February 18, 2026

Morning Briefing

On China's New AI, US Consumer Debt
& Earnings Revisions

Check out the accompanying chart collection.

Executive Summary: The AI innovations emerging from China are hot on the heels of Western rivals. William discusses Alibaba's new AI model with agentic capabilities, its implications for the software industry, and China's political paradox: President Xi wants to dominate global tech, but will AI designed to think for itself eschew the party rule? … Also: Melissa distills takeaways from Fed research on the state of household debt and credit in America, noting some disconcerting trends. … And: Joe updates us on the net direction of analysts' estimate revisions for S&P 500 companies.

Chinese AI: 'Making Alibaba Great Again.' For Silicon Valley, it's been a frenetic week of looking Asia's way. Many of China's top AI powers—including Alibaba, TikTok creator ByteDance, and short-video platform Kuaishou—unveiled new models. For now, it's Alibaba's major update to its flagship model that's drawing the spotlight. The *Qwen3.5 upgrade* speeds up AI's "agentic capabilities" to understand text, images, and video inputs.

The series of releases exemplifies what Google DeepMind CEO Demis Hassabis told CNBC in the same week: Chinese AI models are only "*a matter of months*" behind Western rivals.

China Inc.'s goal is to take the lead with DeepSeek and other Chinese AI contenders. A year ago, the sudden arrival of its seminal R1 model upended the West's AI game board. Nvidia's market capitalization alone lost *$589 billion* in one day. With the first anniversary of the "*DeepSeek shock*" upon us, rivals are bracing for its next big platform debut.

Let's discuss the broader implications of Alibaba's new AI model for the company, the software industry, and China's grand vision of dominating global tech:

(1) *Game changer*. Alibaba's ambition is its own game changer. CEO Eddie Wu has made clear that his $53 billion spending pledge on AI development and infrastructure could grow

over time. With more than one billion active customers globally, Alibaba's capacity to be a dominant AI player is obvious.

In China, the scale of the e-commerce empire Jack Ma created leaves Alibaba well positioned to stay ahead of Tencent Holdings, Baidu Inc., and other top mainland internet giants. Alibaba's new Quen app aims to be an all-in-one platform that expands its already sprawling ecosystem.

(2) *Software woes.* Thanks to AI, "MAGA" in China refers to "*Make Alibaba Great Again*." The company's pivot from an e-commerce platform to an AI and cloud computing powerhouse has driven Alibaba's shares *up 27%* over the last 12 months.

Accordingly, Alibaba represents yet another AI threat for software stocks. The S&P 500's Software & Services industry index is down roughly 27% since late October. SPI Asset Management's Stephen Innes called the downdraft "software eating itself." Many software companies became dramatically overvalued, he says, on the assumption that margins would stay stratospheric forever.

Yet there are reasons to think that, despite the fanfare, Chinese AI may struggle to thrive. One is caution about any AI under a government that restricts citizens' access to historical events and the nuances of current global events. Another: overbearing and ever-shifting regulations directing how internet platforms can operate, where and how they can compete, and who gets to call the shots.

(3) *Tech crackdown.* Alibaba, remember, was the first target of President Xi Jinping's draconian tech crackdown beginning in late 2020. At a time when China was grappling with the Covid-19 pandemic, Xi considered it prudent to scrap the nearly *$35 billion* initial public offering of Ma's fintech unit Ant Group.

The move was partly retaliation for a speech Ma delivered in Shanghai in late October 2020. China's most famous innovator criticized Beijing for having "no financial system" and the state-controlled banks towering over the economy for having a "*pawn shop*" mentality.

(4) *Uninvestable?* Xi's blocking what would have been history's biggest IPO to date was quite the own goal. Ant's IPO would've redefined global finance, heralding China Inc.'s arrival because it bypassed Wall Street with simultaneous listings in Shanghai and Hong Kong (unlike Alibaba's 2014 New York Stock Exchange listing, then history's largest). Instead, Xi's blunder had top Western investment banks declaring China "*uninvestable*."

This is hardly ancient history. More than five years on, Ma is still *trying to return* to polite corporate society. And Xi's political empire continues to remind chieftains that it could strike back at any tech founder getting too big for his or her britches—or at anyone who appears insufficiently loyal to the motherland.

(5) *Regulatory roadblocks*. On February 2, a *New York Times* headline aptly summed up the political paradox governing China's vision for dominating AI: "*Move Fast, but Obey the Rules*." For all Xi's talk of Asia's biggest economy being on the verge of an "epoch-making major technological revolution," social control is the ruling party's top priority in all matters. This puts the Communist Party in direct conflict with a technology that, by design, eschews the rules and stays several steps ahead of legislators.

This has Xi's party paranoid about misbehaving chatbots and the risk that AI tools might spread online content that destabilizes society. The risk that chatbots in particular might veer too far in the direction of thinking for themselves or questioning the party rule has Team Xi formalizing new data-filtering rules to ensure that information passes ideological muster.

(6) *Second-tier status*. AI-generated videos, texts, and images are being policed and removed in ways that limit and distort inputs and extinguish innovation. That might relegate Alibaba, DeepSeek, and other China Inc. developers to second-tier status in what's arguably the most important economic race of the day.

US Consumer: Is Household Debt Facing a Midlife Crisis? Recent *headlines* have highlighted an uptick in mortgage delinquencies. The tone has been alarmist, but the data are not. According to the latest *Household Debt and Credit Report* by the Federal Reserve Bank of New York, the share of mortgage balances 90-plus days delinquent remains below 1% (*Fig. 1*). That is up modestly from pandemic-era lows but remains historically subdued.

More worrisome is another trend uncovered by the report: Credit-card stress has been rising among the middle-aged, in their 40s and 50s. This likely reflects the fact that many folks in the so-called "sandwich generation" are helping adult children financially at the same time that they are caring for aging parents—and caregiving can be expensive.

Rising delinquencies among 40- to 59-year-olds warrants careful monitoring for potential *spillover* into broader credit stress. This cohort anchors key pillars of the broader economic expansion, from consumer spending to housing turnover to retirement savings.

But this is not 2008. So far, the share of revolving-credit debt, a good real-time indicator of stress, is relatively small (around 7% of the total).

More reasons not to worry about an impending household debt crisis include: Credit quality remains solid, especially for mortgages, which represent the largest chunk of household debt. Leverage is concentrated among higher-FICO borrowers (*Fig. 2*). And household-debt-to-income ratios are at serviceable levels and well below those of the pandemic (*Fig. 3*).

Here's a closer look at the state of household debt:

(1) *Selective mortgage lending.* Total household debt stood at roughly $18.8 trillion in Q4-2025 (*Fig. 4*). Mortgages account for the bulk of that total, at roughly $13.2 trillion, or about 70% of the total (*Fig. 5*). Mortgage growth has slowed since early 2023, but credit quality at origination remains strong, with originations between Q1-2023 and Q1-2025 skewing heavily toward borrowers with credit scores of 760-plus.

(2) *Higher auto delinquencies.* Auto lending tells a similar story, albeit a slightly riskier one. While balances have grown to $1.7 trillion (around 9% of total household debt), much of the growth has been concentrated among higher-credit-score borrowers, tempering systemic concerns (*Fig. 6*). However, the delinquency rate on autos has ticked up, too.

(3) *Student borrowers reset.* Student loans could be a weak link, but that's yet to be determined. Student loan balances of roughly $1.6 trillion represent around 8%-9% of total loan balances. There's been a recent surge in delinquencies, which largely reflects the restart of required payments rather than a broad-based deterioration in household credit quality.

(4) *Maxing out the plastic.* Credit-card balances have risen materially since the pandemic from just under $1 trillion in early 2021 to over $1.25 trillion by early 2025. The share of credit-card balances 90-plus days late has climbed above 10%, a level not seen since 2011.

(5) *Squeezed in the middle.* Serious credit-card delinquencies are rising among the middle aged, while most younger and older cohorts have seen more stability or improvement (see chart on page 26 of the Fed report). The sandwich generation isn't falling apart financially, but it is struggling to hold it together.

A widely cited 2022 *study* from the Pew Research Center found that roughly 23% of US

adults are financially supporting both a parent and a child in some capacity. That's true for about half of Americans in their 40s and one-third in their 50s, _according_ to Pew.

Surveys consistently show that sandwich-generation households tap savings, take on new debt, delay retirement contributions or retirement itself, and reduce work hours or forego advancement. Housing compounds the strain. Many midlife homeowners are managing their own mortgage while helping adult children with rent or down payments and contributing to parental care, says a Realtor.com analyst _quoted_ in the January 16 _New York Post_.

(6) _The Great Wealth Transfer._ For today's financially squeezed Gen X and older Millennial households, an eventual inheritance from Baby Boomer parents could represent a significant balance-sheet relief valve. Baby Boomers, now roughly ages 61 to 79, control an outsized share of US household wealth. According to the Federal Reserve's _Distributional Financial Accounts_, households headed by those aged 60-plus own roughly half of US corporate equities and mutual fund shares, as well as a disproportionate share of _housing wealth_.

Over the next two decades, that wealth will shift to younger generations—_projected_ at more than $80 trillion through 2045—making it the largest intergenerational wealth transfer in US history. But while the Great Wealth Transfer may strengthen balance sheets tomorrow, it doesn't solve the liquidity squeeze in the middle right now. And the recipients won't necessarily be the same midlife households leaning most heavily on credit cards today.

Strategy: Analysts Raising Estimates for Beleaguered Sectors. Joe has updated our Net Revenues Revisions Index (NRRI) and Net Earnings Revisions Index (NERI) to reflect February activity, just released by data provider LSEG, and is impressed by what he found: Industry analysts' estimate revisions continue to improve for previously lagging S&P 500 sectors.

(_Note: Our NRRI and NERI reflect three months of analysts' consensus estimate revisions, indexed by the number of upward less downward revisions, expressed as a percentage of total estimates. A zero reading means the same number of estimates were raised as lowered._)

Earnings estimate revisions activity remains strong in February among most of the S&P 500's 11 sectors, as it has since bottoming in May. While NERIs in nearly all of the highest-NERI sectors continue to decline gradually from their recent multi-year highs, readings for

most of the long-lagging sectors tacked on another month of improvement from their cyclical bottoms. Some highlights:

(1) *S&P 500 NERI remains near four-year high.* The S&P 500's NERI index was positive for a seventh straight month in February (after turning positive in August for the first time in 11 months) but fell 0.5pt m/m to a six-month low of 3.4%. While NERI has gradually weakened from a 47-month high of 5.9% in October, it's still up sharply from a 28-month low of -7.8% in May (*Fig. 7*).

February's 3.4% NERI reading ranks in the top 20% of the 490 monthly observations since March 1985 and is well above the average reading of -1.8% seen since. The speedy NERI reversal began eight months ago in June; historically, such reversals have preceded positive readings for the next two years. That suggests further above-trend earnings gains ahead and supports the recent record-high stock prices for now-improving S&P 493 sectors.

(2) *Most sectors have positive NERI, and more laggards are improving m/m.* Six of the 11 S&P 500 sectors recorded positive NERI in February, unchanged m/m and down from seven sectors in the prior four months. That's much improved from May, when only Utilities' NERI was positive.

Four of the 11 sectors improved m/m in February, down from five in January and up from three in December. Three of February's gainers came from the five low-NERI sectors tied to the S&P 493 (as opposed to the Magnificent-7's sectors). They recorded a second month of improvement, further qualifying the S&P 493's solid outperformance recently.

No sectors joined the positive NERI club this month, but the leaders remained at the top and well above their historical averages: Information Technology and Financials (*Fig. 8* and *Fig. 9*). Utilities' 21-month positive NERI streak easily leads all 11 sectors, and its NERI remains near an 11-year high (*Fig. 10*).

Among the long-lagging S&P 493-type sectors showing recent strength, Health Care is on a six-month positive NERI streak and remains very near November's four-year high (*Fig. 11*). Energy was negative for a 19th straight month in February (*Fig. 12*).

Here are the February NERI readings for the S&P 500's 11 sectors: Information Technology (11.7% in February, 13.2% in January), Financials (8.3, 10.7), Health Care (5.0, 5.2), S&P 500 (3.1, 3.9), Utilities (3.0, 4.3), Industrials (1.9, 1.1), Communication Services (0.7, 1.3), Consumer Discretionary (-0.6, -1.3), Consumer Staples (-1.8, -2.6), Real Estate (-2.0, -0.8),

Materials (-6.0, -7.8), and Energy (-8.6, -6.3).

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): During the February 13 week, forward earnings rose for all three of these indexes for ninth time in 10 weeks. LargeCap and MidCap posted new record highs in their forward earnings, while SmallCap's improved further to just 1.3% below its June 2022 record.

LargeCap's rose for a 39th straight week, matching its longest winning streak since the June 23, 2011 week. LargeCap's next milestone is the 46-week streak following the Great Financial Crisis (GFC) through the March 25, 2010 week. The SMidCap's forward earnings are also on solid uptrends too, with both indexes missing just a few of the w/w gains since Liberation Day last April.

LargeCap's forward earnings rose 0.4% w/w to its 37th straight weekly record high. MidCap's improved 0.3 % w/w to 0.2% from a record high, which that index has posted in 13 of the past 16 weeks. Constituent changes helped SmallCap's jumped 1.8% w/w to just 1.3% below its June 2022 record. SmallCap's absence from the record-high forward earnings club has lasted longer than its the post-GFC drought, 43-months now versus 36 months then.

These three indexes' forward earnings downtrends from mid-2022 to early 2023 during Big Tech's year of cost-cutting and again during Trump's Tariff Turmoil were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the GFC. LargeCap's forward earnings has soared 42.1% from its 54-week low during the week of February 1, 2023; MidCap's has slowly gained 14.7% from its 55-week low during the week of March 10, 2023; and SmallCap's has quickly rebounded 15.6% from its recent 42-month low during the May 23 week.

Analysts currently expect all three of these indexes to post double-digit percentage earnings growth in 2026 and 2027. Here are the latest consensus earnings growth rates for 2025, 2026, and 2027: LargeCap (12.7%, 15.0%, 15.5%), MidCap (-1.3, 18.8, 14.9), and SmallCap (9.3, 14.6, 15.8).

S&P 500/400/600 Valuation (*link*): Valuations fell across the board for all three S&P market-cap style indexes during the February 13 week. The forward P/Es for the SMidCaps

have been mostly below LargeCap's since August 2018. LargeCap's forward P/E fell 0.4pts w/w to a seven-month low of 21.3, and is now 1.5pts below its 25-year high of 22.8 during the October 31 week.

LargeCap's P/E of 21.3 remains 4.3pts above the seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. It's down 1.5pts from a 25-year high of 22.8 during the October 31 week.

MidCap's forward P/E fell 0.2pt w/w to 16.9 from a 54-month high of 17.1 and is now 4.7pts above the 12-month low of 12.2 in October 2023. That compares to an 11-year low of 10.7 in March 2020 and a record high of 22.9 in June 2020 (when forward earnings was depressed).

SmallCap's forward P/E fell 0.4pt w/w to a six-week low of 15.8 from a 14-month high of 16.2. It's 2.9pts above its 17-month low of 12.9 during the April 4 week and 5.2pts above its 14-year low of 10.6 in September 2022, but remains 1.3pt below its 41-month high of 17.1 during the November 29, 2024 week. That compares to a record high of 26.7 in early June 2020 when forward earnings was depressed and a record low of 10.2 in November 2009 during the Great Financial Crisis.

MidCap's P/E improved w/w 1ppt to a three-year high 21% discount to LargeCap's P/E. That's up markedly from a 25% discount several weeks earlier and a 26-year-low 30% discount during the October 31 week. MidCap had been at a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021.

SmallCap's P/E dropped 1ppt w/w to a 27% discount to LargeCap's P/E. That's a tick down from a 13-month high 26% discount to LargeCap's P/E a week earlier, but remains well above its 25-year-low 34% discount during the November 20 week. SmallCap had been at a 23% discount during the November 29, 2024 week, which was its best reading since the March 2, 2023 week.

SmallCap's P/E relative to MidCap's dropped to a 7% discount from a 10-week high 5% discount, matching the 18-month-low 7% discount during the November 20 week. That remains well above its 20-year-low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

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