Midland Wealth Management

QUARTER 2

MARKET OUTLOOK

AT A GLANCE

Markets have remained resilient year-to-date despite rising geopolitical tensions, inflation uncertainty, and shifting interest rate expectations. A more fragmented global backdrop, higher rates, and fiscal pressures are contributing to increased volatility and uneven performance across asset classes.

Diversification has played a critical role, helping stabilize returns as leadership broadens beyond mega-cap equities and traditional fixed income faces new challenges. At the same time, dislocations in areas such as private credit and emerging markets are creating selective opportunities for long-term investors.

FIXED INCOME

Higher rates, inflation uncertainty, and rising government debt are increasing volatility, reducing bond diversification benefits, and creating selective opportunities in emerging markets.

ECONOMY

Global fragmentation and supply chain fragility are increasing volatility, reshaping growth expectations, and driving more uneven returns across regions, sectors, and asset classes.

PRIVATE MARKETS

Private credit concerns may be overstated; while less liquid, fundamentals remain stable and recent volatility is creating longer-term investment opportunities.

"SHIFTING MARKET DYNAMICS CONTINUE TO CREATE BOTH CHALLENGES AND OPPORTUNITIES. OUR APPROACH EMPHASIZES DISCIPLINE, BROAD MARKET PERSPECTIVE, AND THOUGHTFUL RISK MANAGEMENT TO HELP KEEP PORTFOLIOS ALIGNED WITH CLIENTS' EVOLVING OBJECTIVES AND UNCOVER OPPORTUNITIES THAT MAY ENHANCE PORTFOLIO PERFORMANCE."

Nicholas Hinkebein, CFA, CFP®
Senior Portfolio Manager

GEOPOLITICS & A MULTIPOLAR WORLD

SUMMARY:

Geopolitical tensions and conflict have introduced a distinct risk that could disrupt energy markets and create a supply-driven economic shock. It is still too early to know how materially global growth will be affected, but it is a risk we are monitoring closely.

OUR PERSPECTIVE:

The COVID-19 pandemic and the subsequent conflict between Russia and Ukraine exposed how fragile global supply chains can become during periods of stress. Those disruptions also spawned a wave of commentary around "onshoring," "nearshoring," and "friendshoring" as ways to improve resilience in critical industrial supply chains.

Those ideas look increasingly well-timed. Heading into 2026, our team identified a broadening of domestic earnings expectations as a key theme, alongside potential labor headwinds as AI tools proliferate across Corporate America.

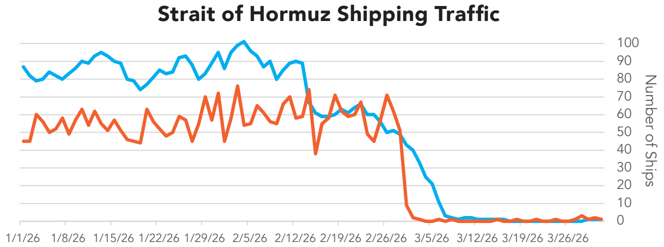
Globally, our focus has been on the reshuffling of power and resources and what that implies for government budgets and market stability. That theme has moved to the forefront following the recent conflict in the Middle East, which has produced an unexpected energy supply shock. It forces us to reassess our initial expectations for 2026 growth, the downstream impact on consumption and borrowing, and the implications for funding markets, particularly as technology firms issue more debt to support AI-related capital expenditures.

ANOTHER MIDEAST WAR

When clients ask what our Investment Team's role is, our answer is usually simple: risk manager first, return seeker second. That mindset shapes how we approach market outlooks and how we set expectations.

In late February, the U.S. government, alongside Israel and Gulf allies, attacked Iran during nuclear negotiations. Iran responded with missile strikes across the region and closed the Strait of Hormuz, a highly sensitive chokepoint through which roughly 20% of the world's oil flows.

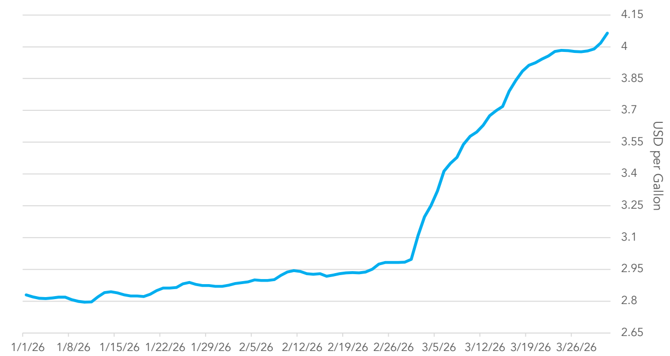
Strait of Hormuz Shipping Traffic



Source: Bloomberg LP

The U.S. is energy independent in the sense that we produce more energy than we consume. That does not mean the U.S. is insulated from higher oil and natural gas prices. Supply disruptions still translate into higher prices at the pump, and if those prices remain elevated long enough, they can begin to change household consumption behavior.

Average Price of Gasoline in the U.S.

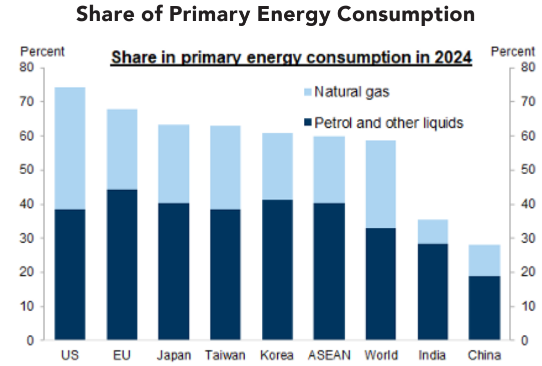


Source: Bloomberg LP

Wells Fargo's economics team estimates that a sustained 50% increase in oil prices would reduce the average annual growth rate of inflation-adjusted personal consumption expenditures (PCE) by U.S. consumers by roughly one percentage point. Goldman Sachs arrives at a similar conclusion, estimating that headline PCE inflation could rise to 3.1% in its base case, while GDP growth slips modestly to 2.1% in 2026. Those forecasts assume supply disruptions last roughly six weeks—yet at the moment, the parties to the conflict appear far apart on demands.

If energy prices stay elevated, they could absorb much of what would otherwise have been a household tailwind from provisions of the One Big Beautiful Bill (OBBB) Act. In that scenario, we would likely become more cautious on domestic growth expectations.

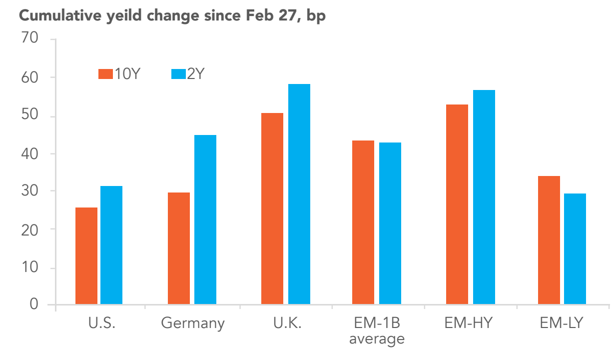
Share of Primary Energy Consumption



Source: EIA, Goldman Sachs GIR

A prolonged conflict that keeps oil prices higher would likely be felt more acutely outside the U.S., particularly in the European Union, Japan, and South Korea, which import a significant portion of their energy and operate export-heavy economies. Those effects can also feed back into the U.S. through higher goods prices, keeping interest rates higher for longer and slowing progress toward additional easing by the Fed (and other global central banks). We will have more to say on this transmission mechanism and its implications for the economy and funding markets in the next section. For now, there is simply too much uncertainty and volatility to speak with precision.

Cumulative Change in Yields



Source: Bloomberg LP; Goldman Sachs GIR

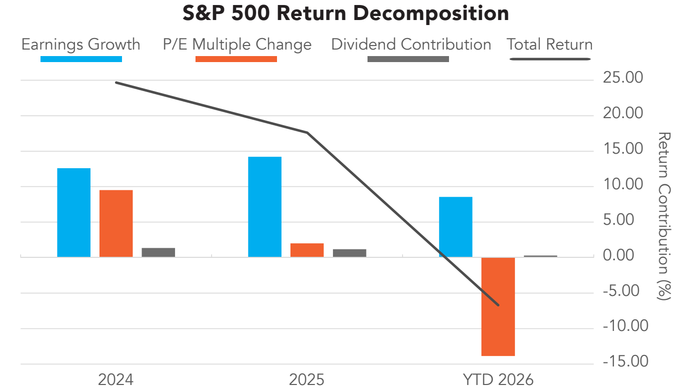
AI IMPLEMENTATION AND VALUATIONS

While the Middle East conflict deserves the bulk of the discussion this quarter, we would be remiss not to address the ongoing evolution of AI and what it may mean for productivity as more firms begin implementing these tools.

The strongest evidence today points to measurable, task-level productivity gains, but not yet a broad, economy-wide step change in profits. In late 2024, the Organization for Economic Co-operation and Development (OECD) surveyed 5,000 small and mid-sized enterprises (SMEs) across Austria, Canada, Germany, Ireland, Japan, Korea, and the United Kingdom. It found that 31% of SMEs were using generative AI (likely higher today), and 65% reported improved employee performance. In the U.S., Stanford University's AI Index reports that 78% of organizations used AI in 2024, up from 55% the year prior.

At the market level, momentum may be shifting away from the hyperscaler firms that led performance in 2024–2025 and toward small and mid-sized companies that can grow earnings faster as AI adoption improves productivity. At the same time, many firms are increasingly relying on debt markets to fund these infrastructure investments, potentially pushing costs forward and truncating future earnings growth.

S&P 500 Return Decomposition

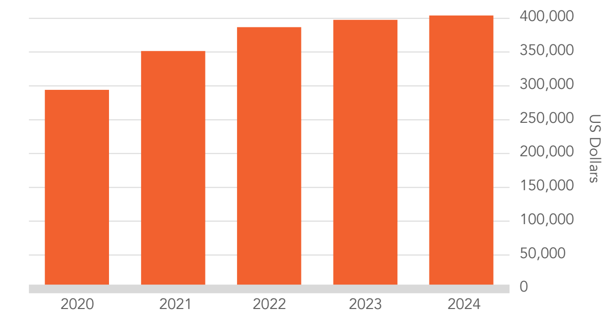


Source: Bloomberg LP

The chart preceding shows a clear shift: the S&P 500's gains have become less about investors "paying up" for the biggest companies (which now represent roughly 30–35% of the index) and more dependent on underlying earnings delivering. In 2026, that valuation tailwind faded and is now a headwind. By contrast, productivity, measured here as revenue per employee, has been improving among smaller U.S. companies, as represented by the Russell 2000

Index, particularly since 2022 (though it is still early given incomplete annual reporting).

Russell 2000 Revenue per Employee



Source: Bloomberg LP

If earnings expectations remain resilient, small- and mid-cap equities may offer better value than large-caps did a year ago. If earnings are revised meaningfully lower, the asset class risks becoming a "value trap." That's why we are focused not just on valuation, but on the credibility of forward fundamentals.

As a reminder, the team recently initiated a portfolio rebalancing to reduce exposure to large-cap U.S. equities and take advantage of more favorable valuations in real estate, as well as a constructive fiscal backdrop in select emerging markets, accessed primarily through the bond market.

CONCLUDING THOUGHTS

The shift from a unipolar, U.S.-dominated world toward a bipolar or increasingly multipolar one is rooted in a simple realization: during periods of global stress, supply chains become too complex and brittle. Geopolitical competition has only reinforced that fragility.

Classical economics teaches that specialization and trade, when friction is low, can make all parties better off. But today's geopolitical environment introduces more frequent disruptions, and therefore more volatility in growth and returns.

In this context, our priorities remain the same: risk management, sensible return objectives, and an emphasis on safety—while staying prepared to take advantage of opportunities as they emerge, both in the U.S. and abroad.

By Emil Suqi, CFA
Portfolio Manager - Team Lead

FIXED INCOME

RISING RATES & EMERGING OPPORTUNITY

SUMMARY:

Markets have repriced the easing path as inflation sensitivity rises alongside fiscal pressure and uncertainty around the Fed's reaction function. The result is a higher-rate, higher-volatility environment, creating relative opportunities in segments with cleaner fundamentals, including select emerging markets.

OUR PERSPECTIVE:

Coming into 2026, fixed income markets priced an easing glide path that extended through 2027. Inflation remained above the Fed's 2% target, but the prevailing view was that disinflation would continue, allowing policy to gradually normalize.

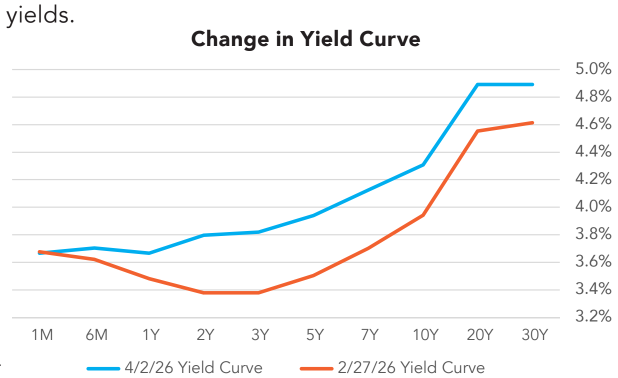
That framing was challenged in Q1. Supply-side inflation risk, policy credibility risks, and fiscal-driven term premium now push investors to reassess not just when cuts arrive, but the level at which long-term rates ultimately settle.

Put simply, the rate story has become less about "when the Fed cuts" and more about how much compensation investors need to hold debt in a world where supply, credibility, and inflation volatility matter again.

IRAN WAR AND ENERGY SHOCK

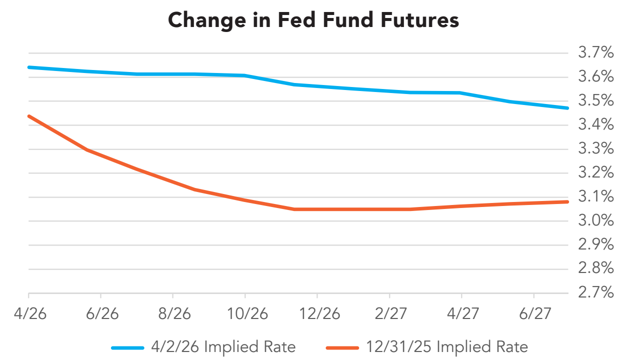
The most immediate variable is the conflict involving Iran and its spillover into energy logistics. The International Energy Agency has described the disruption as among the most severe supply shocks in modern oil markets. With traffic through the Strait of Hormuz (an artery for roughly a fifth of global oil flows) constrained, energy and shipping costs have moved higher, and volatility has increased. Even with a quick resolution, disruptions to routing, insurance, and infrastructure can keep a risk premium embedded in prices for some time.

Energy is not the dominant weight in CPI or PCE, but it is a core input cost—arriving as businesses already navigate tariff-driven uncertainty. That combination matters. Higher energy costs can re-accelerate headline inflation and slow the descent of core inflation, keeping upward pressure on yields.



Source: Bloomberg LP

Supply shocks are the hard case for the Fed because its tools primarily influence demand. In that environment, "data-dependent" often becomes "wait-and-see," and markets tend to do the repricing first—pushing volatility into rates and into Fed Funds expectations.



Source: Bloomberg LP

Energy is the near-term catalyst. The next question is whether markets can continue to anchor inflation expectations if credibility around policy becomes less stable.

FEDERAL RESERVE INDEPENDENCE

A second layer is policy credibility. Recent legal developments involving Federal Reserve Chair Jerome Powell and delays in the confirmation process for Kevin Warsh introduce the possibility that leadership uncertainty extends into the summer.

For markets, this matters less as politics and more as inflation psychology and reaction function. If credibility is perceived as weakening, investors demand a higher inflation risk premium. In other words, the risk isn't just higher inflation; it's less confidence in how inflation will be managed. That tends to show up as higher and more volatile long rates.

But even if credibility concerns fade, the structural pressure point remains: Treasury supply. That's where term premium becomes the transmission mechanism.

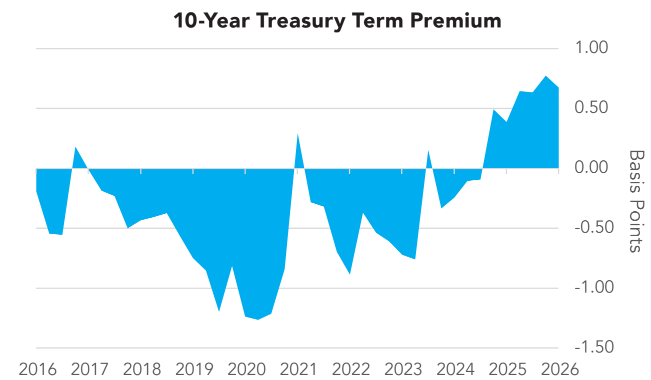
FISCAL DOMINANCE AND TERM PREMIUM

Beyond inflation dynamics, fiscal math is increasingly pressuring rates higher. The One Big Beautiful Bill Act has extended tax cuts, and 2026 is the first full year of revenue impacts, implying heavier Treasury issuance. Layer on tariff rebates and the uncertain cost and duration of the Iran conflict, and borrowing needs may rise further.

At the same time, higher interest rates feed back into the long-term fiscal outlook through debt service. Rising servicing costs widen deficits, which require more issuance, which can keep yields elevated. This is fiscal dominance in practice: deficits and financing needs begin to shape the curve even as growth slows.

That combination—more supply, greater inflation sensitivity, and more questions about credibility—shows up in the term premium, the extra compensation investors require to hold long-duration Treasuries. Term premium was suppressed for years by balance sheet expansion. With the Fed now shrinking its balance sheet through Treasury runoff, it is no longer a large, price-insensitive buyer.

Private investors must absorb rising issuance amid an uncertain macro and fiscal backdrop and are demanding higher yields to do so. The practical effect is a higher-rate, higher-volatility regime where the "free" downside protection investors came to expect from duration may be less reliable.



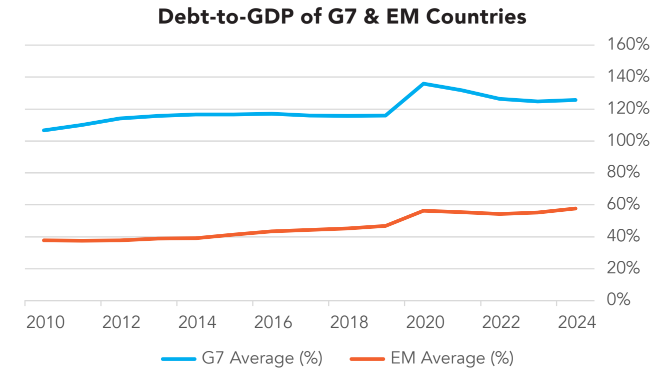
Source: Bloomberg LP

When term premium rises, diversification inside fixed income becomes more valuable—not just across issuers, but across fiscal regimes, inflation paths, and currency dynamics.

PORTFOLIO IMPLICATIONS

While the focus of this piece has been the U.S., similar dynamics are playing out across developed market (DM) economies, such as much of Europe and Japan. Heavier issuance and renewed inflation sensitivity can keep yields elevated and contribute to rate volatility. In this environment, core fixed income can still provide income and act as a ballast, but it may deliver less "crisis insurance" than investors are used to if term premium continues to rise, reinforcing the case for diversification within fixed income.

This makes a strong case for including emerging market (EM) fixed income. Beyond attractive yields, many EM economies exhibit several contrasting characteristics relative to developed markets, creating a compelling opportunity. In aggregate, EM countries tend to have lower debt burdens and comparatively healthier fiscal positions than their DM peers.



Source: Bloomberg LP

Many of these economies also have higher long-term growth potential, supporting tax revenues and debt sustainability over time. Currency dynamics also play an important role. While higher U.S. rates may support the dollar in the near term, persistent deficits and rising term premium can increase dollar volatility over time. In contrast, many EM central banks are further along in disinflation and easing, creating a more supportive environment for select EM currencies and potentially enhancing returns through currency appreciation.

Taken together, EM debt offers a mix of carry, potential capital appreciation, and diversification, particularly in countries with credible policy frameworks and stronger fiscal positions. As referenced in the Global Economy article, the Investment Team has recently established a position in EM debt within the public markets fixed income sleeve of our core strategies.

By Nicholas Hinkebein, CFA, CFP®
Senior Portfolio Manager

MEET OUR INVESTMENT TEAM

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Chief Investment Officer

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Portfolio Manager

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Portfolio Implementation Analyst

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Portfolio Implementation Analyst

THE PRICE OF (IL)LIQUIDITY

SUMMARY:

Recent concerns in private credit mostly reflect liquidity constraints and investor behavior around them. Underlying fundamentals remain generally stable as default rates normalize and institutional participation continues.

OUR PERSPECTIVE:

We view private markets as long-duration allocations by design. Periodic dislocations can create opportunities for disciplined investors who understand (and can live with) the structure.

STRUCTURE, EXPECTATIONS, AND MISCONCEPTIONS

It's been hard to miss the recent wave of headlines around private credit. Most of the concern clusters around two themes: limits on investor withdrawals (gating) and questions about underlying credit quality. Rising scrutiny around defaults and the durability of certain business models has pushed some investors to reassess the asset class more broadly.

But it's worth separating the headline from the category. Much of today's stress is concentrated in direct lending, a segment of private credit where loans are primarily backed by corporate cash flows rather than hard assets. Private credit is broader and more diverse than direct lending alone, and the debate is best framed in that narrower context.

Our view is that the narrative isn't wrong, it's incomplete. While pockets of risk are emerging, the larger issue is less about structural weakness and more about misaligned expectations. The tension isn't between the assets and the vehicle. It's between investor behavior and the long-term nature of private markets.

Private market investments are illiquid by design. Unlike public markets, where transactions clear almost instantly, private investments require time, diligence, and alignment between buyers and sellers. Liquidity isn't continuous; it's event-driven. Put simply: you're not buying daily tradability; you're earning an illiquidity premium.

In recent years, direct lending has gained traction among wealth management investors, offering yields above Treasuries, especially in a low-rate world, along with a smoother, fundamentally driven return profile.

That created a "Goldilocks" environment: strong income, low observed volatility, and the perception of periodic liquidity. Capital flowed in quickly. The Cliffwater Direct Lending Index (CDLI), a widely used proxy for U.S. middle-market direct lending, saw assets tracked in the index grow from approximately $191 billion at the end of 2021 to roughly $550 billion by year-end 2025. We'll use the CDLI as a reference point throughout.

But capital moved faster than investor understanding. Strong performance, paired with limited experience navigating liquidity constraints, led some investors to underestimate the core trade-off: private markets require patience and are not designed to be traded tactically.

WHEN STRUCTURE MATTERED

Blackstone Real Estate Income Trust (BREIT) is a useful example of how structure works, particularly in semi-liquid vehicles designed to bridge private markets with more accessible formats. BREIT offers periodic liquidity, but that liquidity is not guaranteed. In stable environments, redemptions are typically met with ease. In periods of elevated redemption demand, liquidity is intentionally constrained to protect long-term value.

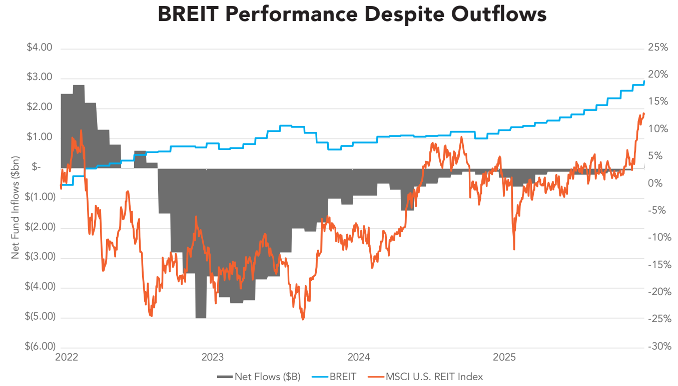
In late 2022, sentiment toward commercial real estate deteriorated quickly as interest rates rose and transaction activity slowed. This coincided with many portfolios carrying an overweight to private real estate after a stretch of strong relative performance versus public markets. The result was a surge in redemption requests, driven more by narrative than realized losses.

Over the following months, requests continued to build. While the fund provided liquidity within its limits, many investors received only a prorated portion. The backlog was not fully cleared until early 2024.

From February 2022 through February 2024, BREIT generated a positive total return of approximately 8%, while publicly traded REITs declined by nearly 10%. Despite sustained redemption pressure, the portfolio remained resilient, with volatility meaningfully lower than that of public markets.

The structure allowed the manager to avoid becoming a forced seller in a weakened market, creating a buffer between short-term investor behavior and long-term asset value.

BREIT Performance Despite Outflows



Source: Blackstone, Bloomberg

Gating is often viewed negatively, but it's better understood as a feature rather than a flaw. It's a circuit breaker: it prevents short-term liquidity demand from forcing the sale of long-duration assets at the wrong time. Without it, short-term decisions can become permanent losses.

WHAT IS ACTUALLY HAPPENING IN DIRECT LENDING

Recent developments in direct lending have been shaped by a rapid influx of capital. As assets expanded, competition among lenders increased, tightening credit spreads and, in some cases, pressuring underwriting discipline.

A few idiosyncratic credit events, alongside evolving risks in certain sectors (software in particular, as AI reshapes competitive dynamics), have made for easy headlines.

But the data looks more mundane than the narrative suggests. Default rates remain relatively low, with trailing four-quarter defaults near 1.5%, below the 10-year average of approximately 2.7%. Even if defaults rise meaningfully, the impact on portfolios should remain contained. Assuming implied recovery rates near 50%, a doubling of default rates would imply an annual performance drag of roughly 1.0% to 1.5%—meaningful, but not thesis-breaking given the income profile of the asset class.

Even under stressed assumptions combining higher defaults and lower recoveries, expected losses would approximate 3.5%, leaving a meaningful buffer relative to the 9–10% historical return profile.

The investor base matters, too. Direct lending remains predominantly held by institutional investors, such as pension funds and insurance companies, which account for approximately 86% of global allocations. Those investors tend to have longer time horizons and less acute liquidity needs, which helps stabilize the asset class in periods of stress.

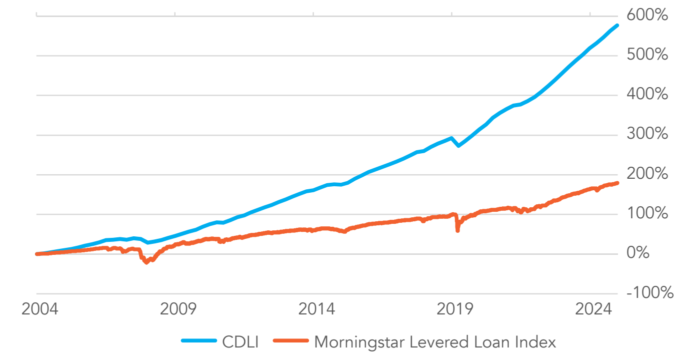
A PERIOD OF ADJUSTMENT–AND OPPORTUNITY

We expect defaults to rise from current levels. In late-cycle environments, shaped by higher rates, geopolitical uncertainty, and technological disruption, excesses built during easier periods tend to surface.

But that adjustment can also create opportunity. As capital becomes more discerning and short-term investors step back, underwriting standards improve, spreads reset, and discipline returns. For long-term investors, these are often the conditions that produce stronger vintages.

For investors who prioritize liquidity, the closest public-market analog is leveraged loans, which have historically underperformed direct lending. From 2004 through 2025, the CDLI generated a cumulative total return of approximately 576% (9.5% annualized), compared to 182% (5.1% annualized) for the Morningstar Levered Loan Index. That gap reflects the core trade-off: liquidity introduces volatility and often comes at the expense of return, meaning investors forgo the illiquidity premium over full market cycles.

Direct Lending vs Levered Loan Returns



Source: Cliffwater, Bloomberg

It is also worth emphasizing that direct lending is only one segment of a broader opportunity set, including asset-based finance, real estate debt, and specialty lending strategies.

By Jake Stapleton, MBA
Team Lead - Research

WELCOME TO MIDLAND WEALTH MANAGEMENT!

Please join us in welcoming:

- **Nicholas Hinkebein** – Senior Portfolio Manager
- **Deshawn Peterson** – Associate Wealth Advisor
- **Matt Raye** – Manager – Risk and Compliance
- **Mason Kaiser** – Associate Financial Advisor

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Midland Wealth Management

QUARTER 2

MARKET OUTLOOK

INSIDE THIS ISSUE:

GLOBAL ECONOMY

Geopolitics & a Multipolar World

FIXED INCOME

Rising Rates & Emerging Opportunity

PRIVATE MARKETS

The Price of (Il)liquidity