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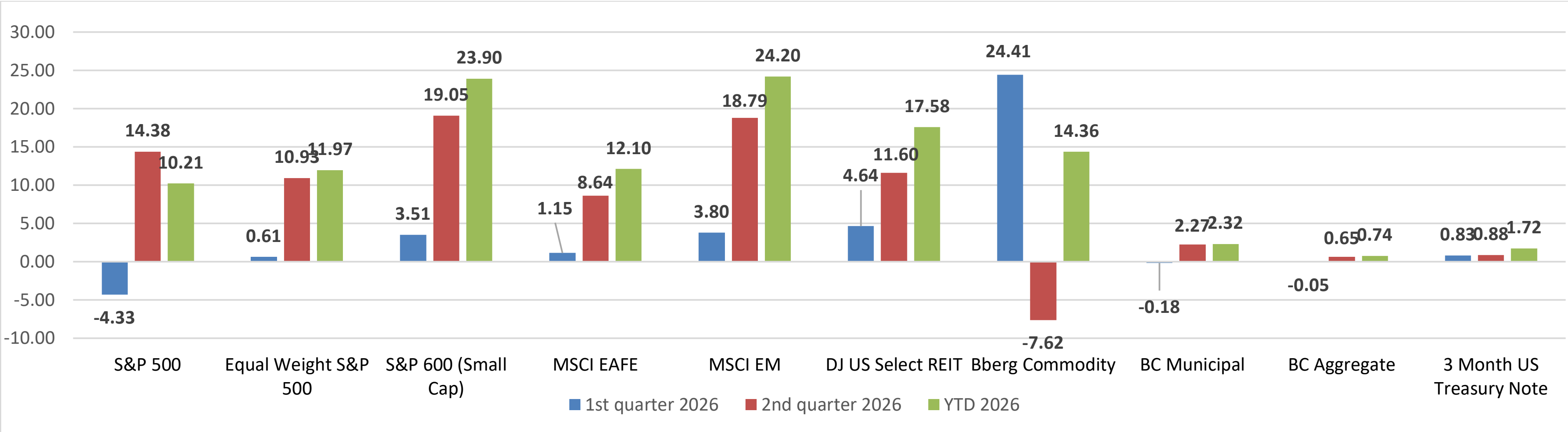
Wealth Management

Markets Live to Surprise Investors: How the 2nd Quarter Reminded Us of the Old Market Adage

Q2 2026 Market Commentary



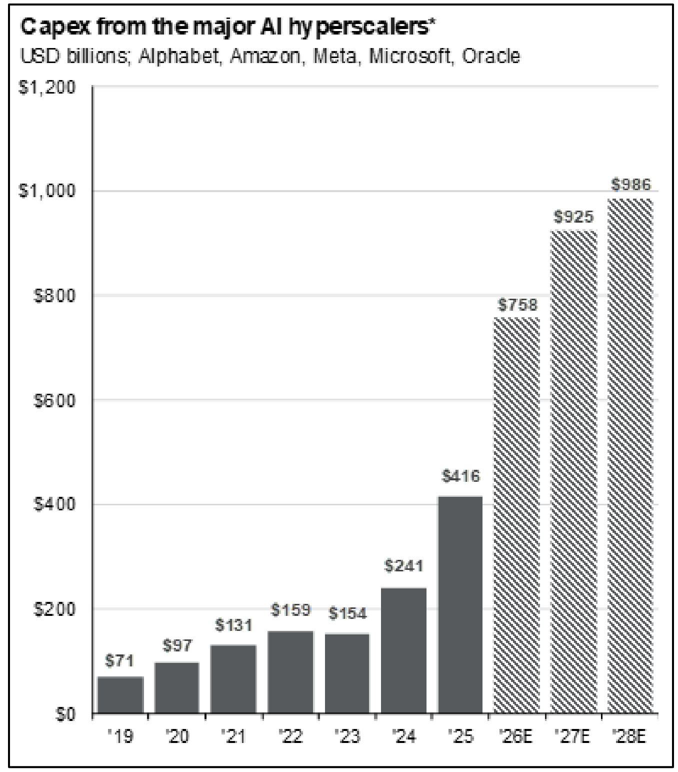
As I often do before writing quarterly commentaries, I find a quiet place in my office, look at the chart above, and write the three to five items or words that I believe defined the quarter (and year). I came up with a violent stock rally, Iran/Hormuz, semiconductors/AI, and SpaceX IPO. My head was spinning in ways that brought me back to the rally that occurred in late March during COVID; a rally so furious and broad-based (and memories that were exponentially greater and visceral) that I needed some measure of calm to balance the emotions. With the help of the Vienna Philharmonic's beautiful playing of Mahler's Symphony No. 5, and without further ado, here is the second quarter commentary.

At the end of the 1st quarter, we witnessed the beginning of this head turning, vertical ride up in capital markets. The question at hand was whether the rally was more of a relief rally, as there was not a conventional "land war" in Iran, or something far greater. Markets live to surprise us as investors and surprise us they did, looking through the prolonged (and still ongoing) conflict in Iran, and focusing on the strong earnings growth and forward guidance. The risk of higher oil prices that in turn causes upward movement in inflation that depresses sentiment and demand remains at risk to the strong returns we saw in the first half of the year. However, coming into the quarter, the fate of the Strait of Hormuz and the broader Iranian conflict were at the forefront for investors; while it remains on our minds, Iran has taken the proverbial back seat to the AI revolution that is catapulting the market higher.

Pulling further on the "markets live to surprise us as investors" thread, one could be forgiven with seeing the description of "violent stock rally" and immediately thinking "the Magnificent 7 stocks[1] have done it again!" While that line of thinking was almost perfect for the past seven years, the market darlings that composed the Magnificent 7 ended 2025 on shaky ground and have yet to regain their footing as of this writing. The Roundhill Magnificent Seven ETF (ticker MAGS) returned -5.01% for the first six months of the year, trailing the S&P 500 by almost 1500 basis points. As

[1] For reference, the Magnificent 7 stocks are Nvidia, Alphabet (parent company of Google), Apple, Microsoft, Amazon, Tesla, and Meta (formerly known as Facebook).

many of the constituents within the Mag 7 invest mind blowing amounts of money to create an "AI moat", investors have begun to question whether the money being spent will deliver the ROI that investors have grown accustomed to receiving. To the right is a chart that JP Morgan's excellent research group put together, showing how hyperscaler capital expenditures have gone from $71 billion in 2019 to an estimated $758 billion in 2026. The capex spending is expected to grow from $758 billion in 2026 to almost a trillion dollars in 2028[2]. To put this into context, I asked Google AI/Gemini how much it cost to build the US railroad network in the 1800's. From my point of view, this AI buildout is only comparable to an era defined by Vanderbilt and Rockefeller (who used his control of the rails to amass Standard Oil's controlling market position). It cost an estimated $10 billion in 19th century dollars, which equates to between $250 billion to $300 billion in today's inflation-adjusted terms[3] to build out the rail network that defined a golden era in America history. Hyperscalers spent more than that in 2024 alone, almost doubling it in 2025, and tripling in 2026. The sheer scale of the money being invested is rightfully causing investors to question whether they will see a return on that investment. There were significant amounts of money spent on the rails that never amounted to much, boom towns that turned into cautionary tales. The economic benefit of the rails was undeniable and supercharged America through the 19th century into the 20th century, but there were cautionary tales that caused the panic of 1873[4], that can help us as we navigate this AI revolution.



The logical question to ask as an investor is: if the Magnificent 7 stocks are not moving the market higher, what cohort is? The most direct answer is the semiconductor and other AI infrastructure stocks that are on the receiving end of all the capex spending in the chart above. However, it is not just a story of semiconductor companies you may (Intel, Taiwan Semiconductor, Qualcomm) or may not (Micron, SK Hyinx and ARM) have heard of, but rather a market rally that is finally broadening out despite (not because of) the performance of seven large technology companies. US small caps are enjoying a resurgence that began late in the summer of 2025 and continued into 2026. Earnings and profits are increasing, and as a direct beneficiary of advances in AI, small and mid-cap US stocks benefit from advancements in AI technology without the overhang of the significant spending that was outlined in the previous paragraph. Due to the nature of the AI supply chain, many of the companies that are receiving significant sums of money from hyperscalers are outside of the US. Companies like ASML (Dutch maker of lithography machines) and SK Hynix (South Korean manufacturer of memory chips) are moving international developed and emerging markets higher. Much like US small cap stocks, emerging markets suffered from a lack of investor enthusiasm after a decade plus of underperformance relative to US large cap stocks. However, emerging market stocks are enjoying a renaissance that mirrors (and has surpassed) that of US small cap stocks over the past 18 months.

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[2] Source: Bloomberg, J.P. Morgan Asset Management. Data for 2026, 2027 and 2028 reflect consensus estimates. Capex shown is company total. *Hyperscalers are the large cloud computing companies that own and operate data centers with horizontally linked servers that, along with cooling and data storage capabilities, enable them to house and operate AI workloads. *Guide to the Markets – U.S.* Data are as of June 30, 2026.

[3]https://www.google.com/search?q=inflation+adjusted+spending+to+build+the+railraods+in+the+1800s&rlz=1C1GCEU_enUS1197US1197&oq=inflation+adjusted+spending+to+build+the+railraods+in+the+1800s&gs_lcrp=EgZjaHJvbWUyBggAEEUYOdIBCjExNzkwajBqMTWoAgywAgHxBVy6hn_vLTxu&sourceid=chrome&source=chrome.rb&ie=UTF-8

[4] 89 of the over 360 railroads went into bankruptcy and almost 20,000 businesses failed in a two-year span that followed.

As we close out the first half of the year in capital markets, there remains a delicate balance of enthusiasm for record corporate earnings and profits and the promise of AI with corresponding trepidation over the ongoing conflict in Iran, potential for a surge in inflation, and the prospect that AI capex leads to suboptimal results relative to stated goals. From an asset allocation perspective, there has never been a better time to be a diversified investor. Yes, valuations are high in a segment of US large cap growth stocks, but US small cap stocks are delivering within the US equity complex without some of the baggage their large cap peers have. Similarly, emerging market stocks are benefiting from being the home to TSMC, SK Hynix, and ARM Holdings and have seen valuations and market caps rise, in some cases, exponentially. The growth in these stocks is helping lead a boom in economic growth, as exemplified by Singapore announcing an economic expansion at an annualized rate of 5.7% in the second quarter, far exceeding expectations[5]. International developed stocks were much maligned for not being the home to Google, Amazon, or Microsoft, and are seeing a resurgence as many of the industrial and materials companies that are making components to AI/Infrastructure are located internationally. As all the growth in the stock market causes enthusiasm, we have our allocation to real assets and fixed income, that serve as the ballast of portfolios. For those of us "nervous Nellies,[6]" adhering to diversification allows you to have safety blanket to generate income into the portfolio and be a source of capital to put money into the market if we do get a correction in markets.

Thank you for your continued confidence and trust that you have in the SDWMA team. We look forward to speaking with you soon and sharing our outlook in greater details in the weeks and months ahead.

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[5] https://www.cnbc.com/2026/07/14/singapore-gdp-iran-war-impact-takes-hold.html
[6] Of which I can certainly be characterized as I constantly worry and go back and forth on where we are in the market cycle.