July 1, 2026

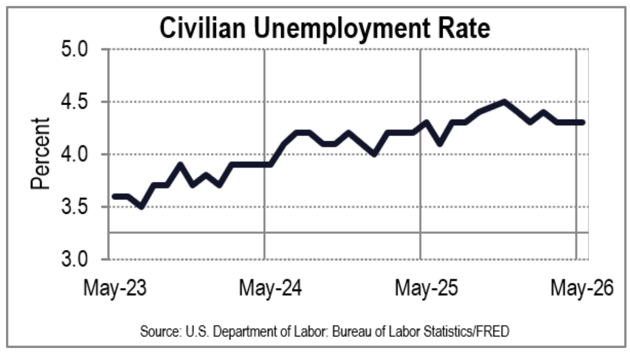
Economic Outlook:

We are now halfway through 2026, and the market recovery from the first-quarter pullback was significant. After declining in the first quarter, the S&P 500 rebounded sharply in the second quarter, supported by solid corporate earnings, resilient employment data, and improving investor sentiment despite elevated geopolitical uncertainty. The rally broadened beyond the largest technology companies, although artificial intelligence-related investment remained an important market driver. The small cap Russell 2000 dominance over the other indexes (including the tech heavy NASDAQ) will surprise many investors who have focused only on the largest technology names.

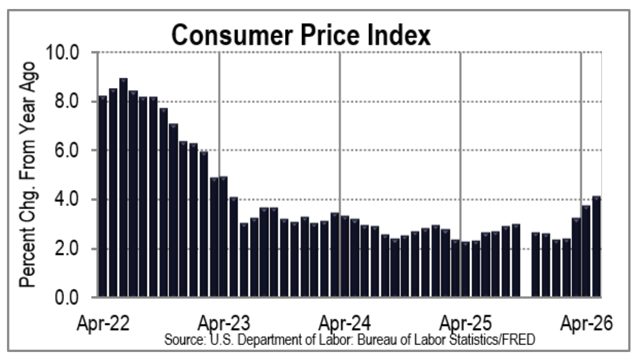
June ended with investors balancing two competing forces: a U.S. economy that continues to expand at a solid pace and inflation that has reaccelerated due largely to higher energy costs. The Federal Reserve held the federal funds target range steady at 3.50% to 3.75% at its June meeting, while signaling that price stability remains the priority. The market is now less focused on the timing of rate cuts and more focused on whether inflation pressures will prove temporary or require a more restrictive policy stance.

The conflict in the Middle East remains a large macroeconomic uncertainty. Higher oil prices have flowed into headline inflation, and the duration of the conflict combined with mixed messages of peace negotiations make it difficult to determine whether this becomes a short-lived supply shock or a more persistent drag on consumer spending.

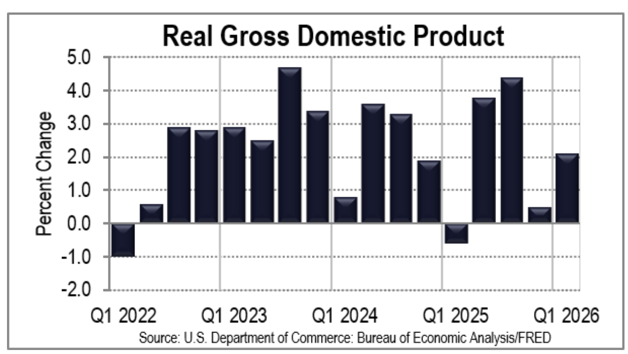
Employment: The latest available employment data as of this writing is the May jobs report released on June 5. Total non-farm payroll employment increased by 172,000 in May, and the unemployment rate was unchanged at 4.3%. Labor force participation held at 61.8%, while the employment-population ratio was little changed at 59.2%. Average hourly earnings rose to $37.53, up 3.4% over the past 12 months. Job gains were led by leisure and hospitality, local government, and health care, while financial activities employment declined.



Inflation: The latest CPI report showed inflation was moving higher in May. The Consumer Price Index rose 0.5% for the month and 4.2% over the past 12 months. Core CPI, which excludes food and energy, increased 0.2% for the month and 2.9% year over year. The increase in headline inflation was driven primarily by higher energy prices, reinforcing the market's concern that the Middle East conflict could keep inflation above the Fed's 2% target for longer than previously expected.

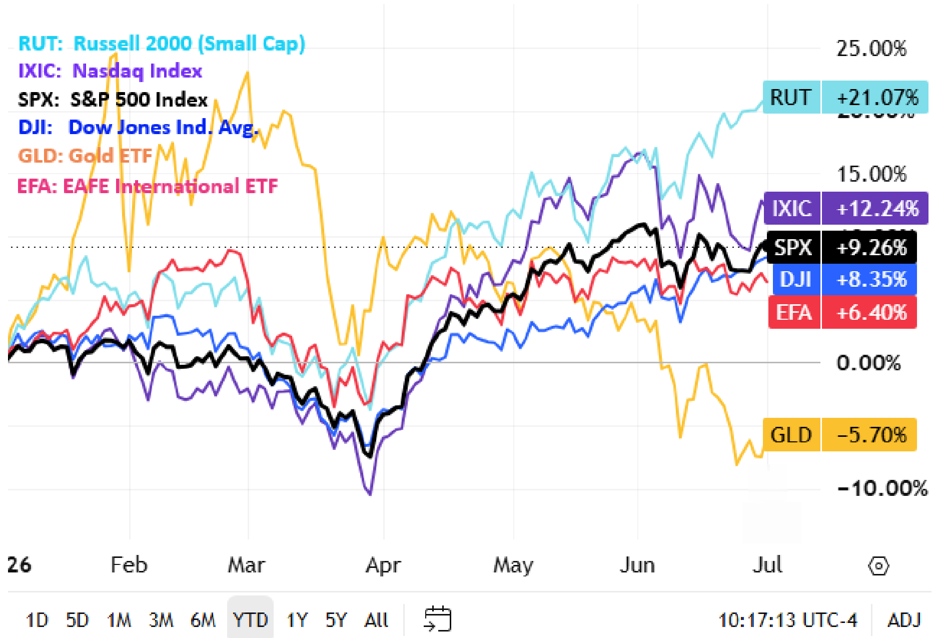


GDP: The economy continued to expand throughout the first half of 2026. The most recent GDP revision estimates GDP grew at 2.0% in the first quarter of 2026. The data indicates that economic activity remains positive, supported by productivity growth, capital investment, and a labor market that has kept pace with workforce growth. While consumer spending remains an important support, higher energy prices and persistent inflation are risks to growth in the second half of the year.



Equity Market Review and Outlook:

Stock Market Returns - Year to Date thru June 30, 2026



The second quarter of 2026 delivered a strong rebound for equities following the first-quarter decline. The S&P 500 recovered much of its earlier weakness as investors focused on resilient earnings, continued capital investment, and the possibility that the economy can avoid recession despite higher energy prices.

Market leadership broadened during the quarter, with value and cyclical areas participating alongside large-cap technology. Artificial intelligence investment remains a key theme, but the market's willingness to reward earnings growth outside of mega-cap technology is an encouraging development. At the same time, elevated energy prices, higher inflation readings, and uncertainty around Fed policy could limit multiple expansion.

Looking forward, the market remains focused on the path of inflation, the duration of the Middle East conflict, and whether the Fed will be able to remain on hold. We continue to believe that clarity on tax policy, progress on trade, and a stable labor market will support equities through the remainder of 2026, but volatility is likely to remain elevated until energy prices and inflation expectations stabilize.

Fixed Income Market Review and Outlook:

The Federal Reserve left the federal funds target range unchanged at 3.50% to 3.75% at its June meeting. After two years of progress reducing inflation, policymakers are now confronting a renewed inflation challenge tied to energy prices. The Fed's June statement emphasized that inflation remains elevated relative to its 2% goal and that the Committee remains committed to price stability.

Treasury yields moved higher during the quarter as investors adjusted to firmer inflation readings and a less certain policy outlook. Near the end of June, the 2-year Treasury yield was approximately 4.10%, the 10-year yield was approximately 4.4%, and the 30-year yield was approximately 4.9%. The yield curve is modestly positive, but still reflects uncertainty about inflation, growth, and the Fed's next move.

The current fixed income outlook is more balanced than it was earlier in the year. Short-term yields provide attractive income, but longer maturities may remain volatile if inflation continues to run above target. We continue to favor quality and disciplined duration management, while recognizing that a sustained decline in energy prices would likely improve the outlook for both bonds and equities.

Conclusion

The foundation of the economy remains sound, supported by continued job growth, strong capital investment, and corporate earnings. However, inflation and geopolitical issues still dominate the outlook. We have made portfolio adjustments where appropriate, but we continue to caution against dramatic changes in asset allocation during volatile market periods. Diversification, quality, and discipline remain the best tools for navigating the second half of 2026.

Thank you for your continued confidence,

Warren M. Hurt

Warren M. Hurt
Senior Vice President/Chief Investment Officer