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Midsummer Outlook

HAVERFORD

QUALITY INVESTING

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Halfway through the year, the market-moving themes we identified in January are coming into sharper focus.

Corporate earnings have exceeded expectations, the AI investment cycle is broadening into a major infrastructure buildout, and the labor market has remained more resilient than many economists anticipated. At the same time, market leadership and earnings growth remain concentrated in AI-adjacent companies, inflation has been lifted by energy prices, and a new Federal Reserve chair wants to reshape how policy is communicated and implemented.

Here is our update on the key forces shaping the economy, policy, and markets over the next six months and beyond.

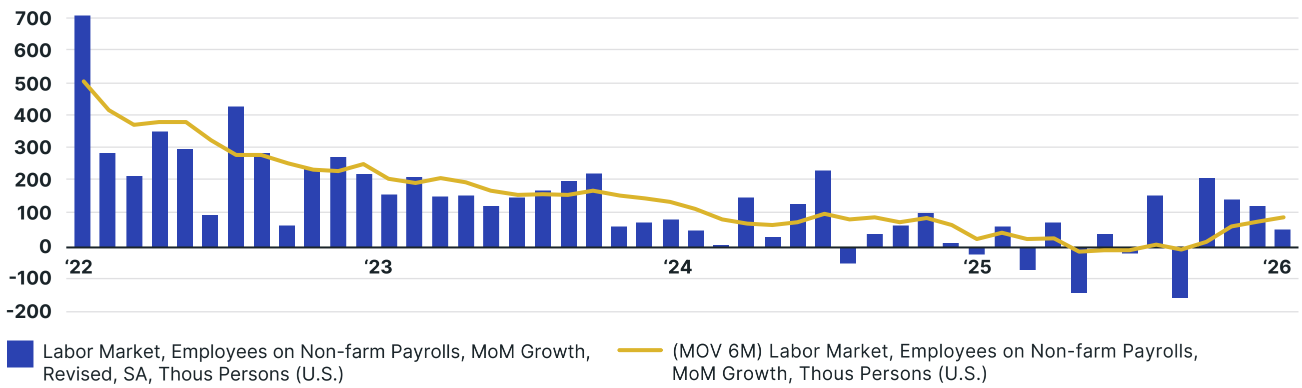
01

Despite widespread concerns of AI-driven job displacement, employment continues to expand and unemployment remains low.

Persistent concerns that artificial intelligence will begin displacing large numbers of workers have yet to materialize. The most recent employment report showed nonfarm payrolls increased by 57,000 in May, while average monthly job growth has exceeded 92,000 per month so far this year. Meanwhile, unemployment has remained steady at historically low levels.

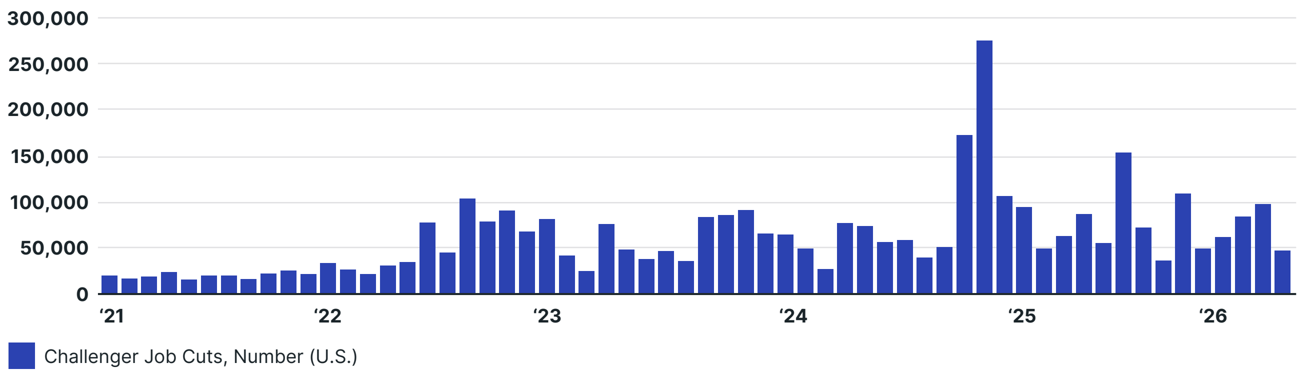
The debate surrounding AI and employment is hardly a new one. Throughout history, each major technological breakthrough—railroads, electricity, computers, and the internet—generated fears that machines would replace workers. Speaking about automation in the 1960s, President Kennedy described it as one of the most important economic challenges facing the country. Yet he also recognized its potential to create greater prosperity.

Employment Trends



Source: FactSet, June 30, 2026. SA is seasonally adjusted.

Layoff Announcements Have Risen but Not at Alarming Levels



Source: FactSet, June 30, 2026.

The concerns surrounding AI deserve serious consideration. The most immediate risk may not be widespread layoffs, but rather reduced hiring for entry-level and routine positions. Companies increasingly have the ability to accomplish certain tasks with smaller teams, potentially affecting demand for junior analysts, programmers, basic finance and accounting, administration, and customer support staff. This transition may prove particularly challenging for younger workers entering the labor force.

While some jobs will inevitably disappear, history suggests that technology is far more effective at eliminating specific tasks than eliminating work itself. AI is likely to follow a similar path. New industries, occupations, and opportunities should emerge as productivity improves and businesses discover new ways to deploy the technology.

Ultimately, the greatest beneficiaries are unlikely to be the companies that simply use AI to reduce costs. Instead, the biggest winners will likely be those that use AI to innovate, develop new products, improve customer experiences, and unlock entirely new sources of growth.

02

S&P 500 earnings growth continues to outpace even optimistic expectations, supported by one of the most significant capital spending cycles in decades.

One of the defining features of 2026 has been the remarkable strength of corporate earnings. At the start of the year, consensus expectations called for approximately $308 of S&P 500 earnings per share. By late June, those estimates have risen to roughly $338, representing one of the strongest periods of upward earnings revisions outside of post-recession recoveries.

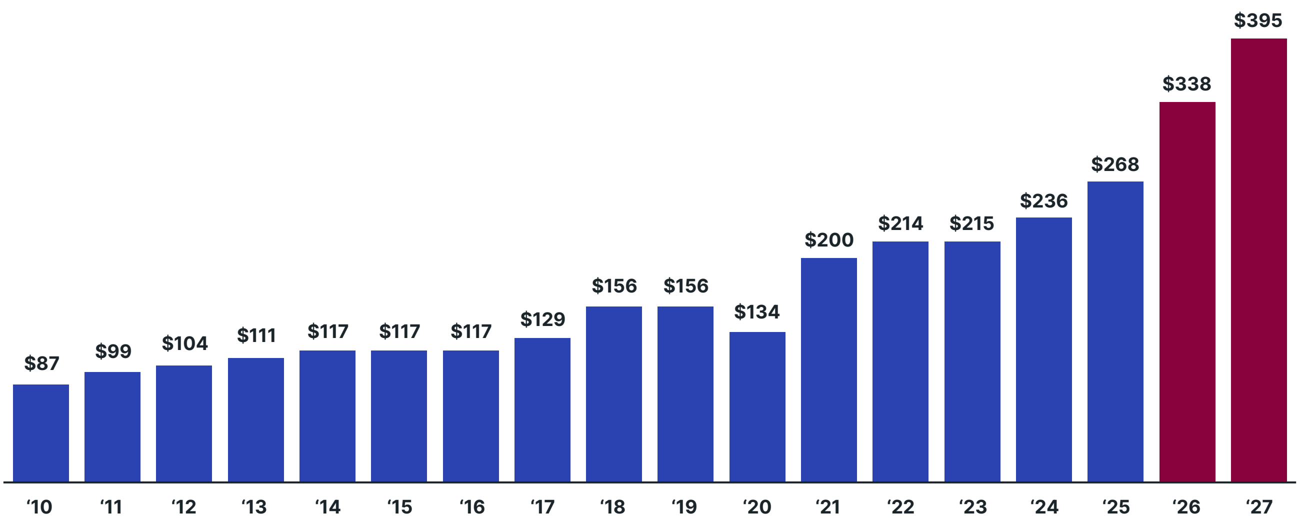
Importantly, earnings growth has accelerated even as market valuations have become more reasonable. Higher profits, not simply higher valuation multiples, have been a key contributor to equity market performance.

Much of this strength can be traced to the extraordinary investment cycle developing around artificial intelligence. Hyperscaler and neo-cloud companies are investing at a pace not seen since the internet buildout of the late 1990s. Spending on data centers, semiconductors, networking equipment, and digital modernization continues to accelerate as we prepare for an increasingly AI-powered economy.

The implications extend well beyond Silicon Valley. Utilities, power equipment manufacturers, engineering firms, industrial suppliers, and electric grid infrastructure providers increasingly view AI-related demand as a multi-year growth opportunity. Many companies serving these markets are forecasting elevated demand through at least the end of the decade.

The AI buildout is no longer merely a technology story. It has become a large-scale physical infrastructure story requiring investments in power generation, transmission networks, cooling systems, semiconductor manufacturing, and industrial equipment. If current trends persist, earnings growth could broaden across sectors and support above-trend profit growth for several years.

S&P 500 Expected Earnings per Share



Source: FactSet, June 30, 2026. EPS for 2026-2027 in red are estimates. The S&P 500 index is a market capitalization weighted index of large cap stocks. Index returns are provided for illustrative purposes. It is not possible to invest directly in an index. Index performance assumes dividend reinvestment, but does not assume transaction costs, taxes, management fees, or other expenses. Past performance is no guarantee of future results.

03

The recent bump in inflation is expected to give way to lower energy prices during the second half of the year.

Inflation has proven somewhat stickier than expected during the first half of the year, but much of the recent pressure can be traced to energy costs. Higher oil prices accounted for a significant portion of the increase in consumer prices during the spring.

Encouragingly, the outlook for energy markets has improved following the de-escalation of tensions involving Iran, as oil prices have retreated toward pre-conflict levels. At the same time, OPEC+, the alliance of the Organization of the Petroleum Exporting Countries and its non-OPEC partners led by Russia, production increases and the prospect of greater Iranian exports point toward increased global supply.

Because energy costs affect nearly every sector of the economy, lower oil prices have the potential to improve consumer purchasing power, reduce business input costs, and provide relief across the broader inflation picture. While these effects have yet to fully appear in official economic data, we believe they should become increasingly visible over the coming months.

The AI buildout adds complexity to the inflation outlook. In the near term, the enormous investment required to build AI infrastructure is creating additional demand and raising prices for semiconductors, electricity, and industrial equipment. Over the longer term, however, AI's productivity benefits may become a powerful disinflationary force.

The key challenge for policymakers will be determining when the economy crosses from today's investment-driven inflationary pressures to tomorrow's productivity-driven efficiency gains.

04

Expect changes at the Federal Reserve under new management.

Leadership changes often create important inflection points for institutions, and the Federal Reserve appears no exception. Chairman Kevin Warsh has signaled that the central bank may reevaluate several practices that have defined monetary policy since the 2008 Global Financial Crisis from mid 2007 to early 2009.

Among the areas under review are the Federal Reserve's balance sheet, its reliance on forward guidance, the role of private-sector data in economic analysis, the measurement of inflation, and how productivity improvements from artificial intelligence should factor into monetary policy.

While the Federal Reserve's dual mandate of price stability and maximum employment remains unchanged, investors should expect a potentially different approach to implementation and communication.

The practical consequence may be a policy framework that becomes more flexible and responsive to incoming data, while potentially becoming less predictable than the highly transparent regime investors have grown accustomed to over the past two decades.

For markets, the most important takeaway is not whether policy becomes more hawkish or dovish, but rather that the rules governing policy decisions may themselves be evolving.

05

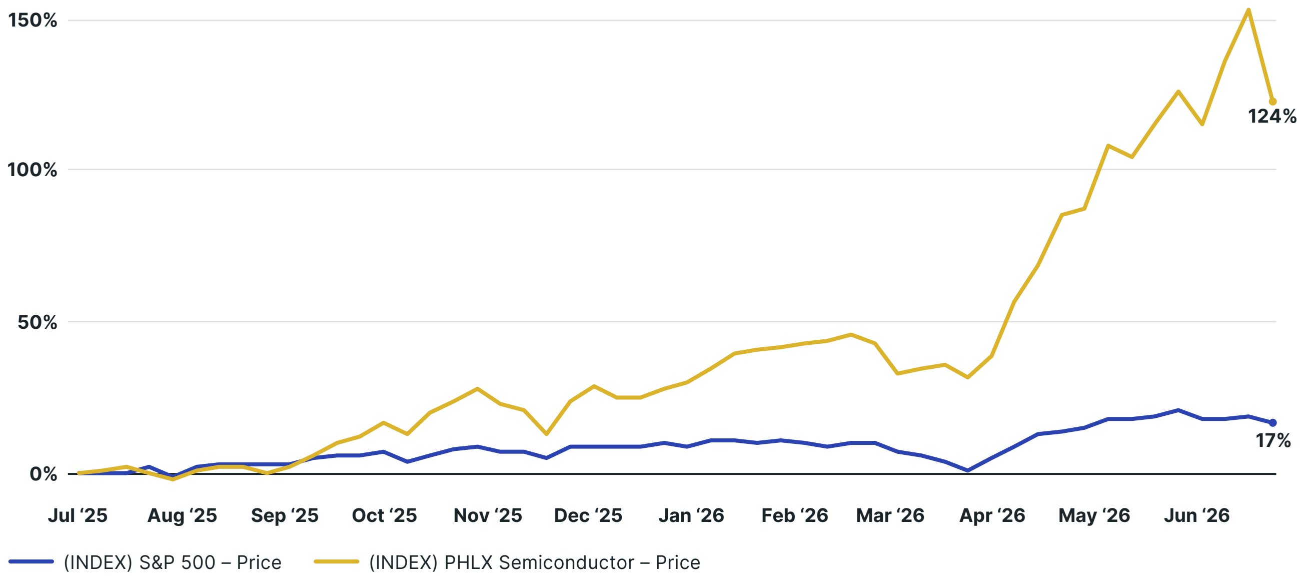
AI Infrastructure Bottlenecks driving a new cadre of market leaders in 2026.

Perhaps the biggest surprise of the year has not been the strength of AI demand, but the severity of the supply shortages emerging across the ecosystem. The memory chips market provides one of the clearest examples.

Demand for advanced memory used in AI systems has surged, leading manufacturers to shift production toward higher-value products and away from traditional consumer markets. The resulting chip shortages have pushed prices sharply higher for products such as iPhones and fundamentally changed the economics of what had historically been a highly cyclical industry.

The consequences have extended throughout supply chains. Hyperscalers are increasingly locking in years of supply through long-term agreements, while downstream hardware manufacturers face rising input costs and longer lead times.

S&P 500 vs. PHLX Semiconductor



Source: FactSet, June 30, 2026.

These shortages have created a new group of market winners. Companies tied directly to AI infrastructure, including memory manufacturers, semiconductor suppliers, networking providers, and power infrastructure companies, have generated outsized earnings growth and stock market performance. The concentration of returns in this relatively small group of technology companies has increased market volatility.

Questions remain whether supply constraints ultimately prove structural or cyclical. The industry's response, including substantial new manufacturing capacity in Asia, will likely contribute to continued volatility in the short term as markets work toward equilibrium. However, the longer-term demand trajectory is clear. The next wave of use cases, including robotics and autonomous vehicles, are meaningfully more chip-intensive than anything in today's consumer stack.

06

Looking Beyond the United States, Emerging Markets offer both diversification and AI exposure.

While U.S. equity returns remain increasingly concentrated, international markets—particularly Emerging Markets—have provided both diversification and direct participation in the AI investment cycle. Much of the world's semiconductor manufacturing and advanced technology supply chain is located in Asia. As a result, countries such as Taiwan and South Korea have become key beneficiaries of AI-related capital spending. Their leading technology companies sit at the center of global semiconductor production and continue to experience strong earnings growth.

Despite strong recent performance, many Emerging Markets continue to trade at valuation discounts relative to U.S. equities while enjoying a more favorable inflation backdrop, lower energy costs, and the possibility of easing U.S. monetary policy. For investors seeking diversification away from increasingly concentrated U.S. market leadership, Emerging Markets offer exposure to many of the same long-term AI trends while benefiting from a different valuation starting point.

Looking Ahead

The first half of 2026 reinforced a theme that has defined much of the post-pandemic investment environment: economic and technological change is occurring faster than many expected. Employment remains resilient, earnings continue to surprise to the upside, inflation pressures appear manageable, and the AI investment cycle continues to broaden across industries.

While we expect volatility to remain elevated as markets digest shifting monetary policy and rapid technological change, we continue to see reasons for optimism. The combination of healthy labor markets, strong corporate profitability, improving inflation dynamics, and unprecedented investment in productivity-enhancing technologies provides a constructive backdrop for long-term investors entering the second half of the year.

Our 2026 Outlook identified seven questions we expected to shape markets this year. At the midpoint, we offer the following perspective on how those questions are evolving.

01 Will the AI capex boom lead to broader productivity and profits?

S&P profits are expected to be up over 24% in 2026 according to FactSet estimates driven by supply shortages in the memory chips critical to AI and the agents anticipated to increase corporate productivity. It's difficult to say AI is driving productivity outside coding, but the promise remains. Earnings growth remains concentrated in the AI ecosystem, shifting from the Hyperscalers to the semiconductor stocks.

02 Will the new Fed Chair maintain independence and retain market confidence?

We could not be more pleased with Kevin Warsh's performance so far as Federal Open Market Committee chairman. We are confident he will prove to be a strong chairman and are optimistic that many of his goals to modernize the Fed will be successful.

03 Will the K-shaped economy increase volatility in a midterm election year?

Historically, the next several months bring more volatility and angst as the market attempts to handicap election outcomes. The recent success of Democratic Socialists in several elections this year could still give the market pause.

04 Will trade wars and geo-politics lead to further global fragmentation?

The war with Iran and the toppling of Venezuela's President are consistent with the Administration's stated goals to exert control over the western Hemisphere and put pressure on China.

05 Will diversification beyond the Magnificent Seven be rewarded?

Market leadership has shifted from those companies able to host and deliver the latest AI models to the semiconductor companies that control the supply of critical chips.

06 Will corporate earnings grow by double digits for the 3rd straight year?

S&P 500 earnings growth is poised to exceed 24% in 2026. While earnings growth could be described as broad-based, since all sectors of the economy are benefiting from rising earnings, the majority of the growth can be attributed to AI-adjacent corporations.

07 How will Fed rate cuts shape fixed income opportunities in 2026?

Higher energy prices and strong employment take rate cuts off the table for the remainder of 2026. Yields continue to trade in a narrow range.

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