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Economic and Market Environment

First Quarter 2026

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Review 2025

- The economy was surprisingly strong, again defying recession predictions.
- Inflation increased, mainly due to tariffs.
- Weakening employment trends kept the Federal Reserve (Fed) on an easing path.
- Both short-term and long-term interest rates declined, resulting in the best bond market returns in several years.
- "Uncertainty" and "affordability" were terms that occupied the minds of consumers and investors during the year.
- Stocks provided solid returns across the board, but the largest gains were concentrated in a few dominant companies and Artificial Intelligence (AI) related firms. This prompted talk of an AI bubble.

Preview 2026

- The Fed's latest projections are optimistic for 2026:
    - Stronger Gross Domestic Product (GDP) growth – 2.3%
    - Lower unemployment – 4.4%
    - Lower inflation – 2.4% PCE
    - Lower short-term interest rates – 3.5%
- If these projections materialize, it should be favorable for investors. However:
    - Lower long-term interest rates may be limited by concerns over growing government debt.
    - Stocks will be challenged by lofty valuations. Continued earnings growth and profit margin expansion will be required for further gains.
    - "Uncertainty" may be less in 2026. "Affordability" likely not.

INTEREST RATES: MORE GOOD NEWS IN 2026?

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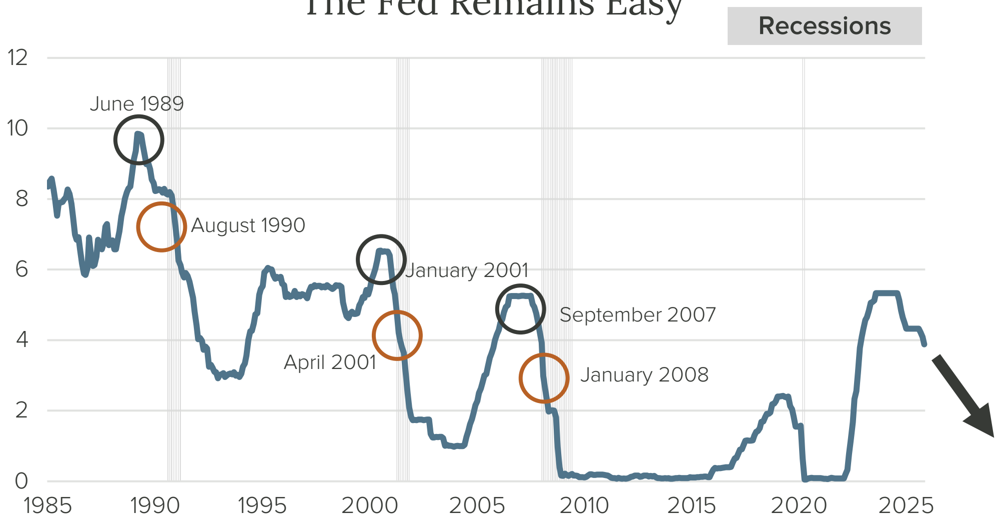
The Fed Remains Easy



Source: Federal Reserve Bank of St. Louis
Federal Funds Effective Rate, Percent, Monthly, Not Seasonally Adjusted (Data through 11/2025)

10-Year Treasury Yield

Source: Federal Reserve Bank of St. Louis
Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis, Percent, Monthly, Not Seasonally Adjusted (Data through 11/2025)

- The level of interest rates is always a huge factor in economic and investment success.
- The Fed as of now remains in an easing mode, projecting at least one federal funds cut this year. The market expects more.
- The Fed's actions will be influenced by unemployment, inflation, and economic growth.
- Recent strength in GDP and sticky inflation could prompt a reappraisal of policy.
- Long-term interest rates also declined in 2025. The outlook for further reductions will depend on Fed policy and tolerance of bond buyers for growing government debt burdens.
- Both short-term and long-term rates will ultimately be determined by the natural rate of interest, the level of which remains a mystery.

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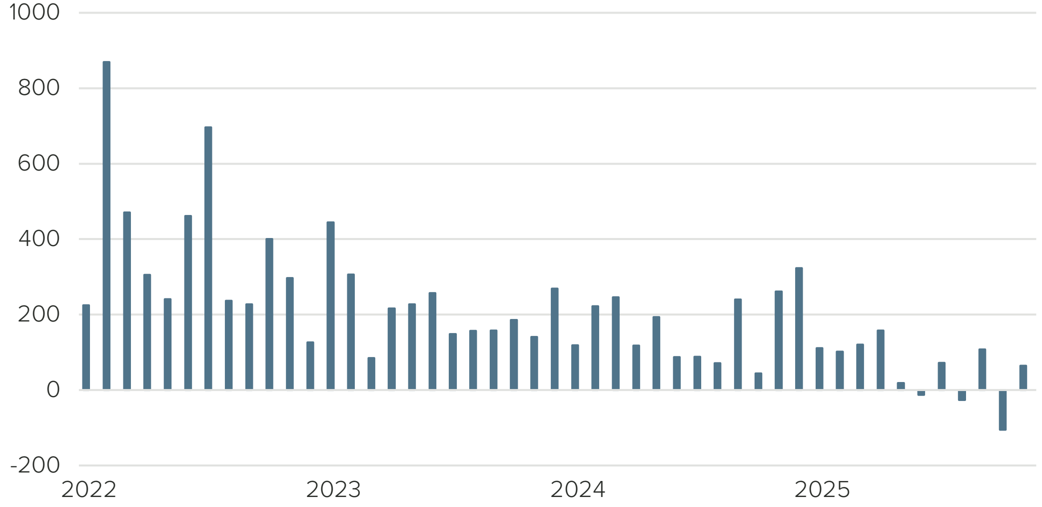
Monthly Job Creation in the U.S.



Source: Federal Reserve Bank of St. Louis
All Employees, Total Nonfarm, Change, Thousands of Persons, Monthly, Seasonally Adjusted (Data through 11/2025)

Where the Jobs Are

	YTD Payroll Gains	Avg Hourly Earnings	Avg Weekly Hours	Avg Weekly Earnings	AWE: NFP AWE
Nonfarm Payrolls	684,000	$36.67	34.2	$1,254.11	
Health Care & Social Assistance Adds	564,600	$32.39	32.8	$1,063.45	85%
Leisure & Hospitality Adds	125,100	$27.93	24.9	$695.80	55%

Source: BCA Research, Bureau of Labor Statistics
August 2025 Data

- The number of new jobs added to the economy has been in a downward trend for several years. This has occurred despite reasonably strong overall economic growth.
- Furthermore, the mix of new jobs is not favorable. Almost all of the new jobs have been in health care & social assistance and leisure & hospitality.
- Note the table opposite. The above noted jobs, which are lower paying, are a substantial portion of the new jobs created. Also, they lack the multiplying effect of jobs in other areas such as manufacturing.
- We do not disparage workers in health care & social assistance and leisure & hospitality. They are valuable workers in our economy, but these jobs create less leverage for economic growth.

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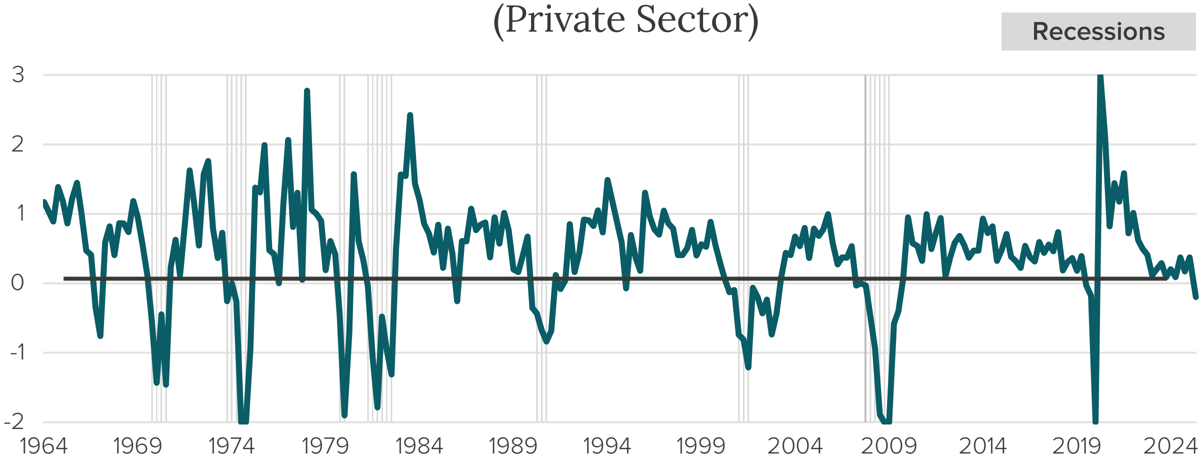
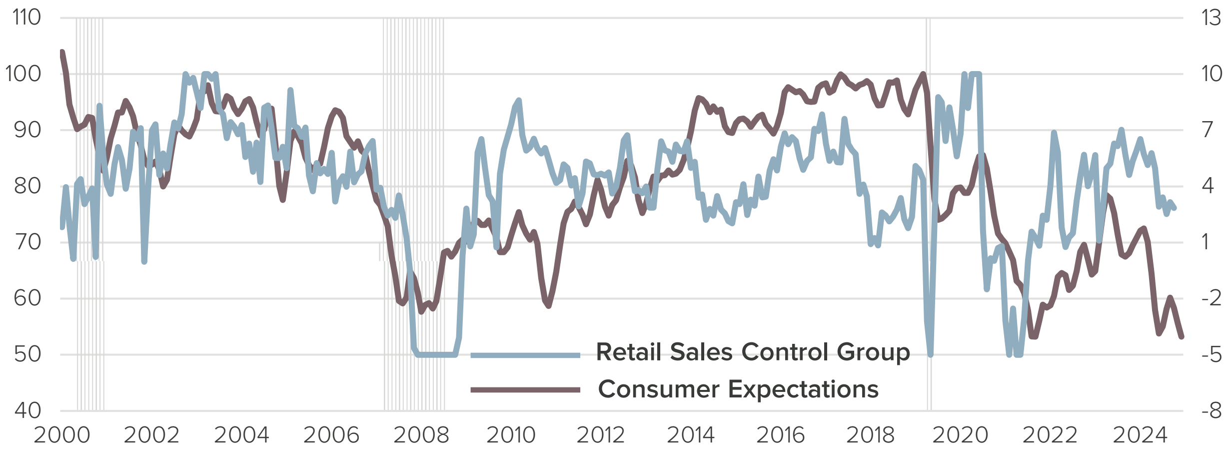
Quarterly Change in Aggregate Weekly Hours Worked (Private Sector)



Source: Federal Reserve Bank of St. Louis, BCA Research
Indexes of Aggregate Weekly Hours of All Employees, Total Private, Percent Change, Quarterly, Seasonally Adjusted; Prior to 2006 data is for Production and Nonsupervisory Employees; Data is truncated at -2% and 3% (Data through 3/31/2025); August 2025 value from BCA Research

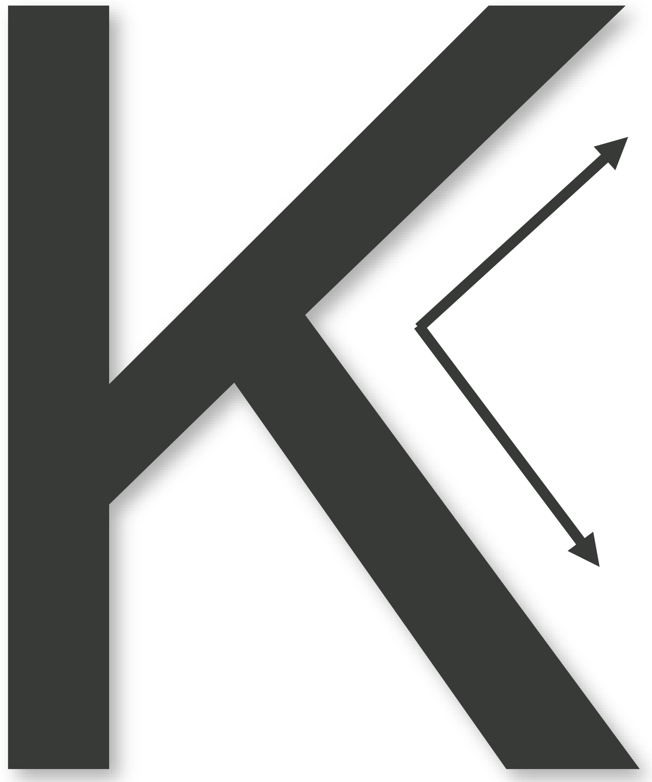
Consumer Sentiment & Real Retail Sales



Source: Federal Reserve Bank of St. Louis
University of Michigan: Consumer Sentiment, Index 1966:Q1=100, Monthly, Not Seasonally Adjusted – Shown as 3-month moving average; Consumer Price Index for All Urban Consumers: Durables in U.S. City Average, Percent Change used to adjust Retail Sales: Retail Trade, Percent Change, Monthly, Seasonally Adjusted – Shown as 12-month moving average, annualized (Data through 11/2025)

- One measure of labor market strength is weekly hours worked. After declining sharply over the last several years, it has recently stabilized. Even so, it is at a low level and has in the past been a recession warning sign.
- This factor is no doubt influencing Fed thinking on monetary policy. They appear to be prioritizing employment stability over further progress on inflation, hoping to engineer a soft landing.
- While the labor market remains resilient overall, gradual softening suggests momentum is fading across cyclical sectors.
- The trend in hours worked will feed into consumer expectations. The end result could be less consumption growth.

THE K-SHAPED ECONOMY: TWO LEGS ON OPPOSITE ENDS



- Wealthy and high-end earners
- Beneficiaries of the wealth effect (stocks and real estate)
- Greater propensity to save

- Lower income earners
- Impacted by inflation, wage growth, and basics such as gasoline, grocery, and utility expenses
- Greater propensity to spend but less to spend

- The K-shaped economy illustrates the wide divergence between high-end and low-end consumers.
- It also highlights growing income and wealth inequality.
- A healthier and more balanced economy could be symbolized by the letter O, illustrating a favorable circular dynamic that benefits all economic participants.

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Corporate Equity Held by U.S. Households & Nonprofits

Source: Federal Reserve Bank of St. Louis
Households and Nonprofit Organizations; Directly and Indirectly Held Corporate Equities; Asset, Market Value Levels, Billions of Dollars, Quarterly, Not Seasonally Adjusted (Data through 3/31/2025)

Corporate Equity Held as a Percent of Financial Assets

Source: Federal Reserve Bank of St. Louis
Households and Nonprofit Organizations; Directly and Indirectly Held Corporate Equities as a Percentage of Financial Assets; Assets, Level, Percent, Quarterly, Not Seasonally Adjusted (Data through 3/31/2025)

- Consumption is increasingly being supported by the top end of the K-shaped economy.
- The two charts opposite indicate the growing scope of stock ownership and its potential effect on consumption.
- A balanced economy is always healthier than an unbalanced one.
- Dependence on stock prices as a support for consumption contains risk, should stock prices correct meaningfully.

AFFORDABILITY: ONE OF THE WORDS OF THE YEAR

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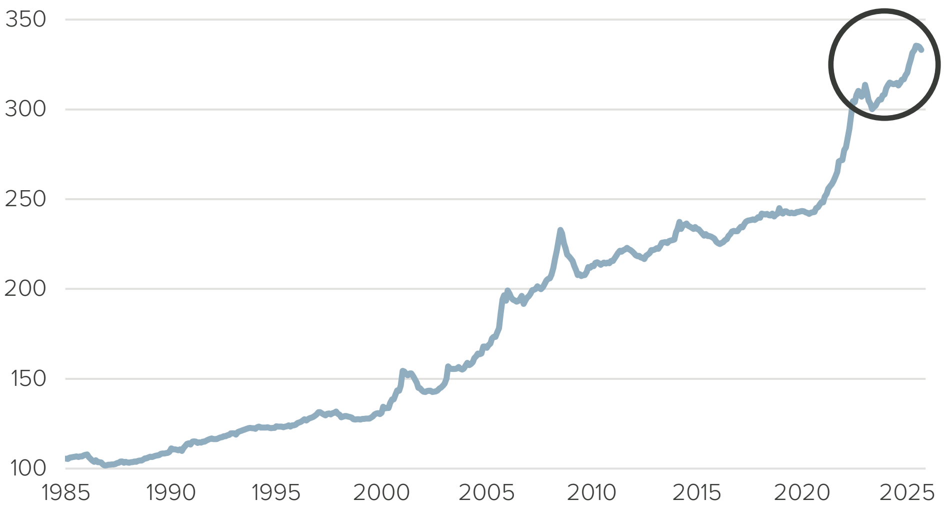
Fuels and Utilities in U.S. City Average

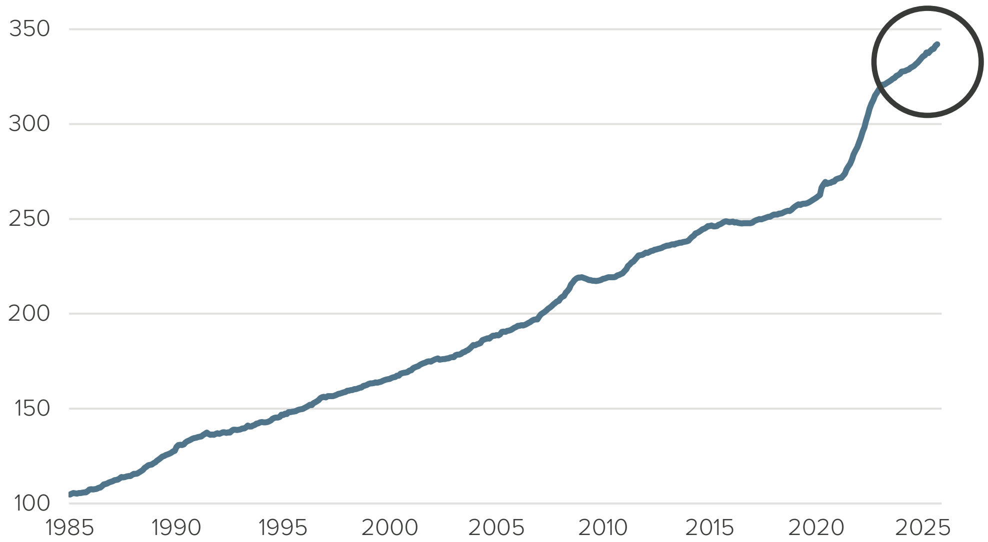


Source: Federal Reserve Bank of St. Louis - Consumer Price Index for All Urban Consumers: Fuels and Utilities in U.S. City Average, Index 1982-1984=100, Monthly, Seasonally Adjusted (Data through 11/2025)

Average Price of Gasoline

Source: Federal Reserve Bank of St. Louis - Average Price: Gasoline, Unleaded Regular (Cost per Gallon/3.785 Liters) in U.S. City Average, U.S. Dollars, Monthly, Not Seasonally Adjusted (Data through 11/2025)

Food in U.S. City Average



Source: Federal Reserve Bank of St. Louis - Consumer Price Index for All Urban Consumers: Food in U.S. City Average, Index 1982-1984=100, Monthly, Seasonally Adjusted (Data through 11/2025)

- "Affordability" became a word that describes consumer frustration with the rising cost of living.
- Even though inflation has declined substantially from its peak of 9%, it continues to rise at around 3%.
- Two items in particular are disturbing to consumers: food costs and utilities. These everyday items continue to pinch consumers.
- The reality is that outside of a depression, prices across the board will not decline. The answer over time is for wage gains to outpace inflation, thus creating real purchasing power.
- One encouraging aspect of affordability is that the price of gasoline has declined fairly sharply.

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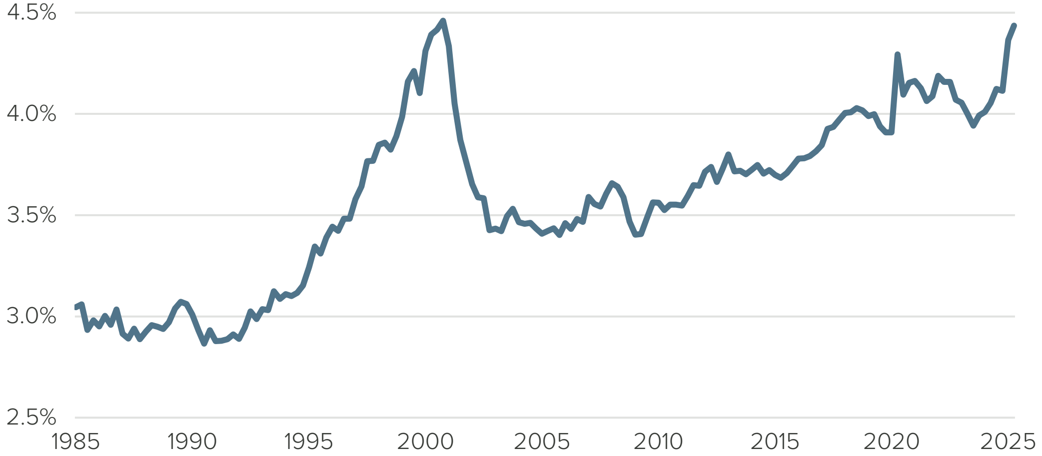
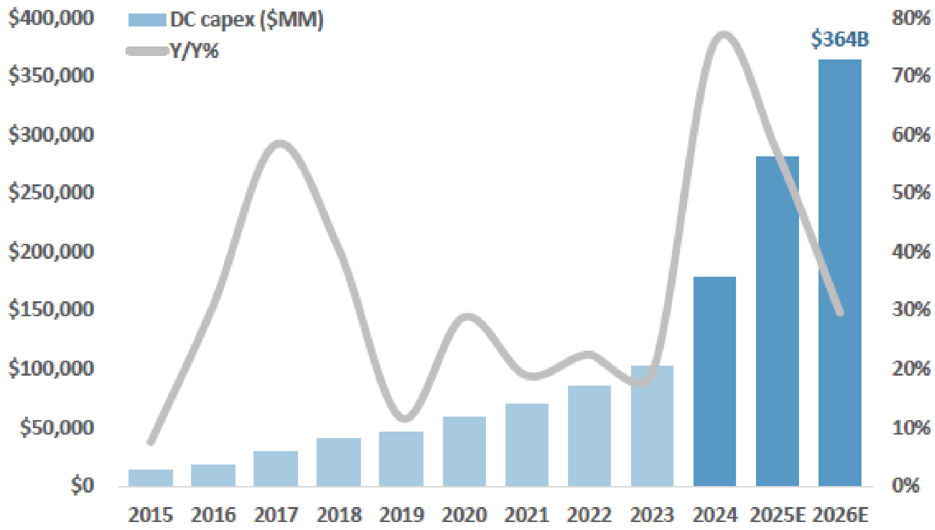
U.S. Investment in Information Processing Equipment & Software as a Percent of GDP



Source: Federal Reserve Bank of St. Louis - Private fixed investment in information processing equipment and software & Gross Domestic Product, Billions of Dollars, Quarterly, Seasonally Adjusted Annual Rate (Data through 3/31/2025)

Top 4 Hyperscalers Data Center Capital Expenditures



Source: 650 Group, J.P. Morgan estimates

- Notice the sharp increase in spending on technology-produced items. This is giving a major boost to overall investment growth.
- A significant portion of this spending is going to AI development.
- Hyperscalers (developers of data centers) have accelerated spending dramatically with the introduction of AI.
- Expenditures in this area are expected to be some $360 Billion in 2026.
- Note, however, from the bottom chart, the rate of increase is slowing sharply from as high as 80% in 2024 to an expected increase of 30% in 2026.

Increases in Labor Force + Productivity = GDP Growth

	Long Run (120 years)	Contemporary Trend	Future?
Labor Force Growth	1.1%	0.4%	0.3%
Productivity	1.9%	1.5%	?
GDP Growth	3.0%	1.9%	?

- The real hope for Artificial Intelligence (AI) is that it can increase productivity enough to meaningfully increase GDP.
- Declining labor force growth (population and immigration) is a secular headwind to GDP growth that needs to be overcome.
- The benefits from greater productivity and faster growth, among others, could be:
  - Rising standards of living
  - Government debt stabilization
  - Higher corporate profits
- These benefits may be achieved with widespread AI utilization across the economy. This will take time but offers optimism about the future of the economy.

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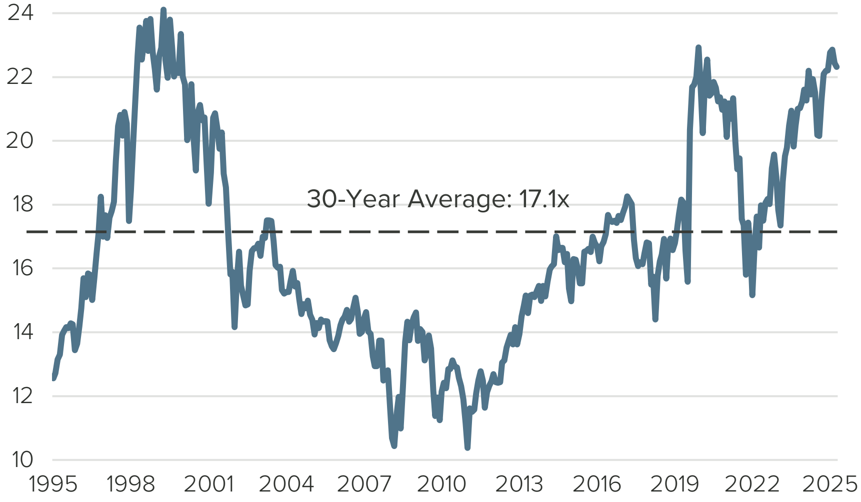
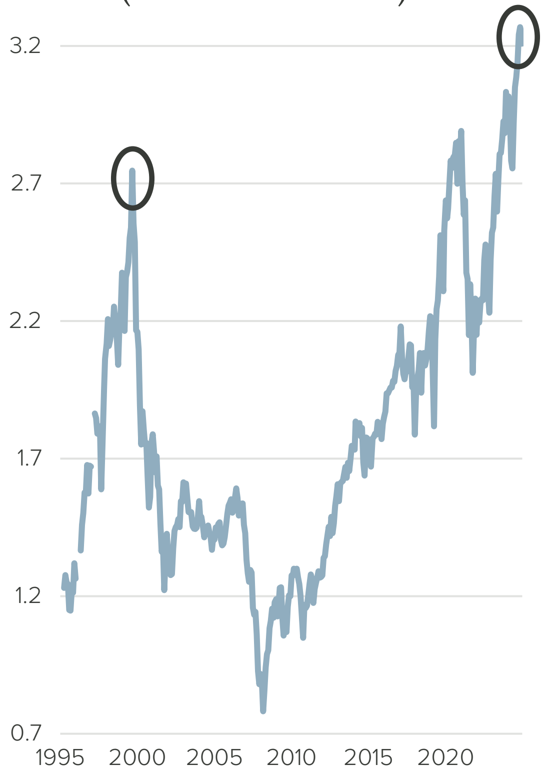
S&P 500 Price to Earnings (Next 12 Months)



	Latest	30-Year Average
Forward P/E	22.4x	17.1x
Shiller's P/E (CAPE)	40.5x	28.5x
Dividend Yield	1.4%	2.0%

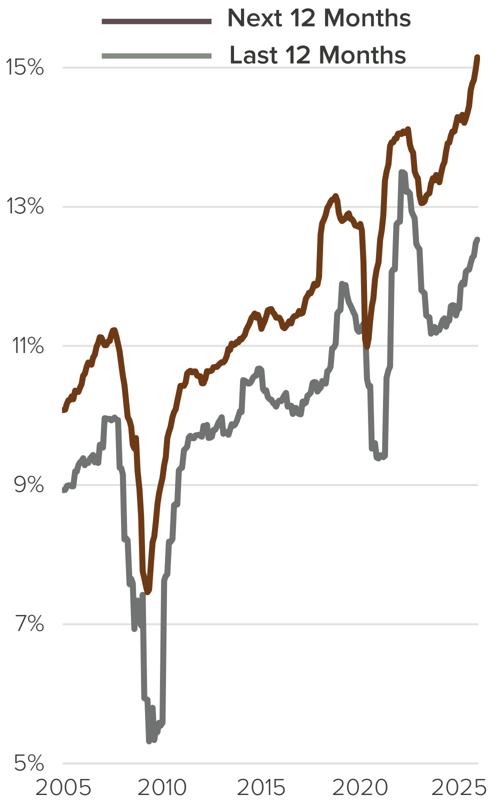
Source: FactSet; J.P. Morgan Guide to Markets – (Data as of 12/29/2025) Table is from J.P. Morgan as of 12/31/2025

S&P 500 Price to Sales (Next 12 Months)



Source: FactSet (Data as of 12/17/2025)

S&P Profit Margins



Source: FactSet - Calculated as EPS/SPS (Data as of 12/30/2025)

- The very strong returns from stocks over the last three years have been very rewarding. However, it leaves us with historically high valuations.
- The S&P 500 now trades at about 22x earnings. Other valuation measures are also extended. To expect further valuation expansion is probably unreasonable. Therefore, the burden of proof falls to earnings growth.
- In the absence of strong sales growth, corporate margins have continued to move higher. They too reside at historically high levels.
- Again, AI may be the secret sauce. Significant productivity gains could lead to even higher profit margins.
- High valuations may reflect optimism about the potential long-term benefits of widespread AI adoption.

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