

**Quarterly Market Review****Strength at the Surface, Risks Beneath It**

The third quarter of 2026 provided investors with a useful reminder that the performance of a market index and the experience of the average stock can be two very different things.

The S&P 500 gained approximately 2.5% during the quarter and was up 12.7% through September. The Nasdaq rose 3.3% in Q3 and 16% year-to-date. However, the Dow fell 2.3%, while the Russell 2000 declined 6.9%.

The divergence was even more pronounced within the market. Large-cap technology and artificial-intelligence-related companies continued to attract capital, while many rate-sensitive and economically sensitive areas struggled. Energy was the strongest S&P 500 sector, gaining approximately 17% during the quarter.

At the same time, the bond market experienced one of its most difficult quarters in years. The 10-year Treasury yield rose from 4.44% at the end of June to 5.29% at the end of September, while the Bloomberg U.S. Aggregate Bond Index declined 3.3%.

In short, Q3 was a quarter in which economic growth and corporate earnings remained strong, but higher inflation expectations and rising interest rates increasingly challenged financial markets.

The Economy: Still Strong

The U.S. economy continues to demonstrate considerable resilience. The Federal Reserve described economic activity as expanding at a solid pace, with resilient domestic spending, strong productivity growth and robust capital investment. Employment also remained relatively stable.

The most important source of economic strength may be the continued investment boom surrounding artificial intelligence. Companies are committing enormous amounts of capital to data centers, semiconductors, networking equipment and related infrastructure. This investment is creating a powerful earnings and productivity tailwind. The challenge is that strong

economic growth can also make it more difficult for the Federal Reserve to bring inflation back to its 2% objective.

The Federal Reserve: Higher for Longer

The Federal Reserve raised the federal funds target range by 25 basis points in September to 3.75%-4.00%. It was the first rate increase in more than three years. The Fed cited elevated inflation while acknowledging that economic activity and capital investment remained strong.

The more significant development, however, occurred in the longer-term bond market. The 10-year Treasury yield surged to 5.29% by quarter-end, while the 30-year Treasury reached approximately 5.64%. These levels represent a dramatic change in the investment landscape.

Higher long-term rates matter because they affect virtually every asset valuation. They increase borrowing costs for businesses and consumers, reduce the present value of future cash flows and make high-quality bonds increasingly competitive with equities. This is particularly important for stocks trading at elevated valuations.

Valuations Leave Less Room for Error

The S&P 500 remains expensive relative to long-term averages. An elevated valuation does not necessarily mean the market is overvalued. Rapid earnings growth can justify higher multiples. However, the combination of elevated valuations and rising interest rates creates a less forgiving environment.

If earnings continue to exceed expectations, stocks can continue to perform well. But if earnings estimates begin to decline—or if long-term interest rates continue moving higher—the market could become more vulnerable to a valuation adjustment.

This is particularly important for the largest technology companies, where expectations for future growth are exceptionally high.

The Market Beneath the Market

Perhaps the most important development of the quarter was weak market breadth. The S&P 500 remained strong largely because of the performance of its largest constituents. The capitalization-weighted index

significantly outperformed the broader market, while smaller companies and many traditional sectors declined.

This creates an unusual environment: the index looks healthy while a large portion of the underlying market does not.

This does not necessarily signal that a bear market is approaching. In fact, narrow leadership can persist for considerable periods when the companies leading the market continue to produce strong earnings. But it does mean that investors should be careful about interpreting an index near record highs as evidence that the overall market is broadly healthy.

Bonds: A Problem That Has Become an Opportunity

The sharp increase in Treasury yields was painful for bond investors during Q3. Year to date, the Bloomberg U.S. Aggregate Bond Index declined approximately 3.3%, while longer-duration Treasury securities performed considerably worse. Yet the rise in yields has also created a meaningful long-term opportunity. Investors can now obtain substantially higher yields from high-quality fixed income than were available only a few years ago. For long-term investors, this changes the role of bonds in a portfolio.

Rather than serving primarily as a low-return defensive asset, bonds can once again provide meaningful income while offering diversification against an equity-market correction.

Investment Strategy & Outlook

As we enter the fourth quarter, we believe three variables deserve particular attention.

Earnings - The earnings environment remains the strongest argument supporting the equity market. If companies continue to exceed expectations and raise guidance, elevated valuations can be sustained. If earnings estimates begin to decline, the market's concentration and valuation risks become considerably more important.

Interest Rates - The 5%+ 10-year Treasury yield is perhaps the biggest change investors face compared with the beginning of the year. A stabilization or decline in long-term yields would provide an important tailwind for stocks. Conversely, another substantial move higher could put pressure on valuations across the equity market.

Market Breadth - We will be watching whether market participation broadens beyond the largest technology and AI companies. A healthier bull market would involve greater participation from industrials, financials, consumer companies and other areas of the economy. If the S&P 500

continues rising while the majority of stocks struggle, the market deserves a more cautious interpretation.

Investment Outlook

We remain constructive on the long-term prospects for the U.S. economy and corporate America. The economy remains resilient, productivity is benefiting from technological investment, and corporate earnings are growing rapidly.

At the same time, we believe investors should recognize that the easy part of the market's advance may be behind us. Higher interest rates, persistent inflation, elevated valuations and narrow market leadership all argue for greater selectivity.

The environment favors companies with strong balance sheets, durable competitive advantages, recurring cash flow and the ability to grow earnings and dividends over time. It also favors a disciplined approach to valuation. The most attractive opportunities may not necessarily be found in the stocks that have driven the market to new highs. They may increasingly be found among high-quality companies that have been overlooked as capital has concentrated in a relatively small number of mega-cap technology companies.

As always, thank you for the trust and confidence you place in us to help manage your financial affairs. We appreciate the opportunity to work with you and your family and remain committed to helping you navigate changing market conditions with discipline and a long-term perspective.

Capital Markets Scorecard

Benchmark Description	Q3	YTD
U.S. Treasury 3 Month T-Bill	0.90%	2.70%
Barclays Aggregate Bond Index	-3.33%	-2.91%
Bloomberg US High Yield Bond	-1.83%	0.10%
S&P 500 Index Total Return	2.52%	12.75%
S&P 500 Equal Weight Index Total Return	-2.11%	10.03%
NASDAQ Composite Total Return	3.29%	16.09%
S&P U.S. Dividend Growers Total Return	-1.01%	10.37%
Russell 2000 Index Total Return	-6.87%	13.71%
Alerian MLP Index Total Return	2.43%	20.70%
MSCI Emerging Markets Index	-2.96%	23.42%
China SCI 300 Index Local Currency	-11.35%	-4.09%
U.K. FTSE 100 Index Local Currency	0.35%	7.78%
Japan Nikkei 225 Index Local Currency	-1.52%	39.03%

Performance data as of 09/30/2026. Stokes Capital Advisors, LLC is a Registered Investment Adviser. This market commentary is solely for informational purposes. Advisory services are only offered to clients or prospective clients where Stokes Capital Advisors, LLC and its representatives are properly licensed or exempt from licensure. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Stokes Capital Advisors, LLC unless a client service agreement is in place.