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In Brief

June was characterized by a modest pullback in U.S. equity markets as investors reassessed elevated valuations, higher-for-longer interest rates, and the outlook for monetary policy. The S&P-500 declined approximately 1.7% during the month, despite continued evidence of resilient economic growth and healthy corporate fundamentals. Semiconductor stocks experienced increased volatility as investors took profits following a period of exceptional performance, although the long-term outlook for AI-driven capital spending remains unchanged. Fixed income markets also faced headwinds. Treasury yields remained elevated as stronger-than-expected economic data and persistent inflation reinforced expectations that interest rates are likely to remain higher for longer. While markets became more cautious in the near term, the underlying drivers of economic growth including artificial intelligence investment, manufacturing reshoring, and infrastructure spending remain firmly in place. Overall, June represented a pause rather than a change in trend. We continue to believe that corporate earnings and long-term structural growth drivers remain the primary determinants of equity market performance.

Economy

Consensus forecasts continue to call for U.S. GDP growth of approximately 2% in 2026, suggesting that the economy remains on a stable expansion path. At the same time, economists continue to assign roughly a 25% probability of recession over the next twelve months, reflecting growing divergences beneath the surface of the economy. Much of this caution stems from an increasingly K-shaped economy. Higher-income households continue to benefit from rising asset values, healthy savings, and investment income, while many lower- and middle-income consumers are experiencing slower wage growth, rising credit card balances, increasing student loan repayments, and higher delinquency rates. As a result, headline economic data remains resilient even as financial pressures are building for parts of the consumer sector. That divergence helps explain why economic forecasts remain mixed. While consumer spending is moderating, business investment, productivity gains, and corporate balance sheets continue to support overall economic activity. We believe these crosscurrents are likely to result in slower, but still positive, economic growth rather than a broad-based contraction.

Labor Market

The U.S. labor market continues to normalize, although recent data suggest that hiring momentum is slowing. Payroll growth moderated in June, while the unemployment rate remained relatively stable at 4.2%. Layoffs continue to be historically low - low hires, low fires. The composition of employment is also beginning to shift. Continued investment in AI infrastructure and data-center construction is supporting employment in manufacturing and construction, while hiring has softened in several white-collar industries, including information services. Although it remains too early to attribute these trends solely to artificial intelligence, businesses are clearly becoming more selective in their hiring decisions. Average hourly earnings continue to increase, but wage growth is no longer consistently outpacing inflation across all income groups. Combined with rising consumer credit balances and student loan repayments, this reinforces the increasingly uneven nature of the U.S. economy. Overall, we view the labor market as moderating rather than deteriorating. Employment conditions remain supportive of continued economic growth, although hiring trends warrant close monitoring over the coming quarters.

Monetary Policy

The Federal Reserve has entered a new phase under Chairman Kevin Warsh. While inflation expectations have continued to decline, the Fed remains committed to restoring price stability and appears willing to tolerate higher interest rates for longer if necessary. Recent economic data, including a softer labor market, have reduced the likelihood of additional rate increases, but they do not yet justify an aggressive easing cycle. Warsh has also signaled a meaningful shift in how the Federal Reserve communicates with financial markets. He has expressed concerns that excessive forward guidance may reduce policy effectiveness and has indicated a preference for a more disciplined, data-driven approach. As a result, investors should expect monetary policy decisions to be increasingly guided by incoming economic data rather than frequent signals from

policymakers. In our view, the direction of policy is becoming clearer. Barring a renewed inflation shock, the current rate cycle is likely near its peak. However, interest rates are also likely to remain higher than investors became accustomed to during the decade following the Global Financial Crisis.

Corporate Earnings

Corporate earnings remain the primary driver of equity markets. While analysts expect earnings growth to moderate in 2027, the slowdown comes from exceptionally strong levels rather than signaling any deterioration in corporate fundamentals. Consensus forecasts continue to call for S&P-500 earnings growth of approximately 18%, following an estimated 24.5% increase in 2026. Technology remains the clear earnings leader, driven by continued investment in semiconductors, cloud computing, and artificial intelligence infrastructure. The semiconductor industry continues to benefit from robust demand, while improving earnings momentum in Health Care reflects advances in biotechnology, pharmaceuticals, and increased merger activity. By contrast, sectors that benefited from the temporary spike in commodity prices during the Iran conflict, particularly Energy and Materials, are expected to return to more normalized earnings growth as energy prices stabilize. Overall, earnings expectations remain constructive and continue to support our positive long-term outlook for equities. While valuations require ongoing discipline, the combination of resilient earnings growth and continued investment in innovation provides a solid foundation for the market.

Food for Thought

Not All ETFs Are Created Equal

Exchange-traded funds have transformed investing by providing low-cost, diversified access to financial markets. However, investors should recognize that not all ETFs are designed for long-term investing. Leveraged ETFs, in particular, seek to amplify daily returns and therefore require frequent rebalancing. As these products have grown in size, their buying and selling activity has increasingly influenced the prices of the securities they track, at times amplifying market volatility rather than simply reflecting it. While traditional index ETFs remain an effective investment vehicle, leveraged ETFs are trading instruments whose long-term performance can differ materially from investors' expectations. At Terra Nova, we continue to favor broad, low-cost index ETFs while avoiding leveraged products as strategic portfolio holdings.

Artificial Intelligence: The Next Phase

Artificial intelligence has already transformed the technology sector, but the broader economy has yet to experience the same productivity gains. Technology companies continue to enjoy expanding profit margins, while margins across most other industries have shown little evidence of AI-driven improvement. This should not be surprising. Sectors such as healthcare, financial services, manufacturing, transportation, and construction must first redesign business processes and modernize legacy systems before AI can materially improve productivity. The key question for investors is therefore not whether AI will reshape the economy, but how long it will take. A slower implementation timeline may create periods of market volatility as expectations adjust, but it also extends the runway for future productivity gains and long-term earnings growth.

Market Outlook

We remain constructive on equities, supported by resilient corporate earnings, healthy business investment, and long-term structural growth drivers, particularly artificial intelligence and productivity-enhancing technologies. At the same time, we recognize that elevated valuations, persistent inflation, and geopolitical uncertainty warrant continued discipline.

Your Terra Nova Team