



Financial Markets Perspective

July 2026

It's Déjà Vu All Over Again

The Global Economy

Three months ago, we began this perspective with an evaluation of the outcome of the US-Iran conflict. So far, it looks like not much has changed, with peace talks on again, off again. As a result, uncertainty surrounding the impact of the closure of the Strait of Hormuz witnessed a surge in oil prices to over \$92 a barrel (West Texas Intermediate Crude). However, peace talks seemed to be on again, attacks were suspended, and oil prices plummeted to below \$70 in June. At this point, there is no clear outcome, and periodic battles may resume with an attendant effect on oil prices.

Even with the volatility and uncertainty imposed by the initial tariffs on virtually all countries that export to the U.S., turmoil brought about by the backlash against illegal immigration, and wars in Europe and the Middle East, the U.S. economy continues to grow at a modest pace. After a 2.1% gain in the first quarter, second quarter expectations are running around 1.5 to 2%. If it were not for the boost from huge infrastructure build-out in the AI space, the economy could be in a different position. As AI continues to gain prominence not only in the US but around the world, expectations are rising for a better global economy through higher productivity and receding inflation.

The outcome of the war in Ukraine is uncertain. The four-year conflict has had a dramatic effect on the conduct of war. The introduction of drone warfare has changed what would be defined as the front line. Both sides remain committed to their objectives, and although Russia is the larger of the combatants, Ukraine's technology is allowing the country to gear up to continue the battle. Growing successes on the battlefield by Ukraine may increase the chances of a peace settlement sooner, rather than later.

One unintended benefit of these wars is a change in attitude regarding defense spending. Already, President Trump is talking about a defense budget of \$1.5 trillion. Europe is upping the commitment to build up defenses against a potential enemy to the East, and several Middle East oil-producing nations are upgrading the ability to defend themselves against further attacks by Iran or its proxies. All these commitments require multi-billion-dollar expenditures to expand war-waging capabilities and, in turn, will translate into orders for defense companies, increased exports of oil and gas to European countries that are reducing oil and gas purchases from Russia, and the motivation to upgrade both offensive and defensive weapons systems.

Interest Rates and Fixed Income Markets

Given international turmoil and the impact of tariff decisions on the economy, interest rates remained relatively stable for the first half of the year. The Federal Reserve did not change the target rate for fed funds, holding the range between 3.50 and 3.75%. The recently appointed Chairman of the Fed, Kevin Warsh, has announced his intention of making some management

changes in the conduct of monetary policy. He said that the Fed would no longer telegraph changes that might be influencing financial markets. From our perspective, the Fed is taking a wait-and-see attitude about near-term changes in interest rates, which could lead to a less volatile interest rate environment. Over the past year, the ten-year government bond yield has remained stable, and stable interest rates have led to more financial transactions. This stability provides the underpinning for a growing economy as long as interest rates remain in a reasonably narrow range.

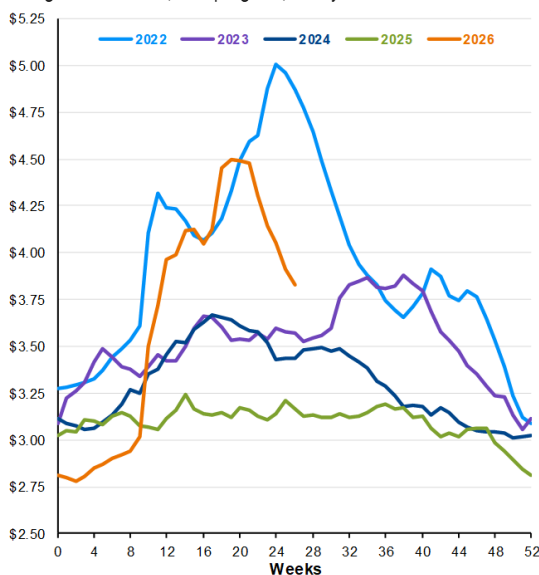
Current Inflationary Environment

Investors have become increasingly sensitive to the outlook for inflation. Yet, growth stocks, which are sensitive to rising inflation, have been driving the market higher. One reason might be that investors see this short-term burst in inflation as temporary, driven by oil prices. Once oil prices return to pre-war levels, inflation may drop back to the 2-3% level even though tariffs could continue to keep inflation from falling further. Longer term, most economists expect inflation to average around 2.2% to 2.6% over the next ten years.

Ever since the oil embargo imposed by OPEC in 1973, the US has experienced major bouts of inflation triggered by surging oil prices. Unfortunately, for the US consumer, higher prices accrued to Arab wealth as the US had to import substantial amounts of oil. Today the circumstances are different, and, due to fracking, as you can see in the charts below. The US has become an exporter of oil and liquefied natural gas. So current oil prices benefit domestic producers because of higher oil prices.

Retail gasoline prices

All regular formulations, USD per gallon, weekly



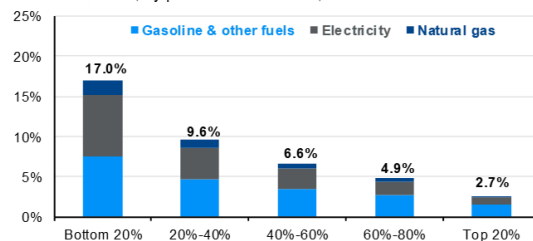
U.S. net imports of petroleum and related products*

% of nominal GDP, quarterly



Consumer expenditures on energy

% of total income, by pre-tax income cohort, 2024



Global Stock Markets

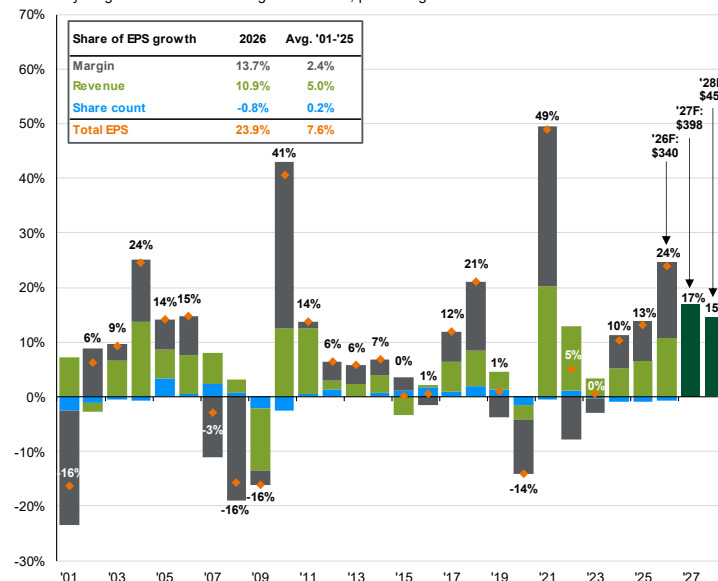
Domestic stock markets have been hitting record highs during the second quarter after a surprising surge in first quarter earnings growth, especially among the companies benefiting from the AI expansion of infrastructure (see charts below). Ongoing regulatory reductions, as promulgated by the Trump Administration, are helping boost productivity, as are broad-based blue-collar tax cuts, which have helped the middle class withstand the near-term surge in oil

prices. History tells us that a strong stock market is a good predictor of a better economy in the months to come.

For investors, the strong performance of equity markets around the world is creating wealth that will benefit global growth. While tariffs have effectively increased taxes on consumers, the increase in foreign investment in the U.S. to avoid those tariffs is contributing to our economic growth. Sharp increases in corporate profit margins are testimony to how domestic companies are benefiting from a combination of improving productivity, partially due to the implementation of AI, lower regulations, and an improving competitive environment.

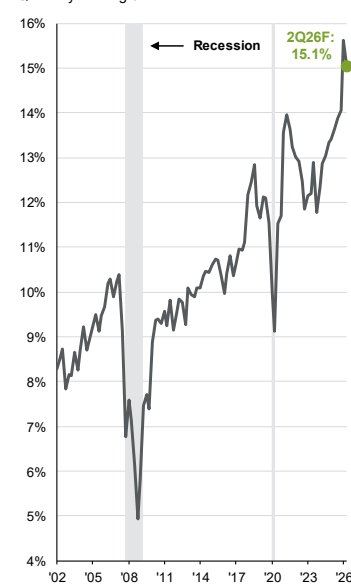
S&P 500 EPS growth

Year-over-year growth broken into changes in revenue, profit margin and share count



S&P 500 profit margins

Quarterly earnings/sales

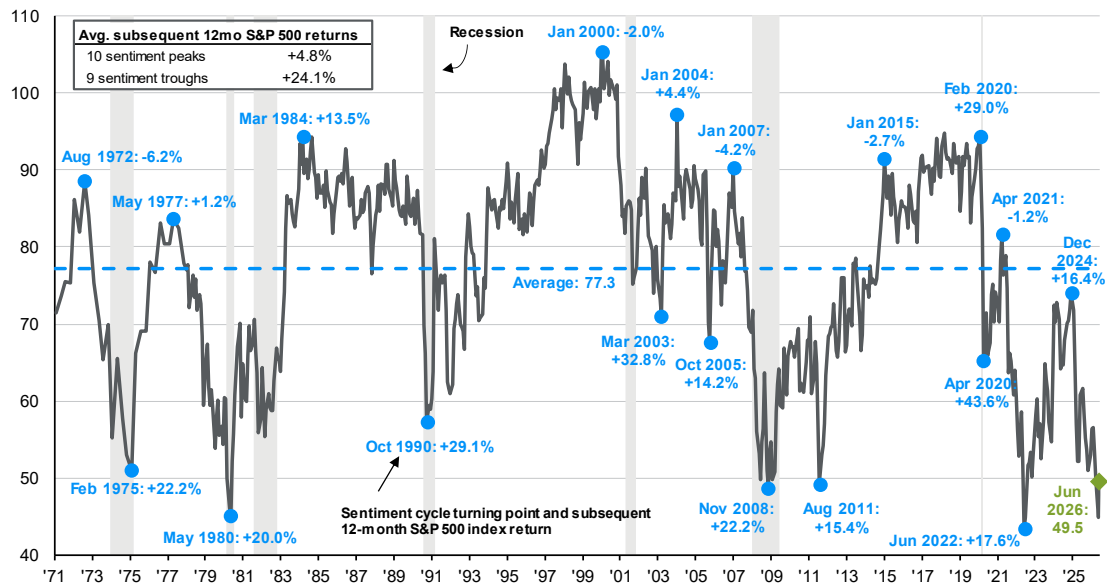


Source: J.P. Morgan

In the face of global conflict, foreign financial markets are also doing well. Both industrialized and developing stock markets are already experiencing double-digit returns for the first six months of the year after similar performance in 2025. Broadly higher stock prices increase the wealth in countries where standards of living are likely to increase. This condition is important for countries that have been subject to mass migration and their need to support immigrants. Unfortunately, ongoing wars have brought hardship to a broad range of citizens in Russia and Ukraine, and the bombing in Iran and Lebanon has made life miserable for average citizens. Peace can make an enormous difference to all countries involved.

Tax rate cuts are buoying middle-income consumers, but higher inflation is having a negative effect on consumer confidence. Maybe the uncertainty about tariffs and higher grocery prices has contributed to the slide in confidence. The exhibit below shows the historic relationship between changes in consumer confidence and subsequent returns of the stock market. History tells us that a low in consumer confidence is usually followed by strong stock market rallies, while periods of consumer ebullience are followed by market weakness. This one indicator can give us some confidence that the outlook for the stock market remains favorable until consumers become excited about the economic outlook.

Consumer Sentiment Index* and subsequent 12-month S&P 500 returns



Source: J.P. Morgan

Conclusion:

As the US celebrates its 250th anniversary, the outlook for the economy and financial markets remains favorable. The surge in stock prices during the second quarter was highlighted by the unexpected rise in corporate profits that went beyond the “Magnificent 7” companies. As capital spending on AI infrastructure explodes, other downstream companies will be major beneficiaries of that spending.

If interest rates continue to stay in a narrow range for the balance of the year, we expect greater economic activity. Another sleeper is the value of the dollar. So far this year, the dollar has been quietly gaining strength, probably due to the increasing exports of oil and natural gas as well as coal, as Europe is committed to reducing dependence on Russian energy. Another important relationship is the forecasting ability of the stock market. Usually, a strong stock market implies that the economy will remain in an uptrend for at least the next six to nine months.

The conflict with Iran introduced greater uncertainty in financial markets, but any indications that the war may be over could give the stock market a push higher. The President’s negotiated Memorandum of Understanding took the S&P 500 to record highs in June. The fact that the US is an energy exporter lessens the pain of rising oil and gas prices, although it does shift wealth from energy consumers to energy producers. Also, other countries’ energy needs have propelled liquefied natural gas exports to become a major US export, bolstering our trade balance.

Politically, the next major event will be the outcome of the November elections and the impact that a changed Congress could have on the current occupant of the White House. At this point, we are not making any changes in our favorable economic and market outlook based on what might happen in November.

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