SMITH AFFILIATED CAPITAL

February Investment Review 2026

Late-Cycle Recalibration

Overview

February marked a clear late-cycle recalibration in both economic data and financial markets. Growth is slowing, inflation remains above target, and policy flexibility is narrowing. The environment remains constructive, though increasingly differentiated.

Fourth-quarter GDP advanced at a 1.4% annualized pace, confirming deceleration without contraction. December retail sales, a month late due to the government shut-down, unexpectedly stalled MoM, while personal spending increased 0.4%, matching November's pace and personal income rose by 0.3%. Household savings decreased to 3.6% from 3.7% MoM, suggesting households are being more selective, favoring balance-sheet preservation over discretionary spending. At the same time, core inflation remains elevated and wage growth, while moderating from prior peaks, remains persistent. The combination of cooling growth and sticky services inflation constrains the Fed's ability to ease policy quickly.

Labor conditions present mixed signals. Payroll growth continues and unemployment remains near 4%, yet revisions to prior employment data suggest private payroll momentum may have been overstated. Weekly jobless claims remain stable but no longer improving. The labor market is stabilizing, not accelerating. This configuration is consistent with a maturing cycle rather than an abrupt downturn.

Markets responded in measured fashion. Treasury yields declined, credit spreads widened modestly, equity leadership narrowed, and precious metals advanced significantly. These moves reflect repricing and increased selectivity—not systemic stress.

Beneath headline returns, dispersion widened. Defensive exposures outperformed more cyclical segments, and quality bias reasserted itself across asset classes.

Macro Overview	Mo.%	YTD %	1Y %	10Y %	10YSTD
DJIA	0.31	2.12	13.59	13.79	15.06
S&P 500	(0.76)	0.67	16.96	15.37	15.00
NASDAQ	(3.33)	(2.39)	21.07	18.40	18.03
EM Equity	5.50	14.85	50.79	11.14	16.61
EM Bond	1.22	1.59	9.90	4.20	7.28
US Agg. Bond	1.64	1.75	6.26	1.98	5.05
Muni. Bond	1.25	2.20	4.96	2.43	5.19
US High Yield	0.19	0.67	7.07	6.61	7.35
Commodity	1.10	11.58	21.51	7.31	13.33
COMEX Silver	18.02	31.27	181.46	18.68	30.08
COMEX Gold	10.49	19.98	74.26	13.92	13.82
BRENT OIL	4.56	23.62	24.72	19.80	35.98
Dollar Index	0.64	0.73	(8.99)	(0.55)	6.57

Taxable Markets

Treasuries led income performance in February, returning 1.82% as yields declined across the curve. The 10-year Treasury yield fell below 4.0%, reflecting moderated growth expectations rather than front-end policy. The rally was reinforced by a risk-off tone that emerged alongside weakness in AI-sensitive equities. As capital-intensive growth sectors faced valuation reassessment, cross-asset flows rotated into long-duration Treasuries. Falling real yields and stabilizing inflation expectations supported the move.

The yield curve flattened as intermediate and longer maturities outperformed shorter tenors. At this stage of the cycle, flattening out the curve signals a recalibration consistent with moderation and increasing caution rather than contraction.

The U.S. Aggregate Bond Index returned 1.64%, driven largely by its Treasury exposure of 46% the index. Investment-grade corporates returned 1.29%, with spreads widening modestly. Dispersion is increasing across sectors facing refinancing needs, margin compression, or elevated leverage. Reflecting emerging stress tied to private credit dislocations and idiosyncratic defaults that could amplify volatility should financial conditions tighten.

Agency mortgage-backed securities outperformed corporates 1.67% versus 1.29%. The Agency MBS sector continues to provide attractive carry relative to incremental credit risk in the current environment.

In late-cycle environments, liquidity and balance-sheet strength regain importance. Duration once again serves as a stabilizing portfolio anchor.

Taxable	Price%	Cpn%	Mo.%	YTD%	Dur	Yield
Agg. Bond	1.32	0.30	1.64	1.75	5.88	4.16
US TSY	1.55	0.27	1.82	1.72	5.97	3.75
US Agency	0.79	0.31	1.11	1.23	3.25	3.83
Corporate	0.90	0.39	1.29	1.47	6.87	4.73
Tax. Muni	2.21	0.37	2.58	2.63	7.70	4.6
Agncy MBS	1.31	0.27	1.67	2.09	4.98	4.38
Gov/Credit	1.33	0.31	1.64	1.64	6.23	4.09
TIPs	1.21	0.10	1.31	1.62	4.78	3.86
AAA Corp	1.69	0.35	2.04	1.79	10.70	4.64
AA Corp	1.28	0.35	1.63	1.58	8.00	4.53
A Corp	0.94	0.38	1.31	1.44	6.87	4.59
BBB Corp	0.79	0.41	1.19	1.48	6.60	4.92

Tax-Exempt Markets

Municipal bonds delivered strong relative performance, returning 1.25% for the month and extending year-to-date gains to 2.20%. Technical conditions remained constructive despite elevated issuance.

New supply was absorbed efficiently, aided by steady reinvestment demand and continued fund inflows. Secondary trading volumes remained active, underscoring stable liquidity conditions and modest spread compression.

Performance favored maturity extension, with long-dated municipals outperforming shorter maturities. Tax-equivalent yields in longer bonds remain compelling for high-income investors seeking durable income. That said, selectivity remains important. Intermediate maturities currently offer an attractive balance between yield and duration risk without excessive exposure to curve volatility.

Credit fundamentals across the municipal landscape remain broadly stable. State fiscal conditions have moderated from post-pandemic peaks but continue to benefit from elevated fund balances and conservative budgeting practices. Rating actions have been balanced, and no broad deterioration in pension funding or liquidity metrics has emerged.

Tax collections are normalizing alongside slower economic growth, reinforcing the importance of issuer-level differentiation rather than broad sector concerns.

We continue to emphasize high-quality general obligation and essential-service revenue bonds, with careful attention to fiscal discipline and revenue resilience at the state and local level. Duration is positioned where compensation is most attractive relative to risk.

Tax-Exempt	Price %	Cpn %	Mo.%	YTD%	Dur	Yield
Muni Agg	0.88	0.37	1.25	2.20	6.66	3.29
1Y (1-2)	0.04	0.37	0.41	0.97	1.26	2.26
3Y (2-4)	0.26	0.36	0.62	1.40	2.32	2.34
5Y (4-6)	0.46	0.36	0.82	1.81	3.61	2.47
7Y (6-8)	0.67	0.35	1.02	2.11	4.76	2.66
10Y (8-12)	0.84	0.35	1.19	2.37	5.76	2.9
15Y (12-17)	0.99	0.35	1.35	2.66	7.09	3.37
30Y (22+)	1.28	0.39	1.67	2.18	11.31	4.42
AAA	0.94	0.36	1.30	2.21	6.94	3.14
AA	0.82	0.36	1.19	2.13	6.52	3.15
A	0.95	0.37	1.32	2.31	6.62	3.54
Gen. Oblig.	0.78	0.35	1.13	2.07	6.33	3.04
Revenue	0.93	0.37	1.30	2.25	6.83	3.4

Equity Markets

Equity markets experienced meaningful internal rotation. The Dow advanced modestly, while the S&P 500 and NASDAQ declined, reflecting pressure on large-cap growth and AI-linked exposures.

All seven “Magnificent Seven” stocks traded below their 50-day moving averages simultaneously for the first time in over two years—a development signaling reduced concentration leadership. The reassessment of capital intensity and valuation discipline within AI-sensitive sectors influenced not only equity performance but also cross-asset flows into fixed income.

Defensive sectors demonstrated relative resilience, while consumer discretionary and housing-related equities lagged amid softer confidence and margin pressures. Markets are redistributing risk rather than retreating broadly.

Elevated margin balances remain a risk factor, as periods of forced deleveraging can amplify volatility and push markets into oversold conditions even in the absence of fundamental deterioration.

Balance-sheet strength, pricing power, and earnings durability remain central to equity and credit positioning in a maturing cycle.

Precious Metals and Digital Assets

Precious metals delivered exceptional performance. Gold advanced 10.49%, bringing year-to-date gains near 20%, while silver rose 18.02%. Sustained central bank demand, fiscal uncertainty, and geopolitical tension continue to support structural allocation to gold as a portfolio diversifier.

Energy markets firmed through February amid rising geopolitical tensions, with crude prices drifting higher as traders priced potential Middle East supply disruptions. Oil reached multi-month highs late in the month as tensions between the United States, Israel, and Iran intensified, culminating in coordinated strikes on February 28. While the most pronounced price movements occurred after the month’s close, the escalation amplified forward supply concerns, particularly around shipments through the Strait of Hormuz.

Digital assets remained range-bound. Institutional participation and regulatory clarity continue to evolve gradually. Exposure remains measured and selective within diversified portfolios.

Outlook

February sharpened the late-cycle contours of this expansion. Growth is slowing toward trend. Inflation is easing but remains above target. Labor conditions are stabilizing beneath the surface. Consumer confidence remains fragile. The Federal Reserve’s flexibility is constrained, and policy calibration becomes more delicate as the cycle matures.

Markets are responding appropriately. Curve flattening reflects moderation in forward growth expectations, not systemic stress. Credit spreads remain contained, but dispersion is increasing — a signal that selectivity matters more at this stage of the cycle. Equity leadership is broadening as concentration risk is repriced. Precious metals provide structural diversification amid rising geopolitical tension. The recent escalation in the Middle East adds complexity, but it does not alter the underlying framework. Geopolitical events may drive volatility; they rarely redefine economic cycles on their own.

Our approach remains disciplined and deliberate. High-quality fixed income is the anchor. Curve positioning and income generation are central. Credit exposure must be intentional. Equity allocations emphasize durability over momentum. Late-cycle environments reward restraint, selectivity, and risk awareness. We remain positioned accordingly.