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VVP Market Update
October 2026

For several months, financial markets seemed remarkably willing to give uncertainty the benefit of the doubt. Investors looked through an ongoing war in the Middle East, stubborn inflation and shifting expectations for monetary policy, encouraged by an economy that continued to grow and corporate earnings that remained supportive. September challenged that willingness—particularly in the bond market. The Federal Reserve had spent much of the year balancing an economy that remained surprisingly resilient against inflation that stubbornly refused to return to its 2% objective, but on September 16th policymakers decided that balance required action, raising the federal funds rate by 25 basis points—the Fed's first increase since 2023 and a reversal from the easing cycle that had begun two years earlier. More important than the quarter-point increase itself was what it said about the Fed's assessment of the economy: growth remained solid enough to tolerate tighter policy, while inflation remained troublesome enough to require it. That combination forced investors to reconsider an assumption that had underpinned markets for much of the past year—that the next meaningful move in interest rates would eventually be lower. Instead, September delivered a rather different message: the economy may be able to live with higher rates for longer, and the bond market may need to as well.

Complicating the Fed's job is a Middle East conflict that has now persisted long enough that it is increasingly difficult to characterize its economic consequences as temporary. The war with Iran has stretched beyond six months, restrictions on traffic through the Strait of Hormuz continue to constrain global energy markets, and repeated periods of escalation and de-escalation have made predicting an endpoint increasingly difficult. That distinction matters. Markets can generally absorb a short-lived geopolitical shock—even a severe one—if investors believe the resulting disruption to energy prices and inflation will quickly reverse. A conflict without an obvious expiration date is different, particularly when it intersects with an economy already struggling to return inflation to the Fed's 2% target. A sustained geopolitical premium in oil can work its way through transportation costs, manufacturing inputs, corporate margins and household inflation expectations, potentially leaving policymakers with less flexibility even if economic growth eventually begins to slow. Investors spent much of the summer treating the war as something happening alongside the economic outlook; September increasingly suggested it may need to be considered part of that outlook.

The bond market took notice. Treasury yields rose sharply across the curve during September, with the 10-year yield climbing from roughly 4.75% at the end of August to around 5.3% at month-end, while longer-dated yields moved even higher. The resulting price declines pushed the Bloomberg U.S. Aggregate Bond Index down more than 2.5% for the month, another uncomfortable reminder that bonds carrying little credit risk can still carry considerable interest-rate risk. The broader historical context is equally instructive: the increase in the 10-year yield during the third quarter was among the largest quarterly moves in decades, inviting comparisons with periods such as 1994 when an unexpected tightening cycle produced one of the modern bond market's more memorable selloffs. September was nowhere near a repeat of 2022, when the Bloomberg Aggregate lost roughly 13% over the full year, but it reinforced a lesson from that episode: when inflation changes the expected path of interest rates, duration can produce equity-like volatility at precisely the moment investors expect bonds to provide stability. Yet there is an important difference today. Investors are now being paid considerably more to accept that risk. A Treasury market offering yields around 5% provides substantially more income—and a much larger cushion against future price declines—than the near-zero-rate bond market investors confronted entering 2022. That creates an interesting paradox for long-term investors: September's selloff provides plenty of reason to think twice about fixed income, but the yields created by that very selloff provide equally compelling reason to think twice about ignoring it. The destination for interest rates remains uncertain, but for the first time in many years, investors willing to tolerate the journey are being meaningfully compensated for taking it.

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Markets in Brief

◆ U.S. Equities

The S&P 500 Total Return Index declined 0.35%[1] in September, breaking the market's late-summer advance but leaving the index close to record territory. The modest headline decline concealed considerably weaker breadth, with roughly three-quarters of S&P 500 constituents falling during the month as higher interest rates and renewed geopolitical uncertainty pressured valuations. Strong earnings and continued enthusiasm surrounding AI investment provided support to mega-cap technology companies, while the Fed's September rate increase and renewed U.S.-Iran tensions weighed more heavily on the broader market. By month-end, equities were effectively caught between resilient corporate fundamentals and a higher-for-longer interest-rate environment that was becoming increasingly difficult to ignore.

◆ U.S. Interest Rates / Bond Yields

September was particularly difficult for fixed income, with the Bloomberg U.S. Aggregate Bond Index losing more than 2.5%[1], its worst monthly performance since April. The 2-year Treasury yield rose approximately 55 basis points to 4.89%[1], while the 10-year climbed roughly 53 basis points to 5.28%[1] as investors absorbed the Fed's 25-basis-point rate increase, persistent inflation and renewed energy-price pressure. September therefore marked an important shift in the fixed-income narrative: rather than waiting for eventual policy easing, bond investors increasingly began demanding greater compensation for the possibility that both policy rates and inflation could remain elevated for considerably longer.

[1]Bloomberg data.

◆ Commodities

The Bloomberg Commodity Total Return Index gained approximately 0.6%1 in September, extending its recent advance but masking considerable volatility beneath the surface. Energy was the dominant driver as renewed U.S.-Iran tensions and uncertainty surrounding the Strait of Hormuz pushed crude prices sharply higher and revived concerns that geopolitical disruptions could again feed through to inflation. Industrial metals were also generally well supported by resilient global activity and continued infrastructure demand, while precious metals weakened late in the month as surging Treasury yields reduced the relative appeal of non-income-producing assets such as gold. The result was an increasingly bifurcated commodity environment in which supply-sensitive energy markets strengthened even as tighter monetary conditions created headwinds elsewhere in the complex.

Economic Commentary

September was a month in which the U.S. economy looked stronger than the labor-market scare of midsummer suggested, but also more inflationary than the Federal Reserve was willing to tolerate. Growth remains solid, consumers are still spending aggressively, and August payrolls bounced back after the weak June–July period. The complication is that inflation has stopped improving quickly enough, with both CPI and the Fed's preferred PCE measure still running comfortably above 2%. That combination ultimately pushed the Fed to do something markets had spent much of the year debating but not necessarily expecting so soon: raise interest rates again.

The three developments that mattered most in September were the rebound in August payroll growth, another firm inflation report, and the Fed's September 16th decision to raise rates by 25 basis points—its first increase after months of holding policy steady. Together, they changed the macro conversation from "when can the Fed ease?" to something closer to "how restrictive does policy actually need to be?"

◆ Growth and Overall Momentum

The broader economy continues to look healthier than many of the monthly headlines imply.

The BEA's September 30th annual update revised 2Q real GDP growth to 2.2% annualized, while 1Q26 growth was revised to 2.5%. Consumer spending, investment, and exports all contributed positively during Q2, reinforcing the view that the economy never really slipped into the kind of broad-based slowdown that some investors feared during the spring energy shock.

Business surveys tell a similar story. The August ISM Manufacturing PMI registered 54.6, marking the eighth consecutive month of expansion, while production remained particularly strong at 58.3. Services were even stronger: the ISM Services PMI reached 55.4, with business activity at 61.7 and new orders at 60.9.

In plain English, the private economy still has momentum. Businesses are producing, customers are placing orders, and investment—particularly around technology, infrastructure, and AI—is providing an important backstop to growth.
The issue is that this stronger demand backdrop is also one reason inflation is proving stubborn.

- **Labor Market:** *the Summer Slowdown Looks Less Ominous*

Perhaps the most reassuring September development was the August employment report, released September 4th.

Non-farm payrolls increased by 162,000, while the unemployment rate remained at 4.1%. Just as importantly, previous estimates for June and July were revised higher by a combined 55,000 jobs, including a revision that turned July from a reported 23,000-job decline into a 21,000-job increase. Average hourly earnings rose 0.3% during August and 3.1% over the past year.

That materially changes the narrative from August. Rather than an economy that may have been tipping toward outright employment contraction, the data now suggests a labor market that is simply growing at a slower, more sustainable pace.

Other labor data supports that interpretation. August JOLTS showed 7.1 million job openings, with hires at 5.2 million, while layoffs and discharges remained essentially unchanged at 1.6 million.

So, the "low-hire, low-fire" characterization still works—but with somewhat less emphasis on the "low-hire" side than we might have thought a month ago.

That is good news for consumption and recession risk. It is slightly less good news for a Fed hoping weaker labor demand would help bring inflation down faster.

- **Consumers:** *Spending Says "strong," Confidence Says Something Very Different*

The consumer remains the economy's great contradiction.

On September 30th, BEA reported that personal consumption expenditures jumped 0.9% in August, while real spending increased 0.6%. Goods spending increased by $114 billion and services spending by nearly $77 billion, indicating that strength was reasonably broad.

But income did not keep pace. Personal income rose only 0.2%, disposable income increased 0.3%, and real disposable income was flat. The personal saving rate declined to 4.1%.

That tells us consumers are still willing to spend—but increasingly out of current cash flow and reduced saving rather than rapidly rising purchasing power.

Sentiment, meanwhile, deteriorated sharply. The Conference Board's September Consumer Confidence Index fell to 81.9 from 88.6 in August, its weakest level in more than a decade, with both current condition and expectations measures declining.

So, households are effectively saying one thing and doing another: they are worried about inflation, wages, and economic prospects, but they continue to spend.

Historically, the spending data matter more—until the labor market begins weakening materially. That is why employment remains the crucial variable going into year-end.

◆ Inflation: *Progress Has Stalled*

Inflation remains the central problem.

The August CPI report showed headline prices rising 0.4% month over month and 3.4% year over year. Gasoline prices rose 3.9% during the month, while energy overall increased 2.1%; shelter also picked up 0.3%. Core CPI increased 0.3% monthly and 2.4% year over year.

The month-end PCE report was somewhat less reassuring. Headline PCE inflation was 3.4% year over year, unchanged from July, while core PCE remained at 3.0%.

That leaves the Fed with a fairly straightforward problem: inflation is no longer surging, but it also isn't converging convincingly toward 2%.

And the pipeline still contains pressure. ISM's August price indexes remained above 70 in both manufacturing and services, signaling that businesses continue to experience meaningful input-cost increases.

The inflation story, therefore, is no longer about an acute Iran-related oil shock. It is increasingly about whether persistent demand, services inflation, and supply constraints are keeping the underlying inflation rate structurally too high.

◆ Monetary policy: *The Fed Hikes*

That brings us to September's defining event.

On September 16th, the Federal Reserve unanimously raised the federal funds target range by 25 basis points to 3.75%–4.00%. The FOMC said economic activity was expanding at a solid pace, domestic spending remained resilient, productivity and capital investment were strong, and inflation remained elevated.

The new projections were equally telling. Fed officials raised their median 2026 GDP growth forecast to 2.3%, lowered their unemployment projection to 4.1%, and lifted projected PCE inflation to 3.7% and core PCE to 3.4%. The median projected federal funds rate for year-end rose to 4.1%, compared with 3.8% in June.

That is not a recession-fighting Fed. It is a Fed looking at an economy that appears capable of tolerating somewhat tighter policy and deciding that inflation risk deserves priority.

The key question is whether September's hike is an isolated adjustment—or the beginning of a second tightening phase.

Big picture as of end-September 2026

Putting everything together:

- **Growth remains solid**, with revised Q2 GDP at 2.2% and business surveys firmly in expansion territory.
- The **labor market looks healthier than it did a month ago**, with August payrolls up 162,000 and earlier weakness revised meaningfully higher.
- **Consumers continue to spend aggressively**, even as confidence deteriorates and real disposable income growth slows.
- **Inflation has stopped making convincing progress toward 2%**, particularly on the PCE measures most relevant to the Fed.
- And the **Fed has moved back into tightening mode**, raising rates to 3.75%–4.00% and signaling through its projections that policy may need to remain restrictive for longer than previously anticipated.

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