

The Economy: Summer 2026

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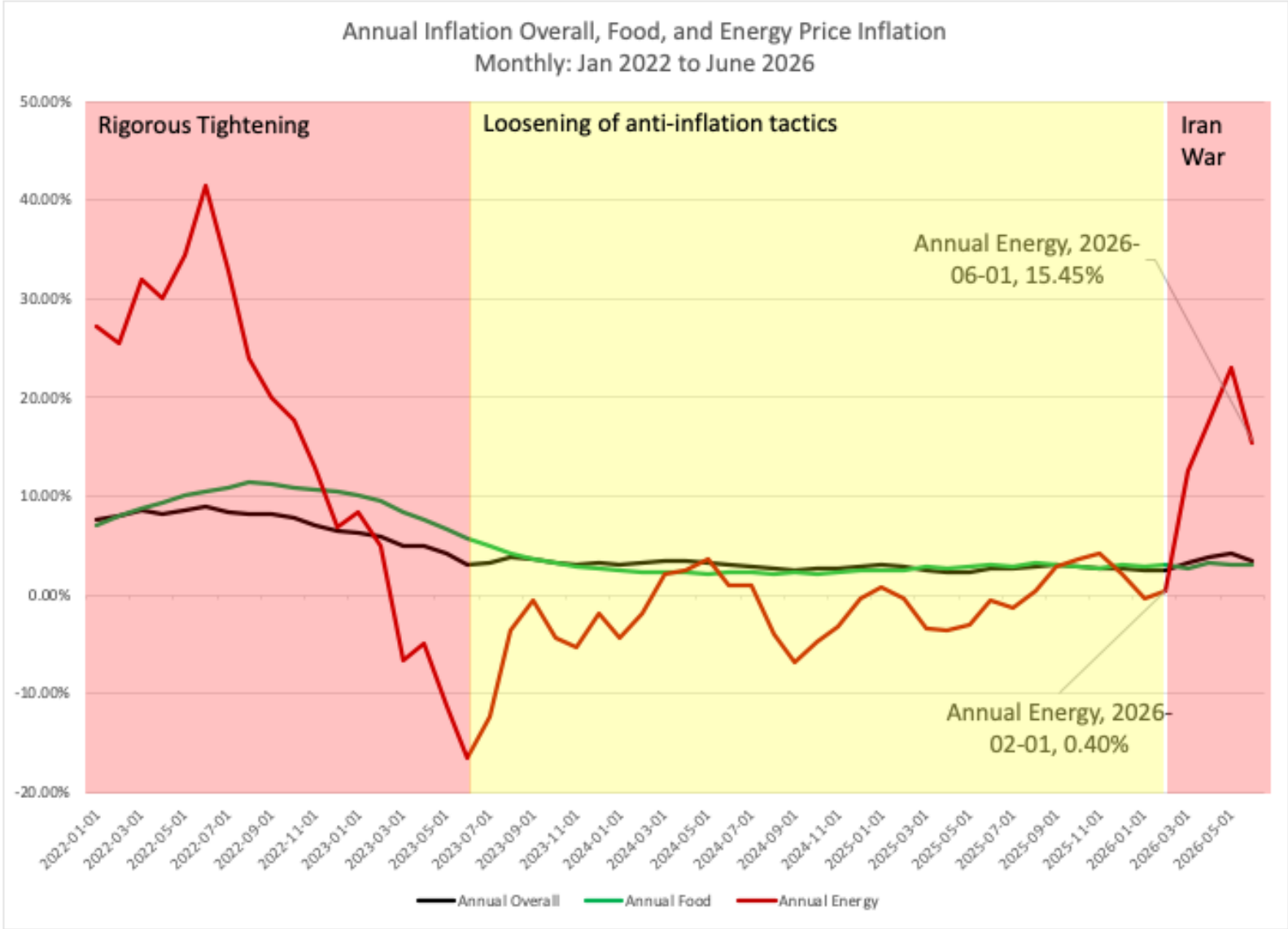
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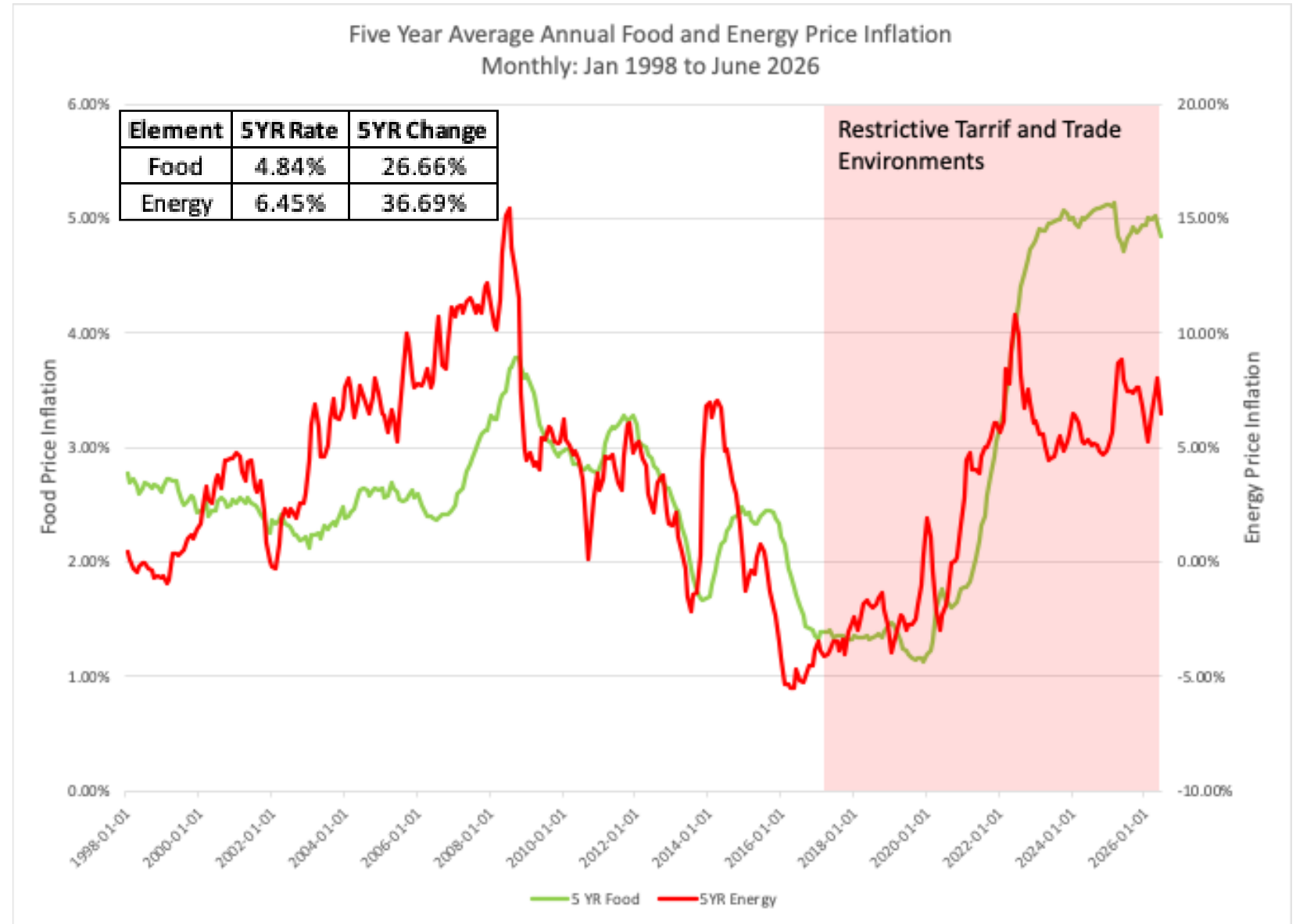
Inflation

- The Fed’s policies initiated in 2022 succeeded in bringing inflation rates down
- Instability in the financial markets resulted in their loosening constrictive policy, but not reducing rates
- Inflation has persisted and is now increasing due to the war, primarily due to energy price increases.
- Pass through rates on tariffs range from 46%/86% on core goods up to 51/115% on durable goods. Rate on consumer core goods is 60-80%.



Food and Energy Prices

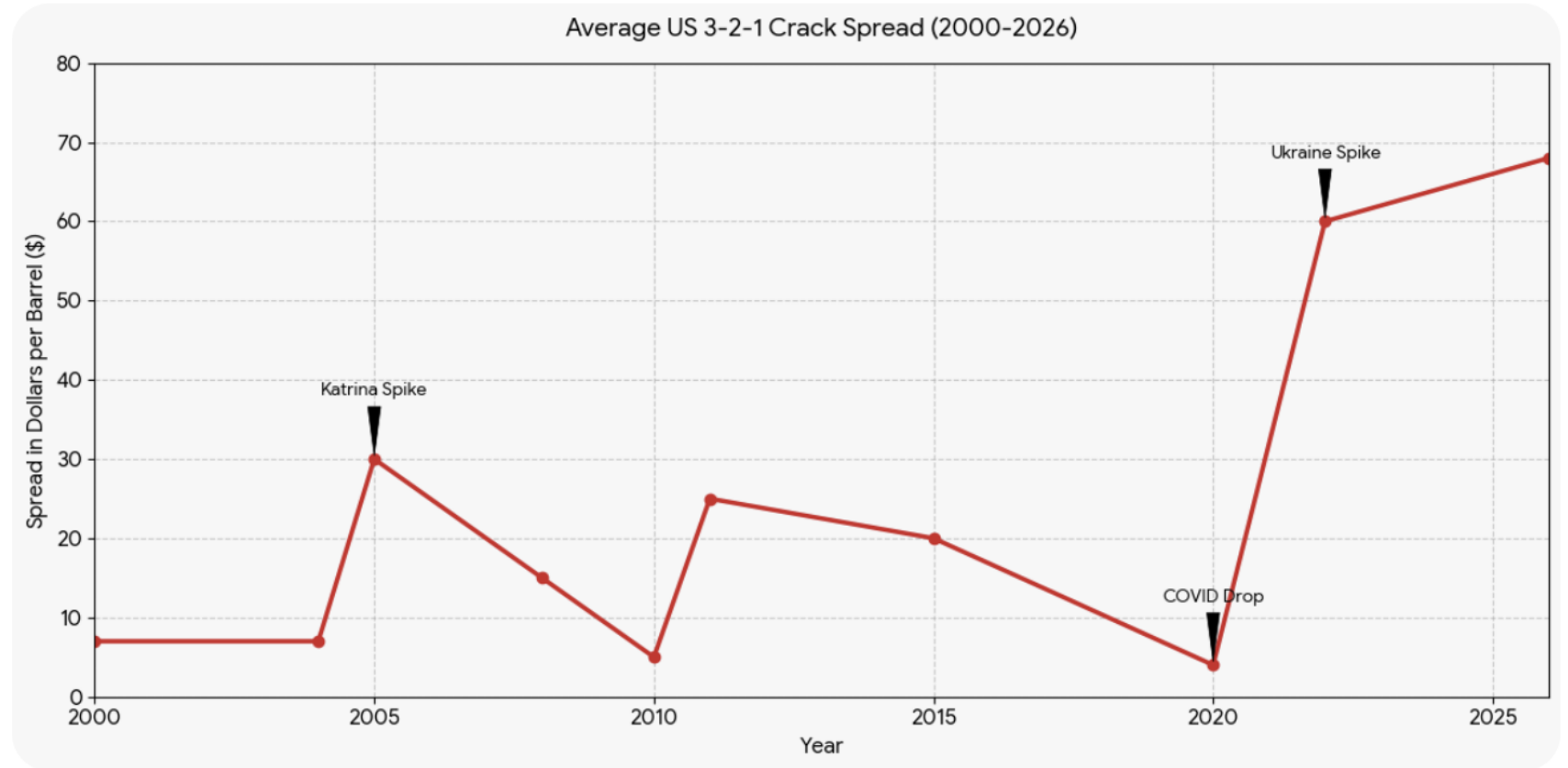
- Food and energy prices are significantly interrelated (correlation of 0.70 to 0.85)
 - Agriculture and fishing are energy intensive
 - Natural gas prices affect fertilizer production and costs
 - High crude prices spur moves over to bio-fuels, competes with food production, increases prices
- Tariff environments
 - Increases costs and prices for domestic energy infrastructure
 - Trade policy multipliers: defensive trade policies during supply shortages;
- Expect data center investments to be energy intensive
 - Increased demand for fossil fuels will lead to global price increases
 - Exacerbated by the Iran war and associated disruptions



Crack Spreads

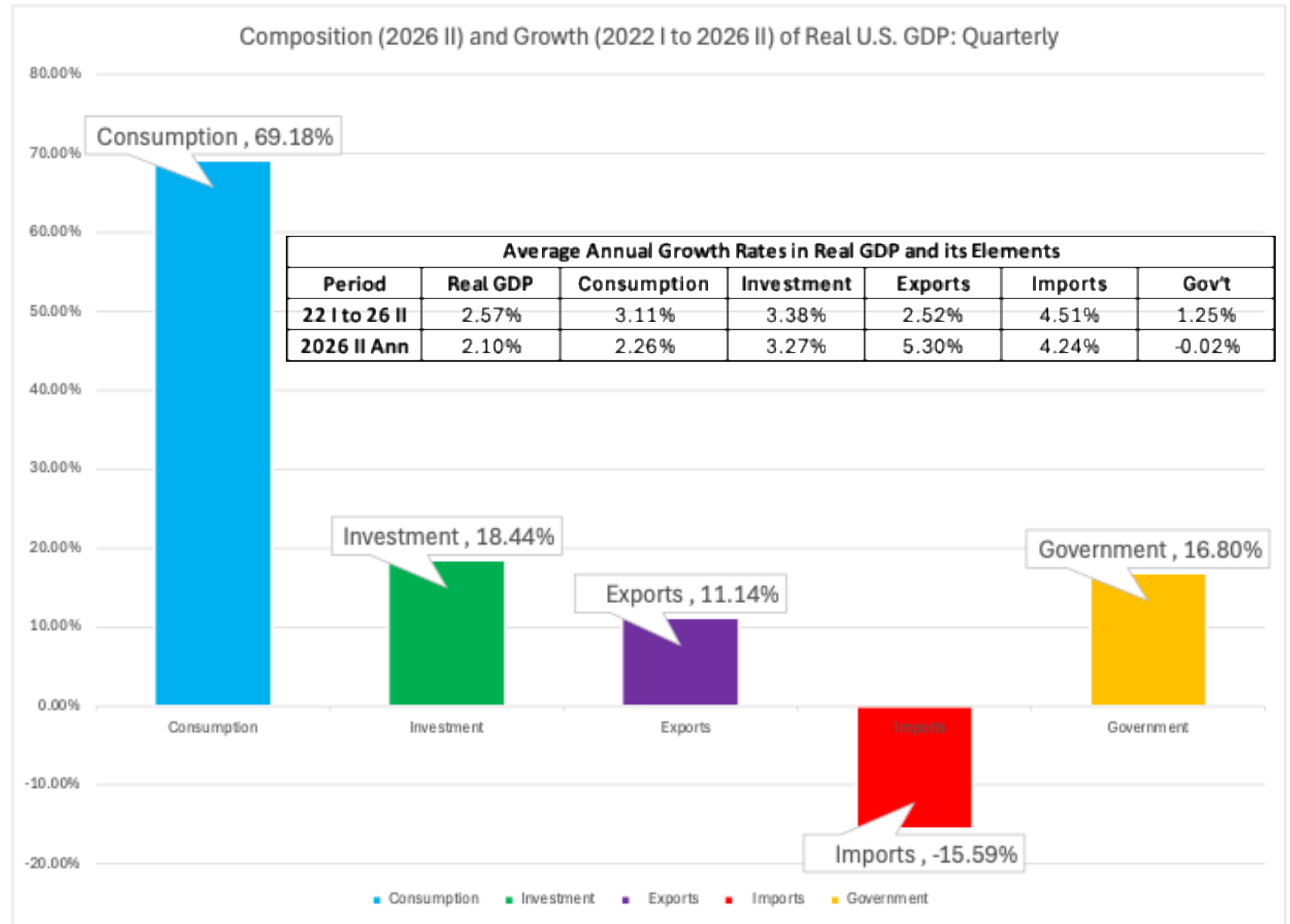
- 3-2-1
 - 3 Barrels of crude
 - 2 Barrels of gasoline
 - 1 barrel of distillate
- Indicator of refiner profit margins
- Part of the basis for determining oil futures prices
- Indicative of where prices are now and heading in the future

Historical 3-2-1 Crack Spread Timeline (2000–2026)



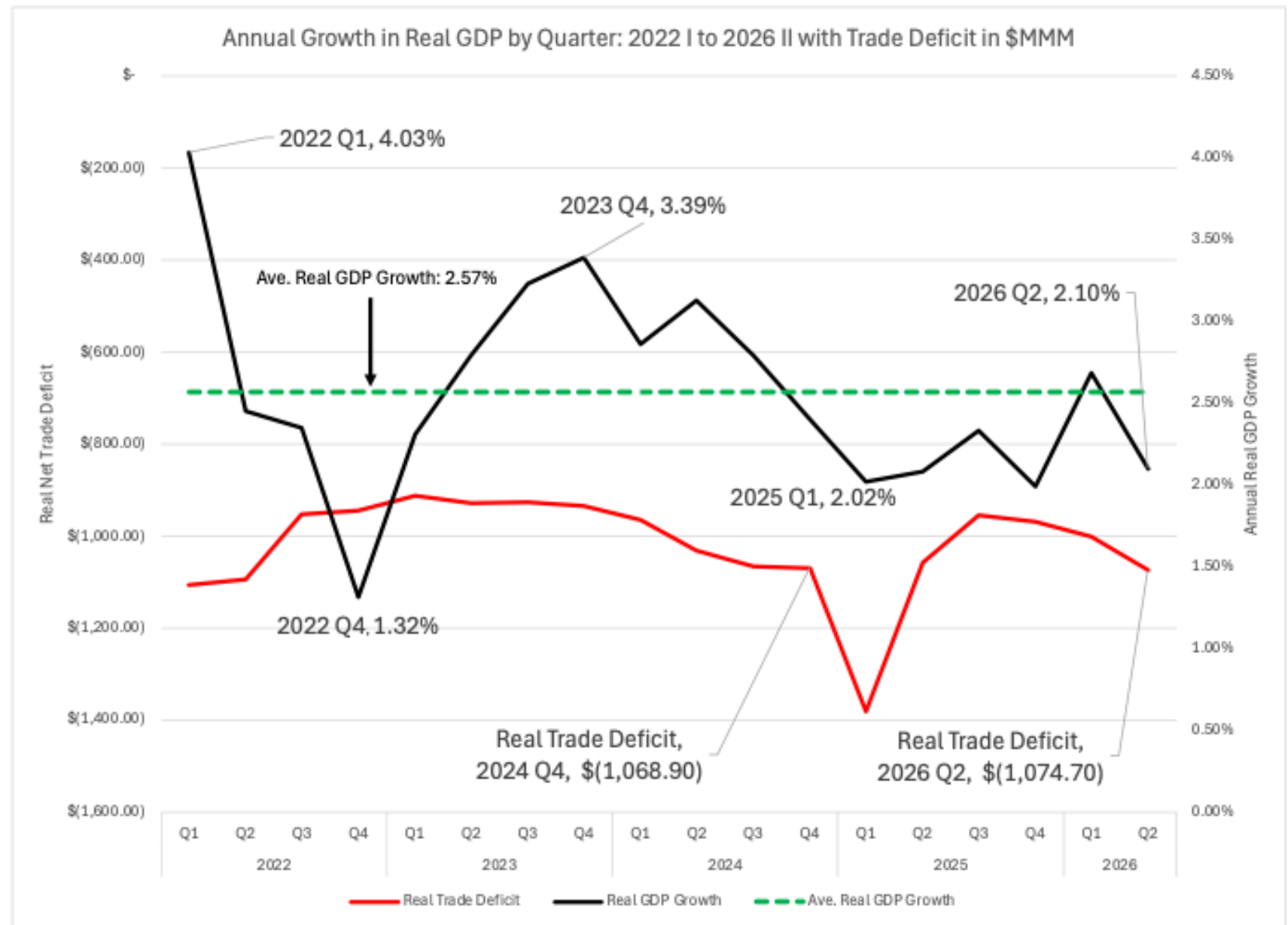
Real GDP elements and growth

- The U.S. economy continues to be consumption driven
- Gross investment continues to be less than 20% of real GDP, but appears to be maintaining its growth
- Exports are growing (but from a lower base level than imports)
- Import growth continues to put a drag on GDP
- The role of government spending has diminished substantially



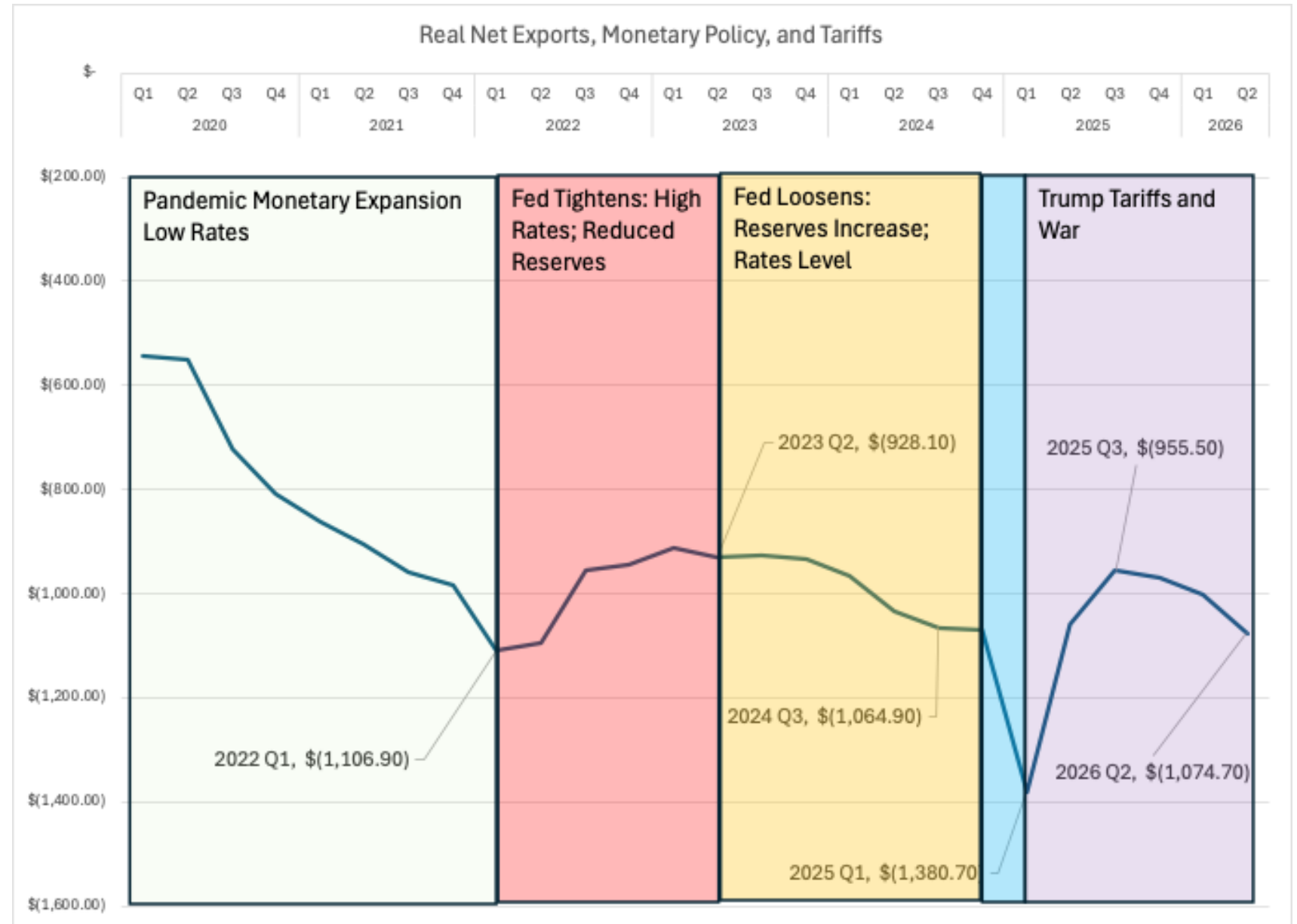
Real GDP and Trade from 2022 I

- Fed tightening constricted GDP growth for 2022
- Real GDP recovered in 2023, in part due to Fed loosening on monetary reserves
- Slowing real growth was accompanied by deepening trade deficits through 2024
- The Trump tariffs have had little overall impact on the deficit, which now continues to worsen and is equal to its pre-tariff real level
- GDP growth has slowed in response.



Trade and Money

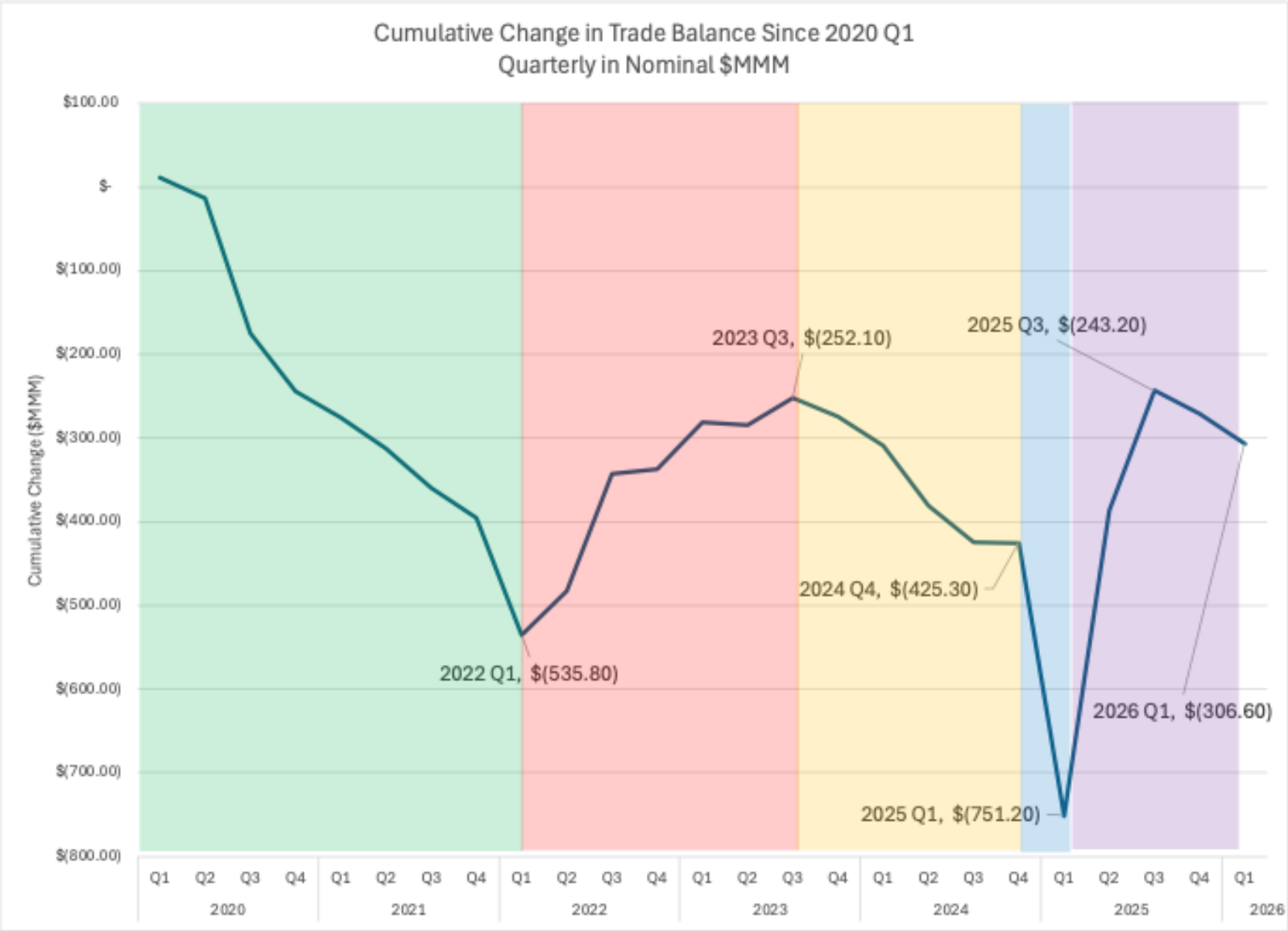
- Prior to 2025, the trade gap is strongly correlated to Federal Reserve Monetary expansion and contraction
- In real terms, the trade deficit is currently at about the same level as it was in 2024 Q4, prior to the initiation of the Trump tariff policies
- The expectation of high tariffs in 2025 Q1 drove the deficit to record levels
- The impact of tariffs on the real deficit has been mixed since



Change in Trade Balance Since 2020

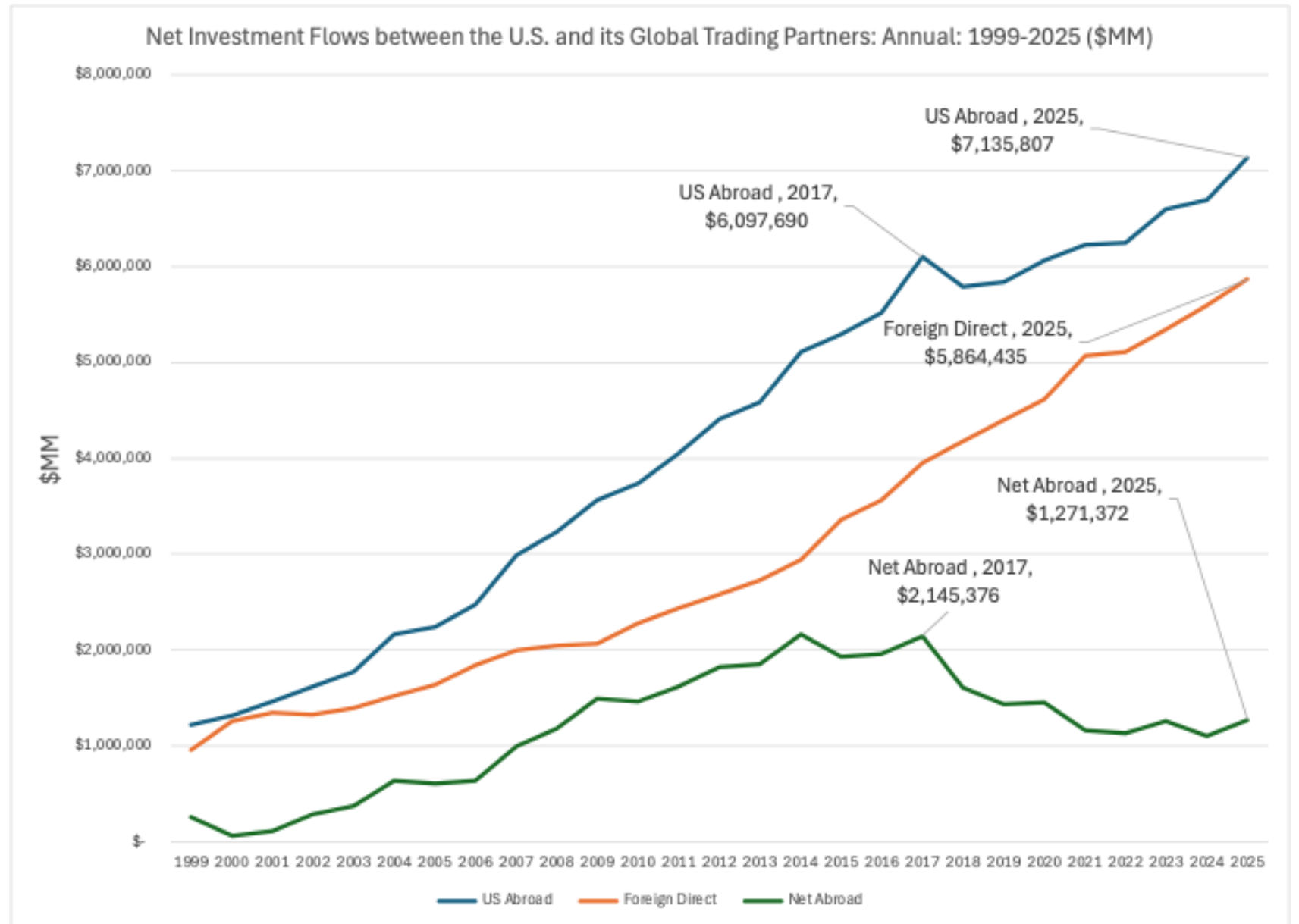
- Trade gap directly correlated to Fed monetary policy
- Since 2024 Q1
 - Upcoming tariffs drive deeper gap
 - Initial tariffs narrow the trade gap
 - Iran War plus adjustments in the global trading market leading toward convergence
 - U.S. still tends to import
 - Lack of domestic supplies

QTR	Net Change from 2024 Q4	
	Nominal	Real
2025Q1	\$ (325.90)	\$ (311.80)
2025Q2	\$ 38.90	\$ 10.90
2025Q3	\$ 182.10	\$ 113.40
2025Q4	\$ 153.70	\$ 100.30
2026Q1	\$ 118.70	\$ 67.10
2027Q2	\$ 69.70	\$ (5.80)



Net Foreign Direct Investment Flows

- The U.S. runs a consistent net investment deficit
- Has come down since the Tax Cut and Jobs Act of 2017 (effective January 2018)
- Spread out among industries and regions



Investment by Region and Industry

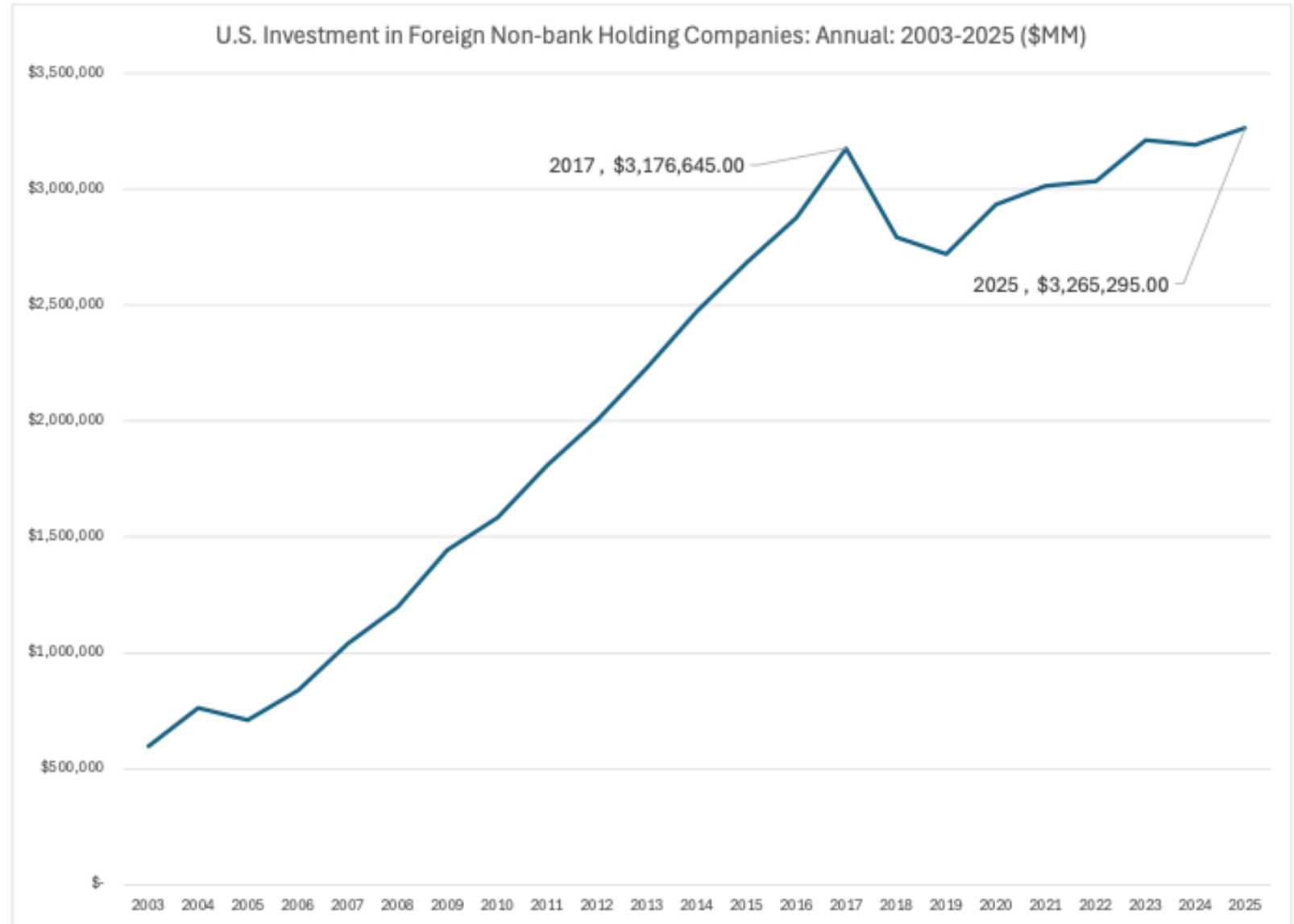
- Greatest volume of activity and difference is with Europe
- The largest volume of activity and differences are in manufacturing (surplus) and food (deficit)
- Most of the deficit is driven by \$3.2 trillion flowing out into non-bank holding companies
- \$2.2 trillion of this flows to Europe due to favorable tax structures.

Foreign Direct Investment in the U.S./U.S Direct Investment Offshore By Region: 2025 (\$MM)			
Region	Foreign Direct in US	US Offshore	Difference
Europe	\$ 3,729,117	\$ 4,300,157	\$ (571,040)
Asia and Pacific	\$ 1,108,447	\$ 1,188,336	\$ (79,889)
Canada	\$ 747,348	\$ 1,022,006	\$ (274,658)
Western Hemisphere (Non-Can)	\$ 223,828	\$ 488,080	\$ (264,252)
Middle East	\$ 45,509	\$ 99,324	\$ (53,815)
Africa	\$ 10,187	\$ 37,905	\$ (27,718)
Total	\$ 5,864,436	\$ 7,135,808	\$ (1,271,372)

Foreign Direct Investment in the U.S./U.S Direct Investment Offshore By Industry: 2025(\$MM)			
Industry	Foreign Direct in US	US Offshore	Difference
Manufacturing	\$ 2,512,269	\$ 161,093	\$ 2,351,176
Food	\$ 135,706	\$ 1,136,713	\$ (1,001,007)
Chemicals	\$ 835,929	\$ 75,235	\$ 760,694
Computers and Electronics	\$ 222,511	\$ 67,055	\$ 155,456
Electrical equipment and Components	\$ 222,511	\$ 207,215	\$ 15,296
Non-bank Holding Companies	\$ -	\$ 3,265,295	\$ (3,265,295)

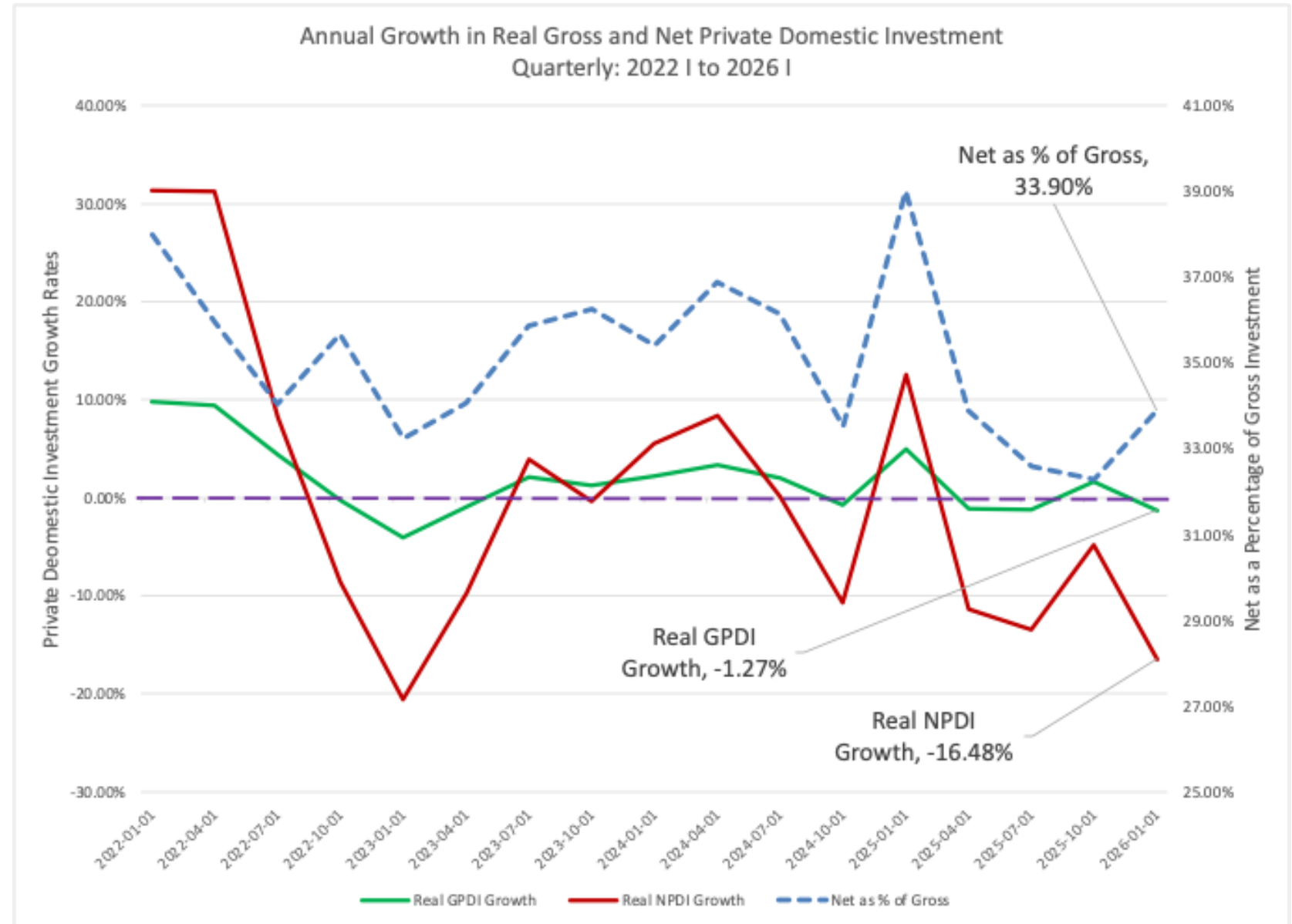
Foreign Non-Bank Holding Company Investing

- Tax cut and jobs act: Companies repatriated \$777 billion in 2018
- Post 2018: Private equity restructuring to optimize tax exemptions
- Broader use of “conduit flows” passing through entities in international financial centers
- Regulatory intermediation: selective locating
- Growth in private markets and fintech
- COVID liquidity explosion



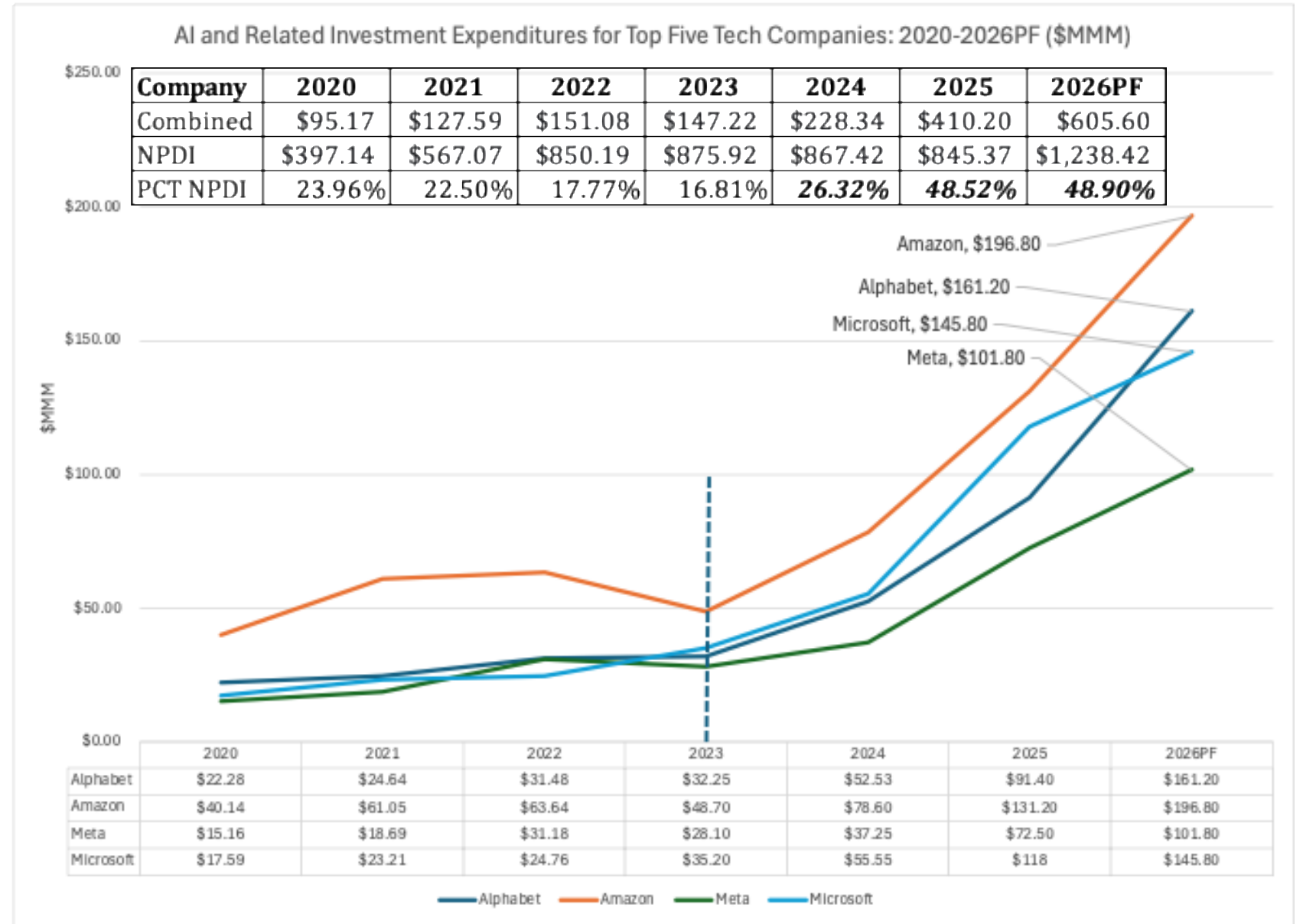
Gross and Net Domestic Investment

- Net private investment is about 1/3 of gross investment
- Annual real growth in both gross investment (-1.27%) and net investment (-16.48%) are down.
- Real gross investment is much less volatile than net investment
- The aggregates don't matter as much as the sectors
- Low aggregates convey low overall economic growth
- Uncertainty rather than risk



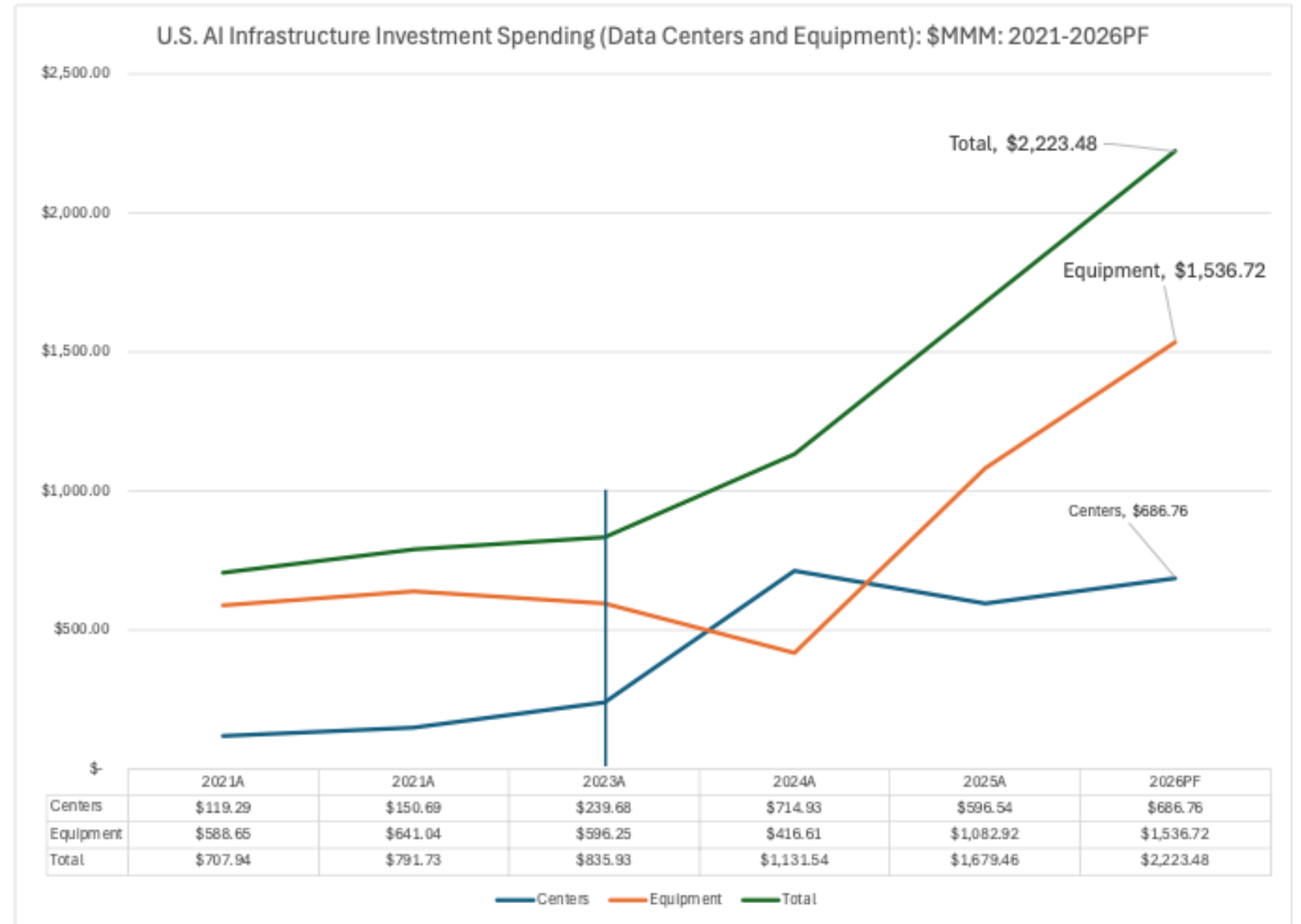
Magnitude of AI Investing

- The “hyperscalers” are expected to invest over \$600 MMM in AI this year
- Ratched up in 2023
- Has gone from less than 20% to almost 50% of net investing in the U.S.
- Much of this is heavily capital intensive: \$489.4 MMM into data centers and infrastructure in 2024-25
- Another \$48.5 MMM into proprietary information systems



AI Infrastructure Investments

- 1990's "Asset light" technology to 2020's "asset heavy" technology
- Total spending exceeds projected net new investment spending nationally
- Need to frequently replace and/or upgrade equipment
- Expected to be as high as \$5.0 trillion by 2030: that's equal to today's gross investment levels



Differences in Capital Intensity: Late 1990's v Late 2020's

- Most of the 1990's ".com" investing was financed by new equity issues
- Capital intensive investments in infrastructure such as DSL and fiber optic networks were more commonly debt finance
 - Default rates within the network of infrastructure providers were high
- 2020's Data Center investments are heavily capital intensive
 - Established companies shy away from new equity: favor operating cash flows
 - Debt is being more commonly used to finance capital intensive development
 - The potential volatility is high and the payback period longer for many of these investments
 - The industry is currently at the "entry level" of development: lots of companies investing in pursuit of the big profit prize
 - In the past, the entry level is often followed by periods of falling margins, shakeouts and consolidations
 - There is a big difference between consolidating under equity as opposed to debt driven capital structures;

Energy Intensity of AI Infrastructure

- In addition to fixed capital assets, data centers will require energy estimated to run up to 20% of the current demand in the U.S.
 - This will have a significant impact on energy prices throughout the economy
 - Fossil fuels (natural gas) now: nuclear later?
 - Microsoft and Constellation Energy reopening Three Mile Island
 - Restart of Reactor 1
 - 20-year power purchase agreement
 - 835-megawatt output: all purchased by Microsoft
 - Opening late 2027
 - \$1.6 MMM (including \$1.0 MMM DOE loan)
 - Power will go into a grid to offset Microsoft's power use in other areas

Structuring of AI Investment Financing

- Tech industry and investing: Late 1990's
 - Equity investing in software and Dot.coms
 - Debt driven infrastructure investing (DSL/Fiber optics)
 - 50% of start-ups lasted at least five years
 - Several big hits (e.g., Amazon)
 - Default rate on speculative debt funding infrastructure reached 10%
- Tech industry and investing: 2020's
 - 2024: \$233 MMM Equity; \$16.7 MMM debt (7%)
 - 2025: \$311 MMM Equity; \$109 MMM debt (26%)
 - Increasing use of “Enronesque” financing tools:
 - SPV's; Partnerships; Vendor leases; Variable interest entities; all designed to take risk off the balance sheet
 - Increased use of private credit sources

Private Credit and Technology: IED's

- High risk sectors:
 - ***Software and technology***—20% of private credit portfolios
 - ***Healthcare services***---concentration of highly leveraged roll-up investments among providers
 - Overvaluation in ***fragmented roll-up sectors***: examples include car washes, veterinary practices, HVAC and other installation and maintenance sectors
 - ***Cyclical industries***—especially those that are energy and chemical commodity intensive-----this will be a huge problem for data centers

Alphabet and Oracle

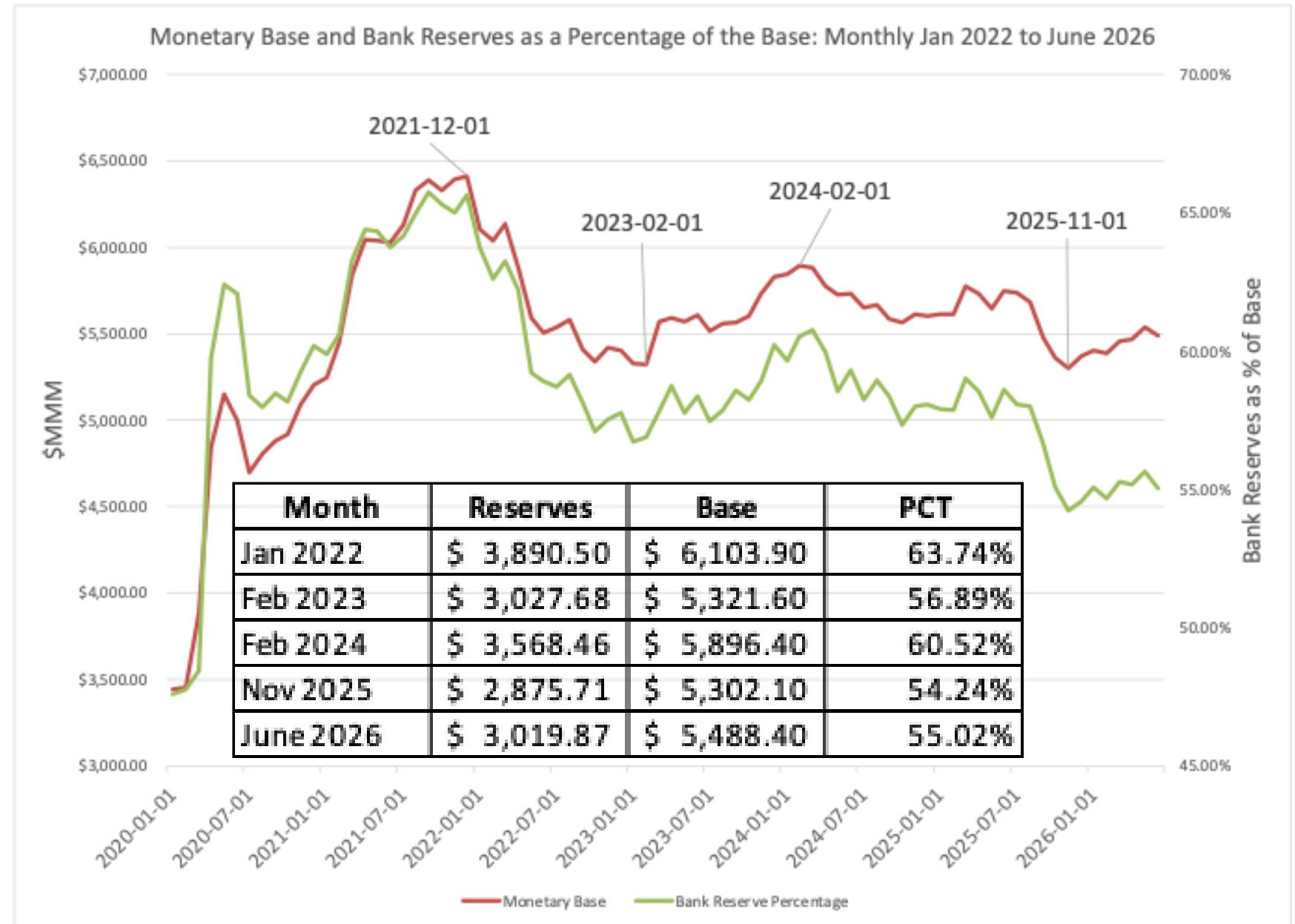
Measure	2025	
	Alphabet (GOOGL)	Oracle (ORCL)
Total Revenue	\$402.8 MMM	\$57.4 MMM
Net Income	\$132.2MMM	\$12.4 MMM
Operating Cash Flow	\$164.7 MMM	\$20.77 MMM
Capital Expenditures	\$91.4 MMM	21.22 MMM
Long-Term Debt	\$46.5 MMM	\$122.3 MMM
Debt-to-Equity Ratio	0.11	2.84
Return on Assets (ROA)	15.40%	6.50%
Net Margin	32.80%	24.50%
Distributions	\$45.7 MMM; \$10.0 MMM dividend	Paused \$203 MM buyback to service debt
Capital Issues	\$29.0 MMM in debt	\$16.0 MMM in debt

Alphabet and Oracle

Measure	2026	
	Alphabet (GOOGL)	Oracle (ORCL)
Data Center Leases	Relatively low	<i>\$260 MMM long term</i>
Revenue (est)	\$445.9 MMM	\$67.36 MMM
Net income	\$244.21 MMM	\$17.09 MMM
Debt/EBITDA	< 1.0	> 4.3
Capital Expenditures	Over \$200 MMM	\$55.60 MMM
Expected Op Cash Flow	\$185 MMM as of June 2026	\$32.0 MMM
Capital Issues	\$85 MMM equity (private placement); \$25 MMM international bond sale; \$25 MMM mega bond US offering	\$47.7 MMM mixed debt and "at the market equity. (\$42.7 MMM in unsecured notes)

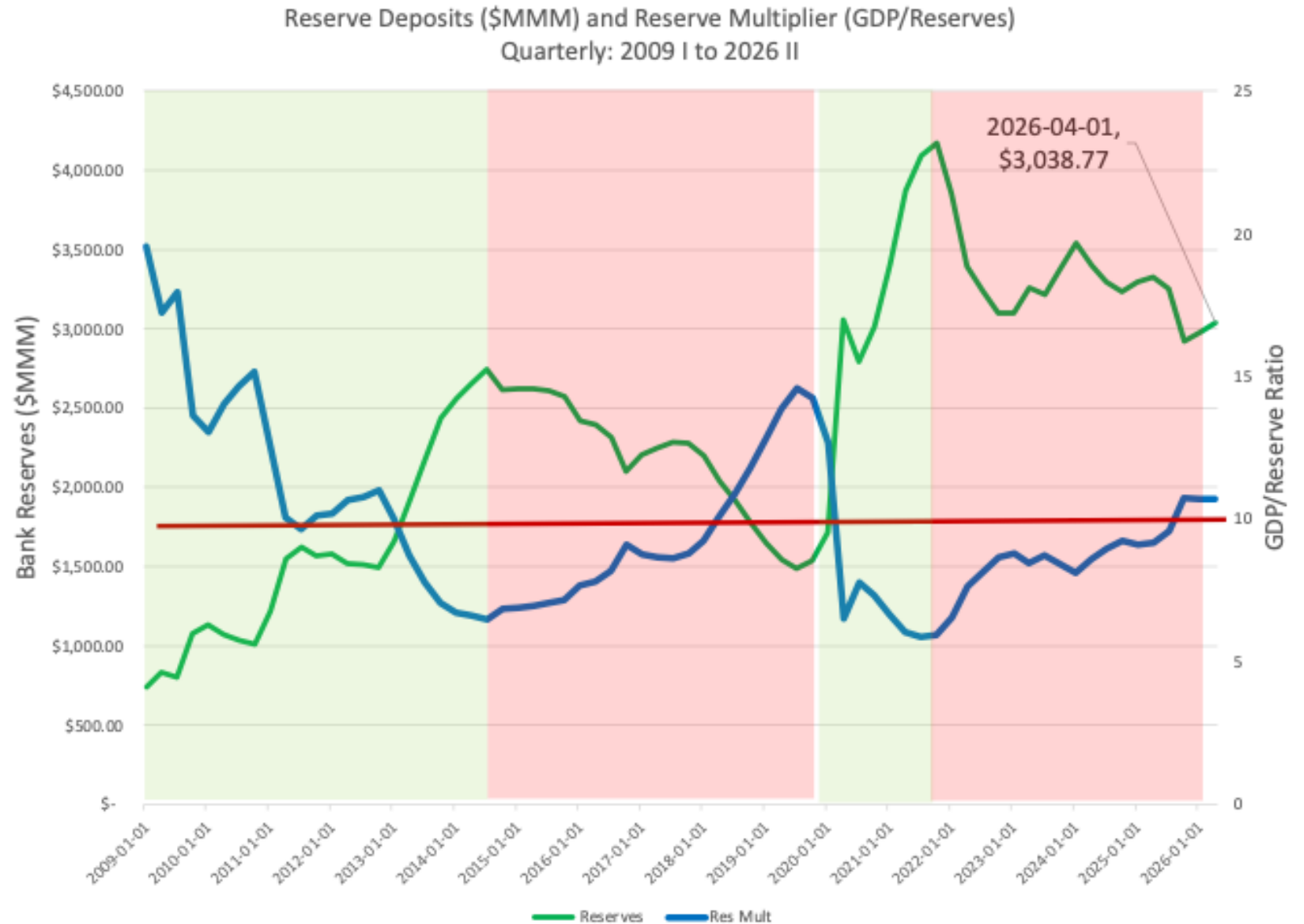
Fed Reserve Management

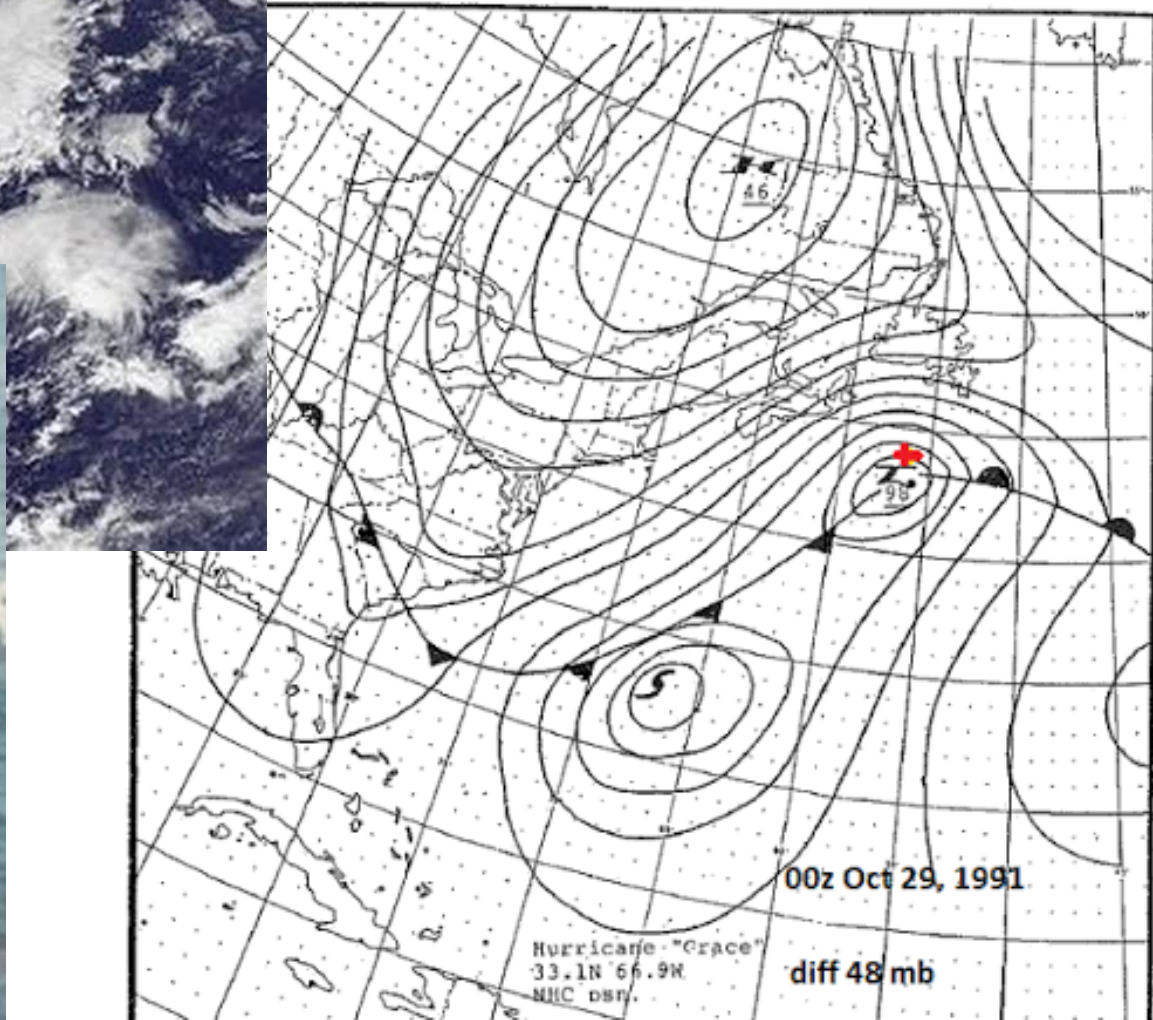
- The Fed appears to be concentrating more on reserves than on interest rates
- Reserves provide both fuel for loans and a safety cushion in a debt crisis (i.e., reserves collapsed in 2008)
- Since 2008, banks have held between 50 and 60% of the monetary base in the form of reserve deposits at the Fed. Prior to 2008, reserve balances were minimal
- When the Fed tightens, reserve percentages typically fall, creating greater potential instability in the financial markets.
- The Fed targets reserves to be about 10% of GDP



Focus on Reserves, Not Rates

- Post 2008 regulation drove lending into private credit markets
- Fed and Treasury both want to see that brought under the Fed's direct influence and control
- Maintain “ample reserve balances”
- Loosen lending regulations to reallocate from private credit into the regulated banking segments





Dashboard

- Economic bifurcation will worsen in an AI regime
- Geopolitical events will continue to disrupt economic markets, in particular, energy and food
- Keep an eye on bank reserves, not rates
- Examine your portfolio for potential impact of energy-related volatility
- Understand your customers' capital structures
- Understand exposure of customers' revenue bases to energy and debt driven volatility
- Don't mistake Artificial Intelligence as your own
- Don't over rely on AI
- Focus on balance sheet liquidity and cash flow
- Act in such a way as to advance the virtue of self-control in our economy

