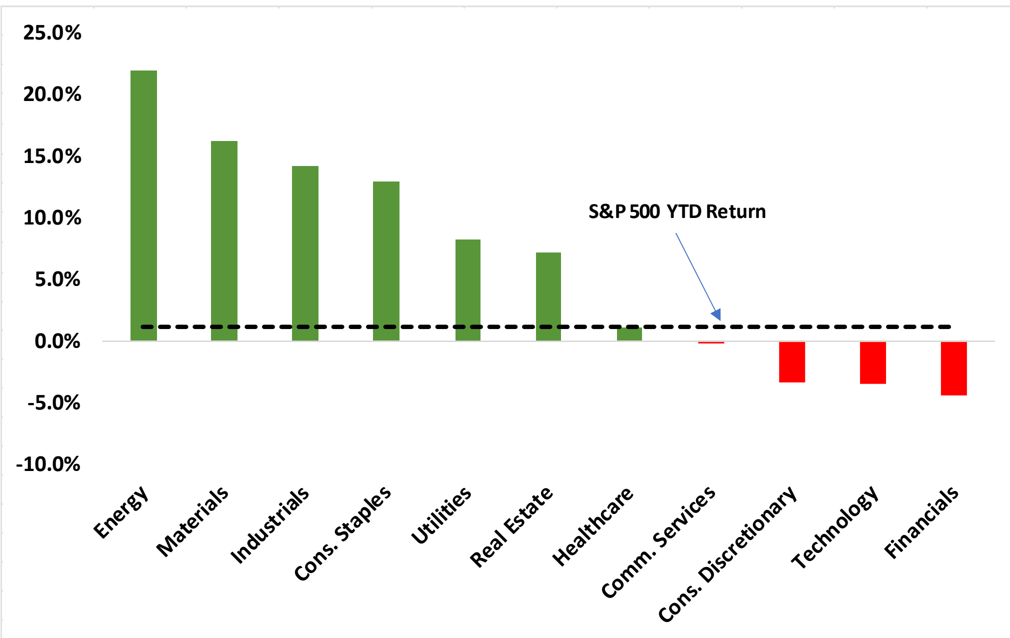
Market choppiness has been a recurring theme thus far in 2026. The index (S&P 500) has been relatively flat and range-bound since late 2025. Beneath the surface, however, there's been plenty of underlying volatility and apparent rotation. Within technology, for example, software stocks are down 24% YTD while semiconductor stocks are up 11%. Consumer staples have risen 13% YTD while consumer discretionary stocks have fallen 3%. This divergence has been apparent across other sectors as well – industrials and energy stocks have gained 14% and 22%, respectively, while financial services stocks have lost 4%. In short, there's been plenty of volatility both within and across sectors despite the market's muted headline performance.

2026 YTD Returns By Sector



Source: S&P Dow Jones Indices

This degree of divergence suggests the current market environment is well suited for skilled active managers. The initial phase of this bull market was powered by the largest technology companies; simply holding a market-weighted portfolio was largely sufficient to capture upside. I believe we have now entered a new phase of the cycle – a slower grind higher for the overall market and wide divergence between winners and losers. In other words, prudent security selection and astute bottom-up research will likely be more important going forward compared to recent years.

When selecting winners, in my view investors should be screening for companies with strong revenue growth, low balance sheet leverage, and likely margin expansion driven by productivity gains. This includers companies enjoying a revenue spike from the hundreds of billions in annual AI-related capital spending as well as businesses likely to see higher profit margins as they implement AI to become more efficient. Companies not included in this list are likely to underperform, in my view, as competitors become more profitable. Correctly identifying these winners requires an understanding of each company's underlying fundamentals and key drivers likely to impact their prospects going forward.

While I believe security selection and active management will play a significantly more prominent role regarding portfolio performance, the macro environment of course also can't be ignored. Last Friday, the Supreme Court struck down President Trump's sweeping tariffs previously enacted under the International Emergency Economic Powers Act (IEEPA). However, following the ruling, the President then pivoted to a 10% global tariff (which he eventually raised to the maximum allowable 15% over the weekend) applied under a different legal statute. While the ultimate path for tariffs is unclear, it is apparent that the risk of higher tariffs and trade policy uncertainty is unlikely to abate anytime soon. This remains a drag on economic growth given the duties are paid by American businesses which import goods. Similar to hiking corporate taxes, tariff duties directly reduce profit margins.

While the continued drag from a more protectionist trade policy is a negative, the economy overall is in reasonably good shape. Fourth quarter GDP growth of 1.4% was disappointing, although this was driven by the shutdown which reduced government spending. Consumer spending remains above 2% while capital investment, driven by robust AI-related spending, is robust and accelerating. I believe capital spending levels will continue to rise over the near to medium term, which should boost corporate earnings and lift productivity levels across the economy. In my view, this suggests corporate profits should enjoy outsized gains while the overall economy should remain strong, providing a fertile environment for American businesses.

In closing, this appears to be an ideal stock pickers environment. The divergence between winners and losers is becoming more apparent, which I expect to continue. We'll hear from Nvidia this week during their earnings call – this has become a key event each quarterly earnings cycle given the company's central role powering the AI buildout. Investors will be keenly focused on the company's comments regarding customer demand and assessing how stocks react following the release. I expect the fundamentals and guidance to remain very strong, although it's unclear if that will be enough to lift stocks given (at least recently) "good/great" news hasn't been enough to ignite a market-wide rally.

Andrew P, Kerai, CFA®

Chairman & Managing Partner

Capital Ideas, Inc.

Disclaimer

The information presented is for educational purposes only and is believed to be factual and up-to-date. All expressions of opinion reflect the judgment of the author(s) as of the date of publication and are subject to change. Nothing in this commentary should be construed as investment advice and does not take into consideration your specific situation. All investments involve risk. Past performance does not guarantee future results. Advisory services offered through Capital Ideas, an investment adviser registered with the U.S. Securities and Exchange Commission.