



Summary

- Most balanced indices were slightly lower for the quarter as the S&P 500 and international indices were moderately higher while bond indices fell significantly. **Of note, Altrius' flagship balanced Global Income was up fractionally, holding onto exceptional year-to-date gains.**
- The quarter's big story was in the bond market: the Federal Reserve delivered its first hike in more than three years, the 10-year Treasury yield closed the quarter at 5.29%, near its highest since 2007. The 30-year reached 5.63%, its highest since 2002.
- The September 16th rate hike to 3.75%–4% was unanimous—a show of unity from an FOMC committee that had been split 9–3 in July. Their projections imply at least one more increase this year. Chair Warsh's message was unambiguous: inflation is too high and has been for too long.
- The war with Iran continues to grind on, with Brent crude rising roughly 35% for the quarter and briefly topping \$108 in September. The artificial intelligence trade completed a round trip—unraveling in July, roaring back on NVIDIA's results in August—and earnings expectations for the third quarter stand near 29% growth.

Altrius' Performance

Each of Altrius' strategies has had strong performance for the year. Our flagship balanced Global Income strategy, which is comprised of our U.S. equity, international equity and fixed income strategies, has posted gross returns of 9.2% for the year through Q3. Our Disciplined Alpha Dividend strategy (U.S. all-cap stocks) was higher by 18.3%, while our International ADR Dividend Income strategy (international stocks) grew by 9.0%. Our Unconstrained Fixed Income strategy (primarily U.S. high yield bonds) was higher by 0.9%. All returns are shown with gross IRR results from January 1 through quarter-end September 30, 2026.

Market Recap

On the surface, the third quarter looks unremarkable. The S&P 500 returned 2.3% in the third quarter and is 12.7% higher for the year. Beneath that modest move in equity markets, however, was a bond market that took over the narrative. The Federal Reserve raised interest rates for the first time in more than three years, long-term Treasury yields pushed to levels last seen two decades ago, and oil rose by more than a third as the war with Iran reignited. The artificial intelligence trade completed a full round trip.



The quarter's internal story was one of divergence. The Nasdaq Composite gained 2.6% and set a record in late September. The Dow Jones Industrial Average, by contrast, fell 2.3%, and September was particularly unkind to the blue-chip index, which dropped 4.1% in the month. It was a particularly difficult quarter for small-cap stocks as the Russell 2000 Index fell 7.2%. International equity markets fared worse in large part thanks to a stronger dollar during the quarter. European equities (MSCI Europe TR) fell 1.6% in USD terms and 0.9% in local terms and emerging-market stocks (MSCI Emerging Markets TR) dropped 0.4%.

Sector returns paint an interesting story. As yields surged in September, the financial sector fell more than 7%, its worst month since early 2023, while energy rode the oil shock higher and technology benefited from AI optimism. The market began the year broadening out but spent much of the third quarter re-concentrating. The market capitalization-weighted S&P 500 Index was flat during September whereas the equal-weighted version fell 4.8%, bringing the former now ahead of its equal-weighted counterpart for the year.

The U.S. economy continues to grow and outpace expectations. The labor market stumbled somewhat over the summer with only a combined 21,000 jobs over June and July. August saw a clear improvement with payrolls rebounding by 133,000 against expectations of roughly 55,000, while the unemployment rate held at 4.1%. Economic growth was revised higher for the second quarter, moving up to 2.2% from 1.5%. It was also revised higher for the first quarter to 2.5% from 2.1%. The economy continues to grow at a decent clip, powered in no small part by the largest capital spending boom in modern history. That resilience is welcome news for earnings, but it is considerably more complicated for the direction of interest rates.

The Fed Hikes: Warsh Draws His Line

On September 16th, the Federal Open Market Committee raised the federal funds rate by a quarter point to a range of 3.75%-4%. It was the first increase in more than three years, and it partially reverses the easing cycle of late 2025. Contrary to many expectations prior to his appointment, Fed chair Kevin Warsh has taken a hawkish stance on inflation and has departed from the Trump administration's desire to lower rates. Hawkish dots appeared in June then there was a split 9–3 hold in July with three dissents in favor of a hike. Then in his August Jackson Hole speech, Warsh gave a blunt declaration on inflation that the Fed had, in his words, work to do. He followed this up with the first hike in three years.

The vote deserves as much attention as the move. In July, the FOMC was fractured with three dissents calling for a hike. However, the September hike passed 12 to zero. Warsh inherited a divided Fed and was able to produce a unanimous hike within four months of taking the reins (and done so over the explicit objections of the White House). Whatever one thinks of the policy, the signal is there: this Fed has united around the view that the inflation fight is unfinished.

The FOMC's projections sharpened the message. The median projection for the fed funds rate at year-end rose to 4.1%, implying at least one more hike at one of the two remaining meetings of the year. The



2027 median estimate sits at the same level, showing an expectation that rates will go up and stay higher, not a quick round trip. September's projections showed that committee members see risks skewed to the upside for inflation while risks to economic growth are not front of mind for them. Like in previous meetings, Warsh declined to submit a projection of his own and offered very little forward guidance during his press conference. However, he did commit the FOMC to price stability.

The Fed delivered its most hawkish act in years into inflation data that promptly cooled (albeit somewhat due to methodology changes). September's final week brought the Bureau of Economic Analysis's annual revisions, which rewrote how several categories of services inflation are measured and applied them retroactively across the last five years. July's core PCE reading was revised to 3.0% from 3.3%, and August held at 3.0% compared to expectations above 3.3%. August's headline inflation came in at 3.4%. However, even the friendlier methodology leaves core inflation a full point above the 2% target, with the services categories the Fed watches most closely still running near 4%. September's inflation data will carry a surge in oil prices. The Fed hiked into an inflation picture that is better than feared over the summer months, but still clearly inconsistent with its mandate. Expectations for at least one more hike this year are reasonable, with the majority believing it happens in December after the midterms.

The Bond Market: The Repricing of the Long End

The 10-year Treasury yield ended the quarter at 5.29%, within sight of its 2007 highs, after rising more than half a percentage point in September alone. The 30-year closed at 5.63%, a level last seen in 2002. Despite the weakness, one survey of market participants suggests the 30-year may not have reached its high for the year yet: a majority of respondents to a late-September Bloomberg poll expect the long bond to trade above 6% before year-end. The curve "bear-steepened" over the quarter, with the long end rising more than shorter dated rates.

The economy is simply running hotter than the consensus believed. The upward revisions to growth coincide with a capital spending boom without much precedent. The major technology platforms are deploying roughly \$600 billion of CAPEX this year, the overwhelming share of it into artificial intelligence infrastructure. The Atlanta Fed's real-time GDP tracker (GDPNow) ran hot through the third quarter—mostly with readings over 4%.

Also adding to the upward pressure in rates is the supply of bonds. The federal deficit for fiscal year 2026 is running at around \$2 trillion (slightly more than 6% of GDP). It doesn't matter which political party is in charge, there is no desire from Washington to curb deficit spending. To finance these deficits, the Treasury's issuance calendar remains fully booked well into the future. The final leg of the stool is growing corporate debt issuance. The same AI buildout driving economic growth is being increasingly financed in the bond market. The hyperscalers and their ecosystem have issued an enormous amount of debt in the AI race. To put that in perspective, AI debt issuance has ramped from 5% of net Treasury issuance a year ago to over 30% this year. Every dollar of investor demand absorbed by the hyperscaler debt is money not bidding for Treasuries.



For bond portfolios, the front and belly of the curve now offer yields near or above 5% with far less sensitivity to the forces pushing the long end higher. As always, we are taking less duration risk and picking up attractive yields among high yield corporates. As a result of September's rate rise, our fixed income portfolios can now be constructed with yields over 6%.

The AI Trade's Round Trip

The artificial intelligence trade traveled a real arc this quarter—from unraveling in July to a sharp revival in September. A well-known AI hedge fund imploded in July as exposure to crowded tech trades and excessive leverage cascaded small losses. There was a momentary shift in sentiment as the same investors who had spent years rewarding ever-larger capital spending commitments abruptly began punishing them. Alphabet fell more than 7% on results that beat expectations but sold off because its CAPEX guidance jumped and its free cash flow turned negative for the first time since its 2004 listing. Meta was treated similarly after its results. Technology stocks slid into their second correction of the year. However, despite two corrections in nine months, technology stocks seemingly can't be kept down and are trailing only the energy sector this year.

Where does all this leave the equity market? Current earnings are real as is the spending on AI infrastructure; however, this run is eerily similar to the tech bubble of 2000 or possibly more akin to the railroad buildout during the late 1800s wherein roughly 25% of all railroad track mileage in the United States had entered receivership. We don't know how or when this AI binge will end, but we do know that we don't need to participate in the madness of the markets and run with the herd. Instead, we will remain disciplined in our approach of not paying too much for companies, and focusing on companies which pay our clients and investors sound and growing dividends to fund their future or current retirement income needs.

Looking Ahead

The fourth quarter is here with a full calendar. The midterm elections come November 3rd. The Federal Reserve meets just a week before midterms (October 27–28th) and again in early December. Third-quarter earnings season begins in mid-October against very high growth expectations. The continuing resolution that passed without much fanfare in early September averted a government shutdown but only funds the government through December 11th.

On the midterms, we will keep our thoughts brief. All 435 House seats and a third of the Senate are up for grabs—putting the control of both the House and Senate in play. Betting markets currently have the odds favoring the Democrats in both branches. The odds of a Democratic sweep continue to build. In an age of populism, it would not be surprising for the incumbents to be turned over. However, should the Republicans be able to hold either the House or Senate, markets have historically been comfortable with divided government, which tends to freeze the policy status quo. Further, as we've seen in recent years, either controlling party is happy to spend. With the deficit and the long end of the yield curve now central to the investment outlook, the election's most important market consequence may be what it signals



about the fiscal trajectory. We will be watching the bond market's reaction more closely than the stock market's. Beyond that, we hold to our long-standing view: portfolios should not be positioned on political predictions or outcomes. Vote at the polls, not in your portfolio.

On the Fed, the market enters the quarter pricing an October pause as slightly more likely than not and a December hike as the base case. The softer late-September inflation data took some of the urgency out of an October hike. Further, the proximity of the midterms should argue against politicizing any move. We would not expect a pivot to easing on any horizon. This Fed has told us its priority is inflation and acted on it with a hike.

Our positioning has remained the same overweight equities—particularly international stocks. This may change if valuations and yields continue to climb. In fixed income, we remain biased to the front-end of the curve (as we historically have been to better potentially contain duration risk) with our focus on high yield issues attempting to provide alpha against Treasuries as we have over multiple decades. Though absolute returns have been only modestly positive this year, we have added value navigating the current market as the majority of fixed income indices are underwater.

There continues to be a meaningful amount of concentration at the top of the market, as well as a single theme driving the economy forward. We witnessed the broadening opportunity set to start the year, but markets again narrowed in the quarter. Remaining diversified is prudent though many may feel compelled to follow the herd. Our eyes continue to be on the bond market as it has started to capture investor attention.

We thank you for your continued trust and confidence. If you have any questions about our outlook, positioning or your personal financial circumstances, please don't hesitate to contact us.



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