THE ECONOMY'S OPTICAL ILLUSION

If recent U.S. economic data were a painting, it would be one of those optical illusions that shifts meaning the longer you stare at it. Initial estimates for fourth quarter gross domestic product (GDP) growth north of 5% stunned commentators, briefly reviving talk of an economy that simply refuses to slow. Yet that burst of growth sits awkwardly alongside weak retail sales, falling inflation and a labor market whose apparent strength looks increasingly narrow. The temptation is to marvel at the headline. The harder — and more useful — task is to look beneath it.

Start with growth itself. The expected fourth quarter strength reflects a confluence of factors rather than a clean acceleration in underlying momentum. Inventory and trade dynamics, fiscal distortions, and shutdown-related timing effects flatter the aggregate number. Strip those out and the picture becomes more mixed, less exuberant and far less informative about where activity is headed in 2026.

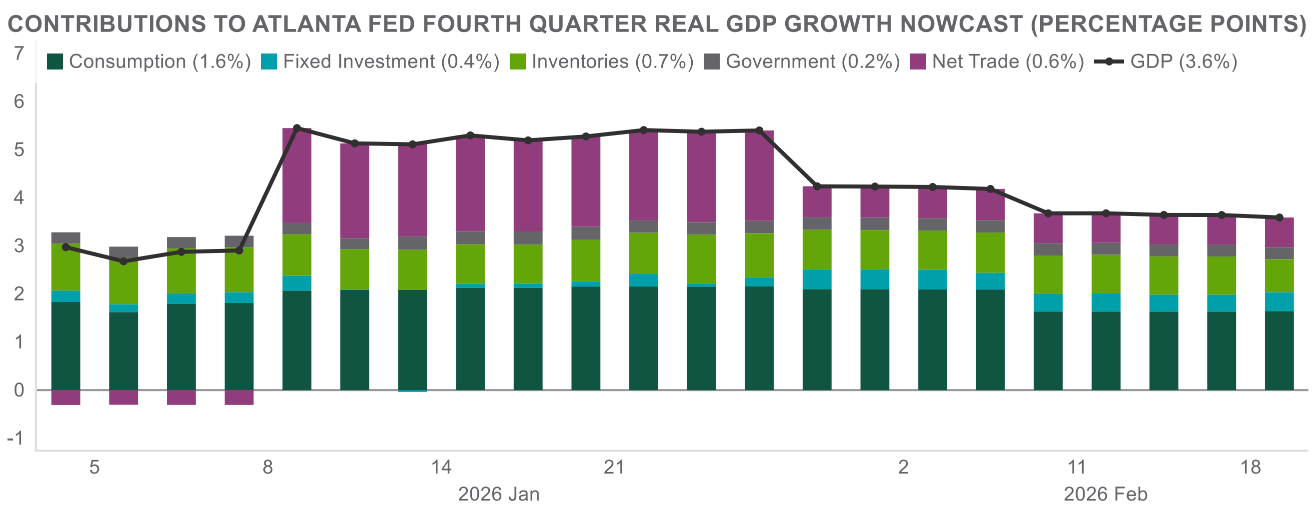
The same applies to the labor market. Recent job creation has rebounded, easing fears of an abrupt slowdown. But composition matters. Over the past three years, healthcare has accounted for the majority of net job gains. Demographics, aging populations and chronic staffing shortages have turned the sector into the economy's shock absorber. This is not a trend that pivots on small adjustments in short-term interest rates. Monetary policy can cool housing and discretionary spending, but it has limited leverage over hospitals and care providers that are structurally short of labor.

Retail sales offer another lesson in context. December's disappointing print grabbed attention, but it followed several months of better-than-expected data. Seasonal volatility remains high, and the consumer is not as fragile as a single data point implies. The calendar also matters. Tax refunds are about to arrive, and history suggests they provide a meaningful, if temporary, boost to spending earlier in the year. A pause is not the same as a pullback.

Inflation may be the most misread signal of all. Recent data still carry the fingerprints of the 43-day government shutdown in late 2025, muddying seasonal adjustments and price comparisons. More importantly, it is premature to declare victory. Tariffs continue to push up input costs, while healthcare benefit expenses are rising at a pace that leaves employers with little room to cut prices. Corporate pricing power may be bruised, but it is far from broken.

Markets have responded to this ambiguity in predictable fashion. Bonds have rallied, benefiting from confusion masquerading as caution. Equities, meanwhile, have churned through sharp rotations driven by micro-level news in the technology sector. That may not last. At some point, investors will have to engage with the broader macro picture — uneven, distorted by one-offs and resistant to simple stories. The illusion fades once the economy is viewed as a whole.

DECOMPOSING HEADLINE GROWTH ESTIMATES



Source: Northern Trust Asset Management, Macrobond, Atlanta Fed. Data from 12/23/2025 through 2/18/2026. Historical trends are not predictive of future results.

POSITIONING SCENARIOS

Fiscal and Productivity Boost (30% probability)

Tax cuts, deregulation and AI adoption more than offset supply restraints. Strong productivity gains continue, allowing for robust economic growth without sparking higher inflation.

Two-Speed Expansion (45% probability)

Soft labor force dynamics and a bifurcated economy govern what would otherwise be a stronger growth environment, resulting in a trend-like expansion and disinflation.

Economic Fault Lines Broaden (25% probability)

The economic expansion is cut short by persistent supply-side restraints that weaken consumer and corporate activity, or AI-related disruption that leads to broad financial tightening.

Note: Probabilities are assumed from proprietary research and are subject to change.

ViewPoints reflects data as of 2/18/26.

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