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Market Commentary – Remaining Bullish but Preparing for a Bumpy Ride

Eric Sterner, CFA, CAIA, FRM, CIPM
Chief Investment Officer, Apollon Wealth Management and Apollon Financial
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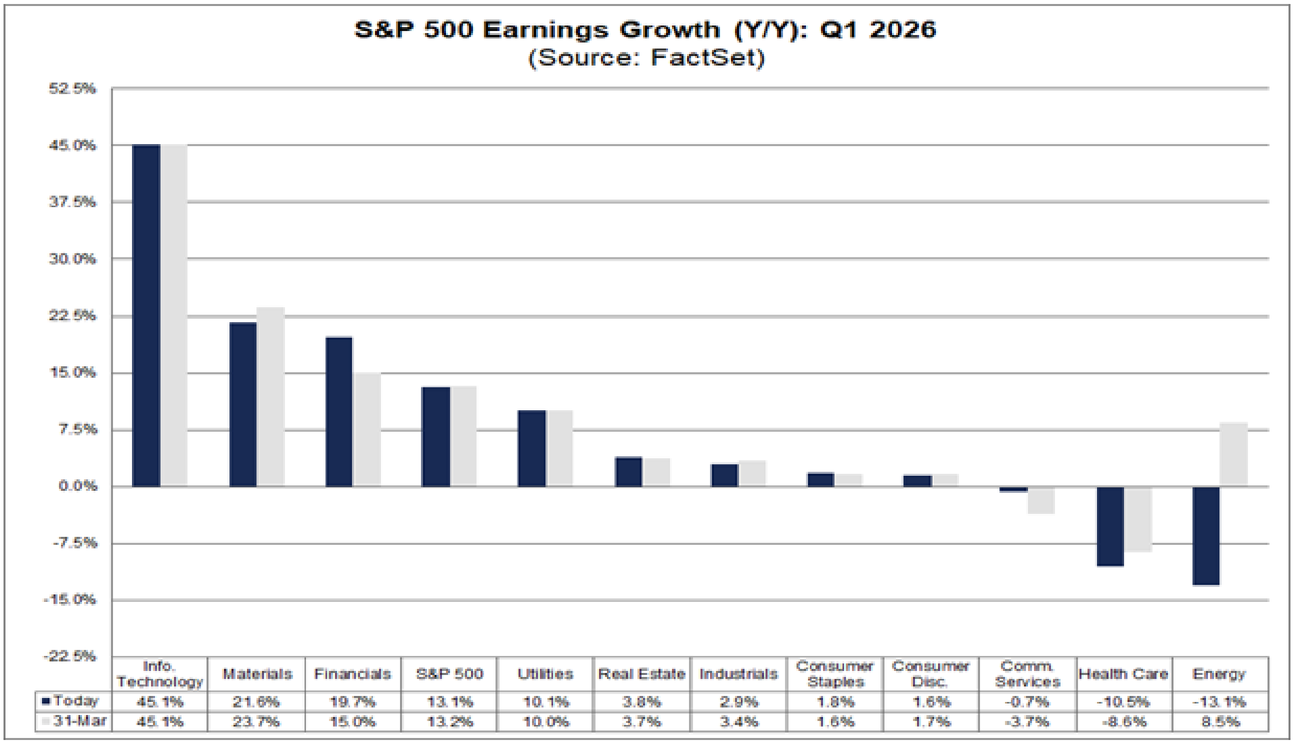
The stock market typically is 6 – 12 months forward looking, which is a big reason why the S&P 500 has rallied 12% from the March 30 low up until last Friday. While the ceasefire negotiations remain very delicate, investors are betting the end of the conflict is near. Many investors may be buying into the so-called "TACO" trade as many believe President Trump will back off certain issues if the stock market is declining. President Trump regularly references the stock market performance as a barometer of his administration's success. Additionally, 2026 is a midterm year and affordability will be a main theme, so I believe the White House was looking for an off-ramp as rising gasoline and oil prices will only exaggerate the financial pains of the lower end consumer and the middle class. The Republicans only have a 5-seat majority in the House and the party controlling the White House has lost an average of 21 seats over the past 10 mid-term elections.

It's interesting to me to look at the sector leaders through different time intervals this year. In the first two months of the year, we saw a strong market rotation with Energy, Materials, Consumer Staples and Industrials leading the way. From the beginning of the war to April 17, Technology reassumed the leadership sector role followed by Communication Services. Investors typically flock to safety and quality during time of distress and Technology and Communication Services have played that role since the outbreak of the war with their strong balance sheets and earnings. While investors were concerned months ago about Technology's frothy valuations, the NASDAQ 100's PE ratio dropped approximately 23% from October to the end of March. Technology's 1st Quarter net profit margin is projected to grow to 29.5%, which would be above its 5-year average of 25% and the sector has the highest projected earnings' growth rate in 2026 at 37.4%. I think Technology may continue to lead the market as the AI trade is regaining momentum. Industrials and Materials strong starts to the year took a pause during the war, but I believe we may see those rallies restart. For Materials, Data centers require up to four times more copper than traditional facilities to support power-hungry GPUs and advanced cooling systems and public infrastructure projects and data center construction are sustaining high demand for steel and cement. For Industrials, U.S. manufacturing output is projected to rise by 3.5% annually, supported by reshoring, with significant investments continuing in semiconductors and rising global geopolitical tensions are leading to increased defense spending and multi-year procurement contract.

1st Quarter Earnings

The 1st Quarter earnings season is off to a great start with the S&P 500's projected growth rate of 13.2% (as of last Friday), which would be the sixth consecutive quarter of double-digit earnings growth. Additionally, the expected aggregate net profit margin is 13.2%, which is higher than the 5-year average of 12.2%. The 1st Quarter earnings will not be greatly affected by the war since it started in the last month of the quarter. The big banks led off with strong earnings results and painted a picture of a very healthy US consumer.



	Info. Technology	Materials	Financials	S&P 500	Utilities	Real Estate	Industrials	Consumer Staples	Consumer Disc.	Comm. Services	Health Care	Energy
Today	45.1%	21.6%	19.7%	13.1%	10.1%	3.8%	2.9%	1.8%	1.6%	-0.7%	-10.5%	-13.1%
31-Mar	45.1%	23.7%	15.0%	13.2%	10.0%	3.7%	3.4%	1.6%	1.7%	-3.7%	-8.6%	8.5%

Source: FactSet as of 4/17/26. The blended earnings growth rate for the 1st Quarter combines actual results for companies that have reported and estimated results for companies that have yet to report.

Health of the Consumer

At an aggregate level, the consumer is doing fine, but it remains a bifurcated story. Rising energy costs will only drive that bifurcation further. The bottom 40% of consumers spend approximately 14% of income on energy, while the top 20% of consumers spend roughly 2% of income on energy. Gasoline prices tend to drop much slower than the rapid pace they rise, and that should continue to apply to the current environment until the Middle East's damaged oil infrastructure is fixed. The lower end consumer was hoping that tax refunds would reenergize their spending, but now that extra money may instead go towards higher energy prices. Consumer spending stalled out in January due to the harsh winter and only rebounded 0.5% in February. I expect consumer spending to continue to grow, but at a slower pace, driven by higher earning consumers, who have generated substantial wealth over the past few years from the market and home value appreciation.

The Fed and Inflation

As a result of the war, we will most likely see some stronger inflation readings in the coming months. Energy and food prices will most likely apply upward pressure on inflation. Diesel fuel is crucial for food prices as it powers farm equipment, and commercial shipping and trucking. Additionally, fertilizer prices are increasing due to the shipping disruptions in the Strait of Hormuz. While we have not seen a strong jump in food prices yet, it can sometimes take time to see those inflationary effects. At the last Fed meeting press conference, Jerome Powell signaled that the Fed would still try to look-through a one-time boost to inflation if there were other signs of progress on inflation and inflation expectations remain anchored. There are signs of disinflation in the pipeline, including the fading of the one-time tariff impact on goods prices, and a slowdown in housing inflation, which should put downward pressure on core inflation by the end of this year. Customs tariff duties collected fell by 20% between January and March reflecting the striking down of the IEEPA tariffs in late February.

One item that is concerning to me is the continuing criminal investigation into Fed Chairman Jerome Powell. Senator Thom Tillis has repeatedly vowed to stall Kevin Warsh's nomination as new Fed Chairman until the Justice Department drops its ongoing investigation. Last week President Trump once again threatened to fire Powell if he stays on the board after his leadership term expires next month. The market will most likely not respond favorably if the White House administration continues to threaten the independence of the Fed, which is critical to the long-term economic health of this country, in my opinion. I don't expect any rate movements at the Fed meeting next week, but it will be very interesting to hear the Fed's latest thoughts.

Labor Markets

The labor markets are healthy, even though hiring has not picked up meaningfully yet. Weekly jobless claims remain very tame. The headline of the March jobs report was outstanding with an increase of 178K, but the headline slightly overstated the pace of job growth as the end of a strike, seasonal quirks, and a rebound from a harsh winter likely boasted jobs in some sectors. The ADP Private Payroll report was also encouraging, adding 62K jobs. Smaller companies were shedding jobs last year, but it was great to see those businesses driving growth for the second month in a row as companies with less than 20 employees added 112K jobs.

Tail Risk

While it's welcoming to see the S&P 500 post back-to-back-to-back weekly gains of more than 3% for the first time since 2020, there is certainly some tail risk if the ceasefire negotiations break down. Additionally, the still elevated geopolitical risk may continue to weigh on business investment and hiring for the next few months (quarters). We may see a slight pullback in the markets from its recent surge, especially if issues re-escalate in the Middle East.

Sector Thoughts

Besides the sector rotation, which was temporarily halted from the war, the rotation to international markets had been on pause. Emerging markets had a very fast start to the year, as that asset class was up nearly 15% in the first two months, but most of those gains were lost during the war due to EM countries' high dependence upon Middle East energy. We may see emerging markets rally restart if there is the Middle East situation does not reignite. Consensus forecasts for emerging markets earnings growth range from 17 – 21%.

As far as other areas of the market I like right now –

- Healthcare – Healthcare has struggled over the past decade and has only outperformed the S&P 500 twice in the last 10 years (2018 and 2022). Both those years were midterm years when volatility has been historically higher. In fact, this sector has outperformed the S&P 500 in 11 of the last 13 midterm election years by an annualized average of 8%, displaying its defensive characteristics. Other tailwinds behind Healthcare include greater clarity on the Trump administration's healthcare policy, deregulation, lower interest rates, aging demographics across developed economies and AI-led efficiency gains. I also expect more M&A activity in this sector in 2026 as pharmaceutical companies may acquire biotech firms to fill up their pipelines.

- Financials – The Financial sector had a great year in 2025 and was poised for another one coming into 2026. However, the sector got hit by two major headwinds, the White House's proposal to cap credit card rates and concerns on private credit. I believe the credit card cap rate is just political banter and such a proposal may face challenges in being enacted into law. Credit cards are unsecured lines of credit and banks need to price them accordingly. A cap would hurt banks revenues and profits. Additionally, if a 10% cap was put in place, various studies have estimated 80% of accounts would be closed by banks. At a time when many consumers are struggling to pay bills, such a proposal would cause more harm than good to consumers. Regarding private credit, I believe the concerns are overblown. Roughly 90% of private credit loans are investment grade quality and most corporate balance sheets are healthy. While the media has focused on financial difficulties of a few companies (First Brand and Tricolor), most private credit funds are very diversified with hundreds of loans. There is currently limited evidence of systemic risk among private credit funds, although conditions can change. I believe once those headwinds die down, Financial stocks may rally as M&A activity is likely to pick up in 2026 due to lower interest rates and deregulation. Investors will once again be able to focus on the fundamentals, and Financials are projected to produce the 3rd highest earnings growth of all 11 sectors in the 1st Quarter. The recent proposal by the Federal Reserve to relax capital requirements for banks should also provide some tailwinds for this sector.

- Mid / Small Cap Stocks - Small Cap stocks have several tailwinds behind them including rate cuts, deregulation, and projected earnings growth rates above large caps stocks. Mid / Small caps stocks' projected earnings growth for 2026 is 24.3%, while large cap stocks are projected to grow 11.4%. Investors may consider focusing on the Quality factor with mid / small cap stocks and focus on profitable companies, such as stocks in the S&P 600. The S&P 600's valuation is very attractive at approximately 16 right now, which is slightly below its 20-year average of roughly 17. Finally, the OBBA creates tailwinds for small cap stocks as the bill changes the maximum deductible business interest expense from 30% of EBIT to 30% of EBITDA, benefiting firms with high depreciation and debt. Small companies typically have nearly double the depreciation and amortization of large companies, so those smaller companies will benefit more from the bill.