

# Ask Von Clausewitz!

## Forecasting Amid War-Driven Economic Uncertainty Is Not Easy

KCM's January 2026 Outlook presented one of our most compelling bullish cases in recent memory and rested on a convergence of favorable forces. These included a resilient consumer, a Federal Reserve pivoting decisively toward accommodation, historic fiscal stimulus, and the early but tangible productivity dividends of artificial intelligence. We believe our thesis was internally reasoned, well-supported by available data, and expressed with the rational expectation of a peacetime forecasting environment.

But now "peacetime" hardly characterizes the forecasting environment. Armed conflict has broken out in Iran and other key geopolitical theaters, prompting oil supply disruptions, commodity price volatility, and inflationary pressure from energy and fertilizer markets. Once again, the global policy path is uncertain. Many of the assumptions that underpinned our January Outlook are proving durable, but clearly others are significantly compromised.

It was Prussian general and military strategist Carl von Clausewitz who introduced the term "fog of war" in the 1800s. He was referring to the uncertainty of information on the battlefield, which can hamper the ability to make tough, lightning-fast, critical decisions. In our April Commentary and Outlook, we decided to rigorously review our January comments in a "Fog of War" context, one where armed conflict degrades the reliability of economic and financial forecasts. We will also assess the major pillars of our January Outlook against three questions:

- Has the war disrupted the underlying mechanism?
- If so, how severely?
- What, if anything, of the original thesis survives in modified form?

What we end up with is a view that is neither entirely optimistic nor entirely pessimistic. Several of our January Outlook's most powerful structural drivers – the AI productivity story, the consumer balance sheet, the technical setup of sideline cash, and the corporate earnings advantage of multinational revenue translation – are intact, albeit with wider uncertainty bands than originally stated. However, war-driven shocks have meaningfully disrupted other pillars of our then-rosier view, particularly the energy price thesis, the inflation trajectory, the Fed's forward path, and the tariff-clarity assumption. These, we acknowledge, require substantial revision. And so, please read on.

# The American Consumer: Resilient Foundation, Eroding Edges

## The January Thesis

The American consumer was at the heart of KCM's January Outlook. Nominal consumer spending, historically 60%-70% of U.S. GDP, was regarded as "exceptionally robust," with household balance sheets described as healthy owing to a "low-hire, low-fire" labor market, near-historic-low unemployment, and sustained wage growth. The University of Michigan Consumer Sentiment Index, hovering near all-time lows, was reframed as a contrarian buy signal (extreme pessimism implies that bad news is already priced in, and any incremental improvement in reality should trigger a market rally).

## The Fog of War Assessment

The consumer pillar is one of the more nuanced cases in our review, neither fully intact nor fully disrupted. The structural underpinning of healthy household balance sheets and a historically tight labor market remains broadly valid. There has been no mass layoff cycle, and aggregate wage growth continues to exceed pre-pandemic trends. In this respect, the foundation of our January thesis is solid.

However, war-driven commodity inflation introduces meaningful erosion at the margins. As the Fog of War framework identifies, oil price shocks operate as a de facto tax on consumption. Higher costs at the pump and for utilities crimp households' discretionary spending, even when nominal incomes are rising. The consumer sentiment paradox that January characterized as a contrarian opportunity may now reflect something less benign: a rational response to erosion in purchasing power because of energy and food price inflation, rather than irrational pessimism that is ripe for reversal.

Moreover, our January Outlook's reliance on the contrarian sentiment signal requires careful qualification. Extreme consumer pessimism is a reliable buy signal when sentiment diverges from economic fundamentals, in other words when people feel worse than the data justifies. It is considerably less dependable as a signal when sentiment accurately reflects economic stress. The Fog of War environment creates the risk that the gap between negative sentiment and positive economic reality, which we identified last January as a catalyst for a sentiment-driven rally, may instead narrow from the top down as economic data deteriorates toward sentiment, rather than from the bottom up as sentiment toward data improves.

# Monetary Policy: The Fed Tailwind Meets the Stagflation Headwind

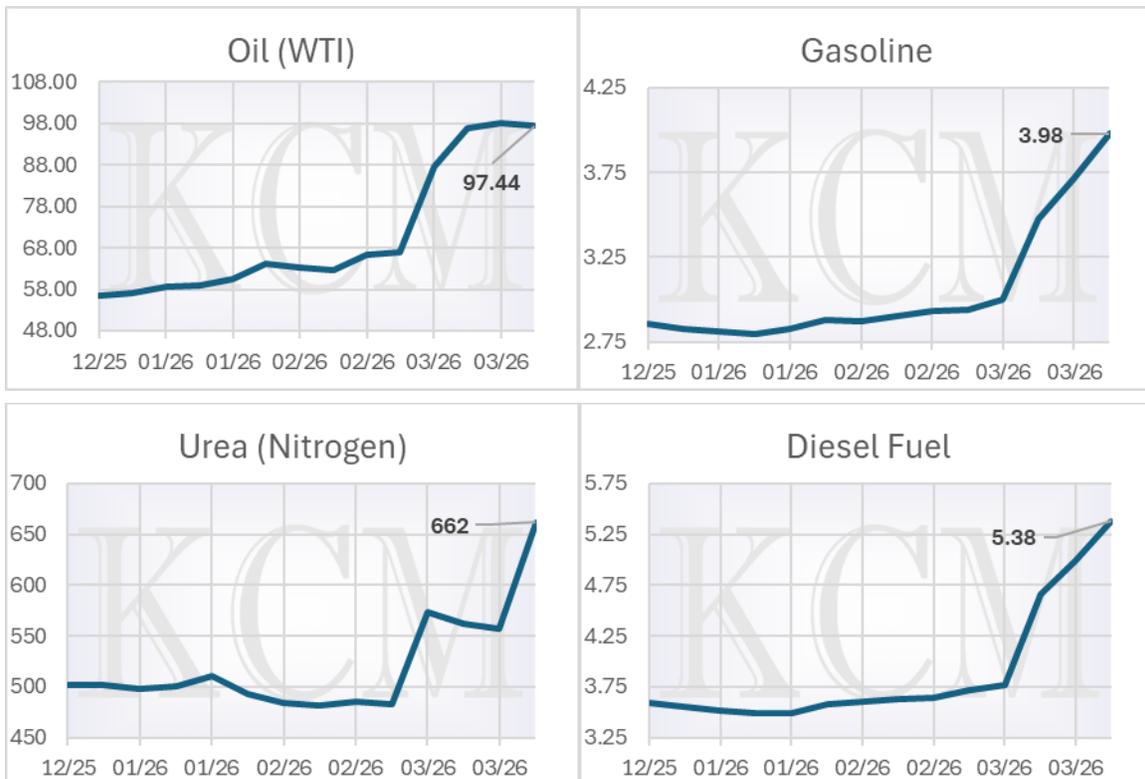
## The January Thesis

The monetary policy section in KCM's January Outlook described what it called the "most critical transition" for the 2026 outlook: a Federal Reserve in sustained rate-cutting mode, not because of recession, but as a proactive response to normalizing inflation, historically but increasing unemployment, and a desire to sustain growth. The analysis projected that lower rates would compress discount rates applied to corporate earnings (boosting equity valuations), normalize the yield curve (reducing borrowing costs), and sustain tight credit spreads (keeping the

financial system's plumbing functional). We cited the anticipated appointment of a new, presumably more accommodative, Fed Chair in mid-2026 as an accelerant of this trend.

## The Fog of War Assessment

The Fed tailwind thesis is the pillar most directly and severely challenged by the Fog of War framework. The analysis of war-driven inflation precisely identifies the predicament now facing the Federal Reserve: a supply-side inflation shock driven by **energy and commodity prices** that simultaneously pushes the price level higher and suppresses real economic activity. This is the stagflation scenario, the one that most thoroughly destroys the simple “cut rates = good for stocks” logic that January’s monetary policy section relied upon.



The Fog of War framework explicitly implies that central banks facing war-driven commodity inflation have no clean policy option. Cutting rates to support growth risks entrenching inflationary expectations and further weakening the currency, exacerbating import price inflation. Raising rates to control inflation risks tipping an already supply-shocked economy into recession. Our January Outlook assumed the Fed would continue cutting because it could, since the inflation problem was largely solved. War reintroduces that problem through the supply side, removing the clean policy space that the original thesis assumed.

The upcoming change in Fed leadership adds further uncertainty. Such a transition always generates market volatility, because market participants must recalibrate their understanding of the reaction function. In a wartime inflationary environment, that recalibration process becomes even more consequential and less predictable. Our January Outlook characterized the new Chair, Kevin Warsh, as a potential accelerant of rate cuts. In today’s environment, he faces a difficult set of trade-offs with no obvious correct strategy, and response to a supply-driven inflation resurgence cannot be assumed.

# Fiscal Policy: The Big Beautiful Bill and the Tariff Clarity Assumption

## The January Thesis

Fiscal policy formed one of the more distinctive elements of our January Outlook, where we described the so-called “One Big Beautiful Bill” as a pro-growth catalyst delivering a “double dose” of fiscal stimulus when combined with residual infrastructure and clean energy spending from the prior administration. Specific mechanisms cited included record tax refunds (projected at \$191 billion), which were likened to COVID-era stimulus checks, and 100% bonus depreciation for capital equipment, incentivizing a wave of corporate capex. On trade policy, our January comments offered a notably optimistic reading: peak tariff uncertainty had passed, markets had adjusted to the new trade architecture, and businesses could move forward with clear supply chain strategies.

## The Fog of War Assessment

The fiscal stimulus elements of our January Outlook represent a mixed picture. The tax refund injection and bonus depreciation provisions are real, legislated mechanisms with direct and near-term economic effects. These are not assumptions about future policy; they are already enacted. In this respect, the fiscal thrust of the January Outlook is arguably one of its most durable pillars. The stimulus is already in the pipeline, and war does not typically reverse domestic tax legislation.

However, war complicates the fiscal story in two ways:

First, when conflict elevates oil and commodity prices, the stimulative effect of a fiscal injection is partially taken by higher energy expenditures rather than flowing cleanly into broader consumer spending or corporate investment. A household that receives a larger-than-usual tax refund but faces meaningfully higher gasoline and grocery bills does not have the same net purchasing power expansion that the January Outlook projected. The stimulus exists, but its multiplier is lower in a war-driven inflationary environment.

Second, the tariff clarity assumption is where January's optimism looks most vulnerable to the Fog of War framework. Geopolitical conflict does not resolve trade architecture uncertainty; typically, it is quite the reverse. Conflict with or involving major trading partners, or in regions that anchor global supply chains, can reopen trade policy debates that our January Outlook assumed were settled. The Fog of War framework's identification of “regime uncertainty,” or the possibility that fundamental institutional and trade frameworks will shift, applies directly to the tariff environment. Businesses that we projected last January would move forward with clear supply chain strategies may instead find themselves in a prolonged period of strategic uncertainty.

## The Energy Price Thesis: The Most Direct Casualty

### The January Thesis

KCM's January Outlook described crude oil and gasoline prices remaining “near their multi-year lows,” functioning as a “stealth tax cut for every American household” and significantly reducing input costs for

manufacturers and transporters. We identified this low-energy-cost environment as a direct contributor to corporate profit margin expansion, a disinflationary force supporting the Fed's cutting cycle, and a form of purchasing power support for consumers. Low energy costs were effectively doing double duty in January's framework, aiding consumers on the spending side and corporations on the cost side.

## **The Fog of War Assessment**

The energy price thesis is the single pillar of our January Outlook most directly, immediately, and severely disrupted by the Fog of War framework. An analysis of war-driven economic uncertainty identifies oil markets as the oldest and possibly most potent transmission channel through which armed conflict disrupts economic forecasts. The specific mechanisms are familiar: supply disruptions in producing regions, credible threats to pipeline and shipping infrastructure, risk premia embedded in futures curves, and the near impossibility of forecasting the path of crude prices when geopolitical variables are in flux.

The January Outlook's assumption of sustained low oil prices was a reasonable starting point given the data available at the time. But it was always a forecast with a highly skewed risk profile. The downside case for oil prices in the presence of active geopolitical conflict is modest, while the upside case, a supply disruption caused by war, is substantial.

The consequences of a reversal in the energy price thesis cascade throughout the January Outlook's other claims. A stealth tax cut becomes a stealth tax increase. A disinflationary force becomes an inflationary one. Corporate margin expansion from lower input costs becomes margin compression. The Fed's cutting cycle faces the headwinds. Consumer purchasing power is eroded. The energy price assumption was not merely one pillar among many, it was load-bearing for much of the rest of the bullish thesis. Energy prices must decline to resurrect our "Promising Investment Environment" outlook.

## **Inflation and the AI Productivity Miracle: The Most Resilient Pillar**

### **The January Thesis**

Our January Outlook devoted substantial analytical attention to what it termed the "AI Productivity Miracle," or the transition of artificial intelligence from speculative infrastructure investment to operational productivity gains at scale. Specific claims included a 0.3%-0.6% annual lift to U.S. labor productivity growth, GDP forecasts upgraded to 2.25%-2.6% from a pre-AI trend of 1.8%, and S&P 500 earnings per share rising 12% to approximately \$305. The mechanism was elegant. AI allows companies to grow output without proportional increases in headcount or input costs. This reduces unit costs, decouples wage growth from price inflation, and creates a sustainably disinflationary environment compatible with continued Fed accommodation.

### **The Fog of War Assessment**

The AI productivity thesis is the most resilient pillar of our January Outlook under a Fog of War analysis. The reason is structural. Unlike the energy price thesis or the tariff clarity assumption, the AI productivity story is not premised on a particular geopolitical environment. Software deployment does not stop when oil prices rise.

Agentic AI does not cease to compress call center costs because fertilizer prices have increased. The efficiency gains from AI integration into enterprise workflows are real, measurable, and largely insulated from the commodity price channels through which war disrupts the macroeconomic environment.

That said, the Fog of War framework identifies important qualifications. The disinflationary effect of AI productivity gains operates with a lag and through a specific mechanism; lower unit costs allow companies to absorb higher labor costs without raising prices. But if the cost increase comes not from labor but from energy, a war-driven shock, the AI productivity offset is less direct. An AI-optimized logistics operation still requires fuel. An AI-managed factory still pays for electricity. The productivity gains reduce one component of the cost structure; war-driven energy inflation raises a different component. The net effect on unit costs and consumer prices depends on the relative magnitudes, which cannot be assumed.

Furthermore, the Fog of War framework cautions against extrapolating the “AI lag is shorter” thesis with too much confidence. While software deployment is faster than electrification, the organizational changes required to fully operationalize agentic AI workflow redesign, employee retraining, and integration with legacy systems take time and involve uncertainty. In a higher-volatility, higher-uncertainty macroeconomic environment driven by geopolitical disruption, the capital allocation and strategic planning horizon of corporate executives tends to shorten, potentially delaying or phasing the full realization of AI productivity gains.

## **Bond Yields, Credit Spreads, and the Yield Curve**

### **The January Thesis**

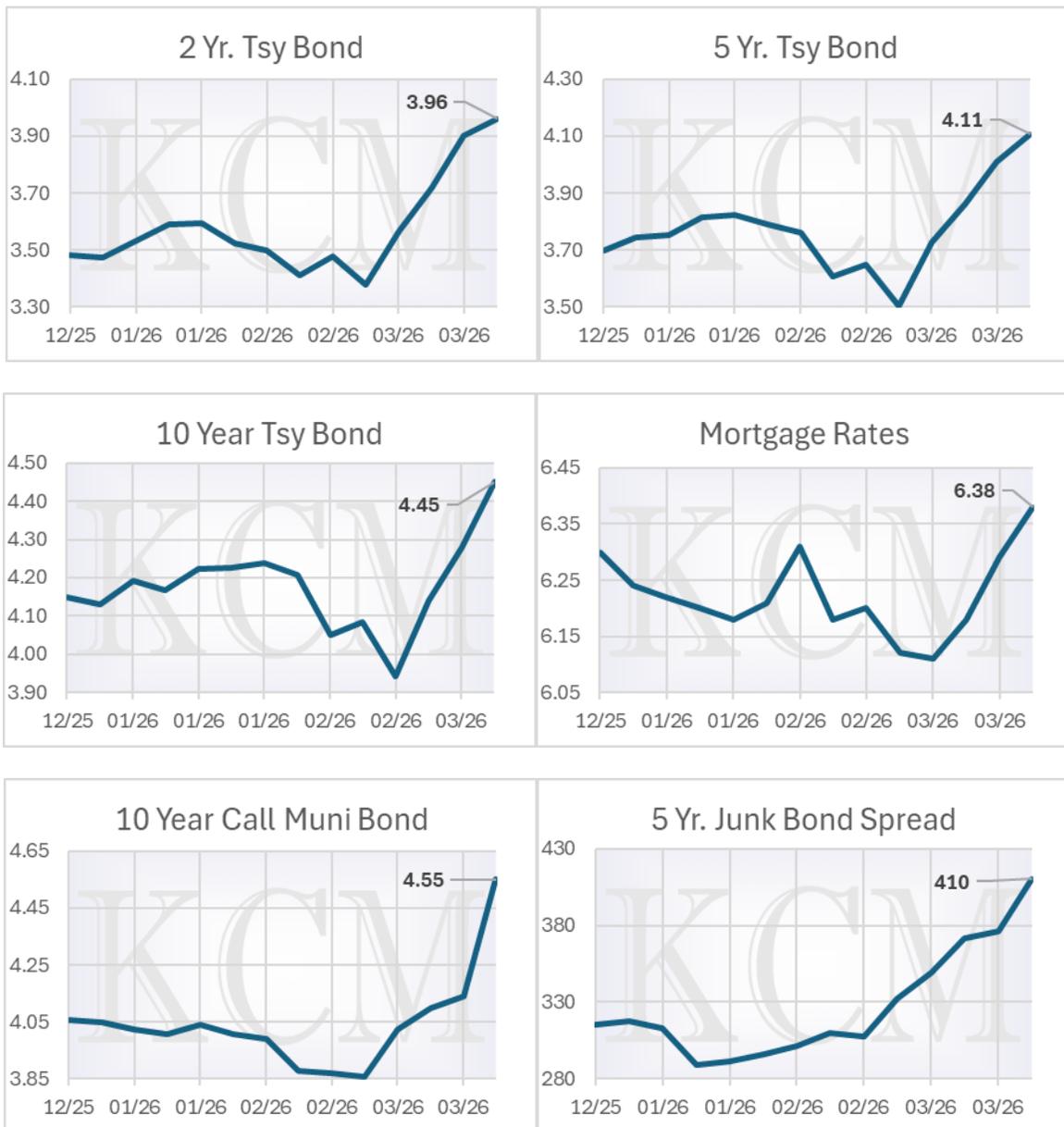
January's bond market analysis described two- and ten-year Treasury yields moving “sideways or downward,” reducing corporate borrowing costs and mortgage rates. Credit spreads were noted as “remarkably tight,” with private credit concerns acknowledged but characterized as contained. The combined picture was one of a well-functioning credit market acting as a transmission mechanism for Fed policy into the real economy, lower rates flowing through to cheaper corporate debt, mortgage refinancing activity, and freed-up cash for buybacks and dividends.

### **The Fog of War Assessment**

The Fog of War framework's treatment of bond markets is among its most detailed, and it raises significant concerns about our January Outlook's yield and credit spread assumptions. Three distinct mechanisms through which war disrupts bond markets were identified: the destruction of the central bank's clean policy reaction function, the widening of sovereign and corporate credit spreads driven by investor risk aversion rather than fundamental credit metrics, and the introduction of Federal Reserve regime uncertainty (the tail-risk possibility that institutional frameworks governing debt will change).

The specific January assumption that yields will move sideways or downward rests on the premise that the Fed continues cutting and inflation remains contained. Both premises are challenged in the Fog of War environment. A supply-driven inflation resurgence pushes yields higher through the inflation expectations channel, even if the

Fed is reluctant to raise rates. Simultaneously, safe-haven flows during periods of conflict can create erratic, cross-cutting yield dynamics – fear-driven demand for Treasuries pulls yields down while inflation expectations push them up, creating volatility rather than the orderly yield decline we projected in January.



Credit spreads represent an additional vulnerability. KCM's January Outlook noted "worrisome cracks" in private credit but characterized overall spread levels as "remarkably tight." The Fog of War framework would identify this characterization as a peacetime assessment of a metric that tends to gap wider suddenly and non-linearly in response to geopolitical shocks. Tight spreads are not a permanent; they are a condition that can reverse quickly when risk aversion spikes. Investors relying on tight spreads to sustain corporate refinancing activity and buyback capacity may find those conditions have changed.

# The Dollar, Multinationals, and Currency Translation

## The January Thesis

January's Outlook acknowledged the dollar's decline as a consequence of the Fed's cutting cycle, concerns about Fed independence, and long-term debt sustainability questions. Importantly, it also reframed what could be seen as a negative (currency weakness) into a specific positive for KCM's "BlueBloods" multinational equity strategy. The currency translation effect – foreign earnings converting into more dollars when the dollar is weak – was identified as a meaningful contributor to the projected 12%-15% earnings growth for large-cap U.S. multinationals. Consumer purchasing power erosion from a weak dollar was acknowledged but characterized as "muted" in the context of stronger disinflationary forces.

## The Fog of War Assessment

The dollar and multinational earnings thesis occupies an unusual position in the Fog of War assessment. It is one of the elements that is not simply disrupted. In fact, it may be strengthened in certain cases by geopolitical conflict, while being complicated in others.

The currency translation mechanism we described in January is structurally sound and war-resistant in its basic logic. If U.S. multinationals continue to earn revenue in euros, pounds, and other currencies, and if the dollar remains weak relative to those currencies, the translation benefit to reported earnings is real regardless of the geopolitical environment. War does not eliminate this mechanical advantage, but it may complicate it. Conflict involving major trading partners or affecting the economic performance of the countries where multinationals operate can reduce the underlying local-currency revenue that is being translated, offsetting the translation gain.

The dollar's trajectory in a war-driven environment is inherently more complex than January's straightforward "Fed cuts = weaker dollar" narrative. As they are doing now, geopolitical crises often trigger safe-haven demand for the U.S. dollar, exemplifying the paradox of the world's reserve currency strengthening precisely when U.S. policy uncertainty is high. This dynamic could partially or fully offset the Fed-driven weakness we projected in January, complicating the translation thesis. Conversely, if the conflict is interpreted as a long-term challenge to dollar reserve status or U.S. fiscal sustainability, the secular weakening could accelerate.

## Market Technicals: Sideline Cash and the FOMO Thesis

### The January Thesis

January's technical section identified a record \$7.66 trillion in money market fund assets as a "massive reservoir of potential buyers." We noted that declining money market yields as the Fed continues cutting would eventually make cash look unattractive relative to equities, triggering rotation. We combined our "sideline cash" argument with an assessment that institutional and retail investors remain structurally underexposed to equities relative to historical bull markets, and that S&P 500 forward valuations at approximately 21x were "fairly valued, not

extremely high like the dot-com bubble.” The conclusion was that the Fear Of Missing Out (FOMO) dynamic could amplify any equity rally as cash rotates into stocks.

## **The Fog of War Assessment**

The market technicals pillar of our January Outlook is, like the AI productivity thesis, largely war-resistant in its structural logic, but with important modifications to the timing and trigger mechanism. The existence of about \$8 trillion in money market funds is a fact, not a forecast. The mechanical observation that current or declining cash yields make equities relatively more attractive is sound financial logic that does not depend on geopolitical conditions. In this respect, January’s “sideline cash” thesis remains viable.

However, the Fog of War framework introduces a critical qualification: the timing and triggering of sideline cash rotation depends critically on investor risk appetite, and war is a powerful suppressant of that. The cash may be there, but there is no guarantee of willingness to deploy it into equities in a high-uncertainty, high-volatility geopolitical environment. Indeed, the Fog of War framework notes that investor risk aversion spikes sharply in the early stages of conflict, and this aversion can stay high for extended periods depending on escalation dynamics.

The FOMO thesis is particularly sensitive to this qualification. FOMO requires that investors see markets rising and fear being left behind, a psychological dynamic that is far easier to sustain in a trending bull market than in a volatile, conflict-driven environment characterized by sharp rallies and sudden reversals. The 21x forward P/E, described in January as “fairly valued,” also looks somewhat different in an environment where the forward earnings estimates embedded in that multiple are themselves uncertain due to war-driven input cost and demand disruptions.

## **Our Positive Thesis Needs Recalibration, Not Abandonment**

A dispassionate review of our January Outlook does not suggest wholesale abandonment of its pillars. The bullish original thesis was not wrong. Rather, it was premised on a set of background conditions (most critically, sustained low energy prices and a clean disinflationary environment) that war-driven commodity shocks have partially, and in some cases materially, disrupted. Understanding which pillars remain load-bearing and which are compromised is the essential analytical task for portfolio positioning as we move further into 2026.

Our January Outlook’s most durable components are the AI productivity thesis, the structural consumer balance sheet analysis, the sideline cash technical observation, and the multinational earnings translation mechanism. None of these depends on geopolitical serenity. They are structural arguments about the architecture of the U.S. corporate sector and the behavior of capital markets that survive a higher-volatility macroeconomic environment, although perhaps with modestly extended timelines and wider uncertainty bands.

The thesis elements that require the most significant revision are those that were explicitly premised on continuation of a specific commodity price environment: low oil prices as a stealth tax cut, a disinflationary trend enabling Fed accommodation, and tariff uncertainty being fully resolved. The Fog of War framework

demonstrates that these assumptions share a common vulnerability: they are extremely sensitive to geopolitical disruption, and we did not adequately flag this sensitivity in our January analysis.

**The appropriate investment posture this review implies is not a shift from bull to bear.** Rather, it suggests a shift from a concentrated, high-conviction expression of the bullish thesis to a more scenario-aware portfolio construction. This means maintaining exposure to the AI-driven multinational earnings story, the most war-resistant element of the thesis, while acknowledging the energy and inflation scenarios that war has rendered plausible. It means not regarding the Fed's forward path as a tailwind but as a variable to be stressed across multiple scenarios. And it means sizing positions with an explicit acknowledgment that several of the catalysts we identified in January – sentiment reversal, cash rotation, and FOMO – may arrive later, and with greater volatility, than we projected.

The Fog of War does not eliminate the January Outlook's underlying bullish thesis. It increases the uncertainty around it, widens the distribution of outcomes, and demands a humbler, scenario-based approach to expressing it. **That is not a counsel of despair. It is what intellectually rigorous investing looks like when the geopolitical environment changes the rules of the game.**

## **Conclusion: Discipline, Quality, and the Wisdom of Staying the Course**

**The Fog of War is, more than anything else, a test of investor temperament. When commodity prices spike, headlines darken, and the clean narrative of a January outlook gives way to the messier reality of geopolitical disruption, the most dangerous thing an investor can do is confuse volatility with permanent impairment of value. Panic selling in the early stages of a war-driven shock is not risk management, it is the monetization of fear at precisely the moment when fear is most heavily priced into markets.**

History is unambiguous on this point. Investors who sold during the oil shocks of the 1970s, the Gulf War of 1991, the post-9/11 selloff, and the Russia-Ukraine eruption of 2022 locked in losses that patient holders recovered from and in most cases surpassed. The fog eventually lifts. Investors who benefit most when it does are those who held quality positions rather than attempted to time the re-entry.

**This brings us to the most important practical conclusion of this entire review. In a Fog of War environment, the most reliable investment strategy is a rigorous commitment to quality, in both equities and fixed income, combined with the discipline not to abandon that quality under duress.**

## **Stay with KCM BlueBloods, Quality Equities Built for Turbulence**

In equities, quality means exactly what KCM's BlueBloods strategy was designed to deliver: large-cap, U.S.-based multinationals with durable competitive advantages, diversified global revenue streams, fortress balance sheets, and the pricing power to navigate inflationary environments without permanent margin destruction. These are not speculative positions dependent on a specific macroeconomic outcome. They are businesses that have survived recessions, wars, inflation cycles, and policy reversals across decades, and have compounded shareholder wealth through all of them.

In a Fog of War environment where the macro forecast is uncertain, the quality of the underlying business becomes the most important variable. KCM's BlueBloods are not just a collection of large, recognizable names. They are enterprises with the balance sheet strength to survive commodity shocks, the global diversification to benefit from currency translation when the dollar weakens, and the AI-adoption leadership to capture the productivity gains that we identified as the most war-resistant pillar of our January Outlook.

## **Also, Stick with High-Quality Bonds, Ballast, Income, and Optionality**

In fixed income, quality means staying with investment-grade bonds, Treasuries, and high-grade corporates and municipals, rather than reaching for yield in the parts of the credit market most vulnerable to sudden spread widening. The Fog of War framework identified private credit and tight-spread environments as potential vulnerabilities in our January Outlook. High-quality bonds, by contrast, retain their role as portfolio ballast. Even when yields are volatile, investment-grade fixed income provides income, capital preservation relative to equities, and the liquidity to rebalance opportunistically when equity markets overshoot to the downside.

In an environment where the Fed's forward path is uncertain and yields may move in either direction depending on whether inflation or recession fears dominate, high-quality bonds provide something that low-rated credit cannot. That is resilience under stress. When risk assets sell off sharply in response to a geopolitical escalation, short-duration, investment-grade bonds tend to hold their value as safe-haven demand rises, providing the portfolio stability and dry powder that allows disciplined investors to take advantage of equity dislocations rather than being forced to sell into them.

## **Do Not Panic Sell. It Is Discipline That Defines Long-Term Outcomes**

KCM'S recommendation for navigating the current Fog of War is therefore straightforward, although it requires real discipline to execute: **stay invested in KCM BlueBlood stocks and bonds**. Do not panic sell. Do not attempt to time the resolution of geopolitical uncertainty. Trust that the structural pillars of our January Outlook that survive Fog of War analysis will reassert themselves as market drivers once the fog begins to clear. Again, these are AI-driven productivity, multinational earnings resilience, and the enormous reservoir of sideline cash awaiting deployment.

The investors most damaged by war-driven volatility are not those who held quality positions and endured the drawdown. They are those who sold at the bottom, locked in permanent losses, and then watched the recovery from the sidelines. **Panic is a strategy that transfers wealth from the impatient to the patient, from the fearful to the disciplined. In every prior episode of Fog of War uncertainty, investors who stayed the course with high-quality holdings were glad they did. There is no reason to believe the present episode will be different.**

Markets do not reward those who flee the fog. They reward those who hold quality positions through it. **KCM's BlueBloods and Bonds** strategy is not merely a portfolio construction choice. It reflects our conviction that:

- Great businesses and sound credit endure,

- Temporary uncertainty does not erase long-term value, and
- The discipline to **stay invested when the news is frightening** has been one of the most reliable sources of investment alpha across every market cycle in history.

We know our forecasts will never be 100% accurate, and there will be more bumps along the way, but we will be here to navigate and adjust through them with you. Once again, we thank you for your patronage.

Referrals are always welcomed!

Jay Kellett

Founder & CEO

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