Beacon Trust
INNOVATING WEALTH STRATEGY

Market Outlook 2Q 2026 Review July 7, 2026

Second Quarter Summary

The S&P 500 rebounded from a 4.3% loss in Q1 with fireworks befitting the 250th Independence Day celebration, rising 15.2% in Q2. It was the S&P 500's biggest quarterly gain since 2020 Q2. The apparent end to the recent military conflict with Iran and strong corporate earnings were the most likely catalysts for the increase. In parallel, oil prices experienced their biggest quarterly drop in 6 years, allaying fears about inflation spiraling out of control. By the end of Q2, oil prices dropped below $70 per barrel, a sharp decline from their peak price this year of nearly $120 per barrel that was reached in early April. Within the S&P 500, memory and semiconductor firms, such as Micron, SanDisk, AMD, and Intel led the charge, each rising more than 100% in Q2 alone. In contrast to recent prior years, small-cap and value stocks have also exhibited strong performance relative to growth stocks. Specifically, on a year-to-date (YTD) basis the Russell 2000 Index of small-cap stocks increased more than 22% and the Russell 1000 Value Index increased more than 16%. This strong performance compares to the roughly 5% gain for the Russell 1000 Growth Index YTD. Elon Musk briefly became the first trillionaire in the world on the heels of the successful initial public offering (IPO) of his firm, SpaceX. The stock has since come back to earth but remains one of the most prized companies in the world with a lofty market value of $2.1 trillion.

Although the Federal Reserve remained on hold with respect to changes in short-term interest rates in Q2, there was plenty of news related to the fixed income markets. Most notably, Kevin Warsh assumed the position as the Chairman of the Federal Reserve. Typically, departing Fed chairs leave the board once a new leader takes over. However, prior Fed Chair, Jerome Powell, said he plans to remain on the Fed board until all the investigations against him are completed and he is fully exonerated. This situation creates a peculiar dynamic that may make it more challenging for Mr. Warsh to put his mark on the Fed. In his first press conference since becoming Fed Chair, Warsh provided somewhat hawkish remarks, stating his commitment to lower the inflation rate to nearly 2% annually and to continue to shrink the Fed's enormous balance sheet. He also reiterated the Fed's commitment to being independent. The overall bond market took these developments in stride, with the Bloomberg U.S. Aggregate Bond Index up almost 0.75% in Q2 and on a YTD basis.

Despite some headwinds, the economy continued to chug along at a reasonable pace. GDP growth for Q1 was revised upward to 2.1% and Q2 seems poised to meet or exceed this number. The U.S. unemployment rate remains low, with the June reading falling from 4.3% to 4.2%. However, the June employment report showed a somewhat disappointing 57,000 jobs were added, implying that the drop in the unemployment rate was primarily driven by people leaving the workforce. Heightened inflation has been partially preventing the economy from achieving its full potential. The most recent reading of the Consumer Price Index (CPI) showed inflation increasing at a rate of 4.2% on a year-over-year basis. As noted earlier, investors are expecting this headline number to eventually decline as lower oil prices and less geopolitical risk permeate their way throughout the global economy.

Market Outlook

We have a moderately optimistic outlook on equities and still expect them to outperform U.S. bonds. Let's start with the good news. Earnings have been strong, with analysts projecting S&P 500 earnings to increase more than 20% in 2026. This figure exceeds the 12%-15% consensus estimates that were published earlier in the year. The Technology, Financial, and Energy sectors have been the source of many positive earnings revisions this year. The S&P 500 is trading at a P/E multiple of almost 21x forward earnings. We do not think this multiple is excessive given the quality of the firms that account for the biggest weights in the S&P 500. However, we believe these valuation levels constrain stock market gains to future earnings growth. Additionally, investors may be looking to derisk their portfolios on the heels of 3 strong years of equity returns as the midterm elections approach in the back half of the calendar year.

Stock market gains may continue to broaden from primarily technology and artificial intelligence names (AI) to domestic and international firms that may benefit from the implementation of AI, as well as others trading at depressed valuation levels. We believe diversification remains a core investing principle for Beacon clients seeking to preserve and prudently grow their wealth. We often encourage diversification both within and across asset classes in order to mitigate risk.

Consumer prices tend to rise faster than they fall, so the Fed may reluctantly be forced to modestly hike short-term interest rates by the end of the year. Futures markets are currently pricing in at least one rate hike of 0.25% by the end of this year. Although Chair Warsh has extolled the virtues of technology reducing long-term inflation risk, in the short-run prices may actually increase. For example, the AI infrastructure buildout has been partially responsible for the increase in energy prices, memory prices, and other tangential items. Balancing these short-term and long-term factors, we expect the benchmark 10 Year U.S. Treasury Note to largely trade between 4.25% and 4.75% for the remainder of the year.

Geopolitical risks seem to be moderately declining with the Iran peace agreement and a largely positive meeting in May between Presidents Trump and Xi, with the Chinese leader expected to make a diplomatic trip to the U.S. this fall. However, political risks are ever-present and may change quickly as we have seen throughout the year. The U.S. government continues to run substantial budget deficits and bipartisan agreements to tackle this issue, and other important ones, such as the solvency of Social Security, seem to be few and far between. Although we are largely positive on the potential of AI to improve productivity, there is a nontrivial risk of it being used for harmful purposes and for potentially putting large numbers of white collar workers out of a job. Retraining displaced workers for new jobs is possible, but it takes time and may not be feasible in all cases. For example, it may not be easy to turn a displaced information technology IT worker into a healthcare worker or electrician. All of us at Beacon hope you had a wonderful 4th of July weekend, and we wish the men's U.S. soccer team the best of luck in the 2026 World Cup!

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