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CJ's Weekly Market Memo

"Space Race Redux"

This week the Commerce Department signed letters of intent to award \$2 billion in federal incentives to nine American quantum computing companies, with IBM receiving \$1 billion and Washington taking minority equity stakes across the group. I read the announcement twice, and the second time I felt the air shift. After more than five decades watching governments try to pick technological winners, I can tell you that what was announced Thursday looks and smells much like 1961, when Kennedy stood before Congress and committed the country to the moon. It is the opening move of a Space Race Redux, and the partner across the table is no longer Moscow but Beijing.

The Economy

Memorial Day weekend is here, and with it the traditional start of the summer rally. Since 1950, the period from Memorial Day to Labor Day has delivered a positive S&P 500 return in roughly two out of every three years, with an average gain in the 3% to 4% range. I have learned not to bet against seasonality unless the macro setup is genuinely broken, and right now the underlying economy is sturdier than the headlines suggest, even if the inflation backdrop is uncomfortable and the consumer is starting to flinch.

Back to the quantum announcement, because it deserves a moment. In the early 1960s, when the United States and the Soviet Union began racing to outspend each other on rockets and satellites, the immediate commercial benefits were thin and the timeline to payoff was much longer than the boosters predicted. But the eventual spillovers, from semiconductors to GPS to integrated circuits and ultimately to SpaceX itself, rewrote the global economy. China is now racing the United States for quantum supremacy, with a national fund reportedly committing the equivalent of a trillion yuan to the effort. Our \$2 billion looks modest by comparison, but it is the down payment that matters, and the equity stakes the Treasury is taking are a meaningful structural change in how Washington finances frontier technology. Expect speculation in the quantum names to be extraordinary. Expect the practical benefits to take longer than the bulls hope. And expect the eventual marriage of quantum and AI, once both technologies mature, to be transformative. This is one of the central observations in my forthcoming book, *Investing in the Second Wave*, due out this fall.

On the Fed, my friend Ed Yardeni put it as plainly as he ever does last week: rate cuts in 2026 are essentially off the table. He cites reaccelerating inflation, five consecutive years above the 2% target, the inflationary impact of the AI infrastructure buildout, and a labor market that simply will not roll over. The two-year Treasury yield is already trading above the effective fed funds rate, which is the bond market's polite way of telling Chairman Warsh that current policy may not be restrictive enough. Fed Funds futures now fully price one hike before year-end, a three-notch upward revision from where pricing sat before the Iran conflict began. Real yields confirm the story, with the 10-year TIPS yield at its highest level in a year. The U.S. economy is too strong to cut, and that, in the end, is why bond yields are grinding higher all around the world.

The Philadelphia Fed survey this month delivered the most important data point of the week, and frankly the one that has my attention. 42% of respondents reported customers becoming more price sensitive, yet among manufacturers anticipating cost changes over the next six months, 75% said they

intended to raise prices in response. Factories see the consumer pushing back and they intend to pass the costs through anyway. That is the textbook setup for sticky inflation, and it is happening before the full Iran energy shock has worked through to PCE. Live cattle futures sit near \$2.40 a pound with real prices at half-century highs, the cattle herd is at a record low, agricultural commodities are up 11% year to date, and the Strait of Hormuz remains closed as the conflict grinds into its third month. Labor remains the genuine bright spot, with initial jobless claims running well below 2023 through 2025 levels and continuing claims beneath 2024. Healthy job market, hot prices, no cuts. That is the mix.

Current Market Technical Conditions

Earnings season finished beautifully on paper. The EPS beat rate closed at 72.8% (94th percentile since 2001), revenue beats at 74.9% (98th percentile), and guidance raises in the top quintile historically. By every traditional yardstick, this was an exceptional season. And yet the market response was, to be charitable, disappointing in exactly the places that should have led.

Nvidia delivered the most important report of the season, and on the numbers, it was a clean beat-and-raise. Revenue beat by 3%, networking grew 199% year over year against estimates of 157%, Q2 guidance came in 2% to 6% above consensus, the company added \$80 billion to the buyback authorization, and CEO Jensen Huang openly discussed securing compute capacity across Azure, AWS, and CoreWeave for Anthropic this year and next. The stocks closed essentially flat on the news. Target had its strongest comps quarter since 2022, with comparable sales up 5.6% against estimates of just 1.9%, traffic up 4.4% versus 1% expected, digital up 8.9%, and adjusted EPS beating by 20%. The stock sold off sharply. Walmart reported solid demand with U.S. comps of 4.1% and e-commerce growing 26% year over year but flagged a 250-basis point fuel cost headwind and guided Q2 EPS one to three cents below consensus. The stock dropped. When excellent reports get poor receptions, the market is telling you something about its mood, and it is worth listening.

The message, I think, runs through the gas pump. Since the Iran war began at the end of February, U.S. consumers have shouldered roughly \$45 billion in additional energy costs. That money has to come from somewhere, and the answer is increasingly clear: it is coming out of discretionary spending and squeezing the lower-income consumer. Walmart's CFO put it in plain language this week when he said high-income customers are spending with confidence while lower-income consumers are budget-conscious and possibly navigating financial distress. Even superb earnings cannot fight a tape where forward expectations are being marked down to reflect that squeeze. Real average hourly earnings just turned negative year over year for the first time since February 2023. By only a tenth of a percent, but the direction matters.

Beneath the surface, breadth remains uneven. The equal-weight S&P 500 is broadly keeping up with the cap-weighted index, but Communications Services, Consumer Discretionary, Consumer Staples, and Industrials are all seeing their equal-weight versions lag. Technology is the standout exception, where equal-weight Tech is making record highs alongside the cap-weighted version. The AI infrastructure rally has genuine breadth behind it. The rest of the market does not, and it is worth noting that the four laggard sectors are precisely the ones most exposed to the consumer who is now being squeezed.

One technical signal that deserves real respect is the SpaceX S-1 filing this week, with OpenAI reportedly targeting a September IPO of its own. Historically, sharp increases in net equity issuance have coincided either with crisis-era recapitalizations like 2009, or with absolute mania peaks like

2000 and 2021. Hyperscaler buybacks have collapsed to almost nothing as AI capex absorbs every dollar of cash flow, and Oracle is issuing equity to fund its buildout. This is a market that has spent two years absorbing supply and is now preparing to provide it. That shift in flow matters, and it deserves more attention than it has received.

A Prognostication for 2026

My near-term caution has not changed, and this week's data only sharpens the reasons for it. A Fed that will not cut, real yields grinding higher, an unresolved Iran conflict squeezing the consumer to the tune of \$45 billion and counting, narrowing breadth in four of the eleven sectors, and a wave of mega-cap IPO supply approaching all argue for measured positioning over the next three to four months. If the Memorial Day to Labor Day seasonal pattern holds, we should see modest upside into the summer, and I would use any meaningful rally to trim positions in the weaker-breadth sectors and stay disciplined.

Step back, and the longer view remains genuinely constructive. The quantum announcement this week reinforces why. The Second Great Wave thesis is fundamentally about pattern recognition across technological cycles, and we are now watching two transformational technologies, AI and quantum, receive massive parallel public and private capital commitments. Hyperscaler capex curves are going vertical while share repurchases collapse. The federal government is taking equity stakes in quantum companies. Nvidia management is openly discussing securing compute for foundation labs across three major hyperscale's. Capital is being reallocated from financial engineering toward physical buildout at a scale we have not seen since the canal and railroad eras. That is not the setup for a market that ends in three months. That is the setup for the defining capital cycle of the next decade.

My father used to say that the hardest discipline in investing is to hold your conviction through the noise that surrounds it. The noise right now is real. The consumer is squeezed, the Fed is hawkish, geopolitics are messy, and the loudest leaders of this rally are the most extended they have been in years. I continue to favor selective exposure to AI infrastructure beneficiaries across power generation, connectivity semiconductors, and data center construction, with measured caution on the consumer side outside of off-price retail and the value-leaning general merchandisers. The bifurcated consumer story will not resolve until energy prices ease, and that requires Hormuz reopening. If the strait stays closed, the only thing holding global crude in check is the cushion of reduced Chinese oil demand (they have large reserves in storage), and that cushion will not last forever. Keep dry powder available for the volatility that hawkish monetary policy combined with geopolitical risk will produce. The next three to four months call for patience. The longer-term picture, as it has been for some time now, remains genuinely optimistic. Space Race Redux, with all that history tells us about how these things eventually play out, is just getting started.

Enjoy your weekend.

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Chairman Emeritus, Capital Ideas

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