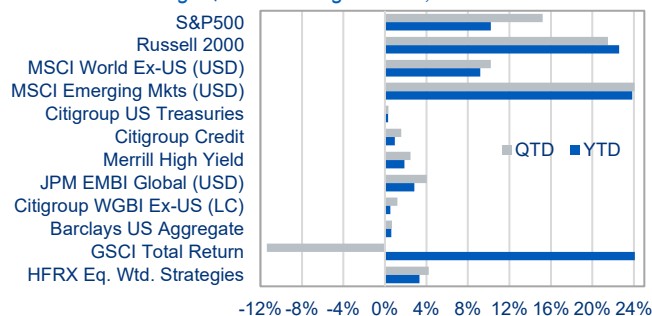


Global Market Review

Despite a mild setback in June, global equity markets soared in the second quarter, resulting in strong gains through the first half of the year. Global economic resilience, a sharp decline in oil and gas prices, strong corporate earnings, and great expectations for the transformative potential of AI have been the main drivers of global equity market returns so far this year. The share prices of global chip manufacturers, which have benefited from strong AI-driven demand, enjoyed particularly strong gains. After its blockbuster IPO, SpaceX shares closed the quarter 26% higher than their IPO price, making it the sixth largest company in the U.S. with a market capitalization of about \$2 trillion. The Fed left rates unchanged in June, as expected. With an ultimately fleeting cease fire in place, Brent crude prices returned to pre-war levels and U.S. gasoline prices plunged. The U.S. dollar index rose. The Japanese yen fell to 40-year lows against the dollar.

Exhibit 1 Performance of Major Market Indices

Source: Bloomberg. Quarter ending June 30, 2026.



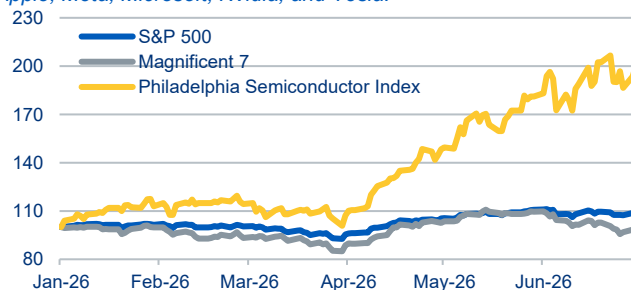
Global equity markets soar, oil prices sink in Q2.

All Pervasive AI Stimulus

The S&P 500 rose 15.2% in the second quarter, reversing the first quarter's decline, to bring the market's return for the year to 10.2%. AI's favorable influence on share prices was everywhere to be seen. Chip producers had a standout performance. With earnings soaring on AI-driven demand for chips, the Philadelphia Semiconductor Index of chip producers rose by more than 87% in the second quarter and doubled in the first half of the year (Exhibit 2). Across market segments, growth and large cap stocks rose sharply in the second quarter. A combination of AI-related demand, tax breaks, and favorable valuations sent small cap stocks sharply higher in the second quarter. They are up 22.6% so far this year.

Exhibit 2 AI-Driven Demand Sends Chip Stocks Higher

Source: Bloomberg. Index January 1, 2026 = 100. The Magnificent 7 grouping of mega-cap tech stocks comprises Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla.



In addition to the AI mania, strong corporate earnings have contributed to rising share prices. Actual corporate earnings were up 28% from a year ago in Q1 and are expected to increase by 24% for the year as a whole. Trading desks at JPMorgan, Goldman Sachs, Bank of America and other big banks generated record-shattering profits in the second quarter, fueled in part by the AI boom. AI related firms are estimated to account for up to half of total U.S. corporate earnings growth so far this year.

AI IPO Surge

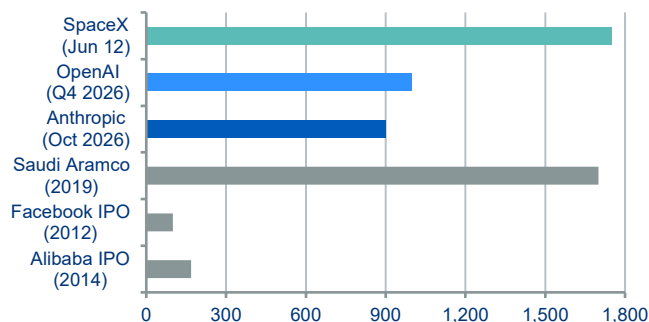
Near record high equity valuations and the need to finance ambitious capital expenditures have contributed to a surge in

IPO activity and secondary issuance by AI firms. SpaceX led the charge, setting the record for funds raised and IPO with the highest valuation. The company expanded its planned issuance of \$75 billion to \$86 billion to take advantage of strong investor interest. SpaceX was able to price its IPO at 94 times 2025 revenue for an initial valuation of \$1.75 trillion, notwithstanding negative earnings (Exhibit 3). At this valuation, the SpaceX IPO generated more exit value than all VC-backed IPOs of the past decade. SpaceX closed the quarter 26% above its IPO price, raising its market capitalization to \$2 trillion, making it the sixth largest U.S. company. It soon followed its IPO with the issuance of \$25 billion in bonds that, like its equity issuance, was also heavily oversubscribed. Anthropic and OpenAI are planning IPOs for later this year with target valuations of \$900 billion (40 times trailing revenue) and \$1 trillion (30 times trailing revenue), respectively (Exhibit 2). Neither has positive earnings. The only previous comparably sized new issue was Saudi Aramco's 2019 IPO which raised \$25.6 billion at a valuation of \$1.7 trillion, reflecting a trailing P/E ratio of about 18 times. Besides being highly profitable, Aramco was and remains the largest holder of oil reserves among global energy companies.

Exhibit 3

AI IPOs Set Valuation Records

Sources: CNBC and Pitchbook. Valuations in billions of U.S. dollars.



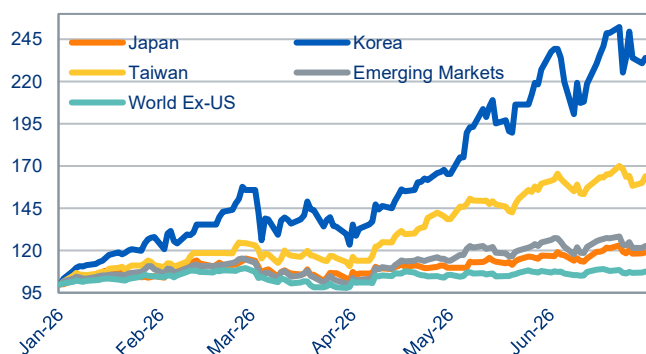
AI Chip Demand Boosts EM Equity Prices

Emerging equity markets are up 23.8% so far this year. Among emerging markets, Korean and Taiwanese markets have performed especially well, rising 133% and 63%, respectively in U.S. dollar terms so far this year thanks to the soaring stock prices of chip manufacturers (Exhibit 4).

Exhibit 4

AI Drives Emerging Equity's Strong Returns

Source: Bloomberg. Index January 2026 = 100.



The MSCI World ex-US index of advanced non-U.S. equities rose 10.2% in the second quarter and is up 9.2% so far this year (Exhibit 4). European and Japanese equity markets gained 7.8% and 15.8%, respectively, in the first half of 2026. The Japanese market's strong gains in both local currency and U.S. dollar terms stand in stark contrast to the depreciation of the yen, which fell to near 40-year lows in June. The combination of yields held artificially low by massive central bank bond purchases and a gross government debt ratio of 240% of GDP has contributed to yen weakness while also boosting the stock market.

New Fed Chair Takes the Helm

In its first meeting with Kevin Warsh as Chair, the FOMC left rates unchanged in June as widely expected. Warsh promised a renewed focus on price stability, less use of forward guidance as a tool of monetary policy, and a smaller Fed balance sheet. Of these initiatives, the most potentially consequential is the push to reduce the size of the Fed's balance sheet, which has grown to nearly \$7 trillion (21% of GDP) today from \$865 billion (6% of GDP) in 2007 prior to the Great Financial Crisis. Reduced central bank holdings of U.S. Treasuries means that other market participants must absorb rising government debt. Some of these have been highly leveraged hedge funds pursuing arbitrage strategies, a factor that has introduced a source of potential market instability.

Hedge Funds Post Positive Q2 Returns

The HFRX equal-weighted hedge fund index gained 4.2% in the second quarter and is up 3.3% so far in 2026. Equity hedge and convertible arbitrage strategies have led all others so far this year.

Modest Gains Across Property Types

Real estate, as measured by the NCREIF Open-End Diversified Core Equity Index (reported with a delay), rose 3.1% in the 12 months through March 2026. Retail and apartments remained the strongest performing property types. Industrial and office properties generated smaller positive returns. Retail properties benefited from strong demand and high occupancy rates. High home ownership costs are a key driver of apartment demand. Real estate yields have stabilized but remain below real 10-year U.S. Treasury yields.

AI Fuels Strong Venture Capital Returns

The Thomson Reuters/Cambridge Index (reported with a delay) was up 11.1% for the year ending December 2025. Venture capital (+21.1%) and growth equity (+11.9%) strategies outperformed buyout (+7.6%) over this one-year period. U.S. venture capital investment activity in the first quarter of 2026 hit a record of \$236 billion, double the level of Q4 2025, the previous record quarter. AI accounted for 80% of all venture investments in Q1 2026. Activity was highly concentrated, with four firms representing 75% of the total.

Outlook & Strategy

A Tale of Offsetting Shocks

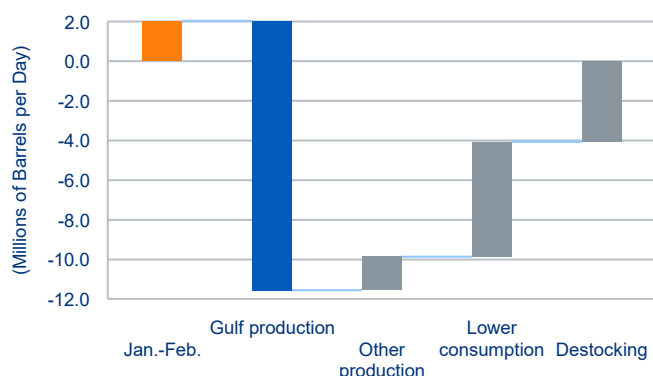
The global economy has proven itself to be resilient in the face of shocks. It adapted ably to widely vacillating U.S. tariff rates since they were initially raised in April of last year. Although the pass through from increased tariffs to consumer prices is still ongoing, the overall impact has been marginal, thanks to a retreat from the very high tariff levels originally announced and the redirection of global trade. More recently, the negative shock of the Iran war has so far been largely offset by a positive shock in the form of a boom in AI capital expenditure and asset prices.

The Iran war precipitated the largest ever negative energy supply shock, disrupting about 20% of global production of crude and refined products. The initial price spike caused by this loss of supply was moderated by a combination of increased production in other regions, demand destruction, and destocking (Exhibit 1). Demand destruction, especially across Asian consumers, was the prime shock absorber.

Exhibit 1

Global Oil Balances March-May vs. January-February

Sources: IEA and IMF. In the months preceding the war, global oil supplies were ample (orange bar). The sharp drop in Gulf production caused by the war (blue bar) was offset by increased production in other regions, demand destruction and destocking (gray bars).



Further offsetting the economic consequences of the war was the positive shock of the AI boom. The impact of the boom has been far reaching. AI has helped fuel rapid corporate earnings growth and a sharp increase in asset prices. The competition for AI dominance has unleashed massive capital expenditure. Large U.S. hyperscalers are projected to invest about \$1 trillion in 2027 (3.5% of GDP) up from \$166 billion (0.6% of GDP) in 2022. Moreover, the wealth effects of AI-supported asset price increases have fueled consumption, further increasing U.S. GDP growth and mitigating the negative shock of the war.

Risks to Continued Resilience

There are three main risks to continued economic and market resilience. The negative supply shock of the Iran war may grow more intense with renewed hostilities. The positive demand shock from AI may prove unsustainable and destabilizing. And record high global debt levels may amplify a downturn and limit the scope for countercyclical measures should they be needed.

An intensification of hostilities with Iran would lead to higher oil prices and increased demand destruction. The buffers that cushioned the initial price shock have been worn down. With spare productive capacity and the scope for further inventory drawdowns limited, renewed supply disruptions would have to be increasingly met by higher prices and demand destruction. A persistent energy shock would ultimately reverberate upstream, broadening already mounting inflationary pressures.

The sustainability of the AI boom is threatened by the sheer scale of the capital expenditure involved, its growing reliance on debt and off-balance sheet financing vehicles, and circular transactions in which hyperscalers take equity stakes in their customers in exchange for purchasing commitments. The opaque links underlying these circular and off-balance sheet financing arrangements increase the vulnerability of the AI boom to a self-reinforcing downward spiral.

Finally, the pace of global sovereign debt issuance and the stock of sovereign debt are at record levels. The U.S. government is running a large fiscal deficit, notwithstanding strong economic growth, at a time when its outstanding debt stock is already high. Issuance is being tilted toward shorter maturities, increasing rollover risk. Moreover, the liquidity of the U.S. Treasury market is increasingly reliant on hedge funds pursuing highly leveraged arbitrage strategies. These developments increase the vulnerability to shocks of the U.S. Treasury market, the bedrock on which all other asset markets depend, while also limiting the scope for fiscal intervention to dampen the impact of a broader economic or market crisis.

Adaptability and Momentum

While these risks are real and rising, whether and when they ultimately become destabilizing is an open question. The energy shocks of the Iran war and Russia's invasion of Ukraine as well as the recent erratic trade and tariff policies of the U.S. have shown that it never pays to underestimate the adaptability of markets. History also suggests that the positive momentum of the AI boom can persist notwithstanding stratospheric stock valuations, and increasingly creative circular financing arrangements and sources of debt. Finally, high and rising levels of sovereign debt, although unsustainable and potentially destabilizing, are ultimately a reflection of policy choices that are, albeit with some pain, reversible.

Focus on Resilience through Diversification

As just described, we are in the midst of an AI-fueled asset price boom that rests on increasingly shaky foundations. These conditions amplify the risks of top-down portfolio construction

while placing a premium on portfolio diversification across a wide number of independent streams of added value.

We thus continue to minimize top-down risk and aim to keep portfolios broadly neutral relative to asset class target weights. This approach rests on our belief that portfolios should be built from the bottom up using many highly diversified sources of potential value added. We do, however, maintain slight underweights to the most expensive market segments.

Public Equity Pricing and Positioning

The valuation of the U.S. equity market has been higher than at present only once in its long history and that was just prior to the bursting of the 2000-2001 dotcom bubble. Equity markets outside of the U.S. are also fully valued, although not nearly as stretched as in the U.S. market. Reflecting these highly divergent valuations, our allocation to public equities targets a benchmark weight structured as a slight underweight allocation to U.S. equities and an offsetting overweight to non-U.S. equity markets. Within the U.S. market, we have a slight underweight to the stocks included in the Magnificent 7, which are among the most highly valued.

We have built the public equity portfolio from the bottom up using a number of active investment strategies and themes. This approach aims to increase the scope for adding value through security selection, diversify the sources of portfolio return, and enhance the resilience of the portfolio.

Quantitative strategies comprise about one quarter of the portfolio. These strategies have the advantage of combining tight risk controls, a highly diversified set of risk factors, an ability to exploit numerous small inefficiencies, and deliver a relatively predictable distribution of outcomes.

We complement this core of quantitative strategies with more concentrated fundamental strategies employing a different skill set and featuring higher expected tracking error. We also include risk-controlled extension and portable alpha strategies in the portfolio as a means of introducing the possibility of adding value through short positions, thus expanding the scope for managers to apply their insight.

A relatively small segment of the public equity portfolio is devoted to niche strategies in key sectors. The U.S. equity portfolio includes allocations to the biotech sector, where we have found managers with highly specialized insights that can potentially add another layer of diversified added value. Although our U.S. equity portfolio maintains a neutral stance relative to value stocks, we do use a deep value manager to exploit opportunities in that market segment. Our non-U.S. equity portfolio includes a Japan specialist seeking to exploit structural changes in that market. We also use specialist managers to exploit the relatively inefficient and attractively valued small cap segment of advanced and emerging equity markets. Reflecting manager preferences, we are currently overweight non-U.S. small cap equities.

Fixed Income Barbell – Flexibility and Alpha

Our fixed income portfolios use a barbell structure that combines U.S. Treasury securities at one end of the barbell and niche credit manager and portable alpha strategies at the other. In our view, this structure is preferable to a core fixed income strategy because the barbell affords us flexibility in managing the duration, liquidity, and credit exposure of the fixed income portfolio. This structure also increases the scope for including niche active credit strategies in the portfolio. These include strategies seeking niche opportunities to add value across mortgage and other asset-backed securities, collateralized loan obligations, and the high yield sector.

Direct Lending and Opportunistic

We complement the public fixed income portfolio with direct lending and opportunistic investments in less liquid credit investments as well as distressed credit strategies. Our opportunistic investments include mortgage servicing strategies, healthcare focused investments, Italian real estate opportunities, trust preferred securities, and strategies focusing on private credit and collateralized loan obligations. These investments have higher expected returns than our public fixed-income investments, broaden the range of sources of value added, and provide a degree of diversification to the portfolio, albeit at the cost of lower liquidity.

Hedge Funds – High Alpha Low Beta

Our hedge fund portfolio comprises a balanced allocation across the full range of hedge fund strategies from equity hedge and equity market neutral to credit, macro, and multi-strategy funds. In structuring our hedge fund portfolio, our overarching aim is to minimize the portfolio's beta to broad equity and credit market factors. We design the portfolio such that the total portfolio minimizes market beta while encompassing highly diversified sources of potential alpha. This structure makes our hedge fund portfolio the ultimate diversifier. Moreover, a hedge fund portfolio whose return is mainly driven by alpha is an ideal building block for portable alpha strategies that we use in our public equity and fixed income portfolios.

Phased Move to Neutral in Real Estate

The real estate sector has repriced significantly. In view of these improved valuations, we are implementing a phased increase in our real estate allocation to a neutral stance. Our commitments have focused on both open-end and closed-end fund investments in the warehouse, retail, hotel, and residential sectors as well as core, value add and opportunistic strategies.

Private Equity Portfolio Construction

Our private equity portfolios combine buyout and growth equity funds at their core with smaller positions in more volatile venture capital investments. We focus on lower and middle market firms with solid earnings growth in the industrial, technology, and consumer sectors. In addition, the portfolio comprises co-investments with select managers.

Special Topic

What's Lurking in Your Index?

The historically high concentration of major stock indexes, changing rules governing index construction, and the unprecedented size of recent IPOs have sparked interest in the hidden and changing risks of widely used benchmark indexes. Passive investors now face increasing exposure to a narrow set of risk factors. Perhaps more worrisome, these exposures can change rapidly and in unpredictable ways as a result of sudden market swings, mega IPOs, and changes in the rules governing index construction.

Shifting underlying benchmark exposures can be especially problematic when they are rapid. Moreover, as index providers adopt different rules for index construction, the underlying composition and risk exposures of one large cap equity index can diverge significantly from another. In a period of shapeshifting markets and indexes, blindly accepting the underlying risks of a benchmark index seems increasingly untenable. As a result, investors, including those pursuing passive strategies, must develop an understanding of how the risk factors bundled in benchmarks evolve over time and how these exposures differ across benchmarks.

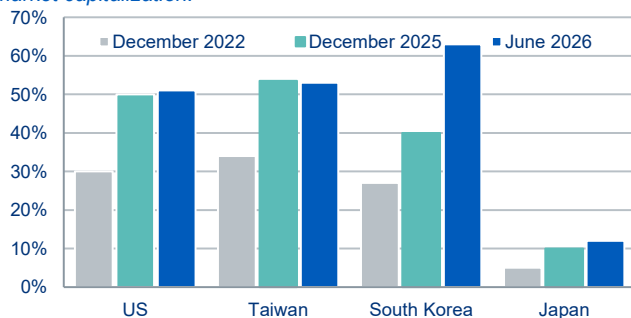
Varying Cycles of Benchmark Drift

The underlying exposures of benchmark market indexes evolve with the markets they represent. The tempo of this change can differ from cycle to cycle. For example, at the long end of the spectrum, the share of U.S. equities in the MSCI World Index has increased from about half in 2000 to nearly 75% today. This drift reflects a long period of U.S. equity market outperformance relative to other non-U.S. markets. As a consequence, the diversification benefits to U.S. based investors of investing in the MSCI World Index has declined over time. This is one reason why we advocate flexibility in strategic allocations across regions.

Exhibit 1

AI's Growing Impact on Equity Markets

Source: Bank of England. AI-related firms' percentage share of total market capitalization.



More recently, increasing concentration has been more rapid reflecting the explosive growth of mega cap tech stocks,

especially those related to AI. This is not simply a U.S. issue. Historically, passive investors in the MSCI Emerging Markets index sought exposure to industrialization and urbanization, while accepting significant commodity risk. Today, roughly 45% of the index's exposure is to technology. The top five firms in the index represent nearly 40% of overall market capitalization. AI-related firms are contributing to this trend (Exhibit 1).

Pursued passively, investing across regions may thus result in a concentrated tech exposure, rather than risk-reducing diversification. This is not an argument against regional diversification. Rather, it is a further illustration of why it is essential to understand the risk factors lurking in the hearts of indexes and use that knowledge to diversify portfolios across risk factors to boost portfolio resilience.

Mega IPOs and Benchmark Construction

The speed of benchmark drift can be accelerated by mega IPOs and changes in benchmark rules to accommodate the inclusion of these behemoths. As illustrated by the SpaceX IPO, the approach of different index providers to the inclusion of large IPOs in benchmark indexes has not been uniform. NASDAQ and Russell have accelerated the pace at which new IPOs can be included in benchmark indexes and eased limits on the weight of their representation. S&P, in contrast, has not changed its benchmark construction methodology.

Changes in benchmark construction unrelated to IPOs can also result in sudden significant swings in benchmark composition. For example, recent changes to the Russell 1000 Value index have boosted the share in the index of Amazon, Apple, and Microsoft to about 15% from 2% under the previous methodology.

Investment Implications

We believe that it is essential for investors, especially passive investors, to understand the changing underlying exposures embedded in different benchmark indexes. This understanding can provide the basis to answer key questions. Does a benchmark still reflect my risk and return preferences? Am I receiving the same diversification benefits that I had anticipated? Does the change in benchmark composition reflect the overvaluation of a market, sector, or industry? What are the implications of rapid increases in market concentration for systematic market risk?

From our vantage point as active investors, understanding how underlying market exposures and the composition of benchmark indexes have evolved is especially important for portfolio construction and risk management. This analysis is central to our evaluation of the strategies of active managers. This analysis is also critical in designing resilient portfolios by diversifying broadly across risk factors and thus avoiding unwanted concentration risk. In our view, passive investors who are unaware of the implications of shifts in the underlying exposures of benchmark indexes face unpleasant surprises.

Note: Opinions expressed herein are current as of the date appearing in this material and are subject to change at the sole discretion of Strategic. This document is not intended as a source of any specific investment recommendations.