July 2026

Dear Clients and Friends,

The second quarter once again showed the resilience of the stock market bulls. Corporate earnings soared while the commodity price impact of War with Iran eased. That dynamic paved the way to a ferocious stock rally in April and May. After posting a negative return in the first quarter, stocks closed the second quarter with strong gains.

The power of the earnings growth as the underlying story is perhaps most evident by examining the performance of typically negative market influencers. Oil prices and interest rates remained elevated throughout April and May. Normally, that action would have kept stock markets from making much progress. Instead, investors returned fully to the AI-related areas of the market – e.g. semiconductors and computer hardware suppliers. After a torrid +30% rally off the market bottom for the Nasdaq, the tech-heavy sectors rested in June. But in true bull market fashion, investors simply rotated money into all the non-tech sectors – financials, industrials, healthcare, and utilities – to keep the broad market uptrend intact. Industrials and utilities, in particular, are also AI-related stories with the massive capital spending powering economic growth.

That capital spending on data centers and other AI infrastructure is THE economic news of the times fueling extraordinary growth in corporate earnings. As Goldman Sachs noted in their recent outlook:

"Our strategists raised their earnings per share forecasts to $340 for 2026 (representing 24% annual growth) and $385 for 2027 (13% growth). AI-infrastructure beneficiaries are expected to account for roughly half of the earnings growth this year."

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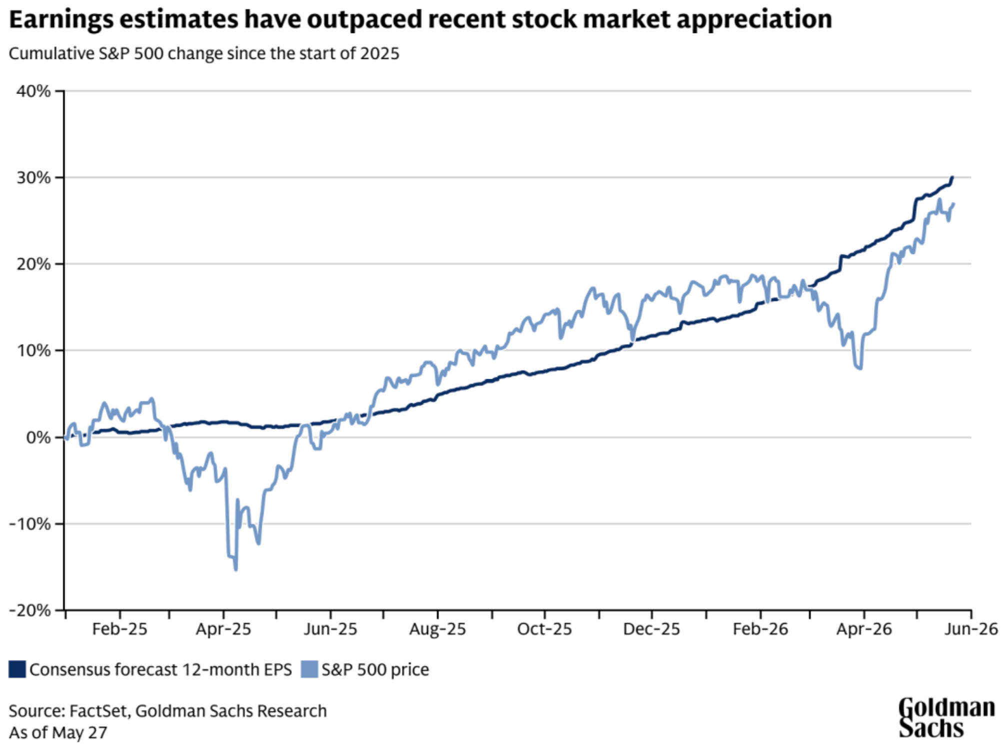

So, powerhouse corporate earnings are the fuel for this market. Where do the worries remain? For one, inflation and the resultant upward pressure on interest rates is likely to continue to be stickier than the Fed would probably like. Further out, we return to a fear that crops up on those days when the tech stocks sell off – namely, what are these trillions of dollars in AI spending going to deliver?

Back to the Goldman report: "the sustainability of the momentum in corporate earnings will depend on corporate America's ability to translate AI investments into recurring profits". As the data centers get built and AI applications take hold in earnest, will these companies really benefit so much? That is a giant unknown. Indeed the companies spending all of this money – primarily the Mag7 (Amazon, Microsoft, Meta, Google, et al) – have seen their stock prices go nowhere for months. Investors are clearly wondering whether it will all be worth it. Further, are these companies grossly overstating or even duplicating demand expectations and overbuilding substantially? That's a common feature of such frenzies.

Another potential wrinkle with the surge in AI spending is the impact on stock buybacks. With the total capital spending for AI now over $1T a year and expected to grow by over 50% next year, even the largest, most profitable companies are borrowing money to fund their AI spending. As part of this funding requirement, they have curtailed their stock buybacks. Buybacks historically supported higher stock prices, with the reduction in buybacks being a drag on the market. How significant will the buyback cuts be going forward?

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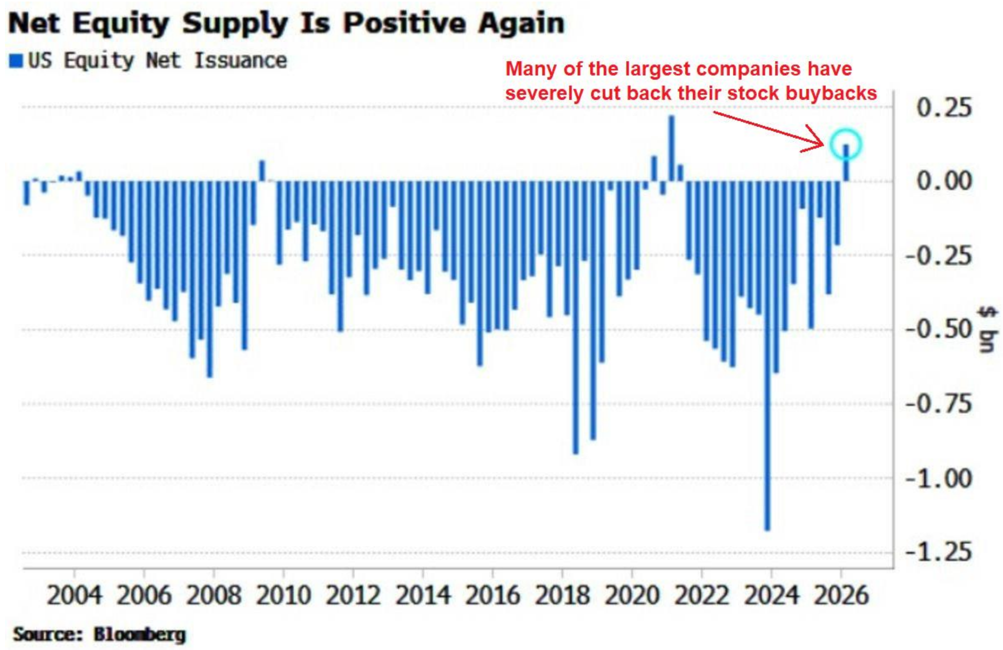

We will be watching the coming corporate earnings announcements for clues about any softening in outlooks and shifts in expectations. Though analysts have routinely UNDER estimated the capital spending outlook that is driving the current economy, markets do remain vulnerable to any about-face in the AI buildout story. There will certainly be more times where investors question the validity of the AI story, just as was done with the internet and other step-function technology leaps. The timing of that shift in attitude is unknown and what we are diligently looking for.

To future profits,

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