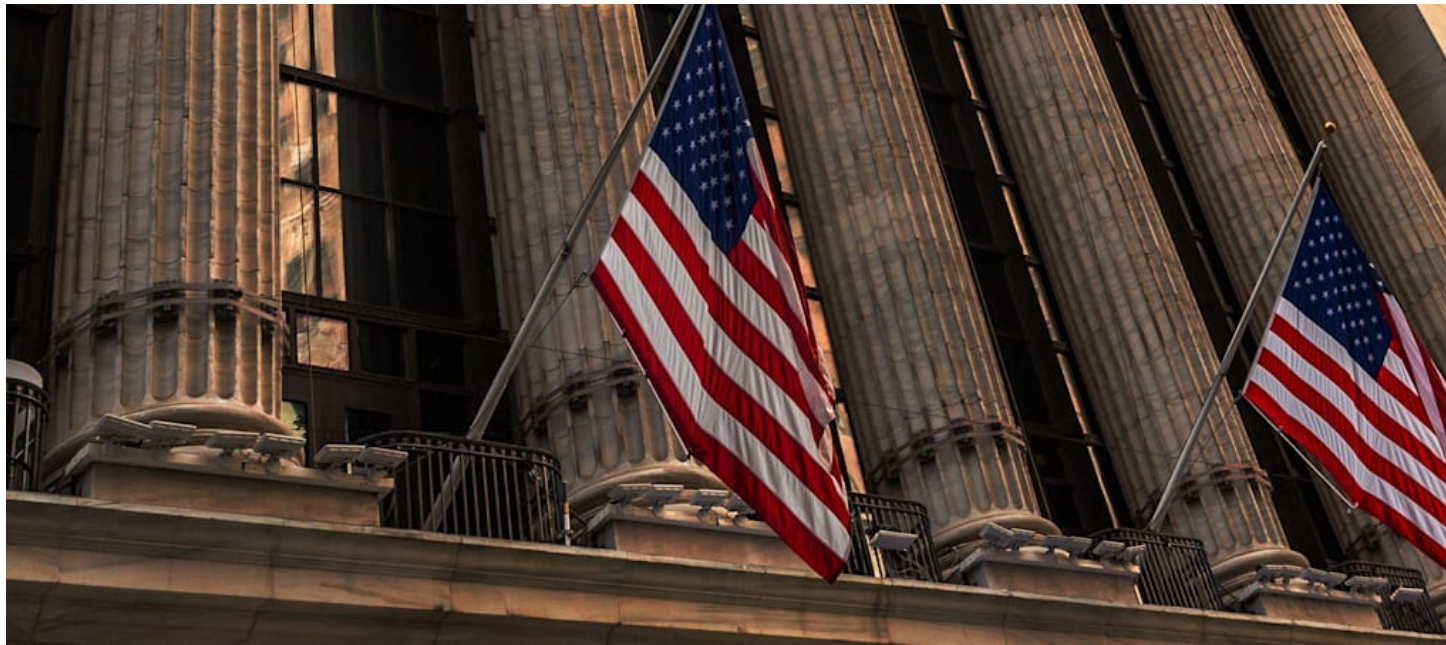


2026 U.S. Equity Outlook

Third Quarter



Key Takeaways

1. **Growth Stocks:** Market volatility is likely to continue under current conditions. However, this shouldn't overshadow the significant opportunity we see for patient, long-term investors.
2. **Value Stocks:** Energy supply disruptions can move markets quickly, but supply takes longer to normalize — shaping prices, profits, and long-term opportunities.

[Explore Our Outlook](#)

Growth Stocks

Opportunities Require Patience Amid Stock Market Volatility

We believe we are in a remarkable period of investment opportunity, but it will likely be marked by significant volatility.

Stocks are at record highs, while we're at historical extremes in market concentration and momentum. Some consolidation and pullback are to be expected. Inflation, interest rates and the possibility that companies fail to meet sky-high earnings expectations are clear risks.

Meanwhile, we see significant innovation across the economy, which we think could likely create long-term growth opportunities in many areas, such as [artificial intelligence \(AI\)](#).

We also see opportunities beyond direct AI investments. These include the space industry, biotech innovation, digital advertising, and a resurgence in certain software stocks. Industrials are performing well, with robotics and physical AI as key themes, along with power generation and distribution.

Our message is straightforward: In times of change and opportunity, patience is a valuable virtue.

What Factors Could Drive More Market Volatility This Year?

War. Inflation. Interest rates. AI disruptions. A “[silver tsunami](#)” of demographic shifts. Soaring federal debt and deficits. Leadership changes at the Federal Reserve (Fed). Incredibly narrow stock market gains. Taken together, these factors point to a market environment where volatility is likely to remain elevated.

While we recognize these challenges, we don't believe they should alter your investment goals.

Remember, investing is a marathon, not a sprint. The biggest financial goals — funding retirement, a bequest or a child's education — span decades. So try to focus on your financial future over short-term market fluctuations.

How Are Strong Corporate Earnings Influencing Markets?

The good news is that corporate earnings, the bedrock of stock returns, have been excellent.

According to FactSet, quarterly earnings for the S&P 500® Index as of March 31 were the best since the fourth quarter of 2021. Back then, the economy was rebounding from the COVID lockdown.

Today, [a series of Fed rate cuts](#), lower taxes and unprecedented AI investments led to the economy's fastest annual growth in a year and a half during the first quarter.

This rosy earnings picture isn't without a potential thorn, however. Expectations are that this stellar growth will continue. Slower economic growth or anything that threatens lofty future earnings will almost certainly lead to market volatility.

How Do Earnings Affect Stock Valuations?

Corporate earnings also drive valuations, as measured by price-to-earnings (P/E) ratios. While it's true that stock prices have jumped, it's wrong to focus only on the numerator. That's because the denominator, the "E" in the P/E calculation, has surged as well.

Powerful earnings gains mean valuations for growth-oriented companies are attractive relative to the broader market, despite the recent price runup. The large-cap Russell 1000® Growth index's valuation is actually below the 10-

year historical average relative to both the S&P 500 and Russell 1000® Value index as of May 31.

Valuation in the Context of the Corporate Lifecycle

We further contend that, on its own, valuation can be a simplistic argument. Specifically, growth-focused companies tend to be “expensive” early on due to the significant investments they make to expand.

We would expect an early-stage company to show zero or negative profitability because revenues haven’t yet matched the capital invested. It’s also true that the significant use of cash to build the business is likely to result in a lower-quality balance sheet (more debt) in the short term.

High Inflation and Rate Uncertainty Are Sources of Volatility

Mentioning debt and corporate balance sheets brings us back to the issue of interest rates and, by extension, inflation.

Rates and inflation are linked because the higher the inflation, the higher the interest rate bond investors demand. In addition, short-term interest rates are the Fed’s main tool for keeping prices in check.

Unfortunately, inflation is running well above the Fed’s stated 2% target. That’s been bad for stocks, as many investors had been expecting more rate cuts. But now, according to the minutes of the latest Fed policy meeting, a majority of Fed officials think a rate hike might be in order.

Consider that the Personal Consumption Expenditures (PCE) index, often cited as the Fed’s favorite measure of inflation, is running at a 3.8% annual rate through April. The Consumer Price Index (CPI) is running even hotter, at a 4.2% annual rate as of May.

That's the fastest rate of CPI inflation in three years, since prices were accelerating amid the stimulus and trade disruptions of the post-COVID period.

Long-term bond investors have also pushed borrowing rates higher. The yield on the 10-year Treasury note has risen from below 4% in February to 4.5% today. That matters because most corporate borrowing is priced at a premium to the 10-year Treasury.

Can Growth Stocks Respond Differently to Inflation?

We all lived through the market and inflation shock of 2022. We know that stocks can suffer during periods of high or rapidly rising inflation.

Nevertheless, we believe that, over the long term, growth equities can help offset the impact of inflation. We think that's true for stocks of competitively well-positioned companies with pricing power.

We aim to invest in companies that generate sustainable corporate earnings growth over time, powered by enduring competitive advantages and strong management teams. One dimension of quality corporate management is foresight in considering the lifetime value of its customers relative to short-term profit. These management teams frequently avoid "overearning."

Said differently, they provide more value than they charge for in the short term. Companies with a very strong value proposition are more likely to be able to raise prices to defend their profit margins.

Companies that manage supply chains and input costs more effectively should also fare better, all else equal. More innovative firms with new and unique products should outperform those with less differentiated, more commoditized offerings.

A key takeaway is that companies are not created equal. Some will deal with high and rising inflation better than others.

Why Are Growth Stocks Sensitive to Rising Interest Rates?

It's also true that, in the short run, growth stocks are negatively correlated with rising interest rates. Of course, this tends to be true of the broader market as well.

We've already laid out the economic rationale for this — higher rates increase debt-servicing costs and curtail spending on new projects.

Higher rates and inflation also mean that cash flows today are more valuable than those in the future. That's a problem for growth stocks, whose primary appeal lies in the potential for future cash flows. So you can see why some investors reflexively sell growth stocks when interest rates rise.

But we believe that high-quality, well-managed growing companies with large addressable markets are likely to survive and thrive over time. This holds true regardless of short-term interest rate fluctuations.

This is precisely why our focus is on the company's fundamental quality and its long-term business opportunity.

Why a Long-Term Investment Approach Is Important During Market

Fluctuations

We're not investing for a horizon of a few days, months or even quarters — our horizon is many years long. We're not trying to outperform every day or at every point in the economic and market cycle; we're trying to outperform across the full market cycle.

So, when market volatility occurs, we do feel disappointed in the short term. However, we also view these downturns as potential opportunities to buy incredibly innovative companies at a discount.



Keith Lee, CFA

Co-Chief Investment Officer

Global Growth Equity

Value Stocks

Energy Disruption May Lead to Structural Opportunity

The war with Iran has put a spotlight on the global energy supply — and on how difficult it can be to restore it once disrupted. Markets tend to react quickly to headlines, whether they signal rising tension or signs of de-escalation.

But the underlying system moves on a different timetable. Ultimately, what matters most is the steady flow of oil through key routes, such as the Strait of Hormuz.

Rebuilding inventories after these flows are disrupted also takes time. Even if tensions ease and ships start moving again, a reliable supply does not return overnight. Markets may price in improvement quickly, but the physical recovery tends to take longer.

That gap between perception and reality can influence pricing, capital decisions, and how energy is produced, moved and delivered over time.

Reopening Isn't the Same as Recovery

Reopening the Strait would be an important step, but it would only be a first step. Before oil flows return to normal, several conditions must fall into place.

Shipping companies need confidence that it's safe to operate. Tankers must return. Insurance must become available again. Buyers need to step back in.

Then there is the production side. In some cases, operators have had to halt oil production because they couldn't move or store it. Restarting production isn't always quick. Wells must be brought back online carefully, and infrastructure may require repairs.

All of that takes time. Even after shipments resume, flows can remain uneven. Inventories may continue to decline before they start to rebuild.

A Slower Recovery Can Support Energy Sector Profits

If supply takes longer to normalize, the support for oil prices can last longer than many expect. Governments and producers may use reserves or existing stockpiles to soften the immediate impact. Rather than eliminating the problem, actions like these tend to spread it out over time.

That environment can support profits across parts of the energy sector. Companies that produce oil directly tend to benefit first, as higher prices translate into stronger cash flow. Refiners can also benefit, depending on the spread between input costs and finished products.

Other parts of the industry may take longer to feel the impact. Companies that provide equipment, technology and services to energy producers often don't benefit immediately from price changes.

Over time, the picture can shift. If countries invest more to expand supply or improve energy security, demand for these services can grow. Pricing power may improve as well. In that environment, differences in business models, capital discipline and cash flow durability may become more important.

The Bigger Story May Be Structural Change

History suggests that disruptions to global energy supply — from the oil shocks of the 1970s to more recent events like the Russia-Ukraine conflict — tend to highlight vulnerabilities. They often push governments and companies to rethink how they source and move energy.

The more important question may not be what happens over the next few weeks. It may be what changes over the next few years. Disruptions like this can expose weak points and accelerate decisions that might otherwise have taken much longer.

Countries that rely heavily on imported energy may seek to develop more of their own resources. Others may diversify their supply, looking beyond the Middle East. Regions like Latin America may become more important.

Producers might also consider investing in alternative transportation methods or contingency strategies. While these options aren't flawless, they can help minimize dependence on critical chokepoints.

While these shifts wouldn't happen quickly, they could create long-term opportunities. Companies involved in finding and developing new energy supplies may see increased demand. Regions with established resources may attract more investment. The global supply base may become more diversified.

For long-term investors, shifts like these can expand the opportunity set, particularly where the market has yet to fully reflect how supply and investment patterns may evolve.

Looking Beyond the Headlines

The near-term path for energy markets remains uncertain. Prices may continue to react to changing headlines.

For long-term investors, we think a different question matters more: how supply recovers and what that means for the future.

The pace of recovery, inventory rebuilding, and producers' response will shape the outlook. Those factors tend to matter more than short-term market moves.

Over time, this adjustment can create meaningful differences across companies and sectors. Those differences may matter most where longer-term fundamentals aren't fully reflected in current expectations — an environment that can reward patient, valuation-focused investors.



[Kevin Toney, CFA](#)

Chief Investment Officer

Global Value Equity