

Two Sides of the Same Coin

"The road up and the road down are one and the same."

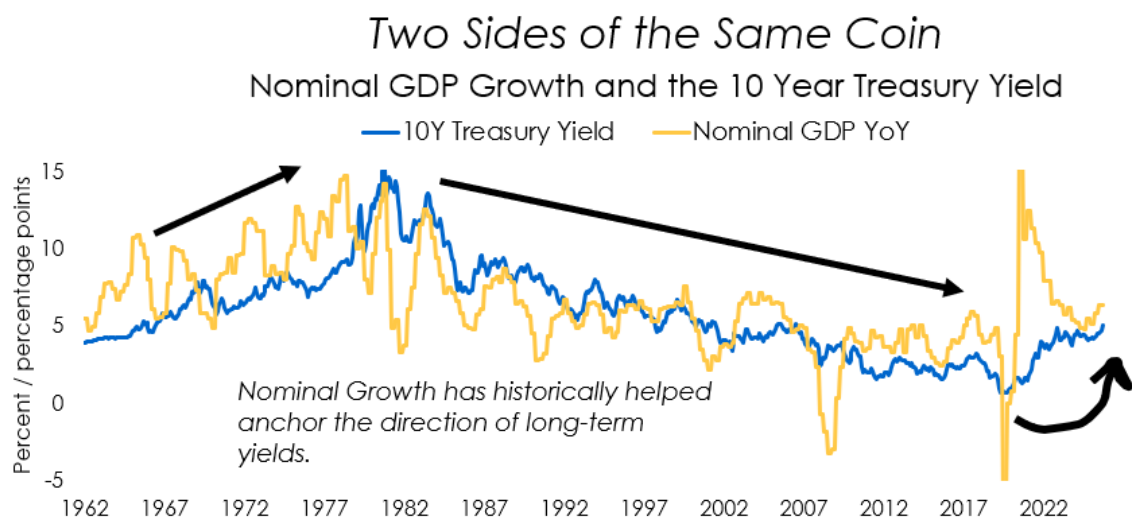
– Heraclitus (pre-Socratic Greek philosopher – 500 BCE)

The old Greek philosopher Heraclitus was not likely contemplating modern-day economics or the relationship between nominal growth and yields, but his idea still applies.

In markets, the same force that lifts one side of the scale can create pressure on the other. September was a good example: strong nominal growth continued to support AI-related CAPEX, resilient consumption, and earnings, but it also pushed yields higher, kept the Fed hawkish, and narrowed market leadership.

The long end of the curve reflected that tension. As can be seen in the chart, the 10-year Treasury yield has historically tended to follow the direction of nominal GDP growth. During the secular rise in yields from the 1960s to the early 1980s, nominal GDP had the effect of helping to pull yields higher along with it. That same effect worked in reverse from the 1980s until COVID in 2020.

This relationship matters today because the same nominal growth that supports revenues and earnings currently can also raise the hurdle rate for valuations. September's stronger growth data, elevated crude prices, sticky inflation, deficit concerns, and a weak Treasury auction all helped push yields higher. The result was a more



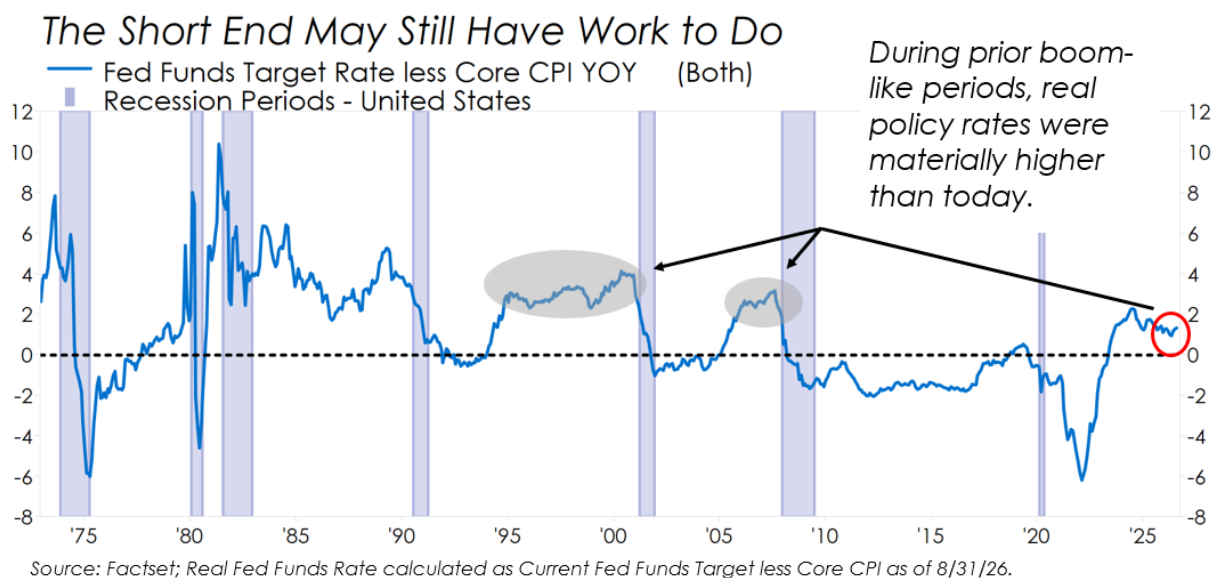
Source: Factset; Data using monthly observations December 1962-September 2026; COVID Nominal GDP truncated with trough at -6.73% in June 2020 and peak at 17.53% in June 2021.



difficult backdrop for rate-sensitive assets, including bonds, REITs, small caps, and parts of the equity market outside large-cap growth, which has held up so far amid continued AI-related CAPEX enthusiasm.

The short end of the curve told a similar story. The Fed raised rates 25 bps in September to a range of 3.75%–4.0%, its first hike since 2023, but the bond market increasingly suggested policy may not be restrictive enough if nominal growth remains strong and inflation remains sticky. Following the Zero Interest Rate Policy (ZIRP) era that existed for much of the past decade and a half, real policy rates are now positive again. However, they still remain materially below levels reached during prior boom-like periods (Tech boom in the '90's and Housing boom in '00's). Please see the chart below.

That doesn't mean rates have to return to those prior highs, but it does challenge the idea that the Fed is already finished. The Fed rate hike cycle might just now be getting underway. Equally as important, are the dynamics of the Fed's balance sheet which remains more than three times higher than where it was (as a percentage of GDP) prior to the Great Financial Crisis in '08-09.



The key question is whether higher rates and more restrictive policy eventually become a governor on the growth momentum that helped create them.

For now, the economy remains resilient, supported by CAPEX, consumption, labor-market stability, and strong earnings. But September showed that growth and inflation are often two sides of the same coin: the better the nominal growth backdrop, the more pressure it can place on yields, policy, valuations, and market breadth. AI-related leadership has held up better so far, but tighter policy could eventually test even the market's strongest growth stories.



Commodities were once again the best performer for the month – also leading all asset classes for the quarter and the year on the back of higher Energy and Agriculture prices. Meanwhile, Stocks delivered mixed results for the month and quarter with companies levered to AI-related CAPEX performed well while those less levered and more rate sensitive struggled. Bonds retreated for the month and quarter as interest rates rose, in part, due to strong nominal growth, high levels of AI-related bond issuance along with ongoing deficit concerns.

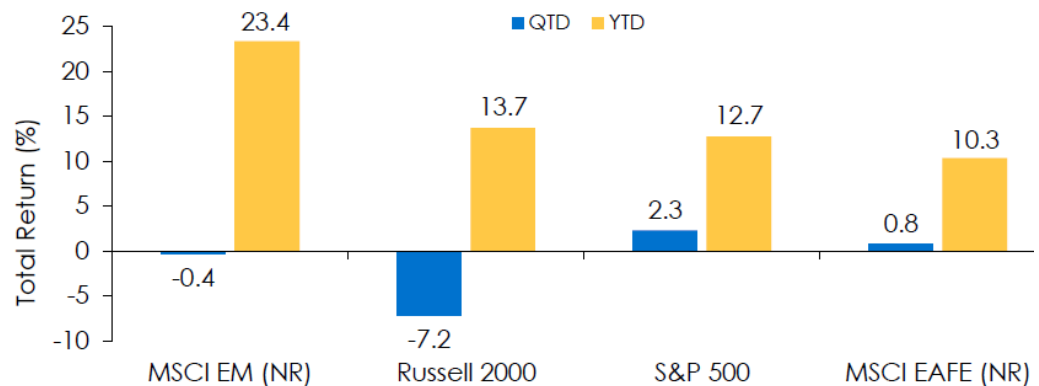
Stocks

U.S. large caps (S&P 500) posted solid returns for the quarter on robust earnings growth, due to continued AI-related infrastructure spending. Developed markets (MSCI EAFE) were up

more modestly for the quarter due to limited AI-related exposure along with the return drag from a strengthening dollar. Emerging Markets (MSCI EM) delivered strong year-to-date returns on accelerating AI-levered earnings growth, though returns for the quarter were flat. U.S. small caps (Russell 2000) retreated in the quarter as the recent increase in interest rates has had a negative effect on this more rate sensitive market segment. From a sector perspective, outperformance has become incredibly narrow with only two sectors leading the charge year-to-date. Similar behavior was seen in the month of September as well. Despite the limited outperformance, it's worth pointing out that eight of the eleven sectors are still in positive territory for the year.

Global Equity Returns

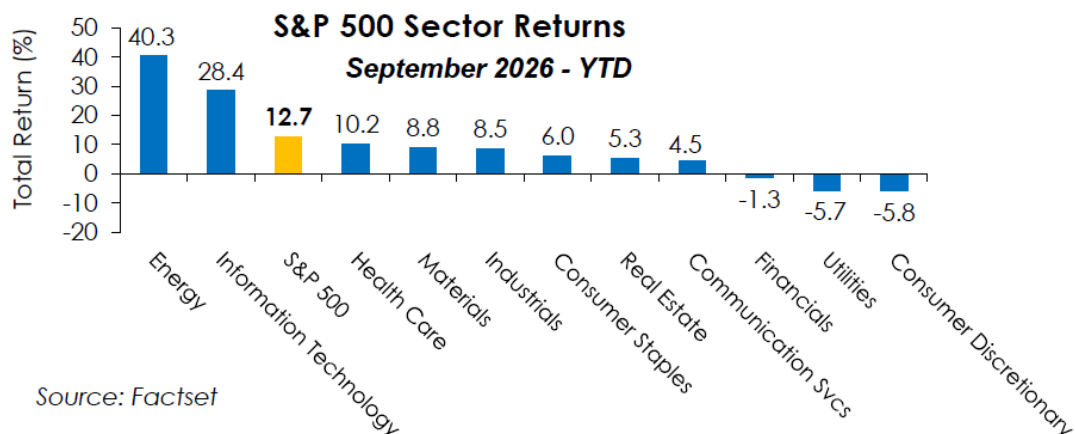
September 2026



Source: Factset

S&P 500 Sector Returns

September 2026 - YTD

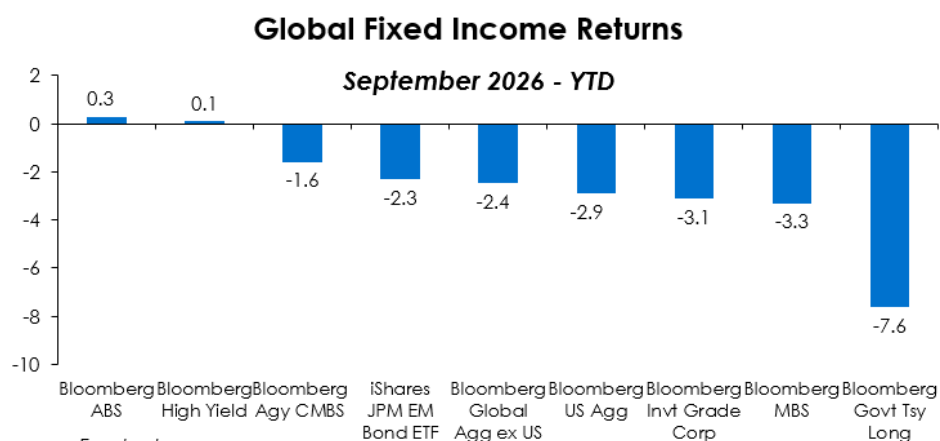


Source: Factset



Bonds

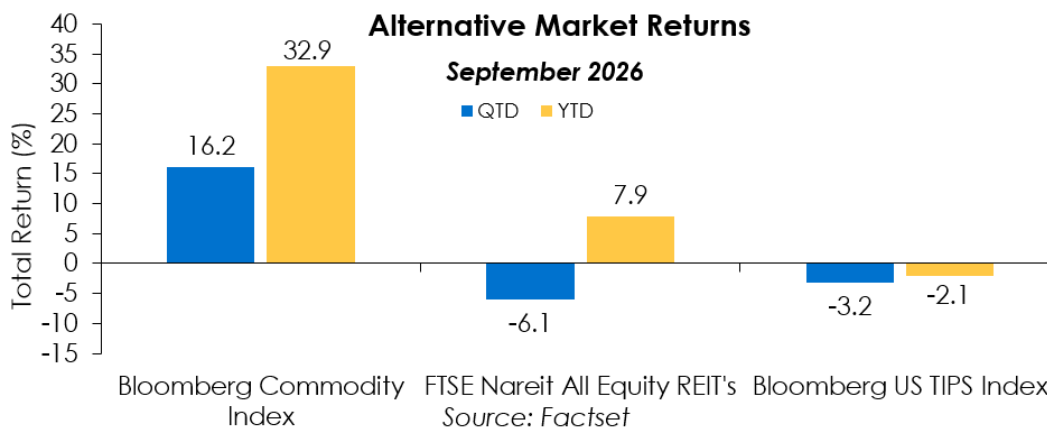
Policymakers hiked rates at their September meeting to a range of 3.75%-4.00%. The updated September "dot plot" implies one more 25 bps rate hike by the end of 2026 with rates remaining steady in 2027. This compares to a more restrictive forward curve with around three to four hikes now priced in by year end '27. 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. Investors viewed the recent rate hike as "hawkish" though market expectations have been volatile regarding when and how many rate hikes are likely as economic, geopolitical, and inflation data remain uncertain. As a consequence of the back up in rates, Bonds posted negative returns for the month, the quarter, and the year. Year-to-date, Asset Backed and High Yield Debt performed best due to their higher starting yields and/or shorter durations. Source: Factset



Meanwhile, long-dated U.S. Treasuries have lagged given their more rate sensitivity.

Alternatives

Commodities were, once again, the best-performing asset class for the month, continuing their strong year-to-date run. Energy, Agriculture, and Metals prices have



all moved higher due to strong demand and supply disruptions. REITs were weak for the quarter as rising interest rates have been a headwind for Real Estate prices. 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.



Market Outlook

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

– William Shakespeare, *Hamlet*

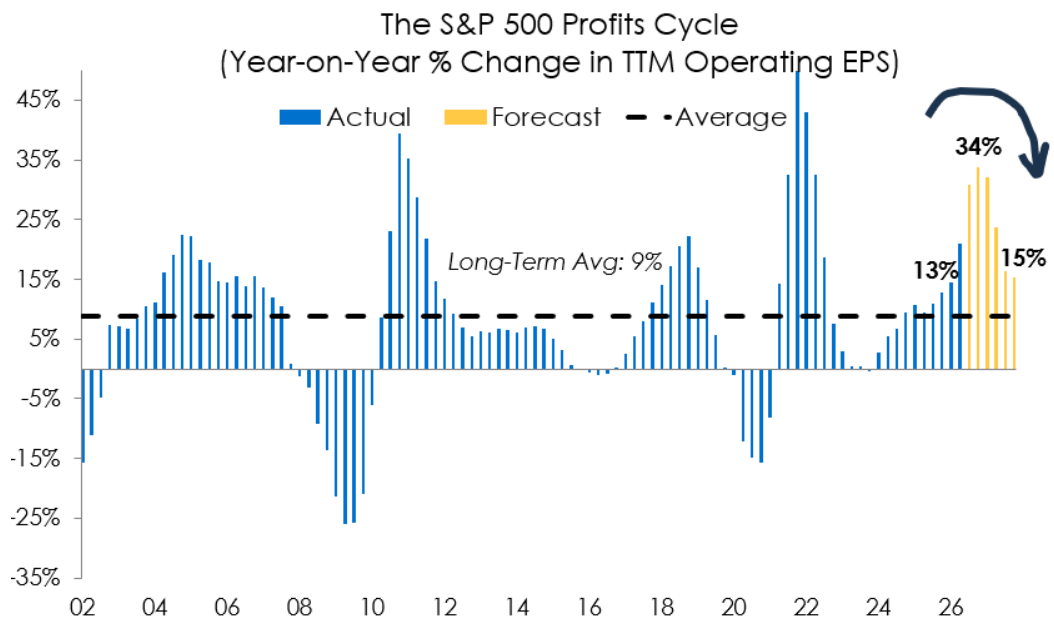
As we begin to look toward 2027, the market discussion may increasingly shift from absolutes to relatives. The question may not simply be whether growth is “good” or “bad,” but whether it’s getting better or worse. That distinction matters because markets are forward-looking and may start to respond more to the direction of change rather than to the level of activity itself. Such a dynamic can occur when a lot of optimism is already priced into stocks.

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 shift could matter for market leadership.

Cyclical areas can still perform if growth remains resilient, but as growth moderates, investors may place greater value on earnings durability, balance sheet strength, pricing power, and defensive characteristics. This doesn’t require a bearish economic view. It simply means that in a more mature cycle, the market may reward more of a balance between stability and cyclicity.

From Good or Bad to Better or Worse



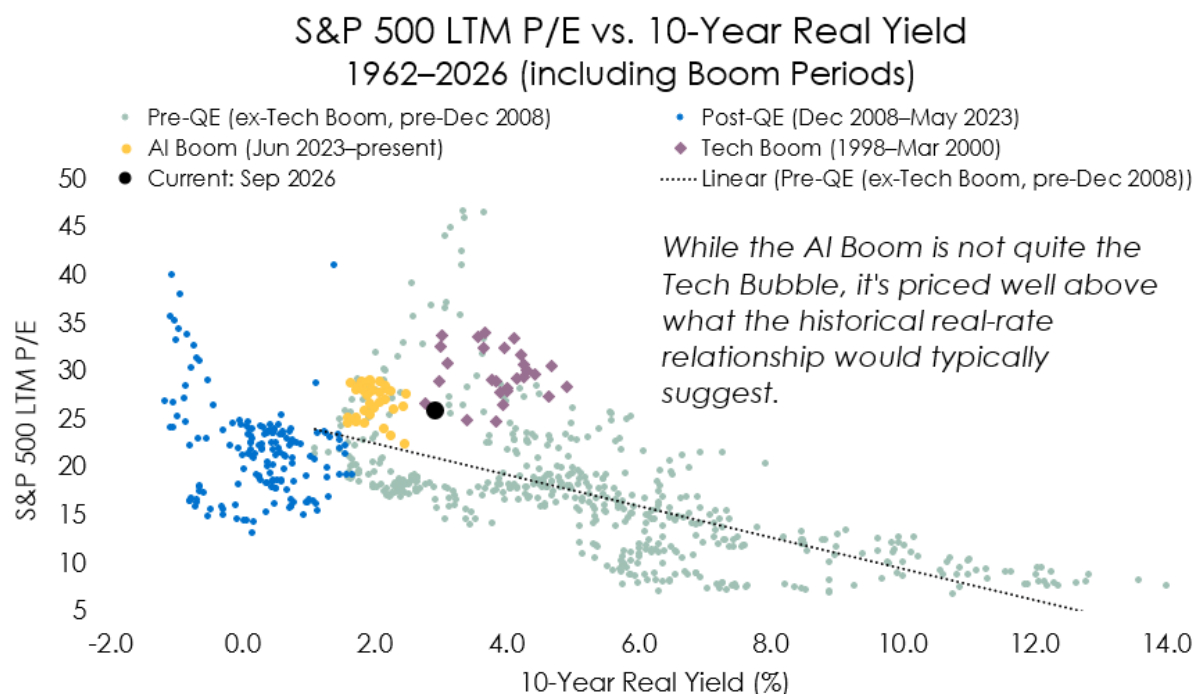
Source: Factset; S&P 500 Quarterly Operating Earnings from 12/02-6/26 with forecasts from 9/26-12/27. Earnings growth rate annotations are listed for 2025, 2026e and 2027e.



Valuation discipline may also become more important. 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 the increased competition from bonds. The dotted regression line illustrates that long-term relationship.

Note that outside of the P/E spikes following recessions ('20-21, '08-09, '01-02), since 1962, multiples haven't eclipsed the peak levels seen during the Tech Boom. Today's valuations sit near the lower end of the late '90s. While the AI Boom is not quite the Tech Bubble, the current market is priced well above what the historical real-rate relationship would typically suggest. Elevated real yields may act as a governor on valuation multiples, leaving less room for disappointment if earnings growth slows or if policy remains restrictive for longer.

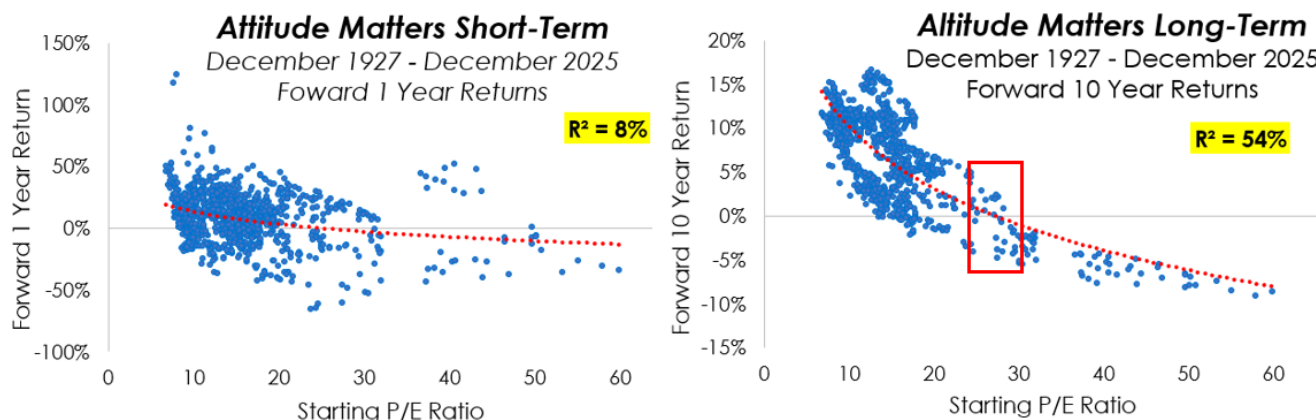
AI remains the key swing factor. If AI-related earnings and CAPEX continue to validate expectations, leadership can remain resilient. But higher real rates, narrowing breadth, and potential new supply from major AI-related IPOs could test sentiment in the market's most crowded growth stories. In that environment, investors may become more focused on normalized earnings durability than the absolute narrative alone.



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.



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.

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 this past month. In addition to reallocating the proceeds to underweighted areas like bonds and alternatives (where applicable), we also reduced some cyclicity 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.

Within alternatives, we remain fairly balanced though slightly overweight in Diversified Alternatives and Commodities. Last year, we adjusted our mix in this former 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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