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THE ECONOMY AT A GLANCE

ECONOMIC HIGHLIGHTS

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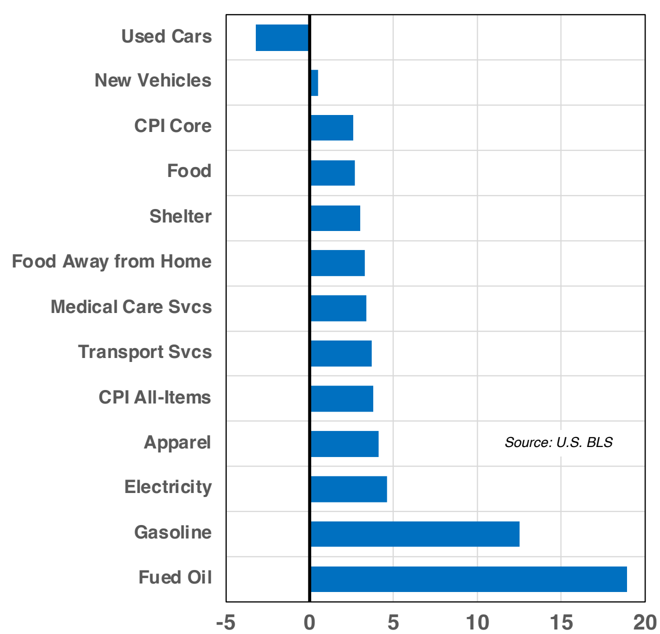
PRICES KEEP CLIMBING

Everything is more expensive, which happens when oil prices jump. Oil, in the form of gasoline, is a critical component in the budgets of consumers. It also is a factor in many adjacent industries, as transportation and delivery costs impact most businesses. So with the war in Iran having pushed oil prices higher, consumers and investors have had to address higher costs. That was evident in two recent inflation reports. The first report was for the Consumer Price Index (CPI), the most widely quoted inflation measure in the financial press. The Bureau of Labor Statistics reported that the CPI rose at a 4.2% rate year over year through May, up from the prior reading of 3.8%. And it was a far cry from the Federal Reserve's stated goal of 2.0%. Moving up the value chain, the Producer Price Index (PPI) report has risen at a 6.5% annual rate through May. These are the costs that manufacturers bear, and ultimately are passed down to consumers. So let's take a step back and think of the inflation cycle. Pricing pressures peaked in 2022 at a rate of 9.0% and came down consistently for years, bottoming at 2.3% last April. Now the CPI is back to 4.2%. It seems safe to say that the down-cycle for inflation is over, and the trend is headed up. We think this change in the pricing environment will keep the Federal Reserve on the sidelines in 2026 and our updated forecast is that the fed funds rate will be stable at the current level of 3.5-3.75% through the end of the year.

CONSUMER INFLATION FACTORS (% CHANGE Y/Y)



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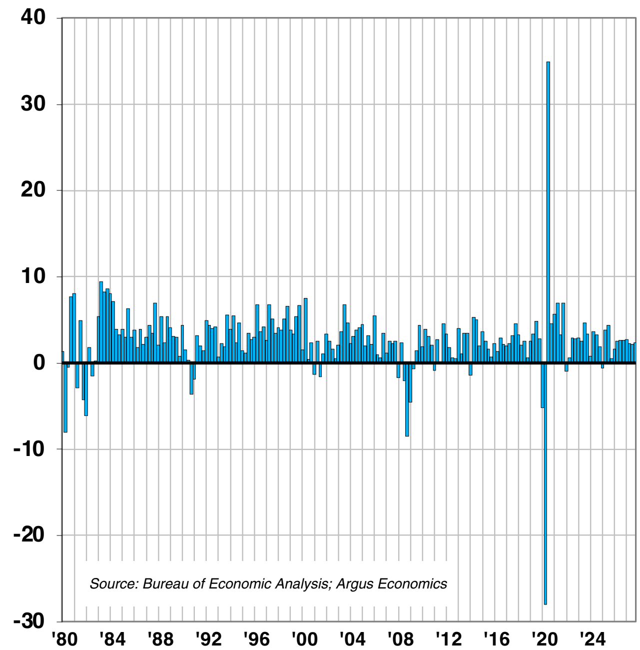
RAISING GDP ESTIMATES

We have raised our 2026 gross domestic product (GDP) growth forecast to 2.3% from 2.1%, our 2Q26 estimate to 2.5% from 2.2%, and our 2027 growth forecast to 2.4% from 2.0%. The major change to our estimates is that indicators point to even stronger Gross Domestic Investment (GDI) even as inflation constrains consumer spending. Companies see an opportunity to raise productivity and their return on capital and artificial intelligence (AI) dominates the increase in investment. The investment dollars then boost the Equipment and Intellectual property categories in the GDP report. We also have increased our estimate of imports, which reflects purchases of gear to support the AI buildout. We did not make major changes to our outlook for consumer spending. On the positive side, bigger tax returns helped, unemployment continues to be low, and hiring has improved. Household net worth is also up 8% from a year ago. But inflation is rising faster than wages. The Consumer Price Index was up 4.2% in May. Average hourly earnings were up just 3.4% in May. Real Disposable Personal Income was down 0.1% year over year in March and down 1.1% in April. Lower gas prices would be welcome news for consumers as we approach the important back-to-school shopping season.

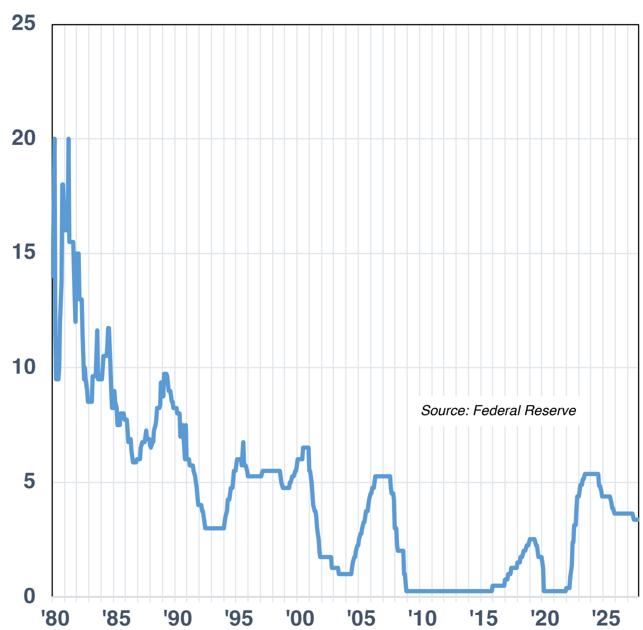
GDP TRENDS & OUTLOOK (% CHANGE)



CHAIRMAN'S FIRST MEETING

As expected, the Federal Reserve left its fed funds target unchanged at 3.5%-3.75%. We think this level -- down 175 basis points (bps) from the summer of 2024 but up from the 0% level during the pandemic -- will prevail at least through year-end as the new Fed chairman, Kevin Warsh, settles in. Economic conditions have changed since Warsh's name first came up as a potential central bank leader. The war in Iran has sent oil prices skyrocketing, and inflation expectations are on the rise. Meanwhile, the other element of the Fed's dual mandate -- the unemployment rate -- has remained low. Chairman Warsh was appointed by President Trump, who was highly critical of former Fed Chair Powell. We don't have the sense that Chairman Warsh is under the same pressure. To that end, Mr. Warsh rolled out five new task forces, and the work of these task forces may shift the focus away from changes to the fed funds rate, at least in the near term. We recently altered our fed funds year-end target and no longer anticipate a rate cut in 2026. If oil prices resume a downward trek, the Fed may be in position to lower rates in a year or so.

FEDERAL FUNDS TARGET RATE & FORECASTS (%)

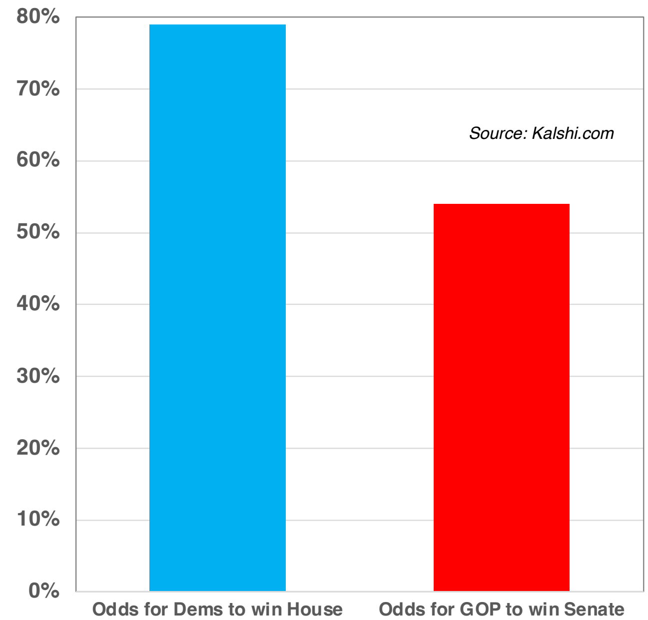


FINANCIAL MARKET HIGHLIGHTS

GRIDLOCK ALERT

Midterm elections are in November. Currently, Republicans have control of all three major national political branches: the presidency, the Senate, and the House of Representatives. That seems likely to change, as incumbent parties tend to lose ground in midterm elections, particularly when voter approval for the president is low (currently the case). Indeed, the latest forecasts from prediction markets website Kalshi give the Democrats a better-than-75% chance to take over the House, while the GOP is poised to narrowly hold on to the Senate. Historically in midterm election years, stocks have stumbled in early autumn on the prospect for change. Average S&P 500 returns in the third quarter of midterm election years since 1980 are -1.5%, including a 5% slide in 3Q22. But once the results are in, investors respond positively to the likelihood of potential Washington gridlock (as odds are low for major legislation changes on taxes, trade, regulations, the economy, or the markets). This positive sentiment is reflected in relative outperformance in the final months of the midterm year, as 4Q S&P 500 returns have averaged 4.1% in midterm election years since 1980.

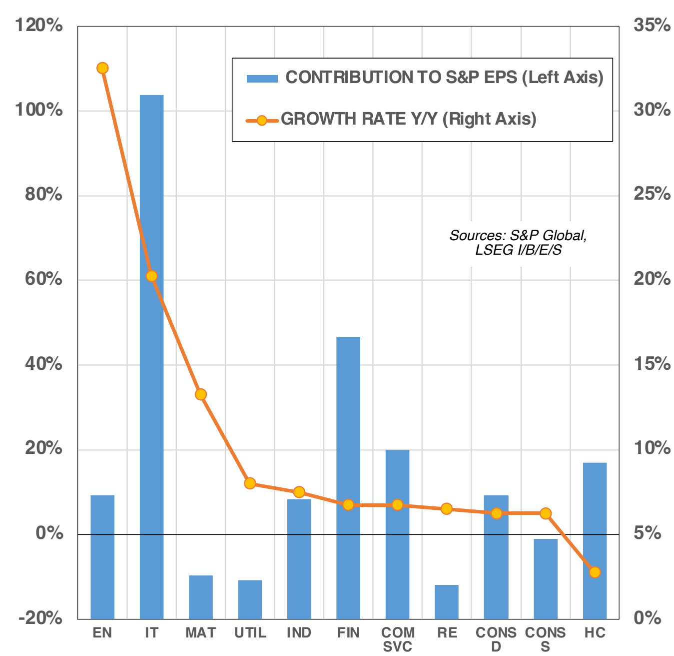
BATTLE FOR CONGRESS IN MIDTERM ELECTIONS



NOT ALL SECTORS ARE EQUAL

When it comes to investing in sectors of the S&P 500, we think it makes sense to focus on the few key sectors that can actually make a difference in terms of earnings and portfolio performance. The Real Estate sector, which accounts for about 2% of S&P 500 market capitalization, is expected to contribute only 1% of S&P 500 EPS during the upcoming earnings period. Materials is another 2% market-weight sector that generates a thin 2% of total earnings. While earnings for the Materials sector are forecast to grow 33% year over year in 2Q26, we don't think clients should be spending a lot of time trying to get the right mix of chemicals-paper-metals, given the group's low weight in the index. The sectors that can really make a difference include Information Technology, which is expected to contribute 31% of the S&P 500 earnings (and for which earnings are expected to grow 61% year over year). Industrials is another likely winner, as it should kick in 7% of 2Q S&P 500 profits, growing at a 10% clip. We also expect the Financial (17% of earnings) and Communication Services (10%) sectors to deliver, with earnings expected to increase at a high-single-digit pace. Energy is typically a wild card.

SECTOR EARNINGS TRENDS



KEY ECONOMIC FORECASTS

- The $32 trillion U.S. economy remains on course for productive long term growth, powered by corporate investments in Artificial Intelligence. Nvidia CFO Colette Kress estimated, on May 20, that AI infrastructure spending is on track to reach $3 - $4 trillion annually by the end of this decade.
- Real Potential GDP – the sustainable speed limit of the US economy is poised to increase to 2.1%, on average, through 2030 according to the Congressional Budget Office. AI is likely to raise productivity, offsetting slower growth in the labor force from an aging population and reduced immigration.
- We recently raised our 2026 gross domestic product (GDP) growth forecast to 2.3% from 2.1%, our 2Q26 estimate to 2.5% from 2.2%, and our 2027 growth forecast to 2.4% from 2.0%. The major change is that indicators point to even stronger domestic investment. The investment dollars will boost the AI-dominated Equipment and Intellectual property categories in the GDP report.
- News of an interim peace deal between the U.S. and Iran sent gasoline below $4.00 a gallon from a peak of more than $4.55 (according to AAA). Lower gas prices are welcome news for consumers as we enter the important back-to-school shopping season, which is getting underway.
- The Misery Index, which is the Consumer Price Index (CPI) inflation rate plus the unemployment rate is below the average of 9.2% since 1949 but it rose to 8.5% in May from 6.9% in January. The May unemployment rate is low at 4.3% but the CPI rose to 4.2% in May from 2.4% in January.
- We are monitoring financial conditions and high-frequency indicators. They show ongoing economic resilience and financial system stability.
- Argus expects S&P 500 EPS to rise almost 25% to $340 in 2026 and increase about 15% to $390 in 2027. EPS is helped by an increase in operating margins to about 18.8% this year, well above 13.9% in pre-pandemic 2019. Growing tech giants such as MSFT and NVDA have operating margins of 47% and 64% respectively while Dow stalwarts Walmart and Caterpillar earn 4% and 17%, respectively.
- Argus Fixed Income Strategist Kevin Heal expects the Fed to maintain the funds target at 3.50% to 3.75% in 2026 and reduce the target by 25 basis points in 2027 as inflation is likely to abate. We expect the dollar to be slightly stronger in 2026 driven by foreign demand for shares of innovative U.S. companies and continuing economic growth.
- Gold is likely to remain at elevated levels amid global uncertainty. The safe-haven asset recently topped $5,000 an ounce. With seeming progress in winding down the Iran war, gold has declined.
- What could go right? Low unemployment, spending by wealthy consumers, strong S&P earnings, capital investment in Artificial Intelligence, productivity gains, slower inflation if the price of oil has peaked, a small economic boost from the World Cup, and ongoing innovation.
- Risks: Strains on affordability from years of elevated inflation, uncertainty related to the interim peace deal with Iran, a lower 10-year Treasury yield could depend on deficit reduction, a weak housing market, low income consumers are struggling, spending by affluent may depend on stock gains.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
25-Jun	GDP Annualized QoQ	1Q "Final"	1.6%	1.6%	1.6%	**2.1%**
	GDP Price Index	1Q "Final"	3.5%	3.5%	3.5%	**3.6%**
	PCE Deflator	May	3.8%	4.0%	4.1%	**4.1%**
	PCE Core Deflator	May	3.3%	3.3%	3.4%	**3.4%**
	Personal Income	May	**2.6%**	2.2%	NA	**3.8%**
	Personal Spending	May	**5.6%**	5.9%	NA	**6.3%**
	Durable Goods Orders	May	19.2%	-4.8%	NA	**-4.4%**
30-Jun	Consumer Confidence	June	**90.6**	94.5	94.7	**91.2**
1-Jul	ISM Manufacturing	June	54.0	54.4	54.0	**53.3**
	ISM New Orders	June	56.8	56.2	NA	**56.0**
	Construction Spending	May	**-2.5%**	1.5%	NA	**-1.5%**
2-Jul	Nonfarm Payrolls	June	172K	125K	110K	NA
	Unemployment Rate	June	4.3%	4.3%	4.3%	NA
	Average Weekly Hours	June	34.3	34.3	34.3	NA
	Average Hourly Earnings	June	3.4%	3.4%	3.5%	NA
	Factory Orders	May	11.7%	2.5%	NA	NA
6-Jul	ISM Services Index	June	54.5	54.6	NA	NA
7-Jul	Trade Balance	April	-$55.9 Bln.	-$77.8 Bln.	NA	NA
8-Jul	Wholesale Inventories	May	3.6%	4.3%	NA	NA
9-Jul	Existing Home Sales	June	4.17 Mln.	4.10 Mln.	NA	NA