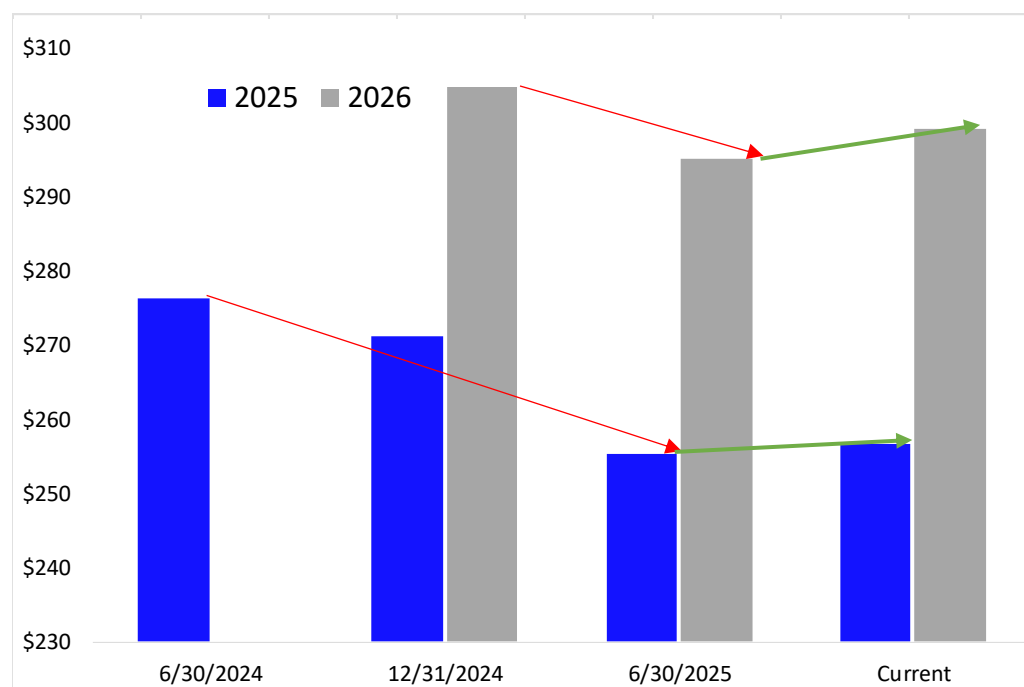


Coming into the week, stocks had been in a relatively tight range throughout most of the month. Since the July 4th holiday through last Monday, the S&P 500 had posted closing levels between 6,226 and 6,296 for 10 consecutive trading days. That trend recently broke to the upside as stocks moved higher throughout the week to notch fresh all-time highs.

The catalyst for this week's positive move was driven by earnings and forward guidance. As written previously, with valuations somewhat elevated I believe strong earnings momentum will be necessary to fuel the next leg of the current bull market. Notably, profit forecasts for this year and next have started to creep higher, reversing the trend of negative revisions that occurred earlier in 2025. Consensus analyst estimates now call for \$257 and \$299 of S&P 500 earnings for 2025 and 2026, respectively, compared to \$255 and \$295 at June 30. While the modest upward adjustment might not seem meaningful, the change in trajectory is what's most significant.

2025 & 2026 S&P 500 Consensus Earnings Estimates



Source: S&P Global

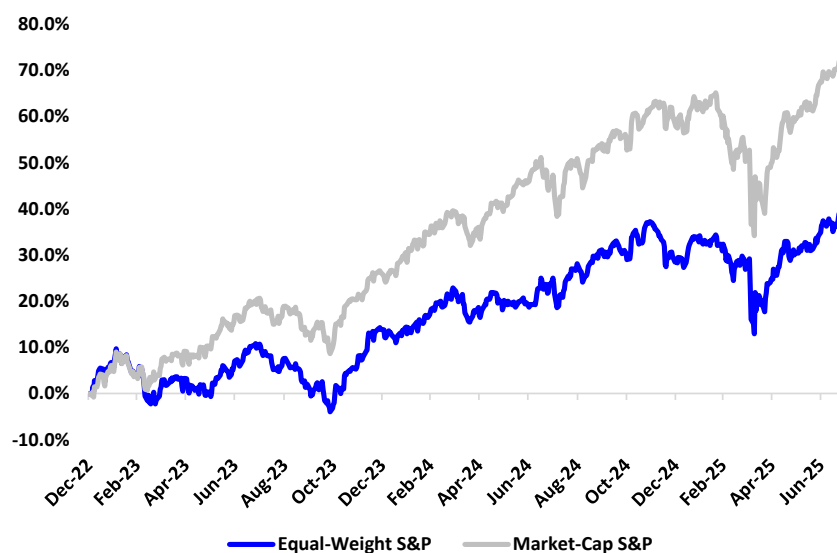
Markets generally move on incremental shifts regarding both sentiment and corporate fundamentals. Higher earnings forecasts following sustained declines is a powerful and healthy bullish trend which may reflect a near-to-medium term inflection point. Stock valuations are based on both multiples (sentiment) and underlying profits (fundamentals). Should go-forward earnings materialize higher than previously thought, this suggests improving fundamentals for the largest and most consequential public companies. This

provides a much sturdier base to support a sustained bull market versus sentiment (multiples) persistently trending higher, eventually becoming overly frothy and fueling a bubble.

Furthermore, the bullish fundamental case for the market is now broadening. While the largest seven megacap stocks (which comprise roughly a third of the index) are expected to continue generating impressive earnings growth, it's becoming increasingly clear that other companies and sectors may finally exhibit meaningful profit expansion over the near term. Through the end of 2026, excluding these largest seven companies, the S&P 500 is now expected to deliver annualized profit growth of 16%, while these remaining stocks on average trade at a relatively modest forward earnings multiple of only 17x. In my view, this leaves room for both profit and multiple expansion across non-technology sectors as sentiment improves and the financial profile of these companies gets stronger over the coming quarters.

The largest technology companies, fueled by hundreds of billions in capital investment earmarked for AI-related initiatives, have justifiably driven the impressive run since late 2022. And all indications point to a further ramp-up in AI-related spending across semiconductors, software, data centers, and other areas. While this suggests the golden goose fueling this rally remains fat and healthy, as performance across other sectors finally improves, we may experience more broad-based upside participation throughout the remainder of 2025 and 2026.

Equal-Weight Vs. Market-Cap Weight S&P 500 Total Return: 12/31/2022 - Current



Source: S&P Global

That broadening has been playing out recently, albeit over a limited timeframe. Quarter-to-date, the equally-weighted S&P 500 has generated a 3.3% return compared to 3.0% for the market-cap weighted index. When considering how much the equal-weight index has lagged its market-cap equivalent (which is heavily represented by large-cap technology companies) for multiple years, should underperforming sectors display improvement there's significant potential for this gap to narrow.

The dynamic of broadly improving fundamentals and valuation dislocations across specific segments suggests that it may be a stock picker's market going forward. While certain stocks may appear relatively cheap, the underlying companies offer wide ranges of quality and valuation metrics. This presents investors with the opportunity to select the best of breed among the under-loved companies that may be experiencing a positive shift in their financial outlook. The price-to-earnings and growth (or "PEG") ratio can be a handy tool when screening for companies that fit this criteria. This measure allows investors to analyze how much the market is commanding per dollar of company earnings and future growth. For example, a company trading at 20x earnings with expected future earnings growth of 10% would be assigned a PEG ratio of 2. It is my view that a "GARP" (growth at a reasonable price) approach to stock selection is ripe to outperform in this environment, and there's ample opportunity across the current investment universe.

We're now in the heart of earnings season, with further clues regarding the go-forward outlook over the coming weeks. Several themes have been emerging, which are consistent with our longer-term bullish thesis:

- The massive capital investment supporting the build-out of AI continues at an unprecedented scale.
- Credit metrics for businesses and consumers remain robust.
- Companies as a whole have proven resilient and efficient while adeptly navigating a shifting economic landscape.

As investors assess the outlook for corporate profits, we are optimistic that earnings growth will continue to outpace overall economic expansion (i.e. GDP) through at least the end of next year. That suggests the bull market we have been enjoying for nearly three years may have significantly more room to run.

Andrew P. Kerai, CFA®

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