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2HFY26 Forecast: Temporary Capital Headwinds, Durable Bull Market

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While consensus increasingly focuses on whether the bull market has gone too far, we believe the more important question is whether investors are confusing temporary capital headwinds with deteriorating fundamentals.

Our answer is no.

According to our equity market macro forecast model, RegimeSignal™, which has delivered 85% average equity market prediction accuracy across the entire market cycle—from pullbacks and corrections to bear markets and the eventual re-fire back into bull markets—the bull market is not only intact but strengthening. Based upon our analysis of 25 to 30 macroeconomic, valuation, sentiment, credit, and internal market factors, economic health currently scores 80 out of 100, while last quarter's earnings growth advanced an impressive 12.4%.

Indeed, our proprietary data suggest we are still less than halfway through the average bull market duration. While valuations are elevated, bull markets rarely end simply because stocks become expensive. More often, they succumb to recession, contracting earnings, or tightening financial conditions. Presently, we see little evidence of any of those conditions.

On that basis, the more recent base-case framework implies a continued grind higher into year-end rather than a breakout acceleration. From current levels around 7,386 on the S&P 500, a further 5–8% advance over the next roughly six months would place the index in a year-end range of approximately 7,750 to 7,980. This assumes no recession, no material tightening in financial conditions, and a continuation of modest earnings growth supported by AI-driven margin expansion.

However, we believe the third quarter could prove considerably bumpier than the fourth.

The likely culprit is not weakening fundamentals, but capital flows. Markets may soon face one of the largest IPO calendars in history. Prospective offerings from companies such as SpaceX, OpenAI, and Anthropic could command trillions of dollars in aggregate market capitalization and attract enormous institutional demand. Pension funds, sovereign wealth funds, endowments, hedge funds, and benchmark-sensitive managers do not create new money; they reallocate existing capital. Consequently, the enormous appetite for the next generation of market leaders may temporarily siphon liquidity away from existing S&P 500 constituents, creating a short-term headwind for momentum and broad index performance.

Adding to the uncertainty is the eventual transition to a new Federal Reserve Chairman. History suggests that markets often require one to three months to gain confidence in a new Fed regime. If the incoming Chair is perceived as more hawkish than currently anticipated, investors could experience a period of repricing and elevated volatility.

Consequently, we would not be surprised by a normal third-quarter pullback of approximately 5%, or perhaps a more meaningful correction. Yet we view such weakness as cyclical rather than structural.

Meanwhile, we continue to believe investors are underestimating the long-term implications of artificial intelligence. Beyond the excitement surrounding AI infrastructure spending, we expect the technology to increasingly manifest itself through improved productivity, greater operating efficiency, and expanding corporate margins. Over time, these forces should provide powerful support for earnings growth and justify valuations that many currently regard as demanding.

Therefore, while the third quarter may prove choppy, we expect the fourth quarter to tell a different story. As IPO-related capital pressures subside and investors refocus on resilient earnings, healthy economic conditions, and accelerating AI-driven productivity gains, we believe equities will recover, and the bull market will continue its advance for the second half of 2026. ■

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