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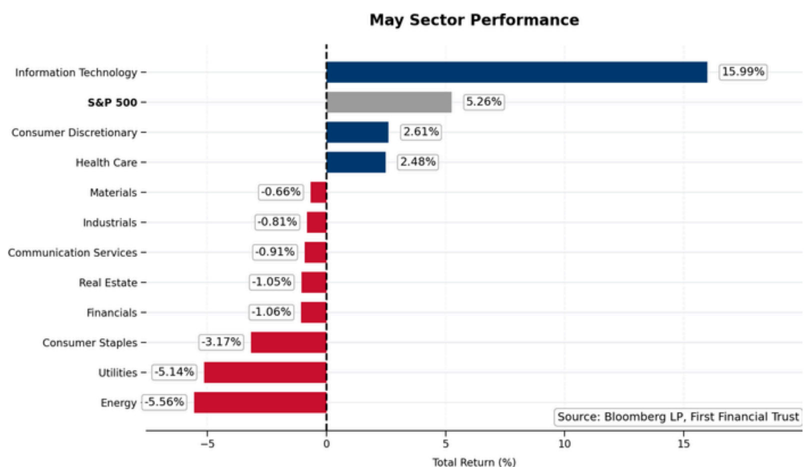
Equity Market Update

As of May 31, 2026 | Volume 15, Issue 5

In May, the stock market extended its powerful upward trajectory as major U.S. benchmarks—including the S&P 500, Nasdaq, and the Dow Jones Industrial Average—meaningfully surged to new all-time highs. This sustained bullish momentum was primarily propelled by an exceptionally robust first-quarter corporate earnings season, in which S&P 500 profits grew in the high-20% range year-over-year and soundly beat pre-season expectations. Investor sentiment was further bolstered by an easing of geopolitical headwinds following a credible ceasefire framework between the U.S. and Iran, which many hope will lead to the reopening of the critical Strait of Hormuz. This constructive backdrop, paired with resilient consumer spending and solid labor data, allowed investors to largely look past rising Treasury yields and the Federal Reserve's restrictive "higher-for-longer" rate stance. Ultimately, mega-cap technology and semiconductor companies directly tied to artificial intelligence infrastructure remained the dominant thematic leaders, masking broader softness in more defensive sectors.

Performance

The tech-heavy Nasdaq led the monthly rally with an 8.43% total return, followed by the S&P 500 at 5.26% and the Dow Jones Industrial Average at 2.93%. Mid-cap and small-cap equities also posted positive monthly returns, with the S&P MidCap 400 and S&P SmallCap 600 rising 2.45% and 1.04%, respectively. Market breadth within the S&P 500 remained highly constructive, with 261 constituents advancing while 239 declined, driving the index up by over 444 points.



On a sector level, performance in May was heavily bifurcated, as investor capital concentrated intensely within technology-driven areas while rotating out of cyclical and defensive groups. Information Technology was the standout leader, surging 15.99% for the month, while Consumer Discretionary and Health Care managed modest gains of 2.61% and 2.48%, respectively. Conversely, eight of the eleven S&P sectors finished the month in negative territory. The Energy sector was the steepest monthly laggard, declining 5.56%, closely followed by Utilities at -5.14% and Consumer Staples at -3.17%.

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Individual stock leaders heavily influenced index movements during the month, with mega-cap technology and hardware providers spearheading the gains. Within the S&P 500, Apple (AAPL) was the primary driver, accounting for 16.27% of the index's upward move, while Micron Technology (MU) and NVIDIA (NVDA) followed as dominant contributors. For the Dow, Goldman Sachs (GS) and UnitedHealth Group (UNH) led the blue-chip index, accounting for 34.02% and 20.22% of its positive monthly shift. On the downside, Meta Platforms (META) acted as the largest single drag on the S&P 500, while Salesforce (CRM) and Microsoft (MSFT) severely weighed on the Dow, with CRM alone subtracting over 113 points.

Looking at the broader year-to-date trajectory, the market has posted strong double-digit gains across almost all major benchmarks. The Nasdaq remains the top year-to-date performer with a 16.34% total return, followed closely by the S&P SmallCap 600 at 15.55% and the S&P MidCap 400 at 13.27%. The S&P 500 has advanced 11.25%, anchored by the enduring strength of the Energy and Information Technology sectors, which boast cumulative gains of 26.04% and 23.81%, respectively. Micron Technology (MU) holds the mantle as the top S&P 500 index mover year-to-date, whereas Caterpillar (CAT) commands the top spot for the Dow, contributing an impressive 69.51% of the average's year-to-date performance.

Economic Data Summary

The U.S. economy nears the mid-year period, displaying a complex mix of steady consumer demand and rising inflation readings, primarily driven by higher energy prices due to the military conflict with Iran. Retail sales grew by 0.5% month-over-month, building on a 0.7% surge in the previous report. However, this consistent consumer spending has come at the expense of household financial cushions. Personal savings as a percentage of disposable income fell sharply to 2.6%, continuing a distinct downward trend from the 5.5% level recorded a year prior. In the labor market, non-farm payroll additions cooled to 115,000 in April, down from 178,000 in March, while the headline unemployment rate ticked up to 4.3%. Though job creation has slowed from previous years, annual wage inflation remains rigid, with nominal average hourly earnings rising 3.6% year-over-year (YOY).

In contrast to the tightening consumer backdrop, corporate and business activity has staged a notable resurgence through the spring of 2026. The ISM Manufacturing Index accelerated into expansion at 52.7 in both March and April, then climbed to 54.0 in May, indicating a solid recovery for a sector that spent most of late 2025 in contraction. This expansion is heavily underpinned by accelerating demand, as ISM Manufacturing New Orders hit 56.8 in May. Similarly, the service sector remains on solid footing, with the ISM Services Index registering at 54.5. However, business expansion is facing severe supply-side headwinds. The manufacturing prices paid index ballooned to 82.1 in May, while services prices paid remained elevated at 71.3, signaling that inflationary pressures are shifting into corporate supply chains. These soaring corporate input costs are increasingly driving a wedge between larger enterprises—which possess the scale and pricing power to absorb or pass along these increases—and smaller, regional businesses that face margin compression.

The most obvious development within the economic landscape is the re-acceleration of inflationary forces. After hovering in the mid-2% range throughout late 2025, headline CPI spiked dramatically to 3.8% year-over-year, while Core CPI moved up to 2.8%. Crucially, the Federal Reserve's preferred inflation metric, the Personal Consumption Expenditures (PCE) price index, echoed this broader alarm by rising 3.8%, while Core PCE remained stubbornly at 3.3%.

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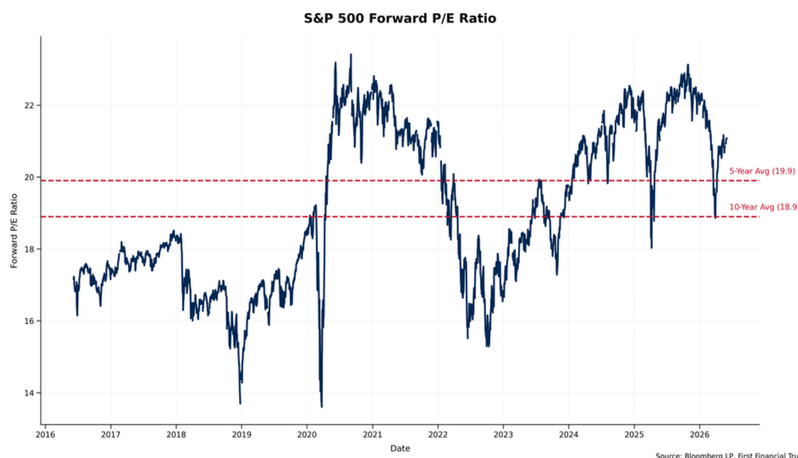
This across-the-board inflation resurgence confirms that price pressures are no longer just "sticky," but are actively rebounding. Much of this, however, can be attributed to higher energy prices from the situation in Iran that has the Strait of Hormuz closed. The divergence between nominal wage growth (+3.6%) and headline inflation (+3.8%) effectively leaves real consumer income trailing behind living costs, explaining the rapid drawdown of personal savings seen over the last few quarters. This pattern underscores the comments from several CEOs warning about a k-shaped economy in which wealthier households continue to prosper given gains in their investment securities, while lower-income citizens are falling behind economically.

The mixture of rebounding inflation, lower savings, and expanding business activity has forced a hawkish shift among some members of the Federal Reserve. At their most recent meeting and subsequent press conference, central bank officials acknowledged that progress on inflation has stalled, rendering any near-term interest rate cuts entirely off the table. The Fed reiterated its restrictive "higher-for-longer" policy stance, signaling a clear willingness to maintain the federal funds rate at its restrictive plateau until a sustainable descent toward their 2% target materializes. During the press conference, Chairman Powell emphasized that while economic growth and business investment remain highly resilient, the central bank cannot afford to look past the supply-side price spikes seen in the ISM reports. Consequently, the market tempered its expectations for lower rates by removing the likelihood of any cuts for the remainder of 2026.

Valuation & Earnings

The valuation of the S&P 500 currently stands at 21.1x forward earnings estimates, basically in line with one year ago (20.9x). It is slightly above the 5-year average (19.9x) and the 10-year average (18.9x). However, the equity risk premium, which compensates investors for the excess risk associated with stocks relative to bonds, remains thin due to the higher interest-rate environment.



The Q1 2026 earnings season demonstrated remarkable resilience, with the S&P 500 achieving its highest year-over-year earnings growth rate since late 2021. The blended growth in profits was an impressive 28.6%, significantly higher than the 13.1% estimated by analysts. This performance was bolstered by a high frequency of positive surprises—85% of companies exceeded earnings-per-share (EPS) estimates, and 81% surpassed revenue expectations. These figures represent the strongest "beat" rates for the index in nearly five years, signaling a robust corporate environment despite broader economic uncertainties. The primary catalyst for this surge has been the exceptional profit growth of the "Magnificent 7" companies, particularly Alphabet, Amazon, and Meta Platforms, which together accounted for a substantial portion of the index's total earnings growth. The Communication and Information Technology sectors have led the pack, with both reporting growth rates in the 50% range!

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The jump in profits from these two sectors is fueling large capital spending programs on the build-out of artificial intelligence infrastructure that is powering above-average profit growth for industries attached to this spending—utilities, pipelines, electrical equipment, semiconductors, memory, etc. Looking ahead, analysts have taken an uncharacteristically optimistic stance by upwardly revising EPS estimates for the second quarter and the full year 2026, a trend largely driven by the Energy sector amid rising oil prices and the belief in even higher AI capital spending.

Conclusion

Stocks remain vulnerable to headline risk from major economic reports, the Fed, and geopolitical events; however, recent earnings reports have shown the economy remains on a growth trajectory. Unfortunately, business activity is widely uneven. Big tech companies are fueling most of the growth via their spending on artificial intelligence infrastructure. According to the most recent GDP report, AI spending accounts for over 50% of economic growth. This lopsided environment is causing investors to pile into companies affiliated with the build-out of AI.

This activity can be seen in market data. As we mentioned previously, the S&P 500 currently trades at 21.1x forward earnings estimates. If you equal-weight the names inside the index, which dilutes the influence of big tech companies, the forward PE ratio drops to 17.3x. That spread of 3.8 turns is lower than one month ago, but it is far less than the 6.1 turns seen last autumn. More importantly, the difference in earnings growth between the S&P 500 market-cap and equal-weight indexes is almost 8% today, up from only 4% last October. This tells us the premium valuation being assigned to AI-related names is warranted, given the increased divergence in growth between the AI names and everyone else.

Finally, we remain bullish on technology and AI-related names; however, we would not be surprised to see this theme take a breather given the massive upside move in many of these names over the past few months. Part of the trade appears crowded, but fundamentals do not warrant fading the structural theme. We also favor financials. The higher-interest-rate environment is conducive to asset repricing, and the underlying economy is still growing, albeit unbalanced. Credit quality, especially among banks, is strong. For larger banks with capital markets divisions, market volatility has boosted trading activity. These factors, along with lower capital requirements from the Fed, should lead to strong profit growth. Concerns surrounding private credit appear to be limited to a small segment of loans and product structures, while banks' exposure to non-bank financial institutions (NBFIs) remains low. Relative valuation of banks versus the market has collapsed over the last three months as concerns about the likelihood of the Fed cutting rates have increased. Lastly, we see several bargains across the healthcare sector. Succinctly put, we prefer quality balance sheets, secular demand, and pricing power during this turbulent and uneven economic environment.

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