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A Painful Summer Swoon, What's Coming Next?

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Q3 2026 | QUARTERLY COMMENTARY

The third quarter reinforced an important investment lesson: strong corporate fundamentals can coexist with increasingly difficult macroeconomic conditions. The equity markets remained resilient throughout the quarter, supported by exceptional earnings growth and continued investment in artificial intelligence and technology infrastructure. At the same time, higher energy prices, rising long-term interest rates, sustained pressure on the Treasury market, and a renewed tightening bias from the Federal Reserve created a more challenging backdrop for valuations and interest-rate-sensitive assets. Despite the Technology driven equity rally, there was a pronounced divergence with the index performance with the Dow Jones closing the quarter down. Our focus as we enter the fourth quarter is whether earnings growth can continue to justify valuations while monetary policy, inflation, and the cost of capital remain restrictive. We will review the 3rd quarter in its entirety and highlight the strategy adjustments we are making for the 4th quarter and beyond.

Quarter End Summary

U.S. large-cap equities continued to outperform much of the broader market during Q3. However, there was a pronounced divergence between the Dow Jones, the S&P 500, and Nasdaq. The headline indices have remained relatively strong, but leadership has been very concentrated. Technology and communication companies were among the strongest areas during September, while most other sectors struggled. With the S&P and Nasdaq having position weight overlap of almost 52%, which is mostly concentrated in large cap and big Tech companies, it’s no surprise for the divergence.

Index	Q3 2026 return	YTD return
S&P 500	+2.03%	+11.77%
Nasdaq Composite	+2.47%	+15.57%
Dow Jones Industrial Average	−2.70%	+5.91%
Russell 2000	−7.52%	+12.69%

Second-quarter earnings results were particularly strong: approximately 78% of S&P 500 companies exceeded EPS expectations, while aggregate earnings increased substantially year over year. Information technology and healthcare were among the strongest contributors for the quarter. Third quarter earnings will being to report mid-October, and analysts have continued to expect exceptionally strong earnings growth. Current estimates put S&P 500 Q3 earnings growth near 29%, although a significant portion of that growth is concentrated in companies benefiting from AI-related demand.

Here are the major themes from the quarter.

1. Big Tech and AI kept the market afloat

The dominant market story was the continued strength of the AI investment cycle. Microsoft, Meta, Nvidia and Apple each gained more than 10% during Q3, helping the Nasdaq rise about 2.5% and the S&P 500 about 2%. The Nasdaq reached a record close on September 22. Corporate spending on AI infrastructure remained enormous, with hyperscalers continuing to invest heavily in data centers, chips and cloud capacity. Nvidia's management also pointed to very strong forward revenue growth expectations.

2. The market became increasingly concentrated

The quarter produced a striking divergence between large technology companies and the broader market. That means the headline indexes substantially understated the weakness in many individual stocks.

3. Higher oil prices and Treasury yields became a major market problem

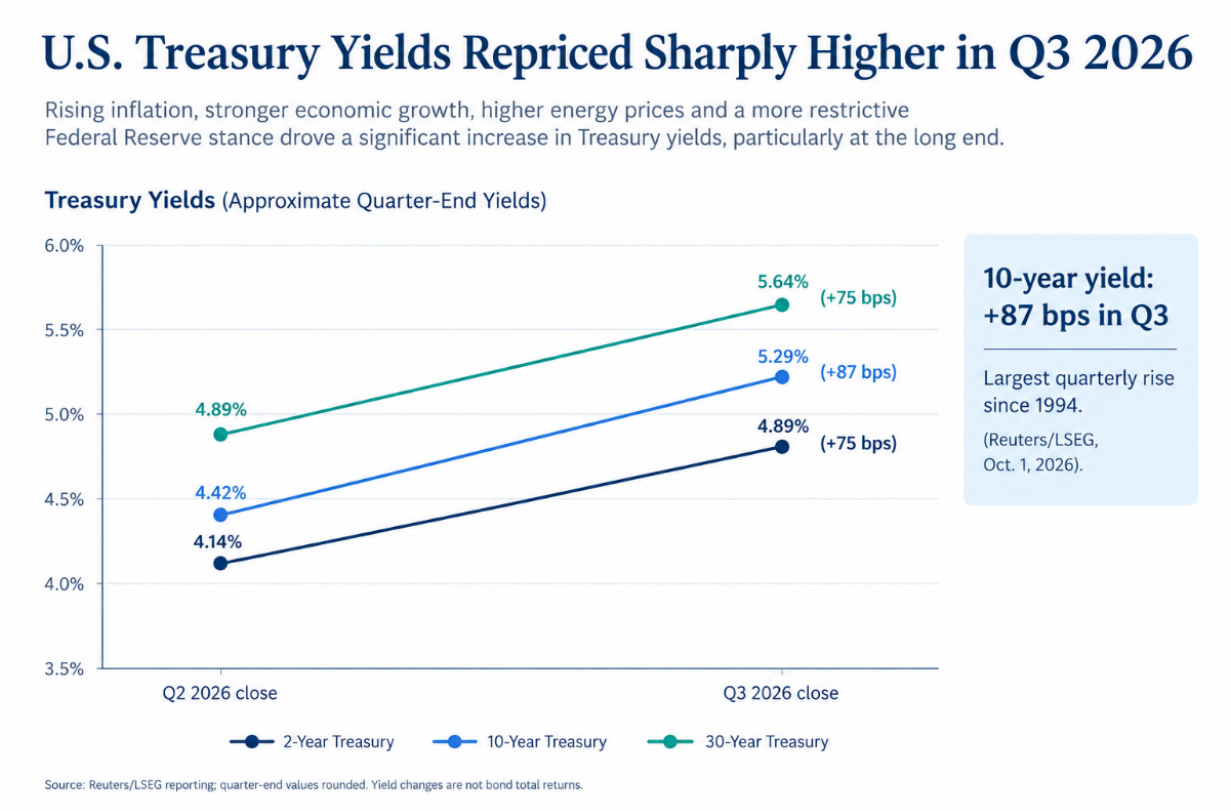
Oil prices surged during Q3, with Brent crude rising about 42% to $103.53/barrel. At the same time, the 10-year Treasury yield rose nearly 0.9 percentage point, its largest quarterly increase since 1994. The geopolitical conflict involving Iran was a major driver of the oil-price shock during the quarter. The combination created pressure on long-duration bonds, real estate, smaller companies, and consumer discretionary companies.

4. Earnings were exceptionally strong—but investors began questioning 2027

This is arguably the most important corporate fundamental story. The S&P 500 earnings for 2026 are now expected to rise roughly 35%, according to Reuters. That would represent the strongest annual earnings growth since the post-pandemic rebound in 2021. Investors have increasingly begun asking whether that growth is sustainable. Current expectations call for earnings growth to slow to roughly 15% in 2027, partly because AI-related capital spending is expected to grow more slowly.

What Happened in the Bond Market?

The major change during the quarter was in the interest-rate environment. Treasuries endured their worst quarter in decades as long-term yields were repriced sharply higher to nearly 5.6%. The 10-year Treasury yield also moved from roughly 4.42% at the start of the quarter to nearly 5.3% by September. These are the largest moves in the yield curve that we have seen in decades. The Federal Reserve raised its policy rate by 25 basis points in September to a range of 3.75%–4.00%, its first rate increase in more than three years.



The Treasury market was not the only bond market to come under sustained pressure. The Muni market also posted a decline of -6.03% for the year, which was heavily accelerated by a massive September selloff, the worst monthly drop since 2008. The Bloomberg Aggregate Bond Index also declined -2.88% in Q3.

Despite the selloff in these markets, credit fundamentals remain resilient, which clearly highlights the distinction between interest rate risk and credit risk. Our strategy holds our corporate bonds until maturity, so we are less concerned with price fluctuations due to interest rate changes, and more focused on credit risks.

Bond index	Q3 2026 return	What it represents
Bloomberg U.S. Aggregate Bond	−2.9%	Broad U.S. investment-grade bonds
Bloomberg U.S. Treasury	−3%	U.S. government bonds
Bloomberg U.S. Corporate Investment Grade	−3%	Investment-grade corporate bonds
Bloomberg Municipal Bond	−3%	Tax-exempt municipal bonds
Bloomberg U.S. Corporate High Yield	−1%	Below-investment-grade corporate bonds
Bloomberg Global Aggregate	−2.2%	Global investment-grade bonds, USD/unhedged

Summary and Winans Outlook

There are several areas of focus we have with our equity portfolios. We will invest in names that have higher quality and fundamentals. Companies with durable competitive advantages, strong balance sheets, recurring revenue, pricing power, and sustainable free cash flow remain particularly relevant in a higher-cost-of-capital environment.

We will also avoid excessive concentration on a single investment narrative. Despite all the headlines around big Tech or AI, being overly concentrated is a huge risk. We will maintain normal weightings to these companies. At the same time, we can’t ignore them. Some may fear we’re too late for the play, but we can’t ignore where the momentum is, and we have added some of these positions to the portfolios already. AI is transforming corporate investment, but portfolio risk should not be defined by one theme—even when that theme is as attractive as the AI investments are.

On the bond side of the market, higher yields have improved the opportunity set across high-quality bonds. For investors who previously viewed bonds primarily as a low-return diversifier, the income component is now materially more significant. This has also made this space much more attractive, and

that is reflected in the amount of dollars that have flowed into the corporate bond market. We have had to elongate our maturity schedule with the bonds to keep higher yields, but we are also focusing on higher quality as we do so.

Looking ahead to the start of the fourth quarter we believe the most productive approach to the markets is to focus on what can be evaluated with greater confidence: the quality of individual businesses, the durability of their cash flows, the strength of their balance sheets, the price paid for future growth, and the role each investment plays within the broader portfolio. We do not need to predict every move in the market. We need to build portfolios capable of participating in long-term growth while remaining resilient when the investment environment changes. We enter the final quarter of the year with that objective firmly in focus.

Questions? Please let us know if you have any questions or concerns. We are closely monitoring the markets and the impactful events that will affect them. The quarterly reports are in the mail, and you should receive them imminently. Please let us know if you have any questions. Stay safe and be well.

Winans Investments Team

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