INVESTMENT UPDATE

Another First Half in the Books...

A first half marked by daily shifts in the AI narrative coupled with the tenuousness of the Iran conflict (and the closure of the Strait of Hormuz) nevertheless rewarded the disciplined and patient investor once again. Through an ever changing and fast moving first half, owning a diversified portfolio again proved useful. While few would have expected Energy to lead most of the year, markets pressed higher despite a backdrop of negative media headlines and a constant echo of Tech Bubble comparisons.

While both international equities and gold that carried momentum from 2025 into 2026, each felt a disproportionate impact from the conflict in Iran. While gold was up ~21% prior to the conflict it fell to -7% YTD by quarter-end. The MSCI EAFE also saw a less dramatic retreat but lost momentum as the conflict ensued, moving from +10.1% before the conflict to +9.4% for the first half.

In stark contrast, semiconductor stocks, memory chip makers, Emerging Market equities, and energy adjacent companies (turbines, fuel cells, etc.) each posted tremendous first half gains. Oil-related equities surged during the early stages of the Iran conflict, only to fade as the quarter concluded. What seemed like a daily rotation continued throughout the first half (and could persist a while longer).

Below is a recap of first half results for the market's largest constituents.

	H1 Performance
S&P 500	10.2%
Russell 2000	22.6%
Nasdaq	20.2%
MSCI EAFE	9.4%
Bitcoin ETF	-33.0%
Gold ETF	-7.1%
Bloomberg Aggregate Bond ETF	0.6%

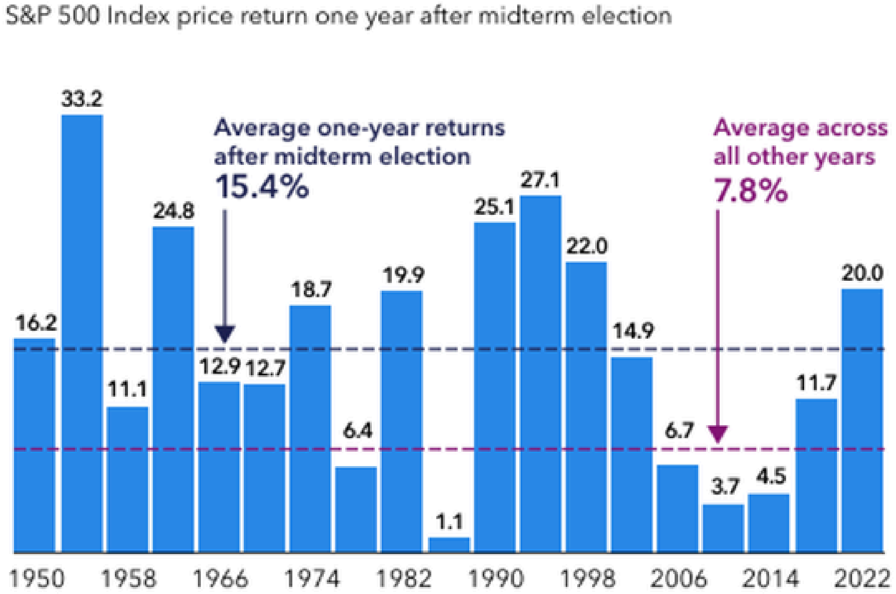
Note that Bitcoin continued to struggle despite positive equity performance. Also noteworthy is the performance of the Bloomberg aggregate bond index. As we will discuss later in the newsletter, **the AGG remains an index we prefer to avoid!** That doesn't imply you should avoid fixed income, just choose more adeptly...***Our fixed income allocations have outpaced it by over 300bp annually over the last 4 years!***

What can we expect in the second half of the year?

As we sit at the year's halfway point, it's logical that one asks himself what could lie ahead in the second half. Below are several of our team's key foci as we enter the back half of 2026:

- Is volatility greater than 20 sustained, and for how long?
- AI Capex and supply bottlenecks...does the "rolling" narrative persist?
- US labor data...is it weakening beneath the surface more than we realize?
- Corporate earnings versus lofty expectations (also guidance about future earnings)
- Do we see further rotation of market leadership away from the hyperscalers? Can indices overcome that with market broadening?

In addition to the list above, we have midterm elections in November and plenty of geopolitical tensions that could spill over into markets to create short bouts of discomfort/volatility. In both instances, we would expect the impact of such scenarios to be limited in both scale and duration. Since the end of the Second World War global conflicts have ceased to cause lasting investor pain unless also accompanied by a faltering economy. We believe durability and resilience of markets will again prevail for now, with further concerns around optimistic earnings expectations in the quarters ahead.



Sources: Capital Group, RIMES, S&P Global. Calculations use Election Day as the starting date in all election years and November 5 as a proxy for the starting date in other years. Only midterm election years are shown in the chart. As of December 31, 2025. Price returns exclude the reinvestment of dividends and capital distributions. Past results are not predictive of results in future periods.

Despite speculation about moves in each direction, we expect the Fed to remain patient and leave rates unchanged in the year's back half. Around each of the second half meetings, however, one can logically expect volatility and market moving headlines that may last like a bad storm: short lived. Never underestimate the market's ability to draw attention to itself. Avoid the temptation "momentum" offers and stay disciplined!

Rather than a lengthy exposé on what could happen in the second half, we believe there's little benefit to guessing during a market such as this. Earnings remain strong and show little sign of slowing. The consumer remains resilient and the Fed remains willing to keep an open mind about inflation. We would expect volatility to be heightened heading into the election but don't anticipate big allocation shifts ahead of it.

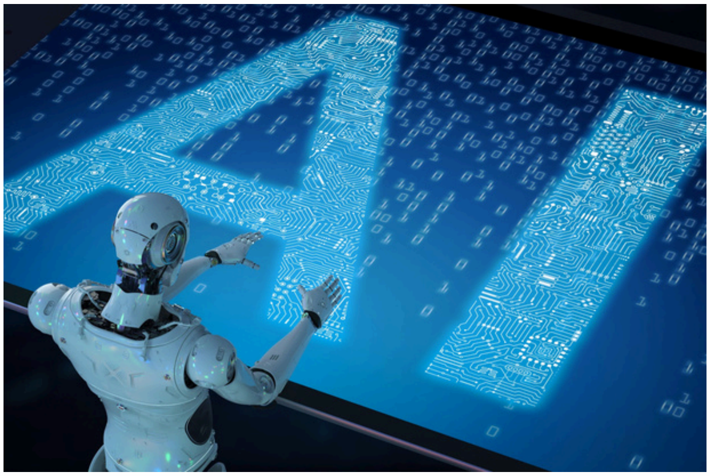
We continue to look to add capital to areas of the market that trade at reasonable prices and that have not been fully appreciated yet. In this mix we would look at US Small caps, EM equities, EM debt, and select exposures in the utility, industrial, and healthcare sectors. ***Today's markets often move fast, too far, and reverse courses before even the most basic analysis can be done. Chasing such trends is called trading, not investing!*** Avoid the temptation to chase trends, stay disciplined, and stay attune to what could change quickly.

AI ecosystem

Keeping up with the seemingly daily evolution of the AI narrative is a full-time job. Morgan Stanley recently summarized it this way: “The bottleneck migrates up the supply chain: first chips, then power, then memory, then networking, then cooling. Each migration turns yesterday's commodity into tomorrow's scarce asset. The semiconductor story is no longer about who makes the best chip. It is about which layer of the supply chain becomes indispensable next. For investors, identifying that layer before consensus is the opportunity.” Fast-moving is an understatement!

So far in 2026, attention has focused heavily on software disintermediation, the surging demand for memory, the pace of data center buildouts—and the political and social resistance to them—and potential IPOs from two of AI’s most important players: OpenAI and Anthropic. Both companies have explored going public before year-end, though OpenAI may delay until 2027. The recent success and subsequent reset of SpaceX have left investors eager for these new entrants while uncertain about their near-term prospects.

During the first half we saw multiple AI companies stock prices increase by over 200%. That's both spectacular and extremely abnormal. It is data like that that elicits comparisons to the Tech Bubble era. Rarely does the week go by without an accomplished billionaire investor coming out to predict the doom of the AI investment phenomena or the markets in general. Many have drawn parallels to the late 1990s while also acknowledging equally remarkable differences. To us, following corporate profits is the most logical starting point for evaluating who may be “right.” It is our view that the greatest disconnect between investors and markets is that the only consensus losers are software companies. ***We believe active, selective, and properly scaled exposures are essential to navigating what lies ahead.***



If one simply revisits two previous eras, parallels will show clear evidence of a broader set of winners and losers. Let's begin with the personal computer era of the early 1980s. The PC was TIME magazine's Person of the Year in 1983. Incredible! When one harkens back to the dominance of Tandy, Commodore, IBM, and later Gateway. and Compaq it's easy to see that first movers and dominant players couldn’t sustain that success indefinitely. Being early can certainly offer an advantage but leadership, capital allocation, and partnerships weigh heavily on the end results.

Fast forward to the oft-referenced ERA of the late 1990s and the Internet Revolution. While the era sported Titans like Microsoft, Cisco, and IBM among its top ten largest companies, only recently did Intel and Oracle make headlines in a positive way. Others among the list were acquired or simply faded away. Out of that era, names in their infancy at the time like Google and Amazon rose to prominence. As the bubble burst in early 2000, it was names like Walmart, Procter & Gamble, and Johnson & Johnson that investors turned to.

Today, it is logical to assume META, MSFT, GOOG, and AMZN will unequivocally be among the AI arms race winners. But will the market support 4, 5, or 6 separate ecosystems? Do you remember the HD-DVD vs. Blu-ray or Netflix vs. Blockbuster battles? What seemed obvious often fails to turn out as expected. While each of the behemoths runs a diversified business, is led by remarkable people, and has a spectacular balance sheet today, it is likely that the AI capital spend for AI will eventually weigh on one or more of these giants as the market consolidates. ***It's prudent to keep an open mind!***

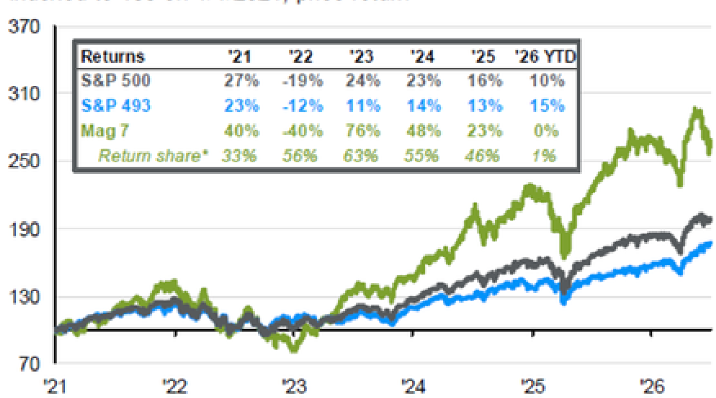
It seems implausible today, but could the biggest AI winners be companies that aren't even household names yet? Few investors were familiar with Bloom Energy (BE), Marvell (MRVL), Coherent (COH), or ASML two short years ago. NVIDIA was a graphics supplier in the gaming industry less than five years ago. We believe it is essential to remain objective and willing to move away from our base thesis if a more plausible one emerges. As the saying goes, never marry any stock!

Magnificent 7…still?

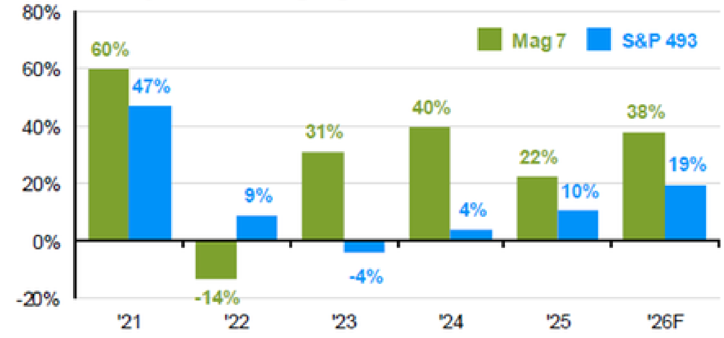
So, is this the death of the magnificent 7? First, the acronym, while catchy, causes more confusion than anything. The Mag 7 or FAANG or FAANGMA had no relevance to a professional evaluation of companies. The common threads of these cohorts are size and success… nothing more. Tesla has little in common with Meta and so forth.

Magnificent 7 performance in the S&P 500

Indexed to 100 on 1/1/2021, price return



Year-over-year earnings growth

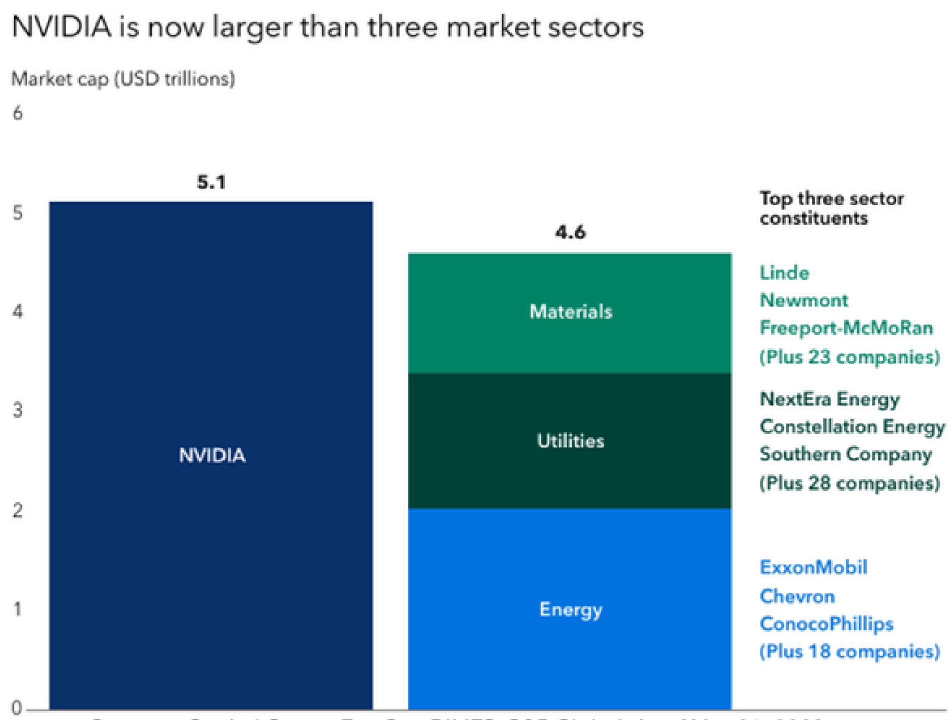


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Magnificent 7 (Mag 7) includes AAPL, AMZN, GOOGL/GOOG, META, MSFT, NVDA and TSLA. The S&P 500 ex-Mag 7 (S&P 493) is calculated by backing out a weighted average Mag 7 price return from the S&P 500 price return. *Return share represents the Mag 7's contribution to the index return. Past performance is no guarantee of future results.
Guide to the Markets – U.S. Data are as of June 30, 2026.

Nonetheless, these 7 names comprise a weighting of well over 30% in the S&P 500, Nasdaq 100, and Russell 100 Growth indices. For some time, we have advocated a smaller allocation to this cohort in favor of a greater allocation into three primary areas:

- Other growth companies who are essential to the AI complex, nearshoring, defense, digitalization, cybersecurity, etc.
- Cheaper and growing segments of the US markets (small cap, industrials, companies underrepresented in broad indices)
- Non-us equities (cheaper assets, growing market shares, government support, and providing essential services that are not easily replicated in the US)

A recent review of our large cap managers found more than 10% underweight the constituents in the Mag 7. Some own a smaller than index percentage to each of the names, while a couple of managers own only one or two at all. We believe active, thoughtful, and objective deployment of capital will be rewarded in the months and years ahead. Even if all members of the Mag 7 fare well, we believe there's a high probability that dozens of other companies will post larger gains that any among this cohort. The chart below is anecdotal evidence of the concentrated bet the markets have made over the last few years. As mentioned earlier, it's rather easy to make a case to own…but don't "marry" them.



Sources: Capital Group, FactSet, RIMES, S&P Global. As of May 31, 2026. Companies shown are the three largest in their respective sectors within the S&P 500 Index. Caterpillar is the S&P 500 Index industrials sector's largest company by market capitalization.

Playing Defense

To borrow a football cliche, defense wins championships.Up markets are awesome while choppy and down ones often wreak havoc on investors, both financially and emotionally. It's been a while since a drawdown lasted more than 1/4, but one is wise not to ignore the possibility always exists. Bear Markets often begin innocently and evolve into something far longer lasting and more painful.

Herein lies one of the greatest challenges of the 21st century for investors. How does one play defense in today's market? Historically, government bonds, gold, real estate, and alternative strategies were seen as defensive assets during large, sustained equity drawdowns. Government bonds may be one of the worst investments an investor can make today, while real estate just saw a 50% increase over the last 5+ years. Gold posted one of its most impressive years ever in 2025, led by insatiable retail demand and steady central bank buying. So far 2026 has not seen a follow-through of that trend.

So, how do we propose playing defense today? First, we believe **reducing concentration** is a minimum first step. Beyond that, owning a greater allocation to out of favor or less optimistically priced equities offers a **margin of safety**. From there, solutions can include structural hedges such as buffer ETFs, cash flow generation from strategies like covered calls and put-writing strategies. An active allocation that works for today's market conditions includes managers who aren't constrained by arbitrary "style boxes." We recognize that the idea of active management has been scorned by many during a nearly 20-year rising market, but we firmly believe the story is far from over.

Ask yourself, how does an index play defense? Therein lies the greatest case for active allocation and security selection.

Finally, defense is not something that can be adopted or implemented "when it's needed." It must always be a central part of an allocation. If you've ever heard the anecdote "you can't time the markets" this is the referenced concept. While the specific sizing and components will change and markets evolve, ***we believe defense is non-negotiable.*** After a crisis, like that of 2007-09, the size allocation committed to defensive equities should logically be trimmed. As markets approach all-time highs and new narratives are developed to support higher valuations, a higher weight to defensive assets is appropriate.

The toughest part is the waiting. As a famed hedge fund manager recently stated in a CNBC interview, "Liquidity always beats valuation.The market can be completely detached from reality and a bubble can stay stretched way longer than you can stay solvent." Bubbles are not formed overnight nor do they burst just because the "math" doesn't align well with logic. If defensive components are scaled properly, they will also be allocated more heavily "early" rather than late. As you've heard us say before. It's far better NOT to have to adjust your direction in the middle of a storm. Stay focused, disciplined, and don't subscribe to the narrative "it's different this time."

Lessons from 70+ years of managing client assets

1. Losing has a greater long-term impact on client outcomes and mindset than winning does.
2. Markets go up at times when it may make little sense and for reasons that are hard to justify. Likewise, markets can fall for reasons that are only clearly understood in hindsight.
3. Economists and Federal Reserve officials know little more about future market directions than you and I.
4. Earnings matter a lot! (yet the media focuses on everything but earnings most of the time)
5. Just because it's consensus doesn't make it correct.
6. If you can't understand it or the math doesn't "math" take a pass... there are plenty of ways to win, but it's difficult to overcome unnecessary losses.
7. Compounding is remarkable period from the beginning of my career in 1981 to today the market is up more than 50X!
8. Few investors regret taking a profit whereas many poor decisions began with tax savings in mind.
9. Regardless of how exciting an opportunity may be, outsized investments and a single opportunity can lead to unintended consequences
10. Irrespective of how boring it may seem, discipline, diversification, and defense help create the highest probability of long-term success for investors.

Some investors look upon the horizon and see nothing but exciting opportunities ahead. For others, it feels inevitable that the next episode of market chaos must be around the corner. Who's right is unknowable! Our team's responsibility is identifying both the up and downside risks and calibrating risk in portfolios according to market conditions and your needs. ***We believe 70 years of experience gives us an edge in both avoiding temptations of the market and maintaining discipline when others lose focus.*** We are committed to using our full suite of tools to navigate the fast moving and ever-uncertain investment landscape. We will remain focused and disciplined in the face of whatever markets "throw" our way.Thank you for your trust in us!

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