INVESTMENT UPDATE
THIRD QUARTER 2026

Equity markets extended year-to-date gains in the third quarter, despite the ongoing war in the Middle East and rapidly rising interest rates. We continue to maintain a close eye on the economy and capital markets. In this issue, we share important updates on several of our investment themes.

EQUITY MARKETS POWERED BY AI

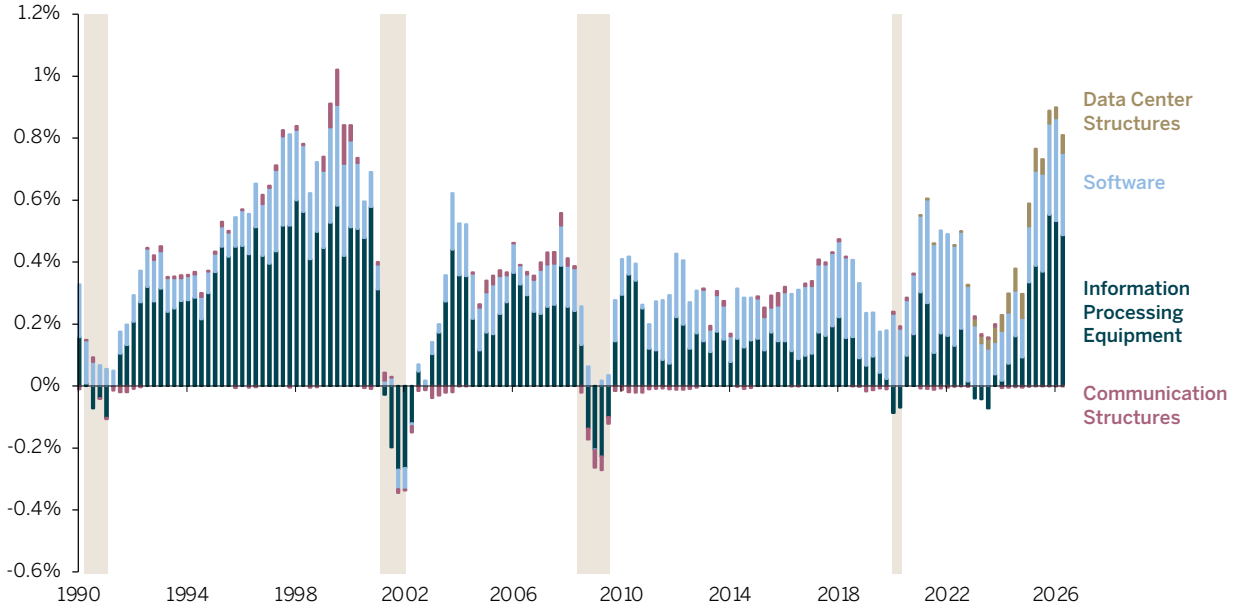
Global equity markets continued their ascent in the third quarter of 2026. The S&P 500 rose 2.3%, bringing its total return to 12.7% year to date. Similarly, the MSCI All Country World Index rose 1.7% in the quarter, generating a year-to-date total return of 13.4%. More notable action occurred in fixed income markets, with global interest rates rising. U.S. Treasury prices fell, with the yield on the 10-year ending the quarter at 5.29%, its highest level since 2007 and almost 10 times the record low it reached in 2020.

The resilience of global equity markets is remarkable. Stocks have risen despite the 2025 trade war, protracted conflict between Russia and Ukraine, a war in the Middle East that has partially closed the world's most important oil shipping lane and rising global bond yields.

Gains reflect exceptionally robust earnings growth, powered by the boom in capital spending on artificial intelligence (AI). In the U.S., capital spending growth on data centers is staggering. Non-residential private fixed investment has contributed more to real GDP growth than at any time since the Internet boom of the late 1990s, nearly three decades ago.

AI Capex is the Engine of U.S. Growth

Contribution of Non-Residential Private Fixed Investment to U.S. Real GDP Growth
January 1, 1990 – April 1, 2026



Note: Shaded areas denote NBER-designated recessions.
Source: BCA

AI-related spending has also had significant indirect impacts on the U.S. economy.

- This year's surge in company earnings and stock prices is buoying consumer spending. U.S. households currently hold $75 trillion in equities, equivalent to 230% of U.S. GDP. That's well above the $13 trillion, or 130% of GDP, that households owned as the Internet bubble peaked in early 2000.
- Major U.S. investment banks have told investors that almost half of their capital market activities, in both fixed income and equities, is at least tangentially related to AI.
- Construction companies, utilities powering new data centers and industrial equipment makers are also benefitting from the very high levels of capital spending.

As a result of this spending boom and its spillover effects, analysts are exceedingly optimistic about long-term earnings growth.

Analysts Have Never Been More Bullish

Expectations of Forward S&P 500 Earnings per Share Growth
February 2002 – September 2026



Source: FactSet

It appears that most analysts believe that the trillions of dollars being spent to build AI data centers will generate large enough profits in a short enough period of time to produce a large number of winners. But high expectations for earnings growth are not necessarily bullish indicators for future equity market returns. When expectations are high, the hurdle to beat them rises, increasing the risk of disappointment.

AI-related companies face a host of challenges. Public opposition to building data centers has soared, and even industry titans are advocating slower deployment, citing concerns about massive job losses and AI agents going rogue. AI and non-AI companies alike must now contend with higher interest rates as well as higher prices for oil and other commodities. Meanwhile, the tax and tariff refunds that boosted economic activity in the first half of the year are ending. It would not be surprising if earnings growth slows from today's extraordinarily high levels.

THEMATIC UPDATE

As we enter the fourth quarter, we are updating two of our newer investment themes where we see powerful secular changes underway. We are also pleased to share positive developments related to a third, longer-standing theme.

We introduced our *End of Disinflationary Tailwinds* theme in late 2020, when U.S. CPI was 1.3% and the price of oil was briefly *negative*. Since then, inflation soared to over 9%, retreated to 2.3% and then started to climb once again.

We added our *Opportunities Abound Abroad* theme in mid-2023, after the S&P 500 had outperformed the MSCI All Country World Index (ACWI) in 10 of the prior 14 years. The cumulative outperformance of the S&P 500 over that period was over 200%. Conversely, over the past two years, the MSCI ACWI has outperformed the S&P 500.

We are updating and renaming these themes to reflect our latest research and repositioning client portfolios for the consequential changes we foresee. With both the macroeconomic and geopolitical winds changing quickly, we would be surprised if we don't continue to refine these themes in the quarters ahead.

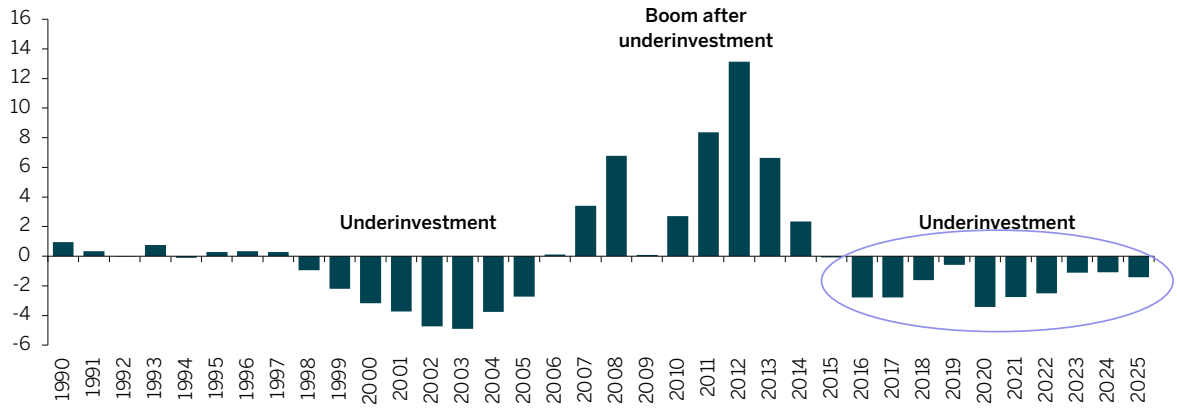
End of Disinflationary Tailwinds evolves into *Structural Supply Shortages*

Our *End of Disinflationary Tailwinds* theme rested on several pillars. Many of them have come to pass or are now widely expected and thus reflected in market valuations. But we believe one pillar--the sustained shortage of capital spending on commodities-related infrastructure--will provide durable investment opportunities for several more years.

Over the past 10 years there have been relatively low levels of investment in commodities infrastructure. Since mines and offshore oil and gas projects can take many years to build, we expect the investment shortfall to cause shortages that drive up prices for key commodities. At the same time, we foresee steady demand growth for materials. Geopolitical concerns and relatively easy financial conditions around the world are boosting demand for redundant supply chains, higher baseline inventory levels, increased defense spending and electricity infrastructure. All of these initiatives are commodity intensive.

Copper Exploration Budgets Appear Poised to Grow

Copper Exploration Budget Divided by PPI Index Relative to Trend
1990 – 2025



Source: S&P Global Market Intelligence, FRED, Chevy Chase Trust

Commodity prices are already elevated. Higher prices lead to higher levels of capital spending. We believe spending on extracting and processing commodities will increase significantly over the next five to ten years. We expect to add exposure to commodity producers and to other companies positioned to take advantage of these trends in the quarters to come.

Opportunities Abound Abroad becoming *Peaking Global Imbalances*

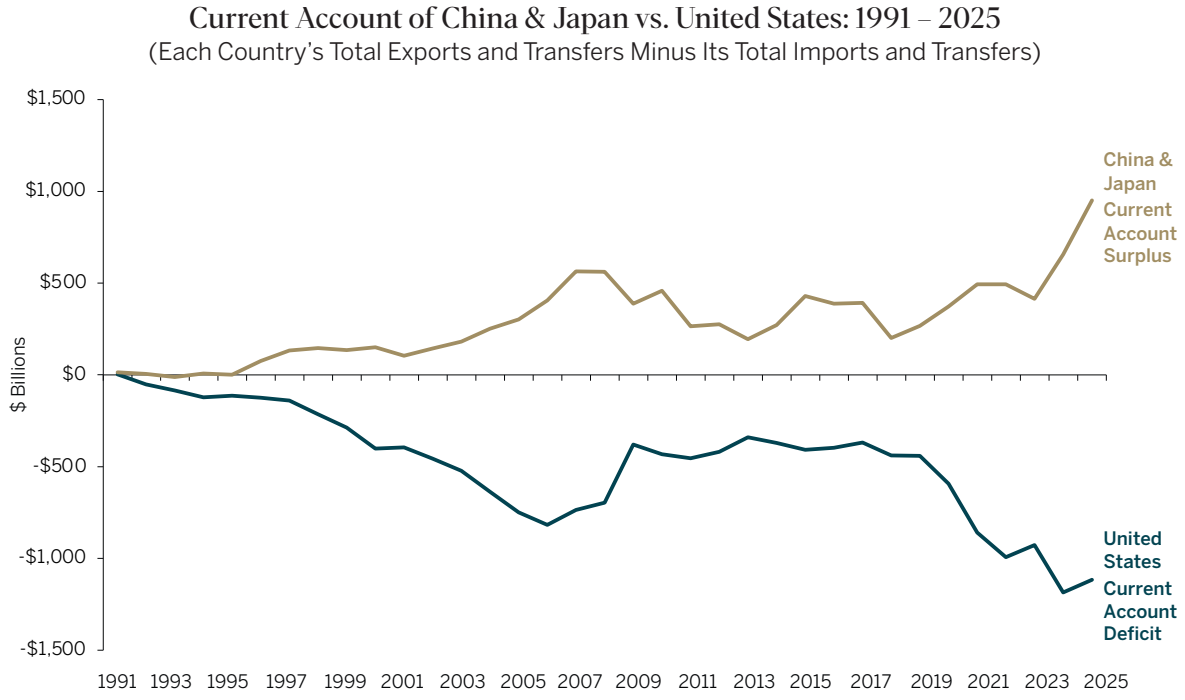
The global economy is a series of equilibria: global supply is equal to global demand, debt somewhere is equal to a surplus elsewhere, exports from one country are equal to imports in others.

Over the past 30 years, several of these equilibria have become extremely skewed by region, as many Asian countries, most notably China and Japan, enacted policies that favored producers by keeping exchange rates low, encouraging corporations to invest in export capacity and consumers to maintain high levels of savings.

These policies made goods produced elsewhere cheaper for Americans to consume. U.S. producers could not profitably compete with foreign-sourced products, and many closed or moved production abroad.

From 1991 through 2026, the U.S. current account deficit (the value of U.S. exports and transfers minus U.S. imports and transfers) ballooned from a small surplus to a deficit of almost $1.1 trillion per year. Conversely, the combined annual current account surplus of China and Japan mushroomed from $13 billion to $950 billion.

Asian Trade Surplus and U.S. Trade Deficit are Extended



Source: World Bank Group

A large share of the dollars that U.S. consumers and companies sent abroad to buy foreign goods and services came back to the U.S. through purchases of U.S. equities and bonds, including Treasuries. For many years, non-U.S. investors garnered strong returns on these assets. The rise in the U.S. dollar compared to their home currencies further amplified their gains.

For a long time, these relationships benefited both sides. China built an astonishing industrial base and moved millions of people out of poverty. Japan was able to maintain a strong industrial base, despite extremely slow domestic GDP growth.

Cheap imports kept U.S. inflation low, which reduced borrowing costs and enabled the U.S. to run massive fiscal deficits. American investors also saw their wealth surge, as money poured into U.S. capital markets. Concerns about the hollowing out of the U.S. industrial base were allayed by relatively low unemployment, and many policymakers viewed the benefits as outweighing the costs.

But the shift of production to the East and the overspending in the West went too far. Shipping disruptions during the Covid pandemic and critical mineral shortages highlighted that offshoring production had reached a point where many essential goods were no longer produced domestically.

Over the past few years, the world has awakened to the risks posed by enormous imbalances in global trade. At the recent meeting of G20 finance leaders, every country except China called on countries with persistent external trade deficits to increase domestic savings and consolidate their fiscal positions.

While these trends may not yet have reached a tipping point, there are clear signs that a critical juncture is approaching.

- The U.S. is adopting policies to encourage domestic production, including tariffs, last year's One Big Beautiful Bill Act (OBBBA) and the 2022 CHIPs Act.
- China is letting its currency, the renminbi, gradually appreciate, which will make its exports less attractively priced and imports more competitive.
- Japan is raising domestic interest rates for the first time in 31 years, which should help strengthen the yen.

Narrowing trade imbalances are likely to have widespread investment ramifications. Over time, we expect countries with large surpluses to spend more, save less and produce less. Conversely, countries with large deficits will likely spend less, save more and produce more. We expect to add exposure to companies likely to benefit from higher consumer spending in Asia and reduce exposure to companies overly reliant on rising U.S. consumer spending. A relatively weaker U.S. dollar may also eventually lead foreign investors to repatriate savings or look to other geographies and asset classes, such as gold, for their savings. In 2025, global central bank reserves held in gold surpassed foreign official holdings of U.S. Treasury securities.

Theme Update: *Advent of Molecular Medicine*

We would be remiss if we did not highlight truly astounding developments for our *Advent of Molecular Medicine* theme. During the third quarter, positive Phase 3 results were announced for the first-ever personalized cancer vaccine. Additionally, there were early indications that the FDA is likely to approve the first blood-based multi-cancer screening test, which uses genomic sequencing data to detect signs of cancer.

The central thesis of this theme, which we initiated more than a decade ago, is that the ability to read and understand genomic information would lead to medical breakthroughs. It is rewarding to see this coming to pass. We expect many more such developments in the coming years.

CONCLUSION

Throughout the first nine months of 2026, we believe we have navigated unpredictable geopolitical, economic and capital market shifts well, striking an appropriate balance between seizing opportunity and seeking protection. As always, we are grateful for the trust placed in us. We look forward to continuing to demonstrate that it is well placed.

SIGNIFICANT PORTFOLIO ACTIONS IN THE THIRD QUARTER

Itaú Unibanco S.A.

During 3Q26, we initiated a position in Brazilian bank Itaú Unibanco as part of our *Opportunities Abound Abroad* theme. We believe Brazil will benefit from the global commodity shortage given its agricultural exports, mining, and energy resources. Itaú is the largest banking institution in Brazil and would gain from GDP expansion. Furthermore, it is an operationally efficient enterprise and is attractively valued relative to U.S. peers, with room to improve through continued digitalization and personalization.

Sumitomo Mitsui Banking Corporation

During 3Q26, we exited our position in Japanese bank Sumitomo Mitsui Banking Corporation, which was part of our *Opportunities Abound Abroad* theme. The position had become relatively small, and we used the exit to add to another Japanese bank holding where we had more conviction, with a more attractive rate-sensitivity profile and similar exposure to Bank of Japan interest rate normalization.

BWX Technologies, Inc.

During 3Q26, we exited our position in BWX Technologies, Inc., a nuclear components and fuel company, which was part of our *Rise of Purpose-Built Tech* theme. While we will continue to evaluate advancements in commercial nuclear power, BWX faces potentially complex project-execution risks, and overall commitments to commercial nuclear development and use may progress more slowly. We may revisit the name in the future, but we are shifting our focus to higher-conviction, nearer-term ideas.

The Williams Companies, Inc.

During 3Q26, we exited a position in The Williams Companies, Inc., a natural gas processing and transportation company, which was part of the Balance portion of the portfolio. We used the sale to add to SLB, an oilfield services company in our *End of Disinflationary Tailwinds* theme. Williams trades at a higher multiple than its oil and gas peers and could face regulatory risks that add execution uncertainty.

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