

GLOBAL PERSPECTIVES

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Q&A:

WHAT A 2026 MANUFACTURING RECOVERY COULD MEAN FOR INDUSTRIAL STOCKS

Despite solid growth in the US service sector over the past few years, manufacturing has been in the doldrums. But there are signs that trend could be changing in 2026, leading to opportunities in industrial stocks and a broadening of equity market performance. For insight into this topic, we sat down with GW&K's Global Strategist, Bill Sterling, and our Industrials Research Analyst, Taylor Cope.



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Q: What has been happening in US manufacturing over the last few years — and why have we seen stagnation in manufacturing despite overall GDP growth?

Bill: Manufacturing has spent much of the past few years in a funk, even while the overall economy kept moving. The sequence matters: 2022 was about supply chains healing; 2023 was about destocking as firms realized they'd built too much inventory when lead times normalized; 2024 was supposed to be a rate-driven rebound but high borrowing costs (and uncertainty) kept demand subdued. By the end of 2025, the Institute for Supply Management's (ISM) Manufacturing Purchasing Managers' Index (PMI) was still contracting. The index was at 47.9 in December, the tenth straight month below 50, after only a brief two-month expansion earlier in the year (**Figure 1**).

Taylor: The other part of the answer is simply that manufacturing is a smaller slice of the pie than it used to be. It's roughly a tenth of the US economy, so GDP can look fine even when factories are treading water. That disconnect has mattered for markets: Industrials investors chased "scarce growth" (AI and data center exposure, defense spending), while more economically sensitive industrial names got priced like the slump would last forever.

KEY POINTS

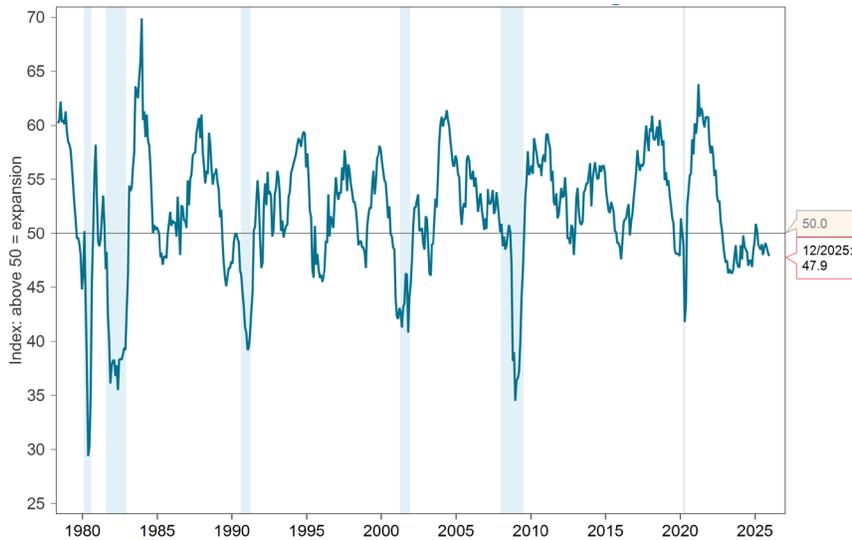
Early indicators point to a potential manufacturing recovery. Orders vs. inventories, low customer inventory levels, and strengthening core capital goods orders all show early cycle improvement — often the first signals before headline PMIs turn.

Policy shifts — both monetary and fiscal — are meaningfully supportive. Falling interest rates and incentives from the One Big Beautiful Bill Act create a more favorable environment for capex and industrial activity in 2026.

A broadening of growth beyond AI/data centers could unlock industrial equity opportunity. Short cycle industrials are positioned for strong operating leverage if demand normalizes; even modest volume increases can drive disproportionately stronger earnings.

FIGURE 1

**Manufacturing Remains in the Doldrums:
United States ISM Manufacturing PMI**



Sources: GW&K Investment Management, Institute for Supply Management, and Macrobond.

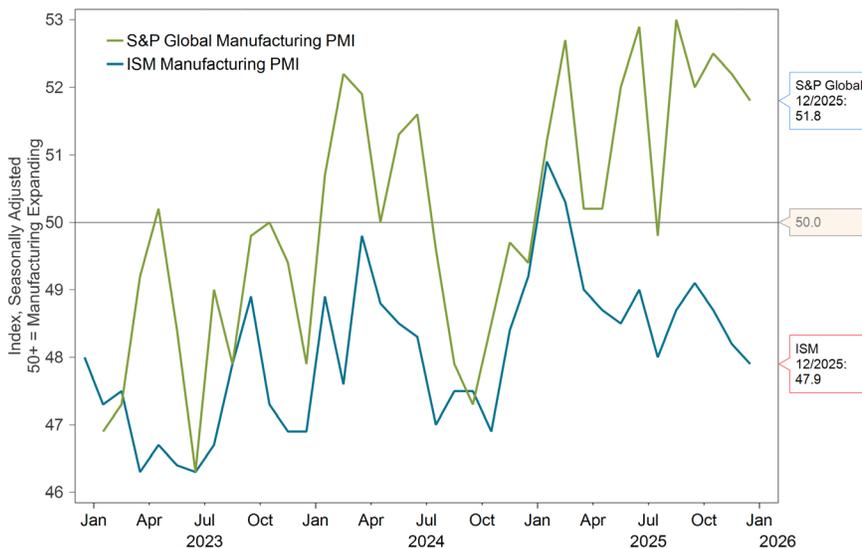
Based on the closely watched ISM Manufacturing PMI, the manufacturing sector remained in contraction for most of 2025 after a brief uptick early in the year.

Q: The headlines keep saying manufacturing is contracting. What should investors make of the mixed signals between the ISM Manufacturing PMI and the S&P Global Manufacturing PMI?

Bill: Start with the scoreboard. Despite a string of readings below 50 from the ISM PMI, the S&P Global PMI has been above 50 for 11 of the past 12 months and stood at 51.8 in December (**Figure 2**). Both can be “right” because they don’t measure the sector in identical ways — different panels, different weighting, and different sensitivity to things like supplier delivery times. A key difference is

FIGURE 2

**S&P Global vs ISM:
Diverging Pictures of Trends in Manufacturing**



Sources: GW&K Investment Management, Institute for Supply Management, S&P Global, and Macrobond.

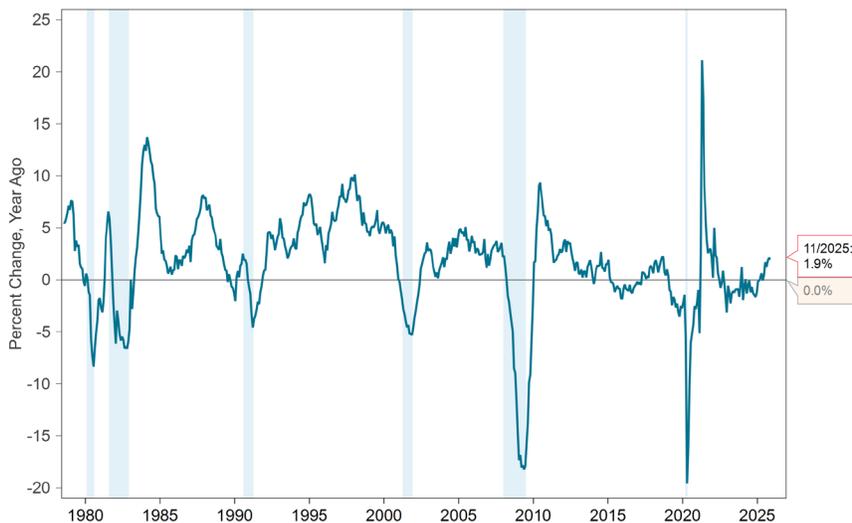
In contrast to the ISM measure, the S&P Global Manufacturing PMI has pointed to expanding activity in 11 of the past 12 months. Its wider coverage may make it more accurate than the ISM measure.

that the ISM measure tends to capture big, globally exposed manufacturers, while the S&P Global measure tends to better reflect smaller and more domestically oriented firms.

For what it's worth, the S&P Global measure seems to have better captured the modest recovery in the Federal Reserve's data on industrial output of the manufacturing sector, whose year-on-year growth turned positive in March 2025 (**Figure 3**).

FIGURE 3

Picking Up: US Industrial Production, Manufacturing Index



Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

In line with the more positive picture from the S&P Global Manufacturing PMI, the Fed's manufacturing output data has been expanding modestly on a year-on-year basis since March.

Taylor: For investors, the practical takeaway is not to anchor on the 49 vs. 51 debate. Use **Figure 2** (ISM vs. S&P PMI) as a “directional” tool, and then look under the hood. When the market’s leadership is concentrated (AI/defense up, classic cyclicals down), PMIs can look like they’re arguing with each other because the economy itself is uneven. That unevenness is exactly why a “broadening” story can create equity opportunity.

Q: If we’re looking for early proof of a manufacturing recovery, what are the most reliable leading indicators to watch beyond the headline PMI number?

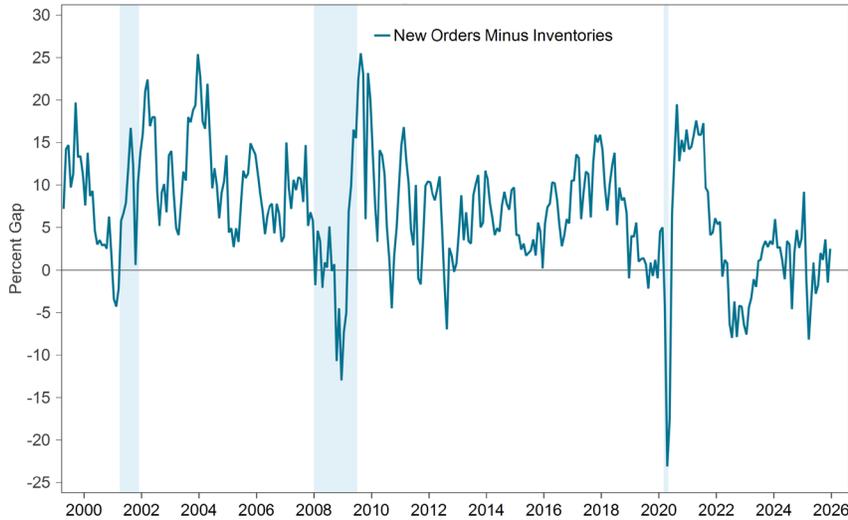
Bill: If you want earlier signals than the headline PMI, focus on orders and inventories. Two favorites: 1) **PMI New Orders vs. Inventories (Figure 4)** — because production follows demand and stock rebuilding; and 2) **Customers’ Inventories (Figure 5)**, which ISM said were still “too low” in December at 43.3. When customers’ shelves are bare enough, stabilization in demand can quickly lead to a restocking pop.

Also watch **Core Capital Goods Orders (Figure 6)** for a clean window into business equipment spending plans. In October data (released with a delay due to the government shutdown), core capital goods orders rose 0.5% for the month and were up 6.2% from a year earlier. It’s not a boom, but it’s the sort of incremental improvement that often precedes a broader industrial upturn.

Taylor: Translate that into equity timing: when orders stop falling and inventory drawdowns end, earnings revisions often follow — sometimes before the PMI prints “50-something.” Short-cycle stocks move on the “second derivative” (less bad → flat → modestly better). In real time, that’s why we watch **Figures 4 and 5** as closely as the headline PMI.

FIGURE 4

New Orders Exceed Inventories Foreshadowing Expansion Ahead

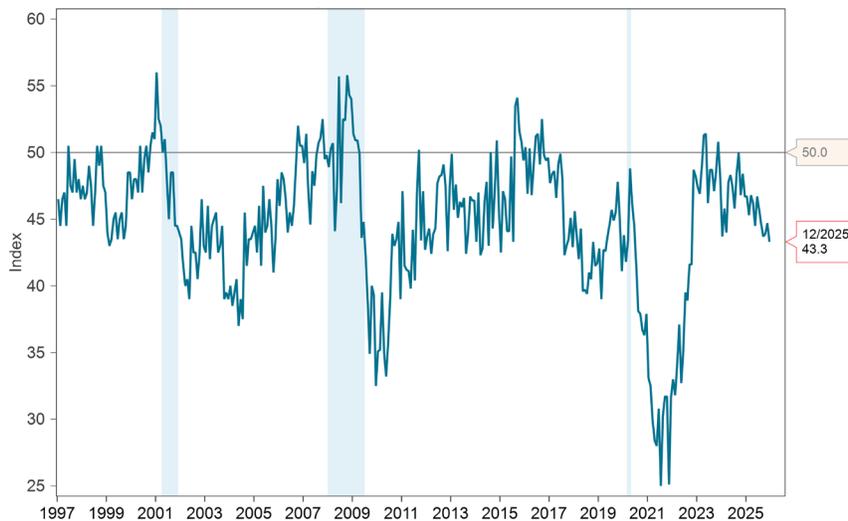


Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, Institute of Supply Management, and Macrobond.

The New Orders component of the ISM survey (47.7) currently exceeds the Inventories component (45.2) which is typically seen as a positive sign for future expansion of manufacturing activity.

FIGURE 5

Lean Inventories: ISM Manufacturing PMI Customers’ Inventories Index

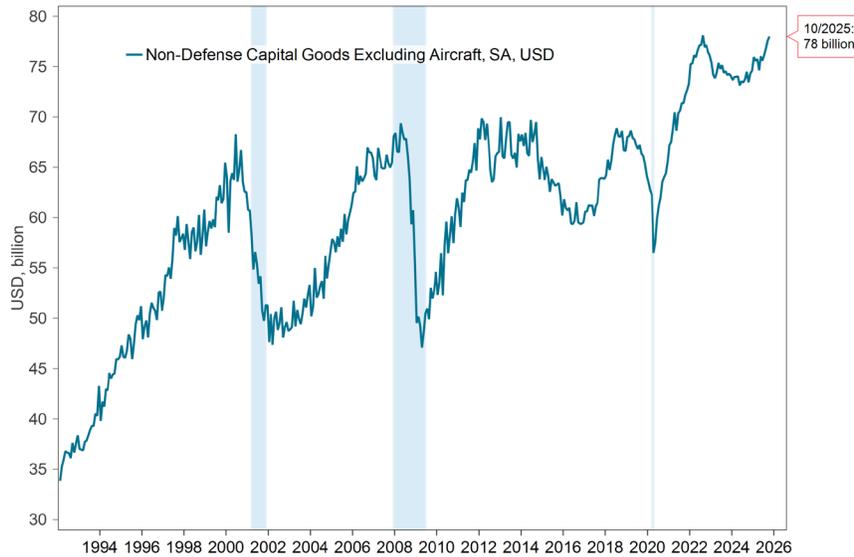


Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, Institute of Supply Management, and Macrobond.

The latest ISM survey also said Customer’s Inventories, at a reading of 43.3, were “too low,” which can lead to a restocking pop in production when demand stabilizes.

FIGURE 6

Business Spending on Equipment Strengthened in 2025



Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, US Census Bureau, and Macrobond.

Another potential tailwind for manufacturing activity is the pickup in capital goods spending that was seen in 2025, which should be further supported by the Trump administration's fiscal stimulus measures in 2026.

Q: How important is the inventory cycle — destocking versus restocking — in driving a manufacturing rebound, and what are the signs that destocking is ending?

Bill: The inventory cycle has been the quiet villain of this story. Destocking can be brutal because it depresses production even when final demand is okay. But as was just mentioned, the signs of a potential inflection point are showing up in survey internals: ISM's statement about customers' inventories being "too low" in December suggests that restocking is quite likely once demand stabilizes.

Taylor: Restocking is also why short-cycle industrials can snap back faster than people expect. Distributors and component suppliers often feel it first — orders turn before end-demand looks great. But there's an important caveat: restocking can also be a sugar high. The better setup is when restocking meets real demand drivers — rate relief, fiscal incentives, and capex programs — so you're not just playing a one-quarter inventory bounce.

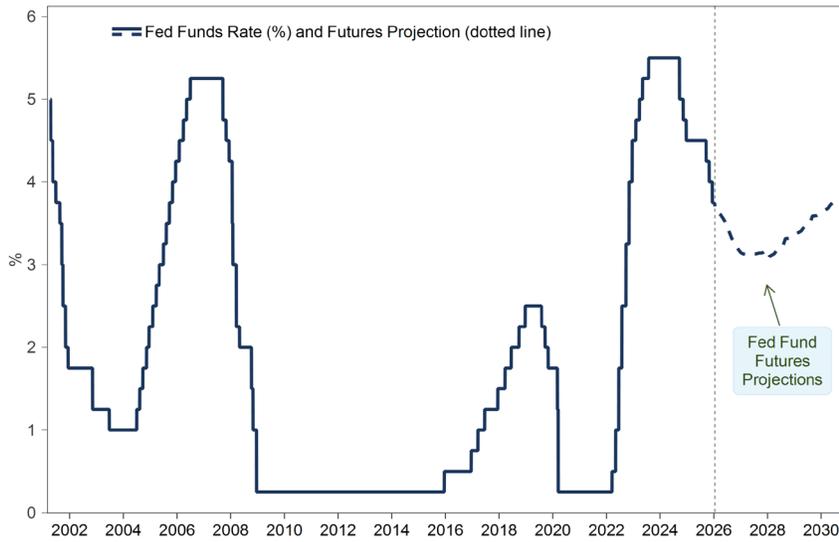
Q: How much could falling inflation and potential Fed rate cuts matter for manufacturing, and which parts of the industrial economy are most rate-sensitive?

Bill: Manufacturing is both directly and indirectly rate-sensitive. Directly, because financing costs hit equipment purchases and inventory carrying costs; indirectly, because housing and autos — big goods' ecosystems — move with rates. As the labor market cooled last year, the Fed ended up cutting rates by 75 basis points (bps) in the fourth quarter and futures markets anticipate two to three more cuts this year (**Figure 7**). While the timing of further rate cuts can be debated, the direction is clear: we are no longer in a "higher for longer" rate environment in 2026, which changes the calculus for factories.

Taylor: Rate sensitivity shows up in some familiar places: equipment rental, construction-linked machinery, building products, transportation, and parts of industrial distribution. Also, don't ignore the balance sheet channel: firms with more leverage (or customers who borrow) get relief when rates fall. The important investor question isn't just "Are rates down?" It's "Are rates down while growth is fine?" The bullish version is a soft landing: lower rates and decent demand.

FIGURE 7

Federal Funds Rate: History vs Futures Market Projections



Sources: GW&K Investment Management and Macrobond.

Another potential tailwind for manufacturing activity is the lagged effects of 175 basis points of US Federal Reserve rate cuts since 2024 and prospects for two or three more cuts in 2026.

Q: What role could fiscal policy play in 2026 – especially investment incentives and demand support tied to the 2025 One Big Beautiful Bill Act?

Bill: This is one of the cleaner tailwinds. The “One Big Beautiful Bill Act” was signed into law on July 4, 2025, and it meaningfully affects incentives for investment and production. Among other provisions, it restores 100% bonus depreciation for qualifying assets (after January 19, 2025) and expands first-year expensing opportunities. These measures were explicitly designed to encourage business investment, including in manufacturing capacity.

Taylor: For markets, the point isn’t just “stimulus,” it’s where the stimulus lands. Investment incentives tend to show up in orders and backlog for machinery, controls, electric equipment, and factory automation: the kinds of areas where a short-cycle upswing is most rapidly evident. We think this policy story is a key reason why core capital goods orders (**Figure 6**) have been trending up even when the ISM PMI has been stagnant.

Q: Tariffs have been a major theme recently. How do tariffs on intermediate goods like steel and aluminum affect US manufacturers, and do they help or hurt the sector overall?

Bill: Intermediate-goods tariffs are a classic case of policy that helps one pocket of manufacturing while taxing the rest. In 2025, President Trump increased the steel and aluminum tariff rates from 25% to 50%. That can benefit domestic metals producers and some protected niches – but downstream manufacturers pay more for inputs, and that pressure can reduce demand or margins.

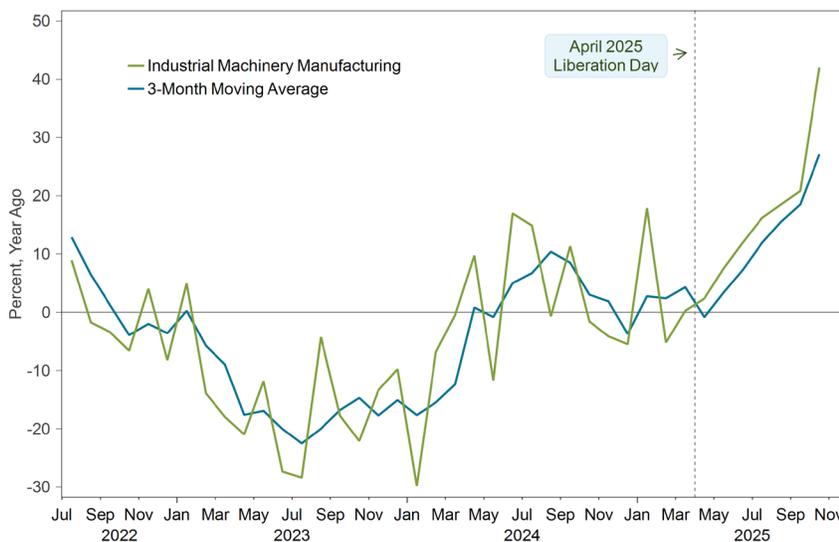
Broadly, the tariff environment has been a headwind, with the average US tariff rate having risen to about 17% in 2025, up from under 3% in 2024. That suggests that at least part of the late-2025 ISM manufacturing slump was due to tariff-driven cost and demand effects.

That said, the intermediate-term and long-term impact of tariffs could become a major tailwind for US manufacturing. That’s because it makes reshoring production facilities to the US a strategic

necessity for corporations looking to mitigate the impact of tariffs on their cost structure. In short, companies are increasingly compelled to manufacture domestically since the cost of imports have gone higher with tariffs.

This shift begins with investments in efficiency and productivity for existing assets as reflected in rising industrial machinery orders (Figure 8). That was accelerated with “Liberation Day” tariffs and such investment should be viewed as a leading indicator or “on-ramp” for a wave of greenfield projects — the construction of entirely new factories and infrastructure from the ground up.

FIGURE 8
Positive Momentum Following Liberation Day:
US Industrial Machinery Orders, USD, SA, YOY (%)



Sources: GW&K Investment Management, US Census Bureau, and Macrobond.

A surge in US industrial machinery orders since Liberation Day signals companies are investing in US manufacturing operations to avoid tariffs.

This reshoring impetus has led Morgan Stanley’s research team to forecast that the US industrial economy will reach decade-high growth rates in the back half of 2026 and into 2027.¹ Their research sees this expansion as a secular, durable opportunity that does not rely on a typical demand cycle. Instead, it is fueled by a \$1.2 trillion trade deficit and a narrowing gap between domestic production and consumer spending. As evidence, they point to a high volume of new project announcements that signals a long-term transformation that will allow the US to begin reclaiming global manufacturing shares lost over the past 25 years (Figure 9).²

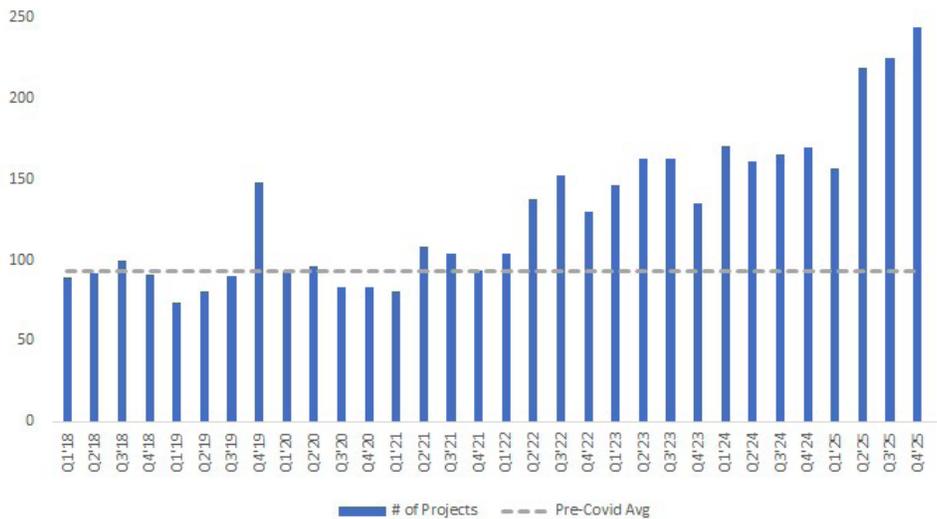
Taylor: The investment takeaway here is that tariffs reward pricing power. The winners are either upstream producers (metals, specialty materials) or downstream firms that can pass costs through without losing volume. The losers tend to be margin-thin fabricators, import-reliant small manufacturers, and anyone with contracts that lock pricing while costs move. In a recovery, watch who gets volume back **and** keeps pricing.

¹ Morgan Stanley Podcast: *Thoughts on the Market*, “Will U.S. Manufacturing See a 2026 Boom?”, January 13, 2026.

² We would highlight Apple’s announcement last year that it plans to spend \$500 billion over four years to expand manufacturing in the US. And JPMorgan recently announced a \$1.5 trillion commitment to finance and invest in US supply chains and national defense. See Alexander Saeedy et al, “Jamie Dimon Seemed to Have Trump Figured Out — Until This Week,” *Wall Street Journal*, January 14, 2026.

FIGURE 9

On the Rise: US Manufacturing Project Starts



Sources: Morgan Stanley and Dodge.

US manufacturing project starts have trended higher through 2025, suggesting that strategic reshoring of manufacturing facilities is becoming a durable driver of industrial activity.

Q: If growth broadens beyond AI and data centers, what does that mean for “short-cycle” industrial companies — and why might they have more earnings leverage than investors expect?

Bill: Right now, parts of manufacturing are already working, just not evenly. Note that in the December ISM industry breakdown, electrical equipment and computer/electronic products were among the few areas showing growth, while many traditional cyclicals were still contracting. That’s the “narrow growth” problem in a nutshell. Broadening means the improvement spreads from those tech-adjacent categories to mainstream machinery, components, and transport.

Taylor: And that’s where the short cycle comes in. These businesses are built on operating leverage: fixed costs plus variable volume. After years of sluggish demand, even modest volume improvement can lift margins disproportionately. Meanwhile, the market has treated many of these names like they’re stuck in permanent stagnation, while rewarding AI/data center exposure with “scarcity multiples.” A broadening recovery doesn’t require data center capex to crash; it just requires other demand channels to stop disappointing, so investors don’t have to pay up for growth in only one corner of the market.

Q: Focusing on specific industrial sub-sectors (machinery, electrical equipment, distributors, automation, transport), where might the clearest equity opportunities be found if manufacturing recovers?

Bill: Use the data to narrow the field. If we keep seeing accelerating core capex orders (**Figure 6**), that argues for exposure to capital goods and the supply chain around them. If new orders vs. inventories turns up (**Figure 4**), that’s typically good for distribution and components. And if the ISM PMI moves above 50 and starts to close the gap with S&P Global PMI (**Figure 2**), that’s a sign that big, globally exposed manufacturers are finally joining the party.

Taylor: Here's where I am looking for opportunities:

- **Distributors & fast-turn suppliers:** Early-cycle restocking and improving order cadence.
- **Automation / controls / electrification:** The rare overlap between secular (reindustrialization, productivity, data centers) and cyclical (factory utilization).
- **Machinery & equipment rental:** High sensitivity to rate relief and capex incentives; tends to respond quickly when projects move off the whiteboard.
- **Select transport & logistics:** A read-through on industrial demand — if freight stabilizes, it's usually not a coincidence.

The key is avoiding “cheap for a reason” traps: prioritize firms with pricing discipline, decent balance sheets, and end markets that can grow even if the rebound is only moderate.

Q: What are the biggest risks to the “manufacturing recovery + industrial stock rotation” thesis, and what data would tell you the recovery is failing or being delayed?

Bill: The most obvious risk is that manufacturing stays stuck in contraction — and the “mixed signals” resolve the wrong way (S&P rolls over to meet ISM, instead of ISM rising). If the ISM PMI stays parked in the high-40s for months, that's not a recovery, it's more stagnation. Watch whether orders re-accelerate and whether tariff and cost pressures keep biting; those issues were central to the late-2025 weakness in both the ISM report and the broader reporting around it.

Taylor: Markets will give you tells, too: Widening credit spreads, repeated downward earnings revisions for cyclicals, and short-cycle management teams talking about “pushouts” instead of “green shoots.” Bill and I will be watching the same data for potential red flags: New orders, inventories, core capex orders, and both manufacturing PMI reports. The rotation trade works when growth broadens. If the economy keeps rewarding only a narrow set of “can't-miss” themes, industrial cyclicals can stay cheap longer than you think — because cheap can be a value, or a warning label.

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