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The Price of Admission: Further equity upside comes with a cost—volatility

Resilient earnings, improving industrial activity and the AI investment cycle should continue to support equities, according to Putnam Equity's Shep Perkins. But the same forces driving the market higher are also making companies harder to value.

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By midyear, equity investors were facing an uncomfortable contradiction: The headlines gave plenty of reasons to be cautious, while the market kept giving reasons to stay invested.

Conflict in the Middle East raised concerns about energy prices and trade flows through the Strait of Hormuz. Tariffs remained a moving target. Inflation pressures resurfaced, and government deficits continued to dominate headlines.

Yet equity markets largely looked through those risks. The S&P 500 Index, having crossed 7,000 earlier in the year, continued to reach new highs.[1] Non-US equities also performed well, particularly in emerging markets.

For many investors, the natural question is why markets have continued to climb despite so many reasons for caution. A less obvious but important question is whether the forces driving the market higher are also making it more volatile. In our view, they will.

That tension frames the second half of the year. Earnings are improving, industrial activity is strengthening, and the artificial intelligence (AI) investment cycle continues to broaden. At the same time, future cash flows, competitive advantages and valuations are becoming harder to assess.

The Constructive Case Remains Intact

- **Strong earnings:** One misconception about today's market is that higher prices have been driven primarily by expanding valuations. Just over a year ago, consensus expectations for S&P 500 earnings this year were roughly $265 per share. Today those estimates are approaching $340, an increase of nearly 30%. During that same period, the S&P 500 has risen from roughly 6,000 to more than 7,400, while the forward price-to-earnings multiple has actually contracted.[2]

That distinction matters. Investors have not simply paid higher prices for the same earnings. Earnings growth has done the heavy lifting.

- **Healthy economic backdrop:** The US consumer remains resilient, industrial activity has strengthened and AI-related investment continues to ripple through the broader economy. What began as a technology investment cycle is increasingly creating demand across power, infrastructure, industrial equipment, transportation and materials.[3]

Where Opportunity Meets Uncertainty

The opportunity, however, comes with a cost. The market's traditional anchors are becoming less predictable.

- Some of the largest companies in the S&P 500 Index remain powerful businesses, but they are also becoming more capital intensive as they invest aggressively in AI infrastructure.
- Semiconductors have become a larger force behind market leadership, but they remain inherently highly cyclical.
- AI is creating new winners, pressuring incumbents, and making long-term earnings streams harder to forecast.
- Promise and potential are being valued, many years before cash flows are fully visible.
- And physical constraints, such as shortages in critical memory components and power, are influencing pricing, margins, and demand.[4]

The common denominator is that companies are becoming harder to value. There are more questions about the durability of earnings and unknowns about the future of potential earnings of new businesses. That does not mean the market cannot continue to rise. In our view, it points to a more uneven path, wider dispersion, and potentially sharper market reactions when companies disappoint.

The 1990s Lesson

Everyone remembers the pop. Fewer remember the climb.

The 1990s offer a useful reminder: powerful investment booms rarely unfold calmly. Investors often remember the eventual dot-com unwind, but they sometimes forget the extended expansion that came first. The decade delivered a 430% total return for the S&P 500 Index, including five consecutive years of returns above 20% from 1995 through 1999.[5] It also included the Asian financial crisis, the Russian ruble crisis, Y2K concerns, and bouts of significant volatility. On average, the Cboe Market Volatility Index (VIX) was in the low-to-mid-20s in the 1990s, versus a more benign mid-teens average in the current decade.[6]

Today, innovation-led markets could run longer than skeptics expect, and they may potentially generate meaningful gains. While many investors believe bubble-like conditions are forming, the timing of any reversal remains uncertain. We believe there is still room for the expansion to continue. That leaves investors with a choice: Tolerate periods of heightened volatility or risk missing further upside by staying on the sidelines.

Looking Ahead

The second half of the year will almost certainly bring new headline risks. But we will continue to focus beyond the headlines—on a market supported by stronger earnings and powerful investment themes, but one that may become more volatile as those themes evolve.

We remain constructive on equities, but investors should expect a less linear path. In an innovation-led investment boom, fundamentals matter more, not less. In our opinion, volatility is not a reason to step away from the market. It is the price of admission.

Endnotes

1 Sources: S&P Dow Jones Indices, “S&P 500”, MSCI Inc., “MSCI EAFE Index” and “MSCI Emerging Markets Index,” index data. As of July 15, 2026.

2 Sources: Bloomberg, S&P 500 Index consensus earnings estimates, index levels, and forward price-to-earnings multiple, data as of July 2025 and July 2026; Goldman Sachs Research, “The S&P 500 Is Forecast to Climb as Earnings Growth Powers Stocks Higher,” Goldman Sachs, May 28, 2026.

3 Sources: US Bureau of Economic Analysis, “Consumer Spending”; Institute for Supply Management, “June 2026 ISM® Manufacturing PMI® Report,” July 1, 2026.

4 Source: Goldman Sachs Research, “The S&P 500 Is Forecast to Climb as Earnings Growth Powers Stocks Higher,” Goldman Sachs, May 28, 2026; Akash Jishnu and Ehteesham Ansari, “AI Memory Boom Squeezes Legacy DRAM Supply, Pushing Prices Higher,” S&P Global Market Intelligence, January 28, 2026.

5 Source: S&P Dow Jones Indices LLC, S&P 500 Total Return Index, calendar-year total return data. December 31, 1989, through December 31, 1999. Annual total returns for 1995–1999 were 37.58%, 22.96%, 33.36%, 28.58%, and 21.04%, respectively.

6 Sources: Cboe Global Markets, “Historical Data for Cboe VIX® Index and Other Volatility Indices”; Federal Reserve Bank of St. Louis, “CBOE Volatility Index: VIX,” FRED.

The Cboe Volatility Index®, or VIX® Index, is a leading measure of market expectations for near-term volatility based on S&P 500 Index® (SPX) option prices. Higher VIX readings are generally associated with higher expected market volatility and greater investor fear, while lower readings suggest a lower perceived-risk environment.

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