LOAD BEARING WALLS

ECONOMY | INTEREST RATES | STOCK MARKET

EXECUTIVE SUMMARY

Labor & Economy

- The unemployment rate eased to 4.2% in June, and has been relatively steady over the past several quarters.
- The Sahm Rule recession indicator has not been triggered despite repeated slowdown concerns.
- Manufacturing has now expanded for six consecutive months and the Services sector for twenty-four.

Yields & the Fed

- The two-year Treasury yield has moved back above the effective Fed funds rate. Historically, Fed policy has trailed moves in the two-year yield.
- With the ten-year yield near 4.70%, markets expect rates to remain elevated near term.

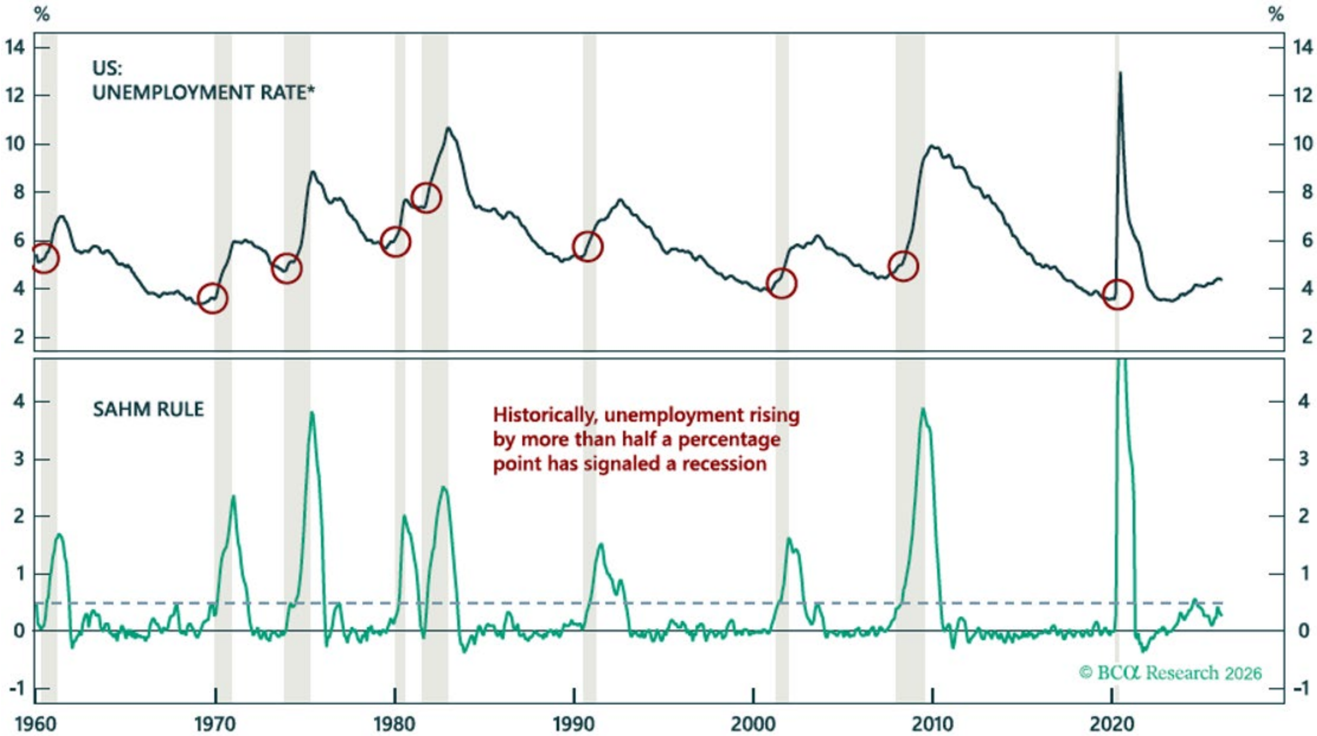
Stock Market

- SpaceX came public near 140 times revenue, an order of magnitude above the Magnificent 7.
- Sector leadership has rotated repeatedly this year, with energy and financials again in front.
- Market breadth improved, with 46% of S&P 500 companies outperforming the index through June.

In any building, some walls hold the structure up and others simply divide the rooms. From the outside they look identical. The difference only becomes apparent when something is removed.

For most of the past decade, markets leaned on a familiar set of supports: fiscal stimulus, low interest rates, a handful of dominant technology companies, and the expectation that policy would ease whenever growth slowed. Those supports are being tested. The two-year Treasury yield now sits above the Fed funds rate, technology companies are seemingly vulnerable, and stock market leadership continues to reshuffle. A broader share of the S&P 500 is buoying the index, and unemployment has remained stable. But earnings growth must carry the market forward from here.

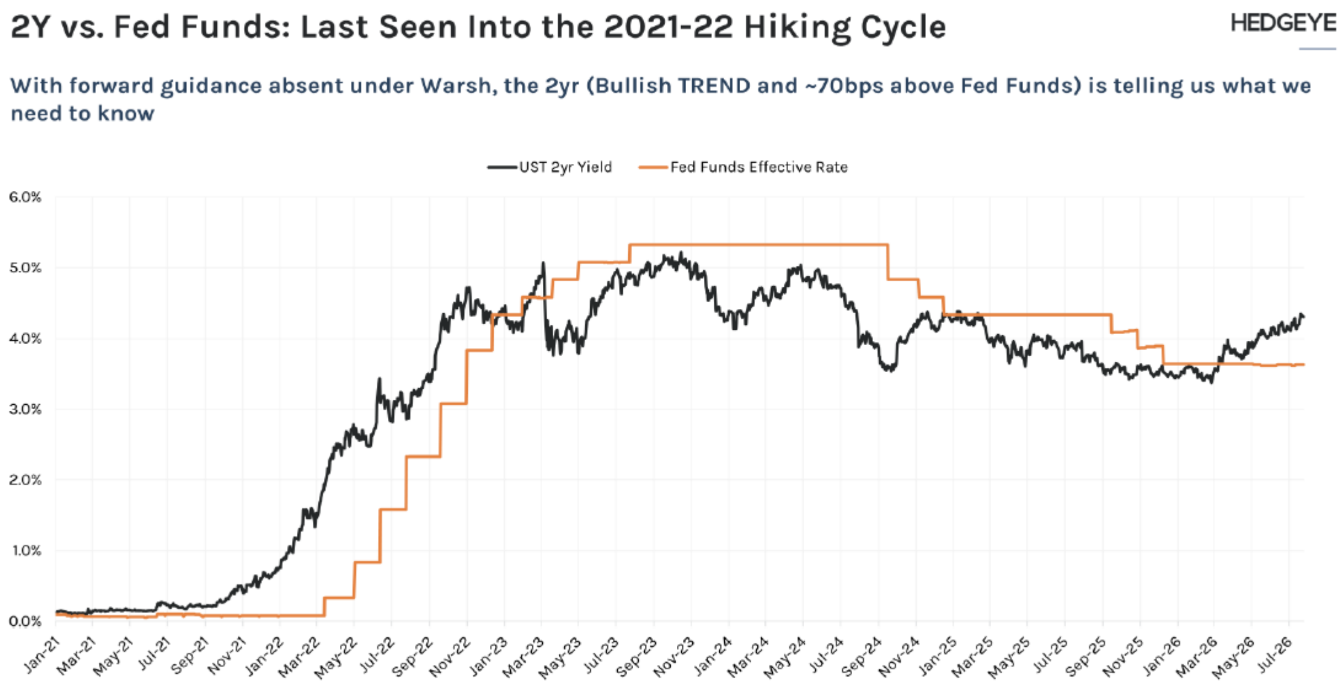
EMPLOYMENT & SIGNALING



* SHOWN AS A 3-MONTH MOVING AVERAGE; SOURCE: BUREAU OF LABOR STATISTICS.
NOTE: THE SAHM RULE SAYS THAT RECESSION FOLLOWS WHEN THE 3-MONTH MOVING AVERAGE OF THE UNEMPLOYMENT RATE INCREASES BY MORE THAN HALF OF A PERCENTAGE POINT FROM RECENT LOWS, SHOWN AS CIRCLES IN THE TOP PANEL OF THE CHART; SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

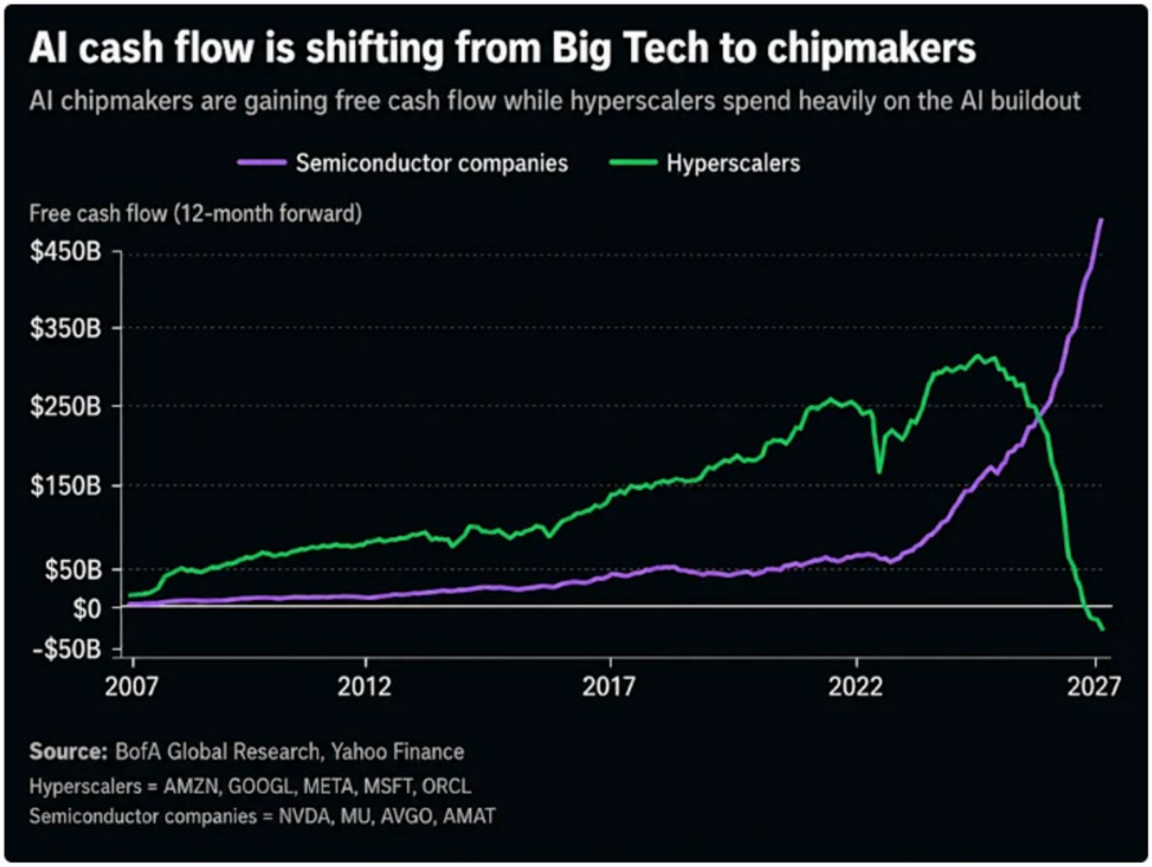
- The unemployment rate eased to 4.2% in June from 4.3% in May and has changed little over the past several quarters. This stability reflects not only steady hiring, but also a structurally tight labor force, as many workers aged 55 and older who left during the pandemic did not return.
- The Sahm Rule, a widely followed recession indicator, has not been triggered. Historically, recessions have followed when the three-month average unemployment rate rises by at least 0.5 percentage points above its recent low, a threshold that has not been decisively crossed despite repeated slowdown concerns.
- Broader economic activity also points to continued, though moderate, expansion. Manufacturing has grown for six consecutive months and the Services sector for twenty-four. Cost pressures have declined, but that improvement will likely be tested with renewed energy-market uncertainty.

YIELDS & THE FED



- The two-year Treasury yield has moved back above the effective Fed funds rate in recent months. Historically, short-term Treasury yields have often turned ahead of Fed policy, making the bond market an important signal of where interest rates may be headed.
- With the ten-year yield near 4.7%, the two-year around 4.35%, and Fed funds just above 4%, markets appear to expect rates to remain elevated through at least the next meeting or two. Renewed inflation pressures or stronger growth would likely push those expectations higher.
- The consequence is a change in what carries the market forward. With easing monetary policy no longer a dominant expectation, the weight shifts to productivity, revenue, margins, and earnings.

TECHNOLOGY CASH FLOWS



- The economics of the Artificial Intelligence trade are shifting within the technology sector. Free cash flow at the hyperscalers (Amazon, Google, Meta, Microsoft, Oracle) has fallen from more than $300 billion toward zero due to massive capital expenditures. Meanwhile, semiconductor free cash flow has moved sharply higher, reversing a decade-long pattern.
- This appears to be a transfer of cash flow rather than a collapse in demand, as hyperscaler spending on data centers and chips becomes revenue for semiconductor companies. The larger question is whether this investment cycle can be funded efficiently, particularly as more capital spending relies on borrowing and may not generate attractive returns on every dollar invested.

LOFTY VALUATIONS

SpaceX vs. Magnificent 7
(Price-to-Revenue Ratio)

Company	Price-to-Revenue Ratio
SpaceX (SPCX)	**141.3**
Nvidia (NVDA)	19.8
Tesla (TSLA)	15.5
Apple (AAPL)	9.7
Microsoft Corp. (MSFT)	9.2
Meta Platforms (META)	6.1
Alphabet (GOOG)	5.1
Amazon.com (AMZN)	3.6

InvesTech Research

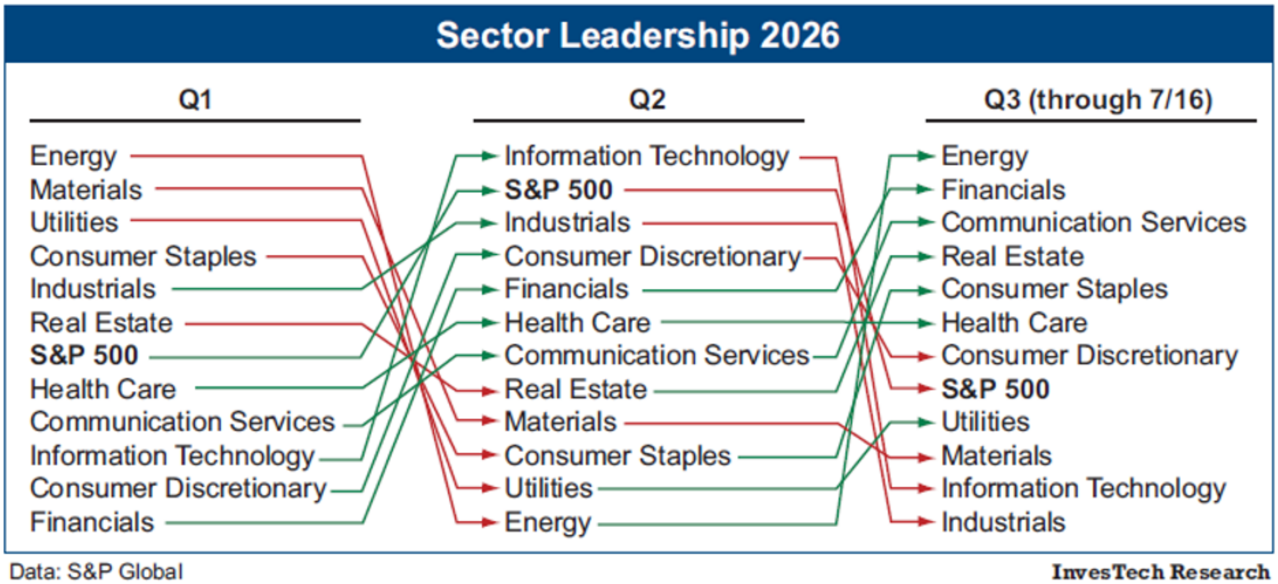
- SpaceX came public on June 12 in the largest offering in market history, trading at roughly 140 times revenue at the initial public offering (IPO). That places it an order of magnitude beyond the companies typically cited as expensive — Nvidia near 20 times revenue, Tesla near 15, Apple and Microsoft near 9, and Amazon under 4.

- The arithmetic behind such lofty valuations was put plainly a generation ago, when Scott McNealy reflected on the excesses of the internet boom. Sun Microsystems traded at 10 times revenues after running from $5 to a peak of $64 in 2000, fell back to $5 by 2002, and was ultimately acquired by Oracle in 2010 for a split-adjusted price of $2.40 per share.

> *"…Two years ago, we were selling…at 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?..."* - Scott McNealy, CEO of Sun Microsystems, March 2002

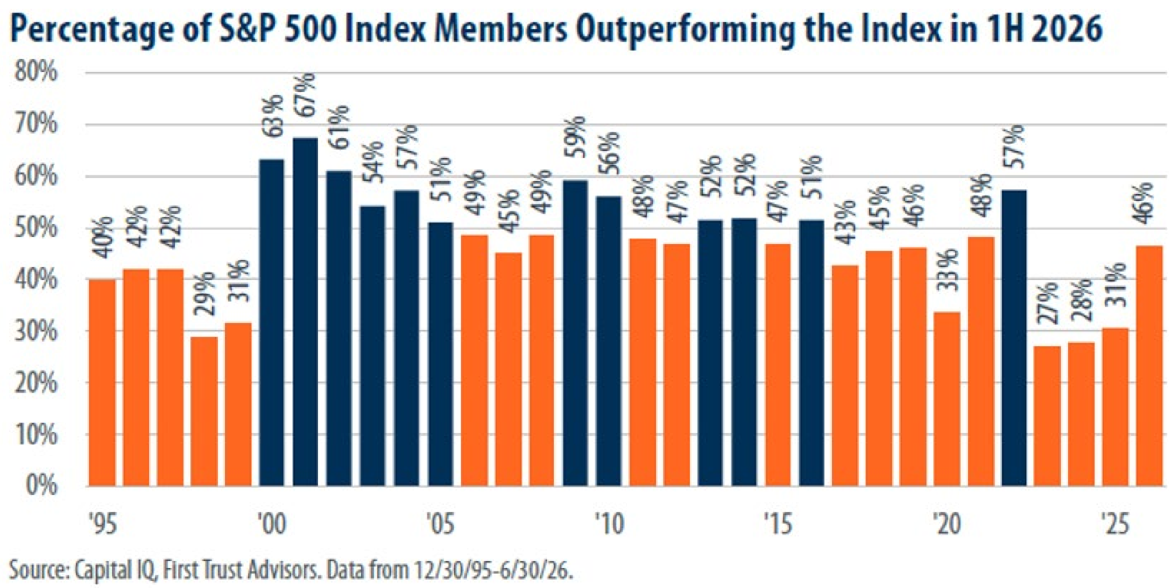
- One important distinction does separate today from that period: many of the companies commanding premium valuations today generate substantial earnings growth. However, valuations at these levels leave little room for disappointment, and history may ultimately pose the same question McNealy asked of his own era.

SECTOR LEADERSHIP



- Market leadership has remained fluid. Energy, materials, utilities, and consumer staples led in the first quarter but fell to the bottom of the rankings in the second, while technology and other early laggards moved to the front.
- The pattern shifted again through mid-July, as technology weakened and energy and financials regained leadership. Energy's relative performance continues to be influenced by developments involving Iran and the Strait of Hormuz, affecting how the rest of the market ranks by comparison.
- Rapid rotation can be difficult to interpret, but it also suggests that capital is moving across sectors rather than concentrating in the narrow group that drove returns over the past three years. With leadership still unsettled, the pattern supports patience and diversification rather than chasing whichever sector has most recently moved to the top.

MARKET BREADTH



- Market participation has improved. Through June 30, 46% of S&P 500 companies outperformed the index, up from 27%-31% over the prior three years, when returns were driven by a much narrower group of stocks.
- The improvement is meaningful, though not exceptional by historical standards. Readings above 50% were common in earlier decades, placing today's level closer to normalization than to unusually broad leadership.
- Six months does not establish a lasting trend, and prior attempts at broader participation have faded. Even so, a market supported by more companies is generally less dependent on a handful of leaders and may provide a more durable foundation.

CONCLUSION

As the second half of 2026 continues, the market is relying on a different set of supports. Low interest rates and concentrated technology leadership are no longer sufficient on their own. With Fed relief less certain, companies must increasingly justify valuations through productivity, revenue growth, margins, and earnings.

The transition is not entirely negative. The economy continues to expand, employment remains stable, and market participation has broadened as leadership rotates across sectors. Together, these trends suggest that the market is becoming less dependent on a small group of companies. However, the newer supports are not yet fully established. Broader participation has been brief, Artificial Intelligence investment is consuming substantial capital, and elevated valuations leave little room for setbacks.

That is the central tension beneath today's market. The structure appears to be gaining more supports just as each support is being asked to carry more weight. Conditions do not need to be perfect, but growth must remain firm, capital must be deployed productively, and earnings must continue to broaden.

A structure supported by many walls is generally sturdier than one resting on only a few, but its strength is ultimately revealed under pressure. In this environment, patience and diversification remain more dependable than conviction in any single policy outcome, technology theme, or sector leader.

If you would like to review your risk exposure and how it aligns with your long-term financial plan, we are happy to discuss your situation, the markets, or anything else you would like to talk about.

We are here to guide you and to provide clarity and confidence along the way.

Sincerely,

Spectrum Asset Management, Inc.

Newport Beach, CA