

Economic and Market Outlook

4Q26

KEY TAKEAWAYS:

1. The economy remains resilient, supported by a historic data center investment cycle, strong productivity growth, and a healthy labor market.
2. While the S&P 500 closed the quarter near record highs, valuations are reasonable given robust corporate earnings growth.
3. Downside risks include higher bond yields, which can raise financing costs throughout the economy, and rising energy costs.
4. The long-term outlook for economic growth is constructive and a diversified investment approach may benefit from the ongoing capital investment cycle.

Effective slogans, such as “it’s the economy, stupid” from Bill Clinton’s 1992 campaign, endure because they capture complex ideas in simple language. While not as pithy, Federal Reserve Chairman Kevin Warsh provided an effective and succinct assessment of today’s economy. Notably, expanding economic activity characterized by strong productivity growth and a healthy labor market, partially offset by elevated uncertainty owing, in part, to geopolitical developments.

Rarely do Fed chairs speak with such clarity. Warsh’s comments followed the Fed’s announcement that they planned to raise short term interest rates by $\frac{1}{4}$ point, the first increase since 2023. By removing “a dose of accommodation,” the Fed hopes to lessen inflationary pressures without negatively impacting the expansion.

The economy’s foundation is solid and unlikely to be derailed by the Fed’s actions. Our economy continues to benefit from a massive data center infrastructure investment cycle. Average annual investment is estimated to be almost 4% of GDP for the next several years, totaling over \$10 trillion. This would be the largest capex cycle in our nation’s history, exceeding the major infrastructure investment cycles in the last century combined.

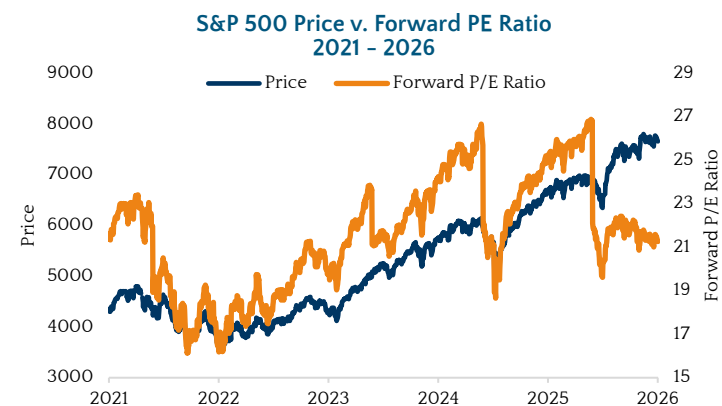
The labor market also remains healthy, though much of the recent job growth has occurred in lower-paying service industries. As a result, wage gains remain moderate, helping contain inflationary pressures while still supporting household income growth. Rising equity and home prices continue to support household net worth, particularly among higher-income consumers, helping sustain aggregate spending.

These forces are evident in robust corporate earnings. Quarterly earnings for the S&P 500 are up 75% over the past eight quarters, with estimates of almost 30% growth in the third quarter of this year.



Sources: Congress Asset Management and Bloomberg

The S&P 500 ended the quarter near record highs, yet valuation is not unreasonable given the strong earnings growth. The index’s forward price-to-earnings ratio is 21x, which roughly aligns with its long-term historical average of closer to 18x.



Sources: Congress Asset Management and Bloomberg

Yet some caution is warranted. The increase in bond yields accelerated over the last quarter, resulting in the highest longer-term yields in decades.

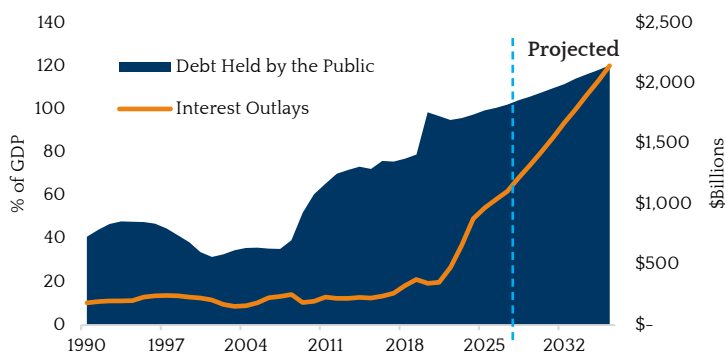


Sources: Congress Asset Management and Bloomberg

Higher interest rates can ripple through the economy, removing some luster. Positively, this reflects a strengthening economy and corporate demand for capital. Record investment grade debt issuance raised to fund the data center and re-shoring initiatives requires issuers (debtors) to compete for capital, enhancing yield prospects for bond investors.

However, the increased yields also reflect potential negative developments. Global bond yields are elevated as countries use deficit financing to fund routine needs. Outstanding US debt now totals almost \$40 trillion, exceeding 100% of GDP, and is expected to hit 120% in the next decade. The interest burden on this debt has largely been ignored since the Great Financial Crisis ushered in an unusual period of low interest rates. Now, with no change in our taxing or spending policies, and longer-term rates over 5%, the interest burden is more onerous. Federal outlays on interest in 2025 were \$1 trillion, almost triple the outlays in 2021, and are projected to top \$2 trillion by 2036.

Federal Debt and Interest Costs: Actual & Projected 1990 - 2036

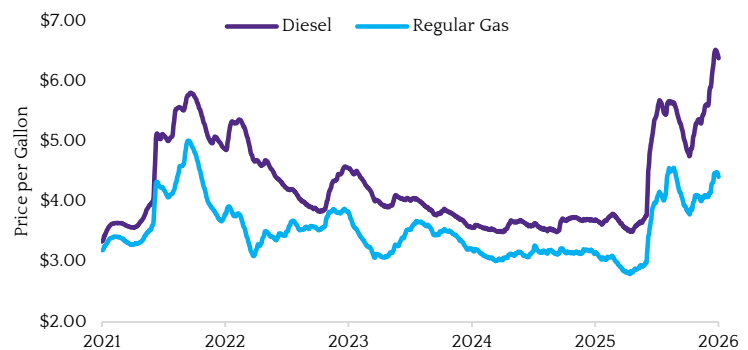


Sources: Congress Asset Management and Congressional Budget Office; Office of Management and Budget. Actual data from 1990 to 2025. Projected data from 2026 to 2036.

Higher government borrowing can place upward pressure on long-term interest rates by increasing competition for capital. This dynamic can raise financing costs throughout the economy, particularly for interest-sensitive sectors such as housing, commercial real estate, and capital-intensive industries.

Energy prices remain an important risk, as higher energy prices can impact spending choices far more quickly. While core inflation measures have generally trended in the right direction for the past few years, gasoline is up over 50% since the beginning of the year and diesel at its highest level on record, increasing both household expenses and business transportation costs.

Diesel & Gas Prices per Gallon 2021 - 2026



Sources: Congress Asset Management and Bloomberg

Historically, such increases act as a tax on economic activity, reducing discretionary spending and compressing corporate margins. Higher energy costs could also drive inflation broadly higher.

Today's challenges are serious but not grave. Often unacknowledged, our economy is the envy of the world. With the unemployment rate close to 4%, growth will not collapse because of rising interest rates or energy prices. To quote Chairman Warsh: "The American economy appears to be strengthening. New hiring, private-sector earnings, business capital investment - each of these markers has improved in recent months and is pointing in a good direction. Credit flows have been robust, particularly for businesses."

Long term investors have more choice now than a few years ago. The capital investment cycle should benefit a broad set of companies, not just the large technology companies. In addition, bond yields offer the most attractive return prospects in years.

Investment Oversight Committee

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