QUARTERLY REVIEW

September 30, 2026

Q3 Economic and Market Commentary

In the third quarter equities once again pushed into record territory with the index gaining 2.29% and 12.7% for the YTD. The S&P 500 set an all-time high on August 13 and ended September within about 2% of the high, driven by strong corporate earnings. The path was uneven: July brought a sharp, leverage-driven selloff in AI-related stocks, August delivered a rebound to new highs, and September has been a choppy, range-bound month as bond yields surged. Coming off a second quarter that was the strongest since 2020 (the S&P 500 gained 14.9%), a slowdown in performance was hardly surprising, especially given the context of rising inflation, interest rates, and the ongoing instability created by the war. The macro backdrop is becoming more challenging, and midterm elections are looming. The fragile Middle East ceasefire that had pulled Brent crude back to $70 at the start of July unraveled within days, and by quarter end Brent was over $100. Higher energy prices (especially diesel) revived inflation concerns, and the yield on the 10-year Treasury climbed above 5% for the first time since 2007. On September 16 the Federal Reserve raised interest rates for the first time in three years. It's not just the recent jumps in inflation that have caused bond yields to rise, but the strength of the economy with nominal GDP growth exceeding 6%, and the structural issues of a national debt that exceeds $40 Trillion. Nevertheless, equities still pushed higher in the quarter, absorbing all of this with remarkable composure and limited volatility. But with yields north of 5% the bar for equities is higher as interest rates on bonds now provide an alternative that some investors will prefer. The Nasdaq advanced 2.6% in the quarter and is up roughly 19% for the year. The fears of an AI capex spending bubble dissipated as the hyperscalers reported strong earnings and a continued plan to build out infrastructure for AI.

850 Ridge Lake Blvd, Suite 205 Memphis, TN 38120 (901).761.9500

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The Economy

Second-quarter GDP came in at 2.2%, slightly below Q1's growth rate of 2.5% but higher than initial estimates and shows that the economy has been growing at a stable rate even in the face of war, tariffs, and higher interest rates. The Atlanta Fed's GDP Now forecast for the third quarter is for growth to accelerate to 3.7%, with AI capital spending being a big driver of growth. We have had 8 consecutive months of expansion in the manufacturing side of the economy, and a September flash PMI showed business accelerating at its fastest pace in more than 5 years. Inflation continues to be top of mind, and while headline CPI has eased from 4.2% last quarter to 3.4% in August, much of the improvement owes to base effects and June's dip in oil. However, energy is again the problem: gasoline was up 27.4% from a year ago in August and diesel has crossed the $6 threshold. Core CPI has continued to cool, slipping to 2.4% — its lowest level since March 2021 — from 2.9%. The Fed's preferred gauge is less comforting: August Core PCE inflation was 3.0% and the same as July on a year-over-year basis, yet still well above the 2% target. There is perhaps more inflation in the pipeline as producer prices rose 5.4% year over year in August (again driven by energy prices). Consumers are expecting higher inflation as the University of Michigan's 12-month inflation expectations jumped to 4.6% in September from 4.0% in August and 3.4% before the war began. Inflation has negatively impacted consumer psyche with the University of Michigan sentiment index dropping to 48.1 in September — the second-lowest reading on record and well below September 2025's 55.1. Real wage growth has stabilized: average hourly earnings rose 3.0% year over year in September, versus 3.4% CPI inflation, a shortfall of 0.4 percentage points that is far narrower than the 0.8-point gap we noted last quarter but still negative. Households are bridging the gap with savings; the personal saving rate is 3%, well below its long-term average of over 8%. Consumer spending remains surprisingly resilient, growing at an annualized pace of 3.8% in Q2, up from 0.7% in Q1. It's likely being driven by the higher income cohorts, but consumers tend to spend if there are jobs. The labor market ended the quarter on a softer note with September adding 29,000 jobs, and the 3-month average now at 51,000. Over the past year we have been averaging just 45,000 per month. The unemployment rate has edged up to 4.2%, but the increase is primarily due to an increase in the labor force participation rate as September came in at 61.8% vs 61.6% in August. The characterization of the job market as "low-hire, low-fire" seems very appropriate. The Fed moved from holding to hiking on September 16th raising the Fed Funds rate by 25 basis points to 3.75%–4.00%. This was the first increase since July 2023 and a sharp reversal from a year ago, when markets were expecting a string of cuts in 2026. We would now expect another hike of 25 basis points before year end, with possibly more in 2027.

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Market Review

Third Quarter Market Recap:

The quarter began with the S&P 500 slightly below its June 2 record close, but the summer proved choppier than the quarterly result suggests. After the mid-June U.S.–Iran memorandum of understanding, hostilities resumed in early July, oil turned sharply higher, and the S&P 500 drifted to nearly 5% below its early-June peak. On July 29 the Dow fell more than 1,100 points, but the market found its footing the next day as strong results and upbeat spending plans from Microsoft and Amazon eased concerns about AI. The market closed at a record high on August 4 (its best day since April and its first record in two months) and then set another high on August 13 intraday after a benign inflation report. The index has spent the weeks since in a range of 7,600 to 7,800 as surging bond yields offset rising earnings estimates. The second quarter earnings season produced eps growth of roughly 50% year over year. That figure was inflated by one-time investment gains at Alphabet ($98 billion) and Amazon ($53 billion); excluding those, growth was still approximately 32%. The second consecutive quarter above 25% and the seventh straight quarter of double-digit growth. Concentration in market cap and earnings growth remains significant, with Nvidia and Micron alone accounting for roughly one-third of the market's 2026 profit growth. The top performing sector in Q3 was Energy, which gained 17.2% as Brent rose 44% in Q3. Technology was the second-best sector, gaining 7.2% as the chip stocks regained their footing after strong earnings results. And while market breadth has narrowed since earlier in the year with the resurgence of tech performance, its not just the chip and memory stocks doing well, the equal weighted Technology index has also been making new highs. Healthcare had a solid performance posting upside of 6.5% in Q3 as both pharmaceutical and biotech segments did well. Utilities were the worst performing group, losing 12.4% as rising interest rates were a negative along with a move away from defensive sectors. Industrials were also weak, dropping 9.7% as machinery, heavy equipment, and air freight and logistics segments were weaker due to higher borrowing costs and slowing consumer freight volumes. Both Consumer Discretionary and Consumer Staples were negative in the quarter as inflation is having a bigger impact in those areas on both consumers choosing where to spend their dollars, and companies dealing with higher input costs. At quarter end Nvidia solidified their position as the largest company in the S&P as they announced a $150 billion increase in their share repurchase authorization on September 28th, a move that helped the stock as well as the sector.

Stock Market Indexes

Market/Index	2025 Close	Q3 2026 Close	Quarterly Change Total Return	YTD Change Total Return
DJIA	48,063.29	50,906.05	-2.34%	7.19%
Nasdaq	23,241.99	26,861.06	2.61%	16.09%
S&P 500	6,845.50	7,651.54	2.30%	12.73%
Russell 2000	2,481.91	2,796.86	-7.19%	13.87%
IEFA	89.46	96.88	0.31%	10.06%

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What to Expect Going Forward:

With the S&P 500 up roughly 12% YTD, the market has largely absorbed a hawkish Fed, 5% bond yields, and $105 oil — a testament to the earnings power we've seen. The bull market's fourth year remains achievable if earnings deliver — but the burden of proof has shifted from "will the Fed cut?" to "can earnings outrun higher rates?" The dot plot points to at least one more increase, and a 10-year yield above 5% is a headwind to valuations, housing, and leveraged borrowers. A further disorderly rise in long-term yields — driven by inflation, deficits, or weak auction demand — would test equity valuations more than any earnings disappointment. The second big risk is oil and the Iran situation, and the subsequent inflation impacts. With talks stalled headline inflation is likely to remain above 3%, keeping the Fed on its tightening path and pressuring consumers. Core PCE at 3% is well above the Fed's 2% target, and with consumer inflation expectations rising, the risk is that a temporary energy shock feeds into wage- and price-setting behavior. For now, we are confident that AI capital spending will continue and likely exceed $1 Trillion in 2027, but it remains a linchpin of both growth and earnings and is increasingly financed with debt that is adding to bond supply. Any change in those spending expectations would be a serious issue given the concentration of earnings growth, and the fact that almost half of S&P market cap is now AI related. July demonstrated how quickly leverage and crowding can turn a sound thesis into a forced sale, and any wobble in AI spending or in Nvidia and Micron results would be felt at the index level. Full-year 2026 earnings growth is now projected to be near 32%, with 2027 at roughly 15%. The forward 12-month P/E ratio has compressed to 19.2 from 20.4 at the end of Q2 — and is now slightly below its five-year average of 19.8. Yet other valuation parameters remain expensive and S&P operating margins for the next year are forecasted at 21.7%, which raises the expectations bar especially if cost pressures persist. It's always human nature to think that "this time is different", but we need to keep in mind that previous Fed hiking cycles going back to the early 1970's have resulted in a median drawdown of 13.7% from the first hike to the last hike. The "K-shaped" economy continues to define the consumer landscape, and rising rates may widen the gap. Higher-income households, whose balance sheets have been buoyed by record equity prices and meaningful yields on cash and Treasuries, continue to spend, which is why retail sales and GDP nowcasts look strong even as consumer sentiment sits near record lows. Lower-income households, by contrast, face gasoline prices up more than a quarter from a year ago, 7% mortgage rates, negative real wages, and a low saving rate. Sentiment readings, retail sales, and any sign of rising delinquencies will be important indicators in the coming months, as they have implications for consumer-facing sectors and the durability of spending. We will be closely monitoring the narrowing market breadth as the earnings breadth is even more narrow. The third quarter was a reminder that volatility can arrive quickly — from a leveraged hedge fund, a weak bond auction, or a headline out of the Persian Gulf — and that diversification, patience, and a long-term view matter most when markets feel the most comfortable. We will continue to monitor the Iran situation, Fed policy under Chair Warsh, the trajectory of Treasury yields and inflation, the health of the labor market and the consumer, and the durability of AI-driven earnings growth as the principal themes shaping the investment landscape in the months ahead.

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Fixed Income Recap and Outlook

The pressure on yields accelerated in Q3 with longer term yields ending at levels not seen since prior to the Great Financial Crisis. The primary driver of the move higher is due to the Fed commitment to bringing inflation down but also the stronger underlying US economic growth which disproportionately impacts longer term yields. We can be confident that this move reflects both stronger growth expectations and the expected path of Fed policy as real rates (ie Yields on Treasury Inflation Protected securities, or TIPS) rose nearly as much as nominal US Treasuries. This increase in real yields suggests investors have become more confident that economic growth can remain durable despite elevated interest rates.

As expected, the Fed hiked 25bps at the September Fed meeting and during the press conference after the meeting, Chairman Warsh reiterated the Fed's commitment to stable prices along with the belief that current policy was not restrictive and underlying inflation was not moving clearly lower and at a sufficient speed. Further bolstering his arguments were his comments regarding the overall strong economy with resilient consumer spending and solid job growth all supporting a higher overnight borrowing rate. The market takeaway was that additional rate hikes were increasingly likely and that, even at 4%, policymakers believed only a "dose of accommodation" was removed.

Regional Fed surveys point to moderate to strong Cap Ex across sectors with particularly large tailwinds from the AI related infrastructure investment. Despite extremely negative consumer sentiment, spending remains resilient as measured by retail sales, card spending and general healthy household balance sheet. Higher rates should continue to pressure interest rate sensitive sectors, particularly autos and housing where affordability has become increasingly stretched. The contrast between Treasury and corporate bond markets has been notable.

While Treasury yields have repriced significantly higher, investment grade corporate spreads remain historically tight. Spreads for longer dated investment grade bonds, including hyper scaler debt actually tightened during September. The market is clearly showing confidence in both corporate fundamentals but the health of the broader US economy as well.

The Agency MBS market was a completely different story. Spreads widened on average 15bps in September and are now back to Q4 2025 levels. Interest rate volatility has spiked higher, which changes the underlying cash flows on mortgage-backed bonds. Underperformance was broad based, with no coupon stack or agency program materially outperforming. Outflows from the sector also contributed to spread widening. As a result, valuation in the sector has become increasingly attractive, especially relative to investment grade corporates.

Recent market moves have provided opportunities to add bonds at attractive yields and spreads without taking significant interest rate or credit risk bets. Nevertheless, several headwinds remain for fixed income investors, including uncertainty surrounding the ultimate terminal fed fund rate, the cumulative impact of tighter financial conditions and the continued very large budget deficit. Even so, the recent rise in yields has improved the prospective return opportunities across many high-quality fixed income sector and enhance the attractiveness of selectively adding duration.

As always are here to assist you in any way and to answer your questions. We appreciate the opportunity to serve you and value the trust and confidence that you have placed in us.