

Understanding What Is Driving Growth and Market Volatility



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Following a period of historically strong stock market returns over the past year and quarter, the Nasdaq posted its largest single-day decline in a year, falling 4.2% on Friday, June 5.

Somewhat counterintuitively, this drop came on the heels of an encouraging jobs report. While strong employment data is broadly positive for the economy, it also heightened the possibility of a Federal Reserve rate hike before year-end.¹ Adding to investor unease, a brief re-escalation of tensions in the Middle East brought geopolitical concerns back to the forefront. Although market swings are a normal part of investing, the current episode of volatility has identifiable causes that historical context can help to clarify.

Just as architects design structures to endure all kinds of weather rather than only ideal conditions, investors benefit from maintaining risk management and portfolio balance even during periods of strong performance. Appreciating positive market results is important, but it is precisely during favorable periods that investors are in the best position to ensure their portfolios are ready for a range of outcomes.

Even accounting for the recent single-day pullback, major market indices have still recorded meaningful gains this year. History also provides reassurance that investors need not overreact to the prospect of Fed rate hikes. Short-term volatility can accompany market expectations of tighter financial conditions, but stock markets have delivered solid performance across many prior Fed rate hike cycles. Keeping these dynamics in perspective can help investors remain focused on their long-term objectives.

The market has seen a resurgence of volatility

Stock Market Cycles

NASDAQ Composite since 1995



Latest data point is Jun 5, 2026

Sources: Clearnomics, Nasdaq
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Major indices, including the S&P 500, Dow Jones Industrial Average, and the Nasdaq, have built momentum in recent months. Part of this strength reflects what can be characterized as a "relief rally." The conflict in the Middle East, for instance, has had a more limited economic impact than many initially anticipated, even as oil prices moved higher. Corporate earnings have remained robust, and growing excitement around a pipeline of upcoming initial public offerings has also contributed to positive sentiment.

Of particular note is the contrast with the bond market, which has faced a more difficult environment as interest rates have stayed elevated. Rates have climbed across the entire yield curve this year, with the 10-year Treasury yield sitting at

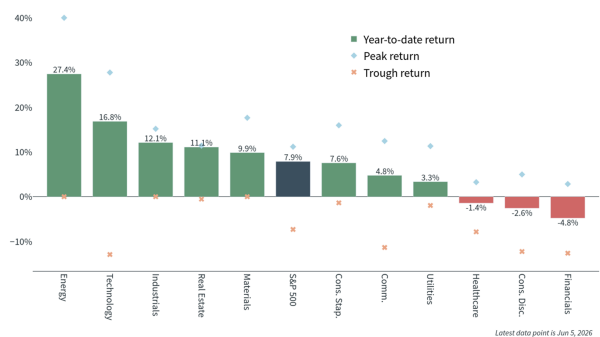
around 4.5%.² The bond market is sometimes referred to as the "smart money," a term reflecting the view that bond investors tend to scrutinize underlying trends in inflation, growth, and Fed policy more closely than equity investors.

Whether or not that characterization holds, the bond market has been signaling that rates could remain higher for longer than some had anticipated, even as equities rallied. It is not entirely surprising, then, that stocks have recently begun to react to these same forces. This is especially true for technology and AI-related stocks, which tend to be particularly sensitive to changes in interest rates.

Technology stocks tend to be especially sensitive to interest rate movements

Sector Returns – Year-to-Date

S&P 500 sector year-to-date, peak and trough returns



Latest data point is Jun 5, 2026

Sources: Clearnomics, Standard & Poor's, I/B/E/S
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The Magnificent 7, the most known group of large technology companies in our economy, illustrates this sensitivity clearly. From their peak at the end of 2021 to their trough in late 2022, a period when inflation was accelerating and interest rates were rising sharply, this group lost approximately half of its value.³ This decline weighed heavily on the Nasdaq as well as broad sectors such as Information Technology and Communication Services. These groups subsequently began to recover as rates stabilized and the Fed moderated its pace of tightening, ultimately rallying to new highs.

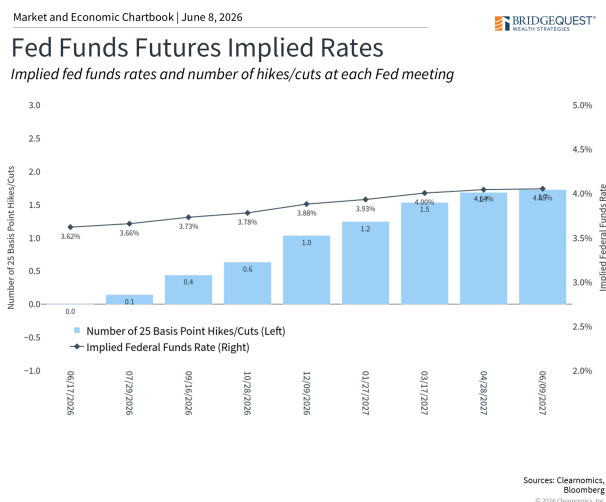
The reason technology stocks are so sensitive to interest rates lies in how they are valued. Investors purchase these stocks largely on the expectation of high growth extending well into the future, rather

than for near-term cash flows typical of more established businesses. Because interest rates determine how those future profits are valued in today's terms, even modest shifts in rate expectations, particularly changes in direction, can produce significant price swings. Interest rates function like a long lever: a small movement at one end can generate a large effect at the other.

This dynamic carries added significance because technology-related stocks now represent a much larger share of the overall market. The Magnificent 7, for example, now accounts for roughly one-third of the S&P 500.⁴ As a result, many investors may hold greater exposure to these companies than in prior years. The chart above shows that, despite the

latest pullback, these sectors have still performed well in the current year. Nevertheless, investors may encounter episodes of volatility that were less common in earlier market environments. This is precisely why monitoring asset allocations and preserving portfolio balance is just as important during rising markets as it is during downturns. As your investment management team, we continue to carefully monitor and regularly rebalance your managed portfolios to keep from getting too weighted into one sector of the market.

Stock markets have historically performed well through Fed rate hike cycles



Expectations for Fed policy can shift quickly in response to changing economic conditions. Earlier this year, the prevailing view was that the Fed would continue on a path of rate cuts. That consensus changed rapidly as energy prices increased and the labor market showed renewed strength in recent months, as illustrated in the chart above. This serves as a reminder that the Fed is frequently responding to economic developments rather than setting them in motion.

There is also some uncertainty surrounding how Kevin Warsh, in his role as the new Fed chair, will approach inflation. He has historically been regarded as an inflation hawk, suggesting a preference for raising rates in order to stabilize prices for consumers and businesses. This stance

could place him in tension with the White House's preference for rate cuts. He has also stated publicly that the Fed should work to reduce its balance sheet, a move that would itself tighten financial conditions.

For now, however, much of this remains speculative until the Fed acts based on actual economic data. It is also not yet clear whether any such action would mark the start of a broader rate hike cycle or simply reflect a brief period of tighter monetary policy.

That said, even if current market expectations prove accurate, the Fed is not anticipated to raise rates until the end of the year, and only by 25 basis points, as shown in the chart above. By historical standards, this is a modest adjustment, particularly when compared to the 2022 to 2023 rate hike cycle, during which the Fed raised rates from the zero-lower-bound to 5.25% across 11 separate increases.

Perhaps most importantly, the stock market has demonstrated resilience across a wide variety of rate environments, including periods of rising rates. This is especially the case when the Fed is tightening because the economy is healthy, as strong growth tends to support corporate earnings. In other words, it is not unusual for equity markets to perform well even as the Fed raises rates. We continue to believe and focus on balance sheet strength coupled with current and future earning potential as the drivers for great investments.

The bottom line? Recent volatility reflects heightened expectations for Fed rate hikes and renewed geopolitical tensions, but neither development is a reason to make fundamental changes to long-term investment plans. While certain segments of the stock market may experience short-term turbulence, history demonstrates that markets have the capacity to perform well across a wide range of rate environments.

References

- <https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html>
- <https://home.treasury.gov/policy-issues/financing-the-government/interest-rate-statistics>
- The Magnificent 7 includes Apple, Microsoft, Nvidia, Amazon, Alphabet, Meta, and Tesla. The peak from 2021 to 2022 occurred on November 19, 2021, and the trough occurred on December 27, 2022.

4. Clearnomics research based on Standard & Poor's data

5. <https://www.wsj.com/opinion/the-high-cost-of-the-feds-mission-creep-role-responsibility-monetary-policy-economy-20a352f8>

6. <https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm#32979>

Index Descriptions

S&P 500

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Dow Jones

The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

NASDAQ

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.

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