

Investment Insights Quarterly

From the Desk of Jack Kraft, CFA, Investment Strategist

October 2026



State of the Market: Third Quarter

Since the start of the year, investors have reaped the benefits of strong earnings-per-share growth that can largely be attributed to the historic investment in artificial intelligence (AI). This has softened the blow of a worsening macroeconomic environment that has weighed on those positives with increased geopolitical risks, persistent inflation and global central banks tightening. Despite the S&P 500 finishing the third quarter up over 2%, many sectors took a dive amid a hawkish pivot from the U.S. Federal Reserve (Fed). Mega-cap tech stocks helped prop up the major averages as sectors such as utilities, real estate and consumer discretionary were down more than 7.0% during the quarter. In this quarterly, we unpack the factors weighing most on investor sentiment, including

the midterm elections, rates and inflation, with a preview of third-quarter earnings season.

Midterm Elections: Clearing the Uncertainty

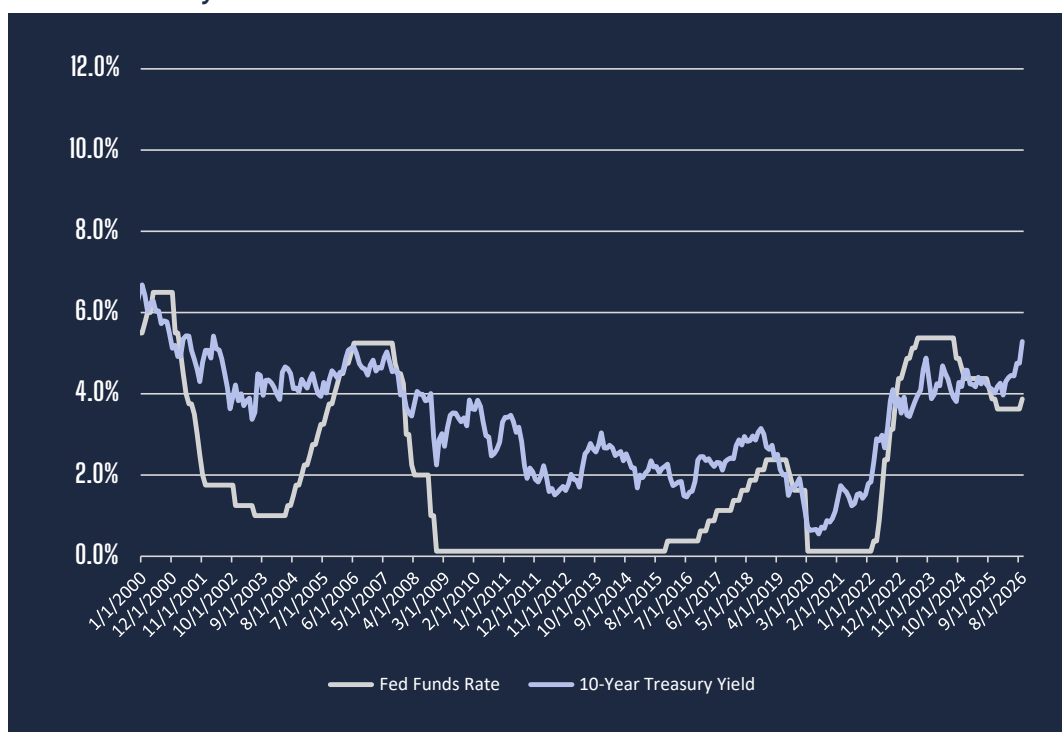
Midterm election years are historically weak for markets, but 2026 has bucked that trend with the S&P 500 up 10.0% through the first nine months of the year. Still, volatility has persisted as changing odds of House and Senate control have amplified uncertainty. The good news is that markets have historically rallied after November elections. As uncertainty clears, the fourth quarter of the midterm year tends to be strong for stocks. In fact, since World War II, the S&P 500 has gained in every 12-month period from October 31 of a midterm year, with an average return of 16.0%.

Betting markets are favoring a blue wave this November, where Democrats have a 92% probability to take the House and a 60% probability to win the House and Senate. Democrats need to flip at least four seats to take control of the Senate with some of the tightest races in Maine, Ohio, Texas and North Carolina. Under this scenario, look for shifts in policy conversation toward affordability, clean energy, data center pushback and preserving existing programs such as Medicaid. The other likely outcome would be a split House and Senate. Historically, this has been most beneficial for equity markets as it reduces policy risk, since neither side can easily push through regulatory changes. Regardless of the outcome, equity markets should get a tailwind post-November as investors regain focus on fundamentals rather than political uncertainty.

Yields Reset Higher with Fed Pivots

Another headwind this year has been the rise in bond yields as the Fed shifts into a hiking cycle to battle persistent inflation. The 10-year Treasury note, which has climbed in a largely uninterrupted line since the start of the year, broke decisively above the 5.0% threshold and hit a 24-year high of 5.36% before pulling back. These are the highest rates in the fixed-income market since prior to the Great Financial Crisis. Borrowing costs as measured by the 10-year yield have been above 4% for four years. In 2022, many economists said rates would be higher for longer until inflation is under control. It is now starting to seem like higher rates could be the new normal and coexist with a growing economy.

10-Year Treasury vs. Fed Funds Rate



As of September 30, 2026
Source: Haver

The latest inflation data did little to argue for relief. Consumer prices rose 3.7% over the 12 months ending in September, above the 3.6% consensus, with gasoline up 9.1% on the month and accounting for half the increase in the index. The Producer Price Index (PPI) pointed in the same direction. The PPI for final demand rose 1.3% in September, the largest monthly gain since March 2022, and is up 6.3% over the past year. Excluding food, energy and trade services, producer prices still rose 5.0% year over year. When cost pressures broaden beyond energy, they tend to find their way to consumers with a lag. Fixed-income investors have taken notice, and markets are now pricing better than 50% odds of a second Fed rate hike this year in December.

The positive takeaway here is that higher yields have yet to break a resilient economy as gross domestic product growth trends above 2.0% for the year. Despite that resilience, bond investors have plenty of reasons to demand higher yields, including elevated government borrowing, growing corporate capital needs and inflation well above the Fed's 2.0% target. The upside of that demand is that yields now compensate investors for inflation risk in a way they didn't a year ago, with the 10-year note yielding roughly 1.3% more than the headline Consumer Price Index and well over 2 points more than core. Nonetheless, this backup in yields creates opportunities for investors who may not have traditionally used fixed income to meet income needs. None of the reasons above look likely to ease soon, so investors who have long looked past bonds should start considering how a higher-rate regime can serve their personal finance goals.

Earnings Preview: The Median Company vs. the Index

Third-quarter earnings season kicked off in mid-October and will be a key indication of whether strong earnings momentum can continue into 2027.

Most of the large hyperscalers report in the final week of the month, with Nvidia following in mid-November. Consensus expects 27% earnings growth for the index, the highest heading into a reporting season since 2021. That headline is heavily concentrated, though. The technology and energy sectors are expected to supply nearly 80% of the growth, and the top 10 companies are expected to account for more than two-thirds of it. Concentration has become more of a main topic as the index sits near all-time highs, but the median stock is roughly 17% below its own peak.

Beneath the surface, the median company looks healthier than its share price suggests. Consensus expects the median S&P 500 company to grow earnings about 9% year over year in the third quarter. That is a step down from roughly 14% in the second quarter, and input costs, such as higher energy prices, are likely to cap margin expansion. The weakness in the typical stock has come from rising yields and persistent inflation, not from a deterioration in profits. Estimate revisions have also stayed positive, and companies have tended to beat expectations, which keeps the bar high for upside surprises.

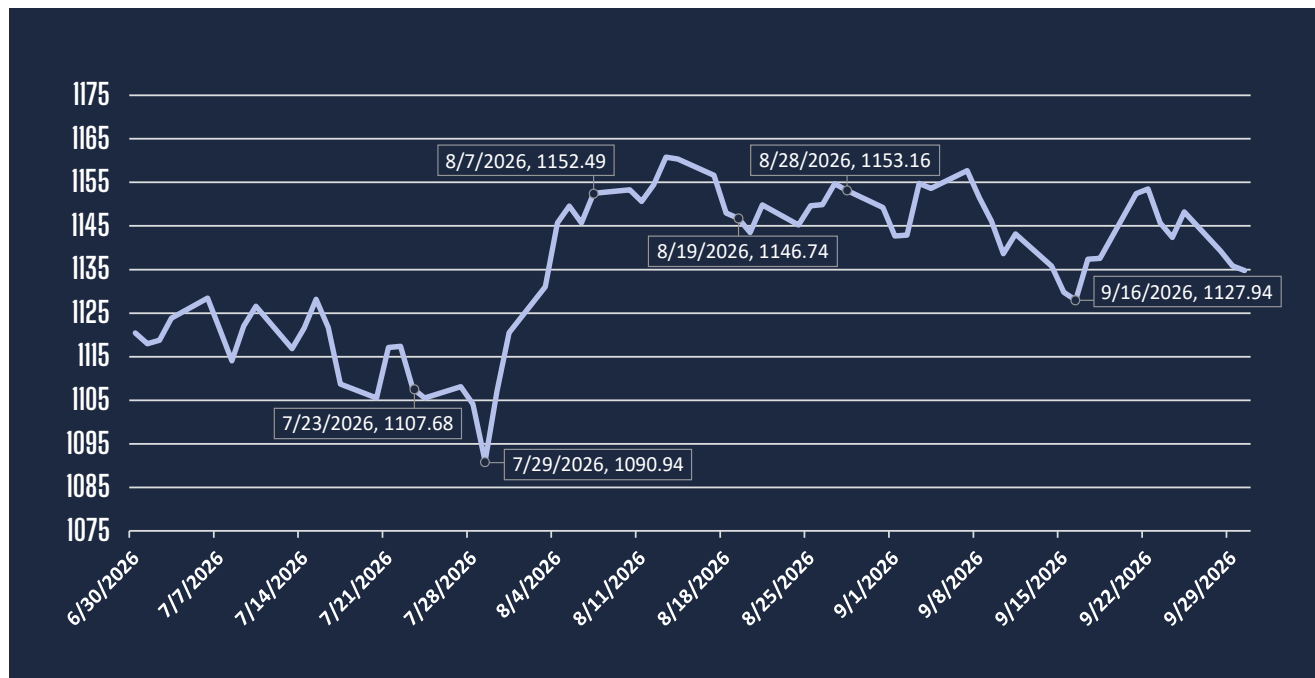
The result of earnings rising while prices have moved sideways is a market that is much less expensive than it was at the start of the year. The S&P 500 now trades at about 19 times forward earnings, near the middle of its 10-year range, while the equal-weighted index trades closer to 15 times. We think that is the market appropriately pricing today's backdrop of inflation near double the Fed's 2% target, a 5% yield on the 10-year Treasury, oil prices near \$100 per barrel and a Fed that has shifted toward hiking. Rather than relying on multiple expansion, returns from here will need to come from earnings delivery, which makes this reporting season, especially management guidance on AI investment and monetization, an important test heading into 2027.

Q3 Key Dates

- July 23 - Oil eclipsed \$100/barrel for the first time since May, fanning inflation concerns.
- July 29 - The Federal Reserve (Fed) held rates steady with three members supporting an increase, a rare public policy disagreement.
- August 7 - Economic data sent mixed signals as nonfarm payrolls fell by 23,000, driven primarily by government job losses while average hourly earnings increased just 0.3% month over month (M/M).
- August 19 - The U.S. national debt level surpassed \$40 trillion, igniting a selloff in bonds amid projected acceleration of budget deficits.
- August 28 - Fed Chairman Warsh's stern remarks at Jackson Hole sparked a market response, leading investors to further price in a future rate hike.
- September 16 - The Fed raised rates 25 basis points (bps) and said, "The Committee will deliver price stability."

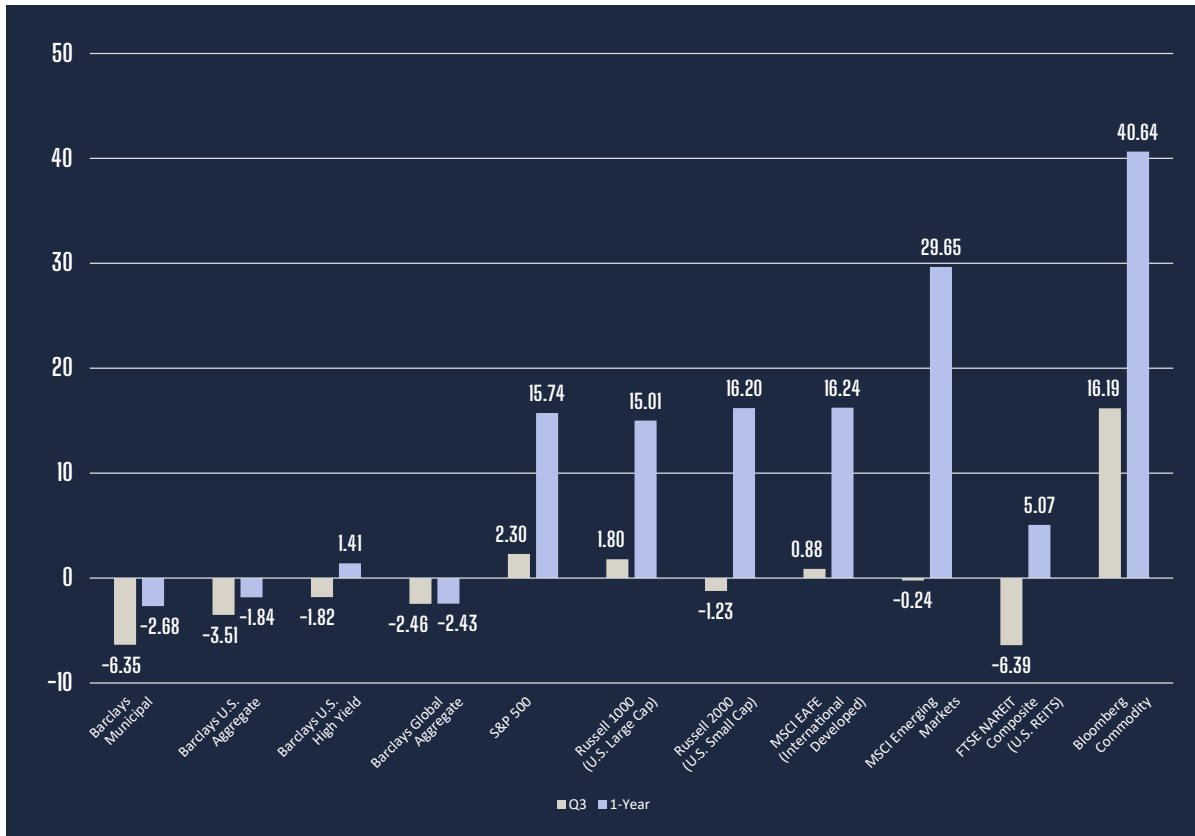
Global Stock Market

MSCI ACWI in USD



As of September 30, 2026
Source: Bloomberg

Asset-Class Returns



As of September 30, 2026
Source: Conway

Fixed Income

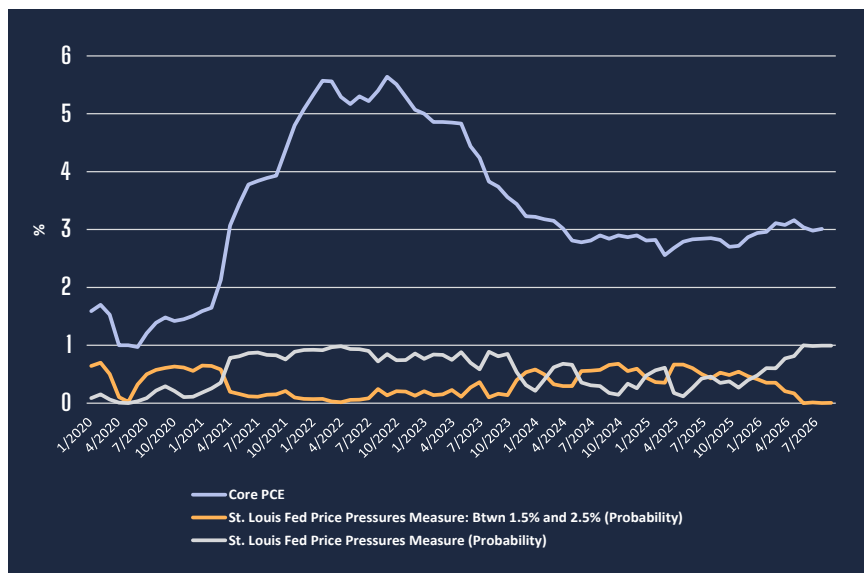
- Interest rates spiked higher again in September, leading to outsized losses in all areas of fixed income except for floating-rate loans.
- Core fixed income and municipal bonds were hit hard.
- Credit markets dealt with spread widening issues on concern over the massive hyperscaler debt issuance.
- Bonds outside the United States also faced the added headwind of the stronger U.S. dollar.

Equities

- U.S. equities performed fairly well, all things considered, on a relative basis. Growth stocks and the Nasdaq generally led the way, driven by renewed interest in the artificial intelligence (AI) trade.
- Small caps struggled in September, while growth stocks outpaced value stocks within large caps. Style mattered less within small caps.
- Despite the September challenges, U.S. equities have still generated solid performance for the fourth straight year.
- Equities outside the United States were weak last month as equities sold off and the U.S. dollar strengthened.
- Unlike what occurred in the United States, small caps beat large caps and value stocks outperformed growth stocks.
- Emerging markets posted a modest loss driven by weakness in China.
- U.S. dollar strength cost Europe, Australasia and Far East ("EAFE") investors 135 bps last month and emerging-market investors 18 bps.

Inflation

Core Personal Consumption Expenditures vs. Saint Louis Fed Price Pressures Index



As of September 30, 2026
Source: Haver

- Inflation remains above the Fed's target and is expected to remain there for a period.
- The Federal Reserve Bank of St. Louis publishes a price pressure index that measures the probability that the expected Personal Consumption Expenditures Price Index inflation rate (12-month percent changes) over the next 12 months will exceed 2.5%. It currently is priced at 99% odds for that to be the case with a probability of between 1.5% and 2.5% less than 1%.

Monetary Policy

Fed Funds Futures Implied Policy Rates

9/30/2025 vs. 3/31/2026 vs. 6/30/2026



As of September 30, 2026
Source: Bloomberg

- Stubbornly higher inflation has changed the monetary policy outlook.
- The Fed raised rates in September and more hikes are expected.
- Traders were positioned for rate cuts prior to the third quarter (Q3).

Oil Prices and the Conflict

West Texas Intermediate Crude

\$/bbl



As of September 30, 2026

Source: Bloomberg

- Oil reached a 2026 high in Q3 at more than \$100/barrel.
- Uncertainty around a resolution to the war with Iran has kept prices volatile.

Equity Earnings

Sector	Consensus Bottom-Up				
	2025A	CONTRIBUTION		EPS GROWTH	
	2025A	2026	2027	2026	2027
Info Tech	\$70	\$113	\$157	60%	39%
Financials	52	59	63	12	7
Comm Services	29	45	40	55	(13)
Health Care	33	33	40	0	21
Cons Discretionary	23	30	29	34	(4)
Industrials	21	24	28	15	16
Energy	12	21	20	82	(7)
Cons Staples	15	15	16	4	6
Utilities	8	9	9	13	7
Materials	5	7	8	36	10
Real Estate	6	7	8	17	7
S&P 500	\$275	\$365	\$418	33%	15%

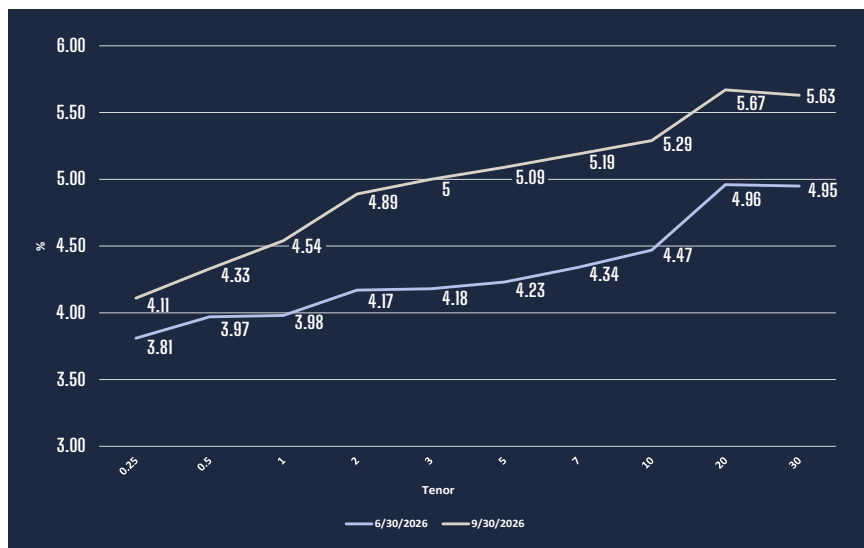
As of September 30, 2026

Sources: FactSet, Goldman Sachs, Conway

- Earnings continue to surprise to the upside and are forecast to remain strong.

Bond Yields

Change in U.S. Treasury Yields: Q3



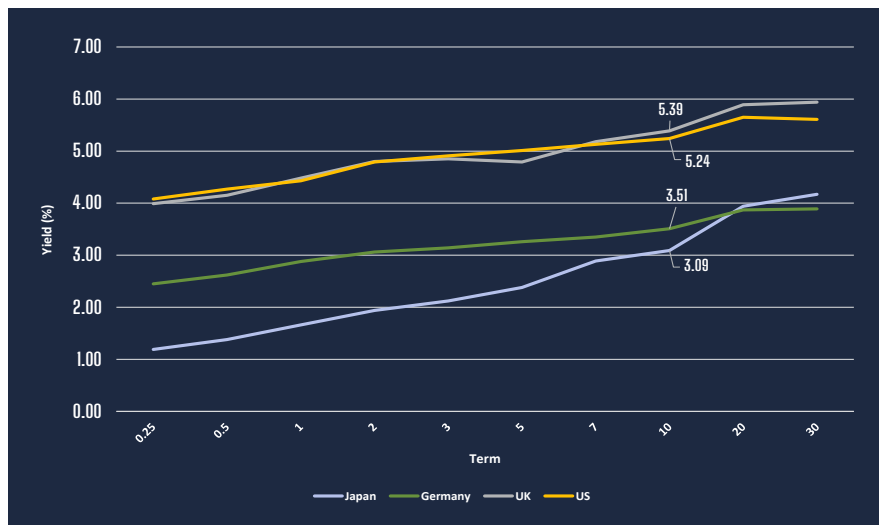
As of September 30, 2026
Source: Bloomberg

- Treasury yields climbed to the highest levels in almost two decades as global bond markets suffered a rout.

Government Bond Curves

Global yields rose noticeably and what many participants termed a rout.

Global Government Bond Yield Curves End of Q3 2026

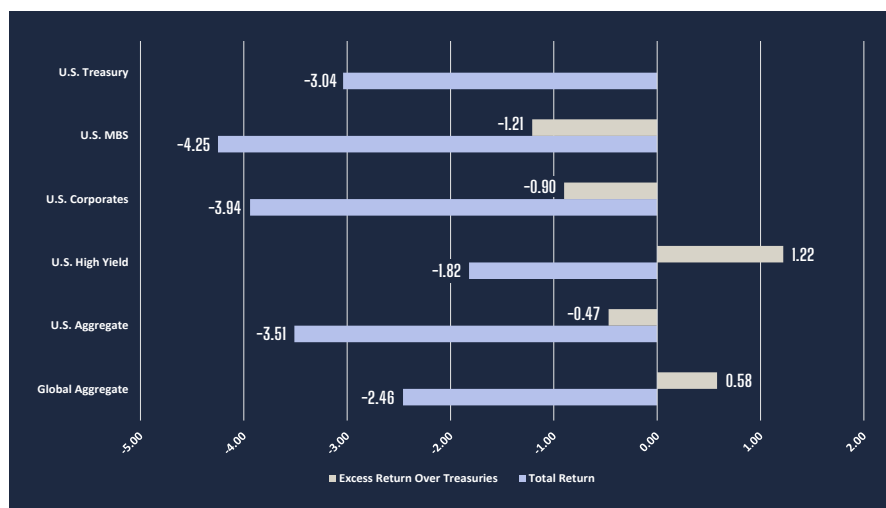


As of September 30, 2026
Source: Bloomberg

Fixed Income Performance (Q3)

A very difficult quarter for fixed income as benchmark Treasury yields rose sharply and credit spreads generally widened.

Fixed Income Performance Q3 2026

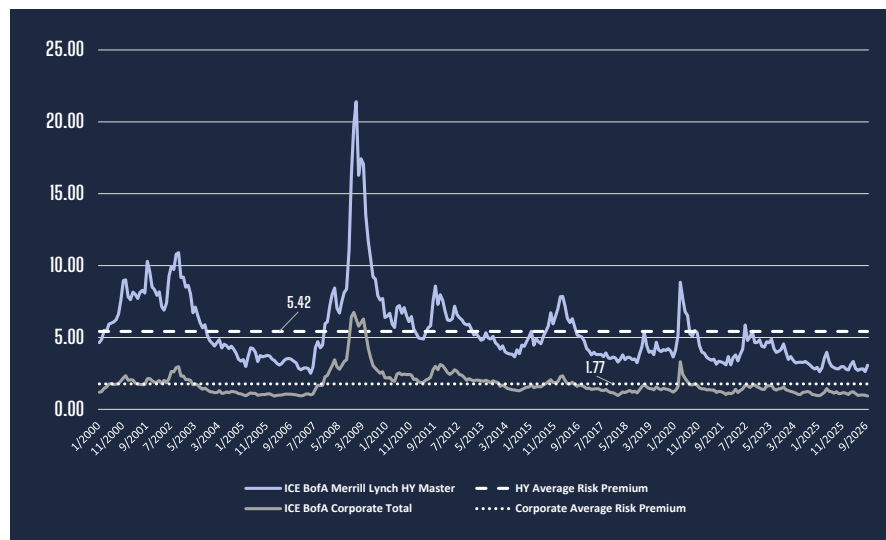


As of September 30, 2026
Source: Bloomberg

Credit

Credit spreads remain well below long-term averages and diverged in Q3. High-yield spreads widened while investment grade were slightly narrower.

Investment Grade and High Yield Credit Spreads



As of September 30, 2026
Source: Haver

Municipal Bonds

Municipal yields have risen more than other sectors, making them very attractive.

Municipal Yields as a Percentage of Treasury Yields

ICE/Bank of America Municipal Master/10-Year Treasury

Term	AAA General Obligation (%)	U.S. Treasury (%)	Municipal % of Treasury
1	3.49	4.56	76.5%
2	3.53	4.89	72.2%
3	3.58	4.99	71.8%
4	3.65	5.04	72.4%
5	3.71	5.09	72.9%
7	3.85	5.18	74.2%
10	4.11	5.30	77.6%
15	4.56	5.56	82.1%
20	4.86	5.70	85.3%
25	5.09	5.71	89.0%
30	5.19	5.62	92.3%

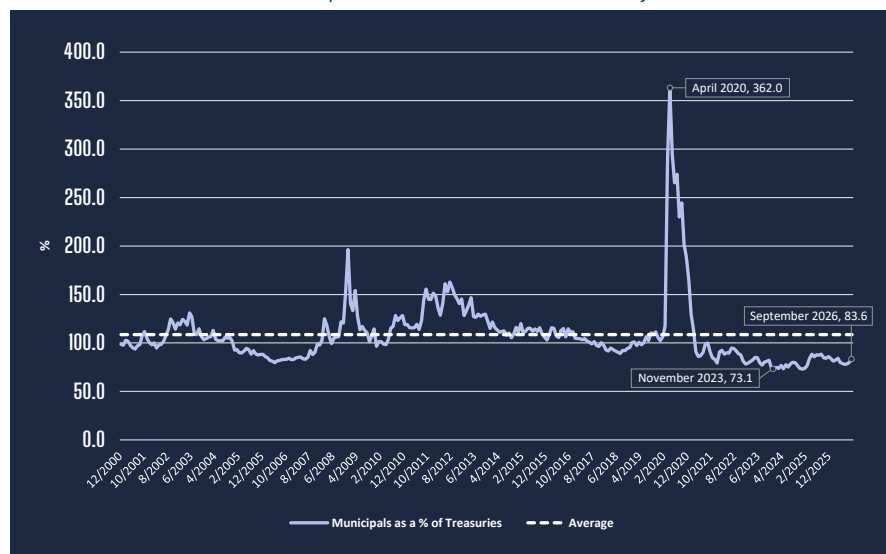
As of September 30, 2026
Source: Bloomberg

Municipal Bonds

Municipal bonds sold off more than Treasuries, making them relatively more attractive than other fixed-income sectors.

Municipal Yields as a Percentage of Treasury Yields

ICE/Bank of America Municipal Master/10-Year Treasury



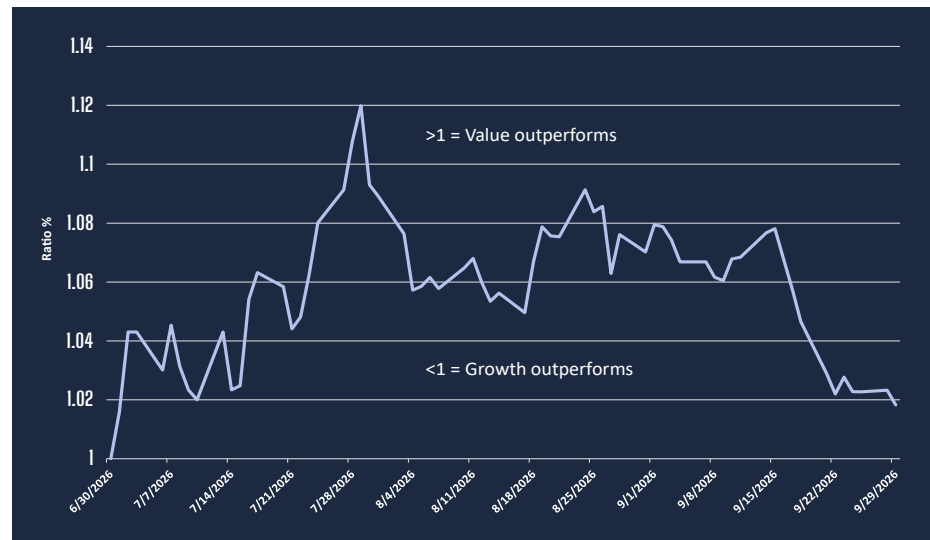
As of September 30, 2026
Source: Haver

Equity – Value vs. Growth

Growth tailed off late in the quarter but still managed to outperform.

Large Cap Value/Large Cap Growth - Q3 2026

Russell 1000 Value/Russell 1000 Growth



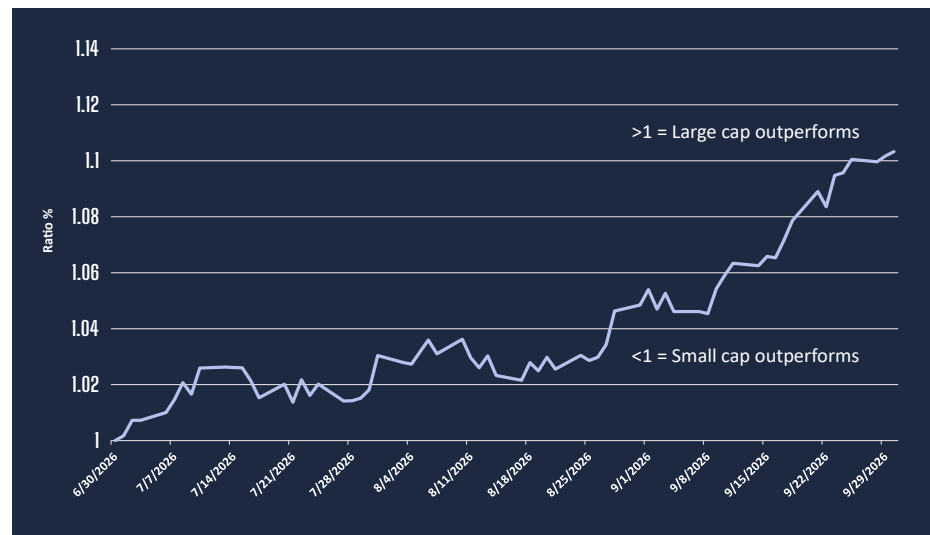
As of September 30, 2026
Source: Bloomberg

Equity – Large vs. Small

Large cap outperformed small cap during Q3, bucking the recent trend.

Large Cap/Small Cap - Q3 2026

S&P 500/Russell 2000

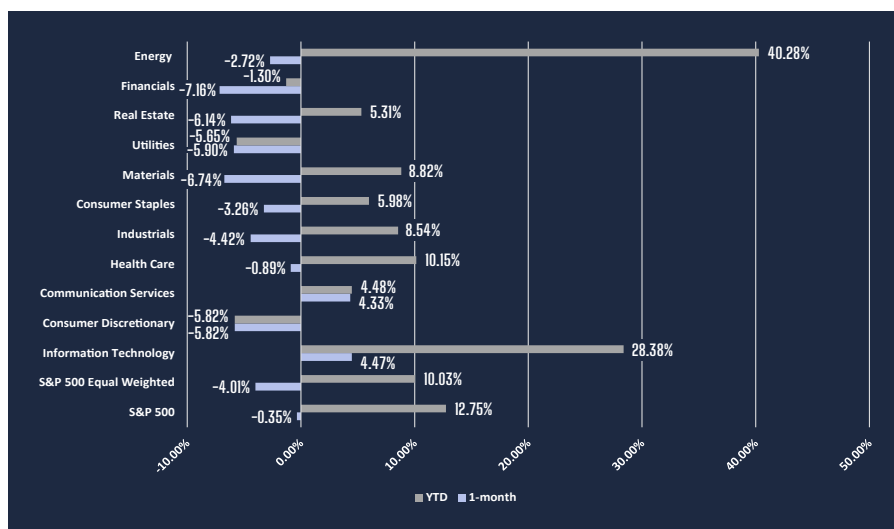


As of September 30, 2026
Source: Bloomberg

U.S. Equities – Return by Sector

Despite generally struggling during the quarter, U.S. equities have still generated solid returns YTD for the fourth consecutive year.

S&P 500 Sector Returns Q3 2026

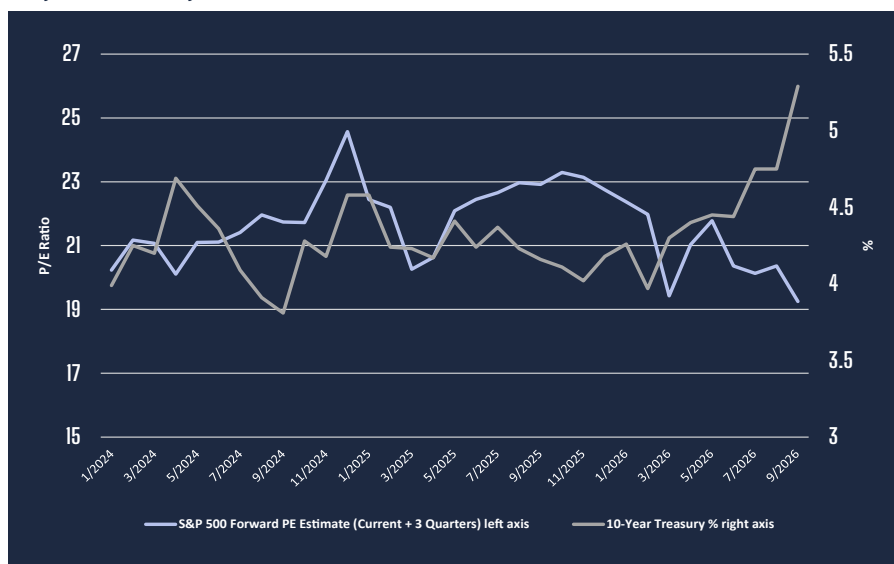


As of September 30, 2026
Source: Conway

Stocks vs. Bonds

The S&P 500 price/earnings (P/E) ratio has declined this year alongside higher bond yields.

S&P 500 Composite: Forward P/E Estimate (Current + 3 Quarters) 10-year Treasury Yield



As of September 30, 2026
Source: Haver

Country Total Returns (%) – 10 Largest Economies

Global equities were generally weaker during Q3 while trailing returns remain strong.

Country Total Equity Market Returns



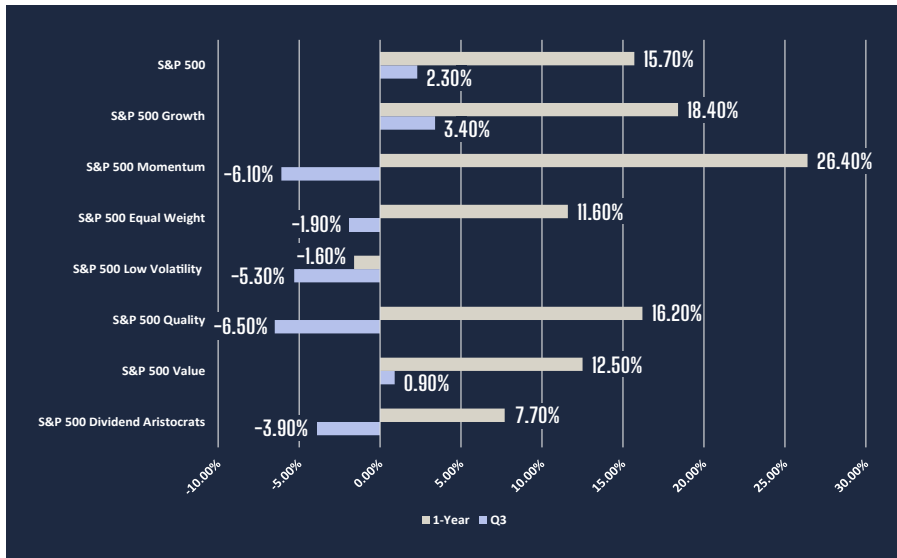
As of September 30, 2026
Source: Bloomberg

U.S. Equity Factors – Total Return Q3

Factors were mixed in Q3, but growth and momentum continue to lead across longer timeframes.

Total Return: Core Factors

Q3 2026

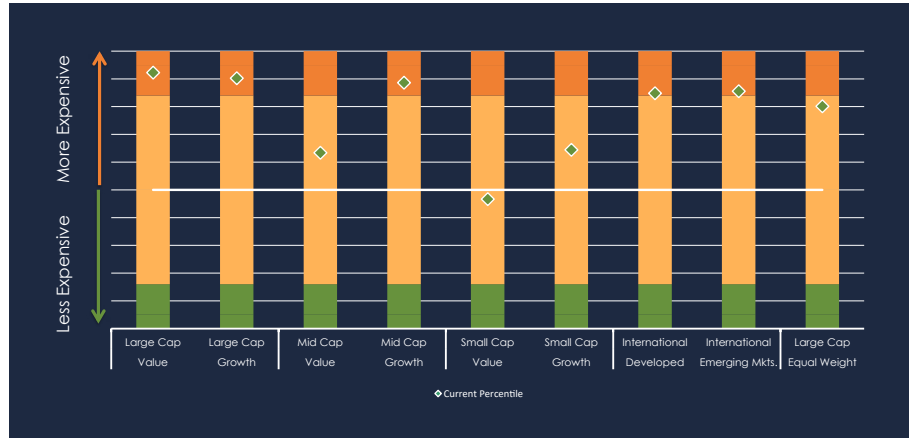


As of September 30, 2026
Source: S&P

Valuations

Large-cap stocks remain expensive relative to history and the most expensive part of the market. Valuations remain above long-term averages for almost all segments.

Equity Asset Classes Value Rank to Own History



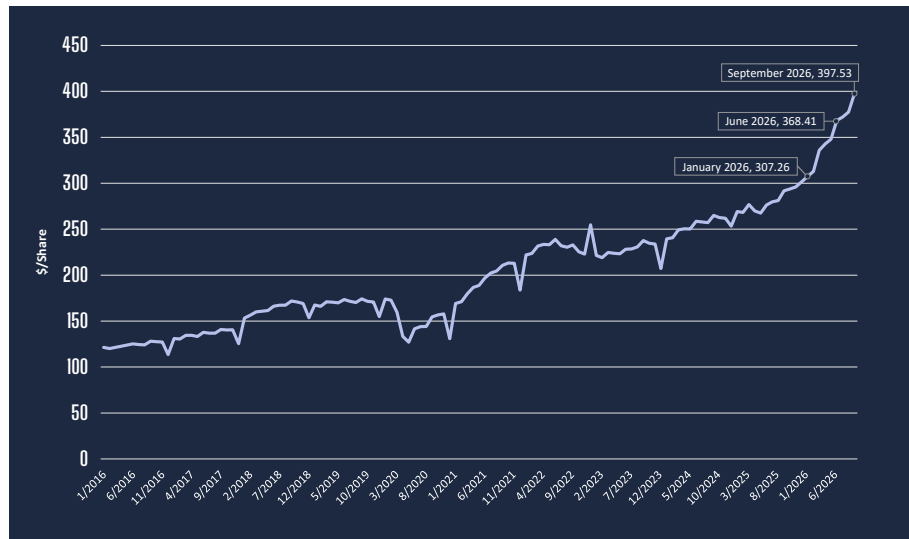
Equally weights P/B, P/CF, P/S, P/E and compares to own history

As of September 30, 2026
Sources: BFE, Bloomberg

Earnings

Earnings for U.S. large-cap stocks continue to surprise on the upside, and strong earnings growth is expected to continue. Earnings growth has outpaced gains in share prices resulting in lower P/E ratios vs. the beginning of the year.

S&P 500 Composite: Mean EPS Estimate (Current Quarter + Next 3 Quarters) \$/Share

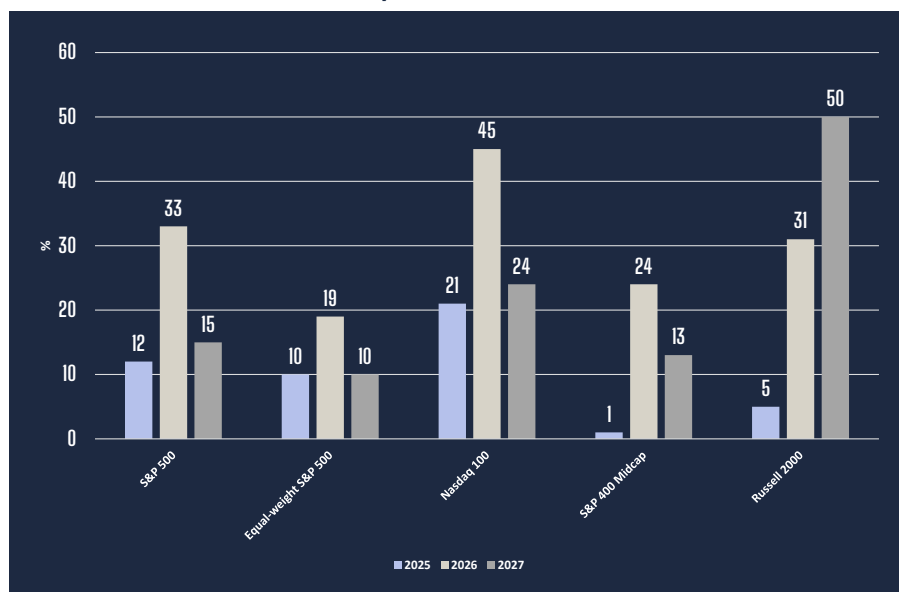


As of September 30, 2026
Source: Haver

Earnings

Earnings growth continues to surge in tech and small-cap stocks.

Annual Realized and Bottom-up Consensus EPS Growth Estimates



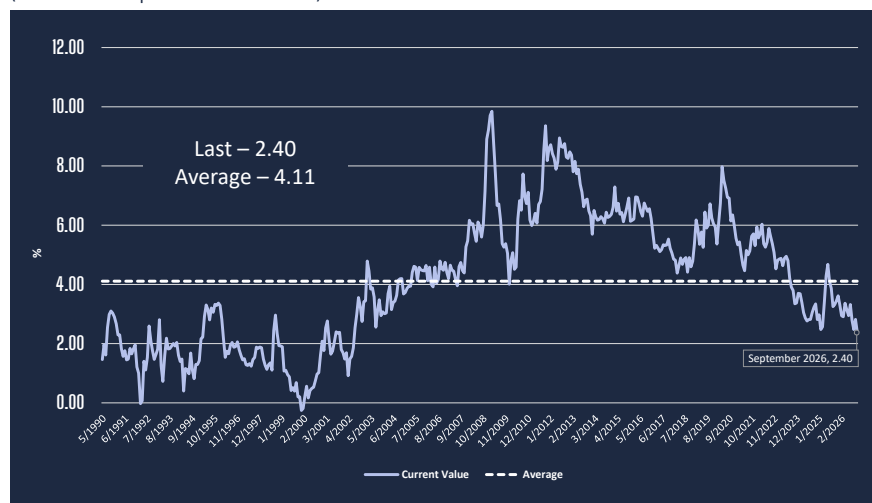
As of September 30, 2026
Sources: FactSet, Goldman Sachs

Equity Risk Premium

The equity risk premium (ERP) is a valuation metric showing an “expected” return for stocks over bonds. The strength of the market has resulted in the ERP below long-term averages. In recent months, the ERP has declined on rising real yields and a declining P/E due to robust earnings.

Equity Risk Premium

Earnings Yield (1/S&P 500 PE ratio) less Real 10-year Yield (10-Year-Expected Inflation)

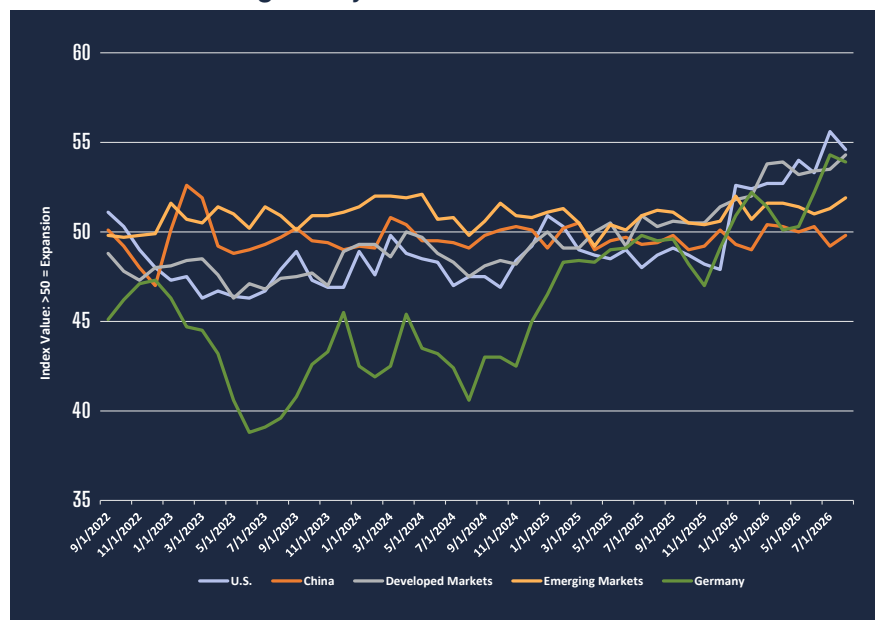


As of September 30, 2026
Source: BFE

PMI Composites

The Purchasing Managers' Index (PMI) is a survey-based measure of the prevailing direction of trends in the manufacturing sector. Readings >50 equal expansion and <50 contraction. By this measure, global economies continue to grow.

Global Manufacturing Surveys



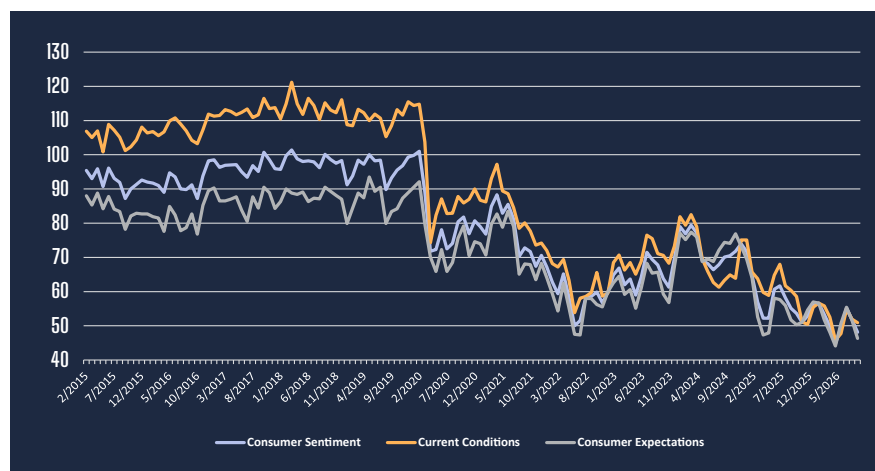
As of September 30, 2026
Sources: Bloomberg, Haver

Consumer Sentiment

Consumer sentiment remains very weak despite the strength of the stock market and low unemployment rate. Higher energy prices and the negative political climate are weighing on sentiment.

University of Michigan: Consumer Sentiment University of Michigan: Current Economic Conditions University of Michigan: Consumer Expectations

NSA, Q1-66=100



As of September 30, 2026
Source: Haver

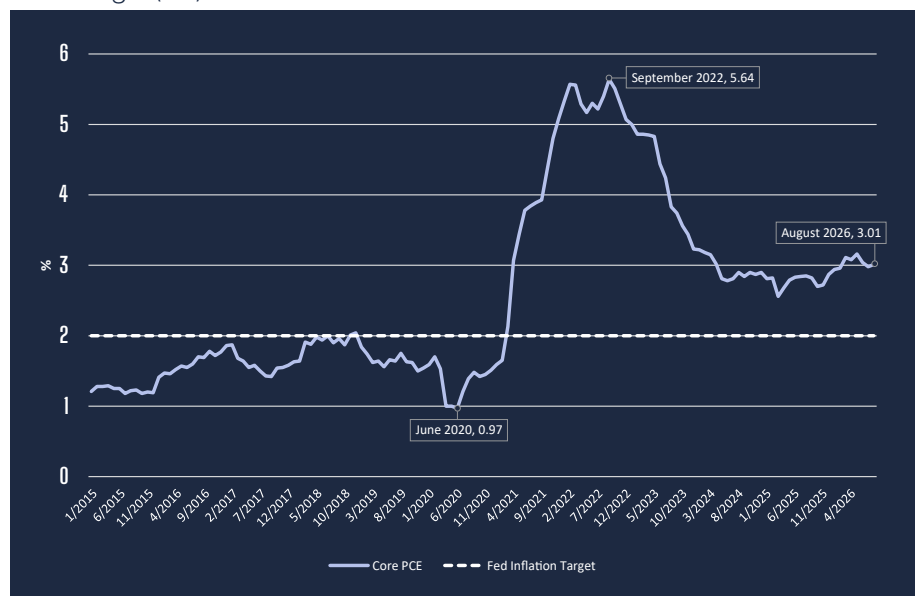
Inflation

Inflation has been above the Fed's target for 65 consecutive months.

Core Personal Consumption Expenditures Price Index

Less Food & Energy

Fed's Target (2%)



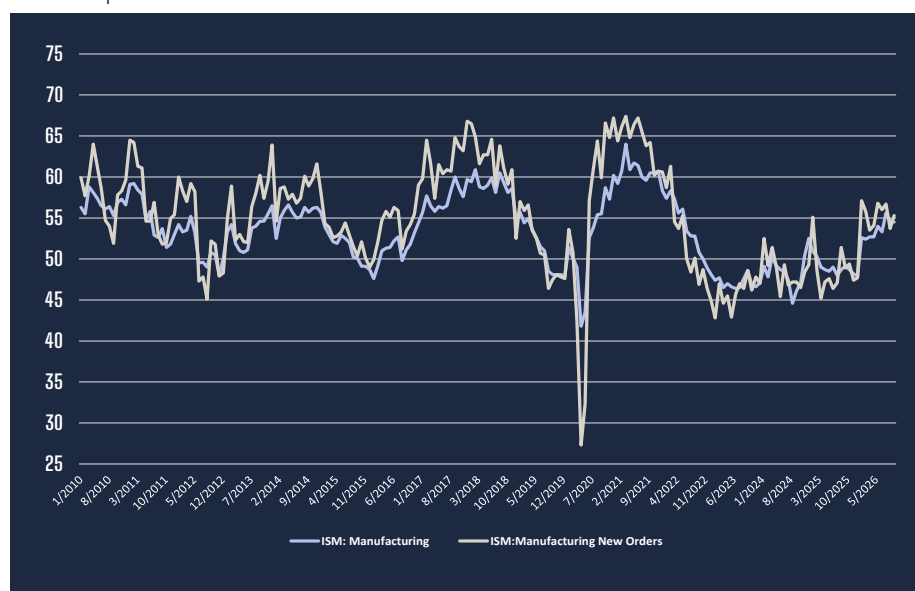
Manufacturing

Manufacturing remains a bright spot in the U.S. economy.

ISM Manufacturing vs. ISM Manufacturing New Orders

<50 = Contraction

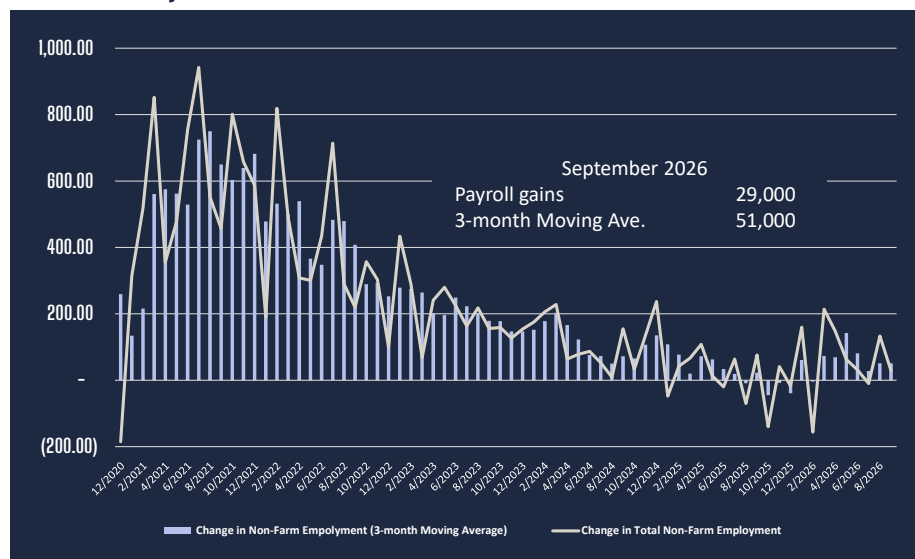
>50 = Expansion



Employment

The labor markets have slowed but still have positive momentum.

Non-Farm Payroll Gains

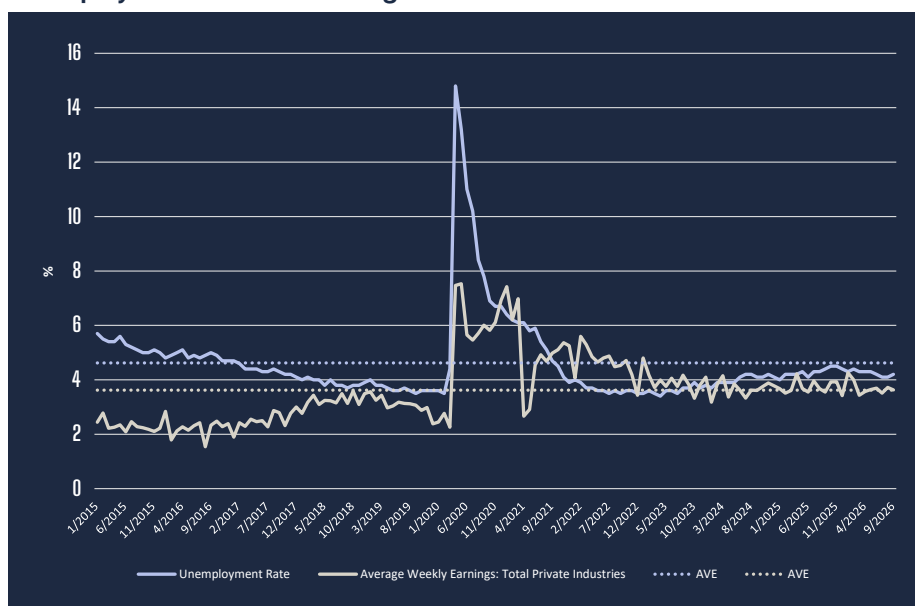


As of September 30, 2026
Source: Haver

Employment

Nominal wage growth is moderating as inflation has fallen.

Unemployment Rate vs. Earnings

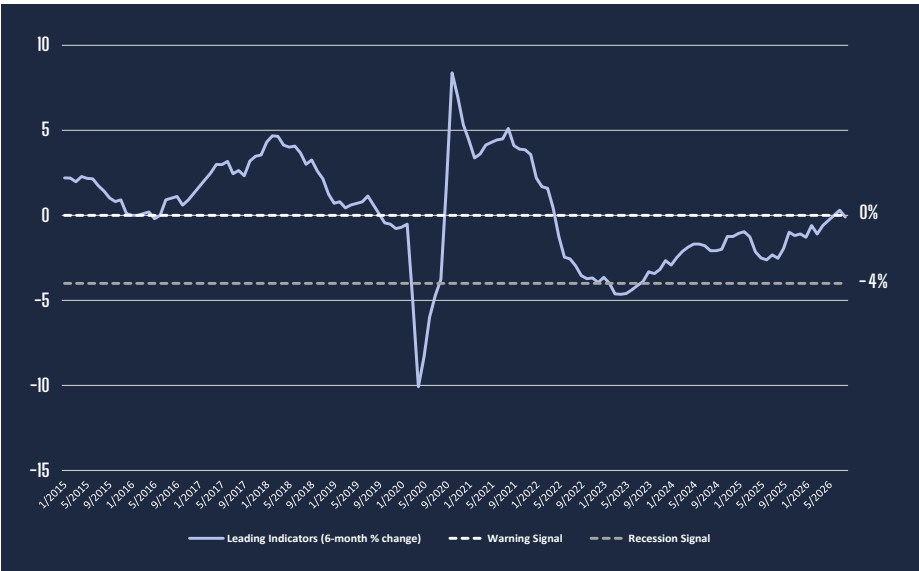


As of September 30, 2026
Source: Haver

Leading Indicators

The index of leading indicators continues to improve.

Composite Index of 10 Leading Indicators 6-Month % Change-Annual Rate



As of September 30, 2026
Source: Haver

September 30, 2026	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
FIXED INCOME INDICES							
Bloomberg U.S. Treasury Bill 1-3 Month	0.30%	0.93%	2.75%	3.79%	4.59%	3.80%	2.44%
Bloomberg Municipal	-4.36%	-6.35%	-4.18%	-2.68%	2.89%	-0.21%	1.51%
Bloomberg U.S. Govt/Credit Intermediate	-0.58%	-0.18%	0.59%	1.75%	4.33%	2.07%	1.98%
Bloomberg U.S. Aggregate	-2.61%	-3.51%	-2.91%	-1.84%	4.06%	-0.64%	1.14%
Bloomberg U.S. High Yield	-2.52%	-1.82%	0.10%	1.41%	8.03%	3.60%	5.05%
Bloomberg Global Aggregate	-2.38%	-2.46%	-2.67%	-2.43%	3.82%	-1.86%	0.05%
U.S. EQUITY INDICES							
DJ Industrial Average	-4.12%	-2.34%	7.19%	11.50%	17.01%	10.58%	13.10%
S&P 500	-0.35%	2.30%	12.75%	15.74%	22.89%	13.79%	15.33%
NASDAQ Composite (Price)	1.86%	2.47%	15.57%	18.54%	26.66%	13.20%	17.59%
Russell 1000	-0.65%	1.80%	12.30%	15.01%	22.48%	13.01%	15.04%
Russell 1000 Growth	2.16%	0.92%	6.30%	7.50%	24.26%	13.66%	18.16%
Russell 1000 Value	-3.13%	2.61%	19.27%	23.81%	20.07%	11.92%	11.43%
Russell Mid Cap	-4.17%	-3.00%	11.84%	12.02%	17.20%	8.04%	11.17%
Russell 2500	-4.95%	-6.37%	14.90%	17.45%	17.74%	7.46%	10.81%
Russell 2000	-5.25%	-7.23%	13.71%	16.20%	17.72%	6.34%	9.84%
Russell 2000 Growth	-5.31%	-9.39%	10.71%	12.05%	17.55%	4.72%	9.90%
Russell 2000 Value	-5.20%	-4.91%	16.96%	20.77%	17.93%	7.80%	9.40%
Russell 3000	-0.84%	1.41%	12.42%	15.13%	22.26%	12.64%	14.73%
NON-U.S. EQUITY INDICES							
MSCI World	-1.15%	1.96%	12.09%	15.68%	21.91%	12.39%	13.37%
MSCI ACWI	-1.08%	1.69%	13.37%	17.19%	22.25%	12.08%	12.92%
MSCI ACWI Ex-U.S.	-2.33%	0.57%	14.66%	20.52%	21.15%	10.11%	9.78%
MSCI EAFE	-3.01%	0.88%	10.81%	16.24%	18.99%	9.87%	9.60%
MSCI EAFE Growth	-3.28%	-2.49%	6.67%	8.69%	14.25%	4.66%	8.18%
MSCI EAFE Value	-2.75%	4.36%	14.97%	24.04%	23.81%	15.11%	10.76%
MSCI Europe	-4.54%	-1.60%	6.60%	13.28%	18.24%	10.16%	9.82%
MSCI AC Asia	0.35%	1.75%	25.06%	30.03%	24.69%	10.02%	10.05%
MSCI EAFE Small Cap	-2.72%	2.99%	11.21%	14.25%	18.79%	6.28%	8.51%
MSCI ACWI Ex-U.S. Small Cap	-2.71%	2.19%	11.78%	15.15%	18.44%	7.26%	8.96%
MSCI Emerging Markets	-0.50%	-0.24%	23.73%	29.65%	24.69%	9.44%	9.53%
MSCI EM Asia	-0.03%	-0.96%	27.13%	32.96%	26.64%	10.07%	10.58%
MSCI China	-4.55%	3.72%	-11.75%	-18.23%	9.96%	-1.93%	3.52%
MSCI EM Eastern Europe	-0.93%	11.54%	27.85%	46.54%	42.44%	-11.21%	1.06%
MSCI EM Latin America	-0.27%	4.03%	15.22%	24.86%	16.04%	13.61%	7.74%
MSCI EM Small Cap	-1.80%	0.37%	13.51%	15.43%	15.75%	8.18%	9.15%
MSCI Frontier Markets	-4.29%	-0.19%	10.21%	17.50%	22.95%	8.35%	9.09%
REAL ASSETS INDICES							
FTSE NAREIT Composite	-6.04%	-6.39%	7.03%	5.07%	10.67%	2.14%	5.18%
Alerian MLP	-8.32%	1.87%	20.70%	25.27%	20.05%	22.39%	9.28%
Bloomberg Commodity	0.61%	16.19%	32.87%	40.64%	15.63%	11.27%	7.85%
OTHER							
Oil Price Brent Crude	14.41%	41.98%	70.14%	54.48%	2.80%	5.69%	7.75%
CBOE Market Volatility (VIX)	9.52%	-0.67%	9.30%	0.37%	-2.30%	-6.72%	2.09%

Source: Morningstar

The information provided is based on internal and external sources that are considered reliable; however, the accuracy of this information is not guaranteed. This piece is intended to provide accurate information regarding the subject matter discussed. Investing involves risk including the potential loss of principal. No investment strategy, including asset allocation and diversification, can guarantee a profit or protect against loss in periods of declining values. Past performance is no guarantee of future results. Indexes are unmanaged and investors are not able to invest directly into any index. This information does not constitute a solicitation or an offer to buy or sell any security mentioned.

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