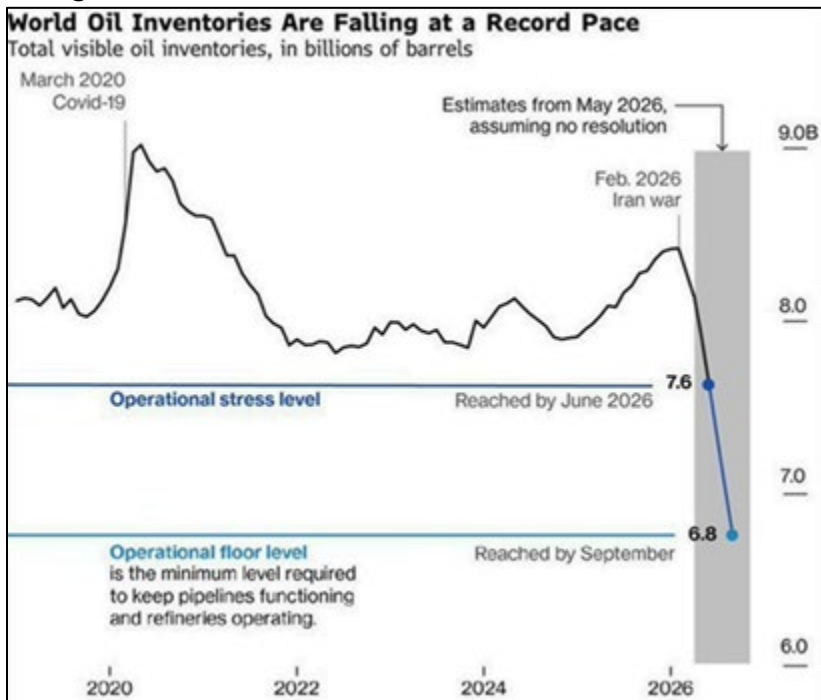


## Mid-quarter Market Update

*Stock markets rallied after the establishment of a fragile ceasefire with Iran. The Strait of Hormuz remains largely closed to maritime traffic, keeping oil prices high and raising interest rates and inflation expectations. Though most stocks have rallied during the quarter, the strength has been extraordinarily concentrated in large technology companies, especially hardware. Developments in Artificial Intelligence have again seized the spotlight in a manner reminiscent of 1999.*

The S&P 500 has risen as much as 18% from the March lows.<sup>i</sup> The immediate catalyst was the establishment of a short-term ceasefire with Iran which has barely remained in place for several weeks. Earnings season added to the bullish sentiment, as reported earnings blew away analyst estimates. Based on the most recent quarter, valuations no longer appear so stretched though they do reflect rosy expectations. Companies are starting to see benefits from Artificial Intelligence manifest in their results. The most recent model released by Anthropic, deservedly called “Mythos,” has specifically sent shockwaves through markets and added further to the AI excitement.

The ceasefire with Iran is obviously an improvement, but the situation remains fluid. Trump’s administration and the Iranian regime continue to exchange peace plans and threats of violence, ping-ponging the price of oil. The US’s inability to open the Strait of Hormuz in the meantime is doubtlessly frustrating. Our centralized & expensive ships and missiles outrate their capabilities by orders of magnitude but are nevertheless less effective against their threat of small-scale drones. The Strait’s reopening is crucial for the global economy. It’s also important to demonstrate the ability to counteract this sort of combat. Bad actors all over the



*Oil inventories are being drawn down in order to offset the closure of the Strait of Hormuz. That can't continue forever.<sup>ii</sup>*

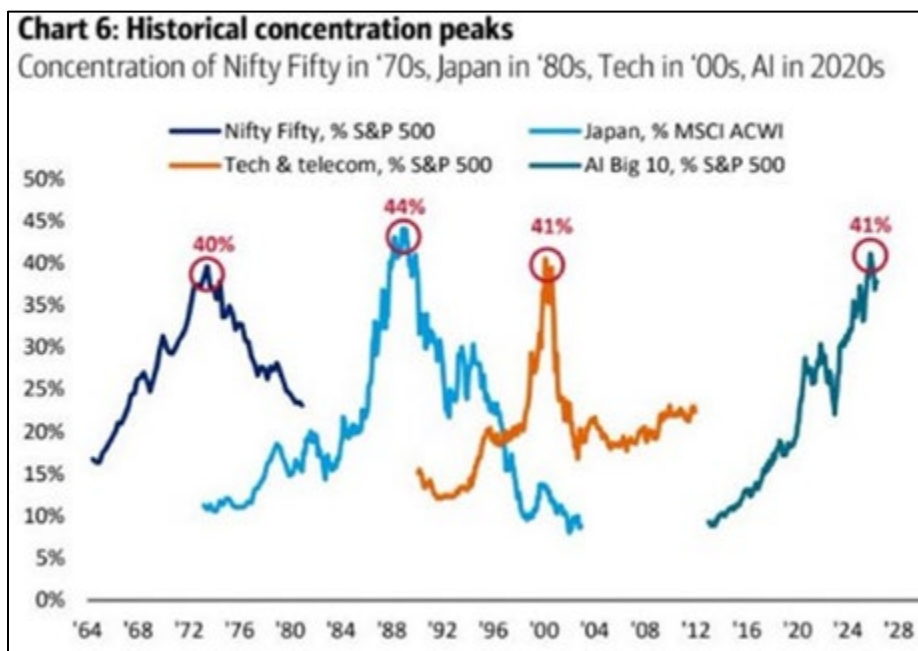
world are watching and taking note. Since we need more acronyms, skeptical traders have invented NACHO – Not A Chance Hormuz Opens. Let’s hope that’s overly cynical.

Oil's price remains slightly above \$100/barrel; before the war it was around \$65.<sup>iii</sup> The price impact has been blunted by drawing down global oil reserves at an aggressive pace. Analysts estimate that this can be maintained until September. This strategy keeps oil contained for now but threatens to keep the price high after the Strait is reopened as inventories will have to be refilled. Short-term oil prices have been stable but oil contracts for delivery farther in the future are grinding higher. The impact on inflation was seen in the most recent CPI data point, which was 3.8% year-over-year compared to expectations of 3.7% and a prior reading of 3.3%. Short-term and long-term interest rates are at their highest levels for the past year, and in some cases multiple years. Hope for interest rate cuts has melted away and investors now expect an interest rate hike before year-end. Newly-confirmed Fed Chairman Kevin Warsh has yet to make comments in an official capacity. It remains to be seen whether he will advocate for lower rates or adjust his thinking based on current events. We believe it will be the latter, as he has shown intellectual honesty in his past roles at the Federal Reserve.

Much of the stock market has rallied since the establishment of the ceasefire. However, the composition of the rally has morphed from what it was before the war in Iran. It was previously a broad global rally with strength specifically from "HALO" companies (heavy assets, low obsolescence). This has changed into a market led by the largest American companies, especially in tech hardware. Higher interest rates disproportionately negatively affect smaller companies who have a higher need to borrow. While oil's rise affects every country in the world, the US is more

insulated as a net exporter. Europe, China, India, and many other countries are not so fortunate.

The S&P 500's year-over-year earnings growth was roughly twice as good as analysts expected. It's normal to exceed expectations, but not usually to this extent. Price-to-Earnings (P/E) ratios don't appear as stretched if earnings are moving higher, and investors are willing to pay higher valuations when growth is stronger. Strong earnings will be a



*The extreme concentration in AI stocks rivals previous well-known eras of market concentration.<sup>iv</sup>*

tailwind for stocks as long as they continue; though if interest rates continue to rise, that could become an offsetting tailwind.

The strength has been especially notable in technology hardware stocks in the wake of the development of Anthropic's Mythos model. The Philadelphia Semiconductor Index is more than

50% higher during the quarter. Some large individual stocks have tripled or more over the past few weeks. Semiconductor and memory chip companies cannot keep up with demand. They have incredible pricing power in the moment, and visibility of exceptional demand for many years to come. This will likely remain the case as long as the AI companies continue to improve their models and grow revenues. At the moment the AI companies mostly run at a loss which is subsidized by venture capital. However, their revenues are growing at exponential rates rarely or never seen before at this scale.

We've drawn parallels with the Dot Com Bubble in the past. We're now at the point where Initial Public Offerings could double in value on their first day of trading. We anticipate several of the major private AI companies going public this year. It will be very interesting to see how they do. We would be cautious about passive stock exposure, as the AI theme has expanded to encompass an enormous amount of market capitalization and recent gains at the index level.

As always, should you need anything from the Verismo team, just let us know!

Best regards,



320 S. Canal St. Suite 2975  
Chicago, IL 60606  
312-763-9662

**Frank DeVincentis, CFP®**  
Founder, Managing Partner  
Financial Advisor  
NMLS # 1255537

**Craig Eyler, CFP®**  
Founder, Managing Partner  
Financial Advisor  
NMLS # 1270172

**Molly Girard, CFP®**  
Partner  
Financial Advisor  
Branch Manager  
NMLS # 2359441  
312-763-9673

**Jennifer Huns, CFP®**  
Group Director  
Executive Vice President  
Senior Registered Client Administrator  
312-763-9602

**Scott Tucker, CFA**  
Chief Investment Officer  
Executive Vice President  
312-763-9651

**Tracy Weidman**  
Director of Client Analytics  
Senior Vice President  
Senior Registered Client Analyst  
312-763-9652

**Yaelle Kimmelman**  
Marketing Director  
Vice President  
Senior Registered Client Associate  
312-763-9603

**Tess Kearns**  
Branch Administrator  
Registered Client Associate  
312-763-9605

**Trey Plummer**  
Registered Client Associate  
312-763-9653

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

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<sup>i</sup> Bloomberg  
<sup>ii</sup> Bloomberg  
<sup>iii</sup> Bloomberg  
<sup>iv</sup> Bloomberg