

Hard to Rattle | 07.10.2026

Renewed tensions in the Strait of Hormuz have done little to knock markets off course. The S&P 500 is still up more than 10% for the year and remains close to its all-time high. Even with President Trump calling off the ceasefire, uncertainty surrounding the recently signed Memorandum of Understanding, and minor attacks by both sides, investors continue to view the risk of significant escalation as relatively low. And while vessel traffic has once again ground to a halt, alternative routes and increased global crude production continue to reduce the economic impact. There are limits to the market's tolerance, particularly if oil prices return to previous highs, but for now, investors remain focused elsewhere.

The bigger question is how companies will fare as they report second-quarter results over the next several weeks. Analysts still expect strong numbers for the quarter, as well as for full-year 2026 and 2027. However, investors will be looking for clarity on several fronts.

First and foremost, the pace of AI investment will be under intense scrutiny. Any suggestion that supply issues or government-related challenges are significantly slowing expansion would be unwelcome. Second, investors will be looking to gauge how higher energy prices may have affected consumer spending in the quarter. Finally, they will be looking for signs that strong earnings are spreading beyond a relatively small group of companies. Currently, 95% of the S&P 500's expected second-quarter earnings growth is projected to come from just 20 companies. More companies have begun contributing to market gains, and it is increasingly important for that broader participation to show up in earnings as well.

Beyond earnings, investors remain closely focused on the Federal Reserve. Choppy oil prices have not made the committee's job any easier. Following Kevin Warsh's first press conference, investors grew concerned that interest rate increases could return after the new chairman reaffirmed the Fed's commitment to bringing inflation back to its 2% target. Since then, however, labor data has cooled, and longer-term inflation expectations have meaningfully subsided. For now, the Fed appears likely to leave interest rates unchanged, which should provide a favorable backdrop for stocks. That could change quickly if geopolitical conflict escalates or economic growth comes in much stronger than expected.

We are also moving closer to November. Historically, the midterm pattern has been quite clear. Markets have generally struggled in the second and third quarters before improving meaningfully in the fourth once election uncertainty is out of the way. This year, however, the S&P 500 performed well above the historical average in the second quarter and is off to a solid start in the third. That does not automatically mean a correction is imminent, but we would not be surprised to see volatility pick up in the lead-up to Election Day. At the same time, markets are pricing in a higher probability of political gridlock after November, an outcome that has historically been favorable for equities over the long run.

Taken together, the overall environment remains constructive, even as potential risks continue to build. Corporate earnings are expected to remain strong, the economy has proven resilient, and the Fed appears content to leave policy unchanged for now. At the same time, geopolitical uncertainty, concentrated earnings growth among a small number of companies, and the approaching midterm election could contribute to greater volatility in the months ahead. At Donaldson, we continue to believe the best response to uncertainty is not to predict every turn in the market, but to remain focused on owning high-quality businesses that can grow through a wide range of environments. The path forward may not always be smooth, but the underlying foundation remains solid.

Thanks,
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