



MONTHLY MARKET PULSE – OCTOBER 2026

HIGHLIGHTS

- ▶ **Interest Rates Rise:** Yields rose significantly in September, with the 10-year Treasury climbing more than 50 basis points as investors weighed the implications of a resilient economy, sticky inflation, monetary policy, and fiscal deficits.
- ▶ **Beneath the Surface:** Despite the S&P 500 declining just 0.3% in September, weakness beneath the surface was more pronounced, with several sectors falling more than 5% as investors priced in the effects of higher interest rates.
- ▶ **Rate Hike:** The Federal Reserve (Fed) raised rates by 25 basis points last month in an effort to curb further inflation. In this month's *Spotlight*, we examine how the current cycle may be both similar to and different from past hiking cycles.

MACRO INSIGHTS

Strong Earnings Mask a Tougher Market

WHAT HAPPENED

The stock market appeared remarkably resilient in the face of higher interest rates and continued geopolitical uncertainty. The S&P 500 declined just 0.3% in September and remains near record levels despite the Fed raising interest rates, the 10-year Treasury yield reaching 5.3%, and oil remaining above \$100 per barrel. That resilience has raised an increasingly common question: **Why doesn't the stock market seem to care about the bad news?**

Look beneath the major indexes, however, and the market is reacting. The equal-weighted S&P 500 fell 5.2% in September and the Russell 2000 declined 5.4%, while Financials, Materials, Real Estate, Utilities, and Consumer Discretionary all fell more than 5%. Technology and Communication Services were the only sectors to advance. The result was an unusually wide gap between the performance of the headline S&P 500 and the experience of the average stock.

Higher interest rates are also being reflected in valuations. The S&P 500 began the year trading at roughly 22 times forward earnings and now trades closer to 19 times. That contraction is consistent with a higher-rate environment: as the return available on bonds rises, investors generally require a higher expected return, and therefore a lower valuation, from equities.

What has prevented that valuation adjustment from producing a larger decline in the S&P 500 has been **exceptional corporate profit growth**. Earnings have grown faster than valuation multiples have contracted, allowing the index to remain resilient even as investors pay less for each dollar of expected earnings. That strength has been particularly pronounced among many of the large technology and AI-related companies that carry significant weights in capitalization-weighted indexes.

Economic data remained firm while the Fed tightened policy. The Fed raised its target rate by 25 basis points, while stronger employment, consumer spending, and business activity reinforced expectations that monetary policy could remain restrictive. Treasury yields moved sharply higher as a result, creating additional pressure on rate-sensitive portions of the economy and financial markets.

WHAT IT MEANS

The market's apparent indifference to higher rates and other risks is therefore somewhat misleading. **Investors are responding—they are simply doing so through lower valuations and greater differentiation rather than a broad decline in the major indexes.** The average stock has weakened considerably, smaller companies have struggled, and rate-sensitive sectors have borne much of the adjustment.

At the index level, however, earnings growth has so far outrun

multiple compression. This distinction is important. A market supported by rising valuations requires investors to continually become more optimistic about the future. A market supported by earnings growth has a fundamentally different foundation. Despite significant multiple compression this year, strong corporate profits have allowed the S&P 500 to remain resilient.

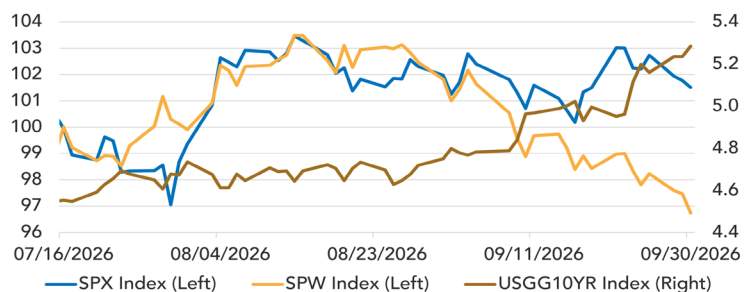
That does not make higher interest rates irrelevant. The higher the risk-free rate moves, the greater the hurdle for equity valuations and capital investment. And the effects are uneven: housing, smaller businesses, leveraged companies, and other capital-intensive areas are considerably more sensitive to borrowing costs than large technology companies that fund AI investment through substantial internal cash generation and for which the **perceived opportunity for growth has so far overwhelmed concerns about the cost of financing it.**

That asymmetry complicates the Fed's task. Inflation remains above target, but some current pressures reflect energy prices and supply constraints rather than excessive economy-wide demand. **This month's *Spotlight* examines whether additional monetary restraint is likely to address those sources of inflation—or primarily increase pressure on the portions of the economy already most sensitive to higher rates.**

We remain constructive toward equities, while recognizing that the environment has become more demanding. **Strong earnings growth continues to provide fundamental support, but higher interest rates are lowering valuations and increasing dispersion across companies and sectors.** September demonstrated that the market does care about higher rates—the impact is simply more visible beneath the surface than in the headline index.

The Market Is Reacting to Higher Rates

As rates have risen, the equal-weighted S&P 500 (SPW) has declined sharply, while the market-cap-weighted S&P 500 (SPX) has been supported by the fundamentals of the AI trade.



Sources: U.S. Department of the Treasury and Macrobond.

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WHAT TO WATCH

With the Fed initiating a hiking cycle due to stubborn inflation, incoming data around price stability will be a primary focus for investors. Consumer spending remains resilient, but higher prices appear to be putting pressure on spending, warranting continued monitoring. Headlines surrounding the conflict in the Middle East will continue to create volatility in energy markets.

- ▶ Following the decision to hike in September, the next Federal Open Market Committee (FOMC) decision will be announced on October 28. The market is currently pricing in a roughly 35% chance of a rate hike.
- ▶ Inflation releases are likely to coincide with elevated market volatility. The Consumer Price Index (CPI) will be in focus on October 14, followed by the Producer Price Index (PPI) on October 15. The Personal Consumption Expenditures (PCE) Price Index will be released on October 29.
- ▶ October 15 will provide further insight into the consumer with the release of retail sales data.

MONTHLY SPOTLIGHT



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The Fed Is Hiking Again—Is This Cycle Different?

The Fed raised the policy rate by 25 basis points in September, its first hike since 2023. Historically, an initial rate hike has often been followed by a series of additional tightening. However, the backdrop for this round of tightening is different from most hiking cycles. That leaves us asking two related questions: *Will this time be different, and what are we watching?*

The Fed's decision to raise rates reflects inflation that has remained above its 2% target for too long, while economic growth and the labor market remain solid. Elevated energy prices and other supply-side pressures create additional uncertainty around the inflation outlook, while resilient consumer spending and robust capital investment, including the AI buildout, continue to support demand.

This backdrop suggests monetary policy may need to remain restrictive and become somewhat more so to bring inflation back toward 2% in a timely manner. What makes this cycle unusual, however, is the Fed's starting point. Unlike many hiking cycles of the past 40 years, policy was not clearly accommodative when tightening began. The Fed is therefore not moving rapidly from easy to restrictive policy, but rather recalibrating from a level already near neutral or modestly restrictive.

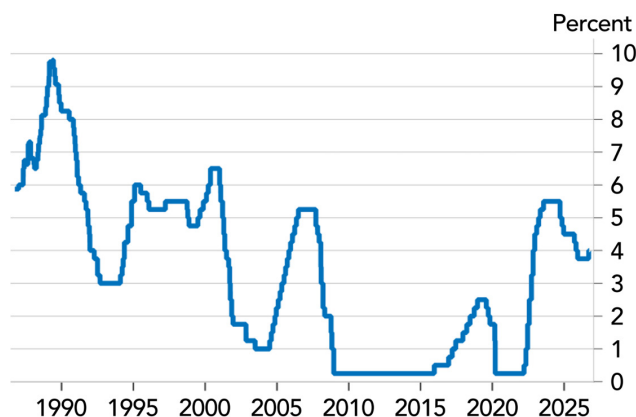
Inflation has remained elevated partly due to a series of supply shocks over recent years, most recently the ongoing conflict in the Middle East. Higher energy prices have a clear impact on headline inflation, but the magnitude and persistence of their effect on core inflation are more difficult to judge. The Fed's traditional playbook is to look through supply shocks because one-time price increases do not necessarily generate sustained inflation. Recently, however, this line of reasoning has been called into question by several Fed participants. Given the recent strength of the economy and recurring supply shocks, the Fed is becoming more concerned that there will be a sustained impact on inflation. Upcoming inflation data will therefore be critical in determining how far the Fed will raise rates.

At the same time, the economy has proven relatively insulated from higher rates. The job market continues to grow despite recent headwinds. Consumer and business spending remain solid, providing a foundation for continued growth. Many households and corporations locked in low borrowing costs before rates rose, while healthy balance sheets have further reduced near-term sensitivity to monetary policy. Whether this recent economic momentum continues will also factor into the ultimate path of Fed policy. Strong growth will give the Fed confidence that the economy can withstand higher interest rates as it seeks to bring inflation back to target.

In our judgment, this cycle may ultimately look more like a mid-cycle recalibration and somewhat different from the past few hiking cycles. While inflation remains above target, underlying inflation has not shown clear signs of renewed acceleration, and we expect economic growth to settle near its longer-term trend of roughly 2%. Against this backdrop, we think the Fed will hike more slowly than the market currently expects, giving policymakers more time to assess incoming data as they navigate this challenging environment.

Chart sources: Bloomberg and Macrobond.

FED FUNDS TARGET RATE



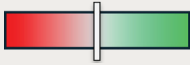
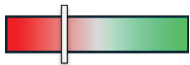
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CURRENT OUTLOOK

TOPIC	VIEW	MoM CHANGE	COMMENTARY
MACROECONOMIC VIEWS			
Economic Growth		–	▶ Growth expectations for 2026 are for roughly trend growth (~2%) as capital expenditures rise and stable consumer spending contribute to economic expansion. The conflict in the Middle East continues to create volatility in energy markets, causing uncertainty for investors and consumers. ▶ Job growth and jobless claims remain steady, keeping the unemployment rate largely range bound. ▶ Risks remain elevated amid geopolitical tensions, sticky inflation, and uncertainty surrounding both monetary and trade policy.
Inflation		–	▶ Market expectations suggest that inflation will remain above 3% until early 2027. In addition to elevated energy prices and AI-driven pressures, economic activity remains resilient enough to keep inflation risks elevated. ▶ Core PCE inflation is running at 3.0% year-over-year, following methodology changes. Goods inflation should moderate if oil prices ease, but service inflation has remained relatively firm, held up by shelter and transportation. ▶ Tariffs continue to be an active part of the administration's foreign policy, with potential implications for consumer prices. In July, the administration announced new tariffs under Section 301 to re-establish some of the tariffs struck down by the Supreme Court.
Monetary Policy		–	▶ The FOMC raised the policy rate by 25 basis points at the September meeting. Investors expect this to be the first in a series of interest rate hikes. Current market pricing implies three to four additional hikes through the first half of 2027. ▶ The Committee remains focused on achieving price stability in a timely manner as the economy continues to grow and the labor market remains stable.
Fiscal Policy		–	▶ Accommodative tax policy is providing support to households, as tax refunds delivered a one-time income boost during the first half of the year, while lower withholding taxes should help sustain spending. ▶ Capital expenditure plans continue to underpin growth, aided by accelerated depreciation. ▶ Flexibility within fiscal policy remains low, as federal debt levels continue to increase and higher interest costs consume a larger portion of government outlays. The Congressional Budget Office (CBO) projects the federal deficit to remain above 5% of GDP over the next several years.
MARKET VALUATIONS			
Rates		–	▶ Interest rates rose aggressively during September, and rate volatility remained elevated given concerns over fiscal deficits, hyperscaler issuance, and uncertainty surrounding monetary policy. The curve flattened as the short end rose more aggressively than the longer end. The 10-year Treasury ended around 5.3%. ▶ We anticipate that the expected path of policy rates will continue to shift with new information related to the Iran conflict, FOMC communication, and inflation data. ▶ Intermediate- and long-term rates are toward the higher end of our fair-value range, resulting in a modest duration bias at current levels.
Credit		–	▶ Credit spreads widened modestly during the month but remain at levels that are expensive relative to historical averages. ▶ We believe the risk-reward is skewed to the downside, although strong corporate fundamentals should help support spreads. ▶ Investment Grade (IG) spreads (10-year BBB industrials) widened modestly and ended the month at their 16th percentile. High Yield spreads (single-B corporates) widened more significantly, ending at their 13th percentile since the 1990s.
Equity		–	▶ The S&P 500 ended September down a modest 0.3% as investors grappled with higher interest rates and the first Fed rate hike since 2023. The index is still up 12.7% YTD, with earnings growth expected to exceed 30% for the year. ▶ Market leadership narrowed during the third quarter after broadening earlier in the year. The capitalization-weighted S&P 500 moved back ahead of the equal-weighted index on a year-to-date basis in September, as mega-cap stocks regained leadership and higher interest rates weighed more heavily on the broader market. ▶ Equity valuations for the S&P 500 remain moderately above historical averages at 19x forward earnings. Market fundamentals remain healthy, and we expect returns in 2026 to be driven primarily by earnings growth.

MARKET DATA & PERFORMANCE | AS OF 09/30/2026

U.S. SNAPSHOT	CURRENT	6 MONTHS PRIOR	1 YEAR PRIOR
Core Inflation (YoY)	3.0	3.1	2.8
Unemployment Rate	4.1	4.3	4.4
Real GDP (YoY)	2.2	2.6	2.6
Retail Sales (YoY)	5.4	3.6	3.8
30-Year Mortgage Rate	7.0	6.4	6.3
10-Year Treasury Yield	5.3	4.3	4.2
US Corporate IG Yield	6.0	5.1	4.8
US Corporate HY Yield	8.4	7.4	6.7

TOTAL RETURNS

ASSET CLASS	MTD	QTD	YTD	1 YEAR	3 YEARS*	5 YEARS*
EQUITY						
Russell 3000 Index	-0.8%	1.4%	12.4%	15.1%	22.3%	12.6%
S&P 500 Index	-0.3%	2.3%	12.7%	15.7%	22.9%	13.8%
S&P MidCap 400 Index	-4.2%	-6.4%	9.9%	11.7%	14.5%	8.0%
Russell 2000 Index	-5.4%	-7.2%	13.7%	16.2%	17.7%	6.3%
MSCI World Index	-1.2%	2.0%	12.1%	15.7%	21.9%	12.4%
MSCI World ex USA Index	-3.2%	1.0%	10.6%	16.5%	19.5%	10.2%
FIXED INCOME						
Bloomberg US Aggregate Index	-2.6%	-3.5%	-2.9%	-1.8%	4.1%	-0.6%
US Corporate Investment Grade	-2.7%	-3.8%	-3.0%	-2.2%	4.9%	-0.4%
US Corporate High Yield	-2.5%	-1.8%	0.1%	1.4%	8.0%	3.6%
Emerging Market Debt	-3.4%	-4.2%	-2.0%	1.5%	9.3%	1.7%
US Treasury (7–10 Year)	-3.3%	-4.7%	-4.8%	-3.9%	2.8%	-1.8%
Cash	0.3%	0.9%	2.8%	3.8%	4.6%	3.8%

Source: Fort Washington and Bloomberg. *Returns for periods greater than one year are annualized. Past performance is not indicative of future results.

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