Investment Strategy

MID-YEAR INVESTMENT OUTLOOK

Earnings, Inflation, and the Next Leg of Global Leadership

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The Earnings Story Remains the Most Important Story

Markets have had plenty to absorb over the past several years: inflation shocks, stress in private credit, geopolitical uncertainty, and a constantly shifting outlook for monetary policy. Through it all, however, the most important driver of equity returns has remained surprisingly consistent: earnings.

Consensus expectations for S&P 500 earnings have moved meaningfully higher throughout 2026. At the beginning of the year, analysts were generally looking for earnings growth in the mid-teens. Today, consensus estimates point to full-year growth approaching 20%, with quarterly growth expectations for the rest of 2026 still near or above that level. FactSet currently estimates second-quarter earnings growth of roughly 22%, which would mark the second consecutive quarter of earnings growth above 20% and the seventh consecutive quarter of double-digit growth. Analysts are also forecasting earnings growth near 17–20% for calendar year 2026, followed by another 13–15% increase in 2027. Goldman Sachs recently raised its forecast to $340 per share for 2026 and $385 per share for 2027, while other strategists have also moved estimates higher. [1][2][3]

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That kind of earnings acceleration is worth paying attention to. Outside of the periods immediately following recessions or the post-pandemic rebound, sustained earnings growth above 15% has been fairly uncommon. Since 1990, growth of that magnitude has usually appeared during periods marked by productivity improvement, rising capital investment, or meaningful technological change.

Today's environment appears to share elements of all three.

The primary drivers include:

- ⇒ Continued investment in artificial intelligence infrastructure.
- ⇒ Strong corporate productivity gains.
- ⇒ Capital spending related to reshoring and supply chain resiliency.
- ⇒ Increased energy and industrial investment.
- ⇒ Better-than-expected operating leverage across technology, financials, and industrial companies.
- ⇒ Broadening earnings participation beyond the largest technology firms.

One of the more encouraging parts of this cycle is that earnings growth is no longer limited to only a small group of mega-cap companies. Earnings revisions have improved across industrials, financials, materials, energy, and selected consumer businesses. Market leadership is gradually broadening, and historically that has been a healthier backdrop for equities.

Inflation Remains the Principal Risk

The clearest risk to continued earnings growth is still inflation.

Inflation has remained above the Federal Reserve's 2% target for much of the past five years, a concern that has been highlighted by a number of economists and market observers. That concern is reasonable. Inflation has been more persistent than many economists expected, and the Federal Reserve's credibility depends on its ability to restore price stability. [4][5]

At the same time, it is important to separate demand-driven inflation from supply-driven inflation. Demand-driven inflation is generally the more problematic form because it reflects an overheating economy. It typically requires aggressive monetary tightening and often results in recession.

The current inflation picture looks somewhat different. Much of the recent pressure appears to be connected to supply-side disruptions, including energy markets, geopolitical conflict, reshoring initiatives, tariff policies, labor shortages, and ongoing supply chain adjustments. The recent spike in oil prices tied to Middle East tensions is one example. The Federal Reserve itself has acknowledged that current inflation pressures are being influenced by supply shocks. [6] This distinction is critical.

Higher interest rates can slow demand, but they do not create more oil, expand refinery capacity, or open new shipping routes. When inflation begins with supply constraints, monetary policy is a blunt tool. The key question is whether the Fed will raise rates again.

That answer has become less clear. Recent Federal Reserve projections show that nearly half of policymakers now expect at least one rate hike before year-end, and market expectations have shifted noticeably over the past several months. [7][8]

Our base case remains that the Federal Reserve will keep policy restrictive but avoid an aggressive tightening cycle unless inflation broadens well beyond energy and other supply-sensitive areas.

The labor market is still healthy, but it does not appear overheated. Long-term inflation expectations remain relatively anchored, and productivity growth is improving. Taken together, those conditions argue for patience.

Dynamic Asset Allocation Positioning

Why Small Caps Remain Attractive

Our dynamic asset allocation continues to favor small-cap equities, primarily because valuations remain attractive.

Large-cap growth stocks have delivered exceptional returns over the past several years. Small-cap companies, by contrast, still trade at substantial discounts relative to their historical relationship with large-cap equities.

Historically, smaller companies have often done well when earnings growth is strong and the economy continues to expand. They are more economically sensitive and can benefit disproportionately when nominal GDP growth remains positive. Several additional factors support the asset class, which includes: improving earnings breadth; lower starting valuations; greater exposure to domestic investment spending; increased acquisition activity; and potential benefits from eventual monetary easing.

Small caps also remain meaningfully under-owned compared with historical allocations. If market leadership continues to broaden beyond mega-cap technology, small caps may represent one of the larger opportunities within public equities.

Value Over Growth

Growth stocks have already received significant valuation recognition for their future earnings potential. Value-oriented sectors, including financials, industrials, energy, infrastructure, and selected healthcare businesses, continue to trade at meaningful discounts despite improving fundamentals. In many of these areas, companies may also have meaningful room for margin improvement as AI and other technologies are applied to older, less digitized business models.

Historically, periods with above-target inflation, higher nominal interest rates, capital investment booms, and stronger commodity demand have often favored value-oriented companies.

Many of the businesses benefiting from AI infrastructure spending are also outside traditional technology indexes. Utilities, industrial manufacturers, electrical equipment suppliers, engineering firms, data-center infrastructure providers, and energy companies are increasingly participating in the same investment cycle.

The Continued Case for International and Emerging Markets

International markets continue to trade at substantial discounts to U.S. equities on both earnings and valuation measures. That discount is especially noticeable in Europe and emerging markets.

Emerging markets could eventually benefit from AI adoption in much the same way they benefited from the internet and mobile revolutions: by using new technologies to improve productivity without carrying all of the same legacy infrastructure costs. Potential drivers include advanced packaging and memory production across Asia, global data-center infrastructure, industrial automation leaders in Europe, and commodity producers supplying the physical inputs required for AI infrastructure.

A weaker dollar, improving earnings growth, and historically attractive valuations could provide additional support for international equities.

The valuation gap between U.S. and international markets remains near multi-decade extremes.

Real Estate's Opportunity

Real estate has spent much of the past several years adjusting to higher interest rates. Commercial real estate valuations have largely repriced, financing markets have stabilized, and new construction activity has slowed meaningfully.

Those developments may be setting the stage for better fundamentals.

Real estate tends to perform well in environments like today's, when economic growth remains positive, inflation is moderately elevated, replacement costs are rising, and new supply is constrained.

Several property types, including industrial logistics, data centers, specialized housing, and infrastructure-related real estate, are directly benefiting from AI investment, reshoring initiatives, and demographic trends.

The sector also offers income at a time when investors are looking for real assets that can help preserve purchasing power.

Gold's Frustrating Quarter

Gold has been one of the more frustrating areas within our dynamic asset allocation framework this quarter.

The metal entered the year with strong momentum, supported by central-bank buying, geopolitical uncertainty, and concerns about fiscal deficits. Since then, stronger equity markets, rising real interest rates, and improving risk appetite have limited further upside.

Gold often struggles when investors become more confident in economic growth and corporate earnings.

That said, the longer-term case remains intact. Potential catalysts include renewed central-bank purchases, further geopolitical instability, declining real interest rates, fiscal concerns around government debt, and any loss of confidence in fiat currencies.

Periods of underperformance are not unusual within longer gold bull markets. In the past, some of gold's strongest advances have followed extended consolidation periods.

Sector Spotlight: The New Space Economy

Every generation experiences a technological shift that eventually reshapes the economy in ways that are difficult to imagine at the beginning.

The railroad connected a continent and changed manufacturing. Electrification reshaped nearly every industry in America. The internet changed how we communicate, shop, and conduct business. More recently, cloud computing created the foundation for artificial intelligence. In each case, the innovation began as a niche investment theme before becoming part of everyday life. I believe the commercial space economy may be following a similar path.

Much of the attention naturally centers on SpaceX, whose IPO was among the larger public offerings of its period. SpaceX has changed launch economics in a meaningful way. Its reusable rocket technology has reduced launch costs and helped open new commercial opportunities. History offers useful comparisons: commercial aviation did not grow simply because people suddenly wanted to fly more; it grew because flying became affordable. Cloud computing expanded as the cost of computing fell. Solar energy became competitive only after years of declining production costs.

The implications go well beyond rockets. Artificial intelligence requires enormous amounts of high-quality data; satellites generate exactly that. Earth observation platforms continuously collect imagery, environmental data, weather information, agricultural conditions, maritime activity, and infrastructure monitoring at a scale that is impossible from the ground. As AI models become more sophisticated, the value of these datasets should increase.

Communications represent another important connection. As AI applications become more integrated into daily life, demand for global, low-latency connectivity should continue to grow. Satellite broadband networks can extend communications beyond traditional terrestrial infrastructure, reaching rural communities, transportation systems, energy facilities, and military operations that have historically had limited access to reliable networks.

National security is another powerful growth driver. Modern defense is also moving further toward space-enabled communications, intelligence gathering, navigation, and autonomous systems. Governments around the world are increasing investment in these capabilities as geopolitical competition intensifies. Defense spending has historically been cyclical, but space-based infrastructure increasingly looks structural.

Once again, the common theme is productivity.

Space can support faster communication, better decision-making, more efficient logistics, and improved resource management across a wide range of industries.

Industry observers generally expect the global space economy to continue growing as advances in communications, transportation, defense, and data infrastructure create new commercial opportunities.

SpaceX sits near the center of this ecosystem. Its Starlink business has created a global communications network serving consumers, enterprises, governments, and military customers. When combined with launch services and future exploration initiatives, the company's addressable market appears substantial.

The IPO may also draw broader investor attention to the sector, much as Amazon helped define e-commerce and Nvidia helped define AI infrastructure.

Perhaps the most interesting part of the sector is that many of tomorrow's applications have not yet been imagined. Few investors buying internet infrastructure companies in the 1990s could have anticipated ride-sharing, streaming media, or cloud computing. Those businesses became possible only after the foundational infrastructure had already been built. Space may be entering a similar stage. The coming decade could represent the first true investment cycle of the commercial space age.

References

1. **FactSet Earnings Insight, June 2026** – S&P 500 Q2 earnings growth estimate of 21.9%
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6. **MarketWatch, June 2026** – Fed attributes elevated inflation partly to supply shocks. (MarketWatch)
7. **Reuters, June 2026** – Nearly half of Fed policymakers foresee a rate hike. (Reuters)
8. **Barron's, June 2026** – Updated Fed dot plot and policy projections. (Barron's)

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The S&P 500 is a capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Russell 2000 consists of the 2,000 smallest U.S. companies in the Russell 3000 index.

MSCI EAFE is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the U.S. and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

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FTSE NAREIT Equity REITs Index contains all Equity REITs not designed as Timber REITs or Infrastructure REITs.

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