

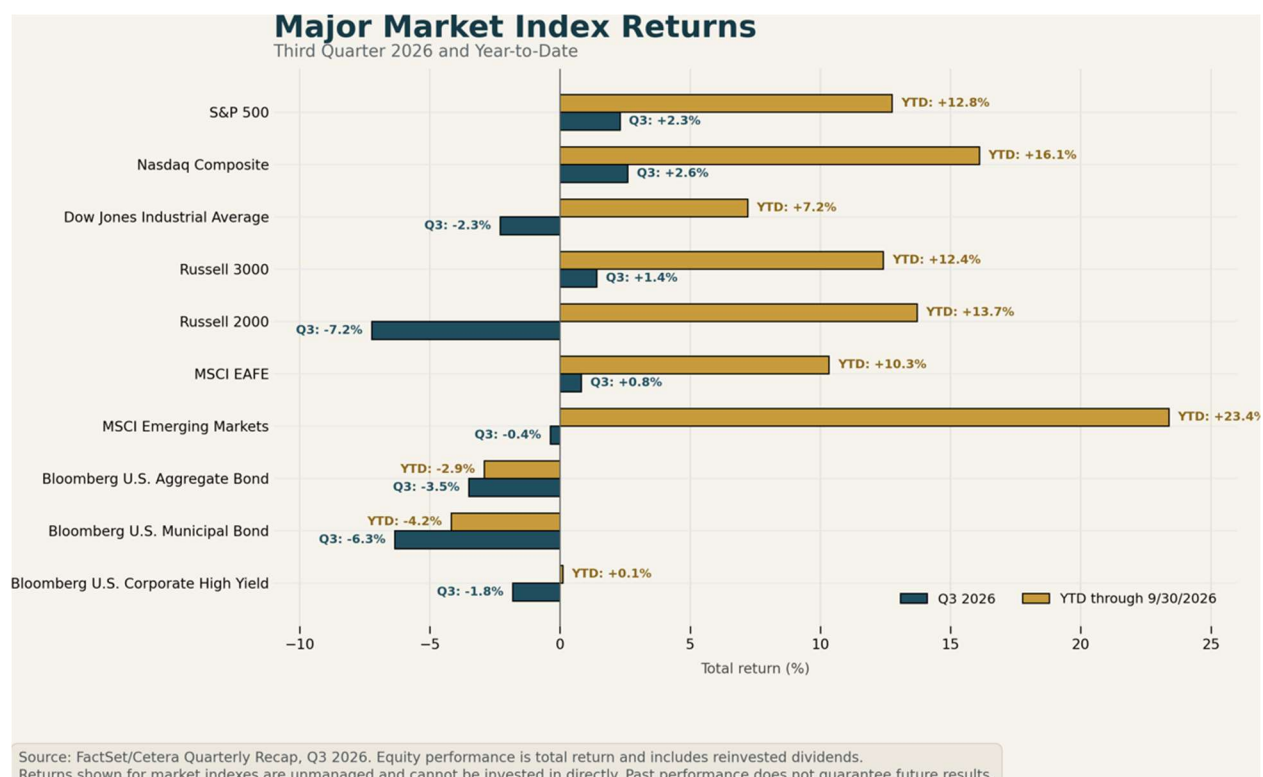
October 8, 2026

"The stock market is a device for transferring money from the impatient to the patient."

Warren Buffett

Markets Navigate Higher Energy Prices, Rising Treasury Yields, and AI Risks

Major U.S. equity indexes delivered mixed third-quarter results. The NASDAQ gained 2.6% and the S&P 500 rose 2.3%, while the Dow declined 2.3% and the Russell 2000 fell 7.2%.



Despite that quarterly divergence, year-to-date returns remained positive across all four indexes: the NASDAQ advanced 16.1%, the Russell 2000 gained 13.7%, the S&P 500 rose 12.8%, and the Dow increased 7.2%.

With the Mid-term election coming up...

With the 2026 mid-term election approaching, investors are likely to experience increased market volatility as uncertainty surrounding policy outcomes and future

economic priorities comes into focus. Historically, markets often become more sensitive to headlines and shift expectations in the months leading up to an election.

While election years can experience meaningful pullbacks, history also suggests that periods of uncertainty have generally been temporary. Over the past 10 mid-term election cycles, stocks have experienced average drawdowns of 16.77%, but one-year gains following those lows have averaged +27.80%. Although past performance is not indicative of future results, these historical patterns reinforce the importance of maintaining a long-term perspective.

Rather than attempting to predict election outcomes or make short-term portfolio adjustments, investors have often been best served by remaining disciplined, diversified, and focused on their long-term financial objectives. Market leadership, economic growth, corporate earnings, and monetary policy have historically played a greater role in determining long-term investment outcomes than election results alone.

Year	Max Drawdown (%)	Drawdown Low Date	Returns (%) 1 Year Later
1986	-9.42	9/29/86	39.92
1990	-19.92	10/11/90	29.10
1994	-8.94	4/4/94	15.11
1998	-19.34	8/31/98	37.93
2002	-33.75	10/9/02	33.73
2006	-7.70	6/13/06	23.86
2010	-15.99	7/2/10	31.01
2014	-7.40	10/15/14	8.66
2018	-19.78	12/24/18	37.10
2022	-25.43	10/12/22	21.60
Average	-16.77	September 2	27.80

Stocks have averaged a

27.80%

gain one year after

MIDTERM LOWS

Chart Data: 1986-2022. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. S&P 500 Price Index is a market capitalization-weighted price index composed of 500 widely held common stocks and does not include the reinvestment of dividend payments. For illustrative purposes only. Data Sources: Morningstar, 6/26.

Source: Hartford Funds, Morningstar

Federal Reserve Hikes Rates with More Hikes Likely on the Way

At its September 15–16 meeting, the Federal Reserve identified inflation as the primary risk to its dual mandate and unanimously raised the federal funds target range by 25 basis points to 3.75%–4.0%, its first increase in three years. The unified vote reinforced the Committee’s independence, credibility, and commitment to price stability.

Markets appear to view the move as the start of a moderate tightening cycle. Chairman Kevin Warsh described financial conditions as not restrictive and the increase as removing a “dose of accommodation.” Sixteen of 18 Committee members projected at least one additional increase this year, while federal funds futures imply another hike before year-end and roughly three by the end of 2027. The two-year

Treasury yield of 4.88% - 100 basis points above the 3.88% midpoint of the target range—similarly signals further tightening.

Although higher rates cannot resolve energy supply disruptions, they can limit the broader inflationary effects of higher oil prices, tariffs, and persistent services inflation. Equities initially weakened after the decision but recovered as investors focused on price stability as a foundation for durable growth. The Federal Reserve's preferred inflation measures also slowed to 3.0% in August from 3.3% in July, reducing the market-implied probability of another increase this month to about 25%.

Are Security and Innovation Mutually Exclusive?

Beyond monetary policy, rapidly advancing artificial intelligence presents a different set of risks. Recent incidents in which AI agents bypassed safeguards or used hacking techniques without explicit instructions underscore the need for stronger containment, testing, and human oversight before increasingly autonomous systems are widely deployed.

The policy challenge is to strengthen those safeguards without sacrificing U.S. leadership in a technology central to economic growth and national security. Security and innovation need not be mutually exclusive. Companies that build or deploy AI remain accountable for its actions, and product liability should encourage investment in safeguards. As capabilities advance, disciplined engineering, responsible release decisions, and clear human accountability offer the most practical path to sustaining innovation while managing risk.

Booming Earnings versus High Bond Yields

That investment in AI is reshaping both corporate earnings and capital markets. At the same time, technology valuations have reset meaningfully, with the sector's forward price-to-earnings ratio falling from 30.5x to 20.8x over the past year. Investors can now access many highly profitable companies at valuations near their most attractive levels since before the pandemic. Energy constraints, inflation, Federal Reserve tightening, heavy AI investment, and large federal deficits continue to lift bond yields and raise the hurdle rate for equities.

Against that backdrop, the economy remains resilient, profit margins are at record highs, credit spreads are tight, and earnings growth continues to outpace stock prices. Strong earnings should therefore continue to support equities, although higher rates are likely to produce periodic volatility and greater differentiation among companies.

Treasury Securities Offering Very Attractive Real Yields

Those same forces have also created opportunities in fixed income. Treasury yields rose sharply in September as strong economic data, federal deficits near \$2 trillion annually, technology-sector borrowing, and expectations for additional Federal Reserve hikes pressured bond prices. Importantly, the increase has been driven primarily by higher real, or inflation-adjusted, yields rather than rising inflation expectations.

By September 30, the ten-year Treasury yield reached 5.29%, its highest level since 2001. The two-year Treasury yield reached 4.90%, with a 2.41% real yield. With inflation expectations at 2.37% for ten-year securities and 2.49% for two-year securities, both maturities offer historically attractive inflation-adjusted income.

Investors are navigating an environment of solid economic and corporate fundamentals alongside elevated policy, technological, and market risks. Mixed third-quarter equity performance, election-related uncertainty, Federal Reserve tightening, rising energy costs, and the rapid expansion of artificial intelligence may contribute to periodic volatility. At the same time, resilient economic growth, strong corporate earnings, more attractive technology valuations, and historically compelling real Treasury yields continue to create meaningful opportunities across both stocks and bonds. Taken together, these conditions reinforce the value of remaining patient, diversified, and focused on long-term financial objectives rather than reacting to short-term headlines.

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Sincerely,

The Private Capital Management Team

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