HOLLENCREST
CAPITAL MANAGEMENT

100 Bayview Circle, Suite 500
Newport Beach, CA 92660-8903
Main: 949.737.7700
Fax: 949.737.7703
clientcommunication@hollencrest.com

Q3 2026 Outlook

July 1st, 2026

Economy: Economic growth remained fairly robust the first half of the year with concerns over both inflation and the labor market moderating as we exited Q2.

- Fed projections currently estimate real GDP growth of 1.2% in Q2, following healthy 2.1% growth in Q1. We see no signs of a major slowdown on the horizon and expect the growth of generative and agentic AI to continue powering economic expansion for many years to come. There will certainly be winning and losing companies and sectors, and the beneficiaries will rotate over time, but we are still in the early stages of a revolution that will dynamically impact growth going forward. Right now, we are seeing massive investment in infrastructure, and far more infrastructure is needed to meet the needs of an AI-driven economy. It will take years for the full benefits to be realized, but the productivity and earning capability of every company and individual could see meaningful positive impacts as the technology proliferates, creating new businesses and jobs that couldn't even be imagined only a few years ago. The power of this economic potential is already being reflected in the earnings reported by related publicly traded companies.

- Inflation fears once again become relevant throughout Q2, largely driven by the surge in energy and materials prices caused by the Iran conflict. However, the collapse in energy prices at the end of Q2 was notable and showed us that recent inflation will most likely prove to be "transitory" (to borrow from our esteemed Federal Reserve's past nomenclature). The new Fed regime has clearly developed a level of concern and, surprisingly, squashed any idea that they would be unnecessarily accommodative with their policy coming out of their first meeting under new leadership.

- We have also seen evidence of labor market improvement. As generative AI came into heavier use last year it appeared a significant number of jobs were at risk and concerns over more widespread unemployment began to rise. Replacing humans with AI, particularly in the tech sector, has proven more expensive than most companies expected. As a result, layoffs have slowed and the unemployment rate has not materially increased. At the same time, these tools have allowed entrepreneurs a far more viable path to starting a business. While software engineers may not be needed in high quantities, those new companies will need skilled employees in other areas such as sales and relationship management. The path to replacing jobs displaced by AI is becoming clearer. Notably, the unemployment rate amongst 20-somethings has begun to improve. That demographic was most impacted by the displacement of entry level jobs, but the labor market has adjusted and the concerning unemployment rate amongst that age group has ticked lower.

- Illiquidity remains an issue in private markets, with private credit and real estate seemingly the most affected. Headlines regarding distress in private credit are still coming across the tape, but they have slowed down and are less concerning in nature. So far, the market has shown these issues to be isolated. Redemptions are still high, particularly at funds allocated more heavily to sectors that have come into question. The redemption activity means less capital available to refinance, so spreads in private credit have begun to creep up, although not yet enough to attract the capital requisite to make the call that the market has bottomed. Although many of the same factors influence private equity, attractive valuation multiples and the hopes that outsized returns can be achieved with company alpha and continuing economic growth leave that part of the capital markets looking more attractive. The IPO window also remains wide open, with the massive SpaceX IPO driving that home. This path to liquidity should help support private markets going forward and lead to the virtuous loop of capital being recycled back into those private markets.

Stocks: Q2 ended with very strong returns in the stock market, with a modest dip in Q1 turning into sizable YTD gains in Q2.

- The S&P 500 ended the quarter a fraction of a point below 7,500, up about 9.5% for the year. The story behind stocks is all about earnings. Semiconductors, riding the wave of AI-related capital investment, led the way. Importantly, expectations for future earnings growth remain very high, creating a massive tailwind for stock prices that we think could push the S&P above 8,000 by year end, with a target of 8,250 seen as reasonable amongst the Hollencrest investment team.

- Earnings growth has left the broad stock market at a healthy level of valuation. Expected end of 2026 forward earnings could reach as high as $400/share for the S&P 500 index. That equates to a P/E multiple of about 18.8x at today's price and between 20-21x our year-end target. Given the earnings growth rate, we feel that is far from a high price to pay for those earnings in this economic and market environment. Multiples in the 23-25x range start to cause us more concern and increase the likelihood of a valuation-driven pullback.

- Breadth has held up as well. While stocks related to the AI buildout, starting with semiconductors, led the way in both earnings growth and price appreciation, the last 6-8 months have exhibited fits and starts of leadership rotation that have left most sectors and industries in healthy uptrends.

- Hollencrest made some small moves within our target equity allocations during Q2. We repositioned some of our hedged equity investments that no longer presented as favorable of a risk-reward profile in favor of new vehicles that would allow greater upside participation. We also made some sector and industry adjustments to try and take advantage of short to intermediate-term rotation.

Bonds and Rates: Rates trended higher throughout the quarter with inflation concerns necessitating higher yields on bonds.

- Longer-term Treasury yields continued higher after Q1's Iran-related rise, although they ended the quarter off of highs after the recent decline in energy prices. The 10-year's yield ended up at 4.46%, up about 14 bps for the quarter after briefly approaching 4.7%. A 10-year yield moving much past 4.75% would present an interesting decision set - with conviction that inflation would be brought back under control, rates could begin to look attractive enough for an allocation to a little more duration at those levels.

- The 2-year's yield is often cited as the probable path for Fed Funds 12-24 months out. This shorter-term yield showed a more pronounced rise from 3.79% to 4.17%. This signals that the market thinks the Fed may need to raise rates to stifle inflationary pressures. We expect they could take action on this front later in the year, however it is even more likely that restrictive policy could come through balance sheet reduction.

- With all of the volatility and noise in the markets, credit spreads for both investment grade and high yield bonds remained well-anchored. Attractive credit opportunities remain hard to find.