WOODSTOCK

Quarterly Market Perspectives

Summer 2026

A quarterly newsletter offering our views on the market and economic topics of interest to investors.

IN THIS ISSUE

On Trade, Tariffs and the Optimist's Dilemma

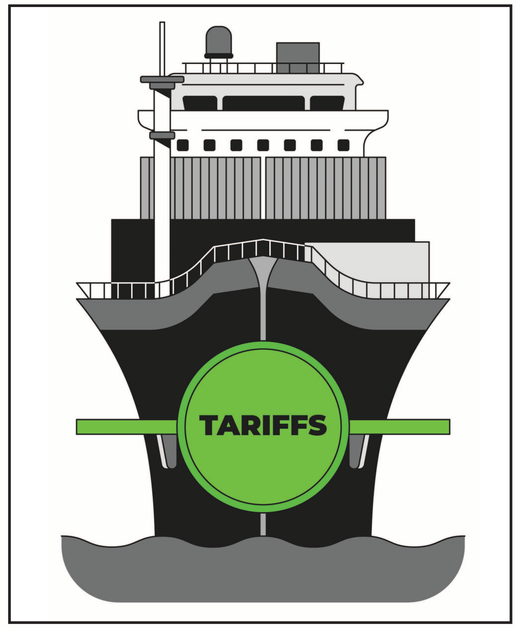
William H. Darling, Chairman & CEO

Recent heavy stock market trading volume has helped fuel earnings at large US banks. "Executives and analysts say that institutional clients are now constantly repositioning their portfolios, reacting to major geopolitical events and dramatic market volatility, seeking to cash in on big gains and protect themselves from a potential drop."[1] As the title of a recent WSJ article says ("Wall Street Traders Enjoying Their Best Year Ever"), this is the very definition of trading, as opposed to investing. It is, though, just the internal workings of the market.

One of the factors driving major geopolitical events is trade imbalances. For the US, the current administration's efforts to correct what they view as decades of mistakes in setting US trade policy have been a factor, but probably not as large a negative factor for the US economy as predicted at the start of the tariff-imposition process. The Europeans have now begun to realize that they need to push back against mercantilist China. The latest domestic problems in China mean that "absent any other convenient alternative, the Chinese aspire to export their excess domestic capacity rather than risking a debt-deflation spiral at home."[2]

The Chinese response to this concern is probably best illustrated by a Chinese commentator's rebuke of European trade negotiators' efforts to rein in the flood of exports from China during the recent heat wave across Europe: "If China stops selling air conditioners, will European gentlemen still be so passionate about 'over-capacity'?" Pretty close to "let them eat cake."[3]

Trade imbalances in goods are only one half of the double-entry bookkeeping required to analyze imbalances; the other



side is currency, the payment for the goods. A devalued domestic currency helps sell a country's goods and an overvalued currency is a headwind to selling goods abroad. International negotiators like to use currency values to influence the trade in goods.

What would be good news to international negotiators? "A plunge in US stocks driven, for example, by disappointment in artificial intelligence (AI) would effectively write down the IOUs the US issued to foreigners to finance its deficits" (partly financed by US stock sales to foreigners).[4] "It could also lower the dollar, further correcting those deficits."[5] This seems to be a particularly one-sided solution, but US investors should probably be ready for it, if other initiatives don't succeed.

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[1] *Ben Glickman and Kystal Hur, "Wall Street Traders Enjoying Their Best Year Ever," WSJ, 7/16/2026, p B1.*

[2] *"Joseph Sternberg, "China's Economy Is in Worse Shape Than You Think," WSJ, 7/17/2026, p. A15.*

[3] *Hannah Miao, "China Turns Up Heat on Europeans Over Trade," WSJ, 7/02/2026, p. A8.*

[4] *Greg Ip, "Trade Imbalances Pose Global Threat," WSJ, 6/12/2026, p. A2*

[5] *Ibid*

“If the US economy pivots pro-cyclically, then those stocks of companies that have been out of favor and have done much cost-cutting will be beneficiaries.”

“Our definition of investing concentrates on high-quality and industry-leading companies with sound financials and strong managements when picking stocks.”

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Possible Initiatives

What are some of those other initiatives or perspectives? I’ll preface this list with an appropriate Wall Street saying about optimists in the stock market: “With feet firmly planted in midair, I remain a chicken-bull.” Investment managers at Woodstock have recited this list of possible initiatives.

- Reshoring is the domestic effect of tariffs succeeding in making foreign produced goods more expensive, thereby boosting domestic production. This could have a dramatic effect over the next three to four years.
- AI has the potential to destroy all moats, thereby commoditizing everything and lowering prices.
- If the US economy pivots pro-cyclically, then those stocks of companies that have been out of favor and have done much cost-cutting will be beneficiaries.
- For some of these, it is hard to determine if they are a benefit or not.

“Minute Sermons” on Investing

A minister friend used to supplement his church’s weekly newsletter with what he called “minute sermons.” We’ve added short vignettes for, hopefully, a similar effect.

If economic events take a turn for the worse, a WSJ letter-writer has reminded central banks, including our own Federal Reserve, that “a central bank should serve as a lender of last resort, but central banks should take only good collateral and charge high rates of interest.”[6] A lesson must be learned by current participants, even if it might be repeated at a later date by others.

A Montana farmer supplementing his income by monetizing social media posts about life on the farm notes that “internet fame has the shelf life of a banana.”[7]

The AI revolution has come to Wall Street. Banker Jamie Dimon said recently, “Certain things won’t change. I tell people you have to move money, raise money, send money, manage money. But everything else can change.”[8]

As opposed to trading, defined at the beginning of this article, our definition of investing concentrates on high-quality and industry-leading companies with sound financials and strong managements when picking stocks. We anticipate that there will be occasional dramatic market downturns and believe that a sturdy portfolio of high-quality companies has the best chance of rebounding from a major event.

We know that you are the most valuable business development tool that we have. Your referral of a friend, colleague or family member to us is the most important way that we grow. We thank you for your support and want you to know that we are dedicated to serving your best interest.

[6] *Tim Quast, “What Walter Bagehot Could Teach the Fed,” WSJ, Letters, 12/30/2022.*

[7] *Amira McKee, “Family Farms Earn More from Clicks,” WSJ, 6/01/2026, p. B1.*

[8] *Ben Glickman, Alexander Saeedy and Gina Heeb, “Wall Street Hiring Dilemma: AI Can Model But Can’t Make Next Rainmaker,” WSJ, 6/22/2026.*

> *"We have to consider how the new Fed might change its approach to monetary policy and what the implications of a different approach will be for capital markets."*

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> *"He believes that in order for the Fed to maintain credibility, it needs to bring inflation back down to its 2% target..."*

What Comes Out in the Warsh Fed

Adrian G. Davies, CFA -- President

After eight years under Jerome Powell, the Federal Reserve has a new chairman, Kevin Warsh, and with him comes the possibility of a new monetary regime. We have to consider how the new Fed might change its approach to monetary policy and what the implications of a different approach will be for capital markets. The Federal Open Market Committee (FOMC), responsible for setting monetary policy, is comprised of twelve voting members. If Warsh is to change how monetary policy is set, he will have to sway the other members to his way of thinking, and he may or may not be successful. However, the chairman still has considerable influence over the agenda and how the Fed is run.

Since becoming chairman, Warsh caught investors off guard by expressing his inclination to raise interest rates. Having been appointed by President Trump and with Trump being such an outspoken advocate of cutting rates, people assumed Warsh would be another official along the lines of Stephen Miran, Trump's prior Fed board appointee, in supporting dramatic rate cuts. Warsh took the opposite tack from Miran, committing to reduce inflation—the implication being he would advocate raising rates if necessary to do so. By defying fears that his Federal Reserve would be subservient to White House policy, Warsh instantly won back some supporters. He believes that in order for the Fed to maintain credibility, it needs to bring inflation back down to its 2% target, which it has been above for the past five years. Fed watchers are still trying to figure out how the two competing objectives of reining in inflation and stimulating economic growth will balance out in practice, but a true measure of the new Fed's priorities won't come until we see how it responds to the next recession or financial panic.

Warsh has suggested that prior Federal Reserve administrations have been too vocal about their thoughts on monetary policy. To Warsh's thinking, the Federal Reserve should communicate less, leaving more room for capital market participants to come to their own independent conclusions about where monetary policy should go. More independent market expectations could then guide how Fed officials should think about the economic outlook and monetary policy. Fed officials have long listened to the markets and will continue to interpret what the market is saying about the economy and monetary policy going forward. But there are reasons to doubt that less communication will result in better policy.

Markets will continue to have some implicit expectation of what they anticipate the Fed will do, whether the Fed gives explicit guidance or not. The outlook for inflation is very much dependent on how the Fed manages monetary policy. One can't have expectations for inflation that are independent from assumptions about how the Fed will manage it. Less communication means greater uncertainty, providing a breeding ground for fear and doubt. Investors won't maintain confidence the Fed is managing monetary policy appropriately without reassurances and an understanding of officials' reasoning. Markets would likely jump between concerns inflation will not be controlled and fears of an economic slowdown. Markets will be more volatile. Warsh's intention may be for the markets to signal whether the greater risks come from inflation or an economic slowdown, but if less confidence and more volatility lead to lower prices overall, it is understandable that most market participants would not be happy about it.

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Put It All on the Table

With less information, the markets will just be less informed and they'll grasp every subtle indication of how policy might change. It's hard for anyone at the Fed to say anything without market participants gleaning some policy implication from it. When Alan Greenspan was chair of the Federal Reserve, he was known for his obfuscating commentary. Reporters would focus on how much paperwork was stuffed in his briefcase to gauge whether he was going to advocate for a policy change.

At present, Warsh does not want to provide forward guidance, but his intolerance of inflation suggests he is much more willing to raise rates than to lower them—that expectation should be built into market prices until there is evidence to the contrary. The FOMC is jokingly referred to as the "Federal Open Mouth Committee," as its being outspoken and giving guidance is itself considered a monetary tool. If Fed officials say, "we think monetary policy should be tighter," markets start to anticipate tighter conditions, and in doing so bring about tighter monetary conditions without the Fed having to change official policy. Warsh may be using this tool when he emphasizes the Fed's determination to bring inflation down, even as he advocates for less FOMC communications overall.

Warsh is also concerned that the FOMC will feel trapped by forward guidance, obliged to remain on the interest rate path they've previously telegraphed even as economic fundamentals shift. Whether the FOMC members feel limited by prior guidance is a separate issue from how much guidance they give in the first place. The FOMC should have the flexibility to change its mind as circumstances dictate.

We do not think Warsh will limit the ability of other Fed officials to express their own opinions on the economy and policy; rather, he seems likely to limit only what the FOMC produces as "official" forward guidance, while his own tenor as chairman may also influence markets. Even though the cacophony of Fed officials' disparate voices can be confusing, we appreciate that the running commentary dilutes the importance of any one statement. Each individual opinion carries less sway in a world where no one has perfect foresight and in an economy that is constantly changing. Even if there is a consensus among Fed officials, that consensus is continually evolving in subtle ways. The more outspoken Fed officials are, the more likely markets will efficiently price multifarious possible outcomes, and the more feedback the Fed will receive from markets. We believe the public discourse between the Fed and its critics is a healthy way to arrive at better policy decisions, and it makes sense to get all perspectives out there as part of the public discussion.

Near-Term Policy

We further have some reservations about policy based on the limited commentary Warsh has provided. Warsh's specific determination to get inflation back to 2.0% may have a "last mile" problem. The Fed's instruments of monetary policy, primarily managing the effective federal funds rate, have an imprecise impact on the economy and on inflation. It can take one to two years for policy changes to show up in economic statistics, with the economy and inflation impacted by other factors along the way. By showing such determination to get inflation down to 2%, the Fed risks overshooting on the downside—overly restrictive monetary policy wouldn't just lower inflation, it very well might constrain

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"Is Warsh willing to weaken economic growth, or even cause a recession, to get inflation from 3% down to 2 percent?"

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economic growth in the process. Is Warsh willing to weaken economic growth, or even cause a recession, to get inflation from 3% down to 2 percent? We don't like inflation, but we hope Warsh will be pragmatic in his intolerance of inflation. What might be more effective at solving the threat of persistent inflation—restraining the federal deficit—is not within Warsh's purview. Tariffs, war, immigration policy, and the data center buildout have also been contributing to inflation.

In addition to emphasizing the need to bring inflation back down to target, Warsh proposed the establishment of five task forces to take hard looks at Fed policy with regard to communications, its balance sheet, the sources of inflation, the data sources the Fed uses to make decisions, and the impact of AI on productivity. While Warsh may have some strong opinions, we do not believe there is a political agenda behind these task forces. He seems to have a genuine interest in improving Federal Reserve operations. Prior Fed Chairman Powell arrived with his own ambitions to rework how the Fed thought about inflation targeting, managing its balance sheet, and addressing the needs of the American people. Though there may be something to be gained from the exercise, a more skeptical view is that it's been tried before. The verdict is still out on how Warsh will change the Fed, and the extent to which the changes might affect the markets. The more things change, the more people cite trite French proverbs.

A Pocket of Lower Atmospheric Pressure

Adrian G. Davies, CFA – President

There seems to be virtually insatiable demand for artificial intelligence (AI) and the compute capacity that powers it. The industry has an "if you build it, they will come" aspect to it: Any additional capacity is readily absorbed. Demand is coming from much more than just large language models (LLMs), graphics engines, and AI agents. Autonomous driving and robotics (physical AI) are two other large applications, and there are many more. The AI investment thesis used to be simple: "AI will grow." Now, the investment thesis is more complicated, and that complexity isn't attracting new investors. LLMs are proliferating, with greater competition resulting in pricing pressure. Lower LLM prices may stimulate even more demand, while AI service providers and their users will still have to pay for compute capacity. We will see if other AI applications face similar competitive pressures.

Builders of AI infrastructure face all manner of obstacles in bringing capacity to market, from public opposition and regulation to water and energy supply constraints. These bottlenecks restricting the pace at which new compute capacity comes online might be unexpected blessings for the industry, assuring that what supply does get built remains in high demand.

Another important question is how all this data center construction will be financed. The five largest hyperscalers[1] are looking to spend about $800 billion on data centers this year, rising to $1 trillion next year (see Table 1, next page). Beyond the top hyperscalers, a cohort of third parties including private equity are also looking to get in on the action, investing alongside the hyperscalers and also building their own data centers. For 2026, the economy is benefitting not so much from an AI boom, but rather a data center construction boom. Since imports do not contribute to GDP however, and more than half of these

[1] *Amazon, Microsoft, Alphabet, Meta, and Oracle.*

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Table 1. Top Five Hyperscaler Capital Expenditures

(In $ billions)	2023	2024	2025	2026 Est.	2027 Est.
Amazon	$ 53	$ 83	$132	$ 216	$ 269
Alphabet	$ 32	$ 53	$ 91	$200	$ 298
Microsoft	$ 35	$ 56	$ 83	$ 162	$ 205
Meta Platforms	$ 27	$ 37	$ 70	$ 137	$ 187
Oracle	$ 8	$ 15	$ 41	$ 77	$ 92
Total	$155	$244	$417	$792	$1,051

Source: FactSet, FactSet consensus estimates

capital expenditures are being spent on imported electronic equipment, the impact on US GDP is less than what one might otherwise expect.

The hyperscalers generate formidable cash flow from their core business operations, now piling it into data center construction. They are borrowing large sums of money and raising equity in order to build more and bigger data centers than what their internal cash flow can support. The hyperscalers probably aren't expecting to continue these buildouts at a $1 trillion rate ad infinitum, although much will depend on the investment returns they are able to generate. As long as demand for data processing exceeds supply, compute providers can set their prices. If capacity catches up with demand, and it isn't clear when or if it will, competition among providers may reduce investment returns.

The capital requirements are a lot for the markets to absorb. JP Morgan estimates that hyperscalers will raise $1.5 trillion in investment-grade debt over the next five years, raising still more with additional debt instruments.[2] The massive supply of debt issuance from data centers and AI providers, particularly when coupled with the supply of Treasurys stemming from our country's burgeoning federal deficit, is having difficulty finding investors. Supply relative to demand sets the price, so the debt will find investors, but at lower prices and higher yields than current market rates. Indeed, the 10-year US Treasury yield rose 0.27 percentage points during the first six months of the year, and has risen further since. Interest rates may continue rising as more debt issuance comes to market.

Because they've been investing all of their cash flow in data centers, hyperscalers have reduced their share repurchases to a virtual standstill. Over the last 20 years, publicly traded US companies have retired more shares through buybacks than they have issued (see Figure 1). That could change this

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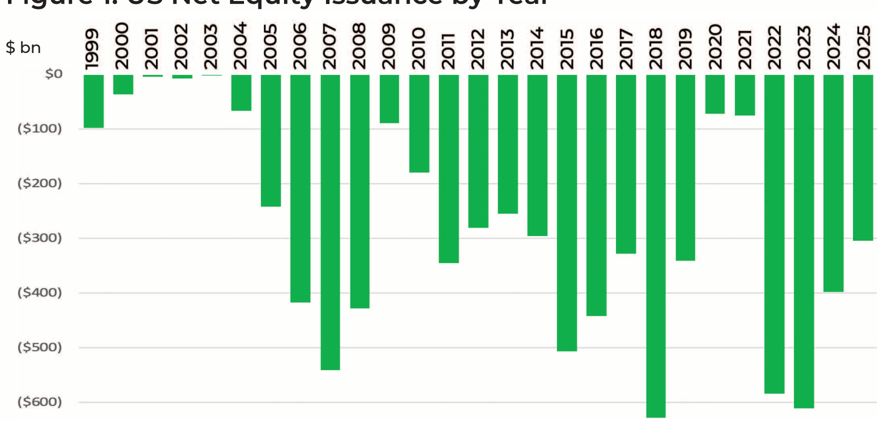
Figure 1. US Net Equity Issuance by Year

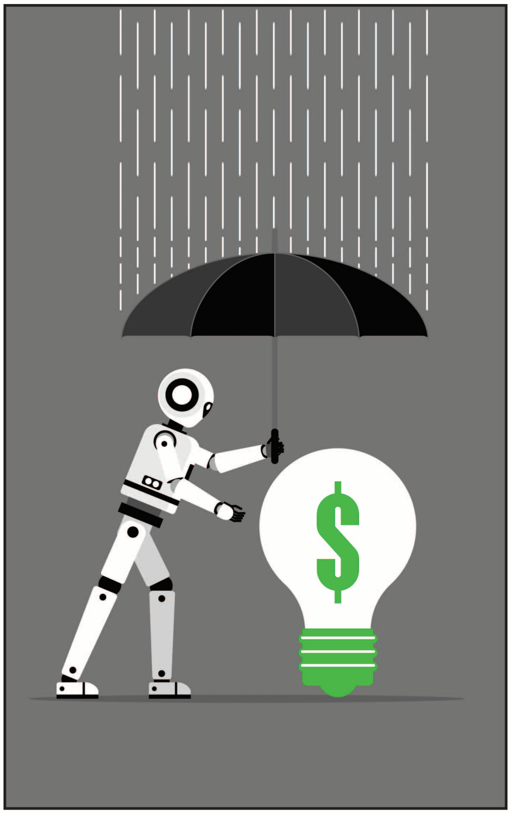


Source: Federal Reserve

[2] Herman Chan and Ravi Chelluri, "Trading Lifts Fees; Wealth & Banking Anchor," Bloomberg Intelligence, 12/12/25.

"Through the first half of 2026, the hyperscalers raised $159 billion in debt and $90 billion in new equity. While the stock market is not far off its all-time high at the time of this writing, demand for capital could yet drive the cost of equity capital up as well, meaning stock prices would fall."

"Within large capitalization AI-related businesses, investor interest has shifted from the Magnificent Seven to semiconductor memory stocks like Micron and Sandisk."



year with all of the fundraising required to pay for data centers and AI labs, particularly if one includes shares coming to market-from private investors following the public offering of SpaceX, the anticipated offering of Anthropic, and other issuances. Through the first half of 2026, the hyperscalers raised $159 billion in debt and $90 billion in new equity. While the stock market is not far off its all-time high at the time of this writing, demand for capital could yet drive the cost of equity capital up as well, meaning stock prices would fall. That construction constraints might limit data center buildout would prove to be a blessing not only for data center investment returns, but for shareholders and for anyone impacted by higher interest rates.

This Is Not 2000

Every year or so there's some small subset of stocks that captures investors' imagination and ends up soaring to sky-high prices. Prices overshooting reasonable valuations is a fairly regular feature of the market. In the last few years, we've seen mini-bubbles in the stocks of special-purpose acquisition vehicles, electric vehicle manufacturers (other than Tesla), cryptocurrency exchanges, buy now pay later businesses, financial technology businesses, battery technology developers, optical transceivers manufacturers, cannabis growers, uranium miners, and quantum computing developers, to cite some examples. There's always a compelling argument for buying these stocks—some fundamental reason to expect strong stock returns—but then investors fail to anticipate competition, overlook some bottlenecks to growth, or at least don't appreciate how much enthusiasm has been built into elevated stock prices. The stocks ultimately fall back to earth. Typically the industry such stocks represent is small enough that there aren't significant consequences for the broader stock market or the economy.

AI has certainly captured investors' imagination, with enthusiasm for the stocks appearing to wane now. To be sure, there are numerous smaller capitalization AI-themed stocks that became overextended. But AI happens to be a very big theme, dominated by very large capitalization stocks. If investors were to become less enamored with AI stocks, the group is large enough to drive the S&P 500 Index lower. The Magnificent Seven stocks,[3] which comprise about 33% of the S&P 500 Index, and which have all become some form of AI investment story, have collectively underperformed since the beginning of the year.

Despite their underperformance however, the S&P 500 Index has continued to approach new highs. Within large capitalization AI-related businesses, investor interest has shifted from the Magnificent Seven to semiconductor memory stocks like Micron and Sandisk. These latter stocks recently traded at modest multiples of around 10x earnings, mostly because their earnings exploded higher by as much or more than their share prices. The stocks are even cheaper now. There could always be further upside in memory, but historically the stocks have been very cyclical. Those low price-to-

[3] Nvidia, Alphabet, Apple, Microsoft, Amazon, Meta Platforms, and Tesla.

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> *"Despite waning sentiment, we believe the fundamentals of the Magnificent Seven stocks will stay strong, and we are looking for them to generate reasonable returns from their data center investments."*

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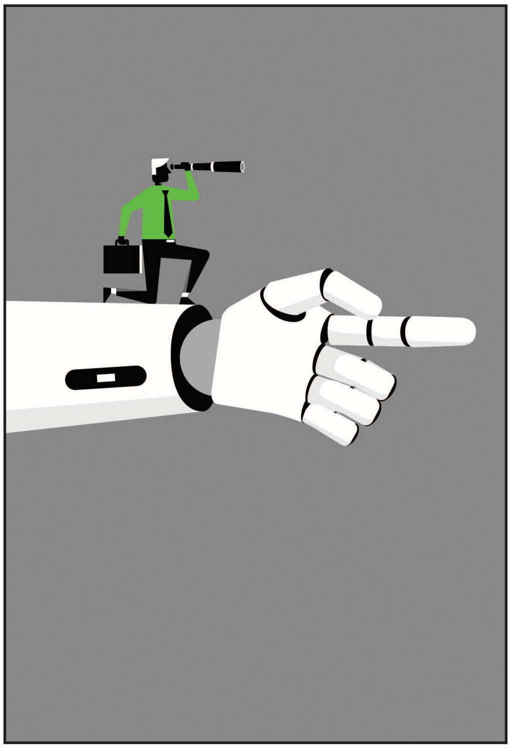

earnings multiples could be deceptive, as earnings forecasts could easily fall from here.

Investor attention may simply shift again to the next set of shiny objects, to the detriment of the current AI-themed beneficiaries. While valuations of the Magnificent Seven stocks could always be lower, we do not see their stock valuations "bursting" the way the technology bubble of 2000 did. There remain new applications for AI to be tapped and massive potential for growth as the technology improves and becomes cheaper. In 2000, the internet promised and subsequently delivered on similar growth potential, with the key differences now being that the Magnificent Seven stocks are supported by large existing businesses that provide strong free cash flow, and, with one exception, they do not trade anywhere near the same levels of overvaluation that comparable stocks traded for during the internet bubble.

Tesla is the only Magnificent Seven stock currently trading above 35x earnings. For the most part, the Magnificent Seven stocks trade at multiples that can be justified on the basis of future earnings growth. Despite waning sentiment, we believe the fundamentals of the Magnificent Seven stocks will stay strong, and we are looking for them to generate reasonable returns from their data center investments. Our main concern, however, is that the massive demand for capital is driving up the costs of both equity and debt capital. Higher capital costs seem likely to put a damper on market valuations generally.

At the risk of repeating ourselves, we are not focused on short-term performance. We are focused on managing diversified portfolios of high-quality companies that will stand the test of time through numerous market environments. In addition to believing AI-themed stocks will continue to generate healthy returns, we further believe there are plenty of opportunities outside of AI which have been overlooked. As we have been suggesting for some time, it seems to be their turn to rise.

We are further hopeful that AI is accelerating economic growth. AI can speed up many manufacturing and services processes. It's making new types of work possible, and can enable technological breakthroughs. There will be winners and losers. Productivity from AI could disrupt the job market, but we expect AI will destroy jobs at a pace that can be offset by the creation of new jobs. On balance, our economy is likely to be more productive, more dynamic, and more robust for adopting AI. A broader group of stocks will likely benefit from the fruits of AI. At the same time, policymakers may be challenged to see to it that the benefits of AI's economic advancement are broadly distributed.

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"The US tax code seems to be governed by strict due dates and complex compliance rules."

Trump-Brand IRAs and Compliance Challenges

William H. Darling, CPA – Chairman & CEO
Jeanne M. FitzGerald, CPA – Tax Manager & Vice President

There are currently two types of retirement accounts labeled "Trump." One is TrumpIRA, which is a "government website (TrumpIRA.gov) that provides links to and information about IRAs from private-sector financial institutions that meet certain Treasury-specific criteria." The program is "set to launch by January 1, 2027, (and) the site will allow savers to compare IRAs from different financial institutions based on criteria such as fees and investment options. The site will also share information about eligibility and instructions for claiming the Saver's Match, which would match eligible savers' contributions up to certain thresholds, depending on their income."[1] There is some criticism of these plans, appearing to center on government interference in private markets and, also, on the potential bidding up of government liability for the success of these plans by competing political parties.[2]

The second type of retirement accounts bearing the Trump label are Trump Accounts, which are "designed exclusively for US citizens under age 18. Parents or guardians can serve as custodians and funds can be utilized after age 18 for expenses like higher education or purchasing a home."[3] It is important to check the exact details if these are of interest to you. One of the advantages of Trump Accounts is that employers can make tax deductible contributions up to $2500 per child for employee's children or dependents per year. When the child or dependent turns 18, the accounts convert to traditional IRAs, but there is an election allowing the accounts to convert to Roth IRAs at the 18-year-old's tax rate.[4] This would seem to present an attractive investment opportunity.

"Economic Substance" Challenges

The US tax code seems to be governed by strict due dates and complex compliance

rules. However, the preamble or initial paragraph of a tax law might say something like, "Depreciation of equipment is meant to approximate the equipment's useful life." Incentives can be added by the legislative process to help the economy or tax collection, but at its base the law is trying to be practical. Taxpayers can use the "preambles" to argue their position before the IRS but it is usually safer and cheaper to fit within the dates and rules.

Of course, an aggressive IRS could work backwards from the dates and rules and challenge transactions on the basis of the "economic substance doctrine." This is a common law doctrine, codified into US tax law in 2010, that seeks to disallow favorable tax treatment for transactions, which on their face meet date and rule requirements but lack "an objectively reasonable expectation of profit, apart from the tax benefits from the transaction" and lack "a substantial non-tax business purpose in entering the transaction."[5] These are the two tests.

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[1] *Fidelity Learn, "What Is TrumpIRA?" Fidelity.com, 6/26/2026.*
[2] *WSJ Editorial Board, "Trump Has an IRA to Sell You," Review & Outlook, WSJ, 5/03/2026.*
[3] *Congressional Research Service, "Trump Accounts: Overview and Policy Considerations," Congress.gov, 6/15/2026.*
[4] *Phil Kerpen, "Trump's Wealth Opportunity," WSJ Letters, 7/10/2026.*
[5] *Freeman Law, "What Is the 'Economic Substance' Doctrine?" 2022.*

Growth Composite Fact Sheet Available

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However, there are many common transactions allowed by statutes that do not meet the two-part test. A business electing to file as an S Corp rather than a C Corp, moving money from a brokerage account to a Roth IRA, or using historic rehabilitation credits might all fail the two-part test because they are mainly, if not exclusively, used for tax benefit purposes.[6]

There is a complex balancing act necessary by taxing authorities that want to maintain a mostly voluntary system of taxation, rather than incur excessive enforcing compliance costs. Why not make it practical, simple and fair? The economic substance argument seems to violate that balance.

We are reminded by a letter writer to the WSJ that “legitimate tax deductions are not loopholes. A loophole would refer to a flaw in the law that allows a work-around to circumvent the intent of the law. Legitimate tax deductions are entirely different.”[7]

If you or any other advisors have questions about the issues raised here, please contact your investment manager or one of us.

[6] *Amicus Curiae Brief of the National Taxpayers Union Foundation in support of Appellant Liberty Global, Inc., 6/12/2026.*

[7] *"Not Every Tax Deduction Is a 'Loophole,'" WSJ Letters, 01/05/2023.*

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