BIRLING CAPITAL ADVISORS, LLC

Think Strategically

Markets Break Out, Puerto Rico Diverges: Wall Street Hits New Highs as the Island's Growth Slows

August 10, 2026

Francisco Rodríguez-Castro, President & CEO

Two economies, two trajectories

Wall Street and Puerto Rico are telling two very different stories this August. On the mainland, the S&P 500 has broken out of a three-month trading range to reach fresh record highs, powered by an exceptionally strong earnings season, easing geopolitical risk in the Middle East, and a labor market cooling just enough to keep the Federal Reserve's next move in play. While the U.S. economy remains resilient — with the Atlanta Fed's GDPNow model now tracking Q3 2026 growth at 5.8%, up sharply from the 2.8%–3.3% range it showed back in June — it is, by most measures, a market and an economy reasserting confidence in the durability of this expansion.

Puerto Rico's economy is moving to a different rhythm. Three independent institutions — the Planning Board, the Fiscal Oversight Board, and the Economic Activity Index — are all converging on the same conclusion: growth is decelerating, and the margin of error is virtually zero. Unemployment is rising off its historic lows. Retail sales momentum has turned negative. And a governance-driven water crisis is now extracting a real, measurable cost from island businesses and households alike. Yet even against that backdrop, our locally traded bank stocks continue to outperform their mainland peers by a wide margin — a divergence between public-market performance and macroeconomic reality that we've flagged repeatedly, and that deserves close attention as the second half of the year unfolds.

We examine both stories below: what's behind August's mainland breakout, and what the latest island-level data tells us about the health of Puerto Rico's economy.

The rally has gained momentum

Wall Steet Weekly Update	8/7/26	7/31/26	Change	YTD Return
Dow Jones Industrial Average	54,036.93	52,485.03	2.96%	12.43%
S&P 500	7,757.64	7,489.72	3.58%	13.32%
Nasdaq Composite	26,690.52	25,373.85	5.19%	14.84%
Birling Puerto Rico Stock Index	5,103.49	5,151.86	-0.94%	28.71%
Birling U.S. Bank Index	10,471.84	10,529.28	-0.55%	14.40%
U.S. Treasury 10-Year	4.65%	4.75%	-2.11%	10.98%
U.S. Treasury 2-Year	4.19%	4.28%	-2.10%	20.75%

For three months, the S&P 500 sat trapped in a summer trading range, unable to decisively break higher despite periodic rallies. That standstill has now given way to a genuine breakout, with the index pushing into fresh record territory in early August. The move wasn't triggered by a single headline or data point. Rather, it reflects the simultaneous unwinding of three distinct pressures that had converged to keep investors on the sidelines since spring: mounting skepticism over whether artificial intelligence capital spending could continue justifying its price tag, geopolitical risk tied to Middle Eastern oil flows, and persistent uncertainty about the Federal Reserve's next move.

Two of those three concerns have now eased significantly, and with these factors diminished, earnings and economic fundamentals have reemerged as the primary drivers of price action. In my view, this distinction is critical. Markets that advance based on fundamentals such as expanding profits, healthy economic data, and reduced geopolitical risk tend to sustain more durable gains than those propelled solely by multiple expansion or short covering. The current market behavior in August corresponds more closely to the former scenario.

It is important to consider the path that led to the current market environment. The consolidation observed over the past three months did not indicate a loss of conviction; rather, it reflected the market's process of addressing substantive questions. During this period, sector rotation occurred, with financials, healthcare, and energy taking leadership roles while growth stocks paused. Recently, robust technology earnings have initiated another rotation, allowing growth to reemerge and drive the index to new highs. I anticipate that these shifts in sector leadership will persist throughout the remainder of the year, rather than converging on a single dominant theme.

Earnings are the primary driver of market performance.

The fundamental story behind this breakout is genuinely compelling. With the large majority of S&P 500 companies having now reported second-quarter results, aggregate earnings growth is tracking near 48%, more than double the roughly 24% growth rate analysts were projecting at the start of earnings season. That places this reporting period among the strongest outside of a post-recession recovery cycle — a noteworthy accomplishment given the economy is not emerging from a downturn but rather extending a mature expansion.

Non-operating items have contributed to some of the headline earnings strength. Alphabet and Amazon recorded significant mark-to-market gains on their deliberate equity investment portfolios, including their respective Anthropic holdings, and these gains are reflected in reported net income. Excluding these one-time items, S&P 500 earnings growth remains close to 29%, accelerating from the first quarter and marking the second consecutive quarter of profit growth exceeding 20%. I advise clients to focus on this figure, as it more accurately reflects operating performance rather than portfolio revaluations.

In my assessment, the breadth of the rally is the most important factor for its endurance. The current market narrative is no longer limited to a small group of mega-cap technology companies. This quarter, consumer discretionary and communication services sectors delivered the largest positive surprises, while six of the remaining nine S&P sectors also achieved double-digit earnings growth. A market advance supported by a broad earnings base is structurally healthier and less susceptible to setbacks from individual companies.

The AI investment cycle appears to be entering a more mature phase, rather than exhibiting signs of weakness. Management teams at major technology firms are expressing increased confidence, not only regarding the magnitude of their AI capital investments but also the expected returns, as evidenced by expanding order backlogs, accelerating cloud revenue growth, and greater visibility into future revenue streams. Capital markets are valuing this discipline selectively. For example, Microsoft's post-earnings increase in market value represents the largest single-day market capitalization gain ever recorded by a public company, driven by accelerating Azure growth and a clearly defined path from investment to returns. In contrast, Meta experienced a decline in share price despite strong top-line growth, as investors questioned the clarity of its monetization strategy. This difference indicates that capital is becoming more discerning regarding the AI theme, rather than more skeptical. Additionally, technology sector valuations relative to the wider index remain below their five-year average on a forward price-to-earnings basis, suggesting further potential for multiple expansion as confidence in monetization increases.

Oil prices decline as manufacturing activity accelerates.

On the geopolitical front, ongoing reports regarding continued access to the Strait of Hormuz have alleviated concerns about a severe energy supply disruption. WTI crude prices have reversed much of last month's spike as investors now assign a significantly lower probability to worst-case scenarios. Although negotiations remain fluid and headline risk persists, markets have become less reactive to individual news events and more attentive to underlying fundamentals. I view this shift as a constructive development in risk pricing.

An important development is the U.S. economy's resilience in response to July's oil price spike. The ISM Manufacturing Index reached its highest level in over four years, supported by stronger demand, increased production, and improved hiring. Additional indicators, such as a rebound in heavy-truck sales, robust railroad earnings, and a strong quarter from Caterpillar, confirm that this is a genuine industrial inflection rather than a temporary fluctuation. These trends demonstrate benefits from both the ongoing AI infrastructure expansion and a larger cyclical upswing in traditional manufacturing. For an economy previously considered to be slowing, this amounts to a significant data point.

A labor market that is moderating, not collapsing

July's employment report conveyed a narrative of moderation rather than overheating, and the market's reaction to it revealed a great deal about where investor priorities currently sit. Payroll growth came in well short of expectations, and meaningful downward revisions to the prior two months' figures confirm that labor demand has been softer than formerly understood. The decline in the headline unemployment rate to 4.1% should not, in my view, be read as a sign of fundamental strength. It largely shows a shrinking labor force — participation has fallen to its lowest level since 2021 — driven by slower immigration flows, an aging population, and a series of retirements rather than robust hiring absorbing new workers.

Despite the weaker headline figures, equities rallied following the report, indicating the typical dynamic where negative economic news can be interpreted positively by markets. The combination of softer labor data and the slowest wage growth in nearly five years has significantly reduced inflation concerns. As a result, bond markets have lowered the probability of a September rate hike to below 50%. However, I caution against assuming this outcome is certain. Upcoming inflation data will likely play a decisive role in the Federal Reserve's decision, and a higher-than-expected reading could quickly alter market expectations.

In my assessment, the wider context is a labor market distinguished by both low hiring and low firing, resulting in limited dynamism. Nevertheless, this environment is consistent with continuing economic expansion and, importantly, does not appear to be generating wage-driven inflation pressures which would necessitate further tightening by the Federal Reserve.

Should investors worry about buying at record highs?

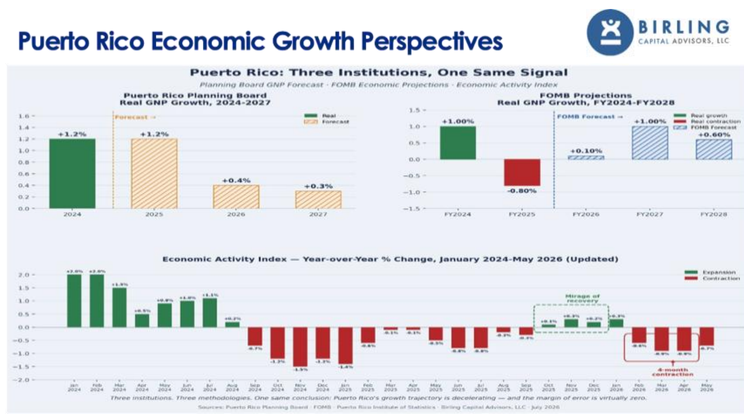
A natural question after any breakout to new highs is whether it is a sound entry point, or whether waiting for a pullback makes more intuitive sense. Average forward three-month returns following a new all-time high do tend to run slightly below the average for a typical trading day — but that gap largely disappears within six months. Over one-, three-, and five-year horizons, average returns following record highs have historically outpaced those following an ordinary trading session.

The rationale is clear: markets achieve new highs as a result of improving fundamentals, not because the upward trend is nearing exhaustion. Record highs typically show underlying strength rather than signaling imminent decline. My consistent advice to clients is that maintaining a long-term presence in the market has historically been more beneficial than attempting to time entry points. Investors who delayed participation in anticipation of a more favorable entry level have generally experienced negative outcomes.

Earnings durability continues to underpin the current market, with breadth confirming the signals already evident in price action. I recommend avoiding over-concentration in any single theme and anticipate ongoing rotation in sector leadership. Our preferences include mid-cap stocks, industrials, and international value for cyclical exposure, as well as communication services and select emerging markets for AI-related opportunities.

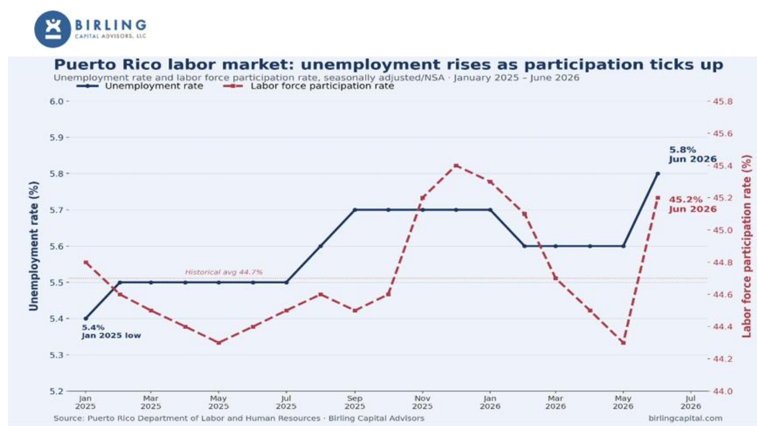
The Final Word: Puerto Rico Economic Update

While mainland markets reach record highs, Puerto Rico's economic forecast remains considerably more mixed. This difference keeps shaping our local investment thesis, which we monitor closely across growth, labor, trade, consumption, and capital markets.



Growth: three institutions, one consistent signal.

The Puerto Rico Planning Board, the Fiscal Oversight Board, and our own Economic Activity Index all point in the same direction — deceleration. The Planning Board's real GNP growth forecast has stepped down from +1.2% in 2024 and 2025 to just +0.4% for 2026 and +0.3% for 2027. FOMB projections tell a similar story: real growth of +1.00% in FY2024 gave way to a -0.80% contraction in FY2025, with a modest +0.10 % recovery penciled in for FY2026 before improving to +1.00% in FY2027 and +0.60% in FY2028. Our Economic Activity Index shows the most granular version of this trend: after peaking near +2.0% year-over-year growth in early 2024, the index spent most of 2025 in outright contraction, briefly touched what we've termed a "mirage of recovery" in late 2025 and early 2026 (+0.1% to +0.3%), and then fell back into a four-month contraction running from February through May 2026, ranging between -0.6% and -0.9%. Three institutions, three different methodologies, one same conclusion: Puerto Rico's growth path is decelerating, and the margin of error is virtually zero.

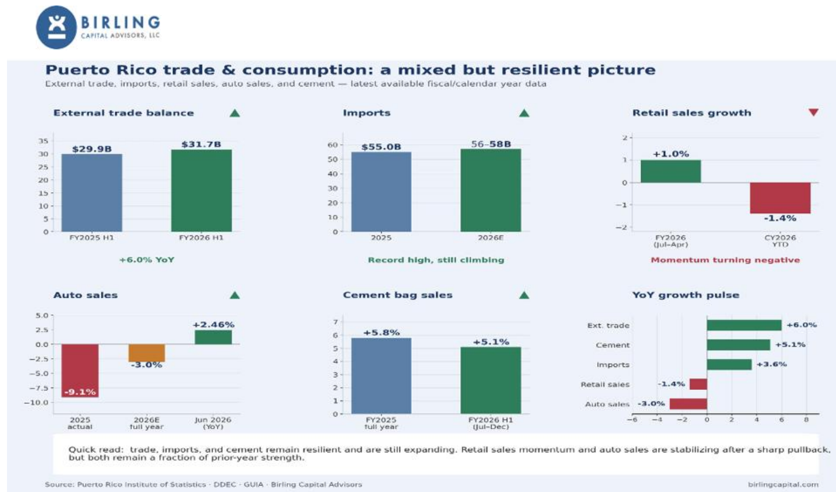


Labor market: the historic lows are behind us.

Puerto Rico's unemployment rate rose to 5.8% in June 2026, up from 5.6% in May — its highest reading since the current expansion began and a clear break from the 5.4% low recorded in January 2025. This is the second consecutive monthly increase after nearly a year of relative stability in the mid-5% range. On the participation side, the news is somewhat more encouraging: the labor force participation rate rose to 45.2% in June, up from 44.3% in May, though it remains within the same tight 44%–45.5% band the island has occupied since early 2025, with a historical average of 44.7%. The combination — rising unemployment alongside a modest participation uptick — suggests more people are entering or re-entering the labor force even as the pace of job creation cools, a dynamic worth monitoring closely heading into the fall.

External trade holding up, imports at record levels.

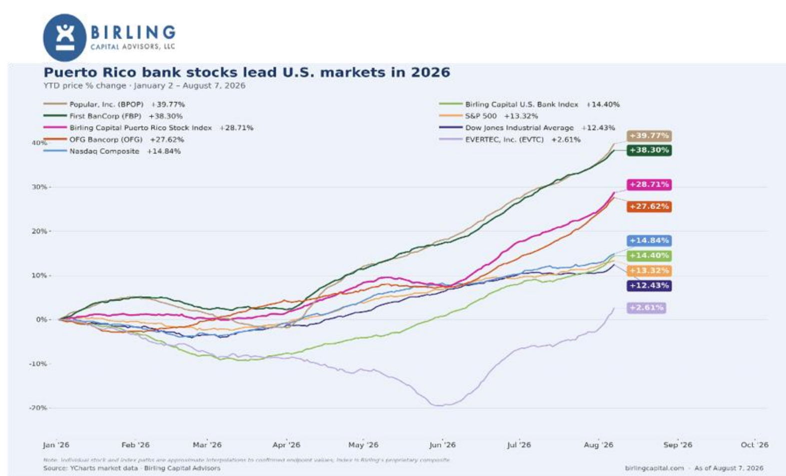
Puerto Rico's external trade balance is still a genuine bright spot. First-half FY2026 trade activity is tracking at $31.7 billion, up 6.0% versus $29.9 billion during the same period of FY2025, continuing a recovery from the $57.9 billion COVID- and earthquake-affected trough in FY2021 toward levels approaching the $71.1 billion pre-hurricane peak of FY2017. On the import side, Puerto Rico's imports reached a record $55.0 billion in 2025, and 2026 year-to-date figures are tracking toward an estimated $56–58 billion — continued growth that reflects sustained consumption and industrial demand even as broader growth indicators soften.



Retail sales: momentum turning negative.
Puerto Rico's retail sector closed 2025 at $52.4 billion, up 2.3% and a nominal high — but that momentum has since reversed. Calendar year-to-date 2026 sales have fallen 1.4% to $16.7 billion, with April posting the steepest monthly decline at -2.2%, driven primarily by weak vehicle and gas station sales. Fiscal-year 2026 sales (July through April) remain positive at +1.0%. Still, that cushion is narrowing quickly as monthly momentum continues to turn negative — a trend we're watching closely as a leading indicator of consumer health heading into the back half of the year.

Auto sales: the freefall is decelerating.
Puerto Rico's vehicle market closed 2025 down 9.1% to 113,289 units, and 2026 opened even weaker, with sales through April down 21.9% and April alone collapsing 27.3%. But June broke that pattern decisively, posting the industry's first year-over-year gain in thirteen months, up 2.46% to 8,738 units. GUIA (Grupo Unido de Importadores de Automóviles) now projects a milder full-year pullback of roughly 3%, to approximately 107,000 units, versus earlier fears of a much steeper decline. Within the H1 2026 data, electrified vehicles are up 19% year-to-date, hybrids specifically up 27%, and June saw medium/full premium sedan sales jump 94.1% — evidence that even in the midst of a broader pullback, certain segments are exhibiting genuine strength.

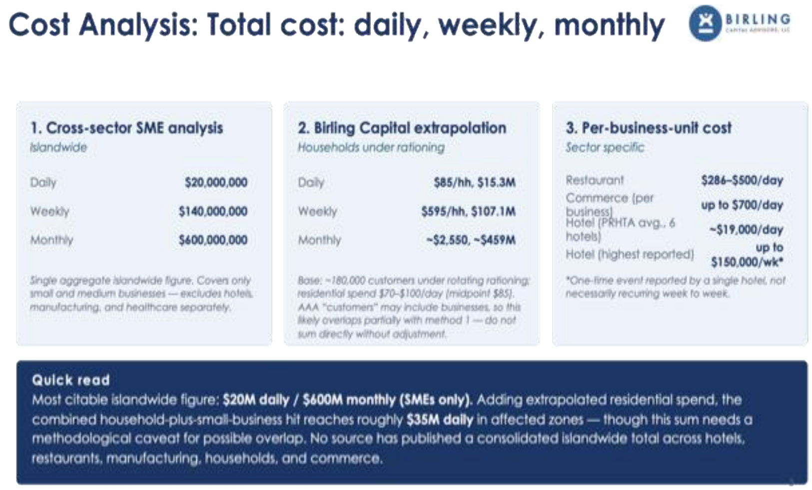
Cement sales confirm a construction recovery.
Puerto Rico cement bag sales totaled 15,184,000 bags in FY2025, up 5.8% from FY2024's 14,355,000 — the strongest complete fiscal year since the FY2021 post-reconstruction peak of 16,290,000. FY2026 opened even stronger, with the first half (July–December) posting 7,675,000 bags, up 5.1% over the same period a year earlier. Combined with the auto sales stabilization, this points to underlying construction and infrastructure activity holding up better than the wider growth indices would suggest.



Birling Capital Puerto Rico Stock Index: The leading performer.
As of August 7, 2026, our Birling Capital Puerto Rico Stock Index is delivering a year-to-date return of 28.71%, more than double the Dow Jones Industrial Average's 12.43% over the same period, and comfortably ahead of the S&P 500's 13.32%, the Nasdaq Composite's 14.84%, and our own Birling Capital U.S. Bank Index at 14.40%. Individual components continue to drive that outperformance: Popular (BPOP) leads at +39.77%, First BanCorp (FBP) follows closely at +38.30%, OFG Bancorp (OFG) is up 27.62%, and Evertec (EVTC), which spent much of the spring and early summer in negative territory — falling as much as roughly 25% below its starting level before a sharp late-summer recovery — is now up 2.61% year-to-date. This continued strength in our locally traded banking names, even against a backdrop of decelerating island-wide GNP growth, underscores a theme

we've emphasized repeatedly: Puerto Rico's public company performance along with its broader macroeconomic trajectory are not moving in lockstep, and credit quality at the bank level has so far proven more resilient than top-line growth indicators would suggest. Notably, our Puerto Rico Index's advantage over the mainland U.S. bank benchmark has widened further—local banks are not simply riding a broader financial-sector rally; they are meaningfully outperforming their mainland peers.

The water crisis: a governance failure with a real economic price tag.



Beyond the standard financial indicators, Puerto Rico is contending with a genuine infrastructure emergency that carries direct financial consequences. San Juan just recorded its driest July in 120-plus years, with roughly 25% of the island under severe drought and another 36% under moderate drought. But this is not simply a weather story — 59% of all treated water is lost before it reaches customers, a chronic pattern of leaks, theft through inaccurate metering, and deteriorated pipes that has endured for 19 years. A 2019 ASCE report gave the island's drinking-water infrastructure a "D" grade, and updated estimates now put the cost of fixing systems serving 96% of the island at $3.9 billion. AAA has placed more than 180,000 customers in San Juan and six additional municipalities on rotating 48-hour rationing beginning August 7, 2026, and repeated failures in the Superaqueduct of the North since June 10 have left over 100,000 customers without potable water across San Juan, Bayamón, Guaynabo, Isla Verde, and Caguas — striking the island's most iconic tourist corridors directly. The economic cost is significant and multi-layered. Our assessment estimates the crisis is costing small and medium businesses island-wide more than $20 million per day, or roughly $600 million per month, concentrated in hard-hit municipalities including Canóvanas, Río Grande, San Lorenzo, Comerío, Loíza, Cidra, San Juan, Guaynabo, and Bayamón. Layering in extrapolated residential spending — households under rationing report spending $70–$100 daily to secure water, against a base of roughly 180,000 affected customers — pushes the combined household-and-small-business hit toward $35 million daily in impacted zones. However, we'd caveat that figure given likely overlap between the two methodologies. By sector, restaurants report spending $2,000–$3,500 weekly on tanker trucks; some hotels report spending up to $150,000 to secure supply, with a PRHTA survey of just six properties finding roughly $800,000 in one week's water spending alone, and six to seven small hotels forced to close outright; and roughly 50 manufacturing operations in the Carolina and Canóvanas corridor — including Eli Lilly Industries, Omega & Delta Co., and PPG Puerto Rico — are absorbing added costs to maintain independent cisterns as contingency measures.

The reputational dimension concerns us as much as the direct cost. PRHTA Board has warned that the disruption threatens the viability of the island's tourism and commercial operations, and historically, basic-service crises in Puerto Rico have triggered cruise-ship cancellations worth up to $439,000 each. For institutional investors, an island unable to guarantee running water — layered atop years of energy and fiscal crisis — reinforces the same infrastructure-risk theme that has weighed on Puerto Rico's cost of capital and its country-risk perception among insurers, rating agencies, and institutional funds. International coverage from NPR, the Washington Post, AP, and Circle of Blue has framed this explicitly as a chronic governance and maintenance failure rather than an isolated climate event — and that framing matters. Reservoir dredging has been discussed for decades, always resurfacing during a crisis, and then quietly dropped once the immediate pressure eases.

That pattern — crisis, media attention, promises, inaction — is precisely the kind of institutional signal we track in our Government Progress Index and Energy & Institutional Index frameworks, and it remains, in our view, one of the more underappreciated risks to Puerto Rico's investment climate heading into peak tourism season.

"Economies do not diverge by accident; they diverge when leadership treats infrastructure as an afterthought and performance as optional. Puerto Rico's banks prove what discipline can build. Our water system proves what neglect can break".
— Francisco Rodríguez-Castro, President & CEO, Birling Capital Advisors, LLC

BIRLING CAPITAL ADVISORS, LLC
Francisco Rodríguez-Castro, President & CEO • frc@birlingcapital.com
PO Box 10817 San Juan, PR 00922 • 787.247.2500 • 787.645.8430