A Volatile July, A Broader Market

Market leadership broadened even as inflation, rates and geopolitical risks weighed on sentiment

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Key Observations

- *July was a volatile month as investors weighed strong corporate earnings against renewed concerns about AI-related valuations, heavy capital spending, and the durability of the recent growth-led rally.*
- *The Federal Reserve held rates steady at 3.50% to 3.75%, but three dissents in favor of a hike and a continued focus on elevated inflation pushed Treasury yields higher and pressured rate-sensitive areas of the market.*
- *Market leadership continued to broaden as value-oriented sectors, real assets, and select non-U.S. equities held up better than mega-cap growth, while Middle East tensions and higher oil prices reinforced the importance of diversified portfolio exposures.*

Market Recap

July served as a reminder that markets continue to navigate a complex environment where economic resilience, persistent inflation pressures, evolving monetary expectations, and geopolitical developments all compete for investor attention. An escalation in tensions involving Iran contributed to higher energy prices and increased volatility late in the month, while investors also digested another Federal Reserve meeting with mixed signals and lack of clarity on the direction of policy. The Federal Open Market Committee voted to keep the federal funds rate unchanged at 3.50% to 3.75%, though a notable number of policymakers favored tighter policy, leading Treasury yields to move higher and weighing on interest rate sensitive asset classes.

U.S. equities finished modestly lower but performance broadened beneath the surface. The S&P 500 declined 0.1% for the month, giving back a portion of its strong year-to-date gains, while the Russell 2000 fell 3.0% as rising bond yields and tighter financial conditions created a headwind for smaller cap companies. The market's leadership continued to rotate away from some of the largest growth-oriented stocks that had led earlier in the year, while investors favored sectors tied to energy, financials and more value-oriented areas of the market.

Financial Market Performance		
Index	July	YTD
S&P 500	-0.1%	10.1%
Russell 2000	-3.0%	18.9%
MSCI EAFE	2.0%	11.6%
MSCI EM	-3.1%	20.0%
Bloomberg U.S. Agg Bond	-1.3%	-0.7%
Bloomberg U.S. HY Corp Bond	-0.2%	1.7%
FTSE NAREIT All Equity REITS	2.4%	17.7%
Bloomberg Commodity	7.5%	23.0%

Source: Morningstar Direct. As of July 31, 2026.

International developed equities delivered positive results despite the uncertain environment. The MSCI EAFE Index gained 2.0%, supported by strength across parts of Europe and the United Kingdom, where equity markets benefited from relatively attractive valuations. A weaker U.S. dollar also provided a modest tailwind for U.S.-based investors. Emerging markets faced a more difficult month. The MSCI Emerging Markets Index declined 3.1%, driven largely by weakness in several technology-heavy Asian markets as investors reassessed growth expectations and semiconductor-related shares experienced a significant pullback after a strong first half of the year.

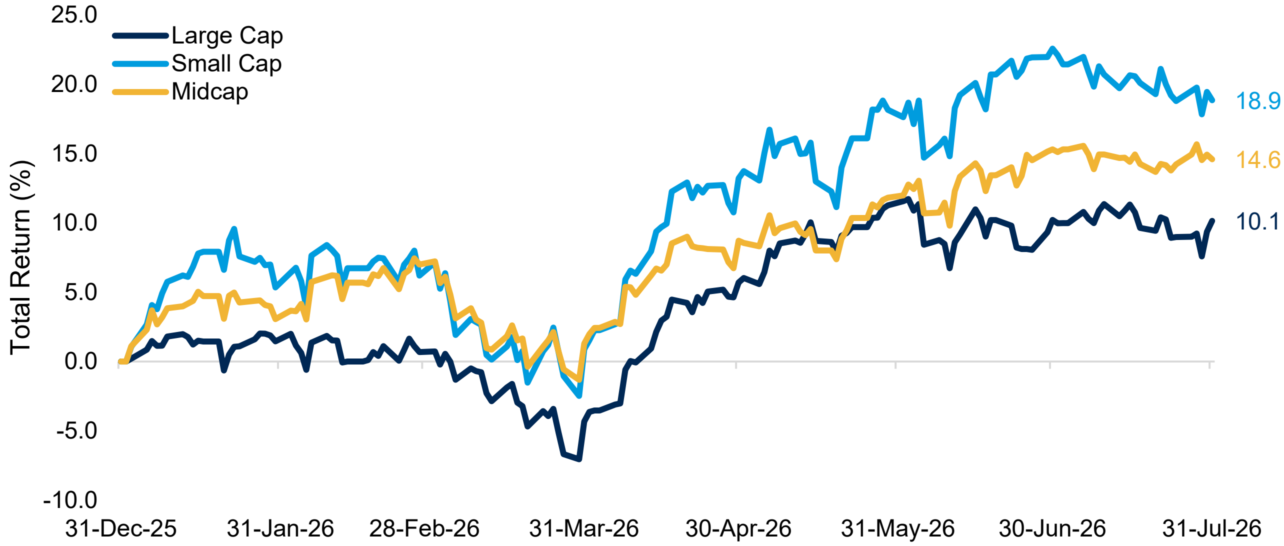
Fixed income markets struggled as yields moved higher following the July FOMC meeting. The Bloomberg U.S. Aggregate Bond Index fell 1.3%, reflecting pressure across both Treasury and investment-grade corporate bonds. The market had mixed interpretation of the Fed's messaging, particularly with inflation remaining above target and energy prices rising amid Middle East tensions. Credit markets proved relatively resilient. The Bloomberg U.S. Corporate High Yield Index slipped just 0.2%, as healthy corporate fundamentals and limited default activity helped offset the impact of rising rates.

Real assets were among the strongest performers during the month. The FTSE NAREIT All Equity REITs Index gained 2.4%, supported by continued strength in data center, industrial and specialized property sectors. Commodities delivered the best performance among major asset classes, with the Bloomberg Commodity Index rising 7.5%.

Small Cap Equities Providing Diversification Benefit

We highlighted in our 2026 Outlook the growing concern of AI concentration and elevated valuations within the U.S. large cap equity market. As part of our *AI Playbook*, we advocated for diversifying positions in portfolios, such as small and mid-cap U.S. equity exposure, as well as non-U.S. equity positions. We believed these companies would be a part of the AI flywheel, benefitting from the use of AI, despite not being the direct builders of AI. Attractive relative valuations of small cap relative to large further supported the case for allocating. Enthusiasm for AI has been a tremendous tailwind for many large cap companies, but growing concerns about valuations and the path to monetization of extreme capex spending has put pressure on some of the mega cap names that have led the market over recent years. Seven months into the year, we have been rewarded for having these diversified exposures within portfolios as small- and mid-cap stocks are up 18.9% and 14.6%, respectively, compared to large-cap up 10.1%.

Year-to-Date Performance by Market Cap



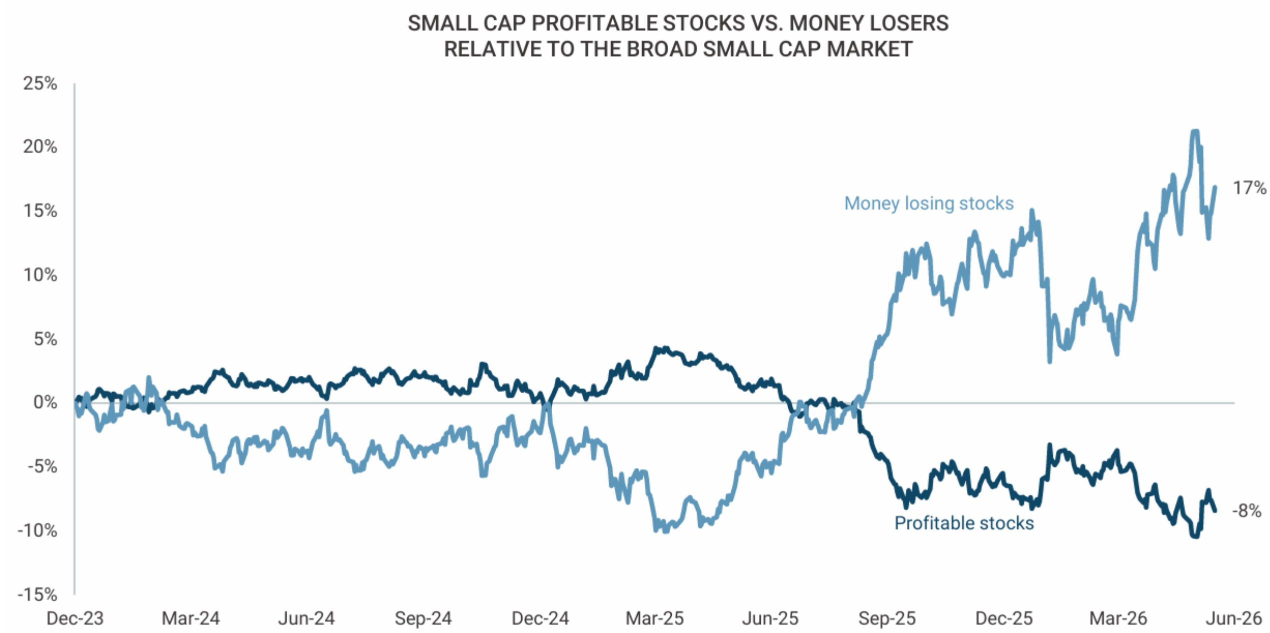
Source: FactSet. As of July 31, 2026. Large cap = S&P 500 Index, Small Cap = Russell 2000 Index, Midcap = Russell Midcap Index.

Despite Strength in the Asset Class, Active Small Cap Has Lagged

While the decision to allocate to small cap has been a boon for portfolios this year, active management within the space has struggled of late. As we discussed in our recent Active vs. Passive white paper (and iterations prior), the small cap space is an area where active management has shown to have efficacy – a greater probability of outperforming the index and with a higher average excess return.[1] We continue to support active small cap, however, over the last year, active management has struggled, with the index ranking in the top quartile of the small blend peer group.[2]

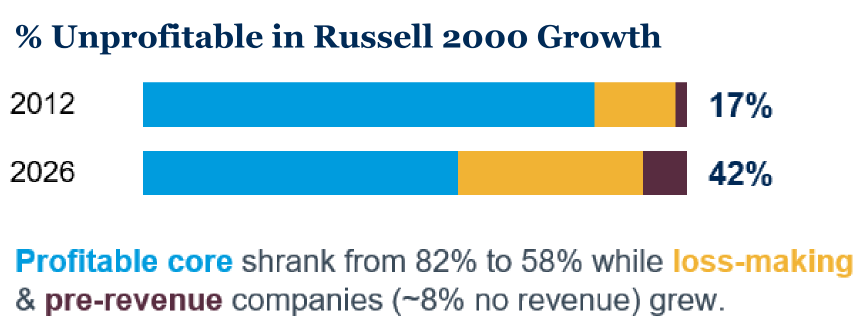
While active managers typically go through periods of underperformance, let's take a deeper look as to factors that may be driving the recent results. There was a major shift in small cap leadership over the past year and a sharp rebound in unprofitable companies, a dynamic that has created a difficult backdrop for many active managers focused on quality and durable earnings.

[1] Fiducient Advisors, The Next Chapter in the Active vs. Passive Debate. As of May 30, 2026.
[2] Morningstar Direct. Russell 2000 Index rank in the Morningstar Small Cap Blend Peer Group as of July 31, 2026.



Source: Hotchkis & Wiley, Empirical Research Partners. Equally-Weighted data. Past performance is no guarantee of future performance.

The small cap growth asset class has been particularly impacted by this trend as the number of profitable companies making up the index fell from approximately 82% in 2012 to just 58% in 2026.[3] This shift in market leadership compounded by the growth in non-profitable companies was a large detractor for active management over the past year. We do not view this as a reason to abandon active small cap exposure, but it does argue for patience, manager selectivity and a clear understanding of what is driving short-term relative performance.



Source: U.S. Securities and Exchange Commission, EDGAR as-filed 10-K/20-F/40-F filings, Morningstar Direct, Fiducient Advisors calculations as of June 30, 2026.

[3] Source: U.S. Securities and Exchange Commission, EDGAR as-filed 10-K/20-F/40-F filings, Morningstar Direct, Fiducient Advisors calculations as of June 30, 2026.

Outlook

This year has reinforced the importance of remaining diversified as market leadership continued to broaden beyond the largest U.S. companies. The strong relative performance of small and mid-cap equities year to date supports a key theme from our 2026 Outlook: investors do not need to rely solely on the largest AI beneficiaries to participate in the next phase of the cycle. As AI-related investment spreads across the economy, smaller companies, non-U.S. equities and real assets may all play a role in capturing a broader set of opportunities. With valuations still elevated in parts of the market, interest rates elevated and geopolitical risks unresolved, we continue to favor balanced portfolios that can participate in broadening market leadership while maintaining exposure to high-quality managers and diversifying asset classes. For a deeper look at the themes shaping markets and the economy for the remainder of the year, we encourage readers to explore our Mid-Year Outlook.

About the Author

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As a member of the Global Public Markets Team, Rob researches and performs due diligence on fixed income investment managers. He is also a member of our Capital Markets Team. Rob joined Fiduciary Investment Advisors LLC in 2011, which combined with Fiducient Advisors in 2020. Prior to joining the firm, he was an Investment Analyst at USI Advisors, Inc. He received his BA from Bucknell University, is a CFA® charterholder and a member of the CFA Institute and the Hartford CFA Society. Rob volunteers as a member of the Finance and Investment Committee for Chrysalis Center, Inc., a nonprofit organization in Hartford, CT providing support to those struggling with poverty, mental health issues and other challenges. In his free time, Rob enjoys biking with his wife and sons, golf, running and platform tennis.