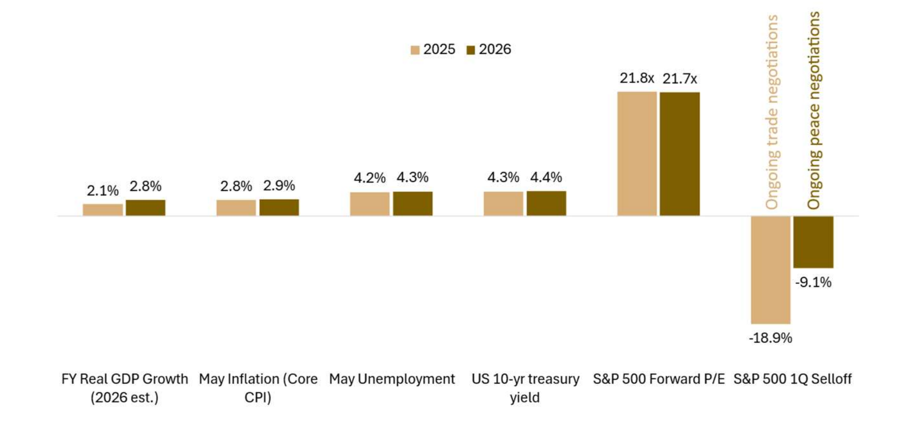
COVINGTON INVESTMENT ADVISORS, INC.
Q2 2026 QUARTERLY NEWSLETTER

The first half of 2026 has come to a close and the economic/market narratives have been dominated by two major themes: the conflict in Iran and the continuation of global “AI fever”. The key theme for us is the remarkable similarities between the economic backdrop of 2025 and 2026. Annual real GDP growth for 2026 continues to track toward a healthy 2.8% for the full year - right at historical trendline growth - proving that the underlying economic foundation remains structurally sound despite some price shocks related to geopolitical conflicts.

The labor market remains in a stable condition that supports the broader economic expansion with unemployment continuing to hover in the mid 4% range. This level is a tick up from the cycle lows in 2023 but still represents a healthy and stable job market. Layoffs have stayed largely contained to localized corporate restructurings, while broad-based aggregate demand continues to support steady payroll additions.

Exhibit 1: The 2026 economic backdrop and market fundamentals are incredibly similar to 2025



(1) June 2026
(2) Source: Federal Reserve Bank of Dallas

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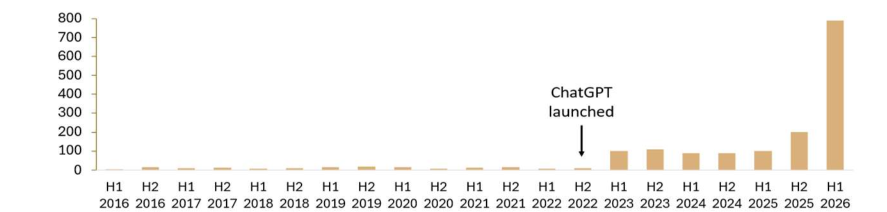
The corporate earnings environment again reflected this backdrop to boost equities in their rally. In fact, the S&P 500 is on pace to deliver 26% EPS growth for calendar year 2026 YoY (18% excluding large one-time gains recognized by Amazon, Alphabet, and Meta). AI component companies again returned to leadership in the market with semiconductor stocks leading the way. However, the median stock in the S&P 500 index is growing earnings by a solid 12% YoY illustrating that strength in the quarter was not reserved to only technology.

2026 monetary policy has been defined by a changing of the guard at the Federal Reserve alongside stubborn consumer prices. Headline CPI inflation finished May at 4.2%, fueled by a sudden energy market shock that temporarily complicated the central bank's path toward monetary easing. Amidst these economic crosscurrents, a leadership transition took place when President Trump officially nominated Kevin Warsh to succeed Jerome Powell as Federal Reserve Chairman, introducing a new era of leadership at the central bank.

The situation in the Middle East remains fluid. Similar to the trade negotiations that shook markets in 2025 - Markets again have to deal with navigating the Trump administration's negotiation tactics of “deal” or “no deal” with Iranian leadership. And just like with trade negotiations - these will likely continue to provide ongoing volatility but at a lower magnitude than the initial shock in the first quarter.

Exhibit 2: Mentions of AI disruptions in global earnings call transcripts



(1) July 2026
(2) Source: Bloomberg, DB

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Now let's review the market performance for the second quarter of 2026.

Market Review

Exhibit 3: Major indices performance table

Index	2025	Q1 2026	Q2 2026	YTD
Stock Indices				
S&P 500 Total Return Index	17.88%	-4.33%	15.20%	9.98%
Dow Jones Industrial Average	14.92%	-3.19%	13.38%	10.99%
Nasdaq Composite	21.14%	-6.96%	21.60%	11.49%
Russell 2000 Index (Small Cap's)	12.81%	0.89%	21.49%	21.43%
Bonds				
Bloomberg Barclays US Aggregate Bond TR	7.30%	-0.05%	0.67%	0.48%
Bloomberg Barclays Municipal Bond TR	4.24%	-0.18%	2.50%	2.23%
ICE BofA US High Yield Index	8.50%	-0.55%	2.45%	1.96%
Gold				
S&P GSCI Gold Spot Price Index	64.37%	7.78%	-13.68%	-4.96%
Real Estate Investment Trusts (REITS)				
FTSE NAREIT REIT Composite Index	2.80%	3.47%	10.50%	16.00%
International Indices				
MSCI EAFE Index	27.89%	-1.87%	9.80%	8.70%
MSCI Emerging Markets Index	30.58%	-0.51%	23.31%	19.92%

(1) As of 06/30/2026 | Data provided by Envestnet Tamarac through data providers Refinitiv. Total Return includes the effects of dividends. Past performance is no guarantee of future results

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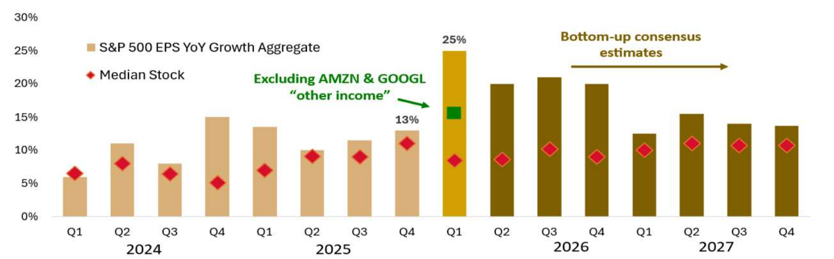
Equities

Following the first quarter's lackluster performance, equities across the board rebounded strongly in the second quarter. U.S. large cap equities, as represented by the S&P 500, rallied 15.20% during the second quarter. This is the index's best quarterly performance since the post-pandemic rebound in Q2 2020.

One sector that performed particularly well was chip stocks. The Philadelphia Semiconductor index rose 88% during the quarter - the best quarterly performance since the index began in the early 1990s. This brings its YTD return to 101.7% as of quarter end. This exceptional chip stock performance pushed the tech-heavy Nasdaq composite to a 21.60% return in the second quarter.

Exhibit 4: Q1 2026 S&P 500 earnings were exceptionally strong



(1) June 2026
(2) Source: Bloomberg, GS

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Small cap stocks, as represented by the Russell 2000 index, continued their outperformance for 2026. The index rose 21.49% during the second quarter bringing its 2026 return to 21.43%.

Looking abroad, international stocks also had strong rebounds in the second quarter. Developed international markets, as represented by the MSCI EAFE Index, rose 9.80% bringing its year-to-date 2026 return to 8.70% as of June 30th. Emerging markets, as represented by the MSCI Emerging Markets Index, rose 23.31% during the quarter as surging global demand for semiconductors and memory chips provided a massive boost to major Asian emerging markets like Taiwan and South Korea.

Fixed Income

Fixed income broadly had positive returns in the second quarter despite rising treasury yields. In the second quarter the Bloomberg Aggregate and Municipal bond indexes produced returns of 0.67% and 2.50%, respectively.

High yield bonds, which tend to be lower credit quality and thus higher volatility, were relatively tranquil in the second quarter, rising 2.45%.

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Summary

In summary, the second quarter reinforced the solid underlying foundation of the economy while also highlighting the extreme positioning in financial markets. While economic headlines were dominated by international shipping disruptions, military strikes, spiking oil prices, and volatile peace negotiations, financial markets rallied to their best quarterly performance since the emergence from the covid pandemic. Some of this rally was driven by extremes in equity positioning and liquidity shortages, particularly in international markets. Companies took advantage of this by ramping up public offerings and so far, markets have shown strength in digesting these new shares, but time will tell as we move into 2027.

Looking into the second half of the year the risks for markets largely remain the same. While the Iran conflict has de-escalated since the first quarter, supply disruptions still persist and any peace deals appear very fragile. Commodity prices have fallen off their highs but any re-escalation in tensions with Iran could reverse this. Any further inflationary pressures could shake markets as rising CPI has already recalibrated fed rate cut expectations. Markets are currently pricing in one rate hike in the second half of 2026.

Concentration and strong performance in technology stocks boosted markets in the second quarter but also presents a risk. While there are similarities vs. the Tech Bubble, including a spike in tech performance dispersion similar to 2000, there are also many differences. Equity sentiment is not yet at bullish extremes, Tech's outperformance has been supported by earnings growth, and the frenzied price action in IPOs and unprofitable stocks that defined 2000 is not apparent in today's market. Our concerns lie with the hyperscalers' shift to an asset-heavy business model plus debt issuance to fund AI growth, when real monetization may be years away.

To us, this volatility in the technology sector represents the biggest risk in financial markets, our diversified, high-quality approach focusing on high-quality equity selection will remain key heading into the second half of the year. As rates begin to rise there may also be attractive opportunities in the fixed income space for routine rebalancing.

Enclosed is your performance report for your account as of June 30th, 2026. Please contact us if you have any questions on your quarterly performance report or if there are any changes to your financial picture.

Sincerely,

Pat

Patrick R. Wallace

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