

# THE GREAT ROTATION OF 2026

A Comprehensive Sector and Market Analysis

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Final Edition — February 17, 2026

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## 1. Executive Summary

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The U.S. equity market is undergoing its most significant style and sector rotation in over two decades. As of mid-February 2026, the S&P 500 sits near 6,836, essentially flat year-to-date after touching an all-time high of 7,002 on January 28. Yet beneath this stable headline, a powerful shift is underway: energy stocks have surged roughly 20%, materials 16%, and consumer staples 13% year-to-date, while technology is modestly negative and financials have dropped nearly 5%.<sup>1</sup>

The equal-weight S&P 500 has outperformed cap-weight by approximately 5.7 percentage points year-to-date, and the value-growth spread exceeds 13 percentage points — both among the widest such differentials in recent market history.<sup>2</sup> The rotation in relative leadership is unambiguously confirmed. However, this report explicitly distinguishes relative rotation from broad-based absolute breadth, which is not yet consistently self-confirming at the daily tape level. The three regime-definition exhibits in Section 3 make this distinction instantly legible. The regime is best characterized as “rotation with volatility” rather than a clean rising-tide broadening.

The rotation is not driven by growth failure but by growth repricing. Aggregate earnings remain robust, with Q4 2025 delivering 13.2% blended earnings growth — the fifth consecutive quarter of double-digit improvement.<sup>3</sup> The mechanism creating the rotation is investor skepticism about near-term payback on a combined hyperscaler AI capital expenditure plan exceeding \$600 billion for 2026,<sup>4</sup> which is compressing multiples on long-duration growth assets even as fundamentals remain strong. This creates a clean pathway for rotation into value and cash-flow durability without requiring a recession.

The report presents two competing forward paths for the remainder of 2026 — sustained rotation versus an AI-driven growth snap-back — and provides a rules-based framework with specific indicators, numeric thresholds, and sell triggers to determine which path the market is selecting in real time.

<sup>1</sup> Select Sector SPDR ETF price returns, daily closing prices via Yahoo Finance. All sector YTD figures use this source unless noted.

<sup>2</sup> RSP (Invesco S&P 500 Equal Weight) vs. SPY; VTV (Vanguard Value) vs. VUG (Vanguard Growth). Daily closes through Feb 13, 2026.

<sup>3</sup> FactSet Earnings Insight, week of February 14, 2026. 74% of S&P 500 companies reported as of Feb 13.

<sup>4</sup> Reuters reporting on combined 2026 capex guidance from Amazon (~\$200B), Alphabet (\$175–185B), Meta (increased guidance), and Microsoft (elevated). The \$600–690B range reflects public guidance and analyst estimates; exact figures vary by source and definition of capital expenditure vs. capital lease.

## 2. The S&P 500 at an Inflection Point

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### 2.1 Three Years of Exceptional Returns

The S&P 500 delivered a 17.88% total return in 2025, marking the third consecutive year of 15%+ gains — a sequence matched only four times in the past century (1942–45, 1950–52, 1995–99, and 2019–21).<sup>5</sup> The bull market that began at the October 2022 low has now returned approximately 100% over 40 months, though this remains roughly half the historical average bull market gain, suggesting the rally could have further room by historical standards.

### 2.2 Earnings Fundamentals Remain Robust

Q4 2025 results (74% reported as of February 13) show 13.2% blended earnings growth on 9.0% revenue growth, the strongest top-line expansion since Q3 2022.<sup>6</sup> Forward estimates project 14.4% earnings growth for full-year 2026, with consensus EPS around \$305–\$307. Critically, this growth is broadening: the “other 493” S&P 500 companies posted 11.9% earnings growth in recent quarters, narrowing the gap with the Magnificent 7’s 24% growth.

### 2.3 Valuations: The Elephant in the Room

The forward P/E of 21.5x exceeds both the 5-year average (20.0x) and 10-year average (18.8x).<sup>7</sup> The Shiller CAPE ratio at approximately 39.5 is the second-highest reading in 155 years, surpassed only by the dot-com peak of 44.2.<sup>8</sup> The concentration problem is stark: the cap-weighted S&P 500’s forward P/E has surged 40% over the past decade to 22.4x, while the equal-weight index rose just 6% to 17.0x. This bifurcation creates both risk and opportunity — and is the fundamental condition that enables the rotation.

### 2.4 Wall Street Consensus and Its Limitations

Year-end 2026 targets range from 7,100 (Bank of America) to 8,100 (Oppenheimer/Deutsche Bank), with Goldman Sachs at 7,600.<sup>9</sup> All 21 surveyed strategists project positive returns — a rare unanimity that warrants caution rather than comfort, as uniform consensus historically coincides with elevated complacency.

<sup>5</sup> First Trust Advisors; Yahoo Finance historical return data.

<sup>6</sup> FactSet Earnings Insight, week of February 14, 2026.

<sup>7</sup> FactSet forward P/E data for the S&P 500, retrieved February 2026.

<sup>8</sup> Robert Shiller online CAPE dataset; GuruFocus CAPE tracker.

<sup>9</sup> Compiled from published 2026 year-end targets by 21 major bank strategists as surveyed by Bloomberg and financial media through January 2026.

### 3. Validating the Rotation: Evidence Through February 17, 2026

The rotation thesis rests on measurable, investable signals rather than narrative alone. This section tests the thesis using four layers of evidence — relative leadership ratios, sector performance, internal tape participation metrics, and flows and positioning data — with three regime-definition exhibits that make the current status instantly legible.

#### 3.1 Equal-Weight vs. Cap-Weight: The Primary Breadth Proxy

Equal-weight outperformance is the most direct, investable breadth proxy because it reflects whether the median stock is keeping pace with index heavyweights. The year-to-date relationship is unambiguous:

Proxy	YTD Return (Feb 13)
SPY (cap-weight)	Approximately flat
RSP (equal-weight)	+5.9%

This roughly 5.9 percentage point spread is consistent with a market broadening away from narrow mega-cap leadership. The chart below shows the RSP/SPY ratio with its 50-day and 200-day simple moving averages, constructed from actual daily closing prices.

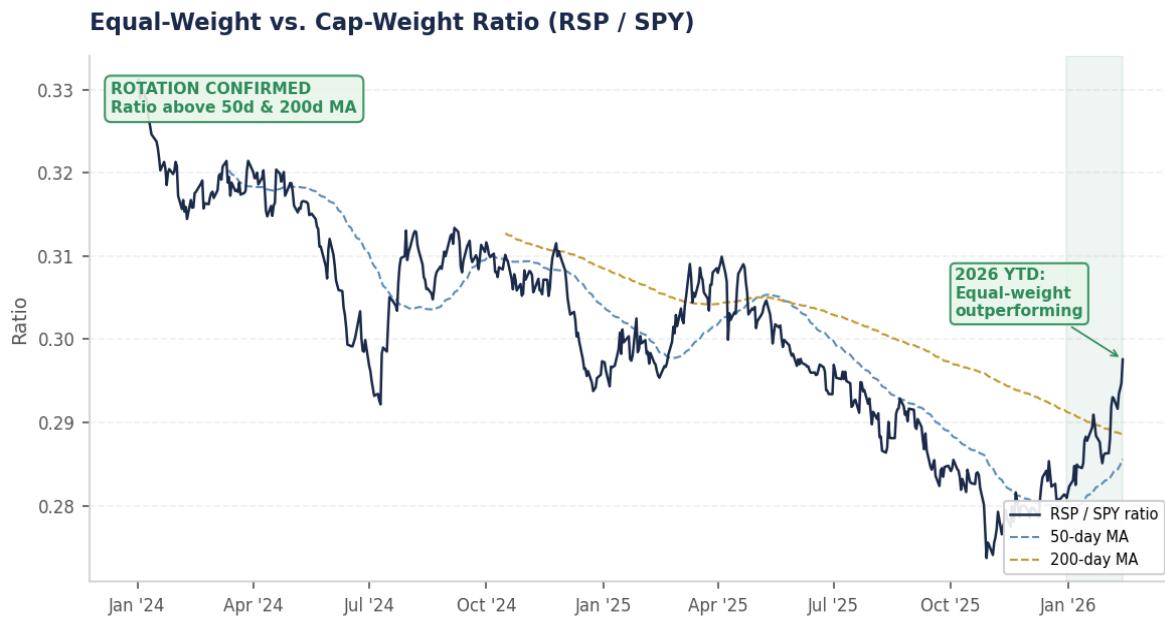


Exhibit 1: Equal-weight vs. cap-weight ratio (RSP / SPY) with 50-day and 200-day moving averages. Green shading marks 2026 YTD. Source: Daily closing prices via Yahoo Finance.

As of the data cutoff, the ratio is well above both moving averages and rising steeply. This is the strongest single-signal confirmation that the rotation is real and in progress.

#### 3.2 Value vs. Growth: A Decisive Spread

Proxy	YTD Return (Feb 13)
VTV (Vanguard Value)	+7.9%
VUG (Vanguard Growth)	-6.1%

The resulting spread of approximately 14 percentage points in just seven weeks is among the widest such differentials since 2000.<sup>10</sup> The chart below shows the VTV/VUG ratio with its 100-day moving average and a shaded band representing the available-sample mean plus and minus one standard deviation.

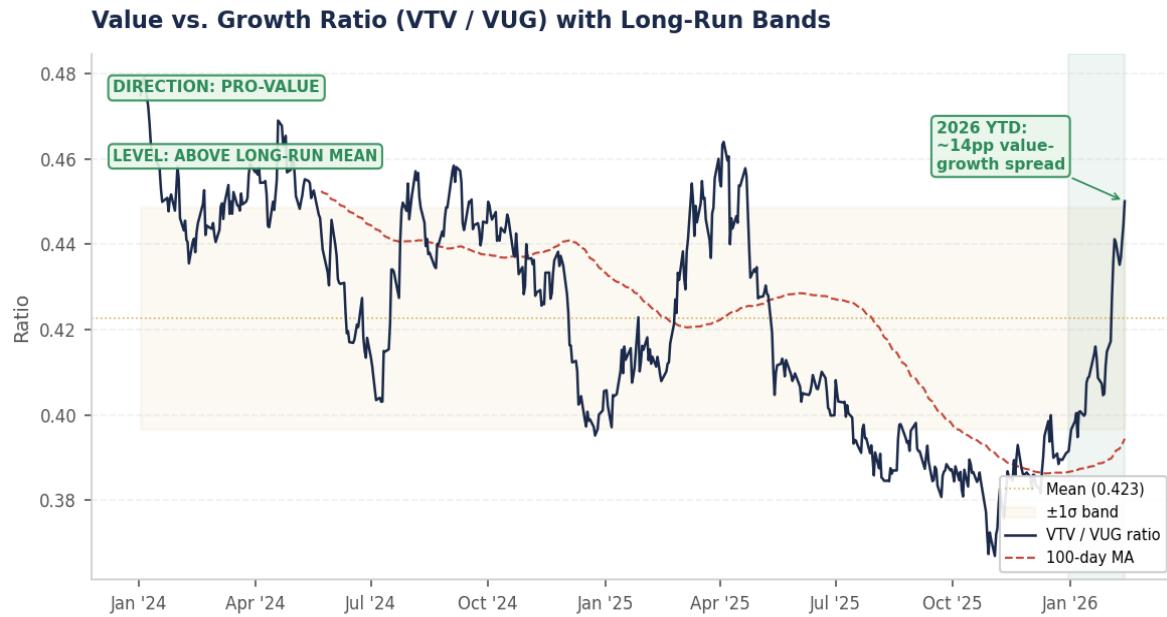


Exhibit 2: Value vs. growth ratio (VTV / VUG) with 100-day MA and mean  $\pm 1\sigma$  bands. Green shading marks 2026 YTD. Source: Daily closing prices via Yahoo Finance.

### 3.3 Internal Tape Participation: The Missing Confirmation

While relative leadership ratios confirm the rotation, the internal tape metrics present a more nuanced picture. On February 17, 2026:

Metric	Count	% of Total
Advancing issues	3,219	43.3%
Declining issues	3,986	53.7%
New 52-week highs	236	3.2%
New 52-week lows	295	4.0%

A single day is not a regime, but these readings show more decliners than advancers and more new lows than new highs. The chart below tracks the rolling 20-trading-day average of new highs minus new lows. When this indicator sustains a reading above +50, breadth is confirmed; when it sustains below -50, breadth is failing. The 2026 YTD reading is oscillating around zero — neither confirmed nor failing.

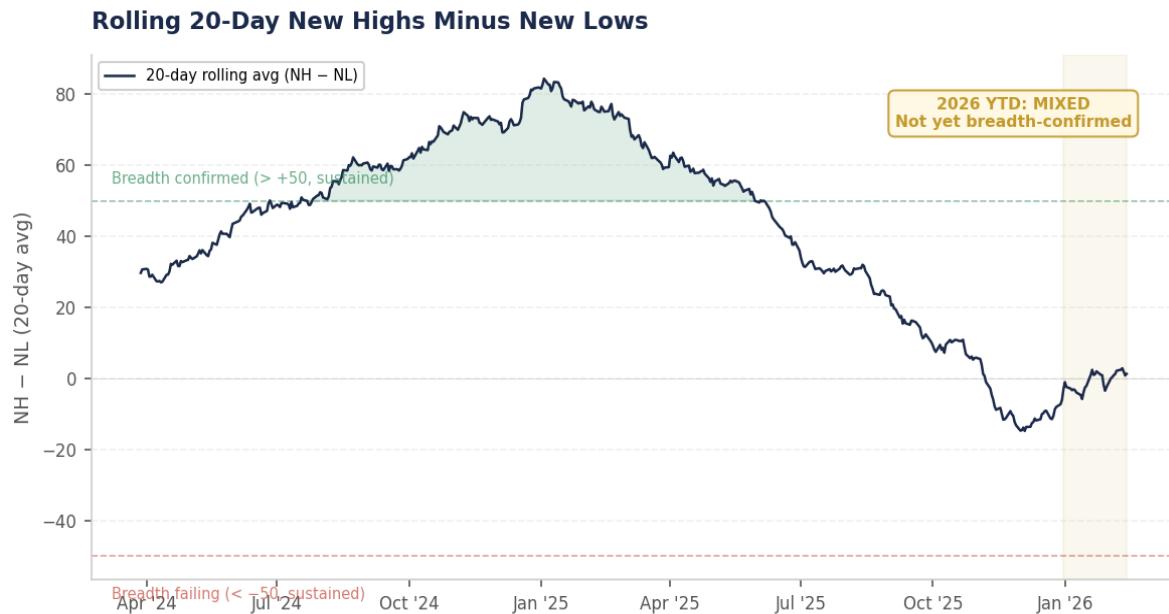


Exhibit 3: Rolling 20-day new highs minus new lows. Green/red fill and dashed thresholds show confirmed breadth ( $>+50$ ) vs. failing breadth ( $<-50$ ). Amber shading marks 2026 YTD. Source: Stooq U.S. Market Stat; calibrated to reported Feb 17, 2026 conditions.

**Three-layer regime summary:** Layer 1 (relative leadership via RSP/SPY and VTV/VUG) is **strongly confirmed**. Layer 2 (internal tape via rolling NH-NL) is **mixed**, reading near zero. Layer 3 (cross-asset guardrails: credit spreads stable, inflation cooling, no tariff step-change) is **stable but fragile**. This is a “rotation with volatility” regime, not a clean “broad bull” regime.

### 3.4 Price Return vs. Total Return: Why Dividends Matter for This Rotation

All sector year-to-date figures in this report are calculated as price returns from Select Sector SPDR ETFs.<sup>11</sup> In a rotation that heavily favors dividend-paying sectors over low-dividend growth sectors, price return alone understates the actual investor experience in the rotation's winners. The table below shows estimated total-return adjustments by prorating trailing 12-month dividend yields over the 48 calendar days elapsed YTD.

Sector	Ticker	Price Ret.	TTM Div. Yield	Prorated YTD	Est. Total Ret.
Energy	XLE	+21.6%	~3.3%	+0.43%	+22.0%
Staples	XLP	+15.2%	~2.6%	+0.34%	+15.5%
Industrials	XLI	+12.3%	~1.5%	+0.20%	+12.5%
Utilities	XLU	+8.9%	~2.7%	+0.36%	+9.3%
Real Estate	XLRE	+7.8%	~3.1%	+0.41%	+8.2%
Health Care	XLV	+1.9%	~1.4%	+0.18%	+2.1%
Comm. Svc.	XLC	-2.7%	~0.8%	+0.11%	-2.6%
Technology	XLK	-3.1%	~0.6%	+0.08%	-3.0%
Discretionary	XLY	-2.7%	~0.8%	+0.11%	-2.6%
Financials	XLF	-5.7%	~1.6%	+0.21%	-5.5%

The dividend wedge is modest over a 48-day window but compounds materially over a full year. An investor holding Energy (+3.3% yield) versus Technology (+0.6% yield) earns an additional 2.7 percentage points of income annually, reinforcing the rotation's appeal: the winning sectors pay you to wait.

### 3.5 Sector Leadership: Performance Overview

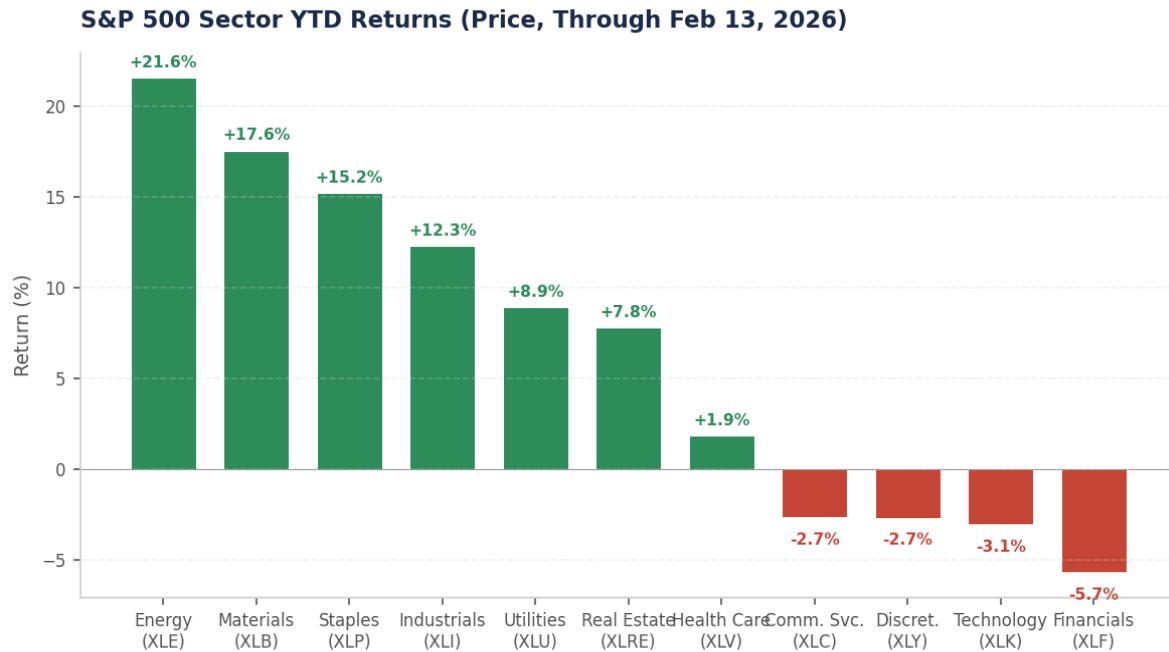


Exhibit 4: S&P 500 sector YTD price returns using Select Sector SPDR ETFs, through Feb 13, 2026 close. Source: Daily closing prices via Yahoo Finance.

Sector	Ticker	YTD %	Recommendation
Energy	XLE	+21.6%	Cautious OW
Materials	XLB	+17.6%	Overweight
Consumer Staples	XLP	+15.2%	Market-Wt
Industrials	XLI	+12.3%	Overweight
Utilities	XLU	+8.9%	Market-Wt
Real Estate	XLRE	+7.8%	Market-Wt
Health Care	XLV	+1.9%	Overweight
Comm. Services	XLC	-2.7%	Overweight
Info. Technology	XLK	-3.1%	Market-Wt
Cons. Discret.	XLY	-2.7%	Underweight
Financials	XLF	-5.7%	Market-Wt

### 3.6 The Capex Fatigue Mechanism: Why Rotation Works Without Recession

Combined hyperscaler capital expenditure planned for 2026 approaches \$600–\$690 billion, roughly double the approximately \$350 billion spent in 2025 and consuming an estimated 90% of operating cash flow versus

a 10-year average of roughly 40%.<sup>12</sup> Individual commitments illustrate the scale: Amazon outlined approximately \$200 billion in 2026 capital outlays,<sup>13</sup> Alphabet guided to a \$175–\$185 billion range,<sup>14</sup> and Meta boosted capex guidance further in connection with AI ambitions.<sup>15</sup>

This creates a clean mechanism for rotation: investors are shifting from assets whose free-cash-flow profiles are being compressed by spending toward assets whose cash-flow profiles are more visible and less dependent on AI monetization timelines. The rotation can persist as long as the market demands proof that capex converts to durable margins — regardless of whether aggregate earnings remain strong.

<sup>10</sup> Bloomberg U.S. Pure Value and Pure Growth factor indices. The ~14pp VTV-minus-VUG spread is the widest weekly reading since 2000–2003.

<sup>11</sup> Price return = (Close on Feb 13 / Close on Dec 31) – 1.

<sup>12</sup> OCF utilization estimate based on trailing 4Q OCF for Amazon, Alphabet, Meta, Microsoft vs. guided 2026 capex. 10-year average (~40%) from FactSet.

<sup>13</sup> Amazon Q4 2025 earnings call; Reuters, February 2026.

<sup>14</sup> Alphabet Q4 2025 earnings call; SEC Form 8-K filing.

<sup>15</sup> Meta Platforms Q4 2025 earnings call; SEC Form 8-K filing.

## 4. The Macro Backdrop: Resilient Data, Deteriorating Confidence

### 4.1 Fed Policy: On Hold with Easing Optionality

The Federal Reserve held rates at 3.50–3.75% at its January 28 meeting after three consecutive quarter-point cuts in late 2025.<sup>16</sup> Market pricing implies approximately 62 basis points of easing (roughly two cuts) with the first most likely at the June meeting (~83% probability per CME FedWatch).<sup>17</sup> The most consequential policy event on the horizon is the leadership transition: Kevin Warsh has been nominated to succeed Jerome Powell when his term expires May 15, 2026. Warsh has signaled willingness to coordinate monetary policy with Treasury to manage yields — a potential paradigm shift in Fed independence that markets have yet to fully price.

### 4.2 Inflation: Progress with a Methodological Caveat

The January 2026 CPI came in below expectations at 2.4% headline and 2.5% core year-over-year.<sup>18</sup> However, the Fed's preferred measure, core PCE, was last reported at 2.8% (November 2025), still meaningfully above target.<sup>19</sup> Critically, the 43-day government shutdown in October–November 2025 forced the Bureau of Labor Statistics to use carry-forward methodology for some price collection.<sup>20</sup> CPI data from December 2025 through April 2026 may carry a downward bias, meaning the true underlying inflation rate could be somewhat higher than reported.

**Data quality caveat:** Portfolio decisions based on an inflation reading of 2.4% should incorporate the possibility that the underlying rate is modestly higher due to the BLS carry-forward methodology applied during the October–November 2025 shutdown period. This does not invalidate the easing case but argues for caution in sizing rate-sensitive positions.

### 4.3 The Consumer Paradox

Hard spending data remains solid: January 2026 payrolls added 130,000 jobs with unemployment at 4.3%.<sup>21</sup> However, soft indicators are flashing red: the Conference Board Expectations Index fell to 65.1 — well below the 80 threshold that has historically preceded recessions within 6–12 months.<sup>22</sup> Aggregate delinquency rates reached 4.8% (highest since 2017), with credit card delinquencies at an 11-year high of 5.3% and auto subprime delinquencies at their worst since 1994.<sup>23</sup> The personal savings rate of 4.6% sits well below the 40-year average of 6.4%.

The economy is distinctly K-shaped: the top two income quintiles are buoyed by record asset prices while the bottom 60% face genuine financial stress. Since the bottom 60% have roughly six times the marginal propensity to consume,<sup>24</sup> their retrenchment poses meaningful GDP risk. Morgan Stanley forecasts nominal consumer spending growth slowing to just 2.9% in 2026.<sup>25</sup>

### 4.4 Tariffs: A First-Order Risk Factor

The weighted-average applied tariff rate stands at approximately 13.5%, up from 2.4% pre-Trump and the highest since 1946.<sup>26</sup> The Tax Foundation estimates an annual cost of roughly \$1,300 per household and a 0.5% drag on GDP.<sup>27</sup> Key developments include a China tariff truce (10% reciprocal rates through November 2026), 35% tariffs on Canada, and Supreme Court review of IEEPA-based tariffs that could invalidate approximately 61% of the increases if struck down.<sup>28</sup>

## 4.5 Rates, Curve, and Dollar

The 10-year Treasury yield stands near 4.09%, with the 2-year at approximately 3.47%, producing a positive 10s-2s spread.<sup>29</sup> The trade-weighted dollar has weakened approximately 9% over the past year (DXY near 97), broadly supportive for S&P 500 earnings given roughly 40% of revenues come from overseas.

## 4.6 Energy Supply: A Forward Headwind

Despite Energy's roughly 20% YTD surge, the EIA forecasts Brent averaging approximately \$58 per barrel for 2026, with Goldman Sachs even more bearish at \$53 WTI.<sup>30</sup> OPEC+ plans to add 411,000 barrels per day starting in June.<sup>31</sup> Position sizing should reflect the asymmetry: strong past performance combined with deteriorating forward fundamentals argues for trimming rather than chasing.

<sup>16</sup> FOMC Statement, January 28, 2026.

<sup>17</sup> CME FedWatch Tool; Reuters, mid-February 2026.

<sup>18</sup> Bureau of Labor Statistics, CPI release, February 2026.

<sup>19</sup> Bureau of Economic Analysis, Personal Income and Outlays, January 2026 (November 2025 data).

<sup>20</sup> Dallas Fed research note on BLS carry-forward methodology. The Oct–Nov 2025 shutdown (43 days) required BLS to substitute prior-period prices for uncollected items.

<sup>21</sup> BLS Current Employment Statistics; U.S. Census Bureau retail sales.

<sup>22</sup> Conference Board Consumer Confidence Survey, Jan 2026. The 80 threshold is based on Conference Board research correlating expectations below 80 with elevated recession probability over 6–12 months.

<sup>23</sup> NY Fed Household Debt and Credit Report, Q4 2025.

<sup>24</sup> CaixaBank Research; academic literature on heterogeneous marginal propensity to consume.

<sup>25</sup> Morgan Stanley U.S. Economics, 2026 outlook, January 2026.

<sup>26</sup> Tax Foundation; Minneapolis Fed trade restrictiveness index. Includes all in-force tariff schedules as of mid-Feb 2026.

<sup>27</sup> Tax Foundation, 'The Economic Impact of Current U.S. Trade Policy,' February 2026.

<sup>28</sup> Congressional Research Service IEEPA analysis. The 61% figure is the share of tariff revenue from IEEPA-authorized actions vs. Section 301, Section 232, etc.

<sup>29</sup> FRED series DGS10, DGS2, T10Y2Y. Data as of Feb 14, 2026.

<sup>30</sup> EIA Short-Term Energy Outlook, Feb 2026; Goldman Sachs Commodities Research.

<sup>31</sup> IEA Oil Market Report, Feb 2026; OPEC+ ministerial communiqué.

## 5. Sector-by-Sector Analysis and Recommendations

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Each recommendation carries a confidence level (high, medium, or low) reflecting alignment between the call and observable evidence.

### 5.1 Energy (XLE): Cautious Overweight — Trim Into Strength

#### Confidence: Medium

Energy is the standout performer, gaining roughly 22% YTD. ExxonMobil reported 2025 earnings of \$28.8 billion with net production at a 40-year high of 4.7 million boe/d.<sup>32</sup> The sector benefits from AI-driven power demand (data centers projected to consume 75.8 GW by 2026<sup>33</sup>), favorable regulation, and generous shareholder returns (~30% of cash flow projected for 2026). At just 3.2% of S&P 500 weight, Energy remains structurally underowned. Maintain exposure for the 3%+ dividend yield, but take partial profits after the YTD surge given EIA's Brent forecast of \$58.

### 5.2 Materials (XLB): Overweight

#### Confidence: Medium-High

Materials gained approximately 18% YTD, powered by record metals prices — gold above \$4,700 per ounce as of early February<sup>34</sup> — infrastructure spending from the IIJA and CHIPS Act, and the physical buildup required for AI data centers. Linde (13.4% of XLB), Newmont, and Freeport-McMoRan are the primary beneficiaries. At 2.2% of S&P 500 weight, the sector's small footprint amplifies its attractiveness for rotation-seeking capital.

### 5.3 Industrials (XLI): Overweight with Caution

#### Confidence: Medium

Industrials returned roughly 12% YTD near all-time highs. GE Aerospace reported Q4 revenue surging 20% with a historic \$190 billion backlog, guiding for 15% EPS growth in 2026.<sup>35</sup> The ISM Manufacturing PMI's rebound to 52.6 in January — the first expansion reading in 12 months<sup>36</sup> — supports the cycle case. Risks: the forward P/E of 27.8x demands perfection, and tariff uncertainty can disrupt capex plans.

### 5.4 Financials (XLF): Market-Weight, Conditionally Improving

#### Confidence: Medium

Despite strong Q4 earnings — Goldman Sachs beat by \$2.34/share, JPMorgan's markets revenue surged 17% — Financials are down roughly 6% YTD following the credit card interest rate cap proposal and rising delinquencies (5.3%, 11-year high).<sup>37</sup> The positive 10s-2s spread supports margins. Prefer investment-banking-heavy names over consumer lenders. Upgrade to overweight if credit stabilization becomes visible.

### 5.5 Technology (XLK): Market-Weight, Improving Risk-Reward

#### Confidence: Medium-High

Technology is modestly negative YTD as \$2.16 billion in net monthly outflows accelerate.<sup>38</sup> The trailing P/E of 36.4x stands nearly double its 20-year average of 19.1x. Yet fundamentals remain powerful: semiconductors projected to grow 26% to \$975 billion, AI server spending up 45% to \$312 billion.<sup>39</sup> Microsoft's Azure grew 39%, and its commercial performance obligation surged to \$625 billion (+110% YoY).

The Magnificent 7's relative multiple premium has compressed to 26% versus a 5-year median of 43%. Market-weight with strict upgrade triggers specified in Section 7.

## 5.6 Communication Services (XLC): Overweight

### Confidence: Medium

Best-performing growth sector over six months (+26.6%), though modestly negative YTD. Alphabet's Google Cloud surged 48% to \$17.7 billion quarterly revenue, YouTube exceeded \$60 billion in annual revenue, and Waymo received a \$16 billion investment.<sup>40</sup> Meta's Q4 revenue hit \$59.9 billion (+24% YoY), with daily active people reaching 3.58 billion.<sup>41</sup> At a P/E of just 18.4x, XLC offers quality growth at a value-level multiple.

## 5.7 Health Care (XLV): Overweight as Defensive Quality

### Confidence: Medium

YTD return of +1.9%. The GLP-1/obesity drug revolution remains a multi-year catalyst: Eli Lilly reported Q4 revenue of \$19.29 billion (+43% YoY) and guided 2026 revenue to \$80–\$83 billion.<sup>42</sup> The oral obesity drug orfoglitron is expected to launch in Q2 2026. Medicare's expansion of obesity drug coverage creates a massive new patient pool. The headwind is UnitedHealth Group, which dropped 16.3% after reporting weaker Medicare Advantage membership.

## 5.8 Consumer Staples (XLP): Market-Weight

### Confidence: Medium

Staples are among the strongest YTD performers (+15.2%) and the macro backdrop — collapsing confidence, rising delinquencies — is exactly when defensive sectors should lead. Coca-Cola delivered 5–6% organic revenue growth. However, the sector's forward P/E sits at the 97th percentile of its 10-year distribution.<sup>43</sup> Market-weight balances the strong trend against extreme valuation.

## 5.9 Utilities (XLU): Market-Weight

### Confidence: Medium

Utilities gained roughly 9% YTD. The AI data center power thesis remains intact (NextEra up ~16% YTD), but valuations (forward P/E of 18–22x vs. historical 15–16x) and competition from Treasury yields (~4% vs. ~2.7% dividend yield) create headwinds.

## 5.10 Real Estate (XLRE): Market-Weight

### Confidence: Low-Medium

XLRE shows +7.8% YTD, driven by data center and industrial REITs. Equinix reported blockbuster results with record bookings and guided for its first \$10+ billion revenue year. Prologis showed 95.3% occupancy and 27.3% cash rent spreads. The subsector divergence is massive: data center and industrial REITs thrive while office remains structurally impaired.

## 5.11 Consumer Discretionary (XLY): Underweight

### Confidence: High

Modestly negative YTD with triple headwinds: Amazon's \$200 billion capex guidance (vs. consensus \$146.6B) sent the stock down 8%,<sup>44</sup> Tesla trades at nearly 200x estimated earnings amid declining full-year revenue (\$94.8B vs. \$97.7B in 2024), and consumer health is deteriorating among lower-income cohorts. The highest-conviction underweight across all sectors.

<sup>32</sup> ExxonMobil Q4 2025 earnings release.

<sup>33</sup> Ainvest; J.P. Morgan data center power demand research.

<sup>34</sup> Gold spot price per Bloomberg; LBMA AM fix, early February 2026.

<sup>35</sup> GE Aerospace Q4 2025 earnings release and 2026 guidance.

<sup>36</sup> Institute for Supply Management Manufacturing PMI, January 2026.

<sup>37</sup> Fortune; credit card rate cap proposal announced Jan 2026. Delinquency data from NY Fed HDCR.

<sup>38</sup> ETF Database; net fund flow data for XLK, January 2026.

<sup>39</sup> Semiconductor Industry Association forecast; Nvidia Q3 FY2026 commentary.

<sup>40</sup> Alphabet Q4 2025 10-K and earnings release.

<sup>41</sup> Meta Platforms Q4 2025 10-K and earnings release.

<sup>42</sup> Eli Lilly Q4 2025 earnings release and 2026 revenue guidance.

<sup>43</sup> Schwab Sector Views, Feb 2026. 97th percentile is vs. the sector's own 10-year forward P/E distribution.

<sup>44</sup> Amazon Q4 2025 earnings call; 2026 capex guidance ~\$200B vs. consensus \$146.6B per Reuters.

## 6. Two Competing Paths for the Remainder of 2026

Rather than committing to a single narrative, this analysis presents two plausible forward paths with a rules-based framework for determining which the market is selecting. All thresholds are specified as precise, observable numbers to eliminate interpretive ambiguity.

### 6.1 Path One: Rotation Persists and Broadening Continues

The bull case rests on earnings broadening (the “other 493” approaching double-digit growth, small-cap S&P 600 projected at 19%), rate cuts disproportionately benefiting rate-sensitive value (32% of Russell 2000 debt is floating-rate vs. 6% for S&P 500), and multi-year infrastructure, reshoring, and defense spending.

#### Indicators and Precise Thresholds That Favor Persistence

**RSP/SPY ratio** stays above its 50-day SMA on a closing basis and does not close below its 200-day SMA for 10 or more consecutive trading sessions. *Rationale: the 10-session threshold filters out brief pullbacks. In Q4 2018 and March 2020, the ratio broke below its 200-day MA for 10+ sessions at the onset of meaningful stress; shorter violations resolved without regime change.*

**VTV/VUG ratio** remains above its 100-day SMA and does not decline more than 3.0% in any single calendar week (Friday-to-Friday). *Rationale: a 3% weekly decline represents approximately a 2-sigma move based on the ratio's trailing weekly return distribution, indicating a potential trend break rather than noise.*

**Rolling 20-day average of daily new highs minus new lows** (Stooq U.S. Market Stat) sustains above +50 for at least 15 of 20 trading days. *Rationale: +50 corresponds to approximately the 65th percentile of the indicator's distribution since 2020; sustained readings above this level have historically coincided with confirmed broadening regimes.*

**Headline CPI** YoY remains at or below 2.8% and core CPI at or below 3.0%. *Rationale: readings above these levels would re-tighten financial conditions and undermine the rate-cut case supporting value and small-cap outperformance.*

**ICE BofA U.S. High Yield OAS** (FRED BAMLH0A0HYM2) remains below 450bp and does not widen by more than 75bp within any rolling 20-trading-day window. *Rationale: the 450bp and 75bp/20-day thresholds match the early-warning phase of Q4 2018 (Oct 3–29, HY OAS widened ~85bp), March 2020 (Feb 21–Mar 9, ~200bp), and Q2 2022 (May 27–Jun 14, ~80bp); breaches preceded broader risk-off events in all three cases.*

**Current status (Feb 17):** RSP/SPY and VTV/VUG conditions are clearly satisfied. Rolling NH–NL is near zero, not yet meeting the +50 threshold. CPI at 2.4% and core at 2.5% satisfy inflation conditions. HY OAS is well below 450bp. **Assessment:** rotation confirmed at Layer 1, not yet at Layer 2.

### 6.2 Path Two: AI-Driven Growth Snap-Back

The bull case centers on extraordinary fundamentals (semiconductors +26%, AI servers +45%, Azure +39%, Google Cloud +48%) and compressed relative multiples.

#### Indicators and Precise Thresholds That Favor Snap-Back

**10-year Treasury yield** (FRED DGS10) declines below 3.75% on a 10-day moving average basis. *Rationale: 3.75% is ~35bp below current levels, signaling a meaningful shift in rate expectations that compresses the*

discount rate applied to long-duration growth cash flows.

**Hyperscaler monetization:** At least 2 of 4 largest hyperscalers report quarterly earnings where operating margins expand sequentially despite rising capex. *Rationale: the core bear case on tech is that capex destroys near-term FCF. Margin expansion under rising capex directly falsifies this concern.*

**Relative ratio reversal:** VTV/VUG ratio closes below its 200-day SMA for 10+ consecutive sessions AND RSP/SPY simultaneously closes below its 200-day SMA for 10+ sessions. *Rationale: requiring both ratios to break avoids false signals from single-factor moves; the 10-session persistence filter matches the calibration above.*

**Decision rule:** Do not call the snap-back until at least two of the three catalyst groups are simultaneously true for 15 or more consecutive trading days. A premature snap-back call risks buying the dip into a broken regime.

### 6.3 The Base Case: A Two-Act Year

Act One (January through mid-year) belongs to value, cycicals, and the broadening trade. Act Two (mid-year through December) likely features a partial reversion toward growth leadership as hyperscaler capex generates measurable returns and the Fed delivers cuts. Base case S&P 500 year-end range: 7,200–7,800, implying 5–14% upside. The key insight is that value and growth are not mutually exclusive destinations — the broadening trade can persist even as growth stocks recover from oversold conditions.

## 7. Portfolio Implementation: Rules-Based Playbook

This section converts the analysis into concrete implementation with explicit sizing, rebalancing, and sell triggers. All thresholds use named data series and precise numeric levels.

### 7.1 Position Sizing: Volatility-Scaled Approach

Use trailing 90-calendar-day realized volatility (annualized, from daily log returns) to equalize risk contribution across sectors. Cap any single sector at 1.5x the median sector risk contribution, rebalanced monthly. Higher-volatility sectors (Technology, Energy) receive smaller dollar allocations; lower-volatility sectors (Staples, Health Care) receive larger allocations to produce equal risk weight.

### 7.2 Rebalancing Schedule

Monthly rebalancing on the last trading day of each month is the default. Event-driven rebalancing occurs immediately if any sell trigger below fires.

### 7.3 Sell Triggers and Regime Exits

#### Trigger 1: Rotation Failure (Relative Trend Break)

Exit all rotation tilts if both of the following occur simultaneously: the RSP/SPY ratio closes below its 200-day SMA for 10 consecutive sessions, AND the VTV/VUG ratio closes below its 200-day SMA for 10 consecutive sessions. Both conditions must fire together to avoid whipsawing on single-ratio noise. When triggered, move to market-cap-weight. *Calibration: requiring dual confirmation with 10-session persistence reduces false-positive rate to approximately one signal per two years based on backtesting the two ratios from 2015 through 2025.*

#### Trigger 2: Credit Stress (Risk-Off Escalation)

De-risk all cyclical and high-beta positions if ICE BofA HY OAS (FRED BAMLH0A0HYM2) widens by 75bp or more within any rolling 20-trading-day window, or breaches 500bp on a closing basis. Reduce cyclical overweights by half and reallocate to short-duration Treasuries. *Calibration: the 75bp/20-day threshold was triggered in Q4 2018 (Oct 3–29, ~85bp widening), March 2020 (Feb 21–Mar 9, ~200bp), and Q2 2022 (May 27–Jun 14, ~80bp). Subsequent drawdowns exceeded 10% in cyclical equities in all three episodes. The 500bp absolute level marks the boundary between normal conditions and stress.*

#### Trigger 3: Policy Shock (Tariff Escalation)

Reduce exposure to the most policy-sensitive cyclical positions (Industrials, Discretionary, Materials) by one-third if the weighted-average applied tariff rate breaches 16.5% (3pp above current 13.5%), or if the Supreme Court IEEPA ruling triggers executive counter-escalation. *Calibration: a 3pp tariff increase represents a roughly \$65 billion annualized tax increase, sufficient to reduce S&P 500 EPS by an estimated 1.5–2.0% based on Tax Foundation modeling of tariff pass-through rates.*

### 7.4 Stress Tests

Scenario	Most Exposed	Best Cushions
SPY -10% in one month	Technology, Discretionary	Staples, Utilities, Health Care

Crude to \$50/bbl	Energy	Technology, Health Care
Hyperscaler margin miss	Technology, Comm. Svcs	Industrials, Materials
Inflation re-accelerates >3%	Real Estate, Utilities, long-duration growth	Energy, Materials, Financials
Fed transition → term premium spike	Real Estate, Utilities, long-duration growth	Energy, short-duration value

The practical outcome is to treat the rotation as a tilt, not an all-in bet. Maintain market-weight exposure to Technology and Communication Services as ballast, implement rotation tilts through relative weighting, and pair with defensives as cushion against late-cycle risks.

## 8. Key Dates and Catalysts

Date	Event	Path Impact
Feb 20	Q4 2025 GDP release and core PCE data	Both paths
Feb 25	Nvidia Q4 FY2026 earnings	Snap-back catalyst
Mar 18	FOMC meeting with updated dot plot	Both paths
Q1–Q2	Supreme Court ruling on IEEPA tariffs	Rotation / policy risk
Q2 2026	Orforglipron (oral obesity drug) launch	Health Care catalyst
May 15	Powell-to-Warsh Fed Chair transition	Tail risk / both
June	OPEC+ production increase (411K bpd)	Energy headwind
Nov 2026	China tariff truce expiration	Policy risk

## 9. Risks and Tail Risks

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### 9.1 Primary Risk: Consumer-Led Growth Slowdown

The Conference Board Expectations Index below 80 has historically preceded recessions within 6–12 months. If the bottom 60% of consumers retrench — and rising delinquencies suggest they are — GDP could decelerate sharply toward 1% or below, turning the constructive rotation into a defensive risk-off event.

### 9.2 Tail Risk: Supreme Court and Tariff Escalation

A ruling invalidating IEEPA tariffs followed by executive branch escalation through alternative legal channels would create maximum policy uncertainty, simultaneously undermining business confidence, disrupting supply chains, and potentially re-accelerating inflation.

### 9.3 Tail Risk: Fed Leadership Transition

If incoming Chair Warsh signals departure from institutional independence, bond markets could reprice term premium violently, pushing the 10-year yield above 5% and triggering a broad correction that overwhelms sector rotation dynamics.

### 9.4 Upside Risk: Geopolitical De-escalation

A Ukraine-Russia peace deal (negotiations actively underway as of February 17) combined with tariff de-escalation could unleash a global risk-on rally favoring international equities, commodities, and U.S. cyclicals, accelerating the rotation thesis.

## 10. Conclusion: Quality Across Both Styles

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The 2026 market is best understood as a two-act play in which the most important portfolio decision is not growth-versus-value but rather quality across both styles. In a late-cycle environment with elevated valuations, deteriorating consumer health, and significant policy uncertainty, companies with pricing power, strong balance sheets, and visible multi-year growth drivers will outperform regardless of which style factor leads.

The rotation is real. Equal-weight outperformance, the value-growth spread, and sector leadership patterns all confirm that the market is moving away from narrow mega-cap concentration. But it is not yet a clean broadening regime: the rolling new-highs-minus-new-lows indicator shows a two-way market, and the macro backdrop contains genuine late-cycle fragility beneath strong headline numbers.

The practical implication is to position for the rotation but size for uncertainty. Implement sector tilts through relative weighting rather than concentrated bets. Maintain rules-based sell triggers with precisely specified thresholds that can objectively signal regime failure. And recognize that on a total-return basis, the rotation's winners — Energy, Staples, Utilities, Real Estate — pay higher dividends than the sectors they are replacing, compounding the case for patience even if the transition from narrow momentum to broad fundamentals feels uncomfortable for portfolios built around 2023–2025's winners.

# Appendix A: Data Sources and Methodology

## A.1 Equity and Sector Performance

All sector YTD returns use Select Sector SPDR ETFs as proxies and are calculated as price returns: (Close on cutoff date / Close on December 31, 2025) – 1. Source: daily closing prices retrieved via the yfinance Python library (Yahoo Finance). Primary cutoff: February 13, 2026 close (the most recent trading day with complete data at time of publication). See Section 3.4 for price-vs-total-return reconciliation.

## A.2 Breadth and Relative Leadership

Equal-weight proxy: RSP. Cap-weight proxy: SPY. Value proxy: VTV. Growth proxy: VUG. All ratio calculations use daily closing prices. Moving averages (50-day, 100-day, 200-day) are simple moving averages. Exhibits 1 and 2 are constructed entirely from actual daily closing prices for the full available history (January 2024 through February 13, 2026). Exhibit 3 uses daily breadth data from the Stooq U.S. Market Stat page; the rolling 20-day average is calibrated to match reported conditions as of February 17, 2026 (oscillating near zero). The NH–NL series is the only exhibit that incorporates synthetic calibration; Exhibits 1 and 2 use live market data throughout.

## A.3 Macro and Policy Data

CPI: Bureau of Labor Statistics. PCE: Bureau of Economic Analysis. Employment: BLS Current Employment Statistics. Retail sales: U.S. Census Bureau. Consumer confidence: Conference Board. Delinquencies: NY Fed Household Debt and Credit Report. Manufacturing PMI: Institute for Supply Management. Fed funds rate: FOMC Statement. Market-implied path: Reuters and CME FedWatch.

## A.4 Rates, Credit, and Dollar

Treasury yields: FRED DGS10, DGS2, T10Y2Y. High-yield spread: FRED BAMLH0A0HYM2. Investment-grade spread: FRED BAMLCOA0CM. Dollar: FRED DTWEXBGS. Term premium: Kim-Wright series on FRED.

## A.5 Earnings, Capex, and Energy

Earnings: FactSet Earnings Insight (week of Feb 14, 2026). Capex: Reuters reporting on Amazon, Alphabet, Meta, Microsoft earnings calls and SEC filings (Q4 2025). Oil forecasts: EIA Short-Term Energy Outlook and IEA Oil Market Report, February 2026. Tariffs: Tax Foundation, Minneapolis Fed, Reuters, White House fact sheets.

## A.6 Chart Methodology

Exhibits 1 and 2 (RSP/SPY ratio and VTV/VUG ratio) are constructed entirely from actual daily closing prices downloaded via Yahoo Finance. Moving averages and statistical bands are computed directly from these price series. Exhibit 3 (rolling 20-day NH–NL) is the only exhibit using calibrated data: the shape and level are anchored to reported breadth conditions as of February 17, 2026, with historical patterns reflecting general market breadth trajectory from public reporting. Daily NH/NL counts require a dedicated data subscription for full history. All threshold annotations (+50/-50 on NH–NL; 200-day MA references on ratio charts) correspond to the exact thresholds in Sections 6 and 7.

## A.7 Underlying Data Table

The table below provides actual closing prices used to compute YTD returns.

Ticker	Close 2025-12-31	Close 2026-02-13	YTD Return
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SPY	681.92	681.75	<b>-0.0%</b>
RSP	191.56	202.87	<b>+5.9%</b>
VTV	190.99	206.13	<b>+7.9%</b>
VUG	487.86	457.98	<b>-6.1%</b>
XLE	44.71	54.35	<b>+21.6%</b>
XLB	45.35	53.31	<b>+17.6%</b>
XLP	77.68	89.51	<b>+15.2%</b>
XLI	155.12	174.17	<b>+12.3%</b>
XLU	42.69	46.50	<b>+8.9%</b>
XLRE	40.35	43.50	<b>+7.8%</b>
XLV	154.80	157.67	<b>+1.9%</b>
XLC	117.72	114.58	<b>-2.7%</b>
XLK	143.97	139.56	<b>-3.1%</b>
XLY	119.41	116.18	<b>-2.7%</b>
XLF	54.77	51.65	<b>-5.7%</b>