

Q4 2026 Market Outlook: Navigating New Highs, Rising Rates, and Fed Rate Hikes



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The third quarter presented a mixed landscape for investors, shaped by two significant forces. Interest rates climbed to 20-year highs, while strong corporate earnings continued to underpin equity markets. Against this backdrop, oil prices surged back above \$100 per barrel, the Federal Reserve raised rates for the first time in three years, and concerns around AI intensified as November's midterm election draws closer.

In spite of these crosscurrents, major U.S. stock indices closed the quarter near all-time highs. Notably, these gains were not confined to a single market segment. The energy sector, developed market equities, and commodities each made meaningful contributions to portfolios during the period. And although the bond market has faced headwinds from rising rates, bond yields are currently at some of the most attractive levels seen in recent history.

These market dynamics serve as a reminder that maintaining a balanced portfolio is essential to navigating shifting market conditions, particularly when those conditions create opportunities for long-term investing and financial planning. With this in mind, how should investors approach the fourth quarter as these trends continue to evolve?

Key market and economic highlights from Q3 2026¹

- The S&P 500 returned 2.3% in the third quarter with dividends and the Nasdaq Composite gained 2.6%, while the Dow Jones Industrial Average declined -2.3%. Year-to-date, the three indices have returned 12.7%, 16.1%, and 7.2%, respectively.
- Developed market international stocks (MSCI EAFE) gained 0.9%, while emerging market stocks (MSCI EM) declined -0.4% over the quarter, both in U.S. dollar terms.
- The Bloomberg U.S. Aggregate Bond Index fell -3.5% in the third quarter for a year-to-date decline of -2.9%, with longer-dated bonds struggling. The 10-year Treasury yield climbed to 5.29%, a two-decade high.
- The Bloomberg Commodity Index jumped 15.1% over the quarter. Brent crude ended the quarter at \$103 per barrel while WTI finished at \$90.
- Gold fell further to \$4,156 per ounce, while the U.S. Dollar Index recovered to 101.45.
- August headline CPI rose 3.4% year-over-year, while core CPI, which excludes volatile food and energy prices, increased only 2.4%. The core PCE price index, the Fed's preferred measure of underlying inflation, rose 3.0% year-over-year in August.

- The Federal Reserve raised its key policy rate to a range of 3.75% to 4.00% in September.
- The third estimate of second quarter GDP showed that growth was better than expected at 2.2% quarter-over-quarter. This was primarily driven by a 2.5% gain in personal consumption expenditures.

Investors are adjusting to a higher interest rate environment

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Historical Interest Rates

10-year and 2-year yields since 1960



The most defining characteristic of the third quarter was the sustained rise in interest rates to levels not seen since the early 2000s. For long-term investors, this is significant because the low-rate era that followed the 2008 global financial crisis is no longer the primary influence on portfolio decisions. The ability of bonds to generate meaningful income today has become an important factor in asset allocation.

A historical perspective on interest rate trends is instructive. From the peak in the early 1980s through 2020, rates followed a long, gradual decline, interrupted only by short-term fluctuations tied to the business cycle and specific economic events.² This era is often described as a 40-year bull market in bonds, as falling rates made existing

bonds more attractive and provided broad support to portfolios and the economy alike.

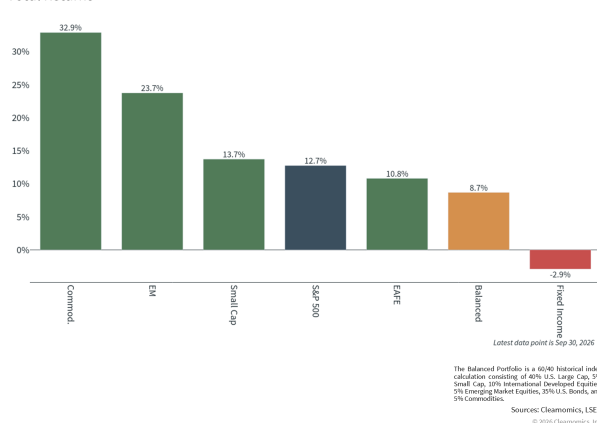
Higher interest rates affect many other parts of the economy as well, particularly the housing market. According to Freddie Mac, the average 30-year fixed-rate mortgage has moved back above 7% after dipping toward 6% at the start of the year.³ This dynamic creates what economists call the "lock-in" effect, where homeowners who secured low rates in prior years have little incentive to sell, dampening overall housing market activity.

Of course, interest rates are inherently difficult to forecast and can shift quickly, particularly given ongoing uncertainty in energy prices and labor markets. Nevertheless, rates remain near multi-decade highs, representing a meaningful development for investors to consider.

Earnings growth and AI investment are supporting multiple asset classes

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Asset Class Performance Year-to-Date Total Returns



Despite recurring bouts of short-term uncertainty, the S&P 500, Nasdaq, and Dow Jones Industrial Average each reached new all-time highs during the third quarter. This performance reflects the strength of the U.S. economy and the continued momentum of trends such as AI infrastructure investment, which have bolstered corporate profitability. Current consensus estimates indicate that the S&P 500 could achieve earnings growth of over 30% for the next twelve months across 2026.⁴

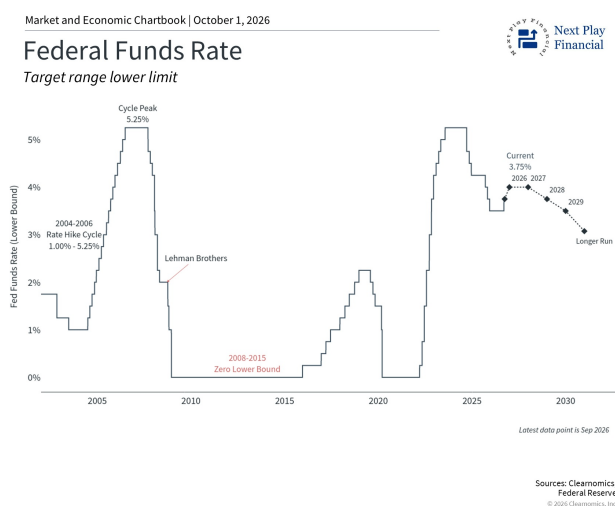
This year's positive performance has not been limited to U.S. large cap equities. Small cap stocks, for example, faced headwinds in the third quarter but have still outperformed on a year-to-date basis, as many of these companies play important roles in the AI supply chain. Other regions have also

benefited from AI-related themes, particularly semiconductor companies across Asia, providing some support to the MSCI Emerging Markets index despite a decline in the third quarter.⁵

Commodities have also added to portfolio returns, albeit for distinct reasons. Driven by ongoing conflict in the Middle East, oil prices rose from approximately \$70 per barrel in early July to over \$100 in September. Copper reached a new all-time high, reflecting mine supply deficits and structural demand from AI infrastructure buildout, while diesel hit a record price due to heavily constrained global refining capacity.

The breadth of contributors across asset classes underscores the value of a well-constructed asset allocation strategy. This will become even more important heading into the fourth quarter, as questions around monetary policy, Treasury yields, and energy prices remain at the forefront.

The Fed raised rates for the first time in three years



At its September meeting, the Federal Reserve raised policy rates by one-quarter of a percent, bringing the target range to 3.75% to 4.00%. This marked the first rate hike in three years, coming after a series of rate cuts that ran from September 2024 through December 2025, as illustrated in the chart above. Investors had priced in the move with over a 90% probability before the meeting, and while the announcement prompted some immediate market volatility, the broader market absorbed the decision without significant disruption.⁶

What distinguishes this rate hike is the underlying catalyst. The Fed is largely responding to elevated energy prices, a dynamic economists describe as "cost-push inflation," meaning that supply disruptions have driven prices higher. While the Fed

cannot resolve geopolitical events through interest rate policy, it can work to prevent higher energy costs from spreading to other inflation categories that affect both consumers and businesses.

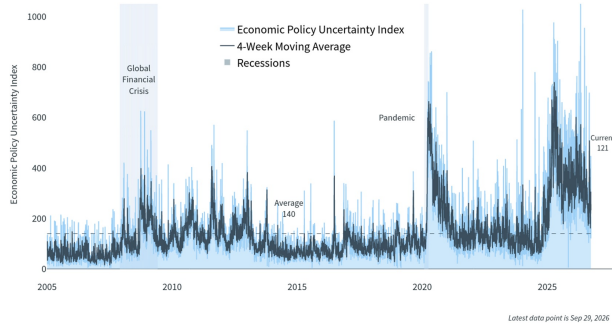
Projections from other Fed officials currently suggest the central bank may raise rates once more this year before pausing through 2027, with only a gradual easing expected thereafter. These projections are subject to rapid change depending on incoming economic data, so they should be interpreted with appropriate caution.

Some investors may instinctively view tighter monetary policy as a negative for markets. In practice, the impact depends heavily on the reasons behind the rate increases. Historically, it is not uncommon for both markets and interest rates to rise together, particularly in later stages of the business cycle when growth, corporate earnings, and capital investment remain robust. The third quarter itself is a case in point, with major indices reaching new highs even as rates climbed. Of course, monetary policy is just one of several forces that will shape the months ahead, alongside the political calendar.

Upcoming midterm elections and policy uncertainty

Economic Policy Uncertainty

Uncertainty based on news, taxes, and forecaster disagreement
Index of 100 represents the average from 1985 to 2009



Sources: Clearnomics,
Baker, Bloom, and Davis,
Federal Reserve
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As citizens, voters, and taxpayers, elections hold enormous significance. They determine the direction of policy on issues ranging from entitlement programs and taxes to the federal debt, and they reflect the values that guide new legislation. When it comes to investing, however, it is important that investors avoid making portfolio decisions based on electoral outcomes.

This November's midterm election is taking place against a complex backdrop of tariffs, geopolitical conflict, inflation, and evolving questions around AI. As the chart above illustrates, significant economic policy uncertainty over the past two years has contributed to short-term market volatility. At the same time, markets have demonstrated a capacity to stabilize and recover in ways that can surprise

investors. While past performance is not a guarantee of future results, overreacting to short-term political headlines is generally not in investors' best interests.

More broadly, it is tempting to assume that political developments should dictate stock market direction, or that election years are inherently more volatile. History tells a different story. The S&P 500 has averaged annual total returns of 8.6% in midterm election years since 1933.⁷ Furthermore, markets have performed well on average across various configurations of Congress. It is not unusual for the sitting president's party to lose its congressional majority during a midterm election, as occurred under Biden, Trump's first term, Obama, and Clinton, among other recent examples.⁸

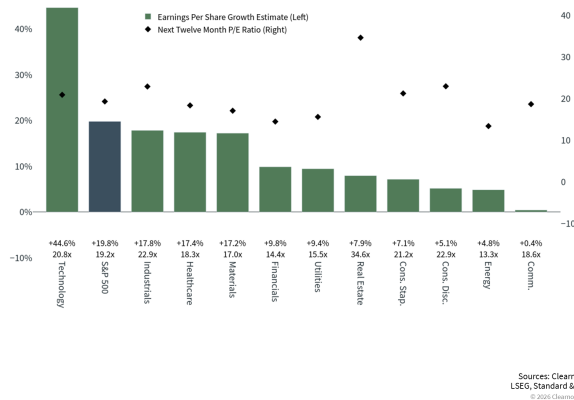
Beyond the question of who controls Washington, other sources of political uncertainty also weigh on investors. The size of the national debt and the annual budget deficit are among the most frequently cited concerns. Total federal debt recently surpassed \$40 trillion for the first time, amounting to nearly \$120,000 per American.⁹ The annual budget deficit is also projected to exceed \$2 trillion for the government's 2026 fiscal year.¹⁰ Over time, these trends could push up borrowing costs for the government and increase the interest payments it must make annually.

While many of these challenges are genuine, the key is to focus on what investors can and cannot control. Building and maintaining a portfolio designed to perform across a wide range of economic and political environments is far more constructive than attempting to predict the outcome of a single election or the precise trajectory of the budget deficit.

AI, productivity, and sector-level earnings trends

Sector Earnings and Valuations

Earnings Growth and P/E Ratios, Next Twelve Month Estimates



Sources: Clearnomics, LSEG, Standard & Poor's, © 2026 Clearnomics, Inc.

AI and related technology trends have been among the most powerful drivers of market performance over the past decade. These themes have not only propelled returns for groups such as the Magnificent 7, but have also directly influenced fundamental earnings trends across sectors. The chart above highlights the divergence in earnings growth between Information Technology and the other ten S&P 500 sectors.¹¹

This degree of "concentration risk" is a concern for some investors who worry that market performance is increasingly dependent on a small number of stocks. While many technology-related areas of the market continue to deliver strong results, it is also true that other sectors have contributed meaningfully to returns over the past year. These

sectors are experiencing above-average earnings growth as well, which supports their valuations. The energy sector, for example, has benefited from elevated oil prices and stands as the best performing sector with a 37.4% year-to-date gain through the third quarter.

Much of the growth driven by AI relates to infrastructure buildout, including data centers. Perhaps the most critical open question is whether AI will translate into genuine productivity gains across the broader economy. The defining benefit of the information technology revolution and the internet was, after all, a sustained boost to productivity. So far, the 2020s have seen average productivity growth of 2.1% per year, compared to only 1.2% in the 2010s. Whether AI and emerging technologies will accelerate this trend further remains an open question that is likely to shape markets and the economy for years to come.

Given these dynamics, maintaining a long-term perspective remains essential. The largest technology companies, for instance, took decades to reach their current scale, even as markets exhibited significant enthusiasm for the sector in the 1990s. Understanding how these trends interact with higher interest rates and the new Fed rate hike cycle can help investors stay grounded as they navigate the final quarter of the year.

The bottom line? Stocks reached new highs in the third quarter, with many asset classes contributing to portfolios, despite bonds struggling as interest rates rise. As new developments unfold and the midterm election approaches, investors should continue to stay balanced and focus on financial goals.

References

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Index Descriptions

S&P 500

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The modern design of the S&P 500 stock index was first launched in 1957. Performance prior to 1957 incorporates the performance of the predecessor index, the S&P 90.

Dow Jones

The Dow Jones Industrial Average consists of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

NASDAQ

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.

MSCI Emerging Markets Index

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia. The MSCI EM Index consists of the following emerging market country indices: Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Egypt, Greece, Hungary, Poland, Qatar, Russia, South Africa, Turkey, United Arab Emirates, China, India, Indonesia, Korea, Malaysia, Philippines, Taiwan, and Thailand.

MSCI EAFE Index

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

Bloomberg US Aggregate Bond Index

The Bloomberg U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

DXY

The DXY is a U.S. dollar index based on a basket of currencies, including the Euro, Yen, Pound, Canadian Dollar, Swedish Krona and Swiss Franc.

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