HAROLD DAVIDSON & ASSOCIATES, INC.

INVESTMENT COUNSELORS

ECONOMIC OUTLOOK & INVESTMENT PERSPECTIVE

THIRD QUARTER, 2026

THE ECONOMY: ECONOMIC RESILIENCE AMID GLOBAL UNCERTAINTY

The recent conflict between the United States and Iran appears to have entered a period of reduced military activity without a decisive outcome. Although a temporary ceasefire had eased immediate tensions, the agreement remains fragile. Key issues remain unresolved, including Iran's nuclear program, freedom of navigation through the Strait of Hormuz, and regional military influence. Despite the conflict, the U.S. economy remains resilient, with expectations for 2026 real GDP growth of 2.1%. Mid-year data, however, points to a cooling manufacturing sector and continued affordability pressure on consumers.

Inflation continues to run hot, with core inflation at 3.4%. New Federal Reserve Chairman Kevin Warsh has reaffirmed the central bank's commitment to returning inflation to its 2% target. Following a period of interest rate cuts, markets continue watching for signs of future monetary tightening to combat elevated price pressures. Harold Davidson & Associates (HDA) expects one rate increase near year-end if inflation fails to moderate.

The Bureau of Labor Statistics reported employers added 57,000 jobs in June 2026, below expectations, while revising April and May payroll gains lower by 74,000 jobs. The unemployment rate declined to 4.2%. Slower payroll growth challenges the recent narrative of renewed labor market strength.

The housing market is showing early signs of cooling because of affordability constraints and elevated interest rates. Sellers are pricing homes more realistically. Buyers are responding with renewed interest. The result is a healthier, more balanced market.

The Manufacturing Purchasing Managers Index (PMI) registered 53.3% in June, down 0.7 percentage points from May. The U.S. economy expanded for a twentieth consecutive month. Corporate America continues to accelerate investments in artificial intelligence. Spending on data centers, semiconductor manufacturing, networking equipment, and power infrastructure remains robust. While these investments place near term demands on capital, they are expected to enhance long term productivity and support future economic growth.

Assuming no major policy shocks, the new vehicle market in 2026 should remain within the high 15 million to low 16-million-unit range. Cox Automotive continues to forecast full year sales of 15.8 million vehicles, a decline of 2.9% from 2025.

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Brent crude oil has fallen roughly 40% from its February through March peak of $119.50 per barrel to about $72 in July. West Texas Intermediate crude currently trades near $68.57 per barrel. Closure of the Strait of Hormuz temporarily reduced global oil supplies by roughly 20%.

Standard and Poor's Global projects eurozone GDP growth of 0.5% during 2026. This forecast assumes oil and natural gas shipments through the Strait of Hormuz recover gradually while remaining below prewar levels until late 2026. Germany, France, and Italy are expected to post the weakest growth. Spain should lead the region.

China returned to expansion during June, supported by improving demand for artificial intelligence related products and stronger pro-growth policies. Resilient exports remain a key source of economic stability. Fiscal spending together with lower oil prices should help China achieve its 4.5% growth target.

As we enter the second half of 2026, the U.S. economy continues balancing inflationary pressure with technological innovation. Midterm elections, evolving trade policy, consumer affordability, and interest rate trends will influence market performance. HDA will continue monitoring these developments together with their impact on businesses, consumers, and investment portfolios.

THE STOCK MARKET: STRONG RECOVERY AMID ONGOING UNCERTAINTY

The second quarter of 2026 demonstrated the resilience of both the U.S. economy and financial markets. Despite continued geopolitical uncertainty, evolving trade policy, shifting interest rate expectations, equity markets rebounded sharply following first quarter volatility. Strong corporate earnings, continued investment in artificial intelligence, and resilient consumer spending helped support investor confidence.

The S&P 500 Index ended the second quarter up 10% year-to-date and finished at new record highs, while the Nasdaq Composite was up 13% as technology and artificial intelligence-related companies continued to lead the market. The Dow Jones Industrial Average also gained 10%, supported by industrial, financial, healthcare companies. Market participation broadened during the quarter, with gains extending beyond the largest technology companies in several cyclical and value-oriented sectors.

Artificial intelligence remained one of the market's most significant long-term investment themes. Capital spending by leading technology companies continued to accelerate as investments in data centers, cloud infrastructure, semiconductor manufacturing, and networking equipment expanded. While investors continue to debate the ultimate pace of returns on these investments, early results increasingly point to meaningful improvements in productivity, operating efficiency, and revenue growth across numerous industries.

Geopolitical developments, including renewed tensions in the Middle East during the latter part of the quarter, contributed to short-term volatility in energy prices. However, financial markets generally viewed these events as manageable, with the broader U.S. economy remaining relatively insulated from prolonged disruptions. At the same time, defense spending and investments in domestic energy infrastructure continued to provide additional support for economic activity.

During the second quarter, Harold Davidson & Associates initiated new positions in a global fiber optics company and a leading energy infrastructure contractor. At the same time, we exited our position in a healthcare distribution company and reduced our holdings in a leading financial services company. At quarter end, HDA asset allocations were as follows: cash or cash equivalents 1%; municipal bonds 5%; corporate bonds 9%; mutual funds 11%; common stocks 60%; real estate 12%; and unit investment trusts 2%.

THE BOND MARKET: INCOME REMAINS ATTRACTIVE

Fixed income markets remained relatively stable during the second quarter as investors continued to monitor inflation trends, Federal Reserve policy, and economic growth. While interest rates experienced modest fluctuations, longer-term Treasury yields remained within a relatively narrow range for much of the quarter.

A notable development during the quarter was the appointment of Kevin Warsh as Chairman of the Federal Reserve. Chairman Warsh has emphasized the Federal Reserve's commitment to price stability while reaffirming central bank independence. Although investors continue to assess how his leadership may influence future monetary policy, we believe a disciplined, data driven approach should continue supporting market confidence. Over the longer term, the direction of corporate earnings, economic growth, and inflation is likely to remain a more significant driver of investment returns than changes in Federal Reserve leadership alone.

High quality fixed income securities continue offering attractive income opportunities. HDA maintained its emphasis on short-duration, investment-grade corporate and municipal bonds, complemented by U.S. Treasuries and money market instruments to provide liquidity, preserve capital, and maintain flexibility as interest rate conditions continue to evolve.

REAL ESTATE: COMMERCIAL REAL ESTATE CONTINUES TO STABILIZE AS INVESTMENT ACTIVITY IMPROVES

The commercial real estate market remains stable despite modest capital market activity and financing rates that remain elevated compared with recent years. Property values have largely stabilized, although capital remains highly selective, with investors favoring well-located, well-leased properties that generate predictable cash flow.

Performance continues to vary by property type. Retail has strengthened because of limited new development, healthy occupancy, strong demand for well positioned centers, although some markets still face oversupply. Industrial fundamentals remain solid, while multifamily continues to perform well despite moderating rent growth, increased concessions, and higher vacancy in markets with significant new supply. The office sector remains challenged, with demand concentrated in newer, high-quality buildings. Alternative sectors, including data centers, student housing, and senior living, continue to attract strong institutional investment.

Looking ahead, we remain relatively optimistic. Improving transaction activity suggests commercial real estate is gradually moving from correction toward recovery, although progress is likely to remain measured. We continue evaluating selective acquisition opportunities while considering strategic dispositions that enhance long term investor returns.

SUMMARY AND CONCLUSION:

As we enter the second half of 2026, our outlook remains cautiously optimistic. Economic fundamentals continue supporting long term growth through a healthy labor market, moderating inflation, resilient corporate earnings, sustained capital investment across strategic industries.

Geopolitical events, artificial intelligence, monetary policy will likely continue creating periods of market volatility. Even so, the current environment remains consistent with a mid-cycle economic expansion rather than a late cycle slowdown. We continue expecting earnings growth and productivity improvements to support equity markets over the long term.

At Harold Davidson & Associates, our investment philosophy remains grounded in quality, diversification, disciplined risk management, and long-term value creation. While periods of market volatility are inevitable, our focus remains unchanged. We continue identifying fundamentally strong investment opportunities while building diversified portfolios designed to preserve capital, generate sustainable long-term growth, and help our clients achieve their financial objectives with confidence.

CLIENT REFERRALS

We greatly appreciate the referrals of new business that we continue to receive from our clients. If you have acquaintances, who in your opinion can benefit from receiving this investment newsletter, please contact Doreen at (310) 553-5551 or email dferritto@hdainvest.com.

We recently launched our newly redesigned website and invite you to explore it at www.hdainvest.com, where you can learn more about our firm, our services, and the types of clients we serve.

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