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Economic & Market Summary

October 2026

The U.S. economy is generally healthy, but there are clear areas of strength and weakness. Job growth has remained muted, and consumer cost of living concerns have worsened. Real GDP grew 2.2% annualized in the second quarter, within the recent 2 to 2.5% trend, though final sales to private domestic purchasers, which exclude government spending, trade, and inventory swings, grew 4.2%. Street estimates attribute roughly a third of recent growth to AI investment. Employers added 29,000 jobs in September, short of the 84,000 expected, and August's gain was revised down to 133,000 from 162,000. Unemployment edged up to 4.2% but remained historically low. The consumer is showing signs of strain. In August, disposable income rose 0.3% but was flat after inflation, while inflation-adjusted spending jumped 0.6%. The saving rate fell to 4.1% from 4.6% in July, its lowest level since late 2022. Spending outpaced income, and savings continued to fund the gap. Household debt service remains a manageable 11.1% of disposable income, but wage growth of 3.1% trails inflation of 3.4%.

The war in Iran, now in its seventh month, has shifted from a short-term supply shock to a more persistent headwind. Brent crude trades near $105, up over 50% from a year ago; Middle East oil flows are still down over 20% from their 2025 average. Elevated fuel and freight costs are moving through supply chains, and business surveys show input costs rising at the steepest rate in four years. Companies with limited pricing power will begin feeling this in their margins.

The inflation data is mixed. Headline CPI eased to 3.4% in August from 4.2% in May, and core CPI slowed to 2.4%, lowest since March 2021. Additionally, the Fed's preferred gauge remains above target, with core PCE at 3.0%. The Federal Reserve followed through on the hawkish turn signaled in June. It raised the fed funds target range to 3.75% to 4.00%, and there will likely be one more hike this year. Higher energy costs and a more hawkish Fed have hit the bond market hard. The 10-year Treasury yield reached 5.25%, the highest since 2007, up from 4.15% at the start of the year.

The federal deficit reached $2.0 trillion in the first eleven months of the fiscal year, equating to approximately 6% of GDP. Gross debt passed $40 trillion, and annual interest costs now exceed defense spending. Dealing with this is a political issue but carries real consequences for equity and fixed income markets. The Treasury has stepped up its buybacks of long-term bonds, which are meant to support bond prices and lower yields. Because buybacks do not change the forces pushing them higher (inflation, expected Fed hikes, and heavy borrowing), the impact has been muted. We don't expect a sudden reckoning. The cost of inaction is chronic rather than acute, and is already being paid through higher borrowing rates. We view the main drivers of the deficit as unsustainable social spending programs, growing interest expense on a larger debt load, and fraud, waste, and abuse across government bureaucracies. If current trends persist, higher financing costs will weigh on housing, capital investment, and the federal budget itself.

The S&P 500 Total Return Index gained 2.4% in the third quarter and is up about 12.8% year to date. The forward price-to-earnings ratio fell to 19.2x from 20.4x at the end of June, slightly above the ten-year average of 19.0x, as forward earnings estimates rose 8.9%. Still, with real Treasury yields at their highest in nearly two decades, stocks offer a smaller premium over bonds than they have in years, which means investors are being paid less for higher risk. Consensus estimates call for 30%+ earnings growth in 2026, but that growth is concentrated. Two chipmakers account for roughly a third of this year's profit growth, and much of their revenue comes from the largest hyperscalers, which are expected to spend about $760 billion this year, and potentially $1 trillion next year, on data centers, chips, and networking equipment. At today's yields, that spending must surpass a higher rate of return threshold.

We continue to focus on high-quality companies with reasonable valuations that have durable competitive advantages, strong balance sheets, and the pricing power to protect margins as costs rise. Market disruptions, whether from war, inflation, or anti-business government policy, are a normal occurrence. Long-term investors who follow this disciplined approach should be rewarded over time.

Daniel Sullivan, Portfolio Manager/Investment Analyst

If your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part 2, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.