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Statement of Investment Policy

Background

Despite a series of challenging policy-driven economic headwinds, highlighted by an immigration crackdown, higher tariffs and a war with Iran that has boosted oil prices and threatened global supply chains, the US economy remains impressively resilient, continuing to expand solidly. Second quarter preliminary GDP growth, weighed down by strong imports which are fueling the artificial intelligence boom, expanded at a 1.5% pace, a bit below the 1.8% rate expected. The Commerce Department report also showed that consumers increased their spending, shrugging off a surge in gas prices and that business investment remained robust as companies continued to fund investments in information technology equipment, software and data center construction for the AI buildout.

Forward-looking economic data we monitor signals continued moderate and broadening overall economic growth underpinned by a strong labor market, solid consumer spending, and AI-driven business investment. Importantly, spiking initial jobless claims, deteriorating credit quality, widening credit spreads, and falling leading economic indicators, conditions that have generally preceded past recessions and prolonged stock market drawdowns, are not currently present. Forward-looking economic indicators and our firm's proprietary **Economic Model** signal expansion ahead.

Labor Market

The US labor market continues to demonstrate remarkable resilience. The unemployment rate remains low by historical standards near 4.2%, payroll employment has accelerated in recent months, labor force participation is approximately 62.6% and prime age participation remains near multi-decade highs. Initial jobless claims have remained near decades-long lows, while job openings still exceed 7 million according to the latest JOLTS report, reflecting continued demand for workers despite fears of widespread AI-related layoffs. Wage growth has eased to roughly 3.5 -4%, a rate more consistent with progress toward price stability than a year ago. Overall, labor market conditions appear balanced rather than overheated, supporting household incomes, consumer spending, and ongoing economic expansion despite the high cost-of-living challenges faced by lower income households.

Taken together, this data suggests that while labor demand remains solid, underlying inflationary pressures from the labor market are gradually cooling. For the Federal Reserve, this combination reduces the urgency to hike rates, supporting a more patient data-dependent stance. The easing in wage growth is consistent with a gradual convergence of inflation toward the Fed's 2% target.

***Nevertheless, sticky services inflation, which is running at a 3.4% rate according to the Bureau of Labor Statistics, and elevated energy prices, are the greatest obstacles to taming inflation*.**

Consumer Spending

Overall, consumer spending continues to provide the principal support for the current expansion, though the underlying pattern of outlays has become increasingly bifurcated. Real personal consumption expenditures have continued to advance at about 2.5% annually, underpinned by the healthy labor market, rising household wealth and solid income gains despite five years of elevated prices. Retail sales remain resilient, while the personal savings rate of roughly 4.5% has fallen well below its 7.5% long-term average, indicating households are continuing to dip into savings to cover their everyday expenses.

The aggregate strength in spending masks significant divergencies across income groups. Higher-income households, which account for about 50% of total consumer spending, have benefited from record equity prices, rising home values and stronger investment income, sustaining demand for discretionary services, travel, dining and luxury goods. In contrast, many middle-and-lower income households remain under pressure from cumulative inflation over the past several years. Although inflation has moderated from its peak, price levels remain roughly 20-25% above pre-pandemic levels, with essentials such as housing, insurance, utilities, healthcare and food accounting for a growing share of budgets. Elevated credit card balances and a modest rise in delinquency rates suggest increasing financial strain for many households.

Overall, consumer demand remains strong enough to support continued expansion, but its durability increasingly depends on sustained employment growth, real wage gains, and further progress in restoring price stability.

Business Investment In AI

Artificial Intelligence has emerged as one of the most important drivers of business fixed investment and a principal source of strength for the US economy. Analysts estimate that between 0.3 and 0.6 percentage points of real GDP growth this year is attributable to AI spending at a time when many business sectors have dialed down capital expenditures. Investment in AI infrastructure, including data centers, advanced semiconductors, networking equipment and electric power generation, has accelerated at an extraordinary pace. These expenditures are not merely expanding production capacity, they are laying the foundation for meaningful future gains in productivity, innovation, and long-term economic growth. Industry estimates suggest that the largest tech companies invested $400 billion in AI-related cap ex last year and that those same businesses' outlays could reach $800 billion this year. Estimates for 2027 exceed $1 trillion as AI adoption broadens beyond hyperscale cloud providers into healthcare, manufacturing and industrial automation. Related investment could also exceed $1 trillion over the 2025 - 2027 period.

While the timing and scale of AI returns remains uncertain, history has shown that sustained investment in transformative technologies often set the stage for extended periods of stronger economic growth. The scale of investment places AI as the largest coordinated capital buildout in economic history, rivaling prior infrastructure and technology cycles in both speed and magnitude. As with electrification, the interstate highway system, and the internet, business outlays for AI related investments are likely to become the defining feature of the current economic cycle. Although close attention to capital discipline will be important, AI investments appear largely productive rather than speculative and, in our view, should form an important foundation for long-term US economic growth.

Despite its scale and strategic importance, the AI investment cycle is not without risks. Key considerations include capital misallocation where portions of current investment may exceed near-term demand or be deployed inefficiently; cyclical sensitivity where high-cost infrastructure may be vulnerable to shifts in financing conditions or demand expectations; technological uncertainty where rapid innovation could render hardware or infrastructure structures obsolete more quickly than anticipated; and, concentration risk as a significant share of investment is currently concentrated among a small number of very large technology companies.

For long-term investors, the greatest risks surrounding AI are not that the technology fails, but that expectations outrun the pace at which economic returns are realized. Experience suggests transformational technologies create enormous wealth over time, but they also experience periods of overinvestment, excessive valuations, and, often, disappointing near-term returns. Disciplined diversification, careful attention to valuation, and a long-term investment horizon remain the most effective means of participating successfully.

Forward Looking Economic Indicators

Leading Economic Indicators are uniformly signaling expansion.

- The ISM Manufacturing Index registered 53.3 in June, marking the sixth consecutive monthly reading above the 50 critical threshold that separates expansion from contraction. Particularly encouraging was the New Orders Index at 56.0, signaling continue demand for manufactured goods, and expanding production despite persistent geopolitical and trade uncertainties. Manufacturing accounts for only about 11% of GDP yet it historically has been an important bellwether for the broader business cycle as changes in factory activity often precede shifts in capital spending and employment.

- The much larger ISM Non-Manufacturing Index, which accounts for over 70% of economic activity, remained firmly expansionary at 54.0 in June. Business activity measured 55.4, new orders 55.1, and, importantly, the employment component returned to expansion at 51.2, indicating that service sector firms continue to add workers despite elevated interest rates. And important for the inflation outlook, while price pressures remain above historical norms, they moderated during June, suggesting inflationary momentum may be easing without materially slowing demand.

- **Initial Jobless Claims** for state unemployment benefits, among the most sensitive indicators of labor-market conditions, remain exceptionally low. The latest reading of 187,000 claims, among one of the lowest readings in decades going back to the late 1960s, is consistent with an economy experiencing very limited layoffs and reflects employers' continued reluctance to reduce payrolls amid a still-tight labor market. Historically sustained increases above 300,000 have often preceded recessionary periods. Current readings instead reinforce the view that the US economy continues to expand at a moderate pace with little evidence of an imminent contraction.

- And our firm's proprietary **Economic Model,** designed to signal a change in the direction of the US economy six to nine months in advance of an inflection point, remains well above-trend, calling for expansion ahead.

Risks

Although we continue to expect the US economy to expand through the balance of this year and into 2027, this outlook is not without meaningful risks as two major conflicts remain unresolved and geopolitical developments remain fluid, defying prediction. The resumption of full-scale war in Iran, possibly spreading to more of the region, could result in further disruption to oil production, shipping routes, or global trade putting upward pressure on commodity prices spurring inflation which is our foremost concern. Higher energy prices, along with persistent wage growth, expanding fiscal deficits, tariffs that raise import costs, and resilient consumer demand, could combine to keep inflation elevated, above the Federal Reserve's 2% objective. This could prompt officials who need to reestablish their credibility, to tighten credit conditions, increasing the likelihood of a slowdown in economic growth or tipping the economy into recession.

Political uncertainty also tends to increase as election cycles approach. With the 2026 mid-terms three months away, businesses and investors will inevitably face questions regarding fiscal policy, taxation, regulation, trade policy and government spending. History suggests that markets can often navigate political uncertainty, but periods of heightened financial volatility should not be surprising.

Finally, the circularity of financing AI capital spending is a source of strength, but it also creates systemic risks as a relatively small group of mega cap companies have become both the principal investor and principal customer for AI infrastructure. Should the AI investment cycle slow materially, a low-odds possibility, the effects could ripple through much of the economy as overall business spending, a key component of GDP, could weaken abruptly.

Equity Investment Policy

Our view that the economy is fundamentally sound leads us to maintain our fully-invested policy notwithstanding the stretched valuations of some technology and telecommunications services shares, and the likelihood of periodic sentiment-driven stock market pullbacks driven by the ebb and flow of investor animal spirits. Diversified large cap core US equities are intentionally balanced between *growth* and *value* investments, a style unique to Front Barnett management. Domestic small cap investments, as well as equities domiciled abroad in both developed and emerging markets, complete our equity investment platform.

Equity markets continue to make new highs, despite the geopolitical risks and concerns over the outlook, focusing instead on robust corporate profits which have widely exceeded expectations, the benefits of the ongoing surge in capital spending largely linked to AI, generally healthy balance sheets, and the belief that Fed policy under new Fed Chair, Kevin Warsh, will do no harm to the economy.

As for equity market performance, year-to-date the cap weighted S&P500 has gained 6.9%, the S&P500 Equal Weight has increased 11.4% and the Nasdaq Composite 5.2%. The most important takeaway from these figures is not the absolute returns they reflect but that they demonstrate the market's long-awaited broadening leadership, showing that the average stock, as measured by the Equal Weight Index, has begun to outperform the largest cap stocks, reconfirming the efficacy of a diversified *growth* and *value* approach to equity investment. Recent weakness in AI-related semiconductor shares has held back both the cap-weighted S&P500 and the Nasdaq, while financials, industrials, healthcare, and other economically sensitive sectors, well- represented in client's portfolios, have assumed market leadership.

A bull market supported by a wider range of companies and sectors is healthier and more durable than one driven by only a handful of mega-cap technology stocks. The improved breadth suggests that investor confidence is expanding beyond AI and into the broader US economy, reducing the market's dependence on a small number of companies to sustain gains.

As for stock market valuation, stronger than expected earnings reported for the first quarter as well as those seen so far for the second quarter have led to multiple compression, though when measured by forward P/E the tech and telecommunications services heavy S&P500 remains a bit richly valued at 20.2X earnings and the Nasdaq's multiple is also on the high side at 27X forward earnings. On the other hand, the S&P500 Equal Weight Index has a 17.3X multiple, not far above its long-term average valuation, leaving the majority of stocks more reasonably priced with room for further appreciation.

Fixed Income Investment Policy

Short and long-term US Treasury bond yields have moved higher since mid-year in response to concerns including elevated inflation, rising oil prices and persistent federal deficits increasing the supply of government debt. At their highest intraday levels on July 24th, yields on benchmark 10-year US Treasury bonds reached 4.715%, up from 4.18% at the end of last year. Two-year US Treasury note yields rose sharply to 4.35% in late July from 3.47% last year-end. Yields for both maturities have since drifted moderately lower. We've used the period of elevated rates to add to the longer end of the maturity ladders in client's corporate bond portfolios, adding modestly where appropriate to portfolio durations which we target at a conservative 2.75-year duration.

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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.