

## MARKET COMMENTARY

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### Growth, Inflation, and The New Rate Reality

*Strong business activity and earnings continue to support markets, even as sticky inflation delays Fed easing and keeps real yields in focus.*

### Looking Beyond the Headlines

Geopolitical tension in the Middle East, renewed inflation fears, and shifting Fed expectations have made for an eventful stretch. But the economic data has been remarkably consistent: the U.S. economy keeps expanding at a healthy pace.

Our framework combines business activity (PMIs), inflation, and interest rates to locate where we sit in the cycle. It continues to point to a **reflationary expansion** of improving growth, resilient earnings, and contained financial stress, even with inflation still sticky. The recent conflict involving Iran briefly spiked oil and revived fears of an inflation shock, but the subsequent de-escalation and price retreat mark it as a temporary supply disruption rather than the start of a spiral. Attention has returned to fundamentals.

### Business Activity Remains Firm

Recent ISM surveys are constructive. Manufacturing and services both remain in expansion, new orders signal healthy demand, and there is no meaningful evidence of demand destruction. Because business surveys tend to flag turning points early, current readings argue for broad-based, resilient growth rather than recession.

Our PMI–inflation framework shows the catch: activity has strengthened while price pressures have not fully cleared. Services inflation and input costs stay elevated, though the fading oil shock should ease some of that pressure in the months ahead.

### Inflation Is Sticky, Not Spiraling

The inflation story has shifted. The temporary oil spike lifted expectations, but the truce and commodity normalization have removed the most immediate upside risk.

What remains is persistence. Businesses still report elevated input costs and firm services inflation, which means inflation likely takes longer to reach target than markets expected. This is **slower disinflation**, with pressures moderating gradually while staying above central-bank objectives, not a new inflation cycle.

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## Higher Yields Reflect Stronger Growth and Fed Uncertainty

Resilient activity and sticky inflation have reset the policy outlook. Markets that recently priced an aggressive cutting cycle now expect rates to stay elevated for longer.

Higher yields are not inherently a warning sign; when driven by improving growth, they reflect confidence in the expansion. The real risk is **rising real (inflation-adjusted) yields**, which would tighten financial conditions enough to pressure valuations and investment. The appointment of a new Fed Chair adds uncertainty, but the core challenge is unchanged: balancing resilient growth against inflation that is easing only slowly.

## Corporate Earnings Continue to Impress

The strongest evidence for the expansion comes from corporate America. Analysts now project second-quarter earnings growth near **21.9% year over year**, with robust revenue and unusually positive guidance. Rather than the typical downward drift into reporting season, estimates have been revised *up*. Margins remain near historic highs despite cost pressures, pointing to durable pricing power and healthy demand. Strong earnings have historically cushioned equities through policy uncertainty, even when higher rates weigh on valuations.

## Markets Are Rotating, Not Breaking

Recent volatility has raised correction fears. Our risk framework disagrees. Credit conditions, liquidity, and market-based stress measures remain consistent with a functioning risk environment rather than systemic deterioration, and the weakness reflects a repricing of rate expectations, not recession or instability. That matches our dashboard, which reads growth and earnings as positive while flagging sticky inflation and higher real yields as the primary risks.

Leadership is also broadening from a handful of mega-cap technology names toward cyclicals and other expansion-linked sectors. Such rotation is typical of mid-cycle reflation and should not be read as a weakening backdrop.

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## Investment Outlook

The evidence supports a constructive medium-term view: healthy growth, positive earnings surprises, and contained financial stress. Inflation persistence and higher rates warrant monitoring but have not undermined the expansion.

The principal risk is tighter financial conditions, not weaker growth. A material rise in real yields, paired with widening credit spreads or softening activity, could turn this regime into a more challenging one for risk assets.

For now, we maintain a balanced pro-risk stance: diversified equity exposure favoring quality cyclicals, financials, and international markets, while staying selective in longer-duration, rate-sensitive assets.

## Bottom Line

Despite geopolitical shocks, inflation surprises, and a shifting Fed outlook, the economic narrative has changed little. Activity is expansionary, earnings are strengthening, and financial conditions remain supportive. Markets are adjusting to **stronger growth and fewer imminent rate cuts**, not impending recession. As long as growth offsets the drag from higher rates, the reflationary expansion stays intact, supporting a constructive but disciplined approach.

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