



Bottlenecks

May 2026

- U.S. large-cap stocks, as proxied by the S&P 500 Index, rose 5.3% in May, while U.S. small-cap stocks gained 4.4% over the month. U.S. intermediate-term bonds ended the month up 0.3%.
- The Strait of Hormuz remains the world's most important economic bottleneck, as the U.S.-Iran conflict continues to pressure energy markets and keep fuel inventories tight.
- AI has become the market's new bottleneck, and memory and power shortages are becoming the primary constraints on AI infrastructure growth.
- The AI investment cycle is accelerating with hyperscalers projected to spend nearly \$750 billion on capital expenditures in 2026 to expand compute capacity.
- Helped by the capex boom, S&P 500 earnings growth expectations have increased dramatically across all sectors, and profit margins are expected to stay near historic highs.

Overview

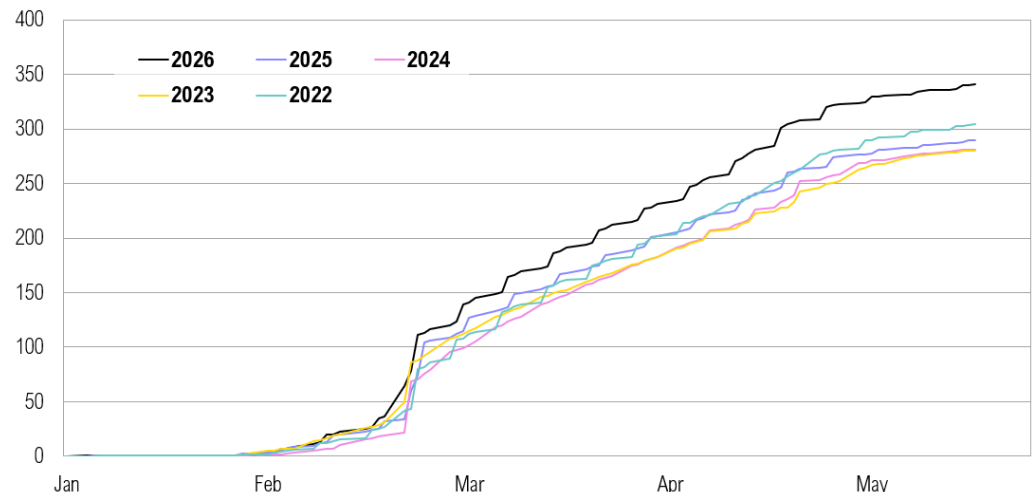
U.S. large-cap stocks, as measured by the S&P 500 Index, gained 5.3%, while the small-cap Russell 2000 Index advanced 4.4%. U.S. intermediate-term bonds, proxied by the Bloomberg U.S. Aggregate Bond Index, returned 0.3%.

Recent U.S. economic data continued to show the resilience of the U.S. consumer. Higher-than-usual tax refunds (with the total amount refunded—\$325 billion—18% higher than 2025 year-to-date) continued to support spending despite rising fuel prices.¹ Per Walmart CFO John Rainey:

"I think higher tax returns muted some of the pressure related to higher fuel prices."²

Year-to-Date, Income Tax Refunds Are 18% Higher Relative to 2025

Individual Income Tax Refunds, \$Bn



Higher-than-usual tax refunds continued to support consumer spending

Source: Bloomberg. As of 5/31/2026.



There has been a sharp reversal in rate cut expectations

The labor market remains similarly resilient, and the U.S. economy added 172,000 new jobs in May.³ Further, job openings rose to 7.6 million in April, the highest since May 2024.⁴ The stronger-than-expected May jobs report increased investors' expectations for interest rate hikes, and markets are now pricing in two 0.25% rate hikes by early 2027, a sharp reversal from the two rate cuts expected only a few months ago.⁵

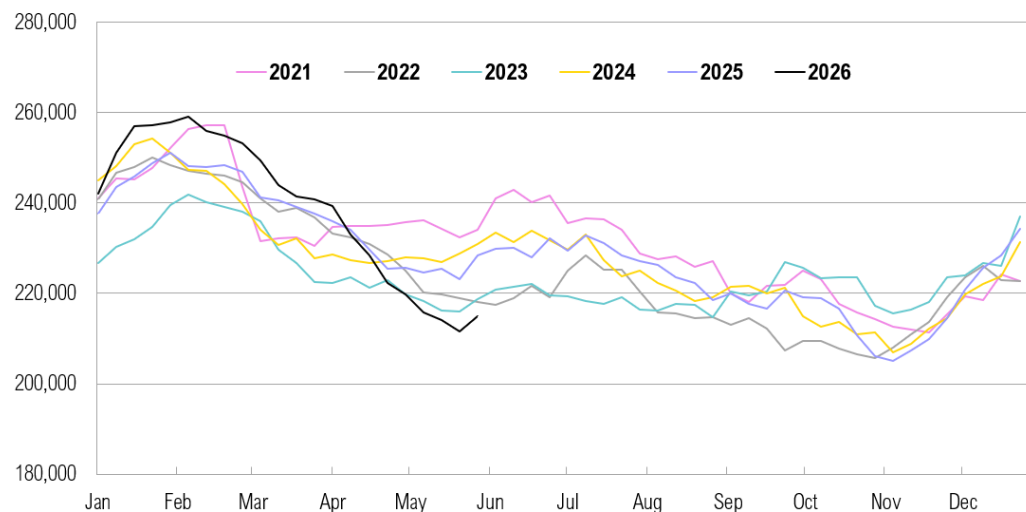
Bottlenecks

Early June marked the 100th day of the U.S.-Iran conflict. Since the war began on February 28, the conflict has shifted from direct military confrontation to a prolonged standoff over the Strait of Hormuz, keeping a critical global energy bottleneck largely closed and contributing to ongoing pressure on oil and gas markets. Oil prices remained volatile throughout May. West Texas Intermediate (WTI) crude reached \$109 per barrel on May 18 (the day President Trump called off an imminent round of military strikes against Iran to allow more time for negotiations) before ending the month at \$87. Brent crude followed a similar path, peaking at \$112 before closing May at \$92. Domestic energy markets have started to reflect the prolonged impact of the Iran conflict. U.S. gasoline inventories have fallen to multi-year lows, and average pump prices for regular unleaded gasoline have risen from \$2.80 per gallon in early January to \$4.32 by the end of May.^{6,7} On the positive side, U.S. exports of crude oil rose to a record 5.6 million barrels per day in May, serving as a tailwind to the U.S. oil and gas industry.⁸

U.S. crude exports reached a record high in May, boosting the domestic oil and gas industry

Domestic Gasoline Stockpiles Have Been Drawn Down to Multi-Year Lows

Weekly Stocks of Total U.S. Gasoline, Thousand Barrels



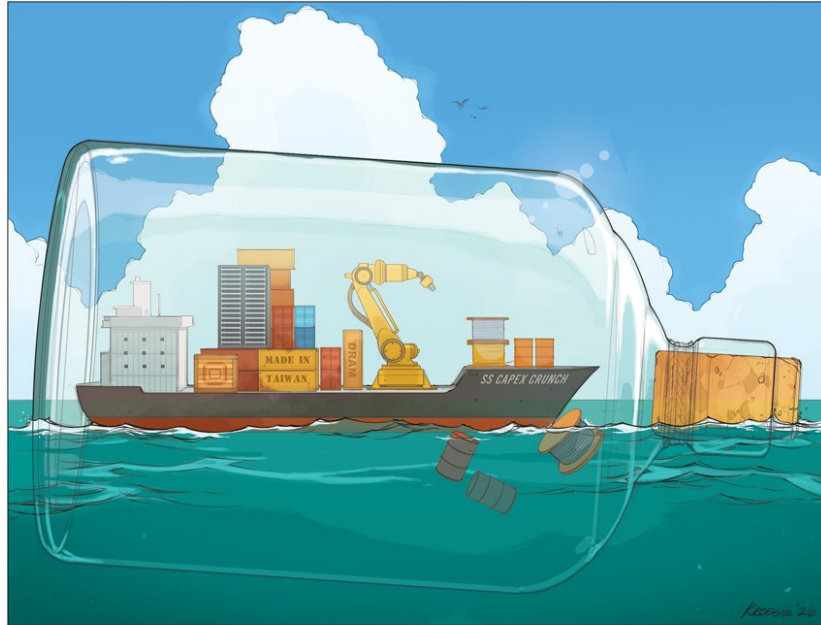
Source: U.S. Energy Information Administration. As of 5/31/2026.

Negotiations between the U.S. and Iran stalled in May

Throughout April and May, several attempts at a broader agreement came close but ultimately failed. Talks in Islamabad on April 12 collapsed over disagreements around Iran's nuclear program and stockpile of highly enriched uranium. In mid-April, efforts to use a temporary Israel-Lebanon ceasefire as a confidence-building measure broke down as military operations continued, while negotiations over reopening Hormuz stalled in May and into June as neither side was willing to remove restrictions first.⁹ Three issues have repeatedly derailed negotiations: Iran's nuclear program, the standoff between the U.S. naval blockade and Iran's restrictions on Hormuz, and ongoing Israeli military operations in Lebanon.⁹

On June 11, Trump called off planned strikes on Iran, citing a breakthrough in negotiations

The pattern intensified in early June, when two days of back-and-forth attacks pushed the region toward a resumption of full-scale war. On June 11, Trump said he had called off new military strikes on Iran, claiming a breakthrough in negotiations just hours after threatening to escalate the conflict by seizing control of Iran's oil industry.¹⁰ According to U.S. and Iranian officials, both countries are moving closer to signing a peace deal around the G-7 meetings in mid-June.¹⁰ Betting markets currently assign a 41% probability to a permanent peace agreement by the end of June and a 77% probability by year-end.¹¹



Source: SpringTide, Noah Kroese

Much of the market's valuation is derived from a handful of mega-cap tech stocks

The S&P 500 ended May up 20% from its March 30 low, and the technology sector advanced 42%. Despite the strong rally, valuations appear less stretched than headline index performance suggests. The market cap-weighted S&P 500 index's 12-month forward price-to-earnings ratio ended May at 21x, above its 10-year average of 19x, while the equal-weight index ended May at 17x, in line with historical norms.¹² The divergence highlights how much of the market's valuation is derived from a small group of mega-cap technology companies rather than more average companies.

The rally in U.S. large-cap stocks has been earnings-driven

Importantly, the rally in U.S. large-cap stocks has been driven by earnings growth rather than multiple expansion. Since 2024, nearly all the S&P 500's gains have come from rising earnings, with consensus forecasting 23% earnings growth in 2026 and revenue growth across all eleven sectors, driven by information technology (28%), energy (18%), and communication services (14%).¹³

AI compute supply has emerged as the key bottleneck to tech earnings growth

The technology-led earnings growth largely rests on AI compute. The supply of compute has become the sector's bottleneck, and a primary risk to these valuations. Initially the difficulty facing AI development was a shortage of GPUs (or graphics processing units), which are specialized semiconductors designed to perform large numbers of calculations simultaneously and used today as the primary hardware to train and run AI models. The barrier once posed by the GPU shortage has now shifted to memory and power constraints, particularly in high-bandwidth memory (HBM).^{14,15} As memory manufacturers redirect production capacity toward AI data centers, these shortages have driven prices significantly higher and increased costs across the supply chain. Memory now accounts for as much as 35% of hardware costs, compared with a historical range of 15-18%.¹⁶

According to Dell CEO Jeffrey Clarke:

“Demand continues to exceed supply with memory as the primary constraint, and we expect to exit the year with a meaningful backlog.”¹⁷

TSMC is struggling to keep up:

“It will be a long time before we can meet customer demand. We continue to see increasing adoption of AI models across consumer, enterprise and sovereign AI applications. This trend is driving demand for greater computing power, which in turn supports strong demand for advanced semiconductor chips.”¹⁸

Per Nvidia CEO Jensen Huang:

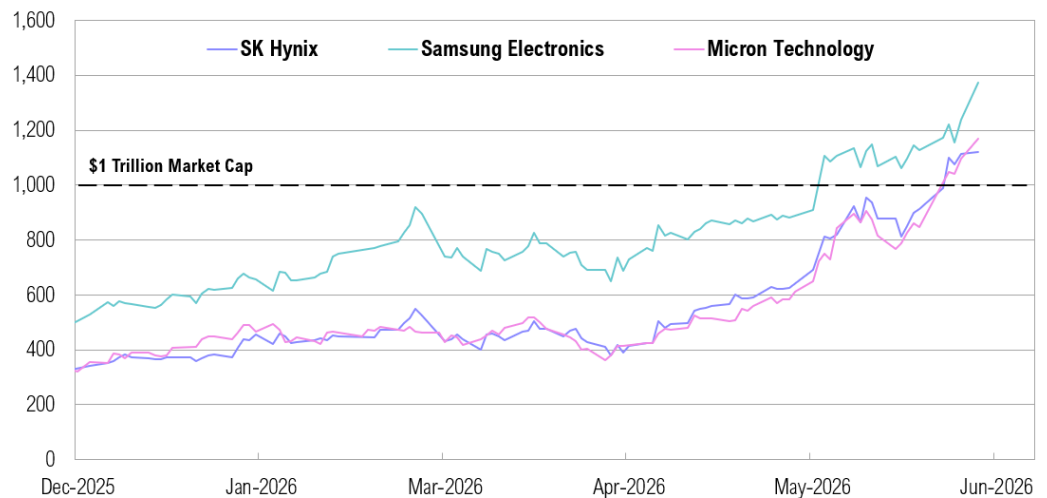
“GPU consumption is going through the roof and even GPUs we sold four or five years ago now are rising in price faster than, you know, good wine.”¹⁹

These constraints continue to support pricing power for chip and memory manufacturers while raising costs for hyperscalers and AI-dependent businesses. Increasingly, however, the effects extend beyond supply chains and into equity markets themselves. Taiwan recently overtook India as the world’s fifth-largest equity market, driven largely by Taiwan Semiconductor Manufacturing Company (TSMC), which now accounts for more than 40% of the local benchmark.²⁰ Meanwhile, three memory-related companies—SK Hynix, Samsung, and Micron—surpassed \$1 trillion market capitalizations during May. None began 2026 with valuations above \$500 billion.²¹

Taiwan recently overtook India as the world’s fifth-largest equity market

Three Memory-Related Companies Surpassed \$1Tn Market Cap in May

Market Cap, \$Bn



Source: Bloomberg

The industry has responded with an unprecedented wave of investment. Global semiconductor capital expenditure is expected to approach \$200 billion in 2026, and memory manufacturers account for nearly half of total spending.^{22,23} TSMC is projected to spend \$120 billion across 2026 and 2027, more than double its combined investment over the previous two years.²⁴ Micron is expected to spend \$63 billion over the same period, nearly three times its 2024-2025 total.²⁵

Global semiconductor capital expenditure is expected to reach \$200Bn in 2026

The effects are already visible in trade flows. South Korean semiconductor exports to the United States rose 670% year-over-year in April, while Taiwan’s export orders to the U.S. increased 48% in May.^{26,27} While this investment is intended to ease current shortages, it also represents a multi-year bet that AI demand remains strong enough to absorb a significant increase in future supply.

U.S. hyperscalers are expected to spend nearly \$750Bn on AI infrastructure in 2026

That conviction was reinforced during first-quarter earnings season. Market concerns earlier this year centered on the possibility of slowing AI investment. Instead, results from Alphabet, Microsoft, Amazon, and Meta suggest AI-related capital spending continues to accelerate. Collectively, these companies are projected to spend nearly as much in 2026 as they did in the previous two years combined, and their aggregate capital expenditures will approach \$750 billion.²⁸ The trade-off is that free cash flow is expected to come under increasing pressure. Current projections suggest both Amazon and Meta could generate negative free cash flow by the end of 2026.²⁹

According to Alphabet CFO Anat Ashkenazi:

“We are investing to meet the unprecedented demand we are seeing from enterprises and consumers. For the full-year 2026, we expect our capex to be in the range of \$180 billion to \$190 billion. Looking further ahead to 2027, we expect a significant increase in our capex compared to 2026.”³⁰

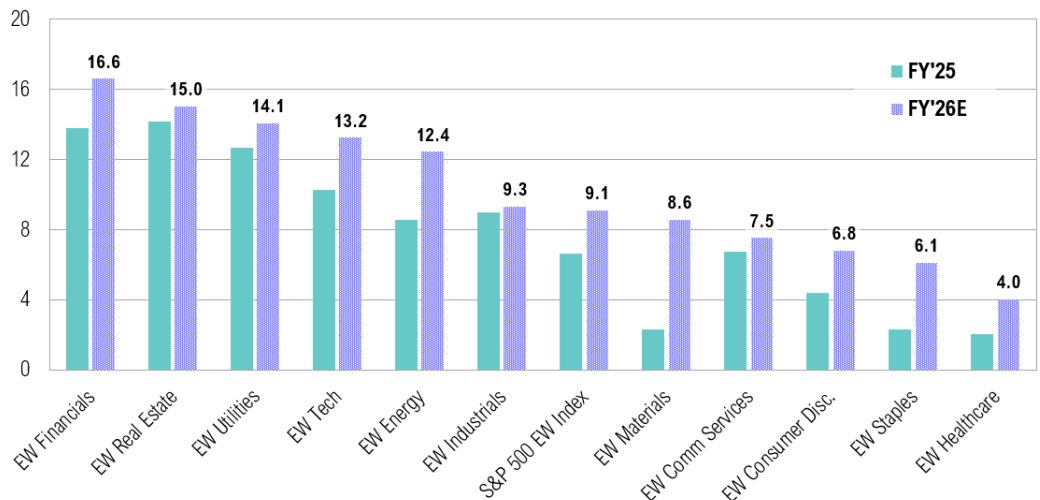
S&P 500 net profit margins reached a record 14.8% in the first quarter

Encouragingly, earnings growth is becoming broad-based. First-quarter S&P 500 earnings growth came in at 28.8%, far surpassing the expected 13.1%.¹³ This strong print pushed full-year 2026 earnings growth expectations from 17% to 23%. Further, S&P 500 net profit margins expanded 14.8% in the first quarter (the highest level recorded since FactSet began tracking the metric in 2009), and margins are expected to improve across all eleven sectors during 2026.¹³ Consensus forecasts now call for 23% S&P 500 earnings growth next year, led by the energy sector (66%), information technology (44%), and materials (39%).¹³ The equal-weighted S&P 500 tells a similar story: every sector is projected to deliver 2026 net income margin growth above its respective five-year median, indicating that earnings strength is becoming increasingly broad-based rather than concentrated in mega-cap technology.³¹

Earnings growth is broadening beyond mega-cap tech

Equal-Weighted Margins Are Expanding, Indicating Broadening Earnings Growth

S&P 500 Equal Weight Sectors: Net Income Margin, %

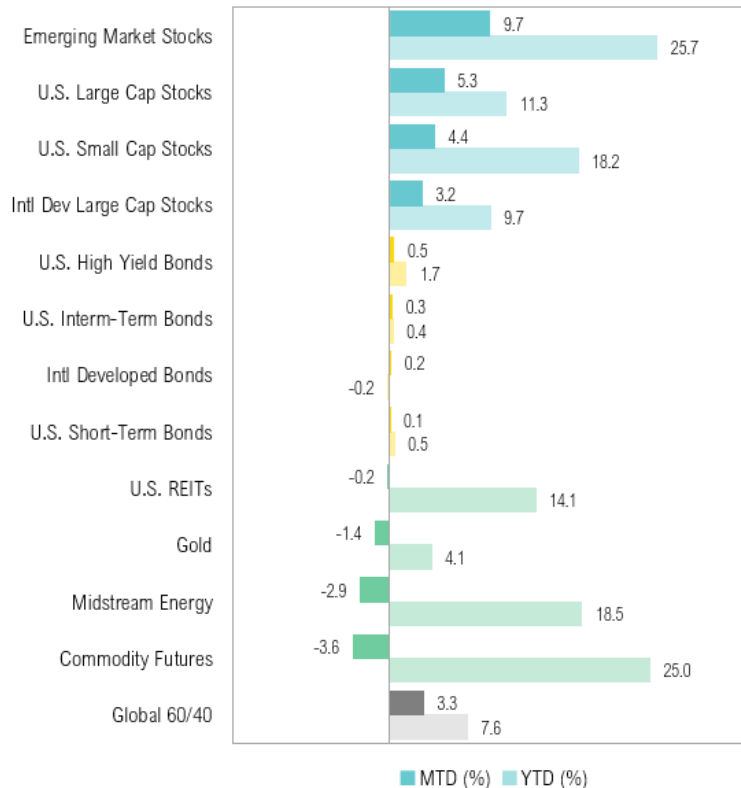


Source: Bloomberg

Markets

Markets fared well in May, taking geopolitical uncertainty in their stride. Notably, emerging markets were, for the second consecutive month, the best performing of all major asset classes, ending May up 9.7%. U.S. large-cap stocks marginally outperformed small-cap counterparts, with the former gaining 5.3% and the latter ending the month up 4.4%. Developed market large-cap stocks ended the month up 3.2%. U.S. intermediate-term bonds ended May up 0.3%. Gold prices declined 1.4% in May.

May 2026 Key Market Total Returns



Emerging market stocks outperformed developed market stocks for a second consecutive month

Source: Bloomberg

Looking Forward

Looking ahead, the key question is whether today's bottlenecks begin to ease or simply shift. The next test is whether the AI capex boom can be monetized in a way that proves profitable for hyperscalers and productivity-enhancing for the broader economy. That would help justify a backdrop in which S&P 500 earnings are expected to grow more than 20% in 2026 and margins are projected to improve materially across every sector.

The next test is whether the AI capex boom can drive profits and productivity

The next wave of IPOs could reshape the supply backdrop for U.S. equities

Investors will also be watching Kevin Warsh's first meeting as Fed Chair, where any inclination to cut interest rates will have to contend with resilient growth and above-target inflation. At the same time, a reopening IPO market will be worth watching as part of a gradually changing supply backdrop for U.S. large cap stocks, with a growing pipeline that now includes SpaceX, OpenAI, and Anthropic, among others. That may become more relevant as post-IPO unlock windows approach and if the hyperscalers continue to prioritize AI investment over buybacks.

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DEFINITIONS

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Interm-Term Muni Bonds: Bloomberg 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Interm-Term Bonds: Bloomberg U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Global Aggregate Bond TR Index.

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