JULY: VOLATILITY CONTINUES AS YIELDS RISE
US GROWTH, INFLATION, EMPLOYMENT, & THE FED

Figure 1: 7/31/2026 Returns (source: FactSet)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-1.3%	-0.6%	2.7%	-4.0%	0.1%
Investment Grade Corp Bonds	LQD	-2.2%	-1.4%	1.9%	-5.9%	0.2%
U.S. 20+ YR Treasuries	TLT	-4.5%	-3.5%	-1.1%	-10.8%	0.4%
Muni Bonds	MUB	-1.6%	0.2%	5.0%	-3.1%	1.7%
US High Yield	HYG	-0.2%	1.5%	4.8%	-2.3%	1.2%
Non-US Corp Bonds	IBND	-0.2%	-1.9%	1.2%	-6.4%	1.7%
Emerging Markets Bond LC	EMLC	0.2%	1.8%	9.0%	-4.4%	2.7%
Global Equity						
ACWI Global Equity	ACWI	-0.3%	11.3%	22.2%	-2.2%	22.4%
ACWI Global Equity ex US	ACWX	-1.1%	13.3%	28.3%	-3.0%	26.1%
International Developed	EFA	1.6%	11.7%	24.8%	-0.7%	21.7%
Emerging Markets	IEMG	-6.3%	16.4%	31.9%	-10.3%	30.1%
Global Equity by Region						
United States	VTI	-0.5%	10.5%	19.8%	-1.7%	21.0%
Europe	IEUR	2.0%	10.3%	23.0%	-0.5%	20.4%
Asia ex-Japan	AAXJ	-7.2%	19.3%	34.4%	-11.3%	34.2%
China	MCHI	9.4%	-6.5%	-1.0%	-17.2%	11.9%
Japan	BBJP	-1.0%	13.2%	29.2%	-5.2%	23.0%
Latin America	ILF	4.8%	17.6%	47.5%	-8.1%	43.0%
US Equity						
US S&P 500	IVV	0.2%	10.1%	19.6%	-1.8%	20.6%
NASDAQ 100 QQQ	QQQ	-6.6%	12.3%	22.3%	-8.1%	24.7%
US Large Growth	IWF	-4.7%	0.2%	7.9%	-8.4%	15.7%
US Large Value	IWD	3.9%	20.5%	31.0%	-0.4%	31.4%
US Eqwt S&P 500	RSP	1.1%	13.2%	19.0%	-1.4%	19.5%
US Mid Cap	IJH	-2.4%	14.6%	21.0%	-2.6%	22.8%
US Small Cap	IJR	-1.9%	21.6%	33.6%	-2.6%	35.8%

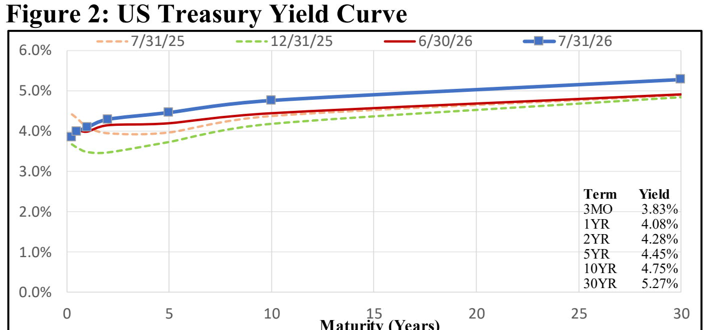
Stocks were volatile and bonds were weak this month amid the expanding Middle East conflict, rising interest rates, and mixed earnings reports from the technology sector. Performance highlights for July and year-to-date (YTD) follow.

- **Bonds:** The US Aggregate index (AGG) fell 1.3% this month (-0.6% YTD). Long-term Treasuries (TLT) are most sensitive to interest rates, losing 4.5% (-3.5% YTD) as interest rates rose. Corporate bonds (LQD) fell 2.2% (-1.4% YTD). Non-US bonds outperformed as the US dollar weakened.
- **Global equity:** ACWI fell 0.3% in July (+11.3% YTD).
- **US Equity:** The broad market (VTI) lost 0.5% (+10.5% YTD); the S&P 500 (IVV) was up 0.2% (+10.1% YTD). Small stocks (IJR) underperformed, falling 1.9% (+21.6% YTD) on inflation and interest rate fears. At the sector level, energy stocks rose 12.1% (+25.0% YTD) as oil prices spiked amid renewed Middle East conflict; tech stocks (XLK) fell 8.0% (+22.1% YTD) on mixed earnings reports from the largest tech companies, but overall earnings reports continue to come in strong, validating the solid YTD performance across most sectors.
- **Non-US Equity:** Developed market stocks logged gains (EFA +1.6%, +11.7% YTD), led higher by gains in Europe (IEUR +2.0%, +10.3% YTD). Emerging market stocks were down sharply this month (IEMG -6.3%, +16.4% YTD), led lower by tech-heavy markets in Korea (EWY -22.2%, +61.6% YTD) and Taiwan (EWT -11.1%, +52.0% YTD) as the high-flying semiconductor and memory chip makers declined amid rising concerns over aggressive global AI spending growth. China gained (MCHI +9.4%, -6.5% YTD on strong AI results.

Interest Rates and the Economy

Interest rates rose this month on elevated inflation concerns (rising oil prices, tariffs), spiking higher after the Federal Reserve (the Fed) left interest rates unchanged last week. Despite his hawkish tone on inflation, new Fed Chair Warsh offered little guidance, stating that the bond market should "play the ball, not the ref". In other words, investors should not depend on the Fed for direction. The bond market sent a clear message of concern regarding inflation and Fed credibility, driving long-term rates higher. The yield curve (Figure 2) plots interest rates for various US Treasury maturities. The US 10-year bond now yields 4.75%.

Figure 2: US Treasury Yield Curve

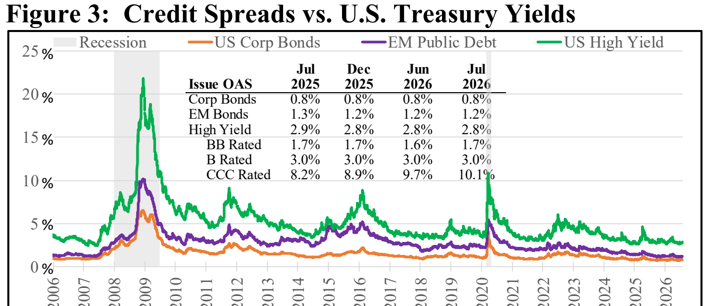


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism; high or widening spreads signal fear. Spreads widened slightly but remain historically low, reflecting the "risk on" market tone.

- Investment grade corporate bond spreads were stable at +0.8% and are basically unchanged over the past year.
- High yield (non-investment grade) spreads were unchanged at +2.8% last month and remain historically low. Spreads of the riskiest bonds (rated CCC & below) widened to +10.1% and have widened materially from +8.2% over the past year.
- Emerging market spreads were stable at +1.2% and have been stable over the past year; investors see low risk in EM debt.

Figure 3: Credit Spreads vs. U.S. Treasury Yields

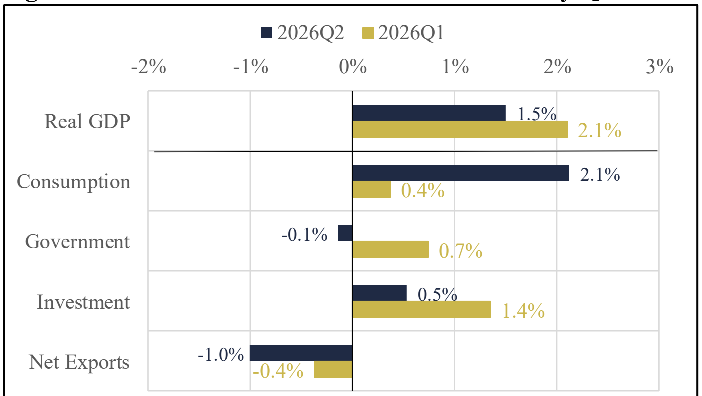


Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

Growth, Inflation, Employment & The Fed

Economic data released last week suggests that US economic growth may be slowing, at least at first glance. The Bureau of Economic Analysis reported second quarter (Q2) US Real GDP growth of 1.5% (annualized quarterly rate), down from 2.1% in Q1 and 2.2% in 2025. (Note: Real GDP stands for Gross Domestic Product, the value of all final goods and services produced in the US, net of inflation.) Figure 4 compares the primary drivers of 2026 quarterly Real GDP growth.

Figure 4: 2026 Real GDP Growth Contribution by Quarter



Source: U.S. Bureau of Economic Analysis via FRED

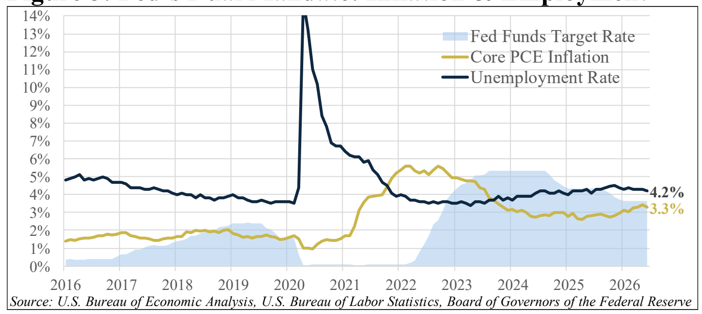
The headline data suggests slowing US economic growth, but the granular data shows that the widening trade deficit is distorting the numbers. While tariff uncertainty and aggressive AI spending have caused periodic spikes in imports since early 2025, underlying growth is actually solid. A summary of the key drivers of 2026 US economic growth follows.

- **Personal Consumption:** 68% of the US economy is powered by consumer spending, which continues to be a positive driver of economic growth; consumption growth was very strong in Q2, likely buoyed by larger-than-expected tax refunds.
- **Government Expenditures:** 17% of GDP is driven by direct consumption of goods and services by federal, state and local governments; the impact on growth has been positive this year despite a slightly negative contribution in Q2.
- **Private Investment:** 18% of US economic activity is due to business spending and investment, including construction, equipment, manufacturing and inventories. Despite an inventory build in Q2, business investment has been strong this year, primarily due to AI-driven investment and infrastructure.
- **Net Exports:** A widening trade deficit (US exports minus imports) detracted from real GDP growth in Q1 and Q2; imports of technology components (semiconductors and memory chips) surged as AI companies continue to ramp up investment. We note that the spike in imports has been partially offset by rising exports of oil and natural gas amid the Iran conflict.

This data indicates that economic activity is healthier than the headline Q2 growth rate of 1.5% suggests. To better assess underlying "organic" economic growth, economists and investors have increasingly focused on a different metric, Real Final Sales to Private Domestic Purchasers, which excludes the volatile trade, inventory and government spending categories from the Real GDP data. By that measure, economic activity grew at a 3.9% annualized rate in Q2, the most in over three years, fueled by aggressive AI spending and larger-than-expected tax refunds.

The economy is on solid footing, but inflation is elevated due to tariffs and spiking energy prices amid the ongoing conflict in the Middle East. Despite rising inflation, the Fed declined to raise interest rates last week. By law, their "dual mandate" is to maintain price stability (manage inflation) and promote full employment. Figure 6 plots the primary measures for each along with the Fed Funds Target Rate over the past 10 years for perspective.

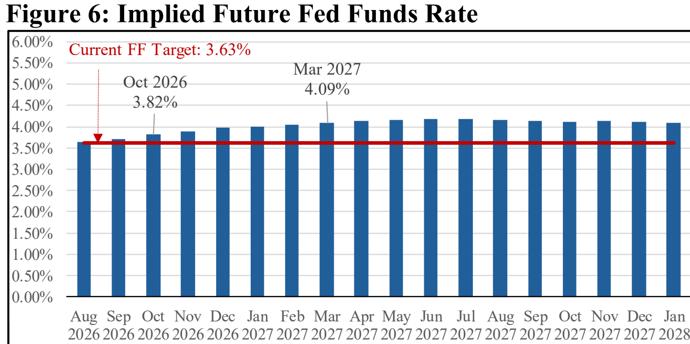
Figure 5: Fed's Dual Mandate: Inflation & Employment



Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Board of Governors of the Federal Reserve

The unemployment rate soared in 2020-2021 during the pandemic, and the Fed aggressively cut interest rates to support the economy. Inflation spiked in 2021 (as measured by the Fed's favored inflation metric, Core PCE, which excludes volatile food and energy categories), forcing the Fed to hike interest rates aggressively in 2022-2023. While the unemployment rate has stabilized at historically low levels, Core PCE inflation has risen to 3.3%, well above the Fed's 2% target. Investors now believe that the Fed will hike rates twice in the coming months (0.25% each) to curtail inflation and hold the Fed Funds target rate above 4% for the foreseeable future, as illustrated in Figure 6.

Figure 6: Implied Future Fed Funds Rate



Source: CBOT Fed Funds Futures via WSJ

Bottom Line

US and global equity markets have been volatile amid heightened uncertainty (geopolitics, war, tariffs/trade, AI spending, etc.) but remain within 2% of all-time highs. Earnings growth continues to be very strong overall, especially for the beneficiaries of AI infrastructure spending and data centers (semiconductors, memory chips and hardware, industrials and basic materials). Meanwhile, the bond market is flashing warning signals. Longer term interest rates are rising, reflecting investors' concerns regarding elevated inflation, rising US debt and deficits, and Fed credibility, which was exacerbated last week as the Fed declined to raise interest rates despite rising inflation. Investors expect rate hikes in the coming months and are preemptively driving up long-term yields, which tightens financial conditions and can slow economic growth. Given the escalating conflict in the Middle East and the potential for higher interest rates, market volatility will likely continue. As always, portfolio diversification remains critical.

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