

GREENROCK RESEARCH

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When Everything Points the Same Direction

There are quarters when the signals are contradictory and the wisest thing you can say is: the picture is mixed, and we will watch it carefully. This is not one of those quarters. As we close the books on the second quarter of 2026, the evidence has not only continued in the direction we warned about — it has intensified. The domestic stock market is more expensively priced than it was when we last wrote to you. A geopolitical conflict has added a new inflationary force that was not in the equation three months ago. And the Federal Reserve, which many investors were expecting to cut rates this year, is now widely expected to raise them. We do not enjoy delivering cautious news, but we would rather be honest with you than comfortable.

The Market Gets More Expensive

In our first quarter letter, we reported that the price-to-sales ratio of domestic large-cap stocks had reached 3.17 — a level with no precedent in over 150 years of data. We called it ridiculous overvaluation. We stand by that word. As of mid-June 2026, the price-to-sales ratio has climbed further, to 3.70. Let that sink in. The most expensive market in recorded history has gotten more expensive in the past three months.

What does history tell us? In 91% of all months over the past 150 years, the price-to-sales ratio was below 2.0. At our current reading of 3.70, the market would have to fall more than 45% simply to reach a level that was historically normal. We are not predicting that fall — no one can tell you when a correction of that magnitude might arrive. But we are telling you that the wind is firmly in investors' faces today, and those who pretend otherwise are making an optimistic assumption that history does not support.

A New Complication: The Iran Conflict and Oil

Three months ago, our concern was simply that stocks were too expensive and that interest rates made bonds unattractive. That was a difficult enough environment. Since then, a new variable has entered the picture. The U.S.-Israel military operation against Iran, which began in late February, disrupted shipping through the Strait of Hormuz — the passage through which roughly 20% of the world's oil supply travels. At its peak, Brent crude oil surged above \$100 per barrel for the first time since 2022.

Oil at elevated prices does two things that investors must take seriously. First, it raises the cost of nearly everything, because energy is embedded in transportation,

manufacturing, and food production. Second, it makes the Federal Reserve's job harder. The Fed cannot cut rates when inflation is rising; in fact, elevated oil prices raise the probability that it will need to raise rates instead. This is precisely what markets are now pricing in. Six months ago, the consensus was expecting cuts.

We want to be careful not to overstate what we know. Geopolitical situations are unpredictable, and oil prices have moderated somewhat from their peaks. But the key lesson from history is that energy shocks have a way of broadening into the rest of the economy. They raise costs, they slow growth, and they complicate policymaking. The combination of high stock valuations and an oil-driven inflationary impulse is not a backdrop that has historically rewarded index investors.

Interest Rates: The Direction Has Changed

In our last letter, we noted that the yield on the 10-year U.S. Treasury was 4.3% and expressed skepticism that rates would fall. That skepticism has been validated. The 10-year yield has risen to approximately 4.5% as of this writing, and the trajectory is upward, not downward. When oil prices are elevated, when the fiscal deficit remains wide, and when the Fed is being pressured to raise — not cut — rates, the case for owning long-term bonds becomes very difficult to make.

We exited traditional fixed income six years ago, and we continue to feel no urgency to return. Instead, we have used a diversified multi-asset strategy that targets similar volatility to the 10-year Treasury but has delivered meaningfully better returns. Over the five years ending June 30, 2026, the 10-year Treasury produced an annualized return of -1.60%.

There is a simple logic to why we prefer this position today. If rates rise from here, bonds will produce negative total returns, and history tells us our substitute does better. If rates stay flat, bonds yield 4.5% and history suggests we do slightly better than that. If rates fall, bonds will produce a positive total return, and in that scenario history shows mixed results for us versus bonds. Two of three scenarios favor us. The third is a draw at worst. We like those odds.

Equities: Our Strategy, Not Theirs

The S&P 500 has continued to climb in 2026, gaining roughly 11% through the end of May. The enthusiasm around artificial intelligence has sustained a level of optimism in the market that is reminiscent of what we saw in 1998 and 1999, when the internet was going to change everything — and it did, just not in a way that rewarded investors who paid those prices.

We are not calling a top. We said the same thing three months ago and the market has risen further since. The lesson of overvalued markets is not that they fall immediately — it is that those who buy at the top pay a very high price over the long run.

Our equity strategy remains centered on portfolios of high and growing dividend payers across three segments: domestic large cap, domestic small cap, and international. We

believe the conditions today — extreme overvaluation of domestic large caps, concentrated index returns, and an uncertain macro backdrop — are the conditions under which our dividend strategy will again distinguish itself over the coming years.

International equities deserve particular attention. For a second year running, international markets have outperformed domestic large caps, aided by a weaker dollar, more attractive valuations, and stronger economic momentum in parts of Europe and Asia. We allocate approximately 42.5% of our equity exposure to international stocks, and that exposure has been a meaningful contributor to results. Research Affiliates, whose long-term return forecasts we have cited in prior letters, continues to project roughly 8% annualized returns for international equities over the next decade, compared to approximately 3% for domestic large caps. We do not take those projections as precise, but the direction is unambiguous.

Bitcoin: Patient Investors Will Be Rewarded

Bitcoin has been volatile this quarter, trading in a range roughly between \$62,000 and \$73,000. We are not surprised by this. We have always been clear that Bitcoin is not for every client, and that those who own it must be prepared for sharp moves in both directions. What has not changed is our long-term view.

We began recommending Bitcoin when the price was between \$6,000 and \$10,000. Today it trades near \$65,000 — a seven-to-ten-fold increase. Our expectation is that the same magnitude of appreciation is possible from these levels over the next ten years. The case for Bitcoin as a store of value, as a gold substitute with superior characteristics, and as an asset that is uncorrelated to traditional markets, has not weakened. If anything, its acceptance by institutional investors and its growing use as a reserve asset by sovereign entities has strengthened the long-term thesis.

We would encourage advisors who have not yet had the Bitcoin conversation with appropriate clients to consider doing so. A small allocation — in our view, no more than 3% to 5% of a portfolio — can add meaningful long-term upside without materially changing the risk profile of a diversified portfolio. We have a short paper on Bitcoin available for those who would like to share it with clients.

Private Investments: Cash Flow in an Uncertain World

In an environment where both stocks and bonds look unattractive, cash-flowing private investments become even more valuable. We currently have three private investments across different sectors and geographies, all with current cash flow yields of 5% to slightly over 6%. These investments carry expected maturities of three to four years and historical and expected total returns in the mid-to-high teens.

We want to be direct about what we like about these investments today. First, they generate income now — they do not require you to wait for a sale at the end. Second, their returns are not correlated to the daily movements of the stock market. Third, in a period when the index investor is earning 11% this year but has very little margin of

safety for the years ahead, private investments with current cash flow offer an alternative path. We have negotiated minimums as low as \$25,000 for some of these investments, making them accessible to a wider range of clients.

A Final Word on Patience

We are aware that caution can feel unrewarding when the market is up 11%. We experienced the same dynamic in 1998 and 1999. Investors who were cautious in 1998 missed the final year of gains. But investors who were cautious in 1999 avoided the decade that followed. We do not know which year this is. What we do know is that the cost of being wrong about overvaluation today — the cost of buying the index at 3.7 times sales and holding it through a mean reversion — is very high. The cost of patience is forgoing some near-term upside in an index that already looks very expensive. We believe that is a trade worth making.

Our strategies are designed precisely for this kind of environment: a bond substitute that has outperformed long-term Treasuries over the past five years, a dividend equity strategy with a long track record of outperforming the S&P 500 in periods of high valuation, private investments with current income, and a small allocation to Bitcoin for those who can handle the volatility. We believe this combination will serve your clients well in the years ahead.

As always, we welcome the opportunity to speak with you directly about any of these ideas or to participate in conversations with your clients. Please reach out to us at any time.

Kevin Malone

Greenrock Research

444 W. Lake St., Suite 1700 | Chicago, IL 60606 | (312) 463-1301

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