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What Happens After Peak Inflation? (With Keith McCullough)

COLLIN MARTIN: I'm Collin Martin.

LIZ ANN SONDEERS: And I'm Liz Ann Sonders.

COLLIN: And this is *On Investing*, an original podcast from Charles Schwab. Every week we analyze what's happening in the markets and discuss how it might affect your investments.

LIZ ANN: Well, hi, Collin. So last week we discussed the possibility or likelihood of a rate hike in the aftermath of the first Federal Open Market Committee meeting with Kevin Warsh as chair of the Fed. And I know that the rates markets have been changing their assumptions and what's been priced in in terms of how quickly a rate hike or beyond or two or three would happen. So what are you thinking about as it relates to the fixed income market, maybe also the dollar, and what your latest thinking is on when the Fed might consider moving toward a tightening stance?

COLLIN: Yeah, it can have a lot of implications, Liz Ann. Let me start with the dollar, because that's something we don't talk about as frequently as my broad Fed outlook. But it could mean if we get a rising, and we've seen the rising likelihood of a Fed rate hike, that could and should mean a stronger dollar. And that has lately, you know, when we talk about the dollar, there's a lot of dollar, you know, currency pairs. But if we look at it, you know, in an aggregate level, and we look at something like the Bloomberg Dollar Index, it's up about 3% or so since early May. It's pretty close to its one-year highs.

And that's because one of the key drivers, there's a lot of drivers of currencies, but interest rate differentials. So if we have if we have the shift in expectations and then resulting rise in Treasury yields, you see that rising interest rate differential that the U.S. offers relative to other developed-market economies that can support the dollar. So we've started to see that.

And there's also been some shifts, not just with the Fed, but the dynamics with other global central banks. So if we look at the European Central Bank, for example, they hiked rates earlier this month, but then it doesn't seem as likely that they might necessarily continue soon with more rate hikes. It looks like they might take a more patient approach. And Christine Lagarde suggested that, you know, maybe a forceful response wasn't necessarily warranted right now. So we had that, what was initially expected to be maybe a few hikes by the ECB, might only be one or two. And now with more rate hikes with the U.S. being priced in, you know, that should lend support for the U.S. dollar. And that's important when you're considering global investments, you know, local-currency-denominated investments.

If you consider, if you're a U.S.-based investor, you can get, generally speaking, higher yields here in the U.S. And then if the dollar, you know, stays strong or even strengthens a little bit, that could actually result in negative currency returns. So something to consider about if you're thinking about the global bond markets as an investment.

Now, when we think about our broad U.S. outlook, Liz Ann, it's pretty uncertain right now. You know, we talked about this last week. Clearly, the likelihood of a rate hike has increased a lot. We are, you know, stopping short of putting our flag in the sand and saying, "Yes, a rate hike is going to come, you know, at this time," but we acknowledge that that the likelihood is rising. I just think there's a lot of moving parts right now. You know, we got this hawkish Fed meeting in an environment where the peak in inflation could be past us or maybe we're approaching it. We're seeing oil prices continue to decline. So I think there's a lot of moving parts there, but any way you slice it, this should keep yields probably elevated for the time being. So we think short-term yields based on those rising expectations of a hike are probably going to remain, you know, north of 4%. So if we look at that two-year Treasury yield, for example.

And we think long-term Treasury yields should probably hold in their recent ranges. So the 10-year Treasury yield probably around 4.5% or so. Even though we might get some good news on the inflation front, there's plenty of factors that, we think, can keep it elevated. So even though we're seeing this shifting outlook, not much has changed in terms of what we're suggesting for our clients here at Schwab.

We like a below-benchmark average duration, you know, short- and intermediate-term maturities, not too short because there's an opportunity cost there. If you're in very short-term investments, you can actually earn slightly higher yields if you consider slightly longer maturities. But we acknowledge, you know, now's probably not the time to go too long right now in long-maturity or long-duration investments.

So that's what we're seeing in the bond market lately. Lots going on in the stock market, Liz Ann. You know, we talk about tech, it makes headlines, but what we have seen a relatively big sell off in tech stocks, you know, over the past week or so. So what's going on there?

LIZ ANN: Well, I've been thinking of it as the great "chip dip." I love me a chip dip, especially onion flavored, but a lot of carnage in the semiconductor stocks, the Philadelphia SOX Index, which is the semiconductor index, down pretty much right at correction territory, which is generally defined as a drop of 10% on an intraday basis. And I think there are a number of factors that have come into play, as opposed to some single specific catalyst. Some of it just has to do with positioning. It was an area that had gotten quite crowded across the spectrum of short-term trading institutions, like systematic funds and the long/short hedge fund community and retail traders to some degree.

So I think when positioning gets really, really crowded, sometimes you don't necessarily need one specific catalyst. But what the concern has started to morph into is about whether the spend, the capital spending associated with AI and the infrastructure build-out, is starting to run into constraints, whether it's because corporations are starting to pull back or concern about them pulling back because the cost of continuing to invest at these levels without anything yet that is concrete in terms of ROI, or return on investment.

You've had concerns about the cost of inputs for this build-out and whether that becomes kind of a binding constraint. So I think it's a whole host of issues, constraints on capacity, also some concerns ... in fact, there was a recent announcement out of Microsoft that they might embed Deepseek technology into their Copilot large language model. And we all probably remember the Deepseek news of a year ago when it was seen as being disruptive to the U.S.-based creators of large language models like Anthropic and OpenAI.

And then lastly, I think I saw that a couple of key senior people from Google left. One went to Anthropic. One went to OpenAI. So that garnered ... so it was like this confluence of things that I think caused some money to find its way out of what had been just, you know, unbelievable gains in that subsector of technology. And frankly, Collin, I think that backdrop is likely to persist here. You know, we've talked about it a ton, I've written about it a ton, this rotational market that we're in and that the real story that gets told by what the stock market is doing and the interconnectivity with what's going on in the AI world and capital spending and the economy more broadly gets told in a more full way under the surface of the cap-weighted indexes. You really don't get a sense of what's happening in ... and we do this only by audio,

but I'm doing air quotes as you can see, but our listeners don't see, that what the indexes are doing is not a full description of what's happening to the market.

And I think these rapid-fire rotations under the surface, even within segments like communication services or technology, just to cite two of the S&P 500® sectors, I think that kind of backdrop is going to persist where you get these narrative changes, you get a piece of news that doesn't move the market in the aggregate, doesn't necessarily move any kind of needle in terms of the economy, but can really trigger some of these rapid-fire rotations, especially among the very powerful cohorts within the market that tend to have fairly short time horizons. So I think that's the nature of the beast that is the stock market these days, and I don't think that that changes any time soon.

COLLIN: You know, I think you say a lot ... you know, the stock market is not the economy, and the economy is not the stock market. And so it sounds like the, you know, chips and these sectors are not necessarily representative of the whole market. But I have a question though, because I kind of forgot about that Deepseek moment. And given what you just said about, you know, looking under the surface and how there are a lot of sectors in there, you know, there's probably some headline risk with a lot of AI-driven things.

LIZ ANN: Yes.

COLLIN: But what is the big risk with all, you know, the spend concerns, chip concerns? I love the "chip dip." I'm more of a hummus guy, but I like the chip dip. You know, what does that mean, if under the surface and broadly speaking, we're seeing strength elsewhere? So you know, how do you kind of tie that together?

LIZ ANN: You know what, Collin? I actually think there is a reflection there between what's happening in the market and what's happening in the economy, and that is that the economic cycle has been anything resembling cycles in the past. There's nothing linear about it. That's really the post-pandemic era where we've had the roll through. We've had rolling recessions in certain segments of the economy. Arguably we just came out of a manufacturing recession just five or six months ago, at a time where the services side of the economy is actually starting to slow a bit. So we've had these rolling recessions, these rolling expansions hitting at a sectoral level and not in a coordinated way bringing on a full aggregate recession.

I think that's because what we haven't had is an accident in the financial system, credit getting overly tight. So some of those traditional triggers for an aggregate full, across-the-economy recession just have not been in place, but we've had these sectoral periods of weakness and strength. And I think that's part of the reason why

we have these sector rotations that are happening and I think that the ... how fierce they are and how short term they are, that is very much driven by the cohorts that have become so dominant in terms of daily trading volume, which are the systematic funds and the commodity trading advisors, CTAs for short, and the long/short hedge fund community, and a very, very powerful cohort, which is the retail trader, somewhat distinct from individual investors. I think that's important to make that distinction.

COLLIN: So this week, Liz Ann, you've got Keith McCullough on the podcast. I think that's going to be a really interesting interview.

LIZ ANN: Yeah, they always are with Keith. I've known him for a long time. Keith is the founder and CEO of Hedgeye Risk Management. Prior to founding Hedgeye, Keith worked as a hedge fund manager at the Carlyle Blue Wave Partners Hedge Fund, also at Magnetar Capital, Falcon Hedge Partners, and Dawson Herman Capital Management.

It was in 2014 that Keith launched Hedgeye TV and since then has not looked back. He is also the author of the popular book *Diary of a Hedge Fund Manager* and also founder of private equity firm Seven7, and that's S-E-V-E-N, and then the number 7, which is kind of a cool name. And in addition to producing a wide array of macro research covering the top 50 global economies, Keith also hosts his own show, *The Macro Show*, as well as *The Call at Hedgeye*, which features the firm's entire 40-plus analyst research team discussing their favorite long and short stock ideas. Keith also hosts the acclaimed interview series *Real Conversations*, which features in-depth conversations with the world's top investors, strategists, and thinkers. I have done many of those with him, and they're really interesting conversations. Keith holds an economics degree from Yale University.

And this is cool, while at Yale he led the men's ice hockey team to a Division I Ivy League championship.

LIZ ANN: All right, Keith, I am so happy to have you on the show again. Thank you for doing this. The first time you came on, it was a widely listened to episode. So we really appreciate it. So thanks for joining us again.

KEITH MCCULLOUGH: Well thanks for having me on again. I appreciate it.

LIZ ANN: We've known each other a long time. I have sat in the hot seat, with you grilling me, on many an occasion, various summits that you do, and it's always nice for me to switch roles and put you in the hot seat. So I want to start where I'm guessing we probably started last time we did this, especially for what I hope are even more listeners than we got the last episode that you joined us. But you work

with a ... what you call a "quads" framework. So maybe just share what that framework is, how you think about markets in that context, and then we'll take it from there and go in multiple different directions.

KEITH: Yeah, sure. So I think about the quads, just think of the weather. Four different seasons, so four different quads. But the weather in terms of it being conditional factors that are occurring in that season. So the two factors that I'm modeling are GDP growth and headline inflation. So you have quad one is Goldilocks, when you have inflation slowing and the economy accelerating.

Quad two is a classic overheating of the economy, when you have both growth and inflation accelerating at the same time. And when I'm talking about acceleration and decelerations, first of all, that's all I care about, the momentum of that. And secondly, I'm talking about that year-over-year growth or deceleration. Quad three is stagflation, so you have inflation accelerating, and then growth is slowing. And then quad four is kind of the death quad, you know, where you have both growth and inflation slowing, and therefore corporate profits generally slow. So that's ... quad four is, you know, more typically where stock markets crash, and the long end of the bond market becomes a bull market.

So what we try to do is again measure and map that and have the market signals, you know, appropriately position us for whatever quad we're going towards, because of course the signal or the market is constantly front-running the future economic outcome. And that's how we do it. Signal to quad, and we have all of our positions that are born out of each quad.

LIZ ANN: So you've built Hedgeye on the premise that process, and you've talked about your process, that it beats prediction. But maybe let's start the conversation still somewhat big picture. You've had a year where we've had geopolitical shocks, not least being the war in Iran and the shock that that fed through to the energy markets. We've got a new Fed chair, Kevin Warsh, a regime change in fiscal policy, and it's all happening simultaneously. So I've been framing it as we're in a backdrop of where unstable is maybe a better descriptor than uncertain. It's always uncertain, but there seems to be some instability here. So how do you work within your framework, in an environment where there's so much instability and so many crosscurrents of that instability?

KEITH: We generally move to monthly quads instead of quarterly quads. So quarterly being three months or more. Of course as investors we'd all prefer to be, you know, holding something for three months to a year or across what we call the full investing cycle. But anytime you get ... in this case, it's war on, peace on, back and forth, like you said, shift at the Fed in terms of who's leading it. There's a lot

going on. So what's happened ... and I actually think that this fits with the current market structure is that everything is happening faster.

You know, what's happening with market structure, as you know, is completely different than, you know, Trump's decision to engage in war. So when you put those things together, you get these, you know, in fractal speak, you get these exponential functions in markets where, you know, you have jump conditions and things, you know, happen faster and faster. You know, so both the breakouts and the breakdowns. So I think, I mean, we've had, you know, relative success as the pace of the game picks up. And I often say, if you can't play fast, then you can't play the game. You got to be able, to borrow one from Kahneman and Tversky, you have to be able to play fast and slow. And I think this year has been a classic example of having a process that allows you to play a little faster.

LIZ ANN: And more movements this year among the quads. So talk about where you see us sitting right now and what maybe the pattern and direction that that has been ... I don't know, the last year, year to date, whatever time frame, recent time frame you want to you talk about that shift from quad to quad.

KEITH: Yeah, I think it's been a, you know, on that, like just staying on the right side of it. So if you if you think of the quads the way that they are, quad two and quad three have one thing in common. Inflation's accelerating, OK? So that was very clear to us, you know, starting in December, never mind when the war kicked things into higher gear. So we were actually positioned for inflation to accelerate in the first half of the year alongside growth. So we call that quad two. We still have a three-handle on GDP for Q2, so the growth piece, irrespective of what people politically or otherwise felt, thought, or dreamed. I mean, the fact of the matter is that economic growth accelerated. So you know, the first half of the year, and it's never always this simple, but I mean simplifying the complex, you get inflation accelerating in the first half of the year, and now we think that inflation is going to quad four or quad one, or to the left side of the four quadrants.

So you can have disinflation in a bad way, which is quad four, or you can have Goldilocks, which is currently what the market's still saying it's good with, which is disinflation in a good way, which is growth accelerating. I actually think the biggest, you know, I again I don't make calls, like thank you for saying that. It's not about prediction; it's about process. I'm just executing on the process. If people are looking for me to make a big call, that's kind of old wall as I like to call it. But if you're just executing on what the highest probability outcome is, one, you'd say inflation peaked in the month of May at 4.25%. It's going to decelerate for the next, you know, really nine to 12 months from here, which would mean that the peak for that inflation cycle in bond yields are in, which is a pretty important call for asset

allocators to understand, and all of the equity factors, rate sensitivity in particular, that are born out of it. So my portfolio today looks drastically different than what it did, you know, in December because I'm positioned for disinflation as opposed to inflation.

LIZ ANN: Now what's the basis for that view that the peak was in May? Because that ... I don't think that that's really the consensus.

KEITH: No, no.

LIZ ANN: I think the consensus is for some sort of further acceleration, whether it's the lagged effect of what's already happened, war related or not, the near-term AI component of inflation. So talk about what you what you're seeing in your data that puts you in that disinflationary camp.

KEITH: Yeah, if you put the first half of the year in context, I mean if GDP's accelerating, demand's accelerating, and you cut off supply, then you're going to have a rip in the primary factor that derives inflation, which is the price of oil. You know, so that's the heaviest weight in our model. So again, I'm simplifying a lot of modeling in the complex, but I think most human beings can understand that. Then the economy's slowing in the back half of the year, therefore demand is slowing, and you're opening supply back up.

So you know, that's a decel, or a deceleration. From a base effect or a modeling perspective, which you and I you can geek out on, but I don't think it'll most people will, you know, find that all that interesting. But I would say "It's the base effects, stupid" in the sense that just think of by this time next year in the first quarter, you know, when you're comparing against \$113, \$115 oil price, you know, and the oil price is currently trading at \$70 or \$80, even if it was at \$90, it would still be a deceleration in that primary input of inflation. So we have a daily, weekly, and monthly "Nowcast" for headline inflation that's extremely accurate. And that's what really leads us, you know, to that. I wouldn't believe that unless the model was telling me that. And I do quite like, to your point that, you know, the Fed is going to be the last one to figure that out because the Fed's essentially going to be too hawkish for too long, and then they're going to have to panic dovish as they generally do when you get quad four or disinflation and growth slowing conditions. Again, I think that starts to manifest into the back part of the year into 2027.

LIZ ANN: Let me pull on that thread a little bit, given the recent Fed meeting and what we now all know about what Kevin Warsh is going to try to do anyway with the creation of these task forces and really implement kind of regime change in terms of everything from how the Fed communicates to the use of press conferences

to how vocal he sees everybody being to whether there's ultimately going to continue to be a dots plot or summary of economic projections, because I remember you describing when we sort of entered into this Strait of Hormuz problem, you described it as an inflationary impulse that the Fed cannot look through.

So what are your thoughts on how the Fed, under its new leadership, is going to navigate this? Beyond what you just said, it's tendency for the Fed to sort of act hawkishly first. Do you think that's his sort of guidelight given he wants to probably establish some hawkish credentials in the face of higher inflation? And then what ... would it just be the slowdown that you anticipate that would trigger then a move back to a less hawkish stance? Like do you think the Fed's going to make a mistake here?

KEITH: Yeah, I think they're already making one. I mean, I do appreciate that he's going to change some things. I don't know how. It's like firing a bad coach. I mean, you know, Powell never thought that inflation would get back to 4%, never mind above 4%. You know, therefore they were behind the curve on how high inflation could go. We can go through this multiple times back in 2022 in particular, where inflation continued to double and they thought that it was transitory.

I think most people who are alive with a pulse and hopefully an internet connection understand how inaccurate the Fed can be in terms of their projections. So you know, I don't worship at the altar of their dot plots. And I don't front-run the Fed in as much as I fade the Fed quite a bit. Like I think it's really important to understand that the bond market front-runs the Fed almost all of the time and that that's ...should be a real humbling point of analysis that I hope they incorporate. You know, if they do have market signals as the point of contact that Powell or certainly Yellen would never touch, they come up with these academic-type linear Gaussian assumptions that don't work.

It's good for me. It's like a perverse thing to say, but you know, it's not great for the people. You know, the American people are funding this, you know, I don't think it's good for the people to have an inaccurate government body, but I do think that it's good for the rest of us who are trying to do the opposite of the mistake that they're making when they're making it.

LIZ ANN: Now you mentioned the bond market. Let's hop on a plane and go overseas a little bit because I've seen some comments recently about, you know, foreign yields, gilt yields in particular, the Japan 10-year hitting cycle highs simultaneously. And I think I saw that you called that a regime signal, not a data point. So talk a little bit about your thoughts on some of the synchronization in

terms of global bond pressures and how to think about it in the context of U.S. markets.

KEITH: Yeah, the key to the quads is also modeling them globally. Like I still find it somewhat interesting, if not entertaining, that people have views on global growth and inflation without models, never mind AI-driven models and data-driven models. Yeah, our models are becoming more accurate because AI is really getting to the answer of the market's question on what the economic data is actually reading on a trending basis. So I think that's great.

You know, what the synchronization, if you will, of the peak in bond yields really reflected a synchronized peak in what we call global quad two. Global quad two is over. Now we're going into a global slowdown in the back half of the year. And that's why, actually, if you just run down the line on the three big ones that matter in my model, the U.K. 10-year gilt yield, the German 10-year yield, and the Japanese 10-year yield, they've all put in cycle peaks and have started to break down on either a trend or trend basis. Like the U.K., you know, the guy just got canned, you know, the prime minister of the U.K. wasn't a shock to anybody that lives there.

LIZ ANN: Because that's what they do every year or so.

KEITH: But they had the worst thing for human beings, which was quad three, right? Stagflation. If you have quad two, you can have a party like we're attempting to have with SpaceX and everything else here in America. But if you're in any other country that doesn't have that, you're stuck with like eating it. And you know, we're super bullish on the dollar, so the rest of the world already has stagflation, you know, because they have weakening currencies, so again, the purchasing power of people goes down. You understand that; most economists don't teach it that way, but just think about it.

I mean, you earn a currency and it goes down, the purchasing power goes down. So the U.K., all of Europe, we actually think the chance of Germany, you know, entering a recession is rising in the back half of the year, not like next year. So we have a global slowdown that's led by, you know, the Western side of Europe and the U.S. eventually starting to slow as well. So that's why I think it's not just U.S. bond yields are done going up, but global bond yields are done going up.

LIZ ANN: You mentioned SpaceX, and I'm not going to ask you to do a deep dive on the company, but I want to ask about it in the context of something that we've talked about before, and I know you often do, which is the whole notion of supply-demand. And a lot more supply coming via some of these mega IPOs at a time when the capex

demands for a lot of companies suggests you might see some compression in stock buybacks.

So putting those sort of two pieces together, what does it tell you about maybe the nearer-term landscape with lots of new supply coming and maybe some compression on demand via fewer buybacks?

KEITH: Yeah, well, thank you for not asking me for my thoughts on colonizing Mars and what multiple you can put on that. And I mean I think Elon, I mean, I've always called it the "mother of all bubbles" or #MOAB, you know, on Twitter I always call it that. That really peaked in 2021. I think, like, this year has actually been very interesting because so many people have been ... that have never called a stock market top or crash or bubble or all the above are experts in how this market's overvalued. Meanwhile they're bag-holding all these bubbles that have already popped and dropped, right? I mean, there's a legit case to make that the real oversupply is going to be in the market cap of the heaviest components of the broadest indices.

So I think that that, like really when I look at it, it's not just SpaceX. It's Marvell. Like Marvell's going to be the second largest addition of the S&P in its history, which is a long history, next to Tesla. If you recall that, obviously, you know ... you'll recall this, but that had a huge impact. So just think of it like, you know, Nvidia's got a 9% weight, you go down the line, Nvidia's got the top. I mean these new issues are going to take away from the heavy weights that are a bubble in and of themselves. You know, there's no history to say that that wasn't a bubble, just these absolute, you know, market cap and percentage of the index. So I think that that, as somebody who understands all that, you know, and all the factors embedded therein, I think that that's probably the big reason why, despite the market, like the Russell 2000 hit an all-time high yesterday ...

LIZ ANN: And has doubled the performance of the S&P on a year-to-date basis.

KEITH: Yeah, and it should. And when you're in a quad one and two, like the month of June we have is a quad one. I don't want to confuse people with all these things. I think that people just get confused because I use my own language, and it's not ... I definitely didn't learn what trades, trends, and tales and quads are at Yale University, I can assure you that. So I don't want them to get lost in that. I think it's very straightforward if you understand the math and what actually happened. But you know, in quad one in particular ...

LIZ ANN: Which is Goldilocks, as a reminder.

KEITH: Right, they love that. So you get a broadening of the rally, you get, you know, small caps, large caps, value, everything that ... and you and I can go back and forth on what those definitions actually mean. But you know, really, I think the point is that from here going forward, if you're going to bring, you know, Anthropic, you're going to bring these competitors to mega cap, that's the real supply problem I see from a market perspective that's already in motion.

Like, you know, we call them the "Bag 7," not the "Mag 7." I mean, I think that that's the real oversupply problem—that and market structure, which go together, I think that the whole thing ... that's where I understand where people have been wrongly bearish all of this year, but it doesn't mean it's not going to be bearish. The key question, as you know, is "When is it going to be bearish?" And I think we're finally knocking on that door, post- the SpaceX IPO.

LIZ ANN: Yeah, you know, I'm glad you brought that up because the ... you know, the Mag 7, which is still the, you know, so popular cohort to talk about, even though it's becoming, you know, the "Lag 7." You know, for a long time, those seven stocks were both good price performers and big contributors to index gains. Now even the latter has faded.

So the best performer of the Mag 7, which I think is Alphabet, is not even in the top 100 best price performers within the S&P. Nvidia is still the largest contributor to S&P returns of the Mag 7, but it's the 10th largest contributor. So there are bigger contributors, nine of them, than even the biggest contributor of the Mag 7, and it's not even in the top 100 in terms of price performance.

So let me then rewind again back to your broadening view. So you've got Russell 2000, you know, 2x the performance of the S&P this year. You've got equal weight kind of in line with the S&P. So do you see that? I'm not going to say secular, that's way too long a time period, but do you still see this as having legs, this broadening out, and is the basis for that ... because I think I've read that you have a pretty optimistic view on the earnings growth trajectory of kind of the rest relative to say a top ten or Mag 7 or "Lag 7" cohort, whatever subset you want to talk about?

KEITH: Yeah, I've had, because this goes back, you know, nine months now where we were calling out that earnings are going to smoke expectations, it's going to be the biggest rate of change acceleration in S&P earnings of our time. You know, that's all happened. That's what's giving birth to the bubble IPO that is SpaceX, because people will believe what they want and need to believe. It doesn't have to be true. But the fact of the matter is that GDP did get back to north of 3%. Inflation was additive to earnings. And most people don't know that for some reason, but you

know, a lot of cyclical companies quite like having pricing and margin expansion, and that's what happened.

So I think that the best of the earnings acceleration, like our case on that, like back in the fourth quarter, that the first half of 2026 would be just that. And that's pre-war, with war, without war, that happened. So I think that by next year, that's going to be the most bearish thing I can tell you, is just to remind you that you have to cycle against 40%, 50% earnings growth. You know, you could easily see S&P earnings growth go to zero on that, so there's like, yes, the broadening, I do think like the broadening for me, right now, my biggest broadening position that I've put on and only in recent weeks is putting on rate-sensitive equities that have lagged, right?

Because, you know, if you have a view that inflation and interest rates are going up, which was our view up until a month ago, then you're going to be short housing, short REITs, short like low-beta factor exposures, like sectors like healthcare. Those were basically all my shorts. Now they're becoming my longs.

So that really, you know, gets you back into ... and I don't know if there's a sector that people, like we run a big institutional business, we have a lot of, you know, similar subscribers that you do in the mass market, RIAs, family offices. I don't think that there's a sector that is more hated than housing, or under-owned for that matter. It's not like a huge component of the S&P, but those are examples of the next broadening, if you will. Because I think that the broadening that we already had was like pretty easy to call, this one is going to be more specific.

LIZ ANN: All right, what other faves from a broader asset-class perspective based on your process? What else do you think looks interesting here?

KEITH: I think you still have to stay with secular growth until non-"Bag 7," that's with a B, like literally, we ... because Google broke trend on our signal in the last week. You know, we only have Apple left. But we've owned like, multiple, kind of what we would call secular growth like nanotechnology, quantum computing, I'm going to stay with that until they stop working. And I know what I'm doing. I know what I'm dealing with this, which is like I'm holding a grenade, but yeah, it's ... I like blending, like, I love to have asymmetry.

Like, I have a max level of 30 different ETFs that I own, currently own. I've gotten it down to 22. So I've raised cash. You know, one of the big lessons of all the things I've screwed up, Liz Ann, which you know is manifest, is that I get out of my winners too early. Like I've been doing this for almost 30 years. And if I go back ...

LIZ ANN: No one ever went broke taking a profit, Keith.

KEITH: Right. But when I look at these things in this environment, like I guess I'm getting less bad at this. I just ride winners for longer. And I let my signal tell me when to get out.

LIZ ANN: All right, one last question, somewhat bigger picture. You talked about some of the lessons you've learned and maybe letting your winners ride a little bit longer, but you've always been vocal about the behavioral challenges of investing, and that's something that, you know, I have focused on for my 40 years doing this, and that relates to, at times, the attachment that investors get to some sort of thesis, some sort of narrative, even when signals, your quad signals, other signals, are changing. So what's the best piece of advice around that you can give to our listeners?

KEITH: I think we've given birth to like a whole new cattle class of post-pandemic investors, you know, that will say things that you wouldn't hold the test of time, never mind one cycle. Like you should invest where you see excitement or you have a passion or you have like, you know, these types of words that Elon Musk would use. Been there, done that, screwed that up more so than most people listening to this call could, but I won't this time. You know, I just think that like you should really check the emotional quotient at the door, and you should be rules-based. They're just tickers. You know, they're not marriages.

I think that that's actually going to be ... if there is like, you know, in the fourth turning, as my partner Neil Howe will call it, a generational event for the baby boom investing class and the learnings for the younger people, younger than us, it's don't do that. I think that that's coming. And, there are plenty of educational components of the script that have already been written, and my hope is that people invest dispassionately, you know, using math and modern, again, you got modern-day AI, it understands fractal math, instead of people saying, "Well, I don't understand that." Well that's too bad, but the machine understands it.

LIZ ANN: Yeah, the machine does. Well, a clinic, as always. Thank you, Keith. Always enjoy our conversations, especially when I get to be the one asking the questions. So thanks for imparting your wisdom to our crowd here.

KEITH: Thanks for having me on. Always good to talk to you.

COLLIN: So Liz Ann, let's look ahead to next week. We have another short week thanks to the July Fourth holiday. Are there any fireworks on your radar, either, you know, personally from a party or barbecue standpoint or in the, you know, potential economic data?

LIZ ANN: Well, always fireworks, the real kind on Fourth of July. That's always a highlight. It doesn't get old no matter how old I get. So that'll be on the docket, and it is a holiday-shortened week, obviously, so there'll be a little bit less in terms of data coming out.

We'll get consumer confidence from the Conference Board. One thing I wanted to remind listeners, and we'd mentioned this before, but I hope we're always getting new listeners, is that measure is very similar to University of Michigan's version, which they call consumer sentiment, but those have diverged quite a bit, with consumer sentiment at a record low and consumer confidence has been a bit more resilient. See whether that continues. But the reason for it is that the nature of the questions that are asked tends to gear consumer sentiment more toward what's going on in the inflation environment, whereas consumer confidence, based on the questions, the labor market and conditions therein tend to influence the answers there. So that helps to explain why there's been a bit of a divergence.

We get the Job Openings and Labor Turnover Survey, JOLTS for short. Lots of interesting data in there, including obviously job openings, that's in the label, but also the quits rate and the layoffs rate. Only caveat with that data, or at least as a reminder, is it lags all other jobs-related data that we're used to getting by a month, so keep that in mind. And then on Thursday, normally we have jobs Friday, but Friday is the holiday, and the market is closed, so we get the labor market report on Thursday. So that will be in sharp focus as it always is, especially in a backdrop, as we already discussed, of the Fed maybe shifting toward more of a tightening bias. How about you? What's on your radar?

COLLIN: The labor market. So you hit on the main points there, but I think the Thursday, you know, non-farm payrolls report and unemployment rate reports are going to be very important, I think, to see if the strength we've seen over the past three months is sustainable and if it's real. Because if we go back to, you know, last week's Fed meeting and the statement, you know, it seems clear that the focus is on inflation as opposed to the labor market right now, probably because the labor market's doing pretty well.

I do wonder if we see a reversal. Not that we're necessarily expecting that, but if we see that the recent strength turned into maybe slower job growth, something like that, is that something that the Fed might be paying attention to, or will it still just be all inflation? So that's going to be very important. And then we also get the ISM manufacturing report, the Institute for Supply Management. We don't get the services one just yet. We get that the following week, but you alluded to this before, Liz Ann, kind of a little manufacturing pickup over the past few months. We've seen improvement in that index. And it's not just the headline that we're going to be

looking at. You know, we also like to look at prices paid. That can be very important to see what these purchasing managers are thinking from the prices that they're paying and if they'll be passing them along.

And then of course the employment sub-indexes. So a little bit mixture of the hard data and the soft data. So even though it's a holiday-shortened week, we have a lot of, you know, big economic releases that that are going to be pretty important.

Let me turn it back to you real quickly, Liz Ann, because, just on more of a personal note, this week we lost the former chair of the Federal Reserve, Alan Greenspan, who passed away at the age of 100 years old. I know that you have crossed paths with him over the years. So you know, any interesting thoughts or insights there?

LIZ ANN: Yeah, I think the first time I met Greenspan was in the late 1990s. He used to be a guest from time to time on the late, great show *Wall Street Week* with Louis Rukeyser, and I became a regular panelist on that show in 1997. So that was the first time. I served on President George W. Bush's bipartisan tax reform commission in 2005. Met him, I think, twice during the span of that commission.

And then I had the pleasure of interviewing Greenspan a couple of times, once at Schwab's IMPACT conference, in front of a small little audience of about 5,000 people. And what I always took away was his brilliance. Unbelievably smart man, photographic memory. He, you know, has been lauded as the maestro, but he's also received a lot of criticism.

And what I found kind of compelling about his views on both of those is he would sometimes push back on the criticism he got. And a lot of that came around the housing bubble bursting and why the Fed hadn't done more with their regulatory tools that they had, macroprudential tools. And he pushed back a little bit on that, just saying, "It's hard to see a bubble before it ultimately pops. It's almost better to, you know, clean up afterwards." But he also pushed back on a lot of the credit he was given, so it wasn't just "I didn't do anything wrong, let's just praise me for the things that I got right." He was humble enough to say, "I probably didn't deserve all the blame that I got, but I definitely didn't deserve all the credit that I got." So I think there that humbleness was resonant with me.

That's it for us this week. Thanks as always for listening, everybody. As a reminder, you can keep up with us in real time on social media. I'm @LizAnnSonders on X and LinkedIn. The imposter problem has gotten really bad again. I'm not sure what accounts for that, but make sure you're following the real me.

COLLIN: And I'm @CollinMartinCS on X and LinkedIn. That's Collin with two L's. And the CS is for Charles Schwab. And you can always find all of our written reports, including lots of charts and graphs, at schwab.com/learn.

LIZ ANN: And if you've enjoyed the show, and we certainly hope that you do, please consider leaving us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen, and please tell a friend or more about the show. Slight break from us next week because of the holiday, and we will be back with a new episode in two weeks.

COLLIN: For important disclosures, see the show notes, or visit schwab.com/OnInvesting, where you can also find the transcript.