Stapp Financial Investment Letter

Stapp Wealth Management, PLLC **Second Quarter 2026**

"There's always something to worry about. But the trick is to separate the valid worries from the idle worries, and then check the worries against the facts."

- Peter Lynch

Market Recap

Once again, there has been no shortage of headlines to keep investor anxiety at peak levels. The Iran conflict continues to rage on, with the Strait of Hormuz, what many people are now calling Schrödinger's Strait, continuing to be a big question mark. The debate over AI also continues to populate the headlines with notable advancements occurring and a slew of mega IPOs coming down the pike – SpaceX being the first.

Despite the tumultuous headlines, markets have largely moved on from the concerns expressed in the 1st quarter over the Iran conflict, with stocks rebounding sharply. US large cap stocks recovered with a gain of +15.2% in the quarter. US small company stocks performed even better, up +21.49% in the quarter. The de-dollarization trade quieted down during the quarter, but international stocks still experienced strong performance, with developed country stocks up +10.82% and emerging country stocks up +24.05%.

Bonds recovered as well, but not as strongly as stocks as inflation concerns persist. High quality, investment grade bonds eked out a gain of +0.67%, and the lower quality high yield bonds returned +2.47%.

Gold was hit hard by the commodity crunch caused by the Hormuz closure as it serves as a source of emergency funds for many countries around the world. Couple that with the de-dollarization trade going silent and the result is a loss of -12.64% for gold for the quarter, which puts it negative for the year. Managed futures continued to push higher, with a return of +1.9% for the quarter.

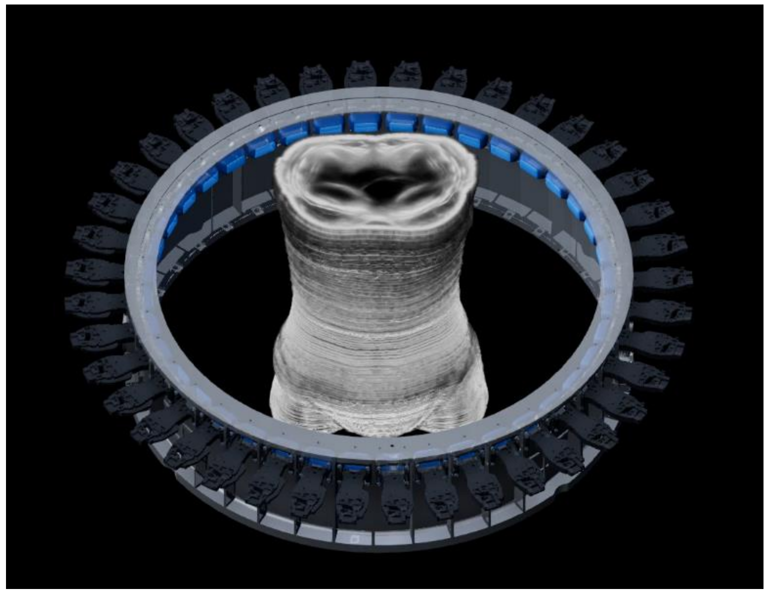
Asset Class Performance		
	2nd Quarter	Year-to-Date
Investment Grade Bonds	+0.67%	+0.62%
High Yield Bonds	+2.47%	+1.96%
US Large Cap Stocks	+15.2%	+10.21%
US Small Cap Stocks	+21.49%	+22.57%
Developed International Stocks	+10.82%	+9.44%
Emerging Market Stocks	+24.05%	+23.85%
Gold	-12.64%	-7.82%
Managed Futures	+1.9%	+7.33%

Data as of 6/30/2026. Source: Kwanti Analytics[1]

[1] Indexes used: Bloomberg US Aggregate Bond Index, Bloomberg US Corp High Yield, S&P 500 TR, Russell 2000 TR, and MSCI EAFE TR, MSCI Emerging Markets Index TR; Gold represented by the change in the gold spot price; Managed futures represented by a 50/50 allocation to ASFYX and PQTIX set to rebalance quarterly.

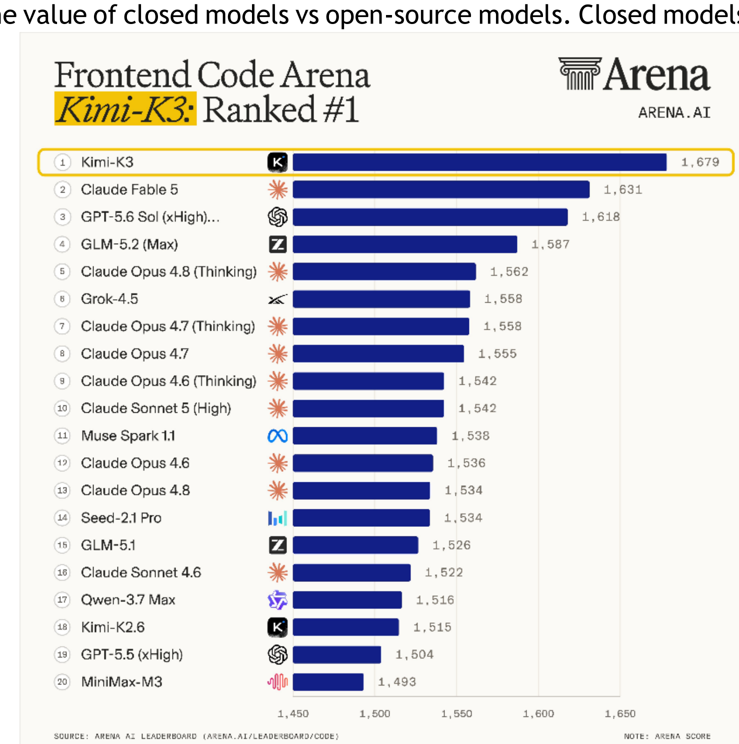
Investment Outlook and Portfolio Positioning

The #1 question every investor is asking now is – "Is AI a bubble?" AI has been the top business story for several years now, and it keeps improving at a steady pace. Whether you like it or not, almost every investor is an AI investor now as roughly 47% of the S&P 500 is directly linked to the AI economy, and corporate debt linked to AI is rapidly growing with about 15% of the US corporate bond market now linked to AI. Additionally, it is becoming clear that most segments of the market and economy will be impacted by AI in some way. A lot of what AI has been used for up to now has largely been related to content creation along the lines of articles, pictures, and videos, but with some of the recent developments, we are now seeing significant potential in other sectors. For example, Midjourney, one of the first AI image generators, just recently announced Midjourney Medical, with their first release being a full-body Ultrasonic CT scanner that will generate a 3D scan of your body 100x faster and for less cost than a traditional MRI machine. This is a first-generation prototype and lacks any sort of FDA clearance, but if this is a sign of things to come, it is becoming more likely that AI will be the most impactful technological advancement of our lifetimes.

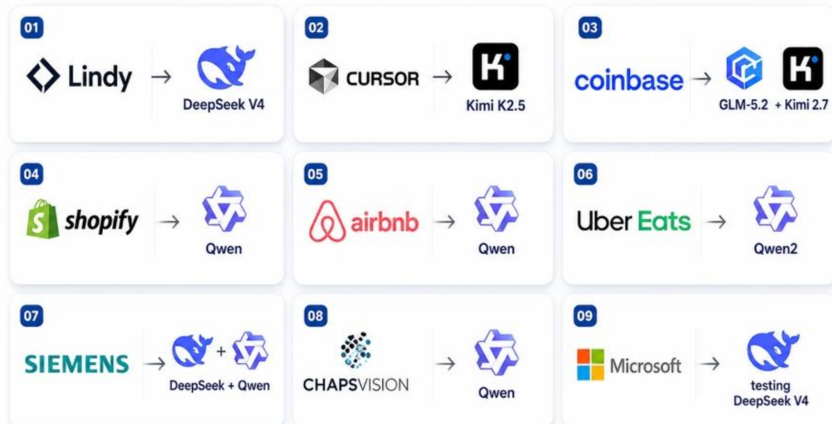


Screenshot from Midjourney Medical release video

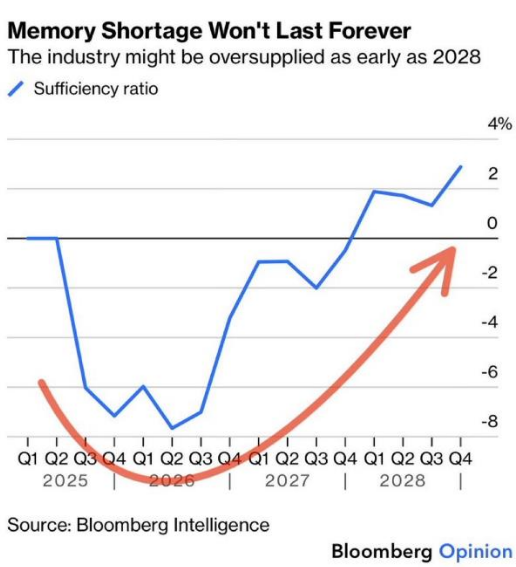
The current debate in AI development is the value of closed models vs open-source models. Closed models are the models produced by the top US AI labs such as Anthropic, OpenAI, and xAI. The best models produced by these labs have, up until just recently, been considered to be the frontier of AI innovation. For reasons that are not exactly known, many of the Chinese AI models are being released as open-source, which means they are free to download, use, and modify. These models have previously displayed worse performance than the frontier models, but they are much more efficient from a cost perspective. However, that may have just recently shifted with the release of Kimi's K3 model. K3 surpassed all other publicly available models in coding. With the release of K3, it is the first time that an open-source model has been on the frontier. In early 2023, a



senior AI researcher at Google, Luke Sernau, wrote a memo titled “We Have No Moat, And Neither Does OpenAI.” At the time he argued that 1) Open-source is moving faster than Big Tech, 2) Cheaper, “good enough” models win, and 3) AI is a commodity, not a moat. His ideas in the article took hold for about a week before everyone focused on the next advancement by Anthropic or OpenAI, as they were pulling ahead of other models. Now, however, after three years of incremental improvements by both closed models and open-source models, we are seeing his ideas becoming more and more prescient.We are beginning to see this play out in corporate America as well. As companies integrate AI into their workflows, we are seeing an increased adoption of open-source Chinese models over closed American models as the costs of these Chinese models are significantly less than the American models. With the proliferation of these open-source models, it is becoming more clear that intelligence will be abundant and cheap. You can already imagine the vast societal impacts this will have.



When it comes to markets and investing around abundant intelligence, this is not an easy theme to invest around. AI commoditization is clearly a negative for the model developers as their value proposition will decline. The market has been piling into bottlenecks in the supply chain, but with the amount of CapEx spend occurring now, it is very likely that we will have an abundance of compute in the next 2-3 years that will be a whiplash to many of the current market darlings. Semiconductors have been the most recent beneficiaries of the AI trade, but if AI becomes a utility, compute will eventually see supply normalization. The hyperscalers have been funneling much of their CapEx spend into the semiconductor companies with the hopes that they will receive a return on that investment in future years, but if model capabilities converge, workloads will get dynamically routed to the cheapest available compute provider, turning a walled garden into a capital-intensive utility. Infrastructure is large and essential, but capital-intensive utilities rarely sustain premium, software-like valuation multiples once the initial build-out normalizes and competition drives down prices. If the intelligence is free, the bottleneck shifts to deployment and data. Companies that enable context and orchestration infrastructure will capture immense value. Proprietary data becomes a critical moat for many companies as software that can be easily replicated loses its unique value, while the proprietary data that flows into that software remains critical. The ultimate beneficiaries will be the strategic adopters who can reduce operating costs through the implementation of AI, therefore expanding margins and generating higher profit capture. Many of these strategic adopters are the high quality, well-managed companies many of



us are already familiar with. Perhaps the most critical investment insight as it relates to AI is that AI will be incredibly disruptive to many businesses and industries. All investors must now think about every investment within the context of how AI might disrupt it. There are many businesses that are like melting ice cubes that will slowly be eroded by AI. Those are the investments you want to avoid.

Quarter-over-quarter, we did not make any notable allocation changes across portfolios. Toward the end of Q1, we slightly tilted portfolio positioning to hedge against inflation pressures by increasing our weighting to energy equities and reducing bond duration exposure further. Bonds have been weak since then, and that has continued to be a good move. Energy equities performed strongly after putting on the position, but they experienced a sharp reversal as the market considered the Iran conflict to be de minimis. Animal spirits roared into the AI momentum trade, which we have some exposure to, but relative to the broader market, we are underweight. Following a year of outperformance, this led to an underperforming quarter. However, as we continue to be wary of inflation pressures, we have kept our positioning intact. This will not show in our Q2 numbers, but it has begun paying off in early Q3 as the AI momentum trade has reversed and inflation pressures have reignited. We see several distinct catalysts keeping these inflationary pressures elevated. The ongoing closure of the Strait of Hormuz has created severe bottlenecks in global fertilizer supply, which, coupled with El Niño, is driving sustained food pricing pressures. Additionally, we are seeing structural pressures in energy markets and elevated compute pricing across the tech sector. Because of these factors, our Reversal of Washington Consensus theme - which reflects a broader shift away from hyper-globalization and free trade - remains highly relevant. We expect these underlying macro headwinds to persist for the next twelve months, though we anticipate the broader market will have fully priced in these specific inflationary dynamics by the end of this year and may make adjustments at that time.

Closing Thoughts

We are in an environment where there are more questions than answers. We continue to believe that a diversified approach makes the most sense in the absence of a unique insight. Markets have shifted to where unique insights are priced into markets much more rapidly than they have been historically. Rather than a main source of edge coming from unique insights, we think adaptive portfolios, capital efficiency, and intelligent position sizing will be a sustainable source of edge. The benefit of this approach is that it is more sustainable than consistently identifying unique insights, and it also allows for higher risk adjusted-returns than an approach based on making large bets based on singular ideas.

We deeply value the confidence you place in us to manage your capital. We do not take that lightly, and as such we are constantly working to improve our investment process and portfolio results. Should you have any questions, insights, or wish to discuss your unique circumstances, please don't hesitate to reach out. We're here for you, ready to connect at your convenience.