SMITH AFFILIATED CAPITAL

July Investment Review 2026

Letting the Market Lead

Overview

July confirmed what June had signaled: the Fed under Chair Warsh remains reluctant to ease, even as inflation showed tentative signs of cooling. The FOMC held rates steady for a second straight meeting on a 9-3 vote, with dissents from Lorie Logan, Beth Hammack, and Neel Kashkari — all favoring a hike. Warsh's press conference reinforced his preference to let markets, not Fed communication, do the work of tightening financial conditions. June's Personal Consumption Expenditures (PCE) data showed headline inflation cooling to roughly 3.7% year-over-year from 4.1% in May, with core near 3.3% — progress, though forecasters are split on whether it's a genuine turn or a pause. Worth noting: Truflation, a real-time inflation gauge that avoids PCE's lagging rent data, was running closer to 2% over the same period — about half the official rate — and Warsh has signaled interest in incorporating its methodology into how the Fed reads the data. A Bureau of Economic Analysis (BEA) methodology revision expected next month is projected to mechanically lower measured core PCE by roughly two-tenths of a point, an improvement that shouldn't be mistaken for a change in trend.

Growth remained resilient despite higher energy prices: Q2 GDP grew a preliminary 1.5%, with final sales to domestic purchasers up a stronger 3.1%, aided by AI-related capex. The AI investment cycle remained the economy's central growth engine and its most consequential risk — a tension that culminated in a forced hedge fund liquidation and a sharp, short-lived global selloff in chip stocks late in the month. Geopolitics resurfaced as a driver too: a surprise attack on a U.S. base in Jordan reignited hostilities around the Strait of Hormuz just as markets priced a durable reopening, sending oil higher and unsettling rates and credit.

Macro View	MTD (%)	YTD (%)	1Y (%)	10Y (%)	10Y STD (±)
DJIA	0.38	10.17	20.91	13.38	15.21
S&P 500	(0.06)	10.12	19.53	15.05	15.36
NASDAQ	(3.19)	9.53	20.87	18.32	18.71
Equity EM Mkts.	(3.03)	20.25	37.04	9.61	17.74
EM Bond Mkt.	(1.30)	0.70	5.65	3.15	7.25
US High Yield	(0.28)	1.58	5.04	5.39	7.16
Commodity	7.54	22.98	35.53	7.15	13.93
COMEX Silver	(3.60)	(20.34)	47.53	8.30	30.76
COMEX Gold	0.26	(9.23)	16.55	9.14	14.63
BRENT OIL	23.54	113.41	90.43	20.11	41.59
Dollar Index	(1.26)	1.62	(0.05)	4.59	6.50

Taxable Markets

Treasury yields moved sharply higher in a genuine bearish steepener: the 2-year rose 12 basis points (bps), the 5-year 22 bps, the 10-year 27 bps, and the 30-year 32 bps over the month. The 2s/10s spread widened nearly 15 bps to 44 bps, and the 1-to-30-year spread now stands at 120 bps. The 10-year climbed to 4.74% intramonth before closing at 4.71%, while the 30-year touched a 19-year high of 5.27% before closing at 5.25%, still only a third of a point above June's close near 4.93%.

The mechanics are telling: during the press conference itself, the 2-year yield fell while the 30-year jumped as much as 14 bps intraday; most of the further selloff came *after* the meeting, not during it. That points to the likely driver — with Warsh offering no forward guidance, markets understand the 2% commitment but not the path to it, and that ambiguity is being priced into term premium.

We used the volatility to reposition rather than retreat — trimming corporates where spreads had compressed and redeploying into technology and financials on sector-specific widening. We held duration near benchmark levels but shifted emphasis toward the intermediate curve, maintaining short Treasuries, TIPS, and short-duration Agency MBS as ballast, improving coupon, book yield, and liquidity — positioning that reflected our view that the multi-year 2s/10s flattening was due to shift toward steepening. That thesis played out, and we enter August prepared to benefit from further steepening.

US Fixed Income	Price	Cpn	Total Returns (%)		Dur	Yield
	(%) Rtn	(%) Rtn	Mo.	YTD	+/-	+/-
Agg. Bond	(1.65)	0.35	(1.30)	(0.69)	5.84	4.98
US Treasury	(1.42)	0.3	(1.11)	(0.84)	5.67	4.57
US Agency	(0.70)	0.34	(0.36)	0.25	3.37	4.59
Tax.Muni	(2.04)	0.38	(1.66)	(0.51)	7.45	5.32
Agency MBS	(1.82)	0.39	(1.42)	(0.45)	5.67	5.30
Gov/Credit	(1.63)	0.34	(1.29)	(0.80)	5.95	4.88
TIPs	(0.80)	0.12	(0.68)	0.46	4.83	4.66
Corporate	(2.07)	0.40	(1.67)	(0.83)	6.61	5.46
AAA Corp	(3.41)	0.36	(3.05)	(3.01)	10.23	5.35
AA Corp	(2.79)	0.38	(2.41)	(2.13)	7.57	5.35
A Corp	(1.98)	0.39	(1.59)	(0.88)	6.59	5.33
BBB Corp	(1.98)	0.42	(1.57)	(0.47)	6.34	5.62

Tax-Exempt Markets

Municipals underperformed Treasuries and the Aggregate by roughly 74 bps in July — a 1.8% monthly loss, driven largely by the broader Treasury selloff. The pressure was concentrated in the belly of the curve, where 7-to-15-year yields rose roughly 40 bps with spreads widening 10 bps. AAA bonds, the richest cohort, lost 2.0% while lower-investment-grade tiers held up better at -1.7%.

The silver lining: the correction restored real value. Muni/Treasury ratios moved back toward or above 90-day averages, with 20-to-30-year ratios near 80% — among the richest levels in five years — and taxable-equivalent yields on intermediate and long municipals are at their most attractive since 2008 heading into a heavy August reinvestment month (roughly $55–57 billion due back to investors). New issuance skewed toward specialty-state and essential-service credits, including a $2.37 billion debut from Connecticut's Aquarion Water Authority that required sizable concessions to clear.

We continue to position portfolios in the intermediate part of the curve with a target duration near 4 years versus 6.68 for the Aggregate Muni Index, adding call protection and favoring yields of 4% or better for tax-equivalent yields near 6% or more. California modestly outperformed New York for the month (-1.72% vs. -2.04%) and remains ahead year-to-date (0.55% vs. 0.18%), with New York weighed down in part by heavier new-issue supply. We're also watching heightened market concern tied to New York City Mayor Zohran Mamdani; we hold less than a 2% position in NYC general obligation bonds and don't anticipate adding to that exposure.

Municipal Market	Price	Cpn	Total Returns (%)		Dur	Yield
	(%) Rtn	(%) Rtn	Mo.	YTD	+/-	+/-
Muni Agg	(2.22)	0.37	(1.85)	0.43	6.68	3.93
1Y (1-2)	(0.43)	0.37	(0.05)	1.34	1.26	2.87
3Y (2-4)	(0.78)	0.37	(0.41)	0.74	2.32	2.91
5Y (4-6)	(1.25)	0.36	(0.89)	(0.10)	3.67	3.10
7Y (6-8)	(1.74)	0.36	(1.38)	(0.56)	4.99	3.52
10Y (8-12)	(2.24)	0.35	(1.88)	(0.81)	6.21	3.78
15Y (12-17)	(3.01)	0.36	(2.65)	(0.39)	7.57	4.13
30Y (22+)	(2.86)	0.39	(2.48)	1.43	10.69	4.72
AAA	(2.47)	0.36	(2.11)	(0.01)	6.91	3.79
AA	(2.19)	0.37	(1.82)	0.33	6.59	3.82
A	(2.13)	0.37	(1.76)	0.73	6.61	4.15
Gen. Oblig.	(2.24)	0.36	(1.89)	0.10	6.42	3.73
Revenue	(2.22)	0.37	(1.85)	0.55	6.81	4.01

Equity Markets

U.S. equities were volatile but essentially flat over the trailing three months, even as earnings strengthened considerably. Q2 season got off to a strong start — an 88% beat rate and +16.4% aggregate earnings surprise — with blended EPS growth tracking toward +24.7%. The Magnificent 7 are on pace for roughly +31% growth versus +23% for the "S&P 493."

Beneath the surface, semiconductors gave back sharply to software after outperforming by a record margin earlier in the year. Microsoft posted standout results, while Meta's disappointing guidance and shrinking free cash flow renewed AI capex scrutiny. Late in the month, forced liquidations at hedge fund Situational Awareness triggered a global chip-stock selloff — Kospi briefly fell over 20% before a Citadel rescue sparked a record rebound, a reminder of how much leverage remains embedded in the AI trade. With the index near 20x earnings, strong Q2 results remain the market's best case for valuation support into August.

Precious Metals

Gold remained volatile, capping a roughly 28% drawdown from its January high near $5,600. After opening July at $4,008.02, gold rallied to a monthly high of $4,167 before reversing sharply to a low of $3,992 by July 16 — a decline that lined up with hedge fund Situational Awareness's forced liquidation and the de-risking it triggered across markets more broadly. Gold then recovered into month-end, helped by a sharp dollar move in the final two sessions: after holding above $101 for most of July, the dollar fell to close the month at $99.914 as Japan and Korea moved to support their currencies against yen weakness. That late recovery lifted Comex Gold to a 0.26% gain for the month, snapping a streak of monthly losses, even as elevated real yields remained a persistent headwind, and central banks kept buying (an estimated 289 tonnes in Q2).

Views on gold's next leg are split: some see a repeat of the 2013 breakdown, while others point to continued central bank demand — JPMorgan sees $6,000, Deutsche Bank $4,700 by year-end. Among the signals we watch, one is the rising cost of insuring euro-denominated U.S. debt against default, which has climbed to levels historically associated with stronger gold performance. We maintain a small, large-cap miner allocation on this and other supportive signals, given wide margins and valuations that still lag fundamentals.

Outlook

August is a heavy reinvestment month across taxable and municipal markets, and with yields at multi-year highs, that money can be redeployed at attractive levels. August is also a new UST refunding month worth watching for technical effects.

On policy, the one confirmed event is Chair Warsh's Jackson Hole appearance; until then, expect continued sparring from the three dissenting governors. This Fed has less room to maneuver than past hawkish regimes: federal debt has risen from roughly 31% of GDP in the Volcker era to about 120% today, with interest now consuming ~21% of tax receipts versus ~10% then — a structural constraint on how aggressively any chair can tighten. Geopolitically, attention may shift from the Strait of Hormuz toward Russia/Ukraine, while approaching midterms raise the odds of political pressure on energy prices amid an already heated domestic political environment.

Finally, two episodes are reminders that leverage and infrastructure risk can surface with little warning: Citadel's rescue of Situational Awareness, and a coordinated cyberattack — possibly linked to Iran — on more than 30 municipal water systems in Minnesota. We enter August constructive on valuations but watchful of risks that may not be fully visible until they surface.

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