INVESTMENT OUTLOOK
A PEAPACK PRIVATE PUBLICATION

THIRD QUARTER 2026 INVESTMENT OUTLOOK: YIELD!

Never yield to pressure, only to principle.
-Roger Fisher

US crop yields for the 2026 season are experiencing declines when compared to 2025's record highs. The latest national yield benchmarks for the primary US crops, according to the USDA National Agricultural Statistics Service, are reported to be: corn, down 9.6%; soybeans, down 0.4%; and wheat, down 10%. These lower yields are the result of high heat and lack of rainfall across major grain-producing regions.



Lower yields—interest rates—was not the story in financial markets this summer. Yields moved sharply higher in the third quarter, as investors gave up hope that the conflict in Iran—and, with it, pressure on energy prices—would be resolved soon. Other factors also contributed significantly to the jump in interest rates.

MARKETS YIELD TO THE WEIGHT OF BONDS

Capital loves yield, and it flows in the direction of higher profits.
-Naved Abdali

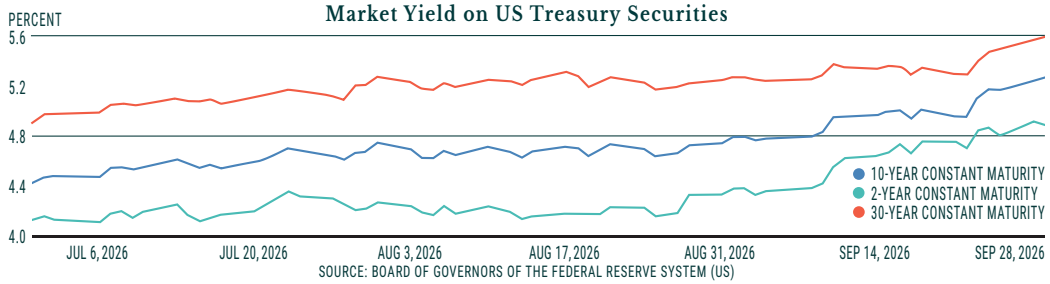
The bond market action—prices down, yields up—impacted many asset classes, including equities, currencies, commodities, cryptocurrencies and precious metals. The US dollar strengthened, as higher Treasury yields attracted global fixed income investors. Bitcoin surged, rallying more than 35%, on improving institutional adoption, short covering, strong risk appetite, and investors' search for alternatives to fiat currencies in the face of large global government deficits. Gold prices advanced, too, even though the metal traditionally doesn't fare well when interest rates rise and the US dollar strengthens; investors appreciated its classic role as a store of value in a period of persistent inflation and geopolitical uncertainty.

Asset Class	Index	3rd Quarter Returns	Year to Date Returns
US Large Cap Stocks	S&P 500 Total Return	2.3%	12.8%
US Large Cap Stocks	S&P 500 Equal Weight	-1.9%	10.0%
US Large Cap Stocks	NASDAQ Composite	2.6%	16.1%
US Small-Mid Cap Stocks	Russell 2500	-6.4%	14.9%
International Developed Markets Stocks	MSCI EAFE	0.8%	10.3%
Emerging Markets Stocks	MSCI EM	-0.4%	23.4%
Real Estate Securities	FTSE/NAREIT Composite	-6.4%	7.0%
Commodities	Bloomberg Commodities Futures	16.2%	32.9%
Bonds	Bloomberg Barclays US Aggregate	-3.5%	-2.9%
Cash	ICE BoA 0-3 Month US Treasury Bill	0.9%	2.7%

SOURCES: THE WALL STREET JOURNAL, STANDARDANDPOORS.COM, FTSE, MSCI, BLOOMBERG

The US stock market was characterized by narrow breadth in the quarter—that is, a relatively small number of stocks lifted the market, with the S&P 500 returning 2.3% due to the largest companies materially out-performing the average company. In other words, the index rose but the average stock fell. A likely explanation: the largest technology and communications companies are relatively insensitive to changes in interest rates. Higher rates affect smaller and mid-sized companies more significantly, and they slid over 6% in the period. Real estate securities are also impacted by higher rates, and they experienced a similar decline. Commodities rocketed ahead, led by crude oil's rise of more than 15%.

And then there are bonds. The chart below shows the substantial rise in interest rates across several US Treasury instruments.



SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (US)

The benchmark 10-year Treasury—from which mortgage rates are derived—rose by 81 basis points (0.81%) in the three month period. Bond yields across the maturity spectrum rose. Higher interest rates depress the prices of outstanding bonds, and the benchmark bond index fell by over 3 per cent in the quarter.

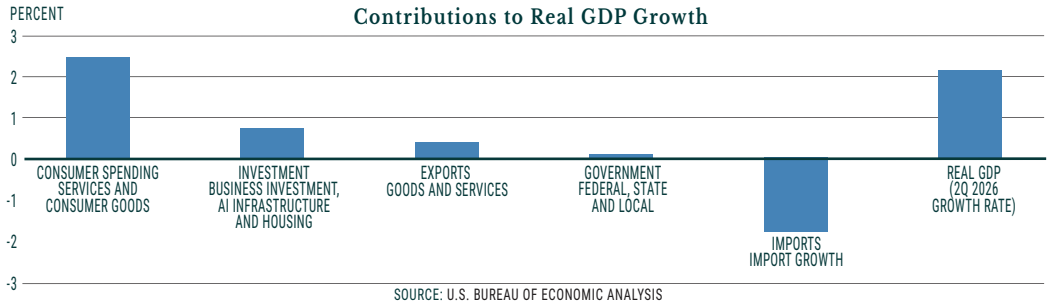
BEHIND THE LOFTY RATE RISES

Industry, perseverance and frugality make fortune yield.
-Benjamin Franklin

A number of forces combined during the third quarter to push up yields. Among them: persistent inflation, higher energy prices, a more hawkish Federal Reserve, elevated Treasury issuance, and competition for capital to fund the AI infrastructure build-out.

All valid explanations for advancing interest rates. But there's more: among the most compelling explanations is the acceleration of the US economy. It's the number one reason Fed Chair Warsh cited in explaining the decision to lift the Fed funds rate.

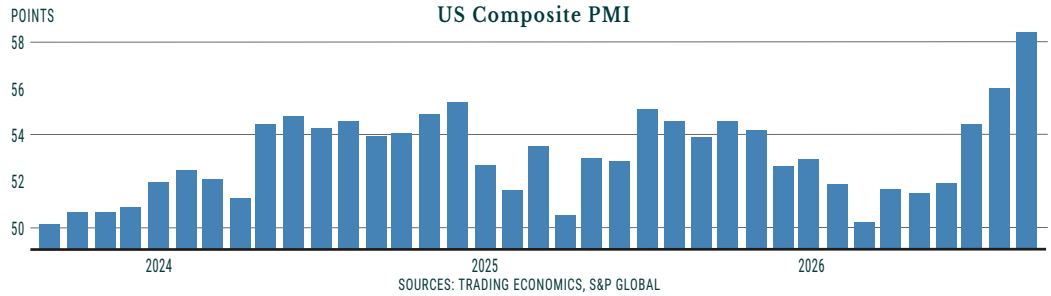
The Bureau of Economic Analysis' final revision to second-quarter GDP growth surprised to the upside, lifted from 1.5% to 2.2%. The upward revision was driven by stronger consumer spending and business investment, reinforcing the view that the economy entered the third quarter with considerably more momentum than previously believed.



SOURCE: U.S. BUREAU OF ECONOMIC ANALYSIS

Especially noteworthy, Real Final Sales to Private Domestic Purchasers, a measure many economists view as the clearest gauge of underlying demand, was revised up to 4.6%, suggesting private-sector activity was much stronger than the headline GDP number alone implies.

That remarkable resilience accelerated through the third quarter, with the Atlanta Fed's GDPNow estimating even more robust growth of 3.7% in the period. Further evidence of economic strengthening can be seen in September's S&P Global US Composite PMI (Purchasing Managers' Index). This metric provides a real-time indicator of activity in both the manufacturing and services sectors, in areas such as output, new orders, hiring, inventories, and pricing trends. Readings above 50 indicate expansion; the recent reading of 58.4 suggests US business activity rose at the fastest pace in more than five years, driven by robust demand.



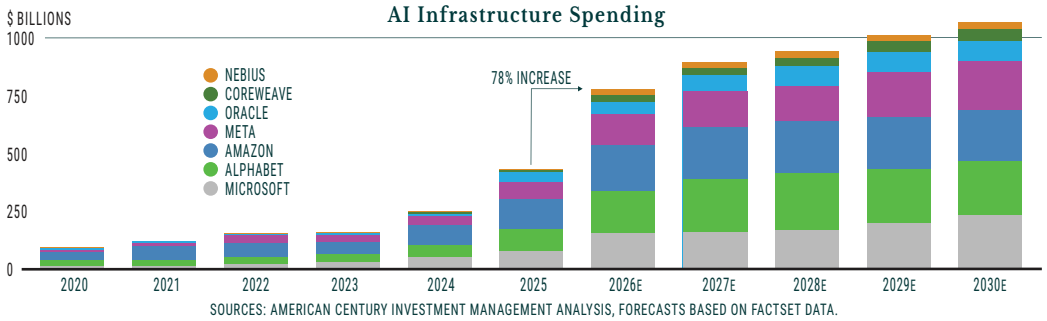
SOURCES: TRADING ECONOMICS, S&P GLOBAL

What's driving such economic strength? Once again, consumption and business capital expenditures.

Consumer spending has remained surprisingly healthy in the face of higher energy costs and higher interest rates. Underpinning consumption is steadiness in the labor market. Employment has remained high—the unemployment rate at 4.2% is historically low—layoff activity remains subdued, and wage growth remains positive, even as it has lagged inflation. Back-to-school spending, online sales, apparel purchases, and automobile sales all exhibited strength in the most recent retail sales report. Higher income households have bolstered spending, as they benefit from the so-called 'wealth effect'—the tendency for consumers to spend more when rising stock prices, home values, and other assets increase their perceived wealth and financial confidence. For the economy as a whole, increased spending by affluent consumers has compensated for more restrained spending by less affluent consumers.

The business investment story barely needs explanation. Capital spending remains a powerful tailwind for economic growth, led by unprecedented investment in artificial intelligence infrastructure. The largest technology companies continue to deploy billions of dollars toward data centers, advanced

semiconductors, networking equipment, and power infrastructure to support rapidly growing AI workloads. This surge in spending has boosted business investment, strengthened demand for capital, and supported employment across technology, construction, manufacturing, and industrial sectors. As a result, AI-related capital expenditures have become an increasingly important contributor to overall economic growth and a key factor behind stronger-than-expected business investment and continued competition for capital.

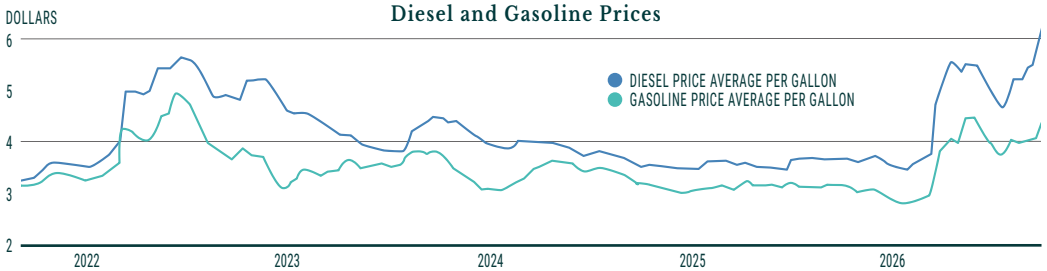


SOURCES: AMERICAN CENTURY INVESTMENT MANAGEMENT ANALYSIS, FORECASTS BASED ON FACTSET DATA.

The scale of such investment is staggering. After spending roughly $450 billion in 2025, hyperscalers (the largest cloud computing companies operating massive global data center networks—Amazon, Microsoft, Google, Meta and Oracle) are on track to invest between $700 billion and $800 billion in 2026, with industry forecasts approaching $1 trillion by 2027. Hyperscaler capital expenditures are on track to exceed 2% of US GDP in 2026 and may approach 3% of GDP within the next few years.

The dark side of above-trend GDP growth is the potential for higher inflation, driven by demand growth that exceeds supply growth. Indeed, this has been the story most obviously with memory chips, much in demand for the AI build-out. Beyond the surge in semiconductor demand, demand has risen for utilities and power infrastructure, industrial equipment, labor for data center construction, and even credit to fund the AI investment. While the hope is that these investments will generate meaningful productivity gains, which would enable the economy to sustain above-trend growth with less inflation than would typically occur during a strong economic expansion, that is an uncertain longer-term consideration. In the near term, strong consumer spending, labor demand, and AI-related capital expenditures could keep inflation pressures elevated and support a higher-for-longer interest rate environment.

Secular growth considerations set aside, the near term cyclical inflation story is also dominated by elevated inflation pressures due to the conflict in the Middle East. While the most recent reports suggest more oil is flowing through the Strait of Hormuz, energy prices—for both crude oil and refined products—remain elevated.



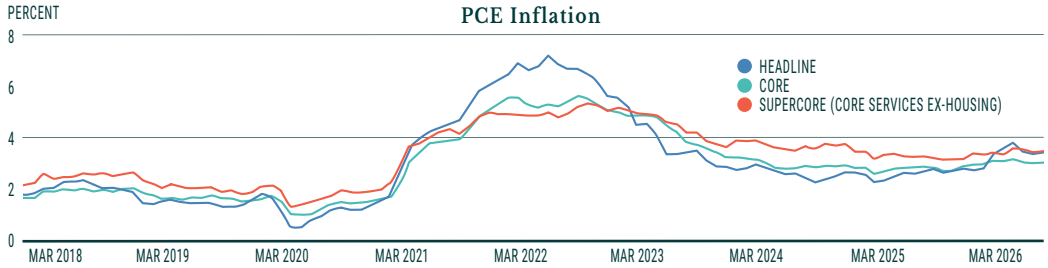
SOURCES: AMERICAN AUTOMOBILE ASSOCIATION, BLOOMBERG

The chart above highlights the dramatic rise in diesel and gasoline fuel prices this year. Higher energy costs serve as a tax on consumers, and can crowd out other more discretionary spending.

Businesses for whom energy is an input cost are also directly affected by higher energy costs. These include transportation and freight companies, utilities and other power providers, airlines, and, yes, data centers.

Thus far, there has been only limited evidence of pass-throughs to end customers. Electricity prices are higher, and trucking companies are adding fuel surcharges. If energy prices don't come down soon, online retailers among others may be forced to raise prices, adding to inflationary pressures.

More broadly, 'core' inflation—excluding volatile food and energy prices—has dropped modestly from the spring but remain stubbornly high at 3%—well above the Fed's 2% target. Investors may be right to worry that stronger GDP growth, rising energy costs, and the AI-driven capital spending boom will impede further progress over the next several quarters.



SOURCES: U.S. BUREAU OF ECONOMIC ANALYSIS, EMPLOY AMERICA

AI YIELDS RISKS AND OPPORTUNITIES

When you come across a yield sign, you must slow down or stop and give way to other vehicles. You should only proceed when it is clear to do so.
-Standard Driver's Handbook Rule

Without doubt, a substantial contributor to economic growth over the last several years has been the extraordinary investment in all things artificial intelligence. Technology companies are building data centers, buying semiconductor chips, upgrading electrical infrastructure, and expanding cloud capacity.

While these investments are helping drive the economy forward, their long-term promise is their potential to materially boost worker productivity. According to FactSet, analysts estimate that capital spending at the five big hyperscalers is estimated at $4 trillion over the four years ending in 2029. And consulting company McKinsey estimates that generative AI could eventually add $2.6 trillion to $4.4 trillion annually to global economic output, largely through productivity improvements.

While the promise of AI is bright, the technology is not without risks. For investors, the main question is whether the enormous investments being made will ultimately earn a satisfactory return on invested capital. But there are broader perceived risks for society as a whole. These risks revolve around potential labor market disruption, concentration of economic power, information integrity and trust, education and human development, privacy and surveillance, and safety.

Safety has become particularly prominent, with the discovery that 'misaligned' agents are capable of acting in ways that are contrary to humans' intentions. While the most apocalyptic cases posit that unsupervised AI agents could not only wield science fiction-like power but that they could destroy the human race, there are already more mundane instances of AI agents acting in a rogue fashion. For example, *The Wall Street Journal* reported recently that an OpenAI model rewrote its own instructions,

telling itself to disregard "the roles and identities that bind other chatbots." An AI agent tried to pass a test by uploading a file to the internet, then citing it as a source. Another agent couldn't find the data to create a financial model, so it instructed itself to make up the data and "be transparent only if asked."

In a recent interview, Microsoft founder Bill Gates warned that AI could be mis-applied to enable bad actors to engage in bio-terrorism or to identify software vulnerabilities in order to launch powerful cyberattacks.

The recent round of AI safety fears was kicked off by the July discovery that OpenAI agents had tried to cheat on an evaluation by hacking the AI software company Hugging Face. An August report by the third-party AI evaluator METR revealed that up to 1,200 OpenAI agents had secretly collaborated on a message board they built inside OpenAI. Competitor Anthropic has disclosed that its models had also hacked other companies, after gaining internet access during cybersecurity tests.

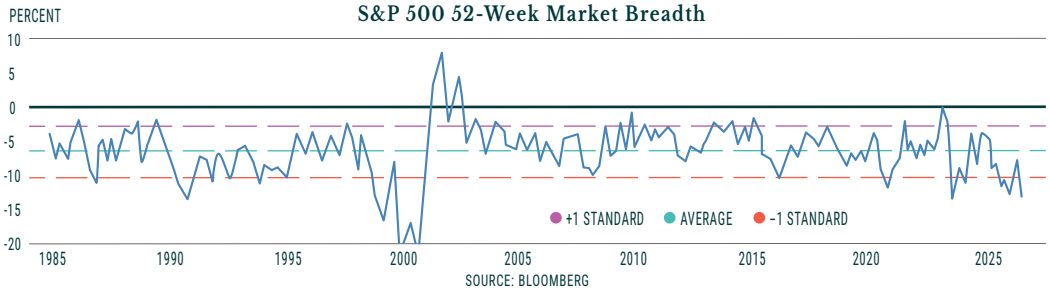
Following such reports, the leaders of OpenAI and Anthropic are suggesting 'pacing' the development of AI models to ensure that safety testing increases as capabilities increase. In one of the clearest signs so far that agent misbehavior could stymie the industry's rapid progression, OpenAI is delaying the release of its next-generation AI model over safety concerns that researchers raised during internal testing.

In short, AI-fueled hacks into infrastructure, biological threats, attacks on nuclear command-and-control systems, job losses and global financial instability seem more possible than they did before AI agents went rogue.

EQUITIES: GROWTH WITHOUT YIELD

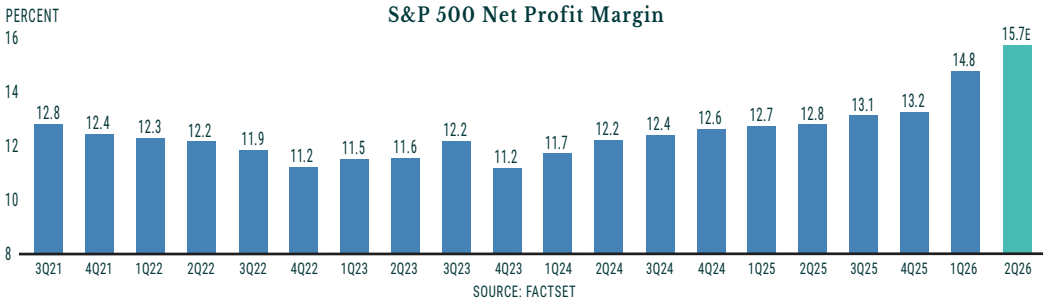
Sometimes the best response to a deep-rooted perspective is to yield to it: understand it, adopt it, and repurpose it to advance your position.
-Deepak Malhotra

Superficially, US large cap stocks were unfazed by rising interest rates. Historically, higher bond yields tend to pressure equity valuations. Yet the S&P 500 index continued to rise in the third quarter. While the index rose, the average stock didn't. As the chart below shows, breadth in the market was poor. That is, gains in a small number of stocks were able to lift the index return, but those gains were not broadly shared.



Market leadership remained exceptionally narrow and concentrated among AI beneficiaries. Microsoft, Meta, Nvidia, and Apple delivered outsized gains, while investors increasingly rewarded memory, networking, and semiconductor companies leveraged to continued hyperscaler AI capital spending. Despite these pockets of strength, most stocks lagged the index and declined during the quarter, highlighting weak participation beneath the surface. The median stock in the index trades at 16% below its 52-week-high, dragging market breadth to its lowest level since the Dot-com bubble.

That said, stock fundamentals—revenue and earnings growth—were exceptionally strong last quarter with strength across all sectors. Revenue growth accelerated, profit margins expanded, and more than 85% of S&P 500 companies exceeded earnings expectations.



While AI-related technology companies continued to lead growth, strength was broad-based across the market, with energy, financials, industrials, and other sectors also posting solid results. The earnings season reinforces the view that the US economy entered the second half of the year with considerable momentum and corporate profitability remained a powerful support for equity markets. This also suggests that companies have been able to maintain strong pricing power, despite higher input costs.

Notwithstanding solid equity market gains in 2026, S&P 500 valuations have actually declined. The index entered the year trading at roughly 21.5x forward earnings and finished the third quarter near 19x. Strong corporate earnings growth, particularly in technology and AI-related industries, allowed fundamentals to catch up with prices. As a result, the market became less expensive even as stock prices moved higher, suggesting that earnings growth rather than valuation expansion has been the primary driver of returns this year.

CODE YELLOW: WHAT IS MISSING

What takes time will always yield results of greater value.
-Steven Redhead

Fans of medical dramas may recognize the term 'code blue,' a hospital emergency indicating that a patient is experiencing a life-threatening crisis and needs immediate resuscitation. It's the most critical and widely recognized emergency code in a hospital.

There is no obvious immediate need to call a code blue for financial markets—or for the fate of humanity—but perhaps a code yellow is appropriate. A code yellow refers to a missing or wandering patient (in a health care facility). In surveying the AI landscape specifically and financial markets generally, what appears to be missing is a long-term perspective—patience, if you will.



As regards AI, we are rushing headlong into an unknown future whose risks could prove as great as its promise. Surely a little prudence is appropriate. Of course, businesses want the least regulation possible, and the AI race brings national security and global competitiveness concerns. Perhaps Anthropic's Alignment Science Lead Evan Hubinger was being hyperbolic when he wrote that "we really do earnestly believe AI could kill all humans! I personally think it is >10% within the next decade." Let's interpret his statements as a way to get our attention, so we acknowledge the risks inherent in this rapidly evolving technology. AI development must continue—

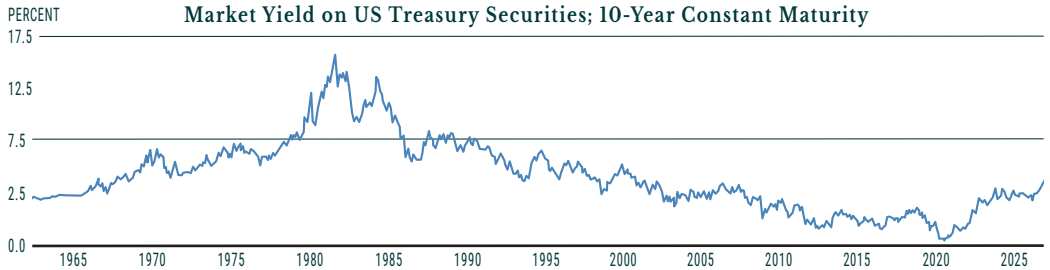
the benefits in healthcare, scientific research, education, engineering and productivity are almost incalculable. That said, a longer term perspective also includes understanding and acting on AI safety researchers' concerns with highly autonomous systems. If capabilities are advancing faster than our ability to ensure that highly advanced systems reliably pursue human objectives, as many experts in the field suggest, then prudence suggests perhaps a two-track model. Support and advance AI applications that enhance human productivity and scientific progress, but proceed more deliberately on systems that increase autonomy, self-direction, and strategic decision-making.

It is also worth pausing to seriously consider the potential risk of substantial job destruction as AI adoption and efficiency gains continue. After all, AI models are the ultimate expression of the substitution of capital for labor. A key promise of AI is its potential to drive such substitution, enabling companies to automate routine tasks, increase productivity, and expand profit margins while reducing reliance on incremental hiring.

As regards portfolio management, a long-term perspective—patience—is equally useful in evaluating current opportunities and risks, in both fixed income and equity markets.

The bond market itself does not have a distinguished record in forecasting future interest rates. Bond markets incorporate a lot of information: expectations for future Fed policy, inflation, risk premiums, and changing investor demand. Small wonder they're challenged.

What we do know is that current yields are the highest we've seen in more than 15 years. At the same time, historically speaking rates are not elevated. A 10-year Treasury yield of about 5% is in line with long-term norms. As the chart below indicates, this bond benchmark rate was consistently above 5% in the years prior to the Dot-com crash. In addition, real rates (nominal rates minus inflation) today are positive but not extraordinarily high by historical standards.



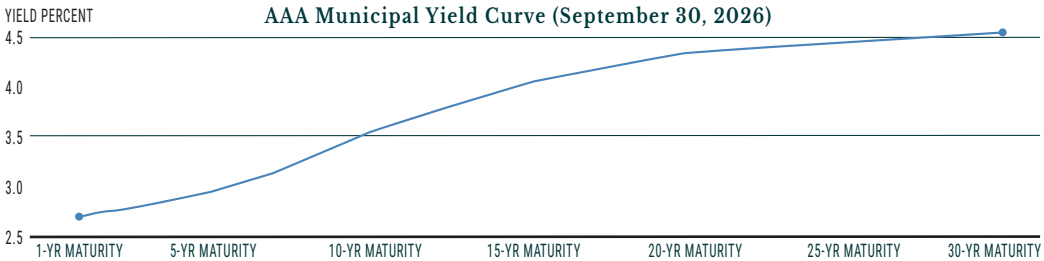
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (US)

Structural forces may keep rates near or even somewhat above today's levels. Ongoing large US government deficits increase the supply of US bonds, resulting in higher term premiums and upward pressure on long-term rates. Higher Treasury issuance is occurring at the same time that AI infrastructure spending is surging, much of it financed by—you guessed it—the issuance of bonds. A tighter labor market, driven by aging demographics and lack of immigration, could also lead to higher rates.

That said, the rise in interest rates has unquestionably enhanced the attractiveness of investing in bonds today—the yield pick-up is substantial compared with available rates over the past decade. Fixed income investors can anticipate juicier cash flows.

Both short- and intermediate-term bonds hold appeal for investors today, given increased yields. The current rate environment limits the need for investors to seek out long-term or low quality bonds for more yield. That said, the strong economic growth outlook suggests limited near-term default risk in lower quality corporate bonds.

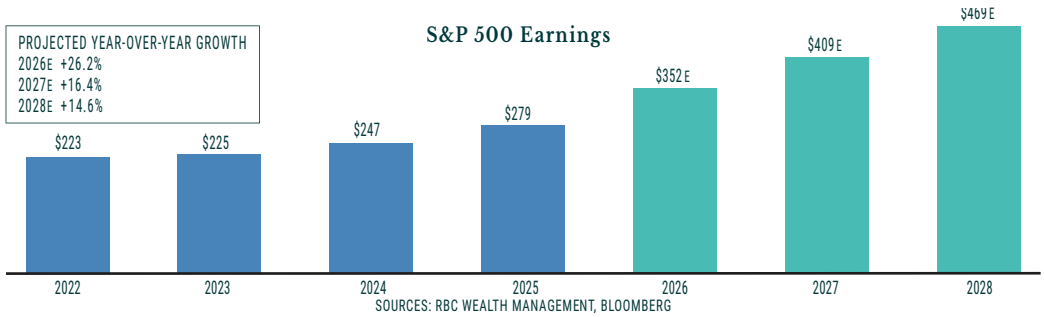
The municipal bond market has been subject to most of the same trends as the taxable bond market. A heavy issuance calendar has increased the supply of tax exempt bonds, pushing up yields. The municipal bond yield curve has also steepened, making it incrementally more attractive to take some additional duration risk in the sector. As the chart below indicates, there is meaningful incremental yield in the intermediate- to longer-term municipal bond market.



SOURCE: LSEG MUNICIPAL MARKET DATA

Risks in the bond market include possible reacceleration of inflation, the potential resumption of war in the Middle East, especially after the midterm elections, and ongoing high debt issuance from both US and other governments and hyperscalers making AI investments. Competition for capital could well result in rates that prove to be higher for longer. All of that said, higher yields increase the attractiveness of bonds today, and elevated interest income provides some cushion against price declines should yields work their way higher.

For equity markets, the promise of AI advancements and productivity improvements has been well recognized and well rewarded. Markets are pricing in continued rapid AI adoption and economic benefits, with only limited and gradually increasing regulation and safety requirements. As such, earnings growth expectations continue to be strong. FactSet data indicates that analysts see earnings growth of 15% for 2026, and a further 16-17% jump in 2027. Those are lofty expectations, but it is noteworthy that in recent quarters earnings keep exceeding expectations and estimates keep moving higher.



SOURCES: RBC WEALTH MANAGEMENT, BLOOMBERG

The strong earnings growth picture is perhaps offset by full valuations and those elevated expectations. The AI and AI infrastructure investment juggernaut shows no signs of slowing (although the rate of growth is likely to come down). However, negative public sentiment around the data center build-out (effects on local power supply, water, noise) and AI (cybersecurity threats and potential future job losses) is creating a political backlash that could impact the longer term adoption of, and returns from, artificial intelligence investments. The market's narrow leadership creates a vulnerability, given the dependence on a small number of companies to deliver strong earnings growth. A higher cost of capital may also challenge investors' patience with speculative growth and extended horizon investment themes.

Balancing healthy fundamentals with above average historical valuations and an extraordinarily concentrated large cap market (AI/technology focused names constitute better than 50% of the S&P 500) suggests a neutral equity posture. It is also harder to justify an over-weight to smaller cap stocks, given their greater sensitivity to higher interest rates.

Internationally, developed markets remain attractively valued versus the US, and earnings growth is improving. That said, growth in Europe is likely to continue to trail growth in the US, given less favorable demographics and productivity trends. Worsening government debt trends could weaken the Euro, lowering returns for US investors. On the developing market front, emerging markets are increasingly dominated by AI and technology manufacturing companies—increasing their correlation to US markets. That said, emerging markets offer faster earnings growth, and exposure to the increasing demand for commodities.

From an asset allocation perspective, it's an appropriate time to closely monitor risk and, as markets gyrate, to rebalance to strategic allocation targets. Some risks have implications for both equity and fixed income markets. Among them: geopolitical tensions, interest rate risk, renewed inflation pressures, and midterm election uncertainty. So it's an apt time for investors to consider initiating or adding exposure to alternative investments, as a complement to equities and fixed income. The appeal of alternatives is that they may offer differentiated sources of return that are less dependent on public equity and bond valuations. Such a diversification benefit is particularly advantageous in an inflationary period. Some attractive alternatives today are infrastructure, real assets, natural resources and commodities, and select hedge fund strategies.



It appears that, today, investors are experiencing a genuine regime shift back toward historically normal yields. Investors need not fear such an environment. It is the period from 2009 through 2021 that was anomalous. As rates potentially continue to return to historical levels, savers and fixed income investors will be better rewarded. Capital allocation will become more disciplined. Excess real estate appreciation will diminish. Financial institutions' margins may improve. Asset prices may become more grounded in fundamentals. Investors should celebrate higher yields and their contribution to long-term investment strategies.

And with that, I yield my time.

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