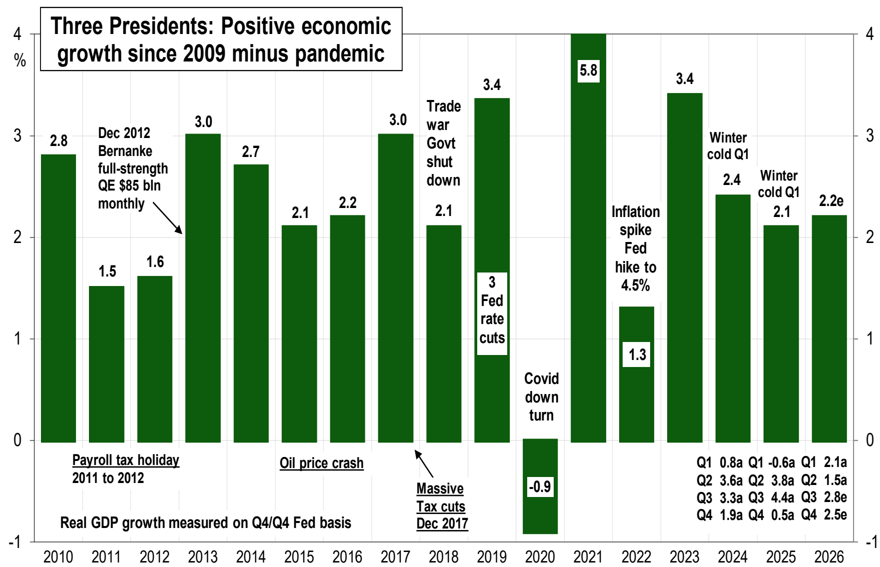
Financial Markets This Week

Christopher S. Rupkey, CFA
Chief Economist
crupkey@fwdbonds.com

31 JULY 2026

SLOW GROWTH NO INFLATION

The minuses outweighed the pluses when it came to economic growth in the second quarter. AI spending on equipment was strong as expected, and consumers did their part with a solid advance that was more than expected at 3.2%. But Federal government nondefense spending fell back subtracting from GDP even if the White House will still brag that shrinking the government is exactly what they want. GDP spending overall was undeniably slow for a second straight quarter this year at 1,5% in Q2 2026. America's reliance on imported goods has not been slowed by the Trump tariffs, and trade overall subtracted 1.0 percentage points from economic growth. The slow growth is due in large measure to the Administration's economic policies.



	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26p
REAL GDP	-0.6	3.8	4.4	0.5	2.1	1.5
REAL CONSUMPTION	0.6	2.5	3.5	1.9	0.5	3.2
CONSUMPTION	0.4	1.7	2.3	1.3	0.4	2.1
Durables	-0.3	0.2	0.1	0.0	0.0	0.5
Nondurables	0.3	0.3	0.5	0.1	0.1	0.6
Services	0.4	1.2	1.7	1.2	0.3	1.0
INVESTMENT	3.8	-2.7	0.0	0.4	1.4	0.5
Business Plant	-0.1	-0.2	-0.2	-0.2	-0.1	-0.1
& Equipment and	1.0	0.4	0.3	0.2	0.8	0.8
Intellectual Property	0.3	0.8	0.3	0.3	0.7	0.5
Homes	0.0	-0.2	-0.3	-0.1	-0.3	0.1
Inventories	2.6	-3.4	-0.1	0.1	0.2	-0.7
EXPORTS	0.0	-0.2	1.0	-0.4	1.1	0.5
IMPORTS	-4.7	5.0	0.6	0.1	-1.5	-1.5
GOVERNMENT	-0.2	0.0	0.4	-1.0	0.7	-0.1
Federal defense	-0.3	0.0	0.2	-0.4	0.1	0.1
Fed nondefense	-0.1	-0.4	0.0	-0.7	0.5	-0.3
State and local	0.2	0.3	0.2	0.2	0.2	0.1

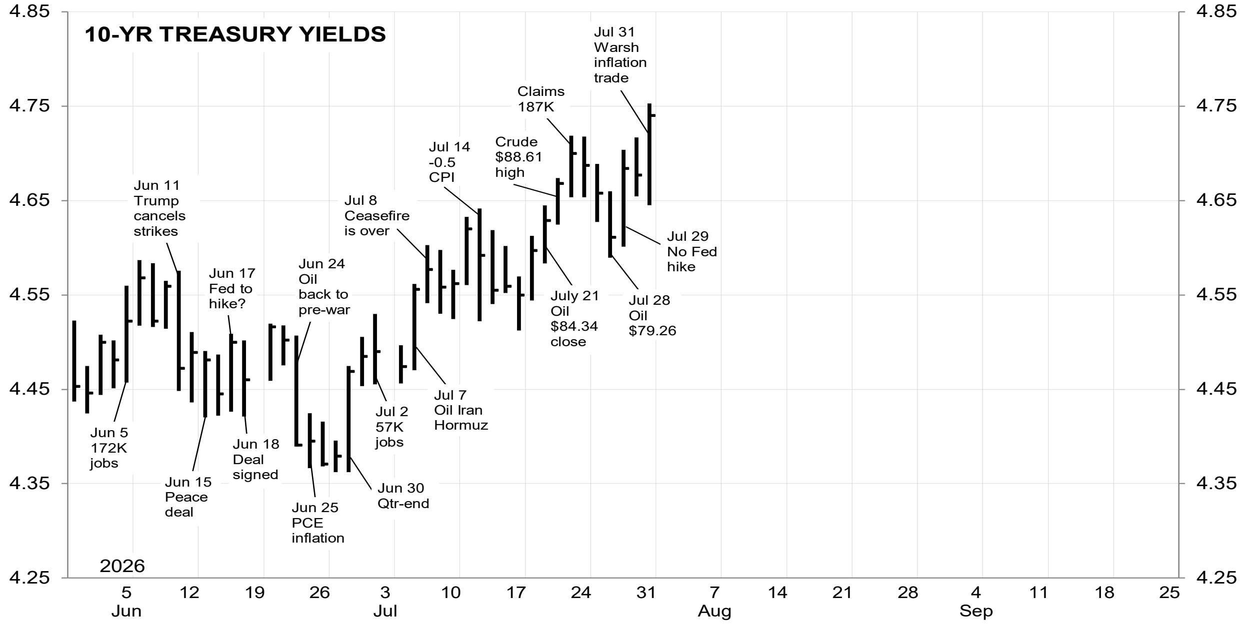
Below line: Percentage point contributions to Q2 2026 1.5% real GDP

Second estimate for Q2 is Wednesday, August 26

Core PCE inflation slowed to just 0.1% and is 3.3% above last year and above the 2.0% target. One month is just a data point, but this change is looking more and more like a turning point where the import tariffs and higher energy prices are not leading to excessive price increases in other consumer goods and commodities. Core goods prices have shown no increase the last two months on a net basis which is astonishing and is looking like a trend. The bond market may have exaggerated the inflation risks out there and the sell-off on Warsh's inaction on rates Wednesday may need to be tempered in the days ahead. Slow growth and little inflation is just the data that Fed officials need to see in order to keep an interest rate hike off the table for now.

Outlook: This is one of those GDP reports that looks bad, but consumption and investment looks good. Real consumer spending was 3.2%, and based on strong monthly 0.4% gains in May and June, this spending is already 1.6% in Q3 2026 without any data for July, August, September yet.

INTEREST RATES

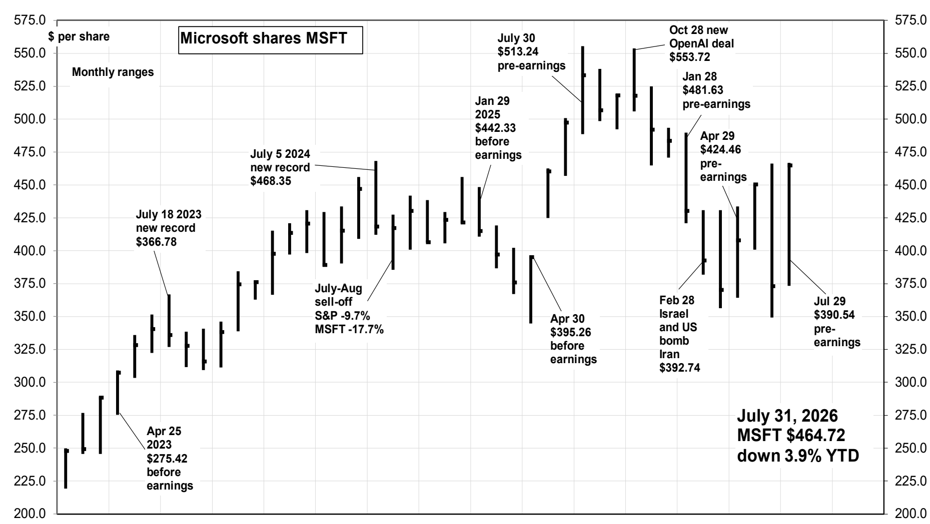


Stocks could not quite close the gap on Monday after the Iran bombing pause over the weekend with crude oil falling $6.70 to $82.61 on Monday. Stocks and bonds thought they liked the no-rate hike Fed announcement at 2pm ET Wednesday, but the yield curve steepened with no Fed tightening imminent, and higher bond yields were the result of Fed inaction (fiddling while Rome burns) and that sent stocks down hard losing 1.5% on the day. The 10-yr fell as low as 4.61% after the Fed did nothing but closed at 4.68% Wednesday. Microsoft rallied 15.5% Thursday after earnings, bringing the broader market back up 1.7% on Thursday. Microsoft had a 4.6% S&P 500 weight so that means 0.046 X 15.5% = 0.7% was the MSFT effect. October Fed funds futures adjusted were 3.995% Tuesday, but fell back to 3.905% on Wednesday after the Fed. Bonds closed 4.74% Friday on Warsh inaction trade.

Microsoft (MSFT) jumps 15.5% Thursday after earnings

Earnings released Wednesday after the bell were finally a winner the next day, following declines of 3.9% in April and 10.0% in January. We hate to think it is all due to Cloud revenues up 31.6% from a year ago versus 29.6% for Q1 2026 and 28.8% for Q4 2025. Operating income of $40.6 billion versus $27.9 billion two years ago when stock was $446.95 at the end of June 2024. Capex was $41 billion in Q2 2026 so you know where operating income goes. Fiscal year 2026 capex was $145.3 billion 64.7% more than 2025.

Calendar Year Mln $	Revenue	Productivity Business Processes	Intelligent Cloud	More Personal Computing
Q2 2026	90,007	37,847	39,306	12,854
Q1 2026	82,886	35,013	34,681	13,192
Q4 2025	81,273	34,116	32,907	14,250
Q3 2025	77,673	33,020	30,897	13,756
Q2 2025	76,441	33,112	29,878	13,451
Q1 2025	70,066	29,944	26,751	13,371
Q4 2024	69,632	29,437	25,544	14,651
Q3 2024	65,585	28,317	24,092	13,176
Q2 2024	64,727	28,627	23,785	12,315
	Income	Processes	Cloud	Computing
Q2 2026	40,603	21,900	15,955	2,748
Q1 2026	38,398	20,973	13,753	3,672
Q4 2025	38,275	20,599	13,873	3,803
Q3 2025	37,961	20,407	13,391	4,163
Q2 2025	34,323	18,993	12,140	3,190
Q1 2025	32,000	17,379	11,095	3,526
Q4 2024	31,653	16,885	10,851	3,917
Q3 2024	30,552	16,516	10,503	3,533
Q2 2024	27,925	15,706	9,835	2,384

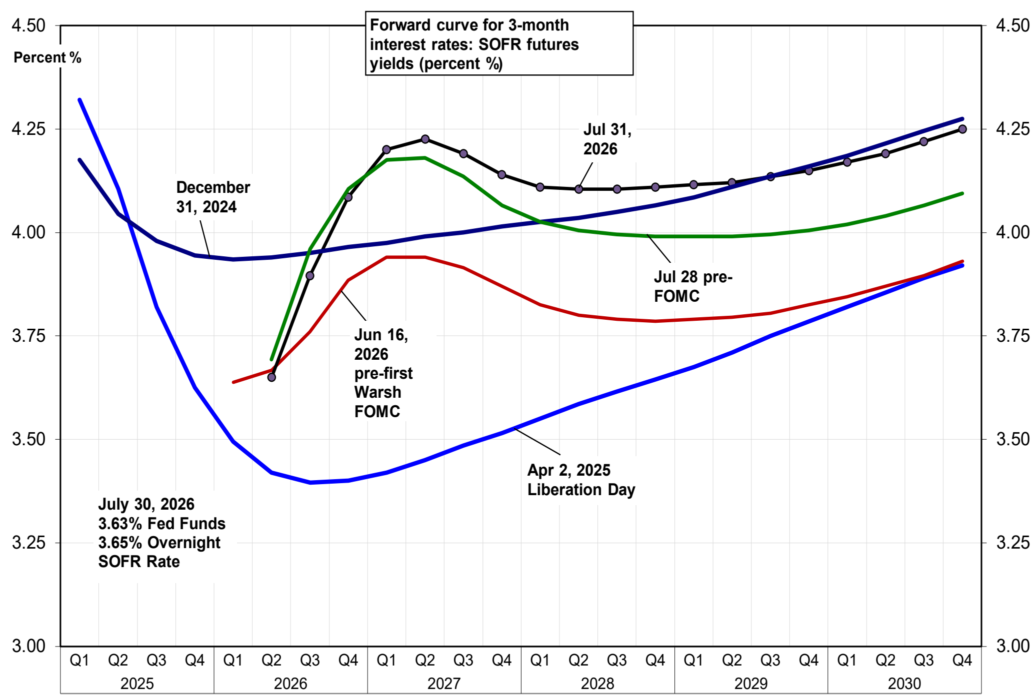


FEDERAL RESERVE POLICY

The Fed met July 28-29, 2026 to consider its monetary policy. We think that is what they did. No Fed Chair has described what happened at the meeting this way ever before. There were three dissents in favor of a rate hike, and that was said to actually be a good thing. Dissent shows impassioned debate or engagement or some other CorpComm characterization. This wasn't a "pause" today, it was a "rigorous review of the economic situation." He would be checking in with his task forces before writing his speech at Jackson Hole, but the FOMC does not have to act on any of their findings. He was gratified the market was coming to its own conclusions for the appropriate setting on market rates and not relying on the Fed for guidance. "Play the ball, not the referee." This isn't the World Cup. The Fed is the ball and the referee. Hopefully the lack of Warsh Fed guidance on where rates might need to be going based on the economy will not be harmful. The economy is less sensitive to Fed rates. Rates went from zero to 5.5% recession-magnitude levels during the pandemic inflation outbreak, but there was no economic downturn. Rates would be starting from 3.75% neutral anyway. Maybe best to just leave it where it is. Do nothing. Like today.

Selected Fed assets and liabilities Fed H.4.1 statistical release billions, Wednesday data	29-Jul	22-Jul	15-Jul	8-Jul	3/11/20*	Change from 3/11/20 to Jul 29
Factors adding reserves						
U.S. Treasury securities	4519.654	4515.661	4509.941	4502.749	2523.031	1996.623
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1930.855	1944.788	1948.337	1948.398	1371.846	559.009
Repurchase agreements	0.003	0.000	0.102	0.000	242.375	-242.372
Primary credit (Discount Window)	6.506	4.885	4.755	5.771	0.011	6.495
Bank Term Funding Program	0.000	0.000	0.000	0.000		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	0.016	0.016	0.016	0.019		
Main Street Lending Program	0.628	0.627	0.628	0.628		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Gold stock	11.041	11.041	11.041	11.041	11.041	0.000
Central bank liquidity swaps	0.132	0.378	0.135	0.170	0.058	0.074
Federal Reserve Total Assets	6789.8	6798.9	6794.6	6787.1	4360.0	2429.802
~~3-month Libor %~~ SOFR %	3.65	3.62	3.64	3.58	1.15	2.500
Factors draining reserves						
Currency in circulation	2472.177	2470.924	2471.831	2474.567	1818.957	653.220
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	970.442	835.417	795.976	749.244	372.337	598.105
Treasury credit facilities contribution	0.000	0.000	0.000	0.000		
Reverse repurchases w/others	2.576	0.376	0.151	3.347	1.325	1.251
Federal Reserve Liabilities	3845.287	3734.003	3694.121	3649.723	2580.036	1265.251
Reserve Balances (Net Liquidity)	2944.541	3064.896	3100.448	3137.377	1779.990	1164.551
Treasuries within 15 days	114.430	118.271	79.092	89.001	21.427	93.003
Treasuries 16 to 90 days	363.933	355.605	387.252	379.529	221.961	141.972
Treasuries 91 days to 1 year	511.313	512.290	514.583	498.247	378.403	132.910
Treasuries over 1-yr to 5 years	1429.729	1429.488	1429.248	1432.105	915.101	514.628
Treasuries over 5-yrs to 10 years	484.121	484.084	484.048	490.642	327.906	156.215
Treasuries over 10-years	1616.129	1615.924	1615.718	1613.225	658.232	957.897
Note: QT starts June 1, 2022	Change	7/29/2026	6/1/2022			
U.S. Treasury securities	-1251.125	4519.654	5770.779			
Mortgage-backed securities (MBS)	-776.591	1930.855	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Fed Policy-key variables	2026	2027	2028	Long Term
Fed funds	3.8	3.6	3.4	3.1
PCE inflation	3.6	2.3	2.0	2.0
Core inflation	3.3	2.5	2.1	
Unemployed	4.3	4.3	4.2	4.2
GDP	2.2	2.3	2.2	2.0
June 2026 median Fed forecasts				



19 bps of a 25 bps rate hike to 4.0% is discounted at the September meeting.

Fed funds futures call Fed policy		
Current target: July 31-- 3.75%		
Rate+0.12	Contract	Fed decision dates
3.940	Oct 2026	July 29, Sep 16*
4.130	Jan 2027	Adds Oct 28, Dec 9*
4.175	Feb 2027	Adds Jan 27
*Oct 2026 could be 3 days at a new rate		
*Jan 2027 could be 4 days at a new rate		

Next up: July CPI inflation Wednesday, August 12 830am ET

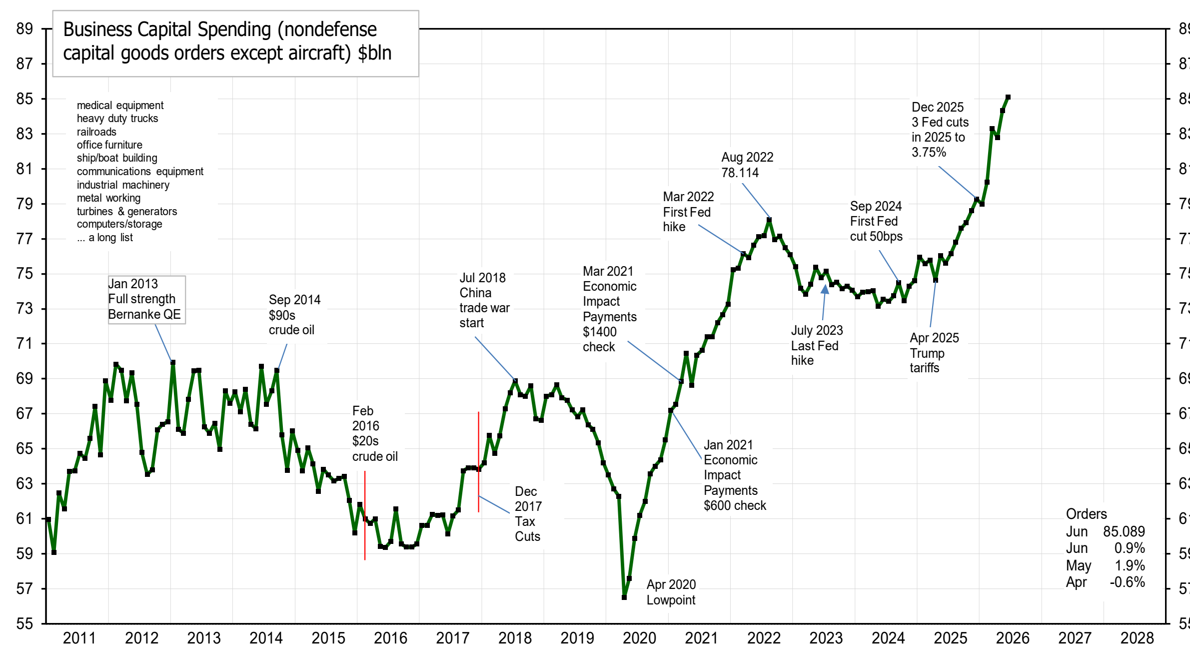
Monthly	2026						2025							
% Changes	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr
Core CPI inflation	0.0	0.2	0.4	0.2	0.2	0.3	0.2	na	na	0.2	0.3	0.3	0.2	0.1	0.2
Core PCE inflation	0.1	0.3	0.2	0.3	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2
Core PCE YOY	3.3	3.4	3.3	3.3	3.0	3.1	3.0	2.8	2.8	2.8	2.9	2.9	2.8	2.8	2.6
Core CPI YOY	2.6	2.9	2.8	2.6	2.5	2.5	2.6	2.6	na	3.0	3.1	3.1	2.9	2.8	2.8

OTHER ECONOMIC NEWS

Durable records (Monday)

Breaking economy news. Durable goods orders rose 0.3% to $334.772 billion in June, but we focus on the subset of nondefense capital goods orders ex-aircraft that increased 0.9% to $85.089 billion in June. Based on this measure of business investment spending, business equipment spending in the Q2 2026 real GDP report due out on Thursday should add 0.8 percentage points to growth again like it did in the first quarter.

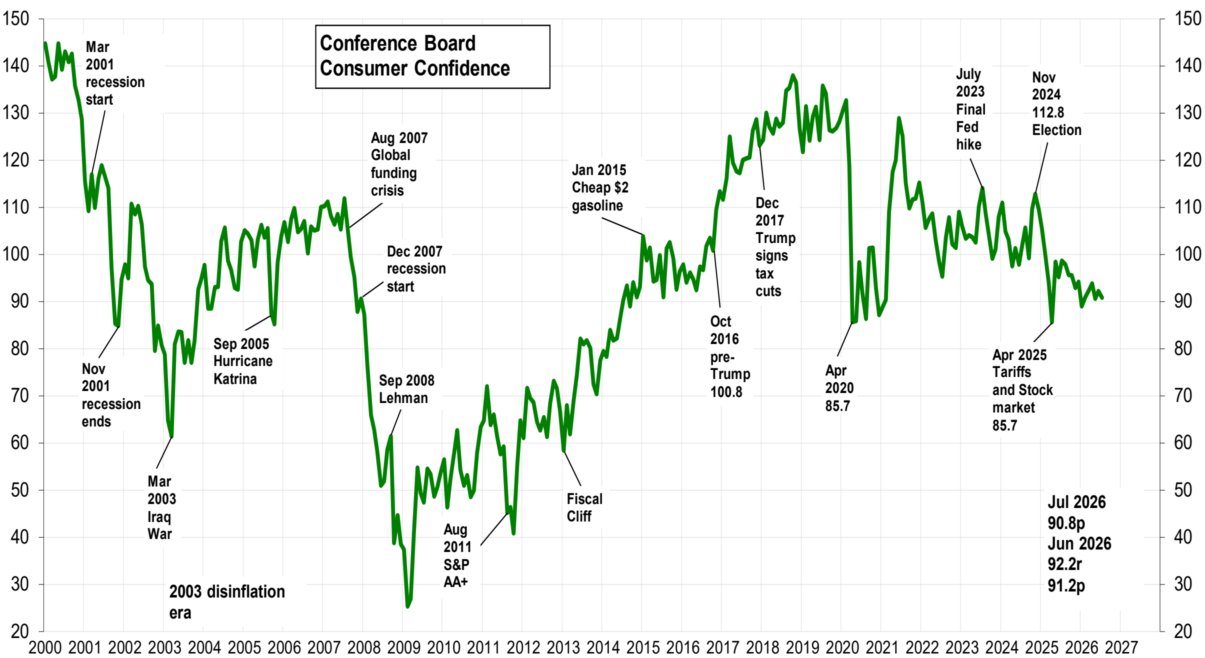
Net, net, AI-related investment in core capital goods orders continue to power the economy forward at the end of the second quarter with computer and electronics purchases fueling the rise. Nondefense capital goods orders ex-aircraft set another record with a 0.9% increase in June and are 9.3% higher than a year ago. Equity markets are still wrestling with the valuations of many of these tech companies, but one thing is certain, and that is the capex expenditures of Corporate America are keeping the economy afloat despite caution in other sectors engendered by the Middle East war uncertainty and higher energy prices.



Consumer not overly confident (Tuesday)

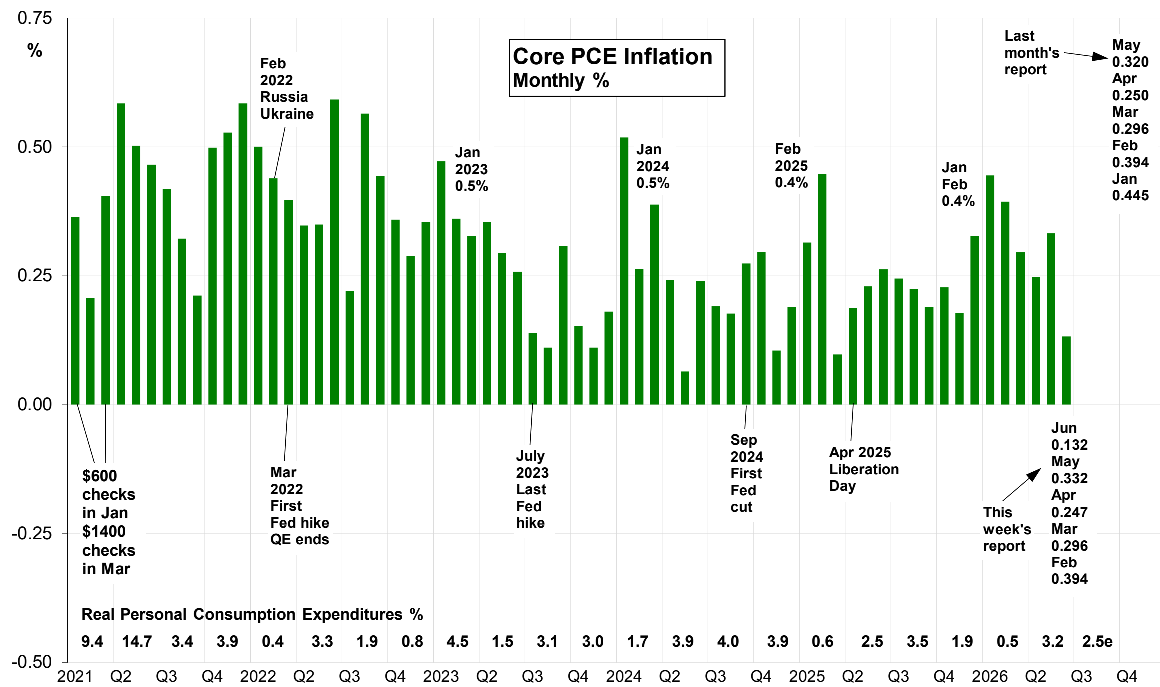
Breaking economy news. The consumer confidence index was 91.0 in February before the Iran bombing began and it is still right there after falling 1.4 points to 90.8 in July. The graph here in 2026 looks like the consumer does not know what to make of current events and the news headlines.

Net, net, consumer confidence remains in a sideways drift pattern little moved by the headlines from the Middle East war. Overall consumer spending is supportive of moderate economic growth even if public sentiment is relatively downbeat. Whatever hopes that the public had for change in Washington after the elections in November 2024 have now been replaced by the same old concerns about the future as a result of inflation's higher prices and the ongoing affordability crisis. Inflation seems to mean higher interest rates according to 61.3 percent of consumers. Both consumers and the bond market's higher yields are telling Federal Reserve policymakers meeting today that interest rates need to go up, but if Fed officials are seriously contemplating such a move it has not been telegraphed to investors ahead of time. Stay tuned. Consumer confidence is on the lower side of the range set since the beginnings of Trump 2.0 back in November 2024, and ahead of the elections in November 2026, the consumer is more uncertain and not especially confident about the future. The latest reading does not herald a pullback or downturn in the economy, but economic growth is likely to remain moderate based on the consumer's future spending plans.



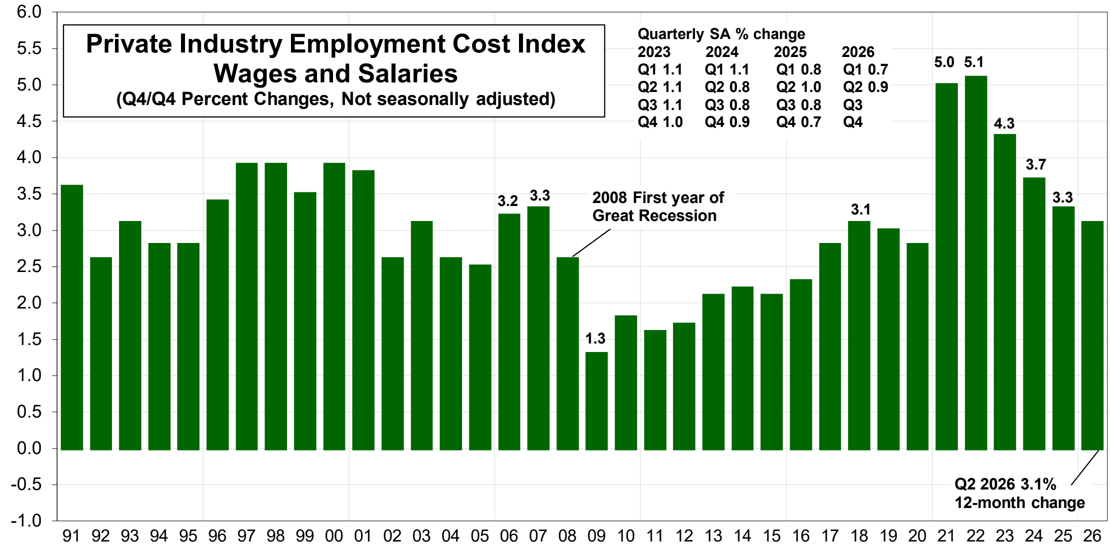
Core PCE inflation 3.3% year-on-year in June (Thursday)

Breaking economy news. Core PCE inflation rose just 0.1% in June, the slowest monthly change since the Trump tariffs "Liberation Day" were announced in April 2025. If you are looking for the most direct tariff effect, PCE goods excluding food and energy rose just 0.1% in June after falling 0.1% in May. Makes one wonder if 3 out of 12 Fed officials voting would have dissented in favor of a rate hike to 4.0% at yesterday's meeting. The dissents were from regional Fed bank presidents and are less of a threat to Warsh's control of the Committee than the count of 9 out of 18 Fed officials forecasting a rate hike this year at the June meeting. Further muddying the inflation waters is the lower June core CPI 2.6% year-on-year rate versus the Fed's Warsh sanctioned PCE inflation target measure (for now) with the PCE core up 3.3% year-on-year. If it helps any, Warsh seems to favor an outsider, fringe economic indicator produced by the Dallas Fed (Logan the president dissented for a rate hike), the so-called [Dallas Fed Trimmed Mean PCE inflation]() rate was up just 2.2% year-on-year in June. White House economic officials will argue there is no inflation and the Fed should cut interest rates.

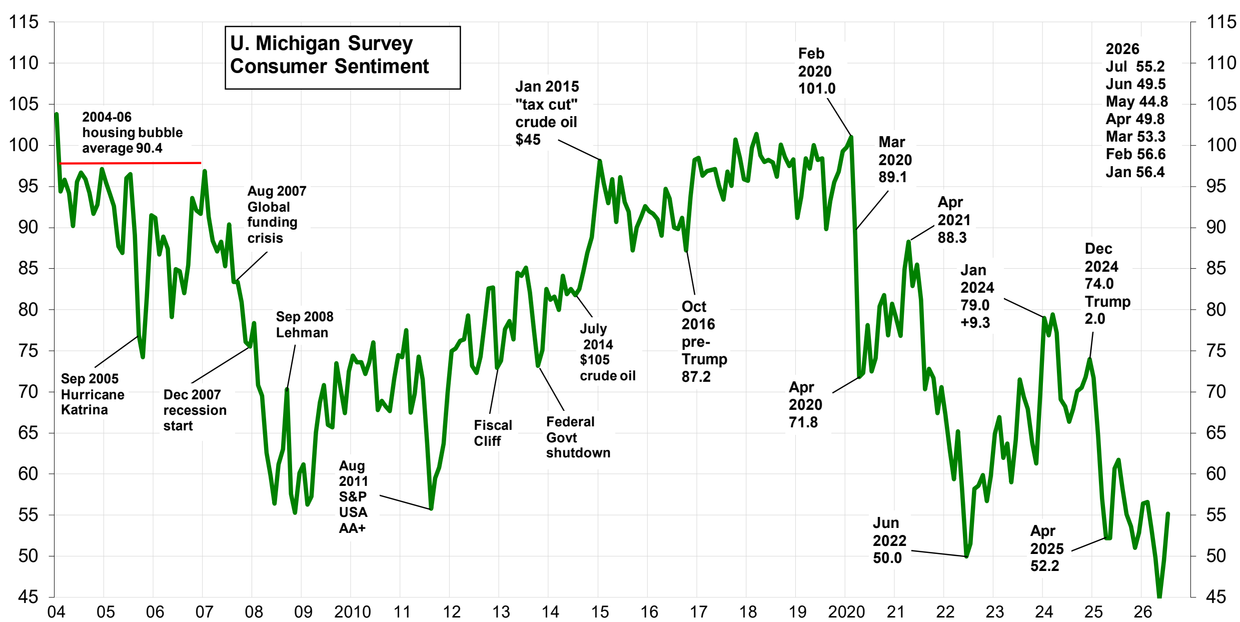


Employment cost index and consumer sentiment (Friday)

Breaking economy news. The employment cost index (ECI) for the June 2026 quarter. In the 12-months ending June 2026, private industry compensation was 3.3% higher, with wages and salaries 3.1% and benefits 3.4%. The nominal wage growth for workers paints a better financial picture for the consumer than is being picked up by confidence and overall sentiment surveys. While it is certainly true that it is hard to get ahead of inflation's pernicious price increases for goods and services, it is also true that consumers' incomes and paychecks are not falling too far behind. Private industry workers wages and salaries increased 3.1% in the last twelve months ending June 2026, and have been running at a plus-3% pace since the third quarter of 2024. Stay tuned. Companies are still paying their employees a living-wage or close to it for now showing the conditions in the labor market remain solid.



Speaking of consumer sentiment, the Michigan survey was released later this morning at 10am offering the revised look at how the consumer was doing in July. The preliminary reading of 54.4 was revised to a final 55.2 figure. The level of consumer sentiment does not match the big 3.2% Q2 2026 real consumption spending in yesterday's GDP report.



Analyst Certification

The views expressed in this report accurately reflect the personal views of the research staff at FWDBONDS LLC, the primary analysts responsible for this report, about the subject securities or issuers referred to herein, and no part of such analysts' compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.