Trust & Investment Services

Market & Economic Update

July 2026

KEY TAKEAWAYS

- Markets staged a powerful recovery in Q2 — the S&P 500's best quarter since 2020 — as a ceasefire took shape in the Middle East and oil prices returned to pre-conflict levels.
- Technology and AI-related stocks led the rally, but the gains were broad. Small caps, mid-caps, and emerging markets have all outpaced the S&P 500 year-to-date.
- Inflation touched a three-year high in May on the spring oil spike. The Fed held rates steady, and the market narrative has shifted from when rates will be cut to whether they may need to rise.
- The emerging markets position we initiated in Q1 was among the quarter's best performers. Our long-term outlook for the space remains positive.

1. Market Review: Q2 2026

What a difference a quarter makes. After a difficult start to the year, stocks rebounded sharply in the second quarter. The recovery began in early April as the U.S. and Iran moved toward a ceasefire, gathered steam through a nine-week winning streak in May, and carried the S&P 500 to a record high in early June. Oil prices, which spiked to nearly $115 per barrel at the height of the conflict, finished the quarter at around $70, near where they traded before the conflict began. The resilience we highlighted in our last letter was rewarded, underscoring the importance of maintaining a long-term perspective through periods of uncertainty.

Q2 2026 Market Snapshot

INDEX	Q2 2026	NOTES
S&P 500 (Large-Cap US)	**+15.20%**	*Best quarter since Q2 2020*
Nasdaq Composite	**+21.60%**	*Tech and AI names led the rally*
Russell 2000 (Small-Cap US)	**+21.49%**	*New record highs; broad participation*
MSCI EAFE (Foreign Developed)	**+11.08%**	*Solid gain; lighter tech exposure*
Bloomberg US Aggregate (Bonds)	**+0.67%**	*Positive despite rate volatility*

Equities: From Selloff to Record Highs

Technology led the way, powered by renewed enthusiasm for artificial intelligence. Semiconductor stocks posted exceptional gains as the largest technology companies continued to pour capital into AI infrastructure. Importantly, however, technology wasn't the only driver of the rally. Eight of eleven S&P 500 sectors finished higher for the quarter, while small-cap and emerging market stocks outpaced U.S. large-cap companies. Emerging markets, a position we added in the first quarter, gained roughly 24%. Year-to-date, small cap, mid cap, and emerging markets have outpaced the S&P 500, a broadening of the market that has been a welcome and healthy development. Energy was the quarter's lone material decliner, falling as oil prices retreated, a reminder that what hurts one part of a diversified portfolio often helps another.

DID YOU KNOW?	*The semiconductor index gained roughly 88% in Q2, representing its best quarter since the index began in 1994. Behind the rally is an extraordinary investment wave where the five largest technology companies building AI infrastructure are projected to spend over $700 billion this year, up from about $32 billion a decade ago.*

Bonds: A Bumpy Ride to a Decent Finish

The bond market spent the quarter tracking the path of oil. Yields rose in April and May as elevated energy prices stoked inflation concerns. Yields reversed lower in June as oil retreated and the inflation outlook improved. The broad bond index managed a modest gain for the quarter, with corporate bonds performing better than government bonds. The bigger story in the first half was the shift in interest rate expectations. Investors anticipated Fed rate cuts at the beginning of the year but are now weighing the possibility of a rate hike this fall.

2. Economic Outlook: Growing, but Watch the Details

The economy proved more resilient during the first half of the year than many feared, though the details are more nuanced than some of the headlines suggest. Here's where things stand among the key indicators that we watch most closely.

GDP & Growth

First-quarter GDP grew at a 2.1% annualized rate, a marked improvement from the 0.5% pace at the end of 2025. The strength, however, was narrowly concentrated. Nonresidential business investment surged more than 10%, driven largely by the data center and AI buildout, while government spending rebounded from the prior quarter's federal shutdown. Consumer spending, which makes up the bulk of the economy, grew only modestly. The economy is growing, but an outsized share of that growth is being driven by the AI and data-center investment cycle.

The Job Market

Hiring cooled as the quarter progressed. The economy added 148,000 jobs in April and 129,000 in May, but just 57,000 in June. The unemployment rate ticked down to 4.2%, though partly because fewer people were participating in the labor force. The labor market has been described as one of “low-hiring, low-firing”, where companies aren't cutting jobs in meaningful numbers, but they aren't adding aggressively either. Importantly, wage growth continues to run ahead of underlying inflation, which supports household spending power.

Inflation

Unsurprisingly, the spring oil spike put upward pressure on prices. Consumer prices rose 4.2% year over year in May, the highest reading in three years, with more than half of the increase tied to energy. Strip out energy, however, and underlying inflation was a more palatable 2.9%. With oil now back near pre-conflict levels, the primary driver of the inflation surge is already fading, and inflation is widely expected to ease in the months ahead.

Corporate Earnings

Earnings have been exceptionally strong of late. S&P 500 companies delivered first-quarter earnings growth of roughly 29%, the strongest since 2021 and the sixth consecutive quarter of double-digit earnings growth. Analysts expect more of the same for the second quarter, with earnings growth estimates north of 20%. As we noted last quarter, however, much of this strength is concentrated in technology, leaving the broader index sensitive to any disappointment from the mega-cap names carrying the load.

WHAT THIS MEANS FOR YOU	*In the span of six months, markets dealt with an energy crisis, three-year-high inflation, and a possible Fed rate hike, yet remain near record highs. Investors who sold during the spring volatility locked in losses and missed one of the strongest quarters in decades. It's the clearest recent example of why we build portfolios to withstand shocks rather than trying to trade around them.*

3. Our Outlook for the Second Half of 2026

The questions we highlighted in April are still relevant, although several have moved in a favorable direction. The conflict that drove the first quarter's declines is winding down, oil has round-tripped, and the recession risk we couldn't dismiss three months ago looks more remote today. Here's what we're watching now.

Things We're Watching

- **The path of inflation and the Fed:** With oil back near where it started, inflation should cool in the coming months. If it does, pressure on the Fed will likely ease; if it doesn't, a rate hike in the fall remains a distinct possibility. The Fed held rates steady at both of its meetings this quarter, and the next several inflation reports will determine what comes next.
- **The AI investment cycle:** Enormous sums have been invested in AI, with stock gains to match, but eventually investors will demand a return on that investment. The late-June pullback in technology shares was a reminder of how quickly sentiment can swing when expectations run high.
- **Whether the broadening continues:** This year's gains have been unusually inclusive, with participation across most sectors, sizes, and geographies — which has strengthened our conviction in the rally. We view the broadening of market leadership as one of the healthiest developments of the year and we will be watching closely to see if it continues.
- **The ceasefire holding:** The conflict isn't fully resolved, and energy markets remain sensitive to headlines. A re-escalation would put the inflation and growth questions right back on the front burner.
- **Valuations:** Although valuations remain elevated in several areas of the U.S. market, improving market breath and stronger participation from international and small company stocks have helped offset some of the concentration risk.

4. Portfolio Strategy & Recent Changes

We made a few modest changes to the fixed income portfolio during the quarter to reflect the changing inflation and rate dynamics. We left our overall equity allocation neutral, however, as we continue to refrain from making a big bet either way on the near-term direction of the markets.

What We Changed

- **Trimmed long-term U.S. Treasuries in favor of short-term U.S. Treasuries:** The gap between short- and long-term interest rates has narrowed considerably in recent months as Fed rate cut expectations have shifted. Because long-term bond prices can swing much more significantly than short-term bond prices when rates change, we didn't feel the risk in longer-term securities was being adequately rewarded.
- **Modestly increased multisector fixed income allocation:** We redeployed a portion of the proceeds from our sale of long-term Treasuries into a blend of investment-grade corporate bonds, securitized debt, and other non-Treasury fixed income, diversifying our income sources while reducing overall interest rate sensitivity.

Current Investment Outlook

Outlook and positioning changes across all major asset classes.

CATEGORY / SEGMENT	OUTLOOK	CHANGE	POSITIONING NOTE
ASSET ALLOCATION			
Equities	Neutral	—	*No change to overall equity weight*
Bonds	Overweight	—	*Reduced interest rate sensitivity*
Money Market	Underweight	—	*We continue to favor bonds*
EQUITIES			
U.S. Large Cap Growth	Neutral	—	*Led in Q2; valuations elevated*
U.S. Large Cap Value	Neutral	—	*Participating in market broadening*
U.S. Small/Mid Cap	Neutral	—	*Record highs; outperforming large caps*
Foreign Developed	Overweight	—	*More attractive valuations than U.S. large caps*
Emerging Markets	Overweight	—	*Top performer since Q1 initiation*
FIXED INCOME			
Government	Neutral	▼	*Trimmed long-term Treasuries*
Investment Grade	Overweight	▲	*Spreads retightened, emphasizing quality*
Duration	Overweight	▼	*Reduced; modestly above benchmark*

A Note from Our Team

Quarters like this one are a reminder of why we emphasize patience during periods of uncertainty. In the span of a few months, markets moved from pricing in some worst-case scenarios to setting record highs. The investors who fared best were the ones who stayed focused on their long-term goals through the turbulence and stayed invested through volatility. We don't take for granted the trust and confidence you place in our team. Our objective remains unchanged: to build portfolios that can participate in long-term growth while remaining resilient through periods of uncertainty.

As always, please reach out to your advisor any time. Whether you'd like to review your portfolio, talk through what's happening in the market, or just check in, we're always glad to hear from you.

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