

A Bank Built on a Strong Foundation

September 2026 Capital Markets Commentary

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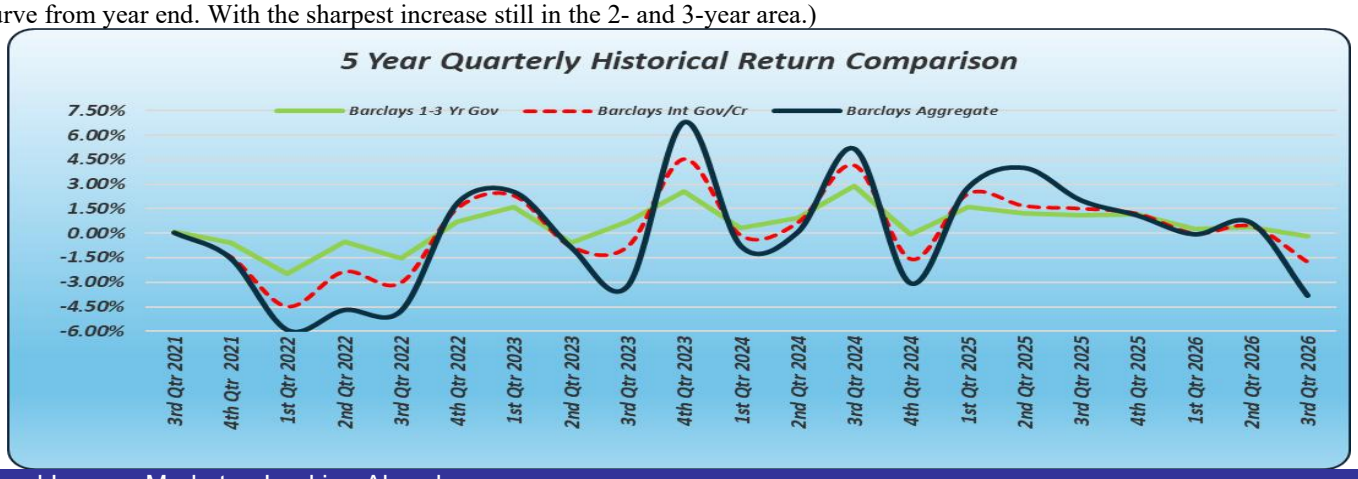
"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas."

Paul Samuelson

Fixed Income

Fixed Income returns during the 3rd quarter of 2026 ended lower with yields higher by 50 to 60 basis points since June. 3rd quarter fixed income markets were defined by higher yields, a flatter curve, resilient credit fundamentals, and selective opportunities across taxable, municipal, and credit sectors. During the quarter, as anticipation of a possible FOMC rate increase gained momentum, front-end yields rose and the curve flattened. Markets shifted from pricing cuts to potential hikes, driven by stronger U.S. growth, above-target inflation, and a temporary stagflationary risk premium from the Iran conflict. The Fixed Income markets continued to have high volatility. U.S. government bond yields moved higher during the quarter, across all areas of the curve. As in past quarters, there is little evidence that higher inflation is feeding through to higher wages. Despite a relatively tight labor market with an unemployment rate of 4.2% and healthy private payroll growth, average hourly earnings for all workers rose just 3.0% in September. Not surprisingly, at the recent FOMC meeting, the Fed the FOMC raised rates by 25 basis points.

With bond yields moving higher during the quarter, returns were negative across all but the shortest parts of the curve. The Barclays U.S. Aggregate posted a -3.51% return for the quarter, the Barclays Intermediate Index was at -1.89%, and the 1-3 Year Government Index was at -0.19%. At the truly short end of the yield curve, you saw a slight positive return of +0.68% on the 1-Year T-Bill. As for yields, the 10-year Treasury yield ended the quarter at 5.29%, the 5-year Treasury yield ended at 5.09%, and the 2-year Treasury yield ended at 4.88%. (As September 2026 ended, yields were higher by 110 to 140 basis points across the curve from year end. With the sharpest increase still in the 2- and 3-year area.)



Fixed Income Markets - Looking Ahead

At the most recent FOMC meeting in Mid-September, the FOMC raised rates by 25 basis points, the first hike since 2023. This was due mostly to inflation numbers continuing to move higher.

Looking ahead, there is a high probability that yields are approaching their peak. If Treasury yields continue to move higher, the Fed and Treasury Department can intervene to restore order, providing short-term reprieve at the expense of future implications like financial repression. No matter what, expectations are that inflation will remain elevated going forward, and high inflation is the nemesis of fixed-income returns. However, real yields are the highest they have been in almost 25 years, which means that there is a significant return premium above inflation to own high-quality bonds. As we move thru the 4th quarter and beyond, there can be value in selectively adding duration through high-quality credit while keeping overall duration intermediate. Although oil has retreated from its highs, investors are now demanding higher compensation due to heightened inflation risk. This risk is contributing to higher Treasury yields and strengthening the expectation that rates could remain elevated through 2026 and beyond. If the markets are approaching peak real yields, long-term investors have an opportunity to lock in historically attractive income today, with the potential for price appreciation if yields fall. The key risk is that inflation stays higher for longer.

As the fourth quarter begins, the silver lining in the markets is that bond yields are the most attractive they have been in years. As we move through the 4th quarter, inflation will still be the strongest influence on bond yields.

Equity

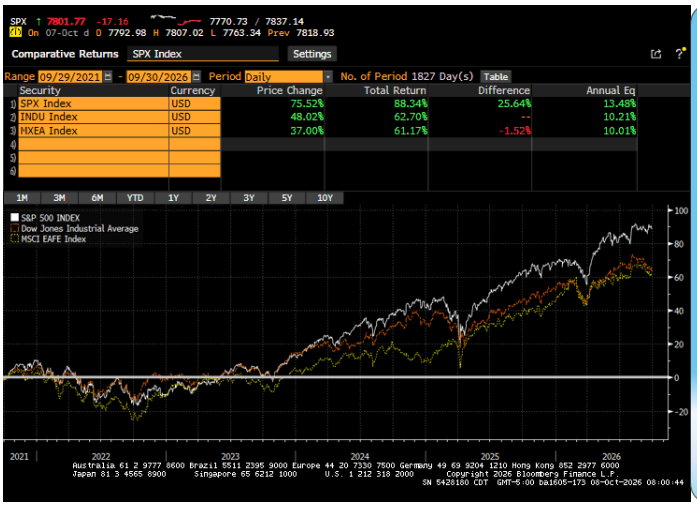
After a great 2nd quarter in 2026, the equity market came back to earth in the 3rd quarter. However, the S&P 500 Index still had a positive return of +2.30% in the quarter. Although low, considering 2nd quarter returns, the equity markets in the most recent quarter, rebounded to record highs. This was driven by resilient growth, strong corporate earnings, and AI-related investment, despite elevated rates, oil volatility, and geopolitical risks.

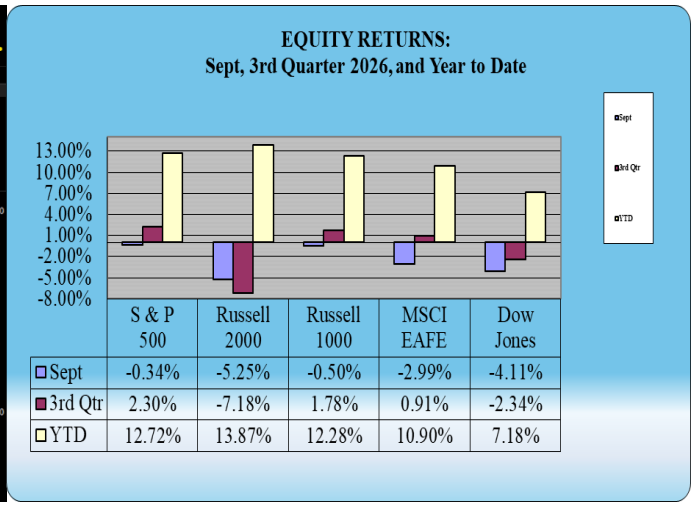
The 3rd quarter combined solid economic and corporate fundamentals with renewed pressure from oil and interest rates. Oil traded back above $100 per barrel, inflation remained elevated, Treasury yields surged higher, and the Federal Reserve raised rates in September. As mentioned, the S&P 500 traded higher and set a new all-time high as corporate earnings and economic activity remained strong. In the meantime, artificial intelligence continued to play a key role in both the economy and financial markets. As companies reported strong 2nd quarter earnings, the gains broadened beyond technology. Several major firms have posted, above-expectations second-quarter results, in 2026, with notable highs in earning per share, revenue, and margins.

Equity markets traded relatively flat throughout the quarter, with most of the positive return coming in August, as stocks recovered from a July malaise. Unfortunately, that positive move did not carry into September, with the S&P 500 posting another negative month with a return of -0.34%. International markets also took a nosedive alongside U.S. stocks, returning -2.99%.

For the quarter, equity returns were mixed, with some positive returns and some negative across the major US market segments, as well as non-US stocks.

The index returns were mixed for the quarter. On the U.S. side, the positives were the S&P 500 Index at +2.30%, and the Russell 1000 with +1.78%. On the negative side, the Russell 2000 returned -7.18%, and the Dow returned -2.34%. As mentioned, the international markets did post a positive return at +0.91% on the EAFE for the quarter.





	S & P 500	Russell 2000	Russell 1000	MSCI EAFE	Dow Jones
Sept	-0.34%	-5.25%	-0.50%	-2.99%	-4.11%
3rd Qtr	2.30%	-7.18%	1.78%	0.91%	-2.34%
YTD	12.72%	13.87%	12.28%	10.90%	7.18%

4th quarter 2026. New questions, or the same ones? Inflation, Military Action, Job Data? Of course, Mid-Term Elections!

The equity markets ended the 3rd quarter relatively flat. It seems that market volatility centered on the Fed Policy had more to do with it than anything else. Of course, the conflict behind the Fed concerns and this volatility isn't fully settled, but at least current oil prices have fallen back under $100.00 per barrel. There are, however, still concerns that the oil spike will slow down the global economy. However, the economy has held steady and although many expected the economic bubble to burst, it kept moving forward.

As the 4th quarter begins, the S&P 500 Index is on path for a fourth year of double-digit positive returns. 4th quarters are typically the strongest quarter of the year for U.S. stocks, and historically, strength in the first part of the year more often indicates a positive final quarter. Of course, every year has a unique set of variables at play that could influence what the market does, and this year it is the mid-term elections.

November 3rd is election day in the United States this year. The Democrats are expected to retake control of the House of Representatives, and who knows about the Senate. Markets don't like uncertainty, and uncertainty is where we are. But the earnings outlook remains very positive in the U.S. and beyond. Analyst estimates suggest 2026 will be the third consecutive year of double-digit earnings growth for the S&P 500, numbers we haven't seen in two decades — and early indications point to 2027 continuing this growth.

As we proceed through the 4th quarter, the markets will probably remain focused on the factors that have historically driven long-term returns: growing earnings, durable cash flows, and attractive valuations. The economy seems to be on solid ground, and earnings continue to surprise to the upside, but with yields at multiyear highs and earnings expectations so high, the markets should be wary of some hiccups.

The Economy

The Economy, and Inflation.

In the 3rd quarter of 2026, the U.S. economy showed continued resilience amid continued aggressive trade policies and increased geopolitical tensions. However, inflation moved in the opposite direction from the Fed's target.

The 3rd quarter combined solid economic and corporate fundamentals with renewed pressure from oil and interest rates. Oil traded back and forth above $100 per barrel, inflation remained elevated, Treasury yields surged higher, and the Federal Reserve raised rates 25 basis points in September. The S&P 500 traded higher and set a new all-time high as corporate earnings and economic activity remained strong. That said, the Federal Reserve did hold rates steady in July before raising the federal funds target range by 25 basis points to 3.75%-4.00% in September as inflation remained above their target. Although some inflation measures showed signs of moderation towards quarter end, the FOMC continued to balance constant price pressures against a labor market that remained generally healthy. The shift towards tighter policy expectations contributed to a significant rise in Treasury yields during the quarter.

The 3rd quarter of 2026 was defined by surging oil prices, renewed inflation pressures, higher global interest rates, and resilient economic and market performance. Growth remained supported by strong AI-driven capital investment, while geopolitical tensions, especially in the Middle East, continued to shape energy markets and inflation dynamics.

The labor market struggled to break free from its "no hire, no fire" rut, but it did show some signs of life at the end the quarter. Nonfarm payrolls grew by a small 21,000 in July (revised up from the original report of a loss of 23,000 jobs), but August brought a nice increase with 162,000 new jobs, nearly triple economist estimates. The unemployment rate has gone down a little to 4.2% from 4.3%. Unfortunately, wage growth has moved down to 3.1% year over year.

The Economy - Looking Ahead

Inflation? Economic Growth? WHO KNOWS.

As we move into the 4th quarter of 2026, the U.S. economy seems to be on solid footing, but there are risks.

The U.S. economy seems to be firmly in the middle of its cycle. Growth is strong, corporate profits are excellent, and the gereral business cycle looks good for the coming quarter. Unfortunately, that same strength, mixed with an oil shock, and continued military action, has amped up inflation and pushed the Federal Reserve to raise rates for the first time in three years. The military action in Iran continues to push oil prices and inflation higher, prompting the Fed to pivot from a rate cutting policy to a hiking policy stance. That shift is adding pressure to bond yields and, by extension, to equities already contending with elevated earnings expectations and midterm election noise. Credit markets, seemingly remain stable, with tight spreads suggesting investors aren't yet pricing in real distress.

As mentioned last quarter, interest rate expectations have shifted dramatically over the course of 2026. At the start of the year, investors anticipated multiple rate cuts. That conversation has reversed course. Under Federal Reserve Chair Kevin Warsh, policymakers have emphasized their commitment to restoring price stability and ensuring inflation remains under control before considering any easing measures.

Inflation and the labor market will be main focus in the 4th quarter. Hiring activity remains suppressed, with historically low layoffs keeping the unemployment rate low. The "no hire, no fire" environment, combined with slower labor supply growth, means changes in labor participation can produce surprisingly strong or weak payroll numbers from one month to the next. As mentiioned, economic growth is relatively strong, but consumers are becoming strained by negative real wage growth, weak savings, and continued high energy costs. As we move through the rest of 2026 and into 2027, consumer spending will remain a key driver.

US and Global growth are expected to remain resilient in the 4th quarter. It will probably be supported by AI investment and manufacturing strength, but inflation and higher interest rates could keep policy and market conditions cautious. For the remainder of 2026, the current futures markets have a low probability that the FOMC will raise rates before December*. But there is a 95% probability of a rate hike before year end, and political developments could ratchet up market volatility in the coming weeks. The U.S. midterms may reshape policy on taxes, regulation, appointments and foreign affairs.*

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