Look at the Markets

An in-depth analysis of U.S. and world markets focused on complexities, risks, and trends shaping the economic landscape

THIRD QUARTER 2026

FINEMARK BANK & TRUST
A DIVISION OF COMMERCE BANK

FINEMARK BANK & TRUST
A DIVISION OF COMMERCE BANK

Table of contents

2 Letter from the Chief Investment Officer

3 Real Gross Domestic Product (GDP)

4 U.S. Energy Consumption

5 Employment's Shifting Picture

6 U.S. Core Consumer Price Index (CPI) Goods versus Services

7 Debt, Deficits, and Higher Borrowing Costs

8 Federal Reserve Interest Rate Expectations Reverse Course

9 Aggregate Free Cash Flow Across AI Investment

10 AI Buildout Surges

11 Indices Change Over Time

12 Global Earnings Momentum

13 Fewer Liquidity Events

14 IPO Volatility



From the Chief Investment Officer

The news cycle during the second quarter of 2026 was dominated by the Middle East conflict, with financial markets focusing on the economic impact of the conflict. The economy also felt the underlying current of larger influences from the artificial intelligence (AI) buildout, fiscal deficits, inflation, and job growth. These influences shaped second quarter and continue to influence the economy and markets going into the back half of the year.

U.S. equity markets logged their best quarter since 2020, as the AI buildout stretched from the tech sector to various domestic sectors including utilities, industrials, and real estate. Emerging markets also saw robust demand from AI components. Earnings from the S&P 500 Index continue with surprising growth as the AI buildout has sparked a revival in capital expenditures. Excluding one-time adjustments, large U.S. companies grew at above expectations with mid-teens growth and continue to adjust upward. While robust earnings are welcome, we are seeing a changing picture. The AI buildout had been funded by current and retained earnings but is now beginning to tap into equity and fixed income markets to fund their plans, a subtle but significant transition.

Inflation remains at the forefront of the Federal Reserve (Fed) policy, as leadership transitions with Kevin Warsh taking office as Chair of the Federal Reserve. Inflation has been impacted by energy, persistent housing shortages, and a resilient consumer.

While inflation has risen recently, the short-term interest rates would indicate monetary policy is currently expansionary, complicating future potential rate cuts. Fixed income markets have remained concerned about increasing fiscal deficits, allowing longer-term rates to marginally increase, slowing fixed income returns.

Even at steady interest rates, enthusiasm for dealmaking has refocused the market on technology and larger privately held companies looking to raise capital in the public market through initial public offerings (IPOs). Dealmaking has been stagnant over the past several years as higher rates were needed to confront inflation. Private investors are eagerly awaiting broader dealmaking outside of high-profile IPOs.

We remain diligent in exploring opportunities and risks inside financial markets and have portfolios positioned with a balanced neutral posture.

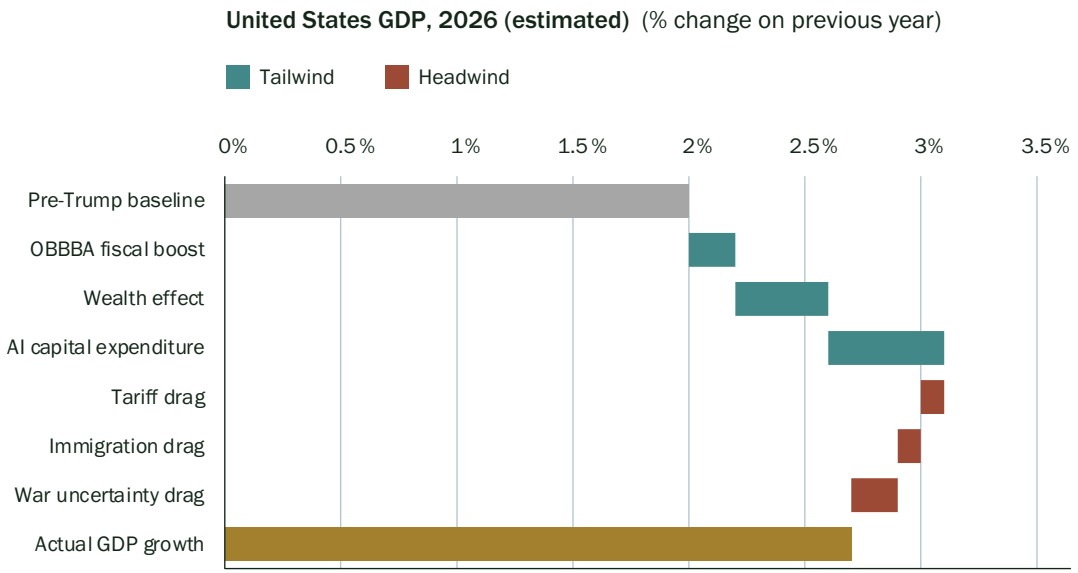
I encourage you to explore this edition of Look at the Markets and thank you for your continued confidence.



DAVID HAGEE
Chief Investment Officer

Real Gross Domestic Product (GDP)

Growth remains buoyant despite headwinds



Source: Bureau of Economic Analysis (real GDP year over year as of 3/31/2026), Commerce Trust

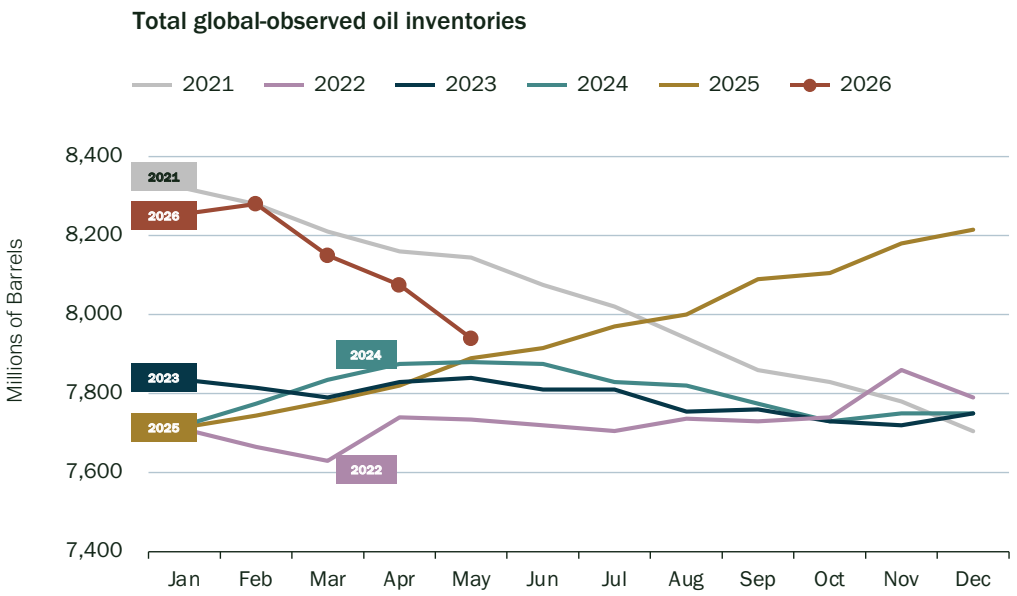
A year ago, the U.S. economy was growing at a steady 2.0% rate, similar to the average growth rate we have experienced for the past several decades. Growth was boosted well above trend rates this year due to the 2026 fiscal influence including the One Big Beautiful Bill Act (OBBBA), a rebound in job growth, a large wealth effect that adds to consumption, and a surge in domestic fixed investment, mainly AI infrastructure spending.

The residual drag from tariffs, less immigration, and the conflict in the Middle East driving up oil prices has pushed back against positive tailwinds. The U.S. economy is currently expanding at a 2.7% year-over-year real pace as of the end of the first quarter of 2026, despite headwinds.

As the impact from tariffs fades and a potential resolution in the Middle East boosts confidence, we anticipate full-year 2026 growth will continue at an above trend 2% plus pace, despite a very weak second quarter.

U.S. Energy Consumption

Oil reserves dampen the economic impacts of the oil shock



Source: IEA, Federal Reserve of Boston, Yale Lab, Commerce Trust

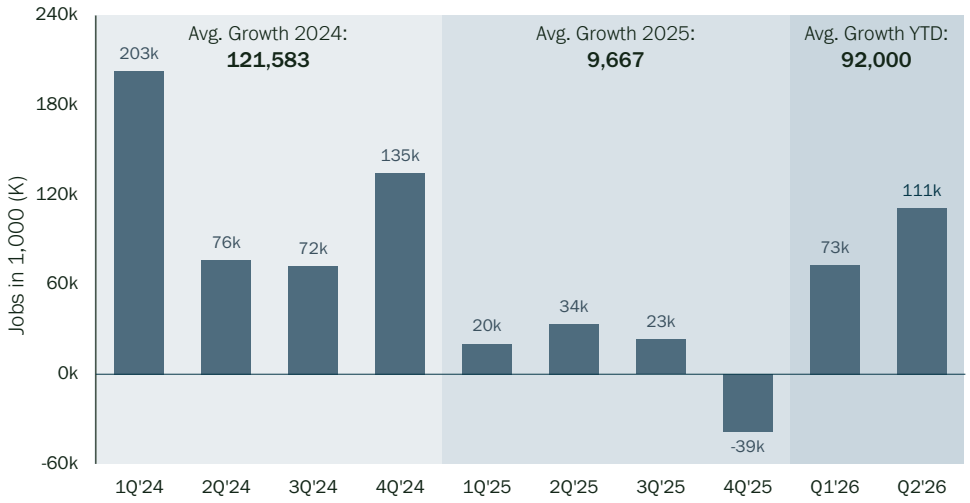
The energy shock from the conflict in the Middle East pushed global oil prices to $144 per barrel. The global economy relies on oil with daily demand around 105 million barrels. Historically, energy shocks have caused inflation surges and economic disruptions. The oil shocks of the 1970s reduced gross domestic product (GDP) by 1.74% and raised Consumer Price Index (CPI) by 2.2%.

The global economic impact from the closure of the Strait of Hormuz has been muted with producers and consumers flexing in response. Oil has been rerouted through UAE and Saudi Arabia to bypass the Strait, non-gulf exports have increased, including from the U.S., but globally we have released approximately 400 million barrels of reserves helping to offset the cumulative loss of 1.1 billion barrels that would have gone through the Strait.

The resilience and flexibility of energy producers and suppliers has kept the U.S. on track for economic growth. We are forecasting around 2% real GDP growth for 2026. Market reactions have produced higher-than-average energy prices year over year, putting inflation into focus. The Fed now has bias toward higher rates instead of the rate cuts projected at the start of 2026.

Employment's Shifting Picture

Job growth seems to rebound after sluggish 2025



Source: Bureau of Labor Statistics; St. Louis Federal Reserve; Bloomberg

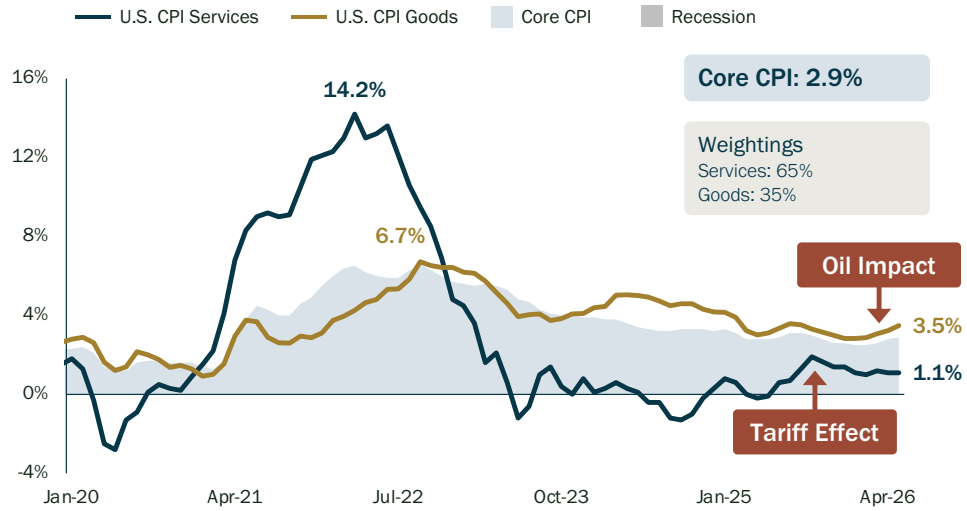
The employment picture shifted dramatically in 2025 with new technologies and the Trump administration's policies. In 2024, the U.S. economy was adding about 122,000 jobs per month, but in 2025 job growth came to a standstill. By the end of 2025 that average monthly job growth had slipped into negative territory.

Several non-repeating factors contributed to last year's slower pace of job growth, including reduced immigration, tariff pressures, and Department of Government Efficiency (DOGE) cutbacks. On the other hand, the net impact of AI has yet to be fully reflected. The unemployment rate ended the year at 4.4%, held down by demographic trends.

Several studies have suggested we are losing 10,000 jobs per month due to AI, but the AI and data center buildout has increased demand for engineering and construction labor. This year's shift back toward employment growth greatly reduces a near-term recession risk but has also provided the Fed clearance to focus solely on rising inflationary pressures.

U.S. Core CPI Goods versus Services

Energy price spike impacting core prices as transportation costs rise



Source: Bureau of Labor Statistics; Bloomberg

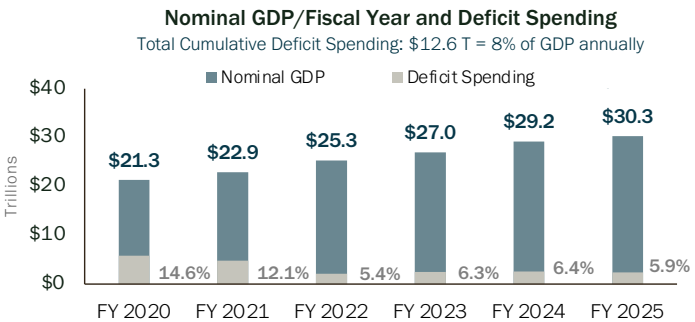
The CPI is one of the primary measures of U.S. inflation. Top-line inflation, including food and energy, has surged to 4.2% year over year given the conflict in the Middle East and the spike in energy prices today.

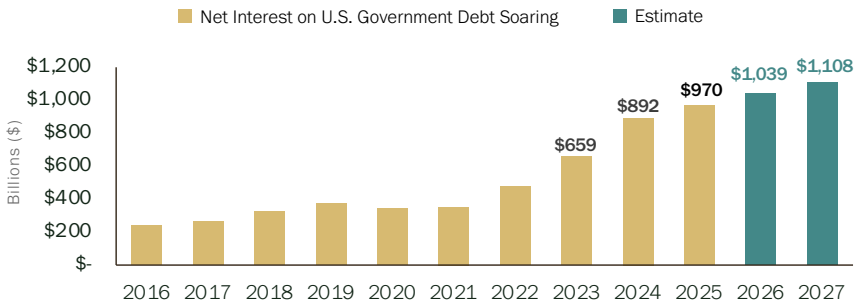
Inflation has been and remains a central focus since 2022, when COVID-era stimulus drove CPI to a peak of 9.1% in June 2022. While inflation was coming down several years ago, tariff-driven goods inflation had given policymakers and market participants some initial concern, but the overall impact on CPI has been muted.

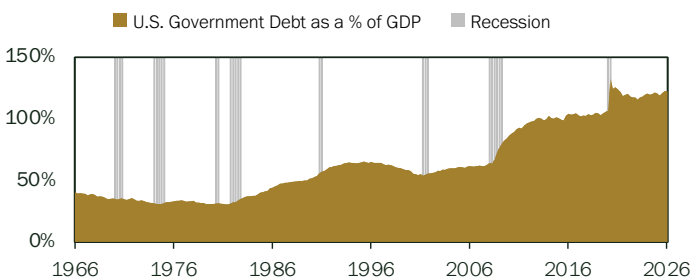
The modest tariff inflation boost last year afforded the Fed room to cut rates three times in 2025 as core inflation fell to 2.5%. The energy price spike is slowly bleeding into core prices, mostly transportation costs, and now the Fed is biased to raise rates if core prices continue to trend higher. We believe they can hold rates steady as oil prices have fallen dramatically recently.

Debt, Deficits, and Higher Borrowing Costs

As federal debt grows, interest expense and Treasury supply continue to climb





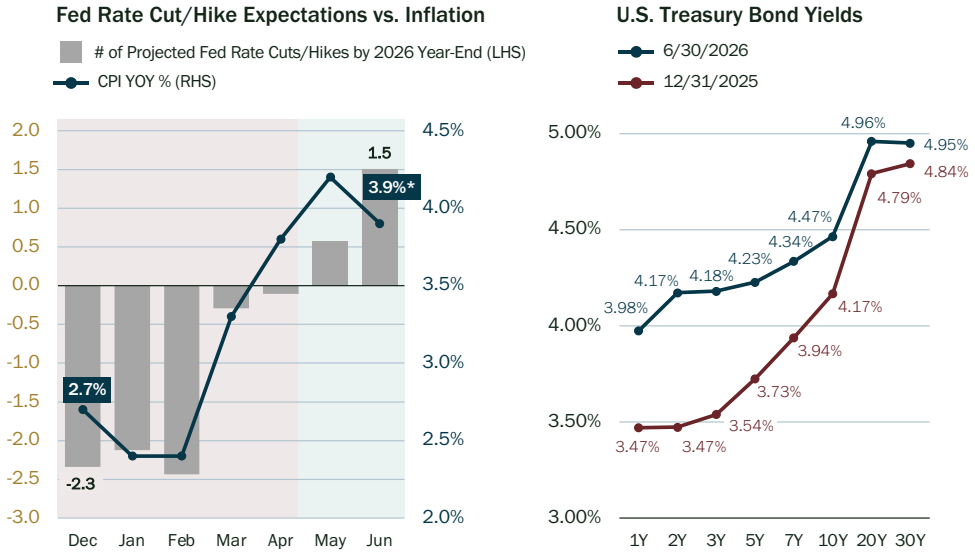


Sources: Bureau of Economic Analysis, Congressional Budget Office, Federal Reserve Bank of St. Louis

- According to the Congressional Budget Office, the OBBBA will contribute to budget deficits over the next ten years.
- Public debt relative to the size of the U.S. economy is approaching levels last seen at the end of World War II, when debt was 113% of GDP.
- While higher debt levels are sustainable at ultra-low interest rates, to the extent rates remain relatively high, debt service will be greater than either defense spending or all non-defense discretionary spending combined.
- Additional U.S. Treasuries must be issued to fund deficits, which must be absorbed by the fixed income market. Should the increased supply of bonds from the U.S. Treasury outpace the demand from global bond investors, rising longer-term rates would result.

Federal Reserve Interest Rate Expectations Reverse Course

Inflation spike leads markets to reprice from easing to tightening, pushing front end of yield curve higher



Source: Bloomberg. Commerce Trust. *June CPI is Bloomberg Survey Median estimate as of 7/6/2026.

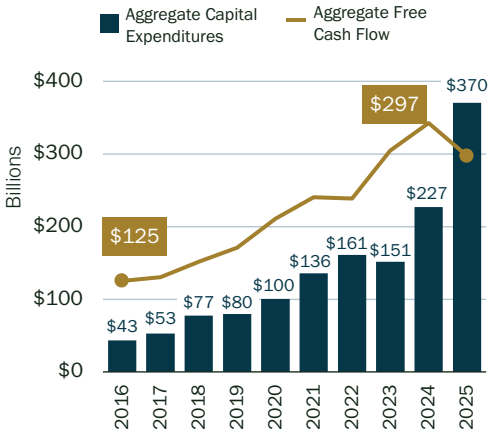
Markets entered 2026 anticipating moderating inflation and slowing job growth would lead the Fed to lower its overnight federal funds rate. As energy prices surged following the Middle East conflict, inflation expectations reversed higher, prompting investors to rapidly reprice the policy outlook from multiple 25-basis-point rate cuts toward the possibility of rate hikes.

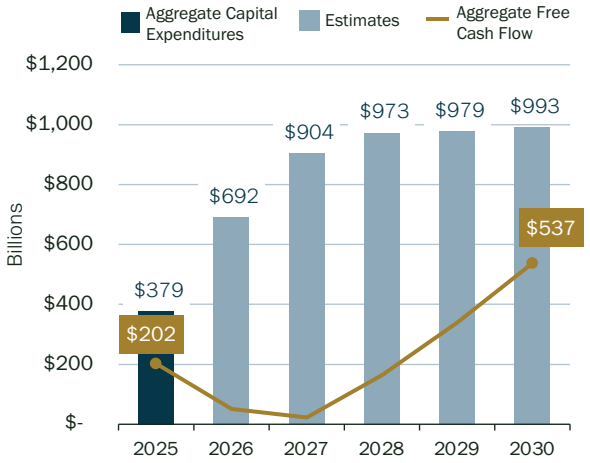
Treasury markets responded to the shift in Fed expectations by pushing shorter-term yields meaningfully higher. Because investors expect inflationary pressures to eventually moderate, impacts on longer-term yields were less pronounced. The result was a flatter yield curve, with front-end rates increasing faster than maturities further out on the curve.

Although renewed inflation concerns have increased volatility across fixed-income markets, higher yields continue to provide attractive income opportunities for investors. We remain focused on balancing income generation and interest-rate risk, recognizing that policy expectations can shift quickly as economic and geopolitical conditions evolve.

Aggregate Free Cash Flow Across AI Investment

Future expectations imply stronger cash generation from AI investment





Source: Bloomberg, CFR, Reuters, Commerce Trust. As of 06/24/2026.

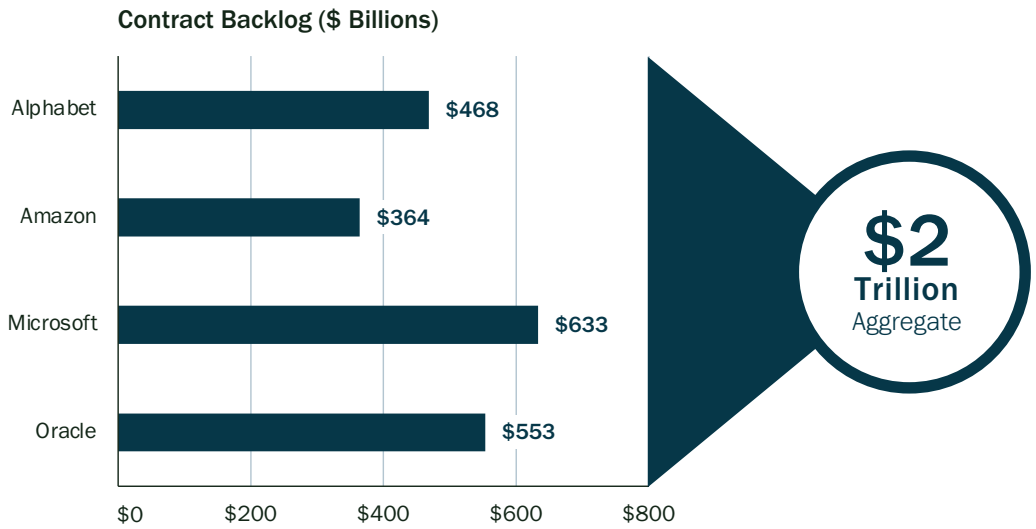
Five of the leading AI infrastructure providers, Alphabet, Amazon, Meta, Microsoft, and Oracle, are accelerating capital expenditures. While this level of spending will consume much of the operating cash flow, the expected returns are strong with free cash flow rebounding in three to five years even with sustained higher levels of capital spending.

In 2025, aggregate capital expenditures outpaced aggregate free cash flow for the first time in the last decade. This is a huge shift from what had been self-funded growth. New AI infrastructure providers, called neo-clouds, do not have other sources of profits and could be considered riskier from a financing perspective.

Contracted revenue backlog for the five leading AI infrastructure companies exceeded $2 trillion in the first quarter of 2026, indicating the firms are building computing capabilities to support already contracted revenue.

AI Buildout Surges

Committed customer demand creates contract backlog



Source: Bloomberg as of 06/24/2026

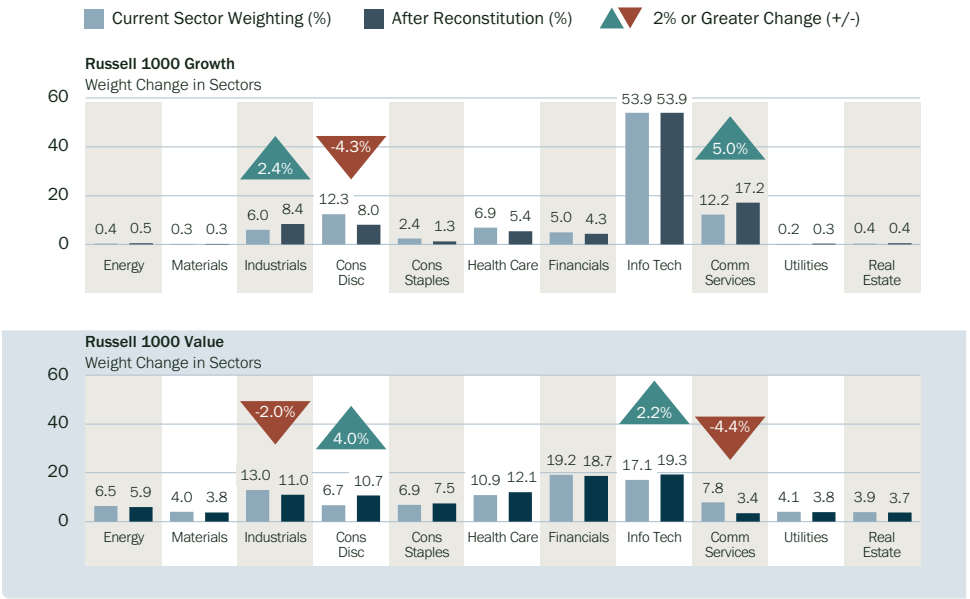
While some investors have expressed concern about the rising capital expenditures required to build and maintain AI infrastructure, the approximately $2 trillion in aggregate contracted revenue across the major AI providers supports continued investment. This backlog reflects both committed customer demand and the increasing importance of AI and cloud services.

The economics of computing continue to improve. As the cost declines, access to AI capabilities becomes more affordable for a broader range of businesses and applications. This helps drive continued growth in contracts for computing capacity, suggesting that demand remains strong despite concerns about the scale of current investment spending.

Lower pricing may unlock additional adoption, new AI-driven use cases are continuing to emerge across industries, and improving returns on investment could encourage broader AI deployment. Slower growth is not necessarily weakening demand. The early-stage surge is transitioning to a more sustainable phase of expansion supported by a larger and more diverse customer base.

Indices Change Over Time

Sector weights driving forced capital migration across style benchmarks



Source: PitchBook Data, Inc.

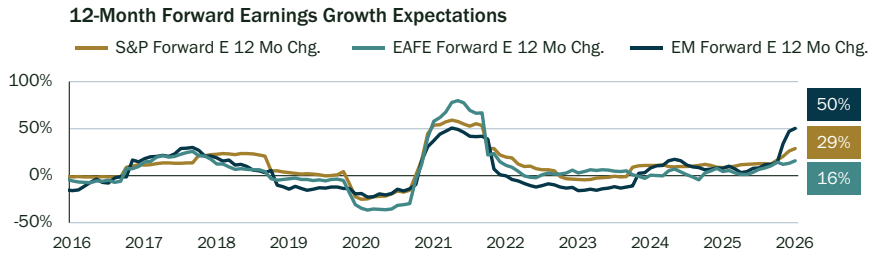
FTSE Russell, an industry-leading index provider, is recalibrating their indices, which could produce substantial shifts in how managers are building their portfolios. Comparing pre- and post-reconstitution exposures shows where benchmark composition changed most significantly, with emphasis on sector shifts of 2% or greater.

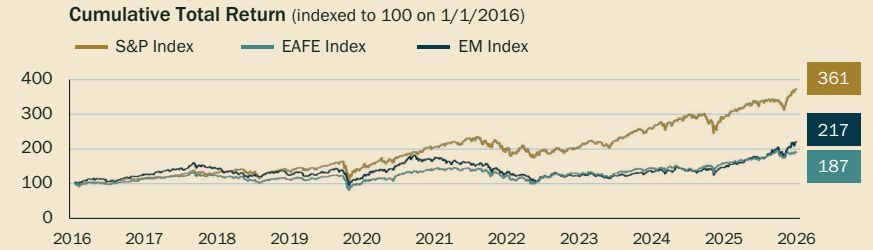
The recalibration of the indices reshapes style benchmarks as companies shift across growth and value classifications. The resulting changes in sector representation reflect evolving market leadership and can drive meaningful benchmark-related capital movement. These shifts will have significant impacts to portfolios, especially for passive and indexed portfolios.

Changes in benchmark composition can alter portfolio characteristics without any active investment decision being made. We monitor these structural shifts to better understand their implications for portfolio exposures, risk characteristics, and long-term investment positioning. Given the considerable appreciation of the securities comprising the affected sectors, capital gains have become an area of concern.

Global Earnings Momentum

Evaluating the sustainability of Emerging Markets' earnings surge





Source: Bloomberg, Commerce Trust

Earnings are the long-term driver of equity markets across all geographies, while in the short term, markets are influenced by geopolitical events and fads. Looking at forward earnings and estimates continues to offer value to investors as participants tend to look at future earnings power rather than reflecting on past financial performance.

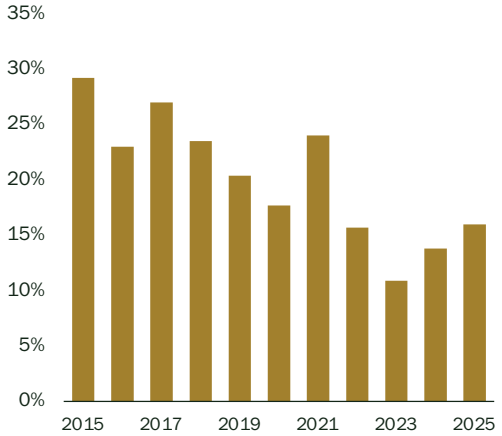
Longer term trends of U.S. tech expansion and now the AI infrastructure buildout has contributed significantly to the U.S. equity markets outperforming their global peers over the past decade. More recently, as the AI buildout gathers momentum, global companies have benefited to see rapid earnings growth, notably Taiwanese and South Korean chip manufacturers, leading to emerging markets surging performance.

So far in 2026, emerging markets (EM) have been the highest performing area geographically. While EM has historically been a more volatile area to invest in, the case remains to evaluate exposure in the context of a diversified portfolio to potentially seize return opportunities while mitigating risk.

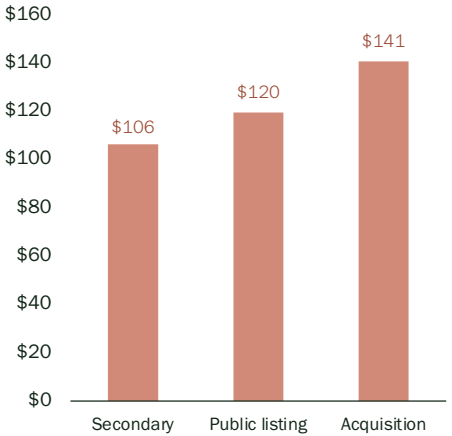
Fewer Liquidity Events

Reduced distributions, uneven exits, and increased reliance on secondaries are tightening fundraising conditions

Private Market Distributions by Year
(% of Outstanding NAV)



U.S. Venture Capital 2025 Exit Values by Type
($ Billions)



Source: PitchBook Data, Inc.

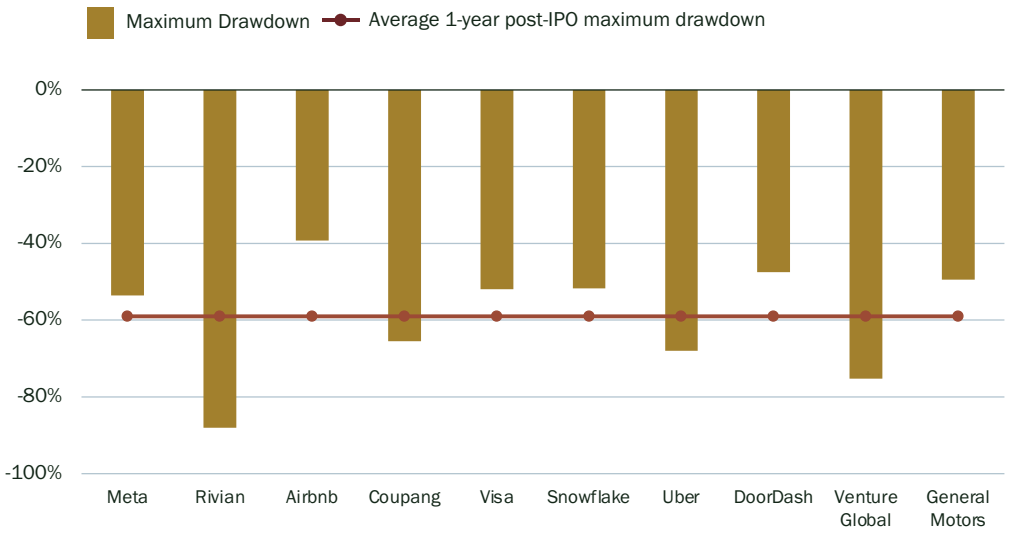
Liquidity in private markets remains limited, with IPO markets largely stalled and distributions still below historical averages, leading to longer hold periods and a buildup of mature assets. These factors have extended holding periods and increased the number of mature assets in portfolios. While distributions have improved since 2025 and are higher than the past three years, they have yet to return to historical norms.

To generate cash for investors, investment funds are increasingly using the secondary market. A common approach is a continuation vehicle, which allows fund managers to keep high-quality investments for longer while offering investors a way to cash out. Even so, these tools have not fully solved the broader challenge of returning capital to investors.

These liquidity constraints have also directly weakened fundraising by limiting distributions back to limited partners (LPs), leaving capital trapped in existing funds and reducing their ability to commit to new vehicles. As a result, LPs have become more selective and pacing has slowed, extending fundraising timelines and concentrating capital flows into a smaller group of established managers.

IPO Volatility

Post-IPO sell-offs create volatility, even in strong businesses



Source: Bloomberg, First Trust, Commerce Trust

The maximum drawdown data highlights a key reality of IPO investing: even the largest and most anticipated offerings often experience significant volatility early on. On average, the 10 largest U.S. IPOs since 2006 experienced a peak-to-trough decline of roughly 59% within their first year. This demonstrates how quickly valuations and investor enthusiasm can reset as companies transition to public market scrutiny.

Importantly, these drawdowns are not limited to weaker businesses. Many high-profile, large-cap companies have experienced similar declines, suggesting that size at issuance does not eliminate execution risk, earnings uncertainty, or shifts in investor sentiment. For investors, this reinforces the importance of distinguishing long-term fundamentals from short-term price discovery.

From a portfolio construction perspective, the data supports a disciplined approach to IPO exposure. While some companies ultimately recover and deliver strong long-term returns, the path is often uneven and marked by sharp declines. Position sizing, entry timing, and diversification remain critical when allocating capital to newly public companies.

The opinions and other information in the charts and commentary are provided as of August 11, 2026 and are subject to change based on changes in the market or other conditions. FineMark Bank & Trust does not undertake to advise you of any change in its opinions or the information contained in these charts and commentary. This summary is intended to provide general information only and may be of value to the reader and audience.

The information contained herein is not directed to, designed for, or individually tailored to, any particular investor or potential investor. Different types of investments have varying degrees of risk and the asset classes and investments discussed in this commentary may not be appropriate for all investors.

Past performance is no guarantee of future results. Diversification does not guarantee a profit or protect against all risk. This material is not a recommendation of any particular investment strategy, is not based on any particular financial situation or need and is not intended to replace the advice of a qualified attorney, tax advisor or investment professional.

Alternative investments often carry additional risk considerations and may involve significant losses, periods of extreme volatility, and lack of liquidity. These investments, in general, are not suitable for all investors. Additionally, certain alternative investments may require investors to be accredited or qualified investors, which have defined minimum asset requirements.

Data contained herein from third-party providers is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed.

FINEMARK
BANK & TRUST
A DIVISION OF COMMERCE BANK

FineMark Bank is a division of Commerce Bank
Investment Products: Not FDIC Insured | May Lose Value | No Bank Guarantee