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Market Review and Outlook 2Q26

Highlights

Stocks finished the first half of the year on a high note, with the S&P 500 Index posting a second-quarter total return of 15.2% and closing the period near its all-time high.

Easing tensions in the Middle East, a sharp retreat in crude prices, and the surge in technology infrastructure investment helped propel equity markets higher during the quarter.

Exceptional earnings growth has comfortably outpaced the market's recent price gains, tempering near-term valuation concerns. Still, the S&P 500's forward P/E multiple of 21.0x sits roughly 22% above its 30-year historical average, demanding sustained capital spending activity to justify current levels.

Stabilizing employment trends and stubborn inflation pressures could force the Fed to hike interest rates later this year—a sharp reversal from earlier in 2026, when multiple rate cuts were expected.

Fixed income returns edged higher in the quarter, despite price pressure from rising Treasury rates, as high starting yields helped the bond index deliver a second-quarter gain of 0.7% (+0.6% YTD).

We continue to favor short- to medium-duration bonds, as their prices are less sensitive to inflation/fiscal risks than long-term bonds.

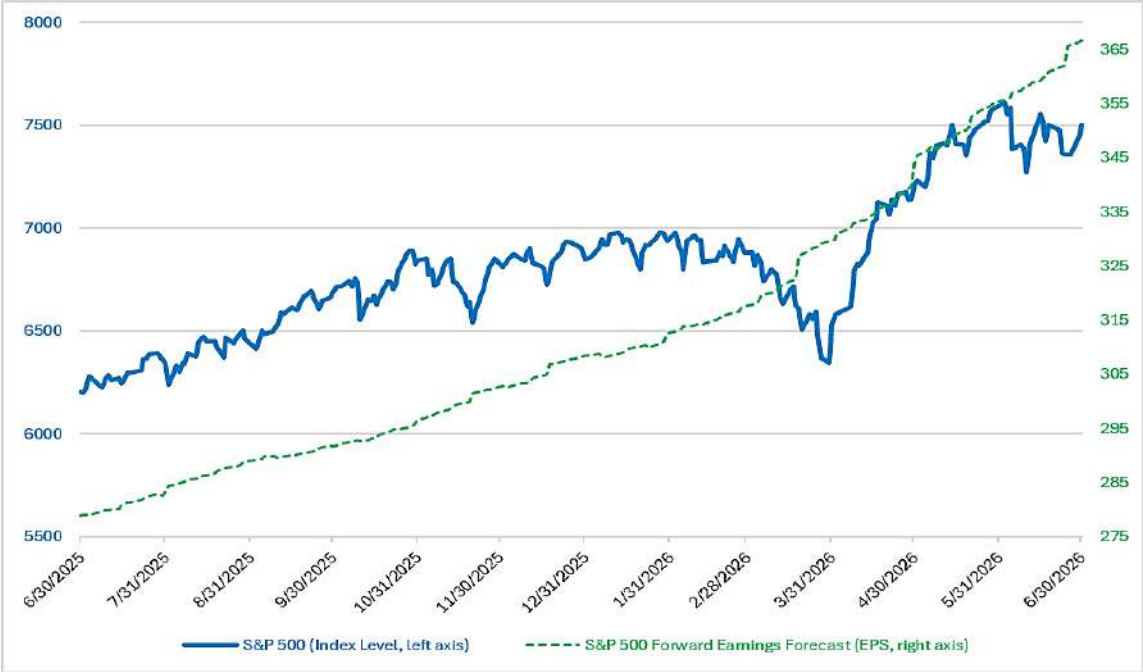
Market Review and Outlook

Global equities regained their footing in the second quarter, with each of the major indices posting strong double-digit returns during the three-month period. Following a first quarter marred by geopolitical volatility, this synchronized global rally delivered the strongest collective quarterly performance for the major equity indices in recent history. The S&P 500 Index recorded a second-quarter return of 15.2% (+10.2% YTD), resuming its pre-war upward momentum. International stocks also saw a pronounced uptick in the quarter, with developed markets (EAFE) advancing 10.2% (+9.4% YTD) and emerging markets (EM) notching an exceptional second-quarter gain of 24.1% (+23.9% YTD).

Geopolitical uncertainty and elevated energy prices loomed over the market for most of the second quarter, until the U.S. and Iran mutually agreed to generally end hostilities in mid-June. Nonetheless, investors anticipated a more stable environment, front-running the truce by pushing stock prices higher early in the quarter. This optimism stemmed from a continuous rise in corporate earnings forecasts. While stock prices had been vulnerable to headline risks earlier in the year, corporate profits proved immune, continuing their steady climb.

S&P 500 Index and Forward EPS Estimate

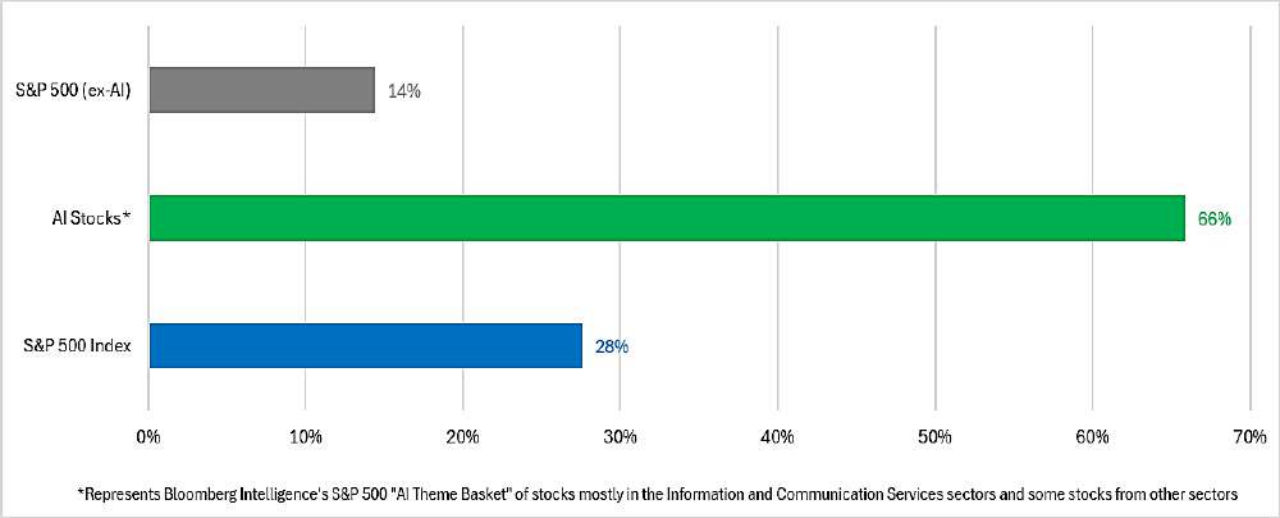
(6/30/25 – 6/30/26)



Source: FactSet

Throughout the second quarter, companies reported first-quarter earnings that came in much higher than anticipated. S&P 500 earnings skyrocketed 28% in the first quarter—more than twice the 13% growth rate projected heading into reporting season—marking a pace rarely seen outside of post-recession rebounds. This outsized profit expansion is being fueled by AI-related stocks, which are riding a tidal wave of corporate spending. Combined capital expenditures from hyperscalers are now projected to approach a staggering $800 billion this year (~2.5% of U.S. GDP). This represents a near-doubling of the $410 billion spent in 2025, driving exceptional profit growth for semiconductor companies and firms tied to data center infrastructure. Ultimately, AI-related stocks posted cumulative 1Q26 earnings growth of 66%, effectively lifting the S&P 500's overall EPS growth from 14% (excluding AI) to the headline rate of 28%, as shown in the chart below.

1Q26 Corporate Earnings Growth
(year-over-year % change)



Source: RBC Capital Markets, Bloomberg

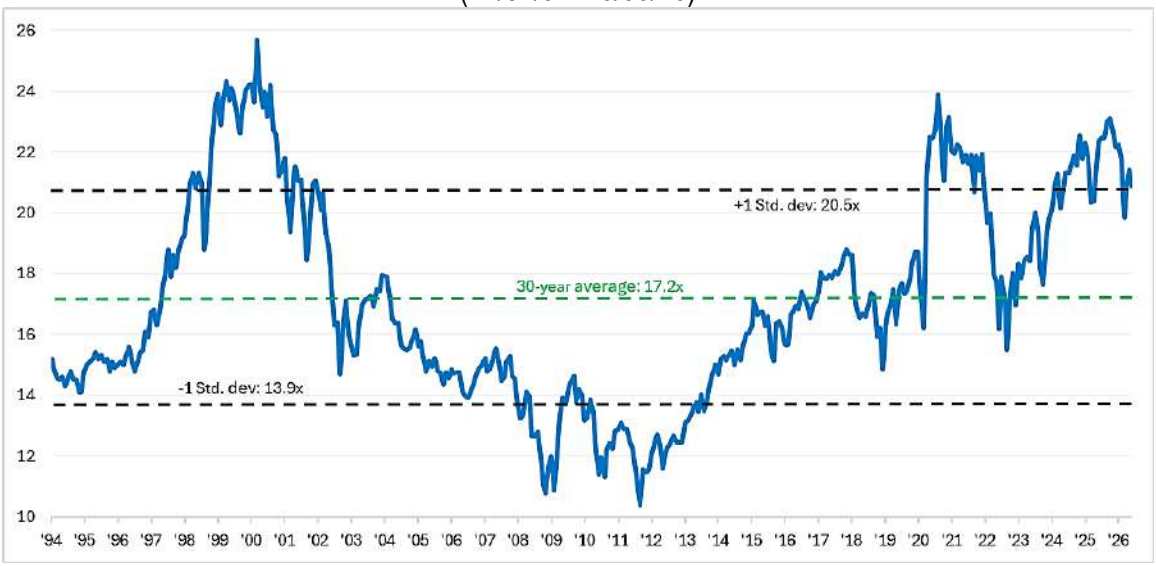
This first-quarter profit surge marked a notable acceleration from the consistent low-teen growth reported over the past several quarters, a dynamic which is expected to continue through the rest of the year and into 2027. Driven by the unrelenting pace of the AI buildout, consensus estimates now project full-year 2026 S&P 500 EPS to grow 24%—compared to the 14% forecast from January—before expanding another 17% in 2027. As semiconductor demand continues to outpace supply and mega-cap tech margins push into record territory, the AI-infrastructure beneficiaries are expected to drive roughly half of all incremental S&P 500 profit growth over the next several quarters. Over time, the consensus view is that this capital spending momentum will expand beyond AI into non-AI business investment, providing broader support for the wider economy.

While this optimistic scenario is certainly plausible, a degree of skepticism towards the staying power of these AI-driven profits is warranted. The relentless escalation of AI spending echoes historical technology cycles, where aggressively scaling capacity takes precedence over capital optimization. At some point, investors will pivot from rewarding "growth at any cost" to demanding tangible returns on investment—a metric the broader AI ecosystem has yet to deliver. In the interim, it is possible that excessive investment could lead to overcapacity, upending the very spending cycle that has become critical to the market's growth outlook. This would be analogous to the telecom buildout of the late 1990s, when over-investment in fiber optic cables initially decimated capital returns, even though it laid the foundation for the modern internet economy.

The sustainability of this market expansion hinges on whether soaring tech earnings can spread into the wider economy—a rotation that could be tethered to Fed monetary policy. The AI value chain has been immune to macroeconomic influences thus far, but higher interest rates would significantly raise the cost of extending the $800 billion infrastructure boom, especially as cash-rich mega-cap tech firms tap debt markets to fund these substantial outlays. Conversely, future monetary easing would provide a vital tailwind for capital investment across non-AI sectors, but that relief remains on hold. While markets entered the year forecasting two rate cuts to shore up a softening labor market, stabilizing employment and stubborn inflation have completely flipped expectations. Following the Fed's pause at the June policy meeting, futures markets entirely priced out any 2026 easing and now view a rate hike by year-end as a distinct possibility.

The prospect of higher interest rates poses a direct threat to the market's primary vulnerability: its premium valuation. While exceptional earnings growth has helped the market absorb recent price gains and temporarily temper this premium, the S&P 500's forward P/E multiple of 21x remains 22% above its 30-year average and in the 95th percentile of its modern historical range.

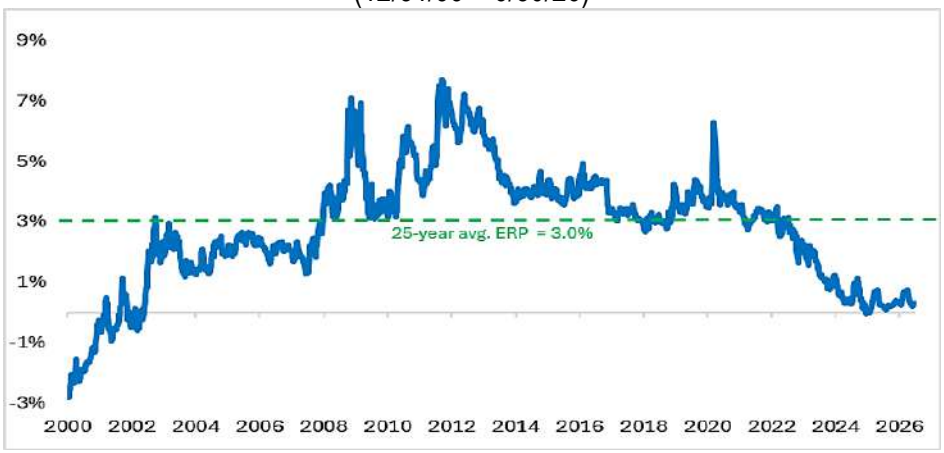
S&P 500 Index Forward P/E Multiple
(12/31/94 – 6/30/26)



Source: FactSet, JP Morgan Asset Management

The concern is that the current equity valuation backdrop risks repeating the 2000 dot-com setup, when a tech infrastructure boom temporarily masked deteriorating economic fundamentals, before restrictive Fed policy ultimately triggered a sharp multiple rerating and market correction. Higher interest rates typically compress equity valuation multiples through three distinct pressures: (1) a higher discount rate mathematically reduces the present value of future cash flows; (2) rising borrowing costs squeeze net margins and curtail growth investments; and (3) elevated Treasury yields make bond returns more competitive, shrinking the incentive to take risk in stocks. The equity risk premium—defined as the gap between the S&P 500's earnings yield (i.e., inverse P/E multiple) and the 10-year Treasury yield—has nearly disappeared and now hovers among its lowest levels since 2002. Consequently, if interest rates trend higher by year-end, it could be difficult for the stock market to build upon (or maintain) the outsized gains recorded during the first half of the year.

Equity Risk Premium
(12/31/99 – 6/30/26)



Source: FactSet

This is not to suggest the market is on the precipice of a 2000-style collapse. Unlike the dot-com era, where valuations for speculative, highly levered startups expanded on little revenue growth, the AI rally is anchored by high cash-producing enterprises whose investments are driving observable multi-sector benefits. Massive capital spending by hyperscalers is functioning as a macro-level stimulus, driving robust demand across adjacent supply chains, industrial sectors, and power infrastructure.

Ultimately, the durability of this capital investment cycle will dictate the market's future trajectory. Bulls view the AI infrastructure buildout as a multi-decade secular transformation akin to the industrial and digital revolutions. Bears counter that aggressive capital spending is detached from near-term downstream revenue realization, arguing that as semiconductor supply catches up and premium prices for processing, storage, and memory chips fade, CapEx levels will normalize. Upcoming quarterly earnings reports will provide a critical reality check, revealing whether enterprise AI application revenues are accelerating rapidly enough to justify this unprecedented infrastructure spend.

Entering the back half of 2026, the market landscape remains generally constructive. A resurgent labor market has buoyed economic activity, while accelerating corporate profit growth continues to support rich stock valuations. Furthermore, robust capital investment is delivering a high-multiplier economic tailwind. However, these cyclical strengths exist within a shifting structural regime. While headline risks and energy prices have eased amid progress toward a U.S.-Iran peace framework, regional history suggests a permanent solution may prove elusive. And while the AI opportunity is real, the runway to profitability may prove longer and bumpier than investors expect. With equity markets priced for near-perfect conditions, investors should guard against complacency as catalysts for volatility—including re-emerging geopolitical tensions, rising interest rates, or a deceleration in the AI spending spree—loom on the horizon.

Core Portfolio

During the second quarter, we initiated a new position in Blackstone Inc. (BX).

Blackstone is the world's largest alternative asset manager, with $1.3 trillion in AUM producing over $8 billion per year in recurring management fees. Its highly scalable and asset-light operational model drives operating margins north of 45%, matching or beating the profitability of top-tier big tech firms. Crucially, the company has emerged as the global leader in AI infrastructure, boasting a $150 billion data-center portfolio and a $160 billion development pipeline—positioning it to capture lucrative performance fees (carried interest) when those investments are eventually sold to an eager pool of buyers for these critical computing infrastructure assets. The stock's recent pullback from historical highs stems from fears surrounding private credit exposure to AI-disrupted software sectors and a subsequent flood of fund redemptions. We believe these concerns are overblown and structurally immaterial for Blackstone, making this selloff a rare opportunity to acquire a premier compounding machine at a deep discount.

We exited our positions in CF Industries and IAC Inc. during the quarter.

CF Industries is the world's largest manufacturer of nitrogen, a critical agricultural fertilizer that is primary produced using natural-gas feedstock (70% of production cost). With its footprint anchored in North America, CF has captured outsized profits by utilizing cheap domestic natural gas while European and Asian competitors grappled with extreme energy volatility. Although this structural cost advantage remains intact, the extraordinary margins CF enjoyed over the past few years are compressing as global supply chains heal. European gas prices have retreated from their historic peaks, and new global nitrogen capacity is steadily coming online. As supply balances with demand, fertilizer spot prices—and CF's profits—could drift lower over a multi-year horizon. As a result, we exited our position to redeploy capital into higher-conviction growth opportunities.

IAC Inc. (which rebranded as People Inc. on June 4, 2026, after our exit) historically operated as a digital incubator, scaling and spinning off major internet properties like Match Group, Expedia, Vimeo, and TripAdvisor. Recently, the company abandoned this successful aggregator/roll-up strategy to focus solely on its digital publishing portfolio (including *People, Better Homes & Gardens,* and *Food & Wine*) and its 26% equity stake in MGM Resorts. Because the MGM holding now accounts for nearly all of the combined entity's market cap, the company essentially became a tracking vehicle for MGM stock. This strategic shift fundamentally dismantled our original investment thesis for the business, prompting us to liquidate our remaining position in the company.

Tactical Portfolio

Tactical Investments were mixed in the quarter, as gains in equities were offset by declines in gold and uranium related securities,

Gold prices dropped sharply in the second quarter, as expectations for Federal Reserve monetary easing reversed—pushing the U.S. dollar and Treasury rates higher. Gold's appeal as a safe-haven asset also faded with progress toward a U.S.-Iran peace agreement. This combination of rising yields, a stronger dollar, and receding geopolitical friction prompted significant profit-taking and momentum-driven selling, following a historic two-and-a-half-year run where bullion prices more than doubled.

Uranium prices trended lower from their late-January peaks, consolidating after a sharp 35% rally that began last November. While the long-term thesis for increased nuclear energy production to serve rising data center power demands remains intact, the deployment of new conventional and small modular reactors (SMRs) will not meaningfully impact fuel consumption for another year or more. This temporary gap between theoretical future demand and actual near-term consumption allowed spot prices to moderate. Despite the drop in spot pricing, the long-term term contract price for uranium remained steady as utilities continue aggressively locking in future supply—supporting the element's bullish secular outlook.

While the portfolio's mid-cap equity strategies tracked closely with the broader domestic market trends, our more tactical positioning in the regional banking index proved particularly beneficial. The biggest overhang on these stocks entering 2026 was the fear of commercial real estate (CRE) defaults amid an economic downturn. With the macro backdrop remaining highly resilient, and recent bank earnings showing that loan defaults are staying well within historical norms, the sector staged a relief rally. Looking ahead, regional banks are well-positioned to expand net interest margins (NIM) as deposit costs stabilize and low-yielding, maturing loan books reprice into today's higher-rate environment.

Fixed Income

Much like the stock market, fixed income rebounded in the second quarter to erase its modest early-year losses. The benchmark Bloomberg U.S. Aggregate Bond Index climbed 0.7% in Q2, pushing its year-to-date return to +0.6%. High starting yields acted as a vital buffer, shielding bonds from the price drops normally caused by rising rates. The 10-year U.S. Treasury yield ended June at 4.44% (up 14 bps for the quarter), though it briefly spiked to 4.67% amid peak Middle East tensions, as traders braced for sticky inflation and persistent federal deficit spending. The gradual progression toward a diplomatic resolution with Iran ultimately calmed the markets, sparking a bond rally that pulled yields back down by quarter-end.

Year-to-date, the yield curve has experienced a meaningful "bear flattening"—when rates across all maturities rise, but short-term rates rise faster than long-term rates—with the 10-year Treasury yield increasing by 26 bps, while the 2-year yield has swelled by 67 bps. This divergence represents a fundamental reassessment of monetary policy. Because the short end of the curve is highly sensitive

to the federal funds rate, and the long end reflects structural inflation and fiscal deficits, markets are rapidly adjusting to a more hawkish reality. Fed Funds futures contracts are now pricing in an 82% probability of a rate hike later this year, alongside a 50% chance of at least two hikes by June 2027.

The front end of the curve has priced in this expectation of a higher-for-longer interest rate backdrop, while the long end faces ongoing upside risk from fiscal expansion. Given this environment, we continue to favor short- and medium-duration bonds. This positioning allows us to capture compelling coupon income while insulating portfolios from long-term rate volatility.

Final Thoughts

The market continues to navigate a wave of macroeconomic noise, as fluctuating prognostications about interest rates, inflation, and geopolitical developments dominate the headlines and spark erratic daily swings in stock prices. While these trends are important to monitor, long-term investment success isn't achieved by reacting to short-term macro conditions. It is accomplished by owning great businesses at fair or attractive valuations and letting the cash flow those investments generate compound over time. Equally important is protecting this process from disruption, by resisting the urge to make reactive, short-sighted adjustments during periods of market duress. This is why we focus on investing in high-quality assets that can weather economic shifts and deliver attractive returns over a full market cycle. While short-term performance remains inherently unpredictable, we are confident that this disciplined investment approach provides the strongest foundation for supporting our clients in achieving their long-term financial goals.

On a final note, it is with mixed emotions that we share news of the retirement of our longtime colleague, Dawn Keach, effective July 31, 2026. Dawn has been a pillar of our team's success, and while she is truly irreplaceable, we wish her nothing but joy, relaxation, and happiness in this next chapter. Moving forward, Chris Engelman will expand his current responsibilities by assuming the role of Chief Compliance Officer, ensuring a seamless transition and leading Parkside's compliance initiatives into the future.

Please do not hesitate to contact us should you have questions, comments, or insights you would like to discuss.

Have a great summer!

Parkside Investments, LLC

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