

Part 3

Growth Across an Uneven Ground

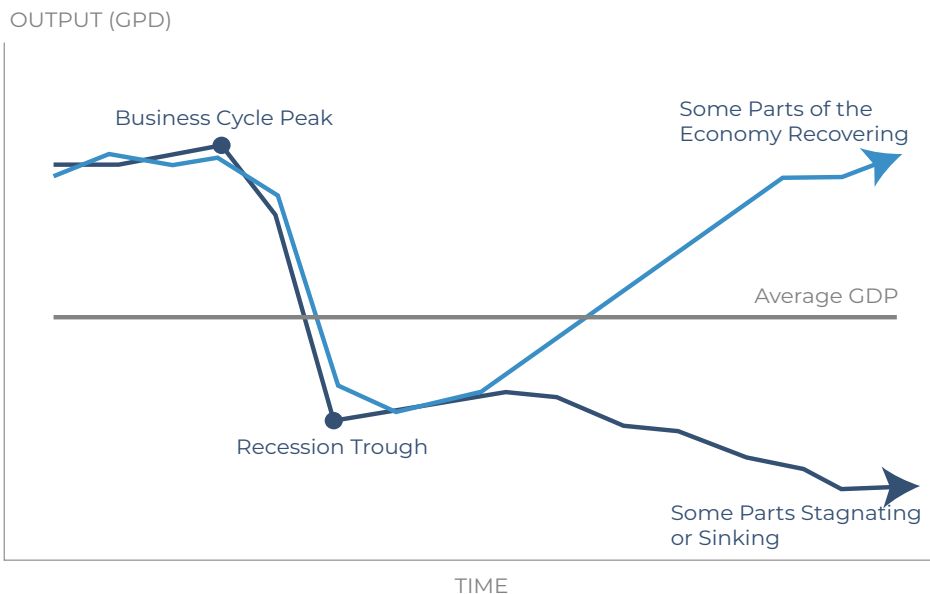


GROWTH ACROSS AN UNEVEN GROUND

In the face of persistent calls for a material slowdown, economic growth in the United States has remained resilient, even as it has become increasingly uneven. Beneath the headline figures lies an economy no longer moving in unison, but instead diverging along lines of ownership, income, and exposure to assets. One in which prosperity and pressure coexist, where the factors that lift one end of the spectrum weigh on the other. US growth has endured not because it has been broadly shared, but because forces supporting one part of the economy have remained powerful enough to offset weakness elsewhere. This dynamic, reinforced by several tailwinds, will remain central to the momentum of the US economy in 2026.

Looking ahead, the unevenness of this environment becomes clearer at the household level. Inflation continues to manifest through higher prices for everyday goods and services, weighing most heavily on low- and middle-income consumers. Wage growth has moderated and labor market conditions have softened making it difficult for many households to feel confident navigating the year ahead. While a recession in aggregate is not our base case, a meaningful portion of the population is likely to continue experiencing conditions that resemble one.

Uneven Recovery



Source: Business Insider, Waterloo Capital

At the same time, a smaller segment of Americans will be operating from a very different position. Rising prices have coincided with a sustained increase in asset values, particularly across financial markets, allowing wealth to expand even as inflation persisted. As portfolios have appreciated, confidence has followed, supporting continued spending and financial flexibility among higher economic status households. With roughly 87% of the US stock market owned by the wealthiest 10% of individuals, the benefits of asset appreciation remain highly concentrated. For those positioned to participate, the wealth effect continues to support consumption, offsetting rising costs and a weaker headline labor market.

This concentration helps explain why the consumer has not tapped out, and why, in an economy that for most feels like its running on empty, growth should continue even amid widening disparities. The top 20% of U.S. households now account for roughly 40% of total consumer spending, while the bottom 20% contribute less than 10%. With consumption generally responsible for 70% of economic growth, it's easy to see how this small segment can have a disproportionate impact. As long as higher-income households remain confident and willing to spend, support for continued expansion this year remains intact.

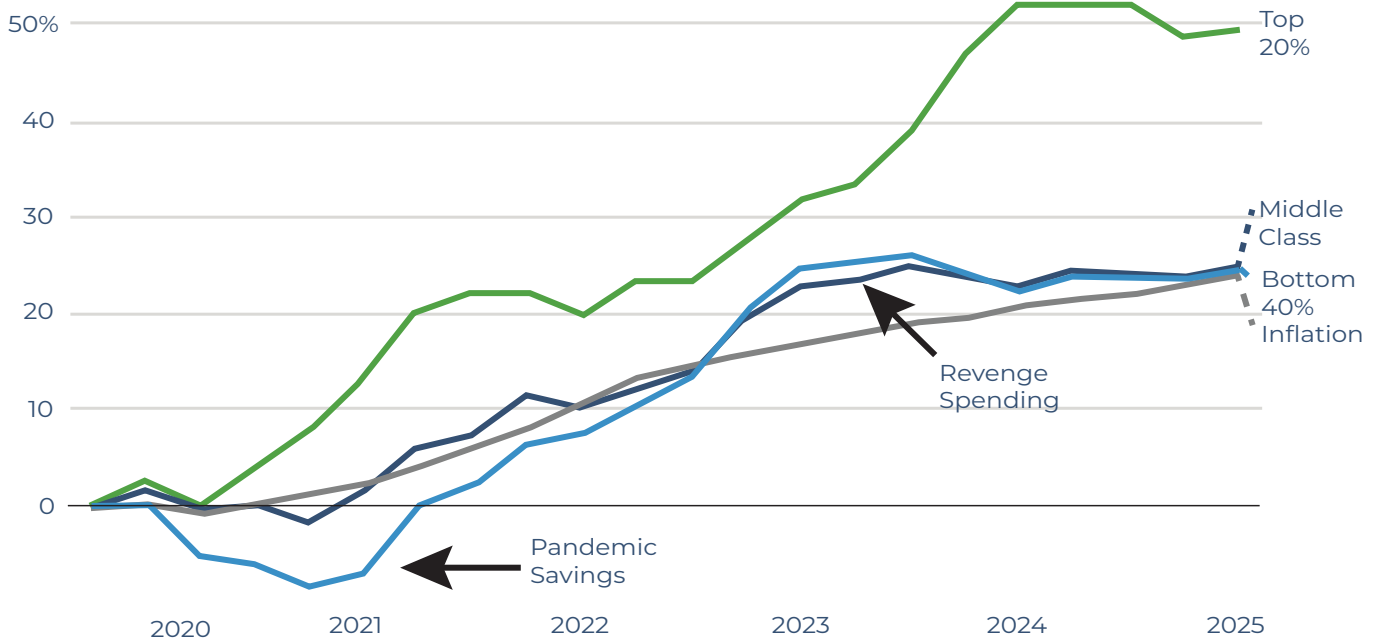
In this environment, financial markets have taken on an outsized role in shaping economic outcomes. Historically, the stock market has tended to lead the economy. Today, that relationship has become more direct. A relatively small group of companies has driven a significant share of market returns in recent years, and those same firms are likely to remain central to economic momentum. As asset values rise, the resulting wealth effect flows through to spending, reinforcing growth through higher-end consumers whose balance sheets are closely tied to market performance.

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That said the same wealth effect that has supported consumption also represents a potential point of vulnerability. A meaningful reversal in asset prices, driven by slower investment, tighter financial conditions, or a shift in confidence, could weaken spending at the upper end of the income spectrum more quickly than headline data might suggest. This is not our base case, however the margin for error has narrowed given how concentrated consumption has become.

The US Economy Depends on Consumption by the Rich

Growth in Personal Outlays vs. Inflation



Source: Moody's Analytics

That feedback loop is being amplified by corporate investment. Large US corporations have played a central role in preventing a broader slowdown by committing significant capital to expansion, infrastructure, and artificial intelligence. Investment in AI alone has accounted for roughly half of recent GDP growth, helping transform what was a sluggish economy into one that surged above 4% annualized in the most recent quarter and approximately 2% for the year. Importantly, these investment plans appear secular rather than cyclical. Corporate commitments to AI and long-term expansion show little sign of nearing an endpoint, providing confidence that this source of growth can persist. As a result, we believe GDP growth can remain near a steady 2% this year.

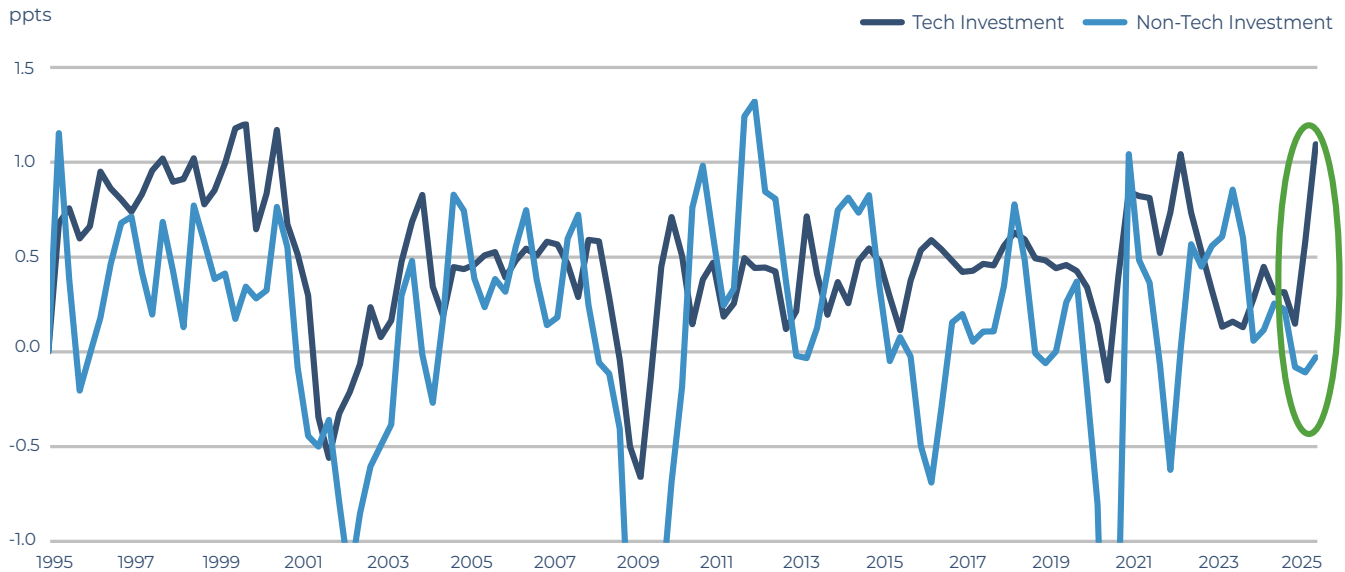
Fiscal policy has added another layer of reinforcement. Recent legislation like the Big Beautiful Bill has added tax incentives to support capital expenditures and moved toward lighter regulation for banks, improving conditions for credit creation. Increased lending capacity has the potential to support activity across Main Street, particularly among small businesses and sectors that have felt recession-like pressure despite operating in a boom. Together, sustained corporate investment and fiscal support form a foundation that allows growth to extend into 2026, even as other policy variables remain in flux.

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AI Investment is Powering US Growth

Growth in Other Sectors Has Been Sluggish

Tech vs. all other investment (quarterly contribution to real GDP growth)



Source: US Commerce Department, Haver, and PIMCO Calculations. As of June 30 2025.

One of those variables is trade policy.

Tariffs have been a near constant concern for investors, yet their economic impact has so far been more muted than initially feared. While tariff conditions have become more orderly compared to the volatility of early 2025, corporations tend not to adjust strategy in response to temporary shifts. Pricing decisions, supply chain investments, and capital allocation are driven by expectations of permanence. To date, much of the tariff regime has been defined by delays and short-lived escalations rather than a fully implemented, stable framework, which has helped limit the near-term cost pass through to consumers.

This uncertainty has shaped corporate behavior. Due to this temporary nature, corporations and global suppliers have been hesitant to raise prices aggressively, knowing that doing so risks losing market share to competitors willing to hold the line. The fear of falling behind has outweighed the impulse to pass costs through, forcing companies to absorb more of the burden or seek efficiencies elsewhere. Corporations have repeatedly demonstrated an ability to adapt by renegotiating with suppliers, adjusting sourcing strategies, and cutting costs rather than relying solely on price increases. This competitive tension extends across the supply chain, leaving, for now, the consumer bearing less of the tariff bill.

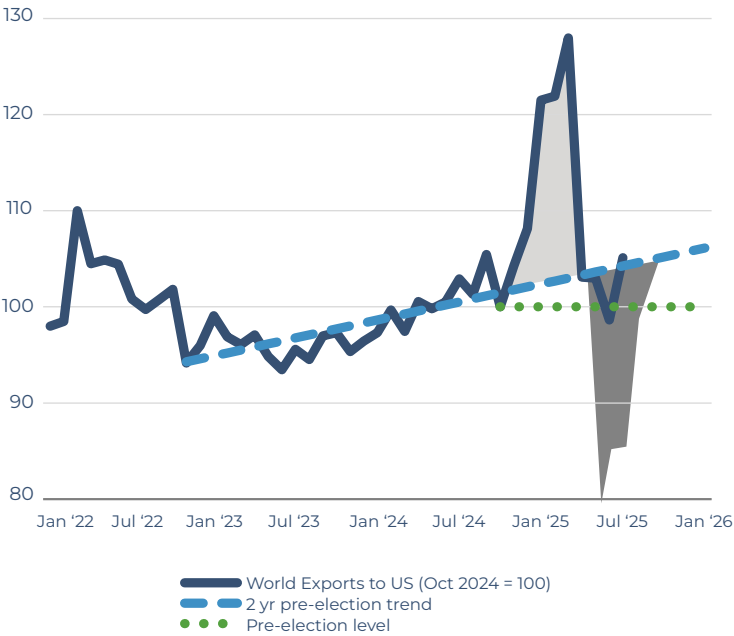
What may now begin to change is the planning horizon. Earlier in 2025, many US corporations proactively front-loaded imports ahead of the roughly 18% tariff rate, temporarily shielding both margins and consumers from higher costs. That buffer, however, may not last indefinitely, particularly if inventories are drawn down before demand meaningfully softens. According to Goldman Sachs, tariff costs are ultimately expected to be distributed unevenly, with roughly 55% passed on to US consumers, 22% absorbed by American corporations, 18% borne by foreign exporters, and the remainder evaded.

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Tariff Effects Are Set to Bite

Front-Loading Payback May Require Meaningfully Below-Trend Activity

World Exports to the US



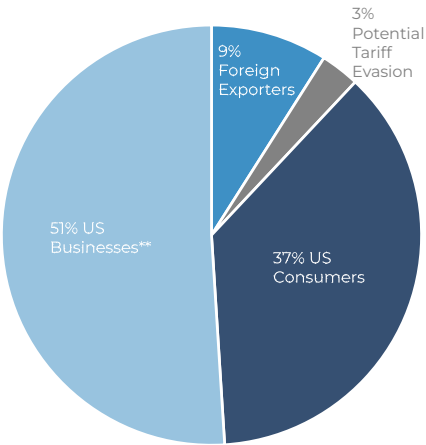
Source: Haver and PIMCO calculations. Data as of August 2025.

The risk, therefore, is less about a sudden inflationary shock and more about gradual pressure. Unlike demand-driven inflation, tariffs introduce cost-driven inflation, where higher input costs are initially absorbed by producers and only later reflected in pricing decisions. If tariff policy stabilizes and remains in place for a sustained period, corporations are more likely to adjust structurally, increasing the likelihood that consumers begin to absorb a greater share of those costs over time. Still, compared to the 2018–19 trade war, the current environment appears more manageable, as companies better understand the landscape. Advances in technology and artificial intelligence have further enhanced these efficiencies, helping offset some cost pressures.

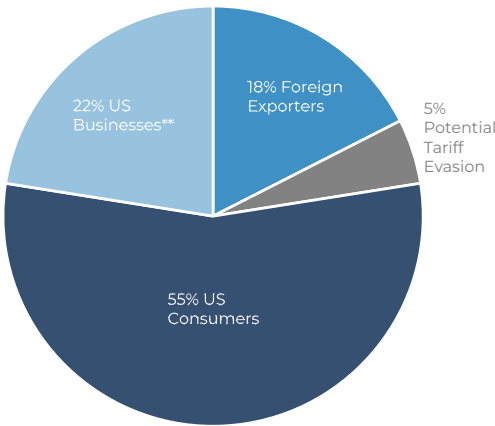
"Corporations front loaded imports, shielding margins and consumers from higher costs. That buffer may not last indefinitely."

Tariff Effects Seen So Far Imply that US Consumers Will Eventually Absorb Over Half of Tariff Costs

Division of Tariff Costs As of August 2025



Eventual Division of Tariff Costs* by 2025E



* Tariffs in effect from February to October.
** The share of tariff costs borne by US businesses is a net amount. Some businesses probably absorbed a larger share of tariff costs, while other businesses that competed with imported goods likely raised their prices.

Source: Goldman Sachs Global Investment Research. Based on Estimates Derived from PCE Data Through August and Import Price Data Through July

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None of these forces point to a smooth or frictionless path forward, yet together they help explain why a narrow set of powerful drivers has kept the growth story intact despite the risks. We expect the artificial intelligence investment cycle to continue playing a central role in generating GDP growth. If sustained, the wealth effect from years of equity market performance should support spending among higher-income households, reinforcing divergence in the economic experience across wealth classes. Conversely, a sharp decline in equity markets would pose a meaningful risk to expansion, reflecting our view that the stock market increasingly functions as a proxy for the economy itself. That risk is partially mitigated by supportive fiscal policy, which makes sufficiently large enough shocks less likely in the near term. Tariffs remain an area of uncertainty, particularly given the limited impact to date as implementation has been delayed. Ultimately, this economy does not look or feel the same for everyone, but the power of these underlying forces that have already shown resilience through shifting conditions is precisely why we remain confident that the next chapter of growth is still being written.

"Growth has held up not because it has been broadly shared, but because the forces supporting one part of the economy have remained powerful enough to offset weakness elsewhere. This dynamic, along with several reinforcing tailwinds, will remain central to the momentum of US economic growth in 2026."

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2801 Via Fortuna #250, Austin, TX 78746 • (512) 777-5900 • www.WaterlooCap.com