First Trust
Monday Morning OUTLOOK

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November 23, 2026

Tech Triumph or Tribulation?

After peaking in early October, the S&P 500 fell 12% through the market close on Friday. Official correction territory. The NASDAQ did even worse, down almost 20% after the peak on October 6.

There are plenty of reasons for the recent downdraft. One, which is getting too little attention, is that stocks were simply overvalued. The S&P 500 closed last year at 6,846 and the forecast we released in early January for the end of this year was 6,000, far out of step with and well below most analysts' projections.

Why were we bearish on stocks? As we said at the time, "since the bottom of the economy during COVID in 2020, corporate profits are up 96.2%, S&P 500 reported earnings are up 140% (they won at the expense of small business closed during COVID), while GDP is up just 55.8%. But the total return for the S&P 500 is up 189.5%! The stock market has outperformed earnings and economic growth and is trading at valuation metrics at the high end of the historical scale. Profits are also at a record level of GDP."

Yes, corporate profit growth was strong in the first half of the year, but the 10-year Treasury yield rose as well. As a result, we think stocks are still overvalued from a fundamental standpoint, in spite of the recent correction.

A second reason for the drop in stocks is the cluster of controversies surrounding Nvidia, including its relationship to its former and now incoming CEO, financing arrangements within the tech industry, as well as sales to China. These issues may lead to more restrictions on future sales (and, therefore, revenue) as well as more difficulty financing the AI and data center expansions.

A third reason for the selloff could be the realization that the economy outside the tech sector has been soft. At present, it looks like real GDP is growing at about a 3.0% annual rate in the fourth quarter. If so, real GDP is up about 2.8% from a year ago. Not shabby at all.

But we estimate that about half of this is coming from AI and data centers, including the wealth effect on consumption from (previously) soaring high tech stocks. This means that the rest of the economy is plodding along slowly. New home construction is still on a downward trend that started a few years ago. Light vehicle sales remain consistently below the pre-COVID trend of about 17 million cars and light trucks per year.

And so if the drop in stocks signals less of a boost from the tech sector, overall GDP growth is going to slow. This fear is exacerbated because some of the winners (including Governors) in the most recent election did so while taking direct political aim at the high-growth tech sector, including proposals to slow or even stop the process of building new data centers.

More generally, and as we wrote two weeks ago, if the Democrats sweep in 2028 – a prospect which we think is at least 50% likely – marginal tax rates are going up broadly, including the top tax rate on regular income, the tax rates on capital gains and dividends, as well as the corporate tax rate. None of that is good for equity valuations, particularly if it leads to even more federal spending.

How all of this shakes out for the remainder of the year and beyond remains to be seen. But it should be clear at this point that what had been until recently a period of tech triumph is becoming one of tech tribulation. Putting aside recent AI-driven cyberattacks, AI has the potential to boost growth…but as in all investment bubbles of the past, the market may be ahead of itself.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-25 / 7:30 am	Initial Claims – Nov 21	200K	**200K**		203K
7:30 am	Q3 GDP Preliminary Report	+3.5%	**+3.5%**		+3.4%
7:30 am	Q3 GDP Chain Price Index	+2.3%	**+2.3%**		+2.3%
7:30 am	Personal Income – Oct	+0.4%	**+0.3%**		+0.2%
7:30 am	Personal Spending – Oct	+0.4%	**+0.5%**		+0.5%
7:30 am	Durable Goods – Oct	+0.6%	**+0.9%**		+1.9%
7:30 am	Durable Goods Ex-Trans – Oct	+0.5%	**+0.7%**		+0.5%
9:00 am	New Home Sales – Oct	0.650 Mil	**NA**		0.676 Mil

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.