

MARKET UPDATE
FOR INFORMED INVESTORS
QUARTER 2 | 2026

Underperforming stock superstars underscore a much different, eventful Q2

The FIFA World Cup has once again demonstrated that championships are rarely won by relying on a single superstar. Instead, success comes from emphasizing team offense to score goals, and focusing on defense to prevent goals. The same principle can be applied to the stock market in the second quarter. More specifically, a diversified portfolio has proven to be an effective team approach for generating returns while managing risk, especially as many of the star players in "Magnificent 7" stocks have underperformed.

A much different quarter emerged in Q2 with the delicate peace process ending the war with Iran. Oil prices fell in anticipation of peace and the return of oil supplies to global markets.

Still, inflation concerns, corporate earnings, and the durability of the peace process remain the three key issues to watch for the rest of the year. Moreover, while strong corporate earnings and a strong stock market display a level of resiliency, they do not necessarily indicate a strong overall economy as we will detail ahead.

HIGHLIGHTS

- **Oil:** Energy prices have dominated headlines throughout the quarter. Since the interim peace agreement, crude oil has fallen from more than \$110 per barrel to below \$70—a decline of nearly 40% from its March peak. Sustained lower energy prices could provide an important tailwind for consumers while easing pressure on central banks.
- **Interest Rates:** The Federal Reserve continues to balance its dual mandate of maintaining maximum employment and controlling inflation. Under the new Chair Kevin Warsh, the Fed has emphasized clearer communication while reevaluating several internal policy frameworks. Despite the recent decline in oil prices, inflation remains above the Fed's target.
- **Inflation:** Core inflation has increased from 2.4% earlier this year to 2.9%, remaining well above the Federal Reserve's long-term target of 2%. While lower energy costs are encouraging, persistent core inflation suggests policymakers are likely to remain cautious before easing monetary policy.

- **Labor Market:** The unemployment rate currently stands at 4.2%. Hiring has slowed, job openings continue to decline, and wage growth has moderated to 3.5%. With the Consumer Price Index (CPI) increasing at 4.2%, many workers continue to experience a decline in real purchasing power. Although the labor market remains relatively healthy by historical standards, signs of moderation are becoming increasingly evident.
- **Economic Growth:** Gross domestic product (GDP) continues to expand at approximately the first-quarter pace of 2.1%, although growth remains below last year's levels. Consumer spending, previously one of the economy's strongest pillars, has softened as households continue to navigate elevated prices and higher borrowing costs. This environment continues to reinforce the concept of a "K-shaped" economy. Higher-income households and companies benefiting from artificial intelligence investment continue to perform well, while many consumers and businesses face rising costs and tighter financial conditions. As a result, corporate earnings and financial markets have remained resilient even though portions of the broader economy continue to face meaningful challenges.
- **Equity Markets:** Equity markets recovered quickly following the volatility surrounding the conflict with Iran and have produced solid year-to-date and one-year returns. Leadership, however, has broadened beyond the large-cap technology companies that dominated recent years. Small-cap stocks have posted particularly strong gains, reinforcing the benefits of maintaining diversified portfolios rather than concentrating investments in a handful of market leaders. International investments remain an important source of diversification, as emerging markets have been the strongest-performing international asset class, gaining 24% year to date. Although a weaker U.S. dollar and shifting trade dynamics have supported returns, much of that performance has been concentrated among a relatively small group of large-cap companies benefiting from artificial intelligence-related investment.
- **Fixed Income:** Fixed income markets have remained relatively range-bound as higher interest rates have offset the benefits of current income. Inflation concerns and elevated policy rates are likely to keep returns within the low- to mid-single-digit range for the foreseeable future. We continue to recommend caution in lower-quality fixed income sectors, where credit spreads remain historically tight and provide limited compensation for additional risk.

As we move through the second half of the year, investment success may depend less on identifying the next market superstar striker and more on maintaining a team approach via disciplined diversification. Markets are likely to continue rotating between companies viewed as artificial intelligence winners and those facing greater competitive or economic challenges, so maintaining exposure across asset classes and investment styles remains one of the most effective ways to navigate that uncertainty.

Artificial intelligence continues to support corporate investment, earnings growth, and productivity, providing an important long-term tailwind for the economy. While periods of market volatility should be expected, most economists anticipate continued economic expansion, albeit at a more moderate pace. Still, lower corporate tax rates and healthy corporate balance sheets should continue to support earnings growth.

Although risks remain, including inflation, monetary policy, and geopolitical developments, there are currently no clear indications of either a global recession or a significant economic slowdown.

We welcome the opportunity to discuss your investments. If your financial situation or investment time horizon has changed, please reach out to your advisor.

Written by North Star Investment Resource Center

	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
S&P 500	10.21%	22.32%	20.61%	13.41%	15.51%
US Small Caps	22.57%	40.78%	18.60%	6.98%	11.62%
Int'l Stocks	9.44%	20.23%	16.44%	9.05%	9.66%
Bond Market	0.62%	3.79%	4.16%	0.08%	1.54%

Returns over 1 year are annualized. S&P 500 index, US Small Caps use Russell 2000 index, international stocks use MSCI EAFEANR USD, Bond Market use Bloomberg US Agg Bond TR USD.

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The Russell 2000 is a stock market index measuring the performance of 2000 small capitalization stocks. It represents the 2000 smallest companies in the Russell 3000 Index, which in turn represents the 3000 largest companies in the U.S. Thus, the Russell 2000 is a barometer of small-cap stocks. Though small, the companies represented by the Russell 2000 are not the smallest of the small as they are not penny stocks. The Russell 2000 is weighted by the market capitalization of the stocks.

MSCI EAFE – Designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted.

The Bloomberg U.S. Agg Total Return Value Unhedged, also known as "Bloomberg U.S. Aggregate Bond Index," formerly known as the "Barclays Capital U.S. Aggregate Bond Index," and prior to that, the "Lehman Aggregate Bond Index," is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Small-cap funds may be subject to a higher degree of market risk than large-cap funds or more established companies' securities. Furthermore, the illiquidity of the small-cap market may adversely affect the value of an investment so that shares, when redeemed, may be worth more or less than their original cost. Additional risks are associated with international investing, such as currency fluctuations, political and economic stability, and differences in accounting standards. The return and principal value of bonds fluctuate with changes in market conditions. If bonds are not held to maturity, they may be worth more or less than their original value.