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Economic and Market Outlook

June 30th, 2026

The Artificial Intellegence Economy

It's very clear that AI is going to impact every industry. I think that every nation needs to make sure that AI is part of their national strategy. Every country will be impacted.

- *Jensen Huang*

Section I. Introduction

Jensen Huang, CEO of nVidia (NVDA), is very clear about the impact that AI will have on every industry and country. AI is already being used by many industries including Healthcare, Finance, Transportation and Education. Many of our investment decisions are based on energy consumption and construction of data centers, along with semiconductors and connectors used by the creators of AI. We feel that we are still in the early innings of this investment trend.

Section II. The Federal Reserve and Interest Rates

Alan Greenspan, former Federal Reserve Chair, recently passed away at the age of 100. He was in charge during the internet bubble of the 1990s. He called the run up in the Market "Irrational Exuberance". Cisco (CSCO) was trading at 160 times earnings. Qualcomm (QCOM) had a similar multiple. We don't see the same multiples in the market today.

We now have a new Fed Chair in Kevin Warsh. He stated that "the committee will deliver price stability." That could mean a rise in interest rates to fight inflation.

Rates in most European 10-year bonds are steady because of a strengthening European economy. The U.S. 10-year bond still remains relatively more attractive to international investors for its yield and AA+ credit rating, though the spread is narrowing. The U.K. 10-year yields 4.70% (AA), German 10-year yields 2..80% (AAA), France 10-year yields 3.50% (AA), Italian 10-year yields 3.60% (BBB) and Swiss 10-year yields 0.25% (AAA). These compare to our 4.40% 10-year yield.

Section III. <u>Inflation</u>

As discussed, the other side of the Fed's mandate is inflation. After making great progress in moving the inflation rate closer to the Fed's target rate of 2%, the past few months have seen a slight increase. Much of the increase has been the blame of oil prices.

Oil prices ran up to over $130 a barrel while shipping traffic thru the Strait of Hormuz was closed due to the war with Iran. The recent Memorandum of Understanding has allowed shipping through the strait to resume for the first time in months. The result has been a recent decrease in the price of crude oil, agricultural chemicals, and the price of gas at the pump.

Currently the Consumer Price Index (CPI) is up 4.2% on an annual basis, and core CPI, which excludes food and energy, is up 2.9%. Both readings are for May 2026. This is still above the Federal Reserve's 2% target. As expected, the move from 3% to 2% will continue to be slow and difficult. CPI has increased since our last report by 1.8%. Core CPI increased by 0.5%. Most of the increase can be blamed on the war and elevated oil prices. While the CPI reading peaked in June of 2023 at 9.1%, the core rate actually peaked in September of 2023 at 6.6%.

The Federal Reserve prefers to use a measure called the Personal Consumption Expenditures (PCE) Price Index to gauge inflation. The reading for PCE in May was 4.1% and the core rate was 3.3%. Inflation in the Euro Zone was running at 3.2% on an annual basis in May. All measures are up reflecting the rise in the price of oil. Energy demand from AI is also contributing to higher inflation.

Average hourly earnings are up 3.4% year-over-year in May and overall inflation is up 4.2% as previously stated. This is a negative for the economy because it means real wages are falling.

Section IV. <u>The Bull Market</u>

As we stated in our December 31, 2024, report, we expected some types of correction or consolidation in the market from time to time. Corrections are part of normal volatility, and are healthy for the market. Within the first four months of 2025, the S&P 500 index had a correction of 18.9%, reaching a level of 4982.77, on a closing basis. It has since rebounded to a high of 7500. Remember that a bear market is defined by a pullback of at least 20%. Therefore the bull market is still intact.

A recent occurrence has only happened 7 times before in history. The S&P gained 19% over a two month period ending May 29th. In the past seven times this has occurred, the S&P had an average gain of 28% over the following 12 months.

Bull markets do not die of old age. We are approaching 44 months in this bull market. Since World War II there have been 13 bull markets and the average gain was 164%, and on average they lasted 57 months. It is also true that recent bull markets have generated higher returns over longer periods of time. On average, the last five bull markets since 1980 have seen stocks advance about 240% over a period of 70 months.

Bull markets end because of Black Swan events or because of recessions in the economy. By definition, Black Swan events cannot be predicted. For reasons cited later in this report, we do not see a recession coming in the near future.

To be clear, in the short term we fully expect more corrections or consolidation in the market from time to time. Corrections of less than 10% are part of normal volatility. In addition, corrections are historically quick and sudden pullbacks while Bear Markets are slow and rolling like a dripping leaky faucet.

As of this writing, the S&P 500 is down from its closing high of 7554.29 on June 15th, 2026, by 2.76%. The average return on the S&P 500 for the last 10 years is around 11%, and over last century the stock market is up on a yearly basis 76% of the time.

Despite recent market fluctuations and uncertainties, the momentum behind AI-driven technologies remains strong. The energy demands of AI will create other opportunities. As companies across industries continue to embrace AI to drive innovation and efficiency, investors are presented with unique opportunities to capitalize on the transformative power of artificial intelligence. The AI revolution is not just a fleeting trend but rather a fundamental shift that is poised to reshape industries and create new opportunities for growth and innovation. In our view this could be the next economic revolution.

Section V. <u>The Recession Model</u>

As we have discussed in past reports, earnings and the economy are the true long-term influences on the stock market. Recessions, or fear of recessions, are the major reason we experience corrections of more than 10%. Corrections of less than 10% are just part of normal volatility and tend to happen multiple times each year.

The official arbiter of recessions in the U.S. is the National Bureau of Economic Research (NBER). They determine when our economy enters and exits recessions. The problem is that usually by the time they declare the official start date of the recession the economy is probably coming out of or already done with that recession, in other words <u>no predictive value.</u>

At Clutinger, Williams & Verhoye, we have developed what we view as a recession indicator, which tracks 5 data sets on a monthly basis. If 3 of the 5 indicators are negative <u>and</u> the S&P 500 is below its 40 week moving average, it is a very strong indication that a recession is near or may already be underway.

Indicator number one compares the current monthly unemployment rate to its 12 month moving average. As of May, the unemployment rate was 4.3% and the 12 month moving average was 4.33%. By being below the moving average this indicator has turned positive.

Indicator number two is represented in Chart #1. This represents the year over year percentage change of Advance Real Retail and Food Service Sales. This is one method to measure the strength of the consumer. Currently the reading is 2.60% for January, so this indicator remains positive since our last report.

Indicator number three is represented in Chart #2. This shows the year over year change in Industrial Production. This indicator has remained positive. It currently sits at 1.67% for May 2026.

For indicator number four (Chart #3), we look at Total Nonfarm Payrolls divided by the Civilian Labor Force Level on a year-over-year percentage change basis. This indicator stands at 0.56% showing a slight strength in employment. Therefore, this indicator is positive.

Indicator number five (Chart #4) represents the Average Weekly Hours of Production and Nonsupervisory Employees-Manufacturing on a year-over-year percentage basis. Currently the reading is 1.46%, so this indicator remains positive.

Currently all five indicators are positive and the S&P 500 Index is 8.40% above its 40-week moving average as of June 19th. The S&P 500 is above its 40-week moving average; therefore this model is not giving a recession warning sign. We will be closely monitoring these indicators in the coming months.

The above indicators are only updated on a monthly basis. To offset this situation, we also track two other indicators. They are both indicators that are updated more frequently (on a weekly or daily basis) and we consider them as early recession indicators. Both are somewhat volatile, so we track three-month moving averages. These two indicators are separate and independent of the first five and either one can indicate the possibility of recession on its own.

The first one is the Aruoba-Diebold-Scotti Business Conditions Index, which is updated on a daily basis and published by the Philadelphia Federal Reserve. The 91 day moving average is at -0.12 currently. The divining line for entering and exiting recessions is -0.8.

The second indicator for recessions is the Chicago Fed Business Activity Index. It is reported weekly and the divining line for entering recessions is -0.7. The three month moving average stands at 0.03.

In summary, the two "early warning signs" are not predicting recession at this time.

Section VI. <u>Market Psychology</u>

For decades we have measured market psychology using price and volume data in the short and long term from the Dow Jones Industrial Average as well as a 17 week moving average of advancing and declining stocks on the New York Stock Exchange.

Currently, 7 out of 12 of our price/volume indicators are positive. The S&P has returned to 7500. But that doesn't necessarily mean the end of the rally. The market needs corrections from time to time in the short term to stay healthy and growing over the long term.

Our advance/decline line has been positive for the last eight out of the past eleven weeks and sits at 50.7%, and is reflecting there may still be some room to the upside by not being overextended.

Our technical model measures the first and second derivative of price and volume for the market. We have developed this model to recognize patterns and spot buy and sell signals from reviewing years of historical data. This model is providing negative signs and may be signaling an intermediate term correction is in the near future.

Section VII. The Economy

Indexes that measure manufacturing data are positive. The Philly Fed Manufacturing Index has stayed positive, moving up to 10.3 in June of 2026. The Empire State Manufacturing Index fell to -20.0 in March of 2025, but after reaching positive territory in October and November, its June 2026 reading was 5.70. The national ISM manufacturing index was 54.0% in May and the ISM services index improved to 54.5% (above 50 is considered growth, above 55 is considered exceptional growth).

GDP came in at 2.4% for the fourth quarter of 2025. GDP for the first quarter of this year was 2.1%, mainly affected by the Iran War and its effect on oil prices. GDPNow is estimating a GDP of 2.5% for the second quarter of 2026.

Section VIII. Conclusion

The market started the year on the weak side, but since then it has been strong. This can primarily be attributed to the expectations of the Federal Reserve being more restrictive with their monetary policy, offset by the surge in AI. Also concerning to markets is the war in Iran. While the market-weighted S&P 500 index is up 7.31% year to date, Yahoo Finance calculates that an equal-weighted return for the index is about 9.84%.

We continue to be optimistic moving forward. As previously stated, we expect a positive, but more muted, return for 2026. As stated earlier, after moves like we have just experienced over the past few years, short-term corrections would not be surprising and are usually healthy for the market. However, we feel that the indicators show that keeping a longer view of the market will be rewarding.

Scott B. Williams, CFA, CFP

Kent Edwin Stone

Chart 1

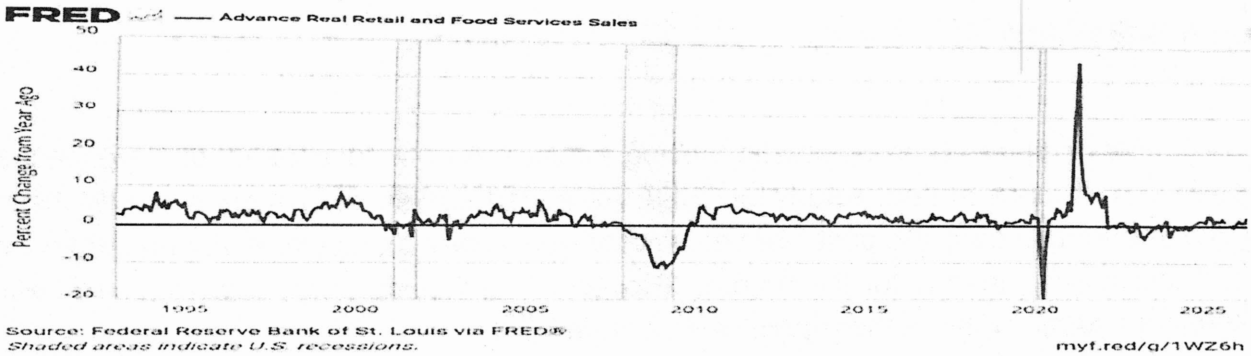

Chart 2

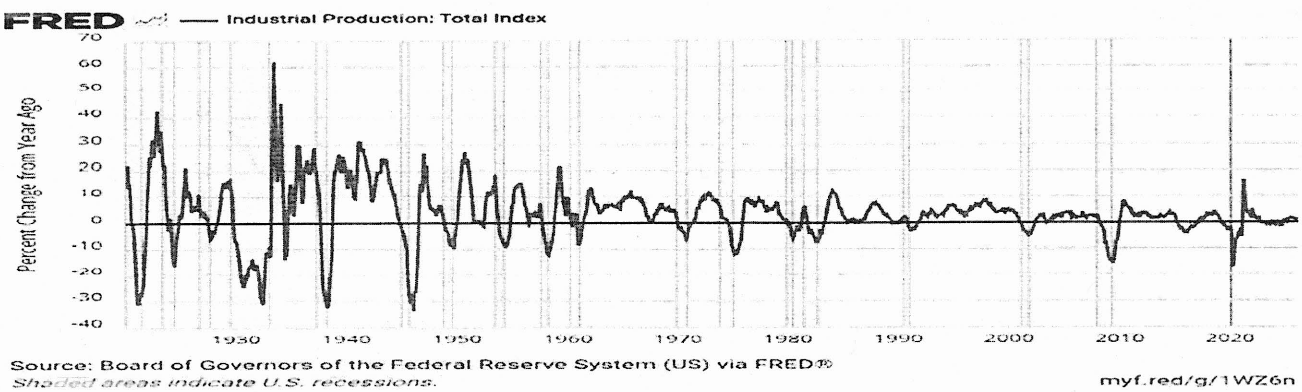

Chart 3

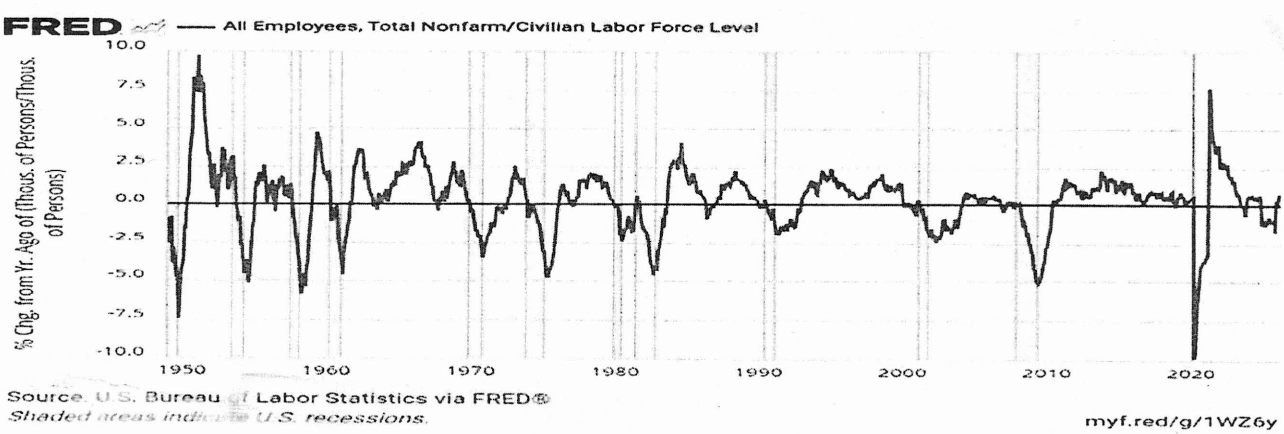

Chart 4