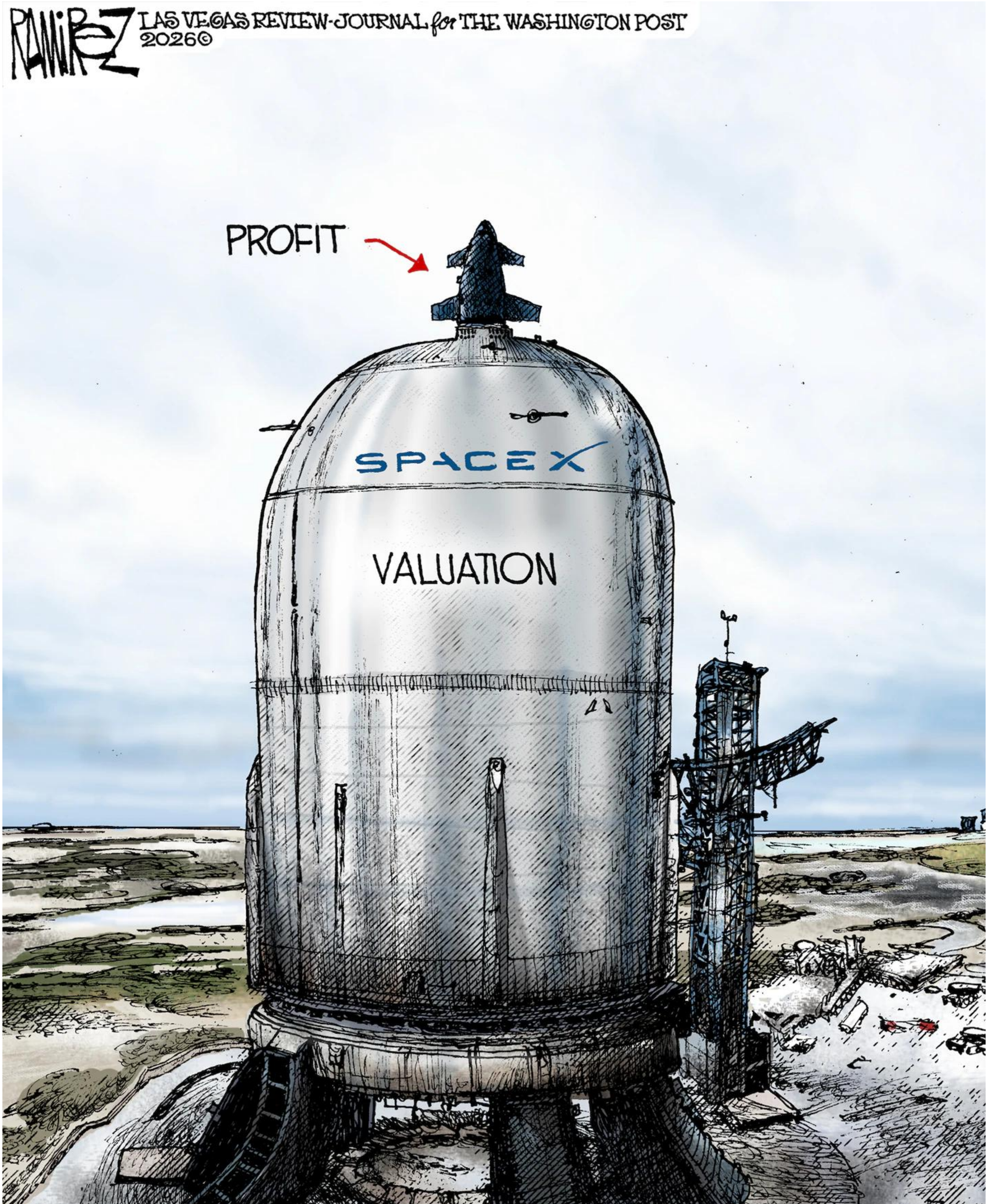
June 2026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PROFIT
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VALUATION

Two from WSJ, beginning with today's front page:

S&P, Nasdaq Post Best Quarter Since 2020

BY KRYSTAL HUR

The S&P 500 and Nasdaq composite powered through a turbulent few months to log their best quarter since 2020.

The largest oil shock in history, worries about the longevity of the artificial-intelligence boom and the prospect of higher interest rates haven't derailed the records.

The market overcame those headwinds, fueled by highflying chip stocks that are the biggest AI winners of the moment, as well as confidence that U.S. companies will continue to churn out higher profits. …

The S&P 500 and Nasdaq composite rose 15% and 21%, respectively, during the second quarter. It was the best quarter for both since 2020. The Dow Jones Industrial Average had its best quarter since 2022, rising 13%.

The S&P 500 and Nasdaq have notched 24 and 20 record closes in 2026, most recently driven by the artificial-intelligence boom that has fueled eye-popping gains in shares of chip makers supplying the build-out. …

The market has defied expectations for some time, but keeping up its breakneck gains would mean overcoming certain challenges. Investors remain skeptical that the billions of dollars funneled into AI will produce blockbuster profits that justify that spending. The rally has left stocks looking historically expensive. While the U.S. and Iran recently agreed to end fighting around the Strait of Hormuz, where 20% of the world's crude oil once flowed, it is unclear when or if shipping traffic will return to normal.

There is also the prospect of higher interest rates later this year. New Federal Reserve Chairman Kevin Warsh surprised investors in his debut by signaling more concern about inflation than many expected. The war-fueled surge in energy prices helped lift the central bank's preferred inflation gauge to a recent 4.1%, much higher than the Fed's 2% target. Back in January, investors were still betting the Fed would move to lower rates. That helped push bond yields lower. But the Iran war and the ensuing surge in energy prices upended those expectations. Inflation estimates are again inching higher, and in recent months yields have climbed to reflect a greater likelihood for rate hikes. …

The possibility of rising rates has weighed on the prices of precious metals. Gold fell 13% to $4,022.90 a troy ounce over the past three months, marking its biggest quarterly decline since 2013. Silver dropped 20% to $59.48, its worst quarter since 2020. …

Investors have already started to look beyond the market's biggest stocks. Both the Russell 2000 index of smaller stocks and the Dow Jones Transportation Average which tracks 20 large companies ranging from railroads to airlines, notched their best start to the year since 1991. Both are considered barometers for the economy's health.

The Dow industrials closed at its 19th record of the year on Tuesday, and in June outperformed the Nasdaq and S&P 500 by the widest margin since October 2022, according to DJMD. The benchmark index's financials sector has gained 4.2%, healthcare has added 6.5% and industrials have climbed 7.2%, all handily beating communication services' and information technology's more than 3% declines this month. …

While tech companies still account for much of corporate earnings growth, other sectors are catching up. About 85% of companies in the S&P 500 beat first-quarter earnings expectations, the highest percentage since 2021, according to FactSet.

The price of oil has fallen toward pre-Iran war levels, easing worries that spiking energy prices will push up inflation. Front-month Brent crude futures, the international oil benchmark, fell 38% in their worst quarterly performance since the Covid-19 pandemic.

Earnings growth is expected to remain robust. Companies in the S&P 500 are expected to report a 22% jump in second quarter profits and see 23% growth for the full year, according to FactSet.

All the Money Flooding Into AI Is a Giant Warning Sign

When companies as a group turn into sellers, it's a reasonable sign that stocks are very overpriced

By James Mackintosh
June 21, 2026

What should you do if investors bid up your stock on the basis that you will be a winner in artificial intelligence, but your product isn't popular? Elon Musk has the answer: Use your expensive stock to buy another AI business.

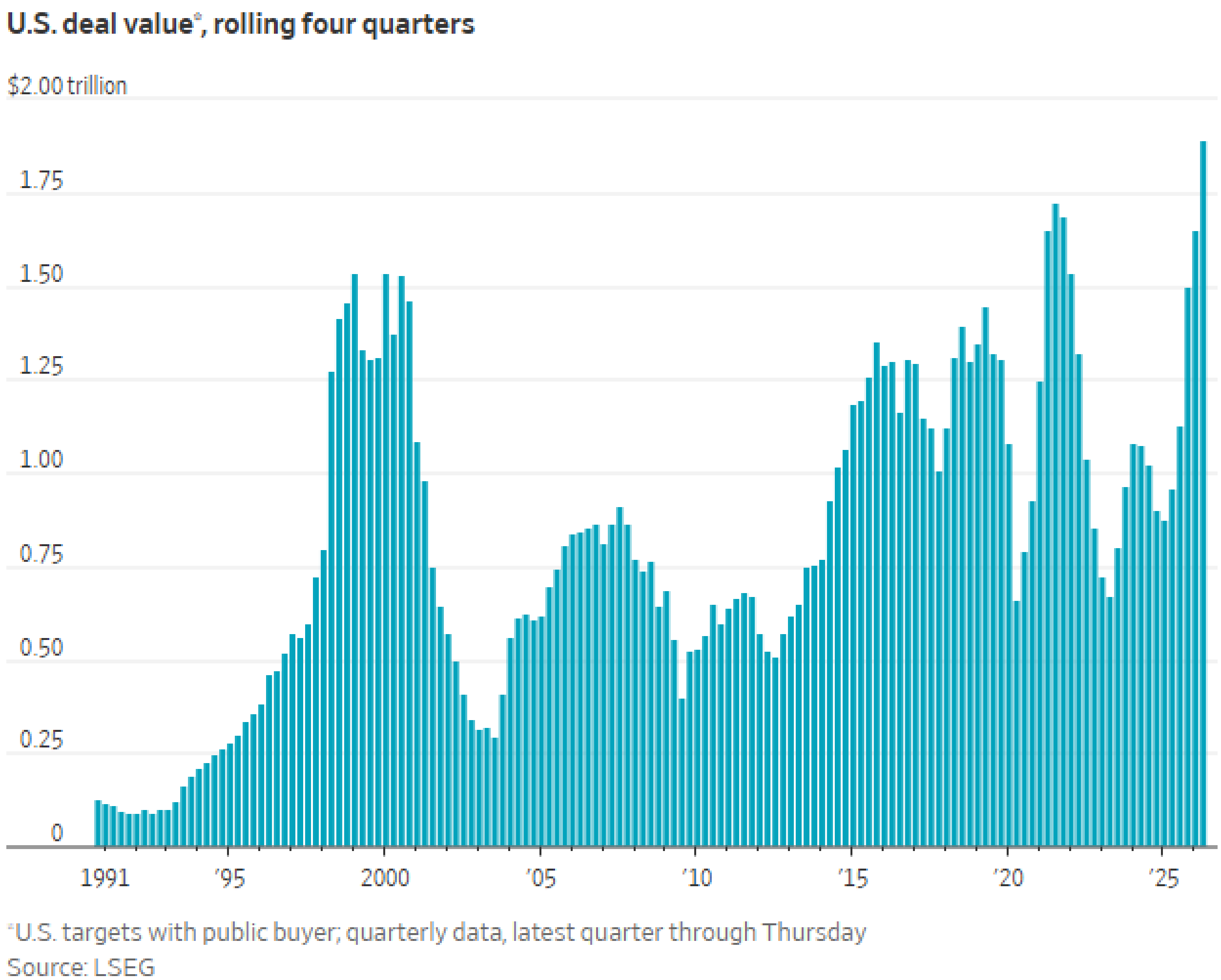
SpaceX's SPCX $60 billion all-stock purchase of Cursor, a programming assistant that popularized "vibe-coding," makes Musk a player in corporate AI in a way that his Grok chatbot hasn't.

It is also part of a rush of stock issuance that should raise serious red flags even among those who dismiss elevated valuations.

Companies always have a choice of how to finance capital spending and takeovers. They can raise debt or issue stock (or a mix). If interest rates are low, debt is cheap for companies. Equally, if stock valuations are high, it is "cheap" for a company to issue more. Only firms in desperate need of cash sell more shares when their valuations are low, because it dilutes existing shareholders and trashes the share price.

Legendary investor Benjamin Graham thought of "Mr. Market" as a manic-depressive, offering daily prices to investors—sometimes far too high (you should sell) and sometimes far too low (you should buy). Mr. Market also offers companies the opportunity to buy from or sell to us investors—and when they issue stock, they are choosing to sell.

In any individual case selling stock can be perfectly reasonable. Balancing the amount of debt and equity a company uses helps offset the perceived riskiness of an investment or acquisition. Equity is good for risky endeavors because it doesn't have to be paid back like debt. The mix of debt and equity feeds into the



company's weighted average cost of capital, a measure that helps determine whether a particular investment is worth it.

But step back, and when companies as a group turn into sellers, it's a reasonable sign that stocks are very overpriced. Indiscriminate demand from investors incentivizes companies to step up to supply them, both with secondary offerings, like Alphabet's GOOGL recent record-breaking issue, or IPOs.

Examples from recent history stand out.

In the dot-com bubble and postpandemic SPAC mania there were waves of IPOs and secondary issues as stock valuations rose. There was also a boom in U.S. mergers and acquisitions, only just surpassed in the past four quarters in dollar value. Companies financed those deals with equity—two-thirds with new stock in the dot-com M&A and 45% in 2020-21, the two highest over a rolling four-quarter period in LSEG data dating back to 1990.

Big deals are flourishing again: giant IPOs blasted off with SpaceX, and companies are choosing to issue stock—using shares to finance almost half the cost in the current quarter, according to LSEG. (Over the rolling four-quarter period, it is still only a third.) Investor demand for stock is, in part, being satisfied by the creation of new stock.

The flip side is, when debt is cheap, it can cause even more serious problems. Pre-financial crisis deal value peaked at $910 billion over the year to the end of September 2007, just before shareholders realized the

S&P 500 price to forward earnings

Note: Monthly data
Source: LSEG

economy was built on sand. Only 19% of that was financed with stock, because debt—helped by endless structured products—was far too cheap. The bubble was in the debt markets, not equities, although the implosion of the banks and deep recession still hit stocks exceptionally hard.

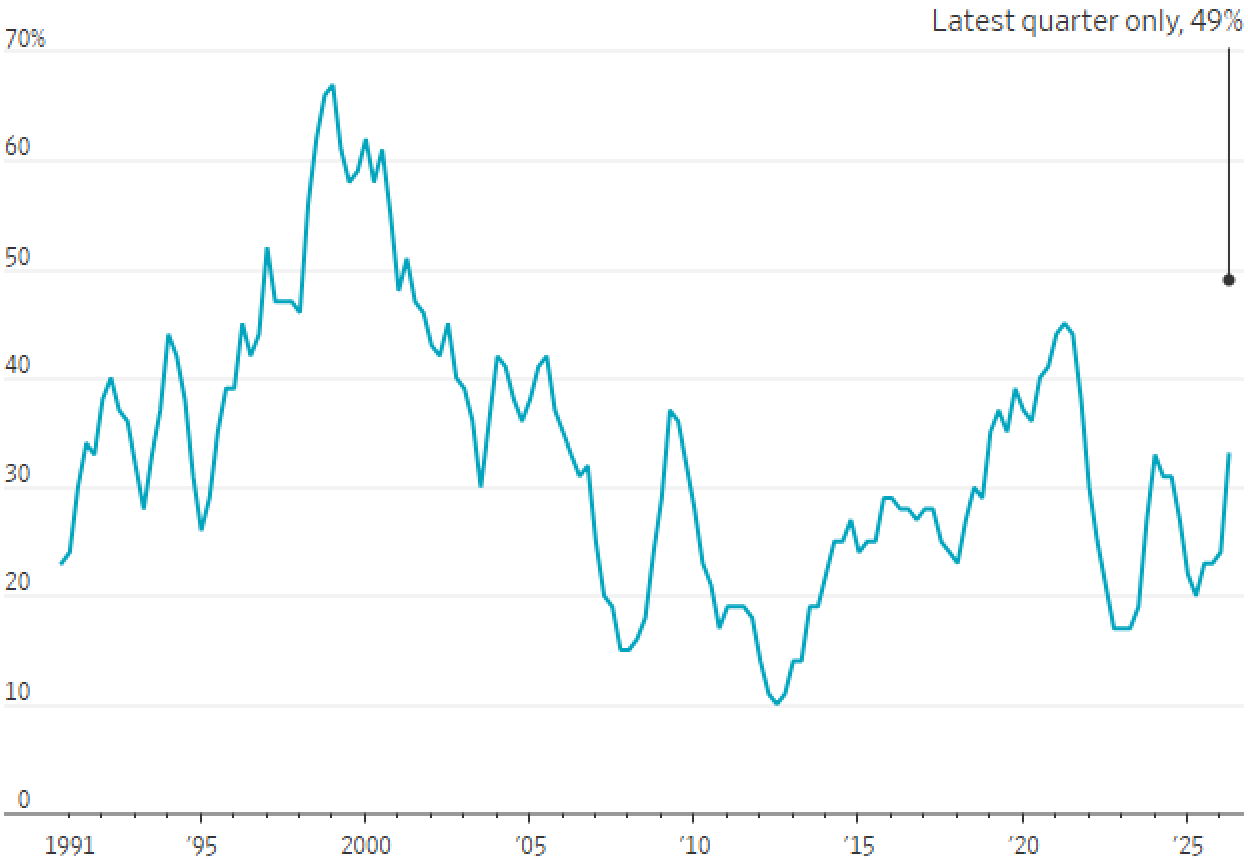
Corporate financing decisions are in some ways better at measuring how expensive the market is than standard valuation gauges, which compare price to some measure of corporate fundamentals such as past or forecast profits (soaring), book value, free cash flow (plunging) or sales.

These can be misleading, often disagree, and mostly have fairly short histories. Worse, the baseline for what counts as expensive can change over time as the structure of companies or accounting standards shift. In the case of book value, it now needs so many adjustments as to be virtually useless.

One example: The S&P 500's ratio of price to forecast earnings currently stands just below 20, well down from the 23 times reached both in 2020 and last year, and the record 24.5 times in the dot-com bubble. It's still very high, but it has fallen because Wall Street expects earnings to boom — particularly in highly cyclical chip stocks where record near-term profit margins are unlikely to be a good guide to the distant future.

There are drawbacks to looking at how much companies choose to issue debt or equity too. The decision on whether to raise money through stock or bond issuance tells us about how companies see the *relative* valuation of stocks vs. bonds more than the absolute valuation.

Proportion of U.S. M&A deal value financed with stock, rolling four quarters



Note: quarterly data, latest quarter through Thursday; U.S. targets with public buyer
Source: LSEG

When it becomes concerning, at least in my view, is when there's a flood of fundraising, debt or equity or both. If lots of companies are raising cash to chase the same opportunity—in this case AI—there are three possibilities.

The bull case is that the opportunity is so huge it can absorb all the cash and still deliver fat profits. The bear case is that the opportunity is real but spending so much will destroy value as competition erodes margins. The deeply depressing third possibility is that companies are raising and spending so much merely because shareholders are cheering them on, and the AI claims are just wildly overhyped.

The danger is it turns out like the dot-coms. Then, like now, companies competed to spend as much as they could as quickly as possible and the "burn rate" was seen as a positive—until it turned out all the shareholder money had gone up in smoke. Five from WSJ's Markets A.M. On Jun. 29:

Five from WSJ's Markets A.M.:

Earnings Forecasts Are on Steroids

By [Spencer Jakab]()

Hall of Fame numbers?

The second quarter ends tomorrow and big American companies knocked it out of the park. Their feat deserves an asterisk.

The first clue about how unusually profitable the quarter has been is that analysts raised their earnings-per-share forecasts for the S&P 500 by 3.4% since the end of March, according to FactSet analyst John Butters. Analysts typically lower them during the quarter, which helps most companies later report a positive “surprise.” The average reduction has been 2.7% over the past 40 quarters.

And those raised forecasts follow the most-profitable quarter ever for the S&P 500, both in terms of net margin and dollars earned. Earnings grew the way they do during the recovery from a recession, not year six of an expansion.

Analysts expect slightly lower profit margins for the second quarter, but positive “surprises” should nudge them to a fresh record once companies report. Those Hall of Fame numbers owe a lot to performance enhancements.

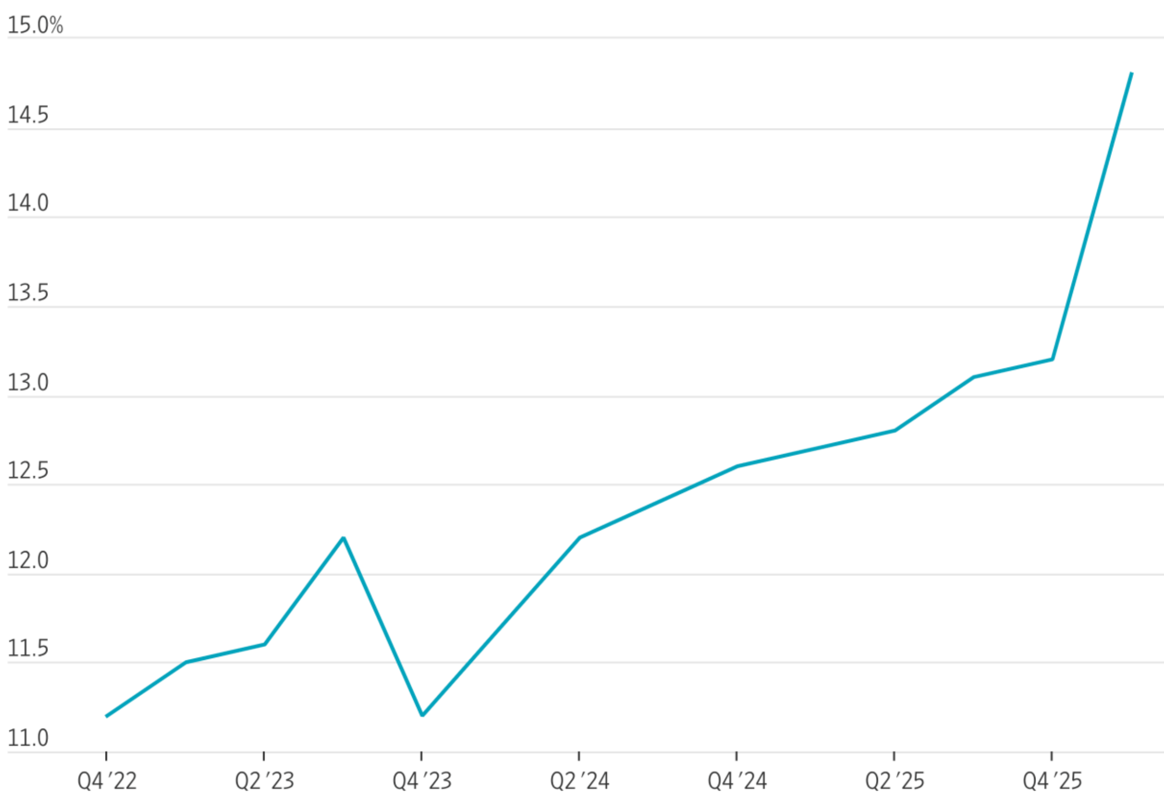
A handful of companies—mainly Alphabet, Amazon and Nvidia—had their operating income boosted in the first quarter by an obscure accounting rule. Their stakes in unlisted AI companies such as Anthropic and OpenAI were marked up when those companies [raised funds](#) at higher valuations.

That [made a normally minor item huge](#), according to University of Florida finance professor Baolian Wang. It was equal to about 12% of the first quarter’s S&P 500 profits overall. But it’s just a paper gain.

Wang’s preliminary numbers call for an effect two to three times as great in the second quarter. The gains could be creating a “circular valuation loop,” warns Wang.

Pumped Up

S&P 500 net profit margin since the release of ChatGPT



Source: FactSet

Excellent earnings growth for publicly listed tech companies is stoking optimism about unlisted ones, sending their valuations higher. That then produces more accounting gains, and so on.

Instead of treating this as a one-off factor that could eventually go into reverse, analysts' bottom-up earnings estimates for the S&P 500 seem to assume the home runs will keep coming. Earnings-per-share growth is seen being higher than sales growth in 2026, 2027 and 2028.

For perspective, the first quarter's net profit margin of 14.8% was about twice the postwar average. Some of that has to do with the types of companies that dominate the market. Companies selling each other lots of AI gear but depreciating it slowly is another temporary accounting boost.

Profits don't look natural.

On Jun. 26:

A Better Mousetrap for Buying Small Stocks

By Spencer Jakab

I Know What You Did Last Summer

The investing world is filled with bright ideas that work until they don't—usually after they've been sold to us as a fund.

Often the best thing to do is shrug and move on, but a factor that beat the market for decades is worth revisiting. At a time when a handful of large companies dominate most portfolios, the "small-stock premium" is due for a comeback.

By the time the premium was written about in the early 1980s, a dollar invested in the smallest tenth of U.S. companies by size would have earned an investor about 11 times as much as one in the large cap S&P 500 over 53 years. Lately, though, the heavyweight index has trounced small caps.

Part of the problem might be how we define the category. "Not all small cap is created equal," says Christine Wang of asset manager Bridgeway.

Wang and colleague Andrew Berkin asked what would happen if you owned an index of small stocks frozen in time. They excluded those that used to be in a larger-stock category and got demoted, or those that entered the market through an initial public offering. Both are known to be poor investments as a group.

The results were surprisingly good. Applying their approach to rolling periods of three years by only owning stocks that were small at the outset improved annual returns by 1.57 percentage points annually.

Their paper outlining the method is titled "I Know What You Did Last Summer" because that's when the leading small-cap index, the Russell 2000, has been rebalanced each year, promoting some stocks and demoting others. Wang and Berkin created their own small cap measure and looked at 60 years of data.

The Russell 2000's simplicity, being based only on size, causes it to include lots of junky companies—great in a bull market but less-so over the long term. Index funds "don't come without baggage," says Wang.

Many funds, active and semiactive, claim they have a way to beat that benchmark by focusing on things like value, quality or free cash flow. It's likely that they wind up avoiding some of the same stocks that Wang and Berkin's study did.

But lots of savers prefer the cheapest, simplest passive funds. It still pays to think about how they're built. The S&P Small Cap 600 and Russell 2000 both measure the same category of companies, but S&P's less-followed index requires them to be profitable before they enter its benchmark.

That excludes some amazing small drug and tech companies. It also weeds out lots of duds. Over the past 30 years, the S&P 600 has had a cumulative total return 600 percentage points higher than the Russell 2000.

It pays to read the active ingredients, not just what's on the label.

On Jun.22:

Strategy's Chairman Keeps Rolling the Dice

By Spencer Jakab

Works until it doesn't

The history of American business is filled with founders who took huge risks.

Walt Disney mortgaged everything, convinced Snow White would be a hit. Steve Jobs made gutsy bets on the Macintosh, iPod and iPhone. Most audacious of all was FedEx's Fred Smith who literally gambled with the carrier's last few thousand dollars to cover its fuel bill.

But none of them can touch Michael Saylor, chairman of bitcoin hoarder Strategy (formerly MicroStrategy).

The distinction is how much smaller those other companies were at the time. When Jobs unveiled the iPod, Apple was worth less than two-tenths of a percent what it is today. Strategy had grown huge by last summer—more valuable than GM and Target combined—when Saylor said he was "willing to disagree with the lawyers and the bankers and conventional investors."

He decided to enhance the company's frenetic bitcoin buying by selling variable-rate perpetual, cumulative preferred stock. The ticker is STRC—dubbed "Stretch." It's an appropriate nickname.

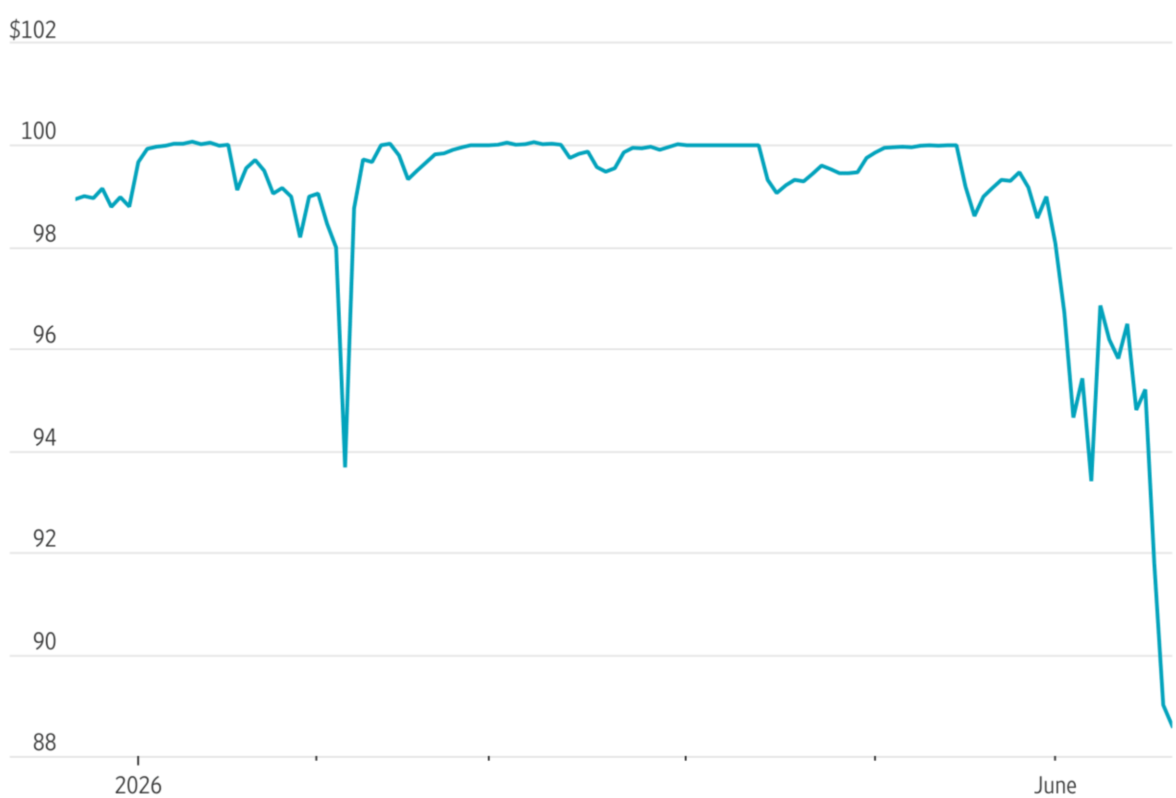
Strategy tries, but doesn't promise, to keep the security at par of $100 a share so it can keep selling more. The coupon has been raised seven times to 11.5% and more than $10 billion has been issued in less than a year.

Ads on Saylor's social media feed show a woman living off dividends on an exotic beach. But owners essentially are being paid with new investors' money—a situation that can't continue.

Stretch fell as low as $82.53 last week, raising its effective yield to 14%, typical of highly risky junk debt. Combined payments on various preferred shares are substantial and the business produces hardly any of its own cash.

Now That's a Stretch

Strategy Perpetual Preferred, par value $100



Source: FactSet

Yes, Strategy has oodles of bitcoin, but selling could backfire. The one time it did, the cryptocurrency's price fell sharply. It could dilute shareholders by selling more stock, now down three-fourths from its peak, to service the dividends.

It also could raise Stretch's dividend again to nudge its price back to par and sell more. That would make its cash flow issue even dicier, though.

Simply halting Stretch's dividend is legal, but a nuclear option. Because it's cumulative, future payments would mushroom. Preferred stock is senior to common stock in bankruptcy. Strategy shareholders, who once inexplicably paid a multiple of its bitcoin value, would surely figure out there's a growing liability between them and their cryptocurrency.

There's a reason no large company has tried this financing method before—it works until it doesn't. Strategy's market value is down $90 billion since last July.

Visionaries gamble when they have little to lose and lots to gain, not the inverse. Saylor doesn't seem to have grasped that: Strategy already crashed 99% once under his leadership.

What's alarming is how many people went along for the ride this time. It says something about this frothy moment in markets.

On Jun. 11:

How Wild the Market's Bet on AI Really Is

By Spencer Jakab

Cloudy with a chance of meatballs

Initial public offerings of AI giants were seen by many investors as a can't miss opportunity, but it's little wonder markets are getting cold feet. They look like extreme long shots when you apply a common sense statistical test to them. So do many stocks that are already listed.

The usual retort in a bull market for the new-new thing is that skeptics "don't get it." Yet a time traveler dropped into the peak of the dot-com bubble wouldn't have had to know anything about that transformative technology. They'd only need to have studied stock-market history to guess that a few of the era's highfliers might be worth owning, but almost certainly not most of them.

Say it was a hot spring in New York and you wanted to place a bet on Polymarket about the temperature reaching 100 degrees in Central Park this month. The first thing you would do is look up climate records and note it hasn't happened for 60 years. The mercury has hit triple digits just three times or on 0.06% of June days since 1869. Even with a nod to global warming, you wouldn't—or at least shouldn't—give it much higher chances.

A smart report by Morgan Stanley Investment Management's Michael Mauboussin and Dan Callahan, "Bayes and Base Rates," focuses a similar lens on AI. Making a return on the vast sums being invested, which already exceed the railroad or internet booms, assumes sales growth unlike anything in history.

OpenAI's projection last year that its revenue would rise to $145 billion by 2029 required compound annual growth of 108% for five years. That's never happened before, based on a sample of almost 19,000 large companies, according to the authors. They admit that base rates "can change as the world changes."

If you set a lower bar, then the chances of clearing it rise. Palantir, Broadcom, Nvidia, Intel and Alphabet were among nearly 70 U.S.-listed companies that fetched a multiple of at least 10 times trailing revenue at the start of this week.

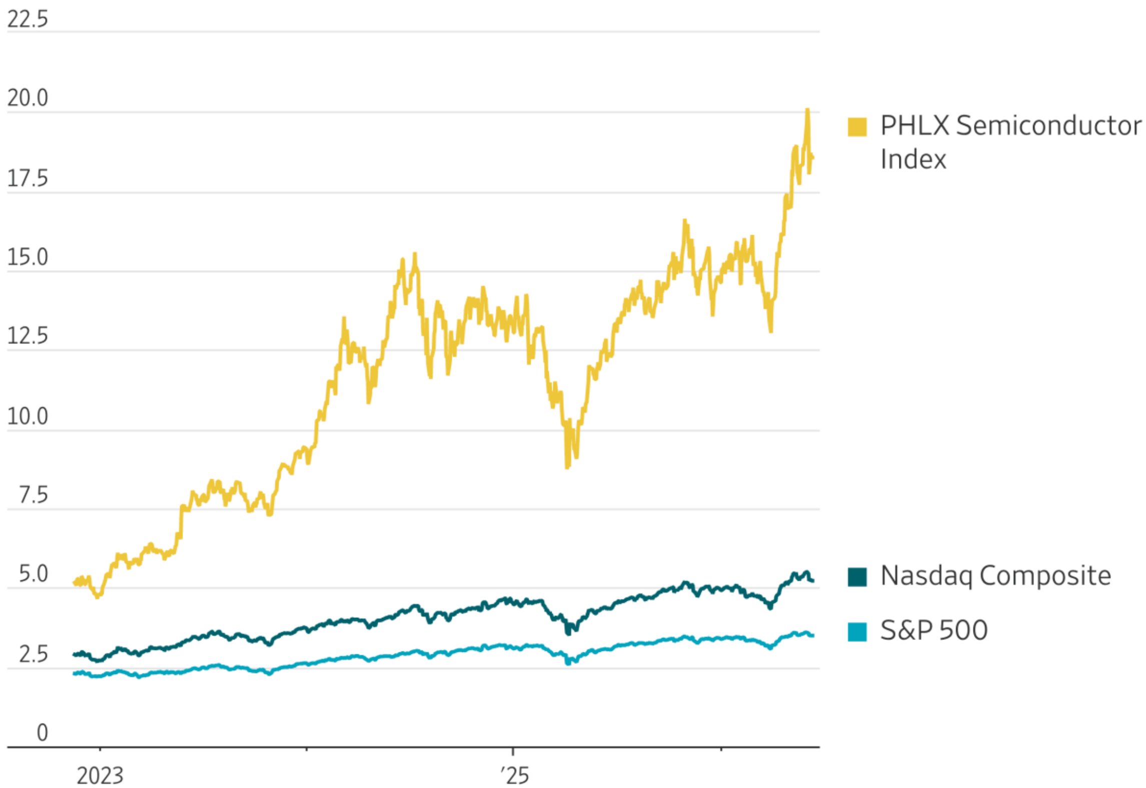
That isn't an insurmountable hurdle, but it's trickier if you're counting on them beating the market as a group. History says you probably have to pick the right stocks.

Asset manager GMO [noted at the end of last year] that a higher share of the U.S. market fetched above the 10-times threshold than at the peak of the tech bubble. Earlier [they looked at the performance] of stocks trading above the threshold across 40 years. Buying just that group would have left an investor with 80% less money than an S&P 500 index fund, taking inflation into account.

The higher the multiple, the bolder the bet. The next IPO up, SpaceX, already priced its shares at 92 times sales. Are you feeling lucky?

Off Base?

Multiple of price to trailing sales since the release of ChatGPT



Source: FactSet

On Jun.10:

Inflation Is Picking Investors' Pockets