

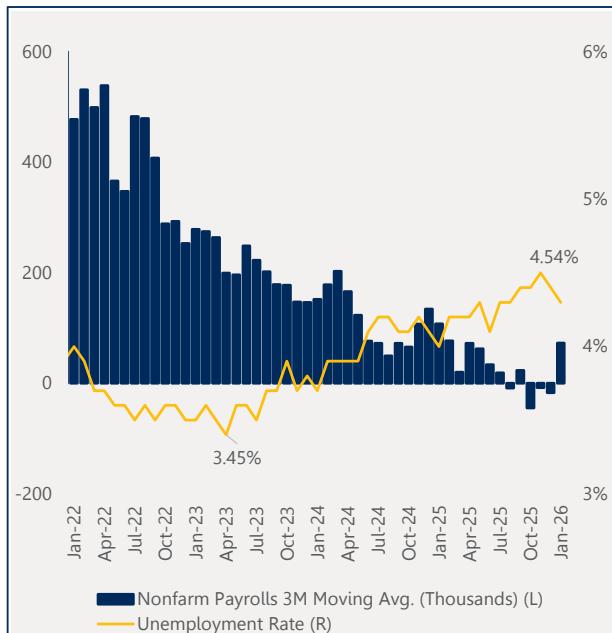
February 2026

Market Review



Turning a Corner?

Nonfarm Payrolls Trends and Unemployment Rate



Source: Bureau of Labor Statistics. Past Performance does not guarantee future results.

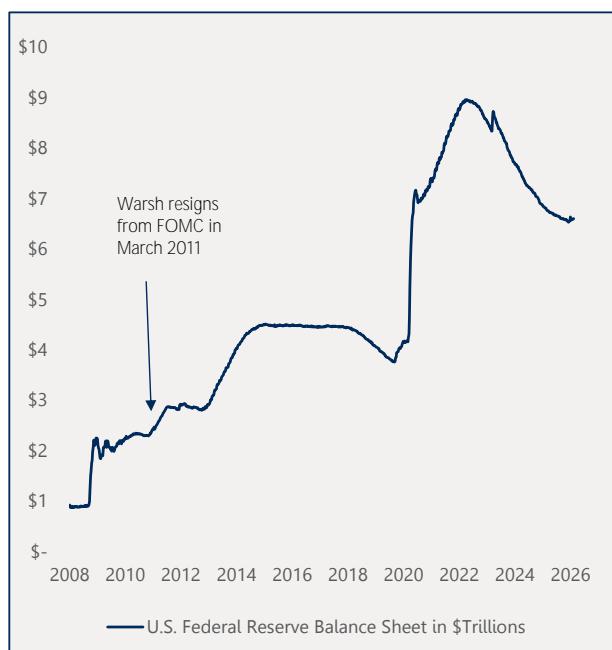
The U.S. labor market rang in the new year with an encouraging burst of resilience. Employers added 130,000 jobs in January, far exceeding the median estimate of 65,000. This robust headline figure, the largest gain since late 2024, accompanied an unexpected dip in the unemployment rate to 4.28%, several months after a multi-year peak of 4.54% in November.

Despite this early-year vigor, the report highlighted significant underlying shifts. Annual benchmark revisions revealed that 2025 was much weaker than initially thought, with monthly job growth averaging just 15,000 instead of the reported 49,000. Furthermore, January's gains remained lopsided; health care continued to drive the majority of growth, while federal government payrolls maintained a steady decline.

For investors, the data effectively reset expectations for near-term monetary policy. With wage growth holding firm at 0.4% and the labor market stabilizing, the Federal Reserve is widely expected to keep interest rates on hold. Consequently, many traders have pushed out their timeline for the next potential rate cut to July.

Warsh and the Balance Sheet

Federal Reserve Balance Sheet (\$Trillions)



Source: Federal Reserve Bank of St. Louis. Past Performance does not guarantee future results.

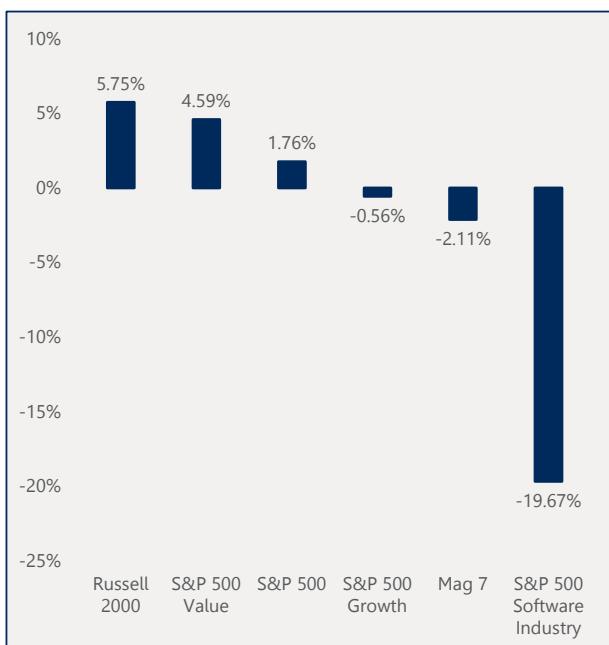
On January 30, 2026, President Trump nominated former Fed Governor Kevin Warsh to succeed Jerome Powell as Federal Reserve Chair. Trump praised Warsh as a "central casting" selection equipped to modernize the institution and improve national affordability. This transition marks a significant shift as the administration seeks to align monetary policy with its broader economic goals.

Warsh's vision seems to rest on two pillars: further rate cuts and a leaner balance sheet. Despite his "hawkish" reputation stemming from his 2011 resignation over balance sheet expansion, Warsh now advocates for a more accommodative rate stance. He argues that a wave of AI-driven productivity is acting as a powerful disinflationary force, allowing the economy to grow rapidly without triggering the inflation traditionally feared by central bankers.

By leveraging these productivity gains, Warsh believes the Fed can justify a lower funds rate. He contends this lower rate environment will offset any financial stress caused by reducing the Fed's balance sheet. This strategy aims to shift away from heavy market intervention toward a model fueled by technological innovation and private-sector efficiency.

Cyclical Rotation

Return Nov 1, 2025 to Jan 31, 2026

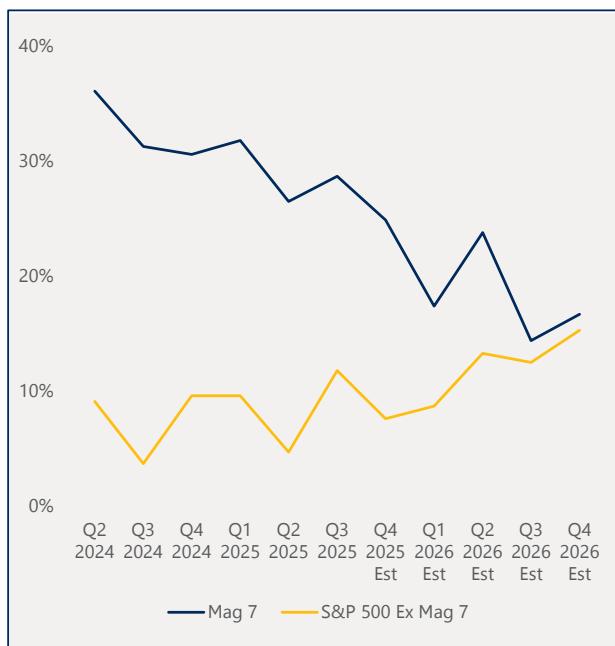


Source: Morningstar. Past Performance does not guarantee future results.

The U.S. equity market posted modest gains in January 2026, with the S&P 500 rising 1.45%. This marked the ninth consecutive monthly advance, the longest streak since early 2018. Solid corporate earnings and positive economic surprises fueled the performance, while market breadth improved markedly as leadership continued to broaden beyond mega-cap technology names.

The rotation toward cyclical and economically sensitive stocks continued from late 2025, fueled by expectations of stronger economic growth, lower interest rates aiding smaller firms, and broadening earnings momentum. Small caps led the way, with the Russell 2000 delivering a strong 5.35% return, its best January since 2023. The S&P 500 Equal Weighted Index surpassed its cap-weighted counterpart for the third straight month. Cyclical sectors such as energy, materials, and industrials drove gains, each rising over 5%.

Technology ranked among the few declining sectors. Software stocks extended their sell-off into a third consecutive month, as AI advancements heightened investor fears. Concerns mounted that AI tools could disrupt traditional software business models by diminishing demand for user subscriptions, prompting reevaluations of long-term growth prospects and valuations.

Narrowing Earnings Gap Expected
Quarterly Earnings Growth

Source: Bloomberg. Past Performance does not guarantee future results.

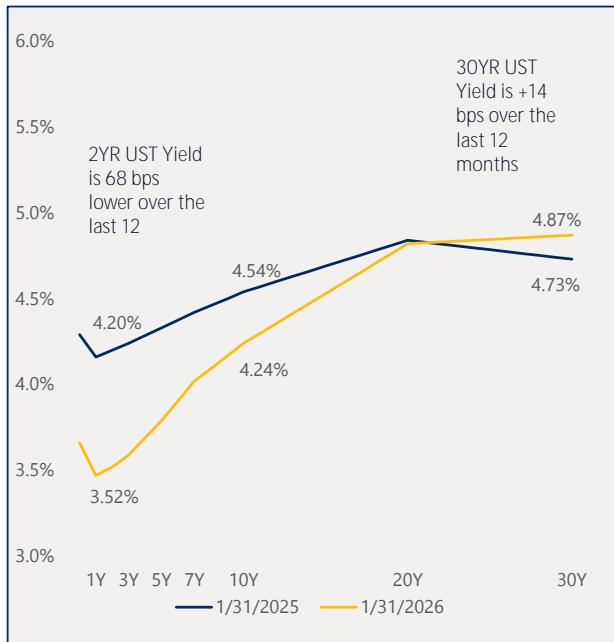
With fourth quarter results reported from around 70% of the S&P 500's market cap, the index's earnings growth is on track to surpass analysts' expectations by nearly 4% (12.1% vs 8.4%). Excluding the Magnificent Seven's outlier results, earnings growth remains solid at 7.8%, well ahead of analysts' 4.6% forecast. Technology, communications, industrials, and financials are on track to lead this quarter with double digit growth.

Looking ahead, analysts anticipate continued momentum, with four of the next five quarters projected to deliver double-digit growth for the S&P 500 index. Forecasts indicate that earnings strength will broaden beyond mega-cap technology, as S&P 500 ex Mag Seven growth is expected to accelerate to 11.1% in 2026 from 8.9% last year. Cyclical sectors are expected to see the sharpest improvement with double digit growth for industrials and materials. Meanwhile, Mag Seven earnings growth is forecast to moderate to 15.3% this year from last year's 31.5%.

Revenue growth of 8.7% is the fastest expansion in three years. Technology, communications, and health care led double digit top-line gains, while energy remained the only sector in decline. The S&P 500's operating margin rose to 16.2% from 15.1% a year earlier.

Steepening Bias

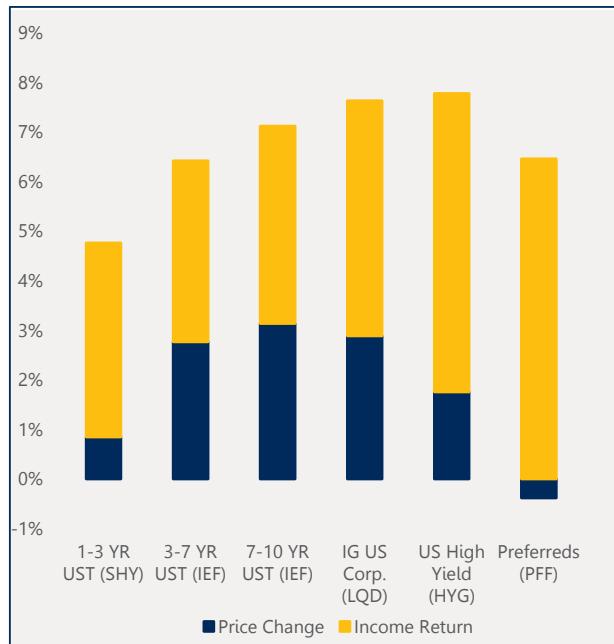
U.S. Treasury Yield Curve: January 2026 and January 2025



Source: Federal Reserve Bank of St. Louis. Past Performance does not guarantee future results.

Back to Basics: The Power of Income

12-Month Return Decomposition: Selected Bond Segments



Source: Bloomberg. Past Performance does not guarantee future results.

Over the past year, the entire U.S. Treasury yield curve out to 20 years has steepened significantly, driven by divergent movements at the short and long ends. The 2-year Treasury yield has declined roughly 68 basis points (bps) over the last 12 months, reflecting 75 bps of Federal Reserve rate cuts delivered in the last four months of 2025.

In contrast, the 30-year Treasury yield has approached 5% several times in recent months, due to markets pricing the potential for higher nominal growth in 2026 alongside an elevated U.S. budget deficit. A yield curve with a positive slope (or steepness) is generally considered normal, as lenders and investors demand greater compensation—known as the term premium—for committing capital over longer horizons, where economic conditions are harder to predict.

Investors typically benefit from focusing on the intermediate segment of the curve and favoring a near-neutral duration stance during steepening environments, when short-term rates fall more quickly than long-term yields.

Over the last 12 months, returns across U.S. fixed income markets have shifted back to a more traditional mix, where income has once again become the dominant driver of performance. Across the six major segments featured in the chart—ranging from short-term Treasuries to preferred equity—income return accounted for an average of 73% of total returns from January 2025 through January 2026.

This shift underscores the importance of starting yields in providing a buffer against price volatility. For instance, ETFs representing broad indexes of investment-grade corporate and high-yield bonds saw total returns bolstered by solid coupon payments, which helped them overcome tight credit spreads throughout the year. Even in segments like preferred stocks, where price changes were slightly negative, the robust income component ensured a competitive positive total return for investors.

We expect income to remain a portfolio ballast in 2026. With credit spreads historically tight and Treasury yields range-bound, the "coupon clip" should continue providing the majority of total returns. In this environment, maintaining diversified yield exposure is likely to be rewarded relative to aggressive duration positioning or bets on capital appreciation.

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