

Westminster

FINANCIAL COMPANIES

Fourth Quarter 2026 Outlook

Third Quarter Recap - A Rally Tested by Rising Expectations The Market

After a strong second quarter, equities continued their advance in the third quarter, led by Technology megacaps, which notched a record high in September propelled by renewed optimism around the artificial intelligence trade. It was a different story for the rest of the stock market. A version of the S&P 500 Index stripped of market-cap bias (the S&P 500 Equal Weighted Index) is eyeing its seventh consecutive weekly loss¹, a development witnessed only twice before, indicative of declining market breadth. Overseas markets struggled as foreign central banks turned mostly hawkish. U.S. Treasuries sold off as yields across maturities rose to the highest levels since 2002. Crude oil rallied over 30% during the quarter as U.S.-Iran hostilities escalated. Precious metals rose slightly, led by a 2.9% rally in gold².

Chipmakers, which were the best-performing equity cohort in the second quarter, were in a bear market (down more than 20% from prior highs) at one point in the third quarter before recovering to correction territory (down more than 10% but less than 20% from highs) to finish the period down 11.2%, per Philadelphia Semiconductor Index³. Concerns in the subsector are the impact of a potential slowdown in “Hyperscaler” CAPEX spending, renewed fears surrounding Artificial Intelligence in general, spurred by the major labs management teams. Additionally, rising bond yields may ostensibly hinder their ability to finance continued investment on data centers.

U.S. stocks showed weak market breadth, especially in September, with small caps lagging and only a handful of select stocks supporting the major indexes. By quarter-end, 40% of NYSE-listed stocks were trading below their 200-day moving averages. Even so, the index still managed to post positive returns for the quarter⁴.

The macro backdrop turned sharply hawkish as the Federal Reserve raised interest rates on Sept. 16th for the first time in more than three years and signaled more to come. The 10-year Treasury yield closed above 5.25% for the first time since 2007 while the 30-year yield hit its highest level since 2002⁵. Energy prices added to the pressure, with crude prices remaining elevated and U.S. diesel prices rising above \$6 a gallon as the Iran conflict entered its seventh month.

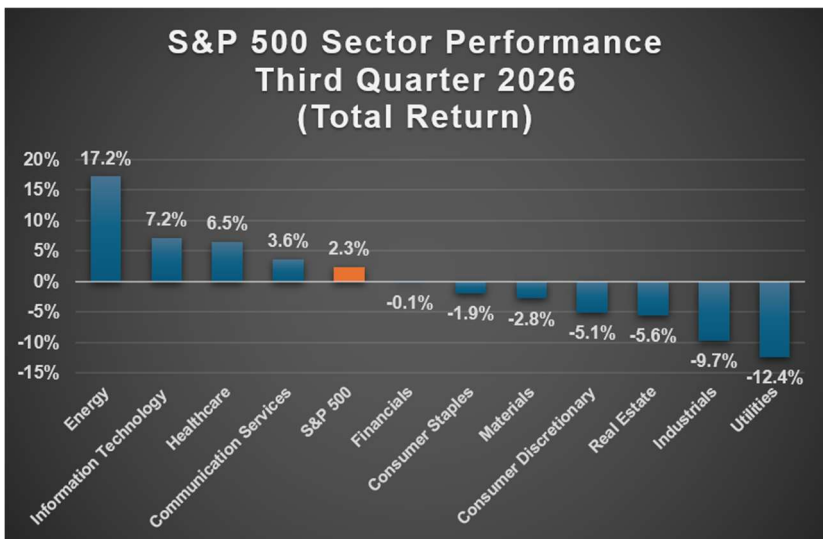


Figure 1 - S&P 500 Third Quarter 2026 Sector Performance (Total Return)

Westminster

FINANCIAL COMPANIES

Overall, in the third quarter the S&P 500 rose 2.3% and the NASDAQ Composite advanced 2.6%, while the Dow Jones Industrial Average, with its value and dividend tilt, declined 2.3%. International markets also advanced, although to a lesser extent given their greater sensitivity to elevated oil prices. The MSCI World ex-U.S. Index rose 1.0% on the quarter⁶.

On the sector front, Utilities, Industrials, and REITs took most of the heat during the quarter on rising long-term interest rates (down 12.4%, 9.7%, and 5.6%, respectively). Utilities posted their worst quarter since March 2020 after California introduced wildfire legislation in August that omitted measures backed by the Governor that would have shifted some insurance liabilities away from utilities. The best sectors were Energy, Technology, and Healthcare, up 17.2%, 7.2%, and 6.5%, respectively (Figure 1)⁷.

Decidedly, the main action was in the bond market. U.S. bonds suffered their worst quarterly decline in four years. The 10-year Treasury yield surged nearly 0.8 percentage point in Q3, its largest quarterly increase since 1994, ending September at a 24-year high. Interest rates moved higher as investors began to price in the risk of a hawkish Federal Reserve (the “Fed”), healthier economic growth, AI debt competing for capital with Treasuries, and the worsening Federal deficit. The most pronounced yield increases occurred in the intermediate and longer portions of the curve (10-30-year maturities), where prices declined the most relative to other maturities (Figure 2)⁸.



Figure 2 - The U.S. Treasury Curve at the Beginning and End of the Third Quarter

The Bloomberg U.S. Aggregate Bond Index, a broad proxy for the overall bond market, posted a -3.5% decline (total return) in the quarter. Treasuries with maturities 20 years out or further were down -9.0%. Corporate bonds underperformed Treasuries as spreads widened. Intermediate- and long-term corporate bonds returned -5.2% and -7.5%, respectively, compared with -4.6% and -7.1% for comparable Treasury maturities.⁹

Westminster

FINANCIAL COMPANIES

In sum, it was a volatile quarter for both stocks and bonds. Markets were rocked by a re-escalation of Middle East tensions, a rise in oil prices that increased headline inflation pressures, a record increase in interest rates, and fears about an AI capital spending slowdown. But, despite all these headwinds, equity markets still advanced, riding enthusiasm derived from very robust corporate profit expectations.

Third Quarter Outlook

The U.S. Economy

Business investment has been the year's dominant theme, supported by the One Big Beautiful Bill Act and AI-related capital expenditures, despite uncertainty surrounding the war with Iran. Consumer spending has also remained remarkably resilient. We expect these trends to continue in the fourth quarter and into the new year, with AI investment remaining a key driver of overall economic growth.

Following the Fed's 25-basis-point rate hike in September, markets are pricing in several additional increases over the next twelve months. The Fed may hike rates one more time in December or even just hold rates steady for the remainder of 2026 as data revisions lower measured inflation, in our view.

STRONG NEW ORDERS AND EQUITY MARKETS SUSTAIN U.S. GROWTH

The latest U.S. economic data point to solid fourth-quarter growth. September purchasing-manager surveys showed new orders for services near their highest level in more than three years (Figure-3¹⁰) with robust manufacturing activity exhibited too. Additionally, equity markets entered October at record highs, boosting the wealth effect. Together, these indicators suggest domestic demand continues to grow above trend despite inflationary pressures, geopolitical uncertainty, and higher interest rates.

The street consensus expects real GDP growth of 2.4% in 2026, exceeding the Fed's 1.8% estimate on longer-run growth. Resilient equipment spending, data-center construction, industrial production, and AI adoption signal a sustained business investment cycle. Meanwhile, elevated equity values support consumer spending through the wealth effect, while low layoffs underpin household income.

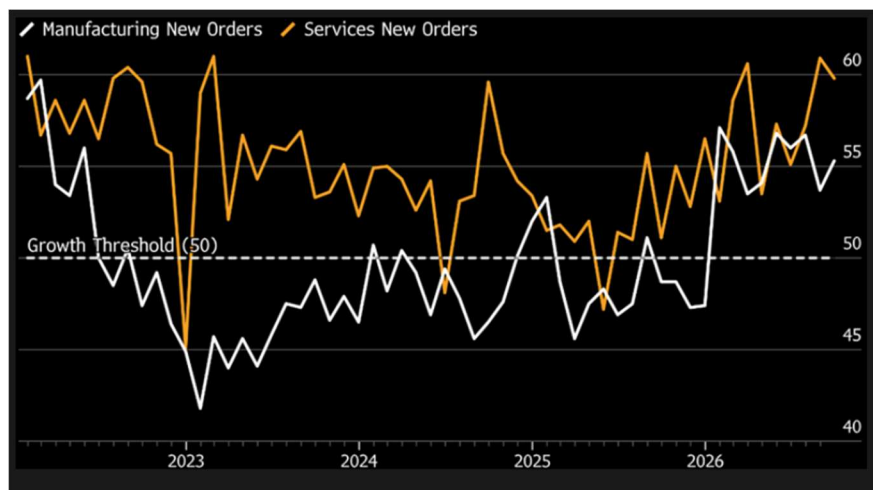


Figure 3 - Purchasing Managers Signal Continued Growth

Westminster

FINANCIAL COMPANIES

JOBS GROWTH COOLS IN SEPTEMBER

September non-farm payrolls rose by just 29,000, with downward revisions to prior months, falling well below an already subdued trend (Figure-4¹¹). Because net employment growth reflects hires minus separations, weak job gains alongside low separations point to a substantial slowdown in hiring. However, the reduction in jobs growth can largely be pinned on changes in immigration policy; dramatic changes to policy have seen fewer jobs created, but many of these forgone jobs were low paying high-turnover positions.

The labor market has therefore cooled primarily through fewer hires rather than more layoffs. This has kept unemployment relatively contained – at 4.2% in September – even as job seekers, career switchers, and new entrants find it harder to secure work. This creates a stable but fragile balance: low layoffs support employment, but subdued hiring leaves little cushion if demand weakens further or businesses begin cutting staff. Slower labor-force growth, driven by demographics and reduced immigration, also helps explain why modest payroll gains have not translated into a sharp rise in unemployment.

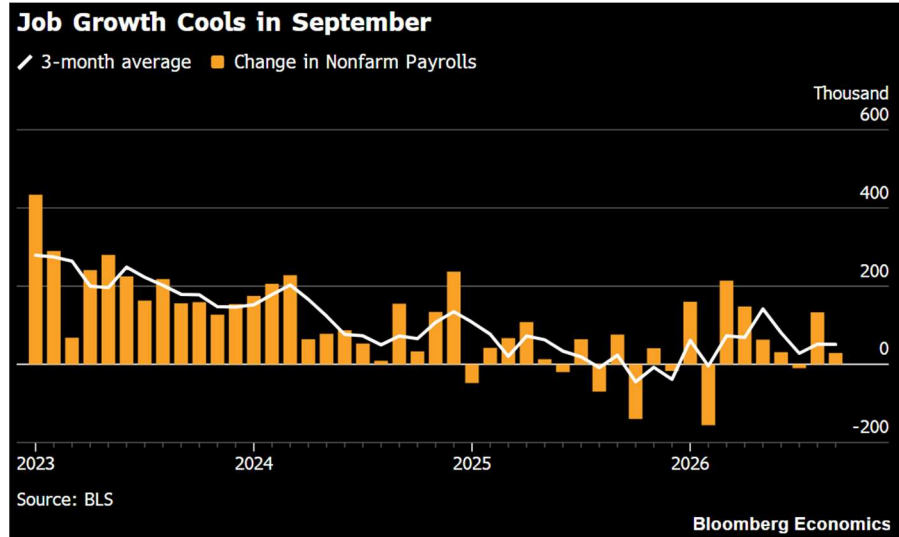


Figure 4 - The 3-month average of monthly job creation is trendless, albeit positive. This points to Goldilocks labor market.

The “low-hire, low-fire” economy persists, with payroll figures alone offering little clear evidence of either an AI-driven productivity surge or widespread job displacement.

HEADLINE INFLATION IS HOT, BUT CORE IS STABLE TO DECLINING

The Fed raised rates on September 16 after August’s CPI report showed firmer monthly inflation, reinforcing policymakers’ caution about declaring price pressures under control. Higher gasoline prices lifted headline CPI growth to 0.40% month over month from 0.07%, while core CPI increased 0.29%, up from 0.22%.



Figure 5 - Despite Hot Headline Inflation, Core Inflation Continues Trending Lower

Westminster

FINANCIAL COMPANIES

Annual headline inflation held at 3.4%, while core inflation (which excludes energy and food prices) eased to 2.4% - its lowest level since March 2021 (Figure-5¹²).

The subsequent PCE report, released September 30, offered some reassurance. Headline PCE inflation rose 0.3% in August, while core prices increased 0.2%, both above July's revised 0.1% readings. Annual headline and core PCE inflation stood at 3.4% and 3.0%, respectively¹³. Although inflation remains above the Fed's target, the relatively modest monthly core reading supports our view that policymakers have room to pause in October while assessing incoming data.

AI CAPEX GOES NEAR VERTICAL

The AI investment boom continues to strengthen the outlook for growth. According to Bank of America's Global Investment Strategy figures, the computers and peripheral equipment measure used as a proxy for AI hardware spending was projected to reach \$401 billion in Q2 2026, up from \$145 billion in Q3 2023 – a near-tripling in less than three years (Figure-6¹⁴)! This surge underscores the scale of the AI infrastructure buildout and supports demand across semiconductors, networking, power equipment, and data-center construction.

In our assessment, AI Hyperscalers' strong balance sheets and substantial operating cash

flows more than support their additional spending needs, for the time being. Access to bond markets gives these companies flexibility to finance infrastructure over time while preserving liquidity. In our view, this borrowing reflects the capacity to fund substantial growth opportunities, and the resulting investment should remain an important driver of economic activity and corporate earnings.

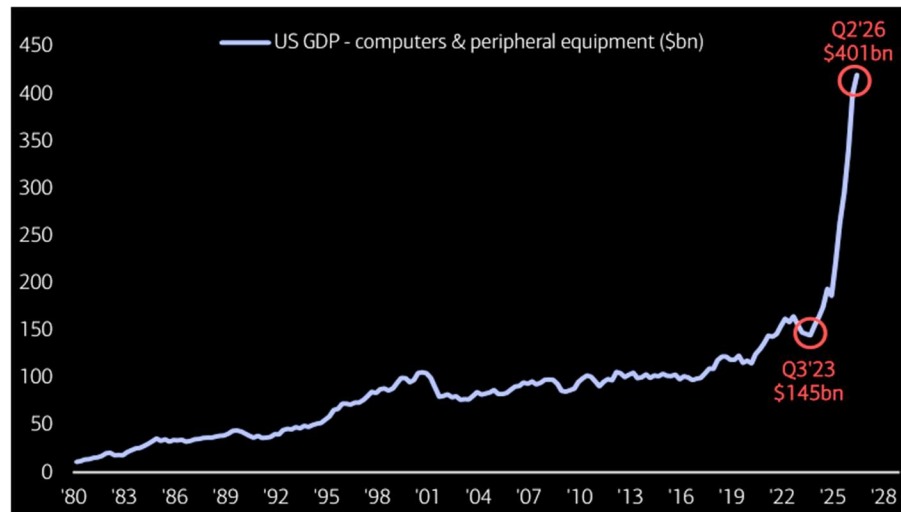


Figure 6 - One Example of How the AI Buildout is Propping Up the Economy

Westminster

FINANCIAL COMPANIES

The Equity Market - Still a Bull Market Driven by Robust Profits

MARKET BREADTH IS NARROW

The major averages do not reflect the extreme dispersion between different sectors and stocks. For example, at the time of writing and over the trailing 30 days, the only S&P sectors in the green are Technology and Energy - i.e. the two "AI Constraints." All other sectors declined with Healthcare down -3.5%, Consumer Discretionary -3.6%, Utilities -4.6%, Industrials -5.8%, Financials -7.7%, Materials -7.9% and REITs -9.8% (Figure-7¹⁵)

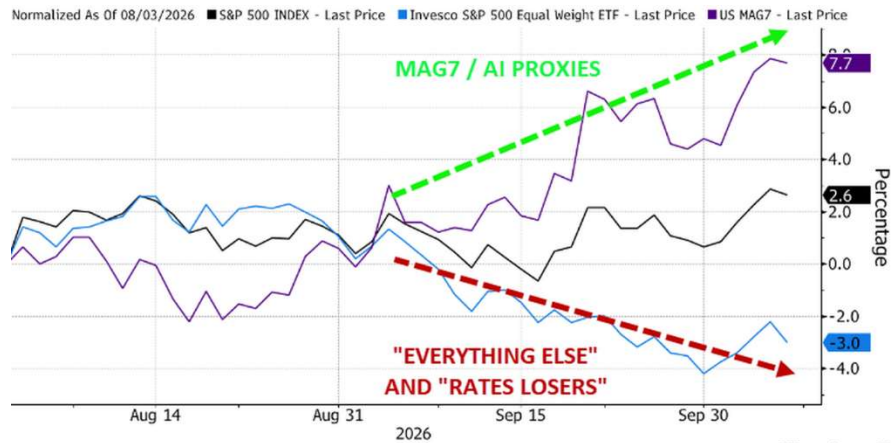


Figure 7 - Interest Rates Shock Is Ripping Through Different Corners of the Stock Market

Another way of illustrating the poor market breadth is the cumulative advance-decline line which tracks the running total of advancing stocks minus declining stocks and thus shows how broadly stocks are participating in a market move. The cumulative advance-decline line has dropped back to its spring lows, even as the S&P 500 holds near its all-time-highs (Figure-8¹⁶). That means more stocks are falling than rising, even if the index is holding steady.

As shown, it seems the market has priced in the rise in higher interest rates. In fact, 59% of the S&P 500 stocks are more than 20% below their all-time highs. Arguably, equities have already been undergoing a "rolling correction" of substantial proportions.

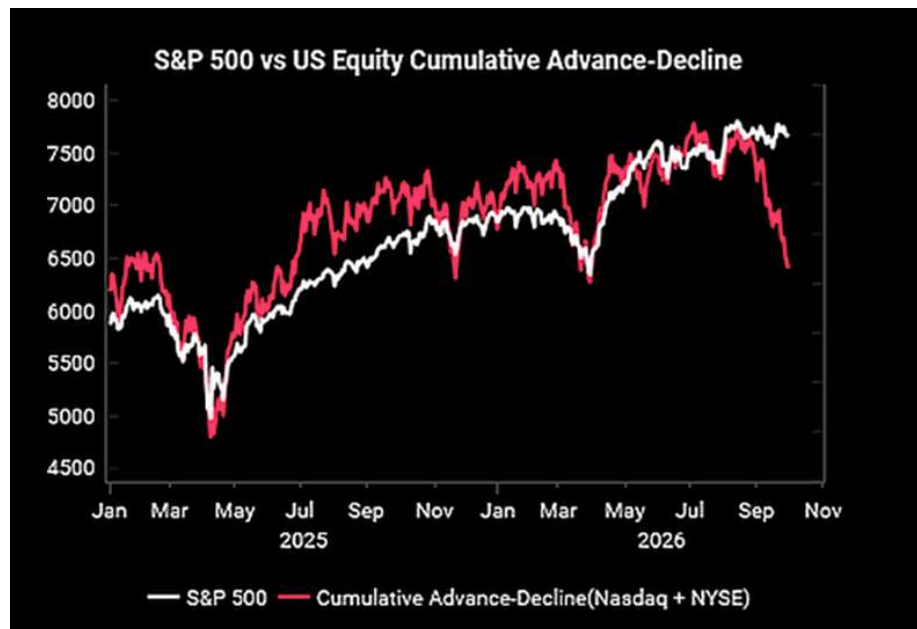


Figure 8 - Despite the Market is Near All-Time-High, There Are More Stocks Falling than Rising

Westminster

FINANCIAL COMPANIES

What does this mean for future returns? Is poor breadth an ominous sign for the major indices? Not necessarily: Bespoke Investment Group ran the numbers on forward returns when breadth measures were this poor. Historically, when the 10-day Advance/Decline

was negative and the S&P 500 was near an all-time high, forward returns tend to be stronger than normal. The next 12-month return for the S&P 500 averaged 14% and was positive 79% of the time (Figure-9¹⁷). Statistically, and based on historical precedent, this study suggests that returns have a good chance of being positive over the next year.

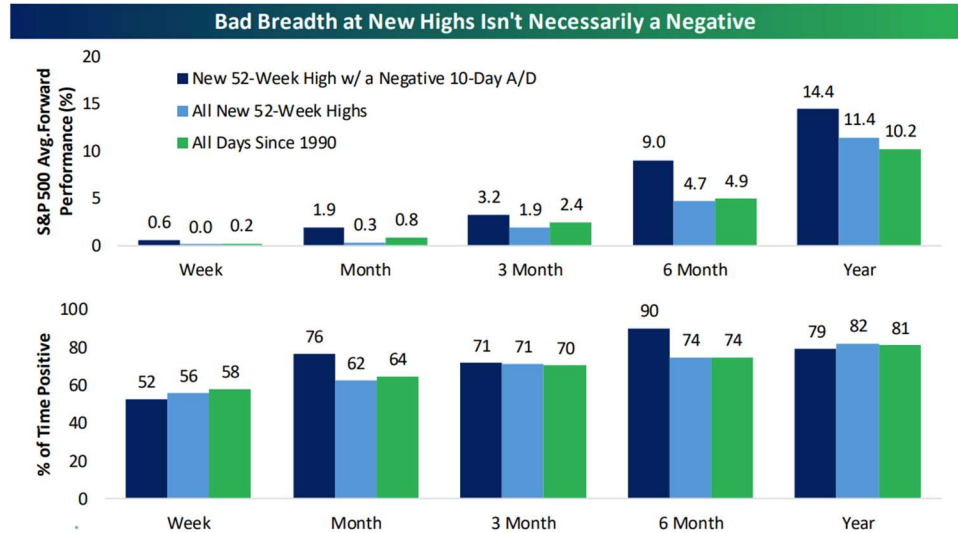


Figure 9 - Bad Market Breadth Is Historically NOT Ominous Sign for Equities

EARNINGS ARE SPECTACULAR. CAN IT BE SUSTAINED?

Second-quarter earnings per share (EPS) rose 33% year over year – a pace of growth rarely seen outside recession recoveries. Although profit growth typically follows a cycle, the current surge stands out. Figure 10¹⁸ illustrates this strength through the annual change in trailing 12-month EPS.

As third-quarter earnings season approaches, consensus forecasts call for 27% year-over-year growth. Companies benefiting from AI infrastructure spending are expected to account for more than half of the S&P 500's EPS growth this quarter, alongside a projected 116% increase in hyperscaler capital spend.

BCA Research's breakdown of trailing 12-month EPS growth by sector highlights how heavily the earnings expansion depends on AI-related industries – a pattern particularly pronounced outside the United States (Figure-11¹⁹).

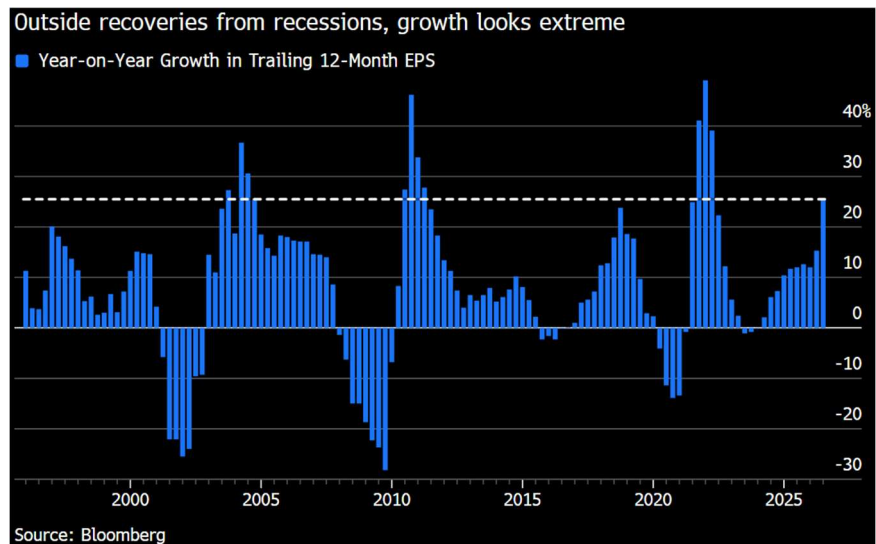


Figure 10 - Can This Pace Continue?

Westminster

FINANCIAL COMPANIES

Higher energy prices have also strengthened reported earnings growth. Oil producers benefit quickly from higher selling prices, while the costs to other businesses and consumers emerge more gradually and more dispersed across the economy. This timing has provided an additional near-term lift to aggregate earnings, with the broader drag yet to be fully realized.

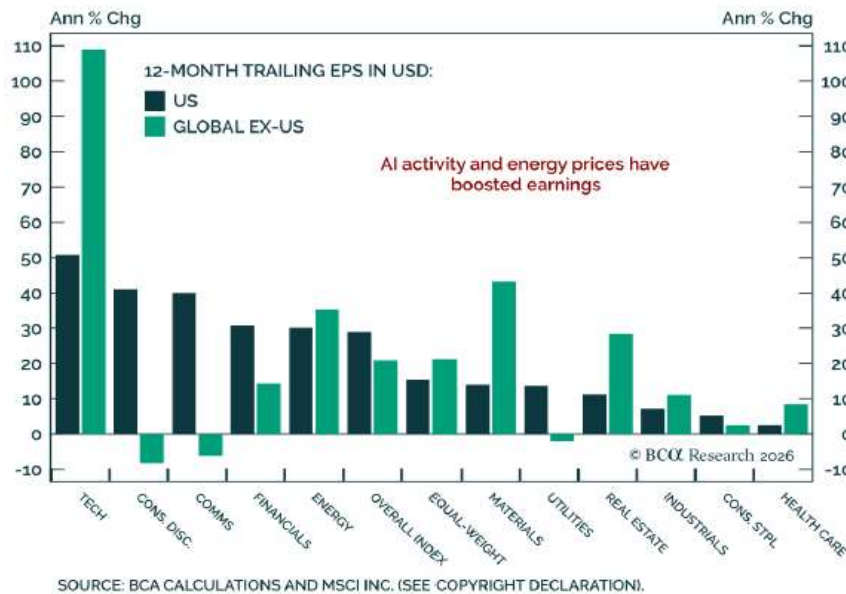


Figure 11 - Global Earnings Growth: An AI and Energy Story

Conclusion – Stay Invested and Add on Weakness for the Year-End Rally

Our message is concise: stay invested and use market weakness to add selectively to quality holdings. Resilient demand, strong earnings, and continued AI investment support our expectation of a year-end rally. The correction already underway in many individual stocks offers opportunities to diversify and add incrementally to portfolios at more attractive prices.

Seasonal and election-cycle patterns lend further support to this outlook. Midterm elections can serve as a clearing event for stocks, reducing uncertainty about control of Congress and allowing investors to refocus on earnings and economic fundamentals. Historically, the fourth quarter has tended to deliver positive returns, with an especially favorable record when the S&P 500 entered October with gains through September. While history offers no guarantees, these patterns strengthen the case for remaining invested heading into year-end.

Higher yields, narrow market leadership, and elevated energy costs can still produce volatility. We favor adding in stages to businesses with durable earnings, strong balance sheets, and reasonable valuations, while keeping allocations aligned with each client's objectives and risk tolerance. A year-end rally is our base case, but by no means a guarantee.

Uneven market performance also creates opportunities beyond the current leaders. We see value in identifying companies whose share prices have weakened while their profit prospects remain intact. Adding selectively to these businesses can broaden portfolio exposure and position investors to benefit if the rally extends to more sectors as the year draws to a close.

Westminster

FINANCIAL COMPANIES

Stay committed to the investment plan. Use pullbacks to build positions and remain allocated to participate in the next advance.

As always, please contact us with any questions or to discuss how these views may apply to your portfolio.

Respectfully,

The Westminster Financial Investment Policy Committee

Resources

- ¹ Bloomberg
- ² Returns through Bloomberg
- ³ Bloomberg
- ⁴ NYSE, and Bloomberg
- ⁵ Bloomberg
- ⁶ Figures are total return. Source: Bloomberg
- ⁷ WFA Charting through Bloomberg
- ⁸ WFA Charting through Bloomberg
- ⁹ U.S. Treasury and Bloomberg
- ¹⁰ Institute of Supply chain Management (ISM) and Bloomberg
- ¹¹ The U.S. Bureau of Labor Statistics (BLS) and Bloomberg
- ¹² The U.S. Bureau of Labor Statistics (BLS) and Bloomberg Economics
- ¹³ U.S. Bureau of Economic Analysis
- ¹⁴ Bank of America Global Research
- ¹⁵ Nomura Global Research, and Bloomberg
- ¹⁶ Variant Perception, NYSE, NASDAQ, and Standard & Poor's
- ¹⁷ Bespoke Investment Group
- ¹⁸ Bloomberg
- ¹⁹ BCA Research and MSCI Inc

Past performance is no guarantee of future results. Historical performance figures for the indices are for illustrative purposes only and are not indicative of any actual investment. Indices are unmanaged and an investor cannot invest directly in an index. The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, Westminster Financial Companies, Inc. is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code, or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Securities offered through Westminster Financial Securities, Inc. member FINRA/SIPC, 50 Chestnut Street, Suite A-200, Beavercreek, OH 45440. Investment Advisory services offered through Westminster Financial Advisory Corp., a subsidiary of Westminster Financial Companies, Inc.