Jumping the Shark?

> **"Every bull market eventually reaches a chokepoint.**
> **The question is whether it jumps through—or jumps the shark"**
>
> – **Ronald G. Albahary,** Chief Investment Officer at LNW

Introduction

I used the phrase "jumping the shark" recently in a conversation and caught myself wondering how many people in the room knew where it came from. For those of a certain vintage, it refers to a two-part Happy Days episode from September 1977, in which Fonzie, leather jacket and all, waterskis over a shark. The scene ends with him suspended mid-air between two ramps, and viewers had to wait a full week to find out how it turned out.

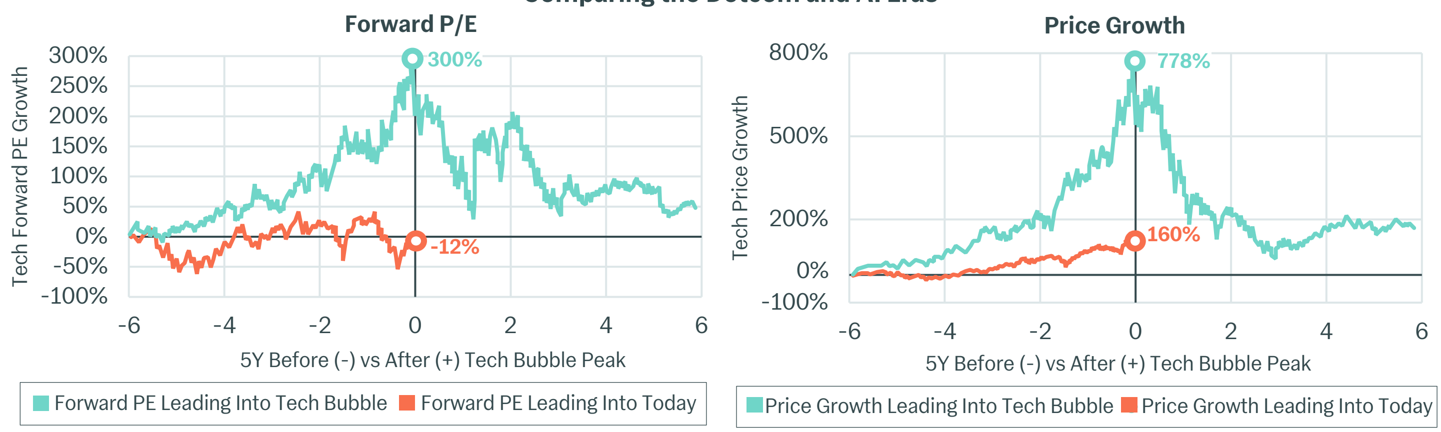
The phrase has since taken on a broader meaning: the moment when something that once felt grounded begins to stretch credibility causing a narrative to outrun reality.

SpaceX may end up being a useful example. The company priced its initial public offering ("IPO") at $135 per share in mid-June, the largest in history, and immediately traded to a market cap above $2 trillion. For a business that lost nearly $5 billion last year and is running capex that has more than doubled year over year, that's a number that reflects something beyond the core business. It embeds expectations for initiatives (many of them AI-related following the company's acquisition of xAI earlier this year) that may take years to develop (like data centers in space!) and longer still to produce durable cash flows. The post-IPO selloff suggests some of that enthusiasm is already being stress-tested.

This is not the late 1990s. AI is not a concept–it is generating real revenue at real companies, and the businesses at the center of it are fundamentally better than anything the dot-com era produced. But moments like SpaceX's debut can serve as early signals of how far the market is willing to project forward, and how readily it will finance that projection.

In prior cycles, peaks were often marked by capital flowing toward unprofitable businesses at increasingly ambitious valuations. The companies behind the stocks that are appreciating this cycle are profitable and some are experiencing accelerated growth rates. But it feels directionally relevant in one respect. Parts of the market may be

Comparing the Dotcom and AI Eras

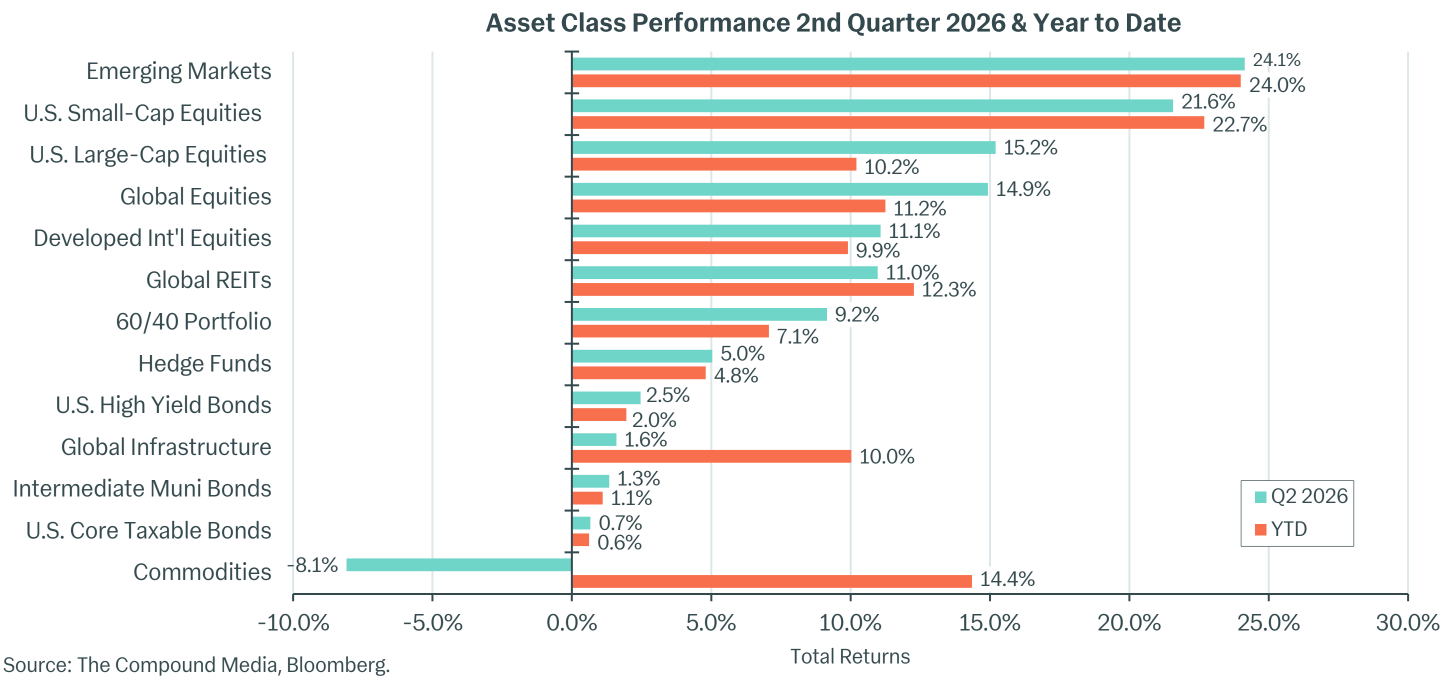


Source: The Compound Media, Bloomberg.

getting ahead of themselves as prices surge, even as the broader backdrop for the benefits derived from the technology remains constructive. Additionally, we need to consider that this may end up being a bubble, not necessarily in stock price prices, but in earnings growth rates and expectations. Only time will tell.

It is also worth stepping back for a moment. That Happy Days episode aired nearly fifty years ago. In 1977, no one watching Fonzie (other than fans of Star Trek) clear that shark could have imagined what the next half century would produce such as the internet, smartphones, GPS in every pocket, and now AI reshaping entire industries in real time. The arc of that change is genuinely extraordinary, and it is a reminder that today's ambitions have a way of becoming tomorrow's infrastructure. But even in the most remarkable periods of progress, there are moments when the market's expectations outrun what any company can reasonably deliver and the gap between the two is where the risk heightens. Even Fonzie's jump came down to one narrow point between the ramp and the water. We may be in one of those moments now.

Quarterly Asset Class Performance Summary



Source: The Compound Media, Bloomberg.

US Equities: With a roughly 15% rally in Q2, the S&P 500 quietly achieved its strongest quarter in 6 years, turning a difficult start to the year into a healthy 10% year-to-date return. However, a weak end to the quarter in June exposed just how quickly leadership can rotate: A sharp June decline in AI and mega-cap technology shares including the Magnificent 7 placed them slightly behind the S&P 500 for the quarter but they still finished with a 12% return. Tech still led US stocks, but it was the providers of AI "infrastructure" such as chip manufacturer Micron Technology (+242% Q2) that led the charge. Meanwhile, industrials (+15% Q2) and energy (-13% Q2) stood out to the positive and negative as investors shifted more defensively in case of the former and prolonged oil shortage concerns given Middle East conflict dissipated regarding the latter.

International Equities: Foreign markets featured a similar shift in leadership and risk sentiment, but now familiar EM tech names continued to drive results with, for example, South Korea's Samsung returning 428% in the quarter. Non-US developed stocks in aggregate trailed just behind US stocks and have returned more than 9% year-to-date. Developed Europe results were competitive with the US with some relief from cooling inflation in Germany, France and Italy, reducing the urgency for additional ECB policy tightening. On the other hand, China's struggles (-5% Q2) continue to weigh on global markets as investors have questioned whether the nation's tech heavy weights are positioned to compete on the AI front. Meanwhile, weak domestic demand and property activity remain structural headwinds.

Fixed Income: Fixed income remained stuck between slowing growth signals and stubborn inflation. The Fed held its policy rate at 3.50%-3.75% in June, but market expectations shifted away from near-term cuts and toward the possibility of another hike given a hawkish introductory statement from new Fed Chair Kevin Warsh. The 10-year US Treasury yield ended the quarter near where it started at approximately 4.4%, but the Treasury yield curve flattened, and high yield corporate credit spreads widened indicating some lack of bond investor confidence in near-term Fed rate relief. Amid that backdrop, core bonds as measured by the Bloomberg US Aggregate Bond Index eked out positive returns. Meanwhile, municipal bonds performed well and lead core taxable bonds year-to-date as strong demand from the unwind of seasonal tax selling alongside attractive tax-equivalent yields drove results.

Market-Implied Fed Funds Policy Rate:
December 2026 Fed Meeting

Source: Bloomberg as of 7/7/26.

Real Assets: Real assets lagged other risk-oriented assets in Q2 despite accelerated inflation. Still, infrastructure and real estate posted positive returns buoying the asset class, each benefitting from the continued build out of AI infrastructure including power grid enhancements and required data centers. Meanwhile, oil prices eased dramatically as the potential reopening of the Strait of Hormuz reduced supply concerns, with analysts cutting 2026 Brent and WTI forecasts after the conflict-driven spike begun in late February. Gold likewise moved in the opposite direction from its early-year strength, falling more than 11% in June alone making for the worst full quarter in 13 years as higher rate expectations reduced demand for non-yielding assets.

Diversifiers and Private Markets: Hedge funds have posted modestly positive returns outpacing fixed income and real assets in the quarter and generally keeping up with a 50/50 global equity/bond blend. Equity biased managers have unsurprisingly been among the best performers year-to-date but so have macro strategies, exploiting the volatility driven in large part by recent geopolitical and macroeconomic uncertainty. Private markets remained characterized by significant dispersion as AI-linked businesses continued commanding premium valuations while more cyclical and rate-sensitive sectors faced a slower exit environment. Transaction activity has improved modestly for private equity, but realizations (and, thus, distributions) remain below historical norms, keeping liquidity a central concern for both GPs and LPs. Elevated financing costs continue to pressure traditional leveraged buyout economics, increasing the importance of operational value creation, sector selection, and manager skill when selecting partners.

A Strong Surface, A More Complicated Underneath

The market continues to hold up well, but the story beneath the surface is becoming more complicated. We are coming through a period where geopolitics, monetary policy, and a powerful technological cycle have all converged. Rather than viewing these as separate forces, we think it is more useful to see them as part of a common structure defined by a series of chokepoints across the global economy and financial markets.

This is an extension of the multipolar world thesis we have been discussing since January 2022. In a world no longer organized around one dominant economic and political center of gravity, power is increasingly exercised through control of critical pathways, inputs, routes, technologies, and sources of capital. Covid exposed the fragility of global supply chains. Russia's invasion of Ukraine exposed Europe's dependence on energy flows and key commodities. The Iran war reminded investors that the global economy can still be held hostage by a small number of strategic transit routes. Now the AI buildout is exposing another set of constraints around semiconductors, power, the electrical grid, water, data centers, and funding capacity.

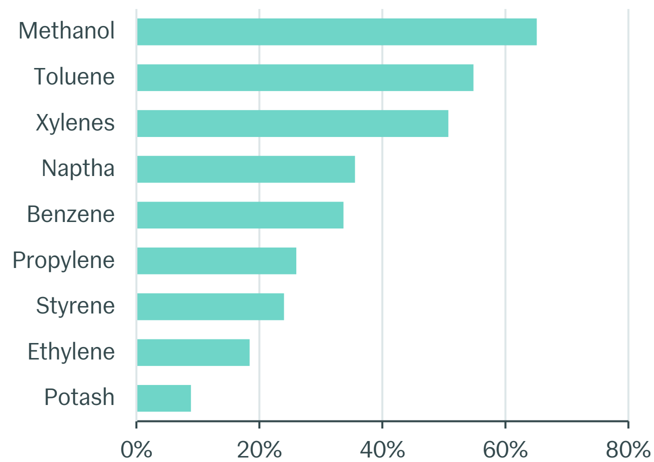
The important point is that we are not simply going back to the pre-Iran war world. A binding ceasefire or de-escalation would clearly be welcome, but to this point that has proven elusive and even if achieved wouldn't erase the fragility that has been revealed. Investors may be tempted to treat the end of the conflict (whenever that occurs) as a return to normal. We think that would be a mistake. The more lasting lesson is that the global economy is increasingly shaped by chokepoints, and those chokepoints can quickly move from the background to the center of market pricing.

Chokepoints Across the System

Some of these chokepoints sit in the real economy. The Strait of Hormuz is one of the most visible examples because it affects energy flows that ripple through transportation, petrochemicals, agriculture, manufacturing, and ultimately inflation. Even when the direct impact is contained, the second order effects can matter for confidence, business planning, and the policy outlook.

Supply chains are another example. The world has spent the past several years talking about reshoring, friendshoring, redundancy, and resilience, but the reality is that many systems remain more fragile than they appear. Energy, petrochemicals industrial inputs, rare earths, and critical components still move through relatively narrow pathways. In a more multipolar world, those pathways are not just logistics issues, but can become sources of economic leverage.

Petrochemical & Fertilizer Components Price Increases
(2026 YTD)



Source: Macro Commodity, IMARC Group, Bloomberg as of 6/30/26.

The same framework applies to the AI buildout. Semiconductors are the most obvious pressure point because the entire ecosystem depends on a narrow set of advanced chips and manufacturing capacity. But the constraints extend beyond chips. Data centers require massive amounts of power. In some regions, they also place increasing pressure on water availability. Grid capacity, permitting, land, cooling infrastructure, and energy contracts all become part of the AI investment cycle. These are not abstract risks, but are practical limits on how quickly capital can be converted into productive capacity.

Financial markets have their own chokepoints as well. Rates set the valuation framework, but they also determine the cost of scaling. The public equity markets must be able to absorb new issuance. Credit markets must be willing to fund the next phase of growth. Equity investors must remain willing to underwrite long duration cash flows. When growth and capital run through a limited number of channels, each of those channels becomes a pressure point.

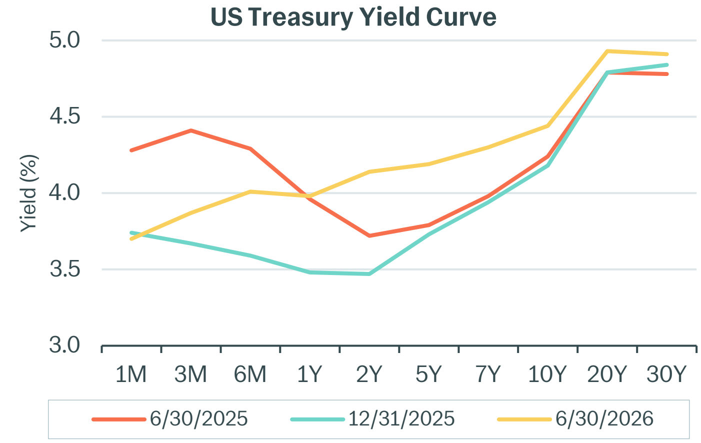
Taken together, this is what we have been referring to as a market defined by **chokepoints**. The issue is not any single chokepoint in isolation. It is the way they interact and reinforce one another across the system.

The Fed, Rates, and a Market Searching for Clarity

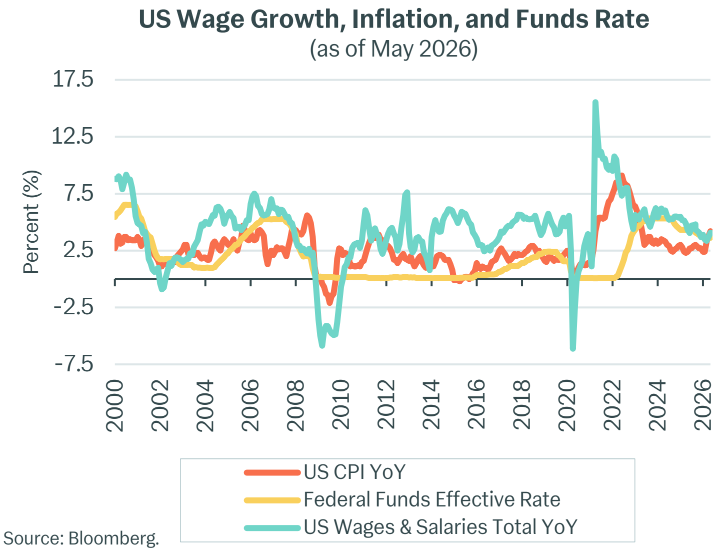
Those chokepoints are feeding directly into the policy backdrop. Inflation has proven more persistent than expected, but longer-term inflation expectations tell a more stable story. Market based measures that look beyond the near-term cycle, particularly expectations five years forward, have remained well anchored in the low 2% range. That is a very different signal than the one implied by the current focus on near term inflation prints. The divergence is important because investor psychology, and to some extent the Fed, appears to be placing greater weight on recent data than on where inflation is expected to settle over time, which creates a risk that markets may be overestimating inflation persistence while underestimating the potential for growth to slow as a result of higher costs related to chokepoints.

The rates market reflects that tension. The two-year Treasury yield remains above the Fed funds rate, which on the surface suggests that investors are assigning some probability to tighter policy. I am not convinced that additional tightening is the most likely path. A more plausible interpretation is that the market is attempting to reconcile conflicting forces: inflation that has not fully returned to target, growth risks that are building beneath the surface, and geopolitical effects that can move quickly through energy, confidence, and financial conditions.

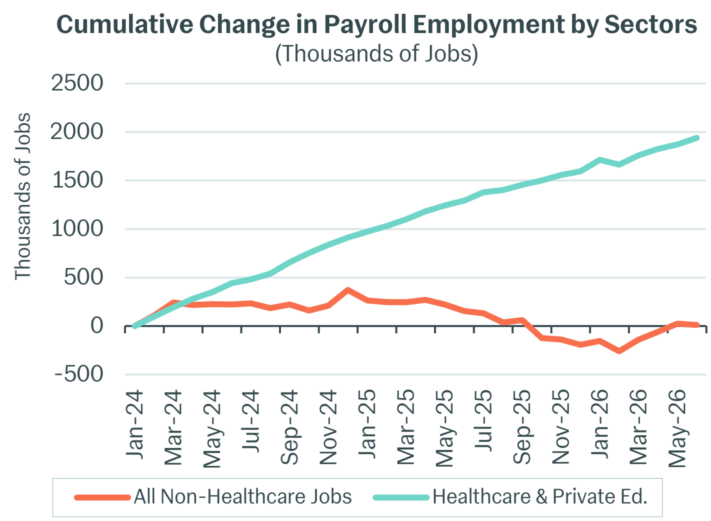
The labor market is a unique chokepoint for the Fed that was already facing structural challenges from declining immigration and Artificial Intelligence changing the landscape for workers. And unfortunately, the labor market data doesn't offer clear support for policy one way or the other. At the headline level, the labor market, including unemployment as well as job and wage growth, underscores the resiliency of the economy, as not many workers are finding jobs but not many are being forced to. However, each of those metrics looks a little weaker upon examination. The unemployment has been held artificially low as the labor market participation rate has fallen back to late 2020 levels, job growth itself has actually been negative outside of health care and wage growth no longer outpaces inflation.



Source: Ycharts as of 6/30/26.



Source: Bloomberg.



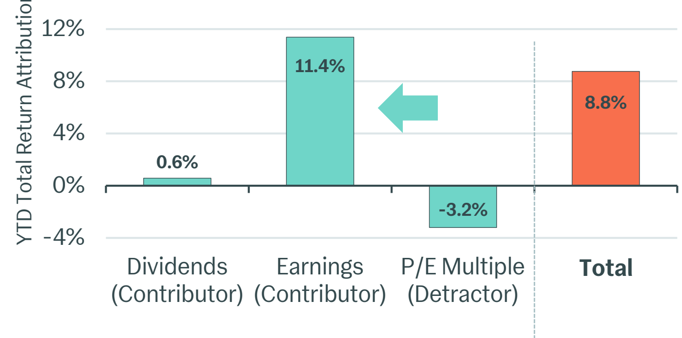
Source: Bloomberg as of 6/30/26.

This is where policy itself becomes another chokepoint. The Fed has less room to maneuver than it had in prior cycles. If inflation expectations remain contained, weaker growth could eventually justify easing. But if energy or supply shocks reemerge, the Fed's job becomes more complicated as supply chokepoint driven inflation persists. Markets are likely underestimating how nonlinear that path may be.

AI: From Narrative to Verification

The AI-driven portion of the market is where many of these dynamics come together most clearly. The case for AI, particularly its ability to improve productivity, remains intact. The scale of the opportunity is significant, and the earnings being generated are real, at least for now. What has changed is not the thesis, but the market's understanding of how the value created by AI will be distributed. The key question is no longer whether AI will generate economic benefits, but which companies will capture them, which will see them competed away, and how much of that outcome is already reflected in today's valuations.

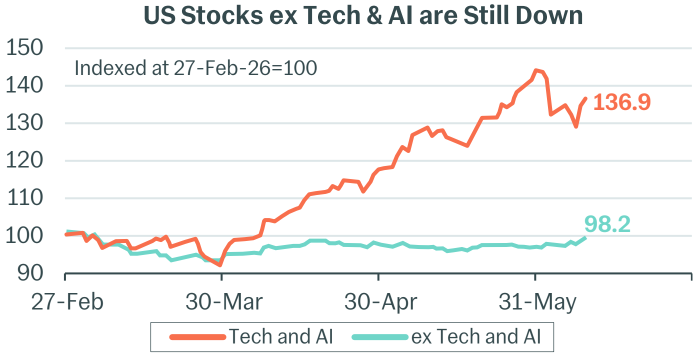
S&P 500 YTD Total Return Broken Down By Contributions From Earnings, P/E Multiple, and Dividends



Source: Factset as of 6/8/26.

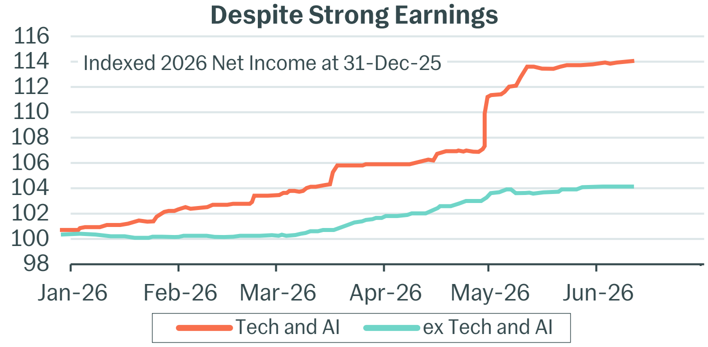
This is where I have been using the term "implicit leverage". By that I mean a narrative driven form of market exposure, tethered largely to the AI narrative, that does not appear as leverage on a balance sheet but shows up through market concentration, valuation dependency, earnings expectations, and positioning. Passive equity portfolios have become increasingly exposed to a narrow set of AI related assumptions including semiconductor demand, continued capital investment, power availability, and the cost of capital just to name a few.

US Stocks ex Tech & AI are Still Down



Source: HSBC, Bloomberg, Factset.

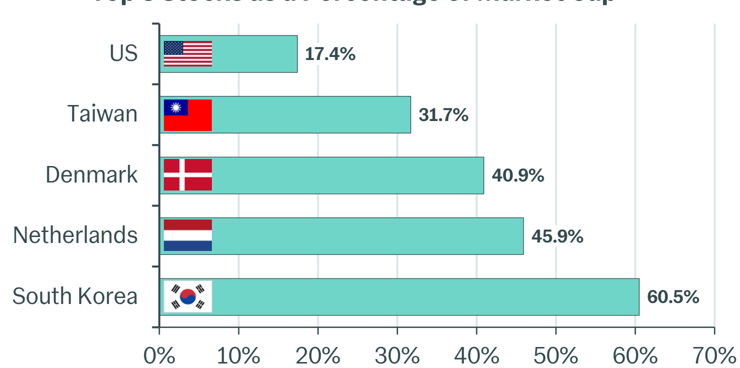
Despite Strong Earnings



Source: HSBC, Bloomberg, Factset.

That is implicit leverage because the market's sensitivity to that narrative is greater than many investors may appreciate. The AI narrative is a global one that has led to market concentrations outside the oft highlighted Magnificent 7. For example, including related entities, SK Hynix, Samsung and Hyundai account for more than 60% of South Korea's equity market cap. Meanwhile, Taiwan Semiconductor alone accounts for more than 20% of Taiwan's. When the narrative is working, it supports returns and reinforces confidence. But when any of the underlying pressure

Top 3 Stocks as a Percentage of Market Cap

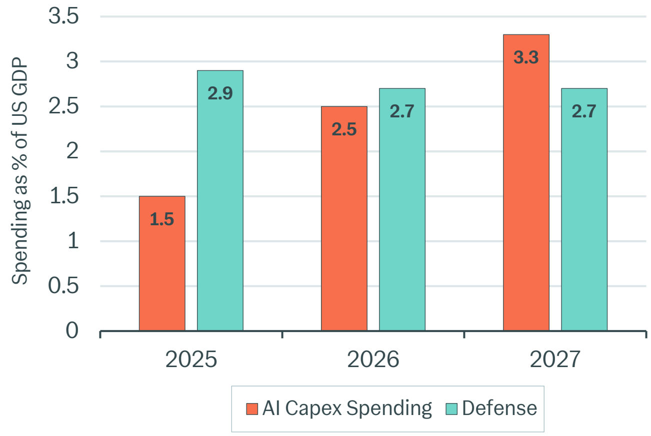


Source: Bloomberg and LNW as of 6/30/2026.

points begin to shift, the effects can be outsized. At the same time, the AI investment cycle is beginning to transition toward more explicit leverage. Much of the buildout has been funded internally to date, but capital expenditures are growing at a pace that may outstrip operating cash flow. If that continues, funding will increasingly rely on debt and equity issuance.

That shift matters because growth funded internally is treated differently than growth funded externally. Debt introduces interest expense and equity issuance introduces dilution. Even if revenues grow, earnings per share can come under pressure as the cost of sustaining growth rises. This does not undermine the long-term AI opportunity, but it does change how the market evaluates it.

Spending on AI Capex vs. National Defense, as a % of GDP



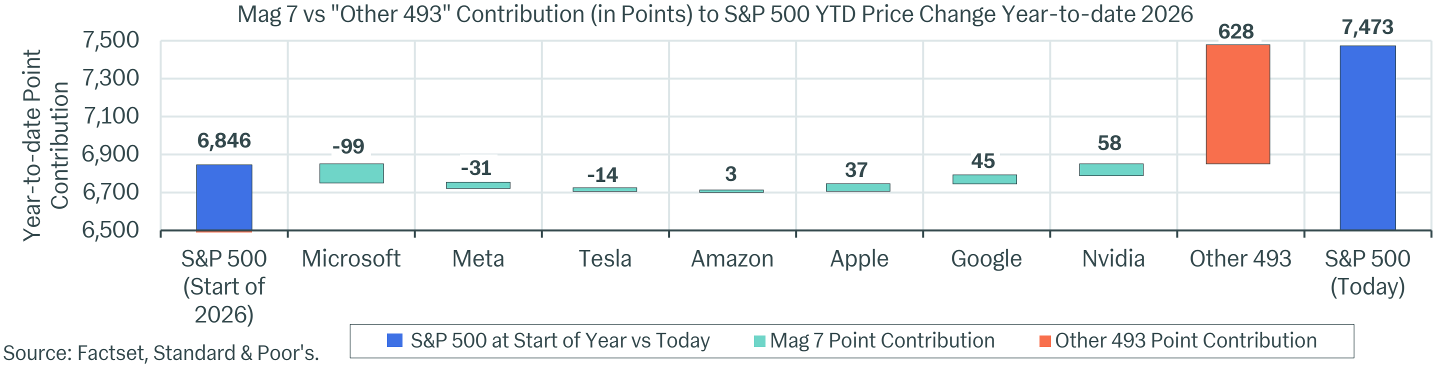
Source: Wall Street Journal, Morgan Stanley, Congressional Budget Office.

A More Selective Market

This does not point to a market that is breaking down. It points to a market that is becoming more selective, with a wider dispersion of outcomes as investors place greater emphasis on earnings quality, cash flow generation, capital discipline, and the durability of business models. Case in point, while the other 493 S&P 500 companies have outperformed the Magnificent 7 year-to-date, since March, the broader group of businesses enabling the implementation of AI have surged.

Illustrating the Mag 7s Less Outsized Impact on the S&P 500

Mag 7 vs "Other 493" Contribution (in Points) to S&P 500 YTD Price Change Year-to-date 2026



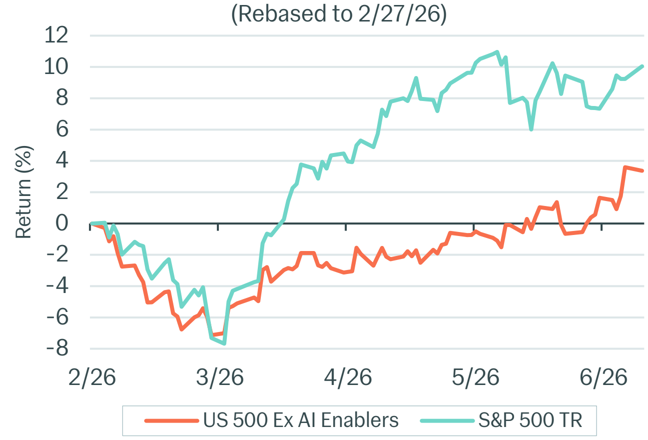
Source: Factset, Standard & Poor's.

Recent volatility in semiconductors is another useful example. As the core input to the AI buildout, they are one of the most important chokepoints in the system and one of the most visible ones to investors. When expectations shift, they reprice quickly while the broader market can remain relatively stable.

That dynamic reflects a broader shift. The 2010s was a period defined by abundance across liquidity (does anyone remember ZIRP and negative interest rates on sovereign bonds?), supply chains, and capital. Today's environment is increasingly defined by constraints. Those constraints do not eliminate opportunity, but they do make the path to realizing those opportunities more demanding.

US 500 Ex. AI Enablers Relative to S&P 500 Index

(Rebased to 2/27/26)



Source: Bloomberg as of 7/6/26.

Closing Thoughts: Staying Grounded at Highs

Let me make one practical and important final point. When markets are at or near highs, it's easy to feel good about risk. That's just human nature. Recent experience starts to shape expectations. What worked continues to feel like it should work, and the risks that were obvious in more volatile periods fade pretty quickly. That is exactly when it makes sense to take a step back and ask a simple question. If the market environment looked very different tomorrow, would your portfolio still feel aligned with what you are trying to accomplish, or has it drifted based on what has worked recently?

That is what we mean by revisiting risk tolerance. Not in reaction to a drawdown, but when things are going well. Because risk tolerance is not just about how you feel when markets are down. It is just as much about the decisions you make when markets are strong.

What we have been describing throughout this commentary is a market that has become more dependent on a smaller number of drivers. Whether it is energy flows, supply chains, semiconductors, capital availability, or the AI buildout more broadly, a lot is running through a relatively narrow set of pressure points, and that is where the idea of chokepoints becomes relevant at the portfolio level. It is not that those risks will necessarily materialize, but that portfolios can become more exposed to them than intended, especially in a narrative-driven environment where performance has been concentrated.

That is also where I think about what I have referred to as implicit leverage. You may not see leverage on a balance sheet, but you can still have a portfolio that is highly dependent on a single set of assumptions continuing to play out.

This is where thoughtful asset allocation is critical. Having the right mix of complementary exposures across asset classes, populated with a range of what I like to call "ingredients," or strategies, is what helps absorb some of that uncertainty and is how we think about infusing portfolios with the right ingredients. Public equities will continue to play an important role, but they do not have to carry the entire load. Fixed income provides ballast and income. Real assets can offer protection in inflationary or supply constrained environments and increasingly provide exposure to the underlying infrastructure benefiting from this wave of capital spending. Private equity can provide access to long-term growth opportunities that are less tied to daily market movements. Diversifiers, including hedge funds and private credit where appropriate, can help reduce reliance on a single outcome and introduce different return drivers. The goal is not to eliminate risk, but to diversify it in a way that reflects how the world has changed.

None of this is a call to step away from the market. The long-term case for innovation, and for many of the areas driving the market today, remains compelling. What it does suggest is being thoughtful about how that exposure is calibrated, making sure true diversification is built into your portfolio, understanding where concentrations exist, and thinking through how a portfolio would behave if one of those pressure points moves in a way we are not currently expecting.

We are not going back to the environment we had before Covid, before Ukraine, or before the Iran conflict. Each of those events revealed a different layer of dependency in the system, and this is a more complex market even if it does not always feel that way on the surface. The opportunity set is still there. The difference is that getting there may require a little more patience, a little more selectivity, and a little more awareness of where the risks are building.

ABOUT THE AUTHOR

Ronald G. Albahary, CFA® is Chief Investment Officer at LNW. As head of the investment team (see below), Ron brings nearly four decades of experience to determining the firm's investment strategy, directing the investment selection process, and working in tandem with client advisory teams to deliver investment solutions structured to attain each client's unique goals. Prior to joining LNW, Ron served as CIO or CEO at regional investment firms focused on ultra-high-net-worth families and foundations. Earlier in his career, he held leadership positions in the private client business of major global financial institutions, including Merrill Lynch and Northern Trust Private Bank. Ron has a degree in economics from the Wharton School at the University of Pennsylvania and currently serves as advisor to the Center for High Impact Philanthropy at the University of Pennsylvania.

The LNW investment team is comprised of 12 analysts and strategists working together to design and implement investment solutions for client portfolios. Six analysts at the firm hold the Chartered Financial Analyst® designation, with expertise spanning macroeconomics, public and private asset classes across the global capital markets, and impact investing. Collaborating with each other and with client advisors, the investment team's overarching goal is to help clients and their families preserve and grow their wealth over many generations.

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DEFINITION OF INDEXES

Global REITs = FTSE EPRA NAREIT Global Index

A global equity benchmark designed to track the performance of publicly traded real estate companies and REITs worldwide. It includes property owners and operators that meet strict criteria for real estate activities, liquidity, and transparency.

Intermediate Muni Bonds = Bloomberg Municipal 1-10 Year Index

A bond index measuring the performance of U.S. investment-grade municipal bonds with maturities between 1 and 10 years. It includes tax-exempt bonds issued by state and local governments and their agencies, focusing on the short-to-intermediate segment of the muni market.

US Core Taxable Bonds = Bloomberg U.S. Aggregate Bond Index

A broad, market-capitalization-weighted benchmark for the U.S. investment-grade fixed income market. It includes U.S. Treasuries, government-related bonds, corporate bonds, mortgage-backed securities (MBS), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS).

Hedge Funds = HFRX Global Hedge Fund Index

An investable index designed to represent the global hedge fund industry using a rules-based selection of hedge funds. It covers multiple strategies (e.g., equity hedge, event-driven, macro, relative value) and emphasizes transparency, liquidity, and lower survivorship bias.

US High Yield Bonds = Bloomberg U.S. High Yield Bond Index

A benchmark tracking the performance of U.S. dollar-denominated, below-investment-grade corporate bonds publicly issued in the U.S. domestic market. It reflects the high-yield (or "junk") segment of the corporate bond market.

US Large Cap Equities = S&P 500 Index

A widely followed equity index measuring the performance of approximately 500 large-capitalization U.S. companies. It is market-cap-weighted and designed to represent the core of the U.S. equity market across multiple sectors.

US Small-cap Equities = Russell 2000 Index

A U.S. equity index that measures the performance of approximately 2,000 small-cap companies drawn from the broader Russell 3000 Index. It represents the small-cap segment of the U.S. stock market and is widely used as a benchmark for U.S. small-cap equities, which typically exhibit higher growth potential and higher volatility than large-cap stocks.

Global Equities = MSCI ACWI (All Country World Index)

A global equity index capturing large- and mid-cap stocks across both developed and emerging markets. It represents the broadest commonly used benchmark for global equity performance, covering roughly 85% of global investable market capitalization.

Emerging Markets = MSCI Emerging Markets (MSCI EM)

An equity index representing large- and mid-cap companies across emerging market countries. It provides exposure to faster-growing economies with higher potential returns and higher volatility relative to developed markets.

Developed Int'l Equities = MSCI EAFE

An equity index covering large- and mid-cap stocks in developed markets outside the U.S. and Canada, specifically Europe, Australasia, and the Far East. It is a standard benchmark for international developed-market equities.

Commodities = Bloomberg Commodity Index

A broadly diversified benchmark tracking the performance of futures contracts on physical commodities. It provides exposure across major commodity sectors, including energy, metals, and agriculture, with weighting constraints to limit concentration in any single commodity or sector.

Global Infrastructure = S&P Global Infrastructure Index

A global equity index designed to measure the performance of publicly traded infrastructure companies around the world. It includes firms involved in infrastructure-related businesses such as transportation (airports, toll roads, railways), utilities (electricity, gas, water), and energy infrastructure (pipelines and storage). The index is structured to provide diversified exposure across regions and infrastructure subsectors and is commonly used as a benchmark for global listed infrastructure investments.

