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by Yellow Cardinal Advisory Group

MARKET UPDATE
July 31, 2026

Belts and Suspenders

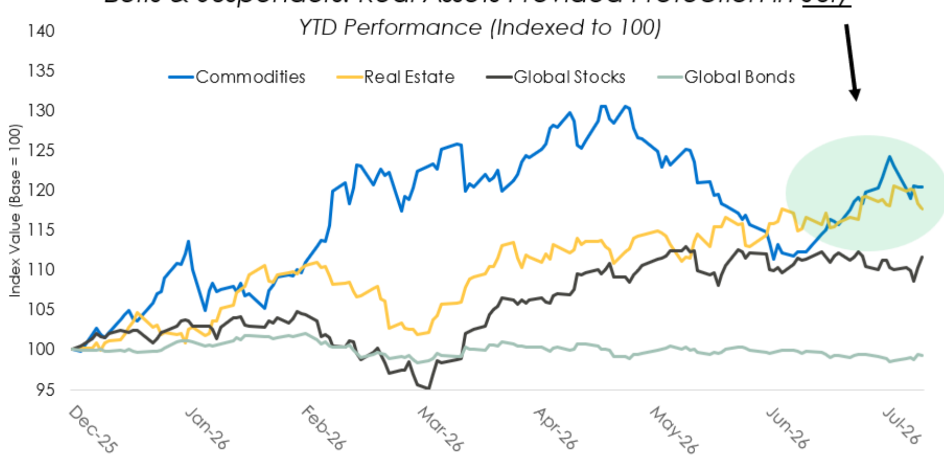
"The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails."

– William Arthur Ward, American writer

"Belts and Suspenders" may sound overly cautious – and a bit awkward to those fashion-forward readers – but July reminded investors why extra protection can matter. The month brought a mix of renewed geopolitical hostilities, volatile oil prices, sticky inflation concerns, and renewed questions about the sustainability of AI-related capital spending. Yet the backdrop was not simply risk-off. Earnings growth remained exceptionally strong, CAPEX trends continued to support nominal growth, and equity-market internals still pointed to rotation rather than outright deterioration.

In other words, July was less about "abandoning ship" and more about "adjusting the sails". Growth didn't appear to be breaking, but the market did seem to be preparing for a more complicated environment — one where portfolios may continue to need both offense and defense.

Belts & Suspenders: Real Assets Provided Protection in July



Source: Factset; Commodities defined using the Bloomberg Commodity Index, Real Estate defined using the FTSE NAREIT/All Equity Index, Global Stocks defined using the MSCI All Country World Index, Global Bonds defined using the Bloomberg Global Aggregate Index. All returns are indexed 12/31/25-7/31/26.

The first observation this month was renewed demand for "Belts and Suspenders" exposure, as shown in the chart at right. Real Assets have significantly outperformed traditional Stocks and Bonds so far this year, with Commodities and REITs benefiting from renewed demand for purchasing-power protection. That leadership remained relevant in July as US-Iran hostilities simmered, crude prices remained elevated, and investors assessed the inflation and Fed implications of higher energy prices. Additionally, economic data continued to point to strong nominal growth in 2Q. Against that backdrop, the July Fed meeting left rates unchanged at 3.5%–3.75%, but three policymakers dissented in favor of a hike. Markets are now trying to reconcile strong inflation jawboning from the Fed Chair with limited policy action thus far. This means that September remains a live meeting, while the Fed appears intent on shifting the market's focus back to the data.

The second important message from July was that the profit cycle appears to be downshifting, not breaking. Second-quarter EPS growth is tracking at an astounding pace — roughly 40% versus 29% in 1Q — helped by AI-related CAPEX and healthy pricing power (along with private investment gains from recent IPOs). Forward forecasts still point to a low-to-mid-teens growth trajectory over the next twelve months. That's slower than the current pace, but still far from a growth scare.

Markets, however, are forward-looking. Even with strong earnings, price action suggests investors may be signaling a peak in the rate of earnings growth. Mega-cap tech results were strong but increasingly disparate, with a sharper divide between winners and laggards. The stakes remain high as renewed concerns around AI CAPEX intensity have weighed on selective higher-valuation and longer-duration areas of the market (with ebbs and flows).

Downshifting, Not Breaking

Monthly relative performance vs S&P 500 by equally weighted sector basket

Month	Cyclical Value	Cyclical Growth	Defensives	Monthly Leader
January	4.70	-1.83	0.81	Cyclical Value
February	6.16	-3.50	6.62	Defensives
March	1.70	0.81	-2.87	Cyclical Value
April	-6.03	4.71	-9.07	Cyclical Growth
May	-7.87	7.10	-6.01	Cyclical Growth
June	3.95	-3.39	5.20	Defensives
July	2.92	-2.55	1.72	Cyclical Value
YTD Cumulative Total	**5.53**	**1.35**	**-3.61**	**Cyclical Value**

Legend:
Values show month-over-month relative performance vs S&P 500 (in percentage points)
Positive = Outperformed S&P 500 that month
Negative = Underperformed S&P 500 that month

Cyclical Value = Financials, Materials, Industrials and Energy
Cyclical Growth = Technology, Communication Services, Consumer Discretionary
Defensives = Consumer Staples, Health Care, Utilities

Source: Factset

The sector heatmap at right helps illustrate the distinction. If markets were pricing an outright break in growth, leadership would likely be concentrated almost entirely in Defensives. Instead, July's sector rotation showed a more balanced message. Cyclical Growth underperformed, while Cyclical Value and Defensives both outperformed.

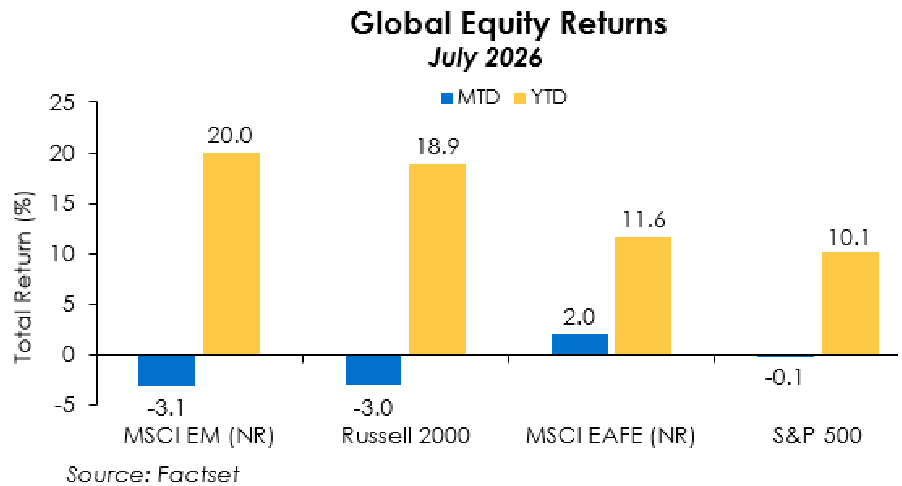
That mix matters. Cyclical Value leadership suggests investors are not abandoning nominal growth exposure. Defensive outperformance suggests they are also adding protection. The result is an offense-and-defense market — consistent with a profit cycle that's slowing from an exceptional pace rather than materially breaking down.

For portfolios, July was a "Belts and Suspenders" month that reinforced the importance of balance. That's not because growth was breaking, but because risks were rising and leadership was rotating. Real Assets provided protection, while sector rotation pointed to a profit cycle expected to downshift from an exceptional pace.

Commodities and REITs delivered another month of strong returns as investors looked to real assets for inflation protection. Meanwhile, Stocks were generally lower for the month outside of the Developed International segment. Bonds were also generally lower as interest rates rose on strong economic data and increased expectations for Fed rate hikes.

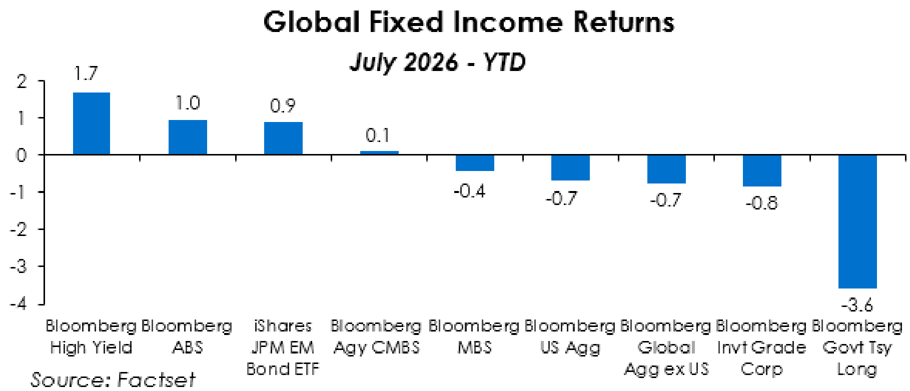
Stocks

Developed markets (MSCI EAFE) led in July, as investors rotated away from U.S. mega-cap tech and into value-oriented areas such as energy and financials. U.S. large caps (S&P 500) were flat for the month, after posting their best quarter in six years, due to market participants rotating selectively away from some cyclical growth pockets. U.S. small caps (Russell 2000) retreated after delivering very strong second quarter and year-to-date returns on expectations of accelerating earning growth. Emerging markets (MSCI EM) lagged as AI-related semiconductor and memory stocks experienced significant corrections in July after leading for much of the year. From a sector perspective, the market continued to broaden in July. Seven sectors outperformed the S&P 500 during the month, with strong performance from Energy and Financials while Technology lagged. Year-to-date, Energy, Industrials, Technology, Real Estate, and Consumer Staples all outperformed – an indication of the market's rotational nature.



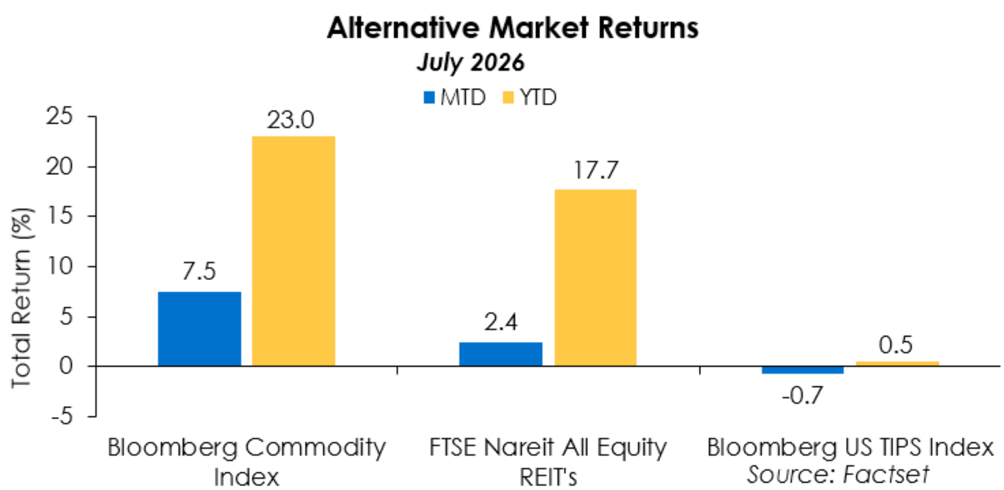
Bonds

Policymakers continued their cut-and-pause approach, with cuts in 2H24 and 2H25 followed by pauses in 1H25 and 1H26. Following the July meeting, the federal funds rate remained unchanged at 3.50%–3.75%, while the "dot plot" implies one 25 bps rate hike by the end of 2026 followed by cuts in '27-28. This compares to a slightly more restrictive forward curve with around two hikes priced in. New Fed Chair Kevin Warsh emphasized price stability and the Fed's resolve to tame inflation, while indicating a preference for reduced forward guidance to increase policy flexibility. Investors viewed this as a "hawkish hold" though markets are sensitive to more talk than action making September a live meeting dependent on lots of data between now and then. For the month, Bonds posted negative returns while delivering mixed results year-to-date, as inflation concerns partly offset the benefit of tighter spreads and carry. High Yield, Asset Backed Securities, and Emerging market debt have performed best due to their higher starting yields. Meanwhile, long-dated U.S. Treasuries have lagged with the back up in rates due to strong economic growth and increased expectations for rate hikes.



Alternatives

Commodities were the best-performing asset class in July and year-to-date as oil prices spiked following a breakdown in peace talks between the U.S. and Iran. REITs were also up in the month and have delivered strong returns year-to-date. Finally, Treasury Inflation-Protected Securities (TIPS) marginally outperformed nominal Treasuries as inflation expectations rose earlier in the year amid the Middle East conflict before substantially moderating more recently.



Market Outlook

"There are two kinds of people in this world: those who believe there are two kinds of people in this world and those who are smart enough to know better."

– Tom Robbins (1980)

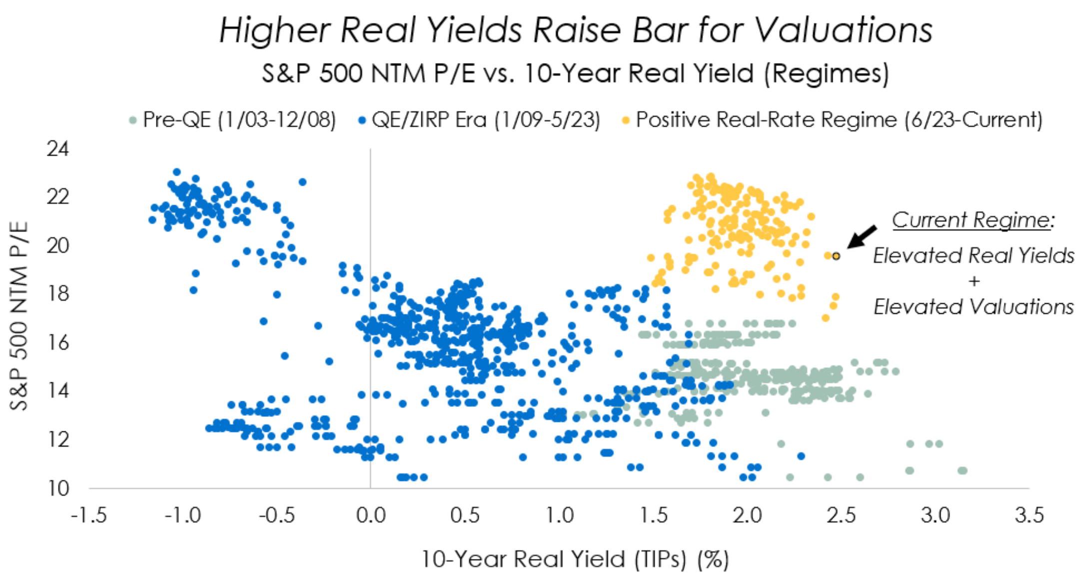
We came into 2026 with the tactical vantage point that this year would require the awareness of more nuanced views and the avoidance of oversimplification. Below is a framework for how we compared the generalized consensus view to the more nuanced views that investors were grappling with coming into this year. As we turn into the back half of 2026, we think it will continue to require more of a chess-than-checkers mentality. The backdrop remains full of crosscurrents:

2026 - The Year of the "Definitely, Maybe"

	Generalized View	Nuanced View	
Consumer	*"The consumer remains resilient."*	*High-income consumers maintain strong spending power from the wealth effect*	*Low and middle-income households struggle from affordability pressure*
Labor	*"It's a no-hire, no-fire labor market."*	*Structural tightening results from aging demographics and immigration policy*	*Structural loosening results from AI productivity initiatives*
Profits	*"Profits are solid."*	*Earnings growth is improving for the small and mid-caps*	*Earnings growth is leveling off in the larger cap companies*
Fed	*"The Fed is getting more accommodative."*	*Lowering interest rates loosens policy to improve affordability as inflation cools*	*A new Fed chair is often tested by the market resulting in a tightening of financial conditions.*
Policy	*"Fiscal stimulus will be a tailwind."*	*Midterm election years often coincide with accelerating economic growth resulting from policies of the incoming Administration*	*Midterm election years tend to usher in above average intra-year volality as markets "buy the rumor and sell the news"*
Markets	*"The AI story is early innings."*	*AI promises to be a transformative application*	*Leading edge AI stocks might be pricing in a lot of the good news*

- Growth has been resilient – helped by the wealth effect of the high-income consumer – but is also shifting towards CAPEX-driven demand.
- The labor market remains stable with hiring gains low but firing impacts limited.
- Earnings are strong with growth well above average and still expected to be superior down market cap. Having said that, the market seems to be looking ahead to a peak in the earnings growth rate.
- Fed direction is more uncertain as the new Fed Chair is less willing to provide guidance and policymakers are grappling with uneven inflation data (oil prices are volatile and realized inflation continues to trend above target).
- AI remains the dominant theme in the market but separating the economic story from the investment story should remain top of mind. As a result, market leadership appears to be broadening though uneven.

<u>If market leadership is rotating and the Fed remains hawkish, investors might be contemplating how to calibrate their portfolios to achieve the right balance of growth, valuation, and protection</u>. Strong earnings growth and AI-related CAPEX still support offense, but elevated valuations, higher real yields, and concentration risk argue against simply chasing the most crowded parts of the market.



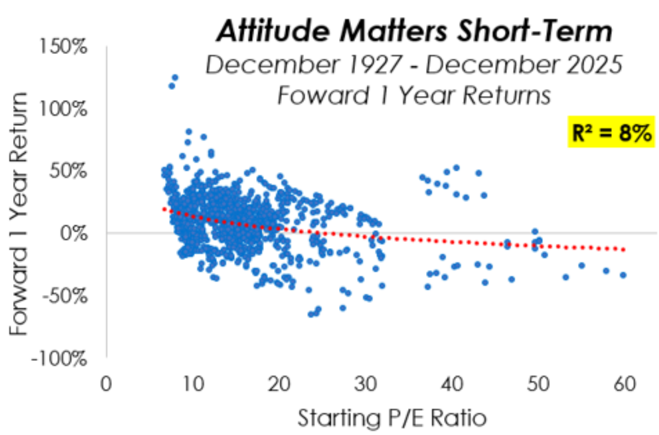
Source: Factset; Quantitative Easing was implemented in response to the Great Financial Crisis at the end of 2008. Positive Real-Rate Regime is defined as a return to a positive Real Fed Funds rate subsequent to an end to Zero Interest Rate Policy (ZIRP) and a move in the Fed Funds rate above the rate of inflation. The ishares IVV S&P 500 ETF is used as a proxy for the S&P 500 P/E NTM. Data is weekly from 1/03-7/26.

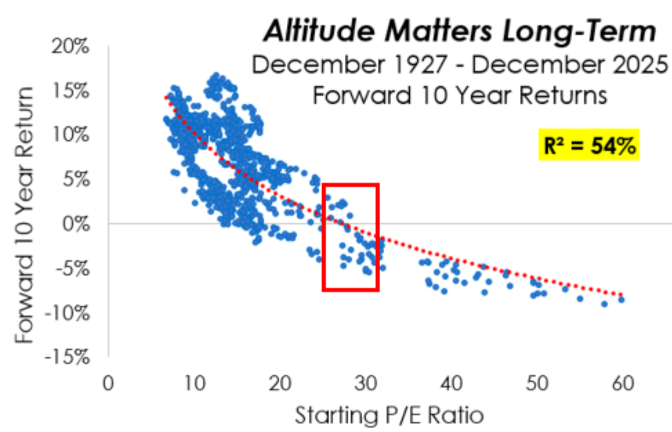
<u>The chart above helps illustrate why valuation discipline remains important. Since the market has moved back into a positive real-rate environment (new regime in yellow), S&P 500 valuations have remained elevated relative to history</u>. Current valuations remain closer to levels seen during the QE/ZIRP (Zero Interest Rate Policy) Era when real rates were negative. This is despite a very different and positive real-rate backdrop today, with 10-year real yields now around 2-2.5%. That doesn't mean equities can't perform, especially if earnings growth remains strong. But it does mean the hurdle rate is higher. In a world where many

cash equivalents and bonds offer positive real yields, investors may become less forgiving of long-duration growth stories where valuations already assume strong execution.

In other words, July's "Belts and Suspenders" message doesn't mean abandoning equities. It means balancing offense with defense, maintaining exposure to durable earnings growth, and being more selective about the price paid for that growth.

This also folds nicely into our strategic frame which requires the discipline to "keep the main thing the main thing". As much as we opine on the factors that influence the shorter term setup, the fact remains that starting valuations tend to be the most influential factor for long-term returns. In short, what you see is what you get. In the past, we've described this as, "Attitude matters in the short run, but Altitude matters in the long run."





Source: PE ratios were calculated monthly based on the value of the S&P 500 and trailing 12-month S&P 500 Normalized Earnings. Normalized Earnings were calculated by determining the constant long-term growth rate that best fit actual S&P 500 earnings. This process is meant to smooth out short term fluctuations in earnings caused by the business cycle. Forward returns are price appreciation only and do not include dividends. Historical S&P 500 data was gathered from Robert Schiller's website (http://www.econ.yale.edu/~shiller/) and Factset.

Please see the charts above for context. In the short run (chart on the left), S&P 500 returns measured over a one-year period have very little to no relationship with the starting price-to-earnings valuation multiple. Investor opinion – driven by a number of factors – can shape popularity for markets and drive short term results that can be both expected and unexpected. However, the chart on the right shows that the S&P 500 returns measured over a longer ten-year period have a much more important relationship with the starting price-to-earnings valuation multiple. We think remembering this concept is an important step to maintaining discipline as a long-term investor.

The combination of the above argues for flexibility in the short run and discipline in the long run.

So what are the implications and key takeaways for portfolios?

- **Think chess, not checkers.** Nuanced markets can produce multiple paths to the same outcome, so short-term decisions require flexibility.

- **Balance offense and defense.** Earnings growth, CAPEX, and broadening leadership support offense, while sticky inflation, Fed uncertainty, and elevated valuations argue for defense.

- **Use diversification as a "twofer."** Diversification can provide both risk reduction and upside optionality if market leadership continues to broaden.

- **Be willing to look different.** Long-term discipline may require going against the grain, especially when concentration risk is high.

- **Mind the pendulum.** When leadership becomes crowded and the risk/reward becomes less favorable, reducing exposure to the most concentrated areas can create room for better opportunities elsewhere.

<u>From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance.</u> We remain on the lookout for opportunities to selectively rebalance – taking profits in equities a couple of times in the prior quarter and reallocating the proceeds to underweighted areas like bonds and alternatives (where applicable). See more specific detail below:

<u>Within equities</u>, our positioning incorporates balance geographically and within our US Large Cap exposure especially (away from the top of the market). Our bias has generally been to have more exposure to less expensive areas (down market cap). As such, we've maintained a larger OW in Cyclical Value and Defensive sectors, combined with a smaller sized cap bias along with a modest OW in Small Caps. We remain UW the most concentrated and expensive larger cap Cyclical Growth areas.

<u>Within fixed income,</u> we remain biased toward the higher quality US Core Fixed Income segment – where we're slightly longer in duration for diversification purposes. We've maintained an EW to International Fixed Income, where the end of negative interest rate conditions has led to more attractive opportunities. Maintaining a higher quality bias means that we still remain UW the most expensive part of the bond market – High Yield – where (still) tight spreads have made the risk/reward less attractive in our view.

<u>Within alternatives,</u> we remain fairly balanced though slightly overweight in Diversified Alternatives. Last year, we adjusted our mix in this area in order to provide greater insurance against market volatility by emphasizing income and short exposure – areas that can benefit from choppy market conditions like what we've experienced episodically this year.

Thanks for giving this a read.