

Equity Newsletter

2nd Quarter 2026

First Trust

"March comes in like a lion and goes out like a lamb." The first part of that old adage about the weather certainly applies to risk assets like stocks and bonds this past month. The S&P 500 Index fell 5% in March and now sits down 6% from its all time high in January. Bonds also fell, as expected rate cuts were priced out of the market with the 10 year Treasury yield rising to 4.32% from below 4% at the start of the month.

Certainly most of these declines relate to the ongoing conflict in Iran, with energy prices up 50% (a barrel of crude oil is at \$101) and still much uncertainty regarding any conclusion to the situation and its aftermath.

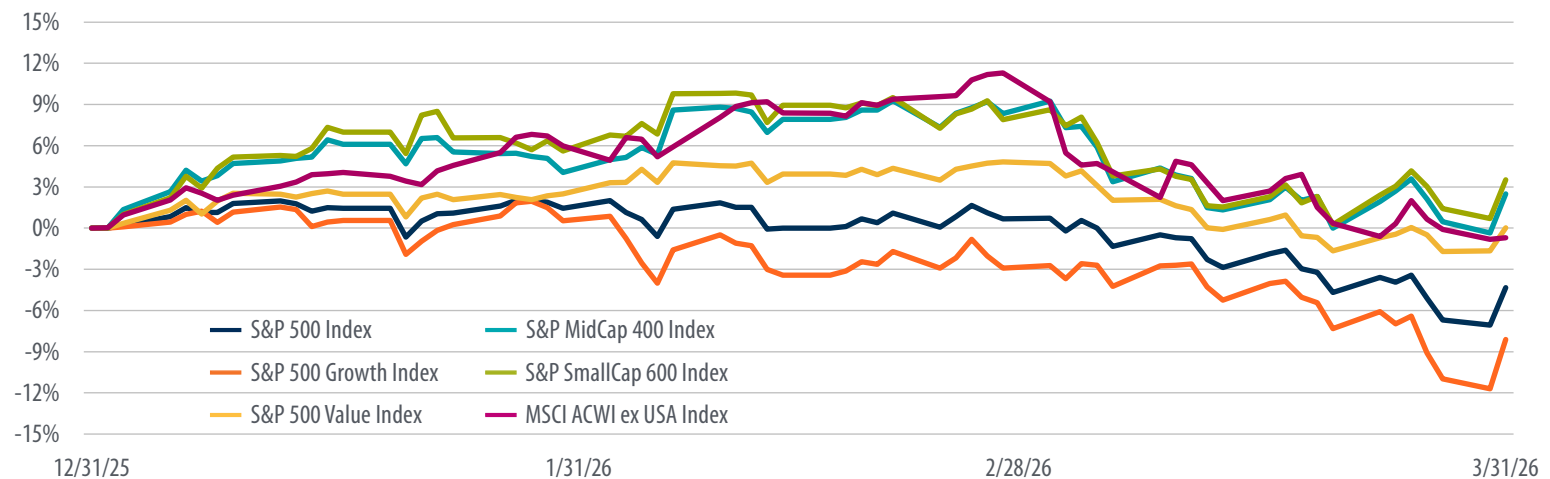
Why isn't the market down more? After all, we came into the year with a historically highly valued market and aggressive earnings growth expectations. Are investors underestimating the risks to economic growth from geopolitical tensions, higher oil prices, and even credit concerns tied to higher interest rates, along with disruption risks from AI in the software space? Perhaps. After all, investors who ignored all the risks the last three calendar years were rewarded with an 86% gain.

In our view, it shows a market that is resilient, able to absorb lots of negative information and remain focused on the big picture, which still supports modest equity gains this year. That resilience may come from the fact that 2026 S&P 500 Index earnings growth expectations of 13% at the start of the year have not declined but actually have increased by 3%. Additionally, since stocks have fallen, the index forward P/E multiple is lower, from 22x to 20x. While there are certainly more threats prevalent after all the events in March, there are no clear signs of long-lasting damage to the US economy. A resolution of much of the uncertainty by the end of April would be positive, potentially preventing further declines and giving investors reason to remain committed.

Year-to-date (YTD), the winners and losers in the market should have reminded investors that **valuation, fundamentals, and growth matter again**. The market has repriced many stocks where one or more of these elements were missing or less certain, even among the world's best companies. A clear example is the Magnificent 7, all of which are down more than the S&P 500 Index YTD. Microsoft is lower by an astonishing 23% YTD, highlighting the impact of high valuations and less certain growth.

The market has broadened out for the year with value outperforming growth, small stocks better than large, and international stocks outperforming the US (see chart). This started long before the hostilities in Iran. We expect these trends to continue if geopolitical tensions ease and the market sees little long-term damage to earnings expectations.

2026 YTD Performance



Source: Bloomberg. For illustrative purposes only and not indicative of any actual investment. Index returns do not reflect any fees, expenses, or sales charges. Returns are based on price only and do not include dividends.

Past performance is no guarantee of future results.

The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. The **S&P 500 Growth Index** contains those securities with growth characteristics from the S&P 500 Index. The **S&P 500 Value Index** contains those securities with value characteristics from the S&P 500 Index. The **S&P MidCap 400 Index** is an unmanaged index of 400 stocks used to measure mid cap U.S. stock market performance. The **S&P SmallCap 600 Index** is an unmanaged index of 600 stocks used to measure small cap U.S. stock market performance. The **MSCI ACWI ex USA Index** captures large- and mid-cap representation across Developed Markets countries (excluding the United States) and Emerging Markets countries. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

Forward price-to-earnings (P/E) of a stock is the price divided by the estimated EPS for the next 4 quarters.

Magnificent 7 (Mag 7): AAPL: Apple Inc. MSFT: Microsoft Corporation. NVDA: NVIDIA Corporation. GOOGL: Alphabet Inc. AMZN: Amazon.com, Inc. META: Meta. TSLA: Tesla, Inc.

References to specific securities should not be construed as a recommendation to buy or sell and should not be assumed profitable.

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Sector Views

Communication Services

- Cloud service providers increasing CapEx to build-out artificial intelligence (“AI”) capacity as adoption increases. Return on CapEx investment is the key question for the industry, in our view.
- We believe agentic AI adoption may lead to a dramatic inflection in utilization for AI cloud service providers.

Consumer Discretionary

- While unemployment remains relatively low, job additions have been modest in recent months. Solid wage growth and relatively low unemployment are current positives for consumption, but job additions are meager.
- Cumulative impact of inflation in recent years remains painful for consumers, especially on the lower end of income distribution, and higher energy prices weigh on real disposable incomes. High income consumers are better positioned, in our view, benefiting from a positive wealth effect from rising asset prices.
- Increasing e-commerce penetration, automation of warehouses are secular positives to profitability.

Consumer Staples

- Defensive sector relatively unexposed to AI disruption, but offers what we see as relatively meager growth.
- Valuation not particularly attractive, in our view.

Energy

- Energy sector equities provide strong free cash flow generation, and an effective geopolitical hedge, in our view.
- While geopolitical risks to supply are currently at the forefront, given Iran’s ability to close the Strait of Hormuz, a potential lasting truce between Iran and the U.S. is a downside risk to oil prices. Additionally, Venezuelan production may improve over time after the recent U.S. actions to oust Nicolas Maduro.
- The U.S. economy is a key source of demand for energy, and we believe the U.S. will avoid recession in the immediate term. Potential improvement in Chinese macro would present a source of demand upside.

Financials

- We expect a more industry friendly regulatory stance towards banking, including less scrutiny of mergers, and easing of capital requirements.
- Investment banking revenue and trading expected to strengthen amid increased capital markets activity and market volatility, respectively.
- Commercial and industrial (“C&I”) loan growth may accelerate in upcoming quarters, in our view, as we believe the outlook for business CapEx is strong. Reshoring also provides a tailwind to C&I growth, in our view.
- Credit quality remains reasonable. That said, any significant rise in unemployment would increase delinquencies, and disruption from AI may increase business credit losses in certain industries such as software.
- AI adoption may increase efficiency in the financial sector through automation of underwriting, fraud detection and document processing.

Healthcare

- Provides potential opportunity to invest in growth that is less correlated to the business cycle.
- We believe healthcare policy uncertainty may lessen in comparison to last year.
- A potential resolution of the Iran crisis may lower interest rates, reducing funding costs for biotechnology firms to develop innovative therapeutics, and we see the possibility of consolidation in the industry as big pharma replenishes their pipelines.
- We expect the life science tools industry to potentially recover gradually as diminished policy uncertainty may result in greater willingness for the biopharma industry to invest in capital equipment. AI may also result in more lab spending, as the industry builds out more capacity to generate data to train AI models. We expect bioprocessing growth to accelerate, as well.
- Valuation is attractive in the sector, in our opinion.

Industrials

- Demand for CapEx is a secular driver that may benefit the sector, as firms are motivated to reshore supply chains and increase productivity.
- Increasing infrastructure requirements to support data centers is another key secular driver for some industrial firms.
- Defense industry names tend to benefit from increasing geopolitical risk, as well as a potential increase in defense spending on the part of U.S. allies over time.

Information Technology

- We expect robust information technology corporate spending driven both by AI related capital spending, and in end markets outside of AI, such as traditional enterprise servers.
- Key semiconductor end markets such as artificial intelligence (AI), high bandwidth memory, and vehicle electrification benefit from secular tailwinds.
- AI increases uncertainty in the software industry, in our view.

Materials

- Macro sensitive sector may benefit from spending on construction and infrastructure.
- We believe incremental demand from clean energy grid infrastructure and electric vehicle transition is a secular positive for some metals, such as copper.
- We believe the materials sector may benefit over time from policies and investment designed to reshore supply chains and improve resource security amid geopolitical tensions.

Real Estate Investment Trusts (REITs)

- Higher yielding sector sensitive to interest rate movements, potential to benefit if rates decline.
- In our view, data center REITs provide a strong secular opportunity but are sensitive to the information technology spending environment on a cyclical basis.

Utilities

- Defensive, dividend paying nature typically more attractive in times of macroeconomic uncertainty.
- Utilities are sensitive to interest rate movements, a potential positive if rates have peaked.
- Data center power consumption is a source of secular growth in electricity demand.

DEVELOPED MARKETS

Europe

- Inexpensive valuation in comparison to U.S. stocks.
- While we believe European policymakers have expressed more willingness to stimulate their economies, which could support long-term growth, we believe Chinese imports redirected from U.S. may negatively impact Europe's balance of trade, and potentially impact the competitive position of Europe's exports.
- Europe's economy is sensitive to rising energy prices given its reliance on energy imports; the European Central Bank may embark on a tightening cycle in response to firming inflation.
- European sentiment stands to benefit from any de-escalation of the Ukraine/Russia conflict
- Geopolitical risk not only from Middle East and Ukraine/Russia conflict, but also increased influence of populism on national politics within Eurozone.

United Kingdom

- We expect sluggish growth, as the labor market gradually weakens and inflation impacts consumer spending.
- The Bank of England may keep interest rate policy on hold until Middle East crisis de-escalates, in our view, while we believe fiscal policy will tighten.
- Inexpensive valuation in comparison to U.S. stocks.

Japan

- We expect robust capital expenditures and exports to the U.S. and EU to support corporate profits.
- Bank of Japan may continue a modest tightening cycle later this year as the Japanese economy improves, potentially strengthening the Yen. Risk of continuation of Middle East crisis impacting oil, which would weigh on consumer spending.
- Japan benefits from "friend-shoring" and increased secular demand for advanced technology exports such as automation equipment.
- We expect corporate governance reforms to improve capital efficiency via increased share buybacks and less cross-shareholder ownership, offering the possibility for higher return on equity for Japanese corporations over time.
- Challenging demographics potentially limit long-run economic growth.

Australia

- We expect solid economic growth, driven by business investment in data center and energy infrastructure.
- Exports of raw materials are another key driver of economic growth.

Canada

- U.S. is key trading partner and stands to benefit from strong U.S. growth; review of U.S.-Mexico-Canada Agreement (USMCA) in mid-2026 may lower tariffs and benefit Canadian exports, but outcome of review is uncertain.
- Energy and metals exporter, which stands to benefit when oil prices rise and demand for basic materials is strong, would suffer from a U.S. recession or a decline in oil prices.

EMERGING MARKETS

Emerging Asia

- Chinese policymakers have signaled a willingness to support growth with fiscal and monetary policy easing, and are taking steps to rationalize industrial overcapacity, as well. That said, we believe Chinese property market weakness remains a headwind.
- Rising geopolitical tensions present risk to supply chains for key technologies and materials, and complicate U.S. firms' decisions to invest in China.
- Despite a one-year trade truce announced in November, Chinese exports to the U.S. are likely to remain impacted by U.S. tariff policy, in our view. That said, we expect China's export share to countries outside the U.S. to potentially trend higher.
- India may benefit from increased exports to the U.S. after reaching a preliminary trade deal and the U.S. Supreme Court ruling against some of Trump's tariff authority. India's information technology outsourcing and consulting industries may be negatively impacted by AI adoption, in our view.

Latin America

- Mexican economy stands to benefit from exports to U.S., review of USMCA may positively impact trade, but also creates uncertainty. Over time, supply chain diversification away from China may be a structural tailwind to exports.
- Brazil and Latin America overall are sensitive to demand for commodity exports.



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