

INTELLIGENT INVESTMENT

Third Quarter 2026

S&P 500 - YTD 11.77%²



MSCI INTERNATIONAL - YTD 12.11%²



**“Baby come back, you can blame it all on me
I was wrong and I just can't live without you”¹**

The band “Player” was very clearly crooning about low interest rates, right? As we “Yacht Rock” & roll our way into autumn and the cooler months, we have a few questions that need answering. What caused the incredible spike in interest rates over these last three months? Why did the Fed raise its policy rate, and will interest rates decrease anytime soon?

Let’s start with a little “Reminiscing.”³ We wrote last quarter, “Our old friend... and foe, interest rates, reacted in kind, as the yield on the 10-year US Treasury note contracted by 30 basis points from 4.66% on May 9th to 4.36% by June 29th.” This appeared to be the beginning of a longer move to lower interest rates. “What A Fool Believes”⁴ as the bond market had other ideas. This quarter witnessed the yield on the US 10-year note spike to 5.30%, the highest since July 2007. To put this expansion of interest rates into perspective, we began 2026 “Low Down”⁶ at 4.17%.

What's so interesting about interest rates lately? Why have they come up in such a dramatic fashion? As usual, it's not one simple reason that can be pinned down; several

factors are in play. A.I., which seems to be at the forefront of everything investment these days has also planted its flag in the bond market. What does the high-flying world of artificial intelligence have to do with sleepy bonds? A.I. needs money, lots of it, to continue to develop, grow, and maintain any advantage over competitors, both foreign and domestic. The bond market is the largest source of capital for corporations. The US investment-grade credit market typically issues \$ 1.2 trillion annually in bonds¹³. This year as a direct result of A.I. development, not least of which is for data center buildouts is projected to be \$2.2 trillion. With an over 80% increase in appetite for corporate debt providing sound competition for Treasury bonds, yields have increased across the board. However, the best math says that only accounts for approximately 30% of the expansion in rates this year. Where did the remainder of the increase come from? Too much debt? Could US debt eclipsing \$40 trillion, along with high deficits, be the boogeyman? We don't think so. Maybe inflation? The Fed has been proselytizing about inflation needing to reach its 2% target, which it has yet to do for several years following the COVID inflation surge. Likely not. 2026 began with the 10-year breakeven inflation rate at 2.25%; we closed out the third quarter at 2.34%, a mere 0.09% increase in inflation expectations.

ARPG believes the bond market is "Sailing"⁷ into a strong, robust, and growing economy for the long term. We're seeing not only the bond markets discount a strong economy but economists and earnings analysts as well. GDP forecasts as well as earnings have been historically healthy, to say the least. The Atlanta Fed GDP tracker is forecasting 5.0% annualized growth for the third quarter of 2026⁸. This is in addition to the earnings juggernaut continuing its historic ascent, as earnings are expected to continue to expand 35% by the end of 2028⁵.

When you zoom out and see what's taking place from a macro perspective, geopolitics, oil prices, and mid-term election years, which are typically the weakest and most volatile of the four-year cycle, will likely prove to be nothing more than a temporary blip. However, with a strong and growing economy, will interest rates ever cry "This Is It"⁹ and begin heading down? That will depend on several factors, not least of which would be a reduction in corporate credit issuance.

The Federal Reserve is keenly aware of the economy likely overheating in the future and decided to step in by raising its policy rate by 0.25%, with ARPG suspecting at least one more 0.25% hike to follow in December of this year. The reason they gave for the rate increase was inflation not reaching its 2.0% target... that bird isn't singing... we're not seeing any outsized inflation directly or anticipated. In fact, the three-month average for the PCE Deflator, the Fed's preferred gauge of inflation, is "Right Down the Line"¹⁰ at a mere 2.05%.

This underlying economic strength, along with robust earnings guidance, has made equity markets incredibly resilient in withstanding these higher interest rates. In fact, earnings multiples have contracted 20%⁵ from one year ago due to the expanding profit guidance, which it would seem has been a key driver of the stock market remaining elevated. Underneath, however, these yields have actually spooked a vast majority of stocks. Less than 25% of stocks on the Russell 3000, an index which represents more than 95% of US investable securities, remain above their 50-day average; in addition, more than 50% of stocks on the S&P 500 are below their 200-day average, typically a lower bar. The

technology sector has been doing the heavy lifting, keeping the index level stronger than the weak breadth would otherwise indicate. This divergence between market price and market breadth cannot last forever. Either breadth catches up with the higher price or the index comes down to meet poor market breadth. We will find out soon enough.

The "Summer Breeze"¹¹ is gone, and it's time to "Ride Like the Wind"⁷ into the holiday season, which is just around the corner. As the weather cools off, "How Much I Feel"¹² the market will likely heat up remains, as we hold our 8250 year-end S&P 500 price target. In any season or market, the best investors always focus on the long term, and ARPG will continue to practice our approach to value investing: "Intelligent Investment is Investment on Value, buying high quality companies in low quality times". This is what we believe sets ARPG apart from the rest. As always, we thank you for your confidence and are humbled by your trust. Please feel free to contact us at any time.

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Sincerely,
Matthew D. Dahl
Chief Investment Officer

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3. Little River Band
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6. Boz Scaggs
7. Christopher Cross
8. Atlanta Fed
9. Kenny Loggins
10. Gerry Rafferty
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