

Key Insights

- Supreme Court Tariff Ruling Injects Maximum Trade Uncertainty:** The U.S. Supreme Court struck down President Trump's "reciprocal" tariffs justified under the IEEPA, prompting the administration to immediately impose a new 15% across-the-board global tariff under Section 122 of the 1974 Trade Act for up to 120 days. The sudden policy pivot caused U.S. stock futures and the dollar to slide, with the EU freezing its trade agreement ratification process and India postponing a diplomatic trip to the U.S.
- U.S.-Iran Tensions Reach Crisis Levels:** Geopolitical escalation between the U.S. and Iran dominated February's risk landscape, with prediction markets placing the odds of a U.S. military strike at roughly 70%. The Energy sector surged 8.20% for its second consecutive month of strong gains, while the broader geopolitical uncertainty reinforced gold's safe-haven bid and contributed to the continued rotation into defensive sectors.
- AI "Scare Trade" Wipes Out \$611 Billion in Software and Services Stocks:** The release of Anthropic's Claude Code and Claude Cowork - AI agents capable of independently reviewing legal contracts and writing software - triggered a market-wide panic that shifted Wall Street's view of AI from a productivity tool to an existential threat to white-collar jobs. A viral Citirini Research report warning of a "human intelligence displacement spiral" accelerated a brutal selloff across 164 stocks in software, financial services, and asset management. The Magnificent 7 plunged 5.91% for the month as the AI disruption narrative supercharged the ongoing rotation out of mega-cap tech.
- Gold's Historic Run Extends - Now Up 74% from April Lows:** Gold gained 6.15% in February to trade above \$5,150/oz, extending its year-to-date advance to over 20% and its cumulative recovery from the April 2025 lows to an extraordinary 74.15%. JP Morgan raised its year-end gold forecast to \$6,300, citing structural demand from central banks - with the People's Bank of China extending gold purchases for a 15th consecutive month - and surging investor interest driven by trade chaos, Iran escalation risk, and softening U.S. economic data.
- The Great Rotation Deepens - Value Outpaces Growth by 5+ Points in February:** The rotation from mega-cap tech into value, cyclical, and defensive sectors intensified, with Russell 3000 Value gaining 2.59% versus Growth's 2.56% decline - a spread exceeding 5 percentage points in a single month. Small-caps (Russell 2000 +2.49%) continued to outperform mega-caps (Russell Top 50 -2.47%) as investors favored domestically oriented companies and commodity producers. Utilities (+9.12%), Energy (+8.20%), Materials (+7.51%), and Industrials (+6.95%) led, while Technology (-2.32%), Communication Services (-2.73%), and Consumer Discretionary (-3.40%) lagged. The S&P 500's flat surface masked a historically fierce divergence underneath, with the equal-weight index significantly outperforming the cap-weighted benchmark for the second consecutive month.
- Record Earnings and Revenue Growth Underpin Fundamentals:** The Q4 2025 earnings season (74% reported) delivered the S&P 500's 5th consecutive quarter of double-digit earnings growth at 13.2%, while revenue growth reached 9.0% - the highest since Q3 2022 and the 21st consecutive quarter of positive revenue growth. The S&P 500 net profit margin hit 13.2%, the highest ever recorded by FactSet since tracking began in 2009. Analysts project 14.4% earnings growth for CY2026, with the forward P/E of 21.5x compressing from 22.0x at year-end as estimates rose while prices dipped. The bottom-up target price of ~8,255 implies roughly 21% upside from current levels.

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Monthly Recap

February 2026 was defined by a dramatic collision of geopolitical shocks, trade policy chaos, and AI-driven market disruption that left the S&P 500 essentially flat (-0.41%) for the month. Beneath the surface, a fierce divergence persisted: the Russell 2000 Index gained 2.49% while the Magnificent 7 plunged 5.91% and the Nasdaq fell 2.49%. The value-over-growth and cyclical-over-tech rotations that began in January continued with even greater intensity, as Russell 3000 Value gained 2.59% versus Growth's 2.56% decline - a spread of over 5 percentage points. Sector leadership was dominated by Utilities (+9.12%), Energy (+8.20%), Materials (+7.51%), Industrials (+6.95%), and Consumer Staples (+6.38%), while Technology (-2.32%), Communication Services (-2.73%), Consumer Discretionary (-3.40%), and Financials (-1.75%) lagged. Internationally, MSCI Emerging Markets surged 5.71% and MSCI World ex-US gained 4.02%, both dramatically outpacing the S&P 500.

The Tariff Shock: Supreme Court Strikes Down

Reciprocal Tariffs: February's most consequential macro event was the U.S. Supreme Court's decision to strike down President Trump's "reciprocal" tariffs justified under the International Emergency Economic Powers Act (IEEPA). In immediate retaliation, the administration announced a new 15% across-the-board global tariff for up to 120 days under Section 122 of the 1974 Trade Act. The sudden pivot injected massive uncertainty into the global economy, causing futures and the dollar to slide. The European Union moved to freeze its trade agreement ratification process, India postponed a diplomatic trip, and investors fled to safe havens, pushing gold above \$5,100/oz and silver up 5%. The S&P 500 traded in its narrowest range for early February in 60 years as markets struggled to price the rapidly shifting landscape.

Geopolitical Escalation: U.S.-Iran Tensions Reach a

Boiling Point: Rhetoric between the U.S. and Iran reached critical levels, with prediction markets placing odds of a U.S. attack at roughly 70%. Iran's Revolutionary Guards conducted live-fire drills and temporarily closed the Strait of Hormuz, through which one-fifth of global oil flows. Brent crude pushed back above \$70/bbl, with analysts attributing ~\$5 to the Iran war risk premium. The Energy sector surged 8.20% for its second consecutive month of strong outperformance.

The "Scare Trade": AI Disruption Triggers a Software

Selloff: The rollout of Anthropic's advanced AI agents, including Claude Code and Claude Cowork - sparked panic across Wall Street, shifting the market's view of AI

from a productivity tool to an existential threat to white-collar jobs. A viral Citrini Research report warned of a "human intelligence displacement spiral." The narrative shift triggered a brutal selloff that wiped out \$611 billion in market value across 164 stocks in software, financial services, and asset management in just one week. IBM dropped 13% for its worst day in 25 years, while Salesforce, ServiceNow, and SAP suffered massive declines, accelerating the rotation out of tech.

The Recovery from April 2025 Lows Continues: Despite February's turbulence, cumulative gains from the April 8, 2025 bottom remain extraordinary: S&P 500 +40.07%, Nasdaq +50.59%, Russell 2000 +53.77%, and Magnificent 7 +59.23%. International markets have outpaced U.S. large-caps, with MSCI EM +64.72% and MSCI World ex-US +47.44% from the lows.

Q4 2025 Earnings: Record Revenue Growth and Margins:

Per FactSet (74% reported), the blended Q4 earnings growth rate is 13.2%, marking the 5th consecutive quarter of double-digit growth. Revenue growth reached 9.0% - the highest since Q3 2022 and the 21st consecutive quarter of positive revenue growth. IT led earnings at +30.7% (driven by NVIDIA), followed by Industrials at +26.0% (driven by Boeing's one-time gain) and Communication Services at +13.6% (driven by Alphabet). The net profit margin reached 13.2%, the highest ever recorded by FactSet. Key revenue surprises included Apple (\$143.76B vs. \$138.39B est.), Super Micro (\$12.68B vs. \$10.42B), and Alphabet (\$113.83B vs. \$111.32B). For Q1 2026 guidance, only 45% of companies issued negative guidance vs. the 5-year average of 58%.

Fixed Income and the Gold Supercycle: Bonds rallied as rate expectations shifted dovish: the U.S. Aggregate gained 1.25% and 20+ Year Treasuries surged 4.00%. Markets now price three Federal Reserve rate cuts for 2026, up from two at month-start. Gold gained 6.15% to trade above \$5,150/oz, extending its YTD gain to 20.26% and its recovery from April lows to an astonishing 74.15%. JP Morgan raised its year-end target to \$6,300, citing central bank demand (PBoC purchases for 15 consecutive months) and safe-haven flows. The crypto market moved opposite, with the Bloomberg Galaxy Crypto Index plunging 18.91% in February (-24.24% YTD).

Forward Estimates, Valuation & Outlook: Analysts project S&P 500 earnings growth of 14.4% for CY2026, with quarterly acceleration (Q1: 11.1%, Q2: 14.9%, Q3: 15.6%, Q4: 15.0%). The forward price-to-earnings (P/E) of 21.5x sits above the 5-year average (20.0x) and 10-year average (18.8x) but has compressed from 22.0x at year-end as

forward earnings per share (EPS) rose 2.2% while prices slipped. The bottom-up target price implies ~21% upside.

February illustrated the complex crosscurrents facing markets. The S&P 500's historically tight trading range masked enormous sector-level divergences and a continued exodus from mega-cap tech into value and defensive positions. The fundamental backdrop remains supportive - double-digit earnings growth, record margins, and positive guidance - but elevated valuations, Iran escalation risk, trade policy chaos, and the emerging AI disruption narrative create meaningful headwinds. With midterm elections in November and a historical average midterm-year drawdown of 17.5%, investors should prepare for a more turbulent path forward even as the broadening of market participation beyond mega-cap tech builds a healthier foundation for the bull market.

Topic of the Month: U.S. Tariff Policy After the Supreme Court Ruling

Executive Summary

In a landmark 6–3 decision, the U.S. Supreme Court struck down President Trump's sweeping global tariffs, ruling that the administration exceeded its authority by invoking the International Emergency Economic Powers Act of 1977 to impose "reciprocal" tariffs on global imports and fentanyl-related duties on goods from China, Canada, and Mexico. Chief Justice Roberts, writing for a majority that included Trump appointees Gorsuch and Barrett, applied the major questions doctrine, concluding that the government's interpretation represented a "transformative expansion" of presidential authority that Congress never intended. The ruling immediately scrambled global trade relations, triggered a \$170 billion refund fight, and forced the administration to pivot to alternative legal frameworks - all while financial markets swung sharply on the news.

Immediate Implications

The \$170 Billion Refund Crisis

The government illegally collected an estimated \$170–175 billion under IEEPA. Because the administration plans to fiercely oppose returning the money, the refund process is expected to become a protracted legal battle - one that disproportionately harms small businesses lacking the resources to litigate against Customs and Border Protection for years.

Geopolitical Winners and Losers

The sudden removal of IEEPA tariffs reshuffled the competitive landscape. Adversaries like China and Brazil emerged as the biggest winners, with Brazil's effective tariff rate dropping from 31% to 10% and China benefiting from the removal of 10% fentanyl levies. Conversely, close allies - the UK, Australia, and the EU - who had negotiated capped reciprocal rates under the old system lost their competitive advantage as the global field leveled. The EU immediately paused ratification of its 15% reciprocal trade agreement, and India postponed its own negotiations.

Federal Deficit Strain

IEEPA tariffs accounted for roughly 80% of Trump's trade remedy revenue. Losing this income, while facing the prospect of \$170 billion in refunds, threatens to significantly widen the budget deficit and increase Treasury issuance.

The Administration's Response

With new tariff legislation unlikely to pass a narrowly divided Congress, the administration pivoted to executive alternatives. President Trump immediately signed an executive order invoking **Section 122 of the Trade Act of 1974** to enact a temporary global import surcharge, initially set at 10% and then raised to 15% - the statutory maximum - for up to 150 days, exempting USMCA-compliant goods from Mexico and Canada as well as civil aircraft. Treasury Secretary Bessent characterized this as a temporary "bridge."

However, this bridge rests on uncertain legal footing. Section 122 requires a "fundamental international payments problem," yet leading economists argue no such crisis exists: foreign investment easily funds the U.S. trade deficit, and dollar strength proves continued confidence in American assets. Further undermining the administration's case, its own lawyers previously argued in court filings that trade deficits are "conceptually distinct from balance-of-payments deficits." Despite these vulnerabilities, trade experts predict the 150-day clock will expire before courts can issue a definitive ruling.

For the longer term, the administration plans to finalize investigations under **Section 301** (targeting unfair trade practices, with active probes into China and Brazil) and **Section 232** (addressing national security threats, already covering steel, aluminum, and autos). Unlike IEEPA or Section 122, these statutes have no cap on tariff rates and could ultimately produce higher, permanent duties - though they require lengthy federal investigations of 180 to 400 days.

Market Impact

Equities

Stocks initially rallied, with the S&P 500 and Nasdaq 100 surging to session highs as investors priced in relief for corporate margins. Retail, apparel, toy, and freight companies emerged as the biggest winners - brands like Gap, Nike, and Mattel are positioned for 20–50 basis points of margin expansion. Freight forwarders such as FedEx and DHL are expected to profit from complex supply-chain adjustments. Auto stocks like Ford and GM saw muted reactions, as their imported parts are taxed under Section 232, which was unaffected.

Bonds and Rates

U.S. Treasuries fell, pushing the 10-year yield to 4.10%, as the bond market priced in the possibility of massive new debt issuance to fund the \$170 billion refund obligation.

Commodities

Investors flocked to precious metals amid fears of retaliatory measures and supply-chain disruptions. Gold futures surged 1.7% to over \$5,171/oz and silver jumped 5% to \$86.61/oz.

Tariff Claim Market

A specialized secondary market for tariff refund claims has exploded, with claims now trading at roughly 40 cents on the dollar (up from 10–20 cents), signaling investor confidence in eventual payouts but expectations of a long legal battle.

Economic Outlook

Even with the new 15% Section 122 surcharge in effect, the average effective U.S. tariff rate is estimated to drop to around 12.1% (down from 13.6% under IEEPA). According to the Yale Budget Lab, removing the IEEPA tariffs will save the average U.S. household approximately \$600 to \$800, as the overall price level will rise by only 0.5% to 0.6% instead of a projected 1.2%. However, economists warn that widespread, immediate price declines at the retail level are unlikely - much of the current inventory was imported under the old, expensive tariffs, and businesses are historically reluctant to lower prices once raised, especially given the uncertainty of future duties.

Looking Ahead

The ruling fundamentally alters U.S. trade policy dynamics and guarantees a prolonged period of uncertainty. Three dynamics will define the coming months:

A Race Against the Clock

With Section 122 tariffs expiring after 150 days, importers will scramble to rush cargo into the supply chain at current lower rates before the administration finalizes potentially higher permanent duties under Sections 301 and 232.

Cascading Legal Battles

Immediate lawsuits are expected challenging whether the U.S. actually faces the “balance-of-payments” crisis required to trigger Section 122. Because litigation timelines will likely outlast the 150-day window, the replacement duties could expire before courts even rule.

A Geopolitical Shift

By stripping the president of the ability to unilaterally impose unbounded tariffs overnight, the Supreme Court has removed a key tool for exerting rapid diplomatic leverage. Foreign allies may grow bolder - European experts suggest the ruling provides the EU with the “geopolitical spine” to resist further U.S. economic pressure. The coming months will test whether the administration can rebuild its tariff architecture on firmer legal footing, or whether the combination of judicial constraints, legislative gridlock, and expiring statutory clocks will leave U.S. trade policy in sustained limbo.

Conclusion

February 2026 will be remembered as the month the market’s calm surface shattered into irreconcilable contradictions underneath. A flat S&P 500 return of -0.41% concealed one of the most divergent months in recent memory: a 5+ percentage point spread between value and growth, a near-10 percentage point gap between the best-performing sector (Utilities, +9.12%) and the worst (Consumer Discretionary, -3.40%), and a widening chasm between surging international markets and stumbling U.S. mega-caps. Three distinct shocks - a Supreme Court ruling that upended the foundations of U.S. trade policy, an Iran escalation that temporarily closed the world’s most critical oil chokepoint, and an AI-driven panic that erased \$611 billion in software and services market value - each would have dominated any ordinary month. Their simultaneous arrival created a uniquely disorienting environment where traditional risk frameworks offered little guidance.

Yet the fundamental story remains remarkably intact. Corporate America delivered its fifth consecutive quarter of double-digit earnings growth, posted record profit margins, and guided forward estimates higher. The recovery from April 2025’s lows continues to compound

across asset classes, and market breadth is broadening as capital rotates from a narrow cohort of mega-cap tech names into a wider universe of sectors and geographies. Gold's 74% surge from the April lows - now the defining trade of this cycle - reflects both the scale of uncertainty and the depth of investor demand for assets uncorrelated with policy risk.

The challenge for the months ahead is clear: the supportive earnings backdrop must contend with a tariff regime being rebuilt on uncertain legal footing, a potential military confrontation with Iran, an AI disruption narrative that is only beginning to be priced, and the historical volatility patterns of a midterm election year. The Great Rotation's message is that markets are adapting - repricing risk, broadening participation, and seeking value where it can be found. Whether that adaptation proves sufficient to sustain the bull market through the turbulence ahead will define the remainder of 2026.

Sincerely,

The James Research Team



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