

## VVP Market Update

### September 2026

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There is something about the week after Labor Day that feels like a collective return to work. Children head back to school, football once again occupies the weekends, and the rhythms of summer give way to a calendar that suddenly feels much more consequential. Financial markets often experience a similar transition. After a relatively quiet summer in which investors seemed willing to look through a surprising amount of uncertainty, September arrives with a decidedly fuller syllabus. The economy remains resilient and corporate earnings have generally held up, but the comfortable assumption that the Federal Reserve would eventually ride to investors' rescue has become harder to maintain. Chair Kevin Warsh used his first Jackson Hole address to emphasize that the Fed must be confident inflation is moving toward its 2% objective—and suggested policymakers still have “work to do” if it is not. Markets heard the message: expectations for tighter policy increased and Treasury yields moved higher following the speech. In other words, summer vacation is over, and monetary policy may once again be the toughest class on the schedule.

Of course, the Fed is hardly the only subject demanding investors' attention. The war with Iran has now stretched beyond six months, and what initially looked like the sort of geopolitical shock markets might quickly digest has instead become a persistent source of uncertainty. Restrictions on traffic through the Strait of Hormuz remain an important constraint on global energy markets, while the expiration of the summer ceasefire has returned oil prices—and the possibility of renewed escalation—to center stage. Like a football team that spent the offseason drawing up its game plan only to discover that the opponent has changed formations, investors are being forced to reconsider how higher energy prices might interact with an already complicated inflation backdrop. That linkage matters: a prolonged geopolitical risk premium in oil could simultaneously pressure consumers, corporate margins and inflation, leaving the Fed with considerably less room to support growth. Markets became remarkably adept this summer at treating the war as background noise; autumn may test whether that complacency was justified.

And then there is November. With the midterm elections now just two months away, politics will increasingly compete with economics for investors' attention. Control of Congress is closely contested, and the combination of inflation, the economy, energy prices and the Iran war is moving to the center of the campaign. Markets have historically learned to live with elections—and divided government is hardly an unfamiliar outcome—but the weeks leading into Election Day can nevertheless introduce another layer of uncertainty around fiscal policy, regulation and the broader direction of Washington. So, as we turn the page from summer to fall, investors might think of the coming months much the way students view the beginning of a new school year or football teams approach opening weekend: everyone starts with a clean notebook and an optimistic record, but the real tests are still ahead. The lesson of the summer was that markets can tolerate an extraordinary amount of uncertainty when growth and earnings remain supportive. The question for the fall is whether investors can continue looking past that uncertainty, once monetary policy, geopolitics, and politics are all back on the field at the same time.

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### Markets in Brief

#### ◆ U.S. Equities

U.S. equities resumed their advance in August, with the S&P 500 generating a total return of approximately +2.7%<sup>1</sup>, bringing its year-to-date gain comfortably into double digits. Strong corporate earnings and continued enthusiasm around AI-related investment supported the market, but importantly, leadership broadened beyond the largest technology companies into areas such as health care, materials and energy. Investors generally looked through persistent inflation and higher long-term interest rates as earnings growth remained strong enough to support elevated valuations. The month ended on a somewhat more cautious note, however, as renewed Iran tensions, higher oil prices and increasingly hawkish Fed expectations reminded investors that the macro backdrop remains less benign than the equity market's headline performance might suggest.

## ◆ U.S. Interest Rates / Bond Yields

The Bloomberg U.S. Aggregate Bond Index returned approximately +0.2%<sup>1</sup> in August, a modest recovery following July's decline, although considerable intra-month rate volatility masked the relatively quiet headline return. The 2-year Treasury yield increased roughly 6 basis points to 4.34%, while the 10-year finished essentially unchanged at 4.75%, as softer growth concerns early in the month competed with persistent inflation worries and increasingly hawkish Fed rhetoric later. Longer-duration bonds came under pressure toward month-end as investors contemplated the possibility that the Fed's next move could ultimately be a hike rather than a cut. The result was an environment in which coupon income provided some support, but elevated yields and uncertainty surrounding the policy path continued to make duration a challenging source of return.

<sup>1</sup>Bloomberg data.

## ◆ Commodities

Commodities were among August's strongest-performing major asset classes, with the Bloomberg Commodity Total Return Index gaining approximately +7.2%<sup>1</sup>. The advance was broad but increasingly influenced by renewed supply concerns, as energy prices strengthened and geopolitical tensions surrounding Iran and the Strait of Hormuz resurfaced late in the month; Brent crude moved back above \$90 per barrel on the final trading day. Agricultural and other supply-sensitive commodities also contributed, while the broader inflationary backdrop reinforced demand for real assets. After June's sharp correction and July's rebound, August effectively restored commodities' role as both a geopolitical hedge and an important source of inflation protection.

## Economic Commentary

August reinforced a theme that has been building for several months: the U.S. economy is still growing, but the mix of growth and inflation is becoming increasingly uncomfortable for the Federal Reserve. Private-sector demand remains surprisingly healthy, manufacturing has strengthened, and the unemployment rate remains low. Yet hiring has slowed sharply and inflation is still running well above the Fed's 2% objective. If May and June were about determining whether the spring energy shock would derail the expansion, August was more about recognizing that the economy absorbed that shock reasonably well—but may have emerged with more persistent inflation than policymakers would like.

The three developments that mattered most during August were the surprisingly weak July employment report and its large downward revisions, inflation data showing that the energy shock is fading but underlying inflation remains sticky, and Fed Chair Kevin Warsh's Jackson Hole message that the bar for additional tightening may be considerably lower than markets previously assumed. Together, those developments have produced an unusual macro backdrop: slower employment growth alongside solid private demand and inflation that remains too high.

## ◆ Growth and Overall Momentum

At first glance, the second-quarter GDP numbers look somewhat underwhelming. Real GDP grew at a 1.5% annualized rate in the second quarter, down from 2.1% in the first. But the composition tells a considerably better story. Real final sales to private domestic purchasers—a useful measure of underlying demand that strips away some of the volatility associated with trade and government spending—rose at a robust 4.2% annualized pace. Consumer spending and business

investment remained healthy, while government spending and trade weighed on the headline number.

Business surveys reinforce that message. The ISM Manufacturing PMI jumped to 55.6 in July, its highest reading since May 2022, while production reached 58.5 and new orders 56.7. Services remained firmly expansionary as well, with ISM Services PMI at 54.1 and new orders at 57.2. The wrinkle is inflation: both manufacturing and services businesses continue to report unusually strong price pressures, suggesting that healthy demand is bumping up against capacity constraints in areas ranging from energy to semiconductors and electrical equipment.

The AI investment boom remains an important part of this story. Data centers, semiconductor capacity, power infrastructure and related equipment spending continue to provide a meaningful tailwind to capital investment. That is good news for productivity and long-run potential growth, but in the short run it is also creating unusually intense demand for electricity, specialized equipment and certain commodities—meaning the AI boom may currently be somewhat inflationary even if it ultimately proves disinflationary through productivity gains.

#### ◆ **Labor Market: *the August Wake-up Call***

The July employment report, released August 7, was probably the month's biggest economic surprise.

Nonfarm payrolls declined by 23,000, but the more important news was buried in the revisions: May payroll growth was revised from +129,000 to just +63,000, while June was revised from +57,000 to +20,000. Combined, May and June employment was therefore 103,000 lower than previously reported. Average payroll growth over the preceding twelve months was just 34,000.

That is a meaningful slowdown.

Yet the labor market still doesn't look recessionary. The unemployment rate remained just 4.1%, permanent job losses were broadly stable, and wage growth was still 3.2% year-over-year. Part of the explanation appears to be supply, as labor-force participation has declined 70 basis points since January, meaning the economy simply doesn't need to create as many jobs each month to keep unemployment stable.

We would characterize the labor market as weak hiring rather than weak employment. Companies aren't adding many workers, but neither are they aggressively firing existing ones. That distinction is crucial. A low-hire environment can persist for quite some time without causing recession; a rising-layoff environment usually cannot.

The risk, of course, is that the former eventually becomes the latter. That makes the September 4 employment report particularly important.

#### ◆ **Consumers: *Still Spending, but Losing Some Momentum***

Consumers remain remarkably resilient, although July offered some evidence that spending is becoming more restrained.

Personal income rose 0.4% in July, while disposable income increased 0.5%. Consumer spending, however, rose just 0.2% nominally, and real spending was essentially unchanged. The composition was telling, as services spending increased substantially while goods purchases fell, continuing the long-running normalization toward service-oriented consumption.

Confidence is less encouraging. The Conference Board's Consumer Confidence Index slipped to 89.4 in August, and its Expectations Index fell to 68.2. Consumers felt better about current conditions but became more pessimistic about the future; a pattern consistent with households that are still financially capable of spending but increasingly worried about employment and inflation.

◆ **Inflation: *Better at the Gas Pump, Less Comforting Underneath***

July's CPI report initially looked encouraging. Headline CPI increased only 0.1% during the month, bringing the year-over-year rate down to 3.4% from 3.5%. Energy prices declined 1.5%, including a 2.9% drop in gasoline, continuing the reversal of the enormous price increases generated by the spring Middle East shock. Core CPI rose 0.2% and slowed to 2.5% year-over-year.

But the Fed's preferred PCE measure tells a somewhat less comfortable story. July PCE inflation was 3.7% year-over-year, while core PCE stood at 3.3%. Those numbers are clearly inconsistent with the Fed's 2% objective.

The encouraging interpretation is that the worst of the energy shock is passing and core CPI continues to moderate. The less comforting interpretation is that inflation has broadened enough that cheaper gasoline alone won't return inflation to target.

That tension largely explains the increasingly hawkish rhetoric coming from the Fed.

◆ **Monetary Policy: *Jackson Hole Changes the Conversation***

The Fed held its policy rate at 3.50%–3.75% in July, but the decision was unusually divided: three FOMC members voted for a 25-basis-point increase.

During August, that disagreement moved closer to center stage.

At Jackson Hole, Chair Kevin Warsh emphasized that inflation remains substantially above target and argued that financial conditions are difficult to characterize as broadly restrictive. He pointed to tight credit spreads, healthy loan issuance and strong private demand, while noting that PCE inflation remains elevated. His message was essentially that the Fed cannot assume current policy is restrictive simply because the policy rate looks high historically.

## Big picture as of end-August 2026

*The economy today presents an unusual combination:*

- ◆ Underlying private-sector growth remains quite healthy, despite headline GDP slowing.
- ◆ Hiring has weakened dramatically, although unemployment and layoffs remain low.
- ◆ Consumers are still spending, but confidence and real consumption suggest greater caution.
- ◆ Inflation has retreated from its spring energy-driven surge but remains substantially above target, particularly on the PCE measures.
- ◆ AI-related capital investment remains an important growth engine, while simultaneously creating near-term pressure on power, equipment and commodity supply.
- ◆ And the Federal Reserve has shifted from contemplating eventual easing toward openly debating whether additional tightening may be necessary.

The interesting part is that this doesn't look much like a conventional late-cycle slowdown. Growth isn't broadly collapsing, credit markets aren't signaling stress, businesses are still investing aggressively, and unemployment remains historically low. Instead, the economy increasingly looks supply-constrained: demand remains strong enough to grow, but labor-force growth, energy infrastructure and certain productive inputs are struggling to keep pace.

That makes the next few months unusually consequential. If inflation continues cooling while employment stabilizes, the Fed can remain patient, and the soft-landing narrative survives largely intact. If inflation remains above 3% while private demand

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stays strong, however, policymakers may conclude that today's interest-rate setting simply isn't restrictive enough. Conversely, if July's payroll decline proves to be the beginning of a genuine employment contraction, tightening policy further would become considerably harder to justify.

For now, the U.S. economy remains resilient. The problem has shifted from whether it can keep growing to whether it can keep growing at this pace without generating more inflation than the Fed is willing to tolerate. That is a considerably better problem than recession—but it is also why monetary policy is likely to remain the dominant macro story heading into the fall.

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