



Why Bonds Are Back and Equities Still Look Healthy | HCM Q4 2026 Update

Doug Johnson CFA®, Senior Investment Strategist at HCM Wealth Advisors and CPAs, gave a quarterly review of equity and fixed income markets and the macroeconomic factors he expects to matter for the rest of the fourth quarter and into next year. His overall message was cautiously optimistic. Equity fundamentals remain strong despite macro worries, bonds now offer their most attractive risk/reward profile in years, and investors shouldn't fear investing at all-time highs.

Asset Class Performance Year-to-Date

Returns across asset classes in 2026 have varied widely. Commodities lead, up almost 40%, driven largely by the jump in energy prices since the Iran war began in early March. Johnson noted there have been several "false ceasefires" and the conflict is ongoing, which keeps energy prices elevated. Emerging market stocks are next at about 21%, helped mainly by the AI trade.

US small caps and large caps are now nearly even. Two or three months ago, small caps led by a decent margin, but that gap has closed over the past 45 days. The turning point was the Federal Reserve taking a more hawkish stance, which pushed interest rates up. Small caps are historically very sensitive to interest rates, so their recent struggles aren't surprising, though they're still keeping pace year-to-date. Mid-caps trail slightly. Developed international stocks are up 9%, real estate 6%, and cash 2.8%.

Several asset classes are negative. TIPS are down 1.6%, bonds down 2.2%, gold down 3.6% after a strong run last year and early this year, and Bitcoin, which HCM doesn't own, down 5.6%.

Johnson spent some time on TIPS, which he called one of the most misunderstood asset classes. Many investors wonder how TIPS can lose money when inflation is above average. His explanation is that TIPS are designed to work as individual securities with set maturity dates. Most TIPS products, however, trade as ETFs that keep a constant, relatively high duration. Duration measures how sensitive a bond's price is to interest rate changes, so when rates rise, these ETFs fall in price even when inflation is high. He pointed to 2022 as a striking example of this.

He also mentioned that the slides now include "key takeaways" in the corner, and clients can get the full deck from their advisor.

US Index Breakdown and Regional Performance

Among the major US indices, the S&P 500 blends value and growth, the Dow leans toward value (though less than it used to), and the NASDAQ is growth-heavy. After the first ceasefire, growth outperformed while value lagged, and the indices later moved back together. Since the Fed turned hawkish and rates climbed sharply, they have split apart again.

Growth has held up well so far, and higher rates haven't hurt the AI trade as much as many expected. Johnson acknowledged concerns about how much the Magnificent 7 and other AI-related companies have borrowed to fund the AI build-out, but said this hasn't yet affected equities. Value, especially cyclical stocks, has struggled because markets believe the Fed is willing to slow growth to fight inflation. Even so, all three indices have done well year-to-date.

By region, emerging markets are up 21.5%, the US 15%, developed international 9%, and Europe just 4.3%. Emerging markets have benefited from close ties to the AI trade, particularly in Taiwan and Korea, which make up a large part of the index, and from commodity-based economies in Latin America. Europe has suffered because it depends heavily on Middle Eastern oil and gas imports. The supply shock from the Iran conflict has squeezed the region and weakened its growth outlook compared with the US.

Equity Fundamentals: Earnings, Valuations, and Margins

Johnson acknowledged plenty of reasons for concern: talk of an AI bubble, the upcoming midterm elections, and interest rates near two-decade highs. So how are equities holding near all-time highs? He credited two things, earnings and profit margins.

Consensus forward 12-month earnings estimates are rising for large-, mid-, and small-cap indices, with large caps showing an especially steep upward inflection. While earnings keep growing this fast, he argued, a "crash" is hard to justify, even if the market doesn't keep rocketing higher.

On valuations, the S&P 500's trailing P/E of 22.3 is above average, but valuations across all three indices have actually fallen even as prices rose. That's because earnings are growing faster than prices. In his view, this undercuts the bubble argument and arguably points the other way.

Profit margin forecasts look similar to the earnings trend. Johnson said AI's "efficiency kicker" gets overlooked because attention goes to data centers and GPUs, but it's now

showing up in margins across company sizes and industries. He cautioned that price is the ultimate arbiter and a correction is always possible. Whether a pullback becomes serious, though, will depend on these fundamentals, which look healthy for now.

Fixed Income Outlook

HCM is writing a blog post arguing that opportunities are appearing in bonds. Results this year have been disappointing: the US Aggregate is down 2.3% and investment-grade bonds down 3.6%, which revives memories of 2022 for many investors. Short-term Treasuries are up 2.8%, mostly from interest income.

Johnson isn't calling a top in rates, but he said the risk/return profile in fixed income is about as good as it's been in a long time. Flows into bond funds suggest investors are starting to notice. The 10-year Treasury yield is at its highest level since 2007. He mentioned that date only as a historical marker, not a prediction of another financial crisis. He urged investors who gave up on bonds after 2022 to reconsider for two reasons: today's yields are attractive, and over 50 to 100 years of data, bonds have reliably hedged equities and reduced portfolio volatility. After a long stretch of above-average stock returns, he expects some reversion to the mean eventually.

Why Rates Are Rising

Johnson pointed to two factors. First, the economy is strong. The Atlanta Fed's GDPNow forecast shows 3.6% growth, up from 2.5% and 2.2% in recent quarters, and he sees little sign of a slowdown. Second, inflation is elevated but not out of control. CPI is around 3.4%, above the Fed's 2% target because of the energy spike, but far below 2022 levels. He also poked fun at core CPI for excluding food and energy, which he considers probably the two biggest parts of inflation.

Energy prices that first looked temporary now seem more lasting and will likely stay elevated until the Middle East situation is resolved. The Fed appears determined to keep inflation from becoming a problem again. Market expectations remain anchored, with 10-year and 5-year breakeven inflation rates at 2.3% and 2.34%. Johnson said both the Fed and investors would happily accept those levels.

The Fed's projections show maybe one or two more hikes before eventual cuts, with a long-run rate around 3.6%. That looks nothing like the aggressive 2022 cycle, when rates went from zero to 5.5% and stocks sold off. He added a caveat that the Fed's forecasting record is spotty. He recalled Jerome Powell calling inflation "transitory" and dismissing large hikes, then raising rates by 75 basis points four times in a row.

Investing at All-Time Highs

Finally, Johnson pushed back on AI-bubble and crash talk, calling much of it fear-mongering. He addressed the common belief that investing at all-time highs is a mistake. Data since 1950 show no meaningful disadvantage: one-year forward returns after all-time highs are actually higher than on other days, three-year returns are about the same, and five-year returns are slightly higher. He discouraged sitting on large cash piles waiting for a drawdown that may never come. For nervous investors, he suggested dollar-cost averaging as a gradual way in.

He closed by inviting questions through clients' advisors, offering copies of the deck, and noting that the next update will return to the podcast format.