SALEM PARTNERS
WEALTH MANAGEMENT

Investment Letter by Erik Ridgley, CFA – 2nd Quarter 2026
Chief Investment Officer of Salem Partners Wealth Management August 15, 2026

- Large-cap U.S. equities returned +15.2% in the 2nd Quarter of 2026 (2Q26), and small-cap U.S. equities returned +21.5% in 2Q26. Foreign developed and emerging markets equities returned +10.8% and +24.0%, respectively, in 2Q26.
- S&P 500 earnings growth rate consensus estimates are +33.4% in 2026, and +13.4% in 2027.
- S&P 500 revenues growth rate consensus estimates are +11.1% in 2026, and +8.3% in 2027.
- Unemployment rates should remain at 4.3%, near historic low levels, throughout 2026 and 2027.
- The economy is running hot with a $1.9 trillion deficit, and a Fed funds rate hike is in play in September. Fed funds rate cuts are not plausible with corporate earnings growth this strong.
- The biggest risks to stock and bond markets would be interest rates moving too high and too fast.

ARTIFICIAL INTELLIGENCE

OpenAI publicly launched ChatGPT on Nov 30, 2022. It was an instant hit, with over a million downloads on the first day, and investors quickly took notice. Within weeks, The Wall Street Journal and Barron's were reporting on this groundbreaking technology development and its potential impact on the competitive landscape, i.e., how it could be a disruptive threat to Google's lucrative search business. By January 2023, OpenAI had over 100 million monthly active users.

Since then, AI's capabilities have grown rapidly, and analysts' predictions of winners and losers have expanded and shifted. New data center buildouts by hyperscalers trying to keep up with surging AI computing demand, along with upgrades to electricity generation and transmission infrastructure, have meaningfully contributed to higher earnings per share forecasts for the S&P 500 Index and higher share prices. Analysts are predicting this will be the biggest capital expenditure boom cycle in history.

Anthropic, OpenAI, and Google own the "frontier labs" at the leading edge of developing the most powerful large language models and agentic software systems. Anthropic is growing AI revenues the fastest (reportedly 600% year-over-year growth in 2Q26), and they are aggressively launching many "AI-native" enterprise software applications to compete with incumbent software firms they are also partnering with. Reuters reported this week that Anthropic is targeting $190-200 billion in annual revenues by 2028.

Artificial Intelligence and Hyperscalers

Estimated revenue run rates are $100 billion per year combined for OpenAI and Anthropic, both of which represent significant customer concentration risks for the hyperscalers. Capital expenditures on new data centers will be at least $785 billion in 2026 for the hyperscalers (Amazon Web Services, Microsoft Azure, Google Cloud, Meta, Oracle) and neocloud CoreWeave, per Moody's. The hyperscalers need to buy an estimated $200 billion of the most advanced graphics processing unit (GPU) semiconductor chips, networking gear, and computer server systems in calendar year 2026 from Nvidia, which represents a significant supplier concentration risk for the hyperscalers.

Amazon CEO Andy Jassy recently disclosed that the chips and computing systems it runs in its data centers have just under 3-year paybacks and at least 5- to 6-year lifespans. This implies 20%-24% internal rates of return (IRR) assuming level cash flows (spot pricing and longer-term forward pricing agreements for installed GPU rental rates have risen rather than fallen due to high demand, despite the aging hardware). AMZN stock jumped 25% on this disclosure.

Amazon Web Services launched its cloud computing service in 2006, running Intel central processing unit (CPU) semiconductor-based computer servers, and this business unit is why Amazon has been so successful (i.e., it's not from selling books). Cloud computing has taken share from on-premises computing for many years, and that trend accelerated further with mass adoption of work-from-home protocols during and after the COVID-19 pandemic. Microsoft Azure is #2 in market share in cloud computing, and this has also been MSFT's most important growth engine for many years. Cloud computing is a proven and profitable business model.

Hyperscalers are confident they can apply the business model of cloud computing to AI workloads. The biggest physical differences are that hyperscaler AI data centers run more expensive Nvidia graphics processing unit (GPU) chips, networking gear, and computer server systems, and they need much more air conditioning per square foot (all of which requires a lot more electricity) and higher ceilings to stack it. Hyperscalers argue that this higher capital intensity of GPU-based data centers creates a barrier to entry against competition from smaller and less well capitalized neoclouds such as CoreWeave. The Wall Street Journal this week highlighted $3 trillion of long-term lease commitments and purchase commitments disclosed in the footnotes of financial statements of hyperscalers, which analysts would typically add back to on-balance sheet liabilities in their models. Hyperscalers have strong incentives to maintain their investment-grade credit ratings.

Each of the hyperscalers spent decades building core business franchises with dominant market shares, massive free cash flows, and pristine balance sheets. They used their free cash flows to buy back stock (investors love this), pay dividends, and subsidize new growth initiatives with varying degrees of success. All of them view AI as both a huge growth opportunity and a potential threat to the future growth of their core businesses. Before AI, they mostly stayed in their own lanes and minted money. Now, they are breezily borrowing money to finance growth strategies that put them in direct competition with each other and taking on significant customer concentration risk with OpenAI and Anthropic. It's lower return on invested capital (ROIC) than their core businesses, but it brings higher revenue growth, and by their calculations these data center projects will be positive net present value. Their judgment is that the riskier strategy would be to stand on the sidelines of the AI technology transition.

Artificial Intelligence and Earnings

Bears have accused OpenAI, Anthropic, and other AI-native software companies of selling tokens below cost, suggesting that high revenue growth is masking negative unit economics. Recent reporting on Anthropic refutes those accusations, although neither Anthropic nor OpenAI provides public investors with audited financial statements showing how revenues, computing costs, research and development expenses, etc. are accounted for. It seems implausible that institutional public markets portfolio managers (some of whom are now getting a preview) would consider a $2 trillion IPO valuation for Anthropic if its true gross margins were negative. Anthropic's IPO is expected this fall, so we will soon find out. OpenAI just announced that their IPO will not occur until 2027 as they work through some changes in the C-suite.

When Nvidia ships equipment, it immediately recognizes revenue and collects cash. In contrast, its customers (i.e., hyperscalers) pay in cash and depreciate the cost of the Nvidia equipment over its estimated life, beginning when it is placed in service rather than at purchase. For tax purposes, hyperscalers can expense 100% of the cost of Nvidia equipment in the tax year when it is placed in service. This is entirely appropriate GAAP accounting, but during a period of rapid capital expenditure growth, it can make reported earnings look considerably stronger than underlying free cash flow (investors care more about free cash flow) across the AI ecosystem.

The high growth rate of data center capital expenditure has caused free cash flow for some of the hyperscalers to decline so much that it is now negative. If hyperscalers hit the brakes on data center capital expenditure, then their free cash flow would quickly recover and rise to new highs. In contrast, this would hurt the free cash flow growth of Nvidia and the semiconductor manufacturers, all else equal.

Artificial Intelligence and Interest Rates

In the long run, AI should be a disinflationary force, but in the short run it is an inflationary force due to an historic capital expenditure boom and the shortages it is creating for certain materials (e.g., memory chips) and specialized labor to build new data centers and electricity generation and transmission systems. Even if they weren't creating shortages and price inflation, the financing needs are so enormous that, all else equal, they would put upward pressure on real interest rates to find a clearing price for the corporate debt needed to build all these new data centers and energy infrastructure. So far, bond portfolio managers are happily buying high-quality investment grade corporate bonds issued by Amazon because they can pick up an extra 0.80% to 1.10% of yield above what they would get for a U.S. Treasury bond with equal maturity. This could be the rare occasion where private sector borrowing crowds out government borrowing, i.e., the "crowding out" effect in reverse.

Artificial Intelligence and Labor Markets

Venture capital pitch decks for the most ambitious AI start-ups envisioned the total addressable market (TAM) for AI would be the labor expenses of corporations, i.e., replacing white collar office workers with AI. Substitution of capital for labor by implementing new technologies has been going on for centuries, but this was going to be much bigger. VC loves big TAMs, and this would be the mother of all TAMs.

Since then, on-the-record comments from some leading AI CEOs have not assuaged anyone's concerns about workers. The pace at which AI is expected to diffuse throughout the economy is sobering. On the other hand, economic historians would argue that past technological advancements have created more new and higher-paying jobs than those made obsolete. For example, in 1980, most office workers had never used a personal computer, and within a decade computers had become an ordinary part of working life for millions of knowledge-based workers.

Artificial Intelligence and National Security

Economic security is a key pillar of national security. America and Europe both watched China hollow out their manufacturing sectors over three decades, and AI looks to many in Washington, D.C. like a new technology that could allow China (or U.S.-based Anthropic!) to do the same to America's vaunted knowledge-based services sectors and its valuable software industry.

How long would it take before the U.S. or China developed an AI tool that could disable their adversary's nuclear missile command, control, and communications systems? Would the "winner" of this AI race be tempted to strike the other before their lead disappeared? These questions echo those raised during the early days of the nuclear arms race between the U.S. and the U.S.S.R. If the past is prologue, the U.S. and China will adopt an AI strategy akin to a 'mutually assured destruction' doctrine and behave rationally.

Other national security or "safety" questions regarding AI are concerned with small-state bad actors and non-state terrorists, or self-actuating rogue software agents. Technology industry leaders are vociferously arguing with each other and lobbying the White House over government regulation of AI innovation, commercial appropriation of intellectual property, and fair business practices, as incumbents and disruptive start-ups jockey for competitive advantage across various strategic dimensions.

TAX PLANNING

Taxes Are Your Biggest Investment Expenses

For wealthy investors, taxes are by far their most significant expenses, and well in excess of other costs such as investment management fees. This stems from the various forms of taxes they encounter, including capital gains tax, income tax on dividends and interest, and estate taxes. Strategic tax planning and tax-efficient investment vehicles and portfolio management strategies become crucial for wealthy investors to reduce their overall tax burden and optimize long-term after-tax investment returns.

We have helped families of significant wealth design and implement their trust & estate plans, working together with leading experts from acclaimed law firms, and we are pleased to use this knowledge and experience to do the same for you. We understand that trust & estate planning issues are complex, and we work shoulder to shoulder with you in achieving your objectives and peace of mind.

Business and Income Tax Planning and Structuring Can Result in Significant Tax Savings

We have guided founders of businesses with high growth potential to plan and structure their ownership to utilize qualified small business stock (QSBS) rules to exclude from their taxable income a portion of capital gains on the sale of their companies — up to 10 times the investor's cost basis or $15 million, whichever amount is greater. Subject to applicable eligibility requirements, holding periods, limitations and then-current tax law, QSBS may allow eligible taxpayers to exclude a portion of qualifying capital gains. In certain circumstances, planning involving eligible family members or trusts may increase the available exclusion. Private investors and limited partners can also receive QSBS tax benefits. Incentive stock options (ISOs) are typically offered to executives and key employees, with potential tax advantages, and non-qualified stock options (NSOs) can be granted to any employee, as well as to consultants and board members. For appropriate clients, private placement life insurance (PPLI) may provide tax-advantaged accumulation when properly structured and maintained, subject to applicable insurance, tax and legal requirements (we don't sell insurance). Business owners looking to contribute up to $300,000 per year of pre-tax money into their retirement plans should consider cash balance defined benefit pension plans. The U.S. Code includes various tax benefits to incentivize entrepreneurs to start and grow businesses, and we help ensure our clients don't miss out so they can focus on building great businesses.

Proven and Repeatable Processes: Portfolio Rebalancing, Tax Loss Harvesting, and Tax Deferral

Portfolio rebalancing is a useful tool for long-term investors because it serves two important purposes. First, it keeps asset allocations in line with targets codified in clients' investment policy statements (IPS). Second, it can be a mechanism to naturally "buy low, sell high" because it means adding to an asset class that has decreased in price (e.g., >10%) relative to the overall portfolio and cutting back an asset class that has increased in price relative to the overall portfolio. Good judgment, disciplined decision-making, and operational excellence are necessary to obtain the best results for every client from portfolio rebalancing.

Another proven methodology for long-term investors to take advantage of market volatility is tax-loss harvesting. Unlike tax-loss selling, tax-loss harvesting precludes adverse impacts on investment returns by simultaneously replacing the sold securities with very similar securities to avoid IRS wash-sale rule violations while maintaining participation in any subsequent market recovery. We actively implement tax-loss harvesting throughout the year whenever material market declines create opportunities.

Tax losses provide economic value because investors can use them to offset capital gains tax, and unused tax losses can be carried forward into future years until they are fully used. The maximum federal tax rate on short-term capital gains is 40.8%, including the 3.8% net investment income tax, and for Californians, the maximum combined state and federal tax rate is 54.1%. The value of tax-loss harvesting varies based on an investor's individual circumstances, including applicable tax rates and the character and timing of gains and losses.

Tax deferral strategies involve delaying or avoiding the realization of capital gains through judicious planning and portfolio management. Under current tax law, certain appreciated assets may receive an adjustment in tax basis at death, which may reduce or eliminate unrealized capital gains for income-tax purposes, depending on individual circumstances and applicable law.

DISCIPLINED INVESTING

First Principles of Long-Term Investing

To paraphrase Warren Buffett, successful investors need to invest for the long term and avoid being swayed by the fear and greed of others, which can cause temporary swings in the market. We do not let the daily noise and volatility of the markets deter us from our mission to be faithful stewards of our clients' capital. As long-term investors, our clients and we have committed ourselves to adhering to carefully crafted investment policy statements, which we custom-built for each individual client, to achieve their long-term investment objectives, while accepting the inevitable price fluctuations of the public markets.

As fiduciaries, we relentlessly seek out the lowest costs and best terms for our clients. As trusted advisors, long-term relationships are of primary importance to helping our clients achieve successful outcomes through personalized financial planning and disciplined implementation.

Risk Management and Disciplined Decision-Making

Asset allocations should be based on well-designed investment policy statements to enable investors to get through bear markets without selling equities, by using fixed income or cash to draw upon until stock markets have recovered, which is common-sense short-term risk management. However, comprehensive risk management should also account for the long-term shortfall risk of not achieving long-term portfolio growth objectives due to inadequate asset allocations or sub-optimal portfolio construction. Along the way, contingency risks (i.e., low probability and high impact) need to be efficiently managed with various tools, including ample portfolio liquidity, limits on leverage, appropriate life, property, umbrella, business interruption, and D&O insurance protection (note: we do not sell insurance). Coordination with clients' trust & estate attorneys, and proactive tax planning with clients and their CPAs, is key to optimizing long-term after-tax outcomes for families with multi-generational wealth.

Focus On Earnings, Earnings, Earnings…and Interest Rates

Investors should focus on future earnings per share (EPS) because that's what drives stock prices. This is a good discipline to avoid being distracted by all the noise in the news. Think of a giant funnel into which all the headlines are constantly dumped and then dripping out of the bottom of this funnel are the forecasts for future earnings of each individual company in the S&P 500 Index. Consensus estimates for S&P 500 Index earnings per share are $410 in 2027. This reflects continued profit margin expansion for the overall index, as more profitable technology companies grow earnings faster than other industry sectors.

Near-, mid-, and long-term interest rates all matter because they are needed to properly discount future cash flows from those periods back to net present values (NPV) of share prices. All else being equal, lower interest rates lead to a higher NPV in a discounted cash flow (DCF) model, and vice versa. Of course, all else is not always equal. For example, if interest rates are higher because the economy will grow faster, then you might plug a higher growth rate into your DCF model, which can give you a higher NPV.

CRUNCHING THE NUMBERS

Asset Class Benchmark Returns – Year-to-Date as of 6/30/2026 (YTD) and 2nd Quarter (2Q26)

YTD:	+10.21%	2Q26:	+15.20%	U.S. Large Cap Equities: S&P 500 Index
YTD:	+11.25%	2Q26:	+14.93%	Global Equities: MSCI All Country World Index (ACWI)
YTD:	+9.44%	2Q26:	+10.82%	Foreign Developed Equities: MSCI EAFE Index (EAFE)
YTD:	+7.68%	2Q26:	+9.96%	60/40 Allocation: 60% ACWI / 40% Muni Bond
YTD:	+22.57%	2Q26:	+21.49%	U.S. Small Cap Equities: Russell 2000 Index
YTD:	+23.85%	2Q26:	+24.05%	Emerging Markets Equities: MSCI Emerging Markets Index
YTD:	+17.84%	2Q26:	+12.41%	Real Estate: S&P U.S. REIT Index
YTD:	+1.96%	2Q26:	+2.47%	Junk Bonds: U.S. Aggregate Corporate High Yield Index
YTD:	+0.62%	2Q26:	+0.67%	U.S. Fixed Income: U.S. Aggregate Bond Index (AGG)
YTD:	+2.32%	2Q26:	+2.50%	Municipal Bonds: Bloomberg Barclays Muni Bond Index
YTD:	+1.81%	2Q26:	+0.92%	Cash: U.S. T-Bills (1-3 Months) Bloomberg Index

Review of 2nd Quarter of 2026: Stock and Bond Markets Rallied as Oil Prices Fell

The S&P 500 index of stocks gained +15.20%, including dividends, in the 2nd quarter of 2026, to 7,499 from 6,528. 10-year Treasury yields rose from 4.32 to 4.47%, while Fed Funds Rates were unchanged at 3.75%. West Texas Intermediate (WTI) crude oil prices per barrel fell to $69.50 from $101.38. The U.S.

Dollar currency index edged up to 101.19 from 99.96. U.S. unemployment rates flatlined at 4.3%, near all-time lows. The St. Louis Fed's 5-yr/5-yr forward inflation expectation rate rose to 2.22% from 2.06%, per Bloomberg <T5YIFR Index>.

Updated Estimates for Valuations, Earnings, Revenues, Margins, GDP Growth, Interest Rates

Price/earnings (P/E) multiples are 20.5 for S&P 500 large-cap, 16.7 for S&P 400 mid-cap, 15.6 for S&P 600 small-cap, 16.1 for foreign developed, and 9.3 for emerging markets, where E is EPS estimates for the next four quarters, per Bloomberg consensus. The quarterly average since 3/31/1990 for U.S. large-cap P/E multiples is 17.0 times the next four quarters' estimated earnings. Thus, U.S. large-cap equity valuations are 21% above average. S&P 600 small-cap equity P/E multiples are 10% cheaper than their 30-year historical averages of 17.3, and emerging markets P/E multiples are 23% cheaper than their 20-year historical averages of 12.1.

Consensus estimates for S&P 500 EPS growth are +11.8% in 2025 (actual), +33.4% (up from +16.3% four months ago) in 2026 (estimate), +13.4% in 2027, and +12.2% in 2028, per I/B/E/S data by LSEG DataStream. Year-over-year quarterly EPS actuals were +11.5% in 1Q25, +10.4% in 2Q25, +15.1% in 3Q25, +12.1% in 4Q25, +19.0% in 1Q26 (act.), +47.3% (up from +15.8% four months ago) in 2Q26 (est.), +23.1% (up from +13.9% four months ago) in 3Q26, and +27.3% (up from +17.7% four months ago) in 4Q26. 2Q26 EPS was flattered by large gains reported on VC investments held by Alphabet and others.

Consensus estimates for S&P 500 revenues per share are forecasted to grow +6.2% in 2025 (act.), +11.1% (up from 8.2% four months ago) in 2026 (est.), and +8.3% in 2027. Consensus estimates for net profit margins are 12.5% in 2024, 13.3% in 2025 (act.), 15.6% (up from 14.4% four months ago) in 2026 (est.), 16.6% in 2027, per I/B/E/S data by LSEG DataStream.

Wall Street's full year consensus forecast for U.S. real GDP is +2.1% in 2025 (act.), +2.2% in 2026 (est.), and +2.1% in 2027, and the quarterly consensus forecasts (QoQ%, SAAR) are +2.1% in 1Q26, +1.5% in 2Q26 (act.), +2.1% in 3Q26 (est.), +2.0% in 4Q26, per Bloomberg <ECFC>. Average U.S. real GDP growth has been 2.3% over the past ten years.

The Eurozone is forecasted per Bloomberg <ECFC> to decelerate growth to trend. Europe's economy is forecasted to grow +1.3% in 2025 (act.), +0.9% in 2026 (est.), and +1.3% in 2027 vs. its trend rate of +1.0% real GDP growth.

Japan's economy is forecasted to decelerate growth to trend. Real GDP growth is forecast to be +1.2% in 2025 (act.), +0.6% in 2026, and +0.8% in 2027 vs. its trend rate of +0.5% real GDP growth.

China is forecasted to decelerate growth in 2026. China's real GDP is forecasted to grow +5.0% in 2025, +4.6% in 2026, and +4.4% in 2027. China's GDP growth forecasts should be taken with a grain of salt, but they signal the CCP's thinking and strategy, i.e., growth rates should be allowed to decelerate despite above-average unemployment among younger workers.

The Treasury yield curve is pricing in Fed Funds Rates to be raised from 3.75% currently to 4.50% one year from now, and 10-year Treasury yields to rise to 4.95% one year from now, per Bloomberg <FWCM>. The yield curve is also priced for 10-year Treasury yields to steadily increase to 5.66% over the next 5 years. The Treasury yield curve represents the "real money" pricing of many trillions of dollars of U.S. Treasury securities across maturities from 7 days to 30 years, based on bond investors' expectations for the future, which is why it commands the respect of equity investors and the Fed. Of course, the yield curve always reserves the right to change its mind.

The yield curve is upward-sloping, with 10-year Treasury yields 55 basis points (bps) higher than 2-year Treasury yields, signaling future economic growth. The yield curve was inverted (downward sloping) from July 2022 until September 2024, with a nadir of 106 bps inverted on June 30th, 2023. Yield curve inversions have historically been reliable leading indicators of future economic downturns, but not in recent years due to pandemic-related distortions. Inverted yield curves disincentivize banks from lending to corporate borrowers.

High-yield bond spreads (over 10-year Treasuries) tightened to 251 bps, after widening to 331 bps on March 30th, per Bloomberg <CSI BARC>, implying that credit markets are not pricing in credit concerns or slower growth, and certainly not a recession.

<u>Our Forecast: 20% Probability of Recession vs. 30% "Soft-ish Landing" vs. 50% "No Landing"</u>

We forecast 20% probability of a recession (i.e., "hard landing"), a 30% probability of a "growth recession" (i.e. soft-ish landing, per Fed Chair Powell) which is defined as two or more quarters of 0.0% to +1.0% real GDP growth (QoQ% SAAR) and a material increase in unemployment rates, and a 50% probability of no recession (i.e., "soft landing" or "no landing" with no increase in unemployment rates). A key wild card will be how soon the Strait of Hormuz can be opened.

<u>The Fed's Updated Economic Projections for Inflation and Fed Funds Rate in 2026 and 2027</u>

The FOMC's June quarterly "dot plot" summary of economic projections signaled that the Fed would raise the Fed Funds Rate to 4.00% by December 2026 and cut it to 3.75% by December 2027. The rule of thumb is that the Fed Funds Rate should be 1% above inflation to bring inflation down. The Fed is now forecasting the core personal consumption expenditure (Core PCE) inflation rate, its preferred measure of inflation, which excludes energy and food, of 3.3% by December 2026 (up from 2.7% in March), and then 2.5% by December 2027 (up from 2.2% in March). Investors agree with the Fed: Fed funds futures pricing implies the Fed Funds Rate will increase to 4.00% through Dec 2026, per Bloomberg <WIRP>. The Fed lowered its forecast for U.S. real GDP growth to +2.2% (down from +2.4% in March) in 2026 and lowered its forecast of the U.S. unemployment rate to 4.3% in 2026.

<u>Nominal GDP and Real GDP</u>

Earnings, revenues, expenses, share prices, home values, etc. are all reported in ***nominal*** terms, not in real terms. U.S. economic output ***<u>nominal</u>* <u>GDP</u>** (QoQ% SAAR) estimates are +5.4% in 3Q26 (est.), +5.4% in 2Q26 (act.), +4.9% in 1Q26, +3.4% in 4Q25, +7.3% in 3Q25, +5.1% in 2Q25, +2.2% in 1Q25, +5.1% in 4Q24, +5.7% in 3Q24, +6.2% in 2Q24, +4.9% in 1Q24, +6.4% in 4Q23, +8.4% in 3Q23, +6.1% in 2Q23, +8.0% in 1Q23, +9.7% in 4Q22, +11.5% in 3Q22, +8.1% in 2Q22, and +6.4% in 1Q22 (Note: the relevant formula is "***nominal*** GDP = real GDP + CPI Inflation Rate").

Real GDP (U.S. economic output, inflation adjusted) temporarily decelerated in the 2nd quarter. The U.S. economy real GDP (QoQ% SAAR) estimates are +2.1% in 3Q26 (est.), +1.5% in 2Q26 (act.), +2.1% in 1Q26, +0.5% in 4Q25, +4.4% in 3Q25, +3.8% in 2Q25, -0.5% in 1Q25, +2.4% in 4Q24, +3.1% in 3Q24,

+3.0% in 2Q24, +1.6% in 1Q24, +3.2% in 4Q23, +4.9% in 3Q23, +2.1% in 2Q23, +2.1% in 1Q23, +2.6% in 4Q22, +3.2% in 3Q22, -0.6% in 2Q22, -1.6% in 1Q22. 1H22 would have been called a recession except there were no net job losses.

Headline CPI Inflation Rate and Core PCE

U.S. **headline CPI** inflation (YoY%) estimates are +3.3% in 3Q26 (est.), +3.9% in 2Q26 (act.), +2.7 in 1Q26, +2.7% in 4Q25, +2.9% in 3Q25, +2.4% in 2Q25, +2.7% in 1Q25, +2.7% in 4Q24, +2.6% in 3Q24, +3.2% in 2Q24, +3.3% in 1Q24, +3.2% in 4Q23, +3.5% in 3Q23, +4.0% in 2Q23, +5.8% in 1Q23, +7.1% in 4Q22, +8.3% in 3Q22, +8.7% in 2Q22, and +8.0% in 1Q22. The Fed's stated target rate is +2.0%.

The Fed's preferred measure of inflation, **Core PCE** (YoY%), estimates are +3.3% in 3Q26 (est.), +3.3% in 2Q26 (act.), +3.1% in 1Q26, +2.9 in 4Q25, +2.9% in 3Q25, +2.7% in 2Q25, +2.8% in 1Q25, +2.8% in 4Q24, +2.7% in 3Q24, +2.7% in 2Q24, +3.0% in 1Q24, +3.2% in 4Q23, +3.8% in 3Q23, +4.6% in 2Q23, +4.8% in 1Q23, +5.1% in 4Q22, +5.0% in 3Q22, and +5.0% in 2Q22. The Fed's stated target rate is +2.0%.

CONCLUSIONS

Artificial Intelligence (AI) is dominating the narrative and the reality in stock markets, bond markets, and sprawling data center construction sites employing blue collar workers across the American countryside.

Large-cap U.S. equities returned +15.2% in the 2nd Quarter of 2026 (2Q26), and small-cap U.S. equities returned +21.5% in 2Q26. Foreign developed and emerging markets equities returned +10.8% and +24.0%, respectively, in 2Q26.

S&P 500 earnings growth rate consensus estimates are +33.4% (up from +16.3% four months ago) in 2026, +13.4% in 2027, and +12.2% in 2028.

Price/earnings (P/E) multiples are 20.5 for S&P 500 large-cap, 16.7 for S&P 400 mid-cap, 15.6 for S&P 600 small-cap, 16.1 for foreign developed, and 9.3 for emerging markets, on next four quarters EPS. U.S. large-cap equity valuations are 21% above average. S&P 600 small-cap equity P/E multiples are 10% below average, and emerging markets P/E multiples are 23% below average (on cycle high earnings).

Unemployment rates will remain near record lows at 4.3% throughout 2026 and 2027, according to consensus forecasts.

We forecast only a 20% probability of a U.S. recession in the next 12 months. The economy is running hot with a $1.9 trillion deficit. With inflation above target, stable 4.3% unemployment, and such strong corporate earnings, a Fed funds rate hike in September is entirely possible.

The biggest risks to stock and bond markets would be interest rates moving too high and too fast.

We hope all our clients and friends are enjoying their summer. We will keep working hard to help our clients pursue their long-term financial objectives through personalized financial planning and customized portfolios. We are grateful for the trust and confidence our clients have placed in us.

Please let us know if you have any questions.

Best Regards, Erik

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• Personalized financial planning and customized portfolios combined with institutional investment management expertise to help clients pursue attractive long-term after-tax outcomes.
• Fiduciary registered investment adviser (RIA) founded in 2004.
• Assets under management are custodied at Charles Schwab ($12 trillion in client assets) in segregated accounts under clients' names.
• Welcoming new clients with over $10 million to invest with us.

SALEM PARTNERS
WEALTH MANAGEMENT

DISCLOSURES

- **Past performance is not a guarantee of future results. Investments can lose money.**
- This analysis is not a guarantee, prediction, or projection of any particular result and your actual results may vary materially from those presented herein.
- Total return is the industry standard and our method of measuring investment performance in client reports. Total return is the investment income received or accrued plus the change in market value over a specified period divided by the market value at the beginning of the period.
- All total account performance returns in client reports are time-weighted total returns, displayed as net of all fees.
- Recognizing that past performance does not guarantee future results and that indices differ from actual portfolios, the data presented are based on the historical performance of their respective asset classes. When necessary, indices serve as proxies for asset classes. The indices are not managed, not subject to fees or transaction costs, and not available for direct investment. In certain instances, assumed rates of return or inflation are included in the presentation. However, there is no guarantee that these assumptions will be realized in the future, and they shall not be deemed as a guarantee of future results.
- Investment returns portrayed are subject to the effect of material market or economic conditions during the specified time periods.
- Investment returns of indexes reflect the reinvestment of dividends and interest income.
- Investment returns of indexes do not reflect the effect of any fees or expenses since they do not ever pay any fees or expenses. You cannot invest directly in an index.
- Investments portrayed can generate profits, but they can also incur losses.
- Equity (stocks), fixed income (bonds), and other investments do not always gain or lose value at the same time. Historically, volatility has been reduced over time by holding multiple non-correlated asset classes in a portfolio.
- Diversification within an asset class is important because it can eliminate idiosyncratic (i.e., individual security) risk within an asset class. Still, it cannot eliminate systemic (i.e., market) risk of an asset class. No investment strategy or allocation can eliminate risk or guarantee investment returns.
- Although single-asset class diversification is an important tool in the toolbox of investing, relying on it alone might cause an investor to forego the benefits of other non-correlated asset classes that may help them achieve their long-term goals. Asset allocation differs from single-asset class diversification because it involves diversification across multiple asset classes.
- Assets are broken out by market cap and style using data supplied from S&P, MSCI, Bloomberg, Morningstar, Inc., and other sources.
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The projections or other information shown in this presentation regarding the likelihood of various investment outcomes are based on publicly available information, or our opinions, and are not guarantees of future results.