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Midterms, rates and the fundamentals that matter

September brought a return of volatility, but closed out another strong quarter for the market.

The S&P 500 finished the month down -0.3%, bringing year-to-date returns to 12.75%. But beneath the index level, the story was more mixed. Small cap stocks struggled, falling 5.25%, and developed international stocks slipped 3%. Growth reasserted itself, with the Russell 1000 Growth Index up 2.2% for the month, while emerging markets saw a modest loss, down -0.5%¹.

This was a counter-trend month, similar to what we saw in August, with a shift back toward technology, growth and the Mag 7. We'll be watching to see whether that trend proves sustainable, but for now, we view it as more of a continuation of the sharp rotations we've seen throughout the year. If anything, it reinforces our thesis that diversification and balance remain important as we employ our RAD 2.0 theme for 2026.

The real headline this month wasn't the S&P's modest advance. It was the move in long-term rates. The 10-year Treasury yield jumped from 4.75% at the end of August to 5.27% by the end of September, and that move came alongside continued strength in oil prices².

Together, those two developments gave market participants plenty to chew on.

Below, we'll walk through what the fundamental, valuation and technical metrics (FVTs) are telling us, examine why rates moved the way they did and what that means going forward and close with a few thoughts on the upcoming midterm elections.

Our assessment of the FVTs

Economic fundamentals remain the strongest pillar of our framework. AI-driven capital spending continues to provide a meaningful tailwind to the economy, while the labor market remains healthy and underlying economic activity continues to expand.

Second-quarter GDP came in a bit light at 1.5%, but much of that weakness reflected a surge in imports, including equipment supporting the AI infrastructure buildout, while consumer spending and business investment remained solid.

More recent data suggests that momentum has carried into the third quarter, with growth tracking near 5% and manufacturing activity trending upward for eight consecutive months.



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Corporate earnings provide another source of support. Q2 results were exceptionally strong, supported by healthy revenue growth, and current consensus estimates for S&P 500 earnings continue to call for earnings growth around 30% or better in 2026.

In short, the fundamental backdrop remains quite constructive.

Valuations have improved as well. The S&P 500 entered the year trading at roughly 22 times expected earnings, compared with about 19 times today. A market that's getting cheaper while earnings expectations continue to rise is considerably more comforting than one being driven primarily by multiple expansion. It also may provide some valuation support if investors demand a lower valuation multiple, as stronger earnings can help offset some of the impact of a re-rating.

Technicals remain neutral. The longer-term trend is still healthy, while some of the shorter-term measures beneath the surface have softened modestly and are worth monitoring. We are not seeing anything that materially changes our outlook, nor would we characterize the technical backdrop as an obvious tailwind.

Taken together, our FVT framework points to a constructive outlook, with strong fundamentals, improved valuations and neutral technicals.

Higher interest rates

Long-term interest rates remain an area we're closely watching. The 10-year Treasury has moved above 5%, while the 30-year is approaching 5.6%³. Those rate levels matter because higher yields can pressure equity valuations, increase borrowing costs, slow economic growth and eventually make bonds more attractive relative to stocks. But the level of rates alone does not tell the whole story.

The reasons for these higher rates are mixed. Some are constructive. Economic growth remains healthy, and the enormous capital requirements associated with the AI infrastructure buildout are creating significant demand for financing. That investment is also supporting corporate earnings. Other forces are less comfortable, including sticky inflation, elevated energy prices, fiscal deficits and heavy Treasury issuance. The investment implications of those two explanations are very different.

That is why we continue to evaluate the bond market as a mosaic. First, we are watching Treasury yields alongside credit spreads. Spreads remain relatively contained, suggesting that higher risk-free rates have not yet translated into meaningful stress on corporate credit. A sustained rise in yields accompanied by a significant widening in credit spreads would be a more concerning signal.

Another useful measure is the relationship between the 10-year Treasury yield and nominal GDP growth. Historically, we become more cautious when borrowing costs begin to overtake the economy's nominal growth rate. For now, nominal GDP growth remains comfortably above the 10-year yield, providing some reassurance that the economy is still growing fast enough to absorb today's higher rate environment.

The relationship between long-term Treasury yields and the federal funds rate provides another point of context. Historically, the 10-year Treasury has often traded roughly 1% to 1.5% above the federal funds rate. With the federal funds rate currently around 4%, a 10-year Treasury yield of 5% to 5.5% would still be within the range suggested by historical relationships between the two rates. In other words, a 10-year yield around 5% is not, by itself, a sign that something is broken.





Lastly, Fed policy bears watching, but we do not currently see policymakers signaling the start of an aggressive tightening cycle. The Fed has shifted toward a more inflation-conscious stance, while its latest projections point to limited additional tightening followed by an extended period of restraint. That distinction matters. A Fed willing to maintain credibility on inflation can provide reassurance to longer-term bond investors, even if short-term rates remain higher for longer.

Bottom line: rates are high enough to have our attention, but the broader mosaic is not yet flashing a clear warning signal. We will continue to watch the yields' level and composition, nominal GDP growth, the term premium and, perhaps most importantly, credit spreads for evidence that higher rates are beginning to create genuine stress.

Midterm elections: expect volatility, avoid the political trade

Midterm elections have historically brought higher market volatility, and we would not be surprised to see that pattern repeat as November approaches. That said, we continue to caution against trading based on election outcomes. Strategies built around assumptions such as "Democrats win, buy alternative energy" or "Republicans win, buy traditional energy" sound intuitive, but often fail to materialize.

While expectations can change significantly before Election Day, prediction markets currently see Democrats as highly likely to win the House and modestly favored to win the Senate.

From a market perspective, that could be constructive in some respects. A divided Washington can reduce the likelihood of sweeping legislative changes, potentially providing businesses with greater visibility around the policy backdrop. On the other hand, it could also create more contentious budget negotiations, government shutdown risk and debt-limit battles.

The Senate outlook is also a useful reminder not to become overly confident in political forecasts. Just two weeks ago, prediction markets viewed control of the Senate as essentially a coin flip. Today, they have shifted meaningfully toward Democrats and those expectations could change again.

More importantly, many of the factors we believe will ultimately determine market direction will persist regardless of who controls Congress. People will speculate about the election's impact on the many wall-of-worry items facing markets, including the duration of the Iran conflict and its impact on oil prices, tariff policy, inflation, Fed policy, AI-related capital spending, interest rates, credit spreads and corporate earnings.

But we don't craft opinions or speculate about how Washington will react to these challenges. We take our cues from the data and look for evidence that these factors are negatively affecting the markets or economy. We stay glued to rates, earnings and spreads to determine where we think the economy and markets are headed.

Our approach remains consistent: don't predict the predictors. We'll pay attention to the election and the policy implications that follow, but we'll focus our investment conclusions on how those developments flow through the economic and earnings data.

Looking ahead

Our 2026 theme of Risk Awareness and Diversification 2.0 remains as relevant as ever. This is not an environment where we believe investors should make large portfolio bets based on election forecasts, Fed predictions or the latest headline. Stay diversified, understand your exposures and let the data tell you when the fundamental story has changed.



¹ Source: FactSet

² Source: FactSet

³ Source: FactSet

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