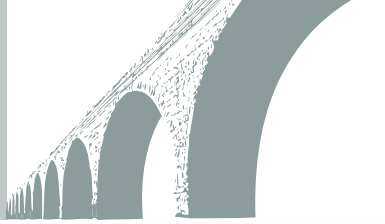
October 21, 2026

# 3Q26 Market Commentary



*While stocks are drifting higher on extraordinary earnings power, prices have recently leveled off, and our sentiment indicators suggest market fragility.*

## Overview

In contrast to the prior quarter, when stocks of all sizes and styles surged and the S&P 500[1] posted its best quarterly return (+15%) in six years, market enthusiasm evaporated over the last three months. With generationally high interest rates, elevated oil prices, and the first Federal Reserve rate hike since 2023, equity indexes not heavily exposed to the AI trade closed the third quarter down 6-7% as leadership narrowed sharply.

The S&P 500 managed to end the quarter in positive territory (+2.3%), thanks to its enormous concentration in mega-cap tech and communications firms. Microsoft (+38%), Meta (+29%), Apple (+15%), and Nvidia (+14%), which together make up one-quarter of the S&P 500's weight, kept the index above water. The Nasdaq[2] Composite, with over one-half of its weight in technology names, performed similarly, up 2.6% in the third quarter.

Fixed income diversification did not ease the sting of equity losses. A global bond market sell-off led to the worst quarter since 2022, and the Fed's September rate hike sent the 10-year Treasury yield to a 20-year high. For the three months ended September, long-term Treasuries fell over 8%, municipal bonds dropped 6%, the Bloomberg U.S. Aggregate Index[3] declined nearly 4%, and high-yield securities lost 2%. As consolation for the painful dive in bond prices, higher yields now offer the most appealing entry point in decades, and the income boost should help moderate future price volatility.

## Equity Portfolios

Our domestic equity strategy didn't make any ground in the third quarter, but that was agreeable relative to large downswings booked across small and mid-cap indices.

The portfolio minimized damage through a barbell-style mix across industries that tend to move in opposite directions. Most notably, investments in both AI beneficiaries and AI-vulnerable names. Further broadening the opportunity set amid potentially increased volatility are positions in defensive areas. Likewise, our flexible approach can be strategically underweight and/or entirely avoid some broad equity sectors, which the S&P 500 cannot do.

Equity performance drivers changed completely from the second quarter to the third. In the second quarter, the AI-mania-driven groups were the standout winners. Over the last three months, the best-performing equity concentrations were the defensive subsets of Biotech, Health Care Facilities, and Pharmaceuticals; Energy investments also profited from the global oil supply shortage (Oil Refiners and Integrated Oil & Gas). Among the biggest third-quarter detractors were groups that were winners in the second quarter: AI and data-center build-out firms (Electronic Manufacturing, Construction & Engineering, Communications Equipment, and Semiconductors).

Like domestic stocks, global equities profited from Energy groups (Integrated Oil & Gas and Energy Equipment Services), which were detractors in the second quarter. Holdings in Diversified Banks and Regional Banks were additionally advantageous. Conversely, overweighting the underperforming Semiconductors and poor stock selection in the Semiconductor Equipment group were drags on third-quarter return.

## Tactical Asset Allocation Portfolios

Our disciplined assessment of stock market health, which guides equity exposure in Leuthold TAA portfolios, hasn't triggered a decisive signal since early March 2025, when it worsened to "negative" ahead of the tariff-tantrum market breakdown. This quantitative analysis, which includes a wide range of factors classified as Valuation, Cyclical, Sentiment, and Technical, shifted back to the "neutral" zone in June 2025.

In response, net equity exposure has not leaned either bullish or bearish since that time. During the most recent quarter, it drifted between 54-56% from July through August. In early September, technical measures of market breadth and momentum showed material deterioration, so the net equity mix was tactically lowered to 51-52%, where it stands today.

With interest rates climbing to levels not seen since before the financial crisis, bonds fell alongside stocks rather than cushion the equity losses. Portfolio holdings in quality

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corporates, mortgage-backed securities, developed-market sovereign debt, and Treasury inflation-protected securities were hit hard, dropping 2-4%. However, given the small portfolio weights of these bond positions, the combined cost of the losses on third quarter results was nominal (less than 40 basis points[5]).

## Outlook

We are in one of the most powerful momentum markets in history, driven by the AI spending boom, which is generating record earnings growth across the equity market. While stocks are drifting higher on that extraordinary earnings power, prices have recently leveled off, and our sentiment indicators suggest market fragility. From a contrarian view, a downswing in optimism often signals underlying strength, but today, with valuations still elevated and the economic backdrop increasingly challenging, fading sentiment may be less a contrarian opportunity than a cautionary reaction to deteriorating conditions.

Stock market breadth appears to be contracting, which is often a sign of tougher circumstances ahead. As such, our equity portfolios balance offensive and defensive plays, reflecting the divide between the prosperous, bubbly technology trade and the "rest of the market." Potential fourth-quarter developments to watch include further narrowing of equity leadership, a possible resolution to the Iran conflict and the impact on oil prices, the mid-term elections, and the sustainability of earnings optimism as the calendar turns to 2027.

Thank you for your continued support.



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[1] S&P 500: A capitalization-weighted index of 500 stocks measuring performance of the broad domestic economy.

[2] Nasdaq Composite: A stock market index that includes almost all stocks listed on the Nasdaq stock exchange.

[3] Bloomberg U.S. Aggretate Index: A flagship market-capitalization-weighted benchmark tracking the U.S. investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market.

[4] MSCI All Country World Index: A global equity benchmark that tracks large- and mid-cap stocks across 23 developed and 24 emerging markets countries, representing about 85% of the global investable equity set.

[5] 100 basis points = 1%.

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**Past performance does not guarantee future results. Investing involves risk, principal loss is possible. Index performance does not reflect fund performance and it is not possible to invest directly in an index.**

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