At the halfway point of 2026, markets continue to successfully navigate an investing environment shaped by geopolitical uncertainty, shifting monetary policy, and the rapid expansion of artificial intelligence. The S&P 500 was up 10.2%, while the Bloomberg Aggregate Bond Index (AGG) was up approximately 0.7% through the second quarter of the year. Stocks continue to produce strong returns as we near the fourth year of this bull market.

The first half of the year was dominated by the U.S. military conflict with Iran, which is now in a tenuous cease-fire. The conflict triggered a combination of negative market conditions: higher oil prices, higher bond yields, and lower stock prices. Fortunately, these conditions were short-lived. Market participants—driven largely by retail investors—jumped on the opportunity to bid up stocks that had pulled back from all-time highs. Parallels can be drawn to the swift crash and recovery seen in April of last year following the proposed tariffs. This market is fast-moving and forward-looking, and so far, those buying the dips during periods of volatility have been proven right.

A trend through the first half of 2026 worth monitoring has been the uptick in capital raises by mega-cap technology companies. Companies like Amazon, Alphabet, Meta, and Microsoft have begun tapping the debt and equity markets to help fund their massive capital expenditure (capex) bills related to the AI buildout. Expected capex by Meta, Microsoft, Google, and Amazon alone is around $725 billion for 2026. This marks a significant shift for businesses that were once asset-light, free cash flow-generating machines to a new era of asset-heavy businesses with dwindling free cash flow metrics and modestly higher debt levels. These companies are the largest and most profitable in the world. That said, the sheer size of this current buildout warrants some scrutiny from investors. The most important question in markets today is: What will be the return on investment for this AI buildout? Time will tell.

Inflation likely peaked during the first half of the year, driven by the dramatic decline in energy costs during the second quarter after a sharp rise in late Q1. Although moderating, inflation remains above the Federal Reserve's target, and with new Fed Chairman Kevin Warsh appearing resolute in bringing down inflation, tighter monetary policy may be on the horizon. This can be seen in market expectations on Kalshi, which currently imply a 55% chance of a rate hike by year-end. A stark contrast to just a year ago, when markets expected rate cuts in 2026. The labor market has remained resilient. The unemployment rate declined to 4.2% in June; however, hiring activity is still subdued as artificial intelligence begins to reshape portions of the labor market and companies continue to downsize following COVID-era over hiring.

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Strong corporate earnings, continued AI investment, and improving energy market conditions have helped offset geopolitical uncertainty and drive stocks higher. Earnings growth has been exceptional, with projections for Q2 S&P 500 earnings to grow at a 29% year-over-year pace according to FactSet. That said, a large portion of that growth will come from semiconductor chipmakers like Nvidia and SanDisk. Concentration surrounding AI should give investors some pause, as the semiconductor industry now accounts for approximately 18% of the S&P 500 (nearly quadrupling 2020 levels). As cash changes hands from the AI hyperscalers—Meta, Microsoft, Google, Amazon, etc.—to semiconductor stocks, often referred to as the "picks and shovels" of the AI trade, hyperscalers have underperformed due to questions surrounding future returns on AI, while semiconductors' have boomed because of supply constraints and rapid investment.

Credit markets remain fundamentally healthy, characterized by relatively attractive base rates and tight credit spreads. Investment-grade corporate bond spreads remain at historically tight levels, suggesting strong buying pressure in debt markets and low perceived default risk for corporations. Interest rates across maturities edged higher in Q2, with the yield on the U.S. 10-year Treasury sitting around 4.5%. The current environment in fixed income provides a solid foundation for future returns, with the AGG's current yield to maturity at approximately 4.8%.

Now more than ever, we believe diversification across asset classes and geographic regions is essential to achieving stable and sufficient returns in today's increasingly concentrated market. We will continue to monitor trends and make portfolio adjustments as needed. We hope you are having a wonderful summer. As always, please do not hesitate to contact us with any questions or concerns or to schedule a portfolio review.

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