



2026 SUMMER INVESTMENT OUTLOOK

As we transition into the second half of this year, the U.S. capital markets have staged a strong recovery from the early Spring weakness and continued their upward trend from 2025. After grappling with the sudden outbreak of hostilities in the Middle East, equity markets appear to have found a firmer footing. The underlying driver of this rebound has been cooling tensions in the Middle East alongside sustained capital spending for artificial intelligence infrastructure and improving earnings growth expectations. This combination has reinforced investor confidence with economic growth demonstrating resilience despite higher prices resulting from tariffs and a surge in oil prices.

U.S. economic growth accelerated in the first quarter to an annualized rate of 2.1% as business investment increased by 10.6% due to surging investment in artificial intelligence. Growth accelerated in part due to a lower base as a result of the 43 day federal government shutdown at the end of last year. Government spending rose by 4.4% in the first quarter while consumer spending expanded by a modest 0.5%. The economic backdrop has remained more durable than many feared during the early stages of the Middle East conflict as higher tax refunds have helped cushion the blow of a spike in oil prices and the labor market has remained resilient. The economy added an average of 188,000 jobs per month from March to April, marking the strongest three-month cumulative advance in more than two years. After near zero job growth last year, the May employment report suggests that the labor market may be exiting the “low-hire, low-fire” environment that has prevailed in recent years.

The capital markets remain enthused even as the inflation picture has become more complicated. May CPI accelerated to 4.2%, up from 3.8% in April, as energy and gasoline prices rose by 23.5% and 40.5%, respectively. More than half of the increase in April came from energy costs and when excluding food and energy, core CPI rose by 2.9% from a year earlier. When combining these inflationary figures with wage data, real average hourly earnings decreased 0.7% from a year earlier, the biggest drop in more than three years. While core-inflation is less alarming than the headline figure, both measures remain above the Fed’s target of 2%.

In his first press conference as Federal Reserve Chairman, Kevin Warsh outlined a less predictable era for the central bank. Warsh abstained from contributing to the Fed’s “dot plot” of economic projections, which revealed a firm stance on inflation with nearly half of the committee projecting at least one rate hike by the end of 2026. The Chairman emphasized the Fed’s failure to achieve its 2% inflation target for a fifth straight year and demurred from providing forward guidance. This transition toward less prescriptive communication, paired with a committee that remains vigilant on price stability, suggests investors will need to navigate the current interest rate environment with fewer telegraphed reassurances from the central bank.

Equity Markets – 6/29/26

	<u>Index Price Level</u>	<u>2026 YTD Total Return</u>
Dow 30 Industrials	51,876	+8.8%
S&P 500	7,354	+8.0%
NASDAQ Composite	25,298	+9.2%
MSCI All Country World Index ex-USA	468	+13.0%

The Dow 30 Industrial Index is a price-weighted index of 30 US blue-chip companies. The S&P 500 Index is a market capitalization-weighted index of 500 large capitalization stocks commonly used to represent the US equity market. The NASDAQ Composite Index is a market capitalization-weighted index of over 2,500 companies listed on The NASDAQ Stock Market. The MSCI ACWI ex USA Index is a market capitalization-weighted index representative of developed and emerging market stocks excluding the US.

Outlook

The principal engines of U.S. economic activity remain intact. While gross domestic product forecasts for 2026 have moderated since the start of the year, emerging diplomatic progress in the Middle East has fostered optimism that easing energy costs could catalyze stronger economic growth relative to last year. Capital markets have responded favorably to this constructive backdrop, propelled further by upward earnings revisions and the secular, multi-year capital investments tied to artificial intelligence infrastructure. However, these positive underlying trends appear largely reflected in today's high equity valuations, which must ultimately reconcile with the structural headwind of rising interest rate expectations.

As oil resumes flowing through the Strait of Hormuz, crude prices have experienced a sharp retracement, returning to pre-war levels. The recent Memorandum of Understanding between the U.S. and Iran is a welcome development, however, it serves as a preliminary framework rather than a final resolution, with several complex geopolitical details yet to be ironed out. A durable de-escalation would help alleviate the pace of inflation, whereas a breakdown in this tenuous agreement risks reviving the supply premium that defined the first half of the year. Although the reversal in crude prices help moderate topline inflation, core PCE price index, the Fed's preferred inflation gauge which strips out volatile food and energy inputs, remains stubbornly elevated. The central bank left little doubt regarding its concerns, with 17 of 18 policymakers judging the balance of inflation risks tilted firmly to the upside. Moreover, the committee revised its year-end 2026 projection for core PCE prices sharply higher, moving to 3.3% from 2.7% just three months earlier. Although the Fed's projections envision a smooth glide path back toward its mandate, easing to 2.5% in 2027 and 2.0% by 2028, recent history suggests such forecasts should be viewed with a degree of skepticism. Core PCE prices bottomed near 2.5% in the spring of 2025 without ever reaching target, only to reverse course and climb steadily to 3.4% this May.

The uncertainty related to the inflationary outlook is compounded by a shift in how the Federal Reserve intends to communicate its policy path moving forward. Chairman Warsh has signaled a decisive break from the forward guidance regime of the past fifteen years. He expressed concern that highly specific projections invite markets to anchor to the Fed's signals rather than the underlying data. The Chairman regards financial market prices to be the most important source of information guiding central bankers and believes they will function more efficiently without the Fed's forward guidance. Modifying these historical signposts may cause investors, accustomed to more than a decade of explicit guidance, to react more acutely to individual data releases. Ultimately, the central bank is deliberately reducing its predictability, requiring investors to navigate a less telegraphed environment amid elevated macroeconomic and geopolitical complexity.

A more hawkish Fed has already led to the unwinding of the so called “debasement trade” which favored assets such as gold that serve as a hedge against currency devaluation driven by inflationary, fiscal, and monetary excesses. Speculative fervor for the trade moved beyond gold into Bitcoin at the expense of the U.S. dollar which has rebounded to a thirteen-month high as the prospect of higher interest rates has alleviated concerns about the greenback’s purchasing power for the time being. The dollar has also benefited from a renewed faith in American exceptionalism in part due to U.S. energy independence and investor excitement about artificial intelligence.

Faced with these macroeconomic uncertainties, investors have increasingly directed capital toward the near-term beneficiaries of artificial intelligence. This rotation reflects a growing perception that the structural build-out of AI and data center infrastructure remains relatively insulated from near-term geopolitical shocks and shifting central bank policy. While reminiscent of the transformative infrastructure build-outs of the past such as the rapid expansion of the railroads in the 19th century or the telecommunications boom of the late 1990s, the sheer scale of this current capital cycle remains staggering. Goldman Sachs forecasts an aggregate expenditure of \$7.6 trillion between 2026 and 2031 on computer chips, data centers, and power. Similarly, Bloomberg projects that capital expenditures by the 14 largest public data center operators will approach \$750 billion this year, a sharp acceleration from less than \$450 billion in the prior year. The beneficiaries of this boom have become the principal drivers of corporate earnings. AI-related firms are projected to generate more than 60% of the S&P 500's forecasted 22% earnings growth in 2026, while accounting for roughly 45% of the index's market capitalization, according to Bloomberg.

However, the source of capital underpinning this growth is shifting. While much of this initial infrastructure investment was previously financed organically through corporate profits, companies have started tapping both debt and equity markets as capital expenditure now outstrips free cash flow. Although the concentration of AI within the equity markets is well documented, its growing prominence across the capital structure is noteworthy. According to Apollo Global Management, AI-related enterprises accounted for 49% of new investment-grade bond issuances, 38% of new high-yield debt sales, and roughly 87% of all venture capital financing through May. The impact of this infrastructure build-out is moving well beyond the technology ecosystem, driving substantial secondary demand for industrial goods, energy, and banking services.

Indeed, as a growing share of capital expenditure is financed by debt, economic growth itself is increasingly being driven by credit. The Fed's latest Flow of Funds report shows the credit intensity of U.S. GDP climbing over the past year, with nonfinancial business debt as a share of GDP posting its largest annual increase since the 2008 financial crisis. That rising issuance threatens to push borrowing costs higher, even as an anticipated surge in IPOs threaten to dilute equity returns. Historically, significant upticks in aggregate equity issuance have often foreshadowed periods of market consolidation or broader selloffs. Net equity issuance turned positive in the first quarter for the first time since 2021, and the market capitalization of AI companies coming public could approach \$4 trillion this year.

This growing reliance on credit is not confined to corporate balance sheets. At the household level, consumer borrowing has risen at its fastest pace since 2022, while the personal savings rate has fallen to a three-year low as wage growth continues to trail inflation. However, aggregate spending has remained resilient, sustained less by paychecks than by rising real disposable income, which owes more to lower taxes and a buoyant equity market than to wages. That resilience, however, is unevenly distributed. Lower-income households are leaning more heavily on alternative financing mechanisms, such as buy-now-pay-later (BNPL) programs. According to a LendingTree survey, nearly half of BNPL borrowers paid late on an installment loan in the past year, up from about a third two years earlier. Notably, the share of these

installment loans used to cover everyday essentials like groceries has roughly doubled over the past two years to 29%. Whether these strains stay contained will ultimately depend on the labor market. Real disposable income turned positive in May for the first time this year, and so long as the economy keeps adding jobs above the breakeven rate, household incomes should continue to support consumption.

Investment Conclusion

As we look toward the second half of the year, the investment landscape presents a delicate balance of emerging tailwinds and structural complexities. On the geopolitical front, recent diplomatic progress has pulled energy prices back from their highs, and with them the most acute threat to the inflation outlook. Furthermore, the secular build-out of artificial intelligence offers the genuine prospect of boosting long-term economic growth through widespread productivity enhancements. However, this optimism must be carefully weighed against the reality that this massive infrastructure cycle is increasingly reliant on debt financing, tethering future economic expansion more tightly to the credit markets and borrowing costs. While the valuation multiple on the S&P 500 remains meaningfully above its historical average, it has compressed in recent months as robust earnings growth has begun to catch up to elevated prices. Nevertheless, we remain highly conscious of the risks presented by these elevated valuations and a less predictable monetary regime.

As responsible stewards of our clients' capital, our focus remains unwavering. Rather than attempting to time macroeconomic shifts or chase narrow market trends, we will continue to navigate this environment by maintaining strict discipline. We continue to selectively add corporate bonds and Treasuries as yields adjust to expectations of higher interest rates. In the equity markets, elevated volatility has provided us with attractive entry points in some stocks, allowing us to deploy capital into fundamentally sound companies that have been largely overlooked by a market fixated on short-term momentum. We remain dedicated to constructing resilient portfolios anchored by durable, high-quality businesses that possess the fundamental strength to sustainably grow our clients capital over the long term.

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