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In Brief

May was characterized by a continued recovery in investor confidence as geopolitical concerns surrounding Iran and the Strait of Hormuz gradually eased. Equity markets advanced during the month, supported by strong corporate earnings, moderating inflation pressures, and growing expectations that the Federal Reserve may be able to ease monetary policy later this year. The S&P-500 gained 5.26% (11.26% YTD), with Technology and Communication Services once again leading performance, reflecting continued investor enthusiasm for artificial intelligence and related infrastructure spending. Market participation also broadened modestly beyond the largest technology companies, suggesting improving confidence in the overall economic outlook. Fixed income markets delivered mixed results during the month. Treasury yields remained elevated as economic data continued to point to a resilient U.S. economy and a stable labor market. While the stabilization of energy prices helped alleviate some inflation concerns, investors remained cautious about the timing and magnitude of future Federal Reserve rate cuts. Higher-quality corporate bonds continued to benefit from healthy credit fundamentals, although longer-duration bonds remained sensitive to changes in inflation expectations and interest-rate forecasts. Overall, May reinforced the view that financial markets continue to be supported by strong corporate earnings and a resilient economy. While geopolitical developments and inflation remain important risks, the market's ability to advance despite these uncertainties suggests that investors remain focused on the favorable earnings backdrop and the prospect of improving monetary conditions.

Economy

The U.S. economy continues to demonstrate resilience despite a gradual moderation in growth. Current forecasts call for GDP growth of 1.5% to 2.0% in 2026, reflecting a transition from the exceptionally strong post-pandemic expansion toward a more sustainable pace. Consumer spending remains the primary driver of economic activity, supported by a healthy labor market and positive real wage growth, although signs of moderation are becoming more apparent. Manufacturing activity remains mixed, reflecting softer global demand and the lingering effects of higher interest rates, while the services sector continues to provide stability. Business investment has remained surprisingly resilient, particularly in areas related to artificial intelligence, digital infrastructure, and productivity-enhancing technologies. A key variable remains the outlook for energy prices. While concerns surrounding the Strait of Hormuz have moderated, any renewed disruption could place upward pressure on energy costs, potentially complicating the inflation outlook and slowing economic activity. Nevertheless, the economy appears well-positioned to continue expanding, supported by healthy corporate balance sheets, stable employment conditions, and ongoing technological investment. Overall, the current environment is consistent with a late-cycle expansion rather than an imminent recession. While growth is slowing, the underlying fundamentals of the U.S. economy remain constructive.

Labor Market

The U.S. labor market continues to provide important support to the broader economy, although signs of gradual normalization remain evident. Job creation has moderated from the exceptionally strong levels of recent years, while wage growth has stabilized at a more consistent pace with the Federal Reserve's inflation objectives. Despite this moderation, overall employment conditions remain healthy, with unemployment near historically low levels, layoffs remaining limited, and labor demand continuing to exceed supply in many sectors. Concerns that advance in artificial intelligence would lead to immediate and widespread job displacement have also begun to moderate. While AI is expected to reshape many industries over time, businesses are currently using these technologies primarily to enhance productivity rather than replace workers on a large scale. Overall, the labor market remains a source of strength for the U.S. economy. While continued moderation is likely, current conditions support the view that economic growth can continue without generating excessive inflationary pressure.

Monetary Policy

Monetary policy remains a central focus for financial markets, with the Federal Reserve maintaining a cautious and data-dependent approach. While inflation has moderated significantly from its peak, it remains above the Fed's long-term target, leading policymakers to remain measured in their approach to potential rate cuts. Markets continue to anticipate policy easing later this year, although the timing and magnitude will depend on incoming inflation and labor market data. The stabilization of energy prices has reduced some inflationary pressures, but policymakers remain mindful that renewed disruptions in global energy markets could quickly alter the outlook. With Kevin Warsh succeeding Jerome Powell as Federal Reserve Chair, investors are also beginning to focus on potential changes in the Fed's communication strategy. While a significant shift in policy appears

unlikely, a more disciplined communication framework could lead markets to place greater emphasis on economic data and less on guidance from policymakers. Overall, monetary policy remains restrictive but stable, suggesting that any easing cycle is likely to be gradual rather than aggressive.

Corporate Earnings

Corporate earnings continue to provide the primary support for equity markets, with profit growth exceeding expectations. Current consensus estimates call for S&P-500 earnings growth of approximately 8% to 10% in 2026, supported by resilient consumer spending, stable economic growth, and continued investment in technology and productivity-enhancing initiatives. Earnings growth remains concentrated in

Technology and Communication Services, where companies continue to benefit from artificial intelligence-related spending, cloud computing, and digital infrastructure investments. However, earnings performance has also broadened modestly across other sectors, suggesting that corporate profitability is not solely dependent on a small group of market leaders. Importantly, corporate America has demonstrated a remarkable ability to protect profit margins despite higher labor costs, elevated interest rates, and ongoing geopolitical uncertainty. Strong balance sheets, disciplined cost management, and continued productivity improvements have enabled many companies to maintain healthy profitability in a more challenging economic environment. Overall, earnings trends remain constructive and continue to support equity valuations. While economic growth is moderating, current profit expectations suggest that corporate fundamentals remain significantly stronger than investor sentiment alone would imply.

Thoughts

One frequently cited concern is the declining number of publicly traded companies in the United States. Since the late 1990s, the number of listed companies has fallen significantly, leading some observers to conclude that public equity markets have become less dynamic. While the trend is real, the implications are often misunderstood. Much of the decline reflects structural changes rather than economic weakness. Mergers and acquisitions have reduced the number of listed companies, while private equity and venture capital have enabled many businesses to remain private longer than in previous decades. At the same time, today's leading public companies are substantially larger, more global, and more profitable than their predecessors, representing a significant share of economic activity despite their smaller numbers. Importantly, a smaller number of listed companies does not necessarily imply less innovation. Advances in artificial intelligence, healthcare, digital infrastructure, and energy technology continue to create new generations of rapidly growing businesses. As these companies mature and seek broader access to capital, public markets may once again experience a period of expanding participation and increased new listings. For long-term investors, the quality, profitability, and growth potential of businesses remain far more important than the absolute number of publicly traded companies. In many respects, today's market reflects an evolution in how companies access capital rather than a decline in entrepreneurial activity or economic opportunity.

Market Outlook

We remain constructive on equities, supported by strong corporate earnings, a resilient economy, and continued innovation-driven productivity gains. While geopolitical developments and inflation remain important risks, we believe current fundamentals continue to justify meaningful equity exposure. As always, our focus remains on earnings, valuations, balance sheet strength, and cash flow generation. We continue to monitor these factors closely and will rebalance portfolios when warranted by changing fundamentals or valuation considerations. While short-term market movements are inherently difficult to predict, our investment discipline remains unchanged: identify high-quality businesses, maintain diversification, and remain focused on long-term value creation.

Your Terra Nova Team