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July Commentary

The U.S.-Iran war did more than push oil prices higher. It exposed how much of the global energy system depended on one narrow waterway: the Strait of Hormuz. For decades, that risk was known but largely treated as hypothetical. Oil prices would spike during a crisis, then eventually settle back down. This time, the bigger impact was not just the price move. It was the realization that the world's supply routes were too concentrated.

Before the war, roughly 20% of the world's oil and liquefied natural gas (LNG) moved through the Strait of Hormuz, with much of that supply headed to Asia. Among Gulf producers, only Saudi Arabia and the UAE had meaningful ways to reach open water without passing through the Strait. The conflict challenged the longstanding assumption that the Strait would remain reliably accessible during periods of geopolitical stress.

Gulf oil producers have responded quickly, pursuing the largest expansion of alternative export routes since the 1980s. These projects aim to move crude around the Strait of Hormuz via overland pipelines to open-sea ports, primarily on the Red Sea and Gulf of Oman. Saudi Arabia was the quickest to move and has expanded a pipeline built during the Iran–Iraq War from a capacity of 5 million barrels a day to 7 million barrels a day. The UAE plans another pipeline that will double capacity to 3.6 million barrels per day by 2027, while other projects could connect Gulf oil to the Red Sea, Mediterranean, Turkey, or Jordan. Incremental bypass capacity could reach roughly 3.8 million barrels per day by the end of 2027 and 7.3 million by the end of 2028. As a result, more than 14 million barrels per day of export capacity could bypass the Strait of Hormuz, compared with the roughly 20 million barrels per day that moved through the Strait before the conflict.

These changes should make the global oil market more resilient, but they do not eliminate risk completely. Red Sea shipping can still be threatened, and some routes are longer, costlier, or dependent on fragile political cooperation. Pipelines provide options, not guarantees. Still, the direction is clear: oil producers no longer want to rely on a single chokepoint, and buyers no longer want to depend on one route or one region.

The disruption also demonstrated that replacing lost barrels is not as simple as sourcing any available oil. Refineries are engineered for specific crude profiles. Many Asian refineries were designed for heavier Gulf crude, which is well suited to producing diesel, jet fuel, and other fuels that support industry, shipping, and aviation. If those refineries receive lighter crude from the U.S., the North Sea, or elsewhere, they can still operate, but they may run less efficiently and produce a different mix of products. That is why certain oil products naturally flow to certain regions. Asia needs large volumes of diesel and jet fuel for factories, shipping lanes, and air travel. The U.S. consumes more gasoline. Europe often depends more heavily on diesel and imported natural gas. A disruption in Gulf crude, therefore, is not just a shipping problem. It can also become a refining and product-supply challenge if the replacement barrels do not match what local refineries and end users need.

The most lasting institutional casualty of the war may be damage to the OPEC alliance. Founded in 1960 by Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela, the group eventually expanded to twelve members. Following weeks of conflict involving a fellow member in late spring 2026, the UAE withdrew from the organization after nearly sixty years of membership. During its time in the group, the UAE increased production from 2.5 million barrels per day in 2006 to 4.1 million barrels per day by June 2026, all while controlling the Gulf's most defensible export route. This exit removed OPEC's third-largest producer, shrinking the cartel's global market share to roughly 25%. Cartels survive only when membership yields greater benefits than independence; shifting infrastructure broke that calculation. Influence now belongs to those who can actually move barrels to market, not simply those who own reserves. Saudi Arabia remains the de facto leader, left to stabilize prices with fewer partners to share the burden, while others may soon follow the UAE's exit.

The longer-term result is a different energy map. Producers are spending money on more pipelines and export routes. Buyers are diversifying suppliers. Compatible crude outside the Gulf is becoming more valuable, and LNG buyers are also looking more to the U.S. and Australia when Middle Eastern supply is uncertain. After years of taking a back seat to cost and carbon reduction efforts, energy security is again becoming a central part of the conversation. In the short term, this supports a higher floor for oil prices as rebuilding, reserve replenishment, and inventory restocking tighten demand for physical barrels. Longer term, once infrastructure is rebuilt, supply routes are diversified, and renewable energy sources increase, that floor should gradually decline as the system becomes less dependent on any single region or fuel source.

The takeaway is simple. The war did not just create a temporary energy shock, it forced the market to rethink how energy moves, which supplies can replace others, and how much security of supply is worth. Additional routes and a more diversified supply should improve resilience over time, but geography, refinery fit, and political risk, heightened by this conflict, will always be issues to contend with. With the Middle East exposed as highly fragile, capital is already shifting toward other production areas, as global energy production leaders redirect investment toward expanded oil production capacity in North America, South America, West Africa, and offshore fields, creating a geopolitical energy counterbalance to the Persian Gulf. LNG is following the same pattern. With some Qatari supply unavailable, buyers are shifting toward North America, especially the U.S., as well as Australia and West Africa.

From an investment perspective, several energy companies should benefit as supply chains are rebuilt and LNG sourcing broadens. Integrated majors such as TotalEnergies, Shell, Chevron, and Exxon Mobil are well positioned given their diversified assets, global LNG exposure, refining and trading operations, and strong balance sheets. Energy services firms should also benefit as exploration and production activity shifts across regions, including the potential for higher Venezuelan output, while pipeline companies stand to gain from a structural move away from ocean tankers toward overland pipelines. Unlike prior boom-and-bust cycles, today's energy companies appear more disciplined and shareholder-focused, leaving many firms positioned to emerge from the 2026 disruption in solid financial condition even if oil prices ease from recent peaks.

Monthly Market Summary

July was a volatile month for markets, shaped by a quick shift from geopolitical risk to questions about the durability of the AI investment cycle. Early in the month, renewed U.S.-Iran tensions briefly pushed oil sharply higher, lifting energy shares, and fueling inflation concerns. As those worries eased, investor attention turned to second-quarter earnings and whether the enormous capital being committed to artificial intelligence will ultimately generate attractive returns.

The result was a sharp rotation beneath the surface. The S&P 500 finished slightly negative, down 0.06%, while the Nasdaq declined 3.2% as semiconductors and other AI beneficiaries sold off. Investors were not abandoning AI, but they became more selective, rewarding companies that could demonstrate near-term monetization and pressuring those with elevated valuations, heavy capital spending, or exposure to export controls and China-related competition. The Philadelphia Semiconductor Index fell more than 20% for the month, while technology lagged and value-oriented sectors led.

The energy sector, up 12.5%, was the clear leader as oil prices rose, while financials, up 6.0%, benefited from higher yields, solid bank earnings, stronger capital markets activity, and improving net interest trends. The S&P 500 Equal Weight Index modestly gained 1.0%, highlighting a continued broadening away from the most crowded growth trades.

Corporate earnings were a bright spot, with most S&P 500 companies having reported by month-end with beat rates running well above historical averages. Earnings growth also came in meaningfully better than expected, though the strongest gains remained concentrated in technology, communication services, and a select group of large AI-related companies. The 2026 S&P 500 earnings estimate rose to 24.2% year-over-year growth, while the 2027 estimate increased to 14.7% growth for the calendar year.

The Russell 2000 declined 3.0% for the month as June's jump in oil prices rekindled inflation concerns and investors took profits following a strong 22.7% first-half rally. Chairman Warsh's hawkish tone at the FOMC meeting also weighed on investor sentiment, as higher rates are especially challenging for the index: about 29% of constituents debt is floating rate, while nearly 30% of constituent companies are unprofitable.

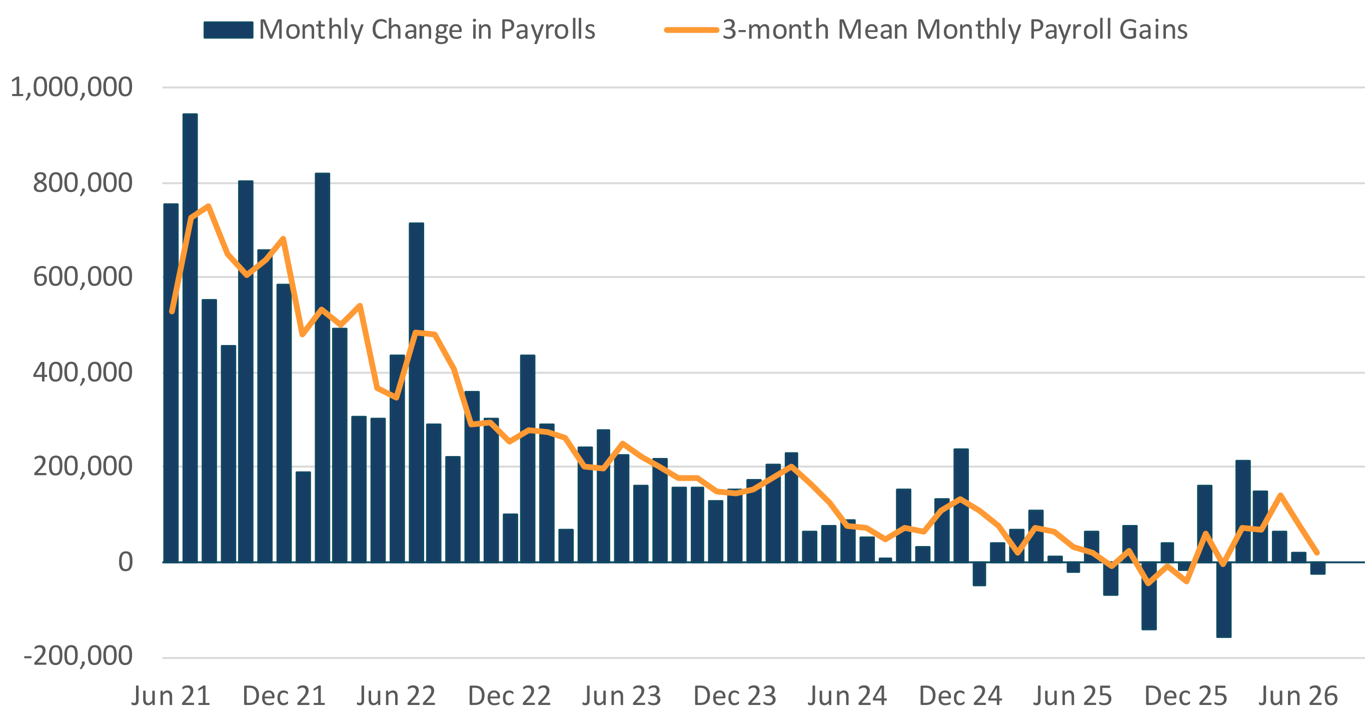
International markets were mixed in July. Developed markets, measured by the MSCI EAFE Index, rose 2.0%, led by European equities as lower technology exposure, stronger earnings, easing energy concerns, and a rotation into value and cyclical sectors supported performance. Emerging markets were more uneven and declined 3.0% as measured by the MSCE Emerging Market Index. Gains in parts of Asia, Latin America, and Southeast Asia were offset by weakness in tech-heavy markets such as Taiwan and South Korea. China also remained under pressure from weak domestic demand, property-sector challenges, and doubts about the durability of its recovery.

Fixed income markets struggled in July as long-term Treasury yields moved sharply higher, pressured by resilient economic data, sticky inflation, rising oil prices, and the Federal Reserve's decision to hold rates steady. The Treasury curve bear-steepened as longer-dated yields rose more than front-end yields. The 10-year Treasury yield increased 27 basis points (bp) to 4.7%, while the 30-year yield rose about 32 bp to 5.3%, its highest level since 2007. The 2-year yield rose 12 bp to 4.3%. Credit markets were moderately weak with U.S. investment-grade corporates underperforming high yield, falling 1.7% versus a 0.2% decline for high yield. While corporate spreads remained tight by historical standards, investment-grade spreads widened due to increasing supply of AI-related debt.

Fed Decision

Monetary policy remained a key market driver in July. The FOMC held the federal funds rate steady at 3.5%–3.8%, though the decision was not unanimous, and Chair Kevin Warsh emphasized the Fed's commitment to controlling inflation before considering any easing. With inflation still elevated, energy prices remaining volatile, and labor market conditions holding steady, investors have shifted away from expectations for multiple rate cuts and are now focused on how long restrictive policy may remain in place. By the end of July, investors were expecting a 25 bp rate hike in October and another 25 bp hike in either March or April 2027. That outlook marked a sharp change from February, when markets had still been pricing in two rate cuts before the Iran conflict began.

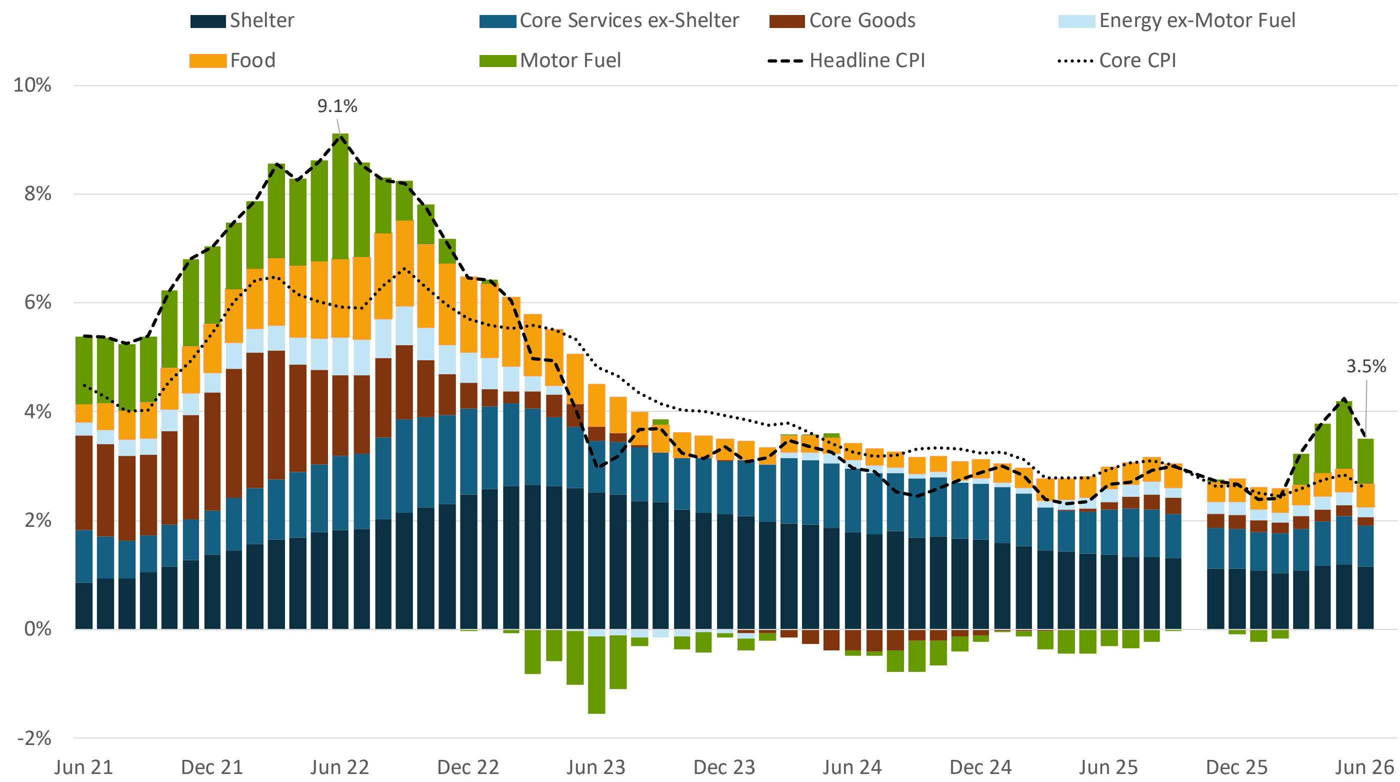
Payroll Data was Positive for June but Below Expectations



Source: Bloomberg, First American Bank.

June nonfarm payrolls were much lower than expected, with only 57,000 jobs added versus an expectation of 113,000, and May's numbers revised down from 172,000 to 129,000. Leisure and hospitality jobs saw the biggest swing, going from 40,000 created in May, to a loss of 61,000 in June, as jobs created specifically for the World Cup held in the U.S. were wound down as the tournament peaked. Healthcare and social assistance job creation continued to be strong with 46,000 jobs created. Despite the softer headline number, the labor market still appeared reasonably healthy. The unemployment rate declined from 4.3% to 4.2% as labor force participation fell from 61.8% to 61.5%, its lowest level since March 2021, while year-over-year wage growth remained resilient at 3.5%, up from 3.4% the prior month.

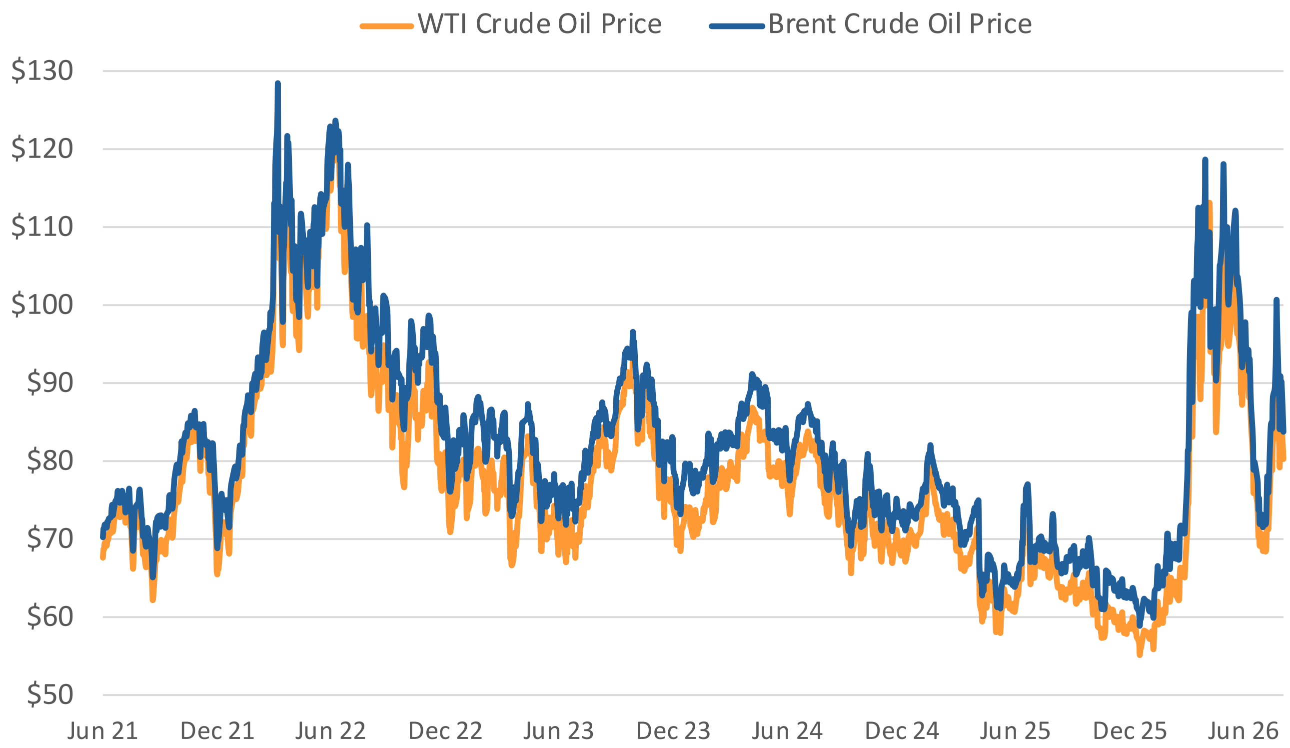
Inflation Readings Improve in June with Help from Lower Oil Prices



Source: Bloomberg, First American Bank.

Inflation news markedly improved as oil prices subsided in June following the ceasefire agreement with Iran announced on June 14. Headline CPI for June fell 0.4% month over month versus an estimate of a 0.1% decline, marking its first monthly decline since May 2020 and driven by a 20% drop in oil prices. Core CPI fell 0.02% versus the expectation of a 0.2% increase, while year-over-year core CPI eased to 2.6% versus the 2.8% estimate, returning to levels last seen in 1Q 2026. The downside surprise in both headline and core inflation, including a second consecutive 0.1% decline in core goods and sideways movement in core services, alleviated some near-term pressure on the Fed to hike rates. However, Chair Warsh reinforced in his inaugural semiannual monetary policy testimony that the June report is only one data point and not a sign of mission accomplished. While he sounded hawkish on the inflation backdrop and stated that the FOMC has "no tolerance for persistently elevated inflation," he did not provide a clear roadmap for returning inflation to target. Oil price fluctuations, as seen with higher oil prices in July, will influence the September decision but do not guarantee a hike.

Oil Prices Rise in July as the Conflict with Iran Reignites



Source: Bloomberg (Generic First Futures), First American Bank.

As the conflict with Iran flared up again in July, the drop in oil prices seen in June were wiped away. WTI rose 22.2% to close at $84.67 per barrel and Brent gained 23.6% to $90.12 per barrel.

Market Outlook

We remain positive on equities and expect the market to reach new highs in the second half of the year. The fundamental backdrop remains supportive, driven by strong corporate earnings, resilient consumer spending, and continued investment in AI and broader infrastructure. Second-quarter earnings have been particularly encouraging, with many companies exceeding both earnings and revenue expectations, while forward estimates for 2026 and 2027 continue to rise. Importantly, earnings strength is broadening, with the median S&P 500 company reporting double-digit earnings growth. Profitability also continues to improve, with operating margins at multi-decade highs, supporting further increases in shareholder returns through dividends and share repurchases.

While markets may stay uneven in the near term, we see volatility as a potential opportunity rather than a reason to turn defensive. Risks related to geopolitics, oil prices, and AI spending remain worth monitoring, but they appear manageable for equities and are not showing signs of deterioration. Inflation appears to be easing, not reaccelerating, and the labor market remains stable despite modest job growth and slower wage gains. This should give the Federal Reserve room to stay patient and avoid more aggressive tightening. Overall, we believe the second-half backdrop remains constructive and supports additional upside for equities.

MAJOR MARKET INDICES

Index	1M	3M	YTD	1Y	3Y*	5Y*	10Y*
	Total Return (*annualized)						
S&P 500 Index	-0.06%	4.19%	10.12%	19.53%	19.28%	12.82%	15.05%
S&P 500 Equal Weight	1.01%	6.17%	13.24%	19.19%	13.57%	9.04%	11.98%
Nasdaq 100	-6.59%	3.17%	12.38%	22.58%	22.41%	14.45%	20.64%
Dow Jones Industrial Average	0.37%	6.12%	10.16%	20.90%	15.92%	10.55%	13.38%
S&P 400 Midcap	-2.38%	3.60%	14.53%	20.91%	12.92%	8.42%	10.87%
Russell 2000 Smallcap	-3.02%	5.00%	18.98%	34.32%	15.10%	7.10%	10.61%
MSCI EAFE International Developed	1.98%	5.32%	12.08%	25.06%	16.66%	10.00%	10.01%
MSCI Emerging Markets	-3.03%	4.94%	20.26%	37.06%	19.87%	8.50%	9.63%
MSCI All Country Ex-U.S. Index	0.38%	4.92%	14.48%	29.16%	18.05%	9.87%	10.06%
Bloomberg Barclays U.S. Aggregate Bond	-1.30%	-0.76%	-0.69%	2.71%	3.72%	-0.40%	1.35%
Bloomberg Barclays U.S. Treasury Bond	-1.11%	-0.72%	-0.84%	1.97%	2.91%	-0.91%	0.71%
Bloomberg Barclays Municipal Bond	-1.85%	-0.54%	0.43%	5.27%	2.98%	0.51%	1.95%
Bloomberg U.S. Corporate High Yield Bond	-0.25%	0.51%	1.71%	5.17%	8.26%	4.03%	5.50%
Bloomberg U.S. Corporate Bond	-1.67%	-0.75%	-0.83%	2.53%	4.57%	-0.27%	2.27%

S&P 500 SECTORS

Sector	1M	3M	YTD	1Y	3Y*	5Y*	10Y*
	Total Return (* annualized)						
S&P 500 Index	-0.06%	4.19%	10.12%	19.53%	19.28%	12.82%	15.05%
Communication Services	0.58%	-8.09%	1.39%	18.95%	26.60%	11.76%	11.60%
Consumer Discretionary	0.82%	-1.41%	0.04%	7.52%	12.97%	6.79%	12.59%
Consumer Staples	2.10%	-0.64%	10.31%	10.32%	8.55%	7.69%	8.21%
Energy	12.60%	0.96%	34.74%	41.17%	14.57%	23.86%	10.11%
Financials	6.16%	9.62%	4.76%	10.36%	19.08%	11.18%	13.59%
Health Care	2.40%	11.89%	5.96%	26.92%	8.49%	6.02%	9.96%
Industrials	-3.01%	3.21%	16.54%	19.71%	19.28%	13.39%	13.60%
Information Technology	-3.43%	8.35%	15.65%	26.22%	28.23%	20.37%	25.18%
Materials	-1.65%	-2.28%	10.12%	15.32%	7.11%	5.52%	9.63%
Real Estate	2.52%	2.30%	14.33%	14.03%	9.87%	3.14%	6.41%
Utilities	-2.23%	-4.74%	5.29%	6.41%	13.17%	9.40%	8.93%

COMMODITIES

Commodity	1M	3M	YTD	1Y	3Y*	5Y*	10Y*
	Total Return (* annualized)						
Bloomberg Commodity Total Return Index	7.54%	-5.14%	22.98%	35.53%	12.12%	10.56%	7.15%
Bloomberg Industrial Metals Total Return Subindex	3.66%	0.65%	10.50%	32.38%	10.41%	5.59%	8.33%
Gold Total Return Subindex	0.55%	-12.43%	-6.92%	21.65%	25.82%	16.21%	10.28%
Silver Total Return Subindex	-3.27%	-21.81%	-18.30%	55.75%	30.90%	16.58%	9.47%
Copper Total Return Subindex	3.69%	8.04%	12.78%	45.59%	16.99%	8.01%	10.82%
Bloomberg Energy Total Return Subindex	15.56%	-7.06%	60.24%	41.68%	8.31%	9.44%	4.17%
WTI Crude Oil Total Return Subindex	22.61%	-9.86%	78.31%	55.70%	20.46%	18.99%	9.40%
Brent Crude Total Return Subindex	17.97%	-15.59%	70.83%	51.77%	18.10%	21.26%	15.84%
RBOB Unleaded Gasline Total Return Subindex	14.38%	-4.73%	81.33%	68.25%	16.91%	26.55%	17.38%
Natural Gas Total Return Subindex	-13.73%	-9.58%	-21.47%	-34.50%	-31.89%	-30.76%	-24.77%
Bloomberg Agriculture Total Return Subindex	6.01%	0.22%	11.01%	12.31%	-0.66%	4.09%	2.90%

Notes on Commodities Indices

1. Bloomberg Commodity Index Total Return weighs up to 25 components across energy, grains, metals, softs, and livestock.
2. Bloomberg Industrial Metals Index components are fully collateralized long-dated futures contracts on aluminum, copper, nickel, and zinc.
3. Bloomberg Energy Index components are fully collateralized futures contracts on crude oil, heating oil, unleaded gasoline, and natural gas.
4. Bloomberg Agriculture Index components: Coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar, and wheat.

Source: Bloomberg.