

Economic and Market Outlook – Second Quarter 2026

Despite dramatic recent advancements, leading artificial intelligence models remain prone to so-called “hallucinations,” confidently-stated outputs that lack supporting evidence and are at times entirely wrong.

Vetting AI-generated content is becoming an essential skill for knowledge workers in the modern economy. Meanwhile, interpreting economic data and the modern media cycle can feel eerily similar. The war in Iran has outlasted numerous proclamations of resolution, tariff regimes have persisted after being overruled, consumer sentiment appears disconnected from consumer spending, and the artificial intelligence boom is spreading unevenly into the broader economy.

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The economic impacts of the war in Iran are accumulating despite an endless drumbeat of optimistic announcements from the White House. The conflict, which in March was described by the Trump administration as “not a war,” “already won,” and “very complete,” caused significant disruptions in the international energy market through the end of the second quarter. Despite President Trump announcing the negotiated reopening of the Strait of Hormuz in April, and then a forcible reopening by the U.S. Navy in May, and then another negotiated reopening in mid-June with the signing of a Memorandum of Understanding, traffic through the strait remains dramatically below pre-war levels amid continued operational, insurance, and security risks.

Trade policy has been equally dizzying. Tariffs implemented under the International Emergency Economic Powers Act (IEEPA) were overturned by the Supreme Court in

February, though mandated refunds have not yet been distributed. Temporary tariffs implemented under Trade Act Section 122 are also being legally contested, and are likely to be replaced with new tariffs under Sections 232 and 301 in late July.

These sources of uncertainty, the country’s extreme political division, and the acceleration of wealth inequality continue to fuel dismal consumer sentiment readings, or a so-called “vibecession.” Yet under the surface, the domestic economy continues to expand. The unemployment rate remains low, with productivity increasing. Consumer spending remains intact, though unevenly distributed. AI-related capital expenditure has accelerated.

While financial market gains may not appear consistent with the media cycle, they have been firmly grounded in strong corporate earnings growth. Valuations remain within a normal historical range rather than in extreme territory.

Second Quarter Performance

Global equity markets rebounded sharply during the second quarter despite continued geopolitical and policy uncertainty. Major benchmarks posted strong gains across regions and market capitalizations. The S&P 500 advanced 15.2%, while the Nasdaq Composite gained 21.6%. Small- and mid-cap stocks also participated, with Russell 2500 rising 20.3%. Outside the United States, the MSCI Emerging Markets Index returned 24.1% while MSCI Europe gained 10.9%. The breadth of the advance contrasted sharply with the defensive positioning that had characterized the first quarter.

Sector leadership also shifted meaningfully. Information Technology was the strongest-performing S&P 500 sector, gaining 31.8%, while Industrials returned 14.9%. Energy, which led markets during the first quarter amid concerns surrounding the conflict in Iran, declined 13.4% as oil prices retraced most of their earlier surge. The rotation away from energy and toward technology and economically sensitive sectors suggests investors are now increasingly focused on the durability of economic growth rather than the immediate geopolitical headlines.

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Valuations and Outlook

Expectations for corporate earnings were repeatedly revised upward during the second quarter, so even as equity prices recovered from the first-quarter selloff, equity valuations moved only modestly higher. Forward P/E ratios rose across most major benchmarks, with S&P 500 increasing from 19.4x to 20.2x, Nasdaq Composite from 22.9x to 25.5x, Russell 2500 from 17.8 to 19.2, MSCI Emerging Markets from 11.3x to 11.4x, and MSCI Europe from 14.6x to 15.4x. At the same time, forward earnings estimates increased meaningfully across global markets, suggesting that much of the quarter's advance reflected improving fundamentals rather than multiple expansion alone.

Viewed in a historical context, current valuations remain broadly within the normal range. The S&P 500 is modestly above its 10-year average, the Nasdaq Composite remains below its long-run average, and the Russell 2500 is near its historical norm. The market's rebound therefore appears more consistent with investors' pricing continued economic expansion and earnings growth rather than with the type of valuation extremes typically associated with speculative excess.

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Looking forward, the inflation outlook remains a key factor affecting financial markets. Tariffs are projected to remain elevated despite shifts in their implementation. Energy flows through the Strait of Hormuz are unlikely to normalize quickly, even assuming the eventual negotiation of a more stable truce. Meanwhile, the surging AI industry, though potentially disinflationary in the long-term, is putting upward pressure on consumer technology prices. If the Federal Reserve deems it necessary to combat these inflationary trends with interest rate hikes, that could dampen the market's optimistic outlook.

Conclusions

American consumers have valid concerns. Wealth inequality continues to rise unabated, and inflation remains elevated. The Trump administration's unpopular approaches to immigration and geopolitical conflict have had humanitarian consequences that our media environment makes inescapable. The rapid expansion of AI infrastructure risks stressing local energy grids and water systems. Even the country's semiquincentennial celebrations were held amid a heatwave that scientists say would have been "virtually impossible" without climate change.

At the same time, financial markets have valid reasons for their recent advances. Investments in artificial intelligence have strengthened manufacturing indicators and appear to be contributing to increased labor productivity. The growth trajectory of both the economy and corporate earnings growth has strengthened. As discussed above, equity valuations appear to be in a normal historical range.

We cannot dismiss either of these economic narratives as a hallucination. Instead, our challenge is to discern the unique market effects associated with each. We continue to focus on companies that can navigate this environment with resilience and flexibility. That means strong balance sheets, durable cash flows, and the capacity to respond effectively to geopolitical and technological change. Through integrated ESG and financial analysis, we assess a company's ability to manage long-term risks and opportunities, while continuing to leverage our voice as investors to advocate for a more equitable and sustainable future.

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