Formative

MARKET COMMENTARY

Q3 2026 · OCTOBER 2026

VALUES-ALIGNED INVESTING

Keep Calm and Carry On…
But Mind the Footing.





Q3 2026 · PREPARED BY

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Keep Calm and Carry On… But Mind the Footing

Throughout 2026, investors who stayed invested through periods of fear were rewarded. Markets recovered again and again from geopolitical disruption, an energy shock, inflation scares, and doubts about AI-driven valuations. Through September 30, the S&P 500 returned 12.75% for the year, including 2.30% in the third quarter (total return, S&P 500 TR Index).[1]

The third quarter looked calm on the surface but was not calm underneath. Large-cap U.S. stocks advanced, while small caps, mid caps, REITs, and nearly every segment of the bond market declined. The rally narrowed, carried by a handful of companies at the center of the AI build-out.

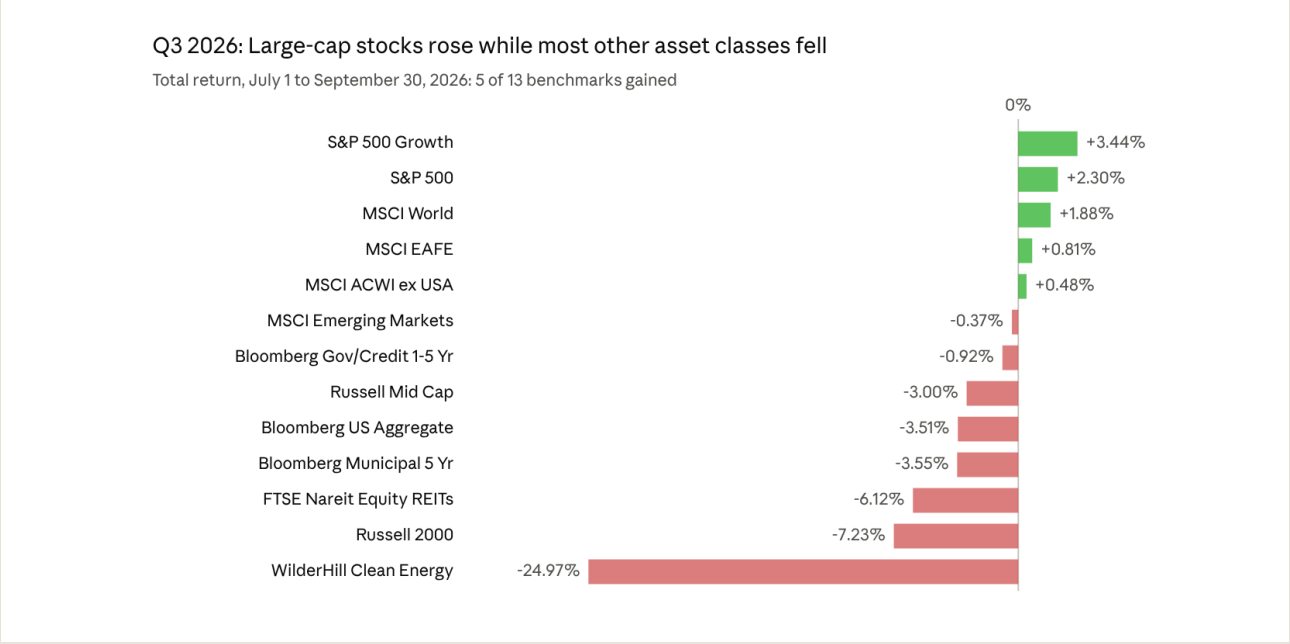
The challenge entering 2027 may be different from what we faced earlier this year. Corporate earnings remain exceptionally strong, but analysts expect the pace of growth to slow sharply in 2027. Because markets look forward, the rate of change in earnings growth may now matter more than the level of earnings. Our message this quarter is the same one that served investors well all year, with one addition: keep calm and carry on, but mind the footing. The path ahead still leads upward: Profits are strong, the economy is growing, and valuations are reasonable. But the trail is rocky and less predictable than it was earlier this year. Earnings growth is set to slow, companies are beating estimates by smaller margins, and borrowing costs are rising.

THIRD QUARTER IN REVIEW

Narrow Gains, Broad Losses

The S&P 500 gained 2.30% in the third quarter (total return, S&P 500 TR Index), but only five of the thirteen major benchmarks we track finished the quarter higher.

Figure 1. Total Returns of Major Benchmarks, Third Quarter 2026.



All figures are total returns, including reinvested dividends; S&P 500 is the S&P 500 TR Index. Source: Morningstar Direct. Data as of September 30, 2026. Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Bonds had a difficult quarter. The Bloomberg U.S. Aggregate index fell 3.51%, the average long-government fund fell 8.14%, and intermediate municipal funds fell about 5% as rising energy prices pushed inflation higher. Bonds are now down for the year, and core bonds did not offset equity volatility this quarter. According to J.P. Morgan, the 10-year Treasury yield rose from 4.2% at the end of 2025 to 5.3% on September 30, and the yield curve now slopes upward from 4.2% at three months to 5.6% at 30 years. On September 16, the Federal Reserve raised its target range for the federal funds rate by 25 basis points to 3.75%–4.00%, its first increase since 2023. Officials cited elevated inflation and resilient spending, and most signaled that another increase could be appropriate before year-end.

The quarter ended on a soft note. In September, the average large-blend fund fell 1.19%, small-blend funds fell 4.61%, and intermediate core bond funds fell 2.64%.

EARNINGS

Earnings Remain Strong, But Momentum Matters

By any historical standard, corporate profits are extraordinary. According to FactSet's October 23 update, with about a quarter of companies reporting, S&P 500 earnings are on track to grow 29.5% year over year in the third quarter. That would be the third straight quarter above 25% and the eighth straight quarter of double-digit growth. Revenue is growing 12.7%, and analysts expect earnings growth of 33.1% for calendar 2026.

The level of growth is not the issue. The issue is the rate of growth. Third-quarter growth essentially matches the second quarter rather than accelerating beyond it, and analysts expect a sharp deceleration through mid-2027.

Figure 2. S&P 500 Earnings and Revenue Growth, Actual and Estimated.

PERIOD	S&P 500 EARNINGS GROWTH (Y/Y)	REVENUE GROWTH (Y/Y)
Q3 2026 (blended)	29.5%	12.7%
Q4 2026 (est.)	29.2%	13.0%
Q1 2027 (est.)	19.6%	11.9%
Q2 2027 (est.)	2.9%	7.8%
CY 2026 (est.)	33.1%	12.8%
CY 2027 (est.)	16.0%	9.5%

Source: FactSet Earnings Insight, October 23, 2026.

J.P. Morgan's breakdown shows how unusual 2026 has been. Of the 31.6% expected EPS growth this year, 19.5 percentage points come from wider profit margins and 13.2 from revenue, compared with long-run averages of 2.4 and 5.0. Consensus EPS rises from $362 in 2026 to $417 in 2027 and $488 in 2028. Growth that leans this heavily on margins is the hardest kind to repeat.

Several early signals in this earnings season point the same way. FactSet's data reflects the 24% of companies that had reported as of October 23:

- **Beats are common but smaller.** 83% of companies beat EPS estimates, above the 5-year average of 78%. However, they beat by only 2.1% in aggregate, versus a 5-year average of 7.5%.
- **Revenue surprises are below average.** 66% of companies beat revenue estimates, by just 1.2% in aggregate, versus 5-year averages of 70% and 1.8%.
- **Investors are giving companies the benefit of the doubt.** Early in the season, beats went unrewarded. As more companies have reported, those beating estimates have gained an average of 1.3% around their reports, above the 5-year average of 0.9%, while those missing have fallen only 0.4%, versus a 5-year average decline of 3.1%. Forgiving misses this readily is a sign that sentiment remains optimistic.
- **Growth is concentrated.** As of October 16, excluding Micron and NVIDIA alone would have cut S&P 500 earnings growth from 29.0% to 20.0%. Without semiconductors, Information Technology earnings growth drops from 65.6% to 24.9%, and without EchoStar and Meta, Communication Services growth drops from 39.8% to 12.9%.
- **Some growth is flattered by easy comparisons.** Meta, EchoStar, and Boeing rank among the top contributors largely because large one-time charges depressed their results a year ago.
- **Margins came off a record.** The blended net profit margin of 14.9% is the second-highest since FactSet began tracking in 2009, but down from the record 17.0% in the second quarter. That second-quarter figure was boosted by large one-time investment gains at Alphabet and Amazon.

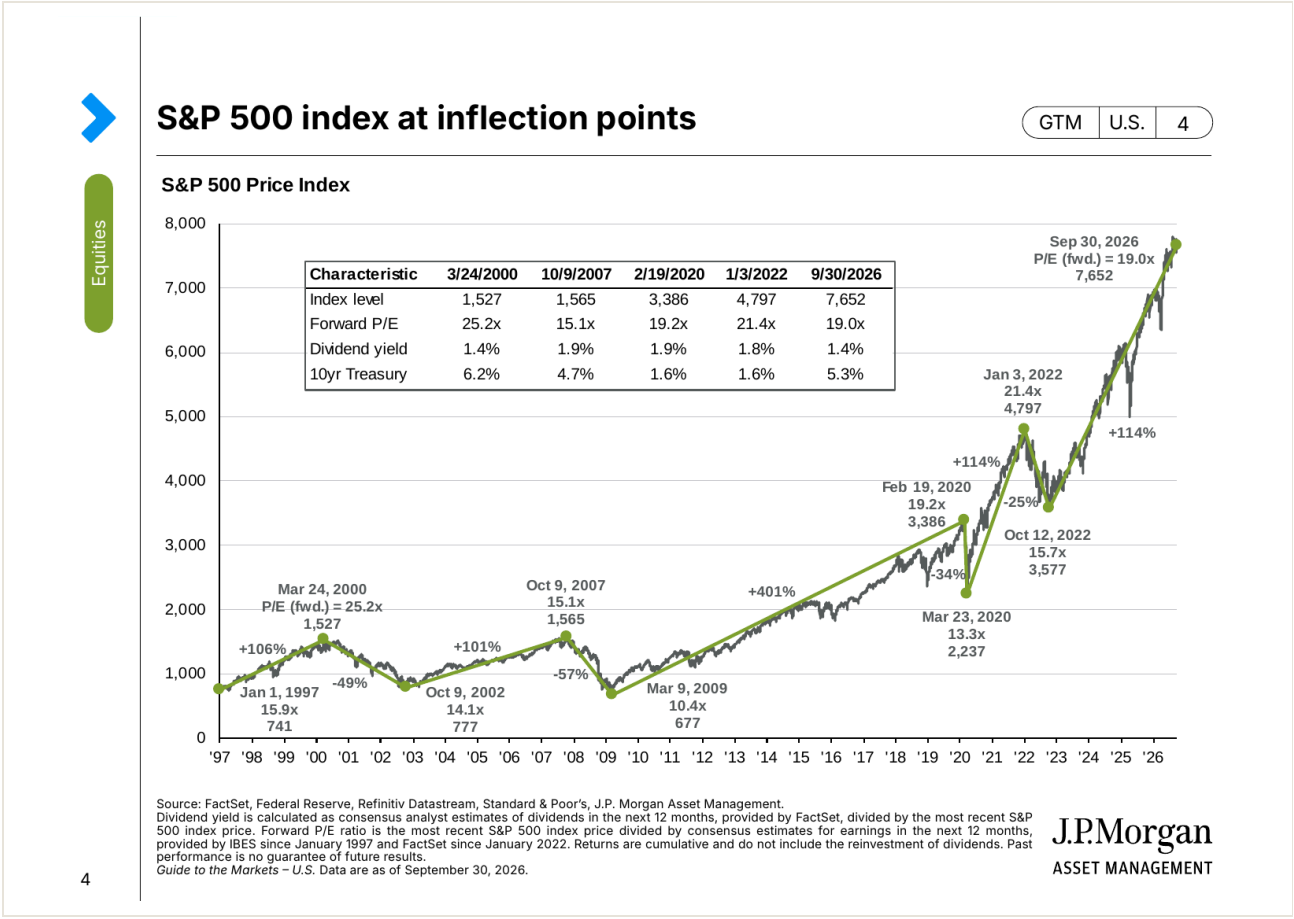
There is a constructive side to this story. Corporate guidance is encouraging: only 41% of companies issuing fourth-quarter guidance have issued negative guidance, well below the 5-year average of 60%. And as of October 16, analysts expected the "Magnificent 7" to grow fourth-quarter earnings 23.6%, compared with 30.6% for the other 493 companies in the S&P 500. If that holds, it would be the first quarter since Q4 2022 in which the rest of the market outgrew the mega-caps. That is the kind of broadening that rewards diversified portfolios.

VALUATIONS

Supportive, Not Cheap

Valuations remain reasonable because earnings have kept pace with stock prices. The S&P 500 trades at 18.7 times forward 12-month earnings. That is below both its 5-year average of 19.8 and its 10-year average of 19.1. On trailing earnings the picture is fuller: The trailing P/E of 25.7 is above both its 5-year average (24.4) and its 10-year average (23.6).

Figure 3. S&P 500 Index at Inflection Points.



S&P 500 Price Index; returns shown are price returns and exclude dividends. Source: J.P. Morgan Asset Management, Guide to the Markets – U.S., 4Q 2026. Data as of September 30, 2026.

The inflection-points chart puts today's market in context. At 7,652 on September 30 (S&P 500 Price Index), the S&P 500 traded at 19.0 times forward earnings, well below the 25.2 times reached at the March 2000 peak but above the 15.1 times at the October 2007 peak. What has changed most is the competition from bonds. The 10-year Treasury yield of 5.3% is higher than at the 2007, 2020 and 2022 peaks, and second only to the 6.2% of March 2000, and the S&P 500 dividend yield is just 1.4%.

Forward multiples only look reasonable if forward earnings arrive as expected. As in our second-quarter commentary, multiple expansion is not what is driving this market. Earnings are. If earnings growth moderates, there is little valuation cushion for the market to rerate higher.

Wall Street analysts remain optimistic. FactSet aggregates the 12-month price targets that individual analysts set for each S&P 500 company into a bottom-up target for the index. As of October 23, that target was 9,314.37, about 21.5% above the index's 7,663.43 close, and 60% of the roughly 13,300 analyst ratings on S&P 500 stocks were Buys. We would treat the target as a measure of sentiment rather than a forecast.

THE ECONOMY

Resilient on the Surface

The U.S. economy is growing at roughly its long-term trend, but the strain on households is growing. Formative's third-quarter economic commentary covers these indicators in depth. In brief:

- **Growth is steady.** Real GDP grew at a 2.2% annual rate in the second quarter. First-quarter growth was revised up to 2.5%, putting 2026 roughly in line with the long-term average.
- **Inflation has re-accelerated, led by energy.** September CPI rose 3.7% year over year. Energy prices were up 20.4%, and gasoline was up 34.2%. Oil averaged $85.68 in the third quarter, 32% above a year earlier. Our second-quarter expectation that the War in Iran would end quickly and oil would fall below $70 did not materialize. As a result, core inflation is steadier at roughly 2.5%, which is above the Fed's target.
- **The labor market is calm on the surface.** Unemployment is low at 4.1%–4.2%. However, monthly payroll gains have been uneven, and wage growth of 3.3% now trails headline inflation.
- **Consumers are pessimistic.** The Conference Board's Consumer Confidence Index fell to 81.9 in September. Its Expectations Index has been below the recession-warning threshold of 80 for 21 consecutive months.
- **Tariffs persist.** The effective U.S. tariff rate stands at about 10.6%, despite three Supreme Court rulings against the legal authorities used to impose them.

The gap between strong corporate profits and weak consumer sentiment has persisted all year. So far, spending has held up. A slowdown in earnings momentum combined with a stretched consumer is the scenario worth watching.

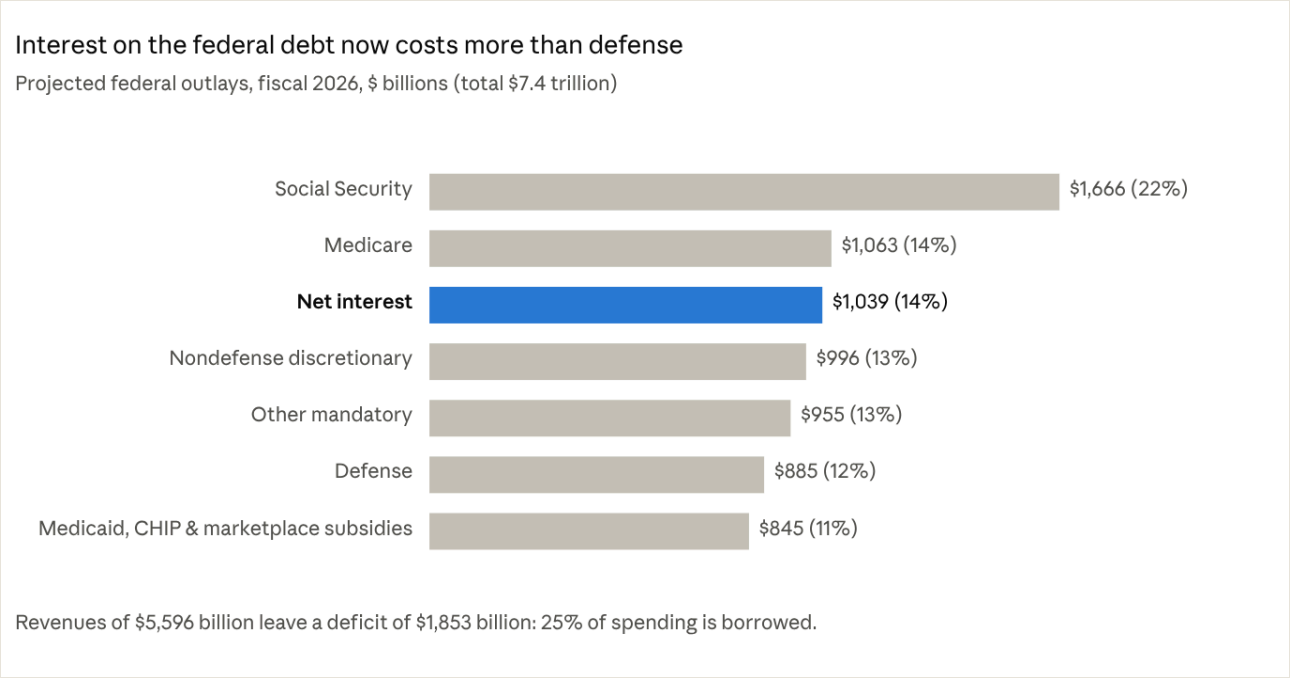
GOVERNMENT DEBT

Not a Problem… Until It Is

For years, high government debt has been a slow-moving concern that markets could safely ignore. Low interest rates kept the cost of carrying that debt manageable, and bond investors kept lending. That comfort depends on two things holding: Borrowing costs staying low, and investors trusting governments to keep their finances under control. In 2026, both are being tested.

The U.S.: Crowding out in plain sight. According to the Congressional Budget Office's February 2026 outlook, the federal government will spend $7.4 trillion in fiscal 2026. Net interest on our exorbitant debt accounts for $1,039 billion, or 14% of that spending. Interest now costs more than national defense ($885 billion), more than Medicaid, CHIP and ACA marketplace subsidies combined ($845 billion), and more than all non-defense discretionary programs combined ($996 billion). A quarter of federal spending ($1,853 billion) is financed by new borrowing. The CBO projects debt held by the public rising from 99.4% of GDP in 2025 to 120.2% by 2036.

Figure 4. Projected Federal Outlays by Category, Fiscal 2026.

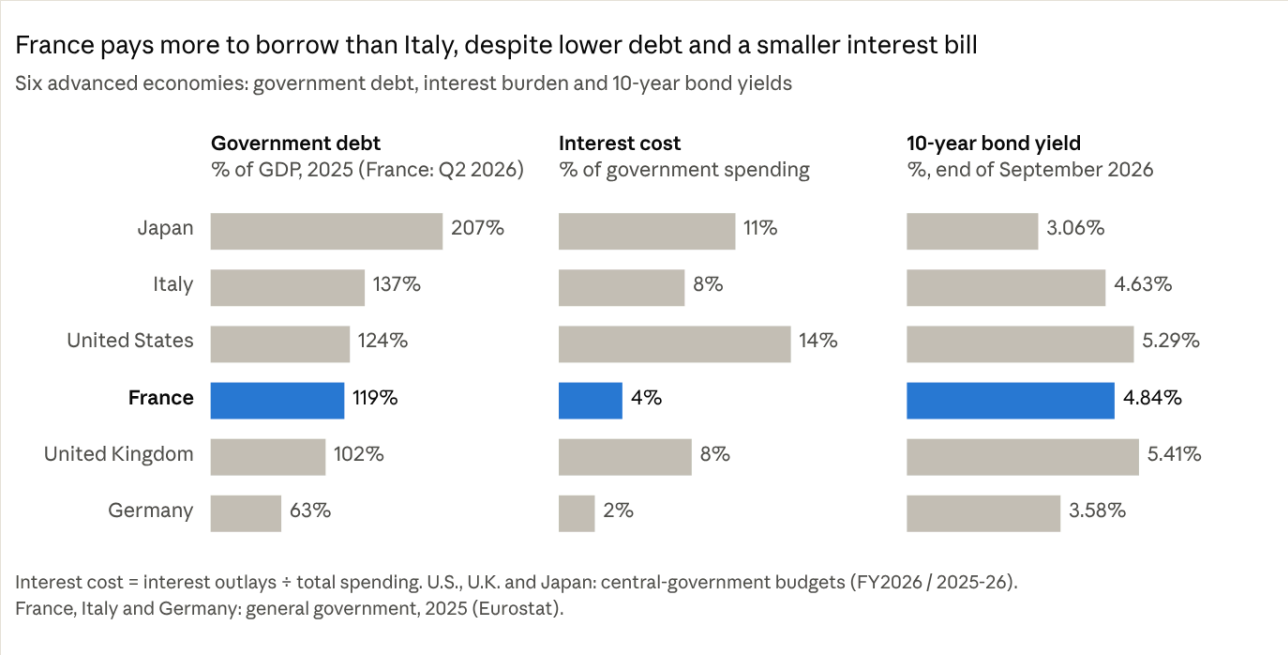


Source: Congressional Budget Office, The Budget and Economic Outlook: 2026 to 2036 (February 2026), Table 1-1. Medicare is net of offsetting receipts. Projections are not a guarantee of future results.

This is what economists mean by crowding out. Every dollar spent on interest is a dollar not available for defense, infrastructure, research, or the social safety net. And as the Treasury borrows more, it competes with businesses and households for the same pool of savings. With the 10-year Treasury yield at 5.3%, that competition shows up in mortgage rates, corporate borrowing costs, and the valuations investors are willing to pay for stocks.

France: When markets lose patience. France shows how quickly sentiment can turn. Its public debt reached €3.6 trillion, or 119% of GDP, in the second quarter of 2026, and its deficit is expected to reach 5.4% of GDP this year. That is above the EU's 3%-of-GDP limit, and France has been in the EU's excessive-deficit procedure since July 2024. Neither number is new. What changed is confidence: France has missed its budget targets in three of the last four years, a minority government lacks a parliamentary majority, and a presidential election looms in spring 2027. In early October, the French 10-year yield rose to about 5%, the highest since 2002. Its spread over German Bunds widened to 1.52 percentage points, the widest since the 2011–12 eurozone crisis, and France now pays more to borrow than Italy or Greece.

Figure 5. Government Debt, Interest Cost and 10-Year Bond Yields, Selected Countries.



Sources: Debt, IMF (2025) and INSEE (France, Q2 2026). Interest cost, Formative calculation from CBO via J.P. Morgan (U.S.), Japan Ministry of Finance, U.K. Office for Budget Responsibility, and Eurostat (France, Italy, Germany). Yields, J.P. Morgan Guide to the Markets (U.S., 9/30/2026) and Tradeweb (others, end of September 2026). Note: Interest cost is interest outlays as a share of total government spending. For the U.S., the U.K. and Japan it reflects central-government budgets (U.S. federal budget, FY2026; U.K. total managed expenditure, 2025-26; Japan general account, FY2026). For France, Italy and Germany it reflects general government (central, regional and local combined), 2025. The two bases are not strictly comparable but show the relative burden across countries.

The comparison above makes the point. By the usual measures, France's finances are not the weakest in the group. Its debt is well below Italy's and Japan's, and its interest bill is a far smaller share of government spending than America's or Japan's. Yet investors now charge France more than Italy. Debt becomes a problem not when it crosses a particular threshold, but when investors stop believing it will be managed. That moment is hard to predict and tends to arrive suddenly.

For investors, the lesson is not to sell stocks because of deficits. Markets have climbed for decades alongside rising debt. It is to recognize that higher government borrowing keeps upward pressure on interest rates, which raises the bar for every other asset.

LEADERSHIP

Narrowing Now, Broadening Ahead?

The third quarter and the year to date tell two different stories about market leadership.

In the quarter, leadership narrowed sharply toward large-cap growth. The S&P 500 Growth index gained 3.44%, while the Russell 2000 fell 7.23% and the S&P MidCap 400 fell 6.36%. That is a gap of nearly 11 percentage points between large growth and small caps in a single quarter.

For the year, the picture is broader than the headlines suggest:

- The Russell 1000 Value index is up 19.27%, versus 6.30% for the Russell 1000 Growth index.
- The Russell 2000 is still up 13.71%, slightly ahead of the S&P 500 TR Index's 12.75% (both total returns).
- Outside the U.S., the MSCI ACWI ex USA is up 14.22% and MSCI Emerging Markets is up 23.38%. Much of that EM gain came from AI-linked markets such as Korea and Taiwan.

According to J.P. Morgan, the ten largest companies now make up 40.6% of the S&P 500's market value and 36.1% of its earnings. They trade at 20.9 times forward earnings, in line with their own long-run average, while the remaining 490 companies trade at 17.9 times, 12% above theirs.

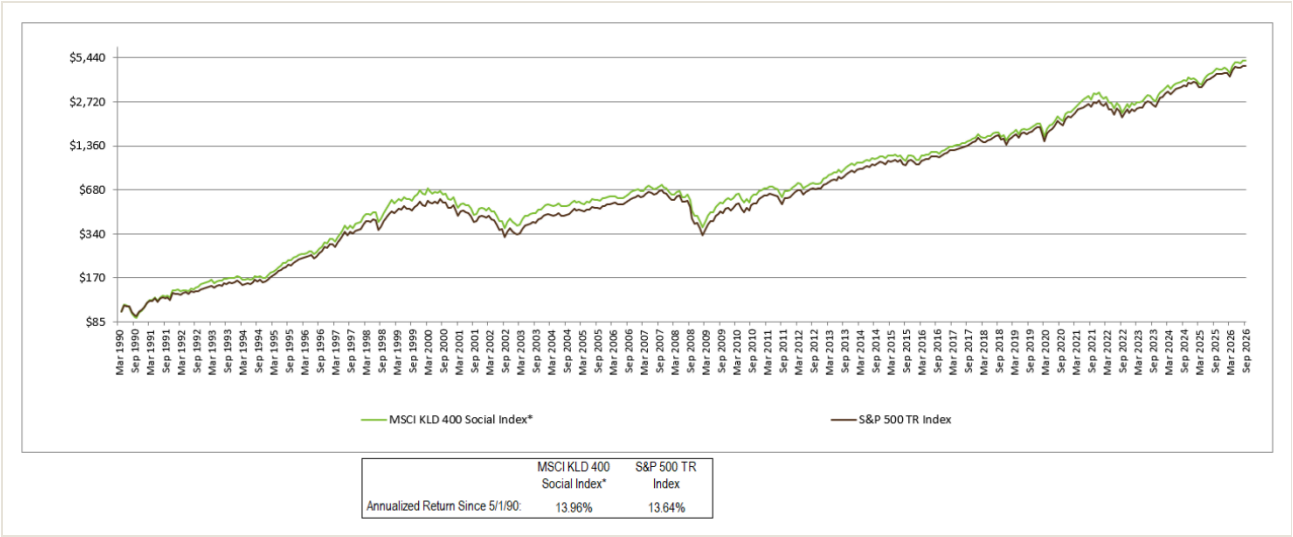
When earnings acceleration fades, leadership typically narrows and volatility rises. That is consistent with what we saw this quarter. However, FactSet's fourth-quarter estimates suggest that profit growth outside the mega-caps may now be catching up. If that broadening takes hold, it favors disciplined, diversified portfolios over concentrated bets on the year's winners.

VALUES-ALIGNED INVESTING

What Impact Does Your Portfolio Have on the World?

After nearly three years of underperformance, many values-aligned strategies turned the corner in 2026, and the third quarter extended that recovery. Through September 30, the MSCI KLD 400 Social Index returned 14.21% year to date, versus 12.75% for the S&P 500 TR Index. In the third quarter alone, the KLD 400 gained about 2.75%, versus 2.30% for the S&P 500 TR Index. Since its inception in May 1990, the KLD 400 has returned 13.96% annualized, versus 13.64% for the S&P 500 TR Index (all total returns).

Figure 6. MSCI KLD 400 vs. S&P 500 Indices, 9/30/2026.



Source: Morningstar. Data prior to 9/1/2010 is that of the MSCI KLD 400 Social Index GR; data since 9/1/2010 is that of the MSCI KLD 400 Social Index NR. Indexes are unmanaged groups of securities. Index performance does not include the impact of cash, fees, or transaction costs. Investors cannot invest directly in these indexes, but may purchase mutual funds or other investment products designed to track the performance of various indexes.

The third quarter was hard on parts of the sustainability universe. The WilderHill Clean Energy Index fell 24.97% in the quarter, and REITs fell more than 6%. Small and mid caps also lagged. The main culprit was rising interest rates. Solar and wind projects are capital-intensive: most of their cost is paid up front and financed. With the 10-year Treasury yield ending the quarter near 5.3%, financing costs rose sharply, and high fossil-fuel prices were not enough to offset that. Tariffs, uncertainty over federal tax credits, and a global solar-panel price war added to the pressure. The sell-off erased the sector's strong first-half rally, in which the WilderHill index gained roughly 29%.

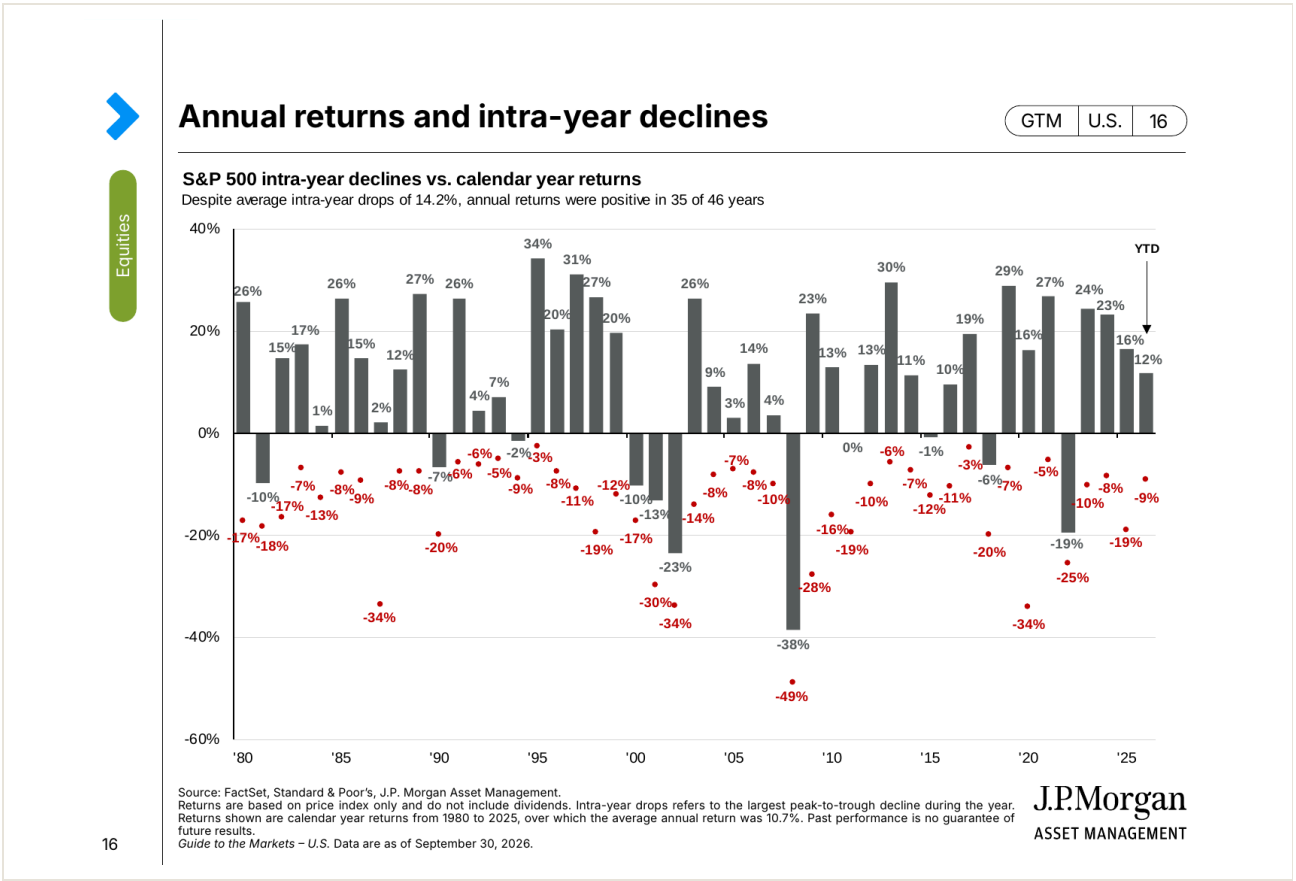
Narrowing leadership tests every diversified approach, and values-aligned portfolios are no exception. Our conviction has not changed. Investors should be able to invest their money their way, incorporating their values into their portfolios and their advocacy. The market reflects the world as it is today. Values-aligned investors invest in the world as they want it to be, and they pursue long-term financial and impact goals that reflect those values.

OUTLOOK

Market Timing Isn't Difficult. It's Impossible.

Earlier this year, the lesson was to stay invested because the panic was unwarranted. The lesson now is more subtle: Stay invested because timing the market is impossible, even when the outlook becomes less favorable.

Figure 7. S&P 500 Intra-Year Declines vs. Calendar-Year Returns, 1980–2025.

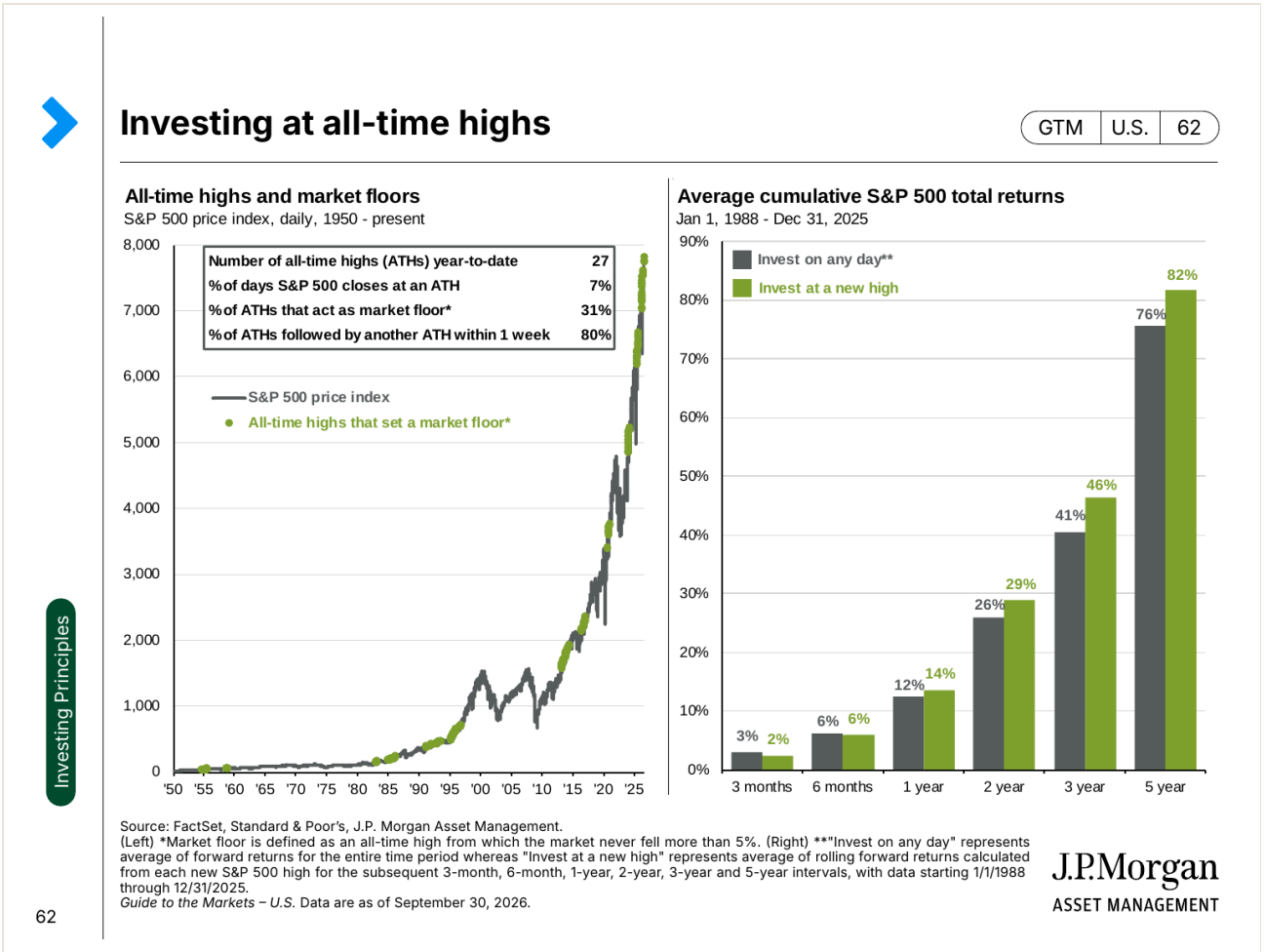


S&P 500 Price Index; price returns, excluding dividends. Source: J.P. Morgan Asset Management, Guide to the Markets – U.S., 4Q 2026. Data as of September 30, 2026.

In my 40 years in this business, I have watched many investors try to time the market, and almost none succeed. J.P. Morgan's data show why. From 1980 through 2025, the S&P 500 fell an average of 14.2% from its high at some point during the year, yet it finished the year higher in 35 of those 46 years (price return, S&P 500 Price Index). Selling during a decline only works if you also buy back in at the right moment, and no one does both reliably.

The instinct to wait for a better entry point fails just as often. The S&P 500 set 27 record highs in 2026 through September. From 1988 through 2025, investing on the day of a new high produced an average one-year total return of 14%, versus 12% for investing on any day. Sentiment is no better a guide. After nine troughs in consumer sentiment since 1972, the S&P 500 gained an average of 24.1% over the following 12 months, versus 4.8% after ten sentiment peaks (price returns, S&P 500 Price Index). Consumer sentiment stood at 48.1 in September, far below its long-run average of 77.2.

Figure 8. Investing at All-Time Highs.



Average returns shown are S&P 500 total returns. Source: J.P. Morgan Asset Management, Guide to the Markets – U.S., 4Q 2026. Data as of September 30, 2026.

Markets rarely peak because earnings are weak. They more often struggle while earnings are still growing, results are still beating estimates, and management teams are still optimistic. The trouble comes when growth stops accelerating after expectations have come to depend on it. A decelerating earnings environment

produces mixed news: Not bad enough to justify panic, and not good enough to justify complacency. That is often when investors make their biggest mistakes.

In the months ahead, we will be watching:

- **The slope of 2027 estimates.** Are analysts revising their expectations down faster than companies are beating them?
- **The breadth of earnings growth.** Does the other 493 overtaking the Magnificent 7 in the fourth quarter materialize?
- **How the market reacts to beats.** So far, investors are rewarding beats and forgiving misses. If strong results start going unrewarded, sentiment will have run ahead of fundamentals.
- **Energy and inflation.** Elevated oil prices are keeping inflation above target and pressuring bonds and consumers.
- **Bond yields and fiscal credibility.** With the 10-year Treasury above 5%, rising borrowing costs, not deficits themselves, are the channel through which government debt reaches portfolios. France is the case to watch.

The outlook for corporate profits remains constructive. However, investors should recognize that the strongest phase of the earnings acceleration cycle may be behind us. History suggests that markets can keep advancing during periods of moderating earnings growth. In those periods, leadership often narrows, volatility increases, and fundamentals matter more. The right response is neither panic nor market timing. It is the same discipline that served investors well throughout 2026: keep calm, stay diversified, stay focused on long-term objectives, and carry on.

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[1] A note on returns: Unless otherwise noted, S&P 500 performance figures in this commentary are total returns from the S&P 500 TR Index (source: Morningstar), which include reinvested dividends. Figures drawn from J.P. Morgan's Guide to the Markets on intra-year declines, calendar-year returns, returns following consumer-sentiment turning points, and the index's level at market peaks are based on the S&P 500 Price Index and exclude dividends; these are labeled "price return" where they appear. Because they exclude dividends, price returns are lower than total returns over the same period and are not directly comparable.

Sources: FactSet *Earnings Insight*, October 16 and October 23, 2026 · Quarter End Reports/Q3 2026 benchmark returns (Morningstar Direct) · Morningstar Category Averages, Q3 2026 · Formative 3Q 2026 Economic Commentary · Formative 2Q 2026 Market Commentary · J.P. Morgan Asset Management, Guide to the Markets – U.S., 4Q 2026 · Euronews, "France's sovereign debt crisis explained" (Oct. 6, 2026) · Tradeweb, Government Bond Update, September 2026 · Analysis Atlas, G20 debt ratios and interest bill (IMF, Eurostat, OBR data) · Mappr, government revenue by country (IMF Fiscal Monitor, April 2026)

ABOUT & DISCLOSURES

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Theresa is Formative's Chief Investment Officer, responsible for producing and delivering values-aligned investment solutions to advisors and their clients. She leads the firm's investment strategy and market research, translating the macro backdrop into what it means for values-aligned portfolios.

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