SUMMIT
ASSET MANAGEMENT

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“GOOOOAAAALLLL! maybe.”

Dear Clients and Friends: July 15, 2026

If the financial markets of the past six months have felt less like a predictable economic cycle and more like a high-stakes, headline-dominating sporting event, you aren't imagining things. This year’s second quarter felt remarkably similar to holding your breath through the drama of the World Cup. Just when we thought the rules of play were set, the macro-environment delivered a series of wild plot twists.

After starting the year plagued by an energy shock that sent oil spiking to $115 a barrel and pushing May inflation to a three-year high of 4.2%, the markets looked to be facing a severe penalty. Over at the World Cup, the U.S. Men's National Team seemed destined to play shorthanded against Belgium, after Folarin Balogun received a questionable round-of-32 red card. However, a highly unusual, direct intervention from the Trump administration managed to get the suspension miraculously overturned by FIFA. Similarly, the stock market managed to sidestep its own looming penalties thanks to a highly unusual and questionable Memorandum of Understanding (MOU) Trump agreed to with Iran. In both cases, when the referee’s decision seemed final, shifting fundamentals and back-channel relief stepped in to keep the star players on the field for the second half.

Economic fundamentals strengthened as the MOU led to a swift cooling of energy prices and blockbuster corporate earnings were reported. The S&P 500 shrugged off the geopolitical whistles and roared back with a spectacular +15% gain for the quarter, bringing year-to-date returns to a resilient +10%. While performance has broadened over the last year, the AI trade is still dominating. The continued AI data center buildout has created shortages in semiconductors and memory chips causing those stocks to become this year’s darlings. The weighting inside of the S&P 500 of that sector has gone from 5% in 2020 to 20% today. We appreciate the returns but are concerned about the concentration.

U.S. small caps did even better, up +21% for the quarter and +22% for the year. However, the data also shows that the gains in small caps were focused on more speculative, non-profitable companies and not a rally in the quality names we would prefer to see. International markets, despite feeling the brunt of the Iran conflict, closed up +11% on the quarter and up +10% for the year. While there was volatility in short-term interest rates, the Aggregate Bond Index finished the quarter with a +0.7% gain, up +0.7% for the year.

Why hasn’t the Iran war impacted the economy more?

Although not perfect, things are not as bad as many feared when the conflict first broke out. Most concerns were centered on gas prices. While still up considerably, so far, they have remained tolerable. Why? There was already a lot of oil on the seas when the Strait of Hormuz was originally shut down. This oil ultimately was delivered and placed into the global system. Additionally, most developed countries had large oil reserves that they were able to push onto the market to keep prices in check. Both of those sources are now depleted, and future disruptions will likely have a more acute effect.

Contradictorily, tariffs have started to benefit the U.S. economy. As you may remember, the Supreme Court struck down most of Trump's tariffs. The Court ordered refunds. Consequently, the U.S. saw net tariff revenue of zero in May and of minus $30 billion in June as the government started sending tariff money back to importers. Interestingly, the companies most likely to pass tariffs on as price increases to consumers are now the very ones receiving the refunds. While we don't expect them to refund their customers, it may reduce the urgency they feel to raise prices further. Overall, we would expect tariff inflation to diminish from here.

The labor market remains steady but in a "no hire - no fire" zone. Economists also see the U.S. in a significant demographic squeeze because of the huge reversal in immigration. June's employment report revealed the total employment in America decreased over the last twelve months, declining by 500,000 foreign workers and over 600,000 native-born workers. With historical domestic birthrates low, the working age population had been supplemented by immigration. That has now stopped. Estimates see the U.S. working age population shrinking by about 20,000 per month. Without a comprehensive immigration policy, which seems highly unlikely in today's politically charged Congress, the squeeze in our labor supply will continue, keeping pressure on wages and potential inflation.

Another reason for equity market resilience can be seen in earnings growth. The estimated year-over-year growth rate for the second quarter is 23%, which is above the five-year average of 16% and ten-year average of 10%, according to FactSet. So, with both actual and estimated earnings growing faster than stock prices, the market itself is getting cheaper. Corporate America is also getting more profitable. Again, according to FactSet, the S&P 500's net profit margin hit 14.8% in the first quarter, the highest on record.

One thing that is changing though is what is happening to all those profits. For most of the post Financial Crisis period, corporate cash deployment was dominated by dividends and stock buybacks. Together, they absorbed 50-60% of operating cash flow. Since late 2025, capital expenditures have now surpassed stock buybacks. Those expenditures are heavily weighted to AI infrastructure. In fact, some of the hyperscalers have seen their free cash flows go negative. This quarter's biggest gains accrued not to the check-writers footing the cap-ex bill, but to the check-cashers on the other side of it being paid to build it out. As long as those checks keep clearing, we can expect the earnings and growth to continue.

A Fed Update

The second quarter brought a meaningful leadership transition at the Federal Reserve. Jerome Powell's tenure as Chair formally came to an end as Kevin Warsh was sworn in. Warsh began a four-year term ending in May 2030. He has been an outspoken critic of the Fed's evolving mandates and practices, especially the use of the balance sheet and forward guidance, that have taken place post the Global Financial Crisis. He is looking to reform the institution, rather than simply conduct monetary policy.

Warsh's first FOMC meeting, held in June, was notable less for what the Fed did than for how it communicated. The Committee voted unanimously to keep the federal funds target range unchanged at 3.50%–3.75%, but the statement was shorter, more direct, and notably absent of the easing bias that had appeared in earlier communications. Warsh also announced a host of new task forces focused on improving Fed communications and the data the Fed uses to make decisions.

In his limited time thus far, Warsh has used his pulpit to repeatedly assure Americans that the Fed "will deliver price stability." This caught markets offsides as most feared he would acquiesce to Trump's easing mandate. Markets adjusted quickly. Investors had been pricing in one or two rate cuts for 2026, reflecting confidence that inflation would continue to cool. By late June, that narrative had flipped, pricing in one or two hikes.

A new tool for online safety

Clients constantly ask about ways to increase their online safety and protect their financial accounts. Because of the two-factor authentication process, using Schwab's website or app, is always the safest way to transact or request money movements. However, Schwab has recently added a new tool with another layer of protection. You can now set your accounts to "Limited Access View." The Limited Access View allows viewing balances and holdings online but disables the ability to make online money transfers. This feature restricts these actions to either Summit or your phone verification, securing your portfolio from potential online fraud. Feel free to give us a call to help you set up this feature.

Outlook

As we have mentioned the last couple quarters, it's hard to write a letter these days. Any attempt to prepare thoughts in advance leaves you at risk of quick obsolescence. On that note, things have changed. Just as the U.S. soccer team flopped against Belgium, so did diplomacy with Iran. As of this writing, the MOU and cease fire have been officially cancelled…maybe. The two sides are back to trading military strikes, closing straits, and implementing blockades. The Trump administration seems to be more amenable to conceding on its original demands if they can just get the Strait of Hormuz open with oil and other commodities flowing again. Iran recognizes its leverage and is not yielding.

The U.S. economy enters the second half of 2026 with a mix of strength and strain. Growth has remained positive, consumers continue to spend, capital investment is strong, and productivity trends look healthier than in prior cycles. However, this market remains unusually uncertain – not in the "there is always uncertainty" kind of way, but in the specific sense that several important variables remain unresolved and could resolve differently than the market expects. When will the Strait of Hormuz really be open? What will inflation's trajectory be? What will be the Fed's response? Will the pace and breadth of AI earnings deliver? What about the durability of the narrow market leadership?

These are not small or simple questions. We cannot predict which resolution occurs. We are here to help clients build durable, diversified portfolios that will hopefully be resilient and compound capital through the range of plausible outcomes and to apply the discipline of planning and longer-term thinking about time horizons. That is our GOAL.

Thank you again for your continued confidence and trust as we work through these extraordinary times. We welcome your comments, questions, and referrals. Please don't hesitate to contact us. Stay safe and well.

Summit Asset Management LLC