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The Long View: Not a Straight Line

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Key Takeaways

- Although markets often pause to digest after large gains, history suggests these episodes usually prove fleeting, meaning major indexes could move higher in the second half of 2026.
- Several economic clouds receded last quarter with the labor market turning the corner and oil prices returning to pre-conflict levels. Combined with the strong overall green signal from the ClearBridge Recession Dashboard, we believe the U.S. economy remains on solid footing.
- While the S&P 500 has been in a higher valuation regime since the pandemic, earnings strength has single-handedly powered the market rally, a trend we believe will continue.

Market Overview

At times, the stock market's climb brings to mind the trek to Everest Base Camp: even though the destination is higher than the starting point, the path is not a simple steady climb. In Nepal, trekkers gain elevation, descend into valleys, and then climb again. They repeat this pattern many times, which is why the total vertical climb is almost double the difference in elevation between the trailhead and Base Camp.

Markets work in a similar way, with a journey higher that often includes pullbacks, rallies and pauses along the way. Just as a trekker must accept the switchbacks, descents and acclimatization stops required to reach Base Camp, investors too must recognize that volatility is not an interruption of the journey but part of the path forward.

Encouragingly, the market appears to have already begun an acclimatization period, with the S&P 500 Index holding roughly flat over the past six weeks. Even so, the index delivered a 14.9% price return for the quarter, its 12th strongest quarterly gain since 1950. The market has typically advanced further following past similarly sharp rallies, averaging gains of 5.5% over the next three months and 10.4% over the next six. Although markets often pause to digest or even correct after large gains, history suggests these episodes usually prove fleeting, meaning that major indexes could move higher in the second half of 2026, bolstered by the easing of several economic overhangs in recent weeks (Exhibit 1).

Exhibit 1: Strength Begets Strength: Top 15 S&P 500 Quarters Since 1950

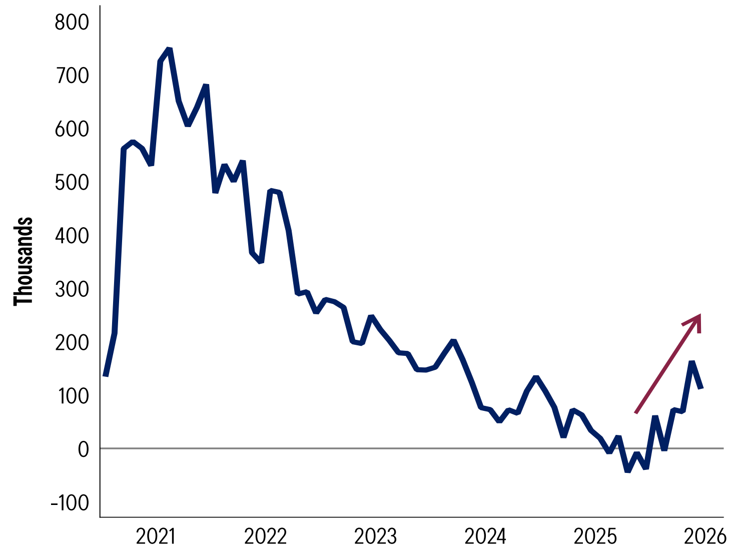
		Average Price Change	
Quarter	% Change	+1 Quarter	+2 Quarters
1Q 1975	21.6%	14.2%	0.6%
4Q 1998	20.9%	4.6%	11.7%
1Q 1987	20.5%	4.2%	10.3%
2Q 2020	20.0%	8.5%	21.2%
2Q 1997	16.9%	7.0%	9.6%
4Q 1982	16.8%	8.8%	19.5%
4Q 1985	16.0%	13.1%	18.7%
3Q 1970	15.8%	9.3%	19.1%
2Q 2009	15.2%	15.0%	21.3%
3Q 2009	15.0%	5.5%	10.6%
2Q 2003	14.9%	2.2%	14.1%
2Q 2026	**14.9%**	**?**	**?**
4Q 1999	14.5%	2.0%	-1.0%
2Q 1975	14.2%	-11.9%	-5.3%
1Q 1976	13.9%	1.5%	2.4%
1Q 1991	13.6%	-1.1%	3.4%
Average		**5.5%**	**10.4%**

Data as of June 30, 2026. Sources: FactSet, S&P.

The first overhang that has eased is the labor market, which appears to have turned a corner (Exhibit 2). Last year's labor market was soft, creating a total of just 116k jobs. By contrast, the economy averaged 111k per month in the second quarter of 2026, an acceleration from the first quarter's 73k monthly average. The job market appears to have stabilized, going from zero to hero in 2026, and giving the economic expansion firmer footing as it heads onward into the second half of the year.

A second area of recent improvement in the economic backdrop comes from falling oil prices. High energy costs had posed a threat to the health of the U.S. economy, although it was one we believed was manageable given the economy's health before the conflict between the U.S. and Iran broke out. The recent Memorandum of Understanding has helped push crude prices back to pre-conflict levels, while prices at the pump have slipped below $4/gallon on a national average basis and should continue to drift lower in the coming weeks.

Exhibit 2: Labor Market: Zero to Hero: Monthly Change in Nonfarm Payrolls (3 Month Moving Average)



Sources: U.S. Bureau of Labor Statistics (BLS), Macrobond. Data as of June 5, 2026, latest available as of June 30, 2026.

This decline comes at an important time as the boost from larger One Big Beautiful Bill tax refunds fades, with less of a headwind from higher gas prices being a positive for the consumption outlook (Exhibit 3). At the same time, tentative signs from bank credit/debit card data suggest resilience in the lower half of the “K” consumer. Job gains have broadened into areas such as construction, manufacturing and professional/business services, which should help to lift this cohort. Ultimately, we believe aggregate real incomes should see improvement due to the combination of a stronger labor market and less of an oil drag, which should support consumption in the back half of the year.

Exhibit 3: Relief at the Pump: Brent Crude Oil

Sources: Intercontinental Exchange (ICE), Macrobond. Data as of July 3, 2026.

With several economic clouds receding, we believe the U.S. economy should remain resilient, a view consistent with the strong overall green signal from the ClearBridge Recession Dashboard (Exhibit 4). For investors, the dashboard serves much like a weather report on the mountain: not a guarantee of clear skies, but a useful guide about the conditions ahead. At present, the dashboard is nearly all green, with 11 of 12 indicators currently in expansion territory and no changes last month.

Exhibit 4: ClearBridge Recession Dashboard

		June 30, 2026	March 31, 2026	Dec. 31, 2025
Consumer	Housing Permits	Expansion	Caution	Caution
	Job Sentiment	Recession	Recession	Recession
	Jobless Claims	Expansion	Expansion	Expansion
	Retail Sales	Expansion	Expansion	Expansion
	Wage Growth	Expansion	Expansion	Expansion
Business Activity	Commodities	Expansion	Expansion	Expansion
	ISM New Orders	Expansion	Expansion	Recession
	Profit Margins	Expansion	Caution	Caution
	Truck Shipments	Expansion	Expansion	Expansion
Financial	Credit Spreads	Expansion	Expansion	Expansion
	Money Supply	Expansion	Expansion	Expansion
	Yield Curve	Expansion	Expansion	Expansion
	Overall Signal	Expansion	Expansion	Expansion

Expansion Caution Recession

Data as of June 30, 2026. Sources: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, Bloomberg, CME Group, FactSet and Macrobond. The ClearBridge Recession Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

Lower oil prices may do more than just remove an economic overhang; they can also set the stage for lower interest rates. Historically, headline inflation pressure often eases following the peak in oil prices, bringing inflation expectations lower. Investors begin to anticipate a less aggressive monetary policy path, which brings down intermediate and long-term interest rates. Since 1990, 10-year Treasury yields have fallen by an average of 28 bps, 67 bps and 81 bps, respectively, over the three, six and 12 months following major Brent crude peaks (Exhibit 5).

Although 10-year yields remain modestly elevated today as the Fed works to bring inflation to the 2% inflation target, which has now been overshot for more than five years, the drop in oil prices could help inflation moderate faster than expected. If inflation does moderate and a re-pricing occurs across the yield curve, lower yields could provide support for equity valuations and returns.

Exhibit 5: Peak Oil, Lower Yields: Change in 10-Year US Treasury Yield Following Historical Peaks in Brent Crude Oil

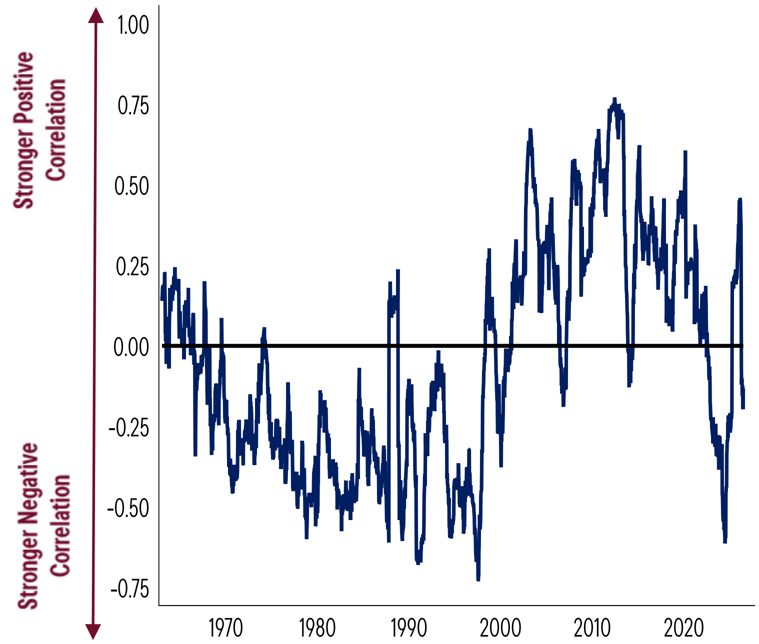
			Change in 10-Year Yield (BPS)		
Start Date	Peak Brent	10 Year	+3 Months	+6 Months	+12 Months
Oct. 1990	$40.15	8.83%	-0.58	-0.80	-1.32
Jan. 1997	$24.80	6.60%	0.31	-0.33	-1.11
Sept. 2000	$34.55	5.76%	-0.44	-0.84	-0.96
August 2006	$78.30	4.93%	-0.27	-0.19	-0.16
July 2008	$146.08	3.99%	-0.36	-1.50	-0.47
April 2011	$126.65	3.59%	-0.56	-1.49	-1.53
Oct. 2018	$86.29	3.15%	-0.59	-0.63	-1.61
June 2022	$123.58	3.03%	0.26	0.45	0.70
		Average	-0.28	-0.67	-0.81
March 2026	**$118.35**	**4.30%**	0.14	?	?

Data as of June 30, 2026. Sources: ICE, Federal Reserve, Bloomberg.

Equity valuations are closely tied to interest rates, but that relationship has shifted historically alongside differing macroeconomic regimes. In the 1980s and 1990s, inflation remained the primary concern following the runaway price spirals of the 1970s, which led to a negative relationship between the S&P 500 and 10-year Treasury yields. In that era, higher inflation went hand-in-hand with a more hawkish Fed, higher rates and pressure on corporate earnings.

However, a new regime took hold in the new millennium, as deflationary fears overtook inflationary ones, and the relationship between stocks and bonds shifted to one demonstrating positive correlation. Since 2022, however, inflation has once again become the primary scourge for U.S. investors, and stock-bond correlations have turned negative once again (Exhibit 6).

Exhibit 6: Negative Correlation is Back: Rolling 1-Year Weekly S&P 500 and US 10-Year Treasury Yield Correlation



Sources: U.S. Department of Treasury, S&P Global, Macrobond. Data as of July 2, 2026.

How long this negative correlation relationship persists is likely to depend on the future path of inflation. Like shifting weather patterns in the Himalayas, macro regimes can persist for extended periods (measured in decades) and require investors to adjust their route accordingly. The current negative stock-bond correlation regime may endure given the secular nature of these shifts in the past. Historically, emerging market and infrastructure equities have performed best during periods of negative stock-bond correlation, delivering average returns of 24% and 20%, respectively (Exhibit 7).

While the path forward for stock-bond correlations may be up for debate, one thing that isn't is that equity market valuations are elevated, with the S&P 500 trading above 20x forward (expected next-12-month) earnings. Higher valuations are the market equivalent of climbing at altitude: progress is still possible, but there is less room for missteps. However, rich multiples have become the "new normal" since the pandemic, with the index trading above 20x 64% of the time since first crossing that level in April 2020.

Importantly, elevated P/Es have not derailed returns, with the S&P 500 rising 157% over those 74 months, or 16.6% annualized — roughly twice the long-term average. Strong earnings have been the oxygen tank powering the market's climb in the face of lofty valuations, with next-12-month earnings expectations up 155% cumulatively over the same period (Exhibit 8). Simply put, the S&P 500 appears to be in a higher valuation regime, with earnings doing all of the heavy lifting behind the market's climb higher — a dynamic we expect to continue in the second half.

Exhibit 7: Negative Correlation, What Now: Equity Asset Class Returns During Historical Negative Stock-Bond Correlation Periods

Annualized Returns

Start Date	End Date	# of Days	S&P 500	Russell Midcap	Russell 2000	MSCI EAFE	MSCI EM (Emerging Markets)	FTSE Global Core Infrastructure 50/50 Index
10/17/1988	4/20/1998	3472	15.9%	-	13.4%	5.5%	58.4%	-
6/7/1999	1/29/2001	602	1.3%	9.9%	8.0%	6.0%	1.9%	-
6/19/2006	2/19/2007	245	26.9%	31.3%	31.5%	33.7%	48.2%	41.2%
11/18/2013	6/9/2014	203	16.6%	18.8%	11.4%	7.1%	3.9%	15.5%
7/25/2022	3/31/2025	980	13.8%	8.6%	3.9%	8.8%	6.1%	2.6%
4/6/2026	?	?	?	?	?	?	?	?
Average			**15%**	**17%**	**14%**	**12%**	**24%**	**20%**

Note: Periods of negative stock-bond correlation based on S&P 500 and 10-Year US Treasury Yield. Sources: Macrobond, Federal Reserve, FactSet, S&P, FTSE Russell, and MSCI.

Exhibit 8: Higher Valuation Regime: S&P 500

S&P 500	April 2020	Current	% Change
Index Level	2,912	7,499	157%
NTM EPS	$145	$369	155%
NTM P/E	20x	20x	3%

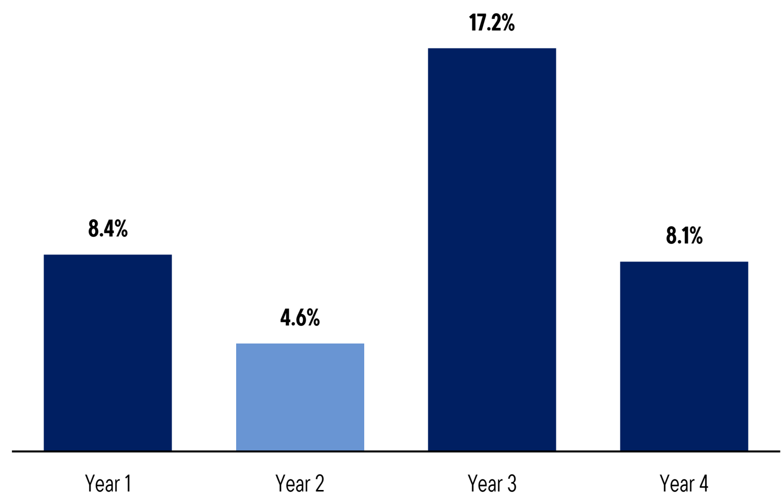
Data as of June 30, 2026. Sources: FactSet, S&P.

Over the course of the summer, we expect investor attention to shift toward this fall's midterm elections, which historically have been a source of volatility. Midterm years can be challenging for equity markets because they introduce political uncertainty: which party has control of

Congress (and by what margin) has implications for taxes, regulation, government spending and sector-specific policies.

Historically, the incumbent president's party loses seats in the midterm, increasing the risk of gridlock or slowing the president's policy agenda. This uncertainty has weighed on market returns in the past, with midterm election years delivering the weakest average performance of the four-year presidential cycle at just 4.6% (Exhibit 9). But political uncertainty, like mountain weather, is only part of the story in determining how navigable the path forward may be.

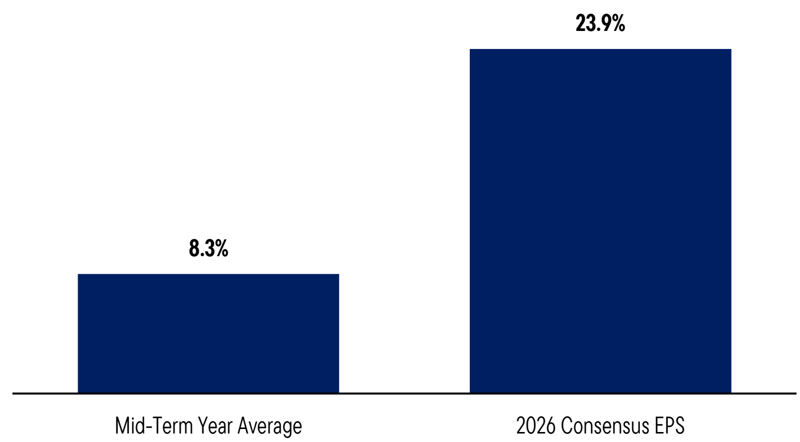
Exhibit 9: The Midterm Year Lull: Average S&P 500 Return by Presidential Cycle Year, 1950 – Present



Data as of June 30, 2026. Sources: FactSet, S&P.

Although equities have historically posted lower annualized returns in the second year of presidential cycles, the business-cycle backdrop ultimately matters more than the policy calendar. Today's earnings outlook is much stronger than the typical midterm year precedent; sell-side consensus expects 2026 EPS growth of 23.9%, which is nearly three times the historical midterm year average of 8.3% (Exhibit 10). In our view, that earnings strength is a powerful tailwind that could help prove 2026 to be the exception to the rule.

Exhibit 10: EPS >Mid-term Seasonality? Historical Mid-Term Year S&P 500 EPS Growth since 1950 vs. Today



Data as of June 30, 2026. Sources: S&P, FactSet, Shiller.

With the economy on solid footing and several headwinds fading, the market's recent period of digestion looks less like a warning sign and more like a normal part of the climb higher. After a historically strong second quarter, a period of consolidation is not atypical; it is the market's version of catching its breath before embarking on the next ascent. Most importantly, the improving fundamental backdrop should boost corporate earnings, which we believe will continue to be the primary driver of the equity market's advance. The potential for lower Treasury yields is a possible tailwind, particularly with the market trading at lofty valuations, but not a requirement for further upside in our view. With the economy bolstered by the strengthening labor market, earnings robust and inflationary pressures easing due to lower oil, we believe the market is positioned to keep climbing in the second half of 2026.