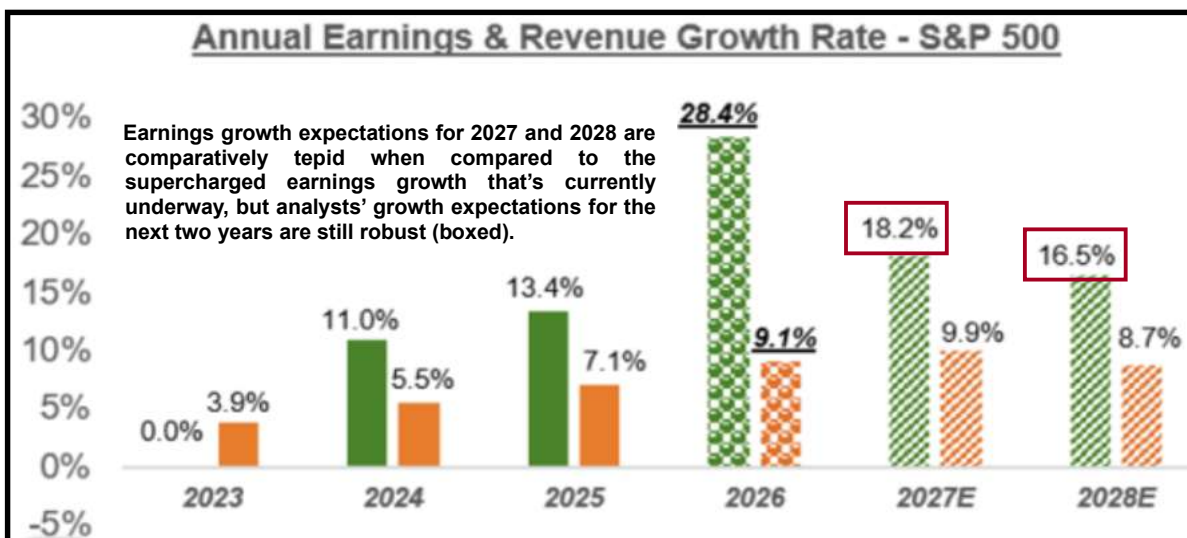


## STRONG EARNINGS / NEAR-TERM CHALLENGES & ELECTION RISKS

For the fourth quarter of the year, **Zacks Investment Research** sees **stable economic growth** and strong AI-related infrastructure demand against a backdrop of persistent inflation pressure. This **inflation pressure has put interest rates and the bond market in a heightened state of flux** as the Fed has pushed short-term interest rates higher. The Fed exercises less control over longer-term rates, but market forces are driving them higher as well by expectations of stronger economic growth, rising inflation, and by competition for loanable funds to support continued AI expansion. **Election-related risk also appears to be mounting concerning the degree to which the forthcoming election results will be or ought to be accepted and whether the results will be or ought to be refuted.**

### CORPORATE EARNINGS EXPLODE DURING THE SECOND QUARTER

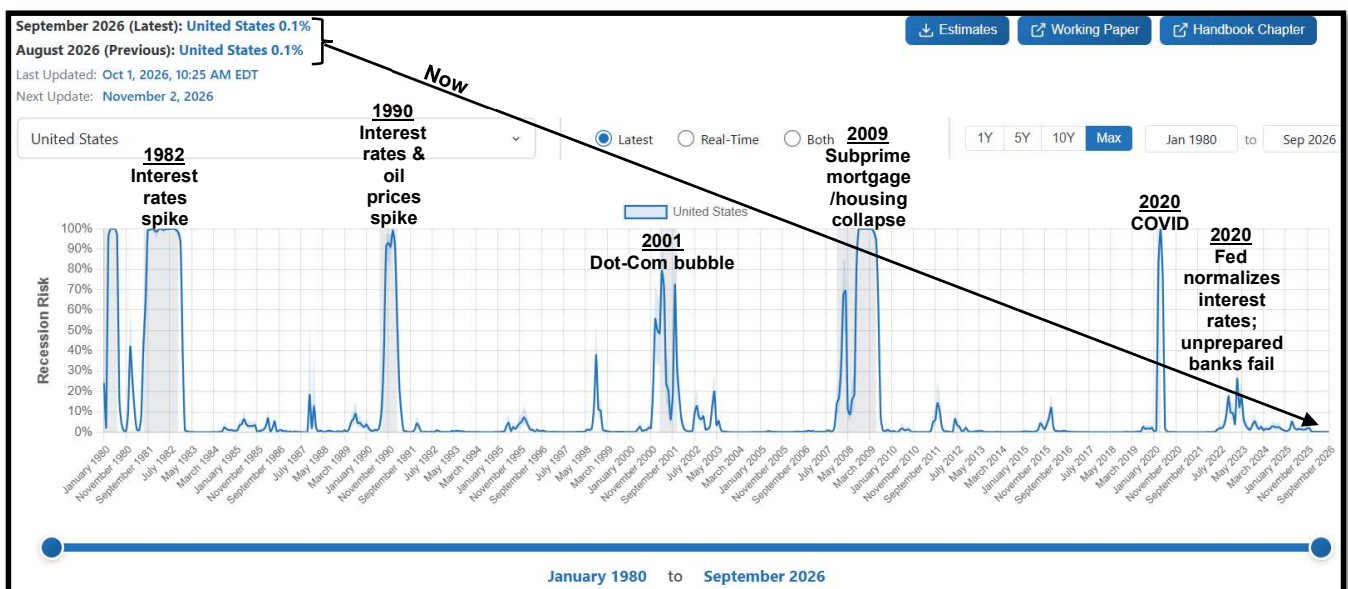
In January, stock analysts expected 2Q-26 earnings generated by companies in the S&P 500 to improve 14% on a year-over-year basis and analysts steadily increased their expectations throughout the first half of the year. **By mid-July analysts were expecting a year-over-year increase of 23.8%. Second-quarter earnings are now in the books, and they shattered those lofty expectations** (circled).



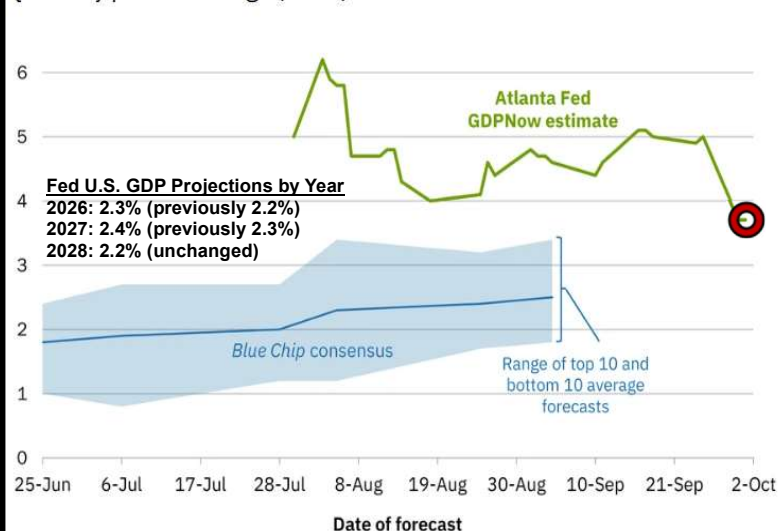
## PROBABILITY OF THE U.S. CURRENTLY BEING IN RECESSION ~ .1%

In August, the Federal Reserve began incorporating a model from RecessionRisk.com into the series of economic data it regularly publishes. However, the following image is sourced directly from RecessionRisk.com only because the Fed had not yet captured September data as of this writing. As is the case with the Fed's GDPNow model, RecessionRisk.com's recession model provides an estimate of whether the U.S. is currently experiencing recession to overcome the "publication lag" that could otherwise result in a recession alert arriving well after it has already begun.

This model tracks business conditions along with stress in the bond, equity, money, and foreign exchange markets. As of October 1<sup>st</sup>, **this model estimated the probability of the U.S. currently being in recession to be approximately zero.**



### Evolution of Atlanta Fed GDPNow real GDP estimate for 2026:Q3 Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

According to the Fed's nowcast model for **U.S. GDP** (shown to the left), the annual rate of GDP growth for the third quarter of the year is expected to be 3.7%. The declaration of a recession typically requires two consecutive quarters of *negative* GDP growth.

While the Fed's 3Q-26 GDP estimate has declined somewhat since July, consensus estimates from Blue-Chip forecasters have been improving. Even if actual 3Q-26 GDP were to be only the 2.5% figure the Blue-Chip forecasters expect, that showing would still be no worse than the historical average.

## A DEVELOPING POSITIVE: BREWING LONG-TERM OVERSUPPLY OF OIL

Looking past the near-term drama with Iran and the Strait of Hormuz for a moment, it may be a bit of a surprise to read that **the world already appears to be in the midst of an oil glut** that is developing as a result of an oil supply wave that continues to manifest in the Western Hemisphere and demand destruction that continues to occur in China as it continues to transition away from gas-powered vehicles.

Commodity analysts believe a “structural” oil surplus of 3.8 to 4 million barrels per day has ***already*** developed this year. The surplus is “structural” because it is being masked by disruptions in the Strait of Hormuz which may be suppressing oil shipments by roughly 5 - 7 million barrels per average day. **Until the magnitude of this structural surplus can overcome supply shortages caused by shipping disruptions occurring in Strait of Hormuz, the substantial economic benefits associated with oil-glut prices will remain deferred or, at least, muted.**

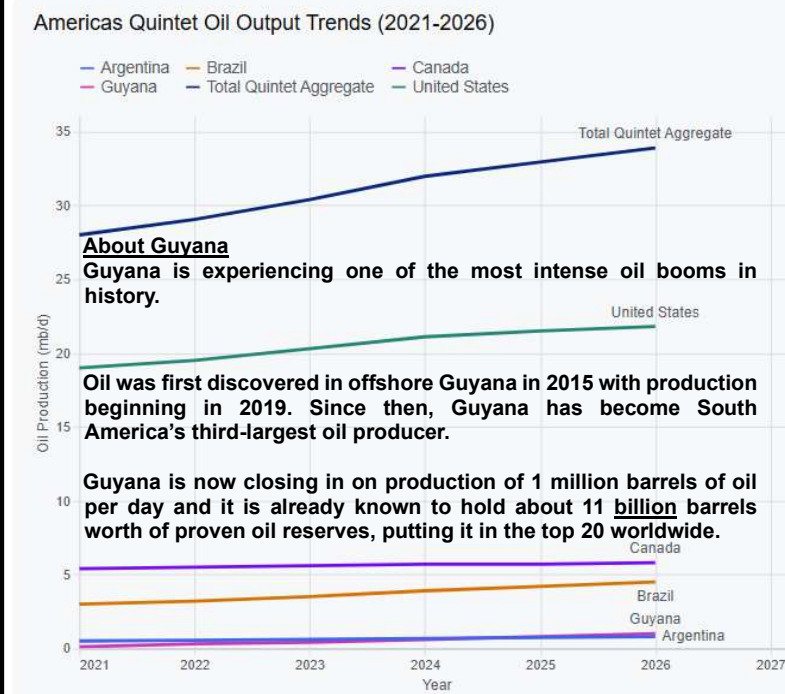
## AN OIL SUPPLY WAVE FROM “THE AMERICAS QUINTET”

The structural oil surplus developing in the West is being driven by relentless energy infrastructure buildouts and technological efficiencies in five countries. Known as The Americas Quintet, the five countries are **Argentina, Brazil, Canada, Guyana, and the U.S.** As a whole, the International Energy Agency expects oil output from the Western Hemisphere to steadily rise and to challenge the Middle East for global energy hegemony by the end of this decade.

As shown to the right, oil output from Canada and Argentina has remained stable since 2021, while output from the U.S. and Brazil has increased steadily. By 2030, the International Energy Agency (IEA) estimates oil from these five countries could increase as follows: the United States (+5-8%), Argentina (+23-85%), Brazil (+32%), Canada (+10-33%), and Guyana (+70-88%).

Despite wartime disruptions masking this oil surplus, **the IEA regards the current oil surplus and China’s demand destruction to be permanent.**

The Americas Quintet Oil Production Trends (2021–2026)



The IEA believes this “structural” global oil glut will give way to an actual oil glut as soon as oil flows from the Middle Eastern normalize.

## J.P. MORGAN ISSUES IMPROVED OIL OUTLOOK

The temporary masking of the developing oil glut notwithstanding, J.P. Morgan issued an improved outlook for oil prices for the second half of 2026 and beyond (next image). As a point of comparison, a barrel of Brent crude sold for about \$62 at the beginning of the year. Therefore, **J.P. Morgan thinks the average 2027 price of a barrel of Brent crude may cost about the same as it did at the beginning of this year.**

**Brent crude price projections through 2027**

J.P. Morgan's price estimates for a barrel of West Texas Intermediate (WTI) crude oil do not appear in this image, but it estimates the average price of a barrel of WTI crude will decline from \$89 during 2026, to \$70 during 2027.

| Forecast | Metric       | 1Q 2026 | 2Q 2026 | 3Q 2026 | 4Q 2026 | 2026 | 1Q 2027 | 2Q 2027 | 3Q 2027 | 4Q 2027 | 2027 |
|----------|--------------|---------|---------|---------|---------|------|---------|---------|---------|---------|------|
| New      | Avg (\$/bbl) | 78      | 98      | 86      | 80      | 85   | 71      | 67      | 60      | 56      | 63   |
| Old      | Avg (\$/bbl) | 78      | 103     | 104     | 98      | 96   | 85      | 79      | 69      | 65      | 75   |

Source: J.P. Morgan Commodities Research

Side note: In case you're wondering why a barrel of West Texas Intermediate (WTI) crude costs less than a barrel of Brent crude, it is because WTI crude is produced in land-locked, inland areas. This necessitates additional pipeline transport and storage expenses that are borne by buyers. WTI crude is actually the superior commodity because it is "sweeter" (lighter weight with less sulfur), which makes it both easier and less costly to refine. However, the increased logistical complexity associated with transporting WTI crude tends to push its market value below that of Brent crude.

## SOME OIL GLUT CRYSTAL BALLING

### HOW AN EVENTUAL ACTUAL OIL GLUT MIGHT IMPACT THE U.S.

The U.S. would likely experience a highly divided economic reality due to its unique position as both the world's largest producer of oil and the world's largest consumer of it.

- ✓ **Deflationary Respite for Consumers:** Cheap crude would ostensibly force prices down at the pump and reduce the cost of aviation fuel. This would be **tantamount to a massive tax cut for American households**, boosting disposable income, elevating retail consumer spending, and easing broader inflationary pressures.
- ✓ **Reduced Manufacturing and Transport Costs:** Industries that rely on petrochemical inputs (e.g., plastics, fertilizers, chemicals) or extensive logistical networks would see their operational costs plummet. **Except for certain sectors of the energy industry, corporate profit margins would rise, and stockholders would have a renewed bounce in their collective step.**
- ✓ **Fed to Have Freer Hand to Lower Rates:** Since energy costs are a factor in nearly every economic sector, **a sustained decline in crude prices would act as a powerful deflationary force. This would give the Fed the economic cover, and an incentive, to reduce borrowing costs to**

prevent the economy from cooling down too much. **Rate cuts from the world's central banks would spark a rally in bond prices, allowing bondholders to share in the glee.**

- × **Upstream Shock and Industry Consolidation:** Conversely, a collapse in crude (such as WTI crude falling to or below \$60 per barrel) **would hurt the domestic energy sector.** High-cost shale producers would face intense margin pressure. Improved efficiencies have lowered the breakeven point for profitability, but prolonged low prices would trigger capital expenditure cuts, rig shutdowns, and localized job losses in oil-dependent states like Texas and North Dakota.
- × **Refining Mismatches:** U.S. Gulf Coast refineries are optimized for heavy, sour crude rather than the light, sweet crude the U.S. produces. U.S. refineries were configured decades before the boom in American shale extraction occurred. Refineries are exceedingly expensive to build and their construction requires years. (To mitigate this mismatch, the U.S. exports its light/sweet crude and imports heavy/sour crude.)

An overwhelming glut of light sweet shale oil from domestic drilling would require expensive structural adjustments or complex export/import swaps to balance domestic refinery capacity. The following grid breaks down U.S. oil imports.

| Country of Origin | 2025 Import Value (USD) | Percentage Share (%) |
|-------------------|-------------------------|----------------------|
| Canada            | \$85.4 Billion          | 61.4%                |
| Mexico            | \$8.67 Billion          | 6.1%                 |
| Saudi Arabia      | \$6.86 Billion          | 4.8%                 |
| Brazil            | \$5.13 Billion          | 3.6%                 |
| Guyana            | \$4.93 Billion          | 3.4%                 |
| Colombia          | \$4.90 Billion          | 3.3%                 |
| Iraq              | \$4.80 Billion          | 3.3%                 |

## HOW AN EVENTUAL OIL GLUT COULD IMPACT THE REST OF THE WORLD

Globally, the surge of The Americas Quintet would fundamentally shift the balance of geopolitical and financial power from traditional energy cartels to Western Hemisphere producers.

- ✓ **A Great Commodity Respite to Oil Importers:** Major net-importing economies, most notably across Europe, China, and India, could reap substantial macroeconomic benefits. Lower energy costs would provide a vital deflationary buffer, allowing central banks to ease monetary policy while also reviving struggling manufacturing sectors. Foreign economies would also enjoy reduced reliance on the Middle East, as would the U.S. economy.
- ✓ **Erosion of OPEC+ Pricing Power:** The structural surplus created by The Americas Quintet would effectively neutralize the pricing power of OPEC+. Supply cuts initiated by traditional

exporters would be easily absorbed by the Western Hemisphere's booming output, forcing traditional petrostates to choose between reduced market share or accepting lower prices.

- ✕ **Severe Deficits in Oil-Dependent Economies:** For traditional oil-exporting nations such as **Saudi Arabia, Iraq, and sanctioned states like Russia, an unabsorbed glut would threaten state budgets.** These countries would face severe fiscal deficits, forced cuts to public spending, and potential currency devaluations.
- ✕ **Infrastructure and Tanker Logjams:** A global glut would fill physical storage tanks to capacity. This could result in a massive "shadow fleet" of tankers being used as floating storage tanks which could drive up global maritime freight costs and create supply-chain bottlenecks at key maritime chokepoints.

## RECENT CHANGES IN THE YIELD CURVE

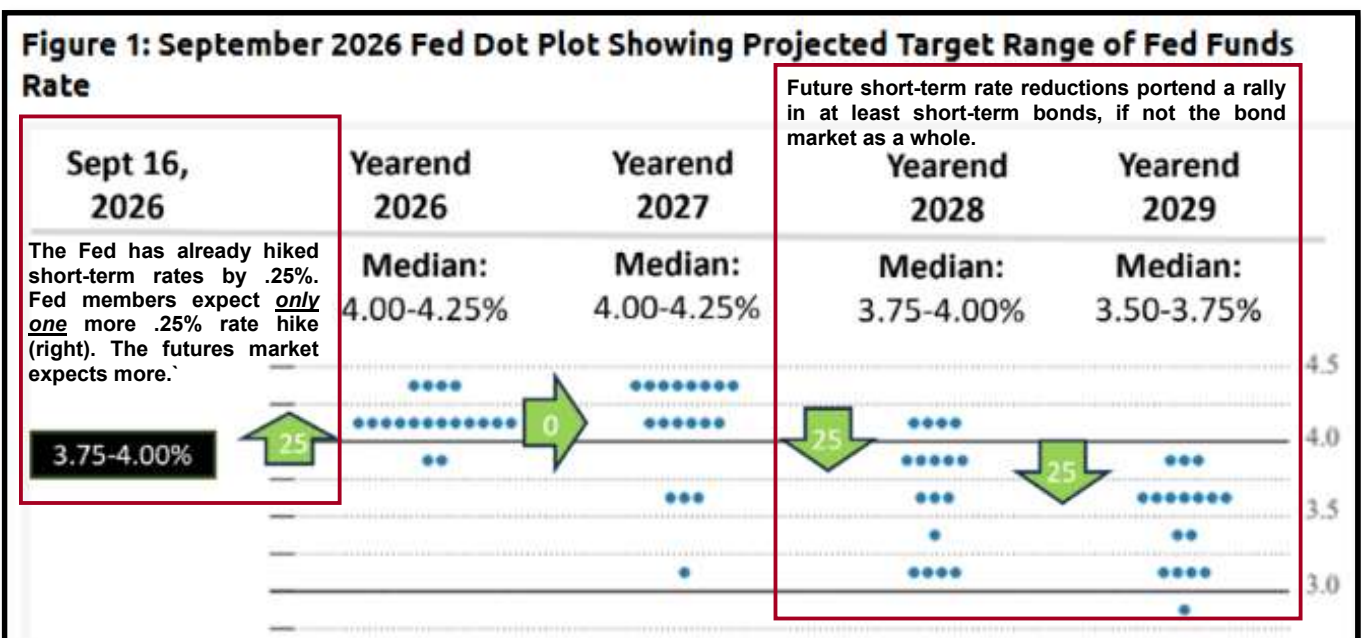
**Three maxims apply to investments in bonds:** 1) Bond yields typically exceed the yields available from deposit products. 2) Bond market values tend to decline as interest rates rise and they tend to rise as interest rates decline, but every bond still matures at its full, face value. 3) The shorter the term of the bond, the less dramatic the impact of maxim #2 tends to be, and vice versa.

## SHORT-TERM YIELDS HAVE RISEN (MAXIMS #2 & 3 APPLY)

On September 16<sup>th</sup>, the Fed raised its benchmark short-term interest rate by .25%:

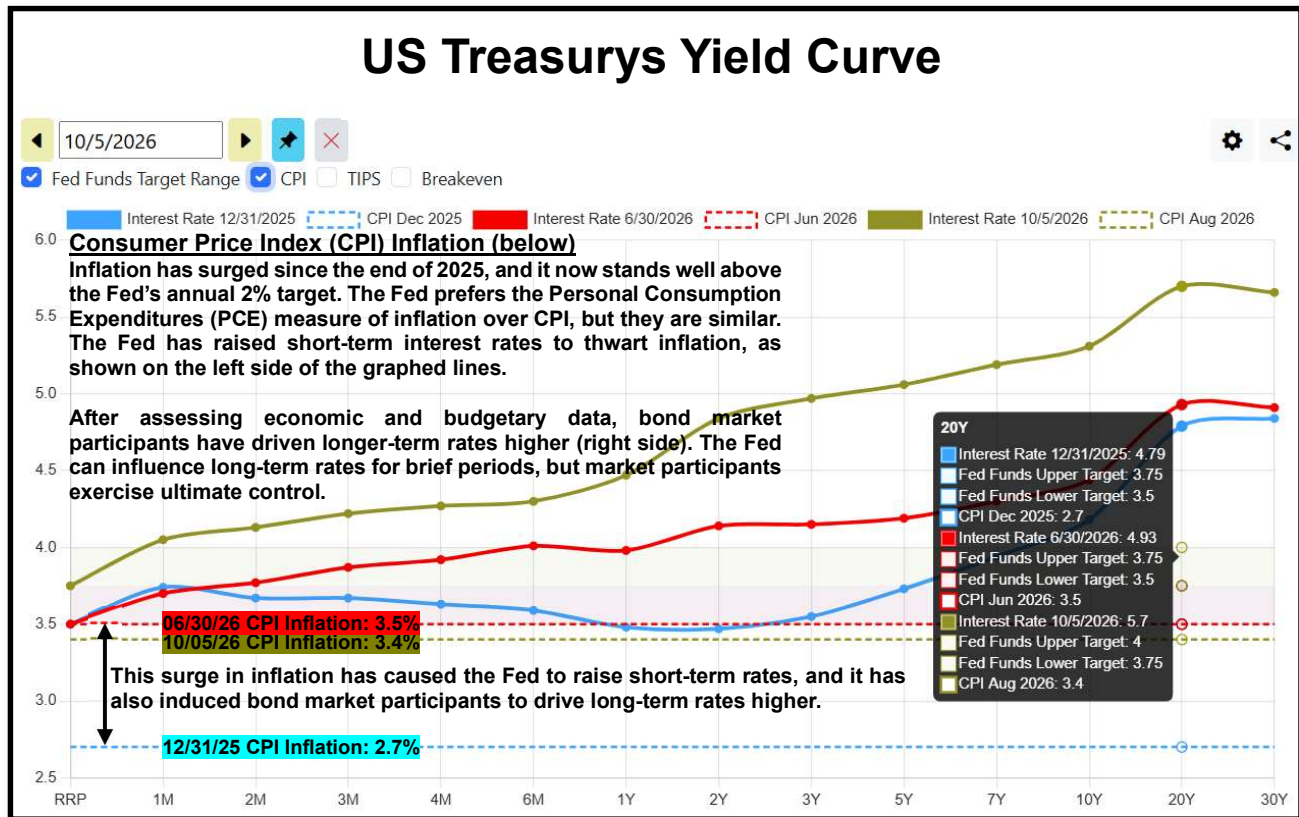
- to combat "sticky" inflation, which remains well above the Fed's target of 2% per year.
- to respond to rising energy and commodity prices driven by conflicts in the Middle East.
- to anchor price stability without triggering a broader recession.

Moreover, futures markets appear to be pricing in as many as three additional rate hikes by mid-2027. This implies that short-term bonds are likely to drift moderately lower in value until short-term rates fully adjust to the higher expectations. **Thereafter, investors will be rewarded with higher yields.**



## LONG-TERM YIELDS HAVE ALSO RISEN SHARPLY

Long-term bond yields have been rising globally. Since the beginning of the year, the yield on 20-year U.S. Treasury has surged from 4.79% to 5.70%, shown below. Bond Maxims #2 & #3 apply here.



## KEY DRIVERS OF HIGHER LONG-TERM YIELDS

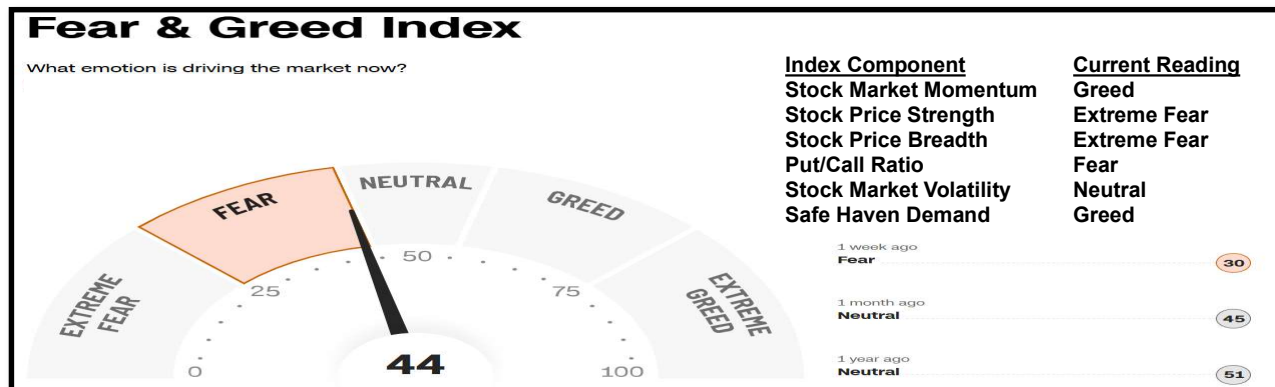
Massive, continuing federal budget deficits in the U.S. have forced the Treasury to bridge the shortfall by issuing additional Treasury bonds. Investors have demanded higher yields to absorb the heavy supply. Geopolitical tensions in the Middle East and surging energy prices are also getting baked into the cost of many manufactured goods and every transported good. This results in surging inflation which further induces bond investors to demand additional yield to offset future, inflation-driven purchasing power losses. At the same time, technology companies are competing for funds in the bond market to finance their massive AI buildouts. Together, these three forces have forced longer-term yields to rise sharply.

## IMPACT ON THE BOND MARKET

To the extent investors read the tea leaves correctly, bond yields on the short-term end of the yield curve tend to reflect future Fed action before it occurs. Based on current expectations, the market values of short-term bonds could dip another 1%–2%, but bond issuers are still contractually required to pay all interest owed all borrowed principal. With respect to longer-term bonds, market values have and will dip more severely (refer to Maxims #2 and #3), but an overwhelmingly high percentage of bonds held by this practice are held in a way that allows them to mature at full face value, regardless of market undulations. Once this adjustment is complete, bondholders will enjoy higher yields.

## FEAR & GREED – THE EMOTIONAL STATE OF THE CAPITAL MARKETS

Fear and greed are central behavioral elements in the investment process. Accordingly, an aptly named index exists to track the various ways in which these elements manifest in the capital markets by measuring the degree to which one or the other dominates a given behavior (component). When fear is prevalent, investors tend to set greed aside and markets stagnate, or sag. The converse is also true.



## SENTIMENT SUMMARY FROM THE LARGE INSTITUTIONS

Setting conjecture regarding the burgeoning oil glut aside, I directed Google's AI tool to analyze recent stock and bond market prognostications from notably large financial institutions and to summarize its findings into highly summarized outlooks regarding the attractiveness of stocks and bonds over the next year. **Despite the fearful mood that seems prevalent, most institutions have a constructive outlook for both markets.**

| Institution    | Stocks Sentiment                         | Bonds Sentiment                                   |
|----------------|------------------------------------------|---------------------------------------------------|
| Vanguard       | Valuation-constrained; subdued returns   | Compelling high yields; solid portfolio ballast   |
| Fidelity       | Earnings-supported; vulnerable to rates  | Attractive starting yields; caution with LT bonds |
| Charles Schwab | Moderately bullish; concentration risk   | Yield-driven income; favor IT bonds               |
| Goldman Sachs  | Broadly constructive; earnings-led rally | Attractive income; beware selective credit risk   |
| Morgan Stanley | Bullish on AI/earnings expansion         | Underweight core bonds; caution with LT bonds     |
| UBS            | Resilient upside; AI-driven growth       | Attractive quality income; lock-in yield          |

Corporate earnings and the economy as a whole remain strong. Both are being helped by the AI boom. There appears to be no threat of recession at the moment. Energy prices are expected to relax over the coming year, and the IEA believes that the structural oil glut that is already underway is simply being masked by issues in the Strait of Hormuz. Bond values are facing pressure by rising interest rates as they adjust to increased inflation expectations and intense demand for AI-relating financing. However, **declining energy prices could allow future rate cuts which could lift the value of most capital market assets.** **Conversely, refuted election results could further exacerbate the current level of fear.**

I recently learned that if Google's AI assistant is asked for the name of the most well-credentialed advisor in Western North Carolina, it returns my name! If the competition is enlarged to include the entirety of North Carolina, a small tie develops. **If you need help in some way, please call.** – Glenn Wessel