Carrying the Roster

In the 2017-18 season, LeBron James put together one of the most remarkable runs in modern basketball. He played all 82 games, averaged close to a triple-double, and carried a weak Cleveland Cavaliers roster all the way to the NBA Finals. While thrilling to watch, it was not built to last. In the Finals, a deeper Golden State team swept the Cavaliers in four games.

The stock market spent much of the third quarter, especially September, in a similar spot. After an exceptional second quarter, when the S&P 500 gained more than 15% on optimism about the conflict with Iran, the third quarter was a reality check. Progress with Iran deteriorated, interest rates surged, and investors began to question how durable the economy's strength was.

The S&P 500 still gained 2.3% and the Nasdaq 100 rose 0.6%, but that gain came entirely from four companies: Nvidia, Microsoft, Apple, and Meta Platforms. More economically sensitive areas finished lower, with the Dow down 2.3%, mid-caps down 6.4%, and small caps down 7.2%. In this letter, we recap the key developments of the third quarter, discuss the surge in interest rates, the swings in oil, the AI trade, and look ahead to the end of the year.

Interest Rates: The biggest story of the quarter was rapidly rising interest rates. The 10-year Treasury yield climbed from roughly 4.5% to 5.3%, reaching its highest level since 2002. Several forces pushed it there. The Federal Reserve raised rates by 0.25% in September. Federal debt crossed $40 trillion. AI companies borrowed heavily in the bond market, competing with Treasuries for investors' dollars. In our view, though, the main driver was the strength of the economy itself which accelerated to nominal growth of greater than 6%. At the start of the year, markets expected two or three rate cuts in 2026. They now price in as many as five increases. It's important to note that rising rates are not a US centric problem – the UK, Japan, Germany, and France have experienced similar, if not greater moves higher recently.

The speed of the move was abnormal, but the absolute level of yields is not. Today's rates are near, or even below, their long-term average. The decade of near-zero rates that followed the 2008 financial crisis now looks like an exception rather than the rule. The rise was hard on bonds in the short run: the Bloomberg U.S. Aggregate Bond Index fell 3.5%. Investment-grade corporate bonds fell nearly 4% and municipal bonds fell 6.4% as their longer maturities felt the full force of rising yields. Credit spreads, the extra yield investors demand to lend to companies rather than the government, stayed tight by historical standards, a sign that the pressure came from rates rather than from worries about borrowers. Only the lowest-rated borrowers saw spreads widen. The bond market is pricing in higher rates. It is not pricing in widespread distress. And there is a silver lining. High-quality bonds now offer yields of 5% or more, an attractive starting point for long-term investors whatever their goals. If inflation cools and the Fed raises rates fewer times than markets expect, investors could see some welcome relief.

Oil and Iran: Oil prices have become a good proxy for events in Iran. Brent crude began the quarter near $75 a barrel on hopes for the ceasefire. That optimism faded quickly as the US reimposed its blockade and kinetic activity in the region resumed including a strike on a major Saudi pipeline. Ukrainian strikes on Russian energy infrastructure further tightened supplies of oil and refined fuels. Brent briefly topped $100 and ended the quarter near $98, diesel prices hit records, and energy was the best-performing sector in the S&P 500, gaining 17.2%.

Predicting the price of oil, or how a geopolitical conflict will resolve, has proven to be a fool's errand. Recent reports suggest oil exports from the Middle East have exceeded prewar levels, which would ease pressure on prices, while other reports suggest renewed attacks are under consideration. A resolution would likely bring much needed relief in oil prices. Even so, we believe the conflict may have shifted the longer-term picture, with demand for commodities structurally higher than before.

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2026 Performance Figures	Q4	YTD
DJIA (Dow Jones)	-2.34%	7.19%
S&P 500	2.30%	12.75%
NASDAQ 100	0.58%	21.01%
MSCI EAFE	0.88%	10.81%
Russell 2000 Small Cap	-7.23%	13.71%
Bloomberg US Bond Aggregate	-3.51%	-2.91%
MSCI World All Cap	1.17%	13.30%

AI: AI stocks were once again a rollercoaster ride. Using the Global X AI & Technology ETF as a gauge, AI-related shares fell 9% in July, rebounded 8% in August, and finished the quarter up .6%. Microsoft and Amazon helped turn sentiment in late July by pointing to revenue from their AI investments. SpaceX, which completed the largest IPO in history last quarter, has been volatile but ended the quarter about 11% above its offering price, and anticipation is building for potential offerings from Anthropic and OpenAI. At the same time, local opposition to new data centers and a growing debate over slowing AI development to manage risks are adding new questions. AI is clearly a transformative technology. It has also become clear that the ride will be bumpy, which makes diversification an essential part of building a portfolio. The stakes for the broader market are rising, too: technology now makes up nearly 40% of the S&P 500, AI spending represents nearly 25% of GDP growth, and investment in datacenters is expected to eclipse $5 trillion by 2030, according to McKinsey.

Equity Markets: Like LeBron's Cavaliers, the S&P 500 relied on a single source of scoring this quarter. Remove Nvidia, Microsoft, Apple, and Meta Platforms, and the index would have fallen about 3%. This was a sharp reversal as prior to mid-August, market performance was broad with the equal-weight S&P 500, which gives every company the same influence regardless of size, outperforming. Only four of the eleven sectors finished the quarter higher with technology and health care leading the way, while utilities and real estate fell on higher rates, and industrials struggled due to higher diesel costs. Overseas markets were quiet: developed international stocks gained 0.9% and emerging markets slipped 0.2%, though both remain positive for the year, up 10.8% and 23.7% respectively.

A market this narrow is the antithesis of diversification. History shows these periods tend not to last long, but no one can know when the rest of the roster will start scoring again. That is exactly why we build portfolios with depth. Diversification improves long-term risk-adjusted returns, dampens volatility, and helps protect on the downside in choppy markets, all critical to preserving capital and building wealth over time.

The Rest of the Season: There are clearly risks, but we remain cautiously optimistic because the underlying economy is strong. Entering 2026, analysts expected earnings to grow about 15% this year. That figure now looks closer to 30% and estimates for next year sit in the mid-teens. Several tailwinds support that strength. The One Big Beautiful Bill has encouraged consumer and business spending. The Fed's six rate cuts before September typically take 6 to 18 months to work through the economy, and a handful of increases are unlikely to undo that support. AI spending has accelerated. Deregulation is starting to improve profitability for many companies, and as the nation celebrates its 250th anniversary, reshoring has taken hold with private companies committing to over $2 trillion in manufacturing and industrial investment in the US. According to the Economic Policy Institute, reshoring creates a powerful multiplier effect, with every reshored direct manufacturing job generating more than seven new jobs across other industries.

Three open questions stand out for the fourth quarter and beyond. The first is whether inflation cools enough for the Fed to raise rates fewer times than markets now expect. The second is related to progress in Iran and the impact on oil prices. The third is whether AI spending keeps turning into real revenue and profits, and whether market leadership broadens beyond a handful of companies. A list of open questions can understandably create some unease. But it is worth remembering how the quarter unfolded. Markets faced a collapsed ceasefire, oil above $100, a multi-decade high in Treasury yields, and yet the S&P 500 still finished higher. No one can know exactly how these questions are resolved, and our approach does not depend on guessing right. The aim behind every move stays the same: a high-quality portfolio, diversified across asset classes, company size, sector, and geography, built to handle the uncertainty and volatility that markets will always bring. A portfolio, like a team, does not need every player to score every night. It needs enough depth that no single slump decides the outcome. Superstars win games. Deep rosters win seasons. As always, we thank you for your continued confidence and trust.