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SECOND QUARTER 2026 ECONOMIC AND FINANCIAL MARKETS REVIEW

After a negative first quarter this year, the stock market rallied during the second quarter, primarily due to better-than-expected corporate earnings. In contrast to the first quarter, when investors were concerned that artificial intelligence could disrupt certain industries, during the second quarter, they began to focus on the positive impact AI could have on future corporate profits and economic growth. This excitement was evident in the outperformance of AI-related stocks and the announcements of initial public offerings (IPOs) by relatively new AI-related companies. Investors also looked past uncertainty related to the conflict with Iran, higher energy prices, rising inflationary pressures, and rising long-term interest rates in hopes of better times ahead. As a result, the S&P 500 Index finished the first half of the year up 9.55%, while the Dow Jones Industrial Average was up 8.85%. Bonds saw some volatility during the first half of 2026, but the Bloomberg Intermediate U.S. Government/Credit Bond Index increased 0.40%.

While it is still true that advances in artificial intelligence could harm the labor market and certain businesses, it may also provide efficiencies that help many corporations reduce costs, thereby improving corporate profit margins. For example, if AI reduces the need for corporations to hire new workers, it will also reduce the wages they have to pay. If AI can quickly perform tasks or projects that formerly required longer lead times or more costly physical infrastructure, it could lead to more efficient production of goods and services, thereby accelerating economic growth. Investors are now looking ahead to the potential of AI to help a variety of businesses prosper, including the AI-related companies themselves. This is why AI-related companies led the market higher during the second quarter of this year.

Although the conflict with Iran caused market volatility in the second quarter, investors are content that at least an interim agreement was reached in June. A “memorandum of understanding” between the U.S. and Iran has led to a moderate decline in oil prices. This is primarily due to a suspension of the U.S. naval blockade and the tentative opening of the Strait of Hormuz, through which approximately 20 percent of the world’s oil and gas supply is transported. Since oil prices have declined from their highs, a burden has been lifted from the economy, and inflation may also come down over time. If inflation declines, the recent increase in long-term interest rates in the bond market should reverse. These would all be positive developments for business and consumer spending, which are very important for economic growth and corporate profits. Investors see these factors as potential catalysts for future stock market appreciation.

Despite the first-half appreciation in the stock market driven by positive corporate earnings, advances in AI, and hopes of better geopolitical conditions ahead, there are some concerns worth watching in the second half of 2026. For example, during the second quarter, a new Federal Reserve Board chairman took office. The expectation was that the new Fed chairman was appointed to lower the short-term Federal Funds interest rate to help the economy grow. However, it is no longer a foregone conclusion that the Federal Reserve Board will lower short-term interest rates. In fact, the Fed may actually raise short-term rates if the pace of inflation does not decline in the second half of this year. Financial markets dislike it when the Fed keeps interest rates high because this increases certain borrowing costs for consumers and businesses, thereby reducing corporate profits.

Additionally, advances in AI may not prove as profitable for corporations or as positive for the economy as investors currently anticipate. Expectations in this regard are very high, so any setbacks could result in significant downward pressure on the stock market.

It is also possible that military action with Iran resumes, increasing energy prices and inflation again, which could lead to a decline in the stock market. Time will tell whether the second-quarter conditional agreement with Iran will lead to a longer-term resolution and allow the stock market to continue to appreciate.

We remain optimistic about the long-term growth of the stock market. However, it is worth keeping in mind that the market has performed well over the past few years and stock valuations are generally not cheap. Therefore, a market correction, or even a cyclical bear market, is not out of the question in the second half of this year or early next year.

In the current market conditions, we are adopting a balanced approach between value and growth investing styles. We prefer the stocks of large companies with strong balance sheets over small companies that generally carry more debt and are more vulnerable to the impact of rising interest rates. We continue to view foreign stocks favorably, as they generally appear undervalued relative to domestic counterparts. We also continue to favor short-term bonds over long-term bonds because they provide a better risk/reward profile, especially in a volatile interest rate environment. We may reduce exposure to stocks and increase exposure to short-term bonds or money market funds if circumstances warrant it for certain investors.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg on July 1, 2026.*