MARKET UPDATE & OUTLOOK | Q3 2026

COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio and Pennsylvania Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options. We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well. Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

MARKET RECAP

The second quarter of 2026 saw a meaningful improvement in market sentiment after the volatility experienced earlier in the year. US equities recovered as investors responded positively to evidence that the economy remained resilient despite slower consumer activity and persistent inflationary concerns. Corporate earnings generally exceeded expectations, while investment activity associated with artificial intelligence and infrastructure spending continued to support broader market confidence. The cessation of hostilities in the Middle East also helped bring some calm to the markets.

Market leadership broadened during the quarter. Only two sectors in the S&P 500 Index failed to generate positive returns, Utilities (-0.5%) and Energy (-13.4%). Information Technology regained momentum after a difficult start to the year and finished the quarter up 31.8%. Industrials, Financials, and selected cyclical sectors also participated as investors looked for opportunities outside the traditional growth leaders. The S&P 500 Growth Index returned 21.9% in the quarter, beating the S&P 500 Value Index, which was up 8%. Small-cap equities also posted a strong quarter, with the Russell 2000 Index up 21.6%. Smaller companies remain fairly resilient despite pressures from relatively elevated financing costs and slower consumer demand.

International equities also participated in the market recovery as growth trends remained durable, and oil prices pulled back. The MSCI EAFE Index of developed market equities was up 11.1%. The MSCI Emerging Markets Index bounced even stronger, up 24.1%, as domestic policy support in several regions offset continued concerns surrounding trade activity and geopolitical risks.

Fixed-income markets remained sensitive to shifting expectations around Federal Reserve policy but had a positive quarter. The Treasury bond yield curve moved higher during the quarter as inflationary expectations rose and further dented the market's expectations for a Fed rate cut this year. Investors were still able to harvest a 0.7% return on the US Aggregate Bond Index in the quarter. Credit markets remained relatively stable, with corporate credit spreads continuing to reflect limited recession expectations. The US High Yield Corporate Index returned 2.5% in the quarter. International bonds were up 1% as per the Bloomberg Global ex-USD Aggregate Index.

Commodity markets delivered mixed performance. Energy prices declined 14.1% as per the Bloomberg Energy Index, with WTI Crude Oil Futures down 31.4% in the quarter as supply concerns waned with the partial opening of the Strait of Hormuz. Copper benefited from ongoing infrastructure and technology investment demand, up 10.3%, but other industrial metals were flat. Precious metals and agricultural commodities both pulled back during the quarter.

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MARKET SCORECARD as of 6/30/2026	TOTAL RETURN IN USD	
	Q2	2026 TR
DOW JONES IND AVG	13.4%	9.8%
S&P 500	15.2%	10.2%
NASDAQ	21.6%	13.1%
RUSSELL 2000 INDEX	21.6%	22.7%
MSCI EAFE EQUITY (GROSS)	11.1%	9.9%
MSCI EMERGING MARKET EQUITY (GROSS)	24.1%	24.0%
BLOOMBERG GLOBAL AGG BOND INDEX	0.9%	-0.2%
BLOOMBERG INTERM. TREASURY	0.2%	0.2%
BLOOMBERG INTERM. GOVT/CREDIT	0.4%	0.4%
BLOOMBERG 5 YEAR MUNI INDEX	1.1%	1.1%
BLOOMBERG HIGH YIELD CORP INDEX	2.5%	2.0%
ishares S&P GSCI COMMODITY TR INDEX	-16.9%	12.9%
HFRX ABSOLUTE RETURN INDEX	1.3%	1.1%

Note: All returns include invested cash flows expressed in U.S. dollar terms.

KEY POINTS

- The US economy has remained resilient entering the second half of 2026 despite slower consumer spending and moderating labor market conditions.
- Business investment, particularly in AI-related spending and productivity initiatives, has become an increasingly important driver of economic activity.
- Inflation has improved from prior peaks but remains above long-term targets, reducing the likelihood of aggressive near-term monetary easing.
- Diversification remains important as elevated valuations in portions of the equity market may limit future upside, while defensive sectors, alternatives, and fixed income continue to offer attractive portfolio characteristics.

GLOBAL MACROECONOMIC REVIEW & OUTLOOK

The US economy continues to demonstrate resilience entering the third quarter, though growth has become increasingly uneven. Economic activity has remained positive despite softer consumer spending and a labor market that continues to normalize from historically tight conditions. The US economy grew at an annualized 2.1% rate in the first quarter of 2026, an improvement from the 0.5% pace recorded in the previous quarter. However, the composition of growth was mixed. Business investment remained robust while consumer spending slowed considerably. Investment in equipment and intellectual property spending—particularly AI-related investment—continued to be a significant source of support. Consumer spending growth slowed to just 0.5%, suggesting that household demand may be moderating following several years of unusually strong spending trends.

Employment growth has continued to moderate, though labor market conditions remain relatively healthy by historical standards. The economy is no longer generating the exceptionally strong job creation observed earlier in the economic cycle, but layoffs and unemployment trends have not deteriorated significantly enough to suggest substantial economic weakness. Non-Farm Payrolls growth has registered four successive months of declines going back to March, with 57k job gains in June, coming in below downwardly revised 129k in May and below expectation of 110k.

Inflation rose steadily during the quarter reaching a three-year high. The Consumer Price Index (CPI) was up 4.2% year-on-year in May, registering a third successive month of increases. Energy prices and certain services categories continue to contribute to inflation persistence. However, even the Core Inflation Rate has risen strongly, registering an increase of 2.9% year-over-year in May, which is the highest reading since September of last year. Inflation has stayed elevated and above the Federal Reserve's long-term objective of 2%, complicating the path of monetary policy. Lower energy prices should help ease inflationary pressure, but historical experience suggests that inflation tends to come in waves and has more to do with the overall monetary conditions rather than just one particular input cost.

The Federal Reserve (Fed) therefore remains in a challenging position given that stagflation remains the path forward. Economic growth has remained sufficiently resilient to reduce urgency for aggressive rate cuts. At the same time, the inflation outlook has not improved enough to allow policymakers to confidently ease monetary policy. Investors, who came into the year expecting two 25-basis-point rate cuts this year, have consequently shifted towards expecting the Fed to raise rates later this year. The arrival of the new Fed Chair, Kevin Warsh, and his first press conference confirmed that the Fed will likely focus on inflation first. The market sees one 25-basis-point rate increase in the second half of the year, with anything more than that not yet priced in and perceived as likely to disproportionately hurt growth expectations. As a result, the interest rate spread between the 2-year yield and the 10-year US Treasury bonds moved down from 51-basis-points to 27-basis-points during the quarter, reflecting rising expectations for higher Fed funds rate in the coming months but slowing growth prospects in the medium term.

INVESTMENT OUTLOOK

Our overall outlook entering the third quarter remains balanced but somewhat cautious. Economic conditions have proven more resilient than many expected earlier this year, but elevated valuations in several areas of both the equity and fixed income markets continue to warrant selectivity.

One encouraging development has been the continued expansion in corporate investment activity. Capital spending has become an increasingly important driver of growth and has had a positive effect on US manufacturing activity. The ISM Manufacturing PMI has been in expansionary territory for all of this year supported by corporate profits, which have also remained strong. One caveat here is that most of this investment has gone towards AI-related initiatives, like data centers. How sustainable that can be and, what the ultimate effect will be on earnings once capital projects move into the operational phase remains to be seen. Nonetheless, the market remains interested to supply capital, with more than 50% of S&P 500 Index weight being in AI-related companies.

We remain of the belief that diversification remains particularly important within the current market conditions. Valuation remains a meaningful consideration for us, particularly within segments of US Large-Cap Growth, where earnings expectations and price multiples remain elevated. We remain underweight Equities relative to our benchmark. Our preference is for sectors such as Consumer Staples and Utilities, which remain attractive given ongoing uncertainty surrounding economic growth and inflation. Materials and Industrials also appeal to us as they should continue to benefit from infrastructure and capital expenditure trends. We maintain a constructive view towards Mid-Caps and Small-Caps as earnings growth continues to broaden out. Our weight in international stocks is in line with the benchmark. Alternatives, such as REITs and commodities, should continue to provide a nice diversifier within the portfolio given their relatively low correlation with other risk assets. Within fixed income, we have extended our duration to 115% of the benchmark and prefer a mix of intermediate-term investment grade corporate and government bonds. Bonds also hold potential to regain their traditional diversification characteristics if economic growth slows more meaningfully.

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