



TRAPHAGEN
CPAs & WEALTH ADVISORS

Q3 2026: RATES RISE, AI MARCHES ON, AND THE MARKET NARROWS

Third Quarter 2026 • July – September 30, 2026

The third quarter of 2026 was a tale of two markets. On the surface, the major stock indices posted modest gains, and the S&P 500 set a new all-time high in mid-August. Beneath the surface, however, the quarter was far more challenging. The fragile US-Iran memorandum of understanding broke down in early July, oil prices climbed roughly 29% and appear likely to stay higher for longer, long-term Treasury yields surged to their highest levels in roughly two decades, and on September 16 the Federal Reserve raised interest rates for the first time since July 2023. The AI trade continued to drive the market higher, but with sharp swings and a growing challenge from low-cost open-source models. Meanwhile, the most rate-sensitive areas of the market — utilities, bonds, housing, and consumer stocks — endured a difficult quarter. Traphagen portfolios navigated these crosscurrents with the benefit of short-duration bonds, floating-rate private credit/cat bonds, and energy infrastructure, while our alternative/private exposure once again provided stability. This newsletter provides our in-depth review of Q3 2026, our analysis of the four key themes that shaped the quarter, and an update on portfolio positioning as we enter the final quarter of the year and look ahead to 2027.

Economic & Market Update

The third quarter of 2026 opened with cautious optimism that the June 17 US-Iran memorandum of understanding (MOU) would hold. That optimism proved short-lived. In early July, Iran was accused of attacking three commercial vessels in the Strait of Hormuz; the US responded on July 8 with a series of strikes and revoked a 60-day waiver on Iranian oil sanctions, effectively fracturing the MOU. Since then, oil has remained elevated in the \$85 to \$105 range; a drag/tax on the global economy certainly, but not at levels which, in our opinion, would trigger a material stock drawdown or a recession. The impacts of rapidly rising long term interest rates and especially the continued historic AI buildout have been the main drivers of both the economy and stock market in the quarter.

The S&P 500 gained approximately + 2.0% for Q3 2026, bringing its year-to-date total return to roughly + 13%. The index reached a new all-time high near 7,800 on August 13 before pulling back into quarter-end. However, the headline numbers masked significant weakness underneath: the Dow fell approximately - 2.7%, small caps (Russell 2000) dropped roughly - 7.5%, **and in September three out of every four S&P 500 stocks were down.** With the ten largest companies now representing roughly 40% of the S&P 500, the market has become increasingly narrow in breath. This 'narrowing' of the stock market we think is due to both a resurgence of the 'Mag7' in addition to rising interest rates having more of an impact on smaller and mid-sized non-technology/non-AI stocks. Utilities, consumer staples, financials, consumer discretionary, public real estate, housing, and any other interest rates sensitive stocks had a rough period in September as the 10-Year Treasury Note jumped a full 0.5%.

Fixed income had its most difficult quarter in some time. The 10-year Treasury yield, which started the quarter at 4.4% rose to 5.3%, its highest level in roughly two decades. The 30-year bond yield climbed to 5.6%, its highest level since 2004. The US Bond Aggregate (AGG) lost roughly 3% for the quarter. On the other hand, our private credit suite continued its steady outperformance, with all our holdings delivering returns between + 1.7% and + 2.6% for the same period with minimal volatility, a favorable contrast to most public bonds, and a further benefit as rising base rates increase the income on floating-rate private credit loans.

Stock Sector Performance: YTD 2026 (Through September 2026)

Sector	2026 YTD	Key Drivers of performance
Energy	+ 40.2%	Iran War (Oil Near \$100), AI Power Demand, Good valuations
Technology	+ 37.4%	AI Infrastructure/Semiconductors, Mega-Cap Concentration
Industrials	+ 8.7%	AI Infrastructure, Defense, Reshoring; Q3 Rate Pressure
Healthcare	+ 7.4%	Defensive Earnings, Reasonable Valuations
Materials	+ 7.0%	Commodity Prices, Reshoring; Sharp September Decline
Consumer Staples	+ 3.4%	Higher Rates and Input/Fuel Costs / Brand Power Erosion
Real Estate	+ 0.8%	Higher Long-Term Rates, Mortgage Rates Near 7.3%
Financials	- 2.4%	Bond Portfolio Pressure, Weak Housing/Loan Demand
Communication Serv.	- 6.6%	AI Disruption Fears, Heavy AI Spending
Utilities	- 7.1%	Surging Bond Yields ('Bond Proxy'), Higher Financing Costs, Longer Term AI Beneficiary
Consumer Discretionary	- 8.9%	Gasoline Above \$4, High Mortgage Rates, Weak Consumer Confidence

Bond Market Insights

After a relatively benign second quarter, bonds came under significant pressure in Q3. Three forces combined to push yields sharply higher: the renewed surge in oil prices revived fears of an inflation re-acceleration, a hawkish Warsh-led Federal Reserve delivered its first rate hike since 2023, and investors around the world demanded greater compensation to own long-term government debt in an environment of persistent inflation and heavy government borrowing. The result was a global bond selloff that pushed the 10-year Treasury yield from roughly 4.4% to 5.3% and the 30-year yield to 5.6%. Notably, the yield curve steepened (long-term rates rose more than short-term rates) which is exactly the environment in which long-duration bonds suffer the most.

The US Bond Aggregate (AGG) lost roughly 3% for the quarter, erasing its modest first-half gain and leaving it down approximately 3% year-to-date. Long-duration Treasuries fared considerably worse. Our AAA/A rated corporate and securitized loan positions (JAAA, JSI) again proved their value — with near-zero interest rate sensitivity, their floating-rate coupons reset higher as short-term rates rose, and they now offer current yields in the 5.4%–5.9% range. Our option-writing Treasury ETF (TLTW)

was not immune to the rise in long-term rates given its long-duration underlying bonds, but its much higher yield from base bond income and option premiums cushioned a meaningful portion of the decline. Although straight long-term Treasuries are down more than 8% on the year (including income), TLTW is down only 5% with meaningfully more income yet to come this year.

As long-term Treasuries (and bonds in general) continue to climb we are gradually becoming more enticed by them as a viable investment. If rates remain at current levels or go up further, we might be adding exposure here (especially with TLTW). This security is currently yielding around 10% with no credit risk and declining interest rate risk. The return math on long term Treasuries is getting more compelling. If rates go up 1% over a year period the return on a long Treasury would be roughly - 6.4% (not good, but reasonable for a 'bad' outcome). On the other hand, if rates go down by 1%, the return would be about 17.5%. That would be an exceptional return for a default/credit risk free security, especially compared to the downside. This asymmetric return is what could make us add exposure here in the future while taking some profits on our private credit or catastrophe bond allocations.

Private credit is predominantly floating rate, so the Fed's September hike directly increases the income these loans generate, while their value has essentially no sensitivity to the long-term bond selloff. As stated previously, all our private credit funds had solid positive returns in the quarter. **Since 2021, most high-quality Treasuries and public investment grade corporate bonds are still showing negative returns while our private credit suite (in aggregate) is up roughly 60%.**

This backdrop of an incredible performance advantage for private credit vs. public 'high quality/low risk' bonds over the past 5 years in addition to much improved public yields might lead us to reallocate between these to some degree. The diversification benefit (allowing us to rebalance at times like this) is another 'hidden' advantage of all our private/alternative investments.

From 2021 through the current period, we have been allocating to credit/bonds with the following three strategies:

- Keep public bond duration/maturity short (~ 2 years or shorter) which minimizes interest rate volatility/risk while still earning a stable 5.0% to 6.0% high-quality yield. (JAAA, JSI)
- Utilize a substantial and diversified suite of private credit, which has no interest rate risk and has a large percentage backed by physical, financial, infrastructure assets, or other collateral with little to do with the overall economy. These generate yields of between 8.0% to 9.5%.
- We have begun to allocate to longer-term Treasuries with a call option writing strategy (TLTW) as this now yields around 10%. This portion of the pie might increase in the future if rates continue to rise.

Real Estate and Alternatives

Our private/alternative suite (TRPALTS) continued to be an indispensable portfolio differentiator in the 3rd quarter of 2026. While public markets endured a historic move in bond yields, a sharp selloff in rate-sensitive stocks and bonds, and significant swings within the AI trade, our alternatives provided the ballast that kept client portfolios on a steady trajectory. For clients with our full alternative/private suite, TRPALTS is now up between 8% to 9% year-to-date through September (on pace for its five-year average of around + 10%/yr. net of fees).

The combination of diversified private credit and insurance linked securities continues to produce a strong foundation for this suite. Together they exhibit little or no volatility, no correlation to the traditional financial markets, and offer 8%+ annual yields. The third quarter is the heart of hurricane

season and the primary risk period for insurance linked securities; fortunately, this season (to date) has been historically quiet with no hurricanes in the Atlantic basin through 10/5/2026. We still have some risk/hurricane season to get through, but if the quiet season holds, another year of double-digit returns seem likely.

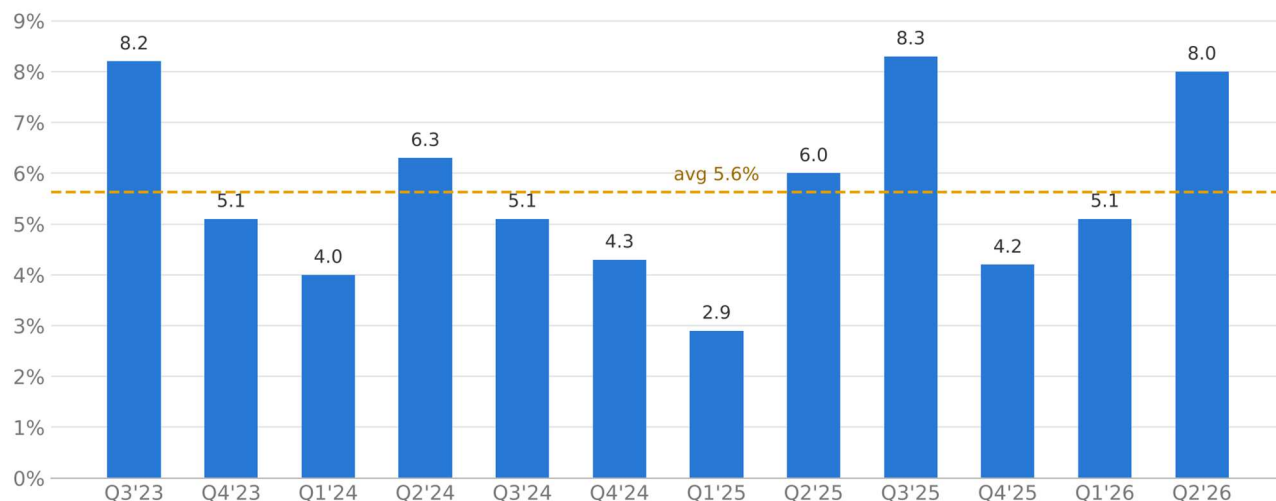
In addition to the more income orientated portion of our suite, our allocation to infrastructure (both a defensive and AI play), private real estate, and private equity offer additional diversification and the potential for higher returns. Infrastructure has had a generally good year, but mixed individual results with private infrastructure and pipelines doing well and utilities lagging. Our private equity holdings continue to provide access to high-growth companies well before they reach the public markets, a theme vividly demonstrated by the SpaceX IPO in June.

Real estate (public and private) after years of lagging due to higher interest rates is turning the corner quickly for our specific allocation; KRSTX and CRAFX. Traphagen has been able to take advantage of esoteric/unique features within both funds, and both have started to outperform over the prior month. We believe both holdings will return in the + 15% range over the next 12 months with a higher-than-normal level of confidence. In addition, they both produce around 5% of tax advantaged rental income for our investors.

Economic Indicators

The US economy continued to show strong resilience in 2026, with the most recent estimates at around 2.3% to 2.5% real GDP growth for the year. Importantly when you adjust for elevated inflation levels, nominal GDP (the rate the economy actually grew) should be around 6%. When you have the largest economy on Earth growing at a 6% annual clip along with an enormous technology advancement (AI), it is tough to get a prolonged stock drawdown, bear market, or recession. And although there are always risks, the general backdrop continues to support higher rates, growth, and inflation for the foreseeable future. This would make Traphagen favor an allocation to inflation resistant and growth benefited assets. This theme would include growth/quality stocks, some dividend growth stocks, real estate, infrastructure, and pure alternative investments not impacted by rates/inflation.

Corporate America is another bright spot: corporate profits jumped by roughly \$400 billion in Q2 per the Commerce Department, and S&P 500 companies are expected to report earnings growth of approximately 29% year over year for Q3, the third consecutive quarter of 25%+ growth. Analysts now expect full-year 2026 earnings growth near 32%, slowing to a still-healthy ~15% in 2027. Importantly, because earnings have grown faster than stock prices, the S&P 500's forward P/E ratio (valuation) has declined from 23.5x earlier this year to roughly 19.5x currently; not cheap, but much more reasonable.



Above: Nominal GDP growth (annualized) for each quarter over the past 3 years. With average US economic growth above 5% per year (includes inflation), bonds/cash tend to be poor investments while real assets and most equities tend to outperform.

Inflation remains the most consequential economic variable for markets heading into year-end. Headline CPI ran at 3.4% year-over-year in both July and August — down from the 4.1% peak in May, but no longer improving, with gasoline prices up more than 27% from a year ago. Encouragingly, the ‘core’ measure of CPI (excluding food and energy) registered 2.4% in August, its lowest reading since March 2021, and the Fed’s preferred PCE measure came in better than expected at 3.4% headline and 3.0% core. The problem for the Fed is that energy prices are spreading into other categories such as airfares and transportation; as Chairman Warsh noted, “too many categories are still posting increases above 3%.” If oil can drop to (and remain) below \$80 per barrel, we think that, along with much higher long term interest rates, (another form of economic tightening/slowing) can go a long way to slowing inflation. If that does occur, that would likely be another large positive push for the stock market. Importantly, this would also create an expansion of the type of stocks that would do well including the very sectors that lagged the most over the past two months.

The mid-term elections are now only about one month away. Historically, markets have tended to perform well in the fourth quarter of mid-term election years once the uncertainty is removed. Citadel Securities notes the S&P 500 has averaged a + 5.6% gain from September 30 through year-end in mid-term years. In addition to statistics and historical averages, Traphagen does believe the mid terms will result in a divided government with democrats taking over the House and the Senate remaining a toss-up, but of course the presidency remaining Republican. This likely outcome would create a ‘gridlock’ situation with no meaningful/sweeping legislation likely for at least two years. We feel the markets would treat this as neutral or positive.

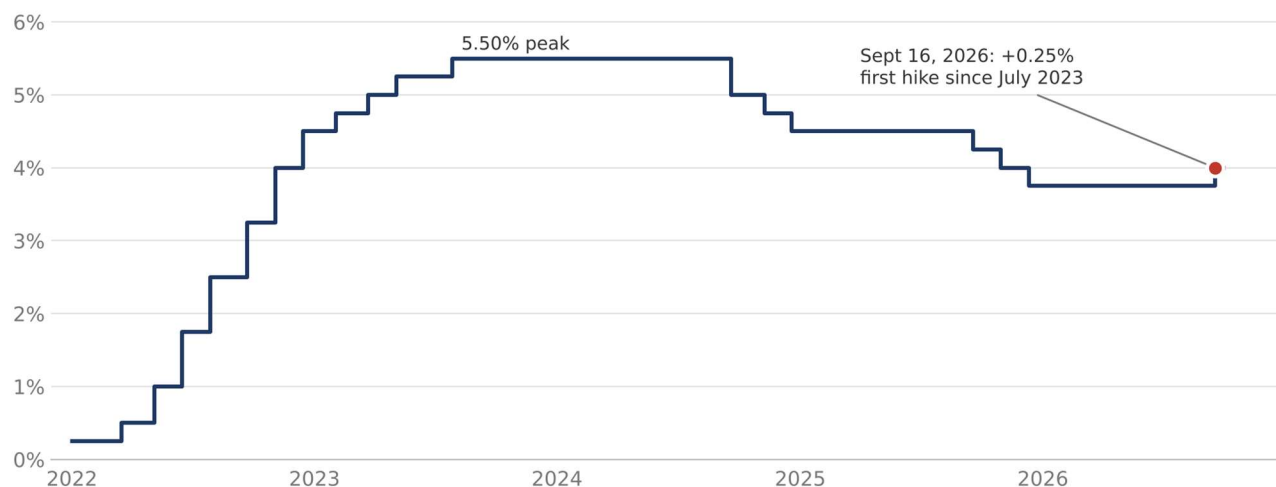
The labor market has remained solid. The unemployment rate was up just slightly to 4.2% in September with no meaningful trend through 2026. Private payrolls continue to show modest but healthy gains in the 60,000 – 80,000 range for the year. We continue to watch the 4.7% - 5.0% unemployment threshold as a potential trigger for a meaningful change in the rate, inflation, and growth outlook.

Major Factors Shaping Q3 2026

1. Much Higher Long-Term Interest Rates and the Fed's First Hike Since 2023

If a single development defined Q3 2026 for financial markets, it was the dramatic move in interest rates. The 10-year Treasury yield rose from 4.4% to 5.3%, its highest level in roughly two decades, while the 30-year yield reached 5.6%, the highest since 2004. These are enormous moves for the world's most important interest rates over a single quarter. The ripple effects were felt everywhere: 30-year mortgage rates climbed to roughly 7.3%, borrowing costs for corporations and consumers rose, and the 'discount rate' used to value nearly every financial asset moved higher.

On September 16, 2026, the Federal Reserve raised its benchmark rate by 0.25% to a range of 3.75% – 4.00%, its first increase since July 2023. Unlike the prior meeting, which drew three dissents, the decision was unanimous. As we highlighted in our Q2 newsletter, the dot plot had already pointed toward a hike, and persistent energy-driven inflation sealed the decision. The updated projections show the median Fed official expecting one additional quarter-point hike before year-end, with 16 of 18 participants projecting at least one more increase. Chairman Warsh again declined to submit his own 'dot,' and the Fed's statement notably removed its prior references to an energy 'supply shock', signaling that the Fed now views inflation as a broader problem. Markets are pricing in roughly three additional hikes over the next year, more aggressive than the Fed's own projections and a huge swing vs. the 2-3 cuts originally predicted as we entered 2026.



Above: Upper bound of the Federal Funds target rate since 2022. The September 16, 2026 increase to 4.00% was the Fed's first hike since July 2023, reversing a portion of the 1.75% of rate cuts delivered between September 2024 and December 2025.

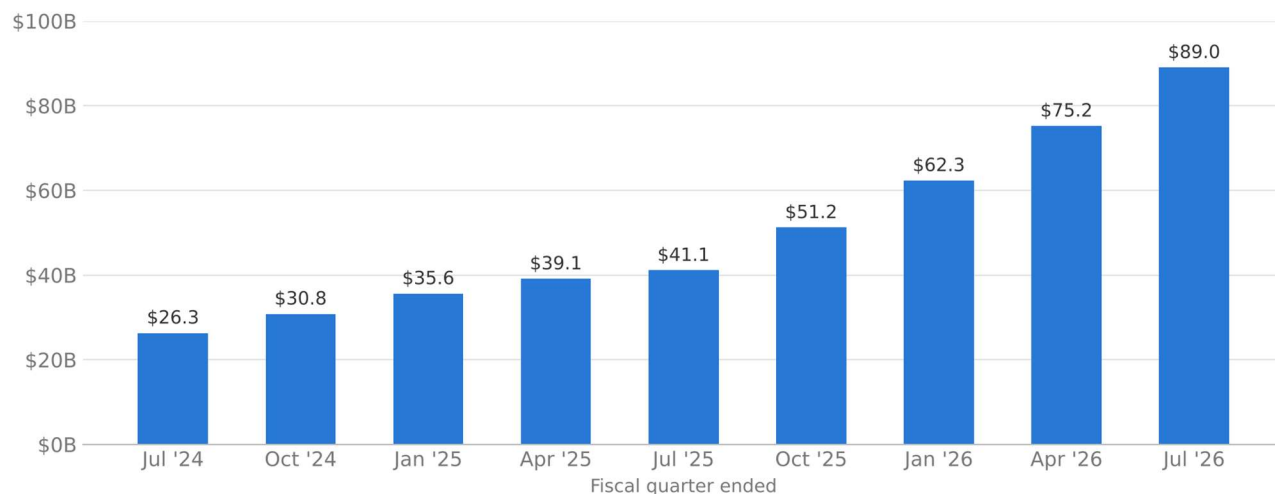
Three implications matter most for portfolio construction. First, higher rates are a genuine positive for savers and income investors: short-term bonds, floating-rate private credit, and cat bonds now earn more. Second, higher long-term rates pressure the valuations of long-duration assets — long-term bonds, some stocks, and 'bond proxy' sectors like utilities and real estate. Third, the combination of Warsh's refusal to provide forward guidance and the market's pricing of more hikes than the Fed projects means interest rate volatility is likely to remain elevated.

Traphagen's view is that the Q3 rate move confirms the structural shift we described last quarter, the playbook that worked during the era of predictable Fed support and near-zero rates no longer applies. Our emphasis on short-duration high-quality bonds, floating-rate private credit, real assets, and high-quality equities was designed for precisely this environment, and it helped protect client portfolios during the quarter. Again, if rates continue to move up, value would be created in longer term bonds, and we would look to reallocate to that space. We do find it interesting (and possibly a positive for the

asset class; as a contrarian signal) that the average investor/institution has the least amount of bonds in their overall asset allocation since 1999/2000 and 2007/2008.

2. The AI Trade Matures: Volatility, Concentration, and the Rise of Open Source

Artificial intelligence remained the single most powerful driver of stock market returns in Q3 2026. The Technology sector is now up roughly 37% year-to-date, semiconductors (SMH) are up roughly 69%, and Technology was the only S&P 500 sector to gain in September. The fundamental demand for AI infrastructure remains extraordinary: on August 26, Nvidia reported quarterly revenue of \$96.2 billion (+ 106% year-over-year), Data Center revenue of \$89 billion (+ 117%), and guided to \$108 billion in revenue for the current quarter, all ahead of expectations.



Above: Nvidia quarterly Data Center revenue (in billions of USD) over the past two years. Despite sharp swings in AI-related stock prices during Q3, the underlying demand for AI infrastructure continues to accelerate — Data Center revenue has more than tripled in just two years.

The path, however, was anything but smooth. In mid-to-late July, a sharp selloff in AI chip stocks, memory names, and more 'frothy' areas of the AI trade saw global chipmakers shed more than \$1 trillion in market value. The semiconductor index fell nearly 10% in a month before recovering. Speculative activity has also cooled significantly — Citadel Securities estimates retail trading activity in semiconductors is running roughly 46% below June levels. At the same time, investors increasingly treated mega-cap technology as a 'safe haven' from the rate and oil shocks, pushing market concentration to new extremes. We view this concentration as a growing risk for passive index investors with the counterbalance to this being several 'Mag7' names sporting reasonable valuations after a year or more of relative underperformance.

The most important strategic development of the quarter was the accelerating adoption of low-cost 'open source' AI models. Open-source models grew from 11% of AI usage volume in April to 29% by July, while still representing less than 4% of AI spending, a vivid illustration of how much cheaper they are. That said, US frontier labs still capture the vast majority of enterprise AI spending (Anthropic and OpenAI together account for more than 80%).

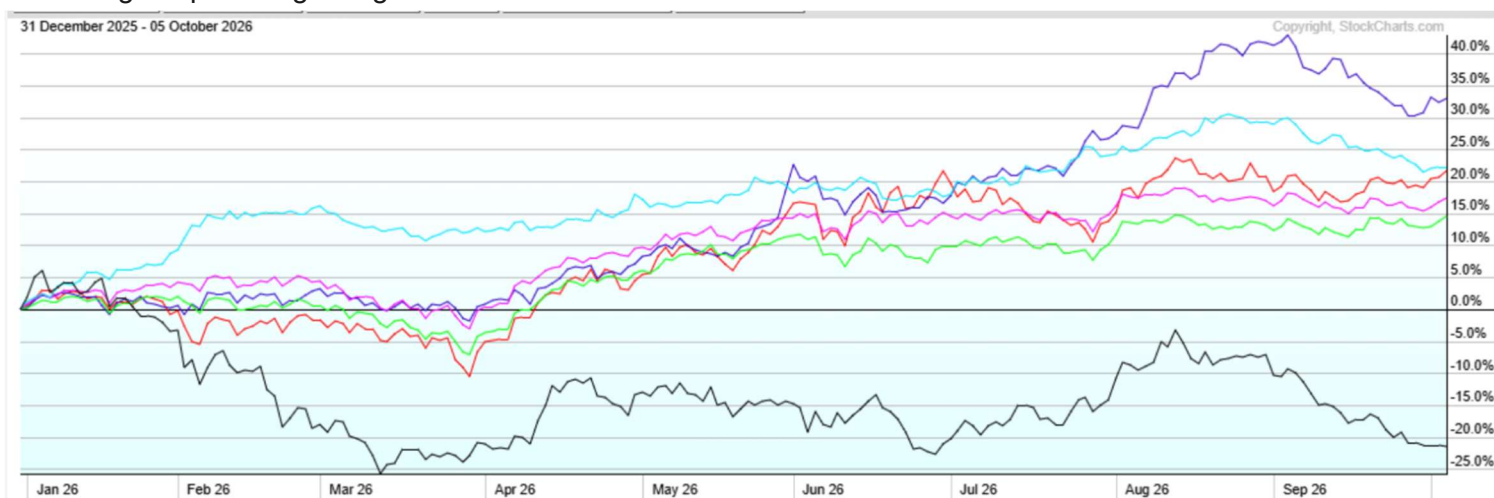
We believe open source is reshaping, not derailing, the AI investment thesis. Falling costs per unit of AI 'intelligence' put pricing pressure on model developers and certain software businesses, but historically, dramatically cheaper technology leads to dramatically more usage. More usage means more demand for chips, data centers, and above all electricity, while companies that deploy AI capture the cost savings directly in their margins.

Our AI portfolio framework continues to distinguish between:

- **AI Infrastructure & Enablers (Overweight or Market Weight):** Energy/power providers/electrical grid, semiconductor and memory companies, data center infrastructure. Cheaper open-source models accelerate AI usage, which only increases demand for compute and power. These businesses continue to print exceptional financial results.
- **AI Adopters & Orchestrators (Growing position):** Companies successfully deploying AI to drive measurable productivity gains. Open-source competition is rapidly lowering the cost of AI for these companies, directly expanding their margins. Our 'ALAI' ETF allocation is positioned to capture this phase as well.
- **AI Disruption Risk (Avoid or Underweight):** Traditional SaaS, public information databases, undifferentiated knowledge services, and businesses whose competitive advantage depends on proprietary AI capabilities that open-source alternatives can now replicate at a fraction of the cost.

Overarching all the above is our commitment to **bringing you the fastest growing and most compelling AI investments whether they are in the public or private markets**. Most pure play AI companies are still private (Databricks, Anthropic, OpenAI, etc.) and most of our investors have access to these companies before the general investing public. We believe the importance of getting invested in companies (within all industries) when they are still smaller/private and can experience outsized growth is very important in adding value for our clients.

Looking ahead, we expect volatility and growth within the AI trade to remain elevated. Traphagen continues to spend a significant amount of research time analyzing new data, themes, and areas to avoid/focus within this technology, and we view periodic pullbacks as the price of admission to the most powerful earnings growth story in the market. At the same time, we are balancing this desire for growth with the concentration risk of being overly exposed to AI. Having material exposure to 'non-AI' ETFs (VFLO, GFLW, SCHD, and AVUS) are important both in terms of minimizing the concentration risk and producing returns regardless of how AI behaves. In fact, despite being a 'AI' market, all of these strategies deployed by Traphagen have outperformed the SP500, with the only lagging US large cap holding being GPZ.



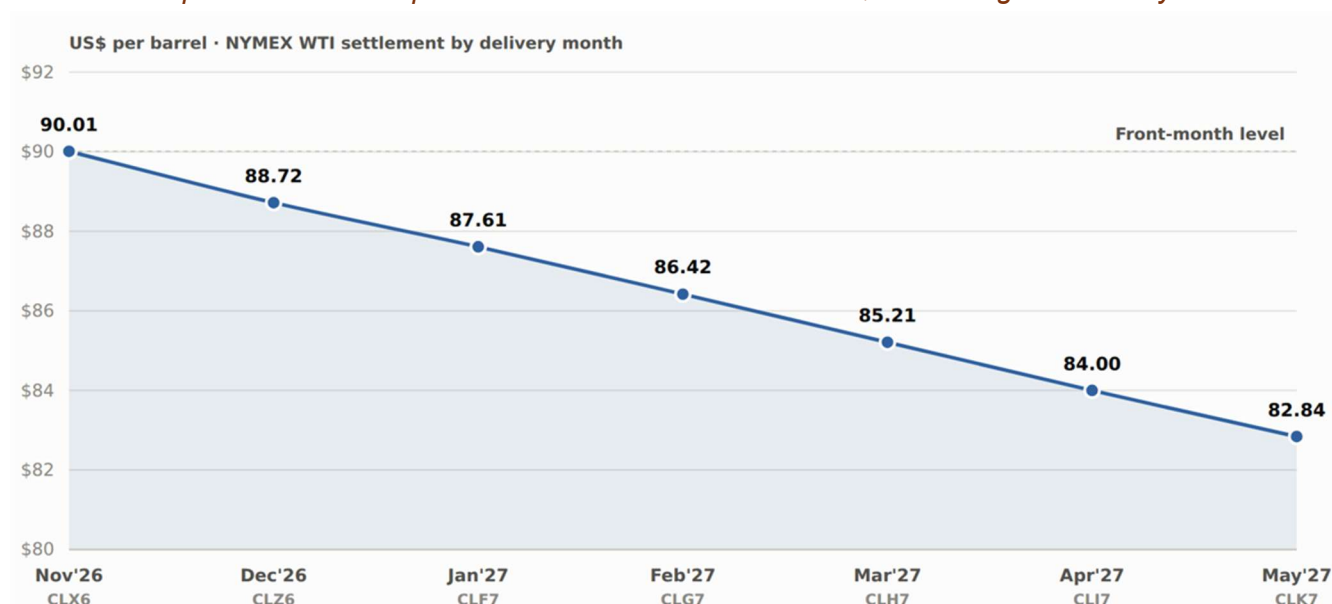
Above: The green line represents the SP500, with dark blue (VFLO), light blue (SCHD), red (GFLW), pink (AVUS), and black (GPZ). In aggregate, we are beating the SP500 by roughly 25% in 2026.

3. The Iran Conflict Continues: Higher Oil Prices for Longer

The optimism surrounding the June 17 MOU unraveled quickly in Q3. After Iran was accused of attacking commercial vessels in the Strait of Hormuz, the US launched strikes on July 8 and revoked a sanctions waiver, and tit-for-tat exchanges continued through the summer. The conflict escalated again in early September with strikes on tankers by both sides, reports of Iranian attacks on US Navy ships, and a second strike on a Saudi Aramco refinery.

Oil prices responded accordingly. WTI crude rose roughly 29% during the quarter (and is up approximately 58% year-to-date), finishing near \$90 per barrel, while Brent ended the quarter near \$100. Importantly, the market increasingly believes this will be a 'higher for longer' environment, which is somewhat of a change from 3-4 months ago where the forward curve implied a relatively quick resolution and return to sub \$75/barrel oil.

Below: Current oil price futures chart looking through May 2027. Although still in backwardation (indicating higher prices now and lower prices in the future), the absolute prices are much more elevated. Oil prices are now expected to remain in the low to mid \$80s through mid-next year.



Oil price impacts extend well beyond the energy sector. US gasoline prices averaged about \$4.15 per gallon in early September, up roughly 39% from \$2.98 before the conflict began, and diesel hit record highs near \$5.90. Higher fuel costs are a direct tax on consumers, they keep headline inflation elevated, and they were a key reason the Fed felt compelled to raise rates — which in turn pushed bond yields higher. In this way, the Iran conflict is connected to nearly every other theme in this newsletter.

For our portfolios, our meaningful infrastructure and pipeline exposure again performed its role as a geopolitical, oil price, and inflation hedge. Midstream/pipeline companies posted their strongest month in over a year in July as oil surged and year to date have returned +18.0%. Given the likelihood of elevated oil prices for longer, along with continued growth in AI-driven energy demand, we continue to retain a large allocation to the asset class across all client portfolios.

4. A Tough Quarter for Rate-Sensitive Assets: Utilities, Bonds, Housing, and the Consumer

The combination of surging long-term rates, a Fed hike, and higher oil prices created a difficult backdrop for the most interest-rate-sensitive parts of the market. Utilities fell approximately - 11.4% in Q3 (the worst performing sector and the weak link within our infrastructure allocation), reversing a positive first half to finish roughly - 7.1% year-to-date. Public real estate fell more than - 7% in September alone, Consumer Discretionary is now the worst performing sector of 2026 (- 8.9% YTD), Consumer Staples declined more than - 5% in September, small caps fell roughly - 7.5% for the quarter, and the US Bond Aggregate lost roughly 3%.

The common thread is interest rates. When a 10-year Treasury yields more than 5.3% with no credit risk, 'bond proxy' sectors such as utilities, REITs, and consumer staples — typically owned for their 3% – 4% dividend yields — become relatively less attractive. Utilities, although down materially and facing higher financing costs, have now become (in our opinion) quite attractively priced, yield 3% or more, and are a beneficiary of the AI buildout.

Housing felt the impact most directly. With mortgage rates near 7.3%, the National Association of Home Builders sentiment index fell to 32 in September, its lowest reading of 2026 and the 29th consecutive month in negative territory. Two-thirds of builders are now offering sales incentives and 38% are cutting prices, while new home sales and starts are down by double digits from a year ago. In addition, **the median home sales price in the US is now down 7.2% from the Q4 2022 peak of \$443,000**. And this data is prior to the recent spike in mortgage rates. Traphagen does expect residential home prices (in aggregate) to be in an extended choppy range or decline some given much higher mortgage rates and record unaffordability.

Private Equity/Real Estate Investment Update

(For Accredited Investors Only; \$1M+ with Traphagen)

Fund / Holding	Q3 2026 Update
Private Equity (GPB Fund II)	Another extension of resolution was granted through November. All assets within the fund remain in T-bBills earning interest. We will communicate any meaningful updates when we receive them.
I-Direct Private Markets Fund (KKR / Vista / Warburg Pincus)	This three-manager direct PE fund delivered + 11.8% in 2025, with modest returns of + 2.1% through August. The relative underperformance is mainly due to outsized software exposure.
KKR Private Equity Fund	Continues to deliver strong results (+ 16.8% in 2025) with ~75 diversified profitable companies. Through August the fund returned + 7.1%.
BREIT (Blackstone)	With roughly 30% of the portfolio allocated to data centers, BREIT has become a partial AI play within real estate, helping offset the headwind from higher interest rates. This continues to be one of the best real estate investments with a + 7.1% return through August.
Stepstone SPRING (Venture Capital)	Traphagen's top equity/stock performer over the last several years. Returned + 38.8% in 2025 and has annualized at roughly 30% per year net of fees since inception. With the help of owning SpaceX prior to IPO, it has returned + 26.5% in 2026 YTD through August.

Stepstone Private Markets Fund (XPMIX)	Our private equity 'index like' fund continues to provide good diversification versus public markets and within private markets. Returned + 12.2% in 2025 and a more modest + 5.6% through August of 2026.
Cascade Private Equity Fund (CPEFX)	Building on a 17% return in 2025, this diversified secondary PE fund continues its strong trajectory. This fund is up another 13.7% in 2026 year to date.

2026 Portfolio Changes & Performance Update

The below highlights changes made to most client portfolios between February 2026 and the current period. In addition, we provide an overview of how these changes have impacted portfolios (negative or positive).

Sector / Asset Class	Action (Sale / Trim)	Reallocation (The Buy)
Infrastructure	Trim or eliminate 'higher risk/higher return' energy companies (GRID)	Adding exposure to TPYP (pipelines) was positive with its + 18% performance, but FUTY (utilities) has been a drag with rate sensitivity.
Artificial Intelligence	Strategic Shift: Trim general US large cap exposure to gain pure 'active' AI allocation.	This proved to be advantageous with ALAI (AI pure play) returning + 30% with the 'Mag7' up just + 10%, capturing a 20% return differential.
Insurance Linked Security Transition	Trim catastrophe bonds (SHRIX/CBYXX) and purchase other insurance securities (XILSX, SRRIX)	This worked well, with XILSX/SRRIX outperforming SHRIX/CBYXX by roughly 2X (12% vs. 6%)
Private Equity	Trim/Sell PIIVX to protect post SpaceX IPO gains.	Purchase public equities and/or other private equity funds. Positive return decision, although SPCX is starting to perform well.
Foreign Developed	Purchase foreign developed stocks for first time in many years (FENI)	Diversification away from USD and AI, lower valuations, higher dividend. This has been a near breakeven trade with both returning roughly the same.
New Private Real Estate Purchase	Over the past week purchased a new private real estate fund (CRAFX)	We are quite confident this will be an outsized performer over the next 12 months. Within the first week of ownership it is already up 2.1%.
Possible Upcoming Investments	We are currently evaluating an 'AI/Machine learning' stock ETF that utilizes the technology to actively under/over-weight stocks. This might be added to portfolios over the next 1-2 months.	

Through the first nine months of the year, virtually all our client portfolios have returned +8% and + +12%. This is well ahead of our estimated average return clip (especially for more conservative and balanced portfolios) and we remain on pace for + 10% - + 13%+ returns if the stock market can at least remain at current levels. Just as importantly, these returns have been earned with between 20% to 60% less risk/volatility than the overall stock market, a benefit that was not needed this year, but remains as a form of 'insurance' against a surprise market drawdown or negative trigger.

2026 Market and Economic Outlook

Looking ahead to the final quarter of 2026 and into early 2027, we maintain a generally optimistic stance. Interest rates, oil prices, and the Fed now take on greater importance than they did earlier in the year, but in our view, they remain outweighed by the strength of corporate earnings and the continued AI investment wave. Below you will see an overview of the largest factors we are monitoring and our view of impacts.

Factor	Near-Term Impact	Long-Term Impact
US Large Cap Valuations & Concentration	Neutral	Negative/Neutral
Fed Hikes / Change in stance	Negative	Negative/Neutral
Iran Conflict / Higher Oil/ Inflation	Negative/Neutral	Neutral
AI Trade Evolution / Growth	Positive	Positive
Corporate Earnings Growth	Positive	Positive
Real/Nominal GDP Growth	Positive	Positive
Higher Alternative / Bond Yields	Positive	Positive
Mid-Term Elections	Neutral	Neutral

The central question for the fourth quarter is whether exceptionally strong corporate earnings growth can continue to offset the headwinds of higher interest rates and higher oil prices. So far, the answer has been yes, earnings have grown faster than stock prices, leaving valuations more reasonable than earlier in the year. We believe (outside of a black swan event) the economy and stock market remain fundamentally in a good place. The developments that could derail the positive momentum would be the 10-year Treasury yield moving sustainably toward 6%, the Fed hiking more aggressively than currently projected, or a sharp unwind of the highly concentrated AI trade.

Given this backdrop, we believe the diversified construction we have implemented — growth and dividend stocks, high-quality short-duration fixed income, floating-rate private credit, insurance-linked securities, private equity, and infrastructure — is well-positioned for this environment. As we move into year-end, our allocation continues to emphasize the AI infrastructure/adopter theme, harvests the higher income now available from private credit and floating-rate securities, retains our infrastructure hedge against higher oil for longer, and maintains disciplined caution around the areas of the market most exposed to higher rates and the risks of extreme moves within the AI/tech trade.

Conclusion

The third quarter of 2026 was a reminder that headline index returns rarely tell the whole story. A modest gain in the S&P 500 masked a quarter in which most stocks fell, bond yields surged to multi-decade highs, oil prices climbed back toward \$100 per barrel, bond prices dropped materially, and the Federal Reserve began raising rates again. Through it all, the diversified construction of Traphagen client portfolios did exactly what it was designed to do.

Two themes merit particular emphasis as we enter the final quarter of the year. **Interest rates are now a central driver of every asset class** — with the 10-year Treasury above 5.3% and a Fed that has shown it is willing to hike, the era of easy money is behind us, which favors real income, hard assets, floating-rate credit, and disciplined valuation work. And **the AI trade is maturing, not ending** — open-source competition and sharp volatility are separating the true long-term winners from the crowded/frothy trades, and we believe that differentiation will reward careful, research-driven positioning. We are thinking carefully about both, making deliberate adjustments in response, and communicating transparently with you.

We are grateful, as always, for the trust you place in us. Our commitment is to protect and grow your wealth with discipline, foresight, and an unwavering long-term perspective. We look forward to discussing this newsletter with each of you in the coming weeks, if you wish to dive in further simply contact your Traphagen advisor.

Best regards,

Your Traphagen Investment Team
Traphagen CPAs & Wealth Advisors