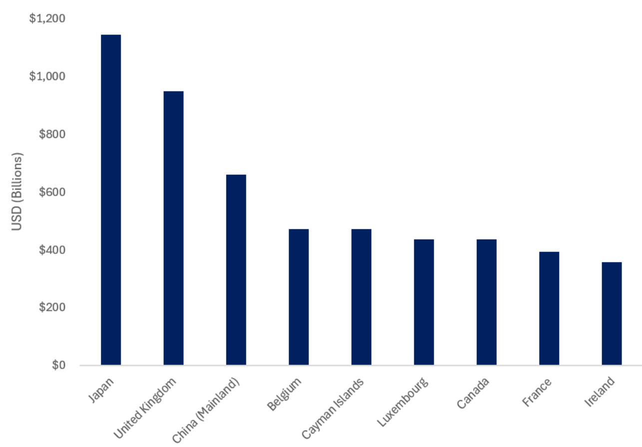
Source: LPL Research, S&P Global 08/12/26

China Importing Less Oil



Source: LPL Research, Bureau of Economic Analysis 08/12/26

Japan: The Largest Foreign Holder of U.S. Treasuries



Source: LPL Research, U.S. Treasury 08/12/26

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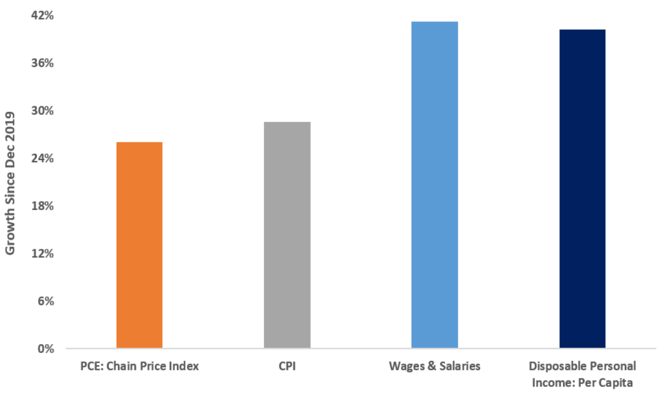
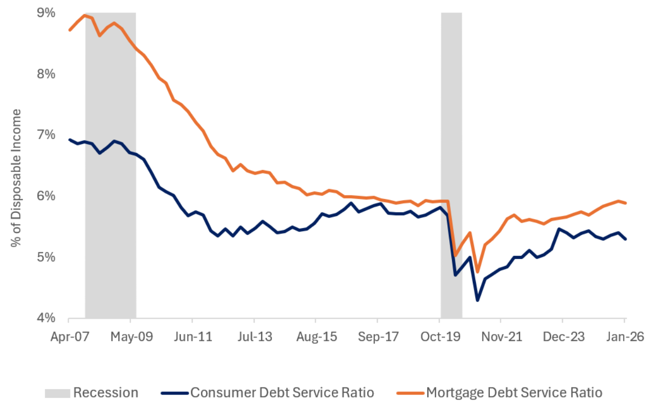
Incomes Have Outpaced Inflation



Source: LPL Research, China General Administration of Customs 08/12/26

Debt Servicing is Historically Low



Source: LPL Research, Federal Reserve 08/12/26

Forecasts Imply 2026 May Be a Pivotal Year

	2025				2026						
Growth	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2024**	**2025**	**2026**
Nominal GDP (Y/Y %)	4.6	4.6	5.4	5.4	6.1	6.5	6.0	5.4	5.3	5.0	6.1
Real GDP (Yr/Yr %)	2.0	2.1	2.3	2.0	2.68	2.10	1.7	2.2	2.8	2.1	2.2
Real GDP (Q/Q Annualized)	-0.7	3.8	4.4	0.5	2.1	1.5	2.2	2.1			
Consumer Spending	0.6	2.5	3.5	1.9	0.54	3.16	1.9	1.8	2.9	2.6	1.9
Government Spending	−1.0	-0.1	2.2	-5.6	4.43	-0.80	2.1	3.4	3.8	1.1	1.3
Private Investment	23.3	-13.8	0	2.3	7.9	3.0	6.1	6.2	3.0	1.9	3.8
Exports	0.2	−1.8	9.6	-3.3	10.87	4.53	4.8	2.7	3.6	1.6	4.3
Imports	38	−29.3	-4.4	-1.0	11.80	11.49	6.4	5.8	5.8	2.7	3.5
Real Final Sales to Domestic Purchasers (Q/Q Ann.)	1.4	2.4	2.8	0.6	2.2	3.1	2.2	2.0	3.1	2.4	2.4
Business Sector											
Nonfarm Productivity (Q/Q Annualized)	-0.9	4.2	5.2	1.6	0.82	1.42	1.0	1.8	2.9	2.2	2.4
Corporate Profits After Taxes (Yr/Yr %)	7.5	4.8	10.8	10.2	11.42	10.5	8.5	8.0	3.9	8.4	8.1
Industrial Production (Yr/Yr %)	0.7	0.5	1.7	1.5	0.8	0.8	0.5	0.4	-0.6	1.1	1.2
Consumer											
Real disposable income (Yr/Yr %)	2.0	1.8	1.8	1.0	0.72	-0.12	1.5	1.8	2.9	1.7	1.5
Retail Sales (Yr/Yr %)	4.5	4.3	4.4	3.0	3.9	6.4	4.3	4.1	2.6	4.0	5.1
Retail Sales Ex-Autos (Yr/Yr %)	4.3	3.9	4.2	3.7	4.6	7.2	4.4	3.7	2.8	4.0	5.2
Consumer Confidence	99.8	93.1	97.4	94.2	90.7	92.2	93.0	95.0	104.5	96.1	92.7
Light Vehicle Sales (Mil. Units, SAAR)	16.4	16.2	16.5	15.7	15.5	16.4	15.8	16.0	15.9	16.2	15.9
Jobs & Housing											
Unemployment rate (%)	4.1	4.2	4.3	4.5	4.3	4.3	4.4	4.5	4.0	4.3	4.4
Nonfarm Payroll (Change in Thousands)	61	101	70	-116	218	231	135	165	1459	29	187
Housing Starts (Mil. Units)	1.40	1.35	1.35	1.32	1.42	1.35	1.30	1.35	1.37	1.36	1.4
Existing Home Sales (Annualized, Millions)	4.08	4.01	4.04	4.16	4.05	4.11	4.05	4.10	4.06	4.07	4.08
Inflation, Annual											
Consumer Price Index (CPI)	2.7	2.5	2.9	2.7	2.7	3.8	3.3	2.8	3.0	2.7	3.2
Core CPI	3.1	2.8	3.1	2.7	2.5	2.7	2.8	2.7	3.3	2.9	2.8
PCE Inflation	2.6	2.4	2.7	2.8	3.1	3.8	3.5	2.9	2.6	2.6	3.4
Core PCE Inflation	2.8	2.7	2.9	2.9	3.1	3.3	3.1	2.8	2.9	2.8	2.9
Brent Crude Spot Price (Average, $)	75.81	68.01	68.97	63.63	80.21	103.28	75.00	73.00	79.86	68.19	82.87
Rates											
Fed Funds (%, Upper Bound, Period End)	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.75	4.50	4.25	3.75
Mortage Rates (30-year Fixed, Period End)	6.79	6.77	6.39	6.27	6.56	6.53	6.50	6.45	6.49	6.60	6.51

Source: LPL Research, Federal Reserve Bank of Philadelphia, Bloomberg 08/12/26

Disclosures: Past performance is no guarantee of future results. Forecasts may not materialize as predicted and are subject to change. Shaded areas are forecasts and are subject to change as additional data is published.

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The Bloomberg U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

All index data from FactSet.

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