Renaissance®
Investment Management
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Market Update

The Market's Next Growth Story: Free Cash Flow

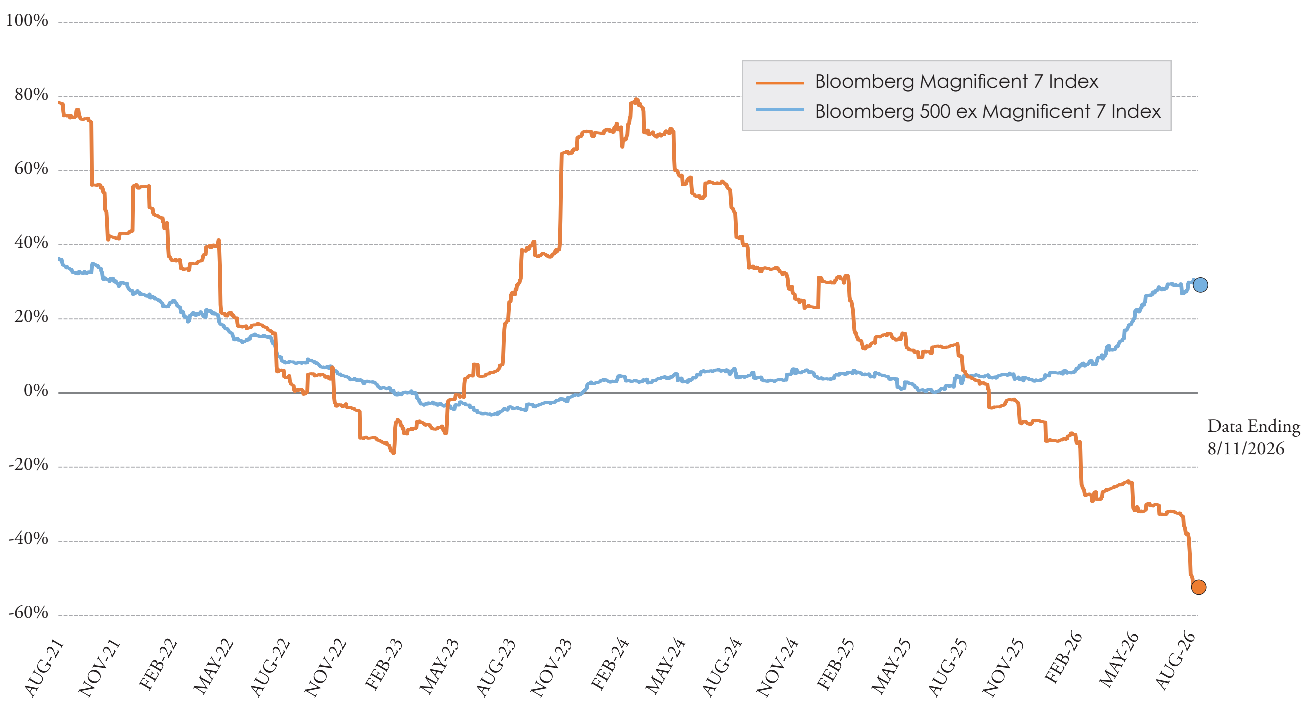
With all S&P 500 companies having reported earnings through the first half of the year, it is safe to say that earnings growth for the overall market has been extraordinarily strong. While stocks in every economic sector have reported robust growth, Technology stocks have accounted for much of the gains. For calendar year 2026, S&P 500 earnings are now expected to surge 32%, more than double the 15% growth that was expected at the start of the year.

While expectations for future earnings growth remain high, expectations for future growth in free cash flow vary widely. The Magnificent 7 stocks have historically produced huge levels of free cash flow due to their highly profitable, capital-efficient business models. However, over the past 18 months the AI/Data-center capital spending boom has substantially reduced free cash flow growth, as capital expenditures absorb a greater share of operating cash flow and several companies increasingly tap the debt markets.

In contrast, expectations for the rest of the market are for strong growth in free cash flow over the next year, as earnings growth broadens dramatically. Many companies outside of the Magnificent 7 are beneficiaries of the AI capex boom, such as those in electrical equipment, power generation, engineering construction, HVAC/cooling, semiconductors, and industrial automation industries, among others. AI investment may be pressuring the free cash flow of the largest spenders while simultaneously creating revenue, earnings and cash flow opportunities across a much broader group of companies.

DIFFERENCES IN FREE CASH FLOW GROWTH

Estimated Free Cash Flow Growth—12 Months Forward



Data from 8/11/2021–8/11/2026
Source: Bloomberg

The fundamental backdrop for broader stock market leadership continues to improve as the free cash flow outlook strengthens across a wider range of companies. We believe that a disciplined approach toward identifying high-quality companies with improving cash flows and strong growth profiles is likely to result in good relative returns going forward.

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REFERENCED INDICES

(Indices are unmanaged and are not available for direct investment.)

Bloomberg 500 ex Magnificent 7 Index— The Bloomberg 500 ex Magnificent 7 Index is a rules based, float market capitalization-weighted benchmark that tracks the 500 largest United States companies, excluding the Magnificent 7 stocks: Nvidia, Microsoft, Apple, Alphabet, Amazon, Meta, and Tesla.

Bloomberg Magnificent 7 Index—The Bloomberg Magnificent 7 Index is an equal-dollar weighted equity benchmark tracking a fixed basket of seven mega-cap U.S. technology and growth giants: Nvidia, Microsoft, Apple, Alphabet, Amazon, Meta, and Tesla.

S&P 500 Index—The S&P 500 Stock Index is a market capitalization weighted index and consists of 500 stocks chosen for market size, liquidity and industry group representation.

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