Investment Update

July, 2026

2026 Second Quarter Update

Review: The S&P 500 rebounded strongly during the quarter, delivering a 15.2% total return, driven mostly by AI-related stocks. The MSCI Emerging Markets (EM) index returned 24.1%, which was also boosted by tech/AI-related stocks. EAFE was the laggard, up a more modest 11.1%, as it lacks the AI exposure that drove the S&P 500 and EM indices. Fixed income returns were positive in the quarter, reversing the modest declines seen in Q1.

	2Q26	1Q26	2025
S&P 500	15.2%	-4.4%	17.9%
MSCI EAFE[1,2]	11.1%	-1.1%	31.9%
MSCI Emerging Markets[2]	24.1%	-0.1%	34.4%
Bloomberg U.S. Aggregate Bond	0.7%	-0.1%	7.3%
Bloomberg Municipal Bond	2.5%	-0.2%	4.2%

[1]Europe, Australasia, Far East

[2]MSCI returns are in U.S. Dollars

Is it different this time?

The growth in investments in AI infrastructure, particularly by the hyperscalers (Alphabet, Amazon, Meta, Microsoft, and Oracle) has been astounding over the past few years, with capital expenditures for the five companies increasing from $157 bill in 2023 to an estimated ~$740 bill this year (see chart on next page). However, this rate of investment has, so far, outpaced the corresponding revenue growth rate of the group. We highlight this because data center spending, by hyperscalers and others, has become a meaningful driver of US GDP growth (~40% of last year's 2.1% figure) and S&P 500 earnings growth.

The bullish argument is that there is "insatiable demand" for AI compute and that this is nothing like the dotcom bubble of the late '90s because the hyperscalers have largely been able to fund these investments from cash flow (with the exception of Oracle). The more conservative argument is that hyperscalers have been rushing to build capacity more as a defensive strategy than an offensive one—i.e., they do not want to underinvest in AI compute capacity if there is a risk that their competitors will be in a better position if artificial general intelligence (AGI) is achieved. Mark Zuckerberg explicitly referenced the possibility of overinvestment on Meta's Q3 conference call last year, when he stated that the company is "aggressively" frontloading capacity so that they are "prepared for the most

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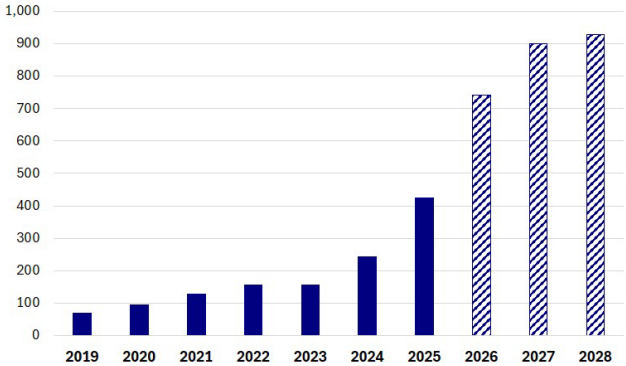
optimistic cases" of superintelligence ("a few years" versus "5, 7 years or longer.") We are positive on a number of the hyperscalers. However, we do believe that this aggregate spending dynamic is having an impact on other parts of the AI value chain that could be leading to overly optimistic assumptions in certain end markets. For example, the massive data center buildout has led to shortages in various commodity semiconductor products, including notoriously cyclical end markets like memory chips. This seems somewhat reminiscent of the internet infrastructure buildout in the late '90s, when there was (temporarily) an "insatiable demand for bandwidth" that boosted revenue and earnings growth for many Tech companies like Cisco, Lucent, and JDS Uniphase. Will hyperscaler spending gradually decelerate, or could we see a pullback that disrupts growth across the AI value chain? The market appears to be overly optimistic, with valuations for many companies in the space seemingly embedding a very low probability of the potential downside case.

Hyperscaler Total Capital Expenditures, $bill, 2019-28E



Source: FactSet; Hyperscalers: Alphabet, Amazon, Meta, Microsoft, Oracle

Outlook: Estimated US GDP growth for 2026 is now 2.1%, down from 2.3% at the end of Q1, and core PCE inflation is now expected to be 3.3% for the year, up from 2.9%. The conflict with Iran has injected uncertainty into the outlook for interest rates, with the market now pricing in at least one rate hike by the Federal Reserve by year end instead of the consensus view at the beginning of the year that there would be likely two rate cuts. The new Fed chair, Kevin Warsh, signaled that they are very focused on price stability, so the expected path of inflation will be a key indicator to monitor. The fragile ceasefire with Iran has helped bring down prices of oil futures and certain commodities, but it will take time to see if actual physical volumes will normalize quickly enough to ease price pressures on a sustained basis.

The outlook for international growth has become increasingly mixed, with large energy importers negatively impacted by the commodity price spike. As a result, the US dollar rallied against a number of major currencies during the quarter.

Strategy: The S&P 500 currently trades at a price-to-earnings (P/E) multiple of ~20x, using forward consensus estimates. Taken at face value, this seems reasonable against estimated EPS growth of 25% and 17% this year and next, well above the long-term trendline growth of ~7%. However, it is also a signal that there are some questions about the sustainability of the earnings growth, which has been largely driven by tech/AI-related stocks. As such, it is prudent to balance exposure to tech/AI with traditionally defensive sectors and, potentially, developed international stocks that have less tech/AI exposure. Additionally, fixed income continues to offer a relatively attractive risk-reward.

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