KAR Investment Management

Market Review Commentary

August 2026

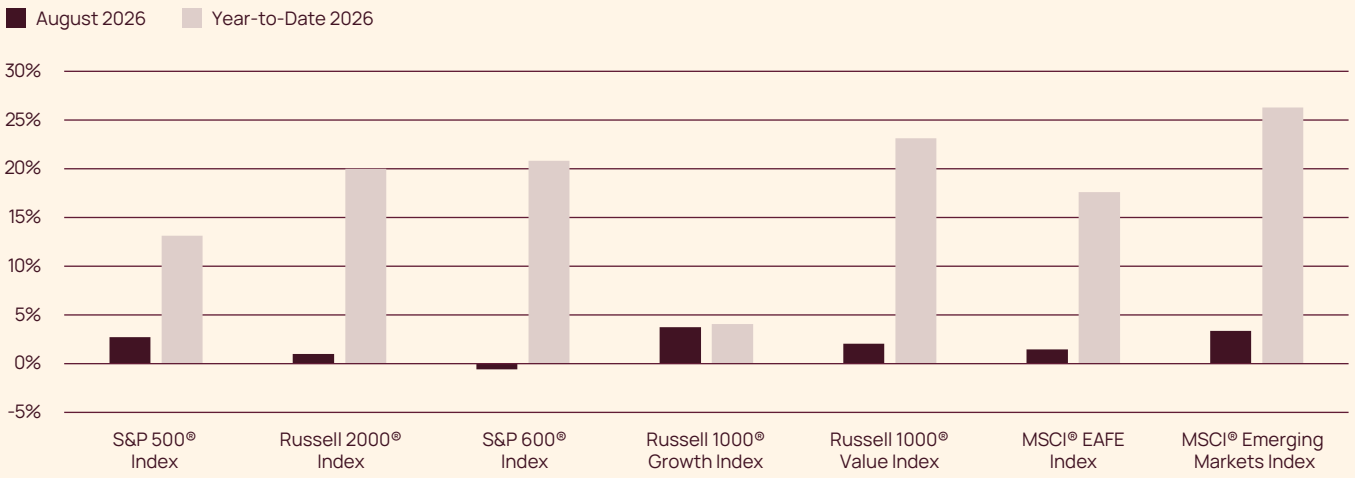
Market Review

August was driven by three closely related themes: the inflation outlook and its implications for Federal Reserve policy, oil prices, and Treasury yields. Markets began the month on a positive note, with the S&P 500 Index gaining more than 3% over the first two trading days as technology stocks rallied and falling oil prices, strong earnings reports, and declining Treasury yields supported risk appetite. A few days later, a weaker-than-expected jobs report showing a decline in July payrolls pushed Treasury yields lower as investors reduced expectations for further Fed tightening, helping the S&P 500 reach a new record high. Inflation data released the following week also eased concerns about Fed policy and supported another market rally.

Mid-month, however, developments in the Strait of Hormuz and growing concerns about the expanding U.S. debt burden pushed oil prices and Treasury yields higher, shifting investor attention back toward inflation risks. By month end, Fed Chair Kevin Warsh reinforced those concerns by focusing on inflation and the possibility of a September rate hike, contributing to a rise in the 10-year Treasury yield and a selloff in technology stocks. On August 31st, the U.S. struck Iranian targets near the Strait of Hormuz, sending oil prices and Treasury yields higher. While energy-related stocks benefited from rising oil prices, broader equity markets weakened as investors focused on the inflation implications.

Looking beyond those broad market themes, return patterns across asset classes and regions continued to evolve. Growth stocks easily beat value stocks in August, but year-to-date, value is trouncing growth. Small caps continue to outperform large caps by a wide margin, and continuing a theme we've seen throughout much of the year, emerging markets outperformed both the S&P 500 and the developed non-U.S. index. Note that Taiwan and South Korea (combined) now represent roughly 41% of the Emerging Markets index, reflecting investors' belief in the continued demand for semiconductor chips.

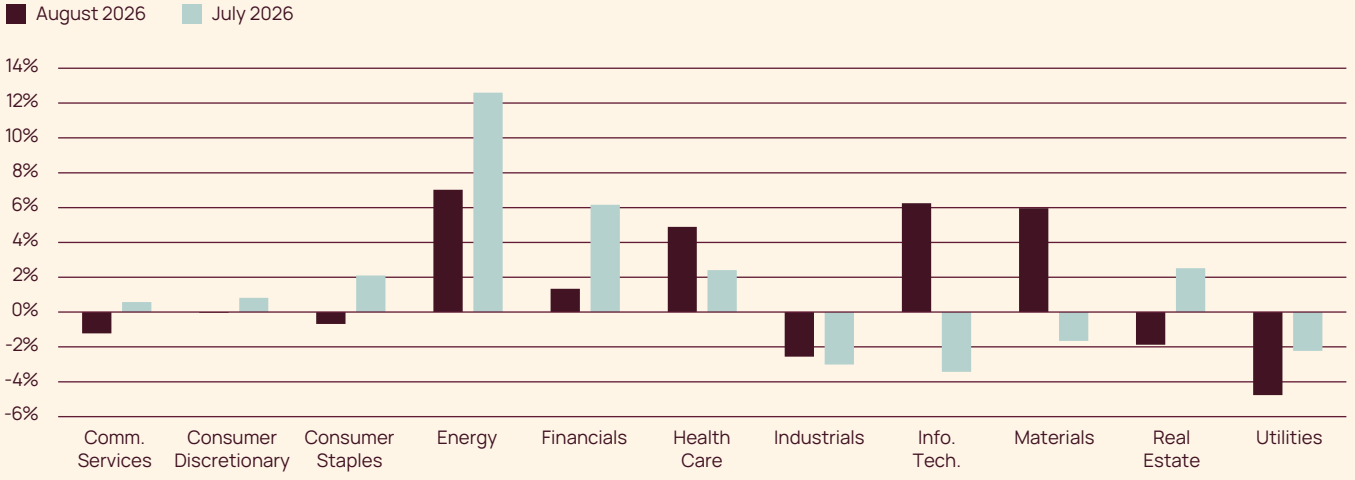
Figure 1: August Performance Relative to Year-to-Date Index Returns



Data as of August 31, 2026. Source: FactSet Research Systems. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. **Past performance is no guarantee of future results.**

The sector rotation theme has been attracting attention, as many investors broaden beyond the headline grabbing sectors of tech and energy. This chart shows that taking a contrarian view works well in some cases, but in others what might have looked like a shift in sentiment proved to be just a head fake. For example, information technology reversed its July losses and roared ahead in August, as did materials. Conversely, consumer staples had a good month in July but a negative return in August. Betting on energy stocks has been working well, but the duration of the hostilities in the Middle East supporting sector profits remains uncertain. We prefer to stick to fundamentals.

Figure 2: S&P 500® Index August versus July Sector Returns



Data as of August 31, 2026. Source: FactSet Research Systems. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and it is not available for direct investment. **Past performance is no guarantee of future results.**

Info Tech Inflation—No Longer Consumer-Friendly

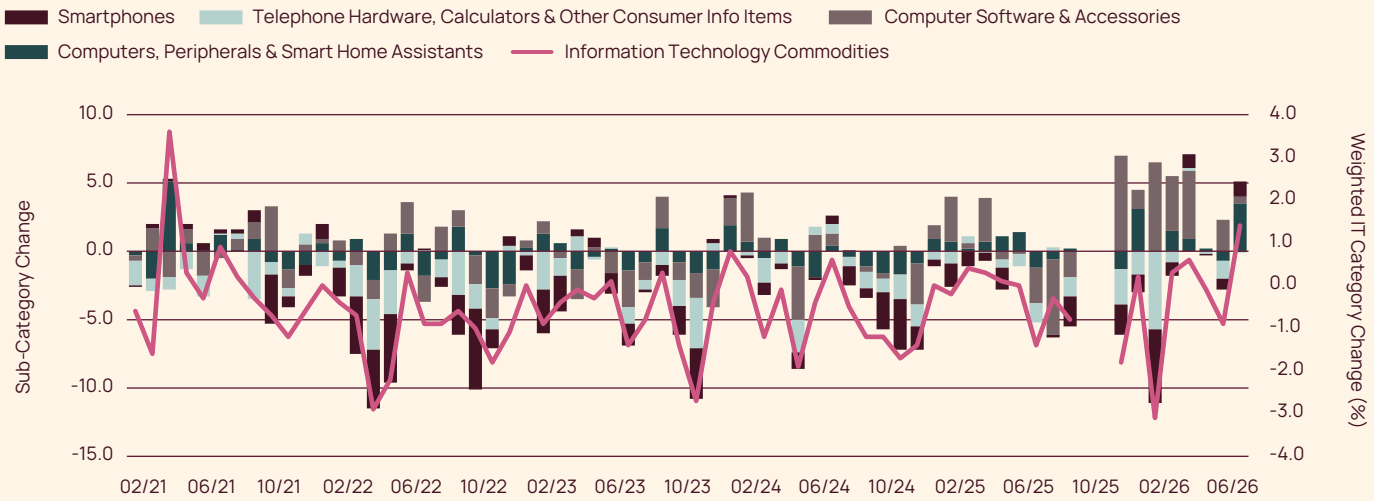
The monthly Consumer Price Index (CPI) report from the Bureau of Labor Statistics contains a great deal of interesting information. It might not be everyone's idea of a good time, but examining the data can offer some useful insights. For example, Food and Energy prices are excluded from Core CPI because, as we so often hear, they are more volatile than the prices for other goods and services. Although we all need to buy both food and fuel, that volatility can muddy the inflation picture for a given month. But just how much more volatile are Food and Energy prices, compared to other prices consumers pay?

Our deep dive into the data reveals that over the past five years, food prices changed an average of 0.4% per month, with a standard deviation, or volatility of 0.31. Energy prices were even more volatile, with an average change of 0.7% per month and a standard deviation of 3.20.

By comparison, the average monthly price change for "non-Core" items over the past five years was 0.3% and the standard deviation of those monthly price changes was comparable to food price changes. While that relative stability is somewhat comforting, note that of the almost 200 "non-Core" items tracked in the CPI report, the average monthly price change is greater than zero. In other words (no surprise here) *on average*, prices go up but rarely go down.

One notable exception is the category of "Information technology commodities", which contains three sub-categories: (1) Computers, peripherals, and smart home assistants, (2) Computer software and accessories, and (3) Telephone hardware, calculators, and other consumer information items, including smartphones. Over the past five years, the average monthly price change for *Information technology commodities*, has been negative, at -0.5%. We believe that's been good news for consumers, but the pattern thus far in 2026 shows this may be changing. In July, prices for the overall category rose 1.4% versus June. We haven't seen these prices rise this much since April 2021, when COVID-era supply chain snarls pushed up inflation for many consumer goods.

Figure 3: Information Technology Prices Turn Higher



Data as of August 12, 2026. Source: U.S. Bureau of Labor Statistics.

Looking across the entire five years, we see computer software often had the biggest monthly price changes, and often those were absolute price *declines*. Prices for computer hardware (which includes peripherals and smart home assistants) have generally declined over the past five years, but rose in January, March, April, and July of this year, most notably 3.5% in July.

Some observers have described this as "chipflation," as rising memory-chip prices driven by AI demand begin to feed through to personal computers, smartphones, and other hardware.

We can't say the roughly 3.5% increase in July was solely due to rising prices on memory chips, but they could continue to show up in consumer prices going forward. The supply of chips is not enough to meet demand from AI hyperscalers and modelers, so makers of personal computers and other consumer devices must pay higher prices for those critical components. Tariffs could be another factor, as chips are not the only components used to make personal computers, and tariffs on some of those components may be playing a role here.

It's also worth noting that CPI calculations attempt to adjust for changes in product quality. If a price rises 5% but quality is deemed to have improved by 5%, the CPI may record little or no inflation even though consumers are paying more. For years, falling technology prices have acted as a tailwind for consumers and a restraint on inflation. Whether that dynamic is beginning to change may be one of the more important questions for investors to watch in the months ahead.

[1] Axios, "Why "chipflation" is here to stay", August 2026, https://www.axios.com/2026/08/11/chips-memory-inflation-ai?

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