

“Flipping the Script”

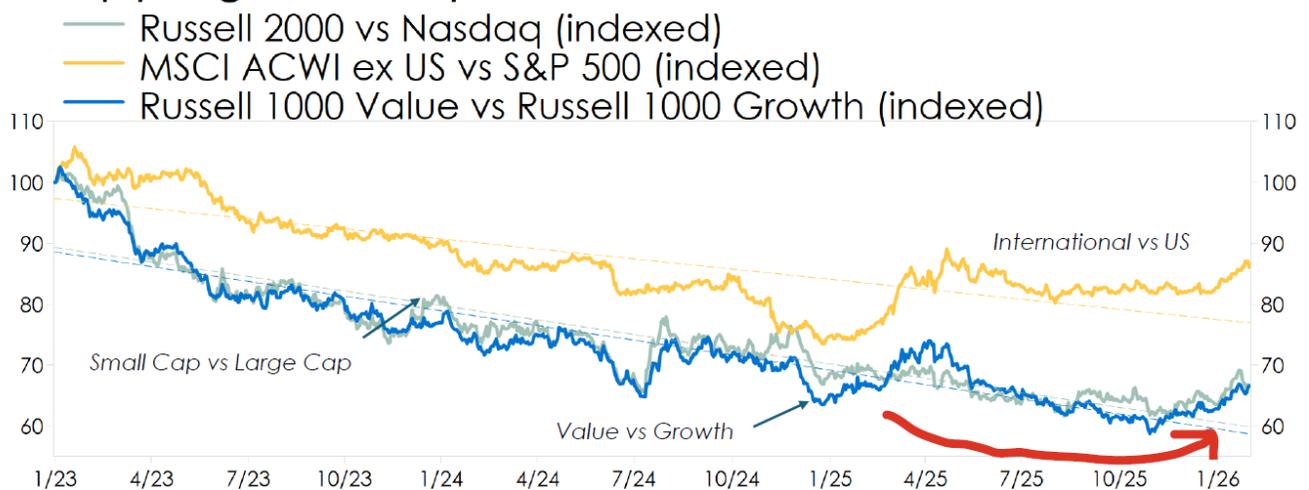
**“Catch the mist, catch the myth, catch the mystery, catch the drift...
He knows changes aren’t permanent, but change is.”**

– Rush, “Tom Sawyer” (1981)

There were so many headlines in January it hardly feels like we’re only one month into the new year. From operation “Southern Sphere” (Venezuela) to rising tensions in Iran to uncertainty over the sovereignty of Greenland, geopolitical headlines have been numerous. There’s been plenty to account for domestically as well – from the tragedy in Minneapolis to a criminal investigation on the existing Fed Chair and recent nominee announcement to take his place (upon his term expiration in May). It feels like a regime change of sorts.

In much the same way, investors have been attuned to a “flipping of the script” as market rotation remains among the most important observations to begin the year. As can be seen in the chart below, rotation is evident from multiple perspectives. Whether the view is based on geography, size, or style there are changes afoot. In all cases, a reversal towards International, Value, and Small Caps was evident in January. However, this isn’t exactly a 2026 phenomenon – the shift away from Large Cap Growth started at the end of last October, and the move overseas started much earlier in 2025. Over the last three years, we’ve seen plenty

Flipping the Script



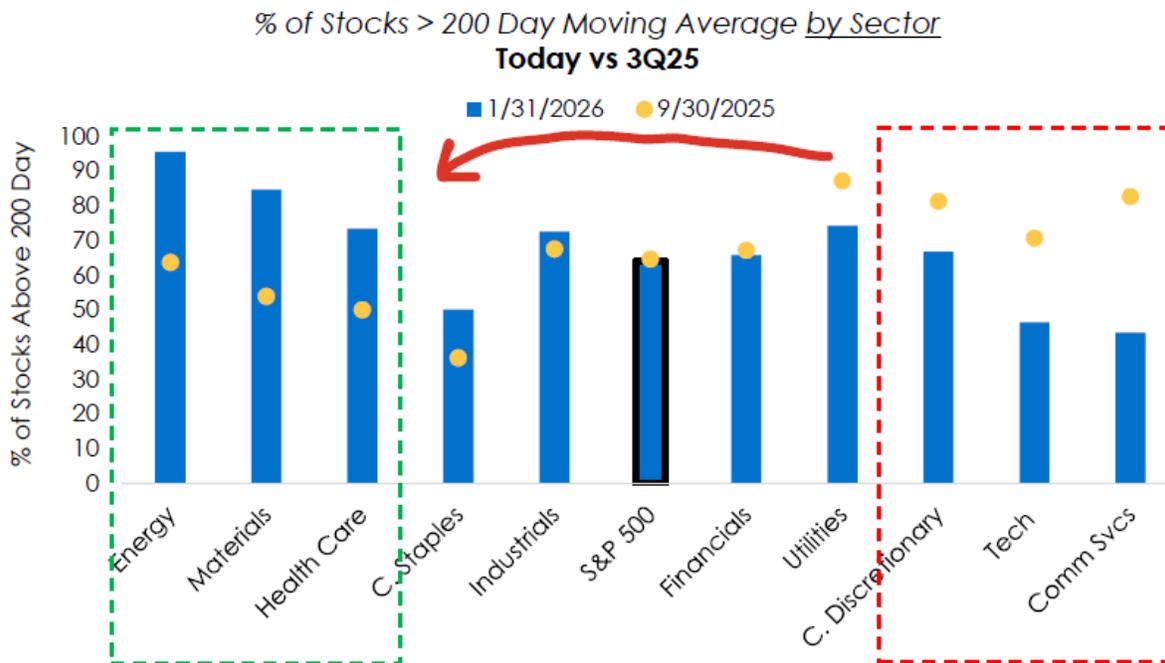
Source: Factset; iShares IWM ETF used for Russell 2000, iShares ACWX used for MSCI ACWI ex US, iShares IWD used for Russell 1000 Value, iShares IWF used for Russell 1000 Growth. All series are indexed to 100 starting 12/31/22-1/31/26. Dashed lines are linear regression lines for each series.



of head fakes in these relative relationships but today – all three are sitting at their highest level versus their respective relative trends.

A “flipping of the script” has also been evident at the sector level. As can be seen in the chart below – from 3Q25 to today – internal trend readings (as measured by the percentage of stocks above their 200-day moving average) have been most improved in Energy, Materials, and Health Care and have seen the most degradation in Communication Services, Technology, and Consumer Discretionary. Meanwhile, the internals for the market (as a whole) have remained relatively unchanged (S&P 500) – the definition of a rotational equity market backdrop.

Perhaps the rock band Rush said it best, catching the mist can initially be elusive as rotational trends are hard to pin down while investors cling to the myth of outdated narratives. Of course, the mystery of unknown variables is always a factor in a backdrop that seems constantly evolving. Ultimately, catching the drift that is the general direction of the underlying shift should remain the primary objective. Because in a landscape where “changes aren’t permanent, but change is”, not adapting might mean investors get left behind by the very script they initially relied upon. Time will tell if the new script is just the start of a new paragraph or that of a new chapter.



Source: Factset; Data sets track % of stocks above the 200 day moving average in each sector as of 9/30/25 and 1/31/26.

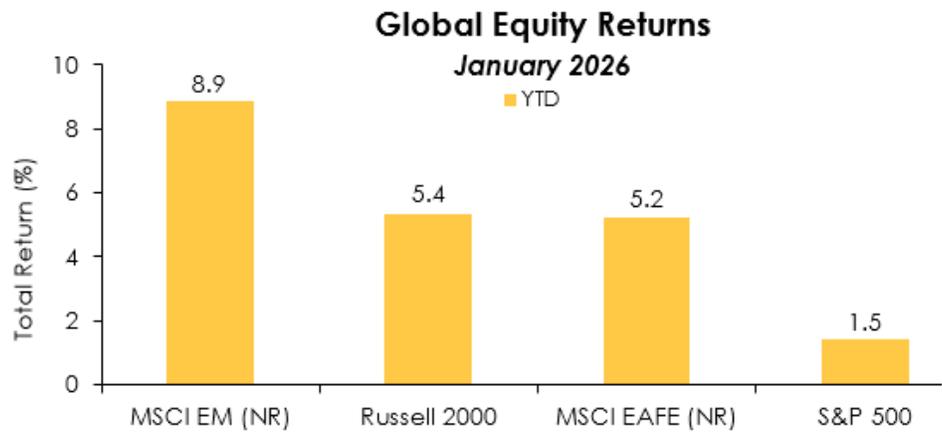


Commodities, International Markets, Small Caps, and REITs started the year with strong performance in January as the dollar continued its decline. US Large Caps and Bonds were up more modestly. As noted above, equity market rotation persisted into the new year.

Stocks

Emerging Markets (MSCI EM) and International Developed Markets (MSCI EAFE) posted strong returns to start the year due to fiscal stimulus and a weaker dollar. US Small Caps (Russell 2000) also delivered strong results following Fed rate cuts and expectations for

accelerated earnings growth. US Large Caps (S&P 500) were up but returns lagged these other areas as investors took profits in mega cap technology and sought out more attractive growth opportunities elsewhere. From a sector perspective, January saw a rotation out of some of last year's leaders – Communication Services and Technology – and into previous laggards like Energy, Materials, and Staples. Also contrary to last year, the majority of sectors outperformed the S&P 500 in January suggesting a broadening tone.



Source: Factset



Source: Factset

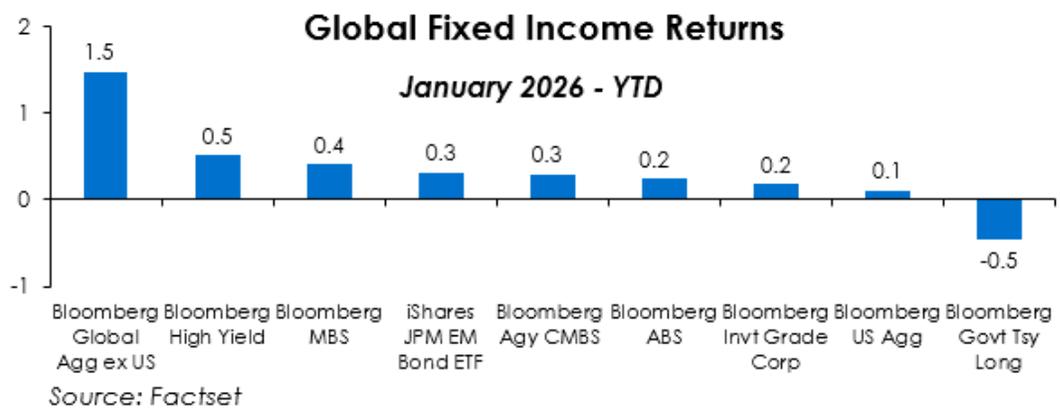


Bonds

Policymakers continued their cut (2H24/2H25) and pause (1H25/January '26) approach. Following the January meeting, the Fed Funds rate remained unchanged at 3.5%-3.75% with the "dot plot" implying one additional cut (25 bps) this year and next year. Meanwhile, the rate market expects two additional cuts this year before an eventual hike in '28. With the recently announced Fed nominee (Kevin Warsh), it will be worth observing how this evolves. So far, any changes to rate cut expectations have been limited. Bond returns were positive (albeit slightly) in January as rates backed up amid a solid growth environment.

International Debt (Bloomberg Global Agg ex US) was the standout due to dollar weakness while Long Dated

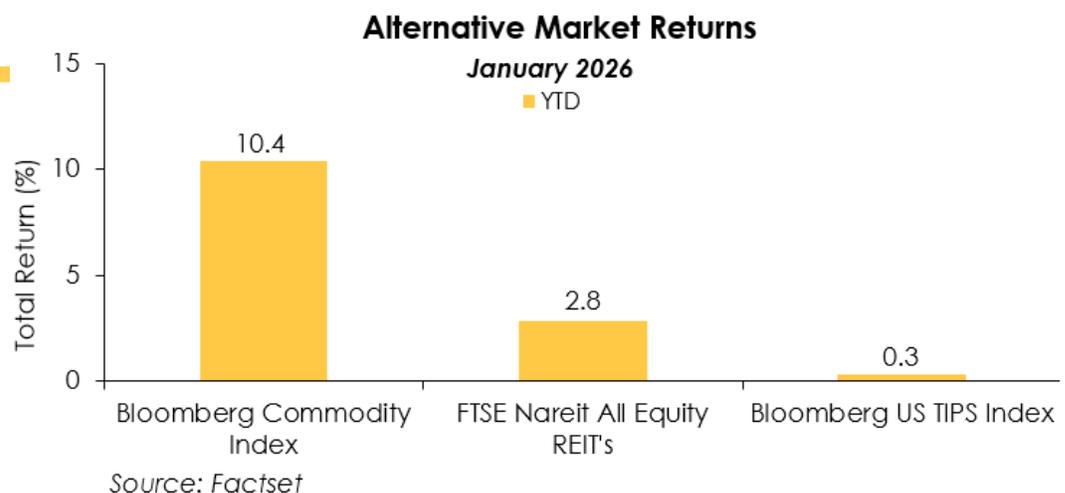
Treasuries (Bloomberg Gov't Tsy Long) lagged given the rate move.



Alternatives

Commodities delivered exceptionally strong returns in January, helped by strong performance in Energy and Precious Metals. Meanwhile, publicly traded Real Estate (REITs) posted

solid returns after lagging last year. Finally, year-to-date returns on Treasury Inflation-Protected Securities (TIPS) outperformed nominal Treasuries as inflation expectations have risen sharply since the end of last year.



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)

As noted in the opening, we think the tactical view for 2026 will require the awareness of more nuanced views and the avoidance of oversimplification. This will likely demand flexibility of thought that results in “strong convictions, loosely held”. Below is a framework for how we compare the generalized consensus view to the more nuanced views that investors are grappling with this year.

2026 - The Year of the "Definitely, Maybe"

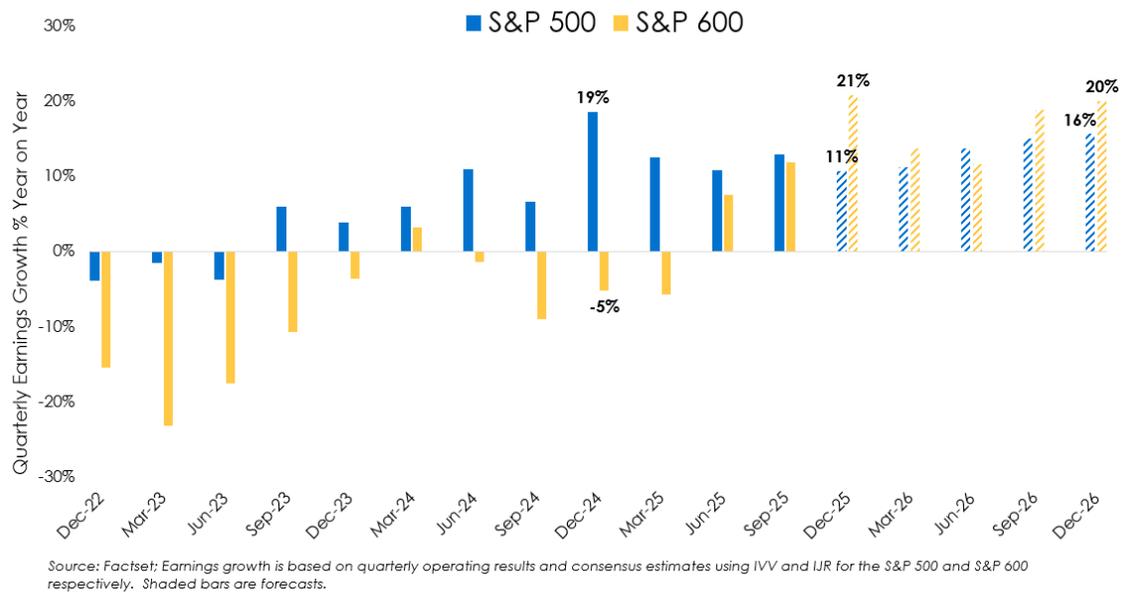
	<u>Generalized View</u>	<u>Nuanced View</u>	
Consumer	"The consumer remains resilient."	High-income consumers maintain strong spending power from the wealth effect	Low and middle-income households struggle from affordability pressure
Labor	"It's a no-hire, no-fire labor market."	Structural tightening 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 volatility 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



Last month, we laid out thoughts on the Consumer and Policy categories. This month we'll be tackling one of the most important fundamental categories for investors – corporate profits.

The consensus view is that corporate profits will be solid. That is seen as the safe expectation with mid teens earnings growth anticipated for the S&P 500. However, the nuanced view is also recognizing what's happening under the hood where a broadening growth concept looks like it may unfold. As can be seen in the chart below, quarterly earnings growth for the larger companies (S&P 500 – blue bars) has been solid and is expected to remain that way. Meanwhile, quarterly earnings growth for the smaller companies (S&P 600 – yellow bars) is expected to show material improvement, which started to come through in 2Q and 3Q of last year. Note the ramping of earnings growth down market cap as large cap earnings growth begins to level off. We're calling this sub-theme the Year of the "Upside Down" (yes we binge watched Stranger Things over the holiday season) because the profit dynamic looks to be shifting with a broadening tone as one looks ahead. Recently lowered interest rates play a role along with what's likely to be a good tax refund season for many. It's also worth pointing out that smaller companies are set up for much easier comparisons as many small businesses have seen their earnings under pressure for much of the last three years. Meanwhile, the law of large numbers might begin to weigh on some of the mega-caps.

2026 - The Year of the "Upside Down"?

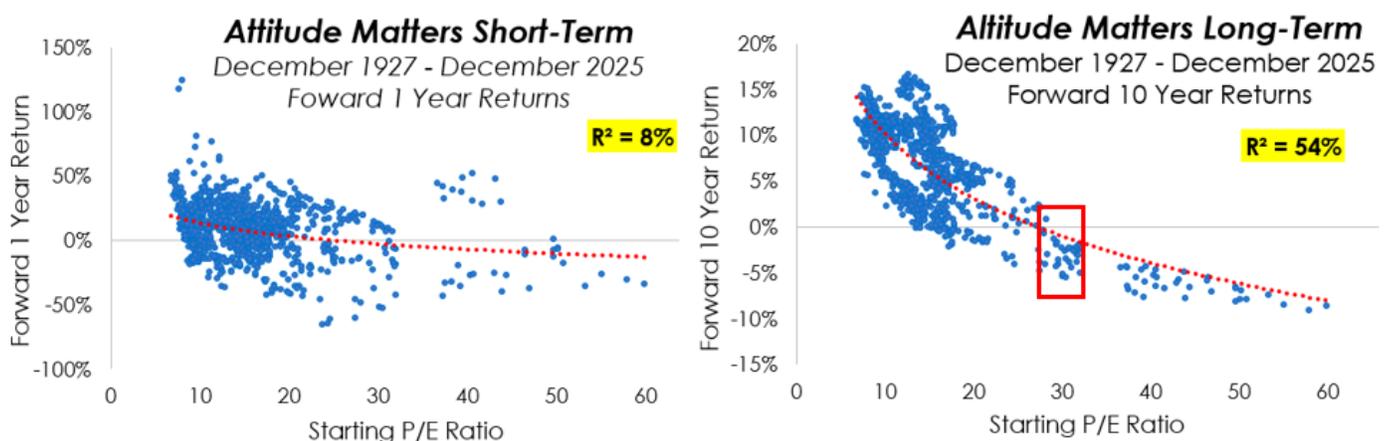


While the tactical frame means having a more flexible view of where opportunities and risks might be, the strategic frame requires the discipline to "keep the main thing the main thing". As much as we opine on the factors that influence the shorter term setup, the fact remains that starting valuations tend to be the most



influential factor on 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."

Please see the charts below 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 much longer ten-year period does indeed 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.



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.

So what are the implications and key takeaways for portfolios?

- We think 2026 will require more of a chess than checkers mentality in understanding that nuanced views might mean multiple paths to an outcome. This means that shorter term decisions demand some degree of flexibility given the "K-shaped" dichotomies that exist.
- Having a balanced portfolio with some defense and offense may be helpful with diversification representing a compelling "twofer" (two for one) opportunity – risk reduction and upside optionality.
- Investors' long-term discipline will continue to be tested and will likely require going against the grain (looking different than the benchmark).
- As the pendulum swings to one side, limiting exposure where the risk/reward is less favorable (and concentration risk is high) should be top of mind and lends itself to diversification.

Please see the summary table on the next page.



From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance. Our macro overweights and underweights have been relatively modest as we've opportunistically rebalanced portfolios in order to maintain that degree of balance. Where portfolios do look different is in the degree of diversification one level lower. As a

2026 KEY TAKEAWAYS	
Be flexible with regards to views in the short run	"K shaped" nature of backdrop requires loosely held convictions
Diversification with a mix of offense and defense remains a compelling opportunity	"Twofer" benefit of risk reduction and upside optionality
Stay disciplined and keep the "main thing the main thing" in the long run	Don't let short run dynamics dictate long run decisions
Limit exposure to speculative areas and lean into diversification	Returns are highest where capital is scarce and lowest where capital is abundant

result, we've remained UW the most expensive and concentrated areas where we've viewed the long-term risk reward less favorably. US Large Caps are a good example given that today's concentration in the largest companies has now made the S&P 500 quite top heavy with the top 10 holdings representing about twice the exposure it averaged during the period from 1990-2010. For investors willing to stay diversified, this mean-reversion potential offers upside which is likely to come when investors have deemed that the pendulum has swung too far. The timing of such an episode is a notoriously difficult question to answer with any kind of certainty. But perhaps investors should take comfort knowing that they generally don't need to. That's because staying diversified still allows one to participate in the solid absolute returns that help one achieve plan success. And at the same time, not overly exposing one to the extreme risks that may ultimately come in the form of exceedingly depressed returns when the bill comes due. In our opinion, that's what prudent investing is all about.

Within equities, 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. We remain UW the most concentrated and expensive Cyclical Growth areas and think that if AI is as transformative as advertised its benefits will need to accrue to more than just the select few.

Within fixed income, 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 extremely tight spreads have made this unattractive in our view.



Within alternatives, we remain fairly balanced across the board with neutral positions in Diversified Alternatives, Real Estate and Commodities. Last year, we adjusted our mix of Diversified Alternative managers in order to provide greater insurance against market volatility by emphasizing income and short exposure – areas that can benefit from choppy market conditions, thus, enhancing diversification.

Thanks for giving this a read.

The information presented in the material is general in nature and should not be considered investment advice, is not designed to address your investment objectives, financial situation or particular needs. Information is gathered from sources deemed reliable but its accuracy or completeness is not guaranteed. The opinions expressed herein may not come to pass, are as of the date of publication and are subject to change based on market, economic or other conditions.

You cannot invest directly in an index. Indexes are unmanaged and measure the changes in market conditions based on the average performance of the securities that make up the index. Investing in small and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Asset allocation and diversification does not ensure a profit or protect against a loss.

Yellow Cardinal Advisory Group, a division of First Financial Bank, provides investment advisory, wealth management and fiduciary services. Yellow Cardinal Advisory Group does not provide legal, tax, or accounting advice. The products and services made available by Yellow Cardinal Advisory Group:

Not Deposits | Not FDIC Insured | Have No Bank or Federal Government Guarantee | May Lose Value



The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.