

Quarterly Economic and Market Review

Q3 2026

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Markets Navigate a Changing Battlefield

David Lundgren, CFA, Chief Investment Officer

The third quarter of 2026 was dominated by a Middle East conflict that increasingly shifted from a traditional military campaign toward an economic struggle. After months characterized by missiles, drones and airstrikes, the United States focused on weakening Iran's economy by targeting critical infrastructure and restricting traditional supply routes. Iran, meanwhile, sought to exert economic pressure by disrupting energy flows through the Strait of Hormuz and other important regional transportation routes. The collapse of an earlier memorandum of understanding and renewed hostilities during the quarter pushed oil prices higher and reinforced the vulnerability of global energy markets. At the same time, global markets demonstrated considerable adaptability as producers rerouted supplies, alternative transportation routes became more effective, and additional production helped offset some of the disruption.

The economic consequences extended well beyond energy markets. Higher oil prices, along with elevated transportation, freight and other input costs, broadened inflation pressures that were already proving stubborn. Although inflation moderated somewhat from its spring peak as alternative oil supply routes became more effective, it remained well above the Federal Reserve's 2% target. In response, the Fed made a dramatic pivot from the easing outlook that prevailed at the beginning of the year, raising the federal funds rate by 25 basis points in September, its first increase since 2023. New Fed Chair Kevin Warsh inherited a particularly difficult environment, but a unanimous decision to raise rates reinforced the Fed's commitment to price stability. Markets ended the quarter anticipating another potential increase before year end and possibly additional tightening in 2027.

Bond investors had even more to digest. The combination of higher oil prices, persistent inflation, a more hawkish Federal Reserve, surprisingly strong economic growth and growing concerns over federal spending and debt drove a significant repricing across the Treasury market. The 10-year Treasury yield surged from 4.47% at the beginning of the quarter to 5.30% at quarter end, while shorter-term yields rose even more sharply as investors adjusted expectations for Fed policy. Rising yields weighed heavily on bond prices, with most major fixed income sectors posting negative quarterly returns and the Bloomberg U.S. Intermediate Aggregate declining 2.6%. The silver lining is that the repricing has left investors with some of the most attractive nominal yields available in decades.



Despite higher energy prices and interest rates, the U.S. economy did considerably more than simply weather the storm. Consumer spending rebounded following weakness earlier in the year, supported by a healthy labor market, rising incomes and exceptionally strong household balance sheets. Even more impressive has been the strength in business investment, where spending on equipment, software, data centers and other infrastructure has helped produce the strongest sustained economic acceleration since the pandemic recovery. Artificial intelligence remains an important catalyst, but the investment cycle extends well beyond AI itself as capital spending increasingly flows throughout the broader economy.

Perhaps most encouraging is growing evidence that this investment is translating into higher productivity. Industries that have been among the earliest adopters of AI tools are now generating productivity growth approaching 5%, providing an important potential source of sustainable economic growth and corporate profitability. Higher productivity allows businesses to produce more with the same resources, supports wage growth without necessarily generating equivalent price increases, and provides additional capital for future investment and innovation. While higher interest rates and energy costs remain headwinds, the combination of resilient consumers, exceptional capital investment and improving productivity leaves the underlying U.S. economy on remarkably solid footing.

Equity investors were understandably less enthusiastic than during the extraordinary second-quarter rally. The S&P 500 gained a modest 2.3% during the third quarter, a sharp slowdown from its 15.2% advance in the second quarter, as persistent uncertainty surrounding Iran, rising oil prices and higher interest rates produced a rockier environment. Market leadership also narrowed considerably, with large-cap technology and energy stocks providing important support while small- and mid-cap stocks declined sharply. Despite the more challenging market environment, underlying fundamentals remained strong, supported by robust economic growth, rising earnings expectations and continued investment in AI and related infrastructure. International markets produced mixed results, while the combination of strong underlying fundamentals and elevated geopolitical and inflation risks left investors with a constructive, but more selective, outlook heading into the final quarter of the year.

As the quarter ended, investor attention increasingly shifted toward November's midterm elections. Political trends became another source of uncertainty as investors considered the possibility of changes in congressional control and what that could mean for the final two years of President Trump's term. Even a change in control would not necessarily translate into major new legislation given presidential veto authority and the Senate's 60-vote threshold for most legislation. However, control of Congress can materially influence the policy environment through government funding and appropriations, committee leadership, investigations and oversight, and, in the Senate, confirmation of presidential nominees. For investors, the more important consideration is not predicting the election outcome, but understanding how potential changes in tax, spending, regulatory, trade and energy policies could ultimately affect economic growth, interest rates, and corporate earnings.

The first nine months of 2026 have provided investors with no shortage of reasons for concern: war in the Middle East, volatile energy prices, renewed inflation, higher interest rates and considerable political uncertainty. Yet beneath those headlines, the fundamental picture has remained remarkably resilient. The economy continues to expand, businesses are investing at a historic pace, productivity is improving, and corporate earnings remain strong. As we enter the final quarter of the year, markets will continue weighing very real risks against an economy benefiting from innovation, capital investment and improving productivity. Periods of volatility are inevitable, but history continues to remind us that maintaining perspective and focusing on long-term fundamentals remain among the most important disciplines for successful investing.





3Q26 Key Investment Highlights

ECONOMY

Inflation and the Fed

Tariff pass-throughs, the oil price shock related to the Arabian Gulf conflict and a change in Federal Reserve leadership reversed the Fed's gradual easing stance under former Chair Powell. New Chair Kevin Warsh has taken a more hawkish approach as inflation pressures have increased.

Economic Growth Re-emerges

With earlier tariff disruptions fading and the oil supply shock stabilizing somewhat, distortions to Real GDP from net exports and inventory swings are normalizing. A clearer picture of a resilient and robust U.S. economy is beginning to re-emerge.

AI and Productivity

Recent revisions to second-quarter Real GDP provide additional insight into productivity growth across industries and the accelerating impact of AI adoption. The benefits of employing AI tools in data and process management continue to become more evident.

EQUITIES

Capex Boom Persists

Business investment in equipment, software and AI infrastructure remained strong during the third quarter, extending a historic capital spending boom. Continued investment is supporting economic growth, productivity growth and corporate earnings.

Market Leadership Narrows

After broad participation earlier in the year, market leadership narrowed during the third quarter. Mid- and small-cap stocks retreated significantly, while large-cap stocks produced mixed results.

Geopolitics Muddies the Waters

Oil prices rose steadily during the quarter as the Iran conflict remained unresolved. Higher energy prices threaten resilient consumer spending, increase inflation concerns and contribute to a more challenging backdrop for equity investors.



FIXED INCOME

Commodity Shock and Geopolitical Strain

Renewed instability at key energy choke points drove a resurgence in crude oil prices, breaking the brief truce witnessed late last quarter. Higher oil prices re-accelerated inflationary pressures and kept global bond markets on a defensive footing.

Policy Tightening Implemented

The Federal Reserve transitioned from verbal warnings to concrete action with a unanimous 25-basis-point interest rate increase. The restrictive shift, combined with signals that further hikes remain possible, established a higher-for-longer interest rate outlook heading into winter.

Unprecedented Yield Shifts

Monetary tightening, rising oil prices, strong AI-related spending and continued economic strength pushed Treasury yields to multi-decade highs. The sharp selloff resulted in meaningful losses for fixed income investors, with the 10-year Treasury yield reaching its highest level since 2007.

POLICY

Iran Conflict and Energy Security

The Iran conflict remains the most significant geopolitical risk for investors as disruptions to key energy shipping routes continue to influence inflation and interest rates. Higher fuel and transportation costs have rippled through the economy, while efforts to expand global oil supplies, including the U.S.-Venezuela energy agreement, may help improve longer-term supply stability.

Trade, Tariffs and Fiscal Implications

Trade policy remains a major source of uncertainty. Shifting tariffs, strained international relationships and declining tariff revenues complicate business planning, increase fiscal pressures and influence investment, supply chains and interest rate expectations.

Midterm Elections Approach

As the 2026 midterm elections approach, investors are focused on how potential policy changes could affect economic growth, inflation and long-term investment returns. Fiscal policy, taxation, regulation, trade and energy policy remain among the key areas of focus.

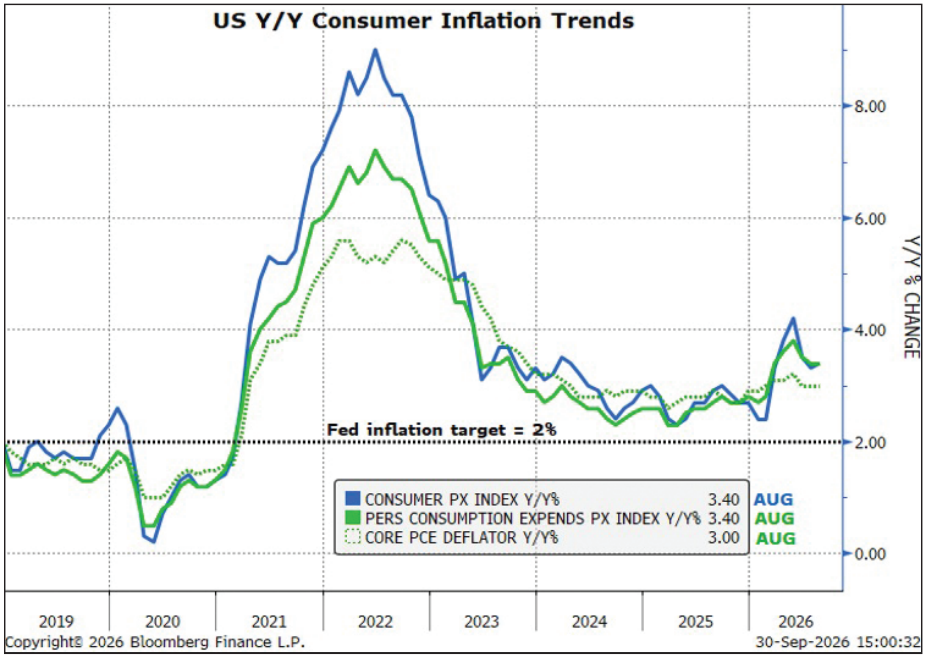


Macroeconomics Review & Outlook [1-3]

Paul Teten, CFA, Chief Investment Strategist

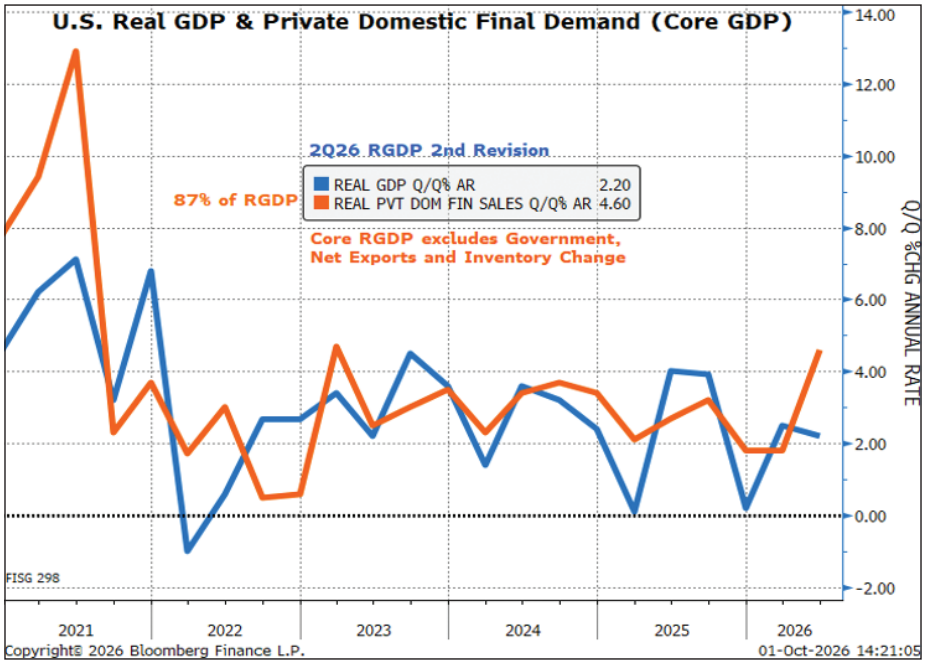
BREWING INFLATION CONCERNS INTENSIFYING

The evident impact on inflation from tariff pass-throughs on imported consumer goods was starting to fade in February when shortly thereafter disinflationary dreams were abruptly interrupted by the severe oil supply crisis developing in the Arabian Gulf. With a magnifying glass one could observe in the adjacent chart that the core personal consumption expenditure deflator (PCE price index, excluding food and energy prices), the dotted green line, made a cycle low of 2.6% Y/Y in March last year, just before the Liberation Day tariff chaos ensued. Both the CPI and PCE inflation measures edged higher the rest of the year, then surged in 2Q26 from the explosive rise in crude oil, gasoline and diesel fuel prices. The core PCE deflator topped out at 3.2% Y/Y in May and has come off the boil a bit, particularly so for top-line inflation measures, as alternate oil supply routes to the Strait of Hormuz have become more effective. Meanwhile, Federal Reserve Governor Jay Powell's term as Chairman of the Board concluded last spring, succeeded as of May 13 in that role by former Governor Kevin Warsh, who by Labor Day established that the new boss was not the same as the old boss. Chair Warsh has emphasized repeatedly, and lately convincingly, that 3% inflation is not acceptable and reiterated that the Fed's inflation target is 2%. The Fed's policy-making body, the Federal Open Market Committee (FOMC), raised the policy rate, the Fed Funds rate, by 0.25% on September 16 to a tight range around 4.13%, with markets also pricing into Fed Funds futures yields another such hike in December and one or two more next year. Our assessment is that constraining inflation



down to 2% from 3% is not the same challenge as former Chair Powell took on in 2022 to bring inflation down from 7% to 2%, which to his credit was nearly achieved without a recession. Nevertheless, uncertainty abounds on the economic impact, with a generational capital investment cycle underway and the labor market balanced precariously at a very low unemployment rate. Our view, expounded further below, is the U.S. economy is on solid footing and will absorb a 0.50% or 1.0% increase in short-term interest rates without missing a beat.





PARTY LIKE IT'S 1999!

The U.S. economy is likely to power ahead even with interest rates long and short on the rise for a number of fortuitous factors. On the consumer front, while high prices for gasoline and other fuels froze consumer appetites for goods for a few months, the fully employed economy wields a strong income effect, with income growth outpacing inflation for the last several years until a few months last spring. Household balance sheets are in pristine condition, with low debt and an enormous wealth effect, which enabled a consumer resurgence last summer. First-time homebuyers are frustrated by tight supply and high mortgage rates, but taming inflation back to 2% is the ideal scenario for driving mortgage rates lower next year. In the corporate sector, AI is real and every business enterprise is studying how to use it to advantage. The benefits are spreading, particularly with data center construction creating demand for labor and equipment while showering sales and property tax income on local communities. Higher long-term interest rates, partly a move back to more normal interest rates after a decade of helicopter money, are magnets for capital investment funding. After the final revision to 2Q26 Real GDP, reported recently, and what we're seeing so far for 3Q26 economic momentum, the U.S. economy is experiencing the strongest sustained acceleration since the pandemic recovery in 2021. Household demand and business capital investment are combining to drive underlying core Real GDP growth trends in a 4-5% range, which we saw in 2Q26 and expect more of in 3Q26. Capital investment in AI technologies, equipment, data centers and other infrastructure buildouts is driving contributions to Real GDP growth not seen in decades. It really is starting to look like the 1990s.

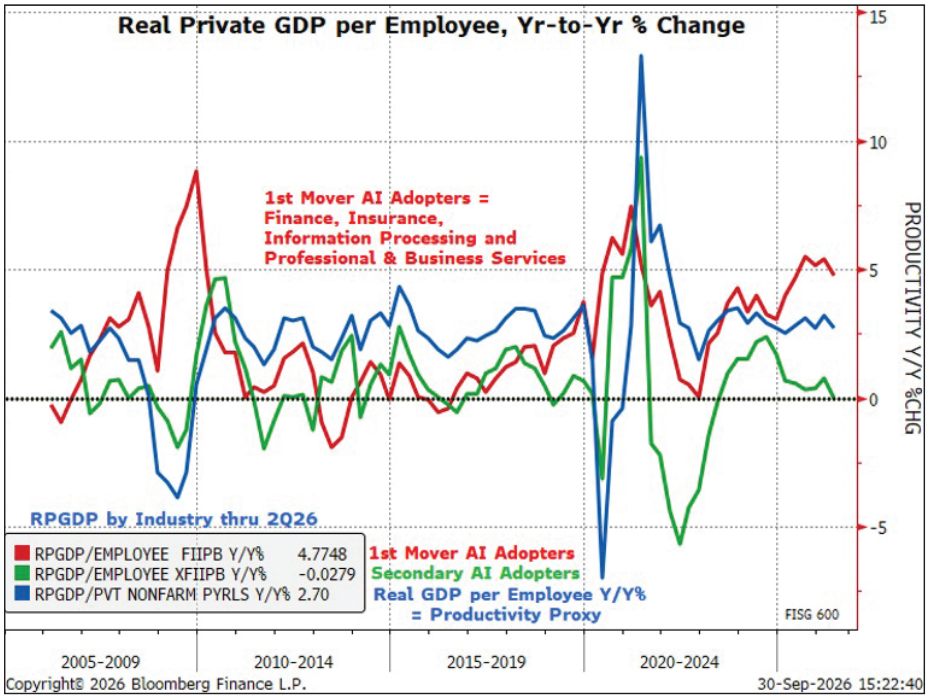
> AI is real and every business enterprise is studying how to use it to advantage.

AI-DRIVEN PRODUCTIVITY GROWTH IS NOT ONLY REAL, IT'S PHENOMENAL

Also included in the final 2Q26 Real GDP revisions were updates to the GDP by industry series, which facilitates our analysis of real output per employee, a valid proxy for productivity by industry. From observation we have identified the most active adopters of AI tools to improve the outcomes of data and process management routines, which include the financial, insurance, information processing and professional & business services (e.g., accounting, legal and consulting) industry sectors, which we have referred to in this context as 1st Mover AI Adopters. While accounting for only 25% of the labor force, these typically white-collar industries produce 43% of Real GDP, and 3 times the output per employee from the remainder of private sector industries. The 2Q26 update to RGDP per employee indicates another near 5% Y/Y gain in productivity, 4.8% to be precise. With the last four quarters clustered around 5% Y/Y, the implication is that productivity growth among the 1st Mover AI Adopters has averaged a consistent 5% trend growth over the last two years, which is a breakout achievement. The productivity growth spikes in 2008-09 and 2020-21 are illusory due to recessionary collapses in RGDP growth, making the 2025-26 span of 5% growth unprecedented in the history of the available data. Productivity growth is adrenaline for corporate profitability, facilitates compensation growth without raising prices and funds innovation. The current doomer debate over sandboxes, guardrails and jailbreak protections against highly improbable disasters from rogue AI agents, the new boogeymen, will be solved because the positive benefits from AI efficiency are too widespread and enormous to roll back. AI is not a fad; it's the foundation of unimaginable innovation to come in the decade ahead.

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	INDEX	2026 THIRD QUARTER	2026 SECOND QUARTER	2026 FIRST QUARTER	YTD 2026	LAST 12 MONTHS
USA	S&P 500	2.30%	15.20%	-4.30%	12.80%	22.30%
	NASDAQ COMPOSITE INDEX	2.60%	21.60%	-7.00%	16.10%	29.50%
	S&P 500 GROWTH	3.40%	21.90%	-8.10%	15.90%	25.70%
	S&P 500 VALUE	0.90%	8.00%	0.00%	9.00%	18.40%
	S&P 500 EQUAL WEIGHTED	-1.90%	11.40%	0.70%	10.00%	19.20%
	S&P MID CAP 400	-6.40%	14.50%	2.50%	9.90%	25.90%
	S&P SMALL CAP 600	-7.90%	19.70%	3.50%	14.10%	37.50%
INTERNATIONAL	MSCI AC WORLD	1.60%	14.90%	-3.20%	13.03%	23.70%
	MSCI EAFE	0.80%	10.80%	1.20%	10.30%	20.20%
	MSCI EAFE SMALL CAP	2.90%	9.00%	-1.30%	10.80%	17.40%
	MSCI EMERGING MARKETS	-0.40%	24.10%	-0.20%	23.40%	43.50%

Equities [1, 4-7]

Martin Sirera, CFA, Director of Equities

COOLING OFF A BIT

U.S. equity markets were mixed in the third quarter with some notably strong performances and some notably weak ones, with Mid Cap and Small Cap shares pulling back significantly. As the bellwether for the U.S. market in general, the S&P 500 Index and one of its variants, the S&P 500 Equal Weighted Index, reflected the changing dynamics of the quarter.

The S&P 500 Index had a total return of 2.3% for the full quarter. The S&P 500 Equal Weighted (EW) Index, which deemphasizes the impact of the largest companies in the S&P 500, posted a negative total return for the quarter, declining 1.9%.

The small decline during the quarter of the S&P 500 EW Index is merely a teaser of the degree of pullback in smaller company stocks in the quarter. The S&P Mid Cap 400 Index was down 6.4% while the S&P Small Cap 600 Index declined more than 7.9%.

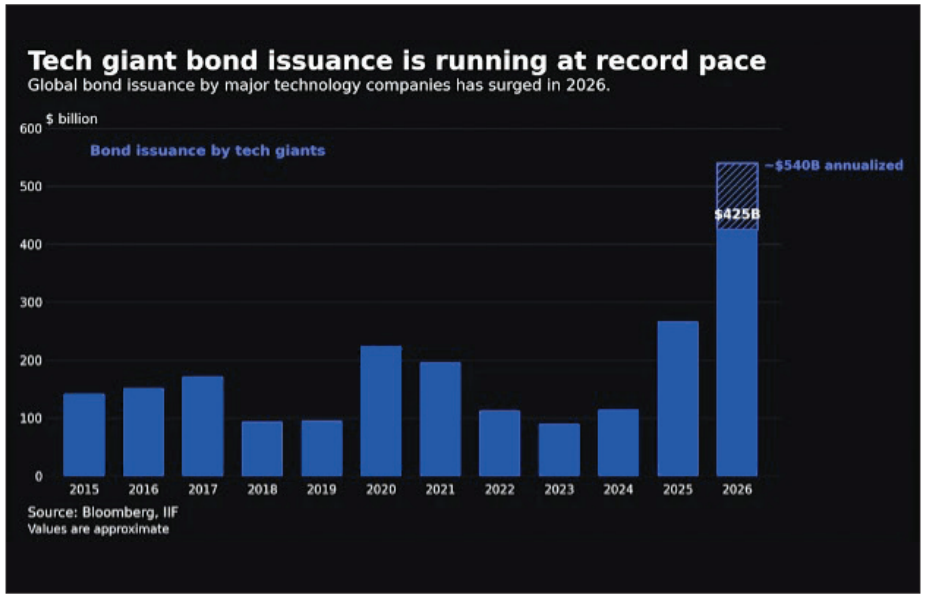
Outside the U.S., markets generally fared better, although there were pockets of weakness. The MSCI EAFE Index, which broadly covers markets in developed economies outside the U.S., finished the quarter with a 0.8% gain, while the MSCI Emerging Markets Index declined 0.4%.

In addition to the dichotomy between the very largest stocks and the smallest ones, the quarter saw a good bit of turmoil in internal dynamics. Despite the 2.3% rise in the overall S&P 500 Index, many U.S. large cap sectors declined. The Consumer Discretionary and Real Estate sectors both fell more than 5.0%; the Industrials sector declined nearly 10.0%, and Utilities shares, sensitive to interest rates, were the worst performers. The S&P 500 Utilities Sector had a total return of negative 12.4% during the quarter. Large Cap Technology shares, including the so-called Magnificent Seven, delivered fairly impressive positive returns. Energy stocks, following a strong rally in product prices, turned in the best results for the period. The S&P 500 Energy Sector was up more than 17.0%.

Coming after the near-historical surge in stock prices in the second quarter of 2026, a bit of a cooling off is not a complete surprise, especially given the crosscurrents of external risks that currently weigh on investor psychology. Investors face an uncertain situation in the Middle East that has dragged on longer than anyone expected. This extended uncertainty has driven crude oil and other energy commodity prices meaningfully higher from June 30 levels. West Texas Intermediate, the U.S. benchmark, currently trades above $90/barrel. On June 30, the closing price was $69.50/barrel.

Interest rates have been another source of uncertainty for equity investors. Much is made of the role of the threat of inflation in long-dated bond yields, but the main signal that appears to be coming from the bond markets is that the domestic economy is booming. Interest rates, after all, are the price for money, reflecting the level of supply and demand for financing. Goldman Sachs reported in early August that nearly $500 billion in AI-related debt has been issued so far in 2026 alone. That is a large increase from last year and any year prior.

The combination of increasing demand for financing and a rising inflation premium sent bond yields surging higher throughout the quarter. The yield on the 10-Year U.S. Treasury Note rose from 4.47% on June 30 to 5.3% on September 30.





STRONG FUNDAMENTAL GROWTH

As an indicator of economic conditions, rising yields do not signal a threat to stock prices per se. In fact, with real domestic private demand surging to a robust 4–5%, the U.S. economy could be described as booming, a condition which bodes well for corporate revenue and profits. The U.S. Bureau of Economic Analysis reported that Real Final Sales to Domestic Purchasers sprang up in the second quarter of 2026 to a 4.6% annualized growth rate from an anemic 1.8% in both the first quarter of 2026 and the fourth quarter of 2025. The Atlanta Federal Reserve GDP NOW model estimates that it grew 4.75% in the third quarter.

So, on that surging domestic demand, S&P 500 revenues are currently estimated to have grown over 12.0% in the third quarter and EPS, more than 29.0%. It is likely that actual growth was better than that. Earnings reports, which will flood the “airwaves” in mid-October through November, will begin to shed light on that.

Perhaps more significant, longer-out forecasts continue to be raised. Equity analysts in the aggregate have raised full year 2027 S&P 500 EPS growth rates upward to more than 15.0%. At the beginning of the third quarter that forecast stood at 9.3% and at the beginning of the second quarter that stood at 1.8%.

Of course, the main driver of these surprisingly strong growth rates is the ongoing AI-Capex boom. Certainly, the forecast for growth in the Technology sector is the highest, but the benefits of booming domestic demand and a recently reinvigorated manufacturing sector are widespread. Many other sectors currently carry strong growth forecasts for 2027. Health Care, Industrials and Materials all have double-digit forecasted growth rates.





RISKS ABOUND BUT EBB AND FLOW

In addition to the geopolitical risk of Middle East turmoil, the November U.S. midterm elections will almost certainly present equity investors an opportunity to re-evaluate market conditions and prospects. Many Trump Administration policies – lower taxes and regulations, domestic manufacturing boosts – are key catalysts to the current health of the private domestic economy. On the other hand, President Trump's actions in the Middle East present their own challenges. Certainly, the world could not abide a nuclear-armed Iran, but the difficulty in bringing the situation to a close adds a level of risk that most would not have expected would remain this late in the year.

And while the price of oil is higher than it was on June 30, it is lower than it was in mid-September, and significantly lower than it was in the initial April spike. The smallest positive development in the Strait of Hormuz would likely send prices falling. Although that would not remove inflation risk entirely from the mind of the market, it would help.

CONCLUSION

Stocks remain attractive on a fundamental basis. In fact, the strong growth in recent quarters and the rising forecasts for near-term future quarters have worked together to improve valuation tremendously. The PEG ratio on the S&P 500 is at a generational low.

However, sticky inflation and geopolitical affairs, domestic and abroad, remain wildcards in any near-term outlook. Investors with balanced portfolios should remain close-to-slightly-above long-term equity targets.



Fixed Income [1, 2]

Mike Leiva, CFA, Senior Fixed Income Portfolio Manager

A PERFECT STORM FOR FIXED INCOME

The third quarter of 2026 proved to be a volatile period for the fixed income landscape, marked by assertive monetary tightening and a dramatic repricing across the Treasury curve. The Federal Reserve's first interest rate hike since 2023, a sharp resurgence in global commodity prices and surging government bond yields collectively disrupted the temporary stability experienced late last quarter.

MACRO CATALYSTS AND THE CRUDE OIL REVERSAL

This pronounced upswing in government financing costs was fueled by a convergence of persistent domestic economic strength and a sharp reversal in commodity pricing. Geopolitical anxieties re-accelerated as global markets faced a rapid unwinding of the late-June truce, causing crude oil prices to experience a substantial resurgence from their prior sub-$80 lows due to ongoing infrastructure concerns and threats to critical energy choke points. Compounding this commodity shock, incoming economic data consistently defied expectations of a growth slowdown. The key catalyst came from the S&P Global U.S. Flash PMI release, which showed private sector business growth surging to a 62-month high of 58.4 in September. This booming private sector activity, paired with intensifying price pressures and a solid labor market, forced market participants to come to terms with a more prolonged and restrictive tightening cycle than previously anticipated.

FEDERAL RESERVE: FROM VERBAL WARNINGS TO ACTION

In a policy pivot, the Federal Open Market Committee enacted its first interest rate hike since 2023 with a unanimous 12-0 vote, lifting the benchmark lending rate by 25 basis points to a target range of 3.75% to 4.00%. This formal action marked a strict departure from the second quarter, where Chairman Kevin Warsh had kept rates steady at 3.50% to 3.75% and merely utilized hawkish rhetoric to signal a tough stance. In contrast, the third quarter saw the central bank transition from verbal warnings to concrete economic tightening. During his post-meeting news conference, Chairman Warsh defended the decision by explaining that "we

removed a dose of accommodation" because the broad economic data continues to strengthen. He delivered a sober assessment on inflation, emphasizing that "the plain fact is that inflation is too high, and has been for too long," while explicitly clarifying that "underlying growth is higher. Inflation is the problem." Subsequent commentary from regional Fed governors reaffirmed that policymakers remain highly sympathetic to lingering price pressures, solidifying a higher-for-longer interest rate outlook heading into the winter.

BONDS BY THE NUMBERS: DEFINITIVE YIELD SHIFTS

The government debt markets bore the brunt of this hawkish transition, resulting in historic, multi-decade highs in Treasury yields and severe yield curve flattening. Shorter-duration debt sensitive to monetary policy led the selloff, with the 2-year U.S. Treasury yield up +72 basis points to 4.89% by the end of the quarter, a significant rise from the 4.17% witnessed at the close of June. Concurrently, the bellwether 10-year Treasury yield surged +82 basis points to 5.29%, matching peak levels not seen since 2007. On the ultra-long end, the 30-year Treasury bond spiked +68 basis points to 5.63%, registering a multi-decade high that exceeded its mid-May peak of 5.18%.

INSTITUTIONAL INDEX AND SECTOR PERFORMANCE

Reflecting the broad-based rout in fixed income prices, the Bloomberg US Aggregate Intermediate Index closed out a difficult third quarter down -2.56%, dragging its cumulative year-to-date total return to -1.99%. While intermediate government debt registered the smallest decline for the quarter, it failed to maintain a positive year-to-date trajectory, with the Bloomberg Intermediate Treasury Index sliding -1.69% during the three-month period and pushing its cumulative year-to-date total return into negative territory at -1.46%. Meanwhile, credit products experienced similar headwinds, as the Bloomberg Intermediate Corporate Index pulled back -2.31% for the quarter, which brought its year-to-date total return to -1.57%. Mortgage-Backed Securities faced far heavier macro pressure as structural duration extension and widening credit spreads compressed valuations, resulting in a steep -4.25% quarterly decline for the Bloomberg US MBS Index and bringing its year-to-date total return to -3.31%.



OUTLOOK FOR THE REMAINDER OF 2026

Looking ahead to the final months of the year, the trajectory for fixed income markets hinges on two critical variables: the volatility of global crude oil prices and the overall stickiness of core consumer prices. If oil continues its resurgence and reignites headline inflation, or if core economic data remains stubborn, the Federal Reserve's willingness to implement additional rate hikes will remain high. For fixed-income investors, this ongoing macroeconomic tension presents a double-edged sword. While rapid price adjustments have caused near-term paper losses, the silver lining is that nominal yields have risen to historically attractive levels not seen in decades. Investors can now capture historically attractive yields without assuming significant credit risk by utilizing short-to-intermediate-duration U.S. Treasuries and high-grade corporate bonds. Portfolios can lock in these elevated yields through high-quality instruments, maintaining a shorter duration focus to mitigate the persistent price volatility generated by the central bank's ongoing battle against inflation.



Policy and Politics [1, 2, 8, 9]

Scott L. Pieper, CFA, Investment Director

IRAN CONFLICT RESHAPES GLOBAL ENERGY MARKETS

The Iran conflict remains the dominant geopolitical risk for investors. During the quarter, a memorandum of understanding between the U.S. and Iran collapsed, leading to renewed hostilities. These events disrupted Gulf exports, damaged energy infrastructure and materially reduced oil flows through the Strait of Hormuz. Roughly 20% of global petroleum products pass through this critical trade corridor, including crude oil, gasoline, diesel fuel, jet fuel and liquefied natural gas. More importantly, the risks expanded beyond a single choke point. Houthi attacks near the Bab el-Mandeb Strait threatened another critical shipping route and strikes on Saudi Arabia's East-West Pipeline amplified the vulnerability of alternative transportation routes.

Even as Brent crude pushed back above $100 per barrel, global energy markets demonstrated adaptability. Gulf producers rerouted supply through pipeline bypasses and ship-to-ship transfers, while global producers elsewhere increased output. These adjustments helped dampen the economic consequences. However, resilience should not be confused with normalization. Elevated transportation, freight and insurance costs continue pushing input prices higher, impacting consumers.

The Iran war amplified the importance of energy security. The recent U.S.-Venezuela energy agreement could produce meaningful long-term implications, even though the near-term impact on oil markets is likely to be limited. By opening development rights to 17 oil fields containing more than 65 billion barrels of proven reserves, the agreement potentially increases Venezuela's daily oil production by 1 to 1.5 million barrels. If successfully implemented, the deal could expand global energy supplies, ease inflationary pressures and support economic growth while simultaneously reducing upward tension on global interest rates. It could also strengthen U.S. energy security by creating a meaningful source of crude oil in the Western Hemisphere and lessen dependence on supplies affected by Middle East disruptions.

Brent crude deserves attention, but diesel prices and refining margins may provide better evidence of whether the energy shock is spreading into the broader economy. Higher diesel prices work their way through trucking, agriculture, construction and manufacturing. What begins as an oil-price shock can therefore spread across a much broader portion of the global economy, influencing household purchasing power and keeping interest rates higher. For investors, the conflict's next phase will be measured as much through markets and trade flows as through military developments. Vessel traffic through the Strait of Hormuz and Bab el-Mandeb Strait, global inventory levels, tanker rates and war-risk insurance premiums remain important indicators. The Iran conflict continues testing global energy security, with potential effects on inflation, interest rates, and corporate earnings.



TRADE POLICY MEETS FISCAL REALITY

Trade agreements matter. They influence the flow of goods, services and capital across borders. Changes in tariffs can alter production costs, investment decisions and commodity prices. The Supreme Court ruled in February that the International Emergency Economic Powers Act could not be used to impose tariffs. After the subsequent 150-day grace period expired, the Administration quickly turned to other trade authorities, including various sections of the Tariff Act of 1930.

The deterioration in United States-Canada relations is a clear result of the Administration using other trade authorities. After negotiations failed in August, the U.S. imposed 50% tariffs on selected Canadian goods, including dairy products and motor vehicles. Canada responded with tariffs on C$27.6 billion of U.S. imports, targeting steel, aluminum, dairy products, agricultural equipment and appliances. This back-and-forth action only complicates business planning and investment decisions.

Trade agreements also shape fiscal policy. Refunds from the Supreme Court's ruling offset a meaningful portion of previously collected tariff-related revenue. By August, the U.S. Treasury collected approximately $292.5 billion in customs duties but refunded roughly $125.2 billion. This exacerbated an already challenging fiscal setting. CBO now projects a fiscal 2026 deficit of approximately $2.1 trillion, roughly $200 billion above its February estimate, largely reflecting lower expected tariff revenue. More importantly, CBO estimates that changes in trade policy will increase cumulative deficits by approximately $900 billion through 2036.

Tariffs can encourage domestic investment, create jobs, and reduce reliance on foreign suppliers. Yet, prolonged trade uncertainty may raise costs and weigh on corporate margins. For investors, the implications extend beyond trade. Lower tariff revenue and persistent government spending could influence interest rates and the cost of capital. The key question for the fourth quarter is whether a more fragmented trading system could shift investment toward domestic production and regional supply chains, leading to greater economic security.



MIDTERMS MOVE INTO FOCUS

Elections inevitably introduce uncertainty into financial markets as investors attempt to anticipate how changes in political leadership may affect fiscal policy, taxes, regulation and trade. Changes in congressional control can alter legislative priorities, influence business and consumer confidence, and reshape expectations surrounding deficits, regulation and investment. As the U.S. midterm elections draw closer, political trends appear to be shifting modestly in Democrats' favor. Republicans are directing increasing campaign resources toward traditionally safe districts while several competitive GOP Senate candidates are distancing themselves from the Administration on the Iran conflict. Finally, voter enthusiasm appears stronger among likely Democratic voters.

From an investment perspective, a stronger Democratic midterm outcome could increase the likelihood of congressional gridlock, heightened oversight investigations, and reduced prospects for major legislative initiatives. The connection between geopolitics and domestic politics is increasingly important. Midterm elections are typically driven by domestic issues, but the Iran conflict has increasingly become intertwined with the political and economic environment heading into November. Higher oil and gasoline prices, disruptions to global shipping and continued uncertainty surrounding the conflict are weighing on voters.

History provides an important reminder that political uncertainty and investment fundamentals are not always the same thing. Markets have repeatedly navigated elections, divided government, geopolitical conflicts and significant changes in public policy. Businesses and consumers have also continued adapting to a post-election environment. Ultimately, economic growth, corporate earnings, inflation and interest rates remain more important drivers of long-term investment returns than any single election. The challenge is not predicting the political outcome but understanding how changes in policy could flow through the economy and financial markets.

Sources

Sources: [1] Bloomberg Finance, L.P., [2] Wall Street Journal, [3] Dr. Grad Levanon, Chief Economist at Princeton University's Burning Glass Institute, [4] FactSet, [5] Goldman Sachs, [6] Yardeni Research, Inc., [7] U.S. Bureau of Economic Analysis, [8] Reuters, [9] Politico

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David Lundgren, CFA is the chief investment officer at Hancock Whitney. He is responsible for directing the bank's investment approach; the delivery of asset allocation solutions to institutional and high net worth clients; the management of a platform of client-focused internal and external money managers; and ensuring the bank meets all regulatory requirements.

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