Midyear Outlook 2026

Still Riding the Wave

CARSON | Investment Research

Current At-A-Glance

As of the end of May

	Strategic View	Policy	Economic	Technicals	Valuations	Tactical View	
Equities	Overweight	+	=	+	=	Overweight	Growth is running a bit below trend, but a massive CapEX boom, fiscal expansion, and a Fed willing to look through inflation should keep supporting earnings.
U.S. Equities	Neutral	+	=	=	-	Neutral	Still the innovation and AI leader, but richer valuations and stretched momentum leave potential opportunities abroad too.
International Equities	Neutral	+	=	+	+	Neutral	Cheaper valuations, supportive policy abroad, and the AI trade broadening beyond the U.S. make the case for balanced global exposure.
Emerging Markets	Neutral	=	-	+	=	Underweight	Structural case is improving as the AI wave broadens globally, but after huge runs in Korea and Taiwan chipmakers we stay tactically cautious on stretched moves and lingering China policy risk.
U.S. Equities							
Large Cap	Overweight	+	+	+	-	Overweight	Home to the AI leaders driving earnings and margins higher; valuations and momentum are stretched, but we still want to ride the wave.
Mid & Small Cap	Underweight	=	=	-	+	Underweight	Scale still wins in the AI CapEX cycle, and higher-for-longer rates are a headwind for smaller, more rate-sensitive companies.
Growth	Neutral	=	+	+	-	Neutral	Rich valuations are a headwind, but fundamentals are strong and growth has actually cheapened relative to the rest of the market; home to many momentum names.
Value	Neutral	=	=	=	+	Neutral	Some traditional value sectors may benefit from deregulation and offer a source of diversification if the AI trade stumbles.
Fixed income	Underweight	=	-	=	=	Underweight	We still prefer stocks in an inflationary growth regime, but higher starting yields supportive.
Treasuries	Overweight	=	=	=	+	Overweight	Yields are attractive and Treasuries remain the best diversifier in an economic downturn; we target below-benchmark interest rate sensitivity.
Investment Grade Corporate	Underweight	=	+	=	-	Underweight	Spreads are tight, though strong balance sheets and a supportive economy limit the risk; we find better value elsewhere.
High Yield	Underweight	=	+	=	-	Underweight	Spreads are tight and the credit cycle is getting later; we prefer the risk/reward in equities, with some floating rate debt for resilience.
Diversifiers							
Cash	Neutral	+	=	0	0	Overweight	Yields stay attractive with the Fed on hold, and cash is safer than core bonds if inflation surprises higher; strategically we lean toward bonds as yields rise.
Diversifiers	Overweight	=	+	+	=	Overweight	Bonds diversify less well in an inflationary growth regime, so we add gold, managed futures, TIPS, and low-volatility stocks to diversify the diversifiers.

Sector and Factor Positioning

Sector Preferences: technology, communication services, healthcare (industry focused)
Factors: complementary strategic and tactical exposure to low volatility and momentum stocks

Introduction

Our theme heading into 2026 was "Riding the Wave." As we look toward the second half of the year, that wave continues to roll. In that spirit, welcome to Carson Investment Research's Midyear Outlook 2026: Still Riding the Wave.

Looking at our calls for the year that made up the wave, fiscal policy has indeed been a tailwind for the economy. Artificial Intelligence (AI) investment has been outpacing even many aggressive forecasts. And earnings growth expectations for the calendar year, which normally decline once the year starts as optimism gives way to reality, have climbed sharply, going from 15.2% expected growth at the start of the year to 23.8% as of the end of May. Yes, the S&P 500 has had a robust start to the year with a 10.2% total return in the first half, but the gain has been driven by strong fundamentals.

Not everything has gone according to plan. Economic growth has slowed, but we still think a recession in the next year is quite unlikely. Job growth has stalled, but the unemployment rate remains low and there has been some recent improvement. Most worrisome, the inflation picture has deteriorated, with the war with Iran putting additional pressure on prices. That likely puts the Federal Reserve on hold for 2026, although a steady policy rate in the face of rising inflation and low unemployment is actually accommodative. Still, between rising inflation and a Fed on hold, the rate environment has become more challenging and bonds undershot expectations in the first half.

But this is often how investing works. Good markets do not usually feel easy while they are happening. There is always something to worry about, and this year has delivered plenty of opportunities. However, the environment still looks good for stocks, and we are raising our S&P 500 forecast to a total return of 15-18% for the year.

We suggest investors keep riding the wave, even if the water is choppier than it looked in January. That calls for balance, discipline, and a willingness to stay invested without pretending the ride will be smooth. We present our Midyear Outlook 2026: Still Riding the Wave as our guide to what may lie ahead for the rest of the year.

'26 Forecast

- A wave of deficit-financed stimulus and a still-accelerating AI CapEX boom keep driving record earnings and margins, enough to overcome higher inflation and a Fed on hold.
- High starting yields cushion returns, but with the Fed on hold and inflation pushing yields higher, we expect to finish near the lower end of the range.

Returns

Stocks
15-18%

Bonds
3-5%

Economy

Economy

In our 2026 Outlook, we wrote about being in an inflationary growth environment and riding the wave of AI-related investment. Those themes have played out even more than we expected. We certainly didn't predict the Middle East crisis and the energy price shock that resulted, but inflation was a growing problem even prior to that. The AI wave has only grown in strength, and technology stocks are riding higher on that strength and pulling the overall market higher.

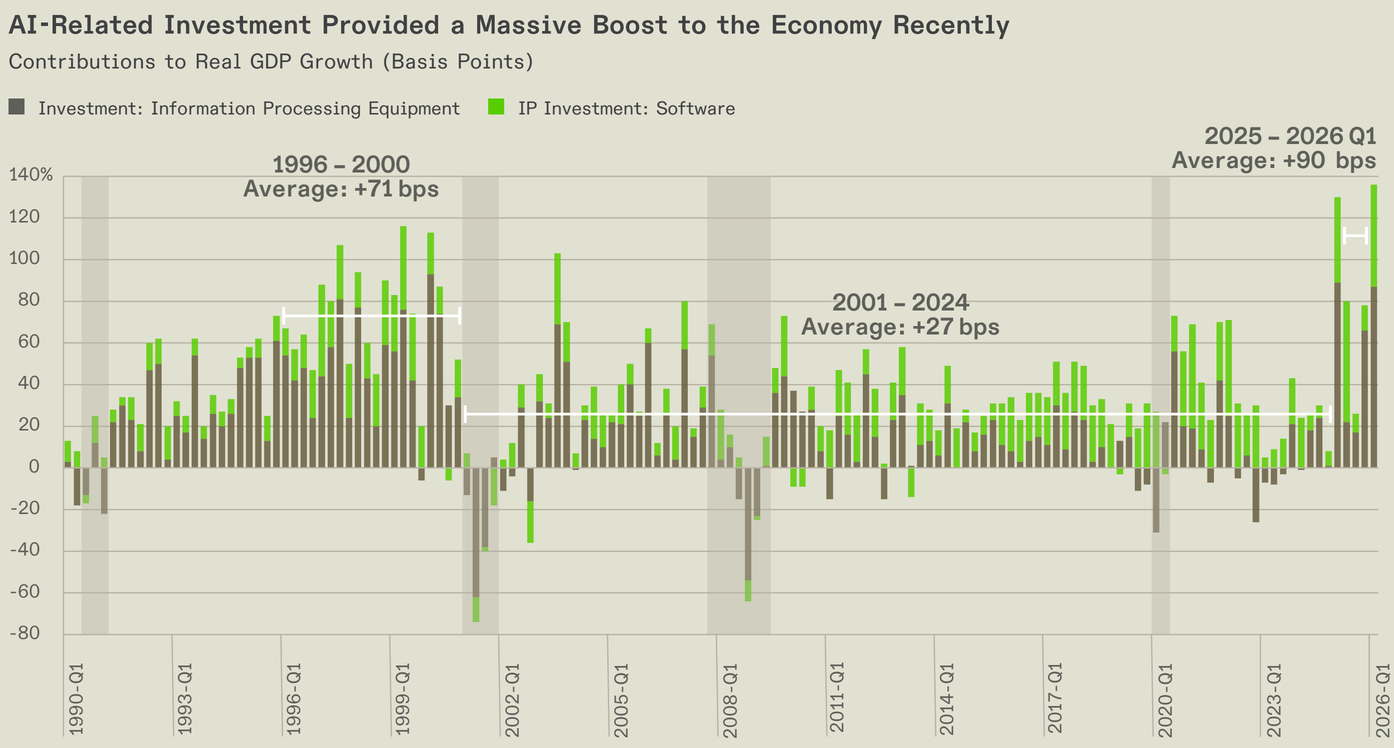
The AI Wave Gets Bigger, Driving Profits Higher

At the start of the year, we believed the best approach for investors was to ride the AI wave, using an equity overweight and broad diversified exposure. Six months later, that picture hasn't changed—if anything, it's only strengthened. AI continues to have a big impact on the economy. But the impact is from investment spending related to AI, rather than the diffusion of AI through the economy boosting productivity. We've yet to see that and probably won't have data on that kind of impact for several years.

Over the last five quarters (through Q1 2026), real GDP growth averaged 1.9% annualized [Chart 1]. Real investment spending on IT equipment and software has added an average of 0.9 percentage points per quarter. That's close to 50% of real GDP growth, from a part of the economy that makes up under 5% of GDP. This is well above what we saw in the late 1990s, let alone the 2000s. So why isn't real GDP growth higher? One issue is that a lot of the AI-related equipment is imported, so it doesn't directly "contribute" to GDP in a strict sense, since only goods produced domestically are included (GDP is gross **domestic** product). But that doesn't mean activity isn't running hot, or that AI investment isn't having a broad impact across the economy and the stock market.

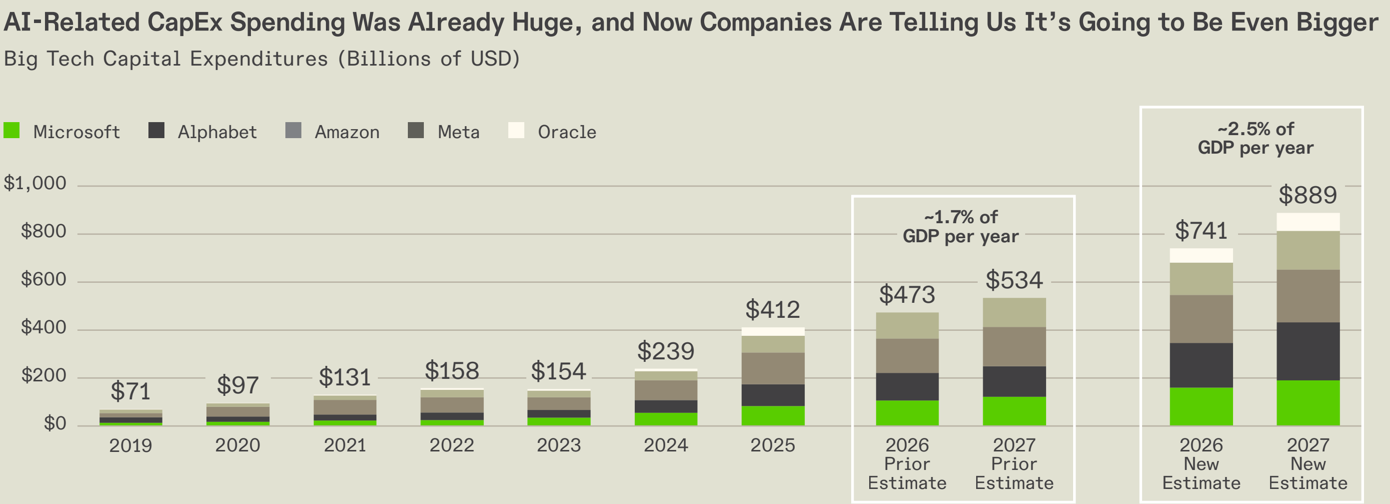
Looking ahead, AI-related CapEX spending is set to keep running hot. The big tech firms, especially those that provide large-scale cloud capacity and operate hyperscale-level data centers (Microsoft, Alphabet, Amazon, Meta, Oracle) are ramping up CapEX to even higher levels [Chart 2]. At the end of last year, these firms were estimated to spend a total of $515 billion on CapEX in 2026, up from almost $400 billion in 2025. That amounts to about 1.6% of GDP, which is staggering. The most recent updates take the 2026 CapEX estimate to a whopping $740 billion, which is about 2.3% of GDP—over 4x the level of CapEX in 2023 (0.5% of GDP) and 7x the size in 2019 (0.3%). 2027 is expected to be even larger.

Chart 1



Source: Carson Investment Research, FRED 6/15/2026. Shaded area shows U.S. recessions. 100 basis points = 1 percentage point.

Chart 2



Source: Carson Investment Research, Bloomberg 5/15/2026. Prior estimates are from the end of 2025.

The melt-up in technology stocks has raised the obvious "bubble" concerns, but notably, this has come on the back of rising profit growth expectations. When it comes to capital expenditures, one company's spending is another company's revenue and profit. That's the connection between all this spending and what we see in the stock market. Interestingly, these profit growth estimates have seen the largest gains during earnings season, as companies tell us they're going to spend even more on AI-related CapEX and firms on the other side of that (like chip companies) see profits rise even more than expected.

The S&P 500's 2026 earnings per share (EPS) expectation has risen over 8% since the start of the year, from $309 to $336. This isn't "pulling forward" from 2027, as 2027 EPS expectations have jumped 7.5% as well, from $355 to $389. A breakdown of the 11 S&P 500 sectors shows exactly which sectors are boosting the aggregate index's profit (EPS) expectations *[Chart 3]*. From the start of the year, three sectors have contributed most of the higher profit estimates:

- The tech sector has seen 2026 EPS estimates grow by 18% and 2027 estimates grow by 26%
- Energy has seen 2026 EPS estimates grow by 58% and 2027 estimates grow by 22%
- Materials have seen 2026 EPS estimates grow by 16% and 2027 estimates grow by 13%

Chart 3

Estimates Keep Coming

	Weight	2026 EPS Estimate			2027 EPS Estimate		
		12/31/25	5/15/26	Change	12/31/25	5/15/26	Change
S&P 500	**100%**	**308.68**	**336.29**	**8.9%**	**354.73**	**389.28**	**9.7%**
Technology	35%	212.65	250.77	**17.9%**	255.48	322.8	**26.4%**
Financials	12%	56.05	56.89	**1.5%**	62.56	63.37	**1.3%**
Comm. Services	11%	20.28	22.83	**12.6%**	23.23	24.42	**5.1%**
Cons. Disc.	10%	65.13	66.21	**1.7%**	76.44	74.51	**-2.5%**
Industrials	9%	55.36	56.54	**2.1%**	63.33	64.76	**2.3%**
Healthcare	9%	97.12	92.16	**-5.1%**	108.35	109.98	**1.5%**
Cons. Staples	5%	39.4	39.23	**-0.4%**	42.55	42.28	**-0.6%**
Energy	3%	43.08	68.28	**58.5%**	51.21	62.24	**21.5%**
Utilities	2%	24.27	24.38	**0.5%**	26.52	26.66	**0.5%**
Materials	2%	30.24	35.02	**15.8%**	34.21	38.64	**12.9%**
Real Estate	2%	14.93	15.01	**0.5%**	15.97	15.95	**-0.1%**

Source: Carson Investment Research, FactSet 6/15/2026.

The AI wave is not just isolated to the U.S. The MSCI Emerging Markets Index was outperforming the S&P 500 by almost 15 percentage points as of the end of May. This is on the back of massive gains in Korea (MSCI Korea Index: +118%) and Taiwan (MSCI Taiwan Index: +60%)—both benefiting from large weights for chipmakers.

The effects of AI investment extend beyond stock prices and corporate profits. As spending accelerates and demand continues to outpace supply in key areas, it is also contributing to inflationary pressures across the economy.

Profit growth and margin expansion also translate to inflation. The three sectors that have seen profit growth estimates soar are technology, energy, and materials, which are all benefiting from inflation related to AI bottlenecks and the energy spike due to the Middle East conflict.

Amid AI-related bottlenecks, the Personal Consumption Expenditures Price Index (PCE) for computer software and accessories climbed at an annualized pace of 64% this year (through April) [Chart 4]. Prices for this category fell continuously over the past two decades, but we're seeing prices surge higher amid the AI boom. The Producer Price Index (PPI) for semiconductor manufacturing is up 26% year over year, while PPI for printed circuit board manufacturing is up a whopping 160%.

Chart 4

AI-Related Bottlenecks Are Also Pushing Inflation Higher

PCE Price Index (Index, Jan 2018 = 100) Computer Software & Accessories

Source: Carson Investment Research, FRED 6/15/2026.

This is where the current AI wave is not quite like the late 1990s yet. AI-related inflation shows that demand is outstripping supply now, whereas in the late 1990s, prices were collapsing. If it was a bubble, we'd probably see massive overcapacity and oversupply (and then return on investment plunge). We're not there yet, but keeping an eye on AI-related bottlenecks is important. If these bottlenecks start to ease and prices fall, it may be a sign that we're moving into oversupply.

AI-related inflation underlines that inflation is not just about energy, or tariffs. Of course, the Middle East war and the Strait of Hormuz closing did not help matters, with PCE inflation up 3.8% year over year as of April. Core PCE is up 3.3%, but the problem is not isolated to a few items. Setting aside goods for a moment, and even shelter (which has normalized), PCE inflation for core services ex-housing is up 3.6% over the past year—well above the 2018-2019 trend of 2.2%. Inflation's hot no matter how you carve it up.

Inflation Has Broadened

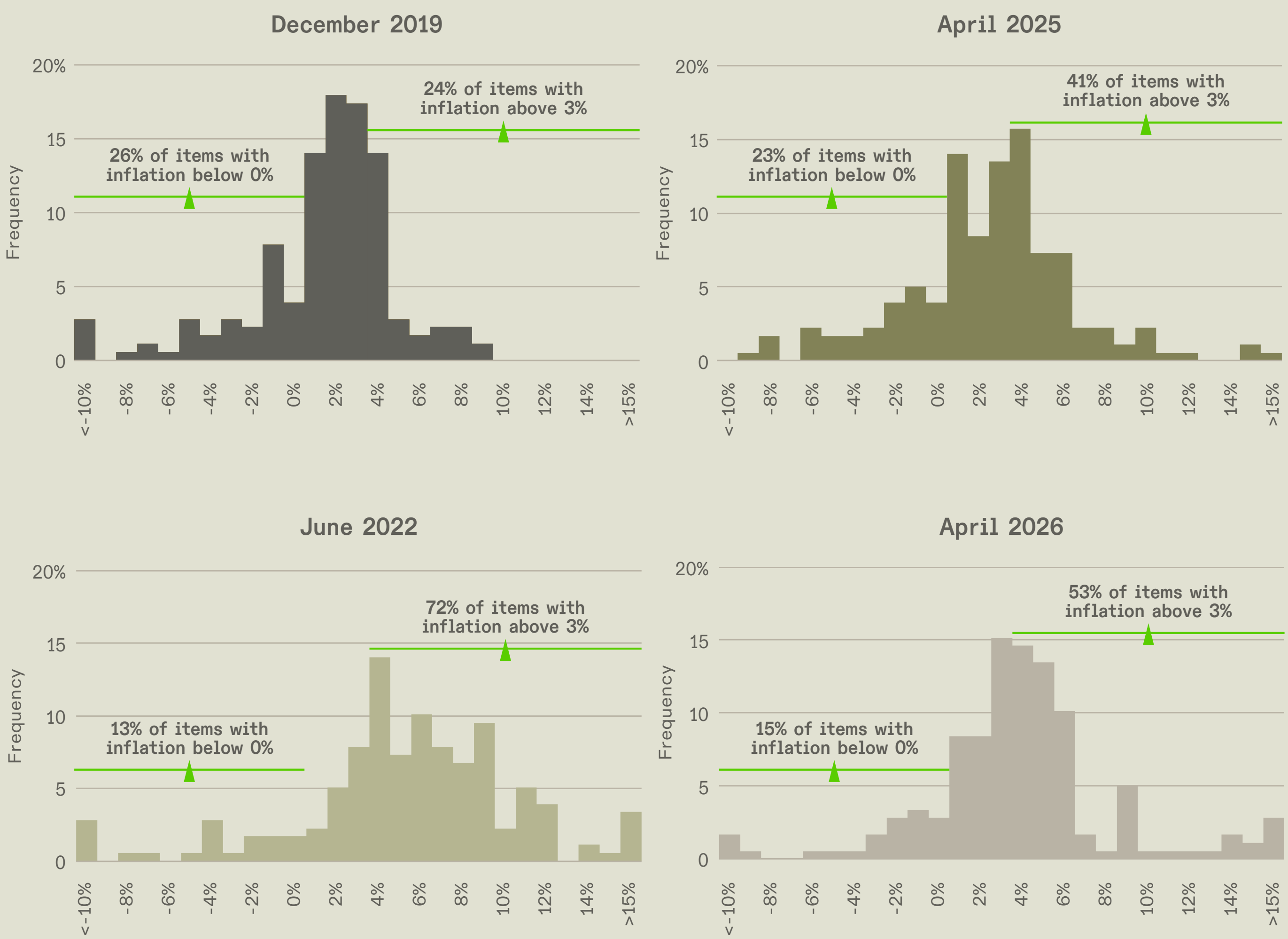
The Federal Reserve focuses on PCE inflation rather than CPI, and one of the reasons is because it's broader (with more categories). We looked at 178 items within the core PCE basket and calculated the distribution of year-over-year inflation at four different times. You can see how inflation really broadened out in June 2022 relative to December 2019. Until last year the distribution was narrowing, but things were still not quite "normal." Things have gotten worse since then. Here's a look at the proportion of items with over 3% inflation rates (with over 4% in parenthesis) [Chart 5]:

- December 2019: 24% with 3%+ inflation (10% with 4%+ inflation)
- June 2022: 72% (58%)
- April 2025: 41% (25%)
- April 2026: 53% (39%)

Chart 5

Not Just Energy and Tariffs: The Underlying Inflation Problem Has Gotten Worse Over the Past Year

Distribution of Core PCE Categories (Year-over-Year Change)



Source: Carson Investment Research, BLS 6/15/2026.

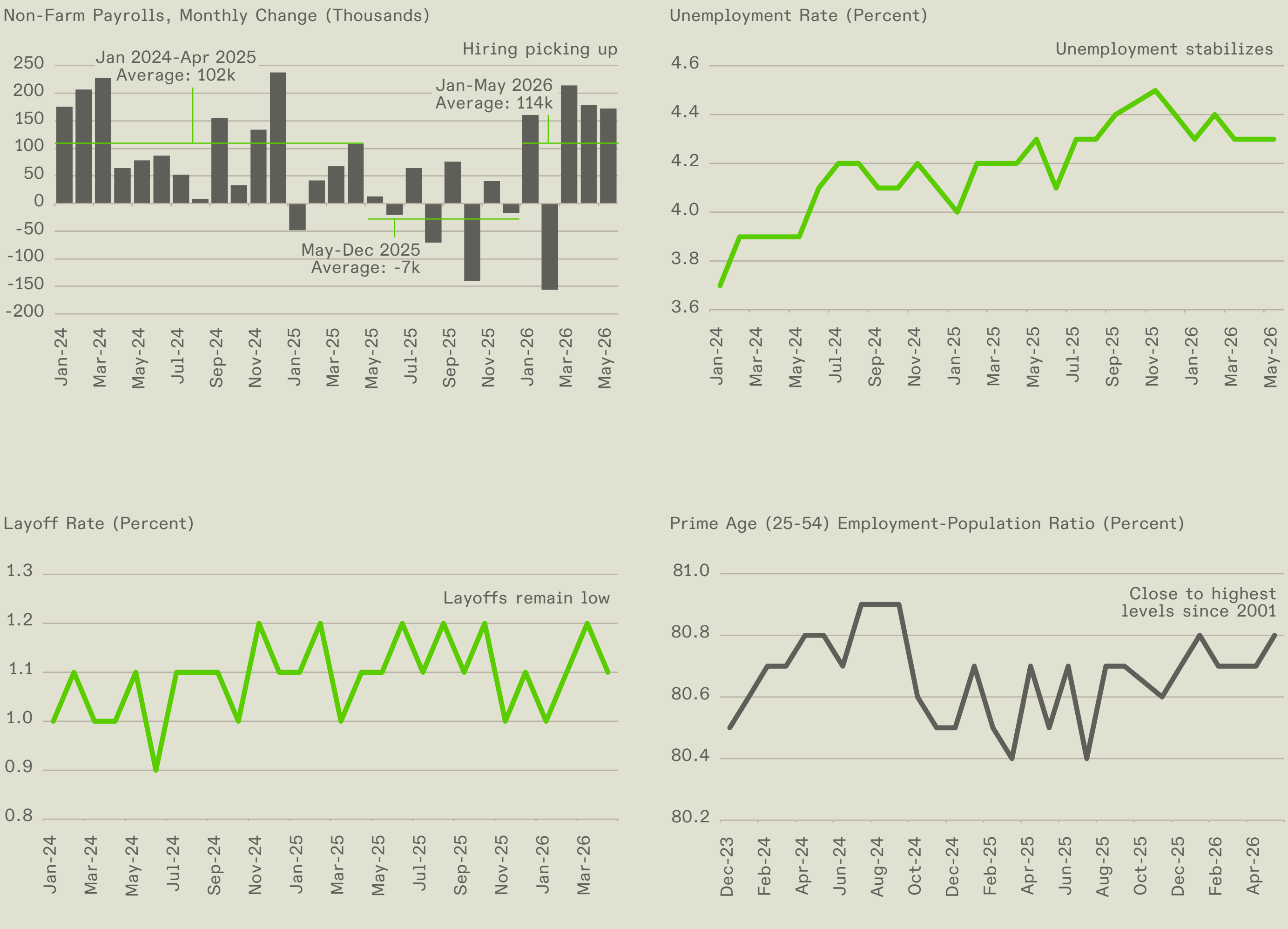
Looking ahead, the indirect impact of the Strait of Hormuz closure may feed into core inflation as well, via items like airfares and transportation costs for goods. Food price inflation is likely to stay elevated amid higher fertilizer costs (a lot of which comes from the Middle East as a by-product of natural gas), and that could push restaurant prices higher. All this to say, the inflation problem is unlikely to disappear anytime soon.

Consumer Spending Resilient Despite Inflation, Slower Job Growth

The biggest potential downside risk when we started the year was the labor market, but it looks like things have turned a corner there. After 10 months of job growth seesawing between positive and negative prints, we finally got back-to-back months of job gains. Job growth is averaging 114,000 per month this year, a vast improvement from the -7,000 monthly average in May-December 2025 **[Chart 6]**. Normally, we'd say average payroll growth clocking in at this level is no great shakes, but with population growth running low amidst the immigration collapse, the economy doesn't need to create a lot of jobs to keep the unemployment rate steady. And the unemployment rate has, in fact, stayed steady at a historically low level of 4.3%. The prime-age (25-54) employment-population ratio has also been holding steady near 80.8%, higher than at any point in the 2000s or 2010s expansion. The aggregate layoff rate is also at historical lows, pushing against the narrative about layoffs at prominent large firms, let alone AI-driven layoffs.

Chart 6

Labor Market Turning a Corner



Source: Carson Investment Research, FactSet 6/15/2026. October 2025 unemployment rate and employment-population ratio imputed due to lack of data.

Of course, the problem is inflation and as a result, inflation-adjusted (real) incomes are falling. However, nominal consumer spending ("consumption") rose at an annualized pace of almost 8% in 2026 (through April), well ahead of the 2023-2024 trend or even 2018-2019 **[Chart 7]**. Yet, real consumption lagged these prior trends.

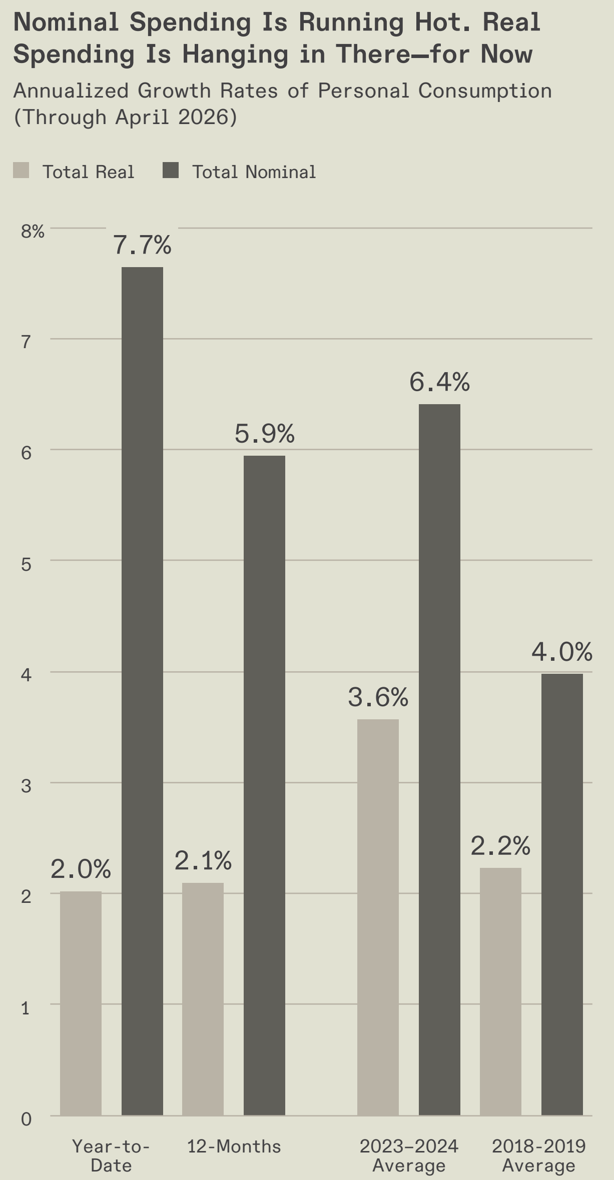
There are a couple of potential reasons why nominal consumption is running hot:

1. Tax refunds from last year's tax bill
2. Consumers drawing down savings to keep consumption steady

Looking at the first point, it's difficult to get a significant economic slowdown when the government is running deficits close to 6% of GDP. That's equivalent to almost $2 trillion of new money being pumped into the economy, which also flows into profits. The U.S. government is running things hot in a way that's unprecedented this deep into an economic expansion (we're over five years from the last recession in 2020).

On falling savings rates, part of it is due to the stock market doing as well as it is. If portfolio values are going up and consumers feel "wealthier" while risk of job loss is relatively low, there's less urgency to save more. In contrast, a rising savings rate would be indicative of consumers pulling back, likely amid a weakening labor market. That's not where we are now, thanks to strong household balance sheets.

Chart 7

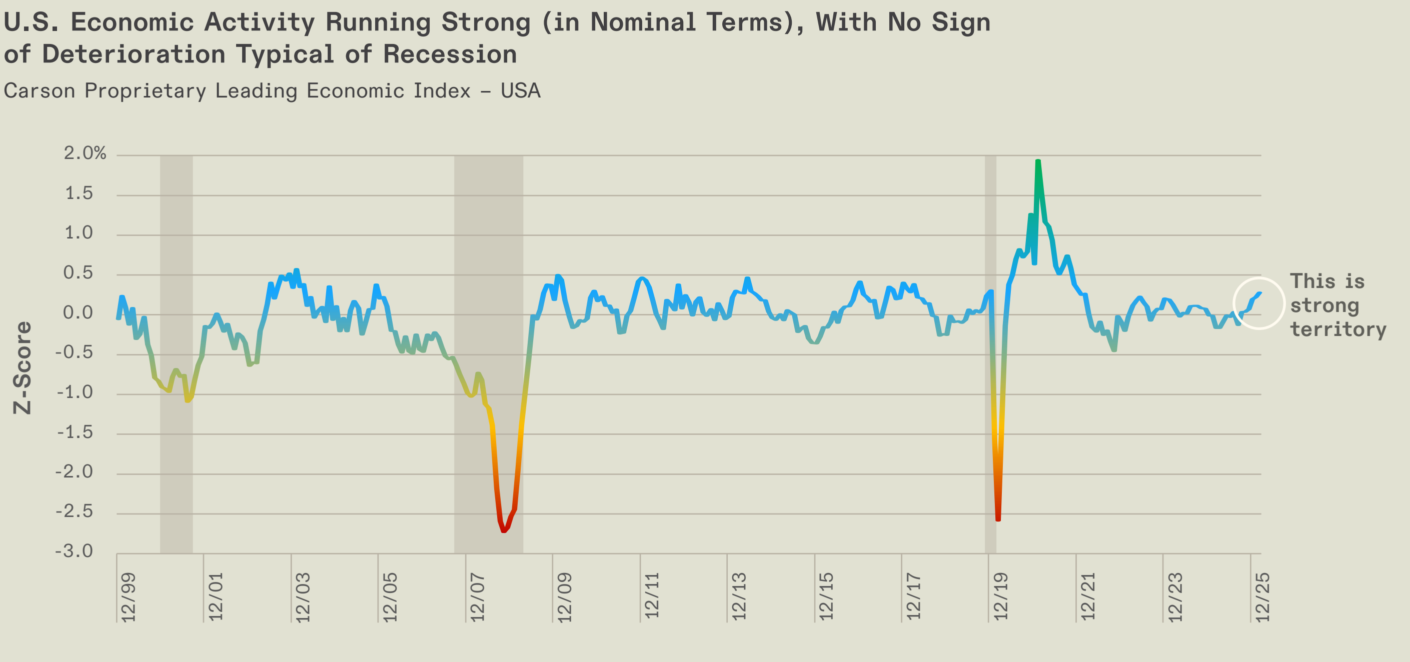


Source: Carson Investment Research, FRED 6/15/2026. Year-to-date is as of April 2026.

This does raise the risk that a decline in asset prices, stock prices, or even home prices can reverse the wealth effect and lead to lower consumption. The economy and the stock market may now be more closely tied than we think. But we don't think that's a pressing problem right now.

The dynamic of strong nominal growth is also captured in our proprietary Leading Economic Index (LEI) for the U.S. [Chart 8]. Even during the worst of the post-Liberation Day downturn (April-May 2025), the index was well above what we would normally associate with a recession, or even in advance of one (like in 2000 or 2007). This is partly why we didn't call for a recession last year. The LEI has seen a bit of an upswing this year, taking it from slightly below trend to above. Nominal activity is running strong, and that's important because nominal GDP growth is where company revenues and profits come from.

Chart 8



Source: Carson Investment Research 6/15/2026. Shaded areas indicate U.S. recessions.

Strong economic activity doesn't just support revenues and profits. It also shapes the policy environment, particularly how the Fed may respond to persistent inflation.

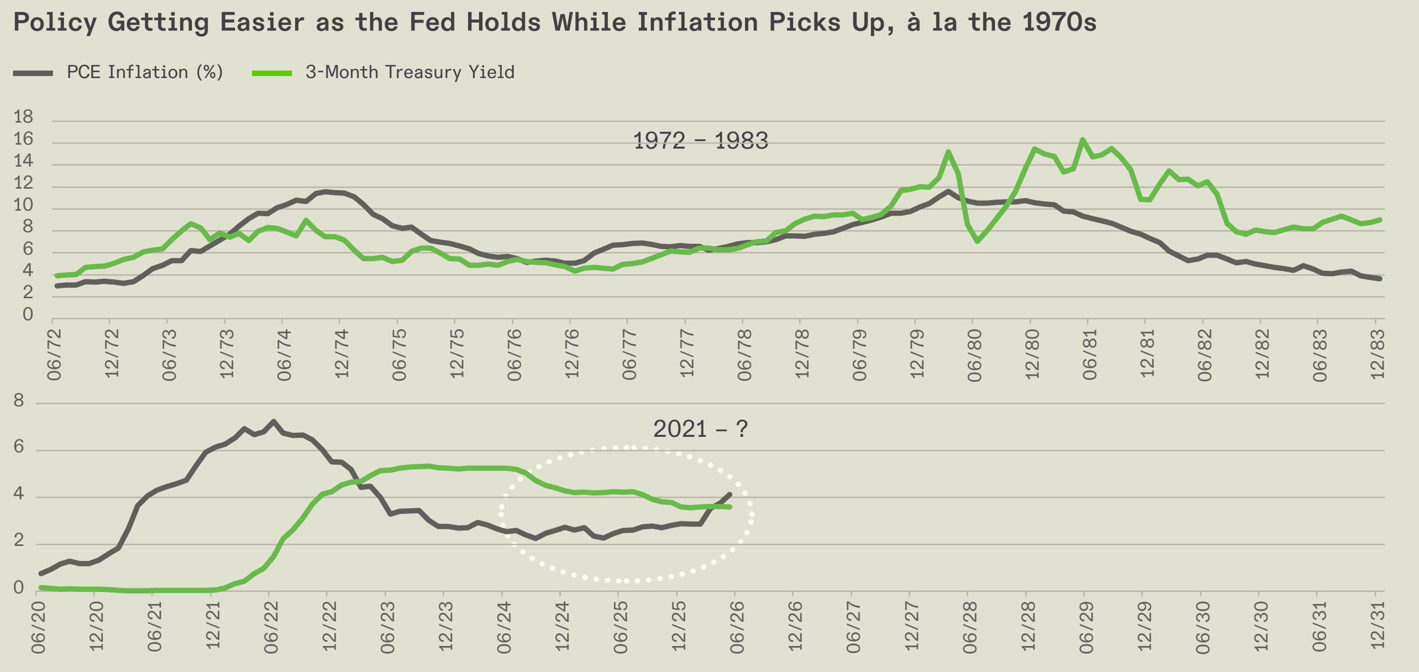
Policy Tailwind: A Fed Expected to "Look Through" Inflation

We're clearly a long way from normal on the inflation front, even if you ignore the energy shock (which you shouldn't because that's going to feed into core inflation as we noted above). Normally, a backdrop of a relatively healthy labor market and elevated (and rising) inflation would have the Federal Reserve thinking about rate hikes. Instead, it looks like the Fed, especially under new Chair Kevin Warsh, is going to look past elevated inflation, treating it as transitory.

The risk here is obvious. At some point, whether it's a year from now or 2-3 years from now, the Fed will realize that inflation has run too high for too long and will have to be even more aggressive to get inflation back to target. The current episode could end up being similar to what we saw in the 1970s and early 1980s. Back then, a relatively easy Fed was looking past elevated inflation, but then Fed Chair Paul Volcker came in and raised rates to over 15% to ultimately crush inflation, sending the economy into a recession. To be clear, we don't expect to see interest rates rise to 10% or more like in the 1980s, but even raising rates to 5-6% from this point would be quite painful.

The 1970s and 2020s inflation episodes are shown in the chart on the next page *[Chart 9]* (using headline PCE inflation), along with the three-month Treasury yield (using this as a proxy for policy rates). Right now, the gap between short-term rates and inflation has closed. In other words, the fact that the Fed is standing pat while already elevated inflation is rising means policy is getting more dovish even if rates stay where they are.

Chart 9



Source: Carson Investment Research 6/15/2026.

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Welcome to the Party, Mr. Warsh

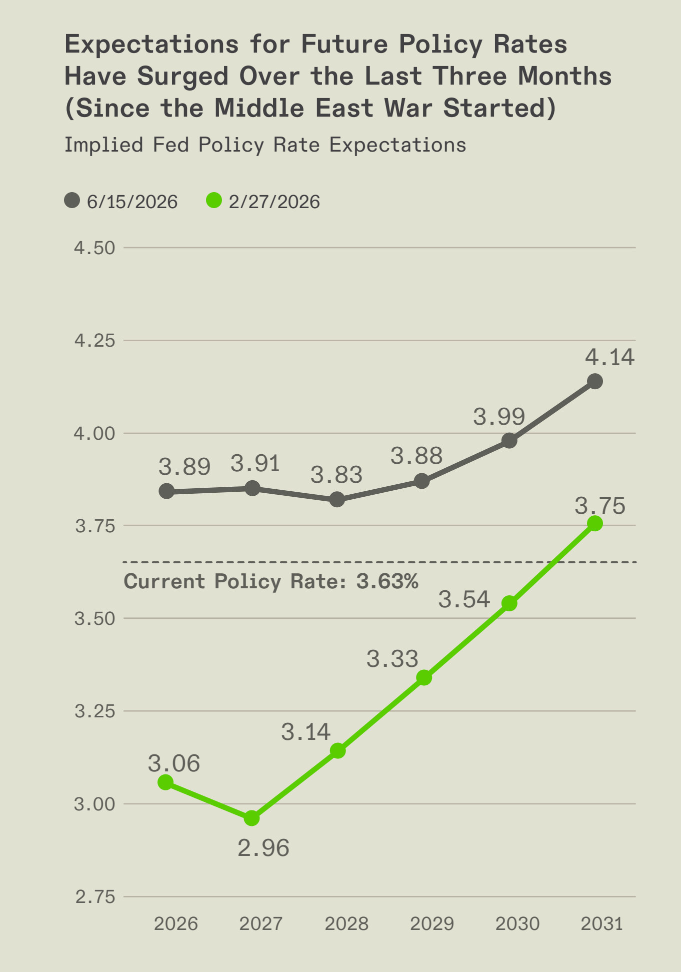
For now, the ultimate beneficiary of a dovish Fed that is looking past hot inflation is the stock market (and investors). At the same time, the cost of higher inflation is reflected in the bond market. We've been talking about an inflationary growth regime since the start of the year, and equities doing well while bonds struggle is par for the course in this environment. However, the second quarter has been a particularly rough stretch for bond investors. The 10-year Treasury yield peaked at 4.66% on May 19. Still, short- and long-term yields are close to the highest levels we've seen this year and reflect the real cost of the war. Since the eve of the war (February 27) through June 15:

- 2-year Treasury yields have risen from 3.37% to 4.06%, an increase of 0.69 percentage points
- 10-year Treasury yields have risen from 3.94% to 4.47%, an increase of 0.53 percentage points

These are significant moves, and they've come about in a relatively short period of time.

The 2-year yield above 4.0% means that the market expects the short-term policy rate to average that level over the next two years, well above the current policy rate of 3.63% ***[Chart 10]***. On the eve of the war, markets were expecting a couple more rate cuts this year, taking the policy rate to almost 3%. Markets did expect a series of rate hikes from 2028 onwards, but gradually, with the policy rate exceeding its current level only in 2031. The entire curve has now shifted above the current policy rate of 3.63%, implying markets expect the Fed to hike rates at least once this year and continue lifting them beyond 2028.

Chart 10



Source: Carson Investment Research, Bloomberg 6/15/2026. Implied policy rate proxied by SOFR futures.

In other words, expect rates to stay higher for longer as the Fed looks to get a grip on inflation. But the longer they wait, the more painful the eventual adjustment. But this is not a 2026 issue. For now, we believe a Fed that lets the economy run hot will benefit stocks but create a more challenging environment for bonds.

The bond market clearly doesn't like elevated inflation, which is why yields are rising. Inflation is also rising around the world, and that means global yields are rising too, including in relative safe havens like Japan and Germany. At the margin, higher foreign yields reduce demand for U.S. Treasuries. Japanese investors were starved for yield for years, and that helped support demand for U.S. Treasuries, especially when Japanese and European yields were negative. That world is gone.

Keep in mind that massive government deficits imply a much greater supply of Treasuries. All said and done, we have higher inflation, more Treasury supply, and lower demand for Treasuries—a perfect cocktail for higher bond yields.

The inflation backdrop and the bond market will give Kevin Warsh a real test as he begins his tenure. It looks like we're going to have to live with higher borrowing costs (including for the government), and that's going to drag on areas of the economy like housing. For now, the AI wave is powerful enough to overcome that, but therein also lies the risk—it can hurt once the party ends.

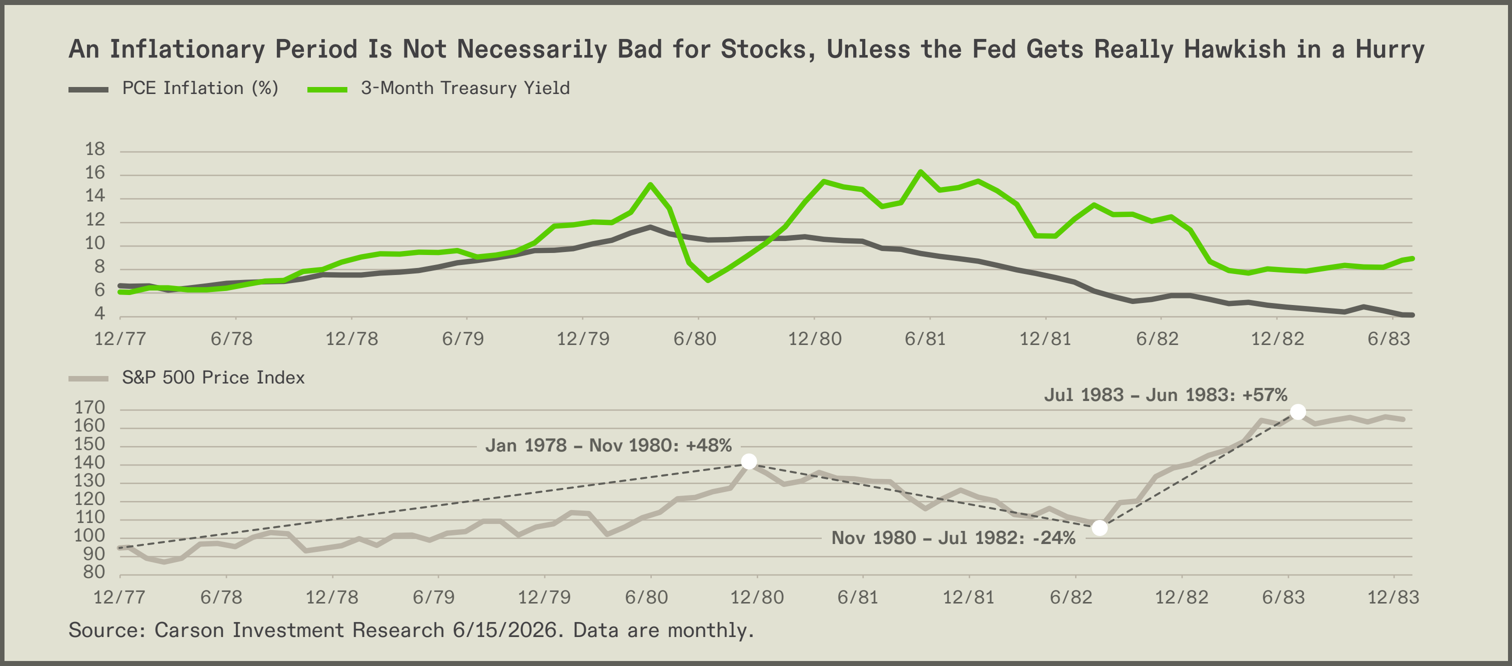
The key question for investors is what this environment means for portfolio positioning. While the risks have evolved since the start of the year, our broader investment outlook remains intact.

Portfolio View: We're Still Riding the Wave, but Looking to Avoid a Wipeout

For our part, we remain overweight equities amid this inflationary growth environment. We have a massive CapEX boom, fiscal expansion, and easy monetary policy. While there are a couple of big risks out there—the Fed eventually shifting to a very hawkish position and reversal of the AI wave—for now the greater risk is the opportunity cost of missing out on a boom that could last a while.

History provides some clues as to how equities behave amid an inflationary growth period conditioned on the Fed response, specifically the late 1970s and early 1980s ***[Chart 11]***. Between 1978 and late 1980, the S&P 500 rallied 48%. The Fed was raising rates during this time, but not enough to send inflation lower. It was only when Paul Volcker raised rates well above inflation levels that we saw an equity bear market (November 1980-July 1982). Equities finally rallied once the Volcker Fed lowered rates when they were satisfied that inflation was under control. Over the entire five-and-a-half-year period (January 1978-June 1983), the S&P 500 gained 77% (137% including dividends), a reminder that equities did quite well despite elevated inflation and huge swings in monetary policy, albeit with a lot of volatility.

Chart 11

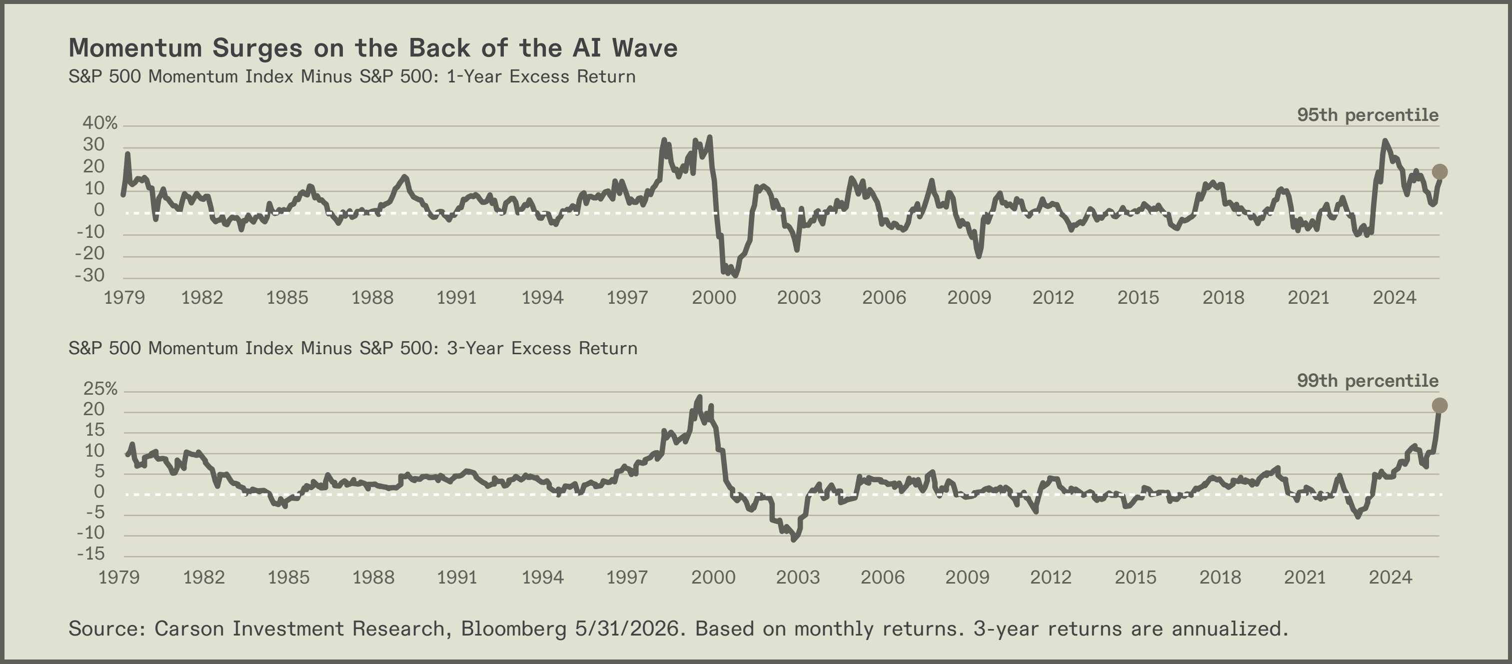


Inflationary growth also means bonds are unlikely to diversify your portfolio as well as they did in the 2010s and 2020s. This is why we continue to diversify our diversifiers, with allocations to managed futures (a long/short trend following strategy with exposure to a wide variety of assets, including commodities), some lower volatility stocks, gold, and bonds that can be a little more resilient in an inflationary growth environment like Treasury inflation-protected securities (TIPS) and floating rate corporate debt.

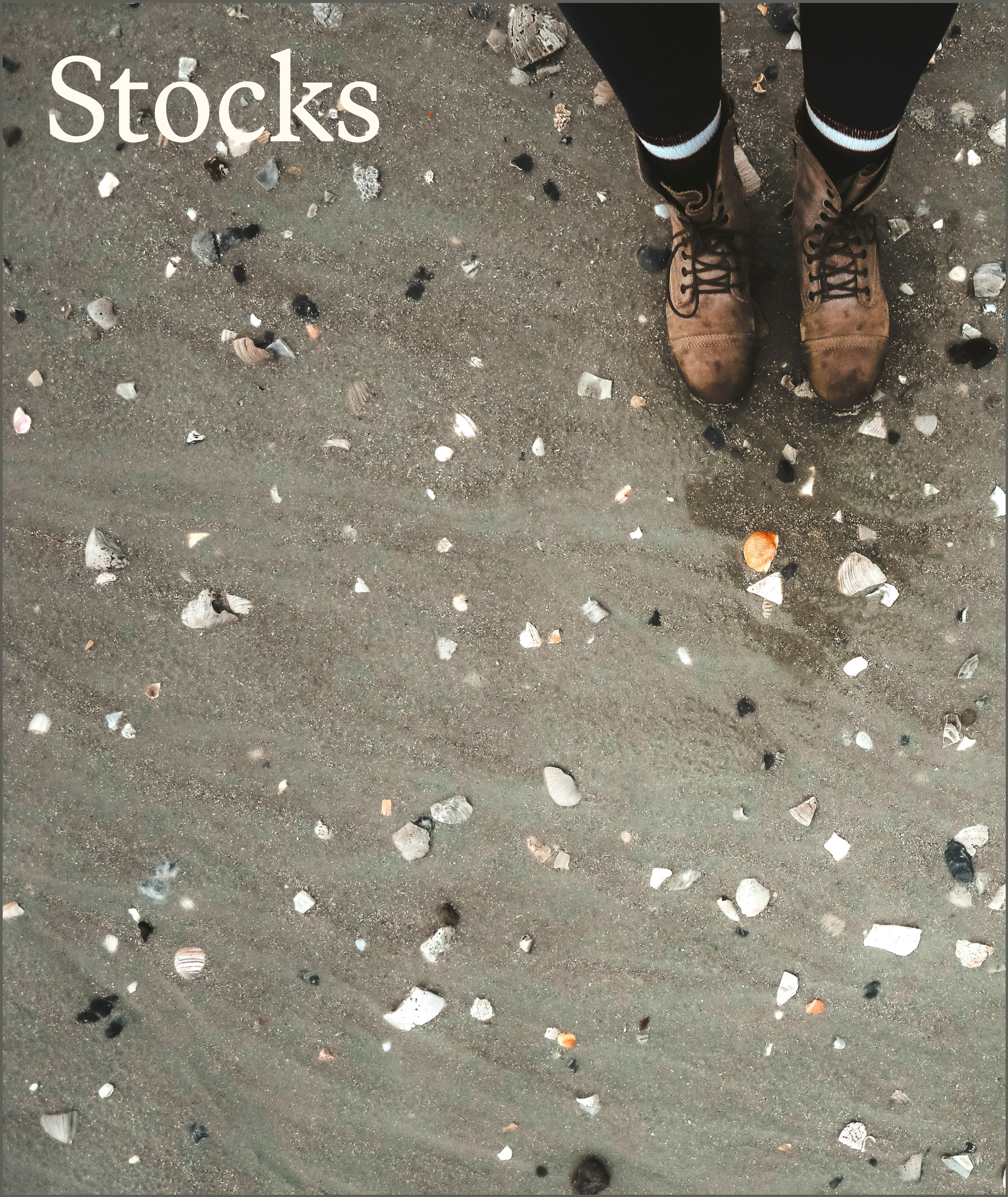
Of course, we also have the AI boom and that is a wave we want to ride, too. One way of doing that is via momentum stocks, which have a lot of AI-related exposure. At the same time, we are wary of going all in, since momentum looks stretched. As of the end of May, the one-year excess return for the S&P 500 Momentum Index over the S&P 500 is currently around the 90th percentile (looking at the last 40 years), while the three-year return is in the 99th percentile ***[Chart 12]***.

The wave is still growing but it's hard to tell whether it's cresting, and we want to avoid a wipeout. We're diversifying equity exposure across U.S. and international stocks. Even within the U.S., we barbell exposure to technology (and related areas) with bets on areas within the industrials sector, real assets, and even low-volatility stocks, which tend to be more risk-efficient.

Chart 12



Stocks



Stocks

The Dual Tailwinds of Earnings and Profit Margins Are Alive and Well

The S&P 500 is up 10.2% at midyear. One of the most important things to keep in mind about the gains is that they have been driven by fundamentals, not sentiment. Many have wondered how stocks could possibly soar in the face of the war, higher inflation, higher rates, and Washington drama. To us, it comes down to earnings and profit margins. Strong earnings can make up for many other sins, as we've seen this year.

Earnings drive long-term stock gains, and so far in 2026 we've seen an extraordinary surge in profits from corporate America. In the first quarter (the most recent quarter available), more than 84% of companies beat earnings estimates, better than the 10-year average of 76%, and the earnings growth rate for the S&P 500 came in at 28.6% year over year, the highest since Q4 2021. At the start of earnings season, that figure was expected to come in at 13.1%, showing just how much better things really were than expected.

One big source of "surprise" in the Q1 earnings season was how valuations for AI firms showed up on the income statement for the hyperscalers and Nvidia. This essentially shows up as gains on "non-marketable securities," which are mostly investments in Anthropic and OpenAI. A significant chunk of earnings growth came from increasing valuations for these private AI firms **[Chart 13]**. For Alphabet and Amazon, it was over 50% of GAAP earnings. This network of AI cross-holdings, with private valuations boosting profits for public mega-cap tech firms (and stock prices), has benefited these mega-cap hyperscalers, and the effect is expected to be even larger in future quarters (as long as private valuations hold up).

The net result of all this is that next 12-month earnings estimates have also surged on the back of upward revisions to both 2026 and 2027 estimates **[Chart 14]**.

Yes, much of the growth came from large-cap technology, as earnings for the Magnificent 7 (the seven major U.S. technology-oriented mega-cap stocks) grew 63.2% year over year in Q1. But don't sleep on the rest of the index. The rest of the S&P 500, the "still okay" 493 (technically 496 right now) still grew earnings a very respectable 17.4%. Earnings for cyclicals grew at a stellar 46.0% year over year, led by technology, industrials, and materials.

Chart 13

It's Not All 'Private'

Revaluations of Private Investments Provided a Big Boost to Public Company Profits in Q1

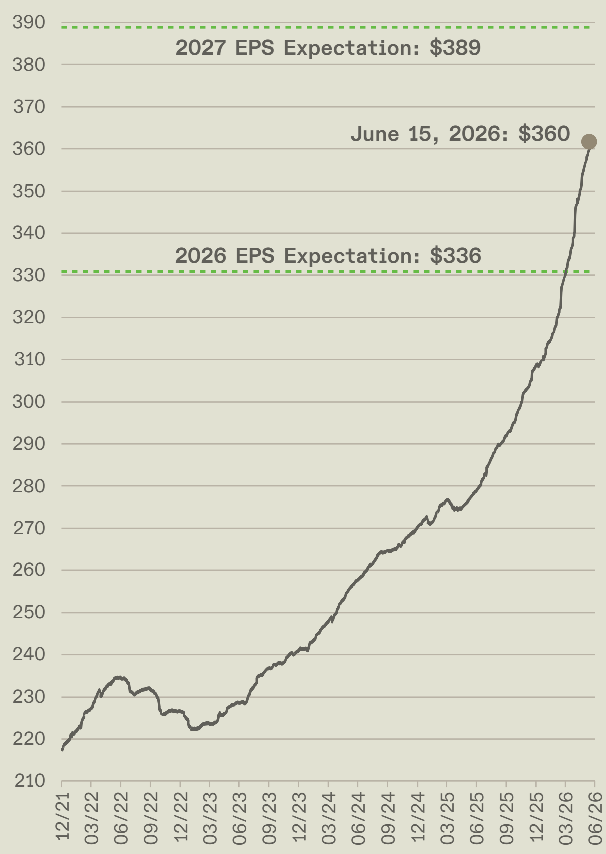
Company	Q1 Net Income (Bil)	Net Income From Re-valuations (Bil)	Percent
Alphabet	$62.60	$36.90	59%
Amazon	$30.20	$15.60	52%
Nvidia	$58.20	$15.90	27%
Microsoft	$38.50	$9.97	26%

Source: Carson Investment Research 6/15/2026.

Chart 14

Forward Earnings Expectations Surging

S&P 500 Index – Next 12 Month Earnings Per Share



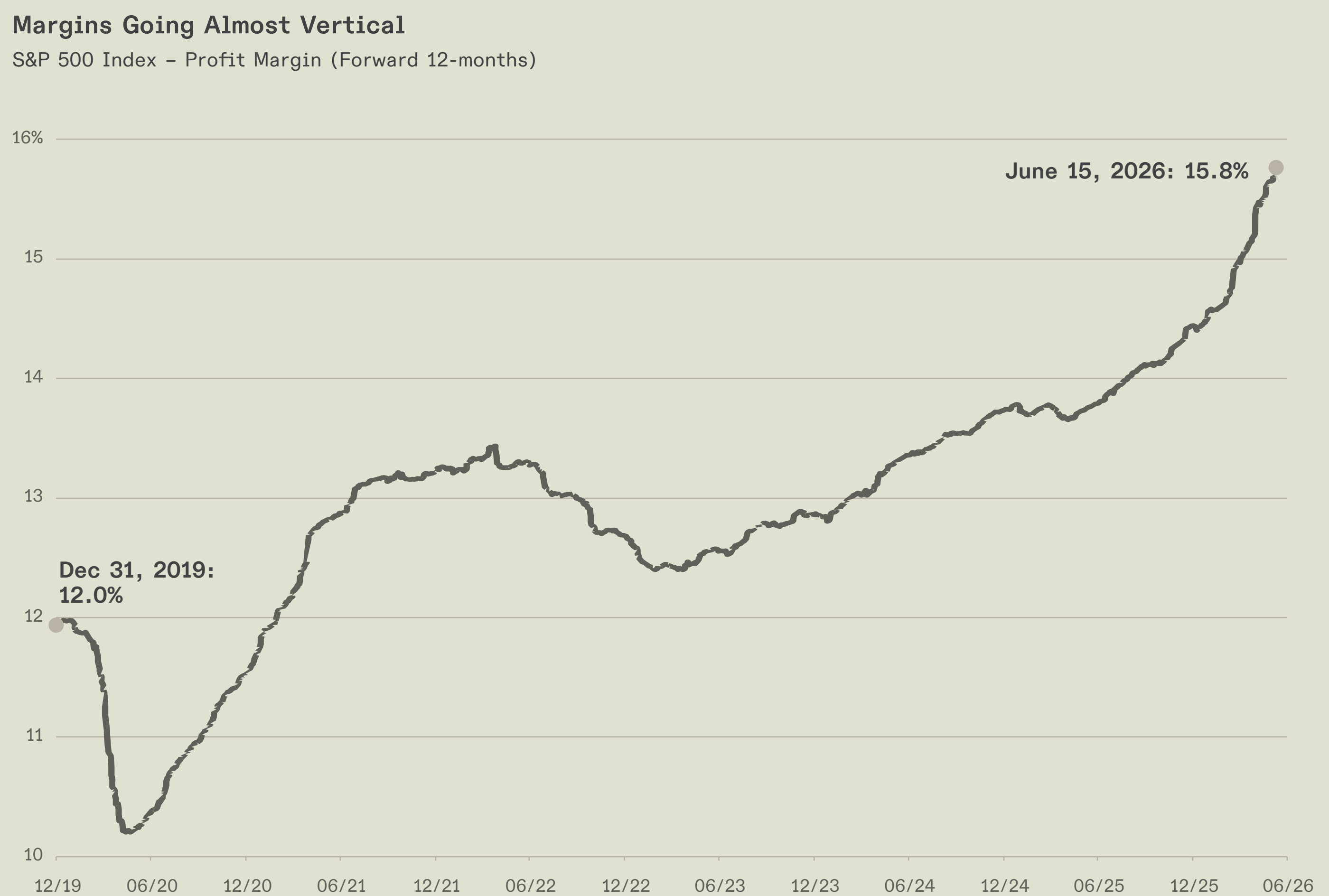
Source: Carson Investment Research, FactSet 6/15/2026.

Profit growth is driven by both revenue growth and margin expansion, and things look good on both fronts. More than 81% of companies beat on revenue and Q1 revenue came in at 11.6% year over year, the best since Q2 2022. All 11 sectors saw positive revenue growth. Even if you removed tech, revenue from the other 10 sectors was still 9.0%. Looking ahead, next 12-month sales estimates are up 6% from the start of the year. None of this should be a surprise given nominal GDP growth is clocking in around 5-6%. That's a big boost from inflation, but that does flow through to revenue and earnings.

An even more powerful story, and a bigger driver of year-to-date S&P 500 returns has been margin expansion. Forward-looking margins for the S&P 500 continue to expand, and this is on top of the massive expansion of the last three years. Forward margins were at 12% at the end of 2019 and expanded to 12.7% by the end of 2022. Margin expansion continued over the next three years, hitting 14.5% by the end of 2025, a new all-time high. But things didn't stop there. Margins have gone vertical over the first half of 2026, taking it to 15.6% **[Chart 15]**. As we discussed earlier, one person's margin expansion is another person's inflation.

Big picture, at the start of the year, S&P 500 earnings were expected to grow 15% in 2026 (which we anticipated would be too low), and they are now expected to be more than 22%. That is the easiest way to describe why stocks have been so strong.

Chart 15



Source: Carson Investment Research, FactSet 6/15/2026. Profit margin estimated as next 12-month earnings divided by sales.

Dual Tailwinds Supporting Solid Returns

In our 2026 Outlook, we said we expected the bull market to continue in 2026, but some rough patches (potentially early in the year) were always possible and even likely at some point. Many large tech stocks were hit very hard in Q1 and software outright crashed on AI worries. The S&P 500 saw a nearly double-digit correction into late March as worries over the war and inflation dominated the airwaves. But the wave of forces we saw supporting the now three-and-a-half-year-old bull market absorbed the shock and stocks soared back to new highs.

Every year has its shocks. 2023 had the regional bank crisis. In 2024, it was the yen carry trade unwind. Last year was the scariest of the three with the Liberation Day meltdown. Well, this year so far it's been the war in Iran. We couldn't have called that in advance, but we knew it was likely that something would come along. And just as we were able to get past previous worries, we were able to get past this one.

We entered this year expecting a better-than-average year for investors with the S&P 500 providing a total return of 12-15%. Even when the S&P 500 was down more than 7% for the year, which made our potential 15% gain look a long way away, we held to our view when many others didn't. Once again, we didn't follow the crowd; we followed the data. Stocks then staged a historic rally, up more than 12% in 13 trading days off the late March lows and up more than 10% in April, then another 5% in May for one of the best April/May returns ever.

As we reach the midpoint of 2026, we think the large and historically unusual upside revisions to 2026 S&P 500 earnings merits a target upgrade and we are moving our year-end target to a 15-18% total return. Solid corporate profits and margins, a Fed that we think will let the economy run hot, strong corporate and household balance sheets, and a continued lack of enthusiasm for this still young bull market are all reasons we expect a solid second half in 2026.

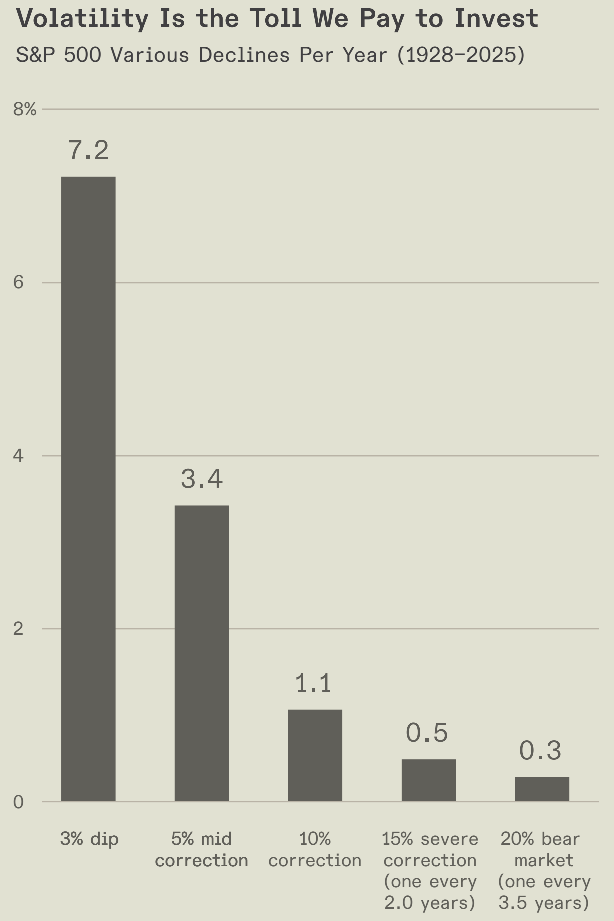
Volatility Is the Toll We Pay to Invest

One of the core components of our investing philosophy is that volatility and scary headlines happen. In fact, most years see a double-digit correction, while multiple mild corrections and pullbacks during the year along the way are common **[Chart 16]**.

No, we didn't know this year's surprise would be the war in Iran and oil literally doubling overnight, but it happened. As we noted at the start of the year, all years have bad days and weeks, and we didn't expect 2026 to be any different.

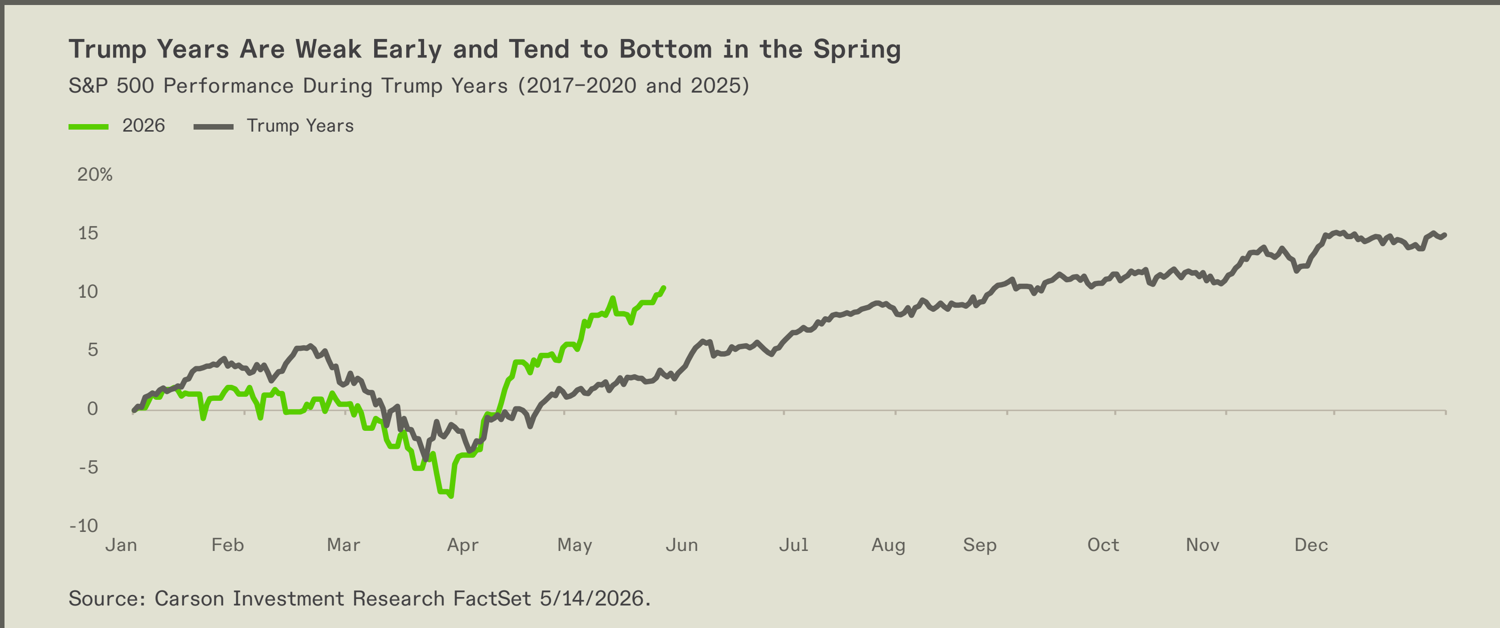
It is also worth noting that years under President Trump have tended to be volatile early, bottom around March or April, and then rally the rest of the year **[Chart 17]**. This could be due to speculative, potentially growth-negative policy being put into play early in the year, then dialed back as the year progresses. Could history be repeating this year? It very well could be.

Chart 16



Source: Carson Investment Research, Ned Davis Research 3/20/2026.

Chart 17



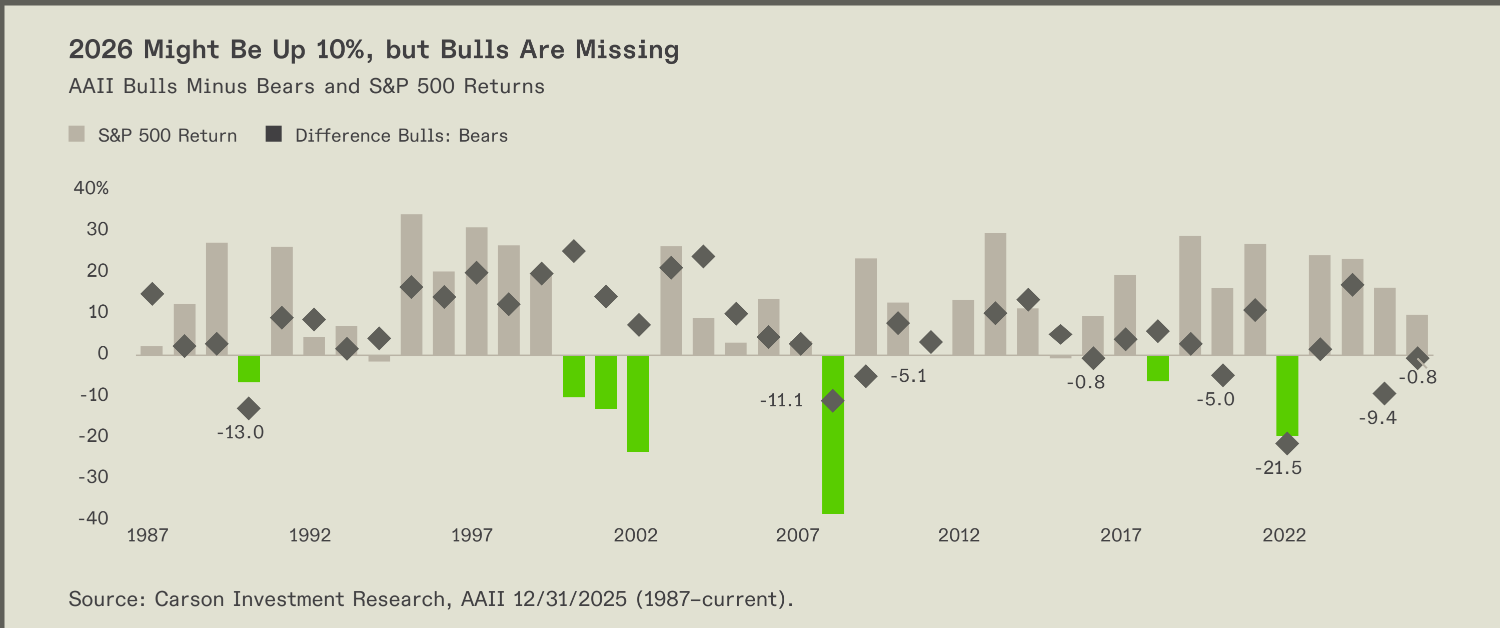
Where's the Fun?

We've noted for years now that stocks continued to go higher, yet many investors haven't felt good about it. The Michigan Consumer Confidence sentiment poll hit all-time lows in May; in an April Gallup poll, 80% of respondents ranked the economy as fair or poor; high profile hedge fund managers were expecting the worst after the war started; and various investor sentiment surveys are nowhere near optimistic levels. Incredibly, after the first five months of 2026, the American Association of Individual Investors (AAII) sentiment poll saw more bears than bulls. This was with stocks up close to double digits at the time **[Chart 18]**.

Near the lows in March, we saw historic amounts of hedging by institutions, CEOs on TV telling us how bad things would get, a huge move into staples and out of technology, and significant outflows from equities, all suggesting the pendulum had swung too far and there was a potential opportunity for a large rally, which is what we saw.

As the old saying goes, markets climb a wall of worry. But at least some positive sentiment is the norm (and even healthy) over a bull market. We're not there yet. We would typically expect a middle stage of a bull market where sentiment was at least neutral. As long as sentiment remains negative, it suggests markets likely have room to run. True, exuberance can be dangerous, but let's have that conversation when we see some.

Chart 18



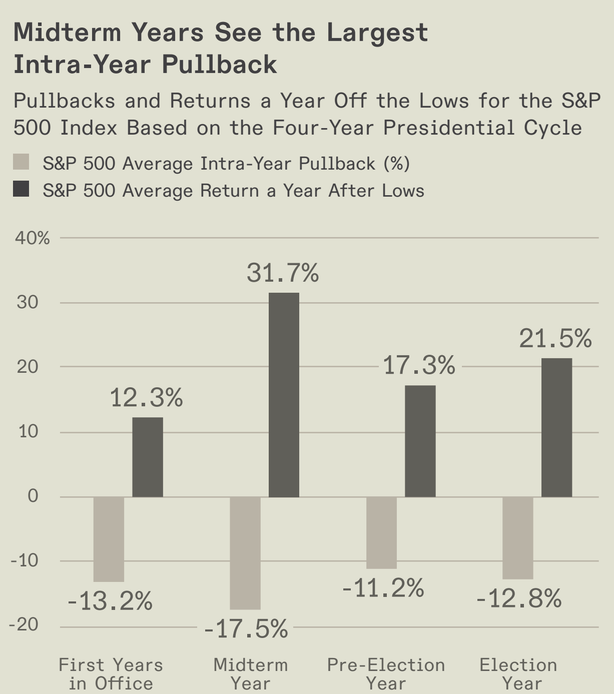
How to Watch for a Wipeout

What could upset the apple cart? Overall, we remain quite bullish, but we should always prepare for bad news. As Bear Bryant once said, "Offense wins games, but defense wins championships." The max peak-to-trough pullback so far in 2026 has been 9.1%, which very well could be the most we see this year, but don't forget that midterm years tend to be the most volatile in the four-year presidential cycle with a 17.5% average decline, and most of those years saw the ultimate lows in August or September *[Chart 19]*. That's the bad news. The good news is during a year of the midterm low, the S&P 500 has been up nearly 32% on average.

It's also important to keep in mind that major volatility is often a surprise. 2020 had a once-in-a-century pandemic and a 34% bear market in six weeks. 2022 was the war in Ukraine. As discussed above, 2023 was the regional bank crisis, and 2024 saw the yen carry trade unwind. Neither were expected catalysts. This year saw the war in Iran and then the Strait of Hormuz remaining closed for much longer than expected. None of those were on anyone's bingo card until they happened.

Could we see another big event the next six months that no one expects? You better believe it's a possibility. What we can have a sense of is how much of a shock the economy can absorb. That's part of what "still riding the wave" is all about. Yes, we've lost some resilience, but we think there's still enough to absorb a fairly large shock. That says to us, remain overweight equities.

Chart 19



Source: Carson Investment Research, FactSet 6/15/2026 (1950–2025).

Are We in a Bubble?

The bubble question continues to surface this year as we look at very strong returns in certain pockets of the market. How long do you ride a wave until it crashes ashore? The short answer is there is no telling, especially in the face of new and transformative technology. As we have returned to many times before, one way to root yourself in some semblance of reality is to look at the actual numbers and data, and in this case boring old valuations. The usual market wisdom applies here: time in the market is more important than timing the market, in part because timing the market is so hard. But we can still look at relative valuations and find some potentially attractive rotation opportunities.

Since our 2026 Outlook was published, relative valuations have seen important changes. Large cap U.S. growth stocks have become cheaper relative to other areas of the market. In particular, strength in value, international, emerging markets, and small cap stocks has adjusted the valuation picture to be a bit less lopsided *[Chart 20]*. As always, there are a variety of reasons for the outperformance of these areas. One would expect that as the AI "trade" continues to develop, it will spread to other areas of the market.

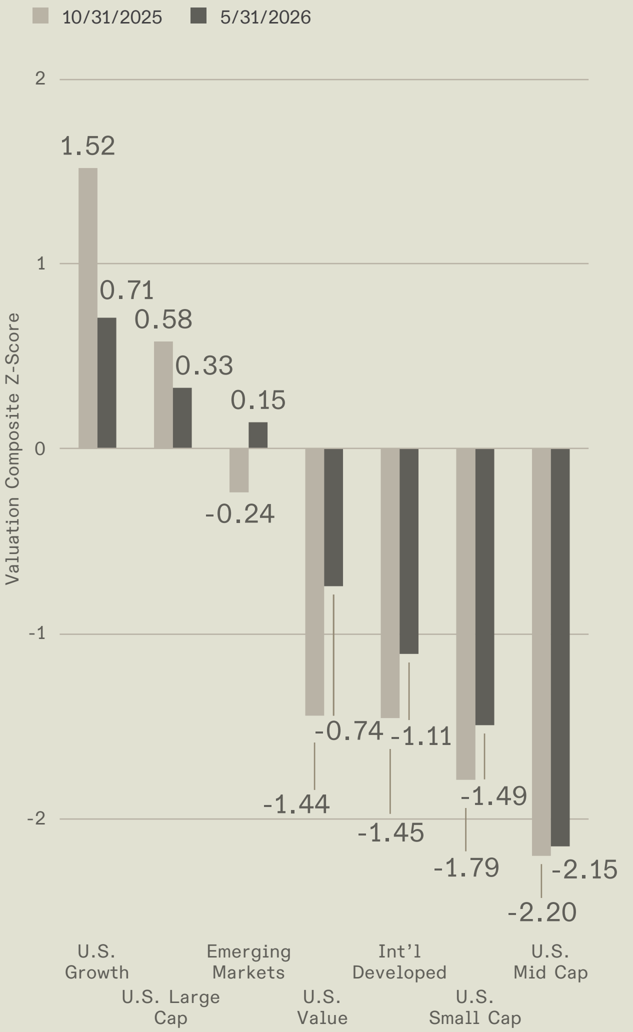
This Is Still a Young Bull Market

The current bull market only started in October 2022 after a 25% bear market and two of the closest bear markets in history (2020 and 2022). In May, the bull market was officially up more than 100% from those October 2022 lows in about three-and-a-half years. What might surprise many investors is that once bull markets double, they tend to last another three years on average and gain a total of 260% before giving way to another bear **[Chart 21]**. So a double doesn't mean the bull market is due to end at all.

Chart 20

Global Equity Relative Valuations

Valuation Composite

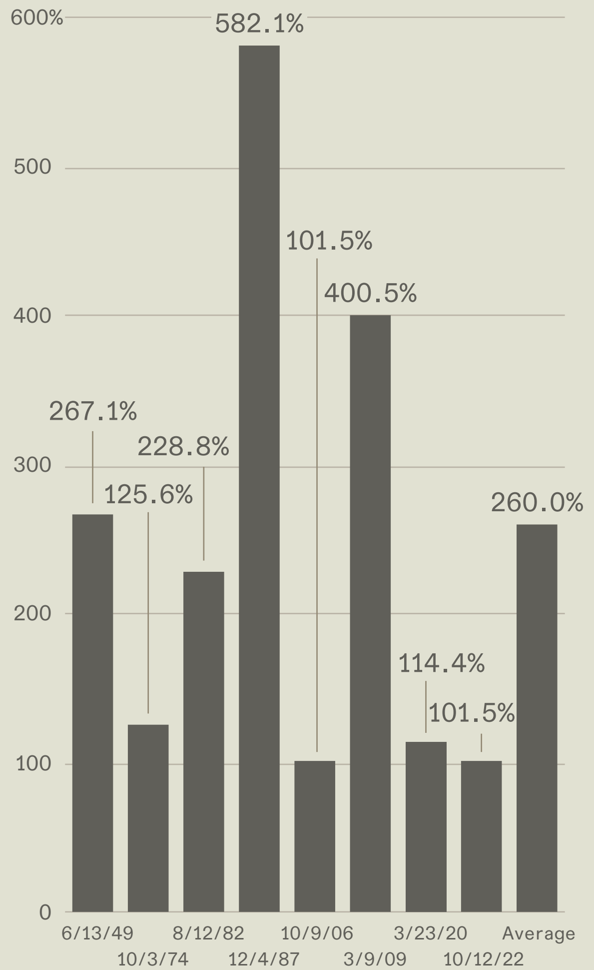


Source: Carson Investment Research, Morningstar Direct 5/31/2026. Relative Valuations utilize P/E, P/B, P/C, P/S ratios relative to parent index.

Chart 21

Bulls That Make It to 100% Usually Last a Lot Longer

Bull Markets That Made It to 100% (WWII to Current)



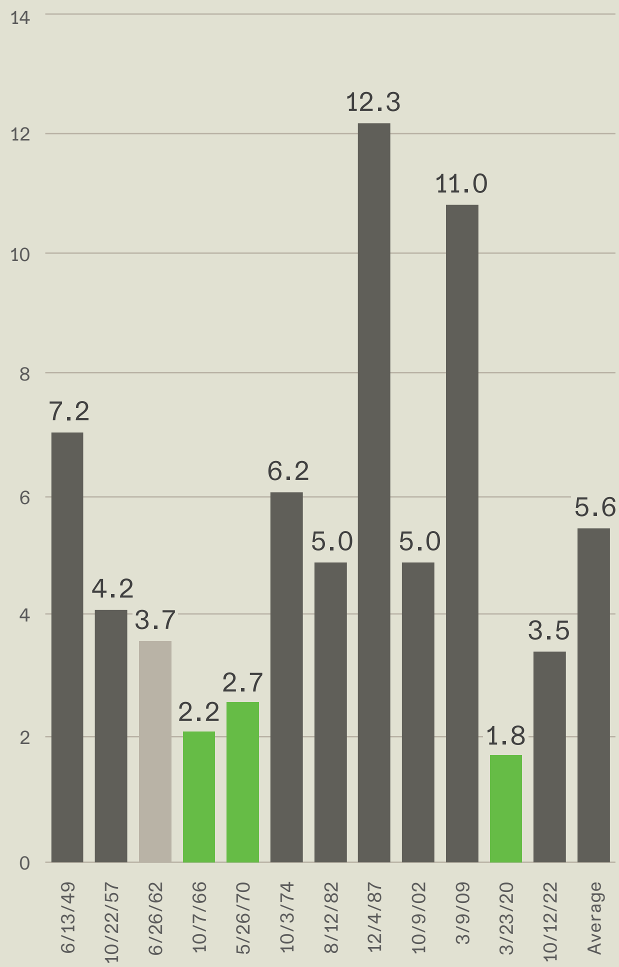
Source: Carson Investment Research, FactSet 6/15/2026.

The average length of all bull markets since the end of WW II is about five years, making this one not even close to the average yet. And once a bull market gets going, it can be hard to stop. Historically, once a bull gets past its third birthday (like this one did last October), seven of the past eight made it to their fourth birthday [Chart 22]. Looking at the past 50 years, the five bull markets that made it this far lasted an average of eight years, with the shortest being five years. We have no idea how much longer this bull might last, but history would say be open to potentially years of gains.

Chart 22

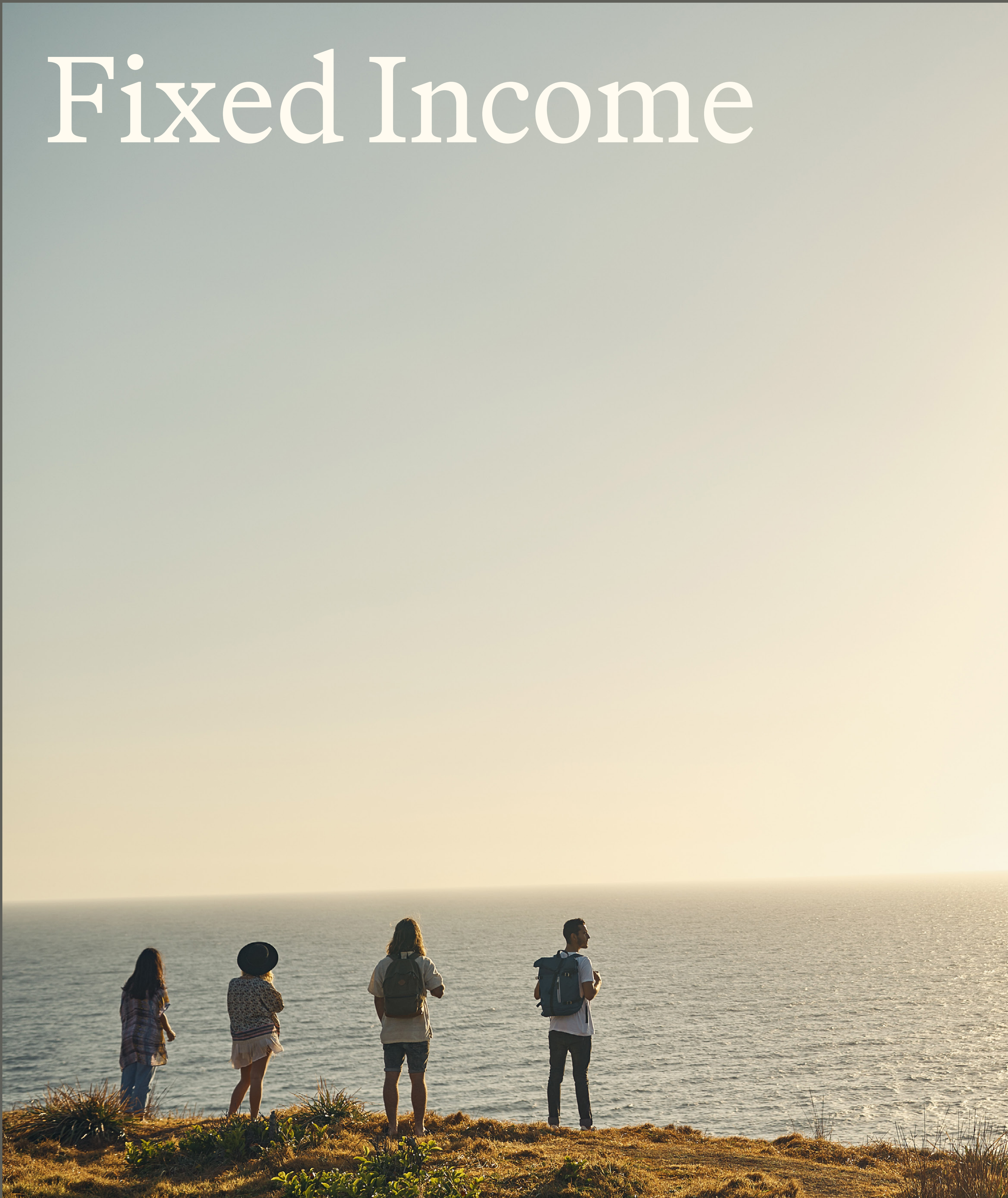
Once a Bull Turns Three, It Usually Gets to Four

Length of Bull Markets (Years)



Source: Carson Investment Research, FactSet 5/4/2026.

Fixed Income



Fixed Income

Bonds Have a Gnarly First Half

The Bloomberg US Aggregate Bond Index (Agg) did not meet investor expectations much of the first half of the year. While the war in Iran and the closure of the Strait of Hormuz didn't rattle the stock market much after an initial period of volatility, it was more of a game changer for the bond market. Through the end of May, the Agg was up only 0.4%, underperforming the Bloomberg 1-3 Month Treasury Bill Index, which returned 1.5%. That's a far cry from the Bondmageddon of 2022 but still a disappointment. Yet the maximum drawdown for the Agg over that period was only 2.8%—perfectly normal for the index, which historically has an average annual maximum drawdown of 3.5%.

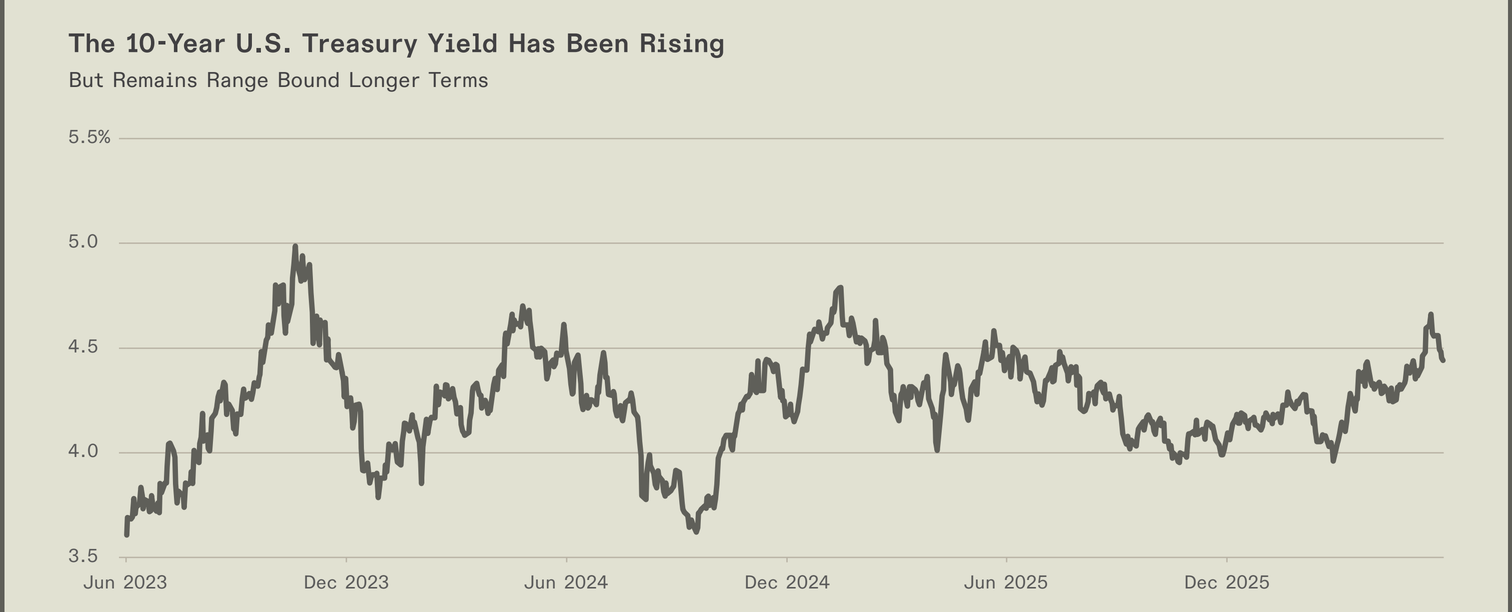
The reason for the muted return is simple. Yields were on the rise the first half of the year, although a higher starting yield provided a little bit of a buffer. We saw the 10-year Treasury yield decline very early in the year, but then came the Iran conflict, the closing of the Strait of Hormuz, rising inflation, and the gradual shift away from expecting additional rate cuts in 2026, not to mention some positive economic data ***[Chart 23]***.

In our 2026 Outlook, our view was that even if the Federal Reserve cut rates, we didn't expect the 10-year Treasury yield to show its historical sensitivity to lower short-term rates. (Historically over full major rate cutting cycles, the 10-year Treasury yield has dropped about half the amount of the three-month Treasury yield on average.) In fact, despite the expectation for one or more rate cuts, we said we expected the 10-year Treasury yield to climb modestly, targeting around 4.25%.

The inflationary growth environment that drove our 4.25% yield target has largely played out as expected, but there are some important new circumstances to reckon with. The conflict in the Middle East was not priced into anyone's expectations heading into 2026 and Fed expectations have also changed. Despite that, our basic framework remains the same.

Given our already cautious view on rates, we wouldn't adjust our 10-year target much from our 2026 Outlook target. Much of what we've seen has been markets catching up with our view, although not entirely through the mechanism expected. But we are raising our year-end target for the 10-year Treasury to 4.5% with a bias toward lower outcomes over higher. But even if we see progress in the Middle East, inflationary pressure is likely to get worse before it gets better. Since markets are forward looking,

Chart 23



Source: Carson Investment Research, FactSet 6/1/2026.

some added inflation is already priced in, but it wouldn't be at all surprising to see the 10-year yield press higher before settling back down just due to normal volatility. If yields were unchanged over the rest of the year, the Agg would add another 2.7% to its current 0.5% return, based on an end-of-May yield of 4.67% with seven months left in the year. That's enough justification to leave our 3-5% year-end return target for the Agg in place. A flattish yield would put us at the lower end of the range, but with a better run rate than the first half of the year.

Put it all together and it means we are more comfortable with core bonds, although we would still target below-benchmark interest rate sensitivity. But this should be viewed from the perspective of an environment that we think will continue to favor stocks over bonds and a portfolio that seeks diversifiers beyond fixed income.

Diversifying Within Bonds, Too

We are also trying to mitigate some inflationary risk through our bond selection. During post-Covid equity sell-offs, which roughly coincides with the start of the rising rate regime, floating rate corporate debt has shown some resilience as investors looked for additional protection against rising rates because the interest rate for the loans adjusts as rates rise **[Chart 24]**. Credit quality is typically below investment grade in floating rate debt, so these bonds do carry credit risk, but in an inflationary growth environment, credit is likely to hold up. We also hold some TIPS in our portfolio, but as you can see from their 2022 sell-off below, TIPS can be very rate sensitive, and the extra inflation compensation is not meaningful over short timeframes. However, TIPS do show some resilience when demand for inflation protection increases amid modestly rising rates.

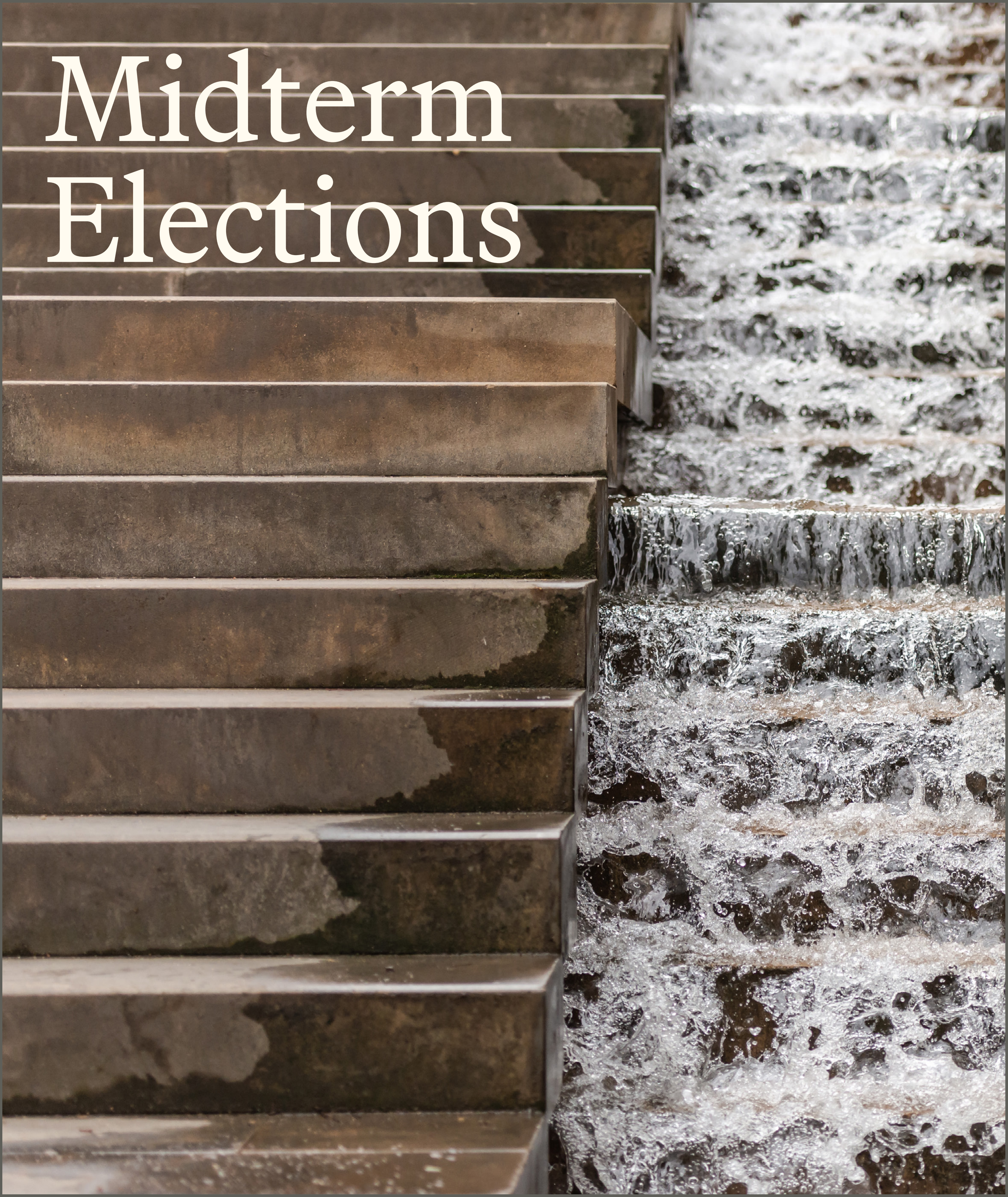
One role of bonds in a portfolio is to play defense, and as the table shows, bonds have done that less effectively since 2020. As a result, we also recommend other forms of diversification in allocations. But remember, bonds are part of "diversifying diversifiers," too. As yields move higher, our bias away from cash and toward core bonds increases, even if we target below-Agg rate sensitivity. Strategically, as rates move higher, bonds become increasingly attractive since yields are a strong predictor of forward returns, and that strategic perspective is the starting point for our tactical allocations.

Chart 24

Cash and Commodities Have Been King During Equity Pullbacks Post-COVID

Start	End	S&P 500	Bloomberg U.S. Treasury - Bills (1-3 M)	Bloomberg U.S. Aggregate	Bloomberg U.S. Government: Intermediate	Bloomberg U.S. Government: Long	Bloomberg U.S. Treasury Inflation Protected Notes (TIPS)	Morningstar LSTA U.S. Leveraged Loan 100	Bloomberg Commodity Index	Bloomberg Gold
9/2/20	9/23/20	-9.5%	0.0%	-0.3%	0.0%	-0.7%	-0.6%	0.4%	-2.8%	-3.9%
10/12/20	10/30/20	-7.4%	0.0%	-0.2%	-0.1%	-0.9%	-0.6%	-0.8%	-1.3%	-2.5%
9/2/21	10/4/21	-5.1%	0.0%	-0.8%	-0.5%	-2.8%	-0.5%	0.5%	5.5%	-2.4%
1/3/22	10/12/22	-24.5%	0.7%	-14.4%	-8.4%	-28.0%	-12.6%	-3.2%	16.5%	-7.5%
2/2/23	3/13/23	-7.5%	0.5%	-1.5%	-0.1%	-1.8%	-0.4%	-1.1%	-3.4%	-0.3%
7/31/23	10/27/23	-9.9%	1.3%	-4.4%	-1.0%	-13.5%	-3.0%	2.0%	-0.3%	0.8%
3/29/24	4/19/24	-5.4%	0.3%	-2.4%	-1.3%	-5.3%	-1.6%	0.3%	3.9%	8.2%
7/16/24	8/5/24	-8.4%	0.3%	2.2%	1.9%	5.1%	1.3%	-0.6%	-5.4%	-2.6%
2/19/25	4/8/25	-18.7%	0.6%	1.0%	2.1%	1.0%	1.3%	-1.9%	-9.0%	1.4%
1/27/26	3/30/26	-8.9%	0.6%	-0.4%	0.0%	-0.5%	0.0%	-1.0%	11.9%	-11.1%
	Average	-10.6%	0.4%	-2.1%	-0.7%	-4.7%	-1.7%	-0.6%	1.6%	-2.0%
	% Positive		100%	20%	30%	20%	20%	40%	40%	30%

Source: Carson Investment Research, FactSet 5/29/2026. Dates represent peak to trough S&P 500 declines of more than 5% since the Covid bear market. Positive returns highlighted in green.


Midterm
Elections

Midterm Elections

Let's Talk About Politics

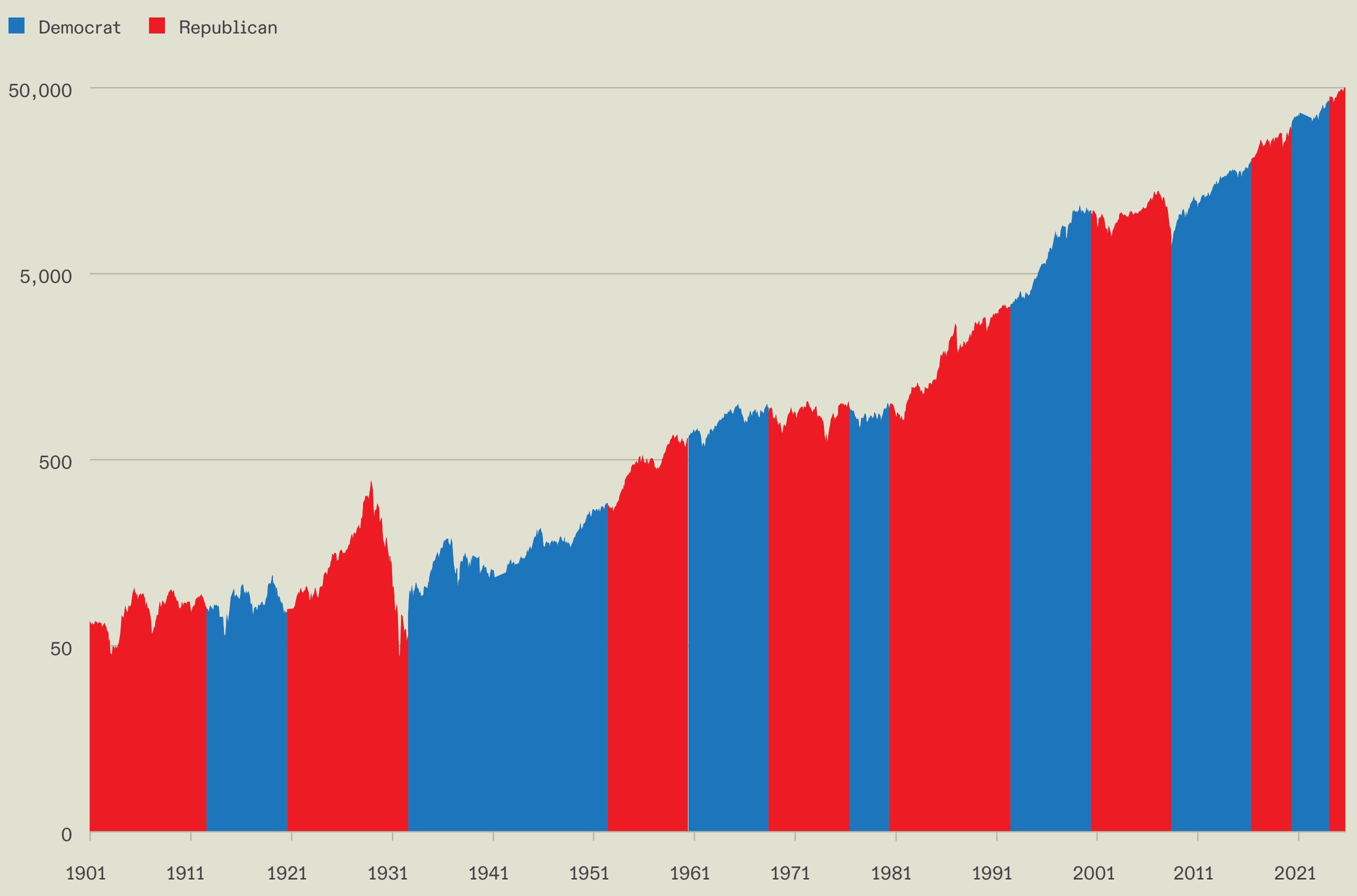
Finally, let's not forget it's a midterm year. Historically, midterm years haven't been very good for investors, as many of us remember the poor returns of 2018 and 2022. But fortunately, so far 2026 is bucking the trend. We noted already that midterm years tend to see the largest peak-to-trough corrections at 17.5% for the S&P 500, and with half the year to go, we don't expect to see that this time.

Let's start here. One of our basic investing principles is that which party is in power should not dictate your view of markets ***[Chart 25]***. Many investors missed big gains under Presidents Obama and Biden because they were sure their policies would lead to ruin. Not the same crowd, but many others missed big gains during President Trump's first term or have now abandoned markets during his second term. It's important to remember two things. First, larger macroeconomic forces dominate policy. Second, where policy matters, there's an important similarity between the parties that is often more important for markets than their differences. Generally speaking, both parties want to juice the economy when they're in power, even if they do it differently and have different priorities. The takeaway: don't let the party in power dictate what you think markets will do.

Chart 25

Don't Mix Politics and Investing

Dow Level (Log Scale) Since Teddy Roosevelt Was In Office (1901 to Current)



Source: Carson Investment Research, FactSet 5/1/2026.

What Could Happen in November

With midterm elections coming up in November, we are often asked what could happen. As of now, the Republicans hold a 53-47 seat majority in the Senate and only a five-seat majority in the House, the smallest in nearly 140 years. Historically, only three of the past 23 midterm years have seen the president's party make gains in the House, so the odds favor the House switching to Democratic control. Will Republicans keep the Senate? This is more of a coin flip, but the reality is the majority will likely be quite small either way, and narrow majorities often give more power to party centrists. Think about it: even though Republicans control both chambers of Congress right now, it's been hard to pass any major policies except for where there is a strong consensus between the wing of the party. But even in the face of this, stocks have soared.

We know we will have a Republican president, but here is how stocks have performed under various configurations of Congress **[Chart 26]**. The bottom line is that stocks tend to perform better in a split Congress, also known as gridlock.

Gridlock Is Good

Is gridlock a problem? Well, from a market perspective, it seems a Washington that can't get anything done is preferred, or maybe we should take a more optimistic view and say it is one where both sides of the aisle must work together. Either way, the takeaway is that a split Congress may be the best configuration for investors in 2027 and 2028. Over the past 13 years with split Congresses, the S&P 500 saw gains every time and achieved an average return of 17.0% **[Chart 27]**.

Chart 26

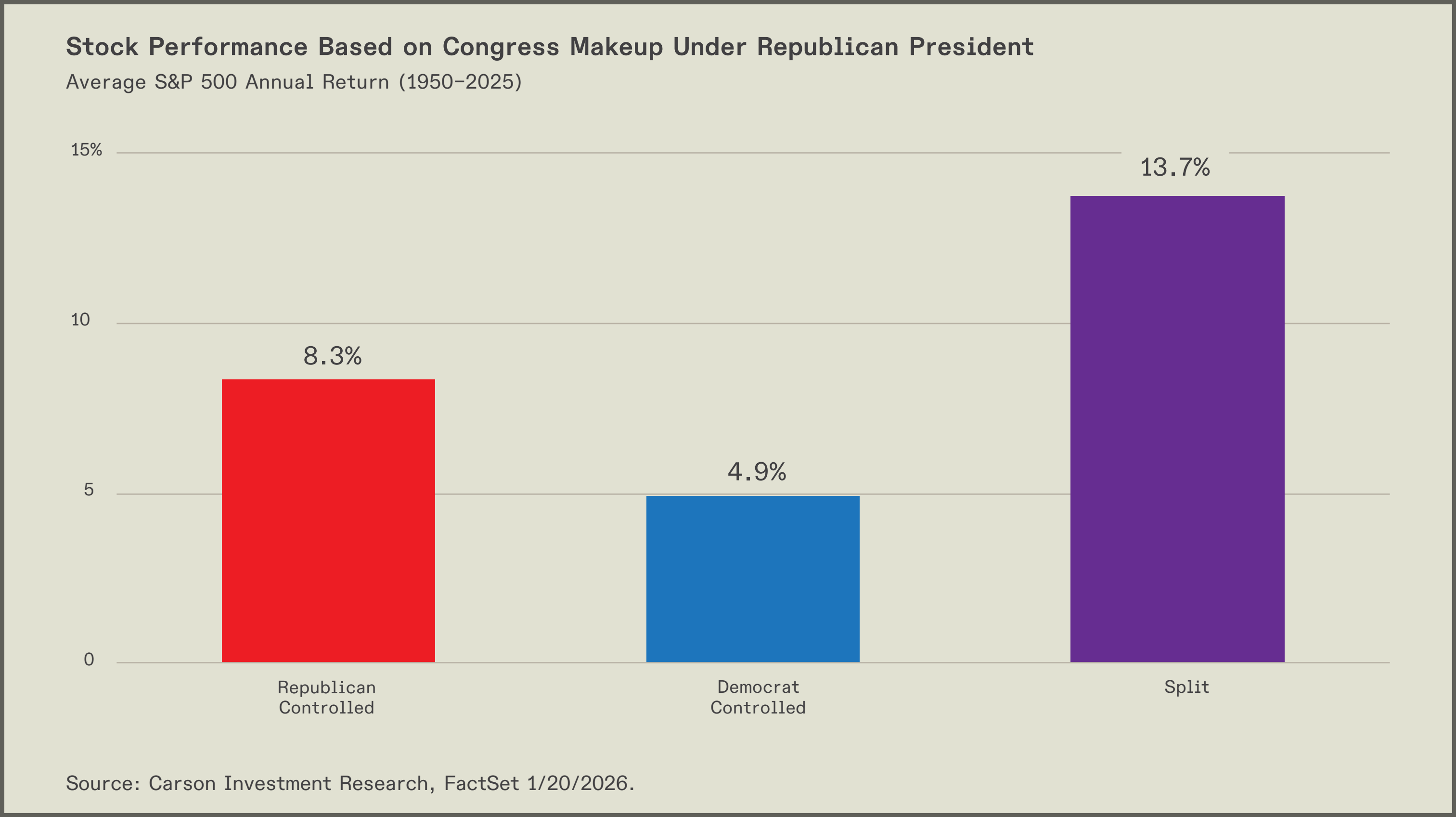
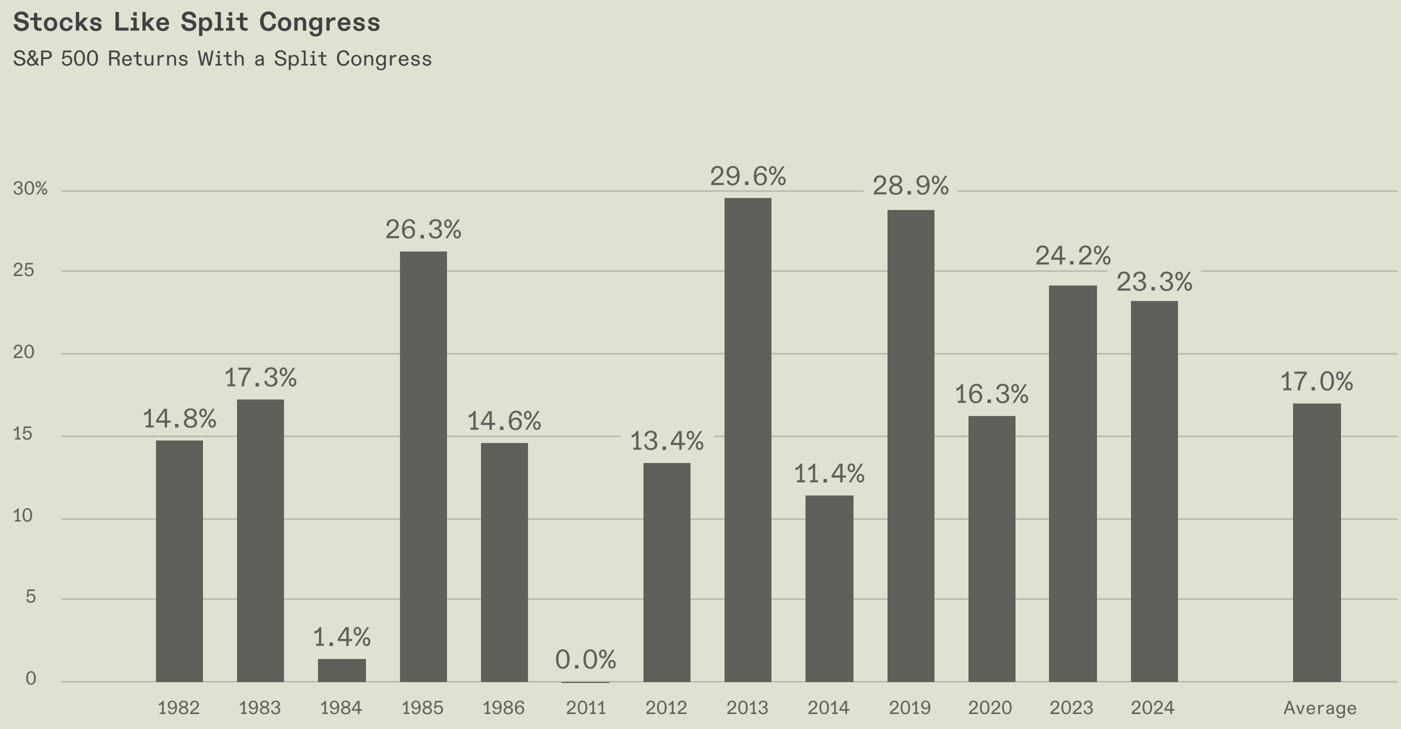


Chart 27



Source: Carson Investment Research, The American Presidency Project 1/18/2026.

Conclusion

As we look to the second half of the year, the economy is still growing, companies are still making money, we're still in the middle of AI's generational infrastructure buildout, and markets have generally rewarded patience. The wave rolls on and we're still riding it.

But the second half may require a little more care. Geopolitical risks can rise or fall quickly, but right now the conflict in Iran remains a concern. The Fed looks to be on hold even as inflation has been harder to tame. And while fiscal policy continues to support growth, it also adds pressure through deficits and long-term rates.

That combination does not argue for getting out of the water; it argues for paying more attention to the conditions. We believe stocks are well set up for further gains even if this period of extraordinary earnings growth starts to normalize. Bonds have disappointed, but drawdowns have been in line with history and other ways of diversifying a portfolio have stepped up. Diversification still matters, but it requires a broader approach.

So our view is largely unchanged, even as we recognize some conditions have shifted. The wave is still rolling and, in some ways, has even grown, but the water may be rougher now. Still, markets rarely offer clean, easy rides. Investors should adjust accordingly: stay invested, stay diversified, and keep your balance. There will likely be moments where it will be tempting to bail, but one of the most important skills of successful long-term investors is knowing how to patiently navigate through volatility. There will be ups and downs, but at the end of the year, we expect to find ourselves still riding the wave.

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The Bloomberg U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

The MSCI World ex-U.S. Index captures large and midcap representation across 22 of 23 Developed Markets (DM) countries—excluding the United States. With 871 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
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