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ARGUS ECONOMIC COMMENTARY

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Earnings off to a Strong Start, but Stocks Hesitate

The second-quarter earnings season has been largely positive, led so far by healthy big-bank profits. Economic data remains reasonably strong, highlighted by a pair of encouraging inflation reports. Still, the good inflation news could prove transitory: U.S. gasoline prices have moved higher again as the war with Iran has reheated and the Strait of Hormuz is again a flashpoint. July, a typically placid market month, has been anything but for the stock market.

2Q26 Earnings: Solid Start with Best Likely Yet to Come

The second (calendar) quarter earnings season has one thing in common with first quarter earnings season, and that is 20%-plus annual EPS growth. Unlike 1Q26, when investors went into the reporting period expecting low-double-digit to mid-teens growth at best, expectations entering July 2026 were for 20%-plus growth for the second quarter. That may be why stocks are mixed on what has been the second-best quarter for earnings growth since the pandemic-impacted comparisons of 2021.

As of the third week of July, and with about 10% of companies having reported, S&P 500 earnings from continuing operations for calendar 2Q26 are up about 24%-26% from 2Q25, according to the tracking firms Bloomberg, FactSet, and Refinitiv. That range of blended estimates is based on both actual earnings data and estimates from companies yet to report. Typically, as actual earnings reports displace estimates, the earnings growth rate creeps higher and usually ends several percentage points above initial estimates. We see a chance that the final EPS growth number for 2Q26 moves up less than normal from original growth estimates, given the high bar entering the reporting period.

The money center banks, as they always do, led off the reporting period -- and results from the group were solid. These companies -- including JPMorgan Chase, Bank of America, Morgan Stanley, Goldman Sachs, Citigroup, Wells Fargo, and others -- reported strong growth in net interest income, fee income, and capital markets activity. Argus Director of Financial Services Research Steve Biggar called out the AI-driven capex “super-cycle” that is driving investment-banking revenues at these banks, along with elevated trading revenue and solid loan growth. With about 25% of all S&P 500 Financial sector companies having reported, sector earnings are up about 20% annually. That is below forecast S&P 500 earnings for 2Q26 in the mid-20% range, but high for the Financial sector on an historical basis.

The Information Technology (IT) sector is forecast to deliver more-than-60% EPS growth for the quarter and is the prime reason 2Q26 earnings growth is expected to be so robust. Just a handful of IT companies have reported to date, along with an earnings warning from IBM. Sector fireworks are due later in July through early August, when Apple, Microsoft, and other IT giants along with Mag 7 names Amazon (Consumer Discretionary) and Meta and Alphabet (Communication Services) are set to report.

Collectively, Mag 7 companies are forecast to report 30%-plus earnings growth for calendar 2Q26. The best AI-driven growth is not likely to come from the hyperscalers, but from the companies whose hardware (semiconductors, memory & data storage, and networking) supports the transition from generative AI to agentic AI. These include memory companies Seagate and Western Digital, with forecast 90%-plus EPS growth; and networking companies Ciena, Arista, and Cisco, with 25%-50% forecast growth. Semiconductor giants Broadcom and Nvidia, which report late in the cycle, are expected to deliver EPS growth of at least 80% year over year.

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While AI and technology capture the headlines, an equally important story in this reporting quarter is across-the-board earnings strength, with sectors such as Materials, Energy, Industrials, Financial, and Utilities forecast to deliver double-digit EPS growth. Still, success in this earnings season remains reliant on Information Technology and Mag 7. Altogether, if the 40% or so of the market representing IT and Mag 7 companies adjacent sectors delivers aggregate 50%-60% growth, that alone would carry the earnings season to mid-20% growth.

Given this reliance, what could go wrong? We are not ready to call the warning from IBM a "tip of the iceberg" problem, but it certainly warrants deep analysis. IBM stated that its customers redirected spending from its mainframe and software offerings to spend on servers, storage, and other legacy products in markets it has exited. Soaring prices for memory are driving up prices for these products, and customers sought to lock in hardware buys before prices get even higher.

The AI revolution has meant riches across the technology hardware space. If the IT sector were to devolve into haves (memory sellers) and have-nots (memory buyers), robust sector earnings could slow more rapidly than most investors are anticipating.

Economic Data Solid

Inflation has been a problem for the U.S. economy since at least late 2021. Through the end of 2024, inflation was being contained gradually by a combination of aggressive central bank policy (rate hikes) and changes in consumer behavior (curbing spending, particularly for lower-tier consumers). Implementation of tariffs in the second Trump presidency created new cost challenges. But as 2025 progressed, companies showed signs of adopting and mitigating cost pass-alongs to consumers.

The war with Iran has created new inflation pressures, while rekindling existing challenges related to tariffs and other factors. June 2026 data, however, provided the most encouraging news on pricing since the war began. The Consumer Price Index (CPI) for June declined 0.4% month over month after rising 0.5% on a monthly basis in May. The annual change in the all-items CPI was 3.5%, down from an annualized 4.2% increase in May. The chief contributor to the monthly decline in the June CPI was the cost for energy, and specifically a 9.7% decline in gasoline prices from May levels. The core CPI (excluding food and energy) was unchanged in June from May levels and rose 2.6% from a year earlier, compared with the annual change of 2.9% reported for May.

The all-items Producer Price Index (PPI) in June declined 0.3% month over month and gained 5.5% on a year-over-year basis; the annual change was 6.5% in May 2026. On a core basis, which strips out food, energy, and trade services, June PPI rose 0.1% monthly and 5.1% annually, matching the annual change as of the end of May. As with CPI, the improvement in June all-items PPI was driven by lower energy and gasoline costs.

The respite from inflation could prove temporary, particularly if the war in Iran continues to intensify. As an offset, other parts of the U.S. economy seem to be in solid shape. Nonfarm payrolls growth slowed in June while remaining positive. The three-month average is still above 100,000, and the best part of the June report was 4.2% unemployment. A fully employed consumer workforce is keeping retail sales moving forward. U.S. retail sales increased 0.2% in June 2026, slowing from 1.0% growth in May. June retail sales increased 6.5% year over year, rising more rapidly than inflation measures over the past 12 months.

Within the first-quarter GDP report, PCE (personal consumption expenditures, or consumer spending) was positive but similarly restrained, rising just 0.5%. Nonresidential fixed investment (corporate spending) rose 10.6% in 1Q26, reflecting all-in investment in the AI economy. Government spending also contributed to 1Q26 GDP growth, mainly reflecting recovery from the government shutdown-impacted fourth quarter of 2025.

We see some risk that GDP growth has become too reliant on AI and not reliant enough on consumer spending. According to the GDPNowcast from the Atlanta Federal Reserve bank, second-quarter 2026 GDP is expected to show a much better balance between corporate and consumer spending. The Atlanta Fed is forecasting 2Q26 GDP to grow at an annualized rate of 1.7%. Compared to 1Q26 GDP, consumer spending and business spending are each expected to contribute about 1.6 percentage points to 2Q26 GDP growth. Also in this forecast, net exports are expected to reduce total gross domestic spending by more than one percentage point.

Industrial economy indicators have become less stable, which we attribute to disruptions from the war. New orders for U.S. manufactured durable goods declined 4.5% in May, but that followed an 8.5% jump in April. Excluding the volatile transportation category, durable goods order growth of 1.3% in May was in line with April's 1.4% gain. Sentiment among business executives reflects confidence and optimism. According to the Institute for Supply Management (ISM), purchasing managers' reports (PMIs) for both the manufacturing and service economies are clearly in expansionary territory.

While business leaders are confident, consumers remain cautious. Consumer sentiment data from the University of Michigan has come off lows, but remains far below trends in recent years. That partly reflects a housing economy that in much of the country is operating at about half of its historical rate.

Conclusion

Earnings are beating sky-high expectations, inflation showed notable improvement in June, and overall data indicates the domestic economy is moving forward. That should be a recipe for a rallying stock market. But stocks are not cooperating. Ahead of the market open on 7/20/26, the S&P 500 in the 7,450 range was down about 1% over the past month and approximately level with the mid-May level. The index is about 2% below its all-time high reached in the beginning of June, when negotiators were progressing toward what felt like a lasting truce between Iran and the U.S.

The strong earnings growth is likely to accelerate across August as technology heavy hitters report. Even if inflation worsens again in the July CPI and PPI reports, underlying U.S. economic growth is likely to continue. But the war with Iran and its related threats of worsening energy inflation and global instability remain the chief overhangs for the stock market across mid-year and into early autumn.

Jim Kelleher, CFA,
Director of Research

KEY ECONOMIC FORECASTS

- The $32 trillion U.S. economy remains on course for productive long term growth, powered by corporate investments in Artificial Intelligence. Nvidia CFO Colette Kress estimated, on May 20, that AI infrastructure spending is on track to reach $3 - $4 trillion annually by the end of this decade.
- 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.
- Our 2026 gross domestic product growth forecast is 2.3%. Our 2027 forecast is 2.4% In the Monetary Policy Report to Congress, the Federal Reserve said, “Overall, economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East.”
- National gasoline prices once again exceed $4.00 a gallon as fighting between the U.S. and Iran has resumed. Gas prices below $4.00 are important to consumers with back-to-school shopping underway and the holidays around the corner. Inflation is likely to be a key issue in fall elections for control of the House and Senate.
- 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 7.7% from 6.9% in January. Unemployment is low at 4.2%. CPI eased to 3.5% in June from 4.2% in May but could be pressured with higher oil.
- We are monitoring financial conditions and high-frequency indicators. They show ongoing economic resilience and financial system stability that accommodates saving, borrowing, and investing.
- Argus expects S&P 500 EPS to rise almost 25% to $340 in 2026 and increase about 15% to $390 in 2027. EPS is helped by an increase in operating margins to about 19% this year, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 47% and 64% respectively while Dow stalwarts Walmart and Caterpillar earn 4% and 17%. Argus expects the S&P 500 to trade in a range of 6,730-8,225 over the next 12 months. Our year-end 2026 price target for the S&P 500 is 8,000 based on a multiple of 20.5-times our 2027 EPS estimate.
- Argus Fixed Income Strategist Kevin Heal expects the Fed to maintain the funds target at 3.50% to 3.75% in 2026 and reduce the target by 25 basis points in the second half of 2027 as inflation is likely to abate. We expect the dollar to be slightly stronger in 2026 driven by foreign demand for shares of innovative U.S. companies and continuing economic growth.
- Gold is likely to remain at elevated levels amid global uncertainty. The safe-haven asset topped $5,000 an ounce in 1Q, but it has declined to approximately $4,100. Prices may have declined because the Fed has stressed its resolve to fight inflation.
- What could go right? Low unemployment, spending by wealthy consumers, strong S&P earnings, strong capital investment in Artificial Intelligence, productivity gains, and ongoing innovation.
- Risks: Strains on affordability from years of elevated inflation, uncertainty related to hostilities with Iran, a lower 10-year Treasury yield could depend on deficit reduction, a weak housing market, low income consumers are struggling, spending by affluent may depend on stock market gains.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
16-Jul	Retail Sales	June	**7.3%**	6.2%	NA	**6.7%**
	Retail Sales ex-autos	June	**7.9%**	6.0%	NA	**6.9%**
	Business Inventories	May	**2.8%**	3.1%	NA	**3.1%**
17-Jul	Housing Starts	June	**1,199K**	1,400K	1,310K	**1,427K**
	Import Price Index	June	**6.6%**	6.3%	6.7%	**7.1%**
	Industrial Production	June	**1.6%**	1.3%	NA	**1.1%**
	Capacity Utilization	June	**76.1%**	76.1%	76.1%	**76.1%**
	U. Michigan Sentiment	July	49.5	50.5	51.0	**54.4**
20-Jul	Leading Index	June	0.1%	0.3%	NA	**-0.2%**
24-Jul	New Home Sales	June	580K	625K	600K	NA
27-Jul	Durable Goods Orders	June	-4.3%	8.5%	NA	NA
28-Jul	Consumer Confidence	July	91.2	91.0	NA	NA
30-Jul	GDP Annualized QoQ	2Q "Advance"	2.1%	2.0%	2.0%	NA
	GDP Price Index	2Q "Advance"	3.6%	3.8%	NA	NA
	PCE Deflator	June	4.1%	3.7%	NA	NA
	PCE Core Deflator	June	3.4%	3.3%	NA	NA
	Personal Income	June	3.8%	3.9%	NA	NA
	Personal Spending	June	6.3%	6.1%	NA	NA

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