

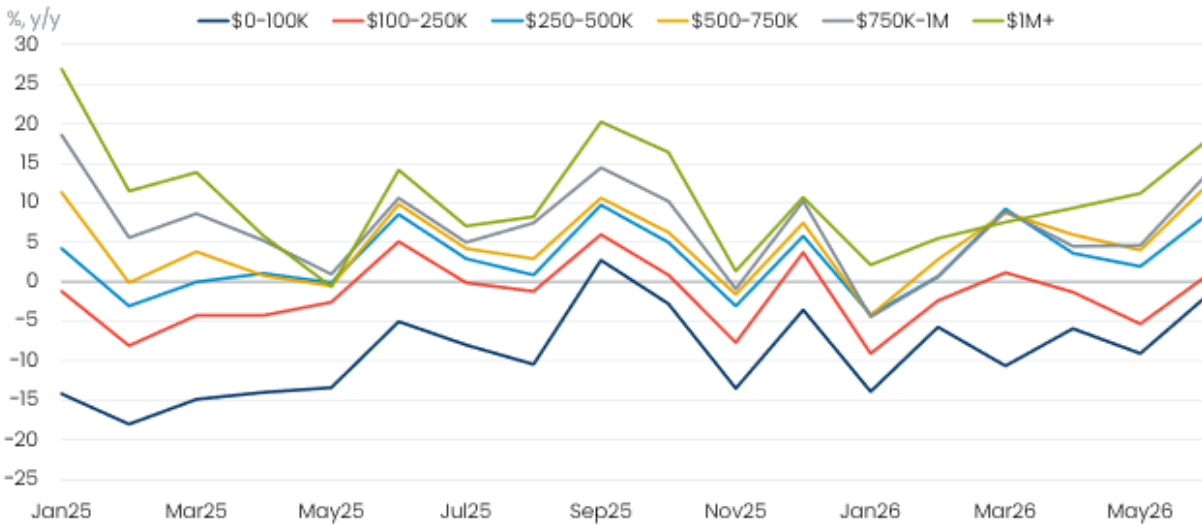
Like a pesky neighbor, the US/Iran conflict continues to command unwelcome attention, capturing headlines and bedeviling forecasters striving to look through external shocks. Just as it seemed the energy-induced inflation surge was behind us thanks to the MOU struck in mid-June, hostilities are flaring up again, and so too are oil prices. To be sure, the rise so far has been relatively tame, with crude prices up less than \$3/barrel over the past week; at just above \$71 on Friday, prices are still well below the \$112 peak reached in April, almost double the prewar level. Still, prices at the pump are creeping up again, snuffing out the relief that motorists were feeling a few weeks ago when gas prices started to follow the steep decline in crude prices.

Despite the dispiriting turn of events on the geopolitical front, the financial markets have not been thrown into turmoil, largely due to the widespread belief that a truce will be restored before hostilities get out of hand. Market yields have increased, as the war has rekindled inflation fears as well as bets that the Fed will raise interest rates this year. Still, the 10-year Treasury yield, at 4.56 percent on Friday, has not climbed back to the 4.67 percent peak set in May.

Meanwhile, the stock market continues to forge ahead, hitting new highs this week after staging an eye-opening 15 percent gain in the first quarter. Traders are more wrapped up with the enigma surrounding tech stocks and what the future holds for AI than the outcome of the Mideast imbroglio. That said, if bond yields continue to climb, stock investors will take notice and in time-honored fashion turn risk averse. Paradoxically, a sharp increase in bond yields might be the most effective catalyst leading to a ceasefire, as President Trump has demonstrated a deep aversion to such an event.

Importantly, the contrasting moves in stock and bond prices continue to amplify the bifurcation of the U.S. economy. The 15 percent increase in stock prices last quarter added some \$9 trillion wealth to shareholders, most of which accrue to upper income households. This cohort is the main driving force behind consumer spending, with the wealth effect supporting discretionary purchases, including big-ticket goods and services. It also shows up vividly in the mostly stagnant housing market, where moribund overall sales are being propped up by transactions in more expensive properties. Sales of homes costing at least \$1 million are growing much faster than cheaper homes, which are not only out of reach for struggling first-time homebuyers, but are also in short supply.

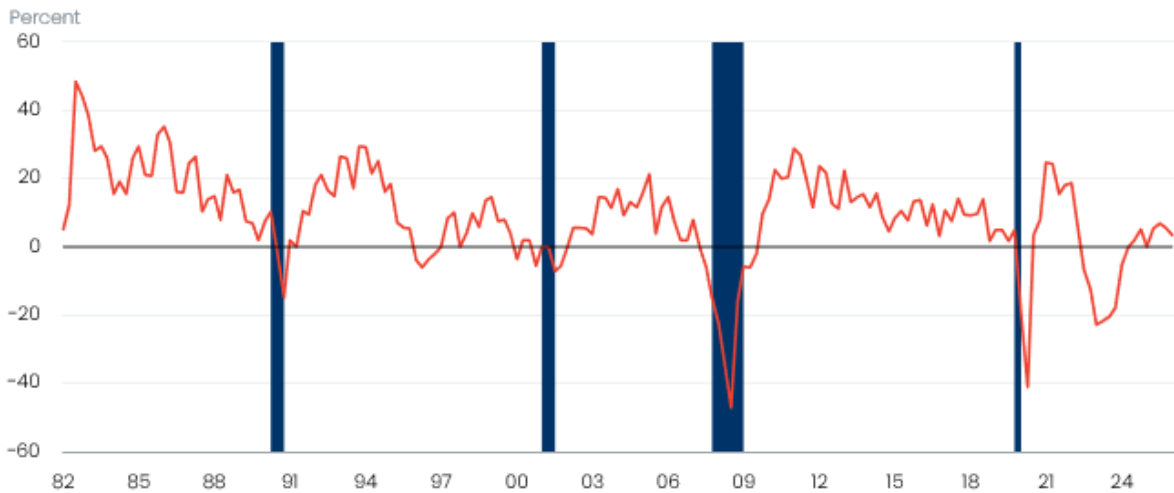
US: Change in existing home sales by price bucket



Just as wealth-boosting gains in stock prices add muscle to the purchasing power of wealthier households, higher interest rates do the opposite for low and middle-income consumers. These households have depleted savings, and many rely on borrowing to sustain living standards, much less making discretionary purchases. The affordability constraints are evident in the housing market, where mortgage rates remain stubbornly above 6 percent and prices on existing homes reached another record high last month.

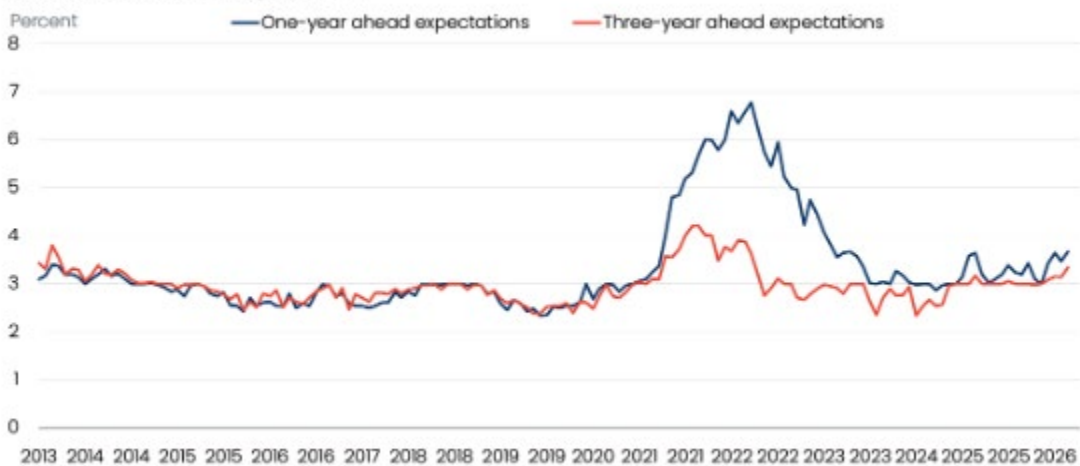
But for day-to-day purchases, these households rely heavily on credit cards, where rates are at nosebleed levels of over 20 percent. Last month saw a \$5.3 billion paydown of revolving credit (mostly credit cards), the first decline since last November. We suspect that a chunk of that paydown was made with tax refunds aimed at reducing some of the huge credit card borrowing undertaken over the previous two months. However, it may not be just high rates that discourage borrowing going forward. With delinquencies perking up and wage growth slowing, lenders are also becoming less willing to extend credit card loans, according to the Fed's latest Survey of Senior Bank Lending Officers.

US: Net % of domestic banks reporting increased willingness to make consumer installment loans



The jury is still out as to the next move by the Fed. With forward guidance now off the table, market bets are becoming more volatile, depending on the ebb and flow of incoming data and, of course, developments on the geopolitical front. From our lens, the data will determine what the Fed does, and we still believe the next move will be for a cut, although we pushed back the trigger to later in 2027. We note, however, that the Fed is keenly sensitive to inflationary expectations and some warning signs are flashing. The latest New York Fed survey of consumer expectations showed a meaningful uptick in one-and-three year ahead inflation expectations among households in June, although the longer-term 5-year outlook remained stable. This pattern is mirrored in the bond market, where short-term breakeven rates are rising and the yield on the 10-year TIPS hit the highest level since January 2025.

US: Household inflation expectations



However, we believe that hotter inflation forecasts revealed in surveys, market pricing and the Federal Reserve's dot plots, are overblown. The disinflation process, interrupted by tariffs and the Mideast war, has stalled, pointing to elevated inflation until the effects of those shocks and their knock-on effects wear off. That may not fully play out until well into next year. But stronger productivity growth is in the early stages and should gather momentum as adoption of technology spreads and becomes more broadly cost effective. Meanwhile, labor conditions should not be a source of inflationary pressures, as wage growth is slowing amid a balanced labor market. What's more, with inflation outpacing wage growth, consumers are becoming more resistant to higher prices; this is already showing up in purchasing behavior as consumers are trading down to cheaper products when possible. We expect the disinflation process to resume later this year and into 2027, setting the stage for the Fed to cut rates heading into the fall.

FINANCIAL INDICATORS

INTEREST RATES	July 10	Week Ago	Month Ago	Year Ago
3-month Treasury bill	3.79	3.76	3.71	4.34
6-month Treasury bill	3.96	3.93	3.80	4.27
2-year Treasury note	4.21	4.18	4.10	3.90
5-year Treasury note	4.31	4.25	4.22	3.98
10-year Treasury note	4.56	4.49	4.49	4.42
30-year Treasury bond	5.06	4.98	4.97	4.96
30-year fixed mortgage rate	6.49	6.43	6.52	6.72
15-year fixed mortgage rate	5.82	5.79	5.84	5.86

STOCK MARKET				
Dow Jones Industrial Index	52,637.01	52,900.07	51,202.26	44,371.00
S&P 500	7,575.39	7,483.24	7,431.46	6,259.75
NASDAQ	26,281.61	25,832.67	25,888.84	20,585.53

COMMODITIES				
Gold (\$ per troy ounce)	4,120.10	4,135.5	4,233.0	3,370.9
Oil (\$ per barrel) - Crude Futures (WTI)	71.51	68.46	84.41	68.65

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Services Index (June)	54.0	54.5	53.6	54.3
Consumer Credit (May) - \$blns	0.2	20.8	22.8	11.7
Existing Home Sales (June) mlns	4.1	4.2	4.0	4.1

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