

Q3 MARKET AND ECONOMIC OUTLOOK

Beyond the Rally: What We're Watching in Q3

The first half of 2026 has been a positive one for stock markets. The Dow Jones Industrial Average, S&P 500 and Nasdaq Composite returned 9.8%, 10.2% and 13.1%, respectively, through June, while U.S. small-caps outpaced them all with a gain near 23%. Emerging markets stocks were the standout performers on both a year-to-date and trailing 12-month basis, a reminder that leadership can shift quickly after years of U.S. dominance.

Heading into Q3, the question is how much further the rally can run, given rising valuations and geopolitical uncertainty.

Q3 Outlook Takeaways

- The Federal Reserve remains on hold under new Chair Warsh, with the committee now more focused on the risk of interest-rate hikes than cuts as inflation stays elevated.
- Earnings growth is broadening beyond the Magnificent Seven, with the technology, defense and energy sectors leading, and financials, industrials and health care showing improvement.
- June inflation data offered the first real relief in months, though price levels remain uncomfortably high.
- The U.S.-Iran ceasefire has broken down, and a fresh round of proposed tariffs on Canadian goods has reopened trade tensions—both add uncertainty to the inflation and growth outlook.
- Midterm election campaigning will increasingly dominate headlines over the coming months, but election results are not typically a reason to depart from long-term positioning.
- Maintaining diversification and balancing risk factors in portfolios will be key to our approach over the second half of 2026.

The Fed Holds the Line

New Federal Reserve Chair Kevin Warsh took office with the expectation that he'd create a faster path to rate cuts, but he has since tempered that tone, emphasizing responsible policy in the face of inflation that remains well above the Fed's 2% target. The rest of the committee appears more focused on the risk of hikes than cuts, a meaningful shift from where sentiment stood earlier in the year.

June's inflation data offered something of a reprieve: The consumer price index fell month-over-month for the first time since 2020, and the year-over-year increase came in below expectations at 3.5%. That said, one month of cooler data doesn't make a trend, and recent events are complicating the picture.

Geopolitics and Trade Add Fresh Uncertainty

The U.S.-Iran ceasefire, which had offered markets some relief through the spring, has broken down. The U.S. and Iran have resumed direct strikes on one another, and disruptions to shipping through the Strait of Hormuz have picked back up, pressuring energy prices and reintroducing the kind of geopolitical volatility investors had started to look past.

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Trade tensions are also rising, with the Trump administration planning to impose steep new tariffs on a range of Canadian goods starting in August. While these tariffs may face challenges in the courts, the resumption of trade wars is worth watching.

Together, these developments could send costs to consumers and businesses higher once more—gas prices are already ascending from recent lows. According to Moody's, the Iran war has cost the average American household an estimated $1,100 to date.

Earnings Are a Positive

Earnings have been a consistent bright spot. Growth remains strong as we move into the back half of the year, and importantly, the story is no longer just about a handful of mega-cap technology names. Financials, industrials and health care companies have all posted encouraging results alongside continued strength in the technology, defense and energy sectors, even as companies work through higher input costs tied to lingering geopolitical and trade uncertainty.

AI-related capital spending continues to lift areas of the market well beyond the largest tech names, though investors are increasingly demanding proof of monetization rather than promise alone—a dynamic that showed up clearly in recent weeks as strong results from bellwethers were met with tepid stock reactions.

Fixed Income: Higher Yields, for Now

Yields reset higher this year as rate-cut expectations faded and inflation concerns resurfaced. This has created a more attractive entry point for income-oriented investors, as higher yields can increase income and total return potential over time. Investment-grade corporate and municipal bonds currently offer higher yields than in recent years, which may help provide income and diversification benefits, although bond investments remain subject to interest-rate, credit and market risks.

What We're Watching, and Our Approach

Beyond the risks and positive earning trends we explored above, midterm election campaigning will increasingly work its way into the headlines this fall. We wouldn't be surprised if that creates pockets of short-term volatility, or at a minimum, a distraction from market and economic fundamentals. While we are mindful of potential policy shifts or new laws that could affect your long-term wealth strategy, we typically do not view election outcomes as investable events.

None of this changes our underlying approach heading into the third quarter. Markets can, and often do, remain ahead of themselves for longer than seems reasonable, and valuation concerns are rarely a catalyst in isolation.

Our focus stays on the fundamentals we can control in your plan: diversification across geographies and market capitalization, awareness of concentration risk in both individual portfolios and the broader index, and a financial plan grounded in cash-flow analysis and liquidity planning so that market cycles don't dictate your decisions. We remain optimistic about the opportunities ahead, tempered by our goal to manage exposure to risks in your portfolios.

As always, your RWA team is here to help you make sense of what's happening and how it relates to your plan—please don't hesitate to contact us with your questions.

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