



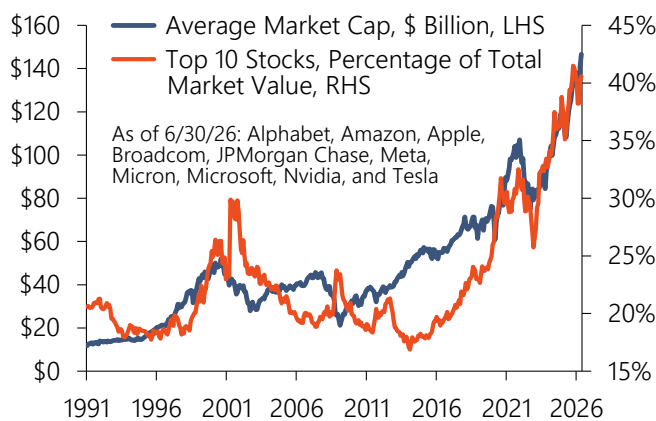
Key Points

- From Oil Shock to AI Boom; U.S. Economy Proves Resilient as Risks Linger
- China's Exports Soar, but Stop-Start Stimulus Restrains Domestic Demand
- ECB Tightens Into a Stall; Post-Shock Recovery Hinges on a Fragile Peace
- Fed's Communications Shift Points to Higher Market Volatility Ahead
- Summer Municipal Bond Performance Tends to Be Seasonally Strong
- Broadening Equity Market Leadership Favors Financials and Capital Goods

In Focus: Record Concentration Nearing a Peak; Broadening to Reward Active Management

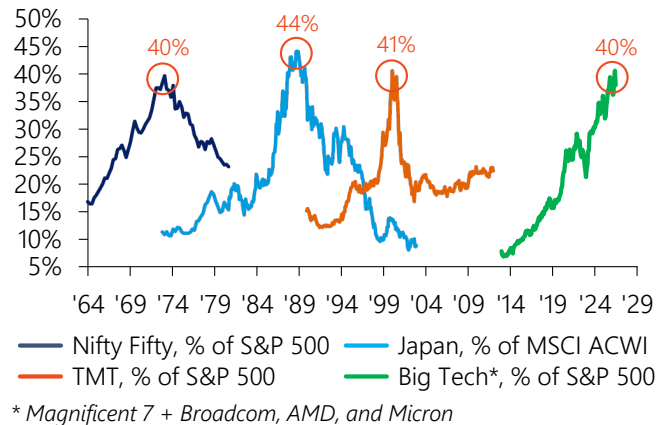
1 S&P 500 Index Increasingly Top Heavy

S&P 500 Index Market Capitalization and Concentration



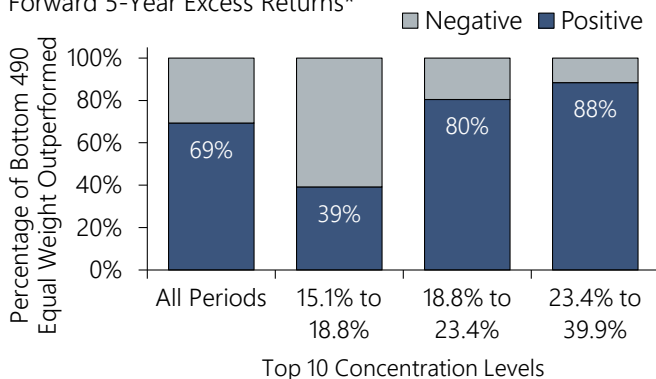
2 Concentration Reaching Historical Limits

Historical Market Concentration by Investment Theme



3 Higher Concentration = Likelier Broadening

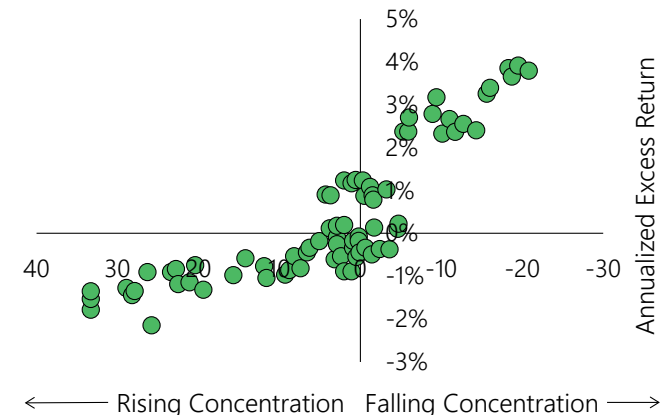
Bottom 490 Relative Performance by Concentration Level Forward 5-Year Excess Returns\*



\*Bottom 490 equal weight minus top 10 equal weight

4 Active Outperforms as Concentration Falls

3-Year Global Active Manager Annualized Excess Returns



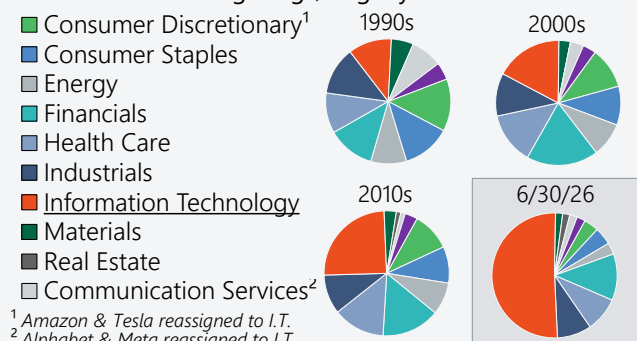
## Equity Concentration Peaks as AI Gains Diffuse

The U.S. equity market has never been this top-heavy. Record top-10 concentration is the natural outcome of the earnings dominance of a handful of mega-cap tech companies, turbocharged by the AI boom, momentum-driven buying, and more than \$2.6 trillion in passive inflows over the last five years. History shows that concentration regimes accompany innovation waves, then fade as the gains diffuse. We believe that concentration is peaking and that the subsequent broadening should reward disciplined, quality-focused active managers.

In 1990, the S&P 500 Index represented a broad cross-section of the economy, with no GICS sector (based on current mapping definitions) accounting for more than 15 percent of its total market capitalization and the 10 largest stocks constituting less than 20 percent. Today, the S&P 500's information technology sector weighting surpasses 50 percent if we reclassify Alphabet, Amazon, Meta, and Tesla. The 10 largest stocks by market value, nine of which we classify as technology, currently make up a record 40 percent of the S&P 500. The tech-heavy Russell 1000 Growth Index is even more concentrated, with 10 stocks constituting over 60 percent of its value.

## S&P 500 Index No Longer a Broad Cross-Section

S&P 500 Sector Weightings, Avg. by Decade and Current



Source: FactSet, 6/30/26

The surge in equity market concentration is the natural consequence of the superior earnings growth profiles of a handful of mega-cap technology firms—it is a feature of market capitalization-weighted indices rather than a bug. The nine tech companies with the biggest weights in the S&P 500 at June-end (Alphabet, Amazon, Apple, Broadcom, Meta, Micron, Microsoft, Nvidia, and Tesla) have grown earnings at a cap-weighted, annualized rate of 26 percent in the last five years, well over twice the aggregate growth rate for the other 491 companies.

By analyzing the common stock returns of companies in the CRSP database, Bessembinder (2018) found that relatively few stocks, or slightly more than 4 percent, of listed companies explain the net gain for the entire U.S. equity market between 1926 and 2016. The remaining

96 percent produced aggregate lifetime dollar gains that only matched those on one-month U.S. Treasury bills. Returns were negative for more than half of the stocks, confirming the importance of portfolio diversification.

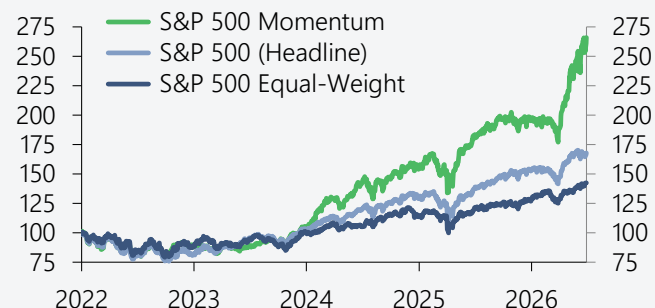
Bye et al. (2026) show that previous episodes of market concentration align with prominent innovation waves. New technologies and economies of scale create a small set of “superstar” firms that capture a substantial share of earnings and market value until creative destruction and diffusion erode their lead. Currently, just 10 stocks account for roughly one-third of the S&P 500's earnings and about 40 percent of its market value, implying those stocks discount additional upside to already optimistic earnings expectations. Still, as the authors note, while valuation concentration tends not to materially outstrip earnings concentration for extended spans, both “move in slow waves rather than sudden bursts.”

Underpinned by the artificial intelligence boom and the “superstar” phenomenon, momentum-based strategies have outperformed significantly since mid-2023. Over the last three years, the S&P 500 Momentum Index has generated an annualized return of 41.6 percent, versus 19.9 percent for the S&P 500 Index and 13.8 percent for the S&P 500 Equal-Weight Index. Investors have piled into AI plays, motivated by attractive opportunities, the fear of missing out, and an upward price surge that has turned skeptics into reluctant bulls. Firms tied to the AI buildout account for almost 45 percent of the S&P 500, leaving it vulnerable to sentiment shifts or AI setbacks.

## The Momentum Trade Went Parabolic in 2Q26

S&P 500 Total Return Indices

Rebased, 12/31/21 = 100



Source: FactSet, 6/30/26

Rising flows into index funds have also lifted U.S. stock markets and, since managers' buys are in proportion to index weights and independent of individual company fundamentals or valuation, discouraged would-be short sellers and reinforced concentration. According to ICI, over \$2.6 trillion has flowed into passive U.S. equity mutual funds and ETFs over the past five years, with net assets rising to \$15.2 trillion (accounting for 64 percent of U.S. equity mutual fund and ETF assets) from \$7.4 trillion. Bloomberg estimates that passive exposure to

the S&P 500 is 28 percent of its market value, a figure that is likely understated due to reporting deficiencies.

### Over a Quarter of the S&P 500 on Autopilot

Total Assets Indexed or Benchmarked to S&P 500 Index  
\$ Million

	2024	Est. Current
Exchange Traded Products	2,272,825	3,328,219
Non-ETPs (Mutual Funds, SMAs, etc.)	6,719,299	8,852,440
Exchange Traded Derivatives	4,006,979	5,261,163
<b>Total Passive Exposure to S&amp;P 500</b>	<b>12,999,104</b>	<b>17,441,822</b>
Actively Managed Funds (benchmarked against S&P 500)	7,161,550	9,045,038
Total Asset Value	20,160,653	26,486,860
Market Value of S&P 500 Index	49,805,003	63,290,864

Source: Bloomberg Intelligence, 6/6/26

The U.S. stock market has posted mean time-weighted annualized returns of 14.4 percent when concentration is climbing and 7.8 percent when it is falling, as concentration and innovation cycles have gone hand in hand. Strong individual stock returns are also well correlated with large passive ownership when the market is rising, as is large active ownership. The key distinction is that active investors are more disciplined, move earlier, and often establish the trend that passive funds follow. Just as passive funds are indiscriminate buyers, they are also indiscriminate sellers—the influence of momentum and passive investing cuts both ways, and often deeply.

Stock market concentration may be verging on practical limits. To qualify for favorable tax treatment under IRS requirements, mutual funds and ETFs must maintain a minimum level of diversification. The “50/5/10 rule” stipulates that at least 50 percent of a fund’s total assets must comprise holdings in which no one issuer exceeds 5 percent of a fund’s total assets and no holding exceeds 10 percent of an issuer’s voting securities. Separately, for a fund to market itself as “diversified,” an SEC rule dictates that the sum of positions greater than 5 percent cannot exceed 25 percent of the fund’s assets.

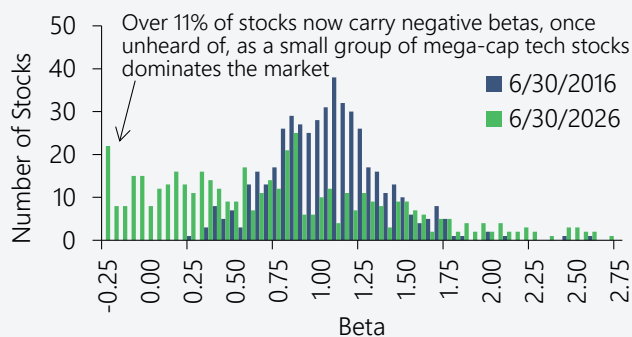
Three issuers (Alphabet, Apple, and Nvidia) in the S&P 500 Index currently have more than 5 percent weight, totaling about 21 percent of its market cap. The Russell 1000 Growth Index has five issuers (Alphabet, Apple, Broadcom, Microsoft, and Nvidia), totaling a whopping 45 percent. Managers may be loath to overweight large index-weighted stocks that risk violating diversification rules, limiting incremental buyers, and contributing to dislocation. At the same time, the profusion of stocks with low index weights restrains a long-only manager’s ability to express negative views on any of those firms.

Not only is total market value concentrated in a handful of stocks, but so is beta. Unlike the late 1990s, when a diverse group of stocks comprised the S&P 500 Index’s top 10, nine of the top 10 are now mega-cap tech stocks.

The cap-weighted beta of those stocks is about 1.28, or 50 percent above the universe median. Since the S&P 500’s beta is always 1.0, the distribution of betas within the index has widened significantly over the past decade to offset the higher beta of the largest stocks. As a result, managers with a high active share outside of mega-cap tech have had a hard time competing in a rising market.

### Betas Fan Out as Mega-Cap Tech Dominates

Distribution of Betas in S&P 500 Index



Source: Bloomberg, 6/30/26

So, where does all this leave us? Market concentration is not going away anytime soon, and is not a U.S.-only phenomenon. Just three AI-affiliated stocks (Samsung Electronics, SK Hynix, and TSMC) currently compose about one-third of the MSCI Emerging Markets Index’s market value and 78 percent of its first-half 2026 return of 24.0 percent. In the U.S., we believe that stock market concentration, or at least the headwind to active management, is peaking. AI will be a very powerful driver of earnings growth for years to come, but the beneficiaries will continue to broaden as it matures and proliferates.

Year to date, price momentum has shifted from the big hyperscalers (Amazon, Alphabet, Meta, and Microsoft—all members of the so-called “Magnificent Seven”) to a broader group profiting from the enormous data center buildout. And, while delayed by the U.S.-Iran conflict, we expect the market to broaden beyond AI as earnings growth differentials narrow. Even though stock market returns have historically been lower, on average, when concentration is falling than when it is rising, it is often an environment in which active managers outperform.

A statistic we highlighted earlier bears repeating: about 45 percent of the S&P 500 Index’s current market value is tied to the AI buildout. For the Russell 1000 Growth Index, the figure is closer to 63 percent, leaving “broad” indices vulnerable to a painful reversal if investors’ high expectations for AI plays are not met. We own many of the leaders in the AI supply chain because we believe in its potential. Nonetheless, we regard portfolios focused on diversification, quality, sustainable earnings growth, and a valuation discipline as best positioned to navigate the ever-evolving macro and equity market landscape.



## Global Macro Developments

### Oil Prices Normalizing, but Fragile U.S.-Iran Situation Keeps Risk on the Table

Brent oil prices, which averaged about \$110 per barrel between March and May, have retreated to near pre-conflict levels as the U.S.-Iran memorandum of understanding has restored partial energy flows. A combination of global emergency stockpile draws, outsized U.S. oil and refined product exports, and the dramatic curbing of Chinese oil imports averted dire predictions of a higher price spike. Still, global inventories have been depleted, and emergency stockpiles need to be refilled. While the resumption of flows through the Strait of Hormuz has been tepid thus far, as shown in Exhibit 1, additional supply is emerging elsewhere. U.S. production is now set to grow moderately, Iranian exports are flowing more freely, the UAE is unconstrained after its exit from OPEC, and Venezuelan production is surprising to the upside. When paired with the existing Strait workarounds, a return to pre-conflict number of crossings may not be necessary to rebalance global markets and sustain oil prices in the more palatable \$60-\$80 range. Even so, a breakdown in U.S.-Iran talks could trigger renewed disruptions, posing a lingering risk.

### Fading Energy Shock Should Revive U.S. Real Income Growth, Buoying Spending

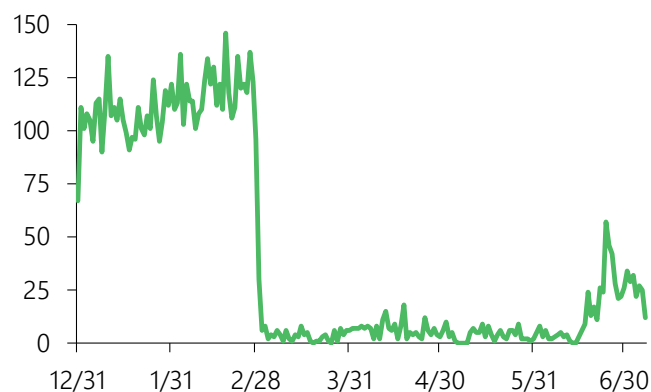
Total IRS tax refunds rose by roughly \$57 billion year over year in the first half of 2026, driven largely by the One Big Beautiful Bill tax cuts. But higher fuel prices alone since the start of the U.S.-Iran conflict have effectively soaked up all of that windfall. Brown University researchers estimate that the rise in gasoline and diesel prices cost U.S. households more than \$64 billion through the end of June, relative to a no-war price trajectory. That figure captures only fuel at the pump and excludes the broader wallet hit from higher energy prices. U.S. retail gasoline prices have dropped by more than 20 percent from their May peak, but remain well above pre-conflict levels. With refining constraints easing, we see prices drifting from the low \$3.80s today toward \$3.00-\$3.50 by year-end, absent new supply shocks. Despite the hit to income growth from higher inflation, overall consumer spending has been remarkably resilient (Exhibit 2). We expect spending growth to ebb modestly into the second half, but a return to positive real income growth, lower savings rates, rising credit, and a favorable wealth effect should provide support.

### Markets Discount U.S. Rate Hikes, but We Think the Fed's Next Move Is a Cut

The ISM price indices, which lead consumer inflation by about 6 months, imply some near-term upside risk to headline figures, but the peak is within sight (Exhibit 3). Given inflation remains well above target, the Federal Reserve may be hard-pressed to cut interest rates soon. In fact, futures investors currently discount two 25-basis-point hikes by year-end. We suspect the Fed will stay on hold, but it may use balance sheet reduction or economic softness as cover for rate cuts later this year. As shown in Exhibit 4, the impact of tariff pass-through will continue to roll off inflation metrics, as should that from the energy shock and AI buildout in the coming quarters, offering a more credible path for further cuts in 2027. Also, the BEA's September 30

**Exhibit 1: Strait of Hormuz Vessel Crossings**

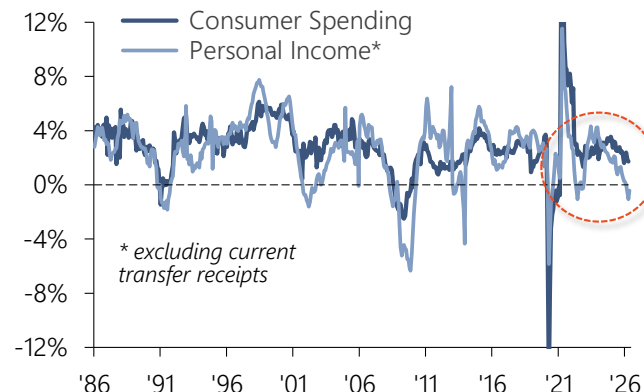
Number of Commercial Ships



Source: Bloomberg, 7/7/26

**Exhibit 2: U.S. Real Income and Spending**

Y/Y Percent



Source: Bureau of Economic Analysis, 6/25/26



methodology revisions to AI-sensitive categories, including software and portfolio management services, could trim core PCE inflation by about 20 basis points. That said, the recalibrated categories are among the leading contributors to core inflation, and any methodology change that conveniently lowers the headline figure will face questions about statistical integrity, even if it is overdue technical housekeeping.

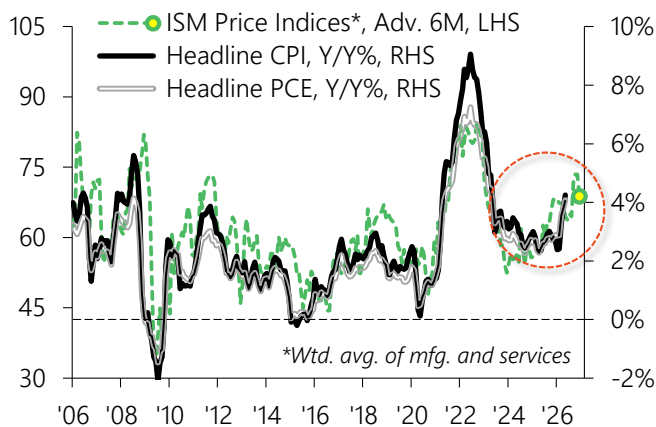
### AI Capex Powers Higher; Broader U.S. Investment Revival Awaits 2027 and Beyond

Capital investment in AI continues to surge, pushing corporate earnings and stock markets ever higher. Wall Street projects that total capex for the five largest hyperscalers (Alphabet, Amazon, Meta, Microsoft, and Oracle) will rocket from \$416 billion in calendar 2025 to \$772 billion in 2026 and \$935 billion in 2027 (Exhibit 5). Still, since data center equipment is largely imported or excluded from the calculation (e.g., semiconductors), the effect on “measured GDP” growth is muted (Exhibit 6). Excluding AI-related categories, real fixed investment has been contracting, but there are some pockets of strength (e.g., aerospace, defense, automation) and green shoots elsewhere. Foreign governments have pledged more than \$5 trillion in U.S.-bound investment, and private reshoring announcements have also been eye-catching, totaling nearly \$1.8 trillion since early 2025. Yet little of that money has hit the ground, suggesting the OBBBA- and tariff-driven capex revival is more a story for 2027 and beyond. But if even a fraction of the promised amounts materialize, the pipeline could support investment growth well into the next decade.

### China's Two-Speed Economy: Exports Surge and Domestic Demand Stalls

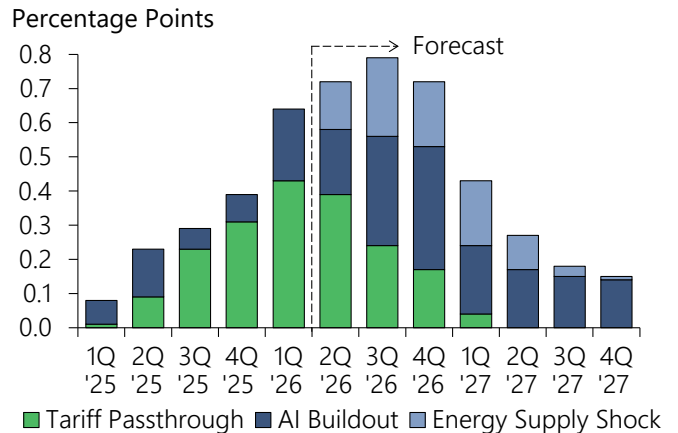
We are sticking with our 4.5-5.0 percent real GDP growth estimate for 2026, even as second-quarter growth slowed sharply to around 4.5 percent year over year, down from 5.0 percent in

**Exhibit 3: ISM Price Indices Versus Inflation**



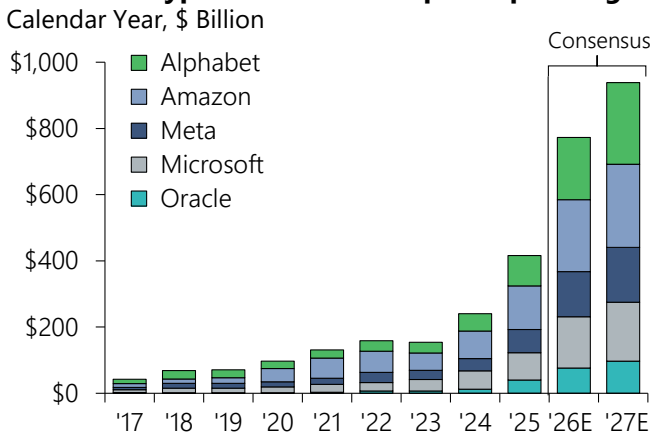
Source: Institute for Supply Management, BLS, BEA, 7/6/26

**Exhibit 4: Contributions to Core PCE Inflation**



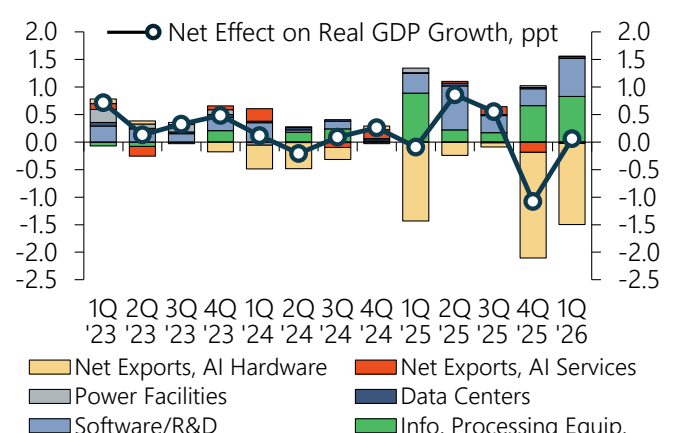
Source: Oxford Economics, 7/2/26

**Exhibit 5: Hyperscaler Total Capital Spending**



Source: FactSet, 6/30/26

**Exhibit 6: AI's Contribution to U.S. GDP Growth**



Source: Oxford Economics, 7/2/26



the first quarter, due to insufficient fiscal spending, a persistent housing downturn, and higher energy prices. April and May data reveal a deepening divide between strong export-led growth and weak domestic demand (Exhibit 7). However, the sharpest deceleration of the year is likely in the rearview mirror. Exports should continue to benefit from the global AI capex cycle and the energy transition, favorable base effects will aid year-over-year comparisons, and below-par first-half fiscal stimulus leaves room for additional support. Even so, a familiar pattern endures: solid economic growth, followed by slower fiscal spending, with easing accelerating only when weak data threatens the government’s full-year growth targets. As Goldman Sachs notes, these stop-start policy shifts undermine confidence; stabilizing consumption and private companies’ willingness to invest requires consistent macro management rather than temporary fixes.

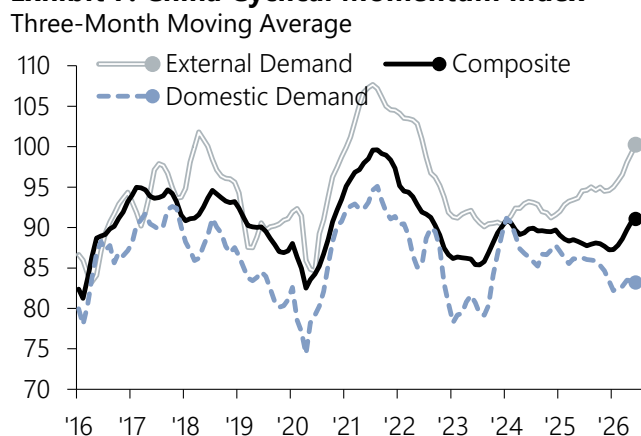
### ECB Hikes Rates for the First Time Since 2023, Even as Euro Area Growth Stalls

The Euro Area finally caught a break, of sorts. The reopening of the Strait of Hormuz has pulled Brent crude oil back below \$75 per barrel, and headline inflation cooled to 2.8 percent in June from 3.2 percent in May (its highest since September 2023). Meanwhile, the European Central Bank increased its deposit rate by 25 basis points to 2.25 percent in June, its first hike in nearly three years, and futures investors assign roughly even odds to another one in September. The interest rate hike comes as the broad economy continues to struggle to gain traction. Euro Area real GDP contracted by 0.9 percent on an annualized basis in the March quarter, its first decline since 2022. However, most of the weakness reflects the payback from the front-loading of Irish pharmaceutical exports in 2025, an issue we flagged in prior outlooks. Excluding Ireland, real GDP grew at an annualized rate of 1.3 percent. The U.S.-Iran conflict took a greater toll in the second quarter, with the composite PMI sinking to an 18-month low in May before recovering to growth-neutral in June (Exhibit 8). Still, we expect a gradual post-shock recovery and now forecast real GDP growth of around 0.8-1.0 percent in 2026, assuming the fragile peace holds.

### Japan Weathers the Energy Shock as Fiscal Stimulus and BoJ Tightening Collide

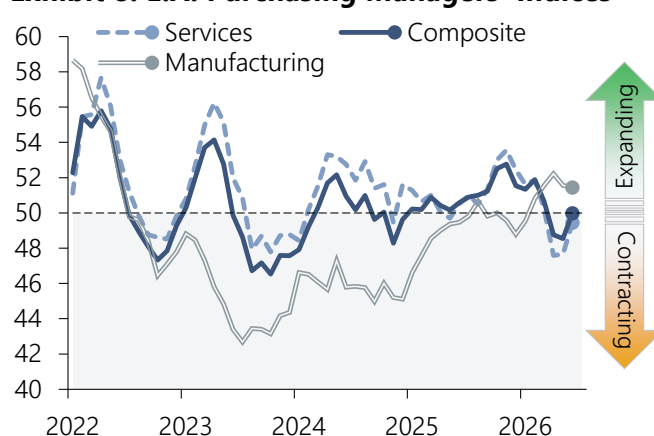
Japan’s economy has thus far withstood the energy price shock, remaining on pace for 0.5-1.0 percent real GDP growth this year. The domestic capital spending cycle is strengthening, real wage growth is firming, and consumption has held up better than expected, thanks to generous fuel subsidies. While it is still early, the feared blow from disruptions in the Strait of Hormuz appears to be fading amid U.S.-Iran talks and the Strait’s reopening. Prime Minister Takaichi’s fiscal spending plans, which include an ambitious growth-strategy spending package and food tax cuts, may further bolster the growth outlook. Yet, inflation remains a concern, and the Bank of Japan (BoJ) appears set to continue its policy normalization efforts after lifting its policy rate to 1.0 percent in June. The BoJ continues to assess underlying inflation as nearing its 2.0 percent target and has highlighted upside risks. Growing friction between the administration’s pro-growth agenda and the BoJ’s tightening cycle is stoking policy tensions and pressuring the yen, compounded by a heavy national debt load. Although we anticipate that policymakers will ultimately manage these pressures, we remain watchful of possible unintended consequences.

**Exhibit 7: China Cyclical Momentum Index**



Source: China International Capital Corporation, 7/3/26

**Exhibit 8: E.A. Purchasing Managers' Indices**



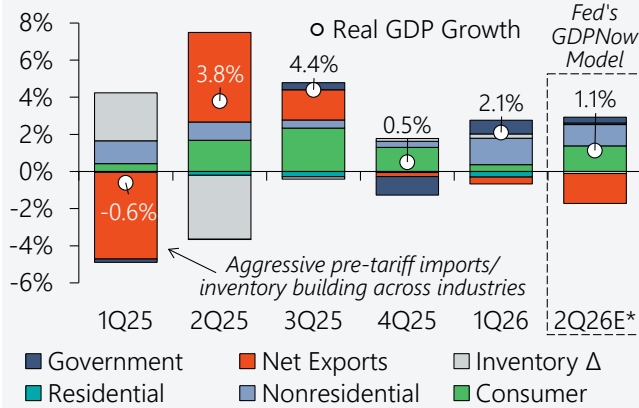
Source: S&P Global, 7/3/26

## United States: Other Notable Data Points

### Net Exports Projected to Be a Large Drag in 2Q

U.S. Real GDP

Contribution to SAAR Q/Q% Change

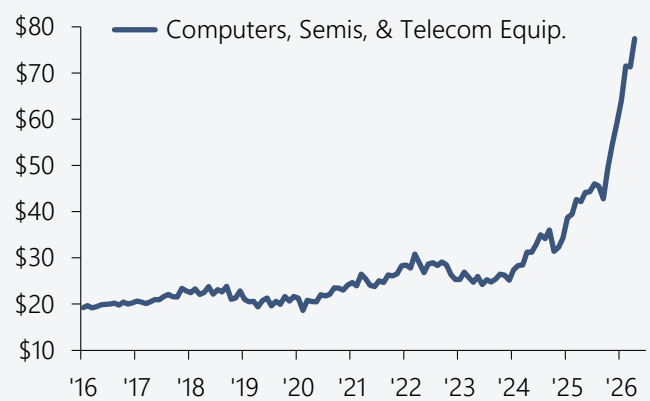


Source: Bureau of Economic Analysis, Atlanta Fed, 7/1/26

### Tech Imports Have Skyrocketed on AI Buildout

U.S. Merchandise Imports

Monthly, Seasonally-Adjusted, \$ Billion

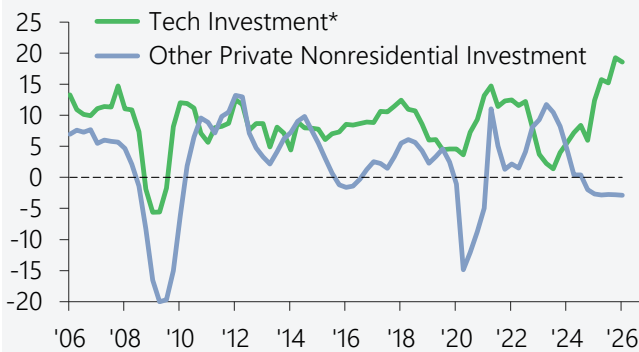


Source: Census Bureau, 6/9/26

### Ex-Tech, Business Investment Is Contracting

U.S. Real Business Investment

Y/Y Percent



\*Software, computers, communication equipment & facilities, electricity infrastructure, and data centers

Source: Oxford Economics, 7/7/26

### Defense: A Pocket of Strength Outside AI

U.S. Manufacturers' New Orders for Defense Goods

\$ Billion, Three-Month Moving Average

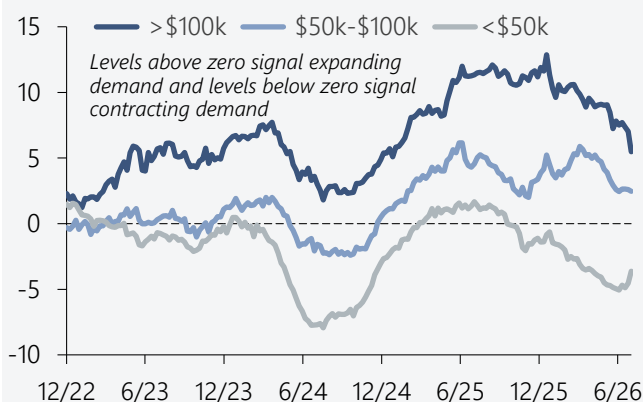


Source: Census Bureau, 7/2/26

### High-Income Demand Continues to Moderate

U.S. Consumer Health Index, by Household Income

Five-Day Moving Average

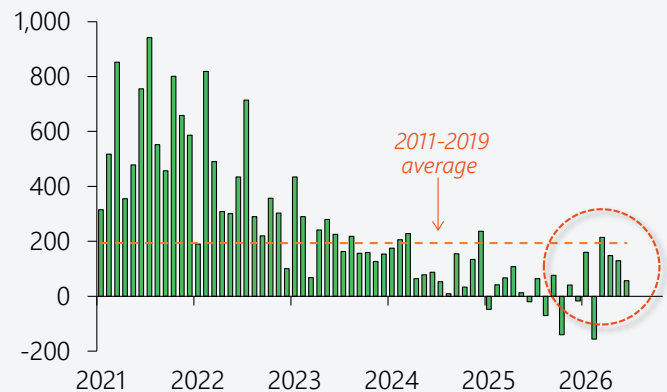


Source: Morning Consult, 7/6/26

### Fading Payroll Growth Keeps Rate Hikes at Bay

Monthly Change in U.S. Nonfarm Payrolls

Thousands

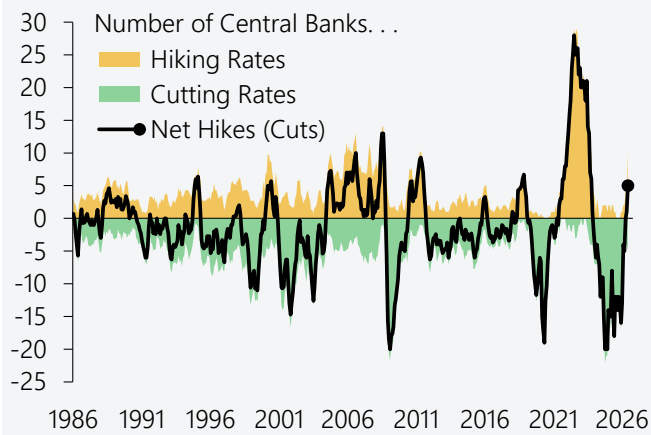


Source: Bureau of Labor Statistics, 7/2/26

## Global: Other Notable Data Points

### Central Bank Rate Hikes Outnumber Cuts Again

Global Central Bank Policy Rate Cycles



Source: World Bank, Bank for International Settlements, 6/30/26

### Easing Peters Out; ZIRP Days a Distant Memory

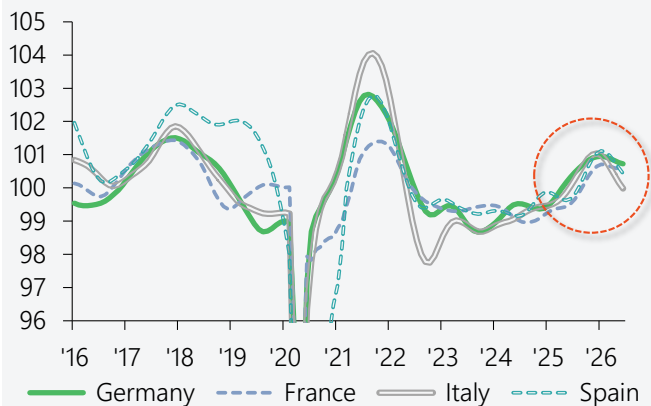
Global Short-Term Interest Rates Weighted by Share of World GDP



Source: FactSet, 6/30/26

### U.S.-Iran Conflict Dents Euro Area Recovery

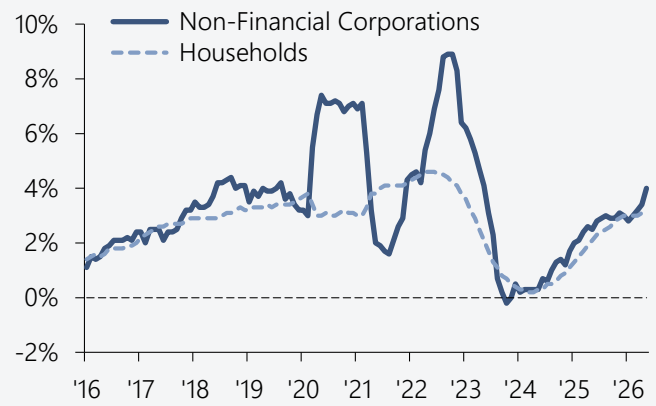
Composite Leading Indicators Amplitude Adjusted, Long-Term Average = 100



Source: OECD, 7/7/26

### But Bank Loan Growth Continues to Rebound

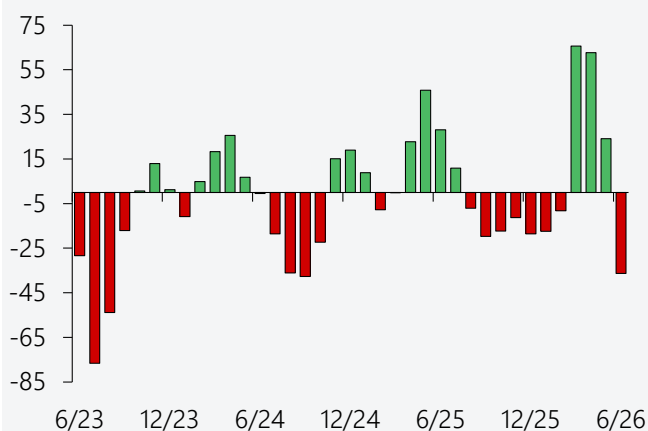
Euro Area Loan Growth Y/Y Percent



Source: European Central Bank, 6/29/26

### China's Data Whipsaw Keeps Markets Guessing

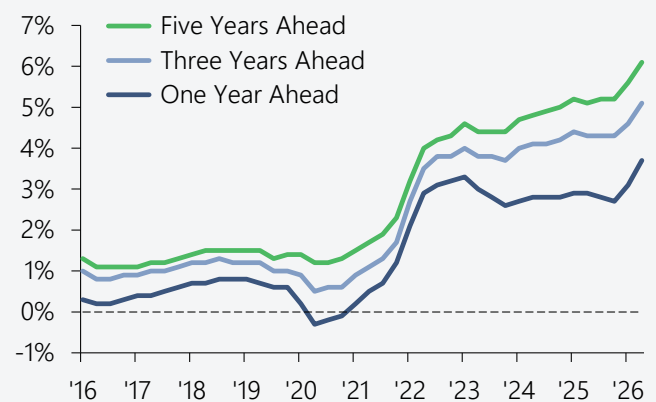
China Economic Surprise Index



Source: Citi Research, 7/1/26

### Price Expectations Back the BoJ's Tightening

Japan Corporate Outlook for Output Prices All Enterprises, % Change Relative to Current Level



Source: Bank of Japan, 7/1/26



### New Fed Chair Scraps Forward Guidance as FOMC Outlook Turns More Hawkish

The Federal Reserve (Fed) has maintained the fed funds target range at 3.50-3.75 percent so far this year, but June's meeting marked the start of a new era under Chair Kevin Warsh. The most notable change is the elimination of forward guidance, reflecting a return to a Greenspan-like approach. Warsh argues that financial markets have become overly focused on anticipating the Fed's response to economic data rather than interpreting it independently, thus reducing the value of market signals to policymakers. At the same time, the FOMC's outlook shifted to a more hawkish stance, with nine members now projecting at least one interest rate hike before year-end, compared with none in March (Exhibit 9). Although labor market conditions have stabilized somewhat, inflation remains stubbornly elevated, partly due to higher energy prices linked to tensions in the Middle East. Warsh reiterated the Fed's commitment to its 2.0 percent target and emphasized that restoring price stability remains a core priority. However, reduced forward guidance will likely amplify market volatility, placing greater responsibility on investors to interpret economic data and the Fed's reaction function.

### Warsh Launches Five Task Forces to Review Core Fed Functions

Chair Warsh also created five task forces to review the Fed's various functions. One task force will assess guidance, press conferences, policy statements, and the Summary of Economic Projections, reflecting Warsh's ambition to rethink how the Fed communicates with investors. Another's focus is the Fed balance sheet, which Warsh believes is too big and should be reduced over time. A third task force will examine improvements to economic data, which have been criticized for their lack of timeliness and frequent revisions, and a fourth will study how AI may affect productivity, labor markets, and inflation. While the Fed's 2.0 percent inflation target is not under review, a task force will also evaluate alternative inflation metrics, including Warsh's preferred one, trimmed PCE. The various reviews are expected to be completed before year-end and could influence the Fed's policy framework and operating procedures for years to come.

### Taxable Fixed Income Strategy

With the 2-5 year segment of the yield curve experiencing the largest increase in yields since the start of 2026, we continue to find this area particularly attractive. Intermediate maturities offer an appealing combination of income and price appreciation potential and should benefit as concerns about more rate hikes fade and the yield curve gradually re-steepens. We remain underweight long-duration bonds, as persistent fiscal deficits, rising Treasury issuance, and mounting federal debt levels are likely to keep upward pressure on long-term yields. Within credit markets, investment-grade corporate bond spreads remain historically tight, supported by resilient fundamentals. We remain constructive on banks, where capital levels and credit quality remain strong, while taking a more cautious view of technology issuers due to heavy debt issuance tied to AI and data center investment. Agency and non-agency residential mortgage-backed securities continue to offer attractive spreads and strong structural credit support. Overall, portfolio durations remain modestly longer than their benchmarks. Our focus remains on generating a meaningful income advantage, which we expect to be the primary driver of long-term outperformance.

### Exhibit 9: Federal Reserve's June 2026 Summary of Economic Projections

Percent	Median				Range			
	2026	2027	2028	Longer-Run	2026	2027	2028	Longer-Run
Change in Real GDP	2.2	2.3	2.2	2.0	1.8-2.6	1.9-2.9	1.8-2.6	1.7-2.5
March Projection	2.4	2.3	2.1	2.0	2.1-2.7	2.0-2.7	1.8-2.7	1.7-2.5
PCE Inflation	3.6	2.3	2.0	2.0	2.7-4.1	1.9-2.8	2.0-2.3	2.0
March Projection	2.7	2.2	2.0	2.0	2.3-3.3	1.8-2.4	1.9-2.2	2.0
<b>Federal Funds Rate</b>	<b>3.8</b>	<b>3.6</b>	<b>3.4</b>	<b>3.1</b>	<b>3.4-4.4</b>	<b>2.9-4.4</b>	<b>2.9-3.9</b>	<b>2.6-3.9</b>
March Projection	3.4	3.1	3.1	3.1	2.6-3.6	2.4-3.9	2.6-3.9	2.6-3.9

Source: Federal Reserve, 6/17/26



## Municipal Bonds Post a Strong Quarter; Issuance Continues at a Robust Pace

The tax-exempt yield curve flattened by 21 basis points in the second quarter, with long-term rates falling further than short-term rates. Municipal Market Data AAA General Obligation yields fell by 28 basis points to 4.19 percent at 30 years and by 7 basis points to 2.35 percent at two years. With municipal yields falling as Treasury yields rose, municipal-to-Treasury yield ratios tightened across the curve. Credit spreads were fairly stable for bonds rated single-A or better, while BBB-rated and non-rated spreads tightened by about 5-6 basis points. Performance was robust, with the Bloomberg Municipal Bond Index returning 2.5 percent, while the 20-year and long-bond sub-indices topped 4 percent, as longer bonds sharply outperformed. Most revenue bond sectors also posted strong returns, led by hospital and housing (Exhibit 10). Despite heavy new issue supply of \$166 billion for the quarter and nearly \$300 billion year-to-date, on pace to exceed last year's record of nearly \$580 billion, demand has kept up, with combined municipal mutual fund and ETF inflows of almost \$60 billion this year (Exhibit 11).

### Tax-Exempt Fixed Income Outlook

The return of income to the bond market, which began in 2022, has been welcome, and we expect this higher level of income to anchor returns going forward. Near-term, we expect municipal bond performance to remain healthy through the summer, which tends to be a seasonally strong period for tax-exempt bonds, given high coupon and maturity inflows and generally lighter supply as the summer progresses. That said, attractive entry points could reappear in the fall, when performance tends to be a bit more volatile due to seasonally higher bond issuance. The strong performance of the tax-exempt municipal bond market thus far this year could exacerbate this trend, particularly if fourth-quarter supply comes in particularly strong or if fund flows weaken later this year. Also, while the ceasefire in the Middle East has been welcome, we seem far from a deal acceptable to all parties, and renewed conflict in the region could continue to drive price volatility and inflation.

### Tax-Exempt Fixed Income Strategy

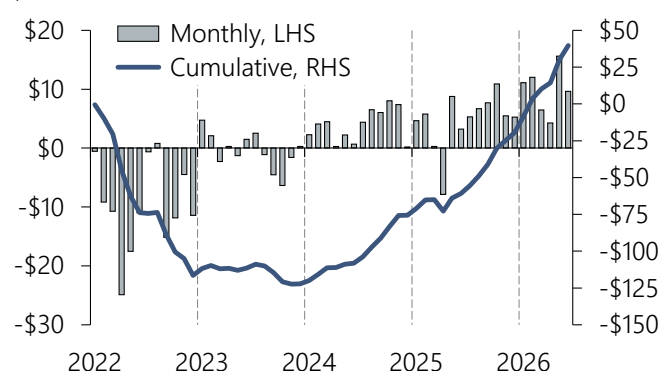
Income advantages over benchmarks remain high, and we continue to focus on revenue bond sectors offering attractive relative yields. We continue to like housing bonds, although we have lately tended to favor the higher coupons of new issues, and have taken advantage of the recent strength in the municipal bond market to reduce some discount housing bonds at attractive levels where appropriate. We also continue to prefer premium coupon bond structures, although it has become more difficult to find tax-exempt bonds rated single-A or better with 5.25-5.50 percent coupons over the last month. We also continue to emphasize transportation bonds, notably airports, and bonds subject to the alternative minimum tax for clients who are not subject to it. Lastly, in terms of structure, we continue to emphasize bonds with short- to intermediate-term calls, particularly for accounts seeking to maintain or shorten duration. Overall, we continue to make progress towards increasing average coupon rates in intermediate and longer-duration portfolios. Duration generally remains longer than its associated benchmarks, positioning them to benefit from the steep tax-exempt yield curve.

**Exhibit 10: Municipal Bond Index Returns,%**

	QTD YTD			QTD YTD	
Muni Bond	2.50	2.32	GO Bond	2.35	2.02
3-Year	0.84	1.31	Revenue Bond	2.57	2.44
5-Year	1.07	1.08	Electric	2.39	2.16
7-Year	1.40	0.83	Hospital	3.10	2.91
10-Year	1.90	1.09	Housing	2.72	2.70
20-Year	4.04	4.42	Transport	2.58	2.67
Long	4.24	4.01	Education	2.69	2.23
AAA	2.49	2.15	Water & Sewer	2.47	2.33
AA	2.39	2.19	Leasing	2.40	2.30
A	2.55	2.53	Special Tax	2.69	2.51
BBB	3.47	3.40	Tobacco	2.38	2.88

Source: Bloomberg, 6/30/26

**Exhibit 11: Municipal Mutual Fund & ETF Flows**  
\$ Billions

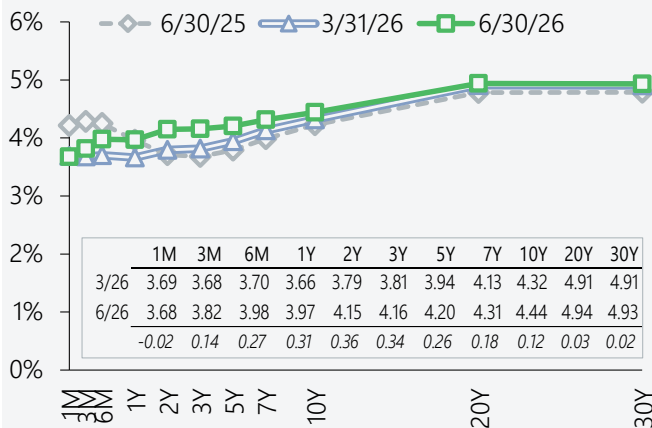


Source: Investment Company Institute, 6/30/26

## Fixed Income: Other Notable Data Points

### Yield Curve Flattened on Rate Hike Fears

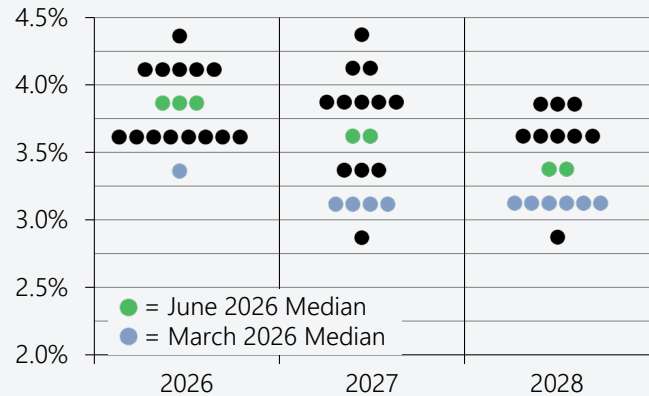
U.S. Treasury Yield Curve



Source: FactSet, 6/30/26

### Energy Inflation Pushed Up Rate Expectations

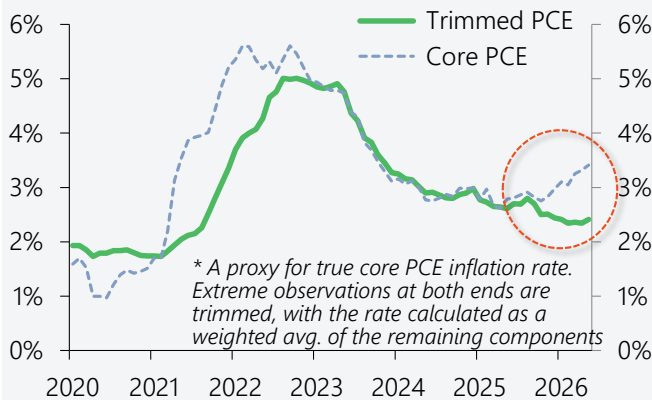
FOMC Participants' Assessments of Appropriate Policy Midpoint of Target Range for the Fed Funds Rate



Source: Federal Reserve, 6/17/26

### Trimmed PCE Points to More Benign Inflation

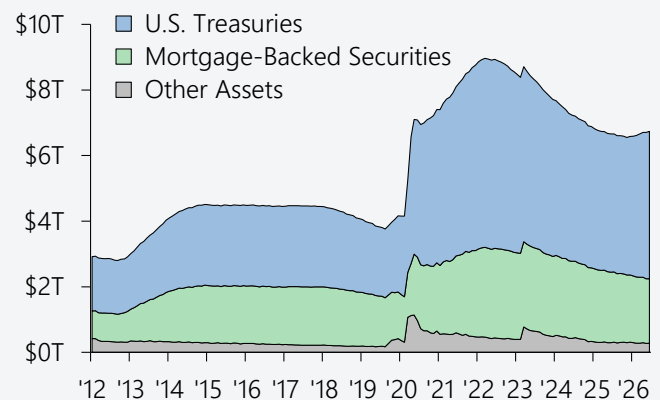
Trimmed PCE Inflation\* vs. Core PCE Inflation  
Y/Y Percent



Source: Federal Reserve Bank of Dallas, BEA, 6/25/26

### Fed Set to Resume Balance Sheet Reduction

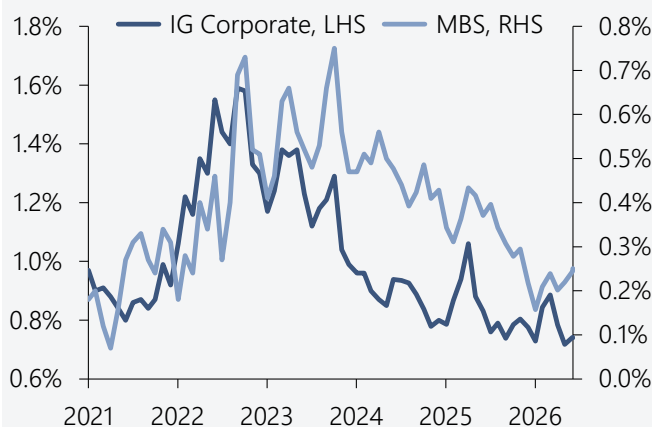
U.S. Federal Reserve Assets  
\$ Trillion



Source: Federal Reserve, 6/30/26

### Corporate Spreads Tight as Mortgages Widen

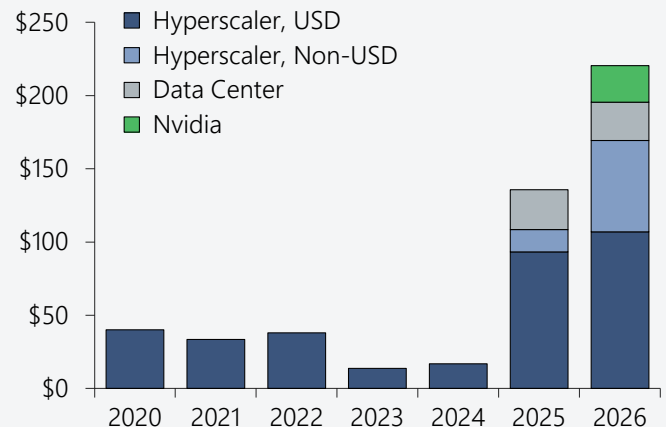
Bloomberg U.S. Aggregate Option-Adjusted Spreads



Source: Bloomberg, 6/30/26

### AI Investment Drives Wave of Bond Issuance

AI-Related Investment-Grade Corporate Supply, \$ Billion



Source: BofA Research, 6/23/26



# Global Equities: Environment and Strategy

## A Narrow, Semiconductor-Led Second-Quarter Rally; Stage Set for Broader Gains

After posting a 4.3 percent loss in the first quarter, the S&P 500 Index climbed 15.2 percent in the second quarter, bringing the first-half return to 10.2 percent. At the index level, that gain came entirely from earnings growth, with rising forward earnings contributing 19 percentage points to the first-half return, offset by 9 percentage points from valuation multiple contraction. Driven by surging AI-driven demand and rising prices amid widening supply constraints, the information technology sector, specifically semiconductors and semiconductor equipment, led the June-quarter rebound (Exhibit 12). Of note, the Philadelphia Semiconductor Index soared 88.0 percent, its best quarterly return on record. Meanwhile, the World Semiconductor Trade Statistics (WSTS) reported that global semiconductor billings were up 72 percent year to date through April, and now forecasts the market will grow 90 percent year over year to \$1.5 trillion in 2026, led by a projected 250 percent spike in memory billings. Importantly, as tensions in the Middle East continue to ease, we expect market leadership to broaden following the narrow, semiconductor-led April and May gains, as it did before the conflict and in June (Exhibit 13).

## Momentum Soars on Semis, but a Fade Could Signal Healthy Market Broadening

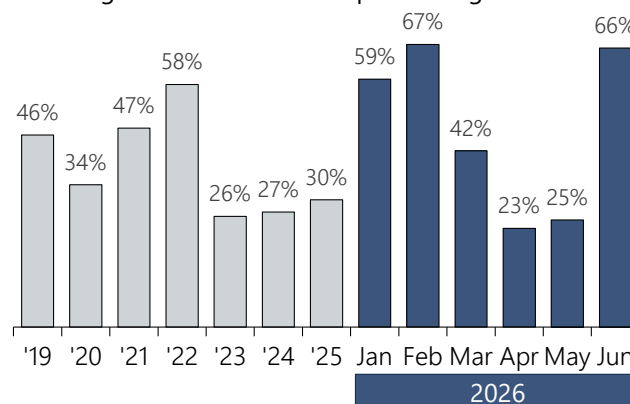
Money continues to pour into U.S. equities, with cumulative flows into mutual funds and ETFs alone of about \$330 billion year to date and over \$1.8 trillion since year-end 2020 (Exhibit 14). Some of that money is undoubtedly feeding the momentum trade, which started to outperform in mid-2023 and went parabolic in the second quarter (Exhibit 15). The S&P 500 Momentum

**Exhibit 12: S&P 500 Returns by GICS Sector**

Total Returns, %	1Q26	2Q26	1H26	2025
Information Technology	-9.1	<b>31.8</b>	19.8	24.0
Industrials	4.6	<b>14.9</b>	20.2	19.4
Consumer Discretionary	-9.2	<b>9.3</b>	-0.8	6.0
Financials	-9.3	<b>9.0</b>	-1.2	15.0
Health Care	-4.9	<b>8.8</b>	3.5	14.6
Real Estate	2.8	<b>8.5</b>	11.5	3.2
Communications Services	-6.9	<b>8.3</b>	0.8	33.6
Materials	9.7	<b>2.0</b>	12.0	10.5
Consumer Staples	7.7	<b>0.3</b>	8.0	3.9
Utilities	8.3	<b>-0.5</b>	7.7	16.0
Energy	38.2	<b>-13.4</b>	19.7	8.7

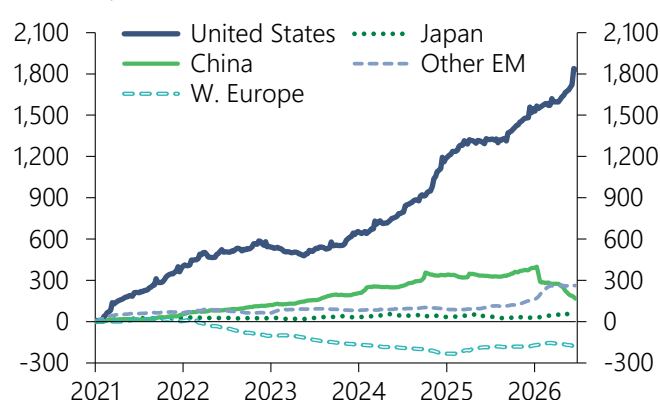
Source: FactSet, 6/30/26

**Exhibit 13: S&P 500 Constituent Leadership**  
Percentage of Constituents Outperforming S&P 500



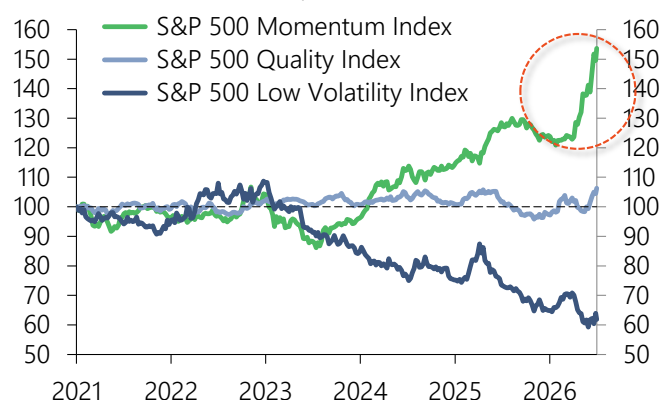
Source: FactSet, 6/30/26

**Exhibit 14: Equity Mutual Funds & ETF Flows**  
\$ Billions, Cumulative



Source: EPFR, 7/2/26

**Exhibit 15: S&P 500 Index Factor Performance**  
Relative to S&P 500 Index, 12/31/20 = 100



Source: FactSet, 6/30/26



Index's 44.4 percent return in the quarter was nearly three times that of the parent index. Its semi-annual rebalancing in March, which loaded the index with semiconductor stocks, could not have come at a better time. The index benefited from and contributed to the group's historic gains. Using the Invesco S&P 500 Momentum ETF as a proxy reveals that its semiconductor and semiconductor equipment weight nearly doubled to 33 percent post-rebalancing, and was about 41 percent at the end of June. Momentum is the factor most exposed to sharp reversals, but a fading momentum trade could signal broadening leadership rather than a fading market.

### U.S. Small-Caps Rally After a Lost Decade With Room to Run, but Selectivity Key

Small-cap stocks have also staged a broad rally after about a decade of lagging large caps, with the Russell 2000 Index outperforming the Russell 1000 Index since mid-2025 (Exhibit 16). The Russell 2000 gained 22.6 percent in the first half, while its weighted-average market cap nearly doubled to over \$8 billion before the late June reconstitution, as some of its largest stocks, many of which are AI-related, posted explosive gains. The S&P Small Cap 600 Index, which excludes many of the non-earners in the Russell, now trades at about 16 times forward earnings, against 21 times for the S&P 500 Index, putting relative valuation near the bottom of its historical range. Plus, after a period of subpar growth, the S&P Small Cap 600's earnings continue to improve, with growth estimates now on par with those of the S&P 500. The group as a whole could be challenged if economic growth slows or if rate cuts are pushed out further, especially since some of the strength stems from momentum and retail investors. But it is also ripe for stock picking, and, at present valuations, offers a rare source of upside in an otherwise fully priced U.S. market.

### Three Stocks Drove the EM Rally; Concentration Is Not Just a U.S. Phenomenon

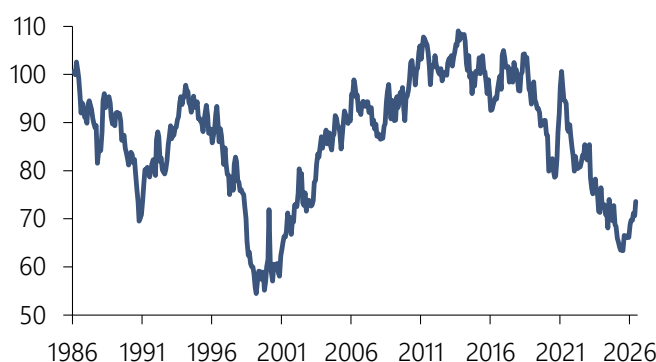
The MSCI Emerging Markets Index delivered a 24.0 percent return, in U.S. dollars, in the first half of 2026, significantly outpacing the MSCI World Index (Exhibit 17). However, just three stocks—TSMC, Samsung Electronics, and SK Hynix—are responsible for nearly all of that gain. Excluding those three, the index's return was 5.0 percent in U.S. dollars. The rally year to date has been in semiconductor stocks rather than in emerging markets. As highlighted in the special topic on pages 2 and 3, market concentration is not limited to the United States. TSMC, Samsung Electronics, and SK Hynix, all profoundly linked to the AI buildout, currently have a combined market value exceeding 30 percent of the MSCI Emerging Markets Index—the top 10 issuers account for about 40 percent, as in the S&P 500 Index. The current memory supply shortages should persist through at least 2027. Crucially, the major producers (e.g., Samsung, SK Hynix, Micron) plan to maintain capital-investment discipline to preserve pricing power and avoid another boom-and-bust cycle. Semiconductor stocks will likely remain sentiment-driven and anticipatory, trading on the rate of change in fundamentals. Still, the rare combination of structural AI demand and newfound supply discipline (if it sticks) supports the investment case.

### Global Equity Strategy

Uncertainty surrounding the U.S.-Iran conflict remains a significant wildcard, but we believe the underlying equity fundamentals are supportive. With valuations generally near fair value,

#### Exhibit 16: U.S. Small-Cap Relative Performance

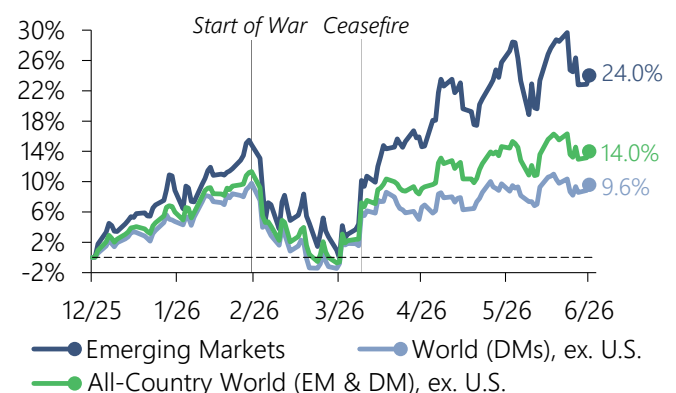
Russell 2000 Index Relative to Russell 1000 Index  
12/31/85 = 100



Source: FactSet, 6/30/26

#### Exhibit 17: MSCI Cumulative YTD 2026 Returns

Total Returns in U.S. Dollars



Source: FactSet, 6/30/26



especially relative to current interest rates, further equity market appreciation will likely depend on sustained earnings momentum, which has remained buoyant over the past several quarters. The continuing surge in AI capital investment remains a powerful growth engine. Beyond AI, several leading indicators, including bank lending, transportation volumes, and manufacturing PMIs, point to resilient corporate earnings fundamentals during the second quarter. Together, these trends provide a solid foundation for broader market participation in the second half of 2026. However, a sustained broadening will likely require greater stability in both energy prices and interest rates, and ideally some moderation.

Against this backdrop, we believe the financial and capital goods sectors are particularly well-positioned to benefit from market broadening. Capital goods firms continue to deliver strong operating results, supported by resilient demand across most major industrial end markets. The U.S. manufacturing PMI has remained in expansion for six consecutive months, signaling continued strength in activity. In addition, disciplined pricing strategies and effective supply chain management have largely offset the impact of higher input costs and tariffs. Ongoing reshoring and nearshoring initiatives also continue to support U.S. capital investment, creating durable growth opportunities for domestic industrial companies. Within the sector, we favor businesses with visible, long-term growth drivers, particularly those with meaningful exposure to automation, aerospace, infrastructure, electrification, defense, and power.

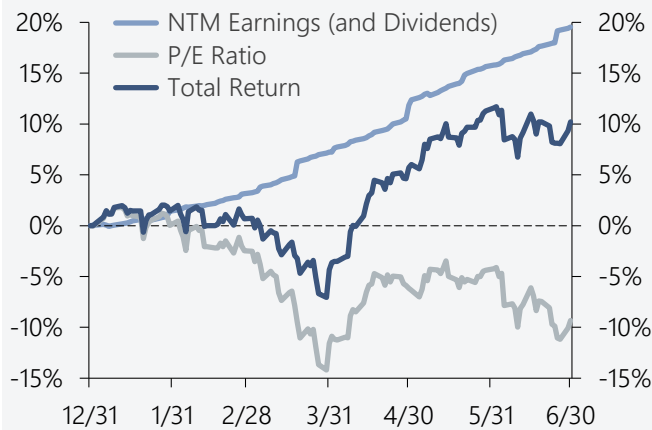
Despite strong performance over the past several quarters, financial sector valuations remain among the most attractive within the “pro-cyclical” areas of the market. Banking fundamentals remain favorable, supported by accelerating loan growth, healthy net interest margins, solid credit quality, and robust capital positions. We also expect M&A activity to continue, providing another catalyst. Beyond traditional banks, we continue to see attractive opportunities across several financial subsectors. Trust banks and wealth managers are benefiting from fee-based business models with limited credit risk, while investment banks will profit from strong trading activity and an ongoing recovery in capital markets activity. We also favor select REITs, chiefly those with limited refinancing needs and limited exposure to the struggling office market. More broadly, the financial sector is among the primary beneficiaries of the Trump administration’s pro-growth policy agenda and has limited direct exposure to tariffs or other international trade risks that could weigh on more globally oriented sectors.

In international portfolios, we are positive on stocks in China, South Korea, Taiwan, and India. Taiwan and South Korea sit at the chokepoint of the global AI buildout. Leading-edge foundry capacity and high-bandwidth memory are vital inputs for hyperscaler capital spending, giving our holdings direct leverage to that multiyear investment cycle. India offers domestic demand-led growth, favorable demographics, and benefits from supply chain diversification away from China. The U.S.-Iran memorandum to end the war, which grants upfront sanctions relief and lifts the Strait blockades, further aids energy-importing Asian economies dependent on Middle East commodities. Finally, China trades at a forward price-to-earnings ratio of about 10 times, which is near one standard deviation below its 10-year average, suggesting it is pricing in heavy pessimism. Despite the pullback in the MSCI China Index year to date, we are maintaining our China overweight, as second-half 2026 growth should firm on exports and the rollout of fiscal measures. We favor secular-growth companies with strong earnings and attractive dividend yields, and view internet platforms’ valuations as underestimating their long-term AI potential.

## Global Equities: Other Notable Data Points

### S&P 500's 2026 Returns Entirely Earnings Driven

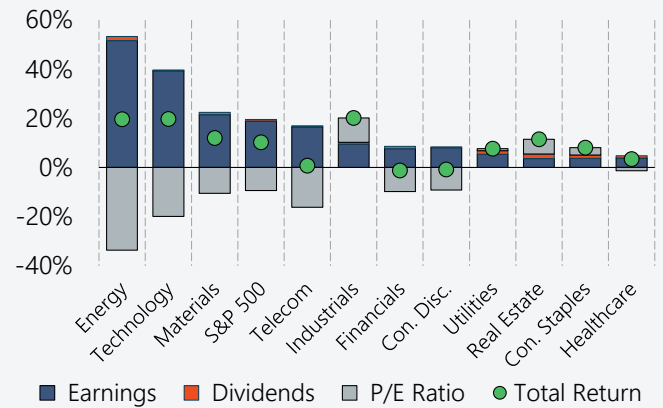
S&P 500 Index Return Decomposition, Year-to-Date 2026



Source: FactSet, 6/30/26

### Earnings Estimates for Energy and Tech Surged

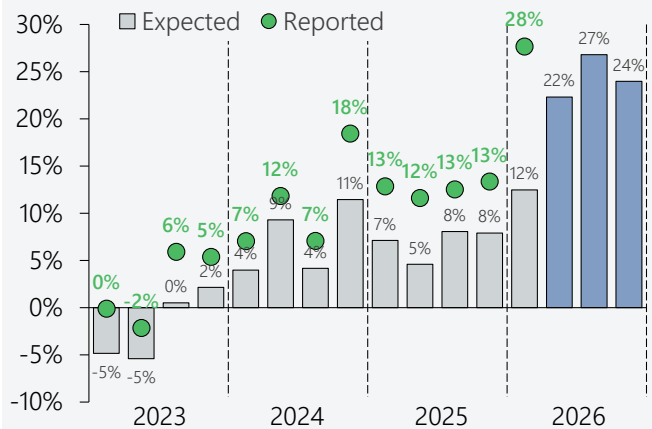
S&P 500 Index Return Decomposition, by GICS Sector Year-to-Date 2026



Source: FactSet, 6/30/26

### Street Raised Earnings Growth Bar Appreciably

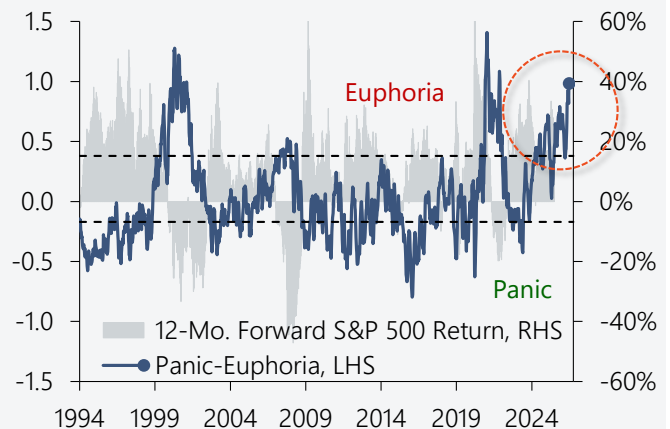
S&P 500 Index Bottom-Up Earnings, Y/Y Percent



Source: FactSet, 6/30/26

### Citi's Model Points to Squarely Euphoric Market

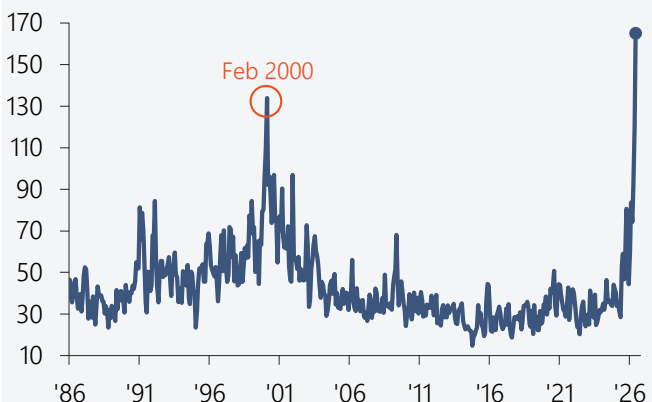
Levkovich Index (a.k.a. Citi Panic-Euphoria Model)



Source: Citi Research, 7/2/26

### Performance Dispersion Tops Dot-Com Bubble

Spread Between Top and Bottom Quintile Within Tech Percentage Points



Source: BofA Research, 6/5/26

### EM Strength Concentrated and Tech-Driven

Total Returns in USD, %	1Q26	2Q26	1H26	2025
MSCI South Korea	16.7	87.6	118.9	100.8
MSCI Taiwan	9.1	48.9	62.6	39.8
MSCI Thailand	15.7	8.6	25.6	7.2
MSCI Mexico	7.7	3.1	11.1	56.9
MSCI Poland	0.8	9.5	10.5	76.2
MSCI Brazil	19.2	-8.1	9.5	50.4
MSCI Saudi Arabia	9.3	-3.9	5.1	-4.9
MSCI UAE	-7.1	8.7	0.9	26.7
MSCI Malaysia	2.5	-1.7	0.7	15.4
MSCI South Africa	-3.2	-1.7	-4.9	78.7
MSCI India	-18.1	10.2	-9.7	4.3
MSCI China	-8.9	-6.6	-14.9	31.4

Source: FactSet, 6/30/26

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