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# Market Commentary and Outlook

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## Capital Markets Performance

Global capital markets were volatile in the third quarter. Continued strong corporate earnings reports and better-than-anticipated economic growth helped to offset a significant rise in interest rates. The S&P 500 ended the third quarter up 2.3%. Value stocks led growth stocks across market caps, with large-cap stocks producing positive gains while mid- and small-cap stocks were negative performers. Large-cap value stocks were the best performers for the quarter, up 2.6%. Four of the eleven S&P 500 sectors were positive for the quarter, led by Energy (+17.2%) and Technology (+7.2%). Utilities (-13.4%) were the weakest sector in the quarter, pressured by higher interest rates.

International stocks were mixed performers in the third quarter as the MSCI All Country World Index ex USA gained 0.5% while the MSCI Emerging Markets Index was down 0.4%. The U.S. dollar index strengthened slightly in the third quarter as investors continued to seek a safe haven as geopolitical tensions remained. Gold ended the quarter up 2.9%, while crude oil (WTI) jumped 30.1% on renewed tensions in the Middle East.

U.S. Treasury yields increased to multi-decade highs on stronger economic growth, heightened inflation expectations and a shift towards a tightening bias by the Federal Reserve. Credit spreads widened for both investment-grade and high-yield bonds. The U.S. Aggregate Index was down 3.5% in the third quarter, with all six sectors recording losses led by Mortgage-Backed Securities (-4.3%) and Corporate Bonds (-3.9%). Three-month T-Bills were relative outperformers (+1.0%) versus longer-duration fixed income, while lower-rated bonds were relative outperformers versus higher-rated bonds. Interest rates continued to move higher in Europe as the European Central Bank raised rates by 25 basis points at its September meeting, citing expectations that inflation would remain above its 2.0% target for an extended period. The Bank of Japan also increased rates by 25 basis points to 1.25%, which represented a 31-year high as the country continued to see higher inflation and a weaker currency.

## U.S. Economy and the Federal Reserve

We still expect the economy to grow at least at its trend growth rate of 2.0% this year despite higher energy prices due to the war in Iran. Strong corporate earnings have supported capital spending, especially those companies levered to artificial intelligence. Higher imports of components levered to AI spend have been a headwind to GDP growth this year.

U.S. job market gains were uneven in the third quarter, with monthly non-farm payroll gains averaging 51k for the quarter. The September unemployment rate of 4.2% was flat with the June level. The participation rate continues

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to move lower due to immigration reform and an aging population, which puts pressure on productivity gains to drive economic growth. We still view the job market as tight but not especially strong, with companies neither hiring nor laying off workers in significant numbers. The challenge for workers remains wage gains being offset by higher inflation.

Inflation remained stubborn in the third quarter due to stronger economic growth and higher energy prices associated with the Iran War. We expect inflation to moderate as energy prices will move lower on the potential of tensions with Iran easing. Personal Consumption Expenditure excluding food and energy is also elevated and has been above the Federal Reserve's 2.0% target for the past five and a half years.

The U.S. Federal Reserve increased its target rate by 25 basis points (bps) at its September meeting. This was the first rate hike in three years as the Fed shifted toward a tightening bias, forecasting one more 25 bps by the end of the year. Work continues with Chairman Warsh's five independent task forces focusing on Fed communications, the balance sheet, economic data sources, productivity and jobs and inflation frameworks. We continue to believe the Fed remains focused on its inflation mandate with a goal of returning to its 2% target over time.

## Outlook and Portfolio Positioning

As we head to year-end, markets will focus on the mid-term election and tensions in the Middle East. We still expect the U.S. economy to grow this year at least at its historic 2.0% growth level, with the job market still adding jobs and inflation trends levered to economic growth and energy prices. Market positives include still strong corporate earnings, which have increased faster than prices, improving market multiples year to date. Expectations for S&P 500 earnings growth for the full year are now over 30.0% or four times the historic average. Corporate earnings are the long-term driver of equity prices.

Market risks in the U.S. include potential earnings disappointments; elevated index concentrations, especially for large-cap stocks; geopolitical tensions around the world; and political and policy uncertainty. Historical evidence shows that market volatility tends to be elevated during mid-term election years. So far, in 2026, this has been the case, with the year-to-date volatility primarily a result of the war in Iran and a significant move higher in interest rates. It appears that we are headed towards a divided government in the mid-term election, which leads to gridlock in D.C. on major policy changes.

We continue to believe investors should maintain a disciplined and well-diversified approach in periods of market uncertainty. That is why we remain balanced in our equity exposures across growth and value styles, market capitalizations and global regions. Market rotation remains evident this year, with value stocks outperforming growth stocks year to date and certain emerging markets outperforming developed markets. A weaker U.S. dollar, fiscal stimulus and still attractive relative valuations remain catalysts for international equities, in our view.

Interest rates are normalizing after years of artificially low levels. Historically, the 10-year Treasury yield should reflect the nominal growth rate of the economy. The current 10-year Treasury rate of about 5.15% reflects real GDP growth of 2.0%-2.5% and an inflation rate around 3.0%, which sounds about right to us. The current yield to maturity of the U.S. Aggregate Index is approximately 5.5%, which is a good starting point to think about potential fixed income returns. The duration of the Agg is currently 5.6 years, which implies an additional one percent move higher in rates to offset the current yield on the Agg. A 1.0% decline in interest rates would lead to a double-digit return for the Agg. The ability to add additional credit and interest rate risk could boost potential returns.

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Despite market uncertainty and volatility, it remains critical to stay diversified and committed to long-term investing. Market history suggests that time in the markets produces better outcomes than attempting to time the markets.

As always, we thank you for your continued support and trust in Newport Capital Group.

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