AEQUITAS INVESTMENT ADVISORS

SUMMER OF 2026 LETTER

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Re: Striving for Equanimity

Warner is Your Team!

Summertime presents a great opportunity to connect with nature and the outdoors, take time off from work, appreciate the longer daylight hours, enjoy time with loved ones, and clear the mind. These are also many of the same ingredients necessary to achieve equanimity in life which is defined as mental calmness and emotional balance. Achieving equanimity with one's financial plan and investment portfolio should allow us to feel less stress and worry so that we can focus on the things which matter most in our lives. And such a sense of balance is one of the best ways to break the cycle of reactive stress which has surged due to the constant barrage of algorithmically-driven news cycles and social media platforms designed to induce emotional responses, including fear and anger.

In this summer's client letter, we will succinctly report on several major economic and geopolitical developments, review the surprisingly favorable year-to-date performance of the stock market, continue last quarter's discussion of the growing wealth gap in the U.S. (which is becoming a hot topic in the political realm), and conclude with a review of many of the key elements in achieving equanimity and balance with our portfolios.

The Seemingly Endless Iran War

The fragile ceasefire between the U.S. and Iran ended in early July and the conflict's outcome appears to be highly uncertain, especially given that diplomatic efforts appear to be in limbo. According to recent reporting from the *New York Times*, Iranian officials feel they are in a position of strength given their continued stranglehold on energy supplies flowing through the Strait of Hormuz. Certainly, the continued U.S. bombing on Iran's military and related infrastructure is exacting a toll on their economy, but for the time being, the Iranian regime appears to believe Trump will become impatient, and that time is on their side. That is yet to be seen, but in the meantime, elevated energy prices continue to negatively impact consumers globally. As of this writing, U.S. gasoline prices during this summer's travel season are more than 35% higher than they were before the war began in late February. Global oil reserves have been drawn down, and with higher related costs for transportation, consumers are facing higher prices for groceries and household goods. The latest inflation report indicated that consumer prices in the U.S. grew at an annual rate of 3.4% in July compared to a more modest rate of 2.4% before the Iran war began (the Federal Reserve's inflation target rate is 2%).

An Update on the Global Economy

The global economy has demonstrated surprising resilience despite the geopolitical headwinds and higher energy costs. In the table to the right, note that Global Manufacturing and Services activity continues to accelerate as indicated by the green colors. A reading of greater than 50 indicates that economic activity is accelerating which appears to be the case in every major region. The Euro Area was in neutral last month but has now turned green. An expanding global economy is favorable for corporate earnings which is one reason the stock market continues to perform well.

Global Economic Momentum

Purchasing Managers' Index (PMI)

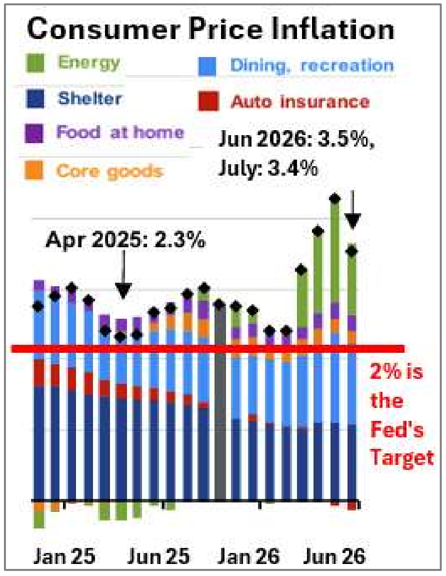
	June	July
Global	52.0	52.6
Global Manufacturing	52.2	52.1
Global Services	51.7	52.5
U.S.	51.9	54.5
Euro Area	50.0	52.0
Japan	52.8	52.7
China	53.6	50.8
India	57.1	54.3
Emerging Markets	53.0	51.2

Green = Accelerating Momentum

50 = Neutral, >50 = Accelerating, < 50 = Decelerating

The New Federal Reserve Chairperson

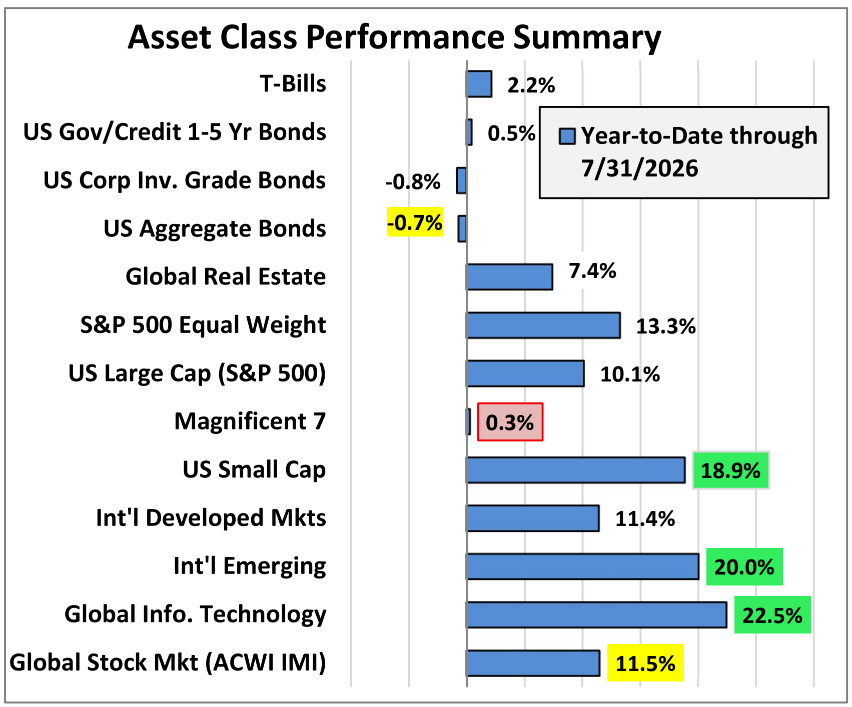
The Federal Reserve's new chairperson, Kevin Warsh, has so far preserved the Fed's independence, helping reassure investment markets. Although the president appointed Warsh with the expectation that he would lower interest rates quickly, Warsh's recent comments suggest a neutral stance on whether rates should rise or fall. With inflation spiking over the past four months due to the impact of the war on energy prices, the Fed appeared to be leaning toward a rate hike at its July meeting (the Fed voted 9–3 to leave rates unchanged, with the three dissenters favoring a rate increase). The Fed's dual mandate is to keep prices stable, i.e., keep inflation in check, and support full employment. The July jobs report probably complicates matters given that



the U.S. economy shed 23,000 jobs. The report also indicated that the unemployment rate fell to 4.1%, which may seem encouraging on the surface, but the decline appears to reflect more Americans leaving the workforce than finding jobs—an unhealthy signal. If inflationary pressures remain elevated, a rate hike would become more likely later this year, unless the labor market weakens further. In that case, the Fed may face a difficult choice between fighting inflation and supporting job growth.

Asset Class Performance Update

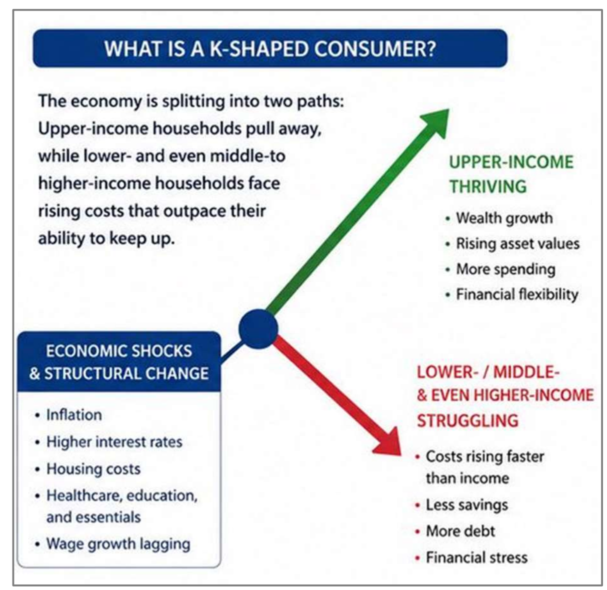
As mentioned above, the global economy has been remarkably resilient despite the geopolitical turmoil and inflationary pressures. Apparently, investors are more focused on corporate earnings which continue to surprise to the upside across most sectors of the economy, not just in the Information Technology sector where much of the Artificial Intelligence development has been taking place. The favorable earnings picture has extended into Mid-Cap and Small-Cap stocks as well. JPMorgan reported that the earnings growth consensus for the Small Cap 600 Index now stands at an annual rate of 15% for the next two years. The picture for Large Cap stocks remains favorable, as well, with Wall Street consensus projecting between 12% and 17% earnings growth for the S&P 500 in 2027. Ultimately, corporate earnings drive stock prices, and at least for the immediate future, the earnings outlook is supportive of current and future stock prices.



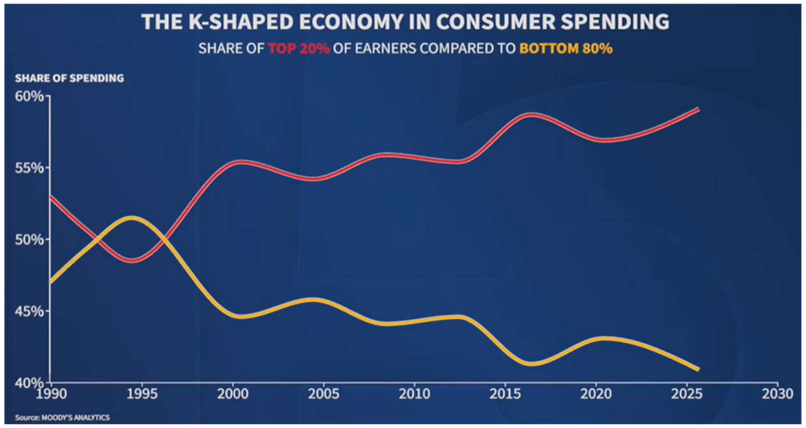
Year-to-date through July 31st, the Global Stock Market gained 11.5%, with returns among other major stock market asset classes and selected sectors ranging from 7.4% for Global Real Estate to 22.5% for Global Information Technology. Although the Artificial Intelligence trade continues to dominate headlines, other areas of the stock market have also delivered exceptional returns, including Emerging Markets (+20.0%) and U.S. Small Cap stocks (+18.9%). Notably, the Magnificent 7 stocks posted very weak year-to-date performance with a paltry return of 0.3%, as Tesla, Meta, and Microsoft weighed on the group with respective declines of 31%, 16%, and 3%. Within the Fixed Assets categories, several of the asset classes posted negative returns due primarily to the upward pressure on interest rates given elevated inflationary pressures. When interest rates rise, bond prices fall to reflect the higher yields looking forward. The current yield curve shows a 4.5% yield on the 5-year U.S. Treasury, compared to 5.5% for investment-grade corporate bonds; at the start of the year, those yields were 3.7% and 4.8% representing a significant improvement for the bond portion of our portfolios.

The K-Shaped Economy and a Wake-Up Call

In our last quarterly letter, we reviewed the record-low level of consumer sentiment and commented that roughly 50% of total consumer spending is attributable to the top 10% income earners (~13 million households earning $250K and higher). The next 35% of consumer spending is attributable to households earning between $60K and $250K (~78 million households), and just 15% is attributable to households earning $60K or less (~42 million households). The chart to the right aptly characterizes the U.S. economy as being “K-Shaped” with the upper-income thriving while the middle- and lower-income earners are struggling.

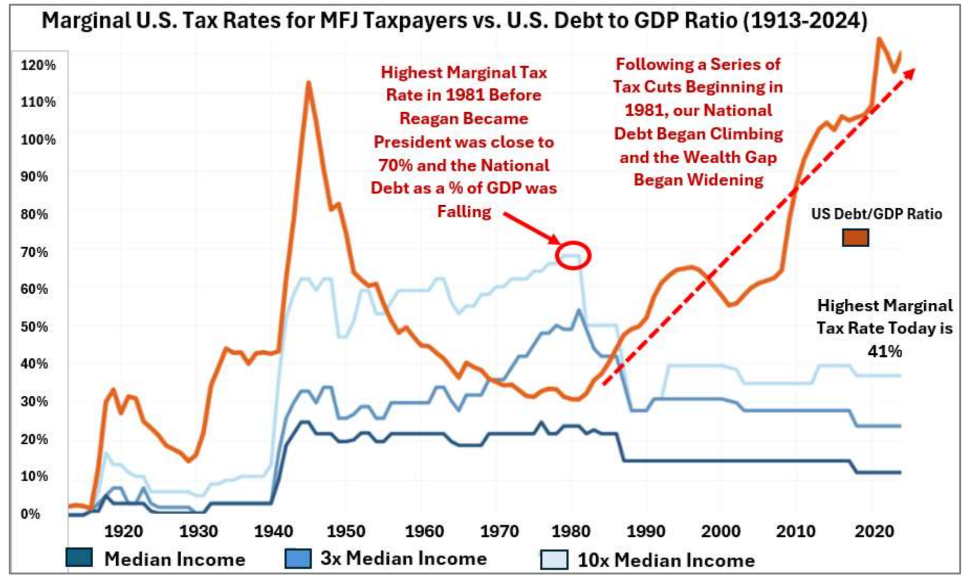


The K-Shape is not a recent development as this trend began more than thirty years ago. In the chart below, note the divergence in the share of consumer spending between the top 20% of income earners and the bottom 80%. At the most recent balanced point in 1995, slightly more than 50% of consumer spending was attributable to the bottom 80% whereas today that figure has declined to 40%.



Income Tax Policy Further Exacerbated the Wealth Gap

The K-Shaped income and wealth gap was fueled to a significant extent by a series of tax cuts over the past four decades beginning with Ronald Reagan's Economic Recovery Tax Act of 1981 when the top individual tax rate was slashed from 70% to 50%, and capital gains tax rates reduced from 28% to 20%. The underlying concept of lowering taxes on the upper income earners was that economic growth would be stimulated, and economic benefits would "trickle down" to the lower income levels. Indeed, economic growth was stimulated over the last four decades of tax-cut policies, but the economic benefits disproportionately favored the top income earners. Not only has the series of tax cuts exacerbated the wealth gap, but with lower tax revenue the level of our national debt has ballooned since the early 1980s. In the chart to the top right, note the orange line representing the ratio of our national debt to our GDP (Gross Domestic Product). During and following WWII, taxes were raised significantly to help pay for the war effort. High tax rates were held in place until the early 1980s when the debt level had fallen from over 100% of GDP to about 31% of GDP. Unfortunately, while tax rates were slashed, federal spending kept growing, deficits grew, and we find ourselves today with the highest level of debt our country has ever faced. To be clear, the national debt crisis was not caused by tax cuts alone, but by a combination of lower federal tax revenue, rapidly rising program costs—including defense, Social Security, and Medicare—and a lack of political will by either party to address the imbalance. (The politically difficult set of solutions, as outlined in detail by the Congressional Budget Office, is to increase federal revenue while also reducing spending. In our next quarterly letter, we will delve into the national debt crisis and related investment implications).



How Might We Begin to Correct the Imbalance?

The K-Shaped economy is unsustainable and will continue to widen the wealth gap, with significant social and political consequences. Perhaps symptomatic of this economic divide were the results of several recent political contests which were won by "democratic socialists" who appealed primarily to the frustrations of the lower- and middle-income earners who feel that the current system is failing to deliver financial security despite their hard work. On this note, more than ten years ago, the venture capitalist Nick Hanauer, who earned much of his wealth as an early investor in Amazon in the 1990s, warned that unless the U.S. addressed economic inequality, society would become destabilized. More recently, Hanauer warned his fellow plutocrats that "Americans can see that no matter how hard they work, they cannot get ahead. Meanwhile, a tiny group of rich people – people like me – can rub money together to make more money." (For reference, a plutocracy is defined as a society or government that is controlled or heavily influenced by its wealthiest citizens.) Rather than a socialistic approach to addressing the wealth gap, Hanauer believes in a capitalistic economy based on "Market Humanism" consisting of three core principles:

- Human Flourishing as the Goal: The ultimate purpose of the economy is to support human well-being and life on earth, not just maximizing GDP or financial returns. [Hanauer believes we can have both.]
- Building Constructive Value vs Extractive Value: Real economic value is created by cooperating to solve human problems, which drives evolutionary progress and innovation. [Constructive value builds new resources, solves

problems, and expands benefits for everyone involved. Extractive value captures, shifts, or monetizes existing wealth or resources without adding new utility, often benefiting one party at the direct expense of another.]

- Shared Prosperity as the Growth Engine: A secure, thriving middle class drives demand and economic growth, rejecting the premise that helping working people harms efficiency. [Key elements: increasing the minimum wage, funding public infrastructure, and creating affordable healthcare and childcare.]

Further information on Hanauer's ideas and solutions can be found in the Summer 2026 edition of the online journal *Democracy* entitled, "[Market Humanism: A New Paradigm for a New Era](),"

Portfolio Balance and Equanimity

While society faces major challenges in achieving greater economic balance, as investors we can still build balance and equanimity into our portfolios and financial plans. We close this summer's update with a chart created by our newest teammate, Matthew McCarthy, highlighting key elements of a well-balanced portfolio designed to help our clients maintain equanimity amid the constant stream of algorithm-driven social, political, and market narratives. We suggest reading the top two panels first beginning from the left which describes the primary need to build a globally diversified portfolio based upon balancing one's future financial needs against one's individual risk tolerances. The next panel highlights the importance of "tuning out the noise," relying on financial science rather than sentiment, embracing market uncertainty, and avoiding market timing. The bottom left panel focuses on key determinants of higher expected future returns, including tilting toward smaller company stocks, stocks with lower prices, companies with higher profitability, and companies which are committed to sustainable practices. The bottom right panel reminds us to stay the course, plan and not predict, and only make portfolio adjustments after careful thought based upon long-term outlooks. Letting time do the work by allowing compounding to create long-term success.

At Aequitas, we strive to help create equanimity for our clients in planning for the future in an uncertain world. With that in mind, we hope that the remainder of your summer is enjoyable!