



# Mid-Year Market Outlook 2026: AI, the Fed, and What's Next for Investors

In this month's HCM Market Brief, Doug Johnson, CFA, and Dan Rinck examine the key themes shaping today's markets, including AI, Federal Reserve policy, market leadership, and the investment opportunities they see for the remainder of 2026.

The first half of 2026 has been anything but ordinary. Investors navigated significant geopolitical uncertainty, including the conflict with Iran, changing Federal Reserve leadership, and continued debate surrounding artificial intelligence (AI). Yet despite these challenges, financial markets have delivered surprisingly strong returns across nearly every major asset class. In this episode of the HCM Market Brief, Doug Johnson, CFA, and Dan Rinck discuss what has driven markets higher, why diversification has once again become valuable, and the themes they believe will shape the remainder of 2026.

One of the biggest surprises has been market leadership. While many investors expected mega-cap technology companies and the Magnificent Seven to dominate performance once again, leadership has broadened considerably. Emerging markets, small-cap stocks, international equities, and value-oriented investments have all outperformed traditional large-cap growth for much of the year. Russell 1000 Growth has lagged relative to many other asset classes, reflecting a rotation away from the narrow market leadership that characterized recent years.

The hosts note that if someone had predicted the geopolitical headlines at the beginning of the year—including military conflict involving Iran, changing Federal Reserve leadership, and ongoing uncertainty surrounding inflation—few investors would have expected markets to produce double-digit gains across most major asset classes. Instead, markets have remained remarkably resilient.

Since the announcement of a ceasefire in the Middle East, market leadership has shifted again. Growth stocks, particularly technology, have regained momentum while maintaining broader participation across sectors. Small-cap stocks remain among the strongest performers, but investors have also seen renewed strength in software companies that had previously been punished amid concerns that AI would eliminate the need for traditional enterprise software.

Instead, many software companies are proving they are benefiting from AI rather than being replaced by it. Companies are integrating AI into their products, creating new revenue opportunities while improving productivity for customers. This broadening within the technology sector is viewed as a healthy development because gains are no longer concentrated in only semiconductor manufacturers or a handful of mega-cap names.

Diversification has finally begun rewarding investors again after several years when concentrating portfolios in a small number of large technology companies often produced the strongest returns. Today, exposure across large-cap, small-cap, international, emerging markets, value, growth, and alternative assets has generated stronger overall portfolio performance while reducing concentration risk.

Artificial intelligence remains one of the most important long-term investment themes discussed throughout the episode. HCM continues to maintain an AI allocation within its tactical portfolios but has intentionally diversified that exposure rather than simply purchasing the largest technology companies.

The firm's AI strategy focuses on three distinct areas of the AI ecosystem. The first is infrastructure and electrification, recognizing that expanding AI requires enormous investments in electrical grids, power generation, and data centers. The second focuses on cybersecurity, reflecting the growing need to secure increasingly sophisticated AI systems and digital infrastructure. The third targets companies deriving substantial revenue directly from AI and large language models through an equal-weighted approach rather than concentrating heavily in companies already dominating broad market indexes.

This diversified approach helps reduce dependence on a handful of mega-cap technology stocks while providing broader participation across the AI ecosystem.

The discussion also addresses one of the most common concerns among investors—that AI investment has become overbuilt and demand may eventually collapse. The hosts review proprietary research tracking GPU availability, a measure of supply versus demand for AI computing power. Current data continues to indicate that demand significantly exceeds available supply, even after substantial investments in new data centers and chip production.

According to the indicators discussed, AI infrastructure remains constrained despite enormous capital expenditures across the technology industry. Rather than signaling oversupply, the data suggests companies continue scrambling for additional computing capacity. This ongoing shortage supports continued investment across semiconductors, infrastructure, data centers, and related AI technologies.

Another widespread concern involves employment. Many fear AI will eliminate large numbers of jobs, reducing overall economic growth. However, current data paints a different picture. Companies adopting AI most aggressively are actually hiring more workers than companies with low AI adoption. Rather than replacing employees outright, AI appears to be increasing worker productivity, allowing businesses to expand operations while improving efficiency.

The hosts also challenge comparisons between today's AI boom and the technology bubble of 2000. Although AI-related investments have generated exceptional returns, they argue the underlying fundamentals differ dramatically from the speculative environment that characterized the dot-com era.

During the late 1990s, technology valuations expanded to extreme levels despite many companies having little or no earnings. Today, while valuations are elevated in certain areas, earnings growth has largely supported price appreciation. Major AI companies generate substantial revenues, produce significant cash flow, and continue experiencing strong demand for their products and services. Although volatility should be expected, the hosts believe the current AI cycle rests on much stronger financial foundations than the dot-com bubble.

Looking ahead, the second major theme involves Federal Reserve policy. New leadership at the Fed has introduced additional uncertainty regarding interest rates. Recent comments have been interpreted by some investors as increasingly hawkish, raising concerns that additional rate hikes remain possible.

Doug and Dan remain skeptical that higher interest rates are justified under current economic conditions. While headline inflation temporarily increased due to higher energy prices during the Iran conflict, much of that inflation appears driven by supply disruptions rather than broad-based demand. As oil prices have retreated, they expect inflation pressures to moderate.

The hosts emphasize that raising interest rates cannot resolve supply-driven inflation such as higher energy prices. Instead, they believe the labor market remains the most important variable to monitor. As long as employment remains stable without accelerating wage inflation, they see little reason for the Fed to tighten policy further.

At the same time, they do not necessarily expect immediate rate cuts. Instead, maintaining current policy until clearer economic data emerges may prove the most appropriate course. They acknowledge considerable uncertainty surrounding future Fed decisions, making this one of the most important factors influencing financial markets during the second half of the year.

The discussion concludes with an overview of HCM's current portfolio positioning. Equity allocations remain near neutral while maintaining broad diversification across value, growth, large-cap, small-cap, international, and emerging markets. The firm continues emphasizing its AI investment sleeve while also maintaining exposure to alternative assets such as gold, commodities, and managed futures to provide diversification outside traditional stock and bond markets.

Within fixed income, portfolios remain positioned with below-benchmark duration as the firm awaits greater clarity regarding future interest rate policy. Investment-grade corporate bonds continue serving as the core fixed-income allocation.

Overall, the outlook remains constructive despite ongoing uncertainty. Strong corporate earnings, expanding market participation, continued AI investment, and improving diversification all support the current bull market. While geopolitical risks, Federal Reserve policy, and periodic volatility remain important considerations, the hosts believe disciplined diversification and long-term positioning continue to offer investors the best opportunity for success during the remainder of 2026.

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