"Move Over, Mega-Cap Technology"
Market Commentary – February 2026

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The updated estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 4.4% in the third quarter of 2025. This is higher than the initial estimate of 4.3% and also higher than +3.8% in 2025 Q2 and -0.6% in 2025 Q1. The Consumer Price Index (CPI), which measures inflation in consumer prices, increased 2.7% year-over-year (YOY) in December (ranging from 2.3% to 3.0% over the past 12 months). The Producer Price Index (PPI), which measures inflation in wholesale prices, rose 3.0% YOY in December (ranging from 2.4% to 3.8% over the past 12 months). Unemployment measured 4.4% in December (ranging from 4.0% to 4.5% over the past 12 months). Overall, the U.S. economy is exhibiting impressive strength without overheating inflation.

President Trump has selected his highly-anticipated nomination for Chair of the Federal Reserve: Kevin Warsh. Warsh, age 55, has a longstanding reputation as an inflation hawk, but he aligned himself with President Trump and publicly argued for lower interest rates in 2025. If confirmed by the Senate, he would take over for current Fed Chair Jerome Powell when Powell's term expires on May 15. Meanwhile, on January 28, the Federal Open Market Committee (FOMC) maintained its benchmark federal funds rate at a range of 3.5% to 3.75%. It stated that "economic activity has been expanding at a solid pace" and "the unemployment rate has shown some signs of stabilization", while noting that "inflation remains somewhat elevated". The next FOMC announcement on monetary policy is scheduled for March 18.

The mathematics of loss recovery make Type 2 error a more serious outcome than Type 1 error. Imagine a $1 million portfolio. If the portfolio falls by -10% ($100,000), it must earn $100,000 on $900,000 to get back to $1 million (+11%). Similarly, -25% requires +33% to get back to even (-50% requires +100%, -80% requires +400%, etc.). Larger losses require exponentially higher returns to break even. Recall that Type 1 error (rejecting a good stock) results in opportunity cost. On the other hand, Type 2 error (failing to reject a bad stock) results in actual financial loss. The moment you decide to buy a stock, you are at risk of committing a Type 2 error and the mathematics of loss recovery come into play. Since actual financial loss is more severe than opportunity cost, Type 2 error is more serious. This helps explain why *buying* an investment is a more complex decision than selling (contrary to popular belief).

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) through December 31, 2026 is $310.27, which implies a price-to-earnings (P/E) ratio of 22.4 with the S&P 500 at 6,939. The earnings yield (E/P) of 4.47% represents fair value relative to the 10-year U.S. Treasury note yield of 4.26% (a yield spread of 0.21%). The eight largest companies in the S&P 500 make up $23.3 trillion of the $61.9 trillion index market capitalization with a weighted P/E of 39.7. If 37.7% of the index has a P/E of 39.7, then 62.3% of the index has a P/E of 11.9 for the overall P/E to be 22.4. A P/E of 11.9 is an E/P of 8.40%, which is attractively priced compared to the 10-year Treasury note yield of 4.26% (a yield spread of 4.14%).

The S&P 500 stayed above 6,900 for much of January, but it has yet to close above 7,000. The index is pinching between the 50-day moving average (currently 6,858 and gently rising) and 7,000, seemingly building energy for a breakout up or down. The stubbornness of the index to materially fall augurs for a bullish resolution. On the other hand, volume on down days in January tended to be higher than volume on up days (such "distribution days" are bearish). Meanwhile, investment dollars are rotating from the mega-cap technology stocks to value stocks, especially small and mid-caps. In January, the S&P 600 Small Cap Value and S&P 400 Mid Cap Value indexes returned +6.46% and +4.12% respectively, compared with +1.45% for the S&P 500 (including dividends). Mega-cap technology stocks have hogged the spotlight for so long, but perhaps the spotlight will finally be shared with, or taken over by, other deserving stocks.