KANOS
CAPITAL MANAGEMENT, LLC

Kanos Capital Management

Quarterly Investor Letter

Second Quarter 2026

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Table of Contents

Second Quarter 2026 Investor Letter

Second Quarter Market Review

War and peace were both at work during the second quarter. The Iran-US-Israel and Israel-Hezbollah conflicts joined the Russia-Ukraine War in dominating headlines, sporadically erupting and settling down numerous times. Financial markets sniffed out the inevitability of a truce, rising almost everywhere around the world as ceasefires seemed to hold in the Middle East, even as the war in Ukraine continued. Energy prices continued their slide as large amounts of crude continued to be exported from the region, either through the Strait of Hormuz or around it. The AI trade reignited, and memory chip companies skyrocketed during the quarter as the tech buildout spread worldwide after the US-Iran memorandum of understanding took shape. The big event was the successful IPO of SpaceX in mid-June, which marked a high point for both the semiconductor and Nasdaq-100 indices.

Looking Forward

Introduction

Crosscurrents are the manifestations of the day as movements in geopolitics and financial markets occur alongside conflicting economic data, bursts of volatility and continued uncertainty about the path ahead. The recent unpredictability of war-related developments and broader geopolitical events has affected financial markets as extremely as seen during the initial outbreak of the conflict.

Financial markets are trying to price the expansion of tech infrastructure, advancement in efficiencies, growing competition and the extreme hunger for new capital in the artificial intelligence (AI) and technology buildout progressing worldwide. Meanwhile, clues of possible oversupply or saturation in the AI ecosystem have led to a correction in some tech companies' stock prices while others have rallied. The extreme capital raising of 2026, which culminated in the June IPO of SpaceX, has put a strain on markets, too. Meanwhile, economies have continued to grow, employment statistics have failed to show any sustained weakness and the Federal Reserve (Fed) has many members still leaning toward rate hikes this year. All in all, it is a confusing environment to navigate.

While the apparent peak of the Iran war passed in the spring, July's recent flareups and renewed attacks by both Iran and the US puts into question the impact they will have on the region. The extent of damage to energy facilities, any constrain on traffic through the Strait of Hormuz (SOH) and escalating attacks on US-aligned Gulf neighbor states continue to affect the prices of crude oil, energy products and other resources, and there is the chance of further escalation. The Russia-Ukraine War continues to rage, punctuated by Russia's apparent progress in the ground war but Ukraine's effective drone war hurting Russian industry, especially the energy infrastructure, to the point of restricting refined products supplies, keeping diesel and jet fuel prices uncomfortably high worldwide.

Despite these geopolitical events and financial crosscurrents, economic growth continues around the world, and bullish expectations are still rampant in financial markets. The capex boom in AI/tech dominates markets and is affecting many parts of the country and economy, in such a manner that there is starting to be some community pushback against datacenters in some parts of the country. We think the AI race, the large amounts of capital expenditures for AI/tech and reshoring, as well as the expedited development of resources in many different regions will continue to support economic growth in the US and worldwide.

We are concerned about the amount of speculation in financial markets worldwide, led by the South Korean Kospi which dominated by two big semiconductor memory firms, and the US Nasdaq, which had huge gains in the second quarter but have been correcting since their June highs.

Economy

The US economy grew at a 2.1% annualized rate in the first quarter, slowed to 1.5% in the second and is expected to grow at a 2+% rate for the rest of the year. Inflation, which appears to have peaked in May, showed slight decreases in June readings although still stubbornly above the Fed's 2% target. Retail sales show steady growth, and stock prices have set all-time highs after recovering from the Iran war swoon. Travel, which many thought would suffer due to higher energy prices caused by the Iran and Russia-Ukraine wars, has continued to be strong, anchored by world travel to the US for the World Cup, and US travel around the world taking advantage of a relatively strong US dollar.

The AI/tech capex boom has been a big part of this economic growth, which analysts estimate added 1% of the 2+% economic growth estimated for 2026. And firms have announced that they intend to grow their amount of capex for 2027 and possibly 2028, signaling a tailwind for the economy for many more quarters in the future. In addition, reshoring and the development of domestic natural resource sourcing and processing for national security have underpinned industrial development in the US, and to a lesser extent, in Mexico and Canada. We see this capex boom in technology, metals mining & fabrication, pharmaceuticals and even more energy infrastructure underpinning the US economy going forward.

We also think the Iran war reignition in July will push back on the recent reductions in inflation as continued shortages of refined products and constrained exports of crude and other resources from the Persian Gulf continue to support elevated prices worldwide as demand stays and supply, especially of refined products from overtaxed refineries around the world, struggles to keep up.

We see the US as suffering from a "K-shaped" economy, where asset holders, skilled laborers and industry specialists will prosper more than rank-and-file service sector workers, who have faced wage growth less than recent inflation, uncertain job prospects with "AI-doom" stories abounding, and higher food, fuel, housing and healthcare costs. Recent policy to improve conditions for these workers, like the Big Beautiful Bill's tax decreases, coupled with reduced competition from immigrant labor, has not achieved enough progress to pick up the people in this economic cohort. Their plight is best seen in continued US retail spending but a dropping national savings rate, showing people are using savings to maintain their lifestyles, which cannot be done ad infinitum. Helping this segment of US workers, which include still-working seniors as well as young workers in the work force who have not perfected career paths, to be able to achieve higher incomes through more opportunities and continuing education, is one key to improving the US economy going forward.

New Fed Chairman Kevin Warsh has exhibited a hawkish tone during his recent appearances, emphasizing his attention to getting inflation down to the Fed's target. The financial markets have interpreted his rhetoric as requiring rate hikes this year and possibly in the future. We think the economic situation of the lower echelon workers and non-workers in our K-shaped economy will force the Fed to skip any rate hikes, which would raise financing costs for the lower economic sector of the population but not affect higher energy prices, the primary cause of the most recent inflationary spikes. We think the Fed will gradually temper its rhetoric to try to walk the tightrope of lower inflation while keeping interest rates at, or possibly even lower than, current levels.

China's economy is probably the most interesting of the rest of the world's economies. China has been trying to accomplish many things, some of which are contradictory. First and foremost, Chinese leadership is trying to keep the population passive, which includes high employment (regardless of need) and ongoing stimulus to the economy (while trying to balance inflationary pressures). Meanwhile, the government is trying to dominate the industries they feel are strategic to their needs (mostly basic and intermediate manufacturing and processing) by keeping export volumes very high (to keep high factory utilization and produce overseas income) while building stockpiles of strategic materials, including semiconductors, crude oil and products, grains and metals (like copper and other industrial metals), to protect against shortages and have a possible large stockpile in case of a war/blockade. These policies keep their populace at work producing electronics and machinery but also furniture, clothes and counterfeit luxury items for export, which keeps employment higher than their economy with domestic consumption growth would normally support. And right on cue, July statistics show Chinese manufacturing slipping back into contraction from recent anemic growth. These policies also cause economic distortions due to the government's misallocation of resources and capital, while driving up domestic prices. Meanwhile, China's real estate sector continues to be in the dumps due to oversupply and financial distress, which is especially bad because real estate is/was the main vehicle for Chinese retirement savings for years but is no longer because of loss of value of properties over the years.

So, China's economy continues to sputter due to overcapacity, misallocation of financing and resources by state-owned industries, and weak consumer demand due to reduced savings and high consumer prices for essentials. The Chinese Communist Party, led by Xi Jinping, has so far refused to relinquish any central planning control, instead allocating capital and mandating results, which has worked for some headline efforts, like Chinese AI, but not for much of the economy, causing them to miss their 2026 GDP target of 4.5-5.0% reported growth. Experts think Chinese GDP growth is closer to 0-1% growth by Western standards, which in mid-July is forcing more stimulus to try to kickstart growth once again. We think lack of Chinese growth will divert leadership attention to internal decisions more than they'd hoped. It has also led to redoubling their concentration on showing their high-tech prowess, as is seen by their recent trumpeting of new AI models that rival Western models at lower costs. We think China will continue to struggle economically until they reform their economy to let smaller entrepreneurs dictate expansion through commercial and consumer demand, not top-down planning executed by state-owned enterprises that farm out business to smaller companies.

Other Asian economies, most notably South Korea and Japan, are both growing moderately, at 2.6% and 2.1% respectively, anchored by semiconductor and other technology manufacturing growth, which is an integral part of the world's AI supply chain. We think they will continue to grow these industries, despite some cyclical ups and downs, as world demand for semiconductors, especially memory, continues to grow at higher than historic rates. We think robotics and other types of automation and technology manufacturing and export will continue to boost Japan's economy as it comes out of decades of disinflationary malaise, boosting Japanese stocks, bonds and eventually the yen.

The rest of Asia (excluding China, Japan and South Korea), led by India, has been hit harder by higher energy prices due to the Iran war, which has impacted the availability of petroleum products and thus prices. We think Asia will grow more slowly due to higher energy and resources prices and their lack of high margin tech manufacturing.

Europe also will suffer from higher energy prices and continued high regulatory constraints, leaving European growth to be subpar but positive, in our opinion.

Finally, Latin America, which has boomed from higher energy and natural resources prices, will continue to provide the world resources but as prices have moved down from 2026 highs, will not be as fast growing as they were earlier in the year. We are still bullish on most of these countries as they embrace freer enterprise policies, less regulatory constraints and more inclusionary political regimes.

Bottom line: We continue to expect US economic growth to average approximately 2% growth throughout the year, as higher resources prices, regulatory hurdles, and capacity constraints slow down the pace of growth from higher levels experienced before the war. The capital expenditures booms underpin this growth, and we think that AI/tech, reshoring and national security-motivated industrial development will keep growth positive for many more quarters. Much of the world suffers from higher energy and natural resource prices, but the worldwide need for expanding technology and infrastructure improvement should keep most regions growing. The uncertainties around the two ongoing wars will continue to produce increasing economic uncertainty, leading to slower economic growth worldwide due to delayed projects and constrained budgets.

Equities

After rebounding once the markets decided peace was the ultimate outcome of the Iran war in early April, US equity markets have seesawed since mid-June, alternately rising on profit expectations (led especially by AI-oriented technology stocks) and falling on worries of AI overspend (scared of a growth slowdown in AI development and datacenters). The market has also been characterized by a distinct narrowing of advancers, with much of the market left behind while the tech trade attracts most of the money and attention.

We are concerned about the durability of the AI trade and its extreme effects on much of the rest of the market. Hyperscalers and AI developers have continued to announce and spend tens and even hundreds of billions of dollars for AI development and infrastructure, confident these huge investments will pay off. Their investments in cloud hosting and corporate infrastructure have paid off in the past decade, and most feel this expansion of memory and computing power is needed not only for AI but for the amount of computing companies and individuals will require for technology-enhanced daily life going forward. Our biggest concern is that they have committed all of their free cash flows to these efforts and also turned to debt financing for the tens/hundreds of billions of more, adding risk to these very large investments and balance sheets in general.

We had been concerned for weeks during the second quarter about the impending IPO of SpaceX to raise an immense $75 million of equity – an all-time record amount – that could crowd out other equity issuance. SpaceX could mark the high in equity markets, where the biggest-ever IPO sucked all the speculative money out of the market, leaving little fuel for further buying. And that is what has happened to an extent – its June 12th IPO actually raised closer to $80 million, taxing the capacity of the equity markets, which have not hit a new high since that time (the Dow Jones Industrials, a very narrow index excepted). Adding to this situation was other capital raises that occurred: Alphabet (Google) "snuck in front" of SpaceX and raised its own $80 billion of equity days before SpaceX's debut (and may raise more, according to the company). After the success of these capital raises and the boom in memory chips (due to predatory pricing to datacenters and other chip users), South Korea's SK Hynix did its own US IPO (the shares have been listed in South Korea for many years), raising $26+ billion, further taxing trader/investor appetite and capital for, or ability to absorb, tech stocks. We are very concerned that tech holdings, led by AI-centric companies, are at traders' maximum absorption capacity, and that new buyers will be hard to find to propel stock prices higher.

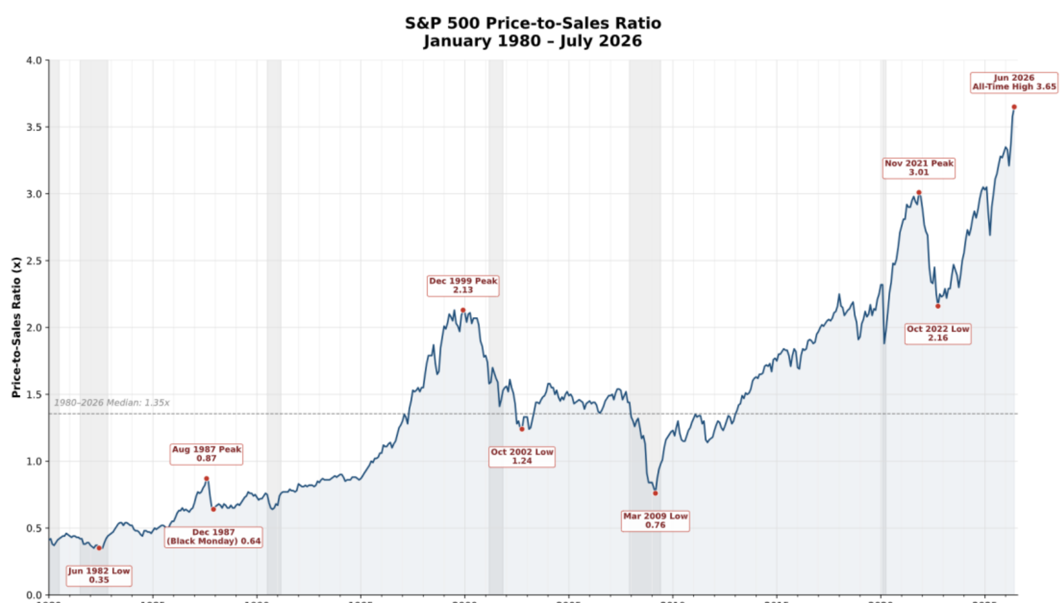
Unfortunately, the capital fueling June's tech buying frenzy had to come from somewhere, and it increasingly came at the expense of other stocks, particularly those outside the AI-theme. Since so many sectors participate in the AI ecosystem, including technology, communications, industrials, financials, utilities and even real estate, they continued to attract buying. However, sectors such as energy, metals/materials, consumer discretionary and staples were sold as investors directed nearly every dollar into stocks like SpaceX, SK Hynix, Google and others. This rotation weighted on many of our positions during the second quarter. But we see investors' under-allocation to these sectors as a tailwind going forward. As the tech trade has cooled (and many tech stocks have experienced corrections in July), traders/investors are starting to rebalance their portfolios, reallocating capital back into more neglected sectors like natural resources and consumer stocks, as well as energy and other stocks sold due to the "end" of the Iran war.

One of the factors that feeds our concern is the continuing fear-of-missing-out rush of tech traders, both retail and institutional, domestic and international, which has been out of proportion historically to the even very high profit expectations for the AI ecosystem. Margin debt has grown to an all-time high, showing investors willingness to lever up their portfolios to boost their gains (but also risk higher losses if positions move against them). This is exacerbated by "hot money" hedge funds and retail investors trading in leveraged stock ETFs, which allow traders to buy 2x and 3x the movement of certain stocks, instead of just buying the volatile stock itself. The largest of these is MUU, the Direxion Daily MU Bull 2x shares, which double the daily movement of Micron Technology (ticker MU), one of the most successful and volatile stocks of 2026. As Micron moved up strongly in April and May, traders used these leveraged ETFs and borrowed money to leverage their returns even higher, which has further driven up momentum stocks as a group, until June. Now momentum stocks have started to settle down, with Micron and other memory and semiconductor firms correcting. As a result, our caution has increased, particularly toward technology stocks. We are leery of the potential for further market moves if these leveraged players sustain more losses and are forced to liquidate positions, selling into an already correcting market, causing further losses.

As we are going to press, news came out about the hedge fund Situational Awareness L.P. (SALP), a fairly new, AI-oriented fund run by a 24-year-old wunderkind with an Ivy League education, crypto experience and a recent stint at one of the leading AI companies. His fund, SALP, was up 450+% this year by leveraging their positions (long AI stocks, short traditional software) 4x, closing at a size of $45 billion at the end of June. The July bear market proved that leverage works on the downside just as effectively, and SALP lost 67% of its value in a couple of weeks and was forced to sell its whole public equities portfolio to Citadel Securities in a liquidation, leaving it with only illiquid private investments. SALP and others which drove memory stocks and other AI-domain stocks to large gains earlier in the year have been forced to sell them as these stocks with meteoric price gains ran out of buyers. We don't think SALP was the only fund that suffered like this (famous Wall Street aphorism is: "There is never only one cockroach!"), and with any further corrections in these high-flying stocks, we see more chaos in the hedge fund sphere.

And there are cracks becoming visible in the AI story: in mid-July, a Chinese AI developer named Moonshot released their most recent AI model named Kimi-3, a big improvement in performance and cost over their previous models. The problem is that it is just about as powerful as its American peers (from Anthropic, OpenAI and Grok) but costs a fraction of the price to operate and is an "open system" which allows customers to set parameters and limit data "leak" to AI developers, a more attractive value proposition to customers than the American "give us all your data, we will give you answers [but keep your data]" approach. A similar occurrence happened in January 2025 when the largest Chinese AI developer DeepSeek unveiled its newest model of that time, which operated almost as fast as then-current American AI models and cost about one third the price; it firmly established DeepSeek and other Chinese developers as worthy competitors who were finding solutions using simpler and much cheaper resources. We are concerned that these efforts (as well as Western copycats) will expand, flooding the AI model marketplace with cheaper, less resource-hungry models that will undercut the American models and the need for all the planned infrastructure to the point that the trillions of dollars spent on AI development and infrastructure will not be recovered anytime in the near future.

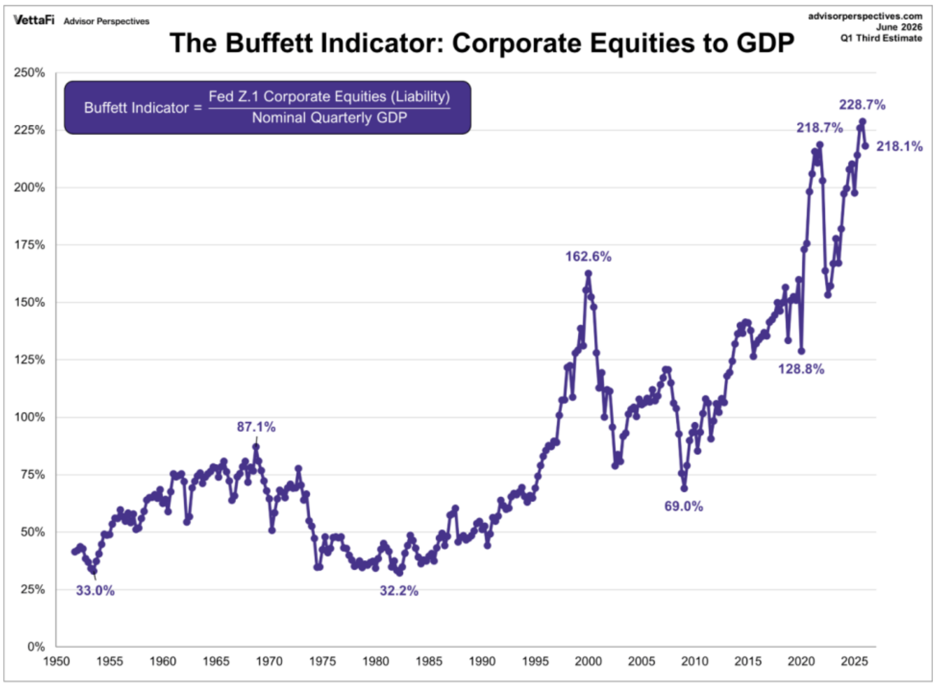
Adding to our market concern are valuations: US markets, dominated by AI-oriented companies and technology companies supplying them, are at all-time high valuations, with some large questions about whether the trillions spent or slated to be spent in the next year or two will yield adequate returns. Price-to-sales, the least manipulatable financial ratio, is at an all-time high of 3.65x for the S&P 500, far above the 45-year median of 1.35x (see graph below). The P/S ratio is a crude but effective way to judging the value of a company's revenue – it is generally highest for hard-to-produce or limited quantity products, where the ability for competitors to take sales is considered difficult or limited at best. Meanwhile, large retailers or gasoline sellers often sell at a P/S ratio of less than 0.5x because their products are widely sold and able to be purchased at many different places, making the value of their sale low. This average ratio at 3.65x shows how high valuations have gotten, especially when compared to the 2000 dot.com peak of "only" 2.13x and the most recent stock market "bubble" post-Covid of 3.01x.



Source: S&P Dow Jones Indices; pre-2000 revenue estimated via FRED nonfinancial corporate revenue, Shiller/Damodaran, and Reilly (1997) series (compiled by DQYDJ). Shaded bands denote NBER-dated U.S. recessions. Data through Jun 2026 (latest available); chart labeled through Jul 2026.

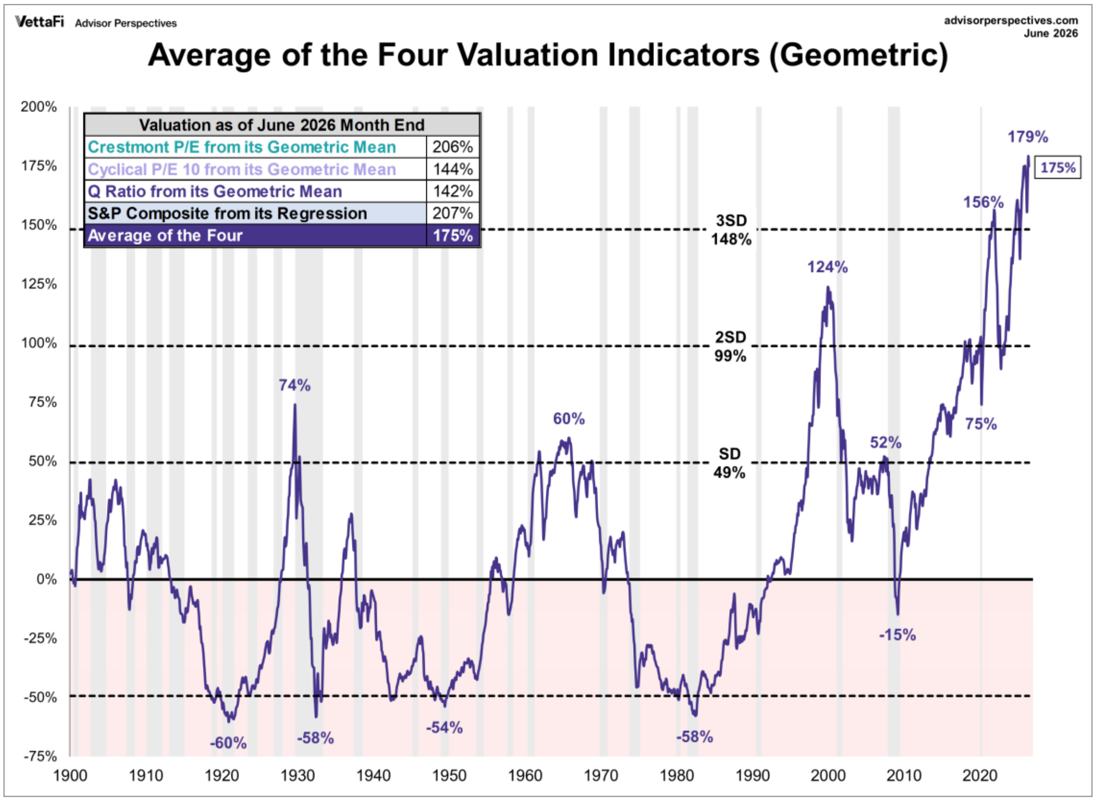
The values concern us, as a reversion just to the median would involve 60+% losses in the markets.

Other valuation measures are also at extremes. The market capitalization-to-GDP ratio, which measures the size of the equity markets versus the size of the economy, is near all-time highs at 218% (see graph from AdvisorPerspectives.com below). The financial press calls this the "Buffett model" because Berkshire Hathaway's former chairman Warren Buffett has called it his yardstick for attractiveness of investments – and true-to-form, Berkshire is sitting on its largest amount of cash in history, unwilling to deploy it into large investments at current levels of (over)valuation. This ratio never even exceeded 100% until the 1990s tech boom.



Another widely watched valuation measure is called the CAPE Ratio, which stands for the Cyclically Adjusted Price-to-Earnings ratio, popularized by former Yale economist Robert Shiller, best known for his book Irrational Exuberance; the CAPE ratio is sometimes called the Shiller P/E ratio. It calculates an average P/E ratio over a number of years, generally 10 years, on inflation-adjusted earnings. The long-term average CAPE ratio is 16x, with extremes of 5x to 44x. <u>The current ratio is 41x</u>, a far cry from the average and near the 1929 and 2021 high readings (all figures from GuruFocus.com).

Finally, a S&P 500 valuation series produced by AdvisorPerspectives.com combines and averages four different valuation methodologies, in both arithmetically and geometrically combinations, and presents the results monthly. In the late July analysis (see graph of the Geometric average below), <u>these methodologies put the S&P 500 at 175% overvalued or more than three standard deviations from fair valuation (0% overvaluation)</u>.



This value compares to the 1929 pre-Great Crash value of 74% and the 2000 tech boom high of 124%, both far above the 0% fair valuation line. If big tech stocks disappoint in earnings and/or the AI boom slows down, an unfortunate analog is the 2000-2003 market, which took these valuation measures from 124% overvalued to just 25% overvalued, a roughly 80% loss by many tech companies.

Who else is concerned about all of this? Corporate executives seem to be. Corporate insiders have sold $77 billion of stock during the first half of 2026, a 20% increase from a year ago and the second-fastest pace in the last 20 years, according to EPFR Global Market Intelligence. The only time execs sold more was in 2021, as stocks recovered from the Covid collapse. In contrast, stock buying by this group as been subdued, with just $7 billion in purchases during the first half. This "vote of little confidence" is not exactly reassuring with so much bullishness by investors throughout June.

Luckily for markets, the "passive bid" – the constant flow of money coming into the market from 401k plans, pension plans, and other periodic investment plans – have continued to put additional capital into US markets. This "automatic" inflow has proven to be a shock absorber in market declines but a propellant during up markets. It is dependent on employment staying high, so any weakness in employment could also remove some counted-on buying in the stock and bond markets.

Despite our increased caution around the extended valuations of megacap tech stocks, we believe our Essentials investments, emphasizing those things needed in developed economies, will continue to be attractive and profitable now and in the future. We think metals, energy, materials, utilities, consumer staples and pharmaceuticals will continue to be cornerstones in business and consumer budgets, and we think there continue to be attractive investments in these sectors.

European markets are still exposed to higher energy prices and delivery problems from the woes around Hormuz, so we continue to be less attracted to European equities. However, there are still some companies domiciled in Europe we find attractive, and we will continue to look for attractive opportunities there.

We continue to like some Japanese stocks, including Japanese financials and conglomerates. Japan's fiscal and monetary authorities are slowly moving in the right direction while the economy has improved, helped by a low yen and low inflation, although hurt by higher energy prices. Japanese leaders have recently been encouraging more investment internally in Japan by large investment pools, so we see that as helping Japanese stocks in the intermediate term, while we see Japanese technology, infrastructure and financial companies as continuing to supply and benefit from the worldwide tech buildout.

We continue to like Latin America for investment opportunities, especially Argentina and some in Colombia and Chile. We have not concentrated on Brazil because we are wary of their current left-leaning government and its political future. We think Latin America has opportunities in raw materials, energy, industrial and financial companies as governments continue to realize the merits of freer markets and reforms, continuing to build opportunities for export to the rest of the world.

South Korea's Kopsi index, the hottest stock market so far in 2026, is dominated by two large companies, Samsung and SK Hynix. Those companies are too highly valued and volatile for us, and we are leery of the sheer amount of outright speculation (gambling) by retail shareholders in these companies' stocks, fearing for the possibility of US price weakness as these stocks gain and lose huge amounts of value on a daily basis.

We still to see China as mostly uninvestible, not only due to their corporate structures, but also for the danger of conflict with the US which would lead to their stocks being delisted for US holders, much as Russian companies were in 2022 after the Russian invasion of Ukraine.

Bottom line: Stocks have plateaued after an unprecedented wave of AI-related capital raising sapped investment capacity in US equity markets. The sky-high earnings expectations and the risk of disappointing returns on massive AI investments have capped recent gains in markets. We see many cautionary signs for the markets, although the economy has continued to hold up well, helping underpin markets. We think there continue to be growth opportunities in our Essentials investments, as many have corrected in price despite maintaining attractive underlying fundamentals. We believe our investments incorporate attractive valuations and growth prospects, margins of safety and relatively attractive governmental / regulatory regimes, making our portfolios feel robust and well-positioned to withstand the geopolitical and economic volatility we continue to see and expect to persist.

Bonds

Bonds in general have not performed very well in 2026, as concerns over persistent inflation and high levels of debt issuance have weighed on prices, although attractive income and perceived stability continue to attract buyers worldwide.

Bonds have more recently sunk on expectations of Fed rate hikes due to reignited inflation concerns caused by the Iran war and its consequences. In addition, there is a lot of supply, both governmental and corporate, hitting the markets and coming down the issue pipeline, thus using up investment capacity.

However, inflation, which flared higher in March after the outbreak of the war, has in many categories settled down, as indicated by the most recently-released June CPI report. This settling down of inflation concerns has started to weigh on hawkish market outlooks, although with the Iran war reflaring, investors continue to be wary of oil-driven inflation becoming a problem once more, tempering any recent gains in bonds.

In our minds, it is hyperscaler and other technology company bond issuances have truly weighed on the market. Despite large equity raises, Alphabet (Google) has raised around $100 billion in bond markets during 2026 (in addition to its large equity raises). SpaceX surprised markets by raising $25 billion in the bond market just ten days after its largest-ever IPO. Meanwhile, Amazon has raised more than $70 billion in bond markets with two big offerings in 2026, while Meta Platforms has also raised two large offerings, raising more than $50 billion. Oracle, a big issuer in 2025, has raised almost $50 billion more in 2026, too, and even Nvidia, who is notoriously asset-light, raised $25 billion in debt in June. There is also debt raised by datacenter developers and private debt groups for AI investments which swell these amounts even more. Morgan Stanley estimates that global AI-linked debt issuance would reach nearly $570 billion in 2026, more than double the 2025 total. These huge sums have mostly been raised at relatively low spreads to Treasuries, meaning bond investors see them as investment grade or near investment grade, thus competing these days with Treasuries for capital. However, one gauge of the health of these issues is the credit default swap (CDS) markets. Recently, Oracle and SpaceX bonds have seen large increases in the prices of the CDSs used to insure against losses in these bonds, indicating bond investors' unease about the financial situation of these firms. This is not exactly reassuring after such huge capital raises and more expected throughout this year and next.

Although 2026 has seen both healthy and strained Treasury auctions, Treasury bonds have remained relatively unattractive recently to investors compared to other bonds. They continue to be weighed down by the large US debt load, continued large fiscal deficits, the added costs and uncertainties associated with Iran war. Together, these factors could lead to continued higher rates, a notion not dismissed by new Fed Chief Warsh in his June and early July pronouncements.

We are not alone in our unfavorable view of bonds, especially Treasuries. Recently, JP Morgan Chase CEO Jamie Dimon has pointedly said he thought Treasuries (and equities) are unattractive at current levels and would not own them here. And Jeffrey Gundlach, CEO of bond firm DoubleLine Capital, and the current "bond king" (according to CNBC) has recently said he doesn't favor Treasuries, finding them unattractive for the risks. Finally, decades-long bond bull Lacy Hunt, of renowned bond management firm Hoisington Investment Management, just came out with his Second Quarter 2026 Quarterly Review and Outlook which expresses his major change to bond bear. He explains that the deflationary tailwind from thirty years of globalization is dead, replaced by 1970s-style inflationary forces and a growing scarcity of liquidity as countries put formerly abundant liquidity into plants, infrastructure and defense. Coupling those forces with the eventual need for economic restraint and rising recession risks, he sees inflation and Treasury yields trending upward. Nuff said.

With all the big tech and Treasury issuance going on, there has been less emphasis on other debt issuance, but it has continued apace, with corporates and financials raising tens of billions of dollars. High yield bonds have rallied with equities. Amazingly, private credit firms, despite continuing to face larger-than-permitted withdrawal requests from their private credit funds, have managed to stay out of the financial spotlight for the most part. The continued withdrawal requests have apparently done little to slow fund raising, however, so the sector continues to function, driven more by private equity and these firms' insurance arms, which have found sources of funds through annuity sales, much of which has been deployed into private credit deals with large borrowers. We dislike the lack of transparency in private credit, and we continue to think that any upset in the economy will hit private credit hard, as they tend to lend to borrowers shut out of public markets due to weaker credit profiles.

International bonds do not hold much interest for us given geopolitical and tariff disruptions occurring almost daily. However, as we have in the past couple of quarters, we'd like to discuss yields in Japan and the UK, two "canaries in the coal mine" for world bond markets.

Japan's long-bonds continue to rise in yield as investors are concerned about inflation due to resources prices (especially energy) and the Japanese authorities' very slow raising of interest rates due to scars from deflation and slow economic growth over the last thirty years. Thus, recently rising Japanese bond yields have continued to become more attractive but not so much that they support the yen, which is hitting multi-decade lows recently. We continue to think the Japanese will let yield go higher, but as slowly as they can get away with, to help cushion the blow of higher interest rates on the still slow-growth Japanese economy. The risk here is that low "interest rate, low yen" Japan has been the source of trillions of dollars worth of funding of overseas investments of the past couple of decades (the "carry trade"). If capital is repatriated to Japan due to attractive higher interest rates, this capital move could hurt US stock and bond markets, where Japanese and investors using yen-loans are large investors. Recently, Japanese governmental authorities, led by the Prime Minister herself, have urged Japanese investment pools to invest more in Japan. If this were to start to happen, this could be a headwind for world markets, especially for Treasuries, where Japan is the largest overseas holder.

The UK has a spending problem, and they have just replaced their prime minister, largely because of PM Starmer's inability to rein in spending and keep his constituencies happy. This has all been mirrored in the British bond market, where long-term bonds ("gilts") continue to hit multi-year highs in yield, putting more pressure on the economy and the government on how to resolve the quandary of too-high expenditures in a weak economic environment.

While we think Japan and the UK are the most visible examples of markets' demanding higher (and thus more attractive) yields on sovereign bonds to attract needed capital, we think most countries around the world face a version of the same challenge. As a result, we remain bearish on bonds. We can see a rush to short-term (2-year) bonds if there is an upset in equity markets, but we think that would be short-term as investors worldwide continue to look for safer, inflation-resistant providers of income.

Bottom line: Bonds have had a difficult few months, culminating in sharp declines in price (rising yields) due to the Iran war. While we hold cash for many clients in very short-term T-bills, longer-term Treasuries are unattractive to us, and we are particularly concerned that demand for Treasuries might have problems in future auctions, especially given recent auctions with weakening bid dynamics. International bonds have performed even worse in many cases, making them also unattractive to us as many countries wrestle with rising energy costs and mounting inflation pressures. We also have avoided US corporate debt as more and more hyperscalers issue debt to finance their very large expansions of data centers and computing resources. We see inflation fears pressuring bond dynamics for months and years to come.

Energy

Energy is probably the most volatile and vexing asset class in the markets right now. Conventional wisdom says that the virtual closing of the SOH for more than three months this spring should have pushed prices to all-time highs, with prices lingering near historical highs as damage to energy infrastructure in the Middle East must be repaired to allow producers to flow crude oil, products, and other produced products (sulfuric acid, helium, aluminum, etc.) anywhere close to pre-war levels. In addition, the world has used a good chunk of emergency stockpiles of crude oil and energy products, thus reducing the safety margin against future supply upsets, and thus, supporting higher prices.

However, this analysis hasn't worked well. Prices suggest the above narrative is incomplete, although a large contingent of analysts in the financial markets continue to preach it. So, what is happening, if the conventional wisdom isn't working this time?

First, looking at prices of crude oil, while some Middle East grades are obviously unavailable during closure of the SOH, WTI crude oil futures prices have come nowhere close to their $147/bbl all-time high in July 2008 or the $126/bbl seen at the beginning of the Russia-Ukraine war in 2022. This time, WTI futures spiked higher to $119.48/bbl on March 9, 2026, reached $117.63/bbl in early April, fell below $95/bbl when the MOU was announced in June, and are currently around $85/bbl, even with the SOH virtually closed again and stockpiles worldwide historically low.

Prices are telling us that there is plenty of supply of crude oil around the world, enough to supply worldwide needs despite the SOH closing unless the shooting war were going to last for months or years. How is this possible when up to 17 million bbls/day were interrupted for four months (or more)? The answer is the number was always far too high – crude was able to be exported through Saudi Arabia's East-West pipeline for up to 7 million per day, crude was able to pass across the UAE to their Fujairah export terminal (bypassing the SOH), tankers have been slipping out of the SOH constantly, and there was enough crude in commercial and sovereign storage to pick up the slack, easily.

Brent crude oil, the world standard for pricing oil, reacted similar to WTI prices: an early March spike, an April high and an eventual decline to pre-war prices, followed by this present spike to around $90/bbl. Dated Brent, a more precise measure of actual physical prices and not traded on an exchange, mirrors Brent futures contract prices, reinforcing there has been adequate supply. Finally, the spread between the front-month of crude oil futures and second-month, generally seen as an indicator of tightness in the market if front month prices are higher (in backwardation), instead has shown at instances throughout the conflict that the front month is the cheapest, indicating plenty of supply available (known as contango). Currently, a slight backwardation has developed with the fighting continuing once again, showing some reestablished stress.

Products are a different story, however. Gasoline prices, unsurprisingly, zoomed up when the conflict started because refineries in the Persian Gulf do supply a meaningful amount of gasoline, jet fuel and diesel to much of the world. When the SOH was closed, these supplies were disrupted, driving prices higher worldwide and causing shortages, most notably in Asia. While prices of products dropped at the hiatus in fighting in the Middle East in May/June, Ukraine's sustained attacks during that time damaged Russian refining capacity to the point that Russia has banned exports of products, especially diesel, leading to higher prices. There are even reports that Russia was forced to import gasoline supplies from neighboring Kazakhstan due to shortages. This damage, plus the resumption of Middle East hostilities, have once again pushed up prices for products worldwide.

So, what have we learned, and how does that affect our positions? First, despite some pre-war statistics and anecdotal evidence that supplies were tighter than prices were signaling, the world currently has adequate crude oil supplies and trade routes. As long as cargoes can pass through the SOH, even at a reduced pace, crude prices can stay in a band of pricing seen to be comfortable to many in the energy markets. Second, despite higher prices and lots of uncertainty, demand did not drop off much, except in places where supply availability was severely challenged (primarily smaller East Asian countries without the financial heft to bid away supplies from developed country demand). Third, product prices did react as one would think when the SOH was closed, thus reinforcing the view that refining capacity and the ability to get energy products to worldwide markets is the constraint point, meaning that working, efficient refiners like the US majors and US independent refiners are worth more than previously thought. Finally, that petroleum and products are still the backbone of business and industry throughout the world The resilience and competence of the worldwide petroleum industry as a whole allowed world economies to barely miss a beat despite what was previously considered a depressionary catastrophe: the disruption of the largest concentrated source of energy in the world.

How does that affect our positions? We continue to own oil majors, which own upstream production but also refining and chemical operations. In a world with economic growth closely tied to higher energy availability, we think these companies continue to be well-positioned to prosper, especially as China, Japan and other Asian energy-hungry countries are some of the fastest economic growers in the world. We also continue to like North American refining and pipeline companies, which prospered during the Iran war and continue to be counted on to provide domestic energy for our growing economy and infrastructure buildouts, while providing exports to global markets when needed. The only subset of energy in question is the independent E&P companies; looking at the charts, these companies' stock prices are still higher than pre-war levels, indicating they are still considered premium producers due to their producing locations, operations and financial position, compared to other production considered higher risk. The impact of the ongoing Russia-Ukraine war must figure into the equation as well: damage continues to mount in each combatant's energy infrastructure, arguably with tensions and strikes mounting, ratcheting up pressure on the world's energy systems as a whole. Thus, we will continue to keep our independent producer positions for the time being, analyzing their situations on a continual basis to judge whether that capital might be better redeployed in more attractive opportunities.

Natural gas is a harder puzzle to crack: the damage and slow ramp-up of Qatar LNG operations would tend to point toward worldwide natural gas staying at higher prices than pre-war levels, but US domestic natural gas has not responded price-wise to LNG upsets. It trades almost exclusively on supply-demand-weather dynamics in North America. Only LNG-oriented companies reacted strongly to the Iran war, and even those have retraced their gains 20-30% as when a peaceful resolution seemed in hand. Thus, we are less attracted to natural gas and LNG, due to their uncertainties and closed market dynamics.

The thermal coal markets have mirrored the US natural gas markets, mostly ignoring the reduction of LNG caused by the Iran war disruptions, and we remain only marginally invested in the industry currently.

<u>Bottom line</u>: We were surprised the Iran war did not have a more profound effect on the energy industry, but we still like most of our investments in the sector because they provide income, operational stability and more predictable earnings. We still think the risk/reward is toward the upside as uncertainty surrounding the resolution of the two wars is far from over, although financial markets have moved energy off the front pages of news and financial concerns, for the most part.

Currencies

The US dollar has dominated the currency markets since the beginning of the Iran war. The combination of the flight-to-safety trade and the need to buy-dollars-to-buy-Western-oil has pushed the dollar higher during the past four months to levels not seen since the Tariff Tantrum of 2025.

The question is, what will the US dollar do from here? We continue to believe the factors which pushed it up recently are temporary, as oil flows from the Middle East are expected to normalize over time and the perceived hawkishness of new Fed Chairman Warsh is likely to proven premature. Markets have projected as many as two rate hikes for short-term rates recently, but inflationary readings and expectations have both dropped lately, reducing the odds of rate increases. That, in turn, tends to make the dollar less attractive versus other currencies.

One market affecting the dollar is the Japanese yen market. The US dollar-Japanese yen rate has risen above the 160 yen/$ level lately, causing Japan to intervene in currency markets during 2026, and most recently in late July in concert with the US Treasury. In the past, Japanese authorities have been reticent to signal any plans, but as the yen dropped near 165 yen/$ at the end of July, the Japanese Ministry of Finance once again sold dollars and bought yen, in concert with the US Treasury also buying yen (and selling euros, in this case). The trade (shorting yen) has been so successful in the past couple of decades that the lower yen has continued to attract more sellers, meaning it has cost the Japanese authorities more and more reserves to buy yen as sellers appeared in droves to sell. Japan is the largest overseas holder of US Treasuries, with over $1.1 trillion worth of holdings, and it was rumored that they had sell $100-150 billion worth of US Treasury instruments to buy yen to support it. This has put additional downward pressure on US Treasuries at a time when large US bond issuances had started to compete with Treasuries for investment capital, so the US Treasury has agreed to intervene in the yen/$ currency market to buy yen, selling excess euros in US reserves so as not to put any more pressure on US Treasuries. Intervention is expensive and is often just a temporary slowing of currency movements; Japan will have to raise interest rates. The Japanese monetary authorities have been reticent to raise rates because it puts pressure on its economy and threatens financial stability by potentially forcing the unwind of the yen carry trade, where traders and financiers have borrowed yen to invest in higher yielding investments overseas. This is a market to watch closely going forward: if the yen does rise, especially if it rises quickly, there could be some financial dislocations in markets in some other parts of the world, as traders cover their short yen position and close out the carry trade.

The euro has stabilized since the ECB cut rates during 2025 and early 2026 but signaled they were on hold going forward, as they see their policy rates at 2.25-2.50% above measured eurozone inflation of around 2.25%. Thus, we have no current interest in any euro position.

The only other currency making news lately is the Chinese renminbi (yuan), which has been strengthening for the most part since the resolution of the Tariff Tantrum last April. The yuan has dipped in March and June but is at its highest level since 2022, as the Chinese try to limit capital flight while balancing export competitiveness during a time of economic weakness in China, weakened by the ongoing weakness in real estate there.

<u>Bottom line</u>: Currencies don't hold much attractiveness as investments at the current time. We will be watching the yen to see if it affects world financing markets in its future movements.

Commodities

Commodities, the darlings of 2025 and early 2026, have corrected during the second quarter, as continued war worries and still-high energy prices (especially in Asia) have caused worries about demand destruction, while the thawing of hostilities and the conditional opening of the SOH have alleviated supply concerns in energy and other commodity products.

Gold came under pressure from a convergence of bearish factors that have dragged its price lower since hitting a new all-time high in late January. First, Kevin Warsh was announced as the new Chairman of the Federal Reserve. He is being judged as a relative hawk compared to the former frontrunner for the position, Head of the Council of Economic Advisors, Kevin Hassert, considered the biggest dove (as far as monetary policy) of those considered for the job. This change to a more hawkish choice made the market reassess the likely path of US interest rates, triggering a selloff in gold in January. Second, Chinese liquidity, very high due to China's all-time high in exports in 2025, started to shrink in 2026 as China used it to build inventories of energy, materials and foodstuffs as its "silent war" with the US started ratcheting up with saber-rattling in the Middle East around Iran. Previously, some of the excess liquidity produced by exports found its way into Chinese investments in gold. Third, the rapid rise of gold prices in late 2025 and early 2026 attracted "hot money" in world financial markets, including US hedge funds, sovereign countries' treasuries worldwide and Asian retail investors. When the Iran war broke out in late February, some Middle Eastern countries reportedly sold portions of their gold reserves to plug budgetary shortfalls caused by missed energy exports. Those rapid large sales frightened out the hedge funds and retail "punters," driving down the price even more. Russian also contributed to this pressure with the World Gold Council (WGC) reporting regular monthly Russian gold sales in 2026. A final factor, covered in the Equities section of this letter, is the AI boom rekindled by the Iran ceasefire in late March / early April. The surge in AI equities attracted much of the available investment capital worldwide, and gold, having just corrected, was subject to selling for capital redeployment in AI investments. So, this mash-up of bearish factors contributed to the weakness in gold, driving gold back under its 200-day moving average, where it has been basing since the second half of June.

On the flip side, the biggest pillar of recent gold strength, central bank buying, continues to be a large bullish factor. According to the WGC, central banks were net buyers in aggregate in the first quarter (despite the volatility in price), purchasing 244 tons of gold, versus 208 tons in 4Q 2025. March was the anomaly with the first net aggregate sales in fourteen months, led by Turkey and Russia. Since April, central banks have returned to buying, with China and Poland continuing to be the largest buyers. Goldman Sachs estimates China accelerated their buying in May, purchasing 48 tons, their biggest monthly purchase in over a year, while aggregate central bank buying was 81 tons. Overall, WGC reported global central banks bought 289 tons of gold in Q2 2026, an acceleration from Q1.

In addition, the WGC released its annual Central Banks Gold Reserves Survey for 2026, and the results were stunning. Even after four years of combined 1,000 tons of annual buying by central banks, 89% of central banks believed that central bank gold reserves would increase further in 2026, and 45% of surveyed central banks expected their bank to add reserves. In addition, 74% of respondents see moderate or "significantly lower" US dollar holdings in central bank reserves in the next five years, another bullish factor for gold demand and presumably gold prices.

So where does that leave gold? Seasonally, the spring and early summer months are cyclically the weakest for gold demand. In addition, fiscal stimuli, driven by war spending and additional funds needed for rebuilding, continue to require more US Government borrowing, with other large economies also relying on debt financing. In the past, this has put pressure on central banks, the US Fed included, to accommodate with relatively easier monetary policy, contrary to the "Warsh is a hawk" narrative that currently dominates analysts' opinions. Large AI providers have also recently joined the large-scale debt issuance arena, introducing another major source of capital users which may influence the Fed toward a more accommodative stance. With few of the factors that originally influenced gold's price rise having changed, we believe that the arrival of more seasonal demand combined with the Fed reality of having to continue to foster an accommodative monetary policy environment that allows continued large issuance and refinancing of Treasury debt, a potentially weakening US consumer and a continued need for US dollars around the world that in the past has been solved by increased Fed liquidity measures should provide a more supportive backdrop for gold.

What about silver? After a stellar price performance in 2025 and zooming up above $120/oz in January 2026, silver has corrected from its spike high price earlier this year, but it has settled down around $60/oz in the past few weeks as the price seems to be basing. Fundamentals of the silver market are still extremely favorable, with a deficit in supply (demand exceeding all supply sources) for the sixth straight year, according to The Silver Institute. In addition, most silver is produced as a byproduct of mining for other metals, and these mines take years from discovery to production, meaning there is little new supply coming online soon to alleviate the shortage. Solar (the main industrial usage presently) and electronics (silver is increasingly used in modern electronics for its superior conductivity) still demand silver, despite the higher prices. And recycling, the traditional source when prices rise, has been mostly exhausted since many recycled their scrap silver at attractive prices over the past couple of years. Thus, we continue to be bullish of silver and expect it, like gold, to absorb any final "washout" selling and proceed higher in price later in 2026.

Other metals, like copper, also continue to have good fundamentals. Copper mining has not kept up with demand, and the recent blockage of the SOH cut off a key global supply of sulfuric acid, used extensively in copper mining to separate the copper from mined rock. This loss of sulfuric acid supply, which has only been partially restored despite the slow, sporadic reopening of the SOH, continues to worsen copper supplies as other sources of sulfuric acid around the world aren't sufficient to meet current needs, much less support an expansion of copper mining. New mines are slow to be permitted and constructed around the world, leading to a continued bullishness barely dislodged by the recent correction in metals prices across the board. Reflecting this, copper prices have hit new recent all-time highs in mid-July, and we expect the copper bull market to continue as supply fails to keep up with demand, which is underpinned by US needs for the data center, electrical infrastructure and reshoring construction booms as well as international demand.

The "Warsh hawkishness" narrative hit most commodities in mid-June when new Fed Chairman Kevin Warsh presided over his first FOMC meeting, exhibiting a more hawkish message than many expected. However, new Fed Chairs are widely expected to show an "inflation fighter" persona initially, to show markets that inflation is a concern for the newly headed FOMC. However, as conditions play out and liquidity is needed in various corners of financial markets, Fed Chairs have for decades been forced to "fight fires" and provide "temporary" liquidity until the current crisis abates, which usually morphs into permanent additional liquidity that is absorbed into the system. Some of this liquidity is always used by investors to protect themselves against inflation and currency debasement, invested in commodities to protect purchasing power.

Agricultural commodity prices have been the laggards lately in the commodities complex, but a but a recent uptick in attacks on both Russian and Ukrainian shipping in the Black Sea in July has re-energized prices of wheat, corn and soybeans. We will continue to monitor price action for the dynamics of these markets and their effects on food prices worldwide, which could lead to more strife in inflation-weary countries.

Bottom line: Precious metals continue to have good fundamentals despite poor performance in June and early July, pointing to stabilizing prices and excellent earnings for mining companies. We continue to maintain overweights in commodity investments and producing companies, led by precious metals but also in industrial metals. Since we think the dollar will continue to weaken over time, and we believe worldwide economic growth and industrial/AI/electrification buildouts will keep demand high, we will continue to be overweight commodities/commodity producers until conditions change appreciably.

Kanos Quarterly Commentary

Rational or Irrational (Exuberance)?

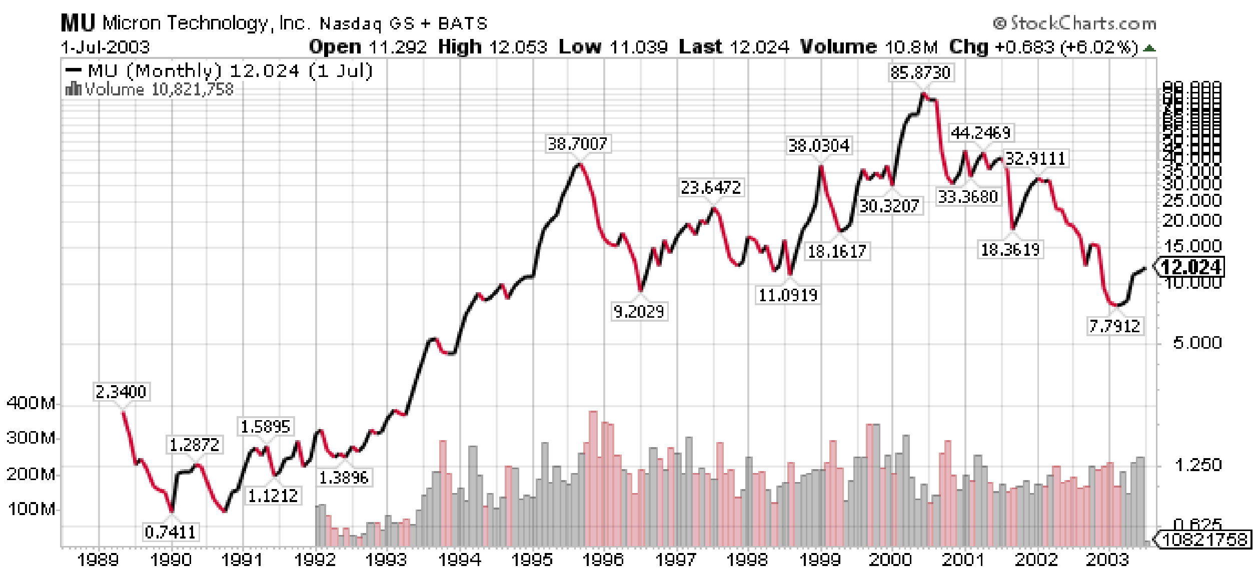
In late June, a famous investment manager, Jeremy Grantham, of investment manager Grantham Mayo Otterloo (GMO) in Boston, was invited on CNBC's morning show, Squawk Box, as one of their hourly guests. Grantham is famous for calling financial markets extremely overvalued at times in the past, and placing his clients' portfolios in safer modes because of his and the firm's views. For this reason, he's often been dubbed a "permabear," and he has had to defend his viewpoints many times, although twice, in 1998-2000 and 2008-09, he was shown to have been correct.

One host of Squawk Box, Andrew Ross Sorkin, invited Grantham on the show in June because Sorkin has a current book out, "1929", that chronicles the Crash of 1929, along with events before the crash and the aftermath in the early 1930s. Another host of Squawk Box, Joe Kernan, apparently regards Grantham as a permabear, and he used Grantham's dislike of Bitcoin (when asked about it) to attack Grantham, blasting him for having done his customers a huge disservice, saying that anyone who listened to Grantham has missed out on a huge market run in the past few years. Grantham, who ran GMO for almost four decades, has not been managing client money since Covid, but he still pens opinions for GMO, and he has been a loud voice about sky-high market valuations in the past few years, including in his own book, titled tongue-in-cheekily, The Making of a Permabear, which shows his journey and mastery of portfolio management, including being an early proponent of index investing as well as participating in exciting new investments, just not at insane valuations.

The exchange between Grantham and Kernan, with Grantham defending his call that markets are extremely highly valued, and arguably higher than the previous peak in 2000 during the dot.com boom, and Kernan standing by his statement that Grantham-managed portfolios have suffered from his "boy who cried wolf" pronouncements while mostly sitting out the latest rally and losing huge potential profits, was not resolved on the show, but it got us thinking about the fact that we are occasionally labeled as too bearish, given our concerns about sometimes eye-watering valuations. Our job is to generate risk-adjusted returns which reflect our customers' risk/reward preferences. We thought we might try to frame the debate from our perspective once more, which we think could be constructive for our customers' evaluation of current and future risks and rewards.

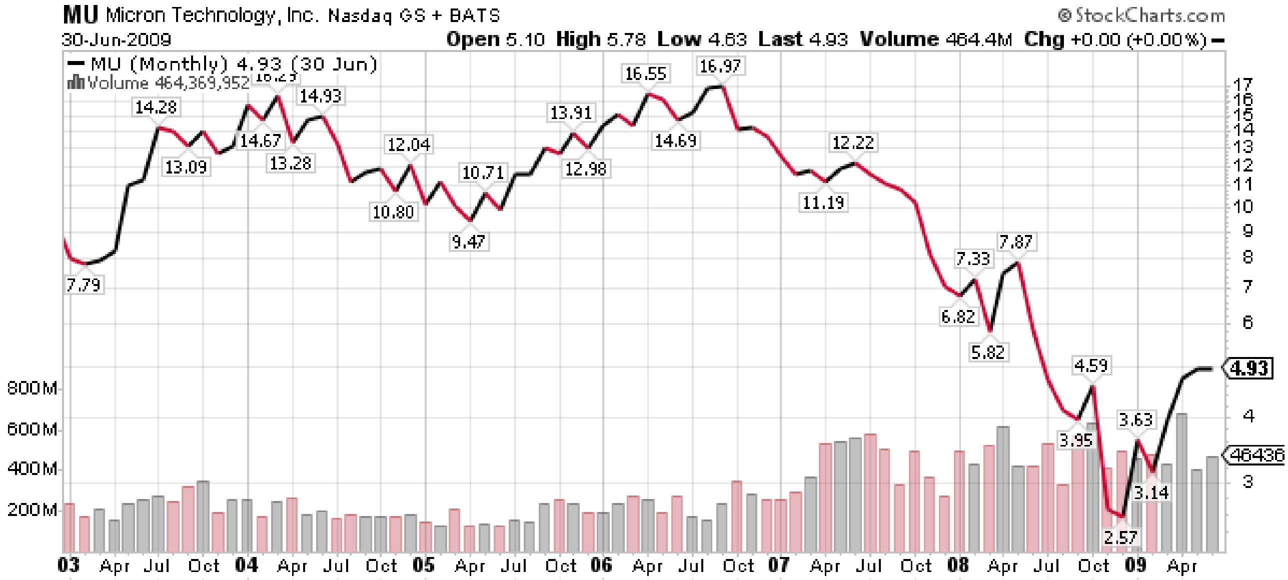
One way to do this is to illustrate with charts and data. Let's start with one of the poster children of this latest technology boom, Micron Technology (Micron or MU), the largest US memory chip maker. Founded in 1978, Micron went public in June 1984 and has competed in this worldwide, very competitive market since then, riding the extreme cyclicality. For illustration purposes, we will be using a few graphs to better show stock movements; we will be using monthly highs and lows, so the returns calculated are close approximations of the actual stock returns.

In the following graph, we see some of Micron's early years of stock performance from 1989 (the earliest we could easily find prices) to 2003:



All prices are split-adjusted, but we will use these prices to show the volatility of Micron's stock price. From early 1989 to a bottom during the 1990-1991 recession, MU lost <u>-68%</u> of its value in less than a year ($2.34 -> $0.7411). After rising several-fold in the early 1990s, the company faced fierce international competition and the stock dropped **<u>-76%</u>** in 1995-1996 ($38.7 -> $9.203). Finally, from its peak during the final days of the dot.com boom in 2000 to its low in 2003, Micron's stock dropped a jaw-dropping **<u>-91%</u>** ($85.873 -> $7.791) during a vicious 30+ month bear market for technology, and especially memory, stocks.

In the mid-2000s, Micron performed as shown in the next chart:

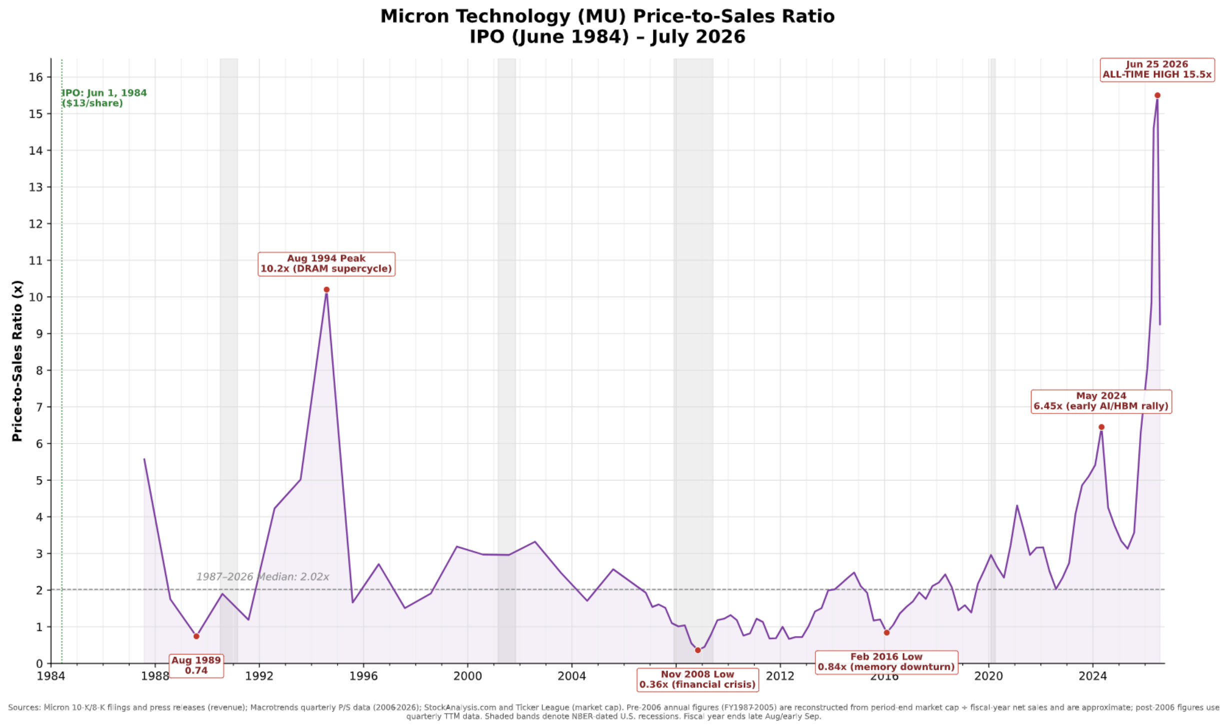


After hitting a bottom in early 2003, Micron recovered some of its value and reached a high in 2007, gaining <u>+117%</u> in those three+ years ($7.79 -> $16.97), but the Financial Crisis took its toll on Micron, pushing it down near its IPO price (from nearly twenty years before) to $2.57 in late 2008, a loss of <u>-85%</u> ($16.97 -> $2.57).

From its low in 2009 to 2025, Micron rose in tandem with the Nasdaq, although with continued extreme volatility, reaching a high of $130.59 in 2024 but retreating to $76.75 during the tariff tantrum of March 2025. However, from that point forward, as the AI trade materialized, the stock has taken off, reaching as high as $1154.11 in June 2026, trading down to $874.40 at the end of June, and "treaded water" in July 2026, having endured another month of high volatility. <u>Its gain since the 2009 low is a staggering +33,931% ($2.57 -> $874.6)!</u>

Micron and its main competitors in Asia have been volatile throughout their histories due to the unusually high cyclicality of their product cycles with respect to their factory capacity. Semiconductor "fabs" (factories) are extremely expensive and technically intricate, yet, most of the time, memory chips are mostly commodity products, able to be produced by a number of large competitors, with most companies' chips being able to be used interchangeably, thus causing price wars during parts of the cycle. The issue is that as more devices and machines use memory chips, new fabs have to be built, but with memory chips being commodities, demand and price are unknown. Also, few customers sign long-term supply contracts because they don't want be caught with lots of high-priced memory inventory when the cycle turns. Thus, memory companies are extremely cyclical, and their results are cyclical too, with companies losing large amounts of money at bottoms (due to expensive new fabs followed by loss of demand and thus poor pricing).

For this reason, we don't think a typical Price-to-Earnings graph works to show MU's valuation over time (due to frequent losses), so we have used the Price-to-Sales ratio to show how Micron's valuation has changed over time. The following is a graph of MU's P/S ratio from 1989 forward:



As the graph shows, the median P/S ratio is 2.02x, and at cycle bottoms (1989, 2008 and 2016), the P/S ratio has dropped below 1 to 0.74x, 0.36x, and 0.84x, respectively. In the mid-1990s, the P/S ratio reached 10.2x, while at the 2000 peak, people were (relatively) reserved about MU prospects, giving the stock only an approximately 3x P/S ratio. Only when the AI trade spread through the markets and investors recognized how much memory – especially more sophisticated high-bandwidth memory (HBM) – was needed for datacenters, did traders/investors bid up Micron and other memory makers to very high valuations, as AI-driven shortages enabled them to raise prices for their products by several hundred percent, not just for HBM chips, but across the broader memory market.

The current boom in memory demand, a bonanza for large memory companies, is expected to last for months or years, as long as datacenter demand keeps up its torrid pace. With that in mind, current valuation metrics are as follows:

Price/Sales:	9.33x
Price/Earnings (trailing twelve months):	16.70x
Price/Earnings (forward twelve months):	4.77x
Enterprise Value/EBITDA (roughly cash flow):	11.93x
Price/Book:	8.29x
Operating Margin:	80.37%
Profit Margin:	55.91%

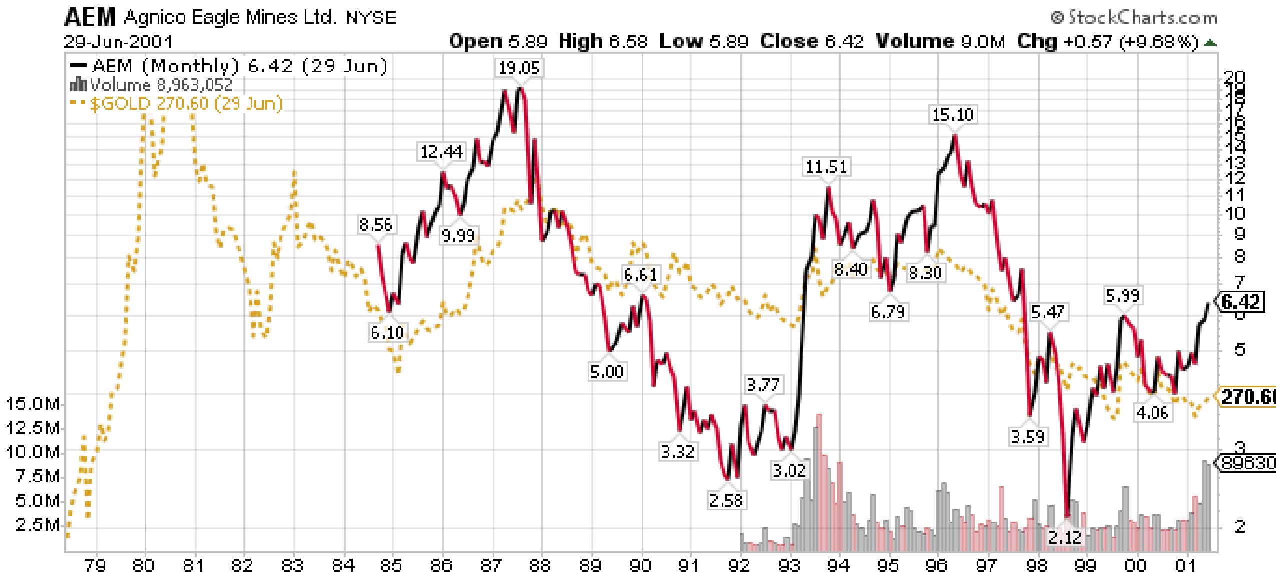
One more major point: MU is a member of the S&P 500, Nasdaq-100 and many other large cap indices, meaning it is a recipient, and recently a large recipient, of investment funds deployed by passive investors, like those in 401ks, pension plans, endowments, and other pools of capital who invest in index-linked funds/capital pools. Thus, as traders and investors have allocated larger percentages of their capital to US stock indices and especially technology (which is a large allocation of many large cap indices, especially the Nasdaq-100), MU stock has been a beneficiary, with this fund flow pushing up its stock price that much further.

We at Kanos have followed Micron since the 1990s, and although its price was far lower in 2024-2025 than today, we thought at that time MU was overvalued as a high-cost commodity chip producer in a worldwide market that is extremely competitive. Its high multiples, 4-6x P/S, during 2024-25 coupled with its high volatility and cyclical earnings, made Micron look like a poor long-term investment, especially late in the tech cycle.

In conclusion, Micron has fantastic near-term prospects with its capacity being used fully and achieving very high current margins for its not-as-sophisticated but supply-constrained chips. Its inability to increase volume means it is relying completely on premium pricing for its earnings projections, which might be dubious farther out than 2027, due to questions on how fast datacenters can be approved, designed, equipped and built, which could reduce demand before new memory chip capacity comes online. In addition, chips of all types, but especially memory chips, have almost always been double- and triple-ordered during booms so that customers could try to receive the full amount of their demand (at the expense of other customers). When demand eases, memory chip makers order books often shrink dramatically as orders are downsized to actual needs. We see Micron as a good company with a historically high-risk profile and an extremely boom-and-bust stock that, like many other companies during a boom, looks best at the top and performs extremely poorly when the boom breaks.

Let's contrast that with one of our largest holdings, Agnico Eagle Mines (Agnico or AEM). Agnico is currently one of the best and largest operators of gold mines in the world. Gold mining is a complex, often difficult business that often experiences unexpected issues, as well as being a price-taker for its products (gold, but also silver, copper, and other metals) and has large fixed costs in land, equipment, operating supplies, especially diesel fuel and large, sophisticated and thus expensive workforces. These elements typically cause volatility in financial results, causing traders and investors to assign lower valuation multiples to reflect that volatility.

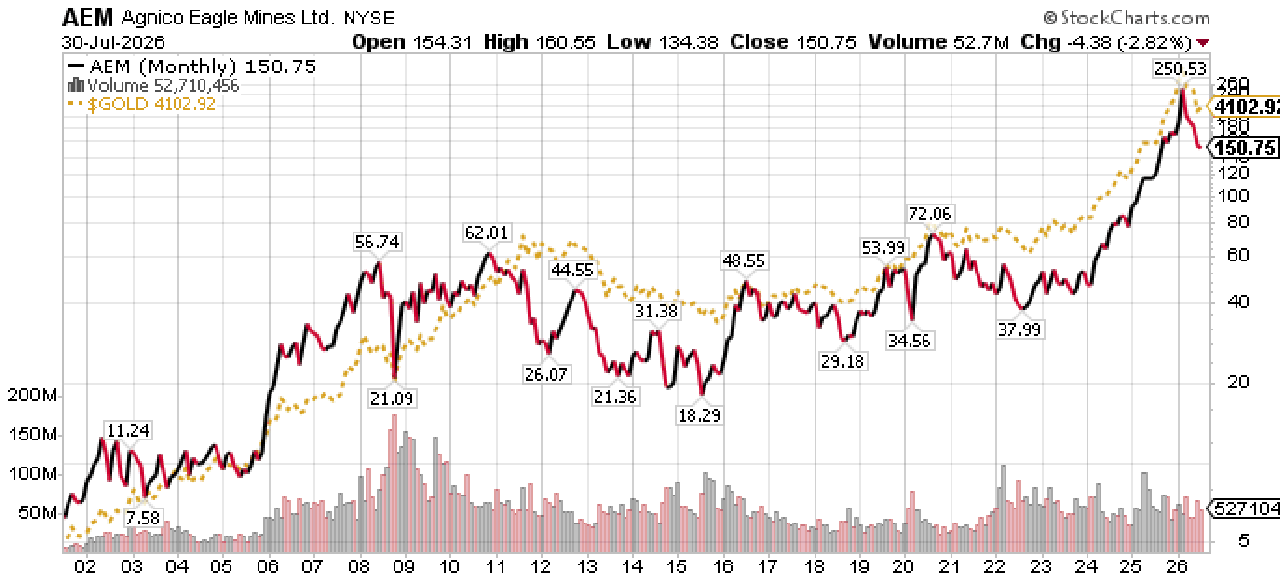
Examining its history and stock price (AEM has been listed on the New York Stock Exchange since 1984, like Micron), Agnico has evolved considerably as it has opened, closed, acquired and operated an evolving portfolio of gold mines over the decades. AEM's early history, as gold was dropping from its 1980 interim high to a low in 1999, was uneven, as shown in the following chart (AEM is the black/red line with the price of gold also charted [as the gold dotted line] to give reference to AEM's movements):



As gold hit a multi-year low in 1985, AEM stock fell to \$6.10, a <u>-29%</u> loss (\$8.56 -> \$6.10). As gold recovered in the late 1980s, AEM stock recovered admirably, rising <u>+212%</u> (\$6.10 -> \$19.05). Mine -related challenges, coupled with the prolonged 1980s-1990s bear market in gold and reconfiguring of AEM's portfolio, led to peaks and even lower valleys in its stock price, resulting in a \$6.42 price as gold itself hit multi-decade lows in the 1998-2001 timeframe.

From gold's low in 2001 to 2011, the gold price rose from roughly \$270/oz to high near \$1,800/oz, and Agnico took advantage, rising from \$6.42 to a 2011 high of \$62.01, gaining <u>+8,659%</u> during that timeframe.

Shown by the graph below, after topping in 2011, gold hit its recent low of approximately \$1,080/oz in late 2015, and AEM stock suffered alongside it, dropping to a low of \$18.29, even though the company had used those years to reposition its portfolio to a much more attractive mix of gold mines in mining-friendly countries (Canada, Mexico and Finland). The stock dropped <u>-71%</u> during this 2011-2015 downturn (\$62.01 -> \$18.29).

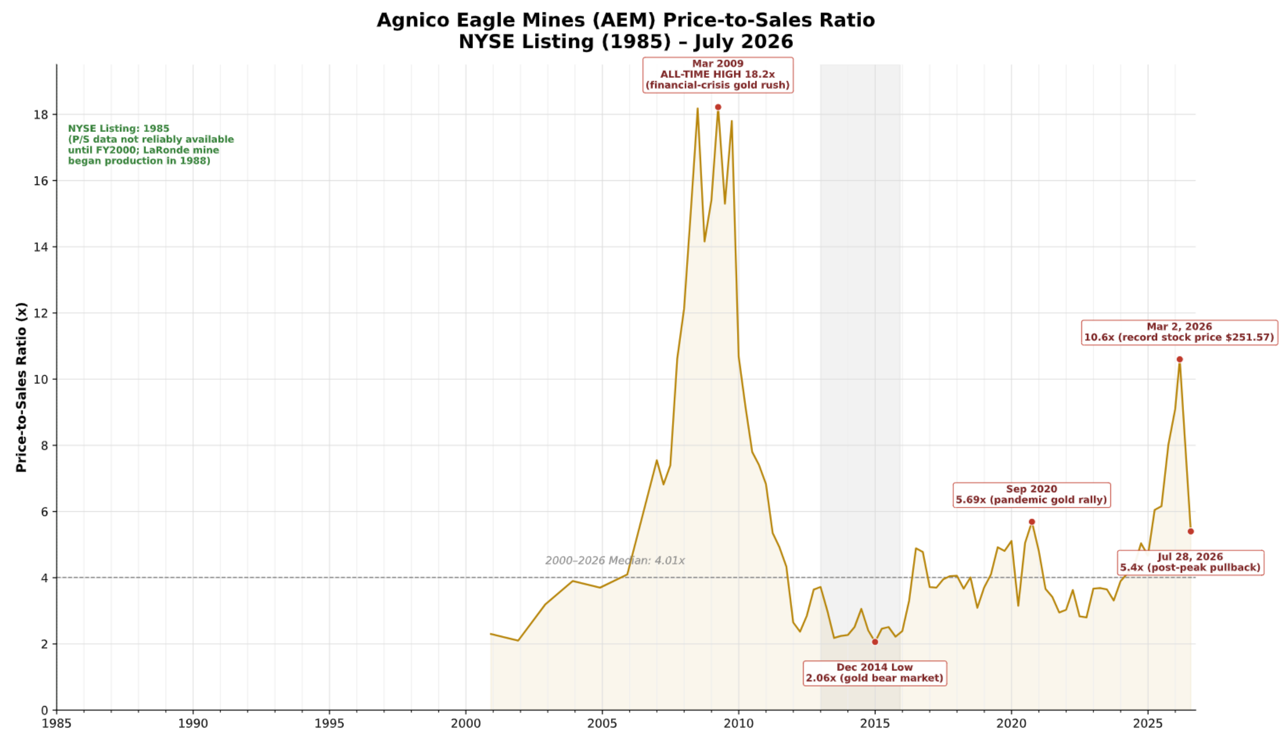


Finally, gold reached its most recent bottom in 2022 but was soon followed by the West freezing Russian Central Bank reserves in the western central banks, a watershed event in central banking circles. World central banks at that point started buying more gold in earnest, headed by China, as central bankers saw the seizure of financial assets of Russia as a reason to beef up their gold reserves, a reserve asset which when held in home country vaults, is liquid, safer and far less exposed to foreign influence or seizure.

Since its 2022 low at $37.99, AEM stock rose as high as $250.53 in January 2026, or a gain of <u>**+5,595%**</u> ($37.99 -> $250.53). As gold corrected from its January high to its recent price around $4,100/oz, AEM stock has corrected even more, with its stock price falling back to $150.75 at the end of June, and is currently at almost that exact same level in late July. This extreme correction pushed AEM lower by <u>**-40%**</u> ($250.53 –> $150.75).

Like memory chip companies, gold miners have been volatile throughout their histories due to the cyclicality of the commodity cycle and their large fixed-cost expense base. Like semiconductor fabs, metals mines are extremely expensive and operationally complex, and when the cycle turns, some mining companies suffer financial losses, which happened to Agnico in the earlier incarnation.

For this reason, we have not used a traditional Price-to-Earnings comparison due to periods of losses that would distort the graph; instead, we have used the Price-to-Sales ratio to show how Agnico's valuation has changed over time, as we did with Micron. The following is a graph of AEM's P/S ratio from 2001 forward (the earliest we could get data:

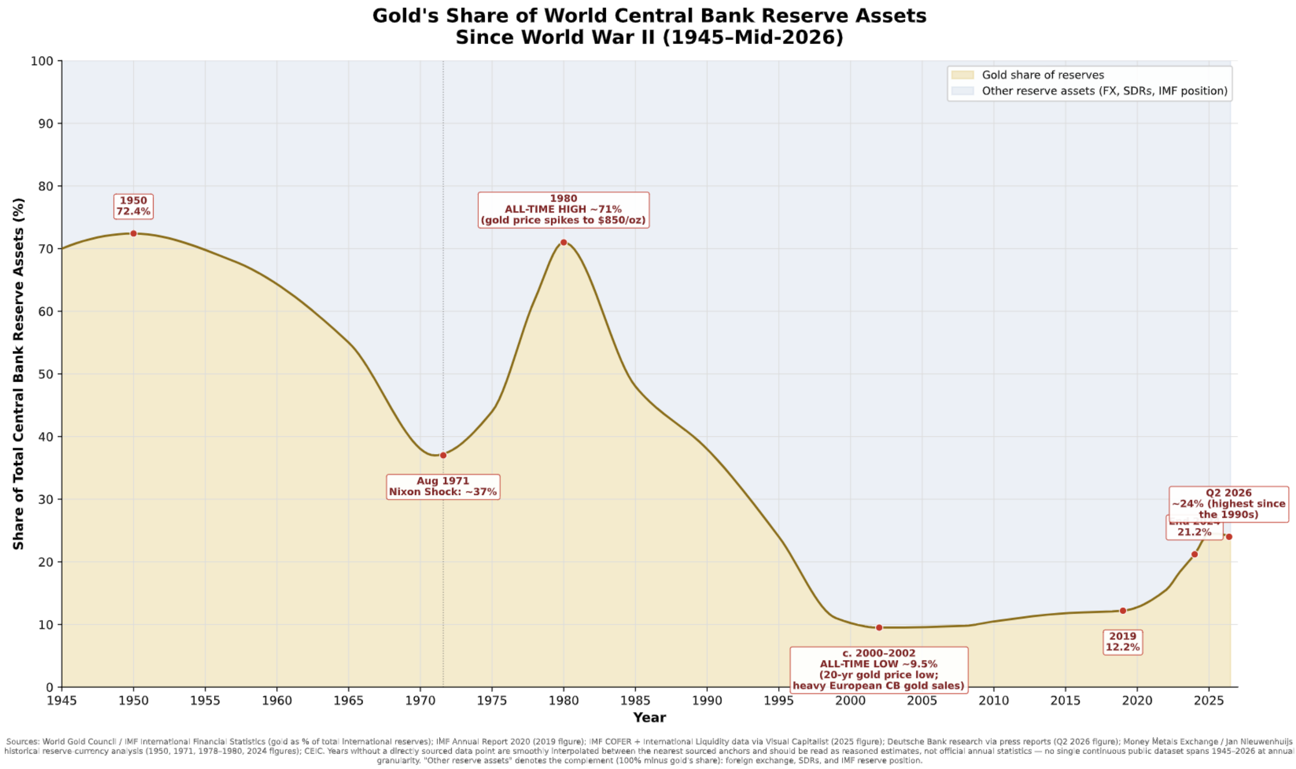


Sources: WallStreetZen (annual revenue, FY2000-2025); Macrotrends quarterly P/S data (2006-2026); company filings and market data for 2026 endpoints. FY2000-2005 figures are approximate, reconstructed from period revenue and estimated market capitalization (precise pre-2000 data is not reliably available for this era of thin trading). Shaded band denotes the 2013-2015 gold-price bear market. Reliable quarterly data begins Q4 2006.

As the graph shows, the median P/S ratio is 4.04x, reflecting the recognition of Agnico being an industry-leading operator, producing metals more predictably than most competitors while producing more steady profits. AEM's P/S ratio fell to lows of 2.06x during the 2012-2016 gold market, but most curiously, AEM's valuation, which peaked in 2009-2011 at a P/S ratio of 18.2x (with gold priced between $1,200-$1,800), only reached 10.6x in early 2026, even though the gold price exceeded $5,000/oz for much of the period. And while gold has dropped to $4,000/oz, AEM's valuation has dropped even more, with a P/S ratio of just 5.4x currently.

The conditions that led to $5,500+/oz gold are still in effect: high and rising sovereign debt levels in the US, China, Japan, Europe, and many other large countries around the world, geopolitical upset (2 wars that seem to be spreading), central banks' still large exposure to US dollars, lots of liquidity in financial markets, and continuing inflation fears in financial markets, governments and consumers (even 2% per year causes higher prices and erodes purchasing power).

As an illustration, according to the World Gold Council, gold as a world central bank asset allocation is nowhere close to the post-World War II high of 72.4% or the 1980 high of 71% after the 1970s inflation and Middle East wars and oil shock (conditions back in existence today). The graph below, showing a current 24% aggregate allocation to gold, illustrates how much smaller gold's reserve allocation is on current world central bank balance sheets than in more similar circumstances:



Thus, demand for gold is expected to continue at current (high) levels, especially among relatively price-insensitive central banks, meaning Agnico should have robust demand for its metals products for months and years in the future. With that in mind, current valuation metrics are as follows:

Price/Sales:	5.00x
Price/Earnings (trailing twelve months):	12.37x
Price/Earnings (forward twelve months):	11.99x
Enterprise Value/EBITDA (roughly cash flow):	6.57x
Price/Book:	2.52x
Operating Margin:	62.82%
Profit Margin:	39.46%

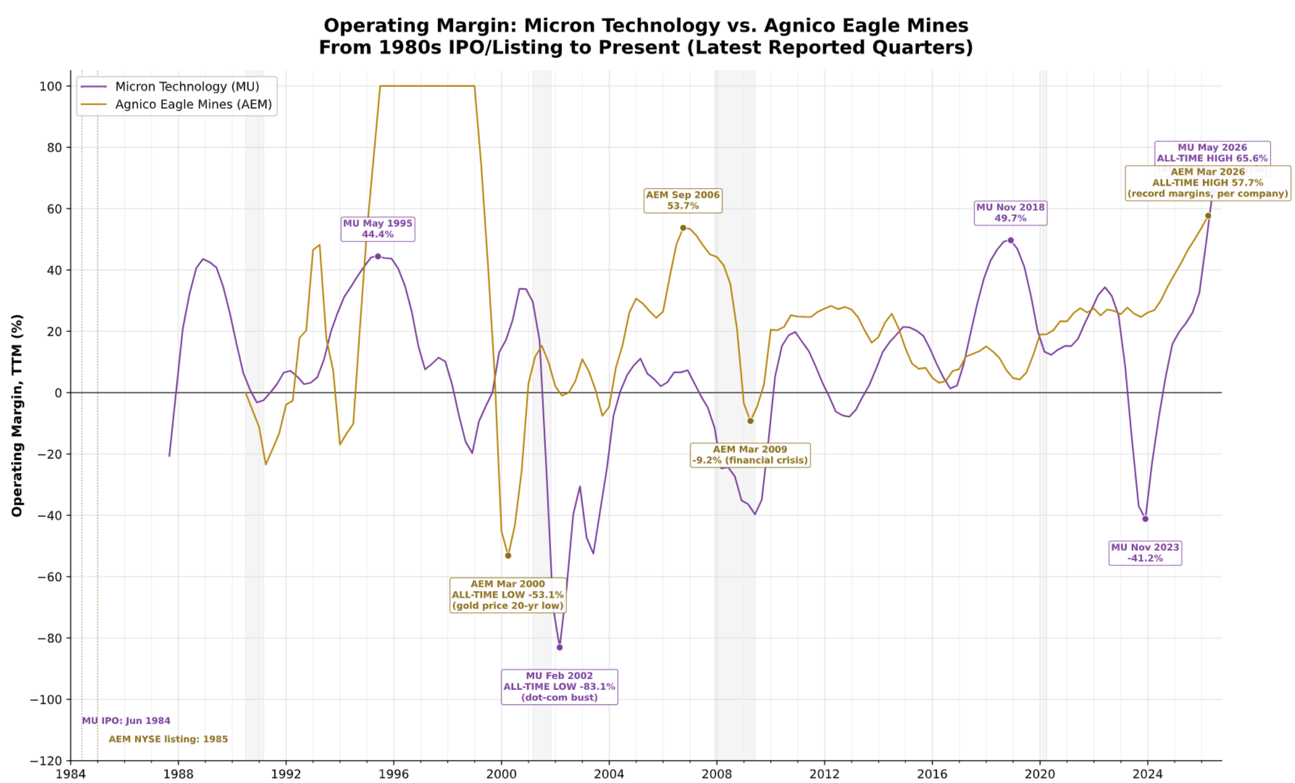
In contrast to MU, Agnico is a Canadian company and not a member of the S&P 500, Nasdaq-100 or any other US large cap indices, meaning it is not a recipient of investment funds deployed by passive investors, like those in 401ks, pension plans, endowments, and others. Thus, as traders and investors have allocated larger percentages of their capital to US stock indices and especially technology, Agnico has received less and less as huge equity raises by SpaceX, Google/Alphabet, SK Hynix and others have sucked investment capital to them, starving other companies like AEM.

Agnico, like Micron, has fantastic near-term prospects with its mines running smoothly and production expected to increase significantly over the next 3-5 years as long-term mine development projects come online. Gold prices are unpredictable in the short-term, but gold's relatively-high price and continued bright prospects allow an excellent mine operator and developer like Agnico to prosper. There are always mining risks that could result in unexpected setbacks; however, with a diversified portfolio of mines in four different countries and consistent long-term operating excellence by the management team, Agnico deserves to trade at a premium valuation.

The gold mining industry in general also has proven to merit higher valuation multiples than in the past as companies have shown investing discipline, capital allocation discipline and operating competence often missing in past gold bull markets.

So, we believe the premium valuation given to Micron for its exceptional, though potentially short-lived, growth opportunities is excessive compared to the valuation given to Agnico. While both have had large gains and corrections, we believe the gap in their valuations is out of whack for the differences in operations and prospects.

Here are two graphs to illustrate our point. In the first one below, it shows the operating margins of both MU and AEM. They both show positives and negatives, but Agnico has been more consistently profitable (notice MU's large negative margin in the mid-2020s). Currently (not shown in this graph), Micron's operating margin has gone higher since May, and AEM's has dropped slightly with gold's correction in the past few months, but the similarities are great.



Source: Macrotrends, trailing-twelve-month (TTM) operating margin by fiscal/calendar quarter, from company financial statements. Micron data begins Aug 1987 (3 yrs after its Jun 1984 IPO); Agnico Eagle data begins mid-1990 (its LaRonde mine began production in 1988). Note: Agnico Eagle's reported margin of exactly 100% for several quarters in 1995–1998 is a data artifact of how the small, early-stage company's simplified filings reported costs, not a literal zero-cost operation — treat that plateau with caution. Shaded bands denote NBER-dated U.S. recessions.

The performances of the stocks in the past few years are not comparable. Seen below, MU has far outperformed AEM, and we think AEM has proven over the past few years to create enough value to close that gap at some point in the near future. The fundamentals and macroeconomic backdrop support such a move, too.

Interesting Article

We occasionally come across articles that offer thoughtful perspectives on today's important issues. We found this piece on rising interest rates around the world to be well-written and compelling. The following is an excerpt from an August 2, 2026 article by analyst Michael Green originally published on his Substack.

Maid In Japan

August 2, 2026

By Michael Green, Simplify Asset Management

...Long-term government bonds across the developed world are selling off together — prices falling, yields rising — and almost every explanation on the news is about local conditions. In the United States it's the deficit, the Treasury's borrowing calendar, and lately the new Fed chairman's refusal to hold the market's hand despite his history of personal advancement by taking hands. In Britain it's fiscal credibility. In Germany, rearmament. In France, politics. Each story is plausible where it lives, but none of them explains the one fact that should dominate the analysis: the markets are moving together.

Consider the past few weeks. Germany's 10-year bund reached its highest yield since 2011. Japan's 10-year JGB reached its highest since 1996, and its 30-year set a record. Britain's 10- and 30-year gilts touched their highest levels since 2008 and 1998. Widen the lens to the season, and the count reaches five countries. The 30-year US Treasury has closed above 5% thirty-five times this year, the most since 2007, and finished July at 5.27%, two days after the Fed held rates. The Australian 10-year crossed 5% for the first time since 2011. And the 30-year JGB, the bond that spent a generation as the world's designated zero, traded through 4% in late July.

That synchronization implies a large common component. The question is which forces created it — and which channels amplified it.

These countries do not share a story. The United States is spending prodigiously on AI and may be accelerating; Japan is old and slow-growing. Germany entered the year with a much stronger fiscal position than France, Britain, the United States, or Japan; Britain and France carry live questions about fiscal credibility; Australia exports commodities to China. What they share is narrower and more important: open bond markets funded from the same global pool of long-term capital. Local conditions explain the size of each country's move. A change in the shared buyer base helps explain why the moves came together.

The common amplifier is the buyer base. For much of the past two decades, long-bond markets relied on two buyers whose decisions were not driven solely by return. Central banks bought for policy reasons. Japanese life insurers bought to match yen liabilities. Both are stepping back at once. That does not tell us where long-term rates ultimately settle. Growth, inflation, fiscal risk, regulation, and the supply of competing assets all matter. What the withdrawals change is the seating chart. We can hear the music and see some of the players beginning to move — central banks returning long bonds to private hands, Japanese institutions shifting from foreign seats toward domestic ones. But we do not know when the music will stop, who will be left standing, or who will occupy each seat.

The first withdrawal of Central Banks is well covered, although I would emphasize it's not universal — many central banks continue to intervene. The focus in this essay is the second, and more broadly leading to a follow-on essay focused on private sector implications, likely in two weeks.

The Japanese insurer bid was among the largest sources of cross-border, liability-driven demand. It bought bonds to match long-dated promises, not simply to maximize return. That marginal bid is beginning to turn home, and the market is pricing the turn. The direction is documented while the magnitude remains to be measured. What replaces these buyers in the United States is a different question, for the companion essay.

The boundary case is China, whose 30-year bond trades at 2.19%, inside a range of less than half a percentage point all year, drifting lower while the rest of the world reprices. A market only partially open to foreign capital, running its own deflation, did not participate. That is consistent with a flow channel as well... just a different set of flows. Another subject to return to.

The trade that built the long end

A Japanese life insurer carries an average liability cost of roughly 2% — the return its old promises require. During the decade of yield-curve control, the 10-year JGB yielded roughly zero. So the money went abroad — into Treasuries, bunds, gilts, and Australian bonds — until Japan became the largest foreign holder of US Treasuries, at roughly \$1.1 trillion by Treasury's count. That count lumps every Japanese sector and maturity together and tracks custodians rather than owners, so it is a blunt insight on the biggest single foreign pile in the data.

Why would one buyer matter so much in markets this large? Because prices are set by the marginal buyer — the investor who shows up for the next bond, not the ones holding the last decade's. A market can have a deep, stable base of holders and still reprice sharply if a large, reliable bidder for the newly issued bonds steps away. And the 10-to-30-year Treasury market has a narrower set of natural buyers than shorter maturities. Pensions and insurers want long bonds because they match long obligations. Hedge funds often hold them with borrowed money. Japanese institutions were among the largest foreign buyers.

The question is not "why are yields rising?" — ask that, and you get the parade of local stories. The question is what changed for this buyer. The answer has two parts: one misunderstood, one ignored.

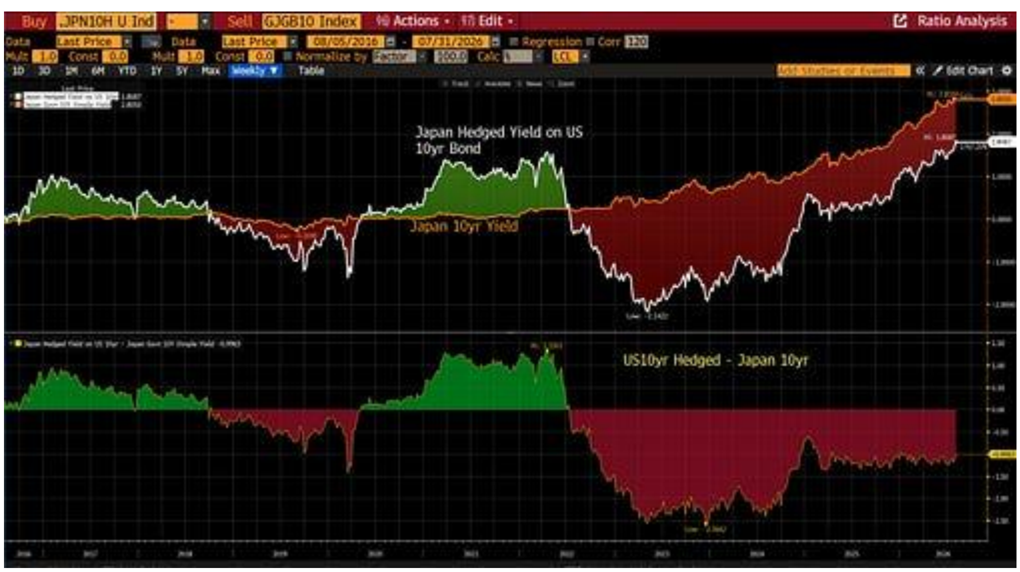
The hedge is not the news

The misunderstood part is the currency hedge. The standard story says the gap between US and Japanese interest rates makes it expensive for Japanese investors to protect themselves against a falling dollar, so they are abandoning Treasuries. True, but incomplete — and the incomplete version predicts the wrong things.

A Japanese insurer buying Treasuries takes two risks: the bond and the dollar. It removes the second with a currency hedge — a contract locking in the rate at which future dollars convert back to yen. The price of that contract is set, in effect, by the gap between the two countries' short-term interest rates: hedging dollars costs a yen-based investor roughly the difference between what the Fed pays and what the Bank of Japan pays. After hedging, the headline American yield is no longer the relevant return. What the investor earns is something close to Japanese short-term rates plus the *slope* of the American market — the gap between America's long rates and its short rates. The headline yield washes out in the hedge; what crosses the border is the shape of the curve.

The hedge is renewed every few months, so the arithmetic moves with policy. All else equal, a Bank of Japan rate increase makes dollar hedging *cheaper*, not dearer, by narrowing the short-rate gap. The hedge is not what is pushing the money home. What pushes is the other side of the ledger: what home now pays.

Run the comparison at matched maturities and from the same base, as it stood at midsummer. Hedged into yen, a 10-year Treasury offered 55 to 80 basis points over Japanese cash, before fees. A 10-year JGB offered more than a full percentage point of additional spread over that same cash: 2.9% outright, the most since the mid-1990s. No hedge, no contract to renew, no currency risk, and payments in the currency of the insurer's promises. For the longest liabilities, a 30-year JGB paid 4%. (Hedge tenor, forward points, and the cross-currency adjustment belong to the source note.) Roughly half of Japan's ten largest life insurers have said they are reducing foreign bond holdings.



American readers watched this logic run live in 2022 and 2023. As higher rates improved corporate pension funding, many plans increased long-bond allocations to match liabilities, locking the improvement in. Japan's insurers face the same choice in yen: once domestic bonds can cover long-dated yen liabilities, taking currency and hedge-roll risk abroad becomes less necessary. The logic binds only a plan that can reach its goal. Underfunded plans keep reaching, a distinction the companion essay will take up. That is the push. The committee calendar is why the holdings data lags the decision.

This is less a story about Treasuries becoming unattractive than about Japanese bonds becoming good enough. The distinction matters. If hedging costs alone were the problem, a sufficiently steep US curve would bring the buyers back. But an insurer's job was never to maximize yield; it was to cover promises made in yen. Once the home market can do that, foreign bonds must offer substantially more — not slightly more — to justify the currency risk and the hedging machinery. Foreign bonds are now judged against yields available in Japan.

"Japanese institutions" are not one actor, and this mechanism is strongest among the insurers. The giant Government Pension Investment Fund holds foreign bonds at almost exactly its policy target and goes nowhere without a policy change. Banks trade for entirely different reasons. The Bank of Japan's own financial-system report describes a picture in transition: currency-hedged foreign bonds cut, total holdings roughly unchanged so far. So the claim is not that Japan has already gone home. It is that the calculation has flipped for the buyers who mattered most at the long end — and holdings follow calculations, with a lag.

The change is also selective by maturity: the same insurers have pulled back from the longest bonds in their own market. They cut Japanese government bond holdings by ¥1.35 trillion in the three months through March 2025, among the largest reductions on record. Demand at Japan's 30-to-40-year auctions has been weak enough that the Ministry of Finance now sells less there. No contradiction. The insurers spent the past decade buying long bonds to close their duration gaps, and much of that work is finished. They do not need 30-year paper in Tokyo any more than in New York. The longest bonds — everywhere — are losing their most dependable buyer.

Why the selling data misses the story

Analysts who track the flows keep concluding the story is overstated, because the observed selling is modest. This mistakes how the mechanism works. Japan's holders do not need to sell a single bond for their departure to matter. They need only to stop replacing the ones that mature — and stop showing up for the new ones.

A bond that matures without being replaced does eventually show up as reduced holdings. But the decline appears slowly, only as fast as bonds come due. And it is hard to distinguish from ordinary price changes, because the official tables report holdings at market value — in a selloff, falling prices look like selling. The Federal Reserve spent a decade estimating true flows from those tables precisely because they cannot be read at face value.

More important, replacing their own maturing bonds was only half of what Japanese investors did. They also bought a share of each new issue, year after year, as government debt grew. When those purchases stop, Japan's holdings do not fall. They simply stop growing alongside the market. You cannot see a purchase that does not happen. It appears most clearly in two places: auction demand and price.

Markets, meanwhile, do not wait for the data. If investors expect a dependable buyer to disappear, yields rise today in anticipation of auctions months away. That is why this selloff feels unexplained by the visible numbers: part of what is being priced is a bid that won't arrive, for bonds that haven't been issued yet.

Japan's Treasury holdings fell $66.7 billion in May, the largest decline since 2022 — a headline that reads like liquidation. The detail says otherwise. Roughly $60 billion of the drop was short-term bills, consistent with raising dollars for the ¥11.7 trillion of currency intervention Japan conducted that month, though the data cannot prove the motive. Long-term bond holdings fell about $7 billion, which is what a quiet failure to reinvest looks like, and exactly what noise looks like too.

The Managers of Kanos Capital Management