

Q3 2026 Summary

Higher Rates, Renewed Energy Pressure, and an AI-Led Market

Presented by: HKS Financial Partners

The third quarter of 2026 tested the optimism that carried markets through Q2. The quarter opened with hopes that a U.S.-Iran memorandum of understanding would bring lasting calm. Instead, the framework broke down, fighting resumed, and crude climbed back above \$100 per barrel in September. Meanwhile, the U.S. economy proved stronger than expected, inflation stayed well above target, and the Federal Reserve raised rates for the first time since 2023. Growth held up, but the cost of money moved meaningfully higher.

U.S. equities finished modestly higher, but the picture was uneven. The S&P 500 and Nasdaq Composite each gained roughly 2% for the quarter, while the Dow Jones Industrial Average fell about 2.7%. Leadership narrowed sharply around artificial intelligence (AI) and semiconductor companies. Large-cap growth stocks outperformed, while small- and mid-cap stocks gave back a meaningful portion of their strong first-half gains.

Bonds had a difficult quarter. Treasury yields rose across the curve, with the 10-year yield climbing from roughly 4.4% at the end of June to near 5.3% by late September, its highest level since 2007. The 2-year yield rose even more sharply as markets priced in additional Fed hikes. Because bond prices fall when yields rise, the Bloomberg U.S. Aggregate Bond Index declined and slipped into negative territory for the year. The silver lining for income-oriented investors is that starting yields on high-quality bonds are now at their most attractive levels in nearly two decades.

US Markets Recap				
	July 2026	Aug. 2026	Sept. 2026	Q3 2026
S&P 500	-0.06%	2.72 %	-0.35%	2.30%
Nasdaq	-3.19%	3.99%	1.93%	2.61%
S&P 600	-1.90%	-0.6%	-5.57%	-7.93%
S&P Composite 1500	-0.23%	2.51%	-0.67%	1.58%
10-Year Treasury Yield (Avg/Period-End)	4.6%/4.75%	4.68%/4.75%	4.99%/5.29%	4.76%/5.29%
Fed Funds Rate Target Range	3.5%-3.75%	3.5%-3.75%	3.75%-4.0%	3.5%-4.0%

Source: Morningstar Direct, US Treasury, and Federal Reserve Bank of New York as of 9/30/2026

Quarter-in-Review: From Ceasefire Hopes to Rate Hikes

July – Ceasefire Unravels, Tariff Regime Shifts

July began with WTI crude near \$67 per barrel, but optimism faded as the U.S.-Iran framework deteriorated and shipping through the Strait of Hormuz was disrupted again. Technology stocks experienced a sharp but short-lived selloff. On trade, the temporary 10% Section 122 tariff expired on July 24 and was immediately replaced by new Section 301 tariffs of 10% to 12.5% on dozens of trading partners. The Fed held rates steady on July 29, but three officials dissented in favor of a hike, an early signal of the shift to come.

August – Earnings Strength Meets a Hawkish Fed

August was the quarter's most constructive month. Second-quarter earnings season was exceptionally strong, capped by a blockbuster report from Nvidia that renewed confidence in AI spending. The tone shifted late in the month when Fed Chair Kevin Warsh delivered hawkish remarks at the Jackson Hole symposium, signaling that inflation was not slowing fast enough and pushing rate-hike expectations sharply higher.

September – Oil, Yields, and the First Hike Since 2023

September brought the quarter's biggest challenges. Renewed U.S.-Iran strikes, attacks on Saudi energy infrastructure, and Houthi activity near the Red Sea pushed WTI crude to nearly \$105 in mid-September, while diesel prices reached record highs. On September 16, the Fed unanimously raised its target range by 25 basis points to 3.75%–4.00%, and most officials signaled another hike is possible this year. Treasury yields surged in response. Stocks held up at the index level, but technology was the only major sector to gain for the month.

Sector Snapshot: Energy and AI Lead, Rate-Sensitive Areas Lag

Sector performance in Q3 was relatively concentrated, with leadership confined to a few areas and split along two clear fault lines: oil and interest rates. Energy was the strongest sector for the quarter, gaining over 15% as crude prices rebounded from their early-July lows. Technology and communication services also finished higher, led by semiconductor and AI infrastructure companies. Chipmakers were especially strong in September, with Advanced Micro Devices surpassing \$1 trillion in market value. Health care also gained.

The laggards were the most rate-sensitive and economically sensitive parts of the market. Utilities and real estate declined sharply, as higher Treasury yields made their dividends less attractive by comparison. Industrials, consumer discretionary, and materials also fell amid higher fuel and borrowing costs. The key takeaway is concentration: market gains depended heavily on a narrow group of AI-related companies, leaving index returns more exposed to any shift in sentiment around that theme.

International Markets: Strong Year, Choppier Quarter

International stocks remain ahead of U.S. stocks for the year, though the third quarter was more mixed. Developed international markets posted modest gains through late September, supported by solid corporate earnings, though Europe faced renewed pressure from higher natural gas prices. Emerging markets were roughly flat for the quarter after an exceptionally strong first half. Technology-heavy Asian markets continued to benefit from global AI demand, while energy-importing economies felt the strain of higher oil prices.

Rising interest rates were a global story. Ten-year government bond yields also climbed in France, Germany, and Japan, a sign that higher borrowing costs are not unique to the U.S.

International Markets Recap				
	July 2026	Aug. 2026	Sept. 2026	Q3 2026
Hang Seng (China)	13.42%	-1.01%	-3.30%	8.57%
KOSPI (Korea)	-23.62%	2.47%	0.97%	-20.97%
Nikkei (Japan)	-8.13%	3.08%	1.14%	-4.23%
Sensex (India)	2.28%	-1.34%	-5.80%	-4.94%
ASX 200 (Australia)	2.26%	1.53%	-2.43%	1.30%
DAX (Germany)	2.53%	2.45%	-4.03%	0.81%
CAC 40 (France)	1.31%	-2.06%	-4.23%	-4.96%
IBEX 35 (Spain)	2.06%	0.97%	-2.73%	0.24%
IT40 (Italy)	0.97%	0.85%	-2.36%	-0.58%

Source: Bloomberg as of 9/30/2026

Economic Overview: Strong Growth, Sticky Inflation

The U.S. economy showed considerable strength in Q3. Second-quarter GDP growth was revised up to a 2.2% annualized rate, supported by consumer spending and AI-related investment. August payrolls rose by 162,000, exceeding expectations, while the unemployment rate held at 4.1%. Retail sales jumped 1.2% in August, and weekly jobless claims fell to some of their lowest levels in decades.

Inflation remained the main concern. August CPI ran at 3.4% year-over-year, and the PCE price index, the Fed's preferred gauge, rose 3.4%, though that reading came in below

expectations. Energy was a key driver, as record diesel prices raise costs for freight, farming, and construction. Tariffs remain a factor as well. A federal trade court challenge to the new Section 301 tariffs heard arguments on September 30, adding another layer of uncertainty. The Fed's unanimous September rate hike suggested more cohesion about policy than it had appeared in the first half of the year.

Looking Ahead: Themes Worth Monitoring in Q4

As investors move into the fourth quarter, several issues deserve close attention:

- Energy markets remain a central variable. Developments in the Middle East can quickly affect oil prices, inflation, and consumer sentiment.
- The Fed's next steps will be closely watched, including its late-October meeting, as policymakers weigh strong growth against stubborn inflation.
- Long-term interest rates bear watching for their effects on mortgage rates, corporate borrowing costs, and equity valuations.
- AI earnings will remain in focus, as market leadership depends heavily on continued strength in a narrow group of companies.
- Trade policy and the November midterm elections may shape the outlook for tariffs, fiscal policy, and market sentiment.

Conclusion

The third quarter reinforced that the U.S. economy remains resilient, but the environment has become more demanding. Growth and corporate earnings stayed strong, while energy shocks, persistent inflation, and the Fed's first rate hike since 2023 pushed borrowing costs to multi-year highs. Equity gains were narrow and bond returns were negative, yet higher yields have improved the income potential of fixed income. For long-term investors, the quarter underscored the value of diversification across asset classes, sectors, and regions.

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Index Definitions

S&P 500® Index – A market-capitalization-weighted index of approximately 500 large-capitalization U.S. companies, representing a broad measure of the U.S. equity market.

NASDAQ Composite Index – An index that tracks the performance of more than 3,000 stocks listed on the NASDAQ exchange, heavily weighted toward technology and growth-oriented companies.

Dow Jones Industrial Average Index - A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

S&P 600® Index – A market capitalization-weighted index of approximately 600 companies that measures the performance of selected U.S. stocks with a small market capitalization.

S&P 1500® Composite Index – A broad-based market capitalization-weighted index of approximately 1500 U.S. companies and is comprised of the S&P 400, S&P 500, and the S&P 600.

Hang Seng Index – A benchmark index tracking large-capitalization companies listed on the Hong Kong Stock Exchange, including both Hong Kong-based and mainland China companies.

KOSPI Index – The primary stock market index of South Korea, tracking large-capitalization companies listed on the Korea Exchange.

Nikkei 225 Index – A price-weighted index of 225 large, publicly traded companies listed on the Tokyo Stock Exchange.

S&P BSE Sensex Index – A benchmark index of 30 large-capitalization companies listed on the Bombay Stock Exchange, representing a segment of the Indian equity market.

S&P/ASX 200 Index – An index measuring the performance of approximately 200 large-capitalization companies listed on the Australian Securities Exchange.

DAX Index – A market-capitalization-weighted index tracking 40 large companies listed on the Frankfurt Stock Exchange in Germany.

CAC 40 Index – A benchmark index of 40 large-capitalization companies listed on Euronext Paris, representing the French equity market.

IBEX 35 Index – A benchmark index tracking 35 of the most liquid companies listed on the Spanish stock exchanges.

IT40 Index – A benchmark index tracking 40 of the most liquid companies listed on Borsa Italiana, representing the Italian equity market.

MSCI EAFE Index – An equity index which captures large and mid-cap representation across 21 Developed Markets countries* around the world, excluding the US and Canada

MSCI Emerging Markets Index – An index representing large- and mid-capitalization companies across emerging market countries.

S&P GSCI™ Gold Index – A sub-index of the S&P GSCI designed to measure the performance of gold commodities through futures contracts.

Bloomberg Global Aggregate Bond Index – A broad-based benchmark measuring the performance of global investment-grade fixed-income markets, including government, corporate, and securitized bonds.

Bloomberg U.S. Aggregate Bond Index – A benchmark index representing the U.S. investment-grade fixed-income market, including government, corporate, mortgage-backed, and asset-backed securities.

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