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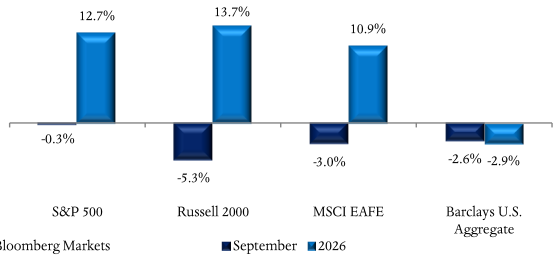
September - October 2026 Issue # 281

Markets

September's modest decline in the major equity benchmarks concealed a more pronounced deterioration beneath the surface, driven by higher interest rates. The S&P 500 index slipped -0.3% last month (+2.3% in the third quarter; +12.7% ytd), supported by a narrow group of large technology companies. Meanwhile nearly 80% of constituents declined, the average stock fell -5%, and 83% now trade more than 10% below their 52-week highs. Only technology (+4.5%) and communication services (+4.3%) advanced, and the Dow Jones Industrial Average (-4.1%) posted its weakest month since March. Small-caps in the Russell 2000 index fell -5.3% for the month (-7.2% in the quarter; +13.7% ytd), weighed down by their dependence on rising borrowing costs. From a style factor perspective, large-cap growth regained leadership in September, though value outperformed over the quarter. Notably, the distinction between the performance of the index and that of the typical stock has become increasingly important.

Foreign stocks, as measured by the MSCI EAFE index, declined -3.0% (+0.9% in the quarter; +10.9% ytd), with a firmer US Dollar reversing an earlier tailwind. Europe's Stoxx 600 fell -2.4% (-0.6% in the quarter; +10.2% ytd), ending five consecutive monthly gains amid an ECB rate hike and French fiscal stress. Japan's Nikkei 225 advanced +1.3%, on a month-end AI rebound, though this only partially repaired July's technology-led correction (-4.1% in the quarter; +34.6% ytd). Across emerging Asia, tech-heavy Taiwan (+3.9%) outperformed while India (-6.0%) lagged. The Shanghai Composite declined -3.4% (-5.3% in the quarter; -1.4% ytd), as strength in export-oriented technology businesses continued to contrast with weak domestic demand.

Fixed income markets delivered the quarter's more consequential message to investors. The 10-year US Treasury yield rose more than 50 basis points in September to 5.29%, while the 30-year yield reached 5.62%, levels not seen since 2007 and 2002, respectively. Persistent inflation, renewed monetary tightening and competition between government and corporate borrowers all contributed. The Federal Reserve raised rates for the first time since July 2023 leading the Bloomberg US Aggregate index down -2.6% (-3.5% in the quarter; -2.9% ytd). Investment-grade spreads held near 85 basis points while high yield spreads widened to roughly 314 basis points as heavy AI-related bond issuance made investors more selective. The US Dollar strengthened (DXY +2.0%) and the euro fell -2.5%. The yen was the notable exception (+1.5%) following a Bank of Japan rate hike.



Source: Bloomberg Markets

Energy prices remained hostage to developments in the Middle East. Brent crude briefly exceeded $130 per barrel before retreating toward $98 as supply conditions improved. WTI finished at $90.42, up +5.4% in September (+30.1% in the quarter; +57.5% ytd). Gold surrendered part of August's advance, falling -6.6% to $4,156/oz (+3.7% in the quarter; -3.7% ytd), pressured by higher yields and a stronger dollar. Overall, commodities rose +16% for the quarter.

Geopolitics

The US-Iran conflict has settled into a pattern of economic coercion punctuated by periodic military escalation, a state that is likely to last at least until the US midterm elections. Under US Navy escort, Gulf oil flows through the Strait of Hormuz have recovered to 13-14

million barrels per day, about 80% of pre-war levels, while a blockade continues to restrict Iranian exports. Tehran has therefore turned to targeting fixed energy infrastructure, with proxies striking Saudi Arabia's East -West Pipeline, a Hormuz bypass, while the Houthis seized nearly all of Yemen's Red Sea coastline, extending their reach over shipping. As a result, Washington is sending a third carrier strike group to the region, and President Trump has threatened renewed military action soon after its late October arrival.

The US-China trade truce was extended through January 10, 2027, reducing the immediate risk of another tariff escalation. However, the short extension leaves critical minerals, advanced technology and Taiwan unresolved. Elsewhere, elections in Brazil (runoff October 25) and Israel (October 27) carry meaningful implications for alignment with the US.

United States

US economic data points continue to present two distinct pictures. First- and second-quarter GDP growth were revised up to 2.5% and 2.2%, respectively, and the Atlanta Fed is tracking third-quarter growth at 3.7%. Business investment remains an important support, and September's manufacturing PMI of 54.5 indicates continued expansion. Yet last month's nonfarm payrolls rose just 29,000, well below the 84,000 expected, and downward revisions of 60,000 turned July into a loss. Unemployment edged back up to 4.2%, even though the household survey was firmer: participation rose to 61.8% and the broader U-6 rate eased to 7.6%, its lowest since January 2025. Wage growth slowed to 3.0% year-over-year, the lowest since May 2021, leaving real wages negative for a fifth straight month. Gasoline ended the month at $4.38 per gallon (+39% year-over-year), while economically significant diesel and heating oil prices have more than doubled. As a result, consumer confidence slumped to 81.9, its lowest in twelve years, with grocers describing customer shopping as "increasingly based on need."

The Federal Reserve raised its policy rate 25 basis points to 3.75-4.00% in a unanimous vote. Looking ahead, sixteen of 18 policymakers project another hike by year-end, and they do not expect inflation to return to their 2% target until 2029. After the jobs report, markets put the odds of a hold at the Fed's October 27-28 meeting at 82.8%, pushing the next expected hike to December. The monetary policy challenge is becoming more difficult: tighter credit can restrain demand, but cannot restore disrupted energy supplies, while waiting risks allowing inflation to become more persistent.

September 2026 Economic Statistics

	Sep-26	Dec-25	Dec-24
Federal Funds Target Rate	*3.75 - 4.00%*	*3.50 - 3.75%*	*4.25 - 4.50%*
Consumer Confidence Index	*81.9*	*89.1*	*104.7*
Manufacturing PMI Index	*54.5%*	*47.9%*	*49.3%*
Unemployment Rate	*4.2%*	*4.4%*	*4.2%*
JPY / USD	*157.39*	*156.65*	*157.18*
USD / EUR	*1.1328*	*1.1745*	*1.0353*
Gold / oz.	*$4,155.99*	*$4,314.12*	*$2,623.81*
Oil (WTI) / bbl	*$90.42*	*$57.42*	*$71.72*

Sources: see disclosure *

Europe

European economic activity has held up better than the energy backdrop might suggest. September's composite PMI reached its highest level since early 2023, and the European Central Bank raised its 2026 growth forecast modestly to 0.9%. Nevertheless, energy-led inflation prompted a second rate increase this year, lifting the deposit rate to 2.50%. The ECB maintained its inflation projection at 3.0% and emphasized that further monetary policy decisions would depend on incoming data.

France, however, has become the epicenter of European sovereign stress. The 10-year French - German sovereign bond spread widened to 119 basis points, its highest since the euro-area debt crisis. And its five-year credit default swaps have doubled in six months. Ahead of next spring's presidential election, poll leader Marine Le Pen and the populist left are both campaigning on pension rollbacks and expanded spending. The EU's October 15 deadline to resolve its trade disputes with

China also looms.

Asia

The Bank of Japan raised its policy rate to 1.25%, continuing the normalization of monetary conditions. However, the 7-2 vote and limited guidance on subsequent increases suggest that the pace remains open to debate. Higher rates may support the currency, but also increase financing costs for businesses and a heavily indebted government, which is selling its US Treasury investments ($12.8 billion in July after $26.4 billion in June). So is China, whose holdings fell to $618 billion, the lowest since August 2008, with Beijing plowing proceeds into gold. The country's non-monetary imports of the yellow metal reached 1,141 tons in the first eight months, 72% above last year's pace. Meanwhile, China's economy remains split. August exports surged +25% year-over-year on AI-related demand, while consumer prices rose just 0.8% and core inflation held near 1%. Producer prices rose 3.8%, reflecting higher energy and commodity costs rather than broad-based pricing power. On the consumption front, policymakers expanded loan-interest subsidies and extended maximum mortgage terms from 30 to 40 years to stabilize the property market.

Outlook

The fourth quarter begins with a familiar tension, but less room for error. Corporate earnings and business investment remain important supports, while higher financing costs, energy inflation and uneven consumer demand increasingly challenge the durability of that strength.

Earnings growth and forward estimates have outpaced prices, compressing the S&P 500's forward P/E to roughly 19x, in line with its medium-run average, underpinning equities. Going forward, index earnings are likely to be increasingly judged by their breadth, cash conversion and sensitivity to higher costs (ie durability of margins) as opposed to simple aggregate growth.

The AI investment cycle remains central to the health of the US economy. Spending on computing infrastructure is generating substantial revenues for suppliers and stimulating related industrial activity. Looking forward, less expensive AI models look to accelerate corporate adoption and eventually benefit sectors well beyond technology. However, the same price competition that makes AI more useful to customers can weaken the economics of its hyperscale developers. Growing usage does not necessarily translate into adequate returns on the capital committed. Power availability, construction constraints and security requirements add execution risks, while increased borrowing extends exposure beyond equities into credit, infrastructure and private markets. Please reach out to your PWP contact to ask more about our views on AI inference infrastructure.

Rising rates are the more immediate concern. Rapid surges in the 10-year yield have historically preceded financial market turbulence. Recently, yields reversed higher on the day of September's soft jobs report. That suggests fiscal deficits, inflation and competition for capital, rather than growth alone, are driving the long end of the curve. At 400 basis points, the gap between the 10-year Treasury yield and the S&P 500's dividend yield is the widest since the early 2000s, restoring bonds as a credible alternative, yet we maintain our short-duration bias, where coupons drive returns due to poor sovereign fiscal management and lofty debt levels. We favor select floating-rate and higher-yielding corporate credit with solid balance sheets.

We reiterate the case for diversification across asset classes. The traditional 60/40 stock/bond model has again proven vulnerable, with both declining together in September. We continue to recommend high-quality, globally oriented equities which offer reasonable valuations, complemented by hedged strategies and hard assets. Gold's correction toward $4,000 has coincided with accelerating Chinese purchases and a record 45% of central banks planning to add reserves. For longer-duration capital, we continue to find compelling private-market opportunities in AI inference, cybersecurity, water infrastructure and battery storage. Lastly, our proprietary efforts to source direct investments continue to gain traction, with several interesting small and middle-market prospects.

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*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.