MARKET PERSPECTIVE

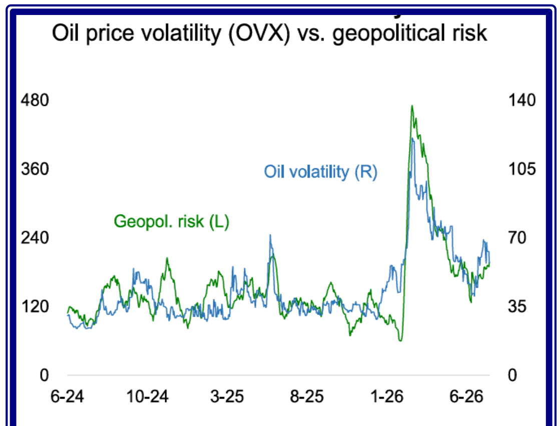
AUGUST, 2026

IN FOCUS:

Growing optimism over a potential U.S. exit strategy from the Iran War, leading to the reopening of the Strait of Hormuz, has supported stocks to record highs through July. Strong corporate earnings continue to fuel these gains as Q2 earnings per share growth tops 30% year-over-year (excluding Amazon and Alphabet's investment markups) vs a 22% consensus estimate. Forward multiples are higher today relative to late 1990s. However, current valuations, particularly as the market continues to broaden, have been driven by earnings rather than multiple expansion.

Oil prices remain well below levels that might otherwise be expected, given significant disruption to global supply caused by the war with Iran and the recent stall in negotiations to open the Straits of Hormuz. This relative resilience reflects several factors, including substantial drawdowns from strategic and commercial stockpiles, the rerouting of shipments through alternative pipelines and routes, cautious investor positioning, and declining demand from China. However, the market remains concerned about the stability of these alternative supply routes and the fact that strategic petroleum reserves are approaching tank bottoms. While reports of potential progress between Iran and Oman had provided some optimism until just a few weeks ago, the market remains skeptical that a long lasting and safe reopening of the Strait of Hormuz can be achieved. The longer supply disruptions persist, the greater the pressure on oil prices to move higher.

Oil Markets Remain Volatile



Takeaway: Geopolitical risk has much less of an impact on the direction of oil prices than it does on price volatility. The breakdown of peace talks in July is again creating volatility. Source: CBOE, Matteo Iacoviello. Source: Numera Analytics

The Federal Reserve continues to balance persistent inflation risks against a resilient, though increasingly mixed, labor market. While the Fed ultimately held rates steady at its July meeting, Kevin Walsh reemphasized at the Jackson hole conference in August that inflation targets are way too high and need to be addressed sooner than later. The bond market has a way of educating policy makers and Kevin Walsh was no exception. This message temporarily rallied U.S. bond markets. However, Walsh may have a credibility problem, and we'll see if he in fact moves on the desire to bring inflation back down to the 2.0% target. During this past July's Fed meeting, three officials backed a rate increase along with several other policymakers signaling that raising rates could be the most effective next move if inflation remains elevated. Despite this split, July's weaker-than-expected employment report suggested that the labor market may be cooling. In July, nonfarm payrolls declined by 23,000, while the prior two months were revised down by a combined 103,000 jobs. At the same time, the unemployment rate did show some progress by dropping 0.1% to 4.1%. The explanation offered by the Fed was that Americans were exiting the labor force. The softer labor data did prompt a short bond rally in July and modestly reduced expectations for a rate hike at the Fed's next meeting this month. At the August meeting, Warsh's apparent redirection had an initial positive reaction. We expect U.S. bond yields will rise further, and U.S. equity market volatility increases in the coming months.

Over the coming weeks, additional labor and inflation data should provide policymakers with greater clarity. Although the new Fed Chairman's preference is to refrain from providing forward guidance, he did signal at Jackson Hole the Fed's continued commitment to maintaining price stability around its 2% inflation target. He appeared to turn decidedly hawkish with respect to leaving rates alone by the September meeting.

10 Year Treasury Yields Are Anticipating Fed Rate Hikes

Source: Bloomberg Analytics

Elevated Treasury yields reflect expectations for future Fed rate hikes, while higher oil prices have renewed concerns about inflation. At the same time, rising levels of corporate and government debt issuance puts upward pressure on bond yields and increases borrowing costs for both consumers and businesses. The 10-year Treasury yield remains near the higher end of its 52-week range. While a sustained decline in oil prices could help ease inflationary pressures, analysts caution that broader pricing headwinds remain persistent, limiting the likelihood of a significant decline in Treasury yields in the near term.

Inflation last month met analysts' expectations with a modest uptick from the prior month, but we expect a sustained increase in September forcing the Fed into a more restrictive policy stance. Overall prices still stand at 3.4% higher year-over-year and only cooling modestly. Core prices, excluding food and energy, were up 2.5%. Volatile gasoline prices dropped 2.9% last month, but remained 25% above last year and may have stalled given the lack of progress at the negotiating table with Iran. Stubborn inflation coupled with an economy operating at full employment, and accommodative financial conditions, increases the likelihood of a Fed hike.

IN SUMMARY:

In summary, the economic backdrop remains supportive, with solid corporate profits, steady economic growth, and accommodative monetary and fiscal policies. However, geopolitical tensions, higher tariffs, and persistent inflation pose growing risks, particularly if these factors continue to push bond yields higher. For now, markets appear hopeful that the United States will be able to pursue a diplomatic solution that ends the conflict, ultimately easing supply disruptions and thus reducing the risk of a sustained surge in oil prices. Although oil prices have not risen as much as initially anticipated, despite the ongoing depletion of strategic petroleum reserves, we remain cautiously optimistic despite the recent cessation in talks with the Iranians and continue to hedge our equity position with higher energy exposure in portfolios going into the fall.

Given the positive backdrop in overall earnings, the S&P 500 is on track to deliver double-digit earnings growth in the final quarter of the year, despite the possibility of one or two Fed hikes before year end. We are maintaining a bias towards stocks versus bonds, with the expectation that the rotation into market sectors beyond the Magnificent 7 stocks will continue and earnings for the S&P 500 hit $415 per share. This is a more reasonable forward price-to-earnings ratio of 20 times versus last month's 24 times. To get bearish, it would take a material rise in yields, a continued fall in the household savings rate, and the Iran war remaining for another six months before household incomes stagnate and an economic recession derails the equity bull market.
