

Growth Resilience Meets Tightening Reality

Q3 2026 Investment Commentary

By Michael Murgio and Larry Hilzenrath



The third quarter began with investors debating whether growth was slowing enough to relieve inflation and interest-rate pressure without ending the expansion. It ended with a harder question: whether growth had remained too strong for financial conditions to ease. U.S. activity proved resilient, labor-market stress remained limited, and business investment strengthened. Higher energy prices and renewed Federal Reserve tightening nevertheless drove Treasury yields sharply higher.

The headline equity returns concealed strain beneath the surface. The S&P 500 gained 2.3% in Q3, but the Dow declined 2.3%, and the Russell 2000 fell 7.2%, while seven of eleven sectors posted losses. Fixed income adjusted more sharply: the U.S. Aggregate fell 3.5%, municipal bonds declined 6.3%, and the 10-year Treasury yield ended the quarter at 5.29%. Credit spreads and equity volatility remained contained, making Q3 less a broad risk-off episode than a forceful repricing of the cost of capital.

We see asset prices as more exposed to uncertainty and volatility around discount rates entering the fourth quarter.

Q3 2026 Market Snapshot

Leadership narrowed after the broad Q2 rebound.

Technology gained 7.2% and Energy 17.2%, while Industrials fell 9.7%, Utilities 12.4%, and Real Estate 5.6%. Small caps and rate-sensitive sectors struggled as yields rose. The sector chart shows how a positive S&P 500 return concealed weakness across most of the market.

International returns were mixed. EAFE rose 0.9%, while emerging markets slipped 0.4%. China rebounded 8.8% in Q3 but remained down 9.6% year to date. Japan gave back 0.8% after its strong Q2 advance.

Oil and Bitcoin each rose more than 40% during the quarter, while gold gained 3.7%. In fixed income, the contrast between large bond losses and modest spread widening points to rising interest rates, rather than credit deterioration, as the dominant source of stress.

Contact Us



MIKE MURGIO,
CFA & CAIA

Partner & Chief
Investment Officer
mmurgio@ampwp.com



**LARRY
HILZENRATH**

Chief Strategist &
Director of Research
lhilzenrath@ampwp.com



EDUARDO VILLA,
CFA & CAIA

Director and Senior
Investment Strategist
evilla@ampwp.com

Market Performance Summary 2026

INDEX OR ASSET	Q1 2026	Q2 2026	Q3 2026	YTD
S&P 500	-4.4%	15.2%	2.3%	12.7%
DOW JONES INDUSTRIAL AVERAGE	-3.2%	13.4%	-2.3%	7.2%
NASDAQ 100	-5.8%	27.7%	0.6%	21.0%
RUSSELL 2000	0.9%	21.6%	-7.2%	13.9%
MSCI EAFE	-1.1%	11.1%	0.9%	10.9%
MSCI EM	-0.1%	24.2%	-0.4%	23.5%
NIKKEI 225	-2.4%	34.2%	-0.8%	29.9%
FTSE China 50 TR USD	-8.5%	-9.3%	8.8%	-9.6%
U.S. Corporate High Yield	-0.5%	2.5%	-1.8%	0.1%
U.S. Aggregate	0.0%	0.7%	-3.5%	-2.9%
Bloomberg Municipal Bond Index TR	-0.2%	2.5%	-6.3%	-4.2%
Bitcoin (XBT-USD)	-22.2%	-14.0%	42.6%	-4.6%
GOLD SPOT \$/OZ	8.1%	-14.1%	3.7%	-3.7%

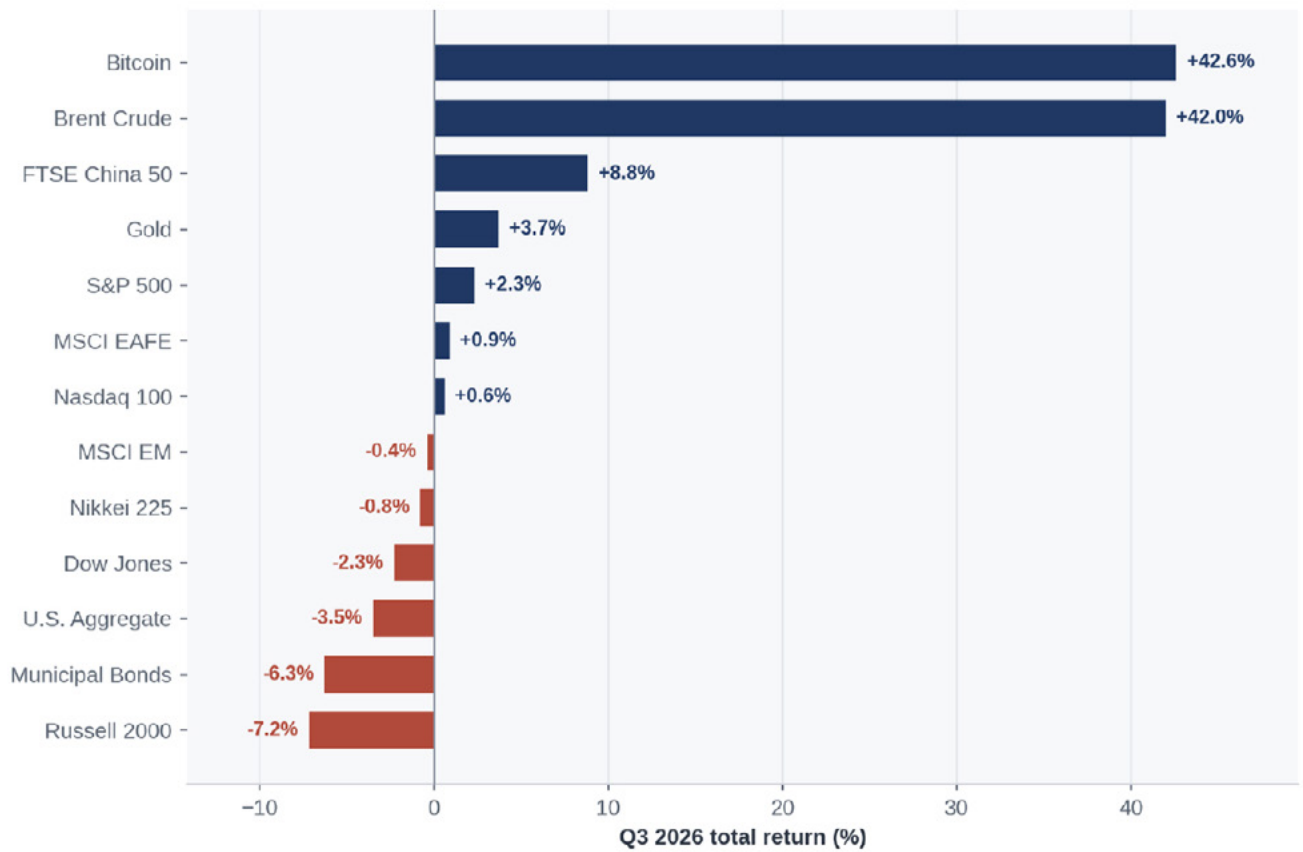
*Source: Bloomberg Finance L.P. Total return as of September 30, 2026.

United States Sector Performance 2026

SECTOR	Q1 2026	Q2 2026	Q3 2026	YTD
Technology	-9.1%	31.8%	7.2%	28.4%
Industrials	4.6%	14.9%	-9.7%	8.5%
Financials	-9.5%	9.0%	-0.1%	-1.4%
Real Estate	2.8%	8.5%	-5.6%	5.3%
Health Care	-4.9%	8.8%	6.5%	10.2%
Consumer Discretionary	-9.2%	9.3%	-5.1%	-5.8%
Consumer Staples	7.7%	0.3%	-1.9%	6.0%
Materials	9.7%	2.0%	-2.8%	8.8%
Utilities	8.3%	-0.5%	-12.4%	-5.7%
Communication Services	-6.9%	8.3%	3.6%	4.5%
Energy	38.2%	-13.4%	17.2%	40.3%

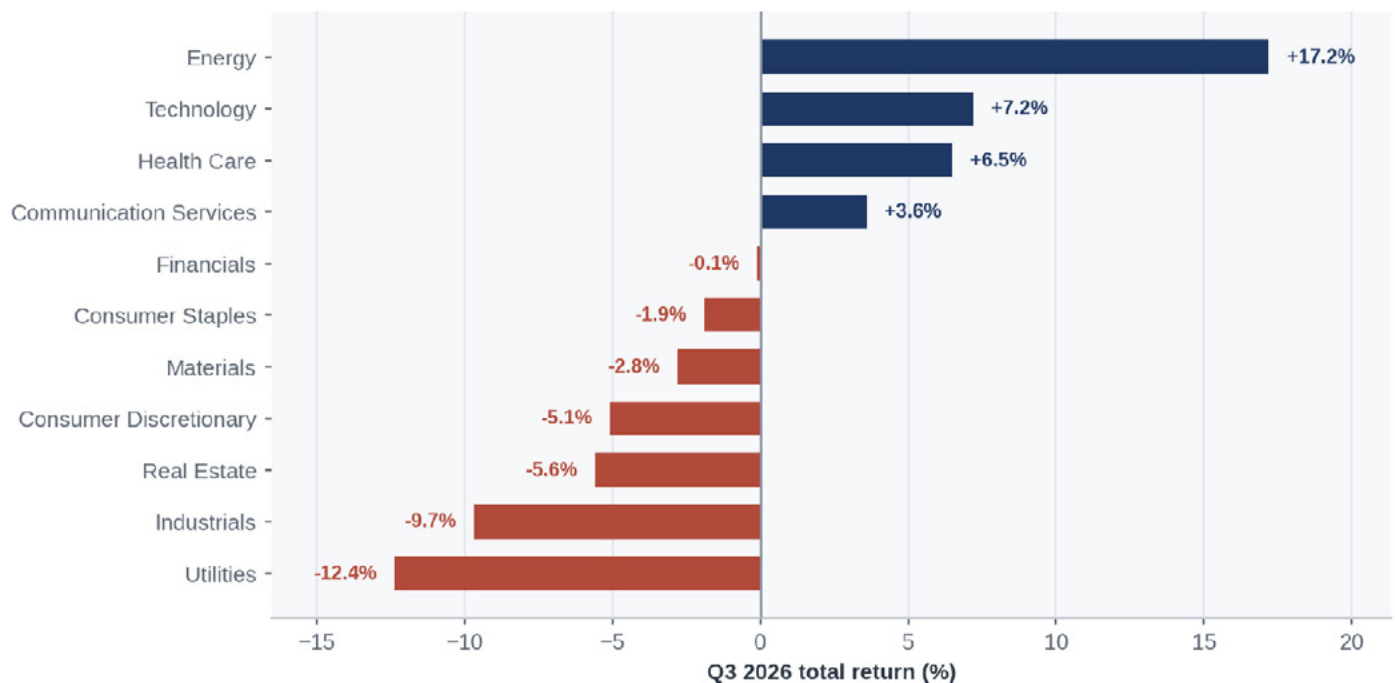
*Source: Bloomberg Finance L.P. S&P 500 sector index total return as of September 30, 2026.

Q3 2026: Hard Assets Led, Duration and Small Caps Lagged



*Source: Bloomberg Finance L.P. Cross-asset total return, Q3 2026.

Seven of Eleven Sectors Declined as Rate Sensitives Broke



*Source: Bloomberg Finance L.P. S&P 500 sector index total return, Q3 2026.

The Macro Backdrop from Stabilization to Constraint

Third-quarter data largely confirmed the durability of the expansion and stabilization we described in our second-quarter review, but it also exposed its cost. Growth accelerated late in the quarter, energy prices rose, and the Federal Reserve shifted from resisting cuts to raising rates. Markets could no longer assume that economic resilience would be rewarded with easier financial conditions.

United States Growth Resilient in Aggregate

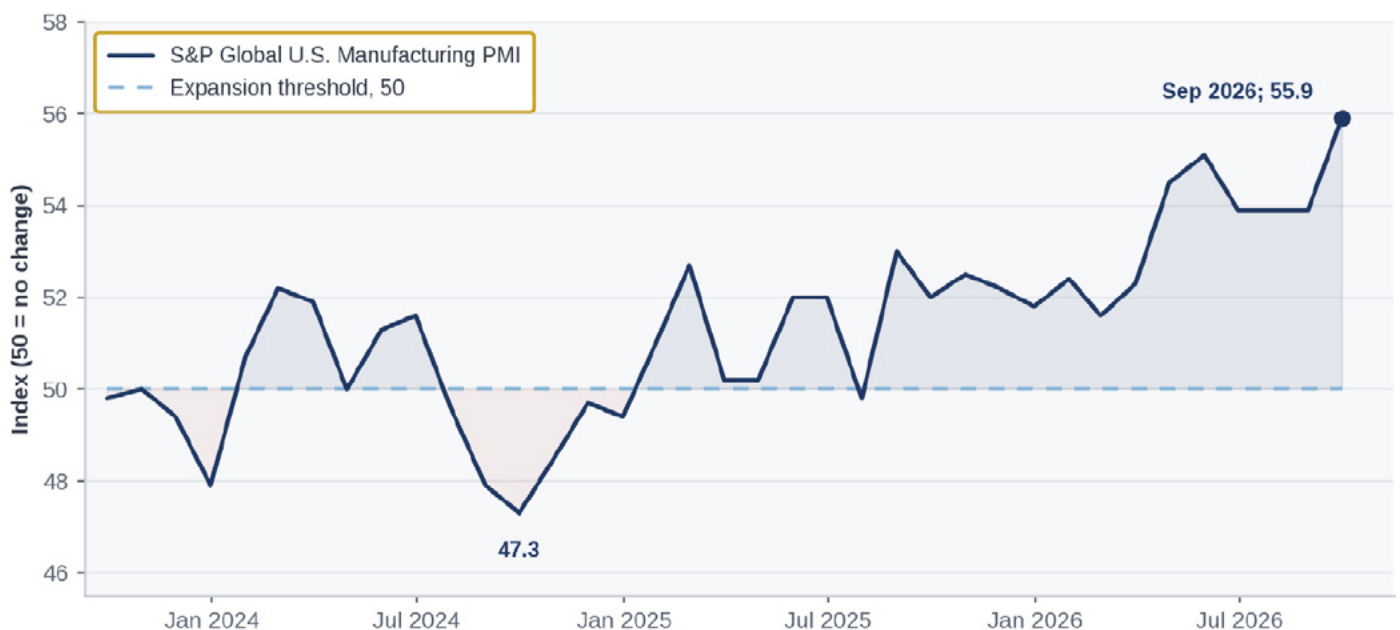
The expansion entered Q3 on firmer footing than previously estimated. Second-quarter real GDP growth was revised to a 2.2% annualized rate from 1.5%, with investment, consumer spending, and government spending all revised higher. Subsequent data pointed to continued strength in consumption and business activity, although income growth and regional indicators remained uneven.

Consumption remained strong. August personal spending rose 0.9% in nominal terms and 0.6% after inflation, the largest real monthly increase in seventeen months. Goods led the advance. Personal income grew only 0.2%, and real disposable income was flat, however, leaving spending growth ahead of household purchasing power.

Business activity accelerated. The final September S&P Global U.S. Manufacturing PMI rose to 55.9 from 53.9, its strongest reading since May 2022. Output and new orders strengthened, although export orders continued to contract amid tariffs and elevated shipping costs. Nondefense capital-goods orders excluding aircraft gained 1.6% in August, reinforcing the evidence of firm investment demand.

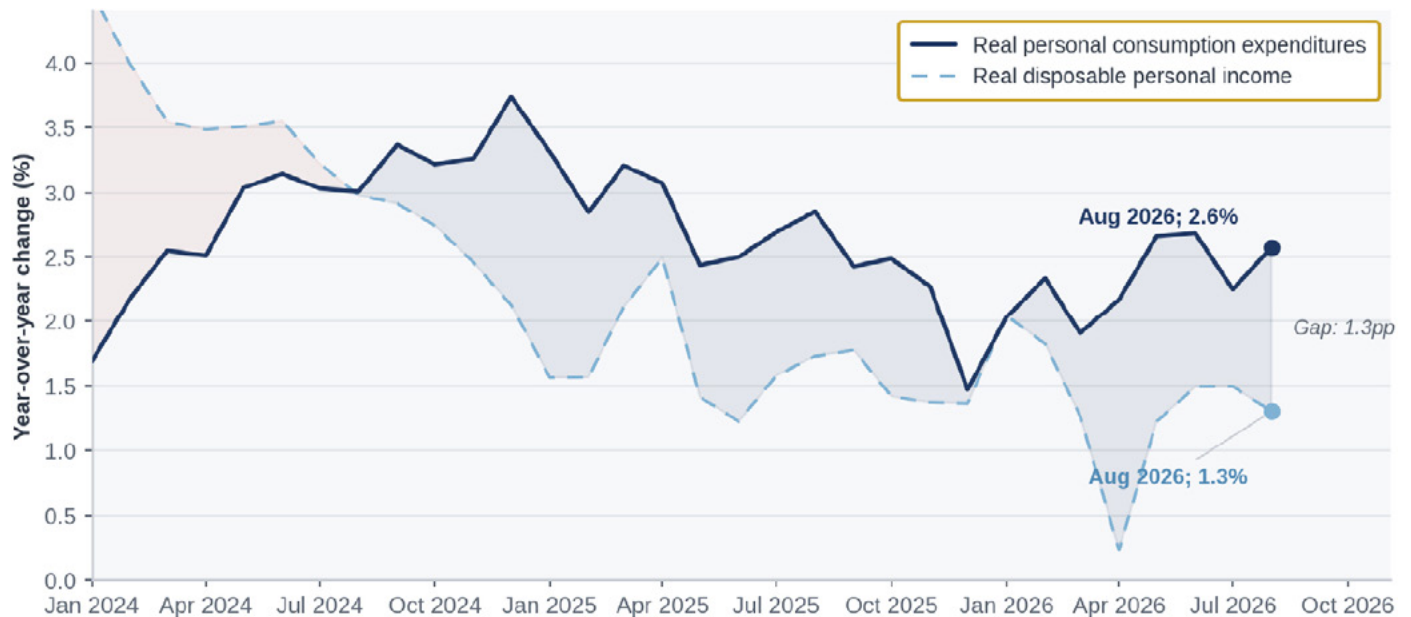
The breadth of that strength remained uneven. The August goods trade deficit widened to \$132.6 billion as imports rose 5.5%, partly reflecting investment and inventory build, but potentially subtracting from measured GDP. Regional manufacturing surveys also diverged: Richmond remained in contraction while Kansas City and Dallas were positive. Aggregate growth continued to coexist with pressure on households and smaller businesses.

Manufacturing Activity at a Four-Year High



*Source: S&P Global U.S. Manufacturing PMI, monthly; September is the final estimate.

Spending Is Outrunning Household Purchasing Power

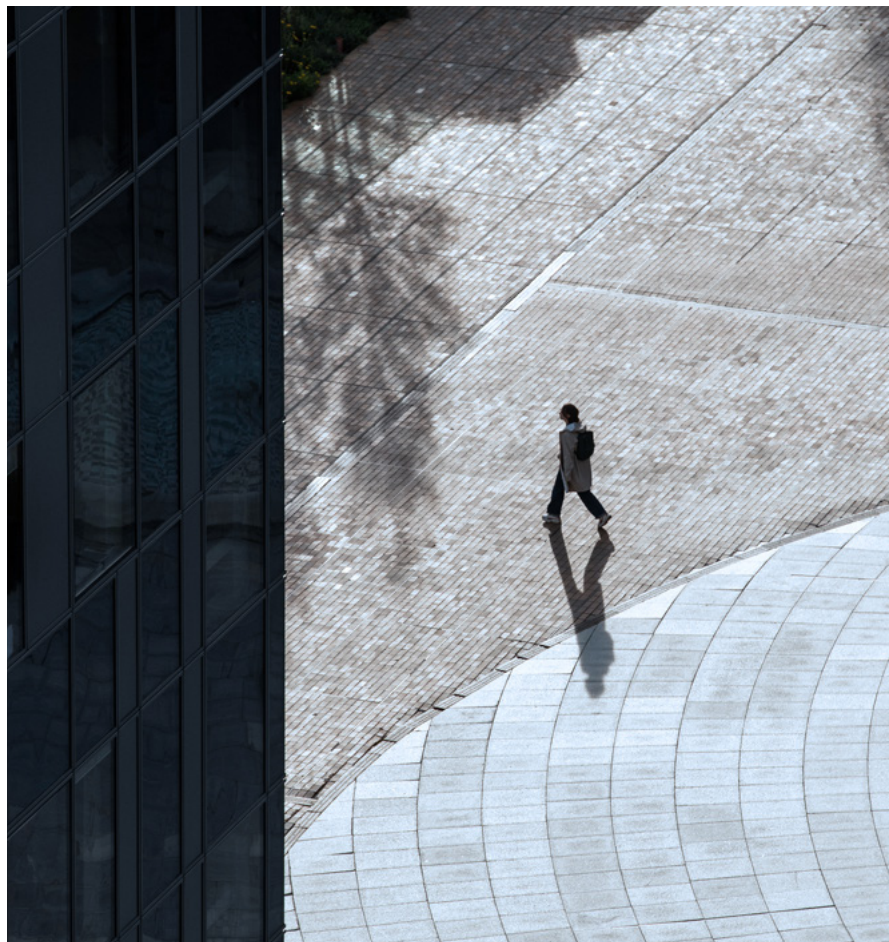


*Source: Bureau of Economic Analysis. Real personal consumption expenditures and real disposable personal income, YoY % change, monthly.

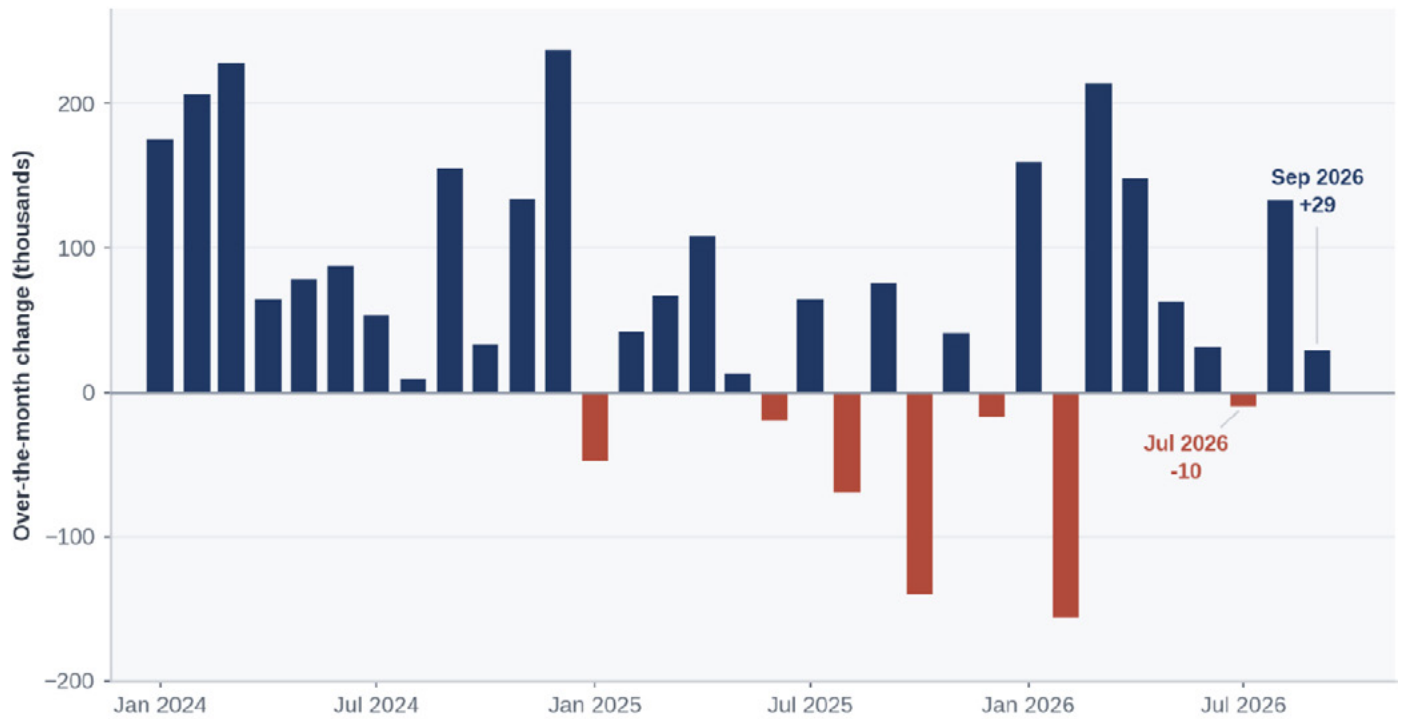
Labor, Consumption, and Housing

The labor market cooled through weaker hiring rather than widespread layoffs. September payrolls rose just 29,000, below the 45,000 monthly average of the prior year. Revisions cut July and August by a combined 60,000, turning July negative. Unemployment remained at 4.2%, and initial claims stayed low, but the private-sector diffusion index fell below 50, and job openings declined to 7.079 million. Employers were holding on to workers while creating few new jobs.

That labor-market balance supported spending, but household finances were less comfortable. September hourly earnings rose 3.0% from a year earlier, only modestly ahead of inflation, while consumer sentiment fell to 48.1. One-year inflation expectations remained at 4.6%. Higher asset prices helped some households, but renters, new homebuyers, and borrowers faced a different reality as rates climbed.

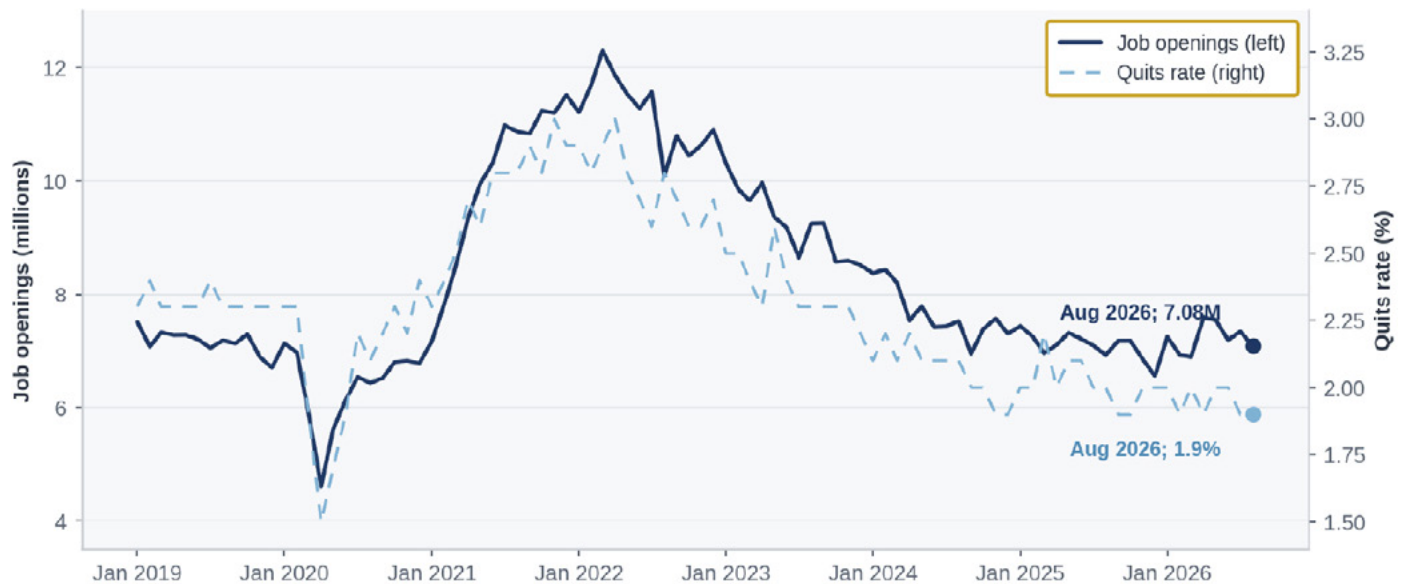


Payroll Growth Stalls as Revisions Turn July Negative



*Source: Bureau of Labor Statistics, Current Employment Statistics. Nonfarm payroll employment, over-the-month change, monthly.

Labor Market Cooling Without Layoffs



*Source: Bureau of Labor Statistics, Job Openings and Labor Turnover Survey. Job openings and the quits rate, monthly.

Housing remained the clearest channel through which higher Treasury yields constrained demand. The average 30-year mortgage rate climbed to over 7% in the final full week of September, and applications fell 6.0%, their fourth consecutive weekly decline. Home prices held up better than transactions: the Case-Shiller 20-City index rose 2.5% year over year in July, although real home prices declined for a fourteenth consecutive month. Limited affordability and homeowners' reluctance to replace low-rate mortgages continued to restrict turnover.

Mortgage Rates Follow the Long End Back Above 7%



*Source: Freddie Mac PMMS; Federal Reserve H.15; Bloomberg Finance L.P. 30-year fixed mortgage rate against the 10-year Treasury yield, weekly.

Inflation, Energy, and the Strait of Hormuz

Underlying inflation improved during the quarter but remained above the Fed's objective. August core PCE rose 0.2% for the month and slowed to 3.0% year over year from 3.4% in May. Headline PCE held at 3.4%, while headline CPI eased to 3.4% from 4.2% in May. The Dallas Fed trimmed mean remained at 2.2%, suggesting less persistent pressure than the broader core measure.

Energy posed a renewed threat. Brent crude rose 42.0% during Q3 to \$103.53, after peaking at \$108.75 on September 15, the day before the Federal Reserve raised rates. Alternative export routes and diplomatic progress eased the disruption, but the Wall Street Journal reported emergency Hormuz shipping costs of \$15 to \$20 per barrel before insurance. S&P Global, citing Marsh, reported war-risk premiums of 7.5% to 10% of vessel value, equivalent to roughly another \$4 to \$5 per barrel for a \$100 million tanker carrying two million barrels. These costs sustained oil's conflict premium, threatening consumption while raising inflation expectations and business costs. September manufacturing surveys also showed rising input costs and longer delivery times, creating tension with the improvement in measured consumer inflation. Monetary policy cannot resolve a supply disruption, but the Fed must respond if it begins to influence wages, expectations, and broader pricing behavior. Household inflation expectations and regional selling-price surveys left that second-order risk material.

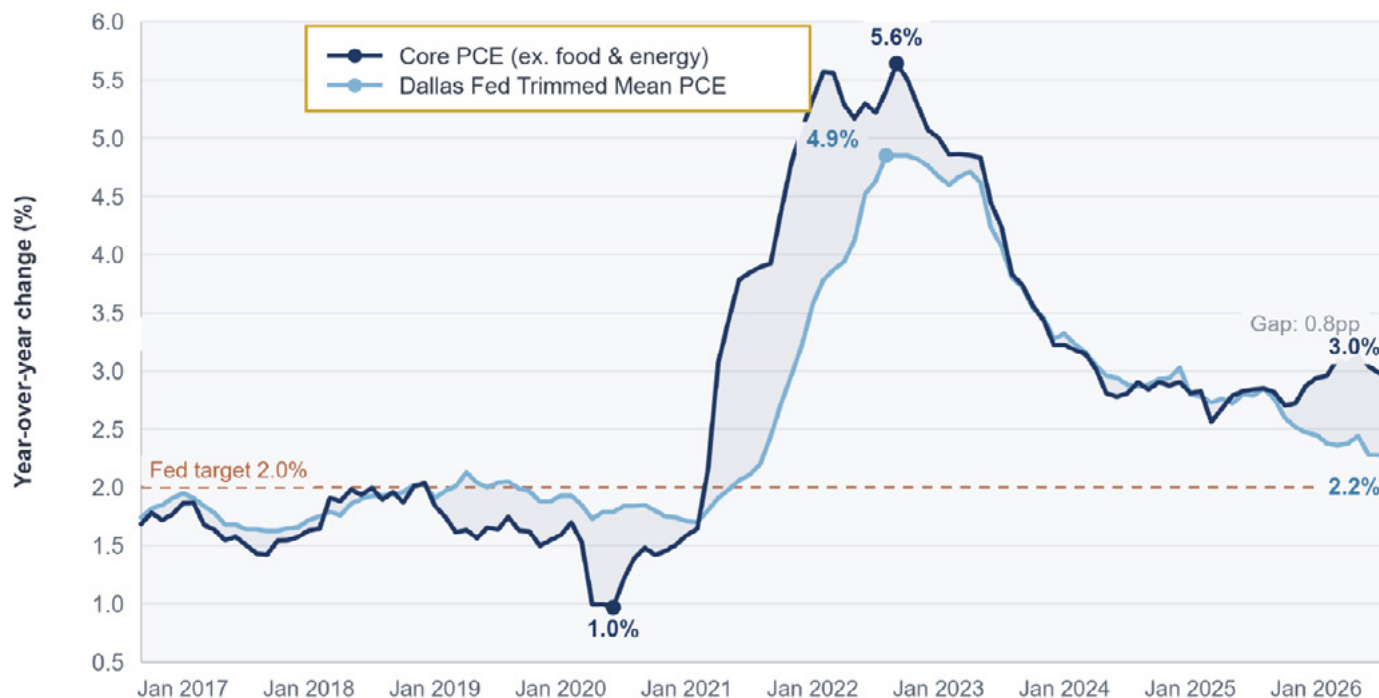
For Q4, oil is the most direct link between geopolitics, inflation, and growth. A further rise would squeeze real incomes and could keep the Fed tightening. Normal shipping and a durable diplomatic agreement would ease that pressure, though neither outcome is assured.

Brent Crude Round Trip on Renewed Hormuz Disruption



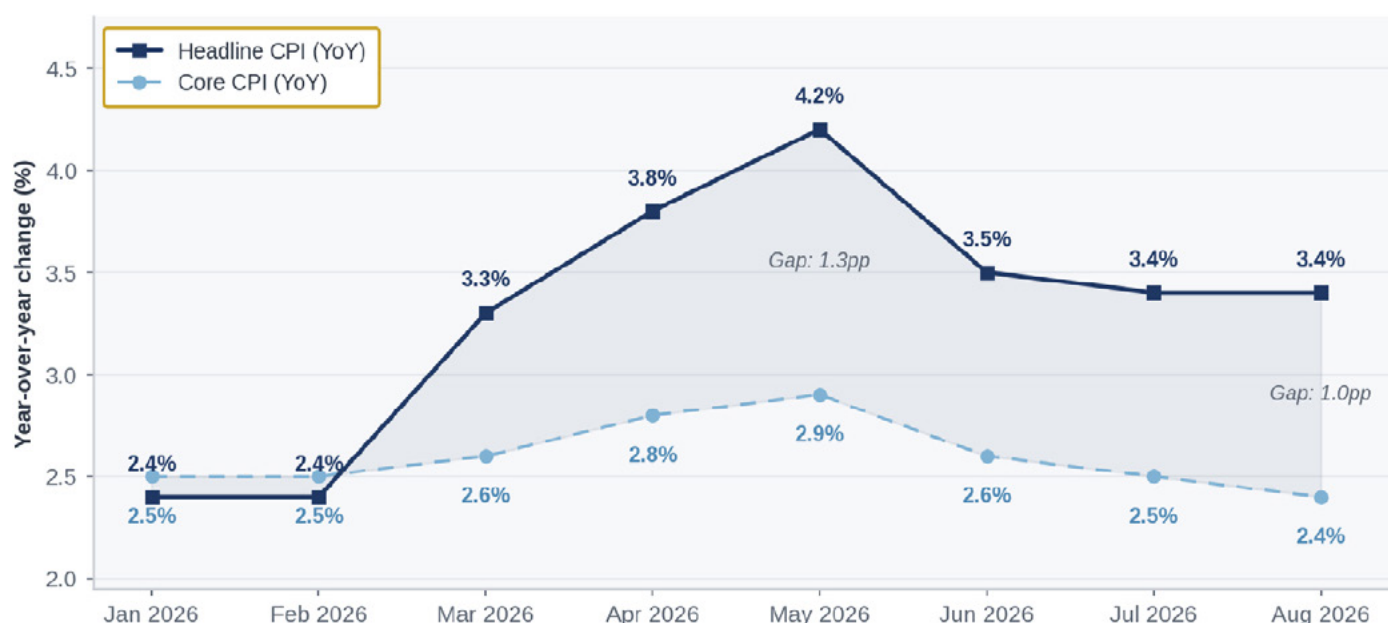
*Source: Bloomberg Finance L.P. Brent crude front-month futures (CO1), daily close, January – September 2026.

Core Inflation Gauges Diverge as Trimmed Mean Holds Steadier



*Source: Bureau of Economic Analysis; Federal Reserve Bank of Dallas. Core PCE against Dallas Fed trimmed mean PCE, YoY % change, monthly.

Energy Spike Unwinds as Core Inflation Falls Below Its January Level



*Source: U.S. Bureau of Labor Statistics. Headline and core CPI, YoY % change, monthly.



The Federal Reserve and the Treasury Selloff

On September 16, the Federal Reserve raised its policy rate by 25 basis points to a range of 3.75% to 4.00%, its first increase since 2023. The unanimous decision and projections left room for another increase this year. With measured inflation moderating, the move appeared to reflect concern that stronger growth and renewed energy pressure could prevent inflation from converging toward target.

Treasury yields had already been repricing before the decision. The 10-year rose 82 basis points during Q3 to 5.29%, while the five-year increased 87 basis points, the largest move among the major maturities. July and August were dominated by long-end pressure consistent with term premium, supply, and fiscal concerns; September brought a sharper front-end adjustment to the expected policy path. The two-year ended at 4.91% and the 30-year at 5.63%.

The sequence points to both policy expectations and the compensation investors require to hold longer-term debt. Together, these forces raised financing costs for mortgages, businesses, and real estate, while increasing the discount rates applied to equities and private assets.

Real financing costs also bear watching relative to growth. Subtracting the five-year breakeven inflation rate of 2.33% from the 10-year nominal yield of 5.29% gives a rough inflation-adjusted proxy of 2.96%, above recent quarterly real GDP growth of 2.2% to 2.5% at annualized rates. This comparison uses different maturities and horizons; it is neither a directly observed 10-year real yield nor a precise debt-sustainability threshold. It nevertheless illustrates the pressure elevated financing costs can place on debt service, margins, and refinancing capacity if growth slows.

The Fed must balance firm activity and limited layoffs against stalled payroll growth, weaker job openings, and weaker consumer confidence and housing. The September employment report arrived after the rate decision and complicates its justification. The question is whether late-quarter strength can persist as the cumulative effect of higher rates spreads through the economy.

Belly-Led Selloff Lifts the Entire Treasury Curve



*Source: Bloomberg Finance L.P.; U.S. Department of the Treasury. Treasury curve at 2, 5, 10 and 30 years, June 30 versus September 30, 2026.

Fixed Income Higher Yields and Concentrated Stress

The bond selloff reset starting yields higher, improving prospective income for new buyers, especially in high-quality and tax-exempt bonds. Municipal bonds fell 6.3%, leaving longer maturities more attractive relative to Treasuries. For taxable investors, that income may be compelling when maturity, credit quality, and liquidity fit the portfolio. Higher starting yields offer a larger cushion, but the case for duration remains conditional. Bonds could benefit if growth weakens and inflation moderates; another energy shock or further Fed tightening could push yields higher first. Our view is that the income opportunity warrants selective exposure rather than an oversized duration position.

Market stress remained concentrated in rates. The MOVE Index rose from 71.96 at mid-year to 110.45, with nearly all the increase in the final seven sessions. High-yield option-adjusted spreads widened from 2.75% to 3.08% but remained historically tight, while the VIX stayed near 15. Investors priced substantial rate uncertainty without a comparable increase in default concerns or equity volatility.

That divergence remains vulnerable to persistent high yields. Rate volatility and credit spreads had worsened late in the quarter, and pressure could spread into housing, credit, capital spending, and valuations. Strong nominal growth and earnings expectations continued to provide support, but tight spreads offered limited protection against a weaker outcome.

Rate Volatility Spikes; Credit Widens Only Modestly



*Source: Bloomberg Finance L.P.; ICE BofA U.S. High Yield Index OAS. MOVE Index against high-yield option-adjusted spread, daily.

Equities, Artificial Intelligence, and Productivity

Equity investors continued to reward AI infrastructure demand but became more selective about valuation and cash-flow timing. Technology advanced 7.2%, but the Nasdaq 100 added only 0.6% after its 27.7% second-quarter surge. The gap reflects composition: the Nasdaq 100's large non-technology holdings in consumer discretionary and staples detracted, with those sectors down 5.1% and 1.9% respectively. Earnings resilience faced a higher discount-rate hurdle.

Technology Outpaced the Nasdaq 100 as Breadth Narrowed



*Source: S&P Dow Jones Indices; Nasdaq. Price return, daily. S&P 500 Information Technology against the Nasdaq 100, indexed to December 31, 2025.



Spending on data centers, computing, networking, and power continued to support demand for technology suppliers. The next test is whether that investment produces durable revenue, margins, and returns on capital. Higher financing costs make the quality of those returns more important.

Productivity could help reconcile solid growth with lower inflation. Nonfarm business productivity rose 2.2% year over year in Q2, but that single reading does not establish an AI-driven productivity boom. Faster productivity would let output grow with less pressure on prices; for now, it is a possibility rather than an assumption.

Productivity Growth Offers a Partial Offset



*Source: Bureau of Labor Statistics, Productivity and Costs. Nonfarm business sector output per hour, YoY % change, quarterly.

Weak small-cap and rate-sensitive returns reinforce for us the importance of balance-sheet strength. Companies reliant on floating-rate borrowing or near-term refinancing have less room to absorb higher rates than firms with durable cash flow and modest debt.

The S&P 500 ended September at 26.2 times trailing earnings, about 30% above its 20.18 average since 1996. The multiple remains below its 2021 peak of 32.9, but higher Treasury yields make today's premium more consequential.

Valuations eased in Q3 because earnings grew faster than share prices. The S&P 500 rose about 2% while its trailing P/E fell from roughly 27.6 to 26.2, implying about 7% trailing earnings growth. Since year-end, the index has gained 12% while its P/E fell from 30.8, implying earnings growth near 31%. Earnings have helped justify prices, but the market still depends on that growth continuing.

Equity Valuations Remain Well Above Long-Run Averages



**Source: Bloomberg Finance L.P.; Federal Reserve Economic Data (FRED). Full-sample average 20.18. S&P 500 price-to-earnings against its full-sample average, monthly.*

Price-to-sales tells a more demanding story. At 3.52 against a full-sample average of 1.88, the index trades at nearly double its historical revenue multiple, and it has not closed a month below that average since 2016. The gap between the two measures is itself informative: a price-to-earnings multiple 30% above average alongside a price-to-sales multiple 87% above average implies that today's profit margins are doing a great deal of work. The valuation case therefore rests not only on earnings growth but on margins holding at historically high levels.

Price-to-Sales Is the More Stretched Multiple



**Source: Bloomberg Finance L.P. Full-sample average 1.88. S&P 500 price-to-sales against its full-sample average, monthly.*

It is also worth mentioning the equity risk premium. Measured as the trailing earnings yield minus the 10-year Treasury yield, it ended September at -1.48%, down from -0.40% at the end of March as the 10-year rose sharply during the quarter. On this trailing earnings-yield measure, the valuation cushion relative to Treasuries has disappeared. That does not establish that equities will underperform Treasuries, nor is it a reliable timing signal. It does indicate that investors are receiving unusually limited earnings-yield compensation for assuming equity risk, increasing the importance of earnings durability, balance-sheet strength, and valuation discipline.

A negative premium persisted for most of the late 1990s while equities continued to rise, and it can resolve through falling yields as readily as through falling prices. Its value is as a measure of compensation, and that compensation has gone.

Equity Risk Premium Turns Further Negative



**Source: Bloomberg Finance L.P.; Federal Reserve Economic Data (FRED). S&P 500 trailing earnings yield less the 10-year Treasury yield, monthly.*

Global Conditions Remained Uneven

Conditions outside the United States were uneven. Euro Area activity strengthened as the September Composite PMI reached 53.1, its highest level in roughly three and a half years, though the ECB raised its main refinancing and deposit rates to 2.65% and 2.50% on September 10, its second increase of the year, as higher energy costs lifted inflation forecasts, and rising yields left the STOXX 600 down about 1% in Q3. China equities rebounded 8.8%, with September official manufacturing and nonmanufacturing PMIs moving marginally into expansion at 50.1 and 50.2. Industrial profits rose 15.7% over the first eight months of the year, although monthly growth slowed to 4.2% in August, and broader growth concerns and unresolved U.S.-China trade and technology issues persisted despite a truce extended to January 10. Japan's Nikkei slipped 0.8% after its strong Q2 advance, as second-quarter GDP grew at a revised 1.4% annualized rate while private consumption was flat, and capital expenditure declined. Wage growth remained firm at 3.8% in August, and the September composite PMI eased to 52.3, still in expansion.¹

What stood out globally in Q3 to us was not synchronized growth but synchronized financial tightening. Europe faced stronger activity but renewed inflation pressure from energy prices. China stabilized but remained dependent on policy support and confidence restoration. Japan continued its gradual transition away from years of extraordinary monetary accommodation. Despite very different economic conditions, long-term interest rates moved higher across many major markets. The result was a global increase in the cost of capital, reinforcing pressure on rate-sensitive assets and reducing the valuation support that investors had enjoyed during periods of extraordinarily low yields.

Outlook and Portfolio Implications

Entering Q4, the key question that we see is whether activity can moderate enough to relieve inflation and policy pressure without materially weakening employment, credit, or earnings. Continued acceleration could require more tightening, while a sudden slowdown could expose the cumulative burden of higher financing costs.

Across asset classes, we emphasize quality: durable cash flows, strong balance sheets, pricing power, and demonstrable returns on capital, since higher rates increase the penalty for leverage, distant cash flows, and valuations dependent on flawless execution. In fixed income, the selloff has improved prospective income, particularly in high-quality and tax-exempt bonds, though we would avoid oversized duration exposure while inflation and Fed uncertainty remain elevated, and tight credit spreads argue for selectivity rather than broad risk-taking. More broadly, we believe that strategies that do not depend on falling rates or expanding equity multiples remain valuable, and cash and short-duration assets provide meaningful income while preserving flexibility as policy and geopolitical conditions evolve.

In our view, Q3's message was not that the expansion had ended. It was that resilience no longer guaranteed easier financial conditions. Growth supported earnings; higher rates raised the hurdle those earnings must clear. That tension is likely to matter more than the headline index return in Q4.

1. Euro Area Composite PMI 53.1: S&P Global via Trading Economics, as of October 5, 2026; ECB refi 2.65%, deposit 2.50%: European Central Bank via Trading Economics, as of September 10, 2026; STOXX 600 down about 1% in Q3: Trading Economics, as of September 30, 2026; China equities +8.8%: Bloomberg Finance L.P., as of September 30, 2026; China PMIs 50.1 and 50.2: National Bureau of Statistics via Trading Economics, as of September 30, 2026; China industrial profits +15.7% year to date, +4.2% in August: National Bureau of Statistics via Trading Economics, as of September 27, 2026; U.S.-China truce extended to January 10: Trading Economics, as of September 23, 2026; Nikkei 225 -0.8%: Bloomberg Finance L.P., as of September 30, 2026; Japan Q2 GDP 1.4% annualized, consumption flat, capex down: Cabinet Office via Trading Economics, as of September 8, 2026; Japan wage growth 3.8% in August: Ministry of Health, Labour and Welfare via Trading Economics, as of October 6, 2026; Japan composite PMI 52.3: S&P Global via Trading Economics, as of October 5, 2026

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