

Letter of the Day – “K” or “V”?

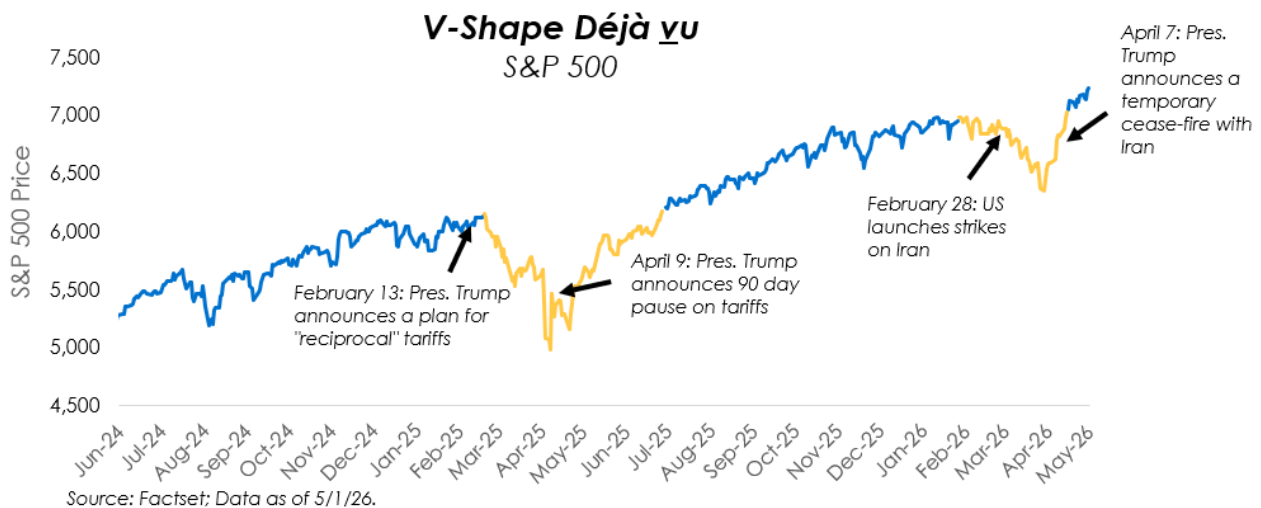
“C is for cookie, that’s good enough for me.”

– Cookie Monster, Sesame Street (1971)

Chances are you remember Big Bird, Oscar the Grouch and, of course Cookie Monster from the long running children’s tv series, Sesame Street. As part of this iconic educational series, the “Letter of the Day” segment was a way to introduce the alphabet to the youth of America. As investors, we currently have two letters in mind to summarize the backdrop. Let’s explain.

The spike in oil and its subsequent impact on prices at the pump leaves many economists wondering how this might further exacerbate the “K” shaped consumer. And yet, after falling precipitously in March, the bounce back in April saw the S&P 500 just turn in its best month since November 2020 in “V” shaped fashion. So, despite a US consumer wealth gap that’s widening, equity investors have pushed the S&P 500 back to new record highs. While at first blush this might seem contradictory, we think they’re more interrelated than one might presume. Let’s take each one in turn.

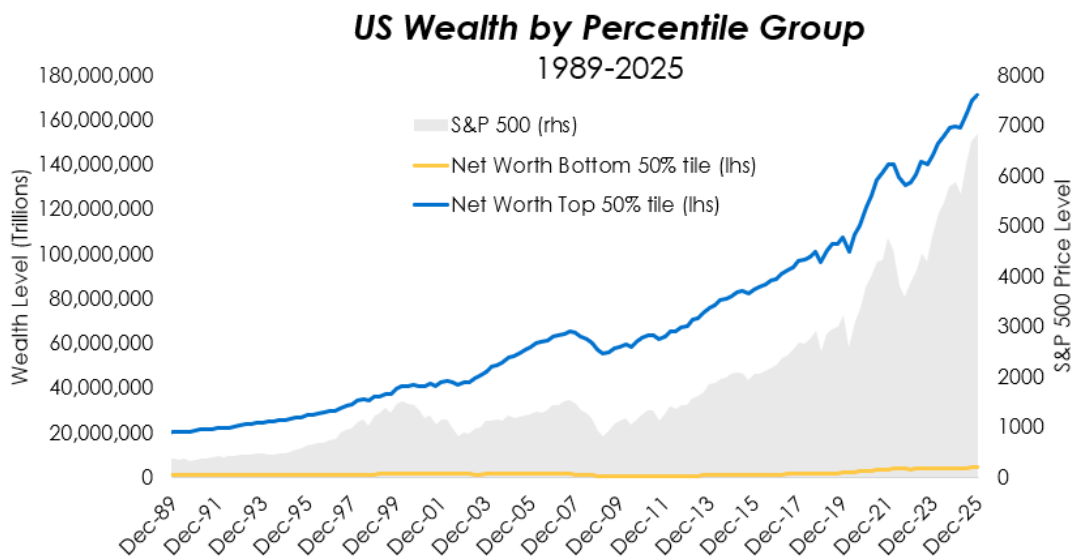
As can be seen in the table below, the market sold off in March but quickly recovered in April giving investors déjà vu from almost exactly a year ago prior. While this year’s conflict was more kinetic with trade consequences of a different variety, investors similarly scrambled to buy the dip and weren’t disappointed. In



fact – according to Strategas Research Partners – of all the drawdowns of 8% or more since 1950 this recovery was the fastest in history – taking just 11 trading days to reclaim the prior highs.

Despite the geopolitical headlines, what drove the equity market’s resilience? To put it simply – growth. First quarter earnings results have been stellar thus far and next twelve month earnings growth expectations have only gone up since the end of February. AI has certainly been a contributing factor as investments by the hyperscalers have been a powerful tailwind. Additionally, the current backdrop has given companies renewed pricing power – allowing them to usher in higher prices – with no immediate signs of material demand destruction. We wonder if that’s sustainable but so far the pain hasn’t been high enough for long enough to change behavior. As a consequence, rates have reversed course and moved back up with a Fed easing bias being taken completely off the table.

But how might this further be intensifying the US wealth divide in “K” shaped fashion? The chart below shows the aggregate wealth level for the top half (blue line) and bottom half (yellow line) of US consumers since 1989. The results are rather dramatic and illustrate an ever widening wealth gap. In short, the bottom half of US households comprise only about 2.5% of the total wealth – a number that has fallen over time. Wages are the most obvious influencing factor, but another less appreciated one might be the degree to which households participate as investors. The contours of the S&P 500 (shaded region) follow very closely with the wealth creation of the upper half, while market ownership in the lower half is significantly less representative (with home prices instead being the dominant driver). The bottom line is that, as long as great disparity of market ownership persists, any “V”-shaped recovery in the markets will drive a furthering divide in the “K”-shaped consumer.



Source: Factset; Federal Reserve DFA Portal - Distribution of Household Wealth in the US since 1989. Data through 2025 and last updated 3/27/26.

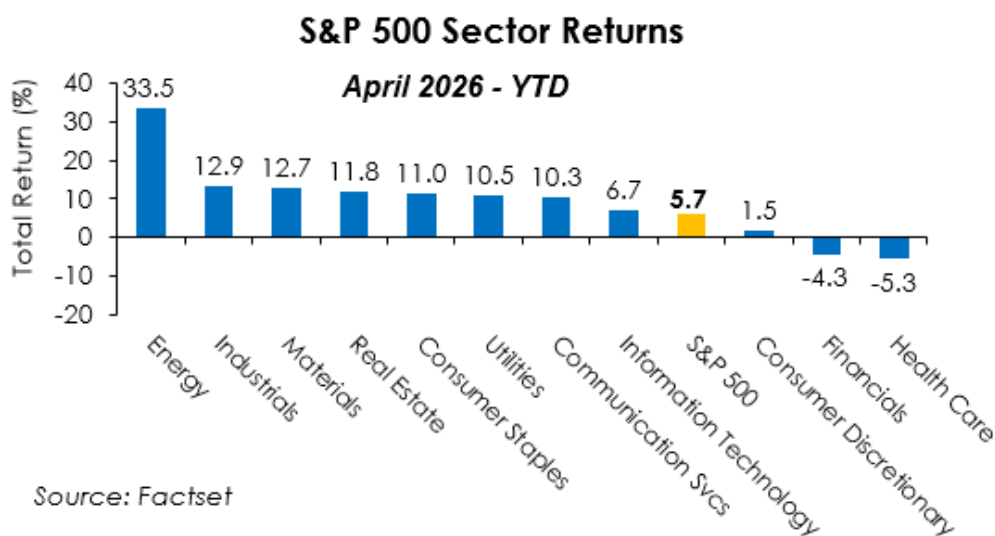
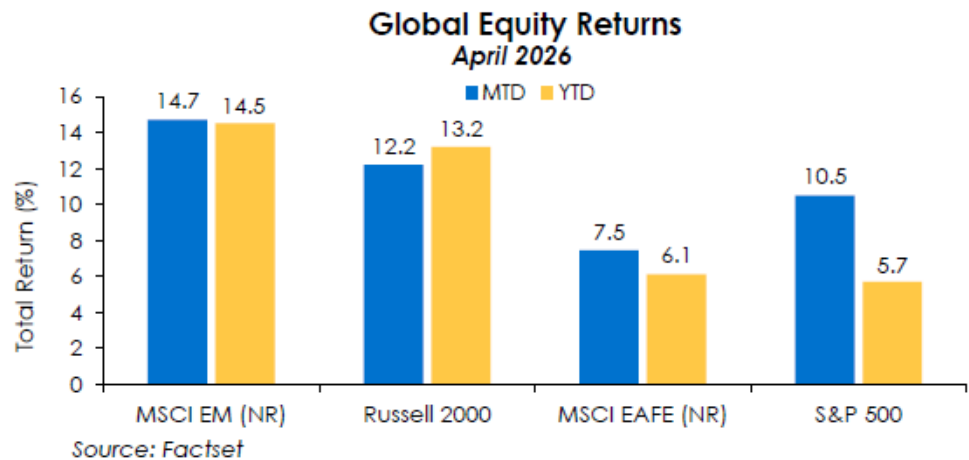


Stocks rebounded sharply in April on the announcement of a cease fire with Iran followed by strong first quarter earnings results. The S&P 500 made a new high in just 11 days after declining almost 10%. Commodities and REITs also posted solid returns with continued strong year-to-date performance. Finally, Bonds were marginally positive led by the more cyclical areas like Emerging Markets and High Yield.

Stocks

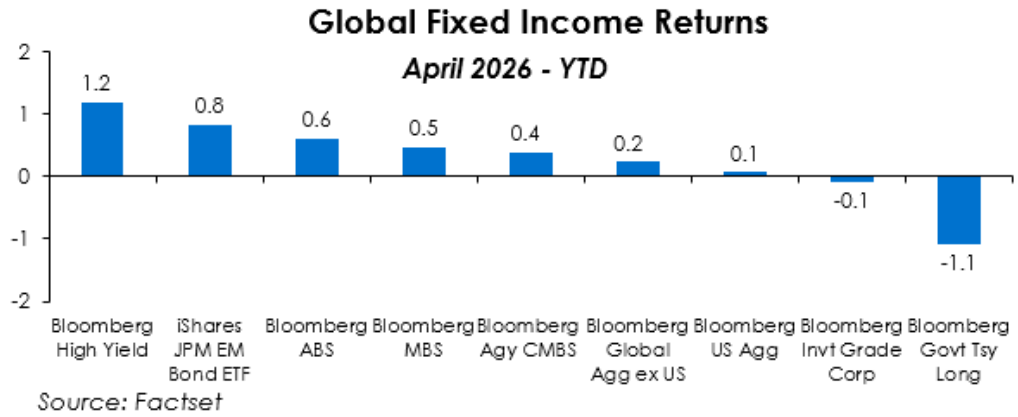
Emerging Markets (MSCI EM) led equities higher on strong earnings growth from continued demand for AI related components such as CPU/GPUs and memory chips. US Large Caps (S&P 500) and Small Caps (Russell 2000) were also up

strongly as the continued buildout of AI datacenters and a surge in CAPEX helped drive 2026 earnings growth. While US equities have been better insulated from the conflict with Iran (due to better relative energy independence), Developed Markets (MSCI EAFE) have lagged as most are far more dependent on middle eastern oil. From a sector perspective, year-to-date performance saw some earlier in the year rotation out of some of last year's growth leaders – Communication Services and Technology – and into some previous year laggards like Energy, Industrials, Materials, and Real Estate – though the gap closed in April.



Bonds

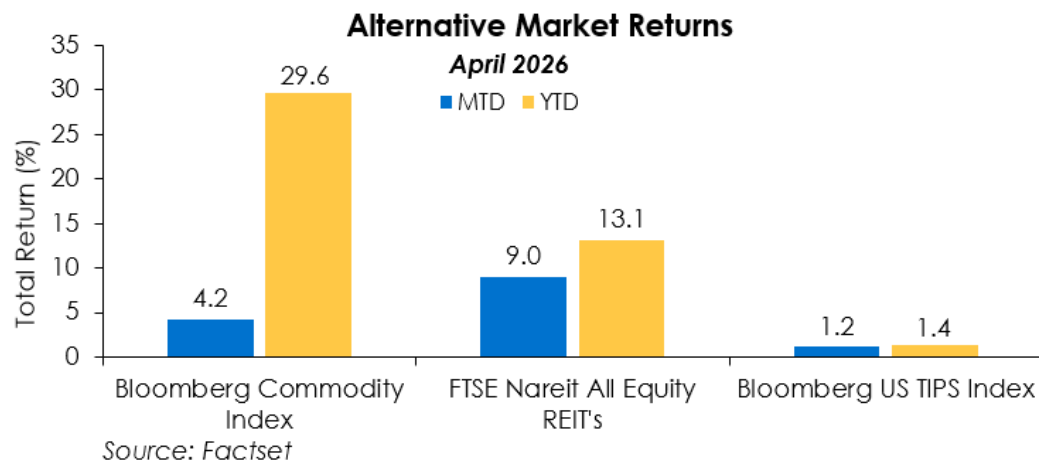
Policymakers continued their cut (2H24/2H25) and pause (1H25/1H26) approach. Following the April meeting, the Fed Funds rate remained unchanged at 3.5%-3.75% with the “dot plot” implying one additional cut (25 bps) this year and next year. Meanwhile, the forward curve of the rate market currently forecasts no additional rate cuts for this year or next. With the recently announced Fed nominee (Kevin Warsh) along with the US military action in Iran (lifting energy prices), it will be worth observing how this evolves though it would appear the Fed



is on the sidelines for the foreseeable future. Bond returns rebounded in April as credit spreads narrowed on the more recent de-escalation of the war with Iran. This rebound left bond returns modestly higher for the year. High Yield bonds have performed best due to their higher starting yields along with the narrowing of credit spreads in April. Meanwhile, long dated Treasuries have lagged due to increased inflation risks along with higher growth expectations that have lifted rates.

Alternatives

REITs rebounded in April reaching new highs for the year while providing a hedge against inflation. Commodities continued their strong performance – led by surging energy prices



– providing beneficial portfolio diversification. Finally, year-to-date returns on Treasury Inflation-Protected Securities (TIPS) outperformed nominal Treasuries as inflation expectations rose amid the Middle East conflict.



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. To us, this meant that flexibility would be at a premium resulting in “strong convictions, loosely held”. Below is a framework for how we compared the generalized consensus view to the more nuanced views that investors have been grappling with thus far.

2026 - The Year of the "Definitely, Maybe"

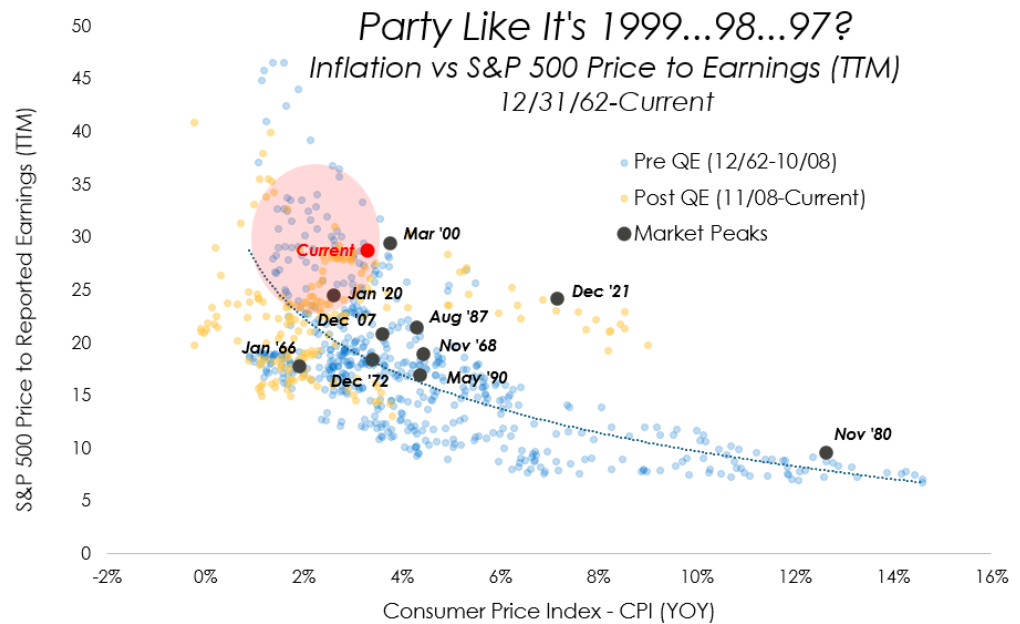
	<u>Generalized View</u>	<u>Nuanced View</u>	
Consumer	"The consumer remains resilient."	High-income consumers maintain strong spending power from the wealth effect	Low and middle-income households struggle from affordability pressure
Labor	"It's a no-hire, no-fire labor market."	Structural tightening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



As we cited in the prior month – of the generalized/consensus views in the table – we think the two that are the most in question are in the Fed and Policy categories. Given the current inflationary tenor, markets have now fully priced out any Fed easing bias and – as a result of higher gas prices – fiscal policy may be less of a tailwind than originally thought (i.e. tax refunds get eaten up at the pump). This also likely has ties to the resilience of the US consumer though that also hinges on the dynamics of the labor market and the wealth effect.

With regards to markets, corporate earnings growth looks incredibly robust as companies are showing renewed pricing power and commitment to the CAPEX story, however, we continue to wonder to what extent that's reflected in stock valuations. That keeps us steely-eyed with regards to how early some investment themes actually are. While many a pundit are still describing the tech AI play as a parallel to the early '90's, we find ourselves drawn more to the late '90's comparison. The chart below plots the S&P 500 Price to (Reported) Earnings ratio and the Consumer Price Index for each month dating back to 1962. Each of the ten major market peaks are annotated as well. A few things stand out. First, there tends to be a long-term indirect relationship between the stock market's valuation multiple and the rate of inflation. Today's inflation backdrop has drawn similar comparisons to the "Guns and Butter" environment in the mid to late '60's under Lyndon B. Johnson (with a sub 20X P/E ratio versus today's 28-29X P/E). And while it's true that for much of the post QE world inflation remained sub 2%, the post COVID environment has seemed to wake inflation up from its decade long slumber. Finally, if one looks at where we currently plot on the chart, the closest resemblance takes us back to the late '90's – the area represented by the red shaded region in the chart.

The bottom line is that history is suggesting that today's backdrop might be resembling something that is suggestive of being closer to the end of a chapter than the beginning.

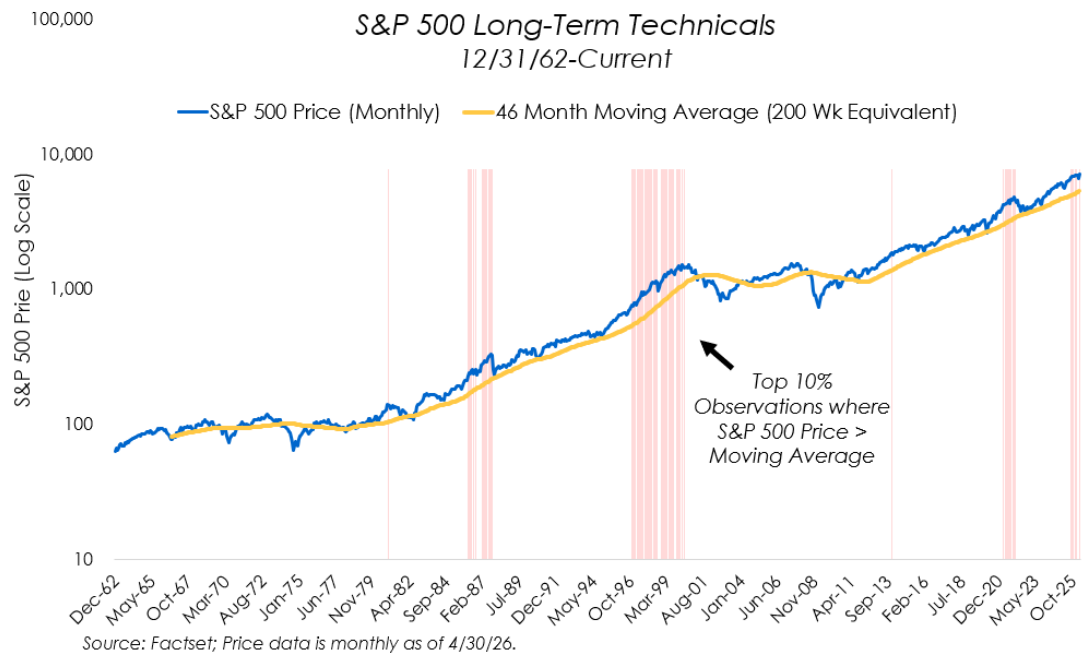


Source: Richard Bernstein Advisors; Factset used for month end S&P 500 price data. Robert Shiller used for S&P 500 reported earnings 12/62-11/88. S&P Global used for reported earnings 12/88-12/25. Factset used for reported earnings 1/26-Current. Earnings are reported based on trailing four quarters and smoothed monthly. P/E scale is truncated at 50X and excludes readings from 12/08-9/09. Current readings for CPI are as of 3/31/26 and for S&P 500 P/E are as of 4/30/26.



Having said that, market shifts are notoriously difficult to time and generally seem to move further and go on longer than expected. That leads us to a secondary observation – this environment feels “melty”. A “market melt-up” generally describes a quick upward surge in prices that often occurs in late stages of bull markets,

driven by a fear of missing out on additional gains. One of the ways we track extreme price moves involves the chart at right, which plots the S&P 500 (monthly price) along with its 200 week equivalent moving average. The shaded regions in red represent the top 10% of monthly price observations



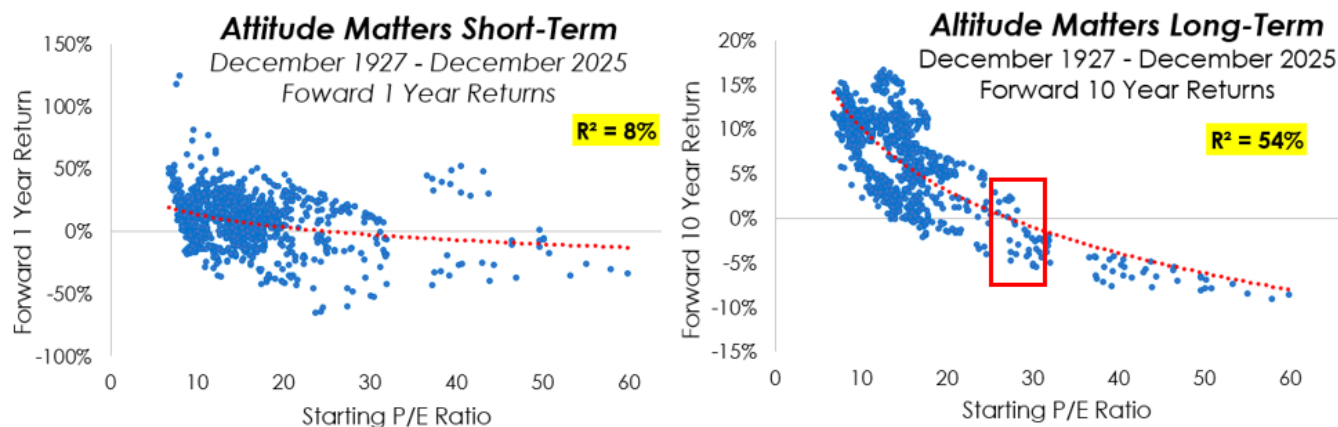
(dating back to 1962) where the current price moved to an extreme relative to the moving average. All three of these historical clusters coincided with past market melt-ups including 1986-87, 1997-2000 and 2021. In the back half of 2025 and into 2026, we’ve started to see several similar monthly extremes. The magnitude of which has still generally fallen short of the peak extremes of these other historical episodes so this might still mean a further lift off of sorts – but we think its noteworthy nonetheless.

The above 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.”

Please see the charts on the next page 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 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 continues to 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.

From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance. Our flagship strategies – which we sometimes refer to as our “belt and suspenders” approach – have especially benefited from their allocation to Alternatives. This exposure, year-to-date, continues to slightly outpace Stocks – despite the latter’s strong rally in April. Alternatives are intended to help preserve purchasing power when historical correlations between the more traditional asset classes break down. As a result, this exposure helped to buffer the magnitude of negative returns experienced in both Stocks and Bonds in March. Managers that provide hedging characteristics have held up better during bouts of market volatility and exposure to real assets like real estate and commodities have been among the better defenders of value. While we remain overweight this area, we recently took some profits in commodities and added to diversified alternative managers as a way to maintain proper balance as certain positions extended. Meanwhile,



portfolios are modestly OW equities and modestly UW bonds – despite trims out of international stocks and adds to US core fixed income that were made earlier in the month. See more specific detail below:

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 (albeit less so) Cyclical Growth areas.

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 (still) tight spreads have made this unattractive in our view.

Within alternatives, we remain fairly balanced though slightly overweight in both Commodities and Diversified Alternatives. Last year, we adjusted our mix in the latter 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 recently experienced.

Thanks for giving this a read.

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