MARKET OBSERVATIONS
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Affordability Squeeze

The expenditures we choose, and the prices we pay, shape our personal cost of living. Although inflation is often discussed as a single number, households experience it differently because spending patterns vary by income, age, lifestyle and financial circumstances. Those differences help explain both consumer behavior and the gap between economic data and household sentiment. The Federal Reserve's long-run objectives remain maximum employment and 2% inflation. Its preferred inflation measure, the Personal Consumption Expenditures (PCE) price index, rose 3.7% over the year through July 2026, while core PCE increased 3.3%. The Consumer Price Index (CPI) rose 3.4%, with prices excluding food and energy up 2.5%. Inflation remains above the Fed's target, though well below post-pandemic peaks.

PERSPECTIVE

Inflation varies by category as seen in Chart I. In July, food prices were 3.0% higher than a year earlier and energy prices were up +14%. Shelter remained a significant contributor, while other categories saw smaller increases or declines. These differences matter because households do not consume the same basket of goods and services. Retirees may be more exposed to healthcare and housing, while working families may feel transportation, childcare, food and education costs more directly.

This distinction between measured inflation and experienced inflation is important for understanding consumer confidence. The University of Michigan Surveys of Consumers complement traditional statistics by showing how households view their finances and economic prospects. The August 2026 survey in Chart II reflected continued pressure. The Current Economic Conditions Index fell to 51.9 from 54.8 in July and 61.7 a year earlier. The Index of Consumer Expectations declined to 51.5 from 55.4 in July and 55.9 a year earlier, while overall sentiment fell to 51.7. Respondents cited concerns about inflation, purchasing power and the broader outlook.

The gap between economic statistics and consumer perceptions bears watching. Household spending has remained resilient, but as Chart III reflects, the year-over-year growth rate of real personal income excluding current transfer receipts (i.e. inflation-adjusted income earned from production excluding government and business transfer payments) has slowed, suggesting that underlying purchasing power is facing greater pressure. Consumers remain concerned that elevated prices will continue to erode their ability to spend. Recently, only 8% of consumers expected their income growth to exceed inflation over the next year.

INVESTMENT IMPLICATIONS

The current environment reinforces the importance of diversification. Inflation remains above the Fed's target and consumer expectations are subdued, yet income, employment, corporate earnings and markets may evolve differently from sentiment. A well-diversified portfolio can help address these risks by combining lower-risk fixed-income investments with assets capable of income and long-term growth. While fixed income may provide stability, equities and other growth-oriented investments offer potential returns that exceed inflation over longer periods.

CHART I

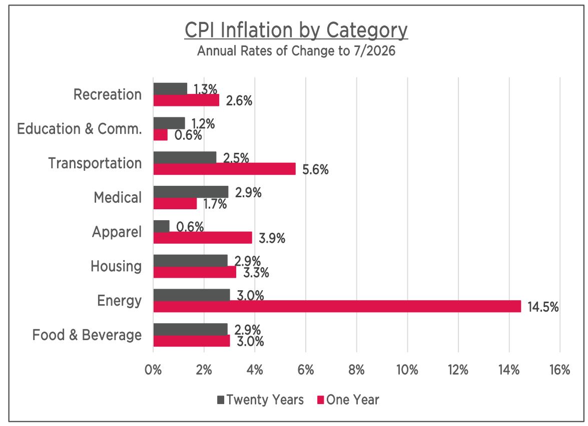

CHART II

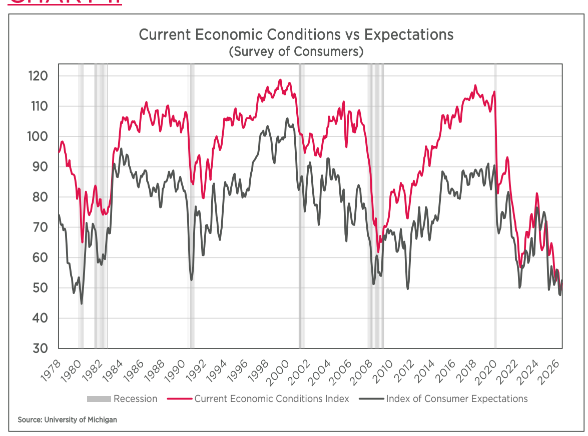

CHART III