AOR Update: A Broader Market Is Finding its Footing

August 7, 2026

Key Takeaways

- Earnings delivery and market leadership are continuing to broaden out to a larger group of market constituents; we believe a focus on earnings should be a part of any equity investor's playbook when trying to ascertain market leadership in the coming months.
- Corporate commentary from key industrial bellwethers suggests a broader capex cycle is finally underway, a view confirmed by key datapoints such as ISM New Orders and the ClearBridge U.S. Recession Dashboard broadly, which maintains its overall green signal this month and had no changes.
- Although the market may still be undergoing a period of digestion following the second quarter's strong gains, we believe the path of least resistance for stocks is higher in the second half of the year with earnings continuing to power the way.

U.S. equity market leadership underwent a rotation in July, with previous leaders turning into laggards and vice versa. This was most notable in the AI and momentum trades, with the latter (as measured by the S&P 500 Momentum Index) giving back ~40% of its year-to-date gains in July, while many AI leaders witnessed even larger drawdowns. Although the very end of the month (and the first few days of August) witnessed a bounce back, many investors are searching for clues regarding future market leadership after several head-spinning weeks.

We believe a focus on earnings should be a part of any equity investor's playbook when trying to ascertain market leadership in the coming months. A review of the last several years shows that earnings have been even more closely tied to market returns than is typical, with more than 100% of the S&P 500's price return attributable to improving earnings expectations — as opposed to multiple expansion — since April 2020. Earnings growth narrowed meaningfully in 2022–24, however, with most of the market's earnings and returns driven by a small group of stocks that became known as the Magnificent Seven.[1]

However, the second half of 2025 marked a shift in this dynamic, with earnings delivery and market leadership broadening out to a larger group of index constituents. This trend continued in the first half of 2026, and we expect it to remain intact in the coming quarters. The market has begun to pick up on this dynamic, with the equal-weight version of the S&P 500 outpacing the cap-weighted by 3.1% through the first seven months of this year.

Looking ahead, we believe the key question U.S. equity investors are facing is whether earnings delivery once again narrows into a more concentrated group of AI darlings, or if instead the next phase of the AI infrastructure buildout benefits a wider swath of the economy. The industrials sector, for example, is benefiting from a strong environment for AI data center buildouts, although AI is not the only source of growth for the sector.

Corporate commentary from key industrial bellwethers suggests a broader capex cycle is finally underway. For example, Old Dominion Freight Line mentioned that it is "encouraged by the continued improvement in demand that began late last year," while Illinois Tool Works, which produces engineered fasteners and components, noted that "growth was

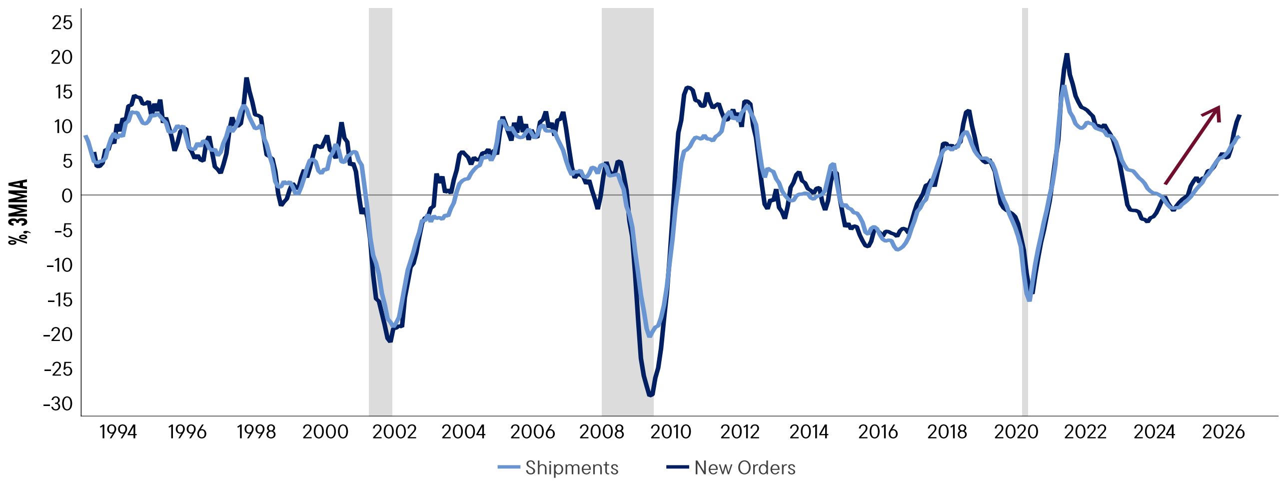
[1] Alphabet (Google), Amazon, Apple, Meta Platforms (Facebook), Microsoft, Nvidia and Tesla.

pretty broad-based.” These anecdotes from bellwether companies are consistent with recent observations from ClearBridge industrials analyst Sunny Huang, who notes:

“Growth is broadening out beyond data centers, supported by improving demand across manufacturing, reshoring, automation, aerospace, infrastructure and select nonresidential construction markets. This suggests that sector momentum is being supported by multiple end-market drivers rather than a single investment cycle.”

This improvement in the industrial economy is also evident in the data, with the output from one of most widely followed measures of business investment: Non-Defense Capital Goods Ex-Aircraft Orders/Shipments, which has been growing at a double-digit pace as of late.

Exhibit 1: Capital Goods Confirm Industrial Strength



Data last updated on August 4, 2026. Sources: U.S. Census Bureau, Macrobond. Gray shading reflects recessionary periods.

Other widely followed industrial metrics such as the ISM Manufacturing PMI tell a similar story. The headline manufacturing PMI rose to 55.6 last month, solidly in expansionary territory and the strongest reading in over four years (last above 55 in May 2022). Importantly, the more forward-looking New Orders subcomponent — a ClearBridge U.S. Recession Dashboard indicator — came in even stronger at 56.7. This indicator remains firmly in green territory along with the overall dashboard signal, and there are no changes to the ClearBridge U.S. Recession Dashboard this month.

Exhibit 2: ClearBridge U.S. Recession Dashboard

		July 31, 2026	March 31, 2026	Dec. 31, 2025
Consumer	Housing Permits	Expansion	Caution	Caution
	Job Sentiment	Recession	Recession	Recession
	Jobless Claims	Expansion	Expansion	Expansion
	Retail Sales	Expansion	Expansion	Expansion
	Wage Growth	Expansion	Expansion	Expansion
Business Activity	Commodities	Expansion	Expansion	Expansion
	ISM New Orders	Expansion	Expansion	Recession
	Profit Margins	Expansion	Caution	Caution
	Truck Shipments	Expansion	Expansion	Expansion
Financial	Credit Spreads	Expansion	Expansion	Expansion
	Money Supply	Expansion	Expansion	Expansion
	Yield Curve	Expansion	Expansion	Expansion
	Overall Signal	Expansion	Expansion	Expansion

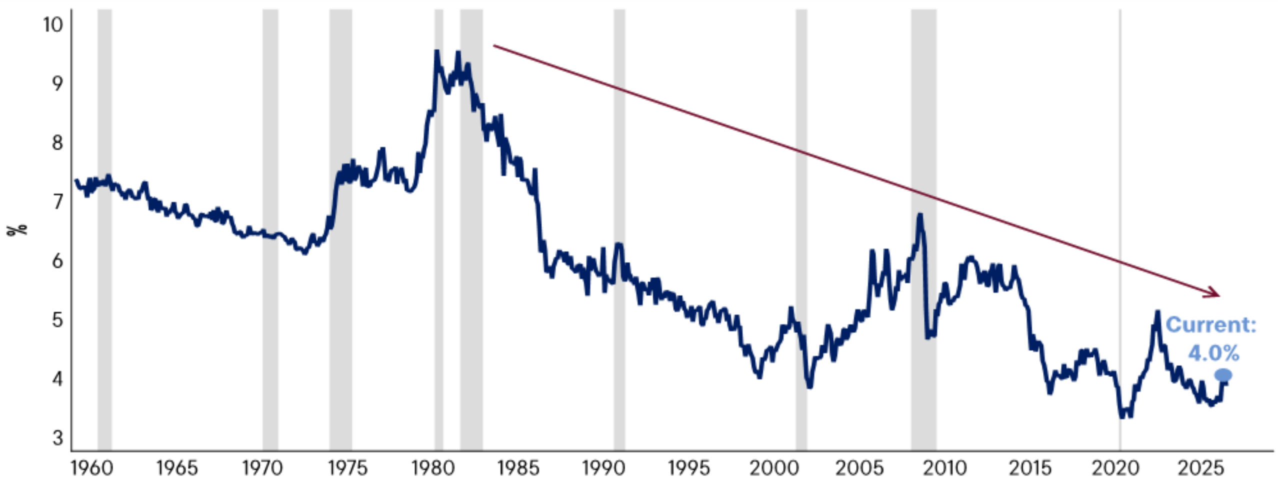
● Expansion ● Caution ● Recession

Data as of July 31, 2026. Source: ClearBridge Investments.

Although the strength from both AI- and non-AI-related industrial activity should be a key support for the economy in the back half of the year, there are concerns that the consumer may come under pressure as the benefits from the One Big Beautiful Bill (OBBB) wane and heavier-than-expected cuts to social safety net programs ramp into year-end.

The underlying resilience of the U.S. consumer should not be disregarded, however. The headwind from higher energy prices has been lessened with WTI and Brent oil contracts both trading back below $80 in the first days of August. Importantly, we continue to believe that structural changes in U.S. energy independence and consumer energy intensity are mitigating factors from an economic risk perspective in the face of oil price volatility.

Exhibit 3: Don't Be So Energy Sensitive



Data last updated on June 30, 2026. Sources: U.S. Bureau of Economic Analysis (BEA), NBER, Macrobond. Gray shading reflects recessionary periods.

Oil prices notwithstanding, doubting the U.S. consumer has been a perilous exercise over the past six years. We do not see material signs of a shift in consumer spending at this point, with high-frequency data such as credit card spending holding up. Despite higher energy prices, real consumption grew at a better-than-expected 3.2% annualized pace last quarter, helped by larger tax refunds and lower withholdings stemming from last year's OBBB. Consumption is expected to slow to 2% in the second half of the year, but easing inflation and a stable labor market (in terms of wages) should continue to support household budgets.

The firm economic backdrop — anchored by a strengthening industrial cycle, a stable labor market and a resilient consumer — supports the case for broader earnings leadership through the second half of 2026 and into next year. Furthermore, sell-side consensus expects the Magnificent Seven to deliver 4.9% next-12-month (NTM) EPS growth in 2027, well below the 16.6% expectation for the other 493 stocks in the benchmark. This is a sharp reversal from earlier this year as well as the recent past, when the group's earnings outpaced the "S&P 493." If realized, this shift should create opportunities for active managers that can navigate the concentration risk embedded in the S&P 500. Although the market may still be undergoing a period of digestion following the second quarter's strong gains, we believe the path of least resistance for equities is higher in the second half of the year with earnings continuing to power the way.

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