Mid-Year Outlook

Global equities have climbed a wall of worry through the first half of 2026. Despite an escalation of Middle East tensions, a spike in oil prices, and renewed inflation anxiety, major indices have pushed to new highs, propelled largely by resilient corporate earnings and continued enthusiasm for the artificial intelligence buildout. Broad equity benchmarks are up roughly high-single to low-double digits YTD.

As we look to the second half of the year, three forces dominate the conversation among major institutional strategists: (1) a Federal Reserve that has shifted from worrying about labor-market softness to worrying about inflation, with policy on hold and a hike no longer off the table; (2) equity valuations that are historically rich, particularly among the largest technology companies, which tempers forward return expectations even as earnings stay strong; and (3) an AI capital-expenditure cycle that remains the single most important driver of both economic growth and market concentration risk.

The Rate Environment

The Federal Open Market Committee has held its benchmark federal funds rate in a range of 3.50%–3.75% since mid-year, pausing after last year's cutting cycle as inflation has proven stickier than hoped. Where the Fed's attention earlier in the cycle centered on a cooling labor market, commentary from several Fed officials in recent weeks suggests the balance of concern has tilted back toward price stability, with core inflation running above the 2% target and energy prices elevated following the conflict in the Middle East.

For fixed income investors, the practical implication is that starting yields remain attractive and continue to do the heavy lifting for return potential. Capital Group emphasizes that higher starting yields can both support returns and help buffer portfolio volatility if geopolitical shocks continue to surface, even as inflation concerns linger.

Valuations

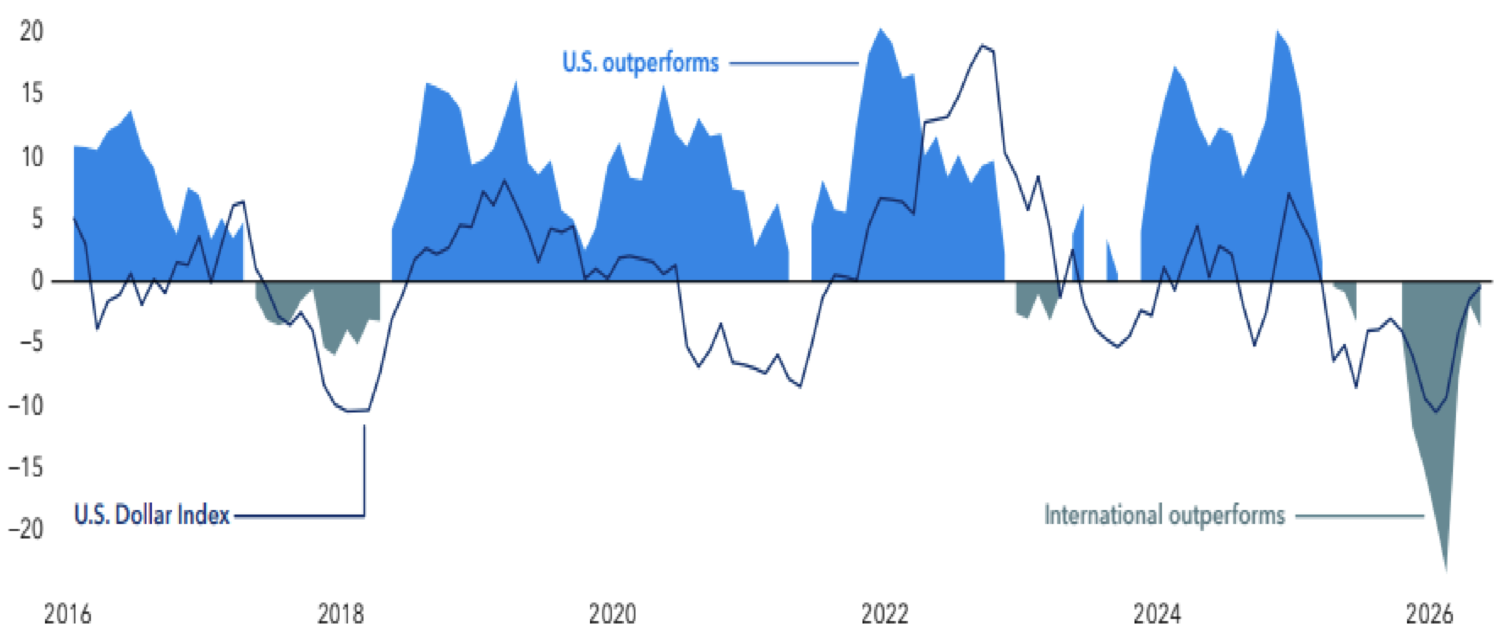
Valuation is the single biggest point of caution for investors. U.S. large-cap equities are trading at elevated multiples by historical standards, with price-to-earnings and cyclically adjusted valuation measures for the S&P 500 sitting well above long-run averages, territory last seen around prior valuation peaks. It is important to note that 2026’s gains can be largely be attributed to fundamentals rather than pure multiple expansion. J.P. Morgan Asset Management's mid-year outlook frames it directly: equities are being supported by strong earnings tied to the AI capital-expenditure buildout. Capital Group echoes this, noting that consensus earnings estimates have continued to rise in 2026, with particularly strong growth expected from emerging-market companies benefiting from the broader AI-driven investment cycle.

Where managers diverge somewhat is on what this means for the next leg of the cycle. While some continue to view AI as the dominant driver of risk-asset performance through year-end, AQR's capital market assumptions take a more valuation-disciplined stance, explicitly treating current elevated valuations as a headwind that should pull future returns lower. Its 2026 assumptions put U.S. large-cap equity expected returns meaningfully below both non-U.S. developed and emerging market equities. AQR's broader research reinforces a theme worth sitting with: after three consecutive up years for equities, five-to-ten year expected returns based on current valuations continue to imply compressed risk premia relative to history. That doesn't mean a correction is imminent, but it does argue for tempered forward-return expectations and a renewed emphasis on diversification across styles, factors, and geographies rather than relying on broad market beta alone.

Global Investing

After years of U.S. equity leadership, several strategists see a more balanced opportunity set taking shape. Capital Group points to a combination of more attractive relative valuations, stronger earnings growth, and a weaker U.S. dollar as tailwinds for international and emerging-market equities, highlighting global industrial and technology leaders outside the U.S. as beneficiaries of continued strength. J.P. Morgan's International Equity Strategy team has set a year-end target for the MSCI Emerging Markets Index that implies continued upside, citing a supportive macro backdrop, strong earnings momentum, and inflation expectations that remain reasonably well anchored.

Relative return comparison: S&P 500 Index vs. MSCI All Country World ex USA Index rolling one-year returns (%)



Risks Worth Monitoring

- **Geopolitical shocks and energy prices**: the closure of shipping routes through the Strait of Hormuz and broader Middle East conflict have already repriced risk once in 2026 and remain a source of tail risk to inflation and growth.
- **An inflation surprise that forces the Fed's hand**: markets are now assigning real, rising odds to a hike rather than a cut at the next FOMC meeting, a reversal from expectations earlier in the year.
- **AI positioning crowding**: narrow market leadership raises the risk of a sharp, technical correction even if the longer-term investment theme remains intact.
- **Fiscal discipline questions in select developed markets**, which J.P. Morgan's personal investing team flags as an ongoing area to watch, with the UK cited as a particular focal point.
- **Elevated valuations broadly**: U.S. large-cap multiples sit well above long-run historical averages, leaving less room for error if earnings growth disappoints.

Portfolio Positioning Considerations

- Stay invested, but temper return expectations. Elevated valuations argue for mid-single-digit long-run equity return assumptions rather than the double-digit results of recent years.
- Diversify the AI exposure. Consider participation through the broader supply chain such as industrials, energy, and select international names rather than concentration in the largest AI-adjacent mega-caps alone.
- Revisit international and emerging-market allocations. Relative valuation, earnings growth, and currency trends are more supportive than they have been in several years.
- Maintain broad diversification across factors and styles, not just asset classes, given that aggregate valuations across most investment styles are closer to long-term averages than at prior extremes.
- Keep a risk-management framework in place for geopolitical and inflation shocks, given that 2026 has already demonstrated how quickly sentiment can shift.

Conclusion

Halfway through 2026, markets have proven more resilient than many feared at the start of the year, powered by durable corporate earnings and the ongoing AI investment cycle. But resilience has come alongside historically rich valuations, a Federal Reserve that has pivoted back toward inflation vigilance, and rising concentration in market leadership. The path of least resistance for risk assets remains intact for now, provided the Fed stays patient, energy-related tail risks fade, and AI-related earnings keep delivering, but each of those conditions bears close watching in the second half of the year. Investors are best served by staying invested while leaning into diversification and disciplined position sizing around the most crowded trades.

Fast Facts

Local electric grid capacity has surpassed chip availability as the single biggest bottleneck for data center expansion. Power utilities in key tech corridors are quoting multi-year waiting lists for new high-voltage connections. – *Bloomberg*

In its latest startup spotlight, Forbes highlighted London-based startup SheMed, founded by sisters Olivia and Chloe Ferro, which crossed a $1 billion valuation this month. The firm provides targeted testing and telehealth care for complex metabolic and hormonal health conditions. – *Forbes*

Sovereign governments and corporations are on track to issue a staggering $29 trillion in new debt paper this year, a 17% jump over 2024 levels that is keeping long-term bond yields stubbornly high. – *Bloomberg*

To commemorate America's 250th anniversary, the U.S. Mint launched a limited-edition $250 copper coin. It is minted using authentic copper salvaged from the original structural restoration of the Statue of Liberty.
– *US Mint & Historical Artifact Projects*

Pharmaceutical titan Eli Lilly acquired drugmaker AtaiBeckley for $2.8 billion. The deal marks Big Pharma's official leap into psychedelic mental health therapies, gaining Lilly access to experimental nasal spray treatments derived from DMT and MDMA aimed at treatment-resistant depression and anxiety.
– *Morning Brew*

Contact Us

As always, feel free to reach out to us if you have any questions regarding your investments or financial plan or would like to schedule a meeting with our team.

Troy Flinn, Managing Partner
Troy.Flinn@AlphaWealthAdvisors.com

Chris Hamner, Dir. Retirement Services
Chris.Hamner@AlphaWealthAdvisors.com

Griffin Flinn, Sr. Wealth Consultant
Griffin.Flinn@AlphaWealthAdvisors.com

Madelyn Flinn, Dir. Client Strategy
Madelyn.Flinn@AlphaWealthAdvisors.com

"Knowing what you don't know is more useful than being brilliant." – Charlie Munger

4435 Waterfront Dr. Suite 203 Glen Allen, VA 23060 o: 804-346-2615 f: 804-346-2618 **AlphaWealthAdvisors.com**