Review & Outlook

Second Quarter 2026

WAYCROSS INVESTMENT MANAGEMENT COMPANY
119 N. Commercial St., Ste. 191 ▪ PO Box 1618 ▪ Bellingham, WA 98227
P: 360.671.0148 ▪ P: 800.292.8794 ▪ F: 360.671.8936

Review and Outlook

The economy and financial markets have been rather defiant over the past several quarters, the most recent included. No matter the concerns about affordability, or even multiple wars, the broad economic metrics continued to show strength, and the major stock market indexes moved up noticeably.

We've written previously about how metrics like GDP and headline unemployment can be a bit misleading. For example, GDP increased by 2.1% in the first quarter of the year, and current forecasts call for something similar in the second. Unemployment also remains low, at 4.3%. This year, consumer spending has increased at a pace similar to GDP, but it is up because the wealthy continue to spend freely (Delta has added more first-class seats to flights because they are in such high demand), and because of inflation (things cost more now so people have to spend more, while saving less or increasing debt). Unemployment remains low, but that's due to factors such as lower immigration and more people retiring, not robust hiring. So, while the numbers may look fine at first glance, the underlying reasons aren't so reassuring.

As we write this edition of our Review and Outlook, the S&P 500 index is up over 8% so far this year, and up over 12% in the last three months, which is remarkable considering it started the month of April already down 4% for the year. It's important to be careful when thinking about return figures right now because they dropped so sharply with the war in Iran and concerns about inflation, then rebounded just as quickly with continued euphoria surrounding great stories like AI and SpaceX.

Index Performance Data
Total Return as of 6/30/2026

Indices[1]	Q2 2026	Trailing 12 Months
CRSP U.S. Total Market Index Total Return	15.59%	23.10%
iShares MSCI ACWI EX-US Total Return	11.16%	24.89%
Bloomberg U.S. Aggregate Bond Index	0.67%	3.79%

We've been enjoying a positive feedback loop where spending on AI has helped improve the earnings and stock prices of many companies. In turn, people looking at their stock portfolio may feel wealthy and spend freely. The more they spend, the more the stock market moves up, and the wealthier they feel. Of course, this backdrop invites questions about what comes next. That wealth effect could easily go the other direction if the market drops. If people start feeling less wealthy, they'll cut back on their spending. So, it's important to think carefully about what might come next.

Looking at the same issue through a different lens: SpaceX made its debut in the stock market this month. Its stock price went up almost 50% over two days, but has since fallen back to much closer to where it first started. So, what comes next? The company offers promise, but isn't profitable, and no one expects it to be profitable for a long time. The question is will the optimists be able to hold on long enough?

We spoke with economists at S&P Global, and they said they are expecting a downturn. Then they added that they said the same thing last year and were wrong. Everyone seems to be yielding to the momentum in the economy and financial markets. Virtually all forecasts call for continued trend economic growth; inflation moving up this year, before slowly falling back towards 2% over the next few years; and unemployment staying relatively low. The National Association of Business Economics is calling for 2% GDP growth through the end of the year, and unemployment at 4.5%.[2] Forecasts also generally call for modest gains in stock indexes through the end of the year, and most analysts are predicting another 5% gain in the

S&P 500 index by the end of the year. Goldman Sachs and Morgan Stanley are both calling for an additional 10% gain by the end of the year.[3] Not surprisingly, the forecasts get interesting when you look at the footnotes and caveats.

One caveat is that inflation could prove to be more of a problem than many investors currently anticipate. On June 29, 2026, ten-year U.S. Treasuries had a yield of roughly 4.37%. With inflation above 3%, those yields seem reasonable only if you think inflation is going to fall noticeably and soon (perhaps an idea bolstered by falling oil prices). If inflationary pressures linger or increase, interest rates could move up, and stock prices would almost certainly fall. In that scenario it would be hard for the stock market to move up 5-10% from where it is now.

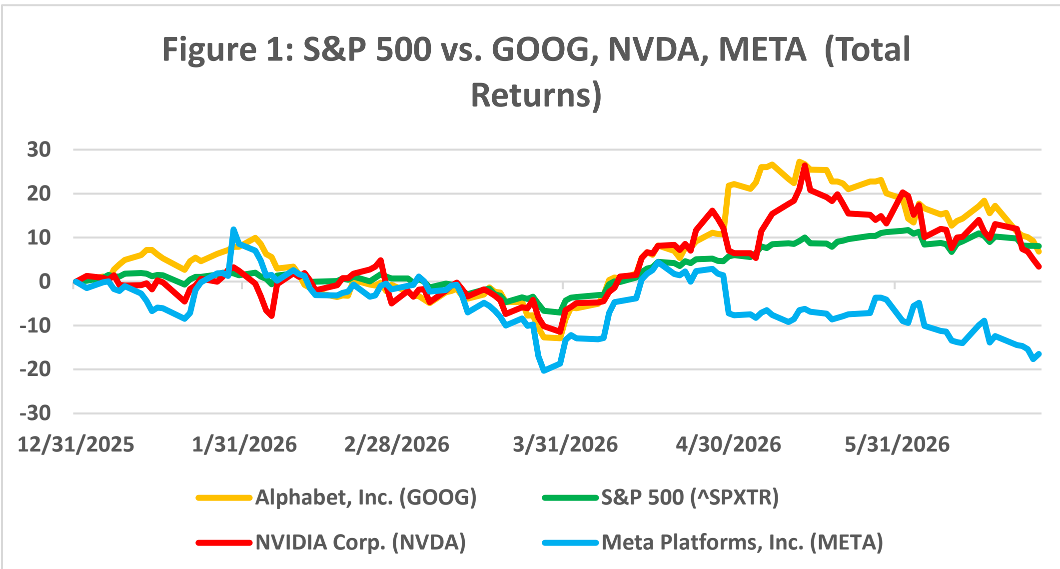

Figure 1: S&P 500 vs. GOOG, NVDA, META (Total Returns)

Another caveat, which has finally started to appear in the news, is that the revenue current AI models are generating does not support the spending we have seen and that is planned for the next few years. Forecasts that call for higher stock prices are supported by forecasts of increasing corporate earnings and profit margins. But what if everyone looked carefully at the math and decided that actual revenues aren't going to be so high?

In fact, that may already be happening. Figure 1 shows the total return for the S&P 500 index and several notable tech/AI companies so far this year. Most are positive for the year, but have seen notable declines in recent months. This could be an indication that investors are starting to look for something to support these lofty valuations (prices relative to earnings).

On June 25th, Apple announced that it would need to raise prices for new iPhones and laptops because chips and other materials are now more expensive. The stock price then fell 5% because investors recognized that higher prices mean Apple's previously forecasted profits might have been too optimistic. Of course, Apple isn't the only company facing higher costs. Everyone is facing higher costs. Apple was just the first to announce that higher costs necessitate higher prices. If and as other companies make similar decisions and announcements, investors are likely to question forecasted earnings figures.

If investors start looking closely at company earnings, including the circular earnings with many AI firms and datacenters, or if investors decide that an AI company just isn't viable (will both Anthropic and OpenAI do well after their IPOs later this year, or might one prevail over the other?), then the complexion of the market could change significantly. Our worry is that such a change could happen quite quickly, making it difficult to decide how long to ride the current wave. Being more conservative would mean losing out on gains, but could mean avoiding a sharp drop, which is the nature of the footnotes in many market outlooks.

In Focus

We noted that stock indexes have moved up despite a list of worries and challenges, but the move up has not been smooth. Even bonds, which are supposed to be the stable part of a portfolio, have moved around considerably in recent months.

Bonds typically have a face value and pay a fixed interest rate (called a 'coupon'). If you buy a bond with a face value of $100 that is paying 4% interest per year, you'd get $4 per year until the bond matures, at which point you'd also get the $100. A bond is like an IOU where you lend someone money when you buy the bond. In return, you get the regular interest payment and the money back on the promised date.

While bonds pay a fixed interest rate, market interest rates change over time. As such, the value of an existing or outstanding bond fluctuates. If the market interest rate was to increase to 5%, no one would pay you $100 for your bond if you wanted to sell it. You'd have to lower the price so that the $4 per year the bond pays would be attractive relative to other bonds people could buy. For example, you could probably sell the bond for $80, since $4 per year would be a 5% return if someone paid $80 to get it.

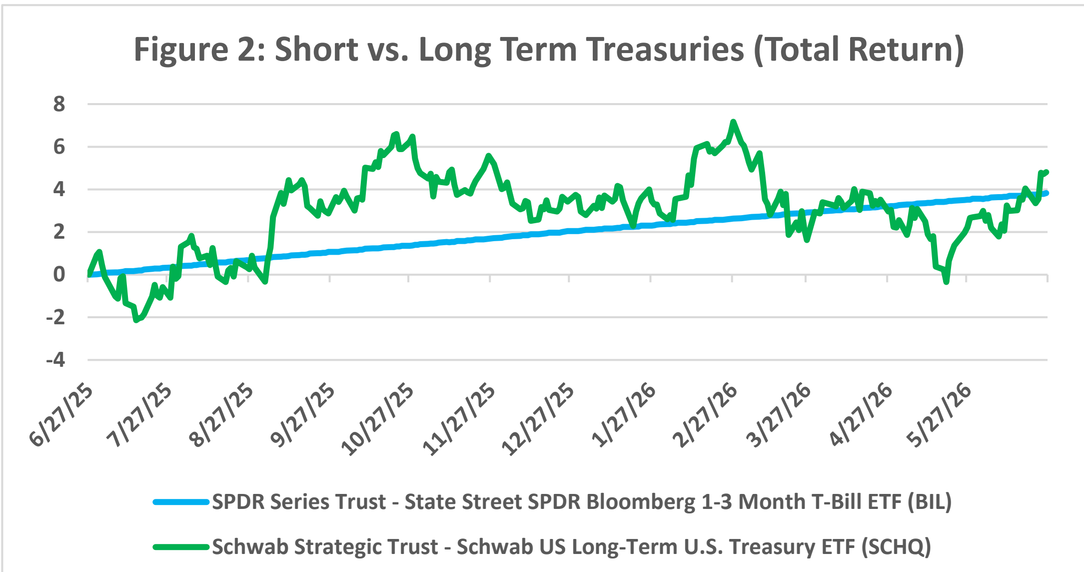

Figure 2: Short vs. Long Term Treasuries (Total Return)

The return for bonds shown in our reports combines the value of the coupon AND the price change IF you were to sell the bond the day the report is run. For bonds we plan on holding to maturity, the reports appear to show that the bond has lost value when interest rates move up, but it isn't a real or actual loss; it's just standard practice for most portfolio accounting systems in our industry.

Figure 2 shows how a set of very short-term bonds (BIL) has performed relative to a set of longer-dated bonds (SCHQ) over the past year. The very short-term bonds do not fluctuate very much in value as interest rates change, but the longer-dated bonds certainly do.

The longer dated bonds pay a noticeably higher coupon, but their price also moves up and down more as market interest rates change. You can see how the value of long-term bonds moved up in the fall when inflation expectations were falling, moved down with inflation worries with the war in Iran, and back up recently as inflation worries have subsided.

One lesson from this chart is that the relative return of the two different bonds looks really different depending on the start date you pick. Just pick the date of a peak or trough for the longer dated bond fund and you get very different stories. Another takeaway is that sometimes it is useful to consider return figures and risk (or volatility) together, not just the return figure by itself, to get a more meaningful picture.

Looking ahead, you are likely to see us moving some of our positions in short-term bonds to longer-term bonds. Our goal is to lock in the higher coupon on longer-dated bonds. The reported return will not look so good if inflation does linger and market interest rates move up, but the longer-dated bonds should do well if/when inflation and interest rates fall. We note that if the stock market corrects or interest rates fall because of a weaker economy, the longer-dated bonds should do relatively well. We believe this adjustment to the bond portfolio maintains our conservative approach to fixed income risk and reward.

1. Index performance data provided by ICE Data Services, and calculated by Black Diamond, an SS&C Advent company.
2. Chart data for Figures 1 and 2 provided by the YCharts! research platform.
3. March 2026 Outlook Survey Summary." National Association for Business Economics, Mar. 2026, https://www.nabe.com/NABE/NABE/Surveys/Outlook_Surveys/March_2026_Outlook_Survey_Summary.aspx
4. The S&P 500 Is Forecast to Climb as Earnings Growth Powers Stocks Higher." Goldman Sachs, 28 May 2026, https://www.goldmansachs.com/insights/articles/s-and-p-500-forecast-to-climb-as-earnings-growth-powers-stocks-higher

This publication is intended to be used as an informational resource only. It is not meant to provide any financial, investment, insurance, legal, accounting, or tax advice, and should not be relied upon by the reader in that regard. We do not receive compensation from any company whose security may appear in our publications. Investments of any type can go up as well as down, and all involve the risk of loss. Please be advised that past performance does not indicate or guarantee future results.