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Economic and Market Overview

Third Quarter 2026

Building a Lifelong Partnership

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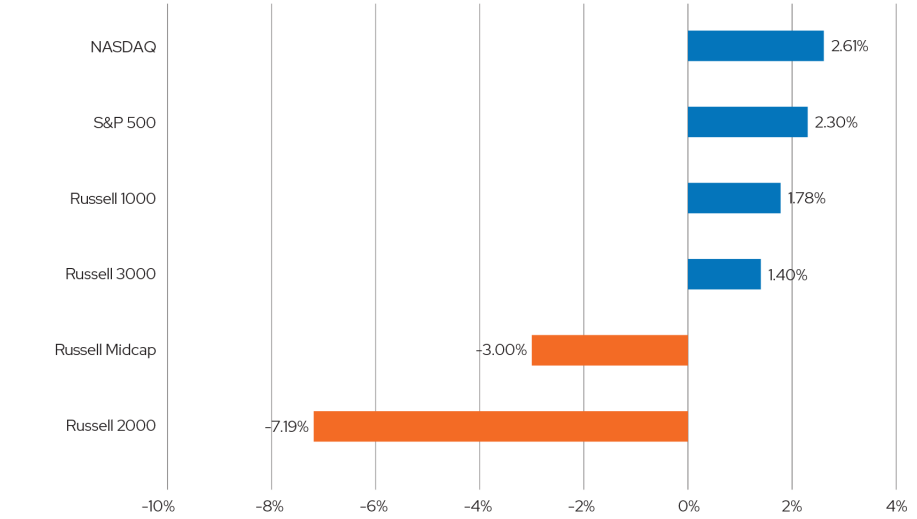
OCTAVIA WEALTH ADVISORS

The Economy

Despite persistent inflation, elevated interest rates, and growing geopolitical uncertainty, the U.S. economy continued to demonstrate remarkable resilience as the third quarter came to a close. Household frustrations with sticky inflation and high interest rates have not yet dented consumption spending, and businesses continue to invest in AI and related assets at breakneck pace, providing strong underlying support for the economy. Reviewing available data, the Bureau of Economic Analysis estimates that U.S. real GDP grew at a 2.2% annualized pace in the second quarter, slowing a touch from 2.5% to start the year. However, trade dragged heavily on the Q2 growth figure, while underlying demand indicators were quite strong. The labor market held steady, with unemployment rates stable at low levels as hiring and firing activity remain muted. Inflation figures were little changed across the quarter and remain above target, prompting consternation among the Federal Open Market Committee, which voted in September to hike interest rates by 0.25%, the first increase to benchmark rates in over three years. The Committee raised its 2026 inflation forecast, indicating that further hikes may be necessary to return inflation to the FOMC's target level.

Broad Market Index Returns

Third Quarter 2026



Source: Bloomberg

Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

According to real GDP data, the U.S. economy expanded at a solid pace in the second quarter, as persistent price pressures and elevated borrowing costs have not meaningfully crimped real spending by consumers or businesses. Real GDP grew at an annualized rate of 2.2% in the second quarter, slowing slightly from 2.5% in the prior period. Consumption spending, the primary driver of the economy, grew at a strong 3.8% pace after a much softer 0.7% in the first quarter. Business investment remained robust at a 4.6% rate as AI investment continued in earnest. Government spending was once again a modest drag on growth amid shifting policies in Washington, and trade dragged as imports grew faster than exports. Stripping out those last two categories to look at core growth drivers, final sales to private domestic purchasers grew at a 4.6% rate, rebounding from 1.8% in each of the prior two quarters to the highest level since the first quarter of 2023. Headline inflation accelerated slightly due to energy prices, with the PCE price index climbing to a 5.0% annual rate from 4.2% in the first quarter, while core PCE, which excludes food and energy, rose at a 3.3% rate, slowing from 3.9% previously. Both remain well above the Fed's 2% target. Corporate profitability remained robust during the quarter as well, as evidenced by burgeoning equity market earnings. Profits from current production for all U.S. business increased by $384 billion during the quarter, much stronger than a $63.4 billion gain in the first quarter.

The first estimate of third quarter GDP will be released toward the end of October. Early indicators point to another strong quarter of growth, with consumption and business spending expanding at a solid pace even as trade imbalances continue to weigh. Per FactSet, analysts currently forecast a 2.8% growth rate, while the Atlanta Fed's GDPNow estimate targets a higher 3.6% pace. The combination of strong consumer demand, continued business investment, and improving profitability suggests that underlying economic momentum remained firmer than headline GDP growth alone would indicate.

HOUSING

Housing market activity remained muted in the third quarter as the combination of high mortgage rates and home prices keeps a lid on transactions. In August (latest data available), sales of existing homes dipped 2.0% from July and 1.2% from a year ago to a seasonally adjusted annual rate of 3.98 million, the first time below a 4 million pace since June 2025. Prices continue to appreciate, but at modest rates. The National Association of Realtors estimated that the median sale price for an existing home sold in August was $429,100, up 1.6% from a year ago. Housing inventory also continues to accumulate as sellers are unable to find buyers willing to meet their pricing demands. The number of homes available for sale reached 1.62 million in August, or about 4.9 months' supply at the current pace of sales. That is the highest level in over a decade. Tentative housing market optimism from prior quarters has quickly been wiped out by the recent surge in interest rates, which have pushed 30-year mortgage rates back above 7% and toward

7.5%, up sharply from around 6% back in March and approaching the 7.79% post-COVID high point that was previously reached about three years ago. As long as mortgage rates remain near current levels, transaction activity is likely to stay subdued as prospective buyers struggle to bridge the affordability gap created by elevated prices and financing costs.

EMPLOYMENT

Labor market reports have continued to alternate between strength and weakness in recent months, but the general trend is that employment growth remains slow on an absolute basis, but sufficient to maintain low unemployment rates amid low layoffs, immigration outflows, and slower population growth. Non-farm payrolls expanded by just 29,000 in September and averaged 51,000 per month during the third quarter after a strong print in August offset a weak July. The third quarter was noticeably weaker than the second quarter's monthly average of 111,000 additions. Digging into specifics, workforce growth remained concentrated in healthcare, which averaged 24,000 additions per month in the third quarter, nearly half of total growth. Manufacturing and construction were also very strong, each averaging 15,000 additions per month. On the other hand, AI-exposed industries like information (-8,000), financial (-8,700), and business services (-6,700) shed jobs on average.

Despite slower additions, the unemployment rate held steady, moving up one tick in September to 4.2%, and workforce participation rose to 61.8% from 61.4% in July. Wage growth has continued to moderate over the past few years, with year-over-year earnings growth reaching 3.1% in September. Unlike the post-COVID period, wage growth is unlikely to be a meaningful contributor to inflationary pressures right now. In total, labor force activity remains muted as it has throughout much of the past two years, with low levels of new hiring and firing. While monthly payroll gains appear subdued by historical standards, the labor market continues to benefit from exceptionally low layoffs and slower labor-force growth, allowing unemployment to remain near historically low levels.

INFLATION

Inflation rates were little changed on balance across the third quarter, dipping slightly in July and August before reaccelerating in September, ending at annual rates similar to those seen in June. The Consumer Price Index ended the quarter at 3.7% over the past year, slightly ahead of the 3.5% rate seen in June, while the 2.6% core CPI print matched June's level. Under the hood, energy remains the biggest contributor to upward pressure, with prices up 20.4% over the 12 months ending in September, a sharper increase than the 15.7% seen over the year ending in June. Other items were little changed over the quarter—food inflation eased slightly to 2.5% from 3.0%, non-energy commodities remained very soft at 0.7%, and services remained sticky, with prices rising 3.1% compared to 3.2% in June. It remains promising that higher energy prices have not (yet) driven up the cost of non-energy goods, but sticky services inflation remains a problem for the Fed, as it is nearly impossible for headline inflation figures to reach 2% as long as shelter (which makes up 60% of the CPI basket) continues to inflate at 3% per year. While the inflation backdrop has improved substantially from post-pandemic peaks, persistent services inflation and rising energy prices suggest that the final leg of the journey back to the Fed's 2% target may prove difficult.

FEDERAL RESERVE POLICY

At its September meeting, the Federal Open Market Committee (FOMC) raised the target rate for the federal funds rate by 25 basis points to 3.75-4.00%, its first hike since July 2023 as officials continue to flag concerns about the level of inflation. The decision was unanimous under Chair Kevin Warsh, whose post-meeting statements remained close to the abbreviated format introduced in June, again eschewing forward guidance.
The accompanying Summary of Economic Projections showed upward revisions to inflation projections, with median forecasts now calling for 3.7% headline and 3.4% core PCE inflation in 2026, both up a tick from June. The median expected policy path turned more hawkish, with the median Fed member penciling in another rate hike in 2026, as well as slower easing in 2027 and 2028 than was previously forecast. Growth expectations were also nudged higher, up a tick to 2.3% in 2026 and 2.4% in 2027.

Warsh's post-meeting comments leaned hawkish, with a distinct focus on inflation rather than growth or unemployment, given that the committee is not concerned about risks to the latter two categories. Specifically, Warsh noted that "inflation is too high and has been too high for too long," and added that the summer's inflation readings "do not tell me that underlying trends have meaningfully improved." Consistent with the approach adopted earlier this year, Chair Warsh offered little explicit guidance on future policy moves, instead emphasizing that incoming inflation and labor market data would determine the appropriate path of interest rates.

INTEREST RATES & FIXED INCOME

Bond market headwinds intensified in the third quarter, as an escalating energy-driven inflation shock and a Federal Reserve policy pivot pushed interest rates sharply higher. Yields on 10-year Treasuries climbed 82 basis points ("bps") to 5.29%, their highest since 2008, while 30-year yields rose 68 bps to 5.63%, their highest since 2004. Increases in the short end of the yield curve are primarily attributed to the hawkish Fed pivot, whereas rising longer-term yields have been associated with several potential factors, including higher growth expectations, higher inflation expectations, concerns around the federal debt, and a general increase in term premium to compensate for the uncertainty created by one or more of these factors.

Credit markets were relatively resilient despite the rise in yields. Investment grade spreads ended the quarter around 79 bps, incrementally wider than at the start of the quarter but still relatively tight, as corporate fundamentals hold solid amid rising all-in yields. High yield spreads also widened slightly, ending around 280 bps, but remained tight by historical standards. Global bond yields rose alongside U.S. yields, as rising oil prices pressured central banks into hawkish pivots. In municipal bond markets, long-term yields rose to their highest levels since April 2025 amid rising Treasury yields and record issuance.

As a result of rising rates and incrementally wider spreads, returns were negative across most fixed income securities during the quarter. The Bloomberg U.S. Aggregate Bond index of investment grade debt fell 3.51%, while the Bloomberg High Yield index of riskier debt returned -1.82%, outperforming thanks to lower interest rate exposure. Municipal bonds, on the other hand, slid 6.35% due to higher interest rate exposure. Global bonds outperformed

U.S., falling 1.64% during the quarter. The third quarter highlighted the distinction between credit risk and duration risk: despite stable corporate fundamentals, longer-duration assets faced significant pressure as interest rates moved sharply higher.

EQUITIES

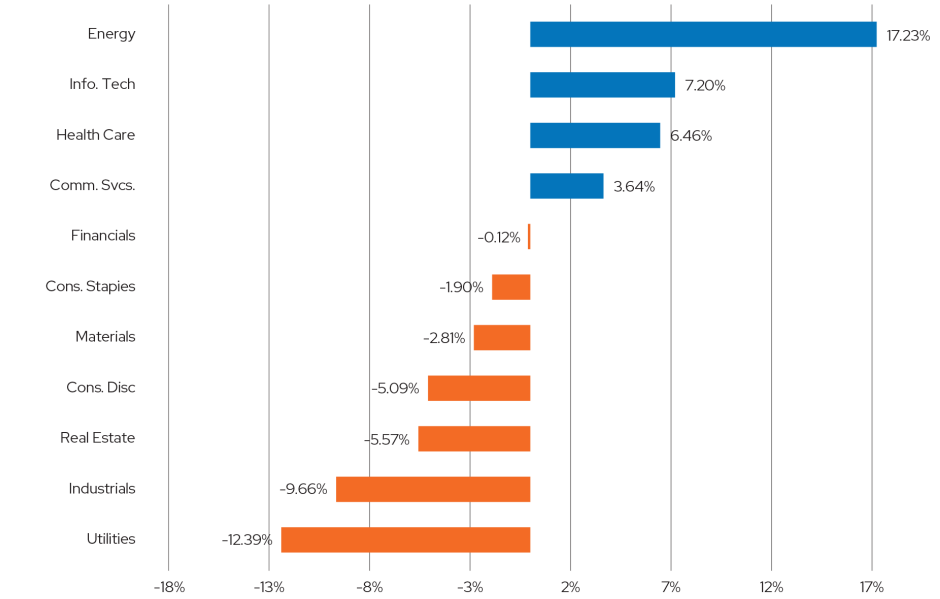
Global equities ended the third quarter mostly higher, with more modest returns than over the summer and greater volatility. Markets hit record highs in August, with broad breadth supported by exceptionally strong second quarter earnings results, before easing in September amid a surge in Treasury yields. Regarding second quarter earnings, 86% of S&P 500 companies reported earnings per share above estimates, and the index delivered its seventh consecutive quarter of double-digit year-over-year earnings growth.

Sector performance was highly uneven, with higher oil prices driving excellent returns in the Energy sector (+17.2%) and AI optimism continuing to bolster Technology (+7.2%). On the other hand, historically rate-sensitive sectors like Real Estate (-5.6%) and Industrials (-9.7%), as well as slower growth sectors like Utilities (-12.4%), were hammered by higher rates. While overall earnings remained strong, leadership continued to be concentrated in a relatively narrow group of sectors and companies tied to AI investment and higher energy prices.

At the index level, the S&P 500 advanced by 2.3% during the quarter and is up about 13% for the year. The Russell 2000 index of small cap stocks underperformed large caps sharply due to greater interest rate sensitivity, returning -7.2% for the quarter to bring its year-to-date return to 13.7%. The tech-heavy Nasdaq composite index rose 2.6% in Q3 and is up 16% this year.

U.S Equity Market Returns by Major Sector

(GICS Sectors in S&P 500, Third Quarter 3Q26)



Source: Bloomberg

International stocks generated positive returns during the quarter and performed similarly to the U.S. The MSCI ACWI ex-US index, which covers all markets outside the U.S., rose 0.5%. The MSCI EAFE index of developed markets rose 0.8% as Japanese stocks performed well, while MSCI Emerging Markets fell 0.4%, with losses in Asia offsetting strong gains in emerging European nations. The MSCI EAFE and Emerging Markets indices have gained 10.3% and 23.4%, respectively, so far this year.

Outlook

As the end of 2026 approaches, the economic backdrop remains complex. Geopolitical conflict, surging oil prices, and persistent inflation serve as obvious headwinds to growth, yet resilient employment and rising asset prices keep households on firm footing in aggregate, and business investment in AI provides a new and substantial lever for growth.

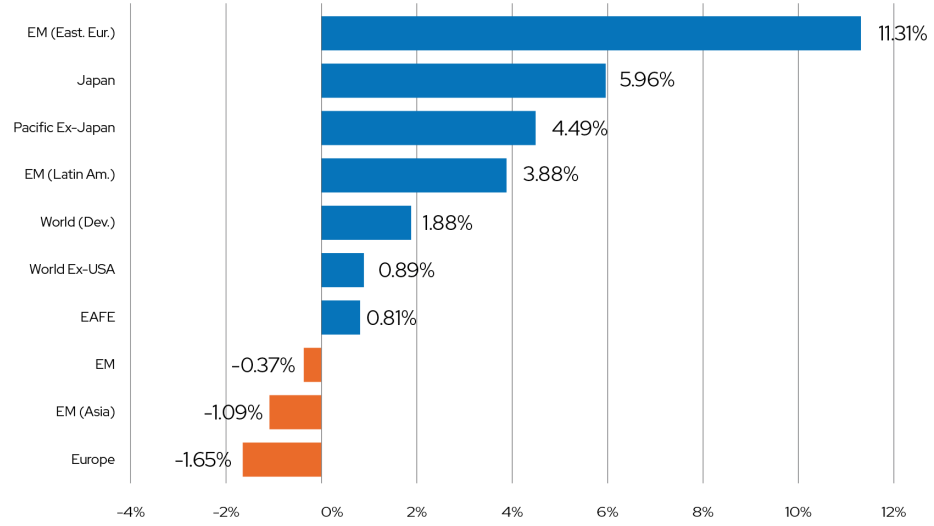
To be clear, while households remain solid in total, signs of the "K-shaped" economy persist, with wealthier households continuing to spend thanks to the wealth effect of rising portfolio values while lower-income households are forced to cut back discretionary spending as prices of necessities continue to rise. Much like in the stock market, such concentration of spending is not a problem until it is. A significant downdraft in equity values, for example, could lead to wealthier households cutting back their own spending, which could pull support out from under the economy.

The corporate side of the ledger is similar—optimistic on balance, but with concentration under the hood. Exceptional earnings growth by the S&P 500 has supported the stock market, but that growth

Non-U.S. Equity Market Returns

By Region (U.S. Dollars)

Third Quarter 2026



Source: Bloomberg

has largely been concentrated in the energy and technology sectors, the former bolstered by higher oil prices and the latter by AI spending. We have no expectation that the pace of the AI buildout will slow based on available information, but downside risks must always be considered.

We maintain our view from prior quarters: risks are meaningful but manageable. It appears that geopolitical conflict or higher interest rates alone will not be enough to derail the economy, which has been powering through both for several years. For now, the evidence continues to favor expansion over contraction, though investors should remain mindful that economic momentum has become increasingly dependent on a handful of key supports, including labor market resilience, AI-related capital spending, and continued strength in household balance sheets. Midterm elections also remain an upcoming wild card, with consensus views currently calling for Democrats to take control of the House while the Senate remains a toss-up. A Democrat sweep of Congress would likely raise fresh questions about AI development, given outspoken opposition to data centers by key party leaders, while a less likely Republican sweep may result in a further push towards the President's stated agenda, which may include tax cuts, cash stimulus payments, and new tariffs.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the

investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

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