JULY 2026

MARKET COMMENTARY

David Homard, CFA

Domestic equity markets closed out the first half of 2026 on solid footing, though the leadership looked very different from what investors have grown accustomed to over the past decade. Through the end of June, the S&P 500 was up a little over 10%, a perfectly respectable half-year. Small cap stocks were the story, with the Russell 2000 gaining more than 22% over the six months. This marks the second consecutive year in which the market's gains have spread out well beyond a handful of the largest domestic companies, and the breadth numbers back it up.

June itself was a good illustration of the shift. The Russell 2000 added 3.7% for the month and the Dow Jones Industrial Average tacked on 2.7%, while the S&P 500 slipped about 1%. It has been a long time since we could write a paragraph in which small caps led and technology lagged, and we would caution against reading a single month as the start of a new regime. That said, when the average stock is outperforming the index, it usually means the market is being driven by something broader than a few very large balance sheets.

The style picture told the same story. Small cap value led in June with a 3.8% gain, followed closely by small cap growth at 3.6% and large cap value at 2.2%, while large cap growth was the lone loser at -2.8%. Stretching the view out to the trailing twelve months, small cap value is up more than 42% while large cap value has gained a comparatively modest 26.9%. Value has quietly done a great deal of catching up, and investors who maintained a diversified allocation through the growth-dominated years are finally seeing that discipline pay off.

Sector performance in June was split almost evenly, with six of the eleven sectors finishing higher. Industrials led the way with a 7.3% gain, followed by health care at 6.6% and financials at 4.3%. On the other end, communication services was the worst performer for the month at -7.2% and energy fell 5.0%, its third consecutive monthly decline. Technology remains the runaway leader over the past year, up more than 51%, while communication services has now slipped into negative territory on a trailing twelve-month basis. A year is a long time in the sector world, and the rotation between the leaders and the laggards has been unusually quick.

Turning to international markets, developed markets were essentially flat in June but have added more than 9% year to date. Emerging markets have been the standout, up 24% through the first six months and more than 44% over the trailing twelve months. International equities were an afterthought in most portfolios for the better part of fifteen years. They are not an afterthought now, and that is precisely the point of holding them when they are out of favor.

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The Federal Reserve remains stuck between two uncomfortable data sets. Inflation rose another 0.40% month over month in May to 4.2%, the highest reading in three years and the third consecutive monthly increase, with core inflation rising to 2.9%. The producer price index has now climbed for five straight months to 6.5%, its highest level since late 2022. At the same time, the labor market is showing wear. The economy added just 57,000 jobs in the most recent report, well below expectations of roughly 115,000, and the labor force participation rate fell three-tenths of a percentage point to 61.8%, a five-year low. The unemployment rate did tick down to 4.2%, though a falling participation rate flatters that figure. Futures markets are pricing in an 82% chance that the Fed will keep the funds rate at 3.50% to 3.75% at the July meeting, and there is growing discussion of a hike later this year. That is not a conversation anyone expected to be having six months ago.

Bond funds were positive across the board in June, with the iShares 20+ Year Treasury Bond ETF leading at 1.2%. The Barclays Aggregate Bond index returned 0.67% for the quarter and 0.62% for the first half, which tells you most of what you need to know about the year so far: essentially all of the index's return for 2026 was earned in the second quarter, and the first quarter was a wash. Over the past year, high-yield corporates have led the fixed-income complex, posting a gain of just over 5%.

So where does that leave us as we move into the second half? We have an inflation rate heading in the wrong direction, a labor market cooling, a Federal Reserve with fewer good options than it had a year ago, and an equity market that has nonetheless delivered double-digit returns across nearly every asset class for which investors were told to be patient. It is a strange combination, and we suspect the second half will be bumpier than the first.

That is fine. Bumpy is normal, and a diversified portfolio is built precisely for the quarters where the leadership changes hands without warning. The investors who did best over the past six months were not the ones who correctly forecasted an emerging markets rally or a small cap resurgence. They were the ones who owned those things all along because their plan said to. Keep your eye on where you are going rather than on the traffic far in the distance, and let the plan do the work it was designed to do.