

Quarterly Market Wrap | Q2 2026

Markets Look Past a Risk-Filled Quarter

FTWA.



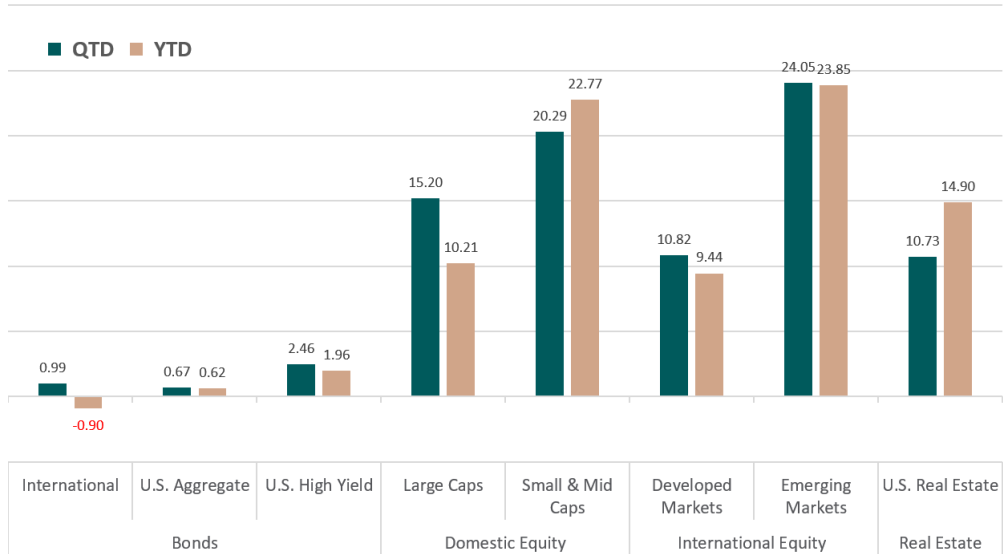
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The second quarter of 2026 was defined by a unique mix of geopolitical conflicts, inflation pressures, shifting monetary policy expectations and one of the strongest earnings seasons in recent years. While the Iran-U.S. conflict disrupted energy markets and reignited inflation concerns, corporate America largely exceeded expectations, helping support a robust advance in U.S. equities, led by investment in artificial intelligence.

During the quarter, markets faced a growing list of risks, including higher energy prices, tariff uncertainty and the possibility of additional Federal Reserve rate hikes. Yet improving earnings, expanding market breadth and continued investment in artificial intelligence helped offset these concerns. The result was a quarter in which strong fundamentals proved more powerful than the headlines.

- 1. The Iran-U.S. conflict reshaped the macroeconomic landscape:** The conflict in the Middle East became a defining macro event, driving higher energy prices, disrupting shipping routes and creating new inflationary pressures. Although a fragile ceasefire emerged late in the quarter, continued disruptions in the Strait of Hormuz highlighted the importance of geopolitical risks to global markets.
- 2. Inflation reaccelerated and the Fed became more hawkish:** Higher energy costs pushed inflation higher and well beyond the Fed's 2% target, prompting investors to reconsider expectations for monetary policy. While the Fed left rates unchanged, markets increasingly priced in the possibility of a rate hike later this year as policymakers signaled growing concern over persistent inflation.
 - Q2 marked the first quarter under new Federal Reserve Chairman Kevin Warsh. Markets are still evaluating how his approach may differ from his predecessor's, creating additional uncertainty around the future path of interest rates and increasing sensitivity to economic data releases and Fed communications.
 - Global growth diverged as inflation rose and trade uncertainty persisted. Economic conditions increasingly varied across regions, with Europe facing slowing growth and stagflation concerns that prompted the European Central Bank to raise rates, while China moved toward additional policy easing.
- 3. Earnings growth produced the strongest season since 2021:** Corporate earnings were a standout story of the quarter. More than 80% of S&P 500 companies exceeded analyst expectations on their way to growing earnings by 28.8% year over year in the first quarter, marking the strongest earnings season in five years. While the largest technology companies led the way, with earnings up nearly 55% year over year, growth extended well beyond the technology sector, supporting the view that the earnings recovery is becoming increasingly broad based.
- 4. Equity markets delivered strong returns despite the risks:** After contracting nearly 5% in the first quarter, the S&P 500 rallied more than 15% in the second quarter to post its strongest quarterly performance in six years, although it was bested by the tech-heavy Nasdaq, which climbed 28%. Supported by resilient earnings and expanding market participation, small-cap stocks outperformed large caps by a wide margin. As small-cap and mid-cap equities remain in an uptrend, the improving breadth suggests the rally is becoming less dependent on a narrow group of mega-cap technology companies.
- 5. The AI Infrastructure boom reached new heights:** Semiconductor stocks delivered a record quarter, gaining 88%, as surging demand for AI infrastructure drove strong earnings, capacity expansion and continued investment across the industry. While the AI buildout remains a powerful growth driver, the quarter ended with increased scrutiny around valuations, supply constraints and the long-term sustainability of current spending trends.

Asset class performance – Q2 and YTD

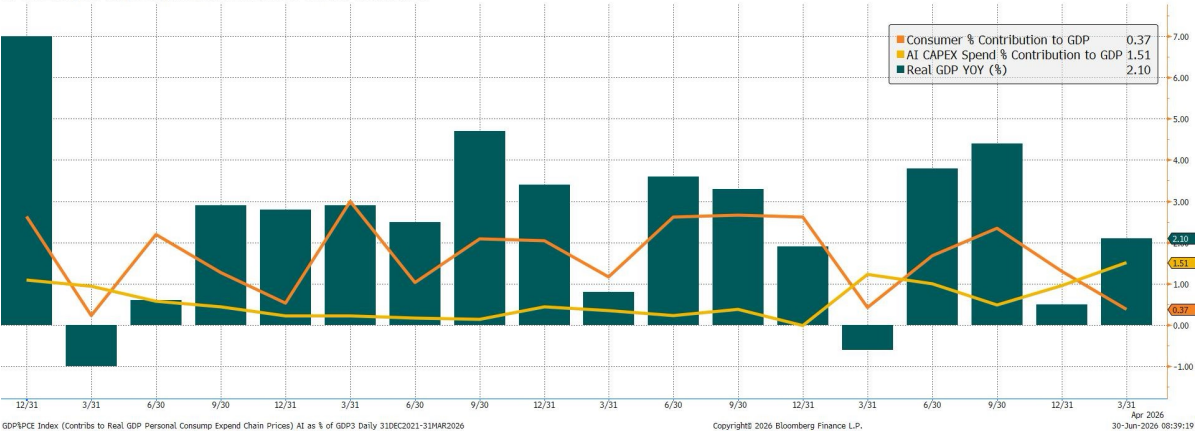


Source: Bloomberg, as of June 30, 2026. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Bloomberg U.S. Aggregate Bond TR), U.S. High Yield (Bloomberg U.S. HY 2% Issuer-Capped TR), International Bonds (Bloomberg Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small & Mid Caps (Russell 2500 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR). Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that will reduce returns.

Chart of the quarter: From shoppers to servers: Is AI driving the new economy?

AI Trumps Consumer-Driven Economy

AI CAPEX Spend in Q1 Surpasses the Consumers' Growth Contribution



Massive spending on AI infrastructure helped offset a slowing consumer backdrop, with cloud providers, hyperscalers and semiconductor firms deploying record levels of capital into data centers, chips and power infrastructure. As inflation pressures weighed on lower- and middle-income households in an increasingly K-shaped economy, AI-related investment emerged as a key source of economic growth, corporate earnings and market performance.

- **Record AI capex:** Technology companies continued to commit unprecedented capital to AI infrastructure, fueling demand across semiconductors, data centers, networking equipment and power generation.
- **Growth driven by investment, not consumption:** While consumers faced higher energy costs and inflation pressures, business investment in AI increasingly became a primary engine of economic activity, earnings growth and equity market leadership. The K-shaped economy debate intensified as spending by wealthier Americans drove an ever-greater share of economic growth, while lower-income cohorts pulled back — a divergence that has become an increasingly important consideration for businesses and policymakers alike.
- **Debt-funded expansion raises questions:** A growing portion of the AI buildout is being financed through debt issuance and large-scale capital commitments, raising investor questions about long-term returns, capacity utilization and whether future cash flows will justify today's spending levels.
- **A powerful tailwind, but not without risks:** The AI infrastructure cycle continues to support growth across the economy, but elevated valuations, funding requirements and the cyclical nature of technology investments suggest volatility is likely to remain elevated as investors evaluate the durability of the buildout.

FTWA outlook & implications

The first half of 2026 demonstrated the market's ability to look beyond uncertainty. Despite geopolitical conflict, persistent inflation and a changing Federal Reserve leadership regime, earnings growth remained strong, market breadth improved and risk assets proved resilient.

As we enter the second half of the year, we remain constructive but selective. Strong earnings, expanding participation beyond mega-cap technology, and continued investment in AI and infrastructure provide support for markets, while inflation, monetary policy uncertainty, and geopolitical and political risks are likely to contribute to periods of heightened volatility.

Optimism:

- 1. U.S. equities** enter the second half of 2026 with a constructive backdrop, supported by strong earnings growth, improving market breadth and continued investment in AI infrastructure. Encouragingly, leadership has broadened beyond the largest technology companies, with small- and mid-cap stocks exhibiting strong technical and fundamental backdrops. Nearly 70% of small-cap stocks and 67% of mid-cap stocks remain above their 200-day moving averages, reflecting participation well above long-term averages. We continue to favor a balanced and disciplined approach, with particular emphasis on small- and mid-cap companies where earnings growth expectations, valuations and improving breadth suggest attractive opportunities as the market broadens beyond a narrow group of leaders, although sensitivity around Fed policy is likely to contribute to volatility.
- 2. International equities** have benefited from strong AI- and semiconductor-driven growth, particularly in Asia, while increased defense and fiscal spending have supported European markets. Although a stronger U.S. dollar and ongoing geopolitical risks remain headwinds, attractive valuations, improving earnings growth and continued investment in AI infrastructure provide a constructive backdrop for international equities in the second half of 2026.
- 3. Fixed income** continues to offer income opportunities, with yields across Treasuries and investment-grade credit remaining compelling by historical standards. While markets are pricing in the possibility of one rate hike this year, our base case remains that the Fed will hold rates steady. In this environment, we favor the belly of the yield curve (5–7 years), where investors can capture attractive income while potentially avoiding the inflation and fiscal deficit concerns that continue to pressure longer-term yields, as well as the greater sensitivity of shorter maturities if the Fed ultimately chooses to raise rates. Fixed income remains an important source of income, diversification and portfolio balance.
- 4. Alternatives** continue to offer opportunities driven by several long-term structural themes, including AI infrastructure, data centers, defense spending and industrial modernization. While the inflation backdrop has become more nuanced as energy prices have moderated, real assets with contracted cash flows, digital infrastructure and select infrastructure investments continue to benefit from strong institutional demand and multi-year capital spending trends. We remain focused on a selective approach, favoring areas with durable cash flows and secular growth drivers while recognizing that valuations and AI-related investment activity warrant continued discipline.

Risks:

- 1. Geopolitical risks remain elevated:** While a ceasefire has reduced the immediate risk of a broader regional conflict, a prolonged path to a lasting resolution — or a renewed escalation involving Iran and the Strait of Hormuz — remains a significant macroeconomic risk facing markets. Any renewed disruption to energy production, shipping routes or global supply chains could place renewed upward pressure on inflation while weighing on consumer spending, business confidence and economic growth.
- 2. Inflation may prove more persistent than expected:** Even if tensions in the Middle East continue to ease, inflation is likely to remain above central bank targets for longer than investors currently anticipate. Producer prices continue to outpace consumer prices, suggesting ongoing margin pressure for businesses as higher input costs work their way through the economy. As a result, inflation may decline only gradually, creating a more challenging backdrop for both earnings growth and monetary policy.
- 3. Monetary policy and Fed leadership regime:** Monetary policy risks are moving back to center stage. Our base case remains that the Federal Reserve will keep rates unchanged for the remainder of 2026 as policymakers balance slowing growth against persistent inflation pressures. However, the risk of an additional rate hike cannot be dismissed if inflation proves more stubborn than expected. Compounding this uncertainty is the transition to new Federal Reserve leadership under Chairman Kevin Warsh. Markets are still assessing how policy communication, decision-making and the balance between inflation and employment objectives may differ from the prior regime, which could lead to greater market volatility around economic data releases and Fed meetings.

- 4. Midterm elections could increase volatility:** The 2026 midterm elections are rapidly approaching and have the potential to reshape the balance of power in Congress. Historically, midterm election years have produced some of the weakest and most volatile periods of the presidential cycle as investors digest shifts in fiscal, regulatory and tax policy expectations. Given elevated geopolitical tensions and inflation concerns, election-related volatility could become more pronounced as November approaches.
- 5. The durability of the AI buildout:** The AI investment cycle has become a major driver of economic growth, corporate earnings and market performance, supported by record spending on data centers, semiconductors, power infrastructure and computing capacity. While demand remains robust, investors are increasingly focused on the sustainability of this spending, particularly as a growing share is being financed through debt and equity issuance in a higher-for-longer interest rate environment. The key question for markets is whether today's unprecedented capital investment ultimately translates into durable revenue growth, productivity gains and returns on invested capital sufficient to justify current valuations and spending levels.

While meaningful risks remain, we believe the longer-term outlook for the economy and markets remains constructive. Earnings growth is the strongest in several years, market participation has broadened well beyond a narrow group of mega-cap technology companies, and long-term investment themes — including AI infrastructure, defense spending and industrial modernization — continue to support economic activity and corporate profitability.

However, FTWA believes optimism should be balanced with discipline. Investors are navigating a market increasingly influenced by geopolitical developments, persistent inflation, evolving monetary policy, approaching midterm elections and questions surrounding the sustainability and monetization of unprecedented AI-related capital spending. In this environment, we believe diversification, quality and disciplined portfolio management remain critical. Our economic posture maintains a long-term perspective, focusing on fundamentals and avoiding reactions to short-term market headlines to help navigate an environment characterized by both opportunity and uncertainty.

As always, our focus remains on helping clients pursue their long-term financial objectives through a disciplined investment process, thoughtful diversification and periodic portfolio rebalancing designed to align portfolios with changing market conditions and individual goals.

DEFINITIONS:

Barclays U.S. Aggregate Bond TR: Measures the performance of the total U.S. investment-grade bond market, including U.S. Treasuries, agency debt, mortgage-backed securities, asset-backed securities, and corporate bonds.

Barclays U.S. HY 2% Issuer-Capped TR: Tracks the performance of fixed rate dollar denominated debt securities. The debt instruments are non-investment grade. There's a limit of 2% maximum exposure to any one issuer.

Bloomberg Global Aggregate ex USD Total Return: Tracks the performance of investment-grade, fixed-rate bonds issued in currencies other than the U.S. dollar, including treasury, government-related, corporate, and securitized bonds from both developed and emerging markets.

FTSE NAREIT All Equity REITS TR: Measures the performance of U.S. publicly traded equity REITs, including both price changes and dividend income.

MSCI EAFE NR USD: Captures large- and mid-cap representation across 21 developed markets countries around the world, excluding the U.S.

MSCI EM NR USD: Captures large- and mid-cap representation across 24 emerging markets countries.

Magnificent Seven stocks are a group of companies in the U.S. stock market: Alphabet, Amazon, Apple, Tesla, Meta Platforms, Microsoft and Nvidia.

Russell 2500 TR: Measures the performance of the smallest 2,500 companies in the Russell 3000 Index. This index is constructed to give a comprehensive and unbiased barometer for the small- and mid-cap segment of the U.S. equity universe.

S&P 500 Total Return: Includes a representative sample of 500 leading companies in leading industries of the U.S. economy, calculated on a total return basis.

RISK CONSIDERATIONS:

Investing involves risks and you may incur a profit or a loss. Past performance does not guarantee future results.

Different types of investments involve varying degrees of risk and there can be no assurance that the future performance of any specific investment vehicle, strategy or product referenced in the material will be profitable or suitable for your particular investment situation.

Equity securities are subject to frequent changes in valuation and are often more volatile than other asset classes. Equity valuation is subject in part to the associated fluctuations in the market confidence of its issuers.

Fixed income securities are subject to credit risk, liquidity risk, call risk and interest rate risk. As interest rates rise, bond prices generally fall.

International securities risks include fluctuations in the exchange rates of foreign currencies that may affect the U.S. dollar value of the investment, the possibility of substantial price volatility as a result of political and economic instability in the foreign country, less public information about issuers of securities, different securities regulation, different accounting, auditing and financial reporting standards and less liquidity than in the U.S. markets. Historically, these risks have tended to be more pronounced in emerging market countries than in more developed foreign countries.

Alts and non-traditional assets such as real estate, commodities, currencies and private companies, are subject to risks that are different from, and in some instances, greater than, other assets like stocks and bonds. Some non-traditional assets are less transparent and more sensitive to domestic and foreign political and economic conditions than more traditional investments. Non-traditional assets are also generally more difficult to value, and less liquid than traditional assets.

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