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Market Commentary – 2026 Mid-Year Outlook

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As we approach the mid-point of 2026, it's been another great, yet volatile, year for the markets. How the 2nd half of the year will play out will be highly dependent upon the conflict in the Middle East. As of mid-June, Iran and the US have agreed to halt their war and reopen the Strait of Hormuz. Peace talks up to this point have been fragile, but for the purposes of my mid-year outlook, I will assume that ceasefire holds.

The war pushed inflation higher with headline CPI for May increasing 4.2% as oil and gasoline surged due to the conflict, which also pushed airfare and transportation costs higher. It remains to be seen how fast oil will drop to levels before the war due to the damaged oil infrastructure across several Middle East countries during the conflict. We do have several disinflationary trends in place including shelter costs slowly decreasing and tariff pass-through effects winding down. With all that said, I don't expect any rate hikes or cuts this year. I think Kevin Warsh will do a great job leading the Fed, but his desire to lower rates may be on hold until these inflationary pressures from the war settle down.

At an aggregate level, the consumer is doing fine, as evidenced by recent retail sales and consumer spending reports. However, it remains a bifurcated story as the lower-end consumer is struggling due to inflation reigniting, while the higher end consumer has generated substantial wealth over the past several years from the markets and housing appreciation. Affordability will most likely be the central theme to the upcoming mid-term elections and I expect market volatility to increase as we get closer to those elections. The job market has been in a low fire / low hire mode for many months, but we see more strength building from the recent job reports as hiring is picking up.

One of the biggest stories of 2026 has been the outstanding earnings for the S&P 500, which was up 28.6% in the 1st quarter, marking the best earnings quarter since 2021. Profit margins are nearly 15%, which is the highest mark since FactSet began tracking this metric in 2009. While S&P 500 valuations are historically rich, they are cheaper as of 6/12/26 than at the beginning of the year as a 17% rise in consensus forward 12-month earnings estimates have exceeded the actual 9.15% return. We continue to hear concerns about an AI bubble and certainly we could see some profit taking after the stock market's incredible multi-year run. However, I dismiss the comparisons between the recent stock rally and the dot com bubble of the late 1990s for one very big reason – earnings. The S&P's earnings growth over the past 5 years (+79%) is roughly in line with its total return of 85%. On the other hand, from 1995 – 1999, the S&P earnings growth was 67%, which greatly trailed its total return of 220%.

In the first two months of the year, we saw a strong market rotation with Energy, Materials, Consumer Staples and Industrials leading the way. However, from the outbreak of the war until the end of May, Technology reassumed market leadership with a stunning return of over 31% during those three months. Investors can sometimes flock to Quality during geopolitical conflicts and these Mega Techs certainly represent quality with their strong balance sheets, cash flows, and earnings. As the market rotation ended at the onset of the war, the market breadth narrowed. During the first two months of the year, 66% of the companies within the S&P

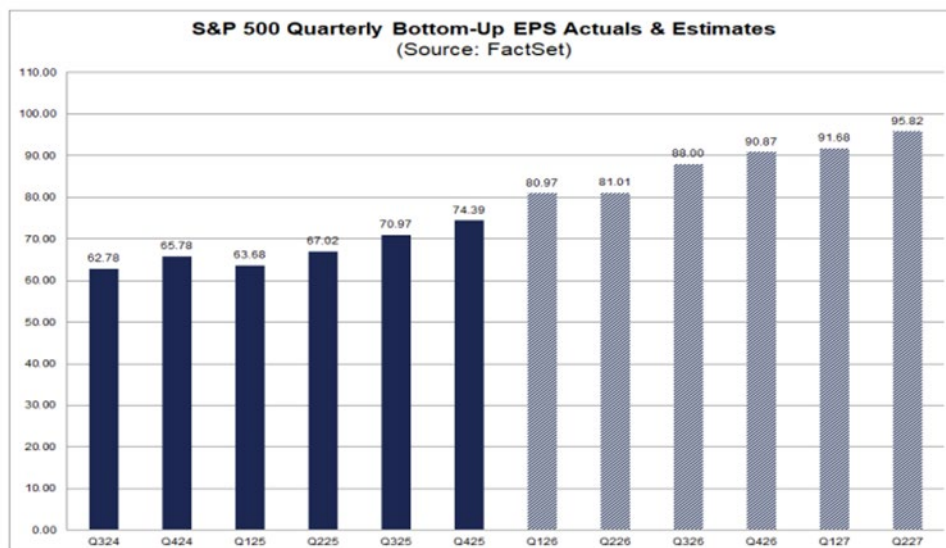


500 outperformed the benchmark. However, since the outbreak of the Middle East war to the end of May, only 24% of the companies outperformed the S&P 500.

With the war (hopefully) behind us, I expect that market rotation to reassume. Valuations are more reasonable across other sectors and the earnings growth is broadening. While I still believe we are in the early innings of this AI revolution, there are other sectors besides Technology benefiting.

- Industrial's strong returns can be partially attributed to durable demand for electrification and AI infrastructure.
- Utilities were once thought of as a defensive sector, but now this sector is very much part of the AI offensive playbook due to the surging data center demand.
- Materials are benefiting as data centers require up to four times more copper than traditional facilities to support power-hungry GPUs and advanced cooling systems, and public infrastructure projects and data center construction are sustaining high demand for steel and cement.

I believe the next sector to enjoy the AI tailwinds will be Healthcare as AI may greatly expedite the drug discovery process for biotech. I'm also bullish on Healthcare as I expect more M&A activity to pick up with pharmaceutical companies acquiring biotech firms to fill up their pipelines. In addition to M&A activity, we are expecting a historic year for IPO issuance, which should benefit the Financials sector along with deregulation.



Investment opportunities are also abundant on the international side. I'm most bullish on Japan due to their corporate governance reforms and AI infrastructure buildout as well as emerging markets due to their technology and semiconductor sectors as well as commodity-exporting countries. It's also interesting to note that the diversification benefits of including international equities in portfolios is increasing. As the world slowly backpedals from globalization and adopts more nationalistic policies, the correlation between US and international equities is dropping. Between 2000 – 2024, the correlation between the S&P 500 and the MSCI EAFE was 0.86. However, from 1/1/25 – 5/31/26, that correlation dropped to 0.61.



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While I remain bullish, I do expect heightened volatility as mid-terms approach. There are investment opportunities across various sectors and areas of the world as the powerful AI tailwinds drive earnings higher. Stay diversified my friends!

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