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Sector Leadership Realigns in an Uncertain Period

April was an “average year” for stocks. That means, of course, it was a spectacular month. The S&P 500 rose 10.4% in April, in line with the average 10.6% full-year gain on the index since 1980. So far, May has carried that momentum forward, advancing 2.6% as of the 5/8/26 close. Uneasy truces hold (for the most part) between the U.S. and Iran and between Israel and Lebanon. With the White House rejecting Iran’s response to the latest U.S. peace proposal, the truces look increasingly frayed as sporadic attacks from both sides intensify. But, so far, that has not stopped the stock market.

The first-quarter 2026 U.S. stock market continued the pattern of the second half of 2025, in that leadership had rotated away from growth and was dispersed across defensive (Consumer Staples), cyclical (Industrial), interest-rate-sensitive (Utilities, Real Estate), and inflation hedges (Energy, Materials). With the second quarter not quite halfway done, the growth sectors of Information Technology, Consumer Discretionary, and Communication Services have come roaring back.

Growth Sectors Rallying in 2Q26

For 2Q26 to date, the S&P 500 has rocketed higher by 13%. That eye-popping number actually understates performances from some of the sector and industry leaders. The Information Technology sector is up 31% in 2Q26 to date. That is not far off the 36% gain for Energy in 1Q26 -- but IT has jumped more than 30% in less than half a quarter. Semiconductors have been in the lead, with the SOX index rising over 35% in the past month and rising over 50% in the second quarter to date. Software, badly beaten up in 4Q25 and 1Q26, is up 17% in 2Q26 to date.

The next-best sector in 2Q26 has been Consumer Discretionary, which is up just over 10% as of 5/8/26. Amazon,

which dominates the retail stocks in this sector, has been surging as AWS generates accelerating growth and margin expansion on AI momentum with Anthropic, OpenAI, and others. The other growth sector, Communication Services, has had a more-muted performance but still has gained 5.5% in 2Q26. Four stocks dominate this sector: Alphabet and Meta Platforms on the social media side, and Verizon and AT&T on the legacy telecom side. Alphabet has been strong thanks to successful AI initiatives, but Meta Platforms has struggled with its AI bets. The big telcos are delivering solid total return with their high dividends, but are not much associated with the AI revolution.

The rotation winners of 3Q25 through 1Q26 have not rolled over; in fact, the overall market has been strong enough in 2Q26 to keep most sectors moving forward. Real Estate, which struggled in recent years as high interest rates limit new property investments, is up about 8% in 2Q26. The overall interest-rate environment has not improved, but pent-up demand is helping leasing activity. Other mid-single-digit gainers in 2Q26 include Industrials (up 7%), Materials (up 5%), Financial (up 4%), and Consumer Staples (up 2%).

Sectors that are negative so far in 2Q26 include Healthcare (down 2%), Utilities (down 3%), and Energy (down 9%). Healthcare came into 2026 riding a wave of optimism as President Trump signed deals designed to bring down prices and hopefully stimulate business. But strained consumers are foregoing elective medical procedures and are even skipping going to the doctor. Utilities have been a winning sector since the Fed began its rate-cutting cycle over two years ago. As the outlook dims for further fed rate cuts, profit-taking in income stocks may be funding rotation back into AI and semiconductor names.

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ECONOMIC & MARKET COMMENTARY (CONT.)

Energy soared 36% in 1Q26, which included a 20% surge in January and February before the first shots were fired in Iran. Energy is down about 9% in 2Q26. While oil and derivatives prices remain near multi-year highs, they have bounced around on optimism that a lasting truce can be reached and the Strait of Hormuz can be reopened. Even if the war ends soon, oil prices are likely to remain elevated for months as supply and demand gradually normalize. Investors betting on a quick resolution to the war and an oil-price drop are being accused of replacing forecasting with “wishcasting.” If oil prices do not come down rapidly, the market is assuming energy prices have reached their highs for the year.

Year-to-Date Sector Map Also Shifts

While April and May have been go-go for growth, the full-year sector performance map also captures a first quarter in which growth was back on its heels. The three growth sectors represent over 50% of S&P 500 sector weight -- and when they are all down, the overall market tends to be down. The S&P 500 declined 4.6% in 1Q26. With the second-quarter surge, the index was up 8.1% for the year to date as of the 5/8/26 close.

Among the 11 sectors in the S&P 500, two sectors are clearly down for the 2026 year-to-date and one is bobbing right around breakeven. Communication Services is down less than half a percentage point for 2026 as it follows a 6% first-quarter decline with a 5.5% second-quarter gain.

The Financial sector appreciated in mid- to high-single-digit percentages in 2025 and 20204 as net interest margins widened and as the environment for fee-based businesses gradually improved. The sector is down 5% in 2026 to date on fears (not yet realized) that rising inflation will slow load demand and worsen an already depressed housing market.

The Healthcare sector has been struggling and getting smaller in S&P sector weight in recent years. In addition to a slowing in consumer medical-procedure utilization, the pipeline of promising new drug candidates is full of GLP-1 variations, but somewhat sparse otherwise.

Sectors that are up in single-digit percentages in 2026 to date, in ascending order, include Consumer Discretionary (up 1%), Utilities (up 4%), Industrial (up 6%), Consumer Staples (up 8%), and Real Estate (up 9%).

Three sectors are up in double digits for the year to date. In ascending order, these are Information Technology (up 19%), Materials (up 20%), and Energy (up 24%). Energy and Materials carried significant momentum from 1Q26, whereas Information Technology has been the comeback kid after ending 1Q26 down 9%.

Conclusion

The stock market has been news-driven in 2026 -- particularly since the war with Iran began. At times, it can seem like stock selection is all “Hormuz, Hormuz, Hormuz” vs. “AI, AI, AI.” That makes it hard to predict which sectors will lead as the trading year progresses.

But stocks across a range of sectors have been working higher on solid fundamentals that have little to do with events in the Middle East. The calendar 2026 first-quarter earnings season, which is now winding down, has so far featured 25%-plus EPS growth. That’s the best growth since the quarters coming out of COVID-19 economic disruption.

Putting aside huge one-time gains from three of the “Magnificent Seven” companies, earnings for calendar 1Q26 have featured notable gross-margin improvement on company efficiencies and supply-chain normalization. Earnings have also benefited from revenue growth that has exceeded any inflation impacts. Consumer spending has rarely been so lopsided, with strains on lower-income consumers worsening. The University of Michigan consumer sentiment index for May 20206 was 48.2% -- the lowest reading in the 70-year-plus history of this series. For now, upper-tier consumers are keeping overall consumer spending healthy, which is helping keep employment trends positive.

These positive conditions could melt away if the situation in Iran evolves into a permanent stasis in which the Strait of Hormuz remains closed or only partly open and hostilities continue at a low level. Economic shocks have a lagged effect, and oil price inflation will take one or more quarters to ripple fully through consumer and business prices. The grinding effects of worsening inflation could restrain spending by even well-to-do Americans. In the stock market, some of the recent sector and industry momentum, particularly in semiconductors, does not appear sustainable. We will continue to monitor the dynamic situation in Iran, while also keeping an eye on all parts of the economy.

Jim Kelleher, CFA,
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KEY ECONOMIC FORECASTS

- The \$32 trillion U.S. economy remains on course for productive long term growth, powered by corporate investments in AI and outsized spending by wealthy households. Nvidia CEO Jensen Huang estimated, in November, that \$3 - \$4 trillion will be spent on AI infrastructure in the next 5 years.
- Real Potential GDP – the sustainable speed limit of the US economy is poised to increase to 2.1%, on average, through 2030 according to the Congressional Budget Office. AI is likely to raise productivity, offsetting slower growth in the labor force from an aging population and reduced immigration.
- The war in Iran is affecting millions of lives. Oil supply disruptions are a risk to affordability. We recently raised our 2026 oil price forecast to \$75 per barrel from \$60.
- The U.S. economy has become more resilient, more diversified and less oil dependent, but it is managing additional supply headwinds from tariffs and reduced immigration. This triumvirate could raise inflation, slow growth, and complicate Fed policy. Tax benefits and AI have helped the economy.
- A simple rule of thumb: National gasoline prices above \$4.00 begin to hurt consumer spending. The current price of \$4.50 would be a concern if it persists into the back-to-school shopping season.
- The Misery Index, which is the Consumer Price Index (CPI) inflation rate plus the unemployment rate is below the average of 9.2% since 1949 but it has risen to 8.1% from 6.9% in January. Unemployment is low at 4.3% but the CPI rose to 3.8% in April from 2.4% in January.
- We are monitoring financial conditions and high-frequency indicators including Nowcasts and weekly jobless claims. We recently reduced our 2026 forecast for GDP growth to 2.1% from 2.3%.
- Argus expects S&P 500 EPS to rise almost 16% to \$315 in 2026 and increase about 15% to \$363 in 2027. EPS is helped by an increase in operating margins to about 18.7% this year, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 47% and 60% respectively while Dow stalwarts Walmart and Caterpillar earn 4% and 17%, respectively.
- Argus Fixed Income Strategist Kevin Heal expects the Fed to reduce the funds rate by 25 basis points in 2026 and by another 25 basis points in 2027 taking the target range to 3%-3.25%. We expect the dollar to be slightly stronger in 2026 driven by foreign demand for shares of innovative U.S. companies and economic resilience.
- Gold is likely to remain at elevated levels. The ancient safe-haven asset recently reached a record above \$5,000 an ounce. We expect gold to trade in a range of \$4,000 - \$6,000 in 2026.
- What could go right? Low unemployment, big tax refunds, spending by wealthy consumers, strong S&P earnings, capital investment, productivity gains, inflation expectations remaining anchored, and ongoing innovation.
- Risks: Elevated Inflation, high fuel prices, weak housing market, low income consumers are struggling, spending by affluent may depend on stock market gains, AI may reduce entry-level hiring.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
7-May	Nonfarm Productivity	1Q	1.6%	2.0%	NA	0.8%
	Unit Labor Costs	1Q	4.6%	3.5%	NA	2.3%
	Construction Spending	March	0.4%	0.8%	NA	1.6%
8-May	Nonfarm Payrolls	April	185K	125K	73K	115K
	Unemployment Rate	April	4.3%	4.3%	4.3%	4.3%
	Average Weekly Hours	April	34.2	34.2	34.2	34.3
	Average Hourly Earnings	April	3.4%	3.6%	3.8%	3.6%
	Wholesale Inventories	March	1.9%	1.4%	1.5%	2.9%
	U. Michigan Sentiment	April	49.8	50.0	49.40	48.20
11-May	Existing Home Sales	April	4.01 Mln.	4.10 Mln.	NA	4.02 Mln.
12-May	Consumer Price Index	April	3.3%	3.6%	NA	3.8%
	CPI ex-Food & Energy	April	2.6%	2.6%	2.7%	2.8%
13-May	PPI Final Demand	April	4.3%	3.9%	NA	6.0%
	PPI ex-Food & Energy	April	4.0%	3.5%	NA	5.2%
14-May	Retail Sales	April	4.0%	4.2%	NA	NA
	Retail Sales ex-autos	April	5.5%	5.6%	NA	NA
	Import Price Index	April	2.10%	2.40%	NA	NA
	Business Inventories	March	1.30%	1.20%	NA	NA
15-May	Industrial Production	April	0.7%	0.9%	NA	NA
	Capacity Utilization	April	75.7%	75.8%	NA	NA
21-May	Housing Starts	April	1,502K	1,350K	1,409K	NA
22-May	Leading Index	April	-0.6	-0.4	NA	NA

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