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by Yellow Cardinal Advisory Group

MARKET UPDATE
October 31, 2026

Still Waters, Busy Feet

"You see, but you do not observe."

– Arthur Conan Doyle, *A Scandal in Bohemia / The Adventures of Sherlock Holmes* (1891)

Before turning to October's market observations, we wanted to briefly address the volatility that has emerged to begin November.

- While market pullbacks are never comfortable, the most acute areas of weakness have generally been concentrated in the more growth-oriented parts of the domestic equity market — particularly Technology, Consumer Discretionary, and Communication Services.

- In our more active Flagship strategies, we've been more materially underweight these areas given our desire to maintain broader diversification and avoid overreliance on the narrow set of growth leadership that's driven a more concentrated focus in the S&P 500 index. As a result, our Large Cap exposure within these strategies remains more diversified than the S&P 500, with greater exposure to defensive sectors such as Staples, Health Care, and Utilities, along with select cyclical value sectors including Industrials, Financials, Energy, and Materials.

- The broader point is that our positioning has been intentionally balanced. We've wanted clients to participate in equity market upside, but with more diversification than the cap-weighted index and less dependence on the narrow growth-oriented areas where valuations, expectations, and concentration risk have become more elevated.

- Our recommendation remains to stay focused on your long-term objectives, maintain a disciplined and balanced investment approach, and avoid overreacting to short-term volatility. Periods of volatility can be unsettling, but recent market action is also a reminder of why diversification, valuation discipline, and thoughtful portfolio construction remain important.

With that in mind, October's market behavior may have offered an early warning. The index looked relatively calm, but the rotation beneath the surface foreshadowed some of the more direct volatility that ultimately emerged to begin November.

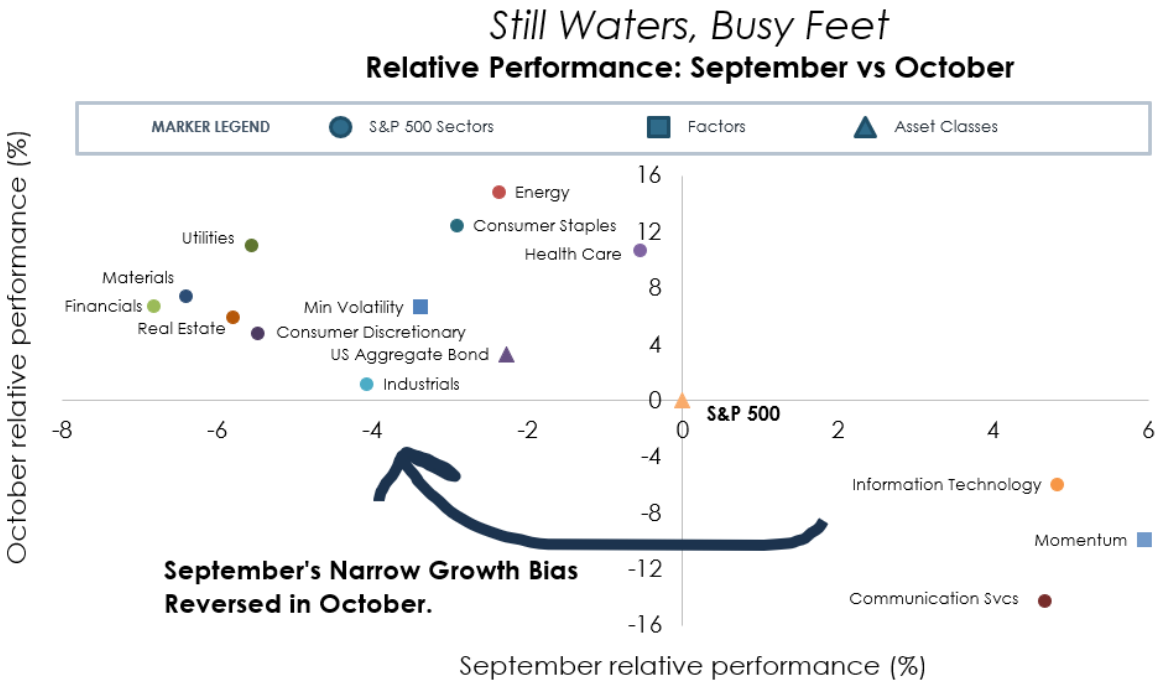
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October was a "still waters, busy feet" market. At the index level, the S&P 500 finished only modestly below recent highs. But beneath the surface, leadership was churning. September's narrow growth bias gave way to a highly rotational environment as investors began to question AI CAPEX, hyperscaler free cash flow, and the durability of earnings growth.

Looking only at the headline index, one could conclude that not much changed. But the underlying leadership tells a different story. The market rotated away from the crowded areas that had led in September and toward more defensive, income-oriented, and stability-focused parts of the market.

The chart below helps illustrate that reversal. In September, leadership was concentrated in growth-oriented areas such as Information Technology, Communication Services, and the Momentum risk factor. In October, many of those same areas lagged, while prior underperformers — including Consumer Staples, Health Care, Utilities, Real Estate, Bonds, and the Minimum Volatility risk factor — improved.

This was not classic cyclical broadening but more of a defensive-led broadening. Staples and Health Care emerged as relative leaders and rate-sensitive assets such as Bonds and REITs benefited from lower yields. That mix is consistent with a market beginning to favor stability as it looks ahead to the possibility of slower growth momentum.



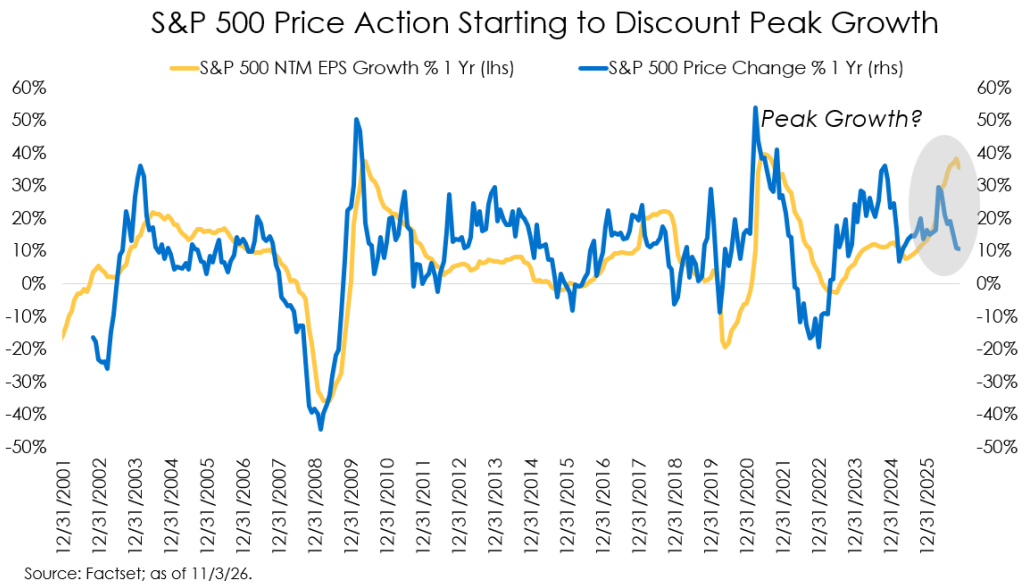
Source: Factset; data points represent performance for the month of September (x-axis) and October (y-axis) relative to the S&P 500 index.

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A key point, however, is that the rotation didn't happen because the economy broke. On the contrary, growth data remained solid. 3Q GDP and CAPEX growth were strong, and consumption remained resilient. However, inflation remained the major risk factor. September inflation data remained elevated and the Fed delivered a hawkish hold that looked more like a skip than a pause. That combination left investors with a more complicated setup: growth is still good, but the hurdle is rising.

The second chart helps explain why October's rotation might have occurred. S&P 500 earnings growth remains exceptional, with 3Q EPS tracking near 30%. Forecasts still point to strong growth through year-end but also suggest the rate of growth may slow toward the mid-teens in 2027. The market may be starting to grapple with that transition.

As shown at right, expected earnings growth has accelerated sharply, but S&P 500 price momentum has begun to fade. That divergence is noteworthy. October's rotation toward stability, income, and cash-flow durability may be an early signal that investors are becoming more focused on peak growth risk.



Source: Factset; as of 11/3/26.

This doesn't mean the earnings backdrop is weak. Far from it. But when expectations are high, "good" may not be enough. Investors may increasingly care whether growth, margins, and free cash flow are still getting better relative to what's already priced in.

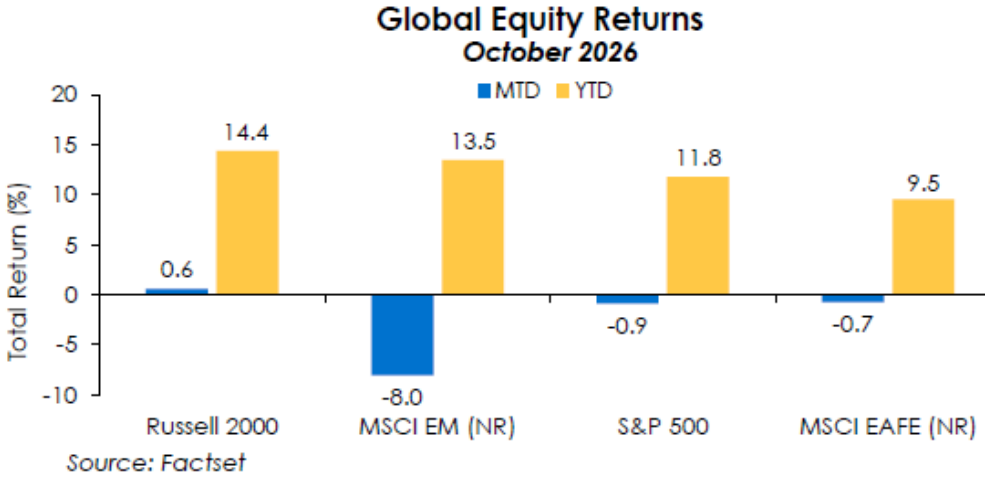
Taken together, October's message was not that investors should abandon growth. Rather, it was that leadership may be shifting as the market prepares for a more mature phase of the cycle. The rotation beneath the surface suggests investors are placing greater value on earnings durability, balance sheet strength, cash-flow visibility, and diversification.

In short, the market looked calm enough on the surface, but the feet were busy underneath.

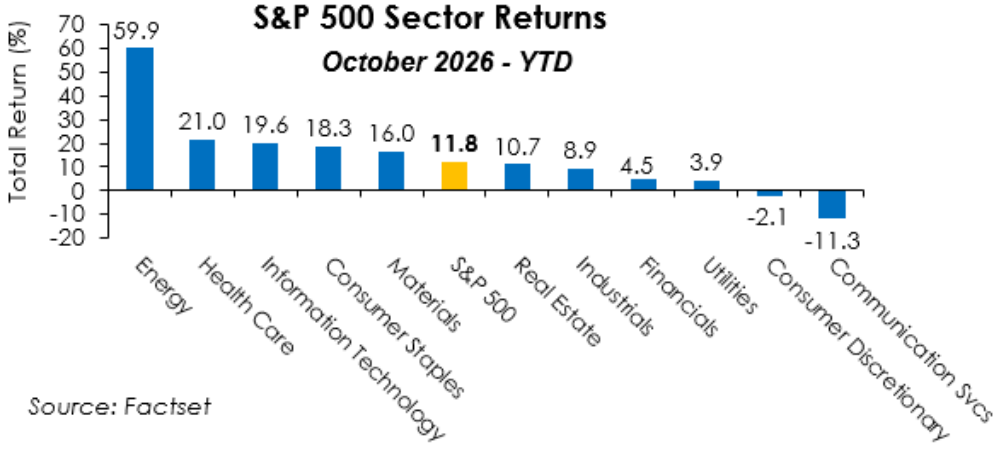
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In a reversal from the year-to-date trend, higher income-producing assets like REITs and Bonds led for the month as higher interest rates provided more competition for stocks and as investors reduced risk. Growth-oriented Stocks were weak as investors questioned the sustainability of AI-related CAPEX spending and its ultimate ROI. Commodities were flat for the month though still lead all asset classes by a wide margin for the year on the back of higher Energy and Agriculture prices.

Stocks



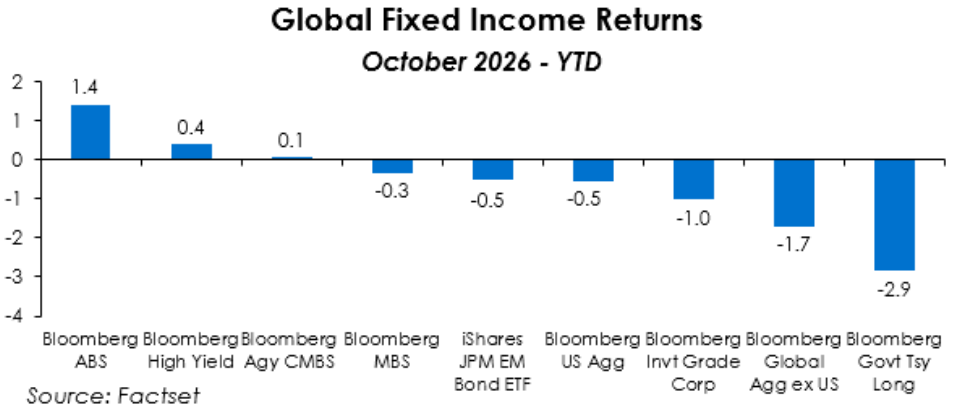
U.S. large caps (S&P 500) posted weak returns for the month as investors scrutinized AI CAPEX spending, declining/negative free cash flow, increasing debt issuance, and the ultimate ROI of the AI buildout. U.S. small caps (Russell 2000) were up modestly in the month as interest rates declined and money rotated out of AI-related stocks. Developed markets (MSCI EAFE) were down modestly in sympathy with the pullback in Technology stocks along with macroeconomic uncertainty. Emerging Markets (MSCI EM) were down sharply due to the AI related sell-off, weakness in Brazil following their presidential elections, and MSCI's proposal to remove Indonesia from the EM index. From a sector perspective, outperformance broadened in October after narrowing significantly in September. Five sectors are now beating the S&P 500 year-to-date while nine of eleven sectors are in positive territory for the year.



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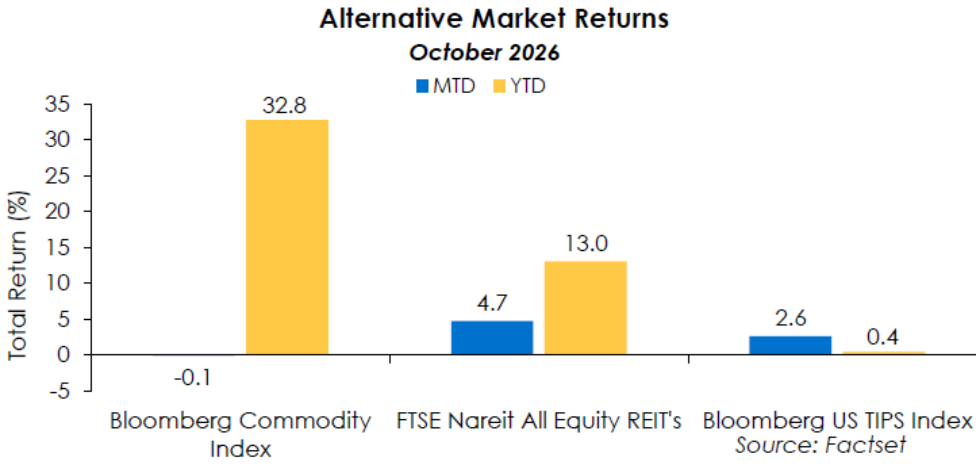
Bonds

Policymakers held rates steady at their October meeting maintaining a range of 3.75%-4.00%. Meanwhile, the bond market is anticipating another two rate hikes by year end '27 – slightly less aggressive than the prior month. So far, new Fed Chair Kevin Warsh has emphasized the Fed's resolve to tame inflation, while indicating a preference for reduced forward guidance to increase policy flexibility. Ultimately, investors viewed October's Fed meeting as a "hawkish hold" with a high likelihood for a December rate hike with one more hike in 2027. Still there remains plenty of uncertainty regarding when and how many rate hikes are likely as economic, geopolitical, and inflation data remain fluid. Due to the drop in interest rates in October, bonds posted positive returns for the month, though returns remain mostly negative for the year. Year-to-date, Asset Backed and High Yield Debt performed best due to their higher starting yields and/or shorter durations. Meanwhile, long-dated U.S. Treasuries have lagged given their more rate sensitivity and with the 10 year Treasury yield higher by about 75 bps from the start of the year.



Alternatives

REITs rallied in October as the decline in interest rates benefited the demand for real estate. Commodities were flat in October, though returns for the year have been exceptional as Energy, Agricultural, and Industrial Metals have all moved higher due to strong demand and supply disruptions. Finally, Treasury Inflation-Protected Securities (TIPS) have marginally outperformed nominal Treasuries amid sticky inflation expectations – which rose earlier in the year followed by weakness in May and June before bottoming out and rising since then.



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Market Outlook

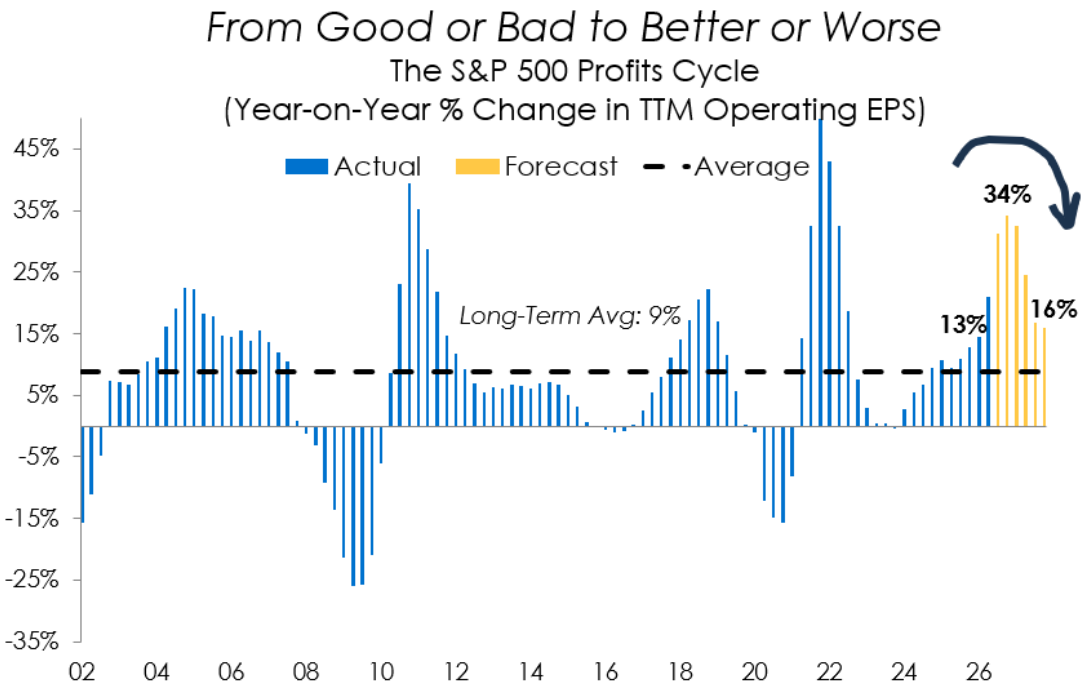
"There is nothing either good or bad, but thinking makes it so."

– William Shakespeare, *Hamlet*

As we begin to look toward 2027, the market discussion may increasingly shift from absolutes to relatives. The question may not simply be whether growth is "good" or "bad," but whether it's getting better or worse. October's rotation suggests that this shift may already be underway. Earnings growth remains exceptional, but leadership has begun to move away from narrow growth areas and toward stability, income, and cash-flow durability.

The earnings backdrop remains strong. As shown in the chart below, S&P 500 operating earnings growth is expected to remain above its long-term average through 2027. However, the rate of improvement appears likely to peak near year-end 2026 before moderating next year. In other words, earnings growth may still be very good, but it may stop getting better.

That distinction matters. When expectations are high, "good" may not be enough. Investors may increasingly care whether growth, margins, and free cash flow are still improving relative to what's already priced in. October's rotation toward defensive and income-oriented areas may be an early sign that the market is beginning to reward durability over momentum. This doesn't require a bearish economic view. It simply means that in a more mature



Source: Factset; S&P 500 Quarterly Operating Earnings from 12/02-6/26 with forecasts from 9/26-12/27. Earnings growth rate annotations are listed for 2025, 2026e and 2027e.

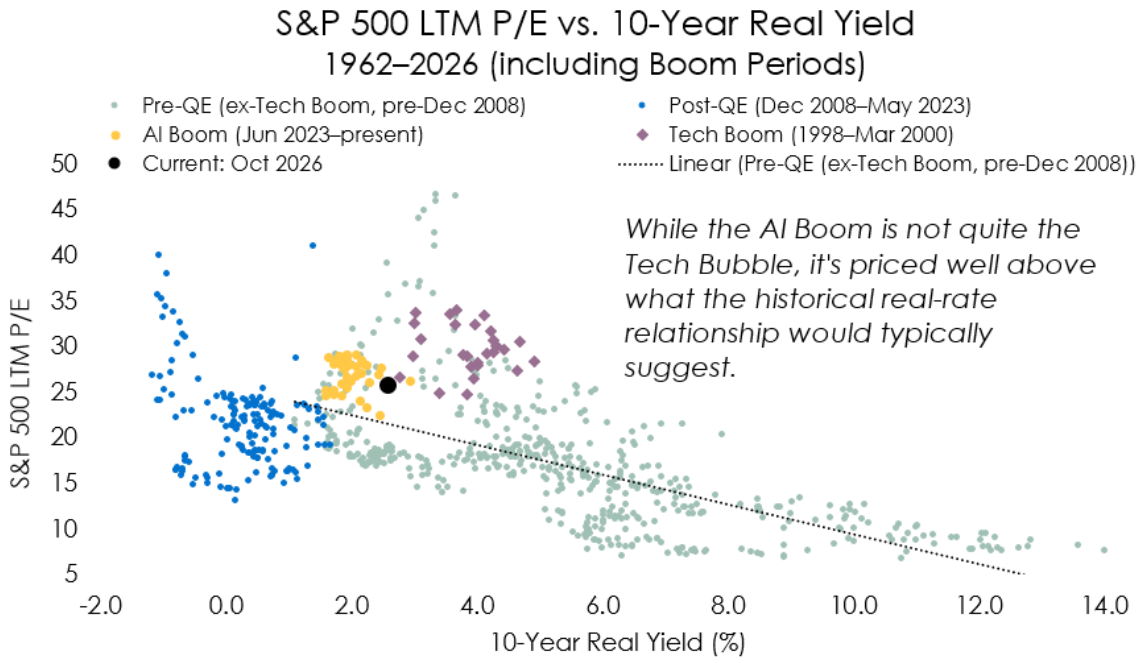
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cycle, the market may reward more of a balance between stability and cyclicality.

Valuation discipline may also become more important as the cycle matures. The recent pullback in yields provided some relief to Bonds, REITs, and other rate-sensitive assets, but it hasn't fully reversed the broader regime shift. Whether lower yields reflect softer forward growth expectations, easing inflation concerns, or some combination of both, the cost of capital remains meaningfully higher than it was during the QE (Quantitative Easing)/ZIRP (Zero Interest Rate Policy) era.

The chart below compares the S&P 500 trailing P/E multiple to the 10-year real yield across different market regimes and boom periods. Historically, higher real yields have generally corresponded with lower equity multiples, as investors demand a higher return to compensate for increased competition from bonds. While the AI Boom is not quite the Tech Bubble, today's market remains priced above what the historical real-rate relationship would typically suggest. That doesn't mean valuations need to correct immediately, but it does mean the hurdle remains higher if earnings growth slows or policy stays restrictive.

AI remains the key swing factor with AI-related earnings and CAPEX spend needed to validate the expectations reflected in (higher) multiples relative to interest rates. Upcoming AI-related IPOs could test sentiment and



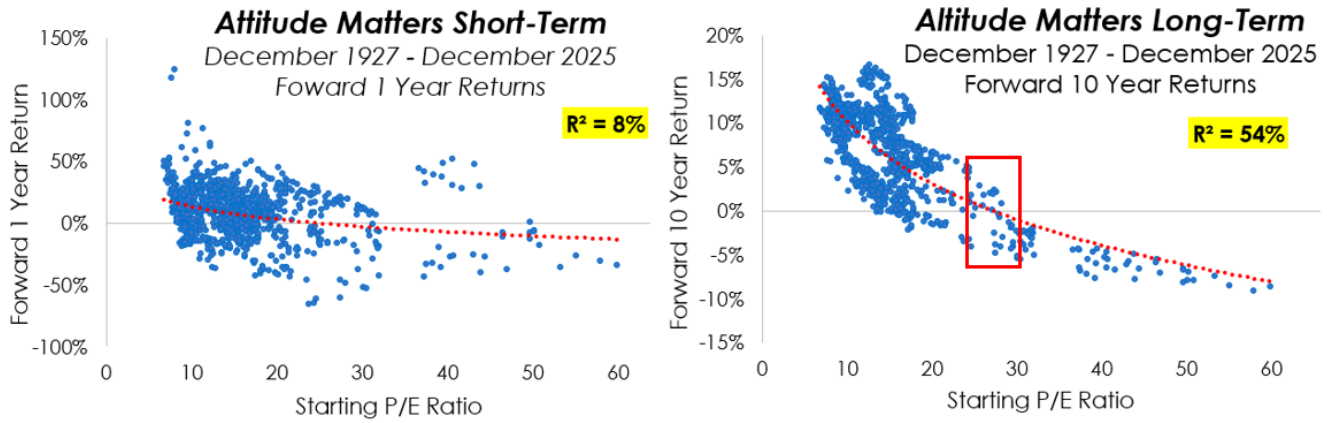
Source: Factset; 10 Year Real Yield based on 10 Year TIPs from 1/03-Current; Real Yield estimated from 12/62-12/02 calculated using regression analysis with 10 Year TIPS as the dependent variable and the price of WTI crude as the independent variable. Pre QE period defined as pre Dec 2008 and Post QE period defined as Dec 2008-May 2023. Boom periods include AI Boom June 2023-Current; Tech Boom Jan 1998-Mar 2000. Robert Shiller used for S&P 500 reported earnings 12/62-11/88. S&P Global used for reported earnings 12/88-12/25. Factset used for reported earnings 1/26-Current. Earnings are reported based on trailing four quarters and smoothed monthly. P/E scale is truncated at 50X and excludes readings from 12/08-9/09.

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influence whether investors may become more focused on normalized earnings durability than the absolute narrative alone.

The midterm results add another layer to the outlook. Decisive Democratic gains and control of both chambers likely point to more gridlock and less sweeping legislative change, but they also suggest a clear shift in voter preferences. Affordability, geopolitical uncertainty, data-center expansion, and governance/transparency concerns all appear to have resonated with voters. For markets, the most relevant implication may be increased scrutiny of AI-related data-center buildouts, particularly around local infrastructure, power demand, permitting, and tax incentives. That could also give Congress more leverage in future fiscal negotiations, including potential reconsideration of favorable expensing treatment for data-center investment. The message is not necessarily anti-growth, but it does suggest some of the fiscal policy tailwinds seen this year are likely to fade.

This also parallels into our strategic frame which requires the discipline to "keep the main thing the main thing". As much as we opine on the factors that influence the shorter term setup, the fact remains that starting valuations tend to be the most influential factor for long-term returns. In short, what you see is what you get. In the past, we've described this as, "Attitude matters in the short run, but Altitude matters in the long run."



Source: PE ratios were calculated monthly based on the value of the S&P 500 and trailing 12-month S&P 500 Normalized Earnings. Normalized Earnings were calculated by determining the constant long-term growth rate that best fit actual S&P 500 earnings. This process is meant to smooth out short term fluctuations in earnings caused by the business cycle. Forward returns are price appreciation only and do not include dividends. Historical S&P 500 data was gathered from Robert Schiller's website (http://www.econ.yale.edu/~shiller/) and Factset.

Please see the charts above for context. In the short run (chart on the left), S&P 500 returns measured over a one-year period have very little to no relationship with the starting price-to-earnings valuation multiple. Investor opinion – driven by a number of factors – can shape popularity for markets and drive short term results that can be both expected and unexpected. However, the chart on the right shows that the S&P 500 returns measured over a longer ten-year period have a much more important relationship with the starting price-to-earnings valuation multiple. We think remembering this concept is an important step to maintaining discipline as a long-term investor.

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So what are the implications and key takeaways for portfolios?

- **When better matters more than good.** As we move toward 2027, investors may care less about whether growth is simply "good" or "bad" and more about whether fundamentals are getting better or worse relative to expectations.
- **Elevated rates raise the bar.** Earnings growth remains strong, but if the rate of improvement moderates while real yields stay elevated, valuation discipline and earnings durability may become more important drivers of returns.
- **Use diversification as a "twofer."** Diversification can provide both risk reduction and upside optionality if market leadership continues to broaden.
- **Be willing to look different.** Long-term discipline may require going against the grain, especially when concentration risk is high.
- **Mind the pendulum.** When leadership becomes crowded and the risk/reward becomes less favorable, reducing exposure to the most concentrated areas can create room for better opportunities elsewhere.

From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance. We remain on the lookout for opportunities to selectively rebalance – taking profits in equities a few times this year as recently as the month prior. In addition to reallocating the proceeds to underweighted areas like bonds and alternatives (where applicable), we also reduced some cyclicality within our large cap stock exposure. See more specific detail below:

Within equities, our positioning incorporates balance geographically and within our US Large Cap exposure especially (away from the top of the market). Our bias has generally been to have more exposure to less expensive areas (down market cap). As such, we've maintained a larger OW in Cyclical Value and Defensive sectors – though recently reducing exposure in the former and increasing exposure in the latter. This is, in part, an acknowledgement of what looks like peak growth in the profit cycle. We remain UW the most concentrated and expensive larger cap Cyclical Growth areas.

Within fixed income, we remain biased toward the higher quality US Core Fixed Income segment – where we're slightly longer in duration for diversification purposes. We've maintained an EW to International Fixed Income, where the end of negative interest rate conditions has led to more attractive opportunities. Maintaining a higher quality bias means that we still remain UW the most expensive part of the bond market – High Yield – where (widening but still) tight spreads have made the risk/reward less attractive in our view.

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Within alternatives, we remain fairly balanced though slightly overweight in Diversified Alternatives. Last year, we adjusted our mix in this area in order to provide greater insurance against market volatility by emphasizing income and short exposure – areas that can benefit from choppy market conditions like what we've experienced episodically this year.

Thanks for giving this a read.

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