PIEDMONT

Second Quarter 2026

Those of us of a certain age will remember Gilda Radner, one of the stars of Saturday Night Live (SNL) back in the day. She often played the character of Emily Litella, a hard-of-hearing elderly woman who would rant about some topic, always confusing words and topics; like "violence" instead of "violins". When she was corrected by Chevy Chase or Jane Curtin, Emily would turn to the camera and say, "Never mind." (It's worth it to find some clips and watch!) We thought about this when looking at what has happened in markets so far this year.

The first quarter was flat to down, hurt by the start of the Iran conflict. Then in April, when a truce was called, investors said, "never mind," and April/May turned up strongly. The conflict resumed in June and intensified in July, causing investors to say, "never mind," once more. While the markets were positive in the second quarter (see the chart below), July has seen some give back as investors began to question the huge run-ups in semiconductor stocks and other beneficiaries of the AI boom.

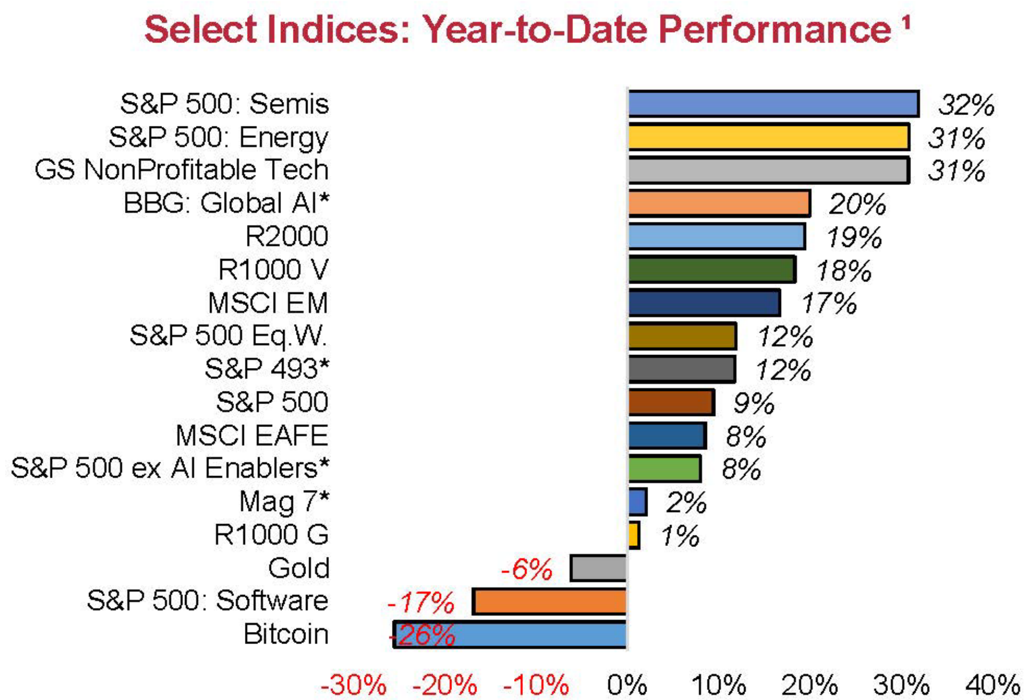
Market Performance	1Q-26	2Q-26	Apr	May	Jun	YTD-26	1 Yr	2 Yrs	3 Yrs	5 Yrs	10 Yrs
S&P 500	-4.4%	15.2%	10.5%	5.3%	-1.0%	10.2%	22.3%	18.7%	20.6%	13.4%	15.5%
Russell 2000	0.9%	21.6%	12.3%	4.4%	3.7%	22.7%	40.9%	23.2%	18.6%	7.0%	11.6%
MSCI ACWI	-3.2%	14.9%	10.2%	5.2%	-0.8%	11.2%	23.7%	19.9%	19.7%	11.0%	12.8%
MSCI EAFE	-1.2%	10.8%	7.5%	3.1%	0.1%	9.4%	20.2%	19.0%	16.4%	9.0%	9.7%
MSCI EM	-0.2%	24.1%	14.7%	9.7%	-1.4%	23.8%	43.5%	28.6%	23.0%	7.2%	10.1%
BBG U.S. High Yld.	-0.5%	2.5%	1.7%	0.5%	0.3%	2.0%	5.9%	8.1%	8.8%	4.2%	5.8%
BBG U.S. Agg Bd	-0.0%	0.7%	0.1%	0.3%	0.2%	0.6%	3.8%	4.9%	4.2%	0.1%	1.5%
BBG U.S. TIPS	0.3%	0.9%	1.2%	0.2%	-0.5%	1.2%	3.4%	4.6%	4.0%	1.0%	2.6%

Source: Bloomberg and Monticello Associates

Despite those crosscurrents, markets produced strong second-quarter results. Smaller-company stocks and emerging-market stocks led the way, and the improvement was broader than the performance of a few familiar U.S. technology leaders. But the headline number does not tell the full story, particularly within Emerging Markets. Looking under the hood, the MSCI Emerging Markets Index has increasingly come to resemble the NASDAQ, with technology occupying a much larger role. Two semiconductor companies in South Korea and one in Taiwan accounted for a significant portion of the index's gains. If South Korea and Taiwan are excluded, the MSCI Emerging Markets Index was negative for the year through July 13.*

That concentration deserves attention, but the performance of these companies also reflects something real: the AI investment cycle has become global. Semiconductor design, manufacturing, memory, electrical equipment, construction, and power infrastructure are benefiting from a major capital-spending cycle. The long-term winners will not necessarily be obvious today, but the breadth of the associated investment is creating economic activity well beyond the largest U.S. technology companies.

Within the S&P 500 there is also big dispersion. In the chart below, notice that year-to-date (YTD) through July 20, semiconductor stocks are up 32%, but software stocks are down 17%. Nonprofitable technology stocks are up 31% YTD while the Magnificent 7 stocks are up only 2%. Some of these moves are difficult to reconcile with near-term fundamentals, and investors continue to move quickly from one theme to another. At the same time, dispersion creates opportunities. When industries and individual companies perform differently, disciplined investors have more chances to distinguish between durable businesses, temporary beneficiaries, and companies whose valuations have moved ahead of their prospects.



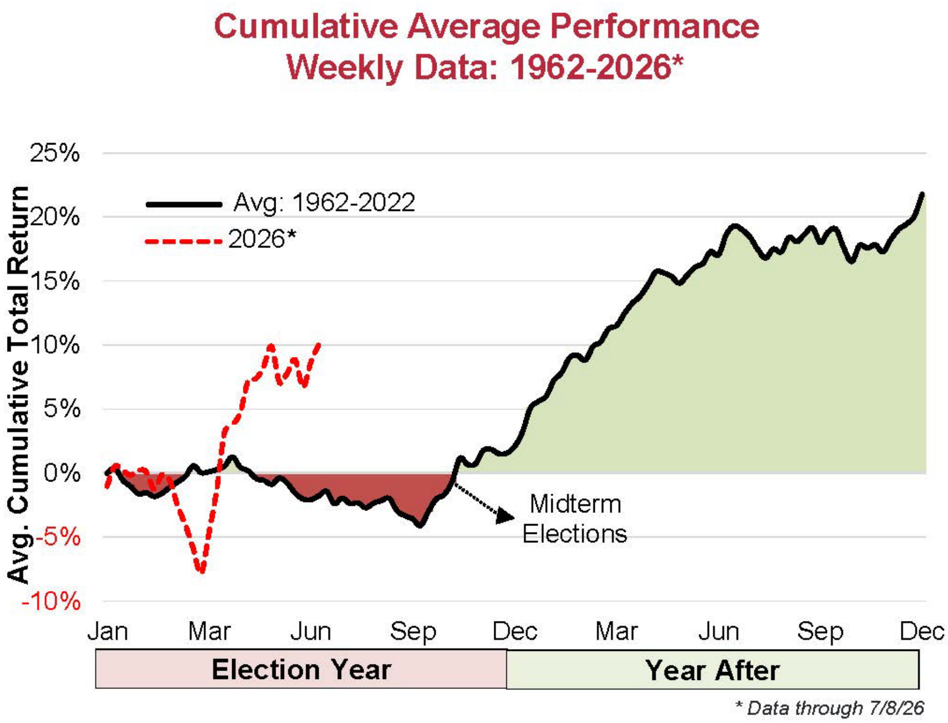
(1) Data as of 7/20/26; Source: Bloomberg, BTIG and Monticello Associates

Oh yes, the Strait of Hormuz is still effectively closed, and the world has dramatically drawn down its crude oil inventories. The U.S. Strategic Petroleum Reserve is the lowest it's been in 40 years and peace remains an elusive objective. Again, most investors are saying, "never mind." In part, investors have looked beyond immediate headlines because businesses and consumers have repeatedly adapted to disruptions. The market may not be saying that these risks do not matter. It may instead be concluding that, so far, they have not been sufficient to derail corporate profitability or the broader expansion.

Speaking of corporate profitability, it appears Q2's earnings will be up over 20% for the second quarter in a row, an impressive fact, however that growth remains uneven. AI-related companies are clearly leading the way in terms of earnings and expectations, and that has expanded to include AI-related infrastructure and materials companies. However, other sectors such as health care, real estate, and consumer stocks are experiencing a more challenging earnings environment. And on those AI-related companies, one item to watch is the earnings contributions from the "Other Income" line in the income statement. This is where companies must report any valuation changes in their investments in other public and non-public companies. As the valuations of private companies like SpaceX, Anthropic and OpenAI race higher, companies like Alphabet (Google's parent) and Nvidia got a huge boost to their bottom lines. For instance, in Q2, Alphabet's Other Income was 68% of its after-tax income. In Nvidia's fiscal first quarter, Other Income was 28% of their net income. Those gains do not negate the operating strength of the underlying businesses, but they can make reported earnings more volatile. If those same private or public companies are revalued lower (which has happened to SpaceX after its IPO), this earnings boost will work in reverse and become a drag on reported earnings. Another "never mind"?

The remainder of 2026 should be very interesting, especially with mid-term elections coming in November. Mid-term election years typically are weak until the election, then show stronger results in the following twelve months. This year looks quite different so far. See below. This year continues to be filled with surprises. It's years like this that require patience and a long-term focus.

Source: Bloomberg and Monticello Associates

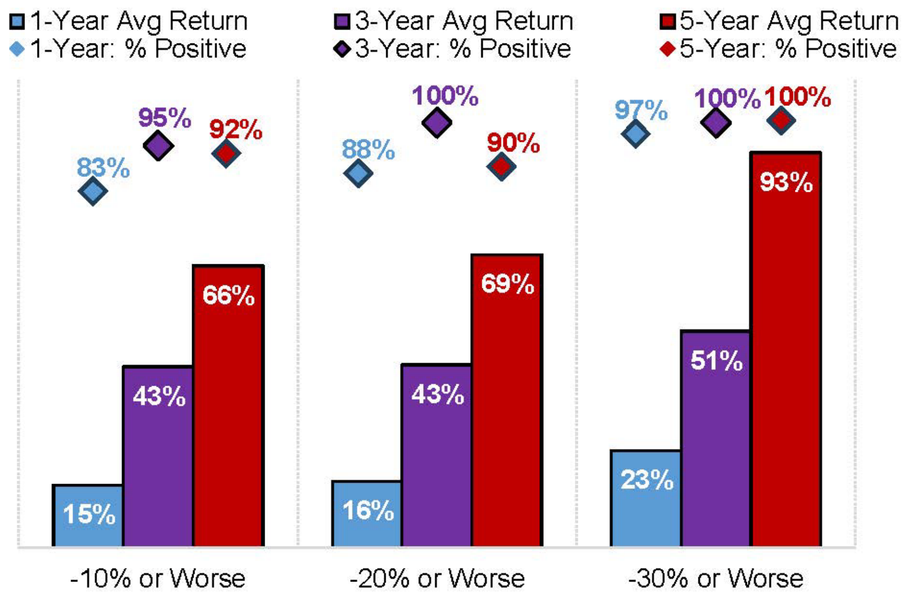


Source: Bloomberg, Strategas and Monticello Associates

Portfolio Positioning

We continue to reduce somewhat our allocation to active managers and increase somewhat our allocation to passive, index-tracking ETFs. This will reduce costs and raise tax efficiency at the margin. As long-term investors we are keenly aware that time in the market is critical to long-term investment success. The ability to maintain cheap, tax efficient exposure to efficient areas of the market is valuable for long-term investment success even if we are facing higher volatility going forward. The chart below looks at subsequent returns of the S&P 500 after drawdowns of various severities. Since 1950, the S&P 500 has demonstrated a remarkable ability to return to positive performance following drawdowns, reminding investors that for those with long time horizons, staying invested in the face of uncertainty and volatility is generally the best approach. As long-term investors, we're in it for the long haul.

Forward Average Returns and Positive Return Rates
After S&P 500 Drawdowns Since 1950



Data as of 3/31/26; Source: Bloomberg and Monticello Associates

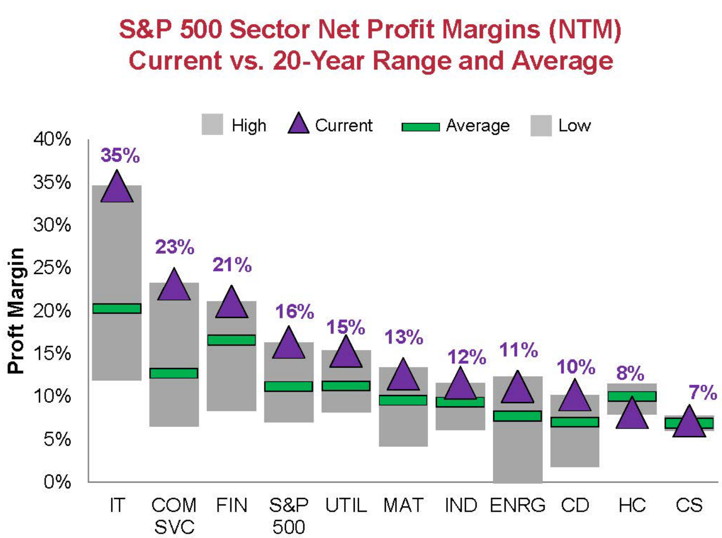
And although the plight of the active stock manager has not changed, it remains our opinion that combining index-like exposure with thoughtful and selective allocations to differentiated strategies provides diversification and the potential for attractive risk-adjusted returns over time. Concentration in the market continues to be a potential risk in our eyes. For instance, the semiconductor sector in the S&P 500 is now as large as the combined weight of Healthcare, Consumer Staples and Utilities. Nvidia is half of the semiconductor sector. This trend creates unintended concentration for investors who are entirely reliant on indexing strategies. In our opinion, thoughtful exposure to diversifying active managers remains a prudent strategy but requires diligence on an ongoing basis.

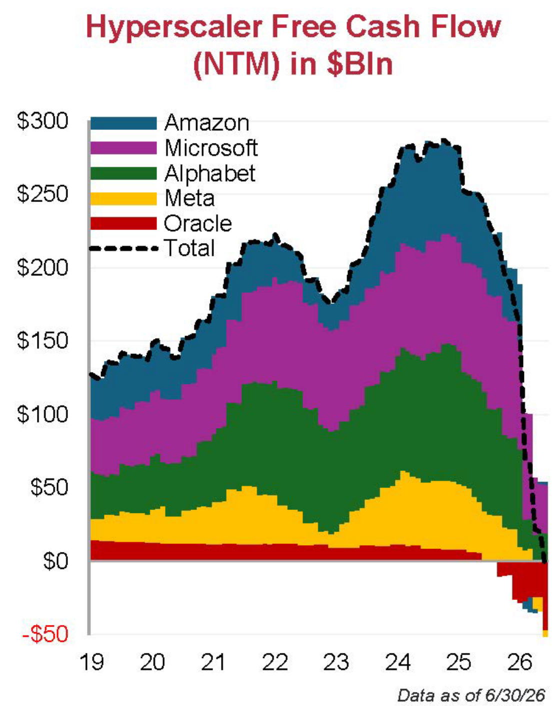
Market Environment and Outlook

Last quarter we listed four drivers of change in the market: geopolitical events, fiscal policy, monetary policy, and corporate earnings. Our list is unchanged. The geopolitical environment is as murky as ever, and we continue to monitor energy supply closely. At the same time, the global economy has demonstrated a considerable ability to adapt. Businesses have adjusted supply chains, consumers have altered spending patterns, and financial markets have continued to function despite a succession of shocks. That resilience should not be taken for granted, but neither should it be overlooked.

Fiscal policy continues a path to some sort of crisis as the funding demands of our debt and deficits crowd out more productive private sector needs. And monetary policy is in a state of flux. We learned a little more as we write this report from the Fed's July 29 policy decision and Chairman Warsh's press conference. He described the Fed's posture as "watchful thinking," implying the Fed is depending on the market to assess the economic and inflation situation on its own. The market's real-time reaction to the Fed's decision to hold rates steady was to push market interest rates higher. But this is very short-term stuff. We'll be much more interested in watching the market's assessment as it evolves over time.

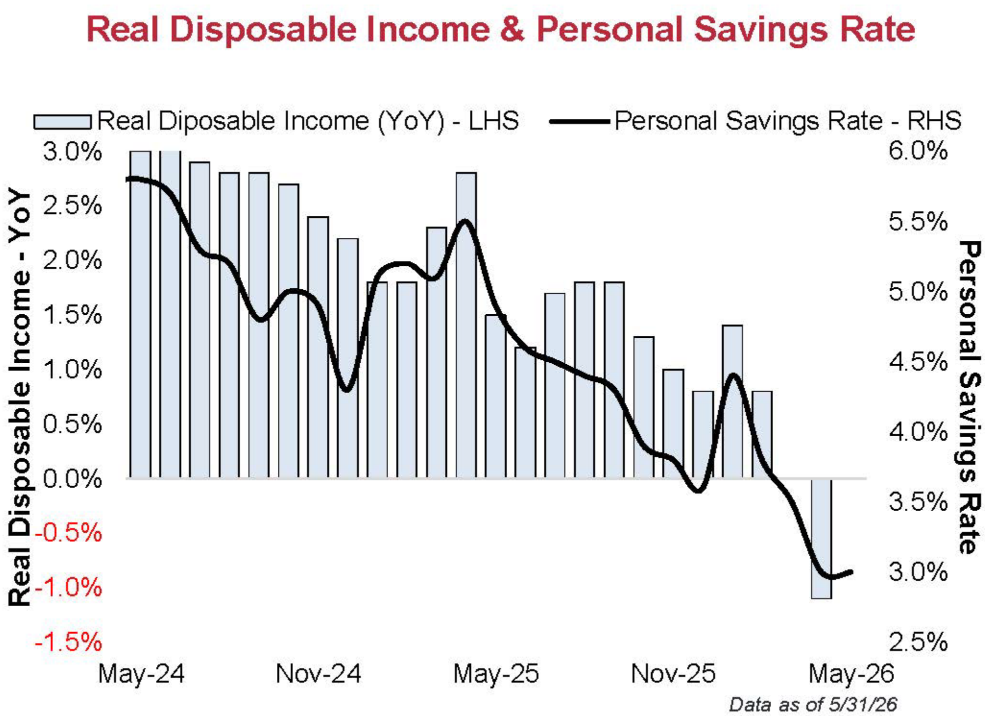
Over the long run corporate earnings remain the main driver of stock prices. Profit margins are at record highs in many sectors according to the chart below on the left. Companies have maintained pricing power, used technology to improve operations, and continued to invest despite higher financing costs. Those results provide a fundamental basis for at least part of the market's strength. Many expect AI to produce efficiencies that keep margins high, not just within technology, but extending to other sectors and industries. That remains an open and important question. The vast spending by hyperscalers is reshaping their cash flow, which is now beginning to turn negative in certain instances. The implications of the AI-created efficiencies failing to live up to expectations or failing to generate an appropriate return on investment should not be ignored, in our opinion. During this immediate AI-spending boom, the impact of the infrastructure buildout cannot be ignored. The construction of data centers, associated equipment, and electrical infrastructure is creating jobs across industries and wealth for investors. However, the speed at which this technology is changing is incredible, and with those developments, the needs and demands will evolve as well. Time will tell if these early investments pay off long-term, but for now, investor expectations remain high, and that is driving market conditions.





S&P 500 Sector Profit Margin Data as of 7/7/26; Source: Apollo, Bloomberg and Monticello Associates

Lastly, the U.S. economy depends mightily on consumer spending. It makes up 68% - 70% of our gross domestic product (GDP). Over the past two years, growth in disposable income adjusted for inflation has slowed, while the personal savings rate has declined. Consumers used some of the reserves accumulated during the pandemic, and certain households are relying more heavily on credit cards. The pressures facing consumers are real, but spending has remained resilient, employment continues to support household income, and many businesses still report healthy demand. Higher-income households continue to account for a substantial share of consumption and have benefited from rising asset values. Other households are feeling the effects of food, housing, energy, and borrowing costs more acutely. This unevenness is important. The consumer does not appear to be collapsing, but the margin for error has narrowed for parts of the population. Spending and the job market remain areas where investors must pay attention, particularly if higher gas prices and interest rates persist.



Source: Bloomberg and Monticello Associates

Bottom line: we have plenty of factors to monitor. We will continue to adapt as necessary should one or more of these drivers of change shift in a big way. We have our heads on a swivel trying to make sense of all that's at play in the economic and financial market environment. It keeps us alert and energized.

Conclusion

As always, our focus remains on positioning client portfolios for the future by asking hard questions of our managers and ourselves about our allocations. We remain confident in our firm's process and prospects and are squarely focused on delivering the results necessary to achieve each client's portfolio objectives. Thank you for the opportunity to work on your behalf.

Daniel F. Smith   John M. Simms, Jr.

**Through 7/13/2026, the MSCI Emerging Markets Index ex. South Korea and Taiwan returned -5.1% YTD. Source: Bloomberg, Cresset Capital, MSCI and Monticello Associates.*