Quarterly Market Update

Second Quarter, 2026 | July 6, 2026

CLIMBING THE WALL OF WORRY

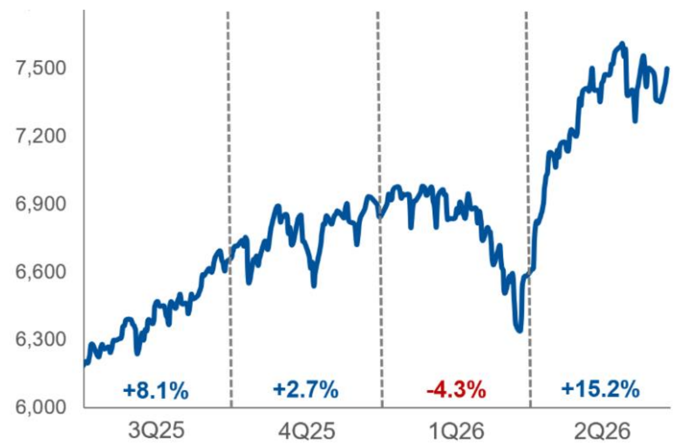
An uneasy rally. The S&P 500 was up 15% in the second quarter (and up 10% year-to-date). Despite this striking Q2 rally, our interactions with clients suggest unease about the bull market's sustainability. At the beginning of the quarter, the primary preoccupation was the war in Iran's impact on the economy and financial markets. Uncertainty about the conflict was running hot then but today we could easily make a presentation to our clients while scarcely mentioning the war.

Worries fading. Despite the likelihood of continued energy supply constraints and a "ceasefire" that doesn't seem to stop the shooting, market action suggests to us that most participants believe the war will resolve itself in a way that allows free passage through the Strait of Hormuz. Private credit was also of great concern at the beginning of Q2, and requests for redemptions from these funds continue to exceed the gates that limit mass withdrawal. However, most investors seem to have concluded that this may be a problem for publicly traded private equity firms, but is not likely to pose a systemic risk.

Worries lingering. While some uneasy peace of mind has been established on Iran and private credit, the bricklayers building the wall of worry have turned their attention to a new Fed chairman looking to establish his inflation-fighting bona fides (potentially by raising interest rates) and the sustainability of capital expenditures on AI. We think the Fed won't want to tighten policy into a supply shock and will wait to see whether hoped for AI-productivity gains come to pass. Regarding AI spending, there seem to be few constraints. Demand exceeds supply, the biggest tech firms fear being left behind, and the capital markets seem to be wide open for business. We take comfort in the fact that the recent sector rotation away from Tech did not harm the broader indices.

Bull fuel. Perhaps the most encouraging thing has been the earnings growth of the S&P 500, which exceeded 29% in the first quarter and appears to be on track to grow at 24% in the second quarter (and projected to be 27% for 2026 overall). All of this is happening in an environment in which the yield on the 10-year Treasury is below 4.5% and corporate credit spreads are tight as a drum. Game on.

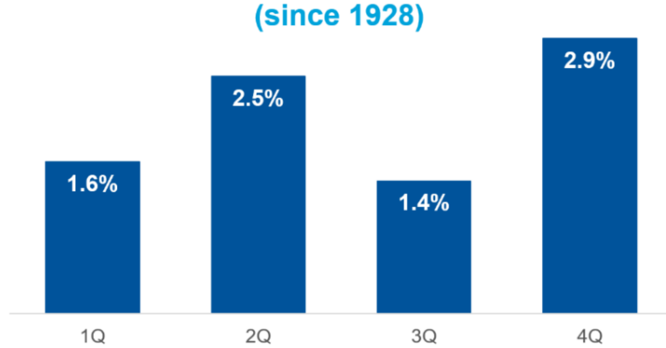
S&P 500



Performance by Asset Class

Asset Class	Representative Benchmark	Q2 2026 Total Return	Year-to-Date Total Return
US Large Cap	Russell 1000	15.1%	10.3%
US Small Cap	Russell 2000	21.5%	22.6%
International	MSCI AC World ex-USA (USD)	14.7%	14.0%
Commodities	Bloomberg Commodity	-8.1%	14.4%
Gold	LBMA Gold PM ($/ozt)	-12.6%	-7.8%
Municipal Bonds	Bloomberg Municipal Bond	2.5%	2.3%
Taxable Bonds	Bloomberg US Aggregate	0.7%	0.6%
Cash	Bloomberg 3-Month T-Bill	0.9%	1.8%

S&P 500 Average Quarterly Return (since 1928)

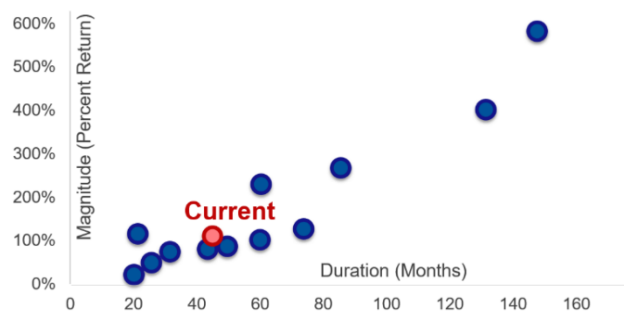


Prepared by Baird Strategas LLC, FINRA member

Source: Data for this page come from data-provider Factset.

Bull Market Lengths and Magnitudes

1942 - Present, Source: Strategas, Factset



With U.S. stocks near record highs, investors are wondering how much longer the current bull market can last. History suggests there may be room to run: the average post-WWII bull market lasted longer and delivered stronger returns than the current cycle, which is roughly 45 months old with a gain of about 110%. And while some signs of exuberance are evident, the conditions that typically accompany a market top do not appear to be in place. Prudence is warranted, but the bull market looks intact to us.

Change in S&P 500 Growth Expectations

	Earnings Growth (%)		Sales Growth (%)	
	January	June	January	June
Comm. Svcs	12.2	27.4	9.9	13.9
Cons. Disc.	10.0	14.8	6.6	7.5
Cons. Staple	6.8	6.4	5.1	6.1
Energy	4.8	63.4	-1.6	15.9
Financials	8.3	10.5	6.1	6.7
Healthcare	8.7	3.2	5.3	5.1
Industrials	6.6	9.2	2.5	5.6
Technology	21.2	47.9	14.8	29.3
Materials	20.3	38.9	5.1	10.3
Real Estate	5.0	5.1	5.3	9.0
Utilities	12.1	13.1	4.0	7.6
S&P 500	**12.2**	**23.9**	**6.5**	**10.6**

Source: Baird Strategas, Bloomberg

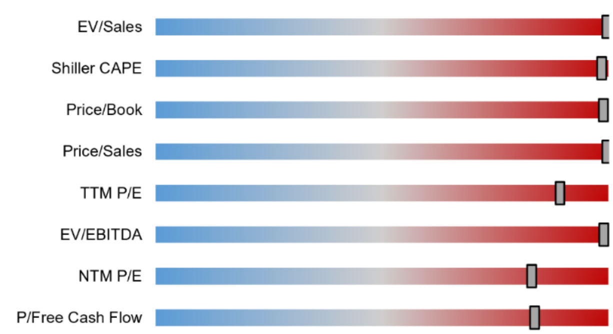
We often hear from clients that today's market feels like a 2000-style bubble. We take solace in the market's fundamentals, which show that prices have risen on the back of stronger profits (as opposed to rising in a market willing to pay more for less). What is remarkable about today's earnings trajectory is that these kinds of growth rates are typically associated with recession recoveries, not mid-cycle environments. Moreover, nearly every sector is reporting stronger expected growth today than it did before the Iran conflict.

Year-to-Date Market Breadth

Leave it to a war and an energy crisis to deliver the eighth-best quarter for the Russell 2000 small-cap index since its 1970s inception. An important observation heading into the third quarter is how rotational this market remains (case in point: the first trading day of Q3 marked the 8th time this year – and the 4th since June – that the Tech-heavy Nasdaq 100 index was down by at least -1% but more stocks advanced than declined in the broader Russell 3000 index (a cap-weighted index that seeks to represent 98% of U.S. stocks). Despite historic concentration in Technology stocks, breadth is not particularly a concern to us at this moment.

S&P 500 Valuation

Current Percentile Ranking Relative to History

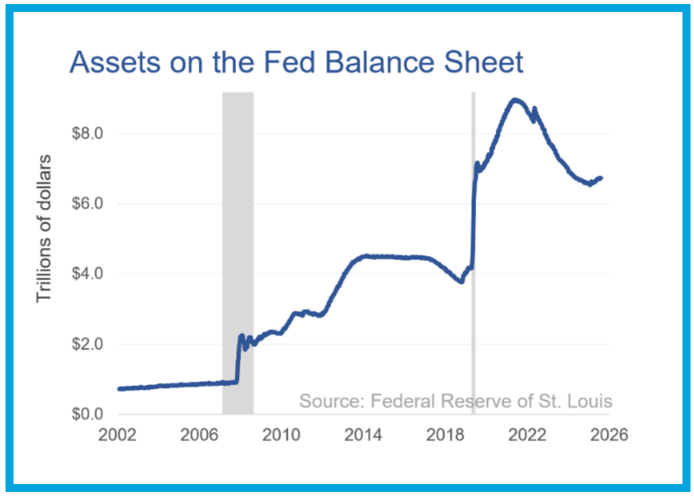


Source: Baird Strategas, FactSet, Bloomberg, Robert Shiller, Data as of 6/30/26

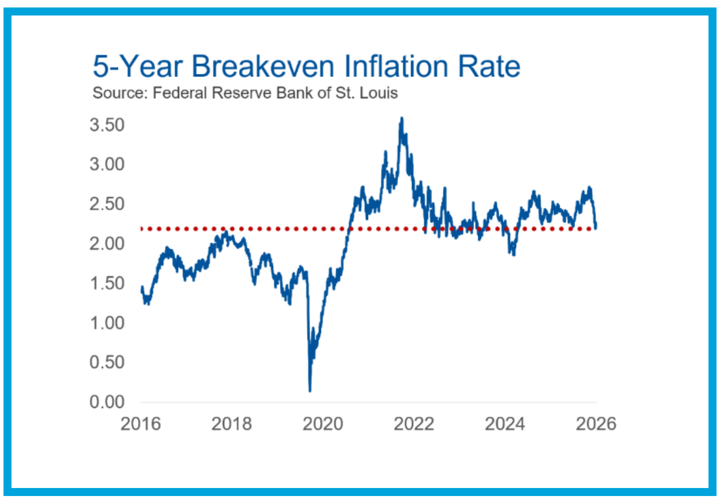
Valuations have compressed year-to-date but are high relative to averages going back to 1950. Given post-pandemic pressure on long-term yields, we would temper expectations for multiple expansion and focus on earnings growth and cash flow.

EV/Sales is enterprise value relative to revenue. **Shiller CAPE** is share price relative to 10-year avg, inflation-adjusted earnings. **Price/Book** is share price relative to book value. **Price/Sales** is share price relative to revenue. **TTM P/E** is trailing 12 month price-to-earnings. **EV/EBITDA** is enterprise value divided by earnings before interest, taxes, depreciation and amortization (focuses on cash generation from day-to-day operations). **NTM P/E** is next-12-months price-to-earnings, based on consensus estimates. **P/free cash flow** is the share price relative to cash generated after operating expenses and capital spending.

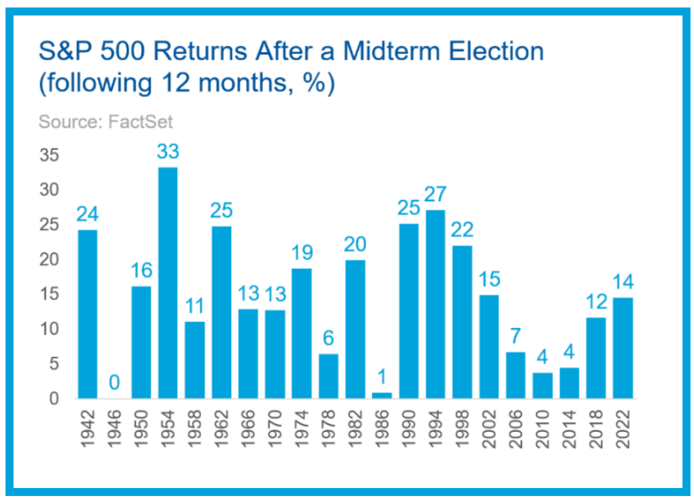
Inflation pressure has built over the past several months as the war in Iran has pressured commodity prices and supply chains. But reasonably tame "sticky price" measures (e.g., prices that are slower to change, and thereby more likely to impact Fed decision-making) indicate that the trend in inflation has, fortunately, not de-anchored yet. Lower oil prices should give the Federal Reserve some room to breathe, but other price pressures are worth monitoring (notably, technology prices as AI demand creates shortages throughout the system). Well-anchored sticky-price inflation gives the Fed room to operate, but sits well above pre-pandemic levels.



Since the Federal Reserve began increasing its balance sheet in December 2025, bank deposits increased by more than $700 billion. In the short run this gives consumers some firepower. But over the next 15 months, this makes it more difficult for the Fed to get inflation closer to 2%. But if the money supply is accelerating (via bank deposits), getting inflation down will be more difficult. This is why we think that the new Fed chair is likely to focus on balance sheet reduction in 2027 and 2028.



Though the tenuous peace deal in the Middle East seems to be holding, Fed policy and Iran remain inextricably linked – a dynamic that sheds some light on the approach to policy by the new Fed chair, Kevn Warsh. Warsh did not contribute to the Fed's rate forecast in June because he has stated that he believes the data gets stale and leaves the Fed stuck with those views. A hawkish dot plot was based on the Strait of Hormuz being closed but once the deal was made and the Strait re-opened, medium-term inflation expectations immediately plummeted to a level near post-Covid lows, rendering most hawkish views somewhat dated. The re-opening of the Strait buys the Fed time to avoid increasing rates in the near term.



The second quarter of the midterm year is typically the worst quarter for the S&P 500 in the four-year cycle of a president's term. Q2 shows why the presidential cycle should be used as a framework, rather than a forecast. This year, Q1 took the brunt of the pain over geopolitical events, setting the stage for a Q2 rebound as Trump moved to a ceasefire in Iran and economic policy cushioned supply chain disruptions. Midterm headwinds may remain, but just simply moving beyond the midterm election has been a catalyst for market upside in the past. Remarkably, the S&P 500 has not declined in the 12 months following a midterm election since 1938.

S&P 500 Index (Large Cap / U.S. Stocks): A sample of 500 leading companies in leading U.S. industries, of large capitalization (generally $7 billion plus market cap) with growth and value characteristics. ● **Russell 2000® Index (Small Cap / Small Core):** Measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represent approximately 10% of the total market capitalization of the Russell 3000® Index. These are equities of small capitalization. ● **MSCI EAFE Index Net (International / Developed Markets):** A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US and Canada. As of December 2024, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. ● **BBgBarc Aggregate Bond Index (Taxable Bonds / Bonds):** Composed of approximately 6,000 publicly traded bonds, including U.S. Government, mortgage-backed, corporate, and Yankee bonds with an average maturity of approximately 10 years. ● **BBgBarc Muni Bond Index (Municipal Bonds):** Bonds must have a minimum credit rating of at least Baa, an outstanding par value of at least $3 million, part of a transaction of at least $50 million, issued after December 31, 1990, and have a year or longer remaining maturity ● **FTSE 3-month T-bill Index (Cash):** This index measures monthly return equivalents of yield averages that are not marked to market. It consists of the last one-month and three-month Treasury bill issues, respectively. ● **Bloomberg Commodity Index (Commodities):** Composed of commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). Subindices include Petroleum, Grains, Industrial Metals, Livestock, Precious Metals, and Softs.

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