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Economic Update

SEPTEMBER 2026

Commentary

This month, the Fed hiked interest rates for the first time in three years. While not unexpected (especially given Kevin Warsh's Jackson Hole speech a few weeks earlier), the Fed's official statement and Chairman Warsh's subsequent press conference was more hawkish than many expected. This created a relatively rapid repricing downwards in Treasuries. Yields increased by over 25 basis points across the curve, with the largest rate move occurring in the 2-year Treasury (up almost 60 basis points). The 10-year Treasury moved above 5% for the first time since 2007, which has moved the 30-year mortgage rate above 7%. Surprisingly, equity markets remained unconcerned, and prices are basically flat on a month-over-month basis (the S&P 500 is up 13% year-to-date).

The Fed's statement removed the language around inflation being elevated partly due to supply shocks, implying that it's time to stop making excuses about higher inflation and time to take action to bring inflation back towards their 2% target. The infamous "dot plots" were updated at this meeting (as they are at every calendar quarter, at least for now). They showed higher GDP growth, higher inflation and lower unemployment compared to the previous quarter. They also showed one more rate hike in 2026.

Many have questioned why the Fed would hike in the face of a supply shock. Higher interest rates certainly have no impact on the supply of oil. The limited supply has been created by the war with Iran and has driven diesel prices up over 80% on the year and to an all-time high. The Fed answered this question by stating that "domestic spending has been resilient" despite geopolitical developments. In addition, Chairman Warsh stated that it is the Fed's job to prevent commodity shocks from broadening out. The bottom line is that the Fed believes that the economy is strong enough to handle higher interest rates and that they need to get inflation back to 2% without excuses.

We agree with the Fed that the economy will remain strong in the near term. The AI capital spending cycle is one of the largest in this nation's history and has shown few signs of slowing down. In addition, the massive run-up in equity prices over the past several years has created a buffer against a consumer spending slowdown. We would prefer an economy that had more broad-based growth, but few indicators point to an impending downturn.

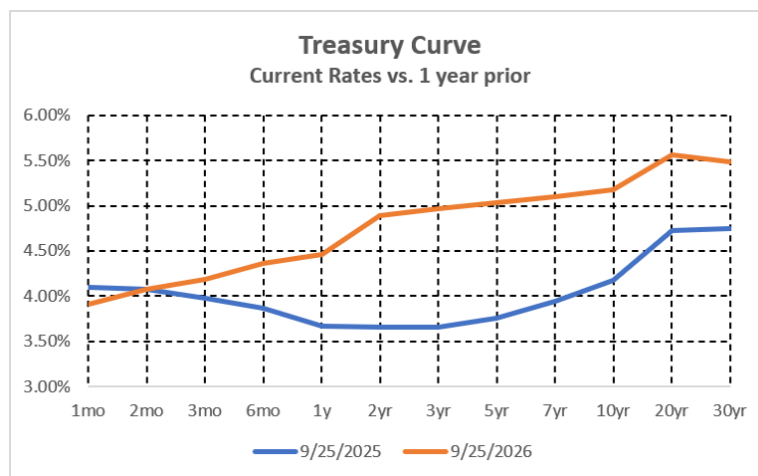
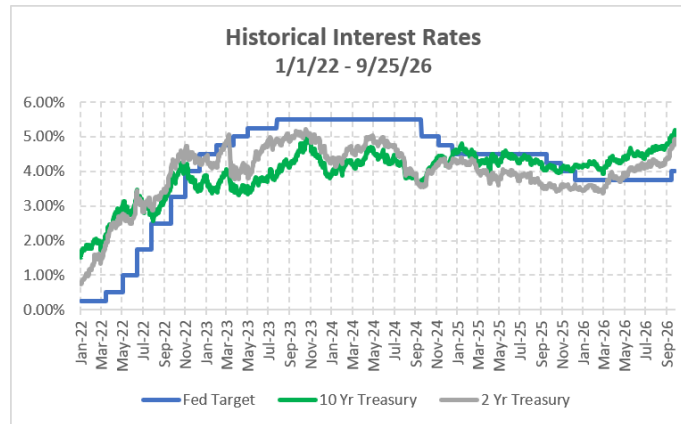
Fixed Income Outlook

The Treasury curve experienced a significant repricing in September. Rates moved higher across that curve, with the shorter-end moving the most. The market is pricing in a 65% chance of a hike at the Fed's next meeting in October and 100% chance of at least one hike by the end of the year. In all, the market is now expecting a total of three to four more rate hikes over the

THIS MONTH

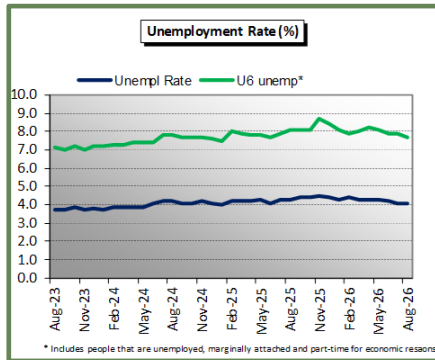
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next 12 months. Based on recent Fed commentary, we see two more hikes by the end of Q1 2027. This would remove the “insurance” cuts that the Fed made in late 2025 in the face of fears of a weakening labor market.



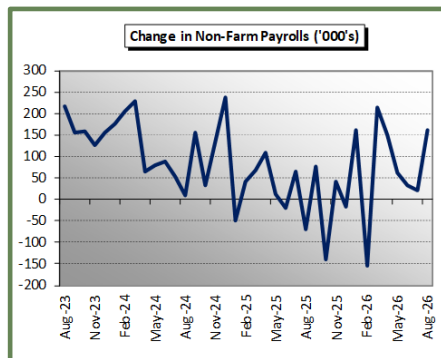
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Holds Steady

The unemployment rate in August was in line with market expectations and remained at 4.1%. This matches the lowest unemployment rate since the beginning of 2025. The details of the report were strong as there was a significant increase in both the labor force and jobs.

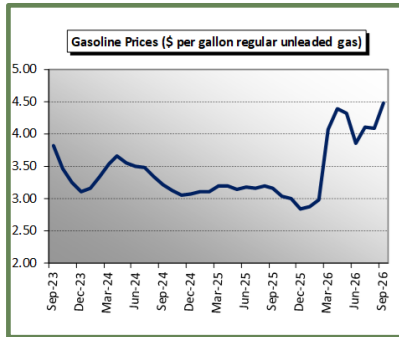


Payroll Growth Stronger Than Expected

Payroll growth in August came in above forecasts. The number of jobs increased by 162,000 versus an expected gain of 55,000. In addition, the previous two months were revised higher by 55,000. The current three-month average payroll growth increased to 71,000, which is above the pace of job growth in 2025.

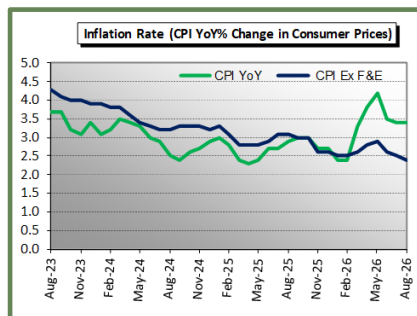
Inflation Readings

(Data source: Bloomberg)



Gasoline Prices Surging Again

Gas prices have resumed their upward trend and are near the highest level of the year for regular unleaded gas. Prices are up more than 50% thus far in 2026. Diesel prices have increased even more and are up over 85% and stand at an all-time high.

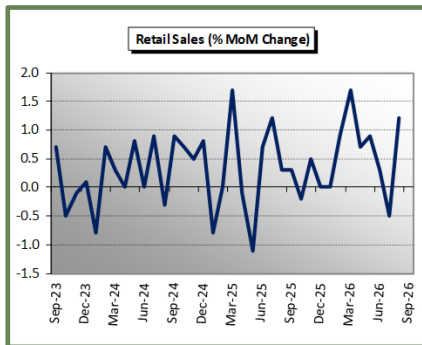


Consumer Inflation Remains Elevated

Consumer inflation in August held steady at 3.4% on a year-over-year basis. Core inflation came in higher than expected on a month-over-month basis. Inflation levels remain well above the Fed's 2% goal (although they use a different inflation index) largely due to the war with Iran, tariffs and AI related spending.

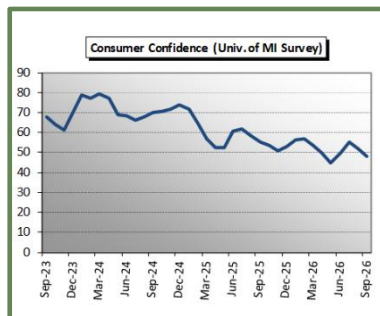
Consumer Readings

(Data source: Bloomberg)



Consumer Spending Rebounds

Consumer spending rebounded sharply in August. Spending gained by 1.2% on a month-over-month basis versus an expected gain of .8%. It was the largest gain in five months.



Consumer Confidence Declines

Consumer confidence declined more than expected based on the preliminary University of Michigan survey for September. On a year-over-year basis, confidence has declined by 13%. Thus far, falling sentiment has not led to a decline in spending.