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Statement of Investment Policy

Background

Recent economic data show the US economy remains resilient, underpinned by a labor market that has moderated without fracturing, a powerful technology investment cycle, durable if uneven consumer spending, and monetary and fiscal policy stances that have supported growth. While these are powerful fundamentals, the risks to continued expansion, including persistent inflation, labor market fragility, fiscal imbalance and concentrated investment, are real. In the face of elevated energy prices, persistent supply chain dislocations, and consumer sentiment readings that have languished near historically depressed levels, the economy has continued to expand at a surprisingly above-trend pace. The question is why.

The economy's most consequential source of strength has been the **labor market**. While we have seen a sharp slowdown in the pace of hiring, what is equally striking is what we have not seen: widespread layoffs. Aside from a handful of high-profile mega cap reductions-in-force, the labor market has settled into what is widely described as low-hire, low-fire equilibrium. Unemployment, having edged higher, has nonetheless stabilized in the range of 4.4%, a level that in historical context remains close to full employment. Wages have continued to grow, supporting household spending. When workers feel secure in their employment, even absent the exuberance of a tighter labor market, they tend to continue spending. And businesses, planning for a continuation of the expansion, have, for the most part, refrained from reducing headcount.

The second driver of resilience has been the extraordinary surge in **capital investment** linked to artificial intelligence (AI), a phenomenon not to be dismissed as speculative enthusiasm. In the first half of last year alone, AI-related capital expenditures spanning data center construction, semiconductors, software, and research and development, likely contributed more than one percentage point to GDP growth. Business investment of this scale and intensity has historically been a powerful counterweight to softening consumer spending. It is also likely, though still unproven, that the widespread adoption of AI will unleash a productivity acceleration that could expand the economy's non-inflationary growth potential over time.

Third, **consumer spending** has proven more durable than sentiment surveys would have predicted. Clearly there is a notable bifurcation at work. Higher-income households, whose balance sheets have

been bolstered by significant equity wealth accretion, continue to spend with confidence. Lower- and middle-income households face a more challenging environment, with the cumulative burden of elevated prices and debt servicing weighing on their purchasing power. Nonetheless, in the aggregate, domestic demand, which accounts for over 70% of GDP, has held up. Recall that the household sector entered this period with relatively healthy balance sheets, the legacy of an unusual post-pandemic deleveraging, and that financial resilience has provided a meaningful buffer to a decline in consumption outlays.

Fiscal policy, however one might assess its long-run sustainability, has provided an important underpinning to economic activity. The enactment of significant tax provisions and capital expensing allowances in last year's OBBBA have encouraged many categories of investment that might otherwise have been deferred. The effects on aggregate demand have been real and measurable.

Finally, **Fed monetary policy** has itself played a constructive role as officials have moved their reference rate through a series of adjustments from a restrictive stance to its current 3.5% to 3.75% range that many believe is nearing neutral. While this transition has reduced the drag on some interest rate sensitive sectors of the economy, housing remains notably weak. All in all, though, financial conditions are currently supportive of continued expansion and are likely to remain so over the next couple of quarters as the Fed works its way through its leadership change and until FOMC members gain greater confidence the risks to growth and employment clearly outweigh inflation risks which have been mounting.

The Risks

The most immediate concern is inflation, which has remained stubbornly above the Fed's 2% target for five years. In fact, recent readings of the Fed's preferred inflation gauge show that core personal consumption expenditures (PCE) elevated at 3% on a twelve-month basis, as the pass-through of Trump's tariff-related cost increases, though more gradual than some feared, continues to work its way through the price system. The risk of second-round effects, (i.e. tariff driven price increases becoming embedded in wage and price setting behavior), cannot be dismissed, though well-anchored inflation expectations signaled by various surveys provide some reassurance. While the recent spike in energy prices following the closure of the Strait of Hormuz is generally thought to only temporarily add to inflation readings, some fear the impact of higher energy and other materials prices will persist long after the strait is reopened.

The labor market, for all its current stability, presents risks that warrant monitoring. Net immigration has declined sharply, constraining the labor supply. Hiring activity has been subdued, and some sectors exposed to trade policy uncertainties show early signs of retrenchment. A further deterioration in hiring could, with a lag, translate into weaker income growth, and ultimately softer consumer spending.

The sustainability of AI-driven investment itself is a source of uncertainty. The current investment cycle is heavily concentrated in a relatively small number of mega cap companies. Should the anticipated productivity gains from AI fall short of expectations at the scale implied by current valuations, or

should financial conditions tighten sharply, the broader economy could be exposed to an abrupt deceleration in the investment component of GDP.

The fiscal path is also at risk. The federal deficit remains in the vicinity of 7% of GDP, roughly double the pre-pandemic norm. Public debt as a share of GDP is on a path that is, by any reasonable assessment, unsustainable over the medium term. While we do not expect near-term fiscal or financial market pressures to disrupt the expansion, the longer these imbalances persist, the narrower the margin for policy error becomes. The bond market's patience is not infinite, and any sudden repricing of sovereign debt could tighten financial conditions in ways that monetary policy alone cannot fully offset.

Finally, the geopolitical and trade policy environment remains a source of uncertainty that is difficult to quantify but impossible to ignore. The trajectory of tariff policy, the ongoing evolution of global supply chains, and the reconfiguration of economic relationships are all forces that will shape the economic landscape in ways we cannot fully anticipate. Businesses have, to their credit, adapted with considerable ingenuity. But sustained uncertainties have their cost in deferred investment, in suppressed hiring and in general reluctance to assume risk.

Forward-Looking Economic Indicators

The **ISM Manufacturing PMI** rebounded convincingly to 52.7 in March, its strongest reading since August 2022, signaling renewed industrial momentum. (Recall that ISM readings above 50 signal expansion; readings below 50 signal contraction). Manufacturing accounts for over 11% of GDP. The March **ISM Non-Manufacturing PMI** showed continued expansion at 54, with orders accelerating to 60.6, confirming durable consumer demand. Services account for over 70% of GDP. **Initial jobless claims and continuing claims** for state unemployment benefits remain well within their recent ranges, evidence layoffs are not spreading. The **Conference Board's LEI** continues to drift lower, but the pace of decline has clearly moderated with 7 of 10 components now advancing. And the latest reading of our firm's proprietary **Economic Model**, using publicly available economic data, designed to signal a change in the direction of the US economy six to nine months in advance of an inflection point, continues to show expansion ahead.

High-frequency forward-looking economic indicators we monitor signal expansion ahead despite tariff-driven and energy related inflation pressures, the most prominent risks to the expansion's continuity.

Equity Investment Policy

In our view, the US economy remains fundamentally sound, positioned for further growth. We believe the double-digit earnings growth we forecast for 2026 is likely to support rising equity market prices as investors anticipate the reopening of the Strait of Hormuz and negotiations to end the Iranian war take shape. Accordingly, stock portfolios under our supervision remain fully invested within their guidelines. Our equity investment platform includes a blend of core, well-diversified, high quality large cap *growth*

and *value* shares, domestic small cap investments, as well as modest positions in developed and emerging market companies.

Triggered by concerns over the US-led war in Iran, global equities came under increasing pressure during March following a positive start to the year, as geopolitical tensions heightened, higher energy prices threatened to exacerbate existing inflation concerns, and shifting interest rate expectations overshadowed the resilient earnings backdrop. The almost 10% March drawdown in the S&P500 index was quickly reversed early this month as investor sentiment turned positive, pegged to hopes for a quick end to hostilities in Iran. The broad stock market indices have since recorded new all-time highs.

Clouding the outlook, the Strait of Hormuz remains a critical chokepoint for global energy markets. Estimates suggest the current disruption has affected 20% of global oil supply, making it one of the largest oil shocks in the post-war period relative to available spare capacity. Even after the sharp repricing in spot oil and gasoline, futures curves suggest investors continue to expect the disruption to prove temporary, though the potential economic damage would rise if supply constraints persist.

Geopolitical shocks often create immediate market volatility as seen in higher oil prices, and in short-term risk aversion. Historically, oil prices have been the clearest transmission channel, but those price spikes have faded over time, with crude prices lower on average three to twelve months after the initial shock. Equity market reactions have also proven temporary with the S&P500 rising by roughly 10% on average over the twelve months following these events.

Equity markets routinely experience fluctuations as sentiment inevitably shifts, with double-digit drawdowns occurring before eventual recoveries. While volatility can be uncomfortable in the moment, the long-term record has favored investors who remained invested through periods of market stress. Corrections are healthy as they help reset valuations and investor expectations. They are often followed by shifts in market leadership. These dynamics reinforce the importance of diversification and disciplined portfolio construction, as narrow, risk-driven advances may not persist, and performance leadership can rotate across market environments.

As for stock market valuation, earnings expectations have continued to rise even as equity prices moved lower this winter, indicating that the March correction was driven more by a repricing of valuations than by weaker fundamentals. Much of that repricing came through lower multiples within the technology sector, where the software and semis & equipment sectors both declined sharply, falling 35% from their late October highs. The correction brought stock market valuations at the end of March back toward levels last seen in prior troughs such as those in 2020 and 2022, even as earnings expectations remained broadly resilient.

In retrospect, the October to March correction resulted in an 18% decline in the forward P/E of the S&P500, bringing its multiple closer to its longer-term average. This month's rebound has largely restored the market's multiple premium.

Fixed Income Investment Policy

Laddered high-quality corporate bond portfolios under our supervision continue to have a conservative 2.75-year target duration. With bond yields having ticked up toward the upper end of their recent trading range, we have been investing the proceeds of existing maturities and cash additions to portfolios in bonds maturing toward the upper end of their four year plus maturity range.

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Indexes are unmanaged, do not include fees or expenses and are not available for direct investment. Definitions: **Personal Consumption Expenditures Index (PCE)**: A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. **Conference Board's Confidence Index**: The Consumer Confidence Survey[®] reflects prevailing business conditions and likely developments for the months ahead. **ISM Manufacturing Index**: The ISM manufacturing index or purchasing managers' index is considered a key indicator of the state of the US economy. It indicates the level of demand for products by measuring the amount of ordering activity at the nation's factories. **ISM Non-Manufacturing Index**: The Institute of Supply Management (ISM) Non-Manufacturing Index is an economic index based on surveys of more than 400 non-manufacturing (or services) firms' purchasing and supply executives. **S&P 500 Index**: The S&P 500 Index, or Standard & Poor's 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the US. **S&P 500 Growth Index**: The S&P 500 Growth Index is a stock index administered by Standard & Poor's-Dow Jones Indices. As its name suggests, the purpose of the index is to serve as a proxy for growth companies included in the S&P 500. **S&P 500 Value Index**: The S&P 500 Pure Value Index refers to a score-weighted index developed by Standard and Poor's (S&P). The index uses what it calls a "style-attractiveness-weighting scheme" and only consists of stocks within the S&P 500 Index that exhibit strong value characteristics.

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