



Quarterly Market Outlook for Q4 2026: Rising Rates, New Market Highs and Fed Hikes

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If you only read the headlines during the third quarter, you might assume investors had a rough few months. But, stocks reached new highs in the third quarter, with many asset classes contributing to portfolios, despite bonds struggling as interest rates rise. As new developments unfold and the midterm election approaches, investors should continue to stay balanced and focus on financial goals.

The Market Keeps Refusing to Read the Script

If you only read the headlines during the third quarter, you might assume investors had a rough few months. Interest rates climbed to levels not seen in roughly two decades. Oil pushed back above \$100 per barrel. The Federal Reserve raised rates for the first time in three years. Questions around artificial intelligence grew louder. And another election season began creeping into the daily market conversation.

That sounds like a pretty convincing recipe for trouble.

Except the market didn't cooperate.

Major U.S. stock indices finished the quarter near their all-time highs. Energy performed well. Commodities contributed. International markets participated. And bonds—while suffering from the move higher in rates—now offer yields that investors haven't seen in years.

That contradiction is worth paying attention to. Because markets rarely move according to the neat narratives we create for them. And that may be the most important lesson as we head into the fourth quarter. The goal isn't to predict every headline. It's to build a portfolio that doesn't require you to.

Higher Rates Are No Longer a Temporary Story

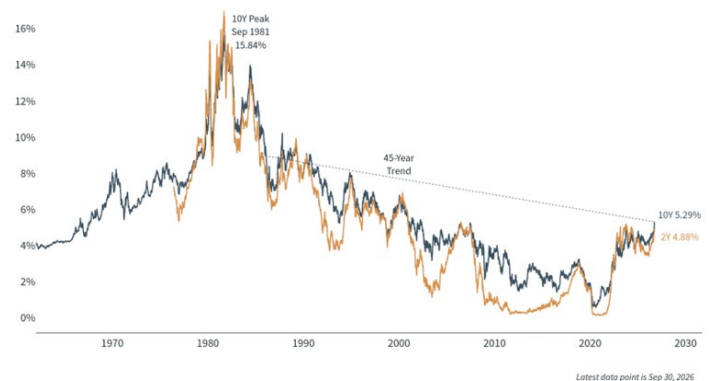
For most of the post-2008 investing world, falling interest rates were part of the scenery. Investors became accustomed to them. Businesses became accustomed to them. Homeowners became accustomed to them. Markets certainly became accustomed to them. That era looks increasingly distant.

The defining feature of the third quarter was the continued rise in interest rates to levels not seen since the early 2000s. And this matters for more than just the bond market.

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Historical Interest Rates

10-year and 2-year yields since 1960



Sources: Cleareconomics, Federal Reserve

For roughly four decades—from the early 1980s through 2020—interest rates generally moved lower. There were plenty of interruptions along the way, but the broader trend was unmistakable. That decline created an enormous tailwind for bond prices, asset valuations, borrowing, housing, and economic activity.

Now investors are operating in a very different environment. But different does not automatically mean worse. Higher yields mean bonds can once again do something investors historically expected them to do:

Generate meaningful income.

That creates new choices in portfolio construction. For years, investors were effectively forced farther out on the risk spectrum to generate returns. Today, fixed income can once again play a more meaningful role in asset allocation. That's an important change. And it extends well beyond investment portfolios.

Consider housing.

The average 30-year fixed-rate mortgage has climbed back above 7%. That creates a powerful economic incentive for homeowners who locked in 3%, 4%, or even 5% mortgages to stay exactly where they are. Why trade a cheap mortgage for an expensive one? Economists call this the **lock-in effect**. Homeowners simply call it common sense. The result is fewer homes changing hands, constrained supply, and a housing market behaving very differently than it did during the low-rate era.

Where interest rates go next is anyone's guess.

Oil prices, employment, inflation, fiscal policy, and economic growth can all move the equation. But one fact is difficult to ignore: **The cost of money has changed.** Portfolio strategy needs to acknowledge that.

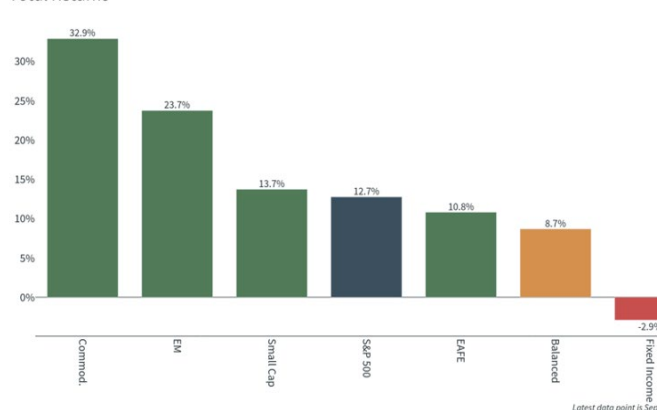
Meanwhile, Corporate America Keeps Making Money

Here is where the story gets interesting. While interest rates were rising, the S&P 500, Nasdaq, and Dow Jones Industrial Average all reached new highs during the quarter. That wasn't supposed to happen. At least according to the simplest version of the market narrative.

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Asset Class Performance Year-to-Date

Total Returns



Source: Clearnomics, LSEG. The chart shows total asset class returns year-to-date. Asset classes included are MSCI Emerging Markets Index (EM), MSCI Developed Markets Index (EAFE), MSCI World Small Cap Index (Small Cap), S&P 500, balanced portfolio, fixed income, and MSCI World Commodity Producers Index (comm.). The balanced portfolio is a historical 60/40 portfolio consisting of 40% U.S. large cap, 5% small cap, 10% international developed equities, 5% emerging market equities, 35% U.S. bonds, and 5% commodities.

Higher rates are supposed to pressure valuations. Higher energy costs are supposed to hurt consumers. Tighter monetary policy is supposed to slow the economy. And yet corporate earnings remained remarkably resilient.

A major reason is the continued strength of the U.S. economy combined with an extraordinary capital-investment cycle surrounding artificial intelligence.

AI is no longer simply a software story. It is becoming an infrastructure story. Data centers. Semiconductors. Electricity. Transmission. Cooling. Copper. Natural gas. Construction. Networking. Industrial equipment.

Suddenly, an investment theme that began with technology companies is rippling across large portions of the economy. That helps explain why market participation has been broader than many investors realize.

Small-cap stocks struggled during portions of the third quarter but have performed well over the broader year, with many smaller companies participating in the AI supply chain. Asian semiconductor manufacturers have benefited. Emerging markets have participated. Energy companies have benefited from higher oil prices. Copper has reached record territory amid supply constraints and growing infrastructure demand. Diesel prices have risen as global refining capacity remains tight.

This is not simply a story about seven giant technology companies anymore. It is increasingly a story about **capital expenditure spreading through the real economy**. That distinction matters.

\$100 Oil Changes the Conversation

Oil began the quarter around \$70 per barrel. By September, it had moved above \$100. That is not a small move. Geopolitical instability in the Middle East has constrained supply expectations and reminded markets of something investors occasionally forget: The digital economy still runs

on the physical economy. Servers need electricity. Factories need energy. Goods need transportation. Aircraft need fuel. Data centers need enormous amounts of power. Artificial intelligence may live in the cloud. Its infrastructure most certainly does not. That is one reason commodities have played an increasingly important role in markets.

Copper provides another example. Growing infrastructure demand has collided with years of constrained mine development and supply challenges. The result? Record prices. This is the recurring investment theme underneath much of what we are seeing:

Demand is accelerating in areas where supply cannot be created overnight.

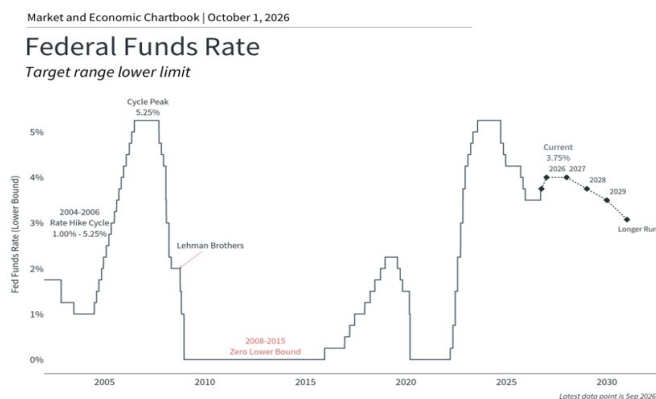
Energy. Metals. Electricity. Infrastructure.

Those imbalances create both risks and opportunities.

And they reinforce why diversification today needs to mean more than simply owning different categories of stocks.

The Fed Just Changed Direction Again

At its September meeting, the Federal Reserve raised interest rates by 0.25%, bringing its target range to 3.75%–4.00%.



Sources: Federal Reserve

It was the first increase in three years. But perhaps the more interesting part is *why* the Fed acted. The primary concern is not an overheated consumer economy.

It is energy. Economists call this **cost-push inflation**.

Translation: Something important gets more expensive, and businesses eventually pass those higher costs through-

out the economy. The Federal Reserve cannot produce another barrel of oil. It cannot negotiate a ceasefire. It cannot build a refinery. It cannot open a copper mine.

What it *can* do is attempt to prevent rising energy costs from spreading into wages, services, inflation expectations, and broader consumer prices.

That is the balancing act.

Current projections suggest policymakers could raise rates once more before pausing through 2027. But investors should treat those projections for what they are: Projections.

Economic data has an inconvenient habit of changing. Fed forecasts tend to change with it. The bigger point is that tighter monetary policy does not automatically equal falling stock prices. Context matters.

Historically, interest rates and stocks can rise together when economic growth, earnings, and capital investment remain strong. That is precisely what we saw during the third quarter. Rates went up. Stocks went up.

Anyone waiting for markets to obey a simple textbook relationship was disappointed. Markets are usually more complicated than the textbook.

Election Season Is Coming. Your Portfolio Doesn't Need to Campaign.

November's midterm elections are approaching. That guarantees one thing: More noise. Political headlines will become louder. Predictions will become more confident. And investors will once again be tempted to turn their political expectations into portfolio decisions.

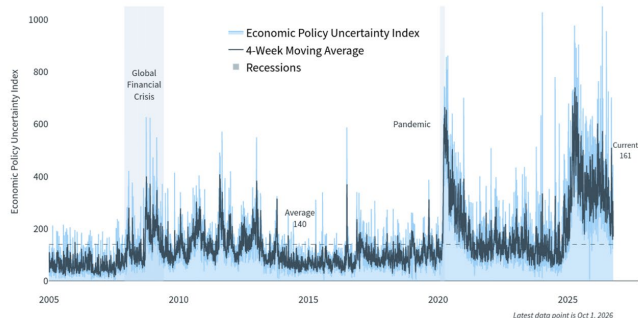
That can be dangerous.

Elections obviously matter. Tax policy matters. Regulation matters. Federal spending matters. Trade policy matters. The national debt matters.

But there is an important difference between recognizing the economic consequences of public policy and believing that we can consistently trade elections.

Economic Policy Uncertainty

Uncertainty based on news, taxes, and forecaster disagreement
Index of 100 represents the average from 1985 to 2009



Sources: *Cleantomics, Baker, Bloom, and Davis, Federal Reserve*

History gives investors plenty of reasons for humility.

Markets have performed under many different combinations of presidents and congressional control. Midterm years have produced volatility at times, but they have also historically generated positive long-term market returns.

Presidential parties frequently lose congressional seats during midterm elections. None of this is particularly unusual. And none of it provides a reliable market-timing strategy. The better question is not: **“Who will win?”**

It is: **“What economic conditions will the winner inherit?”**

Inflation. Interest rates. Energy prices. Federal deficits. Economic growth. Corporate profitability. Those conditions usually matter far more to portfolios than campaign slogans.

The \$40 Trillion Question

There is, however, one political issue investors should take seriously regardless of party: Federal debt.

Total U.S. government debt has now surpassed \$40 trillion. The federal budget deficit is projected to remain above \$2 trillion for fiscal 2026. Those numbers are enormous. But the real issue is not simply the headline debt number. It is the cost of carrying it.

When interest rates were near zero, growing government debt was easier to finance. At higher interest rates, the arithmetic becomes more uncomfortable. More federal revenue must be directed toward interest expense. That potentially leaves less flexibility for other government priorities. And over time, persistent borrowing can put upward pressure on Treasury yields and compete with private-sector demand for capital.

None of this means a crisis is inevitable. It does mean fiscal policy deserves more attention in a world where money once again has a meaningful cost.

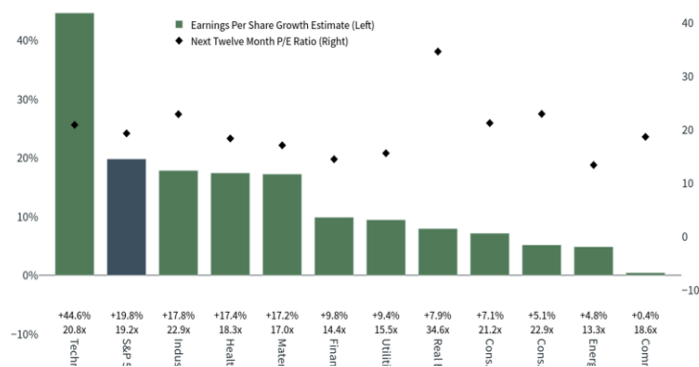
For investors, the takeaway is not to predict Washington. It is to recognize the environment Washington has helped create.

Is AI a Bubble? Maybe That's the Wrong Question.

Artificial intelligence is rapidly becoming one of the most debated subjects in financial markets. Too much spending. Too many data centers. Too much enthusiasm. Too much concentration. Maybe.

Sector Earnings and Valuations

Earnings Growth and P/E Ratios, Next Twelve Month Estimates



Sources: *Cleantomics, LSEG, Standard & Poor's*

But there is another side of the argument. AI investment is also producing one of the most significant capital-expenditure cycles in decades. And that spending is showing up in actual corporate earnings.

Technology companies have experienced exceptional profit growth. But importantly, other sectors are increasingly participating too. Energy is a perfect example. Higher oil prices have helped make energy the strongest-performing sector of the year through the third quarter, with a gain of 37.4%. *Source: Standard & Poor's and Dow Jones Indices data*

Industrials are benefiting from construction and infrastructure demand. Utilities are confronting enormous electricity requirements. Mining companies are supplying the raw materials needed to build the next generation of computing infrastructure. Semiconductor manufacturing continues to expand globally. The AI trade may therefore be broader than the handful of companies getting most of the headlines. But the most important question has yet to be answered.

Will all this spending actually make the economy more productive?

That is the trillion-dollar question.

The internet ultimately justified enormous investment because it transformed the productivity of businesses and workers. AI will eventually face the same test.

There are encouraging signs.

Average productivity growth during the 2020s has been approximately 2.1% annually compared with about 1.2% during the 2010s. That improvement matters. If AI accelerates productivity further, the economic impact could be significant. Higher productivity can support wages. Higher productivity can support profits. Higher productivity can reduce inflationary pressure. Higher productivity can allow an economy to grow faster without overheating. *Source: Standard and Poor's Data*

That is why the AI story is ultimately much bigger than whether a particular technology stock looks expensive next quarter.

The real question is whether AI changes the productive capacity of the economy. We are still early in finding out.

The Fourth Quarter Doesn't Need a Prediction

So where does that leave investors?

With a surprisingly constructive economy operating inside an unusually complicated market environment. Interest rates are high. Corporate earnings are strong. Energy prices are elevated. AI investment continues to accelerate. Fiscal deficits remain enormous. Geopolitical uncertainty is real. An election is approaching.

You could spend every morning trying to predict which of these forces will matter most. Or you could recognize something more useful:

Several of them can be true at the same time.

The economy can remain strong while rates stay high. Technology can outperform while commodities rise. Energy prices can create inflation while corporate profits remain healthy. Bonds can struggle on price while becoming more attractive on yield. AI can attract excessive enthusiasm while simultaneously producing real productivity gains.

Markets rarely offer investors one clean narrative. They offer competing forces. That is why balance matters. Not because diversification is exciting. It isn't. But because the future has an annoying habit of refusing to unfold exactly as expected.

The objective heading into the fourth quarter is therefore not to perfectly forecast the Fed, oil, AI, Congress, or the bond market. It is to construct portfolios capable of functioning across several possible outcomes. Because successful investing isn't about knowing what happens next.

It's about **not needing to know**.

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