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A rally with many engines: the lesson of 2026's first half

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Washington Irving gave us Rip Van Winkle, who slept for 20 years and missed a revolution. An investor who dozed off on New Year's Eve and woke on the first of July would have missed a small one of his own. He'd be pleased to see the S&P 500 up 9.6 percent — a full year's worth of gains delivered in six months — and he would know at a glance that something remarkable had happened. What he would not know is how hard those gains were to hold onto. The first half of 2026 packed in a war, an oil shock, a 7 percent plunge, a new Federal Reserve chairman and two dozen record highs. Our sleeper collected the returns while skipping the fear

The numbers tell the story of a round trip. When war broke out with Iran in late February, the S&P 500 fell as much as 7 percent as oil spiked and tanker traffic through the Strait of Hormuz collapsed. From those lows, the market staged one of the strongest recoveries in recent memory. By June 30 the index stood at 7,499, having set its 24th record high of the year on June 2. The Nasdaq gained 13.1 percent for the half. The Dow rose 9.8 percent for its best first half in five years. The Russell 2000 index of small companies did better still to end up roughly 20 percent. The second quarter alone delivered a 15.2 percent gain in the S&P 500 for its strongest quarter since 2020.

Two forces drove the recovery. The first was the relentless build-out of artificial intelligence infrastructure. The Philadelphia Semiconductor Index surged 88 percent in the second quarter — its strongest quarterly gain since the index was created in 1993. Micron Technology captured the moment. The U.S.-based memory chipmaker reported record quarterly revenue in late June and announced long-term supply agreements with 16 strategic customers stretching to 2030. It was an indication that one of the market's most famously cyclical businesses is perhaps becoming something steadier. The build-out keeps broadening: capital spending plans among the large cloud providers rose again after first-quarter earnings, and analysts now expect S&P 500 earnings to grow nearly 23 percent this year, up from the 14 percent expected in January. Rising earnings estimates, not expanding multiples alone, have carried this market.

The second force was peace, or at least the prospect of it. On June 17, the United States and Iran signed the Islamabad Memorandum — a 14-point framework that opened a 60-day negotiating window and a phased reopening of the Strait of Hormuz. By June 25, 35 tankers transited the strait in a single day — the first time traffic returned to its prewar range. Brent crude fell 38 percent over the quarter to about \$73 a barrel, close to where it traded before the war began. The ceasefire remains fragile. An attack on a commercial tanker in late June drew retaliatory American strikes, providing a reminder that the peace is a work in progress. But a market that had priced oil for war spent the quarter pricing it for peace, and economically sensitive stocks rose on the change.

June 17 was a busy day. The same date the ceasefire was signed, Kevin Warsh wrapped up his first meeting as Federal Reserve chairman. The committee held rates steady at 3.50 to 3.75 percent by unanimous vote, but the signals around the decision were hawkish. The policy statement was cut dramatically in length and stripped of its long-standing bias toward future cuts. The committee's projections now imply there will be at least one rate hike before 2026 ends, and that is a shift from March. Warsh, a skeptic of forward guidance, declined to put his own forecast in the famous dot plot of regional Fed governor opinions at all. The inflation data explains the caution. Core PCE inflation rose 3.4 percent in May from a year earlier — the hottest reading since late 2023 — as the spring's energy spike worked its way into goods and transportation prices. A Fed that spent last year debating cuts now debates hikes. Markets took the change with surprising grace.

For all the drama, the most important development for long-term investors may be one that is less obvious: market leadership is broadening. In June the S&P 500 slipped about 1 percent and the Nasdaq fell 2.75 percent, while the Dow gained 2.7 percent and small caps kept climbing. The magnificent seven mega-cap stocks fell roughly 9 percent for the month even as the average stock advanced. There is an old Wall Street saying that when the generals falter, watch whether the soldiers keep marching. When a handful of giant companies carry an entire index, gains are fragile; when thousands of companies participate, gains rest on firmer ground. The apprehension around the massive SpaceX IPO drawing money out of other stocks did not materialize. The Russell 2000 has now risen five consecutive quarters, industrials are up about 20 percent this year, and value stocks outpaced growth in June. Breadth of this kind usually reflects widespread earnings performance. A rally with many engines can afford to have one sputter.

Looking forward, inflation is running well above the Fed's 2 percent objective, and a central bank leaning toward hikes tends to cap what investors will pay for a dollar of earnings. Economic growth is likely to downshift from the first half's stellar pace as fiscal support fades and households rebuild their savings. The termination of the ceasefire with Iran in early July increases uncertainty. Positioning in the market's favorite names is crowded, and crowded trades correct suddenly. None of this argues for heading to the exits; it argues for owning quality. Companies with strong balance sheets, recurring revenues and robust, free cash flow have a long record of treating turbulence as an opportunity rather than a threat.

Which brings us back to Rip Van Winkle. No one is recommending a six-month nap, least of all this column. But the sleeper had a worthy advantage: he never had the chance to act during the panic of late February, when selling felt safest and would have cost the most. An investor who left the market during the plunge missed the strongest quarter since 2020 and a year's worth of gains along with it. The daily story this year was a war, an oil shock and a new hand at the Fed. The long-term story was rising earnings, broadening leadership and quality companies compounding quietly beneath the noise. The returns came from the second story. They usually do.

William Rutherford is the founder of Portland-based Rutherford Investment Management. Contact him at 888-755-6546 or evaluation@rutherfordinvestment.com. Information herein is from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Investment involves risk and may result in losses.

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