FORTITUDE CAPITAL MANAGEMENT

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"Things that have never happened before happen all the time." – Scott Sagan

"We want to take the fiction out of science fiction." – Elon Musk

Fellow Investors:

We started last quarter's letter with a ceasefire in the war with Iran. As of this writing, it appears that the ceasefire is off, and hostilities may be increased to bring it all to an end. The markets generally seem to be expecting the conflict will not last long as the reaction so far is a bit of a yawn. What we witnessed over the second quarter were positive returns in the equity markets, rebounding from the first quarter, lower energy prices, and looking forward beyond the action in the Middle East.

The S&P 500 returned 18.2% in the second quarter, bringing the year-to-date return to 9.6% after a decline in the first quarter. The index remains heavily weighted toward a few stocks with the top 10 companies accounting for 38% of the capitalization weighted index. However, there was a broadening of returns as the equally weighted S&P 500 outperformed the capitalization weighted S&P 500 by 1.56% for the first six months of the year. For the first half of the year, only one of the Magnificent Seven outperformed the S&P 500 index.

Other indices followed the lead of the S&P 500. The Russell 2000 returned 21.6% for the first half after a 25.3% second quarter performance. The MSCI EAFE gained 7.7% for the first half and the tech heavy Nasdaq Composite pulled through a 12.8% first half return.

Besides current world events, the equity markets struggle with where tech will take us and who will take us there. It is not new as to the uncertainty of tech developments, and it is not new either as to the difficulty of gauging the effect of major innovations. In many respects, these uncertainties were faced as transportation technology went from horses to railroads to autos to flight. Communication technology went from horse to telegraph to telephone to the internet. Now we have artificial intelligence and satellites. They bring possibilities we are already realizing, some we can imagine, and others we may not have even considered. The volatility of the first half of the year partially reflects the uncertainty of what these developments (aside from war effects) may eventually produce. As with prior developments, ultimately, they add to economic growth. The economic concept of "creative destruction" occurs repeatedly as the new overtakes the old. The initial outlook looks grim in the eyes of those accustomed to the old, but the new eventually takes things to a higher level as the old fades away. The anticipation for change also stresses the outlook for labor, but if the past is any indication, the effect on employment will be positive. The buildout for AI has been a boon for certain trades. Some sources estimate we may need 300,000 more electricians, for example. It is helpful to consider that 40 years ago, the use of personal computers was predicted to eliminate jobs (and reduce paper!).

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Also, during the quarter, a new Chairman of the Federal Reserve was installed. In our view, the market in interest rates is a better guide than what the Fed does or says. The ten-year treasury rate finished the quarter at 4.44% after hitting a low of 4.04% in February and a high of 4.67% in May. As of this writing, the ten-year rate is 4.55%, as war activity has picked up. There is pressure on the Fed to reduce rates, but an uptick in inflation and strong labor markets works against that action, although the June inflation read was good, declining 0.4% for the month. In reality, the Fed's influence is at best on very short-term rates. The two-year treasury finished the quarter at 4.14%, relatively close to the ten-year rate, indicating upward pressure on short-term rates to anticipate current inflation. Clearly inflation concerns remain high, although the driving factor of high energy costs may be short lived.

As much as the conversation about interest rates takes up space in the economic discussion, there are a couple of points worth keeping in mind. First, the ten-year treasury is not high by historic standards. We have been lulled into thinking it should be lower after action taken following the Great Financial Crisis and then Covid pushed rates down to historically low levels. Second, healthy economic growth and tight labor markets put upward pressure on prices and interest rates for positive reasons. Inflation caused by an exploding money supply hurts everyone, which was behind the spike in inflation in 2021-22.

So, what are the key takeaways from the second quarter and first half of 2026? The broadening of the equity market performance is a good sign. It is a sign that the expected benefits of technological innovation will broaden beyond the narrow tech sector. That is a vote for being conscious of staying well diversified. Additionally, the patience and long-term outlook we often speak of remains key to long-term success. Abandoning even a portion of an equity portfolio after the disappointing first quarter would have been costly given the recovery of the second quarter, which was the best quarter in years.

Sincerely,

Erik Ford

Jason Marrs

The Magnificent 7 is comprised of Nvidia, Apple, Meta, Amazon, Alphabet, Microsoft, and Tesla.

The S&P 500 Index, or the Standard & Poor's 500 Index, is a market-capitalization-weighted index of the 500 largest publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market capitalization because there are other criteria to be included in the index.

The S&P 500 Equal Weight Index (EWI) is an equal-weight version of the popular S&P 500 Index. Although both indexes are comprised of the same stocks, the different weighting schemes result in two indexes with different properties and different benefits for investors.

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The term Russell 2000 Index refers to a stock market index that measures the performance of the 2,000 smaller companies included in the Russell 3000 Index. The Russell 3000 is a capitalization weighted index representing approximately 96% of the investable U.S. equity market.

The MSCI EAFE Index tracks large cap and mid-cap companies in developed countries around the world. The index primarily covers the Europe, Australasia, and the Far East regions.

The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. Along with the Dow Jones Average and S&P 500 it is one of the three most followed indices in US stock markets. The composition of the NASDAQ Composite is heavily weighted towards information technology companies.

Indices mentioned are unmanaged and cannot be invested in directly. Past performance is not a guarantee of future results.