Morgan Stanley

WEALTH MANAGEMENT

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The 3rd quarter of 2026 was a reminder of how quickly stock market relief can turn to risk. The rally that followed the Iran ceasefire proved to be fragile, and by the end of the summer the forces that had been quietly building underneath – energy prices, inflation, and a more hawkish Federal Reserve – had pushed back to the center of the picture. The Iran conflict was the clearest source of damage. Oil, which had retreated in the spring, rebounded sharply and by September crude was back hovering around $100 a barrel. There were commentators who had declared the war was largely behind us but later had to concede perhaps they were too optimistic. Commodity prices climbed across the board and energy stocks were among the few clear beneficiaries, which is hardly a comfort for an economy that has to pay those prices.

The inflation consequences followed predictably. Prices remained stubbornly high, and newcomer Fed Chair Kevin Warsh cautioned at their Jackson Hole retreat that underlying inflation was not slowing as they had hoped. The Fed raised the benchmark federal-funds interest rate by one-quarter of 1% (i.e., 25 basis points) in September as a result – the first Fed rate hike since 2023[i]. The hike was a unanimous decision amongst the Fed governors, which signals how seriously policymakers view the problem. It also nudged up its projections for core inflation going forward, which suggests the rate cuts that investors were hoping for (to help justify the stock market's lofty valuations) were going to be pushed out, and additional rate hikes might be in store.

Treasury Secretary Scott Bessent also made headlines during the quarter. On the heels of hotter inflation confirmation and the subsequent Fed hike, Bessent's role during the 3rd quarter was to talk down worries about our US bond market while the Treasury tried to hold yields in check – and for most part neither effort worked. In August, he surprised markets by announcing buybacks of long-dated Treasury bonds, saying the higher yields were out of line with "equilibrium" levels and didn't reflect the US economy's fundamentals[ii]. Critics called it a poor attempt to suppress yields artificially and noted that bond buybacks measured in mere billions are tiny against the size of the $40+ trillion treasury (debt) market.

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Bessent's tone grew more arrogant and, perhaps to some, more combative in the following weeks. He dismissed critics by saying that if "Bloomberg Terminal bros" (a backhanded insult to the Wall Street traders who rely heavily – often times obsessively – on Bloomberg Terminal computer systems for market data) were unhappy with what he was doing, "that's too bad." He also declared "I am the house now" and challenged bond bears to bet against him[iii]. The market and the "terminal bros" took him up on that and pushed yields even higher. The interest rate on the closely-watched 10-year Treasury bond jumped +0.83% since the end of the June – its steepest quarterly increase since 1994[iv] – to cross the psychologically-important 5% threshold. By early October, Bessent's tone had softened as he commented that "the house does not always win" and admitted, "I can't control the bond market.[v]" Outside of a brief moment in 2023, the last time the 10-year bond reached 5% was 2007, just before the global financial crisis roiled the stock market. The yield on 10-year Treasury bond remains above 5% as of this writing.

From a performance standpoint, domestic US stock markets finished mostly positive. The technology-heavy S&P 500 and Nasdaq Composite indexes each posted modest gains for the 3rd quarter, increasing +2.0% and +2.5%, respectively. This brings their year-to-date (YTD) returns up to +11.8% and +15.6%. Under the hood, it was a much calmer quarter than Q2 with the gains coming almost entirely from the usual suspects: a small group of popular mega-cap tech companies. The equal-weighted version of the S&P 500 lost -2.2% over the same period, which means the average stock in the index lost money for the quarter. This might be an ominous phenomenon that historical has happened at market extremes. On September 21st, the S&P 500 index rose more than +1% for the day to close within 1% of an all-time new high, yet there were more individual stocks in the index that hit new 52-week lows that day than stocks that hit new 52-week highs. The only two prior examples of this divergence between index-level strength and individual-stock weakness came in July 1929 (roughly two months before the Great Crash that followed the Roaring Twenties) and December 1999 (near the peak of the dot-com internet bubble)[vi]. Meanwhile, the Dow Jones Industrial Average, with much less in technology without nearly the same extreme levels of concentration, fell -2.7% bringing its return to +5.9% for the year[vii].

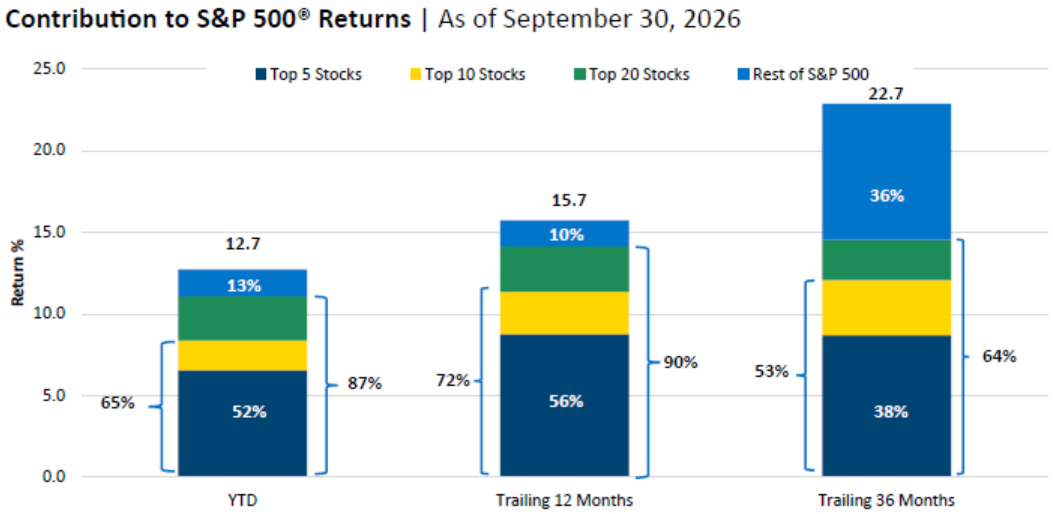
Overseas stocks were roughly flat during the quarter after a strong first half. Stock indexes in developed countries (as measured by the MSCI EAFE Index) gained +0.9% and are now up +10.4% YTD. Stock indexes in emerging countries (as measured by the MSCI Emerging Markets Index) slipped about -0.4% but are still up +23.4% for the year.[viii]

With the aforementioned inflation fears and interest rate hike during the quarter, fixed income had one of its most challenged quarters in years. Broadly speaking, core US bonds (as measured by the Bloomberg US Aggregate Index) lost -3.5% for the quarter, leaving it down -2.9% YTD. But there was a significant divergence between shorter-maturity bonds and longer-dated debt. Total returns fell the most for longer-term bonds, with the US Treasury 20+ Year index down -8.8% during the quarter. Municipal bonds (primarily known for their tax-free income) were also hit hard during the quarter. The Bloomberg Municipal Bond Index fell -6.4%, its worst quarterly showing in the last 45 years. Meanwhile, short-term and ultra-short bonds performed much, better providing the foundational ballast they're designed for. 1-3 Treasury bills earned nearly +1% during the quarter[ix]. The yield on the 10-year maturity bond climbed from roughly 4.4% at the end of June to about 5.3% by late September, its highest level since…you guessed it…2007 (there's that comparison again for those of you paying close attention).

Outside of traditional stock and bond markets, commodities and other hard assets rebounded strongly in the quarter. The broad commodity complex, as measured by the Bloomberg Commodity Index, gained +15.1% during the quarter and is now up +32.9% YTD. The surge higher was led by energy, as the Iranian ceasefire collapsed in July and supply disruptions returned. Brent oil prices rose about +33%, rose about +61% since the beginning of the year, and finished near $98/bbl after trading above $100 in September[x]. Those gains reversed the entire Q2 oil decline.

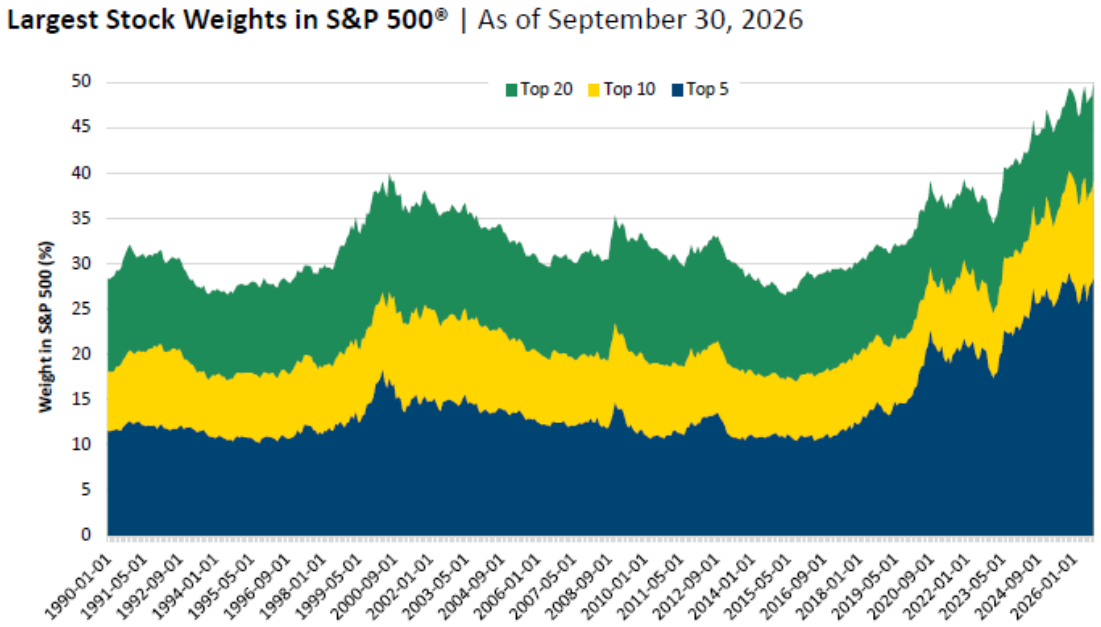
Both gold and silver rose during the quarter. Both metals gained about +4% during the quarter to close around $4,210/oz and $61/oz, respectively, helping to recover a small part of their Q2 losses. There is a simplistic assumption being followed in the US that higher interest rates hurt gold (and other metals), because gold pays no interest – making a 5% Treasury bond look better than a bar of metal. But that rule is incomplete, as there is a deeper argument to make that higher rates can be supportive of gold prices and other hard assets. The reason "why" rates are rising matters just as much. Are rates rising because overall economic growth is strong? Excluding the economic promises stemming from AI and the associated data center buildout, economic indicators suggest growth is tepid. Or are rates rising because investors are worrying about inflation and total government debt (now $40 trillion and still growing). A heavily indebted country facing higher interest rates pays far more in interest, which can widen deficits even further, devalue its currency, and raise fears of overall stability. Gold can be a classic hedge against those threats – supporting bullion prices and providing a boost to its mining companies.

US stocks have delivered strong returns in recent years, but beneath the headline performance of the S&P 500 lies mounting risks: the source of returns has become exceptionally concentrated in a select few individual stocks. These stocks are all technology stocks at the epicenter of the AI craze. Through the first nine months of 2026, just five (of 500) stocks accounted for 52% of the YTD gains, the top 10 accounted for 65%, and the top 20 accounted for 87%[xi].



Source: DoubleLine, Bloomberg

As of the end of the 3rd quarter, that kind of disproportionate performance left the five largest stocks representing 28% of the capitalization-weighted index, the top 10 representing 39% and the top 20% nearly half[xii]. These levels all exceed comparable periods that preceded the bursting of the previous market bubbles.



Distinguishing the number of individual stocks are participating in an overall market's movement is a technical analysis referred to as "market breadth." A strong and healthy market is characterized by a rising market, backed by a large majority of stocks and sectors moving higher together. This "tide lifts all boats" scenario suggests a durable trend. But narrow stock market breadth, like in today's market," is characterized by a rising market but with few individual stocks participating. This historically has been a warning that the market rally may be exhausted and vulnerable to a reversal.

Our team does not advocate for investors to get out of the market. But we are recommending investors carefully choose the type of investments to be involved in. There are lots of investment options outside of the US, and plenty of alternatives to technology stocks. Today, there are serious risks to being an index investor. When, not if, technology stocks, which account for 40-45% of the S&P 500 index, finally succumb to rea-world cash and profit analysis, the index is going to take a significant hit. There are plenty of other investments with more favorable prospects. They just don't have AI in their name. The market and AI stocks could continue to go up for some time, but not forever. We don't think this is the time to be a buy-and-hold investor in index funds. We are structuring client portfolios to be resistant to the potential drama resulting from a major drawdown in mainstream US stocks.

Our team is grateful for our relationship, and we thank you for the opportunity to be of service. Please do not hesitate to reach out to us with any questions. We're available to discuss and review anything on your mind any time.

Hope all is well,



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i CNBC.com: "Fed approves interest rate hike, signals one more to come this year" by Jeff Cox, 9/16/26
ii Bloomberg.com: "Bessent Has No Easy Fix for What's Really Driving Yields Up" by Greg Ritchie, 8/23/26
iii Yahoo Finance: "Scott Bessent dismisses 'Bloomberg Terminal bros as 10-year Treasury yield hits 4.94%" 9/12/26
iv The High-Tech Strategist: "Troubles Brewing in Bubble-Land" by Fred Hickey, 10/4/26
v NY Times: "Rebuked by Bond Market, Bessent Says 'House' Does Not Always Win: by Alan Rappeport 10/4/26
vi WealthProfessional.ca: "Thirty S&P 500 stocks hit new lows as the index rose 1.49%" by Freschia Gonzales 9/22/26
vii All domestic equity returns courtesy of Morgan Stanley Capital Markets Research
viii All international equity returns courtesy of Morgan Stanley Capital Markets Research
ix All fixed income index returns courtesy of Morgan Stanley Capital Markets Research
x JP Morgan Guide to the Markets 4Q 2026
xi DoubleLine Investments: "Diversifying US Equity Exposure in a Concentrated Market" By Eric Dhall, Oct 2026
xii DoubleLine Investments: "Diversifying US Equity Exposure in a Concentrated Market" By Eric Dhall, Oct 2026

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Equity securities may fluctuate in response to news on companies, industries, markets conditions and general economic environment.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive to it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

A basis point is defined as one hundredth of one percent (1%), used chiefly in expressing differences of interest rates.

An investment cannot be made directly in a market index. For index and indicator definitions referenced in this report please visit the following: https://www.morganstanley.com/wealth-investmentsolutions/wmir-defnitions

Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

International investing may not be appropriate for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, the absence of adequate financial information, and exchange control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

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Because of their narrow focus, sector investments tend to be more volatile than investments that diversify across many sectors and companies.

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