OTHER SIDE
ASSET MANAGEMENT

Are you hearing the entire Orchestra?

Listening to the symphony

Have you ever attended a symphony orchestra?

If you've never played an instrument, it's easy to become captivated by whatever sounds the loudest. One moment it's the brass section commanding your attention. The next, it's the percussion. Then the strings quietly take over before the woodwinds add another layer to the performance.

Individually, each section is incredibly talented. Each plays an important role. But no single instrument defines the music.

The conductor understands that.

Rather than focusing on one section, the conductor hears how each contributes to the larger composition. A trumpet may carry the melody for a few measures, but without the rhythm, harmony, and timing provided by everyone else, the performance falls apart.

The financial media often approaches the economy quite differently.

Every month, a new economic report becomes the headline of the day. One week it's inflation. The next it's GDP. Then employment, housing, consumer spending, or manufacturing. Each report is analyzed as though it alone holds the answer to where markets are headed.

It doesn't.

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Other Side Asset Management
4141 Banks Stone Dr.
Raleigh, NC.27603
1-844-300-7344
www.othersideam.com

Managing Principal
Mitchel Krause

Each economic report is simply another instrument in a much larger composition.

Viewed individually, every CPI release, GDP report, employment report, retail sales update, and housing statistic tells only part of the story. Together, however, they reveal something much more important: the economic backdrop markets are attempting to price months before most investors recognize the tune has changed.

That's why we spend far less time reacting to individual headlines and far more time listening to how the entire orchestra is coming together.

This month, that symphony began playing a different movement … just remember … some movements are shorter than others.

Already looking ahead … again

Last month, we discussed an important concept that many investors often overlook. Markets don't wait for economic reports to arrive before adjusting. Instead, they constantly attempt to discount where the economy is headed, often months before the underlying data fully reflects the shift.

As we wrote in Working with Outdated Maps:

> *"Markets constantly discount where the puck is going, not where it currently sits, often pulling forward the next macro regime well before the underlying data fully reflects the shift."*

Based on the Rate of Change data available at the time, we also suggested that markets were beginning to look beyond the reflationary Quad 2 environment toward a likely July/August … Quad 4/Quad 3 cadence, noting that the months ahead could become considerably choppier.

Then, in last month's newsletter, Recalculating, we revisited that same idea, reminding readers:

> *"Markets don't wait for economic reports … markets attempt to discount where economic reports are heading."*

Rather than confirming the strength of the previous quarter, we argued that the market had already begun adjusting to a changing macro environment.

Looking back over July, much of that roadmap unfolded largely as expected.

While the major indices appeared relatively resilient on the surface, the underlying market told a very different story. Several of the highest-momentum areas of the market experienced meaningful weakness throughout the month.

Many of the largest technology names struggled, growth leadership narrowed, and investors concentrated in high-beta momentum exposures experienced considerably more volatility than the headline indices suggested.

Fortunately, our investment process had already led us to maintain a significant underweight position in many of those areas, helping us largely sidestep much of that weakness.

But that isn't the lesson.

The purpose of our process has never been to predict market crashes or perfectly forecast every twist and turn. Some monthly Rate of Change shifts produce only modest market rotations. Others can become far more significant in a remarkably short period of time.

The challenge is that no one knows which outcome will ultimately prevail until after it has begun unfolding.

That's precisely why we remain disciplined. After nearly three decades of managing money through countless market cycles, we've learned that...

After nearly three decades of managing money through countless market cycles, we've learned that abandoning a disciplined process simply because the last warning wasn't 'catastrophic' is often far more expensive than continuing to follow the data.

Risk management isn't about avoiding every decline ... it's about recognizing when the probabilities begin shifting and allowing the evidence, not emotions or headlines, to guide portfolio decisions.

Which brings us to today.

If the market started discounting August in mid-July...

When does it begin discounting September and October and what then, is the highest probability outcome for the months that lie ahead?

As always, we'll begin where we believe every investment decision should begin ... with the data.

Now, let's see what each section of the economy is telling us.

Following the data

If the market is constantly looking several months ahead, the obvious question becomes ... what is it beginning to see now?

As always, we start with the same disciplined process that has guided us for years. We don't begin with opinions, headlines, or predictions. We begin with the data, focusing on one thing above all else ... Rate of Change.

- Is inflation accelerating or decelerating?
- Is economic growth accelerating or decelerating?
- Are labor markets strengthening or weakening?
- Most importantly ... are those trends beginning to inflect?

The answers rarely come from a single economic report. Instead, they emerge as hundreds of individual data points begin forming a broader mosaic. While no single release determines the outcome, each data point becomes part of the collective evidence, helping us identify which investing regime has the highest probability and where markets may be looking next.

Inflation ... The July slowdown may already be behind us

Inflation remained one of the most closely watched data points throughout July, not because the headline number alone dictates market direction, but because changes in inflation's Rate of Change often influence which macro regime markets begin discounting next.

June's Consumer Price Index offered another example of why we focus on sequential data rather than headlines alone ... Headline CPI declined -0.42% MoM, marking the first monthly decline in two years, while the annual rate slowed to +3.53% YoY, down from +4.25% YoY the previous month.

Much of that improvement was driven by energy, where prices fell -5.71% MoM, slowing the annual rate to +15.70% YoY from +23.54% YoY. Food prices, meanwhile, remained comparatively stable, rising +0.21% MoM, while the annual pace eased modestly to +3.01% YoY from +3.08% YoY. 1.

Beneath the surface, Core CPI (excluding food and energy) actually declined -0.02% MoM, slowing to +2.59% YoY from +2.85% YoY, representing its first monthly decline since the early stages of the pandemic.

However, the largest component within Core CPI—Shelter, which comprises approximately 34.9% of the index—continued to move higher, increasing +0.12% MoM, though its annual pace moderated to +3.28% YoY from +3.37% YoY. Rent of Primary Residence increased +0.15% MoM and +2.84% YoY, while Owners' Equivalent Rent (OER) rose +0.24% MoM and +3.24% YoY.

Viewed in isolation, those numbers would suggest inflation continues moving in the Federal Reserve's preferred direction.

But markets don't invest in yesterday's inflation ... they invest in tomorrows.

That distinction matters because much of June's disinflation was heavily influenced by declining energy prices. Since then, geopolitical tensions have intensified, negotiations with Iran have deteriorated, and crude oil has rebounded sharply.

As we've discussed throughout this newsletter, markets frequently begin discounting those shifts in sequential momentum well before they become visible in the Year-over-Year statistics, particularly given oil's roughly one-month lead/lag into the CPI data.

That possibility has not gone unnoticed by the models we monitor.

Throughout July, Hedgeye's inflation nowcasts continued pointing toward additional near-term disinflation following the June report while also noting that the improvement in energy prices was beginning to fade as oil prices recovered.

Their framework remains centered on identifying whether inflation is accelerating or decelerating—the second derivative that often drives market behavior before consensus recognizes the change.

Bottom Line...

The latest inflation data does not suggest inflation is spiraling higher ... nor does it suggest the inflation problem has been completely solved.

Instead, it suggests that the disinflationary trend that helped shape July's market environment may already be becoming less pronounced. Should energy prices remain elevated and other inflation components begin firming, markets may increasingly shift their focus toward the inflation dynamics that could define September and October rather than the disinflation that characterized the first half of July or the current investing regime on the table right now being Quad 3/Stagflation.

Inflation may begin playing a slightly louder role as we move toward September.

Markets don't wait for GDP

If inflation represents one side of the macro equation, economic growth represents the other. Together, changes in Growth and Inflation determine the macro regime markets are most likely to discount.

Throughout the first three weeks of July, markets largely behaved consistent with the Quad 4 environment we anticipated and discussed in previous newsletters ... a backdrop characterized by the simultaneous deceleration of both growth and inflation.

That view helped explain much of the choppiness we expected, particularly beneath the surface, where many of the higher-beta, momentum-oriented areas of the market experienced considerably more weakness than the major indexes suggested.

Then, as markets do … something began to change.

As additional economic reports were released and geopolitical developments pushed oil prices higher, markets began shifting away from discounting July's Quad 4 environment and increasingly toward what the data suggested August *might* look like … Quad 3 (Stagflation), where growth continues to decelerate while inflation begins accelerating.

The growth data has largely supported that shift.

While second-quarter Real GDP rebounded to +3.0% following the first quarter's -0.5% contraction, much of that improvement reflected trade normalization and favorable comparisons rather than a broad-based acceleration in underlying demand. More importantly, the models we follow continue to suggest growth is decelerating—not collapsing.

Hedgeye's GDP NowCast illustrates that point well. Their Real GDP YoY estimate eases from +2.41% in 2Q26 to +2.06% in 3Q26, before stabilizing and beginning to improve again to +2.33% in 4Q26 and +2.24% in 1Q27.

That modest deceleration is consistent with the Quad 3 environment markets are currently discounting.

At the same time, the consumer … the engine of the U.S. economy … continues to show remarkable resilience.

June Retail Sales increased +0.22% MoM and accelerated to +8.40% YoY, while the Retail Sales Control Group, the portion that feeds directly into GDP, rose +0.54% MoM and remained a healthy +6.36% YoY. Those aren't the numbers of an economy falling apart.

The labor market paints a similarly balanced picture. Nonfarm Payrolls continued expanding during June, while the unemployment rate remained relatively stable near 4.1%. Meanwhile, Job Openings improved modestly to 7.59 million, though total hires declined by -45,000, leaving net hiring at just 69,000.

Employers continue adding workers, but at a slower pace than earlier in the cycle. In other words, labor isn't signaling recession, but it isn't providing the type of accelerating momentum typically associated with a broad-based expansion either.

Housing tells much the same story. Existing Home Sales fell below the psychologically important 4.0 million SAAR threshold to 3.93 million, while New Home Sales declined -6.6% YoY. Single-family housing starts remain -10% YoY, and permits have now declined for four consecutive months. At the same time, mortgage purchase applications are running +22.5% YoY, suggesting demand hasn't disappeared … it remains constrained by elevated mortgage rates and affordability rather than a complete lack of buyers.

Taken together, the evidence points to an economy that is moderating … not contracting. Consumer spending remains resilient, labor markets continue expanding at a slower pace, and housing appears to be stabilizing after a prolonged slowdown. That's precisely the type of backdrop consistent with the modest growth deceleration currently reflected in Hedgeye's GDP NowCast and why markets continue discounting a Quad 3 environment today rather than either recession or a broad-based reacceleration.

August still appears consistent with a Quad 3 backdrop. However, if resilient consumer spending begins translating into firmer growth ... as Hedgeye's GDP NowCast currently suggests ... while inflation resumes moderating, markets will likely begin looking beyond August and toward a Quad 1/Goldilocks environment (not too hot, not too cold, but just right) during September and October.

That being said, we react to the environment and the signals directly in front of us. As long as markets continue presenting a Quad 3 backdrop, that's how we'll remain positioned while staying prepared for the next phase transition whenever the data—not our opinions—suggests it's time.

Final thoughts ... keep listening

One of the greatest challenges investors face isn't finding information—it's deciding which information actually matters.

Every day brings another headline, another economic report, or another opinion confidently predicting what comes next. It's easy to become fixated on whichever instrument happens to be playing the loudest.

But successful investing has never been about reacting to a single note.

It's about listening to the entire symphony.

Today, that symphony suggests a market that has largely moved beyond July's Quad 4 environment and is currently discounting a Quad 3 backdrop. At the same time, the underlying data also reminds us that the music continues to evolve. If growth begins firming while inflation moderates once again, markets won't wait for economists to declare a new regime—they'll begin discounting it long before the headlines catch up.

That's why we remain committed to the same disciplined process that has guided us through nearly three decades of market cycles. We don't attempt to predict the future. We simply follow the evidence wherever it leads, adapting as the data changes rather than forcing the data to fit a preconceived narrative.

If you're making important retirement or investment decisions based on headlines, television commentary, or a portfolio that hasn't been reviewed through the lens of today's changing macro environment, now may be a good time for a second opinion.

That said, these notes represent just one piece of the retirement planning puzzle. They provide market commentary—but markets are only one part of a successful retirement plan.

At Other Side Asset Management, every relationship begins with a conversation and a complimentary, comprehensive retirement, income, and legacy plan.

Together, we evaluate your investments, income strategy, taxes, Social Security, insurance, estate considerations, and the broader financial picture to determine whether your current financial picture is aligned with where both your life ... and the markets ... may be headed.

Whether you ultimately become a client or not, you'll leave with greater clarity and a personalized roadmap built around your goals.

Until next month ... keep listening for that new movement.

If you'd like to discuss how these changing economic conditions may impact your retirement income plan, investment strategy, tax planning, or long-term financial goals, we'd be happy to help.

Schedule your free consultation today.

As always ... Good investing!

Mitchel C. Krause
Managing Principal & CCO

4141 Banks Stone Dr.
Raleigh, NC. 27603
phone: 919-249-9650
toll free: 844-300-7344
mitchel.krause@othersideam.com
www.othersideam.com

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