Monthly CIO View

19 August 2026

EDMOND
DE ROTHSCHILD

EXCEPTIONAL EARNINGS SEASON SUPPORTS MARKETS DESPITE GEOPOLITICAL TENSIONS

Nicolas Bickel,
Group Head of Investment Private Banking & CIO

The summer lull, which is generally characterised by relatively low trading volumes, unfolded in two phases this year. First, there was a correction in the "excesses" seen in the technology segment, particularly semiconductors, followed by a broad rebound after an exceptional earnings season that eased concerns over the scale of investment and its monetisation.

This rebound is taking place against a persistently uncertain geopolitical backdrop. The situation between Iran and the United States, particularly regarding the issue of the full reopening of the Strait of Hormuz, still appears intractable. Yet it has been entirely overlooked by equity markets, even as it affects money and bond markets. The 60-day ceasefire provided for under the memorandum of understanding signed by the two parties in June expired last Monday. This deadline could increase uncertainty surrounding the evolution of the conflict and weigh on equity markets. Despite geopolitical tensions, the S&P 500 has posted 28 record highs so far in 2026. The first week of August was notably the S&P 500's best-performing week since last April, with a gain of 3.58%.

Broader participation in index performance

Following the sector and factor rotation that had been underway since June, during which technology stocks had weighed on index performance, the upward trend resumed with renewed momentum. Despite recent volatility in the sector, semiconductors have again risen sharply in recent weeks, rebounding by more than 15% from their late-July lows. However, the current recovery is supported by a larger number of stocks and sectors than just the leading semiconductor names. Around 75% of S&P 500 stocks are delivering positive performance in August, compared with less than 60% in July.
Since the end of June, 50% of S&P 500 constituents have outperformed the index, compared with only 30% in the second quarter—despite the quarter having been one of the five best since 1990. In August, the average performance of index constituents has exceeded 6%, compared with 3.9% for the index itself, highlighting the broadening of market performance. Against this backdrop, and after several years of lacklustre performance, small- and mid-cap companies are outperforming, particularly in the United States. The US Russell 2000 index is therefore up more than 23% year to date, compared with 13% for the S&P 500.

Very strong corporate earnings despite inflation proving slow to decline

As expected, second-quarter 2026 results confirmed the resilience of US and European equities, providing some reassurance to investors about the ability of certain technology companies to sustain exceptional profit growth while monetising their substantial investments.
With more than 90% of companies having reported so far, S&P 500 earnings per share (EPS) are up 30% year on year, 4% above the most optimistic expectations and well ahead of the 18% recorded in the first quarter. Unsurprisingly, artificial intelligence (AI)-related stocks are outperforming, with median EPS growth of 28%, compared with 12% for other stocks.

As a result, the sector posted 72% growth in the second quarter, compared with 54% in the first quarter, supported by strong earnings growth among semiconductor companies and hyperscalers, whose cloud businesses have accelerated. The energy sector also stands out, boosted by higher oil prices and refining margins, with EPS growth of 148%. This did not go unnoticed by Donald Trump, who believes that oil companies are generating excessive profits and has called on them to lower their prices. The materials sector also showed solid EPS growth of 36%, as did banks, which reported record quarterly results, up 21%. By contrast, healthcare was the only sector to post negative EPS growth, at -7%.

The second quarter is therefore set to be the best earnings season since 2021, benefiting from both strong growth in the technology sector and broader EPS growth across sectors. In Europe, second-quarter results for the Stoxx 600 are also expected to be the strongest since mid-2022, with growth rebounding across all sectors. With more than 80% of Stoxx 600 companies having already reported, final second-quarter EPS growth is expected to reach 23%. Financials and energy remain the main drivers, although EPS growth in other sectors still stands at 11%, compared with forecasts of 6%. The consumer discretionary sector remains the biggest disappointment and the main drag on index earnings since the start of the reporting season.

Inflation shows tentative signs of slowing through producer prices

Beyond corporate earnings, encouraging economic data also explain the resilience of equity markets. Among these is the latest US inflation report, which showed a slight deceleration in producer and consumer price growth, at 4.1% and 3.4% year on year, respectively. Core inflation, measured excluding energy and food, fell to its lowest level since 2021, at 2.5%.

This is broadly good news for investors concerned about inflation trends and has helped somewhat to ease expectations of interest-rate hikes. The US Federal Reserve should therefore face slightly less pressure, and as of 18 August, the probability of a rate increase at the next meeting on 16 September had fallen back to just 35%.

Beyond inflation data, economic fundamentals remain solid, with US consumption supported in particular by the “wealth effect” generated by rising financial markets. That said, retail sales fell by 0.6% in July for the first time in six months, although demand for leisure and restaurants remains strong. Moreover, US consumption remains highly concentrated: the wealthiest 10% of households alone account for more than half of total consumption. The July employment report showed a net loss of 23,000 jobs during the month, together with significant downward revisions to the previous two months, although this mainly reflects normalisation after a period of stronger hiring ahead of the Football World Cup.

Sovereign yields continue to rise and could affect equity markets

Corporate bond markets followed the trend in equity markets, with credit spreads narrowing slightly again, with the notable exception of the technology sector. Major US hyperscalers continue to rely on debt issuance to finance their investments. Although they maintain very strong financial ratios, the sector is underperforming, as its main players have issued more than USD 240 billion of debt since the beginning of the year, compared with USD 105 billion in 2025. This issuance volume represents almost 30% of total investment-grade issuance, compared with less than 5% in 2025 and 2% in 2024.

By contrast, and despite the slight easing in inflation, sovereign yields—particularly in the United States—continue to trend upward. They are clearly more influenced by concerns about debt sustainability than by the direction of inflation. A few days ago, the US Treasury issued 10-year bonds at a yield of 4.68%, the highest level in 25 years. The combination of inflation remaining above the Federal Reserve’s target for more than five years, structural budget deficits and declining demand from foreign investors—illustrated by Japan, where rising yields are prompting flows to return to Japanese debt—is leading investors to demand a higher return for holding US debt.

The 5% threshold is now within reach, and these high yields could raise the cost of capital for all investment projects, including those in artificial intelligence. High interest rates could have a greater impact on corporate performance than inflation itself, potentially marking the peak of this AI investment super-cycle.

Despite rising markets, valuations remain reasonably attractive

Strong earnings growth, combined with upward revisions to consensus EPS expectations, has allowed the valuation multiples of the major indices to remain close to their annual lows. The 12-month price-to-earnings ratio stands at 20x for the S&P 500 and 15x for the Stoxx 600, compared with highs of 22x and 16x respectively at the start of the year. The valuation of both indices is therefore broadly in line with their ten-year averages of 19x for the S&P 500 and 14.5x for the Stoxx 600, even though the growth delivered by their constituent companies has rarely been so strong. The technology sector, which now accounts for nearly 40% of the S&P 500, continues to trade at a valuation fully in line with its historical average and close to its lowest level since early 2023, with a P/E ratio of less than 22x.

In this context, as long as consumers continue to spend and companies preserve their margins despite disruptions related to the closure of the Strait of Hormuz, equities should remain a key driver of portfolio performance in the coming months.

That said, investor expectations are very high, and companies that have failed to beat expectations have historically been heavily penalised. While attention has focused on microeconomic developments, it should shift in the coming weeks towards macroeconomics, interest rates and the geopolitical situation in the Middle East. This does not rule out a return of market volatility. Consequently, selectivity remains essential, as does diversification beyond technology players into sectors benefiting from different catalysts, such as financials and industrials, energy and communications.