Substantial Rebound in Q2 Included Several Best One-Month Performances in U.S. Since 2020

As has often been the case since the Covid-induced panic sell-off in early 2020, the weakness experienced in March quickly rebounded, leading to substantial pricing strength in April (highest monthly gains for S&P 500 & NASDAQ since 2020) and the second quarter overall. Q2 saw price strength in public equity markets ranging from developed markets (excluding the U.S. as measured by the EAFE index) at 9.8%, to the technology-heavy NASDAQ and increasingly tech-heavy emerging market index both posting 21% in domestic currency terms. Global stocks increased by 13.3%, lagging the U.S. S&P 500 appreciation of 14.9%. In Canada, the TSX was up a more modest 6.4% due primarily to resource sectors.

In contrast to equity markets, global and Canadian bond markets experienced muted gains, with global bonds delivering a total return in the quarter of 1.3% and Canadian bonds 1.2%.

Not all global assets increased in price. After significant price strength in the first quarter driven by the Iran conflict, WTI crude oil fell over 30%. Elsewhere, the Canadian dollar fell 2% against the U.S. dollar and gold fell 14%. As discussed in our last letter, the market had become a tug of war. High growth large cap equities on one side, and traditional heavy industrial sectors like energy and mining on the other. A barbell strategy continues to be our approach to managing an unknown future. Concentrated and one directional market positioning can work splendidly at one point and not at all the very next.

What is Driving the Market Higher

The outsized growth in technology stocks over the past four years leads one to question how similar this is to the Dot Com era of the late 1990s. At surface, similar themes include the technology sector driving returns with a revolutionary technology taking hold of a promising outlook. However, looking under the hood, and digging deeper into the economic developments over the past several years drives home a very different equation than the fundamentals ending the last millennium.

Over the past year through June 30th, the S&P 500 technology sector has appreciated 37%. Contributing to the return was a 200% increase in analyst consensus profit expectations. Negatively contributing to return was a 99% decline in the forward-year price-to-earnings multiple. The takeaway being that this market is being driven by profit and cash flow growth while valuations remain fairly consistent or even outright decline. As an example, the Magnificent-7 companies are now approaching their cheapest valuation levels in almost a decade. If you compare this to the 12 months leading into the Dot Com peak, earnings drove just 13% of the 107% price return while ever rising valuations drove 87%. That is the clear indication of a bubble – profits were not supporting stock price movements higher. Not so today. Strong job creation and recent earnings reports from global banks highlight a very strong economy with growing consumers spending, particularly in the U.S.

For another comparison, this past year looks quite different than the average dating back to 2012. One of our U.S. partners showed that the average earnings or profit revision on a one-year period (June 30 to June 30) is a decline of roughly 5%, meaning analysts forecast a year of profit, only for reality to set in with actual results being below their original forecasts. However, in the past 12 months, profit revisions for the S&P 500 have been up a very strong 13%. First quarter profits for the S&P 500 grew 29% year-over-year, the fastest since 2021.

This trend has become pronounced when looking back to 2011. When our team broke down what percentage of the stock market's earnings were above, in line or below analyst estimates, there is a visible move higher in earnings that exceeded analyst forecasts. 25 years ago, roughly 20% of companies reported below forecasted profits, another ~10% reported results in line, and less than 70% reported results above expectations. Today that split is 10% below, 5% in-line and 85% ahead. As companies provide outlooks of their budgets and expectations, the math clearly indicates even the company executives themselves have been increasingly surprised by the magnitudes of their financial strength and operating performance.

The Causes of Recent Market Weakness

Oil prices are a key driver of global inflation levels. As a result, the direction of inflation has been volatile with crude prices increasing by nearly 100% earlier in 2026, only to erase nearly all of their gains by end of June. More recently, with renewed conflict in the Middle East and the latest agreement seemingly not being met, crude continued an aggressive climb higher during the month of July.

Generally, rising inflation is negative for asset prices. When inflation runs hot, Central Banks either begin increasing interest rates (as in 2022) or hold rates steady when perhaps cuts had been expected (what we have seen in 2026 so far). Looking back to 1954, breaking inflation into buckets, we see that the valuation level awarded to the stock market is directly impacted by the amount of inflation in the economy. The highest valuation levels occur when inflation is somewhere between 0% and 4% and then begins falling as inflation moves higher. For instance, in the U.S. market, inflation between 2% and 4% commands nearly 20x earnings on average, double the 10x earnings multiple awarded when inflation is greater than 8%. Today inflation was hovering around 4% prior to the July move higher in crude being reflected in future monthly inflation figures.

The outcomes of the Iran conflict will have a direct impact on equity and bond market performance, which have generally been moving in the same direction since 2022. A stark contrast to their longer-term relationship of moving in opposing directions, with bonds becoming acutely strong during stock market weakness.

Adding to the negative backdrop of crude oil supply being constrained from Iranian and U.S. aggression, there are concerns related to the artificial intelligence capital spending cycle that run contrary to the results we have seen to date as outlined above. Some are well documented, including circular financing arrangements taking place. Other, more nuanced concerns, are something that we and our partners are following with extreme attention. With the IPO of SpaceX behind us, Anthropic is about to begin its “testing of the waters” process, meaning the company will allow a handful of the world’s largest investors to see under the hood of its financial and operating performance to ascertain interest in its imminent initial public offering. We expect the IPO sometime in September based on recent partner discussions.

While we do not have nearly enough information to draw conclusions on the company today, through our global network of partners we have come to understand its growth in both paying consumer and enterprise level customers is unseen at this level and duration. Simply put, in the months ahead, we may be reviewing one of the most dynamic growth stages of any company in history that is driving a significant portion of capital spending on data centers. Following Anthropic, it is widely anticipated OpenAI will tap global public equity markets. The plight of these two AI giants follows the public launch of Grok through SpaceX. Our data driven partnership feedback loops are likely to refine their outlooks and probabilities following disclosure from the world’s largest AI companies. For now, the data is not driving significant de-risking of client portfolios, although our current risk positioning is below global equity market levels.

Closing Thoughts

For the past four years, there has been a fairly stable trend line for portfolio performance. To end 2025 and begin 2026, we have seen trend duration shorten significantly. This market is oscillating sideways with the winner of one month or quarter different than the last. Our portfolio construction is purpose built for these environments. Asset allocation will drive the majority of our client returns, but our barbell positioning within each of fixed income, public equities and alternatives portfolios further diversifies risk and return opportunities.

As always, reach out to your BWM representative if you have any questions.

Bessette Wealth Management

July 29, 2026