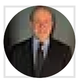
A Few Things which Caught My Attention

A few concepts and questions investors should ponder!



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AUG 19, 2026 ∙ PAID

· Greatest economic uncertainty since 1900.

· S&P 500 profit success is hugely bifurcated.

· Will S&P 500 index follow slower economic momentum lower?

· A dwindling labor force participation rate is grinding U.S. real growth to a halt!

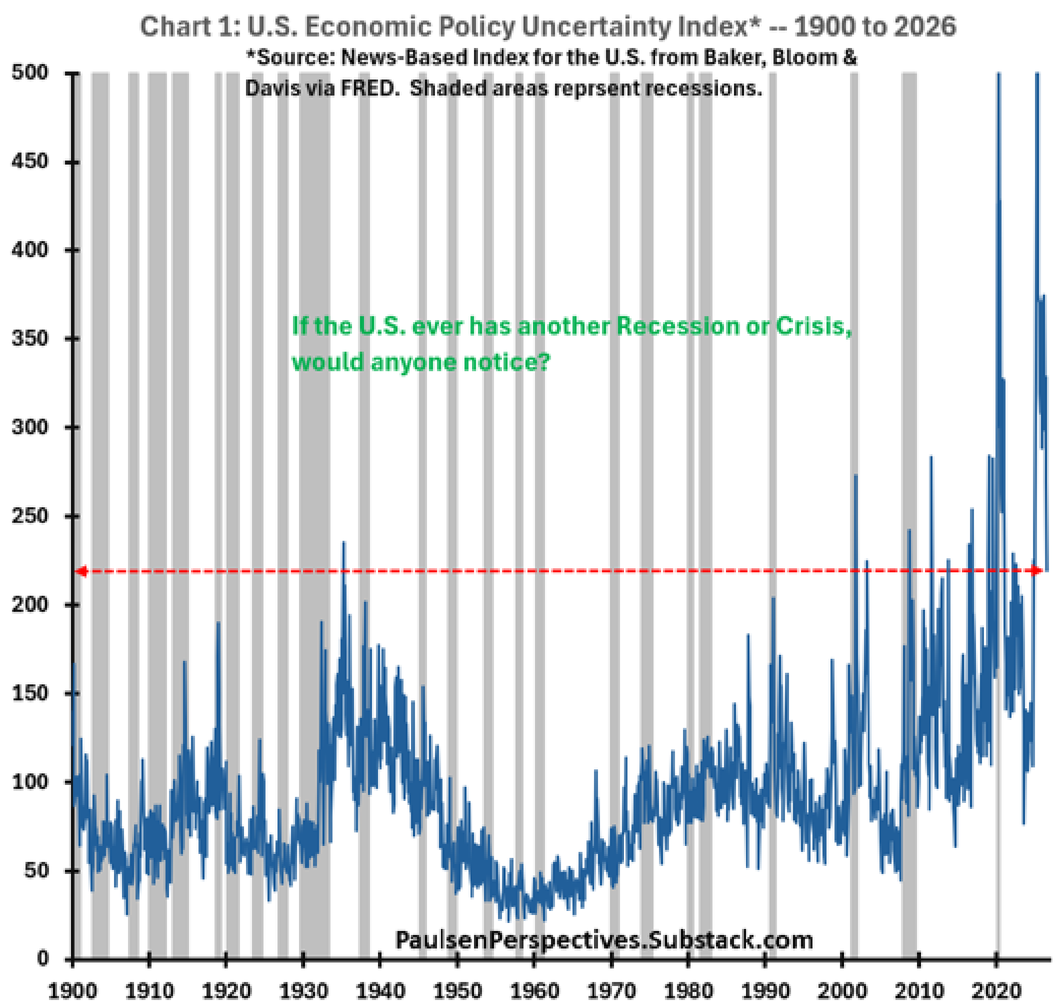
· Could small cap stock leadership be ended by lower commodity prices?

· Aggressiveness is leaving the stock market!

· When and how will the LEI index and the S&P 500 Index reconnect?

1. Economic Uncertainty has been 'Off the Charts' Since the Pandemic!

Americans are becoming used to living with GREAT Uncertainty! Chart 1 illustrates an Index for U.S. Economic Policy Uncertainty derived from a perusal of monthly news items since 1900. During WWI, this index was never higher than 150 to 200, during the Great Depression it never rose even to 250, during WWII it stayed mostly below 150, during the Vietnam conflict and runaway 1970s inflation it never breached 130, and during the dotcom meltdown and the 2008-09 Great Recession crises, it only briefly rose slightly above 250.



However, during the 2020 Pandemic it blew above 500 and since President Trump took office, U.S. 'Uncertainty' has reached as high as 725! Most importantly, uncertainty hasn't just spiked in recent years, it has "persisted" at extraordinarily scary levels. From 1900 to 2019, uncertainty was above the 200 level just 1.5% of the time. But since 2000, it has been above the 200 level 52% of the time! Indeed, average uncertainty since 2000 has been 235 compared to an average of only 88 prior to 2020!

What has chronic uncertainty done to America? Not sure of all its implications but a few possibilities come to mind. Living with tenacious uncertainty probably explains why Main Street sentiment surveys have habitually been near post-war lows despite mostly being in ongoing economic expansions. As demonstrated on chart 1, prior to WWII, the U.S. was in recession nearly one-half the time. But since 2010, excluding a 1-month pandemic bust, the U.S. has enjoyed its longest stretch of a recession-free economic activity. Still, probably because of massive and chronic uncertainty during this time, most Americans remain uncharacteristically pessimistic.

While probably just a coincidence, the legalization of marijuana has really broadened since uncertainty spiked higher in 2020. Nearly half of all U.S. states have legalized adult-use recreational cannabis, up from 11 states in 2020, while public approval has reached historic highs near 70%. Nothing like a comforting brownie to ease tensions created by excessive uncertainty!

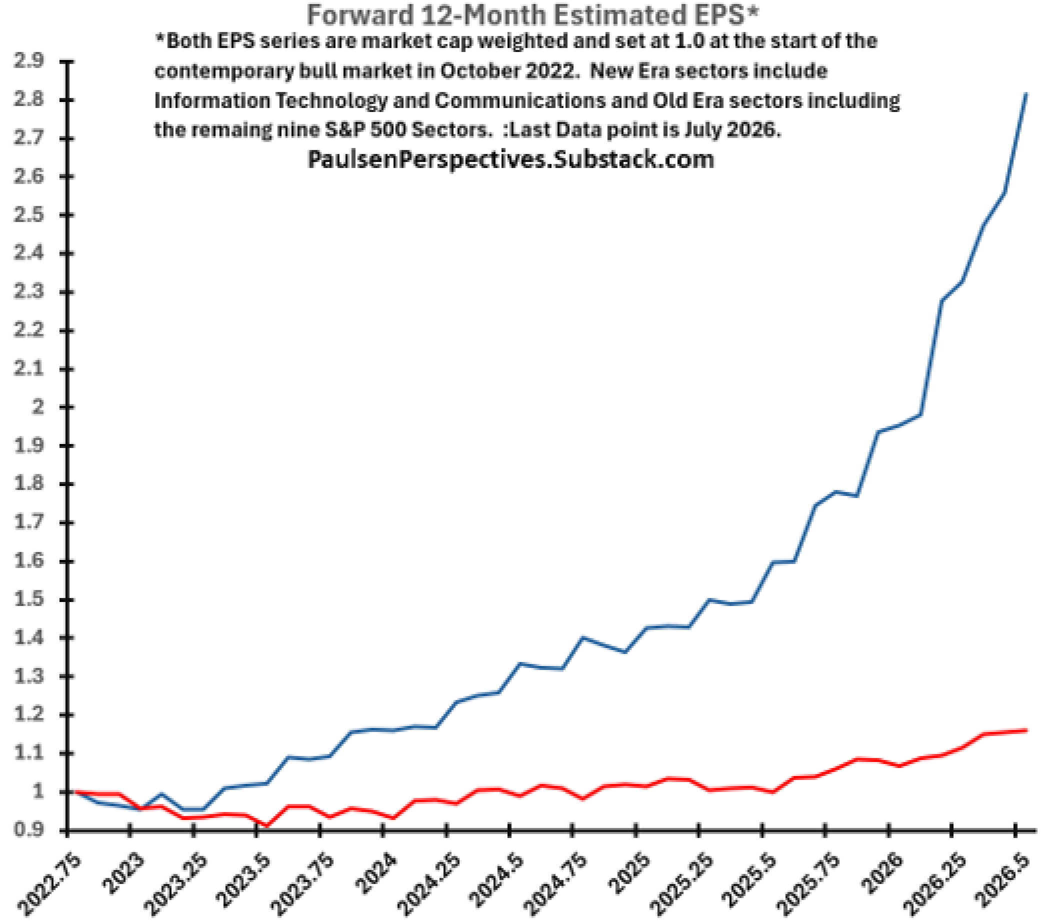
And most importantly, for investors, unprecedented and never-ending economic uncertainty has perhaps provided the "Largest Wall of Worry" in U.S. history underlying and supporting the U.S. stock market. Historically, the stock market performs best when most are unsettled and uncertain. '"Actual" investment risk is accentuated when most become optimistic, calm, or complacent about economic conditions. While nobody enjoys being scared, the chronic state of uncertainty (i.e., a massive and persistent wall of worry) defining America since 2020 has probably been a primary and underappreciated reason why the S&P 500 has provided investors with an almost 16% average annualized total return since 2019!

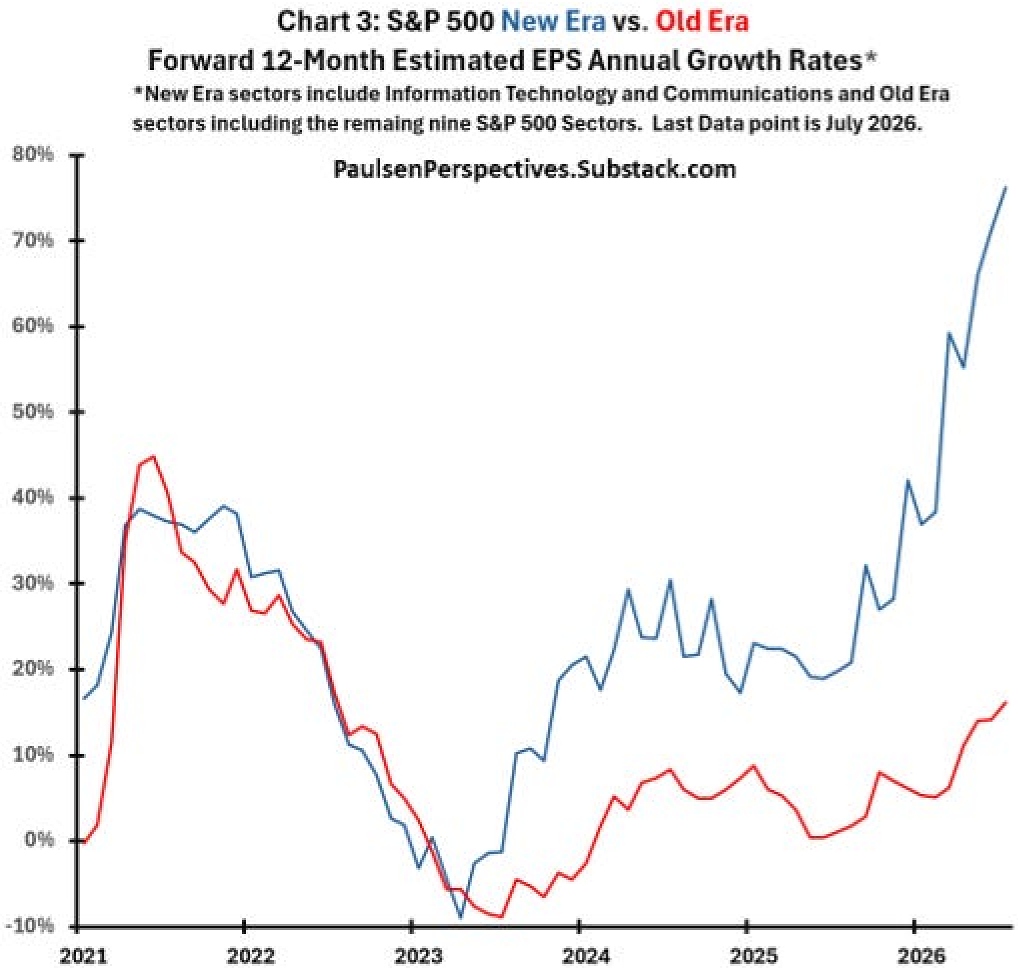
Finally, I wonder if the U.S. does finally suffer an actual crisis, if anyone will notice. Since uncertainty, fear, and pessimism have been rampant for so long, would an actual crisis truly alter what has already been weary Main Street sentiment and would it feel any more concerning than it has in recent years?

2. S&P 500 Bifurcation Continues!

Earnings results across the stock market have been fabulous this year. However, even though EPS outcomes have been spectacular, the bifurcation of EPS performance within the stock market remains remarkably lopsided! Chart 2 shows the forward 12-month estimated EPS for the S&P 500 New Era sectors (information technology and communications) and for the remaining S&P 500 Old Era sectors since the start of the contemporary bull market on October 12, 2022. Since the current bull market's inception, EPS estimates for S&P 500 New Era stocks have risen by over 180% compared to only about a 15% cumulative gain among S&P 500 Old Era stocks! Moreover, as shown in chart 3, the divergence between EPS growth rates has become much worse since the Fall of 2025. From 2023 to September 2025, the average annualized growth of future EPS estimates for New Era stocks was about 16% compared to only about 1% for Old Era stocks. But currently, the average annualized forward 1-year EPS estimate for New Era stocks is about 76% compared to only 16% for Old Era stocks. Estimated 1-year forward EPS growth for S&P 500 New Era sectors is "60% greater" than for Old Era stocks!

Chart 2: S&P 500 New Era vs. Old Era
Forward 12-Month Estimated EPS*

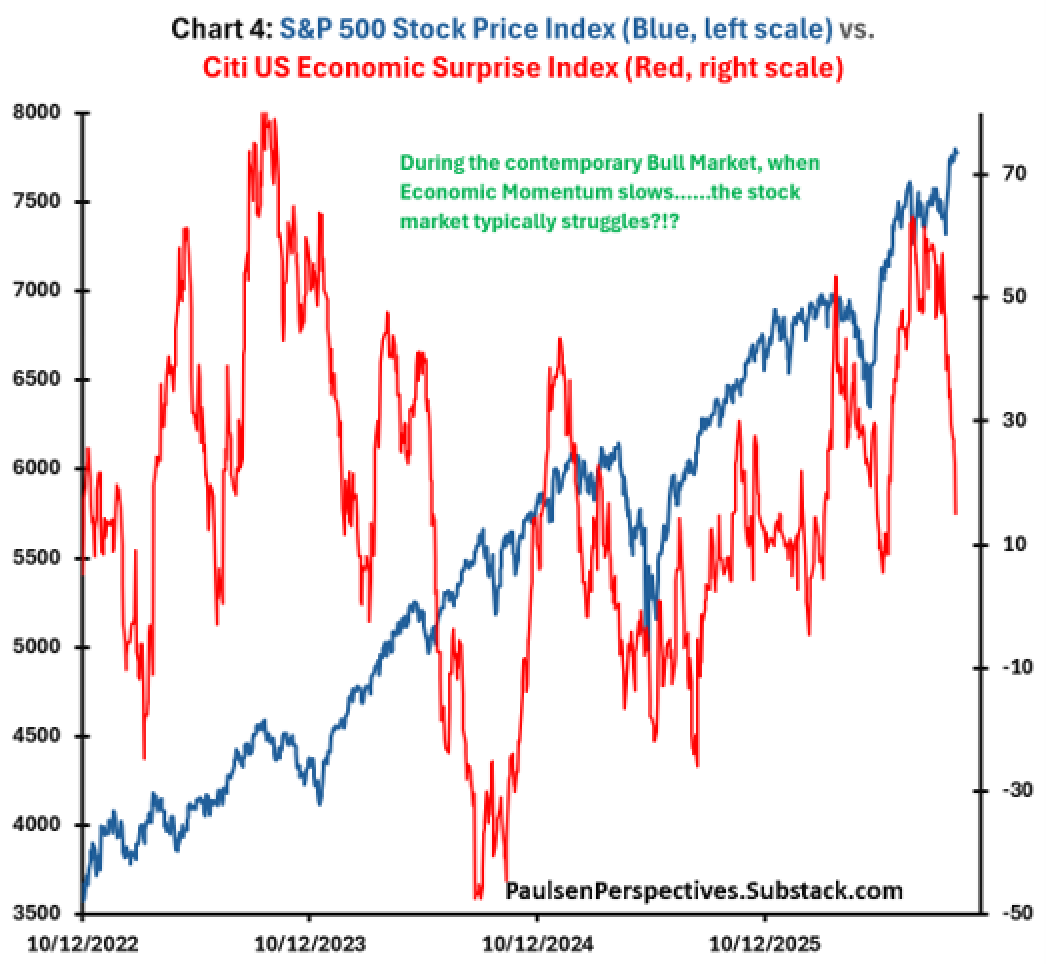




Undoubtably, “all” S&P 500 stocks have recently been enjoying rising forward 1-year EPS estimates. But the lopsidedness of fundamental earnings success is still breathtakingly large. How long can this dramatic bifurcation of fundamental fortunes persist? I know the MLB seems happy to operate professional baseball this way – allowing the payrolls of a few large market teams like the NY Yankees to chronically be much larger than most small market teams like the Minnesota Twins – but can the U.S. economy’s performance and company EPS results remain as dramatically bifurcated as they have in recent years without some major ramifications for both the economy and the stock market? Maybe it can?

3. Slowing Economic Momentum Points to a Struggle for Stocks

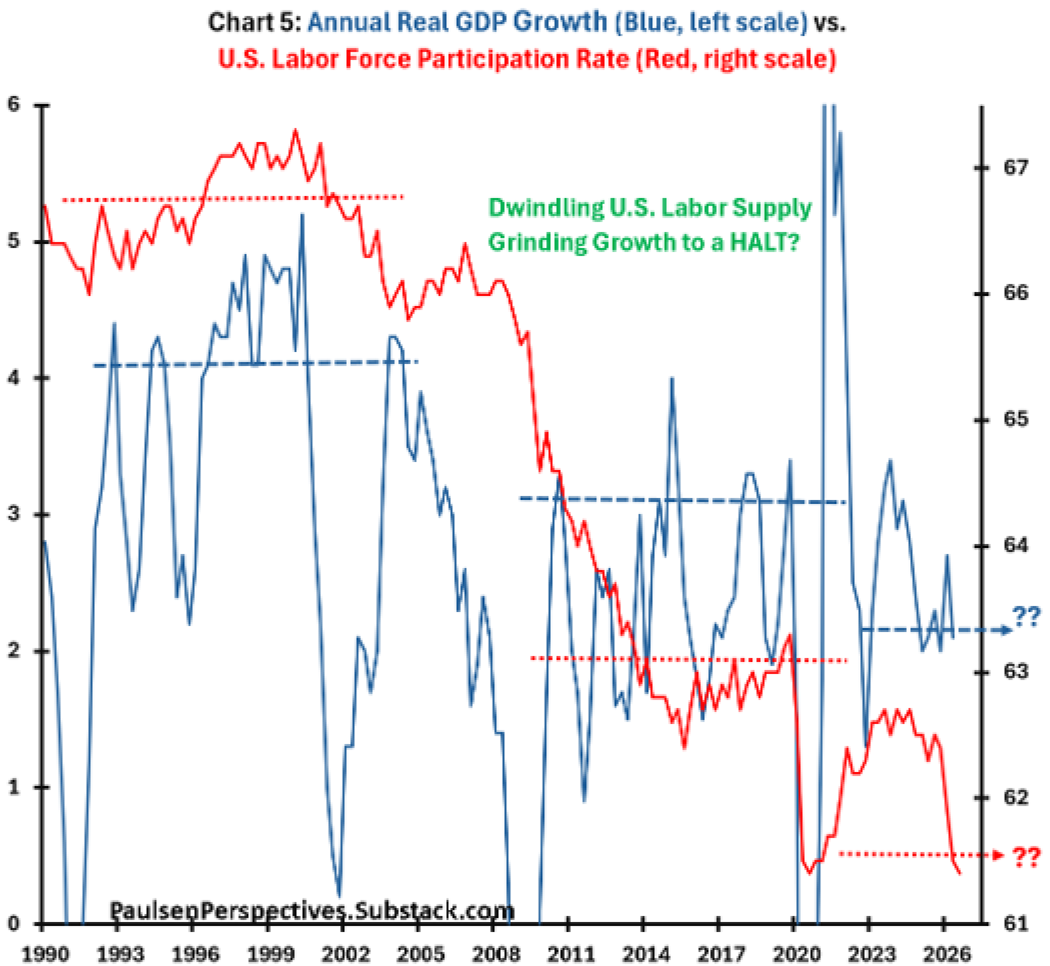
Not surprisingly, the stock market is typically tied to the pace of economic momentum. Recently, U.S. economic momentum has been slowing increasing downside pressure on the stock market. Chart 4 overlays the S&P 500 index with the Citigroup U.S. economic surprise index. The Economic Surprise Index measures economic data surprises relative to market expectations. A positive reading means that economic releases have been stronger than expected (i.e. suggesting positive U.S. economic momentum) and a negative reading means that data releases have been worse than expected (indicating an economy which is losing momentum).



As shown in chart 4, every major decline in the economic surprise index since the contemporary bull market began in October 2022 has been associated with a noticeable pullback in the S&P 500 index. From its peak of 63 in early June, the Citi U.S. surprise index has recently collapsed to only 15. So far, the S&P 500 index has continued climbing being supported by the ongoing excitement surrounding AI. However, should economic momentum continue slowing (which seems likely considering the lagged contractionary impact of recent economic policies like much higher bond yields), the stock market may soon suffer at least some temporary pullback as investor concerns about economic growth intensify.

4. A Dwindling U.S. Labor Supply is Grinding Economic Growth to a Halt

A chronically declining U.S. labor force participation rate is slowly grinding U.S. real economic growth to a halt. As shown in chart 5, during the 1990s into the early-2000s, the U.S. participation rate averaged about 66.5% and the peak pace of real GDP growth during expansions almost always rose above 4%. Since the Great Financial Crisis of 2008-09, however, the labor force participation rate declined to about 63% and real GDP growth during expansions struggled to even surpass 3%. Most recently, the labor participation rate has alarmingly declined to 61.4% “during an ongoing economic expansion”! Since 1990, the participation rate has typically only declined during or after major recessions – e.g., it declined meaningfully from 2001 to 2004 after the dotcom recession, it declined again between 2008 to 2015 after the 2008-09 recession, and it also declined during the pandemic recession in 2020. Conventionally, the participation rate has rarely declined outside of a recession – let alone by a large amount.

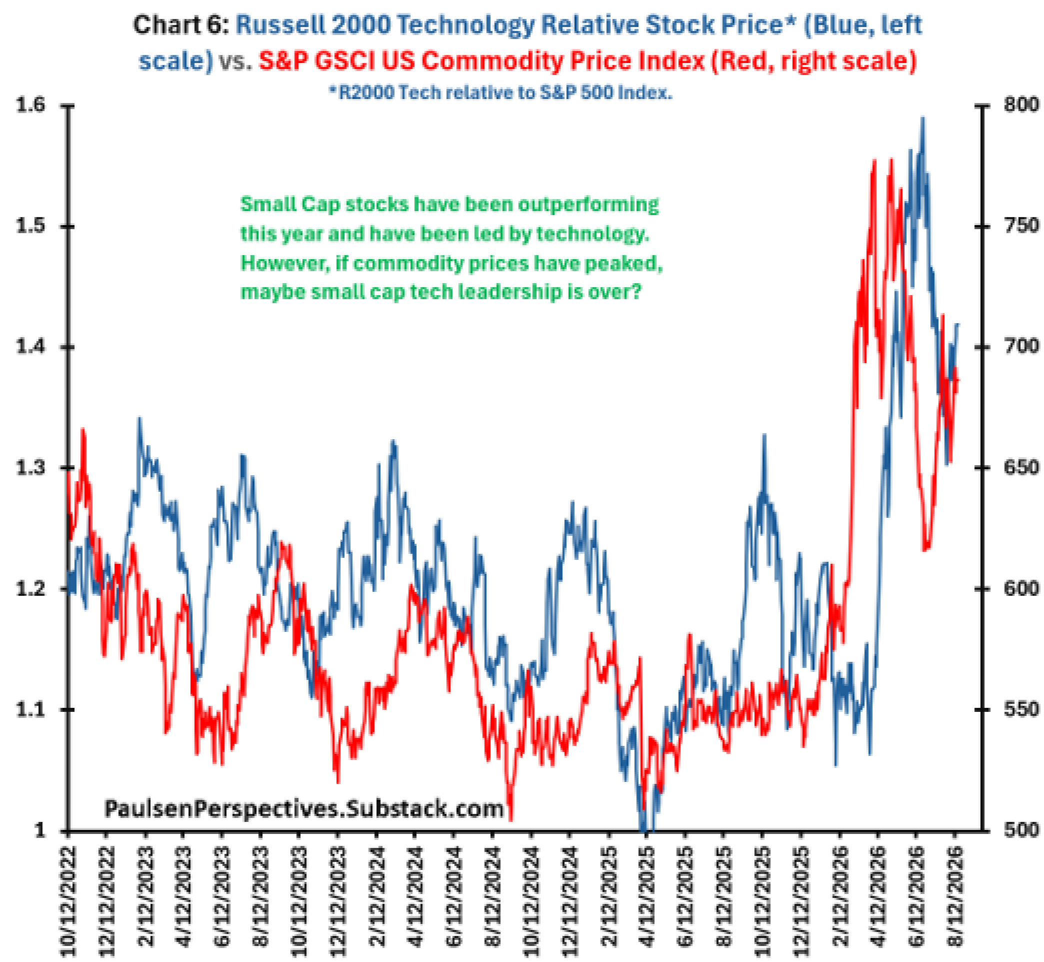


If the participation rate now hovers about 61.5%, what will this imply for sustainable real GDP growth? Could the economy struggle to even surpass 2% growth during upcoming expansions? Yes, aging demographics is driving most of the declining participation rate. But the fact that old people are leaving the labor force does not make its impact on real economic growth any less relevant. And baby-boomer retirements are poised to continue for a few more years. AI better substantially boost productivity or future U.S. real expansionary economic growth may simply be a crawl.

5. Recent Small Cap Outperformance Tied Mainly to Technology

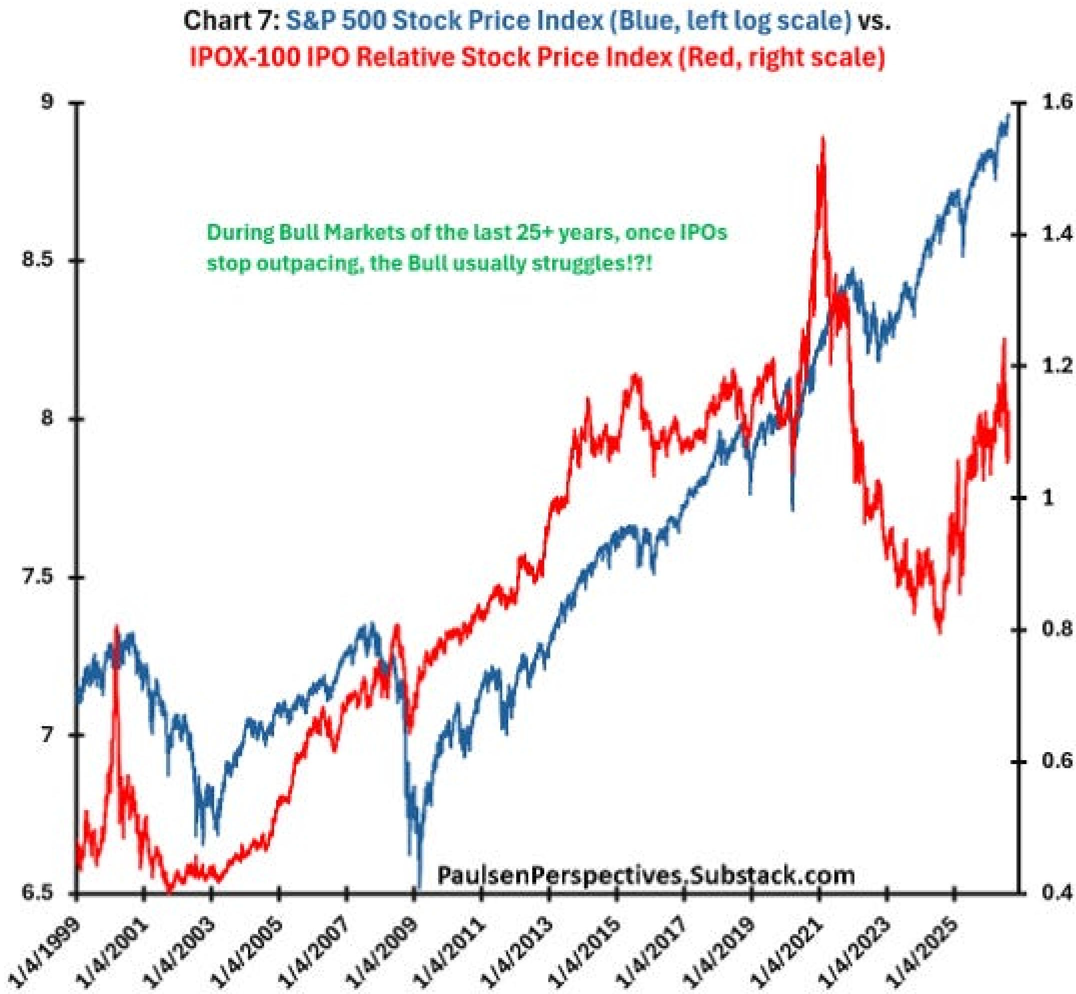
Year-to-date, the Russell 2000 index has risen by 22% compared to only a 12.5% gain for the S&P 500 index. However, a large portion of the gain in small cap stocks this year is due to R2000 technology stocks and energy stocks. The R2 technology index has risen by almost 38% so far this year and the R2 energy sector is up by 33%.

Why is this important? Because as demonstrated in chart 6, the surge in commodity prices so far this year, tied mainly to the Iranian conflict, seems to have driven the relative outperformance of both small cap tech and energy stocks. Naturally, energy stocks are importantly impacted by rising energy prices but as demonstrated in chart 6, surprisingly the performance of small tech stocks also appears to be driven by rising commodity prices. Since the start of the contemporary bull market in October 2022, there has been a surprisingly strong positive relationship between the relative performance of small cap technology stocks and movements in commodity prices. During this bull market, R2 tech and commodity prices have tended to move roughly together. Even if the Iran crisis drags on, it seems unlikely that commodity prices will rise much further and any resolution to this conflict would likely cause a major decline in U.S. commodity prices. Should commodity prices decline in the coming months, both small cap tech and small cap energy sector stocks would likely severely underperform possibly making overweighted small cap investment bets losers? Just something to ponder for those who have significant overweights toward small cap stocks.



6. Is Aggressiveness Leaving the Stock Market?

Often either before or once bear markets begin, “aggressiveness” tends to relinquish leadership. There is some evidence this may currently be happening again. Charts 7 and 8 show that the relative performances of two “aggressive” equity selections – IPOs and Large Cap Growth – have begun underperforming. As demonstrated on chart 7, the relative performance of IPOs began underperforming before the dotcom top in the S&P 500 index in 2000, before the S&P 500 index fully starting collapsing in 2008, before the 2015-16 pullback, before the late-2018 almost 20% S&P 500 decline, before the 2020 pandemic collapse, prior to the 2022 bear market, coincident with the 2025 pause, and recently, it has declined noticeably since the end of June.

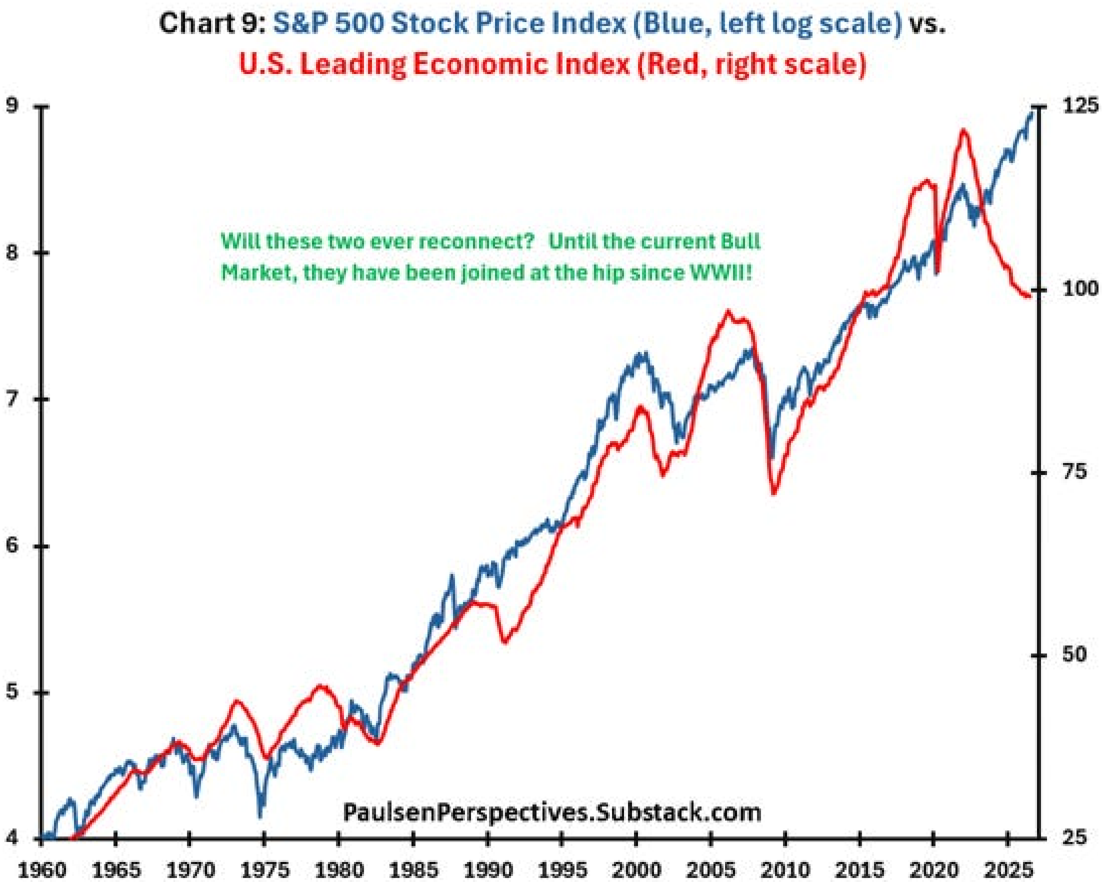


In a similar manner, as demonstrated in chart 8, since at least 1999 excluding the period between 2004 to 2007 after the dotcom collapse, there has rarely been any sustained rise in the S&P 500 index that was not supported by outperformance by large cap growth stocks. After outperforming most of the time throughout the contemporary bull market, large cap growth stocks have now been mostly (except for brief mild periods) underperforming since October 2025.

Other traditional “aggressive” sectors/styles have also recently been underperforming (e.g., S&P 500 technology sector has been underperforming since its early-June high, and the S&P 500 High Beta Index has been underperforming since mid-June), suggesting some caution for the overall stock market. When aggressiveness stops leading, often the stock market suffers a period of turbulence.

7. Will the S&P 500 Ever Reconnect with the LEI Index?

The stock market typically “leads” economic fundamentals and that is why – as demonstrated in chart 9 – since 1960, movements in the S&P 500 Index and the U.S. Leading Economic Index have mostly been closely correlated. The LEI Index uses indicators which “predict” where the economy is headed and the performance of the S&P 500 Index has always provided a leading indication of economic fundamentals.



For reasons not fully understood, since the start of this bull market in October 2022, the S&P 500 Index has continuously headed higher while the LEI index has persistently trended lower! Why have these two excellent indicators of future economic performance suddenly parted company after nearly 62 years of being closely related? I don't know! However, if both reflect future economic performance, they are likely to eventually reconnect? Will the LEI index soon start rising again and catch up with the increase in the stock market during this bull market, or will the S&P 500 suffer some period of pullback and move closer to the already lowered LEI index? Only time will tell, but this unique divergence is concerning and may yet prove to ultimately be a cautionary tale for stock investors.

Thanks for Taking a Peek! Jimp

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