



SPECIAL REPORT

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Corporate Profits as a Deficit: The Kalecki-Levy Corporate Profit Equation

This Special Report addresses a frequent discussion topic among clients right now: **what are the drivers of the extraordinary surge in corporate profits, who benefits most and least, and what might change?**

This report also has a guest co-author: Michael Ferrell, a senior at Creighton University who has done much of the work in this report as part of a summer project for Mill Street Research.

The underlying idea in this report is to discuss the macro drivers of corporate profits through the lens of the Kalecki-Levy profit equation. The Kalecki-Levy equation is an accounting identity that describes the components of corporate profits for the whole economy (more [here](#)). We can then look at the specific trends underlying the key components that are causing the current very unusual later-cycle jump in corporate profits.

Michal Kalecki was a Polish economist (1899-1970) who worked in Poland, England, and the US. He studied business cycles extensively and was a contemporary (and a bit of rival) of the much better-known British economist John Maynard Keynes. His work on the sources of profits were mostly published in the 1930s and 1940s.

Jerome Levy (1882-1967) was an American businessman and economist who originally derived a formula for profits somewhat earlier than Kalecki (or Keynes), in 1908-14, before reliable national accounts were available. He approached the work from the standpoint of a businessman trying to explain his own business, rather than theoretical macroeconomics.

Kalecki and Levy lived around the same time but did not work together -- they were studying the same topic independently and effectively derived the same result, so they are typically both credited with the equations showing the sources of corporate profits that are still widely used today.

We highlight some of the key factors that can help explain profit trends in general and the current surge in corporate profits specifically. Some may be intuitive but some may not: for instance, at a macro level, corporate capex is not in fact the key driver of aggregate profits right now, but is a key factor in which sectors of the economy are benefiting. Federal deficits and household behavior are key drivers of aggregate profits, and both have strongly supported profits in recent years. We also highlight China as a counter-example: conditions that might otherwise seem to be strongly supportive of profits are in fact creating some of the weakest profit trends globally. We hope this note provokes more ideas and questions that we can address in future research.

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A Macro Look at Earnings Reports

The latest data from the Bureau of Economic Analysis (“BEA”) showed corporate profits after tax in Q2 climbing to \$3.9 trillion, 11.9% of GDP, a record. It is an unintuitive record given the price of energy, inflation still over 3%, and earlier interest rate cut expectations now shifting to rate increases. It is also a record that has been helped further as tariff refunds roll into earnings (Apple has already recorded nearly \$2.2 billion and it is far from alone). These tariff refunds are a particularly direct example of the macro relationship between deficit spending and corporate profits: government revenue directly transferred into corporate revenue, expanding the deficit. More than this direct example, however, the macro relationship between fiscal policy and corporate profits is a big part of the latest record and the recent trend of surging corporate profits.

The Kalecki-Levy equation is a macroeconomic look at corporate profits, more specifically, an “accounting identity” (an equation that is true by definition):

Corporate profits = investment + dividends – household savings – government savings – rest of the world savings

What this equation shows are the macro drivers and drags on corporate profits. Government savings, of course, in the U.S means the federal deficit. After coming down from the 2020 high of \$3.1 trillion to \$1.4 trillion in 2022, the federal deficit climbed back to \$1.8 trillion for 2025 and is projected to reach about \$2 trillion for FY2026 ending this month. Expressed in relative terms as a percentage of GDP, current estimates for 2026 put the deficit at 5.9%. Excluding the COVID-driven surge in 2020-21, that is the highest deficit-to-GDP ratio since 2009-2012, when deficit spending averaged 8.2% of GDP to combat the Great Recession. It is higher than most of the “stimulative” periods since WWII, and very unusual given that the unemployment rate is quite low at around 4% -- normally deficits this large are created to fight high unemployment (weak demand). What’s more, the Congressional Budget Office projects the deficit-to-GDP ratio to grow to 6.7% by 2036.

This recession-level deficit spending has been accompanied by another major driver of corporate profits in the Kalecki equation: household savings/dissaving. The household savings rate has plummeted to 3% of household disposable income, down from 10%+ levels in the aftermath of COVID, and half of the 2010-2019 average of 6.1%. The last time household savings were at their current level before COVID was in 2005-07. Rest-of-world savings are also running at a deficit, with a current account deficit of about \$1 trillion, or 3.1% of GDP. Since 2020, the current account deficit has averaged 3.5% of GDP, compared to 2.3% from 2010-2019, representing a nearly 50% increase. Net dividends have also risen, recording \$2.3 trillion in the first quarter of 2026 and averaging 7.5% of GDP since 2020, compared to 5.8% from 2010-2019. Gross private domestic investment meanwhile has remained within historical norms at 17.5% of GDP for H1 2026, despite historically high capex spending in the AI boom.

From the perspective of the Kalecki-Levy equation then, the record-setting corporate profit rate is the result of two principal factors, or two principal deficits. These are high government deficit spending and a drawdown in household savings, which have also been accompanied by a rise in dividends. But these factors do not affect every part of the market equally. Comparisons across industries show which sectors are benefiting the most and least from the prevailing macroeconomic conditions.

A note on mapping the equation to the accounts

Two technical points matter for reproducing these numbers from the National Income and Product Account (“NIPA”) tables. First, the investment term in the identity is *net* domestic investment – gross investment less consumption of fixed capital – rather than the gross figure. The gap between the two has widened materially as the composition of capital spending has shifted toward short-lived assets. Second, the identity holds up to the statistical discrepancy in the national accounts, which ran at 0.91% of GDP in the first quarter and has been persistently positive.

Decomposing the record profit growth

The table below sets out after-tax corporate profits in terms of the five Kalecki-Levy terms, expressed as a share of GDP, averaged by decade and shown for the latest two quarters. Figures are calculated from BEA NIPA Tables 1.1.5, 1.12 and 5.1.

Share of GDP (%)	1980s	1990s	2000s	2010-19	2020-26	2026 H1
Net domestic investment	8.27	6.86	6.69	4.59	5.02	4.63
Net dividends	2.67	3.66	4.58	5.86	7.55	7.11
less: Personal saving	7.04	5.20	3.07	4.60	5.89	2.42
less: Government saving	-4.27	-3.39	-3.81	-6.40	-8.14	-6.28
less: Rest-of-world saving	1.57	1.43	4.60	2.37	3.54	3.12
Profits after tax	5.55	6.29	7.68	10.02	10.68	11.66
Profits before tax	7.65	8.61	9.82	11.88	12.79	14.30
Memo: labor share of national income	66.01	65.59	64.51	61.81	62.43	60.61
Memo: gross private domestic investment	18.51	17.32	17.98	16.89	17.96	17.54

Source: Bureau of Economic Analysis (NIPA Tables 1.1.5, 1.12, 5.1); author's calculations. Terms sum to profits after tax less the statistical discrepancy. Government saving here is the NIPA measure of net federal plus state and local saving, a different basis from the unified budget deficit.

Three things stand out from the decomposition:

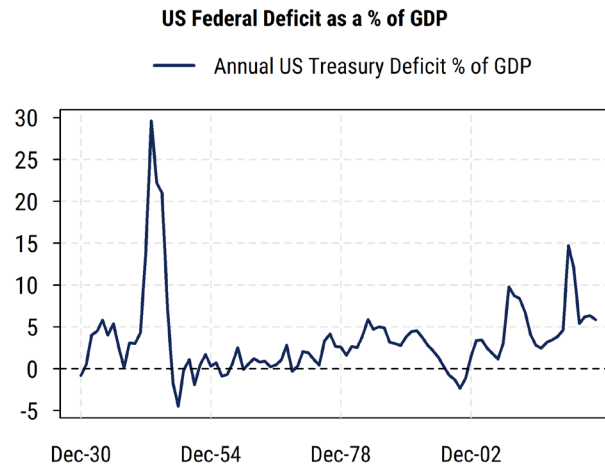
First is the scale of the government contribution. Government dissaving in the first half was \$2 trillion at an annualized rate, equal to 54% of the entire after-tax corporate profit pool. The federal component on its own was 50% of that contribution. This clearly captures the fact that **US federal deficits ("money printing") are the key underlying policy variable affecting corporate profits in aggregate**, though the choices about how taxes and spending are done are important as well.

Second is dividends. Net dividends (all distributions of profits to shareholders, public and private) have climbed from 2.7% of GDP in the 1980s to 7.1% today, and at \$2.3 trillion annualized they now equate to about 61% of the after-tax corporate profit pool. Levy understood why this term compounds: dividends paid out of last period's profits become this period's revenues (profit source) through household spending, and the process builds toward a limit. In his [worked example](#) a 40% payout ratio raised the steady-state profit level by roughly two-thirds within five years even without growth in investment. The US payout ratio has been running near that level for some time. **Whatever corporations earn and distribute to shareholders becomes future spending and thus corporate revenues, and they have been earning a lot more in recent years.**

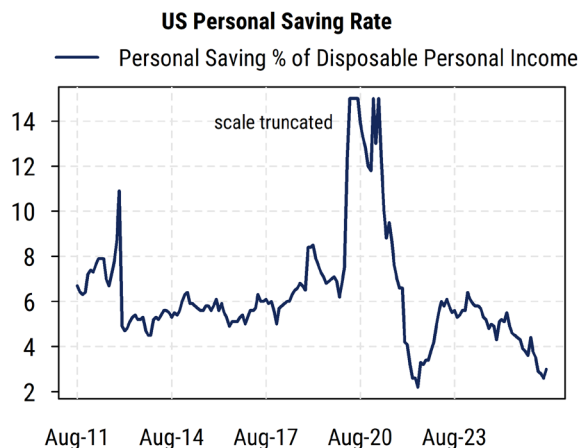
Third, and least appreciated, *investment is the weakest leg of the equation and is the biggest private sector variable*. Net domestic investment is 4.6% of GDP against 8.27% in the 1980s and 6.86% in the 1990s. In 2026 it is slightly lower than it was in 2024 even as investment in equipment and intellectual property products rose more than 10%, because consumption of fixed capital is now growing fast enough to consume much of the gross number. **Higher current technology investment is not enough to fully compensate for slower investment elsewhere (housing, offices, factories, etc.) and the depreciation of fixed capital.**

Level versus change

One distinction is worth drawing carefully because the two framings answer different questions. Measured against the sweep of the post-war record, the deficit is the dominant explanation for where the profit share sits: net government saving (deficit) averaged -4.3% of GDP through the 1980s and -3.4% through the 1990s, against -6.3% today. Measured against the 2010s specifically, however, it is not the marginal driver. On the NIPA basis, which folds in state and local balances and so behaves a bit differently from the unified budget figures cited above, net government saving averaged -6.4% of GDP from 2010-19 and is basically the same now.



What has moved since the 2010s is the household sector and the payout. Relative to the 2010-19 averages, the collapse in personal saving adds 1.7 percentage points of GDP to profits and the rise in dividends adds 1.4 percentage points, while heavier foreign saving subtracts 0.8 points and a wider statistical discrepancy absorbs much of the rest. **The sharper way to put the point is not that the deficit grew but that it stayed at recession-scale levels through a full-employment expansion while households simultaneously stopped saving. Those two together are doing the work.**



The tariff refunds noted at the outset close this loop rather neatly. More than \$100 billion of the roughly \$166 billion collected under the International Emergency Economic Powers Act ("IEEPA") has now been returned to importers following the Supreme Court's February 2026 decision; more than forty S&P 500 companies booked \$9.6 billion of refunds in a single quarter, with Walmart recording roughly \$2.9 billion, Apple \$2.2 billion, Ford about \$1.3 billion, and Nike roughly \$986 million. Apollo's Torsten Slok estimates the refunds add around 0.2 percentage points to third-quarter GDP. But the ruling also removed a revenue source: the CBO's most recent update puts projected 2027-2036 deficits \$0.9 trillion higher than in its February baseline as a result of the Supreme Court's ruling.

The household term: the biggest risk

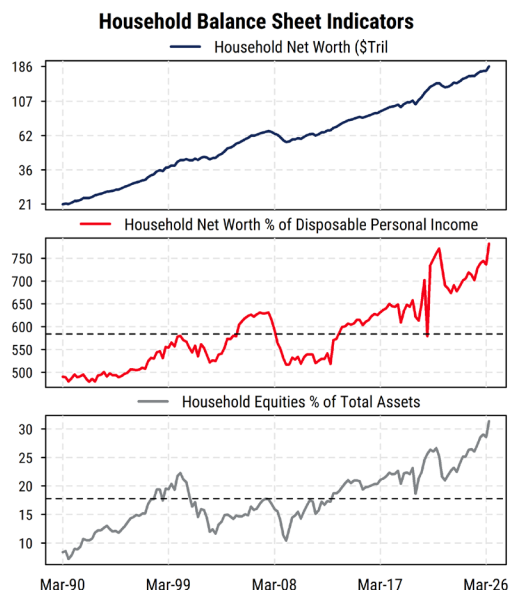
The personal saving rate was 3.0% of disposable income in July and has averaged 2.8% over the past three months. Measured against GDP rather than income, personal saving is 2.87% versus a 4.60% average across the 2010s. **This is the single largest identifiable vulnerability in the profit picture.** If the saving rate returned to its 2010-19 average of roughly 6.1%, households would withhold something on the order of nearly \$800 billion a year from the expenditure stream.

That would represent 2.4% of GDP and 22% of the current after-tax profit pool. No plausible acceleration in capital spending offsets a move of that size, and the fiscal offset required to neutralize it would push the deficit up further to more than 8% of GDP. Such a large further increase from already-high deficits is likely not tolerable absent a sharp economic slowdown. **A softening labor market is therefore an potentially very acute problem as it could trigger households to stop reducing their saving rate.** The recent supportive unemployment rate figures can therefore be seen as a reassuring sign for now, even as overall employment growth is lower due to reduced immigration.

The other factor affecting the household term in the equation is somewhat tied to the discussion of the labor share of income on page 8. The two main ways that households can increase spending faster than wage income are by 1) borrowing more, and 2) spending savings/capital gains, which are not included in the disposable personal income figures.

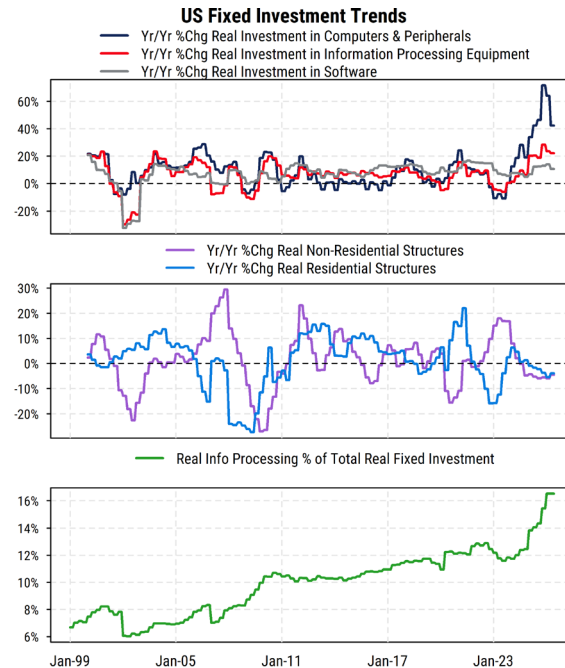
Personal spending has been rising faster than personal income, and we do see higher growth in bank credit that signals higher borrowing. But the huge gains in the stock market, along with large cumulative gains in housing prices since 2019, have produced an enormous amount of capital gains for households in aggregate (though clearly not equally), some of which is supporting current spending. The result has been that household net worth has risen from \$108T as of the end of 2019 to \$185T at the end of Q2 2026. That means assets held by households have grown faster than new household debt to the tune of \$77 trillion in 6.5 years: an 8.7% annualized growth rate, well above the 5.7% growth rate from 1990 to 2019. That is a lot of potential spending power. But . . .

It is also notable that household *net worth relative to annual total disposable income* has risen from 700% to a new record high of 828% since the end of 2019. That compares to an average since 1990 of 584%. **This means asset prices are now more important for supporting spending than they have ever been.** Previous interim peaks were visible in 1999 and in 2007. Because stock prices are the most volatile component of household assets (real estate and fixed income holdings are much less volatile), the US economy is much more exposed to stock market returns than it has ever been: over 31% of *all* household assets are now held in corporate equities (including mutual funds), versus a long-run average since 1990 of 17.8%.

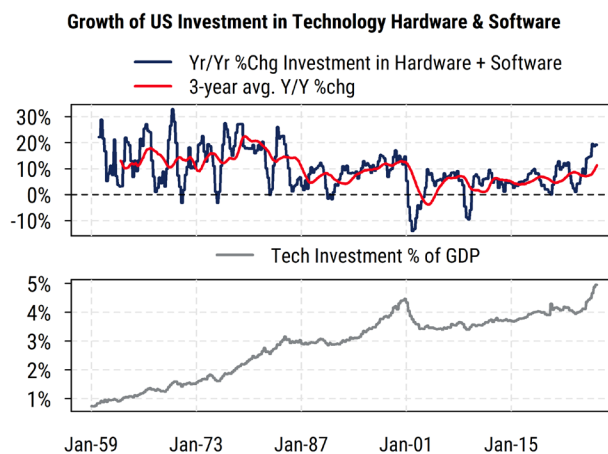


The Investment term: composition, not size, has changed

Gross private domestic investment at 17.68% of GDP is unremarkable, sitting squarely inside the range of the past three decades. Within that aggregate, however, the composition has shifted noticeably in the AI world. Non-residential fixed investment is 14.09% of GDP against 13.72% at the end of 2019; intellectual property products are 5.73% against 5.04%; equipment is 5.60% against 5.51%. Structures have fallen to 2.76% from 3.17%, and residential has fallen to 3.68% from 3.86%. In the last three years, fixed investment in all structures (residential and non-residential) has fallen in real (inflation-adjusted) terms while information processing and software have surged.



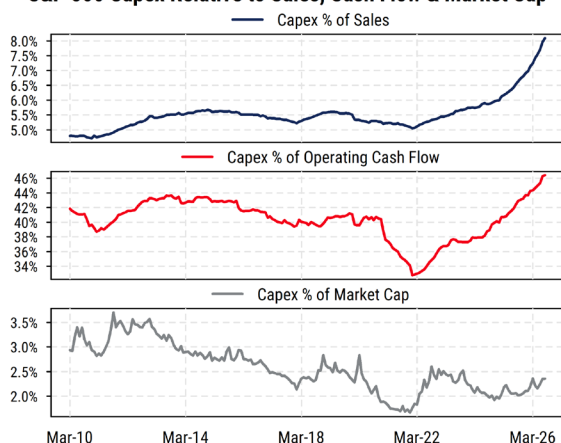
The St. Louis Fed's decomposition puts the contribution of AI-related investment categories at roughly 0.97 percentage points of real GDP growth across the first three quarters of 2025, against 0.81 points for the comparable categories at the 2000 dot-com peak. Software alone contributed 0.57 points in the second quarter of 2025, a record, versus prior highs of 0.44 in 1997 and 0.49 in 2021. Long-run averages for these categories are 0.18 points for information processing equipment, 0.10 for software, 0.07 for R&D and 0.04 for data centers. On that measure, the current cycle has already surpassed the dot-com boom in both level and share of GDP. The aggregate figures for technology investment relative to GDP have also made new highs, exceeding the 2000 peak. **So we see more tech investment, and relatively less of everything else.**



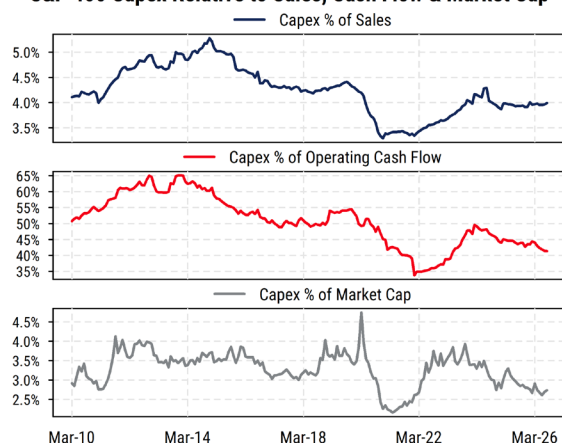
Capex and circular revenue

Mill Street's own work on capex trends found the same picture from the company data. **S&P 500 capex relative to sales has reached multi-decade highs.** Capex relative to operating cash flow has recovered its earlier decline and has just eclipsed its 2011-15 peak readings. Meanwhile, capex relative to market capitalization sits just over 2%, near the low end of its historic range – market prices have risen as fast as capex has. **Midcaps and small caps show no comparable surge** – Technology is 13% of the S&P 400 and 11% of the S&P 600, against 33% of the S&P 500. Whatever is happening in capital spending is happening in a narrow slice of the market, and the equity market has already priced very high future payoffs from it.

S&P 500 Capex Relative to Sales, Cash Flow & Market Cap



S&P 400 Capex Relative to Sales, Cash Flow & Market Cap

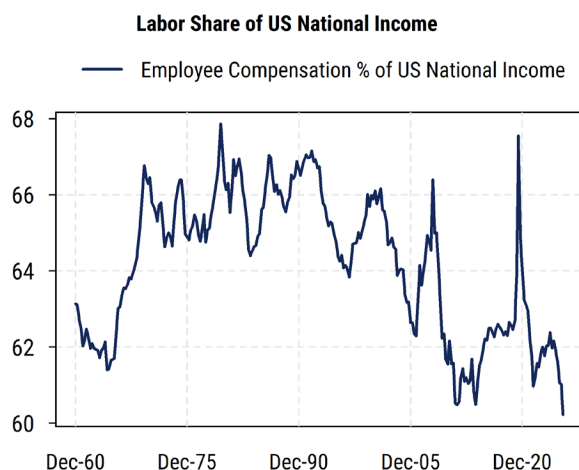


Economist John Maynard Keynes summarized (and famously critiqued) Say's law as the proposition that supply creates its own demand, and something like that anxiety underlies the recurring complaint that AI capital spending is a closed loop of money circulating between a handful of firms. But unintuitive as it is, **for macroeconomics there is nothing inherently suspicious about circular revenue.** The individual investor or firm sees only one side of every transaction. The macro perspective concerns itself with both sides: every purchase is also a sale. It is a circular perspective by construction, and on the scale of a national economy new money can enter the loop from outside in only two primary ways: through a trade surplus or through government deficit spending. In the case of the United States, and especially with the current tariff decisions, that leaves only one channel: deficit spending. And the identity above is the arithmetic of it.

This is the deeper reason the framework matters for allocation. **The terms of the Kalecki-Levy equation, rather than micro balance-sheet concerns like interest rates and leverage, demonstrate that fiscal policy is a far more direct needle-mover of the aggregate profit pool.** Balance-sheet variables determine how that pool is distributed among individual firms and how it is valued by the market, but they do not determine the size of the pool. This is one reason why we often remind clients that fiscal policy is more important than monetary policy for the economy and earnings, but monetary policy is often more salient due to the frequent and explicit decisions made by the Federal Reserve and the fact that traders and investors can bet directly on monetary policy views -- this is harder to do for fiscal policy.

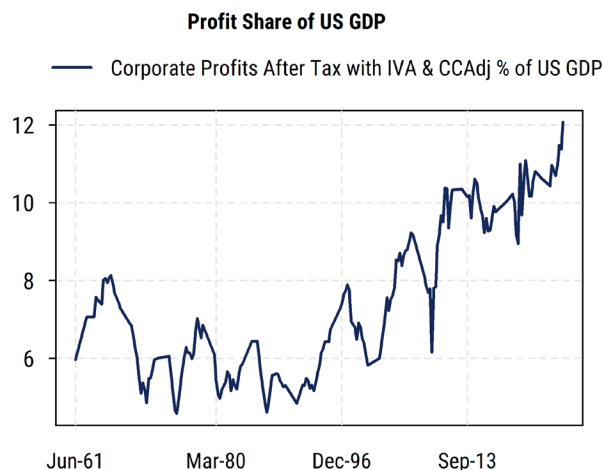
Labor and Profit Share

Compensation of employees fell to 60.2% of national income in the second quarter, from 62.2% in Q1 2025. The latest reading is now the lowest in decades, just below the lows of 2011-12 and 2014. The decade averages tell the longer story: 66.0% in the 1980s, 65.6% in the 1990s, 64.5% in the 2000s and 61.8% across 2010-19.



There are some caveats to these figures, as there is debate about how to measure labor share. It seems clear that a meaningful share of the reported decline is an artifact of the tax code. Smith, Yagan, Zidar and Zwick [document](#) that the raw BEA corporate labor share fell from 62.9% to 57.9% between 1978 and 2017, but that roughly 32% of that decline reflects the migration of business activity into pass-through form, where owner-managers characterize income as profit rather than as wages. Adjusting for it, the decline runs from 62.9% to 59.5%. And since that study, there has likely been a further post-COVID increase in non-corporate business forms that reduce the official “wage” figures. So, while overstated by a third or more, the decline remains real and increasingly visibly felt. Another important aspect of the decline is its concentration among large firms and in manufacturing.

For the profit equation, regarding wage increases, Levy used the metaphor of a cat chasing its own tail. The profit identity implies that a rise in the average wage causes a proportionate rise in aggregate profits, because wages are spent and become business receipts. So it follows that a falling labor share does not, by itself, alter the *magnitude* of aggregate profits. **This cuts against the intuitive story in which profits are a high proportion of GDP because labor is weak.** Labor’s bargaining position explains which firms capture the pool and how the aggregate profit is divided between labor and corporations. It does not explain why the pool is 12% of GDP rather than 8%. For that, the identity points somewhere else entirely.



The Same Identity, a Different Composition: China

The identity is not an American artifact. It holds everywhere and applying it to China is instructive precisely because the composition inverts.

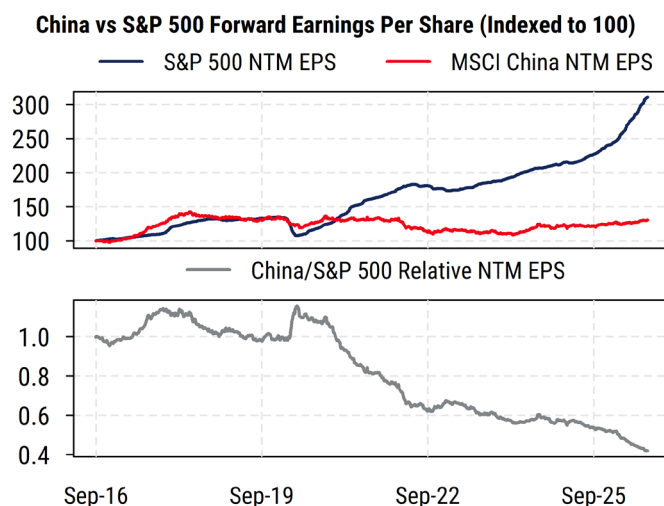
On the face of it, China ought to be a profit machine. Gross capital formation runs near 40% of GDP, roughly twice the US level. The official fiscal deficit target for 2026 is 4% of GDP, but the broad measure including special bonds and off-budget vehicles is around 9.2%, and the IMF's augmented deficit, which consolidates local government financing vehicles, exceeds 14%. And China runs a current account surplus, which means rest-of-world saving is negative from its perspective – a positive contribution to the profit term rather than the drag it currently is in the US.

Three of the five terms are strongly favorable, two of them extremely so. And yet Chinese corporate profitability has been poor. Industrial profits fell 13.1% year-on-year in November 2025, the steepest drop in more than a year, after nearly three years of factory-gate deflation. Meanwhile, 2026 has seen a recovery with profits rising 18.7% in the first half connected to the AI-driven chip boom and the end of the PPI deflation. Industrial margins over January to July were 5.6%, the best for that period since 2022.

The equity market has drawn the obvious conclusion. Forward earnings per share for MSCI China have been broadly flat since 2018 while those of the S&P 500 have more than doubled; the ratio of the two has fallen from about 1.15 in 2020 to roughly 0.4 (chart below).

The resolution is the household term. Chinese households save on a scale with no parallel in developed economies. Household consumption is under 40% of GDP against roughly 68% in the US and that saving is the offsetting negative against the enormous investment and deficit terms. This is part of, and compounded by, China's struggles with deflation and the price wars this large investment and high domestic savings bring as capacity outruns demand, particularly with demographics creating an older and shrinking population.

The bottom line is that the huge scale of investment in China is not very profitable, and the massive household savings required to support it suppresses overall demand growth and thus corporate revenues. **Big deficits usually drive profit growth (and often inflation), but not if it is mostly going toward unprofitable expansion of industrial capacity and infrastructure -- reported GDP goes up, but corporate profits do not.**



By Industry and Sector

Macro flows do not distribute evenly, and the sector data show where they are going. As of mid-September, US aggregate absolute earnings revisions breadth stood at +15% (i.e., meaningfully more analysts raising than lowering next-12-month EPS estimates on average in the US), in the top decile of readings since 2002. But dispersion beneath that headline remains wide: the spread between the best and worst sector on relative revisions breadth was 39 percentage points.

US Sector Avg. Revisions Breadth
22 Sep 2026

Sector	Current	1m Ago	3m Ago	6m Ago
Technology	36.4	38.2	41.2	18.5
Industrials	21.7	26.6	24.3	-1.1
Energy	16.3	10.6	17.7	8.7
Financials	16.3	16.4	14.5	11.9
Real Estate	9.9	17.1	19.1	-6.0
Cons. Discretionary	8.4	11.2	11.5	-10.6
Health Care	6.4	6.7	7.9	-4.8
Comm. Services	4.0	2.6	8.9	3.5
Materials	-0.2	-1.2	4.1	-16.9
Utilities	-1.2	0.0	-1.8	-2.5
Cons. Staples	-3.0	-3.5	-3.3	-12.5

The ordering, which has been broadly similar for months now, maps closely onto the Kalecki-Levy identity. **The sectors at the top are those selling into the investment term or the fiscal term, like Technology, Industrials, and Financials.** At the industry level, three of the strongest estimate revisions breadth readings are in Technology Hardware, Storage and Peripherals. Semiconductors second, and Electronic Equipment. Related areas like Electrical Equipment and Construction & Engineering in the Industrials sector are also well above average. These are the capex suppliers and the firms building and powering data centers. They are the direct beneficiaries of where investment and the government deficit are flowing. Financials benefit from a the steeper yield curve and rising stock markets that the larger deficits tend to support.

The sectors at the bottom are those whose revenue depends on the household term or are on the wrong side of commodity price trends. Consumer Staples is quite weak, as is Communication Services (much of which is involves discretionary entertainment and advertising), while Consumer Discretionary is below-average but more mixed. Materials and Utilities are also facing elevated commodity price (input cost) volatility and are not directly benefiting from fiscal policy or tech-related investment. Energy is currently strong due to high oil prices (supply shocks) but was relatively weak for much of the time before the latest Middle East conflict began.

This is the counterintuitive result that the identity anticipates and that a bottom-up reading would miss: a profit pool sustained by household dissaving (spending more than they earn) does not necessarily reward the firms selling to households. It has rewarded the firms positioned at the other end of the fiscal and investment channels.

Potential Developments

Four potential developments that could substantially alter this macro-economic picture:

- **Household saving increase.** This is perhaps the largest and potentially the most probable. A multitude of factors could drive up household saving, particularly a softening labor market or a sustained stock market decline.
- **Capex digestion.** Net domestic investment is already contracting year-on-year despite booming gross spending, because AI-era assets depreciate quickly. When gross capex plateaus, the net term falls quickly rather than gradually.
- **External balance.** A narrowing or broadening of the current account deficit, based on the Trump administration's aggressive and erratic trade policy. Within the identity, a smaller trade deficit is bullish for domestic profits, whatever else may be said about it, but is unlikely to be the big driver of a cyclical shift given long-standing US current account deficits.
- **Fiscal contraction.** This is probably the least likely given the political circumstances right now, though a significant change in Congress next year could influence it. Every official projection has the deficit stable or widening rather than narrowing. While Congress sets fiscal policy, the binding constraint here is likely not Congress itself but how it responds to the bond market, which so far has not kept pace in a way to curb spending.

A Closing Note on Perception versus Data

There is often a gap between public perception and statistical reality, polls versus election results being the topical example. In 2022 Kyla Scanlon coined the term “vibecession” to describe the economic form of that gap, in which the economic data improves while public sentiment does not. The University of Michigan’s Consumer Sentiment Index is near its lowest levels on record (worse than 2020, 2008, 1991, or 1982). The Conference Board’s Consumer Confidence index is less extreme but is nonetheless currently sitting near its 2020 trough lows. These readings are at multi-year or multi-decade lows despite an unemployment rate of just 4.1%, real GDP growth of 2-2.5%, rising real incomes, and a surging stock market. Inflation, particularly the cumulative inflation since 2020, likely helps explain some of this, but the inflation rate is well below earlier historical levels that did not produce this level of negative sentiment. The public perception is historically unusual, and likely to have political consequences in the upcoming mid-term elections.

The Kalecki-Levy accounts suggest this gap between the data and public sentiment is less mysterious than it appears. **A profit share sustained by government dissaving, household dissaving, and a rising payout ratio is, by construction, a profit rate that does not require the majority of Americans to feel the prosperity, especially if household dissaving is driven by necessity rather than choice, and/or skewed toward high-income households that own assets.** The corporate sector and the household sector can move in opposite directions for a long time, and the identity explains precisely how. Current government policies, financial markets, as well as technological developments have leaned heavily in favor of corporate profits, particularly for large companies/industries that have oligopolistic tendencies. Such conditions may last a while longer, but everything is cyclical and thus extrapolating recent trends too far into the future risks missing the bigger picture cycle shifts.

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