

# Market Newsletter

## Second Quarter 2026

## EXECUTIVE SUMMARY

- U.S. Equity Markets performed well in the quarter. The S&P 500 crossed 7,600 fueled by Artificial Intelligence capex but pulled back in June. Broader market components (such as non -AI stocks, value stocks, smaller stocks) outperformed the lagging, over-concentrated Magnificent 7 giants as profit-taking intensified.
- International equities performed unevenly; emerging Asia gained from AI hardware supply chains, while European manufacturing languished under severe localized industrial power costs stemming from Middle East conflicts.
- In Fixed Income Markets, yields ticked up and long-term bonds sold off. However, cash and shorter duration bonds helped diversified bond portfolios eke out a gain.
- U.S. economic growth remained resilient, supported by a stable employment and consumer spending. Capital expenditures expanded past technology into the physical economy, lifting core orders for primary metals and machinery.
- Corporate earnings anchored equity strength, delivering 28.6% growth in Q1 with record margins of 15.6%. Q2 projections expect growth exceeding 20%.
- The S&P 500 settled at a trailing P/E multiple of 20.1 times earnings. While historically elevated, this multiple reflects a marketplace supported by actual, tangible corporate profit expansion rather than speculative hype.
- Portfolio Construction: Successful investing balances financial science with planning art. Good financial planning ensures portfolios survive behavioral impulses and shifting market environments.

# SARSI

**Table 1: Market indices**

<i>(Returns include dividends reinvested)</i>	<b>Quarter to date</b>	<b>Year to date</b>	<b>1 Year</b>	<b>3 Year Annualized</b>	<b>5 Year Annualized</b>
S&P 500	15.20%	10.21%	22.32%	20.61%	13.41%
S&P Mid Cap 400	14.47%	17.34%	25.89%	15.41%	9.07%
S&P Small Cap 600	19.70%	23.90%	37.50%	16.05%	7.37%
MSCI Emerging Markets	24.15%	24.02%	44.18%	23.62%	7.69%
MSCI EAFE	11.08%	9.84%	20.80%	17.02%	9.60%
Vanguard Total Bond Market Index	0.67%	0.70%	3.60%	4.04%	-0.05%
Investment Grade Credit	1.85%	1.42%	4.90%	5.66%	0.61%
Non-Investment Grade Credit	2.40%	1.8%	5.69%	8.77%	4.12%
Bloomberg Commodity Index	-8.32%	14.06%	25.13%	11.59%	9.31%
Dollar Index	1.54%	3.14%	4.68%	-0.49%	1.87%
10 Yr. Rate	4.42% 06/30/2026	4.16% 12/31/2025	4.23% 06/30/2025	3.82% 06/30/2023	1.44% 06/30/2021

Source: S&P Dow Jones, St Louis Fed, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

**Table 2: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)**

As of 07/01/2026			
	Latest Release	Recent Trend	Notes
Non-Farm Employment	172,000	Positive	May nonfarm payrolls bounced back from a weak April. Reacceleration indicates broad labor market expansion, though sectoral growth remains uneven with gains driven by healthcare and government while leisure and hospitality soften.
Weekly Claims for Unemployment Insurance	226,000	Negative	Weekly claims have drifted from the low 200k range up toward 226k by mid-June, signaling a mild cooling trend and localized layoffs, though overall corporate talent retention remains historically stable.
ISM Manufacturing Index (over 50 indicates growth)	53.3	Positive	June's index slipped to 53.3 from 54.0 in May, but still marked the sixth consecutive month of expansion. A sharp drop in the Prices Paid index to 73 indicates significant easing of inflationary pressures from factory inputs.
ISM Non Manufacturing Index (Over 50 indicates growth)	54.5	Positive	The services sector reaccelerated following a brief dip in April. New orders and business activity remain highly resilient, but the services price component shot up to 71.3, signaling persistent price pass-through concerns.

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	Latest Release	Recent Trend	Notes
Consumer Prices (Month over month change)	0.5%	Negative	CPI rose 0.5% in May, lifting the annual rate to 4.2%. Ongoing Middle East shipping disruptions and regional tensions drove energy and fuel prices up 3.9% for the month, accounting for the bulk of the headline gain.
Producer Prices (Month over month change)	1.1%	Negative	PPI came in hot at 1.1% MoM for a second straight month, lifting annual wholesale inflation to 6.5%. The core PPI was more muted at 0.4%, pointing directly to energy supply shocks as the primary culprit.
Retail Sales (Month over month change)	0.9%	Positive	May retail sales grew by a resilient 0.9%, bouncing back from a weak April. Consumer spending remains robust on nominal items and domestic travel services, though much of the jump reflects higher out-of-pocket gas station costs.
Consumer Confidence (Conference Board)	91.2	Negative	The index edged up slightly to 91.2 in June from a revised 90.6 in May. Falling oil prices due to a US-Iran ceasefire extension eased immediate inflation fears, but views on the current labor market deteriorated heavily.
Durable Goods Orders (Month over month change)	-4.5%	Positive	New orders fell 4.5% in May following April's massive aircraft surge. However, core capital goods (ex-defense and aircraft) rebounded sharply by 1.6%, showing strong underlying corporate resilience in manufacturing.
Industrial Production (Month over month change)	0.1%	Positive	Industrial production nudged up 0.1% in May after a robust 0.9% gain in April. Manufacturing output was flat for the month, while a 1.3% gain in mining and energy extraction offset minor utility declines.
Capacity Utilization	76.2%	Positive	Edged slightly upward to 76.2% in May from 76.1% in April, tracking the minor growth in total industrial output. It remains roughly 3.2 percentage points below its long-term historical average, leaving ample headroom.
Housing Starts	1.177 Million	Negative	Homebuilding plummeted 15.4% MoM in May to an annualized rate of 1.177M units—its lowest level since 2020. The drop was led by a crash in multifamily sectors as high mortgage rates continue to weigh on affordability.
Home Prices (Case-Shiller Home Price Index- Year over Year)	0.80%	Negative	The index logged a modest 0.8% YoY gain in April. High mortgage rates (climbing to 6.3%) continue to pinch affordability, causing real home values to fall behind inflation for the 11th consecutive month.
GDP (Real, Annualized)	2.1%	Positive	The third and final estimate for 1Q 2026 real GDP was revised upward to 2.1% annualized (from 1.6%). The bump primarily reflects a downward revision to imports, which outpaced a slight markdown in consumer spending.

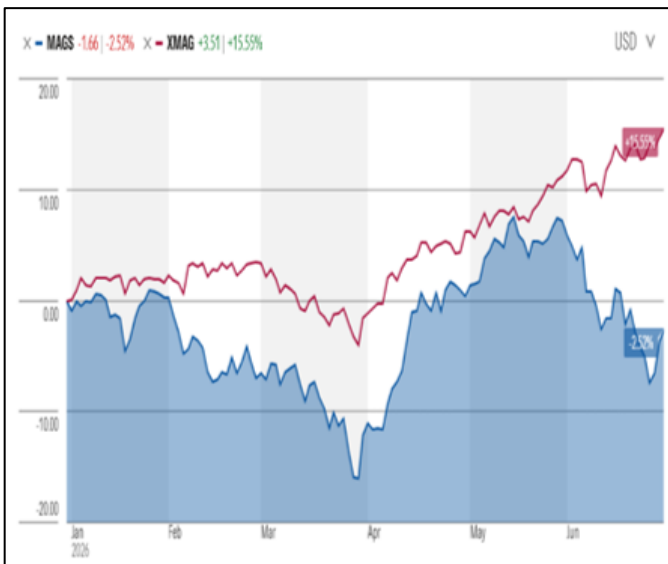
Source: Bloomberg, [www.federalreserve.gov](http://www.federalreserve.gov), [www.bls.gov](http://www.bls.gov), [www.ismword.org](http://www.ismword.org), [www.nahb.org](http://www.nahb.org)

The second quarter of 2026 brought a mix of geopolitical events and volatility across global financial markets. In the U.S., major equity benchmarks reached new all-time highs earlier in the period, with the S&P 500 crossing the 7,600 threshold for the first time. This initial momentum was largely sustained by unprecedented capital expenditures from hyper-scale technology enterprises into artificial intelligence (AI) data centers and semiconductor infrastructure. However, June introduced a sharp market pullback as a series of complex macroeconomic and geopolitical crosscurrents converged to test asset valuations.

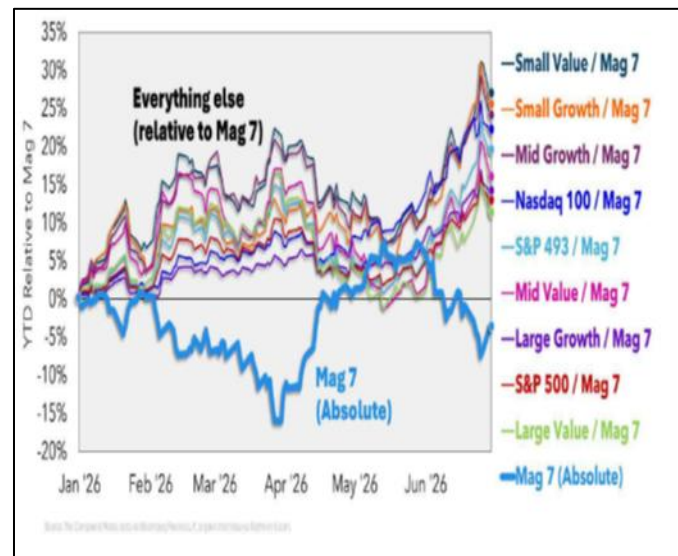
The primary catalyst for mid-quarter market anxiety was the severe escalation of the war in Iran and the subsequent physical closure of the Strait of Hormuz. This direct supply shock temporarily removed a vital chokepoint for global oil transit, triggering energy security anxieties and driving Brent Crude prices rapidly past \$120 per barrel. However, market dynamics shifted decisively in mid-June when the U.S. and Iran signed a breakthrough interim memorandum of understanding. This 60-day truce was expected to facilitate a formal reopening of the shipping lanes, allowing global supply lines to normalize and pulling crude oil prices sharply backward from their late-quarter peaks.

Market dispersion remained high within the domestic equity markets, extending the performance dynamics observed at the start of the year. While the first quarter saw the broader market components (S&P 500 stocks that are not the MAG 7 i.e. Microsoft, Apple, NVIDIA, Alphabet, Amazon, Meta Platforms, and Tesla) outperforming the MAG 7, the second quarter saw that outperformance gap widen even further. Earlier in the period, the MAG 7 attempted to recapture their previous momentum, temporarily lifting the headline S&P 500 Index past the 7,600 threshold. However, as valuation scrutiny intensified in June amid shifting interest rate expectations and geopolitical pressures, they experienced a sharp profit-taking correction.

Fig 1: Performance of Mag 7 (MAGS) vs the rest (XMAG)      Fig 2: ‘Everything else’ outperforming MAG7 this year



Source: Morningstar



Source: Chart Kid Matt

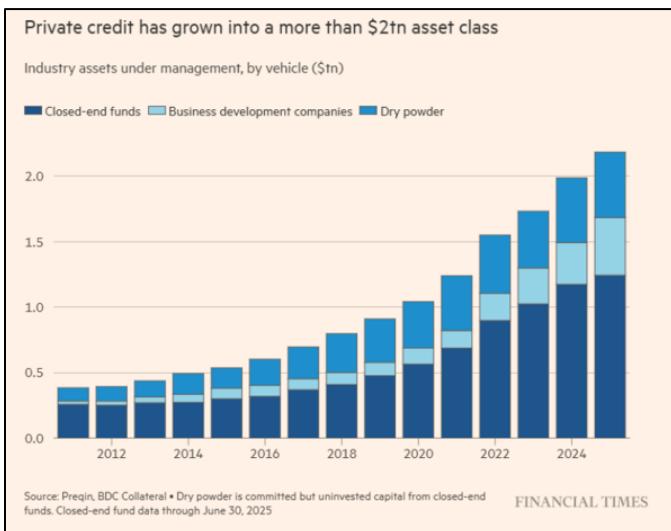
Consequently, the MAG 7 finished the quarter lagging behind the broader index components once again. (Fig 1) Institutional capital rotated dynamically into defensive, asset-heavy, smaller companies and value-oriented sectors. These other areas saw renewed capital inflows, which acted as a crucial defense mechanism for diversified portfolios toward the end of the quarter (Fig 2). Within the S&P 500 Index, roughly 70% of the market's total year-to-date return remained concentrated in dominant technology and data center infrastructure stocks (Though not the MAG 7), illustrating the ongoing structural dispersion under the surface.

International equities faced a more challenging and fragmented environment relative to the U.S. during the three-month period. The performance of non-U.S. developed markets and emerging economies was uneven across regional corridors. Emerging Asian economies continued to find foundational support due to their exposure to the global AI semiconductor supply chain. In stark contrast, European equity markets faced intense structural headwinds; localized manufacturing and industrial sectors grappled with surging electricity and chemical feedstock costs tied directly to the mid-quarter Middle East energy disruptions. Simultaneously, a structurally stronger U.S. dollar acted as a direct translation drag on foreign currency-denominated returns for domestic investors. Regions heavily leveraged to raw materials and commodity exports experienced highly volatile trading as shipping blockades forced a complete rerouting of global commerce. It is worth noting, however, that despite trailing the U.S. during this quarter, international stocks successfully maintained their relative outperformance advantage over domestic equities on a year-to-date basis, owing to the relative performance they accumulated during the first quarter of the year.

In the fixed income markets, traditional bonds felt the heavy pressure of shifting institutional dynamics and stubborn consumer price metrics. A central driver of this fixed income volatility was a historic leadership transition at the Federal Reserve. Following a period of intense institutional and political scrutiny, the central bank underwent a major structural shift when Kevin Warsh was officially sworn in as the new Federal Reserve Chairman, succeeding Jerome Powell. In his first meeting, the Fed held the benchmark federal funds rate steady at a target range of 3.50% to 3.75%. This institutional transition, paired with resilient baseline economic data and supply-side inflation shocks, pushed the yield on the bellwether 10-year U.S. Treasury note marginally upward during the quarter. Because bond prices move inversely to yields, traditional longer term fixed income benchmarks sold-off, though shorter-duration instruments and cash equivalents continued to offer highly attractive, stable yields.

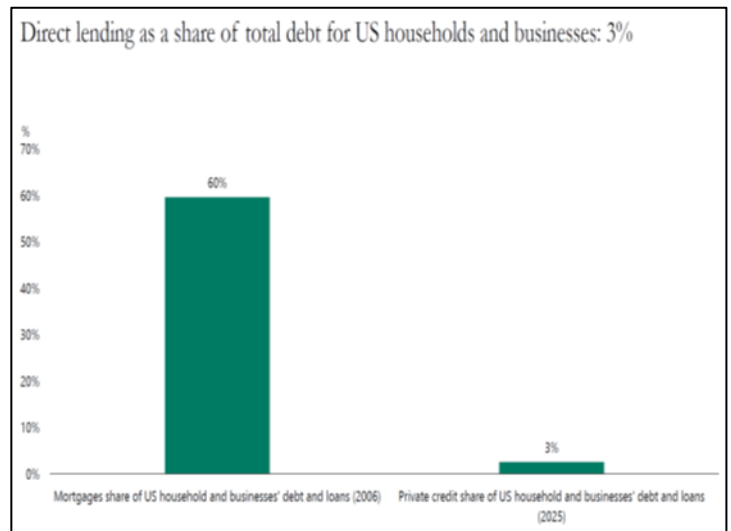
Widespread repricing was also felt across the credit markets. Investment-grade and high-yield corporate bond spreads widened slightly in lower-rated tiers, reflecting a more discerning and risk-averse approach by credit investors toward corporate leverage. However, both sectors generated positive returns during the quarter. Within the alternative credit space, Private Credit faced its first major structural liquidity test of the cycle. A rapid rush toward the exits by certain institutional and retail investors prompted several prominent, multi-billion-dollar funds to officially raise their redemption gates to preserve underlying portfolio liquidity. Despite this localized friction and asset-matching gridlock, private credit continues to represent a relatively small, structurally ring-fenced portion of the overall debt market, remaining isolated from broader systemic contagion risks when compared to historically unhedged credit breakdowns like the subprime mortgage crisis. (Fig 3 and 4)

Fig 3: Assets in Private credit have grown steadily..



Source: Financial Times

Fig 4: ....but are still a small portion of total debt



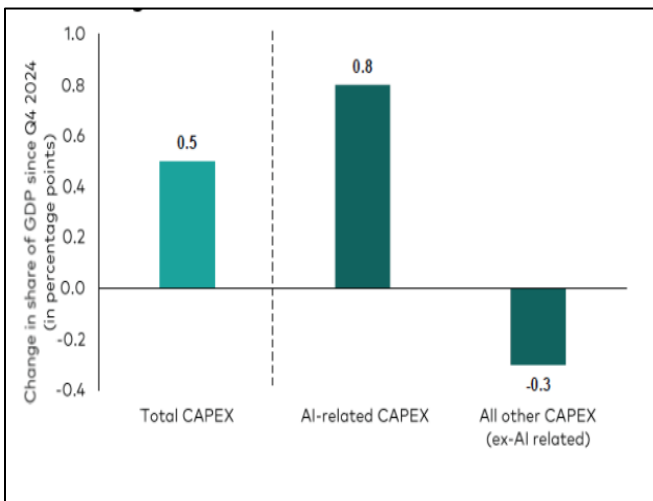
Source: Apollo Global Management

## The Economy and Corporate Earnings

The underlying U.S. economy demonstrated ongoing resilience throughout the second quarter, successfully absorbing significant geopolitical crosscurrents and domestic regulatory shifts. Gross Domestic Product (GDP) continued to expand, anchored by steady consumer spending and robust business capital expenditures. Business spending data showed an interesting shift under the hood during the quarter; while capital expenditures remained heavily driven by hyperscale technology firms investing in digital infrastructure and artificial intelligence processing capabilities, (Fig 5) nondefense capital goods orders show that capital expenditures have begun systematically broadening out into the physical economy. Corporations have broadened their demand into non-technology sectors, significantly expanding orders for primary metals, fabricated metals, and industrial machinery as ongoing reshoring trends strengthen domestic manufacturing output.

The labor market showed signs of a gradual, orderly cooling rather than a sudden contraction. Weekly jobless claims ticked slightly higher, but remained well within historical boundaries, and the national unemployment rate settled at a stable 4.3%, indicating a more balanced hiring environment compared to the severe labor tightness of previous years. Manufacturing indices showed steady baseline output, though input costs remained elevated across industrial sectors due to global shipping bottlenecks and altered ocean freight routes.

Fig 5: Capital expenditure for AI is driving overall capex



Source: Vanguard

Fig 6: Profit margin is at a record high



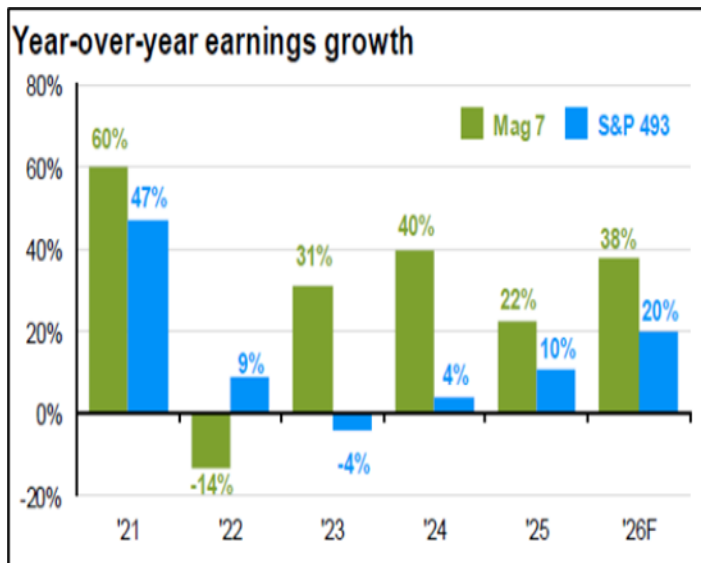
Source: JP Morgan

Inflation remained the most central talking point of the quarter for policymakers, corporate executives, and consumers alike. Driven by the mid-quarter energy supply disruptions from the Iran war and stubborn services costs, the Consumer Price Index (CPI) steadily rose to 4.2% on a year-over-year basis. This persistent inflation data prompted the Federal Reserve, under Chairman Warsh's new leadership, to maintain its "higher for longer" restrictive monetary stance. The central bank signaled that any potential monetary easing would remain strictly on pause until trailing core inflation numbers move sustainably closer to its long-term 2.0% objective.

On the corporate front, fundamental earnings delivery remained the primary pillar of equity market strength. Despite higher baseline borrowing costs, and temporary supply-chain frictions, corporate profit margins proved highly adaptable. The companies in the S&P 500 reported earnings growth of 28.6% in the first quarter. This represented the single strongest corporate earnings season since late 2021, with aggregate corporate profit margins hitting an all-time record high of 15.6%. (Fig 6)

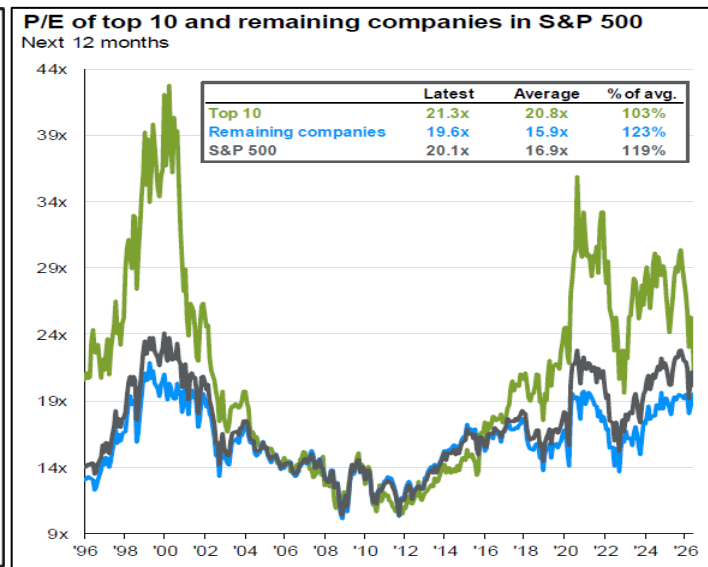
Looking ahead, full-year consensus expectations for corporate earnings remain remarkably constructive, tracking at an estimated full-year growth rate of 24%. Historically, an earnings expansion speed of this magnitude has been surpassed only four times in the past 25 years, with each prior instance requiring the tailwinds of a major recessionary or pandemic recovery shock. This time however, earnings are surging primarily because of growth in sales and continued improvements in margins.

Fig 7: Earnings growth for the Mag 7 vs the rest



Source: JP Morgan

Fig 8: The S&P 500 has become cheaper because of earnings



Source: JP Morgan

For the second quarter specifically, the earnings season is kicking off with FactSet calling for an estimated year-over-year earnings growth rate of 23.1% for the S&P 500. If realized, this data will mark the second consecutive quarter of aggregate corporate growth exceeding 20%, heavily underpinned by the ongoing capital spending boom and energy-sector revenue tailwinds. In terms of market valuations, the trailing price-to-earnings (P/E) ratio for the S&P 500 finished the quarter at approximately 20.1 times earnings. (Fig 8). While this valuation multiple sits above long-term historical averages, it reflects a marketplace that is being fundamentally supported by tangible corporate profit expansion (Fig 7) rather than speculative multiple expansion alone.

## The Science and Art of Portfolio Construction

Investing is often portrayed as a purely mathematical exercise—identify the investments with the highest expected returns, combine them into an efficient portfolio, and allow compounding to do the rest. Modern financial theory has indeed provided powerful insights into diversification, risk management, and long-term investing. Yet successful portfolio construction requires considerably more than mathematics. It requires balancing scientific principles with the practical realities of each investor's financial circumstances and emotional tolerance. In that sense, portfolio construction is as much an art as it is a science.

One example is the mathematics of compounding. Consider a single lump-sum investment with no subsequent deposits or withdrawals. If that investment experiences annual returns of +20%, -10%, +15%, and -5%, the final portfolio value will be identical regardless of the order in which those returns occur. However, once cash flows enter the picture, the sequence suddenly becomes critically important. Investors making regular withdrawals during retirement can be permanently harmed if poor market returns occur early in retirement, while investors making regular contributions during their working years often benefit from early market declines because new contributions purchase more shares at lower prices.

This phenomenon, known as sequence-of-returns risk, illustrates why investment management cannot be separated from financial planning.

Cash-flow planning therefore becomes one of the most important aspects of portfolio construction. Establishing adequate emergency reserves, matching short-term spending needs with relatively stable investments, and ensuring that long-term objectives are funded with long-term assets all reduce the likelihood that investors will be forced to sell growth investments during periods of market stress. A portfolio that is mathematically optimal but poorly aligned with future cash-flow needs may ultimately prove less successful than one that appropriately balances both objectives.

Another example involves the decision between investing a lump sum immediately or gradually investing through dollar-cost averaging. History shows that because stock markets have generally risen more often than they have fallen, investing immediately has typically produced the highest expected return. If markets continue their long-term upward trend, a dollar-cost averaging strategy will gradually purchase investments at progressively higher prices, making it mathematically less efficient than investing all at once.

However, investing is ultimately undertaken by people rather than spreadsheets. Dollar-cost averaging can significantly reduce the emotional burden associated with investing a large sum immediately before a market decline. Conversely, if markets do decline during the averaging period, investors benefit from purchasing additional shares at lower prices, although watching portfolio values temporarily decline is never comfortable. Neither approach is universally superior because each represents a different trade-off between maximizing expected return and managing behavioral risk.

Ultimately, the role of a financial advisor extends well beyond selecting investments. Successful portfolio construction requires integrating sound financial science with thoughtful cash-flow planning, appropriate risk management, and an understanding of investor behavior. The objective is not simply to build portfolios with attractive expected returns, but to construct portfolios that clients can confidently maintain throughout changing market environments. That combination of science and art is one of the primary reasons why comprehensive financial planning remains valuable regardless of market conditions.