



Third Quarter 2026 Market & Economic Commentary

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The third quarter combined solid economic and corporate fundamentals with renewed pressure from oil and interest rates. Oil traded back above \$100 per barrel, inflation remained elevated, Treasury yields moved higher, and the Federal Reserve raised rates in September. The S&P 500 traded higher and set a new all-time high as corporate earnings and economic activity remained strong, but beneath the headline gain, market leadership narrowed as smaller companies and rate-sensitive areas lagged. Meanwhile, artificial intelligence continued to play a large role in both the economy and financial markets.

In this commentary, we look at the forces pushing interest rates higher, the economic and earnings strength helping offset those pressures, and AI's expanding influence on everyday borrowing costs, business investment, and the stock market.

Fed Raises Interest Rates as Oil Remains Volatile

Oil remained a key factor during the third quarter, with sharp price swings carrying implications for inflation, interest rates, and economic growth. After surging early in the year, oil fell sharply in May and June before reversing higher again in the third quarter, with a 22% increase in July. The main takeaway isn't any single monthly move, but how frequently the direction changed.

Most of the volatility is tied to changing expectations for Middle East oil supplies and the uncertainty around the Strait of Hormuz and oil-related infrastructure. The swings in oil prices matter beyond the energy market because oil feeds into gasoline and transportation costs, inflation, and ultimately the outlook for interest rates and economic growth.

When oil fell in the second quarter, some of those pressures eased. As prices moved higher in the third quarter, input costs rose, as did expectations for further inflation pressure.

Strong Earnings and Economic Growth Provide Fundamental Support Amid Volatility

The volatility in oil, inflation, and interest rates made the economic backdrop more complicated, but the underlying data remained strong, providing fundamental support to the stock market. Corporate earnings remained strong and households and businesses continued to spend, providing a constructive counterpoint to the quarter's uncertainty.

Corporate earnings have remained strong, with the S&P 500's 12-month earnings growing nearly 30% over the past year. This is one of the strongest periods of earnings growth outside of the post-financial crisis and post-COVID rebounds and is a significant improvement from the single-digit pace seen in 2023 and 2024. This earnings data stood in contrast to the more volatile macro backdrop, with corporate profits continuing to grow at a strong pace.

AI's Influence on Economic Growth and Financial Markets Continues to Broaden

Artificial intelligence has been a prominent market theme for years, but the scale of today's buildout is extending its impact across the broader economy and financial markets. Its influence is expanding through three channels: investment, financing, and the stock market.

First is business investment. Spending on data-center construction and computer equipment, proxies for the physical infrastructure supporting AI, has risen from roughly \$180 billion at the end of 2023 to nearly \$490 billion today, making AI infrastructure a significant driver of business investment.

The second impact is the stock market. Technology stocks now account for nearly 40% of the S&P 500, up from about 34% at the end of 2025. As that share has increased, the index has become more sensitive to the performance of this sector. As a result, strong AI-related earnings and stock gains can have an outsized influence on the broader index.

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The third impact relates to financing. Major U.S. tech companies remain highly profitable, but the scale of their AI investment programs has grown significantly. An increasing number of these companies are using the bond market to help finance their infrastructure buildout. The group historically was more balanced in issuing and reducing debt, but there has been a significant jump in new debt issuance this year. The main takeaway is that AI's influence is no longer limited to business investment and the stock market; the scale of the buildout is also driving a surge in bond issuance and reshaping the broader capital markets.

As a result, AI has now moved beyond a narrow technology theme. This infrastructure buildout is supporting business investment, drawing on the bond market for financing, and carrying increasing weight in the stock market. We believe its growing scale means AI is now influencing several parts of the economy and financial markets at the same time.

Equity Market Recap – Market Leadership Narrows Late in the Third Quarter as Interest Rates Rise

The S&P 500 finished the third quarter higher and set a new all-time high, but the quarter was marked by an uneven return path and growing divergence beneath the index. Stocks faced some pressure early in the quarter before rebounding in August, when the Russell 2000, Dow Jones, and equal-weight S&P 500 each set new highs. From there, leadership narrowed as larger companies outperformed smaller ones into quarter-end.

The timing suggests rising interest rates contributed to the return divergence across markets, as smaller companies tend to be more sensitive to borrowing costs.

The S&P 500 finished the quarter with a 2.3% gain, compared with a 0.6% rise in the Nasdaq 100, a 1.5% decline for the Dow Jones Industrial Average, and a 6.9% drop in the Russell 2000. Most of the performance gap developed during the second half of the quarter, which overlapped with a sharp rise in Treasury yields. The timing suggests rising interest rates contributed to the return divergence across markets, as smaller companies tend to be more sensitive to borrowing costs.

Sector performance reflected many of the quarter's primary themes. Four of the eleven S&P 500 sectors outperformed the broad index, signaling narrow breadth.



Energy was the top-performing sector with a 17.2% gain as oil climbed from around \$70 per barrel in early July to more than \$100 by mid-September. Energy's outperformance was a reversal from the second quarter, when it was the worst-performing sector as oil prices fell.

Technology was the second-best performing sector and gained 7.2%, followed by Health Care at 6.5% and Communication Services at 3.6%. In contrast, Utilities fell 12.4% as interest rates increased, while Industrials fell 9.7% and Real Estate declined 5.6%.

International markets were relatively muted after their gains in the first half of the year. Developed and emerging market stocks each finished the quarter within 1% of where they started, with developed modestly outperforming emerging. Both international regions are up year-to-date despite ending the quarter flat and are still outperforming the S&P 500 over the past 12 months.

Bond Market Recap – Rising Interest Rates Weigh on Bond Prices and Fixed Income Portfolios

The third quarter was challenging for bonds as Treasury yields surged higher. Yields increased across the yield curve, with the 5-year, 7-year, and 10-year Treasury yields each rising more than 0.80% and the 30-year yield increased nearly 0.70%. Longer-maturity bonds underperformed because of their higher sensitivity to changes in interest rates, while shorter-maturity Treasuries held up better on a relative basis despite trading lower.

Corporate bonds also came under pressure due to rising yields, although they outperformed government bonds. High-yield bonds declined 1.8% compared to investment-grade's 3.7% decline, the latter being impacted more by rising rates due to longer maturities. For most of the quarter, the primary headwind was increasing interest rates rather than weakening credit conditions. Investment-grade and broad high-yield spreads remained relatively stable and tight by historical standards, suggesting investors were still comfortable with corporate fundamentals even as borrowing costs increased.

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The clearest sign of caution appeared at the lowest-quality end of the high-yield bond market. Spreads on CCC-rated bonds, which are the lowest-rated high-yield bonds, widened even as spreads on higher-quality high-yield bonds held steady. We believe the trend indicates investors started demanding more compensation to hold the debt of financially weaker borrowers.

While broader high-yield spreads were comparatively calm for most of third quarter, they also started to widen in late September. The move suggests the market became more selective as the quarter progressed, with the impact of higher financing costs showing up first among the most sensitive borrowers.

What We are Watching in the Fourth Quarter

Economic growth and corporate earnings remain strong heading into the fourth quarter, even as higher oil prices and interest rates have created a mixed and volatile backdrop. One of the main questions heading into the end of the year is whether the underlying strength continues as households and businesses adjust to higher borrowing costs, persistent inflation pressure, and continued uncertainty around energy prices.

The economy has handled those pressures relatively well thus far. Consumers continue to spend, businesses keep investing, and unemployment has remained low. This has helped support economic growth even as interest rates and borrowing costs have risen. The coming months will provide a clearer read on whether the momentum continues, particularly economic data that tracks consumer spending, hiring, and business investment.

Corporate earnings will be another important source of information. Profit growth has been strong over the past year and provided fundamental support to the market amidst a volatile macro-backdrop.

Third quarter earnings season, which begins this month, will provide an updated look at how companies are managing higher interest rates, changing input costs, and continued investment while maintaining revenue and profit growth.

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Higher Rates and the Housing Market

The bond market continues to send an important message. Higher longer-term interest rates have translated into higher borrowing costs throughout the economy, and nowhere is that more visible to consumers than in the housing market.

Mortgage rates are heavily influenced by longer-term interest rates and the mortgage-backed securities market. When those yields move higher, mortgage rates typically follow. The Federal Reserve noted earlier this year that yields on agency mortgage-backed securities, an important component in the pricing of home mortgages, had moved higher along with broader long-term borrowing costs.

The challenge is that housing affordability is already stretched by the significant increase in home prices over the past several years. Higher mortgage rates could compound this problem.

A relatively small increase in the mortgage rate can translate into a meaningful increase in a buyer's monthly payment. This reduces purchasing power, makes it more difficult for first-time buyers to enter the market, and can cause existing homeowners to postpone moving because they do not want to give up a substantially lower mortgage rate on their current home.

The result can be fewer transactions and slower home sales.

We believe this is important because housing does not operate in isolation. Home purchases create economic activity well beyond the actual transaction. Buyers purchase furniture, appliances, flooring and other household goods. They hire contractors, painters, landscapers, movers and other service providers. Real estate agents, mortgage companies, title companies and homebuilders all benefit from a healthy level of housing activity.

If higher mortgage rates cause housing activity to slow further, some of that economic activity can slow with it.

We are not suggesting that weakness in housing automatically leads to a recession. We do recognize, however, that housing is one of the important sectors where higher interest rates can eventually slow the economy. We will continue to pay close

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attention to mortgage rates, existing and new home sales, housing starts, affordability and home prices as we move through the fourth quarter.

Watching the Corporate Bond Market for Signs of Stress

Another area we will continue to watch very closely is the corporate bond market, particularly credit spreads.

Credit spreads measure the additional yield investors demand to own corporate debt instead of comparable U.S. Treasury securities. They provide an important real-time indication of how the bond market views economic and financial risk.

When investors are confident about economic growth and corporate balance sheets, spreads tend to remain relatively tight. When investors become concerned about deteriorating credit quality, defaults, liquidity or the economic outlook, they typically demand greater compensation for taking credit risk, and spreads widen.

Throughout the second quarter, spreads have not been flashing a warning signal. The Federal Reserve reported that corporate bond spreads remained low by historical standards earlier this year, even as overall corporate borrowing costs increased.

This is encouraging, but it is also something we will continue to watch.

Higher interest rates can take time to affect corporate borrowers. Companies that borrowed at very low rates several years ago eventually must refinance that debt. For weaker companies, refinancing at significantly higher interest rates can pressure cash flow, profitability and ultimately credit quality.

This is why we will be watching both investment-grade and high-yield credit spreads, along with default trends and conditions in leveraged loans and private credit. We will be particularly interested in whether spreads begin widening meaningfully and persistently, rather than simply reacting to short-term market volatility.

Credit markets have historically been an important place to look for signs of financial stress. Problems do not always begin in the stock market. Often, the bond

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market recognizes deteriorating conditions first.

We believe the AI investment cycle will remain an important part of the discussion as well. Spending on data centers, computing equipment, and related infrastructure continues to support business investment, while large technology companies are increasingly using the bond market to help finance the buildout. As the cycle matures, the focus is likely to broaden from how much is being spent to what that investment is producing in revenue, profits, and productivity.

Keeping Perspective

As we enter the fourth quarter, it's important to reflect on just how much investors and the markets have already had to absorb this year.

Markets have navigated persistent inflation, an interest rate hike, a significant increase in longer-term interest rates, higher mortgage and borrowing costs, sharply higher energy prices, uncertainty surrounding trade and fiscal policy, and significant geopolitical risks around the world. At various points throughout the year, any one of these issues could have been viewed as a reason for investors to sell stocks.

And yet, the markets have continued to demonstrate remarkable resilience.

That does not mean these risks have disappeared, nor does it mean investors should become complacent. In fact, we believe the opposite is true. Higher interest rates are beginning to work their way through the economy, inflation remains above where policymakers would like it to be, geopolitical risks remain elevated, and financial conditions are considerably different than they were during the era of near-zero interest rates.

At the same time, the economy has continued to grow, consumers have remained relatively resilient, corporate earnings have generally held up, and businesses continue to invest, particularly in technology, artificial intelligence and productivity-enhancing initiatives.

Our approach heading into the fourth quarter remains balanced. We don't believe this is a time to become overly defensive simply because risks exist, but we also don't

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believe it is a time to ignore those risks or become greedy after a period of strong market performance.

We will continue watching for indication that the underlying environment is beginning to change by reviewing interest rates, inflation, housing, corporate earnings and, particularly, credit spreads across the corporate bond market.

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We will continue to keep you updated and are available at your convenience if you have questions.

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S&P 500 Index is a capitalization-weighted index calculated on a total return basis with dividends reinvested. The index includes 500 widely held U.S. market industrial, utility, transportation and financial companies.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

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