



ARGUS ECONOMIC COMMENTARY

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The Stock Market and Economy in 3Q26

Investors did not quite know what to make of the investing environment in 3Q26, so they did a little bit of everything. The S&P 500 fell in two of the three third-quarter months, as the war with Iran appeared to simultaneously slide deeper into stalemate and widen to Yemen (to the detriment of Saudi Arabia). Economic data suggested a resilient though pressured consumer, as inflation continued to worsen without spiraling up to peak 2022 levels. The quarter featured another exceptionally strong earnings season and a solid gross domestic product (GDP) report; but both were for the calendar second quarter and provided limited insight as to what lays ahead.

Environment: Third-Quarter 2026

During 3Q26, the stock market was little changed in typically strong July, rallied in typically so-so August, and declined moderately in typically bad September. That followed a similarly volatile first half, in which stocks were up in three months and down in three months. The turbulent and contra-calendar performance in 3Q26 tracked trends in inflation and interest rates, which in turn were driven by developments in the war with Iran and the flow of oil in the Middle East.

The S&P 500 slipped by 0.1% in July despite a strong start to the calendar 2Q26 earnings season. July was impacted by rotation out of AI and semiconductor stocks and by fears that the collapse of the Memorandum of Understanding with Iran would lead to renewed warfare, reduced oil flow, and higher inflation. The index surprised with a 2.6% win in August 2026, as another exceptionally strong earnings season reassured investors about stock valuations. The U.S. Department of the Treasury announced plans to buy back long bonds, temporarily pushing down rates. September saw a 0.5% decline in the S&P 500 that could have been worse. The Fed raised interest rates for the first time in three years. The war widened as Yemen's Houthis seized Red Sea-adjacent

ports and Saudi Arabia's East-West pipeline was bombed, further constricting Saudi oil flows. Altogether, the S&P 500 posted 2.03% capital appreciation in 3Q26 as tepid July and September book-ended a strong August. That gain followed a 14.9% rise in 2Q26 and a 4.6% decline in 1Q26. The index in 3Q26 delivered its weakest second quarter since 2023.

The Nasdaq Composite Index rose 2.47% in 3Q26 while the blue-chip Dow Jones Industrial Average (DJIA) declined 2.70% in the quarter. Growth stocks narrowed their performance gap with value stocks, and small caps (Russell 2000) retraced from mid-year leadership.

The Memorandum of Understanding signed between the U.S. and Iran, which had seemed to represent the best chance to end the war, lapsed in June and has not been replaced. The U.S. has effectively blocked any Iranian oil exports, causing massive currency devaluation and inflation in that nation.

September 2026 nonfarm payrolls growth of 29,000 was below the consensus estimate of 90,000. Given downward revisions to the prior two months, nonfarm payrolls averaged a monthly gain of 51,000 for July-September, compared with previously reported average gain of 71,000 for June-August. The unemployment rate was 4.2% in September, breaking a two-month string of 4.1% readings for August and July. Average hourly earnings for September grew 3.0% annually. For the past few years, annual wage growth stayed ahead of rising prices, but wage growth is now running behind inflation.

The main bulwark of the bull market has been growth in corporate earnings. Second-quarter 2026 annual earnings growth of about 30% (excluding two massive one-time gains) was the second highest since 4Q21, which had an easy comparison against the COVID-19 shutdown quarter of 4Q20. Annual revenue growth for 2Q26 was about 14%. More than

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ECONOMIC & MARKET COMMENTARY (CONT.)

85% of companies reported calendar 2Q results that were above consensus expectations, higher than the long-term range of 75%-80%. Companies exceeded calendar 2Q26 EPS expectations in low-teen percentages, compared to an historical beat against expectations in the 5%-7% range.

The final report of 2Q26 GDP indicated annualized growth of 2.2%, down slightly from (revised) 2.5% growth in 1Q26. In broad strokes, the 2Q26 GDP report showed a resilient consumer economy rebounding from weak consumer spending in the first quarter and a commercial economy pulling back only slightly from 1Q's aggressive spending on AI. Large swaths of the consumer economy are struggling, with households making hard choices on spending.

Second-quarter 2026 personal consumption expenditures (PCE) increased a healthy 3.8%, rebounding sharply from PCE growth of 0.7% (revised) in 1Q26. Total spending on goods increased 4.5% in 2Q26, led by a 7.4% rise in durable goods spending. Spending on services grew 3.4% in 2Q26, up sharply from 0.7% (revised) in 1Q26. PCE contributed 2.51 percentage points to 2Q26 GDP, after contributing just 0.49 points in 1Q26. Nonresidential fixed investment, the proxy for corporate capital spending, rose by 9.0% in 2Q26, down from 9.9% in 1Q26. The AI boom drove 13.4% growth in equipment spending and 9.2% growth in intellectual property products. Nonresidential fixed investment contributed 1.25 points to total 2Q26 GDP. PCE and nonresidential fixed investment contributed a combined 3.76 percentage points to 2Q26 GDP growth after contributing 1.85 points to 1Q26 GDP growth. That was undercut by net import-exports and private inventories, which subtracted a combined 1.63 percentage points from 2Q26 GDP.

The purchasing managers' reports from the Institute for Supply Management showed the industrial and services economies clearly in expansion territory. The Manufacturing PMI was at 54.5% and the Services PMI was at 54.9% in September, both above the 50 demarcation line between expansion and contraction.

The Conference Board's Consumer Confidence Index fell to 81.9 in September 2026 from 88.6 in August, hitting a seven-month low. The Index of Consumer Sentiment from the University of Michigan was 48.1% in September, down from 51.7% in August as war-related inflation drove gas prices higher and consumers fretted about jobs availability.

The PCE Price Index within 2Q26 GDP rose by 5.0%, compared with 4.2% in 1Q26 (revised down from 4.6%). Excluding energy and food, Core PCE (the Fed's preferred inflation gauge) rose 3.3% in 2Q26 compared to 3.9% growth in 1Q26 (revised from 4.4%).

In the Personal Income & Outlays report for August, the annual change of 3.0% in the core PCE price index was stable with 3.0% in July; both moderated from 3.3% in June, which was the highest in three years.

August 2026 data from the consumer and commercial economies showed that inflation remains a problem. The annual change in the all-items consumer price index (CPI) for August was 3.4%, level with July. The August core CPI (excluding food and energy) rose 2.4% from a year earlier, compared 2.5% for July.

The all-items producer price index (PPI) in August 2026 increased 5.4% on a year-over-year basis, rising from an annual change of 4.7% in July. On a core basis, which strips out food, energy, and trade services, August PPI rose 4.7% annually, flat with July.

Interest rates, which have increased throughout 2026, surged in September. The 10-year Treasury yield was 5.24% as of the end of September 2026, compared with 4.70% as of the end of August and 4.14% at year-end 2025. The two-year Treasury yield was 4.78% as of the end of September 2026, versus 4.24% as of the end of August and 3.45% as of year-end 2025. Fed Chairman Kevin Warsh is confronting the reality of inflation that demands a policy response. At its September 2026 meeting, the FOMC raised the fed funds rate for the first time in three years, by 25 basis points.

The 11 sectors within the S&P 500 began to shift away from growth and toward defensive, rate-sensitive, inflation-hedge, and cyclical in the second half of 2025. The dominance of growth leadership has been broken, although Information Technology is still a perennial top-five sector. In 3Q26, the best performers spanned a variety of investing styles, from inflation-hedge to growth to defensive. Energy led with 14.5% gain. Other winning sectors in 3Q26 included Healthcare (up 6.8%), Information Technology (up 5.0%), and Communication Services (up 3.6%). More sectors declined than advanced in 3Q26, including Consumer Discretionary, Consumer Staples, Financial, Industrial, Utilities, Real Estate, and Materials. We believe that greater diversity in sector leadership and rotation away from overreliance on growth is positive for sustaining the health and length of the bull market.

Conclusion

As the third quarter wound down, the AI trade experienced another one of its bouts of profit-taking, and that trend has carried into the fourth quarter. That rotation out of technology stocks enabled lately out of favor consumer sectors to recover modestly late in the quarter.

October is a solidly positive stock month on average, but it is the weakest of the fourth-quarter months. This often-conflicted month posted stock-market declines in two of the past four years. So far, October 2026 is more conflicted than positive. We continue to expect the stock market in 2026 to carry its tattered but still double-digit gain through nine months into a solid year-end finish.

Jim Kelleher, CFA,
Director of Research

KEY ECONOMIC FORECASTS

- The \$33 trillion U.S. economy remains on course for productive long-term growth, powered by corporate investments in artificial intelligence (AI). Nvidia Corp. CFO Colette Kress estimated in May that AI infrastructure spending is on track to reach \$3 trillion-\$4 trillion annually by the end of this decade.
- Real potential gross domestic product (GDP) — the sustainable speed limit of the US economy — is poised to increase to 2.1%, on average, through 2030, according to the Congressional Budget Office. AI is likely to raise productivity, offsetting slower growth in the labor force from an aging population and reduced immigration.
- We raised our 2026 GDP growth forecast to 2.4% from 2.2%. We also boosted our 2027 forecast to 2.4%, up from 2.2. We initiated an estimate for growth of 2.2% in 2028. In an August 2026 speech, Tom Barkin, president of the Federal Reserve Bank of Richmond, cited the low unemployment rate and a record 59 months with unemployment below 4.5% as keys to the economy's resilience. President Barkin added that "consumers aren't feeling as much pressure to cut back" when they have jobs.
- Argus expects S&P 500 earnings per share (EPS) to rise almost 25% to \$340 in 2026 and increase about 15% to \$390 in 2027. EPS are helped by an increase in operating margins to about 19% this year. Growing tech giants such as Microsoft Corp. and Nvidia have higher margins than Dow stalwarts such as Walmart Inc. and Caterpillar Inc. Argus expects the S&P 500 to trade in a range of 6,900-8,450 over the next 12 months. Our year-end 2026 price target for the S&P 500 is 8,000, based on a multiple of 20.5-times our 2027 EPS estimate.
- The Misery Index, which is the Consumer Price Index (CPI) inflation rate plus the unemployment rate, is 7.9%, below the average of 9.1% since 1949, but up from 6.7% in January. Unemployment is low, at 4.2%. Inflation remains elevated at 3.7% in September, but it is below the recent peak of 4.2% in May.
- Gasoline prices at \$4.30 a gallon are straining consumers' preholiday spending. Inflation will be a key issue in fall elections for control of Congress. Looking ahead to 2027, the Energy Information Administration outlook calls for a recovery in oil supply and ultimately a surplus. If that's the case, West Texas Intermediate likely will resume its secular downtrend. Our preliminary 2027 outlook is \$70 a barrel, down from \$80 in 2026.
- The yield on the 10-year Treasury bond has jumped to about 5.15%, up from 3.95% before the escalation of the conflict with Iran. The 10 year has a bigger and more direct effect on the economy than an equivalent move in the Federal Funds rate. We expect the 10 year to end 4Q27 in a range of 4.0%-5.0%.
- Gold, the ancient safe-haven asset, is likely to remain at high levels, in a range of \$3,500-\$5,000 an ounce in 2027, amid buying by central banks, global uncertainty, and concerns about the U.S. budget deficit.
- The Federal Open Market Committee voted 12-0 in September to raise the Fed Funds target by a quarter point to 3.75%-4.0%. Argus Fixed Income Strategist Kevin Heal expects another hike in December before the Fed moves to the sidelines in 2027. We expect the dollar to be flat to firmer over the next year, helped by higher rates and demand for shares of innovative U.S. companies.
- What could go right? Low unemployment, strong S&P 500 earnings, ongoing innovation, spending by wealthy consumers, massive capital investment in AI, and productivity gains.
- Risks: Higher interest rates, a pause in investment by AI companies, a weak housing market, inflation/ strains on affordability, hostilities with Iran, and U.S. budget deficits raising the national debt.

CURRENT ECONOMIC RELEASES

Current Economic Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
15-Oct	PPI Final Demand	September	5.6%	5.5%	5.4%	6.3%
	PPI ex-Food & Energy	September	4.8%	4.5%	4.4%	5.0%
	Retail Sales	September	5.6%	5.6%	NA	6.3%
	Retail Sales ex-autos	September	6.3%	6.5%	NA	7.2%
	Business Inventories	August	4.0%	5.5%	NA	4.6%
16-Oct	Industrial Production	September	1.6%	1.7%	NA	2.2%
	Capacity Utilization	September	76.4%	76.4%	76.5%	76.9%
	Import Price Index	September	6.7%	7.5%	NA	8.1%
20-Oct	Housing Starts	September	1,288K	1,305K	1,300K	1,221K
22-Oct	Leading Index	September	-0.1%	0.2%	-0.1%	NA
27-Oct	Durable Goods Orders	September	8.4%	13.0%	NA	NA
	New Home Sales	September	684K	645K	650K	NA
	Consumer Confidence	October	81.9	80.0	81.3	NA
28-Oct	GDP Annualized QoQ	3Q "Advance"	2.2%	3.1%	3.7%	NA
	GDP Price Index	3Q "Advance"	6.1%	3.2%	NA	NA
	PCE Deflator	September	3.4%	3.6%	3.6%	NA
	PCE Core Deflator	September	3.0%	3.1%	3.1%	NA
	Personal Income	September	4.3%	4.2%	NA	NA
	Personal Spending	September	6.1%	6.0%	NA	NA

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