

October 2, 2026

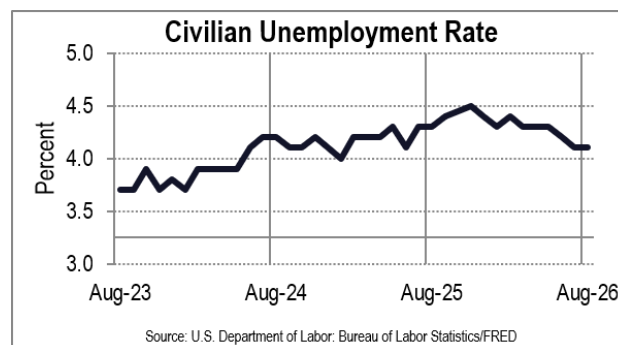
Economic Outlook:

We now enter the last quarter of 2026, and the market recovery of the second quarter has cooled down significantly. The S&P 500 rallied sharply in the second quarter, supported by solid corporate earnings, but with Kevin Warsh taking over as Fed Chair in May and a promise to deliver 2% core inflation, investors are focused on inflation and the potential for higher interest rates.

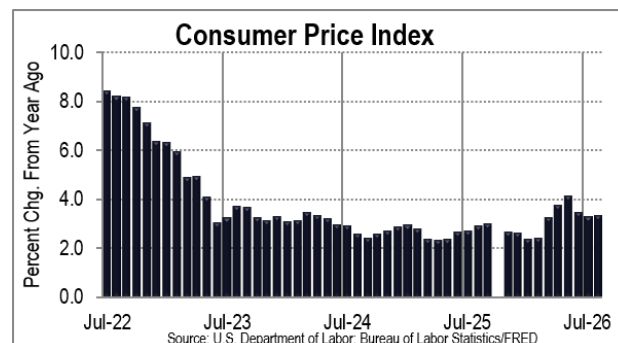
The promise and delivery of higher rates in September erased virtually all the stock market gains enjoyed in July and August. Major equity indexes finished roughly flat for the third quarter. The preference for growth stocks returned in September as higher US Treasury yields weighed on dividend stocks in the industrial and utility sectors. Earlier gains in the small cap and international areas of the market faded as the end of the third quarter arrived.

The conflict in the Middle East remains a large macroeconomic uncertainty. Higher oil prices remain a primary inflation concern despite strong corporate earnings. Equity markets remain near recent highs but the latest spike in long-term bond yield has captured everyone's attention, including ours. Elevated interest rates can be a significant headwind if they become structural. This is something we are watching carefully.

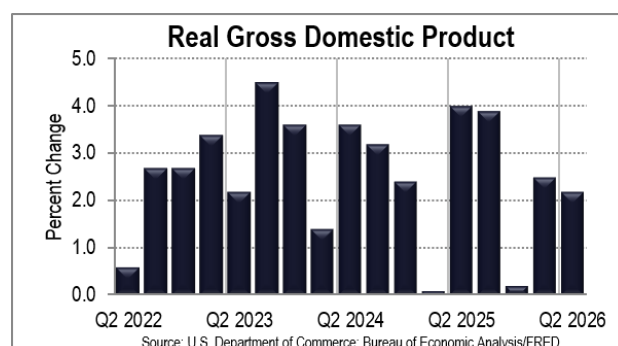
Employment: The September jobs report was just released this morning. Total non-farm payroll employment increased by just +29,000 and the unemployment rate ticked up slightly to 4.2%. This is a weaker than expected report that may relieve some of the concerns over higher yields. Labor force participation held at 61.8%, while the employment-population ratio was little changed at 59.2%. Average hourly earnings rose to \$37.81, up 3.0% over the past 12 months. Job gains were led by leisure and hospitality, healthcare, and construction, while government and temporary help declined.



Inflation: The latest CPI report showed inflation was moving higher in August. The Consumer Price Index rose 0.4% for the month and 3.4% over the past 12 months. Core CPI, which excludes food and energy, increased 0.3% for the month and 2.4% year over year. The increase in headline inflation was driven primarily by higher energy prices, reinforcing the market's concern that the Middle East conflict could keep inflation above the Fed's 2% target for longer than previously expected.



GDP: The economy continued to expand throughout the first half of 2026. The most recent GDP revision estimates GDP grew at 2.2% in the second quarter of 2026. The data indicates that economic activity remains positive, supported by productivity growth, capital investment, and a labor market that has kept pace with workforce growth. While consumer spending remains an important support leg for the economy, higher energy prices and persistent inflation remain risks to growth for the rest of 2026.



Equity Market Review and Outlook:

The third quarter of 2026 extended the equity market's recovery, although performance was more measured than in the spring. The S&P 500 advanced 2.0% and the Nasdaq Composite gained 2.5%, while the Dow Jones Industrial Average declined 2.7%. Resilient economic growth, robust capital investment, and corporate earnings supported equities, but rising Treasury yields, persistent inflation, and geopolitical uncertainty continued to constrain returns for the quarter.

Market leadership evolved during the quarter. Energy, health care, and technology were among the stronger sectors, while industrials, consumer discretionary, and utilities lagged as higher interest rates pressured economically and interest rate-sensitive areas. Artificial intelligence investment remains an important earnings and capital-spending theme, but investors are increasingly scrutinizing valuations and the timing of returns on that spending. With the 10-year Treasury yield finishing the quarter near 5.3%, its highest level in roughly 24 years, continued price to earnings expansion will be significantly challenged.

Looking forward, investors are focused on whether inflation will continue to moderate after the Federal Reserve raised the federal funds target range by 0.25 percentage points to 3.75%–4.00% in September. August headline PCE inflation eased to 3.4%, but it remains well above the Fed's 2% objective, leaving open the possibility of additional tightening. Energy prices, Middle East developments, and long-term Treasury yields, will be important drivers in Q4 2026. We continue to believe that strong economic activity and earnings growth can support equities through the remainder of 2026; however, elevated valuations and tighter financial conditions argue for disciplined expectations.

Fixed Income Market Review and Outlook:

The Federal Reserve raised the federal funds target range to 3.75% to 4.0% at its September meeting. After two years of progress in reducing inflation, policymakers are now confronting a renewed inflation challenge tied to energy prices. The Fed's latest statement emphasized that inflation remains elevated relative to its 2% goal and that the Committee remains committed to price stability.

Treasury yields moved significantly higher during the quarter as investors adjusted to a more aggressive policy outlook. Latest data show the 10-year US Treasury yield at 5.3%, a 24 year high. The current fixed income outlook is quite challenging. Yields across all maturities have spiked recently as inflation continues to run above target. We continue to favor quality but will look to extend duration at these elevated yield levels.

Conclusion

The foundation of the economy remains sound, supported by continued job growth, strong capital investment, and corporate earnings. However, inflation and the recent spike in interest rates now dominate the outlook. We have made portfolio adjustments where appropriate, but we continue to caution against dramatic changes in asset allocation during volatile market periods. Diversification and discipline remain the best tools for navigating the rest of 2026.

Thank you for your continued confidence,



Warren M. Hurt
Senior Vice President/Chief Investment Officer

