

As we begin the final quarter of 2026, equity markets remain elevated relative to fundamentals. We continue to observe a divergence between value and growth stocks, with leadership shifting between the two, similar to last year. Value stocks took the lead at the beginning of 2026, only to relinquish their position to growth stocks, particularly within the technology sector.

The primary catalysts driving equity markets remain unchanged, including continued AI spending and attractive growth rates in corporate revenue and earnings. However, fundamental growth expectations for non-technology companies are increasingly under scrutiny. Higher interest rates can place downward pressure on stock prices due to the potential for a slowing economy and increased competition from yields available on the 10-year U.S. Treasury.

Geopolitical risks remain a consistent concern, particularly their contribution to inflationary pressures. While much of the attention remains focused on oil prices and the cost of gasoline, the broader economic impact extends well beyond the pump. Elevated transportation costs continue to contribute to persistent inflation, particularly in grocery prices and other everyday expenses.

As we have previously discussed, certain inflationary factors cannot be effectively managed through higher interest rates alone. The combination of a slowing economy and persistently elevated prices does not bode well for equity markets in the near term, particularly if concerns emerge regarding a potential slowdown in AI spending.

Our focus is increasingly shifting toward interest rates, as the other variables continue to play their respective roles in equity market valuations. While we did not believe an additional rate increase was necessary, the Federal Reserve's decision reinforced the importance of maintaining its independence, particularly following the recent transition from Jerome Powell to Kevin Warsh as Chairman.

Despite pressure from the White House for lower interest rates, we believe maintaining rates, or implementing only a modest increase, was the more appropriate course of action. Premature rate reductions could further support higher prices, as additional purchasing power may ultimately be absorbed by persistent inflation. This risks prolonging the difficult combination of slower economic growth and elevated prices.

Another factor increasingly entering the discussion surrounding interest rates is the record level of U.S. government debt. While excessive debt is generally viewed as a concern, the implications for interest rates extend beyond the amount outstanding. Investors must recognize that determining an acceptable yield involves several components, including a risk-free rate and an additional premium to compensate for perceived risk.

Viewing the U.S. government as a business entity, rising debt levels could become another factor driving higher yields on the 10-year Treasury, reflecting perceived risk rather than inflation alone. This also raises questions about the possibility of certain corporate debt eventually being viewed as less risky than government debt.

As always, we encourage you to contact your advisor with any questions regarding your investment portfolio, financial plan, or the implications of changing market conditions. Thank you for your continued confidence and trust.