TCM Investment Outlook & Strategy July 2026

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Introduction

The first half of 2026 was driven by three main themes: geopolitical tensions in the Middle East, increasing investment in artificial intelligence (AI), and persistent strength in corporate profits. Although these factors caused periods of higher volatility—including nearly a 9% decline in the S&P 500 during the first quarter—the market ultimately gained 10.5% as earnings growth outweighed macroeconomic concerns.

While macroeconomic developments have dominated financial headlines, equity investors have remained primarily focused on one variable: corporate earnings. As I will highlight in the Equity Markets section, we believe the main driver of stock market performance is consistently strong corporate earnings. We have emphasized in previous letters that the growth of corporate earnings has been the fuel for this bull market, and we believe that will continue to be the case.

U.S. Economy

Despite a surge in energy prices during the first half of the year, the U.S. economy continues to grow, though at a moderate pace. Consumers have felt the impact of the war-related surge in oil prices, which has driven up the cost of energy, food, and other core goods. Nevertheless, overall consumer spending has remained strong, helping to sustain economic growth. Strong investment in artificial intelligence infrastructure and related technologies has helped offset some of the economic drag from higher energy costs.

We expect full-year GDP to grow around 2%, adjusted for inflation, with a nominal growth rate of roughly 5.5% given current inflation at about 3.5%. If energy prices continue to decline with peace in the Middle East, economic growth could pick up in the latter part of this year and early 2027.

However, inflation remains a concern for the economy and financial markets. Current data shows inflation around 3-4%, depending on the source. This limits the Federal Reserve's ability to cut short-term interest rates and may push long-term rates higher. At the June 17, 2026, FOMC meeting, the Fed took a more hawkish tone, removing language that suggested potential rate cuts. Instead, it took a neutral stance, indicating that future policy could keep rates steady or raise them based on incoming data. Newly appointed Fed chair Kevin Warsh said in his press conference that the Fed plans to move away from providing "forward guidance" on monetary policy. We view this as an important change in how the FED signals the markets.

This shift could increase investor uncertainty about policy direction, leading to more market volatility. The Committee emphasized that restoring price stability remains its primary focus. Warsh emphasized that the Fed remains committed to returning inflation to its 2% target.

We expect the Fed to remain cautious about cutting rates until inflation shows signs of improvement. The recent rise in oil prices has contributed significantly to higher inflation. However, potential progress toward a peace treaty with Iran and the reopening of the Strait of Hormuz, which would allow more oil to flow, could lead to lower energy prices. This decrease might help reduce inflation pressures and ease concerns about interest rate hikes.

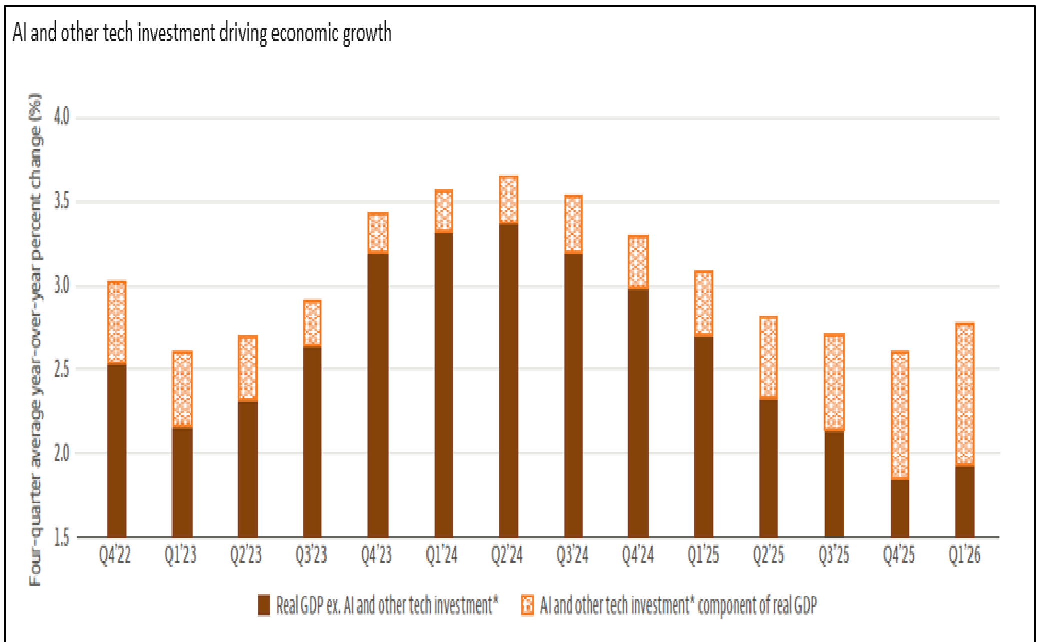
In the first half of 2026, the U.S. employment situation showed steady job growth, with the economy adding 57,000 jobs in June and 552,000 for the first six months of the year. Hiring remained positive, unemployment stayed relatively low, and wage growth was moderate, with average hourly wages rising 3.5% year over year as of June 30.[2]. The unemployment rate ticked down slightly to 4.2% after fluctuating between 4.3% and 4.5% for most of the first half of the year. Although job growth has slowed in recent months, we believe the employment situation will remain a strength for the economy.

Equity Markets

Ultimately, corporate profitability, not macroeconomic headlines, has had the greatest influence on equity performance. Corporate earnings are hitting record levels, with Q1 2026 S&P 500 profits up 23.1% year-over-year.[3] This marks the second consecutive quarter with over 20% growth and the seventh straight quarter of double-digit earnings increases for the index. Analysts predict earnings growth of 26.7% for Q3 and 24.3% for Q4 2026, with full-year earnings expected to grow by 24.0%.[3]

AI appears to be the main driver of corporate earnings growth. The AI infrastructure investment cycle is gaining momentum as Hyperscalers—such as Amazon, Microsoft, Google, Meta, and Oracle—aim to expand computing capacity by building data centers. AI is no longer simply a technology story. It is becoming a capital spending story, an infrastructure story, an energy story, and ultimately an earnings story. As businesses invest in computing capacity, software, power generation, electrical equipment, and industrial infrastructure, AI spending is broadening beyond the technology sector into much of the economy. We anticipate that capital investment will remain robust over the coming years as AI adoption accelerates and businesses and individuals increasingly embrace AI applications.

While concerns about funding for this capital expenditure and AI revenue streams are likely to persist and potentially cause market volatility, we view these debates as a typical part of a major technological innovation cycle. We believe the U.S. is experiencing another significant period of innovation with artificial intelligence, which will propel our economy forward, similar to the productivity surges driven by the automobile and mass production from 1915 to 1945, post-war electronics and aerospace from 1945 to 1970, personal computers from 1970 to 1995, and the internet from 1995 onward. Although AI's full effects on society and daily life remain uncertain, we expect it to influence nearly every sector of the economy in the coming years and become an increasingly important contributor to economic growth and productivity. As you can see in the chart, AI-related capital spending now accounts for an increasing share of U.S. real GDP growth, supporting our constructive outlook for technology and industrial investments.



*Data centers, power, tech, and other electronic structures, info-processing equipment & software. Sources: Wells Fargo Investment Institute, U.S. Census Bureau, and U.S. Department of Commerce. Data as of May 7, 2026.

While we remain constructive on the long-term opportunities created by AI, we recognize that periods of excessive optimism, capacity overbuilding, and valuation expansion could create volatility along the way. Investor excitement can sometimes drive equity prices beyond reasonable levels, making it crucial to consider overall market fundamentals. The price-to-earnings ratio (P/E ratio) is a useful metric to assess whether the market is undervalued or overvalued. Currently, the S&P 500 trades at approximately 21.4 times consensus 12-month forward earnings and 19.4 times consensus estimates for calendar year 2027. Although these ratios are higher than the 16.1 average of the past 20 years, we find the valuations still quite reasonable given current interest rates and anticipated earnings growth. Notably, at the end of the first five years of the Internet boom, the forward P/E ratio of the S&P 500 was about 25 times earnings in August 1999. In our opinion, if earnings continue to grow at or near current levels, equity valuations will remain well-supported.

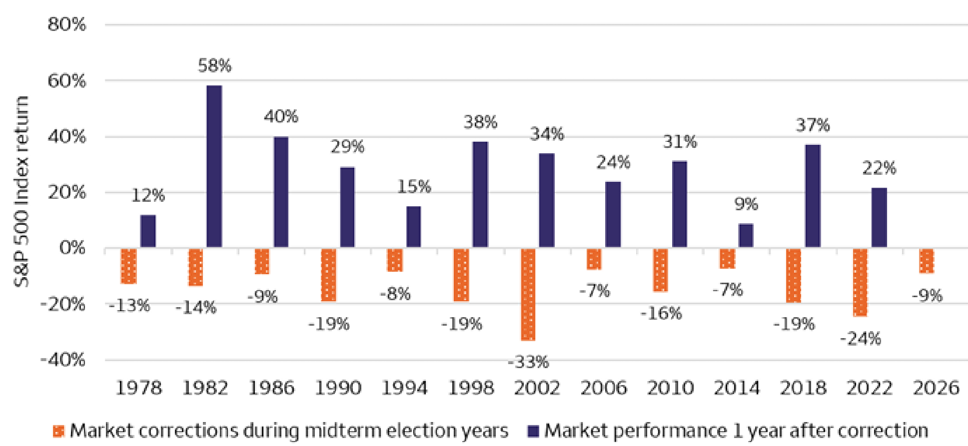
Our equity allocation strategy continues to favor the technology, industrials, energy, materials, consumer discretionary, and utilities sectors while remaining neutral on healthcare, communication services, and consumer staples. We have identified several appealing companies within these sectors. Our focus is on large-cap stocks with solid balance sheets and rising earnings. Additionally, we continue to recommend dividend stocks for investors seeking income.

International equity markets performed well in the first half of the year despite challenges in both developed and emerging economies. However, concerns remain about the growth prospects for most international markets. Many of these economies rely more on energy imports and are thus more vulnerable to supply shocks and price increases compared to the U.S. Moreover, structural issues such as shrinking populations, high debt levels, and a complex regulatory environment may hinder growth. Given these factors and the expectation of a strong dollar in the latter half of 2026, which could hurt international equities, we maintain an underweight position in international stocks in our portfolios. However, select international markets still offer attractive opportunities.

Mid-term Elections

Although the first half of the year was positive for stocks, the midterm elections might cause investor uncertainty and market weakness in the second half. Historically, election years have often seen heightened volatility as investors assess potential policy outcomes. The adjacent chart shows the S&P 500 Index's corrections across 12 election cycles, with an average decline of about 15%. The good news is that the S&P 500 has historically gained 13.1% in the year after an election. While election-related market corrections and subsequent recoveries have occurred during many election cycles, historical patterns do not guarantee future results.

Midterms matter: The equity market view



Sources: Bloomberg and Wells Fargo Investment Institute. Data from January 1, 1978, to May 29, 2026. Analysis was compiled using the daily total returns of the S&P 500 Index. Calendar-year drawdowns represent the largest market drops from peak to trough for each year. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Fixed Income

Interest rates remain within a range, with shorter-term yields around 3.5% and longer-term yields close to 5% for high-quality taxable fixed-income investments.[1] Taxable money market fund yields dropped to the mid-3% range after the Federal Reserve cut the Fed funds rate in 2025. So far in 2026, there have been no rate cuts, and it seems unlikely there will be any for the rest of the year. Before this year, we favored a declining rate environment as inflation appeared to slow down. However, with the war in Iran raising energy costs and inflation staying persistently above 3%, we are less certain that interest rates will decrease in the near future. Our main scenario is that rates will remain near current levels, with the possibility of slightly higher rates on longer-term instruments later this year.

We believe that high-quality bonds offer attractive, risk-adjusted returns, making them suitable for conservative investors. For those seeking income and diversification, we prefer intermediate-term U.S. Treasuries, high-grade corporate bonds, and mortgage-backed securities, with current yields ranging from 4% to 5.5%.[1] Tax-free municipal bonds with yields of 2.5% to 3.75% for longer maturities are especially appealing to investors in higher tax brackets, providing a taxable-equivalent yield of 4.2% to 6.25% at a 40% tax rate.[1] We view the intermediate section of the yield curve as offering attractive income while reducing interest rate risk. Essentially, intermediate bonds yield more than money market funds and shorter-term bonds, and help protect principal if interest rates rise. Prime money market funds and short-term securities remain attractive options, with yields around 3.5% to 4% for investors needing immediate liquidity.

Commodities

Energy markets remain highly sensitive to developments in the Middle East. Improvements in regional stability could reduce energy prices and inflation pressures, while further disruptions could have the opposite effect. A peace agreement between the U.S. and Iran could potentially lower energy prices once the Strait of Hormuz reopens fully and global oil supplies stabilize. However, achieving market stability might take 6-12 months. The International Energy Agency (IEA) reports that since the conflict began, supply losses have exceeded 1.3 billion barrels, marking the largest disruption to global oil markets in history. Restoring the oil market to pre-war levels could take time, keeping oil prices elevated.

We see long-term growth potential in both crude oil and natural gas, driven by rising energy demand from population growth, industrial expansion, and the growing use of data centers for cloud computing and AI. While oil and natural gas supplies have been sufficient over the past two years, we anticipate shortages developing in the coming years as demand continues to rise. We favor energy stocks, especially companies involved in the production and transportation of oil and gas, which often provide dividend yields significantly higher than the S&P 500's 1% rate (note that dividends are not guaranteed and may change). Additionally, demand for copper and silver is expected to grow as solar and wind energy expand and electric vehicles become more widespread, both of which require substantial amounts of these metals. Our research suggests that supply constraints for copper and silver are likely to worsen over the next few years.

Bottom Line

Financial markets are likely to experience periods of volatility throughout the second half of 2026. Factors such as inflation, monetary policy, geopolitical events, and upcoming midterm elections could all influence investor sentiment in the short term. While we expect volatility to remain elevated, we believe investors who remain disciplined and focused on long-term fundamentals are likely to be rewarded. As always, we remain committed to helping clients navigate changing markets with thoughtful portfolio management and a long-term perspective.

We appreciate the trust you place in Trinity Capital Management and remain committed to helping you navigate changing market conditions while keeping your long-term objectives at the center of every investment decision.

If you have any questions or want to discuss your portfolio in more detail, please feel free to contact us.

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Footnotes

[1] Factset Market Watch

[2] U.S. Bureau of Labor Statistics

[3] FactSet, Earnings Insight, June 26, 2026

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S&P 500 Index: The S&P 500 Index comprises 500 stocks selected for market size, liquidity, and industry group representation. It is a market-value-weighted index, with each stock's weight in the Index proportionate to its market value.

Index return information is provided for illustrative purposes only. Index returns do not represent investment performance or the results of actual trading. Index returns reflect general market results, assume the reinvestment of dividends and other distributions, and do not reflect deductions for fees, expenses, or taxes applicable to an actual investment. An index is unmanaged and not available for direct investment.