MILLER TABAK + CO., LLC

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1. The equity bears have vociferously warned market participants all year that the major market indices would succumb to the historic 18% correction witnessed in all but two of the post World War II mid-term Election years. My view has been different. Rather than a broad market decline, investors would see sharp, selective corrections across sectors and individual names , accompanied by rotation into areas of relative strength. That remains a more accurate description of what has occurred. Despite entering what is historically the seasonally weakest part of the calendar, the S+P month-to-date is down less than 1% and once again closed this week above its upward sloping 50 day moving average after testing that figure several times. One can surely find several marquee names and groups that have fallen 18% or more this year, but the broad indices have not approached a comparable drawdown because investors have redeployed capital into other areas of the market. I see little reason to change that view, although a genuine exogenous shock or more material deterioration in credit conditions could validate the bearish case. For investors who disagree with my scenario, there is a direct, liquid alternative which is to buy puts on the S+P. Mathematically puts have never been cheaper all year from an implied volatilty standpoint and therefore the cost of downside hedging remains inexpensive as the VIX closed Friday at its lowest point year-to-date and even below the '25 close. The only date in the last 10 months that the VIX has been cheaper was Christmas Eve '25.

2. Having been unable to bring their overall thesis to fruition, the bears are focused on the fact that the S+P (cash) stalled appraching last week's high of 7,718 and failed to breach the prior week's close near 7719. A decisive move above that zone could prompt systemic and momentum-oriented buyers to add exposure. The bulls will emphasize that this week's low held above the S+P late July/mid-August lows. Small caps remain the more concerning area. The Index has now experienced 5 weeks in a row of a lower high. Fundamentally, the reason seems to be that with the rise in long-dated Treasuries, small caps tend to have more leverage and floating rate debt exposure with less balance sheet flexibility than large-cap companies. Thus the use of the higher coupon figure in any discounted cash flow model produces a lower valuation.

3. The bears will also focus on the HYG registering a new low for '26 this week. Long-term readers of Sunday Comments know that I believe this is the most important indicator for equity markets because sustained credit weakness can signal growing refinancing stress, tighter financial conditions or declining risk appetite. Thus I am rather surprised that equity indices overall have remained resilient despite this divergence.

4. Continuing with the theme of the impact of the fixed income market on equities, the Miller Tabak Economist, Paul Shea, wrote a piece this week entitled "A Rate Hike Without Upside,"(your inbox late Wednesday evening USA/early Thursday morning EU-UK) essentially underscoring his theme that raising rates was a significant "blunder." First, the increase will further weaken the housing market, eliminating any chance that the positive growth of 2Q2026 is the start of a sustained recovery in that vital sector. Secondly, it will "further strain" the finances of low-middle income households, whose leverage ratios are relatively high. Increased rates will therefore hit the parts of the economy least at risk of overheating. For intellectually sound reasons detailed in his last three reports, Shea believes core inflation will subside no matter what the Fed does in coming months. Cynically, Shea states Warsh has now positioned himself to claim credit for the ultimate fall in inflation. While the Fed expects 4.1% unemployment through 2027, Shea's prediction is a rise to 4.7%. Moreover, the Fed expects core-PCE to be 2.5% in 2027; Shea asserts that figure will be below the 2% threshold.

5. Physical gold/Digital Gold: GLD was basically flat on the week. The price action is highly influenced by the US$ and the 10 year yield. The fact that the DXY closed over 100 again and took out its mid-August highs was certainly a negative and, while the latter rose only 3 bps on the week, its flirtation with a 5% + yield did not help a positive GLD case. GLD has also been highly influenced by its 200 day moving average to which it remains below. The first hurdle however will be the early September highs coupled with the late August close. Digital gold got a boost this week as the SEC greenlit trading in tokenized stocks in a move, according to the FT, to push crypto companies more firmly into traditional equity markets. Tokenized stocks are blockchain-based representations of traditional equities. Tokenized stocks on the blockchain can be traded more cheaply and more easily used as collateral than regular equities. Importantly, and a change from how HOOD has traded tokenized stocks outside of the US, blockchain-based tokens traded in the US must give investors voting rights. Note that The Clarity Act once again failed to emerge from the Senate Banking Committee, as Democrats insisted on stronger limits on the Trump family's ability to profit from the digital asset industry. However, this new SEC ruling gives venues that wish to offer tokenized stocks a five-year exemption from "many of the rules" that apply to the NYSE and NASDAQ.

6. With the mess that is occurring in many of the German regional elections and its impact on the leadership of Friedrich Merz, it is difficult to see the DAX making much upside progress. The key downside support is 25100, the late July close. While the NIKKEI is still up 30% y/t/d, the Index has now had 4 weeks in a row of a lower high. Investors are trying to resolve the conflict that has arisen between Takaichi's radical (for Japan) economic program of aggressive fiscal expansion versus the rapid rate hikes advocated by Tamura and Takata on the BoJ board. The weakness in the Dow Jones Transpos, about which I have written, may be consistent with a more cautious view of economic momentum, although transports alone are not a sufficient macroeconomic signal.

7. Key risks: First, US stock margin debt for the current reported period (August) was $1.454 TR, leaving equity markets quite vulnerable to forced deleveraging. Second, China's US Treasury holdings hit an 18 year low of $618Bb in July down from $1.3TR in November, 2013. A further decline would not by itself determine Treasury yields, but it could compound supply-side pressures in the government bond market. Third, the divergence between resilient equity indices and deteriorating credit market indicators--particularly HYG--remains difficult to dismiss.

Jeff
Have a productive week.

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