

The stock market that could...

Global markets just weathered a confounding yet historic second quarter..

- » The U.S. fought a war with Iran in which both sides decided they would rather not be fighting, so they both essentially stopped and declared themselves the victors
- » Hundreds of ships were trapped in the Strait of Hormuz by Iran, cutting off oil and other critical cargo to many parts of the world, causing shortages
- » The S&P 500 had its strongest earnings season in five years, more than doubling expectations for earnings growth and driving stock prices much higher at the same time that earnings multiples showed they were actually getting cheaper
- » In what some fear will be a sign of the market top, Elon Musk's SpaceX launched the largest IPO (initial public offering) ever at over a trillion-dollar valuation, dwarfing any that came before, yet is only the first of three trillion-dollar IPOs in a matter of months, all being AI companies
- » With shortages and price pressures resulting from the closure of the Strait of Hormuz, the U.S. experienced its highest inflation readings in years and market expectations for interest rate cuts were replaced by expectations for rate increases
- » The new Chairman of the Federal Reserve, nominated by the president with the expectation that he would cut interest rates, emerged from his first Fed meeting and left the market with the impression that the Fed was more likely to be raising interest rates

Despite all these challenges, global stock markets surged in Q2.

The S&P 500 had its strongest earnings season in five years, more than doubling expectations for earnings growth.

U.S. Equities

Index	Q2 2026	YTD	1 Year
S&P 500	15.20%	10.21%	22.32%
Equal-Weighted S&P 500 Index	11.39%	12.13%	19.20%
Dow Jones Industrial Average	13.38%	9.76%	20.65%
Nasdaq Composite	21.60%	13.13%	29.48%
Russell 2000 (Small Caps)	21.49%	22.57%	40.78%

Source: Morningstar

Coming off the Iran-related market lows in late March, the U.S. stock markets rocketed to new record highs and digested a record IPO, SpaceX, at over a trillion-dollar valuation. The primary fuel for this ascent was a shockingly strong earnings season that saw forecasted S&P 500 earnings growth jump to about 29% when the numbers had finished rolling in.

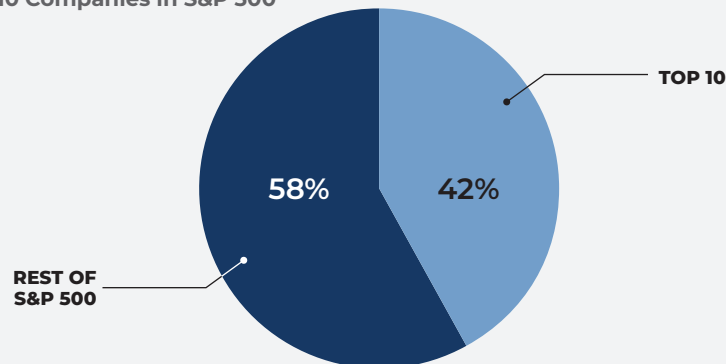
Much of the AI rally in recent years has been driven by expansion of price/earnings (P/E) multiples – meaning investors were paying a higher valuation for each dollar of earnings. That was not the case in the strong rally this spring. Earnings and cash flow were so strong that, even though stock prices were climbing rapidly, the P/E multiples for the stocks and the broader market were actually falling because the earnings were growing faster than stock prices. Forward multiples fell as well because, along with the strong earnings reports, companies also raised their guidance for future quarters, causing Wall Street analysts to reset their earnings forecasts upwards.

Much of the earnings growth came in AI-related equities that are benefiting from the massive boom in the buildout of AI. In fact, the concentration of the S&P 500 continues to climb with the top 10 names, dominated by companies connected to AI, accounting for over 40% of the total value of the index. The S&P 500 is no longer a broadly diversified index upon which investment portfolios should be based.

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The Ten Biggest Companies in the S&P 500 Make Up More Than 40% of the Index

Share of Top 10 Companies in S&P 500



Sources: Bloomberg, Apollo Chief Economist

With the AI buildout showing no signs of slowing down and the new tax bill providing economically stimulative measures such as retroactive tax reductions (larger refunds) and immediate expensing of capital expenditures (immediate tax benefit), the U.S. stock market and the economy have several strong tailwinds as we head into the second half of the year.

As strong as the quarter was for the large cap stocks, it was even stronger for mid- and small caps as demand for components for the AI buildout is spreading beyond just the mega-tech suppliers. The Russell 2000 (small caps) is up over 22% so far this year and over 40% in the past 12 months.

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International Equities

Index	Q2 2026	YTD	1 Year
MSCI EAFE (Developed Markets)	10.82%	9.44%	20.23%
MSCI Emerging Markets	24.05%	23.85%	43.51%

Source: Morningstar

Unlike the U.S., most international markets are net importers of oil and have been more vulnerable to the shutdown of oil coming out of the Persian Gulf due to Iran's closure of the Strait of Hormuz, but that did not prevent them from having even stronger stock market returns in Q2 than the U.S. did, especially emerging markets where they are perhaps the most vulnerable. The AI trade is not just a U.S. phenomenon as two notable markets with strong AI connections had by far the highest returns for the quarter and year-to-date, with Korea in the lead, up almost 120% so far this year and over 200% in the past 12 months.

Index	Q2 2026	YTD	1 Year
MSCI Korea	87.58%	118.61%	213.78%
MSCI Taiwan	48.86%	62.38%	104.97%

Source: Morningstar

Market impact of Iran and midterm elections

For the first month after Israel and the U.S. began strikes against Iran, global stock and bond markets both fell over concerns that oil exports out of the Persian Gulf would suffer, leading to higher oil prices, slower economic growth, and inflation. All these consequences turned out to be milder than expected even though the expected four-week conflict turned into a four-month closure of the Strait of Hormuz with very little oil being exported from the Gulf. The primary reason for this is that the U.S. and the rest of the world drew down their oil reserves, and that drawdown will accelerate over the summer if the flow of oil out of the Persian Gulf does not reapproach normal levels. If those reserves continue to be depleted, we could see oil prices return to very high levels.

The quarter ended with a very strained ceasefire that leaves the exact operating status of the Strait of Hormuz in question, although since the onset of the 60-day negotiating period provided by the Memorandum of Understanding (MOU) that Iran and the U.S. signed, some oil tankers have begun to leave the Gulf. Oil prices have dropped as if the market believes flows will be rapidly restored, but there are still internal power struggles between the Iranian politicians who want to negotiate and the much more hardline Islamic Revolutionary Guard Corps (IRGC), who want to maintain control of the strait at all costs.

We expect both sides to quickly return to the agreement provided by the MOU, but we do not expect a final agreement in 60 days. We think it is in the self-interest of the leaders of both countries to drag out the status quo at least until after the midterm elections, to which the markets would likely continue to respond well for the next several months.

Chairman Warsh...left the market with the impression that he would, in fact, favor rate hikes if inflation persisted, not the rate cuts that President Trump expects.

What matters the most to the markets is that oil flows out of the Gulf continue to be restored, and as long as that happens, the related geopolitical controversies will likely remain much more the concern of political leaders and voters than the markets.

The MOU has provided both Iran and the U.S. with a status quo that both countries' leaders find very beneficial for the time being. In the U.S., the war was very unpopular, and President Trump did not even have solid support from his own party. There was significant concern that if the unpopular war continued, the Republicans would lose both houses of Congress in the midterm elections this fall. As each of these quarterly newsletters has asserted since the beginning of the current administration, we think the top priority of this White House has been the midterm elections, which have driven nearly all major domestic policy decisions. It is now also impacting foreign policy as we believe this was the driving force in the U.S. decision to end strikes against Iran even though the military objectives and the stated goal of "unconditional surrender" had not been met. We suspect, despite occasional skirmishes, the terms of the MOU will largely remain intact and, in fact, will be extended repeatedly until after the midterm elections. We think the terms of the MOU are too unfavorable to the U.S. to form a permanent agreement that the Republicans would be willing to have hanging around their necks come election day.

On the flipside, Iran will likely be very happy to maintain the status quo as the U.S. is waiving all sanctions on Iranian oil exports, which is allowing them to generate tens of billions of dollars of much needed hard currency. It is also protecting them from further military attacks while they reinforce their remaining military equipment and supplies. We suspect Iran would be happy to stay in this state of limbo indefinitely, and as long as the oil keeps flowing, the markets will likely remain pleased. It would avoid an economic slowdown, and it would avoid worsening inflation.

A new Federal Reserve chairman amidst high inflation

After a long and very public selection and nomination process, the new Chairman of the Federal Reserve, Kevin Warsh, had his first meeting with his colleagues on the Federal Open Market Committee (FOMC), the interest rate-setting body at the Fed. With high oil prices leading to the highest inflation readings in several years, there was much anticipation surrounding what Chairman Warsh would do since he was nominated to the role by a president who expects him to engineer interest rate cuts, but newly resurgent inflation seemed to assure that would not be possible.

The surprise was not that the FOMC did not lower interest rates, but rather that Chairman Warsh seemed to strike such a hawkish tone in his post-meeting press conference, committing to restoring price stability to the Fed's 2% inflation target, which left the market with the impression that he would, in fact, favor rate hikes if inflation persisted, not the rate cuts that President Trump expects. Short-term interest rates spiked sharply higher in response.

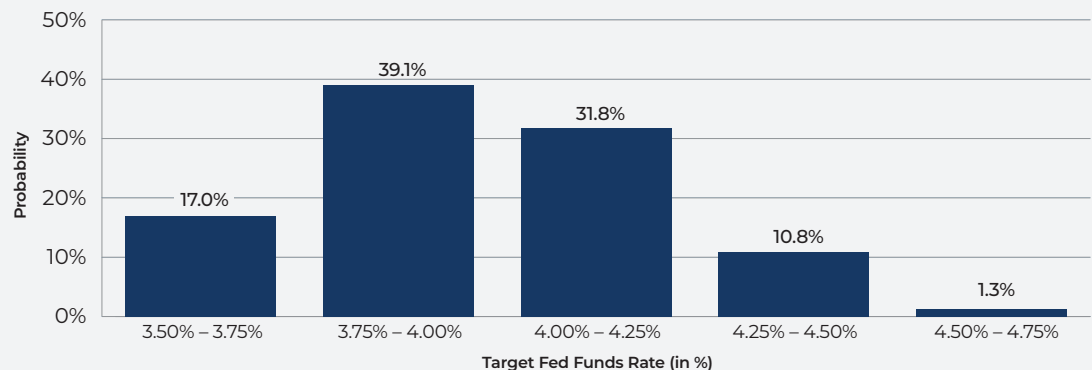
We think the chairman still thinks rates should be lower but will take some time to win over the other voting members of the committee to some new ideas about how monetary policy should be conducted.

We think the markets have misinterpreted his comments, and that he still believes that interest rates should be lower. However, given the president's very public expectations of rate cuts combined with resurgent inflation, if Chairman Warsh had not spoken hawkishly, the long-end of the interest rate curve would have likely traded sharply higher, and it is those longer rates that are more critical to much of the economy, like the housing market. We think the chairman still thinks rates should be lower but will take some time to win over the other voting members of the committee to some new ideas about how monetary policy should be conducted.

He made a point of commenting on how uneven the effects of current monetary policy are on different segments of the economy and hinted at using a more complex and broader set of monetary tools to be more surgical and tactical rather than just the blunt force instrument of raising and lowering overnight rates. Combining that with the fact that he is not a fan of the current metrics the Fed favors to gauge inflation, we think he is trying to lay the groundwork for not hiking rates this year like the market is expecting. As you can see below, the futures market is pricing in at least one 0.25% Fed Funds rate hike by the end of the year, with a second one almost fully priced in.

Target Fed Funds Rate Probabilities for Year-End

Current Fed Funds Rate is 3.50% – 3.75%



Source: Chicago Mercantile Exchange, July 1, 2026

The Fed favors Core Personal Consumption Expenditures (PCE) as an inflation gauge, which is currently at 3.4%. The Consumer Price Index (CPI) is over 4%, and the Producer Price Index (PPI) is around 6%, but Chairman Warsh's preferred measure is called the Trimmed Mean PCE, which is only running at 2.3%. He has already named a task force to assess what measures the Fed should be using to gauge inflation, and if Chairman Warsh gets his way, instead of needing to make a lot more progress against inflation, the Fed might end up simply moving the goalposts.

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This sounds outlandish, but considering that much of the increased inflation is coming from places that are not sensitive to interest rates (such as supply shortages), it is possible that moving to a measure that would enable lower interest rates sooner while using other tools to battle inflation could help unfreeze the housing market, aid struggling low-income consumers, and lower government borrowing costs. Such a change would not be unprecedented as Alan Greenspan engineered a change from relying on CPI, which he believed overstated inflation, to the current preferred gauge of Core PCE.

With all the uncertainty about the direction of interest rates and inflation, fixed income returns have been held in check this year.

Fixed Income

Index	Q2 2026	YTD	1 Year
Bloomberg US Aggregate Bond Index	0.67%	0.62%	3.79%
Bloomberg Global Aggregate Bond Index	0.68%	0.55%	3.63%
Bloomberg Municipal 5-Yr Index	1.07%	1.08%	3.81%

Source: Morningstar

What does all this mean for client portfolios?

Even though most of the AI-heavy "Mag 7" had good recoveries this quarter on strong earnings, the share price gains were slower than the growth in earnings, and only one of the stocks, Alphabet (Google), managed to outpace the S&P 500 for the quarter and year-to-date. In addition, the tech-heavy S&P 500 was outpaced by most other stock markets in which we invest: mid-caps, small caps, international developed markets, and international emerging markets.

"Mag 7" Stocks

Stock	Q2 2026	YTD	1 Year
Apple Inc	14.12%	6.63%	41.55%
Tesla Inc	13.14%	-6.48%	32.41%
Alphabet Inc Class A	24.35%	14.31%	103.27%
NVIDIA Corp	14.87%	7.43%	26.82%
Meta Platforms Inc Class A	-1.45%	-14.51%	-23.40%
Microsoft Corp	1.02%	-22.49%	-24.29%
Amazon.com Inc	14.44%	3.26%	8.64%

Source: Morningstar

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Is the AI stock market boom starting to slow? Most of the Mag 7 also underperformed the S&P 500 last year, and international markets also dramatically outperformed the U.S. last year. This is one of the core reasons we focus on building what we call “durable portfolios” for clients. By using many different asset classes, we try to generate compelling returns even in years in which the S&P 500 might be a laggard. Even more importantly, the use of many asset classes helps protect clients from volatility, and volatility creates a drag on returns over the long run as it requires investors to spend time earning back losses instead of compounding their wealth.

As we mentioned earlier, both stocks and bonds fell in price during the first month of the war in Iran. Many investors only use these two asset classes in their portfolios under the mistaken impression that they diversify and hedge each other, but in recent years they have become increasingly correlated, magnifying losses, not mitigating them. This is why we generally employ many more asset classes in client portfolios, with many clients seeing new asset classes added to their fixed income portfolios this past quarter. Future market volatility is one of the few things we can predict with certainty, so we will continue to seek ways to make client portfolios even more durable.



Dennis Follmer
Chief Investment Officer
July 1, 2026

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