M L L W INVESTMENT ADVISORS

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INVESTMENT REVIEW AND OUTLOOK

A Narrow Path

Following a difficult first quarter of the year, the stock market rebounded strongly in the second quarter with the S&P 500 returning over 15%. The path of the market's gain, however, was a narrow one. Of the 11 S&P industry sectors, only one outperformed the S&P 500 return. In plain language, the S&P technology sector returned 31% in the quarter while the other 10 industry sectors trailed the S&P 500 return. The non-technology sector returns ranged from 14.9% for industrials to -13.4% for energy; excluding technology, the average sector return was 4.3% in the quarter. International stocks lagged U.S. shares and the MSCI EAFE Index returned 10.5%. Interest rates rose slightly in the quarter, and the Bloomberg Aggregate Bond Index returned 0.7%.

There were several notable economic and geopolitical tailwinds in the quarter and these help to explain the performance of equities. The ceasefire between the U.S. and Iran took effect in early April and, following the cessation of hostilities, the price of crude oil declined over 40% from April to June. As a result of a recent court ruling, the absolute level of tariffs collected declined during the quarter and over $70 billion of tariff refunds are expected to be distributed in July, according to the U.S. Treasury. Corporations and individuals also received benefits from tax legislation passed last year: provisions for accelerated depreciation reduced corporate tax payments by an estimated $50 billion, according to Strategas Research Partners. Individuals benefitted from several provisions in last year's tax legislation and the Tax Foundation estimates that individual tax savings will exceed $100 billion in 2026.

All in all, there were many constructive forces at work during the quarter. Additionally, U.S. employment remained solid and inflation, while elevated from one year ago, should benefit from the recent decline in oil prices. While the short-term picture is heartening, there are several developments, some of which we have touched on in past letters, that bear watching.

Memory Suspended?

With the passage of time, one lesson we have learned is not to rely too heavily on the temptation of historical analogies. While patterns of human behavior can often repeat (such as the cycle of fear and greed), actual events rarely repeat themselves. The current cycle of Artificial Intelligence (AI) capital investment is a case in point. While many observers, ourselves included, have drawn analogies to past technology cycles, the facts are that the AI investment cycle has been of a much greater scope and scale than many observers expected. With the foregoing in mind, we do wish to comment on a few developments that we find concerning.

Throughout history, every economic cycle has been dominated by one or two growth industries. In the late 19th century, it was railroads, in the early 20th century it was petroleum, automobiles and later radio. Undoubtedly, today that industry is AI. Of the top 10 holdings in the S&P 500, 9 are companies related to the AI ecosystem. Collectively, these 9 companies represent 36% of the value of the entire S&P 500 Index. This development is of particular note because, as referenced above, much of the recent stock market performance has been driven by technology companies that are benefitting from the rapid adoption of AI; specifically, industries such as computer memory storage and fiber optics. While both computer memory and fiber optics are essential to the growth of AI, both industries share characteristics of commodity industries, and both have a history of cyclicality.

Another development worth noting is the rise of online sports betting/predictive markets. Once the domain of horseracing tracks and Las Vegas bookmakers, today wagers on the outcome of sports events and just about any other phenomenon are easily facilitated via a smartphone or other online device. The Pew Research Center estimates online betting, across all categories, reached $25 billion in 2025. While the average income of users tends to skew towards a more affluent demographic, the rise of predictive markets poses challenges because of the potential to conflate what is essentially gambling with investing. Indeed, several online platforms offer both investment services and prediction market services on the *same* web site.

We have previously written about the rise of private credit and its importance in facilitating the growth of many non-public companies. By the same token, private credit has earned a place in the portfolios of both institutional investors and, more recently, individual investors. In recent months various investment funds focused on private credit have received redemption requests from their investors. In many cases these requests exceed the threshold established by the funds for monthly withdrawals. To date these developments have been accommodated by the private credit funds/sponsors. By limiting the amount of withdrawals in a given period, private credit funds have been given enough “breathing room” to raise the required cash needed to fund redemptions. We should also note that the performance of the underlying private credit securities have not deteriorated significantly. A corner of the private credit industry that has received less attention is the life insurance industry. According to the American Council of Life Insurers, private credit today constitutes approximately 25% of the industry’s fixed-income assets. As we have discussed in earlier letters, the significant growth of private credit raises the question of liquidity, or lack thereof, during times of economic stress. This question will only be resolved in the fullness of time.

The robust stock market has provided optimal conditions for initial public offerings (IPO) and the dollar volume of IPOs doubled in first quarter of 2026 compared to 2025, according to the Securities and Exchange Commission. In the late spring and early summer, several high-profile public offerings occurred or were in process. The revival of the IPO market is a testament to the strength and resilience of our innovation economy. However, it is worth bearing in mind that, according to a study by NASDAQ, 64% of IPOs underperform the broader market in their first three years as a public company.

The Fog of Peace

“The fog of war” is a phrase used to describe the uncertainty, miscommunication and general confusion that often accompanies conditions of the battlefield. Following the recent cessation of hostilities with Iran, it is tempting to ask if the current conditions represent “the fog of peace” as many questions remain unanswered. These include: the durability of the current ceasefire, future of free passage of ships in the Strait of Hormuz, the present and future status of the Iranian nuclear program and structure of senior leadership within the Iranian regime. Broader questions include the resolution of the conflict in Lebanon and the future role of U.S. alliances with the gulf nations.

Beyond geopolitics, many questions remain for investors including the size of U.S. Government deficits, the shape of U.S. Federal Reserve policy, the rate of inflation, the outcome of midterm elections, and the impact of AI adoption on employment and worker productivity.

Favoring Solid Ground

Given the multitude of crosscurrents in today's landscape, our investment strategy has been focused on established, growing businesses that may have been neglected during the current period of stock market enthusiasm for investments related to AI. Clients are aware that recent returns for the equity market have been robust and well above the long-term average returns. For the three years ending June 30, 2026, the compound annual return for the S&P 500 has been 20.7%. Of particular interest in the current environment are companies in the food and beverage and health care sectors where valuations and dividend yields appear attractive. In our fixed income portfolios, we continue to maintain shorter than average maturities of high-quality bonds, in light of the significant borrowing needs of the U.S. Treasury.

As always, we welcome your comments and questions.