

# Doll's Deliberations<sup>®</sup>

## Quarterly Investment Commentary



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### **A review of 2Q26: Leave it to a war (& \$100 oil) to deliver the 12th-best equity quarter since 1950**

Stocks had a powerful quarter, marked by the end of the fighting in the Middle East, the concomitant decline in the price of oil (WTI fell by 31%), and continued amazing earnings growth. The S&P 500 advanced nearly 15% (with the NASDAQ and Russell 2000 both +21%). Semiconductors were the star (+88%). Treasuries were weaker with some curve-flattening. Two-year yields rose 35 basis points (bps) due to expectations of possible Fed tightening. In mid-May, the 30-year yielded 5.18%, the highest level since 2007. Gold and bitcoin each fell near 14%.

AI remained the predominant theme in the market narrative, with robust capex and no sign of slackening compute demand. The economic picture continued to illustrate a solid backdrop. April and May nonfarm payroll reports were both above consensus with June's expected to continue the solid growth trend. Jobless claims remained at low levels despite a continued drumbeat of layoff announcements. Core inflation continued to run above the Fed's 2% target.

The S&P 500 continued to scale a wall of worry, finishing the quarter near an all-time high. The U.S. and Iran have signed a deal that could end their conflict and open the Strait of Hormuz. SpaceX conducted the largest IPO in history without soaking up all of investors' available liquidity. Fears that the Warsh Fed would heedlessly cut rates to appease the White House went unrealized after the new chair emphasized returning inflation to the 2% target at his debut press conference. Uncertainty remains, but equities and the economy have nimbly met a range of challenges.

The only outperforming sector was technology (+31.6%). Negative performance came from energy (-14.0%), utilities (-1.2%), and consumer staples (-0.3%).

### **Summary outlook**

We expect the global macroeconomic landscape to remain highly uncertain in 2H26 and dependent on the evolution and potential conclusion of the Middle East conflict. Furthermore, we see the relentless AI cycle, the entrenchment of geopolitical fragmentation, and a backdrop of sticky inflation, an improving labor market and central bank hikes helping to shape financial markets. The strong fundamental backdrop will keep the AI upstream theme a dominant driver of our growth outlook with the extension and broadening of the capex cycle.

Our base case continues to expect some moderation of the tensions in the Middle East, with an eventual reopening of the Strait of Hormuz. However, we anticipate geopolitical fragmentation to persist, driving uncertainty and remaining a lingering risk to the macro and market outlooks in 2H26. A key anchor of our baseline view for the rest of the year is a controlled and gradual response from DM central banks to sticky inflation. We expect the Fed to stay partly behind the curve: having turned neutral and removing their easing bias at the June meeting. Risks are skewed toward a hike in 4Q26 or 1H27.

Our upside scenario for risk assets would require a reinstatement of the Goldilocks narrative, including: the reopening of the Strait of Hormuz and early delivery of AI productivity gains reducing inflation pressures and subsequently leading to the removal or postponement of central bank hikes.

## The fundamentals

The easing in Middle East tensions has lowered oil prices to pre-war levels, as there are high hopes that supplies through the Strait of Hormuz will return to normal (although it will take time to rebuild depleted oil inventories). This, in turn, has helped to lower bond yields by reducing pressures on headline inflation and measures of inflation compensation.

Any capping in bond yields will likely prove temporary but will nevertheless prolong the economic and investment cycles. Critically, the macro backdrop remains supportive of economic growth and risk-asset markets: Monetary and fiscal policies remain historically accommodative (even when factoring in market forecasts of central bank rate hikes ahead) and the corporate profit uptrend is intact.

This positive backdrop should ensure that periods of broad-based risk-off are temporary, at least until a meaningful economic roadblock develops, such as noticeably higher bond yields. The latter point regarding brief risk-off periods does not mean that the current bubble(s) will continue indefinitely. Two recent asset bubbles have already burst, i.e., bitcoin and gold, and stresses have emerged in the private credit and equity sectors, yet the overall environment has stayed positive for most risk assets.

Investors keep rotating from one burst bubble to the next hot theme, underscoring that there is still no indication of a shortage of investment "liquidity," nor signs of stress in global corporate profits. This validates our view that monetary policy has been accommodative and, thus, will need to be tightened to bring down inflation. Even as the previously red-hot Mag 7 stocks lost some of their relative allure this spring, investors moved on and charged into semiconductor stocks and select AI shares.

Eventually, inflation is likely to be the catalyst for ending the cycle. However, investors are proving extremely resistant to changing their view on inflation, underscoring that this threat remains beyond most investors' horizon. The downside of the benign attitude to the inflation threat is that the longer price pressures are allowed to build, the more entrenched inflation will become.

Events in the Middle East could yet reverse course and again hold markets to ransom. However, enough of the combatants want the Strait to be open, thereby reducing this risk factor to the global economy for the foreseeable future. Even as tensions in the Middle East fade, the past few months will have a lasting impact on supply chains, various input costs, and the desire to hold inventories of important products. Thus, as with last year's trade war, although the economic impact from this energy shock will not be meaningful, it will further entrench a backdrop where prices of many products and even some services tend to rise over time. Perhaps we are overestimating this particular threat to higher inflation. However, it is a new and viable risk fact that is not priced in bond markets and, thus, all asset market valuations.

Much has been made about the FOMC being less dovish and the performance of the new Chair at last week's press conference. Rhetoric aside, the net result is that the Fed is still maintaining an accommodative policy setting in the face of rising and well above-target inflation. Except during the first part of the pandemic, they have missed their 2% target throughout the decade.

The forward markets have swung from expecting rate cuts to modest hikes in recent months. The recent drop in oil prices has allowed bond yields and rate expectations to ease modestly. Measures of future inflation compensation have also rolled over without ever rising to levels that would have come close to covering inflation's performance this decade.

## Inflation and the Fed

Core inflation is now up to 3.4% y/y. Before the war, it was stuck just below 3.0%. Fed Chair Kevin Warsh acknowledged that inflation has exceeded the FOMC's target for more than five years and committed the Fed to restoring price stability. Accordingly, we remain inclined to possibly expect one rate hike before year-end.

The Warsh Fed will speak less and guide less. While explicit guidance was removed, some implicit guidance remains, as inflation was prioritized over employment. To repeat, Warsh's main point was that the Fed was wrong five consecutive years on inflation. To fix this problem, Warsh announced new task forces, including one on the Fed's balance sheet and the Fed's ample reserve regime.

Our view is that core PCE likely needs to print at 0.2% m/m or lower consecutively for the Fed to feel comfortable remaining on hold in this environment, otherwise they will continue to view inflation as being too high. The path to staying on hold is becoming increasingly narrower. The Fed will continue reducing the average maturity of its holdings on the way to eventually shrinking its balance sheet. Curiously, historical equity market performance during the first year of a new Federal Reserve Chair suggests that drawdowns are common, with a median decline of 17%.

## Earnings

Oil has fallen below \$70 a barrel, a meaningful relief for both consumers and businesses with energy-sensitive costs. Gasoline prices have also retreated significantly, offering a welcome reprieve, particularly for lower-income consumers.

S&P 500 earnings growth has seen YTD upgrades to both 2026 and 2027 consensus estimates of ~10%. This type of positive revision is unprecedented and is typically seen only after a recession. However, strong back-to-back earnings have reset the bar higher heading into the 2Q season, making it more difficult for companies to significantly surprise to the upside. While the bulk of earnings season is behind us, and has been extraordinary, a common theme among later-reporting companies has been growing margin pressure.

## Politics and the midterm election

Voters in the U.S. have removed the party in power in each of the last five federal elections since Brexit, and the UK has changed Prime Ministers six times. As noted in prediction 10, we expect U.S. voters in November to turn the House over to the Democrats.

President Trump has minimized his political losses by accepting a nearly one-sided deal with Iran, lowering gas prices, and moving on. There is little doubt the war is likely to be seen as a mistake by a growing number of voters. Trump seems to be prioritizing flooding the market with oil to drive down gasoline prices ahead of the midterm elections. Five-year inflation expectations have fallen from 2.7% at the height of the war to 2.3% now.

The MOU between the U.S. and Iran is highly unlikely to be the basis for a long-term deal between the U.S. and Iran. The 60-day window to negotiate the deal is likely to be extended repeatedly and perhaps indefinitely.

## Valuation and long-term returns

History indicates that investors are too optimistic about capital markets continuing to deliver strong returns in the next 10 years. Global corporate earnings and equity valuations are historically elevated. Inflation expectations remain low, as are expected equilibrium central bank policy rates, thereby dampening government bond yields. Corporate bond spreads are very tight. It is dangerous to extrapolate the capital market returns of recent decades into the future given the dramatically different starting points.

## 2000 versus 2026

### Valuations

|                        | Early 2000 | Late June 2026 |
|------------------------|------------|----------------|
| S&P 500 Forward P/E    | 25x        | 20x            |
| Technology Forward P/E | 55x        | 22x            |

### Expected earnings growth

|            | Early 2000 | Late June 2026 |
|------------|------------|----------------|
| S&P 500    | 19%        | 23%            |
| Technology | 29%        | 38%            |

### Returns

|         | EPS growth | S&P 500 total returns |
|---------|------------|-----------------------|
| 1995-99 | 67%        | 220%                  |
| 2021-25 | 79%        | 85%                   |

Sources: Yardeni Research; Strategas, June 2026

**“Prices are too high’, is far from synonymous with ‘the next move is downward.’ Things can be overpriced and stay that way for a long time ... or become far more so.” – Howard Marks**

## Second-half assumptions

1. Economy will continue to grow above average.
2. Inflation will remain sticky.
3. Fed will not lower rates this year, but may raise them.
4. Interest rates will remain in trading range, perhaps biased higher.
5. Earnings will continue to exceed expectations (but rate of exceeding will slow).
6. Stocks will struggle to build on generous first half gains, and internal stock market volatility will continue.
7. International will outperform in the second half.
8. Strait of Hormuz will reopen, but nuclear conversations will stall/fall apart.
9. AI will continue to move forward at a rapid pace.
10. Midterm elections will be hard fought and result in a divided Congress.

## Conclusions (from June 22 Doll's Deliberations):

1. The deal to extend the ceasefire and reopen the Strait of Hormuz should ensure that the global economic expansion rolls on, to the benefit of risk-asset markets.
2. The Fed has been behind the curve, but has finally shown an intention to act on its inflation problem. With the Fed under pressure from the bond market, the odds of a rate hike this year have increased, though some respite from lower oil prices and therefore lower headline inflation may allow Warsh to kick the can into next year.
3. Our view that we are in a "high-risk bull market" depended on continued earnings exceeding expectations and a Fed that was neutral or accommodative. With the latter getting challenged, we are forced to become more cautious and argue that building on the generous gains in stocks in the first half of the year has become more difficult.

## 10 Predictions for 2026: Review and update (3Q26)

### Introduction (written December 2025)

The U.S. is set to remain the world's growth engine, driven by a resilient economy and an AI-driven super cycle that is fueling record capex, rapid earnings expansion, and unprecedented market concentration. The growth outlook is good, which bodes well for corporate profits and should be supportive of risk asset markets. The recently passed U.S. tax bill (One Big Beautiful Bill – OBBB) should provide a boost especially to capex. Deregulation should also support activity. A combination of the OBBB's impact on both consumer and capital spending, America's hosting the World Cup, and the country's 250th anniversary will all create a tailwind for 2026 economic growth and earnings. Add to that a Fed that seems almost certain to focus more on the full employment part of its mandate rather than inflation and it is difficult to get bearish. However, the downside of good growth may be upward pressure on inflation.

**Key:**  Heading in the right direction  Heading in the wrong direction  Too soon or too close to call

|   |   |
|---|---|
| <p><b>1</b></p>    | <p><b>Economic growth in the U.S. improves from approximately 2.0% to approximately 2.5% real GDP.</b><br/>Despite oil reaching \$100 per barrel (which one might think could bring any economy to its knees), economic growth in the U.S. remains relatively robust on the back of a resilient consumer and significant capital expenditures. The lagged impact of last year's Fed interest-rate cuts and the One Big Beautiful Bill, while diminishing, are still positive. Wealth effect benefits and reasonable productivity growth give further support to this prediction.</p>  |
| <p><b>2</b></p>  | <p><b>Inflation remains sticky, fails to reach the Fed's 2% target, and fails to make much if any progress toward the Fed's 2% target.</b><br/>Sadly, this one is nearly certain. Most year over year and year-to-date inflation measures have a 3-handle, with some over 4%. Oil has certainly been a culprit and will cause inflation to fade somewhat, at least at the headline level. But many non-oil inputs to the inflation rate have risen too. Recently installed Fed Chair Warsh has made it clear that the Fed has missed the inflation target of 2% five years in a row. Even if inflation calms, the "affordability" issue will play a role in the upcoming election.</p>  |
| <p><b>3</b></p>  | <p><b>The 10-year Treasury yield trades primarily between high 3% and mid 4% as credit spreads widen (i.e., a "coupon-ish" year).</b><br/>While price action for the 10-year Treasury has been confined to the high 3% and mid 4%, the threat on the upside still exists, especially with significant debt issuance to come, and the inflation problem mentioned in #2 above. Credit spreads remain surprisingly tight and municipals remain attractive where tax conditions permit.</p>  |
| <p><b>4</b></p>  | <p><b>Earnings growth falls short of consensus +14% and P/Es decline modestly, making it a tougher year to make money.</b><br/>Earnings growth has been extraordinary, both in absolute terms and relative to expectations. Earnings growth has exceeded expectations by nearly 15%, stocks are up roughly 10%, and therefore the P/E of the market has fallen by about 5% (or one P/E turn) since the start of the year. The rise in the price of oil raised energy estimates and did surprisingly little damage to the rest of the market. Technology earnings continue to soar higher.</p>   |
| <p><b>5</b></p>  | <p><b>Stocks fail to advance by a double-digit percentage for only the third time in 10 years.</b><br/>The U.S. stock market has advanced by a double-digit percentage for three years in a row. A fourth year of double-digit earnings growth has happened only once in the last 100 years. (Actually, five years – 1995-99.) As we close the first half of the year, the S&amp;P 500 has advanced nearly 10% already. If the market keeps "walking the tightrope" of good employment and economic growth sufficient to produce double-digit earnings growth but not so strong as to stoke inflation, another double-digit stock market return is possible. No matter the outcome, high valuation levels demand a strong fundamental/earnings backdrop for another significant advance in equity averages.</p> |

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|----|---|
| 6  | <b>Technology, communication services, and financials outperform materials, utilities, and consumer discretionary.</b>  |
| ?  | This prediction looked hopeless on March 31. But, as of June 30, our projected outperformers are leading our projected underperformers by nearly 100 bps, thanks to strong performance from technology and a much-improved financial sector, as well as relative weakness in utilities and consumer discretionary. The strong performance of growth versus value since the March 30 low has also put us in the winning column, even if slightly.  |
| 7  | <b>International stocks outperform the U.S. for the second year in a row (first time in 20 years).</b>  |
| ?  | International stocks handily beat the U.S. for the first two months of the year but then lagged as oil prices rose. (Non-U.S. economies are almost all more sensitive to the price of oil than the U.S.) As oil prices fell, almost all equity markets rose substantially, with international handily beating the U.S. (thanks largely to Japan and emerging markets). Assuming oil prices behave, the relative cheapness of non-U.S. markets and their mostly strong earnings comparisons will likely cause them to outperform the U.S. for the second year in a row (first time in 20 years).   |
| 8  | <b>AI continues to be volatile/erratic, creating another year of elevated volatility.</b>   |
| ✓  | "AI" has become a buzzword all across society. Virtually all agree that AI is a transformative technology. The controversy is over magnitude, timeframe, and winners/losers. The "circular financing" dilemma remains a point of controversy and consternation. Software companies have been at the brunt of that discussion. Our expectation remains that AI will be controversial, create confusion and volatility, and result in some amazing positive stories and some noticeable losses.   |
| 9  | <b>Faith-based share of industry AUM increases for the tenth year in a row.</b>   |
| ✓  | The faith-based share of money management industry AUM has increased nine years in a row, granted from a very small share. We expect this to be the tenth year in a row making it a decade of more than doubling market share. Why? More and more individuals, financial advisors, and institutions are desiring to align their portfolios with their values. Investors are both excluding companies that maim, kill or addict people as well as favoring companies that "do good." With ample evidence pointing to these investors not having to surrender any investment performance, this area continues to be one of increasing interest.   |
| 10 | <b>Republicans retain control of the Senate but surrender the House, losing at least 20-25 seats.</b>   |
| ?  | On average, over the decades, the best economic growth in the four-year presidential cycle has occurred in the second year (this year). But it historically (and by a wide margin) has been the worst performing stock market year. Mid-term elections are rarely good for the party in control. Polls have not only suggested the Republicans lose the House (perhaps losing 25-35 seats), but that the Senate is now reachable for the Democrats. An end to the war will likely moderate the projected Republican losses, but the increase in inflation (and the focus on "affordability") will not help. If this prediction is accurate, it will render President Trump largely a lame duck, making the One Big Beautiful Bill his most significant second term achievement. |

Final Tally:



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### In summary (written December 2025)

Equity valuations and widespread investor complacency make the risk-reward trade-off less favorable than the positive top-down view implies. A shift to a defensive position is likely to occur at some point, although the timing is uncertain. Be quick to cut beta exposure if these tail risks surface. These include a spike in bond yields, a renewed intensity of the trade war, and/or if the AI euphoria fades.

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