Market Review
Second Quarter 2026

In the second quarter of 2026, stocks rebounded sharply on the back of lessening strife in the Middle East and strong corporate earnings growth.

During the period, the S&P 500 Index returned 15.20% while the Russell 2000 Index increased 21.49%. It was, however, a narrow and momentum-driven rally. Growth outperformed Value on both ends of the market capitalization spectrum. The **iShares MSCI USA Momentum Factor ETF (MTUM)** rose 42.85%. The commonality among the winners was strong artificial intelligence (AI)-driven spending and uptake. There were three major developments in the quarter that drove the tone of trading.

In a market eager to move on from the United States – Iran conflict, the primary driver of recovery was robust earnings growth. According to FactSet, the S&P 500 Q1 2026 EPS increased 28.8%, up from initial projections for 12.6% growth. The result, however, was significantly bolstered by the *Information Technology* sector, which grew 54.8% year-on-year. It also led to a concentrated advance. Importantly, market leadership rotated from the hyperscale datacenter operators building AI infrastructure to the semiconductor ecosystem benefiting from that spend. The PHLX Semiconductor Sector Index (SOX) rallied 87.75%, its strongest quarterly gain on record.

While corporate earnings were firm, the macroeconomic picture was more mixed. The central focus was higher inflation reports driven by spiking energy prices and supply chain disruption due to on again, off again access to the Strait of Hormuz. This trend sparked a stark introduction to new Federal Reserve Chairman Kevin Warsh – a Trump appointee – who surprised market participants with his blunt assessment that the central bank is obliged to deliver price stability…which it has failed to do in the past five years. The hawkish press conference triggered a backup in both short- and long-duration U.S. Treasury bond yields, prompting questions about the viability of capital financing.

Lastly, as technology stocks soared, the debate around the sustainability of the AI-fueled bull market grew in tandem. First, the Mega Cap hyperscale datacenter operators rolled over on worries about free cash flow degradation. The unease was reinforced by a massive (and unexpected) $84.75 billion stock offering by Google, which came 10 days before the $1.77 trillion SpaceX IPO. The more troubling wrinkle, however, was (i) increasing corporate scrutiny on large language model pricing and usage, and (ii) the migration to lower-cost Chinese models. These events triggered a 10% overnight decline in the Korean Composite Stock Price Index (KOSPI) in late June that sparked the first of several AI (and momentum) sell-offs.

At this point, the overarching question for investors is how much credence to give the sharp increase in AI apprehension and volatility. Is the recent reversal a predictable reaction to a very aggressive run-up in stocks? Or is the AI economic model and investment engine structurally at risk?

On one hand, the team firmly believes that the stock market unwind and increased investor caution are warranted. On the other hand, we continue to view the investment in, and proliferation of, Artificial Intelligence as the most important growth driver in the global economy. Thus far, the corporate reaction to rising costs and infrastructure and technological bottlenecks has been prudent and appropriate to steer a better, more efficient AI ecosystem. We are also hopeful that a step down in the level and pace of investment has the potential to reduce inflationary pressure, enabling a broader economic and stock market advance.

In this environment, we continue to take a sensible approach to our products that is consistent with our balanced growth process. Although we have fitting exposure to the most important growth themes in the market – including AI – we only invest in profitable companies and avoid “story stocks”. Due to the bifurcated economy and market, we are also continuing to find significant opportunity to invest in high-quality growth businesses, at reasonable valuations, in less well-trafficked parts of the market.

Sources: *FactSet, GICS Sector Classification, Alphabet Investor Relations, Wikipedia, CNN Business*

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Earnings Per Share - Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

Indices are provided for comparative purposes only. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. An investor cannot invest directly in an index. This is an actively managed strategy that does not invest in all of the securities of an index, and will have some associated concentration risk. Comparisons have limitations because indices may have volatility, investment and other characteristics that may differ from an investment account strategy to which it is compared. Indices are unmanaged, include the reinvestment of dividends, and do not reflect transaction costs, management, or other fees. See the following for a description of each index used in this material.

The S&P 500 is widely regarded as the best single gauge of U.S. large cap equities. The index includes 500 leading companies spanning all sectors of the U.S. stock market. It covers approximately 80% of the U.S. equity market capitalization and over 50% of the global equity market.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 7% of the total market capitalization of that index, as of the most recent reconstitution. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small cap opportunity set.

The PHLX Semiconductor Sector Index (SOX) is amodified market capitalization-weighted index composed of companies primarily involved in the design, distribution, manufacture, and sale of semiconductors.

The Korean Composite Stock Price Index (KOSPI) is a group of indexes that track the stock exchange in South Korea. It was previously named the Korea Stock Exchange. Just as the NASDAQ Composite Index and the S&P 500 Index are representative stock market indexes in the United States, the KOSPI represents the stock market index in South Korea. It follows a wide variety of industries, and it also tracks bonds, options, and futures.

The iShares MSCI USA Momentum Factor ETF seeks to track an index of U.S. stocks exhibiting relatively high price momentum. The fund offers a way to capture trends in the market by investing in companies with strong recent performance.

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Index Definition Sources: *Standard & Poor's, FTSE Russell, Nasdaq, Corporate Finance Institute, iShares*

Investment Statistic Definition Source: *Investopedia*