July 2026



# THE LONG VIEW

Investment Philosophy
in Practice

MERIT
Financial Advisors



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## PURPOSE OF THIS OUTLOOK

- Provide advisors with a consistent narrative for mid-year client conversations.
- Explain how Merit's investment process translates market uncertainty into portfolio decisions.
- Offer practical talking points across equities, fixed income, and alternative investments.



# A Letter From the Chief Investment Officer

As we reach the midpoint of 2026, our investment team has taken the opportunity to reflect not only on what has occurred during the first half of the year, but also on how we make investment decisions in an increasingly complex world.

One of Merit's core values is Kaizen—a commitment to continuous improvement. Our investment team, together with our outside research and asset-manager partners, continually refines Merit's investment platform, process, and tools we use to help advisors deliver durable client solutions.

This outlook begins with the philosophy that guides our investment platform and the operating framework that unites our investment organization. It then provides economic and market context, followed by the perspectives of our Asset Class Strategy Directors across equity, fixed income, and alternative investments.

Each strategy area has unique characteristics, but every portfolio is built on the same foundation.



## BEYOND PREDICTIONS

Financial markets reward thoughtful decision-making, not perfect predictions. Each year begins with forecasts about economic growth, inflation, interest rates, elections, and market returns. Some prove accurate; many do not.

Our objective is not to predict the future with certainty. Our responsibility is to provide a high-quality investment platform using the information and strategies available today while remaining prepared to adjust as new evidence emerges.

We believe decision quality—not forecasting accuracy—is the more reliable path to long-term investment success.

Brian Andrew
Chief Investment Officer

## THE FIRST HALF OF 2026

The first six months of the year provided another reminder that markets rarely move in straight lines. Economic growth remained more resilient than many expected, supported by the lagged impact of prior interest-rate declines, fiscal spending, and tax legislation coming into effect in 2026. Inflation moderated, but at a too tepid pace, while interest rates remained elevated and range-bound given uncertainty around the Federal Reserve's next move.

Market leadership also evolved. Artificial intelligence remains one of the defining investment themes of the decade, but leadership has broadened beyond the largest technology companies. Smaller companies have rebounded as earnings expectations improved and investors gained confidence in the durability of the economic expansion.
At the same time, investors have begun to evaluate the largest technology companies through a more demanding lens: not simply how much they are spending on AI infrastructure, but whether that spending can generate attractive returns while preserving free cash flow and operating margins.

Markets continue to evolve, and the themes that worked last quarter or last year may not work in the next phase. Our philosophy is to build durable portfolio solutions for clients rather than chase short-term narratives.

## IMOS: INVESTMENT MANAGEMENT OPERATING STRUCTURE



### IMOS IN ONE SENTENCE

IMOS is the investment platform we create to provide advisors with durable client solutions that assist them in achieving their objectives.

As an independent fiduciary, we have the freedom to seek the best ideas wherever they originate and make decisions solely for the benefit of clients. We can identify partners that strengthen our platform without the burden of product conflict. Our philosophy stems from a simple observation: investment management becomes more effective when high-quality decisions are supported by diverse perspectives, disciplined processes, and continuous learning.

IMOS is not a forecasting model and is not a replacement for investment judgment. It is the operating framework that allows our investment organization to build a stronger platform and make better decisions as markets evolve.

| BEACON PRINCIPLE | HOW IT INFORMS THE PLATFORM |
|---|---|
| **DECISION QUALITY** | We focus on improving the quality of decisions and partners with the information available today. Every investment choice represents a probability—not a certainty. |
| **INDEPENDENT DECISIONS, COLLABORATIVE THINKING** | Our internal team is supported by a broad external network of economists, research analysts, portfolio managers, strategists, and specialists. Independence gives us the freedom to seek the best ideas while retaining accountability for final decisions. |
| **INTELLECTUAL HUMILITY** | No individual or organization has a monopoly on good ideas. Stronger decisions emerge when differing viewpoints are welcomed, assumptions are challenged, and evidence takes precedence over conviction. |
| **LONG-TERM PERSPECTIVE** | Short-term headlines influence prices, while long-term innovation creates value. Our platform seeks to distinguish temporary noise from enduring secular trends. |
| **VALUATION DISCIPLINE** | Innovation creates opportunity, but price determines return. We seek exposure to transformational themes without losing sight of valuation and expectations. |



## APPLYING THE PHILOSOPHY

The commentary that follows demonstrates how these principles are applied across each asset class. While each strategy team approaches its market through a specialized lens, every partnership, investment recommendation, and portfolio decision is grounded in the same philosophy: evidence over prediction; independent judgment informed by broad collaboration; valuation discipline; diversification across opportunities; and continuous learning as markets evolve.

Our goal is not simply to build portfolios for today's environment. Our goal is to build an investment organization capable of making consistently better decisions for years to come.







# Market Backdrop and Key Themes

The first half of 2026 brought new challenges to markets, including the war with Iran, tariff-related volatility, and a fast-changing artificial intelligence investment cycle. Energy prices rose sharply during the conflict and later eased as hostilities gave way to a tentative ceasefire, but the episode reinforced how quickly geopolitical shocks can affect inflation expectations, consumer sentiment, and policy expectations.

Artificial intelligence remains a long-term secular theme, but the investment narrative has shifted. Early AI winners benefited from enthusiasm around infrastructure buildout. More recently, investors have become more selective, differentiating between companies spending capital, companies supplying critical infrastructure, and companies that can convert AI adoption into durable cash flow.

| THEME | ADVISOR TALKING POINT | PORTFOLIO IMPLICATION |
|---|---|---|
| **AI: FROM BUILDOUT TO RETURN ON INVESTMENT** | Clients may hear AI discussed as a single trend, but the market is now separating the spenders from the beneficiaries. | Maintain exposure to the secular theme, but diversify across infrastructure, power, industrial, and software adoption beneficiaries rather than relying only on mega-cap leaders. |
| **SMALL-CAP RESURGENCE** | The rally has been supported by better growth expectations, easier financial conditions, and fading recession risk. | Future outperformance likely requires earnings growth rather than just multiple expansion; quality and profitability screens matter. |
| **RATES AND INFLATION** | Inflation has moderated, but not enough to make the Fed's path simple. Policy uncertainty can keep the front end volatile. | Fixed income allocations should emphasize yield, measured duration, and active sector/ security selection. |
| **ALTERNATIVES IN A MORE DISPERSED MARKET** | Dispersion, volatility, and less reliable stock/bond diversification can increase the value of differentiated return sources. | Manager selection and strategy selection are likely to be as important as the decision to allocate to alternatives. |



## AI: THE MARKET IS ASKING A HARDER QUESTION

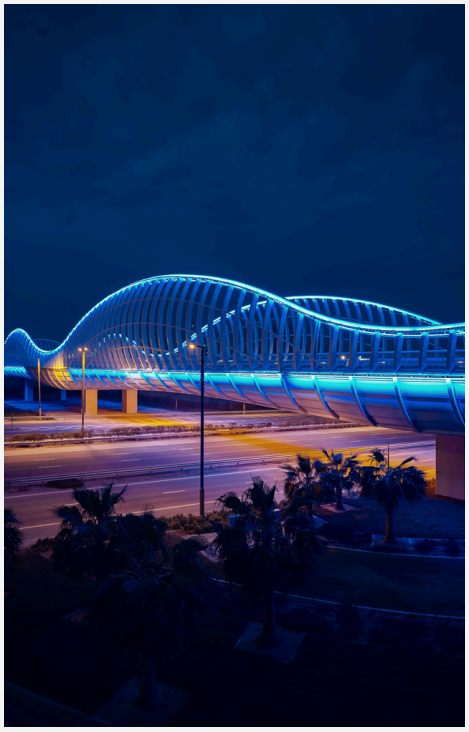
As capital expenditure budgets at the largest technology companies continue to grow, investors are increasingly asking where the return on that investment will come from. The early phase of AI rewarded spending and scale. The next phase is likely to reward companies that can translate AI investment into revenue growth, margin support, productivity gains, or scarce infrastructure capacity.

This is an important distinction for client conversations. The investment opportunity has not disappeared; it has broadened and become more selective. The market may increasingly favor infrastructure suppliers, power providers, industrial companies, equipment providers, and companies that can demonstrate practical AI-enabled operating leverage.

## SMALL CAPS: BETTER FUNDAMENTALS, BUT A HIGHER BAR

The recent small-cap rally appears fundamentally justified, reflecting stronger-than-expected domestic growth, easing financial conditions, and fading recession concerns. However, the next stage of outperformance will likely require earnings growth rather than multiple expansion.

A constructive backdrop remains in place, but clients should understand that small-cap leadership is unlikely to move in a straight line. The opportunity is strongest where balance sheets, profitability, and earnings revisions support the investment case.





# Advisor Conversation Guide

### THREE MESSAGES ADVISORS CAN USE WITH CLIENTS

The outlook is constructive, but not complacent: growth has been resilient, yet inflation, geopolitics, and policy remain important risks.

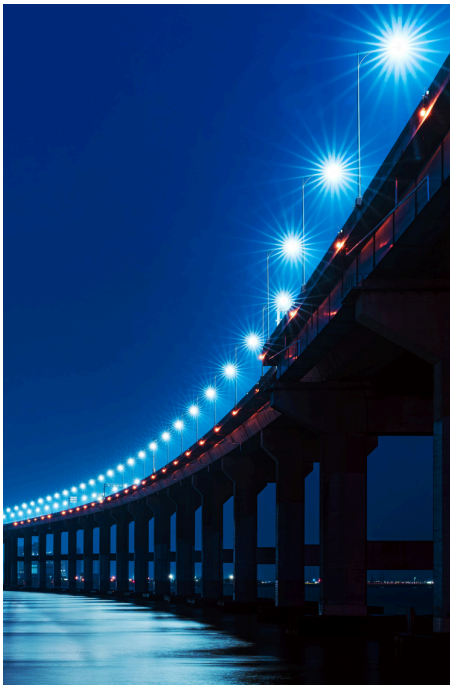
Leadership has broadened: clients should understand why portfolios may benefit from exposure beyond the largest technology stocks.

The next phase may reward selection: across equities, fixed income, and alternatives, return drivers are likely to be more nuanced and manager-dependent.

| CLIENT QUESTION | SUGGESTED FRAMING |
|---|---|
| **"IS AI STILL THE MAIN INVESTMENT THEME?"** | Yes, but the opportunity is evolving. Investors are shifting from enthusiasm over AI spending to a more disciplined assessment of who earns attractive returns on that spending. |
| **"SHOULD WE CHASE SMALL-CAP STOCKS AFTER THE RALLY?"** | The rally has a fundamental basis, but the next phase likely depends on earnings growth. Quality, profitability, and valuation discipline should matter more than broad exposure alone. |
| **"WHY OWN BONDS IF RATES ARE STILL VOLATILE?"** | Higher starting yields improve income potential, but duration should be managed carefully. The goal is not simply to bet on falling rates; it is to generate carry and exploit relative value. |
| **"DO ALTERNATIVES STILL MAKE SENSE?"** | Alternatives can provide differentiated sources of return, income, and exposure to secular growth themes, but the dispersion across strategies and managers makes due diligence critical. |



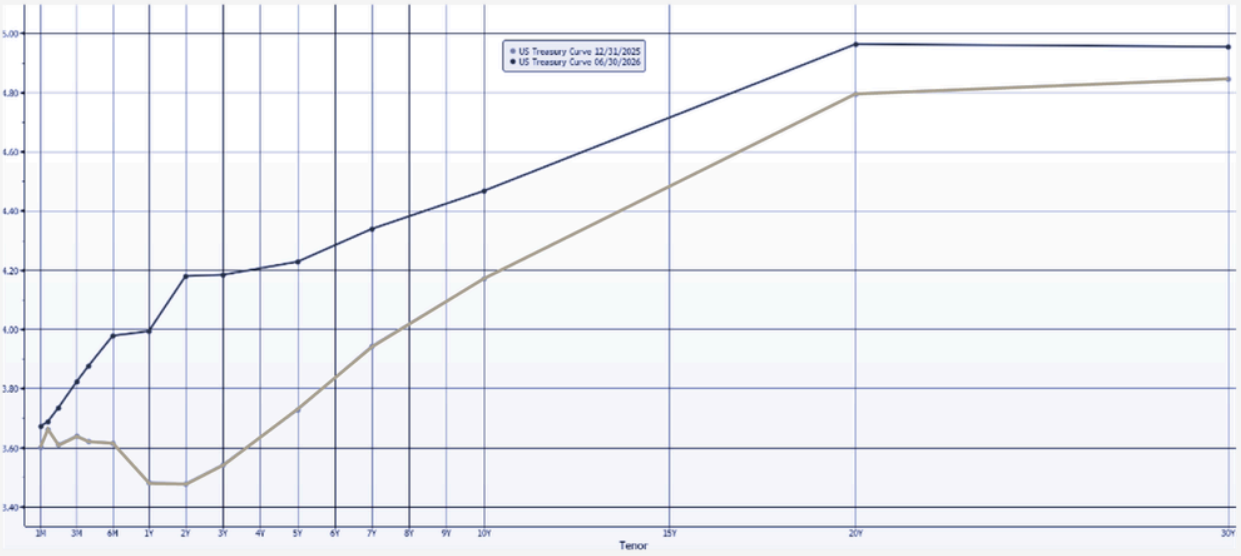
# Fixed Income Markets



The fixed income backdrop changed in the first half of 2026. Markets were forced to reprice a policy path that had become too dovish. Persistent inflation, higher front-end yields, and a more hawkish-than-expected policy reset changed expectations.

The implication is nuanced: expected returns from rallies involving longer dated bonds and yield spreads (difference between corporates and Treasuries as an example) are lower, while higher starting yields improve carry-driven return potential for portfolios that can generate income, manage duration actively, and exploit sector and security-level relative value.

## WHAT CHANGED IN THE FIRST HALF




Front-end rates repriced as markets reassessed inflation and the policy path.

The most important initial move was the repricing in shorter maturity interest rates. Markets entered the year expecting continued Federal Reserve interest rate easing. That view was challenged by inflation that remained too firm, particularly following the Q1 energy shock, which reintroduced inflation concerns and forced a reassessment of the Fed's path.

By the end of the 2nd quarter, markets had shifted from pricing multiple rate cuts to, at times, assigning probability to additional hikes. The adjustment was led by the front end of the curve, reflecting its sensitivity to changing policy expectations.

The leadership transition to Fed Chairman Kevin Warsh reinforced the reset. His early communication emphasized price stability, reduced reliance on forward guidance, and greater data dependence. The result was increased uncertainty around the policy path and higher rate volatility, particularly at the front end.

Credit spreads at the index level remained largely range-bound, supported by healthy corporate and consumer balance sheets. Beneath the surface, however, dispersion across issuers and securities created opportunities for active security selection.



**WHAT WORKED**

Municipals were the top-performing fixed income segment in the first half, supported by strong demand for tax-exempt bonds, manageable supply, and favorable valuations versus taxable fixed income.

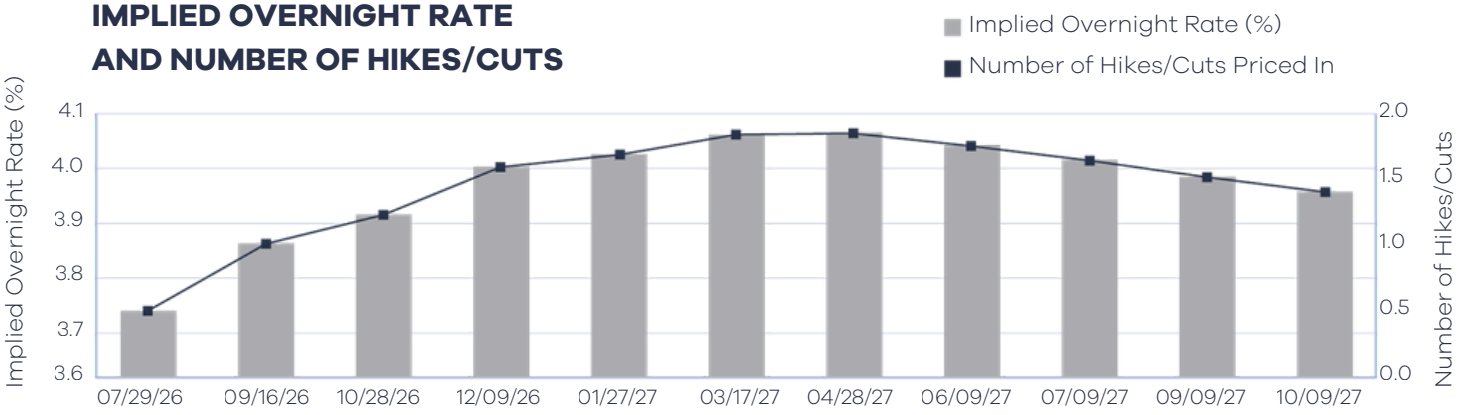
Returns also favored bond market sectors that are income-heavy such as high yield and higher-quality securitized exposure, where stable fundamentals supported performance. Broad high-quality index returns were more modest. Allocation mattered more than benchmark exposure.

## SECOND-HALF BASE CASE

| | | | |
|---|---|---|---|
| Region: United States | | Instrument: Fed Funds Futures | |
| Target Rate | 3.75 | Pricing Date | 06/30/2026 |
| Effective Rate | 3.63 | Cur. Imp. O/N Rate | 3.628 |

| MEETING | #HIKES/CUTS | %HIKE/CUT Δ | IMP. RATE | IMPLIED RATE | A.R.M. |
|---|---|---|---|---|---|
| 07/29/2026 | +0.337 | +33.7% | +0.084 | 3.713 | 0.250 |
| 09/16/2026 | +0.884 | +54.7% | +0.221 | 3.849 | 0.250 |
| 10/28/2026 | +1.117 | +23.3% | +0.279 | 3.908 | 0.250 |
| 12/09/2026 | +1.507 | +39.0% | +0.377 | 4.005 | 0.250 |
| 01/27/2027 | +1.617 | +11.0% | +0.404 | 4.032 | 0.250 |
| 03/17/2027 | +1.790 | +17.4% | +0.448 | 4.076 | 0.250 |
| 04/28/2027 | +1.787 | -0.4% | +0.447 | 4.075 | 0.250 |
| 06/09/2027 | +1.700 | -8.6% | +0.425 | 4.053 | 0.250 |
| 07/28/2027 | +1.567 | -13.4% | +0.392 | 4.020 | 0.250 |
| 09/15/2027 | +1.399 | -16.8% | +0.350 | 3.978 | 0.250 |
| 10/27/2027 | +1.277 | -12.2% | +0.319 | 3.948 | 0.250 |

## IMPLIED OVERNIGHT RATE AND NUMBER OF HIKES/CUTS




Fed funds futures reflected a restrictive and data-dependent policy outlook.



The base case remains restrictive policy, elevated rate volatility, and limited help from longer dated bonds. If inflation stays sticky, the Fed is unlikely to deliver the easing path the market had hoped for. A more data-dependent Fed should keep rates reactive to each data release.

Higher yields have improved the income profile of fixed income, but they do not automatically justify broad duration extension. Without a cleaner disinflation trend, duration should remain selective. Fiscal concerns and a higher term premium further weaken the case for adding duration simply because yields look optically attractive.

Credit should continue to provide income, but current yield spreads do not offer enough cushion for complacency. Excess return will likely come from carry, relative value, and issuer selection.

## PORTFOLIO IMPLICATIONS

- Prioritize carry as a primary return driver.
- Keep duration exposure measured and intentional.
- Be active across sectors rather than relying only on benchmark exposure.
- Focus on relative value and security selection.
- Use the front end and the curve deliberately.



# Equity Markets

Equities advanced during the first half despite bouts of volatility driven by geopolitical tensions and uncertainty surrounding technology. Unlike recent years, when returns were heavily concentrated in the Magnificent 7, leadership broadened as investors rotated toward small-cap stocks, AI infrastructure beneficiaries, and other areas of the market.

Looking ahead, a broadening earnings backdrop, resilient economic growth, and attractive valuations across several market segments could support further expansion in market leadership. For advisors, the key message is not to abandon the past winners, but to recognize that the opportunity set has widened.

## MIDTERMS AND MARKETS

Midterm elections in November could serve as a catalyst for market volatility as investors navigate uncertainty around the outcome. History, however, underscores the importance of separating politics from investing, as long-term returns are generally driven more by economic and corporate fundamentals than by election results.

**S&P 500 TOTAL RETURN: BEFORE AND AFTER A MIDTERM ELECTION**




Sources: Bloomberg, S&P Dow Jones Indices. Data as of 1/31/2026 based on calendar months beginning in 1945. Midterm data includes midterms up through 2022. This example is shown for illustrative purposes only and is not guaranteed. An index is a statistical composite that is not managed. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.

Historical S&P 500 returns before and after midterm elections.

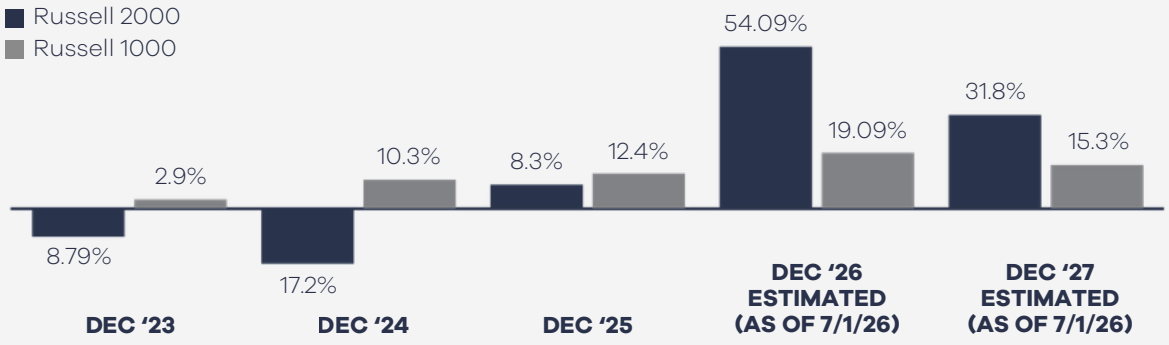
## SMALL CAPS: EARNINGS AND VALUATIONS

Small-cap stocks experienced a resurgence in the first half, with the Russell 2000 advancing 22.5% and outperforming the S&P 500's 10.2% return. The rally may persist in the back half of the year, supported by improving earnings expectations, a solid economic backdrop, and attractive valuations relative to large-cap peers.

The most important caveat is that the next stage likely requires earnings delivery. Multiple expansion can begin a rally, but sustained leadership typically requires fundamentals to confirm the move.

**SMALL-CAP'S ESTLMATED EARNINGS GROWTH IS EXPECTED TO REMAIN HIGHER THAN LARGE-CAP'S IN 2026 AND 2027**

One-Year EPS Growth




Past performance Is no guarantee of future results. Earnings per share (EPS) Is calculated as a company's profit divided by the outstanding shares of Its common stock. The EPS Growth Estimates are the pre-calculated mean two-year EPS growth rate estimates by brokerage analysts. Estimates are the average of those provided by analysts working for brokerage firms who provide research coverage on each individual security as reported by Factset. All non-equity securitles, Investment companles, and companies without brokerage analyst coverage are excluded. Source: Factset.

Small-cap earnings growth expectations are projected to improve in 2026 and 2027.

## AI: BENEFICIARIES OUTSIDE THE USUAL SUSPECTS

Following the launch of ChatGPT in 2022, AI-related returns were initially concentrated among hyperscalers and semiconductor companies. In the first half of 2026, leadership broadened to include suppliers of hardware, equipment, power infrastructure, and components required to support AI data centers.

This shift reflects investor focus on companies that benefit from AI spending rather than only the companies funding it. Industrials and utilities remain well positioned, supported by strong earnings growth and relatively attractive valuations. Semiconductor fundamentals remain robust, but strong performance and elevated valuations could create greater sensitivity to earnings disappointments.

### EQUITY BOTTOM LINE

- Market leadership has broadened beyond mega-cap technology.
- Small-cap opportunity remains constructive, but earnings growth must validate the rally.
- AI exposure should include infrastructure and power beneficiaries, not only hyperscalers and semiconductors.





# Alternative Investments

The first half of 2026 was defined by geopolitical uncertainty, tariff-related volatility, growing AI investment, and a market environment characterized by higher dispersion and episodic volatility. While these conditions created challenges for traditional portfolios, they generally supported many segments of the alternatives market.

Across private markets, capital continues to flow toward sectors tied to AI infrastructure, energy security, digitalization, and operational value creation. Successful outcomes are becoming less about broad asset-class exposure and more about identifying the right sectors, strategies, and managers.

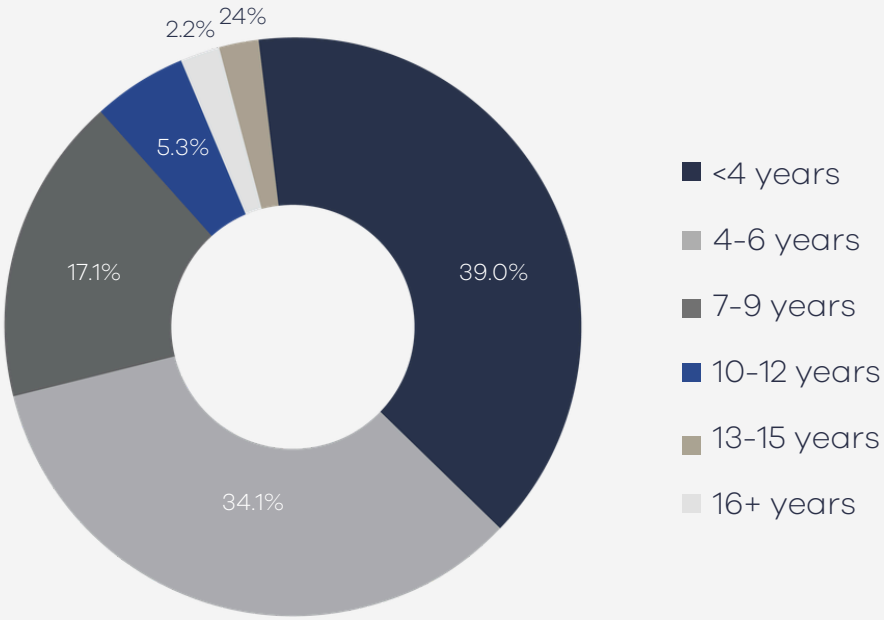
## PRIVATE EQUITY AND VENTURE CAPITAL

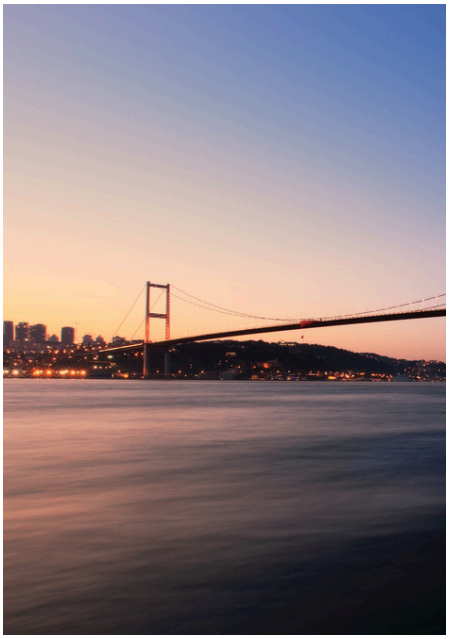
Private equity remains in recovery mode, though liquidity challenges continue to constrain the market segment. Dealmaking activity has improved from 2023 and 2024 levels, financing markets have reopened, and strategic buyers are becoming more active. However, firms continue to hold a large inventory of aging portfolio companies, and distributions remain below historical averages.

**SHARE OF PE-BACKED INVENTORY BY DEAL YEAR**

Source: PitchBook
Geography: US
As of May 30, 2026

Share of private-equity-backed inventory by deal year.





Future returns are likely to be driven less by leverage and multiple expansion and more by operational execution, productivity improvements, AI adoption, revenue growth, pricing power, and operating efficiencies.

Venture capital remains bifurcated. AI-related companies have attracted unprecedented capital, while many non-AI businesses continue to face constrained exit opportunities. The expected IPOs of OpenAI and Anthropic could serve as important catalysts for broader venture liquidity in the second half, but concentration around a relatively small group of AI beneficiaries remains high.

## PRIVATE CREDIT

Private credit has faced increased scrutiny in 2026, particularly within direct lending, as retail redemptions, liquidity concerns, and a handful of higher-profile defaults weighed on sentiment. Most managers view these challenges as isolated rather than systemic, while institutional capital has increasingly viewed recent dislocations as opportunities to re-enter at more attractive risk-adjusted returns.

The opportunity set has expanded beyond direct lending into asset-backed finance, specialty finance, real estate credit, and other collateral-based lending strategies. Elevated base interest rates continue to support current yields, but future returns should depend increasingly on manager discipline and underwriting quality rather than broad market tailwinds.

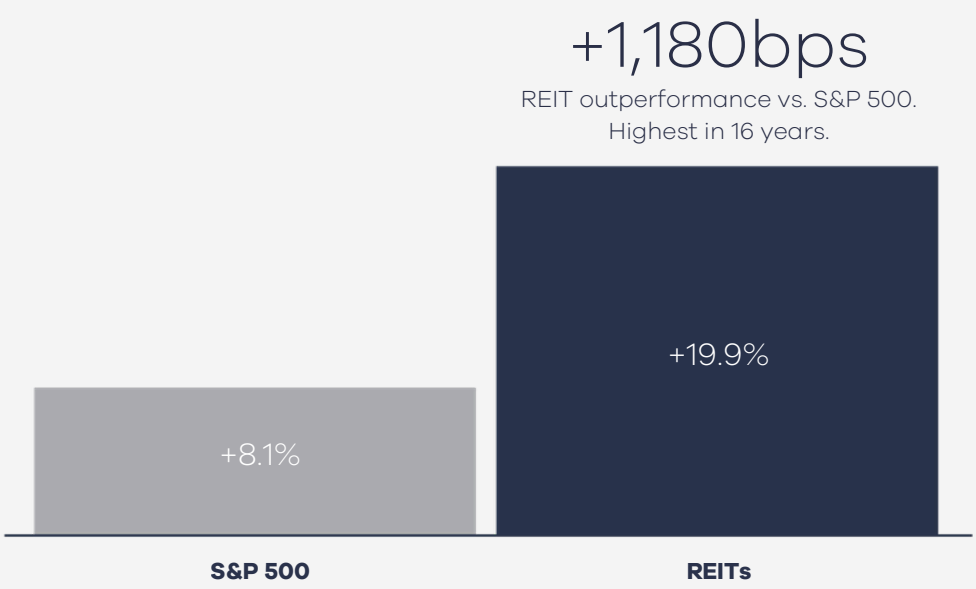
## PRIVATE REAL ESTATE

Private real estate continued its recovery, supported by stabilizing property values, gradually improving financing conditions, and a more favorable supply backdrop. The strongest opportunities remain concentrated in industrial, logistics, residential, and data center properties.



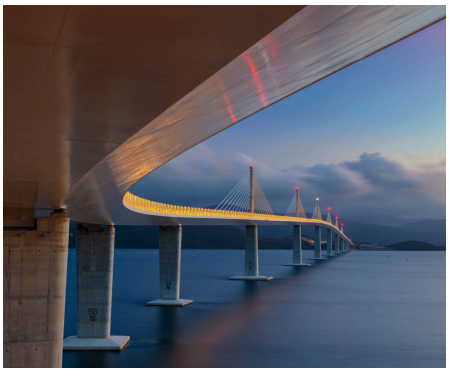
**FIGURE 12: S&P 500 VS. PUBLIC US REITS PERFORMANCE [50]**

% YTD 2026 Total Return




Source: Reflects performance of S&P 500 and MSCI US Equity REIT Total Return Indices, as of June 26, 2026. Public REITs outperformed the S&P 500 year-to-date in 2026.

AI-related demand has emerged as one of the most powerful drivers within the asset class. Supply dynamics are also becoming more supportive, including lower logistics deliveries and elevated construction costs that limit new supply. Office remains challenged by unresolved structural issues around occupancy and long-term demand.



## INFRASTRUCTURE

Infrastructure remains one of the clearest beneficiaries of the secular trends shaping global markets. AI, energy security, digital infrastructure, supply-chain resiliency, electrification, and national security spending continue to support long-term capital investment.

**FIGURE 16: US UTILITY CAPEX FORECAST [69]**

USD in Billions

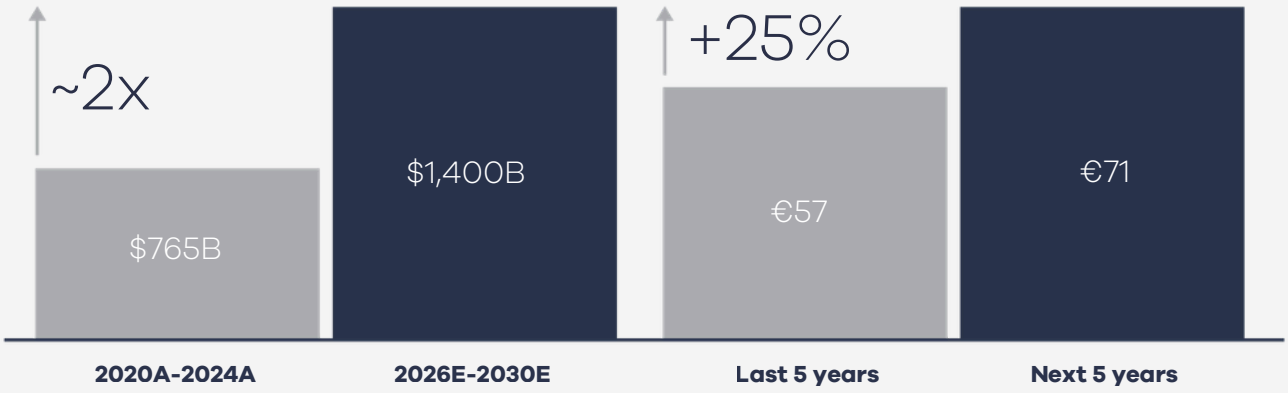



**FIGURE 17: EUROPEAN GRID CAPEX FORECAST [70]**

EUR in Billions, Annual CapEx

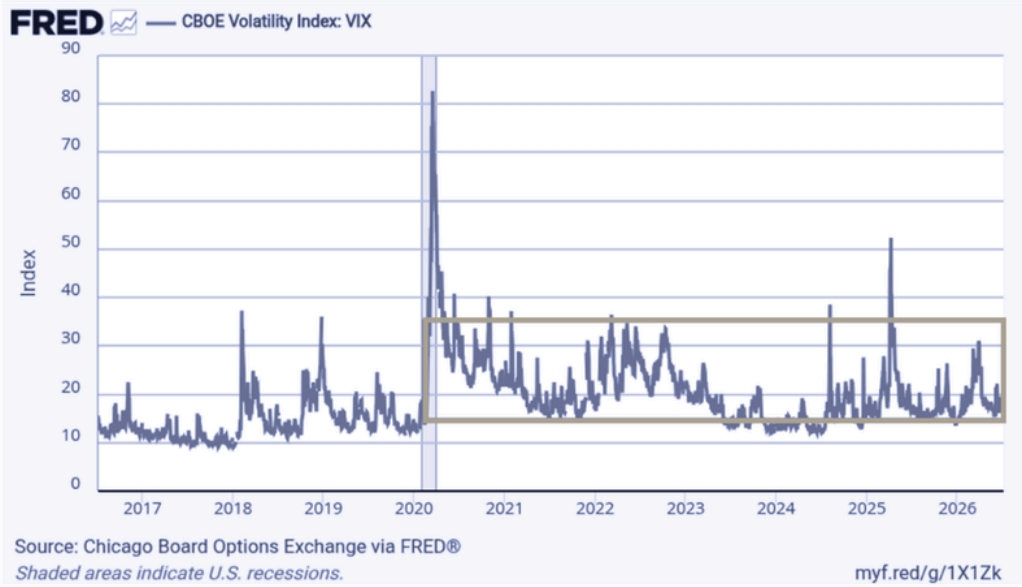



Sources: PowerLines, as of April 2026; represents US investor-owned utilities' 2026E–2030E total CapEx. Goldman Sachs, as of March 2025. Refers to electricity distribution and transmission in Europe including the UK. Last 5 years represents actual for 2021 to 2025; next 5 years represents estimated for 2026 to 2030. Utility and grid capital expenditure forecasts illustrate infrastructure demand.

While enthusiasm has driven valuations higher in certain segments, particularly digital infrastructure, managers generally remain constructive given the magnitude and duration of the underlying demand drivers.

## HEDGE FUNDS

Hedge funds have entered what many managers consider one of the most favorable environments for active management in several years. Elevated volatility, widening dispersion, evolving macroeconomic conditions, and geopolitical uncertainty have all contributed to an attractive backdrop for alpha generation.

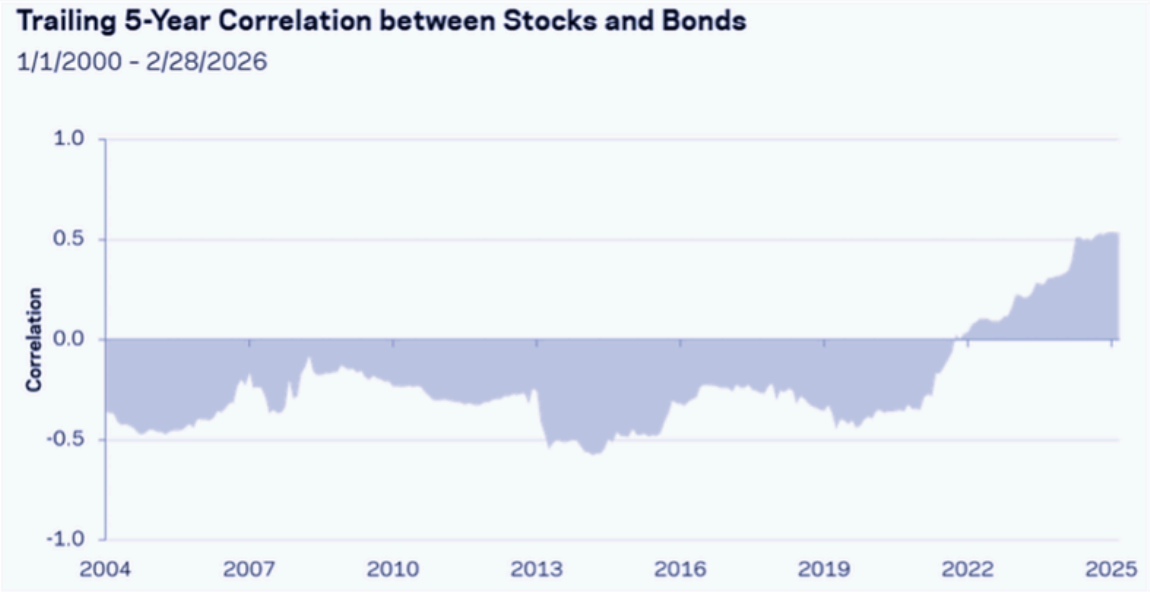



Post-pandemic volatility has stayed higher than pre-2020 levels.




Lower implied correlation can support stock selection and relative value strategies.

**FIGURE 12: S&P 500 VS. PUBLIC US REITS PERFORMANCE |50)**




Source: AQR (S&P 500 and Barclays US Treasuries)
The trailing five-year stock/bond correlation has changed the diversification discussion.



A higher-volatility, higher-dispersion environment benefits strategies that rely on stock selection, relative-value opportunities, and event-driven catalysts rather than broad market direction. As traditional diversification becomes less reliable, hedge funds are increasingly viewed as differentiated return drivers rather than solely defensive allocations.

| ALTERNATIVE SEGMENT | SECOND-HALF OUTLOOK | ADVISOR EMPHASIS |
|---|---|---|
| **PRIVATE EQUITY / VC** | Recovery is improving but gradual; liquidity remains uneven and opportunities are concentrated. | Prioritize managers with operational value-creation capabilities and disciplined sector focus. |
| **PRIVATE CREDIT** | Income remains attractive, but underwriting dispersion is increasing. | Emphasize collateral, covenants, sponsor quality, and manager discipline. |
| **PRIVATE REAL ESTATE** | Recovery is sector-specific; industrial, residential, logistics, and data centers remain favored. | Avoid broad generalizations—sector exposure matters. |
| **INFRASTRUCTURE** | Strong secular demand from AI, power, energy security, and digitalization. | Consider infrastructure as both a growth and real-asset exposure, while monitoring valuation. |
| **HEDGE FUNDS** | Volatility, dispersion, and lower correlations support active strategies. | Use as a differentiated return source, not simply a defensive placeholder. |



# Closing Perspective

## CLOSING PERSPECTIVE

The dominant themes across markets in 2026 are broader leadership, AI-driven capital spending, higher policy uncertainty, infrastructure expansion, operational value creation, and a renewed need for selectivity. The outlook remains constructive, but not uniformly easy.

For advisors, the consistent message is that portfolios should be prepared for a market where the next phase of returns may come less from broad beta and more from disciplined allocation, valuation awareness, manager selection, and exposure to long-term secular growth themes.

That is precisely the environment our investment process is designed to address: independent judgment, collaborative thinking, valuation discipline, and continuous improvement applied across the full investment platform.

### ADVISOR TAKEAWAY

This outlook is not a call to make dramatic shifts. It is a framework for explaining why diversified portfolios need to evolve as market leadership, policy expectations, and return drivers evolve.



MERIT
Financial Advisors

# THE LONG VIEW

Investment Philosophy
in Practice


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