



JAMES

INVESTMENT RESEARCH, INC.

ECONOMIC
OUTLOOK

2026

4th Quarter Outlook

An Indepth Forecast
of the Year 2026

jamesinvestment.com

In This Report

Executive Summary 2

The Economy and
Business Cycle 2

Federal Reserve 5

Equity Outlook 5

Fixed Income Outlook 7

Conclusions 9

For Investors 10

The James Investment Research Team



Brian Culpepper, CKA
*President & CEO
Portfolio Manager*



Fall Ainina, Ph.D., CFA
*Director of Research
Vice President*



Brian Shepardson, CFA
*Vice President
Portfolio Manager*



Trent D. Dysert, CFA
*Associate Director of Research
Portfolio Manager*



Thomas L. Mangan, MBA
Research Consultant



Mackenzie Blair
Junior Analyst

Executive Summary

We enter the fourth quarter cautiously optimistic about risk assets, with the U.S. economy firmly in the middle of its cycle. Growth is strong, corporate profits are exceptional, and our JIR Business Cycle Composite shows no major red flags for the coming quarter. The same strength, combined with an oil shock, has revived inflation and pushed the Federal Reserve (Fed) to raise rates for the first time in three years. That shift sets the tone for every asset class.

The economy is expanding on several fronts. Production and manufacturing have improved over the past three to six months, the labor market remains healthy, and consumer spending continues to accelerate even as sentiment sits near an all-time low. Housing is the clear exception and remains the weakest part of the cycle. Third-quarter real gross domestic product (GDP) is tracking near 3.7% annualized, supported by consumer demand and heavy investment in artificial intelligence.

Inflation is once again the central concern. Headline Consumer Price Index (CPI) rose 3.4% from a year earlier in August, driven largely by energy, with Brent crude currently trading at \$98 a barrel amid renewed conflict involving Iran. Core inflation has eased, but it remains above the Fed's 2% goal. The Fed raised its target range to 3.75%–4.00% in September and has signaled that further increases remain under consideration.

In equities, earnings remain the market's main support. FactSet expects S&P 500 earnings to rise 29.1% in the third quarter, and the forward price-to-earnings (P/E) ratio has fallen to 19.2 as profit estimates outpaced prices. With the 10-year Treasury yield above 5%, however, stocks must deliver more to justify their risk. We favor quality Technology and Communication Services leaders, selected refiners, Industrials tied to rising power demand, and broader equal-weight exposure, while remaining cautious on indebted small companies, Utilities, and other rate-sensitive areas.

In fixed income, the yield curve has flattened as short-term yields rose faster than long-term yields. We favor floating-rate and short-duration exposure, which benefits from higher short-term rates while limiting price risk, and continue to see value in investment-grade corporate bonds for their income. We are more cautious on the intermediate Treasury curve and on high-yield credit, where tight spreads leave little cushion.

The fourth quarter calls for balance rather than bold bets. The direction of oil prices, the next inflation reports, and the Fed's decisions in October and December will determine whether this environment persists or begins to change.

The Economy and Business Cycle

The economy is best described as mid-cycle, and growth remains strong. Our Business Cycle Composite is comfortably in expansion territory and has trended higher since the start of the year. Looking back, we found numerous points in time when the economy looked similar to today. That history argues against a dramatic move in either direction over the next quarter, and most of those periods were followed by moderate growth over the subsequent year.

Production and Manufacturing

Our Production and Manufacturing Cycle Indicator is in a healthy state and has improved over the past several months. A majority of the broad-based indicators are accelerating, while a few industry-specific indicators have weakened. The indicator remains below its level of 12 months ago, but it is showing strength and stability.

The strength is focused within new orders for core capital goods, business inventories, and total manufacturing orders, which are among the healthiest signals in the group. Durable goods orders and factory capacity use have also improved in recent months, suggesting the firmness is broadening rather than narrowing. The ISM Manufacturing PMI (Purchasing Managers' Index) stood at 54.6 in August, its eighth straight month of expansion.

Commercial and industrial lending, mining, and chemicals production remain weak spots and continue to weigh on the overall reading. There is a notable split beneath the surface as durable goods orders and factory capacity pull in one direction while sub-industries such as chemicals and mining are pulling the other way. Divergences like this are common during transitional periods of a cycle. Taken together, factory output, orders, and business inventories point to healthy production, and trends in retail sales and AI spending should continue to support it in the coming quarter.

Labor Market

Our Labor Market Cycle Indicator sits squarely in its mid-cycle reading, signaling strong and accelerating growth over the past year. The strength is concentrated in goods-producing jobs, total payroll employment, and temporary-help staffing. Nonfarm payrolls rose 162,000 in August against a 53,000 consensus, and June and July figures were revised up by a combined 55,000. Unemployment stood at 4.1% in August, according to the U.S. Bureau of Labor Statistics.

A few indicators warrant attention. The average duration of unemployment, the rate of workers quitting their jobs has declined (indicating a fear in the hunt for new jobs), and wage growth remains modest. Headline inflation of 3.4% continues to outpace wage growth of 3.1%, eroding purchasing power.

The labor market's strength should also be read against a labor force that has contracted over the past year on lower immigration and rising retirements, which has kept the break-even pace of job growth low. On balance, the labor market enters the final quarter expanding rather than signaling weakness.

Retail and Consumer Health

Our Retail and Consumer Indicator remains the strongest of our business cycle measures, and its components show remarkably little disagreement. No single indicator in this group is signaling weakness. The strongest indicators within our composite come from restaurant and bar sales, retail sales, and consumer goods. Retail sales rose 1.2% in August, well above the 0.8% consensus, reversing a downwardly revised 0.5% decline in July. Restaurant and bar sales rose 2.5% in July from June and 6.1% from a year earlier, the largest annual increase since September 2025. Real consumer spending is tracking at a 4.1% growth rate.

The gap between what consumers say and what they spend is currently large as spending remains strong yet sentiment low. In fact, the University of Michigan Consumer Sentiment survey sits near an all-time low, and the divergence has persisted long enough that sentiment has lost some of its value as an indicator. If spending begins to reflect sentiment, that would be a cause for concern.

The consumer remains the strongest component among our Business Cycle Composite. However, it should be

noted that historically when it reaches the broad strength seen today, it has been followed by slower growth but remains positive. We would not be surprised to see modest mean reversion in the coming quarters.

Housing

Housing remains the weakest area among our Business Cycle Composite, despite some improvement since the start of the year. The weakest components are housing starts, new homes under construction, and household appliance production. Starts fell 2.6% in August and permits declined 2.1%, with the 30-year mortgage rate rising to 7.23%. Financing costs remain a constraint on demand and builder production, and the Fed's hawkish turn raises the risk that mortgage rates stay elevated longer. New homes under construction have declined 6.6% from a year earlier and household appliance production is down 6.0%, and both have fallen steadily since August 2025.

Home prices have been relatively stable this year, but the Case-Shiller U.S. National Home Price Index remains elevated. Prices have now risen from a year earlier for 38 consecutive months, according to the National Association of Realtors, straining affordability. In many historical periods resembling today, our housing indicator deteriorated further.

Financial Conditions

Financial conditions have tightened materially over the past several months compared with the more accommodative backdrop investors anticipated at the beginning of the year. Persistent inflation, resilient economic activity, and a more hawkish Federal Reserve have shifted market expectations and the expected path for short-term interest rates. Markets have increasingly priced in additional rate increases, and the Fed has shifted from easing concerns to ensuring that financial conditions are restrictive enough to return inflation toward 2%. The updated dot plot points to a further 0.25% rate hike by the end of the year and additional hikes in early 2027. This is the opposite of the easing path the consumer would need as it impacts financing for rate sensitive segments of the market such as auto sales and big-ticket items.

A noticeable change has occurred in the bond market. Treasury yields have risen sharply, increasing borrowing costs for households, businesses, and governments.

Recently, the 10-year U.S. Treasury yield moved towards 5.25% and to levels not seen in decades. Higher benchmark yields have pushed mortgage rates above 7% and raised the cost of corporate financing. The spread of the 10-Year U.S. Treasury and the 2-Year U.S. Treasury has narrowed from the start of the year and is worth monitoring, given the history and predictive power for forecasting recessions.

Growth, AI, and Inflation

Growth has remained strong even as energy prices have climbed. The Atlanta Fed's GDPNow model estimates third-quarter real GDP growth at about 3.7% annualized, up from 1.5% in the second quarter. Nominal GDP has grown about 6.3% over the past year. S&P Global's flash composite PMI rose to 58.4 in September from 56.0 in August, its highest reading since July 2021, with the services index at 58.7 and the manufacturing index at a four-year high. The flash composite PMI is an early monthly survey of purchasing managers that gauges business activity, with a reading above 50 signaling expansion.

Investment in artificial intelligence is adding materially to demand. Spending on data centers, power infrastructure, and computing capacity has surged, and some policymakers have noted that it arrives at a time when the economy is already growing at a solid pace. If demand continues to expand faster than the economy's capacity to produce, inflation could prove persistent even if energy prices stabilize.

Inflation remains above the Fed's 2% target. The CPI rose 0.4% in August, its largest monthly gain in three months, and 3.4% from a year earlier. Energy is the main driver. Renewed fighting involving Iran has pushed Brent crude to \$98 a barrel. Gasoline prices are up 27.4% from a year ago and accounted for more than a third of August's monthly increase, heating oil has risen 52%, and diesel has climbed to record levels.

Underlying inflation presents a more mixed picture. Core CPI, which excludes food and energy, eased to 2.4%, its lowest level since March 2021. Core PCE, the Fed's preferred measure, remains elevated at 3.0%, however, and non-housing services inflation accelerated in August.



Beyond energy, three forces are keeping prices elevated: housing costs, which adjust slowly; rising wages in labor-intensive services such as health care and insurance; and AI investment, which is lifting demand for power, construction, and skilled labor. The key question for policymakers is whether higher fuel costs spread into transportation, air travel, and other services.

The Federal Reserve

The Fed raised its benchmark interest rate by 25 basis points (or 0.25%) in September, its first increase in three years, bringing the target range to 3.75%–4.00%. Prior to the increase, the federal funds rate had remained at 3.50%–3.75% throughout 2026. Fed Chair Kevin Warsh noted that inflation remains above the Fed Committee's objective, and policymakers' projections indicate that additional rate increases remain under consideration.

Attention has now shifted to the timing of any further policy actions. The Fed's next meeting is scheduled for late October, while its final meeting of the year will take place in December. While the Fed may prefer not to alter rates right before the midterm elections, it has done so before. Market participants continue to assess incoming economic data and Fed communications for clues regarding the path of interest rates.

The timing of future moves remains uncertain, and the Fed's recent actions and commentary suggest that inflation remains a primary focus. As a result, interest rates could remain elevated or move modestly higher if inflation pressures prove more persistent than expected.

Equity Outlook

We are cautiously optimistic about U.S. stocks heading into the fourth quarter. Earnings growth is exceptional and valuations have eased, but rising inflation, a Fed that has resumed tightening, and a 10-year Treasury yield above 5% leave little room for disappointment. When a safe government bond pays that much, stocks have to deliver more to be worth their extra risk. For that reason, we prefer to be selective rather than rely on a handful of the largest companies. We favor businesses that can raise

prices without losing customers, hold their profit margins steady, carry manageable debt, and withstand a longer period of high rates and energy costs.

Earnings Remain the Market's Main Support

A strong economy is translating into strong profits, although how much reaches the bottom line depends on margins, wages, materials, and borrowing costs. According to FactSet, third-quarter earnings for the S&P 500 are expected to rise 29.1% from a year earlier, up from a 26.7% forecast at the end of June. If that holds, it will be the third straight quarter of earnings growth above 25% and the eighth straight above 10%. FactSet also expects revenue to grow 12.1%.

Earnings forecasts are moving higher, which is unusual. Analysts normally lower their estimates as a quarter progresses, with average cuts of 2.2% over the past five years and 2.5% over the past ten. This quarter, they instead raised their third-quarter earnings-per-share estimate by 1.3%, to \$89.76 from \$88.64. Companies are equally upbeat. Of the 116 S&P 500 companies that issued third-quarter guidance, 72 set it above analysts' expectations. That 62% share compares with a five-year average of 41% and a ten-year average of 42%.

Expectations for the fourth quarter are also high. FactSet data show analysts expect fourth-quarter earnings to grow 26.8% and revenue 11.9%, with full-year 2026 earnings up 32.0%. FactSet estimates a third-quarter net profit margin of 15.0%, the second highest since it began tracking the measure in 2009 and well above the five-year average of 12.4%.

The bar is high, and it rests heavily on one sector. Technology companies account for 44 of the 72 companies, or 61%, that issued upbeat third-quarter guidance. With Treasury yields elevated, even a modest earnings miss or signs of slower AI spending could weigh heavily on the major indexes.

Valuations Have Eased, but Stocks Are Not Cheap

The S&P 500 has become less expensive relative to expected earnings even as the index has risen. According to FactSet, the forward P/E (price divided by the earnings analysts expect over the next 12 months) fell to 19.2 from 20.4 at the end of June, below its five-year average of 19.8

and slightly above its ten-year average of 19.0. Since June 30, forward earnings estimates have increased 8.9% while the index has risen 2.7%. The recent gain has therefore come entirely from higher expected profits, leaving the market less dependent on rising valuations but more dependent on companies actually delivering.

The trailing P/E, which is the price divided by the earnings reported over the past 12 months, tells a different story. At 25.8, it sits above both its five-year average of 24.4 and its ten-year average of 23.6, so stocks are not cheap by every measure. Higher long-term yields have also erased the extra return investors normally expect for owning stocks. The equity risk premium, which compares the S&P 500's earnings yield with Treasury yields, has turned negative, according to Bloomberg, a condition that last persisted in the late 1990s. Strong profits have kept it from falling as deeply as it did in 1999, before the dot-com bubble burst.

That alone is not a reason for alarm. A 30-year Treasury yield near 5.5% has historically coincided with strong growth and rising stock prices. The risk lies in what could change: slower earnings growth, a sharp reversal in AI-related stocks, or wider credit spreads. Persistently high long-term rates can also raise the odds of a recession or of rising defaults if the economy weakens.

Analysts remain unusually optimistic. Buy ratings make up 59.9% of all recommendations on S&P 500 stocks, which would be the highest month-end reading since at least 2010. FactSet's bottom-up 12-month target for the S&P 500 is 9,275.04, about 20.4% above the September 24 close of 7,704.13. That optimism carries its own risk, because

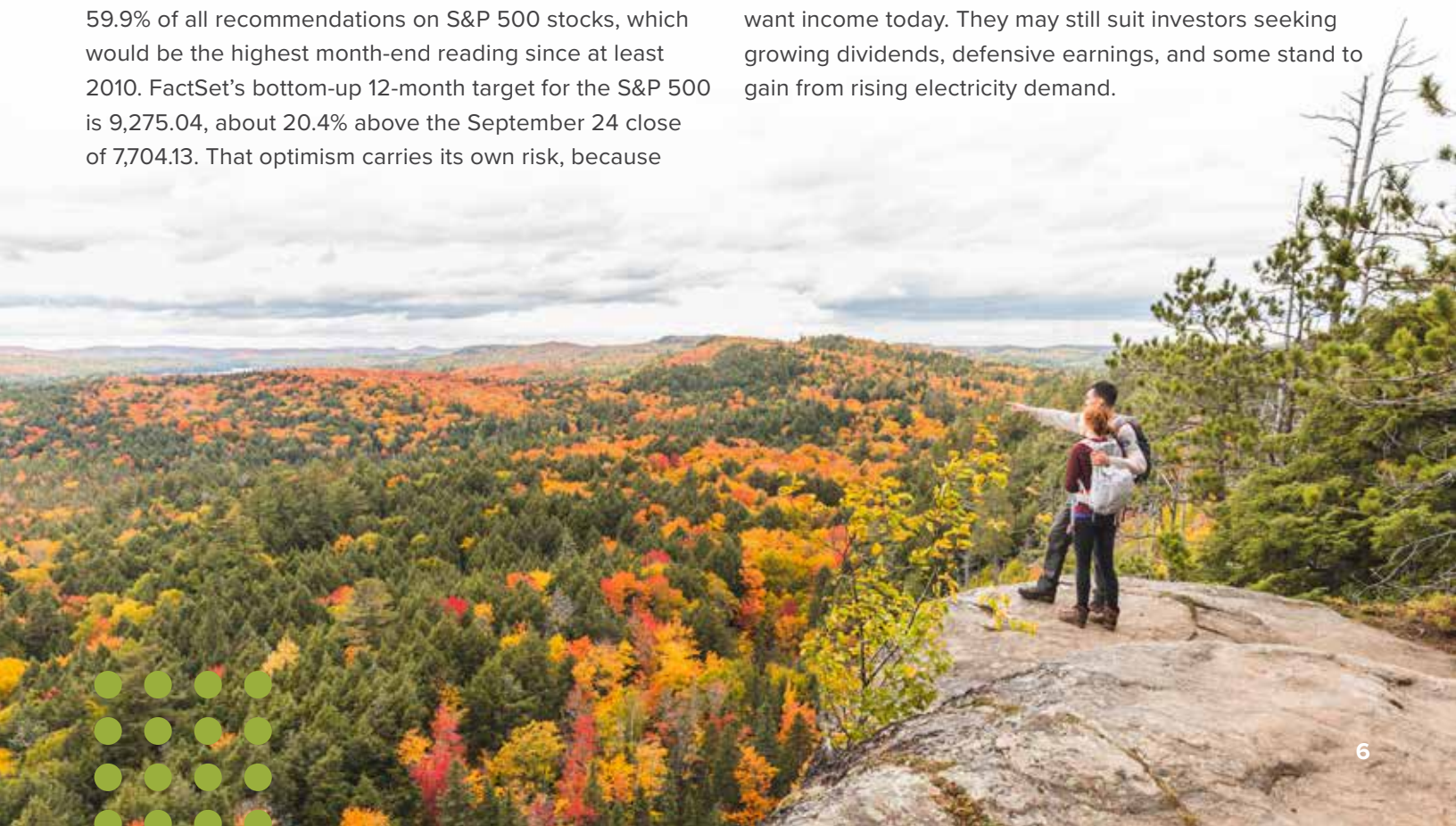
current forecasts depend on unusually high margins holding up. If energy and, especially, diesel costs keep rising, margins could come under pressure, particularly at energy-intensive and transportation-dependent businesses, and analysts could lower their earnings forecasts and price targets.

Where Higher Rates Hurt Most

Higher bond yields give investors an attractive alternative to stocks. Pension funds and other investors that target a fixed mix of stocks and bonds may sell stocks to restore that mix after the drop in bond prices, while more flexible investors may shift money toward bonds that now pay more. The size of those flows is difficult to predict.

Smaller companies tend to feel higher rates first. They usually have less financial flexibility, refinance their debt more often, and rely more heavily on floating-rate bank loans that reprice as soon as the Fed tightens. Long stretches of high oil prices have also tended to hurt small-company stocks, because expensive oil raises business costs, squeezes household budgets, and makes borrowing harder.

Utilities face a different problem. The sector's dividend yield is now well below what a 10-year Treasury pays, which makes Utilities less appealing to investors who want income today. They may still suit investors seeking growing dividends, defensive earnings, and some stand to gain from rising electricity demand.



The Next Chapter of the AI Story

Artificial intelligence continues to drive heavy investment, and its benefits are beginning to reach beyond the companies that build chips, data centers, and large computing systems. Amazon, Alphabet, Meta, and Microsoft, the four largest cloud providers, are expected to spend a combined \$721 billion this year, nearly double the \$376 billion they spent in 2025, according to Bloomberg. Some investors worry that spending has gone too far. Bank of America's September fund manager survey found that those who believe companies are overinvesting outnumbered those who believe they are underinvesting by 33 percentage points.

If this spending keeps growing, even at a slower pace, the next opportunity may shift toward companies that use AI to become more productive, price better, and operate more efficiently. Financial, industrial, health care, and energy businesses could benefit. How much, and how soon, will depend on the cost of deployment, the quality of their data, regulation, and whether competition forces them to pass savings on to customers.

Electricity is one clear example. Estimates based on International Energy Agency data indicate that power use at AI-focused data centers rose about 50% in 2025, and the U.S. Energy Information Administration expects total U.S. power demand to reach record levels in 2026 and 2027. That creates potential opportunities in power generation, transmission, grid equipment, natural gas infrastructure, and nuclear power. Individual utilities face distinct regulatory, financing, and interest-rate risks, so selection matters.

Where We See Opportunities

We favor high-quality Technology and Communication Services leaders with dependable earnings and clear payoffs from their AI investments. According to FactSet, analysts expect third-quarter earnings growth of 63.5% for Information Technology, led by a 126% gain in semiconductors, and 51.3% for Communication Services, with 70% of analyst ratings on both sectors at Buy. With Technology trading at 21.6 times forward earnings, below its five-year average of 25.6, we are concentrating on the largest AI suppliers already turning that spending into revenue, before growth in AI capital spending peaks and slows toward 2027.

We also favor selected energy companies, particularly refiners, as a partial hedge against inflation and oil supply disruptions. Conflict in the Middle East, Russian refinery outages, and an acute distillate shortage have tightened global fuel markets and pushed refining margins to record highs. Within industrials, we prefer companies tied to rising power demand.

Beyond targeted sector positions, we see value in broadening exposure as earnings growth extends past the largest technology names. The S&P 500 Equal Weight Index holds the same companies as the S&P 500 but resets each to an equal 0.2% weight every quarter. After the internet bubble peaked in March 2000, equal-weighted U.S. stocks outperformed the traditional index for a long stretch as gains spread more widely. Part of that result came from greater exposure to smaller value companies and regular rebalancing, not only from broader participation. A similar broadening could favor equal weight over longer periods, although that outcome is not guaranteed.

Fixed Income Outlook

The environment for bond investors has become more challenging. The Fed has resumed raising rates, yields have moved sharply higher, the yield curve has flattened, and credit spreads remain tight. We favor floating-rate and short-duration exposure alongside investment-grade corporate bonds, and we are more cautious on the intermediate Treasury curve and high-yield credit.

A Bear-Flattening Yield Curve

Treasury yields have moved higher in recent months as investors adjust to the possibility of additional Fed rate increases. Shorter-term yields have risen more rapidly than longer-term yields (a bear-flattening yield curve), reflecting their greater sensitivity to changes in monetary policy. The 2-year Treasury yield reached approximately 4.88% during the week, its highest level in two years, while the 10-year Treasury yield traded above 5%, briefly reaching its highest level since 2007.

Because short-term rates have risen faster than long-term rates, the difference between the two has narrowed considerably. The spread between the 2-year and 10-

year Treasury yields is currently around 40 basis points, compared with a historical average closer to 80 to 100 basis points.

The shape of the yield curve will continue to be influenced by expectations for Federal Reserve policy and the outlook for economic growth and inflation. If investors anticipate additional rate increases, shorter-term yields could remain under upward pressure relative to longer-term rates.

Favor Floating-Rate and Short-Duration Exposure

With short-term rates moving higher, shorter-maturity and floating-rate investments can limit the impact of rising rates on bond prices while allowing investors to capture higher income. Three areas are particularly relevant:

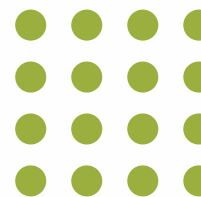
- Floating-rate notes. Coupons on these securities reset with short-term interest rates, allowing income to increase as rates move higher while generally limiting price volatility. Treasury floating-rate notes, which reset weekly based on the 13-week Treasury bill rate, provide this exposure without taking on credit risk.

- Treasury bills and money market instruments. Their short maturities allow investors to reinvest proceeds as securities mature, potentially at higher prevailing rates. Short-term yields are currently near 4%.
- Short-duration bond portfolios. Portfolios with shorter maturities generally have less sensitivity to changes in interest rates, which can help reduce the potential impact of rising yields on bond prices.

Within the Treasury curve, we are maintaining a more cautious approach to the 5-year segment. This part of the curve is particularly sensitive to shifts in Fed expectations, and shorter-duration exposure currently offers a more measured way to manage interest-rate risk.

Credit: Attractive Yields, Limited Cushion

Corporate credit spreads remain relatively tight. Investment-grade corporate bonds yield approximately 5.97%, representing a spread of 0.84% over Treasuries, compared with a long-term average of about 1.5%. High-yield spreads are currently 3.02%, also below their 20-year average of roughly 4.9%.



Corporate issuance has been particularly heavy in 2026, with new issuance exceeding \$1.5 trillion. Much of this activity has been related to capital spending on artificial intelligence and other infrastructure. The increased supply has provided investors with a steady amount of new bonds to consider and has helped meet strong demand for corporate credit.

Even with relatively tight spreads, corporate bonds continue to offer higher yields than comparable Treasuries, with overall yields at some of their most attractive levels in many years. With the economy growing at a solid pace, default rates have remained a relatively limited concern in the near term. At the same time, the narrow spread between corporate bonds and Treasuries leaves less room for spreads to absorb a deterioration in economic or credit conditions.

We continue to see value in investment-grade corporate bonds for their additional income, while taking a more measured approach to high-yield securities given their relatively narrow credit spreads.

Factors That Could Change the Outlook

Several developments could lead to a different interest-rate and credit environment than the one currently described:

- A decline in energy prices. A resolution of the Iran conflict, which the administration has suggested could follow the November midterm elections, could lead to lower oil prices and reduce some of the recent pressure on inflation and interest rates.
- A faster-than-expected economic slowdown. The combination of higher interest rates and elevated energy costs could weigh on consumer spending and economic growth. In that environment, the yield curve could move from flattening toward inversion, while longer-duration bonds could become more attractive.
- A change in the pace of AI investment. A slowdown in spending on AI infrastructure could reduce some of the current support for economic growth and corporate bond issuance. It could also put additional pressure on credit spreads, particularly in sectors with greater exposure to AI-related investment.

- Margin pressure from energy costs. If diesel and other fuel costs keep rising, margins at energy-intensive and transportation-dependent businesses could narrow, prompting analysts to cut earnings forecasts from today's elevated levels.

Conclusion

The economy is mid-cycle and expanding, with strength in production, employment, and consumer spending offsetting a weak housing market. That same strength, together with higher energy prices and heavy AI investment, has revived inflation and pushed the Fed back toward tightening. Financial conditions are becoming more restrictive as a result, which argues for discipline over bold positioning.

In equities, we look to earnings growth, not rising valuations, to drive returns. Technology and Communication Services remain central to our positioning, supported by exceptional earnings momentum, with Technology trading below its five-year average valuation. We complement them with selected refiners as an inflation hedge, Industrials tied to rising power demand, and equal-weight exposure to reduce reliance on the largest names. We remain cautious on small companies carrying heavy debt, Utilities whose dividend yields trail Treasuries, and other rate-sensitive areas.

In fixed income, floating-rate and short-duration investments offer flexibility as short-term rates rise, and investment-grade corporate bonds continue to provide attractive income relative to Treasuries. We are more measured on the 5-year Treasury segment and on high yield, where tight spreads leave little room for surprises.

Across asset classes, our aim is to own businesses and securities that can withstand a longer period of elevated rates and energy costs. We will watch oil, the next inflation readings, and the Fed's year-end decisions closely for signs that the environment is beginning to turn.

FOR INVESTORS Q4 2026

EQUITIES

- Favor businesses that can raise prices, hold margins, and carry manageable debt, since a Federal Reserve that has resumed tightening and a 10-year Treasury yield above 5% leave little room for disappointment.
- Look to earnings rather than rising valuations to drive returns, with FactSet projecting S&P 500 earnings growth of 29.1% in the third quarter and 26.8% in the fourth.
- Keep Technology and Communication Services at the core of positioning, where FactSet expects third-quarter earnings growth of 63.5% and 51.3%, respectively.
- Use selected Energy names, particularly refiners, as a partial hedge against inflation and supply disruption, with Middle East conflict, Russian refinery outages, and an acute distillate shortage pushing refining margins to record highs.
- Broaden exposure through the S&P 500 Equal Weight Index as earnings growth extends beyond the largest technology names, reducing reliance on a narrow group of mega-cap leaders.
- Remain cautious on indebted small caps, which refinance more often, lean on floating-rate bank loans that reprice as the Fed tightens, and have historically struggled through long stretches of elevated oil prices.
- Treat Utilities selectively rather than as income vehicles, since the sector's dividend yield now sits well below the 10-year Treasury, while recognizing that some names stand to gain from rising electricity demand.

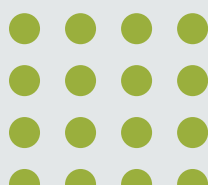
FIXED INCOME

- Favor floating-rate and short-duration exposure as the yield curve bear-flattens, with the 2-year Treasury yield near 4.88%, its highest in two years, and the 2-year to 10-year spread compressed to around 40 basis points against a historical average of 80 to 100.
- Use Treasury floating-rate notes, which reset weekly off the 13-week bill rate, alongside Treasury bills and money market instruments yielding near 4%, to capture rising income without adding credit risk or meaningful price risk.

- Maintain a cautious stance on the intermediate Treasury curve, particularly the 5-year segment, which remains the most sensitive to shifting expectations for further Fed increases.
- Continue to hold investment-grade corporates for income, with yields near 5.97%, even though a spread of 0.84 percentage points over Treasuries, about half the long-term average of 1.5%, leaves a limited cushion.
- Take a measured approach to high yield, where spreads of 3.02 percentage points sit well below the 20-year average of roughly 4.9 and offer little compensation for any deterioration in credit conditions.
- Watch issuance alongside fundamentals, since new corporate supply has exceeded \$1.5 trillion in 2026 on AI and infrastructure spending, and a slowdown in that investment could pressure spreads in the most exposed sectors.

POTENTIAL RISKS TO THE MARKETS

- Persistent inflation could force further tightening, since headline CPI rose 3.4% from a year earlier in August and core PCE remains at 3.0% with Brent around \$98 a barrel.
- A Federal Reserve that has resumed hiking, having lifted its target range to 3.75%-4.00% in September for the first increase in three years, has left additional increases under consideration at its October and December meetings.
- Energy costs threaten margins that FactSet estimates at 15.0% for the third quarter, the second highest since 2009, as gasoline up 27.4%, heating oil up 52%, and diesel at record levels weigh on energy-intensive and transportation-dependent businesses.
- A negative equity risk premium, a condition last sustained in the late 1990s, leaves stocks less compensated for risk and exposed to rebalancing flows toward higher-yielding bonds.
- Analyst optimism leaves room for downward revisions, with Buy ratings at 59.9% of recommendations, the highest month-end reading since at least 2010.
- A faster-than-expected slowdown could follow if higher rates and energy costs catch up with consumers whose sentiment already sits near an all-time low, while housing weakens further with starts down 2.6% in August and the 30-year mortgage rate at 7.23%.



Disclosure

This information is of a general nature and does not constitute financial advice. It does not take into account your individual financial situation, objectives or needs, and should not be relied upon as a substitute for financial or other professional advice to assess, among other things, whether any such information is appropriate for you and/or applicable to your particular circumstances. In addition, this does not constitute an offer to sell, or the solicitation of an offer to buy, any financial product, service or program. The information contained herein is based on public information we believe to be reliable, but its accuracy is not guaranteed.

Investing involves risks, including loss of principal. Past performance is no guarantee of future results.

Artificial Intelligence tools assisted in data gathering, summarization, and editing of this commentary. All views and conclusions are those of James Investment Research, Inc. and have been reviewed by our investment team.

Definitions

*Basis Point: one hundredth of one percent, used chiefly in expressing differences of interest rates.

*Case-Shiller U.S. National Home Price Index: A widely followed gauge of U.S. residential home price changes, based on repeat sales of single-family homes.

*Consumer Price Index (CPI): A widely followed measure of U.S. inflation, tracking the change in prices consumers pay for a basket of goods and services.

*GDPNow: The Atlanta Fed's running estimate of current-quarter U.S. GDP growth, updated as new economic data is released.

*Growth: A company stock that tends to increase in capital value rather than yield high income.

*Price-to-Earnings (P/E) Ratio: A valuation measure comparing a stock's price to its earnings per share.

*The Purchasing Managers' Index (PMI) is an indicator of the prevailing direction of economic trends in the manufacturing and service sectors. The indicator is compiled and released monthly by the Institute for Supply Management (ISM), a nonprofit supply management organization.

*Value: A value stock is a security trading at a lower price than what the company's performance may otherwise indicate.

****Indexes are not managed. One cannot invest directly in an index.**



JAMES

INVESTMENT RESEARCH, INC.

