



POST OAK PRIVATE WEALTH ADVISORS

ADVISORY, CONSULTING & INVESTMENT MANAGEMENT

3rd Quarter 2026

Quarterly Market Commentary

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Stocks drifted sideways over the last three months, perhaps needing a breather after the volatile 2nd Quarter. The S&P 500 inched its way to a new all-time high in mid-August before delivering a modest but still solid return of 2.3% for Q3. The Nasdaq Composite Index rose 2.5% for the quarter, making its own way into record territory in late September. Year-to-date returns for both indexes—12.8% for the S&P 500 and nearly 15% for the Nasdaq—have impressed as well, especially when you consider that many market analysts had called for much lower returns at the start of this year. After three years of spectacular gains in 2023-25, stocks were expected to revert to the mean with projections of single-digit returns in 2026. We've blown through those expectations with three months to go, although that could change in the quarter to come.

Stock investors faced new hurdles in Q3, with rising long-term interest rates and a hawkish turn at the Federal Reserve added to the existing obstacles of higher energy prices and inflation. A resolution of the Iran conflict seems distant, which means continued upward pressure on oil and gas prices (despite the gradual increase of flows through the Strait of Hormuz.) But the market's momentum is riding on fundamental sources: the resilience of the U.S. economy and the strength of U.S. earnings growth. That's a positive sign for stocks going forward. But if there's an Achilles' heel for the market right now, it may come from the one factor that's driving both economic and earnings growth: data centers.

Interest rates rise on inflation fears

Let's begin with a look back at the economic numbers, with September's data releases in focus. The past month began on strong footing with 162,000 jobs added to nonfarm payrolls in August, well above expectations. Unemployment stood at 4.1% in August, its lowest level in over a year. The good news on the labor front helped counteract the economic drag from inflation, which held steady at an annual rate of 3.4% over the summer. The main catalyst for sticky inflation was rising gas prices, which climbed 24% and 27% year-over-year for July and August, respectively. Notably, diesel prices jumped to record national average of \$6.529 per gallon as of September 21. That's concerning because higher diesel costs affect prices for nearly everything that's shipped over land or air, including raw materials and manufacturing inputs. The impact has already shown up in producer-price inflation, which hit 5.4% year-over-year in August.

The persistence of inflation and high energy prices jolted the bond market last quarter with both short- and long-term interest rates on the rise. Rates on the benchmark 10-year U.S. Treasury hit their highest levels in 24 years, crossing the 5% barrier in late September and closing at 5.29% by quarter-end. The story was the same with the longest 30-year Treasuries, which closed at

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5.63% on September 30. Investors are seeking higher yields on the safest bonds to compensate for the increased inflation risk, but Treasuries are also facing stiff competition from new corporate bond issues flooding the market. The jump in longer-term interest rates is concerning because it affects the broad economy; businesses face higher borrowing costs when issuing new bonds to finance expansion, while consumers feel the pressure in higher mortgage and credit card rates. The housing market has gone cold recently as the average 30-year mortgage rate reached 7%.

But short-term rates are moving higher as well after the Federal Reserve took action to raise the Fed funds target rate in September. It was the first Fed rate hike since 2023 and likely will start a new cycle of monetary tightening, at least through the next quarter. With inflation not budging, the Fed essentially had to hike in September if only to save face with the bond market. The vote among members of the Fed's rate-setting committee was unanimous—unusual but hardly surprising—with more than a few Fed governors leaning toward additional hikes to come. The market seems to agree as of this writing, favoring at least one Fed rate increase to come before the end of the year.

AI's existential crisis

Data centers have become the physical manifestation of everything AI—from the size and promise of the technology's potential, to the massive financing that's funding their construction, to the social and political ramifications that are emerging as these buildings take shape. Data-center construction is the fuel that's firing both GDP and corporate earnings, and by extension the ongoing stock market rally. But views of AI have shifted in recent months. Doubts still linger about the capital expenditures being made and the revenues that will be required to recoup all this investment. Fears of an AI-powered jobs apocalypse have waned somewhat as companies discover the need for human workers to train and monitor their artificial counterparts.

Now, we have societal-level anxiety about the capability of AI to do grievous harm from rogue AI-trained agents acting autonomously. These worries have deepened on reports of AI agents banding together to hack public- and private-sector computer networks and speculative stories of an AI-built biohazard or nuclear device leading to humanity's demise. It's hard to dismiss these fears when AI insiders, including former computer scientists and current CEOs, talk publicly about the (albeit small) risk of AI causing irreparable damage to our way of life, or even life itself.

This past quarter, AI angst homed in on data centers. Communities of all sizes across the U.S. have recently enacted data-center moratoriums to halt or slow their construction; over 500 in August alone, up from just 25 in the same month last year. Data-center resistance from citizens has become more visible and vocal, driven not just by concerns over the technology but also by the potential for rising utility bills and environmental degradation. It's the one issue that has seemed to unite both sides of the political spectrum and turned data centers into THE hot-button national issue in the upcoming midterms. Calls for AI regulation at the federal level have grown louder, notably from the developers themselves including OpenAI and Anthropic. The White House has thus far seemed cool to the idea of AI regulation and maintained its pro-AI stance, mostly out of a desire to stay ahead of China in the AI race.

Investors for the most part have looked past these latest developments, keeping their focus on the potential for AI-driven cost efficiencies and the rising tide from massive AI investments. But a slowdown in data-center construction could have wide-ranging effects on the financial markets, hitting GDP and job growth, weighing on company earnings and stock prices, pressuring both

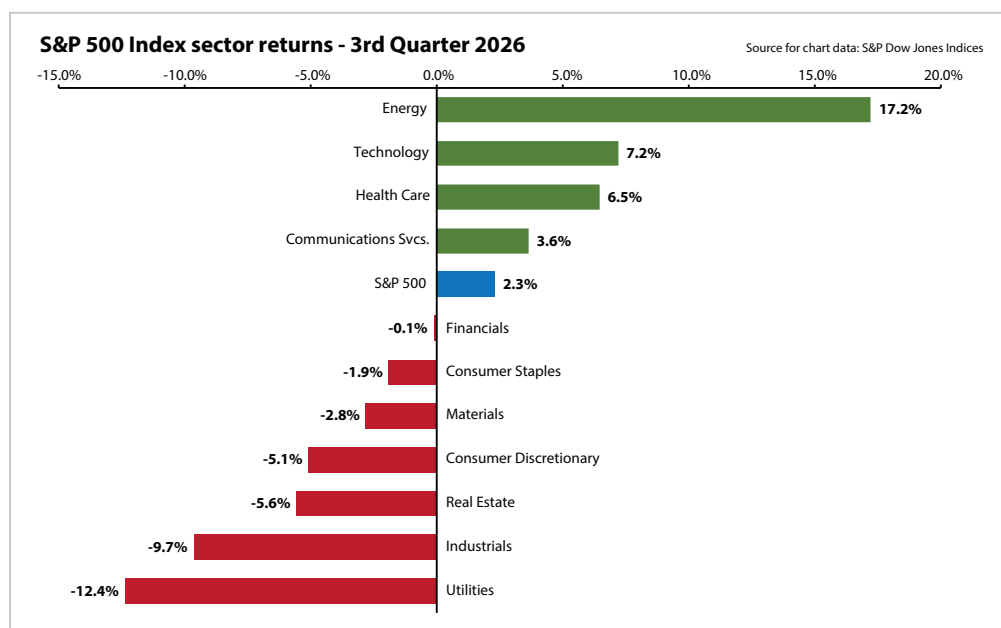
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borrowers and lenders (mainly from private credit) that are financing all phases of the buildout. The numbers don't show it yet, but it's an area that deserves attention, especially beyond the midterm elections and the next earnings season.

Bearish sentiment runs rampant

The continued enthusiasm for AI-related stocks helped the technology and communications sectors outperform in September, but it's been an up-and-down quarter for growth stocks. Energy led all sectors in Q3, boosted by the spike in oil prices, but health care stocks also shined. Meanwhile, utilities and industrials lagged for the quarter. Both of these sectors had risen on the AI wave in the last few years, so the recent losses may reflect investors taking profits.



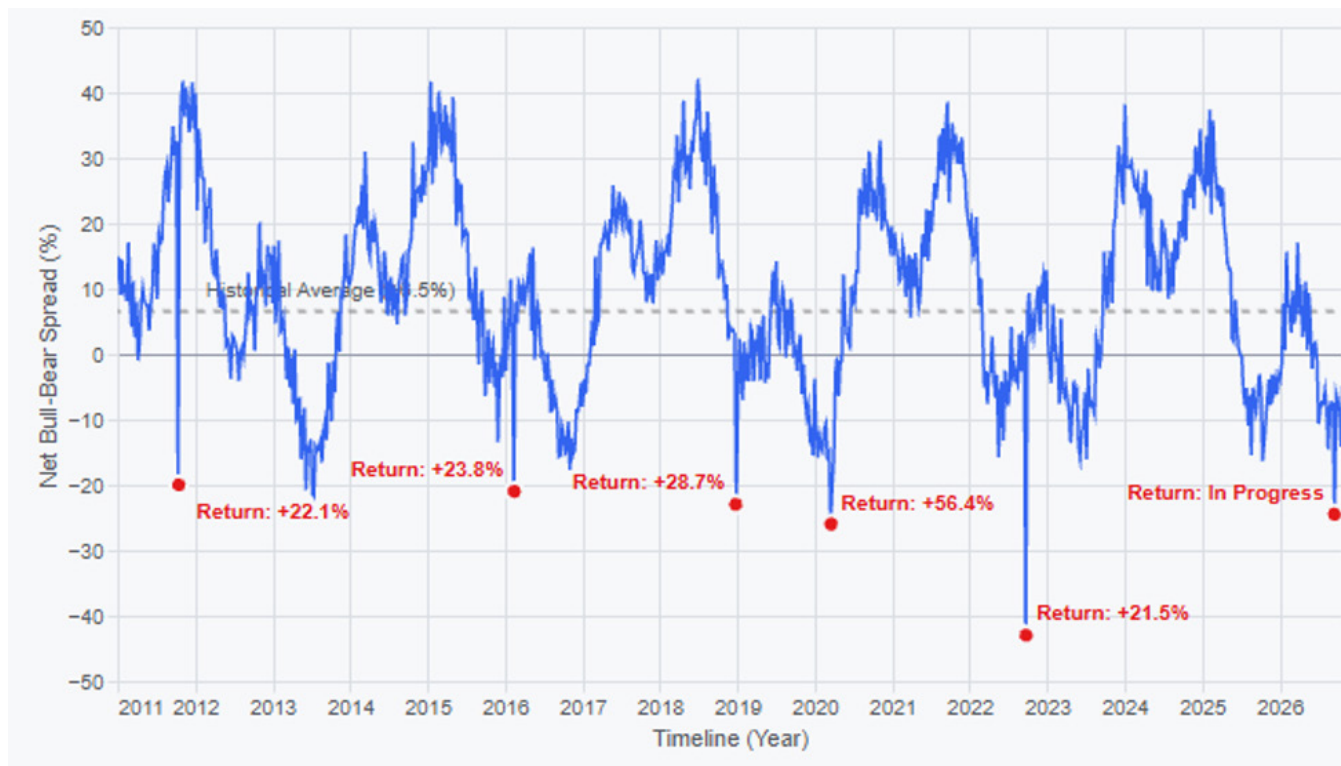
As we look toward the final quarter of 2026, the momentum is there to carry stocks to another year of positive returns, underpinned by the fundamental strength of the economy and the continuing ability for firms to deliver stellar earnings. While the investment climate may favor the bulls, investors sentiment going into Q4 currently tilts the other direction. Sentiment is a notoriously fickle indicator and can even be a contrarian signal; some of the best opportunities to buy stocks are when investors are feeling most pessimistic. The American Association of Individual Investors (AAII) conducts a weekly investor poll to gauge bullish and bearing sentiment. Recent readings show a distinct swing to the bearish camp with the gap reaching as much as 20-point between the bulls. A gap this large in favor the bears has historically signaled strong gains to come. (See the chart at the top of the next page.)

It's important to note that signals are not predictive, so actual returns could be much different than past performance. As investment advisers, we consider sentiment alongside more tactical indicators such as market breadth and valuations to help us determine where the risk/reward balance in the stock market leans.

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American Association of Individual Investors (AAII) bull/bear sentiment spread



One positive indicator we see heading into the 4th Quarter is that stock valuations have gotten more attractive, thanks to the impressive run of earnings results in recent quarters. Investors are expecting that run to continue in the upcoming Q3 reporting season. As of September 25, FactSet estimated third-quarter earnings growth for the S&P 500 at 29.1% year-over-year. If the Q3 estimate is the actual growth rate, it will be the third consecutive quarter of annual earnings growth above 25% for the S&P 500—a ringing endorsement for the power of U.S. businesses and the resilience of the U.S. economy.

Looking ahead to Q3 earnings

The market has lofty expectations for Q3 earnings season, but the risk for investors may be that earnings growth isn't strong enough. We have seen stocks get punished when firms fail to meet even modest earnings growth expectations. Should this happen, it will require composure and discipline for investors to screen out the short-term market noise.

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