

2026 Third Quarter Investment Outlook

Special: Midyear Outlook

Introduction

In the early days of 1776, the 13 American colonies stood at a critical and deeply ambivalent crossroads. For more than a decade, they had passively resisted British taxation without representation and political encroachment, yet their defiance was paradoxically couched in expressions of profound loyalty to King George III. Even after the first shots fired at Lexington and the bloodshed at Concord and Bunker Hill in 1775, the prevailing consensus among the Continental Congress and the colonial public was not separation, but reconciliation. The colonists viewed themselves as aggrieved Englishmen demanding their constitutional rights, not as a new nation seeking independence. It was within this atmosphere of hesitation and political paralysis that an impoverished, recently arrived English immigrant named Thomas Paine published an anonymous 47-page pamphlet entitled *Common Sense* on January 10, 1776.

Common Sense may be the most influential political tract ever written and functioned as a massive intellectual catalyst that utterly transformed the trajectory of the American Revolution. Nearly 250 years

ago, it galvanized countless Americans living among the Thirteen Colonies, who were subjects of imperial rule under a Declaration of Dependence, to break away from the British monarchy and proclaim independence. Paine dismantled the deeply ingrained sanctity of the British monarchy and the “divine right of kings,” exposed the economic and geopolitical disadvantages of remaining tied to the British Empire, and elevated the localized colonial rebellion into a grand ordained mission for global human liberty. His stirring words would set in motion the revolution in America and a series of independence movements across the world over the next century.

Although First Horizon has not yet crossed the semiquincentennial mark, our bank’s storied history spans over 167 years, encompassing economic depressions, world wars, financial crises, and booms and busts in wealth. Through it all, we have always prudently balanced legacy and innovation, and we believe the lessons of history should guide our path forward.

“The more men have to lose, the less willing are they to venture.”

Thomas Paine,
Common Sense (1776)



Eric M. Teal
Chief Investment Officer
First Horizon Wealth Management

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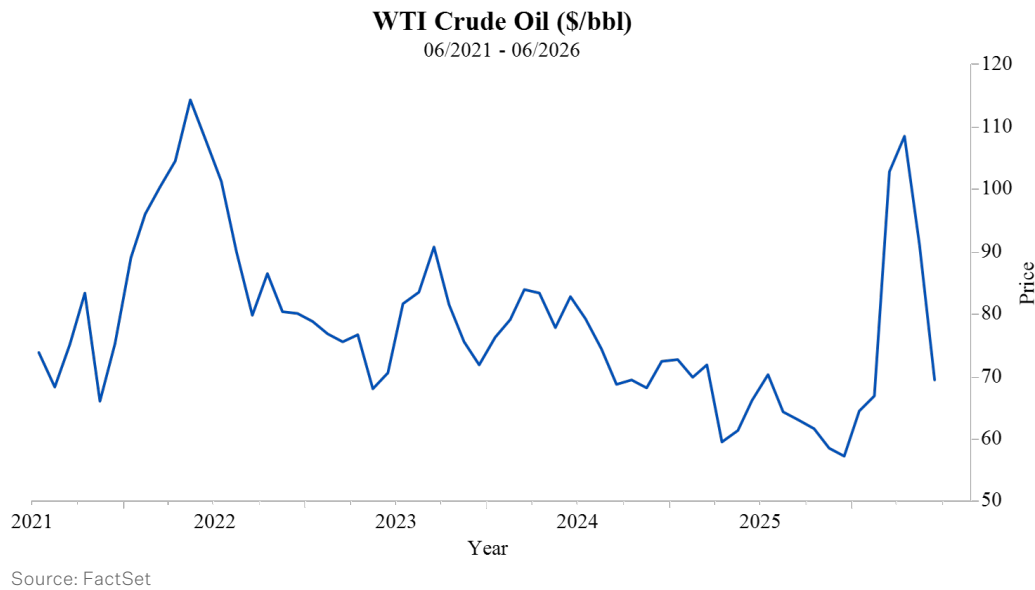
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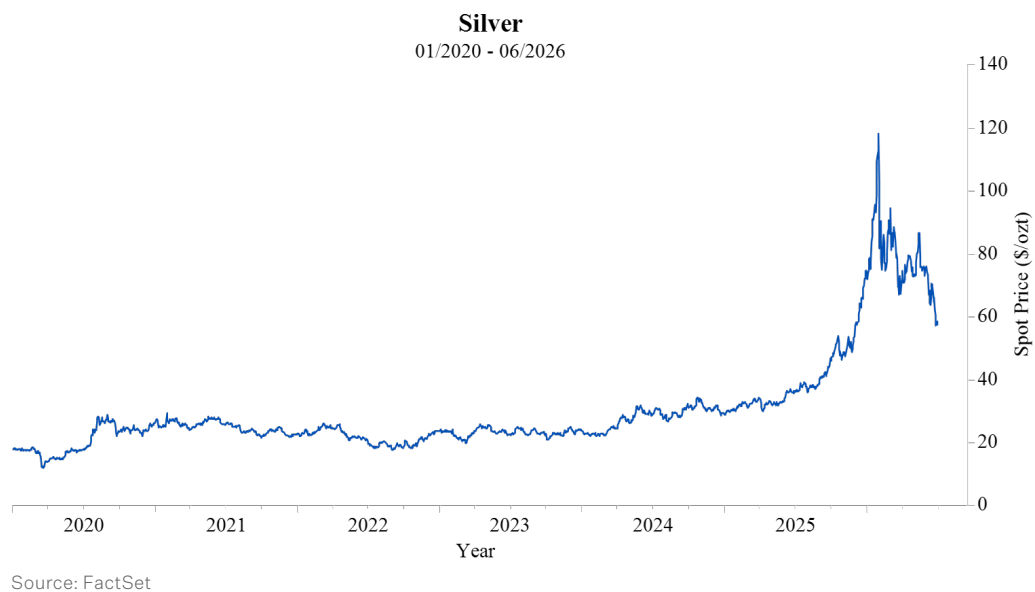
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Executive Summary

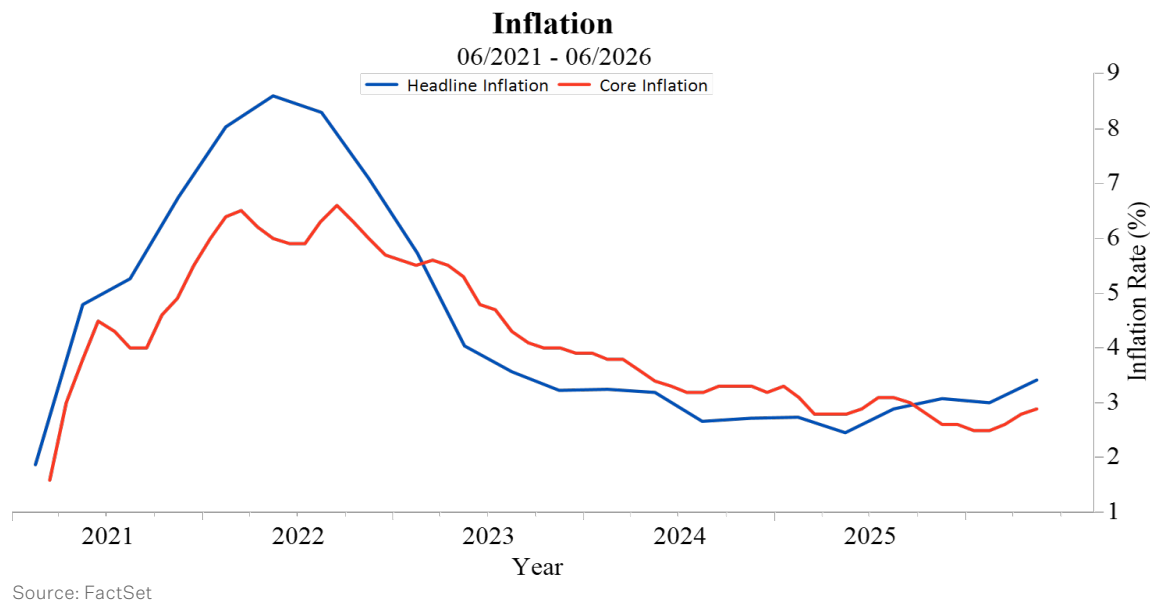
The second quarter witnessed a return to risk taking with unbridled optimism building around the AI trade and a temporary deescalation of the war in the Middle East. The result was a broad-based stock market rally in the face of mounting concerns around private credit and technology valuations. Many traditional commodities fell during the quarter as oil retraced the shock following the war with Iran.



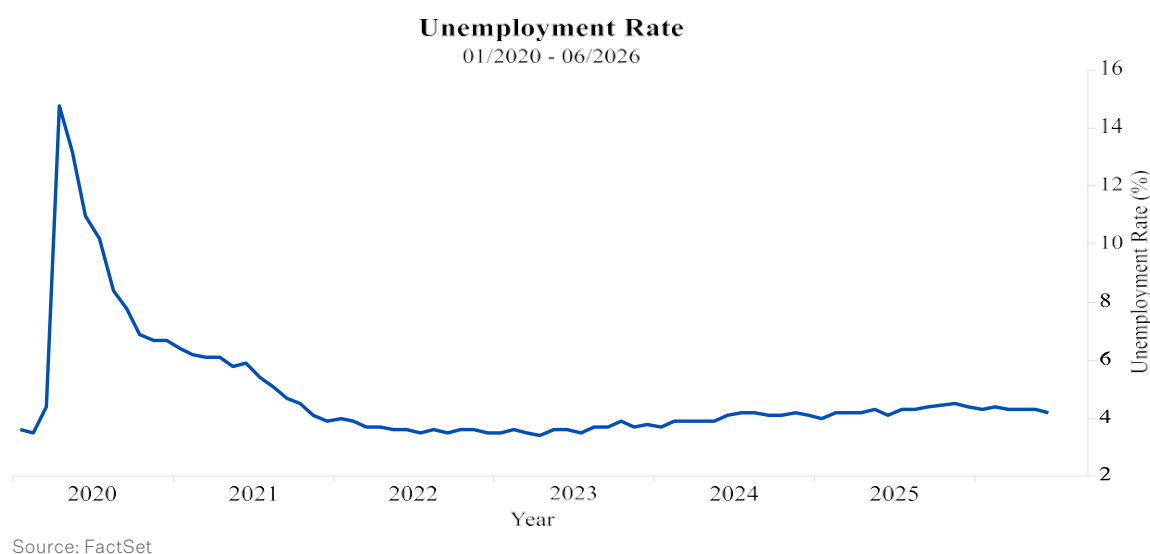
Likewise, gold and silver have declined since the nomination of new Fed Chairman Kevin Warsh.



Yet, the outbreak of the Iran war on February 28 dealt a decisive blow to an otherwise constructive inflation backdrop and reignited stagflation fears. Chairman Warsh has promised to take a more aggressive approach toward inflation that has run well above the 2% target for over five consecutive years, and the market is no longer assuming an easing bias.



However, the story around U.S. economic exceptionalism remains the envy of the world. Despite the elevated and persistent fiscal deficits, the dollar has stayed the world's reserve currency. U.S. economic growth and corporate profits and margins are at record levels and far outpace other developed nations. The employment rate and the job market persist at full employment levels.



Despite the anticipated creative destruction, productivity has also remained high with the promise of AI set to further augment profit margins. So, there is a lot to appreciate as we celebrate 250 years of democracy and capitalism. Now, let us focus on the **Opportunities, Risk** and **Approach** as we pass the midyear mark.



Opportunities | Mind the Gap



“We have it in our power to begin the world over again.”

- THOMAS PAINE
Common Sense (1776)

Across the colonies, local towns, county conventions and provincial assemblies began passing formal resolutions instructing their delegates in the Continental Congress to vote for independence. By the spring and summer of 1776, the intellectual victory of Common Sense was complete. When Thomas Jefferson sat down in June to draft the Declaration of Independence, his task was not to introduce a radical new concept to a skeptical audience, but to formalize a consensus that Thomas Paine had already forged across the continent.

Over the past quarter, we have seen controversy develop around the AI story from those insisting it is a “bubble” akin to the internet mania of the early 2000s to those who proclaim – “it is different this time around,” promising a technology revolution similar to the second industrial revolution in the mid-19th century. The truth probably rests in the middle, but there is little room for error.

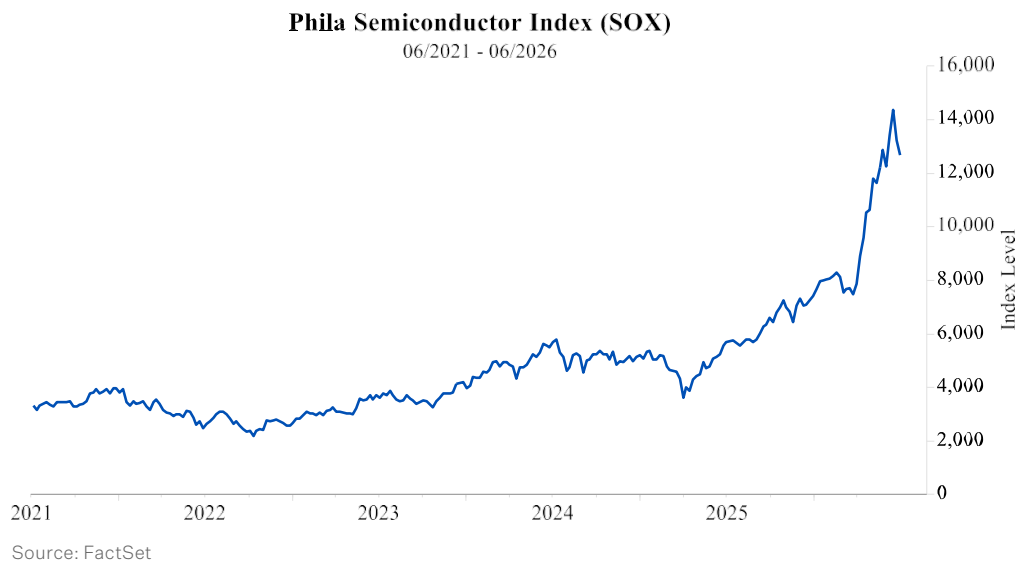
Interestingly, what investors have been able to witness firsthand are the areas of the market that lead when one side of debate is currying favor and conversely when the counterargument is winning

out. From an asset allocation perspective, it remains prudent to hedge the runaway hyperscalers capex spending paradigm with areas of the market that remain highly uncorrelated with the AI euphoria.

Now, no prominent company wants to appear to be left behind in technology and innovation, so the story has rapidly expanded from a handful of companies, Mag 7, to a much larger basket of semiconductors, electric utilities, and professional services, etc., who benefit from embracing the story despite rising political and populist opposition toward data centers and artificial intelligence in general.



Thus, as controversy has ensued and valuations are ever so lofty, the expanded AI-related set of companies have traded with more volatility than traditional history might suggest. This is particularly prevalent in the U.S. large cap market that still has nearly 40% weighting in information technology and semiconductors and the semiconductor equipment industry approaching 20% of the market.



Therefore, our goal is to dynamically and globally diversify into areas of the market that are negatively or less correlated with the AI theme. This includes traditional financial and insurance sectors and healthcare, who despite the disruption of their business models from AI stand to benefit from late-stage adoption. It also includes areas of market often neglected by larger financial firms, like small and microcap stocks. The smallest capitalization can offer larger mispricing and an inverse relationship with the more concentrated large cap exposure.

Top 10 and Other Holdings % As of June 30, 2026			
Index	S&P 500	Russell 2000	Russell Microcap Index
Top 10	36.3%	3.4%	5.5%
Other	63.7%	96.6%	94.5%

Source: S&P Global and FTSE Russell

Additionally, markets outside of the U.S. offer quality companies with stable and predictable earnings and exposure to other investable paradigms like energy, financials and industrials. This requires embracing change, selling momentum and seeking out areas of opportunity that have recently been ignored by investors.

Risk | Concentration Abounds



*“These are the time
that try men’s souls.”*

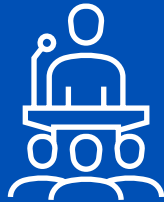
- **THOMAS PAINE**
The American Crisis (1776)

Paine ensured that his ideas could be easily understood when read aloud in public squares, crowded taverns, army encampments and coffeehouses. This approach effectively democratized the political discourse of the revolution.

Irrespective of the enthusiasm about the AI promise, investors should be sensitive to the perils of having so much of their investments in a single basket of correlated companies. Moreover, the concentration is only set to increase with one recent and two upcoming mega IPOs set to go public with market valuations nearing \$1 trillion each despite limited operating histories. All three issues have extraordinary revenue growth but will be unprofitable at the time of listing. The high-profile additions to the public markets are sure to incite investor appetite and further concentrate idiosyncratic risk.

Given the size of the U.S. stock market, the IPOs are not as relatively significant as the money-losing IPOs of the late 1990s, but life as a public company is bound to be different. Recall that the late Alan Greenspan famously coined the expression “irrational exuberance” in late 1996 when reflecting on the internet bubble. However, from the time of his pronouncement, the market would ascend for another four years before bursting in the spring of 2000. The path and duration will unlikely be the same, and there is no sense trying to stake out a position, but instead investors ought to diversify in a way that best grows and preserves capital under any scenario over the intermediate term.

Approach | Active and Dynamic



*“The sun never shined on
a cause of greater worth.”*

- THOMAS PAINE
Common Sense (1776)

Paine provided the intellectual clarity, rhetorical fire and structural vision necessary to break the deadlock. By exposing the absurdity of monarchy, demonstrating the geopolitical and economic necessity of independence, and communicating these complex ideas in a powerful, democratic language, he democratized the political process and mobilized an entire population.

Investing excellence has rarely been about complexity. The fundamentals have largely remained the same since the days of Benjamin Graham, the “father of value investing,” but there have been recurring patterns in economics and human psychology that oscillate from optimism to pessimism.

By studying history and understanding market cycles, investors can prepare for future volatility rather than constantly trying to predict the unknowns.





Given the environment, we recommend the following:

- Bonds have historically outperformed cash through market cycles. Policy has recently shifted from pricing in interest rate cuts to prolonged restraint to the potential for rate hikes entering 2027. A flatter yield curve reflects this repricing with the short end rising more than the long end. Given the shifting Fed policy, bonds are still more attractive than cash.
- Sectors uncorrelated to the AI trade offer attractive valuations, including financials, healthcare and energy, although value realization may take time. Earnings growth and free cash flow generation across technology and related companies remain robust but should be counterbalanced with anti-AI themes when constructing portfolios. Value has outperformed growth this year, a trend likely to continue following years of growth and momentum outperformance.
- Small cap and microcap continue to offer the greatest opportunity within U.S. equity markets with better liquidity and an alternative to private equity allocations following decades of flows and diminishing return potential.
- Among credit markets, there is limited room for further spread tightening. Profitable AI-related companies are issuing debt to fund infrastructure buildouts. The issuance could alter credit fundamentals with areas of the market becoming extended. Thus, the focus remains on selective high-quality allocations across the curve.
- Non-U.S. equities and investment-grade bonds offer a favorable mix of higher spreads and lower duration, with less concentration in technology and greater exposure to hard assets and infrastructure-oriented sectors.
- Real assets and commodities offer the potential to hedge inflation risk and safeguard against ongoing geopolitical and energy supply disruption risk.



Conclusion

Following the egalitarian assertions of Paine, politics was no longer an exclusive, gentlemanly debate conducted behind closed doors by wealthy lawyers and plantation owners; it became a vibrant, participatory public conversation that included the blacksmith, the merchant, the tenant farmer and the shopkeeper. Abigail Adams praised it enthusiastically, noting how its bold sentiments resonated deeply with the desires of the populace.

Thomas Paine's *Common Sense* and *The American Crisis* proved "the pen is mightier than the sword." He would go on to enlist in the Continental Army and serve as an aide to General Nathaniel Greene. Like the American Revolution, there is an ongoing democratization of wealth management that should benefit all investors with access and affordability to sound and prudent approaches to investing, banking and financial planning that can deliver value and insight. It does not require access to privileged investment opportunities or exorbitant fees, but a deep understanding of client issues built on a relationship of trust and experience to guide success for posterity.

**Eric M. Teal**

Chief Investment Officer

First Horizon Wealth Management



Trust services, including investment management services, provided by First Horizon Bank. Investments are:

Not Insured by FDIC or Any Other Government Agency	Not Bank Guaranteed	Not Bank Deposits or Obligations	May Lose Value
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First Horizon Wealth Management is the marketing name for wealth-related services available to First Horizon clients.

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The S&P 500 Index is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

