

May 2026 Market & Economic Summary

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May was a month of records. The S&P 500, Nasdaq, Dow, and Russell 2000 all set new all-time highs, but the gains were powered almost entirely by technology and semiconductor stocks. These gains came despite an interest rate scare, as back-to-back hot inflation readings increased the probability of a Federal Reserve rate hike and sent long-term Treasury yields rising.

Meanwhile, a sharp drop in oil prices somewhat eased the inflation concerns. Corporate earnings growth remained strong with record profit margins, though the strength was concentrated in a handful of large companies and AI-related stocks.

The overall economic picture has become mixed, with the labor market firming and business activity improving even as the consumer showed signs of strain. The Federal Reserve also experienced a change in leadership during the month, adding a layer of policy uncertainty.

The result was an impressive rally built on narrow leadership, one that leaves the durability of the rally as the central question heading into the summer.

Stocks Set New Highs: Resilience or Complacency?

Stocks faced a test in May and passed it, at least on the scoreboard. Midway through the month, two consecutive hot inflation readings put a Federal Reserve rate hike back on the table and pushed the 30-year Treasury yield to levels last seen in 2007. Stocks faced some pressure, but the rate scare faded as oil prices fell more than 13%, easing the inflation pressure that had rattled the bond market.

With oil and interest rates falling, the AI and semiconductor trade did the rest, carrying the S&P 500, Nasdaq, Dow, and Russell 2000 to fresh records. It was an impressive performance, but it raises two questions. First, with so much good news already reflected in prices, where does the next leg of gains come from? Second, was the rebound a sign of underlying resilience or complacency?

Market Performance Recap

May was another record month despite the narrow leadership. The S&P 500 returned 5.3%, and the tech-heavy Nasdaq gained more than 10%, building on its 15% April advance. The Dow, Russell 2000, and the equal-weight S&P 500 also reached new highs, but each increased only between 2% and 3%. Technology was the difference, rising nearly 20%.

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However, remove the technology return, and the rest of the index was slightly negative for the month. Only three of the other ten sectors finished higher. The momentum and high beta factors led the rally due to technology's strength, while more defensive and dividend-oriented stocks lagged. International stocks rose as falling oil prices offered relief to energy-importing regions but still trailed the U.S., with the same technology theme lifting markets exposed to tech and AI stocks.

In the bond market, hot inflation data sent yields surging mid-month before they settled back as oil rolled over, with shorter-term yields rising while longer-maturity yields ended roughly flat. Corporate bonds outperformed Treasuries as credit spreads, the extra yield corporate bonds pay over comparable Treasuries, tightened. One crack did appear beneath the surface, as spreads on the lowest, riskiest tier of high-yield bonds widened, a notable divergence in an otherwise calm credit market.

Oil was the dominant cross-asset story. Gold slipped 1.5% despite the hot inflation data, and Bitcoin extended its decline to nearly 25% for the year.

Fed Policy & Interest Rate Outlook

The message: the longer the disruption in the Strait of Hormuz keeps oil prices elevated, the more likely a rate hike becomes.

May brought a clear shift in how markets are thinking about Federal Reserve policy. The hot inflation readings pushed futures markets to price in the possibility of a rate hike, a sharp reversal from the rate cuts that had been expected earlier in the year. Traders still anticipate no change at the next several meetings, but the odds increasingly tilt toward a hike by December. The message: the longer the disruption in the Strait of Hormuz keeps oil prices elevated, the more likely a rate hike becomes.

The bigger development was at the Fed itself, as Jerome Powell's term expired in mid-May and Kevin Warsh was confirmed as the new chair. Warsh inherits a complicated environment: the base case for 2026 is a December rate hike, the administration has expressed a preference for lower rates, inflation remains above the 2% target, and the oil shock has introduced new inflation risk. Markets will need to adjust to a new communication style at a time when the Fed's independence is under scrutiny.

Technicals, Investor Sentiment, & Positioning

The concern is participation. The rally has been driven by technology and a handful of momentum leaders, while most other sectors and groups have lagged. An index sitting at all-time highs on such narrow leadership is vulnerable to any shift in sentiment around the AI and semiconductor trade.

The technical backdrop is constructive but stretched. The S&P 500 closed May at a record high, well above key moving averages, after trading sideways for most of the fourth quarter of last year and the first quarter of 2026. The concern is participation. The rally has been driven by technology and a handful of momentum leaders, while most other sectors and groups have lagged. An index sitting at all-time highs on such narrow leadership is vulnerable to any shift in sentiment around the AI and semiconductor trade.

Risk appetite, meanwhile, remains strong, with credit spreads tightening and equities trading near records. Investor positioning reflects the same confidence, with institutional exposure to stocks at its highest since late 2024 and steady inflows into equity ETFs. That kind of crowded, one-directional positioning carries some risk, as it doesn't take much to unsettle a market in which most investors are leaning the same way.

Corporate Earnings & Valuations

Stock market valuations remained steady in May. The market's valuation based on expected earnings climbed to 21x from 19.7x at the end of the first quarter, with most of the recovery tied to rising earnings estimates rather than pure multiple expansion. The backdrop is generally supportive of valuation levels, with earnings estimates being revised higher, profit margins rising, money continuing to flow into stocks, manufacturing activity improving, and sentiment strong. However, valuations remain high by historical standards, which leaves earnings growth as the primary path to further gains.

First-quarter earnings season is nearly complete, and the results have been much stronger than expected. Blended earnings growth came in at 28.6%, far above the 13.1% analysts had estimated at the end of the first quarter. This is the strongest pace since 2021, alongside a record profit margin of 14.8%. However, the earnings strength was narrow. Removing some of the largest semiconductor companies cuts technology's growth in half, and a small group of mega-cap names drove most of the beat. The same concentration that defines the rally defines the earnings below it, and the bar for future quarters keeps rising. Analysts have continued to raise their forecasts, with upgrades outpacing downgrades by roughly two-and-a-half to one.

Economic Trends

We believe the net read is an economy where labor and business conditions point to continued growth while the household sector shows signs of strain.

The economy is sending mixed signals, with three trends pulling in different directions. The labor market has firmed after softening last fall, as weekly jobless claims remain low, job growth has rebounded, and the unemployment rate has eased to 4.3% from a recent peak of 4.5%. Business activity is also improving, with manufacturing back in expansion territory after a multi-year slowdown tied to the Fed's rate hikes.

The consumer, however, is moving the other way. Income growth continues to slow, and consumer confidence is very weak, with one closely watched sentiment survey near a record low. We believe the net read is an economy where labor and business conditions point to continued growth while the household sector shows signs of strain.

What has kept households spending is balance-sheet strength, primarily elevated home values and a rising stock market. If that support gives way, reduced spending could translate into slower economic growth.

The consumer is the key risk to watch. After several years in which household spending powered the economy, the support under it is weakening, with income growth normalizing and consumer confidence weakening. What has kept households spending is balance-sheet strength, primarily elevated home values and a rising stock market. The worry is straightforward. If that support gives way, reduced spending could translate into slower economic growth.

For now, the underlying business cycle appears to be turning up, but in our opinion, the health of the consumer will likely determine the durability of the rebound.

