“Buy on the sound of cannons, sell on the sound of trumpets.” This famous investing maxim, meaning to buy when war causes market panic and to take profits after the rally when peace returns, played out in spades during the first half of 2026. The Iran War caused a selloff throughout the month of March, but the stock market staged a strong rally in the second quarter. The benchmark S&P 500 rose over 14% during the quarter, its best quarterly result since 2020. The rally was led by semiconductor stocks, which had their best quarter in history. The Philadelphia Stock Exchange Semiconductor Index (SOX) returned 81% on the backs of historic tailwinds from the continued artificial intelligence infrastructure buildout.

The second quarter rally was driven by growing expectations for a short war, and most notably, by a phenomenal first quarter earnings season. The always forward-looking stock market anticipated that the Administration was uninterested in a prolonged war of choice that would keep energy and food prices high enough to negatively impact the economy and consumers and would seek negotiations to bring the conflict to a quick end. While traffic in the Strait of Hormuz is still down significantly from pre-War levels and the situation remains unresolved, the price of oil has now roundtripped, starting the war around $70, going up above $100, and as of this writing, back down to around $70. However, the biggest catalyst for the rally was the first quarter earnings season which started in early April. First quarter results and guidance on revenue and earnings were broadly strong, but certainly strongest amongst the companies at the heart of the artificial intelligence infrastructure buildout. In December, Wall Street consensus estimates were for 2026 EPS of $309 and 2027 EPS of $351 for the S&P 500. As of now, those estimates have been revised significantly higher, to $341 for 2026 and $399 for 2027. At these revised estimates, 2026 EPS growth is now expected at 25%, a truly remarkable level of earnings growth for a developed economy. This growth is also broadening, with 86% of S&P 500 companies having upward revisions in forward earnings. Despite strong stock returns, valuations have become cheaper since the start of the year, as earnings growth has outpaced stock market returns.

While we expect the earnings outlook to remain bright, risks remain for the second half of this midterm year. First off, the market is still digesting the appointment of a new Federal Reserve Chair in Kevin Warsh, who took office on May 22. Chair Warsh follows Jerome Powell, who led the Fed for over 8 years and was a leader that the market was comfortable with. Many investors were surprised by Warsh’s “hawkishness” during his first press conference and meeting as Chair. In other words, the market worries that a greater focus on inflation over employment and economic growth will lead to interest rate hikes that could slow the economy and earnings growth. While Warsh has a history of hawkishness, investors expected more “dovish” language from the Chair picked by President Trump that had publicly backed the President’s call for the Fed to lower rates. The market is now projecting 2 interest rate hikes during the rest of this year to help cool inflation that has accelerated this year on the backs of energy, food, and technology price increases. Aside from the Fed, an additional risk stems from the potential increase in the supply of stock to the market in the form of high profile IPOs that have either already occurred (SpaceX) or may occur in coming quarters (OpenAI, Anthropic) and secondary issuance from public companies that need additional capital to finance continued data

center buildout (Alphabet and other rumored large technology firms). In order to absorb an influx of new share supply, investors must sell existing holdings to fund these new purchases. When large institutions reallocate billions of dollars towards high flying newcomers, it can create widespread downward selling pressure on established companies. This is amplified if the overall growth of investor capital cannot keep pace with the volume of new shares being issued. Historically, selling new issuances also becomes a problem about 180 days after an IPO when lockup expirations begin, which allows insiders to begin selling further shares. Third, the situation in the Middle East remains very uncertain, and reverberations from Hormuz being effectively closed for months, may assert themselves in the coming months. A stock market at new highs and oil market back at pre-war prices could be vulnerable should peace talks break down. Finally, the greatest risk may be a slowdown in AI spending that has been the catalyst for both economic and earnings growth. The flip side of the rip-roaring rally in semiconductors has been the sputtering of the Magnificent 7 stocks, which have been the darlings of the stock market rally over the last decade. The "Mag-7" as a group is down 3.7% in 2026, as their prodigious cash flows have evaporated in the face of escalating capital expenditures towards data center development, the very spending propelling semiconductors ever higher. Despite tepid short-term returns, these companies remain the most powerful and smartest on Earth, and if investors continue to punish them for their AI spending, they may decide it is in their best interest to slow down. This could buoy their own share prices, but would have dramatic repercussions for the beneficiaries of their spending largesse, and for the stock market as a whole, as the AI winners become a larger and larger percentage of total market capitalization. These are just a few of the key risks that we are monitoring as we enter the second half of the year.

We remain cautiously optimistic despite the aforementioned risks, and welcome investor skepticism as a brake on the bull market becoming too ebullient. Semiconductor stocks, after a blistering run, are now flat since late May. We have started to see a rotation in the stock market in June, where lagging sectors such as financials, consumer discretionary, real estate, and health care have started to outperform technology. The market action since semiconductors peaked has been healthy, and in our view is more of a rotation than a beginning of a deep correction. The artificial intelligence trade may have dominated the market this year, but a decline in energy prices and interest rates, driven by an end to the War, could help lagging sectors move forward. We anticipate some bumps in the road, especially with the midterm elections certain to generate headline risk amongst certain sectors and companies but continued strong earnings growth from Corporate America should keep the stock market on the right course over the coming years.

Please do not hesitate to reach out to any of us in the office if you would like to discuss investment strategy or your own financial circumstances. We hope that had a wonderful "America 250" Independence Day celebration and that you enjoy a happy and healthy summer.