

ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook

October 12, 2026
Third Quarter, 2026

Table 1			
Index Returns as of Sept. 30, 2026	3 Mo.	6 Mo.	12 Mo.
US STOCKS			
S&P 500 Index TR (large-cap stocks)	2.30	17.85	15.34
S&P 500 Equal Weight TR	(1.87)	9.30	11.33
Dow Jones Select Dividend Index TR	(1.83)	2.27	11.06
NASDAQ 100 Index TR	2.61	24.78	18.75
Russell 2000 Index TR (small-cap stocks)	(7.23)	12.71	15.92
FOREIGN STOCKS			
MSCI EAFE Net Total Return Index (US\$)	0.81	11.72	15.03
S&P Europe 350 Index Net TR Index (US\$)	(0.82)	10.70	15.39
MSCI Japan Net Total Return Index (US\$)	5.96	21.02	27.58
MSCI Emerging Markets Net TR Index (US\$)	(0.37)	23.59	28.57
COMMODITIES & CURRENCIES			
US Dollar	0.26	1.49	3.70
Euro	(0.81)	(1.93)	(3.44)
Gold	3.73	(10.94)	7.30
Oil (West Texas Intermediate)	34.58	7.85	79.47
CME CF Bitcoin Reference Rate	42.86	23.43	(26.61)
BONDS			
Bloomberg US Aggregate Bond (inv. grade)	(3.51)	(2.87)	(2.09)
Bloomberg US Treasury 20+ Year	(8.82)	(8.05)	(8.96)
Bloomberg US Treasury Inflation Notes	(3.24)	(2.37)	(2.14)
Bloomberg Municipal Bond	(6.35)	(4.01)	(2.82)
Bloomberg US Corporate	(3.94)	(2.59)	(2.56)
Bloomberg US Corp. High Yield Bond	(1.82)	0.60	1.34
S&P International Sov Ex-US Bond TR USD	(2.00)	(1.50)	(3.50)

Source: Bloomberg

The key macro themes outlined in last quarter's *Review and Outlook* – energy, artificial intelligence (AI), global multi-polarity, supply chains and the Fed's future path of interest rates – continued to influence financial markets during the third quarter, though the stories have evolved.

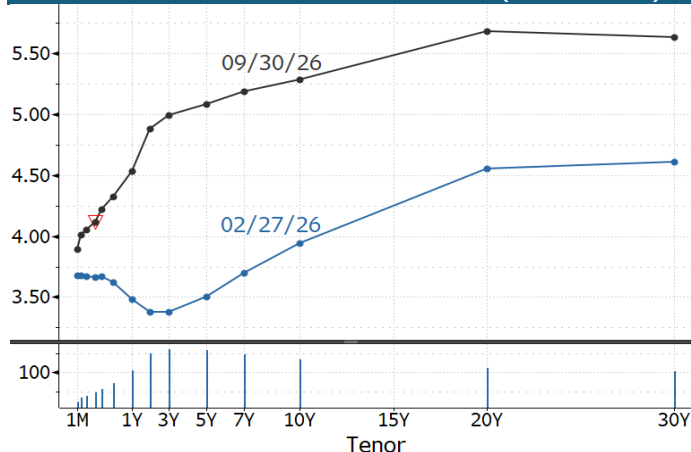
To the list above, we can add the surge in interest rates across the maturity spectrum (Charts 1 & 2). At 5.28% on September 30, the US benchmark 10-year Treasury yield climbed to the highest since 2007. The rate on 30-year US bonds also hit a 24 year high. The average 30-year mortgage rate is, once again, over 7% (Chart 3).

It is unusual for surging interest rates to leave stocks unscathed. But generally speaking, the rise in interest rates has yet to pressure the large cap market capitalization weighted indices which continue to be dominated by technology related names (Table 2). The same cannot be said for equal weighted and small company indices which posted negative returns for the quarter (Table 1).

Energy stocks have been the standout performer this year with a third quarter gain of 16.5% and a Y-T-D gain of 37.4%. But with only a 3.5% weighting in the S&P

500, the sector has had relatively little impact on the Index's return.

Chart 1: Term Structure of Interest Rates (Yield Curves)

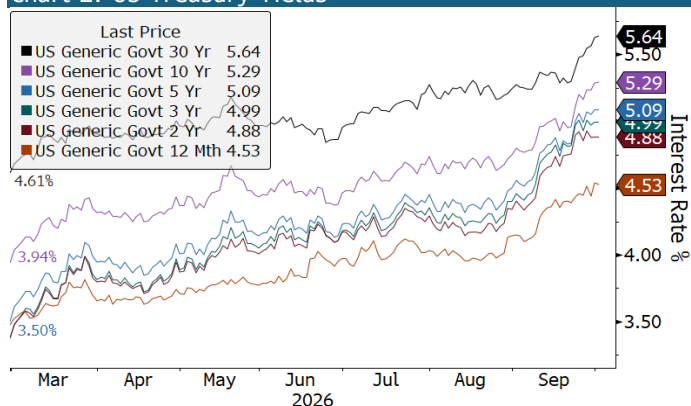


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Chart source: Access Financial Services using Bloomberg Software & Data

Chart 2: US Treasury Yields



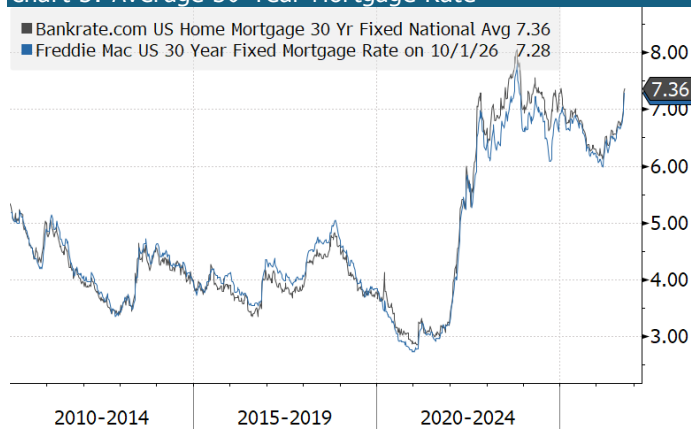
US9330YR Index (US Generic Govt 30 Yr) Interest Rates/Yld Crv Daily 27FEB2026-01OCT2026

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Chart source: Access Financial Services using Bloomberg Software & Data

Chart 3: Average 30-Year Mortgage Rate



ILH3NAVIG Index (Bankrate.com US Home Mortgage 30 Year Fixed National Avg) Impulse: 30 Yr Mortgage1 weekly 01JAN2010-07OCT2026

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Chart source: Access Financial Services using Bloomberg Software & Data

Table 2: S&P 500 Top Ten Stocks

Company	Index Weight
NVIDIA Corp	8.4%
Apple Inc	7.3%
Microsoft Corp	5.8%
Alphabet Inc (Google)	5.4%
Amazon.com Inc	3.7%
Broadcom Inc	2.5%
Meta Platforms Inc Class A	2.4%
Micron Technology Inc	1.9%
Tesla Inc	1.5%
Advanced Micro Devices Inc	1.5%
	40.3%

Source: Access Financial Services using data from Bloomberg

US stocks have also been supported by unusually strong foreign purchases of US stocks (Chart 4).

Chart 4: Foreign Purchases of US Stocks Have Been Supportive

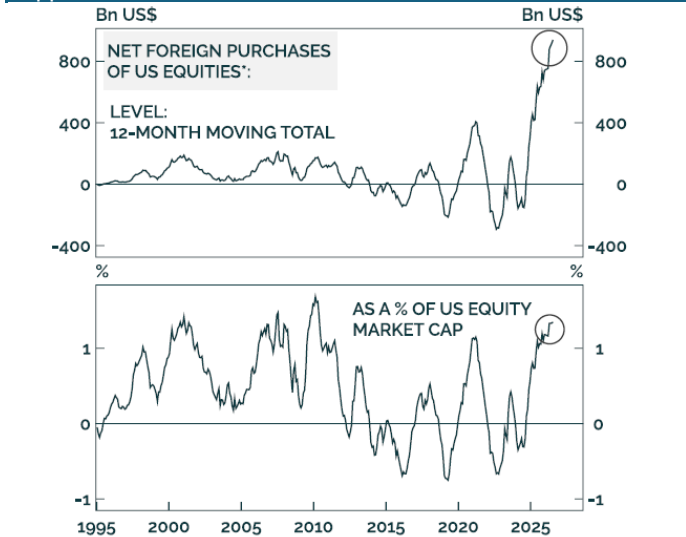


Chart source: BCA Research using data from US Treasury Department

While there are many reasons yields have surged recently, the minimal impact on large cap stocks (so far) can be explained by the two major components of treasury yields: inflation expectations and the real yield.

The inflation expectations component is the market's expectation of CPI inflation over the next 10 years. It is derived from the spread between the nominal Treasury yield and the 10-year Treasury Inflation Protected Securities (TIPS) yield. It represents the compensation investors demand for expected erosion of purchasing power.

The real yield is the yield on 10-year TIPS – the return an investor earns in excess of inflation. It reflects the true cost of money in real terms and is driven by factors such as:

- > Real growth expectations – stronger expected growth tends to push real yields higher

- > Monetary policy stance – the Fed's real policy rate anchors the short end and influences the term structure
- > Term premium – additional compensation investors demand for holding longer-duration bonds rather than rolling short term instruments

Chart 5 shows that while inflation expectations have been rangebound, the real component has risen by around 50% recently with all three of the factors listed above contributing to the move higher.

Chart 5: Real Yields Have Driven Rates Higher

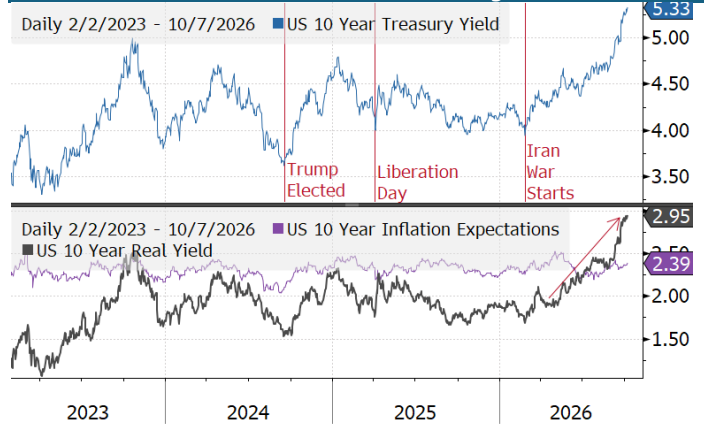


Chart source: Access Financial Services using Bloomberg Software & Data

While the Fed has made it clear it expects to raise short term interest rates over the next year (monetary policy component) and the term premium has been rising as investors are increasingly uncomfortable with the massive amounts of debt being issued, my view is that it is elevated real growth expectations that have allowed stocks to continue advancing as interest rates have broken out. Without strong growth assumptions for both the economy and corporate earnings, the move higher in interest rates would almost certainly pressure the stock market lower.

Again, it has been the largest technology stocks that have supported the stock market. These are the companies with the highest expected earnings growth – growth rates that easily exceed their debt service obligations.

The other part of the story is that ex-tech stocks have come under pressure from higher yields. The stock-to-bond correlation looks very different depending on the equity proxy: semiconductor stock prices, the NASDAQ, or the equal-weight S&P 500 index. The last is roughly 6% below its August peak. Smaller cap stocks and non-technology related stocks with lower growth rates and higher costs of capital are struggling in this environment.

A deeper look shows the positioning shift and deteriorating breadth. The S&P 500 without its AI names has dropped since early September, while the headline index held steady (Chart 6). This can also be seen in

the number of stocks trading above their 50- and 200-day moving averages (Chart 7).

Chart 6: S&P 500 and S&P 500 Equal Weight ex AI

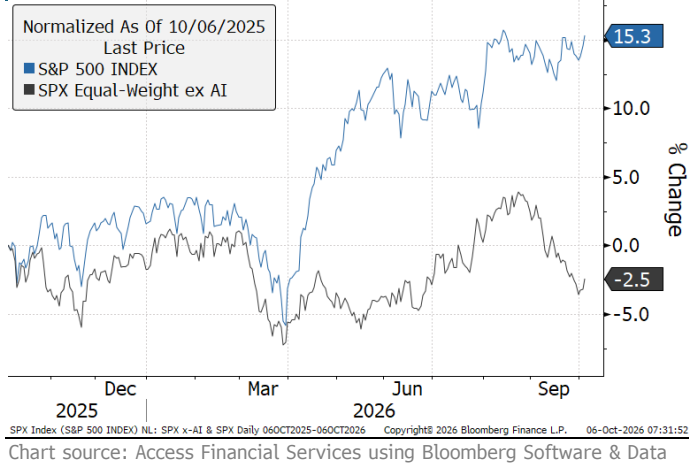
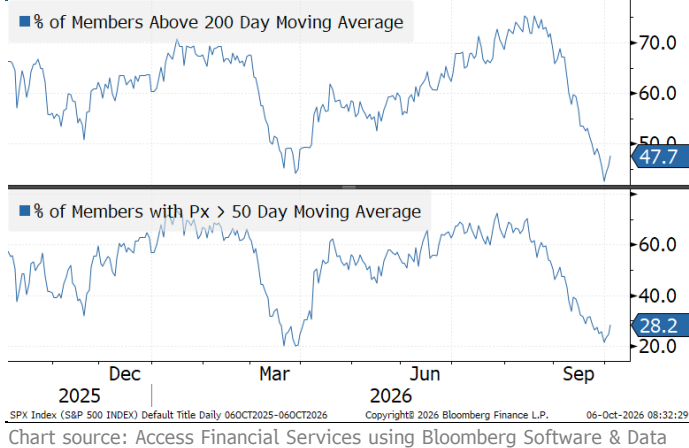


Chart 7: S&P 500 % of Stocks Trading Above Moving Avg.



So far, the yield backup has not been enough to derail consumer spending or AI-related investment, but there must be a level that would. Therefore, we need to heighten our focus on the incoming consumer data over the coming several months for signs that rates have moved too far too quickly for the economy and ex-tech earnings.

Fundamentally, without some form of shock to the financial markets or the economy, or possibly the end to the war in Iran, it is hard to see interest rates declining meaningfully in the foreseeable future given the massive government borrowing and demand for capital by the companies rapidly building out artificial intelligence related infrastructure. Alphabet, Amazon, Meta and Oracle alone account for \$250 billion in borrowing so far this year. The five largest hyperscalers are projected to spend more than \$1 trillion on capital expenditures in 2027 and almost \$1.2 trillion by 2029 (Chart 8).

From a technical perspective, Treasuries have become oversold. Since 2022, such oversold conditions have coincided with a peak in interest rates and a bottom in stocks. While the S&P 500 has held up due to its large weighting in technology stocks, the equal weighted

index has corrected from its August all time high. The elevated Treasury momentum indicators suggest that the broader equity correction *may* have run its course (Chart 9).

Chart 8: Hyperscaler* Capex Estimates by Year

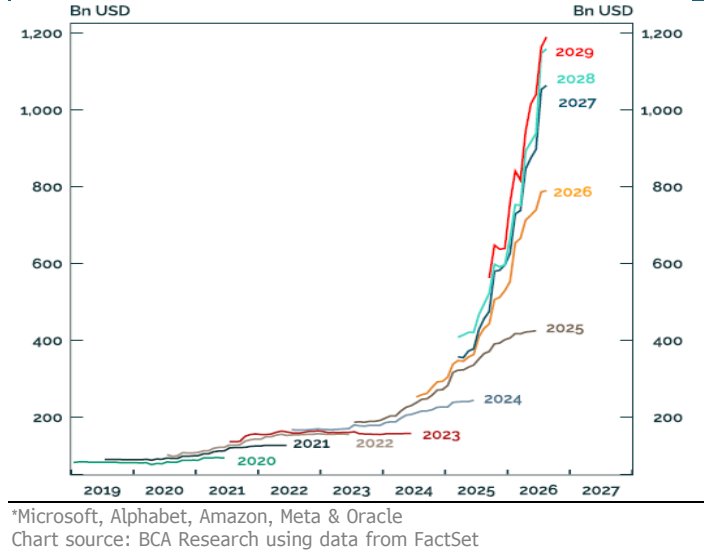
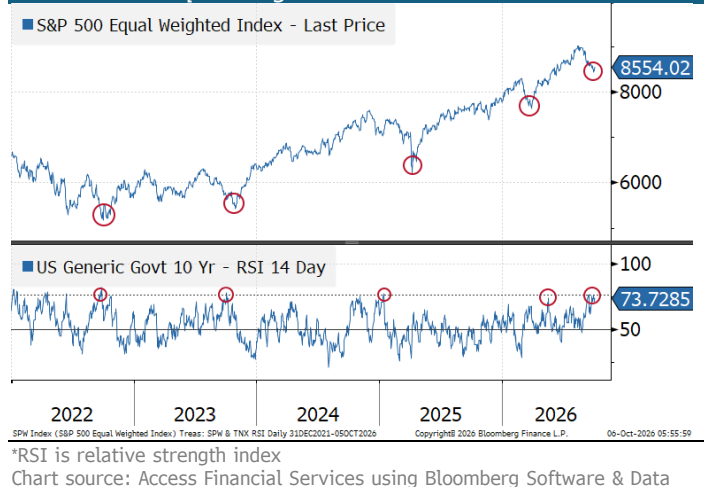


Chart 9: S&P Equal Weight Index & 10-Yr. Treas. Yield RSI*



The advance in earnings expectations has allowed for improvement in the S&P 500's valuation based on the price/forward earnings ratio (Best P/E ratio). That helps explain why the S&P 500 is now trading at a forward P/E multiple of just above 19x, down from a peak of over 23x last year. With the brief exceptions of the selloff at the start of the Iran war and last year's tariff tantrum, that is the lowest reading since late 2023 (Chart 10).

The Federal Reserve's dual mandate requires the central bank to use monetary policy to promote maximum employment and stable prices. While the Fed says it is likely to raise short term interest rates in the year ahead, tighter US financial conditions imposed by higher bond yields and a stronger dollar point to cooler economic surprises over this time period.

Chart 10: S&P 500 Trades Near Lowest Multiple Since 2023

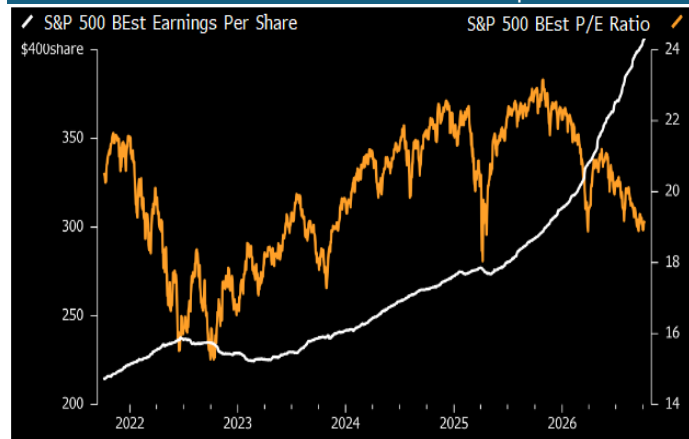


Chart source: Bloomberg

A Dual Mandate Surprise Index created by BCA Research based on the average of the Bloomberg Economic Surprise indexes for labor and inflation has begun to contract (Chart 11). This points to something of a Goldilocks environment ahead. With a balanced labor market and few signs of economic overheating, the Fed is unlikely to hike more than currently priced in by the markets. The investment implications are that peak hawkishness by the Fed is likely behind us and risk assets should also be tactically supported over the short term as implied rates volatility is likely to ease.

Chart 11: BCA Dual Mandate Surprise Index

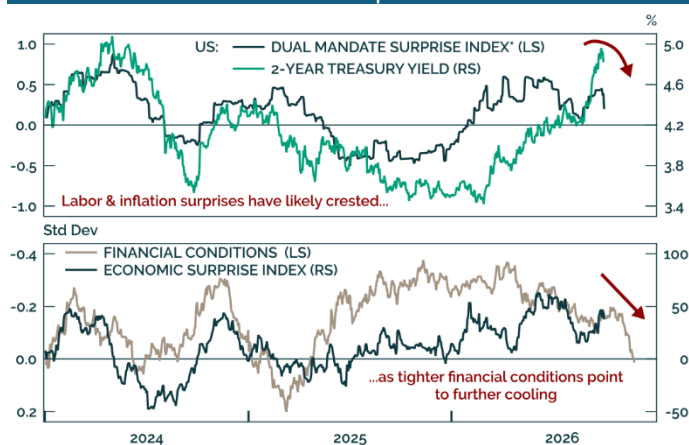


Chart source: BCA Research

While AI related gains in the stock market have been the story for a while, the narrative around AI has evolved from how much AI will improve productivity and our lives in general to AI will kill us all if large language model (LLM) development is not slowed and the frontier LLM companies are not regulated.

The world descended into a full blown doomer panic after the 27-year-old Anthropic engineer, Jacob Coxon, quit over the threat that AI would cause human extinction. The now-famous Coxon posted that “The people building AI earnestly believe that it could kill us all by the end of the decade. This is not a marketing stunt.” Then, in a recent interview with WIRED, Coxon alleged that his former colleagues have described the next few years as the potential “endgame” for

humanity itself. Another Anthropic researcher claimed that there is a chance that AI could “kill all humans” within a decade. (The odds were set below 10 percent, which still seems extremely high.)

There are many well-meaning people at the major AI companies who are worried about these risks and are doing what they can to mitigate them. That said, it would be naive to think there is no self-interest behind the “go-slow” approach that the leaders of many AI companies are now touting beyond their desire to remain above ground.

There are at least three potential reasons these companies are embracing the fearmongering.

The first is valuation. OpenAI is currently valued at ~\$850 billion with annualized revenue of \$40 billion and operates at a projected \$14 billion loss. Anthropic is targeting a \$2 trillion valuation with revenue of ~\$65 billion and recently disclosed a first-ever quarterly operating profit of around \$500 million. But we also do not know anything about these macro-significant companies given that they are private and their finances are thus opaque.

The only way to justify the lofty valuations is if both firms deliver astronomical productivity gains. But total factor productivity claims pale in comparison to humanity becoming enslaved to our AI overlords.

It is reasonable to think that AI will deliver strong productivity gains. And if the predictions of doom do not materialize, achieving artificial general intelligence (AGI) or massive productivity gains becomes the best outcome that every institutional investor needs to participate in. The choices are clear. Either participate in the next funding round or prepare for an extinction level event.

An alternative – maybe one in which Chinese open-weight LLMs are just as good as OpenAI and Anthropic – is just not in the Venn Diagram of future outcomes. To that extent, the decision by OpenAI CEO Sam Altman to conveniently delay the IPO due to these concerns over the wellbeing of 8.3 billion humans is downright altruistic.

The second reason is regulatory capture. In political science, the concept of “regulatory capture” is one where the incumbents in an industry embrace regulation of their sector to create insurmountable barriers to entry.

Just imagine the compliance cost that “not killing every human on the planet” would impose on new entrants into the LLM industry. Sam Altman, for example, claimed that OpenAI would melt all its GPUs to ensure humanity’s continued existence. That sounds like a high compliance hurdle for a small LLM startup to navigate. Consider this on a due diligence checklist: “have you dynamited your datacenters as per code?”

The third is the “rally around the flag” argument. The ultimate form of regulatory capture is to embrace national security and geopolitical competition.

The software leaders of the now distant social media era – Facebook, Google, etc. – did the same in the mid-2010s, particularly once their Chinese total addressable market went to \$0 due to Beijing’s imposition of a “Silicon Curtain” (a metaphor modeled after the Cold War’s “Iron Curtain”).

By emphasizing the power that their models can wield, the Anthropic and OpenAI leadership is also highlighting the dangers that Chinese models would pose. And if American LLMs are about to “pace the frontier,”¹ the implied call to leadership in DC is to ensure that Chinese models are banned since Beijing will obviously not be as responsible as the American corporate actors.

In my view, it is reasonable to at least consider that the focus on regulatory capture and virtue signaling suggests that the leadership of OpenAI and Anthropic think they are in trouble. It is a bit curious that the renewed doomer handwringing follows on the heels of the revelation this summer that Chinese Moonshot AI’s Kimi K3 can rival US frontier models. With Chinese open-weight models nipping at their heels, it is possible that the hysteria is just a preemptive attempt to stifle competition at the border.

The implication is that OpenAI and Anthropic are simply not worth what they are asking investors to pay for equity.

The significance is that if both are successful in transforming the doom and gloom hysteria into regulatory capture, they may actually grow into those valuations. If the world’s largest economy becomes a captive playground of domestic LLMs, those two firms may indeed be incredibly valuable.

There is another possible explanation. Both Anthropic and OpenAI are on the hook for hundreds of billions of committed spend in capex over the rest of this decade. But what if they are simply running out of money? In that scenario, the doomer hype is a useful way to get out of commitments to build datacenters and buy GPUs. Consequently, these developments could be a hint to investors that the top in the AI capex cycle is not as far off as many believe. “Pace the frontier” is not a call to previously unseen levels of corporate responsibility; instead, it could be a signal for Frontier models to walk out on the check.

Every technology – from fire to electricity – has the possibility to harm humans. Many new technologies first started as a tool of war before being

commercialized. Nuclear energy is an obvious example, but even the fertilizer industry saw its explosive phase of growth following the World Wars. The threat that rogue models pose is not new and is likely real. What is new is the implied claim that corporate leaders behind enterprise models are the most responsible in history. I don’t buy it.

From my perspective (not that it matters), frontier model companies need to take responsibility for the safety of their products. If they are unwilling to do so, they need to stop releasing LLMs they claim pose a threat to humanity. There should be no government regulation that protects them from lawsuits stemming from damage caused by their models and/or agents. Essentially, the same standard that applies to all companies should apply here.

At the end of September, President Trump endorsed using outside auditors to assess the safety of artificial intelligence systems through an accord with Silicon Valley leaders that seeks to avoid new government rules in addressing a wave of concern over AI risks.

Under the agreement forged at a White House lunch with nearly two dozen top tech industry executives, AI companies also committed to regularly meet to set best practices for the industry. The document carries no legal weight, though the president told reporters it was “morally binding.” It seems a bit ironic for Trump to imply that “morally binding” means anything whatsoever.

Trump’s willingness to engage on safety after previously dismissing doomsday fears as “a hoax” reflects how AI has increasingly become politically charged ahead of the November elections. Trump has emerged as one of the loudest champions of unfettered AI development, putting him at odds with voters who are skeptical of the technology. More than seven in 10 voters said they prefer candidates who back stricter AI guardrails, according to a recent Quinnipiac University poll.

Speaking of voters, the midterm elections are less than 30 days away and it is not looking good for the GOP.

President Trump has a net approval rating of -21% and his Republican Party has a net -17% support rate. Approval of the Republican-majority Congress stands at a net -60%, while only 34% of the public thinks the country is on the right track. The American populace is rejecting incumbent politicians once again and there has been a rather dramatic shift towards the Left in the US.

Prediction markets strongly favor a Democratic sweep in November. As of October 6, Kalshi² puts the odds of a Democratic sweep at 64%, up from 48% on September 13

¹ Pacing the frontier means slowing down and controlling the release and development speed of cutting-edge AI models rather than rushing forward or stopping all research completely.

² Kalshi and Polymarket are prediction markets where users trade on the outcomes of real-world future events.

and 40% in early July. Polymarket puts Democratic control of the House at 93% and Democratic control of the Senate at 65% (Chart 12).

Chart 12: Prediction Markets Imply a Democratic Sweep

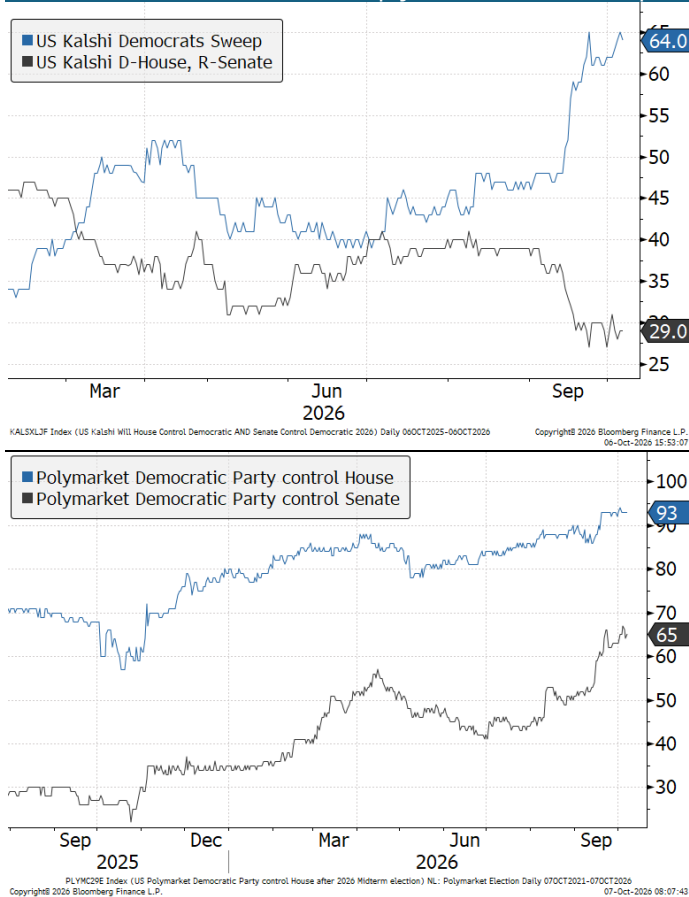


Chart source: Access Financial Services using Bloomberg Software & Data

There has been a real shift towards the Left in the US. What has changed?

In the liberal/progressive cyber-realm, there has been a growing chorus of voices that ‘Woke 1.0’ cost the Democratic Party the 2024 election. The term Woke 1.0 is a catch-all phrase that captures what Hasan Piker – an American left-wing political commentator – has called the “over-the-top, corporatized, and hyper-sanitized version of social justice” that was focused on identity issues and performative acts of virtue signaling.

The term reached the mainstream in early August when presidential hopeful and progressive crusader Representative Alexandria Ocasio-Cortez (AOC) told ABC’s Jonathan Karl that “Woke one was crazy.”

It appears that the Democratic Party has also realized that it cannot win elections without its former base: young, white working-class men. President Trump defeated Kamala Harris among men aged 18-29 by a 14-point margin according to exit polls. This prompted many Democratic strategists to lament the loss of podcaster Joe Rogan from the party, suggesting that his “manosphere” endorsement of Trump – almost

exclusively due to social issues and foreign policy – led to the defeat in 2024.

Unlike Woke 1.0 which focused on identity issues over economics, Woke 2.0 is relevant to investors. Where Americans go to relieve themselves is not relevant (Woke 1.0). What tax rates they pay is (Woke 2.0).

Woke 2.0 is only novel in America, where true left-wing politics based on redistribution of income and wealth – in the European tradition – have rarely seen electoral success.

It is far more competitive in today’s context. Republican strategist and right-wing firebrand Stephen Bannon and AOC agree that wealthy Americans should pay more taxes. By moving away from their previous focus on identity politics, Democrats are focusing on economic issues – inflation, income inequality, healthcare, etc. – that are resonating with voters.

All of this is relevant to investors because, first, progressive Democrats (i.e., Woke 2.0 Democrats) are almost certainly going to win the midterm election. They are not going “too far left.” They are competitive and that will reveal itself in less than one month, let alone in 2028.

Second, their competitiveness is based on the recalibration of the Democratic Party message away from identity and social justice (which has not worked in elections) towards redistribution (which is working).

Third, if Woke 2.0 Democrats win the sweep of America’s institutions in 2028, it is reasonable to assume that US tax rates on capital, corporations and the wealthy will go way up to fund an aggressive fiscal spending program from 2029 onwards.

While this is negative for risk assets in the years ahead, the White House is not up for grabs in 2026. With President Trump in power and Congress likely to shift to the Democrats, markets are actually being set up for the most sanguine of all midterm election outcomes, a split Congress-presidency scenario (Chart 13).

Chart 13: S&P 500 12 Mo. Total Return After Midterm Elections in Real Terms Since 1994

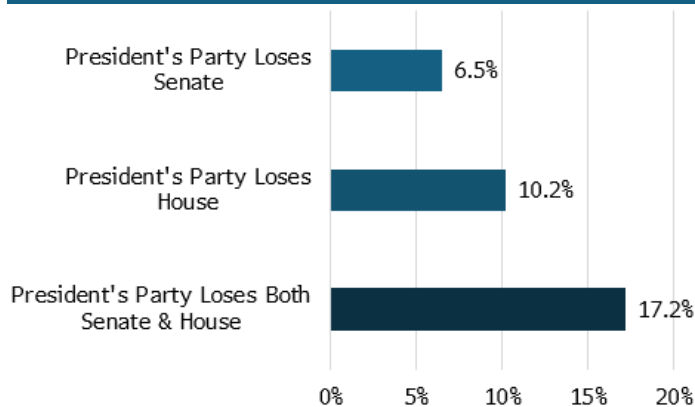


Chart source: Access Financial Services using Data from S&P Global

Turning to the war in Iran and its impact on global energy supply, the story has improved a bit over the last three months but seems to have once again deteriorated very recently.

There are credible reports that crude oil shipments out of the Middle East have rebounded to levels close to pre-war levels. The rebound is mainly due to “dark” Hormuz transits at night protected by fighter jets, helicopters and ships in secretive US naval operations.

Rising Hormuz flows have helped ease the tightness in global crude markets. In that sense, the global crude oil market has passed the point of peak supply strain, at least for now.

A continuation of these flows will ultimately slow the pace of drawdown in global inventories, which are otherwise heading toward their operational floors. If sustained, the export recovery will also restrain crude prices over the coming months.

That said, attacks on tankers sailing through the Strait of Hormuz hit their highest the week of September 28 – October 5 of any week since the Iran war began, according to maritime security sources tracking incidents. During that week, there were at least 12 attacks on oil, liquefied natural gas and liquefied petroleum gas tankers around the Strait of Hormuz. On October 7, an adviser to the Revolutionary Guards’ Commander told the semi-official Fars News Agency that transit routes in the Strait of Hormuz deemed illegal by Iran will soon be closed, referring to the southern pathway hugging Oman’s coast. And, on October 7 *The Atlantic* reported that the White House asked the Pentagon to draw up strike options against Iran that could be executed before the midterm elections which ran counter to a widespread assumption that President Trump would hold off on escalating the war before the polls next month.

Freight rates are also surging. Shipping oil from the Middle East to China cost \$1.4 million a day on October 7, the most on record. Hiring a very large crude carrier to move US oil to Asia now costs \$77 million, up from an average of \$9.2 million last year. At least one very large crude carrier was offered to sail from the US Gulf to Japan at a potential record fee of \$82 million, or more than \$40 a barrel. That’s a 50%-plus increase on the route from just three weeks ago.

Even if flows out of the Middle East return to normal, a couple of factors will likely keep a floor beneath crude prices over the near term.

The first is that geopolitics will remain a source of upside risk to oil prices. The US will likely increase military pressure on Iran and economic pressure on Russia after the midterm elections.

The second is that any easing in global crude oil conditions will be met by increased demand for

inventory restocking (Chart 14). Global inventory releases are a stopgap measure that will shift from adding barrels to the market to creating restocking demand, especially in the context of lingering geopolitical supply risks. A desire for larger strategic stockpiles to buffer against future supply shocks and strengthen energy security should amplify this trend.

Chart 14: US Strategic Petroleum Reserve Lowest Since 1982

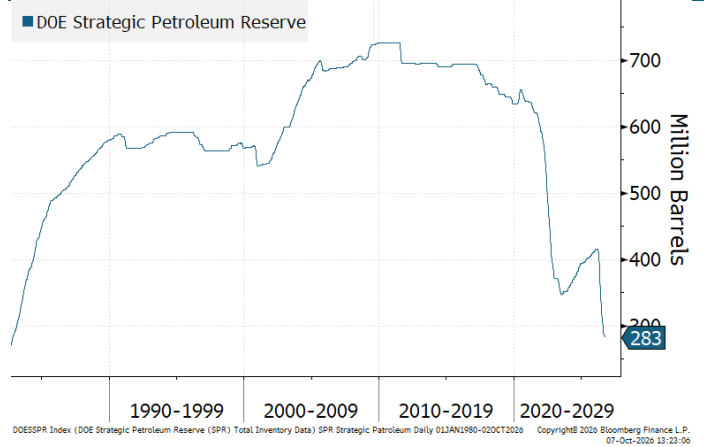


Chart source: Access Financial Services using Bloomberg Software & Data

Unfortunately, the increased flows are mostly confined to crude oil. Natural gas and refined product shipments remain well below normal. The damage is most concentrated in refined products.

About 10 million barrels a day of the world’s refining capacity is offline. Refineries in both the Middle East and Russia are running near 60% of capacity. The Middle East makes about 10% of the world’s refined products, and half of the refining capacity added since COVID was built there. Worldwide, only about 2.7 million barrels a day of refining capacity has been added since 2021, against about 8 million barrels a day of new crude supply. Refined products also travel on smaller, more exposed ships. Only about one million barrels a day of products now moves through Hormuz, against four million before the war.

America now supplies about a fifth of all seaborne refined products, up from 4% in the 1980s. Product exports rose about 900,000 barrels a day to eight million. US refineries ran at 17 million barrels a day in late July, the highest since 2019, with utilization in the high 90s. There is no spare capacity.

The result is that refined product prices have surged (Chart 15) at a time voters say the most important issue facing the country today is inflation/affordability (foreign affairs is at the bottom of the list). There is an uncanny correlation between the price of gasoline and diesel and the GOP’s odds of winning the upcoming midterm elections (Chart 16 – price of diesel shown inverted). According to the most recent University of Michigan consumer sentiment survey, the one year ahead inflation expectation is 4.7% and the current conditions gauge sank to 44.7, the lowest on record.

Chart 15: Refined Product Prices

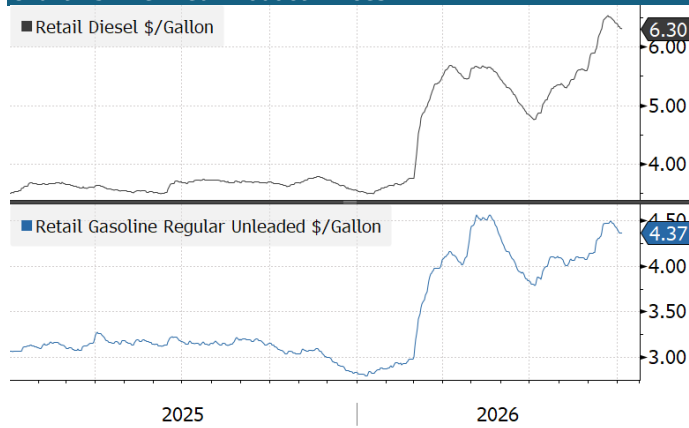


Chart source: Access Financial Services using Bloomberg Software & Data

Still, consumer spending has remained healthy due to a stable labor market and a strong stock market supporting outlays on a wide range of goods and services even as households continue to draw down savings.

Chart 16: GOP Odds Negatively Correlated with Fuel Prices

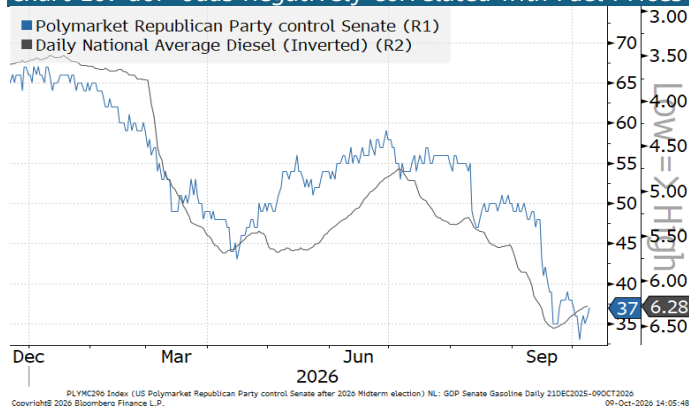


Chart source: Access Financial Services using Bloomberg Software & Data

Table 3 below shows our clients' third quarter returns for three major asset classes.

Table 3: Composite Client Portfolio Returns			
	US Stocks	Foreign Stocks	Fixed Income
Second Quarter			
Average Asset Class Return	1.24%	1.55%	-0.04%
Index Return*	1.40%	0.81%	-3.51%
Difference	-0.16%	0.74%	3.47%
Dispersion	0.75%	0.55%	0.89%

* Index Returns :

US Stocks: Russell 3000 Index

Foreign Stocks: MSCI EAFE Index

Fixed Income: Bloomberg US Aggregate Bond Index

While our US stock allocation underperformed, our foreign stock and fixed income allocations outperformed their benchmarks meaningfully.

Our lagging US stock performance was – once again – due to being underweight the largest technology related names and retaining our hedged equity positions. That said, having very little exposure to

small cap stocks was positive as this universe of stocks returned -7.2% for the quarter.

Our foreign stock outperformance was due to our allocation to stocks based on strong company fundamentals versus the indexes' market capitalization weighting structure:

Table 4: Third Quarter, 2026 Foreign Stock Index Returns

Developed Foreign Fundamental Stock Index	1.88%
Developed Foreign Market Stock Index	0.81%
Difference	1.07%
Emerging Market Fundamental Stock Index	5.52%
Emerging Market Stock Index	-0.37%
Difference	5.15%

Our clients' fixed income allocation outperformed rather significantly due to our allocations to:

- > Short term Treasuries which were essentially flat for the quarter versus the aggregate bond index which returned -3.51%
- > Exposure to alternative fixed income asset classes that posted returns between 0.6% and 2.6% for the quarter

The outlook for risk assets for the rest of the year and into next year is particularly hard to divine in an environment where interest rates have risen significantly, energy prices are likely to stay elevated, the AI buildout is increasingly turning to debt financing as free cash flow dries up and stock market returns are overwhelmingly dependent on a handful of stocks while cracks are showing just under the surface in terms of market breadth.

Starting with the consumer, retail stocks are floundering (Chart 17). Most other consumer discretionary industries are also under stress. Interest rate sensitive sectors are licking their wounds as interest rates have risen (Chart 18). Moving over to deep cyclicals, transportation stocks are weighing heavily on industrials as the surge in diesel costs eats into margins (Chart 19). Materials are suffering a similar fate.

My sense is that the defensive posture of mega-cap tech stocks will likely give way and bring the broad market down with them if the S&P 500's narrow rally does not broaden soon.

What could change the calculus? A definitive end to the war in Iran would bring much-needed relief at the pump (both gasoline and diesel), restore a bid in Treasuries and likely induce a year end equity market rally boosted further by favorable seasonality after the midterms. The jury is still out.

Chart 17: Retail Stocks

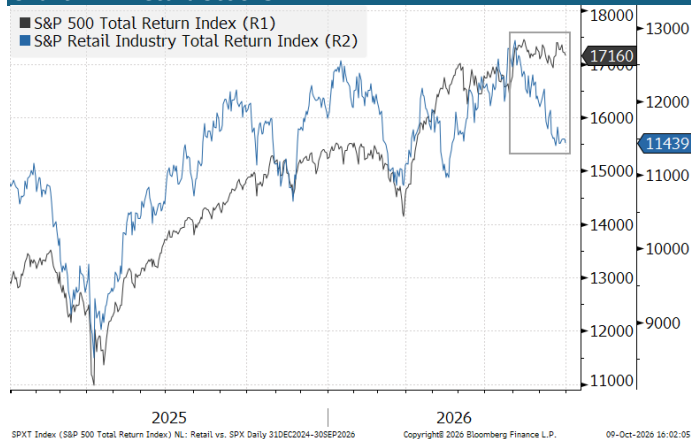


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 18: Interest Rate Sensitive Sectors

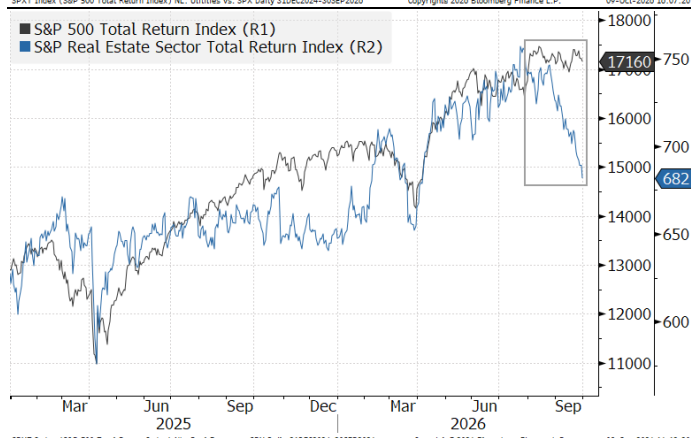
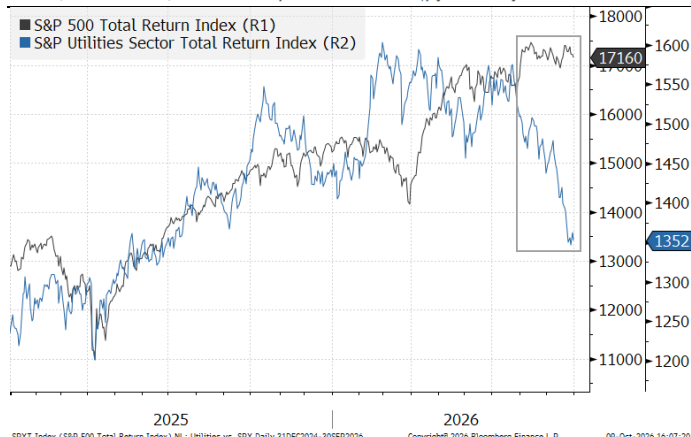
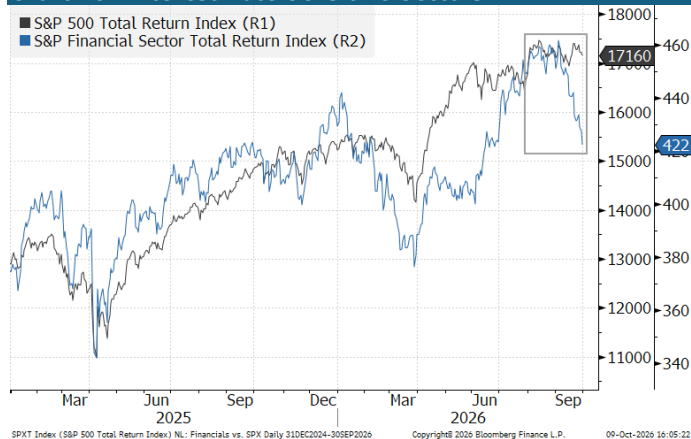


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 19: Cyclical Sectors

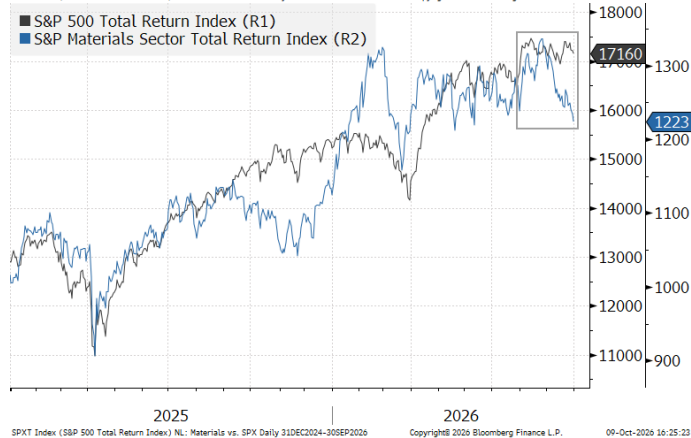
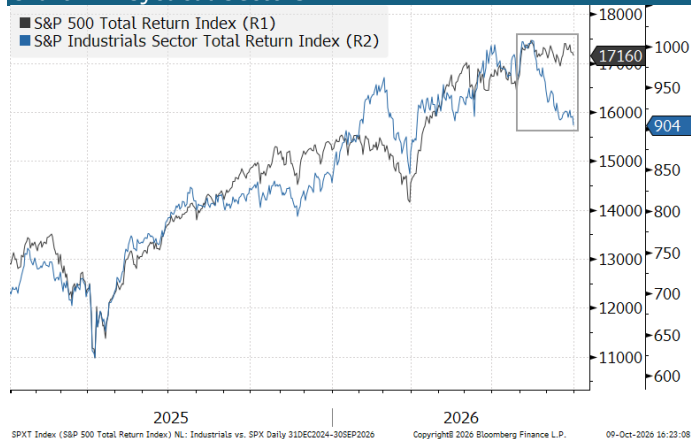


Chart source: Access Financial Services using Bloomberg Software & Data

The S&P 500's narrow rally needs to broaden soon or the calm at the index level is likely to break. Rising volatility around the AI capex narrative and energy markets makes them less reliable engines of market leadership with mega-cap tech benefiting from the AI buildout and energy stocks having done almost all the heavy lifting in keeping the S&P 500 near record highs. They are the only major S&P sectors higher over the past 30 days, while a vast majority of index members are more than 10% below their all-time highs.

From a macro perspective, in prior instances when interest rates, oil and the US dollar have all moved higher, there has been a correction in the stock market.

According to Jim Paulsen, a closely followed investment industry veteran, when his policy pressures index which is weighted 50% 10-year Treasury yields, 25% real US dollar index and 25% crude oil prices was this high in the past, a decline of between 20% and 25% for the S&P 500 followed suit (Chart 20). However, Paulsen said that seven of the index's 11 sectors have been range-bound for so long they will likely avoid that kind of sharp drop. Still, he's expecting a 20% fall for the tech sector.

Recently, a couple of news items are worth thinking about given today's market profile.

First, Bloomberg reported that "Outspoken AI Bear Jain Capitulates After \$36 Billion Exodus." This is eerily

reminiscent of the late-1999/early-2000 anecdote when Stan Druckenmiller (a famous hedge fund manager) gave up and went all-in on the dotcom bubble, piling into internet stocks right at or near the peak.

Second, the Financial Times reported that “Nvidia Turns To Insurers To Spread The Risk Of AI Build-out.” While not identical, this article reminds me of AIG selling credit default protection on subprime collateralized debt obligations. AIG’s tag line was “The Greatest Risk Is Not Taking One.”

Food for thought...

Chart 20: S&P 500 vs. US Economic Policy Pressures



Chart source: PaulsenPerspectives.Substack.com

With the yield on the 10-year Treasury rising from just under 4% in late February to around 5.3% today, longer term treasuries have become more attractive with limited downside. Chart 21 below shows that if the yield on the 10-year Treasury bond increases 1% (i.e. moves from 5.3% to 6.3%), the total return (price change + income) over the next 12 months will be -1.5%. Whereas if the yield drops 1% (to 4.3%), the total return will be 12.8%. This is looking like a nice risk/reward profile and we are getting closer to extending the maturity profile of our clients’ fixed income allocations.

Chart 21: 10-Year Treasury Projected 12 Mo. Total Returns

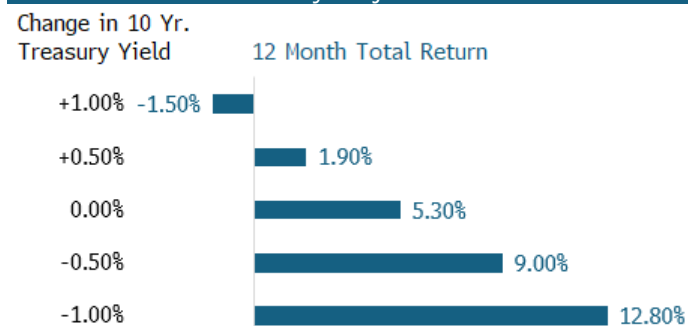


Chart source: Access Financial Services using Data from Bloomberg

With real yields closing in on 3% (Chart 5) and the 10-year Treasury yield at multi decade highs, it seems only a matter of time before a credit crunch rolls

through the economy if interest rates continue to rise. This would be bad for risk assets, but good for Treasuries as interest rates would then have to move lower resulting in higher bond prices making longer term Treasuries a good hedge against a stock market decline.

Speaking of hedges, insurance in the form of S&P 500 put options (which increase in value when the index declines) remains quite inexpensive. It is one of the reasons we continue holding hedged ETFs in our clients’ portfolios. Owning these securities gives us exposure to the S&P 500 while limiting losses if the index declines.

Our clients’ portfolios are underweight foreign stocks which have underperformed US stocks since March as the US dollar has strengthened and the US market’s high weighting to technology related stocks relative to other foreign markets has weighed on developed non-US markets (Chart 22).

Chart 22: Performance of Developed Foreign Market Stocks Relative to the S&P 500 and US Dollar Index (shown inverted)

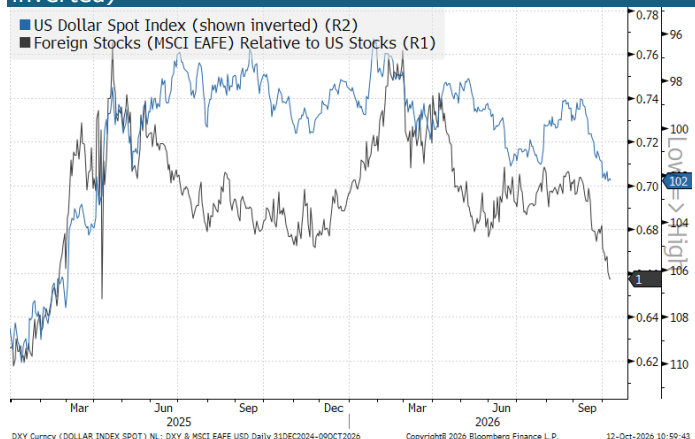


Chart source: Access Financial Services using Bloomberg Software & Data

We will remain underweight foreign stocks until the US dollar finds a bottom and the relative performance of non-technology related shares show signs of improvement.

As always, we thank you for the confidence you have placed in us. Please do not hesitate to contact me if you would like to discuss any of this in more detail.

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