QUARTERLY REVIEW

June 30, 2026

Q2 Economic and Market Commentary

The second quarter saw the equity market gain an impressive 15.1%, with the increase due to a combination of strong corporate earnings, continued AI enthusiasm, declining oil prices, and a MOU to end hostilities in the Middle East. It also didn't hurt that liquidity was ample as the Fed balance sheet was expanding, and companies received $72 billion in tariff refunds. Although the ceasefire appears to be fragile at best, and kinetic activity is still occurring, the market seemed to look through these geopolitical events. The second quarter delivered one of the most remarkable reversals in recent market history. Brent crude, which peaked above $120 a barrel during the worst of the Strait of Hormuz crisis, and caused recent inflation numbers to move higher, ended the quarter near $73 and pre-war levels as traffic through the strait began to recover. The market, ever forward-looking, moved well in advance of any diplomatic progress, seeming to shrug off all concerns. **In April, the S&P 500 staged its sharpest monthly rally since April 2020, surging 10.5% — only the 13th time in the past 50 years a single month has delivered a gain of that magnitude.** By the end of May, all three major U.S. equity indexes had closed at record highs. With the Q2 gains the S&P YTD return now stands at +10.1%, easily erasing the losses of Q1. The Nasdaq, buoyed by a return to AI enthusiasm and blowout technology earnings, outperformed with a year-to-date gain of 19.9%. The Dow Jones Industrial Average, more sensitive to the energy and industrial complex, lagged with a more modest year-to-date gain of 8.8%. The quarter was, in effect, a vindication of the discipline required to stay invested through volatility.

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The Economy

Q1 GDP came in at a final reading of 2.1%, up from a sluggish 0.5% in Q4 2025. **The impact of AI spending has proven to be the primary driver of growth with AI capital spending estimated to have been 40 – 45% of GDP growth in recent quarters.** The Atlanta Fed's GDP Now forecast has Q2 growing at a roughly similar pace of 2.5%. We expect GDP to grow for the year at a 2-2.2% pace. Inflation has continued to be on an upswing, with CPI at 4.2% year over year, and the less volatile Core CPI at 2.9% year over year. The April Core PCE (the Fed's gauge) printed at 3.3% year over year, well above the 2% target. **The resulting inflation has hit consumers' psyche, with consumer sentiment falling to a historic low of 44.8 in May and then recovering a bit to 49.5 in June as gasoline prices experienced a slight decline.** As gasoline prices continue to fall, we would expect consumer sentiment and confidence to improve. To put these numbers in perspective, consumer sentiment a year ago was 60.7. **It's easy to see why consumers feel the "pinch" because real earnings are only growing at 3.4%, well below the 4.2% CPI, causing most consumers to fall behind.** It appears that rather than taking on more debt, the consumer is relying on savings to bridge the gap, as the Personal Savings Rate has fallen to 3%, down from 4.9% last year and the long-term average of over 8%. The "Big Beautiful Bill" tax refunds that averaged close to $3,700 also helped to offset some of the higher energy costs. The labor market, however, has been a bright spot. After losing 156,000 jobs in February after revisions, jobs rebounded with a gain of 214,000 in March, 179,000 in April, and 129,000 in May. We now have produced 583,000 jobs for the year, and have averaged 111,000 over the past 3 months, well above the sluggish pace in 2025 that was negatively impacted by DOGE cuts in the Federal government. The unemployment rate continues to hold steady at 4.2%. So, while we have a consumer that doesn't necessarily feel great about the economy, they continue to spend as retail sales are up 6.9% year-over-year (inflation accounts for part of that increase). In our opinion it would take a downturn in the jobs market to change that equation, and with waning war concerns, very little immigration, and strong corporate earnings we would expect the jobs market to remain solid.

New Fed chair Kevin Warsh conducted his first FOMC meeting on June 16–17 and held rates steady. In a nod to the higher inflation we have experienced, FOMC participants revised upward the projected Core PCE reading for Q4 2026 from 2.7% to 3.3%, a meaningful hawkish shift — and the median federal funds rate projection for Q4 2026 was revised to 3.8%, up from 3.4% in March. **While we started the year with expectations that rates would be cut in 2026, Fed Funds Futures are now pricing in near-zero probability of rate cuts before year-end, with a growing cohort of traders beginning to assign odds to a potential hike by year-end or early 2027.** While the President would like to see lower rates, the data give Chair Warsh no wiggle room. It also appears that Warsh will stand for an independent Fed, as he clearly stated that bringing inflation down to 2% was a goal that would be accomplished. Another element that we like about the new Fed Chair is that he thinks the Fed has perhaps tried to be too transparent, and as a result markets have focused more on Fed policy rather than true price discovery. We agree with him, and while it might lead to more volatility in markets, we view it as a healthy outcome.

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Market Review

Second Quarter Market Recap:

The Q2 of 2026 was the best quarter for market returns since Q2 of 2020 – need we make you remember the days of COVID! In many ways it was the story of April. **After the S&P 500 bottomed in late March — roughly 9% below its prior highs at the worst of the Strait of Hormuz crisis — the index staged a roughly 14% surge from the lows through the end of April resulting in the strong 10% April gain.** May and June consolidated those gains as a combination of strong earnings, easing oil prices, and diplomatic progress on Iran extended the rally to record territory. The S&P 500's new all-time closing high of 7,610 on June 2nd felt, in retrospect, like the quarter's signature moment — a market that had written off the worst of the Iran shock and was looking ahead to an earnings-driven second half. **And strong corporate earnings have indeed been the critical underpinning of this market.** Approximately 85% of S&P 500 companies beat their Q1 estimates, well above the 5-year average of 78%. Q1 was the sixth consecutive quarter of double-digit earnings growth, and this upcoming quarter will reach 7. **In fact, Q1 and Q2 will both be quarters where earnings grew by over 20%, with Q2 forecasted at +23.1%.** After underperforming the index in Q1, the Tech sector bounced back in Q2 with the group adding 31.8%. Semiconductors were the leader within the sector, as the Philadelphia Semiconductor index gained 88%, reflecting the continued AI optimism and demand for chips. Tech earnings provided the impetus as the group produced Q1 eps growth of 54% with Q2 expected to increase 63%. Industrials were the second-best performer in the quarter, gaining 14.9%. The group is also a beneficiary of the capital spending emanating from the AI boom. With the dramatic drop in oil prices, Energy was the worst performing sector, declining by 13.4%. Recall that in Q1 Energy was the best performing sector, gaining 38.2%. Utilities and Consumer Staples were also laggards at -0.5% and +0.3% respectively as the “risk on” trade bypassed these more defensive categories. A positive take away from Q2 performance was that the broadening of the market that we saw in Q1 continued as Small Caps gained 21.5%, and the equal weighted S&P posted a double digit return in Q2 and outperformed on a YTD basis (+11.5%) versus the S&P.

Stock Market Indexes

Market/Index	Q1 2026 Close	Q2 2026 Close	Quarterly Change Total Return	YTD Change Total Return
DJIA	46,341.51	52,319.20	13.38%	9.76%
Nasdaq	21,590.63	26,213.72	21.60%	13.14%
S&P 500	6,528.52	7,499.36	15.20%	10.19%
Russell 2000	2,496.37	3,024.37	21.57%	22.69%
IEFA	90.53	96.58	8.42%	9.72%

What to Expect Going Forward:

So how do we follow up on such a strong quarter and YTD returns? The market did in Q2 what is hard for most of us to do – and that is strictly focus on fundamentals and sift out the noise that can distract us. **If we go back to 1950, quarters of +10% returns have been followed by median returns over the next six months of +9.6%.** This bull market which started in October of 2022 is now 44 months old and has risen 110%. The average bull market has lasted 59 months and gains 178%. So based on those metrics we still could see further advances. History is on our side. Earnings are strong, and corporate operating margins are expected to hit a record over the next 12 months at 20.7%. **Market returns have broadened and non-tech earnings growth is expected to rival Mag 7 growth by Q4 2026.** Capital expenditures for AI from the large hyperscalers is expected to be $750 billion, driving construction, industrial, and technology spend across numerous areas. One risk of course is if capital spending starts to slow, we would see an impact on both earnings and GDP. **Earnings estimates have been rising and are now anticipating eps growth of 24% for this year, and then another gain of almost 17% in 2027**. Yes, there are plenty of positives but as always, we have numerous risks that must be monitored. First and foremost, in our opinion is the trajectory of inflation, and the pressure that it puts on the consumer. Near term inflation rose as oil prices increased, but we should be past the worst unless the MOU negotiations falter, and the Strait of Hormuz is closed again. Yet services inflation remains high and AI spending is causing shortages of electronic components and power, and it's almost inevitable that some costs will increase as the US attempts to reshore or friend shore manufacturing. Electric utility prices have increased due to data center demand and recently Apple announced price increases on some of their products due to higher memory prices. The trajectory of wage inflation has been down, but with high profits and workers falling behind versus inflation (cumulative real wages negative for 6 years), we wouldn't be surprised to see labor demand a bigger piece of the pie. Of course, the offset to that we would hope is that all the AI spending leads to greater productivity. We hear discussions as to whether the current market is a bubble, and the comparison is made to the dot-com era. We would argue against that point, given that the next 12 months P/E of the top 50 companies today is 33X, versus 45X in March of 2000. Due to strong earnings growth the forward P/E of the market is now 20.1X and just above the 5-year average of 19.9X. This has been an earnings led market and not a valuation expansion. Let's not forget however that we have midterm elections upcoming. **Midterm years' experience the greatest volatility within the 4-year presidential cycle with the bulk of the volatility in the runup to the election. But keep in mind that the S&P has not declined in the 12 months following a mid-term since 1938**. Market fundamentals and historical precedence should indicate further gains lie ahead, but whether optimism is warranted will ultimately depend on the direction of inflation, the cadence of AI capital spending, negotiations with Iran, and the policy course set out by a new Fed chair. We will be monitoring all these items closely and encourage you to reach out with any questions.

Fixed Income Recap and Outlook

US Treasury yields moved higher during the second quarter as investors reacted to the conflict in Iran and the uncertainty surrounding its potential impact on global supply chains and energy markets. Concerns about disruptions in the Strait of Hormuz pushed oil and commodity prices higher, contributing to inflation worries and upward pressure on interest rates. Although the subsequent ceasefire framework and ongoing diplomatic negotiations helped ease concerns, Treasury yields remained above pre-conflict levels.

In addition to geopolitical developments, investors focused on the Federal Reserve and the debut of Chairman Kevin Warsh. The June FOMC statement was notably shorter than under previous leadership, highlighting Chairman Warsh's preference for less forward guidance and a more data-dependent policy approach. The Committee adopted a more hawkish posture, underscoring its commitment to restoring price stability with a unanimous vote. The market quickly reacted by repricing rate expectations, pushing short term Treasury yields higher and increasing the probability of tighter policy in 2026. By quarter end, the 2-year Treasury yield had risen 38bps, while the 10 year and 30 year yields increased 15bps and 4bps respectively.

US economic data showed a notable shift from the first quarter. Inflation measures moved higher, reflecting both elevated energy costs and the continued investment associated with the expansion of AI infrastructure. At the same time, labor market conditions improved with positive job growth and low unemployment. The economy increasingly appears to be operating at two speeds: Strong investment in technology and AI related infrastructure supporting growth, while consumers remain cautious after several years of elevated inflation.

Fixed income spread sectors were relatively resilient despite rate volatility. Investment grade spreads tightened during the quarter, even as issuance reached record levels, supported by the financing needs tied to AI related investment. Agency mortgage-backed securities also performed well, with spreads largely stable as investor demand for spread product remains extremely robust.

The Fed faces a challenging task as inflation is well above their target. Recent declines in energy prices and lower market-based inflation expectations have reduced the immediate pressure for rate hikes. As a result, incoming economic data, rather than geopolitical events, will likely play a larger role in shaping both Fed policy and fixed income market performance in the quarters ahead.