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A new Fed, familiar market dynamics

The S&P 500 finished June down 2.9%, but still closed the second quarter with a very healthy 13% return¹.

Through the first half of the year, the index has gained 8%, keeping it well on pace toward our year-end price target. As we've discussed throughout the year, however, the bigger story isn't the return of the S&P 500—it's the broadening of market leadership. Emerging Markets and U.S. Small Caps have led the way, returning 23% and 22%,

respectively, while the more balanced S&P 500 Equal Weight index gained 12%, outperforming its traditional capitalization-weighted counterpart. Together, these trends continue to reinforce our Risk Awareness and Diversification 2.0 (RAD) theme that a broader opportunity set would emerge in 2026.

In the pages that follow, we'll touch on several developments worth highlighting, including the recent leadership changes at the Federal Reserve, another strong quarter of corporate earnings, and the similarities we see between today's market environment and the early stages of the 2023 rally. We'll close with a brief preview of how we're thinking about the next twelve months and why we continue to believe a disciplined, diversified approach remains the right course.

A new sheriff at the Fed

The Federal Reserve was once again front and center this month, this time for a different reason. Kevin Warsh's first press conference as Chair provided important insight into how monetary policy, and just as importantly, Fed communication, may evolve in the years ahead.



Jeff Krumpelman, CFA
Chief Investment Strategist
& Head of Equities, Mariner



The biggest takeaway wasn't a change in interest rates, it was a change in philosophy. Warsh made it clear this is a new era for the Federal Reserve. He plans to rely more heavily on privately produced economic data alongside traditional government statistics, reduce the amount of post-meeting guidance the Fed provides, and allow markets to interpret policy decisions with less hand-holding. In short, expect a Fed that is more data-driven and perhaps a bit harder to read.

His priorities were equally clear. Inflation is front and center. Warsh repeatedly emphasized that he believes 2% inflation remains an achievable objective and rejected the notion that policymakers must choose between low inflation and low unemployment. In his view, strong economic growth, healthy labor markets and price stability are complementary, not competing, objectives. He also acknowledged the role artificial intelligence will play in boosting productivity over time, recognizing that today's surge in AI investment may temporarily increase demand before the longer-term supply benefits begin to materialize.

For investors, the practical implication is that monetary policy may become less predictable than it has been in recent years. Warsh appears willing to make decisions based on his assessment of the data rather than following traditional market signals such as the relationship between the two-year Treasury yield and the Fed Funds rate. That likely means greater volatility in the bond market, but not necessarily a more difficult environment for equities. In fact, we believe Warsh's more disciplined and technically focused approach is likely to enhance the Federal Reserve's credibility and ultimately provide greater comfort to equity investors over the intermediate and longer term. That said, as with virtually every new Fed Chair, there will likely be a short-term "show me" period as markets gain confidence in his leadership, and that process may not be without temporary volatility. We think investors are best served by focusing on the fundamentals rather than trying to predict every move from the Federal Reserve.

A look back at 2023

As we think about the balance of the year, we're reminded of another period that shares some striking similarities with today: mid-2023. In both years, the market delivered strong returns during the first half and investors began asking the same question: "If we're already so close to the expected destination, shouldn't the outlook become even more optimistic?" Our answer was "no" then, and it remains "no" today.

The similarities extend beyond investor sentiment. In mid-2023, inflation had cooled meaningfully from its peak, only to reaccelerate modestly during the summer. The Federal Reserve responded with increasingly hawkish rhetoric, creating concerns that policymakers might need to tighten further to prevent inflation from becoming entrenched. Today, we're hearing a familiar story. Geopolitical tensions and concerns surrounding the Strait of Hormuz have raised fears that higher energy prices could temporarily rekindle inflation, prompting Chair Warsh to make it clear that price stability remains the Fed's top priority.

What happened next in 2023 is worth remembering. Inflation ultimately proved more transitory than many feared, the Fed maintained credibility and investors regained confidence as the data improved. The market experienced a healthy correction before finishing the year with one of the strongest year-end rallies in recent memory.



History rarely repeats itself exactly, but it often rhymes. We are not suggesting this year will unfold identically, nor are we dismissing the risks surrounding inflation, geopolitics or monetary policy. However, if inflation pressures prove temporary and the Fed responds with measured restraint rather than aggressive tightening, we believe a similar path remains entirely plausible. That's why we continue to emphasize the fundamentals, earnings growth and economic resilience, rather than reacting to every headline. We'll be watching the trends in inflation, intermediate-term interest rates and credit spreads closely for signs that this outlook needs to change.

Earnings continue to drive the market—breadth improves

Much like last year, earnings growth, not multiple expansion, continues to be the primary driver of market returns. Consensus expectations now call for Q2 earnings per share growth of more than 20%, supported by healthy double-digit revenue growth.² We take considerable comfort in this type of market environment, where fundamentals are firmly in the driver's seat. Strong top-line growth suggests that companies are benefiting from genuine business momentum, providing a solid underpinning for the earnings outlook.

Equally encouraging is what we're seeing beneath the surface. One concern we've highlighted throughout the year has been relatively weak market breadth. That picture has improved meaningfully. The advance/decline line continued to strengthen throughout the recent pullback and has now moved to new highs, suggesting participation in this rally is becoming broader and healthier. We wouldn't characterize this as an "all-clear" signal just yet, but it is exactly the type of improvement we'd expect to see if this advance is going to prove more durable over the coming quarters.

Looking ahead

As we enter the second half of the year, our outlook remains largely unchanged. We continue to believe the market is being driven by the right things: healthy earnings growth, resilient economic fundamentals and improving market breadth rather than speculative multiple expansion. While we fully expect additional periods of volatility as investors digest evolving inflation trends, Fed





policy and geopolitical developments, we believe those risks are manageable within our base case.

Accordingly, we are maintaining our year-end price target for the S&P 500 and introducing a new 12-month base case target of 8,400 by mid-2027.³ More importantly than the index level itself, however, is how we expect the market to get there. We continue to believe this will be a year defined by Risk Awareness and Diversification 2.0 (RAD), a market characterized by broader leadership and less concentrated returns than investors have become accustomed to over the past several years.

That theme continues to shape our portfolio guidance. We encourage investors to avoid excessive concentration in the largest names domestically and to broaden their opportunity set by considering their allocations to small- and mid-cap equities and international markets. In our view, the next leg of this market is likely to reward diversification just as much as it rewards patience.

As always, we'll continue to monitor the data not the drama and update our views as conditions evolve.



¹ Source: Return data from FACTSET

² Source: Strategas Research

³ Source: Market targets are based on our current assumptions and expectations as of the date of publication and are subject to change. Additional information regarding the assumptions underlying these estimates is available upon request.

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