

# Equity Market Update



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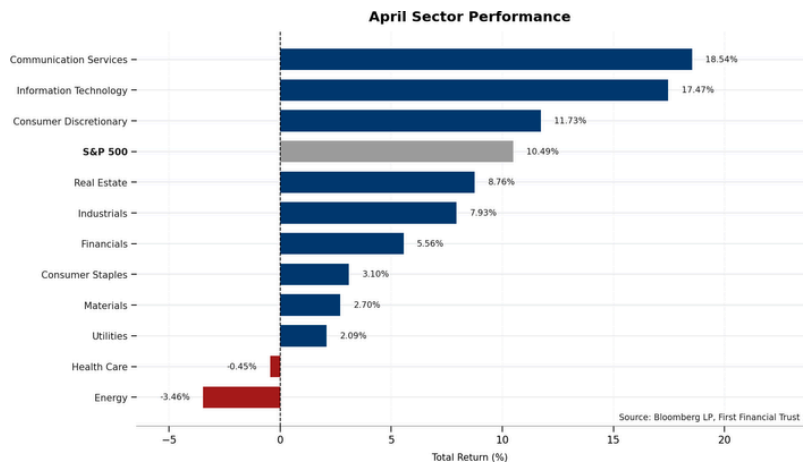


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In April, the stock market staged a powerful risk-on rally that saw major indices reach new all-time highs, largely decoupling from persistent geopolitical tensions in the Middle East. The bullish momentum was primarily fueled by a robust corporate earnings season, where over 80% of reporting S&P 500 companies exceeded consensus expectations, along with a renewed investor fervor for artificial intelligence and semiconductor growth. While the Federal Reserve maintained a cautious stance—holding interest rates steady amid "sticky" energy-driven inflation—the market's appetite for secular growth themes tied to AI offset concerns regarding delayed monetary easing.

## Performance

Stock performance was both significant and broad-based. The tech-heavy Nasdaq led the surge with a monthly total return of 15.32%, while the S&P 500 and the S&P SmallCap 600 also delivered robust double-digit gains of 10.49% and 10.41%, respectively. The Dow Jones Industrial Average followed closely, rising 7.24% for the month. Market breadth was notably positive, as evidenced by the S&P 500, where 365 constituents finished the month higher compared to only 139 that declined.



Sector-level performance was driven by explosive growth in high-innovation areas, particularly Communication Services and Information Technology, which returned 18.54% and 17.47%, respectively. Consumer Discretionary also showed strength with an 11.73% return, led primarily by the jump in shares of Amazon. Conversely, the Energy and Health Care sectors lagged behind the broader market, posting negative total returns of -3.46% and -0.45%, respectively. These results highlight a market environment where investors prioritized growth and technology over defense and commodities.

Individual stock leaders played a pivotal role in driving these index gains, specifically within the technology and semiconductor industries. NVIDIA (NVDA) was a primary contributor to the S&P 500's upward movement, surging by approximately 20.8% during the month, while Alphabet (GOOGL) and Amazon (AMZN) also provided significant lifts to the index.

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Within the Dow, Caterpillar (CAT) and Goldman Sachs (GS) were the standout performers, contributing 31.08% and 16.12% respectively. On the downside, UnitedHealth Group (UNH) and Chevron (CVX) were among the notable laggards that constrained further gains in the blue-chip average.

Year-to-date, the S&P SmallCap 600 index has been the clear standout, posting a total return of 14.36%, followed by the S&P MidCap 400 at 10.55%. Meanwhile, the Nasdaq and the S&P 500 have seen more moderate year-to-date gains of 7.29% and 5.69%, respectively, indicating that the explosive growth seen in April was a critical recovery after two straight months of selling in growth-oriented stocks.

## Economic Data Summary

The U.S. economy continues to navigate a complex landscape defined by resilient growth and unexpected geopolitical headwinds. Real GDP increased at an annual rate of 2.0% in the first quarter, a significant rebound from a sluggish 0.5% in late 2025. This growth was largely driven by a surge in business investment, particularly in equipment and structures related to artificial intelligence, which jumped by more than 10%. While government spending also provided a boost following the resolution of earlier shutdowns, consumer spending has begun to soften as households adjust to higher living costs.

The labor market remains a cornerstone of economic stability, though it is showing signs of gradual cooling. Jobless claims are near historical lows, indicating that employee quitting or mass corporate layoffs are not widespread. The unemployment rate is trending toward 4.0%—4.2% as the workforce dynamics shift under the influence of rapid AI adoption and changing immigration patterns. Despite these tight labor conditions, the "Iran war" has introduced significant uncertainty, causing fluctuations in business confidence and a 36% rise in energy costs that has only recently begun to stabilize.

Inflation has proven stickier than anticipated due to these energy shocks. While core inflation (excluding food and energy) has moderated to approximately 2.6%, the "headline" figures (3.3%) were pushed higher by a spike in gasoline prices, which reached a national average of \$4.56 per gallon. Energy price inflation hit 12.5% on a twelve-month basis, counteracting the progress made in the housing sector, where rent inflation has finally slowed to its lowest pace since 2021. This "two-speed" inflation profile—falling core prices versus rising energy costs—has created a challenging environment for both consumers and policymakers. Similar inflation challenges can be seen in ISM Business Surveys where Prices Paid for Goods (84.6) and Services (70.7) are at their hottest levels in 5 years.

The Federal Reserve responded by maintaining a cautious, "higher-for-longer" stance, holding the federal funds rate steady at 3.50%–3.75%. While there were initial hopes for multiple rate cuts in 2026, the recent inflationary pressures and the relative strength of the job market have forced the FOMC to remain on hold. Market analysts are now split on whether the Fed will manage one or two cuts by year-end or remain stationary until 2027. Meanwhile, fiscal pressures continue to mount, with the national deficit projected at \$1.9 trillion (5.8% of GDP) for the 2026 fiscal year, keeping long-term interest rates elevated as the government manages its growing debt load.

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### Valuation & Earnings

The valuation of the S&P 500 currently stands at 20.9x forward earnings estimates, basically in-line with one year ago (20.6x). It is slightly above the 5-year (19.9x) and 10-year (18.9x) averages. However, the equity risk premium that compensates investors for the excess risks associated with stocks compared to bonds remains thin due to the higher interest rate environment.

The Q1 2026 earnings season has demonstrated remarkable resilience, with the S&P 500 on track to achieve its highest year-over-year earnings growth rate since late 2021. Currently, 63% of companies have reported, and their blended earnings growth rate was an impressive 27.1%, significantly higher than the 13.1% estimated at the start of the quarter. This performance was bolstered by a high frequency of positive surprises—84% of reporting companies have exceeded earnings-per-share (EPS) testimates, and 81% have surpassed

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 exceeding 50%. 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.



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This activity can be seen in market data. As we mentioned previously, the S&P 500 currently trades at 20.9x 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 16.4x. That spread of 4.2 turns is higher 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 10% today compared to 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 month. 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 good for asset repricing, and the underlying economy is still growing. Credit quality, especially among banks, is strong. For larger banks with capital market divisions, the market volatility has lifted trading activity. These factors, along with lower capital requirements from the Fed, should lead to strong profit growth. Concerns surrounding private credit seem to be isolated to a small segment of loans and product structures, while banks' exposure to non-bank financial institutions (NBFIs) is low. Relative valuation of banks versus the market has collapsed the last three months as concerns about the likelihood of the Fed cutting rates have increased. Succinctly put, we prefer quality balance sheets, secular demand, and pricing power during this turbulent and uneven economic environment.