



OUR VIEW



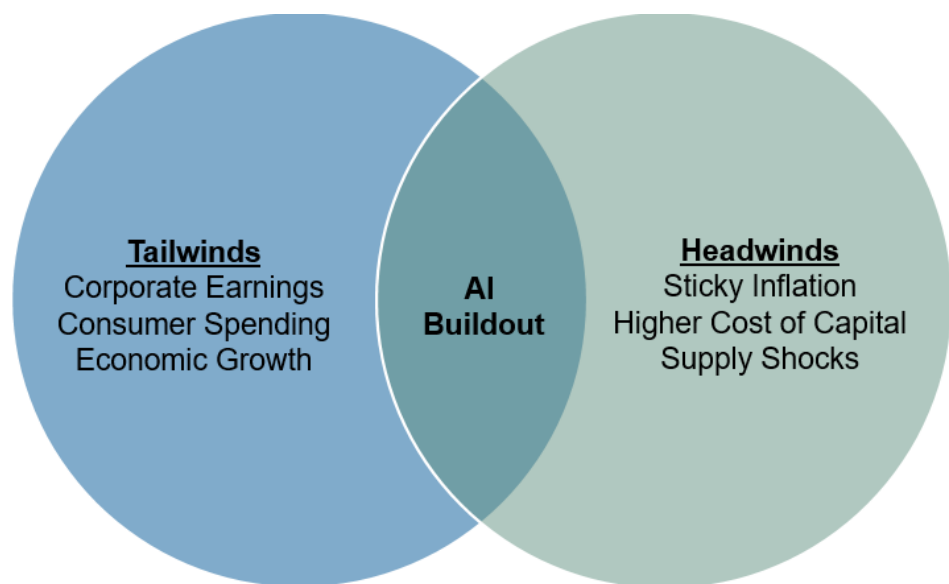
Growing risks challenged the powerful tailwinds that have supported markets throughout the year.

Third Quarter 2026 Review: Split Decision

Executive Summary

In our second-quarter commentary, we suggested that investors temper their enthusiasm following an exceptionally strong first half of the year. While remaining constructive on the economy and corporate earnings, we highlighted three growing risks: the sustainability of AI-related capital spending, a prolonged conflict in the Middle East, and persistent inflation that could prompt more restrictive Federal Reserve policy.

The third quarter resembled a boxing match as these risks increasingly challenged the powerful tailwinds that have supported markets throughout the year. The extraordinary pace of AI investment continued to underpin corporate earnings and economic growth, but concerns surrounding the ultimate return on these investments intensified, especially when considering the higher cost of capital and infrastructure component costs. Prolonged supply chain disruptions in the Middle East led to more broad-based price increases across the commodity complex. The Federal Reserve raised its benchmark rate by a quarter-point in September with expectations for an additional quarter-point increase in December.





Global equities eked out minor gains, although broad market returns in the U.S. belied a more challenging environment underneath the surface.

The U.S. economy was resilient during the third quarter despite higher energy prices, higher interest rates, and geopolitical uncertainty.

For equity investors, the match resulted in a split decision, or perhaps a draw depending on your perspective. Global equities eked out minor gains, although broad market returns in the U.S. belied a more challenging environment underneath the surface. The central question for equity investors is whether the underpinnings of strong corporate earnings and economic growth can continue to offset these growing headwinds.

Perhaps the most consequential development of the third quarter occurred in the bond market. Treasury yields rose to multi-year, and for some maturities multi-decade, highs. Intermediate to longer-maturity bonds, as measured by the Bloomberg Aggregate Bond Index, suffered their worst quarter since Q3 of 2022. As we will discuss later, high-quality bond yields are more attractive than they have been in some time, especially if economic growth slows. Diversifying assets provided valuable portfolio stability during the quarter while delivering positive total returns.

Global Economic Review

Key Developments

- U.S. economic growth remained resilient, supported by consumer spending and AI-related business investment
- The U.S. labor market remained stable
- International economic growth was uneven, with AI-related manufacturing providing an important source of support

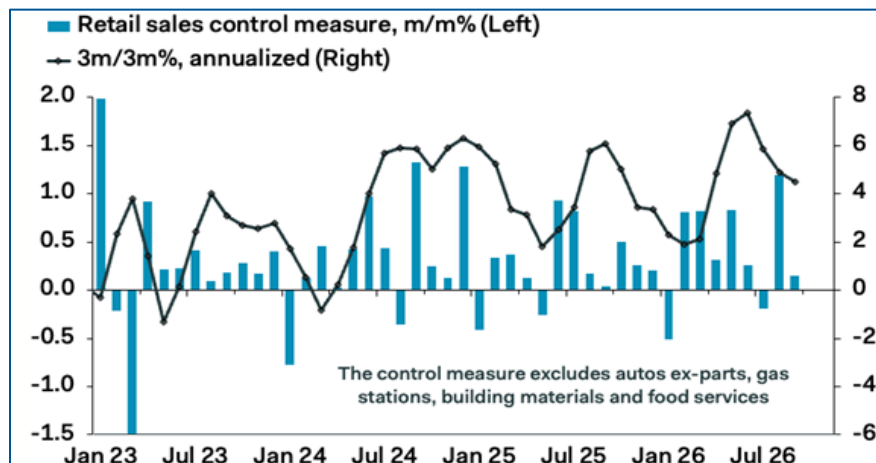
The U.S. economy continued to demonstrate resilience during the third quarter despite higher energy prices, higher interest rates, and geopolitical uncertainty.

In our previous commentary, we highlighted the importance of consumer spending and business fixed investment as the principal drivers of economic growth. These trends continued into the summer.



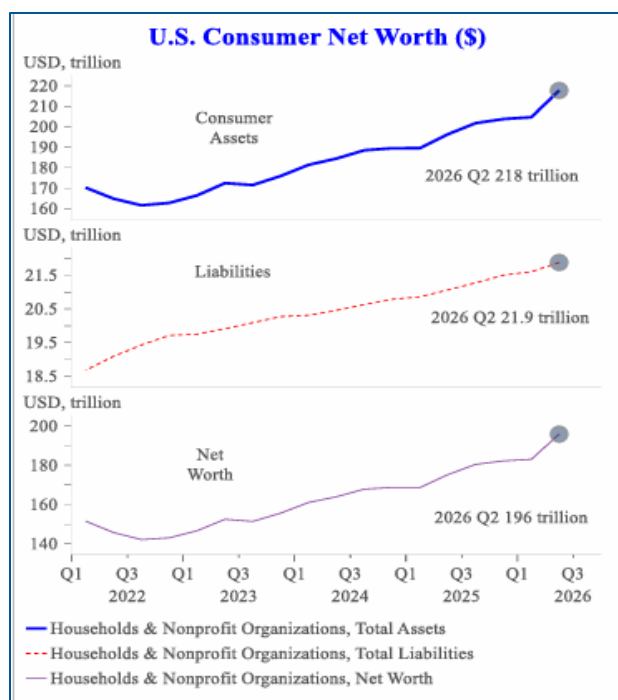
Consumer spending moderated slightly from the pace in the second quarter but still grew at a strong clip.

U.S. consumer spending slowed marginally from Q2 but still grew at a robust pace. Based on the September retail sales report, along with several other leading indicators, Pantheon Macroeconomics estimates real consumer spending grew at an annualized pace of 3.5% in Q3. The pace moderated slightly from the 3.8% growth seen in Q2 but grew at a strong clip nonetheless.



Source: Pantheon Macroeconomics

Consumption has been supported by a stable labor market. However, the wealth effect has also likely played a significant role, especially for upper-income households. The contribution to overall spending from high-income households may leave aggregate consumption increasingly sensitive to changes in financial asset prices.



Source: Baird Strategas



Business investment in equipment, software, and intellectual property continued to benefit from the AI infrastructure buildout. However, the divergence between technology and nontechnology investment raises questions about the breadth and durability of the expansion.

The divergence between technology and non-technology investment raises questions about the breadth and durability of the expansion.

Chart 10: Extremely Rare Capex Divergence

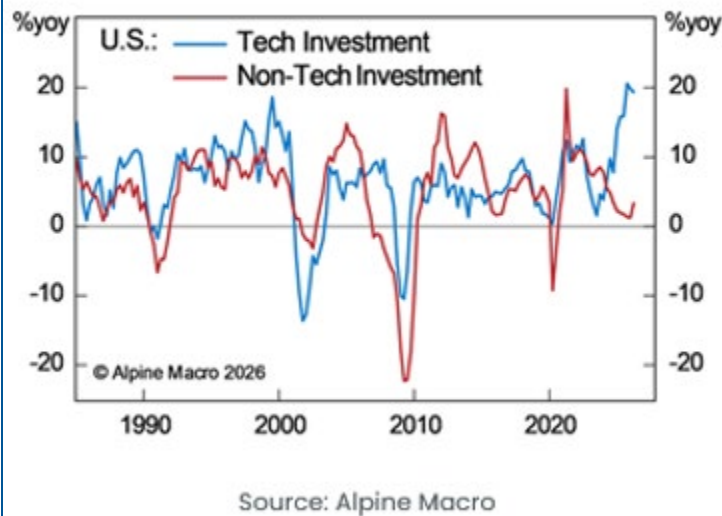
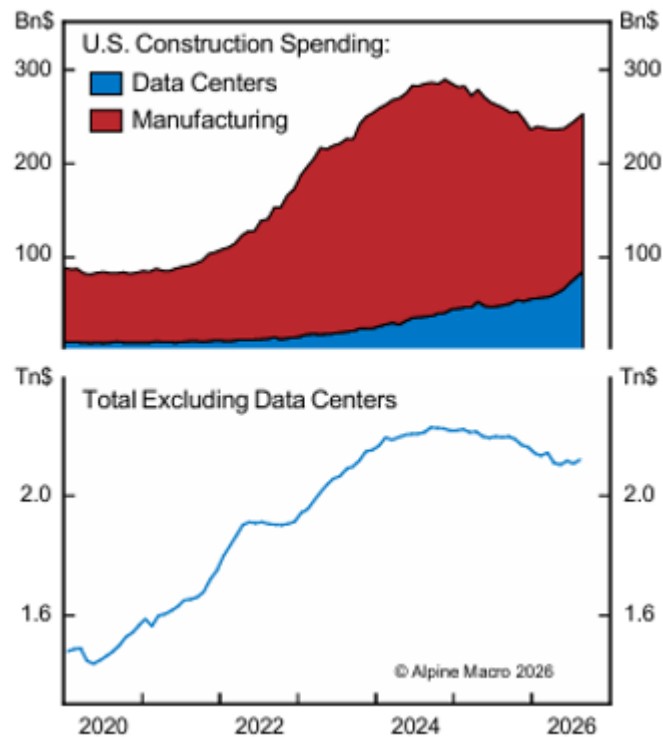


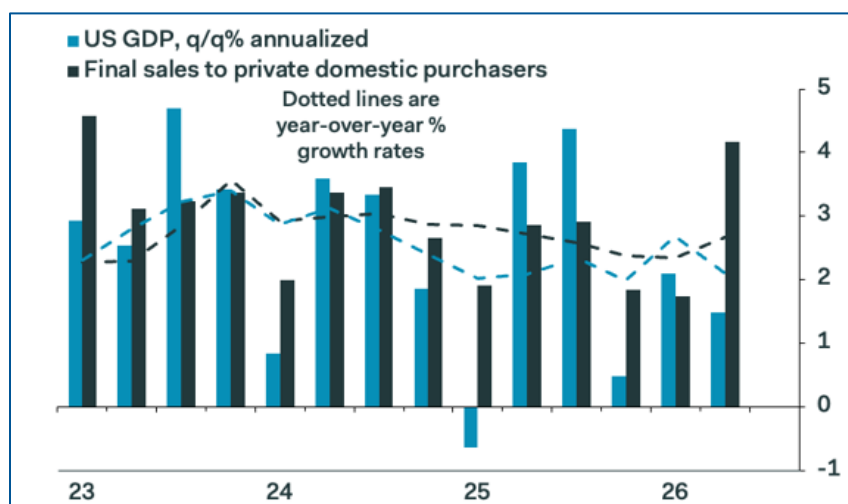
Chart 11: Construction Spending Narrowly Based





Taken together, the economic data suggest an economy that continues to expand but has become increasingly dependent on a narrow set of growth drivers.

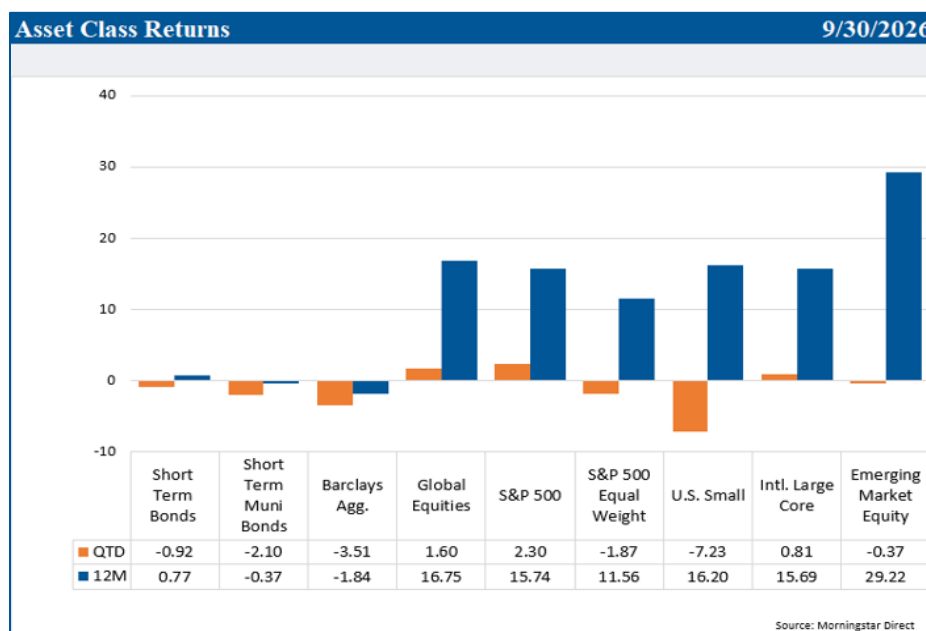
Overall, second-quarter real GDP increased at a 1.5% annualized rate, below expectations. However, the headline figure understated the strength of underlying domestic demand. More encouragingly, real final sales to private domestic purchasers, a measure that excludes the often-volatile effects of inventories, trade, and government spending, expanded at a considerably faster pace than headline GDP and may have maintained a similar pace in Q3.



Source: Pantheon Macroeconomics

Taken together, the economic data suggest an economy that continues to expand but has become increasingly dependent on a relatively narrow set of growth drivers.

Asset Class Performance Review





Second quarter earnings results substantially exceeded expectations.

Despite broader earnings growth, equity market breadth deteriorated during the second quarter.

U.S. Equities

Key Developments

- Earnings growth exceeds expectations (again)
- Rotation trade reverses

The most important support for U.S. equities during 2026 has been exceptional corporate earnings growth.

Second-quarter earnings results, reported during the third quarter, substantially exceeded expectations. Nearly every sector delivered positive earnings growth, while a historically high percentage of companies exceeded analysts' estimates.

S&P 500 2nd Quarter Earnings Scorecard							
	Sales Growth (Y/Y%)			Earnings Growth (Y/Y%)			# Reported
	Jan. 1	Jul. 1	Today	Jan. 1	Jul. 1	Today	
S&P 500	6.9%	11.7%	15.4%	15.2%	24.4%	51.6%	453/500
Discretionary	5.9%	7.2%	8.8%	8.8%	5.5%	89.7%	39/47
Staples	5.7%	7.4%	8.1%	7.0%	5.6%	8.6%	24/34
Energy	-1.3%	23.8%	42.2%	11.6%	116.0%	142.7%	21/21
Financials	5.5%	6.9%	13.8%	7.7%	8.1%	25.3%	74/76
Health Care	4.9%	4.6%	7.4%	7.8%	-9.3%	-6.7%	55/59
Industrials	5.5%	8.2%	11.8%	15.1%	10.3%	20.0%	78/83
Materials	3.4%	7.9%	9.6%	18.6%	32.7%	40.3%	25/25
Real Estate	7.0%	9.7%	11.8%	6.3%	6.2%	9.4%	30/31
Technology	19.2%	33.8%	35.6%	35.5%	65.5%	73.6%	56/73
Communications	8.8%	11.9%	12.8%	6.0%	8.0%	114.6%	20/20
Utilities	7.4%	8.5%	5.3%	11.8%	11.3%	9.7%	31/31

Source: Strategas, I/B/E/S data from Refinitiv (Current Reading is Highlighted If Greater Than January 1st Estimate)

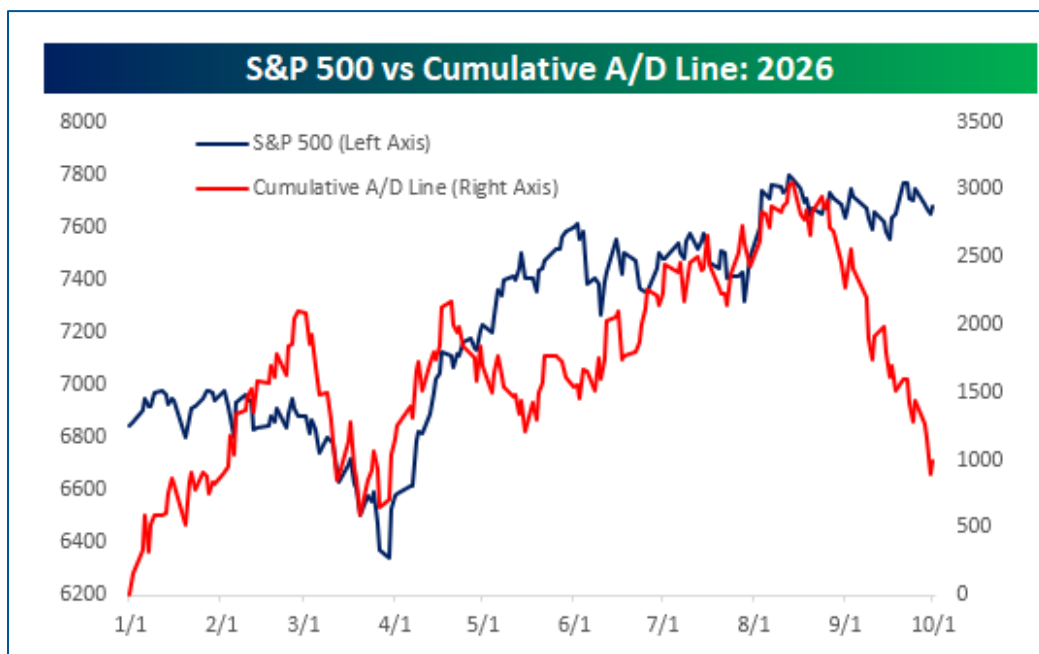
Technology and communication services companies continued to lead, but earnings strength extended well beyond the technology sector. However, despite broader earnings growth, equity market participation deteriorated considerably during the quarter, particularly in September. The resilience of the capitalization-weighted S&P 500 masked significant weakness beneath the surface.



As the quarter progressed, higher interest rates began to affect market leadership.

We believe a well-diversified equity portfolio is best suited to weather ongoing rotations between market capitalizations, sectors, and styles.

While the market cap-weighted S&P 500 advanced 2.3% during the quarter, its equal-weight counterpart declined 1.87%. Moreover, September registered one of the weakest monthly market-breadth readings since 1990, according to Bespoke Investment Group.



Source: Bespoke Premium

As the quarter progressed, higher interest rates began to affect market leadership. Small-cap companies came under pressure due to their greater sensitivity to borrowing costs and domestic economic conditions. Higher energy and diesel costs weighed on sectors such as transportation and industrials. Investors gravitated towards large technology companies which may have greater near-term earnings visibility due to the AI buildout.

We question the perception that companies levered to the AI buildout are less sensitive to changes in the cost of capital. Notably, thus far in October concerns related to higher financing costs have led to a selloff in technology stocks. The return of the equal-weight S&P 500 has exceeded the market cap-weighted version by 2.76% in just the first three weeks of October. We believe a well-diversified equity portfolio is best suited to weather ongoing rotations between market capitalizations, sectors, and styles.



Manufacturing was resilient in Europe and Japan.

Investors took profits in emerging market semiconductor stocks.

After leaving interest rates unchanged in July, the Federal Reserve raised its benchmark policy rate by 0.25%.

International Equities

Key Developments

- Manufacturing resilient in Europe and Japan
- EM exports continued to boom (but semiconductor stocks did not)
- China's economic growth stabilized

The S&P Global Eurozone Manufacturing Index rose to the highest level since May 2022. New orders increased at their fastest pace since March 2022. Japan manufacturing growth slowed during the quarter but still grew at a strong pace.

Select emerging market economies continued to benefit from a semiconductor exports boom related to the global AI infrastructure buildout. South Korean exports maintained their torrid pace, growing 83.5% year-over-year in September. China's economic growth rebounded from a three-year low, improving from 4.3% to 4.5% year-on-year.

Despite the continued boom in exports, emerging market semiconductor stocks broadly corrected. As of 10/20, the semiconductor heavy South Korean Kospi Composite Index has fallen 37% from its July record. The selloff has been driven primarily by concerns about the sustainability of AI-related capital spending, growing competition from China, and the unwinding of crowded, leveraged positions.

Fixed Income

Key Developments

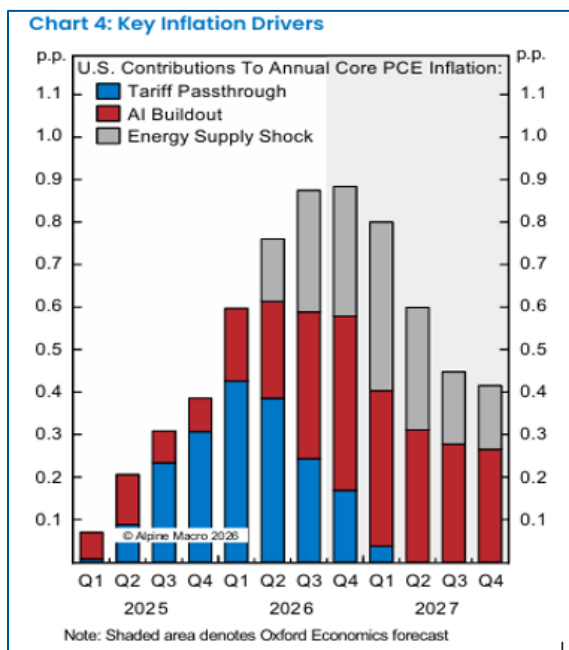
- The Federal Reserve raised its benchmark rate by 0.25%
- Treasury yields reached multi-year/multi-decade highs
- Sovereign bond yields spike in Europe with France the focal point
- Spread widening in AI/Data Center Bonds

After leaving interest rates unchanged in July, the Federal Reserve raised its benchmark policy rate by 0.25% in September, marking a shift toward a more restrictive monetary policy stance.

The decision reflected the Fed's concern that inflation remained too high. The broad momentum seen in the September CPI report (released after the FOMC meeting) suggests another quarter point increase is likely in December. Based on the September data, the Core PCE deflator may have increased to 3.1% from 3.0% in August.

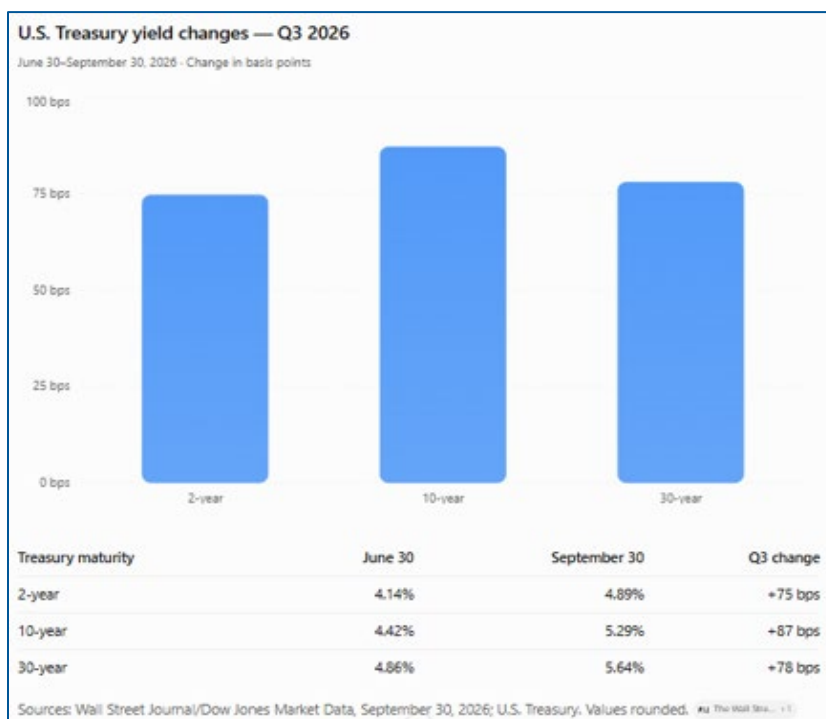


Key drivers of inflation should persist in the near term, although their collective contribution to Core PCE inflation may peak in Q4. A wild card is the duration of the energy supply shock. Pass-through effects from the tightness in refined products (e.g. diesel) typically lag by several months.



The 2-year Treasury yield rose to the highest level since 2024 while 10-year and 30-year yields reached levels last seen in 2002.

Treasury yields rose sharply across the curve. The 2-year yield rose to the highest level since 2024 while the 10-year and 30-year yields reached levels last seen in 2002.

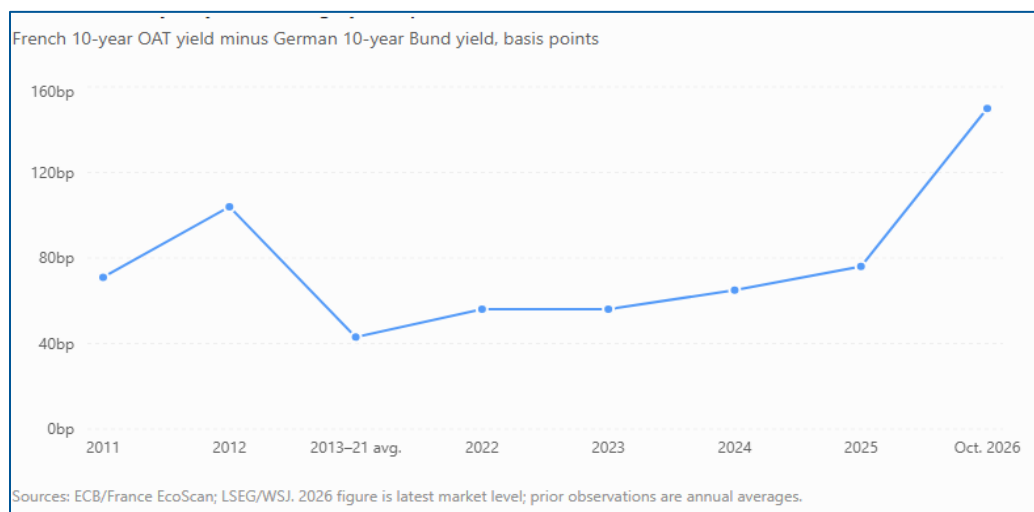




The spread between 10-year French and German bond yields exceeded the peak of the Eurozone sovereign debt crisis.

Interestingly, and perhaps surprisingly, longer-term inflation expectations have remained remarkably benign. Thus, while difficult to quantify with precision, the rise in yields may not reflect the requirement of additional inflation compensation but rather a host of other factors including the enormous new issuance of AI-related debt (competition for capital), widening U.S. budget deficits and interest expense burdens, and perceptions of economic growth and productivity.

The Eurozone has also experienced a significant rise in bond yields over the last several weeks. However, the recent rise in French bond yields has been more dramatic due to several factors. French government debt has risen to 119% of GDP while the budget deficit remains greater than 5% of GDP. The French government recently proposed a budget that contained \$54bn in savings, a plan that was viewed as both underwhelming and unlikely to be implemented. Second, there is a great deal of uncertainty related to the 2027 presidential elections. Investors are requiring additional compensation, a fiscal/political risk premium, to hold French debt given these circumstances.

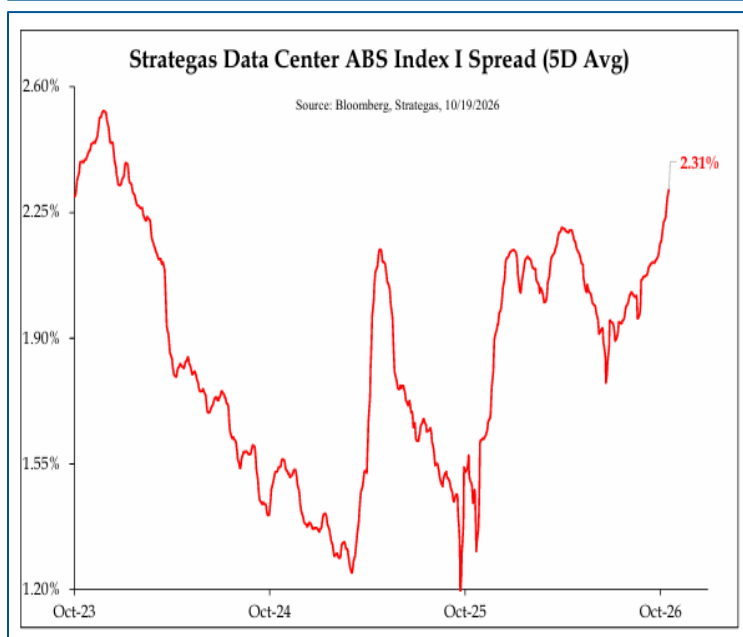
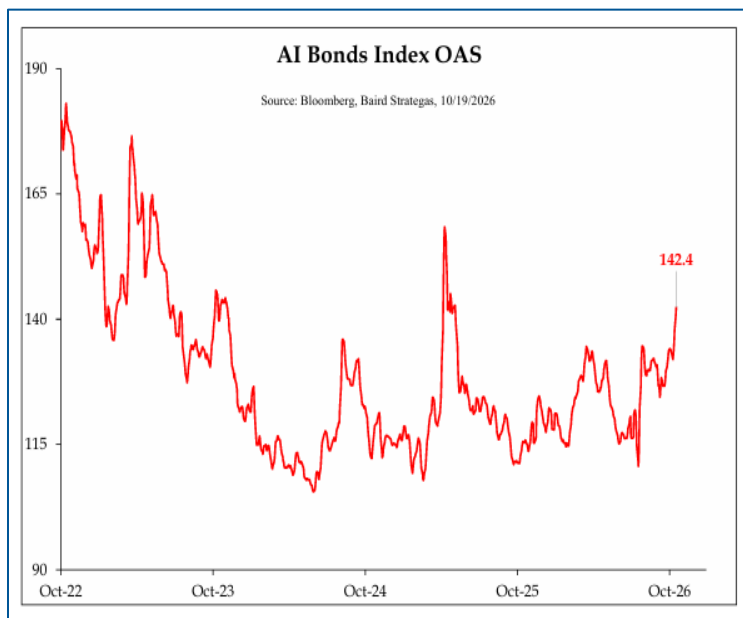


As of 10/21, French 10-year bond (aka OATS) yields have risen approximately 0.90% since early September. Additionally, the spread between 10-year OATS and German bonds (aka Bunds) exceeded the peak of the Eurozone sovereign-debt crisis. A key question is whether stress remains concentrated in France or spreads to other highly indebted sovereign bond markets and/or affects broader financial conditions in Europe.



Spreads on AI-related and data center debt have widened, suggesting that investors are beginning to reassess the financing risks associated with the infrastructure buildout.. Spreads are still below 2022 and Liberation Day levels for AI-related bonds but have surpassed the latter for data center bonds. Thus far spreads in the broader high-yield and investment grade markets have generally remained benign.

Spreads on AI-related and data center debt have widened, suggesting that investors are reassessing the financing risks associated with the infrastructure buildout.





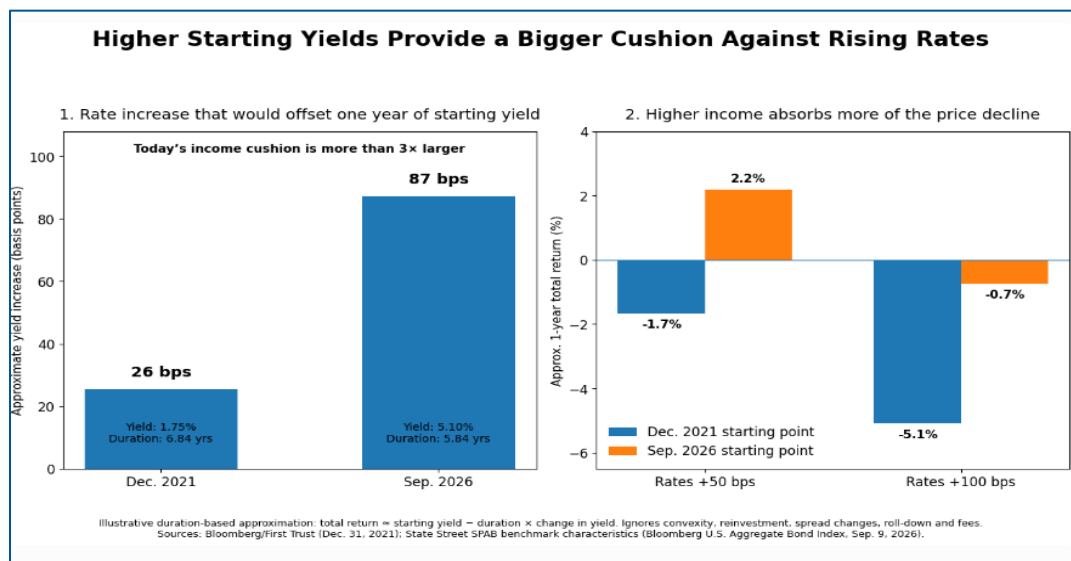
Portfolio Strategy

The case for fixed income

Higher yields create two competing effects for bond investors. In the short term, rising interest rates reduce the market value of existing bonds. However, higher starting yields increase future income and improve prospective returns, providing a greater cushion against additional rate increases. This distinction is particularly important for investors with longer time horizons.

Currently, we believe high-quality bonds are attractive and offer considerably more cushion against rising interest rates than they have in many years. Municipal bonds may be particularly appealing for investors in high marginal income tax brackets.

We believe high-quality bonds are attractive and offer considerably more cushion against rising interest rates than they have in many years.



Although we cannot predict when bond yields will peak, history suggests that periods of sharply rising interest rates frequently contribute to slower economic growth. In such an environment, high-quality bonds may once again provide an important source of portfolio diversification, income, and potential total return. Additionally, fixed income can also be used to supplement or provide liquidity needs.

We believe bonds are “down but not out.” We continue to emphasize high-quality, diversified fixed income portfolios comprised of short-to-intermediate maturity bonds.



The primary benefit of portfolio rebalancing is risk management.

Tax-loss harvesting is a beneficial tool for active tax management in client portfolios.

We expect markets to remain caught between resilient fundamentals and mounting risks in the months ahead.

Disciplined Rebalancing

The bull market which began four years ago may cause portfolio allocations to drift from their long-term asset allocation targets. We have been diligent this year ensuring that portfolios are aligned with these targets. The primary benefit of portfolio rebalancing is risk management. More specifically, as equity allocations grow relative to fixed income and diversifying assets, the portfolio risk profile increases as well. Rebalancing from equities to other asset classes brings the portfolio back to its intended level of risk. Moreover, with the rise in interest rates, we have been able to take advantage of historically attractive income yields on a going-forward basis. Additionally, for appropriate portfolios we have added to diversifying assets, which we believe may continue to provide valuable portfolio stability and attractive total returns.

Tax-Loss Harvesting

Tax-loss harvesting is one of the most beneficial tools available for active tax management in client portfolios. Tax-loss harvesting involves selling a security at a loss and immediately reinvesting the proceeds in a similar security within the same asset class. The realized loss may be used to offset future gains or gains taken this year as a result of additional portfolio rebalancing. We have been actively identifying suitable candidates for tax-loss harvesting and implementing where appropriate.

Summary

We expect markets to remain caught between resilient fundamentals and mounting risks in the months ahead.

Rather than attempting to predict the next market rotation or the peak in interest rates, we believe investors are best served by maintaining diversified portfolios, rebalancing with discipline, and taking advantage of opportunities created by market volatility. These principles remain central to our approach as we navigate an increasingly complex investment environment.

Lastly, many readers may be interested in the potential economic and market effects of the mid-term elections. We will send out an update with our thoughts shortly after November 3rd.

Please contact your TFC Advisor or us directly if you have any questions or would like to discuss your portfolio further. Thank you.



Sincerely,

Renée Kwok, CFP®
President & CEO

Brian Presti, CFA®, Chartered SRI CounselorSM
Chief Investment Officer

TFC Financial Management, Inc.
260 Franklin Street, Suite 1888, Boston, MA 02110
p 617.210.6700 | f 617.210.6750 | www.tfcfinancial.com

Disclaimers:

1. This commentary may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as “believe,” “estimate,” “anticipate,” “may,” “will,” “should,” and “expect”). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements.
2. Past performance is not indicative of any specific investment or future results. Views regarding the economy, securities markets or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss to the investor.
3. This commentary is intended to provide general information only and should not be construed as an offer of specifically tailored individualized advice.
4. Any information provided regarding historical market performance is for illustrative and education purposes only. Clients or prospective clients should not assume that their performance will equal or exceed historical market results and/or averages.
5. While we believe the outside data sources cited to be credible, we have not independently verified the correctness of any of these inputs or calculations and, therefore, cannot warranty the accuracy of any third-party sources or information.
6. Specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified and discussed were or will be profitable.
7. Investment process, strategies, philosophies and allocations are subject to change without prior notice.
8. Adviser has selected the stated benchmarks to allow the comparison of a client’s performance to that of well-known indices. The benchmarks are shown for comparative purposes and to establish current market conditions. Clients cannot invest directly into an index. Clients should be aware that the referenced benchmark funds may have a different security composition, volatility, risk, investment objective and philosophy, diversification, and/or other investment-related factors that may affect the benchmark funds’ ultimate performance results. Additionally, referenced indices may not include fees, transaction costs or reinvestment of income. Therefore, the Adviser’s composite and investor’s individual results may vary significantly from the benchmark’s performance. Benchmarks used by Adviser are current as of the date indicated and may change without notice.
9. Registration with the SEC should not be construed as an endorsement or an indicator of investment skill, acumen or experience.
10. Tax-loss harvesting involves selling an investment at a loss and reinvesting the proceeds in another investment that provides similar market exposure while avoiding applicable wash-sale restrictions. Realized capital losses may be used to offset capital gains and, subject to applicable limitations, other taxable income. The availability and extent of any tax benefit depend on each investor’s individual circumstances.